“Schaeffler India Limited Q4 Results Conference Call”

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Moderator: Good day ladies and gentlemen and welcome to the Schaeffler India Limited Results Conference Call for the Quarter 4 and Full Year ended 31st December 2017. 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. Vijay Chaudhury from Schaeffler India. Thank you and over to you Mr. Chaudhury.

Vijay Chaudhury: Thank you. Ladies and gentlemen welcome to the Q4 and full-year results call for Schaeffler India Limited. Today we have with us Mr. Dharmesh Arora-Managing Director and CEO of Schaeffler India, Mr. Satish Patel-CFO for Schaeffler India and I will now hand over the call to Mr. Arora who will take you through a short presentation on our results. I hand the call over to Mr. Arora. Over to you sir.

Dharmesh Arora: Thank you Vijay. Good afternoon ladies and gentlemen. This is Dharmesh Arora here. I will go through the investor presentation which has meanwhile been uploaded a while ago, so hopefully you have some time to have an access to that and you will be able to follow the conversation as I speak.

As part of my presentation I would reference the slides that I'm on to make it easier for you to follow the conversation.

Let me move to the Slide #2 which is the agenda slide; as always, I will begin with some update on the macroeconomic update primarily in Indian environment, how the market has developed and evolved through the year. We will move into the financial update for Schaeffler India Limited Quarter 4 as well as the full 12 months 2017 Results.

As we have started the journey of merging our group companies INA Bearings and Luk India Private Limited into Schaeffler India Limited which was announced on August 30th 2017 I would also provide an update on the pro forma basis the combined results of the three entities in India. Subsequent to that I will provide a direct latest update of the merger transaction which is progressing well as we speak and I conclude by making some key takeaways that will be followed by Q&A session.

On the Slide #3, the macroeconomic performance and I'm sure you all have been following the macroeconomic developments of last several quarters; after some quarter-over-quarter challenges of GDP growth the third quarter of calendar year 2017 saw a nice rebound and I think most economists predict that this growth and this positive momentum will continue to prevail and the quarters to come hopefully will see even better results than what we did see in this quarter. What's a really heartening for us particularly in industrial segments is the nice developments on the IIP numbers as well as the core industry growth and the core industry growth when you look for the last several months has continued to remain fairly healthy and particularly the numbers for November '17 which was the last one available to us for both the core industry and the IIP have particularly been very-very positive. Yes, the consumer price index is little worrying in factor, I think it has been primarily led by the increasing global fuel prices but also at some local levels some disruptions caused particularly in food prices and so on. So overall, we would say the GDP growth is on a nice recovery path, manufacturing activity is looking up. The post GST particularly in June and July, there were significant disruptions in industrial distribution business that seems to be coming back. The companies are starting to restock some of the destocking measures that they had taken around that time which is bringing in nice recovery on a distribution business as well. Core industries and IIPs clearly showing good growth and stability and the effects of hopefully demonetization and GST are behind us and we can really start 2018 on a strong note.

Slide #4, further details of the core industry, so we have shown some of the core industry sectors here, so most important here would be the steel production, 8.1% year-over-year growth in 2017, year-to-date and till November very strong growth. To some extent that was also helped by the government in terms of encouraging the growth of the local steel industry. We have had a pretty good order book from the steel mills and working with the steel sectors. Other areas coal and electricity also had a nice growth in the year. Cement which started a little slow at the back of demonetization impact at the beginning of the year but through the year it has continued to progress well into more positive territories and with the forecast that the government has in the push that the government has towards infrastructure, many of these core sectors including cement and steel should see nice recovery and nice growth in 2018.

Slide #5 some of the details around the mobility sector, passenger vehicles which is at the bottom left there grew 7.4% year-over-year. To a large extent that growth was led by the utility vehicles or the sport utility vehicle segment within the passenger vehicles. Passenger car segment didn't grow as fast but most of the growth was really led by the utility vehicles. Two wheelers and three wheelers which again started little slow again at the back of demonetization but the growth for the rest of the year has been rather spectacular. I think the rural push and the rural pull rather on the two-wheeler as well as the agricultural tractor was rather strong. Agricultural tractor you can see has 16% growth and this is at the back of another similar growth we experienced in 2016. So 2017 once again at the back of rural support, rural push, good monsoon saw very nice agricultural tractor growth. Commercial vehicles on the other hand had some challenges particularly around April timeframe at the BS4 new emission law introduction, it caused some turmoil in terms of the manufacturers coming to term with the new laws, new requirements adjusting their production plans to building more of the BS4 vehicles. But since then I think in the last few months we have seen high double-digit growth on medium and heavy commercial vehicles. So I think the growth on that part has been rather strong in the last quarter of 2017.

With that background let me move to the financial performance of Schaeffler India Limited which is on Slide #7. The Quarter 4 results were Rs. 5246 million which is a growth of 2.4% over immediately preceding quarter, Quarter 3, 2017 and the growth of 8.8% compared to the same quarter in 2016. The 12 months growth in 2017 was 6.5% for net-net sales revenue of 19,867 million INR. The PBT margin similarly for the last quarter 2017 was 19.4% which is an improvement from 17.8% in the immediately preceding quarter and also better than the last quarter of 2016 of 15.6%. For the whole year PBT margin was 18.2% compared to 16.1% in 2016. The growth in 2017 particularly in the last quarter was really led by—in industrial we had a growth from the—industrial distribution which started recovering post-demonetization. We also had a pretty strong order book from the exports perspective. For the whole year 2017 the growth was led by automotive, so automotive grew 17% for the whole year, exports grew 21%, industrial was relatively flat. And if you recollect in the last investor call as I had mentioned that the first half of the year we saw very strong growth in Wind for example but last half of the year saw some increased challenges due to some new pricings and new power prices being realized in auctions which makes the operators not to really implement too many projects in terms of new capacity coming on board, so that's hurt us in the last half of the year. But certainly some other sectors particularly automotive, exports and distribution has started recovering particularly from the third and the fourth quarter that has really given us nice growth in Quarter 4 and for the overall for the year of 6.5%. On the profitability side our sales mix has been moving in the right direction and when you see the overall mix, 54% of our sales came from products that we produced in India from our own factories and sold them locally in the domestic market which is a year-over-year growth of 5.8%. 18% of our sales revenue came from products that we produced in India and exported them and this was a very strong growth of 21% year-over-year. Products that we import into India and sell to local customers that give us revenue of 28% which was pretty flat compared to the previous year.

So the message here is that our plants did better than in previous years, we grew our production at a faster pace and we were able to deliver more goods to our local customers as well as our customers overseas from our factories in India. So I think that was a nice development for the year 2017.

Going to Slide #8, further details on the EIBT margins. Once again you can see quarter-over-quarter there have been nice development in the last quarter reaching 19.4% margin levels and delivering an overall result of 18.2% for the year 2017 and our better sales mix, export certainly has delivered good did typically a high profit margin business for us. As the distribution is starting to come back in the last quarter again we were helped with that development. And when you really look at our operational performance from the plant and the rest of the areas I think that operational performance improvement has really resulted into an improvement in PBT margin for the quarter and full year.

Going to Slide #9; you see some further details on our Quarter 4 and 12-month performance. I think I have spoken on the sales and the EBIT margin levels. When you see at the bottom the profit after tax, the margins there also have improved quite well. For the 2017, 12 months performance was at 12% level which is 1.5 percentage points improvement compared to that year before.

Now let's move to looking at the whole pro forma level on the Slide #10, I think we have been showing in similar format since last two quarters the performance of each one of the three legal entities Schaeffler India Limited, INA Bearings India Private Limited and Luk India Private Limited. So when you look at INA Bearings performance, we achieved a revenue of Rs. 11,951 million which was the growth of 14% year-over-year compared to calendar year 16 performance; On the PAT level, Rs. 743 million which was a percentage margin of 6.2% from 2017. Luk India Private Limited achieved sales revenue of Rs. 8575 million, growth of 17.3% year-over-year helped greatly by the very strong demand from agricultural tractors, passenger vehicles as well as in last half of the year from commercial vehicles. The margins were, we were achieving 9% margin compared to 8.3% in 2016. Overall on the pro forma level we for the first time breached 40,000 million mark, so we achieved the revenue of Rs. 40,216 million with a growth of 10.8% compared to the previous year's sales numbers and the margins profit after tax 9.7% compared to 8.9% in preceding year. So very strong growth in many of the automotive sectors, engine systems, chassis and transmission I think the entire automotive sector did very well.

Vijay Chaudhury: Hello everyone, this is Vijay Chaudhury. I apologize I think there is some disturbance in the line. We are at an ops location and that's perhaps is the reason. In the interest of time we will go for the Q&A as the management has immediately get on a travel after this call. But we wanted to keep this commitment and speaking to you and interact with all of you. We can open the line for questions please.

Moderator: Thank you very much. We will now begin with the question and answer session. The first question is from the line of Laxminarayanan from Catamaran. Please go ahead.

Laxminarayanan: You have shown impressive performance in terms of EBITDA margin expansion for Schaeffler India; if you can just disaggregate as to what led to that kind of performance is the first question? The second question is related to the steel prices which have been on the upswing in the last couple of months, how do you see that impacting you down the line? The third is that INA has shown a subdued EBITDA growth though the underlying industry caters car segment as well as two wheelers which is shown better than average growth last calendar year, so what led to that? These are my three questions.

Dharmesh Arora: You have three questions; I was talking about our overall performance. I am not sure where we lost you as I was presenting the slides. But overall performance was certainly improving for the reason that the sales mix was lot more conducive for our business. We had a very strong growth in exports in Schaeffler India Limited. So that is typically higher profit business for us. I think that's certainly tells how the overall performance. The overall results from the operational part was also quite strong. Our growth of plant production was better than the sales growth which meant that we had to import less products from overseas locations, so that again was certainly helping the performance at Schaeffler India Limited level. The question on the steel prices going up, maybe it can be expanded even to the commodity prices. Clearly, I think we are seeing some signs that the global oil price is continuing to over hover to $70 to a barrel which again is putting some inflationary pressure in many different areas for us. Maybe steel is a lot more closer to us since we consume in our product manufacturing a lot of steel and this has started strengthening the steel prices globally and started strengthening towards the mid of the 2017. We have globally seen that that trend is continuing and most likely in 2018 will see pretty strong steel prices. For the last several years or couple of years at least we were benefited by low steel prices. But as this trend is now changing we had been working on many different areas in last many years, things like localization, things like continuing to look at our productivity measures, things like looking at value engineering activities of having various sources going from maybe a primary or going from actually secondary steel producer to a primary steel producer. So those had been several actions that were already in pipeline and many of them we were able to implement in short-term to able to better manage the increasing steel prices on a global level. We certainly see the next rounds of increases in steel prices will put additional challenges in front of us but we are also loading our cost reduction activities equally in our pipeline to better manage that situation.

The last part you had was on the INA performance, I think when you see our margins, actually we have been able to pretty much maintain and slightly improve our PBT margin from 9.5% level to 9.7% level in 2017. Beyond that I think on the exchange and other areas also we had a pretty flat situation so we did not have much of a challenge through the year at least in that. I think in my opinion I would say that our performance on INA has been strong relatively maintained as to what we had in the past and with the growth that we see in front of us increasing localization activities that we are doing particularly in INA which is importing lot more than other two companies. You can definitely see that we have opportunities of continuing to improve our profit margins in INA.

Moderator: The next question is from the line of Srinath Krishna from Sundaram Mutual Fund. Please go ahead.

Srinath Krishna: In INA wanted to understand what is driving this growth, is it more of models specific, models that you are present in are successful and in turn helping our performance or any of our products are getting accepted more or what is driving both INA and Luk's performance?

Dharmesh Arora: I think if you recollect Luk business is 100% automotive but within the automotive we are into several segments. Luk has a very strong presence with agricultural tractors, very strong presence with utility vehicles particularly, sport utility vehicles which as you would recollect was the strongest growing segment in 2017. So both agricultural tractors and utility vehicles particularly have done very well in 2017. And our target from the automotive has always been to outgrow the market growth. So when you look at the passenger vehicle industry that is grown maybe 7.5%-7.6% levels, the tractors are grown 16%. But our performance on the automotive side certainly has been more of 17% level. We have been working on improving our content per car, so for us that's the key measure as to how do we try more content into the newer generations platforms that are being developed, the opportunity has been presenting itself in terms of evolving emission laws, new generation power trains required, downsizing of the engines and so on. So, as we speak our content per car with each one of the OEMs has been increasing which makes it possible for us to outperform the industry growth.

Srinath Krishna: For INA in specific and also you mentioned the content per car is increasing. Just if you could educate is better in Luk and INA, at least for the next three years which are the 2-3 main product components that you see will help in increasing content per car?

Dharmesh Arora: As in the last call also I had shared that we are roughly at about €33-€34 per car content today when it comes to the passenger vehicles. This has been driving at a good pace for us. Some of the trends for the next 3 to 4 years the BS6 standards, Euro 6 standards coming in 2020 that requires that many of our customers, the OEMs are upgrading their power trains, so I think that's one event that we will be able to improve our content per vehicle. There are certain products which are required towards meeting those standards. Things like what we make in the valve train system area, things that we make which allow the engines to become smaller so we have some new launches happening in 2018 as we speak with some of the largest customers in India we will be launching our product valve Duel Mass Flywheel which again allows the better absorption of irregularities in our Power Train absorb them better. So this is something that we are bringing into the country, we will be starting that product in 2018. We are also launching two new clutches in the country which are Travel Adjusted-Clutch and also Self-Adjusting Clutch. So TAC, SAC and DMF are the three new products that we are launching in 2018 and we see a good roadmap ahead of us as the volumes will pick up on these products and as the BS6 deadline is coming closer, these products and other valve train components will provide us good growth in years to come.

Moderator: The next question is from the line of Udit Bukharia from Catamaran. Please go ahead.

Udit Bukharia: If you can share the amount of localization that is there in your INA and Luk and what is the company's target like how much sales mix should be from India manufactured domestic manufactured?

Dharmesh Arora: We do have pretty strong business presence in India in automotive industry and industry our portfolio is really huge, on a global basis we have almost 40,000 catalog items that we can supply to our customers and our approach always has been that we want to make the whole complete wide portfolio available to our customers which means that we would never be able to produce all of these 40,000 parts in India or for that matter anywhere else in the world so we always have a pretty healthy mix of continuing to look at as to how we can improve our locally produced basket of products but at the same time make sure that we are also able to complement that by importing products from our other plants as necessary to complement the book of business we have with our customers in India. At this point of time on an India level combining the automotive industry, we have about 70% of our products coming from our own plants going into our customer locations the remaining 30% products we do import from our facilities around the globe. We have the approach to continue to improve as we call it localization ratio year-over-year and we will maintain on that path.

Satish Patel: Just to add one comment to what Mr. Arora mentioned. Your specific questions about how much INA and Luk localization ratio and likely also mentioned in the past that Luk has a higher localization ratio than INA. So Luk has over 90% localized, INA has around 65% localization.

Udit Bukharia: Your parent had I think recently lowered its overall EBIT margin target, so just was wondering, was that because of rising commodity environment or is it something else?

Dharmesh Arora: I am sure if you are able to participate in the global calls or if you've followed the investor presentation which has been shared, the range which we have with the global organizations has provided for 2018 is between 11.5% and 12.5% level. This is something that long-term I think the company wants to be consistent in terms of delivering performance that it can really come and deliver. From the perspective of the mix on a global basis between automotive and industry I think the company expects that the mix would change to some extent and for that the company has found it appropriate to provide the most anticipated outlook for the organization or for the investor.

Moderator: The next question is from the line of Hardik Doshi from First Voyager Advisors. Please go ahead.

Hardik Doshi: In terms of this makeshift towards the domestic manufacturing rather from the traded good, was there any significant disruption in the imports that you did from China, we are hearing that there was some kind of clamp down on their environment regulations. So just wanted to check with you is that something that impacted this makeshift and to that extent will that reverse going forward?

Satish Patel: If I understand your question and I think because we could not follow your question correctly. We could not hear properly. Your question was directed towards the influence of China because of that any impact.

Hardik Doshi: Yeah that caused the make shift is the domestic and away from the traded goods.

Satish Patel: I would say not so much, we are not so much dependent on either imports from China or the origin sourcing from China. Yeah, we do have a very small amount of business through for some of the products but this is unlikely to impact us.

Dharmesh Arora: An overview and approach has been on the long-term improving the localization in India, so it's not something that we have picked up either as a response to some developments elsewhere or even I am sure recently the government has also announced some adjustments in the duty rates. But the good thing is that we had been working on improving and increasing our localization irrespective and this is our group commitment to invest in our capabilities in India so that we can stay on that path.

Hardik Doshi: For the fourth quarter and also for the full year, the growth has been driven by automotive and export and industrial has been weak. So I wanted to understand that if you were to take out the impact of Wind which you said it had an impact in the second half, how much would industrial be growing by in 4Q and for the full year excluding Wind?

Dharmesh Arora: Industrial we all know is lot more matured business so the indication or the key indices for growth in industrial we track them as closest we can say are IIP core sectors and how they have been doing and you can clearly see those are lot more consistent low numbers towards 3.5%-4% year-over-year growth numbers. Our intent and our target still and always are to outgrow those indices and grow faster than how the market is growing and I think we stay on that path. Now talking about 2017, it was in many ways an exceptional year, we did have couple of large environmental changes. Starting the year with the demonetization impact, BS4 coming in and then through the year adjusting the business models to the implementation of GST. So those have caused some issues in the industrial business, we also have the impact from the pricing policies and auction policies rather of the Wind energy which is again meant that the main players in Wind have to kind of adjust their own business model to respond to that. In that context our industrial business arbitrarily has done quite well. We have been able to remain at the levels that we were and participate in areas where we selectively saw opportunities of growing. The last couple of months of 2017 gave us very good pace to build upon and I am pretty confident that going into 2018 the growth on industrial will get back to the levels that we have experienced in the past and complement the strong automotive growth that we are continuing to see.

Moderator: The next question is from the line of Mithun Soni from GeeCee Investments. Please go ahead.

Mithun Soni: I have a question with respect to exports; over the next 2 to 4 years what is the potentials opportunity for the export segment we are seeing, can we make India as the base for some of our products for the global market?

Dharmesh Arora: We all are seeing nice growth happening pretty much around the globe, so the economic activity is developing quite well in many regions around the globe. When you look at our own business last year, we had a very strong pull from the markets of North America as well as Southeast Asia. So our growth to these two regions was very strong and we still have a pretty strong order book available into 2018. So when you coupled with the global demand, global growth with the order book in hand I believe that our experts will remain at a rather strong pace through the year. I think most important thing for us will be to make sure that we can continue to improve our production levels through our factories, some of them are running at quite full levels already. So if there will be any constraint it will be how much can we do from our factories but rest assure that our operation team is taking that on and seeing as to how we can maximize the opportunities which will be available in 2018.

Mithun Soni: What are the key products which we are exporting today? The second question with respect utilization levels, what will be the utilization levels across the standalone as well as Luk and INA?

Dharmesh Arora: Let me take the first one and maybe Satish you can pull some utilization numbers. The products that we primarily export are in industrial segment. We build Cylindrical Roller Bearings in our plant in Maneja which are exported to many parts of the world. We do have Spherical Roller Bearings which again are produced in the plant in Maneja which again are exported to these countries. We also export small Deep Groove Ball Bearing, the Gen C high-quality Ball bearings that are produced in Savli. Those are also exported to many of these regions.

Satish Patel: Capacity utilization across our Indian plants and as you know, we have four plants, two plants in Schaeffler India Limited. One of the two plants of Maneja is fully utilized; the Savli plant is close to 85% utilized so the capacity is installed as of now in Savli plant are nearly fully utilized. For the plant in Pune which belongs to INA Bearings India Ltd. is also quite good utilized close to 90% now and the capacity utilization at our Hosur plant which is part of Luk India Private Limited is close to 70%.

Mithun Soni: Going forward you will need to do major CAPEX in the next 1 or 2 years to increase your capacity, what sort of CAPEX you will be doing?

Dharmesh Arora: I think we shared some of that in the last call that typically we have in the last year invested within the three entities at a level of about €18-€20 million each year into CAPEX. We have been recognizing some of the developments happening and we have in plan to invest close to

€40 million in this year in 2018, planning for which has already been done in 2017 and many of those orders have been placed with the respective builders of those capital equipment. We would have that capacity available installed through throughout the year of 2000 it in. So we are increasing our CAPEX investments, CAPEX commitments into the country both in 2018 as well as in 2019. We would be doing close to 40-45 million for each one of these two years.

Mithun Soni: Just to understand when you are planning this CAPEX are you also factoring some amount of capacity to be used for the export market? That is one question. The second over a period of time is export an important part of your strategy wherein you would like to make some of your products, India as a base for those products?

Dharmesh Arora: Globally our manufacturing footprint always is to try and maximize the local production for the local market and with 70 plants around the globe and presence in most of the markets around the globe, we will remain focused on how we can maximize the production locally. Having said that as I made a remark that with a very wide portfolio it is never possible to produce everything in every location, so we will always have a situation where we'll be importing certain products and we will be exporting certain products to other markets of the world. We continue to look at the competitive environment in India as to what kind of products suit or can be competitively produced in India. I think few products that I mentioned that are being produced and exported from India have been realized that those do make sense that production for those is done in India and we do support other regions where there is demand for such products. So we do this on an annual basis, engaging our global manufacturing footprint and scanning the global market and then we kind of continue to validate our long-term view as to what kind of investments we need to make in India and what kind of capacities and capabilities we have to create in India.

Mithun Soni: You indicated that our strategy is to increase the content per car as we go with the BS6 and all that. So if you were to give a broad ballpark from currently in the next three years if today the basis 100, what sort of content per car we can look at in the next 3 to 4 year period?

Dharmesh Arora: Currently we are at about €33-€34 per car and globally our business of Schaeffler, we are at about between €90 and €100 per car on the global level. So clearly there are opportunities for us to build our business stronger in India, bridge the gaps from 34 to 90 or 100, granted that some part of that is also the maturity of the market the technical complexity and the content per car which is available as the consumer segments or the consumer taste keeps shifting from smaller to larger cars, as the legislation requirements keep asking for more technically superior products in the car and as the safety and comfort requirements drive more content and car, it makes a larger canvas available to us. So I think it's a mix of both, the market maturity, the market development and our own interventions and actions as to how we continue to improve and build our business from €33-€34 to somewhere closer to how we are operating on a global level.

Moderator: Thank you. Ladies and gentlemen due to time constraint that was the last question. I now hand the conference over to Mr. Vijay Chaudhury for closing comments.

Vijay Chaudhury: Ladies and gentlemen thank you so much for participating even through the bad connections and waiting patiently for us. Due to time constraints we are having to close this call a little earlier than four o'clock. If you have any further queries, please reach out to me by e-mail which is vijay.chaudhury@schaeffler.com. Thank you and have a good day.

Moderator: Thank you. On behalf of Schaeffler India Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.