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Q2FY21 result review
and earnings revision

Automobiles

Target price: Rs491

Earnings revision

(%)	FY21E	FY22E
EBITDA	↑ 3.2	↑ 3.4
PAT	↑ 0.6	↑ 4.6
EPS	NC	↓ 3.9

Target price revision

Rs491 from Rs412

Shareholding pattern

	Mar '20	Jun '20	Sep '20
Promoters	85.0	85.0	85.0
Institutional investors	12.1	8.2	8.3
MFs and others	7.6	5.6	5.7
FI/Banks	0.4	1.0	0.7
FIIIs	4.1	1.6	1.9
Others	2.9	6.8	6.7

Source: BSE

Price chart



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INDIA

Varroc Engineering

BUY

Maintained

Rs299

Healthy FCF drives debt reduction

Varroc Engineering's (VEL) Q2FY21 operating performance was ahead of consensus estimates as EBITDA margin came in at 9.1% (up 53bps YoY). VLS' sales grew ~21% YoY to EUR228mn while margins were flat YoY to 7.6% (tad disappointing). FCF generation (~Rs4bn) in 2Q has been strong and is supporting VEL debt reduction target of Rs26bn by 4Q. FY22 is likely to be the point of inflection for earnings for global lighting business (VLS) as utilisations rise in greenfield plants coupled further aided by the fixed cost reductions initiated in FY21. India business is expected to benefit from revival in domestic 2-W demand recovery coupled with increased BS-VI content. Stock remains attractive at ~21% FY22 FCF yield. We maintain our BUY rating on the stock.

- ▶ **Key highlights of the quarter:** Topline at Rs29.4bn grew 8.4% YoY despite India business revenue decline of 7.2% to ~Rs9.3bn, while margins grew 329bps YoY to 13.5%. EBITDA margin stood at 9.1%, up 53bps YoY. China JV performance improved with 16.8% EBITDA margin as revenues grew 12% to Rs1.2bn. VLS sales grew ~10% YoY at EUR228mn, while India business also grew 10% YoY as 2-W OEMs geared up for festive inventory buildup. Free cashflow for the quarter stood at ~Rs4bn, which resulted in net debt reduction of Rs3.5bn to Rs30.6bn to reach the target of Rs26bn in FY21. VEL reported PAT loss of Rs401mn as tax rates were higher as loss absorption w.r.t greenfield plants could not be accounted for, the same could normalise as operations deliver consistent profitability in H2/FY22.
- ▶ **VLS ramp-up as VEL focuses on cost optimisation:** a) VEL reported new business wins of EUR74mn in VLS and Rs5bn in India business, with a pipeline of EUR120mn of likely orders in the near term; b) capex for FY21 has been significantly slashed to EUR45mn for VLS and Rs1.3bn for India business; and c) inventory build-up by OEMs has led to strong volume growth in VLS and India business in Sep/Oct'20. VEL is not yet impacted by the second wave of lockdowns in the Europe although end-customer demand may possibly be impacted.
- ▶ **Maintain BUY:** VLS remains an attractive play on the move towards higher LED penetration among global OEMs and cost reduction from the ramp-up of greenfield facilities. We expect VEL's revenue growth at ~16% CAGR over FY21-FY23E. We lower our FY22E EPS estimates by ~4% on of account higher interest, depreciation costs. Due to the mixing of global and domestic automotive exposures, we value the business on SoTP basis. We rollover to Sep'22E and value VLS and its China JV at 4x EV/EBITDA and 7x P/E Sep'22E, respectively, and India business at unchanged multiple of 8x EV/EBITDA Sep'22E to arrive at a SoTP-based target price of Rs491 (earlier: Rs412). Maintain **BUY**.

Market Cap	Rs40.3bn/US\$543mn	Year to Mar (Std)	FY20	FY21E	FY22E	FY23E
Reuters/Bloomberg	VARE.BO/VARROC IN	Revenue (Rs mn)	1,11,219	1,07,770	1,25,977	1,45,628
Shares Outstanding (mn)	134.8	Adj. Net Income (Rs mn)	2	-2,295	2,214	4,016
52-week Range (Rs)	501/125	Adj. EPS (Rs)	0.0	(17.0)	16.4	29.8
Free Float (%)	15.0	% Chg YoY	(100.0)	NC	NC	81.4
FII (%)	1.9	P/E (x)	NC	NC	18.2	10.0
Daily Volume (US\$/'000)	1,274	CEPS (Rs)	54.3	48.4	86.9	105.0
Absolute Return 3m (%)	34.1	EV/E (x)	7.5	9.3	4.8	3.6
Absolute Return 12m (%)	(37.2)	Dividend Yield (%)	1.2	0.0	1.1	2.0
Sensex Return 3m (%)	13.6	RoCE (%)	3.1	(1.7)	5.3	8.8
Sensex Return 12m (%)	8.6	RoE (%)	0.0	(7.9)	7.7	12.9

Please refer to important disclosures at the end of this report

Table 1: Q2FY21 result review (standalone)

(Rs mn, year ending March 31)

	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Total operating income	29,389	27,120	8.4	12,857	128.6
Raw material costs	18,771	16,600	13.1	8,624	117.7
Employee costs	3,783	3,704	2.1	3,387	11.7
Other expenditures	4,175	4,505	-7.3	2,640	58.1
Total operating expenses	26,729	24,809	7.7	14,651	82.4
EBITDA	2,661	2,311	NC	-1,794	NC
EBITDA margin (%)	9.1	8.5	53 bps	-14.0	2301 bps
Depreciation & Amortization	2,270	1,664	36.4	2,069	9.7
Other income	4	26	-86.3	390	-99.1
Interest costs	443	351	26.0	432	2.6
PBT	-49	322	NC	-3,905	NC
Exceptional Items					
Taxes	429	27	1,491.4	-709	-160.5
PAT before MI/JV	-478	295	NC	-3,196	NC
MI/JV profits	90	-66	NC	110	NC
PAT	-401	223	NC	-3,077	NC

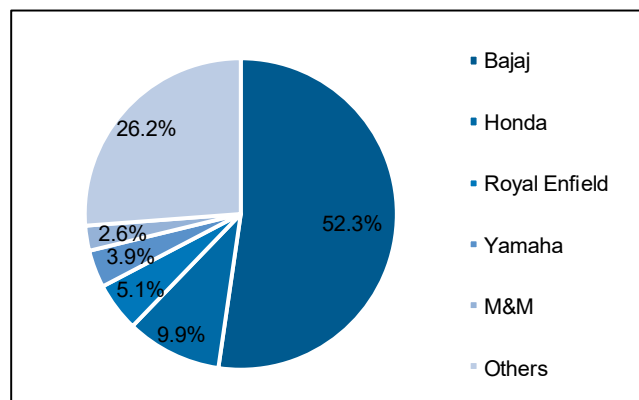
Source: Company data, I-Sec research

Table 2: Earnings revision

	FY21E			FY22E			FY23E
	Previous	New	Chg (%)	Previous	New	Chg (%)	Introduced
Sales	1,04,453	1,07,770	3.2	1,21,820	1,25,977	3.4	1,45,628
EBITDA	6,805	6,844	0.6	11,494	12,021	4.6	14,379
PAT	(1,442)	(2,295)	NC	2,305	2,214	(3.9)	4,016
EPS (Rs)	(10.7)	(17.0)	NC	17.1	16.4	(3.9)	29.8

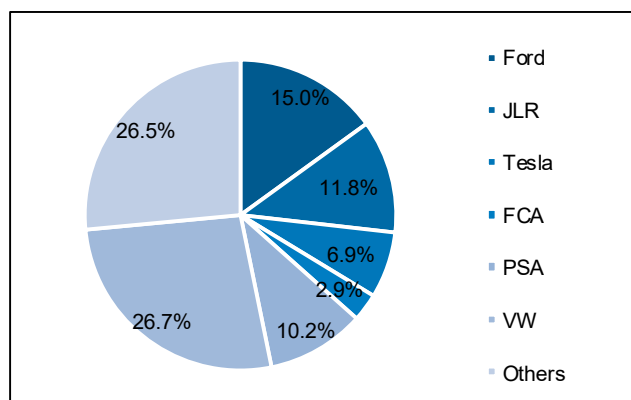
Source: Company data, I-Sec research

Chart 1: India – revenue split by customer



Source: Company data

Chart 2: VLS – revenue split by customer



Source: Company data

Valuation and recommendation

VLS remains an attractive play on the move towards higher LED penetration among global OEMs and cost reduction from the ramp-up of greenfield facilities. We expect VEL's revenue growth at ~16% CAGR over FY21-FY23E. We lower our FY22E EPS estimates by ~4% on account of higher interest, depreciation costs. Due to the mixing of global and domestic automotive exposures, we value the business on SoTP basis. We rollover to Sep'22E and value VLS and its China JV at 4x EV/EBITDA and 7x P/E Sep'22E, respectively, and India business at unchanged multiple of 8x EV/EBITDA Sep'22E to arrive at a SoTP-based target price of Rs491 (earlier: Rs412). Maintain **BUY**.

Table 3: Valuation summary

Business	Sep'22 (EBITDA/PAT)	Multiple	Current market value	Rs/share	Valuation remarks
VLS (ex-China)	8,410	4.0	33,640	250	EV/EBITDA; ~15% discount to global peers
India	4,557	8.0	41,195	306	EV/EBITDA; in-line with domestic peers
Net debt			-14,028	-104	
Equity Value			60,807	451	
China JV	766	7.0	5359	40	PE multiple; ~20% discount to regional peers
Total Value			66,166	491	

Source: I-Sec research

Financial summary

Table 4: Profit and loss statement
(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Total Op. Income (Sales)	111,219	107,770	125,977	145,628
Operating Expenses	103,011	100,926	113,956	131,249
EBITDA	8,208	6,844	12,021	14,379
<i>% margins</i>	<i>7.4%</i>	<i>6.4%</i>	<i>9.5%</i>	<i>9.9%</i>
Depreciation & Amortisation	7,319	8,818	9,508	10,133
EBIT	889	(1,974)	2,514	4,246
Other Income	989	841	857	986
Gross Interest	1,392	1,603	1,377	1,137
PBT	487	(2,736)	1,994	4,095
Less: Exceptionals	-	-	-	-
PBT after Exceptionals	487	(2,736)	1,994	4,095
Less: Taxes	370	(55)	439	901
Less: Minority Interest	23	5	12	29
Add: Profit from Associates	(92)	392	671	851
Net Income (Reported)	2	(2,295)	2,214	4,016
Net Income (Adjusted)	2	(2,295)	2,214	4,016

Source: Company data, I-Sec research

Table 5: Balance sheet
(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
ASSETS				
Current Assets	41,411	39,288	44,199	49,688
<i>Cash & cash eqv.</i>	<i>10,688</i>	<i>8,693</i>	<i>9,125</i>	<i>9,143</i>
Current Liabilities & Provisions	34,003	31,364	37,007	43,179
Net Current Assets	7,408	7,925	7,192	6,509
Investments	3,262	5,262	5,262	5,262
Total Fixed Assets	60,730	57,913	54,405	52,272
<i>Capital Work-in-Progress</i>	<i>7,901</i>	<i>7,901</i>	<i>7,901</i>	<i>7,901</i>
Other non-current asset	3,166	3,166	3,166	3,166
Total Assets	74,566	74,266	70,025	67,209
LIABILITIES				
Borrowings	35,424	37,424	31,424	25,424
<i>long-term borrowings</i>	<i>9,002</i>	<i>9,002</i>	<i>8,002</i>	<i>7,002</i>
<i>short-term borrowings</i>	<i>26,422</i>	<i>28,422</i>	<i>23,422</i>	<i>18,422</i>
Deferred Tax Liability Net	-842	-842	-842	-842
Other Non-current Liabilities	9,938	9,933	9,921	9,892
Equity Share Capital	135	135	135	135
Reserves & Surplus	29,910	27,616	29,387	32,600
Net Worth	30,045	27,751	29,522	32,735
Total Liabilities	74,566	74,266	70,025	67,209

Source: Company data, I-Sec research

Table 6: 5-stage Du-pont analysis
(year ending March 31)

<i>All figures in %</i>	FY20	FY21E	FY22E	FY23E
Tax Burden	0.0	0.8	1.1	1.0
Interest Burden	0.5	1.4	0.8	1.0
EBIT Margin	0.0	(0.0)	0.0	0.0
Asset Turnover	1.5	1.5	1.8	2.2
Financial Leverage	2.5	2.7	2.4	2.1
ROE	0.0	(7.9)	7.7	12.9

Source: Company data, I-Sec research

Table 7: Cashflow statement
(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Operating cashflow before working capital changes	8,712	8,126	13,099	15,286
Net Working Capital Changes	5,344	(2,512)	1,165	701
Others	-	-	-	-
Operating Cashflow	14,056	5,613	14,264	15,987
Capital Commitments	(9,774)	(6,000)	(6,000)	(8,000)
Free Cashflow	4,282	(387)	8,264	7,987
Cashflow from Investing Activities	(22,284)	(8,000)	(6,000)	(8,000)
Issue of Share Capital	-	-	-	-
Inc/(Dec) in minority interest	8	(5)	(12)	(29)
Inc/(Dec) in borrowings	11,031	2,000	(6,000)	(6,000)
Dividend paid	(493)	-	(443)	(803)
Interest paid	(1,392)	(1,603)	(1,377)	(1,137)
Others	0	-	(0)	0
Cashflow from Financing Activities	9,155	392	(7,832)	(7,969)
Net Cashflow	926	(1,995)	432	18
Opening Cash & Bank balance	1,634	10,688	8,693	9,125
Closing Cash & Bank balance	2,561	8,693	9,125	9,143
Increase / (Decrease) in Cash & cash equivalents	926	(1,995)	432	18

Source: Company data, I-Sec research

Table 8: Key ratios
(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Per Share Data (in Rs.)				
EPS (Basic)	0.0	(17.0)	16.4	29.8
EPS (Adjusted)	0.0	(17.0)	16.4	29.8
Cash EPS	54.3	48.4	86.9	105.0
Dividend per share (DPS)	3.7	-	3.3	6.0
BVPS (Adjusted)	224.7	207.7	220.7	244.3
Growth Ratios (%)				
Total Op. Income (Sales)	-8	-3	17	16
EBITDA	-22	-17	76	20
Net Income (Adjusted)	-100	NC	NC	81
EPS (Adjusted)	-100	NC	NC	81
Cash EPS	-26	-11	80	21
BVPS (Adjusted)	-2	-8	6	11
Valuation Ratios (x)				
P/E (Adjusted)	NC	NC	18.2	10.0
P/BV (Adjusted)	1.3	1.4	1.4	1.2
EV/EBITDA	7.5	9.3	4.8	3.6
EV/Sales	0.6	0.6	0.5	0.4

Return/Profitability Ratios (%)

EBITDA Margin	7.4	6.4	9.5	9.9
Net Income Margin (Adjusted)	0.0	-2.1	1.8	2.8
RoCE	3.1	-1.7	5.3	8.8
RoNW	0.0	-7.9	7.7	12.9
Dividend Payout Ratio	NC	-	20.0	20.0
Dividend Yield	1.2	-	1.1	2.0

Solvency/Wkg. Cap. Ratios (x)

Net D/E	0.7	0.8	0.6	0.3
Debt/EBITDA	4.3	5.5	2.6	1.8
EBIT/Interest	0.6	(1.2)	1.8	3.7
Current Ratio	1.2	1.3	1.2	1.2
Quick Ratio	0.9	0.9	0.9	0.8
Inventory (days)	35	37	36	36
Receivables (days)	36	40	39	39
Payables (days)	78	75	75	76

Source: Company data, I-Sec research

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