

IPO Note

IPO Details

Face Value	Rs. 10
Offer Price	Rs. 35
Issue Opens	September 27, 2007
Issue Closes	October 5, 2007
Bloomberg	CSIL IN
BRLM	Centrum Capital Ltd.
Registrar to issue	Cameo Corporate Services Ltd.
Shares on offer for sale	4.24 mn

Pre issue shareholding pattern

Shareholders	% Stake
Promoters	65.1
Non-Promoter Group	34.9

Post issue shareholding pattern

Shareholders	% Stake
Promoters	52.4
Non-Promoter Group	47.6

Segmented Allocation

Promoters	1,244,810
Retail	1,500,000
Others	1,500,000

IPO Details

	Offer Price
Offer Price	Rs. 35
Equity Shares prior to issue (mn)	7.8
Fresh Issue of shares (mn)	4.2
Total Equity Shares (mn)	12.0
Share Capital (mn)	Rs. 120.0
Implied market cap (mn)	Rs. 420.0
Debt (mn) (as on 31/03/2007)	Rs. 203.2
Cash (mn) (as on 31/03/2007)	Rs. 8.8
Implied EV (mn)	Rs. 614.3

Circuit Systems (India) Ltd

Do not subscribe

Circuit Systems (India) Limited (CSIL) is engaged in the manufacturing of printed circuit boards (PCBs), which are used in computers, telecommunication, process control equipments, defense applications, automobiles and space applications. The Company produces three types of PCBs viz single sided, double sided and multilayered. With an annual manufacturing capacity of 84,000 sq. mtrs, CSIL exports 30% of its annual production to overseas customers. The Company plans to expand its production facility to 150,000 sq mtrs of PCB. The proposed expansion project will be located at Gandhinagar Electronic Park (SEZ) in Gujarat.

CSIL plans to raise Rs. 148.6 mn by offering 4.2 mn equity shares, having a face value of Rs. 10 each at an offer price of Rs. 35. The proceeds will primarily be utilized to fund capex for augmenting the Company's production capacity, making acquisitions of the companies in the same business line and meeting the working capital margin requirements.

Valuation and Recommendations

At the offer price of Rs. 35, CSIL is valued at a P/E of 9.8x, while Fine-Line Circuits Ltd., its closest peer, is trading at a P/E of 5.5x. On the basis of EV/EBITDA multiple, the Company is valued at a substantial premium to Fine-Line. CSIL has a return on equity of 14.3% whereas Fine-Line commands a much better ROE of 29.7%. This indicates that the Company is highly valued at the offer price of Rs. 35.

Additionally, factors such as second hand machinery for the proposed expansion, long gestation period of the project, lack of clarity on the acquisition plans and dependence on the rigid PCB segment can hamper the growth prospects of the Company.

Based on the aforesaid factors, we recommend the investors not to subscribe to the issue.

Peer Comparison

Valuation	P/E	EV/EBITDA	EV/Revenue	ROE
Fine-Line Circuits	5.5x	3.5x	0.4x	29.7%
Circuit Systems	9.8x	10.0x	1.6x	14.3%
Premium/(Discount)	77.8%	184.9%	273.6%	(51.9)%

IPO

Issue details

CSIL plans to raise Rs. 148.6 mn through an IPO of 4.2 mn equity shares having a face value of Rs. 10 each at an offer price of Rs. 35. Pre issue, the promoters hold 65.1% of the issued and paid-up share capital of the Company. After the issue, the promoters will own 52.4% of the post-issue paid-up equity share capital. The Company has allocated 1.5 mn shares of the net issue for retail investors.

Issue objective

The IPO is being carried out to raise funds for the following purposes:

- Fund the capital expenditure for expanding capacity from 84,000 sq mtrs of PCB to 150,000 sq mtrs of PCB
- Acquisition of companies/business in the same line of activity
- Meet the working capital margin requirement
- Meeting the issue expenses.

Promoters

Mr. Magan H. Patel (Chairman), aged 60, has an experience of 25 years in the PCB business. From 1983 to 1998 he has worked as a Vice President and President of Circuit System Inc. USA. He co-founded the Company in the year 1995. Mr. Paresh N. Vasani (Managing Director), aged 40, carries an experience of 15 years in various capacities. He worked with Intel Corporation USA as a Senior Design Engineer from 1991 to 1994. After setting up the Company, he is looking after the day to day management of the Company. Mr. Anand A. Patel (Director) is responsible for the overall management of the Company. He is 34 years old and has an experience of 10 years in managing the business of the Company.

Sources of Funds (mn)		Uses of Funds (mn)	
IPO proceeds	Rs. 105.0	Capex for expansion	Rs. 184.3
Promoters contribution	Rs. 43.6	Acquisition of Co./business	Rs. 20.0
Pref. allotment to Europrint	Rs. 19.3	Working capital requirement	Rs. 40.0
Term loan	Rs. 45.2	Expenses related to the issue	Rs. 8.0
Internal cash accruals	Rs. 39.3		
Total	Rs. 252.3	Total	Rs. 252.3

Rationale

Second hand machineries for the new manufacturing facility

For the proposed expansion project, CSIL has procured second hand machineries worth Rs. 38.6 mn. Some of the equipments were manufactured more than 20 years ago and are prone to wear and tear, which will decrease their efficiency. Moreover, a second hand machine runs the risk of abrupt failure and generally requires higher maintenance cost which might negatively impact the operating margins of the Company.

Long gestation period of the proposed project

The Company plans to utilize the issue proceeds to expand its manufacturing unit which will be located at Gandhinagar Electronic Park (SEZ). The construction of the unit will start in November '07 and operations will start only by the second half of the next year. Thus any benefits from the proposed expansion will start accruing to the investors only by FY09, provided the project is implemented on time.

Acquisition plans not in place

The Company plans to utilize the issue proceeds to fund acquisitions of companies in the same line of activity. However, CSIL has not yet identified any such company for the proposed acquisition. The Company might not be able to identify suitable acquisition targets in future which might affect the growth prospects of the Company. Moreover, this indicates that Rs. 20 mn which the Company has allocated for acquiring firms would be lying as liquid investment earning low yield, thus destroying shareholders value.

Limited service play

CSIL manufactures only rigid printed circuit boards. Moreover, it has no plans to diversify its business or enter into the flexible PCB market. Any slowdown in demand in the PCB industry or new technological changes will hamper the growth prospects of the Company.

Outlook

CSIL's revenue has registered a CAGR of 21.2% over FY03-07. The Company has been able to maintain its operating margins for the past five years. CSIL plans to utilize the issue proceeds for expanding its manufacturing facility. However, the project will be on-stream by the second half of the next year and therefore revenues from this project will start flowing in only from FY09, provided the project is implemented on time. Moreover, CSIL has procured second hand machineries for the proposed expansion which means higher maintenance cost for the Company. Additionally, the Company has allocated a substantial portion of the issue proceeds for funding acquisitions, though there are no concrete plans on target companies. Thus, there is lack of clarity over whether the Company will be able to effectively utilize the issue proceeds.

At the offer price of Rs. 35, CSIL's P/E of 9.8x is at a premium of 77.8% to that of its nearest peer Fine-Line Circuits Ltd. The ROE of CSIL is 14.3% whereas Fine-Line commands a much better ROE of 29.7%. Moreover, at 10x EV/EBITDA multiple, CSIL is valued at a substantial premium to Fine-Line's 3.5x. Based on our valuation, we feel that the issue is highly priced and recommend the investors not to subscribe to the issue.

Company Background

Incorporated in the year 1995, Circuit Systems (India) Limited (CSIL) is in the business of manufacturing PCBs. CSIL produces three types of PCBs viz single sided, double sided and multilayered. The Company focuses on high technology boards like PCBs with 4 mil standards, lead free finishes and MCL with complex designs. The products manufactured by CSIL are used in computers, telecommunication, process control equipments, defense applications, automobiles and space applications.

In India the Company's customers include TVS Electronics Ltd., Bharat Electronics Ltd., Essae Electronics Pvt. Ltd., India Nippon Electricals Ltd., Secure Meters Ltd., Consolidated Dynamics Pvt. Ltd., ITI Ltd., ESSAETeraoka Ltd., Inductotherm (India) Pvt. Ltd, Varroc Engineering Pvt. Ltd, Photoequip India Ltd., JNS Instruments Ltd., and Donex Industries Ltd. CSIL also exports 30% of its annual production to overseas customers in Belgium, USA, Italy and New Zealand. With an annual manufacturing capacity of 84,000 sq. mtrs, the Company has its registered office and manufacturing plant in Gandhinagar, Gujarat.

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