

Q1FY22 result review and earnings revision

Automobiles

Target price: Rs310

Earnings revision

(%)	FY22E	FY23E
EBITDA	↓ 3.2	↓ 2.6
PAT	↓ 12.0	↓ 5.0
EPS	NC	↓ 12.9

Target price revision

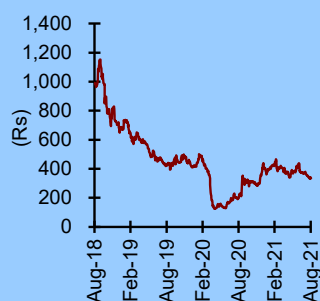
Rs310 from Rs417

Shareholding pattern

	Dec '20	Mar '21	Jun '21
Promoters	75.0	75.0	75.0
Institutional investors	19.9	19.9	19.2
MFs and others	13.6	13.5	13.2
FI/Banks	1.0	1.2	1.0
FII	5.3	5.2	5.0
Others	5.1	5.1	5.8

Source: BSE

Price chart



Research Analysts:

Nishant Vass

nishant.vass@icicisecurities.com
+91 22 6637 7260

Pratit Vajani

pratit.vajani@icicisecurities.com
+91 22 6637 7161

INDIA

Varroc Engineering

HOLD

Maintained

Rs320

Operational challenges remain sticky

Varroc Engineering's (VEL) Q1FY22 operating performance was a miss on consensus estimates as EBITDA margin came in at 0.6% (down 292bps QoQ) and reported PAT loss of ~Rs2.3bn. Global lighting business (VLS) sales fell 18% QoQ to EUR220mn as margins further shrunk 210bps to -2.8% (impacted by weaker mix and cost escalations). Challenges to improvement in greenfield plant profitability remains a key concern as the plants continue to be impacted by production issues, higher sourcing costs (e.g. electronics). India business is expected to recover as domestic lockdowns ease and OEMs witness demand improvement. However, underlying operating performance remains weak due to the VLS drag and the same is likely to cause delay in managements debt reduction plan in FY22E/23E. Maintain HOLD.

- **Key highlights of the quarter:** Topline at Rs29.6bn was down 18.6% QoQ as India business revenues declined ~23% QoQ to ~Rs12.2bn on covid lockdowns, and VLS sales were down 18% QoQ at EUR220mn. EBITDA margin at 0.6% was 292bps lower largely due to lower production volumes and higher employee expenses (up 1.8% / 323bps QoQ). VLS margins lagged (-2.8%) due to drop in Czech production (~21% QoQ) while China JV reported 4.6% margins (vs 7.8% in Q4).
- **Key highlights of earnings call:** Management indicated: a) VLS business was impacted by lower volumes (related to chip shortage) as OEMs shifted to more premium models; North America clocked EUR31mn in Q1FY22 vis-à-vis EUR33mn in Q4FY21; revenues from Czech plant dropped significantly QoQ to EUR116mn from EUR146mn; b) Poland and Morocco plants clocked EUR16mn and EUR16mn revenues in Q1 (flat QoQ); however, with -26%/-15% EBITDA margin respectively; c) VEL is a supplier to Bajaj Auto for its *Chetak* EV for supply of motors, motor controllers, telematics, on-board chargers and vehicle control units (with potential annual revenues of Rs5bn on expected sales of 120k units); d) gross debt was higher at Rs27.7bn due to higher WC requirement (Rs2.3bn) due to higher finished goods inventory and capex of Rs1.7bn aggravated by negative forex impact; of the total debt, Rs6.85bn is in short-term maturity instruments; e) overall, EVs contributed 11% of sales and VLS commands ~14% global market share in EVs.
- **Maintain HOLD:** VLS is in an attractive segment (lighting) which has higher content per vehicle play as electrification progresses. However, continued execution challenges coupled with a weak balance sheet causes us to be cautious. We cut our EPS estimates by ~13% for FY23, we value the business on SoTP basis. We keep our multiples for VLS/ India business unchanged at 4x/8x EV/EBITDA respectively; while cutting the China JV PE multiple to 6x (earlier:8x). We maintain our **HOLD** rating with an SoTP-based target price of Rs310 (earlier: Rs417).

Market Cap	Rs48.9bn/US\$659mn	Year to Mar (Std)	FY20	FY21	FY22E	FY23E
Reuters/Bloomberg	VARE.BO/VARROC IN	Revenue (Rs mn)	1,11,219	1,13,028	1,30,524	1,49,901
Shares Outstanding (mn)	152.8	Adj. Net Income (Rs mn)	2	-6,319	-751	2,850
52-week Range (Rs)	465/211	Adj. EPS (Rs)	0.0	(41.4)	(4.9)	18.7
Free Float (%)	25.0	% Chg YoY	(100.0)	NC	NC	(479.4)
FII (%)	5.2	P/E (x)	NC	NC	(65.1)	17.2
Daily Volume (US\$/'000)	982	CEPS (Rs)	54.3	17.2	53.2	80.2
Absolute Return 3m (%)	(15.9)	EV/E (x)	7.7	16.0	9.3	6.0
Absolute Return 12m (%)	45.5	Dividend Yield (%)	1.1	0.0	0.0	0.9
Sensex Return 3m (%)	13.3	RoCE (%)	3.1	(5.8)	0.0	6.6
Sensex Return 12m (%)	44.5	RoE (%)	0.0	(21.0)	(2.5)	9.3

Please refer to important disclosures at the end of this report

Table 1: Q1FY22 result review (standalone)

(Rs mn, year ending March 31)

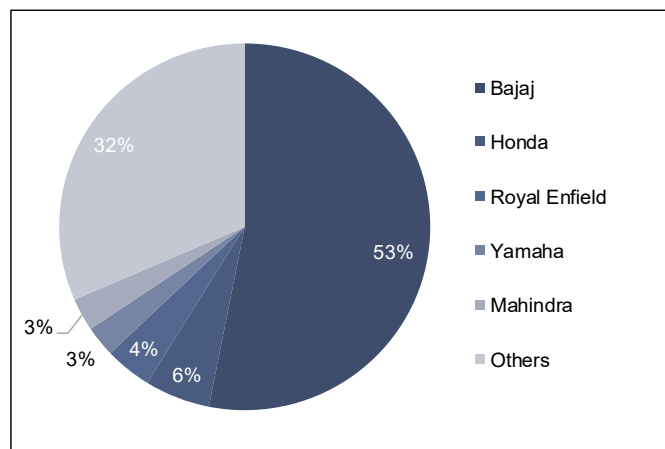
	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Total operating income	29,562	12,857	129.9	36,296	-18.6
Raw material costs	19,893	8,624	130.7	24,644	-19.3
Employee costs	4,763	3,387	40.6	4,676	1.8
Other expenditures	4,730	2,640	79.2	5,701	-17.0
Total operating expenses	29,386	14,651	100.6	35,021	-16.1
EBITDA	176	-1,794	NC	1,275	-86.2
EBITDA margin (%)	0.6	-14.0	1455 bps	3.5	-292 bps
Depreciation & Amortization	2,192	2,069	5.9	2,362	-7.2
Other income	8	390	-97.9	217	-96.3
Interest costs	386	432	-10.6	372	3.9
PBT	-2,394	-3,905	NC	-1,242	NC
Exceptional Items	-	-	-	-	-
Taxes	-127	-709	NC	266	-147.7
PAT before MI/JV	-2,267	-3,196	NC	-1,507	NC
MI/JV profits	-26	110	NC	64	NC
Adj. PAT	-2,303	-3,077	NC	-1,454	NC

Source: Company data, I-Sec research

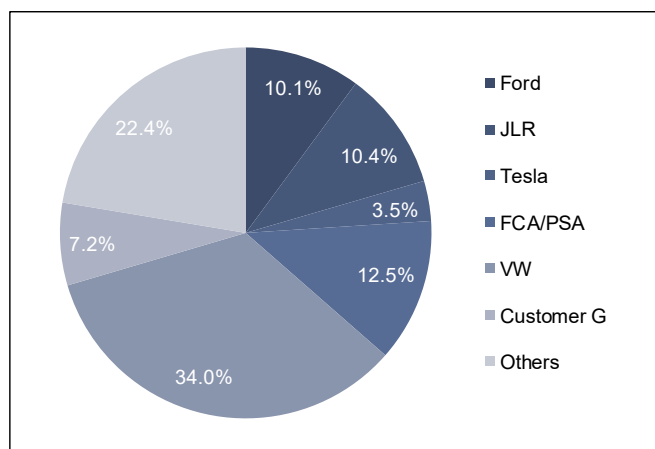
Table 2: Earnings revision

	FY22E			FY23E		
	Previous	New	Chg (%)	Previous	New	Chg (%)
Sales	1,34,865	1,30,524	(3.2)	1,53,885	1,49,901	(2.6)
EBITDA	8,932	7,864	(12.0)	12,775	12,133	(5.0)
PAT	108	(751)	NC	3,273	2,850	(12.9)
EPS (Rs)	0.7	(4.9)	NC	21.4	18.7	(12.9)

Source: Company data, I-Sec research

Chart 1: India – revenue split by customer

Source: Company data

Chart 2: VLS – revenue split by customer

Source: Company data: Customer G is a leading light vehicle manufacturing group in the world

Valuation and risks

VLS is in an attractive business (lighting) which has higher content per vehicle play as electrification progresses. However, continued execution challenges cause coupled with weak balance sheet cause us to be cautious. We cut our EPS estimates by ~13% for FY23, we value the business on SoTP basis. We keep our multiples for VLS/ India business unchanged at 4x/8x EV/EBITDA respectively; while cutting the China JV PE multiple to 6x (earlier:8x). We maintain our **HOLD** rating with an SoTP-based target price of Rs310 (earlier: Rs417).

Downside risks: Continuous losses in greenfield plants, and delayed execution of new programmes.

Upside risks: Faster market share gains in India, global markets in VLS business.

Table 3: Valuation summary

Business	FY23E (EBITDA/PAT)	Multiple	Current market value	Rs/share	Valuation remarks
VLS (ex-China)	6,569	4.0	26,274	172	EV/EBITDA; ~25% discount to global peers EV/EBITDA; ~10% discount with domestic peers
India	5,153	8.0	44,581	292	
Net debt			-27,085	-177	
Equity Value			43,770	286	P/E multiple; ~25% discount to regional peers
China JV	587	6.0	3524	23	
Total Value			47,295	310	

Source: I-Sec research

Financial summary

Table 4: Profit and Loss statement
(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Total Op. Income (Sales)	1,11,219	1,13,028	1,30,524	1,49,901
Operating Expenses	1,03,011	1,09,060	1,22,660	1,37,768
EBITDA	8,208	3,968	7,864	12,133
% margins	7.4%	3.5%	6.0%	8.1%
Depreciation & Amortisation	7,319	8,951	8,880	9,410
EBIT	889	(4,983)	(1,016)	2,723
Other Income	989	1,271	1,017	1,220
Gross Interest	1,392	1,626	1,402	1,457
PBT	487	(5,338)	(1,401)	2,486
Less: Exceptionals	-	1,078	-	-
PBT after Exceptionals	487	(6,416)	(1,401)	2,486
Less: Taxes	370	227	(280)	249
Less: Minority Interest	23	33	(7)	12
Add: Profit from Associates	(92)	356	363	625
Net Income (Reported)	2	(6,319)	(751)	2,850
Net Income (Adjusted)	2	(6,319)	(751)	2,850

Source: Company data, I-Sec research

Table 5: Balance sheet
(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
ASSETS				
Current Assets	41,411	43,072	47,711	52,601
Cash & cash eqv.	10,688	7,452	2,397	560
Current Liabilities & Provisions	33,550	44,649	50,151	54,721
Net Current Assets	7,861	(1,576)	(2,440)	(2,120)
Investments	4,457	3,762	3,762	3,762
Total Fixed Assets	60,731	60,473	59,593	58,683
Capital Work-in-Progress	7,901	8,562	8,562	8,562
Other non-current asset	2,439	2,767	2,767	2,767
Total Assets	76,682	66,760	65,016	64,426
LIABILITIES				
Borrowings	35,425	31,645	30,645	27,645
long-term borrowings	9,002	9,361	8,361	7,361
short-term borrowings	26,422	22,284	22,284	20,284
Deferred Tax Liability Net	1,195	1,334	1,334	1,334
Other Non-current Liabilities	10,017	3,501	3,508	3,496
Equity Share Capital	135	153	153	153
Reserves & Surplus	29,910	30,126	29,375	31,798
Net Worth	30,045	30,279	29,528	31,951
Total Liabilities	76,682	66,760	65,016	64,426

Source: Company data, I-Sec research

Table 6: 5-stage DuPont analysis
(year ending March 31)

All figures in %	FY20	FY21	FY22E	FY23E
Tax Burden	0.0	1.0	0.5	1.1
Interest Burden	0.5	1.3	1.4	0.9
EBIT Margin	0.0	(0.0)	(0.0)	0.0
Asset Turnover	1.5	1.7	2.0	2.3
Financial Leverage	2.6	2.2	2.2	2.0
ROE	0.0	(21.0)	(2.5)	9.3

Source: Company data, I-Sec research

Table 7: Cashflow statement
(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Operating cashflow before working capital changes	8,712	4,258	9,531	13,717
Net Working Capital Changes	5,425	479	(4,191)	(2,157)
Others	-	-	-	-
Operating Cashflow	14,137	4,737	5,340	11,560
Capital Commitments	(9,774)	(7,750)	(8,000)	(8,500)
Free Cashflow	4,363	(3,013)	(2,660)	3,060
Cashflow from Investing Activities	(12,682)	(6,440)	(8,000)	(8,500)
Issue of Share Capital	-	18	-	-
Inc/(Dec) in minority interest	8	33	7	(12)
Inc/(Dec) in borrowings	11,031	(3,779)	(1,000)	(3,000)
Dividend paid	(493)	-	-	(428)
Interest paid	(1,392)	(1,626)	(1,402)	(1,457)
Others	(1,824)	3,833	0	(0)
Cashflow from Financing Activities	7,331	(1,522)	(2,395)	(4,897)
Net Cashflow	8,786	(3,224)	(5,055)	(1,837)
Opening Cash & Bank balance	1,634	10,688	7,452	2,397
Closing Cash & Bank balance	10,420	7,463	2,397	560
Increase / (Decrease) in Cash & cash equivalents	8,786	(3,224)	(5,055)	(1,837)

Source: Company data, I-Sec research

Table 8: Key ratios
(Year ending March 31)

	FY20	FY21	FY22E	FY23E
Per Share Data (in Rs.)				
EPS (Basic)	0.0	(41.4)	(4.9)	18.7
EPS (Adjusted)	0.0	(41.4)	(4.9)	18.7
Cash EPS	54.3	17.2	53.2	80.2
Dividend per share (DPS)	3.7	-	-	2.8
BVPS (Adjusted)	224.7	200.0	195.2	210.9
Growth Ratios (%)				
Total Op. Income (Sales)	-8	2	15	15
EBITDA	-22	-52	98	54
Net Income (Adjusted)	-100	NC	NC	-479
EPS (Adjusted)	-100	NC	NC	-479
Cash EPS	-26	-68	209	51
BVPS (Adjusted)	-2	-11	-2	8
Valuation Ratios (x)				
P/E (Adjusted)	NC	NC	(65.1)	17.2
P/BV (Adjusted)	1.4	1.6	1.6	1.5
EV/EBITDA	7.7	16.0	9.3	6.0
EV/Sales	0.6	0.6	0.6	0.5

Return/Profitability Ratios (%)

EBITDA Margin	7.4	3.5	6.0	8.1
Net Income Margin (Adjusted)	0.0	-5.6	-0.6	1.9
RoCE	3.1	-5.8	0.0	6.6
RoNW	0.0	-21.0	-2.5	9.3
Dividend Payout Ratio	NC	-	-	15.0
Dividend Yield	1.1	-	-	0.9

Solvency/Wkg. Cap. Ratios (x)

Net D/E	0.7	0.7	0.8	0.7
Debt/EBITDA	4.3	8.0	3.9	2.3
EBIT/Interest	0.6	(3.1)	(0.7)	1.9
Current Ratio	1.2	1.0	1.0	1.0
Quick Ratio	0.9	0.7	0.7	0.7
Inventory (days)	35	41	35	35
Receivables (days)	36	53	45	45
Payables (days)	78	96	92	85

Source: Company data, I-Sec research

This report may be distributed in Singapore by ICICI Securities, Inc. (Singapore branch). Any recipients of this report in Singapore should contact ICICI Securities, Inc. (Singapore branch) in respect of any matters arising from, or in connection with, this report. The contact details of ICICI Securities, Inc. (Singapore branch) are as follows: Address: 10 Collyer Quay, #40-92 Ocean Financial Tower, Singapore - 049315, Tel: +65 6232 2451 and email: navneet_babbar@icicisecuritiesinc.com, Rishi_agrawal@icicisecuritiesinc.com.

"In case of eligible investors based in Japan, charges for brokerage services on execution of transactions do not in substance constitute charge for research reports and no charges are levied for providing research reports to such investors."

*New I-Sec investment ratings (all ratings based on absolute return; All ratings and target price refers to 12-month performance horizon, unless mentioned otherwise)
BUY: >15% return; ADD: 5% to 15% return; HOLD: Negative 5% to Positive 5% return; REDUCE: Negative 5% to Negative 15% return; SELL: < negative 15% return*

ANALYST CERTIFICATION

I/We, Nishant Vass, MBA (Finance), Pratit Vajani, MBA (Finance); authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of the ICICI Securities Inc. It is also confirmed that above mentioned Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months and do not serve as an officer, director or employee of the companies mentioned in the report.

Terms & conditions and other disclosures:

ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products.

ICICI Securities is Sebi registered stock broker, merchant banker, investment adviser, portfolio manager and Research Analyst. ICICI Securities is registered with Insurance Regulatory Development Authority of India Limited (IRDAI) as a composite corporate agent and with PFRDA as a Point of Presence. ICICI Securities Limited Research Analyst SEBI Registration Number – INH000000990. ICICI Securities Limited SEBI Registration is INZ000183631 for stock broker. ICICI Securities is a subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on www.icicibank.com.

ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities and its analysts, persons reporting to analysts and their relatives are generally prohibited from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

Recommendation in reports based on technical and derivative analysis centre on studying charts of a stock's price movement, outstanding positions, trading volume etc as opposed to focusing on a company's fundamentals and, as such, may not match with the recommendation in fundamental reports. Investors may visit icicidirect.com to view the Fundamental and Technical Research Reports.

Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

ICICI Securities Limited has two independent equity research groups: Institutional Research and Retail Research. This report has been prepared by the Institutional Research. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, and target price of the Retail Research.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.

ICICI Securities or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the companies mentioned in the report in the past twelve months.

ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its associates or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts and their relatives have any material conflict of interest at the time of publication of this report.

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

ICICI Securities or its subsidiaries collectively or Research Analysts or their relatives do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

Since associates of ICICI Securities and ICICI Securities as an entity are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

This report has not been prepared by ICICI Securities, Inc. However, ICICI Securities, Inc. has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.