"Mahindra & Mahindra Limited 2QFY14 Conference Call"

November 13, 2013

MANAGEMENT: **DR. PAWAN GOENKA**
MR. V.S. PARTHASARATHY
MR. K. CHANDRASEKAR
MR. S. VENKATRAMAN

ANALYST: **MR. ASHVIN SHETTY, AMBIT CAPITAL**

Moderator: Ladies and gentlemen, good day and welcome to the Mahindra & Mahindra Limited 2QFY14 Post Results Analyst Conference Call, hosted by Ambit Capital Private Limited. As a reminder for the duration of the 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 phone. Please note that this conference is being recorded. I would now like to hand over the conference over to Mr. Ashvin Shetty. Thank you and over to you sir!

Ashvin Shetty: Good afternoon ladies and gentlemen. On behalf of Ambit Capital, I welcome you all to the 2Q FY14 results conference call of Mahindra & Mahindra Limited. Today from the management team, we have with us Dr. Pawan Goenka, Executive Director, President, Automotive & Farm Equipment Sectors and Member of the Group Executive Board; Mr. V.S. Parthasarathy, Group CIO, EVP Group Mergers and Acquisitions, Finance and Accounts and Member of the Group Executive Board; Mr. K. Chandrasekar, EVP Corporate Finance and Investor Relations; Mr. S. Venkatraman, Controller of Accounts; and other senior management personnel from Mahindra & Mahindra including the Investor Relations team. I now hand over the proceedings to Mr. Parthasarathy. Over to you, sir!

Pawan Goenka: Even before Mr. Parthasarathy starts, this is Pawan Goenka. I just want to add that Mr. Parthasarathy had just been appointed as CFO by the Board. His title now is CFO and everything else.

K. Chandrasekar: To introduce Dr. Pawan Goenka has also become Executive Director since the last call and Mr. Parthasarathy as CFO.

V.S. Parthasarathy: Thank you, Chandra. Thank you, Pawan. The period between the last earnings call and this one has been more than ever a rollercoaster ride. The rupee has been most volatile and the other financial market indices have done no better. The external development, whether QE tapering or domestic issues, they have had a great influence on the market and demand while growth continues to be very weak across sectors. The silver lining in a large measure is agriculture growth.

The monsoon, the high crop MSPs, all provided a certain amount of balance to the otherwise uncertain atmosphere. Since September, the measures of government and RBI have also boosted the financial market and supported exports. Reduced CAD improved liquidity and stemmed the slide of the rupee. However, the interest rates have remained high for consumers, as RBI prioritised inflation as an immediate threat and this continues to be a concern for demand going forward.

Until September in a highly charged and volatile environment with grim predictions for growth and demand and external confidence in India being weak, industry and business faced a challenging performance. However, I am very happy to share that M&M's performance has been reasonably good, with the auto sector deflecting the challenges and tracking the industry, and tractors attaining traction and continuing the good run well into the festive season in October. On balance, for the quarter, the company has attained the highest OPM of 14.5%. This is the highest in the last ten quarters. This is despite M&M having a quarter where the overall revenue de-grew 6% year-on-year.

I am sure Pawan will talk about in greater detail about the business, but let me just give you an overview first of the overall performance. M&M on an overall basis on a gross level was at Rs 9,888 crores, degrowth of 8.3% but at mixed sales and operating income at Rs8,660 crores. It was a degrowth of 6.4%. However, at the PAT level, at Rs1,028 crores, the growth was 5%. So, to put it, revenue de-grew 6%, but the profit after tax grew by 5%.

The EPS for the quarter stood at 17.41, showing robust value creation as compared to the previous year's 16.59. The ROCE was 25.24% and the debt to equity at 0.31 and debt to EBITDA at 0.8, all remained very robust.

Coming to the overall consolidated results, the total income on a consolidated basis went up to Rs18,676 crores, which is a growth of 3.9%. PAT before minority interest at Rs927 crores grew 18%. Again, the point I wanted to make was that even though M&M plus MVML the results that I shared was a 6% degrowth, overall as a group it was a 6% growth and that shows that the other parts of the Group have started to come and contribute to the topline and the same thing remains with the bottom-line.

There are some highlights I wanted to mention that M&M overseas placed an ECB aggregating 130 million for its investment purpose. The tranche was raised at fine prices which reflect M&M's credit profile and this will pave the way for future international bond raising.

On the accounting side, we did our XBRL filing again for 69 eligible companies within time and quality. While talking about the Group results, the TechM results, the Mahindra Finance results, both of which you have seen already, shows very robust performance with a 60% PAT growth in Tech Mahindra and 21% PAT growth in Mahindra Finance.

Similarly, other companies in the group have performed very well. On the international scenario, SsangYong continues for the second quarter to have a profit though it was a small PAT in quarter two, overall for the first half they have a profit.

On the outlook one word we do not give guidance, but I can say that our cost efforts and prudent financial management will remain the cornerstone as we go forward.

Now I will stop here and request Pawan Goenka to give an introductory speech.

Pawan Goenka: Thank you, Partha. You have first covered the overall scenario. I would not repeat what you have said; just add one or two more points. The first half, as we had talked about earlier also, had very benign commodity prices, which has certainly contributed to our maintaining and improving our OPM, the profit margin. We are beginning to see some sign of commodity prices going up, especially in case of steel and we will have to see how that plays out in the third and fourth quarter.

The interest rates, the bank interest rates have gone up and obviously that has also affected the interest rates on the ground. We are seeing some uptick in the interest rates both for auto and tractor in terms of financing rates.

So let me just give an overview first very quickly of the auto industry. In the industry, for this quarter the only segment that had growth were the Pick-up segment and two-wheeler segment; Pick-up obviously is a very big segment for Mahindra and has positively impacted us, but all the other segments have been degrowing.

Industry overall without two-wheeler has been down by 7.4% in the second quarter. For medium and heavy commercial vehicles, the bloodbath continues. This is the lowest volume in 16 quarters. If one was to look at the overall industry volume, it is more than half of what it was two years ago in terms for the first half. Right now there is little sign of improvement happening in heavy commercial vehicles.

In case of UVs also, the volume was lowest in the last four quarters; for cars it was lowest in the last three quarters. Therefore, industry continues to be in a downturn. The heavy discounting also continues for the industry.

For the tractor industry, the situation is exactly reverse; everything is buoyant. The first half, the industry grew by 23.9% for the quarter; second quarter the growth was 21%. Though this is September results, but for October in fact the growth continued even higher than what we have seen in the first six months. Every state, except for Tamil Nadu, has seen a growth. Full year we expect now that the growth will be about 15-17%, 18%, because even if we grow at zero, that means flat for the next five months, industry will see a 15% growth.

The growth driver we have talked about has been rainfall as one of the primary reasons, but that by itself will not justify the kind of growth that we have seen. It also is overall sentiment, the incomes levels in the rural area have all contributed to it. The Kharif harvest is turning out to be good. We think that by the time the harvest is completed, we should see a 4-5% growth overall in the farm output. That will bode very well going into the Rabi crop.

In our terms of our performance for farm equipment sector, we have kept pace with the industry in terms of volume growth, slightly better than industry. Our market share has gone up by 20 basis points, and so we are at about 41% market share. We introduced some new products during the quarter, but most important, as Partha mentioned earlier, was our OPM has improved, which is a combination of low commodity price increase, good selling price increase, and the product mix that we have had and the profitability of the product mix that we have sold. The implement business, which is a small business, but important business for us, has seen a very good growth during the quarter, growing about 90% and we have met last year’s total output by the end of October.

The Zaheerabad plant, which is a new plant which we invested in is now producing almost 80 tractors per day, which is good for us because this plant has come in handy just in time for us as the growth came.

The challenge that we see right now in the tractor side for Mahindra is that export is down slightly, about 10-14%, primarily because Sri Lanka and Bangladesh, which are very large export markets for us and for all Indian players, the export for the industry is degrowing very rapidly. The second challenge for us is the Powerol business, which again has been an important part of our overall FES business, where the industry again is going down by 15-20% and we are going down in line with the industry.

In terms of our overall performance and the segment result, you already have in front of you growth of 36% as compared to last year. Working capital is under control. There is always a question on inventories, and I can tell you that our inventory for tractors, our plant inventory as at end of September is significantly lower in terms of the number of days compared to last year and about the same in the number of days compared to last year for the dealer inventory, and therefore overall our working capital at the end of September is completely in control.

I would also like to add that month of October is always a month where the industry down-stocks its overall inventory, and similarly Mahindra has down-stocked on the tractor side, including the company stock and dealer stock by almost 12,000 tractors. So, at the end of the October at the end of festive season we are in very good shape as far as inventory is concerned.

I had talked about the AppliTrac business, which has grown 90% and the Powerol business which is down by 17%. The Agri business, which again we have talked about for the last several quarters, again very small business for us. The total revenue of Agri business is about Rs208 crores for the quarter, which is 33% higher than what it was last year for this quarter.

All three arms that are micro-irrigation, the agri inputs and fruits and vegetable, are growing. So, that is all I am going to say on the farm side.

On the automotive side, as I said earlier that the only segment that has shown growth is Pick-up segment and in the Pick-up segment we have seen actually a market share increase for Mahindra, going up from 56% to almost 59%. All the other segments have degrown and the UV segment by 13% and MPV segment by 13%, LCV segment by 18% i.e. less than 3.5 tons and heavy commercial segment by 40%.

We have launched one or two new variants during the quarter. OPM has been protected, which is again very good news as far as we are concerned, because in spite of the volume drop of almost 15% we were able to manage profitability and that is again a combination, the same thing that I said in case of tractor, combination of product mix, commodity prices and the selling price increase including reduction in expenses inside our company.

Important point that does not directly affect the financial results is that we have during this quarter or during this half rather settled for wage agreements in our Nasik plant, in our Igatpuri plant, in our Chakan plant and in our Haridwar plant. The current environment that we have seen where there have been some strong agitations in the industry, we are very glad that we have been able to sign all of these major agreements without any incident and all of these agreements are getting implemented now.

SYMC had a second consecutive profit-making quarter, but more importantly, our volume growth is very good. We have had almost 20% volume growth during this quarter and also our market share has gone up significantly in Korea. In fact, the growth is happening more in the domestic market than in the overseas market.

The key challenge for us continues to be the industry slowdown. Right now, even though the October month was somewhat better than what we had expected, but still I do not expect a significant turnaround happening in the second half. Second half should also see some degrowth but hopefully less than the first half, but we will see some degrowth in the second half also.

Overall, we have seen 23% reduction in segment profit for the automotive business. As I mentioned, material costs impact has been quite subdued, because of commodity prices not going up. Again on the working capital side, at the end of September there was a little bit of stock at the dealers, higher than what our normal comfort level is, but by end of the festive season, by Diwali, it is all cleaned up and right now we are in good comfortable situation as far as both dealer stock and company stock is concerned.

Mahindra Reva, still there is no significant momentum that is gathering. We were concerned about normalcy coming in this business. That still continues and therefore sales in Mahindra Reva are quite low.

I mentioned earlier about the growth prospects that we see and the tractor business 15-17% growth for the year. So it will definitely happen, hopefully little bit higher than that, and Mahindra & Mahindra certainly would try very hard to do slightly better than the market but we will have to wait and see.

I should also point out that in this situation of industry going down, some of our products have performed very well. In fact, the Scorpio had the highest-ever monthly sales since 2002 in the month of October at 5,230. XUV again is beginning to now show upward trend. We had two months of more than 3,000 volumes and some of you would recall that I had said for XUV 2,500 would be a good volume and 3,000 will be delightful volume. So I am very happy that we have seen two months of 3,000 plus volume. We have had the highest-ever monthly sale in Pick-ups and as I said earlier, we have gained market share in Pick-up as well as market share in the sub-1 ton category.

So that pretty much summarises the opening statement from Partha and me and now we are open for questions.

Moderator: Thank you very much Sir. We will now begin the question and answer session. First question is from the line of Nishit Jalan from Nomura Securities. Please go ahead.

Nishit Jalan: Thank you for taking my question and congratulations on a very strong set of results. I have two questions. You have taken a price increase in the auto segment in October. So what was the average price increase that you have taken? Any price increase, have you taken in the tractor segment? So post this price increase, does it cover up for the cost increases that you have mentioned in your opening remarks? My second question would be on the utility vehicles. We have seen a sharp drop in volume for the industry as well for the company, and we have launched a new variant in the XUV. So what has been the initial customer response for that model and what can we expect from the company in this year? Thank you.

Pawan Goenka: So we have taken increases both in auto and tractor at the beginning of October and the tractor increase was about Rs3,500 per tractor and auto increase was about 0.5% on the selling price. I said earlier that the commodity price increases have been very subdued, and therefore these increases do cover all the increases in the cost and that's the reason why we have been able to maintain profit margin, in spite of the volumes being lower in the auto side. The W4 model we have launched at very good price of Rs10.95 lakhs in Delhi and it is too early for us to gauge a response to it, which has been just about a week, not even a week since the time we have launched it. But all the dealers are very happy with the pricing and the product, and the report that we have gotten from experts, from media, from analysts, the auto analysts that is, has also been positive. We will have to wait and see how the customer response is.

Moderator: Thank you. Next question is from the line of Srinivas Rao from Deutsche Bank. Please go ahead.

Srinivas Rao: Thank you very much. Two questions; the first one on the auto side, this year, to be honest, given the level of competitive intensity we were expecting or we are seeing, your margins have held up much better to be honest. Secondly products like EcoSport seem to be maintaining their volumes, even the XUV has also grown. Would you kind of throw any light on the competitive landscape at this stage?

Pawan Goenka: This question obviously, has been there in the minds of everyone for the last several quarters as to what is the implication of all of this. First I want to separate out how we look at the industry. EcoSport is a product that is innovative, finding a new segment, which is sub 4-metre UV segment, where we have a small offering in Quanto, but really it is a different segment and it will not be right to compare volumes in that segment to volumes in segments which are for the larger SUVs, because this is now taking volumes from the hatchback segment. Therefore, we need to be looking at what do you call a competitive segment and it will not be right to take a sub 4-metre vehicle and take 4.5-metre vehicle and say that it is all part of the same segment. So if you look at EcoSport, like you said, it is doing very well. It is holding up its volume, but then so is Scorpio, so is Bolero, and now XUV also is coming up. The Duster has also had a good month in the month of October. Ertiga is also coming back. So all of these products are doing well. Undoubtedly, given that EcoSport is in a smaller or lower price positioning, the overall pool in that price positioning is much higher than it will be in Rs8 lakhs or Rs12 lakhs price positioning.

Therefore, naturally you would see higher volume for a product that is in a lower price position segment than you will see in a higher price position segment. So we are quite happy with the volume that we are getting in Scorpio, in Bolero, in Pick-ups. We are now seeing an improving volume in XUV, and if you hold on to 2,500 plus for the next two or three or four months, that would in a way tell us that both our reduction of price of 3% by reducing ground clearance as well as launching the W4 version have paid off, and then we are getting steady volume of between 2,500 and 3,000 vehicles per month. The one product that we need to focus on and improve our volume is the Xylo and Quanto platform, where our volumes are subdued. That is the only product in Mahindra's table that I would be a little bit concerned in terms of where the volumes are.

Srinivas Rao: Fair enough. This is helpful Sir. On the margins in the UVs, they seem to be holding up quite well. But do you see any competitive pressures over the next 18 months?

Pawan Goenka: Clearly we are not seeing pricing pressure. If you are seeing pricing pressure, we will not be able to maintain our profitability. So right now also, even in spite of the volumes being lower, we are not seeing pricing pressure. But I must caution that that is partly because the commodity prices have not gone up. When the commodity prices go up, then there may be a pricing pressure, different from what we have seen in the first half. So, I am not too concerned about competitive pressure in terms of pricing.

V.S. Parthasarathy: Where we need to be really concerned about is what will be the competitive pressure on volume, and if we were to again breakdown products a little bit, improve sub segment and not treat one size fits all kind of UV segment, then you will see that Scorpio and Bolero in many ways are immune to what is happening in the other sub-segments of the industry because these products are very unique and have a very different unique value preposition and therefore you have not seen any significant drop in these products. In fact, as I just said earlier that Scorpio had its best month ever in the month of October last month. The XUV segment was one that had gone down a little bit and as I said, I am glad to see it come up. Of course our new launches will start happening from 2015. And once the new launches start happening that will be a different competitive scenario at that time and therefore some product, sub-segments where we are currently weakened is the sub-segment that we will be strengthening from the new launches.

Srinivas Rao: Fair enough. This is helpful, thanks, sir.

Moderator: Thank you. Next question is from the line of Jamshed Dadabhoy from Citigroup. Please go ahead.

Jamshed Dadabhoy: Good afternoon. Thanks for the opportunity. Couple of questions; one housekeeping; could you give some indication in your tax rate, why it was slightly lower this quarter, was it due to the dividends on the subsidiaries and how is it going to be for the rest of this year and next year? This is my first question. The second question is on the rural side. Things seem to be improving, could you give us some sense in terms of your dealer outlet development, especially on the UV side in rural India and how you see this playing for a 12-18 month perspective?

Pawan Goenka: Second question is very simple. We always have been a rural-driven company and have a very strong rural network. If anything, other companies are now catching up with Mahindra in terms of the rural network, and we have been strengthening the rural network forever. So nothing different or new that we had to do because of the rural economy becoming relatively stronger. So, we just continued on the same path that we have been following for many years.

Jamshed Dadabhoy: Could you give some numbers in terms of what your reach is today?

Pawan Goenka: I would not have those numbers offline with me. If you send a question, maybe you can get that. I do not have that. The biggest problem always is to define rural. There is no definition of rural that we can consistently follow.

V.S. Parthasarathy: So now coming to the tax rate question, first, principal methodology. We never calculate tax rate for a quarter. It is always what the tax rate is going to be given where we are. So, the tax rate, 1H if you take, not quarter two, but 1H that will reflect what we think is going to be the year's tax rate; however, the quarter tends to be a balancing figure. This is the net tax rate that we are on an annual basis and that is what it was reflected YTD. For the quarter, it will be either a little high or a little more accentuated. Today, as of now YTD you will see that we are tracking a tax rate, however, at 23%. So that is the answer. That is what we expect to see this year. However, if our profit is beyond what we outlook, then obviously our marginal rate of tax would apply to the additional profit. Let me just go ahead and answer some more than what you have asked. Why is the tax rate seemingly coming down and there are some which is in terms of tax planning or what we can do to influence it and some of it is our continued investment philosophy. The investment allowance which is announced in the budget is of course something that gives us benefit. On top of it, our R&D expense, if anything, given the tough times is something that we have continued to focus on and invest in, and therefore that gives us additional benefit.

The tax benefits which come from Haridwar and Rudrapur is accentuated both because we have focused on it to give the best kind of a return to us and also because overall composition-wise that makes for a larger proportion now. A smaller portion is also that dividend income year-on-year rises and that is the tax-free amount. But that is a smaller one of the four. The bigger ones the other three - investments, R&D, and Haridwar account for a large portion.

Jamshed Dadabhoy: This is very helpful. How many years left for Haridwar and Rudrapur?

V.S. Parthasarathy: Couple of years for the one and for other 3-4 years. I can give you better figures off hand, this is what I remember.

Jamshed Dadabhoy: I will come back for more, thank you.

Moderator: Next question from the line of Jinesh Gandhi from Motilal Oswal Financial Services. Please go ahead.

Jinesh Gandhi: Congratulations on a very good set of numbers. Looking at your M&M plus MVML number, the RM cost seems to have gone down on YoY and QoQ basis. YoY it's understandable because of higher contribution of tractors, but on QoQ basis tractor contribution has come down. So have you seen actual moderation in cost, RM cost?

Pawan Goenka: The RM cost has remained overall somewhat lower, because we have had a very small increase in commodity prices but more than compensated by reduction that we have done through value engineering. So you are right that RM cost per vehicle basis and equivalent basis has come down. At the same time, we also have a price increase. Therefore, when you look at the percentage, percentages affect both price increase and material cost coming down together.

Jinesh Gandhi: What was the price increase taken during the quarter? You indicated about from October we have taken price increase. What it could be?

Pawan Goenka: We took a price increase in April about 0.5% and in October of another 0.75% in October. So you will not see that October price increase obviously in this result, but 0.5% in April will be reflected in this result.

V.S. Parthasarathy: But I again would urge you to look at quarter-on-quarter, if you take then you will beat yourself up and you will ask me questions which I will not be able to explain fully. There are too many variations because of the season every quarter.

Pawan Goenka: In all fairness this comparison of the gross margin is okay quarter-to-quarter, gross margin.

Jinesh Gandhi: Second question pertains to SsangYong. While it has seen a consecutive quarter of profits, do we indicate about what kind of volumes they are looking at for the next calendar year and you expect it to be fully profitable next year?

Pawan Goenka: I am sure that you guys are happy with the fact that we do give forward guidance for SsangYong, though we never do for Mahindra & Mahindra Limited. For SsangYong, our target that we announced earlier for this year was 149,000 vehicles overall. We would be falling just 2,000 or 3,000, the same shortfall that we have right now of that, so we will be coming very close to 149,000. CY2014, we will be announcing only after the Board approves the budget, which will happen before the end of this calendar year. We will give the guidance once the Board approves it and I can only tell you that, yes, we are expecting volume improvement would happen in CY2014.

Jinesh Gandhi: What would be the capex and investments in SsangYong?

Pawan Goenka: In SsangYong, we are looking at a total of 1000 trillion won of investment from CY2013, 2014, 2015 and 2016. So that is calendar up to 2016 and when I say, we are just going to make it very clear that sometimes it gets confusing. I am talking right now as Chairman of SsangYong and not as Mahindra & Mahindra Limited. So this investment is happening by SsangYong, 1 trillion won, which if you have not done your math quickly, 1 trillion won will be approximately US$920 million approximately what that is, which will be happening by SsangYong on product development, capacity enhancement, and brand development. Right now we do not see a major need coming from Mahindra to do any equity infusion to support this investment. If there is a small need that comes up during these three years, we will be prepared to do that, but right now we do not see a major need for equity infusion.

Jinesh Gandhi: We maintain our M&M's capex and investment guidance as such?

Pawan Goenka: Yes, we are maintaining that Rs. 10,000 crores, Rs. 7,500 crores capex and Rs2,500 crores investment.

Jinesh Gandhi: Thanks and all the best.

Moderator: Thank you. Next question is from the line of Sonal Gupta from UBS Securities. Please go ahead.

Sonal Gupta: Good afternoon, Sir. Thanks for taking my question. Just one was to understand again, on the capex side, could you split the capex for us on the Mahindra & Mahindra side? I mean, how much is going to product development versus buying plant and equipment, etc, if that is possible?

V.S. Parthasarathy: So that its clear, what we had told you and I am kind of making sure that we are on the same page, is that there is overall Rs. 7,500 crores capex for the next three years and Rs. 2,500 crores of investments, which is in the form of both into our existing subsidiary as well as for new acquisition. That is what we have told you so far. We also told that we will calibrate this in the overall environment. While the quantum over a period will still be the same, the timing we will determine based on how things progress. So that is on the overall basis. Now, your question is, can we split it up further. You understand that out of this, one big chunk is the investment on Chakan, which is Rs. 2,500 crores. So in essence you can say Rs. 2,500 crores investment, Rs. 2,500 crores Chakan, and balance Rs. 5,000 crores just capex for R&D and smaller capacity increase. I would like to leave it at that, beyond that splitting, except to say that R&D and product development are a major focus area and this one of the major area where capex will go.

Sonal Gupta: Just the other question is on the light commercial vehicle side. I mean, we have seen the Pick-up sort of buck the trend, really speaking. I mean, even the smaller commercial vehicles that otherwise is declining pretty sharply. So I mean, can you just highlight exactly what is happening and how do you see that going forward? Do you still see Pick-up sort of continuing to outperform and sort of maintaining that positive outlook?

Pawan Goenka: Are you saying in terms of industry growth?

Sonal Gupta: Yes.

Pawan Goenka: Frankly it has been a surprising growth for Pick-up and it is kind of swing that has happened from the small commercial vehicle, which is sub-1 tonne and the Maxximo and Ace range to the Pick-up range and customers clearly are finding that the Pick-up range is a better value proposition. So, it is very difficult for us to make sort of a forward-looking estimate of whether Pick-up will grow or small commercial vehicle will grow. From Mahindra's viewpoint it is better that Pick-up grows, that is why we are market leaders and right now, there is no sign of slowing down. I really cannot predict anything more definitive on that.

Sonal Gupta: Thank you.

Moderator: Thank you. Next question is from the line of Pramod Amthe from CIMB. Please go ahead.

Pramod Amthe: This is with regards to the SUV per se. Are you seeing any election-related demand coming through, especially from the states where the elections are about to happen? Which models is basically reflected in?

Pawan Goenka: We are not seeing anything major which I can attribute to election-level demand because we have not seen a sudden upsurge in demand opening to the models that are typically seen as election-driven model. So the overall industry degrowth and whatever uptick is coming from election is kind of getting immersed and not able to pick anything. Typically, the vehicles that would get demand during elections will be the Bolero, the Sumo, and the Thar range of vehicles which are very popular rural vehicles and vehicles that are liked for election campaigning because of their capacity to overload and go anywhere. These are typically the vehicles that are used for election duty.

Pramod Amthe: In tractors, if I understood rightly, you indicated that your inventories are down. But if I look at your capital employed per se, it seems to have moved up drastically, almost around 18% year-on-year and 30% QoQ. Can you give some colour?

Pawan Goenka: You are saying for tractor, you are saying overall?

Pramod Amthe: Farm equipment. The farm equipment…

Pawan Goenka: So, we have had 30% growth YoY. Therefore, you expect to have similar growth in overall working capital because of the number of days of tractors and inventory days what we maintain, not rupees of inventories. So, as the business grows, clearly the working capital will grow to maintain the same number of days of stock.

Pramod Amthe: Maybe I will take it offline because QoQ we can clearly see volumes collapsing.

Pawan Goenka: But again I mentioned just to remind you that I mentioned that end of September in fact the industry will always see high inventory because everyone prepares for very high volume in October. The tractor volumes are more seasonal than automotive volumes and nobody would have planned capacity sitting to cater to October volumes. Therefore, we always pre-build and pre-sell in the month of August and September to prepare for October and November, and so, that is the reason you will see in September inventory to be higher and as the festive season is over and I told you earlier that in my presentation about 12,000 inventory, dealer and company combined, has come down in the festive season after the September 30 results.

Pramod Amthe: Thanks. All the best.

Moderator: Thank you. Next question is from the line of Hitesh Goel from Kotak Securities. Please go ahead.

Hitesh Goel: Thank you for taking my question sir. Because you know in Bolero, first half, actually Bolero volumes have also declined. So are you seeing any competition for Bolero?

Pawan Goenka: Bolero volume reduction I will not attribute to competition. Bolero reduction that you see is just overall the industry is down. So, it is not that that volume has gone somewhere else. Where do you get reduction from?

Hitesh Goel: So we get these figures from CRISIL actually.

Pawan Goenka: CRISIL does not have the data. I do not know how they projected it.

Hitesh Goel: So we get these numbers from there.

Pawan Goenka: We do not release model-wise data.

Hitesh Goel: Their number shows 7-8% decline.

Pawan Goenka: I cannot even confirm that it is 7-8% degrowth in Bolero. Yes. There is some degrowth, but I am not sure whether it is 7-8% degrowth in Bolero. The data that CRISIL is presenting is based on their estimate. I do not think that they officially have the data.

Hitesh Goel: Are you seeing any growth? I mean, now the growth has come back in Bolero, are you seeing…?

Pawan Goenka: I have just been informed that SIAM does present the Bolero data separately. So then the information that CRISIL has perhaps is correct.

Hitesh Goel: So just wanted to confirm, are you seeing any growth now in Bolero?

Pawan Goenka: The month of October was better. We crossed 10,000 actually, it was 10,700 Boleros. The month of September was somewhat subdued; October was very good.

Hitesh Goel: Are you willing to give any guidance?

Pawan Goenka: I cannot give guidance. Even if I was willing, I will not know.

Hitesh Goel: Because the rural part is very strong, so you would like to see Bolero doing well in that segment. On Quanto, basically Quanto has gone down significantly. That could be one of the major reasons of your market share loss. So what are you doing in the Quanto side to improve market share?

Pawan Goenka: Your observation is correct. As I said in my summary earlier in response to one of the questions that we are quite happy with the way Bolero, the Scorpio, and how the XUV is performing. The only product that is underperforming for us is the Xylo, Quanto platform, where our volumes are about 2,000. We were expecting Quanto to do much better than what it is doing right now. Obviously, there is a lot of stuff that is going on in terms of trying to increase the volume of these two models. It will not be appropriate for me to sort of walk through on what we were doing.

Hitesh Goel: Because there was a news flow stating that you are planning to launch a mini SUV next year, because you already said that most of the new platforms will come only after FY2015, so just wanted to clarify?

Pawan Goenka: 2015, calendar year 2015.

Hitesh Goel: So that news flow is not right.

Pawan Goenka: The news flow is what?

Hitesh Goel: There was news of mini SUV next year actually.

Pawan Goenka: I have not seen this, so I do not know about it, what it is.

Hitesh Goel: Thank you very much.

Moderator: Thank you. Next question is from the line of Pramod Kumar from IDFC Securities. Please go ahead.

Pramod Kumar: Thanks a lot for the opportunity sir. My first question pertains to the tractor industry, as in this year, as you pointed out, could be 17-18% growth, which will be a very strong come back after the decline last year. But how one should look at FY2015, whether you expect this kind of buoyancy to continue or growth rate will be more in the longer-term CAGR of say 8-9%?

Pawan Goenka: Tractor industry, when we do we would never plan for a growth more than 8-10%, because as you yourself have noted that long-term growth in tractor industry is pretty steady at 8% and there are years of ups and downs, but you can take any 10-year period at 8%. So we always plan for 8-10%. So I have to ensure that if there is a sudden uptick like what is happening this year we do not run out of capacity and we are able to supply tractors. So we do have to keep capacity aggressive to our industry growth, but do it with planning 8-10%.

Pramod Kumar: So in a way the growth this year more for compensating the lack of growth or decline in last year, so one should not…

Pawan Goenka: I would think so; I would think so that since last year was slightly negative, this year's growth should be seen as both last year's and this year's together.

Pramod Kumar: This is for Partha. Partha, congratulations first of all. Sir, regarding any other forex related mark-to-market gains or loss, which have come this quarter, because you have seen those items in most of the companies this quarter?

V.S. Parthasarathy: Thank you, Pramod. First and foremost is the forex is neither loss nor gain. It is a very significant one, but there is what we call a difference in exchange in this quarter, as is there in every quarter, but there is something in this quarter. But we do not give that figure separately. What I can tell you is that there is a hit, mark-to-market and P&L both put together, there is a hit to the bottom line. But whatever results you see is after that hit.

Pramod Kumar: Some part of this hit could be at the operational level as well?

V.S. Parthasarathy: Overall we are net exporter, so therefore from an operational point of view, any weakening in rupee always benefits. On the other hand, on the balance sheet I have more of a debt in foreign currency debt out of my total debt. So that tends to get affected a little more. But overall both of them put together are not very major amounts.

K. Chandrasekar: Just to clarify, as Partha has mentioned, all of them have been reflected in the figures, ultimate figures that you have on hand. Second is they are not substantial to the scale of operations or the revenue that we have or the profit that we have. The third point is we do have risk management practices, which takes care of our exposures.

Pramod Kumar: My next question pertains to SsangYong, are we facing a capacity constraint at SsangYong by any chance on certain models, like say Rexton, or some of the higher-end models?

Pawan Goenka: We are not facing capacity constraint. We are running full capacity.

Pramod Kumar: Because, Pawan, the reason why I ask is Rexton volumes for India have been significantly off-colour for the last 6-7 months, and the competitive segment has not weakened at all. For example, if I were to say your primary competitor, Fortuna…

Pawan Goenka: So capacity in Korea does not affect Rexton sales in India, because Rexton is CKD.

Pramod Kumar: No, but CKD part supplier…

Pawan Goenka: Part supplier capacity has no issue at all.

Pramod Kumar: So it has got to do with demand issue in India?

Pawan Goenka: Just with market performance in India; nothing to do with capacity.

Pramod Kumar: So, Pawan, last question is for you. We have been significantly better on return ratios even in automotive and farm equipment versus the peer group for a fairly long time now and that has been a commendable job. But how do you see this structurally going forward as we invest in a big way in compact SUVs and smaller vehicles which will be facing more competitive intensity. Just to give you an example, predominantly in the UV side, the market has been between you and Tata Motors for a fairly long time. Now because of this compact SUV segment, the price point is coming down and the numbers of players in the market are increasing. So, does that incrementally put more pressure on the value offering from our side in terms of because of sure competition intensity and the customer getting more demanding as we go down the price point? So, how should one look at the return ratios in the automotive segment going forward?

V.S. Parthasarathy: Can I pass that question and move on and when he joins back and we will replay that question and he can answer it. Is that okay, Pramod?

Pramod Kumar: Yes, perfectly fine. Thanks a lot and best of luck.

Moderator: We shall take our next question from the line of Chirag Shah from Axis Capital. Please go ahead.

Chirag Shah: Thanks for the opportunity. The first question pertains to this gross margin improvement that we have seen QoQ as well as YoY. Is it also the impact of negotiations with vendors or how does that flow in a P&L because it would have a quarterly impact as and when the negotiation settled and they are passed duly to the vendors?

Pawan Goenka: Obviously, we will not talk about negotiating the strategy with the vendors.

Chirag Shah: Not from that perspective. Is there a lag impact that happens because you would be negotiating with the vendor?

Pawan Goenka: No. Normally what we do is that we will always make a provision for what we would be expecting the effect of negotiation will be retrospective. That is your question. And therefore, if our sourcing team, purchase team thinks that there will be prospective price increase given that will be built into the accounts of the quarter.

Chirag Shah: Okay and if the estimates were on the higher side, then it would have a lumpy impact in the following quarter? That is the right way. So can we assume that any of that sort of impact is there in the current quarter?

Pawan Goenka: In terms of write-back?

Chirag Shah: Write-back on RMD.

Pawan Goenka: No, I don't think that's the detail that we can.

V.S. Parthasarathy: There is no extraordinary in the costs. Let me put it that way.

Chirag Shah: Second way of looking at it. If the product continues, we can assume that this kind of margin that we have seen in the quarter and the positive surprise is sustainable subject to the raw material cost pressure?

V.S. Parthasarathy: Raw material being what it is then the rest of this is almost of what you are saying and if you do not take a price increase the mix remains the same. Then the gross margin certainly will remain the same.

Chirag Shah: A question for Dr. Goenka. What is the assessment with respect to the diesel price hike on the demand? So, can we make an assumption that is the worst behind in terms of sentiments vis-a-vis that diesel price hike for diesel products, be it cars or UV?

Pawan Goenka: I think the effect of diesel price on UV demand is slightly overplayed in the sense that the difference or the change has not been much. There was a period when the difference had become very big, which was about May 2012. Historically, the difference of that is the diesel price versus petrol price the gap is of the order of 25%. We take petrol at 10, the diesel at 7.5. If you look at the number right now, there is exactly a 25% difference between diesel price and petrol price, which is a price that in my opinion is a good price gap for a diesel vehicle manufacturer or for making diesel an attractive proposition, because when you add a 25% price difference and add another 15% difference in fuel consumption that gives you almost 40-45% benefit in terms of your fuel costs. That's a fairly big incentive for need for diesel vehicles. Of course, it keeps swinging back and forth depending on when the price increase got taken in petrol or when the pricing happened in diesel. But in the last few months, I have seen a reasonably consistent level of 22-27%, 28% kind of gap. That is intentional or incidental, I do not know.

Chirag Shah: But if the gap narrows down further, it could have a continued impact for some more time. That is the right way of analysing it?

Pawan Goenka: If that gap narrows between diesel and petrol, the difference will probably be that people who are at the verge of buying a car versus UV, may choose a petrol car. And therefore, the smaller UVs probably will have a bigger upset if there is widening or narrowing of the gap than larger groups.

Chirag Shah: Thank you and all the best.

K. Chandrasekar: This is about the competitive intensity of the entry-level SUVs and how do you see this on your business. That is a basic I am reducing it two lines. Pawan, there was a question about the compact SUV at the entry level, which is affecting the competitive intensity and how do you see this?

Pawan Goenka: This I had answered earlier, right.

K. Chandrasekar: But he is asking.

Pramod Kumar: Pawan, my question was basically that historically Mahindra as a company has done extremely well on return ratios, both in automotive and farm equipment vis-à-vis competition of the industry peer group. How do you see that going forward as we get into newer segments like, say, compact SUV? Historically we have been seeing limited competition in the UV space with 2-3 players. Now with the entry of Maruti, Hyundai, and another 2-3 players, how do you see the return ratios for you?

Pawan Goenka: Are you asking when – return ratio what do you mean?

Pramod Kumar: The return on capital employed basically? The fact that increasing competition is a one factor; second, as the price point comes down from your traditional SUV range, the volume goes up for the industry level. But there are more players for the same pie as well, and the fact that the customer gets more demanding as the price point comes down, how should one see the return ratios on a structural basis for the automotive business for Mahindra?

Pawan Goenka: Look, my overall view, without getting into the details of entry level and larger UVs is that if volumes are good, return ratios are good. It finally comes down to volume, whether it is the small vehicle or the large vehicle. Having said that, in the industry traditionally and I am not commenting on Mahindra per se, but in the industry traditionally you would find that larger vehicles tend to have higher profit margin and smaller vehicles conversely have smaller profit margins, but when you talk about RoCE or the return ratio that gets compensated by the fact that for the same investment you get smaller volume on larger vehicles than on smaller vehicles. So, for example, if you look at Rs5 lakh vehicle, you would probably sell twice as much, but at a lower profit margin for the same investment. Therefore, my guess is that if a product does well, that means if it meets the business case that we have planned for the product, then the return ratios will be maintained. But that is a big if, I mean, product has to do well.

Pramod Kumar: The competition, given the number of players being much higher than the traditional SUV market in India?

Pawan Goenka: What the competition does is it means that you cannot take success of a product for granted. So when there were fewer players, then a reasonably good product would be successful. When there are more players, the product has to be really deserving to be successful. So, therefore, from that viewpoint; work harder on launching good products, products that customer would be wowed with, and that makes the game more difficult undoubtedly and that will continue to happen in any segment which is highly competitive. You will have to be a strong player to remain on top. As I have said earlier also that if we cannot compete with others in terms of launching wow products, then we do not deserve to be on top. So clearly our intention today will be that the new products that we launch will be as successful as the product that we have launched in the past.

Pramod Kumar: Pawan, if I may take this forward and ask you about the compact car market? Because we have Verito and Verito Vibe and the volumes have not been that great off late. So will we continue to pursue the passenger car market in conjunction with what we continue to do on the compact SUV?

Pawan Goenka: Look, I have said many times in the past and that has not changed, that our strategic direction is UVs and the passenger car, Verito, is a similar platform and we have no intentions of launching other platforms, other passenger car platforms. Whatever we do in terms of new product launches will be on UV platforms.

Pramod Kumar: That is clarified, Pawan, thanks a lot and best of luck.

Moderator: Thank you. We can take the last question from the line of Ambrish Mishra from JM Financials. Please go ahead.

Ambrish Mishra: Thanks for the opportunity and congratulations on a good set of numbers. You talked about tractor volume growth in the range of 15-16% odd for FY2014. Realistically speaking, do you see these positive surprises on these numbers for the full year, given the way momentum is at this point of time, or you see risk and that is even you assume that in a worst case we could do 15-16%?

Pawan Goenka: Are you saying second half?

Ambrish Mishra: No, sir, for the full year.

Pawan Goenka: The full year doing 15% will require flat industry for the five months. Therefore, the risk to 15% is very low, because I do not see that industry will decline for the five months. So even if the growth is zero, you get 15% overall for the year. If you get 10% growth, for example, in our next five months, then you would get about 18-19% growth overall for the year.

Ambrish Mishra: The last question is about the Zaheerabad plant getting operational. Is it fair to assume that the second quarter would have seen most of the cost, be it on operations or depreciation or interest coming on the P&L being reflected fairly for the full quarter, or you think this will actually get reflected completely only in the third and the fourth quarter?

Pawan Goenka: Partha, you can answer that?

V.S. Parthasarathy: So, no, the answer is that it is fully and properly reflecting. If anything this quarter had seen a lot more depreciation because on a year-on-year basis the XUV 500, the Xylo refresh, all those and lines of fully come into action and so has Zaheerabad.

Pawan Goenka: But the question, specific question on Zaheerabad, is going to be the confirmation of – I think the full depreciation has come into this quarter.

P. C. Vaidya: Pawan, it has so because we started in May and so for the second quarter, the full depreciation charge…

Ambrish Mishra: That's what I wanted to say.

P. C. Vaidya: The current investment has come in.

Pawan Goenka: The difference will come when we start running a second shift in Zaheerabad. When we run a second shift, the depreciation will go up. As long as we are running a single shift, depreciation will remain what we saw in the second quarter.

V.S. Parthasarathy: So will the output go up. So, it will be…

Pawan Goenka: Of course. The percentage has one change, but as an absolute number.

V.S. Parthasarathy: Because there is a utilisation. Correct. Agreed, Pawan.

Ambrish Mishra: Thanks a lot and all the best.

Moderator: Thank you. I would now like to hand over the floor to Mr. Ashvin Shetty for closing comments. Thank you.

Ashvin Shetty: Thanks. On behalf of Ambit Capital, I would like to thank you the management team of Mahindra & Mahindra for giving us an opportunity to host this call. Thanks everybody for joining the call. Have a nice day.

Pawan Goenka: Thank you.

V.S. Parthasarathy: Thank you.

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