

10 August 2023

India | Equity research | Q1FY24 result review

Varroc Engineering

Auto ancillaries

Profitability improvement continues; debt reduction the key ahead

Varroc Engineering's (VAR) EBITDAM for Q1FY24 was at 9.5%, up 20bps QoQ, and higher than our estimate of 8.7%. The beat was due mainly to better business mix, operating leverage and continued cost-reduction efforts. Revenue increased 6% QoQ to INR 17.9bn due to higher 2W volumes, which accounted for ~70% of revenue. VAR is at ~60-65% capacity utilisation, with scope for operating leverage pushing margins further up driven by recovery in 2W demand. New lifetime order win in Q1FY24 was INR 9.6bn – split 29% / 71% in 4W / 2W segments, respectively. We have factored-in 15% revenue CAGR for FY23-FY25E as we expect VAR to be a beneficiary of gradual recovery in the India 2W market, post remaining subdued in FY20-FY22. Maintain **BUY** with a DCF-based target price of INR 406 (earlier: INR 366), implying ~17x FY25E EPS.

Q1FY24 conference call takeaways and our views

- Q1FY24 revenue was 6% higher QoQ despite Q4 being a seasonally strong quarter and Q1 being sluggish. Romania electronic component business also performed well in Q1FY24. On YoY basis, most segments showed growth with improving economic activity in both rural and urban areas. 2W and PV lighting segments in India achieved breakeven in Q1FY24. VAR expects to grow at 8-10% higher than industry growth in FY24, largely on the back of content growth driven by new products on the electronic side. Company has won orders for EV powertrain and other parts for both 2W and PV segments. During Q1FY24, new lifetime order win was INR 9.6bn – split 29% / 71% in 4W / 2W segments respectively and ~11% in EV. VAR expects EV revenue to grow to ~INR 10bn by FY25 compared to ~4% of revenue contribution currently (~INR 0.6bn from EV in Q1FY24). VAR is also a supplier for lighting, mirrors and plastic for Triumph, with content per vehicle at ~INR 8k. With content per vehicle higher in EVs (~INR 30k-35k) vs ICE (~INR 6k-8k), increase in EV revenues would drive revenue growth by >10% ahead. We have factored-in 15% revenue CAGR for FY23-FY25E as VAR would be a beneficiary in terms of growth and operating leverage with the India 2W market recovering gradually.

Financial Summary

Y/E March (INR mn)	FY22A	FY23A	FY24E	FY25E
Net Revenue	58,442	68,631	82,000	91,000
EBITDA	3,593	5,467	8,120	9,328
EBITDA %	6.1	8.0	9.9	10.3
Net Profit	(779)	335	2,419	3,578
EPS (INR)	(5.1)	2.2	15.8	23.4
EPS % Chg YoY	(280.5)	(143.0)	623.0	47.9
P/E (x)	(67.3)	156.6	21.7	14.6
EV/EBITDA (x)	18.1	11.9	7.9	6.5
RoCE (%)	9.8	4.2	13.4	15.6
RoE (%)	(9.3)	4.0	20.1	23.4

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Market Data

Market Cap (INR)	52bn
Market Cap (USD)	632mn
Bloomberg Code	VARROC IN
Reuters Code	VARE BO
52-week Range (INR)	410 / 239
Free Float (%)	25.0
ADTV-3M (mn) (USD)	1.1

Price Performance (%)	3m	6m	12m
Absolute	20.1	22.5	0.9
Relative to Sensex	7.8	9.6	13.6

ESG Disclosure	2021	2022	Change
ESG score	-	-	-
Environment	-	-	-
Social	-	-	-
Governance	-	-	-

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

Earnings Revisions (%)	FY24E	FY25E
Revenue	2.5	2.2
EBITDA	9.8	7.2
EPS	17.3	12.3

Previous Reports

25-05-2023: [Q4FY23 results review](#)

09-02-2023: [Q3FY23 results review](#)

- VAR is confident of delivering double-digit EBITDAM in FY24, driven by improving mix, operating leverage and cost efficiencies. Stable commodity prices are likely to aid margins further ahead from ~9.5% levels currently. Overall capacity utilisation stands at ~60-65% as 2W demand remained subdued in the past 4 years. Hence, any recovery in 2W industry would aid utilisation improvement and provide further benefit in terms of operating leverage. Capex for Q1FY24 was INR 0.5bn and VAR is targeting another INR 1bn-1.5bn of capex through the rest of the year. Net debt currently stands at ~INR 12bn with interest cost at 9-10% and interest outgo at ~INR 0.54bn per quarter.

Exhibit 1: Q1FY24 result review (consolidated)

Consol (INR mn)	Q1FY24	Q1FY23	YoY	Q4FY23	QoQ
Total Operating Income	17,924	16,283	10%	16,901	6%
Cost of Materials	11,412	10,498	9%	10,690	7%
As % of sales	63.7%	64.5%	-80 bps	63.3%	42 bps
Gross profit	6,512	5,785	13%	6,211	5%
Gross margin	36.3%	35.5%	80 bps	36.7%	-42 bps
Employee Expenses	1,922	1,729	11%	1,894	1%
As % of sales	10.7%	10.6%	10 bps	11.2%	-48 bps
Other Expenses	2,896	2,875	1%	2,755	5%
As % of sales	16.2%	17.7%	-150 bps	16.3%	-15 bps
EBITDA	1,694	1,181	43%	1,561	9%
EBITDA margin	9.5%	7.3%	220 bps	9.2%	21 bps
Depreciation	802	854	-6%	922	-13%
EBIT	892	327	173%	640	40%
EBIT Margin	5.0%	2.0%	297 bps	3.8%	119 bps
Interest	489	376	30%	525	-7%
Other Income *	188	91	107%	212	-11%
PBT	591	42	1324%	326	81%
PBT Margin	3.3%	0.3%	304 bps	1.9%	137 bps
Tax expenses	102	8	1130%	11	815%
Effective Tax Rate	17.3%	20.0%	(273)	3.4%	1385 bps
Share of profit from associates	61	(45)	N.M.	85	-28%
Adjusted PAT	550	(12)	N.M.	400	38%
Adjusted PAT Margin	3.1%	-0.1%	N.M.	2.4%	70 bps
Reported PAT	550	(39)	N.M.	400	38%

Source: I-Sec research, Company data

Exhibit 2: Revenue and EBITDA breakdown for VAR post divestment

	FY24E					
	India existing	4W lighting India	Romania plant	Global 2W lighting	Italy forging	Total
Revenue (INR bn)	67	5	3	4	3	82
EBITDA margin	11%	5%	5%	5%	5%	9.9%
EBITDA (INR mn)	7,370	250	150	200	150	8,120
	FY25E					
	India existing	4W lighting India	Romania plant	Global 2W lighting	Italy forging	Total
Revenue (INR bn)	73.5	6	3.5	4.5	3.5	91
EBITDA margin	12%	5%	5%	5%	5%	10.3%
EBITDA (INR mn)	8,453	300	175	225	175	9,328

Source: I-Sec research, Company data

Exhibit 3: Estimate revisions

	FY24E			FY25E		
	Old	Revised	% change	Old	Revised	% change
Revenue (INR bn)	80	82	2.5%	89	91	2.2%
EBITDA (INR bn)	7	8	9.8%	9	9	7.2%
EBITDA margin (%)	9.2%	9.9%	66 bps	9.8%	10.3%	47 bps
PAT (INR bn)	2.1	2.4	17.3%	3.2	3.6	12.3%
EPS (INR)	13.5	15.8	17.3%	20.9	23.4	12.3%

Source: I-Sec research, Company data

Downside risks

- Slower-than-expected revival in domestic 2W market.
- Unable to add large e2W OEMs as customers like Ola Electric and TVS.
- Unable to ramp-up profitability or add new orders for India car lighting business.

Exhibit 4: Shareholding pattern

%	Dec'22	Mar'23	Jun'23
Promoters	75.0	75.0	75.0
Institutional investors	16.9	17.1	17.3
MFs and others	9.5	9.7	9.8
FIs/Banks	0.0	0.0	0.0
Insurance	2.5	1.8	1.6
FIIIs	4.9	5.6	5.9
Others	8.1	7.9	7.7

Source: Bloomberg

Exhibit 5: Price chart



Source: Bloomberg

Financial summary

Exhibit 6: Profit & Loss

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Net Sales	58,442	68,631	82,000	91,000
Operating Expenses	16,355	18,858	22,220	24,343
EBITDA	3,593	5,467	8,120	9,328
EBITDA Margin (%)	6.1	8.0	9.9	10.3
Depreciation & Amortisation	3,045	3,367	3,611	3,785
EBIT	548	2,099	4,509	5,543
Interest expenditure	1,184	1,903	2,000	1,600
Other Non-operating Income	339	579	450	495
Recurring PBT	(296)	775	2,959	4,438
Profit / Loss from Associates	-	-	-	-
Less: Taxes	482	441	740	1,109
PAT	(779)	335	2,219	3,328
Less: Minority Interest	-	-	200	250
Extraordinary (Net)	-	-	-	-
Net Income (Reported)	(779)	335	2,419	3,578
Net Income (Adjusted)	(779)	335	2,419	3,578

Source Company data, I-Sec research

Exhibit 7: Balance sheet

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Total Current Assets	83,028	17,377	21,294	24,711
of which cash & cash eqv.	1,178	3,271	2,648	4,018
Total Current Liabilities & Provisions	86,074	18,648	22,713	25,206
Net Current Assets	(3,046)	(1,271)	(1,419)	(495)
Investments	4,000	4,206	4,206	4,206
Net Fixed Assets	20,334	20,513	18,237	18,232
ROU Assets	-	-	-	-
Capital Work-in-Progress	1,398	1,347	3,512	3,512
Total Intangible Assets	-	-	-	-
Other assets	-	-	-	-
Deferred Tax assets	-	-	-	-
Total Assets	23,816	27,491	27,757	29,030
Liabilities				
Borrowings	14,000	16,350	14,350	12,350
Deferred Tax Liability	1,176	1,099	1,099	1,099
Provisions	-	-	-	-
Other Liabilities	-	-	-	-
Equity Share Capital	153	153	153	153
Reserves & Surplus	8,234	9,609	11,876	15,149
Total Net Worth	8,387	9,762	12,029	15,301
Minority Interest	253	280	280	280
Total Liabilities	23,816	27,491	27,757	29,030

Source Company data, I-Sec research

Exhibit 8: Quarterly trend

(INR mn, year ending March)

	FY22	FY23	FY24E	FY25E
Tax Burden (Adjusted PAT/PBT)	2.6	0.4	0.8	0.8
Interest Burden (PBT/EBIT)	(0.5)	0.4	0.7	0.8
EBIT Margin (EBIT/Sales)	0.0	0.0	0.1	0.1
Asset Turnover (Sales/Total Assets)	2.5	2.5	3.0	3.1
Financial Leverage (Total Assets/Equity)	2.8	2.8	2.3	1.9
RoE	(9.3)	4.0	20.1	23.4

Source Company data, I-Sec research

Exhibit 9: Cashflow statement

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Operating Cashflow	6,356	3,779	6,580	8,561
Working Capital Changes	5,956	(1,247)	(1,000)	93
Capital Commitments	(8,436)	(3,495)	(3,500)	(3,780)
Free Cashflow	(2,080)	284	3,080	4,781
Other investing cashflow	611	373	450	495
Cashflow from Investing Activities	(7,825)	(3,122)	(3,050)	(3,285)
Issue of Share Capital	-	-	-	-
Interest Cost	(2,593)	(1,903)	(2,000)	(1,600)
Inc (Dec) in Borrowings	(2,629)	2,350	(2,000)	(2,000)
Dividend paid	-	-	(153)	(306)
Others	416	989	0	-
Cashflow from Financing Activities	(4,806)	1,436	(4,153)	(3,906)
Chg. in Cash & Bank balance	(6,275)	2,093	(624)	1,370
Closing cash & balance	1,178	3,271	2,648	4,018

Source Company data, I-Sec research

Exhibit 10: Key ratios

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
Per Share Data (INR)				
Reported EPS	(5.1)	2.2	15.8	23.4
Adjusted EPS (Diluted)	(5.1)	2.2	15.8	23.4
Cash EPS	14.8	24.2	39.5	48.2
Dividend per share (DPS)	-	-	1.0	2.0
Book Value per share (BV)	54.9	63.9	78.7	100.1
Dividend Payout (%)	-	-	6.3	8.5
Growth (%)				
Net Sales	33.6	17.4	19.5	11.0
EBITDA	6.3	52.1	48.5	14.9
EPS (INR)	(280.5)	(143.0)	623.0	47.9
Valuation Ratios (x)				
P/E	(67.3)	156.6	21.7	14.6
P/CEPS	23.1	14.2	8.7	7.1
P/BV	6.2	5.4	4.4	3.4
EV / EBITDA	18.1	11.9	7.9	6.5
EV / Sales	1.1	0.9	0.8	0.7
Profitability Ratios				
Gross Profit Margins (%)	34.1	35.4	37.0	37.0
EBITDA Margins (%)	6.1	8.0	9.9	10.3
EBIT Margins (%)	0.9	3.1	5.5	6.1
Net Profit Margins (%)	(1.3)	0.5	3.0	3.9
RoCE (%)	9.8	4.2	13.4	15.6
RoE (%)	(9.3)	4.0	20.1	23.4
Dividend Yield (%)	-	-	0.3	0.6
Operating Ratios				
Fixed Asset Turnover (x)	2.7	3.1	3.8	4.2
Inventory Turnover Days	38	36	40	40
Receivables Days	32	32	35	35
Payables Days	76	63	63	63
Effective Tax Rate (%)	(162.8)	56.8	25.0	25.0
Net Debt / Equity (x)	1.5	1.3	0.9	0.5
Net Debt / EBITDA (x)	3.6	2.3	1.4	0.9

Source Company data, I-Sec research

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