



“Varroc Engineering Limited Q2 and First Half FY2021 Results Conference Call”

November 11, 2020



MANAGEMENT:

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Moderator: Ladies and gentlemen, good day, and welcome to the Q2 and first half FY2021 Results Conference Call of Varroc Engineering Limited. 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 management is being represented by Mr. Tarang Jain – Managing Director along with Mr. Stephane Vedie - President and CEO - VLS Business; Mr. T.R. Srinivasan - Group CFO, Mr. Arjun Jain – President and Head - Electrical/Electronic Business, and Mr. Nitin Kalani – Associate VP, Finance. I now hand the conference over to Mr. Tarang Jain. Thank you and over to you, Sir!

Tarang Jain: Thank you. Good morning everyone. I am Tarang Jain and I would like to thank you for joining the Q2 FY2021 Earnings Call of Varroc Engineering Limited. The second quarter started with a gradual ramping up of the two-wheeler and the passenger vehicles volumes in India and the passenger vehicles volumes across major markets including Europe. The volumes saw ramp up in the month of September in major markets. In the first quarter of the financial year, there were some challenges during the quarter mainly relating to availability of raw material, labour along with localized measures to contain spread of COVID; however, our team has worked tirelessly to ensure that we meet our customer requirements in spite of these challenges.

I would like to firstly highlight the industry performance in Q2. The Indian two-wheeler volumes in Q2 were down by about 5% year-on year, European passenger vehicles volumes decline by 8% year-on year and the North America passenger vehicle volumes are almost flat year-on year. The Chinese passenger vehicle market grew 11% year-on year. In the current quarter, consolidated revenue grew by 7.9% mainly driven by the VLS business, we saw a growth of 20.9% year-on year in rupee terms and 8.9% year-on year in euro terms. The India business revenue declined by 7.2% year-on year. The consolidated EBITDA for the quarter does not include our portion of EBITDA in China JV was at Rs.2661 million, a growth of 15.1% over Q2 FY2020.

EBITDA margins improve 60 basis point year-on year. The EBITDA for India business was at Rs.1257 million and EBITDA margins were at 13.5%, an improvement of 280 basis points year-on year. A part of this improvement was due to impact of temporary cost savings measures in place during this quarter. VLS business reported an EBITDA of Rs.1502 million and an EBITDA margin of 7.6%, which was flat year-on year. Depreciation and finance cost were higher largely due to the higher asset base had increased debt levels. The consolidated profit before tax was positive at Rs.42 million, an improvement of Rs.3.8 million over the previous quarter. Overall, on tax expenses were disproportionately higher than the consolidated PBT due to the losses in some of the entities where we are not eligible to recognize deferred tax assets.



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In the first quarter, we have prioritized securing and preserving liquidity till operations have fully stabilized and the visibility on business prospects had improved. These measures helped us weather the storm and navigate our way through the crisis. We also lowered our cost base and improved our operations. The current focus apart from improvement in the profitability, this will improve free cash flows and debt reduction. I am happy to share that this focus helped us to generate a positive free cash flow of Rs.4 billion during the quarter resulting in a net debt to Rs.30.6 billion from the previous quarter. I feel confident of reaching the year end goal of Rs.26 billion in net debt. I would also like to highlight that we have recently started operations at our Romanian electronics manufacturing unit. This vertical integration should also help us improve our sourcing of critical electronic products. With this, we are happy to take your questions now. Thank you.

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

Varun Bakshi: Congrats on good set of numbers and thank you for the opportunity. Sir, I have two questions, firstly on the EBITDA margins of India business, so we have seen a sharp jump in margins for India business, so if you can throw more colour, is it purely led by cost control measures or the new products for BS-VI command higher margin and what led to such a sharp spike in margin?

Tarang Jain: See, on the India side definitely we were supported by some additional cost measures like we had a kind of requested our employees in April that they should take certain salary cut up to September end and this also played out in this quarter so to that extend I think our EBITDA was slightly better, but what I can say is going forward I think we see good utilization of capacities also the introduction of BS-VI products, yes, 13.5% probably a little bit on the higher side on the average, I think we can definitely do between 12.5% to 13% going forward was we do expect the sales to growth, also if the market is not going to that extent in India we have to wait and watch what January brings us, but I think our drive towards more business winds and better utilization of capacities will help us definitely to achieve this level of margins in the India business.

Varun Bakshi: Okay, and do we maintain the similar kind of target of double-digit margin in VLS going ahead or there is a chance of taking it to 12% or so in VLS?

Tarang Jain: Yes, I think that we do want to take the EBITDA margin in VLS also to 12%, in the last quarter, yes, we were little bit constrained because of the lower than expected sales in Europe in the months of July and August, so that normally is a holiday period in Europe and this year was also similar, so we did not really realize our capacity utilization, Europe for us bring a lot because almost two-thirds of our revenues come out of Europe for VLS business, so therefore I think our EBITDA margins were impacted to the extent because the sales really recovered from September onwards where it is a very good level, so I think going forward I think we do want to do a EBITDA of 10% going forward and yes, going forward our target is that we have to maintain it



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at 12% and that is something, which is definitely possible on the capacity utilization we are getting, some of the couple of issues, which we have only are in the new plants because though we have seen a very strong recovery in sales in all of our existing plants whether in the North America, whether in the Czech and China of course, but what we see is that in the plants of Morocco and Poland and also in Brazil, we did not see the same level of increase in revenues as we are seeing in our existing plants, but that is something which I think will happen as we move forward, so I think if those sales are realized as we move forward, which I think would start happening probably if not in Q3, then in Q4 onwards then I think we can definitely go towards more margin of about 12%, for the moment definitely a double digit EBITDA margin is something, which we are definitely looking at in this quarter.

Varun Bakshi: Sir, next question is on depreciation charges like do we expect to see the run rate of around 230 Crores in depreciation and there is some more capitalization, which will happen and which will basically drive up the depreciation charges going ahead?

T.R. Srinivasan: Large part of the capitalization is already done, may be a little bit more to be done in Poland and may be in Morocco early next year, but large part of it is done, but depreciation is also driven by the capitalized lease charges, which we are entering in different places that also has an impact and there some addition may come in Turkey etc., in the next two or three quarters, but by and large the current rate will continue, it will not go up significantly beyond this.

Varun Bakshi: Sir, that is it from my side. For more questions, I will fall back in the queue.

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

Hitesh Goel: Thanks for taking my question. Sir, can you tell us about the VLS new plants, what is the revenue right now from new plants like Morocco, Poland and on what can it ramp to and what is revenue potential from the capex that you have done?

Tarang Jain: You want to take that question, Mr. Stephane?

Stephane Vedie: Yes, I am not sure, I got it to be clear, but I understood about Morocco and Poland plants. As far as revenue is concerned we are in the long space like major projects so we are hopeful, we are just starting to ramp up with the two Renault programs and we see that we can reach in this factory revenue of roughly 5.6 million euro in November, so we see an increase already in October and then in November coming and then we will start reaching where it could be in the last quarter of the year. Poland has a similar path in terms of revenue. We are ramping up the program for VW in Poland, the program is slowly ramping up, but we see significant quantities already coming in October, in November and then the last quarter of our fiscal year, which is where it is at the maximum, so these two plants are really in the state of low in term of revenue right now.



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Tarang Jain:

So, just to add I think in this quarter I think, October and November, the sales are higher and Morocco will see probably 5.5 million euro sale, but December it will dip and then again probably come back to this level from January, Poland probably would be at a level of around 4 million, this also could almost on a monthly basis and then of course we see of course December they will dip a little bit and then in January probably we could go up to levels of between 5 million to 6 million also in Poland, but of course for the investments we are made I think definitely we need a higher volume of sales and definitely I think both Morocco and Poland have to at least go the a level of between at least €8 to €10 million on a monthly basis for us to really kind of achieving a good result in both these plants and that is something, which is underway at the moment so, yes, I mean though that is why I said earlier that though we have seen a strong revenue growth in our existing plants on some of the existing and new models, but here we have only like what Stephane said we have only started seeing a ramp up from October onwards in these two plants where we have made some major investments out of a total new investments we embarked on a few years ago.

Hitesh Goel:

Thank you, just followup there, so are we expecting around €75 coming from Morocco and Poland this year, next time maybe lesser would that be the right revenue, can you give us some guidance because it is difficult to model in the new plant revenue?

Tarang Jain:

Definitely we have cross the €100 million in each of these plants, which is a good volume of sales that is something, I think we should be doing and for this remainder part of the year we really have to see what we really achieved like I said we are ramping up, presently the volumes in Morocco is about probably going to reach 5.5 million in November, Poland maybe around 4 million, the December cannot really be counted as a full level of revenues because of some holiday, January onwards we still see some further ramp up happening, but we really have to wait and watch how much we really do, whether it is okay, let us say 10 million 11, 12 million, because we just wait and watch January how that goes, but I am sure there will be an increase, but definitely next year we should be definitely doing revenue of at least €100 million plus in each of these plants.

Hitesh Goel:

On the India portion, just on the India business, basically there was catalytic converter orders of around 300 Crores, which you had indicated in FY2021, has that fructified in this year or yet to come?

Tarang Jain:

No, we have already started 2 months ago a catalytic converter, at the moment the level of revenues is not that high because in the ramp up we are the second source, we have a commitment from our customer for this level of sales, but at the moment I think last 2 months since we have started we are only achieving about between 10 to 12 Crores of revenues per month, this will go up because there is some shortage also of some of the major raw material products, which is the substrate, which is in shortage at moment, so because of that our supplies are restricted presently, but I think this will change soon after December, I think that we will see



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the sale grow definitely I think the sale will grow to at least to start with about 15 Crores a month and the slowly, slowly further ramp up to 20 and then 25 Crores, this is only with one customer, we also in discussion with other couple of customers, so I think sales for the catalytic converter for these couple of additional customers also should start next year maybe by Q2 also, so we will see a ramp up in catalytic volumes, we are also looking at some additional models with our existing customer from next year onwards, but this is a interesting product for us and here definitely next year we will be looking at a high level of revenues in the catalytic segment.

Hitesh Goel: Thank you and all the best.

Moderator: Thank you. The next question is from the line of Arvind Sharma from Citi. Please go ahead.

Arvind Sharma: Good morning, Sir and thanks for taking my question. Sir, two questions on my side, first on the tax part, there were some losses, so is it possible to elucidate what those losses were and will that continue?

T.R. Srinivasan: Basically, the losses what we have is all in the new entity, which are in the ramp up phase, so this is between let us say Brazil, Morocco, Poland, Bulgaria these are the entities abroad and the other entities, which also recently started productions for the joint venture in Romania with Elba Electronics, so all these entities are still in the ramp up phase in the capacity utilizations till below the breaking point, so that is why you see that we are not able to accrue deferred tax credit on losses, so that is why the effective tax rate is looking very, very high for the quarter, but what will happen is over the next year and year-and-a-half once this start breaking even and start generating profits after a year of being profitable we can start accruing the deferred tax on the accumulated losses, so at that time you will see a big bump up in terms of deferred tax a bit, which will boost the PAT in those effective quarters, but currently, we are unable to do that because they are still in the ramp up phase.

Arvind Sharma: Sure, thank you so much and my second question would be on the revenue breakup in the VLS business, on a quarter-on-quarter basis there are quite a few fluctuations in terms of the proportion of various plants, is there anything you like to highlight in the 21.5% going to 15%, which is the customer A then we have a big increase in customer E going from 7.5% to 10.2% is that something worth highlight here?

Tarang Jain: Stephane, you take this question is about where the growth has come from which customers and how does it really look.

Stephane Vedie: Clearly, we continue what we have previously announced that means that is what I do it becoming the number one customer for lighting system, this is the first time, it used to be always Ford, so it continues and remains very strong with this number two, but with all the growth that we are across the brands was that is VW, we continue the new launches of the new project for that. For your own information last quarter, the quarter 2, we have launched 6 new projects, in



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the quarter 3 we are planning to launch 9 new projects in which the compulsion is coming from that was improved. Then, we are still strong with JLR stable and then we see FCA, we see PSA also becoming a strong customer once the alliance will be consumed and this will be a strong channel for number 3 position.

Arvind Sharma: Thanks and just one question, more on a clarification part, as you go from may be a product range say Eicher down to something slightly more volume like Ford or Volkswagen, is there big impact in terms of absolute gross margins, I understand volumes will be higher base, but in terms of absolute gross margin, is there a big difference between premium end car and say more mass production car?

Stephane Vedie: As far as, margin is concerned we have to same approach in term of quoting to every customer and so we are on that line that we follow. With a customer like JLR we have different types of products, we have a very high range, where the component of electronics is high but for the electronic components until now we did not produce ourselves so that means that we are the very high level of material consumption if you note. So we are not necessarily producing and if you look at the latest launches, the two vehicles are called ID 3 and ID 4, which are the electric platforms of the Volkswagen group, these are technology comparable at the end with what we have launched with JLR. On the rear lamp side, we have the full LED technology, this is not becoming normal, so all the new vehicles in Europe, in North America and as we continue to integrate the electronics on the product we see more material compliance is decreasing so that is a good trend for us.

Arvind Sharma: So, in terms of margins you say there is pressure purely in terms of your mathematical margins?

Stephane Vedie: I am sorry the line was really a miss for me sorry.

Arvind Sharma: Is the difference in terms of premium and regular volume car?

Stephane Vedie: No, we do not have any significant difference in terms margins, what is very important for us is on the Volkswagen side we see the volumes that they announced, the volumes are coming, there is no surprise. The car they are selling we can really rely on the forecast, we can rely on the investment that we have made that the investment are to pick up, in the case of JLR they were the last one to restart after the lockdown and we see some situation in terms of volume especially on the Jaguar brand the other vehicles are doing pretty stable but Jaguar are the ones that are may be a little bit on the disappointing side if you want.

Tarang Jain: That is right, but having said that to answer your question that not really any difference between some premium car pricing or the regular pricing when it comes to LED lamps because the technology metrics on a regular car or a premium car, then the regular becomes a small B segment car, if it has got that matrix headlamp that becomes like a premium car only then yes, at times we may take some calls to be a little more aggressive on our pricing you know where we



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go in for a little bit lower profit margins if the volumes are very high in that program, so those call obviously as in any business one would take, but between a premium segment car or a regular segment it all depends on the technology and then it depends on the volumes, which offered on that technology, so sometimes higher volume programs, you may take some calls, but you may be a little bit more aggressive because the competition that are existing for those programs.

Arvind Sharma: Thank you so much. Thank you for answering my question. That is all from my side.

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

Ronak Sarda: Sir, thanks for the opportunity. First question, on the VLS, given the ramp up in Morocco and Poland still in initial stages, is it fair to assume these plants are still at EBITDA level will be making losses and given the sharp topline jump we have not seen a major margin expansion yet, so we understand on the topline side the ramp up, but how is the margins behave let us say over the next few quarters?

Tarang Jain: We feel fairly confident of being if not tax positive, at least EBITDA positive in a month or in Q4, it could be maybe February or somewhere as we could definitely EBITDA positive, but even PAT positive in Morocco if we touch a revenue of about 6 to 6.5, which is possible because the new programs being launched, but when it comes to Poland, I think we definitely need a higher level of revenue on those programs, so there I think definitely for an EBITDA positive and all we would definitely need to reach between €8 million to €10 million of revenues to touch because we have been having ongoing investment also there, so there I think we do need a little bit high level revenues to be EBITDA positive and then we look at PAT positive once we are at probably more than €10 million of revenue that is what I see at the moment.

Ronak Sarda: Sure, that is very helpful and the second question is on the cash flow management, we have seen a pretty sharp recovery through working capital and given the confidence, which we are showing the next 2 quarters we look further reduction on debt, will this be more driven now from the operations or it will still come from more of working capital, how is the things on the working capital and cash flow side for both India and VLS?

Tarang Jain: See, I tell you in both the regions definitely the operations have to definitely result in free cash flows whatever is the operational results you know have to be good that is given and there is something we are pushing for better results as we have, the good part I think in both our businesses now is that we have the sales revenues whether in India or the global dealers business, revenues are there, now to convert the revenues to profitability is our job, so obviously the operations have to throw out money as free cash flow and other than that both in dealers and India business we have quite a bit of tooling recovery also there at the moment I mean a substantial amount of tooling recovery is there in VLS in Q3 and Q4, which we have to receive also the India we have to receive especially in the polymer business a lot of tooling recovery



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where the payments are not that much that will can now help us also in a good way, so I think operations and this customer funding tooling recovery and control on our capex because this year we will be very focused on capex, the whole idea here is that do very, very limited capex, first utilize the existing capex to the maximum, then only do a fresh capex, so we are trying to see that how do we built our assets more and more our existing assets that is the whole objective, so like I said earlier in some calls also that if you are able to control your capex the 50% of the free cash flow battle one, and that is what we have done this year and that is also one of the major reasons that we are in the situation where we have kind of done a little bit better on the free cash flows than we are expected in the Q2 and of course going forward as the sales is there for us, I think generating cash flow from operations and to that added this customer point of tooling, which definitely help us drive this net debt to lower levels that is the way we see it.

Ronak Sarda:

Sure, and the last question, you mentioned in the presentation that the recent lockdown that has not impacted the manufacturing operations so far, but any risk or change again which can lead to some kind of two steps forward or step backward kind of a thing realistic at least or we are fairly confident of managing the operations?

Tarang Jain:

We are fairly confident of the revenues in VLS for this financial year that is what we hear from customers and this is our understanding that probably December also could be a little bit better than what we expect on the VLS revenues I am saying. On the India revenues, you are also very well aware that we have to see the core season what really happens, but okay whatever the sales that mean very strong revenues we have seen in September, October, even November I think we will be strong, but then December onwards January we will have to really see how the revenues really can pan out for us. On the operation side I think, India side, I think that in this COVID conditions, I think, yes, we had some troubles in the first few months like June, July, August, but I think September we were pretty much stabilized, our labour force and yes, there are some issues with suppliers, which we faced, but hard to mouth some products, which will be there when the ramp up has been so steep, but I think we are managing I would say fairly well in the circumstances in India. Abroad I think all regions are trying, but of course our European region, we do have some challenges at the moment, which we are also dealing with because a V shape recovery has been there and we have faced in this COVID some shortage we have shortage of manpower in the plant especially in the Czech and because of that there has been some premium freight, which we have been incurring since September and that is something we are trying to mitigate through some actions at our end, how to mitigate this premium freight little bit over time also, but these costs, yes, hurting us a little bit, but I think we all as a team working to mitigate this cost. This cost are a little bit on the higher side especially the premium freight, but we had some discussion with some of these OEMs and we are trying to see that with them we are able to share some of these costs so we are looking for solutions here, but having said that the strong level revenues definitely helps our profitability in any case, so that anyway will happen, but yes, I mean you will rather that we are not incurring some of these extra cost in VLS Europe because of this premium freight and some over time and that is the area of bit focus for us currently.



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Ronak Sarda: Thank you.

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

Aditya Jhawar: Thanks for the opportunity and congrats on good set of numbers. The first question is on the VLS, so considering there has been an announcement of lockdown in Europe have we got communication from the customers that change in production schedule so what could be the likely impact of that and considering we almost had more than two weeks of shutdown in Europe, do you think that there could be mean to sequential uptake as we ramp up VW and Renault going into Q3?

Tarang Jain: Frankly speaking, Stephane can add after I have said, we do not hear anything because it is lockdown whatever we are talking about is like a mini lockdown, borders are not closed also you know, borders are also opened and people are going to work even in this lockdown at the moment the second wave or whatever, I mean at least I have not heard any feedback on customers that they are letting up on their volumes, I mean my view is that in Europe especially I think things are going remain strong, which is our main play, I think in December month we have heard that in America there will be some I think probably a reduction in volumes only for the month of December by probably 20% or something because of some shutdowns or something not because of COVID, but generally they want to be maintaining shutdown, maybe Tesla or somebody else and some holidays so there we see, but otherwise and other regions we have not heard anything frankly that there is going to be anything during the lockdown, there is going to be any impact on the sales. Stephane, can you add to this.

Stephane Vedie: Yes, I totally agree with what Tarang just said, the dealership have not lockdown so that means you can still go out, buy your cars, go to your dealerships, they are also implementing the self program online in the last lockdown so you can buy cars in Europe via internet. What we see is according, we have a very strong three month information right now. We have a very good visibility on this. We had a customer like Ford that is thinking about closing a plant for a week, but at the end they decided not to do so and the whole tooling very high volume. We are almost like max with some customers on each of the models, what we have seen and I think this is an important trend for all electric vehicles again, I am going to bring up this electric platform for second we are trying to make and fill as many electric vehicles as possible in order to reduce the carbon footprint exposure for the year if you want because especially in Europe all the car manufacturers are exposed to some fine in case they do not reach to the threshold that they have to commit to the European Union, so we see a very strong demand on the electric vehicles, we see the car manufacturers being pushing to make as many cars as possible on this platform and as you know we are significant market share of electric vehicles in Europe and in the rest of the world. I want to also mention China, you see that the numbers in our inventory in China is also strong, the markets has really taken us since there is stock of the production back in mid



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February. We saw a steady increase every month from our customers, you know our main customer in China is Changan and Changan is one of the most successful right now OEM in China. They are beating the market, they are launching interesting products well prices, well designed and they have a good momentum and we are really benefiting from this momentum from Changan. Overall we see strong volumes right now and no reason to see any risk at least for the next 3 to 6 months

Tarang Jain: Aditya, I think November and December will be a strongest month in China because this is normally their strongest months, so we expect a strong November and December in China, so we can expect maximum sales in these two months.

Aditya Jhawar: Absolutely. Stephane, made a very interesting point on electric vehicles, so Stephane, if you can give us some kind of sense that what are the contribution of electric vehicle in our overall revenue in Q2 and are you seeing a significant change as compared to last year because of the incentives that has come?

Stephane Vedie: I am not sure if I can give you a contribution income of revenue in Q2 of electric vehicles, I think we need to make these analysis but clearly we do have almost 20% of market share on the electric vehicles, so as you know historically we have been very strong with Tesla, we are consolidated our position with Tesla being present on their model, this is a new volume for us. We are delivering them in North America and we will delivery also on other plans as they start including China, including Europe. We are exposed now we do the front lighting or the head lamps on the daytime only lamps for the electric platform of Versa again. This is the biggest electric platform in the world and this capacity that has been put in place the ID3, ID4, we have the business for Europe, we have the business for North America, we have the business for China, Europe has launched, China is just coming up slowly and then North America will come in a year, so that is a very important customer for us. Among electric vehicles, we are just launching right now the Mustang electric with Ford, very appealing vehicle we also supplying for this and this is from our Mexico plant. We are present also on the Renault Zoe which is one of the top seller in Europe, we do the rear lamp in our Czech factory. Values of flap ship electric vehicles where we are present and this a good showcase for our technology of these vehicles.

Aditya Jhawar: Thanks Stephane. One question on India, the margin expansion has been pretty sharp and some of that you mentioned there were cost saving initiative and plus some cost will come back, so if you can split margin expansion between the reduction and employee cost or other cost saving initiative and plus what has been the change in the gross margin in India business as a whole, we are not referring standalone, if you can give us a fair understanding on the impact of product mix change and sustainability of the margins?

Tarang Jain: I think especially we see in this quarter that our margin expanded because of also capacity utilization, the margins have definitely expanded because of that, but yes, I think the margins are



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definitely on the higher side because I think by at least I would say between 0.8% to 1% because of the employee cost and that has returned basically from October onwards, but like I said achieving at the level sales we are our EBITDA between 12.5% to 13% is something, which we can do on a full fixed cost basis and having said that yes, obviously we want to further increase our EBITDA margins as we go long and we will see that as we increase our sales in the Indian market we have a lot of new wings, which we have done even in this year and going forward I think whether it is in the two-wheeler segments or area of products including BS-VI also EV coming in from next year EV power train products of us coming in next year that will really help and significantly increase our revenues in India and of course on the four-wheeler front also across the three, four product groups we have whether this is plastic interior in the car segment and also the truck segment and also our engine valves and our forging machine business, I think we are doing pretty well and can also win new businesses, I think I am pretty confident that we are going to be increasing our EBITDA margins in India also further to this going forward as we see and that is something we are fairly confident about.

Aditya Jhawar: Sorry for repeating, but in this quarter if you see, there would be some products for example BS-VI products, which are not there in the base quarter so for us to understand what was the impact of product mix change on a Y-o-Y basis very important to understand the sustainability of the margin, so we cannot calculate the gross margin on India business, if you can help us understand the delta, the change in product mix had had on the overall margin area?

Tarang Jain: Product mix wise I would say it is driven more, one is the capacity utilization, but I agree the gross margin part, but volumes are important to also increase gross margins even from a purchasing angle, but I would say lot of the electronics, which has come in, the growth in electronics in our organizations whether is to increase digital instrument clusters or the electronic carburetors or the ECUs, the electronics part has generally driven the gross margin of the company because there is significant increase in revenues in our electrical and electronics business. I would say that more than the other businesses of polymer and metallic where it is more of capacity utilization taking place not really from a product angle that we will see probably more on the plastic, four-wheeler side as we go forward we will a lot increase margin there, the two-wheeler business is what it is on the polymer front it gives you a certain level of margins that will continue I mean as such about the gross margins and even in the metallic side, I mean metallic business unit also the gross margins, other than we are driving from efficiencies, which will result in probably 1%, 1.5% increase across all business units of us that is why I am just saying from product standpoint, especially the product standpoint, which is like the differentiator I would say more to do with the electronics that the gross margins are going up for the company.

Aditya Jhawar: Sure, one final question for Srini, Srini, you explained well about the taxation in this quarter, if you can throw some light what could be implication of deferred tax asset we not be able to accrue some benefit on the tax rate for second half of the year and FY2022?



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T. R. Srinivasan: Second half year is little bit difficult to focus now because visibility in terms of the revenues and demand is bit limited at the moment because it all depends on how the ramp up happens across different facilities and capacity utilization of the newer facilities, etc., but what I can say is that the effective tax rate optically will continue to remain high for the next 2 to 3 quarters at least because the losses or the time you take for the newer facilities to come to breakeven and start generating PBT and then after that also there are a lead time of kind of year before we can start accruing the deferred tax, that could take some time and at the same time the tax credits, incentives check we are also not accruing additional because of certain time limits on utilization, etc., and that again once profit generation improves we can start further accrual so all put together I would say next 2 to 3 quarters optical the tax rate will continue to be high and maybe in the later part of next year you will start seeing it improving, but it is difficult to focus exactly what will be rate at the moment.

Aditya Jhawar: That is all from my side. All the best.

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

Abhishek Jain: Thanks for taking my question. Sir, VLS revenue has gone up by 21% this year, just wanted to know how much revenue growth in Europe and North America in Q2 and what is the revenue breakup of North America versus Europe in first half, FY2021?

T. R. Srinivasan: First of all the revenue growth what you mentioned is in rupee terms so you have to also keep in mind that the rupee depreciated against the euro compared to last year, so if you remove exchange rate impact the revenue growth in euro is about 9% or 8.9% to be more precise so that is the reference against which we can compare. Across the region I would say, which is North America mainly little bit from Brazil so that grew by something like 9% in euro terms, the Europe has a double digit growth almost 11% whereabouts. India is small in values of VLS, but it had good growth in Q2 because we have some new demand, new customers like Renault, Nissan, etc., so that was quite high. On the business units for small lamps for two-wheeler actually had a decline in revenue so that is about 5% to 6% decline, so overall 9% revenue growth was mainly driven by Europe followed by the Americas that is the way it played out.

Abhishek Jain: Sir, what is your revenue breakup of the North America versus Europe in first half FY2021?

T. R. Srinivasan: About 1:2 roughly I would say.

Abhishek Jain: Sir, in North America business has been under stress, do you see we loosing business in Tesla so what is current situation and how is the client contribution in North America?

Tarang Jain: Whose contribution.



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Abhishek Jain: Sir, how is the current client wise contribution from North America?

Tarang Jain: Customer wise contribution?

Abhishek Jain: The customer wise contribution to revenue in North America that is the question.

Stephane Vedie: We have three top customers in North America, is Tesla, Ford and FCA, these are the top three. We have another customer that we will develop pretty soon that is Rivian. It is one of the electric car manufacturer, one of the new startup that will launch, this is one of the strongest that is why we decided to partner with them. They are very well capitalized, they have interesting product planning and we are of course pleased to be their partner. With Tesla, the next challenge for us to be on their new platform, so we are working closely on this and we will be able to give some good news soon. With Ford, we are targeting the truck market this is really what is selling in North America, you want to be on the truck and we have been very successful. If you remember we had win of the Ford Expedition and now we are happy to report the win of the Ford Explorer rear lamps this is almost I think €40 million per year of business and this one of the top seller of Ford. In addition to this we have won the stop lamp on the Ford F-250 so that is the pickup truck and we want to continue our penetration on the truck market, SUV market, so we have a very good momentum, our plant in Mexico, we are the highest rated lighting supplier by Ford North America, our Q1 score is at 99% almost at the highest level possible, so definitely Ford will continue to be an important customer for us, and it is important for us to be on the right product, so we are really focused on the to be on the segments of the market that are selling well.

Abhishek Jain: Sir, what is the current inventory at the system level for VLS business, it is normal or it is below the normal level?

Stephane Vedie: In term of inventory income of finished goods, as we were explaining to you that the customers are pretty very high quantities so we are really in the mode of three shifts, we would like to even increase the finished goods inventory and we think that around Christmas time we have a good opportunity as they shutdown at this for Christmas especially Europe. In term of remaining Europe we have refilled the pipeline we are working on implementing consignment stock, we are working in implementing some compound with some supplier so we see some further possibility to optimize the raw material cost and the working capital from that point of view, so the income of finished goods we have to be low and like to increase right now.

Abhishek Jain: Sir, my last question related with the capex you are targeting for FY2021-FY2022 including maintenance capex?

Tarang Jain: I think we really be limiting the capex for next year also because the focus of course will be on the utilization of our existing capacities in VLS also and I think it will be not more than probably at a level of maybe €50 million, I do not think we going to cross that even next year, for VLS I am talking about FY2022 and this year of course is about €45 million in this year.



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Abhishek Jain: So, total capex €45 million in FY2021?

Tarang Jain: Yes.

Abhishek Jain: And what would be the maintenance capex?

T. R. Srinivasan: May be 20% will be maintenance, 80% will be spend.

Abhishek Jain: So, in FY2021 including India and VLS, what may be the capex?

Tarang Jain: I mean in Crores if you take let us say 50 million, they have been now 600 Crores could be maximum 650 Crores, I do not think more than that.

Abhishek Jain: Okay, Sir, thanks. That is all from my side.

Moderator: Thank you. The next question is from the line of Chirag Shah from Edelweiss Securities Limited. Please go ahead.

Chirag Shah: Thanks for the opportunity. Sir, my first question is in VLS, two questions, one on our breakeven point and when I look at your Y-o-Y our revenue has grown but our margins has stayed, so the operating leverage does not seem good for us, so where are we in terms of registering breakeven levels and what are our current breakeven levels, which we get despite the revenue growth of 8% to 9% on a Y-o-Y basis?

T. R. Srinivasan: If you look at revenue growth it has mainly come from the ramping up of the new facility, which is Morocco, Poland and Brazil compared to last year and as we said earlier the facility first year will not reach the breakeven points because of the COVID impact, etc., the volumes has not happened to the level we had originally expected, so they are still not contributing to the EBITDA margin, actually they are negative they are diluting the EBITDA of establish plant to some extent plus in the Q2 we also had a little bit of one off because the volumes are ramping up so sharply then we have to had to incur some premium price over time, etc., to meet up the demand to support the volume ramp up, so that is one off so all this put together made that EBITDA margins flat for the quarter even though the revenue is up, but going forward once the capacity utilization improves further we should start approaching breakeven levels and we should see the margin is going up that is what like Mr. Jain mentioned still our target for VLS is to have double EBITDA margin in the last quarter and thereabout we expect to come close to that so that is the function of how much output happens from the newer facilities.

Tarang Jain: But, to answer your question, we reduced the fixed cost as we said in the last call also and we were definitely hoping that breakeven should be between €67 million to €70 million of revenue is where we should be seeing that kind of a breakeven point, that is something which we have not frankly been able to achieve because of some other challenges, which even Srinivasan has mentioned,



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but this is something, which I think going forward we need to achieve at this level of revenues, we need to achieve the breakeven point and that is what we are working towards to stabilize more of the operations in Europe, revenues in the new plants and I think this is something I have feel that doing that it is very much possible that we achieve this kind of breakeven point.

Chirag Shah: Sir, is there anything one off even in gross margin because on a Y-o-Y basis, we see gross margins are lower, is there anything specific to take note of which is one off or lumpy impact on the gross margin side?

T. R. Srinivasan: Yes some of the things I have mentioned like some premium price and those kind of things are there because of the short ramp up we had in volumes.

Chirag Shah: Okay, Sir, that will be part of gross margin?

Tarang Jain: Yes.

Chirag Shah: The second question is regarding the strategy point, so within premium cars and in volume car, how do you base your pricing that we did in the overall volumes because I always presume that it is much more easy to make money in the premium car versus the mass market cars because of risk of volume and uncertainty in the mass market car, so how do you go about choosing the projects, because these are five years projects I think?

Tarang Jain: Basically, the objective always is to be in the high volume programs, but with the high volume programs there are more pain, so the premium programs like conventionally is that low volume, high end cars and everything, but that is not what we are going to be looking at, for us minimum level of volume is must, we would definitely go for programs, which have got a higher volume, so coming to our technology we do not look at premium cars, we look at a technology, technology could like I said you can have a metric technology also in a regular car like I think the VW ID3 ID4 are actually, we call them premium car because of the technology in it, but they are some regular cars, they are not some like the S Class Mercedes or something like that which require a lot of force, they are sports cars. So the whole idea here for us is that we always whether in India or abroad we are improving a mass production volume, not the low volume high margin business, we are not in that business may be we will pick up one or two products like that if our customers who are our big customer if they ask us to be in those platforms, but we will definitely looking at higher volumes with a technology content basically everything is turning anything anyway and the so called margin, which you see in a business, which is low volume high margin for a company like us actually will not be an true margin, we will be incurring no cost in producing that low volume production. So we have to look a certain level of minimum level of volumes in any platform, on any program we try to win that is important and now in technology as evolving and I think more and more I think in regular cars you will see high level of technology as we move forward, so I think for us it like the volumes and the technology and then we decide our pricing. Pricing is basically based on two factors, basically it is the profit after



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tax where we say that we should at least achieve 5%, but based on the program, the volumes or IRR something we will go down to even 3% or 2% across, but the IRR has to be at least at 18% to 20% level when we are not doing that kind of analysis that is what we work.

Chirag Shah: That is very helpful. Thanks a lot.

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

Nishant Vass: Sir, thank you for the opportunity. My first question is on VLS and your order book, first of all the question is how are you looking at order book situation obviously it seems that the first half has been slower vis-à-vis history so first of all and in terms of customer order programs we put out or competitive intensive some colour on that and second on your mixed in terms of even the order book in the current mix on the technology side, so you highlighted in the previous question on the new technology adoption, so could you shed some light what is the current revenue mix in VLS between traditional technologies and new technologies like LED and what is your revenue and what is the mix of the order book in terms of sales technology structure?

Tarang Jain: Stephane, you want to take that questions?

Stephane Vedie: Yes. Year to date we have booked for 74 million of new business between new business wins and existing. The first quarter was a little slow, but I think it was very slow for everyone, I think everyone was on cash flow generation, so the customers cannot freeze the development that they had. We started to see a few businesses picking up at the end of second quarter. We have booked some marquee projects, I mentioned before explorer and introduced, we discussed that as you know and there is no quotation between Ford and Volkswagen for commercial vehicles and we are just gone also for the Volkswagen branded vehicle part of this platform so very important for us, very important for the future of our plant in Turkey. So, we are confident for this year to book between 200 to 225 between the additional business, additional market share on everything. We are very picky to really identify what makes sense us. Like I mentioned we have been pushing a lot in North America, we have capacity in our plants in Mexico, it was important for us to see these capacities with the right products so we are targeting SUV, we are targeting trucks and I am coming to the previous question and I think we are going to switch from current and our sweet spot is products which we are on boarding on technology. I would not call it the covenant of technology, it is extremely competitive pressure. We do not go on the low volume products. We rely on technology which is in terms of pressure feeling, in terms of product development, innovation, more that you need to put it from. The other sweet spot this is ordinance/technology. As we announce new project that we are bringing under the rear lighting there is LED this is becoming very important. This depends from customers to customers, we see the trend that more and more of the customers are putting on the lighting to define the brand, so I urge you to look at this new lighting of you will see also communicate about the car, your air drums are moving



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when you open the doors of the car, this is an addition to the segment that we are targeting. In the front lighting the trend we are having three levels of trend, so there is an entry level of lighting, rear level and high level. For the entry level, we used to have halogen in the past, now we are seeing low cost LED. This is a new project that we are booking right now. We have entry level LED, low cost LED and we have quite a few interesting technology that we have in Varroc that is very heartening for the market. We see that we have low cost ready technology LED technology that can advocate the halogen technology. We serve white light and scale up the yellow light. There is much more freedom. In the mid level of the trim is usually projector level type of LED and then the top level, which is the technology and we have again very good product, very good modules, that we can offer to customers that we are making. This is in nutshell the technology trend that we see in the new business wins that we are winning now.

Nishant Vass: If I could extend that you response question to it so when do you think you are mentioning in the order book is completed skewed towards LED so in how many years you will think that the mix of the running revenue will move dramatically towards LED from a contribution basis?

Stephane Vedie: I am not sure I got the full question, I am sorry.

Nishant Vass: Let me rephrase it, in your order book is largely LED as you mentioned so as the order book comes to execution, so what is the time lag in which you revenue contribution of LED become a dominant share of your revenue?

Stephane Vedie: I think in the projects we are winning right now it is already a dominant share in the projects we are winning right now of the rear lighting side is more than 80% to 90%, on the front lighting side it is about 70% to 75%.

Nishant Vass: Thanks a lot. My second is on Poland, you can answer on it probably so obviously you were looking at revenue to increase, so in my understanding is correct that your assessment of the revenue from the existing customer or the ability to go up to €10 million revenue with the customers is low is that the case or if that is the case are doing some revenue actions from new further orders or customer constitution addition first in that would be a question on Poland, if that is the reality situation?

Stephane Vedie: In Poland right now we have 2 running projects, we have one that is called K0 with PSA where PSA is increasing the volume and for this project in Poland further volumes increase. This is very stable. This is commercial vehicles of PSA with good volumes. Then second one is the ID4 front lighting this is just at the ramp up level, and we see the volumes starting to pick up in the of this year. We think that with these two projects only we should be close to €40 million revenue this year in a new in Poland. Then the following year we have we have two major launches called Skoda Kamiq and Skoda Karoq, this is for the Volkswagen group, two small SUV cars that are doing well in Europe. With representation of our sweet spot in terms of volume and technology and then we have some products in quotation right now I cannot speak of them but we are pretty



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good at a confidence level for which we are able to announce addition of new programs coming to Poland end of this year, but with the two projects already in the plans plus two we will launch next year and we are still in roughly 65% of capacity.

Nishant Vass: So, basically we have the confident that €10 million revenue from next year?

Stephane Vedie: Yes.

Nishant Vass: One question for Srinivas on the financial side, could you highlight because there is a confusion so could you just be able to highlight what is the organic ex-greenfield growth as well as the margin level for VLS if that is possible?

Tarang Jain: I am not sure I got the question.

Nishant Vass: New greenfield kind of plants what would be the organic revenue growth or de-growth and what would be the margin levels on those on a year-on year basis?

Tarang Jain: Okay, we will get back to you on that, we do not have it readily the thing.

Nishant Vass: Thanks a lot.

Moderate: Thank you. As there are no further questions in the participants, I now hand the conference over to Mr. Tarang Jain for closing comment.

Tarang Jain: Yes, thank you everyone for being on this call. I think we are on a good recovery path both in India business and a VLS business. There are some challenges of course we are facing especially in dealers in Europe, also towards the new plants in this COVID conditions, which is increasing some of our cost at the moment, but we are finding suggestions to those higher cost digit items and we are quite confident we find the solutions in this quarter and definitely I think the positive path here is that the sales are very strong going forward in our VLS business and that will sustain definitely up to March if not beyond so we have that, now it is our job that how we are going to be converting this higher level revenue into profitability. Yes, there will be a little bit of constraints of the new plants like Poland, Morocco, Brazil to a smaller extent and new electronics business unit in Bulgaria and few of these plants will be an issue for some time probably for the coming months in this year, but as something I have seen it has been apart of our overall growth strategy to have these plants, but I remain very, very confident that with the sales that we will probably continue to improve and come up with a better performance as a group. Thank you once again.

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