

November 28, 2022 <sup>(Revised)</sup>

## Varroc Engineering Limited: Ratings reaffirmed; removed from rating watch with developing implications and Stable outlook assigned

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	504.00	490.30	[ICRA]A (Stable); reaffirmed and removed from rating watch with developing implications and Stable outlook assigned
Fund-based Facilities	17.35	-	-
Non-fund Based Facilities	35.00	-	-
Fund-based/ Non-fund Based Facilities	339.55	372.35	[ICRA]A (Stable)/[ICRA]A2+; reaffirmed and removed from rating watch with developing implications and Stable outlook assigned
Unallocated	144.32	177.57	[ICRA]A (Stable)/[ICRA]A2+; reaffirmed and removed from rating watch with developing implications and Stable outlook assigned
<b>Total</b>	<b>1040.22</b>	<b>1040.22</b>	
Commercial Paper (CP)	100.00	100.00	[ICRA]A2+; reaffirmed and removed from rating watch with developing implications
Non-Convertible Debenture (NCD) Programme	450.00	450.00	[ICRA]A (Stable); reaffirmed and removed from rating watch with developing implications and Stable outlook assigned

\*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, henceforth referred to as the Group/ Varroc.

ICRA had placed the ratings of VEL on watch with developing implications in May 2022, following the announcement of the planned divestment of its overseas four-wheeler (4W) lighting business located in the US, Mexico and Europe under its 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.

### Environmental and Social Risks

**Environmental considerations** - Even as Varroc is not directly exposed to climate-transition risks from a likelihood of tightening emission-control requirements, with its products being used by different categories of OEMs, its automotive- manufacturing customers remain highly exposed to the same. Accordingly, the Group’s prospects are linked to the ability of its customers to meet tightening emission requirements. As per the annual report, the Group undertakes organization wide measures towards making its manufacturing processes and products sustainable and accordingly has been investing in safer, lighter and greener technologies. To this effect, the company’s success in gaining orders for supply of auto-components for existing and new OEMs in the electric vehicle space offers comfort regarding its ability to adapt and transition itself to such upcoming clean technologies.

**Social considerations** - Varroc, like most automotive-component suppliers, has a healthy dependence on human capital; as such retaining human capital, maintaining healthy employee relations and supplier ecosystem remain essential for disruption-free operations for the entity. Varroc’s annual report indicates that the entity has been taking initiatives to impart training to its employees towards improvement of their capacity and capabilities. Another social risk that Varroc faces pertains to product safety and quality, wherein instances of product recalls and high-warranty costs may not only lead to a financial implication but could also harm the reputation and create a more long-lasting adverse impact. In this regard, Varroc’s strong track record in catering to leading automotive manufacturers underscore its ability to mitigate these risks to an extent. The Group’s strong technological capabilities are likely to help it align its products with any change in customer preferences.

## 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	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Rating Methodology for Auto Component Manufacturers</a> <a href="#">Rating Approach - Consolidation</a>
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

Incorporated in 1988, VEL is the flagship company of the Aurangabad-based Varroc Group. It 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*
<b>Operating income</b>	4,404.6	5,866.0	3,456.2
<b>PAT</b>	-664.3	-1,106.3	-874.8
<b>OPBDIT/OI</b>	8.4%	6.5%	8.4%
<b>PAT/OI</b>	-15.1%	-18.9%	-25.3%
<b>Total outside liabilities/Tangible net worth (times)</b>	2.6	4.5	11.5
<b>Total debt/OPBDIT (times)</b>	10.0	4.3	3.0
<b>Interest coverage (times)</b>	4.1	3.2	3.4

\*for continuing operations

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	Type	Current rating (FY2023)			Chronology of rating history for the past 3 years							
		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	Sep 1, 2021	Jun 23, 2021	Aug 21, 2020	Apr 30, 2020	Nov 26, 2019 Aug 30, 2019	
1	Term Loan	490.30	504.00	[ICRA]A (Stable)	[ICRA]A&	[ICRA]A (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]AA- (Negative)	[ICRA] AA- @	[ICRA]AA- (Stable)
2	Fund-based Facilities	-	--	-	[ICRA]A& / [ICRA]A2+&	[ICRA]A (Negative) / [ICRA]A2+	[ICRA]A+ (Stable) / [ICRA]A1	[ICRA]A+ (Stable) / [ICRA]A1	[ICRA]A+ (Stable) / [ICRA]A1	[ICRA]AA- (Negative) / [ICRA]A1+	[ICRA] AA- @ / [ICRA]A1+ @	[ICRA]AA- (Stable) / [ICRA]A1+
3	Non-fund Based Facilities	-	--	-	[ICRA]A& / [ICRA]A2+&	[ICRA]A (Negative) / [ICRA]A2+	[ICRA]A+ (Stable) / [ICRA]A1	[ICRA]A+ (Stable) / [ICRA]A1	[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	372.35	--	[ICRA]A (Stable) / [ICRA]A2+	[ICRA]A& / [ICRA]A2+&	[ICRA]A (Negative) / [ICRA]A2+	[ICRA]A+ (Stable) / [ICRA]A1	[ICRA]A+ (Stable) / [ICRA]A1	[ICRA]A+ (Stable) / [ICRA]A1	[ICRA]AA- (Negative) / [ICRA]A1+	[ICRA] AA- @ / [ICRA]A1+ @	[ICRA]AA- (Stable) / [ICRA]A1+
5	Unallocated	177.57	--	[ICRA]A (Stable) / [ICRA]A2+	[ICRA]A& / [ICRA]A2+&	[ICRA]A (Negative) / [ICRA]A2+	[ICRA]A+ (Stable) / [ICRA]A1	[ICRA]A+ (Stable) / [ICRA]A1	[ICRA]A+ (Stable) / [ICRA]A1	-	-	-
6	Commercial Paper	100.00	--	[ICRA]A2+	[ICRA]A2+&	[ICRA]A2+	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1+	[ICRA]A1+ @	[ICRA]A1+
7	Non-Convertible Debenture	450.0	375.0	[ICRA]A (Stable)	[ICRA]A&	[ICRA]A (Negative)	[ICRA]A+ (Stable)	-	[ICRA]AA- (Negative) withdrawn	[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/ Non-fund based Facilities	Simple
Unallocated	Not Applicable
Commercial Paper	Very Simple
NCD	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	490.30	[ICRA]A (Stable)
NA	Fund-based/ Non-fund Based Facilities	NA	NA	NA	372.35	[ICRA]A (Stable)/[ICRA]A2+
NA	Unallocated	NA	NA	NA	177.57	[ICRA]A (Stable)/[ICRA]A2+
NA*	Commercial Paper	NA	NA	NA	100.00	[ICRA]A2+
INE665L07024	NCD	17-Sep-2021	8%	17-Jun-2023	125.0	[ICRA]A (Stable)
INE665L07032	NCD	17-Sep-2021	8%	17-Sep-2023	250.0	[ICRA]A (Stable)
NA	NCD	Not placed			75.0	[ICRA]A (Stable)

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
<b>Direct Subsidiaries</b>		
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
CarlQ Technologies Private Limited	74.00%	Full Consolidation
<b>Step Down Subsidiaries</b>		
Team Concepts Private Limited	100.00%	Full Consolidation
Industrial Meccanica E Stampaggio S.p.a.	100.00%	Full Consolidation
Varroc do Brasil Industria E Commericia 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.

## Corrigendum

Rating rationale dated November 28, 2022 has been corrected with revision as detailed below:

- ESG Risks have been added on Page 3 of the document.

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