



IPO Product note of Varroc Engineering

About the Issue

The upcoming IPO of Varroc Engineering Ltd. will remain open for subscription from June 26-28, 2018. The issue consists of Offer for Sale (OFS) comprising of 2,01,21,730 equity shares with face value of Rs 1 per share. The IPO size is worth Rs 1945.77 crore. The price band is in the range of Rs 965-967 per share. The minimum lot size consists of 15 shares. The company will get listed on both BSE and NSE.

Purpose of the Issue

The objects of the OFS are to achieve the benefits of listing the equity shares on the stock exchanges and to carry out the Offer for Sale by the selling shareholders. The company will not receive any proceeds from the OFS and all the proceeds will be received by the selling shareholders, in proportion to the equity shares offered by the respective selling shareholders as part of the offer.

Company Background

Varroc Engineering is a global tier-1 automotive components group. It designs, manufactures and supplies exterior lighting systems, plastic and polymer components, electrical-electronic components and precision metallic

components to OEMs of passenger cars, commercial vehicles, two-wheelers, three-wheelers and off-highway vehicles (OHV) directly worldwide.

It has end-to-end capabilities across design, R&D, engineering, testing, manufacturing and supply of various products across its business. It has mainly two primary business lines, namely (i) the design, manufacture and supply of exterior lighting systems to passenger cars OEMs worldwide and (ii) the design, manufacture and supply of a wide range of auto components in India, primarily to OEMs of two-wheelers and three-wheelers, including exports. The India business offers a diversified set of products across three product lines, namely polymers/plastics, electrical/electronic and metallic components.

The company has a global footprint of 36 manufacturing facilities spread across seven countries, with six facilities for its global lighting business, 25 for India business and five for the other businesses. It generates 65% of revenue from global plants and 35% from domestic plants.

It has long-term relationships with marquee auto manufacturers across the premium, mid-range and mass market pricing spectrum, including Ford, Jaguar Land Rover, the Volkswagen Group, Renault-Nissan-Mitsubishi, Groupe PSA, FCA, a European multinational car manufacturer and an American electric car manufacturer. It has a long-standing relationship with Bajaj Auto Ltd, a leading two-wheeler manufacturer, and its other key two-wheeler customers in India include Honda, Royal Enfield, Yamaha, Suzuki and Hero. Its global lighting business had 185 patents as on March 31, 2018.

Expansion plans

VLS is in the process of setting up a new manufacturing plant in Brazil to serve the South American market, and in Morocco to serve the southern European and North African markets. These manufacturing plants in Brazil and Morocco will commence production in FY19. An agreement to acquire an exterior automotive lighting company based in Turkey was signed on May 30, 2018, with the sale scheduled to be completed by the end of June 2018, subject to receiving approval from the Turkish competition authority.

Financial Performance

The company's global lighting business has grown at a CAGR of 18.02% from FY14 to FY17 (including China JV's 50% share) in terms of revenue growth. Further, it managed to increase the EBITDA margins by 26.84% CAGR over FY14 to FY18 (including China JV's 50% share) and consequently, the company's EBITDA has grown by 158.8% from FY14 to FY18. But, as we can see from the above table, the company's revenue and profits have not grown consistently and the performance seems cyclical.

Valuation & peer comparison

Considering the upper price band of Rs 967 with EPS of Rs 33.4 of FY18, the P/E works out at 28.9x. For comparison we have the following peers

Particulars	EPS	P/E	RoNW
Motherson Sumi	7.59	40.6	17.6%
Bharat Forge	16.38	39.2	16.1%
Endurance Technologies	27.78	45.7	17.9%
Varroc Engineering	33.4	29.0	15.9%

*For calculating P/E, the market price is as on June 15, 2018.

As compared to its peers, its P/E is lowest and also the industry P/E is 42.6x. Thus, it can be seen that the company's IPO has been fairly priced.

MH Take:-

The company has good presence in domestic and global market and has strong long-term relationships with the marquee auto manufacturers in India and other international brands. Its expansion plans are in process which, on completion, would aid its top line. As a strategy, the company tries to put its big manufacturing and engineering footprints in the low-cost countries. In India, the company has second-largest R&D centre for its lighting business. On the financial front, the growth in revenue and profits has been cyclical. In fact, the pace of growth over the last 3-4 years has slowed down. Looking at the valuation, the issue is fairly priced. Considering all these factors and the current volatility in the market,

So, Market- Hub recommends our valuable investors that they can subscribe to the IPO with limited exposure having a long term perspective.

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