

Mr. Prakash Kanugo
Managing Director
Prakash Steelage Ltd.
701, Mahalaxmi Chambers, Bhulabhai Desai Road,
Mahalaxmi, Mumbai – 400 026

July 14, 2010

Dear Sir,

IPO Grading

Please refer to our letter dated July 12, 2010 on the above subject.

2. The rationale for the grading is attached as an **Annexure - I**. Kindly 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 July 19, 2010 we will proceed on the basis that you have no comments to offer.

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

Thanking you,

Yours faithfully,


[Shailendra Gavali]
Manager

Encl: As above

Annexure - I

Grading Rationale

Prakash Steelage Ltd. (PSL)

Grading Assigned

Particulars	Number of equity shares (in lakh)	Grading ¹	Remarks
IPO Grade	62.50 shares of face value Rs.10 each	'CARE IPO Grade 2'	Assigned

The grading is constrained by low profitability margins, relatively high gearing ratios, delays in payment of statutory dues in FY10, qualifications by the auditor in FY10 annual report, moderately high utilisation of working capital limits, project execution risk associated with the ongoing project and inherently cyclical nature of the stainless steel industry.

The grading factors in the reasonable experience of the promoters in the stainless steel industry, established client relationships, products approved by reputed accrediting agencies, gradual improvement in capacity utilisation and financial support from the promoters through unsecured loans.

Background

Incorporated as a private limited company viz. Prakash Steelage Pvt. Ltd. on May 9, 1991, it was converted into a public limited company and the name was changed to Prakash Steelage Ltd. on August 12, 1997. PSL is a flagship company of Prakash Group.

PSL started business with trading in stainless steel (SS) sheets, coils, plates and scrap. In 1996, PSL set up its first manufacturing facility with an installed capacity of 4,000 tonnes per annum (tpa) for production of welded & seamless SS pipes and tubes in the U.T. of Dadra & Nagar Haveli, Silvassa. In 2007, PSL set up a second manufacturing facility with an installed capacity of 8,200 tpa at Umbergaon, Gujarat. Currently, PSL is undertaking an expansion of the existing manufacturing facilities at

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¹Complete definition of the grading assigned is available at www.careratings.com and other publications of CARE

Umbergaon by adding another 6,800 tpa capacity, which will enhance the total installed capacity to 19,000 tpa.

PSL is an ISO 9001:2008 and Pressure Equipment Directive (PED) certified company and a 'Government Recognized Star Export House'. The company exports its products to several countries, such as USA, UAE, South Africa, European countries, Canada, Singapore, Saudi Arabia, Turkey, Vietnam etc.

Management

The Board of PSL comprises eight members including four independent non-executive directors. Mr. Prakash C. Kanugo is serving as the Chairman and Managing Director. The Board is assisted by a team of senior executives.

Corporate Governance

Separation of ownership and management

PSL has a total of four independent directors on Board out of total of eight directors. Amongst the four independent directors, two were appointed in August 2008 and the other two in September 2009.

Board Committees

Further, in order to comply with the corporate governance requirements, PSL has constituted committees such as Audit Committee, Remuneration Committee and Investor/Shareholders Grievance Committee in August 2008. The company has not constituted the IPO Committee. However, the Board of Directors are assigned to perform the required functions of the IPO Committee.

Pending legal cases & their status

I. Litigations filed by PSL

There are two complaints filed by PSL against two parties for dishonour of cheque to whom materials have been supplied. Further, there are two complaints filed by the promoters/group entities of PSL against two parties for dishonour of cheque to whom materials have been supplied.

II. Notices received by PSL

- PSL has received a notice dated October 20, 2009 stating that the net wealth chargeable to tax for the respective years had escaped assessment. The matter is pending before the Assessing Officer.

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- A show cause notice was issued by the Joint Commissioner of Customs (EP) alleging that some importers viz. Prakash Steel and Prakash Steelage Ltd were clearing consignment of SS coils secondary/defective by misdeclaring the goods to claim benefit and also undervaluing the goods to evade customs duty. The matter is pending with the concerned authority.
- A show cause notice dated November 30, 2006 was issued by the Income Tax Officer to the company. Since the main appeal is pending before the Income-tax Appellate Tribunal (ITAT), the said notice has been kept in abeyance.
- A show cause notice dated December 14, 2007 was issued to PSL by the Asst. Commissioner of Income Tax. Since the main appeal is pending before the ITAT, the said notice has been kept in abeyance.

Operations

PSL has been engaged in the business of SS pipes and tubes for over 19 years. The main areas of the business are manufacturing of welded & seamless SS pipes, tubes, bright annealed/polished pipes and U-tubes of various sizes and grades as well as trading of SS tubes, pipes, sheets, plates, coils and scrap. The company carries out the manufacturing operations through its two production units in Silvassa and Umbergaon, Gujarat, with the total capacity of 15,600 tpa as at the end of FY10.

The total capacity utilisation of PSL was high, at over 100%, in FY07, however, it declined to 49% in FY08 due to addition of new capacity at the Umbergaon plant, which commenced commercial production in September 2007. The overall capacity utilisation witnessed gradual improvement over the years and was 69% in FY10.

Ongoing Projects

PSL is implementing an expansion project at the existing Umbergaon plant. The project involves expanding the total installed capacity of seamless & welded SS pipes/tubes from 12,200 tpa to 19,000 tpa. The total planned cost of the expansion is Rs.48.55 crore and the project is expected to be completed in October 2010. The proposed capacity to the extent of 3,400 tpa has already been installed and the actual expenditure of Rs.27.05 crore was incurred as on February 28, 2010. The proposed expansion project has not been appraised by any bank or financial institution and the fund requirements are based primarily on management's estimates. Any significant deviation on the project cost may impact PSL's future performance.

IPO Details

Size of the Issue

PSL proposes to make a public offer of 62,50,000 equity shares at face value of Rs.10 each for cash at a premium to be determined through a book-building process.

Terms of the issue

Out of 62,50,000 equity shares, 1,00,000 equity shares (being 5% of the issue size) will be available for allocation to the eligible employees (the 'Employee Reservation Portion'). The issue less the Employee Reservation Portion is referred to as the 'Net Issue'. A total of 30,75,000 equity shares (being 50% of the net issue size) will be available for allocation to the Qualified Institutional Bidders (QIBs) and 5% of the QIB portion will be available for allocation on a proportionate basis to Mutual Funds. 9,22,500 equity shares (being 15% of the net issue size) will be available for allocation to Non Institutional Bidders and the balance of the net issue consisting of 21,52,500 equity shares (being 35% of the net issue size) will be available for allocation to Retail Individuals Bidders. Under-subscription, if any, in any of the above categories will be met with spillover inter-se from any other categories, at the sole discretion of the company and Book Running Lead Manager.

Purpose of the issue

- Part-funding of the expansion of the existing manufacturing facility at Umbergaon, Gujarat
- Partly meeting working capital requirements
- Partly meeting general corporate purpose expenses
- Meeting issue-related expenses

PSL intends to utilise part of the IPO proceeds for funding of the expansion project at the Umbergaon plant and the balance will be allotted to meeting working capital requirements, general corporate purpose and issue expenses.

Financial Analysis

PSL's sales, which grew by 42% in FY08 driven by strong sales realisation of SS pipes & tubes as well as an increase in the volume of SS sheet, coil & plate trading witnessed lower growth in FY09 due to decrease in the average realisation of SS pipes & tubes produced and in the volume of trading on account of the slowdown in the

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steel industry starting H2FY09. In FY10, net sales witnessed a healthy 51% growth mainly driven by an increase in the revenues from trading as well as manufacturing activities. PSL's PBILDT margin gradually improved over the past three years. The improvement in margin was due to an increase in the sales from manufactured SS pipes & tubes and higher-margin products, after commissioning of the Umbergaon facility in September 2007. Interest cost increased significantly in FY09 and further in FY10 on account of increase in the working capital borrowings, term loan and unsecured loans taken to support the growth of the operations and addition of fixed assets at the Umbergaon plant. PAT declined in FY09 owing to substantial increase in the interest and deprecation cost as well as a forex loss of Rs.6.55 crore. However PSL's PAT more than doubled during FY10 mainly on account of increased PBILDT along with forex gain of Rs.1.99 crore in FY10. As a result, PAT margin, improved in FY10 vis-à-vis FY09.

The Return On Net Worth (RONW) which deteriorated sharply in FY09 on account of decline in PAT, registered an increase in FY10 owing to increase in PAT. EPS followed a similar trend. The Long-term Debt Equity Ratio (DER) deteriorated to 1.73x as at the end of FY09 due to an additional term debt and unsecured loans taken to fund further expansion at the Umbergaon facility. The overall gearing ratio deteriorated as at the end of FY09 on account increase in the working capital borrowings to support the growth in the operations. The overall gearing ratio though improved in FY10, was high. PSL's current ratio was above unity during FY07-FY10. During February 2009, PSL was subjected to a search operation by the IT Department and on February 25, 2009, Mr. Prakash C. Kanugo on behalf of the company filed a voluntary declaration declaring an undisclosed income Rs.7.11 crore. The auditor's report accompanying the FY10 annual accounts also makes a mention of some delays in depositing statutory dues.

Industry Review

The Indian pipe industry with presence across all categories of pipes is among the top three manufacturing hubs after Japan and Europe. India with its large geographical area has a very low pipe penetration level at 32% compared to global average of 79% in oil and gas transport. The pipeline network of India for oil & gas transport stood at 17,576 kms as on April 30, 2009. Sanitation levels are also lower at 33% compared to 91% in Sri Lanka and 100% in France. Of 143 million hectares of cultivable land in

India, only 40% of it is irrigated. With large investments by both public and private players, the share of transportation of oil & gas through pipeline is expected to increase in future. The Government of India (GoI) has formulated the New Exploration Licence Policy (NELP) for exploration and production of oil and gas. Also, GoI through its public sector companies has embarked on formation of the National Gas Grid with a total investment of Rs.210 bn for the period FY2007-12.

Stainless steel is iron-based alloy usually containing at least 11.5% of chromium. Other elements, nickel being the most important, may be added in combination with chromium to obtain special properties. Stainless steel is highly resistant to corrosive attack and oxidation at high temperatures. Stainless steel pipe and tubes are used to resist corrosion and oxidation, to maintain the purity of materials, which come in contact with stainless steel as well as for cleanliness and low maintenance cost. Seamless pipes and tubes have higher pressure bearing capacity as they do not have any joints along the length. Therefore, they are used for high-pressure applications, such as manufacturing of bearings, automobile parts, drill rods, hydraulic cylinders, gas cylinders, boilers etc.

The growth in infrastructure segment is the major demand driver for stainless steel pipe and tube segment. With increased allocation on infrastructure by the GoI in the budget for 2010-11, spending on infrastructure projects is expected to gain momentum.

Prospects

The main products of PSL find applications in various industries like chemical, petrochemicals, oil& gas, paper etc. With the growing Indian economy, new industrial projects being envisaged and overall increased spending on various infrastructure projects the demand outlook for PSL's products is expected to remain stable in the medium to long term.

Financial Performance

	(Rs. crore)		
For the period ended / as at Mar.31,	2008	2009	2010
	(12 m, A)	(12 m, A)	(12 m, A)
<u>Working Results</u>			
Net Sales	227.57	290.37	437.10
Total Operating Income	239.33	321.40	435.92
PBILDT	17.13	29.44	42.68
Interest	4.90	10.01	13.90

For the period ended / as at Mar. 31,	2008 (12 m, A)	2009 (12 m, A)	2010 (12 m, A)
Depreciation	1.24	2.45	3.84
PBT	12.53	12.07	27.41
PAT (after deferred tax)	8.29	7.73	17.82
Net Cash Accruals	9.59	10.58	20.77
<u>Financial Position</u>			
Equity Share Capital	10.00	11.25	11.25
Net Fixed Assets	37.01	59.54	56.63
Net Working Capital	68.43	102.54	127.73
Tangible Net Worth	26.36	39.12	55.39
Total Debt	80.92	127.35	139.12
Total Capital Employed	107.28	166.46	194.50
<u>Key Ratios</u>			
<i>Growth</i>			
Growth in Total income (%)	43.29	34.29	35.63
Growth in PBILDT (%)	140.63	71.87	44.98
Growth in PAT (after D.Tax) (%)	163.01	(6.83)	130.70
<i>Profitability</i>			
PBILDT/Total Op. income (%)	7.16	9.16	9.79
PAT/Total income (%)	3.44	2.40	4.09
ROCE (%)	22.50	16.13	22.89
RONW (%)	45.07	23.60	37.72
EPS (Rs.)	8.29	6.87	15.84
<i>Solvency</i>			
Long Term Debt Equity ratio (times)	1.44	1.73	1.13
Overall gearing ratio (times)	3.07	3.26	2.51
Interest coverage (times)	3.24	2.70	2.80
Term debt/Gross cash accruals (years)	3.24	5.75	2.81
<i>Liquidity</i>			
Current ratio (times)	1.18	1.29	1.27
Quick ratio (times)	0.85	0.77	0.91
<i>Turnover</i>			
Average collection period (days)	84	92	73
Average creditors (days)	76	78	62
Average inventory (days)	48	67	60
Operating cycle (days)	56	81	71

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.