"Varroc Engineering Limited Q4 FY 2020 Results Conference Call"

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MANAGEMENT: **MR. TARANG JAIN – MANAGING DIRECTOR**
MR. STEPHANE VEDIE – PRESIDENT AND CHIEF EXECUTIVE OFFICER, VARROC LIGHTING SYSTEMS
MR. T. R. SRINIVASAN – GROUP CHIEF FINANCIAL OFFICER
MR. NITIN KALANI – ASSOCIATE VICE PRESIDENT, FINANCE AND HEAD INVESTOR RELATIONS

Moderator: Ladies and gentlemen, good day. And welcome to the Varroc Engineering Limited Fourth Quarter and Financial Year 2020 Results Conference Call. As a reminder, all participant lines will be in a listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the 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 business; T.R. Srinivasan – Group CFO; and Nitin Kalani – Associate VP, Finance and Head Investor Relation. I now hand the conference over to Mr. Tarang Jain. Thank you and over to you, sir.

Tarang Jain: Thank you. Good evening, everyone. I am Tarang Jain here. Sorry for being a little late. I would like to thank you for joining the Q4 and the FY '20 earnings call of Varroc Engineering Limited. As highlighted in our COVID-19 situation updates in April this year, the pandemic led to supply chain issues across facilities, apart from the plant shutdowns in China. As the pandemic spread, most of our global lighting plants and the Indian plants were closed for the entire month of April and a part or the whole of May this year.

Due to the serious disruptions in the operations from late January till mid-May at various locations, revenue for the fourth quarter of FY '20 and the first quarter of FY '21 has been impacted severely. This has been an industry wide phenomena and we have been no exception. The decline of this scale has not been seen in decades. This obviously impacted the profitability. During these challenging times, our main focus has been on cost control by way of optimizing manpower costs, fixed overheads and engineering discretionary spend. We have rolled out measures to achieve recurring SG&A cost savings of almost 25%, and product development spend reduction of more than 15%. I am confident that these initiatives, along with many others, will help us achieve our goal of restoring the profit after tax margins and strong cash flows in the second half of this year.

Apart from cost optimization, we have reduced our CAPEX spend for the financial year to less than half of what has been our spending in the last three years. Over the last three years, we have built four new plants, have acquired a company in Turkey, and have invested in upgrading our Czech facility. As these activities are coming to an end, the CAPEX intensity is expected to reduce in FY '21. The CAPEX spend of VLS for FY '21 is expected to be around EUR 45 million based on the current business environment. I would also like to highlight that during FY '21, after taking into consideration the COVID related disruptions, we expect that our new facilities will contribute meaningfully to the top-line and may not be a drag on profitability as we ramp up in the second half.

Speaking about the current business environment. We are seeing encouraging schedules in the month of June for most of our facilities. In fact, in the North American market, we are expected to see somewhat better results in June than what we had planned for, taking COVID situation into account. Our Czech plants are running closely in line with planned levels. China JV has seen strong results in April and May. Indian two wheeler OEMs are ramping up as the economy is preparing to unlock, which is a positive news for our Indian business.

From the order win perspective, we have had another year of strong order intake in VLS. Our focus has been to win more orders in North America, to fill up the underutilized capacity and we have been successful in securing orders there. We have been successful in securing orders for more futuristic products like the traction motor for the two wheelers, two wheeler electric vehicles and the BS-VI rated products in India, both from new and existing customers. We presented our telematics solutions to a few customers, are in an advanced stage of the discussion with them. All of this bodes well for the business going forward.

To summarize, this pandemic has forced us to review and identify opportunities to optimize the cost structure and improve the efficiencies at Varroc. We have been able to identify substantial cost optimization opportunities, and I am confident that this will help us deliver strong performance starting second half of this financial year. Our target for FY '21 is to achieve a positive profit after tax and free cash flows in both India and VLS on a full year basis through a strong second half performance.

With this, we are happy to take your questions now. Thank you.

Moderator: Sure, thank you very much. We will now begin the question and answer session. The first question is from the line of Niteen S Dharmawat from Aurum Capital. Please go ahead.

Niteen S Dharmawat: My first question is, how is the cash situation now? Because last time we spoke, the situation was still emerging for COVID and now a lot of clarity is there. So how is the cash position now within the company at overall levels?

Tarang Jain: Srinivasan, please take this question.

T.R. Srinivasan: Cash situation, currently we are doing okay, I mean, we are managing overall reasonably comfortable I would say. India factory started operating last month and the volumes are ramping up, now probably we are at around 50%, 60% of the normal volumes. The operating cycle has resumed, so that kind of giving us a relief in terms of getting the cash flow going and VLS is taking a bit more time, the ramping up is a bit slower overall, so there also liquidity wise we are okay for now. So we are hoping that the volumes will pick up. We are also in discussion with some customers to expedite certain payment for tooling, etc., and also shortens the number of payment terms, which we are also making good progress; we should see some breakthroughs on that also in the coming couple of weeks. So with that, I think we should be able to be comfortable there. But overall, yes, liquidity position is okay, manageable for now and for the near future.

Tarang Jain: See, to just add to what Srini has said. We had a comfortable situation in March end, because when this COVID struck globally, we did draw down on our limits, and we had about Rs. 1,000 crores of cash, both India as well as VLS included, which was actually very good for us and has helped us in this period when we have experienced almost zero sales in 15 days in March, and almost the whole of April. The good thing is that in May we did see a recovery, the recovery to the extent of probably overall about a level of 35% to 40%, as a group, to the original level of sales. And we are seeing almost, you can say, I mean, a higher level of recovery in sales also in the month of June, it's about 65% to 70% in our VLS business, our global business. In India also we are seeing around 55% to 60%. So, like Srini said, he mentioned that this recovery is in line with what we were expecting to happen. So, to that extent, I think this recovery happening is helping also our cash flow situations going forward, because, yes, it would have been a tighter situation if probably this recovery would have been postponed.

Niteen S Dharmawat: I understand. My second question is related with promoter stake, and currently it is at around 85%, we have already complicated two years from the IPO days, I think we have one more year before we are to bring down these stakes. So what are the options available? Because stock is down from IPO levels, substantially down and there are multiple reasons. So, what are the options that you have at your hand? Do you have some sense about it, some idea about if you can highlight more about it?

Tarang Jain: See, I think that basically, presently our focus is going to be on debt reduction, not that we are so highly leveraged, I mean, our net debt without any leasing or whatever accounting, we were almost at about probably Rs. 2,470 crores, and our equity is about Rs. 3,000 crores, so we were 0.8 net debt-to-equity margin. Yes, the net debt-to-equity will go up, obviously, at the end of the first quarter for obvious reasons, and probably also into the second quarter. But then we see, of course, our net debt position getting better as we go along in the third and the fourth quarter. But having said that, yes, you are right that the stocks, obviously, the stock level today, the price level today doesn't really justify and really reflects the real value of our company. I mean, the valuation today is even below our book value. But having said that, there is still a year to go, I think we would like to kind of, yes, we would probably need six months before to probably get into this whole exercise of dilution. We are hoping that because of this COVID situation, that the Ministry of Finance and SEBI does give us some kind of extension also, by at least probably a six months to a year period. If that happens, that will give us more relief, because obviously whether you are a strong performer or a weak performer, anyways, all the stocks obviously are battered in this period of COVID. So we are hoping for some extension. As of now, we are supposed to obviously kind of dilute our shareholding by 10% by first week of July. We are hoping for an extension. But if it doesn't happen, we are hoping, obviously, through a stronger performance in third and fourth quarter there is some positive movement in our stock. But yes, I think our focus will be mainly on getting our net debt levels down to, I mean, personally, to at least 0.5 level net debt-to-equity. That is what, personally as an organization we are comfortable with. Today, we are at a higher level, at about 0.8, and in the interim it may go up to more than probably 1 also in the next few months. But that's what answers your question at the moment.

Niteen S Dharmawat: Yes, it answers my question. Basically, I wanted to know if there are any discussion that you had. And the respective regulatory bodies if we could communicate about possibility of extension, but you have no one year available. So thank you so much. And if I have any further questions I will come back in the queue.

Moderator: Thank you. The next question is from the line of Ronak Sarda from Systematix Group. Please go ahead.

Ronak Sarda: Sir, first question is on the VLS side of the business. You mentioned June has particularly been better than what you have been expecting. So, would you share some thoughts on how the ramp up would be on the new plant? How much delay do you see there or things would be on schedule, given recoveries been better than what you have been expecting? Any thoughts on the ramp up?

Tarang Jain: See, today what we see is that, obviously, I mean, we can't take April and May, because that's not really been, I mean, April was zero sales, maybe we can talk about June onwards. So June onwards, we do not see the ramp up that much in the new plants of like Poland, Morocco and Brazil, we see mostly a very good volume growth in North America and in China, and also closer to budget in Europe. So these are the main regions today where we already have existing facilities. But having said that, from July onwards, we expect also a lot of our new plants to ramp up. And when we see those schedules also in the system from our customers that from July onwards even these plants of Morocco in Poland will see a good amount of traction from July onwards. And obviously, that will go forward to much higher levels from September onwards. That's when we see that in VLS we see sales of almost more than 80% returning by September. Because July, August being a little bit of holiday season also, we will see that the levels may not be more than 70% as an overall VLS entity. But from September onwards, we see 80%. And we do see traction in the two major plants of Morocco and Poland where our major investments have gone, and also the expansion in Czech. We do see a good level of traction happening from the month of July.

Ronak Sarda: Sure, that's helpful. And my second question is related to the EBITDA analysis for VLS business on slide 12. If I look at the impact which has happened, mainly because of the revenue and raw material, revenue I understand, but how much of this is reversible mainly on the RM side and the overheads impact? And is there some quantum which will be subsidized by the governments of respect to locations to cover up the employee cost?

Tarang Jain: No, so to answer the second part of your question, I think, in most geographies, except for India, as you know, that we are going to be recovering almost close to about EUR 4 million of manpower related costs in the regions of Europe and North America and the other regions. So, that's something we are maximizing on whatever the kind of COVID incentives are our applicable, we are making full use of it. And that is the maybe the extent of maybe around EUR 4 million. When it comes to, obviously, we are talking about the last quarter, where largely the disruption has happened in our performance in quarter four, and I think I would attribute the major point of it is to COVID, at least 60% to 70% of this whole disruption has been caused by COVID, I think starting with starting with China, because China saw very weak sales from January onwards. And unfortunately, at the same time, I mean, you will appreciate that China is actually the manufacturing, probably hub the whole world, and a lot of our electrical and electronic products are coming from China also. And because of the disruption caused by COVID in China, this has caused us disruption also in other markets, mainly Europe, a lot of our European plants, Morocco, etc., where we saw a lot of backlogs generating. Though we have good level of sales starting from January, in Europe, unfortunately because of the supply situation out of China directly or indirectly, this has caused a lot of disruption where he had to incur premium freight, overtime payments, other kind of inefficiencies in in our plants. That has resulted to very, very kind of high costs. And I would say, mostly, let's say, to the extent of almost about EUR 15 million as a minimum what I can attribute, because of the disruption caused, that is directly disruption caused because of the plants disruptions in Europe, lower sales in China. These are major reasons why that 60% to 70% of this total result in Q4 has been caused by this kind of a disruption. Other than it, of course, I would say just to add, EUR 2 million of backlog has also been because of our Pune fire which occurred in the middle of February, and we lost almost one and a half months of revenues over there. And Pune, India has been a very profit making entity for us so far.

Ronak Sarda: Sure. So what I meant was this EUR 15 million which you think was incremental expenditure, that wouldn't have been a concern in June, right?

Tarang Jain: You are right. So now in the month of June we are not going to have any of the COVID related costs. So we have already stabled, but actually China from April onwards is also showing strong results for us. So, they are, I would say, trending even better than budget, because post COVID they were able to, as we all know, been able to control the COVID like situation in China and I think the sales have returned because of maybe personal mobility also playing a role as compared to shared mobility. And supply chain also is kind of largely back to normal. So, June, even whether it is May or whether it is June, we do not see any COVID related impacts on costs at present.

Moderator: Thank you. The next question is from the line of Pawan Ahluwalia from Laburnum Capital. Please go ahead.

Pawan Ahluwalia: Tarang, just one follow-up to the commentary you had given earlier. Obviously, there is a certain level of utilization above which we are kind of cash flow breakeven and we don't need further debt, and if we think below that we do. And in a way, it's quite difficult to predict where we will be because all the forecasts coming out from the European and U.S. automakers and the associations show some very significant negative numbers. Now, obviously, how this maps to individual models and individual component producers is tough to say, but what is the rough kind of utilization we need to be able to cover our costs, including interest in India and in VLS?

Tarang Jain: India, I would say that probably it would be more as a level at what we are now, let's say, we would be cash positive because even as you know the main thing has been the CAPEX, and CAPEX is actually 50% of the problem solved if your CAPEXs are low. So CAPEX, obviously this year are quite low, I mean, they are almost at 50% level, normally in India we do about Rs. 250 crores to Rs. 300 crores of new CAPEX, this year it's not going to be more than Rs. 130 crores. In the case of VLS, we have done EUR 84 million last year and even higher in the previous years. And this year, we are going to only EUR 45 million of CAPEX. And that too this CAPEX will start probably I think more towards the second quarter onwards, not very much of CAPEX in the first quarter. So, to answer your question, I think that probably from a cash standpoint, I think in India, probably it would be kind for the breakeven it will be lower at the moment. So, I think that probably, I mean, if the sale is probably around the level what we are seeing probably from, I would say, from July onwards where we see us going up to about 70% level, I think we should be fine on a cash basis. I mean, the cash totally we can manage it. And when it comes to, I think, VLS, because the investments have been very heavy over the last two years and everything. And though we have done very well, I would say to reduce optimize or right size the cost on the various overheads to do with SG&A cost and engineering, so there too I think I would say that from September onwards when we see more than 80% sales level is where we can really see more of a positive cash movement. But till then, yes, it will be a little bit of a tight situation till that happen. So, I would say India would be more like July onwards, because we see higher sales. And especially as you know, the two wheeler market demand is quite good in India, and also the entry level cars and this is where we are present more in two wheelers, less in four wheelers. And abroad also, because of our strong order books and our business versus the past, we do see a good level of return from September itself to really kind of a positive cash situation, at 80% level. And India, we see it more at 70% level, which is from next month.

Pawan Ahluwalia: So basically if India and VLS hit these levels, then our debt climbs to about Rs. 3,000 crores over the course of next quarter. But as long as we keep hitting these levels, our debt doesn't need to go up. And as we exceed these levels, we can start to deliver, obviously, there is the issue of the dilution where I presume you can raise equity at some price and take care of a little bit of deleveraging there as well.

Tarang Jain: Absolutely, but see today, to be honest with you, whatever the levels of debt we were at, net debt of about Rs. 2,500 crores at the end of March, we were budgeting that we should be a little bit similar or positive. Because see, whatever we may say we still have COVID, COVID has not going away, you know. So I think, though we remain very optimistic and we see a very good kind of a situation at present, at least as far as Varroc is concerned, June has been really heartening for us. But we still have to be very conservative when we say that we would be happy if we are at the same level by March end, because we also have some of the CAPEXs mostly showing in both from the second and third quarter, not really now. But now is the time when we are kind of not really investing much in CAPEX at present, we are postponing it. So I would say that I would be happy that with the situation we are in at the moment, that through a strong second half performance, we are able to maintain the net debt at this level, I would say it would be a good achievement.

Pawan Ahluwalia: So, if you goal is really it will go to Rs. 3,000 crores over the course of this quarter, and then you would really hope to be able to bring it down by Rs. 500 crores so that we close is back at Rs. 2,500 crores?

Tarang Jain: Yes, that's what it looks like.

Pawan Ahluwalia: But in order to do that you would need significant upside from the June utilization. If the year, let's for argument sake say the year rather than the June, July utilization, then we should expect a to cap it at Rs. 3,000 crores level but not see it fall. Is that fair to say?

Tarang Jain: Yes, that's right.

Moderator: Thank you. The next question is from the line of Jitu Punjabi from EN Capital Advisors. Please go ahead.

Jitu Punjabi: Tarang, I sympathize or empathize with you on managing the business through such a tough environment. I have got two questions. The first one is, when you kind of think of the path to normalization, and I am thinking through the next six months, one, do you think you would get back to 85%, 90% of normative revenues? What are the most challenging issues in getting to that number or getting to a near normal environment?

Tarang Jain: I think like I said, the things we have done well is, while we feel confident in that we have reduced our fixed cost, so that is permanent, because even a single increase in hiring goes through me. So the fixed cost is down, and we are not going to increase our fixed cost. Secondly, the CAPEX is under control, because today cash is more important to us than profitability. Both are important of course, but I think what is going to make a difference, what is going to keep me awake at night is going to be our plant performance. So plant has to perform week-on-week to budget, that is going to be the most important thing. Because I do see sales recovering, but with the sales recovering the most important thing for us would be plant performance. And I would say, not so much in India, but more in certain plants, including the new plants, more I would say the European plants need to perform week-on-week as per budget. If that happens, I mean, we can be rest assured that not only cash flow, but we can kind of get that the level of profits we need.

Jitu Punjabi: And the second question more broadly is when you are looking at the orders and the schedules that have been given to you by the OEs, are you kind of seeing that the revisions to schedules are upwards or downwards? What is your sense that do you think you would see a more normal environment by year end, or you think it would take much longer?

Tarang Jain: No, see, one thing is that people have accepted globally, including the governments, that COVID or no COVID, life has to go on. And in this period, fortunately, people prefer personal mobility than shared mobility, I mean, that is appreciated, because people want to be safe. And that means an increase in vehicle volumes. And that is what we see happening. So I feel fairly confident that in spite of this pandemic and whether it peaks at a certain point or doesn't peak or it extends or whatever, people will want to have personal mobility. And that is what we see happening. And that is why we see that in the month of June already we see the sales kind of recovering in this manner, which has surprised us actually, which has surprised us. Okay, we made a budget in the month of middle of April; we said okay this will be 75%. But going into May, I was quite vary, because May did not play out the way we had budgeted, May was much lower than what we had budgeted. So I was pretty kind of vary about what would happen in June. But I must say that June has played out in the way we would have liked it to play out. So that’s what I am talking about.

Jitu Punjabi: And from what I hear you say, you are saying cash flow and profitability will be better as this recovers relative to history because of all the cost take outs you have taken?

Tarang Jain: Yes, the fixed costs are down, and so the profitability will be better. So I said, fixed cost is one thing, but equally important is your plant performance. Keeping those costs under control and managing this thing, and that is not in all the plants, a lot of plants are very stable, it is only a few of our plants and probably some of the newer plants also. So that's where we have to keep our focus. And to just add, this is something the senior management, like Stephane is on the call also who is our CEO, and I, and also our CFO, we take weekly reviews of our plant performance, in all a major plants reviews we are doing every week to see that they are within budget. That's something I mean I am following in this COVID time, I don't really do it normally. But at this time it is very important that everybody stays focused to see that okay, but lower than normal sales, we are able to hit our numbers. That's very important.

Stephane Vedie: If I can add to Tarang's point on the volumes, we see some very positive sign, for example, Ford the FCA North America; they have announced they are completing the summer shutdown. So they want to try to recover the vehicles that they have lost during the lockdown and try to extend their operating hours. So they will not shut down their plant during the summer. This is a very positive sign. Tarang already developed about China; we are positively surprised by the volumes we are seeing in China, they are pulling really high volumes. Then in Europe, we are very encouraged by the stimulus certain countries are implementing. We look at France; we look at Germany, two very important countries in terms of boosting the demand in Europe. They are committed to help the automotive industry; they have put in place very strong incentives, so this will sustain the demand.

And to Tarang's point in terms of efficiencies, okay, that was bad that we had to close our factories during several weeks. But we didn't waste our time, during this lockdown period we were able to work on our system, we were able to address some of the systemic issues that we had in terms of SAP, we were able to have some working groups to help us on the supply chain point of view. And when we opened, we opened really stronger. So that's why we are really confident when we see the volume and we are really confident when we see the level of efficiency that we are right now in our main plants.

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

Basudeb Banerjee: One, if I look at your numbers where VLS revenue Q4 over Q3 was more or less similar. And we mentioned and shown in the presentation that because of higher overhead costs and raw material the margins declined largely. So can you explain what were those higher scrap and obsolete inventory write-off etc.? And how they will pan out down the line?

Tarang Jain: So, I think I would say that, let's talk about VLS only, I will come to India later. In VLS, I would say that today, if you take just the manpower cost, 17% of the revenues, just for those 15 days impact is about EUR 7 million loss. And the other fixed overheads would be around EUR 2 million. So about EUR 9 million would be just the impact would be of the last fortnight, for the 15 days of March. Other than that, I would say, if we talk about the quarter, the premium freight would be at least about a couple of million, higher overtime would be also about EUR 1.5 million. And China JV, the China JV's profit impact, this on a PAT level I am talking about, would be another EUR 2 million. So this itself would be close to EUR 14, EUR 15 million. Other than that, unfortunately, Pune, our four wheeler lighting plant, because of the fire impact we lost sales, which also contributed to about a EUR 2 million impact. And other than that, of course, there was some of the inventory write-off; we do certain inventory write-off and all for EUR 3.5 million. And there was higher depreciation because of IndAS 116 which was about EUR 2 million. So I think these are some of the main items I can say, which impacted our Q4 performance.

Basudeb Banerjee: And what about the higher scrap line item which you mentioned?

Tarang Jain: See, the higher scrap would be more like a little bit of part of that, I think we didn't have so much of a higher scrap, the scrap must have been, I mean, the inventory that was scrapped that is all kind of also a part of the whole quarter, that what happens is that the backlog created for the plant, then to make up that particular volume you have to produce more, run a higher number of days. And when you do things to make up, your scrap rates are normally higher than what they should be. And other than of course the overtime and also the premium freight, incoming and outgoing.

Basudeb Banerjee: So, like inventory write-off, logistic costs, overtime etc., all those things COVID related are aspects impacting EBITDA this quarter, though COVID is not out of the society completely. So, in coming quarters how much of these line items you think should continue?

Tarang Jain: I don't think there is going to be any inefficiencies, because what happened, this happened suddenly. And like I mentioned earlier, I mean, probably globally people are dependent on China for procurement of a certain level of item, like for us it is more like electrical electronic products, whether it's for India or its for our VLS business, directly or indirectly through another supplier. And we were caught unaware, so though we have made a high level of sales, the good part or the fortunate part was that from January onwards we had a higher level of sales. But then we did a backlog because we were not getting those parts out, because China was kind of shut right from middle of January we started slowing down and we started feeling the pressure. And that is what has impacted, and because of the backlog this situation was created. But now, I mean, obviously, China is back to normal, like from middle of March onwards they have kind of, in a way, been returning to normalcy. And, like I said, that there is a strong performance in China at the moment, whether it is our production there or supplies are there, so all our supplies which we get out of China, or whether it's our manufacturing facilities there, they are all doing probably better than expected. So there is no real situation to do with China anymore. And the other parts and all also which are within Europe or locally in Europe and our suppliers there, that is something we are able to manage fairly well even at this time. So I would not say that today that we are really hampered much because of the COVID situation. There may be some small situations, but nothing really to talk about.

Basudeb Banerjee: Sir, not many talks about substitution of vendors from China for global supply chains. So any steps towards that or is Romania JV good enough to substitute Chinese vendors for you? Anything on that angle?

Tarang Jain: See, I will tell, to be honest with you, it is very difficult. See, today China has become really a world-class manufacturing hub for the whole world. And they are very, very cost competitive at the same time. Yes, to an extent there will be a strategy, and that is something we are discussing, especially in the last one week, because of what is happening at least where India is concerned, we have been discussing over the past week that okay, let's try to go in for alternate suppliers. But having said that, also you were talking about Romania, in India for electronics, we do everything in-house, but the components, the bare components, active or passive components come a lot from China also. So maybe, I mean, my supplies may not be Chinese, but their manufacturing locations a lot of them are in China also, so we can't escape that. And similarly, when we started our Romania facility for electronics, I mean, the passive and the active components are definitely going to be coming from China. I mean, it is not easy to overnight, because of COVID or because of what China and India standoff is doing, we just cannot overnight kind of just get away from China, but we can derisk to some extent. That is something we are thinking about, but these are early days, that is something we started thinking about only the last one week, and more from an India standpoint. We are not really thinking so much from the foreign standpoint, from a global business standpoint, we are thinking more from the India standpoint, because we buy a lot of electronic molds also come from China you know. So, we are thinking of derisking them.

Basudeb Banerjee: Sir, in slide 14 regarding order wins, so EUR 50 million of losses or give back. So, what do you mean by that? Is it giving up low margin orders or…?

Tarang Jain: Maybe I think Stephane can talk about some of the programs like the GM twins we gave up in Brazil.

Stephane Vedie: Yes, exactly. I think the highlight of the last quarter for us of Q4 of FY '20 is we have two major business wins. One was for the transit for Turkey, so this is one of the highest volume platform in the automotive industry. That's a commercial vehicle, that's a long life; we want the head lamp, the rear lamp, the full cell, so we have the full package. This is an order roughly worth EUR 30 million per year, this is incremental, that was always part of our Turkey acquisition strategy, so we are very pleased that we executed on this point. In addition to this, you may have seen in the press, in the news that Ford has once again made some cooperation agreement. They cooperate on the on the field of electric cars, but they will also cooperate in the field of commercial vehicles. So on the same platform, inside the Ford Auto's plant in Turkey, Ford will be manufacturing also transit light vehicle with the Volkswagen badge. So this is another possible incremental volume that we are going after. And hopefully we will have some good news to share with you very soon on this.

The other big win that we had in the quarter was the Volkswagen 316 projects. So that's the continuation of the big electric vehicle platform that was Volkswagen launched in Europe. We won it; launched in China, we want it; and then there was a platform of North America, they have made an extension to their plant in Chattanooga, Tennessee, and that's this incremental volume that we want. So these are the two big business wins, among others, but the two highlights I would say for the quarter. In addition to this, and I think we mentioned it in one of our previous investor calls. We decided to give back the GM twin project, as Tarang mentioned. This is a project, a platform that we previously initially won, but we look at the situation of the market, we look at the situation of Brazil. We didn't want to invest more CAPEX to support this business so we decided to find an agreement with GM to give back this project. And that is what we are mentioning here. So it was initially declared as a business when, as we gave it back we have to have, if you want, a negative business win by giving back this project.

Basudeb Banerjee: And sir, any one from Tesla new model or model wins or anything on that?

Stephane Vedie: So on Tesla we are still the supplier of Model S, Model X. And we won some of the new lamps on the Model Y, this is the face headlamp, this is the reflect lamps, the cheap sell as well. So every lamp that was new on Model Y that was not to carry over from Model 3 we won with Tesla. So that shows that we continue to have a very good relationship and good intimacy with Tesla. We have the volumes for their North American plant. We have the volumes for their European plant. And now we are in quotation process also for the volume they are putting in China, their other venture. There are some new models that are in quotation right now that we are quoting actively, and hopefully we can continue to maintain a strong position with Tesla. Also, I would like to mention that last year during fiscal year 2020; we won a nice project with Rivian, which is also a Tesla like company. Rivian is launching a electric truck, electric SUV. They have as investors Ford Motor Company and they have an investor Amazon, so they have very strong cooperation partners, and we believe in this company. So we are proud of being part of this business as well.

Basudeb Banerjee: Last question, Stephane. With all COVID limited impact, various geographies you can see, Latam getting more impacted. At current juncture, what is the projected or targeted euro million revenue for VLS for the fiscal?

Tarang Jain: Let me answer this question. See, we cannot share really the number. But I can only tell you that, last three years we have won more than EUR 1.2 billion of business. And we are expecting that the market will go down, in this financial year by at least 20%. The car market, let's say, about 86 million cars, it may go down to maybe 70 million cars this year. But having said that, we can only say that from a revenue angle, we will definitely do much better than that 20% drop. That's all I can say at this moment, we cannot share any numbers, and let's see also how things pan out. But definitely we will perform much better than whatever the drop suggests.

Stephane Vedie: And to add also, in terms of new business wins, in the past month we won also very nice projects with Ford, that's the Ford F250, that's one of the heavy duty trucks. We won the sub-plan on this truck on this is a sub-plan that they are looking at carrying over also via the F150, the F200. So this could become the standout sub-plan for Ford Motor Company. We are targeting the truck segment; we want to be increasing our share on the truck segment. You can look at the numbers, even during the lockdown the trucks were selling very well in North America. So that is really where we want to be, where we think we have a good technology to address this segment of the industry.

Basudeb Banerjee: One question I missed out, other than the COVID related one-offs, initial part you were saying that structurally you are going to reduce fixed cost overheads etc., so if you can explain those qualitatively what areas you are targeting?

Tarang Jain: So, so on SG&A cost in VLS, we have almost reduced probably about 25% on the overall cost side. So that is the reflection we will see in this year. So let's say that today, I mean, last year we did an overall revenue with, of course, including today's revenues of probably EUR 950 million. And today, I mean, we just probably felt that there is no exercise we have been doing for the last two months, we started doing this optimizing and right sizing of the manpower cost over the last one year. And we felt that to run a business of about maybe EUR 1.3 billion, we don't really need more of an SG&A cost, so we have reduced it by 25%. I mean to reach a revenue of EUR 1.3 billion around, we don't do any need to increase this quantum cost. And so this year, of course, we are not going to be at that level because of this first two months loss in sales, the first six months loss in sales. But going forward, definitely this is definitely going to help us in quite a big way. Other than that also, we have also reduced 15% of our engineering cost. Because see, engineering cost also tends to be quite heavy. And we have also kind of made a reduction there in the manpower cost in the engineering. So these kind of costs are, I would say, a little bit more fixed in nature. And that's something which will definitely play out when the sales return. So, we are actually reducing our breakeven point from what we were earlier. On this level of sales we are reducing our breakeven point by doing this.

Basudeb Banerjee: So, broadly you are targeting at FY '20 fixed cost levels revenue moving up from EUR 1 billion to EUR 1.3 billion, and fixed cost largely remaining same, that is the target?

Tarang Jain: What I am saying is that, of course, this year is going be obviously a tough year, we don't know, this year sales we don't know where we will end up. But let's say FY '22, let's say if it's a normal year, we can achieve obviously a much higher level of sales, because we have the businesses, we have a programs, the programs have to do higher volumes, which they will start doing right from the fourth quarter, we do expect we will come to 100% level, or the level what the customers told us last year pre COVID. Then obviously, we are at a level which I am talking about, I mean from a production revenue standpoint. So FY '20 you will see a stronger sales. And at that point of time, we don't expect to increase these costs, we can run at the same level of cost, I mean at the lower cost level and still do the revenue. But goes up to a much higher level of sales, then of course we have to look at increasing the manpower.

Moderator: Thank you. The next question is from line of Rikin Gopani from Infina Finance. Please go ahead.

Rikin Gopani: Sir, for the India business, we understand that there is a reasonable traction starting June, in terms of demand. So what is your sense, say, from June onwards what sort of run rate could we expect for the India business? And given that there are certain BS-VI components also that you would supply, will you therefore do far better than whatever the industry does, even into Q1 and Q2?

Tarang Jain: See, Q2 basically is only June, to be honest with you. Because we were hardly at 25% level in May, and almost zero in the month of April. But I must say that June has come back strongly, we are at about between 55% to 60% level of our regular sales in India. And as you know that 85% of our business today is mostly to do with a two wheeler market, including the BS-VI products. So, the good part is that we are already into BS-VI and definitely it is helping our sales for products such as electronic fuel injection, we have already started supplies to the customers, like Royal Enfield and Mahindra Two Wheelers, who are the two customers for this, electronic carburetors we have started. We will start the catalytic converters from next month. We are starting also all the BS-VI electricals like the magneto and some of the other products also BS-VI related. So, I will say that, yes, when I when I talk about the level of sales, I am talking about pre COVID budget levels, which included BS-VI. So, we had told you I think in the last call that probably we would be at around probably Rs. 400 crores plus whatever for BS-VI products. So, given the level of sales, whatever we are going to do, we are already there. So, we already started production. We already started production of all of our BS-VI products, so that's a good part which is helping our sales quantum from, I would say, more from June onwards.

Rikin Gopani: Sir, just a clarification. So when you say that in June you are at 55% to 60%, as a percentage of your budget or it's Y-o-Y you are at 60% of June level, what is it?

Tarang Jain: So let me put it this way that this is 55% to 60% of what we had, which was basically what we had budgeted for ourselves. So, it is not compared to last year, but having said that, I mean last year, I mean, the sales obviously are lower than last year. Sales are lower last year, but I would say 55% to 60% it is to a level of sales we would have expected this year in the market, which would have been probably a growth from last year by about 10%.

Rikin Gopani: Understood, that is very clear. And the second question that I had was with regard to one of the data point that you mentioned in the presentation, which is regards to the data for the order wins at VLS business on Slide #14. So, there you indicate about 110 million of net data. Now, this data I just wanted to understand, last year this data was somewhere around 230 million to 240 million, could you put some context to this as to how does this data move which is more to do with no region or sort of rebids happening this year or did we lose some business, could just put some colour to this?

Tarang Jain: See, I will let Stephane answer it, I mean, the border details. But before that, I can just say that what happens is the rebids means that existing programs which we are already doing, that comes up for kind of refresh. Because, see, a program for a lamp lasts maybe about three, three and a half years, maybe four years at the most. And then maybe a couple of years before that, before the light is getting over the refresh, so the refresh quotation starts. So it's important for us to rewin all our existing programs. But it also depends on how many rewins are possible in that particular year when it comes up for a refresh quote. So I don't know that, okay, it was higher last year the rewin compared to, I mean, previous to last year. And why it is half this thing in the previous year, that's something maybe Stephane can say that why was it in FY '19 rewin was 220, 230 than 150, 160 in the previous year.

Stephane Vedie: Yes, I think it's a lot to do with the cycle plan from the customers. The way we follow our new business win indicator is exactly like you explained, Tarang. We follow the incremental wins, the new wins that are helping us to show the increase of our market share. At the same time, we want to maintain our position on the renew business, so we follow the rewins as well. In case we lose a project for which we are the incumbent, then we declare it as a negative in our new business win, so that we have a net number, so that the number that we are reporting as a new business win can be correlated to the future goals of the company. So that's the way we do the math. Unlike Tarang said, it's equally important to retain the businesses that we already have as a refresh, as a middle cycle action, as a new project. And then also continue to win additional market share. It's good to rewin the current project, because in most of the cases we can reuse existing assembly line, we can reuse a portion of the equipment that we have been using for a given project. So that's important for us in terms of optimizing our load in our plants.

Moderator: Thank you. The next question is from the line of Hitesh Goel from Kotak Securities. Please go ahead.

Hitesh Goel: Sir, just wanted to understand, it's difficult to give guidance on real estate, but what should be our breakeven in terms of sales for this year? Given the fixed costs have reduced, what kind of sales would give you a breakeven on VLS this year?

Tarang Jain: The breakeven I mean, if I have to just guess, I mean, probably I would say more like a 75% level. I think we can breakeven because of our reduced fixed cost, I would probably expect that. I mean, I am just telling you what is my probably feeling at the moment. I have not run the numbers, but I would say that it should be at about… you are talking about EBITDA breakeven or you are talking about cash breakeven?

Hitesh Goel: No, PBT breakeven.

Tarang Jain: So, PBT breakeven, I think we would have definitely more than probably 80%. I mean, probably 75% also is possible, I would say, but around that number.

Hitesh Goel: Okay. Because you are saying that by September also you are expecting only 80% of the sales to return at pre COVID levels in VLS. So that's why I asked the question, because then this year at least it's difficult to make a profit, right, if COVID continues at the way it is right now?

Tarang Jain: Yes, I would say, okay, that probably at the 75% level, at 80% differently we should beat a PAT positive, I can say that. But probably at 70%, 75% we will try to see that how do we keep on kind of lowering this breakeven point. But I would say today that, yes, maybe 75% probably would be a number I would probably have the courage to say yes that can be the breakeven point on the PAT basis or PBT basis.

Hitesh Goel: Okay. And sir, investors also keep on asking on the ROE and ROCE targets of the company. So, next three, four years, do you have in mind that on consol basis what is the kind of ROE, ROCE you want to reach?

Tarang Jain: See, what has happened is, I mean, if you ask me a pre-tax, I mean, a target is 20 always pre-tax. That is the target we set for ourselves for overall business, VLS as well as India. But what has happened is, in the last three years especially, because a number of CAPEXs we have done for growth reasons, and especially in some of the new regions, including an acquisition in Turkey, that has obviously not helped our ROCE. And of course, since October 2018, the markets going down after the China - U.S. trade dispute, markets going down also have not helped our sales, which in normal circumstances, I mean, till October 2018 we were growing at a double digits year on year for the previous many years, minimum double digit. And then what has happened is that our expansion, which we started two and a half years back, in this new regions with substantial investment, coincided with a drop in passenger car sales. And that has been a little bit of a challenge on the ROCE. Because once you accept a business, you have to do the CAPEX; you cannot shy away from CAPEX. So, we knew that, so we will continue to CAPEX starting with FY '18 partly, and then FY '19 and FY '20. We can't stop, because you have an agreement with your customers, and there can be huge penalties if you back out, and we don't want to back out. So that has resulted in lower ROCEs. So obviously, ROCE is going to be in single digit if you take into account April onwards. But if you take from maybe June - July, we will probably be at a double digit at least. But hopefully from next year onwards, with the sales hopefully returning, definitely we should be closer to that 20 level target.

Moderator: Thank you. The next question is from the line of Bharkas Bukrediwala from ASK Investments. Please go ahead.

Bhaskar Bukrediwala: Sir, just wanted to clarify, one, on your gross margins for the quarter and the raw material costs, because that has shot up quite a bit on a Q-o-Q basis if I look at more on a concol basis, so almost a 600 basis points increase. The sales part is understandable given the environment, but why would the raw material shoot up so much, just wanted to understand?

T.R. Srinivasan: I think mainly the thing which goes into raw material cost are a number of factors which are primarily COVID driven actually. Because if you look back at the quarter what we did explain in the presentation, right from January onwards the COVID disruptions from China started. So because of that, there were delays in component supplies from our vendors to our factories in Europe to a large extent, and also Morocco and to some external components coming from there. So because of that there was a buildup of backlog of orders over a period of time. And we had to, in many cases, use premium freights for these components to our plants to be able to manufacture and supply on time. So that was one which contributed significantly. And secondly also, because of the short production cycles, we had to also keep the situation, the scrap generation also went up in the quarter, the manufacturing efficiencies took a beating. So, that is the second reason it went up. And we also had because of the change in volume forecast and, let's say, downscaling of the projected absolute slow moving inventory levels also went up, so based on the policy we had to take some additional provisions on that. So a combination of all this meant that there was a little bit big effect in terms of the product…..

Bhaskar Bukrediwala: Sir, good forward, like you have been mentioning that there is a lot of focus on plant performance, and as some of these supply chain related issues start stabilizing, it's fair to expect that this number would come down to more reasonable level as we have seen in the past quarters.

Tarang Jain: Yes, so to give you a comfort level, already we are seeing a lot of stability on our material costs, even in the month of May and June I think even in the new plants we are seeing a good level of traction. Though there are a number of launches which are happening now in the U.S., a few launches in Europe, and also the new plants. I think we are managing our material costs in quite a good manner. So, just to give you comfort, whatever we have been doing for the last few months, we see a good amount of control there.

Bhaskar Bukrediwala: Sure. And just one small question on the other income. There was a other income of Rs. 49 crores for the quarter, if you could just help understand what was that despite that result?

T.R. Srinivasan: It had a couple of things. One is, they had a foreign exchange gains in Mexico and also in Morocco during the quarter. And then we had government grants, which was partly COVID related in the VLS business. And also in India the normal incentive schemes that we are eligible for the CAPEX in different plant, combination of that.

Bhaskar Bukrediwala: And the FOREX part would be the unrealized gain, right?

T.R. Srinivasan: Yes, unrealized gain.

Moderator: Thank you. The next question is from the line of Pawan Ahluwalia from Laburnum Capital. Please go ahead.

Pawan Ahluwalia: A follow-up question really for Stephane. So you guys have done a terrific job of taking over Visteon's old business and really growing it, and some impressive order wins from pretty demanding customers. This industry in the last decade has gotten reasonably concentrated, your competitors are very good at what they do, you are obviously very good at what you do. But it's a brutally competitive sort of industry. When we are out there bidding against these folks, what is our kind of differentiator? Or is it just the case that once you one of the top four or five, the prices kind of is set by mutual competition and the OE wants to just diversify and make sure everyone gets a little bit of share? And specifically, so if you could give us some colour on what is driving these wins, what is the competitive dynamic, how we differentiate it? And specifically, is there a risk that as sort of the new kids on the block in last five or six years, we may have been quite aggressive in our pricing in order to get an entry into these marquee names and be given a chance. And that may actually cause our margins to be a little bit under pressure, because the whole world was underwriting a very different medium-term growth two, three years ago than they are today?

Stephane Vedie: Okay. I can spend all day on this if you want. I am not sure we have all the day. But I will try to be synthetic. I think we have really tried to target our sweet spot in the market. Our sweet spot in the market is to bring technology innovation to the mass market with cost competitive solution. What we want is to go away from maybe the top three customers we had in the past and realign ourselves with the winners of the market, with the generalist customers that are using technology. So what we have done in the past three years is we have aligned with them in terms of footprint, they needed a supplier of ship out them in Brazil, they needed a supplier of ship out them in Morocco, they needed a supplier to support them also in Eastern Europe. So, we have made the necessary move. Turkey was also very important, this is a country where Ford is strong, Renault is strong, and now Volkswagen is also there together with their alliance with Ford. So, with this global footprint, there are not so many of our competitors that are able to have this location. A big advantage, I think we discussed about this in the past that 100% of our footprint is in cost competitive countries. 95% of our engineering footprint is in cost competitive countries. As the technology content of our product is increasing, this is becoming more and more key in the competitiveness for us. We are dealing with competitors that have their main engineering center in Japan, in France in Germany. For us the main engineering center is in the Czech Republic and then in India. So, the Czech plus India ratio is competitive compared to the competition.

When you look at the business wins that we have communicated, that we have declared, you will see that we have also been successful, first on the global platforms where there is not so many competitors that have the right footprint, but also on the new vehicle. So under vehicles that are the new electric platforms, for example, for Volkswagen, there was no incumbent, this is a new business, this is a new segment. There was no one with already installed capacity for this. So, that's leveling the playing field, if you want. I don't want to say it easier, but somehow it is to win a business where there is no incumbent, where it's anybody's business. So, what we have seen also is, there is a trend to use lighting as a differentiator for the car manufacturers. So, in the past they used to have the same set of lights, headlamps, rear lamps for the full lifetime of a vehicle, the full seven years. Now we see that in order to boost the sales at the mid-life of the vehicle, they want to redo the light, they want to give a new feeling, they want to give a new appearance to the vehicle to boost the marketing. So we have seen that there is more and more MCA middle site collections where they need more capacity at the supplier level. So the OEMs need additional capacity, additional players. And we have done a good job supporting them. We have done a good job providing also the right level of technology. I think we spoke about our front face LED technology in previous calls, with this technology we have been able to reproduce the appearance of OLED technology, organic LED with a conventional LED. So we have done this at a fraction of the price. This is our patented technology; this is something that we own in terms of IP. And this helps us also to win projects without degrading the margin, without being under pressure on the cost side, because we were able to bring technology that was more competitive than the existing one. And this is the technology we will be using for a major JLR project, for example. So I think we have various reasons. And again, I think this would deserve a longer time with you to explain why we have been successful in the past years.

Pawan Ahluwalia: Perfect. Well, maybe we will reach out through IR to set up a call. But just very quickly, as you have been gaining share, who are the folks who have been losing share? Because I assume there are some that have maintained share, and some others that you are displacing. Who are the folks that have lost share in the last couple of years?

Stephane Vedie: So the market is really divided. So we see, for example, Koto was the number one in terms of volume, it's very strong with Toyota, obviously, their main shareholder, and he is very strong with the Japanese car manufacturers. We don't we don't really compete with them too much. Then we see the players for the very high technology level, more the niche market, lower volume products like BMW, Mercedes, we see automotive lighting players fighting with this kind of segment. This is not really where we position ourselves. We find ourselves more on the technology / cost / low cost footprint, where we meet mainly with value. So value has been a stronger contender for the businesses that we want, for example.

Moderator: Thank you very much. That was the last question in queue. I would now like to hand the conference back to the management team for closing comments.

Tarang Jain: So thank you, everyone, for participating in the call today. And I know that probably a lot of people will be disappointed with the results of the company. But I just want to assure everyone that we remain in control of our business; we have a clear plan and a strategy moving ahead. We have taken a lot of steps, even pre COVID in order to make this business stronger, going forward, both from a profitability and a cash flow standpoint. And the biggest thing I think for us is that, we have the confidence of our customers. That's the biggest thing, in a B2B business the biggest thing is that you have the confidence of your customers, and the proof of that is that we are winning a lot of businesses over last three years, almost EUR 1.2 billion of net business wins. And I can just say that let's see how things go. Yes, the first quarter this year is going to be tough, as you all know, it was touch for the whole industry. I think we can start seeing some better results from the second quarter onwards, and definitely in the second half of the financial year. So with that, I want to thank all of you once again. And probably we will speak again, you can always get in touch with us, probably, for a separate call or any questions you may have. Otherwise, of course, we will be again meeting when we discuss the first quarter results. Thank you.

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