Transcript

Conference Call of Mahindra Forgings Limited

Event Date / Time	**:**	**3rd August 2011, 2:00 PM IST**
Event Duration	**:**	**1 hour 14 min**

Presentation Session

Moderator: Good afternoon ladies and gentlemen. I am Ram, moderator for this conference. Welcome to the 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, 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, and Mr. Vikas Sinha, Strategy, Systech. 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. Over to you sir.

Sanjay Joglekar: Okay Rohan, just to clarify, Thomas is not joining, he is travelling, we had informed that.

Rohan: Yeah. Thanks moderator, may I invite Mr. Luthra to give his opening remarks please. Over to you sir.

Hemant Luthra: Yeah, good afternoon everybody and thank you for taking the time to join us here. Obviously we are very pleased with what's happening in Europe , which was a matter of concern for all of our investors, continues to look strong. You have Burkard who is the CFO from Mahindra Forgings Europe on the call and he will be able to answer more questions directly, but we like what is happening there and we believe that the fears of double dip depression that some folks have had are perhaps unfounded. Outlook for the current year looks good. Similarly, there was some concern about, from some of you that at least one of our operations in England Stokes had been a drag on the company, we had taken some impairment also as a matter of abundant caution, but it looks like some of the components that they tried to offload to competition, competition has not succeeded in delivering. And therefore Stokes has been able to get back again into the black and they have approximately 10% EBITDA. There have been some questions in the past, some scares about whether Europe is going to be affected by the PIGS economies and what is going on there. Fortunately, we don't have much of an exposure at all to either Poland, Ireland, Greece, or Spain. So the outlook continues to be strong.

As far as India is concerned, even we have to admit to being a little bit disappointed about not being able to capitalize on the opportunities that the present market presents. I am not mincing words here, but what has happened is that in the last six months that we have had some of our German colleagues who had been responsible for what is called a mentorship program, they were coming in, in lots, somebody from Operations, somebody from Quality Control, somebody from Tool and Die Design, and all these people were helping their Indian counterparts and all of us were working together, but I think what we discovered was that instead of trying to follow a pure advisory role, they are now in much more of an executive capacity, so the CTO from Germany is here full time for the next 3 months and so is the head of their R&D, Mike Muckelbauer, and so is their head of Tool and Die Design, Peter Kolbe, and we are starting to see results in terms of production. I cannot say much more, but I think whatever we have seen in Q4FY11 and Q1FY12, has been bettered in the last month of July itself, which is post the declaration of the results, and we see that momentum will continue and we believe that India is now in a position to capitalize on the European technology. So, all in all, we think the present momentum will continue, cost cutting will continue, the health of the presses will improve. The efficiency that we have, which is measured in terms of what is the total utilization of the plant as opposed to the theoretical utilization in terms of how many seconds of operating capacity is available, is a tough measure, that is going to be moved from 40% to 50% and in Europe we are running it north of 70%, so I think we will get there. There are other initiatives that Europe is taking, which is to, when the orders started coming back, when we fell from a 100 million a quarter to 30 million a quarter in the midst of the crisis, we are now back to about 65-70 million Euros a quarter. And so the first thing was to grab as much market share as we could and now we are trying to ensure that we weed out those products that are not making that much profit for us because we have the luxury of being able to pick and choose some of the products and our customers and if anything we think things will get better.

So, rather than a long introductory statement that eats up into the time that you have for questions, I will stop it here and be happy to answer your questions. For those of you who missed it, just a quick review of the results. During FY11, on a consolidated basis, the income of the company increased by 45%, EBITDA on a consolidated basis was at 9%, which is a big positive swing. Quarter 1 FY12 results that we have declared show that Europe has profit of about Rs 190 million and consolidated profit for the company of about Rs 180 million. And going forward, we think that we can sustain the momentum. So, over to you Rohan for organizing the questions and setting up time with them and the sequence. One request I will make of you please is that, Mahindra's governance standards do determine that we will not be able to do much more than give you indication of where the industry is going, but we cannot make forward making statements, so please don't go down that path, because I will have to be very, very conservative and say, I cannot comment on that. Over to you Rohan.

Rohan: Hello moderator, may we start the question and answer session please?

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 Mr. Aniket Mhatre from Standard Chartered Bank.

Aniket Mhatre: Hello?

Hemant Luthra: Yeah, go ahead please.

Aniket Mhatre: Yeah, good afternoon sir. Sir could you please give us the tonnage sales for both India and Europe?

Hemant Luthra: Q1?

Aniket Mhatre: Q1 for this quarter.

Burkard Rausch: Q1 in Europe was 38,000 tons.

Hemant Luthra: And in India is about 7,700 tons for a total of about 46,000 tons.

Aniket Mhatre: And sir, what would be the capacity utilization in these two regions?

Burkard Rausch: Well, for this quarter, Europe is around 80%.

Ajay Mantry: For India it is around 54%.

Aniket Mhatre: Okay. Sir, and for the India operations, sir, when can we see this capacity being ramped up to about 75%-80% odd?

Hemant Luthra: What we have done, as a courtesy of the program, I have to tell you is that we have been plagued in the last year-and-a-half, we had good results in FY10, most of FY11 we have been plagued with some press breakdowns, some problems with dies, and some new product development. So, what we have done is that we have a planned program, month-by-month, which says that which presses will be taken down, not as a reaction to a problem, but as a proactive measure of taking the press down. And we have already finished 4 out of 9 presses. And the rest will be finished during the course of the next 3 or 4 months and certainly before the end of the calendar year. And similarly what we have done is that we have identified the 14 dies that we want to switch from a process, which says that to make a finished product you need three strokes, most of Europe uses two strokes to finish a product and therefore the dies have to be modified with harder dies and better die-making capability. So 14 dies constitute 85% of our production and those dies have been redesigned, 6 of them have been done, they have been tested, they have gone through the process with customers, and the rest are also going to be done by the end of this quarter, I hope, and certainly no more than the end of this calendar year. That means that the 100 tons per day production of that we saw during the Q1, and which has already increased to about 125 tons per day in July, we believe that we should be able to push this production out to that 75%-80% that is happening in Europe. And if we do that 75%-80% in Europe efficiency, then we should be running at about a150 tons per day as opposed to the 100 tons per day that you have seen in Q1FY11. Demand is not a problem.

Aniket Mhatre: Sure, got it. Sir, and one final thing, on the European market, could you please elaborate on how the European market is panning out right now and what would be the expectations for the market per se, for this year?

Burkard Rausch: What we have seen last year, this sharp ramping up with the growth rates of more than 60% that I would not call growth, but a recovery after this sharp recession we saw during the crisis. Today, this process has more or less stabilized, what we expect is some constant development over the next one or two quarters and then picking up in the next calendar year again.

Aniket Mhatre: Okay, so any ballpark number that we would have for the market as such?

Hemant Luthra: Ballpark number for the market meaning?

Aniket Mhatre: I mean, what are our internal estimates of the European market growth, auto market growth.

Hemant Luthra: See, I don't know whether Burkard would attempt to say auto market growth. Burkard, what is it, what is Daimler and DAF and MAN and Scania telling you in terms of how many more trucks they are likely to produce this year than they produced last year, I think, that is pretty much what we can talk about just now.

Aniket Mhatre: Yeah, sure, that would be it.

Burkard Rausch: I think we have to split it a bit, for there has been a quite significant increase for the first half of this calendar year, in production. And the biggest truck producer, Daimler, is now slipping into a phase and launching new Actros. So there will be phases of two products in the field, the new Actros starting and the old Actros to continue for sales and therefore it is quite difficult to say what the market development for the next half year will be in relation of those two products families. But, all in all, we expect that this plus 20% roughly compared to last year, we saw up to now roughly market-wise will continue. There will be some switches in production and as quite a lot of stock has been produced already, out of that we expect some cooling down of growth for the second half year, but for the new Actros, we will be in this roughly more than 30% parts per Actros out of our production. So our market share in that will grow and that is a key message from MFE actually that the faster this movement from old Actros to new Actros happens, the more positive it is for us.

Hemant Luthra: I am just going to make a light-hearted comment, which is that Germany told us last year that they will do a turnover of approximately 200 million Euros, they finished at close to 250 or 260 million Euros, so my German colleagues have a very conservative DNA, so let me just leave it there. They have done, I think, roughly about 80 million Euros in Q1 and I am not asking them to multiply it by 4, but I think lets just assume that they will continue to over perform their budget.

Aniket Mhatre: Okay sir, great. That was very helpful. Thanks a lot and all the best for the future.

Moderator: Next question comes from Kaushal Maru from Religare.

Kaushal Maru: Hi sir, good afternoon. Question on the margins in Europe operations in this quarter, on a quarter-on-quarter basis there has been a slight dip, is this because of raw material costs or adding employees, or if you can throw some light on that.

Burkard Rausch: When we compare Q1 this year to Q1 last year, there are some effects, the most important one is that surcharges increased so relatively, the surcharges are cost on the sales side and are put through to our customers, so that is an additional revenue without creating margins or profits for the company. If we take this effect out, this makes roughly 2% points in reduction, which is not caused by the business, but just by the effect that scrap and alloy surcharges raised compared Q1 this year to Q1 last year. The second effect is that due to the fact that we keep stocks extremely low; we managed this growth in sales even on lower stock bases, and this effect compared to last year where we had to increase our stocks to be able to deliver to customers, is a difference of roughly 2% as well. The third effect is something more political, probably you heard about that Germany switched off seven nuclear plants this spring due to the fact of the accident in Japan. And out of that energy prices are rising and that is a new problem we have to face and that hit our Q1 results by roughly 0.7%.

Hemant Luthra: There is one other input that I wanted to add, which is that and may be Burkard is being modest about it, when you lose 70% of the market and you cut down headcount from 2000 people to 1300 people and then suddenly because of the high quality of the product and the pace of the customers, the market starts to come back, you have to add a few more peopleand because of how well the German economy is doing you tend to have to hire people who are not fully trained yet, so sometimes the cost of that training and ramping up has been incorporated also in the Q1, but now that we have a stable workforce, which has been adequately trained we should be able to bring those initial one-time training costs under control.

Sanjay Joglekar: Sir, just to understand clearly, I mean, what you asked about the margins between current quarter and the past quarter and Burkard you mentioned some percentage, what was that?

Burkard Rausch: That was the comparison Q1 this year to Q1 last year.

Kaushal Maru: But, I think sir, if you are saying this 70 bps coming from higher fuel cost did not exist in the previous quarter, so I think that would be the key reason for the margin decline on a quarter-on-quarter basis, am I right?

Burkard Rausch: It is not the fuel, but energy, electricity.

Kaushal Maru: Right, sir. Okay, my question has been answered, thanks.

Burkard Rausch: Maru, to give you some additional feedback, of course this is a new situation, which hits all German producers and our competitors as well and this creates a new situation for us towards our customers as well and we started negotiation with our customers to find solutions to cover those costs for that is something that cannot speak on our bills.

Hemant Luthra: Also what happens is that these customer negotiations have a little bit of a lag, okay so the electricity prices have gone up in this quarter by the time we start to get them back from customers might take another quarter or two, so that is what we are, normally the surcharges that Burkard talked about are passed through. There are times when there are customer contracts being negotiated and therefore when you see, what you talked about the decline in margins, the upside there is that we now know what some of the other competitors are doing and how they are going about increasing the margins and we are also seeing how we can move some product from Germany to either out because it is not profitable and now we have the luxury of picking more profitable products or moving that product out to India, now that the German teams are moving in and helping India attain that world class with respect to press uptime and die downtime.

Moderator: Dear participants, please press * and 1 for your questions. I request the participants to press * and 1 for your questions. Next question comes from Mr. Chirag Shah from Emkay Global.

Chirag Shah: Yeah, good afternoon everybody and thanks for the opportunity. Congrats for a good set of numbers. Hello?

Hemant Luthra: Yeah, we are always there to listen to congratulations.

Chirag Shah: Great. Sir, one thing was first, the basic information I wanted to know, how much of your revenues in terms of plants are coming outside of Germany, post the restructuring that we have done, so if you can give a breakup in terms of how much revenues come out of Germany in terms or what is the production percentage ex-Germany for you in Europe?

Sanjay Joglekar: If you are talking about the ex-Germany and Europe, it is only Stokes in UK and the first quarter revenue was about 6 million pounds, so that is roughly 6 to 7 million Euros

Chirag Shah: Okay.

Burkard Rausch: That is less than 10%.

Chirag Shah: Yeah, so the rest all of the revenues comes from plants located in Germany, right?

Hemant Luthra: Let me give you some specific numbers. India constitutes about 20%; Stokes in England constitutes about 8% and Germany's in Germany for Germany constitutes about 73%-74%.

Chirag Shah: Okay great, this was helpful and sir, second is, any thoughts on diversification into other streams like passenger cars, because is there any kind of thought process post regularization of the business and diversification in passenger cars or other parts of automobile sector?

Chirag Shah: Sir, I am talking about Europe.

Vikas Sinha: In Europe we have identified truck forgings as our core competence and we will stick to that for the time being. Cars require slightly different processes, they require more automation and so on, so that is the reason why, and truck forgings are higher margin products, so we would like to stick to truck forgings as our core competence in Europe.

Burkard Rausch: And in addition to that trucks are roughly 70% of our sales and besides that there are special machinery like agriculture, things like that in niche markets where we can generate very positive margins as above.

Chirag Shah: I also read in your annual report, you are talking about non-automotive or non-truck part of the business in European subsidiaries, so can you throw some light over there? You said only 70% is European, so any thought process how that is shaping up and how you are taking it ahead?

Burkard Rausch: Well, that's what I mentioned, the 30% is agriculture, special machinery like railway, mining and projects like that and we are well established in those markets as well and for the moment we see that truck markets are rising much faster than the others, so the pure relation will increase towards trucks, but the other markets are very stable and are growing as well.

Hemant Luthra: The other input that I wanted to give you was that it has been our philosophy and if you look at Stokes, Stokes does a lot of work for Jaguar Land Rover and other car manufacturers and we have always found that a car manufacturer will give you designs for a product and then bid that product out to different suppliers and pretty much go on the basis of build-to-print. So, it is their design and then we build it to their print or print it to their design. That increases some pressure on margins, whereas if you look at the truck market and the way the Schoneweiss plant in Germany is operating in particular or GSA is doing, what happens is that you work collaboratively with the customer and therefore pretty much become a single source for the product that you are making for them, so whether it is I beams that we are making for Daimler. We have also had some benefits in terms of one of the large Indian forging manufacturers has had some problems in Sweden, so those orders have come to us. We have also been told by Daimler that, work with us and reduce the weight of the new truck by 400 kilos, so we have been given some specific charge. When you are working collaboratively with them on engineering you tend to become thrifty and get higher margins, so as we increase the focus on building more design to delivery kind of stuff instead of build-to-print, this is not a forward looking statement, but this is an absolute statement of intent that we are not going to be satisfied with this EBITDA margins and we think we can increase these EBITDA margins by changing our product mix, now that we have the luxury of doing so.

Chirag Shah: Fair enough, so when you say changing your product mix, because I presume Europe does a lot of machining work, right and what would be the mix between machining and pure forging or how it is?

Burkard Rausch: It is roughly 40%-45% machined parts and 55-60% pure forgings.

Chirag Shah: Okay, great and last question I had was, any thought on sharing detailed consolidated quarterly numbers, because a large part of revenue and profitability is coming from subsidiaries, so any thought internally how you can share more detailed numbers, because some organizations share consolidated numbers, some organizations do not share consolidated numbers in detail.

Sanjay Joglekar: See, as you know that we can share the consolidated results provided we go through the limited review process in all the companies, so that is something bit time consuming and costly, but as you can see we are giving all the top numbers, we are giving you the EBITDA and PAT.

Chirag Shah: Fair enough, so that is a bottleneck kind of a thing, the limited review is a problem according to, fair enough. This was helpful. I will come back for more questions, sir, I am through.

Hemant Luthra: And the other thing that I wanted to add is that because of this design-to-delivery model, Europe has been constantly receiving new patents and those patents become a strong intellectual property on our hands and help us with the margins, so even in Europe you have a Schoneweiss, which has got a 12000 ton press that competes with Bharat Forge all across Europe. In GSA you have got, which is the other large plant you have got high end machining that is being done for special products for Kolbenschmidt and other piston manufacturers. You have a plant in Jeco, which has got hammer forgings and they do something specific for the non-auto, but still I think it is the fork-lift truck industry, but in each of these plants there is a constant pressure to keep weeding out and analyzing the product and you will find that inside Germany also there are some plants, which have got an 11% EBITDA margin and there are some smaller plants, which have got between 5 and 7. So, as we adjust the product mix going forward now as I said we have the luxury of doing so obviously we have set up some internal competition between the different plants in terms of their EBITDA margins and our return on capital, so the plant managers are competing with each other just like Pawan and I do when he looks at the results of Systech and I look at the results of auto and I think this little healthy competition is going to show an upward trend in margins.

Chirag Shah: Fair enough. I will come for more questions; I am through with my questions, thanks a lot.

Moderator: Next question comes from Saikanth B. from Premji Investment.

Saikanth B.: Good afternoon Mr. Luthra.

Hemant Luthra: Hi, how are you, nice to hear your voice?

Saikanth B.: Congratulations on a good set of numbers. I just wanted to get a update on the restructuring plan, there is some of these other related businesses within the group and there has been proposals looking at these options, so if you could just give us an update where they are at this point in time?

Hemant Luthra: Let me tread within the parameters imposed by me on…

Saikanth B.: No, I absolutely understand, I just wanted to know if…

Hemant Luthra: As long as you understood that, okay.

Saikanth B.: Yeah fine, thanks.

Hemant Luthra: Since all of you, whether it is Premji Investments, LIC, Reliance and other major shareholders have been asking the same question ever since the QIP, it is not Mahindra philosophy to be deaf to such suggestions, we do not think we know everything and therefore we learn from our investor community. We have had one round of valuations done by a chartered accountant to do relative valuations between all of these companies. So based on FY11 results we are going to have another round of the same thing. We are going to go back to our respective boards to seek their approval about the restructuring and what we are also going to do is that we have started the process of talking to the private equity investors who are invested in the unlisted company about the share exchange ratios between all of this, so the work is on, but I have to qualify it by saying that it has not gone to any of the boards in a formal sense yet, but obviously all of this effort would not have gone on if we did not have the blessings direct and indirect of all of the participants and stakeholders.

Saikanth B.: Understood, so it would be more the financial results for March '11 with the audited numbers around.

Hemant Luthra: I think there will be good guidelines for making an assessment and it is also something of interest to us because when we have seen the actions in the last 12 months, we have created a central business development organization. That central business development organization looks after the 12 or 15 major national and international accounts, so Daimler is looked after by Ronald Rittmann in Germany, Maruti is looked after by Advait Halbe over here with personal support from Deepak Dheer. Deepak you are on the call, right?

Deepak Dheer: Yeah.

Hemant Luthra: And this has started to take effect and therefore what has happened is that only the other day we had a German customer come to us and say that, when are you setting up shop in Mexico. Then we had another German customer for forging who has come to us and say, why can't you supply me almost one whole production line from castings. The cross selling benefits have started to kick in. At the backend what we have started to do is that, and no secret about this, MUSCO happens to be within a 60 or 50 kilometer radius of our gears and castings and forging plants and stamping business, which generates scrap. Now, instead of scrap being first sold to a broker who gets the commission and then we buying it from another broker who also gets a commission, we are buying scrap from stamping to castings. When MUSCO Steel had some quality problems we have started buying steel from Adhunik MUSCO steel has solved some of their problems with respect to quality therefore Deepak Dheer is in a position to buy MUSCO Steel at again arms length pricing I must keep repeating, so the cost savings in the backend and the front-end have happened, a single purchasing organization, a single marketing organization has happened, now we have to convert it into a legal organization.

Saikanth B.: Right.

Hemant Luthra: And as far as I am concerned, the sooner the better, so you will not have to, as investors have to push us, we will be pushing ourselves.

Saikanth B.: Thank you. Just had one more question on the German business. I heard the comment about Daimler, Benz, the new range of trucks and 30% share that your colleague mentioned. So, is it 30% of the new trucks launched and production you would have a 30% share, is that right?

Burkard Rausch: No, when we compare the old volume, all the old parts we delivered to the old Actros and compare it to our deliveries to the new Actros. Then it is a 30% increase for truck.

Saikanth B: 30% increase, okay, okay. I understood thanks. And by value how much do you think you would contribute per new vehicle versus old if you were to use that, what do you say per vehicle the contribution would go up 30%, is that what you are saying?

Burkard Rausch: Let me put it like this. Daimler will be roughly one-third of our sales in one to two years' time.

Saikanth B: Got it, got it, okay great. Thank you very much. Thanks.

Hemant Luthra: And also I think it's not just the progress that we have made on how the One Systech is dealing with the external world, they are also making significant progress on how Systech is dealing with, companies are dealing with each other. And I am hoping that you will be surprised with the speed at which we now move forward.

Saikanth B: Great. Thank you very much Mr. Luthra.

Moderator: Next question comes from Ms. Grishma Shah from Envision Capital.

Grishma Shah: Yeah, sir you said that from Q2 onwards the India operations should see improvement, considering that you are going to replace the dies. Given the current environment in which we are seeing slowdown in the passenger car segment and the other segments in the automobile industry, would the financials then improve, would the volume growth be still intact going ahead for the rest of the year?

Hemant Luthra: You know if I look at the numbers and we just went through our strategy presentation with Mr. Mahindra the other day. The difference between the present demand and supply on forgings alone in India is of the order of about 500 to 600 tons a month. So, our order book can take another 500 tons is approximately, 20 tons a day. You have also noticed from the results that Mahindra continues to do very well both in tractors and in SUVs and the slowdown hasn't affected us that badly. While it takes a little bit of a hit, the other major customers, Deepak that I think we have in India is Maruti?

Deepak Dheer: Yeah.

Hemant Luthra: And I am not sure whether Maruti will take a hit or whether there will not be more migration to small and more fuel efficient cars, if the interest rates continue to rise. So, I am pretty sanguine about the fact that if we increase our productivity and efficiency, demand ought not to be a constraint in producing better results in the fiscal year 2012.

Grishma Shah: And in India we primarily cater to the passenger car market or we also have a larger portion to the SUVs?

Deepak Dheer: We cater largely to the passenger car market and basically to the engine, those car manufacturers who make their own engines. But we do supply to the truck market and SUV. SUV and car market are our major customers.

Hemant Luthra: There is also something that is hidden reserve inside here, which is that at the last QIP we had said that we are going to retire some debt and we had also said that we are going to increase our machining capability. So, two new machining lines have been installed. Unfortunately the vendor that was supposed to install the last of the capital equipment has had a little bit of a problem and therefore we will see these two machining lines kick in with full capacity, one by the end of August or early September and one by the end of December. So the CAPEX on these machine lines has already been incurred. But unfortunately, we are loosing a little bit margin, because we have made some commitments to customers and therefore we are outsourcing some machining and outsourcing some other value addition. Once our own machining line gets commissioned, just because they have been held up by the proverbial weakest link in the chain, we expect that the contribution from machining without having to do any additional CAPEX will kick in. And so compounded by the volume growth, because of better press utilization and die utilization, compounded by the additional contribution that will come from machining for lines that are already installed, I am just waiting for the last bit of commissioning and assuming that all of what we are doing with the help of our German colleagues and with strong support and learning from the Indian counterparts, rejection should come down, we are already showing a downward trend, plant utilization should go up. So, even as the volumes of that 500 tons gap that we are seeing shrink to 300 or 400 tons, margins should improve.

Grishma Shah: Okay. And what is the outlook on the interest outflow then, given that interest rates are increasing and if you could also update on the consol and the standalone debt at the end of the quarter?

Sanjay Joglekar: See, the concerned standalone debt, consol debt is about Rs 680 crores, of which standalone is about Rs 125 crores. And the interest rates are anybody's guess, this is the debt level, so can calculate.

Grishma Shah: No, no, what are we paying?

Sanjay Joglekar: Our average cost in India, Ajay, is it around 13%?

Ajay Mantry: Yeah, right now it is around 14% sir.

Sanjay Joglekar: Alright.

Hemant Luthra: And in Europe?

Burkard Rausch: In Germany, Europe is it's about 6%, much less.

Hemant Luthra: So out of the Rs 680, Rs 125 crores is standalone debt and Rs 555 crores is the European debt, so we are talking about a large percentage of debt being, European debt being serviced by Europe I understand, so there are no pressures on India on account of that debt.

Grishma Shah: Are we planning to borrow more or are we done on the India side or on the Europe side?

Sanjay Joglekar: See, there are no plans to borrow anything at least during current year. In future if we of course decide to go further with larger presses, then the question of borrowing will come. But, just now we are by and large adequately financed. We may borrow a little, but then there are repayments also, so net-net I don't expect any increase in the debt level.

Grishma Shah: Sure. And if you could tell us your CAPEX plans for this year?

Sanjay Joglekar: CAPEX plan for this year in India is in the range of about 60 to 70 crores. And in Europe will be mainly the normal maintenance CAPEX, which is Burkard, is what about 5 to 6 million euro?

Burkard Rausch: It's altogether including dies is roughly 8 million.

Sanjay Joglekar: Right, so dies, apart from dies will be about 5 to 6?

Burkard Rausch: Yeah, something like that, right.

Grishma Shah: Okay, okay fine. Thank you and good luck.

Hemant Luthra: Thank you.

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

Hemant Luthra: Okay, go ahead.

Sunil Jain: Sir, this is regarding your European operation. You had already reached to around 80% capacity utilization, how much more we can go up from here?

Burkard Rausch: Well, what we saw three years ago, roughly 400 million which we have realized time adequately for the fourth half year 2008, this will be full utilization. So, there we will have our capacity limitations right now and we are not planning additional capacity investments. This is our situation in Europe right now.

Hemant Luthra: To supplement what Burkard is saying, Europe had forecast that on present trend they would run out of capacity in FY14.

Sunil Jain: Okay. So, right now we are already doing around 80 million euro.

Hemant Luthra: Per quarter.

Sunil Jain: Scope of around 20 million more.

Sanjay Joglekar: Yeah.

Sanjay Joglekar: Our quarter is about 79 million already.

Hemant Luthra: Okay, 79 million, okay.

Sanjay Joglekar: He's right I think, about 100 million euro roughly is the capacity.

Hemant Luthra: But, I think you should look at it and say that the way to look at capacity is that, even today we may be making some product in some part of the company, where the EBITDA margins are 12% and 13% and there are some other parts where the EBITDA margins are 5% to 7%. So, whenever we get an order from the customer, there is a basket of products that we get, some high, some low. So, our ability to milk the capacity is going to be a function of how efficiently we improve operations in India. So that what makes 5% to 7% EBITDA margin in Europe might still tend up making 11-12-13 EBITDA margin in India, after taking into account transportation cost. Our biggest challenge has been to make India as predictable and reliable as our European customers they want. So, if the India capacity is approximately, let's say 5000 tons a month we could do in India and 60,000 and we are doing about 3000, so there is headroom there for about 2000 tons per month that is 24,000 tons per annum. And in Europe if they are talking about production in the full year of about 140,000-150,000 tons and they have approximately 20% headroom as Burkard is saying, so that's another 30,000 tons. So, between the two plants there is presently enough headroom for approximately 40,000 to 50,000 tons per annum. So, our endeavor will be that if some specific CAPEX is required or opportunities are available, like there are some M&A opportunities currently, we have stayed away from them because we wanted to make sure that, (a) Europe was sustainable and, (b) India had got its act together. Now, with the efforts that Deepak and his team are putting in, India is getting their act together. So, there may be some specific machining capacity, there may be some specific projects that may have low payback period that we might do something on, but for general capacity I don't think we have got problem for couple of years.

Sunil Jain: Yeah, great. In fact another question on Europe, like two or three years back when the crisis was not there, what was our operating margin at that time? And are they achievable?

Burkard Rausch: Well, even today in Europe, we earn more margins out of roughly 20%-30% less sales. So, the cost cutting processes over the last two to two and a half years, you already can find in the margins.

Hemant Luthra: Just to supplement that, just to supplement that, what Burkard and team have done is that I think the peak that we had, EBITDA in Europe was about 32-35 million Euro. And I think we will get to that number at a much lower volume, given the cost cutting that has been done, what Burkard has talked about now. If the volume goes up beyond what we did at or we are currently doing at 275-280 million euros per annum, then I think there is headroom for more profitability to come out of the system.

Sunil Jain: Okay. And sir, one data question, this current year in consolidation you have got around translationgain of around 5 crores. Can we get the similar figure for March quarter also?

Sanjay Joglekar: March quarter, Sunil you remember what was it? I mean we declared it at that time, I am not remembering it. Okay, let's go to next I think or we can get back to you on this.

Sunil Jain: Second related to this only, if this accounted for below EBITDA or above EBITDA, translationgain or loss whatever it may be?

Sanjay Joglekar: It is included in the EBITDA.

Sunil Jain: Before EBITDA.

Sanjay Joglekar: Yeah, yeah. So, without translation again the EBITDA will be less by 5 crores.

Sunil Jain: Okay, okay. Sir, if I consider that then if we see the European operations, European operations if we see the gap between EBITDA and PAT, that has come down drastically from previous quarter, it was around 47 crores that has come down to 33 crores, that may be including interest, depreciation and tax. From EBITDA to PAT, difference has come down sharply, what is the reason for that?

Sanjay Joglekar: Sorry, which gap you are talking about, the Q1 of FY11 and now Q1 now?

Sunil Jain: No, I am talking about March quarter and this quarter.

Sanjay Joglekar: Okay, the gap between EBITDA and PAT for the quarter?

Sunil Jain: For the quarter of the subsidiary Europe.

Sanjay Joglekar: Okay, Burkard.

Burkard Rausch: Depreciation reduced due to the fact that we reduced CAPEX over the crisis. So, that is a consequence out of that. And our refinancing structure we did first half year, last year, now brings us a very efficient financing structure.

Hemant Luthra: Just one second, let me see if I can, Burkard. My read over here is that in Q4 FY11, depreciation was 140 million rupees in Europe and in Q1 FY12 and I think that's what he is trying to bring to our attention, depreciation is about 220 million rupees. I think the question is what are the difference between the two?

Sanjay Joglekar: Yes, he is trying to work out actually the depreciation and interest, isn't it?

Sunil Jain: Yeah.

Burkard Rausch: There has been some write down in Q4 last year at Stokes for closer of Walsall and the hammer forge.

Sanjay Joglekar: There will be, if you are going to PAT, there will be some extraordinary numbers in between.

Sunil Jain: Yeah, true, that's only I was trying to locate. So, that was the write off of something in UK operations.

Sanjay Joglekar: Yeah.

Sunil Jain: Can you quantify that? Is it possible or not?

Sanjay Joglekar: What actually you want is the EBITDA and interest, so let's say the EBITDA and interest for the current quarter is about 5 million euro and for Q4 it was, I think it was around same, there was not a big difference.

Sunil Jain: Yeah, true.

Sanjay Joglekar: So, the rest is extraordinary.

Sunil Jain: Yeah, more or less EBITDA was same, but the PAT has changed drastically. That's why the difference in Europe operation.

Burkard Rausch: Now, I get your point. Last year we had one specific hit in Europe and that was switch from German HGB, German GAAP to BilMoG. And BilMoG is a very specific or change in accounting practice, very close to IFRS. And therefore German Tax Authorities and German Legislation changed to this so called BilMoG, Bilanzmodernisierungsgesetz in German and we took those effects completely into last years accounts that are a one time effect last year.

Sunil Jain: Which came in the fourth quarter?

Burkard Rausch: Yeah.

Sunil Jain: Okay, that's all from my end. Thank you very much.

Moderator: Next question comes from Mr. Paras Nagda from Enam Holdings.

Paras Nagda: Sir, congratulations sir on a good set of numbers.

Hemant Luthra: Okay Paras, thank you.

Paras Nagda: Yeah, sir I wanted to ask you on the breakeven levels of capacity utilization and if you could specifically tell me about India and Europe separately, at what capacity utilization we breakeven at PBT levels say?

Hemant Luthra: If you look at, I will ask Sanjay and I will ask Ajay Mantry, if you look at the results for EBT, okay we have got barely a loss of about a million rupees.

Paras Nagda: So, around 57%-58% you will probably breakeven at India.

Hemant Luthra: No, no, I think we will breakeven even lower, because what has happened is that, if you look at the results for this year, we have got a revenue…

Sanjay Joglekar: No, we are breaking even at the present level.

Hemant Luthra: Yeah, we are breaking even, that's what I am saying. We are breaking in at the present level. But, this includes certain inefficiencies, because we are taking the presses down, that includes certain inefficiencies, because our rejection rates are higher. It includes certain inefficiencies, because we are changing over completely our tool and die design process to make it more, to conform with international standards. So, I think the breakeven level will be lower than what you are seeing in this quarter at when we produce 7600 tons. So, the breakeven level should be in my opinion closer to 7000 tons and if not per quarter, so that's about 2300, Ajay you can correct me and you can do the math on this and pass it on to Enam if you like.

Ajay Mantry: Yeah sir. On a stable cost basis, it is around 48%-49% breakeven capacity utilization, which would be close to 7200-7300 tons per quarter.

Paras Nagda: I got it. And for Europe?

Burkard Rausch: For Europe, it's roughly on the 50% capacity basis for the restructuring we did over the last two years, when we compare it to before the crisis and now. If volumes go down, steel is something that follows on the purchase side. We restructured the second biggest block of personnel that we have roughly 1200 people on fixed cost basis and the additional personnel already bit more than 400, just on a higher basis. So, we built up a high level of flexibility here. So, if another crisis would come up, we are able to react very fast and cost neutral to such a development.

Hemant Luthra: Burkard, do me a favour, just do some calculation, because our capacity at peak was what, 160,000-170,000 tons in Europe.

Burkard Rausch: Totally, yeah. Yeah.

Hemant Luthra: I am just asking you to not to contradict your numbers, but since I have a statement, if it is 160,000 tons in Europe, in Q2 FY11, Europe did about 32,000 tons in a quarter and was breakeven at EBT level. So, 32 upon 160 gives me a breakeven at EBT level of approximately 20%, so just please check this number so that we can give Enam an accurate feedback.

Burkard Rausch: Okay.

Hemant Luthra: Q2 FY11 we did 32,000 tons and had EBT of almost zero.

Paras Nagda: Yeah, so 32,000 tons which will be…

Burkard Rausch: 130 per year.

Paras Nagda: 130 per year, yeah. So, that is around 80% capacity utilization.

Hemant Luthra: No.

Paras Nagda: On a peak capacity of 160.

Hemant Luthra: Yeah, please take a look at the numbers; we will get back to you. If Burkard has said something about 50%, so I am just saying that we will give you accurate numbers by checking.

Paras Nagda: Got it. And sir, in the last conference call, you also mentioned that in Europe there will be some products which you will probably discontinue. So, what kind of revenue impact you will see on the discontinuation of some forging products which we will not supply?

Hemant Luthra: I don't think the revenue will change very much, but let Burkard reply before I step in.

Burkard Rausch: Revenue will not be affected out of that, so for we will not take things simply out, but shift it and what we see over the last month already is, stepping into negotiations with customers. During the crisis there was a lot of price pressure as well and now when we go to customers and tell them, we either need a price increase or we have to take out things, then in most cases we find fair compromises from both sides, or in cases where we give back some orders, we have chances to cover that with new orders from other customers. So, I don't think we will lose volume out of that.

Paras Nagda: Okay. And sir, in Europe particularly in last quarter, could you tell me the top five customers and their revenue break up, if you can share with us?

Hemant Luthra: I think one of the things I will tell, I can read out some stuff that we have got here. But, unfortunately for commercial security reasons, I am not going to name the customers.

Paras Nagda: Okay. So, top five as the percentage of revenue.

Hemant Luthra: So, the top customer in Europe in FY11 was 37%, the next was 12%, the next was 8% and then we had series of, couple of customers at 7%, then 6%, 5%. On an open call where I do not know who are participating, I will be able to give you this, I don't want to give it by name of customers, because (a) that's my commercial comfort and, (b) I don't want any competitive pressures.

Paras Nagda: I got it sir. Whatever you gave was very helpful sir. So, technically top five customers account for more than 70% of your revenue for FY11. Thank you. Thanks a lot sir, thanks sir.

Moderator: Next is a follow up question that comes from Mr. Chirag Shah from Emkay Global.

Chirag Shah: Yes sir, one on the CAPEX side, just missed out that point. What is the kind of the CAPEX that you need in standalone? And for Europe, what could be the maintenance CAPEX and capacity addition related CAPEX, if you can just help us understand?

Burkard Rausch: We will not invest in additional capacity in Europe. So, whatever we will invest is replacement or some very specific machinery for production of specific orders, if something has to be adjusted, but not for additional capacity.

Hemant Luthra: Okay. And in order to supplement Burkard's answer, if a customer says that, we love your new projects so much, on which you have even got a patent for making hollow shafts and he says now can you make hollow shafts for me, for my new truck. And therefore can you invest X amount of money for me? When we look at that investment, we are going to say that, is the payback period less than three years or more than three years. And if the customer can give us a pricing which makes sure that the payback period is less than three years, we will do it. So, as Burkard is saying, it could be specific projects, that is number one. On the India side maybe Ajay can give you the answer and I can add anything if I can, if necessary.

Ajay Mantry: Yeah, in India around, we are looking at around 50 crores of CAPEX for capacity enhancement in machining lines and wherein the capacity would be increased to more than double and around 20 crores of CAPEX in balancing the capacity, line balancing and improvement, for improvement in quality.

Chirag Shah: So, is this CAPEX a part of your plan which has been very well played out in the annual report of improving the efficiency of India plant?

Ajay Mantry: Yeah, yeah.

Chirag Shah: Is this a part of the restructuring efforts that you are undertaking at India plant, right? That is how it is?

Ajay Mantry: Yeah.

Chirag Shah: By what time do you think this CAPEX would be done and when you can see more outflow coming from India plant?

Hemant Luthra: First of all I have to tell you that the majority of the CAPEX which is required for improving the productivity of the India plant is not heavy duty CAPEX, it is making sure that the presses that have suffered some breakdowns will have critical spare parts online, instead of having to change them at the last minute, or order them and then wait for them to be delivered. The other CAPEX will be that some of the dies that were produced in a certain method before will be used by a different method. And if I look at preventive maintenance plus die maintenance, just these two categories, what will be the amount be, Ajay?

Ajay Mantry: Around 15 crores in this.

Hemant Luthra: Okay, so it is as little as 15 crores. Let me finish to give you a complete answer. Then let's move on to the fact that we have got two machining lines in place, we need to have two more machining lines up and running. Most of the machining lines have been done, as I mentioned on the call earlier, there is some little bit that needs to be done, because of some holdup of one little equipment. So, Ajay on the two machining lines, how much more CAPEX is required?

Ajay Mantry: On the two machining lines the CAPEX required is around 25 crores. We have also kept in the vicinity the fifth line, which might come up by the year end and which would be around 20 crores CAPEX.

Hemant Luthra: Okay, so we have 15 crores on tools and dies and press maintenance. We have 25 crores on the machining line to be rounded up and we may have another 20 crores rupees. So, we are talking about 60. Ajay, how much cash do we have on hand just now and the quarter one balance sheet? You have some investments lying with Mutual Funds and so on.

Sanjay Joglekar: Not at all.

Ajay Mantry: No, we don't have. Right now there is a conversion of preferential warrant due.

Hemant Luthra: Yeah, so conversion of preferential warrants is how much?

Ajay Mantry: That is 45 crores, if M&M subscribes to it completely.

Hemant Luthra: Okay. Does that give you a full picture gentleman?

Chirag Shah: Yes. And by this process, is it that all these activities would be through by end FY12? Completely the plant would be up and running and productivity improvement will happen by end FY12? Is it a right way of looking at it? It will happen, it will happen over a period of time I understand that, it will be in a phased manner.

Hemant Luthra: Now I think what you can safely assume, because we are putting pressure on ourselves and Deepak can contradict me, if I am making a mistake, feel free to do so. The biggest chunk of improvement is going to come from the first line item, that is the 15 crores. And that should happen between now and the end of the calendar year. And then the next chunk is making sure that the machining lines which are waiting for some specific improvement. My impression is that that is also due by the end of this calendar year.

Deepak Dheer: That's true, the balancing equipment for the rest of the line is also due by the end of this calendar year.

Hemant Luthra: And then if there is a new machining line, that might stretch to beyond the end of this calendar year into FY12.

Chirag Shah: Okay. So, does that mean, your asset turnover ratio should improve significantly post this and how much? So, how one should look at what is the kind of output you can generate or it is more to do with improving your EBITDA margin rather than output?

Deepak Dheer: It's both.

Hemant Luthra: Ajay, what is the asset turnover today and what will it be at 150 tons per day?

Ajay Mantry: Currently, we are operating at around 1.2 of asset turnover and once these lines, once we improve the productivity and these machining lines are fully operational, it can go up to 1.5, subject to now other CAPEX is there. But, we also have plans of installing other machining lines.

Hemant Luthra: No, leave out that additional machining lines, I am saying that you are assuming that 1.2 will go to 1.5 or 1.6.

Ajay Mantry: Yeah.

Chirag Shah: Fair enough, I understand. I understood, so that is the kind of output we can generate, once you have all these things in place at optimal utilization of asset.

Hemant Luthra: And I have also said on a different part of this call that given what we are planning to do, we will be disappointed if we could not move from the present 100 tons per day that we have seen in Q1 to 150 tons a day by the end of Q3 FY12. All the equipment is in place.

Chirag Shah: Sir last question, any indication from M&M about conversion or subscribing to additional warrants? They had made some conversion in FY10. And when is the expiry date, what does it get expired?

Sanjay Joglekar: It expires on 3rd September.

Chirag Shah: They expire on 1st September this year.

Sanjay Joglekar: , 3rd September.

Chirag Shah: 3rd September. So, any thought process, any indications of conversion given by them?

Hemant Luthra: Are you a shareholder of M&M?

Chirag Shah: No.

Hemant Luthra: Okay. You know M&M well?

Chirag Shah: Yeah, I do know them; I think I know them reasonable.

Hemant Luthra: Okay. Do you think that they will convert and invest for the long term?

Chirag Shah: Yeah, they should. But it is out of the money for them right now.

Hemant Luthra: Since when has M&M worried about being out of the money on a short term basis?

Chirag Shah: Fair enough, fair enough.

Hemant Luthra: But, I cannot speak on behalf of the M&M Board. I know M&M from inside for ten years and you know M&M maybe from outside for maybe much longer than that. Okay, I can't speak for M&M, but given the choice between forfeiting the money that the 25% down payment that has happened on the warrants and conversion of the warrants, your guess is as…

Chirag Shah: Fair enough, fair enough sir, fair enough. This was helpful. Thanks sir, thanks a lot.

Vikas Sinha: Yeah, before we go on to the next question, in the previous question the top five customers in Europe, they are 70%, not greater than 75%. Just a matter of correction.

Moderator: Thank you sir. There are no further questions. Now I hand over the floor to Mr. Rohan Korde of Anand Rathi for closing comments.

Rohan Korde: Thank you to all the participants and to the management for a highly interactive and interesting discussion that we had today. Thank you gentlemen.

Hemant Luthra: And on behalf of the management, thank you all for taking an interest. This company is on the cusp of great things. Mr. Luthra, who has been given the privilege and the honor of leading this company has a big business ego, he is not going to rest till ROCE is greater than WACC. So, watch this space. We have got internal competition from very high benchmarks being set by Pawan Goenka on what kind of returns the auto sector is delivering. And since he and I are colleagues and friends, but also some kind of internal healthy competition, I have to get there to his kind of returns as fast as I can. And with the help of the team that I have in Germany and in India, I am sure we will be able to and not disappoint investors. A lot of you had serious concerns when Europe was going through a tough time, some of you may still have some residual concerns as to whether India will come up to the same quality as Europe and we will make sure that we do. And for anybody else who wants to set up a one on one, please contact our Investor Relations, I think it is Sandhya Sharma and she will help you.

Hemant Luthra: They can contact us directly, okay Rohan can organize it.

Rohan Korde: Thanks a lot sir.

Hemant Luthra: Thank you.

Sanjay Joglekar: Thank you.

Burkard Rausch: Bye, bye.

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.