"Eicher Motors Limited Q1 CY13 Earnings Conference Call"

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Moderator Ladies and gentlemen good day and welcome to Eicher Motors Limited Q1 CY13 Earnings Conference Call hosted by Motilal Oswal Securities Limited. As a reminder for the duration of this conference, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. At this time, I would like to hand the conference over to Mr. Jinesh Gandhi of Motilal Oswal Securities. Thank you and over to you sir.

Jinesh Gandhi Good morning ladies and gentlemen. On behalf of Motilal Oswal Securities, I welcome you all to the Q1 CY13 Earnings Conference Call of Eicher Motors. Eicher Motors is today represented by Mr. Siddhartha Lal – MD and CEO and Mr. Lalit Malik – CFO. We will start with opening remarks from Mr. Lal followed by Q&A session. I would like to hand over to Mr. Lal, over to you, sir.

Siddhartha Lal Good morning everyone and thank you Jinesh for arranging this teleconferences with our investors and analysts**.** I am very happy to join the call and along with the CFO – Lalit Malik and share the update on the sales and the financial performance of Eicher Motors Ltd. for Q1 which is in our case January to March 2013. I will start with the update on sales volume for various segments of commercial vehicle industries and then comment on the performance of our business which is VE Commercial Vehicles and Royal Enfield. So getting into the commercial vehicle side which is of course represented by joint venture - VECV. At the industry level we continue to see a significant pressure on sales volumes in the 5 ton and above segment. In Q1 2013 with is January to March again, the segment recorded the sales volume of 91,837 units which is a decline of 31.2% over the same period last year, so that is still a very large decline and the industry is still falling sharply. Eicher trucks and buses which is a division of our joint-venture, VECV on the other hand did much better than the industry which resulted in an improved market share across all of our segments. The total sales volumes for the quarter were 12,388 units which was 12.7% lower than the Q1 2012 versus a decline of 31.2% in the industry.

So now getting to segment wise performance - In 5 to 14 ton range of trucks that is light and medium duty , we sold 7639 units which is 16.9% less than what we did in Q1 of 2012 versus the industry which went down by 19.5% over the same period, so we marginally improved our market share to around 31%. In the 16 ton and above segment which is the large focus at VECV, which is the heavy-duty segment we sold 2109 units in Q1 2013 which was 7.9% lower than the same period last year whereas the industry declined by nearly 38% and therefore we increased the market share from 3.3% Q1 last year to 4.9% in Q1 this year, so it is a strong increase in market share.

In buses we had another exceedingly good quarter. In Quarter 1, 2013, we sold 2188 units, a growth of 7.1% where as the industry actually declined by 18.7%, so our market share as a result has grown from 9.3% to 12.3% this quarter. Exports have been sluggish for both the industry and for us in Quarter 1of 2013, we did 452 units which was lower than last year by 32.7% whereas the industry declined by 46%.

Our Volvo trucks division continues to be the market leader in the European truck segment and did relatively well in Q1 with 141 units in the quarter which is a growth of 50% over last year which was a very weak quarter in fact last year Quarter 1. So given the circumstances I believe we had a very good considering the CV segment, I believe we have had an excellent performance in VECV where we have grown across-the-board, we have grown in every single area which is light, medium and heavy duty, we have grown in market share and not in volumes necessary but in market share we have grown and we have come out stronger. Of course we will talk about the margin today where in terms of how we have been able to hold to those.

But before we do that we will move on to Royal Enfield which has had an another absolutely best ever quarter once again, so Quarter 1, 2013 we had record sales of 34,736 units which is a growth in unit terms of 45.3% over

Q1 of last year. We hold Q1 within an EBIT 15.9% which is record at Eicher Motors and so it is a growth of 80% over the last quarter which is Q4 of 2012 and almost 100% growth from the same quarter last year, so it has been a lot of operating leverage we have been able to bring out. We have also started commercial production from Royal Enfield Oragadam plant on April 30th and this is a big landmark for the company as we have been pushing our old manufacturing unit to its limit and this new plant obviously set us up for the next level of growth. We plan to produce 1,75,000 motorcycles which we have upped our capacity as it was for the year, deliverable capacity for the year from what was originally envisaged as 1,50,000 so that is 1,75,000 for 2013 calendar year. 2014 we plan to take that further up to 250,000 and this plant will be able to give us in excess of or in the range of let us say 500,000 motorcycles a year at its peak. And of course we are also working on this plant that will help us in improving our productivity, improving our quality and various other things and it also gives us a potential to develop new product platforms and other such things, so this is now our future which we are very excited about so that is on the Royal Enfield front.

Our partnership with Polaris which is the new JV we have started is progressing well, the project timelines are on track for our product which we are planning to launch in 2015.

So overall we continue to make progress on all key projects across the VECV, across Royal Enfield, across Eicher Polaris. We continue to invest for the long term in each of our businesses particularly a lot of those now are on work and all the plans and other thing are on track. The new products in our commercial vehicle are due to launch by the end of this year through 2014 and into 2015 and we are focusing on brand distribution, other aftermarket business developments and other infrastructural areas in commercial vehicles but also similarly in motorcycles. And in particularly in VECV, our medium duty engine products which is an enormous frontier for let us say an enormous challenge we took up because it was the first of its kind Euro VI engine production in any developing country in the world is now ready starting to deliver engines to the European plants of Volvo. The bus body project is also going extremely well and along with all other projects, they are very much on track.

So if you move on to consolidated financial results-We have had a marginal increase in our top line so the total income has grown from Rs. 1668 crores to Rs. 1724 crores. Our earnings before interest and tax have fallen by 12% from Rs. 162 crores to Rs. 143 crores. Our EBIT percentage is down from 9.7% last year Q1 to 8.3% as a result our PAT is down from Rs. 163.4 crores to Rs. 132.8 crores. Having said that, I believe with where we are in the cycle of commercial vehicles which is absolutely at the bottom of the cycle, I believe an EBIT percentage of 8.3% is absolute phenomenal it reflects the type of work that we have been doing in terms of investing during all phases of the cycle and being able to grow our market share profitably and I think that is the most important factor in VECV and overall of course Rs. 1724 crores at the top line also happens to be our highest ever quarterly total from operations at EML, so even in a down cycle we were able to through a combination of our businesses, we are able to post our highest ever top line and yes, of course what we have also seen is that the 8.3% EBIT is, one, is due to the very strong performance of VECV because of being able to do well in the downs cycle but of course the kicker is really come from Royal Enfield this time where we have been able to extract the operating leverage extremely strongly because it is a 100% growth in EBIT over last year, so that has been extremely strong with in terms of operating margins as well as operating leverage as well as good cash management. So that is just giving you a brief overview of what happened at Eicher Motors Ltd. in the last quarter, so now I will leave it up to all of you for question and answers. Thank you.

Moderator Ladies and gentlemen we will now begin with the question and answer session. Our first question is from Pramod Kumar from IDFC Securities. Please go ahead.

Pramod Kumar My first question pertains to your HCV**.** You continued to outperform the industry in a big way even though you do not have a captive financing arm, so just wanted to understand what has been the general feedback in terms of from the existing fleet owners, so in terms of quantifying as to if you can explain how much of your HCV sales are currently repeat orders from existing fleet owners and also how is the delinquency on the portfolio shaping up because it has been since January 2010 we have been selling these rebranded trucks, how has been the delinquency of some faced by banks so far? And also are there any financing subventions which you are providing at this point of time to the bankers?

Siddhartha Lal Yes, our heavy duty is outperforming and but again we'll talk about it more when we have when we are getting to our target numbers which should be in the next couple of years. The 5% market share that we have been able to publish is still out of I would say a 50% reach or effective reach that we believe that we are getting in the industry, so it means that there are a lot of uncovered markets and segments that we are still working on extremely strongly. And basically that is going to results from better distribution and better financing and better aftermarket in newer areas which we are opening up. Having said that we have very strong relationship with all the financers, we have dedicated teams in house, so it is only working on making sure that our relationship with the financers are working well. Till a few months ago that is six months ago from the new VECV range of heavy-duty trucks, there had been no delinquencies since our launch in 2010, of course with the economic condition worsening right now the delinquencies have started and they are increasing as it were as we speak right now. Having said that our portfolio which is the Eicher heavy duty portfolio from a financier's delinquency angle is by and large I would say healthier than the other commercial vehicle portfolios. So that is what is no alarm or concern for us but of course as a general trend the with the economic condition as they are, with transportation and logistics coming down to some extent in certain quarters and certain and end use segments, there have been some delinquencies in the market but that is the absolutely in the normal course of things. As far as the subventions is concern to the financiers your question, clearly there are case to case basis of subventions, there are case to case there are discounts are in the market that we give, that the competitors gives, so overall there is but any subvention that we give, any to the financials or anything whether it is any form or the other it is all accounted for up front as we sell the truck, so there is no futuristic liabilities in the balance sheet whatsoever, it is all up front accounted for and overall we believe we are still doing well on that course, so as you can see from the operating margins of VECV as that rarely while we had also having to play it as a 5% market share player we have to play in the market in terms of discounts etc. we are not certainly immune to that at all but overall we have been able to keep our operating margin at a very respectable level I would say with the type of fall in volumes which is happening and that I think it is a combination of being able to increase market share and maintain healthy operating margins that’s what we have been able to look up this but I believe a strong outcome from all of these, so we are actually quite pleased with the situation even with the financiers, the financers we work closely and we see that there is no cause concern, again the HV market does not seem to be making a phenomenal comeback any time soon, so I think we have to ride out, at least a better part of 2013 but hopefully by the end of it things should start improving.

Pramod Kumar And second question on buses basically that again has been a fabulous market share ramp up for us and I think if you can just explain how much of this is led by incremental gains with the STU pockets and also if JNNURM-II to how do we stand because we could not participate in JNNURM-I, so how do you participate in JNNURM-II and whether we also are going to be doing annual maintenance contracts which has been haunting some of the players under JNNURM-I? So what would be your strategy for these set of orders and that for JNNURM-II?

Siddhartha Lal Buses has been a great story for us and in fact the story should further improve once we get our new bus body plant, so of course that will also take ramp up time to our new bus body plant is on its way. Largely we are still in the retail market which is better remunerating than STUs, having said that we have won some strongest STU orders as well in the past and those orders are also being fulfilled. However our focus currently is more on the retail side of the market.

Moderator Our next question is from Sanjay Doshi of Reliance Mutual Fund. Please go ahead.

Sanjay Doshi I have a couple of questions, first on the two wheeler business; the current quarter has given us a good glimpse of the potential of this business. Can you help us understand a bit more about the true potential when you said that the facility can do 500,000 per annum kind of volumes, when do we expect that and what kind of margins can we look at for this business if volumes scales up to that level?

Siddhartha Lal Royal Enfield business' true potential is difficult to describe, it is on consumer discretion so I would say it is more up to us in terms of how we can further evolve, create the brand and create the demand as we have clearly been doing in the last couple of years. Now on one hand our supply bottleneck is getting opened up and I will just talk a little bit more about that. On the other hand, the supply bottle neck is getting opened up because due to the Oragadam plant and due to all those work that we have been doing in the last year with suppliers, so that is one major initiative that we have been doing. Now beyond that what is happening that in the shorter term we are adding a huge number of dealers across India, so the Indian story is playing out strongly over the next 12, 18, 24 months as we see it because the brand is moving because people are in some sense also waiting for the bikes etc. that further fuels demand, so right now there is a very positive cycle which is going in the Royal Enfield story in the domestic side. So the potential is really a bit further out as long as we continue to do the right thing and all the activities that we are accomplishing. I believe we still have some growth left because at the end of the day we are still 1% on the two wheeler market so probably not even that, so the potential is much higher in my opinion. Of course, if you look at the longer term we have been talking about and we are working on an international play in motorcycles, so currently a big growth is coming only from domestic, in future it will come from international markets as well. So we believe we have the potential, we believe we have the right brand and the right positioning and the right strategy to make us the largest global players in mid size motorcycling which is the great task ahead of us over the next five, eight years, so we are working on that potential to become the largest in the mid-size market. Of course as we rise the 500,000 or the five lakh per annum volume which you asked about is what is let's say this physical location can deliver but we are already like I said, have already invested or already starting the investments in phase 2 of our Oragadam plant which will take us to 250,000 and we continue to push hard on our industrial abilities so that we can continue to rise as fast as the market is demanding. Having said that we have to ensure that we are improving our quality, we are improving our productivity in the same time, so we have been able to grow 50% per annum so far, we expect to grow 50% in terms of our capacity again this year but I don't think the pace is going to be any faster than that because we had to take our entire supply chain along with us. As far as margins are concerned, we don't give any forward-looking margins so I can't tell you that it is 500,000 what will the margins looks like but that's really up to you to figure that one out.

Sanjay Doshi If you can just help us a bit more about the engine plant, you mentioned that we have started deliveries so can you help us understand a bit about the scale up plant for those facilities and second is what part is already capitalized and what will be the further CAPEX for that particular business?

Siddhartha Lal Right now we are in preproduction phase as it was, these are test engines which have gone to France and they are being installed in vehicles etc so these are still preproduction engines. By the end of this year we plan to sell 10 production lots that means as far as series production what is called we are plan to sell series production by the end of this year and of course as we said in phase 1 which is ramping up, starting end of this year through 2014 and into part of 2015 we expect to do around 25,000 that is the big investment that we have done in phase 1 but then of course we already have phase 2, phase 3 which will take us all the way to 100,000 those are already in the pipeline and we will be triggered as soon as we start seeing the numbers coming in, so we said these are replacement engines, so there is a captive market as such in Europe. As the installation starts in certain models, as the norms kick-in in the different countries in the world, the pickup of these engines will happen over 2014-2015 largely.

Sanjay Doshi The CAPEX part of it, how much is already capitalized and what would be the CapEx going forward?

Lalit Malik Like I said the for overall capacity of 100,000, the total CAPEX will be above Rs. 500 crores but obviously not of the whole sum has been spent so far, so for the initial phase of 25,000 we expect, and the sales of phase 2, phase 3 there will be some part of CAPEX that will have to be done upfront irrespective of the phase, if you take that into account also but for this level of capacity that we have spoken of the ballpark number we have is about Rs. 300 crores.

Sanjay Doshi What is capitalized as of now is there anything capitalized?

Lalit Malik Yes, everything has being capitalized as of last calendar year itself.

Moderator Our next question is from Ashish Nigam of Antique. Please go ahead.

Ashish Nigam Just one question on Royal Enfield, with this new RE Plant coming on stream just want your view on RE margins in the near-term , like I know the cost benefits on paint shop etc. but could there be massive operating deleverage in the near-term? I know you do not give guidance on margins but just directionally?

Siddhartha Lal The EBIT margin in EML stand-alone has gone up to now this quarter 15.9% and if you look at the EBITDA margins it is 17.7%. I mean, certainly there is no massive deleverage, I'm certain about that but again I can't comment any further on margins that are coming few years so of course it is positive effect because of volumes which are going up, so there is a leveraging effect because of that but there is no massive deleverage, of course there will be some considering in running two plants over the next year that means our paint shop will be running both in the Oragadam and in the new plant and there will be some other duplication happening over the next year. There will be some additional cost which will be run before we fully switch over our vehicle assembly and paint shop to Oragadam. So engine machining, engine assembly, plating and another couple of smaller functions will continue on the old plant in the foreseeable future and that is the plan but till the time everything switches over to here there will be some additional cost which will be incurring but nothing outstanding or nothing extremely large let me put it that way.

Ashish Nigam Also with the engine project, is there any roadmap on how the eventual capacity of 100,000 engines would be divided between VECV and Volvo globally?

Siddhartha Lal Sorry Ashish, we don't have a exact number to give you, certainly to VECV heavy duty trucks will be taking these engines and like I said there is already a global captive market in some sense which is also growing for Volvo group in terms of their trucks and buses and some other applications for which they are going to use these engines but we don't have an accurate split-up that we give you for 100,000 numbers in terms of how many are going to be retained by VECV and going to Volvo group.

Ashish Nigam Could you now throw some light on in terms of the Polaris JV in terms of what kind of products segments etc?

Siddhartha Lal Yes, what we have announced till now and what we are sticking to right now in terms of disclosure is that this is a personal vehicle category, small personal vehicle category and so that is all we can talk about it at this stage. If the project is going extremely well it is an innovative segment that we are getting into and it will what we have talked about earlier is that we will see the product on the road in 2015 and we still maintain that date, we still maintain the segments that we are going into and that is all we have for right now.

Ashish Nigam And the investments so far has been on the Polaris JV if you can just run us through again?

Lalit Malik This SOB is going to be both parties put together about Rs. 250 crores, our share will be half of that.

Moderator Our next question is from Hitesh Goel of Kotak Securities. Please go ahead.

Hitesh Goel Just wanted to get a sense more on the Royal Enfield business, can you give a sense on the distribution presence of Royal Enfield? How do you want to take it up and what is the share of top 10 cities in the sales and all, can you give some color on that?

Siddhartha Lal We have approximately I would say in excess of 260 dealership in excess of our CV and motorcycle numbers very same and distribution I get confused but we are in excess of 260 dealers in India I'm talking about firstly. There are adding approximately 5 to 6 dealers if not for per month now, so there is an extremely strong pull coming in from mid size cities and towns right now for our bikes so we are adding good dealers across the country. So I would imagine that this year and 2013 we should be adding around 80+ dealers as it were and that they should continue for some time. I do not have an accurate number but what can say is that Royal Enfield is very much skewed towards the city markets so I'm sorry I do not have the numbers so I'm just guessing here but I would imagine that the top 10-12 cities in the country and if you include the larger cities like NCR and Greater Mumbai, etc. I imagine would be contributing maybe even up to 50% of our entire volumes if not more, so it is very much now the move will happened towards the city type of brand behavior and that is going to continue to increase in some sense because we're improving our presence in the top cities tremendously and the markets and type of customers who are buying us are very much sort of the urban customers nowadays, the urban young and middle and upper-middle class customers so it is a very good consumer group that we have and it is going pretty well in our opinion.

Hitesh Goel I was looking at 4 to 5 quarters the ASP on the standalone business has not changed much but your margins used to 14 or 15% for the past few quarters has gone up to 17 to 18%, is there a raw material benefit out there in this quarter which has boosted margins or how should we look at it?

Lalit Malik If we look at ASP, we took a price increase of course in February this year which is two months prior to this but before that our ASP, you are right I am missing the last increase where the increase they took was in June last year or something like that, so last few quarters the ASP would not have moved apart from the 1% price increase we took in February so as far as the really the fact that the material costs has held on pretty well, in fact this quarter that we reported if you look at the numbers we reported it is less than 64%, so that is held off pretty well for us and product mix is beginning to happen, so once the new capacity is firmly in then of course the full benefit of products mix will also be visible to you.

Hitesh Goel Generally when the capacity is increased you tend to see product mix shifting towards the lower end volumes because your volumes tend to increase, do you see that trend or do you see maintaining these ASPs going forward?

Lalit Malik What we see is there's no problem in maintaining the ASPs at all going forward.

Moderator Our next question is from Srinivas Rao of Deutsche Bank. Please go ahead.

Srinivas Rao First your Polaris vehicle wouldn't need any new norms like we have seen some kind of road blocks for Bajaj's Quadricycle that is number one? Secondly, on your Enfield, two questions how are you placed with respect to any change in the emission norms likely in the next two years and related to that how many service points are there, your dealership you mention are all of them do include service points?

Siddhartha Lal In the Eicher Polaris joint-venture we are not dependent on any new norms for selling our vehicles. On the Royal infield side we are totally geared up for any machine changes, we are already supplying to most stringent emission norms to Europe and California, so in fact we were the first I would say Indian company in the world selling vehicles in California which is the toughest market in the world, so we are absolutely equipped to do that and in fact it gives us a lot of confidence because we are already supplying to those markets when we have that we have learned to make those engines. And service points firstly the 260 numbers all have service points along with them and then there will be some additional authorized service points which are in addition to this 260 numbers. I do not have an exact number in front of me but to answer your question all 260 of these have service points and in fact if you just as opposed to these numbers, what is the better to talk about basically, what has happened over the last year or two is that we have increased the capacity and service tremendously. So because of the new vehicles that we are selling, earlier in fact a year and a half I would say that there was also waiting period for getting a bike serviced which is certainly not okay in our eyes, so we worked tremendously on improving our number of days, on number of technicians, on the quality of technicians all of that tremendously over the last 1.5 as a result today in most places you can call up and within a day or two you can go and get your Enfield bike serviced so the capacity of service now absolutely up to the mark and it is growing commensurate with the business, so there is no issues in the market in terms of service capacities.

Moderator We have the next question is from Pulkit Singhal of Treeline Advisors. Please go ahead.

Pulkit Singhal Firstly on the dealerships side given that you have 260 dealers and you already have 6 to 8 months waiting pipeline, adding so many dealers every year, would not that just sustain your waiting period at each dealer because your supply is not really increasing as much?

Siddhartha Lal That is a very good point and I think we have also asked that enough internally, the real issue around that is that we are also setting ourselves some upwards even higher volumes in the future, so as we are increasing our production capacities and there is an intrinsic demand in smaller towns it takes a dealers certain amount of time to set up, to start work, some places we are first asking for the first few months to do only servicing of motorcycles in his catchment area and then we would only give him the sales franchise, so we are working on various different models and also limiting the number of bikes in some of the new dealerships, so we do not come in and sort of appoint a new dealer and say look you can get as many bikes as you want, we will say that look you can get only ‘X’ number of bikes this year and moving forward but we want to get in there and we want to go deeper, we want to get into smaller towns, there is a potential, there are people who wanting our bikes, we’re going to increase our capacity, the capacity constraints it has been happening for a while but I believe in the long term and in automobile type of business that is not going to be the constraints that we have been making the bikes, the constrained will always be front end in capturing customers, so when we have an opportunity we will go for it but what is happening is that some of those customers are anyway coming to the cities and they are booking bikes, so it is not that they are not doing, so they are just making it more convenient for them. So overall we believe that it is the right approach even though I would even say our 6000 numbers a month that we are adding and also restrain in terms of dealerships, so if you see how some of the other two wheeler companies boom in 90's and early 2000 it was much faster than that I'm not saying that we want to follow their model of distribution but certainly we can be much deeper than what we are today, I meant 260 points of which in a typical big-city we have 10-12 points, so a lot of the effective number of points just go in the big cities alone.

Pulkit Singhal There are some data points on that you mentioned I think how fast you can try to ramp up to 500,000 and also like how many dealers do think you want to reach say in 4 to 5 years from 260 currently? And also what would be your exactly your export strategy and what is the market size potential of that mid-size bike that you mentioned globally and how many dealers are you going to add for that?

Siddhartha Lal Sorry I do not have an exact number on number of dealers that you want, right now we're just talking about pace of dealer addition which is I would say 5 to 7 a month and that could also grow, so of course we believe that if we are able to ramp up the capacity even faster then we find that there is room for further growth then we will start adding more than that many dealers but for the foreseeable future I see for the 12, 18, 24 months' horizon we should be adding I would say (+6) dealers a month that is our current pace of growth.

The exports – we do export to 40 countries but that only account for 3500 sales last year, largely our exports are in US, UK and Europe and in such markets which are of course extremely important market for us and will continue to be important market for us but if we see that we want to become a major global players in mid-size bikes then I would say that bulk of that international growth will probably come from emerging markets growth, so it means some markets in Latin America and South-East Asia and perhaps in Middle East and North Africa those kind of markets where there is already a situation of commuter motorcycles like in India where people want to upgrade to something very interesting and a bit more rocketive motorcycling, a bit more brand led, so right now it is very early stages of our international strategy, it is more an intent that we're talking about from a more opportunistic export strategy we're going to go and this is a point that we shift to a much more strategic international approach where we are looking at investing in markets, we're looking at really getting into details, really getting into all those usual marketing price points, positioning and the distribution and the product update and everything else, so there is a lot of background work going on but I think it is still a few years before it sort of flourishes, we're going to do a lot of experiments in different markets, we're going to fail in some, we're going to succeed hopefully in some and then we can replicate those and others, so I believe this is our next phase of growth. I would say it is a more 5-Tier type of strategy that you should hopefully see a significant change in our in the profile of Royal Enfield in the five years' time but it is that type of timeframe that we're looking at. Mid-size bikes we are trying to get numbers on actually if you look at it globally there is above 250 cc motorcycle market we estimate to be around 1.7 million motorcycles out of the total 54 million motorcycles, so the bulk of motorcycles globally are 250 and below. Out of the 1.7 million we estimate give or take 900,000 to (+1) million motorcycles being in the heavy-duty segment which is described differently in different countries but let us say above 650 cc, so that leaves us around 700,000 motorcycles in the mid-size market space globally and so we have already a reasonable player there and we expect to be this year our ambition is to become number one in this segment and of course even grow the segment because in itself 700,000 mid-size bikes in the world are not big, we believe that this market has been largely underserved because most of the global let's say European and American players focus on bigger bikes, most Japanese and emerging market players focus on smaller bikes in fact Japanese also of course have a across the range but as a result of this has been ignored, underserved market but we see that in emerging markets people coming up to this type of market from smaller commuter bikes and in developed markets we see a trend downwards that means people who have had big bikes now either from a affordability issue, from a speed and risk issue and urbanization issue because of the urbanization trend in all developed markets people won't necessarily need 150 hp motorcycle any more or a 100 hp motorcycle any more so they are looking at let us say mid-size options so we believe that the world is hopefully over time is going to convert into mid-size bikes and we should be at the right in the thick of that.

Moderator Next question is from Ragu Nandan of Asian Markets Securities. Please go ahead.

Ragu Nandan I had three questions, first one is with reference to your Royal Enfield there was some media report stating that there is a contemplation of entering into 250 cc segment, any comments on the same? And on VECV I had two questions, one is, you had mentioned for the heavy duty you had a 50% effective reach, what are your plans to scale up on the same and thirdly specifically with relation to result, the raw material cost to sales seems to be lower in the VECV, what would be the reason for that would it be mainly product mix?

Siddhartha Lal I will take the first two questions and I will ask Lalit to take the last one. On media reports of 250 cc segment there is no truth in that as it were because it so happened that we're talking about mid-size motorcycle market that we're interested in which if you look at the classification in most countries in the world, mid-size that is global at International Motorcycle Manufacturers Association level, the classification and we believe is from 250 to 650 so we are talking about leading in that segment so therefore there might have been some talk about it but we have got no intention to get into 250 as such as of today, number one. On heavy duty, yes, we have 50% effective reach today which means if you look at our available dealers, available financing, available after market, available end due segments which are appropriate for us, etc., so there is a lot of different criteria is that we look at for effective coverage where we are selling in reasonable numbers, that is 50%, which basically means that those are the issues that have to be covered in order for us to improve our reach, so firstly and most importantly we need to have an effective dealer that means a good dealer who understands heavy duty, so that the number one. Number two is that we have to have in all the routes which the customer in that area are taking, we must have effective aftermarket which means service, spare parts and service points on the different highways which are serving that catchment area of customers. Then we must have number of financers who are financing our heavy duty trucks in that geography. There are certain geographies which financers blacklist or certain geographies which do not finance certain brands in, so we have to make sure that we have been financed in those markets otherwise no one is going to buy a truck, so we are going about it systematically and we are increasing our reach overtime, and we have been doing a very effective job last couple of years I would say from 30% we have gone up to 50% and we plan to improve that also in the next year or two at an increasingly good pace and of course on the other hand our new range of trucks which is due out this year, so these are the I would say the main points around that.

Lalit Malik Raghu, you have question on the material cost in…

Ragu Nandan Yes sir, in the subsidiary the material cost seems to have decreased on a YoY and QoQ basis, would that be due to product mix?

Siddhartha Lal Largely due to product mix because if you look at Q4, 2012 our Volvo trucks, we did about 193 Volvo trucks, we sold about 193 Volvo trucks that is opposed to this quarter we did 141, so there is almost a 26.9% decline in the Volvo sales itself, so that is largely the fact, apart from it if you see the other shifts in the product mix, buses are much higher now, they grew almost 60% over Q4 last year and so that is really the couple of product mix issues over there.

Ragu Nandan On the dealer ramp up, how are the targets on the CV side? You mentioned it is currently around 250, if I'm right?

Lalit Malik Yes, around that number.

Siddhartha Lal There we are not adding it in such a fast pace but we are certainly adding a few dealers in CV also, it is around 40 or so we are planning to add this year. And there of course, each individual dealership is much larger with a much-much higher investment in the truck front so it is a very different profile of a dealer as it were and there really a lot of work going on and also upgrading some of our dealers for heavy duty, so like I said around 50% of them are at least from a market perspective, 50% of a market is covered with effective heavy duty dealers but now the other 50% of the market has to be covered. So there is a lot of qualitative and quantitative work going on in dealership in our truck business where we are upgrading a lot of our existing dealers also to serve heavy duty trucks better but also buses because the similar formula applies to buses where some of our dealers are not very well equipped to serve buses, the servicing on buses, you may argue rightly even more different from servicing medium and heavy duty trucks, so their body panels, other such things so with upgrading all of our dealers to serve heavy duty, to serve buses and we are adding maybe 40 more dealers this year.

Moderator Our next question is from Sanjay Dham of Motilal Oswal Securities. Please go ahead.

Sanjay Dham I just have a couple of questions on Polaris and VECV, one, Polaris has high end bikes as well, so is there partnership is going to be extended to that part of the product portfolio as well?

Siddhartha Lal Simple answer is no. No plans as of now.

Sanjay Dham And the second question is when the engine JV was thought about the INR-dollar was at least 15% lower than what it is right now, so how does the profit sharing happens on the Rupee depreciation between Eicher and Volvo, can you give us any indication on that?

Siddhartha Lal Sorry again, I can't give you any indication, we have a very detailed contractual way which we are going to price the engines to Volvo and it includes appreciation, depreciation because it could happen both ways so we want to make sure that we have covered. So overall there is a formula which works well for both VECV and for Volvo Group and we are very happy with that but I can't give you any granular details on the contract in terms of how we are going to do the pricing.

Sanjay Dham So would it be fair to say that majority of the contract formula would be cost-plus kind of contract?

Lalit Malik Cost plus that is what I am going to use beyond what Siddhartha has said we can't talk more.

Siddhartha Lal Because it is part of the JV it is 100% transparent, the contract is very clear and Volvo and Eicher jointly own that JV equally so there is a full visibility, transparency into the financials and obviously basis that we have got transfer pricing formula so it is like an arms length business but I believe both parties will benefit well from it.

Moderator We will take our last question from Basudev Banerjee of Quant capital. Please go ahead.

Basudev Banerjee In VECV this tax rate has moved up considerably, is it just because of the surcharge change or something one-off in that?

Lalit Malik No there is no one-off in that, surcharge is number one of course, it is not a very large amount by the way for both the businesses but I think the other bigger issue was the Q1 versus the Q4 as for the financial year is concern the whole towing up a tax estimates and provisions and so and so forth happens in this quarter. So how much of capitalization we did, how much of R&D spend we did and so and so forth is all kind of buffered in over there.

Basudev Banerjee Majority of the commodities have corrected significantly past three months, aluminum, rubber, lead, so are we seeing the positive effect this falling commodity in your raw MAT cost already or it is pending still?

Siddhartha Lal We have been criticized that sometimes, in the past, because we don't do too much forward cover but it helps us in these times because we don't do too much forward buying, it is only case-to-case basis, so yes, lot of the commodity price, let's say reduction has already been factored in. Obviously there is some inventory levels at our side or at the supplier side all of that which could not be reflected but of course the pace of commodity price softening is also just marginal, it is great for us but it is couple of 1-2%here 1-2% there, so it is not like the 30% to 40% drop or 20% drop in anyone commodity, there might be one commodity but in the basket of commodities it is only a couple of percent but what is happening is that as a result of commodity price softening, our ability to get some price out of the market and vey strong cost reduction exercises that we are doing in-house, we have been able to actually therefore get the operating margin that we have been able to get in the last quarter so Yes, it has been a result of all of these if you put together.

Basudev Banerjee Any decrease in blended discount per CV this quarter?

Siddhartha Lal I don't have an exact number again but generally it is still at the bottom of the cycle and some of our competitors continue to push hard on discount so in some cases we have to follow but there is no decrease as it were, I think it is holding up to what it was perhaps last quarter, so it is not in a great position, we prefer to have a better price realization in the market and we believe as the market starts improving over the later of the this year hopefully, the pressure on discounts should ease a bit.

Basudev Banerjee If I look at your Royal Enfield margins, the prime driver of the margin was lower other expenditures to sales and if I see this Rs. 40 crores kind of other expense remaining range bound for past three quarters where as volume has moved up from 30,000 in a quarter to 35,000, so can you give us some color that till what volume can we get generated with the similar other expense level?

Lalit Malik But other expenses as in cases of standalone books is really go to do with the manufacturing and marketing related expenses, so some of those expenses through the fixed part of that is, I would say slightly larger so hence they may not move in tandem with the increase in volumes naturally.

Siddhartha Lal At this point when you are growing our revenue at 50% there is certainly operating leverage coming out of the other expenses, having said that we are investing tremendously in our future in Royal Enfield in terms of new product lineups which we have planned over the next 1, 2, 3, 4, 5 years, so there is lot of activity and increase in spend going to happen there. Like we said in our brand development, in our international piece there will be investments which are going to come in before some of the returns might so it is nothing untowardly but we are going to see some investments which are going to come in these kind of areas, so OPEX is certainly going to rise but of course we will still expect some operating leverage to come out of that.

Basudev Banerjee Further opportunity is there in terms of operating leverage from these levels also?

Siddhartha Lal It depend on the growth really but with a 50% growth like I said in the last quarter, we have been able to get a very strong operating leverage so it is not going to be obviously same every quarter it might be a bit lumpy in fact like you saw, the previous quarter everyone got very disturbed because we had a slightly lumpy expenditure happening in Q4 which is in October to December, so not promising any one thing in terms of it is going to be smooth facing but generally trend wise of course our objective is to continue to get some operating leverage out of the growth that we are getting.

Moderator Ladies and gentlemen due to time constraint that was the last question, I would now like to hand the floor back to Mr. Jinesh Gandhi for closing comments.

Jinesh Gandhi On behalf of Motilal Oswal Securities, I would like to thank the management for giving us an opportunity to hold this call. Also I would like to thank all the participants for joining the call. Thanks.

Siddhartha Lal Thank you.

Moderator Ladies and gentlemen on behalf of Motilal Oswal Securities Ltd. that concludes this conference. Thank you for joining us and you may now disconnect your lines.