



VASWANI INDUSTRIES LIMITED

Issue Details

Vaswani Industries Limited is proposing to come out with an Initial Public Offer (IPO) for a fresh issue of 1,00,00,000 equity shares of face value of Rs. 10/- each. The Issue is being made through the 100% book building method where in up to 50% of the issue to public would be available for allotment on a proportionate basis to qualified institutional buyers (of which 5% would be allocated to mutual funds). Further, not less than 15% of the issue to public would be available for allotment on a proportionate basis to non-institutional bidders and not less than 35% of the issue to public would be available for allotment on a proportionate basis to retail individual bidders, subject to valid bids being received at or above the issue price. Post IPO, the shares will be listed on the National Stock Exchange and Bombay Stock Exchange.

Proposed Use of IPO Proceeds

- Prepayment of term loans
- Meeting long term working capital requirements
- Meeting general corporate purposes
- Meeting issues expenses

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IPO Grading

ICRA has assigned an IPO Grade 2, indicating below average fundamentals to the proposed initial public offering of Vaswani Industries Limited ("VIL"/ "The company"). ICRA assigns IPO grading on a scale of IPO Grade 5 through IPO Grade 1, with Grade 5 indicating strong fundamentals and Grade 1 indicating poor fundamentals.

An ICRA IPO Grade is a symbolic representation of ICRA's current assessment of the fundamentals of the issuer concerned. The fundamental factors assessed include, inter alia, business and competitive position, financial position and prospects, management quality, corporate governance and history of compliance and litigation.

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Strengths

- Experience of promoters in the steel business
- Favorable long term demand outlook for VIL's produce (sponge iron, steel and power), supported by the growth in the construction and infrastructure sectors, and the power deficit situation in the country
- Availability of waste heat recovery based captive power plant strengthens operating profile and also supports profitability and diversifies cash flows to an extent
- Commissioning of the additional sponge iron and power production capacities is likely to augment VIL's turnover and profits in the near to medium term

Concerns

- Moderate scale of operations, despite the commissioning of the expanded capacities recently
- Highly fragmented nature of the sponge iron and steel billet segments with low entry barriers, leading to competitive pressures
- Cyclicity inherent in the commodity steel business, which is likely to make profitability and cash flows volatile
- Moderate capacity utilization of the sponge iron unit and largely idle billet capacity depress the overall business returns of the company, given the lack of backward integration
- Highly raw material intensive nature of operations, making VIL susceptible to unfavorable raw material price movements relatively to finished goods prices
- High working capital intensity, which adversely impacts VIL's liquidity position, leading to occasional delays in debt servicing in the past

Grading Rationale

The assigned grading factors in the experience of the promoters in the steel business, favourable long term demand outlook for VIL's end products (sponge iron, steel and power), cost efficiency derived from the captive power generating units; and the ability to diversify its cash flow from sale of power when steel prices exhibit unfavourable movements. ICRA takes note of the recent additions in the sponge iron and waste heat recovery based power capacities, which would lead to growth in the turnover and profits in the near to medium term. Nevertheless, the scale of VIL's operations continues to be at moderate levels. Further, moderate capacity utilisation of the sponge iron unit and a largely idle billet capacity, coupled with the moderate profitability of business because of a lack of captive raw material sources depress the overall business returns of VIL. The secondary steel industry in which the company operates is highly fragmented and has low entry barriers, which also exert competitive pressures. Going forward, VIL is likely to enjoy stable profitability from the sale of power. Nevertheless, an unfavourable movement in the prices of its iron and steel products, which are highly commoditised in nature, could have an adverse impact on the overall profitability of the company. Also, the iron and steel production process is highly raw material intensive in nature, which exposes the company to the risks of unfavourable raw material price movements relative to its end product realisations. VIL's business has a high working capital intensity, which exert pressure on its overall liquidity position, leading to occasional delays in debt servicing in the past.

Company Profile

Incorporated in the year 2003, VIL is promoted by Mr. Ravi Vaswani, Mr. Pramod Vawani and Mr. Yashwant Vaswani. The Company commenced operations in the year 2004-05 with a 30,000 tonnes per annum (TPA) coal based sponge iron production unit at Raipur, Chhattisgarh. VIL currently has installed capacities of 90,000 TPA, 36,000 TPA and 11.5 Mega Watt (MW) to produce coal based sponge iron, billet and power respectively.

Promoters and Management

Table No: 1 Share holding pattern

Particulars	Pre-IPO shareholding	Post-IPO shareholding
Promoters and Promoter Group (A)		
Mr. Ravi Vaswani	25.22%	14.49%
Mr. Pramod Vaswani	25.72%	14.77%
Mr. Yashwant Vaswani	15.94%	9.16%
Mrs Manisha Vaswani	11.66%	6.69%
Mrs. Juhi Vaswani	11.58%	6.65%
Mrs. Sudha Vaswani	9.05%	5.20%
Ravi Vaswani HUF	0.44%	0.26%
Mrs Kritika Vaswani	0.37%	0.21%
Mr Satish Vaswani	0.01%	0.00%
Subtotal (A)	100.00%	57.43%
Public (B)		42.57%
Total (A)+(B)	100.00%	100.00%

The promoters Mr. Ravi Vaswani and Mr. Pramod Vaswani have about two decades of experience in the steel business. They are also the founding members of the Vaswani Group, which is involved in steel manufacturing and castings business through three group entities apart from VIL viz. C.G Ispat Private Limited, Cosmos Castings (India) Limited and Kwaliti Foundry Industries.

Corporate Governance

VIL's Board has six Directors, of which the Chairman of the Board is an Executive Director. In compliance with the requirements of clause 49 of the listing agreement, the company has three Executive Directors and three Independent Directors. The company has also constituted the following committees: Audit Committee, Shareholders/Investors Grievance Committee and Remuneration/Compensation Committee.

Business and Competitive Position

Moderate scale of operations in VIL's iron and steel units

VIL commenced its operations in the year 2004-05 with a 30,000 tonnes per annum (TPA) sponge iron production unit. The sponge iron capacity was increased over the years to the current levels of 90,000 TPA. During 2007-08, VIL also installed induction furnaces with a capacity of 36,000 TPA, for manufacturing of steel ingots and billets by utilising the in-house sponge iron produce. The company also has a power generation capacity of about 11.5 MW (9.0 MW from waste heat recovery boilers (WHRB) and 2.5 MW from a coal based fluidised bed combustion (FBC) boiler). The power plant capacity was enhanced to the current levels from the erstwhile capacity of 7.5 MW, during 2010-11.

Table No: 2 Capacity and capacity utilisation

Capacity	Unit	2006-07	2007-08	2008-09	2009-10
Sponge Iron	MT	60000	60000	60000	90000
Steel billet/ingots	MT	NA	36000	36000	36000
Power	MW	NA	7.5	7.5	7.5
Power ¹	million units	NA	63	63	63
Production					
Sponge Iron	MT	36231	42422	37810	47378
Ingots	MT	0	4694	0	0
Steel billet	MT	0	9325	36637	4243
Gross power generation	million units	0	0	52.2	60.4
Capacity utilization					
Sponge Iron		60%	71%	63%	53%
Ingots+ billets			39%	102%	12%
Power-PLF				83%	96%

VIL increased its sponge iron production capacity during 2009-10. However, the same was operational only during the last quarter of 2009-10, which led to the decline in the overall capacity utilisation levels in 2009-10, although the production volumes witnessed a year-on-year (Y-o-Y) increase of 25%. During the 9 months of 2010-11, the company produced only 41,848 tonnes of sponge iron, reflecting a capacity utilization of only 62%. The company augmented its power production capacity by 4 MW during 2010-11, through the waste heat recovery mode which, coupled with the increase in the sponge iron capacity is expected to drive its business growth in the near to medium term. Notwithstanding the growth, VIL's scale of operations would continue to be at moderate levels going forward.

VIL's capacity utilization levels in the steel making facility (ingot & billets) have recorded a sharp decline in 2009-10 and during the 9 months of 2010-11. Steel making through the induction furnace (IF) route being a power intensive operation, production of billet/ingot consumes substantial part of VIL's power generation at the captive power plant. Since the cost of power generated is low (a part being generated from waste heat) sale of power is more profitable for the company than sale of billet/ingot, whose prices also witness a high degree of volatility. Going forward, ICRA believes that VIL would use its IF operations depending upon the profitability from the sale of steel vis-a-vis sale of power.

Favourable demand outlook for VIL's end products, however the market is highly fragmented, leading to competitive pressures

India is the largest producer of sponge iron in the world, accounting for over one-third of the total global production. India's production grew from about 5.5 million tonnes in the year 2000 to over 20 million tonnes in 2010, exhibiting a CAGR growth of about 14%. The country's sponge iron making capacity has also increased over the years and currently stands at about 32 million tonnes per annum, 75 % of which is coal-based and the remaining 25 % is gas-based. The domestic sponge iron industry is highly fragmented, with

¹ Capacity calculated based on 330 working days

over 700 coal based plants catering largely to the secondary steel industry, which is largely into production of long products. Besides sponge iron, the secondary steel industry too is highly fragmented with low entry barriers due to low capital investment requirements, leading to pricing pressures and moderate profitability of the players. Also, cyclical nature inherent with the business makes profits variable. However, outlook on the steel industry over the medium to long term is favourable, driven by the expected demand from construction/infrastructure sectors.

The deficit situation in power availability and favourable Government policies including open access in the state of Chattisgarh reduces off-take risks for power producers in the state. Sale of power is more profitable than the steel related business for VIL. Additionally, this provides some diversification to VIL's revenues and reduces the impact of cyclical nature on the company's cash flows. ICRA believes that the sustainability of merchant tariffs and hence VIL's profits from power sale in the long term would depend upon the extent of power deficit levels, the ability and willingness of state utilities to off-take the higher cost power at times of peak deficit and the level of regulatory intervention in the future.

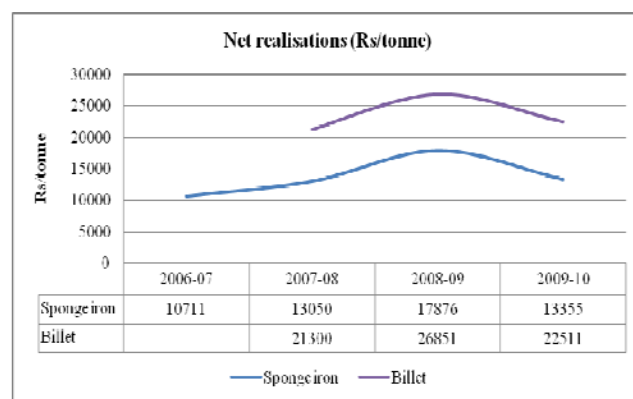
Highly raw material intensive nature of the iron and steel production process

Raw materials and consumables in 2009-10 accounted for about 75% of the turnover of VIL, making the production process highly raw material intensive, and thus making profitability vulnerable to adverse movements in their prices relative to the product realizations. Iron ore and coal are the key raw materials for the production of sponge iron. VIL procures iron ore from NMDC Limited and other private players largely at spot prices. The Company procures coal from South Eastern Coalfields Ltd for a small portion of its requirement for the sponge iron and power production, it is dependent on other sources for a large portion of its requirements

The key raw materials for the production of billets are sponge iron, scarp, pig iron and ferro alloys. VIL largely uses its own produce of sponge iron and power for the production of billets.

Commoditised nature of the key end products makes sales and profits variable; healthy profitability from sale of power however is expected to lend some stability going forward

Sponge iron and billet prices depend on the overall health of the steel industry and specifically long product prices. However the cyclical nature inherent in the steel industry, along with the commoditised nature of these



products makes their realisations highly volatile. VIL's flexibility to sell surplus power provides some support to the overall profitability of the company. The company sells surplus power to private players like Lanco Electric Utility Limited or to the Chattisgarh State Trading Company Limited (CSTCL). VIL generally enters into short term power supply arrangements with the private players and CSTCL, depending on the market rates. Since the cost of power generated is low (a part being generated from waste heat) sale of power is more profitable for the company than sale of

billet/ingot, whose prices also witness a high degree of volatility. Billet/ingot production and sales, going forward, would depend on profitability from sale of steel vis a vis from the sale of power.

Financial position

While analysing VIL's financial position, ICRA has made the following adjustments. There is no impact on VIL's profits for these adjustments.

1. VIL includes interdivisional sale of captive power in its total sales. ICRA has adjusted the company's sales and power cost to the extent of these interdivisional transactions.
2. Sale of scrap, pig iron and ferro alloys, which are adjusted against raw material costs in VIL's annual reports, have been included in the operating income in ICRA's analysis. Consequently, the raw material costs are also higher in ICRA's analysis to the same extent.

Profitability & Earnings:

Table 3: Key profitability indicators

In Rs. crore	FY2007	FY2008	FY2009	FY2010
Operating Income	38.57	71.41	131.34	95.95
OPBDITA	3.26	11.86	14.92	14.47
OPBDITA / OI (%)	8.46%	16.61%	11.36%	15.08%
PAT	0.45	3.43	4.09	3.68
PAT / OI (%)	1.17%	4.81%	3.11%	3.84%
ROCE (%)	8.98%	16.81%	15.37%	13.74%
RONW (%)	3.11%	15.81%	16.43%	11.18%
EPS (Rs/ share)	0.48	3.06	3.63	2.73
DPS (Rs/share)	0.00	0.00	0.50	0.25
Book value per share (Rs/share)	21.13	20.97	23.31	29.38

Source: Annual report

Y-o-Y: Year-on-Year, OI: Operating Income; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortization; PAT: Profit after Tax; RONW: Return on Net Worth; ROCE: Return on Capital Employed; EPS: Earnings per share; DPS: Dividend per share

The operating income has witnessed healthy growth over the period 2006-07 to 2008-09 on the back of the increase in sponge iron capacity over the period, and the commencement of the billet making operations since 2007-08. The annual average realisations from the sale of iron and steel products also witnessed an upward trend during the period. However, the unfavourable steel market conditions since the second half of 2008-09 that continued in 2009-10, coupled with lower billet sales adversely impacted the operating income during 2009-10, which declined by 27% on a Y-o-Y basis. However, the same was supported to an extent by the sale of power during the period. Going forward, the growth in operating income would be largely driven by the increase in sponge iron and power capacities in the short to medium term.

The operating profitability has exhibited considerable variability in the last four years. After the increase in the operating profitability during 2007-08 following the commencement of the billet making facility and the power plant during the year, the same declined in 2008-09 on the back of weak price conditions in the second half of 2008-09. The improvement in 2009-10 to 15.08% from 11.36% in 2008-09 was driven by the higher proportion of external power sales, although sponge iron prices remained at subdued levels for a large part of the year. The net profitability has been impacted due to the high interest costs following the partly debt funded expansion plans undertaken by the company in the past, and high working capital intensity in its operations. The same has moved largely in line with the operating profitability. It is to be noted that despite an improvement in the net profit margins, VIL's profits in absolute terms declined in 2009-10 due to the decline in operating income.

The company's ROCE stood at a subdued level of 13.74% in 2009-10, due to the capital expenditure incurred in the past and during the year, and limited utilization of the same. RONW too suffered and stood at 11.18% in 2009-10 as against 16.43% in the previous year because of the lower profits reported in 2009-10.

Financial leverage:

Table 4: Capital structure

In Rs. crore	FY2007	FY2008	FY2009	FY2010
Total Debt	43.32	59.41	50.53	56.77
Net Worth	19.97	23.54	27.07	40.37
Total Debt / Net Worth	2.17	2.53	1.92	1.43

Source: Annual report

The partly debt funded capital expenditure in the past has resulted in the high debt levels for the company although the capital structure has improved because of profits earned and equity infusion made by the promoter. VIL contracted a total debt to the extent of about Rs 36.50 crore during 2006-07 and 2007-08 for setting up of the 7.5 MW power plant, 36,000 TPA billet making facility and a rolling mill. However, following the management's decision not to go ahead with the rolling mill, the company repaid about Rs 5.00 crore pertaining to the rolling mill project in 2008-09. The company further contracted loans to the extent of Rs 20 crore for the 30,000 tonnes per annum sponge iron unit and 4 MW power plant during 2009-10 and 2010-11. The promoters have also infused equity during the period 2006-07 to 2009-10 to the tune of about Rs 20 crore.

Going forward, the company's working capital requirement is expected to increase due to the capacity additions. VIL, through the proposed IPO proceeds, plans to retire some of its long term debt and meet its long term working capital requirements.

Working capital intensity:

Table 5: Working capital indicators

	FY 2007	FY 2008	FY 2009	FY2010
Debtor days	43	16	10	21
Inventory days	6	27	16	35
Creditor days	36	62	58	29
NWC/OI	36.84%	35.79%	20.01%	25.13%

Source: Annual report

The working capital intensity is high in VIL's business. The company generally maintains raw material inventory of about a month. Given the high bargaining power of iron ore and coal suppliers, VIL has to make advance/spot payments to raw material suppliers. On the other hand, VIL has to extend credit to its customers which increase its working capital requirement. Although the working capital intensity as measured by the net working capital as a percentage of operating income largely indicated a declining trend over the period 2006-07 to 2009-10 following the streamlining of the newly commenced facilities, the same continues to remain high at about 25.13% as on March 31, 2010. This exerts pressure on VIL's overall liquidity position, leading to occasional delays in debt service by the company in the past.

Cash flows:

Table 6: Cash flow indicators

In Rs. crore	FY2007	FY2008	FY2009	FY2010
Fund Flow from Operations (FFO)	-1.88	0.45	13.77	16.31
Gross Cash Flows	-3.04	-3.77	8.32	11.11
Retained Cash Flows	-3.04	-3.77	7.66	10.71
Free Cash Flows	-28.76	-20.33	9.28	-15.38

Source: Annual report

The cash flow from operations improved in the last two years on the back of a fall in the working capital intensity. However, high interest obligations and the capital expenditure incurred impacted the free cash flows during the year 2009-10. The cash flows are expected to be under pressure in the near term due to the increase in the scale of operations, which could impact the overall liquidity position of the company. Going

forward, the company plans to use the proceeds of the IPO to repay a part of the long term debt, and for meeting its long term working capital requirements.

Contingent liabilities

Table 7: Contingent liabilities

Particulars (Amount in Rs. crore)	As on March 31, 2009	As on March 31, 2010
Sales tax related cases	0.04	0.04
Excise duty related cases	1.40	1.93

Source: Annual report

The total contingent liability of VIL stood at Rs 1.97 crore as on March 31, 2010. However, in one excise duty related matter, The Commissioner, Central & Central Excise, Raipur has passed an order dated April 21, 2010, demanding Rs 1.40 crore towards excise duty and also imposed a penalty of an equivalent amount on the company as well as its directors/officials. VIL's total contingent liability therefore increased to Rs 4.04 crore during the current year.

Litigation history

The outstanding litigations involving the company are largely related to exercise duty/sales tax matters. A large part of the same is towards the excise duty claim of about Rs 4.00 crore as detailed above. Outstanding litigations against the promoters/Directors are largely related to excise duty and CENVAT claims against VIL and other group entities.

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