



IPO note: Varroc Engineering Ltd. (Varroc) – Robust play on auto lighting systems - "SUBSCRIBE" 25th June, 2018

Incorporated in 1988 at Aurangabad by Jain Family, Varroc Engineering, is a Tier I automotive component group which is engaged in designing, manufacturing and supplying exterior lighting systems, plastic and polymer components, electrical-electronic components, and precision metallic components to passenger cars, commercial vehicles, two-wheelers, three-wheelers, and off highway vehicle manufacturers. Varroc has a global footprint of 36 manufacturing facilities spread across seven countries. It is the second largest Indian auto component group (by consolidated revenue for FY2017) (Source: CRISIL Research) and a leading tier-1 manufacturer and supplier to Indian two-wheeler and three-wheeler OEMs (by consolidated revenue for FY2017) (Source: CRISIL Research). It 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: Yole). It has a global footprint of 36 manufacturing facilities spread across seven countries, with six facilities for global lighting business, 25 for India business and five for other businesses. Given its global presence, the revenue stream is diversified both geographically as well as across customers.

The Company commenced operations with its polymer business in 1990 and initially grew organically in India by adding new business lines such as its electrical and metallic division. Subsequently, it diversified its product offerings and expanded its production capacity through various investments, joint ventures and acquisitions. Varroc's acquisitions most notably included its 2012 acquisition of Visteon's global lighting business, now known as Varroc Lighting Systems. Prior to the acquisition of Visteon's global lighting business, in 2007 it acquired I.M.E.S (a manufacturer of hot steel forged parts for the construction and oil and 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, the company expanded its global lighting business by acquiring Visteon's holding in a 50/50 joint venture with Beste Motor Co. Ltd. ("TYC") to manufacture automotive lighting in China, namely Varroc TYC (which wholly owns Varroc TYC Auto Lamps, which in turn wholly owns Varroc TYC Auto Lamps (CQ) ("China JV"). The Company received PE investment from Omega TC Holdings Pte. Ltd. and Tata Capital Financial Services Ltd. in FY14.

On February 13, 2018, it entered into a joint venture with Dell'Orto S.p.A., one of its customers, in India, for the development of electronic fuel injection control systems for two-wheelers and three-wheelers. The company has also expanded its manufacturing and R&D footprint by investing in nine manufacturing plants and an additional R&D center in India since 2012. It continues to expand its manufacturing and R&D footprint, and intend to set up one manufacturing facility in Brazil and one manufacturing facility in Morocco, as well as two manufacturing facilities in India.

The Company has witnessed decent track record of financial performance. The consolidated top-line and bottom-line CAGR stood at ~12% and 10% respectively over FY2016-18. In FY18, Varroc reported total operating income of Rs 10,378 crore with net profit at Rs 451 crore.

Objects of the issue

The Offer for Sale (OFS)

The proceeds of the Offer for Sale shall be received by the Selling Shareholder. The Company will not receive any proceeds from the Offer for Sale. The following are the selling shareholders:

- a) Tarang Jain : 1,752,560 equity shares offered by the Promoter in OFS
- b) Omega TC Holdings Pte Ltd.: 16,917,130 equity shares
- c) Tata Capital Financial Services Ltd.: 1,552,040 equity shares

Before the issue, promoters' stake in the company stands at 86.3 per cent while public and others read 13.7 per cent. Post the issue, the promoters' stake will come down to 85 per cent while those of public and others will increase to 15 per cent.

Issue date	June 26 - June 28, 2018
Listing date	July 06, 2018
Type of issue	Offer for sale: 20.22 mn equity shares
Face Value	Re. 1
Price Band	Rs. 965 – Rs.967
Issue size	Rs. 19.55 billion
Issue allocation	QIB: 50% HNI: 15% Retail: 35%
Lot size	15 equity shares and in multiple thereof
Post issue market cap	Rs. 130 billion
Book Running Lead Managers	Kotak, Credit Suisse, Citigroup, IIFL
Registrar to the issue	Link Intime
Promoter	Mr. Tarang Jain (nearly 30 years of experience in automotive industry)

Y/e 31 Mar (Rs. mn)	FY18	FY17	FY16
Total Income	103,785	96,085	82,189
EBITDA	9,162	6,755	5,916
EBITDA (%)	8.83	7.03	7.20
PAT	4,508	3,034	3,698
PAT (%)	4.34	3.16	4.50
Equity Share Capital	134.81	134.81	262.37
Networth	28,268	21,834	17,463
Book value (Rs.)	210	193	156.66#
EPS (Rs.)	33.40	27.74	21.77
P/E (x)	29	35	32
P/BV (x)	4.6	5	4.5
RoE(%)	15.94	13.88	21.15

Source: RHP, #is computed after conversion of CCPS

Investment recommendation and rationale

At the upper end of the price band, the issue is valued at 29 times of FY18 EPS which we feel is slightly expensive owing to the premium it commands due to the following factors like: a) 6th largest fastest growing among top six global exterior auto lighting suppliers, b) strong competitive position in attractive growing markets, c) focus on high growth markets for its global lighting business, d) long standing relationships with marquee clients like Ford, Jaguar Land Rover, Volkswagen, Renault-Nissan-Mitsubishi, American electric car manufacturer - Tesla, Harley Davidson, Suzuki, Honda, Bajaj Auto, Yamaha, Hero, Piaggio, Eicher Motors (Royal Enfield) etc, e) comprehensive product portfolio, f) low cost, strategically located manufacturing and design footprint of 36 manufacturing facilities spread across seven countries, with six facilities for global lighting business, 25 for India business and five for other businesses, g) robust in house technology, innovation and in house R&D capabilities in India, Czech Republic, China, USA, Mexico, Germany, Italy, Romania with 1,414 R&D engineers – 185 patents granted globally, h) strong balance sheet with Net Debt: Equity at 0.31x, positive operating cashflow with decent RoE of 15.94%, we recommend "SUBSCRIBE" to the issue.

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