

Grading Rationale for CRISIL IPO Grading

Kiri Dyes and Chemicals Ltd

CRISIL IPO Grade 2.0/5.0

Public Issue of 5,000,000 Equity Shares of face value Rs 10 at a targeted price of Rs 110-120 per share.

Bid/Offer Opens	*
Bid/Offer Closes	*
Shares Offered	5,000,000
As % of post issue Equity	33%
Shares Outstanding (Post issue)	15,000,000
Lead Manager	
Centrum Capital Ltd	
Registrar to the Issue	
Cameo Corporate Services Ltd	

Kiri Dyes and Chemicals Ltd.			
Past Financial performance		2005-06	2006-07
Operating income	Rs Million	914.0	1,339.5
Operating margins	Per cent	8.5	11.6
Net profits	Rs Million	46.0	86.3
Net margins	Per cent	5.0	6.4
ROCE	Per cent	11.3	14.3
Return on Equity	Per cent	21.3	29.1
No. of equity shares	Million	9.5	10.0
Net worth	Rs Million	251.2	341.1
Basic EPS	Rs	4.8	8.6
Diluted EPS	Rs	4.8	8.6
Book value	Rs per share	26.4	34.1
Gearing	Times	2.2	2.5

Shareholding Pattern	Prior to issue		Post issue	
	No. of shares	%	No. of shares	%
Promoters	9,356,495	93.6	9,356,495	62.4
Promoter group	6,29,005	6.3	6,29,005	4.2
Others	14,500	0.1	14,500	0.1
Public	-	-	5,000,000	33.3
Total	10,000,000	100	15,000,000	100

Overall Assessment

CRISIL has assigned a CRISIL IPO Grade “2/5” (pronounced “two on five”) to the proposed initial public offer of Kiri Dyes and Chemicals limited (KDCL). This grade indicates that the fundamentals of the issue are below average relative to other listed equity securities in India.

This grading reflects the company management's successful track record in setting up a large export-oriented dyes business over the last 10 years, its relationships with global dye companies, and the technical expertise of its founder and Chairman Mr Pravin Kiri. However, the grading is constrained due to the limited upside in the profit potential of the company's dyes business, the moderately lower than existing returns from the planned deployment of the IPO proceeds, and the low pricing power traditionally witnessed by sulphuric acid manufacturers — the facility that the company plans to set up through the IPO proceeds. The company plans to mitigate the price risk by focusing on value-added products.

In order to arrive at the overall grade, CRISIL has considered the following broad parameters:

- Business prospects and financial performance
- Management capability
- Corporate governance

Business prospects

The profitability of dye business has limited upside potential

KDCL has successfully developed its dyes export business over the last few years, largely from contracted sales to global dye players. These arrangements consist of relatively firm volume offtake commitments with a provision for quarterly price revision. This quarterly price revision has allowed the company to pass on any increase in input costs. However, this arrangement also limits the company's ability to record significant growth in profitability from its exports business as it effectively operates as a contract manufacturer for global dye majors like DyStar Textilfarben GmbH (DyStar) and Clariant AG. That said, it is also true that the company's competitiveness as a contract player will be enhanced due to its ongoing backward integration efforts.

Adequate demand for basic chemicals but margins to be volatile

The planned sulphuric acid plant marks KDCL's foray into the basic chemicals business. The company will captively consume around 25 per cent of the production of sulphuric acid and its sub-products to produce dye intermediates. The remaining production will be used to cater to local demand for sulphuric acid in the Vadodara region, which seems adequate in relation to the planned capacity. Additionally, the captive power generated from the sulphuric acid plant will help reduce power costs.

However, non-sulphur based sulphuric acid manufacturers (metal smelting units like Hindalco Industries Ltd. and Hindustan Zinc Ltd) are able to influence sulphuric acid prices as they enjoy lower production costs. As a result, sulphur-based players (of the kind that KDCL is planning to become) are forced to sell at lower rates, thereby affecting their margins. Though KDCL plans to mitigate the effects of this by setting up capacities for oleum and chlorosulphonic acid, this lack of pricing power is likely to keep the margins from the sulphuric acid business volatile. Moreover, even apart from this, incremental returns from the new project are expected to be materially lower than the dye business.

Financial performance

Moderate growth in revenues; ROE to be depressed due to excess cash accruals

The incremental returns from the sulphuric acid expansion project are expected to be moderately lower than the dyes business. This, alongwith the fact that the company is likely to generate significant surplus from internal accruals, will depress KDCL's equity returns as compared to current levels, till the surplus is deployed into new projects. While the management has stated that, the surplus would be invested in new projects, the size, profitability, capital expenditure and funding for such projects would determine equity returns in the future.

As per current tax rules, the company will enjoy tax benefits arising from its EOU status until 2009-10. Hence, corporate tax outgo could increase beyond this.

Management capability

Successful use of technical experience and skills

Mr Pravin Kiri, with his technical expertise and past experience, brought about pioneering changes in dye production in India by setting up the largest dye reactors in KDCL. Over the years, the management has successfully established the company as one of the major players in reactive dyes, which has strengthened its competitive advantage as a supplier through its backward integration efforts. Kiri Dyes is amongst the leading suppliers to global majors like Clariant AG, DyStar.

Corporate governance

Moderate ability of independent directors to exercise management oversight

Of the three independent directors, two have relevant experience in corporate law and finance. They joined the Board after meeting the company management and acquiring knowledge about the company's business and operations. The independent directors have not been involved in deciding the size of the IPO and have minimal experience as company directors. Overall, the independent directors have a moderate ability to exercise management oversight.

Business profile

KDCL manufactures reactive dyes primarily for exports, which accounted for nearly 66 per cent of its revenues in 2006-07. Reactive dyes are applied on fabric to produce coloured fabric of higher wash-resistance. KDCL has two plants — a dye intermediates plant at Padra, Vadodara and a dye plant at Vatwa, Ahmedabad. One part of the dye unit became an EOU in December 2004. The dye intermediates plant to manufacture Vinyl Sulphone and H-acid (which currently account for 60 per cent of raw material costs), was set up in 2006-07. The capital expenditure for the entire project was Rs 260 million.

Demand for reactive dyes is directly related to growth of the cotton fabrics industry. Dye production facilities have been shifting from Europe and the US to China and India, on account of the high production costs in developed countries essentially due to the strict pollution control norms. Hence, over the next 5 years, exports of reactive dyes from India are expected to grow at 8 per cent annually, driven by growth of the cotton textiles segment in countries such as Turkey, Bangladesh, the US and Pakistan.

KDCL now intends to foray into the basic chemicals industry for which it plans to set up a facility to manufacture sulphuric acid and its sub-products (oleum and chlorosulphonic acid), with a combined capacity of 500 metric tonnes per day. This facility will be located near its dye intermediates plant at Vadodara. The capital expenditure for this project, along with the normal capital expenditure for dyes/intermediates unit and working capital margin, is estimated at Rs 505 million by KDCL. The company plans to fund this expansion entirely through the proceeds of the proposed IPO.

Financial profile

KDCL's operating revenues grew from Rs 699 million in 2001-02 to Rs1,340 million in 2006-07. The company's revenue mix, which heavily leaned towards exports (exports accounted for 95 per cent of revenues in 2003-04), has changed over the last few years. In 2006-07, exports accounted for 66 per cent of revenues with domestic sales accounting for the rest

Operating margins improved to 11.6 per cent in 2006-07 from 7-8 per cent in each of the preceding five years. This was on account of the backward integration to manufacture dye intermediates such as Vinyl Sulphone and H-acid (which currently account for 60 per cent of total raw material costs).

The net margins of KDCL have improved from 4.8 per cent in 2002-03 to 6.4 per cent in 2006-07. The average Return of Equity has been at 27 per cent in the past five years, which are expected decline to 17 per cent after the IPO with 50 per cent rise in equity base to Rs 150 mn.

The company's cash accruals have increased from Rs 28 million in 2003-04 to Rs 99 million in 2006-07. However, the higher working capital requirement has added to the short-term debt. As exports account for a major share of revenues, larger debtors days has resulted in higher working capital needs.

Management capability and corporate governance

KDCL's promoter and Chairman, Mr Pravin Kiri started the synthetic organic dyes business in 1998. Before this, Mr Pravin Kiri was associated with Jai Chemicals Ltd, a dye manufacturing company, since 1966. After separating from Jai Chemicals Ltd, Mr Pravin Kiri set up KDCL in 1998. KDCL gained from the technical expertise of Mr Pravin Kiri who set up the largest dye reactor in India, and established KDCL as a leading manufacturer and exporter of reactive dyes.

The export base, set up by Mr Manish Kiri, Son of the Chairman, has helped the company to expand rapidly and widen its export market. In order to ensure stability of production and reduce dependence on dye intermediate suppliers, KDCL backward integrated into the production of dye intermediates such as Vinyl Sulphone and H-acid. Now, the company's management has decided on the current sulphuric acid project expansion in order to reduce dependence on the dyes business, and expand into the basic chemicals business. The company envisages being a basic chemicals player in the long run.

Of the six directors on the Board of KDCL, three are promoters and the other three are independent directors. Two independent directors, who joined the Board on March 5, 2007, have relevant experience in corporate laws and finance. The third independent director has been a player in the dyes industry since 1980, and has been representing the Indian Dyes Industry with various government bodies.

Independent Directors	Date of appointment	Qualification	Experience
Mr Bipin R Patel	1st Sept. 2006	B.A.,L.L.B	Director, Ami Pigments, President, Unique Dye-Chem, Chairman, CHEMEXCIL (Gujarat), Green Environment Co-operative society Ltd, Member of Gujarat Chamber of Commerce and Industries, Loan Advisory committee
Mr Keyoor M Bakshi	5th Mar. 2007	B.Com, L.L.B, FCS	Senior Partner , Kanha Associates, a Company Secretary firm, 28 yrs experience in corporate laws, Finance and mangtt., Vice-president of Institute of Company Secretaries of India (2007)
Mr Yamal Vyas	5th Mar. 2007	B.Com,FCS, ACS,	23 years experience in Finance, Former editor of Dalal Street Journal, Associated with Gujarat chamber of Commerce (member of capital market sub-committee); writes in newspapers on Stock market and invest.

Source: Company prospectus

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