

## CRISIL Research assigns IPO grade '1/5' to VKS Projects Ltd.

CRISIL has assigned a CRISIL IPO grade of '1/5' (pronounced "One on five") to the proposed IPO of VKS Projects Limited (VKS). This grade indicates that the fundamentals of the IPO are poor relative to the other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The grade is not a recommendation to buy, sell or hold the graded instrument, its future market price or suitability for a particular investor.

Weak revenue visibility is the major factor which has constrained the IPO grade assigned to VKS. As of June 2011, VKS' order book of Rs 967 mn translated into 1.6x FY11 sales; this provides revenue visibility for the next 12-15 months only. Though the company has a fairly good execution track record in handling mechanical, piping and heavy equipment erections for various process industries, of late it has been accepting orders for civil construction or earthworks – recently it accepted two such orders worth ~Rs 950 mn. These are not complex jobs and are positioned lower in the value chain; moreover, these orders could also be margin dilutive. Hence undertaking such jobs indicates that the company is not focusing on its core competency. The grade is further constrained by the company's inability to win large contracts from marquee clients. Although the company has in the past bagged orders from clients such as Reliance, Thermax, Deepak Fertilizer, Rashtriya Chemicals & Fertilizers (RCF), and IG Petro, we believe its inability to get repeat orders of large magnitude from these clients is a matter of concern.

The grade also considers the high concentration risk faced by VKS as orders from two new clients comprise 97% of the order book. Any delay or hiccups in these orders or companies could have an adverse impact on revenues going forward. Moreover, working capital is also high with working capital days in the range of 90-100. Owing to higher working capital requirements, debt increased to Rs 132 mn in FY11 from Rs 52 mn in FY10. Besides, the business is highly dependent on promoter Dr V Sukumaran and there is a need to strengthen the second line of management.

The only positive for VKS is its strong execution track record. So far the company has completed ~40 projects, without any major hiccups, in nine different states across India. Over a period of time, VKS has built up capabilities and obtained necessary pre-qualifications, which have led to an increase in average ticket size to ~Rs 400- 500 mn from ~Rs 20-30 mn.

### About the company and the issue

VKS Projects Pvt Ltd (VKS) is a Mumbai-based engineering, procurement and construction (EPC) company which undertakes mechanical and infrastructural construction contracts for fabrication and erection of high pressure piping, and heavy equipment erection. The company is also well-equipped to fabricate and erect reaction vessels, vacuum tray driers, storage tanks and heat exchangers for industries such as refinery, petrochemicals, dyestuff, pharma and bulk drugs, metallurgy, power and textiles. Of late, it is also undertaking civil and land development contracts.

Some of VKS' major clients are Reliance, Thermax, Deepak Fertilizer, RCF and IG Petro. During FY07-09, the company undertook projects with an average ticket size of Rs 20-30 mn. Post FY09, it started executing relatively higher-value projects. Recently, it received an order worth Rs 450 mn from PACL India Ltd and another worth Rs 490 mn from Lanco Infratech (for civil work at the Anuppur Thermal Power Plant in Madhya Pradesh).

VKS' revenue increased from Rs 33 mn in FY07 to Rs 597 mn in FY11 following its order intake increasing at 102% CAGR. EBITDA margins contracted by 125 bps y-o-y in FY11 to 11.4% due to higher employee cost. Reported net profit has increased to Rs 27 mn in FY11 from Rs 1 mn in FY07, owing to robust revenue growth. VKS's net worth for FY11 stood at Rs 128 mn compared to Rs 32 mn FY10.

Through the IPO, VKS plans to raise ~Rs 550 mn. The proceeds will be utilised for long-term working capital requirements, procurement of construction equipment and machineries and setting up engineering design studios and training centers in Chennai, Kochi, Delhi, Hyderabad and Ahmedabad.

### About CRISIL IPO Grading

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