"Varroc Engineering Limited Q1 FY19 Results Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to Varroc Engineering Limited Q1 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 that this conference is being recorded. Varroc Engineering Limited's management is being represented by Mr. Tarang Jain – Managing Director, along with Stephane Vedie – President and CEO, VLS; Ashwani Maheshwari – Wholetime Director and CEO, India business; T.R. Srinivasan -- Group CFO and Nitin Kalani – GM, Finance and Head, Investor Relations. With this I now hand the conference over to Mr. Tarang Jain. Thank you and over to you, sir.

Tarang Jain: Good afternoon, everyone. I am Tarang Jain here. I would just like to start with my opening remarks after which I would welcome your questions.

So, firstly, I would like to thank you for joining the first quarterly earnings call of Varroc Engineering Limited. I am glad to note that we have reported revenue growth of 20.2% YoY, the growth on a comparable basis was robust at 28.8% YoY, excluding the impact of excise duty and the phasing out of the North America interior plastics business. Q1 FY'18 which was prior to the GST rollout, included excise duty as a part of the revenue. It also included about €10 million from the Interior Plastics business in North America which was phased out during FY'18. While the reported EBITDA margin was lower than last year, EBITDA margin on a like-for-like basis was at 8.8% of revenues as against 9% of revenues in Q1 FY'18, a marginal decline. The reported EBITDA for Q1 FY'19 was impacted by cost relating to setting up of new plants in Brazil and Morocco, cost associated with our acquisition in Turkey and the cost of increase launch activity apart from the impact of phasing out of the Interior Plastics business. Further details are available in the presentation already shared with you.

Now, I will go into a little bit of details on the performance during the quarter. On the revenue side, revenue in this quarter increased to Rs.29,188 million, a growth of 28.8% YoY on a comparable basis. The revenue growth was strong across the board with India business growing at (+28.3%) YoY and VLS growing by (+29.1%) YoY and other businesses by 31.8% YoY. On the margin side, reported EBITDA for the quarter was at 2,412 million, and the EBITDA on a like-for-like basis to that of Q1 FY'2018 was at 2,578 million, an increase of 26% YoY. EBITDA of the India business increased by 33.9% YoY leading to a margin improvement of 40 basis points. The EBITDA of VLS business on like-for-like basis increased by 18.3% while the growth in euro terms was 5% YoY. The VLS EBITDA was impacted by higher raw material cost as well as higher shipping and handling cost in our Czech operations due to higher volumes. EBITDA for other businesses which are TRIOM and EMIS increased by 37.1% YoY. Our depreciation on YoY basis has gone up mainly due to the impact of higher CAPEX at our Czech facilities. The finance cost improved to 0.8% of revenue as against 0.9% of revenue in the same quarter last year due to containment of net debt in spite of higher revenue and CAPEX. Our net debt at the end of the quarter was at Rs.14,910 million, broadly similar to the debt levels at the end of Q1 FY'18. The net debt however went up during the quarter from Q4 FY'18 levels due to normalization of working capital which had gone up due to substantial collection of tooling receivables during March '18 along with incremental CAPEX payments during the quarter. The effective tax rate increased in Q1 FY'19 due to higher share of profits from India business and the additional tax credit availed in the Czech Republic in Q1 FY'18. Profit after tax for the quarter stands at Rs.1,004 million as against Rs.984 million in the corresponding quarter last year.

Some of the other key developments are: In the quarter we also announced the intention to set up two new plants for our Global Lighting business for catering to additional customer demand at Chennai and in Poland. With the completion of Turkey acquisition, we now have 37 operating facilities. There are four more plants currently under construction; one each at Brazil and Morocco for our Global Lighting business; one at Halol, Gujarat for the India business and another in Bulgaria which was a part of the Turkey acquisition. This is likely to get the operating facilities count to 41 by the year-end.

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

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. We will take the first question from the line of Aditya Jhawar from Investec. Please go ahead.

Aditya Jhawar: So, one thing wanted to check, 5% YoY growth in VLS revenue, if you can help us understand how is the volume shaped up across different customers and are you seeing some kind of stress especially from JLR where we are seeing some kind of volume pressure and then?

Tarang Jain: I think it would be good, Stephane, if you take this question.

Stephane Vedie: Okay. So, the growth during this quarter was mainly driven by the launches we had in our Czech Republic plant. On these launches, we have mainly JLR products that we launched. These are the products with much higher technology content, these are the most technology advances that we have ever produced in our territory. So, we have all let us say the unit was pretty high for us and allowed us to increase on the whole with JLR. So, JLR was definitely one main contributor of the increase of revenue during the quarter. We have also launched interesting products with Skoda, Czech brand of Volkswagen Group. We were for example the supplier on the Czech car of the year which is called the Skoda Karoq for the head lamp and rear lamp. This is important for us to continue to increase our share of head lamps with the Volkswagen Group. This was another contributor. About your questions, we have seen softening of the volume at JLR. We have the advantage in our Czech plant, especially the big one in a region towards multiple customers. We have a good well-balanced customer portfolio. So, the lower sales what we expected in JLR were compensated by higher sales with all the customers, namely Skoda, PSA and Ford that we are able to come on stage. We have smaller plants in Czech Republic, it is Rychvald plant, this one is more weight of JLR products. So, this one was little more impacted, but we are able to come on stage with the Turkey acquisition and with good success in North America where the volume were well in shape and the customers there were pulling more than what we initially anticipated. So, on the whole, successful quarter in terms of sales of VLS.

Aditya Jhawar: Thanks for this clarification, Stephane. But I am still little confused in terms of 5% revenue growth in terms of Euro terms and we have also scaled up certain OEM contracts. So, is there a sense we can get that are there certain OEMs where we are seeing a decline in volumes on YoY basis?

T.R. Srinivasan: Srini here. Revenue growth in euro terms was 14.6% for VLS, so if we remove the impact of the interior plastics business which was phased out last year, I just want to sure we are reliant on that number.

Aditya Jhawar: The Turkey acquisition numbers are not included in the financial, right?

T.R. Srinivasan: No, the closing happened on 2nd July, so we will start consolidating from the current quarter.

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

Hitesh Goel: Sir, can you just shed some light on how Global Lighting business is moving, any indication on the industry growth because we have also seen some consolidation happening in the industry, I thought the industry is pretty consolidated?

Tarang Jain: When it comes to the Global Lighting business, the global passenger car segment where we play largely expected to grow only at 2% going forward, of course, depending on regions like India may grow faster, but globally it is only 2% but we are seeing that in the first quarter the growth was at about 3.7%, so the growth is still good but coming to our Lighting segment, frankly, our growth is higher on two aspects; one is there is this content growth of more penetration of LEDs, LEDs could be basic LEDs or metrics LEDs going forward or some other higher end kind of LEDs or electronics and the lamps. So, the revenue growth we expect it to grow irrespective of whatever is the passenger car segment growth. Even by 2%, I am just saying the content growth of electronics and LED penetration we can definitely expect double digit growth in any case. Other than that, what Varroc is doing is that we are anyway focusing on increase in market share. I am talking about organically and inorganically. So, organically also, today we have 4% kind of market share in the market but a pound of volumes, we are expecting over the next few years to increase our market share substantially organically and we also at the same time looking at certain acquisition targets because today we are still I would say #6 globally which still are smaller players with 4% market share but we have the wherewithal to grow in a very good way for the main reason that we have the product technology. We own product technology. What level technology present with even the bigger players we are at the same level. So, technology which could have been hindrance for us is actually we are pretty strong there. So, today for us is to align ourselves with the top customers. One thing what we have done is that historically we have been aligned to customers like Ford, Tesla, JLR, PSA, who have been more our actually main customers till the time we bought this entity in 2012. But now what we have done is that we have aligned with some of the bigger players like the #1 and #2 in the world like VW group which includes all the brands, Audi, Skoda, SEAT also, there is a Spanish brand. So, we have aligned as a VW group in a good way and also with Renault Nissan-Mitsubishi Group. So, with these two customers, other than of course whoever else is already there with us, we are actually winning market share. I think our expansion into regions of Morocco, Brazil and now even Turkey is definitely helping us also get more sticky with these two largest players in the world. So, I think that today we are in a very good shape when it comes to future growth in this Lighting segment.

Hitesh Goel: Just wanted a follow up on that; given that Lighting industry grows in double digit and given profitability should be pretty good in this segment, recently ZKW got acquired, right, so just wanted to understand why the consolidation is happening in the industry, you would be willing to invest, right if your business is growing in double digit, any thoughts on that?

Tarang Jain: This company ZKW was I think bought by LG, right. LG as you know is into a lot of consumer electronics. Now they have been more of a Tier-2 player to Tier-1s in the past. Going forward when it comes to Lamps, so Lamps is not only about LEDs, also there is going to be more electronics going forward like light detection sensors lidar, cameras. So, today they want to be a direct supplier of electronics in the auto industry. Today they are only present in the consumer electronics like television sets and other types. They very much want to be a Tier-1 player in the automotive industry which is of course a very big industry. So, that is the reason that they have got into ZKW and the valuations are high because ZKW of course it was a significant player very close to our size, they have the kind of product technology, so the valuations also were quite high, I think they paid close to 10x EBITDA multiple, but that is on the valuations are for companies with the relevant product technologies. Today this is only about LG and ZKW but going forward there is going to be consolidation in the sense that companies like us who own their own product technology for today and understand what are the requirements for the future will survive and only grow. The people who lack the technology are smaller players maybe up to €200, 300 million, people who do not have the relevant level of technologies or people who are going to sell out or die. So, that is the way it is going to work. So, the technology today is only with I think probably seven or eight top players and we are one of them. So, we are definitely going to gain in market share going forward. Do you want to add something to this, Stephane?

Stephane Vedie: The only thing I could add is we see the big players like LG or recently Magna making the acquisition of OLSA trying to enter if they are not yet in the lighting space, because this is a very important space going forward to be positioned on the mega trend of autonomous driving, connectivity, shared mobility. There is no better space around the car than the head lamps the four corners of the car if you want to integrate the camera, sensor or lidar. This is really premium real estate. So, as a lighting company, we own this real estate, this is strategic on the car with all the technology trends going on, so that is why some of the big players want to position themselves. We are lucky enough, we already position, we are already there, we are already up with some value proposition for these new technologies.

Moderator: Thank you. We will take the next question from the line of Jamshed Dadabhoy from Citi Group. Please go ahead.

Jamshed Dadabhoy: I just like to ask a few questions pertaining to the slide #9 in the presentation you all have given. So, the start-up cost that you all have talked about and the launch related expenses which are about €2 million, how many quarters do you expect this to go on for? Second part is this €3.4 million of raw material impact that you all have called out which is associated with the five new programs, how long do you think this will last and sort of what is the impact that you see out there?

Tarang Jain: Stephane, would you like to take that question, then I could probably add on to it?

Stephane Vedie: I think the beginning of the series of questions was about the launch cost, how long do we see this impacting us. At the end of August now we are stabilizing all these launches like I mentioned earlier, we have ever launched in our history some of the most complicated, matrix, LED, Laser, Booster, lot of software. So, we have to adapt our organization. We went through also some lessons learnt there. We see in September some good news. We have in the last days some of the best in terms of efficiencies in our plants. So, we believe that we will see little impact in the first month of the second quarter but now we believe we have stabilized the situation. About the raw material, in the slide we single out five programs that are mainly JLR programs with the high technology content. Here the impact is mainly driven by the fact that we have a lot of electronics content, we have a lot of content that we are buying from outside, from third-party electronics companies. We will be announcing this month the strategy related to the vertical integration of electronics and you will see as soon as we announce it, we will have the opportunity to start positioning our own electronics within one year and this will have impact because we will be able to increase our own value added for the complex lamps and we will be able to reduce cost as well.

Tarang Jain: Stephane, the other question was I think Jamshed was on the start-up cost like Brazil, Morocco, how long will it continue for and the Turkey which of course there will be no cost associated, but there will also be other plants which we are setting up in Chennai as well as in Poland, so what is the expectations on that?

Stephane Vedie: For Brazil, the expectation is that we are starting production in end of December or beginning of January. We have already produced our first lamps there. We are going through the validation with our customers. So, we are going according to the plan. As soon as we launch on which let us say the stable volume which we should reach within the first quarter of 2019, then let us say the long space is behind us. For Morocco, right now the plan is to start in production in April and we are working with first internally but also with our customers to try to accelerate this, because the first launches in Morocco to be safe are concept from Czech Republic. So, it is that we have to wait for a vehicle to launch, we have to wait for the milestone of our customers to be met, it is just that more or less to us. So, as soon as we are ready, we need to go through validation with the customers, once we have the green light from the customers, we can run that. So, right now our plan is to start the 1st of April but more we grow, we are confident that we will be able to start I think a few months earlier, that is the situation about Morocco. Chennai, for the moment, we have zero start-up cost because we are at the planning phase, we are at the phase we just chosen the location, we are finishing the lease agreement, we will be ordering the machine, so we do not have any cost dedicated to Chennai and the same with Poland, this is something that will come later.

Jamshed Dadabhoy: So, just wanted to check Interior Plastics business which you all have sold. Could you give us a sense of what the revenue, EBITDA, PAT was for FY'18? And then my other one is on the China business if you could comment why the business has seen such a decent uptick because last year was a little bit soft on both revenue and EBITDA but first quarter at least seems to have started off very well?

T.R. Srinivasan: I will take the Interior part question, then Stephane, maybe you can talk about the China business. From the Interior Plastics business which was gradually phased out during the course of last year because it was non-core to us and the number of products we were supplying were coming up for rebidding. To continue that business, even though the margins are fairly decent, would have meant additional investments going forward which we did not want to do in a non-core activity. So, during last year that revenue was about €28 million overall for the year and by end of Q4 almost all the activities were wound up and we had EBITDA of around 6 million out of that 2.3 million was in the first quarter this year and then gradually going down over the rest of the year, of course, we do not monitor PAT level on the individual business wise, so you can roughly say half of that or even lower would have been the PAT.

Stephane Vedie: About China, when we look at the numbers in rupee due to the exchange rate it looks like a significant growth. When we look at the local currency situation, the first quarter in China has been pretty stable in terms of revenue. The market has been quite volatile. We are dealing with customers that are changing the forecast a lot from month-to-month, so we are very cautious in

China. Our main customers are Changan, Ford, JLR. So, we are taking it on a month-to-month basis and try to be very cautious, although the market is moving but we try to be flexible as much as we can in China.

Jamshed Dadabhoy: So, one should not extrapolate the strong trends going forward for the full year, is that the read through?

Stephane Vedie: I think it is only for China right now. We are cautious about the trends going forward.

Moderator: Thank you. We will take the next question from the line of Parvin Yeolekar from CGS-CIMB. Please go ahead.

Parvin Yeolekar: Sir, my question was on with the coming emission safety norms in India and BS-VI is just one year away, so what sort of opportunity we are seeing for the Varroc Engineering?

Tarang Jain: I think this BS-VI is a huge opportunity for us. Basically, BS-VI for us means also on a basic business of even Plastics more and more light-weighting. So, we see that some more parts in a two wheeler or in a four wheeler where in the Plastics business we are going to see more and more light-weighting happening and more and more revenues out of our basic core business in India. We have entered into two product lines – one is of course Catalyst for BS-VI where we have tied up with the German company, Heraeus and that is where we are already introducing these products with of course we will be dealing with Bajaj, we are also talking to other customers. So, there is going to be a big opportunity because compared to today's catalyst also the content in these BS-VI catalyst is almost three or four times from a price angle. Similarly, we are also entering into the electronic fuel injection market. So, this is where the play of the big boys because EFI system which is normally associated more with the big players like Bosch, Continental, Keihin but we have tied up with a company called Dellorto and we are also making our entry in a small way with a few customers but in a small way because at the entry level when we enter in 2020 as the first level the larger volume will go to the multinationals. But because we are so strong in a two wheeler market, we are also getting an opportunity, we are a player in this importance product of EFI. But our bigger play here will come in 2023 but when OBD-II comes which is the next level of emissions. So, we will see a very good introduction of these two products. Also, we will see more and more electronics in products such as the electronic dashboard for two wheelers, dashboard which were earlier conventional all turning more and more electronic. Again, that means because of electronic content in the dashboard again there is 2x to 3x kind of revenue increase over there. So, I think BS-VI for us is presenting these opportunities to do with light-weighting, introduction of these new products, also more electronics in our current products, because there are significant players because 16-products, so we have a huge kind of not only in the growth of the market but a huge kind of opportunity which we are grabbing with both hands from 2020 April onwards.

Parvin Yeolekar: Sir, with respect to this electronic fuel injection, can you indicate what will be the market size for this product and what sort of market share are we targeting in this space?

Tarang Jain: As you know, electronic fuel injection which is almost 7-8% of a two wheeler price is mandatory now. So, it will be 100% of all vehicles from April 1st. But we will come in a very small way. Opportunities will be very small but we want to make an entry and then gradually kind of grow in that market. But other than that, what we will be doing is so we may not be selling the whole fuel injection system but we will have opportunities to supply the ECU which is the heart of the fuel injection system. As a standard ECUs we will have opportunities to supply that product to other customers also from 2020 onwards.

Moderator: Thank you. We will take the next question from the line of Suraj Chheda from IIFL. Please go ahead.

Joseph: This is Joseph from IIFL. My question is in relation to the programs that you have mentioned on Slide #9. So, what I notice is that you have mentioned that in this quarter 24 programs were launched compared to 16 in 1Q FY'18. So, in that context, I wanted to understand what is the total number of programs that are on at any point in time?

Stephane Vedie: It is not always the case, there is the European car manufacturers they like to launch at the end of the year, there are North Americans they like to launch during the summer time in July, they have their model choice, it varies. So, I can give you an idea about the magnitude but it is difficult to give you a very precise figure on this. I think at every point of time we may have 130 programs in launches. That is the reason why this concentration in Europe because most of these program launches were in Europe, it is quite exceptional to us.

Joseph: So, my question is what is the total number of programs that you are delivering on at any point in time, that is the number should be available right?

Stephane Vedie: The total number of programs we are delivering right now is in the range of 150. When you say programs, we have lamp with a different quote for ECE reaction, we have the high reaction, mid reaction, the low reaction, so I am giving you an idea about the programs but the lamps number of course is much higher than this.

Joseph: Second question in that connection was what is the average life of these programs?

Stephane Vedie: Average life of these programs we are dealing with, as you know the average life of the car is between six, seven, eight years. Usually at the middle of the lifetime, the OEMs, they like to do refresh Middle Cycle Actions like they call it, MCA, they want to give a new fresh look to the car. So, this means that for our lighting programs the average life is in the range of 3.5-years.

Moderator: Thank you. We will take the next question from the line of Jinesh Gandhi from Motilal Oswal Securities Limited. Please go ahead.

Jinesh Gandhi: My question pertains to Lighting Solutions business that we are looking to grow inorganically. So, what would be our approach to M&As in lighting space and what are we trying to attain given that we already have good technology access?

Tarang Jain: Firstly, there are not too many lighting companies which are for sale because nobody wants to really sell out of the lighting business because it has been such a significant product. There are a few targets but we know of a few targets and our approach is basically to increase market share today. So, what we are focusing on is that firstly we will see who all are available. So, one is generally market share improvement, the other is that we definitely would like to get an entry more into the Japanese and the Korean manufacturers who together control 20% at least for the passenger car market globally. So, that is another objective of ours that when we look for an M&A that we should look for something could be very small also to get an entry into the Korean and Japanese markets where they sell also a lot of cars not only in their region but even in other markets of North America and Europe and other places, even India. So, one would be market share growth, one is also focusing on getting higher entry with Korean and Japanese where we are not present today. We have only recently got into Nissan because of our strong Renault relationship we have won a program from this, so the first entry in the passenger car segment with the Japanese but we need a much stronger kind of penetration. So, that is what is going to define that entry into that. Overall we want to be a more significant player from #6 we are today, our vision is to be in top-3 which is still while to go but we will keep on looking. On the M&A activity generally, we look at whatever the valuations maybe, we look at a five year payback, so whatever we do, there should be enough upside for us to get payback within five year timeframe. So, that is some of the basic I am just saying high level principles which we have in mind.

Jinesh Gandhi: Secondly, in terms of our Lighting business, what would be our market mix country wise currently?

Tarang Jain: Today we are present in the markets of North America, in Europe and also in China and India and now we are making presence also felt in South America putting up a facility in Morocco to not only for the Moroccan market but basically for the Southern European market which is Spain and Southern France and Turkey also we have now entered from this July onwards, this is also 1.1 million car market, so it is quite significant for us. So, this way we are trying to kind of expand our presence because we have to be a part of higher volume platforms with the technology content. The good part is that we have now aligned quite well with the VW group and with Renault Nissan, Mitsubishi. With these two groups, who are the two largest entities in the world when it comes to the automotive sector, other than Toyota we are not present at the moment. So, I think we have aligned well. I think the way we are moving our growth is going to be quite good, with the kind of thinking we have, the approach we have and the kind of traction we are getting with customers.

Jinesh Gandhi: Lastly, with respect to India business, given that Bajaj is almost 50% of our revenues, are we looking to increase our presence with likes of Hero or TVS, so what are we doing there?

Tarang Jain: What the situation is that today of course we are very strongly present with Bajaj, because we have got 16 product books in a two wheeler segment, strongly also doing cross-selling with Honda and Yamaha and Suzuki already and Royal Enfield. So, these customers already we are growing, let us say started off with two, three products, now we are at almost eight or nine products with each of these customers, we are going to 10, 12. So, we go by step-by-step approach which is also leading to higher revenue growth. Also, I am happy to say that for example, the new Halol plant is for Hero Motors in Gujarat. They have given us an order for 2 million lamp sets starting with initially 1 million. That is a very big order. Today we are already finalizing I can say another two or three products groups shortly within the next two or three months. So, Hero who controls 50% of the motorcycle market is going to become a significant customer of us going forward, in fact, on the 7th we are having Texo in the R&D Center in Jaipur where we all present and they are very-very much keen to do more business with. Similarly, I am also happy to state that TVS Motors also has now expressed interest to deal with Varroc. So, now we are going to start engaging also with TVS Motors… we have already started engaging and we are also hoping that we are able to win some business with TVS going forward. So, today for us I would say that the sky is the limit. It is for us how we kind of align with our individual customers and we win business with them. Today we have the product technology wherewithal we were pan India footprint with about 26 plants. So, I think we are feeling quite confident about our future here.

Jinesh Gandhi: Lastly, with respect to our engine management system JV which we have, can you throw some light on by when do we expect to commercialize – is it for India business or for global business?

Tarang Jain: To start with it will be only for India… I will not name because we are not allowed to but we have already engaged with two customers and that is something as you know from April 1st 2020 starts but I think the production of the same will start six months before because it is not going to be an automatic changeover for 100% of the vehicle. So, people are willing to turn, they convert their vehicles with the EFI system which makes the vehicle more expensive, but it will start I would say then from October next year.

Jinesh Gandhi: This is EFI for two wheelers, right?

Tarang Jain: Yes.

Moderator: Thank you. We will take the next question from the line of Riken Gopani from Infina Finance. Please go ahead.

Riken Gopani: I just had two questions: One is if you could help us understand 14% euro terms revenue growth, what would be the contribution of volume and the higher content per vehicle or realization basically the elements that drove the growth for the Global Lighting business?

Stephane Vedie: I am not sure I understood fully the question but I think in the mix between volume and technology, this quarter we had a lot of technology launches. So, usually it is a little more volume and led technology. During this quarter I think it is quite unique but we are close to 50:50 in terms of growth contribution if this was the question.

Riken Gopani: In terms of the way forward, what sort of traction do you think you would continue to get in terms of the higher content per vehicle with the new programs that you plan to launch going forward?

Stephane Vedie: There is a clear plan but we have a very clear positioning of lighting system. We want to play in the market where we see volumes on technology. We do not want to play on the niche market where there is a very high technology but very high volume, we do not want to play on the very high volume but no technology. We think our sweet spot where we can continue to increase our margin and continue to grow the sweet spot of the larger car manufacturers with good level of technology like Tarang mentioned already we are successful going with Volkswagen group, with Renault Nissan group, they are the No.1, No.2 OEMs in the world. So, this is where we want to play and this is where we want to win in the future. Renault, for example, to give you an idea, they have committed already by 2022 every Renault vehicles with full LED lamps. So, that is really the market where we want to play. With Renault, there is volume and this is the kind of technology we want to be in. So, with the customers we are taking right now with the order book that we are working, we are very confident that we will at least have one-third or the new benefit from this technology boost if you want, but clearly we are also increasing the volume significantly.

Riken Gopani: Just one clarification. On Slide #9 where you have given the margin transition, is it that five new programs were the RM cost to revenue is higher. Does it mean there were new programs where you have lower gross margins if you could help us understand what do you imply by that clarification there?

Stephane Vedie: These are programs where the technology content is much higher than what we have been doing until now. As we are not yet positioning on electronics, we need to buy a lot of electronics outside. This will have an impact on the material content to the products.

Riken Gopani: You mentioned that by next year you would have the electronics also manufactured through vertical integration. So, what sort of improvement you would have on margin because of that? What sort of CAPEX does that entail?

Stephane Vedie: We are very advanced, we are very close to sign agreement that we will communicate in the next two weeks, we have already signed the schedule. According to our feasibility study that we have been dong in the past months in a very slow way, we see that on production of electronics we are able to reduce our cost by at least 10%...just on the cost. And then new entity that we will be positioning these electronics we will be also generating quality results and quality EBITDA, quality PAT also. So, we will be able to win on both sides, help us to reduce the material content and help us to increase our margin. So, that is why this is a very step for us going forward.

Moderator: Thank you. We will take the next follow up question from the line of Jamshed Dadabhoy from Citigroup. Please go ahead.

Jamshed Dadabhoy: Two quick ones from my side; the raw material impact that you all have detailed for the domestic business, has this cost been passed through or has it not been passed through yet like when will we see this?

Tarang Jain: Jamshed, the way it works is in India everything is a pass-through. But what happens is that every customer is different, so some pass-throughs happened every quarter and with some customers happen every six months. So, as you know presently in this first quarter we have seen rising commodity prices and also the exchange rate with the depreciation of rupee. So, what is happening is that we have had to face. So, what happens is a one quarter lag or a six-month lag. To that extent, we have to absorb. So, as there is a rising trend, it is a negative trend, we have to absorb that but it is a pass-through. So, eventually we will get it but in a rising trend kind of a thing we are definitely a loser because even the opposite is true if it goes down let us say next year if it goes down then we will be the gainer for a quarter or for six months as such, but it is all 100% pass-through.

Jamshed Dadabhoy: So, this Rs.12 crores is basically what you have not managed the pass-through yet, that is the way to read it?

Tarang Jain: Yes, that is right.

Jamshed Dadabhoy: What is LED as a percent of VLS revenue for the first quarter?

Tarang Jain: Last year I think it was 44%. Stephane, can you answer that?

Stephane Vedie: That is the figure I was ready to provide also. This is the magnitude right now and it is going, we think that within a year it will be in the range of 50%.

Moderator: Thank you. We will take the next question from the line of Aditya Jhawar from Investec. Please go ahead.

Aditya Jhawar: So, with regard to India business, we have about 16 business product lines, so we had indicated that end of the financial year we had about what roughly eight Hyundai's customers for eight products and Hero for three product lines. So, what is the same number as on this quarter end?

Tarang Jain: I would say the number is still the same but we are either one on the process of winning in a new product line both with Hero and with Honda and that is something which is already being agreed with these two customers. But it is not going to start happening from this year, it will happen from probably next year or year after next. In Halol we are already doing the lighting, which is one of the three products, it is only going to be the expansion out of Halol, we are already doing a lot of Pune today.

Aditya Jhawar: So, the Lighting Halol, Tarang, is included in #3, right?

Tarang Jain: Yes, today we are doing lighting, we are doing plastic molding and we are doing painting.

Aditya Jhawar: One on the start-up cost. We have included that there was about €1 million hit of start-up cost in VLS in this quarter. What was the comparable number in the same quarter last year?

T.R. Srinivasan: Aditya, last year the Brazil and Morocco projects did not start, it only started towards the last quarter of last year, this is mainly in this quarter and here also this is the cost incurred outside this jurisdiction, that is why we could not capitalize, otherwise it would have been capitalized. Because of certain withholding tax, etc., recently could not charge it back to the local operator so we have to expense it out. Going forward this will moderate significantly.

Moderator: Thank you. We will take the next question from the line of Rohit Kadam from Credit Suisse. Please go ahead.

Jatin: This is Jatin. Again, on slide #9, you mentioned that this Interior business which you have phased out, it seems it had the decent EBITDA contribution. I know it is not core for you, hence you would have wanted to get rid of it but why not sell it to somebody else instead of just phasing it out?

Tarang Jain: The business was only a standalone one business which we had for supplying to Johnson Controls or now Yanfeng which is a supplier with the Tier-2 priced on a point. The margin is good because we would have phased it out even three years ago, but we were okay maybe happily stuck with it till now. Because what happens is this is not as simple as it sounds that okay, this is standalone one business, today the investments are huge, if you want to get into this Plastics Interior business, we do not want to invest further, because the investments are huge and margins I can promise you cannot be like this if you want to kind of growth in such kind of a business. It just so happens that we were able to kind of get a certain pricing because we were exiting. So, that is the reason it is kind of quite attractive. Otherwise the margins are no so attractive. You can see what the margins are of other global companies in the plastics line, you cannot get this kind of margin, it is just the kind of one-off because we were exiting and we were able to enjoy this on some old machinery. We cannot sell that business. That is not something which is possible to sell a small business like that. There is going to be no buyer for this. It is getting relaunched, it does not work like that, but it is a small business.

Jatin: Is it part of the legacy acquisition?

Tarang Jain: Yes, it is a legacy acquisition and then we came in we had decided actually six years ago only that we want to exit. We are going to exit within a year's time. Chrysler is also a significant customer to us. They were not willing that we let go off this business. So, we had to wait till they were in and then they were ready only last year for us to exit because we should focus on a core, otherwise you can add other products, some standalone products and there are some extra margins, higher margins, but that is not the way it works, you should focus on a core, that is important.

Jatin: You have this 3 million cost on raw material. From what I understood to your replies to the questions earlier, is that a large part of it is because you have these new programs that the technology content is high and over the next 12, 15-months once you start your own electronics plant, that should go down. So, just wanted to get a sense on what kind of production could you see? On that 3 million cost, would you be able to capture bulk of it once you have your kind of electronics plant ready or there are other elements to it as well?

Tarang Jain: Electronics in-housing is very important firstly from a general cost point of view. It is not only about the electronics for these five programs, it is not only for that we are doing it, we are doing it generally as a strategy to improve margins because now when we came into the business, there was no plastics, no electronics, no lamps. Now there is far more electronics and electronics is growing. It is not only about cost, cost of course we need the savings. It is also about our IP. We have to manufacture IP also, the designing of the electronics is done by us. We cannot give it to somebody else for contract manufacturing. So, now it becomes very significant, you can pass on this technology to somebody else also. So, we are starting with about 30-35% of the total electronics business being in-house. Like Stephane said, on the 35% of electronics which we do in-house, 10% saving on these electronics, so that is significant. So, it is not only about these five programs, you look other electronic device. Everywhere there will be a positive impact. This is something very significant and going forward 30, 35% share in-house is going to 50. Of course, we will not do 100% in-house, we will always be also buying electronics from outside, it will never be 100% but definitely I would say that maybe going forward at least 50% we would like to do in-house on the electronic side.

Jatin: Within your raw material basket today, what would be the share of electronics, I know that will be increasing going forward as the LED penetration increases, but as on today, where does that number stand?

Tarang Jain: Last year we did about a billion dollar revenue. I think it would be at least Stephane 150 million?

Stephane Vedie: 150 million is correct, yes, this is including LED.

Tarang Jain: 150 million would be electronics and with more penetration increasing year-on-year. So, faster we get into electronics, the better.

Moderator: Thank you. Ladies and gentlemen, as there are no further questions from the participants, I now hand the conference over to Mr. Tarang Jain for closing comments. Thank you and over to you sir.

Tarang Jain: I just want to reassure all the investors and analysts that we have a strategy in place for our two core businesses, we believe in high growth because that is very important especially more in Lighting business where we want to grow our market share, India Two Wheeler we already got a strong player, but yes, we will take advantage of higher growth there. So, we have strategy in place on where to play, who are the customers we want to play with, the geographies we want to be in, we are very clear and how to win. That is something we are going to be pursuing on a relative basis going forward. So, we have got long-term vision for growth, we have stated vision, we have already shared it and we are pursuing that organically and inorganically will be more on the Lighting business side, not so much on the India side because India side 90% of the business is two and three wheeler where we already enjoy quite a bit of market share acquiring a company there will not really help us and today we have the where all and withal we have the product technology, we own our product technology in both our businesses and a strong level of technology. So, I think for us it is up to us how much we want to grow. That is all I wanted to add.

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