

REPORT

IV

DISINVESTMENT COMMISSION

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1. GENERAL ISSUES AND RECOMMENDATIONS ON DISINVESTMENT

Review of Progress in Disinvestment

The Disinvestment Commission submitted its first Report to Government on February 21, 1997. Subsequently, the second and third Reports were submitted in April and May 1997. In these Reports, the Commission has made general recommendations applicable to all PSUs which are intended to promote the long term disinvestment strategy of Government. The Commission has, in addition, evolved detailed guidelines on modalities and procedures of disinvestment. Specific recommendations in regard to 15 PSUs out of the 50 PSUs so far referred to it (Annex A) have been submitted in these three Reports.

According to item 3(IX) of the terms of reference of the Commission (Annex B), it is required to monitor the progress of the disinvestment process. The Commission has taken due note of the progress of the disinvestment process over the past six months. Although there has been no formal communication from Government, based on the information available with the Commission, the action so far taken by Government on the recommendations of the Commission is reflected in the following tables:

Table 1 General Recommendations

Recommendations	Government Action
Establishment of Disinvestment Fund (I:3.1)	Decision awaited
Formation of Standing Empowered Group (I:4.1)	Core Group Empowered
Guidelines on -Offer of Sale - Book building for domestic and GDR issues (I:4.2)	Book building for GDR only
Guidelines on selection of Intermediaries (I:4.3)	Decision awaited
Retailing PSU shares to small investors & employees (I:4.4)	Decision awaited
Recommendation on joining NSDL (II:1)	Decision awaited

Table 2 Corporate Governance: All PSUs

Recommendations for all PSUs	Government Action
* Professionalising the Board by induction of non-executive directors to be chosen by PESB (I:3.4)	Decision awaited
Provision for Elected Directors (I:3.4) * Selection of Top Management (I:3.4) * Salaries and Incentives for Top Management (I:3.4)	Decision Awaited
* Autonomy in Price Fixation (I:3.4)	Decision awaited
* Accountability (I:3.4)	Decision awaited
* Setting up of Pre-Investigation Board (I:3.4)	Decision awaited
* Strengthening the Investor Interface (I:3.4)	Decision awaited
<u>Moderate Performers</u>	
* Powers to dispose of Assets (I:3.4)	Decision awaited
* Freedom of Investment within certain limits (I:3.4)	Investment Powers of the Board of Directors have been doubled from earlier limits for all PSUs.
<u>Strong Performers</u>	Decision awaited
* Powers to form Joint Ventures (I:3.4) * Full freedom with regard to Investments (I:3.4)	

Table 2A Corporate Governance : For Nine Select PSUs

Recommendations for Strong Performers	Government Action
* Professionalising the Board by induction of non-executive directors to be chosen by PESB (I:3.4)	At least one third of the BoD to be non executive directors to be chosen by an independent panel comprising Chairman, PESB, Secy, DPE, Secy,-Admin Ministry and some eminent non-officials.
*Provision for Elected Directors (I:3.4) * Selection of Top Management (I:3.4) * Salaries and Incentives for Top Management (I:3.4)	The nine PSUs have been granted freedom to structure and implement schemes relating to HR management & personnel and required to ensure that employees have a long term stake in the profitability and performance of the corporation
* Autonomy in Price Fixation (I:3.4)	Decision awaited
* Accountability (I:3.4)	High Powered Committees to monitor performance
* Setting up of Pre-Investigation Board (I:3.4)	Decision awaited
* Strengthening the Investor Interface (I:3.4)	Decision awaited
* Freedom of Investment (I:3.4) * Powers to dispose of assets (I:3.4) * Powers to form Joint Ventures (I:3.4)	Full freedom to incur capital expenditure without any monetary ceiling. In addition, the nine PSUs have been allowed to set up financial joint ventures and wholly owned subsidiaries in India or abroad subject to (1) an equity limit of Rs. 200 crores in any one project, (2) 5 percent of the networth of the PSU in any one project and (3) 15 percent of the networth of the PSU in all joint ventures/ subsidiaries together. However, for entering into technology joint ventures and strategic alliances, the PSUs have to adhere to guidelines to be issued by Government from time to time.

Table 3 Specific Recommendations for 15 PSUs

Recommendations	Government Action
Strategic Sale in respect of ITI, HTL, KIOCL, BALCO, ITDC, MFIL BRPL	Decision awaited
GAIL (I:5.2) -25% disinvestment through GDR Autonomy under Strong Performer Criterion Implement TL Sankar Committee Recommendations	24.84% (210 million shares disinvestment through GDR Decision awaited Decision awaited
CONCOR (III:2.1) -10 million shares offer to institutional investors and public and at a later stage the company could go in for fresh issue of 12.5 million shares thereby reducing the Govt's share to 51%	Disinvestment of 6 million shares approved along with fresh issue of 12.5 million shares - Sequencing of issues not indicated
MTNL (III:2.3) - 60 million shares in GDR market and 28.3 million shares in domestic market through book building Financially restructure - by formation of a new company for raising funds for DoT Grant of Autonomy under Strong Performer Criteria	Disinvestment 47 million shares along with fresh issue of 60 million shares in the international markets Decision awaited Decision awaited
Madras Fertilisers Limited (II:2.5) - Review the terms of agreement with the National Iranian Oil Company	Decision awaited
Manganese Ore India Limited (II:2.6) - No immediate disinvestment	No Action needed
Oil India Limited (III:2.4) - Disinvestment after policy decisions on pricing	Decision on APM awaited
Oil and Natural Gas Commission (III:2.5) - Disinvestment after policy decisions on pricing	Decision on APM awaited
RITES (III:2.6) - no disinvestment	No Action needed

In respect of the 15 PSUs covered in the first three reports, the Commission has recommended different modalities of disinvestment as follows:

Table 4 Disinvestment Modalities Recommended in Reports I, II & III

Modality of Disinvestment	No.	Name of PSU
Trade Sale	2	ITDC [@] , MFIL
Strategic Sale	5	HTL, ITI, BALCO, BRPL, KIOCL, MFL*
Offer of Shares	3	GAIL, CONCOR, MTNL, MOIL*
No disinvestment	1	RITES
Disinvestment deferred	2	OIL, ONGC

Total	15	
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@ Lease-cum-management contracts for hotels in prime locations like Delhi and Bangalore.

* At a later date

It is seen that Government has accepted the recommendations of the Commission in respect of GAIL, CONCOR and MTNL where offer of shares has been the suggested modality of disinvestment. In respect of the other PSUs where either trade sale or strategic sale has been recommended, Government has not taken any decision so far. The Commission would like to quote from its First Report:

“Viewed in this scenario, disinvestment has larger implications than just selling equity at the best price in profitable enterprises, as this alone may not provide long term budgetary benefit unless the question of recurring budgetary support to loss making PSUs is also addressed. The essence of a long term disinvestment strategy should therefore be not only to enhance budgetary receipts, but also minimise budgetary support towards loss making units while ensuring their long term viability and sustainable levels of employment in them”.

(I: 2.1)

The Finance Minister, in his Budget Speech in February, 97, also endorsed this view of the Commission. **The decisions announced so far on the Commission’s recommendations suggest that Government’s present approach seems to be oriented towards getting budgetary receipts by offer of shares in profit-making PSUs and will not solve any of the issues relating to reducing the budgetary dependence of PSUs or achieve the larger objectives of disinvestment. The credibility of the disinvestment process as a whole will suffer and the impression of disinvestment as a short-term budgetary measure intended mainly to raise resources to cover fiscal deficit would be difficult to avoid.**

While strategic sales recommended by the Commission have not been acted upon, Government is reportedly going ahead with strategic sales leading to joint ventures in some PSUs not referred to the Commission. **Transfer of a sizeable proportion of Government shares along with management control to a joint venture partner is no different from disinvestment through the mode of strategic sale as set out by the Commission in its First Report. In the strategic sales mode as recommended by the Commission, a strategic partner is inducted into the management of the PSU with a transfer of share-holding up to 50% to him.** At that time there will be also an agreement with such strategic partner that at a later date within a stipulated period when share values go up, Government will disinvest its balance holding. The Commission has also recommended a transparent and competitive bidding process for the selection of the strategic partner in the PSUs referred to it. **The reported move of converting some PSUs into joint ventures with private capital and management will be no different from the strategic sale recommended by the Commission.** Moreover, the Commission, while recommending disinvestment in any of the PSUs referred to it, considers all the modalities of disinvestment such as offer of share, strategic sale or trade sale, weighs their relative advantages and disadvantages from the standpoint of the company's future performance, receipts to Government through disinvestment, employee interests etc. and then recommends a particular modality to be carried out in a transparent and competitive manner. **By not referring the PSUs to the Commission, duly set up for this very purpose by Government, the benefits of such a detailed consideration by an independent body are being denied to all the interested parties.**

The terms of reference of the Disinvestment Commission state that the Commission will examine PSUs referred to it. The inference of the

Commission was that Government would not undertake any disinvestment without reference to the Commission. This was later confirmed by Government. However, it would now appear that Government is taking a different approach in some selected cases. In any event, disinvestment in PSUs not referred to the Commission, while not acting on the recommendations already submitted by the Commission in respect of PSUs referred to it, puts the Commission in an anomalous position. Two parallel and uncoordinated channels of disinvestment are bound to impact adversely the credibility of the disinvestment process. **The Commission, therefore, would urge Government to review the position and decide whether such cases as mentioned above should be kept outside the purview of the Commission.**

Another aspect which the Commission has been stressing in its successive Reports is the need for improving corporate governance in the PSUs and the granting of greater autonomy to the PSU Boards of Management to enable them to run the undertakings commercially in an increasingly competitive environment. While the Commission is happy to note that Government has come out with a package of measures conferring autonomy to nine selected PSUs, action on the recommendations of the Commission in its earlier Reports on the extension of graded autonomy to all PSUs according to performance criteria is still awaited. **Moreover, even in the case of MTNL and GAIL, two other large PSUs, which are strong performers and where disinvestment is contemplated by Government, no such autonomy has yet been conferred.** The Commission, on the basis of its study of experiences across the world, has underlined the value-enhancing effect of better corporate governance on PSU shares. **The Commission would like to reiterate that undertaking disinvestment without implementing the general recommendations of the Commission, - in particular those relating to corporate governance, managerial autonomy, remuneration, incentives, professionalising the**

Board of Management and restructuring where necessary - would result in undervaluation of Government shares and cause loss to the national exchequer.

Furthermore, continued good performance in a competitive environment by PSUs in which Government has made disinvestment, and visible improvement in their corporate governance are crucial for ensuring ongoing support of institutional and retail investors to future disinvestment in PSUs. From this angle too the value-enhancing effect of improved corporate governance has much significance.

Apart from the general recommendations contained in the Commission's Reports, the specific recommendations in respect of particular PSUs have also highlighted certain areas of organisational and general policy measures which would need to be addressed before Government undertakes disinvestment. **The Commission would once again urge Government to address the recommendations of the Commission fully and in a co-ordinated manner so as to establish the credibility of the disinvestment process and maximise the receipts from it.**

With regard to the offer of sale of Government shares in the PSUs, the Commission has already stressed the importance of sales to domestic investors - institutional as well as small shareholders and employees. It is true that in some cases, particularly the larger PSUs, the domestic capital market would not be able to absorb the entire offer of shares and sale of shares in the overseas market will be necessary. **However, one of the important objectives of disinvestment should be the broad-based dispersal of shares, especially in the profit-making PSUs, among Indian investors. The Commission hopes this important recommendation will be duly taken note of by Government.**

The Commission has also suggested that disinvestment through the National Securities Depository Ltd. (NSDL) in the dematerialised form would facilitate easier participation besides offering other benefits to the small investors in the process, especially in regard to high-value PSU shares like those of GAIL, MTNL, VSNL, IOC and CONCOR. This recommendation also requires urgent attention by Government in the interest of broadbasing the ownership of PSUs in the process of disinvestment.

Voluntary Retirement Scheme (VRS)

The studies carried out by the Commission of the PSUs covered in its Reports reveal that several PSUs including the profit-making ones have staffing levels well in excess of the comparable competing units in the domestic and international markets. Given the need to remain competitive in a globalised business environment it is important and necessary that all PSUs continually review their staffing levels and take appropriate measures to balance the size of their workforce. This process will be facilitated if a stable VRS policy providing meaningful financial and other benefits is put in place.

In its Second Report the Commission has recommended that Government announce a stable VRS policy with reference to its terms and conditions and provide adequate funds for its implementation by different PSUs. In actual fact the Commission has come across instances where PSUs who have implemented the VRS Scheme have not been able to secure funding support from Government.

The Commission would like to elaborate further on this subject as the future of several PSUs and the value of shares sold will change for the better if surplus employees are provided acceptable VRS terms. The following steps are recommended :

- 1. The terms of VRS should be finalised as early as possible on a stable and long-term basis. Individual management may be given a range within which they may deviate from the prescribed terms for different age groups, different categories of employees and different industrial sectors.**
- 2. Prompt funding should be assured to all PSUs which implement the VRS scheme. The Disinvestment Fund can be used for this purpose as recommended by the Commission in its First Report.**
3. The terms and benefits of the VRS scheme should be clearly brought to the attention of the employees through suitable publicity measures.
- 4. As there is danger of a one-time lumpsum payment being frittered away by the employees or drained out by unscrupulous middle men, a special scheme may be drawn up through commercial banks, UTI or LIC, wherein the VRS benefits are invested on behalf of individual employees to provide long-term benefits and some measure of social security.** To illustrate, the scheme will be able to provide with an investment of about Rs. 2 to 3 lakhs for 10 to 15 years a monthly income of around Rs.2000 together with annual lump-sum payments for meeting expenses on account of family functions etc. to individual employees. Insurance cover may also be provided to the individuals. This could in fact be structured to become an Employees Pension - cum - Insurance Scheme. Banks and other institutions should be persuaded to open special branches, if necessary, at the locations of the undertakings to service the scheme.

In the absence of an effective VRS particularly in loss-making or marginally profit making undertakings, an unfortunate and inevitable consequence will be an increasing sickness of the PSU with a progressively increasing burden on

the budget and eventual closure leading to unemployment of the entire workforce in the process. **An effective VRS scheme can ensure long term productive employment for a substantial number of residual employees in a going concern. It will also fetch better prices for shares sold by Government.**

Misconceptions regarding Disinvestment

As mentioned in the First Report of the Commission, the Commission held a series of meetings with a wide cross-section of persons interested in the disinvestment process and organised two seminars to highlight the underlying issues in disinvestment. The Commission also brought out a Discussion Paper on Disinvestment Strategy and Issues. After presentation of three Reports by the Commission, and judging by the reactions of the different groups of persons to the Commission's approach and recommendations, it is seen that there is absence of a clear understanding of the rationale for disinvestment in some quarters.

Even though disinvestment has been going on since 1991, this lack of proper public awareness and consensus has, among other things, definitely hindered the progress of disinvestment. **While there is wide-spread dissatisfaction among the public about the poor performance of a large number of PSUs, there is insufficient recognition that disinvestment could be the corrective action to tackle this problem.** Studies of the experience of disinvestment in the different countries across the globe clearly show that in almost all the countries, the impetus to disinvestment came from the general perception among large sections of the people that the performance of the public sector, by and large, lacked commercial and market orientation and that there existed need for better utilisation, of and returns from, the public resources invested in the PSUs. In India too, therefore, there has to be a conscious effort towards building up such a consensus among the different sections of the people before disinvestment can really take off with any seriousness of purpose. As has been repeatedly mentioned by the Commission, disinvestment, as a long-term strategy, does not mean mere sale

of some proportion of Government shares in blue-chip PSUs but involves concerted action to introduce elements of commercial orientation and market responsiveness into the management of the PSUs to enhance enterprise value. This lack of understanding is not confined to just PSU personnel but it is equally prevalent among some PSU executives, some ministries of Government and the general public. The Commission has stressed that its approach to disinvestment is not ideological but driven by the imperative need for better utilisation of public resources for the good of the economy. **There is therefore a clear need for building awareness and consensus among the general public for the successful pursuit of disinvestment as a long-term strategy for improving public sector performance.**

Common among the *misconceptions* about disinvestment are the following:

Misconception-1 : **Disinvestment is a short-term budget balancing measure by disposing of valuable public assets carefully built over the years without demonstrating explicitly the use of the proceeds for priority investment for long-term benefits to the economy.**

The Commission has stressed that it is for Government to dispel this notion by implementing the Commission's recommendations as a package and not confining action just to the sale of a part of equity in profit-making PSUs. The Commission has detailed the procedure to be followed in respect of sale of shares through the book building process. **A transparent and open disinvestment procedure will maximise the realisation by Government on account of sale of PSU shares and in turn will dispel any misgivings the public may have in this regard. The Commission's recommendation for**

the creation of a Disinvestment Fund is also meant to build the credibility of the disinvestment process and ward off criticism on this account.

Misconception-2 : Disinvestment is seen by organised labour and the Trade Unions as a threat to job security.

The Commission, in its various Reports, has again stressed that mere transfer of ownership from Government to the private sector does not in any way imply closure or total retrenchment. Right-sizing the work-force may be required to improve the viability of a concern in an increasingly competitive environment and this will be inevitable in the long run whether an undertaking continues to be managed and /or owned by Government or not. **There is lack of proper appreciation of the fact that over-staffing in an enterprise adversely impacts its commercial viability and makes continuing employment in it unsustainable. In such cases, there arises a crucial choice between providing employment to a somewhat smaller number on a sustainable basis and maintaining a larger workforce in a loss-making enterprise with an eventual prospect of closure and hence permanent loss of all the jobs. Right-sizing of such enterprises, therefore, turns out to be in the longer term interest of employees as a whole.** This inevitably means loss of jobs for surplus employees who apart from getting VRS benefits would need to be retrained to take up alternative jobs or self-employment or in other activities. During the period of training as well as afterwards, lump-sum VRS benefits can provide immediate financial support as well as a continuing stream of income by properly investing the lump-sum amount provided. Where right-sizing of the work-force is inevitable in the interest of competitiveness and viability, the Commission has in the earlier part of this Report recommended the formulation of an attractive VRS which also provides long-term pensionary and insurance benefits to the workforce.

Ministry of Labour is operating a scheme for retraining and redeployment of employees affected by the closure of units. This Scheme needs to be properly revamped to cover the employees who accept voluntary retirement. Till the establishment of the Disinvestment Fund suggested by the Commission, adequate budgetary provision should be made separately to cover the retraining cost of all surplus employees who opt for VRS. There is need for a conscious effort on the part of all concerned to inspire confidence among labour in this regard.

Misconception-3 : Disinvestment is perceived as a prelude to the withdrawal of State intervention from critical areas of the economy.

As already stated, the Commission's approach to disinvestment is not ideological. **Disinvestment in specific PSUs is recommended solely on grounds of the relevance or otherwise of public sector presence in that sector. Even in the case of currently profit-making PSUs, the decision to disinvest will be based on whether any public purpose is served by continued Government ownership and control in a PSU given the nature of the market in which it is operating.** The establishment of the Disinvestment Fund in fact would enable the resources generated by disinvestment to strengthen public sector presence in sectors where it is still perceived as necessary in public interest. Public investment would thus get reallocated from sectors where public purpose is no longer served by such investment to other sectors where there is greater need for it. **Disinvestment is not aimed at curtailing state activity for economic growth in important areas but towards channelising it to areas of greater priority and towards ensuring better and more effective utilisation of public resources for the good of the economy and maximisation of the welfare of the people.**

Specific Recommendations

2.1 Hindustan Copper Limited

Evolution

Hindustan Copper Limited (HCL) was set up in 1967 to manufacture primary copper products. The company was formed by taking over all copper ores mines located at Khetri and Kolihan in Rajasthan and Rakha Copper Complex in Bihar from the National Mineral Development Corporation. In 1972, Government nationalised the private sector Indian Copper Corporation Limited in Bihar and merged it with HCL. In 1982, the company expanded its operation to Madhya Pradesh by developing the Malanjkhand copper mine which is the largest open pit mine in India. Further in 1990 as a part of a forward integration move, HCL commissioned a 60,000 tonnes per annum (tpa) continuous cast wire rod plant at Taloja in Maharashtra.

In FY 94, Government of India (GoI) disinvested about 1% of the total equity of Rs. 338.20 crores in favour of financial institutions. The shares are listed on the BSE but are infrequently traded.

Industry Analysis

In terms of application, copper is considered as the third most important metal after iron and aluminium. It has high electrical and thermal conductivity, high strength, ductility and corrosion resistant properties.

India has around 205 known deposits of copper with an estimated geological reserves of approximately 588 million tonnes. Nearly 90% of these reserves are located in Rajasthan, Bihar and Madhya Pradesh. However, the quality of copper reserves is relatively poor with only about 1.2% to 1.3% of copper

content as against about 2.3% worldwide. Similarly, the quantity of other precious metals such as gold and silver extracted alongwith copper is low in India when compared with other countries. Thus, the cost of copper mining is high in India.

Prior to liberalisation, imports of copper were restricted and the domestic copper price was administered. During this period, the domestic prices were higher than the landed cost and HCL was the only integrated producer in the country. In March 1992, canalised imports of copper and the system of administered pricing were removed and copper imports were liberalised. Subsequently, domestic prices were directly linked to the prices of copper on the London Metal Exchange (LME).

As part of liberalisation, the customs duty on copper and copper products has been progressively reduced as shown in the table below :

Table 1 Customs duty on copper

Products	FY 97	FY 93
Cathodes	30%	65%
Wire Rods & Bars	30%	65%
Copper Concentrates	10%	60%
Copper Scrap	30%	65%

In the budget for 1997-98, there is no change in the customs duty on copper products except in concentrates where duty has been reduced from 10% to 5%. This reduction will help new smelter projects which can import concentrates and convert them into semi/finished products. Due to the decreasing levels of duty differential between copper concentrates and cathodes, manufacture of domestic wire rod / bars on the basis of imported cathodes is unviable.

Demand

The demand for copper is dependent on the level of economic activities. The total demand grew at a cumulative annual growth rate (CAGR) of 9.2% from 2.1 lakh tonnes in FY 91 to 3.2 lakh tonnes in FY 96. Demand for cathodes grew at a CAGR of 7.9% from 1.6 lakh tonnes in FY 91 to 2.4 lakh tonnes in FY 96.

The demand for copper can be either for cathodes or for scrap. Cathodes are used for high conductor application, while scrap is used for handicrafts and manufacture of utensils. The following table gives the details of consumption in these two segments.

Table 2 Consumption Pattern

Year	Total Demand (tonnes)	% demand of refined copper to total demand	% demand of scrap to total demand
1990-91	207170	77.7%	22.3%
1991-92	187890	70.6%	29.4%
1992-93	195710	77.4%	22.6%
1993-94	239400	72.8%	27.2%
1994-95	287330	69.5%	30.5%
1995-96	321000	73.2%	26.8%

Sectorwise usage of copper for FY 95 and the estimated usage in these sectors by FY 2000 and FY 2005 based on the projections made by Indian Copper Development Centre (ICDC) are given below :

Table 3 Estimated Demand (Tonnes)

End User Sector	1999-00 (E)	2004-05 (E)
Defence and mint	11200	13500
General engineering	19670	26300
Process industries	22120	29600
Consumer durables	27890	44950
Building and construction	32850	43200
Transport	33640	48400
Handicrafts	57600	92800
Electronics & Telecommunication	81900	116300
Electrical sector	136000	186350

TOTAL	422870	601400
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On the supply side, HCL has been the only domestic supplier till date and the balance demand was met out of imports. However, significant capacities are expected to be commissioned in the private sector in the medium term. The supply scenario over the next five years with the new capacities coming upstream are given in the following table.

Table 4 Supply Scenario

Quantity in Tonnes	1995-96 (Actual)	1999-2000 (Forecast)	2000-01 (Forecast)
<i>Supply</i>			
<u>Existing</u>			
HCL	41,000	45,000	45,000
<u>Proposed</u>			
HCL (Expansion)		51,750	62,100
Sterlite Industries		85,000	85,000
Indo Gulf		75,000	85,000
SWIL		17,500*	22,500
Total Supply	41,000	274,250	299,600
SURPLUS/(DEFICIT)	(194,100)	(21,750)	(13,865)

* After considering an export commitment of 20,000 tonnes

As has been mentioned earlier, copper prices in India are linked to international prices on the LME. The LME prices are highly volatile and do not reflect any predictable trend as the pricing is determined on a number of factors like the demand supply gap, inventory build up, etc. The movement of LME copper prices (annual monthly average) for the last past one decade is given below:

Table 5 LME Prices (USD/tonne)

Year	LME Price
FY 87	1373
FY 88	2045
FY 89	2788
FY 90	2652
FY 91	2673
FY 92	2276
FY 93	2291
FY 94	1827
FY 95	2576
FY 96	2844
FY 97	2257

As can be seen from the above table, LME prices of copper decreased and touched a low of USD 1827 per tonne in FY 94 on account of the recession in developed countries and the increased Russian supplies. However, subsequently the prices firmed up to cross an all time high of USD 3076 in July 1995.

Worldwide, the production for FY 96 was slightly higher at 12.27 million tonnes against a consumption of 12.10 million tonnes. Chile is the largest copper producing nation with an annual production of 2.5 million tonnes.

It is expected that the world production would grow at a faster pace when compared to consumption resulting in an inventory pile-up. This is likely to have an adverse impact on pricing and copper prices over the medium term are forecast to move in a price band of around USD 2100 to 2200 per tonne.

Business Analysis

HCL is the only integrated copper producer in India. At present the company has the following facilities;

Table 6 HCL Facilities

Khetri Copper Complex (KCC) - Rajasthan	Under ground mine, concentrator plant, smelter and machining refining capacity of 31000 tpa.
India Copper Complex (ICC) - Bihar	Under ground mine concentrator plant, smelter and machining refining capacity of 16500 tpa, and a by-product recovery plant.
Malanjkhand Copper Project, Madhya Pradesh	Open pit mine. Concentrator and Leach Copper Plant.
Taloja Copper Project, Maharashtra	Continuous cast wire rod plant with 60000 tpa of wire rod.

HCL has 9 underground mines and one open cast mine. The details of mines under HCL and their ore reserves are given in the table below :

Table 7 HCL's Mines And Ore Reserves

	No. Of Mines	Million tonnes
KCC	4	71.78
ICC	5	60.76
MCP	1	67.65
TOTAL	10	200.19

HCL operates these mines on leases from the State Governments. Recently the Supreme Court passed an interim order asking the State Governments to ensure that all mining operations either on or under forest land and reserve forest areas be closed down. These orders affected the operations at KCC mines but were restarted within a short period on receipt of interim permission from Central Government. In future it is unlikely that the mines would be completely shut down due to environmental reasons.

The cost of mining from the various mines of HCL vis-à-vis the imported cost of concentrates is shown in the table below:

Table 8 Cost of Concentrates (Rs./Tonnes)

Source of Concentrate	Cost of Metal*
Indian Copper Complex	125,648
Khetri Copper Complex	70,080
Malanjkhand Copper Project	67,924
Imported	72,000

* *Excluding the value of Gold, Silver etc.*

From the above table it is apparent that it would be profitable for HCL to stop sourcing ores from ICC mines and instead import the requirements of concentrates after utilising the KCC and MCP production. The company has already made a start by applying for closing down the unviable mines at Dariba in Rajasthan and Mosabeni in Bihar. If all the unviable mining operations were to be closed down in a phased manner, it is estimated that the cost of right-sizing the workforce would be about Rs. 100 crores currently.

All mining companies in the copper rich countries get about 25-40% of the total revenue from sale of by products such as Gold, Silver, etc. In the case of HCL, the contents of by-products are low and hence the return from these by-products sale is only 4-5% of the total revenue.

HCL has a total smelting capacity of 47,500 tpa. These smelting plants lack economies of scale as they are relatively small in size when compared with international plants. This acts as a disadvantage and the fixed cost proportion in the overall cost structure is high. The technology used in these smelter plants is also old and inefficient when compared with the latest technology. Presently the recovery of copper from the ore stage to the cathodes stage is low at 81%.

HCL's Taloja plant has a capacity to produce 60,000 tonnes of wire rods annually. HCL's own production of cathodes is presently insufficient to meet

the entire production requirements of this unit. The balance requirement of cathodes is imported predominantly from Chile.

The production of various products at HCL for the past three years is as under :

Table 9 Production Of Copper / By Products

	1995-96	1994-95	1993-94	1992-93
Cathodes (tonnes)*	41153	46134	39002	45275
Wire Bar (tonnes)	24161	21351	21239	25264
Wire Rod (tonnes)	37143	29869	18181	19631
Gold (Kg)	375	480	437	291
Silver (Kg)	4146	5585	5580	3185
SSP (tonnes)	43484	24848	15296	47303
Sulphuric Acid (tonnes)	83749	92455	59471	51946

* Includes cathodes consumed for producing Wire Bars and CC Wire Rods

HCL fixes the prices of copper products on a monthly basis which is based on the average of previous month's copper prices. Currently, HCL is exposed to the volatility in LME prices as only finished products are linked to LME. However, after the expansion of Khetri plant, the company will be insulated from the price volatility to the extent of imported raw materials.

HCL has a total manpower strength of 19,884 as on March 31, 1997. Over the past ten years there has been a manpower reduction of about 6,000 through the VRS. The expenses on this account have been funded through the National Renewal Fund. Further, the company proposes to reduce its employee strength by about 2,500 over the next five years.

Financial Analysis

The financial performance of HCL for the past five years is indicated in the table below:

Table 10 Financial Performance

(Rs.Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	969.8	823.3	610.0	598.4	625.8
Operating Profit	105.5	141.8	-15.5	78.9	147.3
Profit after Tax	75.8	72.3	-69.6	26.4	54.9
Equity Capital	338.2	330.2	305.2	304.2	304.2
Tangible Networth	495.3	416.0	313.5	393.3	365.9
Gross Margin (%)	10.9	17.2	-2.5	13.2	23.5
Net Margin (%)	7.8	8.8	-11.4	4.4	8.8
ROCE (%)	13.6	16.3	-5.1	10.3	16.1
RONW(%)	15.3	17.4	-22.2	6.7	15.0
Earnings per Share (Rs.)	2.24	2.19	-2.28	0.87	1.80
Dividend (%)	1.50	0	0	0	0

Despite increased sales, the sales realisation declined in FY 94 as the LME price of copper fell to USD 1827 per tonne from USD 2291 per tonne in FY 93. In addition, the material cost has risen substantially due to increased imports of cathodes. HCL's gross and net margins have been fluctuating over the past five years depending on the changes in the LME price of copper and the changes in the customs duty.

The lowering of import duties has led to the linking of HCL's realisations with the prices of copper on the LME. As a result of the volatility of international copper prices, the company's bottom line has fluctuated considerably. HCL reported losses of about Rs. 70 crores in FY 94 and net profits of more than Rs. 72 crores in the next two financial years. In FY 97, the company has reported losses again, which is estimated to be about Rs. 130 crores. In spite of accruals to reserves, these losses have eroded the networth of the company and as at March 31, 1997 the networth was substantially represented only by the equity capital of about Rs. 338 crores. During 1997-98, the company expects

to post losses once again, though at much lower levels than the previous year at the current LME copper prices. If the LME copper prices were to decline substantially, the losses would be much higher.

HCL's long term loans amounting to about Rs. 175 crores were from Government. The company has not serviced these loans and the total interest accrued and due amounted to Rs.141 crores. The total amount outstanding towards Government on account of principal and interest amounted to Rs.316 crores as on March 31, 1997. HCL has not been in a position to service these loans due to the fluctuating level of profits over the past five years.

Strengths & Areas Of Concern

Strengths

Only integrated producer HCL is the only integrated copper producer in the country. The private sector producers are still in the process of setting up their plants and it will be some time before their plants are commissioned.

Market share Currently HCL is the market leader and with its proposed expansion can maintain its market share in the near future.

Demand prospects bright The demand projections show a deficit in the medium term. This shortage will enable HCL to implement its proposed expansion.

Areas Of Concern

High cost of mining due to low percentage of copper. The percentage of copper content in the ore in India is relatively low when compared with ore in other parts of the world. This results in higher cost of mining.

Environmental issue The recent Supreme Court decision on the mining will affect the performance of all mining companies. Even though HCL has

received permission from the Central Government, it is not known whether permission will be forthcoming in the future.

Lack of economies of sale in smelting operation The smelting plants of HCL are small when compared with other smelting plant world over. Due to this, the fixed costs in smelting are high.

Poor recovery and low throughput The recovery of copper from the ore stage to the cathode stage is relatively low at 81% due to technological factors.

High employee cost The employee cost in the mining operations of HCL is high. Further, the company is saddled with an excessive workforce at the ICC plant due to historical reasons. However, it should be mentioned that the company has initiated a VRS programme which has resulted in a reduction of about 6,000 workers over the past five years.

HCL's Expansion Programme

As already noted, HCL's realisations are linked to the prices of copper on the LME. Fluctuations in LME prices have cast their shadows on HCL's bottomline over the last five years. After posting losses of about Rs.130 crores in FY 97, HCL faces the prospect of losses though lower again in FY 98.

HCL's road to recovery as a profitable company now hinges on the implementation of the proposed expansion plan at the Khetri complex in Rajasthan. The company is planning to expand its smelter and refining capacity at KCC from the present level of 31,000 tpa to 1,00,000 tpa by using imported concentrates. This will increase the total production capacity of concentrates from 47,500 tpa to 1,16,500 tpa and will result in significant reduction of cost of production of cathodes. The planned expansion is through a brownfield route by modifying the existing furnace thereby increasing the throughput. However, capacity expansion for concentrator dryer, converter, anode furnace

and refinery will have to be undertaken for meeting the increased throughput from the smelter. Due to this brownfield expansion, the capital costs are expected to be significantly lower than it would be for a similar sized greenfield project. The project could commence from August 1997 if Government's approvals are obtained. This expansion is currently estimated at about Rs. 530 crores but with approvals still awaited, it is likely that the project cost could increase to about Rs. 600 crores.

The implementation of this project is expected to be beneficial to the company on account of the fact that it is based on imported copper concentrates. Thus, the low cost of production and the prevailing tariff differential between finished copper and copper concentrates would increase profitability and also partly insulate HCL from the wide fluctuations in the LME prices. This, in turn, would reduce the volatility in the company's profits. The timely implementation is equally important as the company is expected to face competition from the private sector in the future.

Funding Options

The requirements of funds for HCL are two-fold. Firstly, as enumerated above, the company requires funds of about Rs. 600 crores for the expansion at Khetri. Secondly, the closing down of unviable mining operations of the company will require about Rs. 100 crores. Thus the total funding requirements are in the region of Rs.700 crores.

For this purpose, the company will have to either raise the funds from the capital market on its own or has to depend on its principal shareholder i.e. Government. The company's weak balance sheet as at March 31, 1997 and the depressed nature of the primary markets may preclude the options of tapping the capital markets for these funds.

As the majority share holder, it may be worthwhile for Government to examine various options available for the implementation of the expansion and for restructuring the internal operations. This will involve either budgetary support or disinvestment of a majority stake to a strategic partner to enable the company to raise funds. These options have to be evaluated in terms of immediate outflows and inflows occurring over a period of time to Government. Figures mentioned in the table below are only indicative and are taken for the purpose of weighing various options. The implications of the above scenarios are elaborated further below:

Table 11 Government Options on HCL

	Scenario	Immediate Government net outflow	Government Inflows	Remarks
1	No action taken by Government due to paucity of funds	Nil	Nil	Company likely to turn sick
2	Restructure ICC fully & implement project through budgetary support and disinvest fully at a later stage	Rs.700* crores	Rs. 340 crores at 51% disinvestment	Project costs could increase due to financing delays. Further disinvestment would bring in additional revenue
3	Implement project through budgetary support and disinvest fully at a later stage (no restructuring)	Rs.600* crores	Not Ascertainable	Project costs could increase due to financing delays Drag on profitability due to large work force will bring down share value.
4	Disinvest upto 51% immediately without restructuring or implementing the project	Nil	Significantly low when compared to option 2	Buyers unlikely to be interested
5	Restructure ICC and disinvest upto 51% immediately to a Strategic partner and disinvest the balance after Implementation	Rs. 100 crores	Rs. 340 crores at 51% disinvestment	Likely to improve the share valuation Further disinvestment would bring in additional revenue

* The actual outflow to Government would be Rs. 200 crores in the form of equity/loan support. In addition, there would be a contingent liability in the form of guarantee to the extent of Rs.400 crores to enable the company to raise the debt for the expansion. Besides, about Rs. 100 crores would be required in the form of a grant for closing down of all unviable mining operations.

Scenario 1

If due to budgetary compulsions, funds are not forthcoming from Government or are available only partly, the expansion plans will be jeopardised and the advantages accruing from the implementation of the project will not be available to the company. The company's competitive position could be eroded further, and it is most likely that it could lose more money in the medium term. The uncertainties facing the company would increase and it is likely that HCL could turn sick within one or two years. While there would be no outflow in the short term, any inflows on account of loan servicing, dividends or disinvestment proceeds may have to be ruled out. If disinvestment is not undertaken immediately and no action is taken by Government, it is likely that the company would require an increasing level of budgetary support to meet potential future losses.

Scenario 2

The second option involves the closing down of the unviable mining operations which is estimated to cost about Rs. 100 crores and implementing the Rs. 600 crores project on the basis of Government support. Thus, the total commitment would be about Rs. 700 crores. However it may be noted that any delay in project financing could lead to a further escalation of costs. At present HCL is not seeking budgetary support for the project implementation. This level of support has to be weighed against the likely inflows to Government on account of disinvestment proceeds. It is estimated that disinvestment of shares upto 51% after the project implementation and the restructuring will fetch about Rs. 340 crores due to enhanced share value. Further disinvestment beyond 51% will add to the initial disinvestment proceeds.

Scenario 3

As explained earlier, it is doubtful whether the company can raise funds from the markets for project implementation. If Government is intent on turning the company around without any disinvestment at this stage, then immediate Government support to the extent of Rs. 600 crores will be required to implement the proposed expansion. However without restructuring, HCL will continue to have excess manpower and fixed costs will continue to be high. Thus, the break-even LME price for HCL will be much higher than USD 2350 per tonne. Given the bearish outlook on LME prices of copper over the medium term, it is likely that implementing the project alone may not yield desired results as the company's future profitability will be determined by the extent to which cost reduction can be implemented. While there would be outflows to the extent of Rs. 600 crores in the short term, corresponding inflows over a

period of time cannot be accurately assessed at this stage. However, on an overall basis, it is expected that there would be net outflows from Government.

Scenario 4

In the fourth option, Government could disinvest a majority stake of 51% without closing down the unviable mining operations or implementing the project at Khetri. On the basis of the current financial strength and the likely future cash flows, the value realisable by Government will be significantly low. However it has to be noted that if sale is attempted on an as-is-where-is basis without restructuring, the sales realisation could be much lower on account of possible discounts which could be attached by the buyer.

Scenario 5

In the last option, Government could close down the unviable mining operations in Bihar and disinvest 51% immediately to a strategic partner on the basis of an internationally competitive bidding process. This level of disinvestment will fetch about Rs. 340 crores. After meeting the expenditure towards the closing down of the unviable mining operations in Bihar of Rs. 100 crores, it would still result in a net inflow of Rs. 240 crores. If further proceeds from disinvestment are added, the above figure would be higher.

Recommendation

While HCL continues to be the only integrated copper producer in the country, significant capacities based on imported concentrates are expected to be added in the medium term in the private sector. In addition, import duties on copper products have been lowered and copper imports decanalised since 1992. Thus, the markets are expected to become fully contestable. Therefore the Commission reiterates HCL's classification as non-core as recommended in its First Report.

In addition, the Commission is of the view that there is an urgent need to cut operational costs in HCL. The company is already in the process of closing down some of its unviable mines. The Commission suggests that this matter should be expedited and the company should take the earliest possible decision in this regard. This will reduce the fixed costs and in turn lower the break-even level of LME copper prices for the company. However, the smelting operations at ICC in Bihar which employs about 1000 people could continue its operation on the basis of either imported concentrates or sourcing additional concentrate from the Malanjkhand mines.

In order to enable the mines closure, it is proposed that the company formulate an imaginative VRS on the lines suggested in Part A of this Report. The Commission estimates the overall cost of this closure to be around Rs. 240 crores. However, if the closure is done in a phased manner, the immediate costs of closure of a few mines is estimated to be in the region of Rs. 100 crores. The funds required for this purpose could be temporarily funded from the proposed Disinvestment Fund as recommended by the Commission in its First Report.

In the past, HCL's long term borrowings have been mostly funded by Government by way of budgetary support. In spite of concessional rates, HCL has deferred payment of interest although it has been making a provision in its books. As at March 31, 1997 the loans amounted to about Rs. 175 crores while the interest arrears were about Rs. 141 crores. The company has submitted a financial restructuring proposal to Government.

It is therefore, clear that it is extremely vital for the medium term viability of the company that the expansion project at Khetri should be taken up and completed immediately. The company has been making efforts to raise the resources required from the market. However, the rather dismal financial performance during FY 97 would make raising funds from the market rather difficult. Since the company cannot afford any delay in the implementation of the project, the other alternative would be for the company to look to Government for these resources and raise a part of it also from the market backed by Government guarantee. As of now, this contingency has not been dealt with by the company. From the above analysis, it emerges that the options before Government are:

- 1. HCL may implement the Khetri smelter expansion and Malanjkhand mine expansion projects as also restructure the ICC mining operations by closing down unviable mines along with VRS to the affected employees. After the completion of these projects, which may take about two years, Government may select a strategic partner for the company through an open and competitive bidding process after suitable pre-qualification of bidders offering him 51% of the equity of the company, Government may also disinvest 23% of the equity through an offer of shares in the domestic market to institutions, small investors and**

employees. Government may retain 26% equity in the company, keeping in view the importance of the copper mining operations in Malanjkhand and some of the ICC mines. The implications of this option however are that in view of the poor financial performance of HCL in the last two years, Government may have to contribute to the extent of nearly Rs. 200 crores as additional equity/loan besides extending guarantee to the company's market borrowings to the extent of Rs.400 crores for implementing the khetri and Malanjkhand projects.

2. The other option for Government would be to select a strategic partner straightaway and offer him 51% of the equity. The restructuring of the mining operations in the ICC may however be finalised, including the VRS to the affected employees, before such partnership, as this would facilitate better response from prospective partners besides enhancing the value of Government shareholding. After the completion of the expansion projects, Government may disinvest further 23% of the equity in the domestic market to institutions, small investors and employees Government may retain 26% equity in the company for the reasons already mentioned above. In this option, the budgetary demands on Government are totally eliminated, except support to the VRS as applicable to all PSUs.

The Commission recommends that Government should consider these options and take a decision with the least possible delay. The future of the company is dependent vitally on the immediate implementation of the expansion project and any delay will lead to the company turning sick over the next two years, especially in view of the current depressed copper prices in the LME.

In order to conduct the strategic sale, the Commission recommends that the Standing Empowered Group appoint Financial Advisers/Consultants in order to value the company for fixing a reserve price. 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 Financial Advisor may also consider the financial restructuring package submitted by the company and suggest alternatives.

2.2 Pawan Hans Helicopters Limited

Evolution

Pawan Hans Helicopters Limited (PHL) was incorporated in 1985 for providing helicopter services primarily to meet the requirements of Oil & Natural Gas Commission Ltd. (ONGC). In India, the primary requirement of helicopter service for commercial purposes came from the oil sector. Before PHL was set up, ONGC's requirements were met by foreign companies which resulted in large outflows of foreign exchange.

PHL was set up as a joint venture, Government and ONGC contributing 51% and 49% of the total capital respectively. However, due to conversion of unsecured loans in FY 94 and further infusion of equity by Government, its holding went up to 78.5%. The shares of PHL are not listed on any stock exchanges.

Industry Analysis

Commercial helicopter service is relatively unique as this is normally used where other modes of transport are not economically viable or the nature of service is urgent. Globally, helicopters are used commercially for emergency medical services, fire fighting, corporate charters, tour operations, information gathering, traffic watch, agriculture, construction, oil & gas pipeline industries etc.

In India, helicopters are primarily used for oil exploration and agrospraying unlike the wide usage of helicopters globally. The oil sector is the biggest user in India accounting for more than 80% of the total demand as shown in the table below:

Table 1 Usage pattern (%)

Service	Share in Global demand	Share in Indian demand
Charters	25	7
Public Services/Safety/fire fighting	15	0
Emergency Medical Service	9	0
Oil & Gas support	8	80
Agriculture	6	8
Others	37	5
Total	100	100

In the Indian market currently 79 helicopters are operational. Depending upon their seating capacity, these helicopters can be classified as light and ultra light (2-7 seats) medium (10-15 seater) and heavy category (greater than 24 seats). Out of the total helicopters in operation, 65% are in the light and ultra light category while 33% are in the medium category with only 2% in the heavy category. The charter operators own 44 helicopters while the balance 35 are owned by Corporates and State Governments.

The demand from the private sector exploration companies is difficult to estimate at this point of time because private investment in this sector is still in the nascent stage. Similarly, the demand for helicopters in the tourism sector has not yet built up as the sector needs market development. In the corporate charter segment, the helicopters are owned by the corporates themselves. However, there are some sectors like the Mumbai region, Calcutta-Haldia region where there is potential for such services. Overall, it is expected that around 15-20 helicopters will be added in the light category in the next five years to cater to these sectors.

Apart from PHL, the other major company in India is Mesco Airlines which operates 8 helicopters. It is also understood that Mesco Airlines and another private company, Sahara Airlines are planning to expand the fleet strength over the next 5 years.

The key success factors in this industry are the availability of skilled manpower for flying and maintenance, infrastructure facilities for maintenance and high standards in service quality. There are no major entry barriers in the industry. The capital costs of the smaller helicopters are not high. But full utilisation or availability of long term charters are crucial for profitable operations. Helicopter import which was on the restricted list till FY 91 was subsequently moved to special import licences and has been put under OGL from FY 95.

The pricing in the industry operates on two structures viz. long term contracts, through fixed monthly rentals and hourly revenue. The fixed rental covers the fixed expenditure, while the hourly revenue covers variable costs. Secondly in the case of corporates and tourists charters, single hourly tariff is charged which is expected to cover both fixed and variable costs.

Business Analysis

PHL derives about 85% of its operating revenue from the services provided to ONGC . Apart from this, PHL also provides services to State Governments, PSUs, Customs Department, and also operates on charters for corporates and tourists. The company a fleet of 27 helicopters as below:

Table 2 Details of fleet and their current deployment

Helicopter	Type	No.of Helicopters	Deployment
Dauphin	Medium (11-14 seater)	20	11 with ONGC 1 each with Punjab state, Arunachal state, Lakshadweep, Min. of Home Affairs & Vaalco Energy 4 maintenance reserve
Bell	Light (4-5 seater)	3	2 with customs deptt. 1 tourist charter
Robinson	Light (4-5 seater)	2	1 with Oil India 1 with ONGC
M1 172	Heavy (24+ seater)	2	Both idle at present
Total		27	

Apart from its own fleet, PHL operates and maintains 5 helicopters belonging to State Governments, Gas Authority of India Limited, Border Security Force and Punj Llyod. PHL has set up maintenance facilities at Delhi and Mumbai for servicing its own fleet as well as other helicopters.

The details of PHL's operations for ONGC are given below:

Table 3 Total Flying hours of PHL and ONGC's share

Year	Total Flying Hours	ONGC's Share
FY 92	18,012	88.7%
FY 93	16,998	90.9%
FY 94	18,812	86.4%
FY 95	19,242	85.4%
FY 96	19,213	85.5%

Since inception, PHL has been getting the ONGC business on a captive basis. Even ONGC's requirements of heavy helicopters were catered to by PHL through contracting from private operators. In FY 97, there was a change in ONGC's chartering policy. The company invited global tenders for deployment of heavy duty helicopters (M1 172) instead of routing it through PHL. PHL on the other hand, had purchased these machines for

meeting ONGC's requirements. The bid was won by Mesco Airlines which resulted in PHL's machines lying idle. The company is presently looking for alternative deployment of these helicopters. Similarly, in the medium range, the PHL fleet is deployed with ONGC but the situation may undergo a change if the latter were to float a global tender for this category also.

Between FY 87 and FY 89, PHL acquired 21 Westland helicopters from the UK which developed a series of operational defects over a period of time. Following this, the entire fleet was grounded. They were re-introduced in FY 91 after modifications. However at this point of time, it was found that the operating costs of these helicopters had gone up significantly. Moreover it was also felt that the operations of the Westland fleet were still unsafe. Efforts made to sell these machines have not been fruitful so far. Though the funds for the purchase of these helicopters were received by Government as a grant from the Overseas Development Authority (ODA), Government lent this amount to PHL in the form of a loan. As on March 31,1996, PHL has a loan outstanding to Government to the extent of Rs.130.9 crores towards this purchase and an interest liability of Rs.220 crores. Based on this, PHL has claimed tax deduction on this interest liability. In case the company gets a waiver of both interest and principal, there will be a tax liability of Rs.124 crores.

Financial Analysis

The financial performance of PHL over the past five years is indicated in the table below:

Table 4 Financial Performance

(Rs. crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	111.8	97.6	93.1	88.9	73.1
Operating Profit	7.6	18.4	19.1	18.8	15.6
Non-Operating Income	44.9	36.6	38.3	32.4	22.5
Profit after Tax	47.8	40.7	32.3	26.0	12.1
Equity Capital	113.8	113.8	113.8	50.0	50.0
Tangible Networth	237.0	207.6	175.6	124.9	137.0
Gross Margin (%)	6.8	18.8	20.5	21.1	21.4
Net Margin (%)	42.8	41.7	34.7	29.2	16.6
ROCE (%)	1.2	2.0	-	-	-
RONW (%)	20.2	19.6	18.4	20.8	8.8
Earnings per share (Rs.)	4.20	3.58	2.84	5.20	2.42
Dividend (%)	7	7	6	5	-

PHL follows the globally accepted accounting practice of creating a maintenance reserve from the profit and loss account every year. The repair and maintenance expenditure is then charged to this account. The appropriation to this reserve is based on the manufacturer's recommendation. Currently, PHL allocates about 45-50% of the cost of sale every year into this reserve. However, the actual expenditure has been lower by 25-30% every year resulting in an accumulation of Rs.90 crores in the maintenance reserve.

Employment costs are the next important element in the total costs which accounted for 10-15% of cost of sales over the past five years. This has gone up substantially during FY 96 due to the revision in salaries of employees and the consequent payment of arrears and gross margins have consequently substantially declined.

PHL has made significant investments in unsecured inter-corporate loans. The company has advanced loans to Instrumentation Ltd and to Hindustan Photofilms Ltd. which were later referred to BIFR. As a prudent accounting measure, PHL has been providing for these loans and these are expected to be fully provided by FY 97.

PHL's non-operational income is significantly high due to investments in public sector bonds which was Rs.102 crores as at March 31, 1996. This has resulted in substantially higher net margins when compared with the gross margins from operations.

Strengths and Areas of Concern

Strengths

Largest helicopter fleet operator PHL is the largest helicopter fleet operator in India. There is only one other private company operating helicopters. PHL is therefore well positioned to capitalise on the emerging opportunities. The company is planning to enter into areas other than oil exploration like tourism, corporate charter etc.

Own maintenance infrastructure PHL has maintenance infrastructure in Delhi and Mumbai and can maintain all types of helicopters. These facilities help the company to provide improved service qualities.

Areas of Concern

Over dependence on one customer 85% of its total operating revenue is linked to one customer, viz. ONGC. With ONGC inviting tenders for the helicopter services, PHL's status as the sole provider is under threat.

Ageing Fleet The PHL fleet is relatively old. Replacement of these helicopters will involve huge capital expenditure.

Competition As the entry barriers are low, a number of private operators are expected to enter this business. The industry is expected to become fragmented.

Skilled manpower A key success factor is the availability of skilled manpower for operations and maintenance. With the current pay scales in PHL, the company will find it difficult to retain the skilled manpower.

Recommendation

As has been mentioned earlier, PHL was set up as a joint venture company between Government and ONGC for meeting the latter's requirements. The operations and profitability of PHL are directly linked with the business contracts with ONGC. Due to various reasons, ONGC has started inviting global tenders for the deployment of helicopters against the earlier policy of depending on PHL. The operations of PHL may come under further strain if ONGC plans to extend its tendering process for all its requirements.

The Commission reiterates the classification of PHL as non-core as the company operates in competitive markets in which the private sector has a presence.

An important factor which may affect the financial strength of the company is the amount due to Government on account of Westland helicopters. However it may be noted that the funds advanced to PHL for purchase of the Westland helicopters by Government were in the form of loan while the same was received by Government from ODA as a grant. **As the whole transaction was undertaken by PHL at the behest of Government, the Commission recommends writing off the Westland loans together with the accrued interest appearing in the books of PHL. Upon writing off**

the loan with interest, Government could realise Rs. 124 crores in the form of tax as the company had claimed the interest payable on the loan amount to Government as tax deductible.

As PHL derives 85% of its operating revenues from serving the oil exploration activities of ONGC, **the Commission recommends that Government should first offer its shareholding to ONGC so that PHL could become its subsidiary. This transfer of shares is expected to be mutually beneficial. In the event that ONGC is not interested, the Commission recommends that the Government sells its entire holding of 78.5% to an investor.** In order to conduct the sale, the Commission recommends that the Standing Empowered Group appoint Financial advisors/Consultants in order to value the company for fixing a reserve price. The procedure for appointing financial advisors for the sale and conducting the sale has been outlined in Part B of the First Report of the Commission (pp 38-40).

Power Grid Corporation of India Limited

Evolution

The Power Grid Corporation of India Limited (POWERGRID) was set up in 1989 for the purpose of construction of Extra High Voltage AC and High Voltage Direct Current Transmission Lines, Sub-stations, Load Dispatch Centres and Communication Facilities in a co-ordinated and efficient manner to move large blocks of power from central generating agencies and surplus if any, from State Electricity Boards (SEBs), to load centres within and across the geographical Regions with reliability, security and economy.

The basic need for setting up such a centralised system arose on account of the multiplicity of central and joint venture power generation companies such as National Thermal Power Corporation (NTPC), National Hydro Power Corporation (NHPC), North Eastern Electric Power Corporation (NEEPCO), Neyveli Lignite Corporation (NLC), Nuclear Power Corporation (NPC), Damodar Valley Corporation (DVC), Bhakra Beas Management Board (BBMB) etc. and for meeting other requirements relating to the planning, construction, operation and maintenance of transmission lines and sub stations for the evacuation of power in a centralised and co-ordinated manner. The multiplicity of organisations and ownership resulted in numerous operational and commercial problems in actual operations of the regional grids. In order to eliminate the operational and commercial problems and ensure better integrated operations of Regional Grid Systems, it was considered necessary to have a centralised pooling of all transmission lines and substations.

The share capital of POWERGRID as at 31st March, 1996 was Rs.2992.24 crores and the entire equity capital is held by Government.

Industry Analysis

The power sector in India is principally regulated by the Indian Electricity Act of 1910 and the Electricity Supply Act of 1948 which recognises generation and distribution as distinct activities and not transmission. There has been efforts by the Government to correct this anomaly by issuing an ordinance recognising transmission as a distinct activity. However, till date transmission is still bundled with generation and distribution.

The Indian power sector is organised at three levels - the States, the five regions and the Centre. At the State level, the SEBs are the main entities which undertake power generation, transmission and distribution.

At the regional level, the main organisations are:

1. Regional Electricity Boards (REBs) whose principal function is to act as the forum for regional planning; and
2. Regional System Co-ordinating Centres (RSCCs) which provide a dispatch function at the regional level by issuing instructions to the central generating stations and to the State Load Dispatch Centres (SLDC) and Communication Centres.

At the Centre, the principal agency is the Ministry of Power (MoP) which governs the power sector in India. MoP has an advisory arm namely Central Electricity Authority (CEA) which generally carries out technical analysis on matters on which MoP has to issue formal notifications.

The Electricity (Supply) Act, 1948 gives statutory powers to CEA, the central generating companies and SEBs. Some of the important statutory powers/roles vested in these agencies are as follows:

- All investments above a notified level, in the electricity sector have to be approved by the CEA
- Tariff setting powers for Central generating companies are vested with MoP
- Central and State Governments have wide powers to issue directives in their respective jurisdictions
- REBs and RSCCs have powers to issue instructions on system operation and require licensees and generating companies to follow these instructions
- CEA acts as an appellate authority for the resolution of disputes.

Most organisations in the power sector are either owned by the central or state Governments or a combination of the two. The terms of agreement between the companies have normally been not on commercial considerations. The price determination responsibility rests with CEA and based on its advice, the MoP issues notification. The Electricity (Supply) Act, 1948 places regulatory powers in the MoP/CEA at the Central level and in the SEBs at the State level. Even though CEA has been armed with statutory powers, given its role as advisor to MoP, it is difficult to enforce compliance on the issue of tariff fixation. Thus, this system of tariff fixation has not enabled the healthy development of the industry as a whole.

Role of POWERGRID

POWERGRID is the only organisation which has been assigned with the task of transmission of power in the country. The role of POWERGRID as it stands today is still fluid and has to evolve over a period of time. In its present form, the roles could be three-fold viz. providing transmission lines, ensuring the reliability of the system and dispatching power from central generating units.

Role as a transmission service provider The primary function of the regional transmission service is to provide a high voltage network connecting the major generating stations and main load centres. The extent of POWERGRID's role depends on:

- The degree to which POWERGRID takes on responsibility for planning and operating the network as opposed to just constructing and maintaining assets in accordance with contractual obligation and
- Where POWERGRID takes a decision making role, the scope of the regional network for which it has this responsibility.

Role as a dispatcher In the role as a economic dispatch agent, the range of roles POWERGRID could take up as the operator of RSCC are:

- POWERGRID acts as the dispatcher for the whole region and it has the dispatch authority on all plants operating in the region
- POWERGRID is responsible only for the dispatch of the plants of the Central generating companies and the SLDC are responsible for the dispatch of the individual generating units in the State.

Role as an agency ensuring System reliability Ensuring System reliability would involve a multitude of tasks which would include:

- Deciding on operational reserves and on emergency procedures
- Operation of transmission network
- System monitoring
- Operational planning, including scheduling of planned maintenance and operation policy.

Business Analysis

The company's current operations primarily involve development and construction of transmission assets and operating and maintaining them. POWERGRID has completed the consolidation process of taking over of transmission systems from central and Centre-State joint venture organisations viz. NTPC, NHPC, NEEPCO, NLC, NPC etc. alongwith related manpower. The company is in the process of augmenting the power systems for improved co-ordination in the operation of regional grids. As a part of total integrated system operation, POWERGRID will establish power pools to facilitate the exchange of power between States and Regions, thus leading to the formation of the National Power Grid. In this regard, POWERGRID started by taking over the Southern Region RSCC on 1st January, 1994 and all other Regional RSCCs were taken over by January, 1996.

The planning and construction of the new transmission lines are included in the five year plans and are undertaken by several entities at the Centre and State level. Typically before making any large investments, POWERGRID would have to obtain two streams of clearances viz. techno-economic clearance from CEA and PIB/CCEA clearance like any other PSU, which are complex and time consuming. The details of the total transmission system under operation and under construction by POWERGRID are given in the following table:

Table 1 Transmission System

Transmission Lines (Circuit Kms)		
	Under Operation	Under Construction
HVDC	1630	580
400 KV	16575	8390
220 KV	4495	1270
132 KV	700	400
Total	23400	10640
Sub-stations		
Nos.	47	14
MVA	15334	4410

The operating performance of a transmission company is measured on the basis of availability of the transmission system and the number of trippings per line which are attributable to the transmission company. The following table gives the operating performance of POWERGRID over the past three years:

Table 2 Operational Performance

	FY 94	FY 95	FY 96
Availability of Transmission System			
Target (%)	97.8	97.8	97.8
Actual (%)	97.6	98.0	98.3
No. of Trippings			
Standard	8.4	7.0	5.5
Actual	6.2	4.3	4.4

When compared with international utilities such as National Grid Company of U.K, Bonneville Power Admn. USA, Eskom of South Africa etc., the operating performance of POWERGRID has been quite satisfactory.

Financial Analysis

The financial performance of POWERGRID for the past five years is indicated in the table below:

Table 3 Financial Performance

(Rs.Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	976.3	804.8	645.1	631.2	21.3
Operating Profit	788.1	666.2	542.0	538.8	-19.4
Profit after Tax	276.0	225.4	202.6	236.5	-1.8
Equity Capital	2992.2	2972.2	2889.1	1849.2	61.1
Tangible Networth	4158.8	3734.9	3378.8	2068.5	41.5
Gross Margin (%)	80.7	82.8	84.0	85.4	-9.1
Net Margin (%)	28.3	28.0	31.4	37.5	-8.5
ROCE (%)	5.7	5.4	6.2	8.4	-0.7
RONW(%)	6.6	6.0	6.0	11.4	-4.4
Earnings per Share (Rs.)	0.92	0.76	0.70	1.28	-
Dividend (%)	0.33	0.17	0.17	0	0

The company was incorporated in FY 90, and the operations commenced in FY 93. FY 94 was thus the first full year of operation and hence the figures in the above table are strictly not comparable across the years.

POWERGRID earns its revenue through transmission charges. These charges are calculated so as to earn a 12% return on equity (ROE) based on normative parameters. The computation of the tariff takes into account a number of factors such as depreciation, interest on loan capital, O& M expenditure etc. In the computation of the tariff, the debt to equity ratio is taken as 1:1 regardless of the actual debt to equity ratio of the project. However, over the last three years, the company's actual rate of ROE remained low at 9.2% for FY 96, 7.6% for FY 95 and 7% for FY 94. The principal reason for the same is due to non inclusion of capital work-in-progress in the pricing formula for the purpose of calculating ROE. It may be noted that as on March 31, 1996, the capital work-

in-progress of POWERGRID amounted to about 56% of the total gross block of Rs. 5500 crores.

The main elements of operating costs for POWERGRID are employee costs, power costs and administrative expenses which have remained steady over the last three years. As a result, the operating margins have also been at a steady level at about 80% during the same period. However, due to high interest costs and depreciation (about 20% and 33% respectively of the total income in FY 96) the net margins of POWERGRID have generally been low.

Even though the levels of receivables has declined from 236 days in FY 94 to 212 days in FY 96, the absolute amount increased from Rs. 421 crores to Rs. 564 crores. All these amounts are due from SEBs and more than 56% of the same is due for over six months. Keeping in view the mounting receivables, Government of India has instructed all SEBs to open Letters of Credit for receivables of all Central sector power utilities. This is expected to bring down the level of receivables for POWERGRID. Similarly, an appropriation of the Central Plan Appropriation (CPA) amounts due to the SEBs towards the receivables of the Central sector power utilities was agreed to by Government in FY 94. This has resulted in reduction of receivables of POWERGRID to some extent.

Areas of Strengths and Concern

Strengths

Predictable Revenue Stream As the tariff stream of the company is a cost plus tariff, the risks associated with the variability in this revenue is low. The tariff and the returns associated with each project can be predicted virtually at the time of commissioning the assets.

High level of operating efficiency The operating efficiency of POWERGRID is comparable with other international transmission companies. Even though, currently the returns are not linked with the operating efficiency, there is an inherent strength in the company to improve its future earnings as and when the tariffs are linked with the operating efficiency.

Professional expertise POWERGRID was formed by taking over all transmission assets alongwith the trained manpower from the central power generating companies. This has resulted in pooling of expertise in the field of power transmission.

Areas of Concern

Regulatory Risks The tariff for the company would be set by the MoP. Thus under the administered price regime, power being an important input in the development of the economy, there is a tendency to keep down the tariff in order to make it available at low cost to the consumers. Under the current industry structure, any increase in tariff mandated by MoP is being resisted by the SEBs, owing to their inability to pass it on to their consumers, even if they are statutorily required to accept this tariff.

Low levels of return The tariff structure and the return levels applicable to POWERGRID do not allow it to earn returns commensurate with the risks faced.

High levels of receivables The poor financial condition of most of the SEBs is a source of concern as they are the sole purchasers of the services of the company. However over a period of time there has been an improvement in the level of receivables due to action initiated by the MoP.

Recommendation

POWERGRID has suffered in the past due to heavy locking up of funds on account of works in progress. These relate to transmission lines constructed and kept in readiness by POWERGRID but not used commercially on account of delays in completion of generation projects, particularly in the hydro-electric sector. This mismatch between completion of transmission projects and generation projects would need to be eliminated through better co-ordination among all the concerned agencies. There are also some instances of transmission lines remaining unutilised or underutilised because of the poor distribution infrastructure at the end of the State Electricity Boards. This is particularly true of sectors like the North East where POWERGRID has not realised transmission revenues in proportion to the capital expenditure incurred on account of the lower volumes of power actually transmitted over these lines.

In view of the uniformly poor financial health of the State Electricity Boards, POWERGRID has had problems of realising its dues. This is a problem which is likely to continue for some time and would adversely impact POWERGRID's profitability.

POWERGRID has been pressing for a revision of the formula for fixing transmission charges. In particular it has been pressing for an upward revision of ROE from the current 12% to 16%. An early decision from Government on this new tariff fixation formula will have a bearing on POWERGRID's profitability and its attractiveness to potential investors.

Huge investments are called for to strengthen the transmission infrastructure in the country. This has been estimated at Rs. 56,000 crores. POWERGRID would need to raise such resources from the market either through debt

instruments or through equity issue. In view of Government's inability to pump in additional equity to meet such requirements, the alternative would seem to be to identify sectors wherein transmission lines could be established by private parties through a Build, Own Operate, Transfer (BOOT) arrangement.

From the above analysis, it would emerge that POWERGRID operates in an extremely strategic area of infrastructural activity and, therefore, it is a core PSU. The entire sector is also in need of considerable reform covering a wide gamut including *inter-alia* co-ordinated action among all the players, establishment of proper systems and effective implementation thereof and finally commercial orientation of all the players in the system. While Government is seized of these problems, it may take a few years before all the reforms are put in place and the system is given proper commercial and market orientation. The Commission is of the view that until this is achieved, POWERGRID may not be able to attract the right kind of response from institutional or other investors to consider disinvestment. The Commission is also of the view that the long-term potential of the company once the entire electricity sector is fully restructured is high and any premature disinvestment might result in considerable undervaluation of the shares of the Company. The Commission, therefore, recommends that disinvestment in POWERGRID need not be considered for the time being. The requirements of the transmission sector in the short to medium term could be taken care of by commercial borrowings by POWERGRID to the extent required and implementation of select transmission projects through BOOT arrangements.

Shipping Corporation of India

Evolution

The Shipping Corporation of India (SCI) was incorporated on October 2, 1961 by the merger of the Eastern and Western Shipping Corporations through an Act promulgated in that year. At that time, SCI had a fleet predominantly of liners with an aggregate capacity of 0.19 million dead weight tonnage (dwt). Currently, it owns 122 vessels aggregating 5.44 million dwt and operates practically in all areas of the shipping industry. It also operates cargo and passenger vessels owned by other Government agencies.

SCI operates under the administrative control of the Ministry of Surface Transport. Earlier, Government had disinvested in two tranches in FY 92 and FY 94 aggregating 19.88% of the equity of Rs. 282.3 crores. The share holding pattern as at March 31, 1997 is given below:

Table 1 Shareholding Pattern

Shareholder category	% holding
Unit Trust of India	11.74
Other MFs GIC, LIC	5.83
FII's and Retail Investors	2.31
Government	80.12
TOTAL	100.00

SCI's shares were listed on the Bombay Stock Exchange in 1993 after the first tranche of disinvestment. However, trading has generally been infrequent and volumes quite low as the free float available in the market is quite limited. On a par value of Rs. 10, the closing share price of SCI was Rs. 57 on August 5, 1997.

Industry Analysis - International scenario

The global shipping industry can be segmented on the type of cargo being transported. As on January 1, 1996, the total tonnage deployed was estimated at 718 million dwt. Out of this, 72% of the tonnage was deployed in bulk carriage of goods (crude oil, coal, iron ore, grains, etc.) and 18% of the tonnage was deployed in the liner trade including the break bulk (small packages) segment. The balance was deployed in specific segments such as passenger ships, gas carriers, and other specialised vessels. In terms of freight revenues, container and general cargo vessels generate a much larger quantum of freight than bulk carriers as most of the high value items are shipped through the former category of ships.

Globally, the shipping industry is fragmented and most shipping companies are relatively small. Many ships owned by the same owners are legally owned by a single purpose company set up with the specific objective of owning the vessel. Over one third of the world fleet is beneficially owned by the developed countries but are registered in “flags of convenience” countries like Panama, Liberia, etc. for tax advantages and considerable flexibility in manning the vessels.

Globally, the demand for shipping services is dependent on the level of economic activities, trade linkages between various regions, the availability of tonnage and the vagaries of the climate. Given the cyclical nature of these factors, the shipping industry is in turn, cyclical. Typically, each cycle lasts about five to six years. However within the shipping industry, some segments such as the crude tanker segment are relatively less volatile when compared with the dry bulk carriage.

Indian Shipping Industry

As on 30th June 1996, the Indian fleet comprised 477 vessels aggregating 11.57 million dwt. When compared with the global pattern of ownership, Indian shipping companies generally own all the ships within the fold of the same company. Among the important ship owning nations India ranks 17th in the world. The Indian merchant fleet constitutes about 1% of the world's total fleet in terms of numbers and 1.5% of the cargo carrying capacity.

In terms of dwt, the SCI fleet is the largest and accounted for about 47% of the total tonnage the balance 53% being distributed among 79 companies in the private sector. In the private sector, four large shipping companies i.e. Great Eastern Shipping, South India Shipping, Essar Shipping and Chowgule Shipping own about 24% of the Indian fleet. Thus, nearly three-fourths of the Indian fleet are owned by these five companies.

A little over 95% of India's foreign trade, in terms of volume and 77% in terms of value, are transported through ships. While the volume of overseas trade has shown a steady increase, the share of Indian ships in the carriage of national trade has been declining mostly due to the inability of the Indian shipping companies to acquire tonnage to match the volume of overseas trade. This trend is expected to continue in the future mainly on account of the inability of Indian shipping companies to access the foreign debt market in accordance with the norms specified by Government.

Most countries in the world provide incentives to their shipping industry by way of tax relief, low interest loans, and cargo support, as shipping is seen to be of strategic importance for safeguarding national trade interests as well as providing a second line of defence for the country. In India, Government had

been extending soft loans through the Shipping Development Fund in the eighties and also provided other incentives by way of investment allowance, incentive to investors, etc. Increasing budget deficits in the nineties have compelled Government to withdraw these incentives. In addition, the Minimum Alternative Tax has been made applicable to shipping companies also. However, as far as dry bulk cargo is concerned, Indian shipping companies have cargo preference, provided the Indian operator matches the lowest bid offered by a foreign operator. In the case of crude oil imports, the public sector SCI is preferred over private sector and foreign lines.

Business Analysis

On the basis of the type of vessels operated, SCI has three operating divisions: the Bulk and Tanker (B&T) division, the Liner and Passenger Services (L&PS) and the Technical & Off-shore Services (T&OS). The division wise performance as at March 31, 1996 is shown in the table below:

Table 2 Division wise Performance in FY 96

Division	Vessels	Tonnage	Revenue		Op. profit	
	(Number)	%	(Rs crores)	% Share	(Rs crores)	% Share
B&T	77	88	1504.3	71	249.7	98
L&PS	35	10	587.3	27	-3.3	-1
T&OS	10	2	37.3	2	8.5	3
Total	122	100	2128.9	100	254.9	100

As can be seen from the above table, the B&T division is the main stay of SCI's operations with a contribution of about 98% of the operating profits in FY 96. Within this division, crude oil carriage contributed nearly 50% of the operating profits and about 37% of the operating profits for the company as a whole. The crude oil fleet of SCI is mainly engaged by the Oil Co-ordination Committee (OCC) on a Contract of Affreightment (CoA) on a cost-plus basis. Under the

CoA, SCI is responsible for transporting a specified quantity of crude between a specified sources and destination over an agreed period of time. Almost three-fourths of India's imports are made on FoB basis and the carriage from the port of export to India has to be arranged by the importer. Thus, SCI acts as the captive fleet of the Indian oil industry and carries a predominant share of crude for the country.

Under the cost-plus method, the charges for crude oil transportation are fixed by Government on the basis of a formula which takes into account the return on the capital invested on the ship. This method of computation of the freight charges have generally been advantageous to the company when compared with the method of computing time charter rates. These arrangements have ensured returns and have, in addition, minimised the volatility of the company's earnings which is a characteristic in the shipping industry.

However, the dismantling of the administered pricing mechanism in the oil sector could lead to the withdrawal of the cost plus arrangements of SCI with the OCC. SCI's monopoly in the transport of crude could be thus open to competition. In such an event, the oil industry will charter vessels on a globally competitive basis, but the charter rates are expected to be higher than the international prevailing rates due to infrastructural bottlenecks in the Indian ports. Hence, while competition would reduce the deployment advantage of SCI, the dependence of the oil industry on SCI is expected to continue in the long term.

Financial Analysis

The financial performance of the company is presented in the table below:

Table 3 Financial Performance

(Rs.Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	2177.0	1773.6	1555.9	1477.3	1358.3
Operating Profit	655.0	481.3	388.1	347.1	309.2
Profit after Tax	323.3	201.3	167.4	143.1	109.1
Equity Capital	282.3	282.3	282.3	282.3	282.3
Tangible Networth	1273.1	1012.0	841.7	719.6	617.0
Gross Margin (%)	30.1	27.1	25.0	23.5	22.8
Net Margin (%)	14.8	11.4	10.8	9.7	8.0
ROCE (%)	15.2	11.4	10.8	10.9	10.5
RONW(%)	28.3	21.7	21.4	21.4	19.0
Earnings per Share (Rs.)	11.45	7.13	5.93	5.07	3.86
Dividend (%)	20	15	15	10	6

Despite the cyclical nature of the industry, income from operations have exhibited consistent growth partly due to the deployment of a substantial part of SCI's new fleet on a cost plus basis. Further, the diversity of the fleet has helped SCI to withstand changes in business cycles in individual segments. In addition, SCI was able to control direct operating costs. These measures have helped to improve profitability at both the gross and net levels.

Shipping companies generally maintain a high level of cash in order to play on the asset markets. In order buy ships at the right time, SCI has maintained about Rs. 560 crores in deposits with Financial Institutions and about Rs. 200 crores in bank deposits. Interest on these funds account for about 20% to 25% of the total income.

Inspite of these cash assets, the gearing of SCI is high at 1.80 when compared with other major Indian Shipping companies. With the proposed expansion / replacement of the fleet in the ninth five year plan to be funded through predominantly debt sources, the gearing is likely to go up further.

Areas of Strength & Concerns

Strengths

Assured Returns on Crude Transport India's imports of crude oil are carried by SCI through a Government policy which favours the company over other operators. In addition, the cost plus pricing mechanism under the APM assures returns to the company.

Diversified Fleet The company has expanded its operations to practically all areas of shipping. This diversified fleet will enable the company to withstand the proposed deregulation of the oil sector wherein the monopoly position of SCI is likely to be open to competition.

Ability to borrow in the International Markets SCI has been able to successfully tap the international markets for its borrowing requirements. The company has been able to secure these funds at competitive rates.

Areas of Concern

Large Capital Expenditure Outlays The average age of SCI ships is about 14 years and considering the economic life of these ships, they are due for replacement over the next five years. Consequently, SCI is planning a massive replacement programme of its existing fleet. This is proposed to be funded through a combination of debt and equity funds amounting to Rs. 5600 crores.

Overmanning of Vessels As per SCI's own estimates, the current crew strength is about 65% more than its requirements. However, at the current levels of attrition and negligible additions, SCI expects the crew strengths to fall to optimum levels in the next few years.

Recommendation

SCI's crude tanker tonnage constitutes about 60% of the total tonnage of the Company's fleet and currently transports about 70% of the domestic imports of crude to the country. The operations are of strategic importance as India will continue to import crude in the future too. With the commissioning of refinery capacities in the private sector over the next two-three years, the total level of imports of crude is expected to increase. Unless the company adds substantially to its fleet of crude tankers in the same period, it is expected that the share of SCI in crude transport will come down in the future.

SCI's dry bulk and specialised carrier tonnage constitutes about 30% of the total tonnage of 57.6 million tonnes. In FY 95, foreign vessels had a dominant share of 82% of the total trade in this segment, while Indian vessels accounted for the balance 18%. Within the share of Indian vessels, SCI's market share was 44% with the balance accounted by the other major Indian shipping companies. With the relative inability of the Indian shipping companies to expand their fleet to take advantage of the increased trade in the coming years, the share of foreign vessels in this segment is likely to increase further. In line with this trend, SCI's share is also expected to come down in the future.

Excepting the crude carriage operations, where the company has been enjoying a preference, SCI operates in competitive markets both locally as well as internationally. Also, the oil sector is expected to be de-regulated, over a period of time. The preferential treatment for SCI in crude carriage is likely to be replaced by competition from both Indian and foreign vessels. Increased presence of other shipping companies will, in turn make this segment more competitive and a majority share holding directly by Government may thus not be required.

At this stage, the issue of the long term ownership of the company needs to be addressed. Government has already disinvested about 20% of the equity, mostly to UTI, LIC, GIC, Mutual Funds and others.

However, SCI's crude carriage operations are important for the country's refinery companies both in the public and private sector. The Commission is of the view the refinery companies could constitute a core group of stable shareholders in SCI who would benefit from equity linkages with a vital supplier of services. This will be in line with the international practice wherein almost all major oil companies own sizeable tanker fleet to cater to their requirements.

The Commission has noted that the company has a fairly large capital expenditure programme of about Rs. 5600 crores over the 9th Five Year Plan which is aimed at part replacement of the existing fleet as well as adding new ships. The company plans to raise about Rs. 550 crores from the equity markets and borrow about Rs. 3800 crores from the international markets. The balance is proposed to be funded through internal accruals.

While considering disinvestment in SCI, therefore, three important issues need to be kept in mind.

- Government receipts from disinvestment need to be maximised both in respect of extent of disinvestment and the price to be realised for the shares.**
- The strategic role of SCI in the transport of vital supplies of crude and other petroleum products would need to be sustained.**
- SCI would need to tap the equity market for raising resources for its fleet replacement and expansion plans and Government disinvestment should not constrain this in any manner.**

The disinvestment strategy in SCI would need to harmonise all these objectives.

The Commission recommends that Government should disinvest in SCI in favour of the Oil Refinery Companies. 30% of the equity of SCI may be offered to IOC, HPCL, BPCL, CRL and MRL in proportion to their net profits. In addition, 10% could be offered to the private sector and joint-sector refineries. In the event that this offer is not accepted by the private sector refineries it may be offered to the public sector refineries in the manner already indicated. The prices at which the SCI shares are to be transferred to the refineries may be determined through a valuation exercise to be undertaken by a specially appointed Financial Adviser. The provisions of the Substantial Acquisitions and Take-over Regulations of SEBI will have to be complied with, if applicable. Through this transaction,

Government share holding will come down from the current level of 80% to about 40%.

By following the above course of action, Government receipts on disinvestment would be quite significant. Even though Government's direct holding in the company falls below 50%, the oil PSUs and others would be holding 30% and constitute a group of stable shareholders. At the same time, thanks to the reduction of Government holding and the induction of representatives of the user PSUs, the Board of Directors of the Company will acquire a more professional character and the company could be managed more commercially and professionally. The investor perception of the company would improve considerably and the share value of the company would be enhanced significantly.

With this proposed transfer of Government shares to the oil refineries, the direct Government holding will fall below 51% and SCI will be run as a Board managed company. **As a first step, the Commission recommends that the Board of SCI be broad-based by inducting a few non-executive Directors from the relevant disciplines. At the same time, the composition of the Board should also reflect the shareholding of the company and all refinery companies who hold a part of the equity should be represented on the Board.**

After the disinvestment, SCI could tap the equity market to raise about Rs.550 crores. SCI should in the first instance make an equity offer in the Indian market to the institutional investors through a domestic book building process. In the next stage shares may be offered to the small investors and employees in the domestic market at a discount of 10% over

the institutional price. Thereafter, SCI may make an offer in the overseas market through a global book building process. The quantum and timing of these issues may be determined by the Board of Directors taking into account the industry conditions and the requirement of funds for the expansion project. Even at current share prices, the combined holding of Government and the oil refineries will be considerably above 51% after this public issue.

PSUs referred to the Commission

Appendix I

First List - September, 1996

<u>SL No.</u>	<u>Name of the PSU</u>	
1	Air India	AI
2	Bharat Aluminium Co. Limited	BALCO
3	Bharat Earth Movers Limited	BEML
4	Bharat Electronics Limited	BEL
5	Bongaigaon Refineries & Petrochemicals Limited	BRPL
6	Container Corporation of India Limited	CONCOR
7	Engineers India Limited	EIL
8	Fertiliser & Chemicals (Travancore) Limited	FACT
9	Garden Reach Shipbuilders & Engineers Limited	GRSEL
10	Gas Authority of India Limited	GAIL
11	Hindustan Aeronautics Limited	HAL
12	Hindustan Copper Limited	HCL
13	Hindustan Latex Limited	HLL
14	Hindustan Zinc Limited	HZL
15	Hotel Corporation of India Limited	HCIL
16	HTL Limited	HTL
17	IBP Co.Limited	IBP
18	India Tourism Development Corporation	ITDC
19	Indian Petrochemical Corporation Limited	IPCL
20	ITI Limited	ITI
21	Kudremukh Iron Ore Co. Limited	KIOCL
22	Madras Fertilisers Limited	MFL
23	Mahanagar Telephone Nigam Limited	MTNL
24	Manganese Ore (India) Limited	MOIL

25	Modern Food Industries (India)Limited	MFIL
26	National Aluminium Co.Limited	NALCO
27	National Fertilisers Limited	NFL
28	National Hydro Power Corporation	NHPC
29	National Thermal Power Corporation Limited	NTPC
30	Neyveli Lignite Corporation Limited	NLC
31	Northern Coal Fields Limited	NCF
32	Oil India Limited	OIL
33	Oil & Natural Gas Corporation	ONGC
34	Pawan Hans Helicopters Limited	PHL
35	Power Grid Corporation of India Limited	POWERGRID
36	Rail India Technical & Economic Services Limited	RITES
37	Shipping Corporation of India Limited	SCI
38	South Eastern Coal Fields Limited	SECF
39	Steel Authority of India Limited	SAIL
40	Western Coal Fields Limited	WCF

Second List - March, 1997

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

9	Utkal Ashok Hotel Corporation Limited	UTKAL-ASHOK
10	Rehabilitation Industries Corporation Limited	RICL

Appendix II

MINISTRY OF INDUSTRY
(Department of Public Enterprises)
RESOLUTION
New Delhi, the 23rd August, 1996

No. 11013/3/96-Admn. - In pursuance of the Common Minimum Programme of the United Front, Government hereby constitutes a Public Sector Disinvestment Commission, initially for a period of three years.

2. The composition of the Commission will be as follows :-

1. Shri. G.V. Ramakrishna, Full-time Chairman
2. Shri. Dipankar Basu, Part-time Member
3. Shri. M.R.R. Nair, Part-time Member
4. Dr. Suresh Tendulkar, Part-time Member
5. Dr. D.M. Nanjundappa, Part-time Member

The commission will have a full-time Secretary who will be appointed separately.

3. The broad terms of reference of the Commission are as follows :-

- I. To draw a comprehensive overall long term disinvestment programme within 5-10 years for the PSUs referred to it by the Core Group.
- II. To determine the extent of disinvestment (total/partial indicating percentage) in each of the PSU.
- III. To prioritise the PSUs referred to it by the Core Group in terms of the overall disinvestment programme.
- IV. To recommend the preferred mode(s) of disinvestment (domestic capital markets/international capital markets/auction/private sale to identified investors/any other) for each of the identified PSUs. Also to suggest an appropriate mix of the various alternatives taking into account the market conditions.
- V. To recommend a mix between primary and secondary disinvestments taking into account Government's objective, the relevant PSU's funding requirement and the market conditions.
- VI. To supervise the overall sale process and take decisions on instrument, pricing, timing, etc. as appropriate.

- VII. To select the financial advisers for the specified PSUs to facilitate the disinvestment process.
 - VIII. To ensure that appropriate measures are taken during the disinvestment process to protect the interests of the affected employees including encouraging employees' participation in the sale process.
 - IX. To monitor the progress of disinvestment process and take necessary measures and report periodically to the Government on such progress.
 - X. To assist the Government to create public awareness of the Government's disinvestment policies and programmes with a view to developing a commitment by the people.
 - XI. To give wide publicity to the disinvestment proposals so as to ensure larger public participation in the shareholding of the enterprises; and
 - XII. To advise the Government on possible capital restructuring of the enterprises by marginal investments, if required, so as to ensure enhanced realisation through disinvestment.
4. The Disinvestment Commission will be an advisory body and the Government will take a final decision on the companies to be disinvested and mode of disinvestment on the basis of advice given by the Disinvestment Commission. The PSUs would implement the decision of the Government under the overall supervision of the Disinvestment Commission.
5. The Commission while advising the Government on the above matters will also take into consideration the interests of stakeholders, workers, consumers and others having a stake in the relevant public sector undertakings.

S. TALWAR
Joint Secretary