April 30, 2020 Revised

Varroc Lighting Systems (India) Private Limited: Ratings placed on watch with negative implications

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- @; Rating placed on watch with negative implications
Fund-based Facilities	25.00	25.00	[ICRA]AA- @/[ICRA]A1+@; Ratings placed on watch with negative implications
Fund-based/ Non-fund Based Facilities	7.00	7.00	[ICRA]AA- @/[ICRA]A1+@; Ratings placed on watch with negative implications
Total	**70.00**	**70.00**	

*Instrument details are provided in Annexure-1

Rationale

The rating action of Varroc Engineering Limited (VEL) and its subsidiaries follows the impact of the novel coronavirus (Covid-19) outbreak on the automotive industry globally and is in line with ICRA's negative outlook for the sector. Following the rapid proliferation of the disease both globally and in India, the Governments across geographies have resorted to lockdown and have further extended the imposed lockdown to curb the contagion. The unprecedented, large-scale lockdown has disrupted production at automobile OEMs and their supply chain from March 2020 onwards. In addition to the supply side as well as the production disruptions, the demand shock is also witnessed because of the pandemic. The same is expected to continue in the near term due to uncertainty related to lockdown extension and economic recovery, further adding to an already weak demand environment earlier to the pandemic (before March 2020). Subsequently, automotive demand, both for the commercial and consumer segments (passenger vehicles or PVs and two-wheelers or 2Ws), has contracted sharply in recent weeks, following the lockdown and is likely to remain muted in the near term. This subsequently will have a bearing on auto-ancillary manufacturers' financial performance and eventually the credit profile.

A prolonged period of slowdown could result in weak financial performance, despite some flexibility that the company might have in pruning down costs. Additionally, the ramp-up in demand and production is likely to be gradual, even after lifting of the lockdown, on concerns of macro-economic slowdown. Hence, a relatively prolonged period of curtailed automotive demand, given the discretionary nature of the spend, is likely. In the likelihood of sharp reduction in schedules from client OEMs, or delayed ramp up of new greenfield plants set up at significant capex over the past 1-2 years, VEL's financial performance could weaken, going forward. Consequently, weaker earnings and cash flows in FY2021 are likely to restrict an improvement in the company's credit metrices (vis-à-vis previous expectations).

Given the current environment, the liquidity cushion between cash balances and available lines of credit, and debt servicing requirements are key rating drivers. Currently, VEL's liquidity remains adequate, supported by availability of surplus cash reserves along with undrawn credit facilities from banking system for both the fund based and non-fund based (over Rs. 1300 crore as on March 31, 2020 on a consolidated basis). While the liquidity buffer appears adequate, considering the current debt servicing obligations and the fixed costs per month (including employee expenses and other overheads), the liquidity position will weaken in the event of a prolonged production shutdown or significantly lower demand. Accordingly, ICRA will continue to monitor the situation as it evolves over the near-term and assess its impact on the credit profile of MIL.

ICRA notes that VEL is in discussion with the bankers on moratorium on payments from its lenders until May 31, 2020, as allowed per the 'COVID-19 - Regulatory Package' announced by the Reserve Bank of India on March 27, 2020. The debt repayment during Mar-2020 was already paid in a timely manner. Rescheduling of loans, if any, has been factored in the ratings.

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. VEL is also one of the leading global automotive lighting manufacturers, with strong in-house technological capabilities. VEL is already supplying automotive lighting to leading electric PV OEMs globally, and it is expected to benefit from hybridisation and electrification trend of passenger vehicles over the medium to long term.

Diversified and reputed clientele - Varroc has a diversified customer mix, with no single customer accounting for over 20% of the total revenues in FY2019. The client profile is healthy, including reputed OEMs such as Bajaj Auto Limited, Ford Motor Company, Jaguar Land Rover Limited, Tesla Inc, FCA NV, Renault Nissan and Volkswagen AG . 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 the Indian operations, the company has gained traction in order book of leading 2W OEMs such as Hero MotoCorp Limited (rated [ICRA]AAA (Stable)) and Honda Motorcycle and Scooters India Limited (HMSI) for their existing as well as new models.

Diversified geographic presence - Varroc has a diversified geographic profile, with presence across India (34%), Europe (46%), North America (18%) and China as per FY2019 data. This coupled with its entry by organic and inorganic expansion in Brazil, Morocco and Turkish market has resulted in further de-risking its business by means of geographical as well as customer diversification. Furthermore, the manufacturing footprint of Varroc is present in relatively low-cost countries, thus providing it a cost competitive advantage as compared to other players in the Europe and North American market.

Credit challenges

Exposed to the cyclicality in the automotive industry; ongoing slowdown is likely to result in muted performance in near term- Varroc is exposed to the cyclicality in the automotive industry, both in domestic and overseas market. Its subsidiaries cater to the requirement of the various global automotive market segments, which have negative growth outlook in the near term given the uncertainty due to the pandemic. However, VEL is expected to tide over the next 2-2.5 months, given adequate liquidity, implementation of cost control measures along with various government measures across geographies. However, if the period of uncertainty persists for longer than expected, the same may have a bearing on the financial performance and eventually the credit profile of the firm.

Sizeable capacity expansion and investments plans- To fund its growth plans, Varroc has sizeable capacity expansion and investment plans in the near to medium term, which along with incremental financing requirement to fund working capital will restrict meaningful reduction in the overall debt level. Though reduction in capex plan as announced in the recent conference call would help in lowering the intensity of the impact of the same on the credit profile of the firm.

High dependence on European PV market; stiff competition from established and much larger players - VEL'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. However, as VEL is strategically placed in low-cost regions (Mexico, Czech Republic, Morocco and Brazil etc.), the firm has a competitive advantage over larger players in relatively high-cost regions (Western Europe, North America and Japan) due to its unique positioning (low-cost quality products). In the long run, ICRA expects revenue growth for automotive lighting manufacturers to remain healthy over medium to long term, given the improved traction in higher realisation content such as LED, OLED and Xenon lighting, despite modest volume growth in underlying PV industry.

Liquidity position

The company's liquidity profile remains adequate, supported by availability of surplus cash reserves along with undrawn credit facilities from banking system for both the fund based and non-fund based (over Rs. 1300 crore as on March 31, 2020 on a consolidated basis). On a consolidated basis, the cash available stood at Rs. 1039.7 crore as on Mar-2020 (as opposed to Rs 163.4 crore in Mar-2019), given the management call to shore up liquidity, which has provided support to the company during the current lockdown period.

Indian operations have sanctioned used bank lines of over Rs. 150 crore as on March 2020, thus adding to its financial flexibility in the event of short-term fund mismatch. Currently, the international operations have cash and cash equivalents over Rs. ~850 crore along additional Eur ~16.5 Mn bank lines availed recently, providing adequate liquidity cushion. The working capital limit utilisation of the Varroc Group is moderate, over the last 12 months period.

Rating sensitivities

Positive triggers – Under the current scenario, a rating upgrade remains unlikely in the near term. However, over the medium to long term, positive rating trigger implies sustained improvement in capital structure and coverage indicators, with TD/OPBIDTA below 1.5x on sustain basis

Negative triggers – Negative pressure on ISPL's rating could arise in case of significant deterioration in the credit profile of the firm on a sustained basis (TD/OPBITDA>2.5x). Additionally, any major cash outflow by means of capital expenditure or dividend payments or substantial investment in subsidiaries or stretch in the working capital cycle that weakens liquidity would be a credit negative. The company's inability to maintain adequate liquidity buffer or consistently negative asset liability mismatch could also result in downward rating pressure.

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 stepdown 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 of 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
TOL/TNW (times)	1.4	1.8
DSCR (times)	3.3	3.3

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

Rating history for last three years:

	Instrument	Current Rating (FY2021)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding* (Rs. crore)	Date & Rating in FY2021 30-April 2020	Date & Rating in FY2020 30-August 2019	Date & Rating in FY2019 01-June 2018	Date & Rating in FY2018 06-October 2017
1	Term Loan	Long-term	38.00	0.02	[ICRA]AA- @	[ICRA]AA-(Stable)	[ICRA]AA-(Positive)	[ICRA]AA-(Stable)
2	Fund-based Facilities	Long-term/Short-term	25.00	0.00	[ICRA]AA-@/[ICRA]A1+@	[ICRA]AA-(Stable) / [ICRA]A1+	[ICRA]AA-(Positive) / [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+
3	Fund-based/ Non-fund Based Facilities	Long-term/Short-term	7.00	4.54	[ICRA]AA-@/[ICRA]A1+@	[ICRA]AA-(Stable) / [ICRA]A1+	[ICRA]AA-(Positive) / [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+

Source: VLSIPL; *: Amount outstanding as on March 31, 2020

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- @
NA	Term Loan*	-	-	-	30.50	[ICRA]AA- @
NA	Fund-based Facilities	-	-	-	25.00	[ICRA]AA- @/ [ICRA]A1+ @
NA	Fund-based/ Non-fund Based Facilities	-	-	-	7.00	[ICRA]AA- @/ [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
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

Company Name	Ownership	Consolidation Approach
Varroc Lighting Systems Bulgaria EOOD	100.00%	Full Consolidation

Corrigendum

Previously published document dated April 30, 2020 has been corrected with revisions as detailed below:

- Revision on Page 4 – TOL/TNW and DSCR ratios have been included in the Key Financial Indicators table

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About ICRA Limited:

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