

710, Surya Kiran,  
19, Kasturba Gandhi Marg,  
New Delhi-110001  
Ph. : 23716199, 23318701  
Fax : +91-11-23318701  
Website : [www.careratings.com](http://www.careratings.com)

October 19, 2010

Mr. Rakesh Gupta  
A2Z Maintenance & Engineering Services Ltd  
Plot no 44,  
Sec 32, Institutional area,  
Gurgaon – 122001

Dear Sir,

## IPO Grading

2. The rationale for the IPO C...

2. The rationale for the IPO Grading is attached as **Annexure - I**. Kindly note that the rationale would be published in the forthcoming issue of our quarterly journal, 'CAREVIEW'.
3. A write-up on the above IPO Grading is proposed to be issued to the press shortly. A draft of the press release is enclosed for your perusal as **Annexure - II**.
4. We request you to peruse the Rationale and Press Release and offer your comments, if any. We are doing this as a matter of courtesy to our clients and with a view to ensure that no factual inaccuracies have inadvertently crept in. Kindly revert as early as possible. In any case, if we do not hear from you by October 26, 2010 we will proceed on the basis that you have no comments to offer.

If you have any further clarifications, you are welcome to approach us.  
Thanking you.

Thanking you,

Yours faithfully,

*Jyotsna Gadgil*  
[Jyotsna Gadgil]  
Dy General Manager

Encl: As above

**[Santosh Vasudevan]**  
**Analyst**

**Annexure I**  
**Grading Rationale**

**A2Z Maintenance & Engineering Services Ltd.**

**IPO Grading**

**CARE IPO Grade 4**

CARE has assigned a 'CARE IPO Grade 4' to the proposed Initial Public Offer (IPO) of A2Z Maintenance & Engineering Services Ltd (A2Z). CARE IPO Grade 4 indicates above average fundamentals. CARE assigns IPO grades on a scale of Grade 5 to Grade 1, with Grade 5 indicating strong fundamentals and Grade 1 indicating poor fundamentals. CARE's IPO grading is an opinion on the relative assessment of the fundamentals of the issuer.

*The grading reflects A2Z's strong business profile marked by its demonstrated track record of a healthy growth and profitable operations in Engineering Procurement and Construction (EPC) in the power transmission & distribution business, proven execution abilities, healthy order book position and above average profitability and return metrics. The grading also takes into account the strength derived from the experienced & qualified promoters and management team, its ability to successfully identify and scale up in opportunities in the Renewable Power Generation (RPG) & Municipal Solid Waste (MSW) business, policy incentives such as preferential tariffs, Renewable Purchase Obligations (RPOs) etc, provided by the Government of India (GoI) in renewable power in order to make such projects commercially viable.*

*The grading, however, is constrained by significant capex planned over the next two years in new business lines, project implementation risks associated with various RPG and MSW projects where A2Z has no prior track record, the relatively higher cost of power generation from RPG and risks on account of the availability and sourcing of biomass fuel.*

**Background**

Incorporated in January 2002, as A2Z Maintenance Services Private Ltd, A2Z was renamed 'A2Z Maintenance & Engineering Services Private Ltd' in May 2005.



Subsequently, the company became a public limited company in March 2010. Mr. Amit Mittal, the present promoter of A2Z, acquired the equity of the company from its shareholders in December 2003 and February 2004. A2Z was initially engaged in the Facility Management Services (FMS) business and entered the EPC business of Power transmission and distribution in financial year 2006.

A2Z is primarily engaged in providing EPC in power transmission and distribution sectors with a focus mainly on distribution. The company has been in this business since 2006 and EPC services include the installation of distribution line infrastructure upto 33 KV, construction of substations etc. In the transmission line, its services include Extra High Tension (EHT) substations and transmission lines. A2Z has the experience of successfully executing EPC contracts in a difficult environment in places like Jammu & Kashmir, Himachal Pradesh etc. EPC contracts are usually awarded pursuant to various central government policies and schemes such as the Re-structured Accelerated Power Development and Reform Program (R-APDRP) and the Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY) and the policies of the state governments. The company has established a strong presence in the power distribution sector in India within a short period and is pre-qualified to bid for various large power-sector players. The clientele includes leading state and national-level power-sector (generation and transmission) companies.

A2Z has recently focused on the diversification of its business line by providing EPC services to power generation companies and companies in the road and telecom sectors. Additionally, it is also focused on other business such as generating power from renewable energy sources, providing FMS business, providing MSW management services and developing IT solutions for power utility companies.

### **Promoters and Management**

A2Z has a strong management team with its personnel having vast experience in the power and EPC industry and in project execution. The management team is headed by

Mr. Amit Mittal, the promoter and managing director. Mr. Mittal has approximately 20 years of experience in project management and execution and is supported by qualified and experienced professionals, well-versed in technical as well as financial aspects. The board consists of nine directors, including three independent directors. The chairman of the Board is an independent and non-executive director.

The current diversification into the RPG as well as MSW business displays the management's ability to identify emerging business opportunities and scale up by acquiring projects in these areas and thus, de-risk and diversify its core business of EPC. Though the lack of track record poses the execution challenges in the proposed diversification plans, the management has proven its execution capabilities in the past by successfully diversifying from the FMS business to the unrelated EPC business.

### **Current Operations**

A2Z undertakes project management, turnkey contracting and its management in the power sector including design, supply, erection, installation and maintenance of electrical transmission lines, feeder renovation, setting up substations and allied services, mainly for central and state electricity utilities and also for certain private power companies. The company has an order book position of Rs.1383.52 cr as on March 31, 2010 with major clients being State and Central electricity utilities. The company had hived off its FMS division to its subsidiary, A2Z Infraservices Ltd, in FY09, thereby directing focus to the EPC business. The FMS division had contributed around 5.5% of the total revenues in FY08.

### **New projects**

#### **Renewable Energy Generation Business:**

A2Z has recently entered into the power generation business through sources of fuel such as biomass, Refuse Derived Fuel (RDF), agro waste, rice husk, bagasse etc. While many of these projects are being set up through subsidiaries, some of the projects are being set up in A2Z itself to avail tax benefits.

A handwritten signature in blue ink, appearing to be "Jyoti".A handwritten signature in blue ink, appearing to be "Siv".



A2Z is constructing three 15 MW renewable energy co-gen projects in sugar mills located in state of Punjab on a Build Own Operate Transfer (BOOT) basis and are expected to operationalize in March FY11. The total cost of the project is estimated at Rs.246.03 cr and the projects are proposed to be financed by a combination of debt and equity in the ratio of 2.6:1, for which the debt has been sanctioned by banks. The company has received feasibility clearance for connectivity by Punjab State Electricity Board (PSEB) and the civil work has commenced for the project. Though the proposed co-generation plants are based on multiple feedstock, the cost and steady availability of the alternate biomass fuels would be a key factor to successful operations and profitability of these plants.

A2Z is also setting up five 15 MW biomass-based power-generation projects in Rajasthan which are expected to operationalize in FY12. The total cost of all the five projects is estimated at Rs.400 cr and the projects are proposed to be financed by a combination of debt and equity in the ratio of 2.4:1, for which the term debt has been sanctioned by bank. The projects are at initial stages and there are no long term fuel contracts and the supply is dependent upon the local sourcing of crop residue as fuel.

In addition, A2Z is setting up a 15 MW biomass-based power project at Kanpur, Uttar Pradesh under its subsidiary, A2Z Infrastructure Ltd, where the company shall primarily use RDF generated from its MSW business as a source of fuel. The project is expected to commence operations from FY11 onwards. The total project cost of Rs.85.0 cr, is proposed to be funded in debt to equity of 2.4:1, for which debt has been sanctioned by banks. The company is also undertaking MSW management at various locations which will provide the Kanpur plant with adequate raw material feed stock to generate power.

A2Z's subsidiary, Manse Bijlee, has been awarded a contract to set up ten Integrated Resource Recovery Facility (IRRFs) at five locations in the State of Punjab, with each IRRF consisting of one rice mill with a capacity of at least 20 TPH together with biomass-based generation power plant of at least an aggregate capacity of 10 MW each.

A handwritten signature in blue ink, possibly reading "SAG".A handwritten signature in blue ink, possibly reading "SVK".

The total cost of setting up one IRRF is estimated at Rs.102.33 cr. which is proposed to be entirely funded by utilizing the net proceeds of the IPO. A2Z is yet to finalize the funding pattern for the remaining nine IRRFs.

Though the cost of setting up a renewable power plant is lower as compared to conventional sources, the cost of generations is higher. Hence A2Z would be highly dependent on government support for the allocation of land, preferential tariffs, depreciation and tax benefits, Renewable Energy Certificates (REC) and Renewable Purchase Obligation (RPO).

### **MSW Business**

A2Z has commenced its MSW business in FY 2008 by identifying opportunities provided by new public-private participation initiatives of the Government of India in such projects. It has been awarded contracts to handle approximately 5,200 TPD of MSW. The current contracts are a combination of projects that involve only Collection and Transportation (C&T) activities, only processing activities, only Processing and Disposal (P&D) activities and combined C&T and P&D activities through IRRFs on a BOOT basis. An IRRF model is based on the utilization of waste as a resource and aims to recover, recycle and process as much waste as possible and reduce the quantity of material sent to a landfill. The company has been allotted six IRRF contracts, two C&T contracts, five P&D contracts and a processing contract at various parts of India having a tenure varying from 7-30 years. Most of the MSW projects are currently in nascent stages of land allotment, environment clearance etc and currently operations have commenced only in Kanpur (P&D) and in Patna, Indore, Varanasi and Meerut (C&T).

### **IPO Details**

The company is proposing to make a public offer of equity shares amounting to an aggregate of Rs.750 cr and an offer for sale of 5,056,193 shares by existing shareholders. The total number of shares for fresh issue shall be decided on the finalization of price band so as to mobilize about Rs.750 cr. The price band for the issue is yet to be decided.



The IPO proceeds shall be used to finance the construction of biomass power-generation projects, investment in subsidiaries engaged in the business of FMS, MSW and biomass-based power-generation business, repayment of a term loan, finance working capital needs and for general corporate purposes of the company. The total cost of project and the estimated IPO funding for the same are as follows:

| Rs Cr  |   |                      |                            |
|--------|---|----------------------|----------------------------|
| S. No. | Particulars   | Estimated total cost | To be financed through IPO |
| 1      | Investment in three biomass (bagasse)-based power cogeneration projects of 15 MW each in the State of Punjab  | 246.03               | 68.03                      |
| 2      | Investment in five biomass-based power generation projects of 15 MW each in the State of Rajasthan  | 400                  | 120                        |
| 3      | Investment in Subsidiaries  |                      |                            |
| (i)    | Share capital in a2z Infrastructure for the 15 MW biomass-based power generation project in Kanpur  | 85                   | 25                         |
| (ii)   | Share capital in a2z Infrastructure and its subsidiaries for certain MSW projects   | 238.36               | 42.34                      |
| (iii)  | Share capital in Mansi Bijlee Private Limited the subsidiary that will implement one rice mill and associated rice-husk based biomass power generation project in the State of Punjab | 102.33               | 102.33                     |
| 4      | Repayment of loan granted by L&T Infrastructure Finance to the Company  | 41.66                | 41.66                      |
| 5      | Working capital requirements  | 125                  | 125                        |
| 6      | General corporate purposes  | -                    | [*]                        |
|        | <b>Total</b>  | <b>[*]</b>           | <b>[*]</b>                 |

### Financials

With a robust revenue stream, the operating income of A2Z grew at a CAGR of 83% from FY07-10. The company has been getting orders from various state governments as well as private players. PBILDT margin has also been showing a growing trend over the years except in FY10 when it declined on account of higher material costs. PAT margin also declined due to the fall in PBDILT margin in FY10. The company had a collection period of 205 days in FY10. This includes the retention money kept by the principal. Also due to the nature of business, the major part of sales is booked in the last quarter due to which the debtors' period is higher. Out of the total debtors of Rs.787 crore on March 31, 2010, the company has realized Rs.344 crore till July 31, 2010. Overall gearing as on

March 31, 2010 stood at 0.85 times, significantly lower than 1.16 times as on March 31, 2009 due to the ploughback of profits and the issue of additional equity shares and bonus shares in FY10.

### **Industry overview**

#### **Power Sector Overview**

The power sector in India is slowly moving from a regulated return framework to a market-driven pricing mechanism. This has provided a major boost for private entrepreneurs to enter the power sector and set up projects. Currently, significant traction has been achieved in the generation space, while the transmission and the distribution segment is slowly opening to the private sector. Demand for EPC services in the power transmission lines and power distribution business is largely dependent on the development, demand and new investments in the power generation, transmission and distribution sectors. Transmission systems in India have traditionally been government-funded through budgetary support and external borrowings, besides internal resources of companies such as Power Grid Corporation of India Limited (PGCIL). With the enactment of the Electricity Act 2003, the focus on Accelerated Power Development Reforms Programme (APDRP) and the privatization route for the Transmission & Distribution (T&D) Sector, the demand for domestic transmission and sub-transmission lines has increased from State Electricity Boards (SEBs)/Transmission companies as well as from the private sector. The domestic market is highly competitive since the orders are given on the basis of lowest bids. The companies providing a comprehensive supply and erection contracts have better margins than pure suppliers of transmission towers.

#### **Renewable Energy in India**

Renewable energy-based power capacities have registered the highest pace of growth in the overall capacity additions in India compared to non renewable sources, increasing their share of the total power capacity from 2% in FY 2003 to around 10% in FY 2010. Nonetheless, contribution from renewable energy sources towards overall the generation has been low at around 3% due to low plant load factors of renewable capacities. The aim



for the XI FYP, as stated by the working group of the Planning Commission in its Report of the Working Group on New and Renewable Energy for the XI FYP (2007-2012) (published in December 2006), is a capacity addition of 14,000 MW from renewable energy (grid-interactive) during the eleventh plan period.

### **Municipal Solid Waste Management in India**

Urban waste generation is rapidly increasing in India with population expansion and economic development. MSWM is a part of public health and sanitation, and is entrusted to the municipal government for execution. Urban local bodies spend about Rs.500 to Rs.1,500 per ton on solid waste for collection, transportation, treatment and disposal. The problems of collection, transport, proper use and disposal have become a huge task, straining both financial resources of the civic bodies and their physical capabilities, in addition to the problem of the availability of disposal sites. The Government has initiated various schemes like Jawaharlal Nehru National Urban Renewal Mission and the Urban Infrastructure Development Scheme for Small and Medium Towns to address concerns of MSW management.

### **Financial Performance**

(Rs in cr)

| Y.E. Mar.31,              | 2008  | 2009  | 2010   |
|---------------------------|-------|-------|--------|
|                           | A     | A     | A      |
| Income from Operations    | 463.3 | 686.2 | 1118.4 |
| PBILDT                    | 84.4  | 145.0 | 205.4  |
| Interest                  | 15.0  | 48.5  | 62.4   |
| Depreciation              | 1.3   | 1.2   | 2.5    |
| Other Income              | 2.4   | 11.9  | 5.9    |
| PBT                       | 70.5  | 107.2 | 146.4  |
| PAT (After def Tax)       | 44.5  | 68.9  | 94.9   |
| Gross Cash Accruals       | 44.1  | 70.0  | 95.6   |
| <b>Financial Position</b> |       |       |        |
| Equity Share capital      | 19.1  | 21.7  | 57.3   |
| Preference Share Capital  | 75.0  | 0.0   | 0.0    |
| Net Worth                 | 158.3 | 227.1 | 415.4  |

|                            |        |       |       |
|----------------------------|--------|-------|-------|
| <b>Key Ratios</b>          |        |       |       |
| <i>Growth(%)</i>           |        |       |       |
| Growth in Total income (%) | 155.59 | 49.94 | 61.04 |
| Growth in PAT (%)          | 280.85 | 54.82 | 37.83 |
| <i>Profitability (%)</i>   |        |       |       |
| PBILDT / Total Income (%)  | 18.2   | 21.1  | 18.4  |
| PAT / Total Income (%)     | 9.6    | 9.9   | 8.4   |
| ROCE (%)                   | 45.8   | 40.3  | 33.2  |
| RONW (%)                   | 44.8   | 35.7  | 29.5  |
| EPS (Rs.)                  | 9.41   | 10.80 | 17.71 |
| <i>Solvency</i>            |        |       |       |
| <i>Long Term</i>           |        |       |       |
| Debt Equity Ratio          | 0.1    | 0.2   | 0.2   |
| Overall Gearing            | 0.8    | 1.2   | 0.9   |
| Interest coverage (times)  | 5.6    | 3.0   | 3.3   |
| Term Debt/GCA              | 0.1    | 0.3   | 1.0   |
| <i>Liquidity</i>           |        |       |       |
| Current ratio              | 1.5    | 1.4   | 1.5   |
| Quick ratio                | 1.5    | 1.4   | 1.5   |
| Avg. Colln. Period (days)  | 175.0  | 210.0 | 205.0 |
| Average Creditors (days)   | 82.0   | 95.0  | 90.0  |
| Operating cycle (days)     | 99.0   | 120.0 | 116.0 |

**DISCLAIMER:**

CARE's IPO grading is a one time assessment and the analysis draws heavily from the information provided by the issuer as well as information obtained from sources believed by CARE to be accurate and reliable. However, CARE, does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. CARE's IPO grading does not take cognizance of the price of the security and it is not a recommendation to buy, sell or hold shares/securities. It is also not a comment on the offer price or the listed price of the scrip. It does not imply that CARE performs an audit function or forensic exercise to detect fraud. It is also not a forecast of the future market performance and the earnings prospects of the issuer; also it does not indicate compliance/violation of various statutory requirements. CARE shall not be liable for any losses incurred by users from any use of the IPO grading.