



TM

# Varroc Engineering

04 May 2022

## Sale of VLS business deleverages balance sheet

### COMPANY UPDATE

**Sector:** Auto **Rating:** BUY  
**CMP:** Rs 367 **Target Price:** Rs 350

#### Stock Info

Sensex/Nifty	56,416/16,901
Bloomberg	VARROC IN
Equity shares (mn)	153mn
52-wk High/Low	Rs 495/260
Face value	Rs 1
M-Cap	Rs 60bn/USD 0.8bn
3-m Avg volume	USD 0.9mn

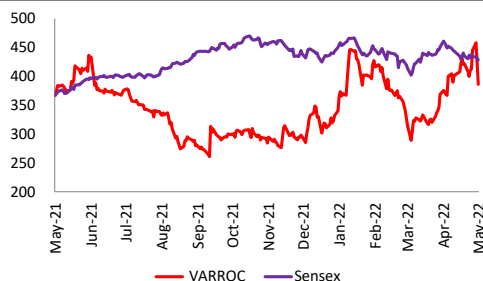
#### Financial Snapshot (Rs mn)

Y/E	Mar	FY22E	FY23E	FY24E
Net Sales		1,32,301	59,679	67,139
EBIDTA		8,211	5,161	6,252
PAT		-1,141	727	1,549
EPS (Rs)		-7	5	10
PE (x)		-61.3	96.3	45.2
EV/EBITDA (x)		10.5	11.9	9.5
RoE (%)		-4	2	5
RoCE (%)		-0	3	6
P/B (x)		2.4	2.4	2.3

#### Shareholding Pattern (%)

	Mar'22	Dec'21	Sep'21
Promoter	75.0	75.0	75.0
-Pledged	-	-	-
FII	3.9	3.5	4.0
DII	14.9	14.2	13.82
Others	6.2	7.3	7.2

#### Stock Performance (1-year)



Varroc Engineering (VARROC) has entered into an agreement to sell its global lighting business, Varroc Lighting Systems (VLS) to Plastic Omnium. The deal equity value post debt and contingency is ~Eur 35mn (Rs 3bn). We expect the company to turn net cash, as a large part of the leverage on its books pertains to VLS. The company plans to focus on expanding its electronics business in India after completing this transaction. The company has started the production of traction motor, controller, BMS and other electronics for the domestic E-2W and E-3W industry (albeit on a small scale). However, we believe the competitive positioning of India business is weak due to depressed return ratios (peak pre-tax RoCE of 15%) and EV risk (~30% of India revenues). As the residual international business too would be a drag on consolidated EBITDA over the next 12-18 months, we downgrade our rating on the stock to HOLD, with a target price of Rs 350 (8x FY24E EV/EBITDA and Rs 10/sh for China JV). While we have factored in the VLS sale in our revised estimates with effect from April 1, 2022, the company would report this until the closing of the transaction as discontinued operations.

- VLS business divested:** VARROC has signed an agreement with Plastic Omnium SE, France, to divest part of its global (PV) lighting business (through VLS) in America and Europe, for an EV of EUR 600mn (equity value of ~Eur 70mn, of which, Eur 35mn would be part of an escrow account for the next 3 years). The divestment would encompass its lighting system operations in the US, Mexico, Brazil, Poland, Morocco, Germany, Czech Republic and Tokyo; closure is expected by 2QFY23. VARROC had invested EUR 130mn towards VLS' new capacities in Morocco, Poland and Brazil over the past 3 years, which were estimated to have peak revenue potential of EUR 525mn. However, owing to the global supply chain constraints, macroeconomic headwinds and weak pricing power with OEMs, new plants have been operating at sub-optimal utilization levels, resulting in consistent losses at its VLS divisions for the past several quarters. VARROC's leverage too has been at elevated levels since the past few years, mainly due to VLS investments (net debt as of Dec'21 at Rs 26bn). The company will continue to operate its China JV, international 2W businesses in Italy and Vietnam, global electronics businesses in Poland and Romania, and PV lighting business in Asia.
- Focus on expanding electronics and EV business in India:** VARROC's India business caters to OEMs across segments through its 3 product categories - polymer/plastics (air filter assemblies, mirror assemblies, seat assemblies, trims, etc.), electrical-electronics (digital instrument clusters, motors, EFI, magneto, etc.) and precision metallic components (transmission assembly, crankshaft, connecting rods, gears, etc.). Recently, VARROC also developed an E-2W product portfolio (motor & controller, DC-DC converter & telematics). It has received orders for the EV products from Bajaj, and is in talks with several incumbent and new-age startups for more orders. Post divestment, VARROC plans to focus on EV components, electronics and connectivity solutions (**Exhibit 1**).
- Outlook and valuation:** We expect VARROC to generate cumulative FCF of ~Rs 28bn between FY22E and FY24E (proceeds from the divestment), which would turn the company net cash in FY23E (from a net debt of Rs 26bn as on Dec'21). RoCE should expand to 5.8% in FY24E (-5.7% in FY21) once the under-utilized VLS facilities are divested. At the CMP, the stock trades at 45.2x PER and 9.5x EV/EBITDA on FY24E.

**Ronak Sarda**  
 ronaksarda@systematixgroup.in  
 +91 22 6704 8059

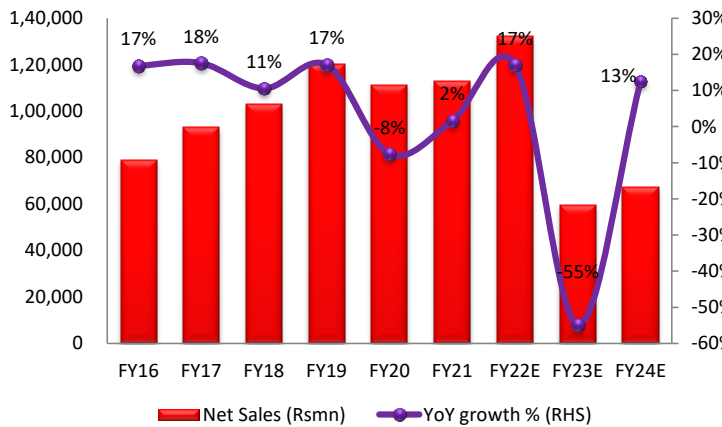
**Poorvi Banka**  
 poorvibanka@systematixgroup.in  
 +91 22 6704 8063

**Exhibit 1: VARROC's EV product offerings**



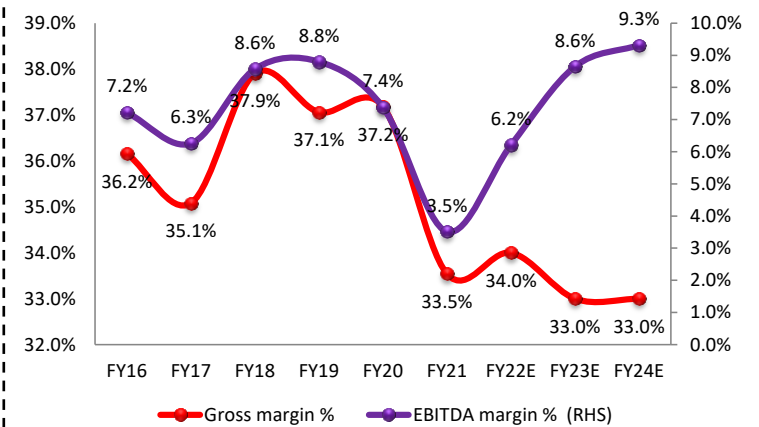
Source: Company

**Exhibit 2: Revenue and growth trend**



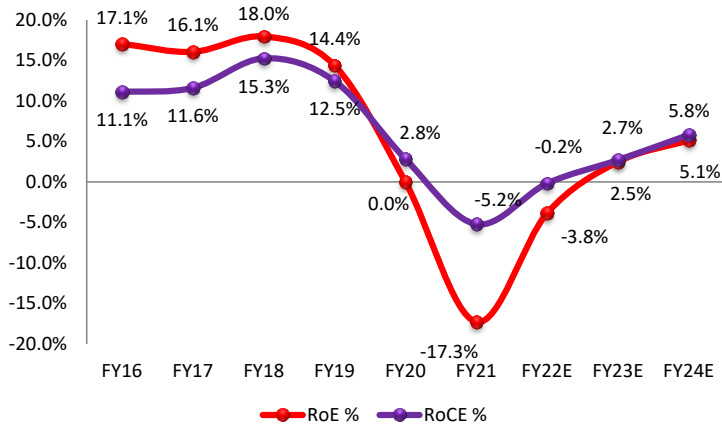
Source: Company, Systematix Institutional Research

**Exhibit 3: Gross and EBITDA margin trend**



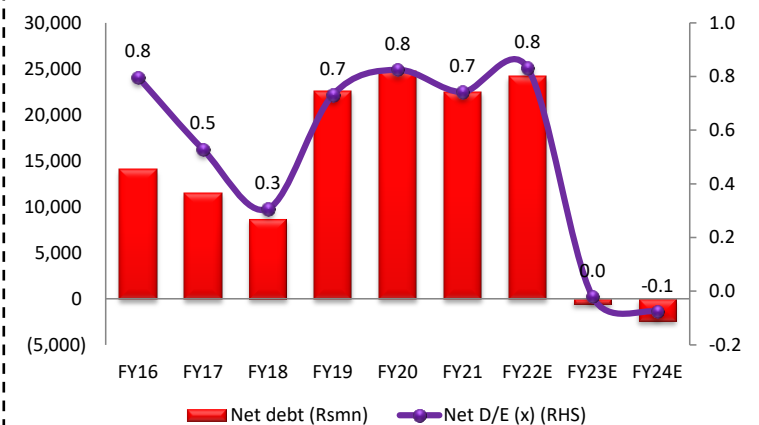
Source: Company, Systematix Institutional Research

**Exhibit 4: RoE and RoCE trend**



Source: Company, Systematix Institutional Research

**Exhibit 5: VARROC to turn net cash post divestment**



Source: Company, Systematix Institutional Research

**Exhibit 6: Business segment-wise revenue, EBITDA and PAT trend**

Rs mn	FY16	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
<b>Revenue</b>									
VLS	48,198	61,242	63,211	75,101	71,692	75,514	85,825	7,040	8,360
India	27,709	28,583	36,508	42,720	38,253	36,088	43,976	50,064	56,127
Other businesses	3,185	3,163	4,278	3,076	2,291	1,918	2,500	2,575	2,652
<b>Total</b>	<b>79,092</b>	<b>92,988</b>	<b>1,03,997</b>	<b>1,20,897</b>	<b>1,12,236</b>	<b>1,13,520</b>	<b>1,32,301</b>	<b>59,679</b>	<b>67,139</b>
<b>YoY growth %</b>									
VLS	9%	27%	3%	19%	-5%	5%	14%	-92%	19%
India	43%	3%	28%	17%	-10%	-6%	22%	14%	12%
Other businesses	-20%	-1%	35%	-28%	-26%	-16%	30%	3%	3%
<b>Total</b>	<b>17%</b>	<b>18%</b>	<b>12%</b>	<b>16%</b>	<b>-7%</b>	<b>1%</b>	<b>17%</b>	<b>-55%</b>	<b>13%</b>
<b>EBITDA</b>									
VLS	3,154	3,807	4,911	6,385	5,101	722	3,004	-70	167
India	2,715	2,775	3,872	4,623	3,917	4,052	5,057	5,257	6,006
Other businesses	47	174	399	303	100	-171	150	-26	80
<b>Total</b>	<b>5,916</b>	<b>6,755</b>	<b>9,182</b>	<b>11,311</b>	<b>9,118</b>	<b>4,603</b>	<b>8,211</b>	<b>5,161</b>	<b>6,252</b>
<b>EBITDA margin %</b>									
VLS	6.5%	6.2%	7.8%	8.5%	7.1%	1.0%	3.5%	-1.0%	2.0%
India	9.8%	9.7%	10.6%	10.8%	10.2%	11.2%	11.5%	10.5%	10.7%
Other businesses	1.5%	5.5%	9.3%	9.9%	4.4%	-8.9%	6.0%	-1.0%	3.0%
<b>Total</b>	<b>7.5%</b>	<b>7.3%</b>	<b>8.8%</b>	<b>9.4%</b>	<b>8.1%</b>	<b>4.1%</b>	<b>6.2%</b>	<b>8.6%</b>	<b>9.3%</b>
<b>Consolidated EBIT</b>	<b>2,787</b>	<b>2,447</b>	<b>4,944</b>	<b>4,931</b>	<b>889</b>	<b>-4,983</b>	<b>-1,761</b>	<b>961</b>	<b>1,962</b>
<b>Consol EBIT margin %</b>	<b>3.5%</b>	<b>2.6%</b>	<b>4.8%</b>	<b>4.1%</b>	<b>0.8%</b>	<b>-4.4%</b>	<b>-1.3%</b>	<b>1.6%</b>	<b>2.9%</b>
<b>Consolidated APAT</b>	<b>2,426</b>	<b>3,173</b>	<b>4,503</b>	<b>4,252</b>	<b>2</b>	<b>-5,209</b>	<b>-1,141</b>	<b>727</b>	<b>1,549</b>

Source: Company, Systematix Institutional Research; Note: Revenue / EBITDA above includes part of other income

## FINANCIALS (CONSOLIDATED)

### Profit & Loss Statement

YE: Mar (Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
<b>Net sales</b>	<b>1,11,219</b>	<b>1,13,027</b>	<b>1,32,301</b>	<b>59,679</b>	<b>67,139</b>
Growth, %	-8	2	17	-55	13
RM expenses	(69,862)	(75,116)	(87,319)	(39,985)	(44,983)
Employee expenses	(16,372)	(16,296)	(18,251)	(20,989)	(24,137)
Other expenses	(16,777)	(17,648)	(18,520)	6,455	8,234
<b>EBITDA</b>	<b>8,208</b>	<b>3,968</b>	<b>8,211</b>	<b>5,161</b>	<b>6,252</b>
Growth, %	-22	-52	107	-37	21
Margin, %	7.4	3.5	6.2	8.6	9.3
Depreciation	(7,319)	(8,951)	(9,972)	(4,200)	(4,290)
<b>EBIT</b>	<b>889</b>	<b>-4,983</b>	<b>-1,761</b>	<b>961</b>	<b>1,962</b>
Growth, %	-82	-660	-65	-155	104
Margin, %	0.8	(4.4)	(1.3)	1.6	2.9
Interest paid	(1,392)	(1,626)	(1,436)	(428)	(428)
Other Income	989	1,271	1,207	250	253
Non-recurring Items	-	(1,078)	-	-	-
<b>Pre-tax profit</b>	<b>487</b>	<b>(6,416)</b>	<b>(1,990)</b>	<b>783</b>	<b>1,787</b>
Tax provided	(370)	(227)	398	(164)	(375)
<b>Profit after tax</b>	<b>117</b>	<b>(6,643)</b>	<b>(1,592)</b>	<b>618</b>	<b>1,412</b>
Others (Minorities, Associates) (115)	356	451	108	137	
<b>Net Profit</b>	<b>2</b>	<b>(6,286)</b>	<b>(1,141)</b>	<b>727</b>	<b>1,549</b>
Growth, %	-100	-3,29,232	-82	-164	113
<b>Net Profit (adjusted)</b>	<b>2</b>	<b>(5,209)</b>	<b>(1,141)</b>	<b>727</b>	<b>1,549</b>

Source: Company, Systematix Institutional Research

### Balance Sheet

YE: Mar (Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
Cash & bank	10,688	7,452	2,240	8,976	10,741
Marketable securities	-	-	-	-	-
Debtors	10,893	16,407	19,205	8,663	9,746
Inventory	10,758	12,565	16,178	8,027	9,934
Loans & advances	283	392	459	207	233
Other current assets	13,368	10,806	11,902	4,393	4,817
<b>Total current assets</b>	<b>41,531</b>	<b>43,243</b>	<b>45,604</b>	<b>29,267</b>	<b>34,471</b>
Investments	3,303	3,762	4,213	500	637
Gross fixed assets	75,684	84,111	89,111	35,000	36,500
Less: Depreciation	22,854	31,805	41,777	15,977	20,267
Add: Capital WIP	7,901	8,562	8,562	500	500
Net fixed assets	60,731	60,868	55,896	19,523	16,733
<b>Total assets</b>	<b>1,10,023</b>	<b>1,12,253</b>	<b>1,10,093</b>	<b>50,290</b>	<b>52,841</b>
Current liabilities	42,465	49,826	52,051	11,622	12,865
Provisions	1,757	1,952	2,284	515	580
<b>Total current liabilities</b>	<b>44,222</b>	<b>51,778</b>	<b>54,335</b>	<b>12,137</b>	<b>13,445</b>
Debt	35,506	29,915	26,415	8,389	8,389
<b>Total liabilities</b>	<b>79,728</b>	<b>81,692</b>	<b>80,750</b>	<b>20,526</b>	<b>21,833</b>
Paid-up capital	135	153	153	153	153
Reserves & surplus	30,160	30,408	29,190	29,612	30,855
Shareholders' equity	30,295	30,561	29,343	29,764	31,008
<b>Total equity &amp; liabilities</b>	<b>1,10,023</b>	<b>1,12,253</b>	<b>1,10,093</b>	<b>50,290</b>	<b>52,841</b>

Source: Company, Systematix Institutional Research

### Cash Flow

YE: Mar (Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
<b>Pre-tax profit</b>	<b>395</b>	<b>(4,982)</b>	<b>(1,539)</b>	<b>891</b>	<b>1,924</b>
Depreciation	7,319	8,951	9,972	4,200	4,290
Chg in working capital	6,146	600	(5,016)	(19,125)	(2,132)
Total tax paid	(1,282)	(198)	398	(164)	(375)
<b>CFO</b>	<b>14,137</b>	<b>4,738</b>	<b>4,801</b>	<b>(17,254)</b>	<b>3,998</b>
Capital expenditure	(14,181)	(7,830)	(5,000)	(2,250)	(1,500)
Chg in investments					
Chg in marketable securities	1,499	1,390	-	45,000	-
<b>CFI</b>	<b>(12,682)</b>	<b>(6,440)</b>	<b>(5,000)</b>	<b>42,750</b>	<b>(1,500)</b>
Free cash flow	(44)	(3,092)	(199)	(19,504)	2,498
Debt raised/(repaid)	4,079	17,906	(3,500)	(18,026)	-
Dividend (incl. tax)	(1,151)	-	(76)	(306)	(306)
<b>CCF</b>	<b>7,480</b>	<b>(1,226)</b>	<b>(5,013)</b>	<b>(18,760)</b>	<b>(733)</b>
<b>Net chg in cash</b>	<b>9,053</b>	<b>(3,235)</b>	<b>(5,212)</b>	<b>6,736</b>	<b>1,764</b>
Opening cash balance	1,634	10,688	7,452	2,240	8,976
<b>Closing cash balance</b>	<b>10,688</b>	<b>7,452</b>	<b>2,240</b>	<b>8,976</b>	<b>10,741</b>

Source: Company, Systematix Institutional Research

### Ratios

YE: Mar	FY20	FY21	FY22E	FY23E	FY24E
EPS (INR)	0	(34)	(7)	5	10
PER (x)	32,326.5	(13.4)	(61.3)	96.3	45.2
Price/Book (x)	2.0	2.3	2.4	2.4	2.3
EV/EBITDA (x)	10.5	21.2	10.5	11.9	9.5
EV/Net sales (x)	0.8	0.7	0.6	1.0	0.9
RoE (%)	0	(17)	(4)	2	5
RoCE (%)	3	(5)	(0.2)	2.7	5.8
Fixed Asset turnover (x)	1	1	1	2	2
Dividend Yield (%)	1	0	0	0	0
Receivable (days)	36	53	53	53	53
Inventory (days)	35	41	45	49	54
Payable (days)	139	161	144	71	70
Revenue Growth (%)	(8)	2	17	(55)	13
EBIDTA Growth (%)	(22)	(52)	107	(37)	21
EPS Growth, %	(100)	NA	NA	NA	113
Net D/E ratio (x)	0.8	0.7	0.8	(0.0)	(0.1)

Source: Company, Systematix Institutional Research

## Institutional Equities Team

<b>Nikhil Khandelwal</b>	<b>Managing Director</b>	<b>+91-22-6704 8001</b>	<b>nikhil@systematixgroup.in</b>
<b>Navin Roy Vallabhaneni</b>	<b>President &amp; Head – IE</b>	<b>+91-22-6704 8065</b>	<b>navin@systematixgroup.in</b>

### Equity Research

Analysts	Industry Sectors	Desk-Phone	E-mail
Ashish Poddar	Consumer Durables, Building Materials, Small & Midcaps	+91-22-6704 8039	ashishpoddar@systematixgroup.in
Ashutosh Joytiraditya	Consumer, Retail	+91-22-6704 8068	ashutoshj@systematixgroup.in
Pratik Tholiya	Specialty & Agro Chem, Fertilisers, Sugar, Textiles and Select Midcaps	+91-22-6704 8028	pratiktholiya@systematixgroup.in
Rahul Jain	Metals & Mining, Cement	+91-22-6704 8066	rahuljain@systematixgroup.in
Rakesh Kumar	Banking, Insurance	+91-22-6704 8041	rakeshkumar@systematixgroup.in
Ronak Sarda	Auto, Auto Ancillaries	+91-22-6704 8059	ronaksarda@systematixgroup.in
Shubhanshu Mishra	NBFCs & Diversified Financials	+91-22-6704 8024	shubhanshumishra@systematixgroup.in
Girija Shankar Ray	Cement, Building Materials, Paints	+91-22-6704 8098	girijaray@systematixgroup.in
Hena Vora	NBFCs & Diversified Financials	+91-22-6704 8045	henavora@systematixgroup.in
Nikhil Shah	Banking, Insurance	+91-22-6704 8091	nikhilshah@systematixgroup.in
Poorvi Banka	Auto, Auto Ancillaries	+91-22-6704 8063	poorvibanka@systematixgroup.in
Pranay Shah	Consumer Durables, Building Materials, Small & Midcaps	+91-22-6704 8017	pranayshah@systematixgroup.in
Shweta Dikshit	Metals & Mining	+91-22-6704 8042	shwetadikshit@systematixgroup.in
Varun Gajaria	Midcaps	+91-22-6704 8081	varungajaria@systematixgroup.in

### Equity Sales & Trading

Name		Desk-Phone	E-mail
Vipul Sanghvi	Director and Head - Sales	+91-22-6704 8062	vipulsanghvi@systematixgroup.in
Ashok Kumar Agarwal	Sales	+91-22-6704 8058	ashokagarwal@systematixgroup.in
Jigar Kamdar	Sales	+91-22-6704 8060	jigarkamdar@systematixgroup.in
Nirbhay Kumar Singh	Sales	+91-22-6704 8061	nirbhaysingh@systematixgroup.in
Sidharth Agrawal	Sales	+91-22-6704 8090	sidharthagrawal@systematixgroup.in
Rahul Khandelwal	Sales	+91-22-6704 8003	rahul@systematixgroup.in
Pawan Sharma	Director and Head - Sales Trading	+91-22-6704 8067	pawansharma@systematixgroup.in
Mukesh Chaturvedi	Vice President and Co Head - Sales Trading	+91-22-6704 8074	mukeshchaturvedi@systematixgroup.in
Vinod Bhuwad	Sales Trading	+91-22-6704 8051	vinodbhuwad@systematixgroup.in
Rashmi Solanki	Sales Trading	+91-22-6704 8097	rashmisolanki@systematixgroup.in
Karan Damani	Sales Trading	+91-22-6704 8053	karandamani@systematixgroup.in
Vipul Chheda	Dealer	+91-22-6704 8087	vipulchheda@systematixgroup.in
Paras Shah	Dealer	+91-22-6704 8047	parasshah@systematixgroup.in
Suketu Vyas	Dealer	+91-22-6704 8050	suketuvyas@systematixgroup.in
Rahul Singh	Dealer	+91-22-6704 8054	rahulsingh@systematixgroup.in

### Corporate Access

Audrey Leolyn Mendonca	Assistant Vice President	+91-22-6704 8088	audreymendonca@systematixgroup.in
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### Production

Madhu Narayanan	Editor	+91-22-6704 8071	madhunarayanan@systematixgroup.in
Mrunali Pagdhare	Production	+91-22-6704 8057	mrunalip@systematixgroup.in
Vijayendra Achrekar	Production	+91-22-6704 8089	vijayendraachrekar@systematixgroup.in

### Operations

Sachin Malusare	Vice President	+91-22-6704 8055	sachinmalusare@systematixgroup.in
Jignesh Mistry	Manager	+91-22-6704 8049	jigneshmistry@systematixgroup.in
Ravikiran Dasaka	Manager	+91-22-6704 8019	ravikiran@systematixgroup.in

## DISCLOSURES/APPENDIX

## I. ANALYST CERTIFICATION

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Disclosure of Interest Statement	Update
Analyst holding in the stock	No
Served as an officer, director or employee	No

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- Details of SSSIL, research analyst and its associates pertaining to the companies covered in this research report:

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**Systematix Shares and Stocks (India) Limited:**

**Registered and Corporate address:** The Capital, A-wing, No. 603 – 606, 6th Floor, Plot No. C-70, G Block, Bandra Kurla Complex, Bandra (East), Mumbai – 400 051

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