"Mahindra & Mahindra Limited Q1 FY2017 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Mahindra & Mahindra Limited Q1 FY2017 Earnings Conference Call hosted by UBS Securities. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sonal Gupta from UBS Securities. Thank you and over to you Sir!

Sonal Gupta: Thanks. Good evening, everyone. On behalf of UBS Securities, we welcome you to Mahindra & Mahindra Limited's Q1 FY2017 earnings call. I am delighted to have with us today the senior management team from Mahindra & Mahindra. The company is represented by Dr. Pawan Goenka, Executive Director and Group President (Auto & Farm Sectors) and Member of the Group Executive Board. We have Mr. V.S. Parthasarathy, the Group Chief Financial Officer, Group CIO, President (Group Finance and M&A) and Member of the Group Executive Board and other senior members of the management team at Mahindra & Mahindra and the IR team. So, I would now like to pass on the floor to Mr. Parthasarathy for his opening comments. Over to you, Sir!

V.S. Parthasarathy: Thank you. I extend a very warm welcome to all those attending this call. Welcome to Q1 FY2017 analyst meet. I will share a glimpse on economic scenario along with financial snapshot for Q1 FY2017. After my comments, Pawan will elaborate on the performance in greater detail.

We continue to see churn, what we call as 'Manthan', some of the headwinds, which we observe internally are Haridwar excise benefit not available from Q4 of FY2016 onwards, higher depreciation and amortization impact due to new product launches in FY2016. And because of the new product launches, the margins pressure during the initial period, even in this churn we continue to focus on topline growth, even as we manage the bottom line. You will remember that we achieved double-digit growth in both Auto & Farm Sectors after 16 quarters in Q4 last year. And now I am happy to report that we continued double-digit volume growth in Q1 FY2017 also. Before I share the financial results, let me quickly talk about some macroeconomic updates. Brexit, this has wider implication in the global market and global stage. The biggest issue currently is uncertainty, the cascading impact on euro and the world is yet to be seen. This causes a lot of concern across the world, however I am happy to share that the impact on M&M is muted. GST, finally Rajya Sabha passes this landmark act with full support and soon we hope to see a landmark tax reform in reality. Monsoon- this has been something which has been a sword which is hanging now, a good bonanza seems to be in store and more of this when Pawan talks about the farm equipment sector and monsoon. Manufacturing growth has been sluggish, IIP growth for April and May together will be close to zero and this poses some concern.

Now let me turn and talk about financials for Q1 FY2017. Before I start that, I want to say that we are starting a new era, a new accounting standard called Ind-AS, IFRS for India becomes applicable. Accordingly, financial statements submitted to exchange are prepared under Ind-AS. Our teams have done a fantastic job and I am very happy to share that we are fully compliant with Ind-AS. In terms of first adoption choices of Ind-AS, let me broadly share that we have tried to be as close as possible to IFRS without any exemption. Example, under fixed assets we opted to reinstate the opening balance of fixed assets, so that they are fully IFRS compliant and in case of long term foreign currency loans, we have done similar practice of making it compliant with IFRS from day one. Another key change under Ind-AS is treatment of excise duty under Indian GAAP; we are required to reduce the excise duty from gross revenue. However, in Ind-AS excise duty is required to be shown as an expense and not as a reduction from gross revenue. However, under GST, tax amount will be required to be reduced from gross revenue, therefore for practical purpose and for purpose of continuity; I will continue to share net revenue and all margins and ratios on net revenue. We will continue to also show M&M plus MVML as we have always done. We restated the financial of Q1 FY2016 based on the same Ind-AS and on an overall basis, there is no material impact on the bottom line. In fact, the impact is 1 Crore at a PAT level.

Let me now share with you the financial of M&M plus MVML. We had a volume growth of 19.5% at FES and 10.9% in auto. Based on the back of this, the net revenue is higher by 11.4% versus Q1 FY2016, which is 10,525 Crores in Q1 FY2017. EBITDA is higher by 10.7% at Rs.1,489 Crores versus previous year figure of 1,345 Crores. PAT before EI is higher by 5% at 871 Crores versus 830 Crores of last year. Considering what is now the new nomenclature, PAT from ordinary activity is 962 Crores, which is higher by 16% against Q1 of last year.

We had a profit on sale of Agri business to MASL, a 100% owned subsidiary, and 91 Crores profit is reported in this quarter. Please note that the above results are after absorbing, what I said is, headwinds, Haridwar excise benefit loss and higher depreciation and new model margin pressure. In spite of challenges, I am happy to report that our OPM has been maintained at previous-year level and above 14%. Once again, our internal resilience has been demonstrated through during external churn. In terms of segment results, auto segment has again volume growth of 10.9%, domestic volume growth of 9.7%, our revenue at 6,492 Crores is higher by 9.7% against Q1. Auto segment result is 505 Crores, which is lower than previous year by 16.1%. However, it is after the excise depreciation and margin impact. Had we to build out this into the last year's figure, and then the growth will be much higher than the revenue growth. FES segment volume growth of 20% as I talked about, it leads to a domestic volume of 21% and revenue at 4,077 Crores is higher by 15% against last year's figure of 3,558 Crores. FES segment result at 768 Crores is higher by 23% as compared to the previous year. The EBITDA margin of 20.2% is one of the highest in the last six years and the second time in six years that we attached 20% plus EBITDA margins for FES.

Financial metrics, debt to equity ratio continues to be 0.2% at a gross level and at a net level zero. Coming to key subsidiaries, Tech Mahindra at 750 Crores shows a growth of 21% over last year. Mahindra Finance at 108 Crores, Mahindra Holidays at 30 Crores and Mahindra Lifespaces at 15 Crores again show a PAT level growth over the previous year, except Mahindra Finance, which is flat as compared to the previous year. I will stop here and pass the baton to Dr. Goenka.

Pawan Goenka: Thank you, Partha. So I will take off from where Partha has left. He's talked about the macro-economic factors and also given you the overall financial performance. Just a little bit on the environment and then I will get on to the performance of our major businesses. So first of all, as you have all been tracking monsoon very closely I am sure. Monsoon has behaved the way we were hoping for at the beginning of the quarter and currently it is slightly above normal. Good news is that all the sowing is keeping pace with the monsoon and as of now, we have a fairly good sowing better than even 2013 when the monsoon was above normal.

Also in terms of the output from Rabi crop last year, it's done better than expected. And therefore, if I add up everything, I think we are in pretty good shape for a continued good crop this year, and therefore should bode well for the tractor industry and agriculture industry and I will come back later to what is our estimate of how the industry might grow. Also what was good during this quarter was commodity prices that behaved well. We were expecting some increase in tractor remained almost flat. There was very little, very marginal increase. And increase in auto was about 1% and we have accordingly taken up price increases, with tractor we have not taken any price increase. In auto, we have taken about a 1.2% price increase, so in line with what has happened to commodity prices. If I move on, one of the other major sort of environmental impact last year, which had an effect on vehicle sales or at least the types of vehicle that were sold, was what's happening with Supreme Court and with NGT, primarily for the NCR area and I am sure that you will have some questions, I will come back and talk more about that, but not an opening statement. So if I now come to the tractor performance very specifically, last quarter was one of the best quarters that we have had in a long time, in fact, the market share at 43.9% was the highest market share in any quarter ever that we can remember at least going as far as back as 10 years. So we have 43.9% market share in an industry that had a healthy growth of about 14.7%. And therefore, we had a growth of 21.1% in that industry. And the growth was across all sub-segments of the tractor, a reasonably well, uniform growth, and for us also it was the same. What was very heartening for us was how Yuvo tractor has performed, that was the new tractor that we had launched in the beginning of the quarter and has done extremely well and we have sold a fairly good volume of this tractor in the mainstream segment of 30 to 50 horsepower.

Moving on to auto; the growth as Partha mentioned was about 10%, 9.7% it was like. But interestingly, Mahindra had the highest growth in passenger vehicles at 11%, amongst the top five players. At 11% growth we had in passenger vehicles in the industry, obviously, the growth has been driven by new launches and many of the new products as you would know have done extremely well. One clear trend that we are seeing now is reducing share of diesel vehicles. In fact, if I go back to FY2013, diesel vehicles were as much as 47% of the total passenger cars and now it's come down 27% of the total passenger cars, impact both of the diesel price parity with petrol, as well as what might be happening in NCR with the Supreme Court and with the density.

Commercial vehicle demand continue to remain strong, growth was about 17% for heavy commercial vehicles, which is roughly what we had expected, last year was 35% but we did not expect that to continue in this year. The good sign is that small commercial vehicle, which was degrowing for several years, for several quarters, has now seen growth for two quarters in a row. Q4 last year was 2.8% and Q1 this year was 6.7% growth. And looking at what is happening in rural environment, we do expect that growth to continue in the small commercial vehicle, which is good for Mahindra specifically, because Mahindra is a major player in small commercial vehicles.

As you are aware that in small commercial vehicle, Mahindra is number one player in Indian market. So for us in the truck segment, our market share grew from 2.6% to 3.6%, is still very small but all the same on the path to increasing towards our eventual goal of getting to 7% to 8% market share. BLAZO, which is truck that we had launched last year, with a first ever kind of money back guarantee, is established very well. And so far I am happy to report there is not a single truck that has been returned, because the customer did not get the expected fuel efficiency. In auto, we also had one of the highest, in fact, the highest quarter of exports 10,569 vehicles, which is a growth of 24% from last year. If I look at the outlook for Q2 to Q4, in the tractor industry we are now increasing our estimate of growth. Last time when we had talked, I talked about 10% growth. Looking at how steady the monsoon has been and how there's no adverse condition of any kind and looking at performance in the industry in the first four months of the year, we are now looking at a industry growth in mid-teens 13%, 14%, 15%, 16% in that order.

In passenger vehicles, 8% to 10% is what we had said last quarter. There is no change in that. We are still maintaining 8% to 10% in the passenger vehicle. Though there may be a higher growth in UV and lower end passenger cars, but overall 8% to 10% is what we expect. SCV, the growth that we have seen should continue into rest of this year, maybe improve a little bit. And MHCV, the forecast that SIAM had given was 12% to 14%. We do hope the growth to be in higher teens rather than lower teens for SCVs. And GST will obviously have an effect, but that effect probably will not be this year, it will be next year.

In terms of launches, the question that some of you may want to know, this year as we exit this financial year, we have no new product launches, because this year is the year for us to leverage the launches that we had done last year. But starting next calendar year, we expect to have one new product launched every year from 2017 to 2020. Of course, there is a lot of work that will happen in meeting the BS VI emission norm that will apply to all the vehicles. For tractor, Yuvo launch was early this year. We have Novo and Yuvo variants, many of the variants that will get launched. And for Swaraj division, we will have a brand new tractor, above 50 horse power that will get launched during this year. For SsangYong, we will have two new products, which are under development, new Rexton, which is to be launched in middle of 2017 and another product that will be launched towards the end of 2018. If I could quickly spend time on other businesses, on SYMC, the good news is that we have now had three quarters of profit for SYMC. First time SYMC has been profitable in the first half of calendar year in nine years. So, during January to June, for six months, volume has gone up by 6.8% and our PBT is KRW 20.4 billion against KRW 53.9 billion loss last year. So that is a swing of KRW 75 billion, which will roughly translate to about 420 crores. Tivoli, of course, is doing very well. And our performance of SYMC to a large extent is on the strength of Tivoli.

Agri business, which as you know, is a new subsidiary now, has grown at about 12% pace last quarter. That pretty much summarizes what I wanted to do as an opening statement. If I could just give a proper headline summary, last quarter was one of the best quarter that we have seen when it comes to tractor industry. Of course, we have expected it to be good, but it was perhaps even better than what we had thought it might be. And within that, our performance also has been, I would say, better than what we would have planned in terms of how the tractor performance would be in this quarter. So we are very happy with that.

In auto, the industry has been sort of patchy in terms of which segments are growing or not growing, which companies are growing or not growing. And in that, Mahindra has a fairly steady performance of 9.7% growth and 11% passenger vehicle growth. Of course, there is lot of pressure coming in the market from the discounting that is happening. And I am sure that some of you will have a question and I will probably come back. I am just sort of putting some teasers for you to come back and ask some questions.

On the truck industry, as per our expectation both in terms of industry performance as well as our performance and in SsangYong, they are quite happy with having three quarters of profit and export auto pretty good. Tractor, a little bit of degrowth, but we will make up for it because the numbers are very small and that pretty much summarizes it.

V.S. Parthasarathy: Now we can open for questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. We will take the first question from the line of Binay Singh from Morgan Stanley. Please go ahead.

Binay Singh: Hi team, thanks for the opportunity. My first question is on the automotive side, it seems the volumes of our new launches like TUV 300 in particular have come off pretty sharply in the past two, three months. So how would the company look at that? Do you think this is more sort of a sector issue or it's more competitive headwinds that are coming up? So that will be my first question.

Pawan Goenka: On some of these segments that we're talking about, there is a significant price correction by competition, and that clearly has an impact in the short term on the volume of our products, of course, we are taking steps to see how do we neutralize in the price reduction that has happened on their products. So that applies more so in KUV100 segment, more so in TUV300 segment, not so much on our existing product like XUV500 and Scorpio, but more in our new product segment, that's one factor. The other factor is the whole sentiment about diesel and even though the smaller vehicles are not affected in terms of any kind of ban but there is sentiment issue and as a result of that the whole segment is moving towards more petrol. We have petrol in KUV, but we have no petrol in TUV300 and that also has some sort of sentimental effect in terms of buying of diesel vehicles and I hope that once the honorable Supreme Court gives the final verdict on ban of some of the diesel vehicles and that will be taken care of. So there are many, many things that we're doing to take care of these short-term impacts that have come because of things that are on the outside environment.

Binay Singh: And Sir just continuing in that when do we see more petrol engines from your end?

Pawan Goenka: There is no change in the time line that we have communicated earlier, you should see the XUV 500 petrol launch happening before the end of this financial year. And should see Scorpio petrol launch happening in the first quarter of next financial year and then the 1.5 litre petrol engine that we have talked about, that's about two years away and that will come in our mid-sized cars.

Binay Singh: Very helpful. Second question on the automotive margin again, you know like very similar to the kind of volumes we are seeing, we are also seeing pressure on the margins. So you talked about the 1% price hike you have taken, but at the same point of time through the year competitive intensity could remain high. So directionally, how do you see pricing power for your automotive portfolio? Do you think that this is the trough margin, it could improve or you think this is like the new normal for the business?

Pawan Goenka: It's very hard for me to say what might happen if the volumes pick up more than 8% to 10%. So right now, the volume growth remains about where it is. It might very well be the new normal where there will be competitive pressures coming from all sides. But if volumes do pick up, then it will clearly have a positive impact on margin, and when I am saying volume pickup meaning industry volume, I am not talking about Mahindra volume. For two reasons, one, of course, our volume pick up automatically in cases of margins because of fixed cost. And also because some of the incentives and the schemes that are going on may become somewhat smaller. You track the market, you would know very well what schemes are being given by various players in the market both reduction in price, as well as giving us schemes. So it's just hard to say, how long it will continue and how bad it would be or it might improve finally.

V.S. Parthasarathy: So, let me just add to what Pawan said. So on the products, he has already mentioned that while you have seen things have come in that are also positive winds and we could in the second quarter, you could see some of the initiative benefiting, including the Supreme Court's clarity on the issue, but not limited to it. But coming to margin, let me specifically add couple of points. One is, the product margin that I talked about at the initial stages tends to be lower, because of not mature margins. As the year progresses, hopefully what one would see is that the sale price and mix stabilizes on higher end, while the cost reduces because the margins are maturing, okay. The second point is, as volume growth, the fixed cost being similar, the absorption is on a larger base, both of that allows for a margin expansion. What is one time loss is the absolute loss that we have, because of Haridwar. Except for that the other two, we must see over a period of time, margins improving.

Pawan Goenka: I mean, it's worth pointing out Partha that if you only correct to Haridwar and nothing else, our margin is better than last year.

V.S. Parthasarathy: Absolutely. So that's in a sense…..

Binay Singh: Automotive margin….

Pawan Goenka: If you just make one correction, which is a very well quantifiable impact, about 130 Crores in the quarter, just that one factor would bring our margin back to in fact slightly better than what we had last year this quarter.

V.S. Parthasarathy: And now the margin impact further improved because of the new model mix as it goes on. I would only see a positive bias. That's it.

Binay Singh: That is very, very helpful actually just on volumes, last question would not repeat, you are a company who is actually seeing the tractor, which is rural improving. So is rural really turning around like, we are not seeing that in UVs, we are not seeing that in Bolero. So why is there a disconnect in that sense.

Pawan Goenka: It's not disconnect, it is the order in which you will see the effect. So clearly at the time when the farmers are getting into sowing for this season, their first priority will be to buy a tractor. And therefore the impact of monsoon where the farmers clearly see this will be a good year will be buying a tractor, the second impact would be in motorcycles because that's lower priced purchase, discretionary purchase, so you are beginning to see if you look at the motorcycle growth, last two months has been a good growth in motorcycles. And the third impact is on four wheelers, in the four wheeler impact actually comes when the farmer is clear that he can see the harvest right around the corner. And that harvest being right around the corner will happen in the festive season. So the impact of good monsoon and good farm output on four-wheeler you could see around festive season.

Binay Singh: Thank you Sir. Good luck for the future quarter.

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

Kapil Singh: Thanks for the opportunity, my question relates to farm equipment segment, I just want to understand whether your guidance is a bit on the conservative side in terms of growth because if I look at, for example, the working capital employed in case of farm equipment, it's one of the lowest we have seen in last few quarters. So does it reflect the fact that volume growth was much higher than what we expected and therefore lower inventory or is it something else?

Pawan Goenka: Our inventory in farm equipment is roughly where it was at the beginning of the quarter. That means our billing and deliveries are about same, give or take a few hundred up and down, and therefore the lower working capital that you see is because of better collection that we have had and would mean the number of days of receivables from our dealers has gone down. I cannot give you precise numbers on it, but that's roughly the reasons for working capital improvement. I do not know what you meant by the guidance being somewhat conservative. Do you mean the volume guidance?

Kapil Singh: Yes, I mean, the volume guidance, because I think first three, four months the growth has been somewhere close to, if I am correct, around 20% mark?

Pawan Goenka: No. That is not true. The growth of the industry in the first three months have been 14.7%. In the month of July, it is in fact about 9%, 10%. So if you were to add it up, in the first four months growth is 13% and we are saying mid-teens. So our growth has been good, our growth, my guidance is about the industry growth.

Kapil Singh: Thank you.

Moderator: Thank you. The next question is from Pramod Kumar from Goldman Sachs. Please go ahead.

Pramod Kumar: Thanks a lot for the opportunity and congratulations on an excellent tractor performance. And my question pertains to Bolero, we have seen some rapid collapse in volumes there, even after the NGT impact, so just want to understand how much of this has got to do with weakness in rural, because a lot of the slump has happened in the last three, four months. And how much of this has got to do with the government departments and others semi-government departments moving away from diesel vehicle in the procurement. So in that sense, where can Bolero come back to in case of a rural recovery?

Pawan Goenka: So, I would not be able to give precise answer, because there are many factors that are working together in this and the diesel sentiment is a factor, but I think the bigger factor is the fact that there are many more products to choose from. Many of us choose from Mahindra, as well as of competition. And when there are so many more products to choose from, which will work well in rural segment. Then obviously it will make a difference. Our own TUV300, for example, is a possible substitute for a Bolero owner or for a Bolero buyer. That itself, we have to almost count the TUV300 volume in the Bolero volume and look at that together from that viewpoint. Even so, I would admit that we would have liked to see a little bit more of Bolero volume than what we have seen and I think that we are doing. I think that we are doing, which you would see in the next four to six weeks on how to get Bolero volumes up.

Pramod Kumar: Pawan related to that is that in the recent at the start of July you gave an interview wherein you talked about diesel cost of compliance per vehicle being around 95,000 for you. I just want to understand what kind of volume levels a diesel as an industry are you looking at when you are making that reference, because the way it is going, we are already at 27% diesel for the industry and the NGT order has led to a lot of scaremongering and lot of customers shying away from diesel vehicles, even in smaller cities. That's the feedback what we have. So just want to understand till what volume level or industry size level does this cost hold?

Pawan Goenka: Are you talking about 95,000 costs for meeting BS-VI?

Pramod Kumar: Yes, Pawan.

Pawan Goenka: Okay. So it's a bit early for me to nail it down, what I have said the 95,000 that is on the basis of what we had spent for meeting the Euro VI norm for XUV500 for Europe, which is already done. So it's coming from there and what I have also said is that is what we have as a reference, but we certainly would look to reduce that number and right now, the work that we have done is for small volume, the work that we will be doing now will be for larger volume and therefore we would expect to reduce that number. And even though there is a shift from petrol to diesel, sorry, diesel to petrol for I guess that's my sort of subconscious function. So even though there is shift from diesel to petrol but my guess is that by that time BS-VI comes around, there will not be anything negative to talk about diesel. And in that situation, if the pricing is maintained, then perhaps diesel could come back in both. I would also like to point out that when we are talking about petrol, we are talking about mostly NA vehicles and some turbocharged vehicles and very few maybe, I am going too much detail, but very few direct injection petrol vehicles. Once petrol goes for direct injection, which will be needed to meet the performance expectation of the customers, the petrol also will become as expensive as diesel is. So therefore as petrol tries to match the performance of diesel and diesel tries to match the emission of petrol, it's quite possible that five years down the road, I am just sort of little bit of stipulating, I do not know the exact number, but it's quite possible that five years down the road, the diesel and petrol vehicles or engines will start converging in prices.

Pramod Kumar: That is very helpful and second question is pertaining to the capex, Pawan, because we have had lot of change in the industry dynamics some purely be out of your control and competition intensity has really stepped up dramatically, customer has more choice as you said. So in this light, having more launches would be really great and we have a fairly lean launch pipeline for the next year or so given what we had last year. So in such a context, is there a relook at the capex at the Group level on various other businesses, which are not exactly very core and at the same time are a significant drain on the cash flows of the company and management resources as well.

Pawan Goenka: So, let me put it this way that today fortunately we are in a situation where for an auto and tractor business, there is no constraint coming because of investments being made in other businesses. So I am not talking about performance or whatever of other businesses, all I am saying in auto and tractors, there is no constraint on investment based on what we need to do for these two businesses. Having said that, the next point that I would want to make again both for petrol both for tractor as well as auto, that in tractor we are fairly well set in terms of investment that we have made already in product as well as capacity. So we have made investment in Zaheerabad plant two, three years ago. Right now, the whole industry is running significantly under capacity. Okay. And Mahindra also has enough capacity to last two to three years of 15% growth. And so therefore, and we have launched Novo, which takes up 50 plus horsepower, Yuvo, which takes up 30 to 50 horsepower and we have a tractor that we are working on under 30 horsepower, which is already half invested. And therefore, when you add it all altogether, the need for any major investment in tractor other than from maintenance is not very high. When you come to auto, there are two types of investment that will happen, again there is no capacity investment that we need to do and therefore Chakan right now has plenty of capacity and we are all set to last us at least two to three years even in a very optimistic scenario of volume growth. What we have to invest is in new product and new regulatory requirements. So when you talk of regulatory requirements, safety requirements have been met completely, so all the vehicles that we have launched last year and even year before meet the safety requirements that are required to be met by 2017 or 2019. So there is no further investment we need to make in that, we need to make investment in meeting BS-VI and I think I have mentioned this on this call also last time, that investment is approximately 500 Crores so we estimate give or take 10%, 15%, 20% up or down, that's not a very large investment, investment wise from our side. There was investment by suppliers. So now we come to product, now if you look at the product offering that we have today and given that we have stated that we will be only in the UV segment and not in anything else, we have product from KUV100 to TUV300 to

NuvoSport, to Bolero, to Xylo, to Scorpio to XUV500. So therefore, we are covering all the bases. Therefore, we do not need to really have a new space created or get into a space that we are not in, what we need to do over the next four years is keep refreshing these products and one or two products may even get replaced by a brand new product, depending on what is happening with those products. So I am just painting a scenario for you the situation of what we need for investment is not as sort of worrisome as one might think, because we have done a lot of investment already. Last year, we have filled the gaps that we had in our product portfolio both on the UV side, as well as small commercial vehicle side. And from here on, we are actually in pretty good shape in terms of what we need to do for investment. That is not to say that we will not launch new products, but the pace of launching new product will not be anything unusual that we need to do, compared to what we have done in the last 8 to 10 years. I do not know, it's sort of a long answer, but I do not know if that helps.

Pramod Kumar: And then finally just on that point, so we do not expect any exits or any divestment of any businesses in a hurry?

Pawan Goenka: I will not want to get into that discussion at all. And that's something totally different and that's not the point that we should be discussing on this call.

Pramod Kumar: Thanks a lot and best of luck.

Moderator: Thank you. We will take the next question from the line of Govind Chellappa from Jefferies Capital. Please go ahead.

Govind Chellappa: I have a couple of questions. One, what was the impact of shift in the Agri business to a subsidiary on the FES topline margins and capital employed? That's first.

V.S. Parthasarathy: Yes. So, will you add the second question also and then we can kind of reply.

Govind Chellappa: Second is more in context of GST, right now for the tractor industry, could you help us understand what is the input tax credit loss on excise duty, so what is the effective excise duty you pay on which you do not get a set off? Second, what is the average VAT you pay across the country? And third, what is the average distribution margin for this industry?

V.S. Parthasarathy: Too many questions but I am sure all of them are very well earned. So first question was regarding the Agri business. Yes, Agri reorganization, actually first and foremost it resulted in a 91 Crores gain to M&M for the quarter, that I have already told you. The key question that you have is that, if I moved into a separate company, what's the impact of the top line and bottom line of FES results. There is a marginal improvement in the bottom line, but there is some about 4% or so of revenue of the top line. And how much will it be, it's about 100 Crores a quarter. 150 Crores a quarter comes of the top line. The bottom line was by and large you can say, what I said is five quarters. Let me repeat, because I do not want to get into trouble, so on the top line about 150 Crores it moves into a separate company. And the bottom line was not significant. So that was your question one. The question two was.

Govind Chellappa: And the capital employed as well.

V.S. Parthasarathy: Yes, capital employed was not much and not material again.. CST input, you had asked about input costs and excise duty, 8% is the current rate.

Pawan Goenka: 8% excise will be neutral in terms of not requiring any price increase.

V.S. Parthasarathy: Average VAT is, many of these states had VAT also, average will be about 5% is what I would assume. However, it differs by state-by-state today. I think that I will at least I will pass that, I am not clear. Very difficult to kind of predict that. That I think will not be in the ambit of GST as far as I am concerned.

Govind Chellappa: So I ask that question, because right now distribution margin is not taxed by the central government, you pay only VAT on the distribution value addition. However, you will pay CGST on the distribution value addition as well. So it could make a big significant difference to your business.

V.S. Parthasarathy: It is the same, because…..

Pawan Goenka: We do not pay price on distributor margin, but we pay VAT.

V.S. Parthasarathy: We pay VAT because the price which is billed by the dealer to the farmer is anyway the price on which VAT is paid

Pawan Goenka: So just, in terms of neutral rate for tractor, when it is 8% on a 12% excise, it'll become 12% on a 18% GST. So if GST is 18%, then we would have 12% of input GST paid roughly, which would mean that if the GST rate on tractor was 12% on the final output then it will be a neutral result.

Govind Chellappa: Thank you.

Moderator: Thank you. Next question is from Amyn Pirani from Deutsche Bank. Please go ahead.

Amyn Pirani: Thanks for the opportunity. My question was on the tractor side, it's still early days for the recovery, but are you seeing any signs that this tractor demand is mainly from the agri side or is there an increase in the usage for non-farm purposes given the infrastructure thrust towards rural areas that has been driven by the government.

Pawan Goenka: There is no specific input that we have right now on this, so I won't be able to answer that question.

V.S. Parthasarathy: So very simply put, the projects if any for construction and others are very, very……..

Pawan Goenka: I do not think much is happening because of that. I would guess, this is a guess that most of the demand increases is coming from agri.

Amyn Pirani: That is all from my side. Thank you.

Moderator: Thank you. We have the next question from Karthik Chellappa from Buena Vista. Please go ahead.

Karthik Chellappa: Thank you for the opportunity, Sir. My question is mainly on the UV business. You alluded to some level of discounting in the market, but if I just look at the brand wise volumes, the big kicker has actually come from the Brezza from Maruti and Creta from Hyundai, both which I believe are on waiting periods and not on discount. So are not those two models probably hampering your market share much more than the discounts by, say, some of the smaller players?

Pawan Goenka: So you see, it depends on which product do our products compete with. If you recall, I had mentioned that there is no discounting pressure on Scorpio and XUV. And I had say, there's discounting pressure on KUV100 and TUV300. TUV300 does not compete with these products that you mentioned. And KUV100 does not directly compete with the products that you have mentioned.

Karthik Chellappa: As far as the KUV100 is concerned, we said that we are looking to increase your production to about 7,500 sometime in the second half, but I noticed that in the last two months the volumes have already started moderating, so can we get an update on how much of bookings do you have and whether you are still in a position to ramp up production, is there adequate booking pipeline that you have as of now?

Pawan Goenka: We do have some booking, but not enough for us to ramp up production to 7,000. So when we had mentioned 7,000, at that time the initial demand was very high. And since then as your sales moderated and right now we think 5,000 would be kind of our target to get to and maintain at 5,000.

Karthik Chellappa: Sir just one follow-up on the GST part on tractor, you said if the GST rate on tractor is 12% that would be neutral to you. You do not need to take up a price increase or a price cut right?

Pawan Goenka: Let me repeat what I said. If the standard rate is 18%, it's not yet 18%, and if the components get GST at the standard rate as is normally the case, then a 12% rate on the tractor will not increase the price of the tractor, because it will be completely moderated by the GST that we have paid on the inputs.

Karthik Chellappa: Thank you very much.

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

Chirag Shah: Thanks for the opportunity. Sir, two questions I had on tractors first you hinted your historic high market share, so what it could be ascribed to, is it more of a regional mix, the regions where you are strong, have seen a far better growth or is the capacity constrained with your peers in the system?

Pawan Goenka: Now, first of all, right now, nobody has a capacity constraint to the best of my knowledge. In fact, even with the 43.9% market share and 21% volume growth, we can make plenty of tractors more beyond this. I believe, and of course, this is my bias and you can judge that. I believe that we have now a very strong product portfolio with the launch of Novo last year and Yuvo at the beginning of this quarter. We basically have 30 to 60 horsepower of brand new tractor, brand new platform, not just brand new tractor, brand new platform, which for a tractor industry is very unusual. It will be very rarely that you will see that 70% of our segment that we compete in has a brand new offering. So that I consider is the primary reason why we think that we have done better than the industry. And the secondary reason, I would say is that there are a lot of initiatives that we have launched in the field to demonstrate what our tractors can do and to create an environment for our customers, who take a very serious look at what we have to offer. Mahindra has always been a very strong brand and therefore it's not that difficult for us to sort of bring back that confidence in Mahindra tractors. So both the activities that we have done in the field and the fact that we have very strong product, brand new product portfolio, is what I believe has helped us to get the kind of market share.

Chirag Shah: Sir secondly on the margins on tractors, we have seen a very strong improvement on the FES margins, is it attributable to volume uptake or also discounting has come down in the system and that has led to report this kind of segmental margin?

Pawan Goenka: I would say, mostly it is because of volume impact. If you look at the overall breakup and I do not know how much of it has been given in the statements that we have released. If you look at overall break up and look at each of the elements like gross margin, personnel cost, variable cost, fixed cost, depreciation, you would not find anything there is sort of standing out. And it's all therefore attributable to overall volume growth that we had and normally you would see that, that in the tractor business, our margin sort of ranges between 17% and 20%. The time when we have a poor volume, we are closer to 17%, when we have good volume, we are closer to 20%.

V.S. Parthasarathy: So on a very overall basis, our revenue growth has been to the tune of about 15% and our bottom line growth PBIT is 14.6% if I remember correctly. And my bottom line growth is about 22% would just substantiate towards what Pawan just now said.

Chirag Shah: So the discounting activity in tractors is yet to come up meaningfully, is that right way of looking at it?

Pawan Goenka: I do not like that sentence that discounted activity has not come up meaningfully. I do not think, I would like to put it that way. I would say that the competition is not irrational. Competitive activity is not irrational.

Chirag Shah: Just on the LCV front, if I can just squeeze in one more, if we just touch base upon, what kind of the portfolio that you have, which are the products that are seeing more traction on the rural side. In the SUV portfolio, are all the models growing in the rural side or there are specific products or applications that you are focusing on?

Pawan Goenka: Our strongest product right now in the small commercial vehicle segment is our Bolero range of pickups, which we have three now, we have the new Bolero pickup, we have the BMT and we have the standard Bolero pickup, so there are three of those, which is what gives us most of our market share in the pickup segment that is 2 ton to 3.5 ton and the second product that is very strong for us is Jeeto, which is what we had launched about a year ago, the first sort of new platform that we had launched last year and that is giving us a healthy volume of 2,300- 2,200 thereabouts. So these two are the strongest.

Chirag Shah: So both of them are more rural oriented that would be a right way of looking?

Pawan Goenka: I would say that Jeeto is more of a last mile connectivity product and therefore Jeeto would have lot of application in e-commerce also. I do not have off hand a split of how much of Jeeto is being sold in rural and how much is urban. And similarly pickup also is used for transport. So, I will not call them a rural product, but certainly with rural economy growing and expected to do well it does speak well for the LCV volume. Can we have the last question for the evening?

Chirag Shah: Thank you very much. I will come back for more questions.

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

Pramod Amthe: Two questions, one is with regard to the tractor business, we have not seen any major correction in margins in the last two years of the down cycle, and in the start of the up cycle itself, we are hitting to the historic high margins, how do you see these margins playing out the up cycle of, say, even if it's for two years. Would you play to raise the margins because you are very comfortable on capacity, you are very comfortable on market share and new products. So will you hit new historic margins continuous?

Pawan Goenka: I wish, I knew.

Pramod Amthe: Are you seeing any cost pressures in terms of any regulatory related to the tractor business?

Pawan Goenka: No, there are no regulatory cost pressures that we see in tractor, the commodity prices, we do expect to firm up a little bit in the third quarter, but I would expect that we will be able to pass that on whatever the quantity price increase is. So therefore, I do not see any pressure coming from that side and basically it's just a game that will go on, and it's very difficult for us to predict right now, whether we will have increased volume, increased market share, increased profit. I mean obviously our objective, always will be to try and achieve all three. But if it comes down to having to choose, then at that point of time, we will make a choice.

Pramod Amthe: And any update on two wheeler business reorganization, because you did attempt some VRS and all in couple of months back.

V.S. Parthasarathy: Before you answer it, one point I wanted to add to the earlier one. One of the things you found and today we mentioned this that FES margin has been on a bend. It is about 17 to 20, it has consistently remained in that kind of band. During value cycle, it allows us that flexibility to be within this band, because the costs are reasonably flexible and we can man for the kind of capacity that we want. So therefore six years, and we say there has been good upcycles as well as in the six years as much as down cycle. So I am just saying, do not take that this is a start-up of a big upcycle.*"* So I would like to see higher and higher margins, but the history shows that have been in a band.

Pramod Amthe: I asked on the two-wheeler business.

Pawan Goenka: Yes, two wheeler business, as we have already communicated that we are right now sort of rightsizing the business, we had set up a business for much higher volumes and we are not getting that kind of volumes, that now we are resigned to that fact and therefore, we are looking at rightsizing the business we have given VRS, which has gone quite smoothly and we have reduced 320 people I think roughly half of the people in the plant have been given VRS. We also are looking at dealer network and rightsizing that for the kind of volume that we expect to get. What we are focusing on is to look more at niche segments, Mojo, which though volume is only 150 a month, but it's a motorcycle that seems to be creating a reasonable brand for itself. And therefore we are really focusing more on the Mojo premium motorcycle, and Gusto 125, which is a higher horsepower or higher CC Gusto that we had launched last year, and that also seems to be doing reasonably well and will be focusing on that. So basically our strategy right now is to not go into very aggressively on the 110cc bike and focus on premium bikes or higher cc bikes and aligning our business for that and that's what is going on. It's going on pretty much as per our internal plan. We can take one more question, since we started a little late.

Moderator: We will take the last question from the line of Raghunandhan from Quant Capital. Please go ahead.

Raghunandhan: Thank you, sir for the opportunity. Can you comment on the new below 4 metre Bolero to be launched and how do you see the volumes going ahead because of this product?

Pawan Goenka: We have not talked about any new sub-4 metre Bolero to be launched. And obviously, I will not be able to respond to something that we have not yet talked about.

Raghunandhan: Also can you speak a little on how you see the positive impact on 7th Pay Commission to pan out and also the positive impact of GST?

V.S. Parthasarathy: Yes. First and foremost of our 7th Pay Commission, see one of the big things that happen with every pay revision in government is a huge amount of arrears people get. So that's the big normal bonanza and good thing is that there is going to be no arrears this time, and a good from a cost point of view from the government and inflationary but it also means that they are not going to be suddenly rich, it's only the cash flows overall improve. And improve in a way that enables consumption. So it is positive, but not positive from a quick point of view, it's positive on an ongoing basis. Coming to GST, I think it drives productivity measures from all the manufacturing consumers. So the manufacturing industry is suddenly going to be able to focus on productivity enhancing tools, rather than focus on fiscal benefits and therefore a build to fiscal benefits, rather build to a lean supply chain. So this is a benefit that is going to accrue over a period of time, not something is not going to change the day GST is done, but suddenly on a positive basis. People talk about 1% to 1.5% of benefit to GDP. I think some portion of benefits suddenly will accrue to the industry. Some industry like service and IT industry will face some administrative challenges, but I hope those can be overcome. Overall, I see it very positive.

Pawan Goenka: And just on GST, I want to add one more point. As many of us have talked in media already that the thing that we really are looking forward to in GST, of course, the tax rate arrears and therefore overall reduction is a good point. But the more important thing is ease of doing business, because it will allow us to optimize our business or what is most efficient way of doing business, and not what is the most efficient way of saving taxes, because taxes will not be an issue anymore. And so therefore, where do we locate our plant, where do we look at our suppliers, where do we locate our warehouses. All of these things will become much easier and hopefully the total documentation required for paying the GST would be less of a burden than what we have today on deferred taxes that we pay in indirect tax. So, we really look forward to that and I think that would give us really efficiencies in terms of our business.

Raghunandhan: Thank you Sir that is useful.

Moderator: Thank you, ladies and gentlemen due to time constraints that were the last question. I now hand the conference over to Mr. Sonal Gupta for closing comments.

Sonal Gupta: Yes, on behalf of UBS Securities, I would like to thank the management team from Mahindra & Mahindra for taking the time out and discussing the results in detail and answering all the questions. Thank you Sir and thank you everyone for joining.

Pawan Goenka: Thank you.

Moderator: Ladies and gentleman on behalf of UBS Securities that concludes this conference call for today.