

Virgo Engineers Ltd. (VEL)**CRISIL IPO Grade 4.0/5.0**

| Details of the IPO | |
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| CRISIL IPO Grading | IPO Grade '4/5'. The grade indicates that the fundamentals of the issue are above 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. (refer Page 2 for further details) |
| Shares Offered to Public | 2,430,000 |
| As % of post issue Equity | 10.34 % of the shares outstanding (23,508,044) |
| Proposed IPO Amount (estimated) | VEL aims to raise Rs. 1.8 billion to Rs. 1.9 billion |
| Lead Managers | Enam Securities Private Limited |

| Company Background |
|--|
| Virgo Engineers Ltd (VEL) is one of the leading manufacturers of manual and automated ball valves in India. These are flow control valves used to regulate the volume or pressure of a fluid (liquid or gas) largely catering to the oil and gas, infrastructure and certain process industries. The company manufactures ball valves upto 56" (2" to 24" in India and 24" to 56" in Europe). The company also manufactures gate valves, check valves and butterfly valves on a smaller scale. VEL has manufacturing units in Hinjewadi (Ball valves), Chinchwad (Butterfly valves), Bhosari (gate valves and check valves) and Europe (Large size Ball valves). |
| Grading Highlights |
| Business Prospects |
| <ul style="list-style-type: none"> ➤ VEL is on the Approved Manufacturer's List (AML) of a few large oil and gas players and into the preferred supplier list of a few large global turnkey service providers. ➤ The company has benefited by being a low cost supplier to the global clients due to lower overheads and efficient raw material sourcing. However, competition is likely to intensify in the long run ➤ Almost 90 per cent of the revenues come from the sale of ball valves exposing it to any downturn in the investments in the oil and gas sector |
| Financial Performance |
| <ul style="list-style-type: none"> ➤ Revenues have grown at robust pace in the past 4 years. Further, VEL is expected to benefit from the strong demand scenario expected to be seen in the exploration activity over the next 3-5 years. ➤ The expected increase in competition is likely to partly impact margins. ➤ The geographic diversification is expected to partly offset the impact of rupee depreciation. |
| Management Capabilities |
| <ul style="list-style-type: none"> ➤ The promoters have capitalized on growth opportunities in the past. Their decision to backward integrate and thereafter expand outside India has translated into significant business growth in the past. ➤ The ability to expand senior management bandwidth and to find suitable and timely replacement for its stock and sale business in the USA will be critical in sustaining the momentum of business growth. |
| Corporate Governance |
| <ul style="list-style-type: none"> ➤ The Board has ten directors, of which five are independent ➤ VEL has a sound corporate governance structure. The directors of the company have shown ability and willingness to exercise management oversight. |

Detailed Grading Rationale

Overall Grading Summary (IPO Grade 4/5)

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 '4/5' (pronounced 'four on five') to the proposed Initial Public Offer of Virgo Engineers Ltd. (VEL). This grade indicates that the fundamentals of the issue are above 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 VEL's favorable business prospects arising from the strong demand scenario expected in the exploration activity over the next 3-5 years. VEL is among the top 35 valve players in the world and the largest ball valve manufacturer in India. The grading takes into cognizance the high level of customer stickiness in the past (over 90% of revenue comes from repeat business) and the cost competitive advantage on account of low overhead cost and efficiencies in raw material sourcing. Given its cost competitive strengths, it is well poised to benefit from the large investments planned by the oil majors in the Middle East, especially since it is on the Approved Manufacturers List (AML) of 3 out of the top 10 global oil players. However, competition is expected to intensify further over the next 3-5 years, which is likely to impact its margins in the long run.

The grading factors in the business acumen of the promoters who have successfully captured opportunities and translated them in terms of strong growth for the company. The grading also takes into account VEL's sound corporate governance structure.

The grading is however moderated by the risk attached to high level of product concentration exposing it to any downturn in the investments in the oil and gas sector. We believe that the company's ability to find suitable replacement and to expand senior management bandwidth to meet future demand will be critical in sustaining business growth over the next 5 years.

➤ Favorable relationship with key clients

VEL's repeat business accounted for over 90 per cent of sales in 2006-07. The company has several strategic alliances with its sales partners across countries and is on the AML of a few large oil and gas players and into the preferred supplier list of a few large global turnkey service providers. Typically, it takes 4-5 years for a company to receive approval from large players. VEL is on the Approved Manufacturer's List (AML) of 3 out of the top 10 large global players such as Chevron, Shell and Saudi Aramco. The other global oil majors who have approved VEL include Petrobras (Brazil), Abudhabi Gas Industries (GASCO), Kuwait Oil and Qatar Gas.

Although being on the AML does not ensure sales, it raises the future business prospects by being one of the preferred suppliers. The approvals by Shell and Chevron have been recent and the impact of the same is expected to be seen in the years to come.

➤ Cost competitiveness to benefit VEL, but competition to intensify in the long run

The company has benefited by being a low cost supplier to the global clients on account of lower overheads and efficient sourcing of casting from vendors. The company enjoyed about 25 per cent margins in the past 3 years due to favorable global demand scenario and due to the cost arbitrage advantage enjoyed by VEL. Going forward competition is expected to increase from low cost Chinese players and the expected increase in the number of global valve players entering India. This is likely

to marginally impact VEL's margins in the long run.

➤ **Promoters have capitalized on growth opportunities in the past**

The promoters' decision to backward integrate and thereafter expand beyond the Indian valves market has translated into significant business growth in the past. Further, the strategy to establish presence in a relatively tough to penetrate - US valve market has provided VEL a competitive edge vis-à-vis other valve players who have been relatively unsuccessful so far.

➤ **Geographic diversification to partly offset impact of rupee depreciation**

VEL has gradually transitioned from a local player to a global player and sales in US account for about 40 per cent of its total turnover. However, the currency risk is partly offset as the company bills its European clients and some of its Middle East clients in Euro.

➤ **High product concentration, a concern**

Over 90 per cent of the company's turnover comes from ball valves leading to risk of dependence on a single product. In addition, the company has increased focus on project based sales which are inherently more volatile. Although the company plans to increase offerings to other segments such as power, mining, etc. we do not expect a significant shift in product mix over the next 3-4 years. Hence, its fortunes will be largely dependent on the prospects of the oil and gas industry.

➤ **Ability to expand senior management bandwidth will be critical**

VEL has witnessed substantial growth in the past 4 years resulting in tightness in management bandwidth. As we expect the business to continue its strong growth momentum, we believe that the company's ability to expand senior management bandwidth to meet the potential demand will be critical in sustaining business growth in future.

➤ **Important to find suitable & timely replacement for the key personnel manning the stock & sale business in the USA**

Vintrol Inc., USA is a 100% subsidiary of VEL, primarily into stock & sale of commodity type ball valves and headed by Mr. Bill Neimann. Mr. Neimann has experience of over 20 years in the valves market and has developed relationships with several clients in the US valves industry. However, as Mr. Neimann is 65 years old, it is imperative that a suitable replacement be identified soon. The company's ability to find suitable replacement with the same caliber will be critical to de-risk future growth in the stock and sale business in the USA.

➤ **Sound corporate governance structure**

The directors of the company have shown ability and willingness to exercise management oversight. The independent directors also bring in professional expertise from their respective fields, which help the company in the decision-making process. The Board of Directors is involved in the functioning of the company and critical business decisions are discussed and debated by the Board.

Business Profile

Virgo Engineers Ltd (VEL) was incorporated as Virgo Engineers Private Limited in June 1987 and was changed to a public limited company in February 1995. Till 1989, the company was in the business of trading in control flow products. In 1990, the company set up its first manufacturing facility for design and manufacture of automation systems in Pune, Maharashtra. It also started distributing actuators and accessories for Mecair, Italy. Thereafter, it backward integrated and started manufacturing ball valves, butterfly valves, gate valves and check valves in Pune, Maharashtra. In late 2006, VEL set up a manufacturing plant at Pogliano, Italy to manufacture large diameter ball valves for global distribution.

Valves are used to regulate the volume or pressure of a fluid (liquid or gas) largely catering to the oil and gas, infrastructure and certain process industries. The company manufactures ball valves upto 56" (2" to 24" in India and 24" to 56" in Europe). Ball valves contribute to over 90 per cent of the company's sales. VEL has a small presence in the butterfly valves and gate and check valves segment. VEL has manufacturing units in Hinjewadi (Ball valves), Chinchwad (Butterfly valves), Bhosari (gate valves and check valves) and Europe (Large size Ball valves).

The company manufactures valves either directly or through its 7 subsidiaries. Out of the 7 subsidiaries, 4 are manufacturing companies which sell their products to the other 3 subsidiaries (trading and marketing companies) which focus on sales to the US, Europe, Middle East and Far East.

VEL is one of the leading manufacturers of manual and automated ball valves in India and is one of the top 35 valve players in the world. The global valves market is a highly fragmented market characterized by stiff competition. From a predominantly domestic player, VEL has gradually spread across US, Europe, Middle East and India. US accounts for nearly 40 per cent of the VEL's sales. India accounts for around 20 per cent, while Europe and Middle East accounted for 22 per cent and 15 per cent respectively.

Almost 82 per cent of the company's products cater to the oil and gas industry. Of the total sales, about 62 per cent of the company's turnover in 2006-07 was from project sales (customized valves) while the rest came through stock and sale (distribution of standard valves). Typically, the oil and gas sector is the largest consumer of valves (18 per cent of total). The other key industries include Refining, Power, chemicals, etc. In terms of products, the ball valves, gate and globe valves, butterfly valves and plug valves account for over 22 per cent, 17.5 per cent, 10.3 per cent and 8.7 per cent of the global valves sales respectively.

VEL plans to expand capacity by constructing a manufacturing plant at Coimbatore. The plant is expected to be complete phase I (10,000 sq.ft.) in the next 2 months and phase II is expected to be completed during Jan-Mar 2009. The company plans to shift the production of standard valves to Coimbatore and expand the production of customized valves in the existing plants in Pune. The Coimbatore plant will also have a foundry, to meet some portion of the raw material requirements. Apart from Coimbatore, the company plans to set up additional manufacturing capacity at an SEZ in Chennai and rent premises for manufacturing in Europe.

The company plans to expand its product portfolio by producing products like metal seated ball valves and triple eccentric butterfly valves. These products will help the company in creating presence in industries (other than oil & gas and infrastructure) such as power, mining and paper. VEL also plans to expand its ball valve product range to include fully-welded ball valves and extend its high pressure ball valves as well as cryogenic ball valve range. These are difficult to manufacture valves performing critical functions in the oil & gas and LNG project plants.

The company also plans to grow inorganically through acquisition of players manufacturing specialty ball valve and other equipment in upstream applications in oil exploration.

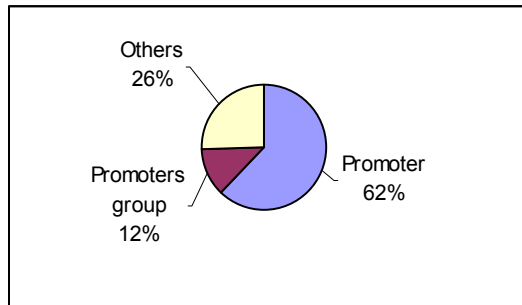
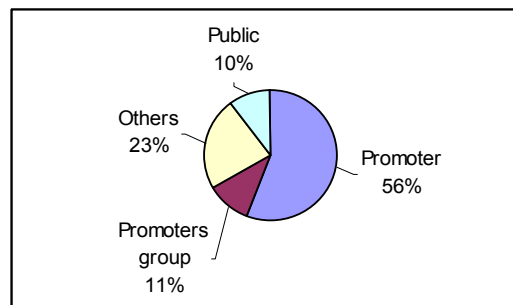
Financial Profile

VEL's revenues grew at a compounded rate of 71 per cent between 2004-05 and 2006-07. This was largely driven by the increasing business from the US and the Middle East. In the past few years, the company has managed to successfully include many global oil and gas players in their list of key clientele. The overseas business has also helped the company in achieving higher profit margins. In 2006-07, the company reported a net profit of Rs 453 million on a turnover of Rs 3,101 million. The company's return on capital employed (RoCE) and return on equity (RoE) was 58.4 per cent and 61.8 per cent, respectively, in 2006-07.

VEL: Past financial performance

| Particulars | unit | 2005-06 | 2006-07 |
|----------------------------|--------------|---------|---------|
| Operating income | Rs Million | 1,637.7 | 3,101.1 |
| Operating margins | Per cent | 25.2 | 25.2 |
| Net profits | Rs Million | 296.8 | 453.1 |
| Net margins | Per cent | 18.1 | 14.6 |
| ROCE | Per cent | 65.4 | 58.4 |
| Return on Equity | Per cent | 107.1 | 61.8 |
| No. of equity shares | Million | 10.0 | 10.5 |
| Net worth | Rs Million | 422.8 | 1,044.2 |
| Basic Earnings per share | Rs | 29.8 | 43.0 |
| Diluted Earnings per share | Rs | 29.8 | 43.0 |
| Book value | Rs per share | 42.4 | 99.1 |
| Gearing | Times | 0.7 | 0.5 |

Note: The above figures have been reclassified as per CRISIL standards

VEL: Shareholding Pattern
Pre IPO

Post IPO


Source: DRHP

Profile of Management and Board

VEL's business direction and vision is governed by its promoter, Mr. Mahesh Desai, who, in turn, is supported by his brother Mr. Jagdish Desai and other senior personnel such as Mr. Silvano Calciolari, Mr. Billy Neimann, Mr. V.R. Jayaraman and Mr. Paresh Rajda. In addition, the company has a well developed second line of management who have been with the company for over 8 years.

VEL's board comprises ten directors, which include two promoters, two non-executive directors, one nominee director (Tano Mauritius) and five independent directors. Mr. Kulkarni who is a distant relative of Mr. Desai joined VEL's board from 1995 while he had been associated with the company since 1989. The other 4 independent directors – Mr. Venkiteswaran, Mr. Abhay Nalawade, Mr. Manu Parpia and Dr. Kelkar – joined the Board in October 2007, and have since then been fairly involved in decisions taken by the company.

Annexure No1: Profile of the Directors

| Name of Directors | Designation | Age | Date of Joining | Qualification | Experience (years) | Other Directorships | Previous Employment |
|------------------------|---|-----|---|---|--------------------|--|--|
| Mr. Mahesh Desai | Chairman | 51 | Since Inception | B.E(Mechanical) and Diploma- Systems Management, Mumbai University; Advanced Management program, Wharton, Philadelphia | 27 | Virgo Control Systems Private, Virgo Valves and Controls Limited, Vintrol India Limited, Stafford Controls Limited, Virgo Engineers Inc., Vintrol Inc., Virgo Europe S.p.a. | Sales Mgr-L&T, Piping design engineer-Tata Consulting |
| Mr. V. Balasubramanian | Whole time Executive Director | 62 | Since Inception | Mechanical Engineering, Diploma in Management from Bombay University | 38 | Virgo Control Systems Private, Virgo Valves and Controls Ltd, Vintrol India Ltd, Stafford Controls Ltd, Virgo Engineers Inc., Virgo Valves and Controls (UK) Ltd. | Reg. Sales Mgr - L&T for Mumbai, Chennai & Singapore regions. |
| Mr. Jagdish Desai | Non Executive Director | 48 | Joined in 1991 and on board in September 2005 | Electrical engineering from Visveswaraya Regional College of Engineering, Post graduate diploma in computer management from JBIMS, Executive education in business management from University of Michigan | 27 | Virgo Control Systems Private, Virgo Valves and Controls Limited, Vintrol India Limited, Stafford Controls Limited, Virgo Engineers Inc., Vintrol Inc. | Sales electrical equipments - Crompton Greaves, Regional manager - International Data Management |
| Mr. Rajaram Ajgaonkar | Non Executive Director | 49 | On board since 1995, has been advising the company since 1989 | B.Com - Poddar College, Mumbai; Chartered Accountant; Studied law from Government Law College, Mumbai. | 29 | Partner - R.M. Ajgaonkar & Associates, Ajgaonkar Deshmukh & Associates; Proprietorship: R.M. Ajgaonkar & Co. affiliated with J.H.I. an international association accountants. | Practising Chartered Accountant, member of international executive committee of the J.H.I. association Chairman, Asia Pacific region |
| Mr. Kishore Kulkarni | Independent Director | 53 | on Board since Oct, 2006; associated with company since 1995 | Mechanical engineer- IIT, Delhi; MBA (marketing and finance) - JBIMS. | >20 | Virgo Valves and Controls, Krupa Enterprises | Volta, ICICI Ltd (20yrs), currently has own investment advisory business. |
| Mr. Hetal Gandhi | Nominee Director, Tano Mauritius India FVCI | 42 | Oct-06 | Chartered Accountant | 16 | Tano India Advisors Private, Chalet Hotels Limited, Ravin Cables Limited, Spice Telecommunications, Bombay Swadeshi Stores Ltd. | Co-founder & MD - Tano India Advisors who are advisors to Tano Mauritius India FVCI |
| Mr. N. Venkiteswaran | Independent Director | 57 | Oct-07 | Economic graduate, Chartered Accountant, Gold medalist - part I - Postgraduate in Management Accountancy- ICAI. | 35 | BPCL, Gujarat State Electricity Corporation Ltd, Gujarat State Petronet Ltd, Dalton Capital Advisors India Private Limited, Asit C. Mehta Investment Intermediates Ltd. | Professor-IIM-Ahmedabad since 1988, Member - Central Direct Tax advisory committee, Ministry of Finance, GOI |
| Dr. Dhananjay Kelkar | Independent Director | 46 | Oct-07 | MBBS- B.J. Medical college, Pune; Master of Surgery - Sassoon General Hospital, Pune | 22 | Kelkar Agro Products Private limited, Kelkar Hotels Private Limited, Trusts: Jnana Prabodhini Medical Trust (Non profit), Deenanath Mangeshkar Hospital and Research Center, Trustee for Adishakti School for Adivasi (Tribal) Children | Founder: Jnana Prabodhini Medical Trust (Non profit), Deenanath Mangeshkar Hospital and Research Center, Shirwal - Kamala Mehta Eye Hospital, Niramay Hospital Dabhol and nursing school |
| Mr. Abhay Nalawade | Independent Director | 58 | Oct-07 | BSc-Physics, Mumbai; MBA - Marketing, Pune University, Senior management training from Harvard Business School, USA. | >25 | EcoAxis Systems Private Limited, Chiron Lasting Solutions Private Limited, Suryaprasanna Speciality Hospitals Private Limited | Thermax (25 yrs, was a MD and later CEO, Thermax), presently MD-EcoAxis Systems Pvt Ltd (JV with A.T.F enterprise) |
| Mr. Manu Parpia | Independent Director | 57 | Oct-07 | Chemical engineer, McGill University, Canada; MBA-Harvard Business School | >30yrs | Geometric Limited, 3D PLM Software Solutions Limited, Inventurus Knowledge Solutions Private Limited, Transafe Services Limited, Citixsys Technologies Private Limited, Geometric Americas Inc., USA, Geometric Technologies Inc., USA, Geometric Engineering Inc., USA, Geometric Asia Pacific Private Limited, Singapore | Setup Electronic Business Equipment division for Godrej; CEO-Geometric. |



(One time assessment)

Rationale for VEL - IPO Grading

Disclaimer

A CRISIL IPO grading is a one-time assessment and reflects CRISIL's current opinion on the fundamentals of the graded equity issue in relation to other listed equity securities in India. A CRISIL IPO grading is neither an audit of the issuer by CRISIL nor is it a credit rating. Every CRISIL IPO grading is based on the information provided by the issuer or obtained by CRISIL from sources it considers reliable. CRISIL does not guarantee the completeness or accuracy of the information on which the grading is based. A CRISIL IPO grading is not a recommendation to buy / sell or hold the graded instrument; it does not comment on the issue price, future market price or suitability for a particular investor.

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