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LEGACY | TRUST | GROWTH

Initiating Coverage Note

Varroc Engineering Ltd.

03rd February 2020

Name:- Mahesh Bendre

Brief Overview

CMP (INR) (As on 3rd Feb 2020)	447
Target (INR)	615
Upside(%)	37%
Recommendation	BUY

BSE Code	541578
NSE Code	VARROC
Reuters Ticker	VARE.NS
Bloomberg Ticker	VARROC.IN

Stock Scan

Market cap (INR mn.)	60,260
Outstanding Shares (mn.)	135
Face Value (INR)	1.00
Dividend Yield(%)	0.2
TTM P/E (x)	16.6
Industry P/E (x)	26.3x
Debt/Equity (x)	0.2
Beta vs. Nifty	1.4
52 Week High/ Low (INR)	667 / 380
Avg. Daily Volume (NSE)/1yr	60,872

Shareholding Pattern (%)

	Dec-2019	Sep-2019	Jun-2019
Promoters	85%	85%	85%
Institutions	12.49%	12.63%	12.19%
Non-Institution	2.51%	2.37%	2.81%

Stock vs. Nifty (Relative Returns)

Tide is Turning

Varroc Engineering Ltd (Varroc) is world's 6th largest external automotive lighting company and among the top five diversified Indian auto ancillary. It is on the cusp of strong double digit sales growth over the next 2-3 years supported by operationalization of its 6 manufacturing facilities in its international lighting business and introduction of BS-VI related products in Indian market. It is expected to add ~29% incremental sales over FY20-22E. This is likely to lead robust operating and financial leverage resulting in 51.4% PAT CAGR over FY20-22E. At Rs447 the stock quotes at a PER of 9.8x FY22E and EV/EBITDA of 4.1x. We find valuations attractive. Initiate coverage with a BUY rating and target price of Rs615 (~14x FY22 PER).

- ◆ Varroc's International lighting business (~62% of its sales) is set to grow at 15%+ CAGR over next 2-3 years on account of scaling up of its 6 newly constructed manufacturing facilities which are backed by assured business (~70% booked) and new orders wins. The Company is in process of investing ~200mn euros in these plants which has a potential to generate incremental sales of ~ 525mn euros (60% additional sales) over the next 2-3 years. We anticipate healthy double digit sales CAGR over FY20-23E.
- ◆ In its domestic business (~38% of sales), Varroc has developed new BS -VI related products like catalytic converter and electronic fuel injection systems. Also it has recently received order for 720,000 AC generators from TVS of Rs0.45bn. These products can add ~10% incremental sales to its existing revenue base. Varroc has also developed prototype for traction motor and controller for 2W EV's which is currently under testing by its potential customers. We expect its domestic business to report ~11% Sales CAGR over FY20-22E.
- ◆ We expect Varroc to report EBITDA margins of 9.8% and 10.6% in FY21E and FY22E respectively (135bps expansion over FY20-22E) on account of strong operating leverage (~29% additional sales) and increased automation in its factories.
- ◆ We estimate Varroc's PAT margins to expand from 2.3% to 4.1% over FY20-22E. The company is expected to report earnings CAGR of 51.4% over FY20-22E resulting in profits more than doubling over the same period.

Valuation : Varroc is expected to spend ~Rs11.5bn Capex over FY20-22E against cumulative EBITDA of ~Rs29bn. This is likely to lead substantial deleverage and expansion in ROE. Net D/E to decline from 0.6x to 0.2x and ROE to expand from 8.3% to 15.5% over FY20-22E. The stock at Rs447 quotes at PER of 9.8x FY22E and EV/EBITDA of 4.1x. We initiate coverage on the Company with a BUY rating and SOTP based price target of Rs615 (~14x FY22 PER) implying 37% upside over 15 months.

Financial Performance at a glance

Rs mn	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	102,788	120,365	115,693	131,879	148,811
Growth %	10.5	17.1	(3.9)	14.0	12.8
EBITDA	8,808	10,889	10,698	12,924	15,774
Margin (%)	8.6%	9.0%	9.2%	9.8%	10.6%
Net Profit	4,502	4,463	2,679	4,075	6,138
Margin (%)	4.4%	3.7%	2.3%	3.1%	4.1%
EPS	33	33	20	30	46
BVPS	210	229	248	274	314
P / E (x)	13.4	13.5	22.5	14.8	9.8
P / BV (x)	2.1	2.0	1.8	1.6	1.4
EV/EBITDA (x)	7.4	7.3	7.2	5.7	4.1
ROE (%)	18.0%	15.1%	8.3%	11.6%	15.5%
ROCE (%) (Pre tax)	15.7%	13.6%	8.3%	11.3%	15.9%

BUSINESS STRUCTURE

Varroc primarily operates through four business divisions across Indian and international market. Following is the broad business structure of the Company indicating its products, user industry, manufacturing facilities, customers and employees.

Product Segment	Global Lighting	Polymer Business	Electric & Electronics	Metallic Business
Sales Mix	62%	16%	12.0%	7%
Description	Tier -1 high-end automotive lighting systems for PV and 2W	One of largest supplier of plastic components & mirror assembly to auto -OEMs	One of largest polymer solution providers to all auto OEMs with pan India presence	Forged and machined parts for engines and transmissions to India & international markets.
Product Portfolio	Head Lamps, Rear Lamps, Small Lighting (CMSL, Fog)	Air Filter Assembly, Seating Assembly, Plastic Interiors, Exteriors, Painted Plastic Products, Mirror Assembly, CV Seats	2W lighting for Indian , Digital clusters, Motors, Magnetos, Regulator & Rectifiers, Body switches, CDI, Catalytic Converters	Engine Parts, Engine Valves, Transmission gears, CV Crankshaft, Connecting Rods, Links & Rollers
Segments	PV and 2W	2W, 3W, PV & CV	2W, 3W, PV & CV	2W, 3W, PV, CV, & OHV, Earth-moving & Oil-drilling
Manufacturing Facilities	Total facilities - 13 (Czech-2, China-2, Turkey-2, Mexico-1, India-1, Brazil-1, Morocco -1, Italy-1, Romania-1, Vietnam)	Total facilities 14 (India)	Total Facilities -11 (India-8, Italy-1, Romania-1, Vietnam-1)	Total Facilities -7 (India -5 and Italy-2)
Employee strength	7870+	1940+	1350+	1785+
Key customers	Ford, JLR, Tesla, FCA, PSA, VW, Renault/Nissan, GM	Ashok Leyland, Bajaj, Eicher, Fiat, GM , Hero, Harley Davidson, Honda, KTM, M&M, Suzuki, Tata, Volvo, Triumph, VW	Atul Auto, Bajaj, Honda, Piaggio, Royal Enfield, Suzuki, Tata, VW, Yamaha	Ashok Leyland, Bajaj, Caterpillar, Eicher Motors, GM, Harley Davidson, Hero, Honda, JCB, KTM, M&M, Maruti, Tata, Piaggio

Source: Company Data

REVENUE SEGMENTATION

Following are the Varroc's FY19 revenue segmentation across a) Geography b) Vehicle type c) Business segment and d) Customers.

Revenue Split by Geography	FY19
Europe	45.6%
India	34.6%
North America	17.9%
Asia Pacific	0.8%
Others	1.1%

Geography

Revenue Split by Vehicle Type	FY19
4W	62.9%
2/3W	34.1%
Others	3.0%

Vehicle type

Revenue Split by Segment	FY19
Lighting	62.4%
Polymer	15.6%
Electrical	11.1%
Metallic	6.7%
Others	4.1%

Business segment

Revenue Split by Customer	FY19
Bajaj	18.4%
Ford	12.5%
JLR	13.2%
Tesla	7.7%
FCA	3.7%
PSA	5.5%
VW	8.6%
Others	30.4%

Customers

Source: Company Data and Stewart and Mackertich Research

EVOLUTION OF VARROC

Varroc has 30 years of business operating history. From a single product – single customer company, Varroc has evolved itself into an India based MNC with its operations spread across globe and India. Over the last 12 years, it has spent ~Rs12bn+ on six acquisitions to increase its reach and customers.

Year	Corporate Development
1990	Polymer Business
2005	2W and 3W Catalytic Converters
2007	Acquired Forging company, IMES Italy for €65mn (40,000 tons of forged and machined)
2011	Acquired Triom (Italy) for €7.2mn, 2W LED Lighting technology
2012	Acquired Visteon's global PC lighting business for \$92mn (now VLS) -
2014	Acquired 50% in Varroc TYC Corporation (China)
2017	Investment in manufacturing facilities in Brazil & Morocco
2018	Acquired PV lighting business in Turkey Rs3.5bn
2018	Varroc listed on India Stock Exchanges (NSE & BSE)
2019	Acquired 74% stake in CarlQ Rs192mn

Source: Company Data

GLOBAL LIGHTING BUSINESS ON THE PATH OF DOUBLE DIGIT GROWTH OVER NEXT 3-4 YEARS

Global lighting business contributes ~60% to Varroc's sales. It is a world's 6th largest external automotive lighting company with 13 manufacturing facilities spread across multiple geographies with 7800+ employee base.

- **Complete solution provider:** VLS (Varroc's Global Lighting Business) is one of the leading global suppliers of exterior automotive lighting for passenger vehicles. The company designs, manufactures and supply exterior lighting for passenger vehicles in Europe and North American market. Its product portfolio include headlamps, fog lamps, rear lamps and center high mount stop lamps meant for passenger vehicles.
- **Robust product portfolio:** The Company has a robust and diverse product portfolio of lighting technologies including Halogen, Xenon, LED, Matrix LED, high definition MEMS and DMD, surface LED and OLED module, Flex LED etc. Diverse product basket enables Varroc to cross-sell its products to its customers as per their requirement.
- **Marque client base:** The Company has a strong business relationship with marquee auto manufacturers including Ford, Jaguar Land Rover, FCA, PSA, Tesla, GM etc. In addition to this, Varroc has expanded its customer base to include new OEMs such as VW Group, Renault-Nissan-Mitsubishi and Volvo Truck etc.

European Car Market Share	CY18	CY19	Varroocs Presence
VW Group	23.9	24.3	Yes
PSA Group	16.2	15.9	Yes
RENAULT Group	10.6	10.6	Yes
HYUNDAI Group	6.7	6.8	No
BMW Group	6.5	6.6	No
DAIMLER	6.2	6.4	Yes
FORD	6.3	6.2	Yes
FCA Group	6.6	6.1	Yes
TOYOTA Group	4.8	5.0	No
NISSAN	3.1	2.5	Yes
VOLVO CAR CORP.	2.0	2.1	Yes
MAZDA	1.5	1.6	No
JAGUAR LAND ROVER Group	1.5	1.4	Yes
MITSUBISHI	0.9	0.9	Yes
HONDA	0.9	0.8	No

Source: ACEA

- **Broad Reach:** Varroc is sixth-largest tier-1 automotive exterior lighting manufacturer globally and one of the top three independent exterior lighting players. Based on its current product portfolio and manufacturing reach (including new Morocco and Brazil plants) the Company covers 80%+ of the global automotive market. The Company does not have presence in Japan and Australia. currently

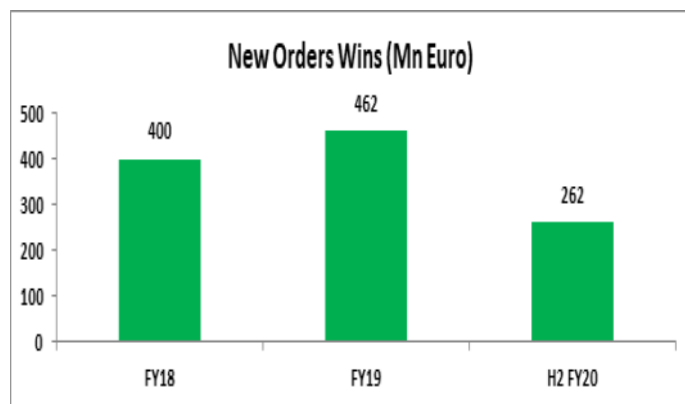
	FY17	Country	Group	Exterior Lighting Tier-1 Mkt share	Market Share for Premium OEM's vehicles (%)
1	Koito	Japan	Toyota	28%	16%
2	Magneti Marelli	Japan (European Op)	Calsonic Kansei (Fiat Chrysler Automobiles)	17%	25%
3	Valeo	Europe	Independent	13%	15%
4	Stanley	Japan	Toyota, Honda Motors	12%	6%
5	Hella	Europe	Independent	10%	18%
6	Varroc	India	Independent	4%	6%
7	Other			16%	14%

Source: Company Data / Stewart and Mackertich Research

- **Robust R&D capabilities:** The Company has a strong R&D team of more than ~900 engineers located in its 10 R&D centers located in the Czech Republic, India, China, Mexico, Germany, Poland and USA. Its R&D focus has enabled it to establish a presence in key emerging technologies (such as LED) as well as a broad portfolio of headlamp technologies (such as matrix LED and laser), and to supply products for electric vehicles. Its Global Lighting Business had 184 patents as of December 2017.
- **Low cost, strategically located manufacturing and design footprint :** The Company has set up its manufacturing facilities primarily in low cost (production and labor costs) countries near major automotive markets .The Company has 13 manufacturing facilities spread across seven countries - Czech(2), China (2), Turkey (2), Mexico, India, Brazil and Morocco. The Company has made further investments to expand into Brazil and Morocco. This manufacturing positioning offers Varroc a competitive advantage over its peers in terms of offering its products from low cost and strategically located manufacturing base.

Global Lighting Business

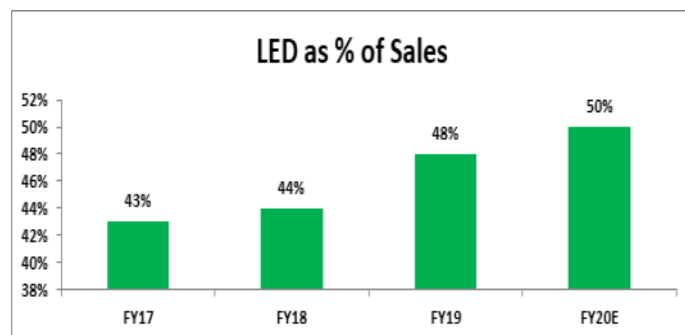
New order wins (1.3 xs to its FY19 sales): Varroc has consistently exhibited its ability to win new orders from international customers. Over the last 30 months it has won fresh orders worth Euro 1124mn which is equivalent to 1.3 xs to its FY19 sales. This gives robust visibility for the Company going forward.



Source: Company Data

Global Order Wins	New orders	Re-wins	Total
Q2FY20	Eur 145 mn	Eur 117 mn	Eur 262 mn
Q1FY20	Eur 81 mn	Eur 12 mn	Eur 93 mn
Q4FY19	Eur 228 mn	Eur 234 Mn	Eur 462 mn
	VW - Eur 122 mn		
	Ford - 110 mn		
	Tesla - 69 mn		
	PSA - 33 mn		
	GM - 30 mn		
	RN - 27 mn		
	JLR - 11 mn		
	Others - 36 mn		

Varroc's Improving LED penetration: LED based automotive lighting system offers more design flexibility, increased efficiency and allows new functionalities compared to traditional halogen based lighting systems. This is why LED lightings are becoming popular and their penetration is going up despite cost of LED technology is higher than halogen (~2x). Varroc has already adopted to this trend wherein ~50% of its current sales is derived from LED lighting compared to 43% in FY17.



Six Manufacturing facilities to be fully running over next 6-9 months: Over the last 2 years, Varroc has invested ~200mn euros in setting up 6 new manufacturing facilities across six countries. Out of these, four facilities have already become operational while remaining two are likely to commence production over the next 3-4 months. These facilities are backed by assured business (~70% booked) and have a potential to generate incremental sales of ~ 525mn euros (60% additional sales) over the next 2-3 years. These facilities are likely to scale up their operations over the next 12 months. Although FY23 is likely to be the peak for the execution; we anticipate 15%+ sales CAGR over the next 2-3 years.

No	Facility	Operational Quarter	Sales at full capacity (EurMn)	Full Year Sales Potential	Target Breakeven	Confirmed orders (Oct 2019)
1	Brazil	Q4FY19	30	FY22	Q4FY21	100% sourced business
2	Czech New Line (H8)	Q4FY19	90	FY22	Q2FY21	100% sourced business
3	Bulgaria	Q4FY19	10	FY22	Q2FY21	100% Sourced Business
4	Morocco	Q4FY19	180	FY23	Q2FY21	~70% sourced business
5	Poland	Q4FY20	200	FY23	Q4FY21	~55% sourced business
6	Chennai	Q1FY21	30	FY24	Q4FY21	~60% sourced business
		Total	540			

Varroc domestic business is on sound footing....

For its India operations, Varroc has set up 26 manufacturing facilities and 5 R&D centers spread across India. The Company has a strong relationship with Bajaj Auto as its customer for the past 30 years. Its other 2W customers in India include HMSI, Royal Enfield, Yamaha, Suzuki and Hero. It also exports to global 2W manufacturers (KTM and Volvo) from its facilities in India. Going forward, Varroc anticipates substantial head room for growth in the value of products it supplies to Hero and HMSI, India's two largest two-wheeler OEMs as they currently constitute a small part of its portfolio

No	India Market Segment	Competitive Landscape	Market Size (FY17)	Varroc Sales (FY19)
1	Polymer segment			
	Air filter assembly	Lumax, Mahle Filters, Ranee Polymers, Varroc	Rs48bn	Rs18.9bn
	Mirror assembly	Varroc, Fiem Industries, Sandhar Technologies		
	Seat Assembly	TS Tech, Bharat Seats, Varroc, Meenakshi Polymers		
	Body part assembly	Fiem Industries, Lumax, Badve Group.		
2	Electrical segment			
	Instrument clusters	JNS Instruments, Minda Stoneridge, Pricol	Rs70bn	Rs14.5bn
	CDI	Denso India, Napino Auto, India Nippon, Varroc		
	Starter motor	Denso India, Ducati Energia, Flash Electronics, Varroc		
	Wiper motors	Flash Electronics, Lucas-TVS, Varroc.		
	Catalytic converters	Mark Exhaust, S.M. Auto, Varroc		
	Magneto	Denso India, Flash Electronics, Mitsuba Sical, Varroc.		
3	Metallic Business			
	transmission assembly	Varroc, Hi-Tech Gears, Musashi, Sundaram Fasteners	Rs15bn	Rs8.3bn

Source: Company Data

Product penetration in Domestic Customers:

No	Domestic Customers	FY19 Sales	% of sales
1	Bajaj Auto	22,418	53%
2	HMSI	3,939	9%
3	Royal Enfield	2,699	6%
4	India Yamaha	2,007	5%
5	Mahindra	990	2%
6	Other	10,613	25%
	Total	42,666	

Source: Company Data

Product penetration in Domestic customers:

- Bajaj Auto: Varroc supplies 16 total products across 3 product lines, namely Polymers, Electrical and Metallic.
- HMSI: Over FY13 to FY19, Varroc has increased its product numbers from 4 to 8+. HMSI has been its customer since 2005.
- Royal Enfield (RE): Over FY13 to FY19, Varroc has increased its product numbers from 8 to 12+. RE has been its customer since 2005.
- Yamaha India: Over FY13 to FY19, Varroc has increased its product numbers from 7 to 8+. Yamaha has been its customer since 2006.
- Suzuki: Over FY13 to FY19, Varroc has increased its product numbers from 3 to 7+. Suzuki has been its customer since 2008.
- Hero: Over FY13 to FY19, Varroc has increased its product numbers from 1 to 3+. Hero has been its customer since 2014

Investment Rationale

BS—VI- Product portfolio to add ~10% incremental sales in FY21

For Indian operations, Varroc plans to capitalize on new trends which include A) migration to BS-VI emission standards B) increased use of electronics and C) light-weighting of vehicles. Under the BS-VI product portfolio, the Company plans to supply catalytic converter and the electronic fuel injection systems for 2W in India. In January 2018, Varroc signed technology tie up with Germany based entity for the development of catalytic converter technology for use in India. Addition to this it also entered into JV with Dell'Orto S.p.A for the production of electronic fuel injection control systems. Also during FY19, the Company acquired TVS as a customer for supply of 720,000 AC generators on yearly basis. The order is expected to start from Q4FY20. The Company expects to garner additional volumes going forward. It has also developed prototype for traction motor and controller for 2W electric vehicle which is currently under test by potential customers.

Customers	Product Line	Sales Potential (FY21)
Bajaj Auto and Other Customer	catalytic converters	Rs3bn+
Royal Enfield	fuel injection system	Rs0.7bn+
TVS	AC generators	Rs0.5bn+
Total		Rs4.2bn+

We believe, these products are likely to add 10% incremental sales to its existing revenue base in FY21 further increasing its content per vehicle in Indian market. We expect Varroc's India based business to report ~11% Sales CAGR over FY20-22E.

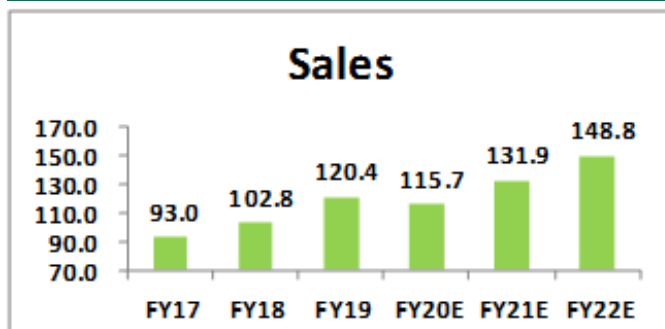
Assumption Table

Rs Mn	FY17	FY18	FY19	FY20E	FY21E	FY22E
Global Lighting Business	61,242	63,211	72,668	72,302	83,389	95,626
India Business	28,583	35,409	42,744	40,373	45,170	49,532
Other Businesses	3,163	4,066	5,485	3,018	3,320	3,652
Net Consolidated sales	92,988	102,686	120,897	115,693	131,879	148,811
Growth						
Global Lighting Business	27.1%	3.2%	15.0%	-0.5%	15.3%	14.7%
India Business	3.2%	23.9%	20.7%	-5.5%	11.9%	9.7%
Other Businesses	-0.7%	28.6%	34.9%	-40.0%	10.0%	10.0%
Net Consolidated sales	18%	10%	18%	-4%	14%	13%
Contribution						
Global Lighting Business	66%	62%	60%	62%	63%	64%
India Business	31%	34%	35%	35%	34%	34%
Other Businesses	3%	4%	5%	3%	2%	2%
Net Consolidated sales	100%	100%	100%	100%	100%	100%
EBITDA						
Global Lighting Business	3,278	4,811	6,285	6,507	8,089	10,136
India Business	2,390	3,772	4,423	3,997	4,698	5,399
Others	149	225	335	59	130	163
Total EBITDA	5,818	8,808	11,043	10,563	12,916	15,698
EBITDA Margins						
Global Lighting Business	5.4%	7.6%	8.6%	9.0%	9.7%	10.6%
India Business	8.4%	10.7%	10.4%	9.9%	10.4%	10.9%
Others	4.7%	5.5%	6.8%	2.0%	3.9%	4.5%
Total EBITDA Margins	6.3%	8.6%	9.2%	9.1%	9.8%	10.6%

Source: Company Data and Stewart & Mackertich Estimates

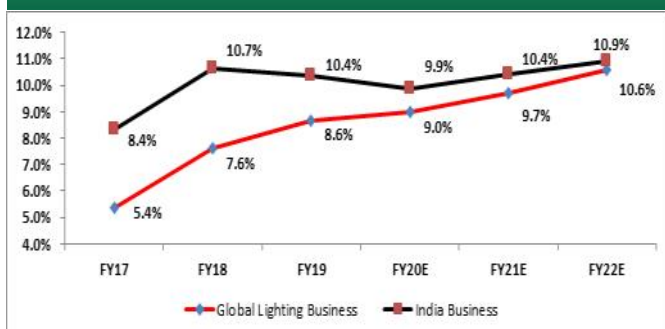
Financial Performance

Sales (Rs Bn)



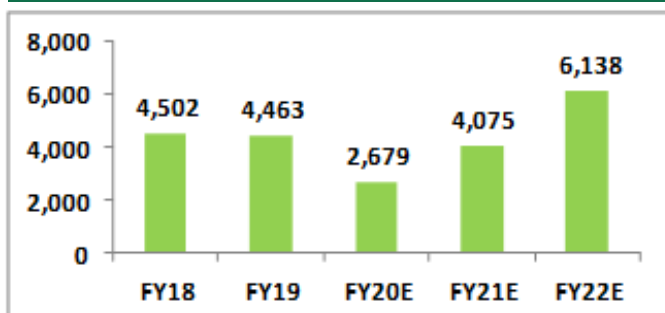
Source: Company Data and Stewart & Mackertich Estimates

Global & India Business

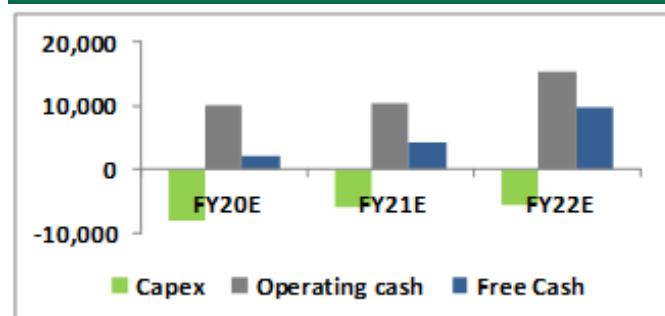


Source: Company Data and Stewart & Mackertich Estimates

PAT (Rs Mn)



Source: Company Data and Stewart & Mackertich Estimates



Source: Stewart & Mackertich Estimates

Sales CAGR of 13.4% through FY20-22E:

We expect Varroc to report 13.4% sales CAGR through FY20-22E on account of a) Global Lighting business segment (~60% of sales) growing at ~15% CAGR and b) India based business (~35% of sales) expanding at ~11% CAGR.

EBITDA Margins to Expand by 135bps over FY20-22E:

We expect Varroc to report 135bps EBITDA margin expansion over FY20-22E on account of strong operating leverage (~29% additional sales over FY20-22E), high utilization in its existing facilities and increased automation within its factories. The Company is expected to report EBITDA margins of 9.8% and 10.6% in FY21E and FY22E respectively

PAT margins to expand from 2.3% to 4.1 - Profit to more than double over FY20-22E:

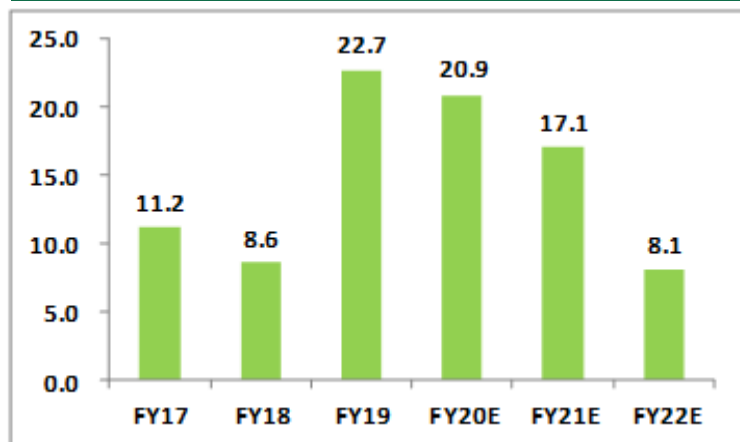
We estimate Varroc's PAT margins to expand from 2.3% to 4.1% over FY20-22E on account of a) 135bps EBITDA margin expansion and b) Interest cost saving on account of debt repayment. The company is expected to report earnings CAGR of 51.4% over FY20-22E resulting in profits more than doubling over the same period.

Decline in Capex to lead substantial improvement in Financial Matrix:

Over the next two years (FY20-22E), Varroc is expected to spend ~Rs11.5bn cumulative Capex as against cumulative EBITDA generation of ~Rs29bn over the same period. This is likely to lead substantial deleverage and expansion in ROE for Varroc. Net D/E to decline from 0.6x to 0.2x and ROE to expand from 8.3% to 15.6%.

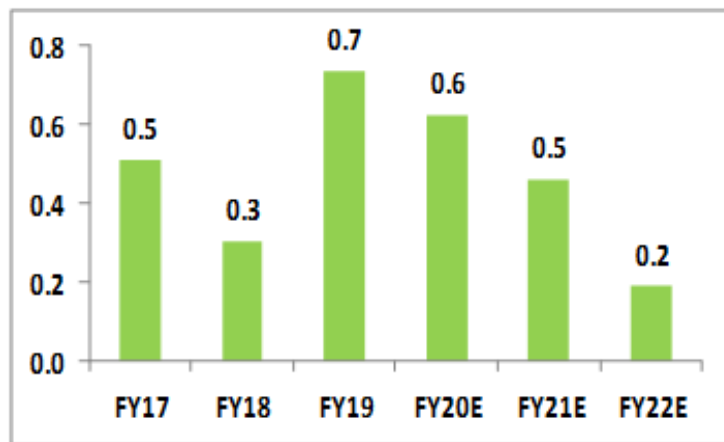
Investment Rationale

Net Debt (Rs Bn)



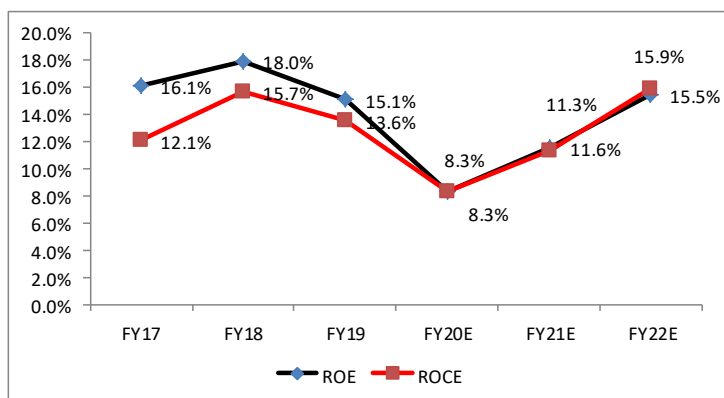
Source: Stewart & Mackertich Estimates

Net D/E



Source: Stewart & Mackertich Estimates

ROE and ROCE



Source: Stewart & Mackertich Estimates

ROE and ROCE to Expand

Varroc is expected to report ROE of 11.6% and 15.5% and ROCE of 11.3% and 15.9% (Pre Tax) in FY21E and FY22E respectively on account on 13.4% sales and 51.4% PAT CAGR over FY20-22E.

Relative Valuations

Indian Peers	Sales (Rs mn)				EBITDA (%)			PAT (Rs mn)			
Company	FY20	FY21	FY22	CAGR	FY20	FY21	FY22	FY20	FY21	FY22	CAGR
Minda Industries	61,832	73,985	85,391	17.5%	12.1	12.6	12.9	2,955	4,154	5,102	31.4%
Motherson Sumi	682,112	718,467	785,731	7.3%	8.2	9.5	9.9	16,985	21,997	29,555	31.9%
Varroc	115,693	131,879	148,811	13.4%	9.2%	9.80%	10.6%	2,679	4,075	6,138	51.4%
Endurance	76,873	84,211	94,747	11.0%	15.3	15.4	15.5	5,668	6,558	7,862	17.8%

Source: Stewart & Mackertich Estimate, Bloomberg

Company	Stock Price	Mkt Cap	PE (x)			EV/EBITDA (x)			ROE (%)		
			FY20	FY21	FY22	FY20	FY21	FY22	FY20	FY21	FY22
Minda Industries	407	106,950	36.0	25.7	21.3	15.5	12.5	10.6	15.3	18.1	19.2
Motherson Sumi	126	396,790	26.6	20.7	20.7	10.4	8.5	7.4	14.9	17.2	18.0
Varroc	447	60,260	22.5	14.8	9.8	7.2	5.7	4.1	8.3	11.6	15.5
Endurance	1,071	150,460	26.2	22.6	18.9	12.3	10.8	9.1	20.5	20.6	21.3
Average			28.3	21.3	17.9	11.5	9.5	7.9	14.8	16.9	18.5

Source: Stewart & Mackertich Estimate, Bloomberg

Global Peers	Sales (Rs mn)				EBITDA (%)			PAT (Rs mn)			
Company	FY20	FY21	FY22	CAGR	FY20	FY21	FY22	FY20	FY21	FY22	CAGR
Koito	537,090	560,940	587,280	4.6%	15.1	16.2	16.6	39,890	44,420	47,700	9.4%
Hella	532,395	556,048	585,668	4.9%	13.1	13.5	14.0	25,948	29,584	32,897	12.6%
Stanley	268,710	277,360	289,090	3.7%	19.0	20.8	21.2	21,320	25,330	27,030	12.6%
Valeo	1,589,370	1,676,729	1,764,403	5.4%	12.9	13.5	14.2	42,066	58,900	76,167	34.6%

Source: Stewart & Mackertich Estimate, Bloomberg

Company	Mkt Cap (Rs Mn)	PE (x)			EV/EBITDA (x)			ROE (%)		
		FY20	FY21	FY22	FY20	FY21	FY22	FY20	FY21	FY22
Koito	767,016	12.6	11.4	10.6	4.5	4.0	3.7	13.1	13.3	13.0
Hella	4,888	14.7	13.1	11.9	5.7	5.3	4.9	11.1	11.7	12.1
Stanley	512,322	14.8	12.4	11.6	5.4	4.8	4.5	8.5	9.6	9.6
Valeo	6,676	12.4	9.3	-	4.1	3.7	-	11.4	13.8	-
Varroc	60,206	22.5	14.8	9.8	7.2	5.7	4.1	8.3	11.6	15.5
Average		15.8	12.4	11.1	5.8	4.8	4.4	10.5	12.0	12.5

Valuations and Recommendation

	EBITDA (FY22)	Multiple	Valuations
India Operations	5,401	7	37,807
International Operations	10,339	5	51,695
China Operations	147.6	10	1476
Total EV			96,379
Less : Net Debt			8,137
Equity Value (Rs Mn)			82,841
Equity Value (Rs/share)			615

The stock at Rs447 quotes at PER of 9.8x FY22E and EV/EBITDA of 4.1x. We find valuations attractive. We initiate coverage on the Company with a BUY rating and SOTP based price of Rs615 (~14x FY22 PER) implying 37% upside over 15 months.

Risks to Estimates and Recommendation

- Majority of Varroc's business comes from European market. Any sharp decline in Europe Auto market likely to have a significant negative impact on its business and earnings.
- Varroc's performance is also likely to get negatively influenced if it is unable to scale up its operations in its 6 newly constructed facilities.

Stock Returns of Global & Indian Competitors:

Sr No.	Name	1M	YTD	1 Year	3 Years
International Peers					
1	Valeo SA	-12.6%	-12.6%	0.7%	-51.4%
2	HUAYU Automotive Systems Co Ltd	2.7%	2.7%	32.1%	60.9%
3	Koito Mfg Co Ltd	-9.7%	-9.7%	-29.5%	-23.0%
4	Hella KGaA Hueck & Co	-11.0%	-11.0%	10.7%	16.5%
5	Stanley Electric Co Ltd	-10.4%	-10.4%	-9.6%	-10.5%

Source: Bloomberg

Indian Peers					
1	Varroc	15.3%	15.3%	-25.6%	-
2	Endurance	2.5%	2.5%	-3.5%	80.2%
3	Minda Industries Ltd	15.1%	15.1%	44.8%	248.7%
4	Motherson Sumi Systems Ltd.	-3.9%	-3.9%	0.1%	-4.5%

Financials

Income Statement

Particulars	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	102,788	120,365	115,693	131,879	148,811
YoY (%)	10.5	17.1	(3.9)	14.0	12.8
Raw material cost	63,827	75,458	72,876	82,809	93,142
Employee Cost	13,135	15,015	14,432	16,249	17,918
Admin Expenses	17,018	19,003	17,687	19,897	21,976
Total expenses	93,980	109,476	104,995	118,955	133,037
EBIDTA	8,808	10,889	10,698	12,924	15,774
(%)	8.6%	9.0%	9.2%	9.80%	10.60%
Depreciation	3,865	5,656	6,606	7,539	8,309
EBIT	4,944	5,233	4,092	5,385	7,465
Interest	862	968	1,224	1,046	710
Other income	386	908	728	757	781
PBT	4,467	5,172	3,596	5,096	7,536
(-) Tax	651	989	683	1,121	1,658
Tax/ PBT	14.6	19.1	19.0	22.0	22.0
PAT	3,817	4,183	2,913	3,975	5,878
Asso. PAT and MI	685	280	(233)	100	261
PAT	4,502	4,463	2,679	4,075	6,138

Balance Sheet

Particulars	FY18	FY19	FY20E	FY21E	FY22E
Equity capital	135	135	135	135	135
Reserves	28,145	30,736	33,254	36,838	42,238
Net worth	28,280	30,871	33,389	36,973	42,373
Total Loans	11,894	24,311	22,311	18,311	9,811
Minority Interest	208	241	276	310	345
Def Liability	(564)	(714)	(714)	(714)	(714)
Total Liabilities	39,817	54,709	55,262	54,881	51,815
Gross block	36,232	45,540	53,540	59,540	65,090
Less: Acc. depreciation	8,668	12,069	18,675	26,214	34,524
Net block	27,564	33,471	34,865	33,326	30,566
Work in progress	3,441	9,995	9,995	9,995	9,995
Goodwill	335	1,993	1,993	1,993	1,993
Other Assets	1,474	2,422	2,422	2,422	2,422

Financials

Cash Flow Statement

Particulars	FY18	FY19	FY20E	FY21E	FY22E
Net profit	4,502	4,463	2,679	4,075	6,138
Depreciation	3,865	5,656	6,606	7,539	8,309
Deferred tax	19	63	0	0	0
Change in W/C	2,243	(1,462)	630	(1,348)	748
Operating cash flow	10,628	8,721	9,915	10,266	15,196
Capex	(10,061)	(20,902)	(8,000)	(6,000)	(5,550)
Investments	97	(19)	0	0	0
Investing cash flow	(9,965)	(20,921)	(8,000)	(6,000)	(5,550)
Free Cash Flow	567	(12,181)	1,915	4,266	9,646
Dividend	(73)	(7)	(127)	(456)	(704)
Equity	1,997	(1,865)	0	0	0
Debt	(2,839)	12,417	(2,000)	(4,000)	(8,500)
Financing cash flow	(915)	10,545	(2,127)	(4,456)	(9,204)
Net change in cash	(251)	(1,655)	(212)	(190)	442
Opening cash	3,541	3,289	1,634	1,423	1,232
Closing cash	3,289	1,634	1,423	1,232	1,674

Valuation Ratios

Particulars	FY18	FY19	FY20E	FY21E	FY22E
EPS	33	33	20	30	46
Book value	210	229	248	274	314
P/E (x)	13.4	13.5	22.5	14.8	9.8
EV/EBDITA (x)	7.4	7.3	7.2	5.7	4.1
P/B (x)	2.1	2.0	1.8	1.6	1.4
EV/Sales	0.6	0.7	0.7	0.6	0.4
ROCE (Pre Tax)	15.7%	13.6%	8.3%	11.3%	15.9%
ROCE (Post Tax)	14.0%	11.5%	7.1%	9.3%	12.8%
ROE	18.0%	15.1%	8.3%	11.6%	15.5%
Net D/E	0.3	0.7	0.6	0.5	0.2
Gross Asset Turnover	3.2	2.9	2.3	2.3	2.4
Avg Net WC Days	4	2	4	2.	2
Net W/C (% of sales)	0.0%	1.2%	0.7%	1.6%	0.9%

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