Commercial Vehicle Solutions

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Date November 07, 2023

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Dalal Street, Mumbai 400 001

Scrip code: 533023

Listing Department
National Stock Exchange of India Ltd
Exchange Plaza, C-1, Block G
Bandra - Kurla Complex
Bandra (E), Mumbai 400 051

Trading Symbol: ZFCVINDIA

ISIN : INE342J01019

Dear Sir(s),

Sub: Transcript of the Investor Call for the quarter ended September 30, 2023

In continuation of our letters dated 25th October, 2023 and 31st October, 2023 pursuant to intimation and recording of investor's call, we hereby inform that the transcript of the call has been uploaded on the website of the Company and the same can be accessed through the following link:

https://www.zf.com/mobile/en/company/investor_relations/zf_cv_india_investor_relations/zf_cv_india_ir.html#shareholderinvestormeeting_acc_656449_0

Request you to take the above information on record.

Thanking you,

Yours sincerely,
ZF Group

MANOHARAN MUTHULAKSHMI
Digitally signed by MANOHARAN MUTHULAKSHMI
Date: 2023.11.07 16:15:17 +05'30'

Muthulakshmi M
Company Secretary
ZF Commercial Vehicle Control Systems India Limited
(Formerly known as WABCO INDIA Limited)

"ZF Commercial Vehicle Control Systems India Limited

Q2 FY 23-24 Earnings Conference Call"

October 31, 2023

MANAGEMENT: **MR. P KANIAPPAN – MANAGING DIRECTOR**
MR. R S RAJAGOPAL SASTRY – CHIEF FINANCIAL OFFICER
MS. M MUTHULAKSHMI – COMPANY SECRETARY

MODERATOR: **MR. ANNAMALAI JAYARAJ – BATLIVALA & KARANI SECURITIES INDIA PRIVATE LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the ZF Commercial Vehicle Control Systems India Limited Q2 FY 23-24 Earnings Conference Call hosted by B&K Securities India Private 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 star then zero on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Annamalai Jayaraj from B&K Securities India Private Limited. Thank you and over to you, sir.

Annamalai Jayaraj: Thanks, Arshia. Good afternoon. Thank you for joining us today and welcome to ZF Commercial Vehicle Control Systems India Limited quarterly earnings call.

The second quarter earnings and half-yearly results for this year 2023-24 will shortly be presented by the management team of ZF Commercial Vehicle Control Systems India Ltd, formerly known as Wabco India Ltd. Your host today from ZF Commercial Vehicle Control Systems India Ltd are Mr. P. Kaniappan, Managing Director, Mr. R. S. Rajagopal Sastry, CFO, and Ms. Muthulakshmi, Company Secretary.

I will now hand over the call to Mr. P. Kaniappan, who will provide you with further insights on the results. Over to you, sir.

P Kaniappan: Thank you, Mr. Jayaraj. Good afternoon to all of you. I warmly welcome you all to ZF Commercial Vehicle Control Systems India Limited's second-quarter results and half-yearly performance for FY 2023-24.

We'll make certain forward-looking statements today based on management's good faith expectations and beliefs concerning future developments. As you know, actual results may differ materially from these expectations because of many factors.

ZF Commercial Vehicle Control Systems India Limited's results for the quarter ended September 30, 2023, were published on October 27, 2023. They are available on the www.zf.com website within the ZF CV India investor relations section. We hope that you have had an opportunity to go through them. A recorded audio and transcript of this call will also be made available on the website at www.zf.com under the ZF CV India investor relations section. I am happy to talk to you today, as we give you an update about the company's business.

Industry and Economic updates:

I want to start with a quick update on our operating environment, which is influenced by economic factors and the development of the commercial vehicle industry. India's GDP growth estimate is projected at 6.3% for FY 23-24 and Consumer Price Index (CPI)-based inflation softened to 6.8% in August, after surging to 7.4% in July. IIP growth of Jul'23 at 5.7% Vs 3.8% in Jun'23, led by infrastructure & construction goods. Industrial activity continues to be supported by robust capital expenditure by the central and state governments.

Future industrial performance trends will be influenced by the following factors.

- Global economic slowdown is expected to intensify from the second half of 2023, which will keep exports weak and spill over to manufacturing sectors based on export demand.

- Monsoon's performance will critically influence industrial prospects through impact on inflation and rural demand. Monsoon remained deficient at 7% below the long-period average until September 2023.

Strong all-round performance with significant Y-o-Y growth in all segments was reflected in the Commercial vehicle production (> 6 tons) in Q2 of FY 2023-24 which was at 102,514 with a growth of +21.20% Vs the same quarter the previous year. This growth of 21.2% is supported by increased government spending, robust replacement demand, and strong end-user sectors, notably construction and mining. Further, the growth is expected to continue in the coming months with government capital expenditure and demand from key sectors and declining raw material costs which positively impact profitability.

Let me give you the performance update within the segments of the company.

OE sales:

The medium and heavy commercial vehicle segment is on its road to recovery. As we are given to understand from various customer interactions, the utilization of trucks has been steadily increasing. Currently, the utilization of trucks is ~ >70% which is an indicator of the replacement cycles kicking in. The freight operators can pass on the fuel price increase and on the back of the various new technologies that the current trucks are equipped with, the cumulative fuel efficiency has also improved. All these factors along with a healthy growth in the trailer production, have helped the Company to record an OE sale for Q2 2023-24 of INR 449.4 crores with a QOQ growth of 28.8%.

OE Sales in Q2 of FY 2023-24 was led by: -

- Penetration of pneumatic & hydraulic ESC in applicable bus platforms as notified by regulation w.e.f April'23

- Increase of EV bus production by about 11% until Q2 compared to last year and the sale of EV aggregates like e- compressor and Electronic Brake Systems

- Increase in Trailer production & penetration of Trailer EBS

Aftermarket:

The aftermarket segment of the Company has registered sales of INR 118.4 crores which is a growth of 14.8% in Q2 23-24 Vs Q2 22-23. Growth in the aftermarket was driven by various factors as follows: -

- Growth in STU's segment through focused engagement initiatives on solution kit penetration (Air compressor, Air processing units), along with increased consumption of Automatic Slack Adjuster and Fitness Certificate kit spares. An exclusive distributor for STUs to fulfil the sales and service requirements has been appointed.

- Fulfilment of export requirements (Sri Lanka and Bangladesh); contributed 63% growth Q2'23-24 and YTD – 44% over last year

- Trailer segment has grown by 41% YTD and 73% in the last quarter as a result of the continuous engagement with key large fleets

- 60 campaigns conducted across the nation to improve secondary sales of focused products

- 185 Training programs conducted to various stakeholders like STUs, WSDs, and Fleet owners, and 2000+ people are trained on our product portfolio

Increased the reach to improve the service of BS VI / EV spares through the appointment of 6 new Authorized Service Centres.

The overall aftermarket sales are facing headwinds coming from the reduction in the mining segment due to seasonality, weak secondary payment collection, and the distributors' stocks climbing to greater than 45 days level.

Exports:

Export sales were at INR 323.4 crores with a growth of 23.1% and export services were at INR 92.3 crores with a growth of 25.3%.

The increase in exports of sales was driven by:

- New Launch of G6x model for BMW, and ramp up of volumes for existing G7x and G2x platform for x series and 5 series

- One-time orders to Global Aftermarket for certain repair kits and ASUs

- DAF Compressors volume ramp up for 564cc Compressors & 440cc Compressors volume transfer from Americas

- Lever volumes to China increased in 2023 as we supply now to 3 plants in China vs last year wherein we supplied to just one plant

- mBSP FBV volumes increased by 40% - Truck model change in Daimler Trucks NA

- Actuators - Volumes increased for Trailers in the EU market, one-time orders from Turkish trailers customers

As updated in our earlier conversations, the technology center is thriving in its new home. The capacity is rapidly filling up as the value proposition offered by the engineering center is appreciated by ZF.

We are adding skilled engineers to provide engineering services to ZF and 238 engineers were added in the last year to the existing resource pool, especially in the areas of embedded systems and software systems.

Change in management:

As already informed to the stock exchanges, we would like to touch upon the change in management as follows: -

- Mr. R S Rajagopal Sastry consequent to his decision to resign to pursue other opportunities will be in the service of the company till 16th January 2024 and Ms. Sweta Agarwal will be joining in as Chief Financial Officer of the Company effective from 10th January 2024

- Dr. Lakshmi Venu had resigned from the Board of the Company due to her pre-occupations and it is effective 31st October 2023. The Board at its meeting held on 27th October 2023 had appointed Ms. Amrita Chowdhury as an Independent Director effective from 27th October 2023.

Awards and Recognition:

ZF Commercial Vehicle Control Systems India Limited was honored with the Partnership & Collaboration Award at the VE Commercial Vehicles Annual Supplier Conference 2023 amongst 500 esteemed supplier partners and technology collaborators.

The company is the proud winner of the prestigious Sustainability Excellence Award at the recent Tata Motors Supplier Meet 2023 selected from a pool of more than 800 CV suppliers and technology partners. MyTVS Group awarded the CVS India aftermarket for our partnership spanning many decades.

Also, our Ambattur plant employees from different functions won the following awards:-

- ‘Platinum’ awards in each of CII National Six Sigma competitions under 2 different categories.

- ‘Gold’ awards in each of QCFI TN state-level QCC competition under 2 different categories

- The EHS team won the Dr.P.P.Santanam Medal for the best paper presentation at the 70th Annual State Conference of the Indian Association of Occupational Health – Tamilnadu Branch

Also, our Mahindra World city plant employees from different functions won the ‘Gold’ award in the QCFI TN state-level QCC Competition, and both Ambattur & MWC plant employees together won a ‘Gold’ award in the QCFI SHE Competition.

Now, moving on to the financial performance for the quarter.

For your ready reference, the results were made public at 12:42 PM on the 27th of October 2023. I hope you have had a chance to go through them.

The overall revenue of the Company from the sale of products was INR 890.9 crores and the total revenue from operations was INR 992 Crores.

PBT at INR 141.2 Crores is 15.9% of revenue from the sale of products. This is a 56.4% improvement compared to the same quarter of the previous year.

Our EBITDA is at 19.0% again a 2.3% expansion on sales compared to the same quarter of the previous year.

Our Profit After Tax is at INR 105.7 Crores which is an improvement of 54% compared to the same quarter last year.

Our focus now is on profitability as we address such products in our portfolio that are low in margin. Concerted efforts to reduce costs, reset prices, or even phased exits are planned to ensure long-term profitability.

Such steps now are considered essential to keep the company in a healthy state to make the best use of upcoming disruptions in technology, the market, and the economy.

We now welcome your questions and feedback.

Moderator: Your first question is from the line of Mr. Mumuksh Mandlesha from Anand Rathi Financial Services Limited. Please go ahead, sir.

Mumuksh Mandlesha: Thank you for the opportunity, sir, and happy festive season for management. Sir, can you talk about how has been the ESC implemented now by the industry? As earlier there was a confusion among the bus bodybuilders and only 60% was implemented.

What is the status of that implementation, sir? And the second question is, can you talk about any new regulation which the government is considering or under draft stage where our products could benefit in the coming years?

P Kaniappan: Yes, thank you. On the ESC regulations, the implementation still remains to be about 50% compliant. The main issue is that the bodybuilding is taking place elsewhere, they don't fit it in as per the plan.

So, there are a few loopholes in the system and that is the general situation in India. Unless otherwise the company fits it in the factory and then the product is certified, the challenges are there.

So, we are working with the regulating authorities, RTOs and others to focus more on education and compliance on this aspect. The results could be a progressive improvement. I don't see an immediate change to a total 100% compliance.

Talking about new regulations. the new regulations are in the area of Advanced Driver Assistance Systems (ADAS), and part of the regulations that is actually likely to come in the market in the next few years is autonomous emergency braking system.

Which essentially will minimize or eliminate the road accident such as collision mitigation to reduce the impact as well. So, this regulation is already in a draft stage and a very important regulation. We expect that to come in the next few years.

Mumuksh Mandlesha: And for ESC for the Truck segment, sir?

P Kaniappan: Yes, it's not yet come, but as I also told earlier, it's a matter of time that what has come in the Bus segment will actually extend it to the Truck segment as well. So far, it is not announced yet because the industry is now going through implementing in the Bus segment. And the market also has to see the benefits.

Mumuksh Mandlesha: Right, sir. And just a clarification on the numbers which you shared on the revenue breakup. Sir, can you once again indicate the revenue breakup for OEM, aftermarket and exports, sir?

R S Rajagopal Sastry: OEM is at INR 449.4 crores.

Mumuksh Mandlesha: Right, sir.

R S Rajagopal Sastry: Aftermarket is 118.4 crores and Exports is 323.4 crores.

Mumuksh Mandlesha: Right, sir. And the production number for more than 6 ton is 102,514, right?

P Kaniappan: That's correct, Yes.

Moderator: Thank you. The next question is from the line of Mr. Varun Arora from B&K Securities Pvt. Ltd. Please go ahead, sir.

Varun Arora: Sir, can you discuss any specific plans for product localization and cost reduction in high content, advanced products like electronic breaking system etc.,

P Kaniappan: First of all, our immediate priority is to focus on those products that come under the same scheme and other subsidies for which certain percentage of domestic value addition is a requirement. So, our current priority is in the area of electric compressors. Electric compressors, soon we will be touching 50% localization.

And then by next year, we are targeting to go up to 70% in the middle of next year. So, this is a separate project that is being driven by our team.

And the second is in the area of electronic breaking systems. As the volume reaches a certain level, we would like to trigger a localization. As of now, we are exploring.

Because there are some of the parts for electronic EBS, which will be economical to import because of the large volume it is being produced in other parts of the world. But in India, we are now looking at the component level, starting in a small way, we will also be initiating the localization. Right now, it is fully imported.

The major reason that we acquired a new site at Oragadam and then also created a new legal entity to get the PLA expertise and to make sure only from that perspective to make sure all these advanced products are localized. So, today we are only in the matured state as far as electric compressor is concerned. The other things, we are studying.

Varun Arora: Okay. So, if I may squeeze a small question on ESC. So, I want to know what is the revenue we are getting through ESC only. If you can share a ballpark number, that would be helpful?

P Kaniappan: There are two aspects in the ESC. One is on the hydraulic ESC; other one is on the pneumatic ESC. For hydraulic ESC, the market today is about 200 vehicles are being produced with it. That's the current trend. Pneumatic ESC has started well but I don't know the exact number in the recent times.

The adaptation level is slightly less. I must have actually indicated the value per vehicle. In the case of hydraulic ESC, it's in the range of about 18,000 to 19,000. In the area of pneumatic ESC, now it may be about 30,000. But actually, also we have got some localization, it will further come down. It is applicable for 60% of Bus segment, this is required to be fitted. But actually, the numbers are much lower today.

Moderator: Thank you. The next question is from the line of Ms. Nirali Gopani from Unique PMS. Please go ahead.

Nirali Gopani: Yes, hi. Thank you for the opportunity. Sir, congratulations on very strong and consistent results. Sir, to start with, predominantly we are a commercial vehicle company. But currently, we do supply air supply unit to BMW. So, going ahead, is there any possibility or opportunity to add newer products for passenger vehicles? Or will that be even a focus area for us? Or to put it either way, can we supply this air supply unit to any other players other than BMW?

P Kaniappan: Yes, but then it's intercompany sales. So, the decision has to come from our global product line. Wherever they secure new business and then if they choose India to be the manufacturing site, we have the opportunity to supply them. But right now, if you see this product globally also, it's only BMW-based platform.

So, BMW is one customer. VinFast is another customer. And we are also supplying this one to Geely, to China. But a major part of the production goes to BMW only. We don't directly identify customers and then go and promote this product. Because that responsibility today within ZF is with the global key accounts and product lines.

As such, I don't see a big change in the numbers in this approach in the next two or three years. But the good thing is, this product volume is growing. It's the last one year. This is one of the fast-growing products in our export portfolio. That is largely driven by the growth of that BMW platform. Because this is also applicable to EV and new energy vehicles as well.

So, from that perspective, in terms of number-wise, there will be a growth.

Nirali Gopani: Right sir, perfect. Sir, secondly, on this outsourcing opportunity, if I understand it correctly, currently, whatever we are manufacturing and selling is largely from WABCO's basket. So, by when should we start seeing newer products from ZF's basket that is outsourced to India for us to manufacture?

P Kaniappan: So, right now, the approach we are taking is to position ourselves as the best cost location and the most competitive production center. Whichever product we are able to do, we get that opportunity. So, if you see, there are a few product lines we are exporting like compressors are becoming more-and-more competitive. Air supply unit and actuators are another segments. And most recently, we have started supplying certain levers for the disc brakes. So, in all these things, we are only continuing to improve our competitive positioning. So, business is expected to grow in these segments.

In terms of new products, as such, we don't have immediate discussion on this in this direction. But I can give an example. For example, the electric compressors, if India becomes a globally competitive site, then we can actually propose India as a production center. But then, first we need to localize and make sure the product is globally competitive. That opportunity exists if we completely able to localize.

We have that opportunity and possibility. But again, globally, customers have to use this platform etc. But we are positioning ourselves in all those areas to be a manufacturing base for ZF. Right now, it's not a commitment, but that's the direction we are working. Also, we are now positioning ourselves as a production center for disc brakes for global requirements.

First, we need to become a successful player in India. With the India volume, if we are able to localize and make ourselves as a globally competitive site. With that price point, if ZF believes that they can expand their market share globally, then it becomes an automatic choice. So, that's the way we are working on a few products. As I said, e-compressor is one thing that we are now seriously focusing on localization and reducing the cost. Second, disc brake is a project that we have now started working on.

Moderator: The next question is from the line of Mr. Mukesh Saraf from Avendus Spark Institutional Equity. Please go ahead, sir.

Mukesh Saraf: Good afternoon and thank you for the opportunity. My first question is regarding the Oragadam facility. I think last time you had mentioned that around October we should start operations here. So, any update on that, sir?

P Kaniappan: The plant is ready now. So, we will be moving the facilities. We have already got a small earmarked space in Ambattur for some of the products, which was meant to be produced in Oragadam because the plant is ready only now. We will be moving there. We are also moving some of the machining lines from Ambattur. Plus, there are projects which are actually listed to be produced there. So, those facilities also will start coming. So, we are now ready to move the machines by the end of November. I think the SOP will start for some of the products.

Mukesh Saraf: Okay. So, in your initial remarks, you had mentioned about supplies to three plants now in China versus one plant earlier. You had also mentioned about 560cc and 440cc compressors. So, are these new export businesses that we have recently won? If so, have you already seen the full potential of these businesses? Because I am seeing that this quarter you have reported a very strong export. I mean, the highest-level export is INR320-odd crores. So, I just want to understand, what is the potential of these businesses that have already started for you, say, over the next six months, nine months?

P Kaniappan: Yes. On the qualitative side, I would like to highlight the DAF compressor. I must have actually made a mention saying that now we will start supplying compressors to DAF globally. You know, in the DAF, there are two aspects. One is the 560cc compressor, where the volume is increasing because DAF is probably gaining market share globally. So, that is one aspect.

Second, the other one, the 440 version of the compressor was actually produced from our US plant and supplied to DAF. Because of the cost advantage that we are able to provide, that also now ships to India, Chennai. This is only in the case of DAF.

In the case of lever, the production started about two years ago in a small way. First to a China location, one of the ZF plants in China. Now, this is again true because of the cost competitive product. So, they see more opportunities to be used in other sites. So, two more sites are also purchasing from us. These are all the projects that we were already working on in the last two to three years, but now more-and-more volumes are coming.

Mukesh Saraf: Right. So, then the potential of these, basically we have to still see the full potential of these in the numbers yet?

P Kaniappan: Yes, in the case of levers, we may see some more potential. I also told; this lever is required for the disc brakes. We are working to make India as one of the possible locations for global supplies. That's the project we are now working. Meaning, this lever already produced here, competitive plus India is a place where all the castings, forging, all those things. Disc brake has got lot of castings, forging, machining, etcetera.

So, globally also our colleagues want to evaluate competitiveness in Indian sites. So, we are now preparing and trying to push in that setting. So, with all that, I would see the opportunity in expanding further.

Mukesh Saraf: Sure. Thank you. And one question, I mean, on the outlook for commercial vehicles, I mean, you did mention about trailers doing better. But on the other hand, you mentioned mining was slightly, maybe seasonally. But how do we look at, say, the next one year for the MHCV industry, sir?

P Kaniappan: Yes, next one year, I would say, we look at very positively only. These are all very short-term issues. You know the monsoon and its impact on the mining. That's a one quarter type of scenario. And we have already got, from the customer indications, for the next three months or next five, six months, it's a very positive indication that has already come. We see a growth, at least up to March, I believe things will only in the positive direction. Expect some good growth.

On the export side, I feel there could be some temporary issues depending on the global scenarios and all that. Well, there are projects in which our demand will be increasing. Some of the regular volume, there could be some moderation in the next quarter or so. Otherwise, also, because of Christmas and the annual New Year, etcetera, there will be some delay. Some pick-ups will be delayed for one or three weeks and all that. So that's the normal phenomenon.

Mukesh Saraf: Sure. Understand. Just one last, if I may squeeze, on the margins. We've seen broadly margins remaining flat on a quarter-on-quarter, basically from the first quarter to the second quarter. So from here on, do you see any margin levers in terms of pricing, raw material cost, or say product mix? Any margin levers from here on?

P Kaniappan: Yes, Mukesh, what we are doing is, we are now looking at each sector. As I also mentioned, we are doing some portfolio management to review some of the products where we are not making a good margin. Particularly if it's a commodity product, we are trying to review our focus on those products. In some cases, we are trying to exceed.

The second is, we are actually also driving a major initiative globally to really see margin improvement and cost reduction. We are also playing a key role there. Last year mostly we were focused on getting the compensation for the commodity inflation. Then, we are now looking at, as I told you, portfolio management. Third is, looking at some of the bleeders and actually insisting that the customers have to compensate.

And also, after we do our homework in terms of cost reduction on the material side., I would only tell you, we are trying to keep improving, but also there is a limit in the industry. But we are trying to challenge the limits.

Moderator: Thank you. The next question is from the line of Mr. Vimal Jamnadas Gohil from Alchemy Capital Management Private Limited. Please go ahead, sir.

Vimal Gohil: Yes, thank you. Thank you for the opportunity, sir. Sir, my question on, actually I have two questions. One is on disc brakes. I probably misheard you, but you are talking of disc brakes as an export opportunity or domestic? And if it is domestic, what is the content per vehicle that you are looking at?

P Kaniappan: Yes. actually what is happening is, already we are supplying in a small way in the domestic market, disc brakes for electric vehicles. The electric vehicles need to be very efficient to conserve their energy and make sure that the battery size, capacity and the distance coverage, everything is optimized. So, already this is being sold and we have also localized a large part of those Components. Numbers are low, but we have been working on this and then localized.

we expect the market, even in this quarter, we may start selling some of our ADAS solutions. In a small way, Advanced Driver Assistance Solution. One of the major customers in India, we are already working with them and in our view, this project will take off. Again, the market should know, understand this, customers should understand this. The volume will be low initially, but there are fleets, who are basically the global fleets which are carrying ADAS's goods. Such fleets, it will start adopting this. There are very clear signals.

Then on the trailer segment, we see a lot of interest in this. So, when you want to put a vehicle with Advanced Driver Assisted Systems, which is essentially, you have a camera, radar and work to eliminate accidents, etc. Those vehicles need to have certain basic requirements. One of that is disc brake.

Not only disc brake, but it will also have an electronic braking system. So, EBS, ADAS systems and disc brake will be a combination. For those vehicles which will have this, Advanced Driver Assisted Systems, which overall we call it as ADAS vehicle. So, this is one topic. So, it will catch up. With or without regulation, now the market has to move to more efficient braking for multiple reasons.

And electronic stability control doesn't work very efficiently if you don't have a disc brake. An Advanced Driver Assisted System or an ADAS system or Advanced Emergency Braking etc., that doesn't efficiently work if you don't have a disc brake. So, we know the requirement of the likely trend in the industry. So, we are now working on to kick off the project. First, to Indian market and taking advantage, if you get the scale advantage, we will also position ourselves as a global manufacturing center.

Because in our view, most of these products are mechanical products. And, you know, castings, forging, machining, where India excels. So, that is the whole logic. Now on the value for vehicle, disc brake, roughly today, roughly about 20,000 in own wheel. So, if they go for two wheels, normally customers go for, today, nowadays they go for only the front axle. So, two wheels, so you talk about 40,000. If the customer chose to go for all the four wheels, then you got 80,000. So, this is the broad indication.

Vimal Jamnadas: Sir, thank you, thank you very much for that detailed answer, sir. So, just one follow up here. In the ADAS ecosystem, component ecosystem, we are supplying the electronic stability control, the disc brake, and if you could just mention what are the other components that we are supplying for the commercial vehicles, buses and trucks?

P Kaniappan: No, ADAS system is basically radar and camera.

Vimal Jamnadas: Are we supplying radar as well, sir?

P Kaniappan: Sorry, actually, in ADAS system today, we are supplying, we call it the collision mitigation. We expect some customers to launch soon, maybe in the next one or two months. There, the value per vehicle for ADAS itself is about INR60,000.

Then you have EBS in that vehicle, electronic braking system, that will come with another INR60,000, INR65,000. Then you have a disc brake, about INR40,000. So, this is the kind of content per vehicle for an ADAS system. But the question is, the volume will be low initially, and then but we expect that market to quickly recognize the value and move in that direction.

Vimal Jamnadas: Right, sir. Sir, one question on exports. So here in this particular quarter, you have done extremely well looking at the macroeconomic conditions. Almost 24% growth rate seems to be phenomenal. Just wanted to understand, do we see some weakness going forward, or given the fact that we have introduced newer products, we are now supplying to BMW and we have also expanded our client base. Do you expect the momentum to continue? Or do we expect macros to sort of take over and maybe second half could be a bit weak? How should we understand that? Thanks.

P Kaniappan: Normally, this quarter, the October-November quarter is a slightly weak quarter because there is an inventory correction. Because this is the year-end for our global plants. And there is strong pressure globally for ZF to manage the inventory. So, there will be some reduced pick-up. It is one thing in the near term.

And if you compare last year and this year, the transportation lead time has been significantly coming down in the global shipping. Even in the case of BMW and all that, now what used to take about 60 days or 45 days, for example, it comes down to probably 25 or 30 days now. So, that much reduction in the pick-up will happen.

Inventory correction, year-end, again normally the December January period, global location, there will be Christmas holidays and all those. So, I see some temporary. But otherwise, I don't see a big sale. As I told in earlier meetings also, we work on specific projects and we see only a continuous improvement. Some of the project will offset some of the traditional volume reduction. We don't see a significant reduction, but there could be short-term, very short-term challenges.

Vimal Jamnadas: Understood, sir. Thank you so much and all the best.

P Kaniappan: Thank you.

Moderator: Thank you. The next question is from the line of Mr. Lakshminarayanan from Tunga Share Investments Private Limited. Please go ahead, sir.

Lakshminarayanan: Yes. Thank you. Good afternoon, sir. Sir, couple of questions. When you started the year and where we are now, it's almost six months down. When you set out in terms of your projections, which specific areas positively surprised you? And which areas where we does the, things did not go as per plan? If I look into OEMs, second export, and the third, regulatory changes. If you look at these three angles, exports, OEMs, sales, and changes in regulations, where we were positively surprised when you started the year and where we are now, and where we didn’t anticipated things will do well, but it didn't pan out?

P Kaniappan: Yes. Thank you, Basically, on the positive surprise, if you ask me, there are two or three sectors are doing quite well now. Trailer segment is for us, is very positively surprising. Today, as we speak, we have almost 20% of the trucks that are produced are tractor trailers, which means trailer-based transportation is rapidly increasing. In that type of situation, we are gaining because we sell products for the truck and for the trailer.

For example, in the truck, we have ABS, and in the trailer, we have EBS. In the trailer segment, the government is facilitating or supporting the industry. If they have air suspension, then they can add an additional one ton per axle. So, all these things are promoting the air suspension solutions, and we are supporting for the air suspension solution. We are also supporting with lift axle.

The surprising thing is the trailer industry itself, which used to be a few years ago, even the basic braking system will not be in good shape. But the government brought ABS to be adopted to that industry. But we have come a long way. I would say more than 20% of the trailers are now with ABS. About 5% are now with EBS, Electronic Braking System. We never thought that industry will actually go for EBS and all that. And it is spontaneous adoption.

It's not because of the value they see. It's not by regulation or anything in the case of EBS but also, in terms of the margin also it is a good segment. And we see more opportunities now with few other technologies, like the trailer pulse. We use the trailer telematics, which is called trailer pulse.

We are also now selling the trailer pulse for many of the suppliers. You know, the recent times, there is also road train products. Some of the big OEMs like truck OEMs, they are also initiating a joint project with a few trailer companies. Road train project in which one prime mover will move two trailers. So, a lot of new things are happening in the industry.

And we are supporting that industry with all that one solution. So, this is one positive, I would say very positive change that is happening in the industry. Also, it will become very safe. Transportation also will become safe. Now, there are new players are coming into the bus segment. Some of them from Chinese orientation.

Also, there are some Indian players like JBM. There are again very new players in the EV domain. Today, the volumes are low in some of them. But many of them have an aspiration to become a global production center. And again, we are very well connected with all of them. And then we are providing all the solutions. Today, in terms of numbers, maybe 40 vehicle sets per month. All put together.

But those companies who came with even a Chinese supply system. There is a need to have a local value addition. So, we see more of them being supported by us. So, there are lot of changes in these two sectors in the last one year. We did not anticipate that the market will go to this level. And more particularly, some of these players are not producing for Indian market. They are producing for global.

And then there are also aspirational India type of initiatives. So, we are partnering with all of them. In terms of what did not go well, I would say the adoption of the ESC is not up to the level we expected. There will be a gap in the implementation. Because the segment itself is very low. But within that, there are some loopholes or whatever. So, there we need to work. I believe we need to work with all of them. Because finally, they also have to see the value. So, our focus is to work with value and show the value. With which we will be able to convince them.

Lakshminarayanan: Thank you so much. What about the export side? Like how are things shaping on the export side? We have done very well. Is this something which we planned for? How are things there?

P Kaniappan: Export actually we planned more. There is some recent about inventory correction, that is temporarily reducing the actual take- off. We planned everything and it started very well at the beginning, and it continues. As I said, there could be a temporary correction in next two-three months. Global supply chains are becoming more efficient. And some holidays and all that. But otherwise, export is probably in line with our plans.

Lakshminarayanan: Regarding the replacement demand for the industry, MSDs, -- Because what I hear is that there is a movement towards higher tonnage. And there is also a movement of replacing old vehicles. So, is that playing out for the industry? I just want to hear your view.

P Kaniappan: Yes. One thing what we understood is, we know that the utilization of the truck has been very much increasing. As I said, it is in the range of 70% above. At this level, people will start replacing and also add more trucks. This will also lead to more aftermarket sales as well. And second, if you see, after the increased axle load that was in the year 2018 and all that, in any case, the size of the trucks have increased.

Mostly now, more and more heavy-duty segments are produced and the industry itself has moved towards higher tonnage transportation. Also, more trailers, as I said, between 15% to 20%. Most recently, I am told, that the industry is working to 35,000 per month. So, 7,000 trailers are being produced. So, about 20% tractor trailers.

All these things mean that there is a huge freight to carry. And then, utilization is also 70%, which means the industry with these new vehicles, higher tonnage transportation, etcetera, all those things, with the tractor trailer also, very efficient way of transporting, making the fleets, I believe, more profitable. So I expect the growth to continue.

We had an opportunity to talk to some of our customers. The growth will only continue. And the growth is in the higher segment. Now, If you see the full year, the growth is not in the light and medium duty type of area. It is largely in the heavy-duty segment only. Also, , tractor trailers, tippers, etcetera.

This trend, as I told you, the data indicates that it will only continue. But that's what we see from the indications from the customers. They all indicated the next few months, at least next three months, the production projections have been very positive. So, we are all gearing up to meet that increased demand.

Lakshminarayanan: Thank you so much, sir. Thank you.

Moderator: Thank you. Ladies and gentlemen, due to time constraints, we have the last question from the line of Mr. Bharat from Quest Investment Advisors, Pvt. Ltd. Please go ahead.

Bharat Sheth: Hi, sir. Thanks for the opportunity. Can you give a little more color from a medium-term perspective? How much total capex will require, the kind of opportunity that we are seeing, and when, say, this year as well as next two years, and how do we see with the export opening up more and more, so our mix of the revenue between domestic and export?

P Kaniappan: The actual numbers, I will request our CFO to give you his own perspective. But in terms of the industry itself, as we see, it is going to grow. At least in the near term, it's very clear. Because the impact of the election and how that will pan out is something that we need to look at.

Otherwise, we are clear, so we are going ahead with expanding our own production capacity and I told that our Oragadam site is now getting ready, so we are now moving, this month we'll be moving some of the facilities and start SOP there. And as far as export is concerned, I said we will be steadily growing. With product export or service export, we've been steadily growing. Again, there are some geopolitical issues.

On its impact, we don't know the exact estimation of what is going to happen, but if you see the last year and one year before also, despite all the geopolitical problems, we were projected to keep growing. Because the industry did not, at least Europe and US, there was not a big reduction in the commercial vehicle transportation in those two years also.

Next, the future years, how it will happen is a question mark, because of these wars and everything that is happening. But we are getting ready with our capacities, we are moving ahead with our new projects in the export area, because our growth is largely driven by offering a solution for our global organizations to expand their sales with our cost structure. So, I don't think there is going to be a big slowdown or something, but we have to keep a watch.

Bharat Sheth: Sir, apart from localization, which other strategies do we have to improve the margin and how much operating leverage, we have as on today?

P Kaniappan: Actually, ours is a continuous improvement company with a continuous improvement culture. Because we are a TPM company, we started, we are the first to get a Deming prize, then we have Sundaram-Clayton, etcetera. So here the issue is, we are always looking at opportunities to improve our margin.

And this time, as I said, we are looking at three areas. One is, how do we make sure that our products, if they are bleeding anywhere, if in any of the portfolio we are not achieving the required margin, then we are reviewing those things, working with the customers, trying to reset our prices. That is one aspect. This is after securing the compensation for the commodities, which was the issue last year.

The second is, we are now looking at all our purchasing, metal purchasing and then trying to put a team to drive a cost down in the purchasing system. In that, one of that is localization. We are also looking at regional, transfer from, let's say, southern, south-based suppliers. We used to buy from south-based suppliers to even our Jamshedpur plant. But we see Jamshedpur is more, nowadays it's also maturing.

Our volume also has reached a very good level in Jamshedpur. So we are trying to localize, regionalize the purchasing there. So the purchase, produce, that's back to the customer and the customers is there. Trying to export, improve our upper market business to make sure that, we get the best, we reach out to all the customers and make sure aftermarket sales also grows.

And then, in the materials area, we also have a concept of designing, redesigning the products to cost. So we redesign the products where we feel we are not competitive. We are competitive, we are not making money, we also constantly re-engineer, redesign the products. There's a separate team working on this.

Also, the sourcing, resourcing, sourcing to another supplier, all that there are many traditional processes also we use. Some area we are also trying to insource some parts. So multiple ways by which, the purchasing is trying to become more efficient. The last one is essentially to make sure that our SG&A cost also is, optimized or reduced.

So as we grow the sales, we make sure that fixed cost is also staying. control is also affected. By and large, we make sure that we don't proportionately increase our fixed cost. Also, all the factories we are trying to become more efficient. We are continuously reducing the conversion cost, manufacturing cost as well.

But all these things are also possible because your top line is growing. It also supports those initiatives. This is at a very broad level. On your question on the budget, maybe I'll request CFO to give you an idea. Yes, you had another question? You had one to ask.

Bharat Sheth: Yes, so what kind of EBITDA margin that we have, targeted over the next two years, three years?

R S Rajagopal Sastry: If you see right now, on the sale of products, we have reached about 19%. And aspirationally, we are looking at reaching our previous best of 20%. So that's what we are targeting in the immediate future. And that's what you'll see that even on a sequential basis, we had a half a percent expansion on margin. So we will be continuing to work towards these lines.

And all the initiatives which the managing director spoke about in terms of addressing the cost, looking at all those products which are currently not contributing as much as certain other products or a benchmark contribution. We are looking at how do we do right from, at the minimum level, we look at the cost, try to reset the prices based on the market status, and also look at exiting if we have to do that. So overall, those are the areas we are looking at.

And from, when you have to address cost, we are looking at right from the element of what is the part cost at which we are sourcing? Are we sourcing at the right price? Does it make sense to insourcing it? Are there costs which are not value-adding like too much of transportation from a geographic footprint perspective? Is the part traveling too much?

So we are looking, also combining it with our ESG responsibilities to see how do we reduce the carbon footprint also that we don't transfer the products too much. In every which way, we are trying to see how do we address this cost. And this is how we want to reach an immediate target from the EBITDA perspective and look at expanding going forward with better value-add and as the new products come in and as we also do the localization, we should see this trend to continue.

Bharat Sheth: Great. And sir, capex side, if you can give some color?

R S Rajagopal Sastry: So the capex side, as you know, we will be capitalizing this Oragadam plant this year. That's about INR80 crores. And there's a lot of equipment, which goes into and which is all coming to capitalization next year. All this will be enhancing the capacities in some of the products which we currently are exporting and certain other products which we are insourcing.

And some products which are currently in the e-mobility and also the electronic stability control and certain other products which need a lot of localizations as the volumes pick up. So all those things would be in the normal capex plans. We have a normal run rate of about INR100 crores.

This year and next year we would see INR150 crores to INR170 crores because of the capitalization of the plant and also the equipment which goes into it. Then we may fall back to the same routine. So we would be not too capital intensive, but at the same time, we will ensure that our capacities are adequate to meet the demand.

Bharat Sheth: And for new product, do we have to spend a little more capex to grow and in case of improvement in the market, so in that case?

R S Rajagopal Sastry: If we are seeing that some of these technologies which are coming in, like the technologies for the e-mobility and certain electronic stability control, as we see bigger volumes, we may have to localize them rapidly and localization would need investments in terms of vendor developments, tooling, some machinery.

They would need them and they are all business plans, which have been well drafted with their returns and proper hurdle rates, which are they made for the investments. And we are ready to put them into action as and when the volumes require those.

Bharat Sheth: Thank you and all the best, sir. Thank you.

R S Rajagopal Sastry: Thank you.

Moderator: Thank you. I now hand the conference over to the management for closing remarks.

P Kaniappan: I would like to take the opportunity to thank all of you. Many of the questions were very interesting and very useful. So thank you very much.

Moderator: Thank you, sir. On behalf of B&K Securities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.