"Sundram Fasteners Limited Q3 FY23 Earnings Conference Call"

February 6, 2023

MANAGEMENT: **MR. R DILIP KUMAR – CFO, SUNDRAM FASTENERS LIMITED**
MR. R GANESH – CORPORATE FINANCE, SUNDRAM FASTENERS LIMITED

MODERATOR: **MR. RAMAKRISHNAN – AVENDUS SPARK**

Moderator: Ladies and gentlemen, good day and welcome to Sundram Fasteners Earnings Call hosted by Avendus Spark.

This conference call may contain forward-looking statements about the Company which are based on the beliefs, opinions, and expectations of the Company as on the date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict.

As a reminder, all the participants' 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 touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Ramakrishnan from Avendus Spark. Thank you and over to you, sir.

Ramakrishnan: Good morning everyone. I really appreciate everyone logging in. Very pleased to be hosting Mr. Dilip Kumar – CFO of Sundram Fasteners and Mr. R. Ganesh from the Corporate Finance team.

We will start with brief opening remarks from Mr. Dilip and then follow it up with Q&A. Sir, would you like to make your opening remarks now?

Dilip Kumar: Good morning. I welcome all the analysts to discuss the Q3 Results of Sundram Fasteners.

I would like to make a couple of announcements:

One is that during the course of the day, we will be uploading our presentation for the benefit of the investors in our website and just in case should any media personnel access the transcription of this meeting, I would request them to check with me prior to publication of any of these things in the newspapers or online editions.

With these announcements, I will set the context for our Results:

We have had a good Q3 in terms of our revenue performance and where we have done revenues from operations of Rs. 1,226 crores for the 3rd quarter as against Rs. 1,024 crores, registering a growth of 19.8%. The domestic sales has come in at Rs. 813 crores compared to Rs. 658 crores, posting a growth of 23%. Even the aftermarket has grown well for us. The export segment has benefited from the rupee depreciation.

Overall, the EBITDA for the quarter has come in at Rs. 188 crores compared to Rs. 180 crores. The margins have been under pressure, which I will explain later. The profit before tax for the quarter was Rs. 142 crores against Rs. 138 crores and net profit for the quarter was at Rs. 106 crores against Rs. 103 crores in the corresponding period.

Moving on to the 9 months' operations YTD numbers:

The revenue from operations was Rs. 3,684 crores as against Rs. 3,026 crores, an increase of 21.8%. The net profit for the 9 months was Rs. 348 crores compared to Rs. 336 crores.

Before we discuss the consolidated financial performance, overall just to give you a background:

I think from an economic perspective, inflation numbers have dropped below 6%. The interest rates may not go up significantly from here, though we expect the US to have a soft landing in this year 2023. The budget has come out well with a huge outlay for capital expenditure as we all know. The government has also maintained fiscal prudence. They have also relaxed or provided an exception up to Rs. 7 lakhs to increase consumption under the new tax regime and they have also compressed the subsidies which form a part of the revenue expenditure of the government. So, this huge capital expenditure of Rs. 10 crores primarily going to railways and the highways, defense, all of these augur well for the Company in general and automotive industry.

The industry has done well in the 9-month period as well as this quarter, registering a significant growth in commercial vehicles, passenger vehicles, and tractors in which Sundram Fasteners is present across all these segments. The exchange for this quarter has been stable. As you know, Sundram Fastener's one-third of revenues come from exports. Composition of that has not changed significantly with almost 70% coming from OE business and aftermarket and about 30% coming from exports. And the rupee has been stable this quarter compared to how it was in the first 2 quarters.

The challenge the Company has faced is primarily the compression of gross margins which you may have observed. It is because of raw material price increase. One is, talking of softening of raw material prices, it may come as a bit of surprise to some of you, but this has been in the air for quite sometime where the way the industry works is the OEMs and steel mills reached a settlement and which are informed to the auto component players. Thereafter, we settled the prices with steel mills and back-to-back recovered from our customers. Largely, this model works in the domestic industry in the OE segment. But in the aftermarket, it is also recovered because once it is sold to a distributor or a dealer or to a common man, thereafter you can't go back with any prospective price increase. Therefore, companies tend to raise prices prospectively in the aftermarket. Of course, you have to take the competitor positioning the market before you raise prices. We have raised prices in the aftermarket in November as well as in December to compensate us for the raw material price increase.

In the export segment, as we have explained before, there are various contracts, there are partial arrangements. There are arrangements where we assure partially with a customer and in contracts we don't get any compensation or an indexation is linked to a different index which does not reflect the metal prices in India with our various models operating. And even within the domestic OEM, we may not get compensation from all our OE customers. So, it operates with a lag effect. And in the windmill space where we are present, we don't get compensation. There are many nuances envelop this. Broadly, we recover in the quarter in which the price increase is given about 70% to 75% and as the months roll by, we negotiate with other customers and we aim to achieve 85% to 90%. In this quarter, the price increase was given with effect from 1st April 2022 for a sum of Rs. 8,500 per tonne. From 1st July, it got reduced by Rs. 4,750. The combination of these two have occurred in Q3 because a settlement was reached only in Q3. So, you are seeing the impact of that in Q3 and where there is a bit of under-recovery from the customers. But I expect in Q4 that gap to narrow as we finish all negotiations and raise supplementary invoices and debit notes with our customers.

Sequentially if you see at the RM stage, we have been impacted by 1%. But I must say here that our variable costs have been fairly stable across different points of time – be it the YTD number, for the quarter or even preceding quarter, it has been stable.

The Company also has controlled fixed costs well and it has been flat with higher revenues as a percentage it has dropped. The compression which you have seen compared to the corresponding period has been offset to some extent by the stable variable costs or manufacturing expenses. Even though in manufacturing expenses also we have experienced inflation, the fixed costs have been controlled. So, overall, the EBITDA has come in at 15.2% compared to 15.8%. And the Company has controlled the interest costs well because we leveraged on our export performance to avail packing credit.

And the Company has also declared a dividend of Rs. 117 crores including a special dividend for the 60th year of incorporation. We have absorbed all of that and warrants have been stable. Debt-equity ratio continues to be stable and attractive, well below 0.2%. The Company has proceeded, gone ahead with its CAPEX program and we have capitalized about Rs. 150 crores at the half-yearly mark and another Rs. 75 crores is under construction. So, our CAPEX program is proceeding as per our plan.

The effective tax rate, the tax provisioning has been made. So, overall, the PAT for the quarter has come out Rs. 106 crores compared to Rs. 103 crores for the comparative quarter. For the 9-month period, we have finished at Rs. 348 crores compared to Rs. 336 crores.

The revenues for Q4 we have had a reasonably good start for this calendar year; January has been good. We expect these levels to sustain in February and March. We did about Rs. 1,225 crores in Q3. We expect some uptick in our turnover for Q4 but also the recovery from customers towards RM prices. So, overall, I think our EBITDA margins and PBT/PAT everything should resume in the upward direction. But if you ask me whether EBITDA will move to 17% or 17.5%, the answer I have is, our analysis suggests that based on the inflation if I break it down for across different points of time, the raw material costs if I remove the inflation from the numbers, is hovering around 38%. The under-recovery has cost about 2%. When I say under-recovery, it is the difference between the customer compensation and the price we paid to the steel mills. And what used to be 40% RM cost, today it is at 46% and the remaining 5% is purely the effect of math where I recover from the customers. It is there in my denominator and what I pay to steel mills is there in the numerator. So, unless and until, the raw material prices soften and roll back which we have already experienced from July, if things improve in this direction further, then our EBITDA will definitely go in the positive and right direction. This is just to give you the background to our EBITDA.

And as far as the consolidated results are concerned, the overall performance for the 3-month period is Rs. 1,400 crores compared to Rs. 1,200 crores. Consolidated net profit was at Rs. 118 crores compared to Rs. 110. The 9-month period performance was Rs. 4,214 crores compared to Rs. 3,562 crores, recording a growth of 18%. The consolidated net profit for the 9-month period was at Rs. 372 crores compared to Rs. 354 crores. So, there have been questions about whether you got a price increase from customers. I will answer that yes, in parts, we have received. We expect this gap to get narrowed in Q4. We don't expect to give any further price increase in the coming quarter. Though there are market news saying there will be a further drop, some people are saying they might go up, but as of now, there are no pressures to give any kind of price increase for Q4. So, I would expect the gross margin to sustain at this level or only improve based on further recovery.

The share of non-auto in our business continues to be around one-third, no big change; and EV revenues continue to be around 3%, but we expect a significant improvement from 2024 onwards. You may have noticed that we had recently given a press release about the huge order which we had won. On 17th January, we had given a press release about $250 million for an OEM and the production is expected to start in 2024, next year, and peaking in 2026. It is a 6-year program where we will be developing parts and assemblies for sedans and SUVs and we are quite excited about that. That is the story of EV and as it brings more and more EV products into our portfolio and this win will definitely give us the impetus and we hope to receive more RFQs from the same customer and from other customers for these kinds of products. These products are intricate, involves complex engineering, and where we believe we have the expertise which we have built over a period of time.

Our domestic subsidiary Upasana's performance has been stable. They have experienced raw material price pressures. The overseas subsidiary Cramlington Precision Forge performance has been impressive for the quarter. It has reported profits and the truck market is very strong in Europe and the waiting period, as we understand, order backlog is 8 months. We have got compensation from customers for price increases.

Overall, the operational capability of our UK subsidiary has improved. And given the strong volumes, stable output, and reasonable control over the employee costs, the UK subsidiary has reported profit and we expect this subsidiary to make profits for the entire year as well.

Moving on to China, China has experienced various pressures as most of you would know. Typically in the Q2, they had this COVID situation where Shanghai was shut down for about a month. We are located pretty close to Shanghai. In Q3, they had a heatwave. In Q4, they relaxed the COVID controls and people also were allowed to travel freely and many of them were reunited with their families after a couple of years. And we understand the labor shortage is there because people have not come back. And while customers have been demanding, raw material prices have gone up. Unlike the Indian context where you get 100% compensation with OE, the situation is not the same and China is a very different market. But then we are also reasonably insulated because we are not dependent only in the auto market, we also have non-auto business split 50% equally.

China has experienced challenges but Cramlington has done well and the domestic subsidiaries have been stable, and we expect this to continue in our Q4 also.

With these comments where the economy is doing well, the industry has done well, the budget has come good, and our quarterly performance has been reasonable despite the market conditions, uncertainties, especially in the western markets. And we expect a stable Q4. With these comments, now I would request the audience if there are any specific questions, we are happy to take them on.

Moderator: We will now begin the question & answer session. The first question is from the line of Ramakrishnan from Avendus Spark. Please go ahead.

Ramakrishnan: I will go first while the question queue assembles. I will let the other participants ask follow-up questions especially on EVs. My question, sir, is on exports. How are you looking at demand in the export market? I am talking about the stand-alone operations here. The last time, you talked about demand in passenger cars being a little soft while truck demand was robust. How you are seeing that pan out? And in USD terms, what revenue targets do you have in mind for exports?

Dilip Kumar: We expect to cross the year somewhere between $180 million to $200 million. That is what I think we would do because despite the slowdown and improving schedules in Q4 based on indications from our leading customers. In dollar terms, we would probably be close to $200 million. That's about Rs. 1,600 crores to Rs. 1,700 crores per annum.

Moderator: The next question is from the line of Vimal Gohil from Alchemy Capital. Please go ahead.

Vimal Gohil: My first question is a follow-up to Ram's question. You mentioned that the truck market in Europe is doing well. Just wanted to make sense of this given the backdrop that we are seeing in Europe on macros. Despite that, typically you would expect the truck markets to be under pressure but what is this driven by? The second question is on your recently announced EV order. If you could mention which is the OEM that we have got this order from? And you had also given the guidance that we will be touching about Rs. 2,000 crores of revenue in EVs in 4-5 years whereas this order mentions about 6 years of peak revenue and where is the disparity in between? Also, what would be the mix over here – PV versus CVs?

Dilip Kumar: The first question on the European front. While the semiconductor shortage may have had a bearing to some extent on the vehicle demand, the driver, as I had explained even in our Q2 call, was the e-commerce. During the pandemic, people had got into the habit of buying online, and the percentage of revenues which all companies now are deriving from online procurement has gone up significantly. Therefore, the trucks are in great demand post pandemic because of the last mile delivery which is now required. So, the shopping malls and e-commerce operators have come to the center stage, which is driving the demand, and like I said, the order backlog is 8 months currently. Not only the demand has gone up for trucks and also the replacement demand and both have helped to position our UK subsidiary well.

Coming to our EV business, we had said is that we would do about Rs. 2,110 crores over a 5-year period and this is a part of that $250 million. It was not the revenue target for a year which we said we will achieve Rs. 2,110 crores over a 5-year period. And this will help to move us from the current level of 3% EV, maybe take us to 5% or 6% and eventually as an intermediate target, we would want to go to about 10% of the revenues and take it ideally to about 15% of the revenues. We have taken the first steps towards that and this is a big win for us and this has set the right direction.

Vimal Gohil: The Rs. 200 crores CAPEX that you have announced in this particular project, would this be fungible? That is point number 1. And also, if you could help us that will you be able to sort of replicate this for other customers in western geographies as well as even domestic? What are your plans for your electric vehicle platforms or products for the domestic business?

Dilip Kumar: As far the domestic business is concerned, we are working with all leading players – be it Tata or M&M. As and when Maruti is ready to come out, I think Maruti is focused more on hybrid vehicles at this point of time. We have a strong customer connect and we are familiar with all of them with their programs and designs; we are working with them. As far as this capital expenditure of Rs. 200 crores will be fungible across different platforms or customers. Therefore, this business with the OE should also open the doors for other products or increasing volume to this OE itself for the same product and also help us with other customers. This order will definitely help us to get more RFQs from this customer itself and from other customers also. Therefore, we are excited about the breakthrough we have made in the EV.

Vimal Gohil: If I may, one more question please on EVs itself. What are the return ratios? The assumption is that the return ratios or the IRRs as you may call it may be similar to our existing business. What will this be driven by? Your margins or capital or your fixed asset turns any different? How is the structure here? Is it any different from our existing business?

Dilip Kumar: We expect both margins and ROCE better than our current level of operations. For instance, if we are doing an EBITDA for 15% to 16%, this business would normally give us about 20% to 21% and ROCE will also be significantly high. Currently, on an all-Company basis, because Sundram Fasteners has got different products. We have assembly operations, we have traditional forging, and we have powder metallurgy. While these are not comparable in terms of returns, but in the EV business, we expect the returns from ROCE perspective also to be closer to 35%.

Vimal Gohil: So, the OEs are comfortable? They are obviously looking at your profitability and then probably giving you the pricing, but OEs are absolutely comfortable with this, right?

Dilip Kumar: Absolutely comfortable. Like we say based on Company's quarterly division's performance if as and when it happens, there may be some pressures may happen, but that is something we are used to. This is not anything new because there are many models which are operating where they promise you volumes, they want year-on-year price discount. Many models are operating. I am not saying it operates in this case, but we are used to all of this.

Moderator: The next question is from the line of Sahil Sanghvi from Monarch Networth Capital. Please go ahead.

Sahil Sanghvi: My first question is regarding the new $250 million EV order that we have got. Can you clarify which component is this exactly?

Dilip Kumar: These are different types of shafts and there are sub-assemblies which will go into mild hybrid, plug-in hybrid, and battery-related vehicles. Our current understanding is that 70% of it would go into pure EV and other 20% would go into the hybrid which is in SUVs and sedans.

Sahil Sanghvi: When you answered the question for the last participant, you did give ROCE number which is around 20% to 25% but on the margin front, I missed the number. Can you give some idea on that?

Dilip Kumar: What I was saying was that we expect our EBITDA to be around 20% of the business and our ROCE to be around 25%.

Sahil Sanghvi: Margins you said 20%, right?

Dilip Kumar: Around 20%.

Sahil Sanghvi: My other two questions are one, when I look at some of these classic truck sales and order numbers because that forms one-third of our exposure in the export side, and again, North America also forms a large chunk of our exposure, there has been a decline in the classic truck orders, 25% month on month in January and the peak has well been gone in September now. Overall, from classic trucks and from this EV side in North America, are you seeing any kind of decline in the demand or moderation on that front or any threat to our export revenues if you can comment on that, please?

Dilip Kumar: We are not experiencing any slowdown. It has been stable in Q2 and Q3. If at all, we expect a slight uptick in Q4 because as you know that it's a new calendar year for the western markets. The customer advice has been for us to prepare for growth only. They have not said the schedules will come down or it will be stable. So, we are preparing for about 5% in revenues in constant currency terms in Q4.

Sahil Sanghvi: My last question is in one of the con-calls 1 or 2 quarters back, you had alluded towards a new power-train component being designed for Ford and you were expected to start commercial production in 2nd half of FY23. Any developments on that front?

Dilip Kumar: I saw it in your email also whether we can discuss separately but maybe there is some mix-up of facts. We are not developing anything for Ford.

Sahil Sanghvi: So, is that for Mahindra? Because you alluded to this in the con-call. Are we doing anything on that front?

Dilip Kumar: No.

Moderator: The next question is from the line of Karan Kokane from Ambit Capital. Please go ahead.

Karan Kokane: First question is on this $250 million order. Initially, in earlier calls, you had highlighted that you would be doing a CAPEX of Rs. 350 crores for EVs over the next 3 years. This CAPEX of Rs. 250 crores that you have stated, is this a part of that Rs. 350 crores or is this over and above that?

Dilip Kumar: Yes, it is part of that.

Karan Kokane: Second question is on the wind energy orders. We are looking to add new customers in Europe. How has that been going?

Dilip Kumar: That is on course. We have started expanding the factory and we expect the revenues to jump up, let us say, from October of this year. The project will realize its full potential in the 12-month cycle from October to September. So, we are on course for that. We are also talking further with the same customer for next stage of expansion, but at this point of time, we have orders and expansion is on course and the elevated volumes will start from October 2023.

Karan Kokane: Sir, if you could just remind us what is the revenue potential from this order and the CAPEX?

Dilip Kumar: We are incurring about Rs. 80 crores of capital expenditure, and at the peak, it should reach about Rs. 150 crores to Rs. 160 crores.

Karan Kokane: In our result note, we have highlighted that we have impairment for an investment in a subsidiary at stand-alone level. What is that regarding?

Dilip Kumar: In our press release?

Karan Kokane: Yes.

Dilip Kumar: No, we have not talked about any impairment, you can write to me.

Karan Kokane: Yes, I will check that. Just the last question on China. You said that China is still weak. Other OEMs have talked about good sales in January and opening a number of retails and production also coming back. So, how is the demand in January in China?

Dilip Kumar: January has been okay. It is still not back to the high volumes or levels we would be comfortable with, but Q1 looks promising, but definitely better than December.

Moderator: The next question is from the line of Nitiksha Shah from Anvil Share & Stock Broking. Please go ahead.

Nitiksha Shah: Sir, I just had 1 question. When you said that non-auto comprises of one-third of your revenue, what all do we include in non-auto?

R. Ganesh: For our non-auto, we include tractors which form a part of the farm equipments and also we have the serving towards the wind energy fasteners, we are into aerospace fasteners, and we also supply fasteners for a wide application in the industrial segment. These are all the broad categories which we include in the non-auto segment.

Nitiksha Shah: How much would the tractors constitute? Because I think they would be the major component of the one-third that you are alluding to, right?

R. Ganesh: No, for us, the tractors would be in the range of 10% to 12%. Predominant business comes from our aftermarket which goes into varied industrial applications starting from steel mills to cement, food processing industry. That's the broad chunk of the non-auto business.

Nitiksha Shah: This aftermarket doesn't include our auto aftermarket, right?

R. Ganesh: Yes, auto aftermarket is not included in this classification.

Moderator: We will move to the next question that is from the line of Naveen Chandramohan from Itus Capital. Please go ahead.

Naveen Chandramohan: Sir, if you take a slightly longer term, I would say a 3- to 5-year view on China, you had commented on the short-term headwinds that you had faced on China, but if we just take a slightly longer term perspective, one of the markets that has grown aggressively in the passenger vehicle EV space globally, it has been China, and considering that you now are transitioning into an EV portfolio on a slightly more aggressive basis, how would you look at your product positioning into China from here going forward?

R. Ganesh: With respect to China, our presence in terms of the segment participation is almost 50:50. We are there in the construction segment that is going strong for us and we also work on the passenger vehicle and the commercial vehicle. In terms of next 3 to 5 years, we see a strong market for that as they manufacture roughly about 25 million passenger cars and in terms of truck also, it is about 3 to 4 million. So, I would say our presence in the construction as well as passenger vehicle and commercial vehicle would augur well going forward. And we are also capacitized to meet customer requirement.

Dilip Kumar: The EV portfolio is yet to grow. We are working on our EV strategy in China, but we probably will have something more concrete to say in about a year's time from now. But right now, it is focused more on our traditional products for the construction segment and the auto where we are equally present between the commercial vehicles and passenger vehicles.

Naveen Chandramohan: Just 1 follow-up question on that. Considering the penetration on the EV side has been reasonably deep with respect to China versus rest of the world and considering that most of the competitors are focused on that area, and based on what you just said, you are looking at it from let's say 1 year down the line in terms of product development there, do you feel that this puts us at a disadvantage as we speak versus some of the competition that we face in China?

Dilip Kumar: Just to clarify, what I am saying is that we would have probably more information to share with you 1 year down the line, but the efforts and the product development have already begun. We are at a disadvantage or start behind our competitors. We have been always ahead of our competitors. Work is going on. But in terms of telling you something concrete progress, products, customers, etc., probably about 2 quarters from now or about a year, that is what I was trying to tell you.

Moderator: The next question is from the line of Prolin from GMO. Please go ahead.

Prolin: First question would be, you also have medium- to long-term aspirations of export contributing half to the top line. Right now, it is close to one-third. If I look at the performance for the last 2 quarters, the share of exports have been coming down and after the Q2 call, you had alluded to the issues in passenger vehicle related to semiconductor and those which were temporary. Going forward, for you to increase the share of exports need to faster than the domestic sales. Why it is not the case and going forward will this change?

Dilip Kumar: The domestic market has been very strong and both aftermarket and OE businesses have been very good. As you know, because of the chip shortage and the high interest rates, for various reasons, volumes were moderated in Q2. The capacity was available and it is fungible and we have used it more for our aftermarket and the OE business. The lockdown trend of one-third for eventually moving to 50% of revenues coming from the export market, that remains our goal and our objective. We will pursue that. And this recent win in the EV business will help us in the direction not only to push the frontier but also give us good hold in the EV business.

Prolin: But because this EV business revenues will start incurring slightly a year from now if I am not wrong, at least in the interim, now that maybe some of these as you are saying that in terms of CVs, demand from Europe is very strong. So, can we see a higher growth coming from export going forward at least in the near term as well?

Dilip Kumar: Yes, in the near term as well, we will see growth definitely compared to Q2 or Q3. Like I said in the earlier part of the call our customers have only encouraged us to prepare for higher volumes, at least by about 5% in 2023 compared to 2020.

Prolin: You mentioned 5% higher order book indication that your customers have given for 2023 for commercial vehicles. Is the case same in passenger vehicles as well?

R. Ganesh: Yes, in passenger vehicles also, we are looking at similar indication. It could be either on the ICE or on the EV. We are working on both. So, we see a possibility of growth in that segment.

Prolin: My second question is on the margins. Now you have mentioned about how the mechanism works and your guidance for improvement in sequential margin in Q4 onwards or starting from Q4, but then you also meant that for us to reach back to those 16% to 18% kind of level, raw material prices have to come down further. Because it's like higher denominator and on that we will earn a lower margin in percentage terms. Maybe in per tonne terms, it would be similar. But my question is that if everything else is equal, because share of exports which I assume would be higher margin will increase, don't you think that there would be a gradual improvement in margins because of the product mix and the geographical mix of the sales? Is that a fair assumption in the near to medium term as well?

Dilip Kumar: Yes, that is a fair assumption to make.

Prolin: Our margin improvement trajectory is not entirely dependent on how the raw material prices would be, right? In a stable raw material prices regime, gradually there would be a sequential improvement of margins because of the changes that I have mentioned?

Dilip Kumar: Yes, your assessment is correct; not 100% dependent on RM moving alone.

Prolin: Last question would be, this Rs. 200 crores of CAPEX that you have announced for this new EV project, obviously a part of that Rs. 300 crores to Rs. 400 crores that you had already specified, does this come under PLI by any chance?

Dilip Kumar: Yes, it is part of the PLI program.

Prolin: And so, when you are mentioning about 20% margins and 25% return ratios, you have calculated or you have included the PLI claims as well, right? Am I correct?

Dilip Kumar: No, we have not taken this PLI into account in all our commercial decisions because as you know, there are many catches to it. So, our return expectations or margin expectations are not predicated on the PLI incentive.

Prolin: This is pure commercial which means that in case if a lot of catches we were to avoid that and there is a benefit, the margins as well as return ratio could be higher than what we have guided for?

Dilip Kumar: Absolutely.

Moderator: The next question is from the line of Mythili Balakrishnan from Alchemy Capital. Please go ahead.

Mythili Balakrishnan: I had a couple of questions. Starting with, could you help us a little bit with mix in the O&E segment? How much CV, how much PV, etc.?

R. Ganesh: With respect to the domestic business, the CV inclusive of engines would be in the range of 30% and passenger car would be in the range of 35% to 40%. And tractors as I mentioned, it will be in the range of 10% to 15%. This is the broad split about our….

Mythili Balakrishnan: And what about wind energy?

R. Ganesh: Wind energy would be about 5% of the overall revenue.

Mythili Balakrishnan: Also wanted to check with you on the CAPEX. On a consolidated basis, what's the kind of CAPEX we are looking at for this year and the next including this whole investment, which is happening for the EV, etc.?

Dilip Kumar: At the subsidiaries level, we are not incurring capital expenditure much apart from what we had committed. It is a plan based on the previous year's indications. We are adding capacity maybe a heat treatment furnace in China and some machining capacity in Upasana but the bulk of the CAPEX will be incurred at the stand-alone Sundram Fasteners. In the last cycle, we had incurred about Rs. 1,000 crores before we took a pause because of the slowdown in 2019 and 2020 and thereafter 2 years of pandemic. That cycle has resumed and we should incur in the next 3 years, i.e., FY23 to FY25 if all our PLA programs come through, another Rs. 1,000 crores of capital expenditure.

Mythili Balakrishnan: And just to get a sense of the Sri City situation in terms of capacity utilization, what happened to that customer who was there, etc.

R. Ganesh: With respect to Sri City, while we have been working with the customer on approval and validations, all those have come in place and we have started billing directly to the customer and the capacity utilization is moving upwards. And the 2023-24 should be a good year for Sri City plant.

Mythili Balakrishnan: Could you just help us out with the initial CAPEX? Is this expected to have similar fixed asset turns as the rest of the business?

R. Ganesh: Yes, the CAPEX whatever we had indicated in Sri City was Rs. 100 crores plus and I think the asset turn would be on similar levels of other Sundram Fasteners businesses.

Mythili Balakrishnan: And that full capacity ramp-up will take till say 2025 or later?

R. Ganesh: The ramp-up will be happening during FY24 itself.

Mythili Balakrishnan: Full ramp-up? To the full extent?

R. Ganesh: No, I said ramp-up will happen starting FY24 itself.

Moderator: The next question is from the line of Nidhi Babaria from Envision Capital. Please go ahead.

Nidhi Babaria: Just want to understand the near-term growth drivers. If EVs and other divisions are going to contribute to the overall growth, will our consolidated margins dilute for a couple of quarters or so?

Dilip Kumar: You want to know about the growth drivers?

Nidhi Babaria: Yes.

Dilip Kumar: Largely, the growth driver is the industry itself. And as you know, being an auto component player, we grow not only in line with the industry but our growth is about 2% to 3% generally over the many many years over the last 2 decades, we outperformed the industry. In general, I think the industry has been growing at about 15%. So, Sundram Fasteners will definitely grow in the domestic segment at least by 20%. That includes both our aftermarket and OE business. And the export business has been flat in this year in dollar terms. We have benefited from rupee depreciation. But going forward, based in indications from the customers, we expect current year FY24 to be a good year even for our export market.

Nidhi Babaria: Capacity expansion, by when do you think we would be going for the expansion because our industrials are expected to grow at 20%?

R. Ganesh: As part of our medium-term plan, like the previous cycle where between FY18 to FY20, we had invested close to about Rs. 1,000 crores. On similar lines, we are working out for meeting the industry expectation by way of incurring additional CAPEXs which we had mentioned earlier in the call.

Nidhi Babaria: Any understanding on medium-term EBITDA margins? Will it get diluted once EV and new segments will start to contribute – even the defense, aerospace, and those segments?

Dilip Kumar: Like I said, the EBITDA is somewhere between 15% to 16% even in the 9-month period and it will only improve from here; I don't see it going down. Like I said, once the recovery from customers happens fully, all built in to our Q4, we expect only an uptick, but significant movement back to 17% to 18% sure will happen only if raw material prices soften. But we expect with our new businesses, export businesses, with more focus on EV, etc., should offset some of this impact on margins.

Moderator: The next question is the last question from the line of Jay Shah from Capital PMS. Please go ahead.

Jay Shah: Sir, could you please throw some light on the opportunities that are arising out of the whole railway CAPEX that you mentioned in the starting commentary, or even let's say on the whole EV front, what are the kind of opportunities and you can say the systems that we are looking to get into like what kind of spare parts or what kind of machinery equipments would you be focusing on to get into the whole EV sub-segment and even for the railway segment?

R. Ganesh: I think while we have mentioned that the India budget called for huge outlay on CAPEX, that would propel multiple industries including the auto components where we are present in a large way as on date. That would propel activity in the area of M&HCV and passenger car segment with so much disposable income in the hands of individuals. People who are in the two-wheeler segment are expected to move up the chain. That would propel the car procurement. Similarly, the pandemic has put the last mile connectivity by way of e-commerce. That is the order of the day, and we see a lot of traction in the LCV segment also. And with good rain and monsoon, the tractor segment is doing well and it is expected to do well. These are all the broad growth drivers which we are seeing emanating out of the India budget.

Dilip Kumar: Also, the government spend on highways, there will be lot of road widening and building new roads which will again require movement of material and resources. So, the truck demand should get further momentum.

Jay Shah: Taking this question further, would it be more of our legacy business of the partner itself getting a good traction or there will be new parts? Can you throw some light on what we are doing on the innovation and R&D front? Are we coming up with some other product for the railways or passenger cars or even M&HCV or we are still continuing majorly with our legacy products is what I wanted to know.

Dilip Kumar: It's largely legacy products. But having said that, the new product also accounts for 30% of our revenues. And unlike other sectors or industries, we don't hear designed products; we only develop products. The customer gives the design or the print and we develop parts according to that plan. So, I was more referring to our existing business.

Moderator: Ladies and gentlemen, that would be our last question for today. I now hand the conference over to Mr. Dilip Kumar for closing comments. Thank you and over to you, sir.

Dilip Kumar: I thank all the investors for a patient hearing and have this delightedness for the last 1 hour to field a variety of questions. I hope we have explained our performance and the outlook for Q4 and how FY24 will pan out and the recovery in the export market. Overall, I think it has been a satisfactory performance from our perspective. Thank you.

Moderator: Ladies and gentlemen, on behalf of Avendus Spark, that concludes this conference. Thank you all for joining us and you may now disconnect your lines.