

Annexure I

Grading Rationale

Omkar Specialty Chemicals Limited

IPO Grading

CARE IPO Grade 3

CARE has assigned a 'CARE IPO Grade 3' to the proposed Initial Public Offer (IPO) of Omkar Specialty Chemicals Limited (OSCL). CARE IPO Grade 3 indicates 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 derives strength from the experienced management team, multi-product capability and flexibility in its manufacturing facilities, strong Research & Development capabilities of the group, healthy profitability margins and long relations with reputed clientele.

The grading is however constrained by small scale of operation, long working capital cycle, project execution risk and raw material price risk.

Background

Omkar Specialty Chemicals Limited (OSCL) (formerly Omkar Specialty Chemicals Private Limited) took over the business of the Proprietorship Firm M/s Omkar Chemicals which was in operation since 1983 with Mr. Pravin S. Herlekar as the Proprietor. At the time of takeover in June 2005, the installed capacity was 318 Metric Tonnes (MT) and the product range was cobalt, selenium & iodine derivatives in addition to molybdenum derivatives. The capacity was gradually increased to 950 MT with the recent addition of 200 MT in FY11. Company has four units, Unit-I, Unit-II, Unit-III and Unit-IV at Badlapur, Thane. OSCL carries out its manufacturing activities at its two units i.e. Unit I and Unit II. Project work at Unit III is over and the company will start the manufacturing activities soon. Unit IV is currently being utilised as a warehouse. However the company has plans to set up manufacturing facilities at Unit IV.

December 2010

1

OSCL is primarily involved in the production of specialty chemicals and pharma intermediates. It manufactures a range of organic, inorganic and organo-inorganic intermediates. The inorganic intermediates include Molybdenum derivatives, Selenium derivatives, Iodine derivatives, Cobalt derivatives, Bismuth & Tungsten derivatives and the organic intermediates include Tartaric acid derivatives and other intermediates. These products find applications in various industries like pharmaceutical industry, chemical industry, glass industry, cosmetics, ceramic pigments and cattle & poultry feeds. The company is planning to set up a new manufacturing unit, Unit-IV at Badlapur, Thane at an estimated cost of Rs.32.1 crore and is also planning for expansion at the existing units at an estimated cost of Rs.14.61 crore, with part proceeds of IPO.

OSCL has recently acquired M/s. Rishichem Research Ltd., which is primarily into research and development activities, to strengthen R&D capabilities of the company. This company was earlier a sister concern and was owned by the promoters only. It was valued at Rs.1.3 crore and consideration was paid in the form of equity shares.

Management

OSCL is promoted by Herlekar family with Mr. Pravin Herlekar, being the Chairman and Managing Director of the company. He is a Bachelor of Technology in Chemical Engineering from the Indian Institute of Technology, Bombay and is a post graduate in management studies from the Mumbai University. He has an overall experience of 27 years in the field. He was running a proprietary concern in the name of Omkar Chemicals since 1983, which was taken over by OSCL in 2005. Mr. Shivdas Herlekar (father of Mr. Pravin Herlekar), the Executive Director of the company, is a Bachelor of Arts from the University of Bombay. He has an overall experience of about 60 years in the field of accounts, finance, policy matters & administration.

Corporate Governance

OSCL has complied with the corporate governance code in accordance with Clause 49 of the listing agreement (as applicable), including in relation to appointment of Independent Directors to its Board and constitution of the audit committee, remuneration committee

 December 2010

2

and shareholders'/investor's grievance committee.. Currently, the Board has eight Directors, of which the Chairman is the Executive Director, and in compliance with the requirements of Clause 49 of the listing agreement, the company has four independent Directors out of eight Directors on Board.

Operations

OSCL manufactures a wide range of products in Iodine, Selenium and Molybdenum related compounds. Its current product portfolio consists of more than 90 products. Its manufacturing facility is well equipped to handle the production of different products in this segment without making any changes. This flexibility provides ease of changing the product mix depending on the market demand.

OSCL's recent acquisition of M/s. Rishichem Research Ltd will strengthen R&D capabilities of the company to develop any new product in this segment as per the customer's requirement. Being in a technology-driven product innovation segment and due to the lack of organised players offering a wide range of products in this segment similar to OSCL, company is placed in the niche segment of the value chain.

About 75% of the sales value is derived from the pharmaceutical industry. Over a period of time, OSCL has developed its relationship with large pharmaceutical companies in the domestic market.

During FY10 total income of OSCL from operations stood at around Rs.68 crore. Majority of the sales come from Iodine compounds which constituted more than 50% of the sales and Rs.36 crore in terms of value in FY10. The global iodine derivatives market is US\$2.5-3.0 bn annually. Considering the size of the industry, OSCL is a very small player. Nevertheless, in the domestic market it is a one of the major players and is tapping the demand from domestic pharmaceutical companies. The company is on a continuous expansion spree and has plans to increase its capacity from 950 MT per annum to 3,650 MT per annum.

 December 2010

OSCL's main raw materials are imported in bulk from the suppliers. This helps the company to reduce the cost of import and also negotiate the prices with suppliers. This bulk import results in higher inventory levels leading to long working capital cycle. OSCL's product is used as a pharmaceutical intermediate. Pharmaceutical companies use these intermediates to manufacture the Active Pharmaceutical Ingredients (APIs). As the company's product is not directly used as any medicine, it does not fall under the purview of any regulatory requirements from pharmaceuticals authorities like USFDA, etc. However, the quality of its product is critical to the quality of the finished product. OSCL's clients do require the company to follow various quality standards. OSCL's quality control laboratory is equipped with various advanced equipments. The Unit 2 of the company has been granted ISO 9001:2008 for its quality management systems. OSCL imports its raw material and also exports part of its finished goods which provides part natural hedge for its foreign currency exposure. Moreover, the company generally takes full cover for the rest of the exposure and remains fully hedged against the foreign currency exchange risk.

Project risk:

OSCL has proposed an expansion plan in its three manufacturing units and has also proposed a new manufacturing facility, Unit-4 from the IPO proceeds. After the proposed expansion and setting up of new facility, the total installed capacity of the company is expected to be raised to 3,650 MT per annum from the existing 950 MT per annum. The company projects to complete this expansion in FY13. The company has projected that the total cost for this expansion/new facility will be around Rs.46.72 crore. The company also proposes that any shortfall for the project from IPO proceeds would be met by the internal accruals. The company has significant experience in executing these projects. However, the scale of expansion is high and the company thus faces project execution risk. As on November 2010, the company has procured land in Badlapur, Thane for the new unit.

IPO Issue Details

A handwritten signature in black ink, appearing to be a stylized 'S' or similar character.

December 2010

4

OSCL intends to issue 81,00,000 equity shares of face value of Rs.10 each and proposes to utilise the Net Proceeds from the IPO for the following objects:

1. About Rs.32.10 crore to be used to set up a new manufacturing facility at Unit 4 at Badlapur, Maharashtra;
2. About Rs.14.61 crore to be used for expansion of the existing manufacturing facilities at Unit 1, Unit 2 & Unit 3 at Badlapur, Maharashtra;
3. About Rs.10 crore to be used for meeting working capital requirements.
4. Balance of the proceeds will utilised for general corporate purpose and issue expenses.

Financials

OSCL's income grew at a Compounded Annual Growth Rate (CAGR) of around 28% during FY08 to FY10 mainly due to the increased sales volumes despite the decline in average realisation from FY08 level. Manufacturing capacity also increased significantly during this period. Realisation declined due to the change in product mix. PBILDT margins of the company improved during FY08 to FY10 due to the improved operational efficiencies, stabilised operations and increasing capacity utilisation. The working capital cycle increased due to the increased inventory period. The Equity share capital of the company increased during FY10 due to the bonus shares issued in June 2009.

As on March 31, 2010 OSCL had long-term debt of Rs.6.67 crore against the networth of Rs.16.31 crore and the debt-equity ratio of the company was 0.41x . The overall gearing as on March 31, 2010 stood at 1.64x due to the working capital borrowing of Rs.19.12 crore. The Return on the Capital Employed is stable around 28%. The EPS declined in FY10 due to the issuance of bonus shares. During H1FY11, OSCL earned a net profit of Rs.5 crore on the income of Rs.52 crore.

Industry overview

From being an import-dependent industry in the 1950s, the Indian pharmaceuticals sector has come a long way post liberalization to attain the current size of around US\$20 billion. India is now not only self-sufficient in terms of pharmaceutical products, but has also achieved global recognition as a manufacturer and supplier of cost-effective, high-quality



December 2010

5

bulk drugs and formulations by exporting to over 200 countries. With India having the largest number of United States Food & Drug Administration (USFDA) approved manufacturing facilities outside the US; the number of drug master filings (DMF) by Indian companies is increasing year-on-year and is expected to remain way ahead of China in the near to midterm.

CARE Research expects that pharmaceutical intermediates will account for over 2/3rd of the speciality chemicals market by the year 2012. The Indian speciality chemical manufacturers have the technical expertise and R&D capabilities to produce niche, complex and high-quality intermediates belonging to the pharma sector. Going forward, the Indian pharma-associated companies can demonstrate considerable potential for collaborative and outsourced R&D projects in new drug development, biotechnology and chemicals.

(Rs. crore)

Y.E. / As on March 31	2008	2009	2010
	A	A	A
Working Results			
Net sales	38.45	47.62	64.7
Total income	41.39	50.93	68.3
PBILDT	6.21	9.04	13.1
Depreciation	0.26	0.48	1.85
PBIT	5.96	8.56	11.2
Interest	2.1	3.6	3.74
PBT	3.96	4.9	7.32
PAT	2.6	3.13	4.99
Gross Cash Accruals	2.87	3.81	7.05
Financial Position			
Equity Share capital	0.26	0.26	11.5
T Net Worth	8.45	11.78	16.3
Key Ratios			
Profitability (%)			
PBILDT Margin	15.01	17.75	19.2
PAT Margin	6.29	6.15	7.3
ROCE	30.74	28.34	28.2
RONW	36.42	30.98	35.5
EPS(Rs)	992.9	1196	43.3
Solvency(times)			

December 2010

6

Y.E. / As on March 31	2008	2009	2010
	A	A	A
Debt Equity Ratio	0.66	0.93	0.41
Overall Gearing	1.66	2.21	1.64
Interest coverage	2.96	2.51	3.5
Term Debt/GCA	3.32	3.74	1.08
Liquidity (times)			
Current ratio	1.47	1.18	1.16
Quick ratio	0.89	0.68	0.66
Turnover			
Avg. Collection Period (days)	51	76	79
Avg. Inventory (days)	84	101	115
Avg. Creditors (days)	28	50	69
Op. cycle (days)	107	127	125

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.

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