

Mr. Jayanti Sanghvi
Managing Director
Sanghvi Forging and Engineering Limited
A-8, Parvati Chamber
Opp. Apsara Cinema, Pratapnagar Road
Vadodara – 390 004

April 14, 2011

Confidential

Dear Sir,

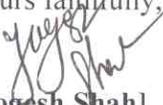
IPO Grading

Please refer to our letter dated April 11, 2011 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 at the earliest.

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

Thanking you,
Yours faithfully,


[Yogesh Shah]
Asst. General Manager

Encl: As above

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.

Annexure I

Grading Rationale

SANGHVI FORGING AND ENGINEERING LIMITED (SFEL)

Grading

Particulars	Amount of Public Issue	Grading ¹	Remarks
IPO Grading	Rs.42.50 crore	'CARE IPO Grade 3'	Assigned

CARE has assigned a '**CARE IPO Grade 3**' to the proposed IPO of Sanghvi Forging and Engineering Limited (SFEL). '**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 fundamentals of the issuer. The grade assigned to any individual issue represents a relative assessment of the 'fundamentals' of the issuer.

SFEL proposes an initial public offering of equity shares of face value of Rs.10 aggregating Rs.42.50 crore through 100% book building process.

Grading Rationale

The grading draws strength from the experienced promoters and comfortable financial risk profile of SFEL marked by healthy (though fluctuating) profitability margin in the last three years, comfortable liquidity indicators and moderately levered capital structure. The grading also factors in SFEL's diversified revenue-mix and relatively stable outlook for the end-user industries.

The grading is constrained by its modest scale of operation, high working capital intensity and project risk marked by project size of almost six times of its networth as on December 31, 2010 and more than four times of its existing capacity. Exposure to raw material price fluctuation risk and foreign exchange fluctuation risk further constrain the grading.

Background

SFEL is a Gujarat-based closely-held public limited company engaged in manufacturing of forged flanges & rings in industrial forging and precision CNC machined components.

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



The plant has an installed capacity of 3,600 Metric Tonne Per Annum (MTPA) for closed and open forgings and has capacity to handle a single job of upto 4 MT. SFEL was promoted by Mr Babulal S Sanghvi in 1989 and started commercial production in 1991.

Operations

SFEL manufactures forged and machined items including forged flanges, stainless steel forged fittings & components, instrumentation forging components, ring forgings etc which find application in the industries like wind energy, oil & gas, steel, power, pressure vessel, petrochemical, sugar industry etc.

SFEL caters to the demand for forgings in the non-automobile segment where there are few players having specialized set-up and skills. Moreover, in this segment SFEL is approved and recognized supplier having established track record of around two decades. SFEL is enlisted/approved with well known and reputed clients/consultants like EIL, Uhde, Toyo, BHEL, BPCL, HPCL, Shell Hazira, GNFC, GSPL, NPCIL, Department of Atomic Energy, Ministry of Defence etc in India and also with TUV Rheinland Industrie (for supply to the European markets), KNPC (Kuwait), PDO (Oman) etc for exports. Its established client base is expected to be advantageous for SFEL's proposed expansion project.

SFEL's customer profile is well diversified with top ten customers accounting for 38% of total sales during FY10. Exports, which constituted about 30% of total sales in the past, declined to 16% during FY10 and further to 14% during 9MFY11 due to subdued economic conditions prevailing in the European region where the company had major exports. The company is exposed to foreign exchange fluctuation risk on the export sales.

SFEL's main raw materials are stainless steel (SS) and mild steel of which SS constituted majority of total raw material consumption. SS prices are mainly governed by movement in nickel prices. Further, its operations are characterized by high level of inventories (82 days during FY10) which exposes SFEL to raw material price fluctuation risk.

Objects of the proposed IPO are to part-finance cost of setting up 15,000 MTPA open die forging unit and fund the margin money for long-term working capital requirements.



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Management

The main promoters of SFEL are Mr Babulal Sanghvi (Chairman) who has overall experience of around 20 years in the forging business. Gradually Mr Sanghvi’s sons, who have professional qualifications, have also joined the company and have now gained considerable experience in the industry. SFEL’s Board of Directors consists of eight directors, of which four are independent directors having expertise in diverse fields.

Corporate Governance

SFEL has complied with the requirements of the clause 49 of the listing agreement with respect to constitution of Board of Directors and various Committees. SFEL has constituted the Audit Committee and Shareholders/Investors Grievance Committee. The constitution of aforesaid committee was approved by the Board of Directors on July 15, 2010

Pending Litigation

A summary of pending litigations as on September 30, 2010 is as follows:

Sr. No.	Matter Related To	Amount Involved (Rs. Crore)
1.	Income tax	0.29
2.	Central Excise	0.14
3.	Customs & others	0.025

IPO Details

Size of the issue

SFEL proposes to make a public offer of equity shares at face value of Rs.10 at the price to be determined through a book-building process aggregating up to Rs.42.50 crore.

Terms of the issue

- Out of total issue 50% of the issue size will be available for allocation to the Qualified Institutional Bidders (QIBs), 5% of the QIB portion will be available for allocation on a proportionate basis to Mutual Funds only.
- SFEL is considering Pre-IPO placement up to 18,37,227 equity shares aggregating upto Rs.16.54 crore. The number of equity shares in the issue will be reduced to the extent of the equity shares proposed to be allotted in the Pre-IPO placement. SFEL has already made Pre-IPO placement of 3,40,952 equity shares at price of Rs.80 per share (including share premium of Rs.70 per share) till April 8, 2011.



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Purpose of the issue

The main objects of the issue are to raise resources to finance part of the new project cost:

Sr. No.	Particulars	Amount (Rs. Crore)
1.	Setting up New project	105.14
2.	Working capital Margin money requirement for new project	8.25
3.	Preoperative expenses including issue expenses	7.00
	Total	120.39
1.	Portion to be financed from the issue of equity shares	42.50
2.	Term Loan	72.00
3.	Internal Accruals / Unsecured loans from the promoters	5.89
	Total	120.39

The project cost for setting up an additional facility has been appraised by State Bank of India and the bank has sanctioned term loan of Rs.50 crore and balance of Rs.22 crore was sanctioned by Bank of Baroda.

Project Details

Land for the project has already been acquired from GIDC. Project implementation has already started and SFEL has placed the orders for two major machineries viz Open Die Forging Plant with M/s Danieli Breda, Italy and Forging Manipulator with M/s Dango Dienenthal, Germany. These two machines would be delivered by October 2011, the civil work would start by April 2011 and commercial operations are expected to commence from May 2012. SFEL had incurred about Rs.12 crore upto March 31, 2011 towards project including Rs.10.59 crore as advance for plant & machinery and balance for miscellaneous expenditure.

Financial Analysis

Total income of SFEL in FY10 remained marginally lower than FY09 levels impacted by slower recovery of industries from economic slowdown and dip in exports from 25% of total income in FY09 to 16% of total income in FY10 on account of low demand from European countries.

PBILDT margin improved in FY10 because of higher production of larger-size jobs which provide better realization and efficient capacity utilization. However, PAT margin improved to a much lesser extent due to high provision of income tax in FY10.

The long-term debt-equity ratio and the overall gearing of SFEL remained comfortable as on March 31, 2010. Interest coverage also remained fairly comfortable during FY10.

The operating cycle of SFEL elongated from 117 days in FY09 to 153 days in FY10 mainly due to higher average collection period. Supply of parts for a single large order from M/s Mazagon Dock Ltd. (a Government of India undertaking) in March 2010 and non-realization of debtors from the same before the end of the year resulted in higher average collection period, which realised in H1FY11. Average monthly working capital utilisation during the last 12 months (March 2010 to February 2011) was moderate at 80%.

Return on networth and Earnings per Share (EPS) declined in FY10 compared to FY09 as improvement in PAT was offset by increase in equity share capital during FY10.

During 9MFY11, SFEL has achieved PBILDT and PAT of Rs.6.26 crore and Rs.3.09 crore respectively on total income of Rs.26.89 crore.

Industry Review

The forging industry has recovered from a tough year of 2009 followed by global meltdown. Both the segments, viz automobile and non-automobile forging showed signs of recovery in FY10, backed by robust demand from automobile companies and picking up of activities in engineering, oil & gas, fertilizers, power generation etc. In the Indian automobile market, passenger cars and commercial vehicles together registered a growth of 29% in production in FY10.

In non-automobile segment, the power sector is witnessing major investments on thermal, hydro and nuclear power generation. As of March 31, 2010, India had an installed power capacity of 155 GW. The Government of India in its 'Power for All by 2030' strategy underlines the necessity to increase the installed capacity to 800 GW. Thus, India is expected to add approximately 600-700 GW of new capacity by 2030. [Source: Central Electricity Authority, Government of India; Planning Commission, Government of India]. Oil & gas, shipbuilding, fertilizers and engineering also seem promising sectors going forward.



Prospects

SFEL caters to the demand for forgings in the non-automobile segment where there are few players having specialized set-up and skills. Moreover, SFEL is an approved and recognized supplier having established track record of around two decades. All of these would help SFEL in leveraging the growth opportunity presented by end-user industries. SFEL's prospects in the medium term would be driven by its ability achieve higher sales leveraging on its client base and enhanced capacities while sustaining its profitability. Further, successful completion of the proposed IPO would also be very crucial, as it has a high bearing on timely implementation of the proposed project.



Financial Performance

(Rs. crore)

For the period ended / As at March 31,	2008	2009	2010
	(12m, A)	(12m, A)	(12m, A)
<u>Operating Results</u>			
Income from Operations	22.50	29.55	29.22
PBILDT	5.01	5.29	6.21
Depreciation	0.40	0.55	0.65
Interest and finance charges	0.99	1.34	1.24
PBT (Operating profit)	3.95	3.35	4.07
PAT	2.18	2.50	2.61
Gross Cash Accruals	3.42	3.14	3.37
<u>Financial Position</u>			
Equity Share capital	3.93	3.93	4.78
Net Worth	7.74	10.34	13.45
Total Capital Employed	17.80	21.71	24.03
<u>Key Ratios</u>			
<i>Profitability (%)</i>			
PBILDT / Total Income	22.28	17.91	21.25
PAT / Total Income	9.67	8.46	8.95
ROCE	33.76	24.02	24.00
RONW	34.93	27.66	21.98
EPS	5.53	6.36	5.47
<i>Solvency (times)</i>			
Debt Equity Ratio	0.50	0.36	0.20
Overall Gearing	1.30	1.10	0.77
Interest coverage	5.05	3.94	5.01
Term Debt / GCA	1.57	1.65	1.01
Current ratio	1.12	1.21	1.32
Quick ratio	0.61	0.80	0.92
<i>Turnover (days)</i>			
Avg. Collection Period	65	66	104
Average Inventory	89	75	82
Average Creditors	38	24	34
Working capital cycle	116	117	153

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Annexure - II

Press Release

CARE assigns 'CARE IPO GRADE 3' to the Initial Public Offering of Sanghvi Forging and Engineering Limited (SFEL)

Grading

Particulars	Amount of Public Issue	Grading ¹	Remarks
IPO Grading	Rs. 42.50 crore	'CARE IPO Grade 3'	Assigned

Rating Rationale

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The grading is constrained by its modest scale of operation, high working capital intensity and project risk marked by project size of almost six times of its networth as on December 31, 2010 and more than four times of its existing capacity. Exposure to raw material price fluctuation risk and foreign exchange fluctuation risk further constrain the grading.

Company Profile

SFEL, incorporated in 1989 by Mr Babulal S Sanghvi, has an operational track record of around 20 years. SFEL is engaged in manufacturing of forged flanges & rings in industrial forging and precision machined components with an installed capacity of 3,600 Metric Tonnes Per Annum (MTPA) in the area of open and closed die forging. SFEL caters to the demand for forging in the non-automobile segment (Refineries, Fertiliser, Power, Engineering etc).

During FY10, SFEL has reported PAT of Rs.2.61 crore on total income of Rs.29.22 crore against PAT of Rs.2.50 crore on total income of Rs.29.55 crore in FY09. In 9MFY11, SFEL has earned PAT of Rs.3.09 crore on total income of Rs.26.89 crore.

Analyst Contact

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