



CONFIDENTIAL

Ref.: VEL \ NS \ 19-11-09 \ 29

Dated: January 11, 2010

Mr. M. Krishnamurthi,
Chief Corporate Affairs
Vascon Engineers Ltd
201, Phoenix,
Bund Garden Road,
Pune - 411 001,
India

Dear Mr. Krishnamurthi,

**Ref: CRISIL IPO Grading for the Initial Public Offer of 108,00,000 Equity Shares
of
Vascon Engineers Limited**

We refer to your request for an IPO Grading and the Grading Agreement for the captioned equity issue.

CRISIL has, after due consideration, assigned a **CRISIL IPO Grade "3/5"** (pronounced "three on five") to the captioned equity issue. This grade indicates that the fundamentals of the Issue are average relative to other listed equity securities in India.

The assigned grade is a one time assessment valid for a period of 60 Calendar days only from the date of this letter. In the event of your company not opening the captioned issue within a period of 60 days from the above date, or in the event of any change in the size/structure of the issue, a fresh letter of revalidation from CRISIL shall be necessary.

Should you require any clarifications, please feel free to contact us.

With warm regards,

Yours sincerely,

Chetan Majithia
Head, Equities - CRISIL Research

Nihag Shah
Analyst, Equities - CRISIL Research

A CRISIL IPO Grading is a one-time assessment and reflects CRISIL's current opinion on the fundamentals of the graded equity issue in relation to other listed equity securities in India. A CRISIL IPO Grading is neither an audit of the issuer by CRISIL nor is it a credit rating. Every CRISIL IPO Grading is based on the information provided by the issuer or obtained by CRISIL from sources it considers reliable. CRISIL does not guarantee the completeness or accuracy of the information on which the grading is based. A CRISIL IPO Grading is not a recommendation to buy / sell or hold the graded instrument; it does not comment on the issue price, future market price or suitability for a particular investor.

CRISIL is not responsible for any errors and especially states that it has no financial liability whatsoever to the subscribers / users / beneficiaries / distributors of CRISIL IPO Gradings. For information on any IPO grading assigned by CRISIL, please contact Client Servicing at +91-22-66913561, or via e-mail: clientservicing@crsil.com.

For more information on CRISIL IPO Gradings, please visit <http://www.crsil.com/ipa-gradings>

CRISIL Limited, a Standard & Poor's company

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IPO Grade

CRISIL IPO Grade '3/5': CRISIL Research has assigned CRISIL IPO Grade '3/5' for the proposed initial public offering of Vascon Engineers Ltd. (CRISIL Research has undertaken a fresh grading exercise for VEL as the grading assigned to the company on December 31, 2007 had expired.) The grade indicates that the fundamentals of the issue are average, relative to other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals.

Issue Details

Shares offered to public	108,00,000
As per cent of post issue equity	11.95%
Object of the issue	a) Funding construction of EPC contracts and real estate development projects b) repayment of debt c) general corporate purposes
Amount proposed to be raised	Rs 2,250 Mn (approximate)
Price band	Not available at the time of grading
Lead managers	Kotak Mahindra Capital Company Ltd Enam Securities Pvt Ltd

Company Background

VEL is a Pune-based player, engaged in real estate construction and development. The company was incorporated in January 1986, and commenced operations with the construction of Cipla's Patalganga factory in November 1986. Up to 1998, the company was a real estate contractor executing contracts for third parties. VEL's real estate business comprises construction of residential and office complexes along with IT parks, industrial units, shopping malls, multiplexes, educational institutions and hotels. As of August 31, 2009, the company completed construction contracts worth Rs 8.8 Bn, out of which Rs 6.4 Bn was for third parties. In terms of saleable area for its real estate development projects, VEL has constructed over 4.58 mn. sq. ft. In 2008-09, the construction business and development business contributed to around 93 per cent and 6 per cent respectively, to the company's total revenues.

Grading Highlights

Business Prospects

- Strong EPC order book provides comfort on revenues and margin front.
- Third-party EPC order book concentration (around 33 per cent of the total order book) towards industrial, hospital, educational and airport clients gives better revenue visibility.
- Being in the construction business for over 2 decades, the company has gained strong technical and design expertise. A large part of the company's reputation in the Pune market is on account of its track record in providing timely delivery to clients.
- The joint development model reduces the working capital requirement as the contribution towards land cost is only in the form of deposits with the land owners. The risk of a fall in property prices is shared with the land owner. In this business model, VEL acts as a real estate contactor as well as developer thereby earning a larger share of the revenues.
- The company's real estate development business is primarily concentrated in Maharashtra, especially in-and-around Pune, exposing it to a high level of geographic and price risk. Also, Pune city, in terms of demand for residential and commercial space, is to a large extent dependent on the fortunes of the IT/ITeS industry.

Financial Performance

- Healthy revenue growth at a CAGR of 54 per cent driven by high growth in EPC business over the past 3 years.
- EPC business in which the company undertakes civil construction of buildings etc formed close to 93 per

cent of the company's sales in 2008-09. The EBITDA margin in EPC business improved from 13.5 per cent in 2005-06 to 15 per cent in 2008-09. Real estate development business accounted for ~ 6 per cent of sales in 2008-09. Real estate development business has also witnessed EBITDA margin expansion from 31.0 per cent in 2007-08 to 76.0 per cent in 2008-09.

- In spite of the Indian real estate sector going through a downturn, the company's EPC business witnessed a healthy CAGR of 20.0 per cent from Rs 3,624 Mn in 2006-07 to Rs 5,114 Mn in 2008-09.
- The company postponed around 90 per cent of its projects on the development front. However, while this impacted revenues and led to postponement of cashflows, it helped the company to maintain low gearing and weather demand uncertainty.

Management Capabilities

- Mr R Vasudevan is the managing director of the company. He is a qualified engineer - BE (Civil) - from the University of Pune and has worked with organisations such as Maharashtra Industrial Development Corporation, Hindustan Construction Company Ltd, Atul Constructions Company Ltd and Beck Engineer Company Pvt Ltd.
- The company has a strong and capable second line of management with people who has been with the company since its inception.

Corporate Governance

- VEL's corporate governance meets the required corporate governance standards.

Detailed Grading Rationale

Overall Grading Summary (CRISIL IPO Grade 3/5)

To arrive at the overall grade, CRISIL has considered the following parameters:

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

CRISIL has assigned CRISIL IPO Grade '3/5' (pronounced 'three on five') to the proposed Initial Public Offer of Vascon Engineers Ltd. (*CRISIL Research has undertaken a fresh grading exercise for VEL as the grading assigned to the company on December 31, 2007, had expired.*) The grade indicates that the fundamentals of the issue are average, relative to other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The offer price for the issue may be higher or lower than the level justified by its fundamentals. The grade is not a recommendation to buy/sell or hold the graded instrument, the graded instrument's future market price or its suitability for a particular investor.

The grading takes into account VEL's track record as a building construction specialist with an ability to deliver quality construction on time. VEL also enjoys strong customer brand awareness in the Pune market, where it has been operational for the last 20 years. The company's past performance has enabled it to withstand the downturn in the real estate sector. The grading is constrained by VEL's high exposure to the Pune market, which is heavily dependent on the performance of the IT/ITeS industry. The grading also reflects challenges associated with the company's plans to scale up its real estate development business.

➤ Diversified portfolio of businesses and diverse revenue streams

VEL commenced its business as an EPC services company and has since, due to synergies between the two businesses, diversified into the real estate development business as well. The benefits of having two revenue streams became especially apparent in the year 2008-09, when the real estate business in India witnessed a significant downturn due to the global economic slowdown. While the company's total income for 2008-09 decreased by 15.43% as a result of the drop in its real estate development business, its EPC services business, which grew substantially for 2008-09 as compared to 2007-08, helped offset the fall in revenues from the real estate business. The company's EPC services business grew by 48.22% to Rs 4,481.38 Mn for 2008-09 compared to Rs. 3,023.52 Mn for 2007-08.

➤ Strong EPC order book

Over the course of the past 2 decades, VEL has provided EPC services for a diverse range of property

developments, such as factories, hospitals, hospitality properties, residential and office complexes, IT parks and shopping malls. As of August 31, 2009, the company had completed an aggregate of 179 EPC contracts with a total contract value of Rs 8,804.79 Mn. As of August 31, 2009, the company is engaged in 59 EPC contracts with an estimated total contract value of Rs 33,788.74 Mn with an order backlog of Rs 27,554.47 Mn. The company provides its EPC services for third parties as well as for real estate development projects developed by the company and its other development entities.

➤ **Diversified client base, with focus on institutional clients**

VEL has been able to perform relatively well as compared to other players due to its customer profile. Around 33% of the total third party order book comes from institutional clients like hospitals and educational institutions, and airports where the impact of the downturn is minimal. VEL's diversified client base offers it better business stability as compared to its other EPC contractor peers.

➤ **Pune real estate market witnessing prolonged downturn**

The company's real estate development business is primarily concentrated in Maharashtra, especially in-and-around Pune, exposing it to a high level of geographic and price risk. Residential capital values in Pune have risen significantly from 2005 to 2009. The economic slowdown and stock market crash in the second half of 2008 have weakened consumer sentiment and constrained liquidity. The execution risk for ongoing and planned projects has increased significantly as demand has fallen sharply and funding has become expensive. The demand for commercial office space from the IT/ITeS sectors is expected to be low as none of the IT majors are going ahead with their expansion plans.

➤ **Growing area under development**

In its real estate development business, VEL develops a diverse range of projects such as residential and office complexes, shopping malls, multiplexes, hospitality properties, IT parks, community centres and other buildings. As of August 31, 2009, the company has completed an aggregate of 41 real estate development projects aggregating 4.58 mn. sq. ft. of saleable area. The ongoing and forthcoming projects developed by the company include 52 projects with an aggregate saleable area of 44.85 mn. sq. ft.

➤ **Sound EPC project execution skills**

VEL has significant experience in providing EPC services, and has established a strong track record of designing and constructing a diverse range of projects. With 23 years of experience in the EPC services business, the company has constructed factories, hospitals, hospitality properties, office and residential complexes, shopping malls, multiplexes, IT parks and other buildings. The company's EPC clients include well-known Indian and multinational companies such as Cipla Ltd, Emcure Pharmaceuticals Ltd, Zensar Technologies Ltd, Kirloskar Brothers Ltd, Symbiosis, and Okasa Pharma Pvt Ltd.

➤ **High concentration of operations in Maharashtra**

The company's real estate development business is primarily concentrated in Maharashtra, especially in-and-around Pune, exposing it to a high level of geographic and price risk. Also, in terms of demand for residential and commercial space, Pune city is to a large extent dependent on the fortunes of the IT/ITeS industry. Therefore, any pruning of expansion plans by IT/ITeS companies will have a negative fallout on VEL's business and financial prospects.

Financial Profile

- The company's revenues grew at a 3-year CAGR of 54 per cent to Rs 5.1 Bn at 2008-09. Of the total revenues EPC business contributed ~93 per cent of revenues whereas the real estate development business contributed to ~6 per cent of the total revenues.
- VEL's net income has registered a decline from Rs 572 Mn in 2007-08 to Rs 250 Mn in 2008-09. The net margins have dipped from 9.2 per cent in 2007-08 to 4.9 per cent in 2008-09.
- VEL reported an operating margin of 14.3 per cent in 2008-09 as compared to 20.4 per cent in 2007-08, the margins declined due to downturn in the real estate sector.
- VEL's debt-equity stood at 0.6x at the end of 2008-09 as compared to 1.09x as at the end of 2007-08.
- VEL has reported an EPS (earning per share) of Rs 3.3 in 2008-09 as compared to Rs 7.5 in 2007-08.
- The company's ROE (Return on equity) stood at 6.9 per cent in 2008-09 as compared to an ROE of 20.7 per cent in 2007-08.
- As of August 2009, VEL had a land bank of 44.85 mn. sq.ft

Financial performance snapshot

		FY05	FY06	FY07	FY08	FY09
		Actual	Actual	Actual	Actual	Actual
Operating Income	Rs. Mn.	1,319	1,388	3,955	6,203	5,093
Operating Margins	Percent	11.7	19.5	18.4	20.4	14.3
Net Profits	Rs. Mn.	79.2	126.6	466.9	572.3	249.7
Net Margins	Percent	6.0	9.1	11.8	9.2	4.9
ROCE	Percent	22.9	23.4	26.9	23.7	12.1
RONW	Percent	31.4	31.8	30.9	20.7	6.9
Basic EPS	Rs	82.5	4.2	13.2	8.8	3.3
Diluted EPS	Rs	82.5	4.2	13.2	7.9	3.3
No. of equity shares	Mn.	1.0	30.2	35.5	72.6	75.9
Net worth	Rs. Mn.	286.0	509.9	2,516.9	3,022.2	4,190.9
Book Value(FVRs10)	Rs	298.0	16.9	70.9	41.6	55.2
Source: DRHP						

*Note: Numbers have been reclassified as per CRISIL standards

Business Profile

VEL is a Pune-based player, engaged in real estate construction and development. The company was incorporated in January 1986, and commenced operations with the construction of Cipla's Patalganga factory in November 1986. Up to 1998, the company was a real estate contractor - executing contracts for third parties. VEL's real estate business comprises construction of residential and office complexes along with IT parks, industrial units, shopping malls, multiplexes, educational institutions and hotels. As of August 2009, the company completed construction contracts worth Rs 8.8 Bn, out of which Rs 6.4 Bn was for third parties. In terms of saleable area, VEL has constructed over 4.58 mn. sq. ft. during the last 7 years. In 2008-09, the construction business contributed around 93 per cent to the company's total revenues.

In 1998, the company ventured into real estate development. As a developer, VEL follows a joint development strategy wherein the land owner brings in the land while VEL provides the construction expertise. As of August 2009, VEL completed 41 development projects with an aggregate saleable area of 4.58 mn. sq. ft. In 2008-09, the development business contributed nearly 6 per cent to the total revenues of the company.

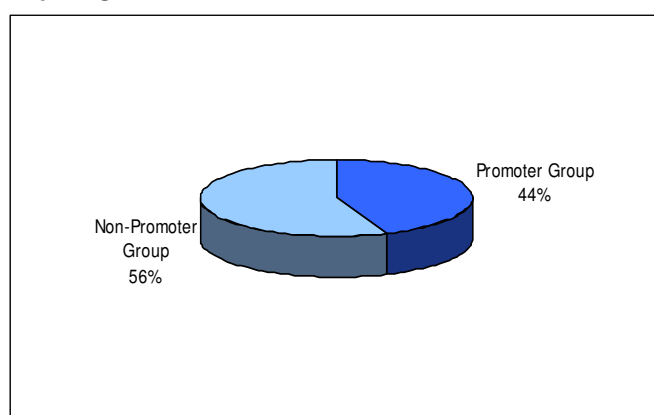
In addition to real estate construction and development, VEL has two wholly owned budget hotels in Goa (with 110 rooms) and a three-star service apartment in Pune (with 71 rooms). While the two budget hotels

were operationalised in January 1999 and January 2005, the three-star service apartment commenced operations in June 2007. This segment contributed 1 per cent to the company's overall revenues.

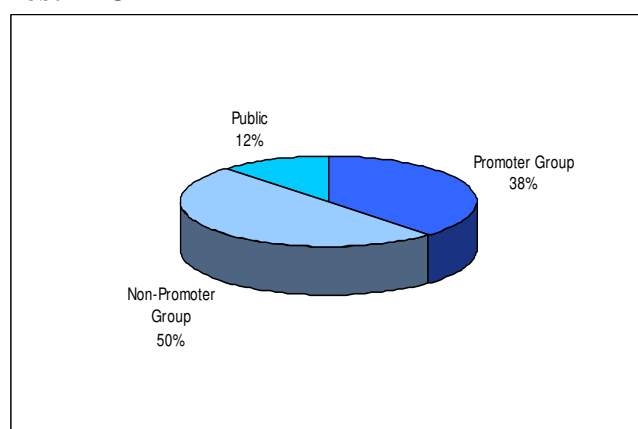
As of August 2009, VEL had an order backlog of Rs 7.2 Bn for third parties in its construction business. As a developer, VEL has ongoing and planned projects aggregating to over 44.85 mn. sq. ft. of saleable area, of which, 48 per cent is residential and the rest is commercial. A majority of VEL's ongoing and planned projects are joint developments in which it has an average 60 per cent share.

VEL: Shareholding Pattern

Pre-IPO



Post-IPO



Source: DRHP

Profile of Management and Board

The company's operations are headed by Mr R Vasudevan (managing director), who holds a first-class bachelor's degree in civil engineering from the Pune University. He started his career with Maharashtra Industrial Development Corporation as a junior engineer and has worked in various organisations from 1981 to 1985. He has been VEL's director since January 1, 1986.

He is responsible for the overall management of the company. He has over 32 years of experience in the construction industry including Hindustan Construction Company Ltd, Atul Constructions Company Ltd, Beck Engineer Company Pvt Ltd and Cipla Ltd. He was employed in Cipla as an executive (engineering).

Mr Vasudevan has put in place a professional team of second line managers who have been employed with VEL for over a decade. The presence of second line managers, who have worked with the company for a relatively long period, has ensured continuity with respect to technical execution and adopting appropriate systems and processes for the smooth functioning of operations.

Annexure: Profile of the Directors

Name	Designation	Age	Qualification	Other Directorship held
Mr R Vasudevan	Managing director	55	Bachelor's degree in civil engineering - Pune University.	Ascent Hotels Private Ltd, Novacare Drug Specialties Private Ltd

Mr KG Krishnamurthy	Non-executive director	51	Bachelor's degree - Indian Institute of Technology, Kharagpur. Degree in business administration from Jamnalal Bajaj Institute of Management, Mumbai.	Managing director and CEO - HDFC Property Ventures Ltd. HDFC Venture Capital Ltd, Gruh Finance, Tata Housing Development Co Ltd, L&T Urban Infrastructure Ltd, New Consolidated Construction Company Ltd, Ascent Construction Pvt Ltd, Matoshri Sahil Infrastructure Pvt Ltd
Mr V Mohan	Independent director	59	Bachelor's degree in commerce - Madras University. Fellow member of Institute of Chartered Accountants of India.	Partner in Shankar Aiyer & Company, Chartered Accountants, Lloyd Insulations (India) Ltd, Isolloyd Engineering Technologies Ltd, Champion Industries Ltd, QH Talbros Ltd, Talbros Automotive Components Ltd, Lakhanpal Pvt Ltd, Aaren Initiative Outdoor Advertising Pvt Ltd, Bid Industrial Investment Pvt Ltd, Cornelia Investments Pvt Ltd, Asal Investments Pvt Ltd, Gauder Investments Pvt Ltd, Muller Investments Pvt Ltd, Cosmo Capital and Investments Pvt Ltd
Mr Ameet Hariani	Independent director	47	Masters in law - Mumbai University. Member of Bombay Incorporated Law Society, Law Society - U K and Singapore Law Society.	Partner in Hariani & Co, Advocates & Solicitors, Batliboi Ltd, Ras Resorts & Apart Hotels Ltd, Hariani Advisory Services Pvt Ltd, Radicle Infomatics Pvt Ltd, Envision Computers Consultancy Pvt Ltd, Capricon Realty Ltd
Mr R Kannan	Independent director	48	Bachelor's degree in commerce - Bombay University.	Novacare Drug Specialties Pvt Ltd, Novamark Specialties Pvt Ltd, Medword Pharmaceuticals Pvt Ltd

Source: DRHP

Disclaimer

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