November 28, 2022

# Varroc Polymers Limited: Ratings reaffirmed; removed from rating watch with developing implications and Stable outlook assigned; rated amount enhanced

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| **Term Loan** | 65.00 | 350.00 | [ICRA]A (Stable); reaffirmed and removed from rating watch with developing implications and Stable outlook assigned |
| **Fund-based Facilities** | 20.00 | 20.00 | [ICRA]A (Stable)/[ICRA]A2+; reaffirmed and removed from rating watch with developing implications and Stable outlook assigned |
| **Non-fund Based Facilities** | 3.00 | 3.00 | [ICRA]A (Stable)/[ICRA]A2+; reaffirmed and removed from rating watch with developing implications and Stable outlook assigned |
| **Fund-based/ Non-fund Based Facilities** | 155.00 | 125.00 | [ICRA]A (Stable)/[ICRA]A2+; reaffirmed and removed from rating watch with developing implications and Stable outlook assigned |
| **Unallocated** | 97.00 | 97.00 | [ICRA]A (Stable)/[ICRA]A2+; reaffirmed and removed from rating watch with developing implications and Stable outlook assigned |
| **Total** | **340.00** | **595.00** | |
| **Commercial Paper (CP)** | 75.00 | 75.00 | [ICRA]A2+; reaffirmed and removed from rating watch with developing implications |

**Instrument details are provided in Annexure-I*

## Rationale

For arriving at the ratings, ICRA has considered the consolidated financials of Varroc Engineering Limited (VEL) along with its subsidiaries/step-down subsidiaries together (including Varroc Polymers Limited (VPL)), henceforth referred to as the Group/ Varroc.

ICRA had placed the ratings of VPL on watch with developing implications in May 2022, following the announcement of the planned divestment of the group's overseas four-wheeler (4W) lighting business located in the US, Mexico and Europe under VEL's overseas subsidiary, Varroc Lighting Systems (VLS), and its global R&D support to Plastic Omnium SE (PO), France.

The divestment has been successfully concluded on October 6, 2022, with the deal consideration ultimately finalised at Euro 520 million (vis-à-vis Euro 600 million indicated in April 2022), and the net cash accretion to VEL at Euro 8.5 million (vis-à-vis Euro 160-175 million expected earlier). While the deal value was impacted significantly by the ongoing inflationary and recessionary trends in Europe and associated subdued outlook for VLS' operations, and further by incremental debt availed overseas and an out-of-court settlement to Valeo, the successful closure has enabled VEL to considerably deleverage and focus on its continuing operations going forward. In light of the above developments, ICRA has removed the rating watch with developing implications and reaffirmed the long-term rating with a Stable outlook.

The ratings continue to reflect Varroc's established position as a leading auto component supplier in India with presence across multiple products such as lighting systems, polymer products, metallic components as well as electrical and electronic components. The ratings factor in Varroc's large scale of operations, along with its diversified revenue mix across customers, products and automotive segments. While its geographic presence has moderated to some extent post the divestment of VLS, comfort is drawn from the healthy growth prospects of the domestic automotive market, from which it derives approximately 80% of revenues. The ratings also draw comfort from its established relationship with customers such as Bajaj Auto Limited (BAL), Hero MotoCorp Limited (HMCL) and Honda Motorcycles and Scooters India Limited, among others. Overall, ICRA expects the Group's revenue to grow at a healthy pace in the medium term, supported by increased share with the existing customers, new products launched in the recent past, customer acquisition in the domestic business and ramping up of operations, especially in the electric vehicle (EV) space.

Post the divestment of the overseas lighting business, which had constrained the overall profitability, and carried significant quantum of debt, VEL's credit metrics have improved and the trajectory is expected to continue aided by healthy cash flow generation and well managed capital expenditure requirements. The company's net debt has reduced to approximately Rs. 1,300 crore (from Rs. 3,007 crore in the year-ago period). Given healthy cash accruals in the continuing operations, the group plans on further deleveraging going forward. Coupled with healthy profitability of the Indian operations, this is likely to aid strengthening of credit metrics, going forward.

Despite the deleveraging visible post the divestment, ICRA notes that the Group continues to have significant quantum of debt repayments falling due in the next fiscal, amounting to Rs. 638 crore (including NCDs of Rs. 375 crore falling due in H1 FY2024). While these are expected to be largely funded out of internal accruals (estimated at Rs. 500-550 crore for FY2024) and existing liquidity (Rs. 191 crore of cash and bank balances and Rs. 97 crore of unutilised lines of credit as of October 31, 2022), the company's ability to repay or refinance these in a timely manner would remain a key monitorable.

The ratings also factor in that Varroc's performance over the near-term remain susceptible to macro-headwinds such as the heightened commodity prices, energy inflation and recessionary trends brewing in developed markets. While the company has sequentially improved its profitability in recent quarters, its ability to sustain and improve its operating performance amid challenging macro-economic conditions remains a monitorable. Nonetheless, the reduced dependence on markets like Europe post the divestment, where the challenges have been more pronounced, offers some comfort. Furthermore, the company's success in gaining additional business from existing as well as new Original Equipment Manufacturers (OEMs), especially in the upcoming EV space, as reflected in sizeable order inflow in the recent past, offers comfort regarding its ability to outpace industry growth, going forward.

## Key rating drivers and their description

### Credit strengths

**Leading Indian auto-component manufacturer –** The Varroc Group is one of the leading auto component manufacturers in India having established relationships with its key customers. It has a strong order book share for supplying electrical, lighting, plastic and metallic components to BAL and has, over the years, gained wallet share with multiple other domestic automobile OEMs as well.

**Strengthening of financial risk profile post divestment of stake in VLS –** Post the divestment of its overseas 4W lighting business, the Group's debt protection metrics and capital structure have improved, and are expected to further improve, going forward, with significant reduction in debt levels and improvement in profitability metrics. Post the divestment, the Group reduced the net debt outstanding to Rs. 1,300 crore approximately (from Rs. 3,007 crore as of September 2021). Accordingly, the consolidated Net Debt/OPBITDA is estimated to improve to 1.8-2.0x by March 2023 (against 5.7x in FY2021 prior to the divestment) and expected to further improve thereafter with scheduled repayment of debt obligations.

**Diversified and reputed clientele –** Varroc has a diversified customer mix, including reputed OEMs such as BAL, Ford, Renault Nissan and VW, among others. In its Indian operations, Varroc has gained traction in its order book from leading 2W OEMs such as HMCL and HMSI for their existing as well as new models. Varroc also enjoys a dominant wallet-share for products it supplies to BAL and management expects the company to gain wallet share in other OEMs as well, which will help reduce its dependence on BAL from current levels of ~40%. Overall, ICRA expects Varroc's growth to remain healthy over the medium to long-term, led by improved offtake from its existing customers and business expansion initiatives undertaken by the Group.

**Presence across multiple geographies –** Varroc has a moderately diversified geographical profile with presence across India and countries such as Italy, Romania, Poland and Vietnam. While the domestic market has emerged as the key revenue contributor post the divestment, comfort is drawn from the healthy growth prospects of the domestic market. Moreover, with limited dependence on geographies like Europe and USA post the divestment, the company is insulated to some extent from the recessionary trends ongoing in these markets.

## Credit challenges

**Continued input cost inflation likely to constrain extent of recovery in margins over the near term –** Varroc's scale and profitability remain susceptible to its dependence on the cyclical automotive industry, stiff competition from larger players in the automotive lighting business, and its limited bargaining powers with customers, who are generally large OEMs. Additionally, the current inflationary trends in terms of commodity and energy prices remain as near-term margin headwinds.
**Sizeable debt repayments in upcoming fiscal, including NCD maturities –** Post the divestment, the group had total net debt outstanding of Rs. 1,300 crore approximately as on October 07, 2022. Of this, a large part is due for repayment in FY2024, to the tune of Rs. 638 crore (including NCD repayment of Rs. 375 crore in H1 FY2024). While these are expected to be largely funded out of internal accruals (estimated at Rs. 550-560 crore for FY2024) and existing liquidity (Rs. 191 crore of cash and bank balances and Rs. 97 crore of unutilised lines of credit as of October 31, 2022), the company's ability to repay or refinance these in a timely manner would remain a key monitorable.

**Recessionary risks and inflationary pressures likely to constrain performance of overseas subsidiaries over near-term; reduced exposure post divestment offers comfort –** While Varroc's credit metrics over the past had been constrained considerably by the weakness in performance of its overseas business, VLS, the situation has reversed to a large extent post the divestment of the overseas business. Nevertheless, while the exposure to overseas markets has reduced to ~20% of revenues (from ~70% prior to the divestment), the performance of the overseas subsidiaries would continue to be susceptible to the uncertainties arising out of the ongoing geopolitical concerns, especially in Europe.

## Liquidity position: Adequate

The Group's liquidity position is expected to remain adequate on the back of healthy net cash accruals of Rs. 500-600 crore annually going forward, coupled with liquidity in the form of free cash and bank balances to the tune of Rs. 191 crore as on October 31, 2022, and an additional buffer available in the form of unutilised bank limits of Rs. 97 crore (as on October 31, 2022). Against the same, the Group has capex plans of Rs. 250-300 crore annually, while it has upcoming repayments of Rs. 134.7 crore in H2 FY2023 and Rs. 638.5 crore in FY2024.

## Rating sensitivities

**Positive factors –** The ratings could be upgraded if the Group exhibits continued deleveraging that supports improvement in its credit metrics and liquidity position, while maintaining healthy profitability margins. The company's ability to refinance the upcoming large repayments ahead of the due date and at favourable terms is also critical. Specific metrics that could lead to an upgrade include Total Debt/OPBITDA of less than 1.8 times on a sustained basis.

**Negative factors –** Weakening in the Group's operational profile leading to weakening of profitability and return metrics, or any large debt-funded capex or investments that leads to sustained deterioration in credit metrics would be a credit negative. Furthermore, any sharp and sustained weakening in its liquidity profile can also result in a rating downgrade.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable rating methodologies** | Corporate Credit Rating Methodology<br>Rating Methodology for Auto Component Manufacturers<br>Rating Approach - Consolidation |
| **Parent/Group support** | Not Applicable |
| **Consolidation/Standalone** | For arriving at the ratings, ICRA has considered the consolidated financials of Varroc Engineering Limited. Varroc's subsidiaries and step-down subsidiaries are all enlisted in Annexure-2. |

## About the company

Varroc Polymers Limited is a part of the Aurangabad-based Varroc group of companies. Its parent entity, VEL is the holding company for the Group's other ventures in auto component manufacturing. VEL, along with its subsidiaries, is present in automotive lighting, plastic-moulded parts, electrical components, forgings and the engine valve business. The Group was initially established as a captive unit for BAL's auto components and gradually diversified by adding new customers and products to its portfolio. In 2012, VEL acquired Visteon's global lighting business, which transformed the company into a global auto component supplier, with presence across Europe, India and China. However, post a challenging two years faced in the European market post the pandemic outbreak and associated macroeconomic challenges, the Group divested its overseas 4W lighting business in the US, Mexico and Europe, in Varroc Lighting Systems to Plastic Omnium SE, France. The transaction was completed on October 6, 2022.

### Key financial indicators (audited)

| Varroc Consolidated | FY2021* | FY2022* | H1 FY2023* |
|---|---|---|---|
| **Operating income** | 4,404.6 | 5,866.0 | 3,456.2 |
| **PAT** | -664.3 | -1,106.3 | -874.8 |
| **OPBDIT/OI** | 8.4% | 6.5% | 8.4% |
| **PAT/OI** | -15.1% | -18.9% | -25.3% |
| **Total outside liabilities/Tangible net worth (times)** | 2.6 | 4.5 | 11.5 |
| **Total debt/OPBDIT (times)** | 10.0 | 4.3 | 3.0 |
| **Interest coverage (times)** | 4.1 | 3.2 | 3.4 |

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; * Consists only of continuing operations*

### Status of non-cooperation with previous CRA: Not applicable

### Any other information: None

## Rating history for past three years

| | Instrument | Current rating (FY2023) | | | | | Chronology of rating history for the past 3 years | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Type | Amount rated (Rs. crore) | Amount outstanding as of Mar 31, 2022 (Rs. crore) | Date & rating in FY2023 | | Date & rating in FY2022 | | Date & rating in FY2021 | | Date & rating in FY2020 |
| | | | | | Nov 28, 2022 | May 06, 2022 | Dec 7, 2021 | Jun 23, 2021 | Aug 21, 2020 | Apr 30, 2020 | Aug 30, 2019 |
| 1 | Term Loan | LT | 350.00 | 65.00 | [ICRA]A (Stable) | [ICRA]A& | [ICRA]A (Negative) | [ICRA]A+ (Stable) | [ICRA]AA- (Negative) | [ICRA] AA- @ | [ICRA]AA- (Stable) |
| 2 | Fund-based Facilities | LT/ST | 20.00 | -- | [ICRA]A (Stable)/ [ICRA]A2+ | [ICRA]A& / [ICRA]A2+ & | [ICRA]A (Negative)/ [ICRA]A2+ | [ICRA]A+ (Stable)/ [ICRA]A1 | [ICRA]AA- (Negative) /[ICRA]A1+ | [ICRA] AA- @ /[ICRA]A1+ @ | [ICRA]AA- (Stable) /[ICRA]A1+ |
| 3 | Non-fund Based Facilities | LT/ST | 3.00 | -- | [ICRA]A (Stable)/ [ICRA]A2+ | [ICRA]A& / [ICRA]A2+ & | [ICRA]A (Negative)/ [ICRA]A2+ | [ICRA]A+ (Stable)/ [ICRA]A1 | [ICRA]AA- (Negative) / [ICRA]A1+ | [ICRA] AA- @ / [ICRA]A1+ @ | [ICRA]AA- (Stable) / [ICRA]A1+ |
| 4 | Fund-based/ Non-fund Based Facilities | LT/ST | 125.00 | -- | [ICRA]A (Stable)/ [ICRA]A2+ | [ICRA]A& / [ICRA]A2+ & | [ICRA]A (Negative)/ [ICRA]A2+ | [ICRA]A+ (Stable)/ [ICRA]A1 | [ICRA]AA- (Negative)/ [ICRA]A1+ | [ICRA] AA- @/ [ICRA]A1+ @ | [ICRA]AA- (Stable)/ [ICRA]A1+ |
| 5 | Unallocated | LT/ST | 97.00 | -- | [ICRA]A (Stable)/ [ICRA]A2+ | [ICRA]A& / [ICRA]A2+ & | [ICRA]A (Negative)/ [ICRA]A2+ | [ICRA]A+ (Stable)/ [ICRA]A1 | - | - | - |
| 6 | Commercial Paper | ST | 75.00 | -- | [ICRA]A2+ | [ICRA]A2+ & | [ICRA]A2+ | [ICRA]A1 | [ICRA]A1+ | [ICRA]A1+ @ | [ICRA]A1+ |
| 7 | Non-Convertible Debenture | LT | -- | -- | - | - | - | - | - | [ICRA] AA- @ | [ICRA]AA- (Stable) |

*&= Under Watch with Developing Implications* *@= Under Watch with Negative Implications*

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| Term Loan | Simple |
| Fund-based Facilities | Simple |
| Non-fund Based Facilities | Very Simple |
| Fund-based/ Non-fund based Facilities | Simple |
| Unallocated | Not Applicable |
| Commercial Paper | Very Simple |

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

### Annexure I: Instrument details

| ISIN | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | Term Loans | FY2021 | NA | FY2025 | 350.00 | [ICRA]A (Stable) |
| NA | Fund-based Facilities | NA | NA | NA | 20.00 | [ICRA]A (Stable)/[ICRA]A2+ |
| NA | Non-fund Based Facilities | NA | NA | NA | 3.00 | [ICRA]A (Stable)/[ICRA]A2+ |
| NA | Fund-based/ Non-fund Based Facilities | NA | NA | NA | 125.00 | [ICRA]A (Stable)/[ICRA]A2+ |
| NA | Unallocated | NA | NA | NA | 97.00 | [ICRA]A (Stable)/[ICRA]A2+ |
| NA* | Commercial Paper | NA | NA | NA | 75.00 | [ICRA]A2+ |

*Source: Company* *Not placed currently

*Please click here to view details of lender-wise facilities rated by ICRA*

### Annexure II: List of entities considered for consolidated analysis

| Company Name | VEL Ownership | Consolidation Approach |
|---|---|---|
| **Direct Subsidiaries** | | |
| Varroc Polymers Private Limited | 100.00% | Full Consolidation |
| Durovalves India Private Limited | 72.78% | Full Consolidation |
| Varroc European Holding B.V. | 100.00% | Full Consolidation |
| VarrocCorp Holding B.V. | 100.00% | Full Consolidation |
| Varroc Japan Co. Limited | 100.00% | Full Consolidation |
| CarIQ Technologies Private Limited | 74.00% | Full Consolidation |
| **Step Down Subsidiaries** | | |
| Team Concepts Private Limited | 100.00% | Full Consolidation |
| Industrial Meccanica E Stampaggio S.p.a. | 100.00% | Full Consolidation |
| Varroc do Brasil Industria E Commercia LTDA | 100.00% | Full Consolidation |

*Source: Varroc Annual Report*
*Note: ICRA has taken a consolidated view of the parent (VEL) and its subsidiaries while assigning the ratings.*

## ANALYST CONTACTS


**Shamsher Dewan**
+91 124 4545328
shamsherd@icraindia.com

**Sruthi Thomas**
+91 124 4545822
sruthi.thomas@icraindia.com

**Kinjal Shah**
+91 22 6114 3442
kinjal.shah@icraindia.com

**Karan Punjabi**
+91-22 6169 3358
karan.punjabi@icraindia.com


## RELATIONSHIP CONTACT


**Jayanta Chatterjee**
+91 80 4332 6401
jayantac@icraindia.com


## MEDIA AND PUBLIC RELATIONS CONTACT


**Ms. Naznin Prodhani**
Tel: +91 124 4545 860
communications@icraindia.com


## Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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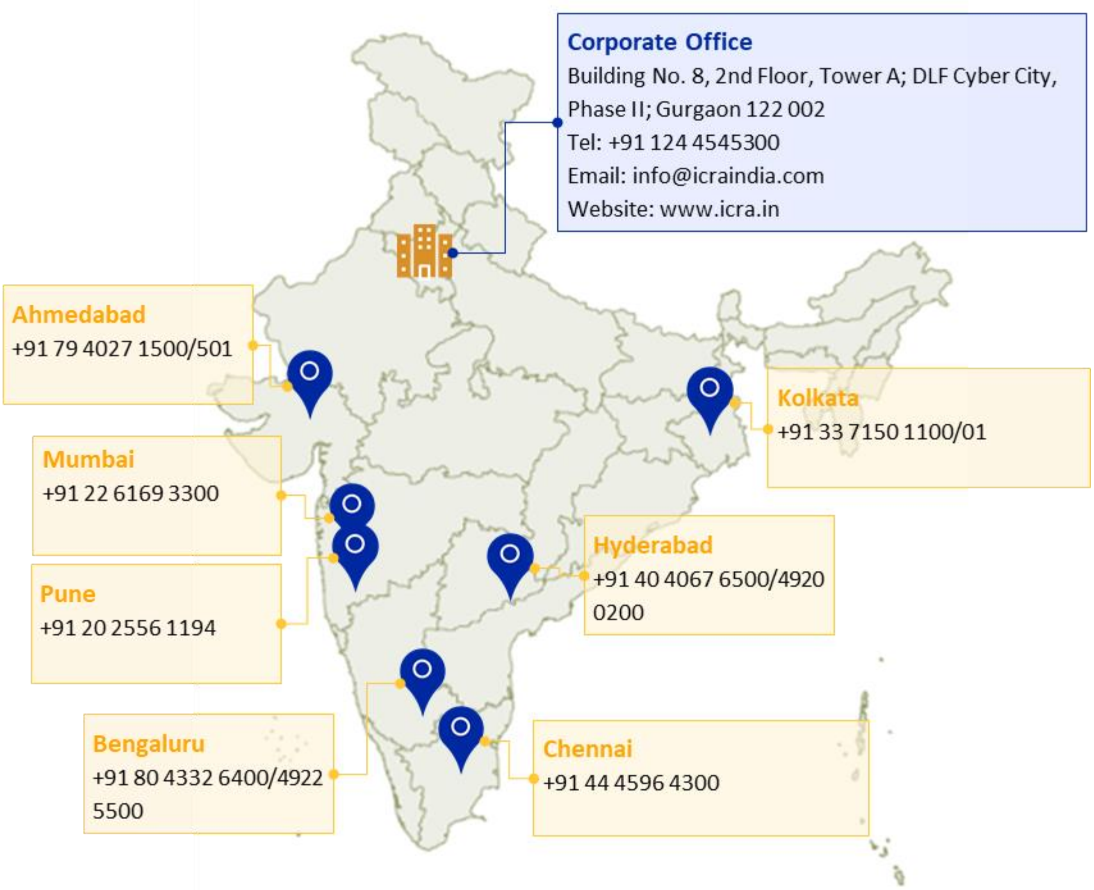
# ICRA Limited

## Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

## Branches



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