BUY (Upgrade from ADD)

CMP: **INR 568** Target Price: **INR 738 (INR 637)** ▲ 30%

ICICI Securities

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18 May 2024

India | Equity research | Q4FY24 results review

Varroc Engineering

Auto Ancillaries

Decent Q4 performance adjusting for one-offs; already executing debt reduction

Varroc Engineering's (VAR) EBITDAM stood at 11.2%, up ~190bps QoQ, and 90bps higher than consensus estimate in Q4FY24, though reported margin included multiple one-offs, including retrospective incentives and provisions from specific EV customer. On an adjusted basis, EBITDAM for FY24 stood at ~9.5%, as per the management. New lifetime order win in FY24 stood at INR 87bn – with split of 19% / 81% in 4W / (2W & 3W) segments, respectively, with ~43% coming from EV models. We have factored-in 15% revenue CAGR and ~11.4% average EBITDA margin for FY24-26E. Upgrade VAR to **BUY** from Add with a revised DCF-based TP of INR 738 (earlier: INR 637), implying ~21x FY26E EPS. Change in TP is led by 1%/2% higher EPS on 30bps/50bps higher EBITDAM in FY25/26E and earnings rollover.

Q4FY24 conference call takeaways, and our views

- Revenue was up 5% QoQ at INR 20bn with increase in growth across segments (other than 3W), mainly due to seasonality of better production in Q4 vs destocking driven lower production in Q3FY24. Revenue growth YoY was 17% and Indian operations grew 24% YoY. Revenue contribution from EV customers stood at ~5.3% in FY24. New lifetime order win in FY24 was INR 87bn – split 19% / 81% in 4W / (2W + 3W) segments with ~43% orders from EV segment. Though this 43% incremental order mix is from EVs, the components need not be EV specific like lightings, plastics, seating etc. These new orders should help VAR grow higher than industry, with likely additional revenue of INR 8.5bn in FY25 from these orders and with higher content/unit in EV (5-6X) vs ICE variants driving growth. VAR expects EV revenue to pick up in the next 12-18 months on account of these new orders. VAR's utilisation has improved from ~65-70% levels in Q3FY24, and any recovery in 2W industry would aid utilisation improvement and provide further operating leverage benefits, taking EBITDA margin towards ~11-12% levels operationally.
- EBITDAM stood at 11.2%, up ~190bps QoQ driven by GM rising by 300bps QoQ. We believe, on adjusted basis, Q1FY25E EBITDAM would be ~9-9.5%. In the medium term, VAR would focus on improving EBITDAM by i) reducing customer risk through higher customer diversification, ii) driving cost efficiencies through working capital optimisation and backward integration. VAR's renewable energy investments are ending soon and may aid in lowering its electricity cost.

Financial Summary

Y/E March (INR mn)	FY23A	FY24A	FY25E	FY26E
Net Revenue	68,631	75,519	87,000	99,180
EBITDA	5,467	7,736	9,845	11,406
EBITDA %	8.0	10.2	11.3	11.5
Net Profit	335	2,049	4,074	5,297
EPS (INR)	2.2	13.4	26.7	34.7
EPS % Chg YoY	(143.0)	512.2	98.9	30.0
P/E (x)	259.6	42.4	21.3	16.4
EV/EBITDA (x)	18.2	12.5	9.4	7.5
RoCE (%)	4.2	16.0	19.1	22.6
RoE (%)	4.0	16.7	21.7	22.5

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Market Data

Market Cap (INR)	87bn
Market Cap (USD)	1,043mn
Bloomberg Code	VARROC IN
Reuters Code	VARE BO
52-week Range (INR)	632 /292
Free Float (%)	25.0
ADTV-3M (mn) (USD)	1.8

Price Performance (%)	3m	6m	12m
Absolute	8.2	2.5	89.9
Relative to Sensex	6.1	(9.9)	69.9

Earnings Revisions (%)	FY25E	FY26E
Revenue	(0.6)	1.2
EBITDA	2.3	5.8
EPS	0.9	2.2

Previous Reports

08-02-2024: Q3FY24 results review

08-11-2023: Q2FY24 results review

- Capex for FY24 stood at INR 2.6bn and may be at similar levels in FY25E. Net debt to EBITDA stood at 1.29x and with strong FCF generation, VAR expects to bring this down further to ~0.5x by next year. VAR expects China arbitration results by H1FY25.

Exhibit 1: Q4FY24 result review (consolidated)

Consol (INR mn)	Q4FY24	Q4FY23	YoY	Q3FY24	QoQ
Total Operating Income	**19,749**	**16,901**	**17%**	**18,846**	**5%**
Cost of Materials	11,982	10,690	12%	12,000	0%
As % of sales	*60.7%*	*63.3%*	*-258 bps*	*63.7%*	*-300 bps*
Gross profit	**7,767**	**6,211**	**25%**	**6,846**	**13%**
Gross margin	***39.3%***	***36.7%***	***258 bps***	***36.3%***	***300 bps***
Employee Expenses	2,071	1,894	9%	2,071	0%
As % of sales	*10.5%*	*11.2%*	*-72 bps*	*11.0%*	*-50 bps*
Other Expenses	3,485	2,755	27%	3,019	15%
As % of sales	*17.6%*	*16.3%*	*135 bps*	*16.0%*	*163 bps*
EBITDA	**2,210**	**1,561**	**42%**	**1,756**	**26%**
EBITDA margin	***11.2%***	***9.2%***	***195 bps***	***9.3%***	***188 bps***
Depreciation	825	922	-10%	893	-8%
EBIT	**1,385**	**640**	**117%**	**863**	**61%**
EBIT Margin	***7.0%***	***3.8%***	***323 bps***	***4.6%***	***244 bps***
Interest	451	525	-14%	496	-9%
Other Income	64	212	-70%	89	-28%
PBT	**998**	**326**	**206%**	**457**	**119%**
PBT Margin	***5.1%***	***1.9%***	***312 bps***	***2.4%***	***263 bps***
Tax expenses	250	11	2136%	114	119%
Share of profit from associates	51	85	-40%	251	-79%
Adjusted PAT	**800**	**400**	**100%**	**593**	**35%**
Exceptional expenses/ (income)	216	-	**-**	(3,246)	**N.M.**
Reported PAT	**584**	**400**	**46%**	**3,839**	**-85%**

Source: I-Sec research, Company data

Exhibit 2: Revenue and EBITDA breakdown for VAR post divestment

FY25E	India existing	4W lighting India	Romania plant	Global 2W lighting	Italy forging	Total
Revenue (INR bn)	72	5	2.5	4.5	3	87
EBITDA margin	12.5%	6%	6%	6%	5%	11.3%
EBITDA (INR mn)	9,000	275	150	270	150	9,845

Source: I-Sec research, Company data

Exhibit 3: Estimate revisions

	FY25E			FY26E		
	Old	Revised	% change	Old	Revised	% change
Revenue (INR bn)	88	87	-0.6%	98	99	1.2%
EBITDA (INR bn)	10	10	2.3%	11	11	5.8%
EBITDA margin (%)	11.0%	11.3%	32 bps	11.0%	11.5%	50 bps
PAT (INR bn)	4.0	4.1	0.9%	5.2	5.3	2.2%
EPS (INR)	26.4	26.7	0.9%	33.9	34.7	2.2%

Source: I-Sec research, Company data

Downside risks

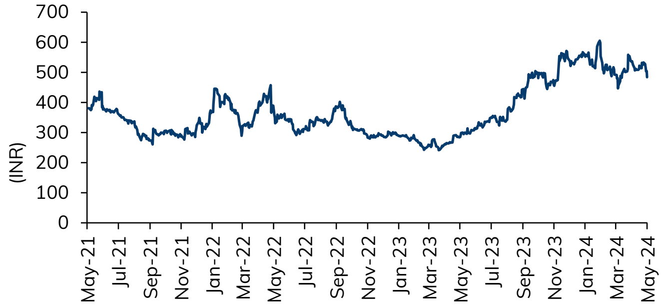
- Slower-than-expected revival in domestic 2W market.
- Unable to add large e2W OEMs such as Ola Electric and TVS as customers.
- Unable to ramp-up profitability or add new orders for India car lighting business.

Exhibit 4: Shareholding pattern

%	Sep'23	Dec'23	Mar'24
Promoters	75.0	75.0	75.0
Institutional investors	17.4	16.0	16.4
MFs and others	10.3	9.4	9.7
FIs/Banks	0.0	0.0	0.0
Insurance	1.5	1.2	1.9
FIIs	5.7	5.4	4.8
Others	7.6	9.0	8.6

Source: Bloomberg

Exhibit 5: Price chart



Source: Bloomberg

Financial summary

Exhibit 6: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Net Sales	68,631	75,519	87,000	99,180
Operating Expenses	**18,858**	**20,450**	**22,345**	**25,291**
EBITDA	5,467	7,736	9,845	11,406
EBITDA Margin (%)	**8.0**	**10.2**	**11.3**	**11.5**
Depreciation & Amortization	**3,367**	**3,368**	**3,650**	**3,827**
EBIT	2,099	4,367	6,195	7,579
Interest expenditure	1,903	1,939	1,400	1,200
Other Non-operating Income	579	276	303	334
Recurring PBT	775	2,705	5,099	6,713
Profit / Loss from Associates	-	-	-	-
Less: Taxes	441	656	1,275	1,678
PAT	335	2,049	3,824	5,035
Less: Minority Interest	-	-	250	263
Extraordinaries (Net)	-	-	-	-
Net Income (Reported)	335	2,049	4,074	5,297
Net Income (Adjusted)	335	2,049	4,074	5,297

Source Company data, I-Sec research

Exhibit 7: Balance sheet

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Total Current Assets	17,377	15,851	19,979	24,881
of which cash & cash eqv.	3,271	1,303	1,876	4,245
Total Current Liabilities & Provisions	18,648	17,943	21,088	24,041
Net Current Assets	**(1,271)**	**(2,091)**	**(1,110)**	**841**
Investments	4,206	5,164	5,164	5,164
Net Fixed Assets	20,513	20,267	16,104	14,742
ROU Assets	-	-	-	-
Capital Work-in-Progress	1,347	799	3,512	3,512
Total Intangible Assets	-	-	-	-
Other assets	-	-	-	-
Deferred Tax assets	-	-	-	-
Total Assets	**27,491**	**25,695**	**25,463**	**26,302**
Liabilities				
Borrowings	16,350	12,094	8,094	4,094
Deferred Tax Liability	1,099	(1,661)	(1,661)	(1,661)
Provisions	-	-	-	-
Other Liabilities	-	-	-	-
Equity Share Capital	153	153	153	153
Reserves & Surplus	9,609	14,818	18,586	23,425
Total Net Worth	**9,762**	**14,970**	**18,739**	**23,577**
Minority Interest	280	291	291	291
Total Liabilities	**27,491**	**25,695**	**25,463**	**26,302**

Source Company data, I-Sec research

Exhibit 8: Quarterly trend

(INR mn, year ending March)

	Jun-23	Sep-23	Dec-23	Mar-24
Net sales	17,924	18,868	18,846	19,749
% growth (YoY)	10.1	3.2	9.8	16.9
EBITDA	1,694	1,943	1,756	2,210
Margin	9.5	10.3	9.3	11.2
Other income	188	67	89	64
Net profit	489	477	593	800

Source Company data, I-Sec research

Exhibit 9: Cashflow statement

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Operating Cashflow	**3,779**	**10,108**	**8,176**	**10,157**
Working Capital Changes	(1,247)	(8)	(645)	167
Capital Commitments	(3,495)	(2,575)	(2,200)	(2,464)
Free Cashflow	**284**	**7,534**	**5,976**	**7,693**
Other investing cashflow	373	(682)	303	334
Cashflow from Investing Activities	**(3,122)**	**(3,257)**	**(1,897)**	**(2,130)**
Issue of Share Capital	-	-	-	-
Interest Cost	(1,903)	(1,939)	(1,400)	(1,200)
Inc (Dec) in Borrowings	2,350	(4,256)	(4,000)	(4,000)
Dividend paid	-	-	(306)	(458)
Others	989	0	0	0
Cash flow from Financing Activities	**1,436**	**(6,195)**	**(5,706)**	**(5,659)**
Chg. in Cash & Bank balance	2,093	657	573	2,368
Closing cash & balance	3,271	3,928	1,876	4,244

Source Company data, I-Sec research

Exhibit 10: Key ratios

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
Per Share Data (INR)				
Reported EPS	2.2	13.4	26.7	34.7
Adjusted EPS (Diluted)	2.2	13.4	26.7	34.7
Cash EPS	24.2	35.5	50.6	59.7
Dividend per share (DPS)	-	-	2.0	3.0
Book Value per share (BV)	63.9	98.0	122.6	154.3
Dividend Payout (%)	-	-	7.5	8.7
Growth (%)				
Net Sales	17.4	10.0	15.2	14.0
EBITDA	52.1	41.5	27.3	15.9
EPS (INR)	(143.0)	512.2	98.9	30.0
Valuation Ratios (x)				
P/E	259.6	42.4	21.3	16.4
P/CEPS	23.5	16.0	11.2	9.5
P/BV	8.9	5.8	4.6	3.7
EV / EBITDA	18.2	12.5	9.4	7.5
EV / Sales	1.5	1.3	1.1	0.9
Profitability Ratios				
Gross Profit Margins (%)	35.4	37.3	37.0	37.0
EBITDA Margins (%)	8.0	10.2	11.3	11.5
EBIT Margins (%)	3.1	5.8	7.1	7.6
Net Profit Margins (%)	0.5	2.7	4.7	5.3
RoCE (%)	4.2	16.0	19.1	22.6
RoE (%)	4.0	16.7	21.7	22.5
Dividend Yield (%)	-	-	0.4	0.5
Operating Ratios				
Fixed Asset Turnover (x)	3.1	3.6	4.4	5.4
Inventory Turnover Days	36	33	34	34
Receivables Days	32	24	28	28
Payables Days	63	58	58	58
Effective Tax Rate (%)	56.8	11.4	25.0	25.0
Net Debt / Equity (x)	1.3	0.6	0.3	0.0
Net Debt / EBITDA (x)	2.3	1.3	0.5	(0.1)

Source Company data, I-Sec research

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