

VRL Logistics Ltd (VRL)

CRISIL IPO Grade 2/5

Details of the IPO	
CRISIL IPO Grade	CRISIL IPO Grade '2/5' . The grade indicates that the fundamentals of the issue 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's fundamentals (refer Page 2 for further details)
Shares Offered	27,000,000
As % of post issue Equity	27.6% shares outstanding (97,700,000)
Proposed IPO Amount (estimated)	VRL aims to raise approximately Rs 2 billion
Lead Managers	Edelweiss Capital Ltd

Company Background
 VRL is primarily engaged in the goods transportation and logistics services business; the company also operates a fleet of buses for passenger transport. VRL, which commenced operations as a proprietary concern in 1976, has a well-established network across the country comprising 799 owned branches and 1,387 exclusive franchisee offices, and a fleet of 2,486 trucks and 197 buses. The company recently ventured into the wind power generation and air charter businesses. The company's promoter is Mr Vijay Sankeshwar.

Grading Highlights
Business Prospects

- Large fleet size, route network and transshipment terminals leads to lower costs and improved utilisation
- In-house operational and maintenance capabilities results in lower costs and higher operational efficiency
- Investments in the country's road network is leading to faster delivery times
- Healthy growth in freight demand resulting in healthy volume growth
- Stiff competition from several large and small players restricts the ability to improve margins

Financial Performance

- Healthy revenue growth over the last 3 years on account of expansion in fleet size
- Weak financial position due to high debt levels
- The contingent liability of Rs 170 million and arrears thereon on account of service tax could get devolved

Management Capabilities

- Experienced management team for the transport business
- Well-structured operational team
- Diversifications in the past led to tight cash flows

Corporate Governance

- No competing entities of promoters in the same line of business
- Independent directors not expected to play a significant role in decision-making

Additional Information

- The proposed issue is for fresh issuance of shares

Detailed Grading Rationale

Overall Grading Summary (CRISIL IPO Grade 2/5)

To arrive at the overall grade, CRISIL has considered the following broad parameters:

- Business prospects and financial performance
- Management capability
- Corporate governance

CRISIL has assigned a CRISIL IPO Grade '2/5' (pronounced 'two on five') to the proposed initial public offer (IPO) of VRL Logistics Ltd. The grade indicates that the fundamentals of the issue 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, the graded instrument's future market price or its suitability for a particular investor.

The grading reflects VRL's large scale of operations in terms of fleet size, route network and transshipment terminals for its hub and spoke model. The company possesses strong in-house vehicle maintenance and tracking capabilities, which helps reduce costs and improve utilisation of vehicles. Further, investments in the country's road network will lead to better road connectivity and faster delivery times for road transporters, thereby improving utilisation. Also, healthy demand for freight movement is expected to support the revenue growth of VRL.

The grading factors in the intense competition from several large and small players in the transportation business. Further, the company's high debt levels are likely to adversely impact net profit margins. Also, the company, in the past, ventured into businesses which led to tight cash flow position, leading to delayed payments.

➤ **Healthy demand growth for movement of freight**

The movement of freight by road in India is expected to increase at a compounded annual growth rate of 11 per cent over the next 5 years, driven by the country's consumption boom. The buoyant growth in the retail sector and increased spending in infrastructure and real estate are expected to continue to the fuel growth of the road transport sector.

➤ **Improvement in the country's road network**

The considerable investments in the country's roads, the completion of the golden quadrilateral and establishment of the North-South-East-West corridor is likely to improve road connectivity, resulting in faster delivery times for road transporters and providing them a competitive edge over the other means of transport. It will also improve the utilisation of vehicles.

➤ **Large scale of operations with many routes, fleet and transshipment terminals**

VRL has a presence in 17 states and 7 union territories, and offers a range of services in terms of parcel cargo, full truck load, express cargo and courier services. The company has a fleet of 2,446 vehicles for parcel services, which enables it to operate on more routes, reduces dependence on hired vehicles and improves reliability. Also, a wide variety of vehicles with different tonnages helps in serving a diverse nature of consignments.

The company follows a hub and spoke model for the delivery of consignments, which ensures cost savings, rationalisation of routes and optimum utilisation of resources, including vehicles and manpower. In order to attract business, it has 799 owned branches, 1,387 exclusive franchises and 43 transshipment hubs, which enable smooth flow of cargo traffic. The large scale of operations also enables the company receive discounts on vehicle components and fuel for the diesel pumps.

➤ **In-house operational and maintenance capabilities**

The company possesses in-house competencies in body designing, vehicle repair and maintenance. The body

designing facility enables the building of structures for vehicles based on the necessary specifications, thereby maximising utilisation of space and minimising body weight. Having maintenance capability reduces costs. A dedicated research and development team works on design and re-engineering components to ensure lower operating costs enhance performance and increase the operating life of vehicles.

➤ **High degree of competition from several large and small players**

As entry barriers in the transportation business are low, VRL faces competition from several large and small players. Among the large players, there are few players with fleet sizes in excess of 2,000 vehicles. In addition there are several small regional players that are a threat on shorter distances and on dedicated routes as their cost structures could be lower. The competition in the sector continues to exert pressure on margins and any significant margin improvement will be difficult.

➤ **Weak financial position on account of high debt levels**

The company's financial position is weak on account of the steep debt levels. It is expected to have a gearing of nearly 4 times in 2007-08. Though the gearing levels will reduce post IPO, but given the company's expansion plans, interest and depreciation costs are likely to suppress profit margins, which in turn would affect return on equity and earnings per share. Further, a service tax liability of approximately Rs 170 million and arrears thereon could get devolved to the company in the event of an adverse ruling by the Supreme Court.

➤ **Management ventured into diversifications which led to a tight cash flow position**

In the past, the management ventured into the media business through VRL, which led to the company delaying payments to bankers due to the tight liquidity situation. Though the company eventually made a profit on the stake sale, it adversely impacted its financial position.

➤ **Corporate governance structure is inadequate**

Some of the independent directors do not have a comprehensive understanding of corporate governance.

Business Profile

VRL has a well-established network across the country with 799 owned branches and 1,387 exclusive franchisee offices, which undertake the transportation and distribution of goods in 17 states and 7 union territories. In addition, the company has 43 transshipment hubs, which facilitate the hub and spoke business model followed by the company. The company caters to full truck load, general cargo, express cargo and courier service in the goods transportation business. It is especially strong in the general cargo segment.

As on February 29, 2008, the company's fleet size was 2,446 vehicles for goods transportation and 40 vehicles for internal use. In addition, it had 197 vehicles for the passenger travel business. The company maintains these vehicles in-house. VRL has a research and development unit as well as a software development centre that helps in route optimisation and vehicle tracking, thereby reducing costs.

In September 2006, the company entered the wind energy business by setting up a wind farm at Kappatgudda in the Gadag district of North Karnataka. It has commissioned 34 wind turbine generators, having a power generation capacity of 42.5 MW, with the assistance of Suzlon Energy Ltd. The company has signed power-purchase agreements with Hubli Electricity Supply Company Ltd (HESCOM).

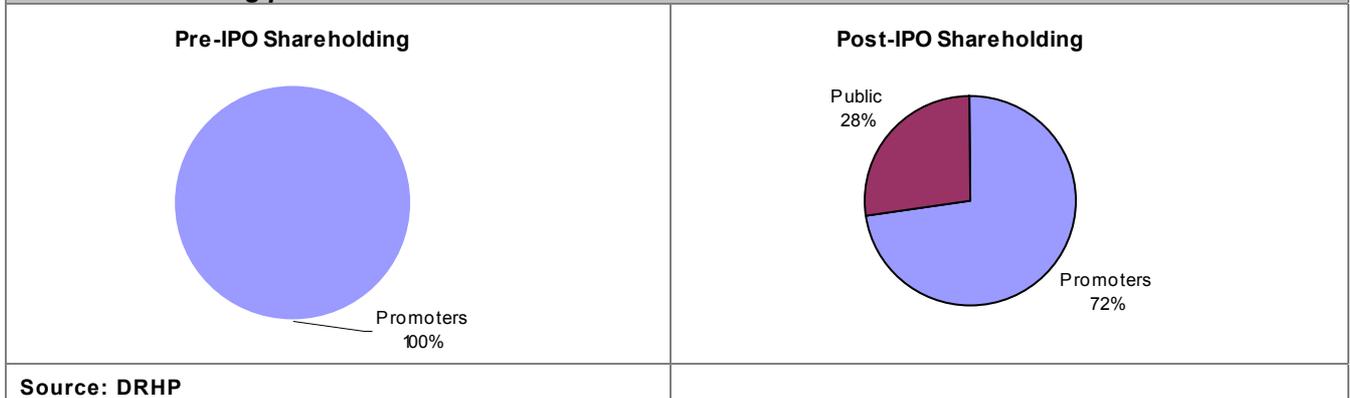
Financial Profile

In 2006-07, the company's total income and net profit were Rs 4,416.2 million (Rs 3,560.5 million) and Rs 852 million (Rs 50.6 million), respectively. Included in VRL's 2006-07 net profit is a one-time gain of Rs 1,165 million on account of the stake sale of its media subsidiary. The company's operating profit margins have been in the range of 10-13 per cent over the past 4 years. The return on equity (RoE) and return on capital employed (RoCE) for 2006-07 stood at 141.6 per cent and 39.2 per cent, respectively, due to the extraordinary income on account of the sale of the media subsidiary. However, in the preceding 3 years, the company's RoCE was in the range of 11-14 per cent. In the past 4 years, the gearing of the company was in the range 4-8 times, resulting in suppressed net profit margins. A large portion of the IPO proceeds would be used towards retiring debt.

Financial performance snapshot			
Particulars	Unit	2005-06	2006-07
Operating income	Rs million	3,560.5	4,416.2
Operating margins	Per cent	10.6	12.6
Net profits	Rs million	50.6	852.0
Net margins	Per cent	1.4	19.3
RoCE	Per cent	10.7	39.2
Return on equity	Per cent	22	141.6
No. of equity shares	Million	20	70.0
Net worth	Rs million	254.6	948.5
Basic earnings per share	Rs	2.5	12.2
Diluted earnings per share	Rs	2.5	12.2
Book value	Rs per share	12.7	13.6
Gearing	Times	7.2	4.1

Note: The above figures have been reclassified as per CRISIL standards; DRHP 2006-07 financials include the extraordinary income on account of sale of stake in the media business,

VRL: Shareholding pattern



Profile of Management and Board

Mr Vijay Sankeshwar, who is VRL’s chairman and managing director, oversees the overall operations. He has over 30 years of experience in the transport business. Mr Anand Sankeshwar is involved with the company’s marketing and network expansion activities, and has over 10 years experience in the transport business. VRL has an experienced management team, with the key personnel having over 10 years of experience with the company.

VRL’s board comprises eight directors, including two promoter-directors, one executive director and five independent directors. Three independent directors joined the board in 2007.

Annexure: Profile of the Directors						
Name of Directors	Designation	Age (years)	Qualification	Background	Date of joining the board	Other Directorships
Mr. Vijay Sankeshwar	Chairman & Managing Director	56	B.Com	Has more than 30 years of experience in the transport business and 7 years in the media business. A three time former MP from Karnataka	Since inception	1.VRL Securities Ltd, 2. VRL Media Ltd, 3. VRL Cements Ltd
Mr. Anand Sankeshwar	Managing Director	32	B.Com	Has more than 10 years of experience in the transport business and 7 years in the media business.	Since inception	1.VRL Securities Ltd, 2. VRL Media Ltd, 3. VRL Cements Ltd 4.Vijayanand Printers Ltd
Mr. R.P. Raichur	Executive Director	51	B Com, CA, CS	25 years of experience in the finance. Earlier working with JSW Steel	June 15, 2005	Nil
Mr. Sudhir Ghate	Independent Director	49	B.Com, CA	Has entrepreneurial experience in advertising	June 15, 2006	1. Magnum Intergrafiks Ltd, 2. Trichur Heart Hospital Ltd
Mr. C Karunakara Shetty	Independent Director	53	CAIIB	Over 20 years of experience in the banking industry. Managing Director of Bhagwati Chits Ltd	June 15, 2007	1. Bhagwati Chits Pvt Ltd 2. Bhagvati Stocks & Shares Pvt Ltd 3. VRL Securities Ltd 4. Davy Elektro Controls Pvt Ltd
Mr. Mallesh Budihal	Independent Director	57	M.A.	30 years of experience in paper industry	February 24, 2007	1. Girish Paper Packaging Pvt Ltd
Mr. R.S. Hugar	Independent Director	67	PG (Econometrics)	Ex- CMD of Corporation Bank and Global Trust Bank	May 28, 2007	1. IPCA Laboratories Ltd 2. Dewan Housing and Finance Corp. Ltd 3. DHFL Vysya Housing Finance Corp Ltd
Mr. Suresh Angadi	Independent Director	52	B. Com, LLb	Has experience in the cement and real estate business. Is a member of parliament	July 28, 2007	1. Shri Vijaylaxmi Real Estate Pvt Ltd

Source: Company prospectus

Disclaimer

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