ICRA

October 06, 2017

Varroc Engineering Private Limited

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Term Loan	120.65 (reduced from 128.65)	[ICRA]AA- (Stable); Reaffirmed
Fund-based Facilities	343.85 (reduced from 424.35)	[ICRA]AA- (Stable) and [ICRA]A1+; Reaffirmed
Non-fund Based Facilities	152.00 (reduced from 202.00)	[ICRA]AA- (Stable) and [ICRA]A1+; Reaffirmed
Fund-based/ Non-fund Based Facilities	288.50 (enhanced from nil)	[ICRA]AA- (Stable) and [ICRA]A1+; Reaffirmed
Fund-based Facilities	Nil (reduced from 50.00)	-
Commercial Paper	100.00	[ICRA]A1+; Reaffirmed
Non Convertible Debenture	100.00	[ICRA]AA- (Stable); Reaffirmed
Total	**1,105.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA- (pronounced ICRA double A minus) with a 'Stable' outlook and the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) for the Rs. 343.85 crore[1] fund-based, Rs. 152.00 crore non-fund based and Rs. 288.50 crore fund-based/non-fund based facilities of Varroc Engineering Private Limited (VEPL)[2]. ICRA has also reaffirmed the long-term rating of [ICRA]AA- with a 'Stable' outlook for the Rs. 120.65 crore term loan facility and Rs. 100.00 crore non convertible debenture, and the short-term rating of [ICRA]A1+ for the Rs. 100.00 crore commercial paper of VEPL.

Rationale

For arriving at the ratings, ICRA has taken a consolidated view of VEPL along with its Indian subsidiaries i.e. Varroc Polymers Private Limited (VPPL), Durovalves India Private Limited (DIPL), Varroc Lighting Systems India Private Limited (VLSIPL) and its overseas operations, together referred to as Varroc Group.

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[1] *100 lakh = 1 crore = 10 million*

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

The rating reaffirmation takes into account Varroc's large scale of operations and long-established relationship with its customers. Its diversified and reputed clientele includes original equipment manufacturers (OEMs) such as Bajaj Auto Limited (BAL), Ford Motor Company (Ford, rated Baa2/Stable by Moody's), Jaguar Land Rover Automotive PLC (JLR, rated Ba1/Positive by Moody's), Fiat Chrysler Automobiles N.V. (FCA, rated Ba3/Positive by Moody's), Tesla Inc (rated B2/Stable by Moody's) and Volkswagen AG (VW, rated A3/Negative by Moody's) among others and has a strong share in their order book. The rating also takes into account the diversified business presence across geographies, which insulates the company from the slowdown in a particular market and provides stable revenue visibility prospects. The rating strengths are partially offset by Varroc's dependence on the cyclical automotive industry and stiff competition from established and larger players in the lighting business, which alone accounts for ~70% of VEPL's consolidated revenue. The return indicator (RoCE) of the company remained subdued in FY2017, owing to sub-optimal capacity utilisation in the Indian operations (polymer and forging-crankshaft divisions) and operational inefficiencies in Mexican operations. ICRA takes note of the sizeable capital expenditure and investment plans of the company in the near to medium term, which will keep pressure on the cash flows and the capital structure. Impact of any significant debt-funded acquisition or investment, on credit profile of the company will be evaluated by ICRA on a case-to-case basis.

Key rating drivers

Credit strengths

- **One of the largest Indian auto-component manufacturers – The** Varroc Group is one of the largest auto-component manufacturers in India and has long-established relationship with its key customers. It has a strong order book share for supplying electrical, power-train and plastic components for BAL. Varroc is also one of the leading global automotive lighting manufacturers with strong in-house technological capabilities.
- **Diversified and reputed clientele -** Varroc has a diversified customer mix with no single customer accounting for more than 15% of the total revenues in FY2017. The client profile is healthy including reputed OEMs such as BAL, Ford, JLR, Fiat Chrysler, Tesla and Volkswagen among others.
- **Diversified geographic presence -** Varroc has a diversified geographic profile with presence across India (33% of revenues in FY2017), Europe (45%), North America (15%) and China. The company has plans to set up one manufacturing unit each in Latin America and North Africa in FY2018 to further expand its geographic reach. Its presence across multiple geographies insulates the company from slowdown in a particular market and provides stable revenue visibility prospects. Furthermore, the manufacturing footprint of Varroc is present in relatively low cost countries, thus providing it a competitive advantage as compared to other players in the Europe and North American market.
- **Exit of loss-making operations and turnaround of overseas lighting operations -** Varroc has gradually exited its loss-making operations in Europe and successfully turned around its overseas operations in Varroc Lighting Systems (VLS). VLS now accounts for ~70% of the Group's revenue. Post turnaround and improved performance of overseas lighting operations, the company is able to generate strong cash accruals, thus supporting its capital expenditure funding for growth, capital structure and liquidity profile. VEPL, on a consolidated level, reported a moderate gearing of 0.7x and Net Debt/OPBDITA of 1.7x as on March 2017.

Credit weaknesses

- **High dependence on European PV market and stiff competition in lighting business -** Varroc's dependence on the European PV market remains high, which at present has tepid demand outlook. Also, the company faces stiff competition from established and much larger players in the automotive lighting business, which accounts for ~70% of the Group's turnover.

- **Subdued return indicator -** Varroc reported a subdued RoCE of ~12% in FY2017 on account of the sub-optimal capacity utilisation in its polymers and forging (crankshaft) divisions and stabilisation issues in Mexican operations. However, the performance of these divisions has improved during 5M FY2018, supported by incremental orders and various cost reduction measures being undertaken by the company. Thus, the RoCE is expected to improve gradually, going forward.
- **Exposure to cyclicality in automotive industry -** Varroc is exposed to the cyclicality in automotive industry, both in domestic and overseas market. Its European subsidiaries cater to the requirement of the European PV market, which has a muted demand outlook.
- **Sizeable capacity expansion and investment plans -** To fund its growth plans, Varroc has sizeable capacity expansion and investment plans in the near to medium term which will keep pressure on cash flows and capital structure. Although, given healthy accruals, the liquidity profile is expected to remain comfortable. ICRA draws comfort from management guidance to maintain gross leverage below 1.0x despite the company's incremental organic or inorganic plans.

Analytical approach: To arrive at the ratings, ICRA has taken a consolidated view of VEPL along with its Indian subsidiaries i.e. VPPL, DIPL, VLSIPL and its overseas operations, together referred as Varroc Group. ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:
Rating Methodology for Auto Component Manufacturers
Corporate Credit Rating Methodology
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 the Aurangabad-based Varroc Group. It is also the holding company for the Group's other ventures in auto component manufacturing. VEPL, along with its subsidiaries, is present in automotive lighting, plastic moulded parts, electrical components, forgings and the engine valve business. The Group was initially started as a captive unit for BAL for its auto component supplies and has gradually diversified by adding new customers and products. In 2012, VEPL acquired Visteon's global lighting business, which has transformed the company into a global auto component supplier, with presence across Europe, North America, India and China.

In FY2017, VEPL on a consolidated basis reported a net profit of Rs. 286 crore on an operating income of Rs. 9,406 crore, as compared to a net profit of Rs. 216 crore on an operating income of Rs. 7,970 crore in FY2016.

Key financial indicators (Audited-Consolidated)

	FY2016	FY2017
Operating Income (Rs. crore)	7,970	9,406
PAT (Rs. crore)*	216	286
OPBDIT/ OI (%)	7.9%	7.3%
RoCE (%)*	11.4%	11.5%
Total Debt/ TNW (times)	0.9	0.7
Total Debt/ OPBDIT (times)	2.5	2.2
Interest Coverage (times)	7.5	8.0
NWC/ OI (%)	7.7%	5.1%

**Adjusted for extraordinary items*
OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress);
NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:

Table:

S. No.	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2017	Date & Rating in FY2016
				October 2017	January 2017	June 2016	Not Applicable
1	Term Loan	Long-term	120.65	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	-
2	Fund-based Facilities	Long-term/Short-term	343.85	[ICRA]AA- (Stable) and [ICRA]A1+	[ICRA]AA- (Stable) and [ICRA]A1+	[ICRA]AA- (Stable) and [ICRA]A1+	-
3	Non-fund Based Facilities	Long-term/Short-term	152.00	[ICRA]AA- (Stable) and [ICRA]A1+	[ICRA]AA- (Stable) and [ICRA]A1+	[ICRA]AA- (Stable) and [ICRA]A1+	-
4	Fund-based/ Non-fund Based Facilities	Long-term/Short-term	288.50	[ICRA]AA- (Stable) and [ICRA]A1+	-	-	-
5	Fund-based Facilities (SBLC)	Short-term	-	-	[ICRA]A1+	[ICRA]A1+	-
6	Commercial Paper	Short-term	100.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
7	Non Convertible Debenture	Long-term	100.00	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	-	-

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

Instrument Details

ISIN No	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
	Term Loan	-	-	Aug 2022	120.65	[ICRA]AA- (Stable)
	Fund-based Facilities- CC, BD, PCFC, SBLC	-	-	-	343.85	[ICRA]AA- (Stable) and [ICRA]A1+
	Non-fund Based Facilities- BG, LC	-	-	-	152.00	[ICRA]AA- (Stable) and [ICRA]A1+
	Fund-based/ Non-fund Based Facilities- CC, BD, PCFC, SBLC, BG, LC	-	-	-	288.50	[ICRA]AA- (Stable) and [ICRA]A1+
	Commercial Paper	-	-	-	100.00	[ICRA]A1+
	Non Convertible Debenture	Feb 2017	8.10%	Feb 2020	100.00	[ICRA]AA- (Stable)

Source: Company

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