



“ZF Commercial Vehicle Control Systems India Limited Conference Call”

February 03, 2023



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Moderator: Ladies and gentlemen good day and welcome to the ZF Commercial Vehicle Control Systems India Limited 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 “*” and then “0” on your touchstone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Jayaraj from Batlivala & Karani Securities India Private Limited. Thank you and over to you.

Annamalai Jayaraj: Thanks Mike. Good afternoon. Thank you for joining us today and welcome to ZF Commercial Vehicle Control Systems India Limited quarterly earnings call. The third quarter earnings and nine months results for FY 2022-2023 will shortly be presented by the management of ZF Commercial Vehicle Control Systems India Limited formerly known as WABCO India Limited. Your hosts this afternoon from ZF Commercial Vehicle Control Systems India Limited are Mr. P. Kaniappan, Managing Director, Mr. R S Raja Gopal Sastry, Chief Financial Officer as well as Ms. M Muthulakshmi, Company Secretary. I will now hand over the call to Mr. P. Kaniappan who will provide you further insights into the results. Over to you Sir!

P. Kaniappan: Thank you Mr. Jayaraj. I warmly welcome you all to ZF Commercial Vehicle Control Systems India Limited’s third-quarter results and nine months performance for FY 2022-23. 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 because of many factors. ZF Commercial Vehicle Control Systems India Limited’s results for the quarter and period ending December 31, 2022, were published on February 1, 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 transcript and recorded audio of this call will also be made available on www.zf.com under the ZF CV India investor relations section.

Let me begin with the business update.

Industry and Economic updates:

I would like to share a few key macroeconomic aspects that are relevant to our industry and GDP growth.



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The projections for India's economic growth (represented by GDP) have been estimated at 7.00 % (source RBI). This remains the strongest growth among the large economies of the world. India's inflation has come down and inflation, measured by the Consumer Price index (CPI), is now down to 5.88% from 7.41% in September. The Index of Industrial Production (IIP) in November 2022 grew by 7.1% supported by manufacturing, mining and the power sector.

Commercial vehicle production in the third quarter of FY 2022-23 was 92,731 units, compared to 65,495 units in the same period of the previous year. This represents growth of 41.6% and was largely driven by:

- Improved economic activity across key segments and increased recovery momentum in the commercial vehicle industry on the back of replacement demand, increased freight utilization, improved transporter profitability and the Government's infrastructure drive;
- Intermediate and light CV growth due to robust demand in eCommerce, intracity last mile connectivity and the increased penetration of CNG/LNG vehicles.

Against this vehicle production backdrop, we registered OE sales in Q3 of INR 405.8 Cr compared with INR 275.9 Cr in the PY – this equates to growth of 47.1% with a market outperformance of 5.5%. Some of the key elements behind our growth story are:

- Consolidation into stronger positions with OEMs'
- Sales to trailer customers due to the introduction of new products;
- RM price inflation recovery.

Now, turning to our Aftermarket performance

The Company achieved 13.9% growth in Q3 22-23 Vs Q3 21-22. Various initiatives driven by management are helping consolidate our position in the aftermarket, namely: -

- The launch of new service kits and introduction of prime dealers for specific products such as door control systems;
- Our AIS 140 compliant FMS device is now acceptable in 23 States/UT and registration with another 14 States/UT is under progress;
- Improving the penetration of our digital products and solutions in the aftermarket;
- Advanced Driver Assistance System (ADAS) and Driver Behavior Management System (DBMS) initiated with major PSU Oil marketing company's POL Trucks.



E Mobility

We are commencing supplies of e-compressors and Electronic Braking Systems to Electric CV manufacturers.

Export of products

We registered export sales in Q3 of INR 282.7 Cr compared with INR 229.3 Cr in PY, representing growth of 23.3%. The key contributors to this growth were:

- A ramp-up of supplies of 440cc compressors to DAF;
- Increased supplies of Air Supply Units to BMW and other customers;
- Scaling up supplies of Air Disc Brake levers, manufactured in our Mahindra World City Plant.

Our export business continued to grow due to our focus on quality, cost and delivery. This was despite challenges in target markets as a result of geopolitical economic factors.

Export of Services

With the continuous expansion of our capabilities and talent acquisition, our export of services registered growth of 34.6% in Q3 of FY 23 compared with the same period in the previous FY.

Engineering

Our engineering team is working on launching ESC for both pneumatic and hydraulic systems. One of our advanced technology solutions designed to enhance safety, our initial plan is to introduce it to the bus segment. Homologation activities are ongoing to meet demand from OEMs generated by the upcoming regulation in India taking effect from April 2023.

The team has also successfully developed and commenced production of the new electric compressor Gen 2.0 which is unique in meeting the market demands of most OEMs in India.

We are also expanding our engineering footprint and capacity in our technology centre to cater for the future demands in line with our strategic growth plans.



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Manufacturing facilities at Oragadam

As we outlined in the previous earnings call, the construction of our factory at Oragadam is progressing as planned. We will continue to update you on its progress in future calls.

PLI

Under the application made for the Production Linked Incentive (PLI) Scheme in the auto sector, the company has been selected as an eligible auto component manufacturer to receive benefits from the scheme along with its subsidiary.

We are in the process of making an application to the testing agency to have our products certified as Advanced Automotive Technology products to be eligible for the PLI benefit.

We are also actively working towards identifying and making the committed investments for eligible Advanced Automotive Technology products in order to qualify for the benefit disbursements.

CSR outreach

At ZF Commercial Vehicle Control Systems India Limited, we strive to be responsible corporate citizens 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 neighbouring communities, contributing towards environmental sustainability, and skill development.

Over the years, our contribution to 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 stakeholders.

Our road safety initiatives align with ZF's vision for 'Zero Accidents' and 'Zero Emissions' as well as the Government of India's 'Vision Zero' initiative that addresses road traffic fatalities. Through structured road safety initiatives, ~600 drivers of various STUs and private fleets were trained on road safety; training camps were conducted in 6 cities across India. Concurrent medical camps for drivers were also conducted to determine operator fitness. ~300 technicians from various STUs were also trained on road safety along with a concurrent medical check-up spanning 6 camps.



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Awards and recognition

The company has been recognized and received the Q Prime certification from a key customer. We have also received the ZF Excellence award for “DNA of Quality” from the Group and were among 100 projects that were submitted in that category.

Our employees won the 1st prize in the CII state-level QIT competition, 1st prize in the ACMA Southern region kaizen competition, Platinum and Gold award in NIQR’s National level six sigma competition as well as achieving 1st Prize in the ACMA Northern region kaizen competition.

Also, excellence awards were achieved in QCFI’s National level QC Competition.

New executive management team at ZF

ZF started the year with changes to its Board of Management with three key appointments taking effect from January 1. Dr. Holger Klein took up position as Chief Executive Officer of the Group. Dr. Klein joined ZF Friedrichshafen AG in 2014 and was appointed to the Board of Management in 2018. He is responsible for Corporate Sales, Research and Development, the System House of Autonomous Mobility Systems, and the Aftermarket division.

Michael Frick is now Chief Financial Officer. Mr. Frick, who joined ZF in December 2022, is also now Head of M&A, IT and Digitalization.

Having also joined the ZF Board of Management, Dr. Peter Laier, is now leading the Commercial Vehicle Solutions and Industrial Technology divisions. Dr. Laier is also responsible for the Group’s India market.

And now, moving on to our financial performance for the quarter ...

For your ease of reference, the results were made public at 5.07 PM on the 1st of February, 2023. I hope you have had a chance to go through them.

Commercial vehicle production registered growth of 41.6% over the same quarter in the previous year. We outperformed by 5.5% this quarter. Our sales to OEMs in this quarter was INR 405.8 Crores and this is 47.1% higher than the prior corresponding quarter. Overall strength in demand ensured that our aftermarket sales was moderate 13.9% QoQ to 99.6 Crores.



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Exports (goods) resulted in an income of 282.6 Crores in Q3 of FY 2022-23 with 23.3% higher than the prior corresponding quarter.

Our engineering and other services continue to provide very strong value to our customers across the group. The growth in service income is a very healthy 34.6% QoQ.

For the quarter ending 31st December 2022, we achieved a PBT of Rs 115.6 Crores, which is 14.7% on sales. This is an improvement of 7.4% as a percentage of sales and a 167.6% improvement in absolute terms. We have improved our profitability by 2% sequentially.

As we present the results, we see that the series of actions which were put in place by the company to mitigate the challenges posed by inflation and other aspects have yielded strong performance results. While the results have been aided to a small degree by the positive effect of foreign exchange fluctuations – a gain of INR 9.2 Crores - we still see the strength of performance is continuing to grow.

Thank you.

We now welcome your questions.

Moderator: Thank you. We will now begin the question and answer session. We have the first question from the line of Vimal Gohil from Alchemy Capital Management. Please go ahead.

Vimal Gohil: Thank you for the opportunity. Just one question. My question on the breakup of revenue has been answered, so thank you. I just wanted to know your thoughts on we are planning to introduce or do we already have some presence in the growing LCV segment because as you said that particular segment has decent growth prospects with a lot of investments coming in with respect to warehousing, etc., so your thoughts on that and my second question related to product is on our engagement with BMW, so this is probably the first and we are hearing ZF or rather WABCO as a group getting into PVs, so any chances of that solution being introduced for the domestic market as well? Thank you.

P. Kaniappan: On the LCV segment we have a small presence, essentially we supply the vacuum boosters to few customers. Because largely ours is a pneumatic system based engineering, so light duty segment is working on the hydraulic system. For a very few products basically the vacuum boosters and we do not have much focus there in that segment, but recently we have been in India now as we are working with many customers to supply the electronic stability control for the hydraulic vehicle. This is also coming as a regulation from April. In the Bus segment the ESC is applicable so we are quite strong in pneumatic segments securing a strong position with all OEMs. In the hydraulic segment we have entered



because there was an opportunity existing to serve the market with a solution from another division. We expect the business to be around 400 units per month, so it will start in a small way to understand the sector. But we see this entry will give us more opportunity, as the demand is increasing. In a small way we are moving into that and as we move forward we will also update. This product is a very advanced product, it is an electronic stability control.

Vimal Gohil:

On BMW my question was that can we expect that you will bring probably the same solution that is the compressor, do you bring it in India as well, and any plans to introduce it in India as well for Indian PVs or are you looking to cross sell that product to any of the other OEMs for export?

P. Kaniappan:

The current situation is we are not able to meet the BMW requirement itself, so we had to ramp up supplies in the last few quarters by almost 50%. We increased the capacity to meet the demand. And now what is happening is of course the product is developed only for BMW and we are supplying it through ZF it goes to BMW and the supply chain is in India and apart from the compressors that we make the air supply unit, so it also has electric motor, so we also sourced the electric motor in India and we integrate and supply it as a subsystem and this has been quite successful both in terms of performance and cost, so this is rapidly growing. Basically BMW, 5 series, 7 series, etc., those vehicles have air suspension and these products will provide the air supply unit. So we will see a steep increase in the products for the fact that BMW has been growing successfully globally and this is almost even for electric vehicles also it is required and now BMW vehicles are produced probably in their own group companies or somebody who have started technology to produce those things also coming, so we will be supplying it to VinFast this is a company in Vietnam so we have got some indications that we will start the supply from June and we were supplying it to other companies in China, but normally China will develop its own supply chain as well but then we started the supply, so we see a good growth in the demand of these products. I think this will continue to grow at least in the next one or two years.. Coming to India essentially it is a matter of evolution of the Indian vehicles moving to this space. Essentially this is used only for the luxury segments and not got much interest in Indian OEMs but going forward it will happen. Of course BMW India will be using this because we do not supply directly to them, we will supply to the group. As such in Indian market there is not much demand right now but it will come. Now it is a matter of industry evolution.

Vimal Gohil:

Understood Sir. Just one more question at this point in time for our domestic commercial vehicle business, what is our content per vehicle currently, you could probably give us a nine month number if it is fair and post the electronic stability control regulation which



comes in April what is the increase, expected in the content per vehicle for our company in the domestic CV business?

P. Kaniappan:

As I said in the last few quarters there is no big change in the content per vehicle but if you see given the last quarter, I just mentioned we outperformed the market by 5.5%, it is essentially driven by through the market share from OEM, but going forward there are few technologies that will come to India. Number one ESC is starting with subsegment now it is from April and this is a number first you can see probably right number of buses, per vehicle content increase will be in rough delta over and above the current ABS system. And in next few years we believe the Electronic Stability Control will get into more vehicles including buses mainly through the regulation book, but our belief is that even before regulation some people started up things through the truck segment also. Most of the buses also we have formulated it already with at least one or two key customers. After that we expect the advanced driver assistance systems and we also call it as autonomous emergency braking system, essentially it is a forward collision warning and foot braking kind of situation. Some of the passenger cars have already started implementing in India, may be in the future calls I will give an update as we are working with many of the OEMs. I will take some time one or two years to really homologate most of the vehicles, but that is today global standard, in the braking system we are also bringing the latest technology, adoption of those technologies to the market will take time, but we are starting. I believe we are starting that revolution now with the ESC, it will see in fact lot of rollover accident reduction through stability control technology and that is the current status and the first improvement will start from the ESC from April.

Vimal Gohil:

Understood Sir. Thank you so much that was very detailed. All the very best Sir.

Moderator:

Thank you. We have the next question from the line of Mukesh Saraf from Avendus Spark. Please go ahead.

Mukesh Saraf:

Good afternoon and thank you for the opportunity. My first question is on ESC trial. We are starting with buses now. Do you think, trucks regulations will also come in next year?

P. Kaniappan:

It is only an assumption that we tell that after the buses the trucks will automatically come in a matter of maybe two years or so because it is in the global trend, more so in India because this is one of the very critical products required to reduce the rollover accident and government has in fact conscious of that fact and lot of interest to really move in the direction because it is coming as a regulation I am not in a position to say any timeline, but it is general trend.



Mukesh Saraf: Right and just one continuation with this have we localized majority of the ESC because we have to start supplies probably in a couple of months so the major electronic companies, etc., localized already?

P. Kaniappan: Actually we have localized the electronic control unit, we actually anticipated and already we are ready with a localized electronic control unit, but in this there are additional electronic systems. It is a more advanced, right now we are not localized, but we will be looking at possibility as the volumes moves up.

Mukesh Saraf: Okay, is it fair to assume that the margins for us in this ESC will be slightly lower than the company level margins or given that there has been more imported components?

P. Kaniappan: In my view at least it will be better, at least it will be equal or better.

Mukesh Saraf: My second question is regarding the pneumatics of the hydraulics that you are working on and in the hydraulic systems, so on the LCV side would that be a traded product now for us with initial 400 sets or is there some value addition that we are doing at ZF CVCS India?

P. Kaniappan: Right now for the first one or two quarters it is more like a trading, but we have plans to produce in our Oragadam site and so actual production also will be done here mostly the final assemblies, but still we may get some component products from some markets where the volumes are very high further. Otherwise we will take the responsibility to deliver to the customers.

Mukesh Saraf: Given the hydraulics when this opens up a lot of new areas for us not just LCVs, passenger vehicles, etc., but obviously that is a competitive market and what is our thought there that we have never entered into hydraulics before?

P. Kaniappan: That is the logic with which we are moving in, of course we started with two OEMs, now major OEMs are also approaching us, so also that is a possibility to extend it to the last mile connectivity vehicles essentially in the electric domain because these products are also applicable to the EV vehicles later.

Mukesh Saraf: Okay, understood and just lastly you have commented on PLI saying that you have kind of applied for certain components, we have already approved under the PLI scheme so just a clarification there, was this for some specific components you had mentioned the PLI approval?



R S Rajagopal Sastry: As a process there are some products for which it is already approved, it means certified agency that they actually fall within the approved block of products and we are in the process of getting that certified agencies approval.

Mukesh Saraf: Okay, got it. Thank you.

Moderator: Thank you. We have the next question from the line of Basudeb Banerjee from ICICI Securities. Please go ahead.

Basudeb Banerjee: The question is other expense has gone up Sir compared to the normal trend it has gone up and is there any one-off?

R S Rajagopal Sastry: Typically all the elements in the other expenses we only have volume related cost and you see that there is a significant increase in the volume and we do have an increase in the other expenses which are related to volume which includes payment like the royalty and freight or factory related expenses, they are all related to volumes.

Basudeb Banerjee: If I look at the gross margin trajectory where raw material sales even two years before used to be some 60% because of raw material and because of inflation it moved up to as high as 66% and has come down to 63% now, so how to look at that from a futuristic perspective because of the product mix change or is because of structural increase a little remain above 60 or there is any scope with mix and raw material price rationalization it can come back to the sub 60% levels?

R S Rajagopal Sastry: If you look at the raw material change, the first if we look at it from Q-o-Q, year-on-year basis and you see significant reduction in the raw material cost and also the overall variable margins and even on a sequential basis you will see an improvement and this is coming from, we clawing back the inflationary impact of the commodity inflation in terms of some price pass through and also productivity activities. If you are going to compare to the long past history 60% material cost that was also time when we had very low sales to OEMs and high sales to the aftermarket and it was a mix which was very favourable in terms of material cost, but as the expansion happens the growth was largely in the OEMs which also meant that the margins from a percentage perspective went down; however, we do have better margin realizations on absolute term basis. So what we are right now looking at is the actions which we had taken in terms of pass through of the commodity inflation have gained traction and we see good benefits from that and also we are continuing to take the initiative in lines of how do we improve our material cost and also productivity in the factories, so we should see better news as we go forward if the economic factors hold and we do not see more bouts of inflation.

- Basudeb Banerjee:** How much exports absolute revenue this quarter?
- R S Rajagopal Sastry:** We had Rs.282.7 Crores as exports.
- Basudeb Banerjee:** Thanks.
- Moderator:** Thank you. We have the next question from the line of Jayaraj. Please go ahead.
- Jayaraj:** I have few questions. One is on the royalty, is there any change in the royalty term Sir?
- R S Rajagopal Sastry:** We continue to provide the same 4% on our external sales, there is no change in the royalty.
- Jayaraj:** Second one is on the export, the currency fluctuations we need to pass on, and generally it is not part of the agreement?
- R S Rajagopal Sastry:** It is normal that we have to earn in domestic currency some fixed percentage so if we have currency fluctuation changing this percentage there are clauses in agreement to pass it on as per the agreement.
- Jayaraj:** My understanding is correct beyond certain limits we have to pass on something like that Sir?
- R S Rajagopal Sastry:** It is provided for the agreement and it is beyond threshold, there are thresholds provided.
- Jayaraj:** Generally, what is the demand outlook on the domestic as well as on the overseas market as of now?
- P. Kaniappan:** Actually the demand situation is very positive, particularly last month was quite good and we see the same trend continues, at a full year level of course in our planning we look at other signs of increase in the vehicle production growth, on top of that we have to outperform the market and near term situation since we have more than that average, so we need to wait for a few more months to see the trend, as of now it is quite positive today.
- Jayaraj:** Overseas market Sir?
- P. Kaniappan:** For us overseas growth comes out of two aspects one is the demand situation itself the production of the vehicles and products, we are supplying to trained market and OE segments globally and again it is I would say it is not just growth there, but there is no reduction. I said in one segment where there is a growth that is in the BMW products that we are supplying that is a growth. In the medium and heavy commercial vehicle segment



the general trend is to those markets where we are supplying particularly Europe and America the demand situation, I would say there is no reduction despite all these challenges. China there is a production last year, now the expectation was probably that will slowly recover, but we do not do much sales to China it does not affect our export business. Second aspect is our business is also growing as and when the new programs are launched. I also spoke in some of the earlier quarters that we are supplying the compressors globally and again the demand is improving. There is sort of ramping up supplies. Now there is a further increase in other platforms in the US market that was earlier supplied by the US plant now the business is inching towards us that we will supply. Another product we see going forward growth is we have installed the facility to produce the lever for the air disc brake assembly for other markets so that is on stream now, we have started getting demand increase. So outlook for export also quite strong for this year.

Jayaraj:

Electric buses now the volumes are picking up in India and so many players, some new players also has come, we are supplying broadly to most of the major players Sir?

P. Kaniappan:

There are actually I said two things we will add to our topline in the bus segment one is the electronic stability control, the mandate will drive the growth and we have a standard position, generally the customers who are fitting our ABS normally take the EBS also from us, so there is an opportunity. The second opportunity is the EV transition in the bus segment is quite strong even though the vehicle numbers have not started increasing, but lot of activity at multiple players in India to produce electric buses and more customers in most cases we have secured the electric compressor. We have started the supply and another product in the segment is the electronic braking system. We are promoting the electronic braking system mainly because this is very, very applicable for the electric buses because of the fact that this system is very intelligent, it can actually regenerate, it can improve efficiency in the vehicle to the extent of about 6% fuel efficiency in this case it is done in the factory and you can still upgrade much in efficient way the system itself. Few customers have already taken a call to move to EBS. Our understanding is progressively more people will move into that, these two products, both are high content products, the electric compressor and EBS give good realization that is a kind of situation today the volume is low but when the volume increases when we more localize it may come down, but these are all very high content products.

Jayaraj:

Since volumes are low as of now they are imported and supplied or we have started manufacturing Sir?



- P. Kaniappan:** As of now imported, but this product will go through the PLI, so we have to have a local content and we have clear plans to follow that, the compressor localization will be more prioritized, that is already there, EBS is difficult to localize because of low volumes.
- Jayaraj:** Thanks Sir.
- Moderator:** Thank you. We have the next question from the line of Mythili Balakrishnan from Alchemy Capital. Please go ahead.
- Mythili Balakrishnan:** Thank you. I just wanted to ask you whether on the capex plans to handle some of these projects, what is the kind of capex you are looking at over the next couple of years?
- R S Rajagopal Sastry:** Our standard run rate of capex was in the rate of Rs.100 to 120 Crores, but in this year we are also have our factory which is getting constructed at Oragadam will also get completed, so there is additional capex for that and we are also looking at some development capex for the sake of PLI, so overall our ballpark number or flat number for the next fiscal is in the range of Rs.250 Crores to Rs.260 Crores.
- Mythili Balakrishnan:** Got it and also could you help us understand a little bit about your wallet share within your customers for your current new products, have you seen sort of moving up along. I just wanted to get an understanding as a wallet share that you have with our customers and how is the trend that you are seeing in that?
- P. Kaniappan:** Share of market?
- Mythili Balakrishnan:** Share of market within your customers.
- P. Kaniappan:** We have been a leading player and normally we do not get into discussions of the market share but you can assume that we are one of the major players.
- Mythili Balakrishnan:** I just wanted to get a sense of trend in that is that sort of improving along the way?
- P. Kaniappan:** Yes, that is what I said in the last quarter we actually improved further our market share in one of the customers that helped us to outperform, so we continued to retain our position, we are very, very tall player in the market.
- Mythili Balakrishnan:** Got it and in terms of EV has electric compressors what would be the competition like in these two segments like who are the major competitors who are also offering similar products to your customers?



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P. Kaniappan: Again we do not share and comment on the competition, but I can give you an idea. In the electric compressors right now there are not many players, but it will come, these are the players from other market, today the volume is low, there will be a lot of global players. Then in the Electronic Braking System globally one or two players only not many, so again in India we are trying to take a lead position on that.

Mythili Balakrishnan: Got it. Thank you. That is all from my side.

Moderator: Thank you. That was the last question. I would now like to hand it over to the management for closing comments.

P. Kaniappan: Thank you for all of you for joining this call today and hope we are able to clarify your questions, but we are available even in offline if you have any questions. Thank you.

Moderator: Thank you. On behalf of Batlivala & Karani Securities that concludes this conference. Thank you for joining us. You may now disconnect your lines.