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Nurturing Financial Excellence

IPO REPORT

“Subscribe with Caution” to
Varroc Engineering Ltd.

Strong fundamentals but valuation not supportive

Salient features of the IPO:

- Aurangabad-based auto component maker **Varroc Engineering Ltd. (Varroc)** is coming with an IPO by offering 20.22mn share between the price range Rs. 965 - 967 per share. The IPO size is in the range of Rs. 19,514 - 19,554.4mn.
- The issue is fully OFS, the company will not receive any proceeds from it.

Key competitive strengths:

- Strong competitive position in attractive growing markets
- Strong, long-standing customer relationships
- Comprehensive product portfolio
- Low cost, strategically located manufacturing and design footprint
- Robust in-house technology, innovation and R&D capabilities
- Consistent track record of operational & financial efficiency

Risk and concerns:

- Subdued economic activities
- Delay in the proposed geographic expansion
- Poor ramp up in the domestic business
- Volatility in the currency rates

Valuation & recommendation:

At the higher price band of Rs. 967 per share, Varroc's share is valued at a P/E multiple of 29x (to its restated FY18 EPS of Rs. 33.4) as compared to the peers average of 23.1x.

Below are few key observations of the issue: (For detailed valuation, refer to page 9 & 10 of the report)

- Varroc is the sixth largest manufacturer in the global exterior automotive lighting space with a market share of around 4%. Also it is among the top three independent exterior lighting players in the globe. Being an independent player, the company has the benefit to target any market with its own product technology. Moreover, in the global premium vehicle market, Varroc has a market share of 6%. In the electric vehicle market, the company has a market share of 20% and is one percent point lower than the market leader.
- Its global clientele includes marquee auto manufacturers across the premium, mid-range and mass market pricing spectrum and includes Ford, Jaguar Land Rover, the Volkswagen Group, Renault-Nissan-Mitsubishi, Groupe PSA, FCA etc. Its domestic customers include Bajaj Auto, Royal Enfield, Yamaha, Suzuki, Honda, Hero, Piaggio etc. Varroc has strong long standing relationship with many of its customers and this can be demonstrated by the fact that since 1990 not a single customer has left the company.
- Varroc has global manufacturing footprint with 36 manufacturing facilities spread across seven countries. Its manufacturing facilities are located in low cost countries like Mexico, the Czech Republic, China (through JV) and India, which allows it to serve North America, Europe, China and Indian market. Further to serve the South American market and Southern Europe & North African market, the company is setting up a facility in Brazil and Morocco, which are expected to commence production in FY19. Through these expansions, it would be in a position to target 85% of the global automotive market.
- During 2014-16, Varroc's lighting business was the fastest growing among its peer set. This business grew by 27.5% CAGR and was higher by 10.5ppts higher than the second fastest growing company in the same period. We are of the view, that with the above proposed expansion and positive outlook for the global and domestic operations, the company would continue to beat its peer set in terms of business growth.
- The company has reported a solid financial performance over FY15-18. During the period, it reported a 14.3% CAGR rise in the total operating revenue to Rs. 103,784.6mn in FY18. Consolidated EBITDA increased by 12.5% CAGR to Rs. 8,775.7mn in FY18. Average EBITDA margin during the period stood at 7.6%. Reported PAT increased by 226.3% CAGR to Rs. 4,502.6mn in FY18. Average PAT margin during the period stood at 3%. Cash flow from operations remained positive and increased by 103.1% CAGR over FY15-18. Total debt declined by 11.3% CAGR, with debt equity ratio improving from 1.3x in FY15 to 0.3x in FY18. Average RoE and RoCE stood at 12.9% and 11.9%, respectively, during the period.
- Based on our quick estimate, for FY19 we are anticipating a top-line of Rs. 115,361.4mn (a growth of 11.2% over FY18) and an EPS of 36.6 per share (a growth of 9.6% over FY18). EBITDA and PAT margin are anticipated at 8.9% and 4.3%, respectively. In FY20, top-line is expected to grow by 14.3% while EPS to grow by 20.8%.

On valuation front, at higher price band, the company is demanding a P/E valuation of 29x (to its restated FY18 EPS of Rs. 33.4) as against the peer average of 23.1x. With respect to FY19 and FY20 EPS too, it is asking a premium valuation to its peers. Thus, the issue seems to be fully priced. However, considering the global market position, future strong growth outlook, low profitability and expensive valuation, we assign a **"Subscribe with Caution"** rating to the issue.

| Recommendation | Subscribe with Caution |
|---------------------------------------|--|
| Price Band (Rs.) | Rs. 965 - 967 per Share |
| Face Value (Rs.) | Rs. 1 |
| Shares for Fresh Issue (mn) | Nil |
| Shares for OFS (mn) | 20.22mn Shares |
| Fresh Issue Size (Rs. mn) | N/A |
| OFS Issue Size (Rs. mn) | Rs. 19,514 - 19,554.4mn |
| Total Issue Size (Rs. mn) | Rs. 19,514 - 19,554.4mn |
| Bidding Date | 26 th Jun. - 28 th Jun. 2018 |
| MCAP at Higher Price Band | Rs. 130,363mn |
| Enterprise Value at Higher Price Band | Rs. 136,844mn |
| Book Running Lead Manager | Kotak Mahindra Capital Company Ltd., Citigroup Global Markets India Pvt. Ltd., Credit Suisse Securities (India) Pvt. Ltd. and IIFL Holdings Ltd. |
| Registrar | Link Intime India Pvt. Ltd. |
| Sector/Industry | Auto Parts & Equipment |
| Promoters | Mr. Tarang Jain |

| Pre and post - issue shareholding pattern | | |
|---|----------------|----------------|
| | Pre - Issue | Post - Issue |
| Promoter and Promoter Group | 86.30% | 85.00% |
| Public | 13.70% | 15.00% |
| Total | 100.00% | 100.00% |

| Retail Application Money at Higher Cut-Off Price per Lot | |
|--|---------------------------|
| Number of Shares per Lot | 15 |
| Application Money | Rs. 14,505 per Lot |
| Employee Discount | Rs. 48 on the Offer Price |

| Analyst | |
|---|--|
| Raj Nath Yadav | |
| Research Analyst (022 - 6707 9999; Ext: 912) | |
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About the issue:

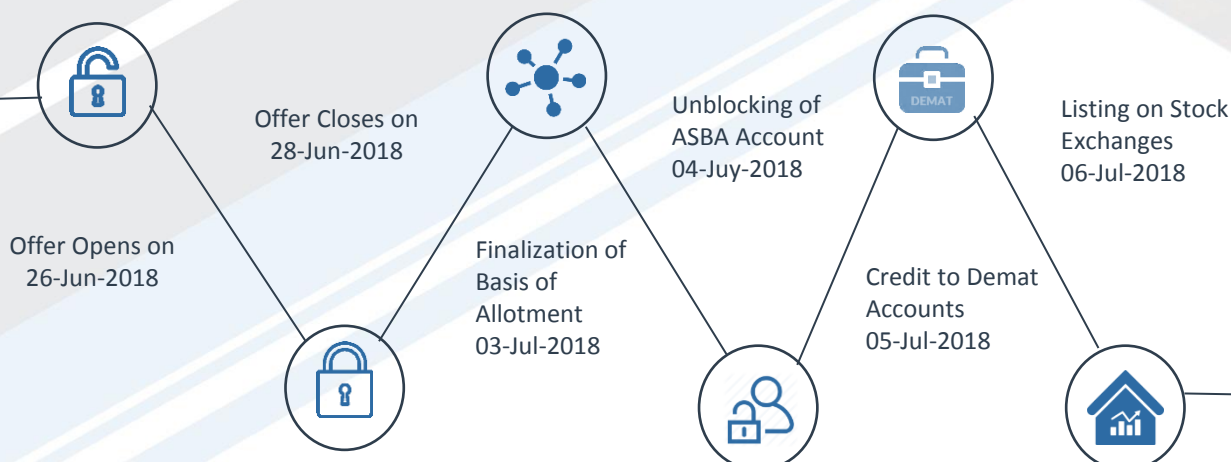
- Varroc is coming up with an initial public offering (IPO) with 20.22mn shares (fresh issue: nil; OFS shares: 20.22mn shares) in offering. The offer represents around 15% of its post issue paid-up equity shares of the company. Total IPO size is Rs. 19,514 - 19,554.4mn.
- 0.1mn shares are reserved for eligible employees. Thus the net issue comprises of 20.12mn shares.
- The issue will open on 26th Jun. 2018 and close on 28th Jun. 2018.
- The issue is book building with a price band of Rs. 965 - 967 per share.
- The employee discount is Rs. 48 per share on the offer price.
- Since the issue is fully OFS, the company will not receive any proceeds from it.
- Its promoter holds 86.30% stake in the company and post IPO this will come down to 85.00%. Public holding will increase from current 13.70 to 15.00%.

Pre and Post Issue Shareholding Pattern (%)

| | Pre Issue | Post Issue (at higher price band) |
|-------------------------------|-----------|-----------------------------------|
| Promoter & Promoter Group (%) | 86.30% | 85.00% |
| Public (%) | 13.70% | 15.00% |

Source: Company RHP

Indicative IPO Process Time Line:

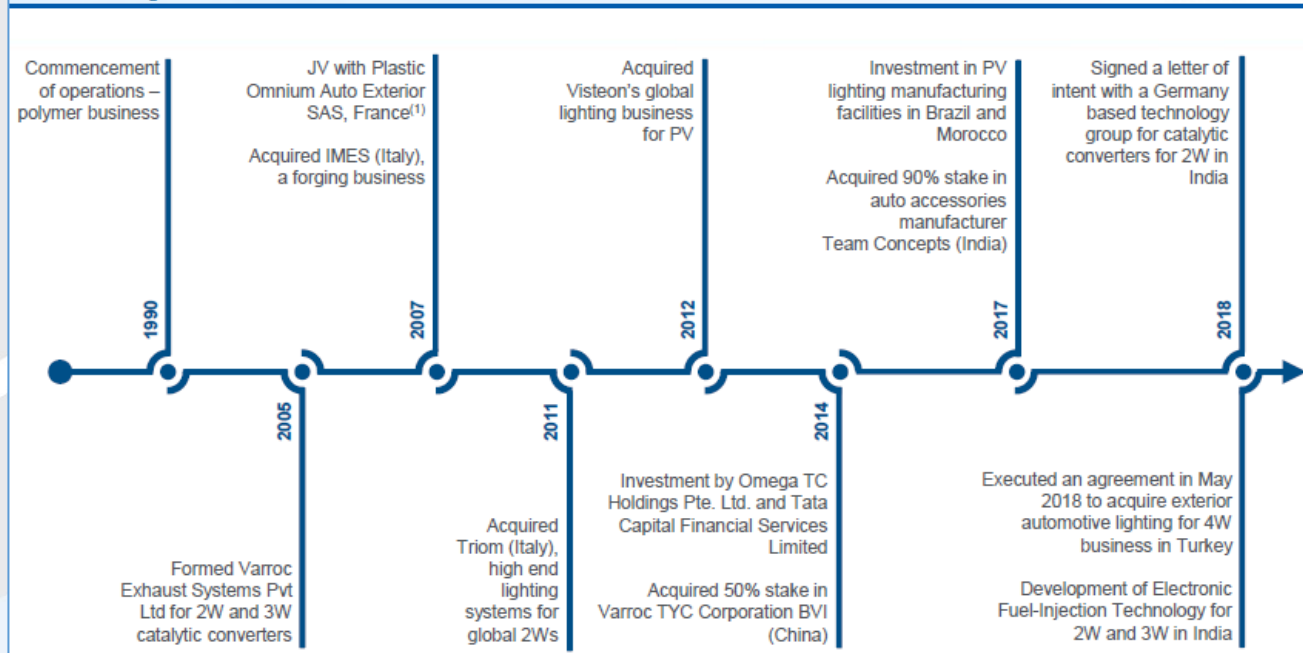


Company Introduction:

Varroc is a global tier-1 (tier-1 companies are companies that directly supply to original equipment manufacturers (OEM)) automotive component group. It designs, manufactures and supply exterior lighting systems, plastic and polymer components, electricals-electronics components, and precision metallic components to passenger car, commercial vehicle, two-wheeler, three-wheeler and off highway vehicle OEMs directly worldwide. The company is the second largest Indian auto component group (by consolidated revenue for FY17) and is a leading tier-1 manufacturer and supplier to Indian two-wheeler and three-wheeler OEMs (by consolidated revenue for FY17) (Source: Company RHP). Also the company is the sixth-largest global exterior automotive lighting manufacturer and one of the top three independent exterior lighting players (by market share in 2016; Source: Company RHP).

Varroc commenced operations with its polymer business in 1990. Initially it grew organically in India by adding new business lines, such as electrical division and metallic division. Subsequently, the company diversified its product offerings and expanded the production capacity through various investments, joint ventures and acquisitions. Most notable acquisitions includes its 2012 acquisition of Visteon's global lighting business, now known as Varroc Lighting Systems (VLS). Prior to the acquisition of Visteon's global lighting business, in 2007 the company acquired I.M.E.S (a manufacturer of hot steel forged parts for the construction and oil & gas industries) in Italy and in 2011 it acquired Triom (a manufacturer of high end lighting systems for global motorcycle OEMs) with operations in Italy, Romania and Vietnam. In 2013, Varroc expanded its global lighting business by acquiring Visteon's holding in a 50/50 joint venture with Beste Motor Co. Ltd. to manufacture automotive lighting in China, namely Varroc TYC. On 13th Feb. 2018, Varroc entered into a joint venture with Dell'Orto S.p.A. for the development of electronic fuel injection control systems for two-wheelers and three wheelers.

Transformation into an Auto Component Group with Global Presence


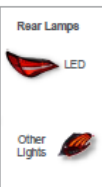
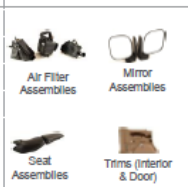


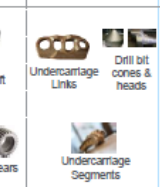
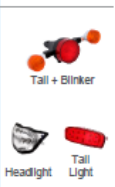


Source: Company RHP

Company Introduction (Contd...):

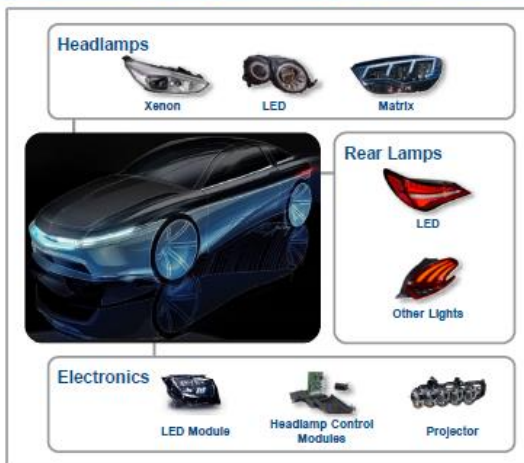
Auto Component Business with Diversified Product Lines



| Description | VLS | | Varroc's India Business | | | | Other | |
|----------------------------|---|--|---|---|---|--|-------|--|
| | PV Lighting | Polymer | Electrical | Metallic | IMES | Triom | | |
| | <ul style="list-style-type: none"> Leading global supplier of exterior automotive lighting systems for PV | <ul style="list-style-type: none"> One of the largest polymer solution providers to the 2W OEMs with a Pan-India presence | <ul style="list-style-type: none"> Offers comprehensive solutions in electrical-electronics components, assemblies for automotive applications and lighting products | <ul style="list-style-type: none"> Supplies precision forged & machined parts for engines and transmissions Supplies engines valves in domestic and international markets | <ul style="list-style-type: none"> Manufactures hot steel forged parts for the construction and oil & gas industries | <ul style="list-style-type: none"> High end lighting systems for the global 2W industry | | |
| Select Product Portfolio |   |  |  |  |  |  | | |
| Manufacturing Facilities | 6 Facilities – Czech Republic (2), China (2), Mexico & India 2 upcoming Facilities – Brazil & Morocco | 15 Facilities – India ⁽¹⁾ | 7 Facilities – India ⁽¹⁾ 2 upcoming Facilities – India | 5 Facilities – India ⁽¹⁾ | 2 Facilities – Italy | 3 Facilities - Italy, Romania and Vietnam | | |
| Revenue Mix ⁽²⁾ | 60.8% | 16.0% | 10.2% | 6.3% | 4.1% ⁽³⁾ | | | |
| Customer Segment | PV | 2W, 3W, PV & CV | 2W, 3W, PV & CV | 2W, 3W, PV, CV & OHV | Earth-moving & Oil-drilling | 2W | | |

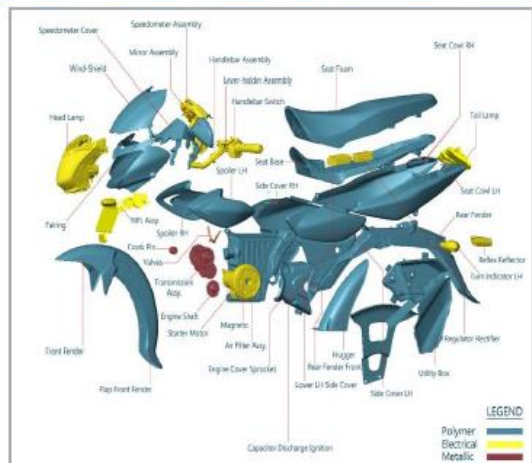
A diversified product portfolio catering to 2W, 3W, PV, CV & OHV Segments
Low-cost strategically located global manufacturing facilities; pan-India presence near major auto hubs

Broad Portfolio of Lighting Technologies for PV OEMs Globally



- Products including headlamps, rear lamps, fog lamps and center high mount stop lamps
- Established presence in key emerging technologies such as LED, Laser, Matrix, OLED

Comprehensive Solution Provider to 2 Wheeler OEMs in India



- Wide range of products across polymer, electrical and metallic segments
- One-stop shop for customers enabling cross-selling

End to end capabilities across design, R&D/Engineering, testing/validation, tooling, manufacturing and delivery

Source: Company RHP

Company Introduction (Contd...):

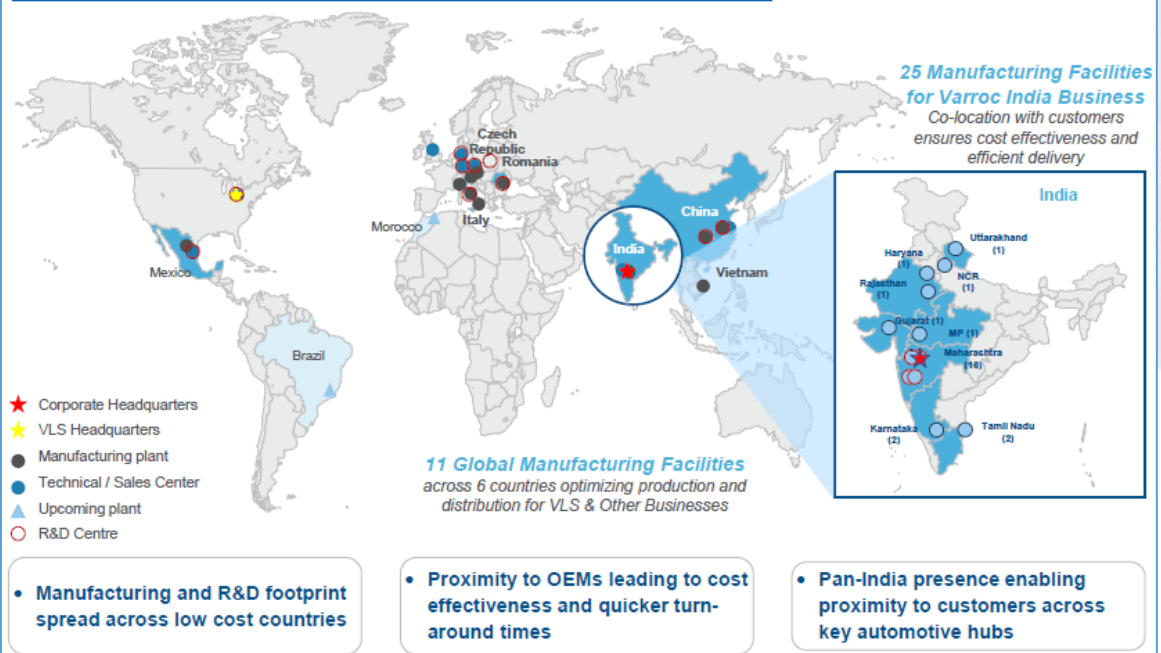
Varroc has end-to-end capabilities across design, R&D, engineering, testing, manufacturing and supply of various products across its business. The company has two primary business lines, namely (i) the design, manufacture and supply of exterior lighting systems to passenger cars OEMs worldwide (Global Lighting Business), which it undertake through subsidiaries forming part of the VLS group and (ii) the design, manufacture and supply of a wide range of auto components in India (India Business), primarily to two-wheeler and three-wheeler OEMs, including exports. The India Business offers a diversified set of products across three product lines, namely polymers/plastics, electrical/electronics and metallic components. Additionally, Varroc has other smaller businesses, which include the design, manufacture and supply of two-wheeler lighting to global OEMs, and under carriage forged machine components for off highway vehicles and drill bits for the oil & gas sector (Other Businesses).

The company has expanded its manufacturing and R&D footprint by investing in nine manufacturing plants and an additional R&D center in India since 2012. As of 31st Mar. 2018, its Global Lighting Business had 185 patents. It continues to expand its manufacturing and R&D footprint, and is in the process of setting up one manufacturing facility in Brazil and one manufacturing facility in Morocco and intend to set up two manufacturing facilities in India. Varroc intends to continue to improve its manufacturing processes and systems, as well as invest in new technology areas to further expand the business. Varroc's goal is to bring leading technologies to the mainstream markets with high quality, cost competitive solutions.

Low Cost, Strategically Located Global Manufacturing Footprint



36 Manufacturing Facilities and 16 R&D Centers Across Asia, Europe and North America



Source: Company RHP

Competition: The automotive component industry is extremely competitive and it faces intense competition both domestically and internationally. The key factors of competition are quality, cost, delivery, development and management. Typically, large suppliers work only with a limited number of OEMs. Consequently, the company do not have a single competitor across all its product ranges.

Company Introduction (Contd...):

Financial performance: On the back of growth across the segments, Varrco reported a 14.3% CAGR rise in the total operating revenue over FY15-18 to Rs. 103,784.6mn in FY18. Global Lighting Business and India Business reported 12.5% and 19.8% CAGR growth in the business over the same period. Moreover, top-line were also affected by the favorable movement in the currencies of the countries where it is operating.

Cost of goods sold, which formed around 60% of the top-line increased by 14.7% CAGR over FY15-18. Employee expenses and other expenses increased by 13.3% and 17.2% CAGR, respectively. Consequently, total operating expenses increased in-line with top-line to 14.5% CAGR during the period. Consolidated EBITDA increased by 12.5% CAGR over FY15-18 to Rs. 8,775.7mn in FY18. Average EBITDA margin during the period stood at 7.6%.

Depreciation & amortization charges increased by 15% CAGR, while finance cost declined by 43.4% CAGR during FY15-18. As a result, reported PAT increased by 226.3% CAGR to Rs. 4,502.6mn in FY18. Average PAT margin during the period stood at 3%. Cash flow from operations increased from Rs. 1,283.4mn in FY15 to Rs. 10,748.5mn in FY18, i.e. a growth of 103.1% CAGR over FY15-18. Total debt declined by 11.3% CAGR to Rs. 9,800.7mn in FY18. Debt equity ratio improved from 1.3x in FY15 to 0.3x in FY18. Average RoE and RoCE stood at 12.9% and 11.9%, respectively, during the period.

| | FY15 | FY16 | FY17 | FY18 | CAGR (%) | Y-o-Y (%) |
|-------------------------------------|-----------------|-----------------|-----------------|------------------|--------------|-------------|
| Global Lighting Business | 44,330 | 48,198 | 61,242 | 63,118 | 12.5% | 3.1% |
| India Business | 21,188 | 30,807 | 31,681 | 36,406 | 19.8% | 14.9% |
| Other Business | 3,989 | 3,185 | 3,163 | 4,261 | 2.2% | 34.7% |
| Total Operating Revenue | 69,507.7 | 82,189.0 | 96,085.4 | 103,784.6 | 14.3% | 8.0% |
| EBITDA | 6,168.8 | 5,709.5 | 5,817.6 | 8,775.7 | 12.5% | 50.8% |
| Reported PAT | 129.6 | 3,693.6 | 3,030.1 | 4,502.6 | 226.3% | 48.6% |
| Restated Adjusted EPS | 1.0 | 27.4 | 22.5 | 33.4 | 226.3% | 48.6% |
| Cash Flow from Operating Activities | 1,283.4 | 2,904.9 | 6,765.0 | 10,748.5 | 103.1% | 58.9% |
| FCF | 653.5 | 263.2 | (1,896.8) | 2,584.8 | 58.1% | -236.3% |
| NOPLAT | 962.9 | 3,435.9 | 2,268.7 | 4,319.0 | 64.9% | 90.4% |
| RoIC (%) | 5.1% | 11.9% | 8.8% | 14.5% | 934 bps | 567 bps |
| Revenue Growth Rate (%) | 13.6% | 18.2% | 16.9% | 8.0% | | |
| EBITDA Growth Rate (%) | 54.4% | -7.4% | 1.9% | 50.8% | | |
| EBITDA Margin (%) | 8.9% | 6.9% | 6.1% | 8.5% | (42) bps | 240 bps |
| EBIT Growth Rate (%) | 124.7% | -23.2% | -12.2% | 100.7% | | |
| EBIT Margin (%) | 5.2% | 3.4% | 2.5% | 4.7% | (49) bps | 219 bps |
| Reported PAT Growth Rate (%) | -69.2% | 2750.7% | -18.0% | 48.6% | | |
| Reported PAT Margin (%) | 0.2% | 4.5% | 3.2% | 4.3% | 415 bps | 118 bps |
| Inventories Turnover Ratio (x) | 11.9 | 13.0 | 13.4 | 12.8 | 2.7% | -4.1% |
| Trade Receivable Turnover Ratio (x) | 6.5 | 7.3 | 8.3 | 8.2 | 8.0% | -1.2% |
| Accounts Payable Turnover Ratio (x) | 7.1 | 7.5 | 7.1 | 6.0 | -5.6% | -15.6% |
| Fixed Asset Turnover Ratio (x) | 3.5 | 3.4 | 3.6 | 3.3 | -1.2% | -7.4% |
| Total Asset Turnover Ratio (x) | 1.6 | 1.6 | 1.6 | 1.5 | -1.2% | -7.6% |
| Current Ratio (x) | 0.9 | 0.9 | 1.0 | 1.0 | 0.8% | -0.8% |
| Debt to Equity (x) | 1.3 | 0.8 | 0.6 | 0.3 | -35.4% | -44.0% |
| Net Debt to EBITDA (x) | 2.1 | 2.1 | 1.7 | 0.7 | -29.8% | -57.1% |
| RoE (%) | 1.2% | 20.7% | 13.7% | 15.8% | 1,463 bps | 207 bps |
| RoA (%) | 0.3% | 7.0% | 5.2% | 6.6% | 628 bps | 140 bps |
| RoCE (%) | 15.9% | 10.4% | 8.0% | 13.3% | (252) bps | 537 bps |

Source: Company RHP



Competitive Strengths:

- Strong competitive position in attractive growing markets
- Strong, long-standing customer relationships
- Comprehensive product portfolio
- Low cost, strategically located manufacturing and design footprint
- Robust in-house technology, innovation and R&D capabilities
- Consistent track record of growth and operational and financial efficiency

Business Strategy:

- Focus on high growth markets for Global Lighting Business
- Focus on increasing customer revenue for the India Business
- Continue to invest in R&D, design, engineering and software capabilities in order to capitalize on future trends
- Pursue strategic joint ventures and inorganic growth opportunities
- Focus on operational efficiency



Risk and Concerns:

- Subdued economic activities
- Delay in the proposed geographic expansion
- Lower or change in the business pattern from the customers
- Poor ramp up in the domestic business
- Poor pricing power
- Volatility in the currency rates

Peer Comparison and Valuation:

| Company Name | Currency | CMP (Rs.) | MCAP (Rs. mn) | EV (Rs. mn) | Total Operating Revenue (Rs. mn) | EBITDA (Rs. mn) | PAT (Rs. mn) | EBITDA Margin (%) | PAT Margin (%) |
|--------------------------------|----------|------------|----------------|----------------|----------------------------------|-----------------|----------------|-------------------|----------------|
| Varroc Engineering Ltd. | INR | 967 | 130,363 | 136,844 | 103,784.6 | 8,775.7 | 4,502.6 | 8.5% | 4.3% |
| Bharat Seats Ltd. | INR | 176 | 5,523 | 5,722 | 10,013.8 | 646.1 | 282.2 | 6.5% | 2.8% |
| Sandhar Technologies Ltd. | INR | 397 | 23,887 | 23,477 | 19,841.2 | 2,082.9 | 650.2 | 10.5% | 3.3% |
| Bosch Ltd. | INR | 17,969 | 548,413 | 520,245 | 118,722.4 | 20,932.0 | 13,710.2 | 17.6% | 11.5% |
| India Nippon Electrical Ltd. | INR | 491 | 11,112 | 9,874 | 4,664.0 | 643.0 | 498.0 | 13.8% | 10.7% |
| Pricol Ltd. | INR | 67 | 6,361 | 10,068 | 17,400.9 | 816.3 | -489.5 | 4.7% | -2.8% |
| Sharda Motor Industries Ltd. | INR | 1,960 | 11,655 | 9,877 | 12,042.6 | 1,454.4 | 879.7 | 12.1% | 7.3% |
| Jamna Auto Industries Ltd. | INR | 87 | 34,786 | 35,134 | 17,573.2 | 2,378.2 | 1,253.1 | 13.5% | 7.1% |
| Lumax Auto Technologies Ltd. | INR | 148 | 10,108 | 9,652 | 11,385.1 | 1,015.8 | 487.4 | 8.9% | 4.3% |
| Minda Industries Ltd. | INR | 1,263 | 109,894 | 113,728 | 45,482.9 | 5,338.2 | 3,101.9 | 11.7% | 6.8% |
| Motherthon Sumi Systems Ltd. | INR | 307 | 645,587 | 712,532 | 565,213.0 | 48,269.3 | 15,970.1 | 8.5% | 2.8% |
| Koito Manufacturing Co., Ltd. | JPY | 7,770 | 1,249,416 | 1,052,216 | 848,900.0 | 136,100.0 | 84,900.0 | 16.0% | 10.0% |
| Valeo SA | EUR | 52 | 12,345 | 14,842 | 18,550.0 | 2,427.0 | 945.0 | 13.1% | 5.1% |
| Stanley Electric Co., Ltd. | JPY | 3,870 | 679,572 | 598,972 | 442,200.0 | 87,200.0 | 38,900.0 | 19.7% | 8.8% |
| Hella Gmbh & Co. KGaA | EUR | 54 | 6,016 | 6,271 | 6,939.0 | 1,004.5 | 398.6 | 14.5% | 5.7% |
| SL Corp. | KRW | 19,450 | 659,355 | 559,955 | 1,455,800.0 | 98,500.0 | 60,400.0 | 6.8% | 4.1% |
| Visteon Corporation | USD | 136 | 4,025 | 3,993 | 3,150.0 | 361.4 | 210.3 | 11.5% | 6.7% |
| Average | | | | | | | | 11.8% | 5.9% |

| Company Name | Currency | EPS (Rs.) | BVPS (Rs.) | DPS (Rs.) | Debt Equity Ratio | Fixed Asset Turnover Ratio | RoE (%) | RoCE (%) | P / E (x) | P / B (x) | EV / Sales (x) | EV / EBITDA (x) | MCAP / Sales (x) | Earnings Yield (%) |
|--------------------------------|----------|-------------|--------------|------------|-------------------|----------------------------|--------------|--------------|-------------|------------|----------------|-----------------|------------------|--------------------|
| Varroc Engineering Ltd. | INR | 33.4 | 211.3 | 0.5 | 0.3 | 3.3 | 15.8% | 13.3% | 29.0 | 4.6 | 1.3 | 15.6 | 1.3 | 3.5% |
| Bharat Seats Ltd. | INR | 9.0 | 27.6 | 0.9 | 0.3 | 6.7 | 32.5% | 37.2% | 19.6 | 6.4 | 0.6 | 8.9 | 0.6 | 5.1% |
| Sandhar Technologies Ltd. | INR | 10.8 | 105.8 | 0.0 | 0.3 | 2.6 | 10.2% | 16.2% | 36.7 | 3.7 | 1.2 | 11.3 | 1.2 | 2.7% |
| Bosch Ltd. | INR | 449.2 | 3,267.5 | 100.0 | 0.0 | 8.2 | 13.7% | 15.6% | 40.0 | 5.5 | 4.4 | 24.9 | 4.6 | 2.5% |
| India Nippon Electrical Ltd. | INR | 22.0 | 151.4 | 3.0 | 0.0 | 6.6 | 14.5% | 16.9% | 22.3 | 3.2 | 2.1 | 15.4 | 2.4 | 4.5% |
| Pricol Ltd. | INR | (5.2) | 70.2 | 1.0 | 0.7 | 1.9 | -7.4% | -0.4% | (13.0) | 1.0 | 0.6 | 12.3 | 0.4 | -7.7% |
| Sharda Motor Industries Ltd. | INR | 147.9 | 646.7 | 6.3 | 0.0 | 6.7 | 22.9% | 26.2% | 13.2 | 3.0 | 0.8 | 6.8 | 1.0 | 7.5% |
| Jamna Auto Industries Ltd. | INR | 3.1 | 10.6 | 0.9 | 0.1 | 5.3 | 29.6% | 39.5% | 27.8 | 8.2 | 2.0 | 14.8 | 2.0 | 3.6% |
| Lumax Auto Technologies Ltd. | INR | 7.2 | 70.6 | 2.0 | 0.0 | 4.3 | 10.1% | 15.4% | 20.7 | 2.1 | 0.8 | 9.5 | 0.9 | 4.8% |
| Minda Industries Ltd. | INR | 35.6 | 184.1 | 1.6 | 0.3 | 2.9 | 19.4% | 16.0% | 35.4 | 6.9 | 2.5 | 21.3 | 2.4 | 2.8% |
| Motherthon Sumi Systems Ltd. | INR | 7.6 | 61.0 | 2.3 | 0.7 | 3.3 | 12.4% | 15.1% | 40.4 | 5.0 | 1.3 | 14.8 | 1.1 | 2.5% |
| Koito Manufacturing Co., Ltd. | JPY | 528.0 | 2,553.0 | 96.0 | 0.1 | 1.3 | 22.3% | 20.9% | 14.7 | 3.0 | 1.2 | 7.7 | 1.5 | 6.8% |
| Valeo SA | EUR | 3.9 | 18.6 | 1.3 | 0.8 | 1.2 | 20.8% | 12.5% | 13.1 | 2.8 | 0.8 | 6.1 | 0.7 | 7.7% |
| Stanley Electric Co., Ltd. | JPY | 221.5 | 2,092.5 | 45.0 | 0.0 | 0.9 | 10.9% | 11.0% | 17.5 | 1.8 | 1.4 | 6.9 | 1.5 | 5.7% |
| Hella Gmbh & Co. KGaA | EUR | 3.6 | 21.3 | 0.9 | 0.6 | 1.2 | 16.3% | 10.9% | 15.1 | 2.5 | 0.9 | 6.2 | 0.9 | 6.6% |
| SL Corp. | KRW | 1,781.7 | 28,018.6 | 400.0 | 0.2 | 0.9 | 10.2% | 8.6% | 10.9 | 0.7 | 0.4 | 5.7 | 0.5 | 9.2% |
| Visteon Corporation | USD | 7.1 | 16.9 | 0.0 | 0.5 | 1.4 | 28.8% | 18.5% | 19.1 | 8.1 | 1.3 | 11.0 | 1.3 | 5.2% |
| Average | | | | | 0.3 | 3.5 | 16.7% | 17.5% | 23.1 | 4.0 | 1.4 | 11.5 | 1.4 | 4.3% |

Note: Market data and per share data in their respective currency;

Source: Choice Broking Research

At the higher price band of Rs. 967 per share, Varroc's share is valued at a P/E multiple of 29x (to its restated FY18 EPS of Rs. 33.4) as compared to the peers average of 23.1x.

Below are few key observations of the issue:

- Varroc is primarily involved into the design, manufacturing and supply of vehicle lighting. It has products across every lighting technology i.e. halogen, xenon, LED and laser. Because of its diversified vehicle lighting products, the company is in a position to target any market and any OEM from its low cost traditional (halogen, xenon etc.) as well as high end lighting products (LED, laser etc.). It operates this business under the segment Global Lighting Business and is largely sold to the global passenger vehicle OEMs. Over FY15-18, this segment contributed around 60% to the consolidated revenue.

Peer Comparison and Valuation (Contd...):

- The company is also involved in the design, manufacturing and sale of wide auto components in India, primarily catering to the 2Ws and 3Ws OEMs. Its diversified set of auto products includes polymer/plastics, electricals/electronics and metallic components. Over FY15-18, this segment contributed around 35% to the consolidated revenue.
- Varroc is the sixth largest manufacturer in the global exterior automotive lighting space with a market share of around 4%. Also it is among the top three independent exterior lighting players in the globe. Being an independent player, the company has the benefit to target any market with its own product technology. Also in the global premium vehicle market, Varroc has a market share of 6%. In the electric vehicle market, the company has a market share of 20% and is one percent point lower than the market leader.
- Its global clientele includes marquee auto manufacturers across the premium, mid-range and mass market pricing spectrum and includes Ford, Jaguar Land Rover, the Volkswagen Group, Renault-Nissan- Mitsubishi, Groupe PSA, FCA, a European multinational car manufacturer and an American electric car manufacturer. Its domestic customers include Bajaj Auto, Royal Enfield, Yamaha, Suzuki, Honda, Hero, Piaggio etc. Varroc has strong long standing relationship with many of its customers and this can be demonstrated by the fact that since 1990 not a single customer has left the company. Through its diversified low cost products, it is continuously adding new customers both in domestic and global market. From FY14 to FY18, the company has increased the number of customers to whom it invoices over Euro 5mn per year from seven to nine. Moreover, there is little revenue concentration risk as its top three customers contribute around 34% and 25% to the global and domestic business, respectively, in FY18.
- Varroc has global manufacturing footprint with 36 manufacturing facilities spread across seven countries. Its manufacturing facilities are located in low cost countries like Mexico, the Czech Republic, China (through JV) and India, which allows it to serve North America, Europe, China and Indian market. In 2016, these markets accounted for 80% of the global passenger vehicle (PV) and light commercial vehicle (LCV) sales. In FY18, the global facilities were operating at around 80% capacity utilization, while domestic facilities were operating at around 50-60%.
- Further to serve the South American market and Southern Europe & North African market, the company is setting up a facility in Brazil and Morocco, which are expected to commence production in FY19. Through these expansions, it would be in a position to target 85% of the global automotive market. Additionally, Varroc has signed an agreement to acquire an exterior automotive lighting company based in Turkey and the sale is anticipated to conclude by the end of Jun. 2018.
- According to Yole, during 2011-16, global PV and LCV sales increased by 3.8% CAGR, while global automotive exterior lighting market grew by 4.5%. Over 2016-21, lighting market is anticipated to grow at 4.3% CAGR as compared to 2% CAGR growth in the PV and LCV sales. Relatively higher growth of auto lighting products as compared to PV sales can be attributed to the increased adoption of LED & other lighting technologies and increase in the value of the lighting products. For the domestic operations, the 2W production is expected to grow at a robust pace of 8-10% CAGR in the next three years.
- During 2014-16, Varroc's lighting business was the fastest growing among its peer set. This business grew by 27.5% CAGR and was higher by 10.5ppts higher than the second fastest growing company in the same period. We are of the view, that with the above proposed expansion and positive outlook for the global and domestic operations, the company would continue to beat its peer set in terms of business growth.
- The company has reported a solid financial performance over FY15-18. During the period, it reported a 14.3% CAGR rise in the total operating revenue to Rs. 103,784.6mn in FY18. Consolidated EBITDA increased by 12.5% CAGR to Rs. 8,775.7mn in FY18. Average EBITDA margin during the period stood at 7.6%. Reported PAT increased by 226.3% CAGR to Rs. 4,502.6mn in FY18. Average PAT margin during the period stood at 3%. Cash flow from operations remained positive and increased by 103.1% CAGR over FY15-18. Total debt declined by 11.3% CAGR, with debt equity ratio improving from 1.3x in FY15 to 0.3x in FY18. Average RoE and RoCE stood at 12.9% and 11.9%, respectively, during the period.
- Based on our quick estimate, for FY19 we are anticipating a top-line of Rs. 115,361.4mn (a growth of 11.2% over FY18) and an EPS of 36.6 per share (a growth of 9.6% over FY18). EBITDA and PAT margin are anticipated at 8.9% and 4.3%, respectively. In FY20, top-line is expected to grow by 14.3% to Rs. 131,854.2mn, while EPS to grow by 20.8% to Rs. 44.2 per share.

On valuation front, at higher price band, the company is demanding a P/E valuation of 29x (to its restated FY18 EPS of Rs. 33.4) as against the peer average of 23.1x. With respect to FY19 and FY20 EPS too, it is asking a premium valuation to its peers. Thus, the issue seems to be fully priced. However, considering the global market position, future strong growth outlook, low profitability and expensive valuation, we assign a **"Subscribe with Caution"** rating to the issue.

Financial Statements:

Consolidated Profit and Loss Statement (Rs. mn)

| | FY15 (Proforma) | FY16 | FY17 | FY18 | CAGR over FY15 - 18 (%) | Annual Growth over FY17 (%) |
|---|--------------------|-----------------|-----------------|------------------|----------------------------|--------------------------------|
| Total Operating Revenue | 69,507.7 | 82,189.0 | 96,085.4 | 103,784.6 | 14.3% | 8.0% |
| Cost of Goods Sold | (41,911.0) | (49,906.3) | (59,731.2) | (63,203.2) | 14.7% | 5.8% |
| Purchases of Stock in Trade | (487.0) | (1,098.1) | (987.9) | (924.0) | 23.8% | -6.5% |
| Changes in Inventories of Work in Progress, Stock in Trade and Finished Goods | 467.4 | 511.9 | 351.6 | 300.3 | -13.7% | -14.6% |
| Excise Duty | (1,807.8) | (3,096.8) | (3,097.5) | (996.3) | -18.0% | -67.8% |
| Employee Benefits Expense | (9,022.5) | (10,399.3) | (12,037.5) | (13,135.2) | 13.3% | 9.1% |
| Other Expenses | (10,578.1) | (12,491.0) | (14,765.3) | (17,050.6) | 17.2% | 15.5% |
| EBITDA | 6,168.8 | 5,709.5 | 5,817.6 | 8,775.7 | 12.5% | 50.8% |
| Depreciation / Impairment & Amortization Expenses | (2,539.7) | (2,922.5) | (3,370.8) | (3,864.7) | 15.0% | 14.6% |
| EBIT | 3,629.1 | 2,787.0 | 2,446.7 | 4,911.0 | 10.6% | 100.7% |
| Finance Costs | (4,754.8) | 426.5 | (904.0) | (861.7) | -43.4% | -4.7% |
| Share of Net Profits of Investments Accounted for Using the Equity method | 364.8 | 498.3 | 791.9 | 690.3 | 23.7% | -12.8% |
| Other Income | 876.9 | 206.2 | 937.3 | 386.1 | -23.9% | -58.8% |
| Exceptional Items | 517.5 | | | | -100.0% | |
| PBT | 633.5 | 3,918.0 | 3,271.9 | 5,125.7 | 100.8% | 56.7% |
| Tax Expenses | (465.4) | (219.7) | (238.0) | (617.9) | 9.9% | 159.6% |
| PAT Before Minority Interest | 168.1 | 3,698.2 | 3,033.9 | 4,507.8 | 199.3% | 48.6% |
| Minority Interest | (38.5) | (4.6) | (3.8) | (5.2) | -48.7% | 36.9% |
| Reported PAT | 129.6 | 3,693.6 | 3,030.1 | 4,502.6 | 226.3% | 48.6% |

Consolidated Balance Sheet Statement (Rs. mn)

| | FY15 (Proforma) | FY16 | FY17 | FY18 | CAGR over FY15 - 18 (%) | Annual Growth over FY17 (%) |
|---|--------------------|-----------------|-----------------|-----------------|----------------------------|--------------------------------|
| Equity and Preference Share Capital | 96.1 | 262.4 | 134.8 | 134.8 | 11.9% | 0.0% |
| Reserves and Surplus | 10,728.8 | 17,366.4 | 21,718.9 | 28,145.2 | 37.9% | 29.6% |
| Minority Interest | 214.5 | 202.8 | 201.6 | 207.7 | -1.1% | 3.0% |
| Long Term Borrowings | 10,231.5 | 7,633.9 | 7,552.7 | 6,361.5 | -14.6% | -15.8% |
| Deferred Tax Liabilities (Net) | 622.0 | 472.7 | 130.0 | 508.9 | -6.5% | 291.3% |
| Long Term Provisions | 754.6 | 765.4 | 740.0 | 1,002.4 | 9.9% | 35.5% |
| Other Long Term Liabilities | 221.9 | 154.2 | 174.3 | 433.1 | 25.0% | 148.4% |
| Short Term Borrowings | 3,830.5 | 6,418.7 | 5,991.9 | 3,439.3 | -3.5% | -42.6% |
| Trade Payables | 9,829.0 | 12,166.6 | 15,062.0 | 19,793.8 | 26.3% | 31.4% |
| Other Current Liabilities | 7,616.1 | 6,757.2 | 6,300.1 | 8,048.8 | 1.9% | 27.8% |
| Short Term Provisions | 139.8 | 258.3 | 597.3 | 448.5 | 47.5% | -24.9% |
| Total Liabilities | 44,284.7 | 52,458.6 | 58,603.8 | 68,523.9 | 15.7% | 16.9% |
| Tangible assets | 17,208.4 | 19,748.5 | 22,512.1 | 25,863.2 | 14.5% | 14.9% |
| Intangible assets | 1,068.1 | 1,209.6 | 1,146.0 | 1,701.1 | 16.8% | 48.4% |
| Capital Work in Progress | 1,488.0 | 2,636.0 | 2,464.6 | 2,440.5 | 17.9% | -1.0% |
| Intangible Assets Under Development | 287.0 | 517.1 | 460.8 | 1,000.3 | 51.6% | 117.1% |
| Goodwill | 150.8 | 150.8 | 150.8 | 334.7 | 30.4% | 121.9% |
| Investment Properties | 157.9 | 152.1 | 146.3 | 140.6 | -3.8% | -4.0% |
| Investments Accounted for Using the Equity Method | 1,959.2 | 2,643.1 | 2,927.1 | 3,565.0 | 22.1% | 21.8% |
| Non Current Investments | 0.2 | 0.2 | 0.2 | 0.2 | 0.0% | 0.0% |
| Long Term Loans and Advances | 58.5 | 63.8 | 82.6 | 106.8 | 22.2% | 29.3% |
| Income Tax Assets (Net) | 144.2 | 161.5 | 153.0 | 124.4 | -4.8% | -18.7% |
| Deferred Tax Assets | | 132.4 | 130.2 | 1,030.0 | | 691.0% |
| Goodwill on Consolidation | | | | | | |
| Other Non Current Assets | 1,589.8 | 1,456.6 | 1,245.3 | 1,613.0 | 0.5% | 29.5% |
| Current Investments | 223.2 | 119.4 | | 30.3 | -48.6% | |
| Inventories | 5,861.0 | 6,828.9 | 7,534.7 | 8,641.0 | 13.8% | 14.7% |
| Trade Receivables | 10,714.5 | 11,852.0 | 11,382.9 | 14,027.3 | 9.4% | 23.2% |
| Cash & Cash Equivalents | 690.3 | 1,770.8 | 3,540.5 | 3,289.4 | 68.3% | -7.1% |
| Short Term Loans and Advances | 494.2 | 1,415.5 | 3,054.8 | 2,652.8 | 75.1% | -13.2% |
| Other Current Assets | 2,189.5 | 1,600.2 | 1,671.9 | 1,963.5 | -3.6% | 17.4% |
| Total Assets | 44,284.7 | 52,458.6 | 58,603.8 | 68,523.9 | 15.7% | 16.9% |

Source: Company RHP

Financial Statements (Contd...):

Consolidated Cash Flow Statement (Rs. mn)

| Particulars (Rs. mn) | FY15 (Proforma) | FY16 | FY17 | FY18 | CAGR over FY15 - 18 (%) | Annual Growth over FY17 (%) |
|--|--------------------|----------------|----------------|----------------|----------------------------|--------------------------------|
| Cash Flow from Operating Activities | 1,283.4 | 2,904.9 | 6,765.0 | 10,748.5 | 103.1% | 58.9% |
| Cash Flow from Investing Activities | (2,453.9) | (5,785.2) | (5,654.4) | (6,012.9) | 34.8% | 6.3% |
| Cash Flow from Financing Activities | 703.1 | 3,860.8 | 936.5 | (5,231.8) | -295.2% | -658.6% |
| Net Cash Flow | (467.4) | 980.5 | 2,047.2 | (496.2) | 2.0% | -124.2% |
| Opening Balance of Cash and Bank Balances | 573.4 | 138.1 | 1,006.0 | 3,613.2 | 84.7% | 259.2% |
| Closing Balance of Cash and Bank Balances | 106.0 | 1,118.6 | 3,053.2 | 3,117.1 | 208.7% | 2.1% |

Source: Company RHP

Consolidated Financial Ratios

| Particulars (Rs. mn) | FY15 (Proforma) | FY16 | FY17 | FY18 |
|------------------------------|-----------------|---------|--------|--------|
| Revenue Growth Rate (%) | 13.6% | 18.2% | 16.9% | 8.0% |
| EBITDA Growth Rate (%) | 54.4% | -7.4% | 1.9% | 50.8% |
| EBITDA Margin (%) | 8.9% | 6.9% | 6.1% | 8.5% |
| EBIT Growth Rate (%) | 124.7% | -23.2% | -12.2% | 100.7% |
| EBIT Margin (%) | 5.2% | 3.4% | 2.5% | 4.7% |
| Reported PAT Growth Rate (%) | -69.2% | 2750.7% | -18.0% | 48.6% |
| Reported PAT Margin (%) | 0.2% | 4.5% | 3.2% | 4.3% |

Liquidity Ratios

| | | | | |
|--------------------|-----|-----|-----|-----|
| Current Ratio | 0.9 | 0.9 | 1.0 | 1.0 |
| Debt Equity Ratio | 1.3 | 0.8 | 0.6 | 0.3 |
| Net Debt to EBITDA | 2.1 | 2.1 | 1.7 | 0.7 |

Turnover Ratios

| | | | | |
|--------------------------------|--------|--------|--------|--------|
| Inventories Days | 30.8 | 28.2 | 27.3 | 28.4 |
| Trade Receivable Days | 56.3 | 50.1 | 44.1 | 44.7 |
| Accounts Payable Days | (51.6) | (48.8) | (51.7) | (61.3) |
| Cash Conversion Cycle Days | 35.4 | 29.4 | 19.7 | 11.8 |
| Fixed Asset Turnover Ratio (x) | 3.5 | 3.4 | 3.6 | 3.3 |
| Total Asset Turnover Ratio (x) | 1.6 | 1.6 | 1.6 | 1.5 |

Return Ratios

| | | | | |
|----------|-------|-------|-------|-------|
| RoE (%) | 1.2% | 20.7% | 13.7% | 15.8% |
| RoA (%) | 0.3% | 7.0% | 5.2% | 6.6% |
| RoCE (%) | 15.9% | 10.4% | 8.0% | 13.3% |

Per Share Data

| | | | | |
|--|------|-------|--------|-------|
| Restated Adjusted EPS (Rs.) | 1.0 | 27.4 | 22.5 | 33.4 |
| Restated DPS (Rs.) | 0.2 | 0.3 | 0.3 | 0.5 |
| BVPS (Rs.) | 81.9 | 132.3 | 163.6 | 211.3 |
| Restated Operating Cash Flow Per Share (Rs.) | 9.5 | 21.5 | 50.2 | 79.7 |
| Restated Free Cash Flow Per Share (Rs.) | 4.8 | 2.0 | (14.1) | 19.2 |

Note: Pre-issue data; Source: Company RHP

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