

Automark Industries (India) Limited

CRISIL IPO Grade 2/5 (Below Average)

December 22, 2011

Grading summary

CRISIL Research has assigned a CRISIL IPO grade of '2/5' (pronounced "two on five") to the proposed IPO of Automark Industries (India) Ltd (Automark). This grade indicates that the fundamentals of the IPO are below average 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 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 has considered the company's business prospects, its financial performance, management capabilities and corporate governance practices.

The assigned grade takes into account Automark's leading position in the organised segment of the road marking industry. Automark is present across the value chain in the road marking industry – it not only manufactures and sells thermoplastic material and road marking machineries but also takes on road marking contracts. The company has an in-house R&D facility to ensure manufacturing of superior quality homogeneous products and adherence to specifications mentioned by National Highway Authority of India (NHAI) and the Ministry of Road Transport and Highway. Automark has successfully executed more than 4 mn sq. mt. of road marking, including more than 50 projects for NHAI. The grade also factors in increased government thrust to improve road infrastructure in the country, which will provide large opportunities for established road marking players like Automark. Further, the management's more than 40 years of industry expertise supports the grade.

The grade is constrained by low entry barriers given the absence of any major technology or capital investment requirement in the industry. As a result, the industry is dominated by unorganised players who constitute ~60-70% of the industry; the sizeable presence of unorganised players leads to pricing pressure. The grade is constrained by Automark's high working capital requirement due to high debtor and inventory days, which necessitates continuous raising of funds. The company also plans to set up a material manufacturing unit in Kenya and Uganda, which could be a challenge since it does not possess relevant experience in the overseas market. The grade is further constrained by the company's significant dependence on the top management as most of the key managerial people as well as independent directors have been inducted recently.

During FY11, the company reported turnover of Rs 677 mn and net profit of Rs 20 mn, which translated into a net margin of 3.0%. Its revenues registered a CAGR of 50.5% during FY07-11. RoE and RoCE were 16.9% and 19.6% during the same period. It posted an EPS of Rs 1.7 at the end of FY11, while its book value per share was Rs 15.6.

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About the company

Automark Industries India Limited is a Nagpur (Maharashtra)-based company operating in the niche segment of road marking. Automark manufactures and markets thermoplastic road marking materials and machines. Automark also undertakes contracts for road marking work from road contractors and developers. Automark's client base includes established companies like L&T, Reliance Infrastructure, IVRCL, Gammon India, and IRB Infrastructure. Some of its well-known road marking contracts are the Bandra Worli Sea Link and the Formula 1 Race Track in Noida (for the Jaypee Group). The company has also been awarded the contract for the Yamuna Expressway project being developed by the Jaypee Group.

The company markets its products under the brand name 'Automark'. It has a pan-India network of sales representatives (channel partners) operating through nine cities. To tap overseas demand, Automark has an MOU with a UK-based channel partner, Mr Geoff Miller (he has over 30 years of experience in the international road marking industry). The company also has an arrangement with Kenya-based Beltpro (K) Ltd for distributing and marketing products in Kenya and Uganda. To expand its overseas reach, Automark plans to set up a manufacturing unit in Kenya and Uganda. These two countries are part of the 19-member Common Market for Eastern and Southern Africa (COMESA), a free trade zone stretching from Libya to Zimbabwe.

Financial Summary (Standalone)

(Rs mn)	FY07	FY08	FY09	FY10	FY11*
Sales	132.0	240.5	422.8	580.6	677.4
PBT	2.7	5.4	10.3	19.7	37.4
PAT	1.6	3.4	6.7	12.6	20.5
PAT margin	1.2%	1.4%	1.6%	2.2%	3.0%

* Consolidated numbers as the company merged associate company with itself

Source: Company, CRISIL Research

Issue details

No. of shares being offered (shares in mn)	12.5
Fresh Issue (in mn)	12.5
Targeted issue size (Rs mn)	680.3 (as per company estimates)
Face value per share	Rs 10
Proposed price per share	Not available at the time of grading
Lead managers	Comfort Securities Limited
Registrar to the issue	Sharepro Services (India) Private Limited
Legal Advisors to the Issue	Mr Sunil Shukla

Detailed Grading Rationale

A. Business Prospects

- *Leading player in the organised segment of the road marking industry*

Automark is a leading player in the organised segment of the Indian road marking industry - an industry which is otherwise highly fragmented and dominated by unorganised players. The company has marked ~8 lakh square meter (sq. mt.) of roads till November 2011. It has an installed capacity of 20,000 MTPA for manufacturing thermoplastic materials in Nagpur. It supplies thermoplastic material and machinery to small road-marking players. The company plans to spend ~Rs 182 mn to buy fully automated machines for road marking which would increase its road marking capacity to 20 lakh sq. mt.

- *Diversifying its product offerings and services*

Besides manufacturing thermoplastic material, the company is also expanding its business to other segments. It has started manufacturing marking material (cold plastic paints) which has more resistance and longevity, and is used to mark industrial plants, airports, ports and cargo. Apart from road-based projects, the company recently did demo marking for Delhi International Airport (DIAL) and Mumbai International Airport (MIAL). It is also in advanced stages of negotiation with many large and private players for marking contracts in industrial plants. The company plans to spend ~Rs 4.7 mn to expand production capacity for manufacturing cold paints.

- *End-to-end solution provider for road marking contracts; has executed marquee projects*

Automark is an end-to-end solution provider for road making contracts and jobs given that it has an in-house set-up for manufacturing materials as well as machineries. The company has an in-house manufacturing unit to manufacture semi-automated machines required in the road marking process. The company also has an in-house R&D facility to ensure homogeneity of products, which also enables it to produce road-marking products as per specifications mentioned by NHAI and the Ministry of Road Transport and Highway (MoRTH).

The company has executed road marking for projects such as Bandra Worli Sea Link and Formula 1 Race Track in Noida for the Jaypee Group. The company has also been awarded the contract for the Yamuna Expressway project being developed by the Jaypee Group.

- *Widespread marketing and distribution network...*

Automark has two separate divisions for marketing – one for road marking material and machineries, and the other for road marking contracting services. For the materials and machineries, to handle domestic product sales, the company has a network of channel partners located across nine Indian cities, mainly in the western and central regions. These channel partners have relationships with various small local road contractors in their region and supply materials to these small contractors based on requirement. The company conducts seminars on a regular basis to keep channel partners informed about recent developments in the road marking industry and products. Automark organises annual conferences (named Autocon) with channel partners and dealers to discuss the industry dynamics, business status and future plans. This helps in strengthening relationship with clients.

To tap the overseas market, the company has signed an MOU with a UK-based channel partner Mr Geoff Miller (he has over 30 years of experience in the international road marking industry). Also, Automark has entered into an arrangement with a Kenya-based Beltpro (K) Ltd for distributing and marketing road marking material in Kenya and Uganda.

For marketing of contracting services, the company has a dedicated team headed by a project manager who keeps track of new orders being awarded and follows up with the road developers for the procurement of marking contracts.

- *... and a strong client base*

In the contracting space, the company executes projects for various large road developers like L&T, Reliance Infrastructure, IVRCL, Gammon India and IRB Infrastructure. Given the integrated business model, the company is able to complete its work on a timely manner, which helps it to bag repeated orders from clients and maintain a strong relationship.

Table 1: Client list for road marking contract

Company
L&T (ECC) Ltd
HCC Ltd
IVRCL Ltd
IRB Infrastructure
Lanco Infratech
GMR Infrastructure Ltd
Sadbhav Engineering
Maytas Infra
Simplex Infrastructure
KNR Construction
Oriental Infrastructure
Gayatri projects
PBA Infrastructure
Punj Llyod

Source: Company

- *Road marking industry in India is well poised to grow driven by increasing government thrust to improve road infrastructure*

The government's increased thrust to improve road infrastructure in the country has also opened up opportunities for the road marking players. According to MoRTH, India has ~33 lakh km of road network, of which 2 lakh km comprise national and state highways which carry more than 40% of the country's total traffic. Given the heavy usage of these roads, markings on these roads do not last long. In order to maintain road safety norms, a contractor has to frequently re-mark these roads, resulting in continuous work for a road marking player.

NHAI plans to award road projects covering 21,841 km over the next five years. This will further enhance growth prospects for road marking players as road-building contractors do not get the commercial operation date (COD) till roads are completed with all road safety norms in place, which includes road markings as prescribed by MoRTH. NHAI also has plans to award large road contracts for operation and maintenance, which would also enhance demand for road marking products and services.

Table 2: Status of NHDP as on July 31, 2011

Km	GQ	NS – EW Ph. I & II	Phase III	Phase V	Phase VI	Phase VII	SARDP NE	Phase IV	Total
Total length	5,846	7,300	12,109	6,500	1,000	700	388	14,799	50,024
Already 4-laned	5,828	5,831	2,617	655	-	-	-	-	16,207
Under									
Implementation	17	891	6,112	2,538	-	41	112	11,343	11,818
Balance for award	-	420	3,380	3,307	1,000	659	276	21,821	21,841

Source: NHAI

- **Expanding footprint to overseas developing nations of COMESA**

Leveraging its vast experience in the domestic road marking industry, the company plans to enter international markets, especially in the COMESA region. It plans to spend ~Rs 57.6 mn to set up a thermoplastic material manufacturing capacity in Kenya and Uganda where infrastructure investment is increasing.

- **Low entry barrier; tough competition from unorganised players**

Road marking industry has low entry barriers as there is no major technology or capital investment required to start the business. As a result, ~60-70% of the industry is in the hands of the unorganised players. Although Automark is a large player in the organised road marking space, the presence of a large number of unorganised players leads to pricing pressure. Though the product quality of the organised players is better and they enjoy a slight premium, they have limited flexibility to increase their realisations due to intense competition from unorganised players.

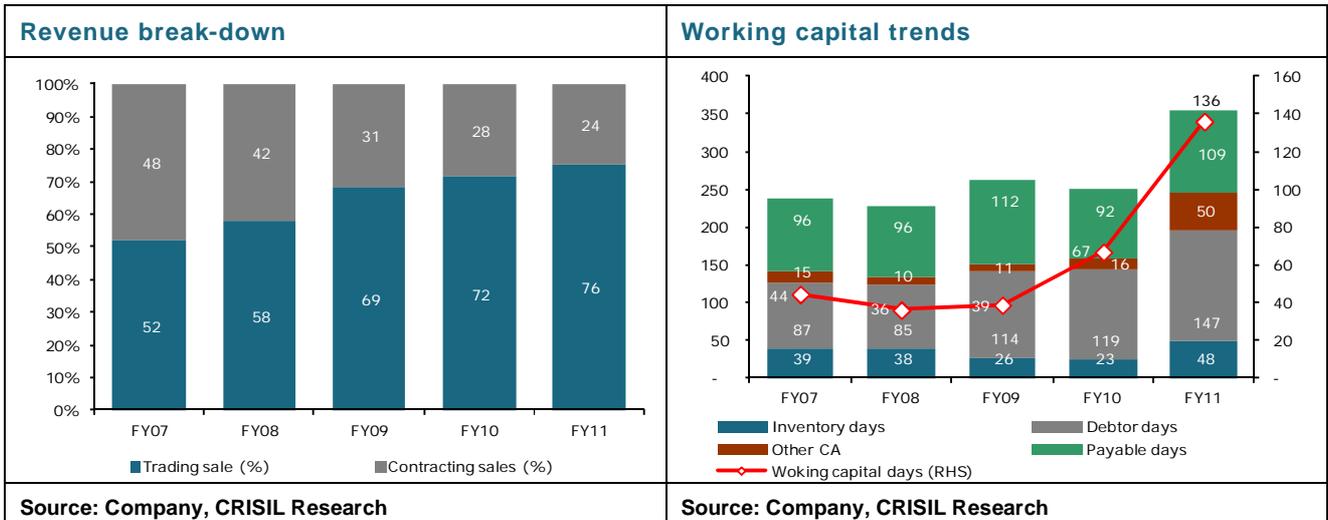
- **No long-term contract for raw material procurement; price fluctuation leads to risk of margin volatility**

Resin, titanium di-oxide and wax are the raw materials required to manufacture thermoplastic road marking materials. The company imports its entire resin (~50% of raw material pie) requirement from China and the US; part of the glass bead requirement is imported from Australia.

However, the company does not have any long-term contract with the suppliers, which exposes the company to the risk of fluctuation in prices. Also, as some of the raw materials, like resin and glass beads, are imported, there is a foreign exchange risk in case the domestic currency depreciates.

- **High working capital requirement**

The company largely consumes the thermoplastic material it manufactures during its own road marking contracts and the balance is sold to small road marking contractors through channel partners. Trading of material comprises ~75% of the company's total revenue. Trading business offers EBITDA margin of 6-7% and materials are supplied on a credit of 80-90 days. Also, the majority of its contracting business clients are private road developers whose payment terms include credit for 90-100 days. Accordingly, this leads to high debtor days resulting in high working capital requirement. This shrinks the company's earnings due to higher interest cost. As of FY11, the company has debtors worth Rs 274 mn (193 days), which has increased debt to Rs 130 mn in FY11 from Rs 78 mn in FY10.



- *High dependence on road infrastructure spending*

Demand for Automark’s product is dependent on the pace of infrastructure development in the country and the government’s approach towards the same. Any slowdown in government spending or any execution hurdle delaying implementation of road projects will adversely impact the company’s growth prospects.

- *Lack of experience in overseas markets is a challenge*

Automark engages in material trading business overseas which is a small portion of its total revenue. The company now plans to set up a material manufacturing unit in Kenya and Uganda. We believe this could be a challenge as the company does not possess any experience of manufacturing and contracting in the overseas market. Lack of understanding and knowledge of operations in these markets could expose the company to unforeseen risks.

B. Financial Performance

Automark's consolidated revenues for FY11 grew by 16.7% to Rs 677 mn compared to Rs 581 mn in FY10. This was mainly driven by higher contribution from the material trading business. EBITDA margin increased by ~200 bps y-o-y to 6.8% in FY11 due to increased contribution from the overseas business and the usage of fully automated machineries in material manufacturing and also in servicing the contracting business. Margins in the international business are ~200-300 bps higher than that in the domestic market. Accordingly, PAT margin was 3.6% in FY11 compared to 2.2% in the previous year.

Financial performance snapshot

	Unit	FY10	FY11*
Sales	Rs mn	581	677
EBITDA	Rs mn	27	46
EBITDA margin	%	4.6	6.8
Net profit	Rs mn	13	20
Net margin	%	2.2	3.0
RoE	%	31.7	16.9
RoCE	%	25.8	19.6
Basic EPS	Rs	5.0	1.7
No. of equity shares	mn	2.5	12.3
Net worth	Rs mn	51	191
Book value (FV Rs 10)	Rs	20.3	15.6
Current ratio	Times	1.7	2.4

Note: Numbers have been reclassified as per CRISIL standards

Source: DRHP, Company, * consolidated

C. Management Capabilities and Corporate Governance

- *Experienced management*

Mr Arun Khara is the founder chairman and promoter of the company. He holds a Bachelor of Commerce degree and has been in the business of road marking for the past four decades. Under his leadership, Automark has made significant progress in the road marking industry which is otherwise dominated by unorganised players.

He is supported by his two sons, Mr Mayur Khara and Mr Amit Khara. Mr Mayur Khara has a Bachelor of Engineering (with specialisation in electronics and telecommunication) degree from Pune University and takes care of business planning and strategy. He has over 20 years of experience in the road marking industry. Mr Amit Khara is a management graduate from Pune University and has more than 10 years of experience in the road marking industry. He oversees business development and the company's contracting business.

- *Second line of management needs to be strengthened*

The second line of management is relatively new. CEO Mr Neville Thompson is a management graduate (marketing) and has been with the company for a year. Mr Thompson does not have any experience in road marking or related industry; he was working with the food industry prior to Automark. We believe bandwidth of Automark's top management is stretched - currently, the entire business is run by Mr Mayur Khara and Mr Amit Khara, who are from the promoter group company - and the second line would require strengthening considering the company's plans for expansion.

- *Independent directors are well qualified but lack experience*

Although two of the three independent directors are well qualified but they have limited understanding of the business as they were inducted recently.

Annexure I

Business Profile

Automark Industries Ltd manufactures and supplies road marking material in India and abroad through its wholly owned subsidiary company Automark Technology (India) Private Ltd (ATL). The company undertakes contracting work from road developers for road marking on national highways and other road projects. Automark also manufactures machinery which is used for road marking.

Details of various business verticals of Automark:

Road marking material – The road marking material manufacturing facility is located in Nagpur (Maharashtra). The company’s total installed capacity for road marking material is 20,000 MTPA. ATL produced 14,572 MT (73% of installed capacity) of thermoplastic material in FY11. ATL also manufactures waterborne paints for roads, highways, runways and kerbs (for concrete and bitumen road).

Road marking machinery – Automark’s road marking machinery manufacturing unit at Yavatmal (Maharashtra) has an installed capacity to produce 20 machines p.a. The company sells this machinery to small road marking contractors through channel partners.

Contracting work for road marking – Automark also undertakes contracts for road marking. Usage of self-manufactured road marking material enables it to be present across the entire value chain in the road marking industry. For contracting assignments, Automark utilises machineries manufactured in house, indigenously made or imported. Automark has already successfully executed more than 40,00,000 sq. mt of road marking including more than 50 projects for the NHAI. The company’s road marking contracting work includes projects like the Bandra Worli Sea Link and the Formula 1 Race Track in Noida.

Capacity expansion plans – The company currently has the capacity to manufacture 20,000 MTPA thermoplastic materials; it plans to ramp up the same to 72,000 MTPA. In the contracting segment, it has the capacity to execute 8,00,000 sq. mt. of job; it plans to ramp up this capacity to 20,00,000 sq. mt. in the next two to three years.

Table 3: Capacity expansion

Road marking material	FY11		FY12	FY13	FY14
	Installed	Production	Installed	Installed	Installed
Thermoplastic materials - Qty (MTPA)	20,000	14,752	20,000	72,000	72,000
Contracting - Surface in sq.mt. p.a.	800,000	612,531	800,000	1,900,000	2,000,000

Source: DRHP

Annexure II: Profile of the Directors

Name of Directors	Designation	Status	Age (Years)	Qualification	Exp. (yrs)	Directorships in other entities
Mr Arun Dalichand Khara*	Chairman & Managing Director	Non Executive & Non Independent	67	B.Com	40	Automark Tech (India) Pvt. Ltd Gain More Savings Pvt. Ltd Automark Polyions Pvt. Ltd
Mr Mayur Arun Khara	Director	Executive & Non Independent	41	B.E. (Telecom)	20	Automark Tech (India) Pvt. Ltd Gain More Savings Pvt. Ltd Automark Polyions Pvt. Ltd Gain More Saving Pvt. Ltd
Mr Amit Arun Khara	Director	Executive & Non Independent	32	B.Com	10	Automark Tech (India) Pvt. Ltd Gain More Savings Pvt. Ltd Automark Polyions Pvt. Ltd Gain More Saving Pvt. Ltd
Mr Dhawalkumar K. Shah	Director	Non-Executive & Non Independent	29	B.Com, CA	-	-
Dr. Harish Balkirishanaji Zawar	Director	Non-Executive & Non Independent	66	M.B.B.S	-	- Automark Tech (India) Pvt. Ltd
Mr Amin Haji Aziz Nagani	Director	Non-Executive & Non Independent	58	D.Pharm	-	-

*Became non-executive director in June 2011, prior to which Mr Arun Khara was director

Source: DRHP

Disclaimer

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