Varroc Engineering Limited (erstwhile Varroc Engineering Private Limited)

June 01, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	120.65	170.65	[ICRA]AA- Reaffirmed; Outlook revised to Positive from Stable
Non-Convertible Debenture	100.00	100.00	[ICRA]AA- Reaffirmed; Outlook revised to Positive from Stable
Fund-based Facilities	343.85	343.85	[ICRA]AA- and [ICRA]A1+; Reaffirmed; Outlook revised to Positive from Stable
Non-fund Based Facilities	152.00	152.00	[ICRA]AA- and [ICRA]A1+; Reaffirmed; Outlook revised to Positive from Stable
Fund-based/ Non-fund Based Facilities	288.50	238.50	[ICRA]AA- and [ICRA]A1+; Reaffirmed; Outlook revised to Positive from Stable
Commercial Paper	100.00	100.00	[ICRA]A1+; Reaffirmed
Total	**1105.00**	**1105.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA- (pronounced ICRA double A minus) and the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) for the Rs. 343.85 crore[1] fund-based, Rs. 152.00 crore non-fund based and Rs. 238.50 crore fund-based/non-fund based facilities (reduced from Rs 288.5 crore) of Varroc Engineering Limited (erstwhile Varroc Engineering Private Limited) (VEL)[2]. The outlook on long term rating is revised from 'Stable' to 'Positive'. ICRA has also reaffirmed the long-term rating of [ICRA]AA- outlook for the Rs. 170.65-crore term loan facility (enhanced from Rs 120.65 crore) and Rs. 100.00-crore non-convertible debenture, and the short-term rating of [ICRA]A1+ for the Rs. 100.00-crore commercial paper of VEL.

Rationale

The long-term outlook revision reflects ICRA's expectation that Varroc Group's credit profile will strengthen over the medium term, supported by strong cash accruals from existing business as well as improved traction in lighting business. VEL's lighting business accounts for about two-third of its overall revenue and recent order wins in automotive lighting business from PV OEMs should help VEL to sustain strong revenue growth over the medium term. ICRA takes note of the large (~ Rs 2,500 crore over FY2019-FY2021) capital expenditure and investment plans of the company in the near to medium term. VEL's coverage indicators like total-debt/OPBIDTA and gearing has improved from 2.8x and 0.9x in FY2016 to 1.3x and 0.4x in FY2018, and ICRA expects overall total-debt to OPBIDTA to remain below 1.5x over the medium term despite large capex and investment plans over the next three fiscals.

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[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

The ratings favourably factors in the VEL's large scale of operations and long-established relationship with its customers. Its diversified and reputed clientele includes original equipment manufacturers (OEMs) such as Bajaj Auto Limited (BAL), Ford Motor Company (Ford, rated Baa2/Negative by Moody's), Jaguar Land Rover Automotive PLC (JLR, rated Ba1/Stable by Moody's), Fiat Chrysler Automobiles N.V. (FCA, rated Ba2/Stable by Moody's), Tesla Inc (rated B3/Negative by Moody's) and Volkswagen AG (VW, rated A3/Stable by Moody's) among others and has a strong share in their order book. The rating also takes into account the diversified business presence across geographies, which insulates the company from the slowdown in a particular market and provides stable revenue visibility prospects. The rating strengths are partially offset by VEL's dependence on the cyclical automotive industry and stiff competition from established and larger players in the global automotive lighting business. The return indicator (RoCE) of the company has increased in FY2018 to ~14.7% from ~12.7% in 2017, owing to increased capacity utilisation in the Indian operations (forging-crankshaft divisions) and increased operational efficiencies in Mexican operations.

VEL is planning to come out with initial public offering (IPO) of its shares to provide exit to existing private equity investors. While there is no incremental fund inflow in the company post IPO, it is expected to strengthen financial flexibility of the company by allowing company to tap capital market, if required.

Outlook: Positive

ICRA believes credit profile of VEL will strengthen over the medium term in the backdrop of strong accruals and improved traction in lighting business, which alone accounted for about two-third of company's consolidated revenue. VEL's credit profile will continue to benefit from established market position, diversified revenue and product mix and improved traction in wallet share of new customers. Impact of any significant debt-funded acquisition or investment, on credit profile of the company 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 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 hybridization 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 more than 16% of the total revenues in FY2018. The client profile is healthy including reputed OEMs such as BAL, Ford, JLR, FCA and Volkswagen among others. In 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 Indian operations, company has gained traction in order book of leading 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 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 has a diversified geographic profile with presence across India (33% of revenues in FY2018), Europe (45%), North America (15%) and China. Over the next two years, company is expected to further expand its footprint by organic and inorganic expansion in Brazil, Morocco and Turkish market. 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.

Exit of loss-making operations and turnaround of overseas lighting operations - Varroc has gradually exited its loss-making operations in Europe and successfully turned around its overseas operations in Varroc Lighting Systems (VLS). VLS now accounts for about two-third of the Group's revenue. Post turnaround and improved performance of overseas lighting operations, the company is able to generate strong cash accruals, thus supporting its capital expenditure funding for growth, capital structure and liquidity profile. VEL, on a consolidated level, reported a moderate gearing of 0.4x and Total Debt/OPBDITA of 1.3x as on March 2018. Supported by strong cash accruals and accretion to net-worth, the leverage is likely to reduce going forward.

Credit challenges

High dependence on European PV market and stiff competition in automotive lighting business from larger peers - 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. ICRA expects revenue growth for automotive lighting manufacturers is expected to remain healthy on account of improved traction in higher realization content like LED, OLED and Xenon lighting, despite modest volume growth in underlying PV industry.

Exposure to cyclicality in automotive industry - Varroc is exposed to the cyclicality in automotive industry, both in domestic and overseas market. Its European subsidiaries cater to the requirement of the European PV market, which has modest demand outlook.

Sizeable capacity expansion and investment 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 overall debt level. Nevertheless, given healthy accruals, the liquidity profile is expected to remain comfortable. ICRA draws comfort from management guidance to maintain gross leverage below 1.0x despite the company's incremental organic or inorganic plans.

In India, VEL's metallic division has underutilized capacity which is a drag on standalone profitability. The forging capacity was initially setup for HCV segment; however due to sub-optimal capacity utilization, 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 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. While overall investment in the JV will be less than Rs 50 crore, it provides strong upside revenue potential for VEL's electrical segment.

Analytical approach: To arrive at the ratings, ICRA has taken a consolidated view of the Varroc Group (VEL along with its Indian subsidiaries i.e. Varroc Polymers Private Limited (VPPL), Durovalves India Private Limited (DIPL), Varroc Lighting Systems India Private Limited (VLSIPL) and its overseas operations). ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology for Auto Component Manufacturers

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.

In FY2018, VEL on a consolidated basis reported a net profit of Rs. 382 crore, which results in a Total comprehensive income of Rs. 451 crore after the addition of share of profits from JVs and Associates.

Key financial indicators

Consolidated	FY2017	FY2018
Operating Income (Rs. crore)	9,311	10,296
PAT (Rs. crore)	234.3	382
OPBDIT/OI (%)	6.4%	8.7%
RoCE (%)	12.7%	14.7%
Total Debt/TNW (times)	0.7	0.4
Total Debt/OPBDIT (times)	2.5	1.3
Interest coverage (times)	6.5	10.4

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 (FY2019)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding* (Rs. crore)	Date & Rating in FY2018 June 2018	Date & Rating in FY2017 October 2017	Date & Rating in FY2017 January 2017	Date & Rating in FY2016 June 2016
1	Term Loan	Long-term	170.65	114.63	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Non-Convertible Debenture	Long-term	100.00	80.00	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	-
3	Fund-based Facilities	Long-term/Short-term	343.85	176.23	[ICRA]AA- (Positive) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+
4	Non-fund Based Facilities	Long-term/Short-term	152.00	27.05	[ICRA]AA- (Positive) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+
5	Fund-based/ Non-fund Based Facilities	Long-term/Short-term	238.50	33.45	[ICRA]AA- (Positive) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+	-	-
6	Commercial Paper	Short-term	100.00	60.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Source: VEL; *: Amount outstanding as on May 15, 2018

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	Feb 2016	9.00%	May 2021	65.00	[ICRA]AA-(Positive)
NA	Term Loan-2	May 2016	9.00%	May 2021	55.65	[ICRA]AA-(Positive)
NA	Term Loan-3	Jun 2016	8.55%	Aug 2022	50.00	[ICRA]AA-(Positive)
INE665L07016	Non-Convertible Debenture	Feb 2017	8.1%	Feb 2020	100.00	[ICRA]AA-(Positive)
NA	Fund-based Facilities	-	NA	-	343.85	[ICRA]AA-(Positive)/ [ICRA]A1+
NA	Non-fund Based Facilities	-	NA	-	152.00	[ICRA]AA-(Positive)/ [ICRA]A1+
NA	Fund-based/ Non-fund Based Facilities	-	NA	-	238.50	[ICRA]AA-(Positive)/ [ICRA]A1+
NA	Commercial Paper	-	NA	7-365 days	100.00	[ICRA]A1+

Source: VEL

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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.

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