"Eicher Motors Limited 4QCY12 Earnings Conference call"

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MANAGEMENT: **MR. SIDDHARTHA LAL – MD & CEO, EICHER MOTORS LIMITED**
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MODERATOR: **MR. ASHVIN SHETTY –AMBIT CAPITAL.**

Moderator: Ladies and gentlemen, good day and welcome to Eicher Motors' 4QCY12 Earnings Conference Call hosted by Ambit Capital Private Limited. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Ashvin Shetty from Ambit Capital Private Ltd.

Ashvin Shetty: Good morning, ladies and gentlemen. On behalf of Ambit Capital, I welcome you all to the 4QCY12 Earnings Conference Call of Eicher Motors. Eicher is today represented by its Managing Director and CEO, Mr. Siddhartha Lal and its Chief Financial Officer, Mr. Lalit Malik. Without spending any further time, I would like to hand over the call to Mr. Lal for his opening remarks and then we will start the Q&A session.

Siddhartha Lal: I am very happy to join this call and to share with you the update on the sales and the financial performance of Eicher Motors Ltd for Q4 2012 and for the calendar year 2012. I will start with an update on sales volume for various segments of the commercial vehicle industry and comment on the performance of our business VE Commercial Vehicles and of Royal Enfield which are our two main businesses. On the Commercial Vehicle, we continue to see significant downturn and pressure on the sales volumes in the 5 tonne and above segment in India. In Q4 , the segment actually recorded a sales volume of over 76,000 units which is a drop of 29% over the same period last year. So, the industry is falling very sharply and it is the lowest quarterly sales volume in the last few years. All four segments that we track, 5-14 tonne, 16 tonne and above, buses as well as export, all declined in Q4 now. For the year 2012, the industry recorded overall sales volume of 395,000 units which is lower by around 12% compared to 2011. So it has been a pretty bleak year for commercial vehicles in the calendar year 2012. In contrast to that, VECV, and in particular, the Eicher branded commercial vehicles have actually done much better than the industry. As a result, we have improved market share in both Q4 and in 2012 as compared to the corresponding periods last year. Our total volumes for the quarter were 11,542 units, which is a decline of only 7.7% compared to 29% for the industry. We have declined much slower than the industry. For the year, we have sold 48,262 units which is very similar to what we sold in 2011 which was at 48,337 units and which is very credible given that the industry has actually declined by close to 12%. As a result our market share for Q4 2012 for 5 tonne and above was about 15.6% as compared to 11.9%, so that is a growth of around 3.5% plus from Q4 2011 to Q4 2012. Also, our market share for the calendar year was 12.7% compared to 11.1% in 2011. So overall it has been a very strong performance on the market share.

Now coming to the segment-wise performance – in the 5-14 tonne, the light and medium duty segment, we sold 7,591 units which is 11% less than the 8,533 units that we sold in Q4 2011; however, our market share has actually increased to 35% which is much higher than the 29.5% in the previous year's quarter. So, it is a jump of 5.5% market share. For the year 2012, our sales volume in the 5-14 tonne segment has been 29,541 units which were only 5.9% lower than 2011 and that has helped us to improve our market share from 30.5% last year, the whole year to 31.4%. So nearly 1% increase in the market share once again which we have been able to bring on the table as far as the light and medium duty segment is concerned. In the heavy-duty segment or 16 tonne and above, we actually sold 1887 units in Q4, which is 13.4% lower than the same period last year but we did much better than the market and actually received our best-ever quarterly market share of 5.2%. For the year, we have sold 7,699 heavy-duty trucks, which is 16 tonne and above as compared to 7,352. So, it is a slight increase of nearly 5% over 2011 whereas the market has dropped dramatically and therefore our market share for the year has increased from 3.1% to 3.9%. So once again nearly a 1% increase in the market share that we have been able to bring out on the table as far as heavy-duty is concerned. In the bus segment, we have seen continued to have a very good run and in Q4 2012, we sold 1,368 units which is a growth of 24% over Q4 2011 and for the year, we sold 8,521 units as compared to 6,496 units last year. It is a growth of over 31% for the year and as a result we have achieved again our highest annual market share which is gone up from 9.7% last year in buses to 11.9%, so growth of over 2% market share in this case. Each segment that we are tracking we have grown by approximately 1 to 2% market share in the year.

Our exports for the quarter were marginally higher than last year; it is 696 units but for the year our exports were 2,501, which is a 20% drop from last year, which has been a concern because of some of the South Asian markets. In our Volvo truck division, while we continued to lead the European truck segment, there is a sharp decline which has been happening because of problems in the coal sector. As a result, for the year, we did a sale of 569 units, which is lower by nearly 20% from 2011. During the quarter, though we sold 193 units which was a growth of 22% over Q4 2011, there was some improvement in this quarter but overall in the year we are down by 20%. Given the market circumstances of sharp de-growth across all the segments in commercial vehicles, we believe that VECV have done extremely well in gaining the market share across all the segments but also I would say containing the reduction in profitability to pretty decent levels in our opinion. Overall we believe it has been a very good story for us as far as commercial vehicles are concerned and as far as VECV is concerned. Once again in the year 2012, we have continued to invest extremely strongly across the board in quality, in capacity. There’s been a lot of pipeline of new products which are coming out as we talked about by the end of 2013 including 2014 and 2015—full new ranges of trucks, buses, engines and other such things. There is also a very large investment going into our entire distribution, into our entire aftermarket, into our brand. A lot of work is being done in our bid to bring great modernisation into the commercial vehicles industry and we believe that we are really heralding that modernisation in Indian trucking. We are very pleased about our performance this year and looking forward to a strong 2013 in the VECV.

Moving on to Royal Enfield – we sold 31,968 motorcycles in Q4 2012 and closed the year at an annual sales of 113,432 motorcycles, which for the first time we had crossed 100,000 motorcycle in the year in the history of Royal Enfield. This was a great milestone for us. As a result, this has made our Q4 the best-ever quarter for Royal Enfield and 2012 has been by far the best-ever year for Royal Enfield. Once again in 2012, we have increased our sales by over 50% and that is despite the fact that we are still running even as of today our entire production is coming from our old plant. As soon as of course the new plant kicks in we should be able to further improve our production. Our order books continue to be extremely strong. We continue to take in more orders every month than we are producing and we are very delighted by the launch of Thunderbird 350 and 500, where the response from customers has been extremely strong in the market. Likewise, we had an excellent response for accessories and apparels which is still in infancy but it is a very strong response and now we're growing that area of business also very strongly. Overall, absolutely phenomenal year for Royal Enfield and again a lot of investments are going into the new plant which is scheduled to start rolling out new products very soon , in brand, in marketing, in distribution and in aftermarket. We are in the investment phase but our cash flows are extremely strong. We are able to actually manage everything and more within our cash flows for sure. So that has been a very strong story for us—the Royal Enfield growth.

Moving on to our partnership with Polaris—it is going on extremely well, the project timelines are being met and we are scheduled to hit our start of production and start of sales timeline as we talked about previously in the year 2015. It is absolutely on track. Overall just moving on like I said we continue to invest tremendously in all of our projects both in VECV and Royal Enfield and in Polaris business. We have our key projects in VECV which is the medium duty engine project, the bus body project, capacity enhancement and development of next-generation products. They are all 100% on track. They are all being executed to the fullest and the outcome of all of those investments which we are making will start coming in 2013-2014. All of those are in place. In Royal Enfield, our new plant is absolutely on track.

Now moving on to the financial results – the result of strong sales performance by VECV and Royal Enfield, we have actually achieved even in this pretty bleak year for automotive. We have achieved our highest ever income from operations at Rs 6,389 crores and if you add up gross sales in other operations income, we have actually crossed Rs7,000 crores at a gross level. So that has been a very solid performance especially under the circumstances. For VECV clearly because of the discounting in the market which has been quite rampant especially in heavy duty, the price realisation has been under a lot of pressure and yet VECV has restricted the profit decline through rigorous cost monitoring and cost controls. On a consolidated basis, our results are for the calendar year 2012, we have actually grown our total income by 12.4% to Rs6,390 crores approximately. Our operating margin on the calendar year has marginal decline by around 7% to Rs589 crores last year to Rs549 crores this year; that is the EBITDA. So, the EBITDA percentage is down from 10.4 to 8.6, which we are actually extremely pleased with that in a down cycle to have 8.6% EBITDA in this. Profit after tax, we have also declined marginally from Rs 497 crores to Rs 475 crores, so that is a 5% decline with the good news is that this has actually been our best-ever year in profit after tax after minority interest. So there we have grown marginally from around Rs 309 crores to Rs 324 crores. Overall we have had if you look at it from a top-line perspective, we have had a record top-line in 2012 and if you look at the profit after tax after minority interest; Eicher Motors has had the best-ever bottom-line as well. This is the overview of the year. So thank you all for joining the call and over to you Ashvin and if there are any questions we are happy to take those now.

Moderator: Participants we will now begin with the question and answer session. We will take the first question from the line of Pramod Kumar from IDFC Securities. Please go ahead.

Pramod Kumar: In Royal Enfield, the margin seems to have fallen off the cliff. Just wanted to understand, is it got to do with some lumpy spending or it is kind of a normalisation in the margins. The margin seems to be abnormally low, so if you can just throw some light on that 11.5% operating margins at RE?

Siddhartha Lal: We guess the performance in VECV has been extremely good based on the circumstances and in Royal Enfield the performance has been excellent well as far as we are concerned. Yes, from Q3 to Q4, there has been actually just before that on a quarterly basis. Also, the actual EBDITA has grown from Rs16 crores at EML standalone to Rs 34 crores. On a quarterly basis we have grown by 114% in EBDITA. The EBDITA margin has grown from 9.4% to 11.2% for the quarter. For the year, it is close to 14% and so we are tracking higher EBIDTA margin. Yes, you are right that Q4 2012 margin is lower because of major expenditures. A lot of them are lumpy expenditures as you said was related to Thunderbird launch that was our once-in-a-year big launch and some other similar expenditure on that has happened in this quarter. Those kinds of expenditures have sort of increased the cost to some extent but I do not think it is an area of concern.

Lalit Malik: The only non-recurring fees which would not happen in the next two quarters will be the product launch. It was a pan-India product launch, and so that is what it is kind of showing up in the other expenses. Apart from that it is all business-related expenditure. No surprises there, exactly as we planned.

Pramod Kumar: So barring those lumpy items, you should see the margins bouncing back into the regular number level basically going forward?

Lalit Malik: That is for one quarter only but also please bear in mind and we have been repeating that in the post result calls also both the businesses on a capex level, we are expanding and therefore we are investing very heavily. There will be some pressures that you will continue to see on the margins here and there but I think given the confidence that we have over the period of time, our revenue top-line will make up for sure for all the investments that we are doing. So the quarter-to-quarter mismatch with the revenue that could well happen but Siddhartha also mentioned in his comments on the investments we are doing on the brand and the branches and distributions all that, will play up. Plus also in opex, the situation of power in Tamil Nadu continues to be pretty bad and given the diesel price increases there is that expenditure also with has kind of gone up.

Pramod Kumar: So you're buying diesel from bulk, is it?

Lalit Malik: Yes, we're paying Rs10 per litre extra.

Pramod Kumar: But once you move to the new plant, I believe that you should have some preferred power supply from the State government because I think the Tamil Nadu government is giving assured power supply for manufacturers in that particular belt. So, with the new plant also will you continue to buy diesel? Will it be depend on diesel power or it will be from the grid?

Lalit Malik: As of now the understanding and the idea is that we will get uninterrupted power but it is all still to be closed as it were but the MoU and the intention from the Tamil Nadu government and from us is that, yes.

Pramod Kumar: And HCVs, we have not been having full presence in HCV in terms of all our dealerships selling the product right now. I think if I'm not wrong last time when we discussed we were also not selling that vehicle to the small truck, single truck owners or new users in the industry. I just want them to understand how will that ramp up happen, as to how many of your existing commercial vehicle dealers are selling HCV already and how do you see that happening? All I'm trying to get at is whether we still not addressing 100% of the market both in terms of touch points and also in terms of the customer target, as in the target customer?

Siddhartha Lal: On the Eicher side of trucks and buses where we have had around nearly 250 dealers, you could say well more than half of them now are truly selling heavy-duty trucks, who are fully geared up, who are fully sorted out and it is not just the dealership it is area. The fact that we're getting the right type of financing in that area that is factored in we have all the aftermarket support in all the routes which are emanating from that area, that we have the spare parts and the training. So, over half of the dealers are well activated and that number is going up sharply every month. We are tracking it. We are adding many dealers every month into our heavy duty fold and over time I think over the next two or three years we should see on the one hand we are increasing our dealer count—30 to 50 dealers every year. On the other hand, we are dealing the penetration of heavy duty in our dealership a lot more. It is bound to rise tremendously over the next year or so.

Pramod Kumar: Finally on the capex, as to how much capex has been done for VECV for this calendar year and similar for Royal Enfield and the forecast for the next year?

Siddhartha Lal: The next two years which is the calendar year 13 and 14 in VECV, we are looking at capex currently from Rs1,200 crores. We are very much in the investment phase. We are going through some of the projects which we talked about are still in the completion phase. So there is some cost left on the engine and the bus body and some on the expansion, but of course a lot of the investments are now going into our new products and tooling, which is coming in 2013-2014 and also now there is a lot of focus going on the front end. So all the work after market and distribution, all the capital expenditure required there for example for fixed warehouses, even for our own setups of distribution, and so all it is also coming into this number over the next few years, we are planning around Rs1,200 crores, which is what we're looking at it right now.

Pramod Kumar: And that of Royal Enfield?

Siddhartha Lal: Royal Enfield what we have talked about right now is only about our new plant. We have not yet got a number on anything more than that. So on our new plant, we have talked about a Rs150 crores that we were spending and that very much is on track. A large chunk of it has already been spent; some of it is still to be done in 2013 but that is all on track. We are not yet sort of giving anything further in terms of proposed capex on Royal Enfield.

Moderator: The next question is from the line of Pratik Mehta from Bajaj Allianz. Please go ahead.

Pratik Mehta: If you can give a bit data point on the order book in Royal Enfield, our run rate has obviously moved up now to 10,000 to 11,000 run rate and with the new plant also coming up, that probably would go up further. How has been the order book situation? Do we continue to add similar numbers in terms of order backlogs or are we still in a situation where the order book continues to grow?

Siddhartha Lal: In Royal Enfield on the back of the products that we have been launching so of course Classic has been one of the big ones, Thunderbird has created a lot of buzz in the market and we expect our Café Racer in the second half of this year also to create a tremendous buzz in the market. On the back of that and on the back of I would say improved and widespread distribution now we have now 250 points and it is growing rapidly now because we're able to have a good dealership in a C class town also. On the back of that we have had a tremendous growth in our orders. Our orders currently are different from model to models and I am not going to give one number in terms of the order book that we have right now but give or take depending on models and if you average it out, we have over in current sales levels we have around 7 to 8 months' orders that we still have direct from customers. So that is one data point. The other is that we are taking in much more orders than we are able to produce even today so on a monthly basis, we are taking much more orders than we are able to produce. That is clearly a healthy sign. Last month in January of course was another record month as far as we're concerned in terms of sales numbers; So close to 11,500. We have been able to push our current Tiruvottiyur plant, and see also right now the order book is healthy and we are not taking anything for granted. We are still pushing very hard on dealership expansion, we are working very hard on new products, launches, brand and marketing activities to keeping this momentum up because as we said our capacity will increase sharply by the end of this year or let us say through 2013 and we want to make sure that we continue to have a very strong order book and position. So we are doing all that we can and make sure that the orders keep rising.

Pratik Mehta: That is on VECV, there are some reports an article stating that Volvo is kind of globally focusing or trying to focus more on the value trucks where in you know a lot of focus on the cost cutting etc. Now given that those ultra-heavy duty trucks or application-specific trucks which are high value in nature and which are outside the purview of VECV JV, is there any likelihood of the scope of VECV being expanded or the more products being introduced purely from Volvo's strategy change? The article also states that they are looking to produce those value trucks in their JV that they have in China. Is there anything similar happening with VECV also?

Siddhartha Lal: The Eicher brand which is of trucks and buses which is part of VECV is one of the now six brands because as you would have heard that Volvo is now taken a 45% stake in Dongfeng which is a leading commercial vehicle there in China along with the entire suite of brand which they have of Volvo, Mack and Renault. UD continues and now there is Eicher which has been there for five years and Dongfeng which has entered the stable. In light of that, Eicher plays an extremely important role for the Volvo Group as a leading brand for emerging markets. There is a lot of effort going in at VECV also from Volvo Group in supporting and in technology and in distribution and in all sorts of areas to be able to ensure that the future range of Eicher trucks and buses which we are now like we have been talking about are being under development. They are not only sort of focused in India but there are products which are going to so that they will be successful not only in India but also in other emerging markets. We have a great ambition to spread to other emerging markets specifically Africa, Middle East, and Southeast Asia, those are immediate or let's say mid-term markets that we gunning after very strongly. There is a lot of action going on in terms of setting up our understanding of distribution for export sales. There is a lot of work going on there but also a lot on the product side. So certainly you may have to ask the Volvo Group further you want more details on their outlook for Eicher. I can only answer from our side but there is I can say tremendous focus from the Volvo Group to ensure that the Eicher brand is extremely successful in India and emerging markets.

Pratik Mehta: So the Rs1,200 crore capex that you spoke about in VECV, obviously that includes new products development, engine, bus body, chassis building, facility etc. but is there any increase in the capacity in terms of volumes, I think, right now we have close to 60,000 capacity, if I'm not wrong. So would there be any increase in the production capacity or that will be outside of that Rs1,200 crore that you'll be spending?

Siddhartha Lal: To be honest, right now as far as we are concerned in the Pithampur plant, a lot of big step investments for increase in capacity have been done, So the new paint shop will cater eventually to let's say 100,000 units of capacity and so that is the one step in investment. Our new light and medium duty line is also ready and is running, which will also cater to a high-capacity. Most of the large capex items of capacity, a lot of them, lets say have been taken care of. We have not of course, manned up. We don't have the manpower right now to cater to higher capacity. Therefore we don't declare a higher capacity today. Also some of the vendor part and tooling, we will need to add more but I believe that the Rs1,200 crores will take us to the higher capacity levels as well. It is not going to be additional from the Rs1,200 crores if that answers your question.

Moderator: The next question is from the line of Sumanta Khan from ICICI Prudential Life. Please go ahead.

Sumanta Khan: Just wanted to know what you feel on the raw material cost at current levels. Are you seeing some kind of stability in the cost?

Siddhartha Lal: Over the past few quarters, we have really not seen; I'm talking about in general, we have really not seen any major movement one way or the other in raw material cost. It's been reasonably steady and doesn't concern us at all. In terms of at raw materials, costs in itself are not concerning as we said today in terms of cost pressure or anything of that sort. On the other hand particularly in VECV we have undertaken very large exercises of cost reduction which is really in terms of weight reduction, in terms of value engineering, in terms of all other areas, also aimed so that even in our new platforms we are able to get a better cost structure. There is a lot of work being done on cost reduction, on alternate sourcing, on other such things; so all that is on very much on track but we are not particularly worried about any major spikes which could happen in the near feature. Also of raw material, I don't think that's on the cards.

Lalit Malik: Also if you look at our standalone results and also the consolidated results, our raw material cost between 3Q and 4Q last year is steady and in terms of near-term outlook at least we don't expect any flare up to happen in one commodity or the other.

Siddhartha Lal Despite some adverse product mix also because our heavy duty is going up as a proportion yet we are able to maintain and even improve marginally our cost to 32%. So, it is not a concern really.

Sumanta Khan: So whatever difference that is visible on quarter-on-quarter is entirely because of mix, that's what you're trying to say?

Siddhartha Lal: Yes.

Samantha Khan: On your other income line which is essentially the investment income, how do you see it now? Last year fourth quarter, there was a bumpy number from 429 crores?

Lalit Malik: I presume you are referring to standalone numbers?

Samantha Khan: Both consolidated and standalone, I mean, they are seeing right, not the other operating income?

Lalit Malik: As far as standalone is concerned, I think our note on the standalone financials are there with you mentioned the fact that there has been a change of any accounting policy really in terms of the way Schedule-6 numbers are to be reported. So as opposed to last year, this year we are not able to account for the dividend that we receive from VECV. The amount there was about Rs41.8 crores, the EML got from the VECV, so there is a accounting issue over here. There is no adverse cash flow issue, there is no adverse tax flow issue. If you are not able to account for in 2012, we will account the same course next year, in fact next quarter. Apart from that, as far as the lumpiness of the FMP is concerned clearly this has got to do with maturities. In terms of our yield we have deteriorated a bit over the whole year because some of the numbers have kind of come up but at a very marginal level. It really has got to do the fact that FMP income is not to be accrued but it is only to be realised based on the FMPs are maturing; so it is only that spend. Overall cash number that we have, over the last year and this year end, has increased actually from Rs517 crores to Rs640 odd crores; this is all standalone numbers. On a consolidated basis, you will also see a bit of a dip happening because VECV, as Siddhartha has mentioned earlier, we are investing very heavily into the business. So last year we spent almost Rs670 crores into the company and a large part of that also came from a fixed deposit holding that the company had. So that is what kind of leading you to a lower consol number that you are seeing.

Moderator: The next question is from the line of S Chellapa from Pari Washington. Please go ahead.

S Chellapa: In Eicher Motors standalone, the tax rate last year has been 16.7% and in VECV it is 22.5%. I want to understand directionally would it be flat or how would be next year going forward?

Lalit Malik: At VECV levels, the tax is really the function of depreciation and also the R&D spend. R&D spend last year for VECV was very heavy because of the new product lines, next generation of products that we are building over there which will of course get launched towards the end of this year and going through next year. So that really is the function of that and that is why in Q4 it has come down a lot. On a quarter-to-quarter way, it really depends upon where we are spending and how we are spending. As per the plan, the numbers will move up and down but I will expect it to be at a fairly low level as opposed to last year at the VECV level. In EML which is a standalone company it also functions apart from these two things, also function of the FMP income. In the quarter that we have been recognising the FMP income or we are receiving the FMP income, the tax rate tends to be a bit lower because that whole income is tax free but the numbers will change.

S Chellapa: Royal Enfield had planned to commence commercial production in the new plants in 1st quarter 2013, and so is the plant ready and have the trial runs started?

Lalit Malik: The plant in terms of physical structure is reasonably ready; we are still going through the process of de-snagging the plant. Commercial production, even the trial production has not yet started, so that is still a few months away.

S Chellapa: Will it start in the 2nd quarter of 2013?

Lalit Malik: We should start by the 2nd quarter.

Moderator: The next question is from the line of HR Gala, from Quest Investment Advisers. Please go ahead.

HR Gala: Can you tell me in this calendar year 2012, what was our total capex spent in VECV and Royal Enfield?

Lalit Malik: 2012 VECV spend was about Rs676 crores to be exact and Royal Field standalone level it was Rs107 crores.

HR Gala: So that Rs150 crore which you mentioned is what is going to be spent in the next year 2013 or Rs150 crores includes Rs107 crores.

Siddhartha Lal: Rs107 crores has a lot of elements. The Rs150 crores is for the new plant, Rs107 crores includes some investments which we are also making into the existing plants, and so the overall investment you can say will be slightly higher than Rs150 crores because we have to make some investments in our engine line and couple of areas in the old plants as well. Of course PT investments are also over and above the Rs150 crores.

HR Gala: So till such time the commercial production starts for a Royal Enfield in the new plant, how much would be the maximum production we can get from the old plants? Like we already did 113,000 last year?

Siddhartha Lal: It is difficult to say really but we did last month. We again had an all-time high in January of 11,500 approximately and frankly may be another few hundred more we could probably do but I don't think there is much scope beyond 12,000 really left in this plant but then better than hitting 12,000 in Tiruvottiyur, the new plan should start kicking in as well.

HR Gala: How much would be the capacity of the new plant?

Siddhartha Lal: That is again a very good question because when we were planning the new plant a couple of years ago, we planned 150,000 capacity of new plant. Clearly, it is obvious that that in itself is not enough to take us through, and so we still maintaining that for the year 2013. We will hit and probably even marginally cross 150,000 units in 2013 but there will be a lot of activity already on to further increase this capacity. The paint shop is upgradable to a higher level of capacity. So now that we have actually a footprint on a new 50-acre area, the ability for us to be able to upgrade capacity is going to be much quicker and much cheaper than the first plant.. So getting the new plant up and ready, getting the land is always a hassle, getting permission all of that have taken a lot of time and getting let's say, the big infrastructure of paint shop up, after that I believe, we should be able to react much faster now to the market. In 2013, we will be working tremendously on ramping our capacity much further but we will give you further updates may be next quarter in terms of how the new plant is shaping up.

HR Gala: And in terms of demand you don't expect any issues in selling this 150k because we are virtually doubling the capacity?

Siddhartha Lal: Really anything can happen in the market so I don't want to take anything for granted but having said that, just to give you an example in January we produced 11,500. Our order intakes are much higher than that, and our order book is to the tune of 6 to 8 months of production and driving. So I don't think selling 150,000 in 2013 at all is a challenge rightly and we are adding new dealers all the time which means more orders are going to be coming in. So really, I absolutely don't see 150,000 as a challenge. Our challenge is the type of work we are doing in terms of demand generation. It's all basically for the 2014-2015 time horizon where we have the full capacity at full tilt, and with the new plants we would have added much more capacity by 2014 as well. So then we have to make sure that we are able to garner that type of demand. Most of the work is more for the 2014 time horizon.

HR Gala: What is the scope of the work in this JV with Polaris if you can elaborate?

Siddhartha Lal: Polaris is a leader in the power sport segments in the US but we decided that we will come up with a totally new product line in India which is unique. We are on the path to creating a new segment. This is in the personal vehicle domain and because we are trying to create a new segment and because of the type of work we are doing, we are not in a position to reveal much more about the exact segment, exact product because that would sort of defeat the purpose to some extent when we are entering the market. We are on track. The development is happening extremely well. Whatever research we have done, we have got excellent feedback from potential customers of that. We are on track to let's say, starting our production and sales in 2015. It is all going extremely well right now.

HR Gala: So right now we have invested Rs5.5 crores?

Siddhartha Lal: Yes from our share, yes, 5.5 crores.

HR Gala: I think I did hear that we have launched some accessories and apparels also?

Siddhartha Lal: In Royal Enfield, yes.

HR Gala: Apparels means?

Siddhartha Lal: In fact, most of the Royal Enfield launches apparel which is mainly riding gear, jackets and boots and helmets and also sort of stuff for riding but also some stuff goes just out of the riding domain like T-shirts and other stuff but it is basically all Royal Enfield branded and mainly meant for riding. You should look up our website and have a look on all the apparel is that we're selling and if you are in Mumbai you can buy some from the Bandra dealership.

Moderator: The next question is from the line of Chirag Shah from Axis Capital. Please go ahead.

Chirag Shah: The first question is on RE, Siddhartha. In your assessment, what is the opportunity size for product like that you provide on the Royal Enfield side? If you can help us and throw light because all of us are going continuously wrong on the potential that this country can provide to you? What is your latest assessment in terms of the demand potential?

Siddhartha Lal: Honestly it is very difficult to say Chirag because we are creating a segment in some sense because it is not an existing segment we are entering into. I can answer that question for heavy duty trucks because we know that there is 200,000 or 250,000 heavy duty trucks being sold but it is much more difficult in motorcycles. The way we look at it is that the two-wheeler industry is 13 million. We can keep growing for many years at the pace we are growing at and still will be the small players in the larger industries. I think there is a lot of scope to grow. There is a lot of work that we are doing to ensure that we capture customers who are wanting to move up the value chain, so may not stay static with our current product line-up or with our current strategy. There is a lot of work happening now that we have earned a lot, we have a lot of cash flows, we are able to invest in new products, and we are able to invest in different areas. On the one hand, I think it is really not that much limit to what we can accomplish in Royal Enfield. I think, the many more years of fast-paced growth which can certainly happen. Having said that, the upper end market in any segment once it is matured and that might take five years, 10 years, 15 years but once it is matured it is 5% to 10% of the market. It depends on how you cut, what is the upper end but even in cars over time you would expect that 5% to 10% of the market is the upper-end market. Even in watches you will expect that, even in computers or mobile phones you will expect that. So similarly you expect in motorcycles also at least 5% to 10% of the market should be the less price sensitive, more style, and performance-oriented markets.

Chirag Shah: Suppose 3 to 4 years ago when you were analysing the demand potential and planning yourself for the next five years and you sit down today, what are the changes or what are the areas where you have been surprised positively or which have caught unaware you in a big manner, which have thrown such a big demand potential?

Siddhartha Lal: Clearly we have been surprised positively otherwise we would have built the capacity for...

Chirag Shah: What led you to this kind of positivity? I believe even you were slightly surprised positively the kind of demand you are seeing, the kind of waiting list you are seeing despite increase in your capacity 4 times?

Siddhartha Lal: Yes, for sure. We believe we have decided many years ago that we will look internally and we will fix internally because really there is an intrinsic demand we believe for our type of products is we have to fixed the products, make it really beautiful, and make it work really well. We have to fix the distribution, fix everything else, and so lot of work till now has been internally. Now we have much more external focus in terms of how we are going about it. Basically it is the function of the external field factors has been of more disposable amongst younger people. There is no question about that. So, somebody who is one years, two years three years into a job, into a reasonable job right now he can afford a Royal Enfield which was not possible 10 years ago. But then 10 years ago, the brand also didn’t suit him because he thought it was nice but not for him. He thought it was for his father or his uncle but not for him. So, we made the brand relevant but now of course apart from like I said, all the new products and all the new things that we are doing, we have a viability of a dealership in a smaller town which we never did earlier. So, today we are able to actually get into a much smaller town than we used to get into earlier because even a small town today is selling 30 bikes or 40 bikes a month and that makes an extremely good proposition for a small business owner. As a result the franchise is getting deeper and growing. What the big motorcycle manufacturers went through 10-15 years ago in terms of their big distribution, let's say, their outreach as it were, we are now going through something like that. I mean, it is not exactly the same clearly but it is something like that because it is viable for smaller towns to have a dealership.

Chirag Shah: And any thought process and lowering the entry point in terms of pricing of Royal Enfield within the current offerings?

Siddhartha Lal: Nothing of a substantial nature, I can't honestly tell you right now because I don't know also that if there is some nonmaterial or marginal change in pricing.

Chirag Shah: It is on the new branding, new positioning may be substantial lower pricing?

Siddhartha Lal: One lakh starting point, Rs1 lakh in India is the approximate starting point. As of today we don't have a plan to significantly reduce that entry-level. Having said that, we certainly have plan to significantly improve our value and our offering over time at different price points that we are at. There is no question that we will continue to improve our offering tremendously. What you're getting for 1 lakh, you are going to get much more value for that always. So we are eventually in a competitive market and we have to make sure that we give an excellent value but obviously as you can see that people are seeing the value in our product but we will improve that.

Chirag Shah: Would like to understand both for RE as well as VECV, what are the extent of expenses which you are incurring for on asset which are yet to yield the benefit? If you can quantify that, how much they would have impacted your margins and how one should look at for next one or two quarters when you are in the transition phase when the new assets are yet to fully utilised?

Siddhartha Lal: Some of it is capital which we told you, last year the pace when the RE was around Rs100 odd crores. I can't imagine extremely different this year. It might be something in 2013 but a lot of which is happening in capex but let's say if we are growing at this pace that if we continue to get this type of growth clearly we will even continue to add more capex because of capacity but also there is a lot of spend in the next year or two which is going to happen in the new product pipeline. So, that is on the capex front. On the opex front, we have been under-spending in some areas in the past because till couple of years ago frankly, till two years ago, Royal Enfield was doing terribly at least not very well. We have underinvested in couple of areas and we are catching up in some of those investments but we believe the margins will continue to expand because our growth is still at a very good level. We are seeing margin expansion. There will be one or two lumpy investments. By and large I think big lumpy investment for us our products launches. When you see a product launch that the only extraordinary cost that we go through which is not on a regular means; everything else is by and large constant.

Lalit Malik: And this also depends on what kind of a company you are and therefore what kind of accounting policy you want to adopt. Product launch happened in last quarter and the benefit of which will continue to happen over the next two or three years at least. But we as a company given the call between servicing up to our balance sheet and taking it to P&L, we rather take it to P&L that is our general philosophy. Part of the stuff that has to belong to balance sheet of course, does belong to the balance sheet also but when there is a grey area we will rather expense it off.

Chirag Shah: And any asset capitalisation in the quarter?

Lalit Malik: Yes. Royal Enfield, you are talking?

Chirag Shah: As far as in VECV, engine plant must have been capitalised by now?

Lalit Malik: No.

Chirag Shah: It is still in the WIP stage.

Lalit Malik: Engine plant is still many months away and for sure will happen this year but is absolutely not capitalised. For example in Royal Enfield, anything that we are doing in terms of capital spent for capacity, quality, and a bit of R&D in the old plant has been capitalised.

Chirag Shah: But there could be pressure on margins for one or two quarters for you, that is the right way of looking at your Royal Enfield as well as VECV EBITDA performance for the next two quarters? There could be pressure on your margins for the next one or two quarters given the transition stage you are in because your other expenditures would be higher?

Siddhartha Lal: Well actually both the businesses behave very differently. VECV is really a function of the CV market now because as you know in January it had been further dropped. We have not yet seen the bottom that was in commercial vehicles and so that is behaving quite differently. There of course we are going more conservative on the cost structure and everything else. Having said that, still we are not sparing expenditure on a long-term objective in VECV. On Royal Enfield, I think, there was some extra expenditure in Q4; it will come down actually by 1Q of 2013.

Lalit Malik: And for the entire Q4, we haven't taken price increase either in VECV or in Royal Enfield. There were a couple of price increase that we have announced in this quarter in January and early February. Some of the benefits for the part of the quarter actually we will get, you will also see in Q1.

Moderator: The next question is from Shreenivas Rao from Deutsche Bank. Please go ahead.

Shreenivas Rao: Could you let us know that the Polaris product which you are planning, will it come under any existing vehicles norms? For example what happens for Bajaj where there is no quadricycle norm and that kind of had has impacted the launch in India, so that is the first question. The second one is on RE. Have you done any internal studies with respect to quality, reliability, those things which, I believe, would have been improved but any comment on that perspective will be helpful say, warranty cost trends? And third will be on your product palette in VECV. Can you throw some light on what is existing and how do you see it move forward over the next two years? This is obviously in the context of the newer Prima range from Tata Motors and some newer versions which are coming from Ashok Leyland. Generally we are seeing our kind of leg up in the product palette for other competitors?

Siddhartha Lal: Polaris, we have products that we are looking at. We are confident that there will be no problem as far as the classification of the product is concerned. So, obviously we are working on it also but we don't see any problem on classification, number one. On RE, two points on the quality and warranty front that you have talked about—warranty is trending down sharply because of improvements in our product and quality and there will certainly be in our opinion a further bump up with the new plants because a few of our problems especially on the rework front and other such things used to come with our old paint shops, really very old in Tiruvottiyur. So over time that will in fact, cease to happen and many other improvements that we are doing on frames and quality and all of that will start kicking in 2013 itself. So we are very confident that on all those areas. We should have dramatic improvement which will result off course in better customer services satisfaction, low warranty cost, low rework rejection and we're tracking those extremely sharply to ensure that we are actually able to, let's say, derive those into our P&L as well so that is on RE. On VECV product line-up, on Eicher truck and bus side, our product line-up has been in the works for many years now. They are extremely exhaustive product line-ups that is like I said starting at the end of 2013 going through 2014 in to 2015, starting from 5 tonne going all the way to tractors trailers, every single products in our lineup over the next, we are starting end of 2013 for two years, every single product will be absolutely brand new from scratch. Our buses will also have same upgrade. Having said that, our focus is always on relevant modernisation. We make sure that it is extremely modern but relevant to India. We make sure that cost structures don't go through the roof. We make sure that the value proposition which Eicher is being able to give tremendously, especially in terms of better turnaround time, better payload capacity, reliability all of that, fuel efficiency is our number one criteria so over all those we will further enhance with our new product line-up. Already we believe in the product front we are ahead of competition in most if not all product areas. Our weakness has been more in, you could say in muscle and distribution and all of that in the past but now a lot of those opportunities are very much under our grip. So product-wise, I think, we have an outstanding future as far as VECV is concerned. We have really worked on it tremendously and we are extremely bullish about what type of products we're going to come out within the next 2-3 years from now.

Shreenivas Rao: If I have just follow on this product issue is, right now the primary range is sub-12 tonne at least the volume numbers, do we expect that mix going forward? I mean the commentary which we hear is that the 16-tonne trucks are the ones which are now the big sellers in the markets. So in that context could you throw some light on that? And finally, one request, is it possible to get VECV financials on a quarterly basis because you could appreciate that drives a lot of equity value for the company.

Lalit Malik: No, numbers on the quarterly basis you can't have but we do publish as per the requirement of the stock exchange. We do publish on a half-yearly basis, the number that you're seen and the format that you are seeing right now.

Siddhartha Lal: We do give consolidated and standalone?

Lalit Malik: Only the P&L part of it.

Siddhartha Lal: So you're talking about P&L or balance sheet, we didn't understand?

Shreenivas Rao: P&L.

Siddhartha Lal: We actually have that because only you have to do is minus the EML consolidated, P&L stand-alone and that is exactly VECV. There is no other subsidiary or anything else. On the product front clearly, I mean for us, 30% of market share in 5-15 tonnes as it were is obviously extremely important for us. There is a lot of evolution and new product coming out in that range but of course in order to accomplish our ambition, we will have to fully crack the heavy duty market which, every year in the last 3-4 years, you have seen we have been actually gaining 1% market share. So from 1% to 2% to 3% now last year full-year 4%. Last year we have already tracking at 5% plus, and so it gives us hope that we can continue to increase in fact, even at a faster pace our market share growth and a lot of that evolution, we expect after the next year will also come from a new range of heavy duty trucks. So in the rigid segment which is 4x2, 6x2, 8x2, we have a full new range of trucks coming out. In the tipper range which is 4x2 and 6x4 tipper also there is a lot of work and also in the tractor trailer range. So there are new products coming out across the board in heavy duty as well as light and medium duty in the coming year, and so I can't really say. The focus is different because really over the two years horizon we will have renewed our entire products range. Having said that, the largest gains we believe we can make is certainly out of heavy duty and the fine tuning that we have done from our existing products to a new product range in heavy duty will be that much more because already we are best in class in light and medium duties. So we are now pushing to become best in class in heavy duty by such a large margin that actually when we have people, customers moving to us much faster and so there is a lot of work going on that.

Moderator: We will be taking the last question from the line of Amrish Mishra from JM Financial. Please go ahead.

Amrish Mishra: Can you just update us on the engine project whether there is any change given the domestic slowdown and the slowdown in the European commercial vehicle markets? Is there any changes in this strategy and if not can you just revisit us through the project details in brief?

Siddhartha Lal: There is no change in strategy, if the demand is marginally less then that means we will make slightly less but there is no such indication as of now from the various constituents who are going to take this engine. A lot of the engines are going into existing products and so it is not like the new product which we are banking on for these engines to sort of coming through.

Clearly in the swing of commercial vehicles, could there be a marginal impact? Yes, by the time actually these engines are well and truly established in the product ranges that we're talking about, it is going to be over here from now. I very much hope that the CV cycle is back in upswing. So, I don't see that at all as an issue because the initial orders that we are going to be serving those will not be changed at all, so that is number one. The plant is in the advanced stage of let us say trial runs and production. Most of the capex is already been done and booked and now we are getting into these operational phase really of that engine plant.

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

Ashvin Shetty: On behalf of Ambit Capital, I would like to thank the management for giving us an opportunity to host this conference call. Also, I would like to thank all the participants for joining the call. Thank you.

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