“Mahindra & Mahindra Limited Q3 FY19 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day. Welcome to Mahindra & Mahindra Limited Q3 FY19 Earnings Conference Call, hosted by IIFL Capital Limited. As a reminder, all participant lines will be in the listen only mode. And 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 phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Joseph George from IIFL Capital Limited. Thank you, and over to you, sir.

Joseph George: Thank you, Aman. Good afternoon, everyone. On behalf of IIFL, I welcome you all to the post-results conference call of Mahindra & Mahindra Ltd. I also take this opportunity to welcome Dr. Pawan Goenka – Managing Director; Mr. V.S. Parthasarathy – Group CFO, Group CIO; as well as other management personnel, including the Investor Relations team. I request Mr. Parthasarathy to make the opening remarks, which will be followed by Q&A. Over to you, Partha.

V.S. Parthasarathy: Thank you. And on behalf of M&M Ltd., I extend a warm welcome to everyone on this call. I will share some updates and key economic developments, along with financials. And after that, Dr. Goenka will give overall comments. After that, we can have Q&A.

First, let me talk briefly about the macroeconomic situation. The global scenario is challenging with some bright spots. Global growth forecasts have been estimated at 2.9%, down from earlier expectation. US is expected to grow at 2.5% in 2019. China's economy is slowing down but still pegged at a healthy level at 6.2% in 2019. There has been disruption in global value chains, with tightening of borrowing cost, increase in public and private debt and continued trade tensions.

In this global scenario, India's performance has been relatively better. Interim budget was presented last week. It was a finely blended cocktail of populism with fiscal prudence. I call it the RAW budget, focused on rural, Aam-Aadmi and welfare. And if you add D of digital thrust in it, it becomes DRAW. And I hope the luck of the DRAW also favours India for investment and growth.

RBI also gave a booster shot to liquidity with a 25-bps cut in repo rate. Also, along with a change in stance to neutral, which all augurs well for the country, the low inflation and RBI projection of 7%-plus growth, both in 2019 and 2020, seems to be all adding up in the right direction.

Still, two negative news. IIP fell to a 17-month low at 0.5% in November, and manufacturing PMI fell to 53.2 in December 2018, versus 54 in November 2018. However, to me, these appear more a reflection of the past rather than signs of things to come.

Now let me share financials of Q3 FY19. Happy to report that we have achieved robust double-digit growth in our revenue, including other income, for the quarter, which grew by

14% over previous quarter. This was enabled by a healthy volume growth in both our key segments, with tractors growing at 10.4% and automotive growing at 11.1%. This revenue growth gives us both efficiency and leverage. I am also happy to say that this is the seventh consecutive quarter where we have had growth 5% and upwards, and most of them have been double-digit growth, like this quarter.

On the cost front, as mentioned by me during the last quarter, we continue to face two headwinds in our core business that has a bearing on the financials. In my mind, these are temporal in nature. First is the commodity price increase. There has been steep increase in commodity prices, and we are able to partially offset the same against selling price increases. The second aspect is introduction of new products and therefore the model mix, where the margins were not the same as mature products due to introductory pricing, associated launch costs and yet to mature, material cost. The current quarter financials have impact of both these factors. However, we see commodity pressure easing in the foreseeable future, and margins of new products will increase with value engineering and other efforts, giving us the headroom on the margin, along with leverage on an expanded revenue base should start showing positively in coming quarters.

In Q3 FY19 our revenues, including other income, grew by 14%, as I mentioned. EBITDA grew by 0.7%, and PBT before EI grew at 11.9%. I am also happy to share that in Q3 FY19, we have achieved the highest ever quarter three revenue and PAT at M&M + MVML level. OPM margin was at 13.2%, lower by 150 basis point versus previous year of 14.7%. As mentioned already, this is largely due to commodity cost increase and new product launch impact in auto.

PBIT of Rs. 1,540 crores is higher by 10.9% versus Q3 FY18 of Rs. 1,388 crores, driven by other income.

We have a one-off tax benefit in this quarter which have brought down our tax expenses this quarter. Considering this, PAT before EI at Rs. 1,476 crores is up 60% versus the previous year, and PAT after EI at Rs. 1,396 crores is up by 6.9% versus previous year of Rs. 1,306 crores. Last year, there was an EI, which was profit on certain investments, while this year we have a small cost for the same reason.

Let me now take you through Q3 segmental financials. Revenue of Rs. 7,915 crores for auto, which was higher by 11.3% versus previous year, and segment result is Rs. 461 crores versus Q3 of last year of about Rs. 800 crores, a 22% decrease.

FES segment revenue of Rs. 4,634 crores, higher by 13.1% against Q3 FY18. Segment result, Rs. 888 crore, which is 5.9% higher than last year Q3. Debt/equity ratio continues to be at 0.1, and net debt equity is below 0.

Now let me move to consolidated financials. At a consolidated level our net revenue was Rs. 26,236 crores, which grew by 16% over the previous year. That is an exceptional gain sitting in quarter of Q3 FY18 pertaining to some investment sale as well as the logistic business getting listed. Current quarter does not have any such element. So in order to find a measure which is comparable I used PBT before EI level. The consolidated profit there grew by 1%.

A few highlights from our key sectors are as follows:

It was a milestone quarter for Tech M, with a $5 billion annual revenue run rate in sight. It posted PAT of Rs. 1,203 crores in Q3, delivering a 28% YoY growth. On a stand-alone basis, Mahindra Finance reported a PAT of Rs. 319 crores as against Rs. 396 crores in the previous quarter. The PAT previous quarter included an exceptional item on account of sale of shares in subsidiary in insurance business, due to which the figures are not comparable, but overall, they have continued to do very well.

Profits at Mahindra Lifespaces of Rs. 21 crores vis-à-vis Rs. 26 crores last year. And Mahindra Logistics reported a PAT of Rs. 19 crores, which was a growth of 29% over previous year.

Now I turn the mic over to Pawan for his comments, please.

Pawan Goenka: Thank you, Partha. Good afternoon, everyone. So, just a small comment on the budget beyond what Partha had said. Clearly, the budget has something for everyone and should drive positive sentiment, as all of us expect. And should give a positive direction to the industry, the segments that we are interested in, though there is nothing direct for either automotive or for tractor segment.

We often say that the devil is in the details. In the budget we looked at the details very carefully, and we have not found any devil in this budget, and all the numbers in our scrutiny add up to the kind of projections that the honorable Finance Minister has made.

The only sort of concern that I have, which is on something that is left out, which is the corporate tax. And as you all know that there was an announcement made four years ago that over a time of four years the corporate tax will come down in steps to 25%, and for large corporates it still remains at that level. And because some of the incentives have been taken away, the tax rate, in fact has gone up slightly from what it was four years ago. And I would hope that in the full budget, that gets presented by the government, they will take care of the corporate tax.

Now, moving to the macroeconomic factors. Again, Partha has talked about a few things. I will focus on five things that I had mentioned at the beginning of FY19, things to watch for, and kind of reflect on how those five things have performed.

And oil prices are the first one, where we had peaked up to US$86 and now are down to about US$61.9. And the peak had happened in October. And just keep that in mind because it will have significance in something that I am going to say later. The US dollar rate had also peaked at about Rs. 74, Rs. 75 and now is down to a Rs. 71, Rs. 72 level. Again, the peak happened in October.

The commodity prices went up very rapidly in the first 2 or first 2.5 quarters and now have stabilized. And, in fact, beginning to show a sign of moderation. And once again, the peak happened sometime in October.

The monsoon was normal until about towards the last two or three or four weeks when the monsoon slowed down, and that did lead to a little bit of a sentiment issue in the rural area, farm area. Again, that sentiment issue happened in October.

And the interest rate came down yesterday, but it had peaked after August. So in September, October, there was a little bit of a concern on the interest rate that was there in the macroeconomic side.

On the rural sentiment, as I mentioned, the southwest monsoon was very good, except for the last few weeks. Five consecutive good harvests that we have seen. In fact, Kharif output has been the best ever, about 1- 1.5% higher than what it was last year, which was a record year. The sowing is a little bit low in Rabi, especially in the rice belt because of the northeast monsoon being somewhat slow. The loan waivers do well for the farming community. And the focus on agri and rural development continues and sustained investment on infra and road development and also availability of good finance. A little bit of concern on lower Rabi sowing and also a concern on reservoir levels being slow in few states like Maharashtra, Gujarat, Andhra Pradesh and Telangana.

Now if I look at the tractor industry, the industry, even though it grew by 19%, was lower than what we had all planned for. Our thinking was that we will grow at about 30% during this quarter for the very simple reason that the festive season, which is a big peak for tractor industry, this year was in the third quarter. And that has then led to a very challenging quarter because most players had done wholesale in anticipation of very good retail in the festive season and, therefore in months of November and December went in trying to correct the inventory. Different players have corrected inventory to different levels, and I will come a little later to what Mahindra has done.

As far as M&M performance is concerned, we grew at about 13.3%. And let me sort of pause here to say that the quarter was challenging both for auto and tractor industry-wise. And that is because the retail during the festive season and for deliveries for tractor during festive season were 8% to 10% lower than what the industry had planned for. And all of this happened for a very simple reason that October, everything appeared to be going wrong. And I have talked about a few things just now. That is the oil prices, the exchange rate, the commodity prices, the monsoon slowing down towards the end, the interest rate being at the highest at that time. In addition to that, there was a concern because some of the regulation changes that had happened in auto, which had led to a price increase and also the axle loading norm that had reduced or significantly impacted the demand of heavy commercial vehicles.

So continuing with the tractor performance for Mahindra. The market share, and I should also say that most players in the industry, both automotive and tractor, try to balance sort of three outcomes: the outcome of market share or volume growth, the outcome of profit margin and the outcome of inventory at the end of the quarter. What Mahindra did was, for both the verticals, focused on getting the inventory right. And therefore, we ended with good inventory, both in auto and tractor, bending between four to five weeks, which is where we want to be, which is where we were last year, that is December 31, 2017.

And in case of tractor, we focused on maintaining good profitability and therefore compromised a little bit on the volume. And we also, because of getting the inventory right, had to compromise on the billing volume. In case of automotive, we focused on getting volume growth, and we got roughly 10% volume growth in this quarter, which is about the best volume growth that we have seen and best that industry had in this third quarter.

One of the sort of good news for Mahindra is the growth in the farm machinery business, which is a very small business right now. And this year we probably will end at Rs. 450 crores, but a business that gives a growth potential which is far better than growth potential coming from tractor side.

The Trakstar brand, which is our new brand that we had launched last year, now is slowly gaining traction. We are now at about 0.6% - 0.7% market share, very small, but going in the right direction. And our target is that this should add about 2% to 3% over a period of three to four years to our overall market share for Mahindra.

Coming to auto. Again, a challenging time for the industry. In the third quarter the passenger vehicles actually de-grew by 0.8%, though April to December there was a small growth of about 4% - 4.5%. And as a result of that, our thinking right now is that the auto passenger vehicle, overall growth for the industry will be 5%.

For Mahindra, we had a small growth, 0.7% growth in third quarter. And we had a small growth in the market share in UVs, only 0.5% growth, but after 10 quarters we have reversed the trend of our market share going down. So that is a good signal and shows that our new launches are working and will help us to improve our market share.

In the LCV segment, the quarter growth was very big in the smaller LCV segment, less than 2 ton, 41% growth. And April to December cumulative is 56% growth. In the 2 to 3.5 ton segment the third quarter growth was 8.6%, lower than what we have seen in the first two quarters. MHCV, on the other hand, had a difficult time with a 8.2% de-growth in third quarter. And again, as I said, this is because of the axle loading norm. If I look at cumulative April to December, the growth is 26%, that means first half was very good. And in the 2 to 3.5 ton segment, we have a market share of about 63%, a growth in market share. And even in the less than 2 ton segment, we have a market share of about 23%.

If I was to look at the outlook for the industry, on the passenger vehicle side, I talk about the passenger vehicle where we think we will end the year at about 4% to 6% with the remaining two months. But in less than 2 ton segment, I am more sort of optimistic and looking at 40%, 42% growth for the year. And for 2 to 3.5 ton segment 10% to 12% growth.

For the tractor we will have to revise our estimate for the year. And right now, we expect quarter four to be flat. And if quarter four is flat, then we will see a growth of 10% for the year. If we see a small growth on quarter four, which we believe is unlikely, then we could see up to 11% growth for that industry overall.

New product launches, I won't spend too much time, we can come back to that in the Q&A time. Marazzo has been launched in September, as you all know. Alturas G4 was launched in November as planned. And both are doing quite well. XUV300 will be launched on 14th February. Our FURIO ICV was launched about 10 days ago. Treo electric three-wheeler was launched. JAWA is getting ready. We have bookings happening for JAWA. And e-KUV will be launched middle next year. So that is the launch calendar for us on the automotive side.

On tractor, there are no new platform that will be launched, but we will be introducing new variants and some refreshes.

On the BS-VI side, there is no major concern that we have. If there are specific questions that any of you have, we can handle those in the Q&A.

Electric vehicle side, things are moving reasonably well. And right now we think that the three-wheeler segment should ramp up very quickly on the electric vehicle side.

Export. We did very well in auto. We have a growth overall in nine months of 45%. All the markets are doing well. And Q3, we had a growth of 37%. On the tractor, on the other hand, there is a de-growth on the export side with 12.7% de-growth for the nine months period.

Material cost increase, as I said earlier, that is sort of slowing down now, flattening. And we hope to see some reductions start happening perhaps soon. But if I look at the nine months, the increase in material cost has been approximately about 4% - 4.5%. And we have been able to pass on about 60% - 70% of that increase in the pricing, both in the auto and tractor.

For SsangYong, we have a calendar year here, that is from January to December, which we ended and announced the results a couple of weeks ago. We have seen a volume overall being flat, and the EBITDA percentage margin has gone up from about 3% in calendar year 2017 to about 4% in calendar year 2018. And the overall PBT losses that we have, have reduced by approximately Rs. 100 crores. The volume target for SsangYong for 2019 is 163,000, which represents a 14% growth.

I am not covering the smaller businesses. We will get into that if there are questions on that. And I will stop here so that you will have about 40 minutes for Q&A on any subject, either related to business or related to financials. Thank you very much.

Moderator: Thank you very much. Ladies & gentlemen, we will now begin the question-and-answer session. First question is from the line of Kumar Rakesh from BNP Paribas. Please go ahead.

Kumar Rakesh: My first question is, in January, there was an investment of KRW 50 billion in SsangYong. Can you give some details around what this investment was for?

Pawan Goenka: Okay. So SsangYong has a fairly heavy investment in product development. We have so far invested more than, we meaning SsangYong, has invested more than KRW 1 trillion, which is roughly $1 billion. And we have plans to invest another KRW 1 trillion over the next three, four years, that is another $1 billion. Now to fund that there is significant level of internal fund generation because of the working capital management. We have been generating KRW 200 billion to KRW 300 billion every year. But yet we will be falling short of the total requirement that we have for investment in product development. And therefore, there was a need for about KRW 100 billion more for SsangYong. And we decided to put KRW 50 billion as equity from Mahindra, and another KRW 50 billion will be borrowed over time to fund all the CAPEX for product development.

Kumar Rakesh: And this CAPEX plan which you said is over what period of time?

Pawan Goenka: About three to four years. Right now, there will be one brand new product that will be launched this month in Korea and next month globally. There will be a new product launch that will happen in about June to July next year and another product launch after one year. And roughly, each product costs about KRW 300 billion. And also, there are expenditures on refreshes and there are expenditures on meeting the emission norms, which are same as European emission norms.

Kumar Rakesh: That is very helpful. My next question was around the tax expense part. Even after adjusting the tax write back which you have sought, it appears the effective tax rate to be very low. Is there something more than that, which we have got this quarter which you haven't called out?

V.S. Parthasarathy: Okay. Yes, so very quickly, I think there is a clarification required here because if you see only the M&M account shows the figures, okay, but that benefit is available both in M&M + MVML. So this quarter, we had certain benefits which are one-off in nature. In the tax provision, the net benefit is about Rs. 400 crores. So you knock it up, the rest will be okay.

Kumar Rakesh: Okay. So instead of Rs. 190 crores, it is actually...

V.S. Parthasarathy: Rs. 193 crores is only in M&M. Rs. 200 crores in M&M, equivalent amount in M&M and MVML.

Moderator: Thank you. The next question is from the line of Anubhav Bajpai from Goldman Sachs. Please go ahead.

Pramod Kumar: This is Pramod here from Goldman. My first question pertains to the automotive business. We have seen margins, which are probably the lowest, at least whatever historical financials. It seems to be the lowest margin for your automotive division on the standalone basis, although revenues have grown meaningfully. So I just wanted to understand, how should one see the margin trajectory going forward? When volumes are growing you have a reasonably good launch pipeline starting with the XUV300 and recent Marazzo. So what are your thoughts on the margin generally for the segment? And related to that, how would you see this evolving in the medium term once the Ford alliance gets going? And any update on that, that will be great.

Pawan Goenka: Okay. So let me just slightly correct something that I said earlier. I said that SsangYong generates free cash flow or operating cash flow of KRW 200 billion to KRW 300 billion before CAPEX. That should be KRW 150 billion to KRW 200 billion it generated internally on average.

Okay, so I can only talk about past, and you will have to extrapolate the future, because I don't want to give a guidance on margins. And now if I look at quarter three, you are right in saying that margin for auto stand-alone is amongst the lowest that we have seen in the recent past. But if you were to compare that to the industry, you will find that we are not worse off than anyone else. In fact, if I know, amongst the published results, we probably are better in margin than anyone else that are published. Now in quarter three the margin is affected by several factors, some of which Partha alluded to. The biggest one is the commodity price increase, where we have perhaps lost about 120 basis points in terms of not being able to pass on the commodity price increase in the selling price. Okay, again, that is a phenomenon across the industry that we have seen from published data. The second one is the extra discount or incentives that have been given in this quarter. And as you know very well, this year in quarter because of the retails being slow in festive season, discounts have been somewhat higher. But I would like to say that we have been perhaps reasonably well disciplined in this. And our hit on the margin because of higher discount is about 40 basis points. Then we have a new product launch expense, and we also have normally lower margin when we launch a new product, as we always announce. And in Marazzo, for example, we already have taken a price increase in the month of January. And another factor that is very important for margin overall at the PBIT level, not in the OPM level, is the fact that we have the D&A of the XUV300 coming into this quarter where the revenue is going to start coming from quarter four. And the hit on the margin because of D&A is about 70 basis points. And now during quarter four we clearly will have very high expense coming in because of launch of XUV300, which will be a large one time expense for launch, including ATL and BTL that we do. And also, again, a new product will always have a lower margin to begin with, and therefore, you would see that effect of XUV300. Of course, we will get some benefit from increased volume. And because as we increase volume, our fixed costs as a percentage do go down, so that will tend to offset the increase and to offset the reduction in margin because of new product. Where the overall equation will end up, that you will have to do your own spread sheet and find out.

V.S. Parthasarathy: Yes. Pramod, I wanted to kind of just, I mean Pawan has covered it in a very comprehensive way, but I just wanted to give a timing color. The key thing is material cost increase. As it tempers down, next quarter or this quarter are not kind of thing, but in the medium-term you have the ability to pass it on to the market. And therefore, that one line item over a period of time, if there is no pressure of increase like what we had, another 4% material cost is a clear possibility, and that I think is one area we should look at. Second, when you come to the other one, 40 basis points or something, I think we could think of it as a new normal. But I am just saying, over a period revenue leverage gives a lot of positives, which should be more than offsetting the other line item if you have a revenue growth, which is what the new products will bring. The third one is amortization, which is at 70 basis points. Again, the same logic. Initially you may have more hit than anything, like we saw in Q3, because we have seen 70 basis points going up rather than anything going up because the revenue is not coming and the hit is coming. But when fully operationalized, that all three products have got full potential, then it will max, and therefore you should be able to see that. So I will see a parabola on the other way, I mean, not a parabola, a downward and then slowly going upwards of here. How much, how much, like Pawan said, you should do your own excel sheet, but I wanted to give you the trajectory.

Pawan Goenka: And there is one piece of data to reinforce what Partha said, and that in our budget for FY20 our estimate for commodity price increase is very modest, much, much, much less compared to what we saw in FY19.

Pramod Kumar: Okay. And Pawan, on the Ford alliance before I get to a tractor question.

Pawan Goenka: On Ford alliance, there is nothing new to report. We have talked about the two definitive agreements that we have signed. They are close to finalizing the definite agreement on the C SUV, and that is the W601 product platform. And everything is going as per schedule, and there is nothing new to report.

Pawan Goenka: And farm equipment, Pawan, I understand it is very difficult to predict. But what are the positive factors which you will watch out for which can kind of support the industry growth next year? And what could be the headwind for the industry growth? Of course, monsoon, positive/negative, I understand. But outside of monsoon what else will you watch out for? And how do you see the current system inventory impacting the wholesale growth next year for the industry and for yourself?

Pawan Goenka: Okay. So a little bit of it is conjecture. So let me first say, even though you said monsoon, we should leave out. But the very first signs that we have of monsoon for next year, which is very early, positive in the sense that there is a prediction by Skymet that El Niño is unlikely to happen during this year. And that was the concern that we had because earlier thinking whether there will be El Niño this year. And normally, if El Niño is not there then monsoon does not become too bad. We still don't have the forecast of monsoon, we will wait and see. And if we get sort of fourth good year of monsoon, that will be a record of sorts because normally we have a cycle of three or four years. The second thing that I would say is that no matter who the government is, it is very clear that the farm support, farmer support and the agri support, rural support will continue. And that is clearly a positive sign that you have for the tractor demand as well as agri equipment demand. Third thing that you should look at is there is lot of specific subsidies being given on tractors by certain states. AP and Telangana are taking lead in that, and a fair amount of tractors have been sold on those subsidies in the last year. And it is possible that other states will follow suit and introduce subsidies for tractors in whatever scheme that they do. So that is the third factor that could happen. And the fourth factor I think is that the overall Kharif output has been good, as I said earlier, at 1% better than last year, and last year was a record output. And therefore, the farm revenue should be good. Rabi, there is little concern on the paddy, but everything else seems to be okay. So we will have to wait and see how the Rabi crop goes. Having said all of that, I do want to caution that we have had three years of very good growth in the tractor industry with 17.7% in FY17, 21.7% in FY18 and about 10% in FY19, which will be compounded. If you do, we will probably add up to 65% - 70% growth in three years. Do not expect a double-digit growth in the coming year. Right now, we have not done a forecast. We will announce that in late February, early March. But my guess right now is that we will not get to a double-digit forecast at least for tractor industry for FY20. Does that answer your question or any follow-up on that?

Pramod Kumar: Infrastructure support to tractor growth. Isn't the infrastructure-led growth, construction norms and all that not supporting the tractor volumes currently?

Pawan Goenka: Infrastructure is supporting the tractor volume, but see, until few years ago there was a higher portion of tractor sale happening for haulage. And now, the tractor sale ratio is more for agri application and less for haulage. So yes, it is a positive thing, but it has been positive in the last two years, three years. And therefore, I don't see that it has changed from what we have seen in the last two years.

V.S. Parthasarathy: Yes. However, it is a very key component of today's rural household income. And therefore, to that extent, overall positive sentiment of the rural area goes up when there is more infrastructure into rural projects, which this government is focused on, and I think it is an ongoing focus and which is positive for overall rural demand.

Pawan Goenka: And one more thing that will clearly have an impact on the tractor sales will be the interest rate and availability of finance for the tractors. So if the 0.25% reduction that we have seen now, if it is followed by another 25 basis points reduction in the next two policy announcements, that will probably bring down the interest rate to a level where it will start affecting EMI positively. And the liquidity would be the determinant of what happens to tractor sales because tractor sales, by and large, are on financing.

Moderator: Thank you .The next question is from the line of Ronak Sarda from Systematix Group. Please go ahead.

Ronak Sarda: A couple of questions, please. On your traditional UV business, how do you see next 12 months? Will it be one of the best years in recent future because of election spending and pre-buying for diesel period before BS-VI?

Pawan Goenka: It is very unlikely that elections will have a major impact on UV volumes. Used to be that the election was something that had a great impact on UV volume, when the UV volumes were very small. And therefore, even 5,000 vehicles sold would mean a large percentage difference. Now UVs are fairly substantial in terms of volume, and at these volumes, any little, 3,000, 4,000, 5,000 kind of extra sales that happens does not really make a significant impact in the overall volume. On the other hand, when we talk about BS-VI, in fact, maybe I can take some time here to talk about BS-VI. No, let me wait for a question. So the BS-VI will definitely have an impact on the sales towards the second half or at least last quarter of the year. The only question right now is how automakers will cope up with estimating the demand because as you know very well, that on 31st March 2020, we have to stop selling, and therefore, nobody can produce more vehicle than they can sell. And therefore, there probably will be a little bit of conservatism in how many vehicles are produced because we need to decide more or less by 31st December how many vehicles will make of BS-IV. And by then, whatever demand that we project. So therefore, it will be little bit of a planning exercise that we determine, and I think most of us will be conservative in BS-IV volume because we know there is target date, and that will come. And I have often referred to the 31st March 2020 as the Y2K event for auto industry because it is lots of uncertainties that we have.

Ronak Sarda: Sure, sir. Just adding to it, what's your expectation for XUV300 given the pricing, whatever we have decided? And is it dependent on success of a petrol variant?

Pawan Goenka: Dependent on what?

Ronak Sarda: Success of your petrol engine?

Pawan Goenka: Yes. Well, let me answer the question in two, three parts. First of all, we have said before we started launching these three products that we expect to get 9,000 volume coming from these three products. And based on the volume, or response to Marazzo and based on response to Alturas and what we expect from XUV300 based on media reports and early bookings that have happened, we think that we will be on track to get the 9,000 volume from these three products. And I said last time also that out of 9,000, there will be some cannibalization. We cannot really quantify whether it is 1,000, 2,000, 3,000, but there definitely will be some cannibalization. And therefore, the net increase in our UV volume will be 9,000 minus some delta. Now XUV300 as of now appears to be a product that should do well. As you know that we have unlike in the past this time we have not held back anything about the product. It is known, it is displayed. There are no secrets, except for the price that we will announce in the 14th of February. There is some advance booking that have started. I think up to now, we have 3,000-plus booking. We have 55 million views on our digital media. From various things that have been put on the digital media, 55 million is certainly a good number. We have 60,000 inquiries already generated on the vehicle, so looks like everything is moving in the right direction. We will know on 15th of February, that is in about a week, how the product does. But I would definitely be very surprised if we don't meet our volume objectives that we have. I should also point out that the total volume capacity for these three products together is 9,000, and this is what I have said in terms of our sales volume also. However, we have ticked off volume capacity increase, which will take about six months. So if we find that the demand is more than 9,000, we will be able to go higher by about August, September time frame. Did I answer your question or did I leave out something?

Ronak Sarda: Your success on petrol, any comment?

Pawan Goenka: Oh, so we are launching both petrol and diesel together. The diesel engine is same as what goes in Marazzo. And petrol engine is a new engine, the 1.2-litre variant of an existing 1.2-litre engine. And again, from the reports that we have seen, both engines' performance is very good, the media write-up. And as far as we are concerned, we can do any mix of petrol/diesel, from 100% petrol to 100% diesel. As we have seen in terms of diesel/petrol penetration, interestingly, while the petrol penetration has gone up significantly when it comes to passenger cars and in a four, five year period, it is gone from almost half-and-half to about 80% being petrol on the passenger car. But when it comes to UV, even for sub 4-metre, even for compact UV, and that is what the XUV300 would be, as of now, the penetration is 80% plus. So I do not know whether it will remain 80% plus for us in XUV300 or whether it will become lower.

V.S. Parthasarathy: 80% for diesel.

Pawan Goenka: 80% for diesel, . But as I said, we are prepared for any ratio of diesel or petrol.

V.S. Parthasarathy: Yes. And just a quick comment. You said based on the new product launch, etc, will FY 2019-20 be the best year? I would say in Hindi – "AAPKE MUH MEIN GHEE SHAKKAR".

Moderator: Thank you. The next question is from the line of Kapil Singh from Nomura Securities. Please go ahead.

Kapil Singh: Could you please talk about the challenges that BS-VI will present across various segments in which M&M is present? And do you expect certain disruptions in some of those segments? For example, could the market shares in UVs shift significantly away from diesel, which is what you were referring to right now? In case of LCVs, will diesel still continue? Or do you see, for example, petrol or CNG options becoming more viable? And maybe some thoughts on electric as well, after BS VI.

Pawan Goenka: So as I said earlier, that I described the BS-VI 31st March 2020 as a Y2K event for auto industry because of lot of uncertainty. Now I am going to take a little bit longer to answer this question, perhaps go beyond the question. Now first of all, let's talk about timing. As you know, because of Supreme Court decision, the last date of manufacturing became last date of selling. And therefore, by 31st March 2020, we have to consume all stock of BS-IV. Now unlike BS-III to BS-IV conversion, BS-IV to BS-VI conversion, it is not possible to retrofit. So any vehicle that is left over on BS-IV cannot be sold in India after 31st March 2020, and we cannot retrofit it. So therefore, we have to be very careful on how we do it. And second question, and this is, again, very important, is that the fuel has to be available to us across India from January 2020 because we will have to start selling BS-VI in small quantities starting 2020. We cannot potentially store BS-VI production for two months. We have to start selling. Because we will start producing BS-VI and start slowing down the BS-IV, and there will be 2, 2.5, 3 months overlap. Now as far as we are concerned in Mahindra, we expect that the first BS-VI vehicle will be ready around December, mid-December 2019. When we start producing that, we will decide closer to the time, but first vehicle will be ready around mid-December 2019. And by 31st March 2020, we will be ready as per current time line with all but one model. Right now, engineers are working on making that one model also become ready before end of March. But right now, as per time line, there is only one model that is going beyond 31st March. And therefore, we don't see any impact because of not being ready with BS-VI, okay? Now the only question will be how quickly we ramp up BS-VI and how rapidly we ramp down BS-IV. And that is going to be a decision that we will make closer to the time. Now post-BS-VI, undoubtedly, on a like-to-like basis, diesel becomes more expensive than petrol. The delta will increase. And my guess is that for small vehicles and for passenger cars, the shift to petrol, which has almost now happened because 75% now is petrol, may become even higher, and we may become 80%, 85%, 90%. And therefore, the small diesel engine vehicle will probably become less viable. And therefore, any diesel engine, which is 1-liter, 1.2-liter, will probably find it difficult to survive beyond March 2020. When it comes to the larger vehicles, my guess is that we will continue with diesel being the primary sort of powertrain because of the need for performance that diesel gives, which for large heavy vehicles, petrol is not able to give. So again, like for vehicles like Scorpio, vehicles like XUV, I think it will predominantly remain diesel at least for some time. Also, there is a fuel efficiency difference, as you know, and that difference becomes even larger when we come to diesel. Now the other thing that is happening, which you are well aware, I am sure, is the price gap between diesel and petrol going down. So not only will diesel car become more expensive, the price gap becomes lower. And now the price gap is less than 10%, something that used to be 18%, 20% not too far ago. And therefore, everything is sort of pointing towards shift towards petrol. And my guess is it will be more for small cars or small vehicles and less for larger cars and larger vehicles. If I have not answered any question on BS-VI, please have a follow-up question on that. I want to clarify the situation.

Kapil Singh: Yes. What I wanted to clarify was, when you mentioned the small diesel engine becoming less viable, does that include the LCVs and pickups as well?

Pawan Goenka: No. In LCV and pickup, because of the very high driving in terms of number of kilometres, I think diesel will continue to be preferred powertrain, t, except in small single cylinder. The small single-cylinder vehicle probably cannot afford the cost of BS-VI. And therefore, the small single cylinder are more likely to become all CNG. Right now, like many other small single cylinders are diesel vehicles that will likely become more CNG and also possibility of them becoming electric. So I will not rule out the electric possibility, especially for three-wheelers, where as I said earlier, for three-wheelers, electric is very commercially viable. So you will probably see a shift to electric in three-wheeler, and you will probably see a shift to CNG on small single-cylinder engines. The two-cylinder engine vehicles probably will continue in the diesel avatar. Now these are all conjectures. We don't know how things will turn, but this is what we are assuming in our planning as we plan for life after BS-VI.

V.S. Parthasarathy: So I want to kind of interject only on one thing, just to add two perspectives. One is whatever Pawan said is an industry challenge that has been given based on whatever has been given. I think in our own preparation, we are very confident that whatever comes, we will be able to meet that, and we have some things in our arsenal, which places us much better than competition. For example, the last point, that single cylinder engine may go to EV. If it was too easy, at least we are ready, able and willing to be able to do that and capture. So I just wanted to put a relative positioning to whatever was said and also the fact that the industry will adapt with the challenge.

Pawan Goenka: So two more relative things since we are talking relative things. One is in terms of readiness for BS-VI. Of course, we don't have any firm understanding of where others are, but from whatever we have heard through grapevine, Mahindra certainly is not behind anyone amongst major players, and some things that we are even ahead of other players. But again, this is just hearsay, grapevine. We don't know what the reality is. The second thing is that our confidence of being ready starting mid-December to ending in mid-March, except for one model, is very high. And unless there is some kind of last-minute problem that comes up, being ready from engineering viewpoint will not be a problem. Where the challenge will come is suppliers being ready. And that challenge is going to be for the whole industry. It's not going to be specific for any one company. The other point that I want to make, which is, again, very important and critical. And that as we talk about more shift towards petrol, as I had said in the past that by 2020 April, we will be ready with petrol on all our major models. So KUV already has petrol. XUV300 will be launched with petrol. The Marazzo will have petrol by April 2020 or thereabouts. And all new products that we are working on today, all are being worked on with diesel and petrol options. So therefore, we would become almost neutral for all our products, whether the demand is for diesel or for petrol.

Moderator: Thank you. The next question is from the line of Chirag Shah from Edelweiss. Please go ahead.

Chirag Shah: Sir, I have a question on the demand side. You indicated a lot of issues in 3Q, which led to demand softness. Many of those concerns have now actually reversed. Still, we are seeing a lingering demand outlook. What will be required to change that? And anything that you are reading from the ground?

Pawan Goenka: You are absolutely right in your observation that all the negatives that I talked about, which were peaking in October, have more or less been reversed. And whether it is interest rate, whether it is exchange rate, whether it is commodity prices, weather it is oil prices, everything has come down to a reasonable level, yet the demand has not picked up. The only thing that I can say is that still the lingering effect of the festive season may still be there a little bit, but beyond that, we just sort of talk about the favorite word of sentiment having not changed yet because I don't see any reason now why the demand should not pick up. And I would hope that just like demand going down in October, November, it will probably come back up. But being conservative, I am not counting on that to happen in February, March. I am counting on that to happen from April.

Chirag Shah: And the related question was on these commodity benefits that the industry is likely to see. In this kind of scenario, do you think that it would be retained or it will be passed on? Because even with such high discount, demand conversion is not really happening the way it should have happened.

Pawan Goenka: See that is a dynamic situation and competitive intensity phenomena. And every player in the industry will try and understand where the industry is headed. Every player will want to retain as much of the advantage of commodity price as they can but without compromising with the sales volume growth. And different people will have different strategy. As I mentioned earlier, that in Q3, in automotive, our strategy was to grow volume at the cost of profitability, and in tractor, our strategy was to retain profitability at the cost of market share. Now as we move forward and depending on how our overall demand is, and my suspicion is that after launch of these three products and full volume ramp-up happening, we would probably be under less pressure to push for high volume because we will get the extra volume coming from these products. And then we may be able to focus a little bit more on controlling the profitability. These are again conjectures, where in case of tractor, it will depend on how the industry grows. Our market share in tractor is pretty sticky, and therefore, if you add 42, it will range between 42 plus/minus 1. And there, if the industry grows well, then there will be less pressure in terms of incentive for volume growth. If the industry is not growing, then there will be more pressure on pricing. So a lot of things are all sort of day-to-day decisions, week-to-week decisions. Very difficult for us to now make a six month plan and say this is what I am going to do three months from now, four months from now, six months from now. It will all depend. But the one thing that is very clear is that the commodity price pressure would be low in the next year. And therefore, at least there will not be any negative impact in profit margin because of commodity price. In the last two years, we have had a negative impact because nobody could pass on the complete effect of commodity price. And that always happens when the price goes up very rapidly. And when it starts coming down, at least you pass on the full impact and sometimes able to get a little bit extra to make up for what you couldn't pass on in the previous year. And that is not something new, it is been happening for as long back as I can remember in the industry.

Chirag Shah: And sir, and just last one clarification on three-wheelers. Anything on electric three-wheeler that you would like to comment, any launch you are likely to do?

Pawan Goenka: Certainly.

Pawan Goenka: Electric three-wheeler is a big opportunity for electrification in general and for Mahindra in particular. Now the reason I am saying this is that the three-wheeler is one segment, where based on current price, current subsidies, current cost, it is commercially better than running a CNG three-wheeler. And our estimate is that using a Mahindra Treo, a driver operator will probably make Rs. 2,000 to Rs. 3,000 more per month than he makes today with the CNG three-wheeler. Now Mahindra is very well-placed because we are the only organized player to have commercially launched a lithium-ion three-wheeler. And to the best of my knowledge, nobody has launched yet, organized or unorganized, a lithium-ion three-wheeler. So we are again first mover, just like we are first mover in four wheeler. We have started selling. In the last month, we have sold less than 200, and we are ramping up volume in our production capacity. And we will probably be selling 300, 400 this month and another 200, 300 added to that next month. The demand situation for electric three-wheeler appears very good. There are a lot of fleet operators who are very keen to get into electric three-wheeler because it is a new opportunity for most of them. And we have kind of demand commitments of 2,000, 3,000, 4,000 from different fleet operators. So therefore, I expect that once we are fully ramped up in production capacity, there will be good volume that we will get out of three-wheeler. And in terms of penetration, perhaps three-wheeler will have the highest penetration of any electric vehicle. Government of India is setting up a target of 30% three-wheelers being sold as being electric by 2030. And I think that is a very realistic target, assuming that there is no change in the stance of the government in terms of supporting three-wheeler, the farmer subsidy that is existing today with Rs. 61,000 for auto and Rs. 45,000 for rickshaw will continue. One more in the three-wheeler is there is a large population of lead acid electric three-wheeler where Mahindra is selling right now between 800 to 1,000 vehicles per month and is the leader in that segment, in the lithium-ion three-wheeler. That segment will continue for a while, but my guess is, at which time, it will give way to the lithium-ion three-wheeler, so lithium-ion three-wheeler will be a better product with longer life, with longer range.

Chirag Shah: Sir, say all these units are a part of our monthly disclosures, and they are a part of M&M, or they are a part of some subsidiary offers?

Pawan Goenka: The three-wheeler and the lithium-ion three-wheeler is part of Mahindra Electric. The lead acid three-wheeler is part of Mahindra & Mahindra. When we announce our volume, we include these volumes in the announcement.

Moderator: Thank you. The next question is from the line of Gurpreet Arora from Quest Investment. Please go ahead.

Gurpreet Singh Arora: My two quick questions. If I look at the brands of Bolero, XUV500 and Scorpio, the decline on an average basis for the first eight, nine months of the year is close to cumulatively around 15% to 18%. So how much would you attribute to the cannibalization from Marazzo? And how much would be the usual decline? That is one. And second and last question is if you can share the development cost for G4 Rexton and the XUV300.

Pawan Goenka: So it is a very difficult question to put a finger on. The reason I am saying that is that the industry has been slow in third quarter. So we do not know that if there was no Marazzo, how much reduction in volume will happen of XUV500 and of Scorpio? And therefore, we cannot extrapolate on how much of the reduction is because of Marazzo. We have only two data points. One data point is that the overall volume for Mahindra was not much higher than what it was pre-Marazzo, right? But we still had a market share gain. That means the whole industry has gone down, and Marazzo has only helped to bring the industry back to where it was if the industry was normal. So I am going round and round only because I don't know how to answer how much of the Marazzo volume is coming from cannibalizing the other products. What I can say is that normally, when we launch a new product in a space where we already have a existing product, we talk about 20%, 25% volume as being cannibalized volume and 75%, 80% being new volume. If we get more than that in our cannibalization, then we have done mistakes in product planning. So that is what will be the reasonable number for us to expect, but I cannot answer whether what is the current reality is that or whether it is something different. There is one more data point that we have, that we always do what we call lost-sale analysis, where we find out that people who didn't buy Marazzo, what did they buy? And we find very little of that being XUV or Scorpio. And therefore, that would tend to indicate that people who are buying Marazzo were not considering XUV and Scorpio. So that is just empirical data point, not a scientific conclusion.

Gurpreet Singh Arora: Alturas And XUV300?

Pawan Goenka: XUV300, we will talk about on the day of launch. Alturas...

Gurpreet Singh Arora: Okay. And in Alturas?

Pawan Goenka: Alturas were not much because Alturas is CKD. We have used the plant machinery that we had set up for Rexton and earlier Rexton that we have now stopped production. And we have some licensing fee that we have given to SsangYong and some royalty that we give on a per-vehicle basis. If I was to estimate, overall, I would say that less than Rs. 100 crore is what we have invested for Alturas G4.

Gurpreet Singh Arora: Fair enough. Last question, if you can say something on JAWA, please.

Pawan Goenka: Yes. We can say a lot about JAWA, but the headline is that we are sold out until September 2019 based on the estimate of 2019. Based on the production capacity that we have planned and the bookings that we have right now, you would have seen clearly all the write-ups that have happened on JAWA, which is all very positive. I think everybody is absolutely delighted that JAWA is back. And there are a lot of people, some who knew JAWA and some who had only heard of JAWA, both getting new people waiting for this vehicle to come. And we will be launching this vehicle soon, making it available for sale soon.

Moderator: Thank you. We will take the last question from the line of Ashish Nigam from Axis Capital. Please go ahead.

Ashish Nigam: Sir, just coming back to JAWA, can you share some numbers in terms of bookings or capacity?

Pawan Goenka: No, I cannot right now. All I can say is that we are booked until September 2019.

Ashish Nigam: Okay. Just lastly, on the BS-VI cost increase, a lot has been said about it, but you were working on bringing that cost down pretty sharply for a diesel vehicle. If I remember, that was initially going be over Rs. 1 lakh. But then you all have been talking about it, working towards it coming down much more, somewhere in the Rs. 60,000, Rs. 70,000 range. How are you seeing that cost increase now?

Pawan Goenka: Who has mentioned these numbers?

Ashish Nigam: I think in the last analyst meet, it was spoken of, maybe not Rs. 60,000, Rs. 70,000, but more like Rs. 70,000 kind of...Okay.

Pawan Goenka: So the number Rs. 1 lakh number is the right number, which I had given at that time. And I had said at that time that the XUV Euro 6 that we have done for export to Europe cost us about Rs. 1 lakh. And what I had also mentioned at that time, that is on a small volume, where most of what we put in is imported because for that volume, we cannot justify localization. And I had mentioned that we will work hard to reduce that cost by localizing, by optimizing the engineering and the design and by tooling up for the kind of volumes that we will have. And I don't want to give you a number of where we are, but all I can tell you is that we have exceeded our target in terms of cost reduction from that Rs. 1 lakh base that we started with from XUV500 for export to Europe.

Moderator: Ladies and gentlemen, due to time constrains, that would be the last question. I now hand the conference over to Mr. Joseph George for closing comments. Thank you, and over to you, sir.

Joseph George: Thank you, Aman. On behalf of IIFL, I thank the management of Mahindra & Mahindra Ltd. for taking out time for this call. I also thank everyone for dialing in. Have a good evening.

V.S. Parthasarathy: Thank you, everyone.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of IIFL Capital Limited, that concludes today's conference. Thank you all for joining us. And you may now disconnect your lines.