

Commercial Engineers & Body Builders Co Ltd

CRISIL IPO Grade 2/5 (Below average)

July 23, 2010

Grading summary

CRISIL Equities has assigned a CRISIL IPO grade of '2/5' (pronounced "two on five") to the proposed IPO of Commercial Engineers & Body Builders Co Ltd (CEBBCO). This grade indicates that the fundamentals of the IPO are **below average** relative to other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The offer price for the issue may be higher or lower than the level justified by its fundamentals. The grade is not a recommendation to buy/sell or hold the graded instrument, its future market price or suitability for a particular investor. To arrive at the overall grade, amongst various other parameters, CRISIL Equities has considered the company's business prospects, its financial performance, management capabilities and corporate governance practices.

The IPO grade assigned to CEBBCO takes into account the company's established presence in the body fabrication business of commercial vehicles (CVs) and its strong relationship with one of the largest players in this segment – Tata Motors. By virtue of this position, CEBBCO is set to reap the benefits of the high growth in the end-segment on the back of higher economic activity in the country, especially in the construction and mining sectors. In addition, the change in focus of the industry players towards selling fully built vehicles (FBVs) rather than chassis to the end-users bodes well for the company's business prospects. CEBBCO's foray into the railway segment through refurbishment of wagons during 2008-09 has met with reasonable success.

However, the grading is constrained by the inherent risks involved in the company's fabrication business, which is prone to intense competition from existing and new players due to low entry barriers. Further, players in this business have a low bargaining power and are exposed to the cyclicity in the CV industry. The grading is also influenced by CEBBCO's client concentration risk (around 70% of its revenues from the CV fabrication business in 2008-09 came from one client – Tata Motors) and its weak competitive position since it has to source a key raw material component (hydraulic jacks) from one of its competitors. CEBBCO is a relatively new entrant in the railway segment and is likely to face stiff competition from the incumbent players in the sector.

Further, its current management team size, and internal processes and systems seem to be inadequate and could prove to be an impediment in achieving its ambitious growth plans.

CEBBCO's operating income amounted to Rs 1.10 bn for the nine months ended December 2009, of which the CV segment accounted for around 72% and the railway segment accounted for the rest. For the nine months ended December 2009, the company's operating margins were higher at 19.9% compared to 6.8% in FY09. The improvement in operating margins was mainly on account of reduction in prices of key raw materials and an increase in contribution to CEBBCO's top line from the railway segment.

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About the company

Incorporated in 1979, CEBBCO is engaged in the production of vehicle and locomotive bodies for diverse applications for road and railway transportation. It designs and manufactures vehicle bodies for the commercial vehicles industry with an extensive portfolio of product offerings. The company also conducts refurbishment of wagons as well as manufacturing of components for wagons, coaches and locomotives for the Indian Railways.

Currently, the company operates five factories - four are in Madhya Pradesh (Richhai I and II, Mandla and Indore) and one is in Jamshedpur, Jharkhand.

Issue details

Shares offered to public	Not available at the time of grading
- Fresh issue	Not available at the time of grading
- Offer for sale	1,698,430
o NYLIM	1,427,890
o Commercial automobiles	270,540
As per cent of post issue equity	Not available at the time of grading
Object of the issue	Issue proceeds would be used to fund the capital expenditure for the railway project and to pre-pay identified loan facilities as well as finance general corporate expenses
Amount proposed to be raised	Not available at the time of grading
Price band	Not available at the time of grading
Lead managers	ICICI Securities Limited, Edelweiss Capital Limited

Detailed Grading Rationale

A. Business Prospects

- *Robust growth in CVs and increasing penetration of FBVs augur well for CEBBCO*

Demand for tippers (which forms the major component of the company's revenues from CVs) is expected to rise on the back of growth in end-use segments such as construction and mining, in line with the economic recovery. At the same time, instances of defective body building by independent garages have resulted in OEMs switching from selling just chassis to selling FBVs. CEBBCO is an established player in the body fabrication business in India and has a strong relationship with one of the largest players in the CV segment – Tata Motors. It has recently commissioned an additional unit within close proximity of Tata Motors' Jamshedpur plant. These factors put the company in a good position to ride the industry growth wave.

- *Foray into the railway segment has met with reasonable success*

The company ventured into the railway business in 2008-09 and has had reasonable success in this segment so far. Its revenues from this segment, where it's involved in refurbishment of wagons, have grown from just around Rs 26.77 mn in 2008-09 to Rs 278.56 mn in the first nine months of 2009-10 depicting its increased focus and success in this segment. The Railway Working Committee has proposed an investment of Rs 2,510 bn in various projects over the Eleventh Plan period (2007-08 to 2011-12), close to three times the Tenth Plan outlay. Of this, around Rs 594.8 bn is slated to be used in enhancing the rolling stock of railways by new additions and refurbishment of older wagons; this brightens the business prospects for the company in this segment.

- *Weak competitive positioning of the CV fabrication industry*

The demand for CEBBCO's end products is closely linked to the overall industrial growth. This makes the company vulnerable to cyclicity in the CV industry. Secondly, the industry is characterised by low entry barriers and presence of a large number of competitors with weak bargaining strength with customers. CEBBCO's competitiveness is also hampered due to its dependence on a competitor for a key raw material component (hydraulic jacks).

- *Dependence on Tata Motors presents a client concentration risk*

While the company's established relationship with Tata Motors ensures a steady stream of revenues, it also makes the company's revenues extremely dependent on the fortunes of its biggest client. Revenues from Tata Motors accounted for around 70% of its total revenues from the CV fabrication business in 2008-09.

- *Is vulnerable to cyclicity in the domestic CV industry*

CEBBCO's dependence on the CV industry and high client concentration also make it vulnerable to cyclical changes in domestic demand for CVs. The domestic CV industry has displayed a high degree of cyclicity in the past, with y-o-y growth of 33% in FY07 and decline of 32% in FY09.

- *Relative inexperience in railways*

CEBBCO is a relatively new entrant in this segment and could face stiff competition from existing incumbents in the refurbishment and wagon businesses. Post the commissioning of its wagon capacity, it would account for just around 4% of the total wagon capacity as of 2008-09. Its ability to bag orders remains contingent on how well the company is able to establish strong contacts within the Indian Railways. Organised players in the fabrications business as well as existing wagon manufacturers could easily cater to the Indian Railways' demand for both

refurbishment and new wagons as the business is neither very capital intensive nor requires a long gestation period and orders are tender driven.

B. Financial Performance

The company clocked operating income of Rs 1.10 bn for the nine months ended December 2009 as against Rs 1.22 bn in FY09 and Rs 1.25 bn in FY08. The CV fabrication business remained the major contributor to overall revenues through this period. The railway segment started contributing to CEBBCO's revenues only in FY09. For FY09 and the nine months ended December 31, 2009 CEBBCO's railway division reported net sales of Rs 26.77 mn and Rs 278.56 mn, respectively. For the nine months ended December 2009, the company's operating margins were higher at 19.9% compared to 6.8% in FY09. The improvement in operating margins was largely on account of reduction in key raw material prices and an increase in contribution of the railway segment to CEBBCO's top line.

The funds to be raised via the IPO will be used by the company to fund the capital expenditure of the railway project. The proceeds will also be utilised to prepay identified loan facilities and finance general corporate expenses.

The IPO is expected to improve the capital structure of the company and render it almost debt-free.

Financial performance snapshot

		FY08 Actual	FY09 Actual	Dec-10 Actual
		12 months	12 months	9 months
Operating Income	Rs. Mn.	1,246.0	1,218.6	1,104.0
Operating Margins	Per cent	11.5	6.8	19.9
Net Profits	Rs. Mn.	61.4	17.4	106.5
Net Margins	Per cent	4.9	1.4	9.6
ROCE	Per cent	22.3	12.0	29.6
RONW	Per cent	18.2	3.4	24.8
Basic EPS	Rs	10.2	2.8	17.4
Diluted EPS	Rs	10.2	2.8	17.4
No. of equity shares	Mn.	0.6	0.6	0.6
Net worth	Rs. Mn.	501.5	519.0	624.4
Book Value (FV Rs 100)	Rs	834.4	846.9	1,018.9
Dividend per share	Rs	-	-	-
Gearing	Times	0.6	0.1	0.8
Net Cash Accruals to Debt	Times	0.2	0.5	0.4
Interest Coverage	Times	3.5	1.8	6.4
Current Ratio	Times	1.6	1.2	1.3

* Note: Numbers have been reclassified as per CRISIL standards

Source: DRHP, CRISIL Research

C. Management Capabilities and Corporate Governance

CEBBCO's business is almost entirely run by its whole time executive director – Mr Ajay Gupta. He joined the company in May 2005 and is relatively new to the automobile and railway businesses. Prior to his joining the company, he was involved in the family textiles business, specifically in the production and sale of bed sheets. There are two executive directors on the six-member board. The other executive director on the board of the company is Mr Ajay Gupta's father in-law - Dr. Kailash Gupta. He has over 30 years of experience in the automobile space – especially in auto dealership, finance and body fabrication.

CEBBCO's growth from the automobile segment has been mainly driven by the management's ability to maintain its long-standing relationship with its prominent customer - Tata Motors - as well as add new customers to its profile. However, in 2008-09, CEBBCO incurred inventory losses as the management's strategy to stock up inventory (especially steel) backfired when commodity prices fell significantly following the global financial crisis.

Faced with a severe downturn in the CV segment towards the later half of 2008-09, under Mr Ajay Gupta CEBBCO ventured into the railway segment, mainly to refurbish wagons. Although more need-based than a planned move, it has enabled the company to diversify its portfolio and also increase its revenue share from this route while maintaining the growth from the body fabrication of CVs in 2009-10.

CEBBCO has a five-member fairly experienced second line of management. The size of CEBBCO's second line along with its weak internal systems and processes could prove to be an impediment for the company in achieving its growth plans.

There have been several instances where the company has illustrated a lack of internal process discipline in conducting its business. Such issues have been prevalent with this promoter group. Kailash Auto Finance Limited, a group company, had not complied with several provisions of its listing agreement with the BSE. This company has been sold off by the group to a third party and is awaiting SEBI clearance for completion of the process.

The company management seems to have started addressing these issues, but CRISIL Equities believes that the company's internal processes and systems are still in an evolving stage and require more management focus.

In addition, there is no board resolution outlining the framework to be followed in related party transactions, especially loans and advances towards family-owned companies like Kailash Vahan Udyog Limited (with plants in Pune and Bangalore), which are in the same line of business as CEBBCO.

The three independent directors have been recently appointed to the board of the company. Although fairly experienced in their respective fields, they are yet to be actively involved in providing guidance and exercising oversight over the management.

Annexure I

Business Profile

Incorporated in 1979, CEBBCO is a flagship company of the JN Group and is engaged in the production of vehicle and locomotive bodies for diverse applications for road and railway transportation. It designs and manufactures vehicle bodies for the commercial vehicles industry with an extensive portfolio of product offerings. The company also conducts refurbishment of wagons as well as manufacturing of components for wagons, coaches and locomotives for the Indian Railways.

Currently, the company operates five factories - four are in Madhya Pradesh (Richhai I and II, Mandla and Indore) and one is in Jamshedpur, Jharkhand.

Commercial vehicles division

The company is engaged in the business of manufacturing vehicle bodies for commercial vehicles manufactured by original equipment manufacturers (OEMs) engaged in the production of fully built vehicles (FBVs).

It has forged long-standing relationships with OEMs, particularly with Tata Motors, who is its chief client. Other OEM clients include VE Commercial Vehicles Limited (a joint venture between the Volvo Group of companies and Eicher Motors Limited), Ashok Leyland Limited, Asia Motor Works Limited, Man Force Trucks Private Limited and Hino Motors Sales India Private Limited (belonging to the Toyota Group of companies), all of which also manufacture FBVs. It also has an established relationship with the Ministry of Defence as well as with corporate groups deploying significant private fleets of vehicles such as Reliance Industries Limited and Som Datt Builders Private Limited.

Vehicle bodies designed and manufactured by the company cater to a variety of requirements in different industries and sectors. Given below is an illustration of some of its product offerings in the commercial vehicles division:

Sector/Industry	Products
Mining & Road Construction	Tipper Bodies Tanker Bodies
Goods Transportation	Load Cargo Bodies Refrigerator-fitted Vehicle Bodies and Containers Trailer Bodies (including for Box Trailers, Tip Trailers, Skeletal Trailers and Flat Bed Trailers)
Solid Waste Management	Skip-Loaders Garbage-Bin Collectors
Municipal Applications	Water Tanker Bodies Light Recovery Vehicle Bodies Garbage Tippers
Defense Sector	Troop Carrier Vehicle Bodies Prison Van Bodies Water Bowser Bodies
Miscellaneous Applications	Vehicle Bodies for Transportation of Animals Fire Engine Bodies Ambulance Bodies

Source: Company reports

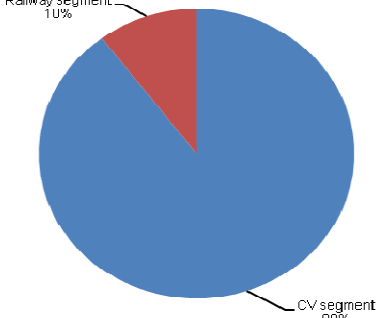
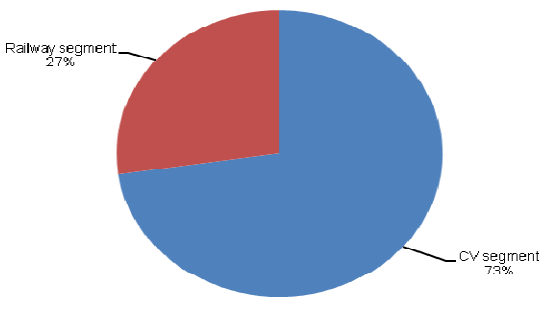
Railway division

In late 2008, CEBBCO ventured into the railway business and received various orders from the Indian Railways through a number of its production units, zonal authorities and workshops. These include Diesel Locomotive Works, Western Railway; Eastern Railway; Wagon Repair Shop, Kota (a workshop of the West Central Railway); and the Northern Railway Carriage & Wagon Workshop, Jagadhari, Haryana. These orders entail refurbishment of wagons, manufacture of side walls and end walls for wagons, and the manufacture of long hood structures for locomotives.

The company has received approval from the Research Design and Standards Organisation (RDSO) for its Quality Assurance Plan (QAP). RDSO is a unit of the Ministry of Railways in charge of maintaining standards for rolling stock and approving vendors to the Indian Railways. This QAP is for the fabrication of side walls, end walls and flap doors of BOXNR wagons. Approval from the RDSO is a pre-requisite in order for companies to be eligible to supply side walls and end walls for BOXNR wagons, which are the most commonly used wagons for transportation of bulk commodities like coal, iron ore, etc.

Further, the company's manufacturing facilities have been certified by the Integral Coach Factory, a production unit of the Indian Railways, to be adequate for the supply of side walls, roof assemblies and car line pillars for LHB coaches (which are modern coaches used for trains such as Rajdhani Express). It has also been included in the approved vendor list of ICF for the supply of LHB design side walls, roof and stainless steel shell construction.

CEBBCO intends to set up a new factory near Jabalpur in Madhya Pradesh to manufacture wagons and stainless steel EMU coaches; this is termed the "Railway Project", for which part of the IPO proceeds will be utilised.

Break-up of revenues (FY09)	Break-up of revenues (for nine months ended Dec'09)
<p>Rs 1.22 bn</p>  <p>Railway segment 10%</p> <p>CV segment 90%</p>	<p>Rs 1.10 bn</p>  <p>Railway segment 21%</p> <p>CV segment 79%</p>
<p>* Note: Numbers have been reclassified as per CRISIL standards</p> <p>Source: DRHP, CRISIL Research</p>	<p>* Note: Numbers have been reclassified as per CRISIL standards</p> <p>Source: DRHP, CRISIL Research</p>

Management and Board Profile

CEEBCO has two executive directors on its six-member board. Of the two executive directors, Dr. Kailash Gupta's involvement in the business is negligible. CEBBCO is almost single handedly run by his son-in-law, Mr Ajay Gupta. He is the whole time executive director of the company.

Mr Ajay Gupta is a commerce graduate from the University of Mumbai with distinction, and has completed a one-year Business Leaders Programme from the Indian Institute of Management, Kolkata. He joined the company in May 2005. Prior to this, he was involved in the family textiles business, specifically in the production and sale of bed sheets.

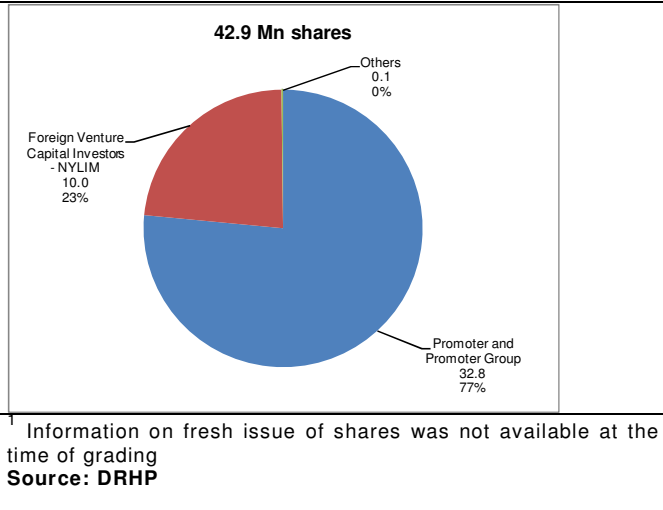
Non-executive board members include Mr Bharat Bakhshi, who is the nominee director of NYLIM. CEBBCO has three independent directors who have a reasonable understanding of the company's business and have the ability to exercise management oversight. Some of the independent directors on the board have years of experience in the automobile and railway sectors. For instance, Mr Sevanti Lal Popatlal Shah (independent director) was previously the general sales manager, Tata Motors, and Mr Arun Kumar Rao was previously director general, RDSO (Lucknow).

CEBBCO has a five-member second line of management that includes a chief financial officer, a vice-president each for the commercial vehicle and railway departments, and two senior managers providing support to the vice-president heading the railway department.

CEBBCO has three independent directors. They have a reasonable understanding of the company's business and have the ability to exercise management oversight.

Shareholding Pattern

Pre-issue¹



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Annexure II: Profile of the Directors

	Name of Directors	Designation	Age	Qualification	Exp. (yrs)	Previous Employment	Directorships / partnership in other entities
1	Dr. Kailash Gupta	Executive Director	63	PG in Physics, Meerut University, Dehradun Awarded a doctorate degree by the Jabalpur University for his dissertation "A Probe into the Environmental Change with the Socio – Economic Development due to Automobiles"	30+	-	<ul style="list-style-type: none"> Commercial Automobiles Pvt. Limited J. N. Auto Private Limited Kailash Auto Finance Limited Kailash Motors Finance Private Limited Shivam Motors (P) Limited. Limited Kailash Moser Industries Pvt. Limited Kailash Rolfo India Private Limited Shivam Phoenix Transport Services Private Limited Commercial Infrastructure Equipments Private Limited
2	Mr Ajay Gupta	Whole Time Executive Director	38	B.Com, University of Mumbai Business Leaders Programme, IIM Kolkata	n.a	<ul style="list-style-type: none"> Family business (Textile Industry) 	None
3	Mr Bharat Bakhshi	Non Executive Nominee Director of NYLIM	41	Bachelor's Degree of Science in Mechanical Engineering from California State University, Fullerton	19+	<ul style="list-style-type: none"> Director, UBS Assistant Vice President, Citigroup 	<ul style="list-style-type: none"> Bajaj Motors Limited Sarvana Global Energy Limited Inventia Healthcare Private Limited

				Masters Degree in Business Administration from the University of Southern California			
4	Mr Sevanti Lal Popatlal Shah	Non Executive Director (Independent)	74	Mechanical Engineer	25+	<ul style="list-style-type: none"> General Sales Manager, Tata Motors 	<ul style="list-style-type: none"> Neptune Equipment Private Limited Conart Engineers Limited Bombay Mills Stores Private Limited
5	Mr Arun Kumar Rao	Non Executive Director (Independent)	62	Graduate from the Birla Institute of Technology and Science, Pilani Graduate from the Institution of Mechanical Engineers, London, the Institution of Production Engineers, London and the Institution of Engineers (India) in Electrical Engineering.	36+	<ul style="list-style-type: none"> Director General, RDSO, Lucknow 	None
6	Mr Sudhir Kumar Vadehra	Non Executive Director (Independent)	63	Post – graduate degree in Chemistry	40+	n.a.	<ul style="list-style-type: none"> Kewaunee Labway Asia Pte. Ltd. Kewaunee Scientific Corporation India Pvt. Ltd. Kewaunee Labway India Pvt. Ltd. Kewaunee Labway Malaysia Sdn Bhd.

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