



“Hero MotoCorp Second Quarter Earnings Conference Call”

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*Hero MotoCorp
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Moderator Ladies and gentlemen good day and welcome to the Second Quarter Earnings Conference Call of Hero MotoCorp hosted by Nirmal Bang Institutional Equities. As a reminder, for the duration of this conference, all participants' line 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. Please note that this call will be for 60 minutes. Should you need any operator assistance during this conference, please signal the operator by pressing "*" followed by "0" on a touchtone phone. Also this conference is being recorded.

I now hand over the conference to Mr. Rahul Arora of Nirmal Bang Institutional Equities. Thank you and over to you, sir.

Rahul Arora Thank you. Good afternoon ladies and gentlemen. On behalf of Nirmal Bang Equities. I thank the management of Hero MotoCorp for taking time out this afternoon to do the earnings conference call presented by Mr. Ravi Sud and Mr. Anil Dua. I would request them to make some opening comments on the results and thereafter, we can open it up for question or answers. Over to you, sir.

Ravi Sud Good afternoon, everybody. This is Ravi Sud here, and my colleague Anil is with me. I am sure the results are already with you, some of you may have seen or some of you may not have seen that yet, but I thought I'll give you some highlights. During the quarter, our total numbers as you aware have been 1.416 million versus 1.332 million of corresponding quarter last year which shows a growth of about 6.26%. And the total turnover for the quarter is 5,726 crores versus 5, 187 crores which shows the growth of about 10.4%.

In terms of EBITDA margin, the absolute EBITDA margin for the quarter is 832 crores versus 719 crores last year which shows a healthy growth of around 15%. Profit before tax is in line with EBITDA which is growing by about 25%, from 526 crores to 658 crores. The profit after tax is up by about 9% to 481 crores versus 480 crores.

Now, here a few things I'd like to mention that , the tax rate for the FY'14 for company has gone up to about 27% which was about 26.78% in the last quarter because the benefit of income tax at Haridwar is available now only for 30% overall profit.

Moderator Thank you. Participants, we will now begin with the question and answer session. We have the first question from the line of Kapil Singh from Nomura. Please go ahead.

Kapil Singh Firstly, just one request, the press release on BSE is not very clearly visible. So maybe later on you can just send across the press release to us, because I think they've scanned it or something.

Ravi Sud Of course, I will just tell my office to resend it to BSE.

Ravi Sud And in the evening, once we are through with this conference call, I'll ask Maria to send it to all concerned.

- Kapil Singh** Thank you. Sir, firstly I just wanted to check on the volumes for the festive season, if you've done any comparison compared to last year, how are things looking.
- Anil Dua** Kapil, this is Anil Dua, hi everybody, this is a very important question of course for the industry because as, industry has been in the region of 3% and we are all hoping that festival time will help us accelerate. So clearly, the volumes have accelerated and that's primarily because as Ravi said, quarter 2 is a monsoon quarter and numbers go down. So sequentially, certainly quarter 3 the numbers move up significantly as the festival time comes in. So numbers are certainly significantly higher than the industry as well as Hero is clocking right now. But in terms of like-to-like comparison, I will say that at the industry level my feel is that it is not very let me say positive, it is flattish. And I will say that a lot depends upon how Dhanteras and Diwali go because they are the big days as we go forward. But at the moment, very high volumes, but because last year festival time was a record time therefore, that base is very high and therefore, even these very high volumes means that maybe at the industry level it's flattish, but I am hoping that they will pickup further as we go further into Dhanteras and Diwali.
- Kapil Singh** Okay and sir we've also done some price increase, so just wanted to check what is the average increase and does that fully cover up for the cost increase that may have happened on account of commodities or weak rupee?
- Ravi Sud** Well, as you rightly said, we have done this price increase very recently and what we also said in our release was that it partially covers the increases, so it is not covering full.
- Kapil Singh** Okay. Sir, what are some of the major commodities where you would have seen increases.
- Ravi Sud** Well, let me tell you a few of them like steel, there was a price increase that had taken place in quarter 2, but because of the low demand, the suppliers never pressed for it, but in quarter 3, the demand for price increase has already come in. Similarly copper, rubber etc.
- Kapil Singh** Okay. And sir, final question from my side, I know you have been personally involved in this cost reduction exercise very deeply. So just wanted to check in the second half of the year should we expect some benefits to kick in from that?
- Ravi Sud** Yes, definitely, as I said in the quarter 1 conference call that we have started this project in April. And I am pleased to inform you that the wave one, which over five and a half months has been completed and certain savings have started accruing. I don't want to just mention the quantum of savings at this point of time, but they are very, very small. But in the second half, we will definitely see savings of anything between 60 crores to 80 crores coming in.
- Kapil Singh** Sorry, could you repeat that, how much.

- Kapil Singh** Hello, yes so could you repeat the number.
- Ravi Sud** I said in the second half, I foresee a saving of anything between 60 to 80 crores.
- Moderator** Thank you. We have the next question from the line of Binay Singh from Morgan Stanley. Please go ahead.
- Binay Singh** Thanks for the opportunity. Just moving back to the first question, like on retail sales, we've been having very mixed feedback from the industry, with one of your competition saying that retail sales are actually down 8% to 10%. Sir, is it more Hero specific that you feel that you guys are flat on retail on YoY basis whereas industry is down and you are actually gaining share, could you throw some light on that? And similar to that, for Mr. Dua, what is the inventory level at your place and how do you see it at the sub dealer level, because seeing that inventory also this time around is much higher than usual festive season, so just comments on these two?
- Anil Dua** So yes, it is a fair question, because we've also seen the comments that you are referring to, given by competitors in the industry that their sales are down 8% to 10% in retail. I think that's the basis why I mentioned that while the volumes are very high, overall it is not looking like, really very high growth for the industry, but it's a base which is very high and therefore the volumes are very high. However, having said that, Hero's story is slightly different, as I had probably earlier also mentioned that Hero's retails have been up more than 7%, and that trend we have maintained throughout the first half.
- So at the end of first quarter I had mentioned that, and at the end of second quarter, and therefore for the full half, I can still say that the retail sales of Hero have been up 7%, 7.5%, and this is thanks to, the five-year warranty that we had. Thanks to the new campaigns that we ran. So clearly, that momentum we've had, which some of the other players have not had? And therefore, as we enter the festival, our situation is better, our retail sales are almost at the same level as last year festival. If I see October-on-October, they are hugely positive; we are high double-digit growth, October-on-October in retails.
- But then, festival last time was slightly later, so if you compare festival-on-festival, we are already clocking the record numbers that we had done last year, we are already clocking that, despite the gravity of the industry, which you are pointing out. And therefore, we feel a little more buoyant than some of these other players. And I am hoping, given the plans we have we've recently spoken about 15 new models that we are launching during this coming three, four months, we've spoken about new campaigns that we have...we are certainly hoping to accelerate further from this level as we go forward, and get into not only very high volume zone, but also into growth zone festival-on-festival, October-on-October certainly we are highly positive.
- And on the second point on inventories you see, what you picked up on the market is right, that the high level of inventory is still maintained in the industry, as well as at Hero, and the reason for that

is that, the Dhanteras and Diwali are the big days for which you stock up the entire system. And therefore, that high stocking has to be maintained as you go forward. Since the retails are very high, that also means that dispatches need to be very high, in order to maintain the inventories at the high levels, suitable for meeting the demand at the time of Dhanteras and Diwali. I hope that answers your question.

Binay Singh

In a way you are not really worried about excess inventory, you think it's more reflective of the upcoming demand.

Anil Dua

At the moment not, because as I said we are already clocking reasonably high volumes, very high volumes in retails, and we are expecting further acceleration, thanks to all the activities and thanks to the real festival days still to come in. So at the moment, not but if the overall sentiment goes down or if there is any adverse thing, then certainly, that will be something which we will have to relook at. But at the moment, I think we are trying to see that we are adequately covered, and we are making sure that we dispatch all models to everyone, so that we are well covered for the festival. My worry is exactly the opposite right now, to ensure sufficient dispatches.

Ravi Sud

Just to add here inventory is a function of what you expect, if we go by our previous years festival retail, which was more than 8 lakhs in 30 days of festival, our inventory is less than three weeks.

Anil Dua

Sorry, I'll just correct that, while Mr. Sud is right, 8 lakhs was basically the festival period figure that he is referring to it wasn't in one month...

Anil Dua

Exactly, so we had a two months figure, which was 1.1 million, which is a record that we created, which is the highest ever. And we are definitely hoping to exceed that this time during October plus November. So October plus November, because festival last time was also contained within October plus November, this time also it is contained within October plus November, so the two months figure which gets reported becomes the relevant figure to look at, last year the same two months our figure was...figure of retail was over 1.1 million, and we are certainly planning to exceed that.

Moderator

Thank you. We will take the next question from the line of Vaishali Jajoo from Aegon Religare Life Insurance. Please go ahead.

Vaishali Jajoo

First is on the market share side, if you could update on, because looking at the recent market share, we have lost some of the market share in the two wheeler to major ones like Honda. If you could elaborate on that, what we are doing on that front. And apart from that, the cost saving initiative, which you have mentioned, that also if you could elaborate, where are saying whether it is a vendor rationalization or on the raw material front. If you could just elaborate on that much and how much improvement is expected in terms of number?

Anil Dua Sure, so Vaishali on market share, I think we need to look at the overall industry and we need to see various competitors. I think there have been losses of market shares. There has been one competitor who has been gaining market share clearly. But I think, it's not Hero which has been losing market share, because we've been more or less holding on to our position. In fact, there are several segments, where we are actually gaining, so the losses elsewhere seem to be much higher. Basically, it is happening, because the industry is overall 3% flat, and therefore, there is this readjustment which is looking extreme. But as far as we are concerned, I would like to highlight that we've been kind of at similar levels as we were. In fact, in scooters, if you look at our first half shares; it has increased first half last year was at 16%, and this year first half is at 20% market shares, we moved up. Within motorcycles there has been about 1% impact, but it is still at a domestic level, we are still at 51.5% market share. So it certainly an industry which is very sensitive to new launches, and as you are aware that our new launches are planned in the second half, and therefore, we are banking on recovering whatever minor losses we've had recently as we go forward in the second half.

Vaishali Jajoo Okay, if you can just also update on your export initiatives, in which countries you have started exporting and how do you see that in next three to four quarters?

Anil Dua So exports has been actually in a special zone, for last one and a half years, because this industry has normally seen very positive growth even in the toughest of years. But last year was negative for the industry and this year first half continues to be negative in terms of two wheelers being exported from India, the industry has been negative. Now, we are not the largest player so we are less effective...

Anil Dua So we are looking forward to future expansion with lot of optimism, first half however has been weighed down by the gravity of the entire industry going down, and some of our key markets being even much worse off, which are the markets around us in South Asia. But thankfully, we have made our beginnings in new markets in Latin America and Africa. As of today, we are available in 10 markets, and as we go forward in the second half we have planned to launch in at least eight more markets, four in this third quarter and about four in the fourth quarter. So about eight more markets we get into. So this will lead to certainly a better position in second half as compared to first half, but it is a real benefit of these market entries will start coming from next fiscal onwards.

Vaishali Jajoo These eight new markets are going to be in Africa, is it?

Anil Dua That's a combination of Africa and Latin America, some new markets. So these are two continents, we've entered and we plan to extend our coverage in these continents.

Vaishali Jajoo Okay. And on the cost front, Mr. Sud?

Ravi Sud Yes, as I had explained earlier, this is not one-time, project which is running for couple of months. This is a project which is done for about 30 months. As I said earlier, we have already completed

wave one, and we started getting some savings and we expect that savings between 60 crores to 80 crores will accrue in the second half of the year. But, as I mentioned earlier this is a project which is not concentrating on any particular area, this is a project which cuts all functions, all areas of costs, and some of them I mean low hanging fruits like logistic costs have already been covered and benefits have started coming, for raw material consolidation certain benefits have already started accruing. Benefits relating to e-bidding have already started. Most of the savings will start coming, but they involve some design change or raw material change or some feedback from the customers through surveys, they will take anything between 12 to 15 months, and wave two we have started effective 1st of October. And we expect more ideas to be generated and my assessment is that in the year FY15 and FY16 we will see substantial amount of savings coming here. But as far as current year is concerned, we have accrued some saving which are not very significant, but in the second half, anything between 60 to 80 crores is expected.

Vaishali Jajoo

Just last the last one, my last interaction with management suggest that you were planning to import certain or procure certain items from China also, can you just throw some light on that?

Ravi Sud

Well, as far as ultimate sources are concerned, that's a continuous exercise and we are moving as per our plans, as of now.

Vaishali Jajoo

Okay, that's fine. Thank you.

Moderator

Thank you. We will take the next question from the line of Pramod Kumar from IDFC Securities. Please go ahead.

Pramod Kumar

Thanks a lot for the opportunity sir, and congratulations on a good set of number. Sir, my first question pertains to, it's directed to Mr. Dua. Mr. Dua you shared that retails your are generally expecting that you will better the performance of last festive season, just wanted a split of that in terms of how would be the growth in say the motorcycle segment for you and in terms of the scooter segment, sir?

Anil Dua

Okay, now that's too much futuristic, I can talk about right now as we speak the 7%, 8% growth that I spoke about, which we have in retail so far, it translates to about 5% in motorcycles and about 15 odd percent in scooters, sorry 20 odd percent in scooters. So clearly, sorry scooters is even higher, 30%, because there is there's Maestro plus Pleasure and our motorcycles are in the region of about 5%, 6%. So that's the growth currently and as I said, going forward in the festival time, currently despite the high volumes because of the record base, the figures are level, but as we go forward, we have a constraint on scooter capacity. So I expect the new scooter capacity to come up in December, January, but at the current capacity levels, we may not see as significant a growth in scooters in the coming two months, and it maybe motorcycles which may pickup from here onwards.

- Pramod Kumar** Excellent. And sir, how are different regions for the market have performed in terms of how you have to just split the retail so far in terms of festive season and in terms of which regions have done well and which have underperformed.
- Anil Dua** So clearly, South is not really the festival region, as; these festivals are more north, east and west centric. And within south, Kerala certainly with Onam has seen some amount of growth, but overall, south zone as a whole will not have the same kind of buoyancy as the rest of the three zones. Between the three regions, I will put my pecking order as North at the top, followed by East, followed by West in terms of relative growth.
- Pramod Kumar** Okay and my next question is for Mr. Sud. Sir, if you can just throw some light on your R&D spending ramp up, because how has been R&D spend so far in the first half, how do you see it second half and for FY15 and 16. And also what are the products which will start coming because of this R&D spending what you are doing?
- Ravi Sud** As we have stated earlier, in FY13 and FY12 there are certain advances which have been given to our technology partners and also there is some expenditures which is being incurred in our own R&D center which is being treated as revenue. But any advances which are given as part of a project for modification or for a variant or doing a refresh or for developing a new platform that will get the accounting treatment only once the model is introduced. As Anil has said earlier, we are planning to launch 15 of these refreshes and variants in the current financial year by March 2014. So you will start seeing our R&D expenditures coming into our P&L and getting converted from advances to the expense. If you look at last year, we were at 0.47% of our net sales, this year our expectation is, it could be about 0.75%. And as we had said earlier, at the peak level we expect it to be anything between 1.2% to 1.25%.
- Pramod Kumar** And does it mean that some of this increase in R&D in second half could start eating into that benefit of 60, 80 crores what you are talking about on the wave one of cost saving what you talked about.
- Ravi Sud** Well, that's a possibility.
- Pramod Kumar** Okay, and sir, finally what would be your royalty payment for the quarter in absolute terms that's because the print is not clear, so I thought I'll just check some number on that.
- Anil Dua** As far as royalty to Honda for the new product or you are talking of the...
- Pramod Kumar** No, the lump sum royalty what we've been paying, sir.
- Anil Dua** That is about 212 crores, if I remember correctly.

- Pramod Kumar** But if I were to just recap, you are saying that commodity pressure will start kicking in from Q3 in a way, as the pressure hasn't come in 2Q, but Q3 you see some pressure coming from commodities right?
- Anil Dua** Yes.
- Pramod Kumar** Okay sir, fair enough, thanks a lot sir.
- Moderator** Thank you. We will take the next question from the line of Aditya Makharia from JP Morgan. Please go ahead.
- Aditya Makharia** Just I had a question, you will be launching a couple of variants like you mentioned, will these now come at a higher royalty rate, because if you understand in the beginning you had mentioned that in case any modifications are made to our Splendor and Passion models, the royalty would go up?
- Ravi Sud** What we had stated earlier is there is no royalty on products which we were manufacturing till April 2011. The royalty which is being paid to Honda now is basically on the four products which have been launched subsequently. And the four products what they are, they are Impulse, Maestro, Ignitor and Passion Xpro. As far as all other products are concerned, there is no royalty; there is only one lump-sum payment which was agreed in 2010, which was 45 billion Japanese Yen. We charge one-fourteenth every quarter to our P&L. So to answer your question, there is no royalty as far as all these products are concerned. So we have the freedom to modify the product, we have the freedom to sub license the technology as per agreement. We have freedom to have joint ventures under certain condition.
- Ravi Sud** Does that answer your question or is there anything else you want to know?
- Aditya Makharia** No, sir, it does partially and also there has been a lot of press about new engines which you will be getting into your models. So I understand that till March end you will be having refreshes but post that you will probably be getting in your new engine, so.
- Ravi Sud** Definitely and we have stated earlier that our new platform will start coming from calendar year '14.
- Aditya Makharia** Okay. Thanks.
- Moderator** Thank you. We will take the next question from the line of Narayan Ravindranathan from Spark Capital. Please go ahead.
- Mukesh Saraf** Sir, firstly on the cost savings, there was some input given earlier on that the savings could be to the extent of more than 1,500 crores by say 2016, '17 and so there surely should be some target as in the way you are going to achieve the savings. So if you could give us some color because you

just mentioned that there are a lot of things that you are going to do, but would it just be a vendor like renegotiations or would it be change in vendors or it would be any other type of cost cutting.

Ravi Sud

This is not an ordinary cost rationalization or cost saving program which will run for two months or three months, that what is a typical cost reduction program. And most of these programs concentrate on what you mentioned on renegotiation with vendors also cutting your internal cost. This program will run for more than 30 months and in different waves, it will run into five waves, and we have just completed one wave, where we had taken certain activities and two models for analysis.

So we had in the first wave as I was saying, we had concentrated on two models, one entry level motorcycle and a scooter to do the analysis of the cost and to see wherever it's possible to reduce the cost by doing some modification in the...or changing the materials or adding or deleting certain features after taking the input from the customer. Second area was on our logistic cost, third was rationalization of our raw material consolidation and then getting certain savings out of e-bidding of certain standard fasteners or bearings. So this was wave one. Wave two which we have started in October, we are taking three models. So what will happen, some of the benefits will come immediately which can be implemented, but if there are areas which need a design change or extensive testing or market surveys or customer's analysis, feedback and surveys and analysis, they may take time. So what will happen is the bucket of idea will keep on growing and some implementation may take longer time. That is why I am confident in the current year we will get about 60 crores to 80 crores. But most of the idea which involve any design change or testing may take 9 months to 18 months. So as we progress in the wave, we are in wave two, when we go to wave three and wave four and wave five, our expectation is, this program if it runs for 30 months, the full benefits will start coming 30 months plus 12 months because average implementation time for any design change idea is 9 months to 15 months.

Mukesh Saraf

Okay, So basically these all together can come up to the 1,500 crores 1,700 crores number?

Ravi Sud

Yes, that is estimation as of now.

Mukesh Saraf

Okay. And sir, one question on the exports, you did see the first half being quite weak, but do you still stand by your target of 1 million exports in say two three years time, that you had early on mentioned?

Anil Dua

Yes, so first half is a short-term period and the 1 million is our long-term plan. So there is no change in our long-term plan at the moment. Of course, it depends upon the overall international markets also kind of reviving which have been down in several markets as we have discussed earlier. South Asian markets, some large African markets have actually gone down for various macroeconomic and regulatory reasons. But we feel that in long-term, there is growth in the international market and therefore, we are sticking to that 1 million plan or 10% of our total volumes coming from international business.

Mukesh Saraf And if I may ask one last thing, do you continue to see the rural side do well in the domestic market or I mean do you see the rural doing much better than the urban like your previous commentary?

Anil Dua So rural certainly is doing better and this is a quarter when it is expected to do even better because the monsoon's positive effect is going to be far more visible in the rural areas. The festival also has a positive good impact in the rural areas. Certainly, urban areas also go up, but relatively speaking, rural areas have outstripped urban areas. I can give some figures which we are looking at, the 7% growth that we spoken about it's roughly 9% in rural areas and 5% in urban areas. So there is a relative difference therefore between the two. For us a little over half of the sales comes from urban areas.

Anil Dua And therefore, it averages out to around 7% between that two. As we go forward, we are actually expecting rural to do even better, but we are also hoping that urban will also hold on and hopefully, the sentiment in urban will also be positively impacted by the festival time.

Mukesh Saraf Thank you so much for answering these questions.

Moderator Thank you. Before we take the next question, a kind request to the participants, all are requested to please limit their questions to two at a time. Should you have more questions, kindly come back to the queue as we have several participants waiting for their turn? We will take the next question from the line of Govind Chellappa from Jefferies. Please go ahead.

Govind Chellappa I have two questions, One, the debtors at the end of September seems to have gone up again. My sense was that the absolute amount of inventory with the dealers is not significantly higher now as compared to last year and certainly not – probably comparable to fourth quarter because your wholesales are down and retail is up. So could you clarify if there has been any change in credit policy? My second question, I know probably everybody else on this call already knows this, but I just wanted to clarify this. If you choose to use the products that you had prior to April 2011, say a Splendor or whatever, without any modification; do you have rights to those engines, designs to perpetuity?

Ravi Sud Yes, to answer your second question, yes, we do have.

Govind Chellappa Okay. And on debtors?

Ravi Sud Coming back to the first question, you see as Anil mentioned, last year the festival season was 15, 20 days later. So that the level of stocking which was done up to September was partial. This year the festival season has just started on 5th of October. So the level of inventory which were required for festival season this year is much more. We as a company were operating at debtors of anything between three to six or at best seven days. But now, because of the increase in our distribution network, we have got 794 or 800 dealers with number of models and the variants and the colors, the

requirement of stocking at each point has increased. And as far as the credit policy is concerned, credit policy remains the same; there is no change in credit policy. It is only because of specific need this September because the festival season just coming after three days of the close of the quarter, that stocking at the retail level has been high.

Govind Chellappa

Yes, sir, if I can squeeze on one more question.....

Ravi Sud

I remember, if I am correct, last September our debtors were about 770 Crores odd, am I right?

Govind Chellappa

Yes.

Ravi Sud

This year we are at about 900 Crores.

Govind Chellappa

Our impression was that last year's stocks were extraordinarily high, so that's why I asked the question.

Ravi Sud

No this policy again, as I said, what I said earlier was, if I see my today's stock at the dealers end I look at the estimated retail for this 30-day period, my stock is only about three weeks, but if I compare it to the average retail which we do over a period of 12 months, it could be close to 4.5 to 5 weeks. And last year also it was 5 weeks only.

Govind Chellappa

If I can squeeze in one more question. Could you reiterate what the CAPEX plan is for FY14, '15, '16 combined, I mean yes, you had earlier listed 2,600 crores of CAPEX for the two new plants and departments in that...

Ravi Sud

Okay, the CAPEX of 2,600 crores which we would have mentioned, this is for our new Neemrana plant, this is for Kukas center, this is for our Global Parts Center for our Gujarat plant and also for our internal CAPEX for the existing three plants. Now, as far as FY14 is concerned, in Q1 call, I have mentioned it very clearly that our total CAPEX during the year should be around 1,100 crores and now, we are already two quarters on. I am still repeating our CAPEX in this current year will be 1,000 to 1,100 crores. And this will be mainly for Global Parts Center and for Neemrana plant. And it's likely that we may commence the production in the last quarter. As far as Kukas is concerned, we have already paid for the land many years back, the only expenditure which will come this year would be relating to some leveling of the ground and the boundary wall. As far as Gujarat plant is concerned, we have already acquired 175 acres of land. Further capex will be very small, may be 40 to 50 crore to have the boundary wall and all. And also the additional 40 acre, which we are to receive from the government.

Govind Chellappa

Sure, thank you.

Moderator

Thank you. We will take the next question from the line of Pramod Amte from CIMB. Please go ahead.

Pramod Amte Couple of questions, one is, if you look at your cost reduction numbers, they look to be almost like 50% of your EBITDA now. Would you like to break them, what you will be bringing in, in terms of your design changes or localization or some buckets, what will be driving this big type of a saving?

Ravi Sud Well, Pramod your question is very valid, but at this point of time we won't like to share any specific details about this program, because the program is in the very, very early stages, we have just completed 5 months, out of 30 months.

Pramod Amte Sure, and in the past, if I look at your cost reduction exercise, a large part of that management philosophy has been to pass it onto the customer in the form of the inflation adjusted prices, and aim for more volume growth, whereas some of the statements coming now are more oriented towards the margin improvement as a focus. What has changed in terms of management thinking with regard to the same?

Ravi Sud Well, management thinking remains the same, the idea is, if you look at last one, one and a half year, we have entered the phase of the industry where the growth has been very, very minimum. Last year growth was about 2.5%, as Anil said, even this year, in the first six months the growth is approximately 3%, and overall we expect for a full year growth of maybe low single-digit. So idea is to initiate something, which has medium to long term impact, and add to the existing margins for the medium term.

Pramod Amte And just on the rural proportion, if I'm right, you are correctly standing at 47%, how it has behaved in last couple of years, can you give us some trend for a company per se and for sectors...for industry as a whole?

Anil Dua Yes, so it has certainly been moving up over the years, and I will say that, it's been inching up almost a 1% a year of late. So we used to be couple of years back at 45 odd percent, moved up 46% now at 47%, and I suspect it will move up to 48%, as we go forward, given the figures that I've already shared. I think the trend is similar in industry, though the percentage contribution of rural is much lower for the rest of the industry, because we have much larger reach into tier 2, tier 3 towns, and into rural populace, so our contributions are higher, industry will be probably more in the region of 40 odd percent, whereas we are in the region of 47%.

Moderator Thank you. We will take the next question from the line of Sonal Gupta from UBS Securities. Please go ahead.

Sonal Gupta Sir, I just wanted to ask, one was, on the scooter side, we are continuing to see the industry growth for scooters continues to remain much better than motorcycles. So I just want to understand, I mean according to your data, what is the sort of penetration level that in terms of the sales of in tier 1 and

metro cities, what percentage of total two wheeler sales is going and what is coming from scooter segment, and where do you think the scooter penetration really go to over the longer term?

Anil Dua

Yes, so clearly scooters has been the buoyant part of the market, and this is something which we have seen over the last two, three years or longer even that this phenomenon has been there. In fact, when we launched our first scooter, the scooter market used to be only 10% of the total market. As we speak today, the scooter market is about 20% of the total market, and now we have two scooters in this segment. The trend is that this will continue to be, and I expect the scooter market to move up from currently about 20% - 21% to even 25% over next two, three years. So penetration of the scooters will continue to increase.

However, coming to your question of tier 2, tier 3 towns, I think in the past, the scooters penetration was really increasing in tier 2, tier 3 towns, that was however in the past, because most of the tier 1 towns and metro cities were really focused on motorcycles, and scooter was seen more as utility vehicles with some storage space, and with some carrying space, which was seen as a good utility for traders, and for typical small town requirements. However, if you look at what we have done with our scooters, we've really made it a fun vehicle, whether it is Pleasure, which was positioned as "why should boys have all the fun", or now it is Maestro which is positioned as "it's a boys thing." We've been clearly pushing the image of scooters to several higher notches. And therefore, what we are seeing is that, many more people in the urban areas are now comfortable buying and being seen on scooters.

Certainly, the women population was in any case coming from the cities, but most of the male users were coming from the smaller towns. And now we find with the launch of Maestro a lot of consumption, a lot of purchases are shifting actually to the bigger towns. So I will say that, now it seems to be balancing out in terms of larger cities and smaller cities. The scooter image is improving, and which is a reason of my confidence that, because of now its universal appeal across the towns, this is likely to move up to 25% contribution going forward.

Sonal Gupta

Okay, so just to clarify, so you are saying that, the tier 1 or metro cities don't really have higher sales of scooters versus the overall number?

Anil Dua

Now, they have, I think, scooters have become cooler, motorcycles used to be the cool vehicle to be seen on in the tier 1 cities and in metro cities. But I think, if you look at the Maestro advertising with Ranbir Kapoor and earlier also, our research clearly shows that young guys in larger cities are also getting comfortable being seen on a scooter, and therefore increasingly you will see scooters sales coming from tier 1 towns and metros as well.

Sonal Gupta

Okay, and sir just my second question was on the supplier side, I mean in terms of vendor consolidation or changes on the vendor side, I mean have you made any significant changes since Honda moved out of the company, and any plans in terms of that side in terms of vendor sourcing and supplies?

- Ravi Sud** Is your question relating to change in the vendors ? I didn't get your question very well.
- Sonal Gupta** Sir, mainly from a supplier stand point, are you seeing, I mean, are you changing your sourcing and localizing more or I just wanted to understand that.
- Ravi Sud** Well, the only major import content is cast wheels. We need about 19,000 sets of cast wheels every day, though it has been localized, the capacity is only 3,000 sets a day. We started with 500, 1,000, 2,000, 3,000, but as far as the dependence on a particular vendor is concerned, that's a continuous exercise depending on the overall size of the business, if there are two or three vendors, their shares keep on changing. But to your question whether we have changed any vendors, yes, which is a part of routine, and but we haven't dropped any vendors specifically because they are Honda vendors or they have connection with Honda, our vendors continue the same.
- Sonal Gupta** Okay, sir. And just finally, any change in the industry financing overall, for the customer financing, I mean as a percentage of sales?
- Ravi Sud** Well, what we have mentioned last time was that Hero FinCorp, which is an associate of HMC has started a direct retail financing, and they started sometime in the month of June, in a very, very modest way. In September they financed about 2,500 two wheeler; in the month of October they are planning about 10,000. But in terms of our data from the FinCorp shows that in our case, the percentage used to be about 20% to 22%, is up to over 25%. Now, but I will say these are early days to take any final call, but we see the upward trend in the financing.
- Sonal Gupta** So 22% was last year or...
- Sonal Gupta** Okay, great. Thank you so much, sir.
- Moderator** Thank you. We will take the next question from the line of Mahantesh Sabarad from Fortune Equities. Please go ahead.
- Mahantesh Sabarad** Sir, just a question related to the festival sales which you began by telling that the volumes are going up, I just wanted to understand at the end of the first quarter you had mentioned you depleted inventories to the extent of 50,000 vehicles. So in the same logic, what is the inventories that you have pumped in at the end of the second quarter?
- Anil Dua** So it's a similar number that we pumped back in preparation for the festival and that is what I think Ravi was explaining sometime back in terms of festival starting on 5 October and therefore by the end of September, we needed to push in stocks to ensure that the system is prepared for the festival. And even as we stand currently, while we are getting very good retails, very good volumes, we are also making very good dispatches because by October end also we need to have sufficient

inventory because Dhanteras is on 1st of November and Diwali is on 3rd of November, so we need stocks to cater to that demand.

Mahantesh Sabarad Right, sir. And any disruptions on the dispatches side for you? We recall in the second quarter, you had some labor problems at few of your plants, especially at Haridwar. So, what is the status and what are the negotiations conducted?

Ravi Sud Well, I can tell you we are producing at the peak volume from Haridwar, there are few days when we even crossed 10,000. So all of our plants are running normally as of now.

Mahantesh Sabarad Any negotiations yet to be concluded?

Ravi Sud No, things are normal.

Mahantesh Sabarad Okay sir, I think that fairly answers my question. Thank you very much.

Ravi Sud All right.

Moderator Thank you. We will take the next question from the line of Sidesh Goel from Kotak. Please go ahead.

Sidesh Goel First question is on price hike. Have you taken any price hike in this quarter because if you look at the Q-on-Q realization increase, it's around 2%, whereas the premium motorcycle sale in executive segments have fallen on a Q-on-Q basis. So just wanted to get a sense on that? And second question is on freight cost that you were talking about. Is it going to be related to when your Rajasthan plant comes in because you'll be able to supply to the South market at a lower freight cost? Is that the theory or are you looking at the overall bucket.

Ravi Sud #1, we had taken a price hike in the month of April effective 1st May, that is one. And secondly, we have taken another price hike on 3rd of October which is the current month which is not part of Q2. As far as sales realization is concerned, apart from the price hike which would have given some increase, in spare parts we had exceeded our plan. And when you compute the average sales realization you divide total turnover by the number of two wheelers and the share of spare parts had slightly gone up, hence 'ASR' is high.

Sidesh Goel And sir, regarding the freight cost, can you give a sense on what...

Ravi Sud Now, you see as far as freight cost is concerned, supplying from Rajasthan is not going to help the freight cost, because (Rajasthan) Neemrana is just 40 kilometers from Dharuhera where we have the existing plant. I think the substantial savings will come when we go to either to South or to Gujarat.



*Hero MotoCorp
October 23, 2013*

- Sidesh Goel** So that is sometime away, so we can look at freight cost savings more or less in FY16 or how should we look at it?
- Ravi Sud** No, those will come as and when those plants come, when I talked about the logistic cost, that is the way we are loading our trucks, the number of two wheeler which we are loading and the way we are routing our whole movement of trucks, that is the savings will come, a part of which have already started accruing.
- Sidesh Goel** Okay, and sir, my last question is on basically on this imported content which you were talking about parts localization, basically if I am right, you have around 15% of direct plus indirect imported content. So are you planning to reduce to zero in two to three years time which will bring you this kind of savings because
- Ravi Sud** Well, as far as direct import is concerned, the only worthwhile item there is cast wheel and we need about 19,000 sets a day, the domestic capacity is now 3,000 sets and it will take a while to totally indigenize. But we also understand that a supplier from where we are sourcing from China is planning to have its own company in India. And so once that happens, automatically the 5.5% should go to zero or maybe 0.2% or something, we've got some gaskets or some other item which come. As far as indirect downstream is concerned, we are working constantly with our vendors to reduce the import contents, I mean which is now about 9.5%.
- Sidesh Goel** Okay, because I was asking because generally Maruti says that 20% 25% is a kind of cost saving you get if you localize in India, so if the kind of things you are talking about, you will get a 3% to 4% margin benefit, so...
- Ravi Sud** I do not agree with that because like I mentioned, there are certain gaskets and all which we import, unless you have a minimum capacity it's better to import those items rather than localizing them.
- Moderator** Thank you. We will take the next question from the line of Chirag Shah from Axis Capital. Please go ahead.
- Chirag Shah** Thanks for the opportunity. Sir, a clarification on your cost reduction program. Even media reports indicated that you are looking at some 1,700 crores of cost reduction benefit by '16, '17. Sir, is this is a cumulative number over four years or it is annualized number you're looking at going from 80 crores to 350 crores to 1,700 crores over the next five years?
- Ravi Sud** This is the annualized number, which we are talking in FY18.
- Chirag Shah** Okay, so we can look at 1,500 to 1,700 crores of annualized cost savings coming in FY17 '18, correct?
- Ravi Sud** Sorry, how much did you say?

Chirag Shah 1,700 odd crores of cost savings in FY18?

Ravi Sud Well, what we have said is, we estimated saving as of now.

Ravi Sud For FY17, '18 is about 1,500 crores.

Chirag Shah 1,500 crores.

Ravi Sud Which is again the estimate and as I said, these are early times because we have just completed wave one. And we have five wave of four months each going forward. So as we progress, these figures will get refined.

Chirag Shah Fair point.

Ravi Sud But, what we are saying is this is a substantial saving which we are aiming.

Chirag Shah Yes. And if you can just highlight what is the price hike you had taken on 3rd October broadly?

Anil Dua So we have actually a hike of up to Rs.1,500 and. 500 was the minimum price increase that we looked at in our couple of models. I think average price increase will be around Rs.1,000 across our models, which is pretty similar to the price increase that we had taken in the month of May, 31st May which was also similar kind of price increase.

Chirag Shah Okay. And what would explain sir, if you look at quarter-on-quarter, you are RM to sale has declined, there is a favorable movement over there, it's more to do with this higher spare parts sales in the quarter, that would be the...

Anil Dua That's right. That is one of the reasons.

Ravi Sud And the model mix.

Chirag Shah And the model mix, okay.

Chirag Shah And last thing is the price hike that you have taken would take care of the cost pressure, the raw material cost pressure that you have highlighted?

Ravi Sud Well, that was the first question which someone asked, and I said that's only partial recovery, not full recovery.

Chirag Shah No full recovery. And when the new Rajasthan plant comes, starts running, it will start at what capacity sir, if you can just throw some light or...

- Anil Dua** The total capacity of the plant is 750,000 p.a.
- Chirag Shah** But it can start with that capacity immediately or it would take six months for you to ramp up?
- Ravi Sud** Of course, any plant which will start will start from zero and will be ramped up depending upon market condition.
- Chirag Shah** Fair point. Okay.
- Ravi Sud** So 750,000 is the peak capacity, which we plan for that.
- Chirag Shah** Would it have any impact in your tax rate, any beneficial impact on your tax rates or direct or indirect?
- Anil Dua** No.
- Chirag Shah** Okay, thank you.
- Moderator** Thank you. We will take the next question from the line of Amin Pirani from Deutsche Bank. Please go ahead.
- Amin Pirani** Sir I just wanted to understand, what kind of growth are you expecting in the second half, and given for the industry and maybe for yourself. And given that your retail in the first half has been better than your dispatch numbers. Would there be a conversion of your dispatch and retail number in the second half?
- Anil Dua** Yes, I think eventually there should be, but let me take your question from where it started. In the first half, we've seen, if you look at our volumes they are, they've just gone marginally positive, first-half-over-first-half, in terms of dispatches, while we have, I think about a 6% growth in turnover. The volume has just gone marginally positive. The retails of course, have been far more buoyant as I confirm to you, and as we go into second half, we are expecting this situation to get better in terms of our volume growth, like-on-like, we definitely plan to improve upon that marginally positive position to reasonably positive position, so that overall for the year as a whole we should have a low single-digit growth. This is in line with the industry, which is at 3% growth at the end of the first half, and it's likely to stay in the low single-digit region. As we go forward, say going up to about 5% or so. So that is our outlook, because this quarter the base is high for the industry, it was a record quarter for us also in terms of festival retails that we did. So while the volumes maybe very good, the growth figures may continue to remain in the low single-digit domain, both for the industry, as well as for Hero.
- Amin Pirani** Sir, and any sense you are getting for next year, in terms of growth...

Anil Dua

Well, I think you can't keep the two wheeler industry down for too long, it grew by only 2 odd percent last year, and it's growing by 3 odd percent this year, it's an industry which typically has a long term CAGR of 10% to 12%. The penetration is far from saturated, there are enough areas within urban and almost all of rural, which is still dry, around 30% or so, which can actually go significantly up in penetration. So I would say that 10% kind of a CAGR going forward is possible. And therefore, I do expect that if post election, we have a stable kind of a situation, politically as well as good macroeconomic business, then this industry can come back to double-digit growth next year.

Amin Pirani

And sir, obviously, you and your competitors have been taking frequent price hikes. But on the retail side or on the dealer side, are you seeing any offers being provided by either your dealer or competition in terms of exchange offers or any other offers during the festive season?

Anil Dua

So listen, there are two kinds of activities that you can do at the time of festival; one as the freebies, the price-offs, the discounts. We at Hero; do not believe in that, and we are not running, any price-offs, any freebies, any discounts. Yes, in the industry, we are aware of several such discounts and such activities, which are running. The second set of activities, which you can run during a festival are, what I call enabling activities, which enables really customers to take decision in uncertain times like these, when the sentiment is not at its peak. So if you can provide finance, if you can provide exchange, it certainly helps the customer to precipitate their decision and to go for it. So certainly, we are encouraging our dealers nationally to run exchange offers, and centrally we are running finance activity, especially in conjunction with FinCorp that Mr. Sud spoke about, and with other preferred financiers that we have. So to sum it up, no freebies, no price-offs, no discounts from Hero; finance and exchange, yes, and as far as the industry is concerned, I think both are happening in sheer number across the country.

Amin Pirani

Okay, sir.

Moderator

Thank you. We will take the next question from the line of Kaustav Kakati from DLF Pramerica. Please go ahead.

Kaustav Kakati

Most of my questions have been answered. I just wanted to get a sense of what is your target export over the next two years?

Anil Dua

So, Kaustav right, I think, I will be able to give you slightly long term guidance rather than immediate because the export markets have been so uncertain, nobody had envisaged the kind of decline that the exports markets saw last year, and then continuation of that into this year. Therefore, this uncertainty is not really helping us to predict short-term very firmly, but long-term as I had said that by 2020 we are looking at a company turnover of 60,000 crores, and we are looking at annualized volumes of 12 million, out of that 10% will continue to be as our vision from international business.

Kaustav Kakati All right, 10%.

Anil Dua Which means more than a 1 million than what we are setting now, because 10% of 12 million will be 1.2 million and today we sell about 150,000...

Anil Dua So that is adding more than a million to our sales, and going up almost 10 times in this period.

Kaustav Kakati All right. Thank you.

Ravi Sud Sorry eight times in this period.

Kaustav Kakati Thank you.

Moderator Thank you. We will take the next question from the line of Jigar Shah from Kimeng Securities. Please go ahead.

Jigar Shah Sir, my question was pertaining to the breakup of scooter and motorcycle sales for first half, if you can give that?

Anil Dua Yes, I think as I had mentioned that first half we've been growing very well on scooters, our retails I mentioned were up 30%, our dispatches are actually up 40%, we've gained market shares vis-à-vis, first half last year gone up from 16% to 20%. Our average volumes on an ongoing basis, exact financial volumes, probably Mr. Sud can throw light on, but our average volumes on an ongoing basis are about 55,000 to 60,000 every month on scooters, and about 4.5 lakh to 5 lakh on motorcycles. That's the average volume that we are clocking on scooters and motorcycles.

Jigar Shah Sir, can you give some idea between the volume...between Pleasure and Maestro, I mean just rough idea?

Anil Dua Yes, it's roughly equally divided at the moment; the 55,000 to 60,000 volume is roughly equally divided. But as we go forward, we are adding another 15,000 to our capacity going to go up to 75,000, and I expect almost 40,000 coming out of Maestro and the balance out of Pleasure.

Jigar Shah Thank you, sir.

Moderator Thank you. We will take the next question from the line of Jatin Chawla from Credit Suisse. Please go ahead.

Jatin Chawla Can you please share the Haridwar production numbers for this quarter and the previous quarter?

Anil Dua Well, I don't have it here.



*Hero MotoCorp
October 23, 2013*

- Jatin Chawla** Okay, is there significant change on percentage level or not?
- Anil Dua** No, Haridwar contributes about 36 to 37% to our total overall production, so it continued that way.
- Jatin Chawla** Okay, second question was, we have seen significant currency volatility during the quarter, but we've not seen any impact of that. During this quarter, will we see a delayed impact on the indirect side coming through in the numbers next quarter or that's not likely?
- Ravi Sud** Well, as we have stated many, many times, every quarter we state that, about 65% to 70% of the vendors we work with the lag of one quarter. So the exchange rate which has been applied for quarter two is basically the average of quarter one. In quarter three, what we will apply would be the average of quarter two. So you can expect, and we do expect that some pressure coming because of that currency fluctuation, which happened in quarter two.
- Jatin Chawla** And the last question would be, you mentioned that for this new product launches that you have, there is some advances that have been given. Now going forward, will you be charging-off those advances in the same quarter or will they be amortized over a four, five year period?
- Ravi Sud** Well, let me restate once again, that we have a policy of amortizing even the model fees over a period of five years. So we charge them over 20 quarters. Now, some of these maybe only minor modification, the expenditure may not be much, we may not amortize them, we may just charge them to profit and loss account. But wherever there are major changes, it's a major variant, and which has a life of longer than three, four, five years, we would amortize. So in a nutshell there will be two accounting treatments; one where our total expenditure will be charged-off in one particular quarter, it's only very, very minor changes. Wherever there is a major variant, and where the cost is high, and the life of the product remaining life of product is more than 3, 4, 5 years we will amortize it.
- Jatin Chawla** Okay, great. Thank you.
- Moderator** Thank you. We will take the next question from the line of Harsh Mehta from Shah Investors. Please go ahead.
- Harsh Mehta** Sir, I just wanted to know one thing, so your payment to Honda will be completed on Q1 FY15 -- by Q1 FY15?
- Anil Dua** Yes.
- Harsh Mehta** Sir, so your depreciation cost will be going down from Q2 FY15?
- Anil Dua** Yes.

- Harsh Mehta** Sir, but if there is any further expansion you are looking out in terms of R&D spend or CAPEX in other plants?
- Anil Dua** Yes, that will add to the depreciation.
- Harsh Mehta** That will add to the depreciation.
- Anil Dua** Correct.
- Harsh Mehta** But the depreciation from FY15 will be much lower than FY14?
- Anil Dua** Yes, of course, because if you analyze the depreciation, it has basically two parts; one is that Honda amortization, which is close to 200 crore to 215 crores every quarter.
- Anil Dua** Depending on the currency fluctuation. Balance is your normal depreciation. So what will happen after Quarter 1, FY15...? But Honda depreciation amortization will go away.
- Harsh Mehta** Okay.
- Anil Dua** And the additional depreciation on account of new capitalization will come in, but that compared to this amount will be very, very small.
- Harsh Mehta** Okay. Thank you, sir. Thank you very much.
- Moderator** I would now like to hand the floor back to Mr. Rahul Arora for closing comments. Over to you, sir.
- Rahul Arora** Thank you. I'd like to thank Mr. Sud and Mr. Dua, for taking time out and doing this call. On behalf of Nirmal Bang Equities, thanks for joining in, and in case we don't speak till Diwali, happy Diwali to all.
- Moderator** Thank you, sir. Ladies and gentlemen, on behalf of Nirmal Bang Institutional Equities that concludes this conference call. Thank you for joining us. You may now disconnect your lines.