

Subscribe for Long Term

| Issue Details | |
|-----------------|---------------|
| Price Band (Rs) | 965-967 |
| Face Value(Rs) | 1 |
| Issue Size(Rs) | 1955cr |
| Issue Type | Book building |
| Minimum lot | 15 shares |
| Issue Opens | June 26,2018 |
| Issue Closes | June 28,2018 |
| Listing on | NSE, BSE |

| Indicative Timeline | On or before |
|------------------------------------|---------------|
| Finalization of Allotment | July 03, 2018 |
| Initiation of refund | July 04, 2018 |
| Credit of Shares to Demat Accounts | July 05, 2018 |
| Listing on Stock Exchanges | July 06, 2018 |

| Other Detail | |
|----------------------------|--|
| Book Running Lead Managers | Kotak Mahindra Capital, Citigroup Global Market India, Credit Suisse Securities, IIFL Holdings Ltd |
| Registrar | Link Intime India Pvt Ltd |

Employee to receive a discount of Rs 48/- on the offer price

| Distribution Team |
|---|
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|--|
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VARROC ENGINEERING LIMITED

Company Background

Founded in 1988, Maharashtra based Varroc Engineering (Varroc) is a global tier-I automotive component manufacturer and supplier. Varroc is one of the leading global passenger car lighting suppliers in India. Further, it is a leading tier-I auto component manufacturer and supplier to domestic two-wheeler and three-wheeler OEMs. Varroc has strong presence in the fast growing domestic 2W and Global PV lighting segments.

Given its global presence, the company's revenue stream is diversified both geographically as well as across in terms of customers. Further, the company 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. Moreover, the company has nine in-house R&D centers located in India, Czech Republic, China, USA, Mexico, Germany, Italy, Romania, and Poland. As on March 31st 2018, the company has 185 patents for global lighting business. Moreover, globally, they are a supplier of external lighting systems to a leading electric vehicle manufacturer with a market share of 20%. In India business, across verticals, the company has 56 customers in the polymer segment, 20 customers in electrical segment, and 58 customers in the metallic segment.

Varroc is led by Mr. Tarang Jain, MD, who has nearly 30 years of experience in the automotive industry.

Issue Details

The company through the IPO will be raising Rs. 1955cr through an offer for sale worth at an upper price band of Rs. 967/- by offering 2.02cr equity shares of face value of Rs. 1 each. Varroc will not receive any proceeds from the offer and all the proceeds will go to the Promoter Group & Selling Shareholders. Issue would comprise 15% of post offer paid-up capital.

Details of Selling Shareholders

| Sr No | Selling Shareholders | No of shares to be sold |
|-------|-------------------------------------|-------------------------|
| 1 | Tarang Jain | 17,52,560 |
| 2 | Omega TC Holdings Pte. Ltd | 1,69,17,130 |
| 3 | Tata Capital Financial Services Ltd | 15,52,040 |
| | Total Shares to be sold | 2,02,21,730 |

Objectives of the issue:

The objective of the offer is to achieve the benefits of listing equity share. Varroc believes that listing of equity shares will enhance the company's brand name and simultaneously provide liquidity to the existing shareholders.

IPO share allotment pattern

| Category | Allocation | Number of Shares | Issue Size (Rs.Cr) at | |
|-----------------------------|-------------|--------------------|-----------------------|---------------------|
| | | | Lower Band (Rs 965) | Upper Band (Rs 967) |
| QIB | 50% | 1,00,60,865 | 971 | 973 |
| Non-Institutional Investors | 15% | 30,18,260 | 291 | 292 |
| Retail Individual | 35% | 70,42,606 | 680 | 681 |
| Employee Reservation* | | 1,00,000 | 9 | 9 |
| Total | 100% | 2,02,21,730 | 1951 | 1955 |

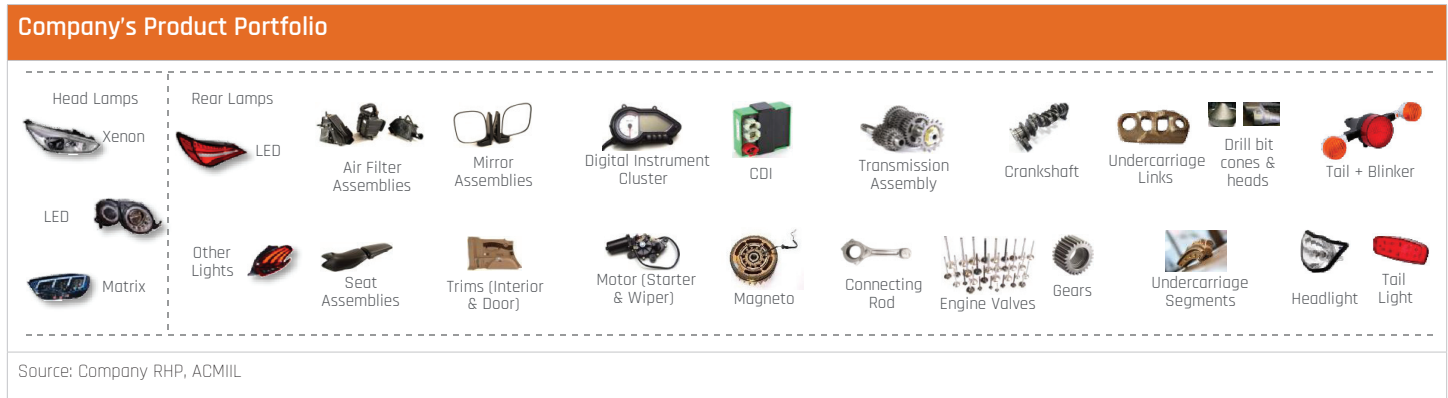
*Employee to receive a discount of Rs 48/- on the offer price
Source: Company RHP, ACMIIL

Outlook and Valuations

Varroc is the second largest Indian auto component group with a strong global footprint. It is also the sixth largest and fastest growing among top six global exterior auto lighting suppliers. The company has well diversified auto component business across geographies, product groups, customers, and segments. At the upper price band of Rs 967/-, the company's stock trades at 28.95x its FY18 EPS of Rs 33.4/-, which we believe is fully priced. Hence, we recommend to **SUBSCRIBE** the issue on a long-term basis.

Business Overview

Varroc is a global tier-1 (tier-1 companies are companies that directly supply to original equipment manufacturers (OEMs) automotive component group. The company designs, manufactures, and supplies exterior lighting systems, plastic and polymer components, electrical-electronics components, and precision metallic components to passenger car, commercial vehicle, two-wheeler, three-wheeler, and off highway vehicle OEMs directly globally. Moreover, the company is a leader in electric vehicle space with 20% market share in supplying lighting products.



Company has two primary business lines, namely (i) the design, manufacture and supply of exterior lighting systems to passenger cars OEMs worldwide ("Global Lighting Business"), which they undertake through their subsidiaries forming part of the VLS group and (ii) the design, manufacture and supply of a wide range of auto components in India ("India Business"), primarily to two-wheeler and three-wheeler OEMs, including exports. Company's domestic business offers a diversified set of products across three product lines, namely polymers/plastics, electrical/electronic and metallic components. In addition, they have other smaller businesses, which include the design, manufacture and supply of two-wheeler lighting to global OEMs, and under carriage forged machine components for OHVs and drill bits for the oil and gas sector ("Other Businesses").

Company commenced operations with polymer business in 1990. Further, it grew organically in India by adding new business lines, such as electrical division and metallic division. Subsequently, company diversified their product offerings and expanded production capacity through various investments, joint ventures and acquisitions. Following is the company's acquisition & JV details over last one decade.

| Year | Particulars |
|------|---|
| 2007 | Acquired I.M.E.S in Italy, a manufacturer of hot steel forged parts for construction and oil and gas industries |
| 2011 | Acquired Triom, a manufacturer of high end lighting systems for global motorcycle OEMs with operation in Italy, Romania & Vietnam |
| 2012 | Acquired Visteon's global lighting business, now known as Varroc Lighting Systems (VLS) |
| 2013 | Acquired Visteon's holding in a 50:50 JV with Beste Motor Co Ltd to manufacture automotive lighting in China |
| 2018 | Entered JV with Dell'Orto S.p.A for development of electronic fuel injection control systems for two wheelers and three-wheelers |

Further, for global lighting Business, company's manufacturing facilities are located in Mexico, the Czech Republic, China (through JV) and India, allowing them to serve the North American, Western Europe, Chinese and Indian markets, respectively. In India, company has long-standing relationship with Bajaj Auto Ltd a leading two-wheeler manufacturer, which has been their key customer for the past 28 years and to whom they have been providing components across product lines. Company's other key two-wheeler customers in India include Honda, Royal Enfield, Yamaha, Suzuki and Hero. They also export to global two-wheeler manufacturers from their facilities in India, namely KTM and Volvo.

Moreover, company's R&D efforts for domestic business seek to capitalize on emerging trends such as the increased use of electronics, stricter environmental regulations, digitalization, fuel efficiency, emission reduction and light weighting of vehicles, as well as the emergence of new technologies such as multi point fuel injection. Moreover, the company has developed their own electronics, control and software, and as on March 31st, 2018, they have filed 14 applications with the Controller General of Patents, Designs and Trade

Marks in India and two applications with the World Intellectual Property Organization for 16 patents which are in various stages of grant. The 16 pending applications relate to, among other things, electrical-electronics, polymer, metallic, lighting and polymer-related products.

Investment Rationale

Strong competitive position leading to robust growth

Varrac is the sixth-largest tier-1 automotive exterior lighting manufacturer globally and one of the top three independent exterior lighting players. Further, company's global acquisition Varrac Lighting Systems (VLS) has outperformed the overall passenger vehicle exterior lighting market. It has grown at a CAGR of 18.02% from FY14 to FY17 in terms of revenue as against global market growth of 4.5%. Moreover, VLS seeks to capitalize on future growth in the passenger vehicle exterior lighting market & thus it is in the process of setting up a new plant in Brazil, to serve the South American market, and Morocco, to serve the southern European and North African markets. Company anticipates that new plants in Brazil and Morocco will commence production in FY2019 & this would aid company to target 85% of the global automotive market. In addition, it is also in discussions to acquire an exterior automotive lighting company in Turkey in FY2019. For domestic market, it is the second largest Indian auto component group & and a leading tier-1 manufacturer and supplier to Indian two-wheeler and three-wheeler OEMs. Company believes that higher domestic as well global growth is the result of growing share of business with existing customers, winning new customer contracts, geographical expansion and the development of more technologically sophisticated products.

A well established & long-standing customer relationship

Company has strong & long-standing relationships with many of their customers. Their Global Lighting Business' customers include marquee auto manufacturers across the premium, mid-range and mass market pricing spectrum, including **Ford, Jaguar Land Rover, FCA, Groupe PSA, the VW Group**, a European multinational car manufacturer and an American electric car manufacturer. While company has many key customers with them for a long time, however they continue to add new customers, such as **Renault-Nissan-Mitsubishi, Volvo**, a Spanish automobile manufacturer and a German automobile manufacturer. Newly added customers for FY2018 and FY2019 include Dell'Orto S.p.A and Tata Cummins. For India business, their customers include nearly all the major two-wheeler and three-wheeler OEMs, including **Bajaj, Royal Enfield, Yamaha, Suzuki, Honda, Hero, Piaggio and Harley Davidson**. Moreover, they have further room to grow their revenue with new customers, such as Hero Motocorp, who currently purchases only plastic and painted parts from them. Moreover, during FY2018, company had only four customers who exceeded 10% of their consolidated revenue from operations individually, with largest customer contributing 18.6% of total invoiced amounts. We believe that company's strong capability strengthens their customer relationships and thus makes them more likely to win key contracts, as many manufacturers look for vendors with supply chain capabilities across geographies.

Comprehensive product portfolio

Company has a comprehensive portfolio of products which allows them to be a one stop-shop for their customers and to cross-sell products. Their global lighting business has a broad portfolio of lighting technologies, including Halogen, Xenon/high-intensity discharge, LED, Matrix LED, high definition MEMS and DMD, surface LED and OLED module, Flex LED and LED Pixel headlamp, covering the five automotive external lighting product lines. Moreover, they are a supplier of external lighting systems to a leading electric vehicle manufacturer. The company's domestic business offers a diverse range of products catering to two wheelers, three-wheelers, passenger vehicles, commercial vehicles and off-highway vehicles across their business segments of polymers/plastics, electrical-electronics and precision metallic components. Further, comprehensive product portfolio is engine agnostic as it is capable of being used across all fuel types. Given that they offer products for use in a variety of vehicle types, their revenue is diversified across market segments with 66.9% and 63.8% of consolidated total revenue for FY2017 and FY2018 respectively attributable to four-wheelers, 31.1% and 33.1% to two-wheelers and three-wheelers and 2.1% and 3.1% to others.

Low cost & strategically located manufacturing facilities

Company has a strong global footprint of 36 manufacturing facilities spread across seven countries, with six facilities for global lighting business, 25 for domestic business and five for other businesses. Further, company has a strong position from a costs perspective as they developed footprints in countries with low labour costs (such as in Mexico or the Czech Republic), thus benefiting from low cost engineering compared to the average engineering cost in European countries. Further they have made additional investments to expand into new countries such as Brazil and Morocco, which allow them to keep costs low while meeting their customers' supply needs across geographies. In line with this strategy, they are also in discussions to acquire an exterior automotive lighting company in Turkey in FY2019. Similarly, for domestic business, the company has also located their domestic facilities in close proximity to major OEMs in India, which leads to greater cost effectiveness, quicker product launches, and faster turn-around times & thus allowing them to serve customers' needs in a timely manner

Robust in-house technology, innovation and R&D capabilities

Company's key focus is on the development of in-house R&D capabilities in order to manufacture technologically advanced automotive components in cost-effective ways so that sophisticated technological solutions are made accessible to the larger mass markets.

Their R&D teams are focused on quick adoption of technology, enabling them to grow their product portfolio in line with customer expectations and industry developments. For global business, their R&D efforts on designing and developing products and technology solutions that is capable of being adopted by their customers across large product platforms. Further their R&D focus has allowed them 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. For domestic business, company's R&D efforts seek to capitalize on emerging trends such as the increased use of electronics, stricter environmental regulations, emission reduction and light-weighting of vehicles, as well as the emergence of new technologies such as multi-point fuel injection.

Diversified Customer Base with Long Term Relationships

Fine Organics' customer base comprises of direct customers and distributors. Direct customers are end-users of their products. Distributors are entities that purchase their products and then on-sell these products. In the 12 months ended December 31, 2017, company has 603 direct customers and 127 distributors (who sold their products to more than 5,000 customers). Company's direct customers are multinational, regional and local players manufacturing consumer products, such as Hindustan Unilever and Parle Products, and petrochemical companies and polymer producers globally. Further, they have an extensive distribution network in India and worldwide, enabling their products to be sold in 67 countries. Also, most of their R&D centers are located in low-cost geographies, which they believe will give them a growing competitive advantage as the technology content of their products continues to increase. As of March 31, 2018, the company's global lighting business has approximately 954 engineers located in nine R&D centers, which are located in the Czech Republic, India, China (through their China JV), Mexico, Germany and the United States of America. Further, their engineering teams work closely with customers to develop new products and technologies. Moreover, they have a new R&D facility which started operations in 2018 in Poland.

Stable Financial Position

Company has delivered a robust growth over the last five financial years both in terms of financial and operational metrics. Given organic and inorganic growth globally, their global lighting business has managed to outperform growth in the overall global exterior lighting market, with a CAGR of 18.02% from FY2014 to FY2017 (including China JV's 50% share) in terms of revenue growth, as compared to competitors' CAGR of 10.2% or lower. In last five years i.e. FY14-FY18, company's revenue & profitability has grown at a CAGR of 14% and 81% respectively. Moreover, during the same period, company's operating margin has improved from 6.5% in FY14 to 8.5% in FY18. Since 2012, they have invested in nine manufacturing plants in India, with two in each of Maharashtra, Tamil Nadu and Karnataka, and one in each of Gujarat, Madhya Pradesh and Rajasthan and one R&D center, which is located in Aurangabad. Company has been successful in managing growth and at the same time has maintained a healthy balance sheet. Company's leverage ratio has improved from 1.09x in FY15 to 0.30x in FY18. As of May 2018, their long-term credit facilities are rated [ICRA] AA- (stable) and short-term credit facilities are rated [ICRA] A1+ by ICRA Limited. Also, company has delivered a stable return ratio with ROE & ROCE stands at 15.9% & 13.3% respectively as on FY18. Having successfully integrated and improved the operating performance of their international acquisitions, company is now looking to grow its international business organically, as evidenced by the ongoing development of two new plants in Brazil and Morocco, which they expect to commence operations in FY2019. They are also in discussions to acquire a lighting company in Turkey in FY2019. We believe commencement of new capacities would aid to future growth.

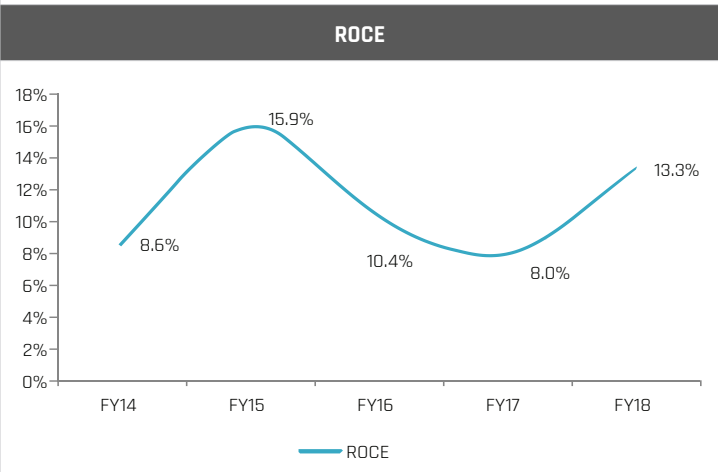
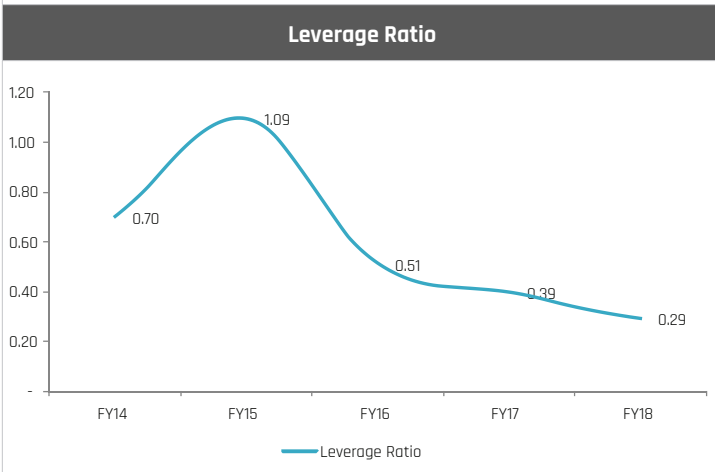
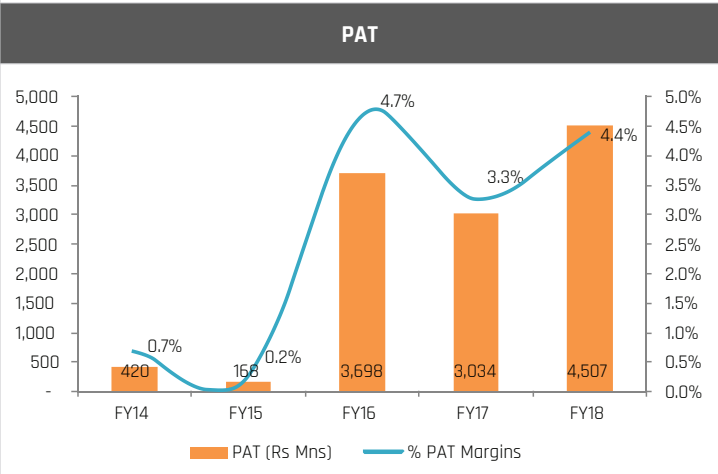
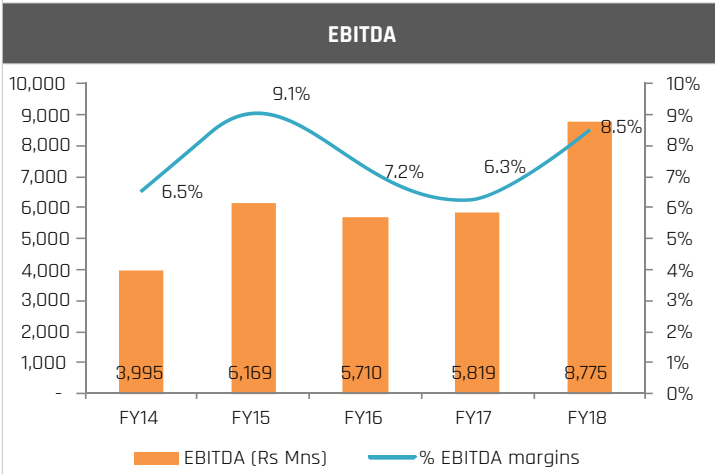
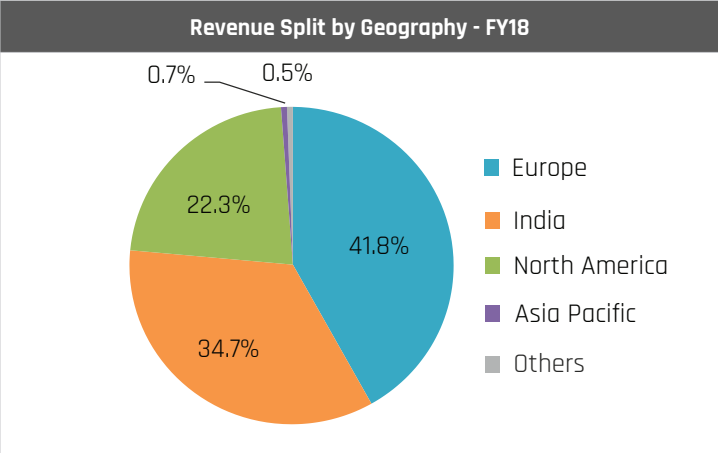
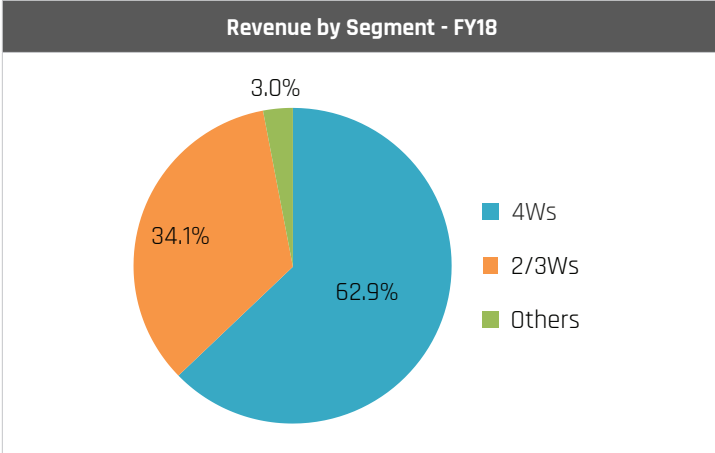
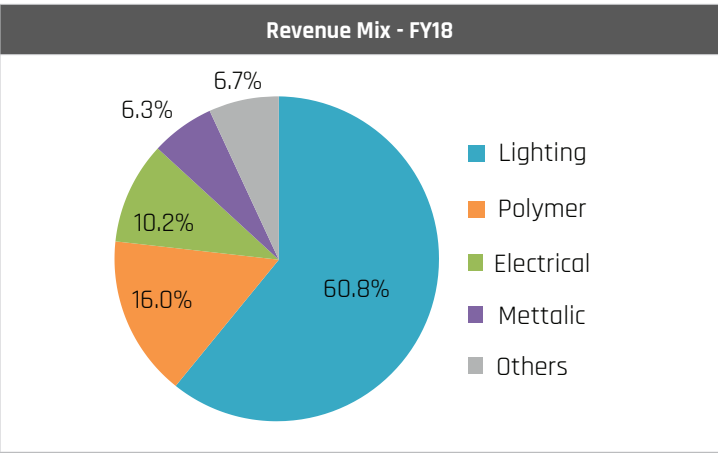
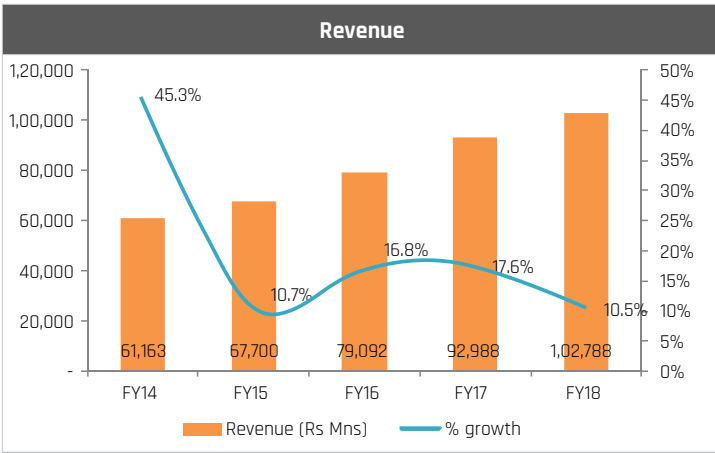
Risk Factors

- Company's business is dependent on certain major customers for revenue & any loss of customer may impact business operations
- Slowdown in automobile industry in global as well as domestic market could impact business operation
- Increasing competitive intensity could impact business performance

Peer Comparison -FY18

| Name of Company | Motherson Sumi | Bharat Forge | Endurance Tech | Varroc Eng |
|------------------|----------------|--------------|----------------|------------|
| Revenue (Rs Mns) | 5,58,570 | 84,147 | 65,381 | 1,02,788 |
| EBITDA (Rs Mns) | 56,260 | 17,230 | 9,277 | 8,775 |
| EBITDA % | 10.1% | 20.5% | 14.2% | 8.5% |
| PAT (Rs Mns) | 19,390 | 7,540 | 3,908 | 4,507 |
| EPS (Rs) | 7.59 | 16.4 | 27.8 | 33.4 |
| Face Value (Rs) | 1 | 2 | 10 | 1 |
| P/E | 40.8 | 38.5 | 45.3 | 28.9 |
| ROE | 17.6% | 16.1% | 17.9% | 15.9% |

Source: Company RHP, ACMIIL



Source: Company RHP, ACMIIL

Financials

Income statement

| Particulars (Rs Mns) | FY14 | FY15 | FY16 | FY17 | FY18 |
|-----------------------------|------------|------------|--------------|--------------|--------------|
| Revenue from operations | 61,163 | 67,700 | 79,092 | 92,988 | 1,02,788 |
| Less: Operating exp | | | | | |
| Cost of materials | 35,994 | 41,911 | 49,906 | 59,731 | 63,203 |
| Purchase of stocks | - | 487 | 1,098 | 988 | 924 |
| Changes in inventory | - | -467 | -512 | -352 | -300 |
| Employee Benefit Expenses | 9,370 | 9,022 | 10,399 | 12,037 | 13,135 |
| Other Expenses | 11,804 | 10,578 | 12,491 | 14,765 | 17,051 |
| Total Expenses | 57,168 | 61,531 | 73,382 | 87,169 | 94,013 |
| EBITDA | 3,995 | 6,169 | 5,710 | 5,819 | 8,775 |
| EBITDA % | 6.5% | 9.1% | 7.2% | 6.3% | 8.5% |
| Less : Dep & Amortization | 2380 | 2,540 | 2,922 | 3,371 | 3,865 |
| EBIT (before Other income) | 1,615 | 3,629 | 2,788 | 2,448 | 4,910 |
| Add : Other Income | 230 | 877 | 206 | 937 | 386 |
| EBIT (After Other Income) | 1,845 | 4,506 | 2,994 | 3,385 | 5,296 |
| Less : Finance cost | 1003 | 4,754 | -426 | 904 | 862 |
| Add: Share of net profit | - | 365 | 498 | 792 | 690 |
| Add: Exceptional item | - | 517 | - | - | - |
| PBT | 842 | 634 | 3,918 | 3,273 | 5,124 |
| Less : Tax | 413 | 466 | 220 | 239 | 617 |
| Less: Minority int | 9 | - | - | - | - |
| Net Profit | 420 | 168 | 3,698 | 3,034 | 4,507 |
| PAT % | 0.7% | 0.2% | 4.7% | 3.3% | 4.4% |
| EPS (Rs) | 4.02 | 1.35 | 21.77 | 27.21 | 33.4 |

Source: Company RHP, ACMIIL

| Particulars (Rs Mns) | FY14 | FY15 | FY16 | FY17 | FY18 |
|------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Share Capital | 405 | 96 | 262 | 135 | 135 |
| Reserves & Surplus | 10544 | 10,729 | 17,366 | 21,719 | 28,145 |
| Total Shareholders Fund | 10,949 | 10,825 | 17,628 | 21,854 | 28,280 |
| Non Controlling interest | 305 | 214 | 203 | 202 | 208 |
| Non Current Liabilities | | | | | |
| Long term borrowings | 6368 | 4,337 | 5,573 | 7,553 | 6,361 |
| Liability portion of CCPS | - | 5,895 | 2,060 | - | - |
| Deferred tax liabilities | 500 | 622 | 473 | 130 | 509 |
| Long term provisions | 188 | 755 | 765 | 740 | 1,002 |
| Other financial liabilities | 0 | 101 | 75 | 91 | 123 |
| Other non current liabilities | 564 | 120 | 79 | 83 | 310 |
| Total Non Current Liabilities | 7,620 | 11,830 | 9,025 | 8,597 | 8,305 |
| Current Liabilities | | | | | |
| Short term borrowings | 2347 | 3,830 | 6,419 | 5,992 | 3,439 |
| Trade Payables | 11397 | 10,293 | 12,691 | 15,497 | 20,004 |
| Other financial liabilities | 0 | 4,754 | 4,996 | 4,692 | 5,653 |
| Income tax liabilities | 0 | 17 | 139 | 179 | 83 |
| Other Current Liabilities | 6497 | 2,381 | 1,099 | 995 | 2,104 |
| Short Term Provision | 543 | 140 | 259 | 596 | 448 |
| Total Current Liabilities | 20,784 | 21,415 | 25,603 | 27,951 | 31,731 |
| Total Liabilities | 39,658 | 44,284 | 52,459 | 58,604 | 68,524 |
| Assets | | | | | |
| Tangible Assets | 13389 | 17,208 | 19,749 | 22,512 | 25,863 |
| CWIP | 3126 | 1,488 | 2,636 | 2,465 | 2,440 |
| Investment Properties | 0 | 158 | 152 | 146 | 141 |
| Goodwill | 275 | 151 | 151 | 151 | 335 |
| Other Tangible assets | 1430 | 1,068 | 1,210 | 1,146 | 1,701 |
| Intangible asset under development | 61 | 287 | 517 | 461 | 1,000 |
| Investment accounted for equity | 500 | 1,959 | 2,643 | 2,927 | 3,565 |
| Loans | 592 | 58 | 64 | 82 | 107 |
| Other financial assets | 0 | 1,169 | 828 | 759 | 316 |
| Income tax assets | 0 | 144 | 162 | 153 | 124 |
| Deferred tax assets | 0 | - | 132 | 130 | 1,030 |
| Other non current assets | 67 | 421 | 629 | 486 | 1,297 |
| Total Non Current Assets | 19,440 | 24,111 | 28,873 | 31,418 | 37,919 |
| Current Asset | | | | | |
| Current Invt | 537 | 223 | 119 | - | 30 |
| Inventories | 7778 | 5,861 | 6,829 | 7,535 | 8,641 |
| Trade Recieveables | 7731 | 10,714 | 11,852 | 11,383 | 14,027 |
| Cash & Cash Eq | 2560 | 690 | 1,771 | 3,540 | 3,290 |
| Short Term Loans & Advances | 1356 | 37 | 40 | 42 | 40 |
| Other financial assets | 0 | 458 | 1,375 | 3,014 | 2,613 |
| Other current assets | 256 | 2,190 | 1,600 | 1,672 | 1,964 |
| Total Current Asset | 20,218 | 20,173 | 23,586 | 27,186 | 30,605 |
| Total Asset | 39,658 | 44,284 | 52,459 | 58,604 | 68,524 |

Source: Company RHP, AcmIIL

Asit C. Mehta

INVESTMENT INTERMEDIATES LTD.

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