

Transcript

Conference Call of Mahindra Forgings Limited

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Presentation Session

Moderator: Good afternoon ladies and gentlemen. I am Rashmiya moderator for this conference. Welcome to the Q2FY12 Earnings conference call of Mahindra Forgings. We have with us today Mr. Hemant Luthra, President Systech Sector, Mr. Sanjay Joglekar, CFO, Systech Sector, Mr. Deepak Dheer, ex-MD, Mr. K. Ramaswami MD Mahindra Forgings Limited, Mr. Thomas Koerner, CEO Mahindra Forgings Europe, Mr. Burkard Rausch, CFO, Mahindra Forgings Europe, Mr. Ajay Mantry, CFO, Mahindra Forgings Limited. At this moment, all participants are in listen only mode. Later, we will conduct a question and answer session. At that time, if you have a question, please press * and 1 on your telephone keypad. Please note this conference is recorded. I would now like to hand over the floor to Mr. Rohan Korde from Anand Rathi. Over to you sir.

Rohan Korde: Thank you and welcome to the gentlemen of the management for this conference call. Let me now hand over the floor to MR. Luthra for his opening remarks. Over to you sir.

Hemant Luthra: Thank you every body. I am sorry to keep you waiting. I know we are a couple of minutes late, but there are a number of meetings that have been happening so my apologies. Mahindra Forging had some good growth in this half of the year compared to the last half. The consolidated revenues are about Rs 616 crores compared to the last year of Rs 461 crores. The EBITDA is about Rs 66 crores compared to last year of Rs 42 crores. Profit after tax is Rs 20 crores compared to Rs 13 crores of last year. If you look at the first half results, consolidated we have about Rs 1230 crores at the revenue this year compared to Rs 866 last year. We have an EBITDA of Rs 121 crores compared to Rs 83 crores last year and we have a profit after tax which is Rs 38 crores which was almost nil last year. I don't want to take too much time because you will have a lot of questions but one of the things that is the highlight from this call is that many of you have been wondering as the press everyday reports about what's happening in Europe and you have been concerned in the past as to how strong the recovery has been or will be or whether it is sustained. So in Mahindra Forgings in Europe, the revenue which had once peaked before the European crisis at a hundred million a quarter, and had then fallen to about Euro 35 million per quarter has picked up to about Euro 62 million per quarter last year and now is running at about Euro 78 million per quarter. Our colleagues in Europe will answer your questions and my colleagues from India will also answer your questions. But what it looks like is that there is no immediate danger of slow down, the order book continues to be strong for quarter 3, and we are keeping our fingers crossed for quarter 4 in Europe. As far as India is concerned, if you look at standalone, the first half of this year has resulted in revenue of about Rs 208 crores versus Rs 169 crores in the first half of last year. EBITDA is at

about Rs 21 crores compared to Rs 15 crores in the first half of last year and we had a second quarter which is a little bit below our own expectation because of some machine breakdown. But we have got that under control in the sense of people we have thrown at it. We have got a full German team consisting of their chief technical officer from Germany spending a couple of weeks, a month in India, their design team is working with us and we now have a new Managing Director, Mr. K. Ramaswami who has an illustrious track record at Sundaram Fasteners where he spent 27 years. He has come in as the MD and we intend to leverage his skills to do what Sundaram Fasteners had done. They first became the iconic if I may use that word, leaders of the LCC high quality exports to the Western World. Mr. Ramaswami himself was leading that initiative and then the rest of the Sundaram group whom we admire greatly even though they are competitors or may have been competitors have won several "Deming" prizes and Japan quality medals and we are hoping all of that will translate into the bottom line at Mahindra Forging. In addition to Mr. Ramaswami, we also have from Mahindra, Mr. L. P. Pareira who built our new Chakan plant about 750 million dollars in less than 2 years. He is now actively associated and is working with Mr. Ramaswami to make sure that the Indian manufacturing operations meet Mahindra standards. So with Germany and India working together under the leadership of Mr. Ramaswami, Mr. Thomas Koerner and Burkard we continue to be optimistic about the future. I will be happy to take questions and you can route them to anybody...there is me and I will just for a few minutes more because I have got another call to go to at 5:35 or 5:40, so I will be there till then. And there is Sanjay Joglekar who is the CFO of Systech, there's Ajay Mantry who is the CFO of Mahindra Forgings in Chakan. There's Burkard Rausch who is both Managing Director and CFO of MFE and then of course there is Mr. Ramaswami now as the Managing Director of MFL, the main holding company. So over to the coordinator, we are happy to answer all the questions.

Question and Answer Session

Moderator: Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone keypad and wait for your turn to ask the question. If you would like to withdraw your request, you may do so by pressing * and 1 again.

First question comes from Ms. Sai Anjali from Capital Market.

Sai Anjali: Hello?

Hemant Luthra: Yes Anjali.

Sai Anjali: Yeah, I just wanted to know like you were saying about the Europe situation, the order book is strong for Q3, whereas Q4 you are still hoping. So can you just elaborate more on how we can see it in Q4 and going ahead?

Hemant Luthra: If anybody could forecast what would happen in Europe, he'd be a magician but I will ask my resident magician Burkard to talk about what he sees happening there and what gives them cause for optimism in Q3 and he is happy to talk about sleepless nights also because we don't want to sound as if we are here to do a fondue (Swiss delicacy), so over to you Burkard.

Burkard Rausch: Thanks Hemant. Let me start from the point that MFE is already had 16% higher revenues compared to budget in the first half year. So we anticipated as a budget has been over fulfilled significantly for the first six months. What we see right now is a strong political discussion about the Euro, the so-called PIGS (Portugal, Italy, Greece, Spain) countries and of course that is frightening everybody who has to do something with the financial growth all around the globe. But on the other hand we see talking to our customers that there is a standard situation...everybody we are talking to that is a general fear, what is happening around financial wise, but there is a very strong and solid economy especially in Germany and our main customers are Daimler, MAN. So the big worldwide acting truck manufacturers also for Q3 expect higher revenues even above budget for the next quarter and what we expect is a slow down in Q4. But the question for slow-down is coming from which level? And as we have been running far above budget right now, a slow down of 10%, 15% and that's roughly what we are expecting would bring us back to budget level. And now combining it with our re-structuring we did over the last years reducing our fixed personnel and re-structuring the whole group, to a level that is much more flexible and can react on economical changes. We are much better prepared than we have been three years ago and protected this flexibility even in the last 1-1/2, 2 years with volumes ramping up, so all in all we are not frightened to see a little bit of slowdown and what German economists expect is a little slow down during the winter period but followed for constantly slowly growth after Q1 again. So the majority meanings from German economists in Germany, in Europe is that we will see probably a bit weaker of the next year but followed by a positive tendency after that again.

Sai Anjali: Okay and is it fair to understand how much did Germany contribute to the overall truck industry in Europe? Do you have an idea on that?

Burkard Rausch: For the whole group it is roughly 75%.

Hemant Luthra: I think the question Burkard was that how much does Germany contribute to the truck market in Europe? Is that the question Anjali?

Sai Anjali: Yes it is Mr. Hemant but it is fine. That is a good answer anyways.

Burkard Rausch: The truck market itself is dominated by a very positive market reaction to the new Actros at Daimler so this ramping up is running much faster than we expected it. The production started in September and so we expect especially for our business, that this positive tendency from our biggest customer will dominate even some slow down with other competitors. So all in all to Daimler for the new Actros we deliver 30% more parts than we do to the old Actros, so our market share is increasing there as well.

Sai Anjali: Yeah. That's it with me, thank you so much Mr. Burkard.

Moderator: Next question comes from Mr. Sunil Jain from Nirmal Bang Securities.

Sunil Jain: Good evening sir. Can I get a few data points like what was the production in Europe and India in tonnes if I can get?

Hemant Luthra: Burkard let's just give them a quick summary and then KR can take over.

Burkard Rausch: Production in terms of Europe was roughly 76,000 tonnes.

Sunil Jain: That was in the first half? This quarter?

Burkard Rausch: Good question. Should be roughly half of it.

Sunil Jain: Okay. First I will complete about Europe only. Last time you were talking about...there will be more shift towards improving the product mix to improve the margin....how is the progress on that?

Burkard Rausch: The margins have improved all over the European plants compared Q2 to Q1, but now the ramping up of the new Actros will have a positive additional impact in Q3 and Q4.

Sunil Jain: Okay so we may see further improvement from here?

Burkard Rausch: That's what we expect, yeah.

Sunil Jain: In consolidated result was there any forex gain or loss this time?

Sanjay Joglekar: There was a forex gain and I think for the half year it was about 12 crores.

Sunil Jain: If I can get the figure for the Indian production...?

Hemant Luthra: KR can you give us a feel of what has been happening in Q1 and Q2 and the improvements that you are effecting and what you may like to see going forward.

KR: The first quarter of the current financial year production was approximately 7500 tonnes and in the second quarter from 7,500 it moved to 8900, a growth of 15%.

Sunil Jain: And this growth has come even after disturbance of that one machine, so we may be seeing a very good growth in the coming period from the Indian plant?

KR: This is despite the disturbance in the press but it kind of happened partly in the second quarter and partly in the third quarter which meant that it can be extended also in October for the first few days. However, the improvement that we have seen in the second quarter vis-à-vis the first quarter in terms of productivity are continued to be budgeted in the third quarter as well.

Sunil Jain: When we will be leaving, will be at the same level in third quarter or further improvement is possible?

KR: We hope to reach percentages which are very similar to the first quarter in terms of growth. But as of now it is an estimate and exact percentages I myself do not know, I cannot guess.

Hemant Luthra: And even if you could guess KR, we probably have to restrain you from giving any forward looking statements. But Sunil we are optimistic that the kind of growth that we have seen in spite of the hiccups...KR is new and he is naturally, sensibly conservative, but we are seeing an up trend in the average daily production and we have full faith that the momentum will continue in Q3 and Q4.

Sunil Jain: Fine sir. One last question, what was the total debt...consolidated debt at the end of this quarter?

Sanjay Joglekar: Consolidated debt at the end of this quarter was about 640 crores.

Hemant Luthra: And I think it is being repaid at the rate of...how much is it?

Sanjay Joglekar: I don't exactly remember the number. Ajay how much it is in India, quarterly repayment?

Ajay Mantry: It is in the range of Rs 10 crores sir.

Sanjay Joglekar: Rs 10 crores and Europe is...?

Sunil Rane: About Rs 13 crores.

Hemant Luthra: So Rs 25 crores per quarter debt is coming down so...and the cash flow of the company are sustaining it and also we have reasonable cash position because as you know that Mahindra in its wisdom has invested and exercised its warrants. And Mahindra exercises its warrants at 137 rupees a share which probably gives you some indication of where Mahindra expects the share price to go.

Sunil Jain: Thank you very much sir.

Moderator: The next question comes from Mr. Amit Kasat from Standard Chattered. Mr. Amit Kasat, please go ahead sir.

Amit Kasat: Good afternoon everyone. My question pertains to the consolidated entity as a whole. Hemant rightly pointed out that the Europe per quarter revenue was...peak revenue prior to the crisis was 100 million Euros per quarter. Today what we stand is 78 million Euros a quarter. In the crisis period I believe we have taken a lot of re-structuring in the European operation but at the EBITDA margin level we have not seen an improvement happening to that extent. Can you throw some light because the EBITDA margin hovers anywhere between 8% to 10% for the quarters which I have seen so far on a consolidated?

Hemant Luthra: Burkard do you want to talk or do you want me to talk?

Burkard Rausch: From a European point of view, we have seen quite a lot of re-structuring. We closed down two plants, one in Germany and one in England and we

re-structured our production facilities. What we see right now is that the margins are a bit below our expectations due to the fact that we had quite a lot of maintenance to do and you can take it as a mistake or however that during the crisis, cash orientated to the reduced maintenance a bit as well and now we have to repair some of our presses and machines, so that gave us a little bit of a hit. And additionally you remember the nuclear accident in Japan in Spring, this caused the political decision from German government to close down six nuclear plants giving up the effect of rising electricity costs and now we are in negotiation with the customers and whether we are able to put that through and to restore our prices but that is hard negotiations so...those are to some effect hitting us right now, but as I mentioned before, from our product mix and especially from our main customer and the new Actros we are expecting improvement here.

Sanjay Joglekar: Amit just to point out that around 9%, 10% of EBITDA is at a level of about 75 million euro of turnover compared to which was earlier at 100 million. So you can imagine that's the effect of volume when it ramps up completely will come.

Amit Kasat: Mr. Joglekar I think in the first quarter of FY11 when our consol revenue was 405 crores that time also we had an EBITDA margin of 10% in the second quarter FY11, 461 crores of revenue, again 9.1% margin...What I am trying to focus right now here is that when the benefit will start flowing on the consolidated numbers.

Sanjay Joglekar: You are absolutely right. Because what has happened, that since the ramp up has taken place much faster than expected, the personnel cost has also gone up a little more rapidly. We have employed people which are all in contractual labor so there is no permanent liability. But then the productivity to start with is always a little low because it takes time. I think that's the reason why you are seeing the margins are almost at the same level.

Amit Kasat: Okay. So when should we look into which quarter? Two quarters down the line or when that benefit will flow in because for most of the other competitor which you have, that benefit has already started flowing in, whatever restructuring they have done in the crisis period.

Sanjay Joglekar: I would expect it from Q4.

Amit Kasat: Okay. My second question is Germany and the truck market and the passenger car market has not been impacted to...Europe market has not been impacted to that extent. What is the order book position whatever visible we have...? Do you think that in the next two to three quarters, our European run rate can be closer to around 95 to 100 million euros?

Burkard Rausch: That's what I mentioned before. We will see quite a comparable level in Q3, but might be a small slow down in Q4 following the general tendency of the economy but in general looking forward for the next year and the economies and our key customers, our market will turn back to a growth again. Not as rapid with double digits, but constantly and our new products in this product mix will give us additional margins so we will see a positive tendency here starting Q4 this year and then next year forward.

Hemant Luthra: And Amit you have been an old friend, to be honest with you, if we are running at about 78 million euros a quarter just now, given present situation where there is uncertainty, we are asking our German teams to do the following. One is that just like last time they were able to re-structure very quickly because they had those concept of temporary labor. If things go south for some reason that I cannot rule out because I am not a political scientist, their ability to re-structure will continue to be as flexible as it has been in the past. If things go up, they are taking the fact that some of the equipment that was not...the kind of replacement or the kind of repairs and maintenance that was not done is being done now so that when the ramp up happens we don't have any artificial breaks on the ramp up. In addition to that if we did approximately 8% in Europe, last year we did a little about 9% something this year without trying to forecast where we will end up, because I don't know where the slow down. The budget for Europe this year is closer to 11%. The Germans have not let us down and the budget I hope they don't let me down again. Even in India, yes we have had some hiccups but I expect that given the monthly results which I can see, and for those of you who are interested at least for the last six months I can share month by month improvement. The half year results tend to disguise the month by month improvement. So whatever input that you are seeing over here, whatever margins you are seeing over here, both in Europe and in India I would be severely disappointed if they did not increase by a couple of percent. I'd be disappointed, I cannot forecast anything. On the other hand you have also got company like Stokes, if we break that out Stokes has started producing one of the highest margins in the business, partly because they have got some orders and price increases from their English customers and partly because they have been able to off load some components to low cost India. So let me be careful and guarded about giving anything about the future but I continue to be optimistic about where we are headed.

Amit Kasat: Right. Hemant one direct question to you on the standalone business; in FY10 when we are doing our run rate in terms of revenue close to around 75 to 80 crores, our EBITDA margin used to be in an average close to around 14%. We had a lot of new addition of capacity which has happened in FY11. When are we going to see...because your revenue is improving a lot but the margin front because of the maintenance of the plant or the machinery break down, keeps happening and hence we have an EBITDA margin which keeps on depressing? So when will we again go back to that level because this is something which will benefit the consolidated margins if this goes back to 14%, 15%.

Hemant Luthra: KR you want to answer how we are handling issues with respect to maintenance and why you think that the margins can improve now that you have taken a hard look at it yourself and then I will answer the question at a more generic level.

KR: Okay most of costs what we are looking at now...there are two or three elements of manufacturing costs which we are currently looking at a lot more seriously. But again these costs are by nature partly fixed and partly variable although we call them variable, as the numbers on the revenue lines going up we expect these costs to come down and therefore indirectly contribute to increased EBITDA. Secondly we are looking at actions internally to keep these costs down which also would contribute to improvement in operating profits.

Amit Kasat: Right. Hemant you want to say something?

Hemant Luthra: Yeah since you are asking me, I think the amount of effort that has gone in between Deepak whom we have to thank for his stewardship for Mahindra Forging, Thomas and Burkard, Peter who comes from there, KR and LP who have started to make a difference, we've identified 14 dies which account for 85% of the production. We've ordered some high speed milling machine that will make dies to international standard, one of these has been delivered and another one is likely to come in shortly. Die life is improving step by step. The investment that we made with respect to power because that is one of the thing that tends to eat up with the price going from Rs.5 to Rs.5.50 to Rs. 6 and then Rs.6:50 we are hoping that KSK power will deliver on commitments to supply wheeled power to us at some discount to MSEB prices during Q3 and maybe start to honor their commitments with respect to these prices and the drastic reduction that we have in Q4. I am happy to sit down with you on the call one-on-one and so is KR and Burkard. We are very serious about this because it is very important for us that when Mahindra has put in shares and the self-imposed pressure that we are all under, that when Mahindra puts in at Rs.137 a share, then Mahindra expects that the management will perform and the management has made commitments to Mahindra that their investment at Rs.137 a share is not going to be only based on the loyalty and their commitment to the company but hard economics. With Deepak Parikh, Ashok Ganguly and the likes on the Board, it is not easy for them to sign up on Rs.137 a share if they don't expect the underlying performance to justify that share price. So let me not say much more, I am happy to sit down with you one-on-one anyone of you.

Amit Kasat: Thanks Hemant. Thanks a lot, it was good.

Hemant Luthra: If there are any questions for me which I am happy to take, if not I need to step out into another call which is also directly linked to the improvement of Mahindra's Systech Fortunes if I may use that word?

Moderator: Next we have Ms. Namrata Lodha from Corporate Database.

Namrata Lodha: Good evening. All my questions are answered, I just had one question. I missed the debt repayment per quarter.

Burkard Rausch: Could you please speak a bit louder, I can't understand you?

Namrata Lodha: Most of my questions are answered. I missed only one question and that is how much is the debt repayment for the quarter? They mentioned some number.

Sunil Rane: It was about Rs 25 crores per quarter.

Namrata Lodha: Okay thank you very much.

Moderator: Thank you ma'am. Next question comes from Mr. Sameer Dalal from Natvarlal and Sons Stock Brokers.

Sameer Dalal: Hi I have a question and this is regarding your production capacities. You said at the peak in Europe, you produced at 100 million. Would that be the peak capacity you can produce or can you go higher than that?

Burkard Rausch: This will be even a bit above our peak, for meanwhile we closed two companies, so the peak should be somewhere around 90.

Sameer Dalal: Okay and what about the India operations?

KR: The Indian operations...I mean it is extremely difficult to say what capacities are enforcing. It would depend on change over times and it would depend on cycle times because when we do a multi product in a forging machine, each product takes a different cycle time. However, just to give a rough estimate, we need to look at the constant growth year-on-year in terms of productivity be it in terms of tonnage or numbers. That's what we are aiming at improvement but the overall market will ultimately determine our capacity. Capacity to that extent is slightly flexible because there are so many parameters that determine the final capacity.

Sameer Dalal: Okay and any expansion for either of the two operations at the moment? Any plans of that?

Burkard Rausch: At the moment from the European point of view, we are optimizing our structures and for the foreseeable period we are not looking for significant additional capacities.

KR: As far as Indian operations are concerned if you look at the second quarter, vis-à-vis the first quarter or the first half vis-à-vis the last year's we have been growing with potentials which we are able to tap internally. So as I see it, the next two quarters as well we'll be looking at tapping further potential inside for improvement.

Sameer Dalal: Okay and the last question is...you need to spend some amount of money this year for some amount of regular CAPEX, so how much would that number be for the total consolidated entity?

Ajay Mantry: Can you repeat please?

Sameer Dalal: There will be some regular CAPEX that is ongoing correct?

Ajay Mantry: Yes.

Sameer Dalal: So what would be the amount you will be spending on that for the current year on the consolidated entity? I don't need the break up of Europe and India, I just want the consolidated.

Ajay Mantry: I do not have the number right now with me.

Sameer Dalal: Maybe I can get back with you all and get that. Thanks a lot.

Moderator: Mr. Rohan please go ahead sir.

Rohan Korde: Yes I had a couple of questions. Could you update us on the Systech integration as to where we are and if there is any timeline that you have finalized for the same?

Sanjay Joglekar: Sanjay here, I just came back inside, I was also to go for the call, as far as Systech integration...I know all of you are curious to know that it has been delayed but we have been examining certain other strategic investor. We have put it on hold for sometime. We are going to take it up soon. I can't tell you the exact timeline just now but it is not far away now.

Rohan Korde: Okay so will it be completed in FY13 or before or after...any broad indication would that be possible?

Sanjay Joglekar: See we are in FY12 if we are able to start the process in about a month's time or so, then I would say somewhere around...I don't think all the process can be completed before March, probably it will go a little beyond March.

Rohan Korde: Okay and sir would it be possible to give us the interest cost that we have incurred on the consol basis for the first half of the year?

Sanjay Joglekar: Sorry?

Rohan Korde: The interest cost that we would have incurred on a consolidated basis for the first half of the year...would it possible to give?

Sunil Rane: Rs 23 crores.

Rohan Korde: Okay. So would it be fair to assume that in the second half our interest cost would be lower significantly as we keep on repaying the debt at a fair clip?

Sanjay Joglekar: Yeah you may assume so.

Rohan Korde: Okay that's all from my side.

Moderator: Next question comes from Mr. Anuj Anandwala from Parag Parekh Financial Advisory Services.

Anuj Anandwala: Hello...? Sir could you give me the capacity utilization at the European and Indian operations for the current quarter?

Sanjay Joglekar: KR what is the Indian...? Around 50%, 55%?

KR: As I said, capacity is not really fixed in a forging industry like our because it depends on the number of products that you take in each of these machines and if you take less number of products for example, the capacity would probably go up and if you take more products in the same machine the capacity will come down. So it is extremely difficult to say this is the utilization percentage. However, as an indicator we can say we are currently at 60% to 65% and it could gain depending on the mix of the product and the number of products that you take year-on-year.

Anuj Anandwala: Okay.

Burkard Rausch: Under the same restrictions or comments about product mix and things like that, I would say roughly about 80% in Europe plus or minus.

Anuj Anandwala: Okay thanks a lot.

Sanjay Joglekar: So we can close the call if there are no further questions and as Hemant said we will always be pleased to meet one-on-one at a mutually convenient time.

Moderator: Now I hand over the floor to Mr. Rohan from Anand Rathi for closing comments.

Rohan Korde: Thank you to the gentlemen of the management for the conference call. Thank you and best of luck for the future.

Burkard Rausch: Thank you.

Moderator: Thank you sir. Ladies and gentlemen this concludes your conference for today. Thank you for your participation and for using Door Sabha's conference call service. You may disconnect your lines now. Thank you and have a pleasant evening.

Note:

- 1.This document has been edited to improve readability.
2. Blanks in this transcript represent inaudible or incomprehensible words.