



“Varroc Engineering Limited Q1 FY20 Earnings Conference Call”

August 9, 2019



**MANAGEMENT: MR. TARANG JAIN – MANAGING DIRECTOR, VARROC
ENGINEERING LIMITED
MR. STEPHANE VEDIE – PRESIDENT & CEO, VLS
BUSINESS
MR. ASHWANI MAHESHWARI – WHOLE-TIME
DIRECTOR & CEO, INDIA BUSINESS
MR. T. R. SRINIVASAN – GROUP CFO
MR. NITIN KALANI – AVP FINANCE & HEAD OF
INVESTOR RELATIONS**



*Varroc Engineering Limited
August 9, 2019*

Moderator: Ladies and gentlemen, good day and welcome to the Varroc Engineering Limited Q1 FY20 results conference call.

As a reminder, all participants' 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 Védie – President & CEO, VLS Business; Ashwani Maheshwari – Whole-time Director & CEO, India Business; T. R. Srinivasan – Group CFO; and Nitin Kalani – AVP Finance & Head of Investor Relations.

I now hand the conference over to Mr. Tarang Jain. Thank you and over to you sir.

Tarang Jain: Good evening everyone. I would like to thank all of you for joining the quarterly earnings call of Varroc Engineering Limited. Before I discuss the financial performance of the last quarter, I would like to quickly recap the industry situation. Our key markets are Europe which generates 46% of our consolidated revenue, India which generates 35%, and North America which generates 18% of our revenue. Besides this, we have a JV in China, the revenues of which are not consolidated but it generated more than 15% of our profits in FY18. Each of these markets have seen decline in volumes over the past few quarters. China during the quarter declined by 16.2% year on year, Europe by 6.6%, North America by 2.1%, and Indian two-wheeler production fell by 10%. Each of these markets are facing several challenges ranging from change in regulatory- and emission-related norms, slow economic growth, and resultant weaker consumer confidence and trade tensions.

Given this background, I am reasonably satisfied about our performance. The revenue for the VLS business increased by 1% in euro terms while the India revenue was almost flat. However, our revenue in China declined by 37%, much higher than the market decline. EBITDA on a comparable basis grew 3.2% overall, EBITDA margin for India business was flat at 10.1% when compared to Q1 FY19 while the VLS margins improved by 40 basis points to 9.5%. The EBITDA of our China JV declined by 70%. Depreciation and finance costs were higher largely due to adoption of Ind-AS 115 and Ind-AS 116 and a higher asset base.

Our profit after tax for the quarter is at Rs. 875 million, a decline of 13% mainly driven by the loss in our China JV and increase in interest and depreciation, partly offset by lower taxes due to tax credit in our Czech operations.



*Varroc Engineering Limited
August 9, 2019*

During the past 4 months, we have won some significant businesses. Our VLS business secured orders of EUR 93 million of which orders for almost 81 million are new orders. In India business, we won a large order for an engine valve complaint with Euro 7 emission norms. We have also won substantial orders from the VW Group, Honda, and Bajaj for various products. I am also pleased to inform you that we have announced a small yet strategic transaction today to acquire 74% stake in CarIQ, a leading integrated connected vehicle solution provider to OEMs, fleet owners, and insurance companies. This transaction will complement Varroc's futuristic corrective vehicle product offerings such as the instrument clusters, telematics devices, and other database alternative products.

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

Moderator: Ladies and gentlemen, we will now begin the question & answer session. The first question is from the line of Hitesh Goel from Kotak Securities. Please go ahead.

Hitesh Goel: Sir, can you just give us some sense on the customer-wise growth, at least key customers in both India and VLS business because of which this performance has come through? And also, what have we done to keep our EBITDA margin flat on a YOY basis and VLS business improve slightly? Can you talk about that please?

Tarang Jain: When it comes to VLS, the growth I would say largely comes from a few customers like Ford. Ford, we have grown by about 9% year on year. Then we have also grown with PSA which we have grown at about 17% year on year, and the VW group we have grown by about 39% and there are other smaller customers. Where we have little bit degrown is with JLR. JLR de-grew about 21%, Tesla de-grew about 47%, and FCA de-grew by about 18%. Overall, I think in the same period in euro terms, in Q1 FY19, we were at 225.9 million euros and in the first quarter of FY20, we are at about 228.1 million euros which is about a 1% growth, not much of a growth in a market like I said which has kind of declined globally. Of course, China, which is not the most significant part of our revenue but that has declined of course 16% and then of course even Europe and North America.

Coming to India, also we have had almost like a flattish kind of performance on the revenue side compared to the previous year. But here as you know that 85% of our business is mostly coming in from two-wheeler market. To that extent, I think the two-wheeler market has kind of de-grown less than the four-wheeler passenger car market in India or the commercial vehicle market. The main customers who have grown with here are Bajaj Auto. As you know, Bajaj Auto has one which has probably performed the best in the two-wheeler segment. So, the revenues with them have grown about 6.4% from about 519 crores to about 552 crores. Then, the other people we have grown with I would say Mahindra & Mahindra where our growth has been from 49.4 crores to 51.7 crores and Suzuki has seen a very small growth, the Suzuki



*Varroc Engineering Limited
August 9, 2019*

group, 19.8 crores to 20.3 crores but largely with everybody else, I would say that we have in India also kind of a de-grown. Royal Enfield we de-grew about 56% because of they have got a de-growth in their volume plus they were carrying some inventory also of our parts. We have de-grown with Yamaha from 50 crores to about 40.6 crores. These are, I would say, the major customers. Honda also we have de-grown by about 14.6% from 119.5 crores to 102.1 crores.

Overall, I would say, considering all this, our revenues for Q1 FY20 was at 2870 crores compared to 2927 crores last year in rupee terms but then for our foreign business which is almost 65% of our revenues, of course, we were at a higher euro rate to rupee. Last year, we were at about, I think, 79.8 and now we are at about 78.1. Of course, in rupee terms, it does make a certain difference to our revenues, about 2%.

Hitesh Goel:

Sir, can you also talk about the EBITDA margin trajectory because last quarter was weak on the India business, but we have recovered the margins. So, just wanted to get a sense on India business and also VLS we have done certain improvements on the productivity side and raw material side. So, can you just give us some sense what....

Tarang Jain:

I will just give you holistically a little bit what we are trying to do because as you can see that all the markets globally as well as India, there has been a de-growth. Obviously, we are not able to control the revenues coming out, though we have been winning new businesses. Last few years, our focus is on market share growth whether for the Indian market or whether for the global lighting market. We are growing and as you can see, we have been winning new businesses in the last few years on a very consistent basis. But having said that, the current global environment and the Indian environment is quite weak. So, what we have decided is that we are going to take certain very proactive steps which we have started taking over the last 3 to 4 months. What we are doing is that we are driving more purchasing efficiencies with our key suppliers of raw materials and vendors, we are focusing a lot on operational efficiencies on the shop floor, and also wherever necessary where plants are underutilized. Of course, we are working lessor shifts on lessor number of days. That's what we are doing. And overall, I think what we are also addressing in a very quiet way is also trying to lower our break-even point by addressing our fixed cost. Fixed cost basically means largely the salaried manpower. That's the major cost and that's why we are also addressing that wherever we feel the opportunities are there, we are going in for a certain downsizing of manpower. And that's on a global basis.

Hitesh Goel:

Sir, can you also talk about the new plant like Brazil, Morocco, and also construction in Poland has started? What is kind of revenue figures or capacity utilization you are looking in '20 and '21 from these plants so that we have some sense on the growth coming from these plants?

Stephane Védie:

If I can add also to Tarang's comment telling about purchasing efficiency, we see this is a major driver of improvement of margin on VLS and that's the commitment we have taken to have a world class purchasing organization. We decided to centralize our purchasing function.



*Varroc Engineering Limited
August 9, 2019*

We created a central purchasing department in the city of Krakow in Poland and all the purchasing now globally goes through this global organization. So, we invested in new sources new competencies and this is starting to pay off. We use, for example, online auctions for the award of every component and every new savvy source globally. We have started seeing some very good results coming out of this investment.

About the new sites, Brazil: industrialization is on track right now to support our second customer launch. We will start to ramp up in December. We have launched already. With Volkswagen, the launch went very well, and the second customer will be Renault. That's the program where we will produce the rear lamp and other headlamp. From Morocco, we had launched the sales products in December last year. The launch went as well very good. So far, the quality has been excellent, and we have a second PSA launch coming up in the next weeks. Then, after that, we have one launch with the Volkswagen group and one launch with Renault. This is the same as on the old projects that will be launched in our phase 2 expansion of this plant. So, we expect to ramp up in end of November with these new quantities.

Hitesh Goel: What is the revenue from Morocco plant? Can you give us that or capacity utilization right now?

Stephane Védie: For the revenue, I can look at the 1st quarter of this year. That was only 12.6 million euro.

Hitesh Goel: In 1st quarter, right?

Stephane Védie: This is what we see for the full year, 12.6 million euro.

Hitesh Goel: And similar number for Brazil if you can give us?

Stephane Védie: Brazil will be around 7 million euro. We are actually in the ramp-up phase for these plants but so far like I mentioned, we are well on track. Maybe a few words about Poland as you were asking as well. I was yesterday, in fact, in our plant in Niemce in Poland. The plant is on track. The team is working right now on the first project also with PSA before launching the second project with Volkswagen. So, we are in the phase of validating the sites and we have moved the first machine in the building. That's a good sign.

Tarang Jain: To add on to what Stephane is saying, this year we don't expect the sales to be.... utilizing a very small part of our capacity. It is only in the coming year, then next year, the FY21, is where you are going to see that we reach about 50% of our utilization or 60% of our utilization. But this year is something where we are launching a few programs which are not going to give us much of revenue.

Moderator: The next question is from the line of Aditya Jhavar from Investec. Please go ahead.



*Varroc Engineering Limited
August 9, 2019*

- Aditya Jhawar:** Congrats on the decent results. Firstly, on the deal that you just closed about 74% stake, what could be the deal value in this?
- T. R. Srinivasan:** The total deal value on 100% valuation basis is 26 crores.
- Aditya Jhawar:** 26 crores is the transaction value for 74% stake?
- T. R. Srinivasan:** No. The total 100% valuation is 26 crores.
- Aditya Jhawar:** In your margin, Stephane, if you can help us a little bit on the backward integration. How it is progressing, and how much contribution we are expecting in FY20 and 21 from backward integration and overall margin trajectory in the next 2 years for VLC business?
- Stephane Védie:** I think you are speaking about the joint venture we have in Romania for the manufacturing of electronics. I think as we have already communicated in the previous calls, we don't expect any impact on the fiscal year '20. Right now, we are in the phase where we have shell of the building that is ready. We have ordered different SMT lines. We have the first management team but by the time we set up the SMT lines and we start producing the first part to go through validation will be at the end of the fiscal year. So, we expect the first impact in fiscal year '21. The game plan is to add up to 6 SMT lines in this building. The first one has been ordered. The first one should be fully operational and impacting in fiscal year '21. Then, in fiscal year 22, we will add additional 1 and then fiscal year '23 additional 2. When we will be in the full-scale production, we will be able to double the initial target that we are planning to produce in this plant. Initially, our plan was to produce the equivalent of 45 million euro of purchase electronics. Now we think we can flirt with the 100 million euro with different type of equipment we have decided to order and by trying to pack a little more SMT lines in the building. So, out of this €100 million, we expect a saving of roughly 10%, they are still working on the purchasing price and then we expect this entity to generate also a 10% return on the result. So, we will have a double impact of this venture.
- Aditya Jhawar:** Overall margin trajectory for FY20 and 21 for VLS, what should we expect all things put together?
- Stephane Védie:** FY20 right now we see a double-digit EBITDA margin.
- Aditya Jhawar:** And FY21, will it be about 11% to 12%?
- Stephane Védie:** Yes. That's the improvement that we are showing.
- Tarang Jain:** Aditya, we do need some help on the growth in the market for sure. A double-digit EBITDA is for sure. And if you see even a small growth in the market, I think that yes, our target is to



*Varroc Engineering Limited
August 9, 2019*

grow the margins year on year as a percentage. Yes, if it is going to be let us say 10% this year as a target, we would definitely want the target level persisting the next year. We would like to grow our margins but that has to come with the revenue. So, revenues have to grow also at the same time. A lot of our big revenues come in from FY22, but next year also, there is a growth. But we do need some growth in the market also for things to happen in a positive way but a double-digit EBITDA is something we will always sustain henceforth.

Aditya Jhawar:

Final question is on China. What is the outlook that we are getting a sense from customers and what I understand is that the new order from VW and Geely will come for execution from FY'22. What is the outlook in FY20 and 21 that we are foreseeing in China?

Stephane Védie:

In China, we go on a quarter-by-quarter basis. It is very difficult to predict. Many people are trying and not many are successful right now. There is a big impact of the trade tensions between the US and China. If they are able to solve this problem which seems to be dumbfounded currently, we can see a pretty fast recovery. This is our opinion. But right now, we prefer to plan for the worst and not for the best. The actions that Tarang was mentioning that we are implementing globally reducing our break-even point, we are even pushing further in China because we don't believe in fast recovery of the market right now. We take it quarter after quarter and then we are ready as soon as the volume come back to jump on the opportunities. We have a decent market share in a market that is planning to launch another 30 different models in the next 18 to 24 months. Will they be successful will with the car sales this will impact also us in terms of the revenue. The new project like you mentioned will impact us fully in fiscal year 2022. This interesting car, the Volkswagen FAW-1, is an electric vehicle and we think this is fitting well in the segment that is currently taking off in China.

Moderator:

The next question is from the line of Nitin Dharmawat from Aurum Capital. Please go ahead.

Nitin Dharmawat:

My first question is what is the consolidated debt on the books of the company?

T. R. Srinivasan:

Even though we don't publish the balance sheet as such in March, but by the end of June, we had a net debt of 2600 crores approximately of which there was an increase of about 240 crores because of AS-116 adoption under which all the operating leases we have to capitalize and show it as financial liability in the balance sheet. Without that, it could have been lower to that extent.

Nitin Dharmawat:

What was the amount as of 31st March on a like-to-like basis? Because you said that 240 crores got increased because of

T. R. Srinivasan:

Comparable basis, it is about 2300 crores.



*Varroc Engineering Limited
August 9, 2019*

- Nitin Dharmawat:** My next question is about the current utilization level. Overall within VLS and in India business, what is the current utilization level?
- Tarang Jain:** I would say it is around 65%. You are talking about overall?
- Nitin Dharmawat:** Overall. And VLS?
- Tarang Jain:** VLS, I think it will be around the same, 65%. What do you think Stephane?
- Stephane Védie:** I agree with you Tarang. We have different realities from different regions but overall the 65 is a great number.
- Nitin Dharmawat:** My final question is about the CAPEX plan for the year because last time you mentioned that the CAPEX is going to be slightly moderate this year. I hope that it remains the same. And what are our plans with regard to CAPEX?
- Tarang Jain:** Overall, I think we will be within the 800-crore mark for sure which we see somewhere not crossing 750 because there are certain CAPEX which are committed for some expansions. That is something we cannot take back. So, instead of 800, we may land up doing 750 or maybe 700 but we will be definitely doing something a little bit around 700 to 750 is what I would guess as a number.
- Moderator:** The next question is from the line of Basudeb Banerjee from Ambit Capital. Please go ahead.
- Basudeb Banerjee:** Congrats for a good set of numbers. As you mentioned the numbers, you are expecting the revenue from Brazil and Morocco and reach 50% to 60% utilization next year. On one side you are doing good fixed cost management. Despite flat revenue, you have improved VLS margin. So, how to look at the fixed cost of Brazil and Morocco? Have they peaked out and despite that, you are reporting 9.5% or there are chances of costs from Brazil and Morocco to inch up in coming quarters against that double-digit margin which Stephane guided for this fiscal?
- Tarang Jain:** Maybe Stephane can add later. I feel that today we have already incurred a certain minimum cost because when you have to run a plant even at a certain level of maybe 10% or 15% where we are today, we have obviously kind of got in the basic people which we need for the business. Yes, at the moment, of course this is not to take care of let us say Morocco today. This year our plan is only 13 million. This plant over the next 3 years probably will go to 180 million euros of revenue. So, there will be some added costs, but I don't see us really adding too much of cost here till we achieve a certain level of volume. So, we may add some more costs, maybe a few salaried people and more of workers, probably in the coming year once more volumes kind of materialize. Similarly for the other new facilities also, the same thing.



*Varroc Engineering Limited
August 9, 2019*

Yes, we are obviously very conscious on the costs in these new facilities. We are very conscious and very prudent when it comes to our manpower structures in every new plant we are setting up. We are very conscious of that. So, the costs are under control.

Basudeb Banerjee:

Bottom line was, assuming this kind of sluggish revenue growth remaining for the rest of the year and fixed cost management on one side and rising fixed cost on the other side, combining all these things, still this double-digit margin which you said so, how much convinced you are on that? I just want to understand from that perspective.

Tarang Jain:

What is happening is that there are certain steps we had not envisaged for the kind of sales we were expecting closer to an 8% to 10% kind of revenue growth and we are talking about the VLS. At that time, we were not thinking of taking some more measures of driving more purchasing efficiencies or taking higher targets there or doing something more on the plant side on the operational side or even reducing certain fixed costs. That we have started now doing from April. That was not something we had thought of earlier. So, obviously, for us, the margins have been important, though we are on a flat sale. If the current trend continues, then there will be no growth. We may be similar to last year revenues. But then, still we want to have an improved margin. That's the reason that we are taking all these proactive steps because like I said earlier that we cannot control the revenues of customers or the markets but definitely we can control our costs and that's why we are proactively working on optimizing costs and driving more efficiencies. That is what we are working on both in VLS as well as in India.

Basudeb Banerjee:

Second thing, as we were discussing last time fiscal '20 VLS euro growth of somewhere around 6% for the full year. Last few months whatever has been the incremental change in outlook and 1% growth this quarter, at the current juncture, how do you see VLS euro growth panning out for the full fiscal?

Tarang Jain:

If the current trend continues, we will have to wait and watch. Yes, we are launching some new programs in the 2nd half of the year, that could give us some growth going forward but it is very difficult to say to be honest. I don't expect more than 1% or 2% growth if you ask me today. I don't think some magic can happen and things will change like what Stephane was saying that if the China-US dispute ends, that will be very good for the global car market. Then, one can say more confidently about growth prospects, but otherwise, it is very difficult. And the India story you know probably more than I do what the situation is. The whole auto industry in India is looking for a certain stimulus. GST cuts we want. Obviously, the RBI did whatever they could on the policy of also helping NBFCs and everything. If the lending goes up and GST goes down, definitely in India, there is going to be a growth for sure. In spite of even the new emission regulations and everything coming in which will again increase the total cost of ownership of vehicles, but we can expect if the government acts in India. But globally, I think things are a little bit more complex I would say for growth to take place.



*Varroc Engineering Limited
August 9, 2019*

- Basudeb Banerjee:** I missed out in the earlier part of the call; you were mentioning about the Romania backward integration. Earlier, we were discussing almost 100 bps of gross margin benefit. What is the timeline when that should start trickling down into EBITDA margin?
- Tarang Jain:** I would say it will be from the next financial year. Stephane, can you say what is the revenue we have planned in FY21 because maybe we will start our plant in December or so but I don't see the volumes really ramping up before April 2020. What is the revenue we have planned for FY21 in Romania?
- Stephane Védie:** FY21 in Romania, we are looking at around 18 million euro of revenue.
- Basudeb Banerjee:** Sir, as you were saying, many of the OEMs were having the products inventory. Now, after the last few months where aggressive production cuts by most of the OEMs, how is the outlook in terms of supply from a base of July-August levels to the OEMs with specific reason?
- Tarang Jain:** You are talking about India?
- Basudeb Banerjee:** Yeah, in India.
- Tarang Jain:** I think that there is still stress to be honest. There are still OEMs with a carrying inventory. They are hoping for a good season to take place, but if the season is not good which is like September-October time frame, if people don't start purchasing, I think we can expect further cuts in output from probably all of them.
- Moderator:** The next question is from the line of Hitesh Goel from Kotak Securities. Please go ahead.
- Hitesh Goel:** Sir, given the outlook that you are presenting now on VLS and we just wanted to get a sense about the revenue target that you had given of around Rs. 200 billion on consolidated revenues by FY22, is that doable or do you want to give a fresh guidance now?
- Tarang Jain:** We had a guidance about FY22 because our guidance for FY21 to be at 20,000 crores. We obviously included some inorganic play which now we are a little bit vary of doing in this kind of a market because at the moment, for us, cash is king and we would not like to go for any inorganic growth. Valuations are still not up to our expectations. Still when people want to sell, they still expect a higher valuation whether it is on the lighting business or whether in some other business we are looking at. Without inorganic play, we are looking now at only organic growth. In organic growth, obviously FY21 is not possible to reach 20,000 crores but the fact is that we are also winning a lot of new businesses. If the growth does come back to at least 5% to 7% levels in the market and with whatever else we are doing at our side to grow market share or cross sell more of our items in India and things like that, maybe I would say, things would get postponed by another couple of years and we maybe could still achieve it by FY23



*Varroc Engineering Limited
August 9, 2019*

if you ask me what I think as of today, but obviously, we need markets to definitely come back into the green where growth is concerned.

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

Aditya Jhawar: Tarang, on the same question on VLS growth. You mentioned that in 2nd half, we are expecting some new programs to kick in. Are you factoring in those new programs when you are talking about the annual growth of about 1% to 2%?

Tarang Jain: Yes.

Aditya Jhawar: For the India business how is our supply for BS-VI ramping up and when we could see in the quarterly run rate? Any indication from OEM in terms of production ramp up in BS-VI?

Tarang Jain: As you know, the BS-VI is for the two-wheeler market where we are present and we are present in the catalytic converter and the electronic fuel injection systems. That's why we are playing today and I do see a decent bump up but it will be I think though there will be certain small volume, we will start off in the 3rd quarter of this year in India, but I think bigger volumes will start from January of 2020.

Moderator: The next question is from the line of Shyam Sundar Sriram from Sundaram Mutual Fund. Please go ahead.

Shyam Sundar Sriram: Sir, my first question is on China. Is the China V to VI emission on transition largely over? It appears from the volumes that the China PV market seems to be stabilizing. From here on, do you see stability in China in terms of volumes? Are you seeing pickup there? Any thoughts on that?

Stephane Védie: We honestly thought that once the new norm would be put in place, we thought the customers were waiting for this in order to order cars that were compliant with the new norms to be able to enter the inner cities of certain mega cities. The point is like we said before, the reality seems that overall the market is depressed in China, the consumers are depressed, and they want to wait and see if the economy and tensions they see between China and US will resolve and the situation will disappear. We think that this is the main decisive factor right now. The norms have not played a major role at the end.

Shyam Sundar Sriram: So, are the schedules stabilizing from here, sir, in terms of your production schedules?

Stephane Védie: What we see in the system right now, it is showing stability but it is still sluggish and pretty low compared to what should be the volume at this time of the year.



*Varroc Engineering Limited
August 9, 2019*

Shyam Sundar Sriram: Just one more point from the India business perspective. You did mention in the last call on the electronic fuel injection order that we have won from Royal Enfield. Any further developments there? Have we won anything more, sir, on the electronic fuel injection side?

Tarang Jain: It is not possible because we have tied up with Italian company Dell'Orto actually came in a little late. We tied up only a couple of years back. We were a little late with in this segment because people had started finalizing suppliers in this segment actually about 3 years ago or 4 years ago. So, we were a little late but we were fortunate that with our solutions, we at least got into the game with Royal Enfield. Now, I think the second phase will be OBD-II which will be after 2 to 3 years. That is when I think that we want to have a larger play whether EFI is concerned because we still believe that the IC engine is going to be there for many more years and they are not going to be probably banned by 2025. So, we are betting quite big on the BS-VI and then the further some of engine parts also such kind of technologies.

Shyam Sundar Sriram: On the integrated starter generator, are we seeing all the two-wheeler OEMs largely by are large moving to that from the independent starter and the alternator kind of a system now with BS-VI? How are the technology trends looking like, sir?

Tarang Jain: I cannot name the company but one of them is surely going in for the lower cc vehicles. One large OEM is already implementing the IC for sure in lower cc vehicles when I talk about 100 cc and 125 cc. And there are a couple of others who are exploring this at this point of time and we are engaged with these people. We are engaged with a couple of customers on the IC because we have developed our own solution in this regard.

Shyam Sundar Sriram: Sir, is this solution only applicable at the lower cc? Is that the case? You mentioned the lower cc. Is there any specific technical reason why customers prefer this at the lower cc motorcycles?

Tarang Jain: It is applicable also for the higher cc. It can be over 150-200 cc also but the interest what we see is more in the lower cc at the moment. Presently, we are seeing more interest for the lower cc vehicles. Therefore, our focus has been at the moment on the lower cc vehicles, but yes, this could also be applicable to the higher cc and I think we will be developing a solution also for higher cc bikes going forward.

Shyam Sundar Sriram: This can give a better fuel mileage, sir? Is that a possibility?

Tarang Jain: One is that you are integrating probably the AC generator, the starter, and the regulator into one particular product as such and definitely it helps to some extent on the fuel efficiency. It all depends on what the OEM specification is. Depending on that, it kind of helps in fuel efficiency and also there is a very good start-stop function which is inbuilt for the vehicle which is also very useful. There are a lot of advantages in having an IC in a two-wheeler.



*Varroc Engineering Limited
August 9, 2019*

Shyam Sundar Sriram: You are also working on this e-carburetor product. How is the progress there, sir? Given the cost differential, are you seeing more interest or are these already testing under progress? Any thoughts on that?

Tarang Jain: We are going to be supplying to one of the OEMs. We cannot name the OEM. We are going to be supplying the e-carburetor to one of the OEMs but is not with our R&D. It is with their R&D. So, it will be more like a built to print. What we see is only 1 or 2 people probably will come in for lower cc bikes. For lower cc bikes, they will go in for e-carburetor where the solutions are more coming in from them. But lot of the OEMs have already kind of made their plans of EFI. There are only maybe a couple of companies or maybe 1 company which is looking at the e-carburetor. All the others are looking at the EFI solution.

Moderator: The next question is from the line of Basudeb Banerjee from Ambit Capital. Please go ahead.

Basudeb Banerjee: Sir, I just wanted to understand if I see for VLS, the business mix from JLR and say Tesla, that is gradually getting substituted by a mix from players like Volkswagen and Renault. So, from a premium segment to a mid-market segment in terms of light assembly value addition per car, is that a structural risk to your gross margin as such?

Stephane Védie: Maybe a few comments on this. JLR, for example, since the beginning of the year, we have received a business extension for the E-Pace headlamp, rear lamp. This is great for us. As JLR is experiencing some difficulties, they are not refreshing the cars like they were expecting. So, they decided to extend the headlamp and the rear lamp. That means we get additional revenue without engine ring, without launches, without all the cost associated to this. And this is the product where we have a good margin. With Tesla, we have won since the beginning of the year, the new launch that we are on the model Y. Some launches were carried over but some launches were new and we won this model Y. So, the relationship is still pretty good with Tesla. You mentioned Volkswagen group and you mentioned other customers. We are still also doing pretty well with Ford. More than 60% of the new businesses that we won since the beginning of the fiscal year are from North America for this one of the important customers for us and we have entered the third segment. So, we have won major headlamp business for truck platform and this is really a profitable segment for the car makers but also for the suppliers. This is really our target for this year. Fill the pipeline with projects and business for North America and for our Mexico plant. Mexico plant is one that we have always communicated that it is a little underutilized right now where we have capacity. That means winning projects in Mexico is great for us because we don't necessarily need to invest there. The third platform that I mentioned, this is also protected for ADB technology. That means, as soon as the ADB will become legal in the US next year, then we are able to order via our electronics make and update and activate the ADB function in this lamp. So, there are some really interesting things coming up and the technology and margin is not only linked to JLR and Tesla as far as we are concerned.



*Varroc Engineering Limited
August 9, 2019*

- Moderator:** The next question is from the line of Ronak Sarda from Systematix. Please go ahead.
- Ronak Sarda:** Sir, a similar question to the earlier one. If I look at your VLS customer mix, that has been changing pretty rapidly. Obviously, it is not just about the premium classes but if assume it right do the tooling revenue and the designing revenues also change meaningfully once you shift from the premium customers to mass market? Is that also one of the considerations? And eventually if I see the order wins over the next 2 years, can you help us understand how would this customer mix look like?
- Stephane Védie:** Tooling and engineering revenue is not much influenced by the customer mix that we have. By the way, I think we are always reporting our revenue on production revenue as well. So, there is a full transparency on this. Going forward, we don't see any major mix change on this. What was the second part of the question, sorry?
- Ronak Sarda:** If I see the new order wins over the next 2 years and the new plants coming up, what would be the customer mix by end of FY21 and how does that change in terms of contribution from mass market vehicles or premium vehicles?
- Stephane Védie:** This last quarter of Volkswagen group was already the No.3 customer for us. We see in the next fiscal year Volkswagen group becoming the No.2 customer and potentially being in the 1st position in fiscal year 2022. Ford remains very strong for us, especially with the recent wins in North America. By the way, we have an excellent relationship with Ford. We just recently received an excellence award from them. We are the only lighting supplier recognized and awarded with this prestigious price. We are also on the very innovative new platforms with Ford. So, Ford will remain No.1 or No.2 for us going forward. And then, we see an interesting growth with Renault based on the previous year new business wins. Based on our footprint, Renault will become an important customer for us in Morocco. Renault is starting introduction with us in Brazil. Renault has started in the last quarter also new business with us in Czech Republic. We have the Renault Master, a commercial vehicle and we have also the Renault Twingo that was launched recently in Czech Republic, so some good products. So, Renault will definitely be the top 5 customers starting also from next year.
- Moderator:** As there are no further questions from the participants, I would now like to hand the conference over to the management for closing comments.
- T. R. Srinivasan:** We would like to thank everyone for joining the call and for the questions and we will be in touch as we go forward. Thank you.
- Moderator:** Ladies and gentlemen, on behalf of Varroc Engineering, that concludes this conference. Thank you for joining us and you may now disconnect your lines.