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India | Equity research | Q1FY25 results review

Varroc Engineering

Auto Ancillaries

Sub-10% EBITDA margin trend continues; downgrade to HOLD

Varroc Engineering's (VAR) EBITDAM stood at 9.2%, down ~30bps YoY, and 100bps lower than consensus estimate in Q1FY25. Margin decline YoY was due to startup costs for two new plants in Maharashtra and higher employee cost (annual wage increase). Revenue growth was 6% YoY, with 11% YoY growth in India operations partially offset by negative growth in overseas operations. We have factored-in 9% revenue CAGR and ~10.7% average EBITDA margin for FY24-26E. We have cut our FY25/26E EPS by 8%/10% due to i) weak revenue growth (underperforming domestic industry growth), and subsequently ii) weak margins, consistently below 10%. We downgrade VAR to **HOLD** (from Buy) with DCF-based revised TP of INR 595 (earlier: INR 738), implying ~22x FY26E EPS.

Q1FY25 conference call takeaways, and our views

- Revenue was up 6% YoY at INR 19bn with 11% YoY growth in India operations partially offset by negative growth in overseas operations. VAR expects gradual recovery in growth of overseas operations from Q3FY25, over the next 1-2 years. Revenue contribution from EV customers stood at 7.8% in Q1 vs 5.3% in FY24. New lifetime order win in Q1 was INR 80bn – split 22% / 78% in 4W / (2W + 3W) segments with ~48% orders from EV segment. These new orders should help VAR's growth, with likely additional revenue of INR 8.7bn 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 near term on account of ramp-up of these new orders.
- EBITDAM stood at 9.2%, down 30bps YoY led by one-off startup costs for Maharashtra plant. In medium term, VAR would focus on improving EBITDAM by reducing costs through working capital optimisation and backward integration (phase 1 of VAR's renewable energy investments is likely to commercialise in Q2FY25 and may aid in lowering its electricity cost). With these initiatives, VAR expects margin improvement from H2FY25. VAR reduced net debt by INR 668mn in Q1 to INR 9.2bn; however, quantum of debt reduction is limited at these levels since last couple of quarters due to lower growth and margins not picking up.

Basudeb Banerjee

basudeb.banerjee@icicisecurities.com
+91 22 6807 7260

Vishakha Maliwal

vishakha.maliwal@icicisecurities.com

Market Data

Market Cap (INR)	92bn
Market Cap (USD)	1,096mn
Bloomberg Code	VARROC IN
Reuters Code	VARE BO
52-week Range (INR)	717 /333
Free Float (%)	25.0
ADTV-3M (mn) (USD)	4.1

Price Performance (%)	3m	6m	12m
Absolute	17.4	(0.6)	78.9
Relative to Sensex	11.0	(9.5)	59.3

Financial Summary

Y/E March (INR mn)	FY23A	FY24A	FY25E	FY26E
Net Revenue	68,631	75,519	80,000	89,600
EBITDA	5,467	7,736	8,375	9,856
EBITDA %	8.0	10.2	10.5	11.0
Net Profit	335	2,049	2,971	4,135
EPS (INR)	2.2	13.4	19.4	27.1
EPS % Chg YoY	(143.0)	512.2	45.0	39.1
P/E (x)	274.9	44.9	31.0	22.2
EV/EBITDA (x)	19.2	13.2	11.8	9.5
RoCE (%)	4.2	16.0	15.5	19.9
RoE (%)	4.0	16.7	16.8	19.4

Earnings Revisions (%)	FY25E	FY26E
Revenue	(8.0)	(9.7)
EBITDA	(14.9)	(13.6)
EPS	(27.1)	(21.9)

Previous Reports

18-05-2024: [Q4FY24 results review](#)

08-02-2024: [Q3FY24 results review](#)

Exhibit 1: Q1FY25 result review (consolidated)

Consol (INR mn)	Q1FY25	Q1FY24	YoY	Q4FY24	QoQ
Total Operating Income	18,989	17,924	6%	19,749	-4%
Cost of Materials	11,873	11,412	4%	11,982	-1%
As % of sales	62.5%	63.7%	-114 bps	60.7%	186 bps
Gross profit	7,116	6,512	9%	7,767	-8%
Gross margin	37.5%	36.3%	114 bps	39.3%	-186 bps
Employee Expenses	2,156	1,922	12%	2,071	4%
As % of sales	11.4%	10.7%	63 bps	10.5%	87 bps
Other Expenses	3,219	2,896	11%	3,485	-8%
As % of sales	17.0%	16.2%	80 bps	17.6%	-70 bps
EBITDA	1,740	1,694	3%	2,210	-21%
EBITDA margin	9.2%	9.5%	-29 bps	11.2%	-203 bps
Depreciation	798	802	0%	825	-3%
EBIT	942	892	6%	1,385	-32%
EBIT Margin	5.0%	5.0%	-2 bps	7.0%	-205 bps
Interest	444	489	-9%	451	-2%
Other Income	36	188	-81%	64	-45%
PBT	533	591	-10%	998	-47%
Tax expenses	133	102	31%	250	-47%
Share of profit from associates	25.0%	17.3%	0	25.0%	0 bps
Adjusted PAT	27	61	-56%	51	-48%
Exceptional expenses/ (income)	86	-	-	216	-60%
Reported PAT	341	550	-38%	584	-42%

Source: I-Sec research, Company data

Exhibit 2: Revenue and EBITDA breakdown for VAR post divestment

	FY25E					Total
	India existing	4W lighting India	Romania plant	Global 2W lighting	Italy forging	
Revenue (INR bn)	67	4	2	4	3	80
EBITDA margin	11.5%	6%	5%	5%	5%	10.5%
EBITDA (INR mn)	7,705	220	100	200	150	8,375

Source: I-Sec research, Company data

Exhibit 3: Estimate revisions

	FY25E			FY26E		
	Old	Revised	% change	Old	Revised	% change
Revenue (INR bn)	87	80	-8.0%	99	90	-9.7%
EBITDA (INR bn)	10	8	-14.9%	11	10	-13.6%
EBITDA margin (%)	11.3%	10.5%	-85 bps	11.5%	11.0%	-50 bps
PAT (INR bn)	4.1	3.0	-27.1%	5.3	4.1	-21.9%
EPS (INR)	26.7	19.4	-27.1%	34.7	27.1	-21.9%

Source: I-Sec research, Company data

Upside risks

- Better-than-expected growth in domestic 2W market
- Faster-than-expected revival in target global businesses
- Better-than-expected margin and subsequently stronger cash flow and debt reduction

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

%	Dec'23	Mar'24	Jun'24
Promoters	75.0	75.0	75.0
Institutional investors	16.0	16.4	17.0
MFs and others	9.4	9.7	10.2
FIs/Banks	0.0	0.0	0.0
Insurance	1.2	1.9	2.1
FIIIs	5.4	4.8	4.7
Others	9.0	8.6	8.0

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	80,000	89,600
Operating Expenses	18,858	20,450	21,225	23,296
EBITDA	5,467	7,736	8,375	9,856
EBITDA Margin (%)	8.0	10.2	10.5	11.0
Depreciation & Amortization	3,367	3,368	3,650	3,827
EBIT	2,099	4,367	4,725	6,029
Interest expenditure	1,903	1,939	1,400	1,200
Other Non-operating Income	579	276	303	334
Recurring PBT	775	2,705	3,629	5,163
Profit / Loss from Associates	-	-	-	-
Less: Taxes	441	656	907	1,291
PAT	335	2,049	2,721	3,872
Less: Minority Interest	-	-	250	263
Extraordinaries (Net)	-	-	-	-
Net Income (Reported)	335	2,049	2,971	4,135
Net Income (Adjusted)	335	2,049	2,971	4,135

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	17,323	20,492
of which cash & cash eqv.	3,271	1,303	678	1,848
Total Current Liabilities & Provisions	18,648	17,943	19,391	21,718
Net Current Assets	(1,271)	(2,091)	(2,068)	(1,227)
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	24,361	24,037
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	17,483	21,160
Total Net Worth	9,762	14,970	17,636	21,313
Minority Interest	280	291	291	291
Total Liabilities	27,491	25,695	24,361	24,037

Source Company data, I-Sec research

Exhibit 8: Quarterly trend

(INR mn, year ending March)

	Sep-23	Dec-23	Mar-24	Jun-24
Net sales	18,868	18,846	19,749	18,989
% growth (YoY)	3.2	9.8	16.9	5.9
EBITDA	1,943	1,756	2,210	1,740
Margin	10.3	9.3	11.2	9.2
Other income	67	89	64	36
Net profit	477	593	800	427

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	6,977	8,959
Working Capital Changes	(1,247)	(8)	(741)	132
Capital Commitments	(3,495)	(2,575)	(2,200)	(2,464)
Free Cashflow	284	7,534	4,777	6,495
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	(626)	1,170
Closing cash & balance	3,271	3,928	677	1,848

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	19.4	27.1
Adjusted EPS (Diluted)	2.2	13.4	19.4	27.1
Cash EPS	24.2	35.5	43.3	52.1
Dividend per share (DPS)	-	-	2.0	3.0
Book Value per share (BV)	63.9	98.0	115.4	139.5
Dividend Payout (%)	-	-	10.3	11.1
Growth (%)				
Net Sales	17.4	10.0	5.9	12.0
EBITDA	52.1	41.5	8.3	17.7
EPS (INR)	(143.0)	512.2	45.0	39.1
Valuation Ratios (x)				
P/E	274.9	44.9	31.0	22.2
P/CEPS	24.8	17.0	13.9	11.6
P/BV	9.4	6.1	5.2	4.3
EV / EBITDA	19.2	13.2	11.8	9.5
EV / Sales	1.5	1.3	1.2	1.0
Profitability Ratios				
Gross Profit Margins (%)	35.4	37.3	37.0	37.0
EBITDA Margins (%)	8.0	10.2	10.5	11.0
EBIT Margins (%)	3.1	5.8	5.9	6.7
Net Profit Margins (%)	0.5	2.7	3.7	4.6
RoCE (%)	4.2	16.0	15.5	19.9
RoE (%)	4.0	16.7	16.8	19.4
Dividend Yield (%)	-	-	0.3	0.5
Operating Ratios				
Fixed Asset Turnover (x)	3.1	3.6	4.1	4.9
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	0.4	0.1
Net Debt / EBITDA (x)	2.3	1.3	0.8	0.1

Source Company data, I-Sec research

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Name of the Compliance officer (Research Analyst): Mr. Atul Agrawal, Contact number: 022-40701000, E-mail Address : complianceofficer@icicisecurities.com

For any queries or grievances: Mr. Bhavesh Soni Email address: headservicequality@icicidirect.com Contact Number: 18601231122
