

Varroc Engineering Ltd.

Varroc Engineering Ltd (VEL) is a tier-1 automotive component group. It designs, manufactures and supplies exterior lighting systems, plastic & polymer components, electricals-electronics components and precision metallic components to passenger cars, commercial vehicles, 2W, 3W and off highway vehicle OEMs directly worldwide. VEL has a global footprint of 36 manufacturing facilities spread across seven countries, with six facilities for its Global Lighting business, 25 for India business and five for Other businesses. Currently, VEL's ~34.7% of revenue comes from India and balance from Europe (41.8%), North America (22.3%), Asian Pacific (0.7%) and others (0.5%).

Positives: (a) Focus on high growth markets for global lighting business, (b) Focus on increasing customer revenue for India business, (c) Continuous investment in R&D, design, engineering and software capabilities in order to capitalize on future trends.

Investment concerns: (a) VEL reported low consolidated top-line and bottom-line CAGR of ~12% & ~10% respectively over FY2016-18, (b) The company's ~35% revenue comes from India i.e. from 2W/3W sector (which are not high growth sectors).

Outlook & Valuation: In terms of valuations, the pre-issue P/E works out to 28.9x FY2018 earnings (at the upper end of the issue price band), which is high considering VEL's historical two year CAGR top-line & bottom-line growth. Further the company's return ratios are also low compare to its other peers. Thus, we recommend **NEUTRAL** rating on the issue.

Key Financials

Y/E March (₹ cr)	FY2015	FY2016	FY2017	FY2018
Net Sales	6,951	8,219	9,609	10,378
% chg	-	18.2	16.9	8.0
Net Profit	17	370	303	451
% chg	-	2,100.1	(18.0)	48.6
OPM (%)	8.9	6.9	6.1	8.5
EPS (₹)	1.2	27.4	22.5	33.4
P/E (x)	775.6	35.3	43.0	28.9
P/BV (x)	11.8	7.3	5.9	4.6
RoE (%)	1.5	20.7	13.8	15.8
RoCE (%)	14.5	8.7	6.9	12.8
EV/Sales (x)	2.0	1.7	1.4	1.3
EV/EBITDA (x)	22.9	24.5	23.6	15.2

Angel Research; Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

NEUTRAL

Issue Open: June 26, 2018

Issue Close: June 28, 2018

Issue Details

Face Value: ₹1

Present Eq. Paid up Capital: ₹13.5cr

Fresh issue: Nil

Post Eq. Paid up Capital: ₹13.5cr

Issue size (amount): *₹1951-**₹1955cr

Price Band: ₹965-967

Lot Size: 15 shares and in multiple thereafter

Post-issue implied mkt. cap:
*₹13036cr - **₹13009cr

Promoters holding Pre-Issue: 86.3%

Promoters holding Post-Issue: 85.0%

*Calculated on lower price band

** Calculated on upper price band

Book Building

QIBs	50% of issue
Non-Institutional	15% of issue
Retail	35% of issue

Post Issue Shareholding Pattern

Promoters	85.0%
Others	15.0%

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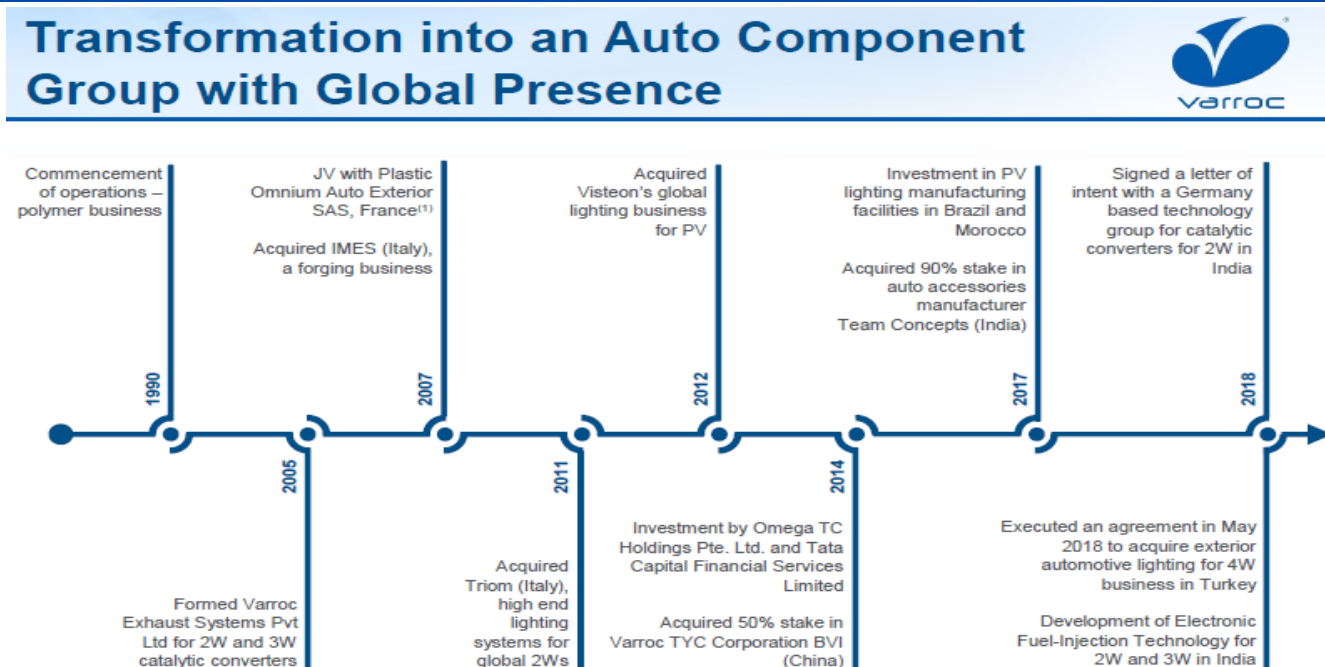
Company background

Varroc Engineering is a tier-1 automotive component group. It designs, manufactures and supplies exterior lighting systems, plastic & polymer components, electricals-electronics components, and precision metallic components to passenger cars, commercial vehicles, two-wheelers, three-wheelers, and off highway vehicle OEMs directly worldwide. It is the second largest Indian auto component group (by consolidated revenue for FY2017) and a leading tier-1 manufacturer and supplier to Indian two-wheeler and three-wheeler OEMs.

The company initially grew organically in India by adding new business lines such as electrical division and metallic division. In 2012, it acquired Visteon's global lighting business, now known as Varroc Lighting Systems. Prior to the acquisition of Visteon's global lighting business, in 2007 Varroc had acquired I.M.E.S (a manufacturer of hot steel forged parts for construction and oil and gas industries) in Italy, and in 2011, it acquired Triom (a manufacturer of high end lighting systems for global motorcycle OEMs) with operations in Italy, Romania and Vietnam.

Varroc has a global footprint of 36 manufacturing facilities spread across seven countries, with six facilities for its Global Lighting Business, 25 for India Business and five for Other Businesses.

Exhibit 1: Transformation into an auto component group with global presence



Source: Company, Angel Research

Issue details

Varroc Engineering is raising ₹1,951-1,955cr through offer for sale of equity shares in the price band of ₹965-967. Public offer of up to 2.0cr equity shares of face value ₹1 each through an offer for sale of up to 1.8cr equity shares by Omega TC Holdings Pte. Ltd. and Tata Capital Financial Services Ltd (combined) and up to 0.2cr equity shares by Tarang Jain (Promoter Selling Shareholder).

Exhibit 2: Pre and Post IPO shareholding pattern

	No of shares (Pre-issue)	%	No of shares (Post-issue)	%
Promoters	116,342,360	86.3%	114,589,800	85.0%
Others	18,469,170	13.7%	20,221,730	15.0%
	134,811,530	100.0%	134,811,530	100.0%

Source: Source: RHP, Note: Calculated on upper price band

Objectives of the Offer

The objects of the Offer are to achieve the benefits of listing the Equity Shares on the Stock Exchanges and to carry out the Offer for Sale by Selling Shareholders.

Outlook & Valuation

In terms of valuations, the pre-issue P/E works out to 28.9x FY2018 earnings (at the upper end of the issue price band), which is high considering VEL's historical two year CAGR top-line & bottom-line growth. Further the company's return ratios are also low compare to its other peers. Thus, we recommend **NEUTRAL** rating on the issue.

Key Risks

- Slowdown in 2W/3W/PV industries could impact the overall sales volume of the company
- Company's ~65% revenue comes from global business, hence, any unfavorable currency volatility could impact the company's profitability
- Increase in competition from other players can impact the company's business

Consolidated Profit & Loss Statement

Y/E March (₹ cr)	FY2015	FY2016	FY2017	FY2018
Total operating income	6,951	8,219	9,609	10,378
% chg		18.2	16.9	8.0
Total Expenditure	6,334	7,648	9,027	9,501
Raw Material	4,193	5,049	6,037	6,383
Personnel	902	1,040	1,204	1,314
Others Expenses	1,239	1,559	1,786	1,805
EBITDA	617	571	582	878
% chg	-	(7.4)	1.9	50.8
(% of Net Sales)	8.9	6.9	6.1	8.5
Depreciation & Amortisation	254	292	337	386
EBIT	363	279	245	491
% chg		(23.2)	(12.2)	100.7
(% of Net Sales)	5.2	3.4	2.5	4.7
Interest & other Charges	475	(43)	90	86
Other Income	88	21	94	39
(% of PBT)	138.4	5.3	28.6	7.5
Share of PAT of invest acc. for using the equ. method	36	50	79	69
Exceptional Items	52	-	-	
Recurring PBT	63	392	327	513
% chg	-	518.5	(16.5)	56.7
Tax	47	22	24	62
(% of PBT)	73.5	5.6	7.3	12.1
PAT (reported)	17	370	303	451
% chg		2,100.1	(18.0)	48.6
(% of Net Sales)	0.2%	4.5%	3.2%	4.3%
Basic EPS & Fully Diluted (₹)	1.2	27.4	22.5	33.4
% chg	-	2,100.1	(18.0)	48.6

Source: Company, Angel Research

Consolidated Balance Sheet

Y/E March (₹ cr)	FY2015	FY2016	FY2017	FY2018
SOURCES OF FUNDS				
Equity Share Capital	10	26	13	13
Reserves & Surplus	1,094	1,757	2,192	2,835
Shareholders Funds	1,104	1,783	2,206	2,849
Total Loans	1,406	1,405	1,354	980
Deferred Tax Liability	64	61	31	59
Total Liabilities	2,574	3,250	3,591	3,888
APPLICATION OF FUNDS				
Net Block	1,721	1,975	2,251	2,586
Capital Work-in-Progress	149	264	246	244
Investments	234	291	307	374
Goodwill	151	188	176	304
Current Assets	2,160	2,499	2,851	3,229
Inventories	586	683	753	864
Sundry Debtors	1,071	1,185	1,138	1,403
Cash	69	177	354	329
Loans & Advances	10	10	12	15
Other Assets	424	443	593	619
Current liabilities	1,855	1,996	2,269	2,965
Net Current Assets	305	502	582	265
Deferred Tax Asset	14	29	28	115
Total Assets	2,574	3,250	3,591	3,888

Source: Company, Angel Research

Consolidated Cash Flow Statement

Y/E March (₹ cr)	FY2015	FY2016	FY2017	FY2018
Profit before tax	63	392	327	513
Depreciation	254	292	337	386
Change in Working Capital	(506)	(252)	70	296
Interest / Dividend (Net)	94	81	83	85
Direct taxes paid	(57)	(40)	(51)	(124)
Others	281	(183)	(89)	(81)
Cash Flow from Operations	128	290	677	1075
(Inc.)/ Dec. in Fixed Assets	(596)	(629)	(606)	(353)
(Inc.)/ Dec. in Investments	350	50	41	(249)
Cash Flow from Investing	(245)	(579)	(565)	(601)
Issue of Equity				
Inc./(Dec.) in loans	168	471	179	(437)
Dividend Paid (Incl. Tax)	(4)	(4)	(5)	(7)
Interest / Dividend (Net)	(98)	(85)	(86)	(86)
Cash Flow from Financing	70	386	94	(523)
Inc./(Dec.) in Cash	(47)	98	205	(50)
Effect of exch diff on translation of foreign	(40)	3	(11)	56
Opening Cash balances	98	11	112	305
Closing Cash balances	11	112	305	312

Source: Company, Angel Research

Key Ratios

Y/E March	FY2015	FY2016	FY2017	FY2018
Valuation Ratio (x)				
P/E (on FDEPS)	775.6	35.3	43.0	28.9
P/CEPS	48.1	19.7	20.4	15.6
P/BV	11.8	7.3	5.9	4.6
Dividend yield (%)	0.0	0.0	0.0	0.0
EV/Sales	2.0	1.7	1.4	1.3
EV/EBITDA	22.9	24.5	23.6	15.2
EV / Total Assets	5.5	4.3	3.8	3.4
Per Share Data (₹)				
EPS (Basic)	1.2	27.4	22.5	33.4
EPS (fully diluted)	1.2	27.4	22.5	33.4
Cash EPS	20.1	49.1	47.5	62.1
Book Value	81.9	132.3	163.6	211.3
Returns (%)				
ROCE	14.5	8.7	6.9	12.8
Angel ROIC (Pre-tax)	16.4	10.2	8.4	15.7
ROE	1.5	20.7	13.8	15.8
Turnover ratios (x)				
Inventory / Sales (days)	31	30	29	30
Receivables (days)	52	54	57	70
Payables (days)	52	54	57	70
Working capital cycle (ex-cash) (days)	31	30	29	30

Source: Company, Angel Research

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