“Varroc Engineering Limited Q3 FY-22 Earnings Conference Call”

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MANAGEMENT: MR. MR. TARANG JAIN – CHAIRMAN & MANAGING DIRECTOR, VARROC ENGINEERING LIMITED
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Moderator: Ladies and gentlemen, good day and welcome to Varroc Engineering Limited Q3 FY22. Results Conference Call. As a reminder, all participant lines will be in listen only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. Varroc Engineering Limited management is being represented by Mr. Tarang Jain – Chairman and Managing Director, along with Christian Paschel – CEO, VLS Business; Arjun Jain – President and Head, Electrical & Electronics Business; and T.R. Srinivasan – Group CFO. I now hand the conference over to Mr. Tarang Jain. Thank you and over to you sir.

Tarang Jain: Thank you very much. And good evening to everyone. Tarang Jain here and I would like to thank you for joining the Q3 FY22 Earnings Call of Varroc Engineering Limited. Let me start first with the India business. The Indian two-wheeler industry volumes were lower on both year-on-year and quarter-on-quarter basis by 23.7% and 13% respectively. Against this backdrop, India revenue in the quarter increased marginally by 2% year-on-year and declined only by 4.2% quarter-on-quarter. This is mainly attributable to the sharp increase in commodity prices during the year, most of which was passed on to the customers.

The EBITDA margin of the India business was at around 10% with margins impacted negatively but a time lag in passing through of the commodity prices, price increases to the customers. Speaking about the global lighting business now. The semiconductor shortage continues to persist globally and is expected to normalize over the next six to nine months. The passenger vehicle volume during the quarter have shown some recovery as compared to the previous quarter but are still significantly below normal levels. The passenger vehicle production volumes in the current quarter in Europe were down 25% year-on-year, North America was down 13% and China was down 3%. This resulted in a 15.1% drop in VLS revenues year-on-year in Euro terms, though it was 10.7% higher on a quarter-on-quarter basis.

The VLS EBITDA margin improved by 510 basis points quarter-on-quarter due to the sequential revenue growth, customer recoveries for low volumes and commodity inflation, improved operating efficiencies and better cost controls. Our China JV revenue also grew by more than 20% on both quarter-on-quarter and year-on-year basis with improvement in EBITDA margins, the quarter-on-quarter increase was of 250 basis points.

Our project RACE launched in Q1 FY22. To improve the profitability of VLS Europe operations to best in class levels has made good progress in identifying improvement opportunities across various parts of the business and implementation of the identified actions is currently underway. The impact of the same will be more visible towards the later part of FY23. Our overall net debt levels have reduced during the quarter by Rs.370 crores due to improve operating cash flow and a weaker Euro. The VLS operations are expected to start generating positive free cash flow from Q4 due to the improved revenues and a better operating performance.

Our order booking, I'm happy to inform you is that our India business has been able to secure an overall net business when of Rs.580 crores of Rs.5.8 billion on a year-to-date basis. And most of these orders are new business wins. Our VLS business has one euro 105 million worth of new businesses on a year-to-date basis, though new ordering activity at a customer end is muted due to the backlog of current model volumes as a result of the semiconductor supply shortage.

Finally, I would like to mention that we received an interest from certain parties for a strategic partnership in a global lighting vehicle systems business. The management is in the process of evaluating the interest with respect to scope, valuation, timelines, et cetera. The investors are currently carrying out their due diligence of VLS and there is presently no firm or binding offer that has been received by the company as on date. With this, we are happy to take your questions now. Thank you.

Moderator: Thank you. We will now begin the question-and-answer session. The first question is from the line of Ashutosh Tiwari from Equirus Securities. Please go ahead.

Ashutosh Tiwari: Firstly on this debt reduction by 370 crores quarter-on-quarter this is mainly toward let's say material reduction or better coming down what is the main reason behind this?

T.R. Srinivasan: I will take that question, so basically this is driven by two factors. One is, in the VLS business in the last quarter, we have seen a sequential revenue growth of about 10% in Euro terms and that has contributed to improving the operating cash flows in addition to certain initiative we have taken in working capital improvements. And during the quarter we also came to certain settlements with customers for some claims we have related to commodity cost increases, and capacity under utilizations during the year and so overall can see the VLS EBITDA margins sequentially have improved by 510 basis points which continues to the improved cash flow. In addition the India business continues to generate positive free cash flow which is also helping in reducing the net debt and the third factor is euro weaken against the rupee during the quarter by about Rs.2 per Euro and that means, debt denominated in Euro also reduced in rupee terms to that extent by about 60 crore of the overall 360, 370 crore reduction we had so I would say roughly 20% due to exchange rate and 80% due to better operating performance, working capital management and stuff.

Ashutosh Tiwari: So, there is loss in the quarter so, at EBITDA level as well. So, this is mainly due to working capital only I guess. So, I want to understand whether it's a payable increase which growth this maybe reduction. So, what happened exactly is this quarter?

T.R. Srinivasan: Yes, payables have been fairly at a constant level. So, it is mainly inventory reduction and also some faster collection of receivables. So, certain payments which were on account of tooling and engineering, et cetera which are due from customers we have been able to collect earlier. So, that mainly has given plus the India overall for free cash flow.

Ashutosh Tiwari: Got it. Secondly on this VLS EBITDA, now if I look at the two plan that you highlighted, Poland and Morocco there, the EBITDA loss has actually gone up by almost €3.5 million quarter-on-quarter and overall reduction of €10 million in the EBITDA. But the other plant would have contributed on €13.5 million improvement while actually in terms of revenue. Mexico was flat, Czech was only €10 million increased quarter-on-quarter. This €13.5 million improvement in EBITDA came from where, is it like some element of receivables from customers of which came in previous quarter as well as this quarter?

T.R. Srinivasan: Lot of the customer settlement happened late to the current quarter actually. So, in the quarter we received let say VLS settlement of something like let's say about €12 million out of that €8 million or thereabout relate to current quarter and €4 million is less to previous quarters roughly that's a broad status. So, essentially certain price correction which we got effective during the current quarter which are under discussion because of the cost increases which had taken place through the year, from the beginning of the year onward. Plus, some capacity and utilization which was there because of the lower volume and the combination of that. And on the newer plans specifically there were two reasons why we still don't see an EBITDA improvement, one is because the commodity price increases have been sharper this year. So, we can offset that and operating leverage we got with higher revenues, plus they're having some supply chain disruptions in terms of availability of materials especially semiconductors, because of which there have been frequent changes in production line and some expiration of site that also contributed to lower operating performance, but both are kind of expected to stabilize in the current quarter and quarter four.

Ashutosh Tiwari: If I get it correctly, €10 million that we got this quarter, 4 million is related to previous quarters right, in terms of pass through?

T.R. Srinivasan: Correct.

Ashutosh Tiwari: And secondly there were some freight correction, will that also include something related to previous quarter that we got in this quarter?

T.R. Srinivasan: No, those are all profit effective in the current quarter. Out of 12, 4 is previous quarter and 8 million is current.

Tarang Jain: So, just to clarify the 4 million was on account of some underutilization claims on certain programs of one of our major customers, which had to be settled before December end because, the customers have December end as their year end, and also some of these programs end of life was also achieved. So, the claims were due as per our purchasing conditions. So, that was 4 million and the 8 million was a general increase already granted by one of our major customers, effective November, but, obviously the commodity increases have been quite sharp in the last one year, more and therefore we are expecting certain increases which would come in, more from the January period onwards in Q4. So, 8 billion was by one of the customers who has actually kind of granted us price increases on due to commodity related inflation, from November onwards of last year. That will continue, it's like compensating us for the commodity price inflation's actually, over the last two years, but people, like in India for example, we have a quarterly settlement, while abroad, probably sometimes annual, or sometimes, in case of some special situation that are increase in commodity prices are really tremendous, then we can go back and ask them, and that's what's happening now, that we will see, you can say a reimbursement of this commodity inflation going forward.

Ashutosh Tiwari: Okay. So, you say that, that 8 million is rated in last one year, November 20 to December 21?

Tarang Jain: So, November 21, with only November and December 4 million is related to the underutilization of these few programs of a major customer, for over the last probably one or one and a half years because of the COVID situation.

Ashutosh Tiwari: Okay, got it. And how do we see Q4, like the versus Q3 in VLS, what kind of revenue increase you can see quarter-on-quarter?

Tarang Jain: So, see what has been happening so far in the first nine months, if I have to just state it simply that with all the investments we've made in new plants, and overall VLS as a production revenue including, of course China, 50% of China, we should be doing a production revenue of €100 million a month. But what we have seen is, that due to the chip shortages, we have seen an average of only €68.8 million in production revenue in the first nine months. So, we are almost 30% down overall, it depends on which plant is more or less, but that's the issue and that's the reason why there has been a cash burn for us in the first nine months. But now, we see from January onwards, we already see an improving revenue trend, revenues are increasing by at least 10%, 10% to 15% and this of course, will help an overall situation of no more no more cash burn and also this price increases due to commodity inflation, reimbursement of that, we already got it from one customer and we are also seeking from other customers in Q4. This will result in a positive I would say free cash flow. And also at the same time we have seen that we have for this project RACE which we have discussed, in the last two quarters also that we have started project race in June of 21. And we started implementing the ideas from you can say September, October of 21. And here also we see a momentum growing. And this also will result in better operational testing and overhead performance in Q4 onwards.

Moderator: Thank you. The next question is from the line of Aditya Jhawar from Investec Capital. Please go ahead.

Aditya Jhawar: My first question is that we have to repay a debt of about €50 million by March 2022. So, does that mean that the strategic sale decision that we are planning to take, the resolution will come before that?

T.R. Srinivasan: Well, it is not necessarily linked to that. What you're referring to mainly is facility we have in Czech Republic from Czech Syndicate. So, where we have an extension till March, because right now we are in discussions with the bank to rollover for a period of six months. So, that negotiation is going on independently. So, there is some prepayment, et cetera which can be managed as operating cash flow plus some additional decorating that we are working on at the moment. So, coming to the strategic sale obviously, we cannot be sure of the timing and the quantum of the investment, et cetera. So, we are not necessarily depending on that to plan our cash flow and take a commitment. So, this will be in different terms.

Aditya Jhawar: Sure, thanks really Srini. So, what could be the timeline broadly if you can help us understand for strategic sale?

T.R. Srinivasan: This is a bit difficult to predict, you will know very well from, these things can take longer or shorter depending on the discussion. So, we can only say that we have the fix interest and the due diligence process is ongoing and as a result we have, a firm or a binding offer or a definitive agreement obviously we will update about it on exchange**,** so you can take anywhere between very difficult to predict it can be anywhere between three to six months or even longer depending on the scope of the deal, the associated complexities and mechanism. So, these things are a bit difficult to predict and there are multiple parties involved it's not like we are engaging with one party. So, we need to wait and see how things develop and we will keep you all updated regularly on the progress as we go.

Aditya Jhawar: Absolutely. The next question is on order wins, specifically on EV in the Indian market, if you can call out specifically any order wins. So, we understand that we have been supplying to Bajaj Auto for Chetak. But other than that, what are the other wins, are there any progress in discussions we were discussing the starters and few existing OEMs as well?

Arjun Jain: Yes, so again like we've talked about before, we have been engaged with multiple different customers. However, also like we have mentioned before, the focus really has been to drive, execution and launches of the order we have already won. And today we are in a very, very strong position there where we have basically launched almost everything, we have either launched or for a couple of components. We have invalidation now, so we will imminently launch all of the products that we've been talking about, anything that really, significant for the Chetak, and really a significant achievement over the last quarter. Of course next, we also work on the three-wheeler, that is something that happens in parallel. And again now that we will have level of capacity again, it bodes well really for the future.

Aditya Jhawar: Thanks Arjun. But, other than Chetak are there any projects which we can go for commercialization in the next three months, or we are at advanced stage of winning orders in EV components?

Arjun Jain: I would rather not talk about where we are in terms of, before there's a business win, I don't think there's any point in reporting it out. So, we would rather wait for an actual, we'd rather wait for a business win before reporting it out.

Aditya Jhawar: Absolutely, thank you. And the final question is on depreciation Srini. So, the capitalization of the new facilities is it largely behind and should we expect this 250-crore kind of run rate on a quarterly basis or how much increase we should expect on from this?

T.R. Srinivasan: Nothing, by and large capitalization of the major facilities will run, of course there will be ongoing replacement CAPEX plus on program, specific CAPEX but that should not exceed replacement, it will be stable around this.

Aditya Jhawar: Sure. And a final if I can squeeze, what could be the EV contribution on a consolidated revenue VLS and India put together?

T.R. Srinivasan: Sorry, come again?

Aditya Jhawar: What could be the overall contribution from sale to electric vehicles that include Tesla, VLS as well as the India business?

Arjun Jain: India I think, see talking about this year it is not that much and you are talking about built of an EV, you're talking about an EV powertrain only. And over there you are talking about lighting?

Aditya Jhawar: Right, absolutely Right.

Arjun Jain: So, EV powertrain in fact, we have just started as you know for the Chetak. So, next year if you talk about the EV components, we would be at least a level of about 250 crores next year for the Indian side, EV powertrain which will be largely in additional revenue. When it comes to lighting, see our lighting portfolio, what we had last was about whatever revenues are, it's about between 10% to 15%. No, sorry that was the market share, Not only that, for the market share, there was a market share. Christian would you be knowing that what out of the total revenue what percentage, would be for EV vehicles, what revenue would it be for the EV vehicles only roughly?

Aditya Jhawar: Yes, for example Tesla, and some of the OEMs.

Arjun Jain: Tesla and Volkswagen program and all that, roughly I would say about, maybe 15% or 20%.

Christian Paschel: I believe it's between 15% and 20%, 22%, 25%.

Aditya Jhawar: 15% to 25%.

Arjun Jain: You can say that let's say if we are on a production revenue side, if you are around 850 or 900 million, so you can just maybe you can take 20% of that. So, let's say, it could be anywhere between 150 to €180 million would be for towards EV lighting, and in India side EV, we just started so it will be a very small revenue this year. And next year, the revenue growth should be there in VLS also so this number of 150, 180 million will also grow. So, there are chances of it going up to maybe 180 to 220 or 230 million next year, at least.

Moderator: Thank you. The next question is from the line of Abhishek Jain from Dolat Capital. Please go ahead.

Abhishek Jain: How is the revenue contribution Europe versus North America in nine months FY22 and how much growth or de-growth in each geography?

Arjun Jain: If you really take on a quarter-on-quarter basis, Q2 to Q3, North America actually was down about 1.4% in revenue terms. And, if I talk about individual plants, I will not just say Europe on a quarter-on-quarter Czech was up by 10%. Poland was up by 40%. And Morocco was up by 17.7%. So, this was I'm saying quarter-on-quarter the increase in revenue. When it comes to a year-on-year change. Obviously as you remember last year in this third quarter was when we saw a V shaped recovery. So, obviously compared to year-on-year North America was down 26%, Czech is down 33% and of course Poland and Morocco at that time were at a very, very low level. So, there Poland has grown 54% and Morocco has grown 48% on year-on-year basis quarter.

Abhishek Jain: Sir, I was asking the revenue mix for the nine-month FY22, Europe versus North America.

T.R. Srinivasan: Yes, if you take it on a nine-month basis, North America from a production revenue perspective, will constitute between 17% to 18% of the overall VLS revenue. Then Europe's together about 55% across Europe, which is Czech, Poland, Morocco, all put together, then there are rest of it is contributed by India, Brazil, Turkey, Italy, Romania, Vietnam, and all that put together.

Abhishek Jain: Okay, sir. And given the geo political issues and sharp increase in the energy cost, how's the outlook for the Europe for growth and margin in fourth quarter and FY23?

Arjun Jain: Christian, you want to take that?

Christian Paschel: Can you repeat, I wasn't able to catch the question.

Abhishek Jain: Sir, I was asking about the outlook for the Europe, given the geopolitical issues and sharp increase in the energy cost, how's the growth and margin outlook going ahead?

Christian Paschel: For me the outlook, let's say it's depending, of course on the availability of the semiconductors, but the overall situation is improving then let's say, month-by-month we have let's say some good agreements in place that will say the dominating effect of the semiconductor, and the other side, we were able to reduce our cost. And therefore, I see a strong improvement on our side, according to the revenues received and again for me, more important is that we have secured production. And as I said, we have some good agreement made with the customers, therefore I'm looking really positive to the next quarter.

Abhishek Jain: Okay and how's the margin outlook for the VLS for the quarter four?

T.R. Srinivasan: I'll take that. Sequentially, we should see an improvement on account of two, three factors. One is we are getting some price summation from customers for the raw material price increases, which have happened, including the energy cost that you mentioned. So, those things, some of it came in during Q3 effective 1st November, which continues to Q4, but there are some more agreements getting finalized now, which will be effective in Q4. And then we also see 8% to 10%, higher revenue in this quarter compared to the previous quarter, because of the improving situation on semiconductors that Christian talked about and roughly project raise, a number of those initiatives are under implementation now. And those benefits are also starting to get relaxed and adding to the bottom line. So, that also will contribute. So, with this in Q4, we hope to have a positive data margin and VLS overall, and we are seeing an improvement over Q3 and improve that further in the next year going forward.

Abhishek Jain: And what is the current breakeven point for the VLS in revenue terms after taking all cost cutting exercise?

T.R. Srinivasan: Okay, to say in EBITDA term, it depends a bit plant specific because the different plants have different operating. But if you say overall at EBITDA level, we can do a revenue of let say €75 to €80 million per month, roughly in the production revenue, we should be able to have a cost to EBITDA generation.

Abhishek Jain: And if the revenue goes up to €120 million, then what EBITA can we expect?

T.R. Srinivasan: Currently, we have capacities with which we can reach a revenue of €100 billion.

Arjun Jain: For €1.2 billion of production revenue at that level, the EBITDA will be at, it will be double digit.

T.R. Srinivasan: Yes, close to double digit.

Abhishek Jain: That is for the VLS?

Arjun Jain: That is for VLS.

Abhishek Jain: And can we expect this sort of numbers, can it be possible in FY23 if the semiconductors shortage issues easing off?

T.R. Srinivasan: It depends on the rate of improvement, because right now it's very difficult to say when things will become totally normal. Everybody is kind of, people are saying it can take anywhere between nine to 12 months. So, that's the segmentation. So, it depends on the rate of normalization, but yes, things become totally normal, and that means the OEM volume go back to normal level and capacity utilization improves then maybe towards the last quarter of FY23 we can look forward to.

Arjun Jain: So, basically next year, we are expecting that we should be able to reach because the situation is anyway improving on the semiconductor shortage but it's improving, but it's not normalizing like what was said that we can only expect not before third quarter of next financial year kind of a normalization, go into the fourth quarter also, but we will see an improved revenue there what we have seen in FY21, in FY22. So, we are expecting the production revenue to be over at least a billion euros is what our expectation is and hopefully that should happen.

Christian Paschel: From my side, I can underline this, let's say because it's not only on semiconductors, we accept countermeasures together with a customer to get rid of the critical components in **–30:51** and therefore, let's say we can actually improve, but I would like to underline the front Jain was mentioning.

Abhishek Jain: Okay, sir. And sir rupee is appreciating versus Euro, so although it's a positive for the overall debt reduction side, how would it be impact on the revenue terms of the VLS?

T.R. Srinivasan: It definitely have some impact which we have seen in the last quarter as such in term of Euro terms revenue grew by +10% but then rupee terms it was less, 11% or so. So, this is something which obviously is beyond our control, but more important is to have a sustained margin recovery in VLS, which will lead to overall improvement in the consolidated results, which is what we are focusing on and we can hit, it can bounce back like shall be doing in this month. So, we have gone back end of December so those movements will be there, but we cannot influence or not be distracted by that.

Abhishek Jain: So, overall rupee appreciate versus euro is positive or negative for the company, if we set up from the revenue losses from the benefit of overall debt reduction?

T.R. Srinivasan: See, overall once the operating performance comes back to normal levels, which mean EBITDA generation is the normal level, et cetera obviously, Euro strengthening in rupee will be a positive one for the business and the operating cash flow improvement will outpace debt increase, so to say in rupee term so, that's what's in the normal course, but now it is we are not in the normal situation. So, that makes EBITDA a mixed bag right now.

Abhishek Jain: Okay. And sir during this quarter, you have incurred M2M losses of around 22 crores on intercompany loans. So, what is the size of the loan and as the rupee is appreciating, M2M losses will bounce, will reverse in the coming quarter?

T.R. Srinivasan: That is expectations but once, exchange rate reversal happening during the period, the mark to market losses will recovery so we are roughly talking about a €100 million loan to company.

Abhishek Jain: Okay. And my last question is on India business in Chetak what all components you were supplying right now?

Arjun Jain: So, we supply the motor, the motor controller, we supply the vehicle control unit, we supply the DC converter, we supply also the switches, the telematics, the BMS and also the charger.

Abhishek Jain: And how much is the content per vehicle?

Arjun Jain: We had a slide around that. So, of course we can't reveal the exact content for a specific vehicle because vehicle-to-vehicle it will change. But in terms of what we stated in terms of the total content that we would expect to do in an electric vehicle, a two-wheeler we expect we do around 37,900, around Rs.38,000 and in a three-wheeler, we would expect to do around Rs.46,000.

Abhishek Jain: And what could be the SOB in this Bajaj Chetak?

Arjun Jain: Again, right defining an SOB, et cetera at this stage, it probably doesn't make no sense, because the market is still evolving today in general, like I spoke about it, actually executing everything we've executed. It's not just the Chetak it is also the new concept which is also running in the background. With the semiconductor backdrop we have, that is really acquisition of strength right now with our customers. And utilizing that we'll see where we go when it comes to SOB, whether it comes to contents, whether it comes new businesses. Our major market share when come to the Chetak and when it comes to the three-wheeler we are a single source.

Moderator: Thank you. The next question is from the line of Basudeb Banerjee from ICICI Securities. Please go ahead.

Basudeb Banerjee: Just continuing with the previous question, as you said for two-wheeler EVs, roughly 35, Rs.37,000, that must be including the existing components which you are supplying to normal petrol models. So, adjusting for that how much one should look for core EVs, which is new per se, which were not supplied for petrol models?

Arjun Jain: The calculation today, we have assumed I would say Rs.6000 for non-EV components. So, I would subtract from 38,000, 6000 so, around Rs.32,000.

Basudeb Banerjee: Okay. Sir, if I look at your standalone numbers, if I missed something in the initial comments, revenue sequentially is down with a domestic two-wheeler market being weak, but your other expenses are up almost 20% sequentially. And your interest outgo also moved up sharply to almost 29 crore up almost 12 crore from previous quarter. So, these are the two-line items which has largely resulted in PBT negative numbers So, anything one off or how to look at them sir?

T.R. Srinivasan: Finance cost is impacted by the exchange rate mark to market thing we booked on intercompany loans. So, that's a notional cost that's not a cash out and product hit or most of it will revert, as and when the exchange rate reversal?

Basudeb Banerjee: How much is that sir?

T.R. Srinivasan: That is 21.8 crores for the quarter.

Basudeb Banerjee: Thanks, and the other expenses?

T.R. Srinivasan: Other expenses are number of things included in that, this includes certain legal cost we are incurring in fighting of some patent litigation and some other cost included as well plus some other operational cost, one off incurred in the real estate business because of the supply disruption from semiconductors and so on. Combination on multiple items.

Basudeb Banerjee: So, this patent increase on one of VLS cost account in standalone?

T.R. Srinivasan: Stand along is mainly the legal cost and some other promotional fee we had during the quarter.

Basudeb Banerjee: So, almost sir I can see 25 crore Q-o-Q increase which is on a base of 129 crore is close to 16%, 17%. So, how much one should look at one off in this number?

T.R. Srinivasan: So, if you are looking on the standalone financial statement not in the presentation then the mark to market class on the exchange rate on intercompany loans is booked under other cost, it is not under finance cost. The finance cost went up because last quarter we issued non-convertible debentures of 375 crore which are mainly to fund VLS for the liquidity requirements on some loan repayments and that is one which contributed to a higher interest cost. It is mainly related to supporting VLS operations.

Basudeb Banerjee: So, standalone interest cost there is nothing one off but how much one of will be in the standalone other expenses?

T.R. Srinivasan: Exchange rate is 21.8 crores which is in account stage. So, other than that, I would say things to be about specific could be region of about 3-4 crores that is what I broadly remember but I can check and confirm back to you later.

Basudeb Banerjee: Okay, so broadly 25 crores Q-o-Q it will be normal. So, that extra part is the one off roughly?

T.R. Srinivasan: Yes.

Basudeb Banerjee: And in your results also but if you can explain about the patent infringement stuff where, you also highlighted no provisioning for that. So, what is it all about?

T.R. Srinivasan: On the patent infringement basically, there are a total of six cases which are going on over and they're in so this is in different stages hearing, et cetera in the court. And we had preliminary ruling in a couple of those cases, which basically said we have to disclose, make certain disclosures in our supplies to customers regarding potential patent infringement and the risks associated. So, far there has been no quantification or decision on any claim either by party who filed the claim or by the court. So, that is still open, because we have contested the patent on prior art basis, which means those original patents granted to the other party were not valid, because those were already widely and publicly known design information in the public domain. And those claims are still not been dissident, those are still under adjudication by the court. So, based on the legal opinion, we have currently chances of, let's say successfully fighting on this is, let's say reasonable and based on which and it's not possible to quantify any potential liability. That's why we're not made any provision, but just made a disclosure. And there are more hearings coming up in the coming months. So, where we will get a clear direction on patent.

Basudeb Banerjee: And how much has been the legal expenses in VLS as you said?

T.R. Srinivasan: On this case probably, we would have spent something like my guess is about €1.5 million something like that over the last year or so.

Basudeb Banerjee: Okay. And last question sir, Tarang sir, like last quarter you also mentioned that because VLS is going so at work for a prolonged period, so even you were envisaging if at all there is a good deal for VLS and it can get sold to some other global light makers. So, any advancement over that angle sir?

Tarang Jain: So, here actually, like what our CFO just mentioned earlier. So, here there has been special interest by a few parties, also from the auto space. So, we have been discussing with them, but we still have not received a binding offer yet, the processes on. So, just to clarify that see, we are absolutely open to a strategic investor for our lighting business, because for the simple reason that, going forward we do see that the semiconductor shortages will remain for at least nine months, to one year. And we also have to then, invest money, we have to invest in the growth, less CAPEX involved, other things, so it's good to have probably at this stage, because already two years have gone during this COVID times and obviously the revenues have been disrupted, we already made a large amount of investments, we still have to see that level of revenue coming still in which will take probably to reach that kind of capacity utilization, what we expect probably will take another probably eight to nine months. So, therefore, we had like last time, there was a little bit of a mention there that we are in, so we are looking at that and we are in discussions now.

Basudeb Banerjee: We will be looking at partial stake sale or full sale as such?

Tarang Jain: No, it will be a kind of a, it won't be a full stake sales, it will be like a JV. It won't be a full stake sale.

T.R. Srinivasan: All those things are part of the discussion. Which entity, with geographies, what percentage stake, all those things are still open. So, we are discussing, so it's too early to say there'll be a minority stake or a majority stake or pool VLS business or product VLS business, et cetera.

Tarang Jain: It also depends on the valuation, so we will have to decide based on that. But there is a good amount of interest that's all we can say.

Basudeb Banerjee: Basically, standalone India business, if you are able to do some 5000 crores revenue at 12% EBITDA margin, so almost 500 crore of annual EBITDA that will be good enough to suffice for the valuation, where there will be no debt and if you have it off the whole debt issue will be also gone. And then it will be a new growth path altogether, from that angle and as you rightly said further three, four more quarters of lower production can continue to impact balance sheets, so that will be the continued per se. And last question, sir if you can highlight how to look at the sustainable tax rates down the line, because I can see so many comments from tax in this quarter result schedule so if, you can explain it?

T.R. Srinivasan: It's a good question, actually because currently what's happening, the losses we are incurring in the newer entities, we are not able to avail the deferred tax credit on those entities because they don't have an establish profit record. So, cumulatively if I have to say at the end of December, we have un-accrued deferred tax assets of something like close to €20 million, which technically we can accrue there is so it's a kind of off-balance sheet asset if you want to call it that. So, that situation will continue for some more time till this entity reach the breakeven point and generating consistent profits, that is for four quarters and after which we can accrue. So, you may see in FY24, or something other, big, deferred tax credits coming into the books, when that happens. So, on a consistent basis, take into account the investment tax credit, as well as the natural tax rates of different geographies. For VLS, we should effectively tax rate of between 18% and 20% that's what we expect. And India obviously will be around 30 to 35 depending on the business EBITDA. So, weighted average for the group I would say is let say around 23% to 25%.

Basudeb Banerjee: And by when India can come down to 25?

T.R. Srinivasan: We are carrying some PAT to date. So, originally we would have kind of used up by now or later, but now that has also delayed because of the COVID and reduced profitability in a couple of years. So, now, we have to actually do the calculations again and see but at least give me some time in FY24 I expect we can switch over to the 25% region.

Moderator: Thank you. The next question is from the line of Ashutosh Tiwari from Equirus Securities. Please go ahead.

Ashutosh Tiwari: I think I missed, you talked about definitely € +1 million revenue in VLS next year, but at that level of revenue what kind of margin, can we expect at EBITDA level at VLS?

Arjun Jain: I can be a high single digit.

Ashutosh Tiwari: Okay. And how should we look at interest cost going ahead, because there is debt reduction in this quarter as of December. So, how should we look at the console interest cost from next quarter?

T.R. Srinivasan: When the debt level we are trying to kind of stabilize and once the operating cash flow becomes probably per se which we hope will happen from Q1 next year, this quarter should be kind of breakeven still or marginally upscale, then we can start considering to bringing on the debt, but at the same time, we have also refinance some of the existing borrowings like, this is earlier on the call, so we are coming up for closure to this. So, this will be a mix impact replacing some of the lower cost debt, higher cost debt for the shorter term. So, you will see in absolute finance cost for FY23 may not be very different from FY22. The debt amount average may come down but the effective cost shorter run may go up somewhat. And FY24 onwards is when you will see a sustained reduction kicking in, repay some of the higher cost and improve the mix as well as reduce the debt.

Ashutosh Tiwari: But this quarter the interest cost around 51, 52 crores so it will come down from that level. Right in the subsequent quarters?

T.R. Srinivasan: Subsequent quarters, see if you're looking at the financial statements, whatever interest cut, you're saying that probably will continue but for the purpose of our analysis in the investor presentation. We reclassified from exchange loss into finance cost and the borrowing which is explained in notes, et cetera. That amount is not likely to continue to that extent you will see lower interest cost finance going forward. With the interest rate that you are looking at.

Moderator: Thank you. The next question is from the line of Nikhil Rungta from Nippon India Mutual Fund. Please go ahead.

Nikhil Rungta: Just one thing from my side, as an investor we have seen it's almost eight quarters that we have posted losses now. When is it that we can start seeing company into the green?

Tarang Jain: I would say probably from Q1 of the next financial year that we can see a kind of a PAT, on a PAT level positive largely because of the higher revenues coming into the VLS business and also because we will be getting by then a lot of our commodity prices, which we have been incurring over the last eight, five quarters that also we will see that, that has been compensated by most of our customers. So, therefore, I see probably the Q1 of the next financial year to be a PAT positive. That hopefully with higher revenues, we are not making a PAT loss, it's probably a smaller PAT loss in Q1, in VLS and India of course does a decent PAT. So, overall, we don't see we see a small PAT positive in few months.

Nikhil Rungta: Okay. And every quarter we have been seeing there is some of the other, if not one of them one of type of things. Last couple of years, say continuing COVID, auto slowdown, then we have semiconductor issue. And every time we have been impacted by the VLS part. So, as mentioned by participant before Basu specifically, so that we are looking for a JV in VLS. Last year as well, we need a QIP, and we have almost utilize the entire amount and now again, we are looking for a JV partner. So, do you think we'll be in a position to turn around that business with the amount coming in or won't it be better to hive it off and start focusing primarily only on the India business?

Tarang Jain: See, to be honest, frankly the lighting business is a good business. And, when we took the business, if you may remember, it was in 12, it was a very low EBITDA business, and with a lower level of revenues, we grew it, we doubled the revenues by, we were making, we increased EBITDA from 3.8%, when we took it to almost 9.5%, if we include China, also to 9.5% in the December 19 quarter. So, the point was, over a period of time, we were able to improve the EBITDA, we could convert even some of the loss-making plants to profitability like Mexico and India at that point of time when we took it over. And, that's the reason we were betting, and when we look at market share growth in this business, and the customers also gave us a thumbs up because we were doing a good job, in this business. It's just that, okay we had not anticipated the virus to be there, the virus it was a situation, which coincided with our heavy investment in lighting business. And that's why we have been faced, we have been navigating this problem for the last two years. We thought okay that, there was this shutdown in FY21 and then there was a V-shaped recovery, but we did not realize the extent of the semiconductor problem, we didn't expect the shortage to be there, to such an extent, that it would again. So, it's not that we don't believe in the business, the business will definitely turn around. It's only that we need the revenues. So, we need the revenues that's primary and secondary, now we're getting back all the cost we've incurred on material back also, from performance from this January, from at least the major amount, the majority of the customers. And thirdly, we are also now looking at the project RACE where we are trying to look at improving our site operations, we're looking at overhead controls, and also control of other costs, including even material cost there are opportunities, so we're looking at and plus also designed to cost, we're looking at also designs, it can be more optimized. So, this business is a profitable business. But you cannot do anything without revenues, you need revenues, you can't just save yourself out of trouble you need to sell, you have to sell yourself, so you need sales to cover up the price, you cannot just do it through savings, and that's why it has been the major problem in the last nine months. But we see the revenues now, going up like I said by 10%, 12% already in January. So, we see that this was sustained in every quarter. We are hoping for a better revenue, but the revenue will only stabilize probably by December of 2022. That's the way we see it. And therefore, we said that look, we should still be there and we should get in a strong partner where together we can see how to look at strengthening this business also also going forward. But let's see how it pans out and we will see how it pans out. So, we are already in discussion. So, let us see how it pans out in the end. But we will take the best decision for the company, for Varroc in the end.

Nikhil Rungta: Okay. Sir just to continue from your comments. The last qualitative question from my side, you mentioned that VNS lighting is a good business to be in. So, is it a good business from the perspective of customers and the management, or do you really think it's good from the shareholder perspective as well?

Tarang Jain: So, it is a good from a shareholder, it is a profitable business. It is unfortunate that, we are in the situation, this was not what we had emphasized to be honest, and like I said it kind of coincided with our CAPEX cycle, in the six new facilities and 2000 crore investment. The problem was that actually, we have a lot of under utilization in our new plants, and then commodity prices, a lot of things have come together. And that's why we've been navigating this, in our business which is a profitable business. So, I feel that this business is good for investors. It is good for the shareholders, it is good for the investors. It is a good business, but honestly, yes but we have to be prudent because of so many uncertainties around, it's good to have a partner, at least that we realized that alone, running a global business, in current times, when you can't predict the external environment. So, well, semiconductors or other issues, so it's good to have a partner and today, we're anyway working on a costs, and also on our pricing on our designs. But all this this can be a stable business going forward. I'm quite comfortable in being, in remaining in this business, for sure.

Moderator: Thank you. As there are no further questions. I would now like to hand the conference over to Mr. Tarang Jain, for closing comments.

Tarang Jain: Yes, thank you. So, we were able to answer the questions both around our lighting business, and also the India business. And now we see after a couple of years, India, of course has been quite stable in its results over the last couple of years, when it comes to lighting business, Yes, there has been a lot of navigating to do. A lot of ups and downs we have seen in the last couple of years. But now we see differently, the light at the end of the tunnel, where we see that the chip shortages are getting better, the availability is getting better. I'm not saying still there. But, today with as three things, improved volumes, getting back the prices on the commodity inflation and thirdly, a project RACE, we are looking at optimizing our costs at the plant level, as well as our overheads. So, with all these actions, I'm pretty confident that going forward that our lighting business will first generate positive cash profits, and then of course, positive PAT as we go along. Over the next nine months to one year. So, I would say that don't lose the confidence, in Varroc and especially in our lighting business. You will see improved results, quarter-on-quarter as we go along. Thank you.

Moderator: Thank you. On behalf of Varroc Engineering that concludes this conference. Thank you for joining us. And you may now disconnect your lines.