

REPORT

II

DISINVESTMENT COMMISSION

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Introduction

The Disinvestment Commission presented its First Report on 20th February, 1997. The report was in three parts: Part A dealing with an overview of the central Public Sector Undertakings; Part B containing general recommendations and Part C specific recommendations with regard to Modern Foods Industries Ltd. (MFIL), India Tourism Development Corporation (ITDC) and Gas Authority of India Ltd.(GAIL). It was emphasised that the recommendations in Parts B and C should be taken in totality in order to enhance enterprise value and maximise Government's receipts from disinvestment.

The Hon'ble Finance Minister, Shri P. Chidambaram in his Budget speech on February 28, 1997 stated that the Government had accepted the specific recommendations with respect to the above three companies. Further, he stated that "We intend to proceed with the disinvestment in these companies along the lines suggested by the Commission.". A reference was also made to the long term strategy formulated by the Disinvestment Commission. Quoting from the Commission's First Report, he stated 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." He further indicated that Government agreed with this view.

The Commission would like to emphasise once again that wherever there is an offer of sale of shares or a strategic sale with Government retaining at least 51% of the shares temporarily, the share values can be increased significantly by implementation of the recommendations relating to corporate governance

and managerial autonomy as outlined in Part B of the First Report. There is a negative perception among the investors that PSU managements are relatively underpaid and generally demotivated besides being excessively controlled and lacking in autonomy. The Commission would, therefore, once again reiterate that in the absence of a co-ordinated approach to disinvestment keeping in view both the general and specific recommendations in respect of the PSUs covered in the First Report of the Commission, there is likely to be loss to the exchequer through lower realisation of sale value.

The Commission has made a study of the privatisation process in several countries around the world and as stated in the introduction to its First Report “has taken due note of experiences of other countries in disinvestment and privatisation”. Available studies on disinvestment in various countries have shown that there is no universally applicable model of privatisation programme and that every country has tailored its approach to its specific objectives and constraints. The process has evolved in most of the countries with mid-course corrections having been made in the light of experience gathered over the years. Various strategies have been adopted and implemented and a wide range of techniques used. There is thus no uniform recipe for success in privatisation and many countries have experienced successes and failures. Privatisation has also been a contentious issue in many countries. The success of the programme depends on the political consensus and the will to pursue a strategy for improving efficiency in the use of public resources invested in PSUs ensuring their competitiveness and providing sustainable employment. In many countries state ownership has been found to be less conducive to efficiency than private ownership in comparable cases. Wherever, state ownership has promoted efficiency it has

been possible through operation in a competitive environment and by providing autonomy and incentives to the PSU managements.

In India what is needed is a pragmatic approach and not an ideological approach to public enterprises. There are PSUs which have performed well and which could perform even better with greater autonomy and incentives to management. There are other PSUs in need of new technology, marketing skills etc. which can be accessed through strategic sale of shares to suitable private sector partners. A differentiated approach to disinvestment will be necessary for each PSU with reference to its peculiar circumstances.

The Commission has continued with its examination of the remaining 37 PSUs out of the 40 referred to it by the Government. A further list of 10 PSUs has been recently forwarded to the Commission. (The Hotel Corporation of India included in the recent list of 11 PSUs already figures in the original list of 40 PSUs referred to the Commission in September, 1996).

In this Second Report the Commission has made specific recommendation in respect of seven PSUs. This is divided into Part A containing general issues and recommendations and Part B specific recommendations for each PSU.

General Issues on Disinvestment and Recommendations

In its First Report submitted to Government in February 1997, the Commission has outlined a long term strategy for disinvestment revolving around four long term objectives:

- To Strengthen PSUs where appropriate in order to facilitate disinvestment;
- To Protect employee interests;
- To Broad base ownership; and
- To Augment receipts for Government.

The long-term strategies to pursue the above objectives have been detailed in the First Report which is reproduced below:

To Strengthen PSUs

- By promoting greater competitiveness and profitability among profit making PSUs to enable payment of higher dividends to the Government and to enhance share values.
- By restructuring financially and reviving loss making PSUs to attract private capital for long term turn around and thereby reduce future dependence on the budget of marginally profit making PSUs.

To Protect Employee Interest

- By sustaining long term employment by providing financial turn around of loss making PSUs
- By providing adequate and fair compensation through VRS to surplus work force
- By providing for employee participation in management

To Broadbase Ownership

- By retailing PSU shares to small investors and employees and offering them at suitable price discount as compared to the institutional investor

To Augment Receipts for Government

- By appropriate levels of disinvestment in profit making PSUs
- By eliminating the need for budgetary support for loss making PSUs.

The Commission has already detailed its approach to disinvestment in loss-making PSUs in the First Report. After a comprehensive study of such loss making PSUs they would be classified for disinvestment as below:

- Those in which Government could disinvest as a going concern on an as-is-where-is basis;
- Those which could be restructured and turned around before disinvestment; and
- Those which may need closure.

In all cases, it would be important to protect the interest of affected labour by devising suitable schemes either for retraining, redeployment or for voluntary retirement with adequate compensation. The cost of such schemes could be met to varying degrees by the sale of assets of the companies concerned. The balance where necessary, could be met from the Disinvestment Fund supplemented if necessary, in any particular year by a provision in the budget.

As regards profit making PSUs, the Commission has, as already mentioned above, emphasised the need for managerial autonomy and corporate governance for promoting greater competitiveness and profitability to secure for Government higher dividends and enhanced share value as also on increasing internal generation of resources and reducing dependence on budgetary outlays. The Commission has also underlined the importance of the pressure that disinvestment and dispersal of ownership would exert on the managements of the PSUs to improve their performance, earn profits and declare dividends.

The Commission at this stage would like to clarify further its approach to profit-making PSUs. These PSUs could be broadly classified into two groups. The first group would consist of those PSUs which operate in monopolistic or oligopolistic markets and enjoy certain special advantages in terms of Government policy. There are other PSUs which operate in a more competitive market environment and which are coming under progressively increasing pressure from private sector competitors in the current liberalised economic scenario.

As regards those operating in monopolistic or oligopolistic markets , while Government does derive recurring benefits through receipt of dividend, disinvestment provides it with an opportunity to cash in on the increases in the networth of the companies through off-loading of shares to institutional and individual investors while retaining control of the management wherever public purpose warrants it. Government, like any other shareholder in a company, needs to benefit not only from annual dividends but also from the appreciation of its investment.

As regards those which operate in internal or internationally competitive markets, some of them may be presently generating profits. However, a long-term view needs to be taken on their viability. Structured as they are today, with limited autonomy involving multiple layers of control and approval procedures, many of them may not be able to capitalise on their existing strengths and seize on new opportunities as they present themselves. There is a danger that they may succumb to the pressures of competition. They may not, therefore, remain profitable in the long run. Hence, there is an urgent need to consider the option of disinvestment in them.

Even where such dangers are not foreseen, disinvestment by the Government will have to be based on whether or not any public purpose is served by Government ownership and control in a PSU given the nature of the market in which it is operating.

The disinvestment proceeds from profit making PSUs would be available to the government to deal with the problems of loss-making PSUs thereby reducing the continued burden on the budget. In this

connection, the Commission had emphasised the need to place proceeds from such disinvestment from profit making PSUs into a Disinvestment Fund and had indicated the use of this Fund. This is intended to take care of the possible danger of mere short-term budgetary compulsions dictating the process of disinvestment in profit making PSUs.

In the first report, the Commission had classified 35 out of the 40 PSUs referred to it into core and non-core categories for the purpose of determining the extent of disinvestment in accordance with the stated Government policy. It was also mentioned in the Report that this classification could undergo change over time. At that time the Commission had not yet gone in depth into the working of these 40 undertakings. As a result of further examination of the PSUs covered in this second report it has become necessary to reclassify some of them for the reasons stated in the specific recommendations relating to them.

Ultimately the decisions on the extent of disinvestment have to be based on whether or not any public purpose is served by government ownership and control in a PSU, given the nature of the market in which it is operating.

The Commission would like to emphasise on three other issues which will have an important bearing on the disinvestment process.

1. One of the major problems that will be encountered in the process of disinvestment will be the redundant employee strength beyond what can be sustained for profit making and competitive operation of the undertakings. There seems to be considerable uncertainty both among

management and employees about the terms of the Voluntary Retirement Scheme. It will help the process of shedding surplus manpower if there is a clear-cut policy statement on the terms of VRS on a stable and long term basis.

2. It is equally important to provide adequate funds for this purpose to the managements of PSUs out of the Disinvestment Fund after merger of the National Renewable Fund (NRF) with it on the lines recommended in the First Report of the Commission.
3. With the large presence of FIIs in the Indian capital market and a substantial number of these FIIs also participating in the GDR sales of PSU and private company shares, the Indian capital market is getting steadily integrated with the global capital market. The conditions for sale of PSU shares through the 'book building' process similar to that for GDRs can be established in India itself in the near future if the various requirements of investors are met. This process can be facilitated if PSUs which were earlier disinvested and which are proposed for disinvestment are directed to join NSDL and have their shares registered with the National Depository to meet the various concerns of the investors including the instant transferability of shares. Where shares are offered to small investors they will have the facility of holding their shares in the Depository after dematerialisation or to get the share certificates according to their preferences.

Bharat Aluminium Co. Ltd.

Evolution

Bharat Aluminium Co.Ltd.(BALCO) was set up in 1965 in Korba in Madhya Pradesh for the manufacture and sale of Aluminium metal including wire rods and semi-fabricated products such as Extrusions, Sheets/Coils and Foils. Subsequently, the company was asked to take over a sick unit in Bidhanbag (West Bengal) in 1984 which added to the downstream facilities in sheets, foils and alloy rods. The production capacities and plant utilisation levels are as shown below:

Table 1 Production and Capacity Utilisation 1995-96

	Korba	Bidhanbag
Production (MT)	91,240	3,134
Capacity Utilisation		
Wire Rods	93%	21%
Sheets/Coils	80%	34%
Foils		21%

The Company's paid up equity was Rs.488 crores as at March 31, 1996. There has been no disinvestment so far in BALCO.

Industry Analysis

The aluminium industry in India can be divided into two segments: primary aluminium manufacturers and secondary fabrication units. Primary aluminium can be sold in the form of ingots, billets and slabs. The secondary fabrication units process aluminium metal produced by the primary producers to manufacture three main categories of value added products: redrawn rods, rolled products and extrusions. The product manufacturers have the additional option of using imported aluminium under OGL.

The main primary producers of aluminium in India are National Aluminium Co.Ltd (NALCO), Hindalco Industries Ltd. (HIL), BALCO and Indian Aluminium Co. (INDAL). Out of these the first three account for 90% of the total domestic output.

The industry structure in the primary segment is oligopolistic in nature due to high entry barriers such as high capital cost, restricted access to technology, long gestation periods. However, with the lowering of the import duties since 1992, the domestic prices of aluminium are strongly linked to the prices on the London Metal Exchange (LME) and hence the primary market may be considered to be competitive in spite of a limited number of players.

The industry structure in the secondary value added segment is fragmented with a large number of secondary producers (including BALCO) spread across the country.

The threat of substitutes has a bearing on the demand for aluminium products and this in turn limits the margins for both primary as well as secondary producers.

Process and Technology

Aluminium is manufactured by refining bauxite and then processing the refined intermediary (alumina) in a smelter to extract aluminium. The process of producing alumina from bauxite is dependent on the nature of the ore.

The reduction of alumina into aluminium is carried out in electric smelters. There are two technologies available for the reduction of alumina viz., the more recent and advanced pre-baked anode process and the older Sodeberg process.

Though there has been a shift in technology, it may be noted that the process technology for manufacture is not likely to exhibit significant changes. Improvements, if any will be gradual and can be easily sourced from other countries.

Demand - Supply

Aluminum's varied properties make it suitable for diverse applications. The increase in applications and the rationalisation of duties are expected to be the key determinants for demand in the future. The major consuming sectors for aluminium and their expected growth rates in the medium term are as follows:

Table 2 Segment wise Domestic Demand Growth

Sector	Share+	Growth Rate*
Electrical	34%	8%
Transport	22%	10%
Consumer Durable	11%	10%
Packaging	11%	15%
Building & Construction	8%	6%
Industrial	8%	7%
Others	6%	6%
Total	100%	9.1%

+ For the year 1995-96.

* Expected growth rates for user industries in the medium term.

Source : CRISIL estimates

Based on the existing capacities of the four major players as well as their on-going and proposed capacity expansions, the demand supply gap is as projected:

Table 3 Demand Supply Gap

(MT)	FY 96 (Est.)	FY 97 (Proj.)	FY 98 (Proj.)	FY 99 (Proj.)	FY 2000 (Proj.)
Total Demand	5,60,135	6,10,690	6,66,557	7,27,214	7,93,390
Total Supply	5,29,000	5,49,000	5,90,000	6,25,000	6,45,000
Surplus/(Deficit)	(31,135)	(61,960)	(76,557)	(102214)	(148,390)

Source : CRISIL estimates

The supply by domestic aluminium producers even at their full capacity will not be enough to meet the total demand and hence secondary producers and other producers would have to import metal.

Global Scenario and India's Position

India has 12% of the world's reserves of bauxite but produces only 3% of the aluminium in the world. Despite higher power tariff prevailing in the country, domestic producers measure up to global standards due to captive power plants and low cost of bauxite. The sectoral usage of aluminium is quite different in India when compared with global usage patterns.

Table 4 Usage Pattern of Aluminium

Sector	India	Global
Electrical	34	8
Transport	22	27
Consumer Durable	11	9
Packaging	11	22
Building & Construction	8	20
Industrial	8	8
Others	6	6

Source: Report on Working Group on non-ferrous metals (1993).

The difference in the usage patterns can be ascribed to the Aluminium Control Order which stipulated that 50% of the Aluminium produced in the country had to be reserved for the electrical sector. This had led to a lopsided consumption pattern. With the abolition of the Control Order in

1989, the growth of consumption in other sectors has picked up and the trend is towards replicating the international pattern.

Internationally, prices had fallen in 1996 due to a decline in copper prices as aluminium prices are strongly linked with the prices of copper. With no fresh additions to smelter capacity, the price of aluminium is likely to be sustained and even witness an upward trend in the medium term.

Key Success Factors in Aluminium Industry

Availability of raw materials The availability of good bauxite ore in close proximity to the smelter will greatly determine the cost of production.

Captive Power Since power forms as much as 35% of the manufacturing cost, uninterrupted power supply in the form of captive power is a key success factor.

Vertically Integrated Operations Primary Aluminium producing companies with a presence in the value added segment have a competitive advantage in terms of higher margins. In addition, nearness of the fabrication facilities to the consuming markets will determine freight costs.

Financial Analysis of BALCO

The financial performance of BALCO for the past five years are given below:

Table 5 Financial Performance

(Rs.Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income (OI)	601.4	598.9	506.5	389.6	394.3
Operating Profit (OP)	197.6	162.3	65.3	51.8	45.5
Profit After Tax (PAT)	163.3	90.5	15.3	1.9	0.9
Equity Capital	488.8	488.8	488.8	488.8	488.8
Tangible Net Worth	757.5	608.2	517.8	502.6	500.7
Gross Margin (%)	32.9	27.1	12.9	13.3	11.8
Net Margin (%)	27.2	15.1	3.0	0.5	0.2
ROCE (%)	21.0	16.8	5.9	4.3	3.6
RONW (%)	21.6	14.9	3.0	0.4	0.2
Earnings Per Share	3.34	1.85	0.31	0.04	0.02
Dividend (%)	2.9	-	-	-	-

The performance of BALCO has shown a steady improvement partly due to the improved outlook of the industry and also due to improved levels of operations. The sales realisation has improved significantly due to the increase in the prices of aluminium on the LME. The effect on profit has been accentuated by a reduction in interest cost through retirement of Rs. 140 crores of debt between 1992 and 1996. All these factors have contributed to an increase in the earnings per share of the company from an insignificant level of 2 paise in FY 92 to Rs.3.3 in FY 96.

Strengths and Weaknesses of BALCO

Based on the above industry, business and financial analysis, the strengths and weaknesses of BALCO are as below :

Strength

Low Costs of Production The depreciated plants even if based on outdated technology have helped in keeping costs of production low. This in turn, has led to increased profitability.

Weaknesses

Inadequate Supply of Ore Although the operations of BALCO are vertically integrated, the ore production is not fully commensurate with the production of hot metal. As a consequence, BALCO has to source its ore requirements from other mine sources which may lead to an increased cost of raw materials. With the implementation of 36,000 TTPA Cold Rolling Mill, the requirement of hot metal and the consequent requirement of ore will further increase. Further the cost of extraction and transportation of ore is high when compared with NALCO. This is on account of contractual (labour intensive) mining being carried out as opposed to mechanised mining and being transported in lorries/trucks as opposed to rail as in the case with Nalco.

Relatively Old Technology The use of the Sodeberg cells for the smelter as opposed to the pre-baked process results in a higher consumption. However, the company is in the midst of smelter modernisation which would reduce power consumption, improve yield levels and reduce consumption of anode paste.

Higher levels of Employee Costs BALCO's operations are less mechanised than other players and to that extent, higher employee costs seem justifiable. However, the merger of the erstwhile Aluminium Corporation of India (the present Bidhanbag unit) has created

overstaffing problems. The company's VRS has not been too successful in downsizing the workforce.

Captive Power Generation Even though theoretically BALCO has enough captive power generation capacity, BALCO has to depend on the State Grid for meeting part of its power requirement. The power cost differential between generated power (Re 0.69/kwh) and purchased power (Rs.5.59/kwh for 1995-96 puts BALCO at a disadvantage compared to its peers.

Lack of Autonomy The lack of autonomy in decision making which is an area of concern for most PSUs is particularly relevant in the case of BALCO. For example, the company had initiated a proposal to set-up a Cold Rolling Mill of 36,000 MT 8 years ago; the proposal has been only recently cleared.

Bidhanbag Unit The Bidhanbag Unit, a sick company in West Bengal was merged with BALCO. The low capacity utilisation, the high manpower costs, and the inconsistent level of quality of the products are a major drag on the profitable operations of BALCO.

Recommendations

BALCO is a PSU which has posted impressive financial results in the last few years and its profitability in FY 1996 has in fact increased quite significantly. While BALCO employs what could be considered an outdated smelter technology with its concomitant disadvantages of high power consumption and lower output in comparison to the advanced pre-baked process, yet because the plant has already been

highly depreciated, this has contributed to its better financial performance. This is also a company which produces a whole range of products from mental to wire rods and semi fabricated products. Besides, the outdated smelter technology, BALCO also suffers from certain other disadvantages which need to be addressed quickly to sustain its competitive position in the market. At least during the next 2 years it will have to depend to a significant extent on out-sourced bauxite. Also it still depends on supply of power from the State Electricity Board to the extent of 20-25% of its requirement, on and off, with resultant higher cost. It also has a loss making unit at Bidanbagh which posts a negative contribution. In spite of all this, however, the company's internal generation is more than satisfactory and all the diversification projects it is considering to implement could be financed through such internal generation. The projects which it needs to take up urgently would include:

- mechanising its mining activities to bring down the cost of bauxite
- adding to its captive power plant capacity to have total low cost of self-generated power which could result in savings as much as Rs.3000/- per tonne of metal.
- modernizing its smelter operations to reduce power and material consumption and to improve yields to gain an overall benefit of upto Rs.1000/MT of metal.
- cold rolled mill project(CRM) for a more diversified product mix, and modernization of the Bidanbagh unit and implementation of the condenser foil project in that unit.

It would also be necessary to take steps to shed the surplus labour force particularly in Bidanbagh unit with an imaginative and acceptable VRS.

Once the above projects and the VRS are implemented, BALCO would be able to improve its profitability much further. BALCO as a PSU has suffered from procedural bottlenecks and lack of managerial autonomy. The CRM project at Korba has been cleared after 8 years with near-doubling of the capital outlay. The company was not able to get clearance from the government for setting up 100% captive power generation. As a result, the company had to depend on high cost power from the state electricity board which resulted in avoidable cost increases. The delays and the lack of autonomy have certainly affected its operating profits which would have been much higher had it been able to implement these projects earlier.

The Commission had earlier categorised the company as belonging to the core group of PSUs which would set the limit on disinvestment at 49%. Having, however, considered the working of the unit in detail and the structure of the Indian aluminium industry the Commission has reviewed the position. There are three major players in the market other than BALCO viz. NALCO, HINDALCO, and INDAL. There are also a large number of small and medium units producing aluminium products. BALCO has a market share of around 17% in the market (including exports). Most of the other major players are also undertaking programmes to enhance capacities in the metal sector as also in the down-stream products. A new project is being promoted by HINDALCO and Orissa Mining Corporation with a capacity of 2,50,000 tonnes of aluminium smelter complex in Orissa. With the commissioning of the

new capacities in the domestic market, the market share of BALCO is expected to come down to 12%. In addition the user industry also has access to imports and the market is fully contestable. Under these circumstances, the Commission has concluded that BALCO be categorised as non-core rather than core for purposes of disinvestment.

The Commission has evaluated various modes of disinvestment and has concluded that the sale of shares in a public offer may get a lower realisation than the sale to a strategic partner through a competitive bidding process from domestic and foreign partners. The Commission recommends that Government may immediately disinvest its holding in the company by offering a significant share of 40% of the equity to a strategic partner either domestic or foreign through a transparent and competitive global bidding process. There could be an agreement with the selected strategic partner specifying that Government would further dilute within 2 years, its holding through a public offer in the domestic market including to institutions, small investors and employees thereby bringing down Government holding to 26%. This is necessary to instill confidence in the strategic partners and thereby attract more and better offers. Further there should be a review at that time of the industry situation and if appropriate, the Government may disinvest its balance equity of 26% in full in favour of investors in the domestic market.

As already recommended by the Commission in Part B of its First Report (p.38-40), the Government would need to appoint a Financial Adviser who would undertake a proper valuation of the company and also conduct the sale. The Financial Adviser should also consider the desirability of capital restructuring by conversion of at least 25% of

equity into long-term debt taking into account the degree of over-capitalization in the company and its extremely low gearing.

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Aluminum's varied properties make it suitable for diverse applications. The increase in applications and the rationalisation of duties are expected to be the key determinants for demand in the future. The major consuming sectors for aluminium and their expected growth rates in the medium term are as follows:

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Vertically Integrated Operations Primary Aluminium producing companies with a presence in the value added segment have a competitive advantage in terms of higher margins. In addition, nearness of the fabrication facilities to the consuming markets will determine freight costs.

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Operating Profit (OP)	197.6	162.3	65.3	51.8	45.5
Profit After Tax (PAT)	163.3	90.5	15.3	1.9	0.9
Equity Capital	488.8	488.8	488.8	488.8	488.8
Tangible Net Worth	757.5	608.2	517.8	502.6	500.7
Gross Margin (%)	32.9	27.1	12.9	13.3	11.8
Net Margin (%)	27.2	15.1	3.0	0.5	0.2
ROCE (%)	21.0	16.8	5.9	4.3	3.6
RONW (%)	21.6	14.9	3.0	0.4	0.2
Earnings Per Share	3.34	1.85	0.31	0.04	0.02
Dividend (%)	2.9	-	-	-	-

The performance of BALCO has shown a steady improvement partly due to the improved outlook of the industry and also due to improved levels of operations. The sales realisation has improved significantly due to the increase in the prices of aluminium on the LME. The effect on profit has been accentuated by a reduction in interest cost through retirement of Rs. 140 crores of debt between 1992 and 1996. All these factors have contributed to an increase in the earnings per share of the company from an insignificant level of 2 paise in FY 92 to Rs.3.3 in FY 96.

Strengths and Weaknesses of BALCO

Based on the above industry, business and financial analysis, the strengths and weaknesses of BALCO are as below :

Strength

Low Costs of Production The depreciated plants even if based on outdated technology have helped in keeping costs of production low. This in turn, has led to increased profitability.

Weaknesses

Inadequate Supply of Ore Although the operations of BALCO are vertically integrated, the ore production is not fully commensurate with the production of hot metal. As a consequence, BALCO has to source its ore requirements from other mine sources which may lead to an increased cost of raw materials. With the implementation of 36,000 TTPA Cold Rolling Mill, the requirement of hot metal and the consequent requirement of ore will further increase. Further the cost of extraction and transportation of ore is high when compared with NALCO. This is on account of contractual (labour intensive) mining being carried out as opposed to mechanised mining and being transported in lorries/trucks as opposed to rail as in the case with Nalco.

Relatively Old Technology The use of the Sodeberg cells for the smelter as opposed to the pre-baked process results in a higher consumption. However, the company is in the midst of smelter modernisation which would reduce power consumption, improve yield levels and reduce consumption of anode paste.

Higher levels of Employee Costs BALCO's operations are less mechanised than other players and to that extent, higher employee costs seem justifiable. However, the merger of the erstwhile Aluminium Corporation of India (the present Bidhanbag unit) has created

overstaffing problems. The company's VRS has not been too successful in downsizing the workforce.

Captive Power Generation Even though theoretically BALCO has enough captive power generation capacity, BALCO has to depend on the State Grid for meeting part of its power requirement. The power cost differential between generated power (Re 0.69/khw) and purchased power (Rs.5.59/khw for 1995-96 puts BALCO at a disadvantage compared to its peers.

Lack of Autonomy The lack of autonomy in decision making which is an area of concern for most PSUs is particularly relevant in the case of BALCO. For example, the company had initiated a proposal to set-up a Cold Rolling Mill of 36,000 MT 8 years ago; the proposal has been only recently cleared.

Bidhanbag Unit The Bidhanbag Unit, a sick company in West Bengal was merged with BALCO. The low capacity utilisation, the high manpower costs, and the inconsistent level of quality of the products are a major drag on the profitable operations of BALCO.

Recommendations

BALCO is a PSU which has posted impressive financial results in the last few years and its profitability in FY 1996 has in fact increased quite significantly. While BALCO employs what could be considered an outdated smelter technology with its concomitant disadvantages of high power consumption and lower output in comparison to the advanced pre-baked process, yet because the plant has already been

highly depreciated, this has contributed to its better financial performance. This is also a company which produces a whole range of products from mental to wire rods and semi fabricated products. Besides, the outdated smelter technology, BALCO also suffers from certain other disadvantages which need to be addressed quickly to sustain its competitive position in the market. At least during the next 2 years it will have to depend to a significant extent on out-sourced bauxite. Also it still depends on supply of power from the State Electricity Board to the extent of 20-25% of its requirement, on and off, with resultant higher cost. It also has a loss making unit at Bidanbagh which posts a negative contribution. In spite of all this, however, the company's internal generation is more than satisfactory and all the diversification projects it is considering to implement could be financed through such internal generation. The projects which it needs to take up urgently would include:

- mechanising its mining activities to bring down the cost of bauxite
- adding to its captive power plant capacity to have total low cost of self-generated power which could result in savings as much as Rs.3000/- per tonne of metal.
- modernizing its smelter operations to reduce power and material consumption and to improve yields to gain an overall benefit of upto Rs.1000/MT of metal.
- cold rolled mill project(CRM) for a more diversified product mix, and modernization of the Bidanbagh unit and implementation of the condenser foil project in that unit.

It would also be necessary to take steps to shed the surplus labour force particularly in Bidanbagh unit with an imaginative and acceptable VRS.

Once the above projects and the VRS are implemented, BALCO would be able to improve its profitability much further. BALCO as a PSU has suffered from procedural bottlenecks and lack of managerial autonomy. The CRM project at Korba has been cleared after 8 years with near-doubling of the capital outlay. The company was not able to get clearance from the government for setting up 100% captive power generation. As a result, the company had to depend on high cost power from the state electricity board which resulted in avoidable cost increases. The delays and the lack of autonomy have certainly affected its operating profits which would have been much higher had it been able to implement these projects earlier.

The Commission had earlier categorised the company as belonging to the core group of PSUs which would set the limit on disinvestment at 49%. Having, however, considered the working of the unit in detail and the structure of the Indian aluminium industry the Commission has reviewed the position. There are three major players in the market other than BALCO viz. NALCO, HINDALCO, and INDAL. There are also a large number of small and medium units producing aluminium products. BALCO has a market share of around 17% in the market (including exports). Most of the other major players are also undertaking programmes to enhance capacities in the metal sector as also in the down-stream products. A new project is being promoted by HINDALCO and Orissa Mining Corporation with a capacity of 2,50,000 tonnes of aluminium smelter complex in Orissa. With the commissioning of the

new capacities in the domestic market, the market share of BALCO is expected to come down to 12%. In addition the user industry also has access to imports and the market is fully contestable. Under these circumstances, the Commission has concluded that BALCO be categorised as non-core rather than core for purposes of disinvestment.

The Commission has evaluated various modes of disinvestment and has concluded that the sale of shares in a public offer may get a lower realisation than the sale to a strategic partner through a competitive bidding process from domestic and foreign partners. The Commission recommends that Government may immediately disinvest its holding in the company by offering a significant share of 40% of the equity to a strategic partner either domestic or foreign through a transparent and competitive global bidding process. There could be an agreement with the selected strategic partner specifying that Government would further dilute within 2 years, its holding through a public offer in the domestic market including to institutions, small investors and employees thereby bringing down Government holding to 26%. This is necessary to instill confidence in the strategic partners and thereby attract more and better offers. Further there should be a review at that time of the industry situation and if appropriate, the Government may disinvest its balance equity of 26% in full in favour of investors in the domestic market.

As already recommended by the Commission in Part B of its First Report (p.38-40), the Government would need to appoint a Financial Adviser who would undertake a proper valuation of the company and also conduct the sale. The Financial Adviser should also consider the desirability of capital restructuring by conversion of at least 25% of

equity into long-term debt taking into account the degree of over-capitalization in the company and its extremely low gearing.

Bongaigaon Refinery & Petrochemicals Limited

Evolution

Bongaigaon Refinery & Petrochemicals Limited (BRPL) was incorporated on 20th February, 1974 as a refinery cum petrochemicals complex. The plant is located in Dhaligaon, Bongaigaon (Assam). The complex initially started as a part of M/s Indian Petrochemicals Corporation Limited and was later on made an independent Public Sector company. The Refining unit was commissioned in 1979 while the downstream petrochemical units were commissioned in phases in 1985 and 1989.

The total share capital of BRPL is Rs. 199.82 crores and presently the Government of India (GoI) holds 74.5% and the balance held by UTI (17.3%), Mutual Funds (4.4%) and others. The shares of the company are listed on BSE and is currently trading at Rs 15 at a P/E multiple of about 3.5. This is quite low when compared with other peer companies such as CRL, MRL and IPCL.

Table 1 Production Capacity and Capacity Utilisation

Products	Production Capacity	Cap.Utilisation (FY 96)
Refinery	2.70 Million TPA	48%
Paraxylene	29000 TPA	99%
Orthoxylene	6000 TPA	6%
DMT	45000 TPA	92%
PSF	30000 TPA	70%

Lower refinery capacity utilisation is due to expansion in FY 96 from 1.35 million tpa to 2.70 million tpa. The paraxylene production was more profitable and hence orthoxylene production was curtailed. The PSF utilisation was lower due to market demand.

Industry Profile

Refinery Sector

Oil sector is highly controlled under the Administered Pricing Mechanism (APM). The marketing of petroleum products is in the hands of three major players viz., IOC, HPCL and BPCL. In the refining capacity, Indian Oil Corporation (IOC) is the market leader with 42% share whereas BRPL has only 4.2%. The major feedstock for refinery is crude oil and 50% of domestic crude requirement is met through imports. IOC is the only importer of crude. There is a decline of crude availability in North Eastern region where BRPL is situated. Average Assam oil production in last five years is 4.83 million tonnes while the current refining capacity based on Assam crude is 7.65 million tonnes and another 3 million capacity addition is coming up with the setting up of the Numaligarh Refinery. This may affect the crude supply to BRPL, in the short run and will act as an impediment for future expansion.

In the liberalised environment, the Government has allowed setting up joint ventures and private sector refineries. Moreover, there may be further decontrol in distribution and marketing, tariff structure, abolition of APM.

Petrochemicals

DMT and PTA are substitutes for manufacture of PSF/PFY. There are only three manufacturers of DMT viz., Bombay Dyeing (66%), IPCL (14%) and BRPL (20%) while there is only Reliance Industries Limited producing PTA (2.5lac tpa). The production Capacity of BRPL is 45000

TPA and operates at 92% capacity utilisation. Since DMT and PTA are substitutes, the overall demand supply scenario shows an excess supply scenario emerging from 1998-99 at the latest. PTA is generally perceived to be a superior raw material for the production of PSF on account of higher yield, better quality and absence of methanol as a by product. All new PSF capacity is planned on the basis of PTA as raw material. Existing PSF manufacturers (except BRPL) have installed dual feed facilities. This keeps the DMT manufacturers under stress. However, for DMT manufacturers with captive PSF units, there is no threat.

In case of PSF, the industry structure is more distributed with 11 players and Reliance as dominant player with 20%. Imports constitute 18% of domestic consumption. There is a declining trend in pricing. With additional capacities, a supply overhang situation is expected.

Business Analysis of BRPL

BRPL is an integrated refinery cum petrochemical complex and has a unique position in the industry. Half its businesses (viz., refining) is under administered pricing while the other half (viz., petrochemicals) is under free market. The company has undertaken an expansion of its refining capacity from 1.35 mmtpa to 2.70 mmtpa. This was done on the basis of ONGC's estimates of oil reserves in the North Eastern region. However the actual production have fallen short of these estimates. As a result of this, the crude availability is a major constraint due to which the capacity utilisation has been below 50%. In order to overcome this, the Government had appointed EIL to study the problems of crude

availability to all refineries in North East including BRPL. The summary of EIL's recommendations is as follows :

The most economical and cost effective option is to augment the proposed IOC's Haldia-Barauni pipeline by providing one booster station for transporting an additional 1.28 MMTPA to BRPL and with minor modifications to the OIL pipeline for reverse pumping from Barauni to BRPL. The cost of this facility is estimated to be around Rs.122 crores and will be complete only in FY 2000 assuming that there are no time delays.

Strengths and Weaknesses of BRPL

Based on the above industry, business and financial analysis, the strengths and weaknesses of BRPL are as below :

Strengths

Forward integrated leading to value addition. BRPL's operations are highly forward integrated leading to substantial value addition from refinery naphtha to DMT to PSF.

Recently commissioned low cost refinery capacity expansion BRPL's refinery capacity has been doubled from 1.35 million tonnes to 2.70 million tonnes at low cost in March, 1996. The capacity addition was based on optimistic projections regarding Assam crude oil availability in future.

Recent addition of LPG to product mix With the commissioning of Delayed Coking Unit-II (DCU-1), and installation of LPG recovery

facility in DCU-1, BRPL started recovering LPG,demand for which is projected to grow at 6-7% per annum.

Self sufficient power through captive power generation BRPL has set up captive power plants which generates steam and power required for all the units of the complex.

The Petrochemical section derives benefits of forward integration on account of raw material availability and cost This integration helps the company to enhance production efficiencies and lower costs, thus adding to the company's competitiveness.

Competitive technology from international Process Licensers BRPL has got the best technology used internationally for the production of petrochemical products.

Debottlenecking of DMT plant would substantially enhance capacity at low cost A low cost expansion of DMT plant is expected to add substantial value to company's profitability.

Weaknesses

Under-utilisation of capacity due to restricted availability of crude This under-utilisation is mainly due to reduced crude production in Assam. The average Assam oil production in the past five years is only 4.83 million tonnes while the refining capacity drawing on Assam crude is about 7.65 million tonnes at present.

Fuel consumption and refinery loss higher Fuel oil consumption per unit crude throughput of BRPL is 69MT per 1000 MT where as that of HPCL is only 27. Similarly, gas consumption is 27MT per 1000 MT as against 12 of HPCL. However, there are scope for improvement exists.

Marketing products through IOC resulting in lack of in house marketing expertise and distribution network This will be a major disadvantage under the liberalised regime with phasing out of APM and BRPL will have to incur a lot of capital expenditure in setting up these facilities. Moreover, BRPL has to cater to a long distance market as there is already an oversupply situation in the North Eastern Region.

Additional refining capacities The proposed Numaligarh Refinery will enhance competition and will affect the crude availability due to low supplies. Moreover, there will be increased competition in HSD segment.

Locational disadvantage Major markets for DMT/PSF situated in North and West.

Low capacity utilisation for PSF PSF capacity utilisation is 70% in FY 96 mainly on account of restricted demand and operational reasons.

Business subject to relatively higher cyclicalities Cyclicalities of prices affects margins. Pricing is linked to international prices which has shown a 50% decline in DMT prices and 35% in PSF.

Emerging oversupply situation in PSF market Additional capacity of 3.82 lac mtpa is expected to come up by FY 97 and this could create a supply overhang. Low cost producers and integrated manufacturers like BRPL are better placed to survive.

Reduction of import duties There is a declining trend in custom duties for petrochemicals particularly on DMT which came down from 35% to 27%.

Financial Analysis of BRPL

The financial performance of BRPL for the past five years are as below:

Table 2 Financial Performance

(Rs.Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	716.4	640.5	574.0	483.5	416.6
Operating Profit (OP)	149.5	104.9	76.6	66.5	88.8
Profit before Tax (PBT)	120.2	85.2	61.7	50.2	65.2
Profit After Tax (PAT)	90.2	61.1	37.9	29.0	36.0
Equity Capital	199.8	199.8	199.8	199.8	199.8
Net Worth	508.3	444.5	402.2	381.2	362.1
Gross Margin (%)	20.9	16.4	13.4	13.8	21.3
Net margin (%)	12.6	9.5	6.6	6.0	8.4
ROCE (%)	22	18	15	10	14
RONW (%)	18	14	9	8	10
Earning Per Share (Rs.)	4.51	3.06	1.89	1.45	1.80
Dividend (%)	13.5	10	7	5	5

Refinery unit contributes 60% of the gross revenue while the balance comes from the petrochemicals and PSF units. Share of PSF unit has been going up over the last three years. Operating income has also shown a significant improvement. Operating margins have displayed a rising trend even though the refinery section is under APM. Due to improved profitability, the EPS has shown a steady increase.

BRPL is an integrated refinery with down stream processing and manufacture of petro chemical products. These integrated operations have helped the company to remain competitive even though in terms of economies of scale the size of the refinery is rather small. While the refinery capacity was recently doubled to 2.7 million tonnes, on account of non-availability of crude, capacity utilization was less than 50% in FY 1996. Till arrangements for supply of imported crude through the Haldia-Barauni pipeline and reverse pumping from Barauni to Bongaigaon are completed in the next 2-3 years BRPL will continue to suffer on account of crude supply constraints.

Apart from crude availability, to capitalize on its strength of integrated operations, the company would need to improve efficiencies in its PSF operations particularly to control fuel consumption and waste reduction to increase profitability. Another area of attention from the point of view of improving its profitability would be to build up its capability to market its products outside the North-Eastern region without depending on the Indian Oil Corporation as at present.

Recommendations

The long-term viability of the company would hinge on arrangements for the crude supply problem and development of marketing capabilities. This company suffers inherently from marketing disadvantages, situated as it is far away from its main market for the refinery products as well as petro-chemical products. The Commission, therefore, feels that it would be desirable to associate a strong partner in the company's operations to enable it to make necessary investment to improve its operations and more importantly provide access to marketing techniques. Already in the oil sector and even in the N.E. region there is adequate presence of the public sector. In these circumstances, keeping in view the special locational problems of the company and the vital need for strong organizational and marketing inputs for its survival, it is considered necessary to review its classification as a core PSU.

The Commission recommends that a strategic sale of 50% of Government's shareholding in BRPL may be offered to Indian and foreign oil companies either on their own or in association with one another. The procedures for strategic sale to be undertaken on an international basis have been detailed in Part B of the first report of the Commission. It needs to be emphasised however that, in order to attract sufficient interest among prospective bidders, it is essential that Government make a policy statement on the phasing out of the Administered Price Mechanism (APM) for all petroleum products (with subsidy only for kerosene supplied under the PDS) within a period of about two years.

Hindustan Latex Limited (HLL)

Evolution

Hindustan Latex Limited (HLL) was incorporated in 1966 with the main objective of assisting in the population control efforts of the Government of India. The commercial production was started in 1969 with the setting up of a male contraceptive plant with 144 million pieces per annum (mppa) which was later enhanced upto 608 mppa. Later during 1990's, HLL diversified into the manufacture of various female contraceptives like Intra Uterine Devices(IUDs) and oral contraceptives and healthcare products like blood bags, latex gloves and hydrocephalus shunts. The equity capital of the company as at 31st March, 1996 was Rs.15.5 crores and the Government of India holds 100% equity.

Industry Profile

The industry profile as well as the share of HLL production in various products are given below.

Male Contraceptives

The total market size of male contraceptives in India is 1250 mppa out of which 80% is purchased by Government for free supply and social marketing. The balance 20% is marketed commercially. The current capacity in the country is 2000 mppa and HLL's share in the total capacity is about 30%. The other major players are Polar Latex, TTK & London Rubber Company, and JK Chemicals. Since the Government is the major buyer, the fortunes of this industry largely depend on the Government's spending in the areas of family planning and population control. HLL is currently operating in 100% capacity.

Female Contraceptives

Oral Contraceptives

Oral contraceptives are one of the female contraceptive. There are two brands which are currently manufactured and Government of India is the sole buyer. These are mostly distributed free and some are sold at a subsidised rate through social marketing channels. The raw materials of the formulation of this pill are supplied by United Nations Family Planning Association. The three companies tableting these are HLL, IDPL and Eupharma Laboratories Limited. These are marketed through various companies including HLL.

Intra-Uterine Device (IUD)

Another female contraceptive is IUD called Copper-T. The total demand from the Government is 7-8 mppa and the entire product is distributed free of cost by Government under its social welfare schemes. HLL has a capacity of 4 mppa and the other main manufacturers are Famicare Ltd., Contact Devices Ltd., and SMB Corporation Limited.

Healthcare Products

Blood Bags

Blood bags are substitutes for glass bottles and there is a gradual switch-over in the usage from glass bottles to blood bags. The domestic blood bag market is currently having a demand of 6-7 mppa. The dominant player in the industry is Peninsular Polymers Ltd. who has a 80% market share. HLL is a late entrant with a capacity of 2 mppa. The commercial production was started only in September, 1995. The other major players in this field are TTK Pharma Ltd., J.Mitra & Co., Eastern Medikit Ltd., and Core Healthcare Ltd.

Hydrocephalus Shunts

This product is used to drain excess fluid in the cranium. The current demand in India is estimated at 20000 pieces per annum. HLL has set up a unit to manufacture with an installed capacity of 5000 pcs per annum. Currently the demand in this product is met through imports.

Latex Gloves

There is an over supply situation in this segment. HLL has an installed capacity of 24 mppa and the other domestic manufacturers are from the unorganised sector. The international price of this product was around USD 60 per 1000 pcs in 1991-92 and has declined substantially to USD 25 per 1000 pcs.

Business Analysis of HLL

HLL manufactures a wide variety of products. The production capacities and capacity utilisation for FY 96 is as under:

Table 1 Production capacities and capacity utilisation

Products	Capacity	Cap.Util.
Male Contraceptives	608 mppa	100 (%)
Female Contraceptive - Pills	870 Mn tablets	60 (%)
- Copper-T	4 mppa	75 (%)
Latex Gloves	24 mppa	5 (%)
Blood bags	2 mppa	15 (%)
Hydrocephalus Shunt	5000 pcs	15 (%)

HLL has a diversified product range. But the main component of sales and profitability is from the male contraceptive business. Sales break-up of various products and their contribution towards profit before interest, tax and depreciation (PBIDT) for FY 96 are as follows:

Table 2 Product wise Sale break-up for FY 96

Products	sales (Rs.Crs)	% of total	PBIDT (Rs.Crs)	% to total Contribution
Male Contraceptives	42.7	81.2	17.6	77.4
Female Contraceptives				
- Mala D/N	3.3	6.3	1.8	7.7
- Copper-T	4.6	8.7	4.1	18.0
- Saheli	0.1	0.3	0.3	1.5
Healthcare Products				
- Latex Gloves	1.1	1.9	-1.2	-5.4
- H.Shunts	0.1	0.1	0.0	0.1
- Blood bags	0.2	0.4	0.0	0.2
Sutures (Trading)	0.6	1.1	0.1	0.5
Total	52.7	100.0	22.7	100.0

Financial Analysis of HLL

Growth in sales has been moderate, but steady, with sales to Government constituting over 80% of the total contraceptive sales. The operations have been profitable in the last few years except in FY 96. The following are the details of financial performance of HLL for the past four years.

Table 3 Financial Performance

(Rs.Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Total Income (TI)	54.5	50.2	43.1	38.0	34.3
Operating Profit (OP)	1.6	6.6	7.8	6.6	8.4
Profit before Tax (PBT)	-6.7	0.8	1.6	1.0	4.0
Profit after Tax (PAT)	-6.7	0.8	0.6	0.7	2.4
Equity capital	15.5	13.0	12.6	12.6	12.6
Net worth	22.6	26.4	24.0	23.8	24.4
OP/ TI (%)	3.0	13.2	18.1	17.5	24.5
PAT Margin (%)	-12.4	1.6	1.3	1.9	7.0
ROCE (%)	-5.8	9.7	12.2	7.7	13.9
RONW (%)	-27.4	3.1	2.3	3.1	9.8
EPS (Rs.) (Par value.10/-)	-4.3	0.6	0.4	0.6	1.9
Dividend (%)	-	2.3	0.8	-	5.5

The reasons for the declining trend in profitability since 1994 is mainly due to realisation not keeping pace with the increase in raw material cost and high and increasing labour cost. The loss in FY 96 was largely due to the one-time charge on account of wage settlement (Rs.4.7 crores) and low capacity utilisation in the gloves and blood bag units. The company expects to make profits at the net level in FY 97.

Strengths and Weaknesses of HLL

Based on the above industry, business and financial analysis, the strengths and weaknesses of HLL are as below :

Strengths

International standards in terms of quality HLL has been awarded the ISO 9002 certification and the AFNOR registration of France and the US-510 K certification. Due to this HLL could increase exports and for direct exports to a few countries like France, Brazil and the USA (through tie-ups with foreign agencies) export realisations have been better.

Entering into New Business areas HLL's diversification into blood bag is gaining acceptance in terms of quality. There is a 30% duty on imports on blood bags which will make domestic products price competitive. Similarly, HLL's hydrocephalus shunt's sales are also picking up. Currently the market is dominated by imports. Once the market accepts the products, there is a good market for this product.

Weaknesses

Over supply in Male Contraceptive market The male contraceptive market is currently having a capacity of 2000 mppa while the demand is only 1250 mppa.

Price & Purchase Preferences Till FY 95, HLL was enjoying price preference and with the result HLL used to get 6-10% more than private manufacturers. Like wise, GoI was giving purchase preferences to HLL upto March 31, 1997. This matter is however under review.

Surplus Labour The total manpower of HLL is 2160. A study conducted with the help of NPC on Thiruvananthapuram units and corporate office has revealed that there is a surplus manpower of 467 which is about 38%. This was further discussed with the trade union representatives and 256 number of surplus labour was identified.

High wage cost The wage cost as a percentage of total cost of production is about 32% which is quite high.

Delay in getting approvals The approval for capital expenditure programmes of the company for the blood bags and the gloves project was delayed due to which the company could not enter the market at the opportune time.

Unviable operations HLL's glove manufacturing unit's contribution in profit before interest tax and depreciation is negative. The company with its high wage costs could not compete with the domestic unorganised

segment and imports. This has resulted in closure of this unit for most of FY 96.

Dependence on single buyer Government is the principal buyer of HLL's products such as Mala-D/N and Copper-T. If the Government's order fluctuates, the capacity utilisation of the company will affect resulting in diminishing profits.

Recommendation

Disinvestment in HLL, as it is functioning today, cannot have any significant impact as far as resource generation is concerned. Given its low and inconsistent profitability record and low equity base, disinvestment will not generate any interest among investors.

Department of Family Welfare emphasised before the Commission the crucial role of HLL in regard to the family welfare programme. It has, however, also to be noted that the Government policy seems to be to phase out preferences to the PSU in the purchase of contraceptive for free distribution as well as social marketing. Price preference has already been discontinued and purchase preference is currently available only till 31.3.1997 . The policy is under review for further extension or otherwise. In the absence of a Government undertaking in the field, it could be argued that the cost of contraceptives for free distribution and for social marketing could be pushed up by the private producers. It is, however, to be considered that in this sector, the technology being simple and easily accessible and the capital costs not very high, the entry barriers are quite low. There is also considerable over capacity in the domestic market viz. 2000 mppa as against the Government purchase

programme of 1000 mppa and the commercial demand of 200 mppa. It is, therefore, difficult to agree totally that Government ownership in the sector is vital or crucial to the implementation of the family welfare programme. In fact with its own costs on the higher side on account of the surplus labour, the usefulness of HLL to keep a check on prices quoted by other private producers for supplies to Government is rather limited. Given the budgetary constraints, in real terms, the Department is said to be facing, a higher cost public sector producer with purchase preference would in fact be counter-productive from its point of view.

In the long run, therefore, HLL has to be enabled to reorient itself to a competitive market scenario. For this purpose it will have to be given sufficient autonomy to reorganize its production pattern to improve its market share in the high priced segment of contraceptives, develop a strong marketing network and also push through the diversification projects in areas like blood bags, and shunts, after properly assessing their individual viability. It would also need the necessary freedom to deal with its surplus labour force through an imaginative and acceptable VRS. The company would also need budgetary support for implementing VRS. The Disinvestment Fund, recommended by the Commission could take care of this requirement. Since it has already established itself as a quality producer of contraceptives and has got not only ISO 9002 certification but also acceptable accreditation in the French and US markets, the company would need to enter the export market aggressively rather than rely only on channels of UNFPA and other international NGO-sponsored sales.

Taking into consideration the importance of the family welfare programme and reservation which the Department has about dilution of Government control in Hindustan Latex Ltd. the Commission would recommend a step by step approach towards disinvestment in this PSU.

The company should implement a VRS to bring down the labour cost to a comparable level vis-à-vis its competitors in the private sector. Once this is achieved, the government can offer 50% of its holding to a strategic partner who would provide further marketing and technological strength to the company to improve its performance in the domestic and export markets. The Government could also go in for further disinvestment in the domestic market through a public offer to small investors and employees. The Commission recommends that the Government should continue to hold 26% of equity in this company to ensure that the company's role in the production of contraceptives in the lower price segment for free distribution and social marketing is continued even after disinvestment. The Articles of Association should be suitably amended to incorporate necessary safeguards for this purpose.

HTL Ltd.

Evolution

HTL Ltd (HTL) was incorporated in 1960 for the manufacture of electromechanical teleprinters primarily to cater the needs of the telegraph wing of P & T Department. In the second half of eighties, the company diversified into manufacture of electric typewriters and electronic typewriters. In 1990-91, the company entered the area of manufacture of switches for telephone exchanges based on the technology of C-DoT. The current lines of business of HTL include manufacture of switches of all categories of exchanges i.e. small (less than 2000 lines), medium (upto 10000 lines) and large (greater than 40000 lines), manufacture of main distribution frames (MDF), transmission access and data communication products. The main manufacturing facility of the company is located at Guindy Industrial Estate in Chennai city and a supplementary facility is in the Hosur Industrial Estate on the TN-Karnataka border. The break-up of HTL's income for 1995-96 is given below:

Table 1 Break-up of income for 1995-96

Product	Rs. (Crs)	%
MDF	19.50	15
Small switches (C-DoT)	19.81	14
Large Switches	85.50	61
Transmission & Access	1.98	1
Data Communication Products	13.12	9
Total	139.91	100

The company has a paid up share capital of Rs. 15 crores which is wholly held by the Government.

Telecom Equipment Industry Characteristics

The telecom equipment industry can be divided into three broad segments - switching equipment, transmission equipment and terminal equipment. These products are manufactured by a number of Indian and multinational companies.

Buyer Power

DoT is currently the largest buyer of telecom equipment in India. Therefore, DoT's future plans, and its technology and product preferences, influence the investment decisions made by Indian manufacturers.

The industry structure is expected to change from a near monopoly, with the entry of private sector basic and cellular service operators, and therefore, DoT's bargaining power is likely to diminish over the next few years.

Dependence on Foreign Collaborations

Indian manufacturers depend on foreign technology for higher-end equipment such as large switches. Continuous access to technology is critical in view of the high rate of product obsolescence and the need to offer the latest technology so as to remain competitive.

Severe Competition

DoT's orders for telecom equipment are based on tenders, with the lowest bidder getting the largest order, and the balance order being split among the other bidders (at the price quoted by the lowest bidder). In order to penetrate the potentially large Indian market, multinational

players seem to have quoted unrealistically low prices in tenders floated by DoT. The entry of multinationals in the switching segment has led to a reduction in prices from Rs. 7,000 to Rs. 4,300 per line. This has resulted in intense competition in the industry, forcing many players to exit the business.

Working Capital Intensity

The manufacture of telecom equipment in India requires long cycle time, which could be increased further by delays in testing and inspection by DoT. This results in large work-in-process inventory in manufacturing units. Delay in payments by DoT and discontinuation of its advance system has led to high receivable levels for the domestic players.

Demand-Supply

The switching equipment industry is expected to grow at an annualised 25% in the medium term as shown in the table below. The demand for transmission equipment industry should increase at a Compound Annual Growth Rate (CAGR) of about 15% in the same period. However, lack of funds with DoT could constrain growth in the short term. The industry will be characterised by overcapacity and severe competition, but prices will improve from current levels (at which existing manufacturers are making losses).

Table 2 Demand for Switching Equipment Figures in million lines

Equipment	1997-98	1998-99	1999-00	2000-01	2001-02
Large	3.12	3.96	3.51	3.62	7.08
Small	1.21	1.56	1.33	1.44	2.90

Competition

The large switch segment is dominated by large MNCs and ITI. DoT has approved seven switching technologies (from Siemens, AT&T, Fujitsu, GPT, Ericsson, Alcatel, and NEC) for integration with the local network. These multinational players have entered India through joint ventures with local partners as shown in table 3.

Table 3 Joint Ventures for Large Switches

Indian Partner	Foreign Partner	Product
BK Modi Group	Alcatel, France	E10B
Tata Group	AT&T, US	5ESS
Siemens India	Siemens, Germany	EWSD
SR Jiwrajika	Ericsson, Sweden	AXE
Punjab State Dev. Corpn.	Fujitsu, Japan	FETEX-150
KK Birla Group	GPT, UK	SYSTEM X

Competition in the medium and smaller segment is among HTL and about fifteen manufacturers in the private sector.

Business Analysis of HTL

The transformation of HTL from a manufacturer of teleprinters to a manufacturer of switching exchanges and transmission products is depicted in the table below:

Table 4 Pattern of income composition 1992-96

Income Composition in %	1996	1995	1994	1993	1992
Teleprinters and Typewriters	0	0	18	73	77
Switching - Large exchanges	61	37	0	0	0
Switching - Small exchanges	14	34	63	5	0
Main Distribution Frames (MDF)	15	14	15	17	16
Data, Access and Transmission	10	15	4	5	7
Total	100	100	100	100	100
Total Income (in Rs. Crores)	139.91	102.15	79.70	77.16	66.71

In 1995-96, the Company derived a large portion of its income from large switches for which the company has a commercial agreement with

Siemens for technology. This arrangement is renewable but does not assure a sustained access to technology. Further HTL has an assured quote of 15% of all DoT purchases which makes its attractive for a multinational to ally with them.

Financial Analysis of HTL

The following tables shows the financial performance of HTL for the past five years.

Table 5 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Net Sales	141	104	81	77	67
Gross Profit	9.7	6.1	7.4	17.0	9.9
Profit before Tax	0.8	1.5	6.7	14.2	14.6
Net Profit after Tax	0.5	0.4	2.6	6.6	6.7
Paid-up Equity Capital	15.0	15.0	15.0	15.0	12.0
Net Worth	41.2	41.3	41.0	38.9	32.7
Gross Profit Margin (%)	6.8	5.9	9.2	21.9	14.7
Net Profit Margin (%)	0.3	0.4	3.3	8.5	9.9
ROCE (%)	8.9	7.0	13.0	30.4	40.1
RONW (%)	1.1	1.1	6.4	17.0	20.3
EPS (Rs.) Par value Rs.100/-	3.3	2.7	17.3	44.0	55.8
Dividend (%)	1	1	3	3	7.5

In the period shown in the table, the company has made the transition to the manufacture of switching products and was totally exposed to intense competition. There was a steady decline in profits although the availability of quote ensured growth in income. HTL's liquidity position has worsened significantly and it had already stretched its suppliers to the limit. The sharp increase in the external liability eroded the net margins.

Strengths and Weakness of HTL

Based on the above industry, business and financial analysis, the strengths and weaknesses of HTL are as below :

Strengths

Strong electromechanical skills The company has been manufacturing electromechanical switches over the past three decades and has consequently built up strong manufacturing skills. This however may not be relevant in the context of digital switching technology.

Emergence of new customers The policy initiatives with regard to privatisation has led to emergence of new customers in the telecom equipment industry. However this may translate into orders at a much later date.

Weaknesses

Dependence on multinationals The component and technology base for telecom products in India is not developed as much as in other developed countries. Consequently domestic companies manufacturing large switches and transmission and access products have to depend on multinationals.

Large workforce with unsuitable skills As the company has changed its focus from electro mechanical switches to digital switches, the current workforce has become unsuitable for the production of digital switches. In addition the large number and the adverse age profile has contributed to the low productivity.

Inadequate financial strength As mentioned in the industry report, the telecom equipment industry is characterised by high working capital requirements. HTL has inadequate financial strengths in this regard.

Possible loss of assured demand Under the liberalised scenario, it is possible that HTL could lose the assured demand i.e., quota from DoT.

Uncertainties in choice of technologies and commercial terms HTL has to depend on technology on foreign players and therefore there may be uncertainty with regard to sourcing of technology as well as the commercial terms for the access with the technology players.

Suppliers turning competitors While multi nationals offers technology to domestic telecom companies who have assured quotas from DoT there is an increasing possibility that these multinationals could quote in competition with the PSUs with whom they have a technical collaboration.

Recommendations

In the report on ITI, the bleak financial future of the company has been brought out. HTL is even more vulnerable than ITI owing to its substantial dependence on imported components, low value addition and lack of in-house R&D for products like large switches and transmission equipment. The company is unable to meet its existing obligations on debt owing to severe liquidity problems. The company has not been able to pay interest and loan installments due to UTI and the Government. In the next one or two years, the networth of the company is likely to be substantially eroded and the company will most probably come under the

purview of BIFR. On the other hand, the company has valuable assets in the form of industrial land in a prime location in Chennai.

The company has around 1600 employees. This manpower strength constrains HTL's competitiveness. In addition, the lack of electronic skills in the workforce has a detrimental effect on the productivity. Already 175 employees have opted for VRS and there is a proposal to offer VRS to another 600 pending a grant of Rs.14 crores from the Government of India. The Commission recommends that the VRS should be initiated immediately.

The Commission therefore, recommends three options for disinvestment which are to be followed in the order as given below:

The possibility of selling 100% shares in HTL along with ITI shares may be considered in the process of strategic sale on the lines recommended in the case of ITI.

In the alternative, 50% of shares of HTL may be offered to a strategic partner through a global competitive bidding. The financial advisors for ITI can be asked to examine this aspect in detail while preparing the terms of sale for ITI. The first two recommendations may therefore, be dealt with along with the recommendation for ITI.

Madras Fertilisers Limited

Evolution

Madras Fertilisers Limited (MFL) was formed in 1966 to manufacture and sell nitrogenous and complex fertilisers. The company was set up as a joint venture with the American Oil Company (Amoco) with the GoI holding 51% and the JV partner the balance. At present GoI holds 70% of MFL's share and the National Iranian Oil Company (NIOC) holds the balance. The plant is located at Manali near Chennai in close proximity to Madras Refineries Ltd.(MRL) which supplies naphtha for producing ammonia.

Industry Analysis

Fertilisers are basic nutrients to soil which help replenish the depletion or original deficiency in the soil. Nitrogen (N), phosphate (P) and potash (K) are primary nutrients whose percentage concentration in a chemical fertiliser is expressed in terms of NPK respectively. Nitrogenous fertilisers account for 70% of the consumption of chemical fertilisers in India.

There are 30 companies in this industry belonging to the public, private and the co-operative sectors with over 65% of the installed capacity in the public sector and co-operatives. However, the industry is dominated by five or six companies who account for more than 60% of the market share as shown in the table below :

Table 1 Capacity in Million Metric Tonnes per annum

UREA (62%)		DAP (88% *)		COMPLEX (72% *)		SSP (30% *)	
Company	Cap.	Company	Cap.	Company	Cap	Company	Cap

NFL	2.08	IFFCO	0.80	FACT	0.86	Dharamsi Morarjee	0.58
RCF	1.91	Paradeep Phosphates	0.72	IFFCO	0.80	Pyrites Phosphites & chemicals	0.26
IFFCO	1.62	GSFC	0.43	RFC	0.66	Rama Phosphates	0.13
KRIBHCO	1.45	SPIC	0.42	Madras Fertilizer	0.54	Sunderban Fertilizer	0.13
Indo-Gulf	0.73	Godavari Fertilizers	0.30	Coromandel Fertilizer	0.35	Phosphate	0.11

* Total markets share of top five players.

The fortunes of the fertiliser industry are determined to a large extent by the Government policies. In order to promote the use of fertilisers among the small farmers, the Government virtually controls all aspect of operations including production, raw material sourcing and distribution. Urea pricing is controlled through the retention pricing scheme which assures 12% post tax return on networth. Both phosphatic and potash fertilisers were decontrolled in 1992 and are presently given adhoc subsidies by the Government.

Consumption of fertilisers depends on a combination of factors, the major ones being monsoon, irrigation facilities availability of rural credit, pricing etc. The production and consumption of fertilisers have grown at a CAGR of 13.52% and 12.86% over the last 37 years but this has somewhat slowed down during the last three years.

Business Analysis of MRL

MFL has facilities for the manufacture of 750 tpd of ammonia, 885 tpd of urea and 2900 tpd of complex (NPK) fertilisers.

In the past, the company's profitability was affected due to changes in Government policies and also due to operational problems such as availability of water etc.

The Company has embarked on a modernisation and expansion project for revamping the old ammonia and urea plants and upgrade inefficient production technologies in order to extend economic life of the plant and also increase capacities of the ammonia and urea plants by removing production bottlenecks. This is expected to increase the capacity of ammonia production by 40%, urea production by 66% and NPK production by 55%. The project cost is estimated at Rs. 518 crores and is expected to be completed by April, 1997.

For its ongoing requirements of funds, the company has proposed a public issue of Rs. 42.95 crores at a premium of RS 5/- per share on a face value of Rs. 10. MFL has also obtained SEBI approval for this initial public offering.

Financial analysis of MFL

The financial performance of MFL for the past five years are as below:

Table 2 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Total Income	686.3	645.1	476.6	430.9	456.5
Gross Profit	56.2	38.4	-10.9	52.2	41.0
Profit before Tax	21.0	6.6	-48.9	7.9	15.2
Net Profit after Tax	21.1	7.5	-58.5	12.1	16.3
Paid-up Equity Capital	137.4	137.4	106.4	98.3	55.7
Net Worth	126.8	105.1	65.7	115.3	72.2
Gross Profit Margin (%)	8.3	6.6	-2.4	10.4	8.8
Net Profit Margin (%)	3.1	1.1	-10.7	1.6	3.3
ROCE (%)	23.0	12.8	-5.8	18.2	20.7
RONW (%)	18.1	7.7	-54.0	8.4	25.2
EPS (Rs.) Par value Rs.10/-	1.53	0.48	-4.59	0.80	2.74
Dividend (%)	0	0	0	12	15

Due to the decontrol of complex fertilisers in FY 94 and withdrawal of subsidy, the financial performance deteriorated considerably as the company was forced to sell its main product below its average cost of production. Other factors which have led to varying profitability are delayed receipts of subsidy, high inventory build up and higher working capital requirements. Net profit margins have exhibited a fluctuating trend over the past five years. This is largely due to higher interest cost, delayed subsidy receipts, high inventory build up resulting in higher working capital requirements.

Strengths and Weaknesses of MFL

Based on the above industry, business and financial analysis, the strengths and weaknesses of MFL are as below :

Strengths

Fairly consistent overall performance over the years In complex fertilisers, MFL currently enjoys market leadership in Tamil Nadu and Karnataka and ranks second in Andhra Pradesh. MFL's complex fertiliser, "Vijaya" enjoys a premium in the market in spite of the price being controlled by Government policies. The company compares favourably with its peer group in respect of wage costs and selling expenses

Expansions of Operations Due to the strong brand image and the established market presence in the South Indian market, the company has significant opportunity to expand its operations and grow at a steady pace in the medium term.

Weaknesses

Fertiliser industry is capital intensive and is characterised by low margins in the decontrolled sector MFL's margins are the lowest among its peer group. Even though wage accounted for over 5% of cost of production, which compares not too unfavourable with comparable units, MFL still appears to have excess manpower to the extent of 30-45% especially after the revamp project is completed.

Operational constraints The capacity utilisation of ammonia and urea have mostly moved in line with the availability of water during the last six years. Continued availability of water after the modernisation programme will be crucial for the continuous operations of the company. The company with its sewage treatment of plant of 2.4 mgd capacity has coped with this problem.

Recommendations

The Commission has classified MFL as non-core. The Commission has noted that the IPO which is being put through by the company will reduce GoI holding to 57.7%. In view of the already decided IPO, there is no scope for further disinvestment of Government shares at present.

In terms of the current agreement with NIOC, GoI is bound to hold a minimum of 51% shares in the company. The Commission, therefore, recommends that Government of India may immediately initiate negotiations with NIOC to change the terms of the agreement which would enable Government of India and, and if they so desire NIOC, to sell 50% of its share to a strategic partner through a competitive bidding

process. The distribution of shares to be offered to the strategic partner between GoI and NIOC should be decided through negotiation. The balance shareholding of GoI can be offered to institutions, small investors and employees through a public offer once the revamp programme is completed and the company's performance improves. The Modalities for strategic sale have been detailed in pp 38-40 of the First Report of the Commission.

Manganese Ore (India) Limited

Evolution

The Manganese Ore (India) Limited (MOIL) was incorporated in 1962, in order to undertake manganese ore mining activity, with 17% each of its share capital held by Central Government and the State Governments of Maharashtra and Madhya Pradesh and the balance 49 % held by British company called Central Provinces Manganese Ore Company (CPMO). In 1977, the Central Government acquired shares held by CPMO and further in 1986, infused equity capital of Rs.2.5 crores to strengthen the company. This has resulted in current Central Government holding of 82 % of the equity of the Company with the State Governments of Maharashtra and Madhya Pradesh holding about 9% each.

Ferro Manganese Industry Profile

India accounts for about 8% of the world's total reserves of Mn. The ore deposits are located largely in the states of Karnataka, Maharashtra, Madhya Pradesh, Orissa and Goa. Almost the entire production of manganese ore is consumed by steel industry either directly or indirectly. High grade manganese ore (>42% Mn.content) is consumed by ferro alloy which is used as deoxidising agents and as alloying agents to provide hardness to steel. Low grade high siliceous ore (LGHS) with more than 25% Mn. content is used in blast furnaces as desulphuriser. Manganese in dioxide form (MnO₂) with 72% to 80% Mn content is used directly or in the form of EMD in dry cells as depolarisor. As the reserves of high quality low phosphorous

manganese ore is limited, the Government has stipulated that exports should be carried out only after meeting all domestic requirements.

MOIL dominates the Mn ore sector in the Ferro grade and Dioxide grade ore. The other producers in the high grade segment are Orissa Mining Development Corporation (OMDC), Orissa Mining Corporation (OMC) and Sandur Manganese ore Ltd. The low grade segment comprises of small mining companies numbering over 200.

The high quality manganese ore is used in the manufacture of ferro alloys. The total ferro alloy manufacturing capacity in India is 1.35 million tonnes of which manganese alloys account for about 50%. The capacities, capacity utilisation of the main producers are given below:

Table 1 Capacity Utilisation of Main Producers

Company	Capacity (tpa)	Utilisation (%)
Maharashtra Electromelt Ltd	100,000	90%
Sandur Manganese ore	72,000	29%
KFA Corporation	60,000	18%
Ispat Alloys	72,000	65%

Demand of Mn ore is a derived demand which has a direct relation to steel industry. SAIL and TISCO account for about 40% of the manganese alloy consumption and the balance is consumed by other mini and alloy steel producers. SAIL sources its requirements from MEL while TISCO has conversion arrangements with a number of small manufacturers.

Internationally the main ferro alloys producing countries are South Africa, China, Australia, Brazil and the CIS countries. In the past,

international prices have varied considerably in the range of USD 420/ton to USD 690/ton (FOB China). However, in the past, Chinese producers have sold in the range of USD 420 - 440 per ton. With the declining duty structure, the following table shows the comparison with the domestic price vis-à-vis the landed cost (including customs duty) for the past five years.

Table 2 Domestic price v/s Landed cost of Ferro Mn (Rs./Tons)

Financial Year	Domestic Price	Landed cost incl.import duty (%)
1993	18000	30101 (85%)
1994	15000	21145 (65%)
1995	16000	21742 (50%)
1996	22000	22269 (30%)
1997	19000	21793 (27%)

A reduction in the duty by 5% in the Union Budget for 1997-98 has been proposed and the Chelliah Committee has recommended that the ultimate duty to be brought down to 15%. The fall in international prices coupled with reduction in import duty has put a lot of pressure to the Indian ferro alloy manufacturers.

The ferro alloy industry is power intensive and the power cost constitute more 50% of the cost of production. The high cost of power in India (Rs.3/KWH as against 0.75/KHW in South Africa) increases the domestic cost of production.

On account of the reduction in import duties and the high cost of power, the viability of domestic ferro alloy industry has been threatened to a significant extent.

Key Success Factors in Manganese Ore Mining

Ore reserves Since the operations of the company is mining of ore, the quality and quantity of deposits is one of the key success factor.

Performance of ferro alloy industry High grade manganese ore (>42% Mn content) is used in manufacture of ferro alloy. Ferro alloy is consumed by steel industry as a deoxidising agent. Hence the success of the manganese ore industry is related to performance of ferro alloy industry.

Performance of Steel Industry Almost 98% of the total manganese ore is directly or indirectly used in the steel industry. Performance of the steel industry has a direct bearing on the future of manganese ore mining industry.

Business Analysis of MOIL

MOIL is operating 10 manganese (Mn) ore mines in Maharashtra and Madhya Pradesh with current production level of 700,000 tonnes per annum. As a part of forward integration, MOIL has set up an unit for manufacturing Electrolytic Manganese Dioxide (EMD) with a capacity of 700 MT per annum. It is producing 49% of the country's total output of manganese ore and 75% of high grade manganese ore. Out of this, four mines account for 68% of the total production. The high grade Mn ore account for 57% of the total production of MOIL in FY 96 while the LGHS account for 29% of the total production in FY 96. Over 55% of MOIL's production and 74% of its total income is from high grade ore.

MOIL sells about 25% of its ferro grade ore to Maharashtra Elektros melt Ltd. (MEL) a subsidiary of SAIL. Bhilai Steel Plant of

SAIL accounts for 90% of the sale of LGHS. MOIL exports a certain amount of ore through MMTC and the principal buyers are Chinese ferryl alloy producers.

Apart from the mining process, MOIL started processing MnO₂ known as EMD. In FY 96 it produced 547 tonnes of EMD and sold 657 tonnes.

Financial Analysis of MOIL

The financial performance of MOIL for the past five years are as given below :

(Rs.Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Total Income (TI)	103.9	80.1	61.4	76.3	71.3
Operating Profit (OP)	24.3	15.6	16.8	27.9	23.1
Profit Before Tax (PBT)	19.7	10.7	11.4	23.5	18.7
Profit After Tax (PAT)	10.8	5.6	5.0	10.5	77.0
Share capital	15.3	15.3	15.2	15.2	15.1
Net Worth	49.7	42.0	39.3	37.3	30.4
OP/TI (%)	23.4	19.5	27.5	36.5	32.4
PAT/TI (%)	10.4	7.01	8.1	13.7	10.8
ROCE (%)	38.7	23.5	26.9	61.1	58.2
RONW (%)	12.2	13.9	13.0	30.9	27.9
EPS (Rs.) Share Value Rs.100	70.3	36.7	32.7	68.9	50.8
Dividend (%)	20.0	20.0	20.0	20.0	14.0

The total income has shown a cyclical trend on a year to year basis. However, MOIL has been able to maintain its profitability even during recessionary period due to its dominant position in the domestic industry. The return on capital employed (ROCE) was at high over 23% even in years in which the industry scenario was not favourable when compared with cost of capital. The company has consistently paid dividend and the earnings per share has shown a

smart jump from FY 95 to FY 96 due to improved financial performance.

Strengths and Weaknesses of MOIL

Based on the above industry, business and financial analysis, the strengths and weaknesses of MOIL are as below :

Strengths

Rich reserves MOIL's share of reserves of both dioxide ore and ferro grade ore is very high and account for 75% of India's reserves.

Dominant producer in manganese ore industry in ferro grade and dioxide categories MOIL is having a production share of 73% in dioxide segment while in ferro grade segment, its production share is 78%.

Cost competitive both domestically and internationally The domestic price of manganese ore is at present lower when compared with international (fob) prices to the extent of 15-17%.

Demand growth expected in Steel whereby the demand for Mn ore should also go up The principal user of manganese ore is the steel industry and the steel industry is expected to grow at 10-11%. This gives a lot of opportunity for MOIL to expand its operation.

Mining leases for longer period Mining licenses are granted for 20 years while the land on which the mining is being carried out is leased to MOIL for 99 years.

Weaknesses

Single user industry which is exposed to business cycles Steel industry is the only user of manganese ore. Steel industry is exposed to business cycles and the fortunes of manganese ore is directly related with steel industry.

Constraints on pricing ability The pricing of ore is normally done on negotiated basis. The principal user is the ferro alloy industry and the ore accounts for 26% of ferro alloy cost while power costs more than 50%. This coupled with the falling international prices and reduction of import duties keeps a lot of pressure on MOIL not to increase prices.

Limited flexibility in decision making Mining operations involve constant developmental work and MOIL has limited autonomy in making capital expenditure programme. MOIL's proposal for forward integration into ferro alloys was made 20 years ago including a proposal to take over MEL. MOIL has not been able to get government clearance for all these years.

Lowering of custom duty on Mn ore and in steel products The customs duty rates on manganese ore, ferro alloys and steel products have seen steady reduction. This has exposed Indian industry to

international competition. There is a further reduction in import duty on ferro alloys by 5% in the 1997-98 budget.

Upward revision of license fee of mining activity Currently license fees are nominal and the Government earns revenue from royalty and cess and the current rate is about Rs.30 per ton. These rates are revised upwards once in three years and the normal escalation is about 10%.

Export Restrictions Government does not allow export of high grade ore at the discretion of MOIL. This reduces the profitability of MOIL.

Recommendation

MOIL has emerged today as a profitable company with a good track record. It dominates the manganese ore industry in the ferro grade and manganese dioxide categories with nearly 70% share of reserves and nearly 75% of production. However, MOIL has not been permitted to venture in to the down stream area of ferro alloy production. Only recently, it has decided to set up a small unit of about 10,000 tonnes capacity within the financial powers of the Board of Directors of the company. Earlier proposals of the company to take over the SAIL managed Maharashtra Electro Smelter or to set up plants of bigger capacity were not cleared. Given the constraints of the high cost of

power of the Indian ferro alloy industry is always under potential threat from imports from low power-cost producers. MOIL with its captive mines could provide a much needed stability in the Indian ferro alloy industry if it were to be allowed to put up a large scale plant of viable capacity, at the pit-head, backed by a captive power plant. With its natural advantages, MOIL could establish on a sound base a domestic ferro alloy industry.

While the company has been categorised as a non-core PSU by the Commission, having regard to its dominant market share in manganese ore reserves and production, the Commission would not recommend disinvestment in the company beyond 49%. Control of the company by private investors has the potential of destabilising the ferro alloy industry. Also taking into account the limited reserves of high grade manganese ore in the country, continued Government control over this company may be desirable to conserve this precious material for the steel industry and safeguard against indiscriminate “slaughter mining” for short-term financial gains. No public purpose can be served by transferring a public monopoly to a private monopoly and therefore the question of disinvestment beyond 51%. This issue can be reviewed once the situation changes in the future.

The Commission, therefore, recommends that the Board of the company be given full managerial autonomy with due regard to the its very successful track record of profitability and dividend pay-out to enable it to implement its projects of diversification relating to:

- establishing ferro alloy production to facilitate viable capacity,

- establishing captive power plant and
- expanding and developing mines for production of high grade manganese ore.

The company will be able to mobilise enough internal resources to take care of the investment in these projects. Once these projects are implemented and its bottom line improves further, Government could consider disinvestment upto 49% in one or more tranches in the domestic market with preferential allotment to small investors and the employees, as set out in the Commission's First Report. Prior to such disinvestment Government may also consider the option of capital restructuring in the company since its debt-equity ratio is rather low at present. Through such restructuring and improved earnings per share of the company, Government's realisation through disinvestment would be considerably enhanced.

ITI Limited

Evolution

ITI Limited (ITI), India's first post-independence public sector undertaking, was set up in Bangalore in 1948, for the manufacture of electromechanical switching equipment. Subsequently, the company set up six more units, which currently manufacture the entire range of switching, transmission and terminal equipment.

The equity capital of the company as on March 31, 1996 was Rs.88 crores and the Government had disinvested about 23% of its holding to public and financial institutions. The shares of ITI has been listed in Bombay Stock Exchange and was quoted on 31st March, 1997 at Rs.7/- (face value Rs.10/-) with a yearly high/low of Rs.18/Rs.6.

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The telecom equipment industry can be divided into three broad segments - switching equipment, transmission equipment and terminal equipment. These products are manufactured by a number of Indian and multinational companies.

Buyer Power

DoT is currently the largest buyer of telecom equipment in India. Therefore, DoT's future plans, and its technology and product preferences, influence the investment decisions made by Indian manufacturers.

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the entry of private sector basic and cellular service operators, and therefore, DoT's bargaining power is likely to diminish over the next few years.

Dependence on Foreign Collaborations

Indian manufacturers depend on foreign technology for higher-end equipment such as large switches. Continuous access to technology is critical in view of the high rate of product obsolescence and the need to offer the latest technology so as to remain competitive.

Severe Competition

DoT's orders for telecom equipment are based on tenders, with the lowest bidder getting the largest order, and the balance order being split among the other bidders (at the price quoted by the lowest bidder). In order to penetrate the potentially large Indian market, multinational players seem to have quoted unrealistically low prices in tenders floated by DoT. The entry of multinationals in the switching segment has led to a reduction in prices from Rs. 7,000 to Rs. 4,300 per line. This has resulted in intense competition in the industry, forcing many players to exit the business.

Working Capital Intensity

The manufacture of telecom equipment in India requires long cycle time, which could be increased further by delays in testing and inspection by DoT. This results in large work-in-process inventory in manufacturing units. Delay in payments by DoT and discontinuation of its advance system has led to high receivable levels for the domestic players.

Demand-Supply

The switching equipment industry is expected to grow at an annualised 25% in the medium term as shown in the table below. The demand for transmission equipment industry should increase at a Compound Annual Growth Rate (CAGR) of about 15% in the same period. However, lack of funds with DoT could constrain growth in the short term. The industry will be characterised by overcapacity and severe competition, but prices will improve from current levels (at which existing manufacturers are making losses).

Table 1 Demand for Switching Equipment Figures in million lines

Equipment	1997-98	1998-99	1999-00	2000-01	2001-02
Large	3.12	3.96	3.51	3.62	7.08
Small	1.21	1.56	1.33	1.44	2.90

Competition

The large switch segment is dominated by large MNCs and ITI. DoT has approved seven switching technologies (from Siemens, AT&T, Fujitsu, GPT, Ericsson, Alcatel, and NEC) for integration with the local network. These multinational players have entered India through joint ventures with local partners as shown in table 2.

Table 2 Joint Ventures for Large Switches

Indian Partner	Foreign Partner	Product
BK Modi Group	Alcatel, France	E10B
Tata Group	AT&T, US	5ESS
Siemens India	Siemens, Germany	EWSD
SR Jiwarajika	Ericsson, Sweden	AXE
Punjab State Dev. Corpn.	Fujitsu, Japan	FETEX-150
KK Birla Group	GPT, UK	SYSTEM X

Business Analysis of ITI

Switching and transmission equipment have been the two key contributors to the company's turnover. Over the past five years, the company has been phasing out the production of electromechanical switches. In 1993-94, it began the manufacture of the state-of-the-art OCB-283 switch, with technology licensed from Alcatel, France.

ITI's production processes involve the assembly of components (partly manufactured in-house and the balance bought-out) into products and the subsequent testing of these products. The technology for lower-end products is available indigenously, but the company has to rely on large multinationals for sourcing technology for sophisticated products. ITI has large and well-equipped plants with modern plant and machinery, and excellent testing and inspection systems. The location of the plants and the product range of each plant is briefly summarised in table 3.

Table 3 Operating Characteristics of Different Units

Location	Product Range	Employee Strength	Operating Characteristics
Bangalore	OCB-283, Small Switches, Entire Transmission Equipment range, Telephone sets	10802	Skilled and mobile workforce but large surplus labour since component manufacturing units are unviable, Broad-product range, Strong manufacturing capabilities
Electronic City	C-DoT Switches	428	Compact unit, Optimal labour-force, Productivity-based compensation systems, Completely dependent on C-DoT technology
Palakkad	DTAX, OCB-283	869	Focused product range
Mankapur	OCB-283	2455	Well-developed infrastructure, Modern production facilities
Rae Bareilly	Small Switches, Open wire equipment, MARR Masts, Optical Cables	6004	Very limited lower-end products, Heavily overstaffed since strowger and crossbar exchanges traditionally manufactured by the unit have been phased out, Redeployment of labour is difficult due to resistance to relocation, Unit does not appear to be viable in the current business environment with existing product line and labour force
Naini	Open wire systems, MARR and other radio systems, Multiplexers, Telephone systems	4618	Limited product range, Large surplus labour, Unit does not appear to be viable in the current business environment with existing product line and labour force
Srinagar	Telephone sets	120	Small and unviable unit, Has been continuing production due to political compulsions

Currently, the company has a contract with Alcatel through which it has access to all upgradation in technology for large switches effected by Alcatel till 1999-2000. Alcatel’s OCB-283 switch, being manufactured by ITI at three locations, uses state-of-the-art technology. The recent joint venture between Alcatel with the B.K. Modi group places ITI in a vulnerable position as regards sourcing further technology after 2000.

In the transmission equipment business, the company has in-house technology for open-wire equipment, Multi Access Rural Radios (MARR) and VSAT equipment. ITI sources technology for higher-end radios from NEC, Japan; and Bosch, Germany; and has a joint venture with NKT for the manufacture of optical fibres.

The following table shows the technical collaborations of ITI.

Table 4 Technical Collaborations

Product	Technical Collaborator	Date of Expiry
Electronic Switch, OCB-283	Alcatel, France	March 2000
7 GHz 34 Mb/s Digital Microwave System	NEC, Japan	2004
6 & 11 GHz (SDH) Microwave Equipment	Bosch, Germany	10 years from effective date or 7 years from date of commercial production whichever is later @
Switch Mode Power Supplies	Ascom, Switzerland	8 years from effective date or 7 years from date of commercial production whichever is later #

@ Agreement signed on August 31, 1994

Agreement signed on December 11, 1995

ITI's Bangalore unit is its oldest manufacturing facility, and has the capacity to manufacture the entire gamut of telecom equipment. It also has a number of component units which have been rendered uncompetitive in the current business environment.

The Mankapur and Palakkad units are mainly single-product facilities, whose operating and financial performance is dictated largely by orders for the high value large switches from DoT and the price realisations on these products.

The large labour force and limited (mainly lower-end, low value products) manufacturing capabilities have affected the performance of the Naini and Rae Bareilly units. VRS schemes have not been successful at these units (particularly, at Rae Bareilly) since these units are in

industrially less developed regions, which limits the availability of alternative employment opportunities for labour.

ITI's future market position is critically dependent on continuous access to technology, and its marketing abilities. In the short term, the company's market position could improve due to inefficiencies in DoT's systems. DoT has been unable to evolve a system of competitive bidding, and finalises prices for tenders on an ad-hoc basis. In the recent switching equipment tender, the minimum price quoted has been Rs 7,299 per line (as compared to Rs 4,273 per line in the last tender). However, DoT has made a counter-offer of Rs 5,112 per line, which has not been accepted by any player. Therefore, ITI, with its assured quantity preference, has been the only supplier of large switches to DoT in 1996-97

The procurement policies of DoT based on the competitive bids from various private parties with some of them with uncertain credentials quoting unrealistic prices at which they have not been able to supply and at which PSUs have to supply 35 per cent of the demand have accentuated problems of the two PSUs. Foreign suppliers who provide components to the PSUs also quote directly to DoT in competition with the PSUs. The pricing of the components is determined after the bids are received. The margin available to the PSUs are thereby squeezed and with the high labour component of the PSUs the purchase preferences given to them at the lowest tendered price very often enable them to meet material costs and only a part of the labour cost and results in book losses.

It is necessary for DoT to streamline purchase procedures and provide for pre-qualification for bidders, substantial earnest money deposits and blacklisting of companies which fail to supply after quoting the lowest bid.

Financial Analysis of ITI

Table 5 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Net Sales	783	1037	1527	1484	1085
Gross Profit	-101.8	45.3	369.6	293.1	252.2
Profit before Tax	-284.0	-89.7	176.4	183.6	78.2
Net Profit after Tax	-284.0	-89.7	84.4	79.6	57.2
Paid-up Equity Capital	88.0	88.0	88.0	88.0	88.0
Net Worth	210.4	461.6	521.1	413.1	346.9
Gross Profit Margin (%)	-12.9	4.3	24.1	19.7	23.1
Net Profit Margin (%)	-36.1	-8.6	5.5	5.3	5.2
ROCE (%)	-0.01	4.1	21.2	22.7	19.5
RONW (%)	-135.0	-19.4	16.2	19.2	16.5
EPS (Rs.) Par value Rs.10/-	3.3	2.7	17.3	44.0	55.8
Dividend (%)	1	1	3	3	7.5

In 1994-95 and 1995-96, ITI's financial performance has been adversely affected due to low realisations resulting from severe price competition in all its key product areas, and the lack of orders from DoT (particularly in case of transmission equipment).

The company which made a pre-tax profit of Rs. 176.3 million during 1993-94, made large losses during the next two financial years owing to: *Fall in orders* During 1994-95 and 1995-96, the paucity of orders from DoT, the major customer for ITI, partially contributed to the losses. In 1995-96, due to the reduction in production and turnover, the value added per employee slipped to Rs. 104,244 as compared to Rs. 268,708 during 1993-94.

Decline in realisations The steep decline in realisations can be attributed to increasing competition, coupled with ITI's weak bargaining power with DoT.

Increased interest outflow Due to a strained working capital position, ITI had to resort to high cost borrowings, which increased interest outflow.

Extraordinary items The company has written off a sum of Rs. 170 million in 1994-95, which is the value of obsolete raw materials and components relating to the OCB 181 technology. This had a direct adverse impact on the company's bottom line. Like many other PSUs, ITI has had to make provisions of about Rs. 40 crore for wage settlement with the employees in 1995-96. This increased employee costs and affected net profits.

Strengths and Weaknesses of ITI

Based on the above industry, business and financial analysis, the weaknesses of ITI are as below :

Strengths

Wide range of telecommunication products By virtue of being the sole supplier of telecommunication products, ITI's product range is encompasses the entire range of telecommunication equipments from terminal equipment to switching systems.

Strengths in digital switching ITI is the only company in India to have built up expertise in the area of manufacturing digital switching. This experience will enable the company to indigenously and access future requirements of technology.

Weaknesses

ITI had a near monopoly position in its key business segments till the late 1980s. Subsequently, with the entry of a large number of players in the small and medium switch and transmission equipment segments, and the strong presence of multinationals in the large switch market, the company's competitive position has been adversely affected.

In 1995-96, ITI derived 88% of its turnover from sales to DoT. In the recent past, DoT has not been able to make large investments in expanding the telecom network. This has affected ITI's business and financial performance. The high dependence on DoT will continue in the short to medium term.

ITI is a public sector undertaking, therefore, key decisions and investments have to be vetted by the government and DoT, which hampers the management's ability to react swiftly to the changing business environment.

India does not have a well-developed component base, which forces the company to import semi-conductors and other specialised components. The high dependence on imported raw materials (net foreign exchange outgo amounted to 34.5% of the turnover in 1995-96) makes the company's margins vulnerable to exchange rate fluctuations.

Technology for large size switches and higher-end transmission equipment is fast changing, with high risk of obsolescence. ITI does not have the research capability to keep pace with these advancements in technology. Therefore, it is entirely dependent on Alcatel for large switch technology. Since ITI derives about 50% of its turnover from the large switch, and sources key components for this switch from Alcatel, this is an area of grave concern.

Alcatel, the company's major raw material supplier, is also its competitor in the Indian market. Therefore, it provides very limited credit to ITI. ITI's inventory levels are high on account of long cycle time for manufacture of its products, repeated changes in specifications made by DoT during the course of execution of orders, DoT's inability to test and certify equipment on time, location of plants in far-flung areas and dependence on imported raw materials.

ITI is estimated to have 75% surplus labour despite reduction of labour force by 18% through a VRS in the past five years. The company's employee costs (as % of turnover) are the highest in the industry, which builds-in a high cost structure, and places the company at a crippling disadvantage in a competitive, low margin industry.

Traditionally, ITI has followed the business philosophy of integrating backwards into the manufacture of raw materials and components. The company's component manufacturing units have high overhead costs, which makes ITI uncompetitive with respect to other smaller domestic manufacturers.

Switching technology now incorporates more of firmware (i.e. software which is wired permanently) resulting in elimination of some switching circuits, thereby reducing costs. Thus, lower labour costs may no longer remain a competitive advantage for developing countries like India.

Purchases by DoT accounts for over 90 per cent of the sales of ITI. The expected private participation in the provision of basic services has been considerably delayed and this has resulted in the two PSUs and other private sector equipment suppliers having capacities in excess of current demand.

Recommendations

In an increasingly competitive market with low entry barriers and with ITI's high cost structure and the huge surplus labour of about 20,000 persons, the future survival of the company in its present form is highly doubtful. The company's needs are in terms of the latest technology in the range of products for the communication industry, additional capital and national and international marketing skills. All these can be provided only by a strong strategic partner having the latest technology, capital and skills to develop and expand the activities of ITI. Such an arrangement will also avoid the need for large capital outlays by the Government or in the alternative avoid closure of the company and wholesale unemployment. The strategic alliance, after shedding surplus labour can provide long term employment for about 8000 persons and make the company strong and competitive.

ITI has already made a report to BIFR under Section 23 of SICA as its net worth has been eroded to the extent of more than 50 per cent owing to accumulated losses. The company is in urgent need of financial support from Govt. to the extent of Rs. 400 crores. However, the company posted a 20% increase in sales and the current year's losses are expected to be below Rs.150 crores. In this situation, the company will still have a positive net worth.

The following recommendations are made :

- Immediate steps may be taken to offer appropriate VRS facilities to the redundant employees in all its factories and to provide funds to the Company for meeting the costs of VRS.
- In order to prepare for strategic sale to bring a strong technical partner/partners to ensure the future survival of the Company in one or two components, technical Consultants and Financial Advisers may be appointed urgently to examine whether strategic sale can be made for the Company as a whole or for two components. The first component could for instance consist of the Bangalore, Palghat and Hosur factories and the second component of Mankapur, Rai-Bareilly and Naini factories. The Consultants/Financial Advisers will also prepare the estimates of valuation for fixing a reserve price and identify the product lines that could be continued in the two components. The procedure for appointing Financial Advisers for strategic sales and conducting the sale has been outlined in Part B of the First Report of the Commission (pp 38-40).
- The terms of sale can provide inter-alia for the sale of 50 per cent or more of Government's share in ITI as a whole with the management passing substantially into the hands of the successful bidders with

Government keeping a minimum essential control by holding 26 per cent of the shares in ITI.

- If it is advised by the Consultants/Financial Advisers that sale can be for the two separate components mentioned above, it may be necessary to hive-off the second component consisting of the UP factories to a separate company. Shares in ITI and in the new company can then be sold through the process of competitive bidding to the extent of 50 per cent or more.
- ITI has a Defence Division in Bangalore where some items of defence requirements are manufactured. This Unit may be segregated and merged with Bharat Electronics Limited (BEL) which is also located in Bangalore.
- HTL Madras is a much smaller PSU with lines of manufacture similar to that of I.T.I. The separate report on HTL shows a bleak future for the Company with increasing losses in the next few years. The Company however has valuable assets in the form of land in a central location. The Consultants for ITI can be asked to examine the desirability of clubbing the sale of shares in ITI with the sale of 50 per cent shares in HTL.

APPENDIX - 1

First List of PSUs referred to Commission in September, 1996

SL.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 Ltd	BRPL
6	Container Corporation of India Ltd	CONCOR
7	Engineers India Limited	EIL
8	Fertiliser & Chemicals (Tranvancore) Ltd	FACT
9	Garden Reach Shipbuilders & Engineers Ltd	GRSEL
10	Gas Authority of India Limited	GAIL
11	Hindustan Aeronautics Ltd	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. Ltd	IBP
18	India Tourism Development Corporation	ITDC
19	Indian Petrochemical Corporation Ltd	IPCL
20	ITI Limited	ITI

21 Kudremukh Iron Ore Co. Ltd	KIOCL
22 Madras Fertilisers Limited	MFL
23 Mahanagar Telephone Nigam Ltd	MTNL
24 Manganese Ore (India) Ltd	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 Ltd	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 Limited	PHL
35 Power Grid Corporation of India Ltd	PGCIL
36 Rail India Technical & Economic Services Ltd	RITES
37 Shipping Corporation of India Ltd	SCI
38 South Eastern Coal Fields Limited	SECF
39 Steel Authority of India Limited	SAIL
40 Western Coal Fields Limited	WCF

Second List of PSUs referred to Commission in March, 1997

1 Hindustan Vegetable Oil Corporation Ltd	HVOC
2 Nepa Limited	NEPA
3 Electronic Technology & Trade Dev. Corpn Ltd	ET&TDC
4 Hindustan Prefab Ltd	HPL
5 Ranchi Ashok Bihar Hotel Corpn. Limited	R-ASHOK
6 Pyrities, Phosphates & Chemicals Limited	PPCL
7 Central Electronics Limited	CEL
8 Engineering Projects (India) Limited	EPIL
9 Utkal Ashok Hotel Corpn. Limited	U-ASHOK
10 Rehabilitation Industries Corpn. Limited	RICL