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August 04, 2009

Dear Sir,

**Grading of Initial Public Offer (IPO) of Rs.120 crore of ARSS Infrastructure Projects Ltd.**

Please refer to our letter dated July 29, 2009 on the above subject.

2. The rationale for the grading is attached as an **Annexure - I**. Please note that the rationale would be published in the forthcoming issue of our quarterly journal, 'CAREVIEW'.

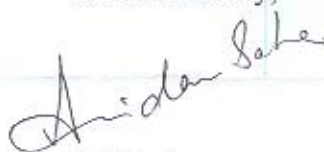
3. A write-up on the above grading is proposed to be issued to the press shortly. A draft of the press release is enclosed for your perusal as **Annexure - II**.

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 August 10, 2009, we will proceed on the basis that you have no comments to offer.

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

Thanking you,

Yours faithfully,



(A.Saha)  
Senior Manager



(S. Nag)  
Chief General Manager

Encl: As above

ARSS Infrastructure Projects Ltd.  
Rationale

**Grading**

CARE has assigned 'CARE IPO Grade 2' grading to the proposed Initial Public Offering (IPO) of ARSS Infrastructure Projects Limited (ARSS). CARE IPO Grade 2 indicates 'below average fundamentals'. CARE's IPO grading assigned to any individual issue represents a relative assessment of the fundamentals of the issuer.

ARSS proposes an IPO of around 23 lakh equity shares of Rs.10 each for cash, at an average price of Rs.522 per share, aggregating Rs.120 crore.

*The grading factors in the experience of promoters in construction business, healthy & diversified order book position, impressive client portfolio, satisfactory project completion track record, improving profitability & comfortable interest coverage and continuous thrust being given by the Government for infrastructure development. SBI taking active interest in the company by virtue of acquiring an equity stake also supports the grading. However, the grading is constrained by a number of pending litigations against the company and/or the promoters, high fragmentation in the domestic construction sector leading to intense competition thereby impairing profitability, high labour intensiveness of the activity, limited geographical diversification, current economic slowdown and strained liquidity position leading to occasional delays in servicing term loans & lease financing. While the company is, by and large, in compliance with the regulatory requirement pertaining to corporate governance practices, it may be too early to comment on the same in view of company taking major initiative in this regard only in the recent years.*

**Company Background**

ARSS was incorporated on May 17, 2000 as ARSS Stones Pvt. Ltd., by Shri Subhash Agarwal of Bhubaneswar and his three brothers, for carrying out construction of railway infrastructure. The company changed its name to ARSS Infrastructure Projects Pvt. Ltd. in May, 2005 and became a public limited company in November, 2005. In the initial years, ARSS operated mainly in the state of Orissa. It gradually expanded its operations to other states (like Chattisgarh, Rajasthan, Jharkhand, Haryana and Tamil Nadu), but to a limited extent, and diversified its activities to other construction segments such as development and construction of roads, highways, bridges and irrigation projects. The company has been accredited

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with ISO 9001:2000 Quality Management System Standard Certificate by Moody International Certification Ltd. for civil construction work. In January, 2008, SBI took a 7.97% stake in the company, at a price of Rs.315 per share (including premium of Rs.305).

The company also has crusher plants in different districts of Orissa for quarrying and crushing stones to produce various sizes of rock products required for execution of contracts.

#### **Promoters**

The main promoter, Shri Subhash Agarwal, and his family have a controlling stake of about 65% in ARSS. The promoters have an experience of more than 18 years in execution of various railway and road projects. After the placement of IPO, the promoter group is likely to have a holding of about 55% in the company, while the stake of Indian public will be around 15-16%. While ARSS has a number of small associate companies, it does not have any exposure to any of such companies.

#### **Management**

ARSS is managed by an eight member Board of Directors (BoD), comprising Chairman (Shri Subhash Agarwal), MD (Shri Rajesh Agarwal, brother of Shri Subhash Agarwal), two professional executive directors and four independent directors (having significant experience in their respective areas of specialisation). The day-to-day affairs of the company are looked after by the promoters themselves who are assisted by a team of qualified professionals having moderate experience in the industry.

#### **Corporate Governance**

The company has adequate number of independent directors in its Board. It is also, by and large, in compliance with the applicable provisions of the listing agreement and clause 49 pertaining to corporate governance, although the entire initiative to this effect has been taken by the company only in recent years. *There are number of pending litigations against the company and/or the promoters, including a criminal case.*

#### **Operations**

ARSS has been a relatively small sized construction company and only, in the last two years, it demonstrated significant growth in its topline. It has varied experience in several construction segments. The company started with execution of railway infrastructure development projects, mainly in the state of Orissa and gradually expanded its scope of activities to other infrastructure segments such as development and construction of roads, highways & bridges, irrigation projects and EPC activities for railways. As on June 15,

2009, the value of orders in hand (including on-going projects) was about Rs.2,518.6 crore.

ARSS has a significant presence in Eastern India, particularly in Orissa; however, in the recent years, it has pursued opportunities in other states as well (like Chattisgarh, Rajasthan, Jharkhand, Haryana and Tamil Nadu).

ARSS has successfully executed over 60 projects involving 300 km of roads & highways, 200 km of rail tracks and 10 minor & major bridges and other general civil engineering works over a span of seven years.

ARSS receives majority of its contracts from Government departments, Government agencies and public sector undertakings, including Ministry of Railways, Govt. of Orissa, Rail Vikas Nigam Ltd., RITES Ltd., IRCON International Ltd., NTPC, Hindustan Steel, PWD – Govt. of Orissa, IOCL, NHAI, etc. The contract completion track record of ARSS is satisfactory and it has received commendation certificates from many of its clients. It gets a good number of repeat orders from its clients in view of its established track record.

During the last few years, the company entered into Joint Ventures (JVs) with other construction companies to bid for large contracts. JVs have been entered into with a few national and international players such as, PT Adhikarya (Persero), Harish Chandra (India) Limited, RITES, Patel Engineering Ltd. and Atlanta Ltd. – to name a few.

ARSS has invested heavily in construction equipment and owns a large fleet of vehicles to meet its logistic requirements.

Overall drawings and designs are generally provided by the clients. Detailed drawings are made by the engineering team of the company and advice from various consultants is taken as per requirements.

Outsourcing contract labourer and sub-contracting are common in construction industry. ARSS mostly employs workers through labour sub-contractors to minimise labour related problems. ARSS also sub-contracts some portion of contract (mainly pertaining to projects outside Orissa) due to operational convenience.

Gross contract revenue grew at a CARG of 119% over the last three years with a significant year-on-year increase of about 99.6% in FY09. The growth in FY09 was on account of demand generated due to the Govt.'s thrust on infrastructure and milestones achieved by the company in this regard. The bidding capacity of ARSS also improved



continuously and this, coupled with its ability to enter into strategic joint ventures resulted in successful bidding for various projects.

Though in value terms, the income from all the segments are increasing; in terms of revenue mix, the road projects are the major income generator (about 47% in FY09, increased from 34% in FY08) followed by the railway projects.

#### **Financial Performance**

The contract revenue witnessed a substantial growth during the last two years, mainly on account of huge flow of orders coupled with continuous improvement in bidding eligibility.

Net sales witnessed a significant growth over the last three years on account of increased order inflow coupled with a continuous improvement in bidding eligibility. Higher revenues coupled with cost savings due to efficient contract management led to increase in PBILDT level at a relatively higher CARG of 141%. Accordingly PBILDT margin improved. Increased PBILDT coupled with relatively lower increase in capital charges led to increase in PAT level, except for FY09.

Long-term debt-equity ratio remained range bound over the last three account closing dates. But overall gearing ratio has been generally on the higher side and deteriorated as on Mar.31, 2009, on account of incremental bank borrowings to support the increased level of operation and relatively lower accretion of profit to reserves.

Interest coverage, although declined from 5.02 in FY08 to 3.61 in FY09 due to higher interest expenses, was comfortable. Though the liquidity position of the company as reflected by current ratio as on the last three account closing dates was adequate, ARSS is facing strain on the liquidity front, leading to the occasional delays in servicing term loan from banks and lease financing with NBFC.

The company has projected a steady increase in its contract revenue, PBILDT and PAT (after defd. tax), in the backdrop of strong order book position, new orders expected to be received in the ensuing period and positive outlook for the domestic construction sector. However, the projections are critical to its ability for successful & timely completion of various on-going contracts, successful bidding in high margin projects and success in IPO placement.

#### **Industry Outlook**

The growth of a construction company depends on government infrastructure spending, scheduling of proposed expansion projects by manufacturing sectors and macro-

economic factors which govern investments in real estate sector. In the last few years, the Government of India has been giving major thrust on the infrastructure sector (primarily for roads, railways, airports and seaports), which has widened the revenue opportunities for most of the players in the construction sector. The Planning Commission has envisaged an outlay of about US\$ 500 billion during 11th five year plan for infrastructure development in the country. These investments in different sub segments of infrastructure would be achieved through a combination of public and public-private partnerships. The proposed investment in the key industrial sectors is also likely to boost up the order book position of the construction entities.

In the latest Union Budget, the Govt. has reaffirmed its thrust on infrastructure creation. Government also allowed NBFCs to raise ECBs to provide funds to infrastructure projects. Despite being highly fragmented, the sector is opening up for foreign players, mainly through joint ventures. In this scenario, civil construction companies like ARSS need to aggressively pursue revenue growth through a well-diversified mix of contracts, in order to make a visible difference in their earnings.

#### Financial Results

For the year ending Mar. 31	(Rs. crore)		
	2007	2008	2009
	<b>Audited</b>		
Net sales	130.2	309.7	617.9
Total operating income	127.9	365.5	721.0
Total income	127.9	365.5	721.0
PBILDT	19.5	51.2	105.0
Depreciation	1.8	4.0	7.3
Interest & finance charge	3.8	9.4	27.0
PBT	14.0	37.9	70.6
PAT (after defd. tax)	10.1	27.4	51.1
Gross cash accruals (GCA)	12.2	32.6	62.2
<b>Financial Position</b>			
Equity share capital	10.8	12.6	12.6
Networth	30.7	102.3	154.7
Total capital employed	71.0	213.4	405.7
<b>Key Ratios</b>			
<b>Growth (%)</b>			
Growth in Total income (%)	102.20	185.70	97.26
Growth in PAT (after defd. tax) (%)	211.40	170.04	86.55
<b>Profitability (%)</b>			
PBILDT/ Total operating income (%)	14.89	16.38	16.89
PAT (after defd. tax) / Total income	7.71	8.77	8.22
ROCE (%)	35.78	33.78	31.94
Average cost of borrowing (%)	12.85	12.45	14.92
<b>Solvency</b>			



For the year ending Mar. 31	2007	2008	2009
	Audited		
Long-term debt-equity ratio	0.48	0.48	0.51
Overall gearing	1.23	0.96	1.44
Interest coverage (times)	4.72	5.02	3.61
Total debt/ GCA	1.41	1.89	1.73
<b>Liquidity</b>			
Current ratio (times)	1.28	1.39	1.28
Quick ratio (times)	1.10	0.99	0.61
<b>Turnover</b>			
Avg. collection period (days)	17	38	24
Average creditors (days)	26	30	22
Average inventory (days)	29	40	74

**Adjustments:**

(i) Advances from customers are strictly not current liabilities, in entirety. Accordingly, two-third of such advances has been considered as current liabilities for this analysis (based on the fact that the average period of ARSS's contracts is about one and a half years), while the remaining amount as long-term liability (but excluded from debt-equity & overall gearing computation, as those are non-interest bearing).

(ii) Retention money outstanding but not due as on the last account closing date has been taken out from Sundry Debtors and shown under " Other Current Assets" to the extent falling due within the next 12 months. Any portion falling due after 12 months is shown under Non-Current Assets.

**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.

Annexure II

ARSS Infrastructure Projects Ltd.  
Draft Press Release

**CARE assigns 'CARE IPO Grade 2' grading to the proposed Initial public offer (IPO) of ARSS Infrastructure Projects Limited (ARSS).**

CARE has assigned 'CARE IPO Grade 2' grading to the proposed Initial Public Offering (IPO) of ARSS Infrastructure Projects Limited (ARSS). CARE IPO Grade 2 indicates 'below average fundamentals'. CARE's IPO grading assigned to any individual issue represents a relative assessment of the fundamentals of the issuer.

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Orissa for quarrying and crushing stones to produce various sizes of rock products required for execution of contracts.

The company has adequate number of independent directors in its Board. It is also, by and large, in compliance with the applicable provisions of the listing agreement and clause 49 pertaining to corporate governance, although the entire initiative to this effect has been taken by the company only in recent years. There are number of pending litigations against the company and/or the promoters, including a criminal case.

ARSS has successfully executed over 60 projects involving 300 km of roads and highways, 200 km of rail tracks and 10 minor and major bridges and other general civil engineering works over a span of seven years, with a satisfactory timely completion track record. For the last few years, the company has also entered into joint ventures with few national and international players to bid for large contracts. ARSS has an impressive client portfolio with a healthy order book position of about Rs.2,518.5 crore as on June 15, 2009.

In FY09, the company earned PBILDT of Rs.105 crore and PAT (before defd. tax provision) of Rs.54.8 crore on gross contract revenue of Rs.617.9 crore. Contract revenue witnessed a significant growth over the last three years on account of increased order inflow coupled with a continuous improvement in bidding eligibility. Higher revenue coupled with cost savings due to efficient contract management led to increase in PBILDT, which togetherwith lower increase in capital charges led to increase in PAT level. Accordingly, PAT margin improved except for FY09.

Long-term debt-equity ratio remained range bound over the last three account closing dates. But overall gearing ratio has been generally on the higher side and deteriorated as on Mar.31, 2009, on account of incremental bank borrowings to support the increased level of operation and relatively lower accretion of profit to reserves.

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facing strain on the liquidity front, leading to the occasional delays in servicing term loan from banks and lease financing with NBFC.

*CARE has classified instruments rated by it on the basis of complexity. This classification is available at [www.careratings.com](http://www.careratings.com). Investors/market intermediaries/regulators or others are welcome to write to [care@careratings.com](mailto:care@careratings.com) for any clarifications.*

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