ICRA

August 30, 2019

Varroc Lighting Systems (India) Pvt Ltd: Rating reaffirmed; Outlook revised to 'Stable'

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	38.00	38.00	[ICRA]AA- Reaffirmed; Outlook revised to Stable from Positive
Fund-based Facilities	25.00	25.00	[ICRA]AA- and [ICRA]A1+; Reaffirmed; Outlook revised to Stable from Positive
Fund-based/ Non-fund Based Facilities	7.00	7.00	[ICRA]AA- and [ICRA]A1+; Reaffirmed; Outlook revised to Stable from Positive
Total	**70.00**	**70.00**	

*Instrument details are provided in Annexure-1

Rationale

The long-term outlook revision from positive to stable reflects ICRA's expectation that Varroc Group's[1] credit profile is likely to witness gradual improvement than the earlier anticipated pace, due to sizeable investment plans as well as slowdown in the automotive sector across Indian as well as overseas markets. Varroc Group's lighting business (VLS) accounts for about two-thirds of its overall revenue and recent order wins for its automotive lighting business from various original equipment manufacturers (OEMs), coupled with incremental business from its existing customers, should help VEL to sustain revenue growth over the medium term. Varroc Group's debt level has increased substantially in FY2019, due to higher than anticipated capex and investments thereby resulting in moderation in leverage and coverage indicators. While cash accruals are likely to remain above Rs. 900 crore in FY2020, capex and investments of Rs. 800-850 crore in FY2020 will continue to constrain overall free cash flows. The company is expected to avail long-term borrowings of Rs. 500-600 crore in FY2020 to fund its investment plans, resulting in further moderation in leverage and coverage indicators. The benefits of these investments will accrue from FY2021 onwards, though actual ramp-up will remain contingent upon prevailing demand conditions in the automotive market. The return indicator (RoCE) continues to remain satisfactory at 14.2% (in FY2019 over 14.7% in FY2018).

The rating factors in Varroc Group's large scale of operations and established relationships with its customers. Its diversified and reputed clientele includes OEMs such as Bajaj Auto Limited (BAL), Ford Motor Company (Ford, rated Baa3/Negative by Moody's), Jaguar Land Rover Automotive PLC (JLR, rated B1/Negative by Moody's), Fiat Chrysler Automobiles N.V. (FCA, rated Ba1/Stable by Moody's), Tesla Inc. (rated B3/Stable by Moody's) and Volkswagen AG (VW, rated A3/Stable by Moody's), among others. The company, moreover, enjoys a strong share in their order book. The rating also considers VEL's diversified business presence across geographies, including North American, European and Asian markets, which insulates the company from slowdowns in any specific market and provides stable revenue visibility prospects. The rating strengths are partially offset by VEL's moderate financial profile as compared to other

[1] Varroc group refers to Varroc Engineering Limited (VEL, rated [ICRA]AA- (Stable) and [ICRA]A1+) along with its subsidiaries.

"AA" rated peers, its dependence on the cyclical automotive industry and stiff competition from established and larger players in the global automotive lighting business.

VEL was listed in FY2019 for an initial public offering (IPO) to provide exit to its existing private equity investors. While there was no incremental fund inflow into the company post IPO, it provided for financial flexibility by allowing VEL to tap into capital markets, if required.

Outlook: Stable

ICRA expects Varroc Group's credit profile to improve over the medium term against the backdrop of expected accruals in future and improved traction in its lighting business, which alone accounted for about two-thirds of its consolidated revenue. Varroc Group's credit profile will continue to benefit from its established market position, its diversified revenue and product mix as well as improved traction in wallet share of new customers coupled with incremental wallet share with its existing customers. The outlook may be revised to Positive in case of significant improvement in the credit profile of the firm on a sustained basis (TD/OPBITDA<1.5x), significant liquidity buffer through unused bank lines as well as quickly accessible funding arrangements in its Indian and, especially, in its international businesses. The outlook may be revised to Negative in case of significant and sustained deterioration in its credit profile (TD/OPBITDA>2.5x), or if any major cash outflow by way of capex or dividend payments or substantial investment in subsidiaries or stretch in the working capital cycle, weakens liquidity. The company's inability to maintain adequate liquidity buffer or consistently negative asset liability mismatch could also result in downward rating pressure. The impact of any significant debt-funded acquisition or investment on the company's credit profile 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 enjoys established relationships with its key customers. It has a strong order book share for supplying electrical, power train and plastic components with BAL. VEL is also one of the leading global automotive lighting manufacturers with strong in-house technological capabilities. It already supplies automotive lighting to leading electric passenger vehicle (PV) OEMs globally, and is expected to benefit from the hybridisation and electrification trend of PVs over the medium term.

Diversified and reputed clientele - Varroc Group has a diversified customer mix with no single customer accounting for more than 18% of its total revenues in FY2019. Its client profile is healthy, including reputed OEMs such as BAL, Ford, JLR, Tesla, FCA, Renault Nissan and Volkswagen, among others. In the lighting business, VLS has added incremental orders from VW and Renault Nissan, which are expected to be key growth drivers over the medium term. In its Indian operations, the company has gained traction with orders from leading two-wheeler (2W) OEMs like Hero MotoCorp Limited [rated [ICRA]AAA (Stable)] and Honda Motorcycle and Scooters India Limited (HMSI) for their existing as well as new models. Given its strong order pipeline from Indian as well as VLS operations, VEL is expected to witness healthy growth over the next three fiscals.

Diversified geographic presence – Varroc Group enjoys a diversified geographic presence across India (35% of revenues in FY2018), Europe (46%), North America (18%) and Asia. Coupled with its entry by organic and inorganic expansion in the Brazilian, Moroccan and Turkish markets, this has resulted in a further de-risking of its business through geographical as well as customer diversification. Furthermore, VEL's manufacturing footprint in relatively low-cost markets provides it a cost competitive advantage as compared to other players in the Europe and North American markets.

Credit challenges

High dependence on European PV market and stiff competition in automotive lighting business from larger peers - Varroc Group's dependence on the European PV market remains high. Also, the company faces stiff competition from established and much larger players in the global automotive lighting business. ICRA expects revenue growth for automotive lighting manufacturers to remain healthy on account of improved traction in higher realisation content like LED, OLED and Xenon lighting, despite modest volume growth in the underlying PV industry.

Exposure to cyclicality in automotive industry – VEL is exposed to the inherent cyclicality in the automotive industry, both in domestic and overseas markets. Its subsidiaries cater to the requirements of various global markets, which has muted its volume growth outlook in the near term.

Sizeable capacity expansion and investment plans - To fund its growth plans, Varroc Group has sizeable capacity expansion and investment plans in the near to medium term, which along with its incremental financing need to fund working capital will restrict meaningful reduction in its overall debt level. Nevertheless, given healthy accruals, the liquidity profile is expected to remain adequate. ICRA notes the management's guidance to maintain gross leverage below 1.0x despite the company's incremental organic or inorganic plans. In India, Varroc Group's metallic division has under-utilised capacity, which is a drag on its standalone profitability. Its forging capacity was initially set up for the medium and heavy commercial vehicle (M&HCV) segment; however, due to sub-optimal capacity utilisation, the company has taken restructuring measures to use these forging presses for 2W components. These measures should improve asset turnover and profitability (RoCE) of standalone operations in the current fiscal. To cater the upcoming BS VI emission norms requirement for 2W segment, VEL has entered into 50:50 JV with Dell'Orto SpA (an Italian company) for technology transfer and manufacturing of electronic fuel injection (EFI) system, also VEL has partnered with Germany based Heraeus for manufacturing catalytic converters. While overall investment in the JV will be less than Rs. 50 crore, it provides a strong upside revenue potential for VEL's electrical segment.

Liquidity position

Varroc Group's liquidity profile remains adequate, supported by available surplus cash reserves and undrawn credit facilities from the banking system for both its fund-based and non-fund based facilities. The working capital limit utilisation of the Varroc Group has been moderate over the last 12 months. Its Indian operations have sanctioned unsecured funding lines to the tune of Rs. 80 crore (in the process of enhancing to Rs. 100 crore) from Bajaj Finance in the form of PO financing, thus adding to its financial flexibility in the event of any short-term funding mismatch. Its international operations have undrawn bank lines of EUR 76 million, providing adequate liquidity cushion. The company's ability to correct its asset liability mismatch remain crucial in the near to medium term.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Manufacturers
Parent / Group Support	Not Applicable
Consolidation / Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of Varroc Engineering Limited. As on March 31, 2019, the company had 22 subsidiaries including direct as well as step down subsidiaries, which 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 also 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 started as a captive unit for BAL for its auto component supplies and has gradually diversified by adding new customers and products. In 2012, VEL 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.

Key financial indicators (Consolidated)

Consolidated	FY2018	FY2019
Operating Income (Rs. crore)	10,296.0	12,076.1
PAT (Rs. crore)	381.8	418.3
OPBDIT/OI (%)	8.7%	9.3%
RoCE (%)	14.7%	14.2%
Total Debt/TNW (times)	0.4	0.8
Total Debt/OPBDIT (times)	1.3	2.2
Interest coverage (times)	10.4	11.7

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); FY2018 financials are provisional

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

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Rating history for last three years:

	Instrument	Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding* (Rs. crore)	Date & Rating in FY2020 August 2019	Date & Rating in FY2019 May 2018	Date & Rating in FY2018 September 2017	Date & Rating in FY2017 June 2016
1	Term Loan	Long-term	38.00	5.68	[ICRA]AA- (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Fund-based Facilities	Long-term/Short-term	25.00	17.16	[ICRA]AA- (Stable) / [ICRA]A1+	[ICRA]AA- (Positive) / [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
3	Fund-based/ Non-fund Based Facilities	Long-term/Short-term	7.00	1.71	[ICRA]AA- (Stable) / [ICRA]A1+	[ICRA]AA- (Positive) / [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	-

Source: VLSIPL; *: Amount outstanding as on July 31, 2019

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 Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan-1	2012-2014	10.00%	2018-2020	7.50	[ICRA]AA- (Stable)
NA	Term Loan*	-	-	-	30.50	[ICRA]AA- (Stable)
NA	Fund-based Facilities	-	-	-	25.00	[ICRA]AA- (Stable)/ [ICRA]A1+
NA	Fund-based/ Non-fund Based Facilities	-	-	-	7.00	[ICRA]AA- (Stable)/ [ICRA]A1+

Source: Varroc Lighting Systems India Pvt. Ltd.; * Yet to be sanctioned

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Direct Subsidiaries		
Varroc Polymers Private Limited	100.00%	Full Consolidation
Durovalves India Private Limited	72.78%	Full Consolidation
Varroc Lighting Systems (India) Private Limited	100.00%	Full Consolidation
Varroc European Holding B.V.	100.00%	Full Consolidation
Aries Mentor Holding B.V.	100.00%	Full Consolidation
Varroc Corp Holding B.V.	100.00%	Full Consolidation
Varroc Japan Co. Limited	100.00%	Full Consolidation
Step Down Subsidiaries		
Team Concepts Private Limited	95.00%	Full Consolidation
Industrial Meccanica E Stampaggio S.p.a.	100.00%	Full Consolidation
Varroc Lighting Systems, Italy S.p.A. (earlier know as "TRI.O.M., S.p.A")	100.00%	Full Consolidation
Varroc Lighting Systems, Vietnam CO. Ltd. (earlier know as "TRI.O.M., Vietnam Co. Ltd.")	100.00%	Full Consolidation
Varroc Lighting Systems, Romania S.A. (earlier know as "Electromures SA")	98.23%	Full Consolidation
TRI.O.M. Mexico SA De. C.V.	100.00%	Full Consolidation
Varroc Lighting Systems SRO	100.00%	Full Consolidation
Varroc Lighting Systems Inc.	100.00%	Full Consolidation
Varroc Lighting Systems GmBH.	100.00%	Full Consolidation
Varroc Lighting Systems S.de.R.L. De. C.V.	100.00%	Full Consolidation
Varroc Lighting Systems S.A., Morocco	99.87%	Full Consolidation
Varroc do Brasil Industria E Commercia LTDA (earlier known as Varroc do brasil Comercio, Importacao e Exportacao de Maquinas, Equipamento e Pecas Ltd., Brazil)	100.00%	Full Consolidation

Company Name	Ownership	Consolidation Approach
Varroc Lighting Systems sp. Z o.o.	100.00%	Full Consolidation
VARROC LIGHTING SYSTEMS TURKEY ENDÜSTRUYEL ÜRÜNLER iMALAT VE TiCARET ANONiM SiRKETi.	100.00%	Full Consolidation
Varroc Lighting Systems Bulgaria EOOD	100.00%	Full Consolidation

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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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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