REPORT XIII

DISINVESTMENT COMMISSION

JANUARY
2002

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

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Note: The Tables contained in this Report are based on information received from the Management of the PSUs.

PART - A

INTRODUCTION

The Disinvestment Commission has been reconstituted with effect from 24th July, 2001. Its terms of reference are given in Annexure A. The composition of the Commission is as follows:

1. Dr. R. H. Patil, Part-time Chairman
2. Shri N. V. Iyer, Part-time Member
3. Shri T. L. Sankar, Part-time Member
4. Dr. V. V. Desai, Part-time Member
5. Prof. K. R. S. Murthy, Part-time Member

Shri G. Ganesh, IAS, continues to be the Member-Secretary of the Commission.

A copy of the Resolution dated the 23rd August, 2001 regarding appointment of part-time Members of the Commission is enclosed at Annexure B.

Government of India has referred following four Public Sector Enterprises (PSEs) to the Commission for review and recommendations:

1. Neyveli Lignite Corporation Ltd. (NLC)
2. Manganese Ore (India) Ltd. (MOIL)
3. Rail India Technical & Economic Services Ltd. (RITES)
4. Projects & Equipment Corporation Ltd. (PEC)

These PSEs had been considered earlier by the Commission and its recommendations were submitted to the Government on different dates as indicated below:

1. NLC ... Report No.VII - March, 1998
2. MOIL ... Report No.II - April, 1997
3. RITES ... Report No.III - May, 1997
4. PEC ... Report No.X - June, 1999

Annexure A

GOVERNMENT OF INDIA
DEPARTMENT OF DISINVESTMENT
Block No.11 & 14, CGO Complex,
Lodi Road, New Delhi 110003

...

RESOLUTION

New Delhi, the 24th July, 2001

F.No.11012/1/2000-Admn. - The Government hereby re-constitutes the Public Sector Disinvestment Commission, initially for a period of two years

2. The Commission will be headed by Chairman Dr. R. H. Patil. The other Members of the Commission will be appointed separtely.

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

   (i) It shall be an advisory body and its role and function would be to advise the Government on Disinvestment in those public sector units that are referred to it by the Government.

   (ii) It shall also advise the Government on any other matter relating to disinvestment as may specifically be referred to it by the Government, and also carry out any such other activities relating to disinvestment as may be assigned to it by the Government.

   (iii) In making its recommendations, it will also take into consideration the interest of workers, employees and other stakeholders, in the public sector unit(s).

   (iv) The final decision on the recommendations of the Disinvestment Commission will vest with the Government.

K. K. GUPTA,
Joint Secretary

OPRDER

Ordered that the Resolution be published in the Gazette of India. Ordered also that a copy of the Resolution be communicated to all the Ministries/Departments of the Government of India and all central public sector undertakings.

K. K. GUPTA,
Joint Secretary

New Delhi
Dated 24th July 2001

Annexure B

(To be published in Gazette of India, Extraordinary, Part-I, Section-I)

GOVERNMENT OF INDIA
DEPARTMENT OF DISINVESTMENT
Block No.22 & 14, CGO Complex,
Lodi Road, New Delhi 110003

RESOLUTION

New Delhi, the 23rd August, 2001

F.No.12012/1/2000-Admn. - In continuation of Resolution No.11012/1/2000-Admn. dated the 24th July, 2001 reconstituting the Public Sector Disinvestment Commission, Government hereby appoints the following part-time members of the Commission with immediate effect.

1. Shri N. V. Iyer
2. Shri T. L. Sankar
3. Dr. V. V. Desai
4. Prof. K.S.R. Murthy

P. K. BASU,
Joint Secretary

To

The Manager,
Government Press
Mayapuri,
New Delhi.

ORDER

Ordered that the Resolution be published in the Gazette of India. Ordered also that a copy of the Resolution be communicated to all the Ministries/Departments of the Government of India and all central public sector undertakings.

P. K. BASU,
JOINT SECRETARY

New Delhi,
Dated 23rd August, 2001

PART - B

2. SPECIFIC RECOMMENDATIONS

2.1 NEYVELI LIGNITE CORPORATION LIMITED. (NLC)

Neyveli Lignite Corporation Ltd. (NLC) was studied earlier by the Disinvestment Commission and its recommendations were given in its Report No. VII submitted in March, 1998. In that report, the Commission had pointed out that power tariff reforms were crucial in increasing market contestability as well as improving the health of the balance sheet and enhancing the share values of power generation companies such as NTPC, NHPC and POWERGRID which had been proposed for disinvestment. Power reforms would lead to improving the rates of return of projects in the public sector when compared with the new projects in the private sector. Disinvestment, if undertaken after the financials improve, would bring in better share holder value. The Commission was, therefore, of the view that, till power tariff reforms were completely in place, it may be desirable for the public sector to play an important role in power generation.

The report of the Commission further reiterated the classification of NLC as 'Core", and felt that there was scope for value enhancement of NLC shares by tariff reforms and by resolving the matter of outstanding dues from the SEBs. On the above grounds, **the Commission recommended that there should be no disinvestment in NLC for the time being** and that the matter could be taken up later, as and when the power tariff reforms take firm shape.

Government had, in August 2001, referred this PSE again to the Commission for review of its earlier recommendations. Pursuant to this reference, the Commission sought a report from the PSE management on the earlier report of the Disinvestment Commission and their views regarding disinvestment. The Commission also sought the views of the Ministry of Coal (which is the administrative ministry) on the disinvestment of this PSE.

The Ministry of Coal has stated that it would not be legally tenable to include NLC in any disinvestment plan till the amendments proposed in the Coal Mines (Nationalisation) Amendment Bill, 2000 are approved by Parliament. Ministry of Coal have opposed any disinvestment in NLC till power sector reforms made sufficient progress.

The present legal position is that only a public sector coal mining company can sell coal to end users. The question whether a power generating unit in the private sector can sell coal/lignite to another company for generating power has to be examined in consultation with Ministry of Law. NLC has a contract to supply lignite from Mine 1A to an Independent Power Producer (IPP), viz. ST-CMS. Supplies are scheduled to start from March, 2002. Further, it may not be feasible to desegregate this mine to enable disinvestment in the rest of NLC. in view of the fact that (i) facilities like housing and other amenities are common to both the mining and power generation activities and (ii) the coal belt is a continuous one. The Commission does not fully agree with these views of the Ministry of Coal. NLC is a power generating company and power companies can operate captive coal mines even under the current policy. **The Commission would, therefore, recommend that the legal issue should be examined expeditiously so that disinvestment in NLC could be taken up without much delay.**

The Commission also examined the disinvestment proposition from the policy angle. It is clear that the earlier categorization of NLC as 'core' is no longer valid. As per the policy announced by the Government on 16th March, 1999, industries are to be grouped into 'strategic' and 'non-strategic' units. It is clear from the definition of 'strategic' and 'non-strategic' enterprises given by the Government, that **NLC would come under the category of 'non strategic' units. Hence under the current policy, there is no bar on considering disinvestment in this company.**

The Commission also examined the issue whether the present time is appropriate for disinvestment in NLC. In 1998, Government have introduced several reform measures which would affect electricity tariff in respect of sales from Central Power Generating companies. Government have set up the Central Electricity Regulatory Commission (CERC), to fix tariff for power sales from all Central Government owned generating companies (under Sec 13a) and generating companies selling power to more than one State (under Sec 13b of the Electricity Regulatory Commission Act, 1998.) Section 28 of the Act of 1998 sets out the principles of fixation of tariff by the CERC. The process of fixing tariff would also be through an enquiry in public. These measures have taken away the arbitrariness in fixing of tariff for NLC. Given the performance it has shown in the last five years, it should easily earn 16% post-tax return on equity, even at the performance norm of 68.5% PLF. With good management, it should be able to operate at higher PLF and earn much better returns.

There is still the problem of availability based tariff. NLC's appeal against the instructions issued by CERC for Availability Based Tariff (ABT) has been disposed of by CERC without giving full relief to NLC. The Delhi High Court has only passed an interim order on the petition filed by NLC in this regard. Ministry of Coal has urged that, in view of this, disinvestment could be deferred. The Commission is unable to agree with this view of the Ministry of Coal. The ongoing litigation is one in which NTPC and other Central Government power generating companies have taken up a common position. This is likely to be decided soon. The outcome of the litigation may reduce the profitability of all the public generating companies but should not reduce it to below 16% post tax return on investment.

The second problem is regarding the very large receivables of NLC which at the end of FY 2001 stood at Rs.2411.18 crores representing 64% of the annual sales income of that year. Government of India has initiated some important measures to resolve this. The group of experts under the Chairmanship of Dr. Montek Ahluwalia has recommended that the dues of SEBs to Central Generating Companies would be settled on a **one-time** basis on condition that (a) 50% of the surcharge/interest on delayed payment is waived, and (b) the amount is securitised through bonds to be issued by the company. These terms are under discussion with the State Governments and SEBs. Already Andhra Pradesh State and APTRANSCO have agreed. It is quite likely that in the Tamil Nadu and Karnataka may also agree in the near future. In any case, for enhancing attractiveness of NLC to potential buyers and realising higher price, the problem of receivables needs to be tackled satisfactorily, if necessary by transferring receivables into a SPV and held by the Government.

In view of the foregoing, the Commission feels that the present time is appropriate for considering disinvestment in NLC.

The Commission examined the modalities of disinvestment in NLC. The Commission had earlier recommended that the company could be restructured in order to enhance share value. Towards this end, it had recommended that the B&C plant should be hived off into an independent company and offered to a strategic buyer. In case the new buyer of the B&C unit wishes to continue the operations with lignite as a feedstock, NLC could enter into arrangements with the buyer for supply of lignite on a long-term basis. The

Commission had also recommended that, in case the buyer is provided the lignite at the present transfer price, there may be more investor interest in the B&C unit. The Commission had further recommended that, if there was no investor interest in the B&C division, Government as a prudent investor may have no option but to dispose of the assets and close down the operation of this unit.

The Commission had, in 1998, also considered the losses incurred by the fertilizer plant being run by NLC and recommended that the urea plant be hived off into an independent company and offered to a strategic buyer. The Commission had also recommended that, if there was no investor interest in the fertilizer plant, Government, as a prudent investor, may have no option but to dispose of the assets and close down its operation.

The Commission *de novo* examined whether the separation of the fertilizer and B&C plants should necessarily precede the initiation of the disinvestment process in NLC. The Commission feels that losses on account of the fertilizer and B&C plants are quite small compared to overall financial performance of NLC. Cumulative losses on account of B&C plant and fertilizer plant as on 31.3.2001 amounted to Rs.183.62 crores and Rs.352.19 crores respectively. Further, the number of people employed by the B&C plant and fertiliser plant were around 1025 and 1300 respectively against a total of 19,905 persons employed in NLC. The B&C plant has some environmental problems while the fertilizer plant is more than 30 years old. Separation of assets and liabilities of these plants would be complicated and time consuming. **The Commission feels that the costs and delays involved in hiving off and selling these two plants or closing them and redeploying the staff would not be commensurate with the value addition likely in the disinvestment of NLC. Therefore, restructuring of units could best be left to the strategic buyer of NLC. This would also expedite the process of disinvestment.**

The Commission had, in its 1998 report, recommended that NLC has surplus

manpower when compared with its peers. It recommended that NLC should initiate labour restructuring exercise in its core business of lignite mining and power generation. The PSE management has undertaken a review of manpower requirement with the help of the Administrative Staff College of India,

Hyderabad. The Commission has not seen this report. Meanwhile, it is understood that VRS has already been introduced in NLC and some progress has been made. The expenditure on salaries, wages etc. of Rs.604 crores as on 31.3.2001 amounted to 30% of the sale value of the main final product, namely, power. **The Commission feels that immediate steps should be taken to downsize the excess labour in NLC. However, this should not be a pre-condition for undertaking disinvestment in NLC.**

The Commission in its 1998 report had also reviewed the administrative arrangements of NLC and recommended that Government should transfer the administrative control of the company to the Ministry of Power with immediate effect. The PSE management has stated that they are not facing any difficulty in remaining under the control of Ministry of Coal. In view of this, **the Commission now does not see the need to make any recommendation regarding which Ministry in Government of India should have administrative control over NLC.**

The financial performance of the company for FY 1997 to FY 2001 (Annexure 1) shows that the profit for FY 2001 is Rs.726 crore representing an increase of 84.7% over the previous year. Net margins have also reached 30.61% in FY 2001 which is 6.57% higher than in FY 2000 and only marginally lower than the 31.12% reached in FY 1999. Projections for the financial years 2001 to 2005 (Annexure 2) show that profits would be going up by 36% in FY 2005 over the base of Rs.726 crores in FY 2001. Net Margins would also move up from 30.61% in FY 2001 to 33.82% in FY 2005. However, in spite of reasonably good performance by NLC, the strength of the company is not reflected in the market value of shares probably due to low volume of shares in the market. The book value of the share is about Rs.30/- (Thirty), while share prices in the market have fluctuated between a low of Rs.4.90 and a high of Rs.15/- during the fourth quarter of 2000-2001.

The Ministry of Coal has also opined that disinvestment should not be taken up in NLC till the capital restructuring of NLC is successfully completed. It is understood that the report of ICICI Securities (ISEC) on capital restructuring of the company is already available with NLC and the Government. **The Commission feels that a view on capital restructuring may be taken at the time of taking a decision on disinvestment by the Ministries of Disinvestment and Coal.**

Since lignite is an important natural resource, and since the concerned regulatory authorities would require some time to gear themselves for ensuring efficient supervision of private mining companies, it is essential that Government should not disinvest all its equity in NLC at one go. It is also clear that NLC would make considerable profits if pricing of power moves away from costs towards market prices.

NLC is a good dividend paying company since FY 2001. **Disinvestment of Government equity in NLC could boost revenues for the government while ensuring continued government involvement as a purely transitory arrangement till the regulatory authorities are fully geared for effective supervision of private mining companies. In case there is no legal hurdle to a power manufacturing company from becoming a strategic partner in NLC, Government could consider selling up to 51% of its equity to a strategic partner after the bidders have been suitably prequalified. If there is a legal hurdle, then at least 49% of the equity could be disinvested in the first instance. The Commission feels that a change in management could further improve the performance of NLC. Residual equity could be disinvested by the Government after a period of time when Government's receipts are likely to be higher.**

Annexure - 1
NEYVELI LIGNITE CORPORATION LTD. (NLC)
FINANCIAL PERFORMANCE

(Rs.Crores)

ITEM	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001
Operating Income	1425	1611	1849	1633	2371
Operating Profit	305	442	668	511	787
Profit after Tax	280	271	575	393	726
Equity Capital	1797	1797	1797	1797	1677
Tangible Net Worth	3350	3647	4162	4422	4959
Gross Margin (%)	49.49	52.8	55.40	51.30	45.16
Net Margin (%)	19.66	16.83	31.12	24.04	30.61
R.O.C.E. (%)	9.35	12.54	14.16	11.17	13.47
R.O.N.W. (%)	8.36	7.43	13.82	8.88	14.64
Earning per Share (Rs.)	1.76	1.51	3.20	2.18	4.33
Dividend (%)	Nil	Nil	5	7	10

Annexure - 2

NEYVELI LIGNITE CORPORATION LTD. (NLC)

TABLE 2 : FINANCIAL PERFORMANCE - PROJECTIONS

(Rs.Crores)

ITEM	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Operating Income	2371	1808	2708	2923	2924
Operating Profit	787	426	797	955	989
Profit after Tax	726	426	797	955	989
Equity Capital	1677	1677	1677	1677	1677
Tangible Net Worth	4959	4867	5459	6210	6934
Gross Margin (%)	45.16	43.17	56.87	59.19	58.50
Net Margin (%)	30.61	23.56	29.42	32.68	33.82
R.O.C.E. (%)	13.47	7.12	13.83	14.56	12.91
R.O.N.W. (%)	14.64	8.75	14.59	15.38	14.26
Earning per Share (Rs.)	4.33	2.54	4.75	5.70	5.90
Dividend (%)	10	7	10	10	10

2.2 MANGANESE ORE (INDIA) LTD.

The Commission had given its recommendations on Manganese Ore (India) Ltd. (MOIL) in its II Report submitted in April, 1997. The Commission had then categorised the company as 'non-core' PSE. However, having regard to its dominant market share in manganese ore reserves and production, **the Commission had not recommended disinvestment in the company beyond 49%.** The reasons given by the Commission for this recommendation were as follows:-

(i) Control of the company by private investors has the potential of destabilising the ferro alloy industry.

(ii) Taking into account the limited reserves of high grade manganese ore in the country, continued Government control over this company may be desirable to conserve this precious material for the steel industry and safeguard against indiscriminate "slaughter mining" for short-term financial gains.

(iii) No public purpose will be served by converting what is almost a public monopoly to a private monopoly and therefore disinvestment beyond 49% is not considered desirable. This issue can be reviewed once the situation changes in the future.

This PSE has been referred to the present Commission for review and recommendations. The Commission had sought a report from the PSE management on action taken on the recommendations of the Commission. It had also sought comments from the Ministry of Steel (Administrative Ministry).

MOIL and the Ministry of Steel have opposed disinvestment in MOIL on the following grounds:-

(i) MOIL produces about 70% of the country's total production of high grade manganese ore for production of ferro alloys, which in turn is used for production of steel.

(ii) Reserves of low phos ore will last for only 30 years and such limited reserves should remain under the control of the Government so that the interests of all domestic users are adequately safeguarded.

(iii) Privatisation may lead to selective mining and closure of several mines producing low quality ore and lead to import of ore.

Internationally, the main ferro alloys producing countries are South Africa, China, Australia, Brazil and the CIS countries. According to available figures from the US Geological Survey, January 2001 (as reported by MOIL), the world reserves of manganese ore are 5000 million tonnes, out of which India has only 167.31 million tonnes or 3.3% (as per estimates made by Indian Bureau of Mines.) South Africa has the largest share of reserves viz. about 4000 million tonnes (80%).

According to MOIL, out of 167.31 million tonnes of reserves of manganese ore, only about 47 million tonnes are of high grade, which could be used for manufacturing ferro alloys. Out of this 47 million tonnes, low phosphorous (phos content of 0.10% or less) ore reserves are only about 16 million tonnes. At the present level of consumption, the reserves of low phos ore will last only about 30 years. MOIL has only 21 million tonnes of high grade manganese ore suitable for use of ferro alloys/steel industries. This would imply that 80% of the country's high grade manganese ore reserves are in the leasehold areas of MOIL, confined to two mines viz. Balaghat and Ukwa mines in the State of Madhya Pradesh. These two mines produce about 35% of the ore containing high manganese and low phos content. The other mines of MOIL produce ore with low manganese and high phos content. MOIL blends the ores suitable for consumption by the user industries to conserve scarce mineral resources. MOIL and Ministry of Steel apprehend that if MOIL is privatised, the private owner may resort to selective mining which may, in turn, result in closure of several mines producing low quality ore and loss of employment for the large work force employed therein. Environmental issues may also receive a setback.

The Commission has considered the issue of conservation and prevention of slaughter mining. It is clear that both high grade and low grade ore are mined jointly and they are segregated only after extraction. It is, therefore, not possible to extract only high grade ore (high manganese and low phos

content). Even MOIL is resorting to blending high and low grade ore in a proportion which is acceptable to the user industries. It stands to reason that even a private miner would have to try and sell the lower grade ore by blending it with higher grade ore in a manner which would be acceptable to user industries. The private miner is not going to leave the lower grade ore lying around unsold. Further, he would try to optimise his output of high grade and lower grade ore, looking to the demand for ore in the market.

The Indian Bureau of Mines regulates the conservation of minerals, mine planning etc. while the Directorate General of Mines regulates safety of men and mines. It is clear, therefore, that the Indian Bureau of Mines is the competent regulatory authority to ensure conservation of minerals, including manganese ore. The Ministry of Forests and Environment have stringent rules for preservation of the environment in mining areas. The Commission does not concur with the view point of the Ministry of Steel that private producers of manganese ore would behave irresponsibly and only a public sector organisation could look after the conservation and environment aspects. It is not necessary for the Government to be in the business of mining for manganese ore in order to subserve the objectives of conservation. **The Commission, therefore, feels that the continuance of MOIL in the public sector is not essential for conservation of this mineral. However, in view of the finiteness of natural reserves and in order to ensure that there is greater clarity in regulatory issues - until the regulatory authorities gear themselves up to preventing slaughter mining and adoption of optimal exploitation practices - Government's involvement in the running of MOIL would be necessary for some more time.**

The Commission also considered the issue of domestic price of Ferro Manganese vs imported price. According to MOIL, the international price of Ferro Manganese is presently quite depressed due to world wide recession in the steel industry. From a high of USD 420 per tonne, it is now ruling around USD 345 per tonne. Similarly, domestic prices of Ferro Manganese are also depressed due to slow growth in demand. The landed price of imported Ferro Manganese of domestic grade is around Rs.22,841/- per tonne (including import duties of 29%) against domestic price of Rs.19,243/- per tonne excluding excise duty. It is clear, therefore, that the domestic price of Ferro Manganese would be higher if import duties are removed. The ability of domestic producers such as MOIL to stand up to international competition,

if tariff protection is taken away, is in serious doubt. **The Commission, therefore, does not view the continuance of MOIL as a public sector unit as vital for maintaining the domestic price of Ferro Manganese. The Commission, therefore, feels that the present time is opportune for considering disinvestment in MOIL.**

The Commission also considered the earlier classification of this industry as 'core.' As per the policy announced by the Government on 16th March, 1999, industries are to be grouped into 'strategic' and 'non-strategic'. Going by the definition of 'strategic' and 'non-strategic' enterprises given by the Government, it is clear that MOIL would come under the category of 'non-strategic' units. **Hence there is no bar to considering disinvestment in this company.**

Presently, Government of India holds 81.54% of the equity capital of Rs.15.33 crores, while the State Governments of Madhya Pradesh and Maharashtra hold about 8.81% and 9.65% respectively. The company has made a profit of Rs.20.4 crores in FY 2001 which is an increase of 70% over FY 2000. Net margin in FY 2001 is 12.11% which shows an increase of 3.4% over FY 2000. Earning per share has gone to a high of Rs.130.72 in FY 2001 (Annexure 1).

Future projections show that profit would be almost constant year after year while net margins would decrease gradually. Earning per share would stabilize around Rs.100/- over the next four years. (Annexure 2). This indicates that the future outlook is not going to be more promising than at present. Obviously, these projections would have to be revised after taking into account the likely revival in steel industry in the near future.

Ministry of Steel had also recommended that the issue relating to capital restructuring should be sorted out in order to improve the debt equity ratio, which is very low at present. The Commission had recommended this in its 1997 Report for the consideration of Government in order to improve the earnings per share by the company and thereby Government's realisation through disinvestment. It is understood that a report of SBI Capital Markets on capital restructuring of MOIL is pending decision with the management of MOIL. The Commission has not seen this Report. However, the Commission

feels that the issue of capital restructuring in the company may be taken up at the time of disinvestment in the company. Diversification into other investment projects need not impede decisions on disinvestment.

In view of the above circumstances, **the Commission recommends that a minimum of 51% of Government equity in MOIL should be disinvested to a strategic buyer after bidders are suitably prequalified. Further disinvestment can be considered at a later stage on enhancement of share value.**

Annexure - 1

MANGANESE ORE (INDIA) LIMITED (MOIL)
ACTUAL FINANCIAL PERFORMANCE

(Rs. in crores)

Particulars	95-96	96-97	97-98	98-99	99-2000	2000-2001
1. Operating income	104.08	108.41	113.92	118.27	134.32	165.50
2. Operating profit	23.40	22.87	23.77	18.06	20.59	32.25
3. Profit after tax	10.78	13.30	14.31	13.71	11.73	20.04
4. Equity capital	15.33	15.33	15.33	15.33	15.33	15.33
5. Tangible Net Worth	49.65	59.89	70.43	80.77	88.83	102.13
6. Gross Margin - % of operating income	23.69	26.26	25.51	22.00	17.00	22.25
7. Net Margin - % of operating income	10.36	12.27	12.47	11.59	8.73	12.11
8. ROCE - % (PBT/CE)	40.98	38.49	38.60	25.27	20.81	30.92
9. RONW - % (PBT/NW)	39.72	38.19	33.74	24.80	19.37	30.34
10. EPS (Rs.) Share value of Rs.100/-	70.32	86.76	92.69	89.43	78.52	130.72
11. Dividend %	20	20	20	20	20	27

Annexure - 2

MANGANESE ORE (INDIA) LTD. (MOIL)

PROJECTED FINANCIAL PERFORMANCE

(Rs. in crores)

Particulars	2001-02(RE)	2002-2003	2003-2004	2004-2005
1. Operating income	155.00	164.95	170.31	174.77
2. Operating profit	21.60	21.75	23.06	22.41
3. Profit after tax	15.49	15.21	15.54	15.4
4. Equity capital	15.33	15.33	15.33	15.33
5. Tangible Net Worth	113.60	124.78	136.30	147.71
6. Gross Margin - % of operating income	20.21	19.44	19.28	20.16
7. Net Margin - % of operating income	9.99	9.22	9.12	8.83
8. ROCE - % (PBT/CE)	21.70	23.02	22.71	16.53
9. RONW - % (PBT/NW)	21.21	18.95	17.73	16.25
10.EPS (Rs.) Share value of Rs.100/-	101.04	99.22	101.37	100.72
11.Dividend %	27	27	27	27

2.3 RAIL INDIA TECHNICAL AND ECONOMIC SERVICES LTD. (RITES)

The Disinvestment Commission had submitted its recommendations on Rail India Technical and Economic Services Ltd. (RITES) in its III Report May, 1997. **The Disinvestment Commission had not recommended any disinvestment in RITES in May, 1997.** The Commission had then felt that the PSE status of RITES had helped it to secure assignments from Government - both Central and State - and PSEs. This, however, may not be sustainable in the long run. RITES has received support from the Indian Railways in its operations in terms of business and manpower as also infrastructure. In a sense, RITES provides the cutting edge to the globalisation efforts of Indian Railways except in terms of export of materials and rolling stock as also project expertise. Based on these facts, the Commission had then felt that the balance of advantage was in favour of RITES continuing as a public sector undertaking for some time to come. Further, the Commission felt that the uncertainty surrounding the Iraqi dues would also preclude any disinvestment effort till that issue was satisfactorily resolved and that there would not be a favourable response from small investors or institutions to a limited offer of shares in the company.

This PSE has now been referred to the Disinvestment Commission for further review and recommendations. In pursuance thereof, the Commission had sought a report from the PSE management on the action taken on the recommendations of the Commission. It had also sought comments from the Ministry of Railways, which is the administrative Ministry for RITES.

The Ministry of Railways have recommended that the Commission's

recommendation in May, 1997 that RITES should continue as a public sector undertaking should remain unchanged for the following reasons:

(a) Half the inspection business is from Indian Railways which might not be available if the company ceases to be PSE.

(b) Easy access to skilled and experienced manpower of Indian Railways, Ministry of Surface Transport, Border Roads Organisation etc. would face a serious threat should the company cease to be a PSE.

(c) Almost the whole of export of rolling stock business from Indian Railways might be lost if the company does not remain a PSE.

RITES is executing international contracts in Bangladesh, Botswana, Columbia, Ghana, Iran, Malaysia, Mozambique, Myanmar, Nepal, Sri Lanka and Tanzania. In the domestic market, RITES is doing consultancy work for international airports, contractors/designers work for hospitals, bridges, tunnels, etc. (Annexure 1). However, it would appear from the table on Financial Performance (Annexure 2) that RITES' profit for FY 2001 is only Rs.7 crores. This is down by Rs.5 crores over the previous year's figure of Rs.12 crores and is the lowest in the last five years. Net margins have declined to 4%, which is the lowest in the last five years. Earning per share is going down which is currently at a low of Rs.35 from a high of Rs.95 in FY 97.

During financial year 2001-02, the Iraq receivable issue is likely to be resolved. The Cabinet Committee on Economic Affairs (CCEA) has recently approved, in principle, to issue bonds/payments in respect of BAAR (Iraq) projects. A group is being set up by Ministry of Commerce to finalise the modalities with regard to exchange and interest rates. On finalisation of these modalities, there would be positive impact on growth and financial performance of the company in the coming years.

Profit for the year 2001-02 has been projected higher at Rs.82 crores as against Rs.7 crores in 2000-01 probably due to anticipated receipts from outstanding Iraqi dues. However, in the subsequent year, profit has been projected at Rs.15 crores, due to reduced income from consultancy fees abroad on account of increased competition. Net margin has been projected as 7% in 2001-02 as against 4% in 2000-01. Earning per share in 2001-02 has been projected as Rs.45 compared to Rs.35 during 2000-01 (Annexure -3). Consulting Fees which currently form 77% of income of RITES is expected to go down to 71% in FY 2005 (Annexure 4), probably due to increased competition.

The dues from Iraq total Rs.155 crores whereas the tangible net worth of RITES is Rs.144 crores. If these dues are written off, RITES will have a negative net worth. **Therefore, the Commission is of the view that the outstanding Iraq dues may be segregated and transferred to ECGC or similar institutional mechanism.** This will help cleaning up of the Balance Sheet of the company.

It is clear that 80% of the business of RITES is related to railways. In the local market, about 35% of its business is railway related while it is 90% railway related in international markets. In financial terms, income from railway related work is 22% in FY 2001. This is projected to increase to 29% in FY 2005.Around 24% of the engineers and higher grade officers are on deputation from the Ministry of Railways while another 24% of the officers are reemployed or absorbed from Government. In respect of employees below engineers grade, around 12% are on deputation/remployed/absorbed from Government. This shows the extremely close relationship RITES has with the Railways, which has worked to their mutual advantage. **Therefore, continuous link with railways in the form of induction of railway personnel appears to be desirable in the short term. However, it would be to the advantage of RITES to develop its own cadre by absorption of experts from fields other than railways, in view of the likelihood of increase in non-railway consultancy business.** Further, RITES should develop a performance-linked incentive system so that they attract talented personnel from the open market. This would help in establishing RITES as a top grade consultancy firm and reduce its dependence on the railways. Export of rolling stock business can be handled directly by the Ministry of Railways. Similarly, inspection work relating to quality of project equipment can be handled directly by the Ministry of Railways. Enough expertise and manpower is available with the Railways for these purposes. There is no need to use RITES as an arm of the Railways for meeting these objectives.

The equity of RITES is Rs.2 crores and 100% of it is owned by the Government. As per the policy announced by the Government on 16th March, 1999, industries are to be grouped into 'strategic' and 'non-strategic' units. Going by the definition of 'strategic' and 'non-strategic' enterprises given by the Government, it is clear RITES would come under the category of 'non-strategic' units. **Hence under the current policy, there is no bar on considering disinvestment in this company.**

The Commission feels that, in view of the emerging scenario of international competition of consultancy business, RITES should be an independent and competent organisation which would be vibrant and internationally competitive. It should have support from the Railways but it should be, at the same time, fully free to recruit the right type of personnel and conduct its business without interference from Government. **These objectives can best be met if RITES does not remain a PSE. In view of**

the stiff competition in international consultancy business, the Commission feels that the present time is opportune to consider disinvestment in this company.

Since the asset of RITES is mainly knowledge and expertise of its cadre of officers, it appears that a management/employee buy-out would be a viable option for disinvestment in RITES. At the same time, there should be continuous involvement and participation of the Railways with RITES at least for a period of five years. It would make good business sense to associate reputed infrastructure consultancy organisations such as IL&FS, IDFC etc. in the ownership pattern of RITES. **The Commission would, therefore, recommend that a minimum of 51% of Government equity may be given to the employees (both present and past) of RITES while Government should retain 25% of the equity. The balance equity may be distributed among reputed infrastructure consultancy organisations and infrastructure leasing and financing organisations after suitable prequalification. In addition, the Railways should have an agreement with RITES under which continuous induction of talented railway personnel would be guaranteed for a period of five years.**

Annexure - 1

RAIL INDIA TECHNICAL & ECONOMIC SERVICES LTD. (RITES)

TABLE : BREAK-UP OF INCOME

(Rs.Crores)

ITEM	FY 2001	FY 2000	FY 1999	FY 1998	FY 1997
Consulting Fees-DOM	96.0	91.5	77.1	61.4	53.8
Consulting Fees-INTL.	17.5	10.0	8.9	8.7	9.6
Inspection Fees	13.6	14.7	13.6	11.9	10.6
Export of Rolling Stock	19.1	22.4	20.9	28.6	37.5
Sub-Total	146.2	138.6	120.5	110.6	111.5
Other Income	24.8	24.2	21.0	22.0	23.0
TOTAL INCOME	171.0	162.8	122.6	132.6	134.5

Annexure - 2

RAIL INDIA TECHNICAL & ECONOMIC SERVICES LTD. (RITES)

FINANCIAL PERFORMANCE

(Rs.Crores)

	FY 2001	FY 2000	FY 1999	FY 1998	FY 1997
Operating Income	181.0	172.0	142.0	133.0	134.0
Operating Profit	24.0	24.0	14.0	20.1	25.0
Profit after tax	7.0	12.0	9.0	15.0	19.0
Equity capital	2.0	2.0	2.0	2.0	1.0
Tangible Net Worth	144.0	139.0	130.0	124.0	110.0
Gross Margin (%)	27	26	23	28	31
Net Margin (%)	4	7	6	11	14
R.O.C.E. (%)	19	19	12	17	25
R.O.N.W. (%)	5	9	7	12	17
Earning Per Share (Rs.)	35	60	45	75	95
Dividend (%)	100	160	100	100	100

Annexure - 3

RAIL INDIA TECHNICAL& ECONOMIC SERVICES LTD. (RITES)

FINANCIAL PERFORMANCE - PROJECTIONS

(Rs.Crores)

ITEM	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Operating Income	181.0	264.0	172.0	174.0	189.0
Operating Profit	24.0	38.0	22.0	23.0	25.0
Profit after Tax	7.0	82.0	15.0	15.0	16.0
Equity Capital	2.0	5.0	3.0	3.0	3.0
Tangible Net Worth	144.0	221.0	233.0	245.0	258.0
Gross Margin (%)	27	23	16	17	17
Net Margin (%)	4	7	6	11	14
R.O.C.E. (%)	32	26	12	12	13
R.O.N.W. (%)	5	37	6	6	6
Earning per Share (Rs.)	35	45	75	75	80
Dividend (%)	100	250	150	150	150

Annexure - 4

RAIL INDIA TECHNICAL & ECONOMIC SERVICES LTD. (RITES)
BREAK-UP OF INCOME - PROJECTIONS

(Rs.Crores)

ITEM	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Consulting Fees- DOM.	96.0	98.0	100.0	103.0	107.0
Consulting Fees - INTL.	17.0	24.0	15.0	17.0	18.0
Inspection Fees	14.0	15.0	15.0	15.0	15.0
Export of Rolling Stock	19.0	99.0	30.0	29.0	37.0
Sub-Total	146.0	236.0	160.0	164.0	177.0
Other Income	25.0	19.0	12.0	10.0	12.0
TOTAL INCOME	171.0	245.0	172.0	174.0	189.0

2.4. PROJECTS & EQUIPMENT CORPORATION LTD. (PEC)

The Disinvestment Commission had submitted its recommendations with regard to Projects & Equipment Corporation Ltd. (PEC) in its X Report submitted in June, 1999. **The Commission had then inter alia recommended that no public purpose would be served by PEC being under Government ownership and control.** Hence the Commission classified PEC as 'non-core' entity. Further, the Commission recommended "Government should consider enlarging the scope of exports from the small and medium scale industries through PEC by suitable coordination between NSIC, SIDBI and other agencies representing or dealing with small and medium scale industries. .... **In case there is no significant increase in the turnover and profitability of PEC from the exports from the small and medium scale industries within a period of two years, Government should offer 100% equity in the company to a strategic buyer. In the absence of investor interest in PEC, there will be no alternative but to close the company."**

This PSE has been again referred to the Commission for review and recommendations afresh, keeping in view the earlier recommendations and the present position of the PSE. The Commission had sought a report from the PSE management on the action taken on the recommendations of the Commission. It had also sought comments from the Ministry of Commerce & Industry.

PEC have stated that it is a specialised marketing company for export of small and medium scale projects and equipments which is complemented with an exclusive line of credit. During the year 2000-2001, exports of projects and equipments by PEC amounted to Rs.43 crores representing only 3% of the total turnover of the company and 2.4% of the country's export of industrial plant and machinery by the small scale sector. Thus the role of PEC in the export of small and medium scale projects and equipments is marginal.

Profit for FY 2001 is Rs.2.58 crores which indicates an increase of 6% over the profit for FY 2000. Net margin in FY 2001 is around 0.15%. Earning per share has gone up from Rs.107 during FY 2000 to Rs.172.00 during FY 2001. (Annexure -1). According to PEC, profit is expected to go up by 48%

between FY 2001 and FY 2005 though net margin is likely to be constant. Earning per share is expected to go up to Rs.257 in FY. 2005. (Annexure 2) These projections do not appear to have taken into account world-wide recessionary trends and trade/shipping restrictions following recent terrorist attacks in the USA. It must be also noted that a significant portion of the profit of PEC accrues from non-operating income. For instance, in FY 2001, non-operating income accounted for nearly 50% of the profit.

PEC has stated that with a view to enlarging the scope of exports, it has entered into a Memorandum of Understanding with Technology Bureau of Small Enterprises, Delhi (a joint venture of United Nations - Asia Pacific Centre for Trade & Technology and Small Industrial Development Bank of India (SIDBI) and the National Institute of Small Industries Extension Training, Hyderabad.) However, there is no significant increase in turnover of exports from small and medium scale industries.

Project and Equipment exports of PEC account for less than 10% of its total exports during FY 2001 while commodities exports accounted for the other 90%. Similarly, imports of industrial raw material accounted for only 17% of total imports of PEC during FY 2001 while bullion and commodities import accounted for 59% and 24% respectively (Annexure 3). Even the projections made by PEC up to FY 2005 (Annexure 4) show that export of projects and equipments in FY 2005 would account for only 12% of total exports of PEC while commodities export would account for the balance 88%. In fact, export and import of commodities which constitute 46% of PEC's turnover in FY 2001 will go up to 74% in FY 2005.

It is clear from these figures that PEC is engaged primarily in commodities trading - a field in which STC and other agencies are already engaged. Since most of the items of exports/imports are now on OGL, there does not appear to be any role now for a canalising agency like PEC. The continuance of PEC in the public sector as an export organisation for project exports and equipments does not appear to be justified in the face of these facts. It is also clear that the objectives with which the company was set up are no longer relevant.

The Commission also considered the earlier classification of this PSE as 'non-core.' As per the policy announced by the Government on 16th March, 1999, industries are to be grouped into 'strategic' and 'non-strategic.' Going by the definition of 'strategic' and 'non-strategic' enterprises given by the Government, it is clear that PEC would come under the category of 'non-strategic' units. Hence, under the current policy, there is no bar on considering disinvestment in this company. There is enough competition in the trading industry and it is doubtful whether PEC would be able to face competition without the patronage of Government and other public sector agencies. **Hence the Commission feels that the present time is opportune to consider disinvestment in this company.**

In view of the foregoing, the Commission would like to reiterate its earlier findings that no strategic interest of the Government would be served by the PEC remaining under the control of the Government. The Commission, therefore, feels that Government should divest 100% of its shareholding. The Ministry of Commerce, which is the administrative Ministry for PEC, has no objection to disinvestment of PEC but have opined that this can be done after the process for STC and MMTC had advanced to a certain extent. This is a question of timing and sequencing of disinvestment, which will be doubtless considered by Government.

The equity base of the company is Rs.1.50 crores, 100% of which is owned by Government. The total strength of staff is 240. Out of total strength, 150 employees are surplus to the requirement and most of the business skill is concentrated in the senior management. **Since the assets of the company are mainly knowledge-based, Government could consider a management-employee buy-out in PEC. If this is not found feasible, Government could consider a strategic sale of 100% to any reputed international trading organisation. In case there is no investor interest in the company, there would be no option but to close the company after liquidating its assets.**

Annexure - 1

PROJECTS & EQUIPMENT CORPORATION LTD. (PEC)

FINANCIAL HIGHLIGHTS - FY 1998 TO FY 2001

(Rs. in Crores)

	FY 1998	FY 1999	FY 2000	FY 2001
Operating Income	449.13	793.98	1531.78	1744.28
Operating Profit	(-) 0.64	0.43	2.20	4.23
Non-operating Income	2.76	1.51	0.52	1.29
Profit After Tax	0.92	1.08	1.60	2.58
Equity Capital	1.50	1.50	1.50	1.50
Tangible Net Worth	18.57	19.32	20.47	22.47
Debt-Equity Ratio	0.14	0.08	0.00	0.33
Gross Margin (%)	N.A.	0.05	0.14	0.24
Net Margin (%)	0.20	0.14	0.10	0.15
R.O.C.E. (%)	2.21	3.78	21.12	31.08
R.O.N.W. (%)	4.93	5.59	7.82	11.48
Earning Per Share (Rs.)	61.0	72.0	106.7	172.0
Dividend (%)	20	15	20	15

Annexure - 2

PROJECTS & EQUIPMENT CORPORATION LTD. (PEC)

FINANCIAL HIGHLIGHTS - PROJECTIONS - FY 2001 TO FY 2005

(Rs.Crores)

ITEM	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Operating Income	1744.28	1462.00	1727.00	1864.00	2010.00
Operating Profit	4.23	1.62	3.32	3.99	4.97
Non-operating Income	1.29	2.00	1.05	1.05	1.00
Profit After Tax	2.58	2.60	2.90	3.30	3.85
Equity Capital	1.50	1.50	1.50	1.50	1.50
Tangible Net Worth	22.47	20.47	19.32	18.57	17.98
Debt-Equity Ratio	0.33	7.60	7.00	1.50	1.10
Gross Margin (%)	0.24	0.11	0.19	0.21	0.25
Net Margin (%)	0.15	0.18	0.17	0.18	0.19
R.O.C.E. (%)	31.08	9.00	17.29	18.28	20.01
R.O.N.W. (%)	11.48	10.59	10.79	11.18	11.81
Earning Per Share (Rs.)	172	173	193	220	257
Dividend (%)	15	20	15	20	20

Annexure - 3

PROJECTS & EQUIPMENT CORPORATION LTD. (PEC)
SALES TURNOVER AND PROFIT FOR THE FINANCIAL YEAR 1998-99 TO 2000-01

YEARS	1998-1999	1999-2000	2000-2001
Sales Turnover	787.88	1522.68	1729.18
Net Profit/Loss (After tax)	1.08	1.60	2.00
ITEMWISE TURNOVER %	1998-1999	1999-2000	2000-2001
EXPORT			
Projects & Equipment	3	2	3
Commodities	28	1	31
IMPORT			
Bullion	42	39	37
Commodities	16	45	15
Ind. Raw Material	10	12	11
DOMESTIC	1	1	3
TOTAL	100	100	100

Annexure - 4

PROJECTS & EQUIPMENT CORPORATION LTD. (PEC) PROJECTIONS FOR THE FINANCIAL YEAR 2001-02 TO 2004-05

(Rs. crores)

YEARS	2001-02	2002-03	2003-04	2004-05
Sales Turnover	1587.00	1715.00	1854.00	2000.00
Net Profit (After Tax)	2.60	2.90	3.30	3.85
ITEMWISE TURNOVER %	2001-02	2002-03	2003-04	2004-05
Exports of Projects & Equipt.	4	4	4	5
Commodities*	37	37	37	37
Import - Ind. Raw Material	18	19	20	21
Import-Bullion	41	40	39	37
TOTAL	100	100	100	100

*PEC has been in the import and export of commodities for the last seven years and its business does not show any consistent trend. In 1999-2000 wheat **was** imported. However, in 2000-01 and 2001-02 wheat is being exported. In case of commodities the projections for export and import have been combined.