

Varroc Engineering Limited

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VARROC/SE/INT/2019-20/63

November 25, 2019

To,

1) The Manager- Listing
The Listing Department,
National Stock Exchange of India Limited
Exchange Plaza, Plot No. C/1, G Block,
Bandra-Kurla Complex,
Bandra (East), Mumbai-400051.

NSE Symbol: VARROC

2) The Manager – Listing
The Corporate Relation Department,
BSE Limited,
Phiroze Jeejeebhoy Towers,
Dalal Street, Fort,
Mumbai-400001.

BSE Security Code: 541578
Security ID: VARROC

Dear Sir/Madam,

Sub.: Transcript of Investor Conference Call for Varroc Engineering Limited for the quarter and half year ended on September 30, 2019

We submit herewith the transcript of Investor Conference Call of the Company, which was held on Wednesday, November 13, 2019 at 09:30 a.m.

Kindly take the same on your record.

Thanking you,

Yours faithfully,

For Varroc Engineering Limited

Chetan Sharma

Sr. Manager (Legal & Secretarial) & Compliance Officer



Encl.: Transcript of Investor Conference Call



“Varroc Engineering Limited Q2 & H1 FY-20 Results Conference Call”

November 13, 2019



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



*Varroc Engineering Limited
November 13, 2019*

Moderator: Ladies and gentlemen good day and welcome to the Varroc Engineering Limited Q2 & H1 FY20 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 telephone. Please note that this conference is being recorded.

Varroc Engineering Limited Management is represented by Mr. Tarang Jain – Managing Director along with Stephane Védie – President and CEO VLS Business, Ashwani Maheshwari – Whole Time Director and CEO Indian Business, T.R Srinivasan – Group CFO and Nitin Kalani – AVP Finance & Head Investor Relations.

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

Tarang Jain: Thank you. Good morning everyone, Tarang Jain here. I am the Managing Director of the Varroc Group. I would like to thank you for joining the quarterly earnings call of Varroc Engineering Limited.

Before I discuss the financial performance of the last quarter, I would like to quickly recap the industry situation. Each of our major passenger vehicle markets has seen declining volumes over the past few quarters. This quarter too we saw flat volumes both in Europe and North America. The Chinese market during the quarter declined by 5.3% year-on-year and the Indian passenger vehicle production fell by 20%. The Indian two-wheeler market too saw substantial decline of almost 15%. Each of these markets are facing several challenges ranging from a changing regulatory in emission related norms, slowing economic growth and result in weaker consumer confidence and trade-related uncertainties.

As you are all aware we are in the middle of expanding our geographical footprint in Varroc Lighting Systems Business and are adding capacities at various locations. This is in line with our long-term global strategy and is towards catering to the new business won by us over the last 2.5 to 3 years from large global OEMs. The new facilities at Brazil, Morocco and the H8 Lines in Czech Republic which were commissioned towards the end of last year, are ramping up gradually. In the initial phase of the operation these facilities run at sub-optimal capacity utilization resulting in operating losses in the first few quarters. The rate of ramp up has been slower than expected due to the weak market conditions resulting in lower unexpected profitability for VLS for the current year.

In the current quarter our revenue declined by close to 10% overall. The revenue of the India business declined by 12% year-on-year while for VLS it declined by 8.6% part of which is due to the exchange rate impact. Our consolidated EBITDA margins were impacted by the lower revenue along with the sub-optimal capacity utilization in the new facilities. EBITDA margin for India business was at 10.2% while lower than the margin of 12.2% in Q2 FY19; improved

sequentially as compared to the previous two quarters. The VLS margins at 7.2% in the current quarter were lower than the 8.5% margin recorded in Q2 FY19. However excluding the new VLS facilities in the ramp up phase VLS was about 9.6% for the rest of the business. Our China JV also suffered both from declining revenue and higher overheads, the EBITDA of our China JV declined by 96%, loss for China was at about Rs. 64 million negative as against a positive PAT of Rs.71 million in the same quarter last year.

Depreciation and finance cost were higher largely due to the adoption of Ind-As 115 and Ind-As 116 and a higher asset base. Our PAT for the quarter is at Rs.229 million, a decline of 77%. PAT was impacted negatively by lower revenue, largely driven by market decline, operating losses at new facilities during the ramp up phase, higher interest and depreciation and losses in China JV. During the first seven months of the year we have won some significant business, our VLS business secured orders of €262 million equivalent annual revenue of which orders for almost 145 million are new orders. I would also like to highlight that of these orders almost 50% are from North America region which de-grew this year were almost 26% year-on-year in the first six months. The new order wins in the region bodes well for our future growth. We are on track to achieve our full year target order intake of €385 million in annual revenue.

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

Moderator: Thank you very much. Ladies and gentleman, we will now begin the question and answer session. We take the first question from the line of Varun Bakshi from Equirus Securities.

Varun Bakshi: My first question is regarding our North America business; we have demand more than 25% in North America while the industry has been flattish. So can you through more color on this?

Stephane Vedio: About Varroc Lighting System in North America especially in Mexico, the decrease has been driven by the decrease of revenue from our Tesla customer. We are present in module S, module X; we anticipated decrease of these vehicles. They have been on the market for almost 5 years; earlier or more than 5 years now, so we did forecast for this decrease. At the end we have less decrease than what we initially forecasted for. But compared to the trade this year in this quarter; we have a decrease on revenue with this customer by 41%.

Varun Bakshi: Going ahead, what could be the outlook for North America business in VLS?

Stephane Vedio: In North America we have been able to win some major projects, some with shorter time to market. We don't anticipate recovery during this year but when we start up the new businesses and some will start early next fiscal year, will start to recover some of the revenue. This is very important for us that we focus on this region on this plant in particular to acquire new businesses because this is one of the few plants where we have really available capacity. So that means every incremental business that we are putting in this plant, we don't need new

investments; we don't need new CAPEX, so that's really interesting for us to leverage these plants going forward.

Varun Bakshi: Can you please provide the customer-wise growth for India and our VLS business?

Tarang Jain: We are talking about VLS now, if you talk about VLS when it comes to the VW Group we have grown about 47% over the previous year. They are our major customers we have grown with this year. Other than that where we have had a de-growth has been largely with Tesla which is de-growth of about 38%. When it comes to Peugeot, we have had an increase of about 22.5% over the previous year. When it comes to JLR, we have had a de-growth of about 20%, when it comes to Ford which is our largest customer, we have had a de-growth of about 6% and with FCA we had a de-growth of about 14%. In VLS these are our major customers at the moment, Renault is also there, Renault is still a smaller customer at the moment but there we have seen a 400% growth but on a lower revenue base. This is how we are actually moving ahead. Going forward with for the various businesses we have won over the last 2.5 years; there is a lot of focus on the two of the large groups, the VW Group and the Renault-Nissan-Mitsubishi Group where we have won substantial business in the last 2.5 years and that would start playing out from this year onwards gradually and ramp up in the next 2 years largely more with these two groups. Other than of course with our traditional customers of Ford, JLR and also PSA will of course remain as strong customers for us moving forward.

Varun Bakshi: Similar kind of numbers for India business, if you could provide?

Nitin Kalani: India Bajaj declined by 9.4% year-over-year, Honda group declined by about 14%, Royal Enfield grew by about 6%, India Yamaha was down by about 25%. Mahindra & Mahindra was flat as compared to last year.

Tarang Jain: The overall for the India business this year we were expecting a growth in the Indian market but seeing the way the situation is and with some of the new BS-VI products in the last quarter, which will show up in the last quarter, we are hoping that we are almost at a similar scale to last year that is what we are counting up in India.

Varun Bakshi: On margin front, we have been guiding for double-digit margins in FY20 in VLS; so do we still see such kind of double-digit margins in FY20 given the slow economic conditions as well as other new plants coming up?

Tarang Jain: What we are seeing now is that; we were expecting of almost like a 10% growth in our VLS business this year and at the moment we are trending a little bit negative for the half-year may be at around 4.5%-5%. In Indian rupee terms for the full year we probably see a flattish sale in Euro terms. In Euro terms this year almost a similar sale to last year and with the Ind-As 116 impact, we are still hoping for a double-digit EBITDA margin.

- Varun Bakshi:** The adjusted margins?
- Tarang Jain:** Adjusted to Ind-As 116 would be 9.5%, if we knew were to take that out.
- Moderator:** Next question is from the line of Aditya Jhawar from Investec Capital.
- Aditya Jhawar:** In Renault, in VW the progress has been quite encouraging even in Renault but if you see the others share that is almost 15% – 16% of our overall VLS revenue there has been still little bit of a decline so Renault has also grown by 400%, there would have been a steep decline of other customers. If you can throw some light Stephane on this?
- Stephane Vedio:** With the other customers we went at the end of the projects with Daimler. We have the one project phasing out in Europe and one project phasing out in North America. There the new Daimler projects that will start at the end of the third quarter this fiscal year that the Mercedes CLA; so this will help us to recover some of the revenue in Daimler. Daimler was one of the main competitors than the others of the decline.
- Aditya Jhawar:** Stephane are you hearing some kind of a deferment of commissioning of new project especially from the two big customers like VW and Renault where the growth is linked to the new plant coming on stream. Are you hearing some kind of deferment of commissioning dates?
- Stephane Vedio:** With Renault so far, we are able to start the Renault Master, The Renault Twingo. Right now we are hunting up the Renault Zoe, so Renault has been very good to expect the timing initially committed. We are also anxious to start in Morocco, the new Dacia Logan from Deho that will come in two quarters from now. With Renault we have been on time. We would again see them starting on time the project but we see them with a very slow ramp up. It's our understanding that one of their major platform, they have some software issues so this is delayed the ramp up of this platform so this is impacting the ramp up of our H8 additional line in Czech Republic instead of ramping right now we will be ramping up, most of them you will see in the term of revenues in the next 5 months.
- Aditya Jhawar:** Tarang if you can help us understand how the ramp is up in TVS happening and in terms of the number of product line, TVS is engaged with us now and what are the discussions for the other product lines?
- Tarang Jain:** TVS is a customer we have acquired almost 9 months ago and they have given us one product, the AC generator or the magneto as you call it. These are all for the BS-VI kind of production which will start probably in January. So I think initially the business which we have received is for about 720,000 magnetos a year that is something which will start from January onwards and based on how we perform; within six months they will take a decision whether can give us additional volumes to take us to almost hundred thousand, it is generate as a month. So there

are lot of other products also under discussion with TVS. I find TVS to be a very open customer, very open to Varroc; they just want to test us as it's a first-time relationship. They just want to test us on how we perform for this first product and once they get the confidence it will open doors for multiple other products at least a few other products which are all already in a discussion with also probably get finalized. So this probably may happen somewhere around March-April where we can see some more traction on some new business with TVS.

Moderator: Your next question is from the line of Niranjan from Equitas Capital.

Niranjan S: On the downward revision in the Lighting business of the revenue potential from Brazil. In Q4 you had mentioned 60 million at full capacity whereas we now see about 30 million. Similarly the Romanian JVs, Romanian revenue potential has been marked up from 50 million to 85, if you could give us reasons behind that; that's the first question. The second question was on if you could give us some guidance on the tax rates on the Lighting business as well as the Indian business?

Stephane Vedio: About the first question, I did not catch the second but I can answer for it first. In Brazil we started in two-phase in Brazil. Phase 1 is capaciticizing the plant for 30 million, on our plant for Phase 2 was towards second module to reach 60 million. Right now in the current situation of our industry we decided not to proceed with this Phase 2. We are going to stay with our Phase 1 investments, maximize the capacity. We have very older business to fulfill one of the present capacity and deciding not to invest in Brazil which is a more challenging country or more challenging area towards very-very good return. So that's to answer about Brazil. In Electronics on the other hand the return that we can reach on the Electronic has been very convincing. Every business case that we have been working on show that it's really where we need to put our money, so we decided to increase the capacity there. We were able to fit additional SMC lines, so we decided to really with our partner to take a full advantage of return and add additional revenue to this.

Niranjan S: Just a follow-up question to that; does that mean that CAPEX which you would have planned for Brazil that would come down to reduction on what we were planned for Phase 2 and secondly is that is it linked to not getting as much expected revenues as you expected from Volkswagen Group?

Stephane Vedio: In terms of CAPEX we are cancelling this Phase 2 CAPEX. Right now we are offering to put the brake on older CAPEX so I think this was a good opportunity to use CAPEX here. In Brazil the issue is not to have enough business to be when it first comes to be with Phase 2, we had even to go back to customers and return some business in order to fit with this plan of staying only with our Phase 1. In fact plenty of business in Brazil to choose from because many suppliers are a little shy right now investing there.

Tarang Jain:

Just to add to what Stephane had said, the reason we have got a Brazil footprint is to support our main customer, the VW Group and the Renault-Nissan-Mitsubishi Group and support ourselves also for the global platform where the volumes are very high like this Dacia Logan. I don't think that we could have got this big program of 800,000 vehicles if we didn't have a Brazil location. So I think it's more from a strategic angle that we have a Brazil location, it's not the most exciting location to be in, it is a difficult location to work in, there is a lot of overcapacity which already exist there at the moment. It's just that we have got that footprint mainly to support these two bigger customers in that region and the reason that we are reducing the sales thing is that because if one of the global customers where we are not so present at the moment; we were hoping that if we were to take some business in Brazil we would get some of the other platforms from them in North America or in China. That was actually our wish but that's not something which is playing out. If that's not playing out we don't want to increase our exposure in Brazil. That's the reason that we are not going ahead with that much of revenue; than that much of revenue which is being downside is basically from this one customer and we have offered that this particular program we can do it out of our existing part in Mexico or otherwise we would not want to do it.

Moderator:

We take the next question from the line of Chirag Shah from Edelweiss.

Chirag Shah:

Is this the new facility that you are separately indicated in presentation; at what level they will breakeven and what level they can generate better return on capital than the existing businesses?

Stephane Vedio:

On the slide #5 in the deck that we made available we are trying to communicate with breakeven of each of this new facility, each of this new capacity that we put in place. You can look at this for each of the facility. The Morocco, Poland, Electronic JV to track all of this major facilities with the most important side, they will help us improve of the older profitability. The business case for each of this plants is showing a better return than what we have right now.

Chirag Shah:

At what level of utilization you can achieve those desired results; is it 70% level, 65% level and this revenue number that we have shown at 123 crores of revenue, it represents what level of utilization?

Stephane Vedio:

When you look at the slide #5 in our deck I don't know if this is an available to you right now....

Chirag Shah:

I am looking at that.

Stephane Vedio:

The full revenue corresponds to the full capacity. The breakeven is obviously much earlier than this. If I take the example of our Morocco plant; right now we are just at the revenue of € 1 million per month, our full capacity we are putting in place in Morocco will be at €15 million

per month. We will go gradually in Morocco but we will reach the breakeven at around €3 to €4 million per month, to give you an idea.

Tarang Jain: This is EBITDA breakeven.

Moderator: Ladies and gentlemen that was the last question. I would now like to hand the conference back to the management for closing comments. Over to you all.

Tarang Jain: Thank you. I just would like to conclude by saying that we are working, we worked medium and long-term strategy that will continue, in our case both for our India Business as well as for our Global Lighting Business. There have been some challenges, this year which we have faced because of lack of growth in the global markets and the de-growth in the Indian market. But having said that like I have also mentioned in my statement; that we are of course looking inwards and this also gives us an opportunity to right size our various costs were come whether its material, whether its manpower, other overheads and that's something I think we have been working on for the last 6 months and we are pretty confident of achieving much better results going forward. Thank you.

Moderator: Thank you. On behalf of Varroc Engineering Limited we conclude today's conference. Thank you for joining. You may disconnect your lines now.