

Q4FY20 result review and earnings revision

Automobiles

Target price: Rs283

Earnings revision

(%)	FY21E	FY22E
EBITDA	↑ 3.9	↑ 5.0
PAT	↓ 0.2	↑ 2.8
EPS	NC	↓ 35.1

Target price revision

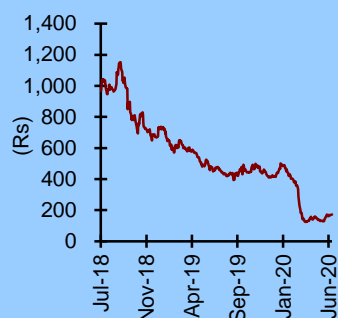
Rs283 from Rs307

Shareholding pattern

	Sep '19	Dec '19	Mar '20
Promoters	85.0	85.0	85.0
Institutional investors	12.6	12.5	12.1
MFs and others	5.8	5.8	7.6
FI/Banks	0.2	0.4	0.4
FII	6.6	6.3	4.1
Others	2.4	2.5	2.9

Source: BSE

Price chart



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INDIA

Varroc Engineering

BUY

Maintained

Rs198

Healthy FCF generation the key focus point

Varroc Engineering's (VEL) Q4FY20 operating performance missed estimates due to Covid-related shutdown and supply chain disruptions from China. VLS sales declined ~10% YoY to EUR233mn while margins slumped by ~690bps YoY to 2.5%. FCF generation (~Rs4.4bn) in FY20 has been strong considering the large capex incurred (Rs9.7bn). FY22 is likely to be an inflection year for the global lighting business (VLS) as steep fixed initiatives are likely to provide additional boost to profitability as new plants stabilize and revenues ramp up. India business is expected to benefit from domestic two-wheeler demand recovery coupled with increased BS-VI content. Stock is trading at ~16% FY20 FCF yield which we believe remains alluring. We maintain our BUY rating on the stock.

- **Key highlights of the quarter:** Topline at Rs27.4bn was down 12% YoY due to: a) India business revenue decline of 16.4% to ~Rs8.5bn and India margins down 56bps YoY to 8.2%. EBITDA margin stood at 4.1%, down 485bps YoY. VEL has reported an inventory overstatement of Rs294mn in Q4FY19 resulting in PAT readjustment of Rs211mn. Net debt levels remained reasonable at Rs24.7bn (up Rs2bn YoY). Auditor qualification has also been raised for a warranty claim of Rs944mn from an overseas customer, which could impact profitability in future the company believes claim settlement would be at much lower terms. VEL reported PAT loss of Rs1.37bn.
- **Key takeaways from earnings call:** Management indicated: a) sales in June is at 65-70% of pre-lockdown levels in VLS (30% in May) and is likely to reach 80% by September; for India business, sales in June stood at 55-60% and is likely to reach 70% by July-end; b) capex for FY21 has been significantly slashed to EUR45mn for VLS and Rs1.3bn for India business; recurring SG&A costs have been pruned by 25% and product development costs reduced by 15%. Benefits of the cost-cutting measures and manpower rationalisation are expected to be visible from H2FY21 onwards; c) Covid-related losses: manpower costs – EUR7mn, overhead costs – EUR2mn, premium freight and overtime charges – EUR2.5mn, inventory write-off – EUR3.5mn and China JV – EUR2.5mn in losses; Pune plant fire also led to EUR2mn in lost sales; d) major order wins from Ford (Transit/F250/F150), VW (electric) and Tesla (model Y) are expected to aid plant utilisations.
- **Maintain BUY:** We expect VEL's revenue growth at 6.7% CAGR over FY20-FY22E. We lower our FY22E EPS estimates by ~35% on account higher interest, depreciation costs. Due to mix of global and domestic automotive exposures, we value the business on SoTP basis. We value VLS and its China JV at 3.5x (earlier:4.0x) EV/EBITDA and 6x (earlier:7x) P/E FY22E respectively and India business at unchanged multiple of 6x EV/EBITDA FY22E to arrive at an SoTP-based target price of Rs283 (earlier: Rs307). Maintain **BUY**.

Market Cap	Rs26.7bn/US\$353mn	Year to Mar (Std)	FY19	FY20	FY21E	FY22E
Reuters/Bloomberg	VARE.BO/VARROC IN	Revenue (Rs mn)	1,20,365	1,11,219	1,09,154	1,26,723
Shares Outstanding (mn)	134.8	Adj. Net Income (Rs mn)	4,252	2	-645	1,738
52-week Range (Rs)	501/125	Adj. EPS (Rs)	31.5	0.0	(4.8)	12.9
Free Float (%)	15.0	% Chg YoY	(5.6)	(100.0)	(33534)	(369.3)
FII (%)	4.1	P/E (x)	6.3	13854.9	(41.4)	15.4
Daily Volume (US\$/'000)	580	CEPS (Rs)	73.5	54.3	58.9	83.4
Absolute Return 3m (%)	40.2	EV/E (x)	4.4	5.9	5.8	3.5
Absolute Return 12m (%)	(56.0)	Dividend Yield (%)	2.5	1.8	0.0	1.6
Sensex Return 3m (%)	22.3	RoCE (%)	12.3	3.1	1.0	5.2
Sensex Return 12m (%)	(10.8)	RoE (%)	14.4	0.0	(2.2)	5.8

Please refer to important disclosures at the end of this report

Table 1: Q4FY20 result review (standalone)

(Rs mn, year ending March 31)

	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Total operating income	27,926	31,760	-12.1	28,118	-0.7
Raw material costs	18,628	20,495	-9.1	17,272	7.9
Employee costs	4,055	4,028	0.7	3,978	2.0
Other expenditures	4,085	4,381	-6.7	4,173	-2.1
Total operating expenses	26,769	28,904	-7.4	25,422	5.3
EBITDA	1,157	2,856	-59.5	2,695	-57.1
EBITDA margin (%)	4.1	9.0	-485 bps	9.6	-544 bps
Depreciation & Amortization	2,066	1,530	35.1	1,942	6.4
Other income	8	60	-86.6	17	-54.0
Interest costs	362	259	40.0	366	-1.1
PBT	-1,263	1,128	NC	405	NC
Exceptional Items					
Taxes	4	-111	-103.5	193	-98.0
PAT before MI/JV	-1,266	1,239	NC	212	NC
MI/JV profits	-105	51	NC	81	NC
PAT	-1,376	1,283	NC	287	NC

Source: Company data, I-Sec research

Table 2: Earnings revision

	FY21E			FY22E		
	Previous	New	Chg (%)	Previous	New	Chg (%)
Sales	1,05,020	1,09,154	3.9	1,20,652	1,26,723	5.0
EBITDA	8,446	8,429	(0.2)	11,553	11,874	2.8
PAT	136	(645)	NC	2,676	1,738	(35.1)
EPS (Rs)	1.0	(4.8)	NC	19.9	12.9	(35.1)

Valuation and recommendation

We expect VEL's revenue growth at 6.7% CAGR over FY20-FY22E. We lower our FY22E EPS estimates by ~35% on account higher interest, depreciation costs. Due to mix of global and domestic automotive exposures, we value the business on SoTP basis. We value VLS and its China JV at 3.5x (earlier:4.0x) EV/EBITDA and 6x (earlier:7x) P/E FY22E respectively and India business at unchanged multiple of 6x EV/EBITDA FY22E to arrive at an SoTP-based target price of Rs283 (earlier: Rs307). We maintain our **BUY** rating on the stock.

Table 3: Valuation summary

Business	FY22 (EBITDA/PAT)	Multiple	Current market value	Rs/share	Valuation remarks
VLS (ex-China)	7,943	3.5	27,801	206	EV/EBITDA; ~15% discount to global peers
India	3,914	6.0	23,486	174	EV/EBITDA; in-line with domestic peers
Net debt			-14,338	-106	
Equity Value			36,949	274	
China JV	191	6.0	1143	8	PE multiple; ~20% discount to regional peers
Total Value			38,092	283	

Source: I-Sec research

Financial summary

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

	FY19	FY20P	FY21E	FY22E
Total Op. Income (Sales)	1,20,365	1,11,219	1,09,154	1,26,723
Operating Expenses	1,09,777	1,03,011	1,00,724	1,14,850
EBITDA	10,588	8,208	8,429	11,874
% margins	8.8%	7.4%	7.7%	9.4%
Depreciation & Amortisation	5,656	7,319	8,588	9,508
EBIT	4,931	889	(158)	2,366
Other Income	908	989	841	1,009
Gross Interest	968	1,392	1,530	1,377
PBT	4,871	487	(848)	1,998
Less: Exceptionals	-	-	-	-
PBT after Exceptionals	4,871	487	(848)	1,998
Less: Taxes	898	370	(203)	439
Less: Minority Interest	35	23	7	10
Add: Profit from Associates	315	(92)	6	189
Net Income (Reported)	4,252	2	(645)	1,738
Net Income (Adjusted)	4,252	2	(645)	1,738

Source: Company data, I-Sec research

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

	FY19	FY20P	FY21E	FY22E
ASSETS				
Current Assets	33,376	41,411	41,109	46,065
Cash & cash eqv.	1,634	10,688	10,121	11,824
Current Liabilities & Provisions	29,678	34,003	31,766	37,921
Net Current Assets	3,698	7,408	9,343	8,144
Investments	3,434	3,262	5,262	5,262
Total Fixed Assets	45,593	60,730	58,143	54,635
Capital Work-in-Progress	9,995	7,901	7,901	7,901
Other non-current asset	3,166	3,166	3,166	3,166
Total Assets	55,891	74,566	75,914	71,207
LIABILITIES				
Borrowings	24,393	35,424	37,424	31,424
long-term borrowings	4,572	9,002	9,002	8,002
short-term borrowings	19,821	26,422	28,422	23,422
Deferred Tax Liability Net	-842	-842	-842	-842
Other Non-current Liabilities	1,675	9,938	9,931	9,921
Equity Share Capital	135	135	135	135
Reserves & Surplus	30,529	29,910	29,265	30,568
Net Worth	30,664	30,045	29,400	30,703
Total Liabilities	55,890	74,566	75,914	71,207

Source: Company data, I-Sec research

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

All figures in %	FY19	FY20P	FY21E	FY22E
Tax Burden	0.9	0.0	0.8	0.9
Interest Burden	1.0	0.5	5.4	0.8
EBIT Margin	0.0	0.0	(0.0)	0.0
Asset Turnover	2.2	1.5	1.4	1.8
Financial Leverage	1.8	2.5	2.6	2.3
ROE	14.4	0.0	(2.2)	5.8

Source: Company data, I-Sec research

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

	FY19	FY20P	FY21E	FY22E
Operating cashflow before working capital changes	10,877	8,712	9,472	12,622
Net Working Capital Changes	(850)	5,344	(2,502)	2,903
Others	(364)	-	-	-
Operating Cashflow	9,662	14,056	6,970	15,525
Capital Commitments	(19,328)	(9,774)	(6,000)	(6,000)
Free Cashflow	(9,666)	4,282	970	9,525
Cashflow from Investing Activities	(15,096)	(22,284)	(8,000)	(6,000)
Issue of Share Capital	-	-	-	-
Inc/(Dec) in minority interest	34	8	(7)	(10)
Inc/(Dec) in borrowings	12,403	11,031	2,000	(6,000)
Dividend paid	(657)	(493)	-	(434)
Interest paid	(968)	(1,392)	(1,530)	(1,377)
Others	(2,779)	0	0	(0)
Cashflow from Financing Activities	8,032	9,155	463	(7,821)
Net Cashflow	2,598	926	(567)	1,703
Opening Cash & Bank balance	4,758	1,634	10,688	10,121
Closing Cash & Bank balance	7,356	2,561	10,121	11,824
Increase / (Decrease) in Cash & cash equivalents	2,598	926	(567)	1,703

Source: Company data, I-Sec research

Table 8: Key ratios
(Year ending March 31)

	FY19	FY20P	FY21E	FY22E
Per Share Data (in Rs.)				
EPS (Basic)	31.5	0.0	(4.8)	12.9
EPS (Adjusted)	31.5	0.0	(4.8)	12.9
Cash EPS	73.5	54.3	58.9	83.4
Dividend per share (DPS)	4.9	3.7	-	3.2
BVPS (Adjusted)	229.2	224.7	219.9	229.5
Growth Ratios (%)				
Total Op. Income (Sales)	17	-8	-2	16
EBITDA	20	-22	3	41
Net Income (Adjusted)	-6	-100	-33,534	-369
EPS (Adjusted)	-6	-100	-33,534	-369
Cash EPS	18	-26	8	42
BVPS (Adjusted)	8	-2	-2	4
Valuation Ratios (x)				
P/E (Adjusted)	6.3	NC	(41.4)	15.4
P/BV (Adjusted)	0.9	0.9	0.9	0.9
EV/EBITDA	4.4	5.9	5.8	3.5
EV/Sales	0.4	0.4	0.4	0.3

Return/Profitability Ratios (%)

EBITDA Margin	8.8	7.4	7.7	9.4
Net Income Margin (Adjusted)	3.5	0.0	-0.6	1.4
RoCE	12.3	3.1	1.0	5.2
RoNW	14.4	0.0	-2.2	5.8
Dividend Payout Ratio	15.5	NC	-	25.0
Dividend Yield	2.5	1.8	-	1.6

Solvency/Wkg. Cap. Ratios (x)

Net D/E	0.6	0.7	0.7	0.5
Debt/EBITDA	2.3	4.3	4.4	2.6
EBIT/Interest	5.1	0.6	(0.1)	1.7
Current Ratio	1.1	1.2	1.3	1.2
Quick Ratio	0.8	0.9	0.9	0.9
Inventory (days)	27	35	37	35
Receivables (days)	41	36	40	37
Payables (days)	62	78	75	77

Source: Company data, I-Sec research

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