



“Mahindra Forgings Limited  
Conference Call”

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ANANDRATHI

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**Moderator:** Ladies and gentlemen, good day and welcome to Mahindra Forgings Q1 FY'14 Results Conference Call, hosted by Anand Rathi Shares and Stock Brokers. As a reminder, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing "\*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Rohan Korde. Thank you and over to you Mr. Korde.

**Rohan Korde:** Thank you, Malika. Let me welcome the management participants. We have from the management side, Mr. Hemant Luthra, President, Systech Sector, Mr. Sanjay Joglekar, EVP and CFO, Systech Sector, Mr. K. Ramaswami (KR), M.D., Mahindra Forgings Limited, Mr. Ajay Mantry, CFO, Mahindra Forgings Limited, Thomas Koerner, CEO, Mahindra Forgings, Europe, Mr. Burkard Rausch, CFO, Mahindra Forgings, Europe, Mr. Vikas Sinha, Head Strategy, Systech Sector and Mr. Deven Kataria, Senior VP, Business Development of Systech and Mr. Guru Prasad Iyengar, Finance Controller, Systech Sector. I now hand over the floor to the management for their opening remarks. Over to you Sir!

**Sanjay Joglekar:** Good afternoon to all of you. The board meeting is over about a couple of days back and all of you must have seen the results. Just to give you a quick idea, the Mahindra Forging India standalone quarter revenue was about Rs 104 Crores and 13.5% EBITDA, which is about 2% point more than the corresponding quarter of the previous year. PAT was also recorded about 6 Crores and all of you know this is despite of the market situation not being so good.

At a consolidated level, the Forging business recorded revenue of about Rs 589 Crores with an EBITDA of Rs 60 Crores and PAT of about Rs 5 Crores. We have described in the press release that the consolidated EBITDA and PAT it has some positive effect of currency translation gain. I will respond to any questions in connections with this when we speak further.

I will leave it open now to the questions.

**Hemant Luthra:** KR is going to talk about some of the improvements that has happened last year on the operations and so on and what we believe he can continue to do this year.

**K. Ramaswami:** Good afternoon. Last year has been a fairly good year for Mahindra Forging India operations while we had to combat all the difficulties in ramping up revenue numbers we were able to exercise fair amount of control in operations in terms of costs and therefore we have had a significant EBITDA last year. In the first quarter it also remained good although our sales revenue dropped from Rs 105 to Rs 104 Crores, our EBITDA moved up from Rs 12 Crores to Rs 14 Crores and our PAT moved up from Rs 5 Crores to Rs 6 Crores.

We expect market to remain at the current levels or go down a little bit in this quarter as well as probably in the third quarter we expect to exercise the same amount of control on costs in order to remain as profitable as we are today. Now I will leave it open to questions.

- Moderator:** Sure Sir. Thank you very much.
- Rohan Korde:** My question is firstly towards Mr. Burkard. I wanted to know how the market has been developing in the European region.
- Burkard Rausch:** Compared to what we budgeted and the budget is slightly below last year. What we see is a stable and slightly positive development. From this point of view we are very much to our expectation. What we see even with the order income that there is a slight improvement foreseeable for the month or so.
- Rohan Korde:** Any new orders that we could be receiving? Any visibility on that?
- Burkard Rausch:** Well we have a number of projects with customers in realization, so that is an ongoing process; very much in line that is part of this stable development.
- Rohan Korde:** In terms of the overall CV market would we be actually seeing a recovery in FY'15?
- Burkard Rausch:** What we see right now is a flat development. What is quite uncertain right now, coming out of the legal situation between Euro V emission norms and Euro VI, which will start beginning of next year and there is still some uncertainty from our customers whether there will be a last minute rush on Euro V trucks or whether the markets will follow directly into Euro VI, but right now there is a gap in prices from our customers to the truck markets so it might be that we see even a stronger development at the end of this year in Q2 and Q3 after the summer holiday period, if the demand really picks up for Euro V trucks.
- Rohan Korde:** What is the date for the change?
- Burkard Rausch:** February 1, 2014.
- Hemant Luthra:** This is about Europe. I do not know if you people have read the Financial Times article. Two articles that appeared day before yesterday; one was about Euro zone purchasing managers index, which created a flutter because it was very positive and we are happy to circulate that if you people have not seen it on the Financial Times, London, and the other report was that the European truck manufacturers are suddenly seeing a spurt in volumes. We do not want to say very much because a swallow does not make a summer. But there are signs as Burkard said that that increase in volumes is starting to show through to our order books. Just to remind you that when the volumes was running at Euro 275 mn or Euro 290 mn in FY'12, we made an EBITDA of Euro 22 million and FY'13 was particularly bad year because it compounded some of our internal problems and the fall in the market in the second half which I believe has affected most auto component people.
- Rohan Korde:** On the Indian operations the EBITDA margins while we have seen a good improvement on a year-on-year basis, it is down relatively as compared to the nine months trailing three quarters.

So is there any one-time cost impact that we have to consider or it is a normal operational thing that we are seeing?

**K. Ramaswami:** The Indian operations have remained very steady and as far as operating profits are concerned as a percentage of sales has remained very healthy. The only concern is on the sale numbers which are dropping. With respect to comparison with the last quarter obviously the numbers are a little down in terms of revenues. If you look at the Q4 numbers, Q4 was 109 Crores and in Q1 we have done only 104 Crores. There has been a drop in sale because of the current market conditions.

**Hemant Luthra:** Also in Q4, Ajay Mantry are you on the line?

**Ajay Mantry:** Also in Q4 we had one time annual discounts received from our suppliers. So the raw material cost as a percentage point was lower.

**Hemant Luthra:** I know that we cannot give forward-looking statements just now but if you see that the standalone EBITDA of FY'12 was Rs 41 Crores for India and the EBITDA was Rs 66 Crores for FY'13. I do not think these are random events and they are a result of continued effort of cost cutting, which has shown the results and therefore I would not read too much into one quarter being representative of a slowdown in bottom line as there maybe one quarter that is representing a slowdown of the same, but we will take steps that are necessary to protect what we have built up during FY'13.

**Sanjay Joglekar:** On top line there is one thing, Hemant in the market, but what you are saying is we will try to counter the market.

**Hemant Luthra:** That is what we will protect what we have created. We will protect the momentum that we have created.

**Rohan Korde:** In terms of the sales mix we have, are we going to see a big change in the way the mix is structured towards the tractor segment this year in particular. Is that the feeling you are getting from your customers?

**K. Ramaswami:** Yes, the tractor segment business will significantly go up because of the current market condition and production of tractors. Our focus this year given the depressed market condition here will be to increase our exports and I am happy to say that we have made significant progress in getting some export orders. Of course development and start of production of these orders would take time, but we are on the right track.

**Hemant Luthra:** On a slightly strategic front the only that I can point out is that if some of you were present during the analyst calls or press conferences or you have the access to the investment stuff that has been given, CIE has a complimentary set of customers and whether it is for our forging business for which this call or any of the other businesses, we hope to extract value because we serve one side of the market and they have a different set of customers who are also operating in

India. So, we are starting to look at tapping into them to make purpose of the alliance worthwhile.

**Rohan Korde:** When is the visibility for say CIE? Assuming say in the next quarter we get an order from CIE how much time would it take for us to ramp up production and meet their requirements?

**K. Ramaswami:** We are not referring to orders from CIE; we are referring to the export order. Hemant's point probably is on the possible benefit that would have arisen out of the alliance overtime. What I was referring to is export orders which are other from CIE.

**Rohan Korde:** The point being that would not we be facing some capacity constraints if we see a significant increase in the export orders from FY'15 perspective assuming the Indian market also sees some recovery at that point of time?

**Hemant Luthra:** We have adequate capacity to take care and when we get the export order booking we make sure that there is adequate capacity even when Indian market comes back to normal level.

**Rohan Korde:** What would be the utilization for this quarter?

**K. Ramaswami:** Forging around 65% to 70% and in machining about 85%.

**Hemant Luthra:** I want you to think about this that as KR has pointed out that with the Rupee being where it is, there will be even greater incentive for people to move their products from Germany to India or from England to India. Secondly, we are tapping into which is a different subject altogether. We are tapping into customers of the CIE who we have not looked at as aggressively yet because they may have not been as familiar as with our capability as the CIE customer. The third thing is that if you look at the balance sheet of Mahindra Forging just now it is almost down to zero debt. So should there be a welcome increase in the number of orders it is not as if it is going to require any capital increases, which will dilute the equity. The balance sheet of Mahindra Forging in India is down to zero debt.

**Rohan Korde:** For machining would we look into increase of capacity?

**K. Ramaswami:** Yes, depending on customer call, as such we are planning to invest for about an additional capacity for crankshaft machining 50,000 to 60,000 crankshafts per year but this investment will be spent in the third and fourth quarter.

**Rohan Korde:** That is it from my side at this point in time. Moderator, if you can just check?

**Moderator:** Thanks. The first question is from the line of Srinivas Rao from Duetsche Bank. Please go ahead.

**Srinivas Rao:** Thank you very much. Just wanted an update on the current status of the proposed transaction CIE. There was a leg of the transaction where Mahindra buys out a JV. Is that completed?

- Sanjay Joglekar:** I think we are at the moment in the process of regulatory approvals like competition commission and SEBI, the leg that you are saying will probably be completed immediately after the regulatory approvals come. The leg that you said about buying the steel JV or buying the land from MUSCO by M&M will be completed as soon as the regulatory approvals comes particularly the competition commission.
- Srinivas Rao:** After that only when the share base of Mahindra Forging should expand? Is that what it is?
- Hemant Luthra:** Let me try and give you some specific timelines because maybe we misunderstood the question. Which is your question that is Mahindra buying MUSCO or is Mahindra buying CIE? What is the question? We may have misunderstood it.
- Srinivas Rao:** First is you are right. The Mahindra buying the MUSCO land and JV stake, so is that completed. That is my first question. Second what is the timeline for the next two to three legs of the transaction?
- Sanjay Joglekar:** If I may clarify after this basic regulatory approvals are done, we will carry out open offer process or even simultaneously thereafter the next one will be to apply for the court for merger, so once the open offer is done simultaneously CIE will buy the shareholding stake in three companies that is Mahindra Forging, Mahindra Hinoday and Mahindra Composites. Of course till the companies will continue to be the independent legal entity. Then we have two merger schemes, one is that all the entities like Castings, Gears Holding Companies, Stamping, they will all merge into Mahindra Forgings. Similarly by way of a merger scheme, Mahindra Composites will also merge into Mahindra Forging. Mahindra Forging will be named Mahindra CIE. Now this application, which is tentatively all these approvals are in time then it, will be made some time in October of this year. Then it is a matter of court process, but we generally expect about six months time, so you may expect by March 2014 or early April 14, the entire process will be through and one legal entity will be created. During the similar process, CIE's Forging Companies in Europe will also come under Mahindra Forging or Mahindra CIE. At the same time, when CIE buys the stakes in Mahindra Forging, Casting and Composites, Mahindra will cross invest it into CIE, Spain spend at the parent level, taking around 13.5% stake.
- Srinivas Rao:** The open offer Sir it just says that after open offer CIE will have approximately 79.2% stake so that includes the current 53% which M&M has right?
- Sanjay Joglekar:** After open offer we might have to look at one combined entity while all this depend on how much open offer is subscribed to, so difficult to predict but we are not anticipating it to go beyond 75% of the combined entity.
- Hemant Luthra:** But, CIE alone could be somewhere between 46% and 51% and Mahindra could be about 20% or 22%, 23% depending upon what the response to the open offers.
- Srinivas Rao:** Understood and just to the clarify Mahindra is not putting any money barring that 340 the money, which they are investing to cross invest in CIE?

- Hemant Luthra:** I think, I just want to make it absolutely sure there has been a lot written about in the press about this whole thing being about cash neutrality on which is not correct. The deal is as follows that CIE buys some stake from Mahindra and everybody else and goes to that 51% including something that they put into the open offer. I think they will spend somewhere between I do not know
- Sanjay Joglekar:** I think Hemant it is a matter of what is the prevailing exchange rate at that time, so I cannot really predict the amount but if you go by with the current exchange rate that rupee has depreciated against the Euro, M & M will have to put in some extra money, which could range around Rs 60/ 70 Crores for having that stake into Mahindra CIE.
- Hemant Luthra:** it will be spending 340 Crores to buy the steel JV shares and will be spending something to buy. The combined amount is about 340 Crores.
- Srinivas Rao:** Yes, that is the 340 Crores is the land for the steel JV and you said for the stakes you said somewhere around 60 to 70 Crores is that what it is?
- Sanjay Joglekar:** Let us put it like this. Whatever CIE puts in is for buying the stake in the Indian company. That is around 670 Crores or so. So another leg of the transaction is that Mahindra buys a stake of about 13.5% in CIE that value is defined in Euro and the rupee amount will depend on what is the exchange rate.
- Srinivas Rao:** At the current exchange rate that is about 350?
- Sanjay Joglekar:** No, at the current exchange rate it will be something like 730 Crores or so.
- Hemant Luthra:** That also just as an aside so that everybody knows what this thing is about. If we went by what the press was saying that the cash neutral and we did not inflate our offer for by the amount of depreciation of the rupee against the euro, we would have ended up being not the second largest shareholder but the third larger shareholder. We are absolutely sure that we want to get a second largest shareholder. Be absolutely clear as a strategic thing we are make it absolutely clear that we want to be the second largest shareholder and the rupee devalues further so be it and the rupee appreciates so be it, but our intention and understanding is that we will be the second largest shareholder of CIE and we will have to spot position on CIE.
- Srinivas Rao:** Understood Sir and that brings me to one related question. Till now Mahindra Forgings in its current or Systech Sector let me say has obviously been put together through various acquisitions whatever I have followed combination of let us say market developments and other factors we have not seen any great benefits from synergies coming through or at least it is not visible to us given obviously I understand partly it is on account of the timing of the acquisitions and the following global crisis. However now that the company becomes bigger, more complex, how do we think about the synergies or let us call it how will the operations melt together, because now it becomes even bigger and the complex entity to manage?

**Hemant Luthra:** I love this question, because that is what this whole thing is about. We have done some internal math for ourselves and obviously we have to do it to get our shareholders and the board approval. Over the period of time that we made the domestic acquisitions and we compare it with book value of what we have invested, the Indian operations have created a significant value all of which will start showing up when all these mergers will be completed. We have been affected by as you correctly pointed out to Euro crisis but in spite of the Euro crisis in 2012, we did pretty well in Germany with 22 million. In calendar year 2012 or FY'13 we had some problems. Now you asked me what the bigger entity looks like. So let us just look at putting all of these together under Mahindra CIE and that will look like a 4000 Crores company and then instead of having multiple staff functions we will probably be able to look at the synergies and purchasing and repayable to look at the synergies and marketing which we are already pulling together. Each of these companies may not have had the resources to have a high quality R&D function but now we have got technology development function that will put this together. Some of these companies for example MUSCO Stamping has been selling scrap to our casting operation and our forging operation may have been selling scrap to our casting operation and they may have been operating as divisions and paying to certain inefficiency charges all those things will go away because that scrap can be rotated from within the system. We have so far been looking at transferring products from Germany to India when the rupee was 70 and Indian operations had not reached a level of efficiency, we could not guarantee to our OEMs in Germany the same quality and prompt delivery that we could have done if India was functioning well. Now that India is functioning well I think KR has already told you that there are between 35 to 40 new products that are coming in from Germany to India. In spite of this what may also happen is that some sub-customers in spite of the economic benefits may not want to risk such long supply chain so what might happen is that instead of moving all products to India, now you can move products between Germany and Spain instead of competing between our English operations and what will be our collective Spanish operations. We may be able to move product and machining around instead of two companies forming axle beams on the forging front we may be able to move some things around inside Europe itself. So there will be operational synergies, there will be marketing synergies, there are set of customer that our complementary to each other and then there will be cost savings. Do I know how much those cost savings will be? Again it would be a forward-looking statement about what but we have made some estimates and we are quite pleased to what kind of saving those estimates will show up as. I do not know that is a long answer but since you asked very interesting question I just wanted to make sure that everybody got it.

**Srinivas Rao:** No Sir that is fair enough absolutely, but to be honest and again I may be wrong.

**Hemant Luthra:** Be honest as like and if you want to say something, which you are afraid of saying, I will say it on your behalf yes the European operations run the result from the European operations have disappointed us and that is being absolutely truly honest with you.

**Srinivas Rao:** That is a bigger challenge right now that you take our company, which also has further operations in Europe, albeit which I understand our profitable and to be honest in India we have

looked at forging the sector itself it seems somehow very difficult for the sectors to actually come up and build world class processes or companies and we have seen a very little synergies even in companies which are within CIE, good group like Mahindra so that is the apprehension to be honest.

**Hemant Luthra:**

I hear what you are saying but and I do not make any excuses because at the end of the day I am responsible for what has happened. We can do the math for you and if somebody comes in offline I will compute the math for you and give it to you, you means that people on the call as to how much value has been created in India because we were able to leverage the growth in India. I can also tell you that the same team that was doing a 100 million Euros per quarter managed the 2008 – 2009 crises quite well then the volume fell from 100 million a quarter to 30 million a quarter. I can also tell you that it is a dam good job and they move the volume back up from 30 million a quarter to 70 million a quarter and then the volumes have fallen back down to something like 60 million a quarter. Now when you look at the rollercoaster that they have been on you have to make some allowances but no excuses. We believe that with India having reached the point where it can take on some European responsibility for products that can be moved and have been identified, you will see delta X margins in the high single digits or mid single digits improvement because of moving of that product from Europe to India. You will also see some additional margins and ask KR the jump in with some sample cases of what happens when you move a product that is lying in Western Europe, Germany where the labor cost may be 25% of sales and you move it to Spain where the labor cost is 10% of sales because they have been going up to the same customers or you move it to 15% in Spain or you move it to India where the labor cost may be close to 8% or 9%. So also I only want to say is that we have been around for seven years, our competitors have been around for 40, we do not ask your patience for 40 years but we ask your patience for another two.

**K. Ramaswami:**

If you look at the European operations of Mahindra Forging as of now one of the main factors that has affected the performance has been the revenue line, obviously the revenues in Europe are not very good given the current economic scenario there. What we are planning to do in the short run is to take arbitrage of one the difference in labor cost, second the current prevailing exchange rate and try to transfer products and start producing these parts in India and sell it to Germany. Therefore Germany has enough opportunity to cut down on costs. Now from an international standpoint of view, when CIE merges two forging plants, I would like to state that CIE has got operations not only in Europe, but also in South Americas as well as in China and elsewhere. So what would happen is it will go up plenty of opportunities for our existing plants in Europe for exporting to US and all of you know that US economy is actually strengthening and we are quite confident it to remain strong in the future as well. Today's problem is that our European operations are suffering because of lack of revenue and I think this alliance will give lot of opportunities to improve revenue. So that way it will make a sense. So short-term we are transferring parts to India to make sure that the costs are down and parallelly work on increasing opportunities as and when we get aligned with CIE.

**Srinivas Rao:**

This is helpful.

- Moderator:** Mr. Rao do you have any further questions.
- Srinivas Rao:** I am done with my questions. Thank you so much.
- Moderator:** Thank you. Next question is from the line of Aryn Pirani from Deutsche Bank. Please go ahead.
- Aryn Pirani:** Hi Sir thanks for taking my question. My question was more just to go back to the situation in Europe and the revenue expectation like you mentioned the truck demand scenario seems to be improving. So is that reflecting in the order book that your customers are giving you, because we have been hearing that of late customers have not been giving any long-term order outlook, so is that changing as the demand environment is improving?
- Thomas Koerner:** Yes, what we have right now in Europe is a situation that of course it is quite an uncertainty coming from the truck manufacturers right now, but even in the first quarter of this financial year we received the orders till end of this year that means these are orders are more or less fixed. We never know what is going to happen with Euro V and Euro VI, but right now are the matter that we are receiving from the truck manufacturers is that they are relatively stable and that the truck manufacturers are expecting to increase their demands important this year. So to answer your question correctly the orders are right now fixed.
- Aryn Pirani:** Okay, and just what is your sense of the channel inventories because I think that was a huge problem in December and January that the channel inventories were very high and production had to be cut at manufacturers by I think 40%, 50% so what is your sense of channel inventories for your customers right now?
- Thomas Koerner:** Inventory at our customers are now on an acceptable level so that they do not cut down their inventories anymore. So what they have is the inventory of the average of the truck manufacturer industry the inventory of a little bit more than one week and when these guys cut it down they were coming from 2.5 weeks so they cut it down in December and now they are relatively stable with inventory of one week and I am from my personal point of view I think that is a healthy inventory level what do your truck manufactures have right now.
- Aryn Pirani:** Thanks for taking my questions.
- Moderator:** Thank you very much. Participants anyone who has a question may press “\*” and “1” on their touchtone telephone.
- Rohan Korde:** I think we do not have any more questions Mr. Luthra would you like to offer any closing comments?
- Hemant Luthra:** I think the only thing that I am saying is we are not here to make excuses for the low performance of Europe. It is public knowledge what is happening in Europe just now. We only would invite those people who are on the call to look at what happened in Europe in FY’12, which was EBITDA Euro 22 million and assume that the Mahindra system does not allow people

to underperform their own best. That is all that I can say. Most of the analysts that we talked to are optimistic about what this alliance means and that optimism shows up in many different ways. One is that if you look at the price at which M&M has invested in CIE was about 6 Euros a share. It effectively meant that the valuation of 600 or about 700 million of CIE there was some question mark and I am not talking addressing if those of you who may also have shares in Mahindra. It effectively meant that there was some question mark how liquidities, what the prices. Last Friday Blackrock went and bought 5% at the same price as Mahindra did a big knowledge on Bloomberg. The other piece of thing that could give people some comfort about because there are lots of questions, which are not so much related to the quarterly performance of Mahindra Forging I think they are related to what Mahindra CIE will look like when it is all put together. When it is all put together Mahindra CIE if you look at what the corresponding numbers would have been in a normal year of fiscal year 2012, Mahindra CIE would have looked like 5400 Crores and about 540 Crores of EBITDA. There have been some hiccups in FY'13 but I do not think those hiccups of FY'13 are permanent in nature. They are caused by some equipment issues. As we go forward, we just finished the last of our AGMs yesterday with Mahindra Forging been done, Mahindra MUSCO Stamping been done and the uniform reaction of all the shareholders is basically that this is a good thing for us instead of being present on two continents, we are going to be present in five. We have a global footprint and we are following what the market is saying in terms of how the number of OEMs have shrunk from 50 to 25 and how the number of suppliers have shrunk from 30000 to 7000 as the industry consolidates and we think we are going to play an important role in that consolidation. If there are more questions from anyone or if there is a one-on-one meeting that anybody wants of the analysts, our investor relations people would be happy to organize.

**Rohan Korde:** Thank you very much Sir and thanks to the entire management team for the conference call. Thank you and best of luck for the future.

**Moderator:** Thank you. On behalf of Anand Rathi that concludes this conference call. Thank you for joining us. You may now disconnect your lines.