

May 06, 2022

Varroc Engineering Limited: Ratings placed on watch with developing implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	504.00	504.00	[ICRA]A&, Rating placed on watch with developing implications
Fund-based Facilities	17.35	17.35	[ICRA]A&/[ICRA]A2+&, Ratings placed on watch with developing implications
Non-fund Based Facilities	35.00	35.00	[ICRA]A&/[ICRA]A2+&, Ratings placed on watch with developing implications
Fund-based/ Non-fund based Facilities	339.55	339.55	[ICRA]A&/[ICRA]A2+&, Ratings placed on watch with developing implications
Unallocated	144.32	144.32	[ICRA]A&/[ICRA]A2+&, Ratings placed on watch with developing implications
Total Bank Line Facilities	1,040.22	1,040.22	
Commercial Paper (CP)	100.00	100.00	[ICRA]A2+&; Rating placed on watch with developing implications
Non-Convertible Debenture (NCD) programme	450.00	450.00	[ICRA]A&, Rating placed on watch with developing implications

*Instrument details are provided in Annexure-1

Rationale

Material Event

Varroc Engineering Limited (VEL), vide a BSE press release dated April 29, 2022, indicated that it had signed a binding securities purchase agreement (SPA) with Plastic Omnium SE (PO), France on April 28, 2022, for 100% divestment in its overseas 4-wheeler lighting business located in US, Mexico and Europe under Varroc Lighting Systems (VLS) as well as the global R&D support. As per the scheme of divestment, Varroc group would retain and continue operating the 4-wheeler lighting business in India, global 2W lighting business in Italy, Romania and Vietnam, Electronics business in Poland and Romania and its China Joint Venture with TYC Brothers for passenger vehicle lighting products.

Plastic Omnium, based out of France is an Auto component manufacturer engaged in manufacturing of external plastic elements like bumpers and energy-absorptions systems, fenders and front-end modules with presence across 20+ countries and 137 plants. As per the arrangement, PO will take over the net assets of VLS for a total consideration of 600 mn Euros (~Rs. 4,800 crore approximately). The net cash accretion for VEL is likely to be in the range of 160-175 mn Euros (Rs. 1,280-1,400 crore approx.), post-tax and net of escrow (escrow of 35 mn Euros is expected to be released over 2-3 years subject to certain conditions and milestones).

The deal is subject to requisite statutory and regulatory approvals in Mexico, US and Europe and is expected to be closed by September 2022.

Impact of Material Event

ICRA has taken a consolidated view of VEL and its subsidiaries – Varroc Polymers Private Limited (VPPL) and Durovalves India Private Limited (DIPL), while assigning the credit ratings, given the common management and significant operational and financial linkages between them; the ratings are based on the consolidated financials of VEL (hereafter referred to as Varroc Group).

ICRA has placed the ratings outstanding on the bank facilities, NCDs and CP Programme of VEL (along with VPPL and DIPL) on watch with developing implications, as the aforesaid development is likely to have a favourable impact on the credit profile of VEL, the extent of which would be ascertained over a period of time, given the nascent stage of developments and the dependence on various stakeholder/regulatory approvals. The Varroc Group had undertaken more than Rs. 3,000 crore of capex (excluding development cost/lease capitalisation) over the last three years with a view of enhancing presence across geographies and strengthening the business risk profile of VLS. However, post the setup of new plants, the operating performance of VLS remained constrained on account of culmination of various factors such as delayed ramp up of new plants, adverse impact of the Covid-19 pandemic, chip shortage issues impacting customer offtake and other exogenous factors. The Group's net debt levels consequently had increased to ~Rs. 2640 crore as of December 31, 2021 (from Rs. 880 crore in FY2018) and the debt coverage indicators had significantly weakened, thereby exposing the company to refinancing risk.

The divestment of stake in VLS is likely to have a positive material impact on the credit profile of the company, leading to significant deleveraging of its balance sheet; VEL is likely to have negative net debt position post the divestment (basis initial estimates of the company). Further, with divestment of VLS business which was generating losses since the previous few quarters, the overall operating performance and credit metrics are expected to improve materially. The divestment will also help enhance the group's focus on its global 2W lighting business and India business, along with focus on development of Electronics and EV components.

ICRA notes that the company continues to remain exposed to refinancing risks for certain debt repayments/rollovers due over the next few months. However, with the signing of the SPA, the company's ability to attain timely refinancing/rollover of select working capital facilities has increased; additionally, the company is in advanced discussions to raise funds to boost liquidity across companies till the closure of the transaction. The group's ability to achieve the aforementioned rollovers/fund raises in a timely manner till the closure date would remain a key monitorable.

ICRA would continue to monitor the developments related to the divestment, and take appropriate rating action, post analysing the impact of the same on VEL's credit profile.

Please refer to the following link for the previous detailed rationale that captures Key rating drivers and their description, liquidity position and rating sensitivities: [Click here](#)

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Suppliers 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

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. VEL has signed a securities purchase agreement with Plastic Omnium of France in April 2022 for divestment of its overseas 4-wheeler business, while it will continue operating its overseas 2-wheeler business and domestic 4-wheeler business.

Key financial indicators (audited financials)

Varroc (Consolidated)	FY2020	FY2021	9M FY2022*
Operating Income (Rs. crore)	11,146.7	11,302.8	9,109.2
PAT (Rs. crore) (*excluding share from JV)	11.7	(664.3)	(789.5)
OPBDIT/OI (%)	7.6%	3.5%	0.3%
PAT/OI (%)	0.1%	-5.9%	-8.7%
Total Outside Liabilities/Tangible Net Worth (times)	2.6	2.6	-
Total Debt/OPBDIT (times)	5.0	9.3	-
Interest Coverage (times)	6.1	2.4	0.2

Source: Company Annual Reports; ICRA Research; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Note: Some figures are adjusted as per ICRA; Limited Audit

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 May 6, 2022	Date & Rating in FY2022		Date & Rating in FY2021		Date & Rating in FY2020	
					Dec 7, 2021	Jun 23, 2021	Aug 21, 2020	Apr 30, 2020	Aug 30, 2019	
1 Term Loan	LT	504.00	504.0	[ICRA]A&	[ICRA]A (Negative)	[ICRA]A+ (Stable)	[ICRA]AA- (Negative)	[ICRA]AA- @	[ICRA]AA- (Stable)	
2 Fund-based Facilities	LT/ST	17.35	-	[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	35.0	-	[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	339.55	-	[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 Fund-based/ Non-fund - Unallocated	LT/ST	144.32	-	[ICRA]A& / [ICRA]A2+&	[ICRA]A (Negative)/ [ICRA]A2+	[ICRA]A+ (Stable)/ [ICRA]A1	-	-	-	

6	Commercial Paper	ST	100.00	-	[ICRA]A2+&	[ICRA]A2+	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
7	Non-Convertible Debenture	LT	450.0	-	[ICRA]A&	[ICRA]A (Negative)	-	-	[ICRA]AA- @	[ICRA]AA- (Stable)

& Rating under Watch with Developing 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
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, is available on ICRA's 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 Loans	FY2021	NA	FY2025	504.00	[ICRA]A&
NA	Fund-based Facilities	NA	NA	NA	17.35	[ICRA]A&/[ICRA]A2+&
NA	Non-fund Based Facilities	NA	NA	NA	35.0	[ICRA]A&/[ICRA]A2+&
NA	Fund-based/ Non-fund Based Facilities	NA	NA	NA	339.55	[ICRA]A&/[ICRA]A2+&
NA	Unallocated	NA	NA	NA	144.32	[ICRA]A&/[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&
INE665L07032	NCD	17-Sep-2021	8%	17-Sep-2023	250.0	[ICRA]A&
NA	NCD	Not placed			75.0	[ICRA]A&

Source: Company

*not placed

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure-2: 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
CarlQ 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 Lighting Systems, Italy S.p.A.	100.00%	Full Consolidation
Varroc Lighting Systems, Vietnam Co. Ltd.	100.00%	Full Consolidation
Varroc Lighting Systems, Romania S.A. (earlier know as "Electromures SA")	98.23%	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 Commercica LTDA	100.00%	Full Consolidation
Varroc Lighting Systems sp. Z o.o.	100.00%	Full Consolidation
VARROC LIGHTING SYSTEMS TURKEY ENDÜSTRUYEL ÜRÜNLER İMALAT VE TİCARET ANONİM İRKETİ	100.00%	Full Consolidation
Varroc Lighting Systems Bulgaria EOOD	100.00%	Full Consolidation
Varroc Lighting Systems Electronics Romania SRL (earlier known as Varroc Elba Electronics SRL)	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.

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