"Schaeffler India Limited Results Conference Call"

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**Moderator:** Good morning ladies and gentlemen. Welcome to the Schaeffler India Limited Results Conference Call for quarter 1 results for the period ended March 31, 2019. 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 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 sir.

**Vijay Chaudhury:** Thank you. Good morning ladies and gentlemen. Welcome to the Q1 results call for the period ended March 20, 2019 for Schaeffler India. Today we have with us, Mr. Dharmesh Arora – CEO, Schaeffler India and Mr. Satish Patel – CFO and Director of Finance, Schaeffler India Limited. I now hand over the call to Mr. Arora who will take you through a brief presentation and thereafter we will open for Q&A. Over to you, Mr. Arora.

**Dharmesh Arora:** Thanks Vijay. Good morning ladies and gentlemen. Welcome to our quarter one 2019 call. This morning, we had uploaded the presentation on our website that I will use at the basis to walk you through the industry and our own performance and subsequently, we would be opened for questions and answers.

As usual, I normally start the presentation by looking at the market environment and now I am on the slide #3 of my presentation. The GDP growth for most of 2018 or the financial year 18 and 19 as maybe the companies in India would look at was fairly robust, 7.4% expected for the whole year 2018, but clearly we have seen the peaks reached in the first two quarters of 18 and then some slowdown in the economy in quarter 3 and quarter 4. Good part is that the consumer price index more or less has remained at relatively under control as the impact of pricing exchange rate as well as the crude prices had subsided through the second half of 2018, though we do see some increasing pressure again from the crude oil perspective, but hopefully the rest of the commodity prices for us, particularly when it comes to steel, we should see some moderate levels for the rest of the year 2019.

The Central Bank did step into cut the repo rate by 25 basis points in April in order to sustain growth, so that momentum is, government is trying to put the momentum behind the economy. We did see though significant slowdown in automotive sales towards the last quarter of 2018, which unfortunately still continues and again, I think we all can blame it on low consumer sentiments coming from global concerns or maybe some local stuff like the oil, insurance rates or maybe even the interest cost being high and then of course the ongoing general elections and the sentiments around that. Within all of that we do expect that 2019 might see height and volatility compared to what we had seen for the last some years, so that something we need to be prepared for.

Going into the next two slides, which give a little bit more detail on the sectors that we are most interested in, so slide #4 shows the infrastructure or some of the core sectors, cement, steel, coal and electricity. Most of them were in positive territories, anywhere between 1, 2, 7 or 8%, 9%

growth, so I think these were relatively good numbers for 2018 and now at least for the first two months, the data for which we have available also continued in the positive territory.

Coming to the slide #5, which is where I have the automotive sectors of two wheelers, commercial vehicles, tractors and passengers vehicle shown, I think we all know that all of these sectors have been under pressure for the quarter 1 of 2019 as was the case for the quarter 4 of 2018, but if you were to look at for here today, it numbers for the year 2019; passenger vehicles had a negative growth of 3.5%, agricultural tractors were down 8%, commercial vehicles were more or less flat and two wheelers were down 9% for the quarter 1 2019, so not a very pretty site. Most of the segments here had negative numbers and when you look at our business which good part of our automotive business comes from passenger vehicles and agricultural tractors combined, both of these were down anywhere between 4 to 8%, so clearly when our customers are not doing well, they are not pretty using enough tractors or cars, it does affect our revenues as well.

Now, let me get to our own performance which is what now I am on slide #7, so we reported for the quarter 1 Rs. 11,723 million as the revenue which is 8.2% higher than the quarter 1 of 2018, but slightly slower by 1.2% compared to the immediately preceding quarter which was quarter 4 of 2018, so our automotive business continued weakness coming from the organic developments in the industry. On the other hand, industrial business showed some really strong growth of 14.6% for this quarter compared to the same quarter of 2018. Automotive was down 3.4% and exports was up, almost 24%, so when you look at our mobility segment, within that automotive showed weakness, but railways, for example had a pretty nice growth in this quarter. In other sectors, raw materials, power transmissions and distribution or aftermarket for industrial showed some really positive and strong growth, giving us an overall nice 8% growth compared to the year before.

Now, coming to the bottomline or our earning quality on slide #8, we reported Rs. 1626 million, which was 13.9 percentage point of sales compared to 13.2% in the immediately preceding quarter, but 15.6% which was the case for quarter 1 of 2018, so key takeaways from this is that we continued to be faced with adverse sales mix, clearly automotive not performing well, put pressure on the mix as well as from the volume perspective that volume loss clearly affected our performance. On the other hand, we do see nice smart recovery from the low that we experienced in quarter 4 of 2018, so we were able to reverse the trend on the profitability side through improved operational performance, controlling overheads, we were able to deliver better result than the quarter 4 of 2018. We do see continued cost pressure or we did see continued cost pressure through the quarter 1 2019. Hopefully, the current expectation that the commodity prices particularly the steel which is showing some downward trend should help for the remaining quarters in the year. We did experience higher inventory levels, working capital levels in this quarter and that certainly needs attention and correction clearly when there is a significant change in the automotive industry at a short notice, corresponding to that does take time with the long value chain we do have, but we are intervening in terms of looking at our plant production levels and also the inventory pipeline that we do have, so that we are able to bring this in control or to our targeted level as soon as possible. So key takeaway, yes the quarter 1 earnings quality was impacted by volume loss and adverse mix, but it is better compared to quarter 4, so that something we are very happy about and I think the team has done an excellent job in looking at our operational performance and overheads to try and deliver these results.

The next slide, slide #9 gives some details and I think you have this in your handouts. I would probably not speak whole lot onto that other than saying that our performance certainly on the bottomline ways was better than the quarter 4 2018 and we hope to maintain this trend in the coming quarter.

With that I will come down to quickly the summary slide, so that we can leave enough time for the Q&A. In an economy maintained strong momentum, though we are seeing some weakness and hopefully after the election, these sentiments are gone and we do hope that we will see stronger growth for the second half of 2019. Automotive sales were now impacted by the industry sales slowdown, but at the same time, some mix lost due to the rapid than expected shift from diesel to gasoline engines. Our PBT at 13.9% is better than the quarter 4 2019 and the efforts that we are making are showing results in terms of delivering this. We need to have close monitoring and agility to keep inventories in check, but at the same time, we want to remain aggressive in the market place and particularly in the industrial segment. At times, it is very important that availability is there, so that the sales can be realized, so we would maintain a close sort of balance between minimizing inventory or controlling inventory, but at the same time ensuring that we do not lose any sales and lastly, the one Schaeffler India project, particularly the synergies out of the post-merger integration that we had announced and concluded last year continues to be on track and we continue to monitor that and we feel good that we should be able to deliver the kind of projections we had shared with you earlier in the year or last year. So with that let me come to the conclusion of my presentation and I hand it over back to Vijay for him to describe the next steps.

**Vijay Chaudhary:** Thank you Mr. Arora. Over to you, moderator.

**Moderator:** Thank you. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Nishit Jalan from Kotak Securities. Please go ahead.

**Nishit Jalan:** Sir, my first question is on the automotive segment, you have talked about the revenue decline. Can you give some more colour into how was the OEM and how was the aftermarket business within the automotive space?

**Dharmesh Arora:** Yes, the automotive business within the OE space is where we have seen significant weaknesses and I think we have all seen the numbers which I have been announced by large OE customers. They all have been correct at inventory and making sure that they remain cautious in terms of the production levels maintained in their own plants. Automotive aftermarket, I think we did have pretty good quarter, so automotive aftermarket was not impacted to the extent that automotive OE was, so automotive aftermarket for us should have grown pretty close to 10% level whereas the automotive OE, I have seen a decline for us.

**Nishit Jalan:** Sir, secondly, when you talk about industrial segments, you classified two wheelers and truck business within the industrial segment, right?

**Dharmesh Arora:** Yes, except the clutch business, so we kind of a little bit complicated, so the clutch business is counted as automotive whereas the bearing business is typically called as industrial.

**Nishit Jalan:** Why I am asking this question is because as you highlighted two wheeler and tractor were down significantly and your industrial business has still grown at 15%, does that mean that the core industrial business, the growth was much higher and just wanted to check where is this growth exactly coming from? We have seen utilization levels moving up across segments, but we have still not seen new CAPEX being announced by different companies, so just wanted to get some more colour on where the growth is coming from?

**Dharmesh Arora:** Sure Mr. Jalan, so the two wheelers and tractors or trucks, even if they were split between automotive and industrial for us, I think either one of the divisions would have the same impact because clearly if the customers are not pretty using as many tractors or trucks, it does impact both the divisions, whether it is clutches or bearings, so I think you can safely assume that either one of them had the negative impact from that state. Now, coming to the industrial business, yes that continue strong growth that we also experienced in calendar year 18 and some sectors for us particularly which delivered strong results in this quarter, our railways, raw materials or sectors like steel production, mining, cement and paper and pulp and stuff like that and then our aftermarket or the industrial distribution business within industry, so those were three particularly, I would highlight in our industrial businesses which delivered strong growth.

**Nishit Jalan:** And sir, my third and final question is, we have seen OEMs coming up with, some of the companies have come up with BS6 compliant vehicles and in the past, you have highlighted that certain of your components in your entities like LuK like Double mass fly wheel or couple of components on I&A side, the content of those products will increase as we move towards BS6, so I just wanted to hear more from you on this front as to whether you are seeing that trend actually playing out, whether OEMs are actually using those components and what kind of content increase can we see for Schaeffler products in passenger vehicle segment particularly?

**Dharmesh Arora:** Since our last conversation, I think we have seen significant developments in terms of some of the announcements that major OEMs have made in preparation for the BS6 norms, some are positive and some clearly are not that positive for suppliers, I think there is a higher realization of the challenges that the small diesel engines face in the phase of BS6 norms coming up in 2020 and again in the last couple of weeks, I am sure you have seen announcements from two of the largest OEMs in India. So those reductions in diesel penetration next year would not be that positive for us. That is why I said. I mean when you have more content per vehicle available because diesel typically have more content that does not very positive, but the same time, those diesels then would be replaced by more of gasoline engines to be produced, maybe each one of them does not have as much content as diesel has, but still there is replacement coming from the gasoline, so for us, overall I would say, some of the developments in the last two weeks have not been that positive for 2020 onwards because they will mean some short-term adjustments, many of the component suppliers like us will have to make in their product mix to be able to support the OEM requirement, so overall I would say, I think we continue to monitor that but the developments are not necessarily extremely positive in terms of how the diesel story will play out for 2020.

**Nishit Jalan:** Sir, just to extend this, any sense you can give us, for example, any vehicles, if for example, mid-sized vehicles like Baleno or Swift, in those segments, on the petrol side, what used to be your content earlier and what it could be with BS6 or after the companies launch the BS6 models, I am not asking for exact numbers, any index numbers or any, just to get some sense whether the content increase is 5%, 7%, 10%, what sort of content increase can come only on the petrol side, I understand the diesel part that you just made?

**Dharmesh Arora:** I think we all know the largest OEM announced that they would not be doing any diesels in 2020 and I think we all know how many diesels they do currently, so when there is no diesels in 2020 or further pretty much from April 2020, there is no diesel, typically diesel is anywhere between 60,000, 70,000, 80,000 or even up to Rs. 100,000 more expensive and for us our content, depending on the complexity of the diesels in terms of the NVH expectation, the refinement and so on, we could have anywhere between Rs. 3000 to Rs. 5000 of more content on the most highly equipped diesel engine. So that kind of impact we could see. Now, when you do not have those diesels, some of these gasoline engines are increasingly now being equipped by multiple cam phasers by newer content which also is required for them to meet the emission norms. I think overall from the mix perspective, we were doing some evaluation for the current year, for example and from there we could project that the next year we could have an impact of up to 2% to 3% on the diesel mix change alone and that is something to be looked at as to how that can be compensated by other sectors and other segments.

**Moderator:** Thank you. We will move onto the next question that is from the line of Sandeep Tulsiyan from JM Financial. Please go ahead.

**Sandeep Tulsiyan:** Sir, my first question is pertaining to one of the observations in the annual report. We noticed that the traded goods have grown at a very significant pace in the past year, almost of 40% kind of a jump and also we saw similar kind of an increase in the first quarter results of almost 36% in purchase of our traded goods, could you just elaborate the reasons, why we are seeing such a large jump?

**Dharmesh Arora:** Two reasons I would say, one is that we did have a pretty strong growth last year in industrial, almost 20% growth last year and this year again for the first quarter we have reported almost 15% growth in industrial and industrial has a larger component of traded growth. Again, just from the business mix perspective and the product portfolio perspective that is how that business is, so when that business grows rapidly, the supporting traded goods business also moves in a similar manner, so that is sort of one reason. The other reason I would say which is something we are not very proud of or not very happy about is the way the inventories have grown, so traded products typically also have a longer leak times and when the market is a little bit more volatile like it is turning out to be, you want to make sure that you stay very active in the market place, you try to understand the customer demands and able to predict and secure the inventories that you think would be necessary to realize sales 3 months, 4 months, 6 months down the road and that has not been as précised as we would like it to be yet. We are continuing to invest into creating new IT infrastructure which is what we did last year, we upgraded our IT infrastructure to be able to better predict the customer demand and have a better demand management. As the capability of our own people, our own team in using those IT tools in a more productive manner, we think we will continue to get better. So again, to summarise two reasons, one is the mix perspective that industrial that was growing very strong and we wanted to make sure that we realize those sales, we did take action towards that and the second which is unintended consequence of that but something we would like to improve which is our inventory situation.

**Sandeep Tulsiyan:** Sir, second question is regarding the CAPEX guidance that we have given in the past that company was trying to aggressively ramp up its CAPEX, given this recent developments on the BS6 engine and a lot of companies trimmed down their diesel engine portfolio, would you want to trim down this CAPEX guidance or would you still maintain that the company will incur almost 1000 crores CAPEX over 3 years?

**Dharmesh Arora:** Well, we continue to revisit the planning cycle every year, so that is something we are in the midst of it as we speak and may be more towards the third quarter we would have an outcome from it as to how the situation is evolving. At this point of time, we haven't not changed any of our short-term or mid-term investment plans yet, we believe in the long-term story for India that it is still pretty solid, so as of now, we have not made any changes, but once again I think the like many of us and many of you, I think we are awaiting as to how things turn around again as we get into towards the end of second quarter and third quarter of the year which is also time to dwell with our own annual planning cycle and we will take the appropriate call as necessary, but at this point of time, we have not changed any of our investment plans for the country.

**Sandeep Tulsiyan:** And sir, my last question, this could break up last year's full-year growth between volume and value just to determine what sort of price hikes has the company rolled out?

**Dharmesh Arora:** Unfortunately, I do not have that readily available, so you were looking at how many pieces we have pretty used versus the value, right?

**Sandeep Tulsiyan:** Yes, broadly want to get a sense as to how much price hike have we been to take?

**Dharmesh Arora:** I mean what I can tell you is last year, I think through the calls we have had through the year, I had been mentioning that we started that action around second quarter of 2018 and towards the end of the year, we wanted to see that most of the price actions were realized. On industry, we were able to do good part of that. On automotive, my own internal tracking is that we have realized close to 80% of the price increases that we were intended to go for, so I think more or less most of that is in the back, we have a couple of customers or couple of negotiations still outstanding which should be concluded anytime soon and with the way the commodity prices are going, we do not see any other reason at least in the automotive space for any other price actions through the year, but most of the ones that we started from last year, good part of that have been realized.

**Moderator:** Thank you. We will move onto the next question that is from the line of Priya Ranjan from Antique Stock Broking. Please go ahead.

**Priya Ranjan:** Couple of things on the core industrial, what will be our sale of business, I would say an overall at topline, what will be the industrial segment, the core industry except traction, two wheeler and tractor which we have been putting inside the industrial so far?

**Dharmesh Arora:** What we show and I think in one of the slides #7, there is a pie which shows the automotive and industrial business, so automotive was 48%, industrial was 42% and I do understand that we count some of the two wheelers and off-road in it if you were to eliminate that still the 42% could drop down by another 10% to 11%, so 30% to 31% would be core industrial as you defined it and most of the export which is shown as 10% is also core industrial, so with that the picture now should be close like 41% core industrial, once again like the way you have to find and the rest would be automotive.

**Priya Ranjan:** And second question is on, I mean you have mentioned that impact of the diesel, so any sense or so far what has been or mix between gasoline and diesel in terms of our sales mix per passenger cars?

**Dharmesh Arora:** I think the industry is now projecting that the quarter 1 2019, the mix was more like 26% diesel penetration, so that was the product mix coming from the automotive OE, passenger vehicle production for the first quarter which I think has stopped by almost 10 percentage points between 2018 and 2019, so that is a significant change in a very short period and projection is that this may continue to go in the direction more of gasoline for 2020.

**Priya Ranjan:** But my question was more related to the Schaeffler mix, so you said you have a higher relation or higher content in terms of diesel, so my question was more related to how much we are fetching from say, diesel portfolio rather than?

**Dharmesh Arora:** The challenge when you start evaluating business like ours, it is not just the mix between the two, it is the content per vehicle, the content per power train and depending on the refinement of diesels are significantly different for high performance diesel which has a very high expectation when it comes to refinement, smoothness, NVH level, the content on that diesel engine can be very different than a very entry level diesel engine, so for the sake of not creating a misunderstanding that is not a number I have readily available to be used as a benchmark, but like I said, the mix changes alone could have an impact of our topline revenue anywhere between 2 to 3% for us.

**Priya Ranjan:** And in terms of, you have witnessed very strong growth in railways, so any thought, I mean what kind of growth we have witnessed in the first quarter?

**Dharmesh Arora:** So, first quarter, we have witnessed in excess of 30% growth in railways and some of that was our product portfolio and the pipeline which was getting loaded particularly as this transition is happening from simple bearings to more Tarol bearings, our pipeline of orders and execution was strengthening, so we have been able to deliver superior performance and I expect that for most of the year, I think we will maintain a strong growth for railways.

**Priya Ranjan:** So the CAPEX in terms of railway, it is also linked with the CAPEX of the railway, so you see that is going strong for the rest of the year?

**Dharmesh Arora:** We did start the Tarol production early last year in 2018 and that is ramping up and now we are investing into improving our value addition within that product line and increasing our level of localization, so that we can improve our competitiveness in that segment.

**Priya Ranjan:** So just coming back on the localization part, so I mean couple of plans or couple of businesses have low localizing level when all the integration has happened, so where are we in terms of say, localization level that is one part and second part is on the raw material side, we have witnessed the steel price has come down sharply in last quarter for 5 months, so can we see some kind of gross margin improvement because of that going ahead or we have to pass it on the incremental benefit?

**Dharmesh Arora:** The localization continues to improve, localization from the perspective of the products that we supply from our plants to our customers, we are close to 70% of the products that our customers receive come from our plants in India, though within those products that we make in our plants, we do have some raw materials and some subcomponents being imported and our effort is towards improving both these numbers to increase this 70% to a higher level at the same time to improve our value addition, so that we are less dependent on imported components which of course hurt us from the perspective of foreign exchange variation, at the same time the last year's unexpected import duty hike that we experience, so our effort remains on continuing to improve our localization level and each year, I think we are able to ramp up the level by about 1 percentage point or 2 percentage points and that has been our consistent road map for the last year and we will continue to maintain that. Coming to the steel price levels, yes we did that come in 2019 from somewhat of relatively very high levels of steel prices last year. For the last few months, we have seen this softening in the prices globally and many of the input cost whether it is the prices of coke or the scrap have also been seeing softness, so I think that is good signs. We typically negotiate our contracts on a quarterly basis, so the new prices for us have not kicked in into our performance for quarter 1 2019 yet. They typically will go into our input cost and depending on the inventories we carry, etc., sometime in quarter 2 of 2019, so we do hope that should start benefiting us when it comes to gross margin in 2019.

**Priya Ranjan:** And lastly, one thing from the annual report side, I have read the schedule of having say, technical fee, etc., pay out to the parent, so it is showing like some, annually it is like 20% growth in terms of technical fee or royalty, whatever you want to say it, to the parent despite and there is no linkage of that to the sales growth, so is it the true understanding?

**Dharmesh Arora:** There are two portions that we just described that I will ask Satish Patel to delve a little more into it, so the cost that we might have is the work that we get done from overseas locations of our group, so for example, if you are developing a new program, there are certain kind of tests and certain kind of engineering support that we receive from other locations of Schaeffler and those are paid out and the other fees probably is the royalty fees and our focus on the first piece is to have increased level of work done in the country, so we have continued to make investment in our R&D capabilities with the objective that most of the work we would like to do within the country, so as we go into the next year, you should see as percentage of sales, this should come down, but then we will invest a higher level into the local R&D in India, so that is the first fees and then royalty, I don't think there should be any change, but let me pass on the mike to Satish and let him make some comments around that.

**Satish Patel:** Absolutely right what Mr. Arora mentioned. As far as the royalty is concerned on a consolidated basis, the royalty is below 2% of the total revenue. Our total licence fees and royalty which consists of royalty for technology and royalty for trade mark together is around 1.9% of the total revenue; however, we do have other type of service payments to the parent, for example, for the information technology services, for the system upgradations, those are also the charges which are in the nature of fees but they are in addition to the royalty and they are not for the royalty which is for technology and trademark. Also for the last year, we increased that you are referring probably 20% also that is more or less in line with sales, the sales also grew 16% year-on-year and that was in line with this also the growth, but there has not been otherwise any increase in the royalty.

**Priya Ranjan:** And also talking about the futuristic projection you have made for the technical know-how and the royalty pay-out, so in all this, you have mentioned that it will be keep growing by around 20% annually until 2022 or 2023, so if I have to do the sales projection of 10, 12, or 13% annually, then your royalty rate which is now around 1.9% might go up to say 2.4% or so, how should we look at, I mean is it the right way to look at?

**Satish Patel:** I think you are referring the statement that we have made for increasing the amount of transactions for the related parties and there are the services including the royalties with the related parties, we are projecting a max of 20%, so should there be self-increase beyond our normal projection that should also accommodate the increase in the service fees, so it was more in the context of related party transaction that does not mean that we are actually going to increase that fees by 20%.

**Moderator:** Thank you. We will move onto the next question that is from the line of Vimal Gohil from Union Mutual Fund. Please go ahead.

**Vimal Gohil:** The first question was on inventory levels, you suggested that inventory levels have increased this quarter, what would be the quantum of increase sir, in terms of number of days as compared to calendar year 18?

**Dharmesh Arora:** So at the end of the year 2018, we had an increase in our inventories and for the quarter 1 of 2019, again we have experienced some negative developments there and for the quarter 1 2019, the development came primarily because of the reduction in the automotive industry, while last year, it was more of intervention from our side in support of the industrial business sales, at the same time, some of the transitions we did from our IT infrastructure in putting together a new demand management system. Overall, we have seen an increase of inventory which is close to 25 days for us and this is now something that we would like to see. We have taken significant interventions in terms of how this inventories can be brought down quickly while protecting the possibilities of upsides which could be available in the market place on the short term, so I am pretty confident that from quarter 2 onwards, you would start seeing the change in terms of bringing this inventories to what we typically have and this direction and this development should continue for the rest of the year.

**Vimal Gohil:** So by the end of the year, you should see this normalization happening by the end of CY19, right?

**Dharmesh Arora:** For sure, once again we do see some significantly high volatility or possibility of volatility in the quarter 4 2019 due to the BS6 norms and so on, so as much as at this point of time, we would target to bring it down to the levels that we normally have, at the same time, I am cautious that we may face increased level of volatility and at the same time want to make sure that we do not lose sales, so I think we will maintain a good balance of the two, our intent remains to bring it down to the normal levels, but in the phase of any unforeseen volatility, we may have to respond to the market the way we need to.

**Vimal Gohil:** Sir, second question is on this increase in the replacement or rather the traded goods segment, shouldn’t our localization initiatives help us to reduce the replacement or imported goods that we get from our parent going forward?

**Dharmesh Arora:** Absolutely, that should be expected, I mean we are continuing to make investments into the country, we have a target of improving our localization rate by 1 to 2 percentage points each year, so directionally over the longer period, you should certainly see that as a percentage of overall sales, the credit should go down. That is certainly the objective in the target.

**Vimal Gohil:** Out of that 1 to 2%, how much do you think you will be able to keep it yourself and how much will you have to be pass it on to your customers?

**Dharmesh Arora:** Typically, those are always shared with customers and depending on the situation and the customer leverage and so on, the percentages could be different but the benefits of the localization are typically shared between the customer and us.

**Vimal Gohil:** And sir, last question from my end, how much, sorry I haven't really followed this, but how much is your current CAPEX guidance, I know your planning stage currently, but for CY19 what is your current estimate?

**Dharmesh Arora:** For the year, we are targeting 340 crores of CAPEX investment and last year, we had done 240 crores.

**Moderator:** Thank you. The next question is from the line of Keyur Shah from Emkay Global. Please go ahead.

**Keyur Shah:** Sir, I would like to know what is your growth in wind power segment and what is your outlook on the same for CY19?

**Dharmesh Arora:** Well, our quarter 1 result was certainly positive, we grew at least, I mean that something we are happy about from 2018 which was not that great for wind energy in general and just reading a news report of this morning, I think you would have seen that as well, the execution of the two tenders that solar energy corporation had of gigawatt each, the execution to those have been not that encouraging, I think our customers have missed those deadlines, so that is not very positive for the wind energy in general, but the good thing is that we have some of our customers who have a pretty strong developments coming from export business, so some of our customers are building the transmissions in India for exporting them to other markets and that is something which has been helping us to at least deliver positive growth, so it is not a great positive number that I can talk about, but it is certainly in positive territory when it comes to wind energy growth for us in the quarter 1.

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

**Shyam Sunder:** Sir, with this ABS implementation in passenger vehicles, is there a complete shift to Gen 3 bearings and have we benefited in terms of getting nominated on new platforms, how would our share been and is Gen 3 mandatory for this ABS implementation? Or one can still do with the Gen 1 bearing with the sensor embedded event, if you can throw some colour on that sir?

**Dharmesh Arora:** As far as I understand the Gen 3 is not necessarily prerequisite for ABS, though I think the OEMs generally are graduating towards Gen 3 for not just ABS alone but from the overall total cost of ownership and the customer perspective, higher life time, more reliability and so on. Having said that the trend towards the Gen 3 continues, increasingly the new RFQs we see are more towards Gen 3, but there are couple of OEMs who still stick with the Gen 1 and Gen 2 as they have designed philosophy, so I think it is a little bit of sort of misbag there, but generally the trend towards Gen 3 continue. The other trend that if I may had is not just the ABS sensors on the Gen

3 bearing, but the ABS pumps themselves, so as the ABS penetration is increasing, many of the producers of ABS pumps are now considering to localise these pumps in India which could provide us some opportunity when it comes to the bearing usage within those pumps.

**Shyam Sunder:** Historically, on the automotive side we have grown better than the underlying industry, given that diesel mix is coming down, are there any specific products on the gasoline side which can give us better than underlying auto industry growth or do we see as growing more in line with the industry, any colour on that will be helpful, sir?

**Dharmesh Arora:** I think clearly the industry has to still address the long-term objectives beyond BS6 and those are the evolving cafe norms which become or we go to cafe 2 norm in 2022 which limits the CO2 grams per kilometre 213 grams or maybe even lower. Diesel secondly as much of as the challenge the customers are facing from diesel, diesel typically is a low CO2 output engines, so now as the mix of our OE customers moves away from diesel, they have a larger challenge to meet the future CO2 now and that could only be met, for example, by introducing some kind of hybridization, for example into the gasoline engine in order to compensate for the loss of the high efficient diesel engines, so that is the trend certainly we should experience, we should see. Hopefully, the same 2 incentives which now also include hybridization into the incentives which is providing also provide some incentives for our customers to consider that, so that in my opinion could be a big trend which should materialize over the next year.

**Shyam Sunder:** So on the gasoline side, do we have any new products from a BS6 perspective and with this situation, do you think we will grow better than the underlying market or we may grow more in line with the market, any talks on that?

**Dharmesh Arora:** So BS6 is all engineer done, the engines are being launched as we speak, so compared to the relevant BS4 engines, we do have more content per engine on BS6 as an average, not significantly higher, but somewhat higher levels, not as much as we would like to have on the diesel, so overall mix is still, this whole transition and the change is not that positive for us since the diesel is losing ground. On the other hand, the longer-term developments now which have to happen on the gasoline are suddenly very positive and we are starting to receive those RFQs from our customers as they now try to upgrade their gasoline engine and try and see as to how they can make up for the loses of the high efficient diesel engine.

**Shyam Sunder:** From Schaeffler perspective, is there any new products that you would like to highlight that might go into these efficient Gasoline engines that will make up for the diesel loss?

**Dharmesh Arora:** I think the most important probably would be the cam phasers which is used in the valve train areas, I think that is probably one of the most relevant technology which is necessary for BS6 compliant vehicles and also increasingly the engines are using more of hydraulic lash adjusters and finger followers or HLA and RFF that is something we do very strongly in India, so the newer engines are increasingly changing the valve train components to improve the compression efficiency in gasoline engines.

**Shyam Sunder:** Sir, just one last question, we announced about the crores CAPEX, between the bearing side and INA and LuK, how will this broadly look like, where is the majority of the CAPEX going and added to that sir, with higher focus on localization, will the incremental ROC on these investments be better than the average company level ROC, if you can throw light on both of these aspects?

**Dharmesh Arora:** Yes, obviously each localization program is centred around the business case. Localization is not for the sake of localization alone, but it is geared towards increased value addition for all the stakeholders and that is how we look at each localization program and each investment. So guidance wise, yes, I mean that is how we would target that each localization step brings improved overall results for everyone involved in the business. Coming to the capital investments, overall 340 crores revenue, this year a good part of the CAPEX investment goes towards new building constructions that we also have to provide for the future intended growth of the buildings and so on, so Savli as we speak is undergoing a construction of new building hall, which is targeted to be completed by the end of the year. We have some new capacities for bearings coming into both Savli as well as Maneja through the year and then similarly we are bringing some new investments in Talegaon in the building that we completed last year in terms of expanding our capacities for our ongoing or the current program. So I do not necessarily have a readily available split between bearings and non-bearings, but it is a mix of all plant investments, building investments, land and building investments, then we have investments for bearings as well as some of the investments going into non-bearing investments including R&D.

**Shyam Sunder:** Sir, why if I can squeeze in one last question, you spoke about strong growth in the industrial aftermarket, if you can please quantify the growth in the industrial aftermarket and added to that is this growth driven by shift to the more established players from the unorganized players, is that what is driving the growth over and above the underlying increase in utilization levels?

**Dharmesh Arora:** Some of the sectors like I mentioned the raw material sectors, steel, cement, paper, pulp, etc., have seen strong growth both on the OE side as well as MRO side which is a good reflection of the capacity utilization at the sectors and typically this MRO customers are supported through our distribution channel, so I think that is certainly one of the trend, so the continued investments into the infrastructure sector which is driving the growth in the supporting sectors like the cement, steel and so on has been driving other MRO growth for sure. Other than that we have been looking at expanding our product portfolio for last year, for example, we did launch new industrial housings under the FAG, SNP brand names, so we also are taking actions in terms of increasing our portfolio and being aggressive in the market place in realizing opportunity through product portfolio expansion and the availability of inventory of the shelf, so these were some of the actions through which we were able to better realize high double-digit growth in industrial distribution segment.

**Moderator:** Thank you. We will move onto the next question that is from the line of Pavan Parekh from Renaissance Investment. Please go ahead.

**Pavan Parekh:** Just to understand this better, all the product applied to two wheelers and off roading is part of industrial or CV is also part of industry or is it that only bearings to auto signal is industrial?

**Dharmesh Arora:** Once again, my apologies for putting you into this complexity of how we track our business, but let me make an attempt at describing this one more time, so all the sales to passenger vehicles bearings or clutches or automotive components are all counted as automotive sales for us. In two wheeler, all the bearing sales we count them as industrial and all non-bearing which include some engine components and if we were to make clutches which we do not that would have been counted as automotive. In tractors, similarly all the bearing sales is counted as industrial and all nonbearings, engine components and clutches that we do supply is counted as automotive and the similarly is the split in trucks. Did you have a question beyond that or you just wanted to understand how we count our business?

**Pavan Parekh:** This is fine, secondly if you could just indicatively state what is railways as percentage of total revenue contribution?

**Dharmesh Arora:** So, railway for us will be about 4% of our overall Schaeffler India business, but growing since it is growing faster than others, then this ratio, even if in a smaller percentage will continue to raise.

**Pavan Parekh:** Of about 25% to 30% pure domestic industrial business, what would be the largest piece of this business, say railways about 4%, if you could give any other further industrial takedown within this?

**Dharmesh Arora:** Half of that 30% which is about 16% to 17% business is distribution, which has the bearing sold through our distributors for MRO customers and other smaller OE customers which might be serviced through the distribution business and then the whole mix of other sectors which is railways, you said, raw materials, wind, industrial automation, power transmission, so these are the other sort of core industrial sectors which all would have sort of single digit business of our overall business.

**Pavan Parekh:** And sir finally, if you could highlight in terms of your concentration in the automotive space, so the top 10 customers are largest OE or top three customer's revenue contribution, if you could throw some light on that?

**Dharmesh Arora:** I mean more or less that should be in line with the OEs presence and our fair share with them, so no surprise that Marutis are largest auto customer, I mean they do have the largest market share in the country, then we are very strong with customers like Tata, Mahindra, Hyundai, all the other OEMs in India. Good part is that we have relationship and supplies to every OEM in the country. On tractor side, similarly we do supply to all the large tractor customer, be it again Mahindra, Swaraj, Tafe and so on and within two wheelers, TVS, Bajaj, Honda, Yamaha, Hero, they all are customers or in trucks which we supply to Tata, Ashok Leyland, Daimler, Volvo, Eicher and so on.

**Moderator:** Thank you. Ladies and gentlemen, due to time constraint, we will be taking the last question that is from the line of Mukesh Saraf from Spark Capital. Please go ahead.

**Mukesh Saraf:** My first question is could you quantify what kind of extra content per vehicle you have on the automatic transmission versus the manual transmission, just like you had mentioned for diesel, it would be may be 3000 to 5000 mode, but any indicative number on automatic versus manual?

**Dharmesh Arora:** Most of the automatic transmissions which are currently being used other than the AMT or the AGS are currently being imported. I think most of the OEMs are importing those transmission units in a completely assemble form as far as I know and hence, we will have content on each one of them, but those content typically would not be the sales of Schaeffler India. Those content would have been provided by our business units in the country of manufacture wherever those transmissions are produced, so today our automatic transmission sales out of India into the transmission is very limited just on the simple fact that those transmissions are not currently being produced or assembled in India.

**Mukesh Saraf:** Any near term plans or the OEM looking to source it more locally and are you working with them for that in the next one year or something like that? Do you have some timeline there?

**Dharmesh Arora:** As far as I know I don't see whole lot of activities there, I think the OEMs are still evaluating the various options which are available towards the transmission automation and there are some business cases, there are some interest from the OEMs in considering few possibilities but as far as I know, I don't know of any program which will go into production in the next 12 months.

**Mukesh Saraf:** And my last question is last year around this time when you had shared your presentation on the merger, you had mentioned about synergies, you had a 3-year target and a 5-year target on synergies on revenue and cost, could you give some update now that it is a year? Could you give some update on where we stand on those targets?

**Dharmesh Arora:** We had come up with our assessment that on the revenue side, we may have synergies up to 470 crores over the course of next 5 years as the next programs get sourced by the OEMs and so on and on the cost synergy side, we had forecasted opportunity of reducing our cost by up to 50 crores in the next 3-year time horizon, so those were the numbers we had shared and we continue to evaluate our progress towards both of these actions and at this point of time, I think I would like to state that we would like to maintain our forecast more towards the higher range. These are the higher range that we had forecasted as achievable, so we are continuing to track them as in the last 6 months we have implemented to new warehouses, one in Mumbai, another one in Baroda. The efficiency gains through that through the logistics cost reduction, some of the central shared services we have introduced, for example in our recruitment process within our HR functions. Things like these will start to deliver cost efficiencies and benefits to us and at this point of time, our forecast is that whatever we had shared with you in the last 12 months are still achievable.

**Mukesh Saraf:** But does it mean that we have not yet seen anything material in the first year, is that what it means and we will probably see a lot of this coming in the next 2 years?

**Dharmesh Arora:** On the logistic side, for example, our logistics cost as a percentage of overall sales has gone down by 1 percentage points in the last 12 months, so not all of that is towards synergy, but good part of that is because of some of the warehousing improvements we have been doing, some of the networking improvements we are doing and so on. So we are starting to see the benefits of that, continue to realize some of the revenue related things, we have secured the contracts, but those contracts will start execution in may be 2 years from now, so we have done the contracts, but the revenue does not stop throwing in until they go into production and that is the reason we have projected that it will take up to 5 years to realize those synergies, but the confidence level of our ability to realize in that 5 years or 3 years is relatively high.

**Moderator:** Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. Chaudhury for his closing comments.

**Vijay Chaudhury:** Thank you. Thank you for participating in the call ladies and gentlemen, we will close the call now. If you have any follow up queries, you can reach me on vijay.chaudhury@schaeffler.com. Thank you and have a good day.

**Moderator:** Thank you. Ladies and gentleman, on behalf of Schaeffler India, that concludes this conference. Thank you for joining us and you may now disconnect your lines.