

## Grading Rationale for CRISIL IPO Grading

### Precision Pipes and Profiles Company Ltd

### CRISIL IPO Grade 4.0/5.0

Public Issue of 5,000,000 Equity Shares of face value Rs 10 at a targeted price of Rs 150 per share.

Bid/Offer Opens	*
Bid/Offer Closes	*
Shares Offered	5,000,000
As % of post issue Equity	35.7%
Shares Outstanding (Post issue)	14,000,000
<b>Lead Manager</b>	
UTI Securities Ltd., NEXGEN Capitals Ltd.	
<b>Registrar to the Issue</b>	
Intime Spectrum Registry Ltd	

Precision Pipes and Profiles Company Ltd			
Past Financial performance		2005-06	2006-07
Operating income	Rs Million	805.9	1,097.8
Operating margins	Per cent	23.0	26.3
Net profits	Rs Million	79.9	138.8
Net margins	Per cent	9.9	12.6
ROCE	Per cent	31.2	43.0
Return on Equity	Per cent	25.2	37.2
No. of equity shares	Million	6.0	9.0
Net worth	Rs Million	330.8	416.0
Basic EPS	Rs	13.3	15.4
Diluted EPS	Rs	13.3	15.4
Book value	Rs per share	55.1	46.2
Gearing	Times	0.5	0.4

Shareholding Pattern	Prior to issue		Post issue	
	No. of shares	%	No. of shares	%
Promoters	8,775,000	97.5	8,775,000	62.7
Other Body Corporate	225,000	2.5	225,000	1.6
Public	-	-	5,000,000	35.7
Total	9,000,000	100.0	14,000,000	100.0

### Overall Assessment

CRISIL has assigned a CRISIL IPO Grade '4/5' (pronounced 'four on five') to the proposed initial public offer of Precision Pipes and Profiles Company Ltd (PPAP). This grade indicates that the fundamentals of the issue are above average relative to other listed equity securities in India.

The grading reflects company management's success in transforming a small plastic processing business into a Tier-I supplier of PVC profiles to leading passenger car OEMs. It takes into account the company's track record of strong client and collaborator relationships over an extended period, healthy revenue growth potential, strong product and tool development capabilities, the expected enhancement in management's corporate governance performance with the appointment of high profile independent directors on the board, and the possibility of revenue and profit upside from the proposed export project. The grading also takes into account the fact that future margins are likely to be lower than in the past, and the uncertainties arising out of the absence of a succession plan in the group's finance function and the impact of any future separation of promoters on the company.

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**

### ***Healthy revenue growth potential, but incremental margins to be lower than existing levels***

PPAP has successfully established and maintained supply relationships with major passenger car OEMs. The key drivers of future revenues include sustained healthy growth in car production, acquisition of new customers (such as Tata Motors, Mahindra & Mahindra, and Nissan), supply to new models of existing customers (including Maruti Udyog, Honda Sael, Toyota Kirloskar) and the company's focus on improving value per car by acquiring more products from OEMs. The ongoing negotiations with Hyundai, if successful, would provide further upside to future revenues. Although PPAP's dependence on Maruti Udyog would reduce gradually, the concentration of few large customers would continue to remain high in the company's revenues.

Currently, PPAP enjoys high operating margins, driven by its strong product and tool development capabilities, particularly for extruded products, and cost reduction ability acquired with the successful absorption of manufacturing techniques. However, its incremental operating margins are likely to be lower than present levels because new business will be acquired at lower margins — for instance, lower margin products will be supplied to new small cars, like Tata Motors' Rs 1-lakh car — and an assured annual price reduction will be offered to all OEMs as per manufacturing agreements.

## **Financial performance**

### ***Low gearing and expected reduction in margins to depress existing high RoE***

The incremental returns from the planned deployment of the IPO proceeds are likely to be moderately lower than existing levels, due to low gearing and expected reduction in margins. This, along with the fact that the company is likely to generate significant surplus from internal accruals, will also depress PPAP's incremental returns, till the surplus is deployed into new projects. While 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.

## **Management capability**

### ***Successfully transformed business: From small plastic processor into Tier-I PVC profiles supplier***

This group was founded by Mr DC Jain in 1961 with a small plastic processing unit. Subsequently, PPAP was incorporated in 1978. Over the years, management has successfully established itself as one of the major players in PVC profiles for automobiles. Management has also demonstrated its capabilities in product development, tool design and absorption of manufacturing techniques. It has been successful in building and maintaining relationships with both customers and collaborators over an extended period of time, under the business guidance of Mr AK Jain and financial control of Mr SC Jain. However, absence of the group's succession plan, especially for Mr SC Jain's role of financial controller, and the likelihood of separation between promoters, remain uncertain.

## **Corporate governance**

### ***Experience of independent directors will be positive in enhancing corporate governance performance***

The independent directors of the company have a strong career profile. Most of the independent directors bring in significant administrative experience, after having held several important and senior positions in various government departments. Also, most independent directors hold directorship on the boards of other companies. Apart from experience and willingness, the ability of the independent directors to exercise management oversight is likely to enhance the company's future corporate governance.

## **Business profile**

PPAP was incorporated in 1978 as a partnership firm under the guidance of Mr DC Jain, the founder of the group. The company was converted into a public limited company in 1995. PPAP manufactures and supplies PVC profiles to various customers in the automobiles, white goods and other segments such as electrical and construction. The company derives over 90 per cent of its revenues from the automobile segment, whereas, the white goods segment accounts for 5 per cent of its revenues. PPAP's product range for automobiles include sealing systems, and exterior products — such as weather strips, trim door opening, windshield moulding, roof moulding, quarter window seal, A-pillar garnish, B-pillar garnish, skirt air damper, and body side moulding.

Since 1989, PPAP has had a technical collaboration with Tokai Kogyo Co Ltd (TKCL), Japan, a supplier of PVC profiles to OEMs such as Honda, Toyota and Suzuki in Japan. PPAP's key customers in the automobiles industry include passenger car OEMs such as Maruti Udyog, Honda SIEL, General Motors and Toyota Kirloskar Motors. In the white goods industry, its customers include refrigerator OEMs such as Godrej, Voltas, Videocon and Carrier Refrigerators.

At present, PPAP has five manufacturing facilities in the NCR region of Delhi with an aggregate capacity of 4.75 million kg of PVC. The company has proposed a capital expenditure of Rs 946 million over the next 2 years to double its PVC capacity to 9.9 million kg by 2008-09. The capex is to set up a new plant at Surajpur to manufacture automobile profiles, expand its existing facility at Noida, upgrade its in-house tooling capabilities and lastly, set up a new plant at Badarpur dedicated for exports to Power and Data Corporation Pty Ltd, Australia. PPAP plans to fund this capital expenditure through term loans of Rs 250 million from ICICI Bank, and internal accruals of Rs 60 million. The balance amount of Rs 750 million will be met through the proposed IPO.

PPAP also has two other group companies: Ajay Industrial Corporation (AIC) (partnership firm) and Ajay Poly Private Ltd. While AIC is among the few players in India with the capacity to manufacture CPVC pipes (substitutes for GI pipes), Ajay Poly Private Ltd is a leading manufacturer of gaskets for major refrigerator OEMs in India, with 14 factories across the country that are close to the facilities of refrigerator OEMs. In 2006-07, the group's total turnover and net profits were Rs 1,953 million and Rs 198 million, respectively.

## **Financial profile**

PPAP's operating income increased at a healthy CAGR of 29 per cent from Rs 402 million in 2003-04 to Rs 1,098 million in 2006-07. Its revenues are mainly driven by the automobiles segment, which accounts for over 90 per cent of its revenues. Past revenue growth was driven by a rise in car production, acquisition of new customers and increased supplies of its products.

The company enjoys high operating margins (average of 26 per cent in the last 5 years), due to its significant product and tool development capabilities, particularly extruded business, and focus on cost reduction. However, the company's ratio of raw material cost-to-operating income tends to follow average raw material prices; this implies limited pricing flexibility to pass-on increased input prices, due to the fixed price supply contracts with its customers.

PPAP recorded net margins of 10-13 per cent during 2002-03 to 2006-07. Its net cash accruals increased from Rs 51 million in 2002-03 to Rs 137 million in 2006-07. However, the higher working capital requirement resulted in increased short-term borrowings during this period. The company's average return on equity (RoE) has been 28 per cent over the past 5 years.

## **Profile of Management and Board**

Founded by Mr DC Jain in 1961, the group commenced operations as a small plastic processing business with its partnership firm Ajay Industrial Corporation. Subsequently, in 1978, PPAP was incorporated as a partnership firm to manufacture PVC-based products for the white goods industry. Over the years, management has successfully established itself as one of the major players in PVC profiles for automobiles and refrigerators. The management has demonstrated exemplary capability to build and maintain relationships with both customers and collaborators, under the business guidance of Mr AK Jain and the financial control of Mr SC Jain.

PPAP's board comprises twelve directors, which includes six promoter directors and six independent directors (joined the board in January 2007 and July 2007). The independent directors have wide administrative experience and have held important offices in their career. Also, most independent directors hold directorship on the boards of several other companies.

<b>Independent Directors</b>	<b>Date of appointment</b>	<b>Qualification</b>	<b>Other directorships</b>	<b>Experience</b>
Mr. Kaushal Kumar Mathur	Jan-07	Retired IAS officer, M.A.	Max Healthcare Institute Ltd., Delhi Guest House Pvt. Ltd.	Retired as Chief Secretary of Delhi and Goa. Held various offices with Government of India including CMD of ITPO (India Trade Promotion Organisation).
Mr. Brij Behari Tandon	Jan-07	M.A. (Economics), L.L.B.	Ambuja Cement Foundation, Nagarjuna Fertilisers and Chemicals Ltd, Sagar Sugar and Allied Products Ltd., Adani Power Pvt Ltd., Cosmo Ferrites Ltd., Abhishek Global Ventures Ltd., Birla Corporation Ltd.	Retired as Chief Election Commissioner of India from in June 2006. Has been a member of the Indian Administrative Services from 1965 to 2001.
Mr. Satish Lal Tandon	Jan-07	B.E. (IIT), PGDM&SM	Alfa Laval India Ltd., Esab India Ltd., Modern Dairies Ltd., Kolte Patil Developers Ltd.	Retired as Managing Director of Alfa Laval India Ltd. in October 2005. Has received "Udyog Ratna – Life Time Achievement Award" from the International Award Committee of Wisitex Foundation.
Mr. Surender Kumar Tuteja	Jul-07	Retired IAS officer, M.Com, FCS, G.D.C.S	Shri Renuka Sugars Ltd., HMT Ltd., Swaraj Mazda Ltd., Central Warehousing Corporation, Shri Renuka Infraprojects Ltd., Tiger Cold Chain Pvt Ltd., Abhishek Global Ventures Ltd., Mundra Port and Special Economic Zone Ltd.	In 2005, retired as Secretary, Department of Food and Public Distribution. Also served as Chairman of Punjab State Industrial Development Corporation (PSIDC). At present, working as the Chairman of Central Warehousing Corporation
Mr. Vinod Vaish	Jul-07	Retired IAS officer, M.Sc (Physics), M.Phil, PG (Public Admn.)	Nil	Retired in March 2007 as the member of Telecom Disputes & Appellate Tribunal. Also served as Chairman, Telecom Commission and Secretary, Department of Telecommunications
Mr. Sudarshan Kumar Duggal	Jul-07	B.Tech, M.A.,L.L.B.	Hisar Spinning Mills Ltd., Rana Sugars Ltd., SR Industries Ltd., Cheema Spintex Ltd., Indian Yarns Ltd., Fazilka Cotton & Synthetics Ltd., Rana Polycot Ltd., Sohrab Spinning Mills Ltd., Usha Yarns Ltd., Supreme Yarns Ltd.	Retired as Executive Director (Textile) from Punjab State Industrial Development Corporation (PSIDC), Chandigarh. Also served as Managing Director of NITCON after his retirement from PSIDC.

### **Source: Company prospectus**

#### **Disclaimer**

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