



“Varroc Engineering Limited Q4 FY 2021 Results Conference Call”

June 04, 2021



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Varroc Engineering Limited
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Moderator:

Ladies and gentlemen, good day. And welcome to the Varroc Engineering Limited Q4 and FY 2021 Results Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “*” then “0” on your touchtone phone. Please note that this conference is being recorded.

Varroc Engineering Limited's management is being represented by Mr. Tarang Jain – Chairman and Managing Director, along with Stephane Vedie – President and CEO, VLS business; T.R. Srinivasan – Group CFO; Arjun Jain – President and Head, Electrical & Electronics Business; and Nitin Kalani – Head of Treasury, FP&A and Head Investor Relations.

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, and I would like to thank you for joining the Q4 FY 2021 earnings call of Varroc Engineering Limited. I will first start with the India business.

The Q4 of FY 2021 witnessed a robust growth in the two-wheeler the passenger-vehicle volumes in India, held by a lower base due to lockdowns in the last fortnight Of March 2020. The Indian two-wheeler production volumes in Q4 for higher by almost 29% year-on-year, and passenger-vehicle volumes were up by 27%. Our revenue in India grew by 45% year-on-year and our EBITDA in India more than doubled and our margins continued to be strong at close to 12%.

I will now move to our Global Lighting business. If you recollect, Q4 FY 2020 volumes were impacted negatively by almost a fortnight long COVID first wave related to rigid lockdowns across major markets globally. In Q4 FY 2021, however, despite this low base of Q4 FY 2020, the passenger-vehicle volumes, excluding China, were down by 2.7% year-on-year, mainly due to significant semiconductor shortages. Both Europe and North American markets declined year-on-year, as OEMs had to work in a supply constrained environment, while consumer demand continued to be strong. As a result, our established plants in Mexico, in Czech Republic, which contribute almost all of the profits of our Lighting business today saw a sharp decline in production revenue.

Our Mexican plant declined by almost 20% quarter on quarter, while revenues for our Czech Republic plants declined by about 4% over the previous quarter. Our new plants in Poland and Morocco however continued to ramp up the volumes but have not since reached breakeven levels. The EBITDA margins in the Lighting business declined sharply in the quarter due to this change in revenue mix between the older and the newer plants, rising commodity prices in semiconductors and in plastic resins, as well as sudden one-off cost like customer chargebacks on account of premium freight from a large customer pertaining to Q3 supplies.

While the current demand for chips is continuing to outstrip supply, semiconductor suppliers are adding capacities and the supply situation is expected to normalize by September of this year.

This is critical for stabilizing the revenues and improving the financial performance of the Lighting business in the short-term. On a consolidated level, our EBITDA for the quarter was at Rs. 1,275 million, an increase of 11% year-on-year. Depreciation and amortization costs were higher by 14% as compared to Q4 FY 2020, largely due to a higher asset base. The consolidated profit before tax was negative at Rs. 1,178 million.

The overall tax expenses were disproportionate due to the losses in the new plants on which we are not eligible to recognize deferred tax assets. On new business wins, I am happy to inform you that in FY 2021 our India business has been able to secure overall net business wins of Rs. 13 billion equivalent annual revenue, and almost Rs. 11 billion of these orders are new business wins. These new orders which will add to our India business organic growth also include our new technology driven products such as EV products, including DC to DC converters, battery management systems and telematics. The orders also include a sizeable portion from a new customer, both on two-wheelers and the passenger-vehicles.

Our VLS business has also been able to secure orders worth EUR 210 million overall in FY 2021, which included new business wins of EUR 162 million, net of givebacks and cancellations. Finally, we recognize that there are a number of structural improvements required in our Lighting Systems business in order to achieve sustainable profitability in line with industry benchmarks. We have launched project RACE, with the support of a global consulting firm to put together a comprehensive performance improvement plan for the business over the short to the medium-term. We expect the benefits of this program to be visible within the next 12 to 18 months, and we will be providing you regular updates on the same going forward.

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

Moderator: Thank you very much. First question is from the line of Ashutosh Tiwari from Equirus Securities. Please go ahead

Ashutosh Tiwari: Sir, you mentioned that in the VLS operations, the EBITDA loss is mainly because in the older plants drawdown in volumes on a quarter-on-quarter basis. So, is that volume normalizing now? And you also mentioned in the PPT that some part of it because the customer decided to focus on new models which we are not suppliers of, so are we going to see normalization of, say, North American volumes at our plant or the Czech plant in Q1 or Q2 of this year?

Tarang Jain: So, like we mentioned that compared to let us say in Q3 or the earlier months, even Q2, North America has been a premium plant, and even the Czech Republic is our largest region where we kind of play in. So, what we saw in Q4 was that the North American volumes fell from an average of EUR 16 million a month to EUR 11 million a month, which has impacted the profitability. So, the profitability that we were generating in the previous two quarters, the second and third quarter we could not really realize the benefit over here, and this was mainly because the semiconductor issue which impacted all our customers in North America. That was the only reason for this decline in volume, not the demand, the demand is strong in North

America. And in North America, we do see that even presently the volumes have been soft in April, May and also I think probably in June. I think we expect recovery to start happening, I would say, to good levels what we have seen earlier only from August. Because this is where we see, or we hear that the semiconductor shortages will start probably normalizing for the month of August or most September. But I think what we have got the kind of schedules from our customers in North America is more, I mean, from August onwards where we return to the level of profitability. And then of course, we have won a lot of new business in North America. And we will see increasing kind of sales there as we go towards the fourth quarter where we have won a substantial amount of new programs for the North American market.

Coming to the Czech Republic, there we saw a little bit softening of sales to the third quarter and in January to March, instead of EUR 51 million we were at EUR 46 million, a drop of 11%. It did impact our profitability to some extent over here. But largely, I think in this particular region, we were impacted by a one-off of closer to EUR 5 million debit to us won by large OEM, which was not only pertaining to this quarter it was more pertaining to last quarter. But that is not something which there was an agreement about. So, something which we were not expecting, was not something which we feel in our view was not justified. So, this EUR 5 million also one-off in this fourth quarter also impacted the Czech performance.

Coming to this question of yours about new programs and the other, it is not about new programs, new programs of course are something which are already running for the last many months in our various plants. It is just that what we want to mention in our presentation was that the plants, which were kind of can producing better results for us in the past quarters, they were impacted by probably a little bit lower volume because of semiconductors, and that one-off in the Czech Republic. And we did see increased volumes in the new plants, though not of course still at levels of capacity utilization. So, there, I mean, we saw that, okay, as we mentioned that Poland went up for the quarter from EUR 13 million in Q3 to EUR 16 million, and Morocco went from EUR 12 million to EUR 15 million, but this did not really significantly kind of improve our EBITDA performance. So, this is basically what we wanted to kind of share with you.

Overall, semiconductors, we see really normalization by September, really more to close levels where we can kind of see a strong growth. So, I think that probably from September we can probably hopefully see return to probably a normal level of sales. That is what we expect today, if we here all our customers on the semiconductor matter that from September onwards that we will see probably more of normal sales, which we are really budgeting for ourselves in all the regions.

Ashutosh Tiwari:

So, is it fair to assume that, like, say, in the first and second quarter of this year, the revenue in Europe will be similar to what we have done in Q4, it will not increase and probably from September month you are saying that it will start evolving from Q3 we will see the impact of higher revenues?

Tarang Jain: Yes, you are right. So, in fact, I think we will see probably in Q1, I cannot say about Q2, because Q2 normally is soft because of summer, but you do not know, because of this Q1 being soft because of semiconductor. Semiconductor has hit us harder in April and May, it has hit us harder in these two months. So, there is a possibility, which we are not 100% sure, but there is a possibility that July and August which are normally soft months could see improved sales. But that is something which we see today. But as we come closer to date, we will have more clarity, because we do not know, because if the semiconductor is not available, nowadays what is happening is that we get to sort of intent for the next month, which shows probably a good volume. But as we come closer to the date, we see that at the customer end that they have not received electronics, and then they decided to kind of go for a shutdown for a few days or a week or something like that. So, this is something which we will have to wait and watch, because we are in the situation of shortage on the electronics front, not on the demand front. Demand front is very strong, I think, globally all over.

Ashutosh Tiwari: And secondly, you mentioned in the PPT that there is some kind of impact on margin also because of commodity inflation, which we have not been able to fully pass on the impact to customers. So, will the full loss of the commodity will happen over the coming quarters or maybe we cannot pass on the full impact? Because commodities are still rising in this quarter versus last quarter.

Tarang Jain: See, according to us, there is some impact of this commodity increases, mainly resins I would say, but it is not something significant we can talk about, to be honest with you. It has impacted us to some extent, but it is not something significant in the last quarter, but we are definitely discussing with various customers to recover this amount, but it is not something which is so significant that will impact the performance in such a manner.

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

Basudeb Banerjee: A few questions to understand. One, what has been your standalone EBITDA margins this quarter?

Tarang Jain: You are talking about in Q4?

Basudeb Banerjee: Yes.

Tarang Jain: So, the Q4 you are talking about the VLS or you talking about the India side?

Basudeb Banerjee: India sir,

Tarang Jain: India side margin has been around 12% EBITDA.

Basudeb Banerjee: Okay. So, from that, just wanted to understand that as you have been saying that other than the traditional two-wheeler components which we have been supplying till date, where almost Rs. 25,000 to Rs. 30,000 value per unit of new products you are in a position to supply. So, can you give us some outlook of next two to three years what kind of customers you are going to supply? So, many new entrants in the market or even the existing entrants coming up with new models, so just wanted to understand how one should look at the size of opportunities which you are able to grab in next two to three years from two-wheeler, EV perspective.

Tarang Jain: So, from a two-wheeler, EV perspective, See, we have kind of developed our own motor and motor controller and a number of electronic products like the vehicle control unit, DC to DC converter, and we have tie ups for the battery management system and the onboard charger. Plus, also we have a telematics unit which is also linked to the EV. So, today, our biggest customer in India on the two-wheeler side, there the content is very high, because we are in both a two and three-wheelers segment, and this production we are hoping that it will start somewhere towards probably the end of the second quarter. And we are the major supplier when it comes to this product. So, I would say that today if we talk about EV products, even for just a single customer, and what we are I think given to believe, I think we could be adding just on the EV side, going forward, I think probably around, I am not talking about this financial year, this financial could start up on a lower side, but I am just saying that today if you are going to be doing even 10,000 of EVs a month for this one customer, both two-wheeler and three-wheeler where we expect disruption to happen, it is almost a Rs. 500 crores additional revenue for us. And that is something I feel is a possibility, there is a possibility going forward, I think two-wheeler disruption will happen quite fast.

And when it would be like how it happened from the geared scooter to motorcycle many years ago, 20 years ago, I feel that a similar kind of situation is possible in this. So, I am just saying, for a single customer where we are very much present, two-wheeler side and three-wheeler side I think disruption will happen even much faster, because it makes economic sense to have a three-wheeler EV. So, I am just saying that today if the customer does 120,000, it is a Rs. 500 crores business, we do more than obviously that. And other than that, we are anyway in touch with all the major OEMs on the EV side. So, I am not saying that with all these products we can sell to all the other OEMs on the EV side, but we are actually in very, very close contact on at least selling one or two of these products in the Indian market. I must say all the majors, we are focusing on all the major people at the moment or the major OEMs who are coming out with their EV products. So, there we are closely engaged, and we are looking forward to winning some business this year with them, which will probably start, which will also kind of help us in the coming years. So, it will be both on the two and three-wheeler side of things, so I am just giving you a bit of a flavor. But I cannot talk about certain things till we win the business with them. But we are a strong player, we have a first mover advantage as we have already won a business and we will be starting production with one customer in this year.

Basudeb Banerjee: Sure. Always very encouraging to hear the Rs. 500 crores number which you mentioned, and that too from a single customer. But all media articles are showing that so many fresh entrants,

being incumbents or backed by private equities are seeing big, big numbers of volume in next one to two years' time. How to understand that what kind of supplier relationship you are building up with those kinds of new entrants to the E two-wheeler space?

Arjun Jain:

So, I would say, a majority of the new entrants, and especially the ones that I assume you are speaking about, but I think as we have stated before, our focus today is really with the traditional OEMs. And for the very simple reason that these are very high engineering effort type of products. So, the volume realization also is extremely, extremely critical to really model. Now, of course, the volume realization when we talk about uniting 10,000 per month volume sounds great. But really for us, it also becomes a question of you really prioritization of capacities. So, this is why our focus is really with the traditional OEMs.

Basudeb Banerjee:

Sure. And last question from my side is, as you said semiconductor issue is expected to get resolved by September, more or less similar commentary by other ancillary suppliers also. So, in that perspective, volumes should spike up further in next three to six months' time. What is the cost you are paying to the consultant for margin turnaround of VLS? And, as you say, 12 to 18 months for the timeline for the consultant action to get percolated into the EBITDA margin numbers, how one should look at the VLS EBITDA margin in next two to three quarters?

Tarang Jain:

Okay, I cannot share the amount we are paying, but I can tell you it is not a significant number. I think we will get 10x to 20x I think we are paying them. So, I cannot share that number with you, but it is not a substantial number which we are paying them, I mean, in relation to our business it is a very small number. But what we expect is an industry benchmark, I would say, because here the focus is more Europe in the two new plants of Poland, Morocco and Czech, this is where we are focusing more which is 70% of our revenues. Here we expect that today, I mean, to achieve an industry benchmark would be a minimum of 6% to 7% EBIT. So, this is something we would like to achieve in this period between 12 to 18 months. Now, yes, at presently we have been impacted, I would say, at the moment, even in this quarter, the volumes are going to be lower. And definitely I would say that volume impact will impact, of course, our EBITDA or EBIT results. But I think that today the whole idea is, see today we are in COVID times and there are so many uncertainties here today, especially if you are an electronics company, you are dealing with a lot of electronics, managing supply chain today is very, very difficult.

But today, the whole idea is that today even with this fluctuations, which we have not been able to manage in a good way, but we have seen in the last three quarters as a company, I feel getting in this global consultant I think will definitely kind of help us improve our results. Also, the volumes are at a lower level, we can still have improved EBITDA or EBIT results as we move forward. So, our target is to at least achieve 6% to 7% EBIT, I would say, as a business. And I think everyone else, I think reaching this a bit of 6% or 7% not really a problem with the balance of 30% of our business. The problem is more in Europe and that is why our focus is more on Europe to read the 6% to 7% within the next 12 to 18 months. And of course, it is not that it is going to reach just one fine day as go along quarter-on-quarter, you will see that we are getting

closer to the EBIT. But yes, we do need a certain level of volumes, we cannot have volume which are 20% lower, that obviously makes it difficult, we have put out a certain investment and capacity over the last three years, we do need certain level of volume at least to be achieved, to be able to achieve that 6% to 7% EBIT. So, we are hoping that we are out of this COVID, or we stabilize more from the semiconductor because of COVID only within, let us say, the next one year. And then we can see very stable performance. Also, an industry level performance coming out of European plants also.

Basudeb Banerjee: That's very nice to hear from you of 6%, 7% EBIT margin. But that 12 to 18 months horizon, I just was trying to understand that by September, as you said, semiconductor issue getting resolved. So, if I can recall six months back when volume of VLS was improving and the fixed cost management you were doing, outlook of 10% VLS EBITDA margin was there. Only after that the semiconductor issue came up. So, just trying to understand that the moment semiconductor issue gets resolved, and your consulting benefits trickle down in 12 to 18 months, but what about the timeline in between? Can we expect close to 10% EBITDA margin because your depreciation is longer? So, can we expect 10% EBITDA margin before the consulting benefits trickle down?

Tarang Jain: See, if I were to answer your question, I would say that the third is something because we need the volumes, the third quarter is something we definitely want to achieve the 10% EBITDA, because we do expect the volumes to return and we will be striving for a 10% EBITDA as a company as VLS in the third quarter.

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

Abhishek Jain: Sir, during this quarter VLS revenue has gone up by 3% quarter-on-quarter in euro terms. And tooling business was to be also strong, despite we have seen EBITDA margin turn negative. Gross margin hit significantly in this quarter, whereas most of the auto OMCs have seen improvement in margin. So, my question is, are you able to pass the commodity cost in the coming quarter, given the long-term contracts on materials? And there is also a jump into employee expenses, that was another reason of the lower margin. So, if you can give some sense, what are the key margin drivers for the VLS business as you are talking about the 6% EBIT margin in the coming year?

Tarang Jain: Yes. See, if you see really the quarter four to quarter three that slide, our production revenue was EUR 234 million versus EUR 236 million, so it was like a flat sale on which we did not achieve the EBITDA margin. So, tooling revenue, what happens at tooling revenue is controlled by our customers, there you do not make any margin really, you may make 1% or something, that is just mainly more a top-line. Because in the Lighting business, the tooling suppliers and all are all controlled by the OEMs. So, a higher tooling revenue does not really help us. What helps us is basically money coming, a higher production revenue and we are making money from there. Now, going forward, I mean, let me not get into the other question, but the main question is,

right question you have asked is, what is other levers we have to look at to go to the 6% to 7% EBIT? So, this will call for all-round action, and I am talking only about Europe here, because maybe there will not be issues of other 30% much, when you talk about Turkey or you talk about Mexico or China and other regions, we do not have those issues. The issues are only in the European plants. So, here, I would say, of course other regions also there is a continuous improvement, but I am saying that where we are affected is more because of Europe.

So, here, I think we have to attack three different areas. One is, we have to address a certain level of pricing also on a few programs with customers on certain programs or some pricing or a few programs. We also have to look at some recoveries on certain programs we have seen underutilization of equipment for the last two to three years for which we have invested. So, getting in some recoveries or underutilization, and some price increases in some of the programs where we feel that we should ask for a price increase, including I mean towards resins and some of the other materials also, is one sided action which we will be focusing on as we move forward in the short-term.

The other area we are looking at is that we find is that, now today most of the lamps are all electronic. 60% to 80% of the Bill of Materials now is electronics. So, here we feel that whatever sourcing we have done in the past, probably there is more scope of reduction in the PCB accounts which we procure from various companies, various EMF companies like Flex or Zoller other people. So, here we are looking at in Europe, we are looking at resourcing 12 programs, so in 12 programs we want to resource the PCBS, what we are finding is that we will see a good reduction, only the timeline for getting this reduction because the resourcing takes about eight to nine months, we will try to see whether we can do it faster. But this is an area also which can actually very positively kind of benefit, in the short-term I would say within a year we can start seeing some benefits on the bill of material costs.

Also, parallelly we have got our own electronics plant in Romania, where we have today only one SMT line. We are going to be getting our second SMT line within the next few months. And then we have plans to order another three SMT lines over the next two, two and a half years. This is something I mean; I would say that we would like to accelerate and see. Because whatever we kind of put inside, there is a minimum 10% saving which we achieve by transferring it from a PCBS supplier outside to our own plant. So, the major action will be on the electronics purchasing cost, that is the second area.

And third area is on the plant operation side, the plant cost, how efficient are we, what is our rate of scrap or OE achievement on various machines, how many direct labour as a percentage, indirect labour, salaried people are overheads in the plant, I am talking about plant size. Plant size in these four plants, we want to do this full analysis benchmarking with the best in the business in Europe. And that's why also Bane is there. So, bane is there here to kind of do this diagnostic very clearly for us with the best benchmarks on the plant side operational cost, customer side pricing where there is an opportunity. And also, on the electronics purchasing on the PCBS. These three areas is something we are focusing on. And I think correcting this in a

certain way you cannot do it overnight, so this will take this period of 12 to 18 months, but the point is that we feel fairly confident that with the help of this global consulting company, we will be able to achieve the industry standard in the coming future.

Abhishek Jain:

So, will it also impact your deleveraging program? Because, most probably that FY 2022 EBITDA will impact in both sides, like VLS and India business, because most of the India business would be impacted because of the lower to two-wheeler sales. So, will it impact of your deleveraging program? Because this this quarter, this year we have seen a significant reduction on the debt, and you have also raised money from QIP. So, just wanted to understand what is your CAPEX and debt payment plan for the FY 2022 or FY 2023?

Tarang Jain:

See, the CAPEX is going to be very, very controlled, in India we are growing. Like I said, we are going to control it because there is a very good level of growth also in India. But still, I think we are driving a lot of efficiencies here, in all our plants focus is a lot on efficiencies and not doing CAPEX. But I think around Rs. 150 crores, Rs. 160 crores CAPEX year-on-year in India will happen, because we are looking at a significant double-digit growth as we move forward to FY 2022 and FY 2021. But I think we will be able to limit our investments in that range in India. Also, I think two-wheeler sales may be impacted at the moment, but what we hear is that already we will see a good amount of increase in the second half of June, all the dealerships have already opened. Yes, there is an issue on two-wheeler sales, the demand it is still there because people are scared now of the third wave and everything. But still because personal mobility also is driving purchasing on two-wheelers, not only cars. So, we do see a close to a normal sales from July onwards. And we also have a witnessed last year that we were so badly impacted for the first five months of last year, but the way these recoveries happened, actually last year we had made a COVID budget, but we have beaten the COVID budget last year, because in the months between September to March, the growth was tremendous. So, we do expect that whatever budget we have had for the full year in India will be met.

Now coming to coming to the VLS business. Here also we have said, we have capped our investments, we are not going to cross more than EUR 40 million, EUR 45 million a year as a growing company. Here also the attempt will be that, especially now we are focusing more in Europe, of course, we are going to focus elsewhere. How do we drive more OE better efficiencies in the equipments we have today already? We have a lot of new equipments we have bought in last three years, how do we utilize this in a better way? How do we reduce CAPEXs? Why should we even do EUR45 million, why can't we do less, EUR35 million, EUR40 million? I mean, why can't we do less CAPEX? That is also we are going to be striving for, but definitely not more than EUR 45 million a year we are going to be spending in our VLS business. And we do want to grow, yes, we have our troubles at the moment in operations but that is something which we do not expect to last for too long. And that is the reason we have got in this global consulting firm to also kind of support us. And when it comes to FY 2022, VLS, yes, there is a softer demand at the moment because of the semiconductor, but like last year also we saw a huge growth between September, October, November; December also was a growth but December because of holidays of Christmas and all we do see some softer sales in December. But here, I

mean, we feel fairly confident with all the new business wins and also the recovery which will start happening, that we can capitalize on a decent level of sales also in the VLS business this year and in the coming years.

Abhishek Jain: So, how much debt reduction we can assume in FY 2022 and FY 2023? And as you also raised money from the QIP, what is the utilization in payment of the debt?

Tarang Jain: So, what we are doing is that we have a net debt of Rs. 2,250 crores in March end which was a slightly lower number than FY 2020 where we were at some Rs. 2,450 crores. Now, this year is a challenging year in the first five, six months for us. So, here I think the whole idea for us would be that, I mean, for this year we do not want to promise more, we would like to maintain that level of net debt for this coming year at least, because there are challenges. And see, today this semiconductor, yes, we have also heard from other suppliers and other companies like us, we are looking at September. But I would say that to be on a probably little bit more conservative side, we would like to maintain the net debt, we would be happy if we were to maintain a net debt at this level even in March 2022. This is what we will be looking at. Now, whatever the money which we have realized, whatever, around Rs. 685 crores net which we got from the listing, I will say that about probably 60% or 65% has been deployed towards the VLS business partly, of course, more than about 50% was more towards meeting the debt repayment schedules for the year, more that. And partly also to help in the cash flows towards CAPEX payments and things like that. So, we have already deployed you can say about 60% to 65% of the money towards VLS, the balance is already in India.

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

Aditya Jhawar: One thing just wanted to understand that, until Q3 absenteeism rate in freight they were quite a bit impacting our margin. So, where are we on this absenteeism rate? And on the premium freight, we clearly understand that there is a kind of a dispute that we have with a customer and the amount of the EUR 5 million that you alluded to, how we should expect in the next few quarters? And has the customer agreed on funding the part of it and incremental how should we expect this number in the next quarters?

Tarang Jain: Basically see, we have no premium freight or labour issues now in Q4 at all. So, that is a thing which we had mentioned that that came to an end in Q3 itself. What had happened was that in the month of January or whatever, one of our major customers, they put another demand of this major thing, due to premium freight they said this is something also pertaining to the earlier quarters, Q3 or Q2 or whatever. And we disputed and I was myself involved in this with this customer, myself I was involved. And we tried to tell them that this is not fair, and we do not accept this. And we negotiated for a long time with them, but somehow they were hell bent on debiting this amount and they have debited it. So, that is something we will not get it back, that is something debited, and they are not willing to discuss it. But what we are doing now is that, with various customers what we have taken up this year is, there are a lot of underutilization, not

only due to COVID or something, even earlier with this customer and some of the other customers also we are aggressively going after the underutilization claims on various programs where our assets have been underutilized, where the promise volumes have not been generated. So, that is something we are quite confident of getting some money back from them against this, not against what they have already debited, that is gone. But we are claiming money towards the underutilization on various programs where we find there has been an underutilization. Also, we are going in for resin price increases, but that is not a very substantial amount, but it is an amount and there also with various customers we are going in also for resin price increases over there. And also, we are now studying also internally on a few programs in Europe of going in, because there has been some extension also on certain programs by the customer. So, here also we are asking him for some price increases on certain programs, we will also be going in for price increases on these programs. So, this is what is the thing, but Aditya to answer your question, we do not have any premium freight or labour issues anymore from Q4 from January onwards.

Aditya Jhawar:

Okay, fair enough sir. Sir, this recovery of this underutilized, Tarang, has there been precedence of customer agreeing or do you think that this might not foil the relationship with some customers if you go by that route?

Tarang Jain:

See, the point is that anyway the system is normally that an underutilization claim is always honored during the end of the life the program. So, let us say if a customer said that they will take over a four-year period 1 million pieces, I am giving you a number, I am not saying that is a number. 1 million, and if he takes only 700,000, then we can put in a claim of 300,000 on them, and they normally address that issue. But now what we are doing is that in all the cases we are not even waiting for that, we are asking for a little bit earlier only for some of the underutilization stating that we are in COVID times and there is a lot of issues on volumes on certain programs. So, this is something worth to be addressing, and in some cases we may have to wait for end of life, there is some end of life also happening in this year and in some cases we are not waiting and this year we are trying to claim it, and we are hoping that we will be successful. We are actually quite advanced in some of the cases. What do you feel, Stephane? Stephane, do to add on this point?

Stephane Vedei:

Yes, I fully concur with what you are explaining. We are going to push for resolution on get cash settlements, but in some cases we are opting for a compromising and maybe instead of getting some price reduction that we have already agreed on the credit terms in the contract, we will consider the price reduction that should have applied this year or next year. So, this is also another way to get compensation. The fact is that in the current situation it is very difficult for a supplier like us to adapt to the roller coaster from the customers. Sometimes we get a phone call on a Tuesday that from tomorrow, from Wednesday their plant will be stopped, and they are not able to make cars, and they will remain stopped for a week or two. So, we have the people, we have the lines, we have the equipment, we have the material and so this is not possible to really orderly wind down the operation and work on this fixed cost and reduce them. So, this is part of the negotiation on the discussion that we have with the customers. Obviously, we are very mindful, we do not want to break the relationship. But as long as we are fair, we are fact based,

we put the data on the table. This is part of the relationship, and this is a give and take. And so far I think the momentum is pretty positive and we have already first small wins in the last few months.

Aditya Jhawar:

Okay, that is helpful. My second question is your commentary indicated that demand is not an issue and the other auto ancillaries also suggested that semiconductors is a challenge. So, since we are also seeing ramp up in some of the facilities and when the semiconductor issue gets resolved, should we expect non-linear kind of growth from Q3 onwards as compared to the current quarter that was reported, as these issues get resolved and as our new facilities get ramped up, both in terms of top-line as well as impact on margin as early as Q3 onwards?

Stephane Vedei:

We have already the heads-up on the information from the customers, that as soon as they are able to stabilize the pipeline of semiconductors, they want to work at maximum capacity, they are already running some studies with us, can we go even above the maximum capacity that initially was contracted. Because they want to recover the loss vehicles that have not been able to be produced in the beginning of the year. As Tarang mentioned, there is no demand crisis. Right now, when you look everywhere in the world in terms of the stock level at the car manufacturer, this is the lowest in the history almost. We have never had such a low inventory of vehicles. And it is starting to become a problem at the dealership, in countries where you buy vehicles on stock, you go to the dealership, you do not find the right options, you do not find the right colour. So, the OEMs are already eager to produce more because the demand is there. So, that is also the situation we are in right now. When the customers are shutting down sometimes for two weeks, four weeks, we have some extreme cases eight weeks or nine weeks, what do we do with the labour? What do we do with the cost? Do we remove everything right now, knowing that we will need the people, we will need the capacity in the next few months coming up? So, with this is a trade-off, this is a day-to-day management decision that we have to make. But the demand is there, and we expect a digital increase as soon as the semiconductor will be available. Our best guess, and I think the industry best guess is September we have witnessed, we are speaking with the semiconductor makers on a daily basis right now. So, we have a pretty good visibility that starting in September we see that the demand is pretty sustained. Now everyone will try to produce more and add the maximum capacity. So, that is the next challenge coming at us and coming at the industry I would say.

Aditya Jhawar:

Okay. And Stephane, if you can tell us like what is the contribution of electric vehicle, supply of pure electric vehicles in VLS revenue now?

Tarang Jain:

What would it be today Stephane, what would you guess?

Stephane Vedei:

I do not have a case size figure in front of me, but we see that the share of the electric vehicles is growing steadily. You know that we have even more market share for the electric vehicles than even the conventional ICE vehicles. We have been historically always very strong in this segment. It was before yesterday and they were happy to convey to us that in last month they produced more Mustang Electric, the Mach-E than conventional Mustang. So, for the Mustang

last month, the first time in history they produced more electric vehicles, where we are by the way the supplier for the headlamps than the normal Mustang. So, I think this is a very strong sign here that the industry is shifting, and it is shifting very fast.

Tarang Jain:

And Aditya, I think that what we mentioned also earlier, I think we should be around 8% or 9% of our total industry. We would be supplying for at least 8% to 9% I feel of the market. Because the VW programs are very strong in the market now, in Europe, and that is also, and plus of course the new models what Stephane also mentioned. So, I think we would be 8%, 9% of the global market today.

Aditya Jhawar:

Okay, perfect. My final question, Tarang, is on India business. The BS-VI products that we had launched, are we able to engage with more than one customer in that? And the related question to this is similarly for electric vehicles, we understand that one of the customer we have the firm order with, at what speeds the talks are with other OEMs, have that reached a stage of RSU and ordering levels? Where are we or it is at only the decision speed of supplying EV products to other than the one OEM that we are engaged with, both BS-VI and EV?

Tarang Jain:

See, on the BS-VI products, I think when it comes to certain products like the Magneto, I think there is something which is going to be the BS-VI Magneto, this I think probably various customers have shown interest in us because I think our product is very good in the market, is very well acknowledged by all, I think they know the performance of a Magneto in the market whoever we supply to. So, I think this volume is going to grow I think substantially as we move forward on the BS-VI side. There also we are driving more on the EFI side, I think we see that even with RE I think in the coming this thing through the new models that whatever we were doing in the last year, our volumes will double for RE on the EFI front. Plus of course, also we are talking to one or two other OEMs, the problem is things are a little slow, I mean, this lockdown and some of the testing and all has gotten a little bit postponed and everything. But I think on the EFI, today we are doing only with RE and for Mahindra minor Java, where the volumes are also doing fairly well. But now there are another one or two OEMs, I think one is more serious, we are already in discussing. And another one OEM in serious discussions, I think we should be getting two more customers this year, we should be winning these programs. Other than this basics, the BS-VI, the other products I do not know which ones you are pertaining to.

Aditya Jhawar:

Second, similarly for EV if you can highlight.

Tarang Jain:

On the EV side, here I would say nothing has really kind of concluded, I would say. We are still discussing with all the large OEMs, we are in very, very close discussions. But yes, nothing is something close to formalization, let us say, in the next few months. But I think in this year, this year we feel fairly confident that we will win some EV products with the other customers. But yes, because some of the lockdowns and all even in these last one or two months, honestly, we did not have much of a discussion with the OEMs, they have not also had meetings with us. So, I think that we move forward, we are very confident because people know that we have very some very good tie-ups on some electronics also. And also, I mean we have been a first mover

I would say in the product, maybe there have been maybe one or two other companies also, but we are definitely the first mover in some of the products. So, we feel very fairly confident that we will achieve some decent results in this financial year, we will win some business on the EV side, but other customers other than our main customer.

Aditya Jhawar: Perfect. Just last question if I can squeeze. What would be the overall value of our products put together for electric two-wheeler now? And if we have to think about our improving capabilities, what that number can be after two years, per value how much we can potentially supply to an electric two-wheelers?

Tarang Jain: So, I would say, the total sum of content that we would enjoy on a two-wheeler I think would be close to around \$500. But of course, this varies also by what exactly the two-wheeler is trying to do, right. Now I think our focus has been, as we went about developing our product, was to really develop products that would be compatible or that would operate at EV that is comparable to an Activa 110 cc. And I would say the number that we have here or this, around \$500 number, that is really what it would kind of be comparable to. Of course, I would say the specification etc., the exact architecture etc., some OEMs have finalized, some OEMs are still in the process of finalization. So, it will really evolve I think based on what the vehicle really becomes. But from our perspective, I would say in particular on products like the motor, the controller, the DCDC converter, telematics which we have completed total proprietary capability around, we really should be able to address majority of market needs.

Aditya Jhawar: That is very good to hear, that \$500 as of now it is our capability to supply to an electric two-wheeler, right?

Tarang Jain: While I say that statement, there will be, let us say, over time maturation of cost as well also. Right now, I mean, when I say that what I mean to say is, there might be some reduction, etc. that take place over time. But the fact of the matter is that it is a significant growth in content per vehicle versus what ICE engine. But one more product which you should see here I would say, see I think these are the gamut of products we have for the EV at present, we are not looking at anything else because there are already five or six electronic products and the motor, and this is a big range. We are not looking at something else. But one product which I think was very significant, which is going to be really a good product in a two-wheeler electronic clusters, the dashboards, there are technology coming in around telematics, the TFT clusters, there the value add is huge. That is one thing. And secondly is on the high-end lamps, the LED lamps. And even a transition, like today let us say you have two-wheeler vehicles like say even the Hero, the Hero is a very big customer for lamps other than Bajaj, there they have HF Delux and all, I think a lot of these when they go to LED lamps, a product which is hardly any Rs. 300 or something, straightaway goes into Rs. 1,000 or Rs. 1,200 is a big jump, and we see that happening quite fast. So, for us other than okay the EV side, obviously disruption that is happening is going to be a huge swing for us. But even other than other BS-VI products, the cross selling or whatever, but these two products, the LED lamps, conversion of LED lamps plus the high-end lamps also.

And this cluster side, we will see a huge growth here. And it is all electronics, and we see a huge growth we see in these two product groups for India, with all two-wheelers.

Arjun Jain: And if I go a step further, I think core reason why we are able to drive potentially more Magneto business, potentially more starter motor business, etc., also maybe around the RR, is because it is partially also because of this transition towards more electronics and the lighting and the clusters, right. If you have an LED headlamp, there is impact on the rest of the electrical system of the vehicle also.

Moderator: Thank you. Next question is from the line of Kaushal Mehta from Nepean Capital. Please go ahead.

Kaushal Mehta: Sir, a single question, which is, if I look at the sequential numbers from Q3 to Q4, the revenue for both the India business and VLS is actually higher. And despite that margins on both the businesses have come off. So, despite higher utilization levels as well as getting over the freight cost as well as absenteeism, margins have actually come off. So, just wanted to sort of understand what is happening there.

Tarang Jain: See, what is happening there is, see, let us not take the tooling revenue, let us take the tooling revenue out. Tooling revenue is all controlled by customer, it is just a top-line for us, you may make 1% or you do not make any money on tooling. So, there, I mean, if you really say that our total reported revenue Q3 was EUR 260 million or EUR 267, but the tooling revenue went up from 7 to 26. So, our production revenue actually went down by EUR2 million, not much, was actually flat, from EUR236 million to EUR234 million. So, that is what it is. But the issue here was that where we made the maximum profit within North America and Czech, so North America went down, the mix changed basically, it went down from 41 million to 33 million, and Czech went down from EUR 152 million to EUR 146 million. But see, North America was a big impact for us from a profitability angle. And Czech went on over to EUR 5 million, but I do not know whether you heard me earlier, we had close to EUR 5 million debit from a customer in our Czech operations, which is unfortunate, it was something we believe should have been debited to us pertaining to the earlier quarters. So, that spoilt the results for Czech other than just a small decrease due to some sales and all. So, these two are our main component. And Poland and Morocco, unfortunately the sales were higher, they are probably 50% of what we should be achieving for the investments we have made. There should be minimum, I mean, you did almost like only a EUR5 million revenue when you should be doing at least a EUR 10 million revenue for the investments we have made. So, that, of course, impacted us. And yes, in these two plants also we do believe that we need to kind of work on other areas, like I said, we have to work on all three areas from customer side actions, supply side action and operations also, which we are doing to improve the results. So, I agree with you that our results should have anyway been still better in Poland and Morocco, also as the sales were lower. And in Czech also the results should have been more. America, I feel is purely an issue of semiconductor and 16 million average and 11 million average, that has definitely impacted our profitability. So, that is only pure semiconductor, while in the European plant, other than semiconductor it is also do with

something more on the operations side where we can do better, and which we are going to do, which we are addressing now.

Kaushal Mehta: Got it. And the same question on the India business, margin sequentially came off while revenues were higher.

Tarang Jain: So, I think India side, I think what has happened is that there has been also a lag. See, from October we have seen increasing raw material costs, there have been substantial cost increases on steel and aluminium and even resins and everything. Now, there is always a lag of at least three months in our business, and the lag has been substantial. So, okay, somehow we were able to manage the quarter of October to December because we did not feel that pain, but we have felt the pain in January to March, we have had to absorb certain costs. Now we will get that difference in the month of April, January to March we have lost some margins, our material costs have been a little bit higher as a percentage because of the lag, and it is not some normal kind of increase, the steel increases, price increases, or some of the resin increases have been substantial even on a polyurethane foam, which we buy for our seats, which is a big business for us. It is a huge increase; it is very difficult to kind of be able to absorb all those costs and the customer is also not kind of addressing that issue. So, that is why also with a good level of sales in Q4 as compared to Q3, we have not been able to kind of really absorb all the costs. You wanted to add something, Arjun?

Arjun Jain: I think there has also been a level of impact in terms of some of the fixed cost reductions we drove in the earlier quarters. And I think part of that also has come back in Q4, which is not necessarily a continuous impact.

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

Ronak Sarda: Just a clarification first. This EUR 5 million hit in Czech plant, what does it pertain to? I mean, is it related to warranty or is it purely on the freight side or something like that?

Tarang Jain: The 90% of this is purely claim against premium freight of the earlier Q3 quarter. Which actually we thought was already settled, and there was nothing due from our side. But it but it came up again. And we did not have any bargaining power to stop it.

Ronak Sarda: Got it. And the other question was, I mean, if I see your previous interactions, you had highlighted that Morocco plant will be like a PAT positive at a EUR 6 million monthly run rate. We obviously are almost there in terms of the overall revenues; the manufacturing revenues are slightly lower. But still pretty substantial negative EBITDA. So, any specific concern here? Or do you see some more ramp up, I mean, is it more of a ramp up issue now or is it some other issues now impacting the profitability?

Tarang Jain: I think the cost side of things in Morocco, whether it is something on the material side or something, we have also strengthened some of our team in Morocco now. So, I do not think that

at EUR 6 million we will be able to make PAT anymore, I think it requires a higher revenue. Because see, all the investment we made in Morocco is for a revenue of about annually EUR 130 million for which we have won the programs, and we were expecting it to go to at least EUR 10 million by now, which has not happened. But at EUR 6 million PAT, I think maybe I do not know whether we mentioned this as PAT or EBITDA, I do not know. But I think for PAT we will definitely need at least EUR 8 million to EUR 9 million to reach a PAT kind of a positive number. I do not think it is going to happen at a EUR 6 million in revenue, I do not think that is possible. We can be looking at probably more towards the EBITDA side of things, that we are EBITDA positive at that level. Because the investments which are made are very high and also we have a certain level of cost there. So, it is not possible to meet this PAT at EUR 6 million revenue.

Ronak Sarda:

Got it. And the last question on the India side, I mean, while we obviously are interacting with the large OEMs on the EV product, but given how Ola Electric has made a splash with the volumes, and they have the financial backing given the capital raise just now, would you carefully comment are we in discussion with them or any serious discussion with them, specifically on Ola, I mean, not the other startups, but if you can talk about Ola Electric specifically.

Arjun Jain:

So, of course, I think with all of our different customer engagements on EV, I think we are covered by NDA, beyond a point so I am not for how much I can really speak about specific customer per se. But again, what I would repeat is, with every significant EV startup that you would know, it is not that we have not had discussion, right. We know all of them, I think all of them know us also I think quite well. But again, if we are thinking about, let us say, this big volume ramp up by June, I mean, or let us say by July, let us be honest, we are already too late to the party. So, I mean, that is not really the volume story that we will be a part of today anyway. Because like I said, these are very engineering intensive products. Over time for sure, and I do not think that we are saying no, but where our engagement has been the deepest is the customer that we know the best. And again, given the fact that resource constraints do exist, that is really where we will look to continue to priorities. Thank you.

Moderator:

Thank you. The next question is from the line of Pritesh Chheda from Lucky Investment Manager. Please go ahead.

Pritesh Chheda:

Sir, I have two questions. One, I wanted to know the bridge of the margin differential on an annual basis for VLS, which is, let us say about I think 1% odd this year versus 6%, 7% last year. If you could help us give a bridge on what would be the gross margin erosion in that and what would be volume-led operating deleverage impact, so that it is very easier for us incrementally to track on an annual basis the progress in VLS. That is my first question.

My second question is, on Slide #8, for the U.S. operation we have mentioned about a customer not picking up the model for which we are a supplier. So, I wanted to know the reason here, is it transitional or this gap needs to be now filled up with a different model, if you could help.

Because this part of the business is actually profit making in VLS, which is I think a Mexico plant.

Nitin Kalani: On the gross margin side, if you see last year where we were at about 22%, 23% basically, that has gone down to roughly to 18% this year basically on account of change in mix of the revenue coming from the new plants and old plant, basically that is one reason. Apart from that, we see a lot of scrap increases, scrap rates have gone up because of new programs which we have started in the new business. So, a mix of that and also I would say, during COVID our overheads were higher than sort of normal, basically. So, as a result, we have seen the gross margin drop a bit.

Pritesh Chheda: Sir, just to intervene here, when you are saying mix of plant, I think it is contribution margin.

Nitin Kalani: Yes, I am referring to the contribution margin.

Pritesh Chheda: Can you just tell us what will be the gross margin erosion?

Nitin Kalani: Gross margin erosion also will be about 5% to 6%, I would say.

Pritesh Chheda: If the total differential between the two years is 7% in margin or 6% in margin, you cannot have both items at 5%, 5%, right?

Nitin Kalani: Yes, both will not be at 5%. I think raw material would be about 400 basis points. And I think manpower would be another 1%, and about 1% on fixed cost.

Pritesh Chheda: So, basically 4% from GM and 2% from plant mix?

Nitin Kalani: Yes, that is right.

Pritesh Chheda: Okay. Done. But there was no volume slide in the two years, or volume was largely intact?

Nitin Kalani: Volume was I would say a little lower than last year because the average selling prices have gone up because of the LED content. At the same time, obviously the raw material percentage to sales in new products like LED are higher as compared to the traditional lamps. As the new plants sort of play a larger role in the overall scheme of things, basically the Poland and Morocco, there the nominal costs as a percentage of sales is higher because they are largely the LED category lamps.

Pritesh Chheda: Okay. On that Slide #8, customers model loss? The question was, in U.S. you have written that a customer...

Stephane Vedei: Maybe I can answer to this one. This is directly linked to the semiconductor, this specific customer had a limited number of semiconductor and decided to focus the production on their newer model, not on the older model. That is purely their decision, they are making decisions driven by the limited availability of the components.

Pritesh Chheda: Do you consider this to be a transitional impact?

Stephane Vedei: This will not reflect the mix that we will see in the subsequent quarters. This will not replicate in the subsequent quarter.

Pritesh Chheda: So, those semiconductor issue at the customer end is rectified for that model?

Stephane Vedei: I cannot speak on their behalf, but this is directly linked to the semiconductor. So, if they have enough availability, then they will come back to the mix that they had before.

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

Nishant Vass: So, my first question is on VLS. I think, obviously, at least looking at from an order cycle perspective, India definitely has done better than last year. But I think it obviously looks quite stark that you are seeing a 50% drop in your net order wins over last year. And again, we can clearly see that your re-win rates have dropped by nearly 60%, 70% over last year. So, can you shed some light as to what is the issue happening here, is it you are going away from a pricing basis with certain programs or in a new electric programs more pricing competition, so you are not having the same win rate? So, can you shed some light on the order structure, please.?

Stephane Vedei: So, about the new business wins. During this COVID year, I would like to remind everyone that in the first almost two quarters, the customers were stopping all the new business RFQ, they were putting on all new developments. And people were working from home also at customers. So, this slowed down the process. So, we consider that winning EUR 210 million of net new business win is a good performance for the previous year. That was not a year as usual, that was not business as usual, that was not a year where we had the same amount of opportunities handed over to us. On this year, we are coming back to a more normalized situation. And we started pretty strong with the wind, for example, of the new OGA3 rear lamp, both for European volumes and China volumes. We continue to be very strong or so with Changan in China, very successful OEM in China, we won two small SUV projects with them. So, we see a pretty good momentum with this new year. But for last year, we think that was a good performance. And then as a consequence also of last year, we will see some customers that will decide not to launch new models but extend the life of current models. So, we expect to benefit from this also in the next month with some good news in terms of business expansion.

Tarang Jain: And, Stephane, I think this business extension, I would say also one of the major reasons also for us not having that level of business wins, because I think it is not only one customer, but also a few customers who are extending the life of their programs, quite a few of them. We do not want to invest in new programs presently to that extent, like it was in the past.

Stephane Vedei: Yes, that is true. And for us it is always good news the business extension, because we do not have to invest additional engineering for this additional revenue. And we do not have to put in

place new CAPEX obviously. But also, we do not have to go through another launch phase of these new programs because this is just the extension of the existing program where the launch is behind us, where the operators are trained, where the production is stabilized. So, it is always good news. So, I think this is one of the positive from this negative situation of the crisis last year.

Nishant Vass:

So, Stephane, thanks for that. Obviously you seem to be quite confident, so could you shed some light in terms of your one of the largest customers, Ford, they have embarked on a large-scale electrification program with Ford F150 Lightning, obviously their largest selling model, as well as the Mustang. So, are you guys doing the front lighting for them?

Stephane Vedei:

So, the Ford has just unveiled this model, so they have not sought yet any supplier for the Ford F150 Lightning for the electric truck. You know that we are a strong partner of Ford, especially also on the electric vehicle. So, we are the supplier of the Mustang Mach-E, like I mentioned earlier, we are the supplier of the new electric vehicle platform that Ford will be launching in North America, this we won. So, we will be a strong contender for the Lightning, but the competition is not yet open. There is no RFQ out there, so it is not a business that is sought yet.

Nishant Vass:

Okay. And my second question on the customer is, again, this North American EV customer, the revenue seems to be not stopping in terms of the drop. Can you shed some light in terms of are you guys making any headway with that North American EV customer incrementally?

Stephane Vedei:

In North America, we will be launching I think in September, it is confirmed now, the new radial platform. So, they have an SUV that they are launching, I do not know if you are familiar with Rivian, this is a new EV player with the shareholders are mainly Ford motor company and Amazon. So, this will be a sizable business for us. The volume is about 100,000 vehicles per year, and we have the full rear lighting for this customer. So, this will impact our EV position in North America. Then in the North America we will be launching in a few months the ID4, I will remind you we are the supplier in Europe, we are the supplier in China, and now forwards again this business will be launching in North America also. And I mentioned the Mach-E, Mach-E is very successful, we are running at max capacity right now and speaking with a customer to even increase further the capacity as the vehicle is selling very well. So, these are few of the high-profile EV vehicles that we are serving in North America. You know that historically we have always been a partner of Tesla, we are still on Model X and then we are on Model 3 and Model Year, but only for the small lighting, only for the models that were available. So, we have the facial lamp, we have the reflex lamp, and we are producing for the North American business, but out of our plants in Europe. And then we are very close to get good news for the Berlin plant. There is a decision that will be taken in the next days.

Nishant Vass:

Okay. And my small data question is, quarter-on-quarter China joint venture profitability seems to have dropped. So, can you shed some light into what is the stable profitability level at the China joint venture level? Thanks.

Stephane Vedei: I believe the main driver when we look quarter-over-quarter, that means it is driven by the Chinese New Year. That is the same topic every year. There is a period where we have to close the operation on when the customers are also closing their operations. So, I believe this is the main driver here. We do not have any significant impact of performance in China. The production is still very well under control and the volumes are pretty strong. China is also impacted by semiconductor by the way, but we see North America impacted the strongest, then Europe and then Asia as the number of turn market I would say.

Moderator: Thank you. The next question is from the line of Giriraj Daga from KM Visaria Family Trust. Please go ahead.

Giriraj Daga: So, I have a two questions. First, the CAPEX number what you have mentioned, Rs. 150 crores on India operation and EUR 45 million in the VLS, it does not include the costs incurred on intangible assets, is my understanding right? And if yes, what is the number you are considering in FY 2022 and FY 2023? And just a related question, how do we see this line item for the next, let us say, two, three, four, five years kind of an outlook?

Tarang Jain: So, yes, so intangibles is not in this figure, intangible is more the engineering capitalization which we do, which would be about Rs. 300 crores a year. This number could go down slightly as we go forward. Because see, both CAPEX and engineering, both we are driving efficiency. So, obviously, there is no question of this number going higher, you can only go lower. But this is a ballpark number which we have today, for this year. And this is all paid by the customer, that intangible is all paid for, it is in the piece price.

Giriraj Daga: Okay. But since the amortization is 40% not fully, so I just wanted to understand that number.

Nitin Kalani: There will be some differences across a period basically because the capitalization and the actual piece volumes are different in year. So, that should eventually catch up.

Giriraj Daga: Okay. My second question was on the claim of underutilization. So, I want to understand like what kind of IRR we have been promised by the customer, if you can give a fair range of that at four-year period you have promised that kind of IRR, and once that is not achieved will be paid at the end of the period. So, what is that IRR number?

Tarang Jain: See, they do not promise any IRR because if you see, they only go by which is the lowest cost they are getting. My point is that we have an IRR target, which would be at least 20% IRR. So, we are looking at program and now we are far more focused also on the IRR, because sometimes earlier we were saying okay 15%, 16% also, but now we are pretty much focused on the IRR. And it is possible also if you are driving more efficiencies across the 20% IRR is possible. So, we have our own internal target of 20% IRR. It is not customer is giving you something, you have to make it happen.

Giriraj Daga: Customer gives you the outlook for the volume, right, and on the basis of that you calculate your IRR.

Tarang Jain: You are right. So, basically what happens is, you are doing a 20% IRR on the stated volume, which they have said. And what happens is that over the life of the program, if it is three and a half, four years as an extension, then you do not only include the extension also. Let us say four years is the life, at end of the four years you will have to see that what has been the underutilization, what has been a depreciation which has been as a cost or maybe some engineering which is under amortized or whatever, all that you can claim from them end of the life.

Giriraj Daga: Okay. But your customer must also be having the similar kind of a calculation. So, my question is that we are in a country where the cost of capital may be 5%, 6%, or the cost of equity capital maybe 8%, 10%. In that country you are able to have a 20% IRR. So, is the customer more like okay that in the end of the period there might...

Tarang Jain: Just to clarify, the IRR is different from a discount factor. So, today we may take a 10% discount factor in Europe, I may take a higher discount factor by doing NPV and all that kind of thing. But IRR we take it as 20% which is something which we feel is definitely possible.

Giriraj Daga: But the European programs, I am more particular concerned about the European programs not on the domestic side.

Tarang Jain: See, the western world the discount factor, because see, we also internally have to do a NPV calculation, right. So, there we take a 10%, we take a lower discount factor compared to what we would do in India.

Giriraj Daga: Yes, that was my query.

Tarang Jain: Yes, India would be 14%, 15%. In any case the discount factor maybe there, but IRR what we have to kind of also kind of look at the other side has to be 20% in both cases. India as well as abroad.

Giriraj Daga: Okay, maybe at some point of I will take this maybe in more detail offline with Nitin. Sure. Thank you from my side.

Moderator: Thank you. The next question is from the line of Apoorva Mehta from PAM Investments. Please go ahead.

Apoorva Mehta: Sir, just wanted to know, where we can really go back to the 9%, 10% of margins in the VLS business and what kind of utilization you should see, what kind of revenue you could see that you can reach to that level? Because the margins are dragging a lot from 7% we have dropped

to again 1%, and what is the outlook for maybe next year or next two years, where we can look ourselves over the next two years?

Tarang Jain:

See, the point is that we have always said that we have to do 10%. Yes, there have been issues at our end, and we have not met those numbers and for that we are to blame. It is not that the whole industry is at a bad level. I am not talking about last year, whole year okay maybe bad. But last quarter, I mean, surely people have kind of performed. So, that is what I was saying initially, that see, we have to address Europe as a focus, that is what we feel it is only a question of just sales. Sales, of course is important, that would be 50%, 50% is the sales side that we have to do a level of sales in Europe, which should be in our view at least, I mean if you take all the three plants together, we should at least try to do EUR 65 million, EUR 70 million of sales. EUR 50 million sale is something which we need. But I am just saying that is only 50%, today, I mean, we have to also look at certain other areas structurally also where we feel that there are certain things we have to do, if we have to get enough stability on the EBITDA or EBIT level. One is, I said customer side actions. There, in some programs we have to go for a price increase, there is no option. Few things we will do, yes, it is not that easy, but we have to address it in a certain way, some programs we want to go. And there are opportunities to do that, because they are asking you for some program extension, and now that we can find a way how to get a better price on a few programs, we cannot do it all around and only a few programs we will target.

Other is, I said on electronics purchasing, I do not think we are competitive today in Europe, and major bomb today is electronics. So, today we are buying PCBS from outside. Of course, today the industry, all our competitors at least do 50%, 60% in-house. For that, I think we will take at least four or five years to reach that 50%, 60% level of doing in-house. And we have a plant we have started in Romania with one assembly line, we will touch five in about two, two and a half years. But then we have to go to at least 10, 12 lines to be able to largely 50%, 60% at our end we have to do minimum that much of SMT lines to put inside our own thing, which will give us a right level of bill of material. But other than that, you also have to purchase from outside. So, there I feel we are more expensive in our buying, and we are looking at resourcing 12 major programs in Europe today where we are going to take a decision in this month, maybe before the 15th and we are going to resource this problem at lower cost for the rest of the life of these programs. Yes, it may take probably eight months or something, but then post that we will probably kind of get a better margin out. And thirdly is the operation side, operation side also we are not kind of, I would say, I think we need to get more efficient in our plants in Poland, Morocco, and Czech. And that is the reason in these areas to focus and get better results. We have got in this global consulting firm to kind of support us in being able to achieve the industry benchmark of 6%, 7% EBIT or maybe 11%, 12% EBITDA.

Moderator:

Thank you. Ladies and gentlemen, as this was the last question for today, I would now like to hand the conference over to Mr. Tarang Jain for closing comments.

Tarang Jain:

So, thank you, everyone, for this call today. Yes, I know that I think all of you are very disappointed in our Q4 results, especially on the VLS results where we had the revenues, but

still we did not come out with a decent performance. And there is really no excuse for it. But I think going forward, I can tell you, yes, there are some disruptions happening today because of semiconductors our volumes are also impacted presently. But we are fairly confident that going forward we will be able to reach, I think, this industry level EBIT margin of 6%, 7%. Yes, as we go quarter-on-quarter let us say from third quarter, we will see that the margins are getting better. And then within 12 to 18 months, I think between that period, we will reach the industry-wide EBIT bit benchmark, we feel fairly confident. And that is the reason we have kind of also contracted this global consulting firm to support us in this exercise. I think it is not something of a rocket science to be able to achieve this. Yes, we have been able to do it in this last 15 months or two years, we have not got in those results in VLS. So, that is something we are committed to kind of, I would say, reach sooner than later. We know fairly well where we have to attack and what we have to do in VLS, and it is mostly in Europe, which is 70% of our revenues.

When it comes to India, I think we have had an improved performance in last two years. We are improving year-on-year, and we also are looking at kind of a huge growth as we go in the future years. We are looking I think maintaining a 12% EBITDA or higher is something which is very much possible, as we move forward. And I think we will only grow from strength to strength when it comes to our India business. On the two-wheeler side of course, which is 85% of our revenues, there we are in all segments whether it is a BS-VI and even EV side. We are very well kind of covered over there for the long-term. And also, I think on the four-wheeler side where we do various products, especially plastic interiors, engine valves, certain forge products for hybrid vehicles, also for EV vehicles there, there also we have a very clear strategy on what we want to do in the next five years. So, I think that India side we are very well placed. VLS side also from a business angle we are very well placed. From operations side we have not performed, which is showing in our poor results. But going forward, I can assure you that definitely you will see better performance from the third quarter onwards.

So, with this, I thank you once again for this call and also for all the patience in the last couple of years you have kept this patience. I would just request you to please bestow this trust as we move forward for a little bit more time, and you will see better results. Thank you.

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