

## Varroc Engineering Limited

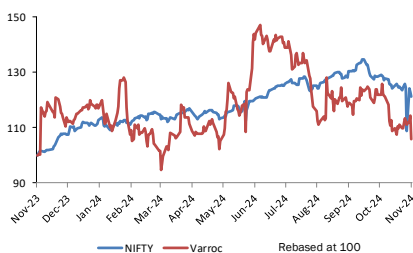
18 November 2024

Strong order book and new products to drive future earnings

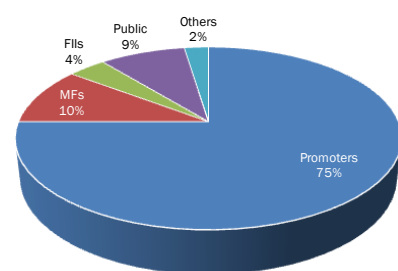
BUY

Sector	: Auto Ancillary
Target Price	: Rs 608
Last Closing Price	: Rs 499
Market Cap	: Rs 7,617 crore
52-week High/Low	: Rs 717/433
Daily Avg Vol (12M)	: 5,32,677
Face Value	: Re 1
Beta	: 1.13
Pledged Shares	: 0%
Year End	: March
BSE Scrip Code	: 541578
NSE Scrip Code	: VARROC
Bloomberg Code	: VARROC IN
Reuters Code	: VARE.NS
Nifty	: 23,454
BSE Sensex	: 77,339
Analyst	: Research Team

### Price Performance



### Shareholding Pattern



## 2Q FY25 Update

### Result Analysis

- Varroc Engineering reported healthy revenue growth of 10.3% y-o-y in 2Q FY25. The growth is primarily attributable to the strong performance of the Indian business, which saw a 13.4% expansion, offsetting the decline in overseas operations.
- Quarterly EBITDA (excl. MTM FX impact) increased 7.4 % y-o-y, whilst EBITDA margin contracted by 26 bps y-o-y to 9.7%.
- 2Q FY25 PAT increased by 3.7% y-o-y while PAT margin slid 18 bps to 2.8%.

### Outlook & Valuation

Varroc won orders worth a lifetime value of Rs 3248.4 crore during 1H FY25 with 46.3%/53.7% split between the 2/3W and 4W segments. The EV vertical accounted for 37.2% of 1H FY25 order value. Bajaj Auto constitutes 47.4% of the cumulative lifetime value of order wins acquired during 1H FY25. Varroc is currently developing four new products: interior ambient lighting, soft-touch door panels, battery management systems, and integrated starter generators (ISG). These innovations are expected to drive future growth. The company plans to invest approximately Rs 260-270 crore in capex this year. These funds will be used to expand capacity in electronics and EV powertrains, as well as to acquire land for future growth initiatives. Varroc's net debt decreased by Rs 155.4 crore in 1H FY25, resulting in a net debt balance of Rs 827.3 crore. Consequently, the net debt-to-equity ratio was reduced to 0.5x. The Varroc stock currently trades at a FY26 forward EV/EBITDA of 8.4x. Based on a target EV/EBITDA multiple of 10x FY26E EBITDA and adjusted forecast (including debt reduction), we value Varroc at Rs 608 (implying a P/E of 24.3x FY26E EPS), informing a BUY rating with a 22% upside from current levels.

### Key Financial Metrics (Consolidated Continuing Operations)

₹ crore	FY 22A	FY 23A	FY 24A	FY25E	FY26E
Operating revenue	5,844.2	6,891.2	7,551.9	8,110.8	8,857.0
Growth		17.9%	9.6%	7.4%	9.2%
EBITDA	359.3	574.8	773.6	841.9	983.1
EBITDA margin	6.1%	8.3%	10.2%	10.4%	11.1%
PAT	(78.3)	38.8	553.0	267.5	389.6
PAT margin	-1.3%	0.6%	7.3%	3.3%	4.4%
Diluted EPS (₹)	(5.33)	2.36	35.80	17.10	25.07

Note: EBITDA comprises FX losses/gains

Source: Company data, Khambatta Research

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### Financial Performance (Consolidated Continuing Operations)

₹ crore	2QFY24	1QFY25	2QFY25	Y-o-Y	Q-o-Q	1H FY24	1H FY25	Y-o-Y
Operating revenue	1,886.8	1,898.9	2,080.8	10.3%	9.6%	3,692.5	3,979.6	7.8%
EBITDA (excl. MTM FX impact)	187.1	172.4	201.0	7.4%	16.6%	367.2	373.4	1.7%
EBITDA margin (excl. FX impact)	9.9%	9.1%	9.7%	-26 bps	58 bps	9.9%	9.4%	-56 bps
EBITDA (incl. MTM FX impact)	194.3	174.0	208.2	7.2%	19.6%	376.9	382.2	1.4%
EBITDA margin (incl. FX impact)	10.3%	9.2%	10.0%	-29 bps	84 bps	10.2%	9.6%	-60 bps
PAT	55.7	34.1	57.8	3.7%	69.7%	110.7	91.9	-17.0%
PAT margin	3.0%	1.8%	2.8%	-18 bps	98 bps	3.0%	2.3%	-69 bps
Diluted EPS (₹)	3.55	2.12	3.64	2.5%	71.7%	7.03	5.76	-18.1%

Source: Company data, Khambatta Research

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### Guide to Khambatta's research approach

#### Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

*Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.*

#### Stock ratings

*Buy recommendations* are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

*Hold recommendations* are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

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