



“Varroc Engineering Limited Q3 & 9 Months FY19 Results Conference Call”

February 8, 2019



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RELATIONS**



Varroc Engineering Limited
February 8, 2019

Moderator: Ladies and gentlemen, good day and welcome to Varroc Engineering Limited's Q3 & 9 Months FY19 Results Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note this conference is being recorded.

Varroc Engineering Limited's management is being represented by Mr. Tarang Jain – Managing Director along with Mr. Stephane Vedie – President & CEO, VLS-Business; Mr. Ashwani Maheshwari – Whole-Time Director & CEO, India Business; Mr. T. R. Srinivasan – Group CFO and Mr. Nitin Kalani – GM-Finance & Head-Investor Relations.

I now hand the conference over to Mr. Tarang Jain – Managing Director. Thank you and over to you, sir.

Tarang Jain: Good evening everyone. I am Tarang Jain here. I would like to thank you for joining the quarterly earnings call of Varroc Engineering Limited.

During the quarter the global macro challenges continued to impact the automobile industry. The effect of changes in Euro emission norms and the uncertainty regarding Brexit hampered the automotive sales in the European market. The Chinese auto sales were very weak in the quarter as it was affected by the macro economic situation, the trade sanctions by the US and the withdrawal of government incentives for new car purchases leading to a Year-on-Year decline in passenger vehicle sales after many years.

India also witnessed subdued demand during the festival season. The negative impact of change in Euro regulations may continue into the fourth quarter and the market conditions in China are likely to remain challenging. In this complex environment, we have outperformed the market and have reported another quarter of strong revenue growth and EBITDA margin improvements.

The revenue growth for the quarter was healthy at 18.3% Year-on-Year on like-for-like basis. The EBITDA for the quarter grew by 40% on a like-for-like basis and the margin was higher at 9.3% as against 7.9% in Q3 FY18. And the operational efficiency improvement initiatives in the VLS Czech operations started to show results.

The reported EBITDA for Q3 FY19 was also positively impacted due to lower launch expenses in the current quarter but was negatively impacted due to mainly the cost relating to setting up of new plants in Brazil, Morocco and Poland.



Varroc Engineering Limited
February 8, 2019

Now we will go in to a little bit of details on the performance during the quarter. Speaking of revenue, revenue in this quarter on a comparable basis increased to Rs. 29,276 million, a growth of 18.3% Year-on-Year. The revenue growth was strong across the board with India business growing at plus 22.6% Year-on-Year. VLS growing by plus 15.9% Year-on-Year and our other businesses by 23.6% Year-on-Year.

The India business continues to benefit from the strong growth of a largest customer as well as increased share of business with other major OEMs. In our VLS business, revenue on a comparable basis increased by 8% in Euro terms. Coming to margins, our reported EBITDA for the quarter was at Rs. 2,779 million and the EBITDA on a like-for-like basis was at Rs. 2,737 million, an increase of 40% Year-on-Year.

EBITDA of the India business increased by 39.9% Year-on-Year leading to a margin improvement of 150 basis points. The EBITDA of VLS business on a like-for-like basis increased by 41.6% leading to margin expansion of 140 basis points. Primarily due to improvement of operational efficiencies in our Czech operations.

EBITDA margins for our other businesses that is VLS Italy and EMS Italy improved to 12% as against 9.1% in Q3 FY18. Speaking of depreciation, our depreciation on Year-on-Year basis has gone up mainly due to capacity expansion at VLS Czech facilities and the adoption of the IND-AS 115.

The effective tax rate increased in Q2 FY19 due to higher share of profits from India business as well as tax credits availed in Czech Republic in Q3 FY18. We were able to only partially avail the additional tax credits for our Czech operations during the quarter. The balance tax credits are likely to be accrued in the next quarter.

The profit after tax for the quarter stands at Rs. 1,022 million as against Rs. 1,117 million in the corresponding quarter last year. Some of the other key developments were that our Turkey acquisition is progressing well. We have initiated integration of the same with VLS Italy to leverage synergies from these two entities. The Bulgaria plant, part of the Turkey acquisition, has started production as planned.

Our Brazil and Halol, Gujarat in India the facilities have started production. The Morocco facility is expected to start production in February and we have already started construction of the phase 2.

With this I would like to thank you and we would now be happy to take your questions.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session.



Varroc Engineering Limited
February 8, 2019

We have our first question from the line of Basudeb Banerjee from Ambit Capital. Please go ahead.

Basudeb Banerjee: Few questions were there. One VLS 8% Euro revenue growth how much was volume and how much was mix of price hikes?

Tarang Jain: Stephane, would you like to take this question?

Basudeb Banerjee: Outlook on VLS growth in this current environment for next fiscal?

Stephane Vedie: So first the first part of the question. In this quarter it is mainly volume growth the revenue I would say 80% volume, 20% let us say technology increase in this quarter. About the next fiscal year obviously we are very cautious on the forecasting volumes with customers. JLR has been impacted heavily this year and we are very cautious in our forecast for next year.

Chinese market has shown a degrowth the first time in the last eighteen years, so we want and we are building our assumption based on the similar level of market with a slow degrowth but we have gained significant new businesses in the past couple of years that are kicking in and that will be impacting our revenue in terms of increasing our market share. So we still see for next year an increase in revenue that should be close to double-digit increase for VLS.

Basudeb Banerjee: Sure and presently how much is LED mix within your VLS revenue?

Stephane Vedie: I think in the last quarter the quantum of LED out of the lamps that we have been producing is close to 48%. On this front we have a lot of momentum, we see all the projects that we are quoting right now. We are quoting the project that will start in roughly two-and-a-half, three years and most of the projects now are LED content. So we will see this share increasing consistently and significantly over the next three year period. In VLS we position ourselves to bring technology and innovation to the customers to the mass market with our cost competitive solution.

Right now we are focusing on developing what we call this is our internal name for this but we call this halogen killer. We have developed the reflective based LED solution that is very competitive still a little more expensive than halogen but that brings so much in terms of its functionality. First it is a white light compared to a yellow light of halogen. Second it is significantly lower consumption in terms of energy. And third this give you so much more styling freedom for the OEMs that we think that this will help us to attack the market share of halogen and increase the penetration on this front. That is one of the highlights of the next quarters to come.



Varroc Engineering Limited
February 8, 2019

Basudeb Banerjee: Sir how to look at employee expenses for VLS from a quarterly perspective, it is quite volatile in nature it seems so like sequentially it is up more than 10%, in a quarter where revenue is down. So how to look at that, any one offs in that or it is more to do with currency or provisioning?

Stephane Vedie: I cannot comment about the headcounts. I do not have the cost in front of me but what I can tell you is that in each of our operations in the world we have a certain percentage of flex labor, agency people and a part of the good work that we have been able to show during the previous quarter is the fact that we have been able to flex the labor.

For example when I compare the headcount in our Czech operation in our biggest plant at the end of December to what we had in October we have reduced in three months by 300 people which is a significant decrease. We are reducing the same magnitude also in our Monterrey (Mexico) facility. So we are really very sensitive in terms of flexing the labor and following very closely and being very almost practical if you want from a week to another to manage the headcount to flex it to the real revenue.

Basudeb Banerjee: Just wanted to understand from a quarterly staff cost, which you account in the numbers which are reported. There is a sharp jump on a sequential basis so how to understand that, whether this is sustainable or this is the quarter of your annual wage hike or there was some bonus provisioning what is the reason?

Tarang Jain: Stephane, let me take that question because this question is from the overall Varroc consolidated numbers, it is not specific to VLS. So there are two, three things one has to keep in mind. One is that there are certain new locations in VLS where we have started recruiting people prior to the commencement of production which is Brazil and Morocco mainly.

So there we have added people but the revenue will start coming in from this current quarter, but we have to recruit people a bit in advance and train them etcetera, etcetera. So that is one. And also we keep updating our accruals for incentive scheme based on the business performance etcetera so that also has an impact so combination of that.

Basudeb Banerjee: Sure. And last question sir, like with Brazil Morocco now coming up, and on the other side global markets being not that great, so there is a risk of operating leverage getting impacted plus start-up costs for the new facility is impacting VLS margin?

Stephane Vedie: The program that we are launching right now in Brazil and Morocco are new businesses, in terms of volumes they are launching and they are doing pretty good in Brazil. This is the also in Morocco. This is all utility vehicles on the PSA platform. These are the first programs that we are launching. We are so far in line with the expectation in terms of volume what we see



Varroc Engineering Limited
February 8, 2019

from the customer and by the way we have been able to start these two facilities ahead of schedule.

We were expecting to launch a few months later and both in the case of Brazil and in the case of Morocco we have been able to get the release from external third-party certification companies plus all the milestone all the gauge from the customers ahead of schedule. We did not feel any audit, we passed everything the first time including the full audit for the plant including the when I sit with the customers so I think the teams they have done a great job.

Basudeb Banerjee: That is great. So you do not see any quarter of sub optimal utilization in those new plants because you have full order book?

Stephane Vedie: No, I would say obviously when we have a machine that is being shared by several programs we are starting the first program right now. The second program will kick in, in three months so we are not fully utilizing this given machine right now. But this is part of the business plan that we put in place, that we have planned and we are well aligned with what we put in place. But I cannot tell you that right now as we speak the full plant is fully loaded. This is not the case.

Moderator: Thank you, sir. We have the next question from the line of Aditya Jhawar from Investec Capital. Please go ahead.

Aditya Jhawar: My first question is on VLS. If you can provide us customer wise break up of revenue that you have given in Slide # 8, for the same quarter last year?

Tarang Jain: Aditya, I think you are looking for the top five customers, right?

Aditya Jhawar: Yes for VLS as well as for India separately?

Tarang Jain: Okay let me start with VLS and so let us start with Customer A right. So Customer A year-on-year for the quarter it is actually a 15% reduction in terms of the revenue. Customer B actually is a 10% growth. Customer C is kind of flat, there is no movement more or less remain at the same level. Customer 4 is a fairly significant reduction there around 40% but Customer E grew by about 8% and the last one grew by 24% Customer F.

Aditya Jhawar: Okay. And same way if you can do for, so let us continue with the discussion in VLS so I mean customer C I mean that is where you know American EV manufacturer is we are seeing kind of a flattish is there you would have seen some kind of cannibalization of volumes specifically in Customer C?



Varroc Engineering Limited
February 8, 2019

Stephane Vedie:

For this customer it is difficult I cannot say the name but for this customer we see that their older model slowly decreasing in terms of sales. We see that they have rationalized their lineup of cars using their newer model, the model 3 at the entry level and the older model, Model S, Model X has more the high end of the model. So they have tried to eliminate some of the low end of Model S, Model X so that they do not cannibalize the model 3 in their catalogue if you want a product.

This is what is happening right now so we are anticipating a small decrease of model S and Model X in the following month. At the same time, we are close to this customer for the new vehicle that is being launched and we think we have a good chance to work with them on this new generation.

Aditya Jhawar:

Okay that was helpful Stephane. And Srinivas, if you can give a same breakup for India the top customers for the same quarter last year?

T. R. Srinivasan:

So Bajaj grew by about 23%; Honda grew by 22%, Royal Enfield was kind of flat, Yamaha degrew by about 16% and Mahindra was kind of flat.

Moderator:

Thank you, sir. We have a next question from the line of Ujwal Shah from Quest Investment. Please go ahead.

Ujwal Shah:

Sir, looking at the net debt levels that has gone up quite a bit, so is this the peak debt levels that the company is seeing or how do we see our debt levels for year end as well as next year? And is it a foreign debt or local currency so the impact on interest cost as such?

Tarang Jain:

So I will take that question. So net debt increase is mainly in the foreign operation. There are two, three reasons. One is we have been spending a significant amount of CAPEX this year for setting up the new capacities in Morocco and Brazil. But also the capacity increase in Czech and so of course all this new capacities have not yet started generating revenues and cash flows.

And second thing there is little build of an inventory buildup in the lighting system business because the customer demand had kind of slowed down so which means we are now correcting but that will take a little bit of lag to bring it back in line. And these are the main reasons there is a little bit of buildup but we are still net debt to equity is only about 0.73 which is well within our target of less than 1. And we expect in Q4 this should improve so we hope to end the year around 0.6 kind of a level.

Ujwal Shah:

Right sir. And if you can also throw light on other operating income going down Quarter-on-Quarter so is there someone off over there?



Varroc Engineering Limited
February 8, 2019

Tarang Jain: See other operating income mainly is driven by the timing of recognition of the various government incentives we have in India and abroad. So it is mainly driven by the India various state level in the programs. The timing depends on various factors like how much revenue is generated from the project, when we get the government approval etcetera. So that is not a fully stable thing. So it can fluctuate a little bit from quarter to quarter.

Ujwal Shah: Right sir, and in terms of impact that Ind-AS had on the depreciation so we have seen quite a volatility in depreciation numbers on Quarter-on-Quarter levels. Should we take this quarter numbers as a base and add the new facilities and that would add some to it or we still have some impact left for Ind-AS in 4Q as well as on depreciation?

Tarang Jain: There will be a little bit I mean if you are comparing Q4 last year to this year Q4 there will be an increase but Q3 if you take it will be broadly in line with Q3 plus as you said the new facilities that we are commissioning in this quarter that depreciation will start accruing on that. So that should be the right thing to do, yes.

Ujwal Shah: Sure and your thoughts on Poland expansion as well as CAPEX for this year and next year?

Tarang Jain: Poland maybe Stephane you can provide an update on the Poland?

Stephane Vedie: We are using this switch of plant in Poland to continue to be able to grow in Europe, more in Eastern Europe, some part of Europe perimeter. Our plans in Czech Republic are now with launches that we have end of this year beginning of next year will be full. So we need a new area to be able to go in Central Europe. We want to start production in Poland by the end of 2019 and we want to bring gradually this plant to a revenue of €200 million.

That is the plan. In terms of CAPEX as we are pushing very hard right now on improving efficiencies in Czech Republic we are able also to free some equipments by reducing the scrap by improving the cycle time by layout of some of our operational set up. We are able to free some equipment and we want to send some of these equipments also to the Polish plant. So this is helping us overall to reduce the CAPEX for this new investment.

Ujwal Shah: Right sir. But on the console if you can provide some guidance in terms of CAPEX for this year and next year?

Tarang Jain: Current year broadly lot of CAPEX was actually front ended both in VLS and in India so we will probably be in line with the guidance which we had given earlier which will be close to Rs. 80 million in VLS and another Rs. 300 odd crores in India. So total roughly let us say about a close to a Rs. 950 crores to Rs. 1,000 crores, but we are now relooking at our plans for next year taking into account the updated industry and demand scenario and also capacity



Varroc Engineering Limited
February 8, 2019

utilization at different locations both again for VLS and India and to see where we can kind of how we can optimize both in terms of quantum as well as the timing.

So we are reworking on that so maybe by the time we have the next call we will have a better idea of that number. But it will be lower than this year for sure. It will not be at the same levels.

Moderator: Thank you very much, sir. We have the next question from the line of Riken Gopani from Infina Finance. Please go ahead.

Riken Gopani: Sir, firstly I wanted to understand the comment regarding this year's VLS revenue for this quarter being broadly driven by volumes. So given that if the understanding has been that you will be launching new products and typically there has been some premiumization going and LEDs increasing as a proportion. So is it there any component of mix related or price related improvement in the revenues here or am I missing something in this?

Stephane Vedie: Most of the launches we had last year were in the fourth quarter and that means they were not impacting the third quarter in terms of revenue. So they started to come back on the fourth quarter and now we are I think the full impact of this on launches. We have some with Land Rover, with JLR, we have a few with Volkswagen for example on Volkswagen in Poland with PSA. So now we are seeing the full impact of this revenue. So that is the impact in terms of volume if you want that we have seen in the third quarter compared to the third quarter of last year.

Riken Gopani: And also if you could help us give an update on one, the raw material environment how it is currently for you and in the previous call you had outlined that you wanted to backward integrate and that was one of the way of improving the operating margins as well. So on both these fronts, where are we?

Stephane Vedie: So raw material that is mainly impacting us to be categorized. One is the resin the plastic raw material that we use for our plastic injection processes also plastic parts that we are outsourcing so that is more on the plastic side and the second category is more electronics. The plastic the resin is mainly a supply and demand game. And right now with China showing a significant degrowth the demand on the plastic and resin is going down and this has an impact to decrease the pricing of this commodity.

So we see the main commodities like polycarbonate like PMMA, like ABS, these are the main resins that we are buying. We see that the trend now is going down. The next quarter we are showing a degrowth in term of pricing. So that is a good news. About the plastic parts that we are buying outside from sub-suppliers as we have been working on that we have been



Varroc Engineering Limited
February 8, 2019

successful in increasing the efficiency in our Czech plants. We have been able to reintegrate some of the position we had outside, inside. So this is a really positive impact.

We are continuing to do this over the next quarter as well, instead of paying external purchasing price to a supplier, we just have to cover our internal buyable cost. So the benefit is big. In terms of electronics, from the suppliers now we are in negotiation for the next year the next fiscal year condition. So it is not finished and closed. But we see a similar trend in terms of decrease double-digit on LED. This is our expectation for the year to come.

So more to come maybe on the next call. In terms of our vertical integration a maiden venture with the company Elba has been signed. We have formed a legal entity we have a team there with a General Manager, with a Production Manager with the key functions that has been already recruited. We are in the process of ordering the SMG lines and we are in line with start of production in this JV with the first ECUs and the first LED PCB assemblies in let us say eleven months from now.

Riken Gopani: Just one more aspect that I wanted to understand. If we look at your performance with Customer B in the VLS operations your performance definitely looks better than what they have done in terms of volumes. So if you could highlight, are there any specific models or any market share gains which are driving your performance to be quite superior compared to their own performance?

Stephane Vedie: We launched the Range Rover and the Range Rover Sport in the fourth quarter last year so this is the main impact in term of increasing the revenue we discussed. Then the technical content on this product is also pretty high. So this has helped us increasing the revenue with the customer that has been overall decreasing their volume on the market.

Riken Gopani: And just on the Brexit uncertainty, we understand that some of the players are preparing themselves by having a plant shutdown in this part of the year? How are you planning to manage the uncertainties around the same and what sort of impact do you anticipate from the same?

Stephane Vedie: So we are trying to stay as flexible as possible like I mentioned in term of workforce with the flexibility of having agency people especially in Europe we are able to adapt our workforce from week to week. Our self-condition with our main customer based in UK is exports so they come to pick up the goods, so we do not have to worry ourselves about crossing the border, about the duty, about all these possible orders that could impact this business at the very end of March of 2019. Everybody is anxious to see how the things will pan out.

We read also like you in the press that some customers want to make some stock of product before so that their operation is not disturbed, but this is not what we are seeing from JLR right



Varroc Engineering Limited
February 8, 2019

now. We did not see them making the stock we found them rather reducing their stock of cars that are on their lot. We are ready in terms of processes but right now, with our ex-works in control, the issues are more in the end of our customer right now and we are supporting them with anything they need but they are still expecting and hoping that there will be rules of the game better defined because as of right now it is still very fuzzy of what will happen on the 29th of March 2019.

Moderator: Thank you, sir. We have the next question from the line of Jamshed Dadabhoy from Citibank. Please go ahead.

Jamshed Dadabhoy: Couple of ones. One is housekeeping. I just wanted to get a better sense of what happened to your consolidated depreciation expense this quarter and why it has on a quarter-on-quarter basis declined so sharply? So that is one. And then I will ask after this I will ask the second one.

T.R. Srinivasan: Jamshed, Srinivasan here. On the depreciation part if you recall we implemented the Ind-AS 115 in Q2 effective 1st April so that impact of the Ind-AS 115 on depreciation was for two quarters but it was booked in the Q2 numbers and now in Q3 it is only one quarter that is why you see a reduction sequentially.

Jamshed Dadabhoy: So your quarterly run rate is roughly to the tune of Rs. 140 crores, understood. Second question going back to what comment that Stephane made earlier in the call, for next year you are expecting revenue growth of only roughly high single digits in Euro terms and this includes ramp up of Brazil, Morocco?

Stephane Vedie: No, I thought I said double-digit, that must be my French accent.

Jamshed Dadabhoy: Okay, so you are looking at double-digit revenue growth?

Stephane Vedie: Yes, despite the current market condition. I think we are showing that in decreasing market we continue to show growth, we continue to show more than average growth. It is important we continue to improve our operational level. We are demonstrating that we are able to launch new plants on time at a good level of quality. Speaking of quality by the way we have just received an important recognition in China. We won the Changan QCA Certification and that is the first lighting supplier to achieve this certification with 1,300 points. So that is really an important recognition and our team is very proud to be able to display this.

Jamshed Dadabhoy: Okay. And if I may just squeeze in one more, on this every quarter we are seeing a lot of these one off expenses which keep occurring startup costs etcetera. How many quarters more should we expect to see this run through?



Varroc Engineering Limited
February 8, 2019

T.R. Srinivasan:

Jamshed, if you see this one off it is mainly because of these new plants which are being put up and the cost led to that which we cannot capitalize under Ind-AS so that is why you see this cost. Now in the current quarter both Brazil and Morocco are getting commissioned. Further quarter this will be there but then once the kind of operationalized then it will become this thing but even though there will be an effect still because the ramp up takes a bit of time, so it will get normalized in over the next couple of quarters.

Poland is the one where we have started the project but it will again take another three to four quarters for it to come on stream. And then the other next plant which is now we are starting work on is the Chennai plant for VLS which also would be a three to four quarters kind of a thing but that will start probably only next quarter. So it is a kind of a phase in which we are investing setting up capacities etcetera so as I said, so will some of them phase out some new ones are phasing in so you will see probably for the next twelve months or so, this will be there but the amounts will kind of vary little bit.

Jamshed Dadabhoy:

Okay and Srin, when you said you are trying to optimize CAPEX right could you give us a sense of what is your capacity utilization right now in both VLS and the India businesses?

T.R. Srinivasan:

VLS Stephane may be if you can take it.

Stephane Vedie:

Yes. So just also to add to what Srin was saying before, right now we are in the process of doubling the revenue of VLS. If you look at last year, compared to fiscal year 2024 and we are doing this mainly organically. So we need to add this additional capacity. When we look at opportunities for inorganic place and when you look at the cost of growing the company organically it makes a lot more sense in the current ongoing months to grow organically. It is a lot cheaper right now. In terms of utilization, our plans in Czech Republic loaded I would say in the runs of 80%, 85% right now and we still have some launches that will bring them to the maximum capacity.

The plans in Brazil and Morocco they are ramping up and we are growing by phases. So now we have built the Phase 1 and the Phase 1 will be full within twelve months. But we are already starting to build the Phase 2 in Morocco and we are trying not to bring too much capacity, in fact we are trying to go step by step. I hope I am clear enough here. The main plant where we have capacity available right now in our footprint is in Mexico in Monterrey where I would say one third of our capacity is available right now and this is where we are working very hard to be able to win some new businesses to fill this capacity and this would have a nice impact on the whole on VLS as well.

Jamshed Dadabhoy:

Got it. And Srin, in India?

T.R. Srinivasan:

Yeah India part, Ashwani will take that call.



Varroc Engineering Limited
February 8, 2019

Ashwani Maheshwari:

So India we have currently variety of products and also the plants are all over, we have varied capacity utilization. If you also recollect the way our customers have grown so for plants which are dedicated to Bajaj, there is a fairly high degree of capacity utilization. I would say we are almost neck to neck. There are certain plants which we have sort of implemented towards the end of the year which is plants at Halol which are dedicated to HMCL.

There the capacity utilization is now picking up. So since the plant itself got on to stream somewhere towards the end of the year. There is one particular plant which is a crank shaft, large crank shaft plant which is in Aurangabad in metallic. That plant is one which continues to be at a lower capacity utilization. There it is impacted by two ways, one is there has been towards the end of the last quarter there is also a decline and we are also experiencing decline now.

And also we need to sort of work more aggressively in getting business in that area. Rest if I look at south plants dedicated to Yamaha there are plants which are dedicated to Yamaha because the almost flattish growth there is a capacity I would say 60% to 70% capacity utilization the plants up north.

Moderator:

Thank you, sir. The next question from the line of Ujwal Shah from Quest Investment. Please go ahead.

Ujwal Shah:

Just wanted your idea on VLS margins from this level we have already seen some benefit coming in from our Czech plants. Where do we see VLS margins for the year end as well as margin expansion next year considering three of our plants would be on stream by then?

Stephane Vedie:

So we had a difficult start of the year, now we have seen that we have recovered and the coming quarter will show even more progression. We want to show an improvement year-over-year on the margins, so I think despite the slow start of this fiscal year we will be able to reach this goal of showing an improvement this year compared to the previous fiscal year.

And for next year it is the same. We want to go into the top line and the bottom line at the same time. It is not easy but that is exciting and so far we have been successful in showing this several years in a row and we will continue next year as well.

Ujwal Shah:

Sir, when do we see our VLS margins being in the double digit zone, so which of our plants need more work and which year do we think we will hit that double-digit kind of a margin for?

Stephane Vedie:

We are already floating with the double-digit right now so once we are able to load this new investment a little more I think we will be there. Clearly expectation is already next year and we are working on this right now. But I think it is not a crazy expectation. We have all in mind that the best-in-class right now, they have EBITDA around 13% and this is still where we want



Varroc Engineering Limited
February 8, 2019

to be so we are growing much faster than these bigger companies. This growth is slowing us a little bit in increasing the profitability but still we are able to increase and still we are getting there. So we still have this as a target and we still go there.

Ujwal Shah: And sir, what percentage of our Czech revenue comes from JLR so what kind of dependence our Czech facility has on JLR?

Stephane Vedie: This is mainly for our smaller Czech plants that is majorly serving this customer JLR. Overall the Czech business is well spread between JLR for Volkswagen mainly the Skoda brand of Volkswagen Group. So I would say JLR in Czech is in the runs of 20%.

Ujwal Shah: Right sir and the Romania backward integration that we have planned sir so by when will we see margin improvements on account of the same and the percentage that we look forward to?

Stephane Vedie: On this to answer the previous question I told you that we should be able to start producing our first products in roughly eleven months from now. We need to alter the process we need to set up the process, we need to go through qualification, we need to go through validations. So it is not something we do immediately and then after we need to earn this up so I would say we will start feeling the impact eighteen months more significantly twenty four months from now.

With our feasibility study we have been able to demonstrate that we can reduce the cost of our electronics by roughly 10% but also generate positive margin from this activity. So far we are focusing on revenue equivalent of €45 million and we are buying roughly for €150 million of electronics right now. So we would be making a 10% reduction on one-third of our electronics.

Moderator: Thank you sir. We have the next question from the line of Prayesh Jain from Yes Securities. Please go ahead.

Prayesh Jain: Sir, my questions were on the India business with regards to the catalytic convertor and the electrical fuel injection. What kind of contracts we are already in place and what do we see the outlook on that front?

Tarang Jain: So you know so these are very, very interesting products for us. See EFI for us is of course a new entry into our product and we have already have a contract with Royal Enfield where we have a contract to do about 300,000 of the sets of EFIs for them a year and that is only first of this thing and we are hoping that we are able to add one more customer going forward on the AFI front. When it comes to catalyst, catalytic convertors we are already doing BSIV but only for Bajaj Auto at the moment.

But now that on BS-VI we have gone in for a new technology partner over here for a technical co-operation and here we are looking at a stronger customer base. So Bajaj is already there I



Varroc Engineering Limited
February 8, 2019

mean this thing for this product and we are also looking at entering into a couple of other customers in India. And we should come to know this soon.

So here what is happening is that obviously the catalyst which we will do now, there are now two catalysts per vehicle with the new emission norms instead of one and obviously the content is also much higher in the new catalyst. So we do expect a significant revenue growth at least probably three to four times the current value of what we supply let us say to Bajaj and now going forward a bit also with the others. So there is good scope here of increase in revenues on catalyst as well as on the EFI system.

Prayesh Jain: And what would be the size of the catalyst business right now?

Tarang Jain: So today I think it is pretty small I would say that it is more I think in the tune of about I think probably Rs. 50 crores a year and this would significantly go up I think to at least Rs. 250 crores, Rs. 300 crores in the immediate term and then of course higher in the sense with bit more customers we add.

Prayesh Jain: Okay and with regards to the customers like Hero where we have just limited number of parts that they are supplying any new contracts that we have been able to for new parts?

Tarang Jain: So at the moment we have basically we do I think insignificantly we are into the lighting business. So lighting we have put up a new plant in Halol for 6,000 sets per day. Today we are at about we have a capacity which we have set up for 4,000 to start with and by this month end we will be at around 3,000 sets per day and from April we will be at about 4,000 sets per day and 6,000 we should probably reach hopefully by December-January later this year. So this basically only for Hero.

Now coming to the other and we also do a little bit of painting business in the North which we are doing for a few years, but that is not significant. But there are about at least six to seven product groups which are in discussion today ranging right from the metallic products like crank pins very close to finalization crank pins to switches to the AC generators. There are number of products in our stable so we are very close to finalization in some of these products probably before the end of March.

Prayesh Jain: Okay. And so what is the outlook for the growth in the domestic business the way you said for VLS that you are looking at a double digit growth. What is the kind of growth that we are looking at domestic business in the next year?

Tarang Jain: So I think it would be I think we are still doing the numbers but definite double digit. See the aspiration is always to grow at minimum 15% to 20% and that is something we will always try to do year-on-year.



Varroc Engineering Limited
February 8, 2019

Moderator: Thank you, sir. We have the next question from the line of Rakesh Jain from Asit C. Mehta. Please go ahead.

Rakesh Jain: The question I had was can you just tell like what is the performance of Turkey because this was the first full quarter post the integration and another question is like what is the status on the Bulgaria CAPEX?

Stephane Vedie: So Turkey we are very pleased with this acquisition performing well in terms of margin. You are all aware that currency the Turkish Lira went down but all our contracts are in Euro or Dollar. When I say all the contracts I mean 96%, 97% of our commercial contracts. So this has helped us to increase the profitability of this operation even more than what we initially planned and expected. I think we ended the last quarter in the range of 25% of operational margin. Bulgaria it is a side that is now operational that we started in production.

We thought to start Bulgaria few products from Turkey for customers that are based in the European Union and that wanted to have a source inside the European Union. So far it is a small plant and nothing compared to what we are put in place in Morocco for the moment but we will be growing this plant carefully slowly, but in terms of investment we will go step by step year after year.

So not a big investment like we are doing in Morocco but more gradual ramp up of capacity. This side is mainly focused today on small lighting what we call small lighting is fog lamp, stop lamps, sign markers reflects so more the smaller light that we were not selling to our customers until now. So that is what we are focusing on with this side. But this location is very interesting. It is inside the European Union, it is a very low cost and it is pretty close to some customers that are established for example in Romania.

When you look at the footprint in Romania, it is in Pitesti in the south of Romania and this is only 400 kilometers away from our Bulgarian plant. So we want to grow this plant, we want to grow the competencies of the team, and then potentially offer a rear lamp, head lamp out of this location in the years to come to attract new markets. So this is a good positioning.

Rakesh Jain: Okay. And could you share that which are the clients whom we are serving from the Brazilian plant right now?

Stephane Vedie: Brazilian plants we have two customers right now. Volkswagen that is already in production we have already started to deliver since beginning of January and the second one is Reno. Reno we will be starting I think in three months from now the start of production.

Rakesh Jain: Okay and what would be the utilization at this stage?



Stephane Vedie:

Just to remind you in Brazil it is not a full-fledged plant, we wanted to be very careful because Brazil is a very volatile market, so we went in Brazil in partnership with an established company in Brazil. The name of this company is Mekra. This is German owned, family owned, they have been operating in Brazil for the last fifteen years and we are sharing the plant space with them. We are sharing the fixed cost, we are sharing like payroll, like IT, like import, export. So we have in fact just put assembly lines molding machine dedicated to this program.

So right now Brazil is really loaded I would say when the customer ramp up fully the program Brazil will be loaded at 85%, 90% which was our target. Minimum investment by the way the most expensive equipment we have concept from Mexico which is a place where I told you we have some capacity. So in Brazil we are being very careful but Brazil has been very important for us, it is a very important step to position ourselves as a global partner to customers like Volkswagen and Reno. They needed a supplier in Brazil we have agreed to come there, we went there at a low investment, low risk but thanks to this now we are really growing at a fast pace with these two major customers.

Rakesh Jain:

Sure. My next question is on the domestic business. So if you could just elaborate like what is the scope of improvement over here considering that the plant utilizations are low and how quickly can we ramp this up?

Tarang Jain:

So in India we have been growing well with all the important customers largely we are in the two-wheeler space, 85% of our revenues come from India and let us say we have about 26 facilities in India out of which about 8 to 9 are dedicated only for Bajaj which enjoys anyway very high capacity utilization because as you know they have really grown this year.

So there we are in a good space. Now when it comes to the other plants which are like say in the south, in the north a little bit of west yeah there we have capacities available but there also we are looking at we are discussing with certain customers how we can increase some market share with them.

They have been very open because our performance on the QCD scorecard has been pretty good with all our existing customers and they are pretty much responded quite positively. So we are kind of that is one thing and we are also kind of looking at a certain level of growth anyway in the market next year overall with everyone.

So we do feel that next year we do not have really to significantly do any CAPEX in India and I think that a very small CAPEX we will be able to achieve this kind of a double digit growth we have set for ourselves with a low CAPEX and I think we will be focusing more on utilization of the existing capacities.



Varroc Engineering Limited
February 8, 2019

Rakesh Jain: But we are not looking at consolidation at this juncture?

Tarang Jain: A consolidation from what?

Rakesh Jain: Consolidation of the plants?

Tarang Jain: So we are not looking at shutting down any plants because at the moment I feel that there is still a kind of scope maybe if the time comes temporarily we may think of but it will not be a permanent kind of thing like what some of the other suppliers are doing. But in our case, yes there are certain remote plants where utilizations are a little bit low but we are still quite hopeful of getting in business over there.

On a temporary basis, if things do not work out we may look at temporarily kind of shutting part of the operations of a particular plant and shifting it consolidating in one plant. But only part of the operations so that everything is actually at a low utilization.

So that is something we are anyway looking at but that we have to see whether because last few months yes there has been a lack of growth in the Indian market but I think going forward we do hope the growth to come back and if that does happen then I do not think that we need to really do much of a consolidation within plants but we are not anyway looking at any plant closure going forward at least in the next year.

Moderator: Thank you very much, sir. Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. Tarang Jain for closing comments. Sir, over to you.

Tarang Jain: I would like to thank everyone for their questions and as the organization I remain confident about our future I think both our core businesses of lighting as well as our India business remain strong, we have a strong foundation. And we do hope for improved results in the last quarter as well as going forward in to the next year. Thank you.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of Varroc Engineering Limited, that concludes this conference call. Thank you for joining us with us and you may now disconnect your lines.