January 25, 2017

Varroc Engineering Private Limited

Instrument*	Rated Amount (in Rs. Crore)	Rating Action
Long Term - Non Convertible Debenture (Proposed)	100.0	[ICRA]AA- (Stable) Assigned
Long Term – Term Loan	128.7	[ICRA]AA- (Stable) Outstanding
Long Term/Short Term – Fund Based	424.4	[ICRA]AA- (Stable)/ [ICRA]A1+ Outstanding
Long Term/Short Term – Non Fund Based	202.0	
Short Term – Fund Based	50.0	[ICRA]A1+ Outstanding
Short Term – Commercial Paper	100.0	[ICRA]A1+ Outstanding
Total	**1005.1**	

*Instrument Details are provided in Annexure-1

Rating Action

ICRA has assigned the long-term rating of [ICRA]AA- (pronounced as ICRA double A minus)[1] to the Rs. 100.00 crore[2] proposed non convertible debenture programme of Varroc Engineering Private Limited (VEPL). The outlook on the long-term rating is Stable.

With its release dated June 03, 2016, ICRA had assigned the long-term rating of [ICRA]AA- with Stable outlook to the Rs. 128.7 crore term loan facility of VEPL. ICRA had also assigned the long-term rating of [ICRA]AA- with Stable outlook and the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 424.4 crore fund based and Rs. 202.0 crore non-fund based long-term/ short-term bank facilities of VEPL. ICRA had also assigned [ICRA]A1+ rating to Rs 50.0 crore standby line of credit facility and Rs 100.0 crore commercial paper program of VEPL.

Rationale

The assigned rating take into account VEPL's large scale of operations; diversified presence across various products, automotive segments and geographies; long relationship with reputed OEMs and strong share in their order book and comfortable debt coverage indicators. The rating strengths are partially offset by its dependence on the cyclical automotive industry; stiff competition in the global lighting industry with entrenched and much larger players; subdued performance of the European forging business and sizeable investment plans in the medium term, which will keep the pressure on the cash flows in the interim. While ICRA expects the company to maintain its credit profile through its organic or inorganic investment plans, the impact of any such investments, on the credit profile would be evaluated by ICRA on a case by case basis. The operating margins of the company are likely to moderate slightly in FY2017 from FY2016 level owing to increased overheads in its lighting business which is currently in ramp-up mode and operations are expected to stabilise FY2018 onwards. The liquidity profile is expected to remain stable, supported by adequate undrawn bank facilities and a standby line of credit facilities provided by lenders. Despite increase in debt levels for funding the capital expenditure and increased working capital requirements, the capital structure is likely to remain comfortable below 1.0x in medium term, supported by healthy accruals and comfortable net worth position.

VEPL's consolidated revenues have witnessed a healthy CAGR of 18.3% during FY2013-FY2016, aided by a healthy performance of the lighting and polymer divisions, which jointly account for ~80-82% of the total sales. The growth in the lighting and the polymer divisions over the years can be attributed to the addition of new clients, coupled with the introduction of new innovative products. Further, an in-house research and

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[1] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

[2] 100 lakh = 1 crore = 10 million

development (R&D) team has helped in the timely development of new innovative products, matching the OEM demand, and supported the company to maintain/ gain its order book share with existing as well as acquire new customers.

The debt-funded acquisition of VLS has resulted in a leveraged capital structure in the past (during FY2013); however, an equity infusion of Rs 300 crore from the Tata Opportunities Fund and subsequent healthy cash accruals resulted in a much improved capital structure, with gearing of 0.8x (including bill discounting) as on March 2016. The coverage indicators are robust with Total Debt/OPBIDTA of 1.9x (3.5x: FY2013) and interest coverage of 7.7x (3.6x: FY2013) as on March 2016. The liquidity profile of company remains comfortable with unencumbered cash and liquid investments of over Rs 225 crore and adequate undrawn bank lines as well as in-principle approved stand-by line of credit facilities from lenders. A portion of funds raised via proposed NCD will be used towards working capital financing, which will further support liquidity profile of the company.

Over the next three fiscals, the company will be investing Rs 2,000 crore towards capital expenditure and other investments. With the proposed capex, the debt levels of the company are expected to increase, though with stabilisation of expanded capacities and order book, the coverage indicators like TD/OPBIDTA as well as gearing are likely remain below 2.25x and 1.0x in the interim.

Key rating drivers

Credit Strengths

- One of the largest Indian auto component manufacturers with a long relationship with Bajaj Auto Limited (BAL)
  - Strong order book share for components supplied to BAL
  - Amongst the largest automotive lighting manufacturers having in-house technological capabilities
- Diversified customer mix with no single customer contributing over 20% to overall revenue
- Diversified presence across various products as well as automotive segments (2W and PV)
- Economies of scale reflected in healthy and stable operating margin, despite muted performance of domestic automotive industry over the last two years
- Supported by strong cash accruals, there has been a considerable improvement in capital structure, post private equity infusion and turnaround of overseas lighting subsidiaries
- Varroc has gradually exited its loss-making subsidiaries and has turned around operations of the Varroc Lighting Systems (VLS), which now constitutes over 60% of the consolidated turnover

Credit Weakness

- Sizeable capacity expansion and investment plans in the near term will keep pressure on cash flows and capital structure, though liquidity profile is expected to remain stable
- Dependence on European PV market remains high; stiff competition from established and much larger players in automotive lighting business, which constitute about two-thirds of the group’s revenue
- Exposure to cyclicality in automotive industry, both in domestic as well as overseas market
  - European subsidiaries cater to the requirement of European PV industry, which remain fragile
  - Performance of its principal customer, i.e. BAL, in domestic 2W segment, also remain tepid

Description of key rating drivers highlighted above:

VEPL was started as a captive unit supplier for injection moulded components for Bajaj Auto Limited (BAL) and it subsequently ventured into polymer components, electrical components, forgings and engine valves. At present, the company is one of the largest auto component suppliers for the Indian two-wheeler industry. Over the years, the company has grown organically by setting up manufacturing units near its OE customer and inorganically, by acquiring companies in forgings and lightings business, primarily in Europe. In 2012, company acquired Visteon’s global lighting business, which has catapulted it as one of the leading auto component suppliers globally, apart from adding reputed customers like JLR, Ford and diversifying its geographical and segmental risk. While VLS Czech unit has benefited from JLR’s strong performance, performance of the Mexican unit also improved considerably in the backdrop of new orders from Tesla and Chrysler. In the backdrop of a recovery in European passenger vehicle (PV) demand, cost rationalisation initiatives as well as new order inflows, VLS’s operating performance improved considerably since acquisition, with operating margin more than doubled in FY2015-FY2016 from FY2013 level. Over the last two years, the company has bagged orders for the upcoming models of JLR, Tesla, Ford and Chrysler which is likely to support healthy revenue growth in the medium term.

Prior to the VLS acquisition, VEPL was primarily present in the two-wheeler business – however, acquisition of VLS has helped it strengthen its position in the PV business, which in FY2016, contributed 63% of the company's revenue. While the company has added various domestic OEMs to its clientele, BAL continues to dominate Indian revenue and contribute over 50% to the Indian operations. VLS' acquisition has, however, helped VEPL diversify its overall client-revenue mix, with no single OE/customer contributing over 20% of its revenue during FY2016 at the consolidated level.

Some of the other overseas acquisitions like IMES, Italy (industrial forging unit) failed to make any meaningful contributions to the bottom-line, owing to a slowdown in European construction equipment industry. These units are currently barely profitable and drag return indicators like RoCE and RoNW at a consolidated level. Some of the international subsidiaries have raised debt in their local currency, which is backed by corporate guarantees from Indian operations as a credit enhancement tool to raise funds at competitive rates. Given that these overseas entities are cash profitable, the incremental fund infusion from India is expected to be limited.

Analytical approach:

For arriving at its rating, ICRA has taken a consolidated view of VEPL along with its Indian subsidiaries Varroc Polymers Private Limited (VPPL), Durovalves India Private Limited (DIPL), Varroc Lighting Systems India Private Limited (VLSIPL), Varroc Elastomers Private Limited as well as its overseas operations.

Links to applicable Criteria

Corporate Credit Ratings: A Note on Methodology
Rating Methodology for Auto Component Manufacturers
Financial Consolidation and Rating Approach
Framework for Liquidity Analysis in Corporate Ratings
Impact of Parent or Group Support on an Issuer's Credit Rating

About the Company:

Incorporated in 1988, VEPL is the flagship company of Aurangabad based Varroc group. VEPL is also holding company for group's other ventures in auto component manufacturing. VEPL along with its subsidiaries is present in plastic moulded parts, electrical components, forgings and engine valve business. The group was initially started as captive unit for Bajaj Auto Limited (BAL) for its auto component supplies and has gradually diversified by adding new customer and products. In 2012, VEPL acquired Visteon's global lighting business which has transformed company to a global auto component supplier having presence across Europe, Americas, India and China. In FY2016, India accounted for 36% of company's revenue followed by Europe (35%), Americas (21%) and China (8%).

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years:

Table: Rating History

Sr. No.	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. Crore)	Month-year & Rating	Month- year & Rating in FY2016	Month- year & Rating in FY2015	Month- year & Rating in FY2014
				January 2017	June 2016	Not Applicable	
1	Non Convertible Debenture - Proposed	Long Term	100.0	[ICRA]AA- (Stable)	-	Not Applicable	
2	Term Loan	Long Term	128.7	-	[ICRA]AA- (Stable)	Not Applicable	
3	Fund Based	Long/Short Term	424.4	-	[ICRA]AA- (Stable)/ [ICRA]A1+	Not Applicable	
4	Non Fund Based	Long/Short Term	202.0	-	[ICRA]AA- (Stable)/ [ICRA]A1+	Not Applicable	
5	Standby Line of Credit	Short Term	50.0	-	[ICRA]A1+	Not Applicable	
6	Commercial Paper	Short Term	100.0	-	[ICRA]A1+	Not Applicable	

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1

Details of Instrument

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Non Convertible Debenture – Proposed	-	-	-	100.0	[ICRA]AA- (Stable)
Term Loan 1	-	-	May 2021	65.0	[ICRA]AA- (Stable)
Term Loan 2	-	-	December 2017	7.0	[ICRA]AA- (Stable)
Term Loan 3	-	-	March 2018	6.7	[ICRA]AA- (Stable)
Term Loan 4	-	-	August 2022	50.0	[ICRA]AA- (Stable)
Fund Based -Cash Credit/Bill Discounting/WCDL/Packing Credit	-	-	-	424.4	[ICRA]AA- (Stable)/ [ICRA]A1+
Non Fund Based – Bank Guarantee/Letter of Credit	-	-	-	202.0	
Standby Line of Credit	-	-	-	50.0	[ICRA]A1+
Commercial Paper	-	-	-	100.0	[ICRA]A1+

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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