"Rane Group of Companies Q1 FY-22 Earnings Conference Call"

August 10, 2021

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Moderator: Ladies and gentlemen, good day and welcome to Rane Group of Companies' Q1 FY22 Earnings Conference Call. 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. Binay Sarda from Christensen Advisory. Thank you and over to you, Mr. Sarda.

Binay Sarda: Thank you, Nirav. Good afternoon friends. Welcome to the Q1 FY22 earnings call of the Rane Group. To take you through the results and answer your questions today, we have with us the management team from Rane Group represented by Mr. L. Ganesh – Chairman & Managing Director, Rane Holdings; Mr. Harish Lakshman – Vice Chairman; Mr. P. A. Padmanabhan – President-Finance & Group CFO; Mr. Siva Chandrasekaran – Executive Vice President of Secretarial and Legal Services; and Mr. J. Ananth – CFO of Rane Holdings.

Please note that we have sent you the press release. And also, we have sent you the presentation link of the deck. In case any of you have not received the presentation, you could look it in our website, or even the BSE or you could also write to us, and we will be happy to send the detailed earning presentations over to you.

Before we start, I would like to say that everything that is said on this call that reflects any outlook for the future, or which can be construed as a forward-looking statement must be viewed in conjunction with the risks and uncertainties that we face. These uncertainties and risks are included but not limited to what we mentioned in the prospectus and subsequent annual reports which you can find on our website.

With that said, now I hand over the call to Mr. Ganesh. Over to you, sir.

L. Ganesh: Thank you, Binay. Good afternoon, ladies and gentlemen. Thank you for dialing in. I would like to welcome you all to this teleconference. Hope all of you are staying safe and healthy. You would have seen our Quarter 1 FY22 performance highlights of the group companies, which is posted on the website. I would like to provide a few comments on the industry before handing it over to Harish.

Quarter 1 was rather testing quarter with us weathering a wave two in India of the COVID-19. As we started the year on a positive note our plants were doing nearly 100% plus in terms of capacity utilization and achieving plans. However, as you know, the COVID problem started in a big way, the second wave and shutdown, lockdowns, partial restrictions, etc., started affecting and the level of activity came down sharply.

In June there was some recovery, although not fully. And in going forward, what you find is from July, things are much better, and the recovery seems to be on its way. Some of our plants built stocks during the first quarter because we could not switch our plants in such an uncertain environment and also because commodity prices were going up, we thought it may not be a bad idea to build and funding it.

The export demand was good. And this was despite some impact due to semiconductor chip shortage and otherwise the export could have been even slightly better. The wave two resultant lockdown has slowed down the economic recovery. Various agencies have moderated their growth forecast for India. The wave two was different compared to wave one on multiple counts. The National lockdown in wave one is a state specified lockdown in wave two. This had its own challenges.

Manufacturing continued in wave two catering to exports, but with many, many on the ground challenges. The pent-up demand and low level of inventory after wave one triggered a strong recovery whereas recovery post wave two seems to be more gradual as we look at it today. In terms of inflation of vehicle prices, the fuel costs increase very sharp in the last couple of months seems to be having a negative influence on vehicle purchase.

However, this has to be seen in addition the commodity price inflation is also affecting the businesses. We are working on recovering from various customers. But as you know, there is always a time lag. RBI seems to be extending its accommodative stance, to help to revive and sustain the growth in the economy. We hope there will be no severe third wave thanks to the vaccination coverage and better preparation by all the state governments.

On the Export front the risk is further due to the impact of semiconductor chip shortage. We hope that it will not worsen further from what it is today. Subject to these risks, we hope to see a good recovery in the economy and the auto industry. I now hand it over to Harish for his comments and review of the Q1 performance.

Harish Lakshman: Thank you, Mr. Ganesh. Good afternoon, everyone. As Mr. Ganesh mentioned, Q1 was a challenging quarter for India and for the entire industry due to the strong second wave of Coronavirus. This coupled with the impact of the semiconductor shortage that was felt definitely pulled back the growth momentum of the automotive segment and that too coming from a very strong Q4 of last year. I will now give a quick overview on the quarter 1 performance of each of our businesses starting with Rane Madras. The hydraulic business continued its traction and we achieved the highest production of cylinders.

The light metal castings business in India continues to win new business and we have recently won a new business worth about Rs. 43 crores. The US subsidiary has improved the operational performance and they are experiencing a ramp up in the volumes with the overall improved demand environment in the US as well as some of the new business kicking in. With the operational improvements, the new orders, and the emerging demand for aluminum components in the auto industry particularly due to the electrification, the Rane Madras Board has decided to stay invested in this business for strategic reasons.

Coming to REVL, the market declined due to wave two impacted some of the operational improvement initiatives. Nevertheless, we continue to prioritize on cost reduction and achieve breakeven at lower volumes. The company continues to focus on enhancing the non-auto customer and today the non-auto customers contribute 22% of sales and we are hopeful of enhancing our order book further in this segment.

Rane Brake Lining, due to lockdown the proportion of aftermarket segment to the sales dropped significantly. This impacted the product mix and resulted in a drop in profitability. RBL is continuing to enhance its presence in the export market. And we are recently expanded to Saudi Arabia and also introduced some new products in Sri Lanka and Bangladesh. Coming to Rane TRW, we continue to enjoy dominant share with the domestic customer for the steering gear products.

However, the company is significantly dependent on the CV segment and the CV segment sales continue to remain muted. On the occupant safety side, the exports accounted for almost 67% of the revenue for this quarter. We also won about Rs. 78 crores of new export business to our partner ZF. Rane NSK, we have secured some new business with Maruti Suzuki for an upcoming UV program.

The plant also struggled to meet demand due to some labor availability in the month of April and May. With the relaxation on restrictions post the wave two we are seeing favorable recovery in the demand environment in India. The export demand continues to remain robust as Mr. Ganesh said except for the semiconductor shortage, and we hope that wave three and the resultant lockdown does not derail the growth momentum.

The commodity price increase is another concern, and our teams are working for the recovery. We continue to prioritize the safety of our employees and our focus on cost management to navigate these challenging times. With these remarks, we will now open for any questions that you may have.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Ashwin Agarwal from Akash Ganga Investments. Please go ahead.

Ashwin Agarwal: Sir, you mentioned in your opening remarks, that for strategic reasons, the Board of Rane Madras has decided to continue with the investment in the subsidiary in the US. Could you highlight by when do you expect, because of the new orders the company to break even at the EBITDA level, and also the Rs. 3.8 million which we received as stimulus, whether any stimulus is expected even for this year, or there would be no stimulus from the US government?

Harish Lakshman: Yes Ashwin, I will answer the second question. Yes, there is some more stimulus that we are likely to receive in the remaining part of this financial year. So, we are still hopeful of receiving that from the government. As far as the position of the company, as I explained, even in the last call, and this call, I think with the operational turnaround there has been significant improvement that happened in the last two years and the order book position is also improving.

So, as a result we are not forecasting any further cash loss in the subsequent years. So, there will not be any significant cash loss. So, therefore, what I am saying is, we are expecting us to be EBITDA positive next year.

Ashwin Agarwal: Do you also expect to win further orders from the US subsidiary as the outlook is improving there?

Harish Lakshman: Yes, it is improving.

Moderator: Thank you. The next question is from the line of Rajakumar V, an individual investor. Please go ahead.

Rajakumar V: Just a couple of questions. So, the first one the Rane US subsidiary. I just wanted to know what would be their projected cash support we would be required to give for the next two years till they become cash making?

Harish Lakshman: So, we do not have a clear number. Definitely there will be some cash support that will be needed from India. But however, all of this cash support will be going towards either CAPEX, which we fund the growth of the business or to repay some debt that is there in the books.

But the numbers, I do not have a clear number as yet, butmaybe in the region of about $10 million over the next couple of years.

Rajakumar V: So, that is after taking in the projected support that you will be getting from the US government, you mentioned that some more incentives we are going to get?

Harish Lakshman: Yes.

Rajakumar V: Sir, the second question is on the warranty provision in NSK JV. I just want to know what is the unutilized provision as at the end of June and also do you expect any further provisioning in the current and subsequent quarters and also if you can give more color as to you must have had some more history or some more claims that would have come in? I think in the last call and now so if you could give more color on this?

Harish Lakshman: So, the unutilized credit available in the books is about Rs. 75 crores in that region. And as far as future is concerned, as I had indicated in the last call, we are continuing to monitor the situation. We believe that we have provided for everything, but we cannot say for certainty for another six months. We have to observe how the reduction is taking place in the field and the decision will be taken based on that.

Rajakumar V: So, this Rs. 75 crores is as at the end of June, right?

Harish Lakshman: Yes, as of June 30th.

Rajakumar V: Sir, can I ask one more question or should I come back in the queue?

Harish Lakshman: Go ahead.

Rajakumar V: Sir, the question is, I just want to know, you mentioned about inventory stocking, because of the steep increases you have stocked more inventory in the June quarter? Do you also see similar behavior happening at the OEM level also, that they also order more from you or from suppliers like Rane Group?

So, basically, I want to know, the sales that we are seeing this is going to kind of tone down as the quarters come by?

L. Ganesh: In terms of inventory, what I meant was, there are two things. One is this quarter was so uncertain unlike earlier one when there was a total lockdown. Here it was left to the state. So, some of our plants worked, some of our customers were working, some of our supply chain was working. So, the whole environment was slightly more complex than the previous year lockdown.

So, therefore, we could not respond so much to cut the inventory or take decisions. So, what we felt was, since the commodity prices are anyway going up, it is quite safe to push up the inventory a bit although it will consume some working capital. We are very confident that starting Q2, it will get consumed and that is happening. The schedules from customers from July has been very good.

And that is happening. In terms of customers, I do not think so because the inventory at the very customer end, as we kind of keep track of that. Although we do not have 100% accuracy and inventory in none of the segments has been very high.

So, I do not think they have been because they had to make up and try to build up for the festive season. So, I think the ordering is only for that. I do not think there is much of inventory built up at the customer end.

Rajakumar V: Sir, just one related question. So, this current quarter you said you are almost back to or closer to pre-COVID levels. So, is it fair to expect that the current quarter will be I mean the September quarter will be closer to your Q4 of last financial year?

Harish Lakshman: No, I do not think it will fully come back to the Q4 levels. But definitely it will be close to it.

Rajakumar V: Both in terms of sales and the EBIT, right?

Harish Lakshman: Yes. I mean, I was only commenting largely from the sales standpoint. But yes, the EBIT is an automatic flow through as a result of that.

Moderator: Thank you. The next question is from line of Sunil Kothari from Unique Portfolio Management Service. Please go ahead.

Sunil Kothari: Basically, what I am trying to ask Mr. Ganesh and Harish is, we strategically decided to remain invested in US subsidiaries, we are planning to invest for further CAPEX and expansion maybe around $10 million over a long term. So, would you like to talk something more about this strategic thinking what are the possibilities, what we can achieve from this investment and this decision?

That will be really helpful. I understand we in the past, it has taken a little longer, but hopefully it should turn around positively. So, if you can throw some light on your thought process and your strategy towards US subsidiaries?

Harish Lakshman: Sure Sunil. See if you recollect the fundamental strategy of why we have expanded into North America was because of the growing market requirement there. One is aluminum content on vehicle and being diecasting aluminum content continues to increase per vehicle. And with more electrification, it gets further accelerated.

So, that means an EV vehicle has even more aluminium diecast parts compared to a non-EV vehicle. So, Rane's fundamental strategy was to get into continue to grow our diecasting business. Even though it is capital intensive, we see continued growth opportunity there. And therefore, entering the North American market was the strategy.

And that strategy by itself, nothing has changed. In fact, if at all anything, the aluminum content is only going up further, thanks to electrification, because four years ago, none of us imagined the electrification will happen so fast.

The second was, we purchased consciously a distressed asset. And we thought that we can turn it around in three years. And we will also get lot of new business by this acquisition. Both those assumptions went wrong. I mean, the operational turnaround today in hindsight, if you look at instead of three years, it has now taken us five years. Just to share two years ago, our premium freight bill alone was almost $1 million, today last nine months, it is zero.

So, operational improvements, while there has been a delay, instead of three years, it has taken five years. The new order books, unfortunately also we thought that we will get new business more quickly, that also did not happen. And maybe that was also partly to do with the way the operations in the plant where and maybe customers, they did not see enough improvement. But now that has also changed.

So, if you look at and if you go back to five years ago, in 2016 when we bought the company, the fundamental strategy nothing has changed. What changed was, there are some delay in our assumptions, in terms of operational turnaround and growing the business. And in that you must recognize out of these last five years, two of those years or almost two years is because of COVID, which significantly impacted the business last year.

And as you can see, last year where the losses were close to $10 million. Today, you can see some of the government incentives that were there by the government to support that is also slowly coming through.

So, we must look at especially last year loss, keeping in mind the COVID situation and the government support that has come for that. But clearly, government support is one off, that is not going to keep on coming and saving the business.

But we believe, as we told a few years ago that with this operational improvement, and with the new business coming in, we are seeing EBITDA positive in the next financial year, and there is further opportunity for growth. So, that is why the board after a lot of deliberation, decided that taking any other decision of selling the business, closing down etc, will hurt the company even more. So, it is in the interest of the company to stay invested for the near future.

Sunil Kothari: Harish, one more thing is looking at our technical capabilities, standalone I am talking now and our size almost we are doing now Rs. 300 crores plus revenue. But we are not able to reach a respectable double digit EBITDA margin.

So, would you like your thoughts? I am not asking for any commitment, but will it be possible with our product range and our capability, cost reduction and opportunity to maintain and sustain double digit EBITDA margin maybe over wherever the physical timeframe?

Harish Lakshman: Your question again is overall RML, correct Sunil?

Sunil Kothari: Yes, standalone.

Harish Lakshman: So, the answer is yes, I mean, I think if the market was supporting us, and we sought out all our problems, whether it is capacity underutilization in the diecasting business in India, and we manage our operations well, our commodity prices we are able to exchange with our customers in growing our export portfolio.

Definitely at double digit EBITDA for Rane Madras is something that we need to perform. So, I think it is various circumstances that has prevented us from achieving that for the last two years. But I think the entire team in the company across all the divisions are working towards this.

Sunil Kothari: And sir, last question on since long, we are proven globally very competitive in some of our product range like Rack and Pinion, ball joints and all. So, are you seeing now really sizable and scalable enquiries orders and maybe execution over a time? Your thought process on exports opportunity because of this global supply chain realignments, some consolidation, some thoughts on those will be really helpful?

Harish Lakshman: Definitely I think Sunil, exports continue to grow. Our new order booking pipeline is looking very good. And I think even this quarter, you will see that the export business has grown substantially compared to last year same quarter. And it will only this kind of growth is something that we see as maintainable.

Moderator: Thank you. The next question is from the line of Rajakumar, an individual investor. Please go ahead.

Rajakumar V: Sir, you mentioned that we may have to invest almost $10 million in the Rane US subsidiary for the next two years. Just want to know how will you fund that in Rane Madras be able to generate so much cash internally and then funded or are you planning to sell any of the non-core assets of Rane Madras?

Harish Lakshman: As I said again, this Rs. 10 million is just a number. I do not have the exact number, but we will spend that kind of amount over the next few years. As far as the funding is required definitely, we are not planning to sell any non-core assets. So, it will be through other means. Combination of internal generation as well as debt.

Rajakumar V: And as regards to the Rane NSK so how is the working capital situation there because last quarter you mentioned because of the warranty claims there is pressure on the working capital? So, are there any funding requirements for that JV?

L. Ganesh: The working capital is under pressure. You are right. But since the sales has improved this month and collections have improved, we are managing and also partners the NSK kind of helping us out. We have got a recent increase from one of the Japanese banks in terms of working capital limits. So, we are able to manage but yes, we would like to be much more comfortable. But that might take another six to nine months.

Rajakumar V: And lastly, last call also I asked this question. So, any thought on consolidating the Rane Group entities into one single entity?

Harish Lakshman: I have mentioned many times before, this is something that we keep looking at. And I am sure at the appropriate time, we will when we are clear on the way forward, we will definitely share with the shareholders.

Moderator: Thank you very much. The next question is from the line of Manish Goyal from Enam Holdings Private Limited. Please go ahead.

Manish Goyal: Sir, on the margins front, just like we are witnessing commodity inflation and then sort of supply chain issues. So, are we able to kind of get price hikes from our OEM customers and meanwhile are able to pass it in the aftermarket? Do you think that exercise we have been able to achieve in the quarter one and going forward?

Harish Lakshman: Yes, so by and large, yes, Manish we have been able to get commitments from our customers in terms of absorbing all the commodity price increases, but there will always be that lag effect. Okay, with many customers, there is already a back-to-back arrangement. They will take in the next quarter, they will adjust the price based on the previous quarter's commodity increase.

So, that is one standard model that exists with many OEMs. With some OEMs where there is no back-to-back contract, we negotiate and even those negotiations we have been by and large successful. But net-net there will always be a lag and similarly, that lag will also become favorable as and when the commodity's price stocks softening, we will only pass on to the customers the following quarter.

So, over a long term it gets kind of evened out. As far as aftermarket is concerned, yes, across all the group companies we have passed on the price increases to the aftermarket. So, revisions have taken place. Of course, many of them happened during Q1 when the sales were poor due to the lockdown, but we have done that.

Manish Goyal: And sir, on margin front basically what even Sunil was asking on Rane Madras. Now with the domestic diecasting getting enough business and kind of expected to operate on a full capacity in the current year. So, overall, then definitely and also, we are seeing very good exports pick up in the Rane Madras even the annual report has been talking about very strong order book and prospects building up. So, ideally it should not be like quite challenging to achieve double digit margin in near future, right?

Harish Lakshman: I mean overall, definitely yes Manish. But as Mr. Ganesh and I also mentioned the only headwind we are seeing the problem with export business is in the short term we are getting more impacted because of the semiconductor shortage, which was unanticipated. Actually, our performance in Q1 would have been slightly better and even in Q2 we are losing out on sales because of this chip conductor shortage, which is more noticeable when you are exporting to European market and US market compared to even India.

Manish Goyal: And sir, in Rane Engine Valve, would it be possible to share as to like even last call, you mentioned that we are looking to increase non-automotive business. So, what is the percentage in total revenue, which is non-automotive and what we aspire in probably next two to three years?

Harish Lakshman: Yes, so, as I mentioned already today, as we speak today 22% is already non-automotive which is all off highway power generation sector, things like that. So, it is already 22%. I think we are aspiring to grow them to about 28%.

Manish Goyal: Probably next couple of years?

Harish Lakshman: Yes, three years.

Manish Goyal: And sir, would it be possible to share Rane TRW revenue break up between say steering products and occupant safety products?

Harish Lakshman: Yes. Steering was Rs. 105 crores.

Manish Goyal: As compared to last quarter how much?

Harish Lakshman: Rs. 22.4 crores. And occupants were Rs. 160 crores compared to Rs. 59 crores last year.

Manish Goyal: Okay and total exports in Rane TRW?

Harish Lakshman: Total is Rs. 114 crores.

Manish Goyal: And you have already said that exports accounted for 67% of the occupant safety, so fine I will work out those numbers. So, why not, is it possible to share this number because now occupant safety is significantly large portion maybe if you can share the revenue breakup of steering and occupant safety in the presentation itself so, it becomes a bit easier for us to monitor how things are growing? Because exports over here is growing very strongly.

So, that helps us to kind of not always ask the question in the quarterly call? And also, one last question on like annual report also specifically talks a lot about growing exports as a group like we are aiming for roughly almost between 25% to 30%. So, which are the companies which will be, no doubt we are seeing Rane TRW is doing well. And probably Rane Madras. So, how do we see exports growing as a group going forward?

Harish Lakshman: I see , your first point Manish, we will definitely review about sharing the steering and occupant this thing and we will come back on that. The export definitely Rane TRW and Rane Madras are the key two main companies which is driving all the international sale, followed by Rane Engine Valves. And also, REVL obviously the base is also lower.

Rane Brake Lining has just started. We are spending quite a bit of business development as well as some engineering and research R&D money towards enhancing exports. But that will take another, maybe two, three years before we can see the results.

Manish Goyal: Okay. And sir, on just one more product like on manual steering in Rane NSK, how is the progress on that product and it was anticipated that likely Indian operation to become a sourcing base for NSK. So, any development on manual steering?

Harish Lakshman: Manual, there is some work going on. And we are in early stages there is some we are seeing some opportunities to supply to Europe, but it will all be in the Rs. 50 crores range. So, gradually it will build up.

Manish Goyal: Okay.

Harish Lakshman: Manish, I had one question for you. Since you are asking for steering and occupant restraint separately as a company when you compare Rane TRW in the industry, is there any peer that you look at who is comparable to Rane TRW?

Manish Goyal: Not really, because ideally the portfolio what Rane TRW has in the seatbelt and airbags, on the listed entity we are not able to have a comparable because we have both steering and occupant safety whereas ZF, which is listed is only the steering gear part and is owned by Bosch. So, anyway sir, I will definitely look into it and get back to this.

Moderator: Thank you very much. The next question is from the line of Sunil Kothari from Unique Portfolio Management Service. Please go ahead.

Sunil Kothari: Sir, just one of your thoughts on we are hearing from many auto component companies that there is a very growing and good opportunity happening because of everybody's auto value, auto mobile manufacturers focus is on now EV. So, they do not want to do much development or R&D work or the manufacturing work on IC engine related products. So, can it be a possibility and opportunity for us for maybe for next three, five years? Any of your I mean thought process or anything should we understand from you that this is a possibility for us or not?

Harish Lakshman: So, I will answer the question in two parts, Sunil. One is as you know, other than Rane Engine Valves in the Rane Group, every other product is there in electric vehicle and there is a lot of focus that the business development teams of all the companies including Rane Madras, etc., is looking at targeting specifically business in electric vehicles. And I can assure you that we have already booked lot of export business for electric vehicle platforms.

So, that target and focus is there trying to latch ourselves on into more EV vehicles because the growth will be even faster. The second is whether we can do some other products through a portfolio expansion for electric vehicle, that by and large will probably only be through an acquisition process.

And as you know, given the performance of the group in the last two years and the overall financial position, there is nothing in the immediate but once we achieve turnaround and improve the underlying profitability, definitely we will be looking at more opportunities.

Moderator: Thank you. The next question is from the line of Rajakumar V, an individual investor. Please go ahead.

Rajakumar V: My question is on the telematics. Just wanted to know how big is the opportunity because I see a lot of other companies getting into the service space even if you take Pricol I heard that they had almost having 300 software engineers to focus on the EV and the ADAS. So, is Rane looking at those spaces?

Harish Lakshman: So, right now the companies that we have in through Rane Holdings, they are focused on telematics solutions for the transportation, logistics sector as well as mining sector etc. We are not directly doing solutions and being a supplier to OEMs for their vehicle content. Now, as far as the telematics in the logistics and transportation sector there is lot of opportunity.

Clearly, we are seeing our opportunity, but the competition is also quite intense, because in the market there are many, many players. And obviously, there are different types of sectors even with the e-commerce boom, there is a lot of opportunity, but also a lot of players.

So, we are working on capturing, trying to get few more enterprise customers who can generate revenues for us. But in terms of doing something on ADAS, etc., for vehicle manufacturers, this company is not yet fully equipped for that. And that is something that we rule out in the future.

Rajakumar V: And sir, given your events of many decades of experience so would it not be good if you have some of the software companies because most of the software companies are into this space of ADAS and all that? So, even if we are not able to do it on your own, I think I am sure now you can be of greater help and that can be also an avenue for generating revenue for the company?

Harish Lakshman: Sure, we will definitely look at it.

Moderator: Thank you. As there are no further questions, I will now hand the conference over to the management for closing comments.

L. Ganesh: Thank you very much for your time and as we said things are kind of looking up now. We are hoping that there will not be a big severe third wave and we will be able to manage the economy and the industry will therefore recover better. Exports subject to this problem of semiconductor chips we have good order book position. So, we look forward to better quarter in Q2. Look forward to seeing you later. Thank you.

Moderator: Thank you very much. On behalf of Rane Group of Companies, that concludes this conference. Thank you for joining us. You may now disconnect your lines.