

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

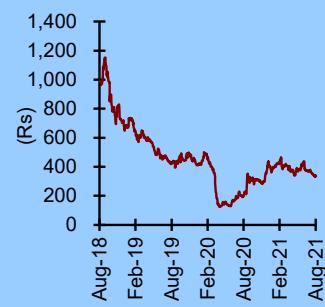
Target price revision
Rs310 from Rs417

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)

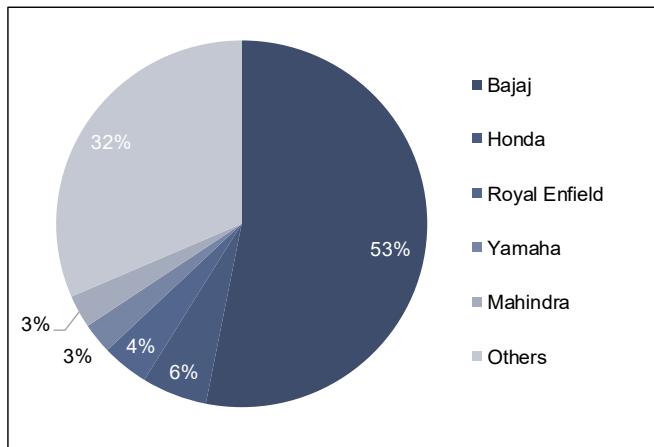
	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Total operating income	29,562	12,857	129.9	36,296	-18.6
Raw material costs	19,893	8,624	130.7	24,644	-19.3
Employee costs	4,763	3,387	40.6	4,676	1.8
Other expenditures	4,730	2,640	79.2	5,701	-17.0
Total operating expenses	29,386	14,651	100.6	35,021	-16.1
EBITDA	176	-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

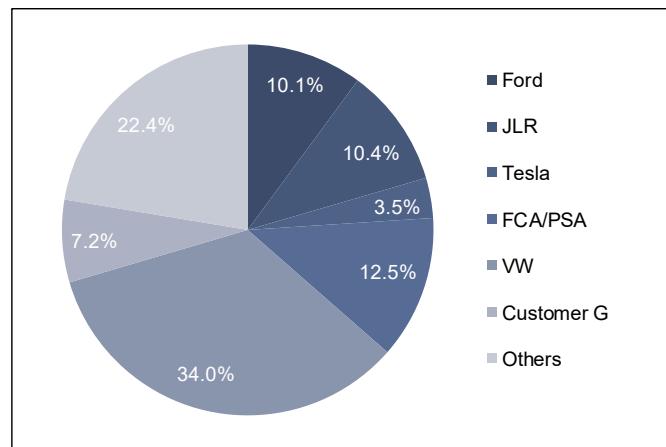
Table 2: Earnings revision

	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
India	5,153	8.0	44,581	292	EV/EBITDA; ~10% discount with domestic peers
Net debt			-27,085	-177	
Equity Value			43,770	286	
China JV	587	6.0	3524	23	P/E multiple; ~25% discount to regional peers
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 equiv.	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
<i>Capital Work-in-Progress</i>	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

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