



"ZF Commercial Vehicle Control Systems India Limited Q4 FY22 Post-Results Conference Call"

May 23, 2022



Management: Mr. P. Kaniappan – Managing Director, ZF Commercial Vehicle Control Systems India Limited
Mr. R. S. Rajagopal Sastry - Chief Financial Officer, ZF Commercial Vehicle Control Systems India Limited

Moderator: Mr. Annamalai Jayaraj – Batlivala & Karani Securities



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Moderator: Ladies and gentlemen, good day and welcome to ZF Commercial Vehicle Control Systems India Limited 4Q FY22 Post-Results Conference Call hosted by Batlivala & Karani 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 '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Annamalai Jayaraj from Batlivala & Karani Securities India Private Limited. Thank you and over to you, sir.

Annamalai Jayaraj: Thank you. On behalf of B&K Securities, welcome to the 4Q and FY22 Post Results Conference Call of ZF Commercial Vehicle Control Systems India Limited, formerly WABCO India Limited. From the management side, we have Mr. P. Kaniappan - Managing Director; Mr. R. S. Rajagopal Sastry - Chief Financial Officer.

Certain forward-looking statements that we'll make today are based on management's good faith expectations and beliefs concerning future developments. As you know, actual results may differ materially from these expectations as a result of many factors.

ZF Commercial Vehicle Control Systems India Limited's results for the quarter ending March 31, 2022, and the annual performance for FY 2021-22 were published on May 20, 2022. They are available on the website www.zf.com under the ZF CV India investor relations section. We hope that you have had an opportunity to go through them.

A transcript & recorded audio of this call will also be made available on the website www.zf.com under the ZF CV India investor relations section.

I will now hand over the call to Mr. Kaniappan for the opening remarks to be followed by question-and-answer session. Over to you, sir.

P. Kaniappan: Thank you, Mr. Jayaraj. I warmly welcome you all to ZF Commercial Vehicle Control System India Limited's fourth quarter results and annual performance for the financial year 2021-22. Let me begin with the business update.

Industry and economic updates,

I would like to start by talking about few key macroeconomic aspects relevant to our industry and GDP growth. The government's thrust on capital expenditure coupled with initiatives such as the Production Linked Incentive, PLI scheme should bolster private investment activity amidst improving capacity utilization, deleveraged corporate balance sheet, higher offtake of bank credit and favorable financial condition. The manufacturing purchase manager's index was 54.0 in March 2022 compared to 55.4 in March 2021. Based on data provided by the NSO on the supply side gross value-added rose by 8.3% in 21-22 with its major elements including services exceeding pre-pandemic level. Sector wise, agriculture has remained a silver lining while contract-based services, manufacturing, construction were hit hardest and have been recovering steadily. The government has announced several fiscal measures to incentivize capital formation, attract foreign investment and create employment. The Reserve Bank of India has also stepped in to provide adequate liquidity.



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Indian economic growth is estimated at 8.6% in FY21-22 (Source: national statistical organization and 7.2% in FY22-23. The GDP growth estimate for FY22-23 is 7.3% down from 7.8%, (source: latest estimate released by S&P) in view of the global geopolitical situation arising from the Russia-Ukraine conflict and elevated global commodity prices.

Commercial Vehicle (CV) sales are directly linked to economic activities in the country. While global automotive industry demand largely recovered from the COVID-19 pandemic, severe pressure from ongoing semiconductor shortages, the Russia-Ukraine conflict and raw material inflation hampered growth. The Indian commercial vehicle sector saw growth of 55% over the previous year due to market recovery from COVID-19 and growth led by infrastructure projects and last mile connectivity for the growing e- commerce business. At this stage, FY23 demand looks promising due to the healthy growth indicators from segments like construction, infrastructure and logistics. Demand is expected to improve in the near-term due to the phased introduction of the vehicle scrappage policy. Growth in the CV segment is expected through rising vehicle demand, albeit against a background of raw material inflation and ongoing semiconductor shortages.

Here are some of the trends that will drive demand for commercial vehicles

- e-commerce will boost retail sales with approximately 25% of new sales expected via online channels,
- Connectivity and digitalization will open new opportunities and avenues for industry,
- New business models such as freight aggregators will create demand for commercial vehicles,
- The vehicle scrappage policy for Government vehicles and re-opening of schools and offices post COVID-19 will also help revive the bus market.

With the implementation of GST, the increase in mega fleets is a possibility, creating a demand for sophisticated and technologically advanced commercial vehicles. A well thought out vehicle scrappage policy with attractive incentives will help spur demand for commercial vehicles in the short term. The increasing adoption of digital connectivity solutions will also make fleets increasingly safer, more efficient and helps lower the Total Cost of Ownership.

The Government of India's FAME-II scheme has led to an increase in the adoption of electric buses in the country. Appropriate policies and intervention from the Government to support State Transport Undertakings in procuring buses with alternate fuels like CNG, biofuel, electric etc., would also lead to further demand for commercial vehicles.



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The production cycle will increase in the coming years as a result of export markets seeking budget trucks that are compliant with global emission standards and quality norms. The commercial vehicle industry is likely to sustain this growth for the next 2 to 3 years. Demand, particularly medium- and heavy-duty commercial vehicles, is likely to also benefit from the various government initiatives to help revive the economy.

Now I would like to share insights on the specific initiatives undertaken during the last quarter.

OEM:

The company is making progress in being a player of significance in the e mobility arena. We secured sizeable orders for delivering the electric compressors from major electric bus manufacturers and have commenced deliveries. We are jointly working with various OEM's to upgrade the braking system to regenerating braking system (EBS) in electric vehicles to improve the regeneration efficiency.

This is also the right time to make it known to you that we are selected as one of the component champions in the auto PLI. As we see stability in the demand for the products in our pipeline for e mobility, we will improve the local content so that we can offer high quality products at competitive prices.

Further as the regulation that commercial vehicles should be equipped with electronic stability controls is soon expected to be implemented in buses from April 2023, the company has secured nominations from major customers to be a vendor for the said solution. In addition, the company successfully demonstrated its capabilities and progress in developing the Autonomous Driver Assistance Systems to some key players in the industry.

Aftermarket:

The Indian aftermarket grew by 25% (As per ACMA Report) whereas ZF Commercial Vehicle Control Systems India Limited registered 28.6% growth in FY 21-22 Vs FY 20-21. Our aftermarket sales are largely driven by the "Solution Provider" approach. We grew our reach within the country by adding new national and regional distributors in 2021-22 through project compass. This has helped us in growing our sales and in new product introduction into the market.

The company has launched a customer center as part of a successful e-commerce and retail connect program. A WABCO reward scheme was also launched via the customer center for retailers and mechanics for certain select products. We've also had significant orders for our ABS retrofit kits and Trailer Pulse, which helped the AM growth story for Q4'21-22.



Export:

Export growth was flat in the quarter due to the shortages of semiconductor components as well as sea freight delays due to COVID lockdowns in China with even container availability still at a critical level. The freight rates have increased fivefold in certain sectors. We are planning to expand capacity for some product lines including Car compressor, air compressor assembly, automatic slack adjusters and spring brake actuator.

Commodities:

The greatest single impact on the industry and our company has been the commodity price inflation. Between the same quarter of the previous year, vs the current quarter, Aluminum is 55.5% more expensive, hot rolled steel cost rose by 30.9%, cold rolled steel was up 21.7%, pig iron by 23.4% and copper by 19.4%. This had a significant impact on our material costs although we have worked very closely with our customers and secured partial compensation to help offset this impact. We are implementing multiple initiatives, including seeking further compensation from customers, driving productivity initiatives in the supply chain and factories, increasing localization, and redesigning some products to cost.

Exchange Rates:

The company has significant export content, and our standard reporting currency is Euros. The quarter began with a euro of INR 85.22 on the 1st of January to 84.01 on the 31st of March 2022. As of 30th April, the euro has further depreciated to INR 82.57. This had an impact on our results because of the mark to market of forex denominated assets and liabilities.

The global commercial vehicle market continues to feel the impact of semiconductor shortages. We are working with our global supply chains to move carefully, with agility, to protect the interests of our customers and business.

Integration and Expansion:

As CVS India, our vision is to help shape the future of commercial transport systems in India. By leveraging synergies across the ZF group, we are uniquely positioned to offer the next generation of solutions and services for commercial vehicles and fleets in India and world-wide. Our support will play a key role in making them more efficient, safer, connected, intelligent and automated. Under the umbrella of ZF's strategic vision for 'Next Generation Mobility', we will leverage our capability to innovate, integrate and advance CV vehicle controls systems and set the pace to address the challenges of the commercial transportation industry in India. By mobilizing commercial vehicle intelligence, we will powerfully contribute to the 'Next Generation Mobility' corporate strategy.



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As we informed you in our last Earnings Call, the name of the Company has changed to ZF Commercial Vehicle Control Systems India Limited. This took effect in March 2022 with shares in the Company trading under the new name since April 2022. The new trading ticker symbol is “ZFCVINDIA”.

Our expansion project at Oragadam is going through the ZF Group approval process. While we have commenced the activities pertaining to land development, we expect the construction to commence during the end of Q2 or beginning of Q3. We will invest approximately 150 crores within the next two years on the expansion, including plant and machinery.

Pursuant to the application made under the Production Linked Incentive (PLI) Scheme for the Auto Sector, the company has been selected as an eligible auto component manufacturer to receive benefits from the scheme. The PLI scheme will enable the company to claim incentives on incremental sales achieved on the manufacture of specified Advance Automotive Technology products over a period of five years, beginning FY 2022-23.

Corporate social responsibility outreach:

At ZF Commercial Vehicle Control Systems India Limited, we strive to be a responsible corporate citizen and make a positive difference through our Corporate Social Responsibility initiatives. Our CSR initiatives are based on four tenets -- improving road safety, enhancing the quality of life of neighboring communities, contributing towards environmental sustainability and upgrading skills.

Over the years, our contribution towards society has touched thousands of lives in several ways and benefitted a wide range of stakeholders. The scope of our initiatives has now been expanded to make a positive difference to even more of our stakeholders.

Our road safety initiatives align with ZF’s vision of ‘Zero Accidents & Zero emission’ and the Government of India’s ‘Vision Zero’ initiative that addresses challenges around road traffic fatalities. Through the structured road safety initiatives, 43 Programs were conducted in the year. We rolled out vehicle check camps and around 2,000 vehicles have been safety checked so far.

Holistic community development encompasses a spectrum of initiatives ranging from access to quality healthcare to infrastructure upgrading. We continued to proactively support hospitals during the pandemic to upgrade their infrastructure and provide essentials as well as critical care equipment. We contributed significantly towards helping alleviate the oxygen shortages experienced during the pandemic by supplying O2 concentrators and setting up O2 generation plants.

The company contributed Rs 50 lakhs towards a free vaccine drive to support Greater Chennai Corporation. To provide access to quality healthcare for people from disadvantaged backgrounds, several upgrading projects are under way at community hospitals. The team at



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Jamshedpur organized a blood donation camp where our employees actively participated. We also supported the Assam State Transport Corporation with hand-operated sanitizer kits.

In pursuit of our sustainability goals, we upgraded solar streetlights at Ambattur Industrial Estate.

Digitalization plays a crucial role in upskilling youngsters and increasing the employment rate in India. On that note, we have made significant strides in setting up Centers of Excellence in educational institutions and have trained around 1400 students across niche areas such as IoT, Smart Factory and Industry 4.0 to make them future ready.

Awards and Recognition:

ZF Commercial Vehicle Control Systems India Limited won the “Supplier SAMRAT Award” and “INNOVISTA” award from major customers as well Best Supplier award for Technology Innovation. Our Ambattur plant was also nominated for the Global Kaizen award through the Integrated Manufacturing Excellence Initiative (ImexI):

- One of 6 finalists globally and the only company nominated from India having secured a platinum medallion
- Jamshedpur site also underwent the ImexI assessment and secured the silver medallion

Ambattur plant won a silver award (5 star) and Mahindra city plant won a bronze award (4 star) in the CII EHS Excellence awards.

ZF Commercial Vehicle Control Systems India Limited, MWC unit has been chosen for Export Excellence Award for our export performances in FY 2016-17 (2nd position) and FY 2017-18 (1st position)

Our employees continued to demonstrate high levels of engagement and participated in various external TEI conclaves, winning numerous awards across several categories in the fourth quarter of the fiscal. I am happy to share that, in this quarter, our teams won a total of 10 awards both at national and regional level in the various competitions organized by the CII, ACMA and QCFL.

Now, moving onto our financial performance of the quarter:

For your ready reference, the results were made public at 6:00PM on 20th of May 2022. I hope you have had a chance to go through them.



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The commercial vehicle production in the country grew by 6.7% over the same quarter in the previous year and 40.9% for the full year 2021-22, over 2020-21. We outperformed by 6.4% this quarter. Our sales thus to OEMs in this quarter is 365.5 Crores. This is 13.1% higher than the prior corresponding quarter. We also closed the year with sales to OEMs at INR 1031.1 crores, which is 50.6% higher than the previous year.

Overall strength in demand ensured that our aftermarket sales were up 8% QoQ to 101.2 Crores and YoY up by 28.6% to 334 Crores.

Exports resulted in an Income of 247.3 Crores in Q4 of FY 2021-22 and YoY 30.8% growth with 944.3 Crores.

Our engineering and other services continue to provide very strong value to our customers in the group. The growth in service income is a very healthy 35.3% QoQ and 23.8% YoY.

While I have shared the good news on our top line, I must be clear that the current period is very challenging from a profitability perspective. Overall, we have achieved a profit before tax of Rs.76.72 crores in this quarter and Rs.195.74 crores for the FY 2021-22. Our FY 2021-22 PBT is 8.5% of product sales. Our EBITDA for this quarter is 13.6% and for the year 2021-22 is 12.6%.

We continue to carefully review the environment and our performance to consider further opportunities for actions to mitigate ongoing commodity inflation. This is important as we also see softening of the commodity prices going forward.

Thank you. We now welcome your questions.

- Moderator:** Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Vimal Gohil from Union AMC. Please go ahead.
- Vimal Gohil:** Sir, just one clarification, if you could just highlight your domestic aftermarket business once again, I missed that number, the revenues?
- P. Kaniappan:** For the full year or?
- Vimal Gohil:** For the quarter, sir?
- P. Kaniappan:** Rs. 101.2 crores.
- Vimal Gohil:** Sir, just on the performance that you consider, when you say that this industry has grown by 6%, the data that I have in front of me which consider the whole MHCV industry that has grown by roughly 12.8, very close to 13%, so when you say the industry has grown at 6%, are you considering tonnages over and above 13 tons or how is it?



- P. Kaniappan:** We always refer the air brake vehicle production, so it is largely MHCV plus part of the light duty segments which is with Air brake.
- Vimal Gohil:** But sir, over a period of time, your addressable market will go up, right, you will cater to other segments as well, going forward as and when you introduce newer products?
- P. Kaniappan:** Yes, the braking systems as such is now moving to, as the industry is moving towards electric mobility, we see opportunities to really provide high value content products like the electric compressors. We are working with customers to really move from ABS based braking system to electronic braking system, it is much more intelligent and closed-loop solution which will be much more efficient. Also, the industry will move towards electronic stability control which will come as a mandate. Further, we expect the autonomous emergency braking, many features of that also will come in the industry, partly through regulations, partly through TCO, total cost of ownership.
- Vimal Gohil:** Which means that over a period of time, you will cater to most of the other segments, not only the air brake using segments, some of the others, the tonnages that you are not considering right now, that will also come under your ambit going forward?
- P. Kaniappan:** But largely, our technologies are only related to air brakes, so the vehicle segment itself may not change very much except in areas like aftermarket where we have now solutions that we can offer through the connectivity technologies which can be extended to other segments, but there again we still are focusing on the air brakes, but then the opportunity there is wider.
- Vimal Gohil:** Sir, in the exports, what is the outlook here, we are seeing, what we are seeing in the US and Europe and when you look at the Class 8 production data, how do we look at this segment, we are putting up capacity as well in Chennai, so do we see FY23 as a year of recovery or are you seeing some recovery some wide away in exports?
- P. Kaniappan:** So, exports we are currently serving the CV industry, we are also serving to the passenger car industry. We supply one product for the passenger car industry to BMW and similar vehicle platforms. Essentially, the product that we supply for the air suspension system in those cars, that segment is growing despite all these global challenges. Today, even now it is growing, and we see a good growth in that segment. In terms of other product lines that we supply, if you look at compressors, we are producing in Mahindra City to global customers. The customers are expanding. What we started with one customer, now we are expanding the customer base, more customers are sourcing from us and there is another product which we make that is actuators, brake chambers, type of products where we are gaining global market share. So, that also is expanding. So, I see a positive growth, whatever is a temporary phenomenon, in our view it is temporary, but we have clear road map to grow in these products and we have also launched a new product, automatic slack adjuster, again there is a huge global market available. We have started increasing our supply, so opportunities are there for us to grow.
- Vimal Gohil:** Sir, what was the name of the last product you just name, automatic?



- P. Kaniappan:** Automatic slack adjuster.
- Vimal Gohil:** So, this product is from ZF's table or this was indigenously developed by WABCO entity?
- P. Kaniappan:** It is a locally developed product, so we also supply to some segment in India, but we see a good margin in global market, so we are expanding to global.
- Vimal Gohil:** Sir, lastly, I just have one question on margins, considering the raw material cost and freight cost, as and when this normalize, do you see your operating margin reverting back to 15% over the longer term?
- P. Kaniappan:** That is the plan. That is the target with which we are working. We are taking many initiatives, one is of course, trying to recover the commodity inflation from the customers, which is steadily improving from what it was a year ago, but now in terms of percentage we have improved our compensation from the customers. We are also rapidly localizing product that we use to import plus few products we are also redesigning to reduce the cost. Plus of course the factory and the supply chain productivities also is the key topic which we have been working, so we have clear road map to really regain our earlier position subject to any further uncertainties etc., but we are clear, we have clear actions.
- Moderator:** Thank you. The next question is from the line of Jinal Sheth from Awriga Capital Advisors. Please go ahead.
- Jinal Sheth:** Sir, in terms of competition, we had Knorr-Bremse which is present in the core business, but in last few years, obviously we have been talking about new product introduction and obviously today and tomorrow in terms of how the industry evolves is more a serious player, any other players that have come in and or could be any threat in that sense, just wanted to understand the changing industry landscape there?
- P. Kaniappan:** Yes, competition in our view, we cannot discount the fact that the new competition can come because many of the future technologies will be driven by software-based solution, so new players can enter, but the advantage that we have is the global support in the areas of like the functional safety and the data security or cyber security type of, certain dimension is very difficult for new players to address, we have certain competitive position and competitive advantage. In terms of the technological strength, I am not discounting that the new players cannot do that, but the point is that the advantage that we have to scale that we are able to leverage globally, also new product in the area of advanced driver assistance, etc., but you need a scale. We are trying to leverage the global scale with us in terms of manufacturing radar or a camera or such sensors such thing. Also, in India market, you also need to have strong presence in the aftermarket to be a successful in the OE business. Likewise, there are a few differentiations that we have created over the years, further strengthening those differentiation with our new parent ZF, one of the top 3 global players you always leverage on the scale and the competencies that are available globally. While we are constantly monitoring the competitive positioning, we are also strengthening our differentiation further.



- Jinal Sheth:** Sir, with all these points that you mentioned, currently there is no serious peer or player that is focusing in all these areas, is it?
- P. Kaniappan:** No, if you look at braking, it may be so, but if you look at connected solutions, we also want to play a key role in the connected solutions. We are partnering with one of the OEMs and are providing the connected solutions support. Also, the entire aftermarket vehicle parts, we have got 30 lakhs vehicles on road, you can all make them connected and offer solutions. That is why it is very wide. In those areas, anybody with the software competency or an electronic hardware design capability can supply, the large player is there, but the point again the market will more and more move towards the high technology areas in the field of digital. While there could be competition, but the way we are positioning ourselves is to play again a lead role. We have set up a global engineering center in Bangalore for developing digital solutions, capabilities on data analytics, all those competencies we are building there, not only for India, but also for global. It is a very robust engineering release processes, defined solutions etc., which is the strength that we have versus any other small player, but I believe as the industry moves to the next technology level, it started with the track and trace. Anybody who can actually put a track and trace system, initially started into the business, but today you need to have the over-the-air update capability which soon we will be launching. We also have a global platform, so we come with the global platform, which is developed for the global requirement, so we have now released it in India. So, these types of global support, global capabilities, technology evolution is something that will differentiate us. Again, offering those solutions to the market at the price in the market accept, so while it won't discount new players, but we are also strengthening our position. That is what I would say.
- Jinal Sheth:** And just lastly, when are you expecting the new facility for the exports to come up?
- P. Kaniappan:** Right now, we are doing the land development. We expect the investment approval to come in a matter of next 1 or 2 months, so we expect next year by this time the site will be ready, around the time. Of course, our planned time is August 2023.
- Jinal Sheth:** And lastly, do we expect a strong pickup in export once this facility is ready to go?
- P. Kaniappan:** Yes, that will help, but we are not stopping. Actually, the current facilities will support. We expect the growth to continue, but that facility will actually more than export, it will support to the domestic market also because that has been approved for the PLI, Production Linked Incentive, so some of the advanced product that is included in the PLI, we will be making there to get both in terms of tax benefit also in terms of the PLI benefit.
- Moderator:** Thank you. The next question is from the line of Priya Ranjan from HDFC Mutual Fund. Please go ahead.
- Priya Ranjan:** My question is related to, most of your products are related to the braking systems and if I include all the braking systems, say ABS, disk brakes and the electronic stability control ESC etc., so what kind of the content a truck can really have in India if all the systems is actually taken from



you and depending on the Indian cost, there might be global cost, but Indian cost will be obviously much lower than the global cost?

P. Kaniappan: You can probably turn, today it is in the range of around Rs. 45,000, you can probably assume it can be three times than this. Globally, it is still higher, but all these technologies that we have, it is adapted and applied with OEM, so we can go up to, I would say, three times up there, which is roughly about 1500 Euro, but again there are many exceptions but that is kind of numbers that one can expect when the industry matures and applies to all these technologies.

Moderator: Thank you. The next question is from the line of Shyam Sundar Sriram from Sundaram Mutual Fund. Please go ahead.

Shyam Sundar Sriram: Sir, in a EV bus considering that you will be supplying electric compressor and the ABS per se, how much is the content approximately, just on a ballpark range in an EV bus that is the first question? Secondly, as we stand today, what is the kind of market share we have in EV buses within India, I understand this segment is very nascent, but just to give a sense of who are the other competitors because in the traditional braking system, we were the dominant players for this, so how does it look like in the EV bus from a market share perspective?

P. Kaniappan: Actually, the e-compressor, electric compressor, roughly it is in the range of, I would say, \$1000 to \$1300 depending upon the different variant. That is the current content. The electronic braking system again it is a matter of, customers have adapted in all the EV, but that is not the current situation. Few customers have adapted, few customers were still trying to operate with the ABS based solutions. So, if people adapt, then it can add another possibly about Euro 400 delta to the braking system itself, but again as you also said that the size of the market is very small today, but the good thing is that we have very proven products and we have started delivering some of these products already. Other products will come in this sector. Anything that will improve the efficiency of the vehicle will find the place in the electric vehicle because you need to save the battery power. We have tyre pressure monitoring system which again will help improve the efficiency of the vehicle. Disk brake will improve the efficiency of the vehicle. So, all these things are being adapted by the customers, not all, but few customers have started adapting and our focus is to make sure all these products find a place. Now coming to your question of what is the market share etc., see again it is a too early stage and in the electric domain, nobody knows who will be there, who will not be there, but we are in a very strong position, I don't want to actually give any number, but we are in a very strong position in all these products, because these are all either demonstrated successfully, demonstrated and proven elsewhere in the world and that advantage we have because some of these products are in the series production.

Shyam Sundar Sriram: And these are all localized sir, what we supply, the electric compressor for the EVS, is that localized, or will that take time given the volumes are still picking up?

P. Kaniappan: Some of the products like disk brake we have localized because we will be adapting that for even the normal braking vehicle, and the other products not localized, but we will be meeting



the localization requirements because OEMs demand certain percentage localization, so we are adapting to that.

Shyam Sundar Sriram: Sir, under PLI, you did talk about that we are also where we have been selected as one of the component champion, many congratulations on that sir, what kind of product aggregates are we targeting in the PLI and how much investments are earmarked under PLI per se?

P. Kaniappan: Of course, I will talk to you on the products, Raja will actually give you some idea of the investment because in PLI you need certain minimum threshold investment to be done. So, as far as the products are concerned, are these are advanced products, basically anything on electric vehicle, at a very broad perspective, anything on advanced braking system like electronic braking system, ADAS, etc., and also the connected vehicles and new vehicle, the digital solutions, those products, mostly electronic, the ECU based electronic control units, etc., at a very broader level, but we have clearly included quite a few of our products in the PLI scheme. So, Raja, would you like to take the question on the investment requirements and other plans?

R. S. Rajagopal Sastry: At this point of time Shyam is that we are looking at all the different categories of products, if we must put it in categories, there is one category which is already in the advanced automotive listing of the PLI. We have some products already as part of it and they are already in a strategic plan and the recent investment already planned for those and beyond that we have some products which we have made a special representation, because predominantly the list was made looking at the passenger car segment and given that some of these products very strongly qualified, some of the products which we had recommended qualified to be as advanced automotive, if you look at it from the perspective of commercial vehicles, they are also, government said that they are considering them. The third category is the electric side. In all this, we are formulating our plans both from the investment and also planning our sales based on the evolving scenario, you would appreciate that quite a few of the products which I have put in the list belong to those areas of industry where the government itself is expecting an evolution and they are in their nascent stages. So, we do have plans and we are making plans first to somehow exceed the threshold limits of Rs. 150 crores of investment within the period and also ensure that we have significant sale which is a 10% growth over the base year, so as and when we have more firm plans and we are clear that this is the direction we will go, we will be giving this information to you all so that you are understanding our plans going forward.

Shyam Sundar Sriram: Sir, just one additional question on this, how CAPEX are we planning over next 2 years, that Rs. 150 crores Oragadam CAPEX that you already spoke about, other than that how much CAPEX are we planning at ZF Commercial Vehicle Control Systems India Limited sir?

R. S. Rajagopal Sastry: At the ZF Commercial Vehicle Control Systems India Limited level, our run rate has always been Rs. 100 crores of normal CAPEX and if you remember the last year, also have invested on the plant, the site about Rs. 75 crores, so it took us all the way to Rs. 175 crores and the Oragadam plant and the machinery associated with that will bring in another Rs. 150 crores but stand at Rs.



100 crores would continue. Then, we must see what more comes as a part of this electrification and other areas which we will also do as and when the projects are getting more matured.

Shyam Sundar Sriram: Sir, one last question on the margin side in the last quarter you had mentioned specifically at the OEM segment that we have recovered 70% of the inflation per se and about 50% in the aftermarket and it appears from the Q4 numbers that we have not recovered much incrementally, as we stand today how much more raw material cost is yet to be recovered, sir, any broad understanding if you can please provide?

R. S. Rajagopal Sastry: If you look at the results from a sequential Q-o-Q basis, you would see that there is a significant improvement in the margins, which came from better recovery and also better efficiencies which we are putting in and we also have to understand that as recovery happens, recovery happens on a material cost in a rupee to rupee basis. It does not bring in the additional margins as we normally have, so we are putting in quite a few projects to identify that particular load which doesn't come, which is additional because of the rupee-to-rupee compensation, but the overheads have not been covered, we are trying to identify more and more projects. Now, if you ask me what percentage that we have secured, we are progressing very strongly to ensure that every rupee is recovered. Our target is at least 90% from the OE side and 100% from aftermarket and so on with other segments and we are progressing in those directions, and I say the progress is good so far.

Shyam Sundar Sriram: At least until Q3 cost whatever we saw is that all recovered, sir, leaving aside any inflation in Q4?

R. S. Rajagopal Sastry: Q3, as I told you, that improvement of about 3% in margin which I was saying is coming from lot of recoveries and also efficiencies. We have recovered, the recovery progress is on, it is gaining traction, but generally it will not be right to quote the exact percentage of how much we incur and how much we recover, but it is gaining traction and going in the right direction.

Moderator: Thank you. The next question is from the line of Priya Ranjan from HDFC Mutual Fund. Please go ahead.

Priya Ranjan: My question is related to the air suspension usage in the truck, globally, what is the percentage, and do you see any reason or any adaption in air suspension in trucks right in India?

P. Kaniappan: Air suspension in India largely is used only in the bus segments and now there is adaption of air suspension in the trailer segment because there is incentive that if you use air suspension you can have additional 1 ton each axle so we are actually having a solution for the trailer segment and we are offering, of course, not full air suspension, mechanical system, but ours is more on a control system. On the Bus Segment we have a solution, one developed in India, also the other one much more, I would say, light weight solution from ZF, so both actually the bus segment if you see in the last two years, there is no production of bus segment, so we didn't make any big breakthrough or entry, but also what is unique in ZF or WABCO is that we have an electronic control for air suspension, we call it ECAS, so electronic control in air suspension makes the



mechanical suspension very intelligent. It is a smart suspension, so technically we have very elegant and excellent solution that the bus market is picking up, our solution that we are having globally we would like to really promote this in a big way, not only for the bus, but also for the truck segment. Truck segment also, progressively it will start adapting in certain segments where they need to carry fragile goods type of things, it may start from there. Right now, we have not made a big entry except in the trailer, but going forward this is one of our priority topics, but it will take some time, because we have to localize the solution for the market, I guess. I don't have much to give you at this point of time, but maybe in the future calls, we will update you with the progress.

- Priya Ranjan:** And any thought on, say what is the percentage of expansion usage in trucks in Europe, etc.?
- P. Kaniappan:** Yes, in Europe, I think more than 65% that is my feeling, but generally in those markets, these things are all very highly adapted, penetration is very high.
- Priya Ranjan:** And then sir, in terms of the domestic revenue, ABS is contributing how much now broadly, about full year level?
- P. Kaniappan:** I couldn't get that question, so in India ABS as the percentage of the total volume.
- Priya Ranjan:** What was the turnover of the Company?
- P. Kaniappan:** I don't have the correct numbers here right now, maybe we will give you.
- R. S. Rajagopal Sastry:** During 2017, we used to track what is the incremental revenue which came because of the ABS introduction. We stopped tracking it because all the vehicles which are coming with ABS and we call the entire thing as one braking system, so we don't track it separately anymore.
- Priya Ranjan:** And this is the accessible market, so all the accessible market, our market share will be like say 75-80%, if I am not wrong?
- P. Kaniappan:** Yes, accessible market, if you see, it is mandated, so by and large air brake vehicles, our mandate will have ABS. In that case, accessible market is quite high, and we are playing very major role in that segment.
- Moderator:** Thank you. The next question is from the line of Mukesh Saraf from Spark Capital. Please go ahead.
- Mukesh Saraf:** Sir, looking at your sense on the MHCV industry, how do you think the growth for the industry in FY23, may be FY24 as well, we have seen some pick up in volumes, but do you think that the pickup in the CV cycle is now going to stay and we are going to see growth and if you can give some number, say on percentage growth in the industry that we can see?



- P. Kaniappan:** Few things we are tracking, number one is the utilization of the truck in the market, and we see the truck utilization has been quite high in the range of 80% plus. This we see one of the highest in the recent years, so we believe this will trigger replacement cycle because in our view that anything more than probably 65-70% will drive the replacement cycle plus we also understand freight index, the freight rate also has been increasing even offsetting the increase of diesel, so all these things indicate that the freights will be profitable, so they will be investing on more trucks, etc., so this is one aspect. Second is, of course, you know the tipper segment has been doing quite well, even last more than a year, they are doing quite well. We believe it will continue because of the investment on infrastructure and construction, mining and so many things. Also, we believe the increase due to e-commerce activity also will be driving the growth in the industry. So, from every respect, we believe the growth will continue, not in a position to put an exact number, but we believe this growth cycle will continue. That is why I also said in the note that it could continue for at least next 2-3 years barring any adverse events, etc., but it is a very positive outlook. The bus segment also started picking up in a significant way.
- Mukesh Saraf:** And sir, secondly, on the ABS part when you mention that we are largely already kind of supplying to be addressable market, as a trailer market also now started adapting because what I remember in the past is that was one segment where ABS was still not adapted in all that and so has the trailer segment also started adaption on ABS?
- P. Kaniappan:** Very good question, trailer segment has been adapting these technologies very well in the recent times. In a way we will anticipate that way, but now lot of vehicles are adapting the trailer ABS. We also see good amount of sale for the trailer EBS, Electronic Braking System, particularly those fleets which are carrying the hazardous goods type of global fleets, the fleets of the global companies, they are all adapting to trailer EBS, and we also launched one advanced product which is called intelligent trailer program which is basically the trailer EBS with additional features. Also, as I said, the air suspension system is also getting adapted in the trailers. Trailer segment is very well adapting the technology, so again a positive news for us.
- Mukesh Saraf:** And just one last clarification sir, in the last conference call, you had mentioned that the start of construction of the new plant will start sometime around March, April, but is there some delay in that now because now I think you said it will start in say second or third quarter?
- P. Kaniappan:** Basically, we have started, of course there is a delay from what I did communicate, mainly because the architecture and other things had to be gone through certain process globally and we know we have already started that land development activity, etc., already, so the building construction, we expect as it will take little time because the final invest approval in the final stage this year.
- Mukesh Saraf:** But this should not have any impact on say its demand suddenly shoots up, we can still cater to the demand even if there is something in this?
- P. Kaniappan:** Yes, we are in a position to handle this.



- Moderator:** Thank you. The next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.
- Pritesh Chheda:** Sir, my question is, when it comes to margins, we see that in the last 4 years, other than the gross margin, the biggest cost price is the employee cost, can you give some comments there as to this steep increase in cost and does it mean that the benefits, first of all, why has this cost increased so much?
- R. S. Rajagopal Sastry:** Pritesh, you should look at the employee cost from the perspective of the annual inflation which actually is minimal in our case, but you also have to look at the raise in the other operating income which is essentially a service income. ZF India provides a lot of services to global ZF, in the form of engineering, the global business services and also the hardware, the mechanical engineering side or product engineering. Even that has been growing significantly, so largely, the major portion of the employee benefit which you saw across many quarters would be because they have been adding people and skill sets which also is generating revenue for the Company.
- Pritesh Chheda:** And can you tell us what is the service income in 22 and I have the service income in 18, but what is the service income in the current year gone by?
- R. S. Rajagopal Sastry:** I could give it to you, maybe we could talk again, and I can give you the details, but largely it is deciding the other operating revenue. So, you could just track what is there in the other operating revenue and publications, it will be clear to you.
- Pritesh Chheda:** Sir, one more question linked to the volumes, so you mentioned that the OE India growth for us was 50% revenue, what would be the inherent ideal volume growth in that number?
- P. Kaniappan:** Sorry?
- Pritesh Chheda:** What should be the inherent volume growth for us in the India OEM business?
- P. Kaniappan:** I didn't understand?
- Pritesh Chheda:** So, one number which we mentioned in the call was CV industry volume has grown 41% that refers to the air brakes vehicle in India. The other number that you mentioned on the call was our OEM business has grown 50% in value which is Rs. 1031 crores, right, what would be the volume growth in this 50%?
- P. Kaniappan:** See, 40% is the industry growth, we have outperformed by about 10%, so overall 50% growth.
- Pritesh Chheda:** Then sir, the volume growth is equal to value growth?
- P. Kaniappan:** So, the selling variance, you are saying how much is out of that selling price variance, how much is the volume growth variance?



- R. S. Rajagopal Sastry:** Your question again is not clear, so the industry has grown 40% and our sales have grown 50%, so would you not say that there is a 10% growth of value growth over volume growth.
- Pritesh Chheda:** I was just trying to look at whether there is any market share increase or loss for us versus that 40% number?
- P. Kaniappan:** I will tell you, the increase of 10% includes the price increase that we have got because of the commodity increase. That is one aspect, but also in some cases we must have also given a reduction as per the agreement with some customers, but in terms of fundamentally we are not losing any market share, we did not lost any market share, but then again each segment wise we need to look at, but all that I would like to tell you is that there is no loss of market share in this year, but it is the exact growth only if we say the number of components or product, it may not be 10% growth, 10% growth includes the variance and selling price as well.
- Pritesh Chheda:** And sir, one clarification, the domestic replacement business for FY22, you mentioned is Rs. 400 crores, full year?
- P. Kaniappan:** Rs. 334 crores, I remember it is around Rs. 334 crores.
- Pritesh Chheda:** And the growth was 8%?
- P. Kaniappan:** No, at the full year level, it is 28%, 8% in the Q4.
- Moderator:** Thank you. The next question is from the line of Shyam Sundar Sriram from Sundaram Mutual Fund. Please go ahead.
- Shyam Sundar Sriram:** Sir, on this software services or the engineering services business that we provide, under ZF, how has the scope of this business expanded, any perspective that you can share per se, there is the first point? Secondly sir, because it is like a separate organization and itself a separate business than the manufacturing business, how to think of margins for this sir, so will employee cost be 50% of this services revenue per se and hence the margin should largely be around the balance 40% to 50% per se, how to think of this business if we were to think of it as a separate engineering services business there in?
- R. S. Rajagopal Sastry:** On the margins, I will give a very quick answer to Shyam and then about the composition we could take. Margins, this is a captive engineering and a contract engineering service, and the margins are based Transfer pricing study and these are based on the arm's length principle and it is on the cost plus model, but what exactly is the margin is something which we will not be able to, however, it is based on TP study.
- P. Kaniappan:** On the composition, it doesn't change from whatever we used to do except that the new skill sets are required as the world is after the COVID, there has been lot of demand for certain skill sets in the software side and we have opportunity to really rise the number hugely in India and the requisite demand for the skill sets and headcounts and the new skill sets areas and we are



actually trying to really fully support from here with that, certain challenges in terms of getting the skill sets is the current challenge, but otherwise in our view, this business will grow in a big way.

Shyam Sundar Sriram: And are we servicing other than our WABCO as in the ZF Commercial Vehicle Division, any other division are we servicing, have we started servicing any other division for their engineering requirement, sir?

P. Kaniappan: Not yet, but the way ZF is organized is ZF has a big engineering center in Hyderabad, about 2500 people are there. They are actually serving the other divisions. Right now, the Chennai team is actually only supporting the commercial vehicle division, so earlier it was form of WABCO part, but now there is an opportunity, expand it to the other part of ZF division, but I would say it is yet to start, because the challenge right now we face is getting more people recruited and getting the challenge into the same and as I said, our focus will continue to be only the commercial vehicle part which means apart from the WABCO side of the braking part, you may also have an opportunity to extent it to the other aspects of the commercial vehicle which is essentially may be clutch, may be transmission, etc., which will progressively coming in, but right now, the software team is really expanding in the same area as whatever they were working with the new skill sets in the software side.

Moderator: Thank you. The next question is from the line of Bibhishan Jagtap from Canara Rabeco AMC. Please go ahead.

Bibhishan Jagtap: Sir, you talked about reducing the import content, just wanted to understand what was our import as a percentage to sales in FY21 and how much it has reduced in FY22 and how much further it can come down in coming years?

P. Kaniappan: Given the choice, we would like to get everything done here only because of the global supply chain challenges and of course the opportunity to reduce the cost. The exact percentage I do not have right now, but all that I can tell you we are in the range of about 80-85% of localization by and large. It may vary from product to product, but now we are looking at, we used to even import products from China, but with increased freight cost and so many other reasons, we see more opportunities to produce in Indian supply chain. So, our focus is to get given the choice everything here, but we are in the range of probably 85%, step by step we are moving.

Bibhishan Jagtap: And sir, what was our market share in MHCV segment, sorry I missed that number?

P. Kaniappan: No, I only talked to you about the localization. Currently, we are in the range of 85% localization, roughly you can take because there are some products which we completely import, because the volume is low and the Indian supply chain has not developed. There are some products we are 100% making here, but if you want to get a rough idea, it will be in the range of 85%, but our idea is to move towards 100% if possible, so we are taking, there are many project teams working here to look at those products for which there is an Indian supply chain which has really



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developed, so exact number, how much we have achieved in each quarter, I am not in a position to answer that.

- Bibhishan Jagtap:** My question is, actually what is the market share in ABS segment now in MHCV segment?
- P. Kaniappan:** Normally, we don't share the exact the market share, I can only tell you we are the leader in India, may be above 80%.
- Moderator:** Thank you. Ladies and gentlemen, due to time constraint, we will take that as the last question. I now hand the conference over to Mr. Annamalai Jayaraj for closing comments.
- Annamalai Jayaraj:** We thank all the participants. We thank the management for taking time out for the call. Have a good day.
- P. Kaniappan:** Thank you.
- R. S. Rajagopal Sastry:** Thank you.
- Moderator:** Thank you. Ladies and gentlemen, on behalf of Batlivala & Karani Securities India Private Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.