

Innoventive Industries Ltd. (IIL) - IPO Note: "SUBSCRIBE"

26th April, 2011

Pune based Innoventive Industries Ltd. is a multiproduct engineering company engaged in the manufacturing and sale of precision steel tubes, tubular components, auto components, machined components and other steel products which find application in diverse industrial sectors such as transportation, oil & gas, power, farm equipments and general engineering. IIL has six manufacturing facilities located across Pune and Silvassa.

At the upper band of the issue price, IIL is valued at 14.5x its 9MFY11 annualized earnings of Rs.8.3/share (post issue). With due consideration to factors like a) impressive revenue and PAT CAGR of 35% and 29% respectively, over the period FY06-10, b) improvement in OPM by 900 bps to touch 26% in FY10, b) diversified product portfolio and strong in house R&D, c) long term relationships with clients and increase in customer base from 447 in FY 2006 to over 700 in FY 2010, d) mega project status from the government e) capacity expansion to drive growth, f) positive operating cashflows and good return ratios, g) attractively valued as compared to peers like Tube Investments, Lumax Auto Technologies, h) pre IPO placement to Standard Chartered Private Equity at Rs. 117 instills confidence on valuation front, we recommend investors with a higher risk appetite having an investment horizon/waiting period of 2-3 years to "SUBSCRIBE" the issue.

Financial summary (Consolidated)

Y/e 31 Mar (Rs. mn)	FY09	FY10	9MFY11
Total income	3,711	4,252	4,570
Total expenses	3,009	3,100	3,340
PBT	232	428	532
Reported PAT	141.3	343.4	369.1
Equity Capital	50	50	384.6
Networth	427.8	771.2	1,487.3
Total Borrowings	3157.2	3265.1	3559.8

Source: RHP, Ajcon Research

PEER ANALYSIS

Segment	CMP (Rs.)	FV (Rs.)	Book value (Rs.)	EPS (TTM)	PE(x)	RONW (%)
Innoventive Industries	117-120	10	97.5	8.3*	14.5	23
Tube Investments	141.9	2	44	8.2	17.3	9.9
Lumax Auto Technologies	161	10	33	10.3	15.6	17.4
Gandhi Special Tubes	113	5	69	17.5	6.5	25

Source: RHP, Ajcon Research, *9MFY11 annualized

Issue date	26th-29th, April, 2011
Issue size	Rs. 2.19bn
FV	Rs.10
Price Band	Rs. 117-120
Fresh issue	18.3 mn equity shares
Issue structure	50% - QIBs 35% - Retail 15% - Non Institutional Bidders
Equity shares prior to issue	41.06mn
Equity shares post issue	59.36mn
Post issue market capitalization	Rs. 7.12bn at upper price band
Promoters	Mr. Chandu Chavan, Mr. Sanjay Waghulade, Mr. Ravindra Katre
Book Running Lead Managers	Axis, Aventus
Lot size	50 and multiples of 50
IPO Grading	Grade 3/5 by ICRA
Registrar to the issue	Karvy
Shareholding Pattern (%)	Pre Issue
Promoters	65.6
Others	34.4
Total	100

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COMPANY BACKGROUND AND BUSINESS MODEL

The company, originally known as Arihant Domestic Appliances Pvt. Ltd, was incorporated in 1991 by a different set of promoters for the manufacture and assembly of mixers, grinders and emergency lights. The present promoter-chairman, Chandu Chavan, joined the board in March 2002. The company's name was changed into the present one only in March 2010. The Managing Director, Ravindra Katre, and the whole-time director Sanjay Waghulade joined the board in November 2002. Prior to the acquisition of the company, Chandu Chavan was part of Phoenix Enterprises, engaged in trading of precision tubes which was acquired by Innoventive in 2006. Before joining Innoventive as promoter, Sanjay Waghulade was associated as an executive with Kalyani Seamless Metal Tubes and Jindal Saw Pipes for two years each. Today, the company sells its products in the domestic as well as in export markets. Its Promoters, who are first generation technocrats, acquired the company in 2002 under the leadership of Mr. Chandu Chavan.

It manufactures a wide range of precision steel tubes and other value added products mentioned as below:

ERW Precision Tubes: It manufactures Electric Resistance Welded (ERW) precision steel tubes from mild and carbon steel alloys that conform to various industrial standards as desired by its customers from transportation, power and general engineering sectors.

CEW Tubes: Cold drawn Electric Welded (CEW) tubes are value added products manufactured by cold drawing ERW tubes using draw benches and/or cold pilgering respectively. The company also machines these tubes to manufacture tubular components. Its CEW tubes and components find applications in power, farm equipments, transportation and general engineering sectors.

Auto Components: It manufactures a variety of machined components, press fabricated parts, welded components and assemblies catering to the transportation and farm equipments sector

Power Equipment Components: It manufactures membrane strips and energy tubes that are used for boilers and heat exchangers.

Oil Country Tubular Goods (OCTG): It manufactures, through its subsidiary, fully machined ready-to-assemble parts such as machined tubing, couplings, casing couplings, pup joints, crossovers, open-die and closed-die forgings which are used in the oil & gas sector.

Other Steel Products: The company, through its subsidiaries, cold rolled (CR) sheets, metal wires, laminates and stampings. These products are used in transportation, consumer durables, energy and general engineering sectors.

The company claims to export to 10 countries across the globe catering to over 475 customers worldwide which accounts for 18% of total sales.

KEY SUBSIDIARIES

Segments	III stake	Nature of business
Sankalp Forgings Pvt. Ltd.	51%	<ul style="list-style-type: none"> a) Engaged in manufacturing fully machined ready to assemble parts such as machined tubing, coupling, casing couplings, pup joints, cross overs etc, which are used in oil rigs/ oil wells b) Engaged in manufacturing open die and closed die forgings, castings used in precision engineering components, oil fields and automobile components
Saicon Steel Pvt. Ltd.	51%	<ul style="list-style-type: none"> a) Engaged in converting Hot Rolled Steel Coils ("HR coils") to Cold Rolled Steel Coils ("CR coils") and selling the finished product to diverse industries for

		various applications b) Engaged in manufacturing and selling laminates and stampings, primarily to electrical industries
Arihant Steel and Metal Wires Pvt. Ltd.	100%	a) Engaged in manufacturing of steel wires using steel scrap generated in the company's various manufacturing plants

Source: RHP

OBJECTS OF THE ISSUE

Particulars	Estimated cost (Rs. in mn)
Capacity expansion of manufacturing facility	1,630.6
Repayment of term loan	500
General corporate purpose	-

Source: RHP

KEY POSITIVES

Diversified product portfolio for catering to high growth segments of the company

It manufactures a wide range of products comprising ERW and CEW precision steel tubes, tubular, auto, machined components and assemblies. The company's products find variety of applications in the transportation, oil & gas, power, farm equipments and general engineering sectors. The following table provides break-up of its sales amongst various industries:

DIVERSIFIED PRODUCT PORTFOLIO – CONTRIBUTION TO REVENUES

Segment	FY08 (%)	FY09 (%)	FY10 (%)	9MFY11 (%)
Transportation	62.5	53.0	47.7	49.3
Oil and Gas	1.4	10.4	10.4	12.1
Power	11.3	11	12.5	11.4
Farm Equipments	-	1.4	2.9	2.7
General Engineering	24.8	24.3	26.5	24.5

Source: RHP

Strong focus on R&D and Product Innovation

The company's continuous R&D efforts have helped it to develop processes, tools and technology to make its manufacturing process more efficient and broaden the product range. It has innovated the use of cold pilgering process to make CEW tubes directly from ERW tubes without the use of draw bench. This process results in energy, labor and process-related conversion cost saving and provides tubes with enhanced mechanical properties like better surface finish, dimensional accuracy and strength, compared to typical CEW tubes. It has made an application to obtain a patent for this process. IIL has developed an in-house capability to slit steel coils into narrow width strips which are used as membrane panel strips in boilers and heat exchangers. Currently these membrane strips are largely being imported in India owing to technical complexities. In addition to this, it has also developed hydraulic cylinder tubes, rubber to metal products and profiled tubes in house. Further, it has 11 products under various stages of development and commercialization.

Long term relationships with multiple customers

IIL's ability to satisfy its customers' requirements helps it to expand business from its existing customers as well as attract new customers. The company has long established relationship with its customers like Bajaj Auto Limited, Salem Steel North America, LLC, Bharat Heavy Electrical Limited, Thermax Limited, Lindsay International, Alstom Projects Limited amongst others. Its lower dependence on few customers increases its competitive position and thus reduces the volatility of its revenues and margins. The following table shows the revenue contribution in percentage terms from top customers on a consolidated basis:

CLIENT CONTRIBUTION TO REVENUES

Segment	FY08 (%)	FY09 (%)	FY10 (%)	9MFY11 (%)
Top customer	25.2	22.0	21.7	20.1
Top five customers	39.5	38.2	36.6	39.4
Top ten customers	44.3	43.8	46.8	49.8

Source: RHP

CONTRIBUTION TO COMPANY'S TOTAL SALES BY ITS LONG TERM CLIENTS

Segment	Sales amount Rs. in mn	Share (%) total sales
Bajaj Auto	910.9	20.1
BHEL	79.3	1.7
Lindsay International	104.4	2.3
Salem Steel North America LLC	176.4	3.9
Thermax Ltd.	27.1	0.6

Source: RHP

Well positioned to tap the global CEW tube market

In 2008, IIL managed to successfully implement cold pilgering technology for manufacturing CEW tubes directly from ERW tubes without the use of draw bench. This process results in energy, labour and process related conversion cost saving and tubes with enhanced mechanical properties like better surface finish, dimensional accuracy and strength, compared to typical CEW tubes. As per the study was conducted by the Indian Institute of Technology, Mumbai, the process saves energy costs up to 80% and also has significant environmental advantages. The usage of chemicals is greatly minimized and the wastage of steel is reduced by 7% without comprising on the quality of the product.

The company has made necessary application for obtaining patent for this process. With this cost saving on account of pilgering process, it enjoys a significant advantage in pricing the products in the competitive global markets. IIL's CEW tubes have found acceptance by 93 customers worldwide and It is selling its CEW tubes under the brand name of ARIDOMTM in the USA.

Capacity expansion for CEW tubes and other value added products

IIL is going to expand its CEW tubes capacity to 76,701 MTPA from the current 27,000 MTPA by March 2012. The company intends to reduce concentration of ERW tubes by concentrating on selling CEW tubes and other high margin products like strips and machined components.

Eligible for benefits under the Package Scheme of Incentives 2007 granted to the "Mega Projects"

IIL's new plant at Pimple Jagtap has been granted 'the Mega Project' status by the Government of Maharashtra under the "Package Scheme of Incentives 2007" which entitles the company to the following benefits and translates into cash inflow and the overall business growth:

- 1) Electricity Duty exemption for the period of seven years ending November 30, 2015;
- 2) 100% exemption from payment of Stamp Duty;
- 3) Industrial Promotion Subsidy (IPS) equivalent to 75% of the eligible investment in the plant made with effect from March 28, 2007.
 - The IPS will however be limited to 75% of the eligible investments less the amount of benefits availed as mentioned in serial number 1 and 2 for the period from December 1, 2008 till November 30, 2015; or
 - To the extent of taxes paid to the State Government within a period of 7 years, whichever is lower

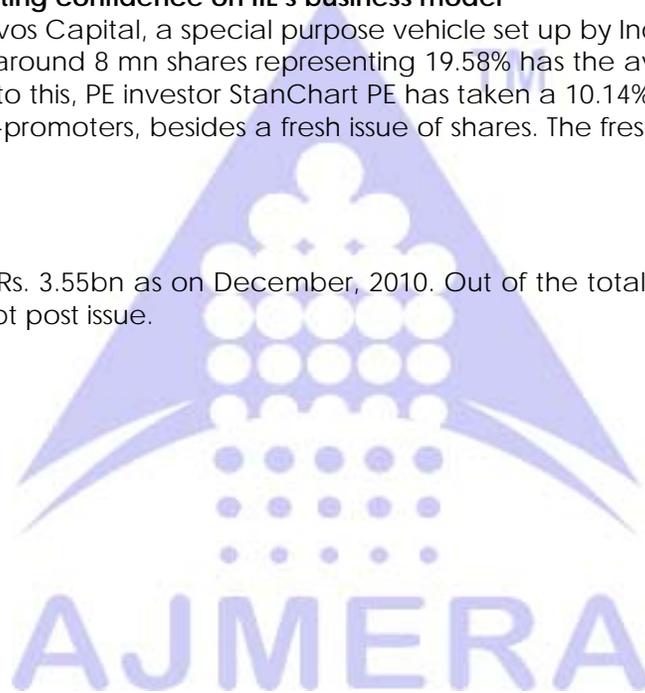
As at November 30, 2010, an overall investment of Rs. 2.6bn has been made by the Company; of which Rs. 945.3mn has been sanctioned as eligible investment, on March 17, 2009; and the balance investment amounting to Rs. 1.67 bn is in the process of validation. Further, the Government of Maharashtra, Directorate of Industries has disbursed an amount of Rs 3.8mn towards IIL's first claim, for the period December 1, 2008 to March 31, 2009.

Investment by PE investors reflecting confidence on IIL's business model

PE investor Lighthouse Funds, Kavos Capital, a special purpose vehicle set up by India 2020 Ltd (a PE fund sponsored by Lighthouse Funds) is holding around 8 mn shares representing 19.58% has the average cost of purchase pegged at Rs 62.2 per share. In addition to this, PE investor StanChart PE has taken a 10.14% stake in the company through a mix of share purchase from non-promoters, besides a fresh issue of shares. The fresh issue was at Rs 117, which is the lower end of the price band.

KEY NEGATIVES

IIL has a heavy debt burden of Rs. 3.55bn as on December, 2010. Out of the total IPO proceeds, company intends to repay Rs. 500 mn worth of debt post issue.



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