

REPORTS

IX-XII

DISINVESTMENT COMMISSION

OCTOBER
1999

'Trikoort-I', IInd Floor
Bhikaiji Cama Place, R K Puram
New Delhi-110066

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REPORT

IX

DISINVESTMENT COMMISSION

**MARCH
1999**

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PART A

1. GENERAL RECOMMENDATIONS

In his speech presenting the Budget for 1996-97, the then Finance Minister had stated that "Government have approved the proposal to establish a Disinvestment Commission. Any decision to disinvest will be taken and implemented in a transparent manner. Revenues generated from such disinvestment will be utilised for allocations for education and health and for creating a Fund to strengthen public sector enterprises."

The Disinvestment Commission was set up by Government Resolution dated 23 August, 1996 (Appendix I) in pursuance of the Common Minimum Programme (CMP) of the then United Front Government. The perusal of the terms of reference would indicate that Government intended to give advisory as well as supervisory and monitoring role to the Commission. For instance, para 4 of the terms of reference states as follows.

"4. The Disinvestment Commission will be an advisory body and the Government will take a final decision on the companies to be disinvested and mode of disinvestment on the basis of advice given by the Disinvestment Commission. The PSUs would implement the decision of the Government *under the overall supervision of the Disinvestment Commission.*"

This had been further confirmed by item IX of para 3 of the terms of reference which states:

"To monitor the progress of disinvestment process and take necessary measures and report periodically to the Government on such progress."

Following the setting up of the Disinvestment Commission with the aforementioned terms of reference, much expectation was generated in the country that the Commission would play a major role in the formulation of overall strategy for disinvestment and in the monitoring and supervision of the disinvestment process on the basis of specific decisions taken by Government. Expectations were also built up that as a result, the disinvestment process would gather momentum.

In pursuance of its role, the Commission had wide ranging consultations with a cross-section of persons and organisations interested in the

disinvestment process. These included senior Government officers in the various Ministries, management experts, representatives of Central Trade Unions and academicians. The Commission also organised two conferences, one in Delhi and another in Bombay, focussing on the strategy and issues involved in the disinvestment process. The Commission had also taken due note of the various views expressed during these meetings and conferences as well as experiences of other countries in disinvestment and privatisation.

In its First Report submitted in February 1997, the Commission gave its views on the long-term strategy that should be followed on disinvestment. In line with CMP classification, the Commission laid down the criteria for classifying public sector undertakings (PSUs) into strategic, core and non-core units for the purpose of deciding on the extent of disinvestment of government shares in these units.

The Commission also enunciated broad guidelines and modalities of disinvestment for consistent application across all PSUs and for enhancing the transparency of the disinvestment process. Besides these, the Commission made general recommendations in significant matters such as creation of a Disinvestment Fund for being utilised to restructure PSUs, wherever necessary, prior to disinvestment, to fund a Voluntary Retirement Scheme for employees found surplus, to fund social infrastructure projects and to retire public debt. Recommendations were also made in the First Report of the Commission for improving corporate governance and accountability along with grant of graded autonomy to all the PSUs. In making these recommendations, the Commission believed that these would have significant impact on the investor perception of PSUs and enhance their share values at the time of disinvestment.

The Commission also made specific recommendations in Part C of its First Report on three PSUs. viz. -

1. Modern Food Industries (India) Ltd. (MFIL)
2. Gas Authority of India Ltd. (GAIL)
3. India Tourism Development Corporation (ITDC)

In his speech of February 27, 1997, presenting the Budget for 1997-98, the then Finance Minister stated "We intend to proceed with disinvestment in these companies along the lines suggested by the Commission." Till

now, no disinvestment has taken place in any of these three PSUs. The then Finance Minister had, in his Budget speech, also agreed with the view of the Commission that “the essence of a long-term disinvestment strategy should be not only to enhance budgetary receipts but also minimise budgetary support towards unprofitable units while ensuring their long-term viability and sustainable levels of employment in them.” The disinvestment undertaken during 1997-98 and 1998-99, however, appears to have been budget-driven whereas other modalities of disinvestment recommended by the Disinvestment Commission which would have subserved the larger objectives mentioned above have not so far taken place.

Since the submission of the First Report, the Commission has been giving its general recommendations in Part A and specific recommendations in Part B of their subsequent seven Reports. These reports also contained the status of action taken on these recommendations. The Commission has submitted Eight Reports to Government covering 43 PSUs referred to it. In keeping with the Commission’s transparent approach these Reports had been simultaneously released for wide coverage. The approach and recommendations of the Commission have generally been widely supported. The gist of general recommendations and action taken by Government on them is given in Appendix II. The modalities of disinvestment recommended in specific PSUs and action taken by Government on them is given in Appendices III and IV. It would be observed that action is yet to be taken by Government in respect of a number of the Commission’s general as well as specific recommendations.

At this point, the Commission would like to reiterate the important recommendations that have already been made in its various Reports to help improve the process of decision making and speeding up implementation of Government decisions on disinvestment. The Commission believes that these are critical to the success of the disinvestment process and are summarised below:

- (1) The disinvestment process needs to be delinked from the short term budgetary compulsions. Proceeds from disinvestment should be placed separately in a Disinvestment Fund which may be used to (a) restructure PSUs, wherever necessary, prior to disinvestment; (b) fund Voluntary Retirement Schemes for surplus employees in PSUs; (c) fund

social infrastructure projects and (d) retire public debt. This would help create greater public awareness of the justification for disinvestment and the perception that the sale of assets of PSUs will lead to tangible social benefits. This would induce understanding and support for the disinvestment programme.

- (2) Government should follow the earlier Cabinet decision of May, 1997, communicated to the Commission in September, 1997 that all future disinvestment from any PSU would be done only after obtaining the recommendations of the Disinvestment Commission.
- (3) The monitoring and supervisory role of the Commission should be restored in the interest of effective, coordinated and speedy implementation of Government decisions.
- (4) The Commission welcomes the constitution of a Cabinet Committee on Disinvestment chaired by the Prime Minister. The Commission's recommendations should be put up to the Cabinet Committee on Disinvestment along with the views of the Core Group and the Ministries concerned, in a time-bound manner, without the recommendations being filtered by official groups. This would call for evolving a mechanism of interaction between the Commission and the Core Group and other official agencies. It was also suggested that Chairman of the Commission should be invited to meetings of the Cabinet (now the Cabinet Committee on Disinvestment) to offer clarifications, wherever necessary, on the Commission's recommendations.
- (5) Experience so far has revealed considerable delay in the implementation of Government decisions on disinvestment. A full time implementation machinery should, therefore, be set up under the Finance Ministry for timely implementation of all the decisions of Government.
- (6) Decisions should be taken without further delay on all the recommendations of the Commission which have been pending for the last several months.
- (7) The Cabinet Committee on Disinvestment should be kept informed of the status of implementation of Government decisions at regular

intervals of two months by the Finance Ministry through the Core Group of Secretaries.

The following table indicates the action taken by Government on the recommendations of the Disinvestment Commission on individual PSUs:

Table 1 : Action Taken@ on Recommendations of Disinvestment Commission .

Accepted	Decision Deferred	Decision Implemented	Decision being Implemented	Decision Awaited
1. RITES^	1. FACT	1. MTNL* (May, 97)	1. GAIL (Feb. 97)	1. ET&T (Dec. 97)
2. MOIL*	2. NFL	2. CONCOR* (May, 97)	2. KIOCL (Mar. 97)	2. RIC (Dec. 97)
3. OIL*			3. MFIL (Feb. 97)	3. NALCO (Mar. 98)
4. ONGC*			4. EPIL (Nov. 97)	4. HCL (Aug. 97)
5. SAIL*			5. HTL (Apr. 97)	5. NEPA (Nov. 97)
6. NTPC*			6. EIL (Nov. 97)	6. HZL (Dec. 97)
7. NHPC*			7. IPCL (Mar. 98)	7. PHL (Aug. 97)
8. PGCL*			8. HCIL (Dec. 97)	8. AI (Aug. 98)
9. NLC*			9. R.Ashok (Nov. 97)	9. PPCL (Dec. 97)
			10. U.Ashok (Nov. 97)	10. CEL* (Aug. 98)
			11. BALCO (Apr. 97)	11. HVOC (Dec. 97)
				12. SCI (Aug. 97)
				13. IBP (Nov. 97)
				14. HPL (Nov. 97)
				15. HLL (Mar. 98)
				16. ITI (Apr. 97)
				17. BRPL (Apr. 97)
				18. MFL (Apr. 97)
				19. ITDC (Feb. 97)

Note : Information given in brackets indicate month and year of the Commission's recommendations.

@ Information communicated by Government (As on 1st February 1999).

Commission had recommended that disinvestment be deferred in these PSUs pending fulfilment of certain specified conditions.

& Implemented in December 1997.

* Implemented in November 1998.

^ The Commission had not recommended disinvestment in this PSU

It would be seen from this table that out of 43 PSUs for which recommendations have been made by the Commission, the Government have initiated action in only 24 of them, while decision is awaited in the remaining 19 cases. Out of 25 cases of strategic sale/trade sale recommended by the Commission (Appendices III and IV), Government have initiated appointment of global financial adviser only in three cases.

Of these, only in one case appointment of global financial adviser has so far been made. In as many as 19 cases, Government has not taken any final decision even after lapse of periods ranging from six months to two years. Only in two cases have the recommendations been partly implemented whereas in 11 other cases, recommendations are at various stages of implementation. Where views of Core Group / Ministries have been at variance with those of the Disinvestment Commission, there has been no opportunity for the Commission to interact with them.

In October 1997, the Commission pointed out to the Government that in the case of ITDC, Government's decision to appoint a Global Adviser to examine the recommendations of the Commission would warrant reconsideration. For, bringing in a Financial Adviser from outside the Government to give a second, opinion on the Commission's recommendations would show the Commission and the process of Government's decision making in poor light. It was pointed out that the Government's resolution constituting the Commission had stated that "Government will take a final decision on the companies to be disinvested and mode of disinvestment on the basis of advice given by the Disinvestment Commission." The Commission informed the Government that financial advisers should be appointed for implementing the decisions of Government and not for reviewing the recommendations of the Commission and the Core Group of Secretaries. Despite this, in July, 1998, Government put out an advertisement in the Indian and the Overseas Press inviting bids from financial advisers to examine the various alternatives and options of restructuring/disinvestment/privatisation of ITDC. Attention of Government was once again drawn to this undesirable procedure. Government was informed that placing a global financial adviser in the position of an arbiter over the recommendations of the Commission might place the Government in an indefensible position as it would be seen to be acting on the advice of an outside adviser rather than that of the Commission. This also whittles down even the advisory role of the Commission and renders the Commission superfluous. Press reports indicate that the Commission's point of view has been accepted in regard to ITDC by the Finance Minister. A formal decision is yet to be taken.

However, there is another case where second opinion is being sought from an outside body i.e. on the modalities of disinvestment in IBP, on which specific recommendations were made by the Commission in November

1997. The Commission hopes that this decision would be reviewed and instructions would be issued to all Ministries not to seek second opinion from outside the Government in cases where the Disinvestment Commission has already given its recommendations.

In January 1998, the Government modified the earlier resolution of August 1996, constituting the Disinvestment Commission and stated that the Disinvestment Commission "shall be an advisory body and its role and function would be to advise the Government on disinvestment in those public sector units that are referred to it by Government." Thus, even the supervisory and monitoring role of the Commission was withdrawn. A copy of the January, 1998 resolution amending the terms of reference of the Commission is given in Appendix V.

In its Seventh Report submitted in March 1998, the Commission had considered the amendment of the terms of reference of the Commission issued by Government by the resolution of January 1998, and felt that the role of the Commission in the disinvestment process had been considerably diluted. It was pointed out that the role of the Commission as an advisory body without powers of monitoring and supervision of the overall disinvestment process would render the Commission ineffective. The Commission, therefore, made a strong recommendation that the powers of monitoring and supervision as envisaged in the original Government notification of August 1996 should be restored.

The Commission further stated in its Seventh Report that it was not aware if all its recommendations had been taken before the Cabinet for a decision. The Commission emphasised that both its general and specific recommendations should not be filtered by official groups but should be placed before the Cabinet in their entirety to enable Government to appreciate the interconnected strategy of the various recommendations and take decisions thereon. It was also suggested that the Chairman of the Commission may be invited to the meetings of the Cabinet to offer clarifications, wherever necessary, on the recommendations of the Commission. The Commission has not been informed of Government decisions on any of these suggestions.

In its Eighth Report in August 1998, the Commission felt that in view of the present state of Indian and overseas capital markets, offering in

these markets might not achieve optimum results. The Commission, therefore, suggested giving a big push to strategic sales of PSUs. The Commission noted that there has been inordinate delay in the implementation of Government decisions on strategic sales due to dispersed implementation by various Ministries. It, therefore, reiterated the recommendations made in its Seventh Report for setting up of a full-time implementation machinery for enabling speedy and timely implementation of disinvestment decisions of Government. It further stated that there was a clear need for monitoring the disinvestment process and supervising the implementation so as to make it transparent and effective. It was pointed out that the Disinvestment Commission was the logical choice for this purpose as envisaged in its original terms of reference. Government's decisions on these recommendations are still awaited.

In September 1998, Government had proposed formation of a special purpose vehicle (SPV) for fast track privatisation of certain PSUs and sought the comments of the Commission on its proposal. The Commission suggested that it would be preferable to set up a National Shareholding Trust for some of the blue chip PSUs in which government holding has already come down to 51% - 70% and which would not be put up for strategic sale but could become professionally managed and with broad based public shareholding. With the disinvestment ranging between 10 and 20% shares, these companies would cease to be PSUs. This would have improved investor perception and raised share values and generated substantial immediate receipts for Government. There has been no response from the Government so far.

Presently, the Government is in the process of major disinvestment of oil companies through cross holdings. There have also been GDR sales in VSNL. Government is also contemplating disinvestment in Indian Airlines. The Disinvestment Commission has not been consulted for advice on these disinvestments in spite of the earlier Government decision conveyed to the Commission in September 1997 to the effect that "all future disinvestment from any PSE will be done only after obtaining the recommendations of the Disinvestment Commission." This has been brought to the attention of the Government.

The Commission feels that, on the one hand, Government has, in a number of cases, not taken any action on its recommendations despite considerable

time lag, it has, on the other, gone ahead with disinvestment in several cases without any consultation with the Commission, contrary to Government's own decision referred to earlier. The role of the Commission has been significantly curtailed by the resolution of January 1998 amending the Commission's terms of reference. All this has seriously eroded the credibility of the disinvestment process as well as that of the Commission, and has led to public perception that the Commission has been marginalised. The Commission, therefore, hopes that Government would pay urgent attention to all these outstanding issues and take corrective measures so that necessary conditions for rapid, transparent and credible disinvestment process are created.

PART B

2. SPECIFIC RECOMMENDATIONS

2.1 Hindustan Steel Works Construction Limited

Evolution

Hindustan Steelworks Construction Limited (HSCL) was set up in 1964 at Bokaro as a captive construction company for integrated steel plants. The objective was to pool available construction expertise to create a well-equipped public sector organisation that would take up construction works of modern integrated steel plants from site levelling to commissioning stage.

Between March 1973 to April 1978, HSCL was a subsidiary of Steel Authority of India limited (SAIL). Subsequently it was converted into an independent entity with GoI as the sole shareholder mainly to enable HSCL to stand in its own right as an independent construction company and to also take jobs outside SAIL.

HSCL has expanded its scope of activities beyond steel. Over a period of time it has gained some experience in civil and structural works in the coal, power, oil and refinery sectors as well as in the construction of roads, dams, bridges and office and residential buildings. To reflect this enlarged scope of activity, the company has been renamed "HSCL Infrastructure Limited" with effect from December 1998.

HSCL's share capital has remained unchanged at Rs 20 crores, wholly owned by GoI.

Industry Analysis

Construction industry in India has traditionally been labour intensive. This had been facilitated by the relatively low skill and specifications requirements of civil/structural jobs. With increasing private sector participation and the ability of the private sector to upgrade technology in line with global trends, capital intensity levels in project execution has increased.

With domestic and international institutional funding for construction projects, also now forthcoming, the focus is on minimising project risks.

Availability of certain types of equipment is now mandatory for companies to ensure timely completion of projects and to reduce the possibilities of quality related complaints.

Project contracts are now increasingly being awarded on an Engineering, Procurement and Construction (EPC) basis. To qualify as an EPC contractor, a construction company requires a broad range of expertise. This is more relevant for non-steel sectors like power, oil & refineries and infrastructure projects.

Construction business has largely been self-financing by virtue of up-front mobilisation advances received by contractors as well as periodic billings and collections during project progress. Declining trend in non-interest bearing customer advances and delays in payments from customers have resulted in increasing focus on the ability of the contractor to raise working capital on the strength of its balance sheet.

Expectations of market growth led to significant increases in steel capacity both in the public and private sector between 1991 to 1997. With the anticipated growth not forthcoming, there is now an excess capacity both in saleable steel and finished products like hot rolled & cold rolled sheets & coils. Incremental investments in this sector are therefore expected to be limited.

On account of variability in project earnings, construction companies tend to minimise fixed overheads by keeping the number of permanent employees low. As an industry wide practice, unskilled construction workers are seldom taken in the permanent rolls.

Business Analysis

The range of activities of HSCL are summarised below:

Steel - Construction, Maintenance and Repair of Integrated Steel Plants (ISP), Repair and Maintenance of Coke Oven Batteries.

Power - Foundation for Boilers, Turbo Generator, Erection of plant. Erection of chimneys, utilities and auxiliary buildings, structural work for coal handling plants, ash dyke. Raw water system, belting / conveyor and material handling systems

Oil and Refineries - LPG Bottling plant, pipelines, public utility systems at refineries, foundation for tank erection

Roads, Dams and Bridges - Design and Construction

The company was associated in constructing and erecting Bokaro Steel Plant, Vizag Steel Plant while it was associated with the modernisation and expansion work of other steel plants at Bhilai, Rourkela, Durgapur etc. Being set up with the objective of undertaking the construction requirements of the Steel sector, HSCL's core competence lies in this area and consequently, 70% of HSCL's income is still generated by the steel sector. Also the steel sector provides better margins for HSCL than jobs in other sectors. With no Steel plant construction contracts possible due to the surplus capacities existing in the industry currently, HSCL's operations would come under stress.

The proportion of Steel sector jobs in the total turnover has been consistently declining and the company is getting into other areas as mentioned above. It has taken up small civil and structural work in thermal power plants of NTPC, DVC, NLC and many State Electricity Board run plants. Apart from this, the company is associated with the execution of various hydel power projects of NHPC, KPCL etc. Of late, HSCL also started executing various projects for oil sector companies like setting up of LPG Bottling Plant etc. The company has also been associated in the construction of Calcutta Metro Rail, Hooghly Bridge, International Sports Stadium at Kochi apart from various townships for steel plants, schools etc.

HSCL had taken up a project in Libya and had to close its operations on July 28, 1998 on as-is-where-is basis. At the time, it had executed work valued at Rs 248.94 crores against which a loss of Rs 118.97 crores was incurred. The GoI had extended a non-plan loan of Rs 92 crores for part funding the Libyan operations. As on March 31, 1998 the total dues to GoI were Rs 494.29 crores including the accrued interest.

Large labour force is the most important factor in making the operations of HSCL unsustainable and inefficient. HSCL began its operations in 1964 with 95 personnel. By 1973, the labour force went upto 20,135. Between 1975 and 1978, when HSCL was a subsidiary of SAIL, the average number of employees was 24,500. Since then, there has been a gradual decline and the current manpower strength is 13,850.

Workers and Non-Executive support staff comprise 88% of the total workforce. There is a significant mismatch between the expertise available and the job requirements as a majority of the workers is with Mechanical and Electrical expertise while the current jobs are civil in nature. This necessitates sub-contracting despite the excess workforce.

Most of the increase has been in the Unskilled/Semi-Skilled worker category that were 'absorbed' at the steel plant sites at Bokaro and Bhilai. These two sites along with Rourkela, Durgapur and Vishakhapatnam together account for 87% of the total number of employees, which is against the normal industry practice.

HSCL introduced a Voluntary Retirement Scheme in 1988-89 when the manpower strength was 22,412. By Sept.'98 a total of 7,776 employees had opted for VRS.

The effectiveness of the VRS was however limited. The increase in average employee costs per head has outweighed the reduction in the number of employees through the VRS. This has happened because of annual increments along with the implementation of the periodic Pay Commission Recommendations in salary scales. Also since HSCL could not target the VRS towards the less productive employees only, a number of the more efficient employees opted for the VRS.

Financial Analysis

The financial performance of HSCL for the past five years is summarised as follows:

Table 1: Financial Highlights Rs. Crore

	FY98	FY97	FY96	FY95	FY94
Operating Income	319.5	411.8	408.3	387.8	334.2
Operating Profit	-36.5	6.1	-8.2	-11.9	-33.1
PAT	-231.7	-131.7	-124.4	-100.5	-88.5
Equity Capital	20.0	20.0	20.0	20.0	20.0
Tangible Networth	-1081.7	-857.0	-724.5	-609.8	-513.9

(Financial Ratios are not shown as they are negative and hence meaningless)

From a profitability level (PAT/Operating Income) of 21% in 1965-66 soon after the company began its operations, HSCL reported a 70% loss in 1997-98. Barring 1985-86 when it made marginal profits, it has been making continuous losses since 1978-79 and in most years it has been making operating losses. The accumulated loss as on March 31, 1998 was Rs 1,101.7 crores and the Tangible Networth has been fully eroded. The company has been a consistent defaulter in terms of servicing its interest obligations to GoI, both for Plan and Non-Plan loans.

Most of the operating cash losses each year have been funded by non-plan loans. Of the total outstanding GoI loans of Rs 281.97 crores as on March 31, 1998, 67% was Non-plan in nature. As against an average Plan loan of Rs 4.50 lakhs received annually by HSCL between 1980 to 1998, Non-plan loans were of the order of Rs 10.55 crores. These loans are over and above the grants received by the company from the National Renewal Fund (NRF) aggregating Rs 120 crores since 1988-89 for implementing Voluntary Retirement Scheme.

Out of the total accumulated losses as on March 31, 1998, 43% were on account of Libya and the loans taken for the Libya project continue to remain in the books and accrue interest.

Interest and finance charges accounted for 50% of operating income in 1997-98 and contributed significantly to the net losses for the year. The interest and finance charges are expected to increase further, both in absolute terms and as a percentage of operating income on account of falling operating margins and compounding interest charges.

Employee cost for HSCL constituted 40% of the company's turnover in 1997-98. HSCL's Contribution Margin (Operating Income minus Contract Payment minus Stores Consumed but excluding Direct Labour) at current levels is insufficient to cover its employee expenses. With Contribution Margins under pressure and average salaries increasing, the problem is likely to be accentuated in future.

The Cabinet first reviewed the deteriorating health of HSCL in April 1986. The Committee of Secretaries (CoS) recommended winding up of HSCL in 1994 with the following rationale:

- Inadequate orders and inability to attract business
- Pruning down labour, by at least 5000, appears impractical
- Rampant inefficiency in the organisation and low capacity of management
- Holding in abeyance, the winding up of the company, (Cabinet's decision in 1986) has resulted in additional losses of Rs 469 crores.

The Ministry of Steel however, suggested turnaround through Financial Restructuring. The detailed restructuring proposal submitted by the Department of Steel is under examination by various ministries. The salient features of the proposal are as follows :

Financial Restructuring

1. Conversion of Plan Loan of Rs. 97.10 crores into equity
2. Grant of repayment moratorium and interest holiday for ten years.
3. Waiver of Interest accrued and outstanding amounting to Rs. 975.17 crores.

Financial Assistance Package

4. Financial Assistance of Rs. 174.33 crores as Non-Plan Loan for meeting Statutory liabilities, wage arrears, expected cash loss for the current year.
5. Continuance of government guarantee and waiver of guarantee commission.
6. Grant/Loan from NRF of Rs. 338.36 crores for administering VRS to 8,000 employees.

Strengths & Areas of Concern

Strengths

Expertise in steel plant construction: HSCL is the first company which was engaged in the construction of steel plants and has constructed all the major steel plants in India.

Areas of Concern

Large labour force : The labour force strength in HSCL is 13,850 and out of which 88% are workers and non-executive support staff. This has resulted in high cost.

No diversification plan for existence : All the steel plants in India were set up long ago and there is limited possibility of setting up of new steel plants. In this circumstance, the existence of HSCL with only expertise in steel plants will not enable the company to survive. Even though the company has started taking up construction work in other sectors, given its weak financials and high labour, it would be difficult for the company to meet competition.

Weak balance sheet : The company for the past two decades is incurring losses and the accumulated losses amount to Rs 1,102 crores. Moreover, its assets are also not significant putting the company in a disadvantageous position to bid for new contracts that involve owning of equipment etc.

Recommendations

As is clear from the earlier discussion, HSCL is experiencing problems on account of reduced business, high employee cost, overheads and debt overhang. HSCL, which in the past, had depended on public sector steel plants for bulk of its business is unlikely to be able to do so in future. Even though HSCL has diversified into other construction related activities, due to strong competition and the drag of large and immobile manpower, its operations have been unviable. HSCL's poor financial position reflected by the high debt and the large outstanding interest is proving to be a big hindrance in getting orders, as strong financials are a prerequisite for a construction company to secure business. There is also a substantial private sector presence in the construction industry. **The Commission, therefore, classifies HSCL as a non-core company operating in a competitive environment.**

The Commission notes that for the continued existence of HSCL and to enable it to bid for new orders, implementation of financial restructuring measures as recommended by Department of Steel (Page 14) would be critical. However, this entails a large financial burden on the Government

to the extent of Rs. 513 crores and this, by itself, will not improve the operating efficiency of the company.

Under the circumstances, the Government has the following three alternative courses of action.

Alternative 1. Status Quo

Alternative 2. Implementation of Financial Assistance Package, proposed by the Department of Steel, and continue in the public sector

Alternative 3. Implementation of Modified Financial Assistance Package followed by disinvestment

Alternative 4. Closure of HSCL

Alternative 1 : Status Quo

Under this alternative, after meeting statutory liabilities of Rs. 136 crores comprising (a) arrears due to Fifth Pay Commission, (b) PF dues, (c) gratuity premium arrears to LIC and (d) Salaries & Wages arrears, the Government would have to fund HSCL's cash deficit, every year to keep it afloat. During 1997-98, HSCL incurred a cash loss of Rs. 62 crores, which is likely to increase in future. Government would have to fund these through budgetary resources, year after year.

Alternative 2 : Department of Steel's Proposal

In the second option, the Government will have to implement the Financial Restructuring and Assistance packages as elaborated earlier (page 14). This will involve a cash out flow of about Rs. 513 crores towards VRS package, to reduce the workforce by 8,000 employees (Rs. 338 crores), and towards the statutory and other pressing liabilities (Rs. 175 crores).

The Department of Steel feels that implementation of this package will enable the company to bid for new orders and continue operations as a public sector enterprise.

Alternative 3 : Modified Assistance Package followed by Disinvestment

In this option, the Government will have to provide cash funds to HSCL to implement the Financial Restructuring and Assistance packages similar

to the package proposed by Department of Steel with provision for further reduction of manpower by 1,500 employees i.e. total of 9,500 employees. This package would involve an additional outflow of about Rs. 70 crores.

After the implementation of the Financial Restructuring and Assistance Packages, the Government should disinvest its entire holding to a strategic bidder through a global competitive bidding process. The interest of potential bidders can not be assessed at present. However, the success of such a strategic sale is doubtful. Even if the disinvestment is successful, the proceeds would only partially offset the Government cash support of about Rs. 583 crores and avoid recurring financial support from Government.

Alternative 4 : Closure

Under the fourth alternative, Government can close down the operation of HSCIL and liquidate all its assets and liabilities, which are as follows.

1. Employee Separation Cost under statute : Rs. 328 crores
2. Other statutory dues : Rs. 136 crores

Liabilities (as on March 31, 1998)

3. Outside Contractors and Suppliers : Rs. 500 crores

Assets (as on March 31, 1998)

1. Fixed Assets : Rs. 38 crores
2. Debtors : Rs. 410 crores
3. Current Assets : Rs. 160 crores

After examining the above alternatives, the Commission feels that the Alternative 2 and Alternative 3 are not viable options, as they would involve substantial financial outgo from the Government without any prospect of strategic sale for reasonable value. **The Commission is of the view that if the Government does not find it feasible to close down the enterprise, the only other alternative would be to continue the enterprise by meeting recurring annual cash losses of around Rs. 60-70 crores per annum, after meeting the statutory liabilities of about Rs. 136 crores. In this case there should be a clear understanding that there would be no fresh recruitment or replacement of retiring employees.**

2.2 The State Trading Corporation of India Limited

Evolution

The State Trading Corporation of India Limited (STC) was registered in May 1956 under the Indian Companies Act. The main objective of STC was to broaden and enlarge the scope of India's exports and to arrange for essential imports. STC functions under the administrative control of the Ministry of Commerce. STC has traditionally functioned as one of the canalising agencies of GoI along with the Mining and Metals Trading Corporation Limited (MMTC) and the Projects and Engineering Corporation Limited (PEC).

In 1989, Bharat Business International Limited (BBIL) was formed as a holding company for four Government-owned trading companies - STC, MMTC, PEC and the Spices Trading Corporation of India (SPTC). The objective of BBIL was to streamline the trading operations of all these four companies. However, the experiment did not succeed and in 1992, all the four companies were made independent again.

Government disinvested 9% of its stake in STC during 1991-92 when the shares were sold in bundles along with the shares of other public sector units (PSUs). The price realisation by GoI was Rs. 67.61 for each share of Rs. 10 face value in the first round, followed by Rs. 75 per share in the second round. Even though the shares are technically listed at the stock exchange, there is little or no trading history available. The shareholding pattern as at March 31, 1998 is as follows :

Table 1 : Shareholding Pattern of STC

Shareholder	Percent Holding
President of India	91%
Canara Bank	3%
UTI	2%
GIC	2%
Other	2%
TOTAL	100%

Industry Analysis

Trading companies, essentially, perform two tasks: they act as trade intermediaries, linking product suppliers with users, and they develop trade flows by engaging in activities that increase the supply of products and stimulate additional demand. Some of the major functions of trading companies globally are :

Trade Services

Trading companies, particularly the larger ones, are extensively involved in the distribution process also i.e. delivering the goods by air, sea and land. They have to obtain favourable trade financing using their knowledge of import and export procedures, shipping, warehousing and insurance. The scale of operations of large trading companies is expected to result in lower unit costs and greater efficiency in distribution. The activities of trading companies generally require large amounts of working capital, purchasing expertise in the area of internationally traded commodities and bearing of considerable risk.

Counter Trade

Counter trade has become essential to trading companies' efforts to support economic progress in developing countries. Counter trade arrangements alleviate problems associated with shortages of hard currency and insufficient credit from international financial institutions by enabling developing countries to pay in kind for imports of good and services.

Information

Modern information gathering and analysing capabilities are a necessity of general trading companies, the largest of which maintain more than 100 offices around the world. Satellite-based communication systems allow the almost instantaneous transmission of messages around the globe, thus enabling general trading companies to handle vast amount of information exchange each day. The information networks of trading companies permit them to find market opportunities that would be difficult to locate for individual manufacturing companies.

Trade Development

Their comprehensive information capabilities place general trading companies advantageously for identifying new trade opportunities. Utilising their financial power and knowledge of products and markets, these companies are able to actively develop new sources of supply and create effective economic infrastructures. The role general trading companies have played in fostering the development of industrial parks in Thailand and other countries is one example of their trade promotion activities.

Finance and Investment

Trading companies are not banking institutions in the usual sense of the term; however, their ability to provide finance has become indispensable to many industries. Generally, the receivables of trading companies exceed that of the payables indicating that these companies are extending net credit to their client companies. Financing also takes place in the form of letters of credit guaranteed by the bank to help either importers or exporters. Additional types of financial assistance extended to companies include equity investments, direct loans and guarantees of loans and other obligations of their client companies. They maintain their own credit evaluation sections and make periodic reappraisals of the credit standing of client companies.

Risk Absorption

The size and diversity of the markets in which they are active and variety of products they deal with underlies the particular ability of trading companies to absorb risk. They play a key role in helping manufacturers alleviate foreign exchange risk. Currency fluctuations can have substantial impact on exporters operating independently unless they hedge their currency risks. Trading companies are thus able to sign contracts that guarantee stable forward exchange rates, extending in some cases to more than a year.

Key Success Factors in Trading

Some attributes of large trading companies that have been important in supporting trade development are as follows:

- Familiarity with and expertise in working in most of the global markets.
- Access to vast amount of information pertaining to industry and trade and the capability to process and disseminate this information quickly.
- The ability to provide financial assistance in the form of trade credits to finance import/export activities, investments, loans and loan guarantees, and lease financing for capital equipment.

The means to absorb some of the risks inherent in trade. This ability stems from the wide range of products handled by trading companies and their effectiveness in managing foreign exchange and other types of risk.

- Ability to spot opportunities and act quickly.
- Certain degree of trade secrecy is required.
- Availability of captive supply of products.

Business Analysis

The primary business of STC is international trade. It imports and exports commodities on both government account and for private parties. In addition, STC is also the nodal agency for counter/off-shore trade and undertakes domestic trade in selected commodities like edible oil. The company's main activities can be divided into four major areas:

- Activities handled on behalf of the Government of India which primarily include import and export of canalised items
- Non-canalised imports
- Non-canalised exports
- Domestic Trading

STC is geared to undertake export or import of any item from manufacturing products to bulk commodities by view of the various strengths developed by it since inception. GoI has granted it the status of **Star Trading House**.

STC has witnessed significant changes in its business profile over the last seven years. Till the late 1980s, both STC and MMTC enjoyed the benefits accruing from their position as the canalising agencies for foreign

trade for GoI. Between STC and MMTC, there existed a clear demarcation of commodity groups, with MMTC trading in metals and minerals, gems and jewellery and fertilisers and STC in all other commodities. During the 1970s and early 1980s, trade in about 118 commodities was canalised through STC exclusively. STC reached its peak of operations with operating income of Rs. 3,646 crore and net profit of Rs. 34 crore in FY 88. With the liberalisation of the Indian economy, the environment in which STC was operating changed drastically. Its role as a canalising agency of GoI was rendered meaningless and its primary activity of import and export of canalised items reduced significantly.

With the comfort of operating in a protected-environment no longer available, STC has faced declining profitability and margins. Imports constituted around 82% of STC's gross sales in FY 98 as against 21% in FY 94. Of the total imports, the share of imports on behalf of GoI was around 72% in FY 98. This comprised mainly import of wheat, fertiliser and edible oils. Exports and domestic trading accounted for 12% and 6% of the gross traded sales respectively in FY 98. The details of the STC's division-wise sales and trading profits for the past four years are given below.

Table 2 : Division-wise Sales and Trading Profits Rs Crores

	1997-98			1996-97			1995-96			1994-95		
	Sales	Profit	Margin	Sales	Profit	Margin	Sales	Profit	Margin	Sales	Profit	Margin
EXPORTS												
Non-canalised Exports	338.72	-13.55	-4.0%	512.89	3.13	0.6%	543.31	4.57	0.8%	363.79	2.72	0.7%
Off-shore	0.00	0.00		0.00	0.00		5.09	0.07	1.4%	65.30	2.91	4.5%
Counter Trade	0.00	0.00		0.00	0.00		201.00	0.92	0.5%	376.53	1.58	0.4%
TOTAL EXPORTS	338.72	13.55	-4.0%	512.89	3.13	0.6%	749.40	5.56	0.7%	805.62	7.21	0.9%
IMPORTS												
Govt. Account Import	1,692.62	23.39	1.4%	1,742.76	29.71	1.7%	714.20	18.26	2.6%	904.06	27.31	3.0%
Non-canalised Imports	658.17	7.75	1.2%	152.69	9.86	6.5%	142.99	3.89	2.7%	61.28	1.56	2.5%
TOTAL IMPORTS	2,350.79	31.14	1.3%	1,895.45	39.57	2.1%	857.19	22.15	2.6%	965.34	28.87	3.0%
DOMESTIC SALES	177.45	3.25	1.8%	116.18	3.89	3.3%	78.20	7.88	10.1%	90.00	11.54	12.8%
TOTAL SALES	2866.96	20.84	0.7%	2524.52	46.59	1.8%	1684.79	35.59	2.1%	1860.96	47.62	2.6%

Import on Government account has become the primary activity accounting for about 59% of the total turnover in 1997-98. The Government trade through STC has been mainly in the event of a shortfall in domestic supply for sugar, wheat, edible oil, etc. and hence has been fluctuating in the past. It is extremely difficult to predict the quantum of the imports on

the Government account. Moreover, the Government can utilise / permit other agencies like NDDB, FCI, NAFED, etc to canalise its imports.

Non-canalised imports account for 23% of the total turnover of STC in FY 98. Import of Gold/ Silver, against a Special Import License (SIL), comprises a substantial portion (of the total non-canalised imports during 1997-98. However, with GoI allowing various banks to import gold, STC does not have the infrastructure and the expertise to compete. During the first half of the current financial year, STC has imported gold worth only Rs. 50 crore. Trading margin in non-canalised imports is also subject to lot of fluctuations. It declined from 6.5% in FY 97 to 1.2% in FY 98.

Exports by STC has shown significant fluctuations in the past. Exports declined by 32% and 34% in FY 97 and FY 98 respectively. STC has met with limited success in the field of non-canalised exports. The main reasons for this are the Non-availability of captive supply for exports, Lack of experienced personnel for exports and Lack of risk-taking confidence.

Traditionally, STC's domestic trade operations comprised of two main businesses: purchase and sale of imported cars and Extraction/oil/cakes. Till recently, the major domestic trading operations of STC were confined to the sale of imported cars that were sold to STC by foreign diplomats. These cars were then auctioned to the public. However, with the availability of better cars in India and much lower excise duty (40%) as compared to the import duty (100%), the volume of this business as also the profitability has declined drastically.

Sales of edible oils emanating from oilseed crushing operations. It is proposed to gradually increase the sale of edible oils in consumer packs under its own brand called 'Darpan.' However, it has met with limited success and posted a trading loss in FY 98.

With the decline in sale of imported cars, trading margin has also been adversely affected in this business. It has declined from 12.8% in FY 95 to 1.8% in FY 98. Another reason for the decline in performance was the poor performance of the extractions business.

Subsidiary

The Tea Trading Corporation of India Limited (TTCI), a wholly-owned subsidiary of STC owns tea gardens and is involved in manufacturing,

selling and exporting tea. It was made a subsidiary of STC in 1985. GoI paid a sum equal to the accumulated losses of TTCI (around Rs. 12 crore) to STC. STC's investment in the Rs. 11.14 crores share capital of TTCI cost Rs. 3 crore.

The company's net worth has been wiped out and has not paid the salaries to its 427 employees for the past seventeen months. STC has also provided a loan of Rs. 1.71 crore to TTCI during FY 96 and FY 97. STC has started the winding up procedure for TTCI. About 290 employees of the total employee strength of 427 have already opted for the VRS.

Competitive Analysis

STC does not compare favourably with the other major trading companies operating in India. Since STC's loss in 1997-98 was primarily due to poor condition of the extractions market, we have also considered the 1996-97 results. Its gross trading margin is considerably lower than the other GoI trading companies. However, MMTC's higher margins could be attributed to the higher amount of canalised business. When compared to private Indian trading companies like Adani and Tata International, STC's margins are substantially lower. Their employee expenses as percentage of the operating income are also significantly lower than GoI trading companies.

Table 3 : Peer Comparison

Rs Crores

	STC 1997-98	STC 1996-97	MMTC 1997-98	PEC 1997-98	Adani 1997-98	Tata Intl. 1996-97	Itochu 1997-98
Gross Sales	2867.01	2524.54	4473.43	448.71	2258.78	1662.21	500106.00
Gross Trading Profit	20.17	47.62	114.76	9.92	160.50	92.46	19196.68
Trading Margin	0.69%	1.83%	2.54%	2.21%	6.65%	5.47%	3.83%
Employee Expenses/OI	1.37%	1.16%	1.24%	1.29%	0.13%	0.93%	N/A
Trading Overheads/OI	2.32%	2.21%	2.49%	2.40%	3.03%	3.71%	3.25%
Net Trading Profit	-47.44	-9.97	2.41	-0.87	100.86	43.99	713.85
Net Trading Margin	-1.63%	-0.38%	0.05%	-0.19%	4.18%	2.60%	0.14%
Non-Operating Income	56.10	86.77	44.22	2.76	13.56	11.64	3877.38
OPBT	-58.51	-29.29	-19.83	-1.37	75.80	35.42	—
Non-Operating Income/OPBT	N/A	N/A	N/A	N/A	17.89%	32.86%	—
Profit After Tax	2.57	37.73	17.37	0.92	62.51	19.92	-3056.43
Net Margin	0.09%	1.45%	0.38%	0.20%	2.59%	1.18%	-0.61%
Employees	1683	1816	3144	230	—	—	6675
Sales per employee	17,035,116	13,901,652	14,228,467	19,509,130	—	—	749,222,472
Gross Sales/Rupee of Employee Expense	71.71	71.71	80.18	77.23	701.48	105.47	—

Financial Analysis

Earlier STC was the sole canalising agency for various products and it was assured of earning profits as GoI paid a fixed commission. However, the liberalisation of the Indian economy since 1991 has adversely impacted STC's operations. Currently, the edible oil for PDS is the only product canalised through STC. This change has adversely affected the trading profitability of STC with the trading margin declining from 6.4% in FY 93 to 0.7% in FY 98.

Table 4 : Financial Highlights

Rs. Crore

	FY98	FY97	FY96	FY95	FY94
Operating Income	2914	2602	1749	1879	1133
Operating Profit	-47.4	-10.0	-13.4	6.5	-3.3
Non-operating Income	56.1	86.8	66.2	48.2	51.1
PAT	2.6	37.7	22.1	22.1	22.6
Equity Capital	30.0	30.0	30.0	30.0	30.0
Tangible Networth	439.5	446.9	409.1	396.1	383.0
Gross Margin (%)	-1.6	-0.4	-0.8	0.3	-0.3
Net Margin (%)	0.10	1.45	1.30	1.20	2.0
ROCE (%)	0.65	6.71	8.79	10.88	9.69
RONW (%)	0.60	8.44	5.40	5.58	5.90
Earning Per Share	0.86	12.58	7.35	7.37	7.55
Dividend (%)	33	0	30	30	30

Turnover increased in FY 97 and FY 98 primarily due to import of wheat on behalf of GoI. Although operating income increased by 12% during FY 98, trading profit and net profit declined by 58% and 93% respectively due to Rs. 14 crore loss suffered by STC in exports of extractions. STC has been registering net profit over the last few years only because of substantial interest income from its investment portfolio (Rs. 163 crore in US-64) and rental income from its headquarters at New Delhi. Its non-operating income was Rs. 56 crore in FY 98.

Even though around 700 employees of STC opted for the VRS between FY 90 and FY 98, its overheads have been steadily increasing since FY 95. As on March 31, 1998 the current employee strength was 1649.

Though STC's debt in the books was Rs. 557 crore at the end of FY 98, around Rs. 537 crore (banker's acceptance) is an accounting adjustment for wheat purchase in conjunction with the Food Corporation of India (FCI) matched by corresponding receivables.

Strengths and Areas of Concern

Strengths

Trading Experience and Credibility as a result of operating in the trading business for more than last 40 years.

Government's Canalising Agency - Almost all the non-metallic imports by the Government are routed through STC.

Areas of Concern

PSU Status - The PSU status of STC hampers in quick transition and appropriate organisational culture to cope with the changing competitive environment.

Lack of Global Information Network - STC has extremely limited research of its own and it relies completely on the Reuters Information Network for all its information needs. STC has failed to keep abreast of the latest developments and is woefully under-computerised.

High dependence on Government Trade - In the recent past the Government trade has shown high fluctuations and Government has also started routing imports through other agencies. STC has not been able to develop Non-Government trade in India to diversify its operations.

Over-manning with adverse skill profile - STC's employee expenses take away a major portion of its trading profits. The Staff to Manager proportion for STC is high at 4:3. As a result of time-based promotion policies, many senior level executives lack the requisite qualifications.

Lack of Backward/Forward Client Base - Even though STC played an important role in developing exports from India, it was not able to create a captive supply base. Its business associates utilised its services to gain knowledge of the overseas buyers and then bypassed STC to save the service charges.

Weak Balance Sheet - STC's financial position does not allow it to use trade credit to expand its business.

Recommendation

As has been discussed above, the objectives for which STC was formed in 1956 are no longer relevant. STC's performance has also been suffering due to excessive employee strength and poor trading margins. It is dependent for business on GoI which has started engaging other companies for imports such as FCI (Wheat), MMTC (Metals & Fertilisers), Indian Potash (Fertiliser), NDDB (Edible Oil), NAFED (Other agricultural commodities). STC has been incurring losses from their trading operations in recent years. However the company is showing net profits only because of large non-operating incomes such as rent, income from investments etc.

The company has been incurring losses on trading business primarily on account of high employee cost. Normally the trading business offers low margins and competitiveness and profitability mainly depends on keeping the overheads to bare minimum. The employee cost over the years has risen significantly due to salary revisions etc. In case of STC, the employee cost amounted to Rs. 40 crore as against the gross trading profit of Rs. 20 crore during 1997-98.

In the liberalised scenario, where STC would have to compete with Private Indian and International Trading Companies, responsiveness, efficiency and cost control would be critical for successful trading operations.

It is to be noted that State Trading, which was widely prevalent at one time, has been gradually phased out in most countries. This has led to loss of significant market opportunities for STC. **The Commission feels that no public purpose would be served by STC being under the Government ownership and control. Hence the Commission classifies STC as non-core. Further, its viability as an enterprise under government ownership and management is doubtful.**

Under the circumstances, the Government has the following options for disinvesting its holding in STC.

Option 1: Through a strategic sale to a bidder from a group of pre-qualified bidders through global competitive bidding and transfer of management.

Option 2: Closure

Under the first option, there is likely to be interest in acquiring the Government's current holding in STC as it is one of the larger trading companies in India. The strategic sale would enhance share values consequent on the company going out of the public sector.

Simultaneously with the decision to disinvest, manpower reduction through VRS should be initiated. As an added incentive, a 5% share could be reserved for sale to employees who opt for VRS. This sale would be at a discount to the strategic buyer's price.

Under the Second Option, STC could be shut down after offering an attractive compensation package as provided under the law to the employees. The cost of closure can be met out of the realisation of assets.

In both the options, the work relating to market intervention for price stabilisation, wherever necessary, would have to be entrusted to other agencies by the Government, as it has been doing in the past.

The Commission recommends that the First Option be adopted for the disinvestment of entire GoI holding in STC to a strategic buyer, after reserving 5% share for employees who opt for VRS - at the rate of not more than 200 shares per employee - at a discount to the strategic buyer's price, as this would provide continuation of the trading operations under private ownership and management with sustainable levels of employment. Manpower reduction through VRS would have to be undertaken simultaneously with the decision for disinvestment.

REPORT

X

DISINVESTMENT COMMISSION

JUNE
1999

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PART A

1. GENERAL RECOMMENDATIONS

1.1 STATUS OF PSUs REFERRED TO THE COMMISSION

In 1996 and 1997, Government had referred a total of 50 PSUs to the Commission. Government then withdrew seven PSUs, effectively leaving 43 PSUs for the Commission to examine and give its recommendations. The Commission had, in eight Reports, submitted its recommendations in respect of all these 43 PSUs. The VIII Report of the Commission was submitted in August, 1998. Ten PSUs were referred to the Commission in October 1998. Eight more PSUs were referred to the Commission in January, 1999 and another four in April, 1999. Out of these, five PSUs were already under reference to BIFR. Thus, out of 22 PSUs referred to the Commission in 1998 and 1999, five already stood referred to BIFR. Out of these 22 PSUs, the Commission had given its recommendations in respect of two PSUs, namely, HSCL and STC, in its IX Report submitted in March, 1999. In this X Report, the Commission has given its recommendations in respect of five PSUs including ONGC on which the Commission had earlier suggested that disinvestment be deferred. This leaves 11 PSUs (excluding five referred to BIFR) for examination by the Commission. The Commission is in correspondence with Government regarding the PSUs that are already referred to BIFR.

The list of PSUs referred to the Commission is given in Appendix I. The list of PSUs withdrawn from the Commission is given in Appendix II.

1.2 PROGRESS OF IMPLEMENTATION OF COMMISSION'S RECOMMENDATIONS

The Commission has so far submitted Nine Reports to the Government covering 45 PSUs referred to it. The gist of general recommendations and action taken by Government on them is given in Appendix III. The modalities of disinvestment recommended in respect of specific PSUs and action taken by Government is given in Appendices IV and V. The following Table indicates the action taken by Government on the recommendations of the Disinvestment Commission on individual PSUs.

Table 1 : Action Taken@ on Recommendations of Disinvestment Commission

Accepted	Decision Deferred	Decision Implemented	Decision being Implemented	Decision Awaited
1. RITES 2. MOIL 3. OIL* 4. ONGC* 5. SAIL* 6. NTPC* 7. NHPC* 8. PGCL* 9. NLC*	1. FACT 2. NFL	1. MTNL^ (May.97) 2. CONCOR* (May.97)	1. GAIL (Feb.97) 2. KIOCL (Mar.97) 3. MFIL (Feb.97) 4. EPIL (Nov.97) 5. HTL (Apr.97) 6. EIL (Nov.97) 7. IPCL (Mar.98) 8. HCIL (Dec.97) 9. R.Ashok (Nov.97) 10. U.Ashok (Nov.97) 11. BALCO (Apr.97) 12. SCI (Aug.97)	1. ET&T(Dec.97) 2. RIC (Dec.97) 3. NALCO (Mar.98) 4. HCL (Aug.97) 5. NEPA (Nov.97) 6. HZL (Dec.97) 7. PHL (Aug.97) 8. AI (Aug.98) 9. PPCL (Dec.97) 10. CEL# (Aug.98) 11. HVOC (Dec.97) 13. IBP (Nov.97) 14. HPL (Nov.97) 15. HLL (Mar.98) 16. ITI (Apr.97) 17. BRPL (Apr.97) 18. MFL (Apr.97) 19. ITDC (Feb.97) 20. HSCL (Mar.99) 21. STC (Mar.99)

Note : Information given in brackets indicate month and year of the Commission's recommendations.

@ As per information communicated by Government (As on 1st February 1999).

Commission had recommended that disinvestment be deferred in these PSUs pending fulfilment of certain specified conditions.

& Implemented in December 1997.

** Implemented in November 1998.*

^ The Commission had not recommended disinvestment in this PSU

It would be seen from this Table that out of 45 PSUs for which recommendations have been made to the Government, decision is yet to be taken in 21 cases. Out of 27 cases of strategic sale/trade sale recommended by the Commission (Appendix V), decision is awaited in 16 cases.

There has been no further progress in the implementation of recommendations of the Commission after it submitted its Ninth report in March, 1999.

PART B

2. SPECIFIC RECOMMENDATIONS

2.1 MMTC Ltd

Evolution

MMTC was incorporated in September 1963 as The Minerals and Metals Trading Corporation of India Limited for the purpose of canalising import/export of metals and minerals in the country. MMTC was also made the sole canalising agency for the import of fertilisers and fertiliser intermediaries in 1971.

The Government disinvested its stake to the extent of 0.7% in the company in 1993, at an average value of Rs. 92 per share. This stake is held by institutions and other companies.

MMTC's facilities include 7 overseas offices, 52 domestic offices, 10 site offices and a well-established storage and transportation network.

Industry Analysis

Global Trading Industry

In terms of nominal export value, the world trade in 1997 was about US\$5.46 trillion.

Table 1 : Growth in Global Trade

	1997	1996	1995	1994
Growth in Global Trade (By Volume)	4.1%	6.2%	10.3%	10.2%
Growth in Global Trade (By Value)	3.4%	3.9%	19.7%	13.8%

Table 2 : Growth in Trade by Developed and Developing Countries

For the year 1997	Developed Countries	Developing Countries
Exports	US\$3.63 trillion	US\$1.83 trillion
<i>Growth in Exports</i>	2.3%	5.8%
Imports	US\$3.62 trillion	US\$1.97 trillion
<i>Growth in Imports</i>	2.3%	8.0%

Among the developed countries, US accounted for the major share of trade. Japan and the EU (with the exception of the U.K.) generally made only a small contribution to the expansion in world trade.

Indian Trading Industry

International trade in almost all commodities was canalised through the two government trading houses - STC and MMTC prior to liberalisation in 1991-92. This resulted in assured volumes and guaranteed operating margins for the company. However, with the decanalisation of trade and entry of international trading houses in the Indian market, the monopoly position of these companies has been eliminated.

Several players in the private sector including Adani Exports Ltd., Tata International Ltd., Ganapati Exports Ltd., etc. entered the business of trading in commodities in the last few years. With the end of monopoly status for the government owned trading corporations, the trading business has become competitive and less remunerative for the public sector units. MMTC is the largest trading company in India, despite large-scale decanalisation by the government.

Table 3 : Comparison of some Prominent Indian Trading Houses

(Rs. Crores)

	MMTC	STC	Adani Exports	Tata International
	1997-98	1997-98	1997-98	1996-97
Gross Sales	4473.43	2866.96	2417.77	1693.60
Profit After Tax	17.35	2.57	76.97	20.50
Net Profit Margin	0.4%	0.1%	3.2%	1.2%
Return on Capital	4.9%	7.6%	20.9%	17.2%
Return on Networth	2.7%	0.6%	31.5%	20.3%
Total Debt/Networth	0.18	1.27	0.94	1.31

The Role of a Trading Company

The fundamental role of a trading company is to accurately grasp the needs of the buyers, to identify the goods and services they require, to find the suppliers for these products, and to ensure timely delivery

of these goods and services to hedge against the risks associated with uncertainties in supplies and uncertain markets. General trading companies, like Mitsubishi, Mitsui, Marubeni, Itochu and Nissho, have now gone beyond simply offering mid-stream intermediary services for sellers and buyers. The current range of services of these trading companies include :

1. Moving up-stream into development and production of goods (for ensuring an assured and captive supply base)
2. Moving down-stream into actual transactions and sales (for ensuring an assured market)
3. Possessing captive/owned trade-related logistics and infrastructural facilities including intermodal transport facilities, warehousing, and material handling facilities to maximise distribution efficiency
4. Undertaking treasury and risk management functions

In the West, it is generally manufacturing companies that have been the engines behind trade expansion. Trade intermediaries have tended to diminish in importance as manufacturers acquire the skills to procure raw materials overseas and sell products in foreign markets on their own behalf.

In Japan, major commercial enterprises like Mitsui and Mitsubishi set up separate companies or divisions to handle external trade transactions for their affiliates. These companies have since become increasingly involved in downstream investment activities through international diversification and investment in a wide spectrum of industries. They are now involved into upstream activities such as mining and manufacturing and downstream activities such as retailing, catering, leisure and other service industries.

The growth of Chaebols (South Korean trading houses) has, however, been due to government's industrial expansion plans. Today, these chaebols trade in a number of commodities and have integrated backwards into manufacture of a number of products like cars, planes, machinery, electronics, textiles, chemicals, glass, etc. In India, large trading houses were set up in public sector predominantly to cater to the government's exports or imports. These have not diversified and have remained as trading companies only.

Business Analysis

MMTC is a "Superstar" trading house engaged in international trading operations and related activities. MMTC now trades mainly in minerals, fertilisers, gold/gems and jewellery, non-ferrous metals and agro products. The canalised products contributed to around 34% of MMTC's turnover in FY 98.

Table 4 : MMTC's Commodity-wise Turnover and Trading Profits(*)

(Rs. Crore)	1997-98			1996-97			1995-96		
	Turnover	Trading Profit	% margin	Turnover	Trading Profit	% margin	Turnover	Trading Profit	% margin
<i>Canalised Exports</i>									
Minerals	947	55	5.84%	848	58	6.81%	807	56	6.98%
<i>Non-Canalised Exports</i>									
Agro Products	75	2	2.14%	135	0	0.17%	198	2	1.10%
Minerals and Ores	33	3	9.96%	37	2	4.05%	21	2	8.32%
Others	132	5	3.76%	117	14	11.82%	351	-1	-0.20%
TOTAL EXPORTS	1187	65	5.49%	1137	73	6.45%	1376	60	4.33%
<i>Canalised Imports</i>									
Urea	562	2	0.37%	849	2	0.26%	1898	4	0.23%
Sugar				0	0		252	3	
<i>Non-Canalised Imports</i>									
Fertilisers	110	5	4.52%	203	-13	-6.34%	189	-7	-3.60%
Non-ferrous metals	272	5	1.78%	317	0	-0.09%	655	-2	-0.25%
Gold/gems and jewellery	2115	37	1.76%	2019	35	1.72%	1447	38	2.65%
Others	73	4	6.06%	18	1	7.65%	11	1	5.42%
TOTAL IMPORTS	3132	53	1.71%	3407	25	0.74%	4451	38	0.86%
DOMESTIC TRADE	155	-4	-2.53%	195	-12	-6.20%	398	-7	-1.67%
TOTAL TRADE	4473	115	2.57%	4738	86	1.82%	6224	91	1.46%

(*) Trading Profit = Total trading income less cost of sales, manufacturing cost etc. but doesn't include salary & wages, administrative expenses, overheads, interest and depreciation.

Gems, Jewellery and Gold Division

The main activities of this division are import of gold and export of jewellery. It has been one of the fastest growing divisions of the company and the sales of this division (excluding domestic sales) have increased from Rs. 793.8 crores in 1993-94 to Rs. 2156.20 crores in FY 98.

The operations of this division involves duty-free import of Gold and Silver for use by jewellery exporters in DTA /EPZ /EOU areas and import of gold and silver against Special Import Licence for domestic consumption. In FY 98 the company imported 49 tonnes of gold and 266 tonnes of silver.

Recently, the Government of India has also allowed 10 commercial banks to import gold into the country, which has created substantial competition for MMTC as these banks are able to transact the business at lower costs as compared to MMTC. These banks have advantages over MMTC of not having to incur remittance fees, vault rentals and some other incidentals, since they have access to banking facilities owned by them, while MMTC has to rely on other banks for these services.

Minerals Division

The main activity of this division is export of iron, chrome and manganese ore. Manganese and Chrome ore exports are relatively small as compared to the iron ore.

Currently, all iron ore with iron content over 65%, manganese and chrome ore is canalised through MMTC. Iron ore is mainly exported to manufacturers in Japan, Korea, China and Pakistan. For its exports to Korea and Japan, MMTC has entered into a long-term contract with Pohang Iron & Steel Company (POSCO) and Japanese Steel Mills Association and this agreement is valid till 2002. Around 60% of the iron ore export is through long-term contracts. These companies can source their requirement of high quality iron ore from other countries also. The sales to China and Pakistan are on a spot basis.

The ability of MMTC to continue exporting minerals is closely linked to the policy of canalisation being followed by the government. As per the new EXIM policy for 1997-2000, the policy of canalisation of Iron Ore with Fe content over 65% & above, Manganese Ore and Chrome Ore has been extended till 2002. As long as this policy of canalisation continues, MMTC is expected to have a role in export of high grade iron ore.

Fertilisers Division

MMTC's fertiliser division is engaged in three main areas of activity, namely, canalised import of urea, import of non-canalised fertilisers and intermediaries (DAP, MOP Sulphur and Rock Phosphate), and domestic distribution of fertilisers.

The turnover of this division has varied considerably in the past five years, in line with the variation in the level of the urea imports. Canalised imports of urea forms the largest portion of MMTC's fertiliser operations, accounting for between 70% to over 90% of MMTC's fertiliser operations. The fertilisers division has been making losses for the past three years on account of the high level of competition in the domestic and non-canalised segment.

MMTC is one of the canalising agencies for urea imports in the country, the other canalising agencies being Paradeep Phosphates Limited, National Fertilisers Limited and State Trading Corporation. Urea is the only item currently under canalisation, the import of other items such as MoP, DAP, Sulphur and Rock Phosphate is decanalised.

In the non-canalised business, MMTC imports DAP, MOP, Rock Phosphate and Sulphur into the country and supplies the same to the domestic users of the products. The company also distributes the imported DAP within the country. In the domestic operations, MMTC bids for the distribution of imported urea into the country and supplies the same. In the both these business, the competition is very intense and MMTC's profit margins have been under pressure and have been fluctuating.

Agro Division

The main activities of this division are export of rice, Soya bean meal, wheat and pulses. The division also imports sugar on government account and also trades Agro products domestically. A substantial part of the turnover of this division in the past has come in from the import of sugar into the country. However, with the government not placing any orders for the import of sugar on MMTC in the past two years, and since import of sugar is placed under OGL from time to time, the turnover of this division has decreased considerably from Rs. 711.70 crore in 1994-95 to Rs. 133.70 crore in 1997-98. MMTC earns a commission of around 1-1.5% of the imported value of imported sugar. MMTC also exports Soya meal,

rice and wheat and pulses through its Agro Division. The business prospects for MMTC on these commodities appears uncertain.

Non-ferrous metals

MMTC's Metals Division mainly imports copper, zinc, lead, tin and nickel. The turnover of the division has declined considerably in the past three years from Rs. 881.20 crore in 1995-96 to Rs. 286.90 crore in 1997-98. This decrease has been largely due to other importers entering the market which resulted in decline in the traded volumes and the declining prices of metals in these years. The profitability of this division has also varied in the past five years largely on account of the volatile movement in the metal prices.

MMTC imports metals at LME based prices and supplies the same to customers in India. MMTC imports both on its own account for trading purposes and against firm orders from end-users.

Financial Analysis

Table 5 : Financial Highlights

(Rs. Crore)

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	4,523.3	4,822.8	6,293.7	5,296.8	3,239.9
Operating Profit (OPBDIT)	14.2	1.2	25.4	53.5	26.6
Interest and finance charges	19.6	37.1	45.3	37.5	10.7
PBDT	-5.4	-35.9	-19.9	16.1	15.9
PBT	-8.0	-38.4	-22.4	14.2	14.0
Non-operating income	32.4	52.3	76.1	66.7	52.1
PAT	17.4	27.4	50.2	67.4	51.9
Equity Capital	50.0	50.0	50.0	50.0	50.0
Tangible Networth	634.9	636.4	628.5	593.4	540.9
Gross Margin (%)	0.3%	0.0%	0.4%	1.0%	0.8%
Net Margin (%)	0.4%	0.6%	0.8%	1.3%	1.6%
RONW (%)	2.7%	4.3%	8.0%	11.4%	9.6%
Earning Per Share	3.5	5.5	10.0	13.5	10.4
Dividend (%)	11.0	16.5	15.0	15.0	—

Immediately after decanalisation the turnover of the company decreased to Rs. 3217 crore in 1993-94, from approx. Rs. 8100 crore in the preceding year and has been fluctuating thereafter.

The operating margin has decreased continuously from 1% in FY 95 to 0.02% in FY 97 with a marginal improvement in FY 98 to 0.3% in FY 98. However, with the declining margins, the Profit after Tax (PAT) of MMTC has declined from Rs. 67.44 crore in FY 95 to Rs. 17.35 crore in FY 98. MMTC has been able to show a positive Profit after Tax, largely on account of the considerable non-operating income which also ranged from a level of Rs. 76 crore in FY 96 to Rs. 32 crore in FY 98.

In addition to its investments in its subsidiary companies, MMTC has made investments in units of UTI and public sector bonds.

Table 6 : MMTC's investments (As at March 31, 1998)

Particulars	Rs. Crore
<u>Subsidiary</u>	
MMTC Transnational Pte. Ltd., Singapore	3.14
<u>Affiliates</u>	
Kings International Acqua Ltd.	2.25
Suvarna Acqua Farms & Exports Ltd.	2.40
Indo French Biotech Ltd.	4.75
Visaka Acqua Ltd.	1.15
Classic Mushroom Ltd.	3.25
Total Investment in Affiliates	13.80
<u>Other Investments</u>	
PSU Bonds	127.78
UTI Units	41.76
Total Other Investments	169.54
Total Investments	186.48

MMTC has no long-term loans outstanding as at March 31, 1998 and all its loans are short term in nature. The Debt to Equity ratio of the company has declined continuously from 0.50 as at March 31, 1995 to 0.18 as at March 31, 1998.

Strengths and Areas of Concern

Strengths

Large Network of over 50 domestic offices and 7 international offices providing sizeable infrastructure for its trading operations.

Over 30 year's Experience in the trading in the Metals, Minerals, Fertiliser, Gems & Jewellery and Agro Products.

Strong capital structure with a low Debt to Equity ratio of 0.18 providing leveraging opportunity for future funds requirement.

Areas of Concern

PSU Status - Inability to respond fast to opportunities in the trading environment on account of government procedures

High Dependence on Government - High level of dependence on government trade, to the extent of 35% of turnover and 50% of profits (1997-98).

Excess Manpower – Surplus manpower estimated at about 2000 out of the 3400 employees, leading to high employee costs.

Low Margins – MMTC is incurring losses (PBDT) in its operations as evident from the table shown in the Financial Analysis section.

Recommendations

In the liberalised scenario, where MMTC has to compete with private Indian and International Trading Companies, responsiveness, efficiency and cost control would be critical for successful trading operations.

It is to be noted that state trading, which was widely prevalent at one time, has been gradually phased out in most countries. India's export-import policies have also been liberalised in the last few years. This has led to significant loss of market opportunities for the government owned trading companies in India. **The Commission is of the view that no public purpose would be served by retaining MMTC under government ownership and control. Hence the Commission classifies MMTC as non-core.**

After the progressive de-canalisation and liberalisation of trade, MMTC's dependence on government related trade has decreased considerably, from about 50% to 33%. With the recent stiff competition from the 10 commercial banks, both turnover and profit of MMTC from the gold business would decrease. Hence the sustenance of mineral trade, of which iron ore exports account for 80%, assumes increased importance for MMTC's viability. However, the question of whether export of high grade iron ore should be canalised through MMTC or allow NMDC, which mines these high quality iron ore, to directly export is a matter to be decided by Government.

Moreover, MMTC has been incurring operating losses (after interest) on account of the low trading margins and the high employee related cost. MMTC's manpower strength of about 3,400 is substantially in excess of the sustainable level. The company has been reporting positive Profit After Tax (PAT) largely due to its non-operating income. In case the company wants to remain profitable, employee strength has to be reduced substantially for which a suitable VRS should be implemented on priority basis.

It is expected that in the foreseeable future the existing list of the canalised products will be pruned further resulting in further reduction in the turnover of the government trading agencies including MMTC. However, MMTC's expertise in trading and infrastructure that it has developed over these years could be of interest to a prospective buyer.

Keeping in view the above, the Commission recommends reduction in employee strength through implementation of a suitable VRS and transfer of the management control in MMTC to a private partner by disinvestment of 51% of equity of MMTC through strategic sale. Before such strategic sale, the canalised export of iron ore will need to be transferred to another agency such as NMDC. The government could later sell the remaining equity holding in favour of public, when the value of the residual equity holding of government increases as a result of transfer of the management control.

In case there is no investor interest in the strategic sale, there would be no option but to close the operations of MMTC after transfer of canalised export of iron ore to NMDC.

2.2 National Mineral Development Corporation Limited

Evolution

National Mineral Development Corporation Limited (NMDC), was incorporated as a private limited company on November 15, 1958 and converted into a public limited company on May 5, 1993. NMDC was set up to develop and exploit mineral resources of the country other than coal, oil, natural gas and atomic minerals. Since 1958, NMDC has identified and developed various mineral deposits like iron ore, diamonds, copper, magnesite, dolomite, low silica limestone and rock phosphate. Many of these operations were later transferred to separate companies such as Hindustan Copper Ltd., Hindustan Zinc Ltd. and Kudremukh Iron Ore Company Ltd.

NMDC's current operations include mining of iron ore, limestone and diamonds. It is currently India's largest independent producer and exporter of high value iron ore, operating mines at Bailadila in Madhya Pradesh and at Donimalai in Karnataka. At current production levels of about 15million tons, NMDC's reserves of 896million tons can last 61 years. NMDC also operates India's only mechanised diamond mine at Panna in Madhya Pradesh.

The company's paid up share capital is Rs. 132.2 crore of which GoI holds 98.38%. GoI divested 1.61% in FY 93 to banks and FIs and 0.01% to employees in FY 98. NMDC's shares are listed on six stock exchanges. However, there has been negligible trading in its shares.

Industry Analysis - International scenario

Iron ore is the primary source of iron (Fe). Virtually all, 98.7% of it, is used in the steel industry. Most iron ores mined comprise iron oxide minerals, hematite goethite, limonite - a mixture of hydrated iron oxides, and magnetite. The quality of ore is determined by iron content, good mechanical strength, high reducibility and as little disintegration as possible during reduction.

Iron ore resources in the world are estimated at over 2 billion tonnes of which India has only a share of (approx.) 5.2%. India ranks sixth in iron

ore production and seventh in iron ore reserves. However, Indian ore has a high iron content and therefore a higher economic value. India's competitors in high quality ore are Brazil, Australia and South Africa. China, the world's largest producer, has poor quality iron ore (Fe content 39%).

Traditionally, the blast furnace/basic oxygen furnace route has been used in steel making. In recent years Electric arc furnace (EAF) steelmakers, because of lower capital costs and superior quality control, have become important and are expected to constitute 34% of world steel making by 2000. Steel scrap, the raw material for EAFs, however, is likely to be inadequate according to projections made by World Steel Dynamics (A Paine Webber Publication). The sponge iron industry, which provides an alternate source of raw material for EAFs, has therefore witnessed a rapid growth.

Sponge iron plants require iron ore with higher iron content than blast furnaces. Indian ore, being of high quality, is expected to gain from the shift towards the sponge iron route of steel making.

In 1996, 435 million tons of iron ore, accounting for 39.7% of the world iron ore production was exported worldwide. Australia and Brazil dominate the international export market for iron ore. Japan was the largest importer, accounting for 27.7% of all iron ore imports, followed by China and Germany at 10.1% and 9.1% respectively.

Indian scenario

In FY98, India exported 46% of its iron ore production, consuming 36million tons domestically. With production of steel projected to rise from 24million tons in FY98 to 35million tons by FY2005, domestic demand for iron ore is expected to increase to 54mn tons.

Generally, iron ore prices are set on a yearly basis and negotiated directly between buyers and sellers. Export prices are set in US Dollars. The benchmark level in price negotiation is usually set by the major market players; either between Australian ore producers and the Japanese steel industry, or between Brazilian producers and German steelmakers. Other buyers then demand comparability with Japanese and German buyers. With its limited share of world trade in iron ore,

India and NMDC have little possibility of influencing international price levels. With a downturn expected in the global steel industry in 1999, prices are expected to fall by about 10% in 1999 from 1998 levels and remain at low levels in 2000.

Domestic prices in India are negotiated between the main seller, NMDC, and the buyers, Vizag Steel plant, Essar and Ispat. SAIL and TISCO have captive iron ore mines. Domestic prices do not necessarily follow the same trend as international prices as they are influenced also by the depreciation of the rupee against the US\$.

Business Analysis

NMDC operates fully mechanized iron ore mines at Bailadila in Madhya Pradesh and Donimalai in Karnataka. It also operates India's only diamond mine at Panna in Madhya Pradesh. Besides, it is also involved in mining of limestone and magnesite. Iron ore mining was, however, the main activity of the company, accounting for about 98% of sales in FY98. NMDC's Bailadila mines have one of the best quality ore (Fe content of >65%) deposits in the world.

Reserves and Production

Table 1 : Reserves and Production (Million Tonnes)

Deposit	Reserves on 1/4/98	Production in FY 98	Reserve/Production (*) years
Bailadila Dep 14/11C	130	6	22
Bailadila Dep 5	111	5	21
Bailadila Dep (#)			
11A	17	—	—
11B	104	—	—
Bailadila Dep. 10(#)	220	—	—
Bailadila Dep 3(#)	80	—	—
Donimalai	55	4	15
Kumarswamy	179	—	—
Total	896	15	61

(*) based on FY 98 production

(#) unmined deposits

The Bailadila range consists of 14 deposits. NMDC has mining leases for all the 7 deposits where mining is economically feasible and currently mines Deposit 14/11c and Deposit 5. In Donimalai, NMDC operates one mine. All of NMDC's operating mines have a high iron ore content ($Fe > 67\%$). The Bailadila deposits contain, chemically and metallurgically, some of the best quality iron ore in the world. Ore at Donimalai, however, has a high phosphorous content.

The production grew from a level of (approx.) 10 million tonnes in FY 93 to approx. 15 million tonnes (approx.) thereby resulting in a CAGR of 6.6%. Similarly, Despatches grew from approx. 11.5 million tonnes (approx.) in FY 93 to X 15.6 million tonnes (approx.) in FY 98 resulting in a growth rate of approx. 6.2%.

NMDC exported all its iron ore upto FY91. Domestic sales began in 1990 with commissioning of Vizag Steel plant. In response to the setting up of sponge iron plants by Essar and Ispat, NMDC developed at Bailadila, Calibrated Lump Ores (CLO) which can directly be used in sponge iron making. However, with new domestic capacities in steel making coming up, GOI in 1991 placed export restrictions on Bailadila ore. From FY92 to FY97 only 2.4 mn tons of lumps and 1 mn ton of fines was allowed to be exported from the Bailadila sector,. This limit was relaxed partially in FY98 to 3 mn tons of lumps and 3.8 mn tons of fines. CLO exports are banned.

In the absence of an adequate domestic market, export restrictions place a constraint on the expansion of NMDC's production. This is why NMDC mines only three deposits in the Bailadila sector although it has mining leases for 7 deposits.

Further, NMDC does not have the right to market its ore in export markets. MMTC is responsible for marketing of the ore and all export has to be canalised through MMTC. The absence of direct on-going interaction with international steel buyers cuts off NMDC from competitive information; technology changes quality issues and even steel industry cycles. In an industry downturn, when steel makers reduce offtake of iron ore, they inform MMTC, which, in turn informs NMDC. MMTC is just an additional intermediary in the sales chain delaying the transmission of information. MMTC recovers all expenses

relating to export sales from NMDC. In addition, it charges commission on sales. In FY 98, the domestic and export sales quantities were as given below:

Table 2 : Iron Ore Sales By NMDC in FY 98 (Mn Tonnes)

	Exports		Domestic		Total	
	Qty	%	Qty	%	Qty	%
Bailadila						
Lumps	2.4	39	3.8	61	6.2	100
Fines	1.3	23	4.4	77	5.7	100
Donimalai						
Lumps	1.1	82	0.2	18	1.3	100
Fines	2.4	99	0.1	1	2.4	100
Total	7.1	46	8.5	54	15.6	100

NMDC exported 93% of the production at Donimalai, while it exported only 31% of Bailadila ore. The large export of the former is due to the absence of the type of steel plants which can use Donimalai ore. Exports are mainly to Japan, China and Malaysia.

Prices

The current ore prices at the mine head (i.e. net of freight cost) are given below:

Table 3 : Ore Prices at Mine Head US\$/ton

	Bailadila 14/11C		Bailadila 5		Donimalai	
	FY98	FY99	FY98	FY99	FY98	FY99
Lumps	9.63	8.82	9.78	8.99	8.42	7.72
Fines	6.65	6.02	6.83	6.19	5.14	4.61
CLOs	11.27	10.45	13.58	12.28		

Prices vary depending on the quality and type of ore; lumps, fines or CLOs. Bailadila 5 ore is considered the best, while Donimalai ore earns a lower value because of relatively poor chemical and metallurgical properties.

NMDC currently charges the same rate to domestic buyers as to international buyers. Considering freight costs, domestic steel

manufacturers get ore at their plants at rates of about US\$20/ton as compared to about US\$40/ton for Japanese steelmakers. NMDC has thus priced its ore to give a competitive advantage to domestic steel makers.

Export prices follow international trends. NMDC has been unaffected by price declines in the past because of rupee depreciation. Like all commodity producers in India, NMDC raises prices for domestic buyers also in case of rupee depreciation.

Competitive Advantage

NMDC's mining costs at about US\$4-4.5/ton are among the lowest in the world. Mining costs are about US\$5 for CVRD and US\$6-6.5/ton for BHP and Rio Tinto. The reasons for NMDC's low mining costs are (a) superior ore quality and (b) low labour costs.

a) Ore quality : The richer the deposits of ore, the lower are the ore raising charges and the better the quality of ore, the lower are the beneficiating and blending costs. The NMDC ore is comparable to CVRD's ore from Carajas region and better than that of Rio Tinto (Hammersly) and BHP. Even after spending higher amounts on beneficiating and blending the ore; Rio Tinto and BHP are not able to guarantee Fe content as high as NMDC.

b) Labour costs : International companies have higher level of mechanisation than NMDC and earn a higher level of revenue per employee. NMDC's employee cost/sales percentage is however, lower at 14% to BHP's 19% and CVRD's 18%.

Freight Cost

NMDC's competitors manage logistics by owning and operating mine-rail-port systems. CVRD, in fact, owns a major railway network in Brazil. It operates terminals at three ports in Brazil, one at Los Angeles and has its own ships. BHP and Rio Tinto (Hammersly), Australia also own the rail links from mines to their self managed terminals at ports. LKAB, which is owned by the Swedish Government, has assumed control of ore-rail systems in Norway and Sweden and is developing the harbour at Lulea in Sweden. LKAB also gains from proximity to the markets of Western Europe.

NMDC, on the other hand, is adversely affected by deficiencies of the Indian Railways and Ports. The Vizag Port has an average pre-berthing detention time and turnaround time of 1.3 days and 6.0 days respectively as against, for example, a few hours in Australia. NMDC spends US\$10/ton on transportation of ore from Bailadila to Vizag, a distance of 475kms, whereas CVRD (Brazil) spends US\$8/ton on transportation of ore over a distance of 800kms from Carajas to the port of Ponta da Madiera, and BHP about US\$7/ton to transport ore over a distance of 600kms.

NMDC's sales realization, net of freight cost, is therefore lower than that for its competitors. This is the main reason why inspite of having the lowest mining costs, NMDC has a lower profitability than CVRD and LKAB.

Royalty

On an average, royalty rates in India are 50% higher than international norms. Currently, NMDC at Bailadila pays a royalty of US\$0.44/ton for lump ore and US\$0.36/ton fine ore with Fe content greater than 65%. CVRD in contrast pays about US\$0.25/ton.

In conclusion, NMDC has the potential for becoming a world leader in iron ore mining (in terms of profitability). It has quality ore and low mining costs, but suffers from the inefficient and high cost infrastructure in India.

Other Mining Activities

Diamonds are normally found in 'Kimberlite ore'. NMDC operates the only mechanized diamond mine in India at Majhgawan in Panna District, Madhya Pradesh. Bigger and better diamonds are sold by a tender process while smaller diamonds are sold through auctions at Mumbai. There is a variation in the average realizations and profits on a year to year basis, depending on the quality of diamonds found. Diamond mining operations of NMDC have been, by and large, loss making. The company expects that a higher level of mechanisation would improve production and profitability by FY2001.

Future Plans

NMDC has plans to incur a capital expenditure of approx. Rs.1900 crore during FY 99 to FY 2005 for expanding its activities in mining of iron ore, limestone, diamond, gold etc. Apart from these, the company proposes

to invest in setting up of a pig iron plant using Romelt technology as a part of forward integration. The company is also considering a proposal to set up a pellet plant and pipeline in joint venture.

NMDC has plans to diversify its activities from iron-ore mining to mining of other metals. The company proposes to expand its operations for gold and diamond minings in Namibia, Madagascar, Angola etc. through joint ventures. This is in addition to its plans to explore more minerals in India itself either directly or through joint ventures.

Manpower

As on October 31, 1998, NMDC had a total employee strength of 6716 comprising of 1464 executives and 5252 workmen. The total employee strength has been maintained at less than 7,000 over the last ten years, although production of iron ore increased from around 9-10 MMT to 15 MMT in FY98 and the diamond production has doubled. NMDC has not adopted the VRS notified by Gol in 1998, because it considers that there is no surplus manpower.

Financial Analysis

The financial analysis of NMDC for the past five years is as follows:

Table 4 : Financial Highlights (Rs. Crore)

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	804.6	730.3	619.8	317.3	298.8
Operating Profit (OPBDIT)	263.3	223.2	189.6	141.0	132.6
PAT	175.0	129.9	95.5	72.2	70.7
Equity Capital	132.2	132.2	132.2	132.2	132.2
Tangible Networth	698.5	561.3	471.3	403.9	360.0
Gross Margin (%)	32.7	30.6	30.6	44.4	44.4
Net Margin (%)	21.8	17.8	15.4	22.8	23.7
ROCE (%)	41.7	38.8	37.5	30.0	33.6
RONW (%)	27.8	25.1	21.8	18.9	20.8
Earnings Per Share (Rs.)	13.24	9.83	7.23	5.46	5.35
Dividend (%)	25	25	20	20	20

Iron ore mining is the main activity of NMDC, accounting for 98% of sales in FY98. Sales were considered net of freight upto FY94. From FY96, the freight cost on export sales is included in the sales, while domestic sales do not include freight. Iron ore sales, net of freight cost, grew at a CAGR of 15.86% during FY94 to FY98, comprising a 25.28% growth in domestic sales and 3.36% growth in export sales. Domestic sales realizations increased at a CAGR of 10.15% while quantity sold increased by 14.49% during FY94 to FY98. On the other hand, export sales realizations (net of freight) and quantity sold increased at CAGR of 1.62% and 1.70% respectively. Growth in export sales realizations during FY94 to FY98, in rupee terms, was lower than rupee depreciation against the US\$ at a CAGR of 4.02% since FY94. Growth in export realizations was lower because (a) increase in freight costs could not be passed on to buyers and (b) the proportion of fines in the total exports increased from 42% in FY94 to 52% in FY98. NMDC, being amongst the lowest cost iron ore producers in the world, has been able to achieve high gross margins even in downturns.

Strengths & Areas of Concern

Strengths

Large reserves of high quality iron ore : NMDC's iron ore deposits are having very high Fe content of +67%. This gives the competitive advantage to the company in competing with other supplies both in domestic and international market. NMDC's iron ore reserves can last upto 61 years at the current level of production.

Low mining cost : As discussed in the Competitive advantage section, NMDC is having clear advantage in terms of cost when compared with its competitors.

Strong financial position. NMDC is a zero debt company with high gross and net margins which enables it to withstand business down cycles. This will enable the company to expand its operations in future as and when the demand for its products improve.

Mining Facilities – Mining facilities developed in Bailadila and Donimalai regions would facilitate opening new mines in these areas at lower cost than setting up of greenfield ventures.

Areas of Concern

Restrictions on export : After the decontrol of steel industry in 1991 and setting up of new steel plants, there has been quantitative restrictions on export of ore from Bailadila sector.

Low domestic demand : Currently Indian steel industry is passing through recession which has resulted in lower offtake of iron ore from NMDC. This coupled with export restriction has put NMDC's operations under stress.

Compulsory canalisation of exports : Compulsory canalisation of high quality iron ore export through MMTC reduces NMDC's profitability.

Increased competition : The GoI has opened up the iron ore mining to private sector. This will result in increased competition in future.

Poor Transport Infrastructure : NMDC's freight cost per tonne of iron ore is higher on account of deficiencies of the Indian Railways and Ports and hence its sales realisation, net of freight cost, is therefore lower than that for its competitors.

Recommendations

NMDC mines and exports the best quality iron ore in India (Fe contents of more than 65%) apart from meeting the demand of domestic steel producers. The iron ore reserves of NMDC can last for 60 years at the current levels of production. The company has been making consistent profits for the past eight years and has been a foreign exchange earner for the country. The current Government policy allows exports of high quality iron ore only through the canalised agency i.e. through MMTC. The company feels that the present arrangement is inefficient because it deprives them of continued interface with the customer, adds to cost, cuts into their margins and thus reduces their profits. NMDC feels that they are fully geared to handle the export business on their own. This is the practice followed by iron ore mining companies in other countries. The Commission is of the view that there is considerable merit in the contention of NMDC. There appears to be a prima facie case for transfer of iron ore export to NMDC. It would, therefore, recommend serious consideration of this aspect by Government.

Given the large reserves and the quality of iron ore NMDC owns, its strategic importance to the Indian steel industry and the absence of effective regulatory mechanisms in exploration and export of this mineral, the Commission categorises NMDC as 'core.'

The operations of NMDC have been consistently improving and have improved its networth substantially over the last five years. Based on its improved performance, the company has drawn large capital expenditure plans. The company proposes to get into exploration and mining of metals other than iron-ore in African countries. Given the financial requirements of such ventures overseas, the Commission feels that NMDC should get into these activities through joint ventures with overseas parties. This will enable NMDC to get the required financial support from the overseas partner and can use its technical expertise that it has developed over these years. This will also enable NMDC to expand its operations to more countries.

In order to attract one of the best mining companies globally to join hands with NMDC in their overseas ventures, the Commission is of the view that GoI could offer up to 20 - 25% of NMDC shares to such a foreign

partner in return for joining hands with NMDC in their overseas venture(s). This will enable NMDC to gain understanding of the latest technologies and management practices in mining industries on an ongoing basis.

The Commission recommends disinvestment up to 20-25% of NMDC shares to the selected JV partner on the lines suggested above, preferably after transferring the work relating to export of iron ore from MMTC. The selection of JV partner should be undertaken through a transparent competitive global bidding process after pre-qualification of the bidders. This arrangement will enable GoI to realise better value for its shares in NMDC. Subsequently, GoI should disinvest its partial holding in NMDC through offer of sale under favourable market conditions. If disinvestment of up to 20-25% to selected JV partner is not found to be feasible, equity up to 49% should be sold in stages either in domestic or international market under favourable market conditions. In either case, Government should retain 51% of the equity till such time as an effective regulatory mechanism is put in place to regulate exploration and export of iron ore. At that stage, the question of further disinvestment may be considered.

2.3 Oil & Natural Gas Corporation Limited (ONGC) - Update

The Government has requested Commission to review its recommendations on ONGC in the light of the Government's announcement regarding dismantling of Administered Pricing Mechanism (APM) and New Exploration and Licensing Policy (NELP) legislation.

Commission's Recommendations on ONGC in Report III

"The Commission recommends that disinvestment in ONGC be considered after the organizational changes are in position and the new pricing policy is known. That would be the time to clearly assess ONGC's own requirement of funds and to plan the disinvestment of Government shares and the company's IPO requirement in a co-ordinated matter. Any disinvestment prior to this could result in a loss to the exchequer, as an announcement regarding the dismantling of APM would significantly improve share values. The Commission would review the position from time to time and make its recommendations at the appropriate time."

Industry Scenario – Exploration and Production (E&P)

The Government has been giving active encouragement to participation of foreign and Indian companies in the exploration activities, to meet the widening gap between supply and demand. Government offered exploration blocks in six successive rounds of bidding between 1991 and 1995. These fields were awarded during the period September 1994 to December 1996, subject to finalisation of Production Sharing Contracts (PSC). In May 1998, Government decided to sign PSCs for 18 blocks and signed PSCs for 6 blocks covering an area of 20,970 sq. km in June 1998 and another 7 blocks covering 26,905 sq. km in July 1998. The trend in production and import of crude over the last five years are as follows:

Table 1 : Trends in production and import of crude (Million MT)

Particulars	FY 94	FY 95	FY 96	FY 97	FY 98
Public Sector – Onshore	11.65	12.01	11.85	11.37	11.49
– Offshore	15.38	20.23	22.66	20.18	19.86
Private/JVCs			0.65	1.35	2.48
Total Production	27.03	32.24	35.16	32.9	33.83
Imports	30.88	27.35	27.34	33.9	34.49
Total Crude demand	57.91	59.59	61.9	66.8	68.32
Domestic Share (%)	46.7	54.1	55.8	49.2	49.5

In line with the recommendations of R-Group, Government announced phased dismantling of APM in November 1997, as a result of which, the market determined price mechanism for petroleum products came into effect from April 1, 1998. Following the decontrol, the scope of operations of the oil pool accounts would be restricted to the five controlled products, i.e. Petrol, High Speed Diesel (HSD), Aviation Turbine Fuel (ATF), Superior Kerosene Oil (SKO) and Liquefied Petroleum Gas (LPG). As part of the dismantling process, the cost plus normative return pricing of crude has been withdrawn and price receivable by national oil companies would be linked to international levels in a phased manner. The national oil companies will get 75%, 77.5%, 80% and 82.5% of the weighted average FOB price of actual imports of crude oil during the year FY 99, FY 2000, FY 2001 and FY 2002 respectively. Government has also fixed a floor price of Rs. 1991 per tonne, based on the international crude price of USD 12 per barrel. In the event of international price falling below USD 12 per barrel, the oil pool account would provide for a subsidy to crude producers. The floor price will continue till the deregulation process is completed in FY 2002.

The Government has introduced The Oilfields (Regulation and Development) Amendment Bill, 1998 on July 1998. The adoption of the bill would enable Government to implement the NELP. Some of the salient features of this policy are as follows:

- No mandatory state participation through national oil companies (ONGC and OIL). In the earlier rounds of bidding for exploration blocks, the national oil companies had to necessarily be one of the JV partners.

- ONGC and OIL to compete for obtaining petroleum licences along with other companies of the private sector.
- Freedom to market crude oil and gas domestically
- Royalty payment @ 12.5% Ad Valorem for on-land areas and @10% for off-shore areas.
- Cess, which was earlier levied on crude production, to be abolished for blocks offered under NELP.

Business Analysis

ONGC's production is concentrated in six sedimentary basins, out of which a major part comes from offshore installations in Bombay High. The other installations are in the Cambay, Kutch, Saurashtra and North-Eastern regions.

Table 2 : Trends in production and share in domestic production

Particulars	FY 98	FY 97	FY 96	FY 95	FY 94
Crude – Domestic (MMT)	33.83	32.90	35.16	32.24	27.03
– ONGC	29.22	29.20	31.63	29.36	24.22
% age to Domestic	86.4	88.8	90.0	91.1	89.6
Natural Gas-Domestic (BSCUM)	24.72	22.75	22.31	19.38	18.34
ONGC	23.71	21.29	20.88	17.95	16.81
% age to Domestic	95.9	93.3	93.6	92.6	91.7

The fall in production in FY97 was on account sub-optimum reservoir design, necessitating change in technology to achieve optimum production, in the Western Offshore Region (Bombay High and Neelam). Most of the ONGC oil fields are at the plateau stage requiring secondary recover process for extracting hydrocarbons. There has been no new significant discovery of hydrocarbon after the discovery of Neelam Oil Field in 1987. The Reserve Replacement Ratio has been below 1.0 since FY92 except for 1.1 in FY96 and has been 0.33 and 0.3 during FY97 and FY98 respectively.

ONGC proposes to drill four deep-water wells in the potentially prospective regions in the Krishna-Godavari, Cauvery, Kerala-Konkan and Kutch basins. ONGC's Joint Venture arrangements (with 40% participating interest) with private companies for the development of

mid-sized fields of Panna & Mukta, Mid and South Tapti and Rava have commenced production.

ONGC has promoted Petronet LNG Ltd. in association with GAIL and others for setting up LNG terminals and Dahej and Cochin. ONGC is also in the process of setting up 300MW power plants each with NTPC and IOC at Hazira and Panipat respectively.

Financial Analysis

The financial performance of ONGC for the past four years is indicated in the table below:

Table 3 : Financial Performance (Rs. Crore)

	FY 98	FY 97	FY 96	FY 95
Operating Income	15,306	13,282	13,436	13,614
Operating Profit	7,491	6,383	6,376	6,618
Profit After Tax	2,678	2,034	1,945	2,345
Equity Capital	1,426	1,426	1,426	1,426
Tangible Net Worth	22,323	20,035	17,601	15,448
Gross Margin (%)	48.9	48.1	47.4	48.6
Net Margin (%)	17.5	15.3	14.5	17.2
ROCE (%)	14.4	13.0	13.3	17.9
RONW (%)	12.6	10.8	11.8	14.2
Earnings Per Share	18.78	14.26	13.64	58.1
Dividend (%)	25	20	14	14

In FY97, the total operating income declined by 1.2% over FY96 due to fall in crude oil sales by 8%. This was primarily on account of rectificatory measures taken at Bombay High field. During FY9, the total operating income grew by 15% mainly due to increase in natural gas sales by 12% and on account of receipt of arrears of Rs. 831 crore for price revision. Even though the operating income increased only by 15%, PAT grew by 32% due to lower growth rate in expenses, fall in interest expanses and increase in non-operating income.

The Government of India still holds 96% of shares in ONGC. The current market price of ONGC shares at the Bombay Stock Exchange (BSE) is Rs. 153 (4th June, 1999) with a yearly high/low of Rs. 321/105.

Recommendations

In recent times, investor perception of ONGC has not been very good. Some of the important contributing factors are listed below.

1. Low and Declining Reserve Replacement Ratio due to no new significant discovery of reserves since 1987.
2. Though administrative pricing will be gradually phased out, the full realisation of international oil prices would be possible only after 2002.
3. General negative investor perception for PSU stocks arising from recent crossholding exercises in the hydrocarbon sector.

Investor perception is not likely to turn positive unless the following issues are addressed by the Company and Government.

1. The oil pool account is reported to be owing ONGC, even now, an amount of Rs. 1300 crores.
2. The increase in international oil prices in the last few weeks are not being passed on to the consumers at least till October 1999. ONGC, according to the time table for dismantling the APM, should be getting 77.5 per cent of the current oil prices. The refineries will be unable to pay this amount, as they are unable to recover the amount from consumers. The oil pool account will have to absorb these substantial increases and will be in deficit by owing the refineries and ONGC amount equivalent to price increases not passed on to consumers.
3. After the NELP offered the most prospective areas to the international bidders, the ONGC has been left with the less prospective areas on which it is spending a substantial amount on exploration. Even then, ONGC does not get the same terms as the bidders in NELP.
4. Exploration by ONGC has been expensive without yielding any significant results. With reduced outlays on exploration, ONGC can share both outlay and risk with high tech strategic partner

for deep sea exploration not only in Indian waters but also elsewhere.

5. ONGC manpower is sought to be reduced by bringing down the retirement age from 60 to 58 years which have been approved by the Board of Directors of ONGC. This is awaiting Government approval for the last several weeks.

In the light of the above, the Commission feels that there is urgent need for improving investor image of ONGC prior to disinvestment. **The Commission recommends that the disinvestment in ONGC should be deferred until the investor confidence in ONGC improves. Both the Government and ONGC would have to develop specific action plans to enable achievement of this objective. Thereafter disinvestment can take place in the foreign and domestic market up to 49 per cent when market conditions are favourable.**

2.4 Paradeep Phosphates Limited

Evolution

Paradeep Phosphates Limited (PPL) was incorporated on 24 December 1981 in Bhubaneswar, Orissa. The company was set up with the objective to develop additional capacity of phosphatic fertiliser in the country to meet the progressive increase in demand of phosphatic fertilisers. The company was entrusted with the task of setting up the Asia's largest DAP ((Di-ammonium Phosphate) fertiliser plant along with the sulphuric acid plant (SAP), phosphatic acid plant (PAP) and captive power plant (CCP). The entire project was constructed in two phases. Phase I comprised the DAP plant and its offsite facilities with an annual capacity of 720,000 tonnes. Phase II consisted of the SAP, PAP, CPP, material handling systems etc.

The company paid up capital is Rs. 331.65 comprising of Rs. 214 crore of equity and Rs. 117.65 crore of preference share capital. It is 100% owned by GoI. Initially, the company was set as a 51:49 joint venture between the Government of India and Government of Nauru respectively. However, in June 1993, the Government of India acquired the entire shareholding of its joint venture partner.

Industry Analysis

Agriculture is the mainstay of Indian economy and constitutes approx. 33% of Indian GDP. Fertilisers have played a key role in the transformation of Indian agriculture, making India self-sufficient in food grain production. In fact, of the total increase in food grain production during the last 20 years, nearly 55% can be attributed to the increase in use of fertiliser. Interestingly, India's fertiliser consumption level is at a low of 74 kg per hectare as compared to 370 kg for China and 345 kg for Egypt. Fertiliser includes organic fertilisers, bio-fertilisers and chemical fertilisers. Fertilisers are classified on the basis of their nutrient content. Primary nutrients are nitrogen, phosphorous and potassium, which is required in large quantities and are normally supplied through chemical fertilisers. Secondary nutrients, required in smaller quantities than primary nutrients, include calcium, magnesium and sulphur.

Indian fertiliser industry has expanded rapidly over the past two decades, with substantial capacity additions in the period. Demand has however outstripped supply and in order to bridge the gap between demand and supply of fertilisers, India has been importing fertilisers. Competition fuelled by perceived threat of imports, and continuous increase in demand has led to capacity addition and increase in operational efficiencies. Production, imports and consumption of urea, DAP and MoP are given below:

Table 1 : Production, Imports and Consumption - Trends (Lakh MT)

Years	UREA			DAP			MoP		
	Prod'n	Imp.	Cons.	Prod'n	Imp.	Cons.	Prod'n	Imp.	Cons.
1991-92	128.28	3.91	140.04	28.65	20.77	45.18		20.40	17.01
1992-93	131.22	18.57	149.05	25.95	14.51	40.52		17.66	9.74
1993-94	131.48	27.83	158.1	19.68	15.69	34.80		14.67	10.52
1994-95	141.43	28.70	171.12	28.23	8.65	35.86		18.48	12.70
1995-96	158.20	37.85	179.08	26.47	15.15	34.46		21.92	14.37
1996-97	156.20	23.03	190.25	27.59	5.34	36.26		10.21	11.98
1997-98	185.02	23.89	205.57	33.29	14.60	52.84		20.20	17.56

DAP : Di-Ammonium Phosphate; MoP : Muriate of Potash

The key issues facing the fertiliser industry are: (1) retention pricing, (2) farmgate prices, (3) raw material costs, (4) freight and distribution and (5) nutrient content and soil imbalance.

In setting the retention pricing scheme (RPS), the manufacturers will be providing a guaranteed return on their investment. Retention prices are fixed taking into account the cost of variable inputs, conversion costs, selling expenses and capital related charges. RPS provided a security and healthy environment to the producers. However, the system is non-competitive, administered in nature and has a combination of norms and actuals. The system gives over-emphasis on cost claiming rather than cost control resulting in inflated capital costs and RPS is computed on the prevailing net fixed assets, hence, retention price for older units has declined over the years.

Farmgate prices (FP) have always been a sensitive economic and political issue. Over the years, FP has increased but not to the same

extent as that of cost of inputs. This difference is borne by the Government and paid to the manufacturer in the form of subsidy or ad hoc concessions. Since 1990-91, the subsidy has increased at a rate of 16.5% but the FP has increased at a rate of 5.5%, which is not sufficient to offset the increase in the costs.

The increasing cost of raw material is another issue faced by the fertiliser industry. With inadequate deposits of minerals and natural salts in the country, the decontrolled fertiliser industry is dependent on imported raw materials to a large extent. The imported inputs like phosphoric acid and rock phosphate account for almost 80% of sales realisation of decontrolled fertiliser manufacturers. Secondly the volatility of Indian rupee vis-à-vis other currencies has a significant impact on the cost of production. Increased dumping of DAP in the country is forcing domestic manufacturers to extend heavy discounts. The major DAP units in India along with their installed capacities are given below:

Table 2 : Major DAP Capacities in India (Lakh Tonnes)

Name/Location	Product	Comm.	Inst.cap.
FACT, Kochi	DAP/NPK	1960	4.85
GSFC, Vadodara	DAP/NPK	1967	1.08
MFL, Madras	DAP/NPK	1976	7.24
ZACL, Goa	DAP/NPK	1973	3.00
IIFCO, Khadala	DAP/NPK	1975	8.00
SPIC, Tuticorin	DAP	1975	3.12
HLL, Haldia	DAP	1986	1.54
PPL, Paradeep	DAP/NPK	1986	7.20
MCFL, Mangalore	DAP/NPK	1986	1.38
GSFC, Sikka	DAP	1987	3.26
Godavari Fert.	DAP/NPK	1988	4.73

In a bid to reduce the mounting fertiliser subsidy, the Government decontrolled phosphatic and potassic fertilisers with regard to price, distribution and movement in 1992. This was followed by decanalisation of DAP imports. Decontrol was, however, not total with the Government introducing an ad hoc on-time subsidy of Rs. 1000/tonne

on domestic DAP. In 1993, Ministry announced continuation of this ad hoc subsidy scheme. Ad hoc subsidy was increased to Rs. 3000/tonne in 1996. The existing subsidy was not adequate to cover cost of production and industry demanded increases in selling prices. Later in February 1997, ad hoc subsidy was increased by Rs. 750/tonne. In January 1998, concessions on DAP was once again reduced by Rs.450/tonne for domestic DAP and Rs.250/tonne for imported DAP. In August 1998, acute shortage of fertilisers prompted Government to increase the domestic DAP concessions from Rs.3500/tonne to Rs.4000/tonne and imported DAP from Rs.2000/tonne to Rs.2500/tonne. This increase in the concession amount will continue upto March 2001.

With the existing policy, any improvement in the industry's prospects is limited. However, if the company's adopt strategies such as backward integration into manufacture of phosphoric acid, ammonia and better utilisation of by-products can help producers insulate their earning to some extent from fluctuations in international prices of phosphoric acids. DAP trading could also provide some insulation against losses on domestic manufacture.

Business Analysis

PPL has one of the largest DAP production facility in the industry with an all India market share of about 21% in FY 98. The DAP plant has an installed capacity of 7.2 lakh tonnes and was commissioned before schedule in February 1986. Capacity utilisation over the last decade has been erratic. The primary reason for this drop in capacity utilisation was due to shortfall in supply of raw materials. Import of phosphoric acid was earlier regulated by the Department of Fertilisers and the co-ordinating agencies were IFFCO for phosphoric acid and RCF for ammonia. In late eighties, the task was entrusted to STC and MMTC. The phase II plant comprising of SAP and PAP were commissioned in 1990 but suffered technical problems. SAP was finally shutdown for a whole year in 1993-94, for overhaul, which further aggravated the problem due to corrosion in plant equipment.

The details of capacity, production, capacity utilisation and sales of major products of PPL for the past four years are as follows:

Table 3 : PPL's Product Mix – Trends

Particulars	FY 95	FY 96	FY 97	FY 98
Installed capacity (MT)				
DAP	720000	720000	720000	720000
Phosphoric acid	225000	225000	225000	225000
Sulphuric Acid	660000	660000	660000	660000
Production (MT)				
DAP +NPK	704845	640920	492610	799695
Phosphoric acid	2255	52292	37214	90006
Sulphuric Acid	78020	179687	138041	302440
Capacity Utilisation (%)				
DAP +NPK	98	89	68	111
Phosphoric acid	1	23	17	40
Sulphuric Acid	12	27	21	46
Sales (MT)				
DAP	628098	549593	574021	715590
NPK	347	30139	71524	53427
Avg. price realisation (Rs/MT)	2714	2942	2642	2218

In addition to manufacturing activities, PPL also trades in products like Muriate of Potash (MOP), gypsum, urea as well as DAP and NPK from time to time in order to augment profitability.

PPL markets/sells its products mainly through institutional agencies and a network of private dealers. The company has strong presence in the states of Orissa (85% market share), Maharashtra (44%), Uttar Pradesh (21%), Madhya Pradesh (36%) etc.

PPL employs 1059 employees as at March 1998 comprising 394 executives and 665 non-executives.

Financial Analysis

The financial analysis of PPL for the past five years is as follows:

Table 4 : Financial Highlights

(Rs. Crore)

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	1256.4	585.4	896.1	988.3	392.6
Operating Profit	-18.6	-2.5	44.0	61.9	138.3
PAT	-105.5	-60.6	2.2	27.7	47.4
Equity + Pref. Capital	331.6	331.7	356.9	356.9	357.0
Tangible Networth	75.1	180.8	241.3	239.1	211.4
Gross Margin (%)	-1.6	-0.3	5.6	7.1	36.2
Net Margin (%)	-9.0	-7.9	0.3	3.2	12.4
ROCE (%)	-5.9s	-4.3	2.5	5.4	17.1
RONW (%)	-31.8	-18.3	0.6	7.8	13.3

In 1992-93, the company's net worth was almost wiped out and PPL was on the verge of being declared sick. The Government of India stepped in with a financial restructuring package which involved conversion of government loan to equity and preference shares. Interest and repayment holiday was extended for a period of 3 years. The details of the Financial Restructuring Package is as under:

1. Conversion of Rs. 54.70 crore GoI loan into equity
2. Conversion of Rs. 35.30 crore advance against equity into equity
3. Conversion of Rs.117.65 crore outstanding interest into 7% non-cumulative redeemable preference share capital
4. Waiver of Rs.146.39 crore penal interest and compound interest on the outstanding interest liability and principal amount by the GoI
5. Repayment of balance outstanding loan of Rs.230.28 crore in ten equal annual instalment with effect from 1st April, 1997
6. Interest holiday on Rs. 230.28 crore for three years with effect from 1st April 1994.

Due to the implementation of Financial Restructuring package, equity share capital of the company was increased from Rs.120 crore to Rs. 214 crore, and preference share capital went up to Rs. 117.65 crore. The accumulated losses of PPL as at 31st March 1994 came down to Rs. 145.54 crore.

However, these measures did not yield any improvement in the performance of PPL. PPL's accumulated losses as at 31st March, 1998 of Rs. 256.5 crore resulted in erosion of networth to Rs. 75.1 crore. In order to save PPL out of BIFR, a new proposal for Financial Restructuring (FRS-II) is currently under way. The salient features are as under:

1. Write down of face value of existing Rs. 1000 per equity share to face value of Rs. 10 per share. This will reduce the equity base of the company from Rs. 214 crore to Rs. 2.14 crore and will be set off against accumulated losses of Rs. 256.48 crore.
2. Conversion of plan loan of Rs. 230.28 crore from GoI into equity. This will restore the equity share capital of PPL to Rs. 232.42 crore.
3. Waiver of interest and penal interest on Plan Loan accrued till 31.3.98 amounting to Rs. 43.92 crore and interest amounting to Rs. 3.66 crore on MoP purchased by the company from GoI under German Soft Loan Scheme.
4. Waiver of interest on GoI Plan Loan.
5. Interest holiday on balance outstanding Plan Loan of Rs. 37 crore for 3 years.
6. Infusion of cash by GoI to the extent of Rs. 70 crore as Plan Loan and non-Plan Loan to meet the company's working capital gap and capital expenditure required for revamping of acid plants and pollution control measures.

Strengths & Areas of Concern

Strengths

Wide marketing network : PPL has substantial presence in almost all major states. This will enable the company in adverse market conditions in any particular State. Further the company is making attempts to increase its presence in the states of West Bengal, Orissa, Bihar and Andhra Pradesh. This will give locational advantage and with lower freight, PPL can improve its profit margins.

16-20% market share : PPL 's market share of 16-20% in the total DAP market is second to SPIC. Moreover, the company is making all out efforts to enables the company to increase its capacity utilisation which would further enhance the market share.

State of art plant technology : PPL has state of the art production facility which was set up in 1986. Due to improved performance, the company is currently operating at more than 100% capacity utilisation. Moreover, it has set up production facility for meeting its raw material requirement which will substitute imports.

Areas of Concern

Government controlled DAP farmgate price and adhoc concessions : The price of output of PPL is controlled by Government. Since the company has suffered high capital cost and cost overruns, its cost of production is high compared with its competitors. This has resulted in poor margins and losses.

Plant location – far from high demand markets : PPL's production facility is located farther from the actual consumption centres for its products. The major fertiliser consumption centres are the states of Uttar Pradesh, Madhya Pradesh, Punjab, Haryana etc. This has put PPL in a disadvantageous position and the company has to incur high freight costs for transportation of its products to the high demand markets.

Competition : DAP fertiliser industry is highly competitive and only producers who are cost competitive can only survive in the long run. The industry is represented by players mostly from private sector and co-operative sector.

Single product strategy : PPL is the largest stand-alone DAP unit while majority of its competitors have multiple product portfolio. This will enable its competitors to withstand industry downcycles.

High manpower : PPL's manpower is quite high. The total numbers of contract labourers are more than the total number of permanent labour. This has resulted in overmanning.

Recommendations

PPL was set up to augment the progressively increasing demand for phosphatic fertilisers in the country through a joint venture between GoI and Government of Nauru, which later became a 100% GoI company. Even though the project of setting up of the fertiliser plant was completed well ahead of schedule, the phase-II commissioning of acid plants (both SAP and PAP) were delayed substantially which resulted in cost over-runs. These plants also suffered from technical problems which have affected the production of fertiliser. Due to all these reasons, the company was making losses, which resulted in erosion of its networth in 1994. GoI's implementation of a financial restructuring package did not help the company in the long run since its operational improvement plan did not fructify. This has resulted in huge losses and by 31st March, 1998, the company has once again eroded its networth. The company has again approached GoI to implement the second financial restructuring package(FRS-II detailed above). This is presently under the consideration of GoI.

In order to reduce the mounting fertiliser subsidy, Government decontrolled phosphatic and potassic fertilisers in 1992. However, the Government had to re-introduce adhoc subsidies later. The Hanumantha Rao Committee has recommended free-float pricing which will mean that domestic products would have to compete freely with imports.

The Commission classifies PPL as "non-core" because of market structure of the DAP fertiliser industry. There are large number of players both in private sector and co-operative sector who are engaged in the manufacture of DAP. Further, Government control on the prices and distribution of this fertiliser will continue in the foreseeable future. Therefore, Government ownership of production facilities is neither necessary nor justified.

Given the financial health of PPL, Commission is of the opinion that implementation of FRS-II is a must to avoid referral of PPL to BIFR. The financial restructuring package will enable the company to write off its accumulated losses. FRS-II also envisages infusion of cash to the extent of Rs.70 crore which will enable the company to meet its working capital and capital expenditure for revamping of acid plants

etc. The Commission therefore, recommends the implementation of FRS-II without any further delay which will enable PPL to start its operations on a clean slate.

Since PPL is non-core, the Commission recommends disinvestment of not less than 51% GoI holding in PPL through a strategic sale. The strategic sale action should be initiated simultaneously with the implementation of FRS-II by inviting bids through a transparent competitive bidding process after suitably pre-qualifying bidders.

This will enable GoI to recover its investment in PPL as the Commission feels that there would be investor interest in acquiring majority stake in PPL. This is primarily because of the comparatively new plant and machinery PPL owns and the improvement in operations which PPL has currently been able to show. Further, once the revamping of acid plants is complete, the company's dependence of imported raw material also will reduce.

After the strategic sale is completed, GoI could disinvest its balance holding through public issue under favourable market conditions, once the company starts performing consistently under the new management. This will enable GoI to realise better value for its remaining holding.

2.5 PEC Ltd

Evolution

Projects & Equipment Corporation Ltd. (PEC) was originally created as a division of State Trading Corporation of India Ltd. for undertaking export of railway wagons, engineering equipment and turnkey projects. PEC became a subsidiary of STC in 1971.

Initially, the exports of railway equipment were canalised through PEC, but after liberalisation in 1991, canalisation was discontinued. Consequently, PEC was allowed to diversify into exports of products and commodities other than projects and engineering equipment.

Currently, the company is involved in trading of commodities such as wheat, rice and sugar. Recently, PEC has also diversified into import of gold bullion and export of defence equipment. In view of the change in activity profile of the organisation, the name of the company was changed to 'PEC LIMITED', effective from 25th November 1997.

The entire paid-up capital of the company of Rs. 1.50 crores, consisting of 1,50,000 shares of Rs. 100/- each, is held by the Government of India.

Business Analysis

PEC's major markets are Bangladesh, Sri Lanka, Vietnam, Myanmar, CIS countries, Iran, Ethiopia and some other developing countries. PEC's mainly exports agro-commodities such as rice and wheat, electrical conductors, line hardware, transformers, flour mills, tea machinery, textile machinery, defence exports etc. and import of industrial raw materials and bullion.

Table 1 : Sales turnover and profit of PEC for the last 5 years (Rs Crores)

YEARS	1997-98	1996-97	1995-96	1994-95	1993-94
Sales Turnover	448.71	235.87	485.57	241.73	202.31
Net Profit / Loss	0.91	0.62	0.93	0.66	0.46
ITEM-WISE EXPORTS (%)	1997-98	1996-97	1995-96	1994-95	1993-94
Export of Agro-Products	30.68	46.17	71.15	42.40	—
Export of Engineering Equipment	14.45	31.00	8.47	13.60	31.85
Project Exports	1.05	5.46	2.78	20.80	20.54
Defence Exports	3.59	2.68	5.50	3.90	2.84
Pharmaceuticals	0.05	0.40	1.48	0.70	2.21
Others	0.13	0.27	0.45	—	16.69
Railway Equipment	—	—	—	3.90	6.67
Textiles	—	—	—	1.70	0.40
Domestic	—	—	1.50	—	0.10
Imports – General	00.57	02.68	8.67	11.00	18.70
Bullion – Imports	49.48	11.34	—	—	—
TOTAL	100.00	100.00	100.00	100.00	100.00

The Project Exports of PEC include Cement Plant, Textile Plant and Tea Processing Plants. PEC's government agency status benefits it in its project export business. Over the years business profile of PEC has been changing with greater emphasis on commodity trading, while project exports have been reducing. The project exports from India are not considered viable both on account of obsolete technology and inability to offer suitable financial packages, as compared to the competitors.

PEC has been assisting in exports from the small and medium industries to the developing countries. This constitutes about 2.75% of the total SSI engineering goods exports from the country and about 3.5% of the PEC's turnover in FY 98. This shows that PEC has not been able to make much headway in garnering exports business from the SSI sector.

Most of the PEC's business comes through bidding against open tenders and in most of the deals, either the buyer or the seller is a government entity.

In the year 1996-97, PEC entered into the business of importing gold/silver through special import licenses and did a turnover of Rs. 27

crores. However, since last year gold imports have been placed under OGL and due to increase in the competition, the profit margin in this business for PEC has declined to 0.2 % from 2% earlier.

PEC covers a small part of the value chain and value added by it is fairly small as PEC is only an intermediary and generally does not trade on its own account.

PEC benefits from its public sector status as it is one of the agencies identified for canalisation of key commodities like bullion and cotton as well as for undertaking defence export from India. It also gets priority allocation of railway wagons and shipping berths. PEC has also been able to leverage the lines of credit being offered by the Government of India to other developing countries e.g. Vietnam and Sri Lanka etc. Recently, PEC has shifted its focus on securing business from the developing countries that are receiving aid from the World Bank and other international funding agencies, where a government agency is more likely to secure orders.

It is estimated that out of the existing employee strength of 238, more than half is in excess of the sustainable level.

Financial Analysis

Table 2 : Financial Highlights

(Rs. Crores)

	FY98	FY97	FY96	FY95	FY94
Operating Income	449.13	236.98	485.57	241.97	202.39
Operating Profit	-0.64	-2.53	-0.07	-1.56	-1.87
Non-operating Income*	2.76	5.97	7.21	5.98	4.36
Profit After Tax	0.92	0.62	0.93	0.66	0.46
Equity Capital	1.50	1.50	1.50	1.50	1.50
Tangible Networth	18.57	17.98	17.69	16.51	-16.08
Debt-Equity Ratio	0.14	0.18	0.21	0.41	0.55
Gross Margin (%)	N.A.	N.A.	N.A.	N.A.	N.A.
Net Margin (%)	0.20%	0.26%	0.19%	0.27%	0.23%
ROCE (%)	2.21%	3.58%	2.64%	1.07%	1.55%
RONW (%)	4.93%	3.47%	5.27%	3.98%	-2.84%
Earning Per Share	61.0	41.6	62.1	43.8	30.4
Dividend (%)	20%	20%	20%	15%	11%

*Includes interest from Bank and Other Sources

The company has been incurring operating losses for the last 5 years and has been able to achieve positive PAT due to non-operating income. The poor profitability of the company also reflects on the low Net Margin, ROCE and RONW in the above table.

Company is very comfortably leveraged with a Debt to Equity ratio of 0.14 as on March 31, 1998.

About one-third of the company's receivables of Rs. 19.66 crores are more than above 3 years old and about a half are less than one year old.

Strengths and Areas of Concern

Strengths

Experience of trading - Over the years PEC has successfully executed trade deals, both imports and exports, in several commodity items and equipment with different countries, though mainly in developing world.

Contractual Abilities - Knowledge of frequently changing rules and regulations relating to export and import trade and drafting of contract agreements with buyers and sellers is another positive strength of the organisation.

PSU Status - Since PEC is a wholly owned government company, it gets a fair share of government directed business from India and abroad.

Areas of Concern

Low risk taking ability - The PSU nature of PEC restricts its risk taking ability leading to a low margin business with safe position.

Surplus Manpower - It is estimated that PEC has about 150 employees who are surplus out of total strength of around 238 employees.

Absence of second and third tier of professionals - Most of the business skills are concentrated in the senior management. There is hardly any attempt to spread the skills to middle and lower levels.

Dependence on Government - PEC's business depends heavily on the government policies and the Government mandated trade.

Recommendations

In the liberalised scenario, where the government owned trading companies have to compete with private Indian and International trading companies, responsiveness, efficiency and cost effectiveness would be critical for successful trading operations.

It is to be noted that State Trading, which was widely prevalent at one time, has been gradually phased out in most countries. This has led to loss of significant market opportunities for the government owned trading companies in India. **The Commission feels that no public purpose would be served by PEC being under the government ownership and control. Hence the Commission classifies PEC as non-core.** Further, its viability as an enterprise under government ownership and management is doubtful.

PEC has presence in some developing countries like Vietnam, Myanmar, Bangladesh, Sri Lanka, CIS countries and Ethiopia. PEC's government agency status benefits it in its project export business. Over the years business profile of PEC has been changing with greater emphasis on commodity trading, while the project exports have been reducing.

PEC has been incurring trading losses on account of the low trading margins and the high administrative costs and has been reporting positive PAT largely due to its non-operating income from investments.

PEC has not been able to make much headway in garnering exports business from the SSI sector. Since this is the only public sector organisation besides NSIC dealing with project exports of SSI units, there would be a need to suitably reorganise PEC to be able to fulfil its raison d'être. The commission, therefore, feels that there is considerable scope for PEC to play a useful role in promoting exports from small and medium scale industries in the country by capitalising on PEC's existing trading links in Asia and Africa. This would only be possible if the Department of Small Scale Industries were to lend its support to PEC by introducing them to the small scale industries in the country through concerned Government departments, NSIC, associations of SSI units, etc. so that such units which cannot undertake sustained exports on their own could make use of PEC's expertise and contacts.

Hence the Commission recommends that Government should consider enlarging the scope of exports from the small and medium scale industries through PEC by suitable co-ordination between NSIC, SIDBI and other agencies representing or dealing with small and medium scale industries. The Commission also feels that aggressive and imaginative management by PEC is necessary in this field which should be backed up by proper co-ordination between the funding agencies and other organisations concerned with development of small and medium scale industries for improvement of quality standards, etc. This suggestion is worth trying since sale of Government equity in PEC is unlikely to fetch substantial revenue to the Government, given the size of the company. There is, therefore, no urgency for proceeding with disinvestment of Government equity in PEC.

In case there is no significant increase in the turnover and profitability of PEC from the exports from the small and medium scale industries within a period of two years, the Government should offer 100% equity in the company to a strategic buyer. In the absence of investor interest in PEC, there will be no alternative but to close the company.

REPORT

XI

DISINVESTMENT COMMISSION

JULY
1999

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PART A

1. GENERAL RECOMMENDATIONS

1.1 STATUS OF PSUs REFERRED TO THE COMMISSION

Government have so far referred 72 PSUs to the Commission out of which eight stood withdrawn, leaving 64 PSUs for examination by the Commission. Out of this, the Commission had given its recommendations in respect of 49 PSUs up to the X Report. With the present Report, the Commission has given its recommendations in respect of 53 PSUs. This leaves 5 PSUs (excluding six referred to BIFR) for examination by the Commission. The Commission is in correspondence with the Government regarding PSUs which are already referred to BIFR.

The list of PSUs referred to the Commission is given in Appendix I. The list of PSUs withdrawn from the Commission is given in Appendix II.

1.2 PROGRESS OF IMPLEMENTATION OF COMMISSION'S RECOMMENDATIONS

The Commission has so far submitted ten Reports to the Government covering 49 PSUs referred to it. The gist of general recommendations and action taken by Government on them is given in Appendix III. The modalities of disinvestment recommended in respect of specific PSUs and action taken by Government is given in Appendices IV and V. The following table indicates the action taken by Government on the recommendations of the Disinvestment Commission on individual PSUs.

Table 1 : Action Taken@ on Recommendations of Disinvestment Commission

Accepted	Decision Deferred	Decision Implemented	Decision being Implemented	Decision Awaited
1. RITES 2. MOIL 3. OIL* 4. ONGC* 5. SAIL* 6. NTPC* 7. NHPC* 8. PGCIL* 9. NLC*	1. FACT 2. NFL	1. MTNL*** (May.97) 2.CONCOR* (May.97)	1. GAIL** (Feb.97) 2. KIOCL (Mar.97) 3. MFIL (Feb.97) 4. I:PII (Nov.97) 5. HTI (Apr.97) 6. EIL (Nov.97) 7. IPCL (Mar.98) 8. HCIL (Dec.97) 9. R.Ashok (Nov.97) 10. U.Ashok (Nov.97) 11.BALCO (Apr.97)	1. ET&T(Dec.97) 2. RIC (Dec.97) 3. NALCO (Mar.98) 4. HCL (Aug.97) 5. NEPA (Nov.97) 6. HZL** (Dec.97) 7. PHL (Aug.97) 8. AI (Aug.98) 9. PPCL (Dec.97) 10. CEL#** (Aug.98) 11. HVOC (Dec.97) 12. SCI (Aug.97) 13. IBP (Nov.97) 14. HPL (Nov.97) 15. HLI** (Mar.98) 16. ITI** (Apr.97) 17. BRPL (Apr.97) 18. MFL** (Apr.97) 19. ITDC** (Feb.97) 20. HSCI (Mar.99) 21. STC (Mar.99) 22. MMTC (June.99) 23. NMDG (June.99) 24. PPI (June.99) 25. PEC (June.99)

Note : Information given in brackets indicate month and year of the Commission's recommendations.

@ As per information communicated by Government (As on 1st February 1999).

Commission had recommended that disinvestment be deferred in these PSUs pending fulfilment of certain specified conditions.

& Implemented in December 1997.

** Implemented in November 1998.*

^ The Commission had not recommended disinvestment in this PSU.

** Some decisions reportedly have been taken by Government in respect of these PSUs, but no formal communication has been received by the Commission.*

It would be seen from this Table that out of 49 PSUs for which recommendations have been made to the Government, decision is yet to be taken/communicated in 25 cases. Out of 29 cases of strategic sale/trade sale recommended by the Commission (Appendix V), decision is awaited in 18 cases.

PART B

2. SPECIFIC RECOMMENDATION

2.1 MECON Limited

Evolution

Metallurgical & Engineering Consultants (India) Limited (MECON) started its operations in 1959 for self-sufficiency in consultancy and engineering services, as the first three Integrated Steel Plants (ISPs) of Steel Authority of India Limited (SAIL) were being set-up with foreign technical collaborations.

Due to its close association with the steel industry in its earlier years of operations, MECON has been able to develop a strong technological base and engineering capabilities in the steel sector. Initially, MECON's scope of work included design, detailed engineering, project management etc. for the various expansions which took place at the ISPs. In 1979, MECON expanded its range of services to include Engineering Procurement & Construction (EPC) work for the steel sector, to achieve forward integration from the consultancy activity. The company has also been undertaking small consultancy assignments for parties outside the country, mainly in the steel sector.

The company has its head-office at Ranchi, Bihar and has more than 20 construction and design offices in the country, wherein it maintains design/engineering staff capable of handling relatively small assignments on their own.

MECON's entire paid-up share capital of Rs. 2.42 crores is owned by the Government of India.

Business

From its initial business of technical consultancy, MECON has forward integrated into equipment supply business. In the year 1997-98, the consultancy business (including project management) contributed about 53% of MECON's operating income and the balance came from the equipment supply business.

MECON's largest sphere of activity has been in the Steel industry. It has engineered six integrated steel plants and contributed substantially to others. MECON has also expanded its areas of activities, covering non-ferrous metals, mining, refractory, power plants & energy engineering coal and chemicals

equipment & systems design for rolling mills, processing lines, coke ovens, coke dry cooling plants, BOF converter, gas cleaning plants, blast furnace equipment and a host of other related industries.

The company's involvement in the non-ferrous sector has been in the areas of aluminium, lead, zinc, bauxite & copper mining, lead & zinc smelting & refining, silver recovery, gold mining & beneficiation, etc. Major activities in these areas are in the public sector, for which the company has been providing varied services to public sector companies like Bharat Aluminium Company Limited, Hindustan Zinc Ltd., Hindustan Copper Ltd., Bharat Gold Mines Ltd., National Mineral Development Corporation Limited, Kudremukh Iron Ore Co. Ltd., etc.

Consultancy Business

Consultancy services provided by MECON are in the nature of preparation of feasibility reports, conducting market surveys, preparing detailed project reports, assisting in site selection, carrying out detailed engineering, etc. These consultancy services are provided in the areas of steel, power, petrochemicals, oil and gas etc. EPC services are provided mainly in the steel sector. Services related to project management include civil, structural work, supervision, erection, etc.

There is a wide variation in the scope of the assignments handled, which range from the smaller sized orders such as feasibility reports and market surveys reports (order size ranging from Rs. 0.10-0.20 crore) to detailed engineering and design (which could have an order value as high as Rs. 100 crore).

By virtue of rendering consultancy in the steel industry for the last 40 years, the company has developed strong in-house design capabilities in the steel industry. Further, the composite nature of the ISPs (which comprises several aspects such as captive power plants, roads, coal handling plants) has enabled the company to gain experience in other areas also.

While historically, almost the entire consultancy business for MECON came from the steel industry (especially SAIL), the company has made attempts to diversify its revenue base. However, still around 60-70% of the revenues comes from the steel industry. Within the non-steel sector, most of the orders procured by the company are relatively small in comparison to the orders the

company has been getting in the steel sector. The typical order size in the non-steel sector is less than Rs. 1 crore. The penetration has been slow mainly because the respective fields already have well entrenched strong players such as Development Consultants in Power, Engineers India Ltd. in Petrochemicals, etc.

The order book size as on December 31, 1998 is about Rs. 275 - 280 crores, out of which the steel sector is expected to contribute Rs. 135-140 crore. This highlights the high dependence of MECON's consultancy business on the steel industry. However, in the medium to long term, as the company's reference list strengthens, the revenue diversity is expected to improve from the existing levels. It also needs to be noted that, while the current order book size appears to be comfortable, revenue generation out of the same could take time, given the slowdown in the economy.

Most of MECON's consultancy business is Indian based and the foreign consultancy business is comparatively insignificant. Most of the foreign consultancy carried out by MECON is in developing countries such as Saudi Arabia, Iran, Indonesia, Nepal, Nigeria, etc.

MECON's major competitors in the consultancy business are listed below:

Table 1 : Competitors in the Consultancy Business

Area	Competitors
Metals	M. N. Dastur & Co.
Petrochemicals	Engineers India Ltd. (EIL), Humphrey Glass
Power	Development Consultants, Desein, Tata Consultancy Services (TCS)
Roads	Consulting Engineering Services (CES), Rail India Technical Engineering Services (RITES), TCS
Ports	CES, RITES, EIL, Howe India
Software	TCS, Wipro

In the steel sector, MECON's major competitor is M.N. Dastur & Co. Among the two players, there has historically been a demarcation in the clientele among the ISPs and the private sector. MECON has traditionally been strongly positioned with the ISPs at Durgapur, Bokaro and Bhilai. In the other areas, the competition is well entrenched and MECON's entry has been slow.

The company has tied with the following foreign parties in various areas for the consultancy business:

Table 2 : Foreign Tie-Ups in the Consultancy Business

Foreign Party	Area of Tie-Up
Davy Distington, England	Process Control in Automation Industries
Central Engineering & Research Inc., China	Pulverised Coal Injection in Blast Furnace
Zeemag, Germany	Material handling for TNEB
White Industries, Australia	Coal Washery
Haskoning, Netherlands	Ports
BKH, Netherland	Environmental

Outlook for Consultancy Business

A demand-supply gap exists in the infrastructure sector. This could act as a demand driver for the consultancy services. Demand is likely to arise in the infrastructure areas such as power, roads, ports, refineries, etc. The company is yet to create a strong presence in the infrastructure areas.

The consultancy industry is characterised by strong entry barriers such as an established presence, a strong reference list and longer experience. In the long term, the large players with track records are likely to dominate the market. While this factor would be positive for MECON as far as the steel industry is concerned, it could work negatively in case of other sectors.

The sustained slowdown in demand and the strained liquidity position of most of the end consumers has led to stagnation in orders in the past. This has made the market increasingly price sensitive, thereby impacting the margins of most of the players. In the short to medium term, this scenario is likely to continue.

Supply Business

MECON entered the equipment & systems design and supply, for rolling mills, coke ovens, coke dry cooling plants, chemical plants, blast furnaces, BOF gas

cleaning plants and continuous casting plants in the Early Eighties as a forward integration of their consultancy and project management services. This has in turn helped the company to enter into Lump Sum Turn Key (LSTK) business.

Typically, in LSTK jobs, MECON arranges for equipment by contracting the same to sub-contractors, for which the company receives advance from the client for sourcing the equipment. The company takes responsibility for commissioning the project as per schedule and as per agreed parameters.

MECON's strong presence in the steel sector has helped it to enter the supply business, especially in the areas of rolling mills and coke oven batteries employed in the steel plants. This has enabled it to build a strong reference list as compared to other players. While among the private sector, the other players are likely to have comparable market shares, the company has a definite edge within the Durgapur, Bokaro and Bhilai steel plants.

While historically almost all of the supply business for MECON came from the steel industry (especially SAIL), the company has made attempts to diversify its revenue base. The business has gradually improved its customer diversity. It has been able to procure relatively small sized projects in the areas of copper, aluminium and zinc besides oil and gas, power plants, materials handling, chemical plants, gas cleaning plants etc.

Recently, MECON, in consortium with Zeemag, Germany and Mukund, India, was awarded a turnkey order from Tamil Nadu Electricity Board (TNEB) valued at about Rs. 241 crores. The order involves setting up material handling facilities, for TNEB's own plants, involving design, engineering, civil works, supervision, erection of structure and equipment supply. The order is significant for MECON both in terms of value and in respect of entry into a non-steel sector.

Of the balance order position, about 63.41% is from the non-steel sector. Within the steel sector, SAIL constitutes the largest portion of the balance order position. Thus, while, the company's dependence on the steel sector is still on the higher side, its attempts to diversify have received a boost with the TNEB order for material handling.

It needs to be highlighted that, in the supply business, payment terms from the customers are typically less favourable as compared to those in the

consultancy business. Further, gross margins in supply businesses vary substantially from job to job. The supply business therefore has extreme variability in earnings. On the average, the gross margins are of the order of 7-8%.

The ratio of manpower deployed in supply business to the ratio of manpower deployed in consultancy business is about 20:100. Preliminary estimates suggest that the supply business is comparatively less profitable at the operating level.

The income from the supply business has been in the region of Rs. 80 - 100 crores (45 - 50% of Operating Income) during the last four years (except in 1995-96). In 1995-96, there was a substantial spurt in income from the supply business on account of equipment supply for a continuous casting project for Rourkela Steel Plant (RSP).

The major competitors to MECON in the Supply business are listed below:

Table 3 : Major Competitors in Supply Business

Area	Competitors
Steel	SMS, Demag, Hitachi, Kawasaki, Nippon, L&T, Mukand
Coke Ovens	Auto India, Krupp
Blast Furnace	Demag, TPE (Russia)

While the company has strong engineering skills in areas related to steel, the company has followed the strategy of tying up with international players in specific areas for projects in other sectors. At present, the company has entered into a number of MoUs / Collaborations. Some of the major foreign tie-ups are listed below:

Table 4 : Foreign Tie-Ups in the Supply Business

Foreign Party	Area of Tie-up
Biazzi SA, Switzerland	Chemicals - RDX
Sumitomo Chemical Engineering Company, Japan	Petrochemicals - Butane
Giprokoks, Ukraine	Coke over battery
Zeemag, Germany	TNEB material handling assignment

MECON is presently facing difficulties in prequalifications in LSTK tender, as it does not have significant track records in the business and it also does not have adequate financing capabilities to take an equity stake in the projects, as is the current practice.

MECON has requested Government to infuse equity of Rs.150 crores in it to enable it to take a stake in the projects.

Outlook for Supply Business

The sustained slowdown in the economy and the strained liquidity position of most of the companies would impact the margins of most of the players, as in the consultancy business.

Turnkey projects by their very nature involve some risks. Typically, these projects involve payment of liquidated damages for deviation from project parameters and schedules. For successful execution of large turnkey projects, strong linkages in respect of technology, contractors / vendors and finance are required. Further, most large turnkey projects are awarded on the basis of competitive bidding, which requires sharp skills and strong tie-ups. Hence MECON's future business potential in this area would depend on its tie-ups and development of its capabilities.

Additionally, in the contracting / turnkey projects, the payments from customers are received only upon completion of certain milestones during which time a portion of the financing has to be done by the contractor. This coupled with the frequent delays in payments from the clients could lead to negative cash flows for the contractors for some periods of time.

A number of multi-national equipment suppliers and EPC contractors like Bechtel, ABB, Siemens, General Electric, etc., have entered the local market or are in the process of doing so. This is likely to result in a higher competitive pressure on MECON's supply business. Further, these EPC players are also willing to invest in the equity of the project, offering a strategic advantage over MECON.

Financial Analysis

Table 5 : Key Financial Figures of MECON

Rs. Crores

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	185.8	211.8	272.4	206.7	138.7
Non-operating income	7.87	10.92	12.21	9.28	8.26
Operating Profit	-7.06	-1.03	0.60	-3.45	0.47
PAT	1.6	8.3	10.2	5.4	7.1
Equity Capital	2.42	2.42	2.02	2.02	2.02
Tangible Networth	103.6	102.9	95.5	86.0	81.5
Gross Margin (%)	-3.8	-0.5	0.2	-1.6	0.3
Net Margin (%)	0.9	3.9	3.7	2.6	5.1
ROCE (%)	4.3	13.0	12.4	11.5	12.6
RONW (%)	1.6	8.1	10.7	6.3	8.7
Earning Per Share	6.69	34.38	42.27	22.27	29.13
Dividend (%)	22%	30%	40%	40%	40%

The company's turnover has varied significantly in the last five years. This is on account of the nature of the industry in which the company operates. Further, in 1997-98 the company's sales declined both in the consultancy as well as in the supply business. This was due to a slow-down in the economy and, in particular, in the steel industry, on which the company is heavily dependent.

For a company operating in an industry with widely varying turnover, the company's cost structure has contributed to its losses. The company has extremely high employee expenses, owing to which it has been making operating losses in the past. The employee costs comprised 43.6% of the operating income in 1997-98, an increase from 34.6% in 1996-97. While the large employee strength enhances the company's operating flexibility, it has also significantly impacted its cost structure.

The Net Profit Margin of MECON has decreased consistently from 5.1% in 1993-94 to 0.87% in 1997-98. In all the years, MECON has been able to show a positive profit after tax largely on account of the considerable non-operating income and cash adjustments.

The company's operations are highly working capital intensive, as is evident from the high level of receivables and payables. The working capital intensive nature of the company's operations can be attributed to the turnkey projects, in which the payments from customers are received only upon completion of certain milestones, and the current difficult liquidity position of the public sector clients of MECON.

Strengths and Areas of Concern

Strengths

Good domestic track record in the steel sector – The company has been operating in the steel sector for about forty years providing a formidable exposure to the technical issues in the sector

Proximity to PSU clients – The PSU nature of MECON and its past relationships position it competitively for business from its PSU clients

Experience in Lumpsum Turnkey jobs – As the activity in infrastructure and industrial sector increases, MECON's past experience as LSTK contractor, though limited, is likely to benefit MECON in procuring business

Large pool of qualified technical manpower – MECON's large pool of technically qualified and experienced professionals (more than two-thirds of the total employees) provides it an opportunity to consolidate in the existing business segments and enter new areas

Areas of Concern

Inadequate commercial orientation – In the current scenario of increasing competitive pressures lack of commercial orientation would further severely impact the viability of the organisation

High Average Age – This could result in a top management vacuum in three years' time

Locational disadvantage – Most of the existing and potential clients are located at metro locations and hence location of the largest operating base at Ranchi imposes logistical constraints especially in business development efforts

Adverse cost structure – High fixed costs result in consistent operational losses and declining net margins

Inadequate financial capacity and information systems – Essential in the consultancy business and also in the LSTK jobs

Excess manpower – The employee expenses, for a high employee base of about 3260 employees, take away a very large portion of the Operating Income resulting in losses at operational level

Recommendations

As can be seen from the above analysis, MECON has in the past played a major role in providing engineering consultancy support to the growth of steel industry in the country. However, the recent changes in the economy, including the downturn in the steel industry, require a long-term business strategy that would enable it to build on its current strengths and complement them through strategic partnership, with other capabilities to cover areas of weakness, so that it could benefit from emerging opportunities and combat the competition of global consultancy and LSTK companies.

Another dimension of MECON that has emerged from the analysis is its strong manpower base. It has a large pool of qualified technical manpower. This pool is likely to be the target of new players, particularly the international consultancy companies and MECON has to address HRD with positive measures, building up employee loyalty and commitment.

The field of consultancy services and LSTK contracts over the years has become increasingly competitive with the entry of a large number of Indian and international companies. **Hence, the Commission is of the view that a consultancy company operating in a 'non-core' steel sector should be classified as non-core.**

There is a need to view the disinvestment in the case of MECON from the standpoint of strengthening MECON as an important domestic consultancy company which has played a prominent role in the industrial growth of the country and is seen to have a similar role in the vital infrastructural sectors in the future. MECON would, however, need to complement its strength in the area of trained technical manpower with access to better technology and finances and LSTK capabilities, if it has to successfully face competition from a large number of players, both domestic and international.

The Commission, therefore, recommends strategic sale of a minimum of 51% equity stake in MECON along with appropriate role in the management. A strategic partner would be able to add to MECON's strengths in terms of technical consultancy and project management particularly LSTK capabilities, global acceptance and access to international funds, without, at the same time, eroding its strong domestic brand equity. This would also aid MECON in entering the non-steel and infrastructure sectors. The selection of the strategic partner should be done on the basis

of global competitive bids from a set of pre-qualified bidders. Simultaneously, suitable reduction in manpower through VRS should be undertaken.

In the event of inadequate interest in the equity stake in MECON, the government would not have any other option but to close the company in view of the poor prospects of viability of the company in its current structure and positioning.

2.2 MSTC Ltd

Evolution

MSTC Limited was incorporated in 1964 as The Metal Scrap Trading Corporation Limited and its name was later changed to MSTC Limited. The company is a Government of India public sector enterprise under the administrative control of the Ministry of Steel and Mines.

The company was set-up with the primary objective of regulating the exports of surplus metal scrap arising in the country after meeting domestic demand. During the late 1970's, MSTC was made the sole canalising agency for imports of scrap (mild steel, stainless steel, high speed steel, and re-rollable scrap), with a ban on direct imports by private parties.

Currently, 90% of total shareholding is held by GoI, 3.77% by various Indian companies, 0.91% by Visveswaraya Iron and Steel Limited, and 5.47% by various individuals.

Business Analysis

MSTC is divided into three divisions, namely, the Foreign Trade Division (FTD), Domestic Trade Division (DTD) and Exports Division.

The FTD has been mainly involved in importing ferrous scrap in addition to small quantities of finished steel items. However, in the current year, owing to reduced scrap imports, the company has commenced import of other items like furnace oils and slab iron casting, among others.

The DTD is involved in domestic trading of both ferrous and non-ferrous scrap, while the Exports Division is not doing any business at present.

Table 1 : Division-Wise Volumes Traded and the Gross Margins

Traded Sales (Rs. Cr)	1997-98	1996-97	1995-96	1994-95	1993-94
FTD	14.21	97.40	134.06	165.77	143.27
DTD	497.83	440.37	399.67	288.39	240.00
Exports	—	0.22	3.39	7.04	1.03
Total	512.04	538.00	537.12	461.20	384.30
Gross Margin					
FTD	2.27	1.89	2.23	6.55	4.38
DTD	7.16	6.61	6.15	4.43	4.00
Exports		0.01	0.13	0.26	0.06
Total	9.43	8.50	8.51	11.25	8.44

The volumes traded through FTD have been fluctuating in the last four years, while the volumes of DTD have been increasing steadily.

Consequently, the share of DTD in the overall business has shown an increasing trend, from 42% in the year 1992-93 to 75 % in the year 1995-96. However, since historically the margins of DTD have been much lower than those of FTD, higher share of DTD in total business has resulted in lower overall profitability for the company.

Foreign Trade Division

During the late 1970's MSTC was made the sole canalising agency for imports of scrap, with a ban on direct imports by private parties. This rendered monopoly status to MSTC in imports of scrap. The customer base of FTD comprises of the secondary steel producers and Electric Arc Furnace (EAF)/ Induction Furnace (IF) units etc.

The traded volumes of imports of scrap witnessed a substantial increase in the 1980s under the canalised era with rapid growth in the EAF and Induction furnace units, and the turnover of FTD from imports peaked at Rs. 700 crores in 1989-90.

However, on account of decanalisation of imports of scrap in February 1992, the imports of MSTC decreased sizeably thereafter as many of its customers started importing scrap on their own. Further, on account of the recession

in the steel industry and closure of large number of Electric Arc Furnaces, the volumes of import decreased to zero by 1997-98. The larger players have moved towards integrated operations with increasing dependence on sponge iron/DR1/pig iron.

The reduction in import of scrap was also precipitated by the difficulty in recovery of receivables from some of its customers. Consequently, on account of the adverse market conditions and its bad experience in the past, the company decided to stop importing ferrous scrap since 1997-98. In recent times, the company has ventured into the import of steel related items like CR/HR Coils, HMS, pig iron and trading in other unrelated commodities like SKO/ furnace oils, iron castings etc.

The counter measures taken by MSTC include Enhanced Credit measures, sale against Post Dated Cheques (PDC) instead of LCs/ Guarantees, venture into stockyard sales as against high-sea sales and diversification into new areas.

The gross margin of FTD had been declining after decanalisation with increasing dependence on other finance income vis-a-vis business.

In future, the scrap import turnover is expected to be low/negligible. The diversification into non-traditional areas may not be sustainable due to high degree of competition, MSTC's limited experience and lack of autonomy & slow decision making.

Domestic Trade Division

The Domestic Trade Division was formed in 1975-76, and its role was primarily to act as an agent to dispose off scrap from the four plants of SAIL viz. Rourkela, Bokaro, Bhilai and Durgapur. The volume of scrap handled at that time was around Rs. 20-30 crores. However, when MSTC got delinked from SAIL in 1982, it started providing scrap-disposal services to other entities such as government departments, the defence sector, etc.

The main business of DTD is to trade scrap (both ferrous & non-ferrous), stores, consumables & other disposable items. This division is also involved in marketing of various steel items like pig-iron, semis (ingot, blooms etc.) & finished products (longs & flats). Ferrous items, Non-ferrous item and Misc. items comprise about 80%, 15% and 5% of the division's turnover, respectively.

The main clients of the company are various PSUs and government bodies, such as ISP's in the government sector, various PSU's government departments like Ministry of Defence, Ordnance factory board, Ministry of Home affairs and State Government departments like SEBs, State Transport Corporations etc.

By virtue of MSTC's status as a PSU, as well as owing to the experience it has gained over the years in scrap disposal, MSTC has been getting substantial business from these bodies on a regular basis.

The company disposes scrap either through tenders / auctions / tender-cum-auctions, as explained below:

- **Fixed price sale** is typically held for homogenous materials like steel skulls and other homogenous scraps generated from steel plants. In these cases, MSTC arranges for a buyer for the scrap at a mutually agreeable price. For conducting these sales, MSTC charges a fixed amount of commission which typically works out to be in the range of 0.3% to 0.5% of the sale value.
- **Auction /tender/tender-cum-auction sales** are the more common type of sale agreements, and are typically organised for other non-steel plant customers, as well as for non-homogenous scrap generated by steel plants. Here, MSTC merely acts as an agent to conduct auctions or announce tenders, on behalf of the selling company. The commission is linked to the value of the sale, and varies between 1.75% to 2.5%, depending on the seller.

In all the arrangements, MSTC acts as a mere agent and bears no risk of price fluctuations or non-selling of the items.

Increasing competitive pressure has resulted in declining spreads for the company. Margins of this division have remained low, but steady over the years, at around 1.5% of the value of domestic trade. While the margins from these operations are very low, the company is able to generate income indirectly, such as through interest earnings on earnest money deposits from the prospective buyers, etc.

The future prospects of DTD are expected to be adversely affected by the following factors :

- Reduction in scrap generation with better steel production efficiency & completion of the modernisation by many steel plants
- Continued low margins due to low importance accorded to the function – the customers have not been switching agents due to low importance accorded to the function of scrap disposal
- Negligible presence in the private sector

Financial Analysis

Profit After Tax (PAT) of MSTC has declined from Rs. 5.25 crores in 1994-95 to Rs. 1.79 crores in 1997-98, as MSTC, being a trading outfit, operates on very low spreads leaving little buffer for absorbing any event risk. Additionally, the company has relatively high fixed cost on account of its expenses on employees and administration. The company's employee cost has more than doubled from Rs. 2.42 crores in 1993-94 to Rs. 5.35 crores in 1997-98.

Table 2 : Financial Highlights

(Rs. Crore)

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	26.09	109.23	147.82	183.46	151.88
Operating Profit	0.86	3.40	1.77	6.85	4.74
PAT	1.79	2.26	1.34	5.25	4.76
Equity Capital	2.2	2.2	2.2	2.2	2.2
Tangible Networth	50.97	49.62	47.8	46.9	42.3
Gross Margin (%)	3.3%	3.1%	1.2%	3.7%	3.1%
Net Margin (%)	6.9%	2.1%	0.9%	2.9%	3.1%
ROCE (%)	6.1%	8.9%	5.4%	24.1%	12.3%
RONW (%)	3.5%	4.6%	2.8%	11.2%	11.3%
Earning Per Share	0.81	1.03	0.61	2.39	2.16
Dividend (%)	20.0%	20.0%	20.0%	30.0%	17.7%

In line with the declining operating income and trading margins coupled with high level of fixed overheads, MSTC has been showing a loss at the OPBT (Operating Profit Before Tax) level in the past three years, the OPBT /

Operating Income standing at a level of (-) 2.6% in 1997-98. The company has managed to show profits as the PAT level on account of the considerable non-operating income in the last three years, which stood at a level of Rs. 3.5 crores in 1997-98.

The company has receivables of around Rs 42.9 crores as at March 31, 1998, out of which Rs 40.85 crores has been overdue for over 6 months. The high receivables levels are mainly on account of the 'Post Dated Cheque transactions' mentioned earlier, as well as old debtors, where litigation is involved. Recovery of the above overdues seems difficult over the short-to-medium-term on account of the poor financial position of most of the defaulters, as well as long drawn out court procedures.

MSTC has a 60% equity stake in Ferro Scrap Nigam Limited (FSNL) with Harsco Corporation, USA holding the balance equity. The book value of this equity stake, as on 31 March 1998, was about Rs 45 crores.

Strengths and Areas of Concern

Strengths

Over 30 years Experience in the trading in the Metal Scrap.

Reasonably Wide Network of 10 regional offices and branch offices. Additionally, the company has also been able to build an extensive network of business contacts both within the country, as well as abroad.

Areas of Concern

Low future business potential and profitability – The future turnover and the profitability is expected to be low on account of reduced opportunities in traditional businesses, limited experience in non-traditional businesses and increasing competitive pressure

PSU Nature - Inability to respond fast to opportunities in the trading environment on account of government procedures

High Level of Receivables – An amount of Rs 42.9 crores, nearly 80% of the Networth, is locked in unrealisable debtors.

High Dependence on Government and PSUs for business

Low Margins – MSTC has incurred loss at the OPBT (Operating Profit Before Tax) level in the past three years and the company has managed to show positive PAT on account of the considerable non-operating income.

Recommendations

It is to be noted that State Trading, which was widely prevalent at one time, has been gradually phased out in most countries. This has led to loss of significant market opportunities for the government-owned trading companies in India. **The Commission feels that no public purpose would be served by MSTC being under the government ownership and control. Hence the Commission classifies MSTC as non-core.** Further, its viability as an enterprise under government ownership and management is doubtful.

MSTC has discontinued dealing with trading of scrap on its own account. MSTC is a large player engaged in the disposal of scrap and has a well established client base, it is likely to continue to get business from its existing clients. However, given the low importance accorded to the scrap disposal function and the increasing competitive pressures, the profitability for this division is likely to be low. Also, the overall size of this market is expected to shrink, and consequently, the business at current levels may not be sustainable.

Additionally, the operations of the company are unprofitable, and it is on account of non-operating income that the company has been able to show profits. The business and financial outlook for the company in future therefore, appears to be bleak.

Given that the role played by the company could be easily performed by the private sector and that the government has no meaningful rationale for continuing in the business of scrap trading/disposal, **the Commission recommends sale of 100% GoI holding in MSTC alongwith MSTC's holding in FSNL.**

In case there is no investor interest in the company, the Commission of the view that there would be no option but to close down the operations of MSTC and liquidate all its assets and liabilities. In order to part finance its cost of closure, MSTC should also disinvest its stake in FSNL in favour of a strategic buyer.

2.3 Mineral Exploration Corporation Limited

Evolution

Mineral Exploration Corporation Limited (MECL) was established in October 1972 for planning, organising and executing time-bound mineral exploration programmes in the country. It became a Public Limited Company in July 1975 and it is under the administrative control of the Ministry of Mines. Prior to MECL, Geological Survey of India (GSI) was the sole agency for carrying out exploration work in the country, except for coal where exploration was carried out by Central Mine Planning & Design Institute Ltd. (CMPDIL), a subsidiary of Coal India Ltd., and Singareni Collieries Company Ltd. (SCCL). To give a commercial bias to mineral exploration and to bridge the gap between initial discovery of a mineral prospect and its eventual exploitation, functions such as detailed mineral exploration, equipment and personnel were transferred from GSI to MECL. The equity capital of MECL is Rs. 63.8 crore and is 100% owned by Government of India.

Industry Analysis

India has been endowed with a wide variety of mineral reserves. There are over 20,000 known mineral deposits and 84 minerals being mined with an aggregate annual production of about 500 mn tonnes. Mineral production in the country has increased from Rs.700 mn in the 50s to over Rs.330 bn in FY'97. Mineral resources are non-renewable and therefore, call for vigorous exploratory efforts for the discovery of new mineral deposits. This assumes a greater significance in a country like India which is a net importer of minerals and metals and is expected to remain so.

GoI has been taking steps towards the development of mineral resources through policy initiatives. The first attempt for development of minerals was the enactment of Mines and Minerals (Development and Regulation) [MMRD] Act of 1957, which essentially evolved from the Industrial Policy Resolution, 1956.

In March 1993, GoI announced a new "National Mineral Policy" (NMP) whose main objective was to develop mineral resources taking into account national and strategic considerations and to ensure their adequate supply, keeping in view the present needs and future requirements. To this end, the policy

entrusted the State with responsibility of playing a more active role for mining and processing of minerals, either on its own or through private sector participation.

Subsequently, in January 1997, Gol announced relaxations in equity participation by foreign companies in the Indian mining and exploration sector, to encourage flow of foreign investments. The new policy encouraged private initiative and investment, both domestic and foreign. A number of foreign exploration and mining companies came to India. However, even after five years, most of these projects are yet to take off. This is because State Governments have not displayed the same kind of zeal and enthusiasm as was expected of them by the NMP. In most of the states, prospecting licenses (PLs) are yet to be awarded as there has been no clear-cut policy by the state governments regarding grant of licenses, evaluation of applications and clearances required. Further, states like Andhra Pradesh and Madhya Pradesh have reserved areas in favour of their state Corporations to carry out exploration.

So far the primary responsibility of development of basic geological data, fall on the Government. Financial constraints have resulted in very low outlays for mineral exploration. To illustrate, the expenditure incurred for mineral exploration in India (\$50 million per annum) is insignificant compared to that in other countries like Canada (\$528 million), US (\$396 million), Australia (\$462) and Indonesia (\$132 million).

Domestic Industry Structure

Mining and mineral exploration industry in India can be segregated into four distinct segments:

Survey & Exploration : This includes the following entities:

- GSI, involved in regional exploration, geo mapping surveys on land sea and air;
- MECL, into detailed exploration various minerals/ores ; and
- CMPDIL, engaged in detailed exploration for coal, preparation of project reports for new/expansion/reorganisation of mines including safety, and related R&D. CMPDIL is also a nodal agency for co-ordinating Science & Technology activities in coal and lignite.

Apart from these, there are a few small sized regional players who provide specialised services like drilling and mining.

Mining & Processing : This segment includes entities engaged in the commercial exploitation and/or downstream processing of ore. Public sector organisations include BALCO, Bharat Gold mines, HZL, HCL, NALCO, Sikkim Mining Corporation, CIL etc., and private sector companies include companies like HINDALCO, Sesa Goa etc. There are also other companies like Sterlite Industries and Birla Copper, which are only into processing.

Regulation & Conservation : Indian Bureau of Mines and Controller of Mining Leases are GoI bodies engaged in ensuring compliance with various laws concerning mineral exploration.

Research & Educational Institutions : Jawaharlal Nehru Aluminium Research & Development Centre, National Institute of Rock Mechanics, National Institute of Miners' Health and Indian School of Mines are GoI sponsored bodies engaged in R&D.

International Scenario

Internationally, there exist large integrated mineral exploration-cum-mining companies alongwith small scale prospectors known as "Junior Explorers". Junior Explorers (numbering about 1400) have been extremely successful and have accounted for nearly half the significant gold and base metal discoveries over the last 25 years in North America and Australia. One of the reasons for the existence of a large number of prospecting companies is the transparency in the regulations particularly with respect to the prospecting licensee having the first right to mining leases (MLs). As a result, 'juniors' are able to share or even sell their "interest" in a prospected deposit to a larger mining company which would have the resources and expertise to bring them into commercial production. The strike rates of discovering a deposit which can be commercially exploited are extremely low and as such, the exploration programmes are high cost operations. Consequently, most of these 'juniors' are loss making but the occasional discovery of a suitable deposit results in super-normal profits. Till then, junior explorers are mainly funded by specialised, high-risk investment funds and individual speculators, hoping to share in the high returns from the occasional discovery. The downturn in the commodity prices has resulted in a cutback in the exploration budgets

of mining companies. Consequently, mining majors have been doing away with their in-house exploration wings and entering into alliances with junior explorers, as a cost-cutting measure. These alliances are however, project-specific in nature.

As against the large number of junior exploration companies internationally, over the last two decades, no other major exploration company has emerged in India. Till then, companies like MECL would continue to depend on support from Gol.

Business Analysis

MECL is essentially a 'service' organisation: its efforts are directed at undertaking mineral exploration programmes to establish viable deposits for commercial exploitation. Accordingly, it provides allied services like drilling, mining, laboratory analyses and geophysical survey, etc.

MECL's mineral exploration programmes are of two types

- Promotional activities which are carried out on behalf of and funded by Gol; and
- Contractual activities which are carried out on behalf of other agencies including public sector, private sector and state governments.

Promotional Activities : GSI is involved in regional exploration, i.e., exploration on a large area which would give an indicative idea about the existence of mineral resources. Based on the data available with GSI, MECL chalks out its plans for carrying out promotional exploration programmes. These are finalised by the 'Standing Committee on Promotional Projects' in case of projects under Ministry of Mines (MoM) and by a Sub-Committee on Coal and Lignite in case of coal projects.

Priority Regional Exploration : Apart from detailed exploration, MECL acts as a sub-contractor to GSI and carries out Regional exploration, under the 'Priority Regional Exploration Programme'. Under this programme, the company has carried out over 20 mn meters of drilling for coal and 0.23 mn meters of drilling for lignite, over the last ten years.

Contractual Activities : MECL participates in tenders floated by various agencies for mineral exploration work. The company also gets mandates to

carry out exploration activities from agencies like CMPDIL and acts as a sub-contractor.

MECL's clientele has been mainly GoI and public sector undertakings and its total revenues have been limited by the outlays for mineral exploration and related activities. Contractual and promotional work availability has thus, fluctuated widely, depending on the budgetary allocations of GoI and PSUs.

The share of promotional activities as a percentage of total revenues which had been 35-40 between 1985 to 1990, has dropped to about 15 in FY'98. Since the objective of promotional exploration is to prove viable deposits in freehold areas and to ensure availability of a 'shelf' of mineral deposits for attracting investments, it is imperative that GoI continues to extend support for mineral exploration. The importance of promotional exploration is further accentuated by the fact that India is a net importer of metal and mineral products and is likely to remain so.

Recognising the acute shortage of funds for exploration programmes, GoI has created a Mineral Exploration Fund (MEF) for promoting sustainable activities for exploration and development of minerals. The MEF is envisaged to have a corpus of the order of Rs.160 mn, to be funded mainly by PSUs like National Aluminium Company Ltd (NALCO), Bharat Aluminium Company Ltd (BALCO), Hindustan Zinc Ltd (HZL) and HCL. Other modalities are yet to be worked out.

Drilling has been the main source of income for the company, contributing about 65 to 70%, followed by geology and mining (about 10-15% each).

Mineral exploration drilling involves drilling in soil and rock formations to obtain physical core and rock chip samples, primarily for evaluation by geologists. Exploratory drilling is necessary to confirm the existence of a mineral deposit as well as to determine whether there is sufficient deposits of minerals to justify development of a mine. MECL has the largest fleet of drills in the country for mineral exploration and related activities. It has the capability of drilling upto 1100 meters of depth and 76 mm diameter and caters to more than 60% of the mineral exploration needs of the nation. Over the last 25 years, the company has conducted over five million meters of exploratory drilling.

The drilling performance has been on decline in between FY'94 and FY'96. However, during the last two years there has been significant improvement in drilling performance mainly due to organisational restructuring, infusion of fresh capital, emphasis on maintenance of equipment, focus on business development etc.

MECL has a fleet of 146 drills, of which 102 are in operation. The company has not been able to upgrade its drills due to financial constraints and consequently the average age of the fleet is about 12 years.

For promotional exploration programmes, MECL gets payments as per the schedule of rates specified by Gol. Average rates during the last three years for different minerals are given in the following table:

Table 1 : Average Rates for Minerals

Price (Rs./Metre)	FY'96	FY'97	FY'98
Coal	1560	1920	2148
Lignite	1079	1148	1209
Copper	3634	3870	4079
Gold	2899	3087	3254
Bauxite	2441	2600	2740

The rates had been fixed in 1990, with a cost escalation factor applicable every year. The rates are based on normative costs considering working environment, depth of borehole, strata and geological complexity pertaining to each mineral.

Mining

The company meets about 60 percent of the exploratory mining needs of the country. The main purpose of exploratory mining is to extract large samples (upto 1000 tonnes) of the minerals to carry out further studies for establishment of the quality of deposits. MECL currently has two ongoing exploration mining projects for bauxite and molybdenum.

Developmental mining is carried out mainly for coal and base metals (zinc and copper) and involves mine construction, i.e., construction of vertical/inclined shafts to provide access to the mineral deposit. The company is currently undertaking seven projects for HZL and various CIL subsidiaries.

The company has during FY'99, begun supplying ballast stones to Railways, for which it has obtained mining lease at certain areas near Ranchi. MECL also plans to enter into commercial mining of limestone, dolomite, sillimanite and fluorite in the state of Maharashtra, which are presently under leasehold of Maharashtra State Mining Corporation (MSMC). A joint venture is planned with MSMC for commercial mining of these minerals in the state.

Geological studies

MECL, with its large pool of talented geologists and geoscientists, carries out geological and economic evaluation of mineral deposits from initial reconnaissance to deposit parameter assessment. The company also carries out environmental and remote sensing studies, surface geophysical surveys etc. to support drilling activities. This is one of the key strengths of MECL as, apart from being able to generate geological data through drilling, it can provide incisive geoscientific interpretation towards design of quality exploration programmes.

Further, the company has also offered its services to a number of foreign exploration and mining companies and their Indian subsidiaries like RGC Exploration Pty Ltd and Rio Tinto India Pvt Ltd.

The company's manpower strength is about 3,300 employees. This has been reduced due to implementation of VR scheme since FY 93. The maximum manpower requirement has been assessed at 2500 as against the present strength of about 3300.

Financial Analysis

The financial performance of MECL for the past five years is summarised as follows:

Table 2 : Financial Highlights (Rs.Crore)

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	58.6	42.4	32.2	34.4	45.1
Operating Profit (PBDIT)	2.2	-1.2	-5.9	-6.8	-3.6
PAT	-2.5	-8.2	-12.2	-14.0	-11.9
Equity Capital	63.8	60.0	56.5	56.5	56.5
Tangible Networth	8.3	8.4	9.6	21.2	33.2
Gross Margin (%)	3.7	-2.9	24.4	25.2	24.7

(Other financial ratios are not shown as they are negative and hence meaningless)

Though MECL's total income grew from Rs.451 mn in FY'94 to Rs.586 mn in FY'98, the growth has been uneven, due to skewed availability of work orders and disruptions in work due to poor emphasis on repairs and maintenance. MECL has been incurring losses for the last five years due to lack of adequate work, high labour bill and low productivity. For the first time in five years, it earned profits before interest and depreciation in FY'98, largely due to the sharp jump (38%) in work done during FY'98. Employee cost as a percentage of total income has declined from 94 in FY'96 to 78 in FY'97 and further to 60 in FY'98, because of healthy growth in income coupled with reduction in manpower.

Due to mounting losses, MECL's networth has been significantly eroded. Accumulated losses stood at 87% of the paid-up equity capital and reserves as on March 31, 1998. Long term debt equity ratio and overall gearing at 0.40 and 0.53 respectively, as on March 31, 1994, increased substantially to 4.12 and 4.54 as on March 31, 1998, due to erosion of networth and funding of capital expenditure/working capital through debt rather than equity. Interest coverage remained negative throughout the period.

Restructuring Measures : As the performance of MECL has been declining, GoI constituted an Expert Committee to conduct a diagnostic study of MECL and advise on strategies for restructuring. The major suggestions of the Committee are as follows:

- Manpower should be pruned to a level required for operation of 100 drills and 4000 metres of mine development on a regular basis.
- Productivity should be improved through replacement of substandard machinery and redesigning of incentive scheme for workers.
- GoI funding for promotional activities should be atleast 30% of the total work load and should be continued for atleast 3-5 years.
- MECL should consider
 - strategic alliance with leading foreign mining and exploration companies
 - exploration for Coal bed methane
 - applying for PL/ML for mineral prospects
- Financial restructuring package should include
 - Release of working capital loan of Rs.5 crore with interest waiver and moratorium

- Equity infusion of Rs.10 crore during FY'97 to meet working capital requirements
- Write off of accumulated loss of Rs.37.3 crore as on March 31, 1995 [Due to delay in implementation of revival plan, the Review committee suggested writing off accumulated losses of Rs.49.6 crore as on March 31, 1996]
- Write off outstanding loans alongwith interest thereon (Rs.10.0 crore) as on March 31' 1995
- Generation of Rs.3 crore through disposal of surplus land.
- Enhancement in cash credit limits by Rs.2 crore.

The revival plan as recommended by the Committee has been accepted by GoI. The Financial restructuring package is under consideration of GoI, as per which MECL has sought the following relief measures :

- Accumulated losses as on March 31, 1997 (Rs. 53.75 crore) to be adjusted against equity
- GoI loans amounting as on March 31, 1997 (Rs. 21.29 crore) to be converted into equity and interest accrued (Rs.6.33 crore) to be written off/adjusted.
- Interest of GoI loans drawn during FY'98 and thereafter to accrue only from FY'2002, after a moratorium for three years for payments of interest and principal. Principal payments to be made in five equal instalments.

Strengths & Areas of Concern

Strengths

Highly skilled manpower : MECL is having the largest pool of technological skill comprising of geologists, geophysicists and mining engineers. This will enable the company to undertake more and more projects in future.

Large fleet of exploration equipment and facilities : MECL is having more 100 drills and are deployed throughout the country. This will enable the company to undertake projects in all parts of the country.

Potential opportunities : Since the country is having huge mineral reserves which are not yet fully explored, exploration companies in India has got potential opportunities to grow.

Areas of Concern

No Commercial orientation : MECL does not carry exploration work on its own and consequently none of its reports are saleable. MECL works as an extended arm of GSI.

Overstaffed : MECL's manpower strength is very high and hence it becomes uneconomical to operate on commercial lines.

Old, outdated, low productive drills : Even though MECL has large number of drills, many of them are old and outdated. Moreover, the productivity of MECL drills are very low.

Low value added services : As MECL does not have PL, the company will not benefit from any new findings. MECL will only be reimbursed for their work.

Competition : GoI, as a part of liberalisation process, is opening up the mining sector. This will enable large international mining companies to start their operations, which will affect MECL.

Recommendations

MECL was set up with a view to give commercial bias to mineral exploration and to bridge the gap between initial discovery of a mineral prospect and its eventual exploitation. However, during its 27 years of operation it failed to accomplish its objective as a commercial venture. MECL in the past had always worked as an extended arm of GSI and never got any Prospecting License (PL) in its name, which it could transfer after the finding of mineral. Universally all mineral exploration companies start their exploration with the PL in hand, which would enable them to realise better value from their findings. As mentioned in the business analysis section, MECL is engaged in the promotional activities undertaken on behalf of GoI. However, over the years, its share of promotional activities as a percentage of total revenues reduced to 15% in FY 98 from about 30% in FY 94. With the falling share of its operations in promotional activities for GoI, the Commission is of the view that MECL's operations are no more Core. **Hence, the Commission classifies MECL as non-core.** Further, the Commission is of the view that, if the promotional work of MECL is very important to GoI, the same can be separated from MECL and could be merged with GSI (Geological Survey of India).

Mineral exploration activity is a capital intensive industry. In order to emerge as a leader in this sector, MECL has to make huge investments to upgrade its ageing drills, procurement of new equipments etc. With its current financial health, MECL would not be in a position to raise resources for investment. So far, MECL was getting budgetary support from GoI both as equity and loan and the same may not be available in future from GoI. Under these circumstances, the Commission is of the view that GoI has the following options.

1. **Implement a VR Scheme and allow MECL to continue their operations and apply for PLs.** Under this option, in order to make the offer attractive, downsizing of manpower would be necessary. MECL is having huge manpower and the Expert Committee's assessment of overmanning is to the extent of 800. In order to reduce manpower, GoI has to support MECL and the estimated outflow on account of VR would be Rs. 20 crore. As mentioned earlier, MECL undertakes only contractual assignments. The Commission is of the view that MECL should apply for PLs in all their future assignments. This will enable the company to realise

better value once the exploration is successful. Further, this will attract national/international mining companies to acquire stake in MECL. Disinvestment of up to 51% GoI holding could initially be attempted once MECL acquires PL rights and succeeds in establishing commercially valuable reserves. Once this is achieved, GoI could consider disinvestment of its balance holding through public offering.

2. **Sell 100% equity of MECL on as is where is basis.** Even though the company is currently making losses, it has certain assets in the form of drills, technical expertise etc. This may be an attraction for the prospective buyer, as many of the international mining companies are trying to establish their operations in India. This will enable GoI to realise some value and would stop further draft on the budget. The selection of strategic buyer should be undertaken through a globally competitive pre-qualified bidding process.
3. **Closure.** If none of the above options are viable, the Commission of is the view that Government should close down the operations of MECL and liquidate all its assets and liabilities.

2.4 Sponge Iron India Limited

Evolution

Sponge Iron India Limited (SIIL) was incorporated on March 18, 1975. SIIL was set up as a subsidiary of Andhra Pradesh State Industrial Development Corporation (APIDC), but it later became a PSU in which GoI owned majority of shares. SIIL set-up a Demonstration Plant of 30,000 tpa capacity to establish the techno-economic feasibility standard of manufacturing sponge iron suitable for steel making, using indigenously available iron ores and non-coking coals. The other reasons for setting-up the plant at that time were:

- Non-availability of coking coal of the required quality and quantity.
- Wide fluctuations in the availability of ferrous scrap for both the Primary and Secondary steel manufacturers.
- Need to find a substitute for the ferrous scrap used as feed stock in electric arc furnaces.
- Saving foreign exchange on import of iron scrap, a substitute for sponge iron.

The paid up share capital of SIIL is Rs. 32.58 crore with GoI and GOAP holding 97% and 3% of the equity respectively.

Industry Analysis

Sponge Iron industry was visualised and set up in India as an import substitute for scrap. Sponge iron is a metallic product produced by direct induction of high-grade iron ore or pellets in solid state. Sponge iron, a substitute for scrap, is a reduced form of iron ore into Direct Reduced Iron (DRI) or sponge iron. However, DRI has the disadvantage of rusting easily and it is, therefore, converted into Hot Briquetted Iron (HBI) by some producers.

There are primarily two routes to produce sponge iron - coal based and gas based. Coal-based plants use non-coking coal for converting iron ore into DRI in a rotary kiln. Gas based plants are large in size (typical one million tonnes), require higher capital investment, use iron ore and pellets blend as raw material and natural gas as reductant. Output is briquetted and is called hot briquetted iron.

The three gas based sponge iron plants in western India had been exporting substantial amount of their output. However, exporters of sponge iron faced certain infrastructural difficulties at the ports for berthing space and handling. However, the major issues in the recent past have been the reduction of customs duty on scrap and the generation of huge amounts of scrap by the CIS countries. Moreover, the prices of natural gas, is roughly 2-2.5 times more than that in Venezuela (a country with similar gas based sponge iron industry).

Sponge iron is used as feedstock for mini steel plants/ induction furnaces (IF)/ electric arc furnaces (EAF). Mini steel plants use either sponge iron or scrap to manufacture steel. Steel melting scrap and DRI are two major inputs in electric steel-making through electric arc furnace and induction furnace routes. From the scrap availability point of view, as far as the integrated steel plants are concerned, the internal generation of scrap is coming down due to the increasing adoption of concast technology. It is expected that in future these plants will emerge as net purchases of scrap or DRI.

The sponge iron industry was originally visualised and set up as an import substitute for scrap for saving foreign exchange of the country. However, due to demand recession during the past few years, the sponge iron industry began exporting from 1992-93. After an initial rise during 1993-94, exports of sponge iron, mainly of the HBI grade, dropped to 6.6 lakh tonnes in 1994-95 from 7.2 lakh tonnes in 1993-94.

Table 1: Demand supply of metallics (Sponge iron / Scrap)

(Million tonnes)	1996-97	1997-98	1998-99	1999-00
Production				
Production by mini steel plants (longs)	4.95	6.03	6.48	7.61
Production of Flats	2.40	2.40	3.60	3.60
Total steel production	7.35	8.43	10.08	11.21
Requirement @ 1.1 (Total demand for Metallics)	8.08	9.32	11.08	12.33
Supply				
Sponge iron supply	5.97	6.28	6.40	6.40
Pig iron (to the extent of 5%)	0.40	0.46	0.55	0.61
Balance to be met through scrap/ Sponge iron imports	1.71	2.58	4.13	5.32

There might be a serious mismatch between the requirements of the metallics vis-à-vis domestic availability in India. As a result, India may be constrained to import metallics, causing a severe pressure on the country's foreign exchange situation. Therefore, the expected shortfall of metallics was not realised. In fact there has been a reduction in the production fuelled by low demand.

Sponge iron production increased by 6.8%, from 5 million tonnes in 1996-97 to 5.34 million tonnes in 1997-98. This increase has come from new capacities and increased utilisation from the existing plants. Nippon Denro's 10 lakh tpa plant was commissioned in mid-1994. The plant produced 4.57 lakh tonnes in 1994-95. Vikram Ispat's plant, which was commissioned in April 1993, produced 4.05 lakh tonnes in 1994-95 as compared to 95,000 tonnes in 1993-94. Prakash Industries achieved full capacity utilisation in 1994-95 producing, 1.5 lakh tonnes in 1994-95 as compared to 15,000 tonnes in 1993-94. Production from Essar Gujarat declined to 1.33 million tonnes in 1994-95 from 1.5 million tonnes in 1993-94. (The company had to shut down its plants for two months in 1994-95 due to non-availability of gas from GAIL and ONGC).

Demand for sponge iron has grown from 1.69 million tonnes in 1993-94 to an estimated 2.7 million tonnes in 1994-95, an increase of 62 percent. The improvement in demand is due to a number of factors : (1) Increased production from Electric Arc Furnace (EAF) units. The production by the EAF industry (both alloy steel and mild steel) increased by 13 per cent. Demand for alloy steel improved during the year due to increased demand from the automobile and engineering industries. (2) Reduced availability of scrap in the international market, due to increased demand from the EAF units in the US and Europe (the largest exporters of scrap) and the increasing usage of scrap generated in-house by steel plants for further value addition. (3) Domestic scrap availability has been declining because of Integrated Steel Plants (ISPs) are producing more steel through the continuous casting route (continuous casting technology generates 50 per cent less scrap)

Exports, mainly of HBI, declined to 6.6 lakh tonnes in 1994-95 from 7.2 lakh tonnes in 1993-94. During 1994-95, Essar Gujarat, the main exporter of sponge iron, exported only 5 lakh tonnes; Nippon Denro exported 1.6 lakh tonnes and Vikram Ispat 40,000 tonnes. Exports increased marginally from 3.72 million tonnes in 1996-97 to 3.74 million tonnes in 1997-98.

Domestic sponge iron (HBI and DRI) prices do not follow the landed prices of scrap as closely as they used to earlier. Firstly, the landed prices of scrap depend upon a number of variables such as freight costs, LC opening charges, (besides international prices, exchange rates, and customs duties). On the other hand, domestic sponge iron producers offer their product at a fixed price (including transportation charges) for a contractual period. Secondly, the oversupply in the domestic sponge iron industry has resulted in additional downward pressure on domestic prices.

Business Analysis

SIIL was initially set up with a capacity of 30,000 tonnes of sponge iron, which was doubled in 1985. The following table shows the production and sales of SIIL for the past five years.

Table 2 : Production and Sales of SIL

	1997-98	1996-97	1995-96	1994-95	1993-94
Installed Capacity (t)	60,000	60,000	60,000	60,000	60,000
Total Production (t)	57,610	51,402	55,605	50,375	48,500
Capacity utilisation (%)	96.0%	85.7%	92.7%	84.0%	80.8%
Total Sales (t)	45,905	55,778	53,165	50,858	43,898
Sale of Sponge Iron (t)	36,782	45,613	46,441	39,743	31,897
Sale of Briquettes (t)	9,123	10,165	6,724	11,115	12,001
Sale of Sponge Iron (t)	1,647	2,088	1,998	1,622	1,382
Sale of Briquettes (t)	427	460	289	464	543
Sale Price of SI (Rs.)	4,478	4,578	4,302	4,081	4,332
SP of Briquettes (Rs)	4,684	4,524	4,305	4,174	4,522

SIIL purchases iron ore from National Mineral Development Corporation (NMDC) supplied from Bailadila, which is about 300 kms from the plant. Average transport cost of iron ore is about Rs.500/ton in an average total price Rs.939/per ton in 1997-98. SIIL has indicated that it is planning to source the raw material from Bellary, which is about 350 Kms and hopes thereby to reduce cost. SIIL purchases coal from Singareni Collieries. The transport cost of coal is about Rs. 100/ton in a total average cost of Rs.1237/ton. The cost of iron ore, coal and limestone increased at a CAGR of 8.95%, 9.64% and 3.24% respectively. This includes the increase of both the base cost of

raw material supplied by NMDC & Singareni Collieries and the cost of transport.

Efficiency factors indicate the usage of raw material and therefore the effect on cost. SIIL has efficiency factors of 1.88 and 1.27 for iron ore and coal respectively, during 1997-98. The accepted efficiency factors are 1.65 and 1.35 for iron ore and coal respectively. That is, for every ton of sponge iron produced, the usage of iron ore is 1.65 tons and coal is 1.35 tons.

Diversification of SIIL : SIIL set up a 7 MVA SAF for smelting pre-reduced SI/SI fines produced in the rotary kilns, into high quality low phosphorus, low sulphur pig iron. But cost of power, availability of power and low sale price of pig iron ensured non-profitable operations. The project cost was Rs.3050 lakhs. As a consequence, SIIL commissioned a study by Dastur & Co to ascertain the possibility of converting the SAF plant into a manufacturing facility for Silico Manganese. Based on the technical report, the SAF plant was converted into a silico manganese plant. However, as the market prices for Silico Manganese too fell, SIIL did not deem it profitable to operate the plant. The plant is not being operated as on date. SIIL also cites the lack of working capital as another reason for the non-operation of the plant.

As the plant is embedded into civil construction structures, sale by stripping and individual units is not feasible. Nor can the plant be relocated. If a sale is contemplated, it has to be on an as-is-where-is condition.

SIIL supplies sponge iron predominantly in the south Indian states of Tamil Nadu, Pondicherry, Kerala, Karnataka, etc. This results in high transport cost.

Table 3 : Composition of Sales of SIIL

Year	Total Despatches Tonnes	Despatches to (in % ages)		
		AP	TN, Kerala & Pondicherry	Karnataka
FY 92	45242	52	10	3
FY 93	44157	43	11	1
FY 94	41447	32	44	4
FY 95	47652	46	38	12
FY 96	52575	21	51	7
FY 97	55778	16	84	
FY 98	45905	6	94	

The three states in which SIIL supplies sponge iron viz. Karnataka, Tamil Nadu and AP saw growth rates at 39%, 17% and -7% respectively. It can be observed that there is a fall in the intake in AP. Therefore, SIIL has to perform sell its product in TN and Karnataka. While it has to contend with transport costs for supplies to other states, SIIL is in a better position in TN as Tamil Nadu Sponge has been closed. SIIL's market, as mentioned above, was virtually next door. SIIL was adversely affected by closure of AP Steels, which accounted for about 40% of its turnover. After closure of AP Steels, over the last 6 years, SIIL has been increasing supplies to IA/EAF units located in TN, increasing the cost of transport of end product, in comparison to local manufacturers.

SIIL produces sponge iron and briquettes for sale. The sale price of briquettes is slightly higher than sponge iron. The manufacturing process also generates 'fines' which is a waste product and it is sold at a very low price. SIIL has been selling its product at an average price of Rs. 4,581 per ton (for the year ended 31/3/98), which compares fairly with the industry average of about Rs. 4,996 per ton. Bellary Steels average sale price in 1997-98 was Rs.4,716 per ton. However, the average price realisation during the nine months beginning April 98 has shown a continuous fall from Rs.4,057 per ton to Rs.2,463 per ton. The fall in the average price can be attributed to an increase of the quantum of fines/waste products in the sales mix. In the last two months ending December 98, the percentage of fines was 34% and 42%. The reasons could be:

- A reduction in the production due to lack of demand or other market conditions.
- Cutback in production due to poor recovery of receivables or a high incidence of default in receivables.
- Sale of fines accumulated over the past six months.
- Offer of discounts for cash purchases.

SIIL's labour cost per tonne is the highest in the industry at Rs.1089. SIIL employs 536 persons (as on 30/06/99). SIIL's labour cost in 1997-98 was Rs.628 lakhs whereas that of Bellary Steels was Rs.393 lakhs for a capacity of 60,00 tons of sponge iron and 100,000 tons of steel products.

SIIL has been able to effect a reduction of about Rs.80 /per ton in the power cost by setting up a captive generation plant from waste heat recovered. SIIL

has a requirement of about 1.5 MW per annum for operating the sponge iron plants. The silico manganese plant would have a requirement of about 22.5 MW. SIIL has a captive generation plant of 4.5 MW capacity. The power is generated from the waste gases produced from the kilns manufacturing sponge iron. It is also proposed to set up another 4.5 MW of captive power generating unit from waste heat from the expanded sponge iron plant.

Financial Analysis

The financial performance of SIIL for the past five years is summarised as follows:

Table 4 : Financial Highlights (Rs.Lakh)

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	2957	2780	2879	2682	2534
Operating Profit (PBDIT)	400	619	702	675	625
PAT	-368	-117	12	-148	-237
Equity Capital	3258	3258	3145	2845	2808
Tangible Networth	2943	3280	3296	2967	3128
Gross Margin (%)	13.5	22.2	24.4	25.2	24.7

(Other financial ratios are not shown as they are negative and hence meaningless)

An analysis of SIIL shows up the following:

- The CAGR for sale price is only 1.86% over the past 6 years, as against the increase of raw material at a CAGR of about 8% to 9%.
- The production has been at a high level but efficiency factors seem to affect the usage of raw material adversely.
- There is distinct decline in the quantity produced and sold.
- Discounts are separately accounted. Therefore, the actual sale value could be lower.

SIIL has two types of loans both provided by the GoI-Interest free loans and interest bearing loans. Interest cost per ton has been steadily increasing from about Rs. 512 in 1992-93 to Rs. 793 in 1997-98. In absolute terms, SIIL had an interest expense of Rs. 251 lakhs in 1992-93, which increased to Rs.457 lakhs. SIIL has been transferring an amount of Rs. 200 lakhs (approximately),

every year from 1995-96, to capital account representing the interest on loans pertaining to setting up of the SAF/ silico manganese plant. Therefore the actual interest cost is higher. SIIL has been capitalising the interest cost pertaining to SAF/silico manganese plant stating that the commercial production has not been commenced. The interest costs are mounting as there is no source of income, especially from the SAF/silico manganese plant. In addition, SIIL has not provided for a cumulative penal interest of Rs. 634.78 lakhs upto 31/3/98, indicating that such loans in the past have been waived by the GoI.

The non-capitalisation of the SAF/silico manganese plant has led to a non provision of depreciation of Rs.166.71 lakhs.

Strengths and Areas of Concern

Strengths

Good technology base: SIIL was set up to establish the technology of manufacturing sponge iron. The technological capability of SIIL is excellent which enables it to offer consultancy services both in India and abroad.

Areas of Concern

Small plant with very low capacity : SIIL's capacity is very small when compared with the total industry. The plant size of SIIL makes it uneconomical when compared with its competitors.

Diversification not yielding benefit : SIIL's diversification into SAF/silico manganese plant at an approximate cost of Rs.40 crore is lying unused. This has resulted in huge interest cost.

Far away from the market : SIIL was originally set up with a view to cater to the needs of AP Steels which was located close to SIIL. But after the closure of AP Steels, SIIL has to despatch its products to longer distances. This has resulted in higher transportation cost and hence, the product becomes uncompetitive.

Large labour force : SIIL's labour cost is substantially high when compared with its competitors. This has resulted in higher cost of production for sponge iron by SIIL.

Overcapacity in Industry : Sponge iron is a substitute for scrap. In the past, when scrap was in short supply, more and more producers set up new production facility. The steel industry is currently in recession and hence, there is an overcapacity in the sponge iron industry.

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Recommendation

SIIL is engaged in production of sponge iron, which is one of the primary input in steel making through EAF/IF route. SIIL was set up with a view to establish the technology to manufacture sponge iron. The company was successful in establishing this, which resulted in creating more and more capacities in India. This, to an extent substituted the import of scrap that resulted in savings of foreign exchange. However, today, there are large number of producers producing sponge iron in India and SIIL's capacity vis-a-vis the total industry capacity is negligible. **Under these circumstances, the Commission classifies SIIL as non-core.**

SIIL's current financial health is under stress. This is primarily due to adverse market conditions and its past capital expenditure. SIIL's diversification to SAF and later conversion into silico manganese plant still remains a non-starter. Due to higher labour cost, interest and depreciation, the operations of the company have become unviable. Continuing the operations of SIIL under GoI control will continue to be a draft to the exchequer. SIIL's funding of capital expenditure was primarily met out of equity and GoI debt. The recovery of these loans alongwith interest accrued and due on these loans is doubtful. **Under this circumstance, the Commission recommends disinvestment of 100% of GoI equity in SIIL after cleaning up the balance sheet i.e. by writing off GoI loans and accumulated interest thereon. This will enable the buyer to start the operations of SIIL on a clean slate and would result in a better valuation of SIIL.** Simultaneously with the move for disinvestment, manpower reduction through VRS would have to be undertaken, so as to improve investor interest in the company.

REPORT

XII

**DISINVESTMENT
COMMISSION**

AUGUST
1999

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New Delhi - 110066

PART A

1. GENERAL RECOMMENDATIONS

The Disinvestment Commission was set up by Government Resolution dated 23rd August, 1996 (Appendix I) initially for a period of three years. The Terms of Reference of the Commission were substantially altered and its role considerably reduced, vide Government Resolution dated 12th January, 1998 (Appendix II).

With this report, the Disinvestment Commission has completed examination of all 58 PSUs referred to it by Government, except for 6 cases, which were already under reference to BIFR prior to their reference to the Commission. In the case of BIFR cases, the Commission had urged the Government that it should take a view based on legal opinion on whether these cases could be simultaneously considered by the Commission. Government has, so far, not clarified the matter. As such, the Commission could not proceed to examine these six PSUs under reference to BIFR. The PSUs referred to the Commission so far, and those withdrawn from the Commission are listed in Appendices III and IV respectively. The list of PSUs referred to the Commission which are already under reference to BIFR is given in Appendix V.

The Commission had recommended that disinvestment should be deferred in certain PSUs, viz., OIL, ONGC, MOIL, NTPC, NHPC, NLC and Power Grid pending decision on certain policy issues by Government. The Commission would take up these PSUs for consideration as and when Government informs it of the decisions on issues raised in the Commission's Reports on these PSUs. The Commission had also recommended that disinvestment be deferred in certain PSUs viz., SAIL, CEL and PEC pending fulfilment of certain specified conditions. The Commission would be in a position to take up these PSUs for consideration as and that the specified conditions have been fulfilled.

The Disinvestment Commission had, since its very first report submitted to Government in February 1997, given recommendations in respect of a number of important issues basic to the process of disinvestment which needed to be addressed by Government. These covered creation of a Disinvestment Fund,

Restructuring, Corporate Governance, Grant of Autonomy, Setting up of Pre Investigation Board, Selection and Remuneration of Top Management, Professionalising the Boards of the PSUs, addressing labour issues through VRS, ESOPs etc. It had also suggested procedural measures for speeding up the disinvestment process through setting up of a full-time implementation machinery, selection of global financial advisers and modalities of disinvestment that could be adopted by the Government in individual cases. A gist of general recommendations made by the Commission and action taken by the Government is given in Appendix VI.

The Commission has observed that shares in blue chip companies have been sold in the GDR and domestic markets without any concomitant benefits to the public sector or without generating additional resources for the social sector. Such disinvestment has resulted in reduction of Government's equity in blue chip companies merely to bridge the budgetary deficit of the Government. This lends support to the criticism that precious family silver is being sold off to meet day to day expenses. Disinvestment should be a part of a well thought out strategy of public sector reform and not made to serve merely as a means of raising revenues for the Budget.

The Commission had, in its very First Report (February, 1997), laid out the strategy for disinvestment and recommended inter alia the setting up of a Disinvestment Fund in which all receipts from disinvestment should be deposited. It was recommended that this fund be used for temporarily meeting the losses of some PSUs where required, for strengthening marginally loss making PSUs in preparation for disinvestment, meeting expenses on VRS for surplus work force and funding specific social sector projects. However, though Government stated that it had decided to create such a Fund in September 1996, the Disinvestment Fund is not operational till date.

The Commission has consistently emphasised the importance of transparent processes in disinvestment. In this connection, the Commission would like, in particular, to reiterate its guidelines given in its First Report relating to

selection of merchant bankers/global co-ordinators and their appointment by Government for carrying out the sale of Government equity in PSUs. The Commission had recommended that selection of merchant bankers/global co-ordinators/global financial advisors should be made from amongst those prequalified on the basis of their track record, through a process of transparent competitive bidding for fees and expenses. Such a transparent selection is imperative for lending credibility to the disinvestment process, creation of confidence in the investors and maximisation of disinvestment proceeds.

The Disinvestment Commission had also given recommendations for disinvestment in specific PSUs which had been referred to it. The gist of the recommendations given in the case of specific PSUs is given in Appendices VII and VIII.

It would be seen from the following table that out of 53 PSUs for which recommendations have been made to the Government, decision is yet to be taken/communicated in 30 cases. Out of 33 cases of strategic sale/trade sale recommended by the Commission (Appendix VII), decision has not been taken/communicated in 23 cases. However, even where decisions have been taken, their implementation has been extremely slow as will be evident also from the following table:

Table 1 : Action Taken @ on Recommendations of Disinvestment Commission.

Accepted	Decision Deferred	Decision Implemented	Decision being Implemented	Decision Awaited
1. RITES [^] 2. MOIL [#] 3. OIL [#] 4. ONGC [#] 5. SAIL [#] 6. NTPC [#] 7. NHPC [#] 8. PGCL [#] 9. NLC [#]	1. FACT	1. MTNL ^{^**} (May.97) 2. CONCOR [#] (May.97)	1. GAIL ^{**} (Feb.97) 2. MFIL (Feb.97) 3. KIOCL (Mar.97) 4. BALCO (Apr.97) 5. HTL (Apr.97) 6. EIL (Nov.97) 7. R.Ashok (Nov.97) 8. U.Ashok (Nov.97) 9. EPIL (Nov.97) 10. HCIL (Dec.97) 11. IPCL (Mar.98)	1. ITDC ^{**} (Feb.97) 2. ITI ^{**} (Apr.97) 3. BRPL (Apr.97) 4. MFL ^{**} (Apr.97) 5. PHL (Aug.97) 6. SCI (Aug.97) 7. HCL (Aug.97) 8. NEPA (Nov.97) 9. HPL (Nov.97) 10. IBP (Nov.97) 11. ET&T (Dec.97) 12. RIC (Dec.97) 13. HZ L ^{**} (Dec.97) 14. HVOC (Dec.97) 15. PPCL (Dec.97) 16. NFL (Mar.98) 17. HIL ^{**} (Mar.98) 18. NALCO (Mar.98) 19. AI (Aug.98) 20. CEL ^{***} (Aug.98) 21. HSCL (Mar 99) 22. STC (Mar 99) 23. MMTc (June,99) 24. NMDC (June,99) 25. PPL (June,99) 26. PEC(June,99) 27. MECON (July,99) 28. MSTC(July, 99) 29. MECL(July, 99) 30. SILL(July, 99)

Note: Information given in brackets indicate month and year of the Commission's recommendations.

@ As per information communicated by Government (As on 1st February 1999).

Commission had recommended that disinvestment be deferred in these PSUs pending fulfilment of certain specified conditions.

& Implemented in December 1997.

* Implemented in November 1998.

^ The Commission had not recommended disinvestment in this PSU

** Some decisions reportedly have been taken by Government in respect of these PSUs, but no formal communication has been received by the Commission

PART B

2. SPECIFIC RECOMMENDATIONS

2.1 BHARAT HEAVY ELECTRICALS LTD.

Evolution

Bharat Heavy Electricals Ltd. (BHEL) was set up in November 1964, with three plants at Hardwar, Hyderabad and Trichy established in 1956. During the period 1965 to 1967, BHEL commissioned new facilities at Hyderabad and Hardwar to manufacture heavy power equipment and machinery. The operations of Heavy Electricals (India) Ltd. and its Bhopal facility were merged into BHEL in 1974

BHEL's business includes manufacture and sale of power plant equipment (PPE), electrical equipment such as transformers, switchgears, motors, mechanical equipment such as boilers, pressure vessels, transportation equipment and other industrial capital goods.

BHEL's operations are broadly categorised into two sectors viz., Power and Industry. The Power sector business constitutes designing and erection of power plants, supply of equipment/spares, overhauling, servicing and maintenance of power plants. The Industry sector covers supply of equipment to process industries (including captive power plants), transportation, power transmission, defence, telecommunications and non-conventional energy systems.

Table 1 : Shareholding Pattern of BHEL

Types of Shareholders	(%)
Central Government	67.7
FII	14.9
Mutual Funds	12.6
Insurance Companies	3.0
Nationalised Banks	0.2
Corporate bodies not covered above	0.4
Others including Indian Public	1.2

Industry – Power Plant Equipment (PPE)

Global PPE Industry

The Global PPE industry is dominated by four players namely, ABB-Alstom, General Electric, Siemens and Mitsubishi. The dominance of the four players results from leadership in technology for turbines and boilers, the most important equipment of PPE. These companies have a presence in all major international markets, which reduces the volatility in sales turnover resulting from bunching of projects in a country.

Globally, around 70,000 MW of power generating capacity was added in 1997. The Asian PPE industry has recorded good growth in the last few years following strong economic growth for most of this period. As a result, the share of the region in the global PPE market has increased steadily over the last few years, and was over 50% in 1997.

The global PPE industry is characterised by fluctuations in demand, and thereby lumpiness in capacity additions in individual markets. The industry is technology intensive, and requires PPE manufacturers to offer financial packages to support sales.

The global PPE industry has witnessed significant addition of PPE manufacturing facilities in the last few years. The installed capacity for PPE is estimated to be around 120,000 MW, while the demand was around 70,000 MW in 1997. Owing to the overcapacity in the industry, PPE prices fell steadily till the end of 1998, leading to depressed margins.

The fall in margins in the PPE industry in the last few years has resulted in the exit of a few players from the business, and led to consolidation in the industry. Several large manufacturers have been acquired by global leaders like Siemens, ABB and GE.

Indian Power Plant Equipment (PPE) Industry

The evolution of the Indian power plant equipment (PPE) industry traces back to the fifties, when the focus of the Government was on increasing power generating capacity to meet the needs of the fast industrialising nation. The need for indigenous facilities was felt when the number of projects as also

the size of projects increased. Bharat Heavy Electricals Limited (BHEL) was set-up in 1964, with three plants at Trichy, Hardwar and Hyderabad to meet this demand.

In the eighties, with the need for faster power generation capacity addition and with the rate of investment not being able to be met through the plan allocations, recourse was taken to borrowing from international bodies such as the World Bank, the Asian Development Bank and other multilateral agencies. The government opened the sector to private sector participation in 1991 because of the large investments required to meet the huge projected demand-supply gap. The government lowered its spending on power in the following years in anticipation of significant investments by the private sector. However, capacity additions by the private sector were low due to lack of clear government policies. As a result, total capacity addition fell sharply in the period 1992-93 to 1994-95. From 1995-96 onwards, revival of orders from central utilities as also the entry of private players into the market, lead to an improvement in the order book position of the industry.

Industry Characteristics

The Power Plant Equipment (PPE) industry can be broadly classified into boilers (coal or liquid fuel fired), turbines (gas, steam or hydel), alternators and generators. PPE is a high value item involving long lead times and unique features. The growth of the PPE industry is dependent on investments in power generation projects.

Given the strong global linkage, pricing of PPE is determined by the global demand-supply conditions. Owing to the overcapacity in the industry, PPE prices fell steadily till the end of 1998, leading to depressed margins. This has resulted in the exit of a few players from the business, and led to consolidation in the industry. Several large manufacturers have been acquired by global leaders like Siemens, ABB and GE.

The domestic market is dominated by BHEL, which manufactures the entire range of Power Plant equipment. Around 65% of the total installed power capacity (around 90,000 MW) in India has been set-up by BHEL. ABB Ltd. and Siemens Ltd. are the other major players in the domestic PPE market.

The State Electricity Boards (SEBs) and Central Utilities are the major

customers for PPE accounting for around 95% of the total installed power generation capacity in India. The private sector accounts for only 5% of the existing power generation capacity in the country, since the sector was opened to private sector participation only in 1991. Their share in future capacity addition is expected to increase steadily.

Central and state utility projects are funded either by budgetary support of the government or by multilateral agencies like the World Bank and Asian Development Bank. Independent Power Producers (IPPs), however, require funding support from equipment manufacturers or other external sources for their projects.

The manufacture of PPE requires long cycle time and involves complexities in the manufacture and transportation of high value, bulky equipment. This results in high work-in-process inventory. State Electricity Boards (SEBs) and Utility Companies mostly belonging to the public sector are the major consumers of PPE. The poor financial health of the SEBs has resulted in high level of receivables for PPE suppliers. Given the high working capital intensive nature of the industry, high levels of receivables result in tremendous financial strain for the PPE manufacturers.

Key Success Factors

- Power projects are typically awarded through the International Competitive Bidding (ICB) route, where pricing is an important criterion in awarding the contract. Cost competitiveness is dependent on factors such as access to technology at low costs, local manufacturing facilities resulting in lower freight costs, low manpower costs and efficient procurement and processing practices.
- As the share of IPPs in new capacity additions increases over the long term, the ability to provide finance and take up equity stakes in these projects will influence the competitive position of Power plant equipment manufacturers.
- Power projects are long gestation projects involving significant risks relating to project completion and implementation. The past track record of the PPE manufacturer in the country and in international markets also plays an important role in winning project bids.

- Power projects have long gestation periods of around 30-50 months depending upon the nature and size of the project. The ability to reduce project implementation time is projected as a key strength and a means of differentiation, by the companies. Expertise in project implementation skills, knowledge of local infrastructure and prior experience in implementing similar projects are, therefore, critical.
- The PPE industry is technology intensive, with significant investments required in R&D to improve efficiency and performance, and keep pace with technological developments in the sector. The ability and resources to invest in research is a significant competitive advantage for global leaders in the PPE industry.

Outlook

The Ministry of Power has targeted a capacity addition of around 80,000 MW till 2010 at an average annual capacity addition of around 7,300 MW. Capacity additions from the state sector are expected to decline over the medium term on account of the poor financial health of most State Electricity Boards (SEBs). Additions from the central sector are expected to increase moderately. Overall, the state and central sectors could be expected to add around 35,000-40,000 MW (approximately 50% of total targeted capacity addition) till 2010.

Given the increasing power demand and the need for capacity additions, the proportion of capacity additions by the private sector is expected to increase significantly over the medium to long term.

With the growing significance of the private sector in the setting up of power projects, the requirements from PPE manufacturers would be in terms of ability to offer the lowest cost with short delivery schedules as also the ability to provide funding packages to the IPPs.

Business Analysis

Power Sector Group

BHEL manufactures the entire range of products required in a power generation plant at its various units. The major products sold to the power sector can be broadly classified into:

- Turbine generators for thermal, hydel, nuclear and gas based generation
- Boilers and auxiliaries
- Electrical Equipment like transformers, switchgears and motors
- Spares for after sales service

BHEL is the largest player in the domestic Power Plant Equipment (PPE) business. The company's power business recorded a turnover Rs. 3628 crores (54% of turnover) in 1998-99. BHEL built sets now account for around 65% of the country's total installed power generating capacity of 90,712 MW as on March 31, 1999.

The company's order book position has been stagnant over the past three years, following the slowdown in capacity additions planned by the state electricity boards, and fall in PPE prices over the past few years due to global overcapacity in the industry. This is expected to affect the company's growth in the short term.

The company has significant experience in implementing power projects in India, and has a good track record of implementing projects without significant cost or time overruns. The projects implemented by the company have shown good performance over the years.

BHEL also has a strong presence in overhauling, renovation & modernisation (R & M), plant performance improvement and maintenance of old power plants. With most of the thermal and hydro sets in India being of the BHEL make, the company's prospects in after sales service, and R&M is significant.

Currently, most of the power projects are being implemented by central utilities like National Thermal Power Corporation (NTPC) and State Electricity Boards (SEBs). State and central sector projects are funded with support from budgetary allocation by the government or funding from multilateral agencies such as World Bank and Asian Development Bank (ADB). World Bank funded projects give a 15% price preference to local manufacturers. Till recently, only BHEL in India was entitled to this price preference, which enhanced its competitiveness vis-à-vis international majors who import the equipment.

In Independent Power projects (IPPs), the ability by PPE manufacturers and Errection, Procurement and Construction (EPC) contractors to invest in equity and provide financial support in the form of debt, plays an important role in the awarding of contracts. Multi National Companies (MNCs), which receive financial support from their domestic financial institutions, export credit agencies or through their own financial affiliates are able to offer financial packages alongwith equipment supply. BHEL's competitiveness with regard to IPP's has been affected due to its inability to offer matching financial packages.

With an aim to gain market share in the private sector power projects, BHEL has commenced joint bidding with foreign companies as an EPC contractor. Recently, the Bakreshwar power project was won by the BHEL-Itochu combine, while the Bina power project was bagged by the BHEL-Siemens combination

Industry Sector Group

BHEL set up its industry sector group in the eighties as a buffer against the volatility of the power sector as also to optimise utilisation of its existing facilities. Most of the products of the industrial sector have strong synergies with the power sector and utilise existing manufacturing facilities. As a result of BHEL's strong engineering capabilities and synergies with the power sector, the industry group has recorded strong growth, accounting for around half of the total turnover.

The Industry sector sales have grown strongly by 17.2% over the five year period ending 1997-98 to aggregate Rs. 3,072.3 crores in that year. The group's sales in 1998-99 aggregated Rs. 3,173 crores (46% of total turnover).

BHEL's industry sector operations broadly consists of:

1. Transmission products and services (10% of total sales)
2. Transportation products (9% of total sales)
3. Industrial Products (26% of total sales)
4. International sector sales (3% of total sales)

1. Transmission

In the transmission business, BHEL manufactures power transformers, shunt reactors, switchgears, insulators, energy meters, control and relay panels, capacitors substations, and high voltage direct current (HVDC) transmission systems. BHEL is in the higher end of the transmission products markets and has a strong market position in this segment. This business recorded a turnover of around Rs. 650 crores in 1997-98, with an annualised growth of 15.9% in the five-year period ending 1997-98. The power transmission business has synergy with the PPE business, and a large part of the total production is supplied as part of turnkey power projects implemented by the company.

2. Transportation

In transportation products, the company mainly supplies AC locomotives, AC/DC dual voltage locomotives, diesel electric shunting locomotives, traction motors and transformers, electrics for EMUs, diesel power car and diesel electric locomotives. This transportation business recorded a turnover of Rs. 593 crores of the turnover in 1997-98, and recorded an annualised growth rate of 12.8% over the last five years. BHEL has a dominant presence in the domestic transportation segment. However, in the recent years, the shift to higher power locomotives by the Indian Railways, has resulted in marginal erosion of the company's market position. The increasing shift to the high power locomotives, could lead to a loss of market share in the medium term.

3. Industrial Products

Other Industrial products include electrical machinery comprising mainly of motors; mechanical equipment such as centrifugal compressors, heat exchangers and pressure vessels; process plant equipment such as boilers, turbines and captive power plant equipment such as diesel generation sets. The sales of these products aggregated around Rs. 1,830 crores in 1997-98, growing at an annualised rate of 19.4% in the last five years.

4. International Sector Sales

BHEL's exports (on FOB basis) have increased at an annual growth rate of 30% to Rs. 166.6 crores in 1997-98 from Rs. 97.39 crores in 1995-96.

However, exports are restricted mainly to equipment sales, and still comprise only a marginal part in the total turnover of the company. They accounted for only 2.6% of the total sales turnover in 1997-98.

The major PPE manufacturers in the world bid for projects in all major markets, since this diversifies the earnings stream, and expands the market reach. BHEL has not been able to successfully bid for more projects abroad since it has no significant past track record in international markets, and it has not been able to completely match the financial packages offered by multinational companies.

Operating Efficiency

BHEL is the only company in India with manufacturing facilities for the entire range of PPE. The company's wide product range enables it to offer complete PPE packages. Its product range includes over 180 products under 30 major product groups and meets the needs of major sectors like power, industry, transmission, railways, defence, telecommunication and oil & gas.

The company has 14 manufacturing locations, of which plants located at Bhopal, Hyderabad, Trichy and Hardwar manufacture the critical PPE and industrial equipment, and account for around 70% of the total sales turnover. The multi-locational operations offer significant advantages like multiple lines having product focus, which facilitate in parallel processing and enable reduction in delivery schedules. Moreover, the impact of problems relating to labour (with 62,000 employees) or natural calamities is lower as compared to a single unit operation.

BHEL has a cost advantage (in terms of lower capital servicing charges) over any other player planning to set up new facilities in India, due to depreciated plants, and existing infrastructure at several locations. The company is also better positioned to supply PPE within the country as compared to equipment imports due to lower freight costs, especially of high volume equipment. Local manufacturing facilities also facilitate lower transportation lead times and thereby shorten delivery schedules.

BHEL's products are technology intensive, with continuous developments taking place in various segments in PPE, power transmission and transportation

equipment. In the past, the company has entered into a number of technological collaborations with international majors for most products, and has successfully adapted technology for Indian conditions. Given that other players are global and BHEL's sales are restricted mainly to India, its ability to invest in R&D is limited. BHEL's relatively small size of operations, therefore, limits its ability to make the necessary investments in R&D to keep pace with the international majors in technological developments in the sector. The company would therefore have to primarily rely on technological collaborations/licensing arrangements to meet its technology needs.

R&D plays an important role in critical equipment such as gas turbines and boilers, which account for around 50% of the equipment value in a power project. Additionally, technology is important in the products designed for the industrial sector, especially transmission systems (HVDC), transportation (high power locomotives) and electrical machinery. Consequent to the opening up of the Indian Power sector and the entry of some of BHEL's licensors in the Indian market, BHEL's access to technology could become increasingly difficult in the long term.

Table 2 : Trends in BHEL's turnover, costs and Employee Productivity

	Units	1998-99	1997-98	1996-97	CAGR (%)
Number of employees	No.	62212	62502	65061	-2.2
Turnover	Rs. Cr.	6803	6471	5755	8.7
Employee Costs	Rs. Cr.	1138	952	874	14.1
Turnover per employee	Rs. Lakh	10.9	10.4	8.8	11.3
Cost per employee	Rs. Lakh	1.8	1.5	1.3	17.7
Contribution per employee*	Rs. Lakh	9.1	8.9	7.5	10.2

* Defined as Turnover per employee – Costs per employee

BHEL's employee productivity (measured as turnover per employee) increased on account of steadily rising turnover from a falling employee base. While turnover per employee has increased from Rs. 8.8 lakh per employee in 1996-97 to Rs. 10.9 lakh in 1998-99. BHEL's productivity does not compare favourably with that of international majors such as Siemens, ABB and GE as they have a greater concentration of high value items as also higher

automation at their units. However, costs per employee are also significantly lower as compared to the foreign players, on account of the high labour charges in the developed countries.

Financial Analysis

Table 3 : Financial Highlights

(Rs. Crore)

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	6,088.00	5,401.09	4,559.38	3,889.99	3,453.62
Operating Profit	806.48	843.04	449.67	355.13	367.12
PAT	719.53	463.19	350.16	140.93	136.87
Equity Capital	244.76	244.76	244.76	244.76	244.76
Tangible Networth	2,595.02	1,924.83	1,488.50	1,154.42	1,010.22
Gross Margin (%)	13.2	15.6	9.9	9.1	10.6
Net Margin (%)	11.8	8.6	7.7	3.6	4.0
ROCE (%)	22.9	26.1	14.0	11.8	11.6
RONW (%)	27.7	24.1	23.5	12.2	13.5
Earning Per Share	29.40	18.92	14.31	5.76	5.59
Dividend (%)	25.0	20.0	20.0	15.0	15.0

BHEL's gross sales have increased at a CAGR of 16.2% from Rs. 3556 crores in 1993-94 to Rs. 6471 crores in 1997-98, driven primarily by a strong sales growth of the industry sector. Good growth in sales turnover, along with higher operating margins led to the sharp increase in operating profits from Rs. 367.10 crores in 1993-94 to Rs. 806.40 crores in 1997-98.

The company has reduced its total debt levels significantly over the last five years. As a result, the capital servicing charges have fallen steadily over the last five years. Rise in operating profits combined with declining capital charges, resulted in a steep rise in net profits from Rs. 136.90 crores in 1993-94 to Rs. 719.50 crores in 1997-98. Higher operating margins combined with improved asset turnover led to the increase in return on capital employed (ROCE) from 20.6% to 39.9% in this period.

The company's operations have been characterised by high working capital intensity with high receivables and inventory. BHEL had a total debt of Rs.

387.10 crores as on March 31, 1998 while its networth was Rs. 2,595 crores as on the same date. Thus, BHEL's gearing was low at around 0.15 times as on March 31, 1998. This had declined from 1.36 times as on March 31, 1994 as the company has repaid debts during this period.

The expected increase in share of IPPs in new capacity additions over the medium to long term would require BHEL to offer financial support to greater number of projects. The company has secured lines of credit from domestic financial institutions for funding of projects.

In 1998-99, BHEL's gross sales increased marginally to Rs. 6,765 crores Gross margin fell during the year due to significant increase in employee costs and other operating costs. Net profits fell during the year to Rs. 562.20 crores in line with decline in operating profits.

Unitwise performance

The unitwise working results for the last three years have been as follows:

Table 4 : Unit-Wise Performance

(Rs. Crore)

Unit	Turnover	%	Operating Profit		
			1997-98	1996-97	1995-96
Heavy Power Equipment Plant, Hyderabad	1426.34	22.0	306.27	278.3	128.85
Heavy Electrical Equipment Plant, Hardwar	765.32	11.8	200.27	120	66.89
Power Group	697.06	10.8	173.33	145.3	133.93
High Pressure Boiler & SSTP, Trichy	1493.32	23.1	159.73	134.2	103.27
Heavy Equipment Plant, Bhopal	930.09	14.4	100.73	113.1	123.98
Electronics Division, Bangalore	386.55	6.0	90.69	94.8	75.82
Transformer Plant, Jhansi	181.12	2.8	42.07	31.6	27.21
Boiler Auxiliary Plant, Ranipet	70.53	1.1	10.86	13.55	16.74
Electroporcelain Division, Bangalore	41.65	0.6	4.69	3.65	2.15
Industrial Valves Plant, Goindwal	0.02	0.0	2.55	0.6	1.22
Industrial Systems Group, Bangalore	33.83	0.5	1.55	1.5	4.33
Central Foundry Forge Plant, Hardwar	28.32	0.4	0.21	-2.4	-12.56
Insulator Plant, Jagdishpur	43.84	0.7	-2.62	-3.9	-4.58
Other Units	373.32	5.8	58.95	32.85	9.78
Corporate adjustments			-127.61	-98.75	-94.7
Total	6,471.31	100	1,021.67	864.40	582.33

The oldest unit amongst the manufacturing units viz., the Bhopal plant, manufactures a wide range of products with transmission products such as transformers, switchgears; transportation products such as traction motors and electrical machinery being the main products. The Bhopal unit employed around 13,500 employees (1997-98), with the productivity at around Rs. 689,000 per employee, significantly below the company average of around Rs. 1,040,000 per employee.

The most profitable units of BHEL are its plants at Hyderabad (which makes industrial turbo sets, and other ancillary equipment), Heavy Electrical Equipment Plant, Hardwar (which makes electrical machines, turbo and hydro sets), the Power group (all four regions) and its Trichy Boiler plant.

The least profitable units include the Central Foundry Forge Plant, Hardwar and the Insulators Plant, Jagdishpur. These plants manufacture products that are used as inputs by other units of the company.

Strengths and Areas of Concern

Strengths

Market Dominance in the Indian Power Sector - The Company has a formidable success record in bidding for projects implemented by state owned NTPC and SEBs. BHEL has adopted several technologies to suit Indian conditions. The company has demonstrated the ability to implement projects successfully without time and cost overruns. All these factors make BHEL a strong player in the Indian market.

Cost Competitiveness - The company's cost competitiveness results mainly from the its depreciated plants, the domestic manufacturing facilities and the low employee costs.

Strong Presence in other Core Sectors in the Industrial Segment - In order to reduce volatility in its revenue stream from the power sector, BHEL has developed and successfully sold products to cater to the industrial sectors like oil refining, petrochemicals, paper, defence and transport sectors, leveraging its manufacturing facilities and technical skills.

Areas of concern

Financing Capability - Though BHEL is competitive with the international majors in terms of cost, delivery and equipment in the domestic market, the company's inability to match financial packages provided by the multinationals (MNCs) has been one of its major weaknesses.

High Dependence on Foreign Technology - BHEL depends on foreign technology for almost its entire product profile. Though the company has been successful in assimilating and adapting the technologies to Indian conditions, it would face significant difficulties in terms of developing and commercialising new technology on account of small size of its R&D expenditure, in comparison to leading PPE manufacturers.

Insignificant Exports - BHEL has not been able to bid for projects abroad since it has no significant track record in international markets, and cannot match the financial packages offered by multinational companies. BHEL, with its manufacturing facilities in India, is well positioned to meet the demand of the entire Asian market, due to proximity to both West Asia and East Asia. The inability to arrange for finance of projects in export markets, and lack of track record inhibited the company's growth particularly in the period 1990 to 1994 when the demand from the domestic market was low.

Recommendations

BHEL is a dominant player in the Indian Power Plant Equipment industry (PPE), with a sales turnover of Rs. 6,765 crores in 1998-99. The company is the market leader in the power equipment business and BHEL sets now account for around 65% of the country's total installed power generating capacity. The company also enjoys leadership in electrical equipment such as motors, transformers and High Tension (HT) switchgear. The company is the only player in the Indian market to be able to supply the entire range of power plant equipment with local manufacturing facilities.

BHEL has a cost advantage over any other player planning to set up new facilities in India, due to depreciated plants, and existing infrastructure at several locations. The company is also better positioned to supply PPE within the country as compared to equipment imports due to lower freight costs, especially of high volume equipment. Local manufacturing facilities also facilitate lower transportation lead times and thereby shorter delivery schedules.

However the PSU status of the company and the consequent emphasis on elaborate procedures does not permit quick commercial decisions, essential for efficient functioning in a competitive environment.

BHEL's products are technology intensive, with continuous developments taking place in various segments in PPE, power transmission and transportation equipment. In the past, the company has entered into a number of technological collaborations with international majors for most products, and has successfully adapted technology for Indian conditions. While other players are global, BHEL's capacity is less than 10 per cent of global capacity and its sales are restricted mainly to the Indian market, with exports accounting for less than 5% of sales. BHEL's relatively small size of operations limits its ability to make the necessary investments in R&D to keep pace with the international majors in technological developments in the sector. The company, therefore, has been relying primarily on technological collaborations/licensing arrangements with several overseas companies to meet its technology needs. However, there is a need to step up investment in R&D within BHEL to improve the quality of its PPE and Industrial products in order to compete more effectively in the market on their own.

The ability of PPE manufacturers and EPC contractors to provide financial support to the project plays an important role in the award of contracts. BHEL's competitiveness in relation to its global competitors has been adversely affected by its inability to match the financial packages offered by MNCs along with equipment supply offers. BHEL has not been able to secure more contracts abroad partly due to lack of global track record but mainly due to its inability to offer competitive financing packages. Its presence abroad is, therefore, marginal. The company would need adequate project and equipment financing capabilities if it has to gain a competitive edge over its MNC competitors, both in India and abroad.

Though BHEL enjoys a dominating market position in most of its products, in regard to supplies to State and Central sector power utilities, the presence of a large number of players including private sector and Multi-National players and the forces of competition in the power sector have made the market fully contestable. **The Commission, therefore, classifies BHEL as Non-Core.**

IPPs have sourced their equipment from foreign suppliers who have taken equity and arranged cheap credit from their financial sources and BHEL has got a very small share of their orders. With the increasing share of new capacity envisaged to be set up by IPPs in the future, BHEL has to become more competitive in a comprehensive manner in an increasingly competitive market.

The Commission is of the view that low cost of production is a valuable strength for BHEL. Additionally, BHEL also needs flexibility, autonomy and financial support to consolidate its market position in the country and expand its international operations. While autonomy could be provided to the company by reduction of Government's equity stake in BHEL below 51%, support from financial institutions would be critical for enhancing the financing capability of the company and enabling it to compete successfully with MNCs, both in India and abroad.

A strategic partnership of one of the global major power equipment manufacturers with BHEL would, on one hand, help through a better access to technology for the related products but, on the other hand, could lead to possible conflict of interest with the partner's global consolidation strategy and could undermine BHEL's market position in the products that are part

of the partner's product range. A strategic partnership with a single EPC contractor would also not be a preferred alternative to the existing arrangement, by which BHEL has the freedom to form specific JVs with different EPC contractors for different projects depending on their size and location.

Considering the dominant market position enjoyed by BHEL in the Indian PPE industry and the expected substantial future growth in the infrastructure sector in the country, there is a need for BHEL to continue play an important role in the industry. The Commission, therefore, feels that BHEL needs to induct strong financial institutions as strategic partners in order to expand its international operations. However, looking at the global trend towards consolidation in the PPE industry, it would be desirable that BHEL remain an Indian company with a majority Indian equity stake.

Hence the Commission recommends induction of Financial Institutions (FIs) as strategic partners through a disinvestment of 20% of BHEL's equity in their favour. In order to ensure enhanced funding capability in Rupee as well as Foreign Currency to enhance its competitiveness, it is recommended that domestic FIs may be offered equity stake of 10% and foreign private equity funds/FIs including multilateral institutions (foreign funds) be offered a further equity stake of 10% in the company with appropriate role in management to both Indian and foreign parties. The Government should enter into separate shareholder agreements with the strategic partners to ensure that, in the event of the their exit from shareholding in BHEL, Government's prior consent or first refusal is taken, so that the new buyer is also acceptable to Government as a strategic partner, from the point of view of its support to BHEL, and is willing to enter into an appropriate shareholder agreement with Government.

The requirements of SEBI Take Over Code, if applicable, should be observed. The acquisition from minority shareholders, if required under SEBI's Take Over Code, should be over and above the acquisition of shares offered by Government.

2.2 HINDUSTAN INSECTICIDES LIMITED

Evolution

Hindustan Insecticides Limited (HIL) is a wholly owned Government of India enterprise operating in the agrochemical industry. It is the sole producer of D.D.T. (a banned product except for use in public health) in the country. HIL was incorporated in 1954 with the setting up of a D.D.T plant in Delhi. HIL later commenced production of certain other agrochemicals namely Malathion, Endosulphan, Monocrotophos, Butachlor and Dicofol.

Besides the Delhi plant, HIL has two more plants in Rasayani, Maharashtra and in Udyogamandal, Kerala. The Delhi plant is closed since November 1996 following an order by the Supreme Court directing the shifting out of all polluting units in Delhi.

HIL has a 76% equity stake in a formulations subsidiary located in Hyderabad – Southern Pesticides Corporation (“SPC”). SPC has been referred to the BIFR.

Industry Analysis

The origin of the Indian Pesticide industry can be traced back to the early 70's, following the green revolution when the government started encouraging the use of pesticides in order to improve crop production and minimise crop losses on account of pest attacks.

The two pesticides, namely D.D.T and B.H.C, which were being used extensively in the 1970s, came under heavy scrutiny as hazardous products. Subsequently, the production and sale of D.D.T (except for purposes of public health) and B.H.C have been prohibited as per a Supreme Court of India directive, thus giving rise to a new generation of pesticides.

The Indian Pesticide industry, with an estimated market size of Rs. 2,250 crores in 1997-98, is amongst the top ten consumers in the world. The Indian Pesticide Industry comprises of basic manufacturers, formulators, importers, distributors and dealers, both in the public & the private sector. The government reviews the pesticides that are produced in the country.

At present, Indian law provides only for process patents. With the enforcement of Trade Related Intellectual Property Rights (“TRIPS”) by 2005, product patents will come into existence. Domestic companies will have to depend increasingly on investment in R&D and launch of new products that will decide the extent of their value addition, competitive ability and profitability of operations.

Manufacture of pesticides can be divided into two broad steps – production of technical grade material (“technical”) and conversion of technicals into formulations that are supplied to the end-user. Technicals are not suitable for commercial use because of their high level of toxicity and concentration. Technicals further need to be converted into formulations, in forms the pesticide is finally used.

There are about 30 producers of technicals in the country making around 66 pesticides out of the total 143 registered in India. The top 10 of the 30 manufacturers produce approximately 80% of the total technical grade production in India.

Prior to liberalisation, technical manufacturers were forced to sell at least 50% of their output to the small-scale sector. This led to mushrooming of small formulation units all across the country. Over 450 formulators - of which some 150 are located in the organised sector - presently undertake this activity.

After this law was repealed in 1992, most large technical manufacturers have also ventured into manufacturing formulations, thereby becoming fully integrated manufacturers. This has put severe pressure on the small formulators.

The demand pattern for pesticides is influenced to a large extent by climatic conditions in the various states, the extent of pest attacks on crops and is a function of the farming community’s increasing need to safeguard their crops from pest attack and to minimise their losses.

Demand for pesticides is seasonal, the main off-take time being from July to November. Pesticides are mainly deployed for cotton (45%) and rice (22%) crops and to some extent for vegetables, soybeans and fruits. Punjab is the only state that uses pesticides for the wheat crop.

The consumption of pesticides is geographically concentrated in four states, namely Andhra Pradesh, Punjab, Karnataka & Tamil Nadu.

The consumption pattern (in value terms – 1996) of the pesticide segment in India varies with that in the developed world, as is illustrated below :

Table 1 : Consumption Pattern in India

Segment	Indian share	World share
Insecticides	76% ¹	44%
Herbicides	10%	30%
Fungicides	13%	21%
Fumigants	1%	5%

Source: Pesticides Association of India

Possible reasons for a different consumption pattern of pesticides in India are climatic differences, different cropping patterns and availability of cheap labour in India, which restricts the use of herbicides/ weedicides for economic reasons.

The consumption level of pesticides in India is as low as 450 – 500 grams per hectare as compared to about 10 kgs per hectare in the developed world. In India, the consumption level in Andhra Pradesh / Karnataka is comparable to that in developed countries like the US and Japan,

The Indian market also differs from that in the developed world in terms of the chemical class of compounds used :-

Table 2 : Use of Chemical Class of Compound in India and World

Chemical class	Indian Share	World share	Products
Organic Phosphorus	50%	37%	Monocrotophos, Acephate
Synthetic Pyrethroids	19%	22%	Cypermethrin, Fenvalerate
Organo-chlorine	16%	6%	DDT, BHC
Carbamates	4%	23%	Carbaryl
Bio-pesticides	1%	12%	Neem based
Others	10%	0%	

Source: Wood & Mackensie, Industry estimates

¹ Likely to fall to some 55% due to DDT/BHC ban

Though Organic Phosphorus compounds dominate both the Indian and the world market, the extent of usage in India is much higher at 50%. The usage pattern is indicative of the low maturity of the domestic industry and the fact that several chemicals, such as organo-chlorine compounds, which have been banned in the US and Europe are still in use in India. In the more developed countries, such first and second generation pesticides are now being replaced by synthetic pyrethroids, which are more effective and less toxic. These account for around 45% of the world market as compared to 23% in India.

Indigenous production of pesticides began with the establishment of a DDT & BHC plant in 1954. Today, India is the largest manufacturer of basic pesticide chemicals in South Asian and African countries, next only to Japan. Production of technical pesticides has increased over the years as follows :

Table 3 : Production of Technical Pesticides

Year	Production (MT)
1960-61	8,488
1973-74	32,745
1990-91	74,300
1994-95	90,758
1997-98 (estimated)	1,02,240
1998-99 (estimated)	1,12,000

Source : Pesticides Association of India

The domestic capacity for technical pesticides has grown at the rate of 10% annually to reach 145,622 tonnes in 1997-98 (formulation capacity is estimated at about 70,000 tonnes in terms of technical material). As against this, the domestic demand for 1997-98 is estimated to be about 91,606 tonnes.

The total size of the industry is estimated at around Rs. 2,500 crores in 1996-97 with exports accounting for 30% approximately. The year 1997-98 saw a 10% decline in this market to Rs. 2,250 crores, primarily due to the following reasons :

- The *El Nino* effect on the global weather had its impact on the already erratic Indian monsoon. Most crops including large pesticide consumers such as cotton had a bad year.

- Sharp fall in the prices of some of the top selling generic pesticides such as cypermetherin, chloropyriphos and monocrotophos.

The Indian pesticide industry has grown at the rate of about 10.70% per annum over 1986 to 1996. Presently, the industry is being hit by a combination of a downward slide in prices, fall in demand due to natural disasters (1996-97) reduction in import duties and a slump in international prices due to the entry of cheaper chinese products. All this has combined to put tremendous pressure on margins.

Decline in prices of technicals has led to similar decline in formulation prices. This has hit both the Indian companies and MNCs alike. MNCs have, however, fared better given the presence of high value added and branded products in their portfolio.

MNCs have access to the latest products from their parents' portfolio giving them a tremendous technological edge over Indian companies. Newer & more effective products combined with lack of competition ensure much better margins.

Even in generic pesticides, strong brands tend to command a premium of about 5-10% over similar products. These generally comprise the products that were pioneers in their segment in India and enjoy tremendous reputation among farmers. For example, Nuvachron (Moncrotophos formulation) introduced by Novartis commands a premium over other similar formulations.

The leading Indian Companies in Agro-Chemicals include the following:

Table 4 : Indian Agro-Chemical Companies

Company	Sales (Rs. Crores)	Market Share
United Phosphorous	474	19%
Excel Industries	356	14%
Rallis	333	13%

* Others include Searle, Sabero, Aimco, Gharda Chemicals etc.

Most Indian technical manufacturers are focussed on off-patent pesticides, which comprise over 70% of the Indian market.

Traditionally, strong volume growth and low cost production have helped Indian companies enjoy healthy margins. This led to excessive capacity build up over the past few years that has now set off a steadily declining trend in the prices of most generic pesticides.

This has led to lower margins for most large Indian companies over the past few years. Most of these companies have reported a sharp drop in profits in 1997-98.

Despite the loss of volume due to the ban of BHC in March 1997, the industry saw a sharp increase in insecticides such as monocrotophos, acephate, quinalphos and endosulphan. However, these are relatively low-value products, which did not boost the margins of most Indian companies.

MNCs, which once dominated the Indian market, now have a market share of some 40%. Lack of patent protection discouraged MNCs from launching their latest generation molecules in India. This is likely to change as the Patents Act is passed by the Parliament. The leading MNCs in agrochemicals include the following –

Table 5 : MNCs in Agro-Chemicals

Company	Sales (Rs. Crores)	Market Share (%)
Novartis (Agro)	300	12%
Agrevo-India	244	10%
Cynamid	102	4%
Monsanto Chemicals	85	3%

* Others include Bayer, BASF, DE Nocil etc.

Indian subsidiaries of MNCs have the advantage of access to the product portfolio of their parent companies. Strong brands have helped them perform better.

As mentioned earlier, insecticides dominate the Indian market. The top 11 insecticides account for around 80% of the market.

Table 6 : Estimated major insecticides sales in 1997-98 (*Rs. Crores)

Insecticides	Sales*	MNCs	Indian companies
Monocrotophos	425	Novartis	Sudarshan Chemicals, Nocil, UPL
Cypermethrin	250	ICI Zeneca	Magmani, Gardha, Rallis
Endosulphan	200	Hoechst	Excel, HIL, EID Parry
Quinalphos	200	Novartis	Gujarat Insecticides (Gardha), UPL
Chloropyriphos	225	De-Nocil	Gardha, Montari, Excel
Fenvalerate	150		Gujarat Insecticides, Rallis, RPG Life
Acephate	150		Rallis, Shaw Wallace, Magmani, Lupin
Phorate	100	Cynamid	Pesticides India, UPL
Total	1,700		

Source : Industry estimates, HIL

The leading brands of the formulations produced from the technicals and the company manufacturing them are set out below :

Table 7 : Leading Brands of Formulations

Insecticides (Technicals)	Leading Brand	Manufacturer
Monocrotophos	Nuvachron	Novartis
Cypermethrin	Cimbush	ICI-Zeneca
Endosulphan	Thiodon, Endocel	Hoechst, Excel
Quinalphos	Ekaulax	Novartis
Chloropyriphos	Dursban	De-Nocil
Fenvalerate	Sumicidin	Rallis
Acephate		Rallis, Shaw Wallace
Phorate	Thimet	Cynamid

Though generally the companies having leading formulation brands produce their own technicals, it is not always the case. e.g Hoechst does not produce Endosulphan Technical but owns the leading brand in the market, Thiodon.

Even though Indian companies dominate the Indian pesticides market, a majority of the leading brands (even in the generic pesticides segment) are owned by MNCs. As discussed earlier, this gives them a price advantage over their Indian competitors.

India is a net exporter of agro-chemicals. Exports have shown an impressive growth rate of 35% over the last 5 years and touched US\$ 203 million in 1996-97. Imports in the same year totalled US\$ 43 million resulting in an export surplus of some US\$ 160 million.

Critical Success Factors

- Strong R&D capability
- Low cost of production through improvisations in process technology and backward integration into technical manufacturing for achieving cost leadership in generic pesticide manufacture;
- Strong brand name and distribution network; and
- Diligent testing and data generation to facilitate registration of products.

Patent protection will enable producers having strong R&D capability to command higher prices helping them increase or maintain their margins. Investments in R&D to identify newer and more effective and less harmful products, will drive the industry.

Business Analysis

The Delhi plant commenced production in April 1955 and HIL added DDT Technical / Formulation manufacturing plants in Udyogmandal, Kerala and Rasayni, Maharashtra.

The Udyogmandal plant of HIL produced BHC, which has been banned by the Government of India and hence the production was stopped in April 1997.

In order to diversify, HIL ventured into agro-chemicals such as Malathion, Endosulphan and Butachlor among others.

HIL's activities can be broadly divided into two businesses -

DDT business

This includes the manufacture and sale of DDT. DDT is now banned in India except for the purposes of public health. National Anti Malaria Programme ("NMAP") is the sole buyer of DDT and HIL is the sole supplier in India.

DDT sales to NAMP amounted Rs. 62 crores in 1997-98.

Table 8 : DDT Sales and Realisations

	1993-94	1994-95	1995-96	1996-97	1997-98
Order placed (MT)	12,749	8,521	10,878	8,225	8,542
Production (MT)	12,497	8,302	10,827	8,224	8,857
Sales (MT)	12,749	8,481	10,850	8,206	8,542
Sales (Rs. crores)	57.76	48.09	70.98	60.53	61.47
Sale Price (Rs./kg)	45	57	65	74	72

India intends to stop the use of DDT by the year 2005 in association with the world-wide ban recommendation by WHO. Due to the health hazards posed by the use of DDT, NAMP has also reduced the usage of DDT and has started replacing it with Malathion. This has led to a steady decline in HIL's production and sales.

The Government compensates HIL on a cost-plus basis.

Table 9 : Profitability of DDT division

Rs. Crores

	1994-95	1995-96	1996-97	1997-98	1998-99
Sales	48.09	70.98	60.54	61.47	59.43
Profit before tax	2.68	4.02	3.64	4.80	5.37
Cost of Idle Labour in the Delhi unit	0.00	0.00	0.00	-5.64	-6.72
Adjusted Profit before tax	2.68	4.02	3.64	-0.84	-1.35

In order to meet the growing demand, HIL increased its existing capacity in Delhi and set up new plants in Udyogmandal and Rasayani.

Table 10 : DDT production capacities of HIL's plants

Location	Capacity MT
Delhi	2,744 (T) / 5,488 (F)
Udyogmandal	1,344 (T) / 2,688 (F)
Rasayani	5,000 (T) / 10,000 (F)

Note: T stands for Technicals and F for Formulations

The Delhi unit was closed in accordance with the order of the Supreme Court to shift all polluting units out of Delhi with effect from November 30, 1996.

The closure of the unit has left HIL with unused land of some 4.99 hectares. The Supreme Court order has directed that 57% of the unused land is to be surrendered to DDA. The estimated market price of the remaining land is about Rs. 27 crores. Closure of the unit has rendered 524 employees surplus.

The Company's proposal to set up a formulations plant in the PSIDC developed industrial complex at Bhatinda has been approved by the Government. The project is estimated to cost some Rs. 7.70 crores and is likely to provide employment to some 100 people (who will be sourced from the surplus labour in Delhi). The Government has already provided HIL Rs. 7.5 crores (Rs. 3.35 crore by way of equity and Rs. 4.15 crore by way of loans) for this purpose. The project is slated to be completed by March 2000.

Agrochemicals business

This business includes manufacture and sale of various technical pesticides/formulations, other than DDT. Unlike the DDT business, sale of almost all these pesticides is in the open market in direct competition with the various large Indian companies and MNCs. SPC's formulations business would also form a part of this division.

HIL produces 5 technical pesticides, their formulations and various other formulations. HIL has the capacity to produce 4,350 tonnes of technicals per annum as detailed below :-

Table 11 : HIL's Agro-Chemicals Capacity, Sales and Market Share

PRODUCT	Capacity (MT/KL)	Sales (FY 98) (MT/KL)	Market Share (Approx.)
Technicals			
Malathion ^{&}	1,800	422	33-35%
Butachlor ^{&}	500	34	3-4%
Monocrotophos ^{&}	300	89	2-3%
Phosphamidon [*]	400	—	—
Endosulphan [§]	1,600	500	6-7%
Dicofol [§]	150	63	24-25%
Formulations			
Malathion ^{&}	3200	1,604	71-74%
Butachlor ^{&}	905	133	8-9%
Monocrotophos ^{&}	255	374	2-3%
Endosulfan [§]	1910	558	12-14%
Dicofol [§]	500	41	50%

* Phosphamidon production has been stopped following a ban on this pesticide

& Produced at Rasayani

§ Produced at Udyogmandal

As is evident from the above table, HIL is operating at very low capacity utilisation levels in most of its product segments. While HIL has a reasonable presence in the Malathion and Docifol market, it is a marginal player in the rest of its product segments.

Table 12 : Summary of the total agro-chemicals sales of HIL

Products	FY96 Rs. Crore	FY97 Rs. Crore	FY98 Rs. Crore
Technicals & Formulations Malathion	4.98	6.49	10.34
Monocrotophos	7.08	6.97	10.18
Endosulphan	34.79	32.76	22.55
Butachlor	2.42	2.45	2.18
Phosphamidon	0.06	0.35	0.25
Dicofol	0.73	2.26	2.50
Total	50.06	51.28	48.00
BHC	4.29	1.64	0.00
Other formulations	9.78	14.66	10.57
Total	64.13	67.58	58.57

HIL's export sales of Endosulphan were hit in FY98 due to the lack of supply of Hexachloro Cyclo Pentadine (HCCP). HIL's inability to meet the demand of its international customers has made them shift to other players. Given this, Endosulphan exports are not expected to pick up soon.

Of the five technical pesticides produced by HIL, one (Phosphamidon) has been banned and three other (Malathion, Endosulphan & Dicofol) are under review for environmental reasons. A ban on these will reduce HIL to the status of a small formulator.

Table 13 : Profitability of the Agro-Chemical Division

In Rs. Crores	FY95	FY96	FY97	FY98	FY99
Sales	55.84	64.13	67.58	58.57	75.63
Profit before tax	-0.42	2.01	2.80	-1.13	-1.79

Losses in FY98 & FY99, on account of decline in Endosulphan exports and fall in prices of various insecticides, highlight the vulnerability of HIL to market changes.

HIL set up a manufacturing facility at Udyogamandal in 1957 for the manufacture of BHC Technical and its Formulations. The production of BHC

has been stopped since April 1997 in pursuance of a Government of India order for discontinuance of production and sale of BHC in the Country.

A comparison of the broad cost structure of HIL vis-à-vis that of large Indian agrochemical companies and MNCs operating in India is given below –

Table 14 : Cost Structure Comparison

Cost structure (FY98)	Indian*	MNCs*	HIL
Raw material	55%	55%	54%
Energy	5%	2%	6%
Wages	7%	4%	24%
Repairs	2%	2%	3%
Advertising & Marketing	8%	8%	0%
Other overheads	10%	15%	9%
PBDIT margin	13%	14%	4%

* Average

Proportion of wages to sales clearly shows the extent of over-manning in the Company.

Financial Analysis

Table 15 : Financial Highlights

(Rs. Crore)

	FY 98	FY 97	FY 96
Total Income	129.75	144.57	144.27
Operating Profit	6.25	14.52	13.35
Other income	4.05	8.64	3.31
PAT	-1.97	5.90	6.03
Equity Capital	47.40	45.75	42.25
Tangible Networth	30.52	32.78	25.12
Gross Margin (%)	5.21	11.33	9.83
Net Margin (%)	-1.64	4.60	4.44
RONW (%)	-6.45	18.00	24.00
Earning Per Share of Rs. 1000/-	-43.10	139.52	147.88
Dividend (%)	0	0	0

It would be observed from the above table that the operating losses have been increasing mainly on account of idle wages being paid to the employees in Delhi plant. The company was making profit in earlier years mainly on account of other income. However, this has come down substantially resulting in a net loss in FY 98. The company's net worth has been constantly eroding and a similar kind of loss next year could wipe out the net worth.

Strengths and Areas of Concern

Strengths

Reasonable distribution network – HIL's network of 650 dealers across the country covering all the key states provides a reasonably strong distribution base.

Good image in the market - Being a PSU, HIL is perceived to be a producer of quality formulations, which gives it an edge over small formulators.

Areas of Concern

Lack of market leadership - None of the HIL brands holds leadership position in the market. HIL's brands are unlikely to allow the company to command a premium over products of MNC or large Indian companies. All HIL pesticides are generic and off-patent, a segment which is witnessing a decline in margins.

Lack of marketing strength - Owing to lack of funds, the Company has been allocating very nominal amounts for sales promotion and marketing. With such low marketing expenditure, HIL cannot face competition from Indian players and MNCs.

No Research & Development - Like most other Indian companies, HIL has not invested in any basic research and development. HIL's R&D centre in Gurgaon is mainly used as a testing facility. Given its financial position, HIL is unlikely to be able to afford to invest in R&D in the near future.

Over-manning - HIL is significantly over-manned compared to other agrochemical units in the industry. In FY98, HIL's salary & wages bill was

some 24% of its sales as compared to 7% & 4% for MNCs and Indian companies respectively. Further, idle wages of some Rs. 5 crores per annum being paid out to workers in Delhi is eroding the company's bottom line.

PSU Status - Being a Government Company, HIL suffers from certain disadvantages such as elaborate and complex decision making processes and government controls. This often hinders its ability to respond promptly to market conditions and competition.

Recommendations

HIL's DDT & BHC business has been adversely affected by the ban for agricultural use on these pesticides and HIL is a relatively small player in the agro-chemicals market. While HIL has a reasonable presence in the Malathion and the Dicofol market, it is a marginal player in the rest of its products. Three of the technical pesticides produced by HIL – Malathion, Endosulphan and Dicofol – are under review for environmental reasons. A ban on these will reduce HIL to the status of a small formulator. Government of India is going to phase out the purchase of DDT for National Anti Malaria Programme by 2005. Future survival of the company will then depend on the diversification into permitted agro-chemical and pesticides which will call for new technological inputs and additional investments.

Closure of the Delhi plant is causing an annual loss of more than Rs. 6 crores on account of costs of the Delhi plant's idle workforce. Both the businesses of HIL, namely DDT and Agro-Chemicals, are incurring losses.

HIL has a marginal market share in the Indian agro-chemicals market with seven large domestic and MNC manufactures accounting for about 75% of the market size. There are also a large number of small and medium formulation units. Imports are also freely allowed. Under these circumstances, **the Commission concludes that the Indian agro-chemical market is fully contestable and no public purpose would be served by HIL continuing under government ownership and control and hence HIL be categorised as non-core.**

The Commission recommends that Government should offer a minimum of 51% of the equity to a strategic buyer along with management control in order to enable it to diversify its product range with new technology and additional investment. The selection of the strategic buyer should be made on the basis of global competitive bids from pre-qualified bidders. Simultaneously, as part of the preparation for strategic sale, a suitable VRS should be offered to the surplus manpower including those rendered surplus due to closure of Delhi plant. Subsequently, the remaining equity of GoI, if any, could be offered to retail investors in one or more public offerings. In the absence of investor interest in the equity stake in HIL, the government would not have any other option but to close the company.

2.3 HINDUSTAN ORGANIC CHEMICALS LIMITED

Evolution

Hindustan Organic Chemicals Limited (HOCL) was incorporated on December 12, 1960, as a wholly owned enterprise of GoI, to manufacture chemicals for dyes and dye-intermediates, drugs and pharmaceutical, rubber, chemicals, laminates and solvent industries. It was set up as part of the Government's initiative for substituting import of bulk organic chemicals, which until then, were imported. Its first production unit, located at Rasayani in Maharashtra, commenced operations in 1970 and the principal products produced by this unit are: Nitrobenzene, Aniline, Hydrogen, Acetanilide, Formaldehyde, Meta-amino-phenol apart from Nitric Acid.

The second unit, at Cochin in Kerala, was set up in 1987-88 and it started production of phenol. In 1987-88, HOCL set up Hindustan Fluorocarbons Limited (HFL), a wholly owned subsidiary, at Hyderabad. The company has recently entered into a joint venture with Chematur Engineering AB of Sweden, i.e., HOC Chematur Limited, to manufacture methyl diphenyl di-isocyanate (MDI).

Subsequently, the company undertook expansion of aniline, nitobenzene, hydrogen, monochlorobenzene and nitrochlorobenzene units. In addition, two new projects were implemented viz. 20000 TPA caustic soda lye/chlorine at Rasayani (backward integration) and 5225 TPA hydrogen peroxide at Cochin.

The share capital of the company is Rs. 67.27 crore of which GoI holds 58.61 percent. Between April 1992 and October 1994, GoI disinvested 20 percent share in favour of Mutual Funds and the Unit Trust of India (UTI). HOCL raised Rs. 96.55 crore equity through a public issue of equity shares in November 1994, at a premium of Rs. 40 per share. This raised its paid up capital from Rs. 49.35 crore to Rs. 67.27 crore and reduced GoI's stake to 58.61 percent. The current shareholding pattern is as follows:

Table 1 : Shareholding Pattern

Share holder	% holding
Government of India	59.0
Public	15.0
Fis/Banks	14.0
MFs/Corporates	6.0
FII's/NRIs	4.0
Employees and others	2.0

Industry Analysis

Organic chemical is the basic input for some major user industries such as Dye-Intermediates and Dyes industry, Drugs and Pharmaceuticals, Rubber Chemicals, Paper and Textile, Resin industry for Plywood, Particle Boards, Laminated sheets, Foundry, Leather and Explosives. The Chemical industry globally has been dominated by multi-national companies such as Bayer, BASF, ICI. etc. When compared with these companies, HOCL's capacity is insignificant.

Aniline. In India, 76 percent of the demand for aniline comes from two industries – pharmaceuticals and dyes. This is at variance with the user profile in the rest of the world, where these two industries account for only six percent of the total demand. The two major user groups in the world market are polyurethane manufacturers and rubber chemical manufacturers. This is because most dyes are no longer produced in the West due to environmental reasons. The Indian market size for aniline was estimated at around Rs. 140 crore in FY98. The prospects for the aniline industry are dependent on the performance of the dyes and the pharmaceutical sectors. The dye industry will depend on the performance of the textile sector and a revival in exports. The pharmaceutical industry, which uses aniline for sulpha drugs, has shown an increase in demand. However, this trend may be reversed after 2002, when the patent regime in India changes.

The total demand for aniline in India was estimated to be 35,000 MT in FY98. India has an installed capacity of 44,500 TPA of aniline. There are only two producers of aniline in India; HOCL and Narmada Chematur Petrochemicals

Limited (NCPL). NCPL has an installed capacity of 20,000 TPA. This is comparable to HOCL's capacity of 24,500 TPA.

Phenol. Major user industries of phenol include resins (57%), Chemicals (18%), Dyes (10%) etc. The Indian market size for phenol was estimated at Rs 250 crore in FY98. As half the demand for phenol is from the resin manufacturing industry, the demand for phenol is dependent on the growth in resin industry. The average price realisation from phenol dropped by nearly 9 percent in 1997-98. This was less than the 15 percent drop in international prices. Any further drop in international prices may further squeeze the domestic margins.

There are two major producers of phenol – HOCL and Herdillia Chemicals Limited (HCL), who between them account for 95 percent of the market in FY97. A third company, Bengal Chemicals and Pharmaceuticals, has four percent market share. HCL has an installed capacity of 26,500 TPA and plans to increase this to 30,000 TPA. HOCL's installed capacity has risen from 40,000 TPA to 50,000 TPA through de-bottlenecking.

Acetone. The pharmaceutical industry is the single largest consumer of acetone accounting for 80 percent of the total consumption of the chemical. Acetone is also used in the chemical, petrochemical and textile sectors. The Indian market size for acetone was estimated at Rs. 135 crore in FY97. Growth in demand for acetone is linked to growth in the pharmaceutical industry, which is likely to be adversely affected after the WTO norms come into force.

HOCL and HCL dominate the Indian acetone market with 66 percent of the market share between them, in FY97. HOCL has an installed capacity of 24,640 TPA, which is more than HCL's capacity of 16,170 TPA.

Nitro-products. Ortho-nitrochlorobenzene (ONCB) is primarily used in the agro-chemical industry while, para-nitrochlorobenzene (PNCB) is used to manufacture drugs such as paracetamol. Until 1990-91, HOCL accounted for 85 percent of domestic production. With the capacity expansion HOCL now accounts for 18.1 percent and 16.5 percent of the installed capacity in PNCB and ONCB respectively. HOCL's PNCB capacity is 6,190 TPA out of a total domestic capacity of 34,190 TPA. The largest PNCB capacity is that of Aarti Industries Limited (AIL) with a capacity of 7,800 TPA. In case of ONCB, HOCL's capacity of 2,810 TPA is less than that of AIL (3,900 TPA), Kothari Sugars and Chemicals (3,600 TPA) and Deepak Nitrite (3,000 TPA).

Business Analysis

HOCL is in the business of manufacture of chemicals which are used in dyes, drugs and pharmaceutical industries. In 1997-98, six products of the company – nitro products, aniline, acetone, acetanilide and formaldehyde accounted for 94% of the sales. The product-wise turnover of the company is as follows:

Table 2 : Product-wise Turnover

Product	% share
Phenol	35.7
Aniline	17.2
Acetone	15.6
Nitroproducts	14.3
Formaldehyde	6.5
Acetanilide	5.1
Others	5.5
TOTAL	100.0

Aniline is an intermediate chemical used for manufacturing dyes, drugs, rubber and photographic chemicals. In 1997-98, the total demand for aniline in India was estimated at 35,000 TPA. For aniline, HOCL has an installed capacity of 24,500 TPA and enjoys a 57 percent market share. Phenol is an aromatic compound, which is used in the manufacture of resins, abrasives, textiles, pesticides, pharmaceuticals and dyes. The total demand for phenol in India was estimated at 82,000 TPA in 1997-98. HOCL has an installed capacity of 40,000 TPA at its Cochin manufacturing facility and a market share of 55 percent. Acetone is a co-product obtained in the manufacture of phenol. Nearly 80 percent of acetone is used by the pharmaceutical industry. It is also used in the manufacture of paints and rubber chemicals. HOCL has an installed capacity of 24,640 TPA and a market share of 40 percent. Nitro-products are used in the manufacture of rocket propellants, lubricants, explosives, agro chemicals and pharmaceuticals. Nitro-products manufactured by HOCL are nitrochlorobenzene (NCB), orthonitrotoluene (ONT), para-nitrotoluene (PNT), metanitrotoluene (MNT), monochlorobenzene (MCB), meta-dinitrobenzene (DNB) and nitrobenzene (NB). HOCL has an installed capacity

of 53,430 TPA of nitroproducts with market shares that vary from 25 percent for PNT to 60 percent for ONT.

Sales volume have grown at a CAGR of 6.6% in volume terms since 1993-94 while the sales (in value terms) grew faster at a CAGR of 10.8% during the same period. However, sales value growth has slowed down considerably to 2% since 1995-96 due to lower realisation. In terms of consumer profile, three industries – resin, dyes and drugs – account for 85% of the sales value of HOCL. This is contrary to the trend in the developed world countries where the dye industry account for only a small percentage of the total demand of organic chemicals.

As mentioned above, HOCL is having two production facilities. The Cochin unit is more profitable compared to the Rasayani unit. This is primarily due to old plant & machinery at Rasayani and large workforce. Over the last three decades, the Rasayani unit has emerged as an integrated nitro-aromatic complex with gradual expansion into different product lines. The Cochin unit was established in 1987-88 with a new plant and did not have to carry the social commitments of the Rasayani unit such as (township, school, hospitals, employment to locals etc.)

The total number of employees in HOCL is 2366 and out of which 1850 are employed in Rasayani while the unit in Cochin employs only 516 people. Estimates suggest that for Rasayani unit to reach the productivity level of Cochin unit, around 775 employees would be required at the current level of production.

HOCL has made investments in its subsidiary, Hindustan Fluorocarbons Ltd. which is currently a BIFR company with total accumulated loss of Rs. 40.17 crore as against a paid up capital of Rs. 19.61 crore.

The company has ambitious plans for investments. Some of these are in related areas of organic chemicals while others are unrelated diversifications. HOCL and Chematur Engineering AB of Sweden propose to set up joint venture for the manufacture of 20000 tpa methyl diphenyl di-isocyanate (MDI). HOCL's commitment towards equity in the JV is Rs. 48.64 crore and this project was conceived when the company was making profits. Under the current

circumstances, it seems unlikely that HOCL will be able to fund its share without market borrowings. This might further affect the profitability of the company.

Apart from this JV, HOCL plans to set up a phenol plant in Saudi Arabia, and a chemical store terminal at New Mangalore Port.

Financial Analysis

The financial analysis of the HOCL for the past five years is as follows:

Table 2 : Financial Highlights (Rs.Crore)

	1998-99*	1997-98	1996-97	1995-96	1994-95
Operating Income	418.43	404.30	359.30	383.70	299.60
Operating Profit	28.65	22.93	35.67	66.44	33.45
Profit after Tax	-15.01	-5.09	9.61	54.30	27.89
Equity Capital	67.27	67.27	67.27	67.27	67.27
Tangible Net Worth	357.20	375.68	387.86	390.74	345.63
Gross Margin (%)	6.85	5.67	9.93	17.31	11.17
Net Margin (%)	-3.59	-1.26	2.68	14.15	9.31
ROCE (%)	3.14	-0.24	3.09	11.25	5.98
RONW (%)	-22.31	-1.36	2.48	13.90	8.07
EPS (Rs.)	-2.23	-0.76	1.43	8.07	4.15
Dividend (%)	N.A	5.00	5.00	20.00	16.00

* unaudited and provisional figures

The operating income has shown a mixed trend over the last five years. It rose by 28 percent in 1995-96 and fell by six percent in the subsequent year. In other years too, the percentage growth has fluctuated considerably.

Although the overall production quantity has increased over the years, price realisation has declined for most of the products due to competition from cheaper imports. This is evident from the declining gross margins.

HOCL's interest burden and depreciation charge has increased substantially over the last two years due to capitalisation of chemicals and other utility units resulting in a negative net margin for 1997-98 and 1998-99.

As can be seen from the above table, 1995-96 has been a significantly good year for the company during which both operating income and profits improved substantially. The reason for such a performance was a 10 percent increase in production coupled with favourable prices for three of the company's major products viz. phenol, acetone and nitroproducts. Acetone prices were up 38 percent during this period (acetone accounted for an all time high 23 percent of the turnover in 1995-96).

The Cochin units generates profits from operations while the Rasayani unit incurs huge losses. The poor performance of the Rasayani unit can be attributed to the drop in the gross margins and high expenditure as a percentage of net sales. Salaries and wages account for about 5% of the total cost in case of Cochin unit while it is approx. 17% in case of Rasayani unit. Similarly, manufacturing expenses are nearly 29% for Rasayani as against Cochin's 18%.

Strengths and Areas of Concern

Strengths

Market leader : HOCL is a pioneer company in the area of bulk organic chemicals. The company has a substantial presence in this sector. The Cochin unit of the Company has received Productivity Award among large industries in Kerala for the last nine years. HOCL has a market share of 57 percent in aniline, 55 percent in phenol, 40 percent in acetone, 25 percent in PNCB and 26 percent in ONCB.

Core Competency : The company has developed core competency in handling hazardous chemicals. It has an impeccable record of safety in plant operations. It has been handling hazardous chemicals and there has been no accident in the past five years of operations. The Cochin unit of the Company has received the National Safety Council Award for eight successive years for its safety performance.

Technology Integration : In the past three decades the company has used technology from various countries, always evaluating the best which may be used in the Indian conditions.

Areas of Concern

Surplus Workforce : Although no study/exercise has been commissioned for determining surplus labour, estimates are that the surplus labour could be as high as 30-40 percent of the total employee strength.

Smaller size of plants : It is realised internationally that economies of scale play a significant role in determining the bottom line of a company as well as influencing the market leadership position. The company's plants are small by international standards.

Pressure on Margins : The Company's Operating and Net Margins are steadily declining on account of reduced price realisations and increased interest and depreciation charges.

Investment in Subsidiary : HOCL's share of losses incurred by HFL has completely wiped off the investment made by the Company in its subsidiary (Unaudited losses for the year 1997-98 were Rs. 40.17 crore). Proportionate share of these losses has not been recorded in its balance sheet but they have the potential to bring down HOCL's networth substantially.

Infructuous Investments : Jawaharlal Nehru Port Trust Tanker Terminal was an infructuous investment made by the Company. Instead of contributing to the bottom-line of the company, it has become a cause of fund blockage. The company has not been able to realise its investment in this project.

Recommendations

The organic chemical industry in India is highly competitive with large number of players operating. The fortunes of chemical industry in India are linked with the state of the international chemical market which is influenced by large multi-nationals. HOCL is currently the market leader in both of its principal products. However, over the years, HOCL lost its market share to private producers and imports. In pricing of its products, HOCL has to face domestic competition and imports. **Given the nature of market in which HOCL operates, the Commission classifies HOCL as non-core.**

HOCL is having production facilities at two places. The Rasayani plant is old and is loss making. It has production capabilities of large number of chemicals. It has also got large manpower. The Cochin unit is comparatively new, producing a single product and employing lesser manpower. It has been estimated that HOCL Rasayani unit is having a surplus manpower of approximately 1000. **The Commission is of the view that HOCL should initiate a VRS to reduce manpower.** This will bring in substantial savings in manpower cost and will improve the profitability.

In the past, HOCL was making consistent profits. However, during the last two years, the company is incurring losses which may further go up in the coming years. The primary reasons for the decline in profits are squeeze on margins on its products, increased interest and depreciation charges etc. The company has made many ambitious capital investment programmes for future. However, due to depressed market conditions and losses, it would not be in a position to finance these projects. In order to undertake these projects, it would be necessary for HOCL to induct a suitable as strategic partner with substantial equity stake and management control.

The Commission, therefore, recommends disinvestment of 33% of HOCL shares of the company's equity out of the GoI holding of 59% to a strategic buyer while retaining 26% with GoI. This will enable the company to acquire new technologies and necessary funds for its expansion. The selection of strategic buyer should be done through a transparent competitive global bidding process from pre-qualified bidders. In implementing the strategic sale, the conditions in SEBI's take over code would need to be fulfilled. As per SEBI's take over code, the strategic buyer has to make a public offer

to acquire additional 20% shares. The strategic buyer may acquire the 33% shares offered by Government in strategic sale, in addition to his acquisition from the public. In case the strategic buyer wants to acquire less than 33% of Government shares, after acquiring shares from the public, he may be allowed to do so. In such a case, Government may sell the remaining shares out of the 33% to domestic and international institutional investors at the accepted bid price for the strategic sale.

2.4 RASHTRIYA CHEMICALS AND FERTILISERS LIMITED

Evolution

Rashtriya Chemicals and Fertilisers Limited (RCF) came into existence on the 13th of March 1978 pursuant to the Government's decision to reorganise the Fertiliser Corporation of India Ltd. (FCI) and National Fertilisers Ltd. (NFL) into 5 companies.

The manufacturing facility allocated to RCF at the time of its formation was an Urea plant at Trombay. Shortly after its formation, the company expanded its urea capacity and also extended its product portfolio to include complex fertilisers and industrial chemicals. In 1985, the company commissioned a second manufacturing unit at Thal in Raigad District of Maharashtra with a capacity of 1.485 million tonnes. At that time, it was the biggest manufacturing centre of urea in Asia at a single location.

The company's paid up equity capital is Rs. 551.69 crore. In 1992 - 1993, the government disinvested 7.5% of its holding in RCF to Financial Institutions and Mutual Funds and the GoI current holding is 92.5%.

Industry Analysis

India is the third biggest consumer of fertilisers after China and the USA. Agriculture contributes 32% of India's GDP and provides employment to over 60% of the nation's workforce. Therefore, agricultural production is a key factor in determining economic performance. Agricultural production in turn is dependent on the timely availability of agricultural inputs such as water, fertilisers and pesticides.

Fertilisers replenish the soil of its key nutrients; Nitrogen [N], Phosphorus [P], Potassium [K] and help in improving agricultural productivity. Nitrogenous Fertilisers in nutrient terms account for 71% of the total nutrient consumption in the country of which about 84% is provided by Urea. Di-Ammonium Phosphate [DAP] is the primary phosphorus replenishing agent and accounts for 60% of the phosphatic fertiliser usage in India.

India's total installed capacity for the manufacture of fertilisers has increased from 2.5 million tonnes in FY75 by over five times to 13.5 million tonnes

in FY98. The average consumption has increased from about 1 kg/hectare in the 1960s to 82 kg/hectare in the 1990s making India the third largest consumer and producer of fertilisers in the world.

The usage of fertilisers depends on the cropping pattern, irrigation intensity and soil characteristics. About two-thirds of the total cultivated area is assigned to the production of foodgrains, with cash crops such as sugarcane, oilseeds, cotton and tobacco accounting for the rest. Wheat and paddy are the principal foodgrain crops and account for 77% of total foodgrain production. These two crops also require larger doses of urea, compared to other foodgrains, since their nitrogen depletion rates are higher than other crops.

While nitrogenous fertilisers account for the largest share of Fertiliser consumption, an optimum balance between nitrogenous, phosphatic and potassic fertilisers [known as the NPK ratio] of 4:2:1 is essential for maximising crop yields. The consumption ratio remained close to the desired ratio until the 1990s. The consumption pattern thereafter became skewed in favour of nitrogenous fertilisers resulting in a NPK ratio of 7.9:2.9:1 in 1997-98. This shift became more pronounced after FY93 when the Government of India reduced the subsidy on phosphatic and potassic fertilisers.

There are 22 fertiliser manufacturing companies both under government and private ownership. Private sector plants produce 45% of the total urea but account for only 40% of the installed capacity. There is a relatively high level of concentration with the top 6 manufacturers of urea, viz., IFFCO, KRIBHCO, NFL, RCF, Nagarjuna and Tata Chemicals accounting for more than 65% of total urea production.

The Government of India has framed a fertiliser policy, whose objectives are:

- (a) Provide urea to the farmers at low and stable prices to encourage consumption to increase/sustain agricultural growth, which is vital for food security
- (b) Provide incentives to Fertiliser manufacturing units to increase production to meet demand
- (c) Ensure balanced regional distribution of urea

However, the first two objectives are inconsistent, as low prices might not be remunerative for producers and hence insufficient to increase supply. Therefore government designed the Retention Price Scheme (RPS) in order to reconcile the above conflict. Under this scheme, a price was fixed for each unit so as to provide a post-tax return of 12% on net worth based on prescribed efficiency norms. These key norms included capacity utilisation, consumption of raw materials, utilities and capital costs. The farm gate price of urea was kept low and the government paid the difference between the retention price and the farmgate price to each unit as subsidy.

While the RPS was very successful in the 1980s leading to huge capacity additions, the resulting subsidy has become a major concern presently given the steep hikes in input costs especially feedstock prices. Following large increases in subsidy owing to high capacity utilisation (of more than 100%), the government made the consumption norms more stringent. The new norms are difficult to achieve making full cost recovery difficult.

In order to correct the deficiencies of the RPS system, Government of India appointed a High Power Committee (HPC) on Fertiliser pricing under the Chairmanship of Hanumantha Rao. The HPC submitted its report in April 98 and has recommended significant changes with regard to pricing policy and attracting fresh investments. The following were its key recommendations:

Discontinuation of the unit wise RPS and its replacement by a uniform Normative Referral Price (NRP) based on the long run marginal cost principle. The recommended NRPs for each category of units is shown in the table below:

Table 1 : Recommended Urea Prices (Rs./ton)

Feedstock Used	NRP (Rs./ton)
Natural Gas-Existing units	6,050
Naphtha/fuel oil-Existing Units	7,800
Natural Gas-New Units	6,983
LNG-New Units	8,299
Naphtha-New Units	9,192

The excess of NRP of other feedstocks over gas is termed Feedstock Differential Cost Reimbursement (FDCR). This is to compensate units for their higher cost due to use of inferior feedstock. HPC has recommended that FDCR be withdrawn after 5 years during which the units operating on inferior feedstocks are expected to switch over to LNG. NRP would not factor price increases of raw material upto 5% per annum.

As in the case of urea, the Retention Price scheme was operating in the complex fertiliser segment until August 1992 when the Government decontrolled the sector. In the aftermath of the decontrol, no major investments have taken place for production of complex fertilisers. The state governments introduced ad-hoc subsidies in this sector. The slow down in demand due to higher prices and distorted implementation of the ad-hoc subsidy severely affected the profitability and liquidity of the complex Fertiliser industry. So, in February 1997, the Government simplified the procedure for disbursement of the subsidies. Fixation of selling prices by the GoI in consultation with the industry and their timely announcement (i.e. before the commencement of the kharif season), provision for 80% of adhoc subsidy on account payment without verification from the state governments helped increased production. Thereafter, there was a prolonged delay in subsidy disbursements which was followed by a decrease in ad-hoc subsidies. In September 1998, the subsidies were increased. One important feature of subsidies in the complex fertiliser sector is that it is the same for all producers (unlike in the case of urea). This helps low cost producers.

Business Analysis

RCF's business can be divided into 3 broad categories – manufacture of urea and complex fertilisers, manufacture of industrial chemicals and trading of imported fertilisers. The first category dominates RCF's turnover. The contribution of each of these categories to RCF's income in FY99 is as follows:

Table 2 : Contribution of RCF's Businesses

Category	% of turnover
Urea & complex Fertilisers	76.0
Industrial chemicals	10.6
Trading of Fertilisers	13.4

Urea

Urea accounts for a major share of fertiliser consumption in India. In FY99, Urea contributed 30.8% (excluding subsidies) to RCF's operating income. If one did not consider trading income, urea contributed 46% to RCF's turnover. Profitability in urea manufacture depends primarily on government policies of fixing the Retention Price and hence the subsidy.

Assuming a conservative estimate of consumption growth (4.9%) to account for the possible adverse movements of exogenous variables such as rainfall and rural credit, the supply demand projections are given in the table below.

Table 3 : Demand – Supply Projections (Mn. tonnes)

	1999-00	2000-01	2001-02	2002-03	2003-04
Demand	22.5	23.8	25.2	26.8	28.4
Supply	20.3	20.3	23.2	24.7	25.0

The supply demand scenario implies that the shortfall has to be met by imports. China and India, which together account more than 50% of total urea consumption and imports drive the international traded prices of urea. While India has been importing urea, China's absence from the international markets has caused the continuous fall in traded urea prices in FY97 and FY98. The current price of imported urea per ton is Rs. 6740. Since RCF caters to markets in the coastal states, the comparison of imported price should be made without the inland freight charges, viz. Rs 5160/ton. Currently, the cost of production of RCF is Rs 6257/ ton for the Trombay unit and Rs 4091/ton for Thal unit. Clearly, the Trombay unit is not competitive against imports, while even at the depressed international urea price, the Thal unit would not be threatened by imports. The levying of a 5% customs duty on the import Fertilisers in the latest budget also enhances the viability of the Thal unit against imports.

While RCF has problems under the current retention price system, it would thrive in a free pricing scenario on account of its depreciated plants. The closest competitor, in terms of cost of production, is National Fertilisers Ltd. (NFL). Given below is the cost of production of urea/tonne at NFL's plants in the 3rd quarter of FY99.

Table 4 : NFL's Cost of Production

(Rs/ton)

Nangal	Panipat	Bhatinda	Vijaipur	Vijaipur Expn
7681	6547	8209	4046	5171

RCF's cost of production at Trombay and Thal are respectively Rs.6257/tonne and Rs.4091/tonne. The capacity at Thal is more than 4 times that at Trombay. Clearly RCF is more competitive than NFL in a free pricing scenario.

Though RCF is low cost producer, its competitiveness is impaired by uncertain gas supply from GAIL. This problem is becoming more severe in the last few years. The company is looking at the possibility of buying LNG from international players such as Enron.

Complex Fertiliser

The two complex Fertilisers, Suphala (nutrient composition 15:15:15) and ANP (nutrient composition 20:20:20) contributed 25.26% of RCF's turnover and a bigger chunk of its profits. In fact, these two products were the reason for the sharp rise in RCF's profits before tax in FY98 of Rs 253.3 crores (compared to Rs 115.3 crores in FY97).

Among the domestic players in the complex fertilisers market, RCF is very competitive. The predominant reason is RCF's fully depreciated plants. While many other domestic players like Deepak Fertilisers (which has a product profile similar to RCF's-36% of turnover from urea, 16% from complex Fertilisers, 26% from industrial chemicals and 17% from trading) made a loss in FY93 when subsidies on complex Fertilisers were removed, RCF was not as badly hit. To protect the domestic players, the government gave an ad-hoc subsidy per tonne produced to all the players in FY94. The ad-hoc subsidy was increased considerably in September 1998 (to Rs 2814/tonne of Suphala and Rs 2752/tonne of ANP). Since this subsidy was the same to all players (unlike the urea subsidy), it benefits low cost producers. RCF was running its complex fertiliser plants at low capacity when the subsidy was low. As the subsidy went up, RCF hiked its production of these fertilisers. The company has the ability to vary its product mix between these two fertilisers depending on demand.

Industrial Chemicals

Industrial Chemicals contributed 10.55% to RCF's turnover. The products manufactured are Methanol, Ammonia, Dilute and Concentrated Nitric acid, Dilute and Concentrated Sulphuric acid, Sodium Nitrite and Nitrate, Methylamines, Technical Grade Urea, Ammonium Bicarbonate, Dimethyl Formamide, Dimethyl Acetamide, Ammonium Nitrate melt and carbon dioxide. Among these products, only Methanol, Ammonia, Methyamines and Technical Grade Urea contribute significantly to the turnover.

The performance of the industrial chemical business can be directly related to industrial activity in the country. The chemical business was very profitable in FY95 and FY96 when the economy was booming. The slow down in domestic industrial production coupled with recessionary conditions in South East Asia have reduced the profitability of industrial chemicals. In fact, some products are even making a loss. RCF's chemical business has one major advantage. It can change its product mix very easily. In FY99, the company cut down its production of methanol and increased that of Methyamine, which was enjoying higher margins.

Trading of Fertilisers

To shore up their top lines and bottom lines in a highly regulated business, many fertiliser companies in India have started trading fertilisers by buying in the international markets and selling in the domestic market at prices fixed by the government. RCF trades in DAP and Urea. Trading contributed 13.4% of RCF's turnover in FY99. The company plans to trade even more this year.

Manpower

The manpower strength of RCF is 5545 and the company plans to freeze hiring and use the existing staff in the expansion projects. VRS possibilities are being looked at by the company. Salaries and wages constituted only 4.5% of RCF's operating income.

Financial Analysis

The financial analysis of the RCF for the past five years is as follows:

Table 5 : Financial Highlights

(Rs. Crore)

	FY 99	FY 98	FY 97	FY 96	FY 95
Operating Income	2032	1720	1286	1256	1352
Operating Profit	325	288	137	147	232
Profit after Tax	108	183	74	73	167*
Equity Capital	552	552	552	552	552
Tangible Net Worth	1420	1236	1089	1033	977
Gross Margin (%)	16.0	16.8	10.6	11.7	17.2
Net Margin (%)	5.4	10.6	5.8	5.8	12.3
ROCE (%)	11.5	18.5	10.6	12.7	22.2
RONW (%)	7.7	14.8	6.8	7.1	17.1
EPS (Rs.)	1.97	3.32	1.34	1.33	3.02
Dividend (%)	7	7	3.5	3	5

RCF's operating revenue has shown an Compounded Annual Growth Rate (CAGR) of 8.2%. Between FY96 and FY99, the net profit recorded a CAGR of 10.3%. However, in FY99, the net profit was lower due to the extraordinary expense in the form of write-off of a bad loan amounting to Rs 87.08 crores. In FY95, RCF had an extraordinary income of Rs 166.6 crores because the Government made good the losses suffered by the organization earlier on Kuwait Dinar loans. In FY 98, the profits showed substantial increase primarily due to improved realisation from complex fertilisers. As regards operating margins, the increase from 11.7% in FY 96 to 16.8% in FY 98 was primarily due to improved capacity utilisation of urea and complex fertilisers and higher realisation of price for complex fertilisers.

Urea's contribution to RCF's operating income (including subsidy income) has fallen from 60% in FY95 to 51.3% in FY99. The fall has been due to increased trading income. The cost of production per MT of Urea of Trombay plant and Thal plant varies substantially. The cost of production of Trombay plant is Rs. 6257 per tonne while that of Thal is only Rs. 4091. Accordingly, Trombay plant makes losses from its urea operations while Thal makes profit. The profitability of RCF's complex fertilisers has been profitable since September 1998 when the Government hiked the subsidies on complex fertilisers.

Industrial chemicals (inorganic chemicals) contributed 10.7% of RCF's turnover in FY99. The division's profitability is linked to the general performance of the domestic and the global economy. If there is a slowdown in the global economy (as is the case now), there is dumping of chemicals into India from countries of Europe and the Far East. It is possible for some chemicals to be profitable at a given point in time while some other products are making losses. In that scenario, RCF's flexible product mix allows it to increase the production of the profit making chemical and decrease that of the loss making products.

Income from trading accounted for 13.6% of turnover in FY99, up from 4% in FY98 and 0.03% in FY97. Trading is a high risk activity. RCF is taking two risks while trading. Firstly, it has to forecast the likely prices of the Fertilisers. This is dependant on governmental policies, which are largely unpredictable. The second risk is foreign exchange risk. RCF does not have formal policy for managing foreign exchange risk. Sometimes RCF has hedged its foreign exchange risk to the extent of 50%. The lack of a formal system for managing foreign exchange risk could adversely affect profitability. Since RCF plans to expand its trading activities, this risk is all the more serious.

Strengths and Areas of Concern

Strengths

Low Cost Producer : RCF is one of the low cost producers of both urea and complex fertilisers. This will enable the company to do well in a decontrolled scenario. In the past also, when government withdrew the subsidies on complex fertilisers, RCF could make profit while the others in the industry made losses.

Locational advantage : RCF's production units are located on the western coast of India. This will enable the company to import its raw materials for complex fertilisers at lesser cost compared to its competitors.

Multi-product manufacturing facilities : Since RCF is in the business of manufacture of urea, complex fertilisers, industrial chemicals etc, it can easily switch its products depending upon the market conditions and can survive in case of unfavourable market conditions for one of them.

Demand and supply imbalance : Imbalance between domestic production and consumption exists in fertiliser industry in India and is likely to continue in the foreseeable future. This will help the company to operate at full capacity and will enable to generate profits.

Areas of Concern

Energy inefficient Plants : RCF's plants are energy inefficient. If energy prices move up sharply, RCF's profitability will be affected sharply. Levels of power and steam consumption are unfavourable compared with its competitors.

Erratic supply of feedstock : The feedstock used by RCF is natural gas. Its competitiveness is impaired by uncertain gas supply from GAIL.

Recommendations

The Commission in its earlier Reports had dealt with other fertiliser companies in Public sector such as NFL, FACT, MFL etc. Out of the total urea production capacity in the country, public sector and co-operative sector account for 26% and 19% respectively. The rest of the capacities are owned by private sector. The domestic demand for urea is far in excess of the domestic production and imports are allowed to bridge the gap. **Under these circumstances, Commission would like to reiterate its views which it had expressed while giving its recommendations on NFL [Report VII (2.5)] viz., that the market structure in the Urea segment is competitive, Urea is a well-traded commodity in the international markets and any shortage in domestic supplies can be easily met through imports. RCF's share in Urea supply in the country is very low i.e., around 8.3% only and in complex fertilisers, its market share is less than 10%. Hence the Commission classifies RCF as non-core.**

As has been discussed above, RCF is one of the low cost producers of Urea in India. The company has two manufacturing facilities viz., Trombay and Thal. The Trombay facility is old and was incurring losses till the recent past. The unit started making profits due to modernisation and revamping. The Thal unit is a relatively new facility, which RCF set up in 1985. The unit produces urea at very low cost. This is primarily due to the modern facilities, economic size of the plant and efficient operations.

Currently Government regulates the pricing and distribution of Urea. Government fixes retention prices of urea for each production unit based on the cost of production of that unit. Hence under this scheme, RCF cannot reap the full benefit of its low cost of production. Once the Government decontrols Urea fully or partially, RCF's profits would increase substantially since its cost of production is very low and it would be able to charge prices equal to those charged by other higher cost producers. A free-pricing scenario for Urea would benefit RCF immensely since Urea contributes nearly 50% of RCF's turnover. Further, the company is planning to expand its capacity at Thal by about one million. This will enable the company to exploit the market more under a decontrolled scenario.

As has been mentioned above, under a future decontrolled scenario, RCF would benefit due to its low cost of production. However, for its future expansion and modernisation, RCF would have to keep pace with the technology changes that would reduce costs. Further, it may require financing also for meeting its future expansion programmes. The Commission is of the view that in case a strategic partner is inducted in RCF, the company could further enhance its profitability by accessing latest technology, additional financial resources etc. **The Commission therefore, recommends that a minimum of 51% of RCF's equity should be offered to a strategic buyer with transfer of management control. The selection of strategic buyer should be done through global competitive bidding.** It would enhance investor interest and valuation if Government could spell out its fertiliser policy and retention pricing mechanism before the strategic sale. At a later stage, GoI could disinvest its balance holding if any, through one or more public offerings.

2.5 RASHTRIYA ISPAT NIGAM LIMITED

Evolution

Rashtriya Ispat Nigam Limited (RINL) was set up in February 1982 with its Registered office located at Vishakapatnam. The Vishakapatnam Steel Plant was conceptualised in April 1970, under the aegis of SAIL, as an integrated plant adjacent to a seaport with a view to promoting exports of finished steel. The technology originally conceived was Russian, using continuous casting technology being implemented in India for the first time with an estimated cost of Rs. 2256 crore. Due to several delays, the plant was eventually commissioned in 1992, i.e. 22 years after it was initially conceived. This delay in commissioning of the project led to its overcapitalisation, from which it has never recovered.

In 1985, RINL approached Government with revised cost estimates of Rs 7464 crores which led the Government to critically review the project and the time schedule. It constituted a high level committee to recommend an alternative for implementation of the project with rationalisation and a Rationalised project report was finalised in 1985. According to this report, the capacity was reduced to 3.0 mt of liquid steel per annum with a corresponding decrease in the project cost to Rs 6849 crores. Certain technological changes were suggested from the original concept of the project. While the project cost did go down, the technical changes resulted in an imbalance in the manufacturing process.

The plant units were eventually commissioned in a phased manner from 1990 and the 3 million tonne liquid steel capacity was commissioned in August 1992, 5 years behind schedule. Whilst the project was declared as commissioned in 1992, the first full year of commercial production was the financial year 1993-94. Today, RINL is a fully integrated steel plant with the capability to manufacture value added steel from iron ore.

The paid up capital of RINL is Rs. 6494.85 crore (comprising Rs.4889.85 crore of equity, Rs. 1604 crore of 7% redeemable preference Shares) and Rs. 1333.47 crore as share money pending allotment from Government as on 31st March, 1998. Government of India holds the entire equity of RINL.

Industry Analysis

Finished steel production in India has grown from a mere 1.1 million tonnes in 1951 to 23.15 million tonnes in 1998-99. Steel consumption growth has high correlation to GDP growth. If the average of growth of steel consumption for the years 1991-92 to 1998-99 were to be taken, it exhibits an elasticity coefficient factor of about 1.1 with reference to GDP growth. However, in the last few years, higher GDP growth has not led to a corresponding increase in steel consumption.

Historical perspective - in India

Till about the mid 80s, integrated steel making was essentially in the government sector in India. A host of small steel making units based on small capacity electric arc furnaces / induction furnaces and re-rolling mills were established in the private sector in the 70s. During the first two decades of planned economic development i.e., 1950-1970, the average annual growth rate of steel production exceeded 8%. However, this growth rate could not be maintained during 1970-80 and it came down to 5.7% per annum, picking up marginally to 6.4% per annum during 1980-90.

During post liberalisation period, i.e. after 1991, a large number of new / green field steel plants were planned to be commissioned or implemented and the investment therein is expected to be around Rs. 20,000 crores.

By mid 90s, the industry started growing at a rate of 15%. However by mid 1996, growth had flattened out. The increased availability of imported iron and steel materials at very low prices has further intensified competition amongst the domestic producers in the steel market.

Currently, the steel industry has been severely affected by the general economic slowdown. Major infrastructure projects are yet to take off and the demand from major consuming sectors has remained slack. Besides, dumping of cheap steel by CIS and other countries has posed serious problems for all steel producers in India.

Regulatory environment in India

The adoption of a series of major economic policy decisions since July 1991 has had far-reaching implications for the Indian steel industry. The delicensing of the steel industry in late 1980s together with the removal of controls on distribution and prices and imports in the early 1990s witnessed additions to the total capacity of steel production and consequently, higher availability and consumption in the country.

Due to liberalisation and opening up of the steel sector, there has been a shift in the percentage share of public sector production to private sector production. The estimated share of public sector in Indian steel industry in 1998-99 was 33% as against 41% in 1995-96. More and more capacities are coming up in private sector and it is estimated that the share of public sector would eventually come down to 15% by FY 2005.

Comprehensive strength of Indian steel industry

Indian steel industry has tremendous strength such as:

- Availability of high quality iron ore at lower prices
- Highly skilled manpower and comparatively lower levels of wages
- High demand potential as per capita consumption in India is low.
- One of the lowest cost producers of steel

However, the growth rate of steel consumption has been around 2-3% during the last three years. The slow down is mainly attributable to:

- Sluggish demand in the steel consuming sectors via construction industry, capital and engineering goods, auto sector, white goods sector reinforced by lack of major projects in oil sector, power sector, fertilisers sector.
- Overall economic slow down in the country – All major sectors of the economy have been facing an economic slow down including power, coal, cement, mining and steel.
- Continuous reduction in import duty and increase in excise duty on iron and steel.

- Many capacities have been introduced in the country on the basis of previous demand projections, leading to over supply situation.
- Cost escalation in the input materials for steel such as coal prices, power tariff etc.

As a result, the industry is saddled with large inventories and profit margins of large steel companies have been almost eroded.

Steps taken by the government in the year 1999-2000

In the union budget for 1999-2000, Government has placed special emphasis on revival of the Indian economy through several means, which inter alia include accelerated development of the infrastructure sector, irrigation projects, housing projects and rural water supply schemes.

The total installed capacity of crude steel in the country has been provisionally estimated at 32.88 million tonnes during 1997-98. The quantity of crude steel produced during 1997-98 was 24.71 mt. Though steel companies have not been performing well, the domestic consumption of steel has registered a marginal growth of 3% to 23.4 million tonne in 1998-99 from 22.63 million tonne in the previous year. The flat products registered a 3% demand growth whereas the non-flat steel products used in construction grew by 4%.

While the demand has stagnated for almost all the categories of steel during 1998-99, the excess supply prevailing throughout the year in the market has compelled the producers to sell their materials reluctantly at prices much below the reasonable levels. The following table gives the domestic consumption of iron and steel for FY 99:

Table 1 : Domestic Consumption of Iron and Steel in FY99. ('000 tonnes)

Category	Sales - Main Producers	Sales - Secondary Producers	Import	Total supplies
Pig iron	858	1600	2	2460
Semis	2783	4002	400	7185
Bars and rods	2815	5300	60	8175
Structurals	1090	1700	70	2860
Plates	1165	565	160	1890
HR Coils	2220	1475	600	4295
HR Sheets	267	160	40	467
CR Coils/sheets	1025	1405	230	2660
Galvanised plates/coils	310	855	50	1215
Electrical sheets	53	52	75	180
Tin plates	32	70	120	222
Pipes	62	275	50	387
Railway materials	442	80	50	572
Total finished steel	9757	11937	1505	23199

On the export front, the continuous downward slide of international prices and flow of the cheap material from South East Asian Countries led by Japan and South Korea has prevented Indian Steel Exporters from enhancing their presence abroad. In 1998, total export of saleable steel plummeted to around 1.9 million tonnes which is nearly 25% lower compared to that in the previous year.

Business Analysis

RINL is engaged in the production of iron & steel products. Its main products are pig iron, semi-finished products such as billets and blooms, long steel products such as wire rods, bars, rounds and structurals. The production of hot metal, pig iron, crude steel and saleable steel of RINL for the past five years is as follows:

Table 2 : Trend in production in the past 5 years (000 tonnes)

Year	Hot metal	Pig Iron	Crude steel	Saleable Steel
1993-94	2369	985	1355	1184
1994-95	2836	848	1940	1560
1995-96	3213	771	2381	2136
1996-97	3213	700	2423	2136
1997-98	3165	521	2542	2250

Due to imbalanced production facilities, RINL is producing huge quantities of pig iron and semi-finished products which are very low value products. This has affected the profitability of RINL also.

1993-94 was the first full year of commercial production. The company achieved a turnover of Rs 3028 crores in 1995-96 and has consistently maintained those levels till 1997-98. A decline in sales was observed in 1998-99 due to the recessionary conditions prevailing in the economy. Exports have contributed 15% of the total turnover in 1997-98 amounting Rs.488 crores (on an annualised basis), which is lower than the 1995-96 figures. The domestic and export sales data for the past five years are as follows:

Table 3 : Domestic Sales and Exports (Rs.Crore)

	FY 99*	FY 98	FY 97	FY 96	FY 95
Domestic	2220	2839	2367	2332	1761
Exports	329	489	661	707	453
Total	2549	3327	3028	3039	2215

* Provisional

The proportion of pig iron and billets in total domestic sales has declined over the years while sale of blooms, wire rods, rounds and structurals has shown an increase over the corresponding period. Realisations have been declining in the domestic market primarily on account of the economic recession and the resultant oversupply of steel. Prices of steel, after remaining steady over a period of time, have declined in the recent past due to the same reasons.

In the export market, pig iron constitutes a large proportion. Export of blooms and billets is almost negligible in the year 1998-99 and is at considerably lower levels than the previous year. Exports of long products have also declined at levels in 1998-99 lower than the base year levels of 1994-95. Pig iron exports by RINL have dropped from 443,000 tonnes to 236,000 tonnes in 1998-99 though it continues to form the highest proportion followed closely by wire rods.

The increasing weightage to finished products in total sales is beneficial to the company since they are higher value added products as compared to pig iron and billets. In addition, sales of billet is not an attractive proposition for RINL since billets are sold to local re-rollers thereby increasing competition in the market for the existing mills of RINL. The contribution analysis of RINL's product mix is given in the table below:

Table 4 : Contribution of various products

	Sales Price (Rs/T)	Variable Cost (Rs/T)	Contribution/ Ton
Pig Iron	5023	4056	967
Blooms	8049	5781	2268
Billets	8597	6113	2484
LMMM Products	10507	6499	4008
WRM Products	11047	6683	4364
MMSM Products	9709	6557	3152
Saleable Steel	9889	6436	3453

The main raw materials used in manufacture of steel are coal and iron ore. RINL has to depend on outside source for these three raw materials. Nearly 80% of the total coal requirements is met from imports from Australia. RINL procures its iron ore requirements from Bailadila mines of NMDC. In the case of iron ore, it has to incur heavy freight to transport the ore from Madhya Pradesh.

RINL employs 17,400 employees. Approximately one-third of them have been employed by the company for accommodating those displaced in the process of acquisition of land.

Financial Analysis

The financial performance of RINL for the past five years is as follows:

Table 5 : Financial Highlights (Rs Crores)

	FY98*	FY97*	FY96	FY95	FY94
Operating Income	3070.9	3135.3	3038.6	2208.6	1751.0
Operating Profit	478.5	625.2	648.7	436.3	129.1
Profit after Tax	-412.6	-245.9	-204.3	-364.3	-572.7
Equity Capital	4889.8	4889.8	4889.8	4889.8	4889.8
Pref. Share Capital	1604.0	1604.0	1604.0	1604.0	1604.0
Tangible Networth*	4196.6	2858.0	3315.8	3529.0	3890.9
Gross Margin (%)	45.0	36.0	41.0	37.0	36.0

Note : Other financial ratios are not shown as they are negative and hence meaningless

* Annualised;

*(Equity Share Capital + Preference Shares + Share Money Pending Allotment) – (Accumulated Losses + Deferred Expenses Not Written off)

As can be seen from the above table, the company has been making losses since inception. Reasons cited for the company's dismal performance include inadequate budgetary support, teething problems arising due to technological imbalances and enormous interest costs. In addition, continuous casting technology had been introduced in India for the first time and there were additional problems that arose due to inadequate training of skilled manpower leading to lower productivity. While the company could successfully reduce its losses till 1995-96, any further chances of breaking even were thwarted due to the recessionary conditions prevailing in the economy, in general, and the steel sector, in particular.

As on 31/3/98, accumulated losses amounted to Rs 3626 crores, implying that approximately 46% of the net worth has been eroded. Thus the Company was caught in a vicious circle wherein due to losses and inadequacy of internal funds, more loans were taken, which, in turn, resulted in increasing the interest burden.

Interest and finance charges are incurred on loans availed from the Government of India, other public sector units and banks. The interest expense as a percentage of sales has declined from 1990-91 (78%) to 1992-93 (23%). This was on account of capital restructuring which was effected as on 31 July 1992 wherein a part of the Government loan was converted into non-cumulative preference capital. Details of the first capital restructuring are given below. In the years 1995-96 to 1997-98, interest expenses had stabilised to 11 to 13% approximately. In 1997-98, interest amounted to 11% of the sales after the Government had waived interest charges till September 1997 and converted its loan to preference capital. If the interest payable were to be added back, then the interest charge as a percentage of sales would increase to 15%.

Interest as a percentage of loans has increased to 17.5% in 1997-98 as compared to 8% in 1991-92. This is primarily on account of decrease in volumes of loan in the later years while the interest charges over the years has increased.

First Financial Restructuring (FRS-1)

The Government approved the first capital restructuring scheme in July, 1993, the main features of which are as follows:

1. GoI loans outstanding as on 31/3/92 amounting to Rs. 2369 crore were converted into equity (Rs.1184 crore) and preference shares (Rs.1185 crore)
2. Interest of Rs.791 crore on GoI loans upto 31/7/92 was converted into 7 year interest free loan
3. GoI loan received after August 1992 during 1992-93 would be converted into preference shares
4. GoI loans receivable in 1993-94 would be converted into preference shares after a review
5. Funds to meet project requirement (assessed at Rs.1507 crore) would be provided by GoI
6. Penal interest leviable upto June 1992 on GoI loan was waived.

In turn, Government set challenging tasks for RINL viz.

- Achieve 100% capacity utilisation in 1996-97
- 1997-98 to be the first year of net profit
- 2004-05 to be the first year of cumulative net profit

RINL could not achieve the targets set above and the reasons cited by management included inadequate support from GoI (Rs. 1160 crore instead of Rs. 1507 crore) of which Rs. 542 crore was interest bearing loan.

Second Financial Restructuring (FRS-II)

GoI approved a second restructuring in May, 1998. Under this package, GoI had converted the outstanding loan into equity capital. The interest bearing loan of Rs. 542 crore and interest free loan of Rs. 791 crore were converted into preference shares. At the time of approval of the second restructuring, GoI had directed the company to submit a revival plan to be drawn in consultation with consultants. Accordingly, RINL appointed AT Kearney and MECON to work on the revival plan. These consultants have since submitted their recommendations, which are presently under the consideration of the GoI.

RINL is currently making huge losses, which has resulted in partial erosion of its networth. Presently, the company is about to get reported to BIFR. The proposal before the GoI comprises of a revival package and a financial restructuring (FRS-III) to keep the company from being referred to BIFR.

Strengths & Areas of Concern

Strengths

Integrated Steel Plant with modern technology : RINL was set up in eighties and has all modern facilities for steel making. It has the continuous casting technology which is energy saving technology.

Coast location : RINL's plant is the only integrated steel plant which is coast based. This has enabled RINL to export its products and import coal without incurring extra freight for inland transport. This has however, been partially offset by higher freight cost for transport of iron ore.

Operating efficiencies : RINL's operating efficiencies such as blast furnace, energy consumption etc. are better than its competitors.

Areas of Concern

Over Capitalisation : The undue delay in setting up this plant has resulted in massive interest and depreciation costs with consequent over capitalisation. In order to enable RINL to be competitive, it has to have sustained high capacity utilisation.

Technological imbalance : As stated earlier, in order to minimise the effect of time and cost over-run, certain facilities were not set up in the initial phase. This has resulted in operational imbalance and the plant is currently producing low margin products such as pig iron, billets etc.

Weak financials : As the company has been incurring losses since inception, its financial position has become very weak. The company is no longer in a position to raise funds from the market on its own strength.

Recommendations

As has been discussed above, the commissioning of RINL took 22 long years after it was initially conceived. The initial project cost was estimated at Rs. 2256 crore, which eventually ended at a total cost of more than Rs. 9000 crore, even after curtailing certain facilities. This has resulted in excessive interest and depreciation burden on the company and made RINL a loss-making company since it was commissioned. The upturn in steel prices, which reached its peak in 1995-96, enabled the company to mitigate the financial stress.

Currently, the industry is in downturn and steel consumption has remained stagnant for the last two years. This has resulted in further losses to the steel companies, as there has been a situation of over supply in almost all the steel products. Steel industry in India is completely decontrolled with the presence of large number of private producers. Imports are now being freely permitted with declining import duties. Hence, the market has become fully contestable. The Commission is, therefore, of the view that no public purpose would be served by retaining RINL under government ownership. **Hence the Commission classifies RINL as non-core.**

RINL iron making and steel making facilities are comparatively new. It has amongst the best operating parameters in the industry. However, due to unbalanced facilities, RINL has to produce large quantities of low value pig iron and semi-finished steel. This has also affected the profitability of the company. All these factors have contributed to the huge accumulated losses of Rs. 3,626 crore as on 31/3/98. The company is on the verge of being referred to BIFR as 50% of its networth is close to being wiped-off. In the past, GoI had twice undertaken financial restructuring which prevented the company from being referred to BIFR. This was done through conversion of debt into equity. This has resulted in a large capital base of Rs. 7,827 crore for RINL (including Rs. 1,333 crore as share money pending allotment). The past two financial restructuring packages failed to address any of the company's basic structural problems. With mounting losses, the company has approached the Government for the third time for assistance to prevent further erosion of networth. While approving the second financial restructuring package, GoI had appointed management consultants to look into the operations of the company and suggest restructuring to make RINL a profitable company. The

third restructuring package is based on the consultants recommendations. The main features of this package are as follows:

- Write-off of accumulated losses in phases against equity capital of the company.
- Capacity expansion from 2.7 million tonne to 4 million tonne with a total cost of Rs. 1742 crore.
- Hiving off power plant into a separate subsidiary company to generate cash.
- Seeking out strategic alliance for achieving further growth.

From the above proposal, it is clear that the company needs substantial financial support from GoI for financial restructuring and capacity expansion. The accumulated losses have to be written off against equity capital. In the past, GoI had converted its loans into equity capital. In this manner, Government has had to write-off its loans, which it had given to RINL. The revival of the company solely on the basis of GoI support will involve huge cash outflow from GoI apart from substantial write-offs, which would not be justified and is avoidable. Given its past track record of project execution, the Commission is of the view that capacity expansion would be more expensive in terms of time and money for the company if undertaken while remaining under GoI control.

In these circumstances, **the Commission recommends that GoI should write-off the entire accumulated losses of RINL against its entire 'Share Money Pending Allotment' and 'Preference Share Capital' and part of Equity Capital to keep the company from being referred to BIFR and to clean up its balance sheet. Simultaneously, the Government should initiate the process of disinvestment of not less than of 51% of its remaining equity holding in RINL to a strategic buyer. The write-off of accumulated losses will not entail any cash outflow and would enable better realisation from the strategic buyer. As the plant is port based and its facilities are comparatively new and are operating efficiently, the Commission feels that there would be investor interest in acquiring RINL after the balance sheet is cleaned up. The selection of the strategic buyer should be done through global competitive bidding by pre-qualification of bidders. At a later stage, when the steel market improves and RINL starts making profit, GoI could disinvest its balance holding, through one or more public offerings.**

APPENDICES

Terms of Reference of the Commission

MINISTRY OF INDUSTRY
(Department of Public Enterprises)

RESOLUTION

New Delhi, the 23rd August, 1996

No. 11013/3/96-Admn. - In pursuance of the Common Minimum Programme of the United Front, Government hereby constitutes a Public Sector Disinvestment Commission, initially for a period of three years.

2. The composition of the Commission will be as follows :-
1. Shri G.V. Ramakrishna, Full-time Chairman
 2. Shri Dipankar Basu, Part-time Member
 3. Shri M.R.R. Nair, Part-time Member*
 4. Dr. Suresh Tendulkar, Part-time Member
 5. Dr. D.M. Nanjundappa, Part-time Member

The commission will have a full-time Secretary who will be appointed separately.

Shri G. Ganesh was appointed Member-Secretary vide Government of India Notification No. 13/18/97-ED(SMI) dated 11-12-1997 vide Shri P. Shankar.

3. The broad terms of reference of the Commission are as follows :-
- I. To draw a comprehensive overall long term disinvestment programme within 5-10 years for the PSUs referred to it by the Core Group.
 - II. To determine the extent of disinvestment (total/partial indicating percentage) in each of the PSU.
 - III. To prioritise the PSUs referred to it by the Core Group in terms of the overall disinvestment programme.
 - IV. To recommend the preferred mode(s) of disinvestment (domestic capital markets/international capital markets/auction/private sale to identified investors/any other) for each of the identified PSUs. Also to suggest an

* Shri Rajendra Singh, C.M.D., N.T.P.C. has been appointed part time Member in place of Shri M.R.R. Nair, vide Deptt. of Public Enterprises Resolution No. A-12023/2/97-Admn. dated 14-10-1997.

appropriate mix of the various alternatives taking into account the market conditions.

- V. To recommend a mix between primary and secondary disinvestments taking into account Government's objective, the relevant PSU's funding requirement and the market conditions.
 - VI. To supervise the overall sale process and take decisions on instrument, pricing, timing, etc. as appropriate.
 - VII. To select the financial advisers for the specified PSUs to facilitate the disinvestment process.
 - VIII. To ensure that appropriate measures are taken during the disinvestment process to protect the interests of the affected employees including encouraging employees' participation in the sale process.
 - IX. To monitor the progress of disinvestment process and take necessary measures and report periodically to the Government on such progress.
 - X. To assist the Government to create public awareness of the Government's disinvestment policies and programmes with a view to developing a commitment by the people.
 - XI. To give wide publicity to the disinvestment proposals so as to ensure larger public participation in the shareholding of the enterprises; and
 - XII. To advise the Government on possible capital restructuring of the enterprises by marginal investments, if required, so as to ensure enhanced realisation through disinvestment.
4. The Disinvestment Commission will be an advisory body and the Government will take a final decision on the companies to be disinvested and mode of disinvestment on the basis of advice given by the Disinvestment Commission. The PSUs would implement the decision of the Government under the overall supervision of the Disinvestment Commission.
 5. The Commission while advising the Government on the above matters will also take into consideration the interests of stakeholders, workers, consumers and others having a stake in the relevant public sector undertakings.

**S. Talwar,
Joint Secretary**

Modified Terms of Reference of the Commission

**MINISTRY OF INDUSTRY
(Department of Public Enterprises)**

RESOLUTION

New Delhi, the 12th January, 1998

No. 11013/3/96-Admn. - In partial modifications of this Ministry's Resolution No. 11013/3/96-Admn. dated 23-8-96 constituting the Public Sector Disinvestment Commission, Paras 3, 4 and 5 thereof are deleted and substituted by the following :-

- 3(i) The Disinvestment Commission shall be an advisory body and its role and function would be to advise the Government on Disinvestment in those public sector units that are referred to it by the Government.
- 3(ii) The Commission shall also advise the Government on any other matter relating to disinvestment as may be specifically referred to it by the Government, and also carry out any other activities relating to disinvestment as may be assigned to it by the Government.
- 3(iii) In making its recommendations, the Commission will also take into consideration the interests of workers, employees and others stake holders, in the public sector unit(s).
- 3(iv) The final decision on the recommendations of the Disinvestment Commission will vest with the Government.

**S. Talwar,
Joint Secretary**

List of PSUs referred to the Commission

First List - September, 1996

S.No Name of the PSU

1	Air India	AI
2	Bharat Aluminium Co. Limited	BALCO
3	Bharat Earth Movers Limited	BEML
4	Bharat Electronics Limited	BEL
5	Bongaigaon Refineries & Petrochemicals Limited	BRPL
6	Container Corporation of India Limited	CONCOR
7	Engineers India Limited	EIL
8	Fertiliser & Chemicals (Travancore) Limited	FACT
9	Garden Reach Shipbuilders & Engineers Limited	GRSEL
10	Gas Authority of India Limited	GAIL
11	Hindustan Aeronautics Limited	HAL
12	Hindustan Copper Limited	HCL
13	Hindustan Latex Limited	HLL
14	Hindustan Zinc Limited	HZL
15	Hotel Corporation of India Limited	HCIL
16	HTL Limited	HTL
17	IBP Co. Limited	IBP
18	India Tourism Development Corporation	ITDC
19	Indian Petrochemical Corporation Limited	IPCL
20	ITI Limited	ITI
21	Kudremukh Iron Ore Co. Limited	KIOCL
22	Madras Fertilisers Limited	MFL
23	Mahanagar Telephone Nigam Limited	MTNL
24	Manganese Ore (India) Limited	MOIL
25	Modern Food Industries (India)Limited	MFIL
26	National Aluminium Co.Limited	NALCO
27	National Fertilisers Limited	NFL
28	National Hydro Power Corporation	NHPC
29	National Thermal Power Corporation Limited	NTPC

30	Neyveli Lignite Corporation Limited	NLC
31	Northern Coal Fields Limited	NCF
32	Oil India Limited	OIL
33	Oil & Natural Gas Corporation	ONGC
34	Pawan Hans Helicopters Limited	PHL
35	Power Grid Corporation of India Limited	POWERGRID
36	Rail India Technical & Economic Services Limited	RITES
37	Shipping Corporation of India Limited	SCI
38	South Eastern Coal Fields Limited	SECF
39	Steel Authority of India Limited	SAIL
40	Western Coal Fields Limited	WCF

Second List - March, 1997

1	Hindustan Vegetable Oil Corporation Limited	HVOC
2	Nepa Limited	NEPA
3	Electronic Technology & Trade Dev. Corpn. Limited	ET&TDC
4	Hindustan Prefab Limited	HPL
5	Ranchi Ashok Bihar Hotel Corporation Limited	R-ASHOK
6	Pyrites, Phosphates & Chemicals Limited	PPCL
7	Central Electronics Limited	CEL
8	Engineering Projects (India) Limited	EPIL
9	Utkal Ashok Hotel Corporation Limited	UL-ASHOK
10	Rehabilitation Industries Corporation Limited	RICL

Third List - July, 1998

1	Minerals and Metal Trading Corporation	MMTC
2	State Trading Corporation of India Ltd	STC
3	Project & Equipment Corporation of India Ltd.	PEC
4.	Hindustan Steel Works Construction Ltd.	HSCL
5.	Metal Scrap Trade Corporation Ltd.	MSTC
6.	Metallurgical and Engineering Consultants (I) Ltd.	MECL
7.	National Mineral Development Corporation Ltd.	NMDC
8.	Sponge Iron India Ltd.	SII
9.	Paradeep Phosphates Ltd.	PPL
10.	Mineral Exploration Corporation Ltd.	MEC

Fourth List - January, 1999

1.	Heavy Engineering Corporation Ltd.	HEC
2.	Hindustan Organic Chemicals Ltd.	HOCL
3.	Hindustan Insecticides Ltd.	HIL
4.	Indian Drugs & Pharmaceuticals Ltd. (BIFR)	IDPL
5.	Hindustan Antibiotics Ltd. (BIFR)	HAL
6.	Bengal Immunity Ltd. (BIFR)	BIL
7.	Smith Stanistreet & Pharmaceuticals Ltd. (BIFR)	SSPL
8.	Bengal Chemicals & Pharmaceuticals Ltd. (BIFR)	BCPL

Fifth List - January, 1999

1.	Bharat Heavy Electricals Ltd.	BHEL
2.	CMC Ltd.	CMC
3.	Rashtriya Chemicals & Fertilizers Ltd.	RCF
4.	Rashtriya Ispat Nigam Ltd.	RINL

List of PSUs withdrawn from the Commission

1. Bharat Earth Movers Limited	BEML
2. Bharat Electronics Limited	BEL
3. Garden Reach Shipbuilders and Engineers Limited	GRSEL
4. Hindustan Aeronautics Limited	HAL
5. South Eastern Coal Fields Limited	SECF
6. Western Coal Fields Limited	WCF
7. Northern Coal Fields Limited	NCF
8. CMC Limited	CMC

List of PSUs referred to the Commission which are already under reference to BIFR.

1. Heavy Engineering Corporation Ltd.	HEC
2. Indian Drugs & Pharmaceuticals Ltd.	IDPL
3. Hindustan Antibiotics Ltd.	HAL
4. Bengal Immunity Ltd.	BIL
5. Smith Stanistreet & Pharmaceuticals Ltd.	SSPL
6. Bengal Chemicals & Pharmaceuticals Ltd.	BCPL

General Recommendations by the Commission and action taken thereon by Government.

A. General Recommendations

1. Establish Disinvestment Fund (I:3.1, II:1, V:1 and VII:1)

The proceeds from the disinvestment may be placed, separately in a 'Disinvestment Fund' and the National Renewal Fund should also be merged with this Fund. The resources of the Fund may be primarily used for

- temporary funding of losses of some PSUs in preparation of disinvestment,
- for providing benefits to workforce found to be surplus
- for conducting the publicity campaign for the disinvestment of PSU shares

The Fund would also help the government in undertaking disinvestment at the most opportune time in the market for maximum realisations.

A reasonable percentage of Disinvestment Fund should be earmarked for funding social infrastructure for promoting rapid growth of the economy.

Action Taken : According to Government communication, Fund had been set-up in September 1996. Details regarding the scope or purpose are not available.

2. Delink the disinvestment process from the Budgetary Exercise of Government (IV:1)

Linkage of the implementation of disinvestment with the budgetary exercise may hinder achievement of the larger objective of the disinvestment exercise.

Action Taken : Decision awaited.

3. Standing Empowered Group (I:4.1)

Given the advisory nature of the Commission, the Commission recommends formation of a Standing Empowered Group (SEG) to ensure smooth

implementation of its recommendations. SEG may also be entrusted with the selection of Financial Advisors, supervision of the overall sale process and decisions on instrument, pricing, timing, etc. SEG could comprise the Cabinet Secretary, Secretaries of the Ministry of Finance, Department of Public Enterprises, Administrative Ministry of PSU alongwith the CEO of the concerned PSU.

Action Taken : Core Group has been empowered as recommended.

4. Transfer of Management (V: 1)

While selling a substantial stake in the Undertaking, management would be transferred to the strategic buyer and the time frame for a further dilution of its share holding, where necessary, as agreed with the strategic buyer.

Action Taken : Decision Awaited.

5. Reduction of Government Equity (V: 1)

The Commission also recommended that in the interest of establishing credibility with the strategic buyers, the Government may, where necessary, keep its direct share holding below the level of investment being offered to the strategic bidder by divesting some portions of its equity to multilateral financing institutions, private equity funds, mutual funds and a few select PSUs, who have business interest in the particular PSU being disinvested.

Action Taken : Decision Awaited.

6. Referral of PSUs to the Commission (V:1)

The matter whether a PSU should be considered by the Commission for disinvestment or not should be sorted out between the SEG and the administrative ministry before the referral to the Commission. This would avoid wastage of the Commission's time and efforts and Government resources. Also, the subsidiaries of PSUs should not be referred to the Commission, as the decision in this regard would have to be taken by the Boards of Management of the concerned parent PSU.

Action Taken : Government has decided not to refer subsidiaries of PSUs to the Commission.

7. Voluntary Retirement Scheme (II:1 and IV:1)

Commission recommends that Government should frame a clear cut policy statement on the terms of VRS on a stable and long term basis and also suggest a modality for the implementation of VRS. A pension cum insurance scheme could be thought of as an alternative to a one-time payment.

Action Taken : Decision awaited

8. Disinvestment without reference to the Commission (III:1 and IV:1)

Disinvestment of the PSUs whether through Joint Venture participation or strategic sale not referred to the Commission, is likely to deny the benefits of detailed consideration by an independent body. Therefore, Government should review the position and decide whether such cases should be kept outside the purview of the Commission.

Action Taken : Decision awaited

9. Public Offer of equity by the PSUs referred to the Commission (III:1)

Primary issue by any PSU referred to the Commission, without involvement of the Commission, would be inconsistent with the terms of reference of the Commission to take a co-ordinated view or to recommend a mix between primary and secondary disinvestment.

Action Taken : Decision awaited

10. Disinvestment Package (IV:1)

The Commission reiterates that undertaking disinvestment without implementing the general recommendations of the Commission, - in particular those relating to corporate governance, managerial autonomy, managerial remuneration, accountability, incentives, professionalising the Board of Management and restructuring where necessary - would result in undervaluation of Government shares and loss to the national exchequer.

Action Taken : Decision awaited

11. Restoration of Monitoring and Supervision Powers (VII:1 and VIII:1)

The Commission is of the view that the disinvestment process can be an important instrument for building up a lean and strong public sector and for providing funds for development. The amendment dated 12 January 1998 of the terms of reference of the Commission has considerably diluted the role of the Commission in the disinvestment process. It limits even its advisory functions apart from removing overall monitoring and supervisory functions. The role of Commission as an advisory body without powers of monitoring and supervision of the overall disinvestment process renders the Commission ineffective. Therefore, the powers of monitoring and supervision as envisaged in the earlier Government notification dated 23 August 1996 should be restored.

Action Taken : Decision awaited

12. Setting Up of Full-time Implementation Machinery (VII:1 and VIII:1)

In order to get the best prices for the shares disinvested by Government, particularly in the undertakings that will remain in the public sector, it is essential to time the sale under favourable market conditions. Timely action to select the financial advisers and a close watch on market conditions are necessary to get the best results. The Commission therefore recommends that a full time **implementation machinery** under the Ministry of Finance including public sector merchant bankers be set up under Government with a clear mandate. This machinery will select financial advisers and put through the sale of shares, either through offer of sale or by strategic sale and get the best price for the shares within a reasonable price band, that should be approved in advance by Government.

The implementation group should seek the advice of the Commission whenever necessary and be subject to the overall supervision of the Commission.

Action Taken : Decision awaited

13. Presenting the Commission Report in its entirety before the Cabinet (VII:1)

The Commission is not aware if all its recommendations have been taken before Cabinet for decision. The Commission would emphasise that both its general and specific recommendations should not be filtered by official groups but should be placed before the Cabinet in their entirety to enable Government to appreciate the interconnected strategy of the various recommendations and take decisions thereon. The Chairman of the Commission may be invited, wherever necessary, to the meetings of the Cabinet, to offer clarifications on the recommendations of the Commission.

Action Taken : Decision awaited

14. Disinvestment through Strategic Sale to optimise realisation under the present state of Capital Markets (VIII:1)

In view of the present state of the Indian and Overseas Capital Markets, offerings in these markets may not achieve optimum realisation. The Commission, therefore, suggests giving a big push to strategic sales of PSUs recommended by the Commission. At the present juncture, the advantages of such a big push operation for strategic sales are many. They are :

1. Since strategic sales depend not on capital market conditions but on the intrinsic value of the concerned enterprises, they can be undertaken straightaway.
2. The response to the offer of strategic sales will send the right signals about the confidence of the international community in the Indian economy. This will also stimulate foreign direct investment in India.
3. Substantial amounts of foreign exchange can be earned to strengthen our foreign exchange reserves.
4. Successful strategic sales will boost the confidence of the Foreign Institutional Investors and induce their increasing support to the Indian capital market. This will also encourage domestic investors. Even the GDR market is likely to pick up as a result of successful strategic sales.
5. Government's realisation from proceeds of disinvestment would be substantial.

Action Taken : Decision awaited

B. Guidelines on Modalities

1. Offer of Sale (I:4.2 and II:1)

“Book building” process similar to that followed in the international market for GDR issue should be followed for Domestic Offer of Sale to institutions also.

Action Taken : Book Building followed in GDR issues.

2. Strategic Sale (I:4.2 and V:1)

Detailed and transparent procedure for the selection of strategic partners recommended including the selection of Financial Advisors for strategic sale. In order to ensure that the strategic partner brings in necessary technological and financial inputs the selection should be made through a process of pre-qualification.

The Government should assure the strategic buyer of its commitment to withdraw from the PSU by spelling out the details, including the time frame. The restructuring and VRS measures should be implemented before inviting the offer for strategic sale for realising the efficiency gains in the disinvestment proceeds.

The Commission recommends that the Government may keep its direct share holding below the level of investment being offered to the strategic bidder by divesting some portion of its equity to multilateral financing institutions, private equity funds, Mutual funds and a few select PSUs who have business interest in the particular PSU being disinvested.

Action Taken : Process for selection of global financial advisors for the strategic sale of BALCO and KIOCL has been initiated.

3. Selection of Intermediaries (I:4.3 and V:1)

Detailed and transparent procedure for the selection of all intermediaries for the Offer of Sale of shares either in domestic or international market. The financial advisors need not evaluate the disinvestment options recommended by the Commission.

Action Taken : Accepted

4. Retailing of PSU shares to Small Investors and Employees (I:4.4)

Detailed procedure for offer of shares to small investors and employees has been recommended by the Commission. The Commission has also recommended on the maximum number of shares and the discount to be offered to small investors and employees.

Sale of shares of the PSUs, especially the profit making ones, to the small investors would broad base the shareholding.

Action Taken : Accepted

5. Recommendation on Joining the NSDL (II.1)

In order to enable the PSUs to prepare for meeting the demands of the capital market, Commission recommends that all PSUs which were earlier disinvested and which are proposed for disinvestment to join the NSDL.

Action Taken : Accepted

6. Audit of Disinvestment Transactions (V:1)

It would be desirable to conduct an audit of the disinvestment transaction within six months by C&AG with the involvement of professionals familiar with working of the industry and capital markets. This provides opportunities for improving the quality of subsequent disinvestment transactions.

Action Taken : Decision Awaited

C. Recommendations on Delegation of Autonomy

Commission has recommended delegation of autonomy on a graded scale as given below :

1. Professionalising the Board of Directors (I:3.4)

The Commission recommends that the Government initiate necessary steps to select experts and professionals from outside the Government as non-executive Directors on the Board of Directors of PSUs.

Action Taken : Government has decided to broadbase Boards of PSUs by inducting at least three non-official part-time Directors (four for Navratna

PSUs). Government has also specified that such Directors should be at least one-third of the total strength of the Board. These Directors would be selected by Search Committee comprising of Chairman, PESB; Secretary, DPE; Secretary of the Administrative Ministry; and some eminent non-official(s).

2. Provision for Elected Directors (I:3.4)

Government, in the interest of efficient management of the PSU, should enable election of Directors who would represent the minority shareholders in the PSUs. Also the Government should enable election of employee representatives on the Board of Directors in proportion to the extent of employee shareholding.

Action Taken : Decision Awaited

3. Selection of Top Management (I:3.4)

The Commission recommends that the Public Enterprise Selection Board (PESB) should be broad based. PESB has to be given more powers to select the CEOs and other functional directors without going to the Appointments Committee of the Cabinet. Minimum tenure of five years for the CEOs and Functional Directors are recommended and the age of superannuation be relaxed, if necessary, for this purpose.

Action Taken : Decision Awaited

4. Salaries and Incentives for Top Management (I:3.4)

In order to attract and retain talents, the salaries and allowances for CMDs in Schedule (A) post should be raised to Rs. 50,000 per month immediately and should be reviewed and brought in line with industry in a gradual manner. Similar revision should be undertaken for all in other Schedules.

Action Taken : Decision Awaited

5. Autonomy in Price Fixation (I:3.4)

PSUs should be fully empowered on par with the private sector units to determine the prices of their products and services.

Action Taken : Decision Awaited

6. Accountability (I:3.4)

Present MoU should be revamped in order to measure the performance of PSUs more qualitatively with reference to meaningful and challenging targets. Performance assessments should be carried out at routine intervals by a joint team of the Secretary of Ministry, CEO and an outside senior professional.

Action Taken : Accepted

7. Setting up of Pre-Investigation Board (I:3.4)

An independent specialised institution viz., the Pre-Investigation Board is to be set up to evaluate the instances of malfeasance in PSUs. It should evaluate all questionable commercial decisions at the Board level to determine whether the decisions were taken with malafide or corrupt intent. The members of the Pre-Investigation Board could include among others retired top executives from the financial sector, former CEOs of leading PSUs and professionals with relevant business experience.

Action Taken : Decision Awaited

8. Strengthening the Investor Interface (I:3.4)

PSUs in general should equip themselves to meet the investor queries by setting up investor relations group. This group should regularly communicate with the investors and update them with the performance of the PSU.

Action Taken : Decision Awaited

Apart from the recommendations in respect of corporate governance, mentioned above, which are applicable to all PSUs, the Commission recommends additional autonomies to Moderate Performers and Strong Performers.

9. Moderate Performers

(i) Powers to Dispose of Assets (I:3.4)

Board of Directors should be empowered to transfer assets to a subsidiary or for the propose of outright sale, with requiring Government approval.

Action Taken : Decision Awaited

(ii) Freedom of Investment within certain limits (I:3.4)

The Government should enhance the investment limits in cases where banks or institutional lenders have appraised and financed the projects and link the limits to the turnover and requirement of funds in the medium term.

Action Taken : Category* I PSUs have been allowed to incur capital expenditure on new projects, modernisation, purchase of equipment, etc. upto Rs. 300 crores or equal to their networth, whichever is lower while Category* II PSUs have been given a limit of Rs. 150 crores or upto 50% of their networth, whichever is lower.

10. Strong Performers

(i) Powers to form joint ventures (I:3.4)

The Board of Directors of these PSUs should be empowered to form joint ventures with Indian or foreign companies so long as the other partner holds less than or equal stakes, without prior approval of the Government other than the regulatory approvals as applicable to private sector.

Action Taken : Category I PSUs have been empowered to establish JVs and subsidiaries in India by investing upto Rs. 100 crores or 5% of their networth in any one project or 15% of their networth in all JVs/subsidiaries put together. Category II PSUs can invest upto Rs. 50 Crores or 5% of their networth in any one project or 15% of their networth in all JVs/subsidiaries put together to establish JVs and subsidiaries in India.

(ii) Full freedom with regard to investments (I:3.4)

The Commission has recommended complete autonomy to these PSUs with respect to investment decisions subject to the condition that these projects are appraised and financed by banks or institutional lenders or where the total requirements of funds are met from internal accruals.

Action Taken : The autonomy granted to strong performers is same as that granted to the moderate performers.

* *Category I PSUs* are PSUs that have made a profit in the last three years continuously and earned pre-tax profits of more than Rs. 30 crores or more in at least one of the three years and have a positive net worth. *Category II PSUs* are PSUs that have made profit for the last years continuously and have a positive net worth.

Recommendations for 53 PSUs and action taken by Government

Recommendations		Government Action
1.	Modern Food Industries India Limited (MFIL) (1:5-1) Sale of entire Government shareholding on an as-is-where basis	Decision being implemented
2.	Gas authority of India Limited (GAIL) (1:5-2) - 25% disinvestment through GDR Autonomy under Strong Performere Criterion Implement TL Sankar Committee Recommendations	Decision being implemented
3.	Indian Tourism Development Corporation (ITDC) (1:5.3) Handing over the hotels located in prime locations to established hotel chains to run on long term structured contract on lease cum management basis. The hotels in other locations may be demerged into separate companies and Government to sell 100% of its equity in those new companies.	Decision awaited
4.	Bharat Aluminium Company Limited (BALCO) (II:2.1) Immediate disinvestment of 40% of the equity to a strategic partner with an agreement to dilute Government holding to 26% through public issue within 2 years. The Government to disinvest its balance holding of 26% in full at an appropriate time in future	Decision being implemented
5.	Bongaigaon Refineries and Petrochemicals Limited (BRPL) (II:2.2) Strategic sale of 50% of Government holding with an agreement to further dilute to 26% or below through public offer at a latter date	Decision awaited

Recommendations		Government Action
6.	<p>HTL Limited (HTL) (II:2.3) 3 options for disinvestment -</p> <ul style="list-style-type: none"> • Sale of 100% shares in HTL alongwith ITI in the process of Strategic Sale • 50% of shares of HTL may be offered to a strategic partner through a global competitive bidding • If none of the above options is feasible, straight sale of assets of the company through competitive bidding 	Decision being implemented
7.	<p>ITI Limited (ITI) (II:2.4) Immediate reduction of manpower through VRS and hiving off the Defence Division in Bangalore and merge with Bharat Electronics Limited followed by strategic sale of 50% of the shares with an agreement to reduce the Government holding to 26% through public offer to Indian institutions, small investors and employees later</p>	Decision awaited
8.	<p>Madras Fertilisers Ltd (MFL) (II:2.5) Recommended to initiate negotiations with National Iranian Oil Company to change the terms of agreement which would permit sale of 50% of the shares in the company to a strategic partner</p>	Decision awaited
9.	<p>Manganese Ore India Limited (MOIL) (II:2.6) - No immediate disinvestment</p>	Accepted
10.	<p>Container Corporation of India Limited (CONCOR) (III:2.1) - 10 million shares offer to institutional investors and public and at a later stage the company could go in for fresh issue of 12.5 million shares thereby reducing the Govt's share to 51%</p>	Decision implemented
11.	<p>Kudremukh Iron Ore Company Limited (KIOCL) (III:2.2) Strategic sale of 30% and induction of the strategic partner in the management. There should be an agreement with the strategic partner for further dillution of Government equity to strategic partner and public offering within 2 years</p>	Decision being implemented

	Recommendations	Government Action
12.	<p>Mahanagar Telephone Nigam Limited (MTNL) (III:2.3) - 60 million shares in GDR market and 28.3 million shares in domestic market through book building</p> <p>Financially restructure-by formation of a new company for raising funds for DoT Grant of Autonomy under Strong Performer Criteria</p>	Decision implemented
13.	<p>Oil India Limited (OIL) (III:2.4) - Disinvestment and Company's IPO only after company's prospects are clearly established through the outcome of exploration activities in the North Brahmaputra area and Government's policy on APM</p>	Accepted
14.	<p>Oil and Natural Gas Commission Ltd. (ONGC) (III:2.5) - Disinvestment after the organisational changes are in position and Government's policy on APM</p> <p>(X:2.3) - Disinvestment should be deferred until investor confidence in ONGC improves. Government and ONGC should take steps to improve investor perception. Thereafter disinvestment can take place in the foreign and domestic market up to 49 per cent when market conditions are favourable.</p>	Accepted
15.	<p>Rail India Technical & Economic Services Ltd. (RITES) (III:2.6) - No disinvestment</p>	Accepted
16.	<p>Hindustan Copper Limited (HCL) (IV:2.1)</p> <p>- Two options suggested :</p> <ul style="list-style-type: none"> • HCL to implement the expansion programme and also restructure the ICC mining operations by closing down mines through VRS. Afterwards, Government to divest 51% of its holding through a strategic sale. The balance 22% to be disinvested through offer of sale to domestic institutions, small investors and employees 	Decision awaited

Recommendations		Government Action
	<ul style="list-style-type: none"> • Immediately disinvest 51% through a strategic sale and after restructuring and expansion, disinvest balance 22% through offer of sale to domestic institutions, small investors and employees 	
17.	Pawan Hans Helicopters Limited (PHL) (IV:2.2) - Recommends writing off the Westland loans together with interest. Offer the entire Government holding to ONGC. If ONGC not interested, sell the entire holding of Government to an investor.	Decision awaited
18.	Power Grid Corporation of India Limited (POWERGRID) (IV:2.3) Disinvestment only after entire electricity sector is fully restructured.	Accepted
19.	Shipping Corporation of India Ltd (SCI) (IV:2.4) Government to disinvest 40% of its holding to oil refineries, (30% to public sector and 10% to private sector refineries). This can be followed by the company's own equity raising.	Decision awaited
20.	Engineers India Limited (EIL) (V:2.1) GoI to hold 26% for retaining the character as an Indian Consultancy company in strategic areas; GoI to disinvest 30% equity stake in the company alongwith appropriate role in management; 10% to employees under ESOP; 10% to public sector oil companies and other user PSUs; 24% through public offer to domestic investors after the strategic partner is inducted.	Decision being implemented
21.	Engineering Projects (India) Limited (EPIL) (V:2.2) GoI firstly to try disinvestment of 74% of its holding as approved by Cabinet; in the absence of satisfactory response, closure and sale of asset	Decision being implemented

Recommendations		Government Action
22.	Hindustan Prefab Limited (HPL) (V:2.3) GoI to offer 74% of its holding to a strategic buyer	Decision awaited
23.	IBP Limited (IBP) (V:2.4) GoI to hold 26% and offer upto 33.9% of the company's equity out of GoI holding of 59% to strategic buyer	Decision awaited
24.	National Thermal Power Corporation (NTPC) (V:2.5) - No disinvestment presently	Accepted
25.	NEPA Ltd. (NEPA) (V:2.6) Immediate sale of 51% to a strategic partner which could go up to 100%	Decision awaited
26. 27.	Ranchi Ashok Bihar Hotel Corporation & Utkal Ashok Hotel Corporation Ltd. (V:2.7, 2.8) ITDC to disinvest 100% holding in favour of any private entrepreneur	Decision being implemented
28.	Electronics Trade and Technology Development Corporation (ET&T) (VI:2.1) ET&T to discontinue all its operations with immediate effect and sale of assets of the company	Decision awaited
29.	Hindustan Vegetable Oils Corporation Ltd. (HVOC) (VI:2.2) hiving off breakfast food division and sell off 100%; Close down of operations in vanaspati and packaging of refined oil	Decision awaited
30.	Hindustan Zmc Ltd. (HZL) (VI:2.3) 25% equity to be offered to strategic partner with role in management	Decision awaited
31.	Hotel Corporation of India Ltd. (HCIL) (VI:2.4) The hotels at Mumbai and Delhi to be sold as separate units; Initiate dialogue with J&K government for Centaur Srinagar and AI to decide about the flight catering services	Decision being implemented
32.	National Hydroelectric Power Corporation Ltd. (NHPC) (VI:2.5) No disinvestment presently	Accepted

Recommendations		Government Action
33.	Pyrites Phosphates & Chemicals Ltd. (PPCL) (VI:2.6) Initiate action to sell Amjhore and Saladipura units to strategic buyers and close down Dehradun operations	Decision awaited
34.	Rehabilitation Industries Corporation Ltd. (RICL) (VI:2.7) With immediate effect discontinue all the operations and sale of assets	Decision awaited
35.	Fertiliser and Chemicals Travancore Ltd. (FACT) (VII:2.1) Offer a minimum of 51% equity to strategic buyer along with management control	Decision awaited
36.	Hindustan Latex Ltd. (HLL) (VII:2.2) Offer a minimum of 51% equity to strategic buyer along with management control	Decision awaited
37.	Indian Petrochemicals Corporation Ltd. (IPCL) (VII:2.3) Offer 25% equity to strategic buyer along with management control	Decision being implemented
38.	National Aluminium Co. Ltd (NALCO) (VII:2.4) Offer of sale of upto 30% equity to retail as well as institutional investors including a GDR issue of 15%	Decision awaited
39.	National Fertiliser Ltd. (NFL) (VII:2.5) Offer a minimum of 51% equity to strategic buyer along with management control	Decision awaited
40.	Neyveli Lignite Corporation Ltd (NLC) (VII:2.6) No disinvestment, presently	Accepted
41.	Steel Authority of India Ltd (SAIL) (VII:2.7) No disinvestment, presently. Government assistance in writing-off IISCO's losses and sale of IISCO. Conversion of SAIL's SDF dues into equity.	Accepted

	Recommendations	Government Action
42.	Air India Ltd (AI) (VIII:2.1) Infusion of Rs. 1000 crore as equity, followed by strategic sale by issue of new shares reducing Government holding to 60%. Subsequent offer of sale of 20% to domestic investors.	Decision awaited
43.	Central Electronics Ltd (CEL) (VIII:2.2) Priority to CEL's performance improvement. One year to reduce manpower through VRS and another year to improve performance. If substantial surplus manpower reduction is not achieved, disinvest CEL through a trade sale after hiving-off defence related operations.	Decision awaited
44.	Hindustan Steel Works Construction Ltd. (HSCL) (IX:2.1) Government should try to close down the enterprise. If it does not find it feasible to do so, the only alternative would be to continue the enterprise by meeting recurring annual cash losses of around Rs. 60-70 crores per annum, after meeting statutory liabilities of Rs. 136 crores.	Decision awaited
45.	State Trading Corporation (STC) (IX:2.2)- offer of entire GoI holding to a strategic buyer, after reserving 5% share for employees who opt for VRS at a discount to the strategic buyer's price. Manpower reduction through VRS should be undertaken simultaneously with the decision for disinvestment.	Decision awaited
46.	Minerals and Metal Trading Corporation of India Ltd. (MMTC) (X:2.1) Offer of 51% equity through strategic buyer alongwith reduction in employee strength through implementation of suitable VRS. Offer of sale to public, when the value of the residual equity holding of government increases as a result of transfer of management control.	Decision awaited

	Recommendations	Government Action
47.	<p>National Mineral Development Corporation Ltd. (NMDC) (X:2.2) Offer of shares up to 20-25% to selected JV partner in return for joining hands with NMDC in their overseas venture(s). Subsequently disinvestment through offer of sale. If disinvestment of up to 20-25% to selected JV partner is not feasible, equity up to 49% should be sold in stages in domestic or international market.</p> <p>Government should retain 51% of the equity till an effective regulatory mechanism is put in place to regulate exploration and export of iron ore.</p>	Decision awaited
48.	<p>Paradeep Phosphates Ltd. (PPL) (X:2.4) Disinvest not less than 51% holding through strategic sale. The strategic sale should be initiated simultaneously with the implementation of FRS-II. Later, GoI can disinvest its balance holding through public issue to realise better value for its remaining holding.</p>	Decision awaited
49.	<p>Projects & Equipment Corporation Ltd. (PEC) (X:2.5)</p> <p>No disinvestment at present.</p> <p>In case there is no significant increase in the turnover and profitability of PEC from the exports from the small and medium scale industries within two years, the Government should offer 100% equity in the company to a strategic buyer. In the absence of investor interest in PEC, there will be no alternative but to close the company.</p>	Decision awaited.
50.	<p>MECON Ltd. (MECON) (XI:2.1) Sale of a minimum of 51% along with an appropriate role in management to a strategic partner who has LSTK capability.</p>	Decision awaited

Recommendations		Government Action
51.	MSTC Ltd. (MSTC) (XI:2.2) 100% disinvestment along with MSTC's holding in FSNL	Decision awaited
52.	Mineral Exploration Corporation Ltd. (MECL) (XI:2.3) GoI to choose from three options. 1. Implement VRS, allow MECL to continue and apply for PLs 2. Sell 100% equity on as-is-where-is basis. 3. Closure	Decision awaited
53.	Sponge Iron India Limited (SIL) (XI:2.4) 100% disinvestment, after cleaning of the Balance Sheet of the Company.	Decision awaited

Appendix VIII

Disinvestment Modalities Recommended in Report I to XI and Action Taken by Government

Modalities of Disinvestment	No.	Names of PSUs	Status of Government Decision				
			Accepted	Deferred	Implemented	Being Implemented	Awaited
Trade Sale	8	ITDC, MFIL, HCIL R-Ashok, U-Ashok, PHL, SIIL, MSTC				MFIL, HCIL, R-Ashok, U- Ashok	ITDC**, PHL SIIL, MSTC
Strategic Sale	24	HTL, IIT, BALCO, BRPL, KIOCL, MFL, EIL, HPL, IBP, NEPA, HZL, PPCL, NFL, FACT, IPCL, HCL, SCI, HLL, AI, HSCL, STC, MMTC, PPL, MECON		FACT		HTL, BALCO, KIOCL, EIL, IPCL	IIT**, BRPL, MFL**, HPL, IBP, NEPA, HLL**, PPCL, HCL, HZL**, SCI, AI, HSCL, STC, MMTC, PPL, MECON, NFL
Offer of Shares	5	GAIL, CONCOR, MTNL, NALCO NMDC			CONCOR, MTNL**	GAIL**	NALCO, NMDC
No Disinvestment	1	RITES	RITES				
Disinvestment deferred*	11	OIL, ONGC, MOIL, NTPC, NHPC, NLC, POWERGRID, SAIL, CEL, PEC, MECL	OIL, ONGC, NTPC, MOIL, NHPC, PGCL, SAIL, NLC				CEL**, PEC MECL
Closure/sale of assets	4	EPIL, ET&T, HVOC, RICL				EPIL	ET&T, HVOC, RICL
Total	53		9	1	2	11	30

* Pending fulfilment of certain specified conditions.

* Some decisions have reportedly been taken by Government in respect of these PSUs, but no formal communication has been received by the Commission.

