



INNOVENTIVE INDUSTRIES LIMITED

Issue Details

Innoventive Industries Limited proposes to come out with an Initial Public Offer of issue size of Rs. 219.58 crore[†] through the book building route. Post-IPO, the shares will be listed on the National Stock Exchange and Bombay Stock Exchange. The company has also raised Rs. 30.42 crore through a Pre-IPO placement to Standard Chartered Private Equity (Mauritius) II Limited. The company has allotted 26,00,000 equity shares of Rs. 10 each for cash at a premium of Rs. 107 per share.

Proposed Use of IPO Proceeds

The IPO proceeds are proposed to be used primarily for:

- Capacity expansion of manufacturing facility
- Repayment of term loans
- General corporate purpose

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IPO Grading

ICRA has assigned an IPO Grade 3, indicating average fundamentals, to the proposed initial public offering (IPO) of Innoventive Industries Limited (IIL). ICRA assigns IPO grading on a scale of IPO Grade 5 to IPO Grade 1, with Grade 5 indicating strong fundamentals and Grade 1 indicating poor fundamentals.

An ICRA IPO Grade is a symbolic representation of ICRA's current assessment of the fundamentals of the issuer concerned. The fundamental factors assessed include, *inter alia*, business and competitive position, financial position and prospects, management quality, corporate governance, and history of compliance and litigation.

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[†] 100 lakh = 1 crore = 10 million

Key Grading Considerations

Grading Strengths

- Diversified client base; Tier I and Tier II supplier status for several domestic OEMs
- Focus on value added products backed by superior operating efficiency; in-house technology developed for manufacturing cold drawn electric welded (CEW) tubes resulting in lower wastages and savings in labour and fuel expenses for which IIL has applied for process patent
- Well diversified product profile within automobile industry (i.e. among 2-wheeler, 3-wheeler, CVs and PVs) and also started focusing on Power and Energy Sector; targeting 40% of its revenue from energy/power sector by FY12
- Well experienced first generation technocrat promoters having close control on the company's day to day operations

Grading Challenges

- Stretched capital structure with high gearing on account of debt funded capital expenditure in the past; weak coverage indicators
- Working capital intensive operations with substantial amount of working capital blocked in inventory; tight liquidity condition as evident from high working capital limit utilization
- Sizeable investments planned towards capacity addition despite current utilization level being considerably low (~45%)
- Considerable intercompany transaction with subsidiaries
- Limited ability in passing volatility in raw material prices makes it susceptible to raw material price fluctuation

Grading Rationale

The assigned grading takes into consideration diversified client base of IIL which is spread across various industries like automobile, power and energy, general engineering, furniture etc. The company has developed an in-house process known as Tube Cold Rolling or Pilgering to manufacture CEW tubes which results in relatively lower fuel and labour expenses and thereby improving the profitability. The company has applied for process patent for Tube Cold Rolling process. IIL has also developed an import substitute for membrane panel strips which is used in boilers and being a critical component, the profitability is relatively superior in this component as compared to tubes provides for automotive applications. The company claims to be the largest domestic supplier of membrane panel strips to companies like Bharat Heavy Electricals Limited, Thermax Limited, Alstom Projects India Limited, Cethar Vessels Limited. The grading also favourably factors in long standing experience of the promoters in the industry and their close control on operations of the company. The grading is however constrained by weak capital structure of IIL characterized by high gearing; low capacity utilization; high working capital intensity and limited ability in passing raw material price fluctuations. ICRA also notes that regular investment towards capacity addition and working capital intensive operations of the company has resulted in stretched cash flow position over the years, which is likely to persist in the near to medium term.

IIL is amongst the leading manufacturer of Electric Resistance Welded (ERW) and Cold Drawn Electric Welded (CEW/CDW) tubes in India with an installed capacity of 88,065 MT per annum. The company is an approved supplier of tubes for several domestic Original Equipment Manufacturers (OEMs), and it caters to the tube requirement of various auto ancillary units in and around Pune. Besides their varied application in automobile, the tubes also find its usage in various other sectors like power, energy, general engineering and furniture. Due to its capital intensive nature, the competitive pressure is comparatively less in CEW tubes segment and hence profitability is relatively better in CEW tube segment as compared to ERW tube segment. The company is primarily engaged in manufacturing of welded tubes, however given the high competitive intensity in ERW

tubes segment, the company has increased its CEW tubes capacity from 7,920 MT (FY08) to 23,265 MT (FY10). The new CEW capacity is added using its in-house "Tube Cold Rolling" process. As of now, the capacity utilization has been low as majority of its enhanced capacity came into operation during the slowdown in automobile industry. The capacity utilization is expected to improve from current level (~45%) to about 70% in FY12; however, given such large capacity addition the new unit will take about 2-3 years to reach optimal utilization level. Going forward, IIL is expected to report robust growth in operating income in FY12 as reflected from its current order book position (~Rs 790 crore). IIL has also developed bimetallic tube which finds its application in consumer durables and the management is hopeful that these product innovations and diversification strategy will help company to further diversify its customer base and reduce its dependence on cyclical automobile industry thereby providing some revenue stability.

During 2006-10, IIL's operating income has reported a robust CAGR of 35.29% driven by both organic as well as inorganic growth. Focus on value added activity like manufacturing of membrane panel tubes, in-house innovations like Tube Cold Rolling process and replacement of costly CEW tube with micro alloyed ERW tube, the operating margins have improved considerably over last two year. IIL profitability also benefits from the subsidy provided under Industrial Promotion Subsidy (IPS), wherein it is eligible for 75% refund on investments made towards capacity addition from March 28, 2007.

In last five years, IIL had made investments in excess of Rs 250 crore towards organic as well as inorganic expansion. The promoters being first generation entrepreneurs had limited financial flexibility and they have to rely majorly on debt financing to fund their expansion plans. Further the operations of IIL are working capital intensive as the company has to manage about 3-3½ month of inventory and has to extend 3-4 months credit period to its customer whereas all suppliers provides raw material on cash/LC basis. As a result, due to debt funded capacity expansion and working capital intensive nature of business, the capital structure of IIL is stretched which is characterized by very high gearing and weak coverage indicator. In FY11, Kavos Capital infused equity to the tune of Rs 35 crore to finance ongoing capital expansion and ease out liquidity condition of the company. The company is in the process to raise funds of Rs 219.58 crore from primary market via IPO process which if successful is expected to further strengthen the capital structure of the company.

Fund flow from operation has been positive for last two years, however due to large capacity expansion plan undertaken by the company, free cash flows has remained negative. As the revenue is expected to grow the company will need additional fund to finance its working capital requirement which is likely to put pressure on its operating cash flows. Going forward, effective working capital management and optimal capacity utilization would be the key sensitivity factors for determining the free cash flows in the near to medium term.

Company Profile

Innoventive Industries Limited (formerly Arihant Domestic Appliances Limited) is the flagship company of the group, primarily engaged in manufacturing of Electric Resistance Welded (ERW) and Cold Drawn Electric Welded (CDW/CEW) tubes. IIL manufactures precision steel tubes which are used in automobile industry, energy sector, general engineering and furniture industry. The company currently has an installed capacity of 64,800 MT/annum for ERW tubes and 23,265 MT/annum for CEW tubes.

The group was established by first generation entrepreneurs in the year 1996 as a steel trading business, servicing the requirements of automotive ancillaries located in and around the automotive hub of Pune in western India. The main product lines were steel strips, sheets and tubes. In 2000 the group made its foray into manufacturing of ERW and DOM tubes, initially at a leased facility and subsequently moving to company owned premises in the year 2002. The company is ISO/TS 16949:2002 certified and it has been approved by Bajaj Auto Limited (BAL) to supply precision tubes to its supplier.

The business focus of group was into manufacturing of auto component for automobile and auto-ancillary industry; however the group has diversified into other industries as well with a focus on power and energy sector. The group has forward integrated by setting up various auto-ancillary companies which primarily source raw material (ERW, CEW tubes) from IIL and supply component to OEMs and their Tier-I suppliers. Subsidiary companies and their area of operations have been enlisted below.

Name	Shareholding	Business/Manufacturing
Arihant Auto Components Pvt Limited	99.99%	Precision Machines Parts
Arihant Steel & Metal Wires Pvt Limited	99.99%	Wires manufacturing
Sevenstar Electrodes Pvt Ltd	99.99%	Steel Bar and Press Fabricated Auto products
Arihant Steel Products & Services Pvt Limited	99.99%	Defunct unit
Saicon Steels Pvt Ltd	50.99%	Hot Rolled into Cold Rolled Steel
Sankalp Forgings Pvt Ltd	51.00%	Forgings & Couplings

Source: DRHP

Promoters and Management

IIL was incorporated by six technocrat promoters who were earlier working in material purchase department of Bajaj Auto Limited, and they later started their own company dealing in trading of Auto components and related products. They later acquired unit of Arihant Domestic Appliances Limited located at Sanaswadi region in Pune to avail the interest free sales tax deferral loans available at this unit due to its presence in backward region. The promoters acquired the company for undisclosed sum and they later installed ERW and CEW tube manufacturing unit at the said plant.

Name	Designation	Key Responsibilities
Mr. Chandu Chavan	Chairman	Financial and Strategic Planning
Mr Ravindra Katre	Managing Director	Purchase, Finance and Material Handling
Mr Sanjay Waghulade	Whole Time Director	Operations
Mr Ramprasad Joshi	Independent Director	-
Mr Yashpaul Gupta	Independent Director	-
Mr Pradeep Tupe	Independent Director	-
Dr. Rajendra Jagdale	Independent Director	-
Mr. William Sean Sovak	Nominee Director	-

Source: DRHP

Promoters and their relatives hold about 74% of shareholding whereas remaining 21% is with Kavos capital, a Singapore based private equity firm, and remaining 5% is with employees' welfare fund. The management has tight control over all operational, financial and marketing related activities and they are actively involved in day to day operations of the company. Earlier, Deutsche Bank had invested Rs 50 crore in the company and they had two board representatives but the company has repaid their amount and currently there is no representation of Deutsche bank on the board of IIL.

Business and Competitive Position

Amongst the leading supplier of ERW/CEW tubes for automobile industry; sole supplier of certain products to Bajaj Auto Limited and Tata Motors Limited

IIL is amongst the leading manufacturer of ERW/CEW tubes in India with a cumulative installed capacity of 88,065 MT per annum. The company is an approved supplier of tubes for Bajaj Auto Limited (BAL), Mahindra & Mahindra Limited (M&M) and Tata Motors Limited (TML) and it caters to the tube requirement of various auto ancillary units in and around Pune. Tubes find its application in automobile chassis, side bar, handle bars, transmission control systems, frames and other auto components. The company has developed *membrane panel strip* which is used by various boiler manufacturers like Thermax Limited, BHEL and others. Currently these strips are imported by domestic BTG manufacturers and IIL is targeting revenue of about Rs 120 crore (by FY12, ~Rs 50 cr in FY11) from this particular product by providing an import substitute. The strips manufactured by IIL will also be cost effective and it will provide a savings of about 40% to the customers like Thermax and BHEL. It is the most profitable segment for the company.

Auto sector still accounts for majority of revenue though diversification strategy paying off with the share of other industry rising

Table 1: Sector Wise Revenue breakup

	2007-08	2008-09	2009-10
Transportation	62.53%	53.02%	47.68%
Oil & Gas	1.42%	10.35%	10.41%
Power	11.30%	10.95%	12.49%
Farm Equipments	-	1.35%	2.94%
General Engineering	24.75%	24.33%	26.47%
Total	100%	100%	100%

Source: DRHP

Given the operating margins are better in supplying tube to the power/energy sector as compared to the automobile sector, the diversification strategy is expected to have a positive effect on profitability which is reflected in higher OPBDITA margins in FY10.

The company was initially started to manufacture tubes primarily targeting Tier-I auto ancillary suppliers in and around Pune, as a result the share of auto component has traditionally been higher. Also, being closely associated with BAL, the share of 2-wheeler has been the highest among the auto sector. However, marked by muted growth in automobile sector during FY08/FY09 and company's focus on diversification by adding new products/clients, the dependency of revenue on auto sector has reduced considerably.

Table 2: Client wise revenue breakup

	2007-08	2008-09	2009-10
	% of Revenues	% of Revenues	% of Revenues
Bajaj Auto Limited	25.18%	22.03%	21.71%
Top 5 customers	39.47%	38.18%	36.61%
Top 10 customers	44.29%	43.76%	46.80%

Source: DRHP

BAL is the largest client for IIL accounting for more than 20% of the revenues and the share/exposure of BAL has increased considerably after acquisition of Seven Star Auto-component (in FY08) which is a Tier-I supplier of BAL. There is a moderate concentration risk due to its sizeable exposure towards BAL however the strong market position of BAL in domestic 2-wheeler and 3-wheeler automobile industry and IIL's preferred supplier status for tubes and other key components mitigates this risk to a certain extent.

Overall the client concentration risk is moderate with top five clients contributing about 37% of overall revenues, and the share of top five clients has decreased over last three years without affecting growth of the company.

Focus on continuous innovation and R&D; applied for process patent for its “Tube Cold Rolling” (pilgering) process

Being from technical background and to create a niche in competitive ERW tube segment, the company has placed great importance to innovation and process improvement.

IIL has recently developed “Tube Cold Rolling” (pilgering) process for making CEW tubes. When compared to conventional Draw Bench Process, the new process will provide competitive advantages to the company, some of which are listed below:

- Very high cross sectional area reduction up to 80%
- Tubes of low Diameter/Thickness (d/t) is possible in one single pass of pilger which is not possible using conventional process
- High Yield of 98% as compared to 95% in conventional process thereby resulting in low wastages
- Savings in power and labour cost, resulting in higher operating profitability as compared to usual CEW process

The company has applied for process patent for its modified pilgering process. The process is in public domain now and as of now there has been no objections raised by any entity, as per the management. The company is hopeful of getting the patent in 33 countries by FY12.

Competitive Scenario marked by intense competition in ERW segment but competition is limited in CEW tubes segment; low capacity utilization primarily on account of added capacity in CEW tubes segment is a concern and it will take about 2-3 years to stabilize

ERW tube industry is highly competitive with the presence of several large as well as unorganized players. However, the competitive intensity in CEW industry is limited and it is mainly dominated by four big players including Tube Investment of India (TII), Bhushan, TISCO and IIL (source: DRHP). Currently, TII is the market leader in domestic tube market with 22% market share. IIL is primarily targeting OEMs in the western region of India and hence it has got significant presence in order share of OEMs present in western region however the share in the order book of OEMs present in other part of India is limited.

Table 3: Capacity Utilization Trend

	2007-08	2008-09	2009-10
Normal Capacity			
ERW	64,800	64,800	64,800
CEW	7,920	12,105	23,265
Available Capacity¹			
ERW	64,800	64,800	64,800
CEW	7,920	8,811	19,759
Production			
ERW	55,081	53,083	51,473
CEW	5,841	5,989	8,822
Utilization			
ERW	85.0%	81.9%	79.4%
CEW	73.8%	68.0%	44.6%

Given the commoditized nature of ERW tubes, the company has enhanced its CEW tubes capacity from 7,920 MT (FY08) to 23,265 MT (FY10). The new CEW capacity is added using its in-house “Tube Cold Roll” process. While the capacity utilization has been satisfactory for ERW for last three years, the utilization is low for CEW as a result of capacity addition. IIL is primarily targeting Power (boiler) and export market where usage of CEW is higher. However, given such as large capacity addition, the new unit will take about 2-3 years for stabilization of operations.

¹ Capacity available since commercial operation date, for e.g. if 10,000 MT capacity becomes operational on October 1, 2010, the available capacity for FY11 would be 5,000 MT (10,000 MT x 0.5)

Raw Material sourcing arrangement

Currently the company is sourcing majority of its raw material requirement from Essar Steel Limited, Ispat Industries Limited and SAIL. The company has signed MoU with Essar Steel Limited to ensure smooth supply of raw material. The prices are fixed on quarterly basis and hence the company is exposed to the volatility in steel prices during three month period.

On an average, IIL keeps an inventory for about 90-105 days which is on the higher side as compared to industry average. The higher raw material requirement is due to requirement of higher grade steel for the products manufactured by IIL which are usually purchased in larger tranches. High inventory is also on account of strategic buying of steel by the company and higher finished goods inventory required for exports.

Debt funded capacity expansion plans in the past has resulted in stretched capital structure though equity infusion from Kavos Capital in FY11 provided much needed liquidity support; company is eligible for certain region specific government incentives

In last five years, IIL had made investments in excess of Rs 250 crore in capacity expansion and acquiring new companies. As a result of this debt funded capital expenditure, the capital structure of IIL is quite stretched. However, due to its presence in backward region and eligibility for 'Mega Project' status, the company is eligible for various tax incentives and government subsidies.

IIL is expanding its CEW tube manufacturing capacity by and it has received status of 'Mega Project' under the scheme of Government of Maharashtra which entitles the company for various benefits which includes sales tax refund upto 75% of investment in fixed assets among others. The company is eligible for below mentioned incentives under the proposed subsidy scheme:

- Electricity duty exemption for the period of seven years from the date of commencement (Jan 01, 2009) of commercial production
- 100% exemption from the payment of stamp duty
- Industrial Promotion Subsidy equivalent to 75% of investment in fixed assets made w.e.f March 28, 2007

Besides the 'Mega Project' incentives, the company has been also availing interest free sales tax deferral loan from the government due to its presence in backward area. The repayment of sales tax deferral loan will start from FY2014 onwards.

In FY11, Kavos Capital infused Rs 35 crore thereby taking its overall shareholding in IIL from 5.0% to 20.9%. The main rationale for capital infusion is to fund ongoing capacity expansion project of IIL and improve its capital structure. IIL has raised Rs. 30.42 crore via a pre-IPO placement of shares to Standard Chartered Private Equity (Mauritius) II Limited.

Substantial investment in subsidiaries and group companies**Table 4: Investment Breakup**

(In Rs. Crore)	Shareholding (%)	FY 2009-10
Arihant Auto components Pvt Ltd*	99.99%	1.90
Arihant Steel & Metal Wires Pvt Ltd*	99.99%	0.80
Saicon Steels Pvt Ltd	50.99%	0.01
Sankalp Forgings Pvt Ltd	51.00%	9.78
Sevenstar Electrodes Pvt Ltd*	99.99%	12.00
Arihant Steel Products and Services Private Limited**	99.99%	0.01
TOTAL		24.50

Also, IIL had made substantial investments in subsidiaries. Out of these investments, Sankalp Forgings and Sevenstar Electrodes accounts for majority of share. Company had transferred the assets of Seven Star Electrodes on the books of IIL and Seven Star as such is now a shell company.

*1 share is with employee (non promoter) of IIL;#:defunct unit

Sankalp Forgings has been recently shortlisted as global supplier of couplings for Arcelor Mittal's Oil exploration activities. In FY10, Sankalp Forgings has reported an operating profit of Rs 6.53 crore on an operating income of Rs 30.62 crore. IIL holds 51% shareholding in Sankalp Forging whereas remaining 49% is with original promoters of Sankalp Forgings from whom IIL acquired this entity.

Financial Position

Profitability Indicators (Rs in crore)	Standalone					Consolidated		
	FY07	FY08	FY09	FY10	H1 FY11	FY08	FY09	FY10
Operating Income	192.3	274.5	348.2	391.1	242.8	325.5	371.1	425.2
Growth (Y-o-Y)	64.5%	42.7%	26.9%	12.3%	-	-	14.0%	14.6%
OPBDITA	27.4	23.8	52.7	102.4	61.8	37.3	70.2	115.1
PAT	12.04	3.64	11.69	27.39	27.01	8.57	15.53	28.49
OPBDITA/OI	14.2%	8.7%	15.1%	26.2%	25.4%	11.5%	18.9%	27.1%
PAT/OI	6.3%	1.3%	3.4%	7.0%	11.1%	2.6%	4.2%	6.7%
RoCE	27.2%	10.9%	14.3%	19.5%	18.6%	-	15.3%	18.7%
RoNW	46.8%	11.8%	31.5%	48.3%	53.0%	-	38.2%	43.9%

Source: company; Y-o-Y: Year-on-Year; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortization; PAT: Profit After Tax; RONW: Return on Net Worth; ROCE: Return on Capital Employed

IIL is the largest company in the group which contributes more than 90% of the consolidated operating income. Operating profitability on consolidated level is higher on account of cancellation of intercompany transactions and relatively more profitable subsidiaries like Sankalp Forgings Private Limited which is engaged in manufacturing of fully machined ready to assemble parts like machine tubing, couplings, pup joints, cross overs etc. The company as a part of its Mega Project (Package Incentive Scheme (PIS) 2007) status receives capital subsidy from Government of Maharashtra. The PIS subsidy received benefitted the company and resulted in higher operating margins.

Due to focus on value added activity like membrane panel strips and in-house innovations, operating margins have improved considerably in last two year. Given that the company is focusing more on CEW tube as compared to commoditized ERW tube, the operating margins are expected to remain healthy. Due to highly leveraged capital structure RoNW is healthy.

Capital Structure (Rs in crore)	Standalone				Consolidated		
	FY08	FY09	FY10	H1 FY11	FY08	FY09	FY10
Total Debt	231.1	422.3	473.9	509.1	315.2	477.8	543.1
• Sales Bill Discounting*	78.0	117.7	165.2	180.4	78.0	117.7	165.2
• Purchase Bill Discounting*	44.8	44.4	65.2	59.0	44.8	44.4	65.2
Total Net worth	31.3	43.0	70.4	133.3	29.0	42.8	70.5
Gearing	7.4	9.8	6.7	3.8	10.9	11.2	7.7
Gearing (Excluding Bill Discounting)	4.9	7.1	4.4	2.5	8.2	8.4	5.4

Source: company; *sales bill discounting and purchase bill discounting for consolidated financials is assumed at same level as that of standalone in absence of sufficient information

Capital structure of IIL is stretched primarily on account of debt funded capital expenditure in the past and working capital intensive nature of business. Since the company is still in growth phase and its capacity utilization is still not at optimal level, the coverage indicators are weak. At standalone level, gearing of the company has reduced from 6.7x in FY10 to 3.8x in H1FY11 primarily due to equity infusion by Kavos Capital to

the tune of Rs. 35 crore. With likely infusion of equity via IPO, the capital structure is expected to improve from current level.

Working Capital	Standalone					Consolidated		
	FY07	FY08	FY09	FY10	H1 FY11	FY08	FY09	FY10
Debtor days	65	126	109	195	166	116	121	151
Creditor days	154	72	50	81	87	76	69	78
Inventory Days	106	105	91	141	156	120	128	189
NWC/OI	11.8%	50.3%	53.6%	72.9%	71.3%	42.9%	55.1%	72.3%

Source: Company Data, DRHP, ICRA Estimates

The company has to manage about 3-3½ month of inventory and has to extend 3-4 months credit period to its customer whereas all suppliers provides raw material on cash/LC basis. Since substantial amount of funds are blocked in working capital to finance inventory as well as receivable, working capital intensity is very high (72.3%, FY10).

Corporate Governance

Company's board has six directors, of which the Chairman of the Board is an executive director. In compliance with the requirements of clause 49 of the listing agreement, the company has three executive directors, four independent Directors and one Nominee Director. This satisfies clause 49 requirements, which states that a company with executive chairman should have at least half of the board comprising of independent directors.

Compliance and Litigation History

IIL is involved in some legal proceedings (over disputes relating to recovery of payments related to suppliers, construction etc.) and some labour cases.

March 2011

ICRA Limited



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