

# Varroc Engineering Ltd.

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VARROC/SE/INT/2020-21/36

August 21, 2020

To,

- (1) The Manager – Listing  
The Listing Department,  
**National Stock Exchange of India Limited**  
Exchange Plaza, Plot No. C/1, G Block,  
Bandra-Kurla Complex,  
Bandra (East), Mumbai-400051
- (2) The Manager - Listing  
The Corporate Relation Department,  
**BSE Limited**  
Phiroze Jeejeebhoy Towers,  
Dalal Street, Fort,  
Mumbai-400001

NSE Symbol: VARROC

BSE Security Code: 541578  
Security ID: VARROC

## **Sub: ICRA reaffirms Ratings for Varroc Engineering Ltd; Removes it from Rating Watch**

Dear Sir/Madam,

In compliance with Regulation 30(6) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, we wish to inform you that the Credit Rating of the Long-term Bank facilities of the Company has been removed from Rating Watch and has been reaffirmed at '[ICRA]AA- with negative outlook'. Further, the Credit Rating on the Company's Short-term, Bank facilities and Commercial Paper programme has been reaffirmed at '[ICRA]A1+'.

We request you to take the above on record and the same be treated as compliance under applicable provisions of the Listing Regulations.

**Yours faithfully,  
For Varroc Engineering Limited**

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**Ajay Sharma**  
**Group General Counsel and Company Secretary**

Encl: Letter received from ICRA Limited for Credit Rating

August 21, 2020

## Varroc Engineering Limited: Ratings removed from Rating Watch with Negative Implication and Negative outlook assigned on the long-term rating

### Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	170.65	605.37	[ICRA]AA- reaffirmed; Removed from rating watch with negative implication and Negative outlook assigned
Non-Convertible Debenture**	100.00	-	[ICRA]AA- (Negative) Withdrawn; Removed from rating watch with negative implication and Negative outlook assigned
Fund-based Facilities	343.85	22.35	[ICRA]AA- / [ICRA]A1+ reaffirmed; Removed from rating watch with negative implication and Negative outlook assigned on long term rating
Non-fund Based Facilities	152.00	132.50	[ICRA]AA- / [ICRA]A1+ reaffirmed; Removed from rating watch with negative implication and Negative outlook assigned on long term rating
Fund-based/ Non-fund Based Facilities	238.50	280.00	[ICRA]AA- / [ICRA]A1+ reaffirmed; Removed from rating watch with negative implication and Negative outlook assigned on long term rating
Commercial Paper	100.00	100.00	[ICRA]AA- / [ICRA]A1+ reaffirmed; Removed from rating watch with negative implication
<b>Total</b>	<b>1,105.00</b>	<b>1,140.22</b>	

\*Instrument details are provided in Annexure-1

\*\*The NCD is fully redeemed and there is no amount outstanding against the same

### Rationale

Varroc Engineering Limited<sup>1</sup> (VEL) is one of the leading auto component suppliers in India and among the leading automotive lighting suppliers globally. The rating factors in VEL's large scale of operations; diversified revenue mix across customers, products and automotive segments (two-wheeler, or 2W, and passenger vehicles, or PVs). The rating also factors in 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 compared to other peers in the similar rating category; and its dependence on the cyclical automotive industry and stiff competition from established and larger players in the global automotive lighting business.

In April 2020, ICRA had placed the ratings of VEL along with other group entities on rating watch with Negative implication due to the possible fall-out of the novel coronavirus (Covid-19) pandemic on the automotive industry globally and its

<sup>1</sup> VEL along with its other subsidiaries is referred to as Varroc Group

impact on VEL's financial profile. The ratings are now removed from rating watch, and a Negative outlook is assigned on the long-term rating due to expected pressure on profitability and coverage indicators of Varroc Group entities in FY2021. Gross debt ballooned during March 2020, as the company maintained sizable liquidity to tide over the Covid-19 impact during Q1 FY2021, although the net-debt (excluding lease liabilities) level was below Rs, 2,500 crore. ICRA expects total-debt/OPBIDTA (adjusted for lease liabilities) to remain around 3.0–3.5 times in FY2021, especially due to a significantly weak quarter during Q1 FY2021 when its performance across geographies was impacted by the Covid-19 related lockdown. However, ramp-up in new units along with several cost control measures should result in TD/OPBIDTA at around 2.2–2.5 times in FY2022.

VEL was under an investment phase during the last two years, which resulted in a high debt level without commensurate contribution to cash flows. The revenue contribution from new units for the confirmed orders along with improved content per vehicle (especially due to transition from halogen to LED lamps in Varroc Lighting Systems (VLS)) should aid VEL in outperforming the underlying industry growth rate over the next two years. In the likelihood of a sharp reduction in schedules from client OEMs, or delayed ramp-up for new greenfield plants set up at significant capex over the past 1-2 years, VEL's financial performance could weaken. Judicious working capital management along with timely ramp-up in new units remain crucial for company in addressing its deleveraging plans and maintaining prudent capital structure.

VEL was listed in FY2019 for an initial public offering (IPO) mainly 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.

## Key rating drivers and their description

### Credit strengths

**One of the largest Indian auto-component manufacturers** - The Varroc Group is one of the largest auto-component manufacturers in India with established relationships with its key customers. It has a strong order book share for supplying electrical, power-train and plastic components to Bajaj Auto Limited (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 PV OEMs globally, and is expected to benefit from the hybridisation and electrification trend of passenger vehicles over the medium to long-term.

**Diversified and reputed clientele** - VEL has a diversified customer mix with no single customer accounting for over 20% of its total revenues in FY2019. Its client profile is healthy, including reputed OEMs such as BAL, Ford Motor Company, Jaguar Land Rover Limited, Tesla Inc., FCA NV, Renault Nissan and Volkswagen AG (VW), among others. In the lighting business, VLS has added incremental orders from Volkswagen and Renault Nissan, which are expected to be key growth drivers over the medium term. In its Indian operations, the company has gained traction in its order book from 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.

**Diversified geographic presence** - VEL has a diversified geographic profile with presence across India (33%), Europe (49%) and North America (15%) during FY2020. Coupled with its entry by organic and inorganic expansion in Brazil, Morocco and Turkish markets, this has resulted in further de-risking of its business by means of geographical as well as customer diversification. Furthermore, the manufacturing footprint of VEL is extended to relatively low-cost countries, thus providing it a cost competitive advantage against other players in the European and North American markets.

## Credit challenges

**Exposed to the cyclical in automotive industry; ongoing slowdown likely to result in muted performance in near term** - VEL is exposed to the cyclical in the automotive industry, both in the domestic and overseas markets. Its subsidiaries cater to various automotive market segments globally, which have a muted growth outlook in the near term, given the uncertainty from the ongoing pandemic. 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, VEL has made sizable (~Rs. 2,000 crore) debt-funded investments over the last two years, which has resulted in deterioration in its capital structure. These units were in ramp-up mode and hence incurred operating losses due to sub-optimal capacity utilisation, dragging profitability and coverage indicators. The company has undertaken various cost rationalisation measures, which along with expected ramp-up in these new units should aid in deleveraging the capital structure, going forward. However, in the near term, the coverage indicators and return indicators are likely to remain weaker than other ICRA rated auto ancillaries at the similar rating level. Overseas subsidiaries have a negative working capital cycle, which results in high asset liability mismatch at the consolidated level. The company's ability to correct its asset liability mismatch remains crucial to allay liquidity concerns in the medium term.

**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, given that VEL is strategically placed in low cost regions (Mexico, Czech Republic, Morocco and Brazil, etc), which helps the firm in competing with much 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 the medium to long-term, given the improved traction in higher realisation content like LED, OLED and Xenon lighting, despite modest volume growth in the underlying PV industry.

## Liquidity position: Adequate

The company's liquidity profile remains adequate, supported by availability of surplus cash reserves along with undrawn credit facilities from the banking system for both the fund-based and non-fund based facilities with over Rs. 400 crore as on July 31, 2020 on a consolidated basis. Indian operations have sanctioned used bank lines of over Rs. 120 crore, thus adding to its financial flexibility in the event of any short-term fund mismatch. Currently, its international operations have cash and cash equivalents of over ~Rs. 175 crore, providing adequate liquidity cushion. Moreover, the Group is working on committed bank lines of over Rs. 250 crore, which may further support liquidity.

## Rating sensitivities

**Positive triggers** – Given the negative outlook, the long-term rating upgrade from the current level is unlikely in the near term. The outlook could be revised to Stable in case of improvement in the underlying demand environment in the industry, along with improvement in the company's coverage indicators.

**Negative triggers** – Negative pressure on the rating could arise in case of deterioration in the credit profile of the firm on a sustained basis (such that TD/OPBITDA>2.5x after adjustment for lease liability impact). 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	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Rating Methodology for Auto Component Manufacturers</a>
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, 2020, 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 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 a presence across Europe, North America, India and China.

## Key financial indicators (Consolidated)

Consolidated	FY2019	FY2020
Operating Income (Rs. crore)	12,076	11,147
PAT (Rs. crore)	418	13
OPBDIT/OI (%)	9.3%	7.6%
PAT/OI (%)	3.5%	0.1%
Total Outside Liabilities/Tangible Net Worth (times)	1.8	2.6
Total Debt/OPBDIT (times) – Adjusted**	2.2	4.6
Interest Coverage (times)	11.7	6.1

\*\*adjusted for lease liabilities

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

### Rating history for last three years:

Instrument	Type	Current Rating (FY2021)		Chronology of Rating History for the Past 3 Years				
		Amount Rated (Rs. crore)	Amount Outstanding* (Rs. crore)	Date & Rating in FY2021 August 2020	Date & Rating in FY2021 April 2020	Date & Rating in FY2020 August 2019	Date & Rating in FY2019 May 2018	Date & Rating in FY2018 November 2017
1 Term Loan	Long-term	605.37	339.83	[ICRA]AA- (Negative)	[ICRA]AA- @	[ICRA]AA- (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)
2 Non-Convertible Debenture	Long-term	-	-	-	[ICRA]AA- @	[ICRA]AA- (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)
3 Fund-based Facilities	Long-term/Short-term	22.35	9.50	[ICRA]AA- (Negative) / [ICRA]A1+	[ICRA]AA- @ / [ICRA]A1+ @	[ICRA]AA- (Stable) / [ICRA]A1+	[ICRA]AA- (Positive) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+
4 Non-fund Based Facilities	Long-term/Short-term	132.50	19.80	[ICRA]AA- (Negative) / [ICRA]A1+	[ICRA]AA- @ / [ICRA]A1+ @	[ICRA]AA- (Stable) / [ICRA]A1+	[ICRA]AA- (Positive) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+
5 Fund-based/ Non-fund Based Facilities	Long-term/Short-term	280.00	117.15	[ICRA]AA- (Negative) / [ICRA]A1+	[ICRA]AA- @ / [ICRA]A1+ @	[ICRA]AA- (Stable) / [ICRA]A1+	[ICRA]AA- (Positive) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+
6 Commercial Paper	Short-term	100.00	0.00	ICRA] A1+	ICRA]A1+@	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Source: VEL; \*: Amount outstanding as on June 30, 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](http://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%	Mar 2021	13.84	[ICRA]AA-(Negative)
NA	Term Loan-2	May 2016	9.00%	May 2021	5.72	[ICRA]AA-(Negative)
NA	Term Loan-3	May 2016	8.10%	Aug 2024	187.5	[ICRA]AA-(Negative)
NA	Term Loan-4	May 2017	8.55%	Aug 2022	27.78	[ICRA]AA-(Negative)
NA	Term Loan-5	Feb 2020	7.15%	Aug 2022	70.00	[ICRA]AA-(Negative)
NA	Term Loan-6	Nov 2019	7.45%	Dec 2024	35.00	[ICRA]AA-(Negative)
NA	Fund-based Facilities	-	NA	-	22.35	[ICRA]AA-(Negative)/[ICRA]A1+
NA	Non-fund Based Facilities	-	NA	-	132.50	[ICRA]AA-(Negative)/[ICRA]A1+
NA	Fund-based/ Non-fund Based Facilities	-	NA	-	280.00	[ICRA]AA-(Negative)/[ICRA]A1+
NA	Commercial Paper	-	NA	7-365 days	100.00	[ICRA]A1+

Source: VEL

## Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
<b>Direct Subsidiaries</b>		
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
<b>Step Down Subsidiaries</b>		
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

<b>Company Name</b>	<b>Ownership</b>	<b>Consolidation Approach</b>
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 İMALAT VE TİCARET ANONİM ŞİRKETİ.	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](http://www.icra.in)

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