



“Mahindra Forgings Q2 FY13 Results Conference Call”

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MODERATOR: **MR. ROHAN KORDE – ANALYST. ANAND RATHI SHARES & STOCK BROKERS LTD.**

Moderator

Ladies and gentlemen good day and welcome to the Mahindra Forgings Q2 FY13 Results Conference Call hosted by Anand Rathi Share and Stock Brokers Limited. As a reminder for the duration of this conference all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Rohan from Anand Rathi. Thank you and over to you, sir.

Rohan Korde

Thank you Myron and let me welcome all the participants to this conference call. From the Management side we have Mr. Sanjay Joglekar, Executive Vice President & CFO – Systech Sector; Mr. K Ramaswami – MD, Mahindra Forgings Limited; Mr. Ajay Mantry – CFO, Mahindra Forgings Limited; Mr. Burkard Rausch – CFO, Mahindra Forgings, Europe; Mr. Vikas Sinha – Head Strategy, Systech Sector and Mr. Deven Kataria, Senior Vice President, Business Development at Mahindra Systech. Let me first now hand the floor to Mr. Joglekar for his opening remarks. Over to you, sir.

Sanjay Joglekar

Good afternoon everybody and I hope you had the opportunity to see the results that we have published on the stock exchange and also the Press Release that we have given. I will just quickly summarize the results and then we will throw it open for questions.

In Q2 if you see the Mahindra Forgings India's stand alone results the revenue is 117 crores with an EBITDA of 17 crores and H1 is 222 crores with an EBITDA of 29 crores. Both the periods showing a very significant improvement over corresponding period of the previous years. Improvements have been largely due to increase in the sale of machine forging which has been a high value addition and you may recollect that we have been outlining this as our strategy for quiet sometime and other significant reason is control over operational cost primarily the rejections have come down significantly.

If you look at the consolidated results you will get a feel that the situation is not as good in Europe. The revenue for Q2 on a consolidated basis is 565 crores and half-yearly 1,162 crores with an EBITDA of 20 crores in Q2 and 62 crores in H1. Both the results in terms of revenue and EBITDA are lower than the corresponding periods of the previous year. The main reason is that in Europe our main business is in Germany in the heavy commercial vehicle market is not really doing very well and if I look at the prime reason, the main reason for the fall in the margins is lower revenue. Also of course due to some operational efficiencies and costs that we have been incurring. We have been briefing you about the breakdowns in the presses that happened in Europe mainly in Germany which have been brought under control and Q2 there is an improvement but I think we still have a few milestones to cross before it comes to the original levels of profitability.

Let me at this stage wouldn't narrate much more and throw open to questions and my colleagues from India we have. It is already explained who are in the call and we will answer the questions depending on what kind of questions.

Moderator Thank you very much sir. Participants we will now begin the question and answer session. We have the first question from the line of Sanjay Shah from KSA Securities. Please go ahead.

Sanjay Shah Sir we appreciate your Indian performance. So can you throw light on the future prospects as far as Indian operations are concerned?

My second question is regarding European operation. When do you see we get the efficiency from the equipment breakdown?

Sanjay Joglekar Okay I will just give a broad answer and then I will respectively and request Mr. K Ramaswami and Burkard. For Indian operations on the whole if you see that there has been some slowdown in the revenue but what we have gained is by improving our product mix mainly the machining operations and improving the operational efficiency and reducing the rejections. Going forward I can't really make any concrete statement because they will be futuristic but I can make a statement that we expect the trend of improvement to continue.

Sanjay Shah But can we see the same margin improvement further ahead the bad days are over for Indian operations. Can we take it that way?

Sanjay Joglekar Well as of date if the market continues like this and all the improvement that we have made are on a very concrete footing I would say that we expect to continue the same trend.

Sanjay Shah Great sir. And about the European operations, sir?

Sanjay Joglekar Well Europe we have as I said not fully come out of the operational efficiency part particularly in one company Schöneweiss that is where I think some operational improvements in the big press that we have there are being worked out. We have identified. The diagnosis has been done and it is a matter of some more time. Some is related to you know the gradual improvement in the efficiency, some is related to changing some parts and I would feel the other end, may be Burkard you may feel free to comment but it would take probably another quarter or little more to come back to the normal levels of efficiency. Burkard.

Burkard Rausch You are absolutely right. That the diagnosis has been done but we are in a bit chicken and egg situation actually for all those analysis that have been prepared and the things we want to change. We have to concentrate and do it in a joint activity not to take the big press too long out of production. So we have decided and I am sure you are aware that December around Christmas is over the period where the industry comes down in Europe that we use those weeks and we have to take a press out of production for three weeks in December and concentrate all those maintenance and rework activities in December.

On one hand we need the time to order the parts and prepare everything for this activity on one hand and now we have to use the time and prepare the parts our customers need. First half in December not to stop the lines of our customers so that's something that has to be managed and prepared very carefully but we expect significant improvement out of that after all those activities have been done.

What we see right now that some small improvement already took place and we see positive tendencies already but in parallel from market point of view we saw especially in the last three months that our customers are very careful in what is happening with Euro and from their markets so the situation in Europe especially producing heavy machinery and trucks is still a big question mark and everybody is quiet cautious but what we see and I would take it as a positive sign as well that our customers do not reduce personnel and there is always a critical indicator in Europe when Daimler and MAN, Scania, Volvo all of them tell us that their people should take their holidays. Then it is to bring down the provisions for holidays but to keep the people on board to be prepared if markets come back.

And when you compare it to the situation 2008-09 where the big political discussion was about short time working and then social programs and unemployment rates all around Europe. Then the general mood of the companies is careful on one hand but much more let me call it being optimistic that the situation will improve on short or the mid-term and therefore they keep the people which are trained. We need to be able to follow this upfront after this cooling down sizes now.

Sanjay Shah Right sir. Well understood. My another question is how about this new products which were developed for these new norms which are coming in, am I right? Is it going slow when the demand is coming in from that side?

Burkard Rausch What we see is that especially with Daimler the norms are coming up in one and half years' time and right now it is a question of cost for the end user as well and the old and the new across families are built in parallel and right now with some price advantage the old across family is selling even slightly better than expected and the more expensive version of the new across is not ramping up as fast as it was expected but the norm is coming closer and closer. This tendency that's just today's situation but it will move.

Sanjay Shah And my one more question is to Mr. Sanjay. Can you update me on the merger of this Systech, what is the progress on that ground sir?

Sanjay Joglekar Well the call is not primarily meant for that but I can say that we are moving ahead in that direction.

Moderator The next question is from the line of Aniket Mhatre from Standard Chartered. Please go ahead.

Aniket Mhatre Can you please share with us the tonnage sold for standalone entity as well as the consol level?

Sanjay Joglekar What tonnage sold for standalone and consolidated?

Ajay Mantry For India for the quarter the tonnage is 8,661 and for the half year it would be around 16,600.

Aniket Mhatre And what is the growth rate?

Sanjay Joglekar Growth rate compared to?

Aniket Mhatre Year-on-year.

Ajay Mantry Around 6% growth rate.

Aniket Mhatre And for the consol levels?

Sanjay Joglekar Well for the European level Burkard you want to comment?

Burkard Rausch First half year in Europe we forged 67,000 tonnes and it is a negative growth rate.

Sanjay Joglekar About 10% negative.

Burkard Rausch Roughly 10% negative.

Aniket Mhatre And my second question would be on the outlook for the auto industry both India and Europe. How do you see it going forward? Are we seeing any positives off take for the fiscal demand within India and how about Europe for FY14?

Sanjay Joglekar Would you like to talk about India first?

K. Ramaswami I don't have a crystal ball to say what will be the outlook on India because I can only say we are entirely dependent on auto industry. This kind of business comes from the auto industry. We have a mixed bag of some customers have done well and have grown negative in the first half and that's the reason why we have value of cumulative positive at 6%. It couldn't be much higher because most of our customers did not do as well as they originally anticipated.

The second half I would say looks better than first half, how much better is anybody's guess.

Daven Kataria I guess this is Daven Kataria. I think this is I am sure you guys are watching the industry you have seen there has be an interesting mix change going on utility vehicles are growing pretty dramatically. I think our press release also alluded to that. And the passenger cars themselves have been moving a little slower and I think from that perspective we have an assorted mix of customers in India. We have on passengers vehicles, we have UVs, we have light commercial vehicles so if you look at this mix like KR said we are been around this 4% number clearly hoping that things will start to turn around in India and little more positive sentiment comes into the market. And if it does it will do pretty well positioned to take advantage of that. In the meanwhile clearly having a good UV exposure helps us with the kind of products that we have and we are supplying in to the market. From the European standpoint again we have been giving you guys the prview to what is happening or a view of what's happening. In the first

quarter of heavy registration the best information we can get is on sales in Europe on heavy trucks so heavy truck registration declined in the first quarter of this fiscal, had about 5% and that stays accelerated a little bit in the second quarter and I think we were expecting this kind of go forward for the next couple quarters right now. Again we would like to be surprised in a positive going back but I think that is what we are seeing right now.

Aniket Mhatre

And sir what is our CAPEX plans for the year and the next year?

Sanjay Joglekar

Apart from our normal CAPEX what I understand is that we are still finalizing but we might invest into one more 6,000 tonne press and all other will be normal CAPEX. And the market in Europe I would request Burkurd to comment.

Burkurd Rausch

From our markets which are more or less flat to be expected right from today's point of view we invest in maintenance and things that have to be repaired but we are not looking for making investments in additional capacities.

Aniket Mhatre

But any number that you would share with us?

Sanjay Joglekar

It is very difficult to throw numbers knowing the vulnerability.

Moderator

Thank you. The next question is from the line of Chirag Shah from Axis Capital. Please go ahead.

Chirag Shah

Sir I have one question. Wanted to understand, what is this possibility of bringing the press lines from Europe to India?

Sanjay Joglekar

From where this question is emerging.

Chirag Shah

Wanted to understand the utilization levels in Europe are lower so there would be excess capacity over there.

Sanjay Joglekar

This kind of calls cannot be taken on the basis of quarterly performance because if you want to really shift press line here, it needs to be seen then comptability, the demand here, from here we want to supply where and we have to really take a call, okay on a permanent basis we want to shift the capacity from Germany to India.

Chirag Shah

If I can put the question other way, what is the possibility for you to do an outsourcing thing from India to Germany?

Sanjay Joglekar

To some extent it has already been started and probably Ajay you can narrate on what kind of parts we are already supplying from India?

Ajay Mantry

It has started for some of the parts may be on a relatively small scale but in the last 1.5 ~ 2 years we have done exports of parts to our German / UK Plants of around 25 crores. This number may seem small but it's a lengthy process in terms of customer approvals are required

for the operations in India and there is also an inspection cycle for which we have to supply in various lots to the customer. So this is an ongoing process which we evaluate and whatever parts are feasible to be made in India we are shifting without considering right now shifting of any presses.

Chirag Shah And what would be your current utilization levels in European business?

Burkard Rausch Roughly in average about 75%.

Chirag Shah If I can ask has there been any capacity reduction done over there given the scenario has there been any press line that have been sold of here or made your business slightly more asset light to reduce your fixed income?

Burkard Rausch During the crisis 2008-2009 we closed two plants in England, a press forge and hammer forge and we closed on one plant in Germany **Hunnighaus** we concentrated those activities which gave us the opportunity to reduce cost and the flexibility now on this reduced basis gives us the freedom and the space of collaboration between the plants to shift customer demands from one plant to the other to use our capacities in an optimum rate. So this flexibility we have built 3 years ago. Now is used to have a much higher and better flexibility plus the fact that we have got a capacity on labor cost, employees of 10% -15% of hired labor which can be set off. Some months ago we had roughly 100 contracts workers more than we have got today so this is exactly the way we breathe and reduce and adjust our cost structure to that for in this market of uncertainties. Those are the main cost driver which you have to keep flexible.

Moderator Thank you. The next question is from the line of Deepak Malhotra from Silver Streak Advisors. Please go ahead.

Deepak Malhotra Just one question. I think what we are witnessing primarily today you know the automobile industry in the domestic side has really been weak and the trend continues especially on the YTD basis even prior to that. Now my question to you is how do you really see the outlook from your perspective? I mean are we at bottom already or the trough is still likely to continue going forward because most of the numbers which are being reported I think it doesn't look very encouraging at the moment. So would just like to hear what's your perspective on the same?

Deven Kataria Hi Deepak this is Deven again. I think at some level we are speculating about the future over here but if you read the news I think people are starting to feel a little more positive about the consumer durables. I think that is the word of the street. And we are hoping that with interest rates moving in the right direction and little more certainty coming to people I think we are hoping that the automotive market is probably seen its darkest moment in the recent past and will then start to move up. I think from long-term perspective and that is truly how we look at the business we think there is plenty of growth we had in this country and obviously that is the way we want to build our business model so we are not really looking at it quarter-to-quarter.

Certainly we have to perform quarter-to-quarter for you guys but I think our business view is much longer than that.

Deepak Malhotra

So what you are in effect saying is that if we look at the trucks, for example, I mean if I just quote the numbers from what I can recall from memory FY10 we are about 2 lakh, FY11 about 2.75 lakh, FY12 almost 3 lakh so the growth is coming down although in absolute numbers and now we just have seen the Daimler Benz coming out with the Bharat Benz Trucks in the HCV category but except in the smaller LCV categories where companies like Ashok Leyland, for example, have launched some new products one doesn't really see a spark so I was just again at the cost of repetition trying to understand from you that may be one or two quarters could be bad but you think we are really at the bottom and accordingly you are factoring the same into your business plan or not?

Deven Kataria

I think on the heavy truck side which is positioning the maximum weakness the medium having commercial vehicles, we are not very really exposed from the Indian context in that space. We have these HCVs, LCVs and some of the HCVs the market has still been fairly robust but in the overall industry we share the same concern, it is the economy in general. Heavy trucks are driven by lot of infrastructure, lot of mining, lot of activity transportation so I think over there it is available bigger than us but I think the segments we are in passenger cars certainly we want to see that starting to move up thinking that the festive season would probably help a little bit with that as well.

Rohan Korde

I was just wanted to check these machining and forging mix that we had in the first half of the year in terms of India operations?

Ajay Mantry

We have almost reached around 30% of our sales in machined condition..

Rohan Korde

And how much here?

Burkard Rausch

Europe is 60%.

Rohan Korde

And in India how much can this increase to the machine proportion on existing capacity?

Ajay Mantry

Without any further investment we propose to increase it further by may be more than 5% to 7%.

Sanjay Joglekar

And Ajay are your plans for investments in machining parts already done or you are anticipating for some investments?

Ajay Mantry

Right now we do not have any plan of further investment in machining.

Sanjay Joglekar

Right so as strategy you feel that roughly around 40% of sale of machine forging is what is the strategy at the moment?

Rohan Korde

And for Europe as well it will remain constant at the same 60%?

- Burchard Rausch** We have got 60% and with ramp up of this new HS for Daimler it will go up to 55% - 57% something like that.
- Rohan Korde** And secondly on the India operations I just wanted to check whether the changes in the product mix that is the industrial shifting tools utility vehicles has it also contributed positively to the performance that we have seen in this quarter or it is entirely attributable to the internal steps that Mahindra Forging has taken?
- Ajay Mantry** In utility vehicles we have a better proportion of machined products, so that way our machined sales have increased because of the increase in utility vehicles.
- Rohan Korde** You have mentioned that there has been some delays in new launches by your European customer so would it be possible for those new launches which have delayed to actually take place in this year or will it overrun into the next year?
- Burkard Rausch** Of course from a customer's point of view, from the end user's point of view you can delay your investments for some time. But the fleet itself is ageing and what we saw over the last year already that the average of the running time of especially the trucks is ageing and therefore even if there is some uncertainty and some restriction in investing in new trucks this leads to a situation where customer demands will rise after this crisis and at some stage new trucks have to be invested. The market itself then will show a bigger potential after this.
- Rohan Korde** That is from my side. Moderator, have you got any further questions.
- Moderator** Currently there are no questions in queue. As there are no further questions I would now like to hand the floor over to Rohan for closing comments.
- Rohan Korde** I would like to thank the managers for participating in this conference call and it was really informative. Thank you sir. Thank you gentlemen and best of luck for the future.
- Moderator** Thank you. On behalf of Anand Rathi Share and Stock Brokers Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.