# Company Analysis and Financial Due Diligence

October 2012

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To,
Mr Hari K
National Stock Exchange of India Limited
Exchange Plaza
Plot No. C/1, G Block
Bandra - Kurla Complex
Bandra (E)
Mumbai - 400051

Date: October 29, 2012

Dear Sir,

This is with reference to your request to provide a Company Analysis and Financial Due Diligence report ("FDD Report") covering the limited scope and for the purpose of potential listing of Veto Switchgears and Cables Pvt Ltd ("the Company") on the EMERGE Platform of the National Stock Exchange (NSE).

We enclose our Company Analysis and FDD Report dated October 22, 2012. This Company Analysis and FDD Report is based on the information provided by the Company to us and also on the meetings with the Management of the Company.

For the purpose of preparing the Company Analysis and FDD Report, we have not independently verified the information provided by the Company or collected by us from other sources. CRISIL does not guarantee the accuracy, adequacy or completeness of any information contained in such Reports. CRISIL especially states that it has no financial liability whatsoever to you / Company / users of the Reports. CRISIL's Reports submitted to NSE do not constitute recommendations to list or not to list the Company on the SME Exchange.

All the Company Analysis and FDD Reports submitted by CRISIL are confidential and are meant for the internal use only of NSE and should not be used for purpose other than the potential listing of the Company on SME Exchange.

This Letter shall form an integral part of the Company Analysis and FDD Reports.

We appreciate the opportunity given to us to conduct financial due diligence on Veto Switchgears and Cables Pvt Ltd.

Yours faithfully,

For CRISIL Limited

Mohit Modi
Director – CRISIL Research

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## Glossary of terms

| | |
|---|---|
| AS - Accounting Standards | MAT - Minimum Alternative Tax |
| bps - Basis points | MIS - Management Information System |
| Capex - Capital expenditure | Mn - million |
| CAGR - Cumulative average growth rate | NDA - Non disclosure agreement |
| CC - Cash Credit | PAT - Profit after tax |
| CFO - Chief Financial Officer | PBT - Profit before tax |
| COGS - Cost of goods sold | RM - Raw materials |
| CWIP - Capital work in progress | SG&A - Selling, general and administrative |
| DRHP - Draft Red Herring Prospectus | sq. ft. - Square feet |
| EBITDA - Earnings Before Interest Tax Depreciation and Amortisation | SEZ - Special Economic Zone |
| EPS - Earnings per share | w.e.f - With effect from |
| FG - Finished goods | y-o-y - year-on-year |
| FIFO - First in first out | |
| FS - Financial statements | |
| FYXX - Financial year ended March 31, 20XX | |
| GFA - Gross fixed assets | |
| KG - Kilogram | |

# Company Analysis

## Company background

Incorporated in 2003 as a partnership firm called Veto Industries, the company's name was changed to 'Veto Switchgears and Cables' in April 2007. Subsequently in June 2007, the partnership firm was converted into a private limited entity and was re-named 'Veto Switchgears and Cables Private Ltd'. The company was rechristened as 'Veto Switchgears and Cables Ltd' (VSCL) in 2012. It manufactures and sells wires and cables and electrical accessories in India. The product portfolio encompasses industrial, stand, telephone cables and co-axial wires, general and modular switches, ceiling and rechargeable fans, compact fluorescent lamps (CFLs) and other electrical accessories. Except for CFLs and fans (the production of which are outsourced), all products are manufactured in Hardwar, Uttarakhand. Electrical accessories are sold under the 'Veto' brand while wires and cables are sold under the 'Vimal Power' brand. The company is promoted by Veto Electropowers (India) Pvt. Ltd (VEIPL), which is a subsidiary of Gurnani Holding Pvt. Ltd, which in turn is owned by the Gurnani family. VEIPL manufactures and exports wires and PVC cables to the Gulf countries.

## Key positives

- VSCL manufactures and sells wires, cables and electrical accessories. The company has a diversified product basket, which includes around 20 product categories. It sells electrical accessories under the 'Veto' brand, and wires and cables under the 'Vimal Power' brand. In FY12, wires and cables contributed 54% to Veto's revenues and the rest was contributed by electrical accessories.
- VSCL has an extensive presence in Rajasthan and derives 70% of its revenues from the state. The company is also present in Delhi, Gujarat, Madhya Pradesh, West Bengal and Assam and has nearly 2,400 dealers overall. 'Veto' and 'Vimal Power' are well known brands in the north-western region of India. The company leverages its dealer network by introducing new products or variants of existing products.
- The company's promoters have a long standing presence in PVC (polyvinyl chloride) wires and cables business, which has enabled the company to expand the electrical accessories business and increase its dealer network in the domestic market.
- VSCL stands to benefit from the healthy growth expected in the various segments - (a) Switchgears: Domestic switchgear market is expected to grow at 12-15% with modular switches market posting the fastest growth, (b) Wires and Cables: Domestic wires and cables segment has grown at 25% CAGR over FY08-12 and is expected to register steady growth in the future (c) Compact fluorescent lamps (CFLs): Volumes are expected to grow at 10% annually over the next few years, and (d) Consumer appliances: Veto is present only in the fans business; the fan segment is expected to register healthy growth led by low penetration levels especially in rural areas.

## Key negatives

- VSCL's scale of operations is small and its product offerings are limited compared to the bigger players in the industry viz., Havells, KEI Industries, Anchor, and others, which limit its bargaining power with dealers/distributors. We believe the company's plan to establish itself in other geographies is likely to take some time because it will have to invest in advertising and brand building.
- VSCL's operations are working capital intensive as reflected in its working capital cycle of 200 days. It has to maintain an inventory of two to three months in anticipation of orders. It also gives credit of around 100 days to its dealers to counter intense domestic competition. However, it gets minimal credit from its suppliers which include suppliers of copper and PVC/PVC compounds.
- VSCL has strong inter-linkages with its group entities and in the past has extended and received interest free loans from promoters and other group companies. However, VSCL's reliance on related parties for debt funds has reduced over a period of time, as the company has substituted these loans with bank loans.
- Copper accounts for nearly 45% of Veto's total raw material costs. The company is entirely dependent on a single supplier for sourcing of copper. The company's margins may be adversely affected in case it is unable to pass on the increases in copper prices to end consumers.

## Management and corporate governance

- The promoters have nearly three decades of experience in the industry. Most of the senior management and some middle management positions are occupied by the promoters. Senior management personnel including the managing director, whole-time director and the CFO are involved in operations of other group companies also. However, there is no policy with regards to allocation of costs of shared resources between the group companies.
- The board consists of six directors, of whom three are independent. We believe the size of the board is appropriate for the current size of the company and its planned progress. The board has diverse expertise in areas of government administration, textiles, finance and marketing. While the independent directors are known to the promoters, they have been associated with Veto only since August 2012. (see director's profile in annexure)
- Veto Electropowers (India) Private Ltd (VEIPL), the holding company of Veto, is in the same line of business and manufactures and exports wires and cables to Gulf countries. VEIPL is an export oriented unit (EOU). Veto will have to compete with VEIPL if the latter enters the Indian market; this may impact Veto's operations.

## Key financials

- VSCL's operating income has grown at 20.8% CAGR over FY09-12 to Rs 686 mn led by management's focus on augmenting distribution network, new product launches and branding.
- The company's EBITDA margin has expanded to 16.2% in FY12 from 10.9% in FY11. We expect moderation in EBITDA margin going forward due to increase in employee costs and marketing and advertising expenses.
- Average PAT margin over FY10-12 was 9.6%. The company's Hardwar plant received 100% income tax holiday over FY08-12. While Veto is liable to pay minimum alternate tax (MAT), it set off its income tax with the MAT credit. Therefore, its effective tax rate was negligible during this period. Starting FY13, the Hardwar plant is entitled to 30% income tax holiday for a period of five years.

# Financial Due Diligence

## Company Overview

### Background and Key Milestones

- Jaipur-based VSCL manufactures and sells wires, cables and electrical accessories in India.
- Veto Industries, incorporated in 2003 as a partnership firm, changed its name to Veto Switchgears and Cables in April 2007.
- In May 2007, the company's Hardwar facility commenced operations.
- In June 2007, the partnership firm Veto Switchgears and Cables was converted into a private limited entity and renamed as Veto Switchgears and Cables Pvt. Ltd. In 2012, the company was renamed as Veto Switchgears and Cables Ltd (VSCL).
- The product portfolio encompasses industrial, stand, telephone cables and co-axial wires, general and modular switches, ceiling and rechargeable fans, CFLs, and other electrical accessories.

**Product and Brand Profile**

- VSCL's products are sold primarily under the 'Veto' and 'Vimal Power' brands in north-west India, through a network of nearly 2,400 dealers.
- Brand 'Veto' is owned by Veto Switchgears and Cables Ltd (VSCL). It was acquired by the company in 2006. All the electrical accessories (switches, fans, CFL and others) are sold under the 'Veto' brand.
- Brand 'Vimal Power' is owned by Veto Electropowers (India) Private Ltd (VEIPL), which is the majority shareholder in VSCL. The wires and cables are sold under the 'Vimal Power' brand.

### Shareholding structure of VSCL

| Name | As on September 10, 2012 | |
|---|---|---|
| | No. of shares | Percentage holding |
| Veto Electropowers (India) Pvt. Ltd (VEIPL) | 9,378,118 | 80.43 |
| Akshay Gurnani | 995,334 | 8.54 |
| Harish Kumar Gurnani | 666,666 | 5.72 |
| Kishore Kumar Gurnani | 399,922 | 3.43 |
| Master Rohit Gurnani (under the guardianship of Mr Kishore Kumar Gurnani) | 99,980 | 0.86 |
| Master Kanishka Gurnani (under the guardianship of Mr Kishore Kumar Gurnani) | 99,980 | 0.86 |
| Narain Das Gurnani | 12,000 | 0.10 |
| Mukesh Gurnani | 6,000 | 0.05 |
| Pushpa Devi Gurnani and Akshay Gurnani | 2,000 | 0.02 |
| Total | **11,660,000** | **100.00** |

### Background of VEIPL (holding company) and Gurnani Group

- VEIPL was incorporated as a partnership firm in 2001 under the name M/s Veto Electropowers. The partnership firm was converted to a private limited company on March 20, 2007. (see appendix 3 for VEIPL's summary financials)
- VEIPL manufactures wires and cables through its three state-of-the-art 100% EOU facilities located in Jaipur, Rajasthan. Its products are sold only in international markets.
- VEIPL is a subsidiary of M/s Gurnani Holding Pvt. Ltd, which in turn is owned by Mr. Vishnu Kumar Gurnani, Mr. Mohan Das Gurnani and Mr. Narayan Das Gurnani. (see Appendix 3 for VEIPL's detailed shareholding structure)
- The Gurnani Group, founded in 1968, was originally involved in retailing of electrical products in Jaipur. The group backward integrated into manufacturing of wires and cables in 1975.
- In 2005, the group diversified into construction and development of residential and commercial projects; it has completed more than 500,000 square feet of construction projects both independently and as joint ventures.
- The group recently commissioned a 5-star hotel in Jaipur, named 'Radisson Blu' which is owned by the Gurnani Group and managed by the Carlson Group of Hotels.

### Details of VSCL's subsidiaries

| Group companies | Year of incorporation | VSCL's shareholding* | Description |
|---|---|---|---|
| Veto Electricals Pvt. Ltd | 24/03/2008 | 90.00 | The company currently does not have any operations. During FY10, it acquired 3 acres of land in Mahindra World City SEZ for Rs 17 mn. The management plans to set up an export oriented manufacturing unit for electrical accessories here. This unit is expected to commence operations in two to three years. |
| Veto Lighting Pvt. Ltd | 17/11/2009 | 51.00 | The company currently does not have any operations. The management originally intended to foray into retailing of electrical goods through this entity. However, the company's future plans are uncertain. |
| Vankon Switchgears and Cables Pvt. Ltd | 20/04/2011 | 98.00 | The company currently does not have any operations. The management originally intended to sell products under the 'Vankon' brand which is owned by this company. However, future plans for this entity are uncertain. |

## Manufacturing facility overview

- VSCL's manufacturing facility is located in Hardwar, Uttarakhand on 60,000 square feet of constructed building area. It enjoys tax benefits being offered by the central government under section 80-IC of the Income Tax Act. All of the company's products (except fans and CFL) are being manufactured at this facility.
- Key tax benefits:
  - 100% income tax exemption for first five years starting FY08
  - 30% income tax exemption for five years starting FY13
  - The company is, however, liable to pay MAT

### Installed annual assembly capacity

| Capacity | As of FY12 |
|---|---|
| Wires and cables | 14.08 lakh bundles |
| Electrical accessories | 380 lakh pieces |

## Manufacturing process

### *Electrical Accessories*

Raw material

↓

| Moulding Powder | Brass Parts | Drawing of copper on drawing machine | Packing material |
| --- | --- | --- | --- |

↓

Injecting Moulding/Hand Moulding

↓

Moulding goods to buffing machine for smoothing of edges

↓

Testing/Sorting

↓

Worker table for tightening of brass parts

↓

Testing/Sorting by worker

↓

Testing/Sorting in lab machine

↓

Packing in inner box

↓

Packing in outer box

↓

Packing in cartons

↓

Dispatch

### *Wires and Cables*

Raw material

↓

Drawing of copper on drawing machine

↓

Twisting & rewinding of copper on Twisting & Rewinding Machine

↓

Extruder—PVC lamination of PVC Compound on twisted copper as per required size of wire

↓

Rolling of PVC insulated copper wire/aluminium wire

↓

Cutting Machine - Cutting of wire for coil size

↓

Stitching of bundles

↓

Packing in boxes

↓

Packing in cartons

↓

Dispatch

# Executive Summary

## Key Findings – Employee costs

**Salary paid to key management personnel is on the lower side; Mr Dinesh Gurnani (whole-time director) and Mr P.V. Sharma (Group CFO) have not drawn any salary in the past**

### Background

- Salaries paid to key management personnel are on the lower side compared to their position/experience.
- Mr Vishnu Gurnani (managing director) did not receive any salary during FY08-11, and received only Rs 79,000 as compensation in FY12.
- Mr Dinesh Gurnani (whole-time director) has not received any salary in the past. Group CFO, Mr P.V. Sharma, while involved in the operations of VSCL, does not receive any salary from the company.
- Salaries of other key managerial personnel (other than promoters) are also lower than market standards.
- Mr Vishnu Gurnani, Mr Dinesh Gurnani and Mr P.V. Sharma hold key managerial positions in other group companies also. However, there is no group-wide policy for allocation of cost between group entities, for shared resources.
- The company does not have a policy of paying sitting fees to its board of directors. Independent directors have been appointed on the board of directors in August 2012.

### Comments / implications

- The current salary cost may not be representative of future costs. Salary costs could increase post fund raising, as the company attains higher scale of operations. VSCL plans to add 100 employees post IPO.
- Given the size of the operations, the quantum of salary increase may have an adverse impact on profitability. Employee cost as a percentage of sales has decreased from 7.5% in FY11 to 6.2% in FY12.
- As there is no group-wide policy on payment of salaries to shared management personnel, VSCL's current employee costs may not be appropriate in relation to the scale of its operations.

### Management Comments

- Compensation to Mr Vishnu Gurnani has been fixed at Rs 1.44 mn per annum and will be paid from FY13 onwards. Similarly, Mr Dinesh Gurnani's salary has been fixed at Rs 0.6 mn per annum and will be paid from FY13 onwards.
- Mr P.V. Sharma will continue to receive his salary from VEIPL, even though he will be involved in VSCL's operations.
- The company gives around 10% salary hikes to its employees each year and is likely to continue with this policy. Employee costs increased at a slower rate in FY12 as some high salaried employees left the company and were not replaced.
- The company has fixed sitting fees for the directors at Rs 3,000 per board meeting per member. The same will be paid for future board meetings.

## Key Findings - Funding pattern

**VSCL, in the past, has relied on its parent company and promoters for interest free loans for working capital**

### Background

- The company has relied on loans from related parties in the past to meet its working capital requirement. These loans are short term unsecured loans, with VEIPL as the main lender.
- Outstanding loans from related parties have declined substantially over the years. The current outstanding loan amount from related parties is less than Rs 1 mn compared to Rs 162 mn in FY12.
- VSCL has gradually substituted these interest free loans with loans from banks. Further, loans amounting to Rs 47 mn were converted to equity shares.
- VSCL has advanced Rs 18 mn (loans and advances) to related parties as of FY12. Of this, Rs 17 mn was interest free loan to Veto Electricals Pvt. Ltd for purchase of land at Mahindra World City SEZ in Jaipur, Rajasthan. VSCL holds 90% stake in Veto Electricals Pvt. Ltd. VEIPL and Mr Vishnu Gurnani hold the balance 10%.

### Comments / implications

- VSCL's reliance on loans from related parties has declined significantly by FY12. Therefore, the current interest costs are reflective of the cost of funds required for a business of this nature.
- In the future, transfer of funds between related parties is a key monitorable.

### Management Comments

- In future, Veto Electricals Pvt. Ltd and VSCL's other subsidiaries will raise equity capital only through allotment of equity shares to VSCL. Therefore, VSCL's shareholding in the company will increase to more than 90%.

## Key Findings - Lease rent agreements

**Lease rental terms with related parties may not reflect commonly accepted market practices**

| Background | Comments / implications | Management Comments |
|---|---|---|
| ■ VSCL has taken on lease 2,400 square feet of built up area from its promoter Mr Vishnu Gurnani for monthly rent of Rs 5,000. The lease rental is subject to increase at 10% per annum (agreement date: August 9, 2012). In our opinion, the lease rental is below the market rate.<br>■ VSCL has taken on lease 2,500 square feet built up area from Gurnani Infra Developers Pvt. Ltd for monthly rent of Rs 15,000. The company has also given Rs 20 mn as interest free security deposit to the lessor (agreement date: August 8, 2012). | ■ Monthly lease rental rate of Rs 5,000 for corporate office premises is low compared to market standards. The company's rental expenses will increase in case the lease rates are revised upwards.<br>■ In our opinion, interest free security deposit of Rs 20 mn for leasing of warehouse space is high, given the nature of use of the property and the monthly lease rental. | ■ Not applicable |

# Key Findings: Company needs to strengthen its quality of MIS and internal control

**Limited scope on account of quality of information**

## Background

We noted gaps and limitations in the information provided for the purpose of due diligence. Gaps in information include:

- Quarterly / half-yearly financial statements – Although not a statutory requirement, the company has not maintained historical quarterly and half-yearly financial statements.
- MIS – the company does not maintain monthly / periodical MIS that captures the key operating metrics, profitability and key balance sheet numbers. The company also does not capture the data on state-wise sales.
- Apart from the corporate office in Jaipur, VSCL has six branch offices – Hardwar, Delhi, Ghaziabad, Mumbai, Bhiwandi and Surat. Consolidated operational data on product-wise sales (volumes and amount), debtors, creditors and others was not available. The company also did not have historical data on revenue split between key product segments viz. electrical accessories and wires and cables.

## Comments / implications

- The weak quality of MIS and internal control is a characteristic of SME companies due to the small scale of operations.
- Our analysis has been restricted due to limitations in data. CRISIL Research was not able to conduct analysis on quarterly / monthly trends on profitability and other key matrices.
- The management was accommodative in providing data. Some information required for the purpose of due diligence was prepared by the management for the first time.
- Although management has been able to manage the business effectively till now, it will have to strengthen MIS and internal controls to monitor operations centrally with increasing scale.

## Management comments

- Not applicable

## Key Findings: Other issues

| Background | Comments / implications | Management comments |
|---|---|---|
| ■ While brand 'Veto' is owned by VSCL, brand 'Vimal Power' is owned by VEIPL. Both the companies have issued 'letters of consent' to each other, permitting the usage of these brand names by both the companies. Apart from this, there is no formal agreement or a royalty structure between the two entities.<br>■ Selling, General and Administrative (SG&A) expenses as a percentage of sales have declined 2.4% in FY09 to 1.8% in FY12 primarily due to decline in advertising and sales promotion expenses in absolute terms. | ■ Having key arrangements, such usage of brands, without a formal agreement is a risk to VSCL's operations in case of any disagreements.<br>■ Current advertising and sales promotion expenses are not reflective of future costs. In case these costs increase in the future, it may adversely impact margins. | ■ There are no plans to pay or receive royalty from VEIPL at present.<br>■ VSCL's advertising expenses include providing display boards for dealers and 'Veto' branded cloth bags, diaries and pens. These expenses are not necessarily linked to sales and are driven by dealers' requirements. Therefore, they have declined in FY12, in spite of revenue growth of 29% in that year. |

# Analysis of Financial Statements (Standalone)

## Income Statement Analysis

| | Rs mn | | | | Common size statement | | | |
|---|---|---|---|---|---|---|---|---|
| **Particulars** | **FY09** | **FY10** | **FY11** | **FY12** | **FY09** | **FY10** | **FY11** | **FY12** |
| **Income** | | | | | | | | |
| Gross sales | 418 | 504 | 566 | 729 | 107.3% | 107.2% | 106.5% | 106.2% |
| Less: trade discount | (28) | (34) | (35) | (43) | -7.3% | -7.2% | -6.5% | -6.2% |
| **Operating income** | **389** | **470** | **531** | **686** | 100.0% | 100.0% | 100.0% | 100.0% |
| **Expenditure** | | | | | | | | |
| Raw material consumed | 291 | 368 | 374 | 499 | 74.8% | 78.4% | 70.3% | 72.7% |
| Change in inventory | (5) | (29) | 9 | (7) | -1.3% | -6.2% | 1.7% | -1.1% |
| Power and Fuel | 4 | 5 | 5 | 6 | 1.1% | 1.0% | 1.0% | 0.9% |
| Employee costs | 30 | 37 | 40 | 42 | 7.7% | 7.8% | 7.5% | 6.2% |
| Other manufacturing Expenses | 4 | 7 | 6 | 8 | 1.0% | 1.4% | 1.2% | 1.1% |
| Other expenses | 13 | 13 | 12 | 15 | 3.3% | 2.8% | 2.4% | 2.2% |
| SG&A | 10 | 13 | 15 | 13 | 2.4% | 2.7% | 2.8% | 1.8% |
| **EBITDA** | **43** | **57** | **71** | **111** | 10.9% | 12.2% | 13.3% | 16.2% |
| Depreciation | 8 | 9 | 9 | 11 | 1.9% | 1.9% | 1.7% | 1.5% |
| **EBIT** | **35** | **49** | **62** | **100** | 9.0% | 10.4% | 11.6% | 14.6% |
| Interest | 8 | 8 | 13 | 26 | 2.2% | 1.7% | 2.4% | 3.8% |
| **Operating PBT** | **26** | **40** | **49** | **74** | 6.8% | 8.6% | 9.2% | 10.9% |
| Other income | 0 | 0 | 0 | 1 | 0.1% | 0.1% | 0.1% | 0.1% |
| Exceptional inc/(exp) | 1 | - | (0) | - | 0.4% | 0.0% | 0.0% | 0.0% |
| **PBT** | **27** | **41** | **49** | **75** | 7.3% | 8.7% | 9.3% | 11.0% |
| Tax provision | 2 | (3) | 1 | 3 | 0.5% | -0.5% | 0.1% | 0.5% |
| **PAT (Reported)** | **26** | **44** | **49** | **72** | 6.8% | 9.3% | 9.1% | 10.5% |
| Less: Exceptionals | 1 | - | (0) | - | 0.4% | 0.0% | 0.0% | 0.0% |
| **Adjusted PAT** | **25** | **44** | **49** | **72** | 6.4% | 9.3% | 9.2% | 10.5% |

## Revenue Analysis

| Revenue details | | | | |
|---|---|---|---|---|
| *(Rs mn)* | FY09 | FY10 | FY11 | FY12 |
| Manufactured goods sales | 284 | 396 | 443 | 575 |
| *y-o-y change* | *57.0%* | *39.0%* | *12.0%* | *29.9%* |
| Traded goods sales | 133 | 108 | 123 | 153 |
| *y-o-y change* | *69.4%* | *-18.7%* | *13.7%* | *24.7%* |
| **Total gross sales** | **418** | **504** | **566** | **729** |
| *y-o-y change* | *60.8%* | *20.6%* | *12.4%* | *28.7%* |
| Less: trade discount | (28) | (34) | (35) | (43) |
| *Trade discount as % of gross sales* | *-6.8%* | *-6.7%* | *-6.1%* | *-5.9%* |
| **Net sales / operating income** | **389** | **470** | **531** | **686** |
| *y-o-y change* | *55.9%* | *20.8%* | *13.1%* | *29.1%* |

## Distribution network

| No. of dealers | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Number of dealers | 1,366 | 1,878 | 2,187 | 2,375 |
| Average revenue per dealer (Rs) | 284,952 | 250,288 | 243,022 | 288,798 |

- VSCL's operating income has grown to Rs 686 mn by FY12 at a three-year CAGR of 21% The company sells around 20 products, which can broadly be classified into two categories – wires and cables and electrical accessories. The wires and cables business contributed 54% and 58% to VSCL's revenues in FY12 and FY11, respectively. The rest was contributed by electrical accessories. We are unable to comment on the revenue contribution prior to FY11 as the same has not been provided by the company.
- Sales of traded goods averaged 21% of total gross sales in the past three years. Traded goods include, among other products, CFLs and fans which VSCL does not manufacture and has outsourced to local companies.
- We are unable to comment on the historical growth in product realisations and sales volumes as the company has not shared these data with us.
- The company directly sells to dealers/retailers and has over 2,300 dealers as of FY12, most of them located in Rajasthan. VSCL derives its maximum revenue from Rajasthan (over 70%). In the recent years, it has ventured into other states including Gujarat, Delhi, Madhya Pradesh, West Bengal and Assam. In the future, the company intends to export electrical accessories.
- The company reports both gross sales and net sales – net of discount and duties. For our analysis, we have used net sales.

- VSCL's dealer base has grown at around 20% CAGR over FY09-12, which we believe has led to revenue growth. As the company has increased its dealer base, its average revenue per dealer has declined, except in FY12.
- According to the management, VSCL has been able to pass on the increases in prices of key raw materials (such as copper, PVC/PVC compounds and others) to end consumers. This is also reflected in the company's raw material cost, which has remained constant at around 72% of sales over FY10-12. Consequently, we believe that product realisations have also grown during the past few years.
- As per our discussions with the management, the company added fans and CFLs to its product portfolio and has contributed around Rs 60 mn to the company's revenues in FY12. Remaining sales have been derived from existing products.
- The company has given an average discount of 6% on sales to dealers. These are usually given to dealers placing large orders with the company or in order to clear old inventory.
- The company has two umbrella brands under which it sells all its products – 'Veto' and 'Vimal Power'. While 'Veto' is owned by VSCL, 'Vimal Power' is owned by its parent, VEIPL. VSCL has issued a 'consent letter' to VEIPL, permitting it to use the brand name 'Veto'. VEIPL has also issued a 'consent letter' to VSCL, permitting it to use the brand name 'Vimal Power'. However, these companies are not paying any royalty to each other.
- 'Veto' was acquired by the promoters in 2006 for a sum of Rs 11,000, which in our opinion is very low.
- Within its two umbrella brands, VSCL has other brands such as 'Carino', 'Power', 'Puf', 'FM' etc.

## Seasonality of revenues

The company's revenues are typically seasonal - Q2 contributes the highest sales, followed by Q4. Sales are usually higher in Q2 as this period is followed by the festive season (Diwali) leading to strong demand for VSCL's products in the residential real estate sector. Historical quarterly/half yearly revenue breakdown is unavailable as the company has not maintained quarterly/half yearly financials in the past.

## Production and capacity utilisation

| | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| ***Wires and cables*** | | | | |
| Installed capacity (lakh bundles) | 14.08 | 14.08 | 14.08 | 14.08 |
| Capacity utilisation (%) | 18.25% | 30.00% | 23.58% | 30.82% |
| Production (lakh bundles) | 2.57 | 4.23 | 3.32 | 4.34 |
| ***Electrical accessories*** | | | | |
| Installed capacity (lakh pieces) | 140 | 140 | 380 | 380 |
| Capacity utilisation (%) | 24.41% | 65.30% | 23.40% | 15.48% |
| Production (lakh pieces) | 34.18 | 91.43 | 88.93 | 82.33 |

- VSCL's installed capacity for wires and cables is 14.08 lakh bundles whereas for electrical accessories it is 380 lakh pieces. The company increased its capacity for manufacturing electrical accessories from 140 lakh pieces to 380 lakh pieces in FY11 in anticipation of growth in demand.
  - Capacity expansion in FY10-11 in electrical accessories comprised investment of around Rs 25 mn in construction of additional space within the company's factory premises, investment in dies and furniture. This created space for more workers for the assembly operations and therefore increased VSCL's throughput capacity.
- Production of electrical accessories declined from 91.43 lakh pieces in FY10 to 82.33 lakh pieces in FY12. As per the management:
  - The company launched new products/brands during the initial years and ran promotional schemes to market new products. Therefore, volume offtake from the dealers was higher in the initial years, leading to higher production.
  - Company's sales portfolio keeps changing and the same products may not contribute to sales in the same proportion each year. Therefore volumes cannot be compared across the years.
- Production of wires and cables declined in FY11 to 3.32 lakh bundles from 4.23 lakh bundles in FY10. As per the management, significant volatility in copper prices in FY11 resulted in lower demand from end users, leading to lower capacity utilization in wires and cables manufacturing.
- We have not been able to verify the product-wise production volume data, as the same was not available with the management.

## Raw material cost

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Copper | 98 | 149 | 171 | 223 |
| PVC/PVC Compounds | 15 | 20 | 20 | 31 |
| Packing materials | 8 | 12 | 10 | 14 |
| Stores and spares consumed | 1 | 1 | 1 | 1 |
| Traded goods purchased | 103 | 95 | 97 | 130 |
| Freight inward | 2 | 2 | 2 | 2 |
| Other costs | 64 | 89 | 72 | 98 |
| **Total** | **291** | **368** | **374** | **499** |
| Less: Change in inventory | (5) | (29) | 9 | (7) |
| **Raw material costs net of change in inventory** | **286** | **339** | **383** | **491** |
| Raw material cost (% of sales) | 73.5% | 72.1% | 72.0% | 71.6% |
| Imported raw materials | 6% | 0% | 1% | 0% |
| Indigenous | 94% | 100% | 99% | 100% |

| Raw material cost per unit | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Copper (Rs mn) | 98 | 149 | 171 | 223 |
| Volume consumed (kg) | 349,456 | 477,624 | 387,095 | 455,113 |
| **Average cost per unit (Rs/kg)** | **282** | **313** | **442** | **491** |
| MCX average daily price for the period (Rs/kg) | 262 | 291 | 373 | 407 |
| PVC/PVC compound (Rs mn) | 15 | 20 | 20 | 31 |
| Volume consumed (kg) | 262,618 | 361,209 | 314,587 | 460,557 |
| **Average cost per unit (Rs/kg)** | **58** | **56** | **63** | **68** |

- Raw material cost as a percentage of sales has remained around 72% during FY10-12. We expect this to be on account of VSCL's ability to pass on the increases in raw material costs to end consumers. Nearly 100% of VSCL's raw materials are procured domestically.
- Copper is the key raw material and accounts for 45% of raw material costs as of FY12. Company's sole copper supplier is Sterlite Industries. Other raw materials include brass, aluminium and PVC/PVC compounds.

### Major suppliers of raw materials

| Raw material | Suppliers | Location |
|---|---|---|
| Copper | Sterlite Industries Ltd | Silvassa, Dadra and Nagar Haveli |
| PVC Resin | Shriram Polytech | Kota, Rajasthan |
| Polycarbonate powder | Sulochana Organic Pvt. Ltd | Panipat, Haryana |
| | Sabic Innovative (I) Pvt Ltd | NCR, Delhi |
| | G. Khanna & Co | Baddi, Himachal Pradesh |
| Brass parts | Keyur Enterprises | Jamnagar, Gujarat |
| | G.B. Godavaria | Jamnagar, Gujarat |
| | Baba Brass | Jamnagar, Gujarat |
| | Shashi Products | Jamnagar, Gujarat |
| | Crazy Combine | Mumbai, Maharashtra |

- Purchase of traded goods includes, among other items, fans and compact fluorescent lamps, which the company purchases from other manufacturers to re-sell under its own brand name.

### Employee cost

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Salary, wages and bonus | 27 | 33 | 37 | 39 |
| Contribution to PF and other funds | 2 | 2 | 2 | 2 |
| Staff welfare expenses | 1 | 1 | 1 | 2 |
| Director's remuneration | - | - | - | 0 |
| **Employee cost** | **30** | **37** | **40** | **42** |
| As % of operating income | 7.7% | 7.8% | 7.5% | 6.2% |
| **Number of employees** | **359** | **417** | **464** | **482** |
| Cost per employee (Rs) | 83,565 | 88,729 | 86,207 | 87,137 |

- Employee cost as a percentage of sales has decreased from 7.7% in FY09 to 6.2% in FY12. We believe this is partly because of economies of scale.
- According to the management, the company has historically given an average increase of 10-12% in salaries and wages. However, employee cost has grown at around 7% in FY12. The management attributes this to some employees leaving the company during FY12. ***In our opinion, current employee cost is not fully reflective of the true costs and therefore likely to increase going forward.***
- Members of the Gurnani family drew Rs 2.3 mn in salary from VSCL in FY12. The managing director, Mr Vishnu Gurnani, has received Rs 79,000 in salary in FY12 and was not paid any salary during the earlier years. The company has fixed his remuneration at Rs 1.4 mn per annum going forward.
- Mr Dinesh Gurnani, whole-time director, has not received any salary from VSCL in the past. According to the management, his remuneration has been fixed at Rs 0.6 mn per annum from the current financial year.
- During our interactions with the management, we learned that Mrs Pushpa Gurnani and Ms Jyoti Gurnani have ceased to be employees of VSCL and therefore will not receive any remuneration from the company in the future.

**Remuneration of promoters**

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Vishnu Kumar Gurnani | - | - | - | 0.1 |
| Rajesh Kumar Gurnani | 0.5 | 0.2 | 0.2 | 0.2 |
| Ragini Gurnani | - | - | - | 0.0 |
| Dharam Gurnani | 0.2 | 0.2 | 0.2 | 0.2 |
| Sarita Gurnani | 0.0 | 0.1 | 0.2 | 0.2 |
| Pushpa Gurnani | - | 0.2 | 0.6 | 0.6 |
| Jyoti Gurnani | - | 0.2 | 0.6 | 0.6 |
| Priyanka Gurnani | 0.1 | - | - | - |
| **Total** | **0.8** | **0.9** | **1.8** | **1.9** |

- In our opinion, salaries of the key managerial personnel are on the lower side and the company may have to raise the salary levels if it has to retain the key employees. Mr P.V. Sharma, Group CFO, receives his salary from VEIPL and not from VSCL.

**Remuneration of key managerial personnel (other than promoters)**

| Key managerial personnel | Designation | Salary (Rs mn) |
|---|---|---|
| P.V. Sharma | Group CFO | 1.0 |
| Govind Ram Gurnani | AVP, Marketing | 0.4 |
| Vasudev Lalwani | AVP, Marketing | 0.6 |
| Mohammad Khalid | Production Head | 0.5 |
| Sanjeev Nigam | Sr Manager, Finance and Accounts | 0.6 |
| Vandana Ravi | Company Secretary | 0.3 |

- VSCL came into existence starting June 20, 2007. Until FY12, the company followed the policy of accounting the gratuity on cash basis. However the same was not in conformity with AS 15 prescribed by Institute of Chartered Accountants of India (ICAI) in relation to disclosure of present value of obligations with respect to the retirement/ future benefits to be paid to the employees and was in contravention of section 211(3C) of the Act. The Accounting Standard stipulates that these liabilities should be accounted for in the books of accounts on accrual basis. The company has now created a gratuity fund of Rs 34.64 mn and has obtained a gratuity bond dated August 28, 2012 from Life Insurance Corporation of India, and thus is in compliance with the prescribed Accounting Standard.
  - The company has paid a premium of Rs 3.2 mn towards the gratuity bond during FY13. Going forward, this premium is expected to amount to Rs 0.6-0.7 mn per annum, as per our discussions with the management.
- The paid up share capital of VSCL has increased beyond Rs 50 mn w.e.f. March 31, 2011. In terms of section 383A of the Companies Act, the company was required to appoint a company secretary. Veto could not appoint the company secretary during FY12 but has obtained a compliance certificate from the qualified practicing company secretary for the said year as required. However VSCL has appointed a whole time company secretary w.e.f. May 01, 2012.

## Power and other manufacturing expenses

| | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Power and fuel (Rs mn) | 4 | 5 | 5 | 6 |
| Power and fuel (% of sales) | 1.1% | 1.0% | 1.0% | 0.9% |
| Other manufacturing expenses (Rs mn) | 4 | 7 | 6 | 8 |
| Other manufacturing expenses (% of sales) | 1.0% | 1.4% | 1.2% | 1.1% |

- Power and fuel forms a small proportion of the company's total costs as it does not have manufacturing machineries which consume a large amount of electricity.
- Other manufacturing expenses (which include expenses such as factory rent, insurance, repairs to plant and building and others) as a percentage of sales have decreased by around 1.4% in FY10 to 1.1% in FY12 due to economies of scale.

## Selling, general and administrative (SG&A) & other expenses

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Advertising and sales promotion expenses | 6 | 6 | 7 | 4 |
| *% of sales* | 1.6% | 1.3% | 1.3% | 0.6% |
| Commission on sales | - | 3 | 3 | 2 |
| *% of sales* | - | 0.6% | 0.5% | 0.3% |
| Transportation, Freight and handling charges | 3 | 4 | 5 | 6 |
| *% of sales* | 0.9% | 0.8% | 1.0% | 0.9% |
| Other expenses | 13 | 13 | 12 | 15 |
| *% of sales* | 3.4% | 2.8% | 2.4% | 2.2% |
| **Total SG&A and other expenses** | 23 | 26 | 27 | 28 |
| ***% of sales*** | 5.8% | 5.5% | 5.1% | 4.1% |

- SG&A expenses as a percentage of sales have declined 2.4% in FY09 to 1.8% in FY12 primarily due to decline in advertising and sales promotion expenses. VSCL's advertising expenses include providing display boards for dealers and 'Veto' branded cloth bags, diaries and pens. According to the management, these expenses are not necessarily linked to sales and are driven by dealers' requirements. Therefore, they have declined in FY12, in spite of revenue growth of 29% in that year. ***However, we find the same to be abnormal.*** Other SG&A costs include commission on sales and transportation, freight and handling charges which form a small proportion.

- The company does not have any policy for provisioning for bad and doubtful debts and product warranties.
- Other expenses include rent, rates & taxes, travelling and conveyance, and other expenses. VSCL has leased the following properties from its related parties:
  - VSCL's corporate office at Jaipur. The company has taken on lease 2,400 square feet of built up area from its promoter Mr Vishnu Gurnani for a monthly rent of Rs 5,000. The lease rental is subject to increase at 10% per annum (agreement date: August 9, 2012). In our opinion, the lease rental is below the market rate.
  - VSCL's branch office at Surat. The company has taken office space on lease from Gurnani Infra Developers Pvt. Ltd (promoter group company) for a monthly rent of Rs 8,000. The lease rental is subject to increase at 5% per annum (agreement date: February 11, 2011).
  - Warehouse at Jaipur. VSCL has taken on lease 2,500 square feet built up area from Gurnani Infra Developers Pvt. Ltd. for a monthly rent of Rs 15,000. The company has also given Rs 20 mn as interest free security deposit to the lessor (agreement date: August 8, 2012).

## EBITDA margin

| *Cost as a percentage of sales* | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Raw material cost | 73.5% | 72.1% | 72.0% | 71.6% |
| Power and fuel | 1.1% | 1.0% | 1.0% | 0.9% |
| Other manufacturing expenses | 1.0% | 1.4% | 1.2% | 1.1% |
| Employee cost | 7.7% | 7.8% | 7.5% | 6.2% |
| Selling, general and administrative expenses | 5.8% | 5.5% | 5.1% | 4.1% |
| Total cost | 89.1% | 87.8% | 86.8% | 83.9% |
| **EBITDA margin** | **10.9%** | **12.2%** | **13.3%** | **16.2%** |

- The company has been able to improve its EBITDA margin over FY09-12 because of its ability to pass on the increase in raw material cost, low salary of key management personnel and operating efficiencies. We expect VSCL's EBITDA margin to moderate going forward as its employee costs and advertising expenses are likely to rise as the company expands manufacturing, forays into new states and introduces new products.

## Interest cost

Table below illustrates the break-up of interest cost over the period under review:

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Interest cost | 7 | 7 | 12 | 24 |
| Bank charges | 1 | 1 | 1 | 1 |
| Total | 8 | 8 | 13 | 26 |
| Year end debt | 233 | 238 | 200 | 204 |
| Interest rate on average debt (%) | 4.0% | 3.4% | 5.9% | 12.8% |

- Interest expense has increased significantly from FY09 to FY12. VSCL relied on interest free loans from related parties in the past due to which interest costs were low at 4.0% in FY09. However, the company has gradually reduced its dependence on such loans and has replaced them with working capital loans from banks. Further, unsecured loans amounting to Rs 47 mn were converted to equity shares. As a result, its interest costs have increased over FY09-12. Total debt, however, has declined from Rs 233 mn in FY09 to Rs 204 mn in FY12.

## Depreciation

| *Cost as a percentage of sales* | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Depreciation expense (Rs mn) | 8 | 9 | 9 | 11 |
| Depreciation expense (% of sales) | 1.9% | 1.9% | 1.7% | 1.5% |
| Gross block (Rs mn) | 70 | 95 | 100 | 116 |
| Depreciation rate (% of average gross block) | 11.7% | 10.6% | 9.3% | 9.8% |

- The depreciation expense increased from Rs 8 mn in FY09 to Rs 11 mn in FY12 because of investments in factory building, plant and machinery, furniture and fixtures and vehicles. Average depreciation rate declined after FY09 due to lower capex and written down value method of charging depreciation.

## Tax rate and net income

- The company's manufacturing facility in Hardwar enjoys income tax benefit offered by the state government of Uttarakhand. It has got 100% tax exemption for the first five years starting FY08 and 30% income tax holiday for the next five years starting FY13. While the company is liable to pay MAT, it has been able to avail MAT credit, leading to negligible tax rate in the past few years.

| | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| **Profit before tax (Rs mn)** | **27** | **41** | **49** | **75** |
| Profit before tax (% of sales) | 7.3% | 8.7% | 9.3% | 11.0% |
| Tax (Rs mn) | 2 | (3) | 1 | 3 |
| **Effective tax rate (Rs mn)** | **7.0%** | **-6.2%** | **1.4%** | **4.2%** |
| Net profit (Rs mn) | 26 | 44 | 49 | 72 |
| Exceptional items (Rs mn) | 1 | - | (0) | - |
| **Net profit after exceptional (Rs mn)** | **25** | **44** | **49** | **72** |
| **Net profit margin (%)** | **6.4%** | **9.3%** | **9.2%** | **10.5%** |
| MAT credit utilised (Rs mn) | 3 | 7 | 9 | 12 |

- VSCL's PBT margin has improved in line with EBITDA margin. PBT margin has expanded from 7.3% in FY09 to 11.0% in FY12.
- The net profit for the company has increased at a four-year CAGR of 40% from Rs 25 mn in FY09 to Rs 72 mn in FY12.

# Balance Sheet Analysis

| (Rs mn) | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| **Liabilities** | | | | |
| Equity share capital | 27 | 50 | 53 | 54 |
| Share premium | - | - | 7 | 7 |
| Reserves and surplus | 46 | 90 | 138 | 211 |
| **Net worth** | **73** | **140** | **198** | **271** |
| Convertible debt | - | - | - | - |
| Other debt | 233 | 238 | 200 | 204 |
| **Total debt** | **233** | **238** | **200** | **204** |
| Deferred tax liability (net) | 5 | 2 | 2 | 2 |
| **Total liabilities** | **311** | **380** | **400** | **477** |
| **Assets** | | | | |
| Net fixed assets | 58 | 73 | 70 | 77 |
| Capital WIP | 10 | - | 6 | 5 |
| **Total fixed assets** | **68** | **73** | **76** | **82** |
| **Investments** | **0** | **1** | **2** | **4** |
| **Current assets** | | | | |
| Inventory | 124 | 130 | 142 | 179 |
| Sundry debtors | 132 | 144 | 181 | 225 |
| Loans and advances | 21 | 63 | 37 | 56 |
| Cash & bank balance | 21 | 15 | 21 | 18 |
| Marketable securities | - | - | - | - |
| **Total current assets** | **298** | **352** | **381** | **478** |
| **Current liabilities** | | | | |
| Creditors | 48 | 42 | 56 | 85 |
| Provisions | 7 | 4 | 2 | 2 |
| **Total current liabilities** | **55** | **46** | **59** | **87** |
| **Net current assets** | **243** | **306** | **322** | **391** |
| **Intangibles/Misc. Expenditure** | **0** | **0** | **0** | **0** |
| **Total assets** | **311** | **380** | **400** | **477** |

| Particulars | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| **Activity ratios** | | | | |
| Inventory days | 139 | 123 | 119 | 119 |
| Creditors days | 51 | 37 | 45 | 54 |
| Debtor days | 115 | 104 | 117 | 113 |
| Working capital days | 194 | 211 | 194 | 187 |
| Gross asset turnover (x) | 6.1 | 5.7 | 5.5 | 6.3 |
| Net asset turnover (x) | 7.0 | 7.2 | 7.4 | 9.3 |
| Sales/operating assets (x) | 6.4 | 6.7 | 7.1 | 8.7 |
| | | | | |
| **Liquidity ratio** | | | | |
| Current ratio (x) | 5.4 | 7.6 | 6.5 | 5.5 |
| | | | | |
| **Capital structure ratios** | | | | |
| Debt-equity (x) | 3.2 | 1.7 | 1.0 | 0.8 |
| Net debt/equity (x) | 2.9 | 1.6 | 0.9 | 0.7 |
| Interest coverage | 4.2 | 6.0 | 4.8 | 3.9 |
| | | | | |
| **Profitability / Return ratios** | | | | |
| EBITDA margin (%) | 10.9 | 12.2 | 13.3 | 16.2 |
| Adj PAT Margin (%) | 6.4 | 9.2 | 9.1 | 10.5 |
| RoE (%) | 41.5 | 40.9 | 28.8 | 30.8 |
| RoCE (%) | 12.9 | 14.2 | 15.9 | 23.0 |

## Equity Share Capital

- The company increased its share capital from Rs 25 mn in FY08 to Rs 54 mn in FY12. The company has issued shares to promoters between 2007 and 2012.
- As of FY12, the company has 5,830,000 outstanding shares. Of this, 497,667 shares were partly paid up to the extent of Rs 1 per share (face value Rs 10 per share). These shares became fully paid up post FY12.
- In May 2012, VSCL issued bonus shares in 1:1 ratio, taking the overall shares outstanding to 11,660,000 at present.

| Rs mn | FY08 | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|---|
| Share capital | 25 | 27 | 50 | 53 | 54 |
| Share premium | - | - | - | 7 | 7 |
| Reserves & surplus | 21 | 46 | 90 | 138 | 211 |
| **Shareholders' funds** | **47** | **73** | **140** | **198** | **271** |

### Share allotment history

| Allotment details | Number of shares allotted | Total price at which allotted (Rs mn) | Face value | Issue Price (Rs/share) |
|---|---|---|---|---|
| Allotment on 20.06.2007 (Promoters) | 100,000 | 1.0 | 10 | 10 |
| Allotment on 17.12.2007 (Promoters) | 2,400,000 | 24.0 | 10 | 10 |
| Allotment on 04.02.2008 (Promoters) | 36,000 | 0.4 | 10 | 10 |
| Allotment on 21.01.2009 (Promoters) | 155,490 | 1.5 | 10 | 10 |
| Allotment on 22.10.2009 (Promoters) | 2,307,510 | 23.1 | 10 | 10 |
| Allotment on 31.03.2011 (Promoters) | 333,333 | 9.9 | 10 | 30 |
| Allotment on 29.03.2012 (Promoters) | 497,667 | 46.5 | 10 | 80 |
| Bonus Issue 1 bonus shares for each equity share 14.05.2012 | 5,830,000 | NA | 10 | 10 |

## Borrowings

### Details of the company's borrowings

| *Rs mn* | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Working capital loan (secured) | 39 | 73 | 105 | 187 |
| Interest free loans from related parties (unsecured/short term) | 162 | 141 | 74 | 0 |
| Term loans (secured) | 23 | 15 | 10 | 2 |
| Long term debt due within one year | 8 | 8 | 9 | 10 |
| Hire purchase loans (secured) | 1 | 2 | 1 | 5 |
| **Total loans** | **233** | **238** | **200** | **204** |

- **Interest free loans from related parties**
  These are short term unsecured loans and are interest free. Over FY09-12, Rs 47 mn of such loans were converted into equity by allotting shares to the promoters. As of FY12, the outstanding amount of these loans has declined significantly.

| Name of the related party | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Veto Electropowers (India) Pvt. Ltd | 154 | 119 | 74 | 0 |
| Narain Das Gurnani | - | - | 0 | - |
| Babu Lal Gurnani | 7 | 0 | - | - |
| Kishore Kumar Gurnani | - | 0 | - | - |
| Vishnu Kumar Gurnani | 0 | - | - | - |
| Kanchan Cables Pvt. Ltd | 1 | 13 | - | - |
| Shipra Plastics | - | 7 | - | - |
| Gurnani Infra Developers Pvt. Ltd | - | 1 | - | - |
| **Total** | **162** | **141** | **74** | **0** |

- **Working capital loan**
  The working capital loan of Rs 187 mn has been taken from Indian Overseas Bank. (For details, please refer to Appendix 1)
- **Term loans**
  Term loans comprise the secured term loan taken from Indian Overseas Bank. (For details, please refer to Appendix 1)
- **Hire Purchase Loans**
  Hire Purchase Loans comprise vehicle financing obtained from BMW Financial Services, HDFC Bank and ICICI Bank. (For details, please refer to Appendix 1)

## Fixed Assets

### Composition of net fixed assets

| *Rs mn* | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Leasehold land | 8 | 12 | 11 | 11 |
| Factory building | 14 | 24 | 23 | 21 |
| Plant & machinery | 30 | 30 | 28 | 29 |
| Office equipment | 1 | 1 | 0 | 0 |
| Furniture and fixtures | 2 | 3 | 4 | 4 |
| Vehicles | 3 | 4 | 4 | 11 |
| **Total assets** | **58** | **73** | **70** | **77** |
| **CWIP** | 10 | - | 6 | 5 |

- VSCL's assets comprise primarily of plant and machinery and factory building. The installed capacity for wires manufacturing is 14.08 lakh bundles and for electrical accessories it is 380 lakh pieces. The company expanded its capacity for manufacturing electrical accessories from 140 lakh pieces to 380 lakh pieces in FY11.
- The company has purchased land for Rs 17 mn at Mahindra World City SEZ in Jaipur. The land is held in the name of its subsidiary Veto Electricals Pvt. Ltd.
- Fixed assets are stated at actual cost less accumulated depreciation. Cost comprises the purchase price and any attributable cost of bringing the asset to its working condition for its intended use. Depreciation on all fixed assets is provided on written down value method as per the rates and in the manner specified in Scheduled XIV of the Companies Act, 1956.

## Intangibles

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Goodwill | 0.3 | 0.2 | 0.1 | - |
| Trademark | - | - | 0.001 | 0.005 |

- Goodwill was created upon conversion of the company from a partnership firm to a private limited company in 2007. The company has completely amortised the goodwill over FY08-12.
- Trademarks include registered trademarks of some of the company's key brands. These will be amortised over a period of five years.

## Inventory

| Veto Switchgears and Cables Ltd | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Sales (Rs mn) | 389 | 470 | 532 | 686 |
| Inventory (Rs mn) | 124 | 130 | 142 | 179 |
| Inventory days (based on sales) | 116 | 101 | 97 | 95 |

| Havells (India) Ltd | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Sales (Rs mn) | 23,415 | 25,928 | 31,971 | 40,109 |
| Inventory (Rs mn) | 2,075 | 3,312 | 4,699 | 6,489 |
| Inventory days (based on sales) | 32 | 47 | 54 | 59 |

- An overview of VSCL's inventory is as follows:

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Raw material | 40 | 31 | 43 | 57 |
| Stock in trade | 47 | 34 | 42 | 56 |
| Finished goods | 33 | 63 | 53 | 61 |
| Packing materials | 3 | 3 | 3 | 5 |
| Total | 124 | 130 | 142 | 179 |

- As on March 31, 2012, the company had around 95 days of inventory (on sales basis) compared to 97 days in FY11 and 101 days in FY10. VSCL's inventory days are also higher than industry leader Havells'.
  - Havells' sales model involves selling to distributors, who in turn sell to retailers. In this case, distributors purchase the goods from the company and stock it in their own warehouses. On the other hand, VSCL sells directly to retailers. Retailers usually do not have the capacity to store large amount of inventory, and therefore VSCL has to stock inventory at its own depots and service the retailers based on demand.
- The business was in expansion phase and the inventory days were high during FY09. With increase in sales, although inventory on absolute terms has increased, inventory days have improved over time.

- Stock in trade includes goods that are purchased through trading. These include fans, CFLs, wires and cables.
- As per the management, the company does not have any work-in-process inventory as the production cycle is very short.
- Inventory of raw materials, stock of finished goods, packing materials and stock in trade are valued at lower of cost or net realisable value. FIFO is used for determining the historical cost.

## Sundry debtors

| | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Sales (Rs mn) | 389 | 470 | 532 | 686 |
| Debtors (Rs mn) | 132 | 144 | 181 | 225 |
| Debtor days | 115 | 104 | 117 | 113 |

- Sundry debtors mainly include amount receivable from dealers. It also includes loans and advances to related parties. Debtors amounted to Rs 21 mn outstanding for more than six months as on FY12. Of this, around Rs 8 mn is currently outstanding, as per the management.

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Receivables due from related parties | 4 | 21 | 23 | 21 |

- Receivables from related parties include a loan of Rs 17 mn given to subsidiary Veto Electricals Pvt. Ltd for purchase of land in Jaipur. Other receivables to related parties are interest free loans given to members of the Gurnani family.
- According to the management, the company has a policy of giving 90 days credit to its dealers. However, most dealers pay VSCL only when they sell the goods, which is typically 100-120 days. Hence, the debtor days are over 100 days of sales. VSCL's top customers are as follows:

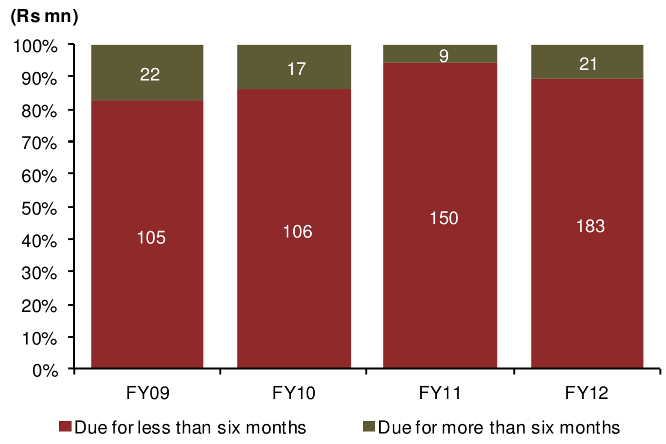
| Top customers (FY10) | % of total sales |
|---|---|
| Jai Electricals, Jaipur | 7% |
| Sundaram Ele. Pvt. Ltd, Kota | 3% |
| Rahul Sales Corp, Sikar | 3% |
| Imperial Shah Store | 2% |
| Sagar Metal | 2% |
| Vimal House, Bhilwara | 2% |
| Ashoka Industries, Bhilwara | 2% |
| Vaishali Ele., Jaipur | 1% |
| Kunal Electricals, Jaipur | 1% |
| Shivam Marketing, Bhilwara | 1% |

| Top customers (FY11) | % of total sales |
|---|---|
| Jai Electricals, Jaipur | 3% |
| Sundaram Ele. Pvt. Ltd, Kota | 3% |
| Rahul Sales Corp, Sikar | 2% |
| Sagar Metal | 2% |
| Vimal House, Bhilwara | 2% |
| Jaipur Electrical Install & Tools | 2% |
| Ashoka Industries, Bhilwara | 2% |
| Imperial Shah Store | 1% |
| Prakash Ele. & Deco, Bhilwara | 1% |
| Jaipur Electricals Ins. & Tools, Dubai | 1% |

| Top customers (FY12) | % of total sales |
|---|---|
| Sagar Metal | 3% |
| Sundaram Ele. Pvt. Ltd, Kota | 3% |
| Vimal House, Bhilwara | 2% |
| Rahul Sales Corp, Sikar | 2% |
| Jaipur Electrical Install & Tools | 2% |
| Jai Electricals, Jaipur | 1% |
| Shivam Marketing, Bhilwara | 1% |
| Prakash Ele. & Deco, Bhilwara | 1% |
| Imperial Shah Store | 1% |
| Gupta Steel Tube, Jaipur | 1% |

- Jai Electricals and Jaipur Electricals Ins. & Tools are promoters' group companies. Pinkcity Build Home Pvt. Ltd is also a promoter group company but sale to this company has not been disclosed under related party transactions (around 1% of sales in FY12).

## Ageing of sundry debtors (ex related parties)



- The company does not provision for bad and doubtful debts. The company has a policy of taking post-dated cheques, which are collected as security immediately from the dealers once the goods are sold by the company. VSCL also collects security deposits from its dealers in some cases. As per the management, the company has not had any bad debts in the past and therefore has not formulated any policy regarding bad debt provisioning.

## Loans and advances

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Loans to employees | 2 | 5 | 8 | 9 |
| Input VAT credit | 0.2 | 1 | 1 | 1 |
| Prepaid expenses | 0.2 | 0.002 | 0.2 | 0.2 |
| Advance recoverable in cash or kind | 13 | 43 | 4 | 10 |
| Loans and advances to others | - | 0.3 | 0.2 | 0.2 |
| Security deposits | 1 | 2 | 2 | 2 |
| Advance tax and TDS (net of provisions) | - | 0.2 | - | - |
| MAT credit entitlement | 5 | 12 | 21 | 33 |
| Accrued interest | - | - | 0.01 | 0.01 |
| **Total** | **21** | **63** | **37** | **56** |

- Advances recoverable in cash or kind include advance payments made to suppliers.
- VSCL has accumulated MAT credit entitlement of Rs 33 mn as of FY12. The company's Hardwar plant enjoyed 100% income tax holiday in FY08-12 and will receive 30% income tax holiday from FY13-17. However, the company is liable to pay MAT.

## Cash and bank

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Cash on hand | 3 | 4 | 1 | 4 |
| Current account balance | 18 | 10 | 19 | 14 |
| **Total** | **21** | **15** | **21** | **18** |

- The company had Rs 4 mn in cash and Rs 16 mn in different bank accounts (Indian Overseas Bank, Bank of Baroda and Bank of Rajasthan) as on March 31, 2012.

### Creditors

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Due to micro, small & medium enterprises | - | - | - | - |
| Due to others | 40 | 35 | 37 | 55 |
| Employee benefits payable | 1 | 0 | 2 | 2 |
| Duties and taxes payable | 2 | 2 | 5 | 7 |
| Trade deposits | - | 3 | 3 | 3 |
| Advance from debtors | 5 | 2 | 10 | 18 |
| **Total** | **48** | **42** | **56** | **85** |

- Creditors (due to others) include creditors for capital goods, creditors for goods and creditors for expenses.
- Advance from debtors includes advance payments received from dealers and distributors.
- Duties and taxes payable includes outstanding liabilities towards payments of central sales tax, value added tax, tax deducted at source and contribution to provident fund.

### Provisions

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Provision for income tax (net of advance tax and TDS) | 0 | - | 2 | 1 |
| Provision for expenses | 6 | 4 | 0 | 0 |
| Interest accrued and not due | 0 | 0 | 1 | 1 |
| **Total** | **7** | **4** | **2** | **2** |

- Provision for income tax amounted to Rs 1 mn as on March 31, 2012.
- VSCL has not made provision for gratuity in the past. It will provide this provision FY13 onwards.
- According to the management, the company does provide provision for product warranties as the incidence of defective goods requiring replacement is negligible (less than 0.1% of sales). The company provides lifetime warranty for its products.
- The company does not have a policy for carrying forward its employees' unutilised leaves to the next year and provides leave encashment for unutilised leaves in the same year. Therefore, VSCL does make any provision for leave encashment.

## Other Matters

### Contingent Liabilities

| Rs mn | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Guarantee given by banks on behalf of the company | 0 | 0 | 5 | 0 |
| Estimated amount of contracts remaining to be executed on capital account | 0 | 0 | 1 | 1 |
| **Total** | **0** | **0** | **6** | **1** |

- As per the information provided to us, there are no significant claims, pending or threatened litigations against the company in the latest available period.
- The company has not given any significant guarantees, performance bonds, letters of comfort or similar documents of assurance and any indemnities provided for the benefit of the company.

### Other related party transactions

- VSCL's purchase of goods from related parties includes purchase of wires and cables from group companies, primarily Vimal Power Cables Pvt. Ltd.

| Nature of transaction | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|
| Sale of goods (Rs mn) | - | 14 | 19 | 10 |
| Purchase of goods (Rs mn) | 78 | 34 | 32 | 20 |
| Rent paid (Rs) | 0.2 | 0.2 | 0.2 | 0.3 |

- As informed by the management, all the transactions with related parties are on an arm's length basis.

# Appendix

## Appendix 1: Summary of loan agreements

| Lender | Nature of loan | Primary Security | Collateral Security | Balance as at 31st March 2012 (Rs mn) | Interest Rate | No. of EMI | Amount of EMI | Starting date of Re-payment |
|---|---|---|---|---|---|---|---|---|
| Indian Overseas Bank | Term Loan | Hypothecation of factory building, plant & machinery | Personal guarantee of three directors | 7.43 | 12.25% | 60 | 0.6 | 3-May-08 |
| Indian Overseas Bank | Term Loan | Hypothecation of factory building, plant & machinery | Personal guarantee of three directors | 3.29 | 12.25% | 60 | 0.10 | 20-Jan-11 |
| BMW Financial Services Private Limited | Hire Purchase Loan | Hypothecation of vehicle financed | Nil | 3.30 | 11.00% | 60 | 0.10 | 1-Jul-11 |
| HDFC Bank Ltd | Hire Purchase Loan | Hypothecation of vehicle financed | Nil | 0.48 | 9.70% | 60 | 0.00 | 5-Sep-10 |
| ICICI Bank Ltd | Hire Purchase Loan | Hypothecation of vehicle financed | Nil | 2.68 | 2.22% | 36 | 0.10 | 15-Nov-11 |
| ICICI Bank Ltd | Hire Purchase Loan | Hypothecation of vehicle financed | Nil | 0.07 | 10.90% | 60 | 0.00 | 10-May-08 |
| HDFC Bank Ltd | Hire Purchase Loan | Hypothecation of vehicle financed | Nil | 0.09 | 9.70% | 36 | 0.00 | 5-Dec-09 |
| Indian Overseas Bank | Working Capital Loan | Hypothecation of stocks of raw materials, work in process, finished goods, book debts | Personal guarantee of three directors | 186.51 | 12.00% | NA | NA | NA |

# Appendix 2: Profile of Board of Directors

| Name | Age | Designation | Date of Joining | Qualification | Role and Experience |
|---|---|---|---|---|---|
| Mr Mohan Das Gurnani * | 59 | Non-executive director and Chairman | August 22, 2012 | An undergraduate | Promoter. He has over 30 years of experience in the wires and cable industry and other electrical accessories besides real estate. He is an NRI based in Dubai, United Arab Emirates. |
| Mr Vishnu Kumar Gurnani* | 61 | Managing Director | August 31, 2012 | An under graduate | Promoter. He has over 38 years of experience in the wires and cable industry and other electrical accessories. He plays a vital role in formulating business strategies and effective implementation of the same. |
| Mr Dinesh Gurnani* | 31 | Whole-time Director | August 31, 2012 | Graduate (Commerce) | Promoter. He has over 10 years of experience in the field of wires and cable industry and other electrical accessories besides real estate. He is instrumental in the formulation of distribution policies in India and abroad. |
| Mr Murlidhar Kaurani | 66 | Independent Director | August 31, 2012 | Not available | He is a retired IAS officer and has over 35 years of experience. |
| Mr Mohan Sukhani | 59 | Independent Director | August 31, 2012 | Graduate (Science) | He has over 30 years of experience in the textile and hotel businesses. |
| Mr Govind Ram Thawani | 72 | Independent Director | August 31, 2012 | Graduate (Arts) | He has over 35 years of experience in the field of marketing and finance. |

* Mr Mohan Das Gurnani and Mr Vishu Kumar Gurnani are brothers while Mr Dinesh Gurnani is their nephew. No other directors are related.

# Appendix 3: VEIPL's summary financials and shareholding structure

| Rs mn | FY10 | FY11 | FY12 |
|---|---|---|---|
| Equity capital | 14 | 131 | 131 |
| Reserves (excluding revaluation reserves) | 411 | 349 | 357 |
| Networth | 426 | 480 | 488 |
| Total income | 286 | 255 | 363 |
| Profit after tax | 15 | 46 | 8 |
| Earnings per share (Rs) | 10.7 | 3.5 | 0.6 |

| Shareholders | Percentage holding |
|---|---|
| Gurnani Holdings Pvt. Ltd. | 62.87 |
| JMTC FZCO LLC, Dubai | 18.63 |
| Mohan Das Gurnani | 6.71 |
| Ms Jyoti Tolani | 4.47 |
| Narain Das Gurnani | 4.19 |
| Pushpa Devi Gurnani | 2.52 |
| Harish Kumar Gurnani | 0.62 |
| **Total** | **100.00** |

# Disclaimer / Important notice

This Company Analysis and FDD Report is based on the limited scope of financial due diligence of Veto Switchgears and Cables Ltd. ("the Company") The Scope of Work covering the procedures to be performed for financial due diligence of the Company is defined below. In this Report, we may choose to not include matters that we believe to be insignificant. There may be matters, other than those noted in this Report, which might be relevant in the context of the issue and which a wider scope might uncover. The financial due diligence is based on the audited standalone financial statements for FY10, FY11 and FY12.

The Report has been issued on the understanding that the Company's management has drawn our attention to all matters, financial or otherwise, of which they are aware which may have an impact on our Report upto the date of this Report. Additionally, we have no responsibility to update this Report for events and circumstances occurring after this date.

Our work does not constitute recommendations about the completion of the operation. This Report also does not constitute an audit in accordance with the Audit Standards and we have not independently verified all the matters discussed in this Report and have relied on the explanations and information as given by the management (verbal as well as written) of the Company. We have assumed the genuineness of all signatures and the authenticity of all documents submitted to us, whether original or copies. In this regard, management of the Company is responsible for the proper recording of transactions in the books of account and maintaining an internal control structure sufficient to permit the preparation of reliable financial information, including financial accounts. Consequently, we do not express an opinion on the figures and other information included in this Report. CRISIL does take any responsibility towards the usage of the Report in any form.

The information and conclusions of this Report should not be the basis for the listing or for any investor to place a value on the business of the Company or to make a decision whether to acquire or invest in the Company. Our due diligence and analysis should not be construed as investment advice; specifically, we do not express any opinion on the suitability or otherwise of entering into any transaction in this regard. We accept no responsibility for matters not covered by the Report or omitted due to the limited nature of our analysis. The future plans of the Company, if any, are as informed to us by its Management. We do not have any view on the same.

## Scope of Work

The limited scope of coverage of the Company Analysis and Financial Due diligence Report would be:

**i)** Study of the financial statements of the Company for the financial periods ended March 31, 2010, March 31, 2011 and March 31, 2012 ("Historical Period").

**ii)** Review and comment on the reasonability and consistency of significant accounting policies adopted

**iii)** Highlight significant matters in internal audit reports, audit committee reports and statutory auditors' management letters

**iv)** Analyze quality of earnings with particular focus on:

- **a)** recurring versus non-recurring transactions (income and expenditure)
- **b)** changes in accounting policies
- **c)** impact of related party transactions, if any.

**v)** Analyze the key drivers of revenue and margin growth with particular reference to:

- **a)** price and volume changes of key products
- **b)** geographical expansion – export revenues vs. domestic revenues
- **c)** key customer wins and losses during the reporting period
- **d)** movement in prices of key raw materials and
- **e)** changes in direct manufacturing costs

**vi)** Comments on the distribution network, commission, discounting arrangements and credit terms with distributors.

**vii)** Analysis of selling costs, discounting policies and marketing overheads.

**viii)** Analysis of insurance costs including public and product liability insurances.

**ix)** Analysis of variances in significant administrative overheads.

**x)** Analysis of movement in head count and employee costs during the reporting period.

**xi)** Highlight key financial terms in top 5 customer contracts.

**xii)** Analysis of the cost sheet for the top 5 products and comment on the movements in the costs over the Historical Period

**xiii)** Analysis of historical trends in replacement/maintenance capex. Based on discussion with management, comment if there has been any deferred maintenance/replacement capex.

**xiv)** Analysis of the basis of capitalization and components of costs such as borrowing costs, pre-operative expenditure, exchange fluctuations, etc.

**xv)** Summarize details of investments held, highlighting investments in related entities, if any.

**xvi)** Analysis of the trends in working capital during the reporting period.

**xvii)** Analysis of and comment on the ageing profile of receivables and inventories. Inquire into provisioning policy and comment on provisions for uncollectible amounts and write-offs.

**xviii)** Analysis of the basis of inventory valuation and reasons for high inventory levels historically. Emphasize on slow moving/obsolete and non-moving inventories. (physical verification of inventories will not be conducted)

**xix)** Comment on other current assets, loans and advances and major creditors. Comment on recoverability and provisioning for uncollectible amounts.

**xx)** Comment on the current liabilities including accounts payable and provisions/accruals.

**xxi)** Obtaining bank reconciliations for key accounts and comment on reconciling items.

**xxii)** Summarize repayment schedule for the loans outstanding as at the latest available date

**Commitments, contingencies and litigation**

**xxiii)** Highlight significant claims, pending or threatened litigations against the company at latest available period, after discussions with the Management of the Company their views on the likely outcome of the cases/claims.

**xxiv)** Highlight significant guarantees, performance bonds, letters of comfort or similar documents of assurance and any indemnities provided by / or for the benefit of the Company, including details of such guarantees, etc given by the company for the period under review.

**xxv)** Status of tax claims and disputes thereof, if any.

**Related party transactions**

**xxvi)** Highlight major related party transactions and comment on recoverability / payment of balance due from / to related parties at period end.

**xxvii)** Comment on key financial terms and conditions of such related party transactions after discussions with the Management.

The following areas (indicative list) are excluded from the scope of the Report.

**1)** Valuation of the Issuer's business

**2)** Human Resource review

**3)** Technical and Commercial Due Diligence

**4)** Legal and Tax Due Diligence

**5)** IT review and risk management

**6)** Physical verification and valuation of fixed assets, inventories and other current assets

**7)** Third-party confirmations, meetings with suppliers/customers

**8)** Environmental compliances

**9)** Overview of the Supply Chain Management

**10)** Actuarial valuation of the company's retirement benefit arrangements

**11)** Checking of accounting records

## Contact us

Phone: +91 (22) 3342 3561/ 62

Fax: +91 (22) 3342 3501

E-mail: clientservicing@crisil.com | research@crisil.com

## Our Office

**Ahmedabad**
706, Venus Atlantis
Nr. Reliance Petrol Pump
Prahladnagar,
Ahmedabad
Phone : 91-79-4024 4500
Fax : 91-79-2755 9863

**Bengaluru**
W-101, Sunrise Chambers,
22, Ulsoor Road,
Bengalore - 560 042
Phone : 91-80-2558 0899
Fax : 91-80-2559 4801

**Chennai**
Thapar House,
43/44, Montieth Road, Egmore,
Chennai - 600 008
Phone : 91-44-2854 6205 - 06
Fax : 91-44-2854 7531

**Hyderabad**
3rd Floor, Uma Chambers
Plot No. 9&10, Nagarjuna Hills,
(Near Punjagutta Cross Road)
Hyderabad - 500 482
Phone : 91-40-2335 8103 - 05
Fax : 91-40-2335 7507

**Kolkata**
Horizon, Block 'B', 4th Floor
57 Chowringhee Road
Kolkata - 700 071
Phone : 91-33-2289 1949 - 50 |
Fax : 91-33-2283 0597

**Gurgaon**
Plot No. 46
Sector 44
Opp. PF Office
Gurgaon - 122 003, India
Phone: + 91 124 6722 000

**Pune**
1187/17, Ghole Road,
Shivaji Nagar,
Pune - 411 005
Phone : 91-20-2553 9064 - 67
Fax : 91-20-4018 1930

**About CRISIL Limited**

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CRISIL Limited
CRISIL House, Central Avenue, Hiranandani Business Park,
Powai, Mumbai – 400076. India
Phone: + 91 22 3342 3000 Fax: + 91 22 3342 3001
Email: clientservicing@crisil.com
www.crisil.com