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Mumbai

CRISIL Research assigns IPO grade '1/5' to Modern Tube Industries Ltd

CRISIL has reaffirmed a CRISIL IPO Grade '1/5' (pronounced 'one on five') to the proposed initial public offer (IPO) of Modern Tube Industries Ltd (Modern Tube). 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, or a comment on the graded instrument's future market price or its suitability for a particular investor.

The grade exhibits Modern Tube's weak position in the intensely competitive stainless steel welded and seamless tubes and pipes segment. Despite scaling up its manufacturing assets, Modern Tube continues to operate largely as a trader (trading sales contributed 63% to revenues in H1FY12). The receivable days has deteriorated to 159 days as on H1FY12 from 78 days in FY09, significantly higher than industry average of 65 to 80 days, thereby putting stress on the company's financials. The promoter has limited experience in manufacturing though he is highly experienced in the trading of stainless steel products. Lack of technical expertise has resulted in low capacity utilisation at 34% in FY11. The management's ability to scale up manufacturing operations in a segment where there is intense competition from established domestic manufacturers and cheap imports from China is a key monitorable. Further, quick churning of key management personnel within six to 18 months of joining is an area of concern. Also, Modern Tube portrays below average corporate governance with three out of four independent directors attending only 50-60% of the board and other committee meetings in FY11. Independent directors' engagement level in the company needs strengthening.

The grade has, however, taken into account Modern Tube's growth prospects, as it is scaling up asset utilisation in the current year through the manufacturing of tubes for critical applications. It has successfully added clients in the past year for the sale of these tubes, which enjoy relatively better margins. Also, the company is making efforts to move from a promoter driven firm to a professional set-up – for which it has hired a few experienced people (three to four people across business functions) from the industry.

About the company and the issue

Vadodara-based Modern Tube manufactures stainless steel seamless and welded tubes, u-tubes and pipes. Its manufacturing facility - spread across 6 acres - is located near the GIDC Port (Gujarat). Although currently it has a capacity of 8,700 metric tonnes per annum (MTPA), up from its initial capacity of 180 MTPA in 2006, it continues to be largely a trading company. When Mr Mahendra Bhansali started Modern Tube, he had over 10 years of trading experience in stainless steel products. The trading business was being run under a proprietary concern – M/s. Modern Tube Industries - floated in 1996, the entire operations of which were gradually shifted to Modern Tube Industries Ltd incorporated in 2006.

The capacity utilisation continues to be low at 34% in FY11. In H1FY12, Modern Tube derived 63% of its total sales through trading goods (average of past four years - 75% of net revenues), while the balance was contributed by the manufacturing business. The company reported revenues of Rs 1,104 mn and net profit of Rs 22 mn in H1FY12; net worth was Rs 235 mn as on H1FY12.

Modern Tube plans to raise Rs 650 mn through the IPO and will use the proceeds to expand manufacturing capacity from 7,200 to 14,400 MTPA (capacity has been expanded to 8700 MTPA by H1FY12) and fund working capital requirements.

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CRISIL IPO (Initial Public Offering) grading is an opinion on the fundamentals of the graded issue that reflects CRISIL's independence and expertise. This opinion is expressed as a relative assessment in relation to other listed equity securities in India. The assessment is based on a grading exercise carried out by industry specialists from CRISIL Research. A CRISIL IPO Grade 5/5 indicates strong fundamentals and a CRISIL IPO Grade 1/5 indicates poor fundamentals. CRISIL IPO Grading reflects its assessment of the graded company's equity fundamentals as distinct from an assessment of debt fundamental. A CRISIL IPO Grade should not be construed to mean a comment on the price of the graded security nor is it a recommendation to invest or not to invest in the graded security.

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