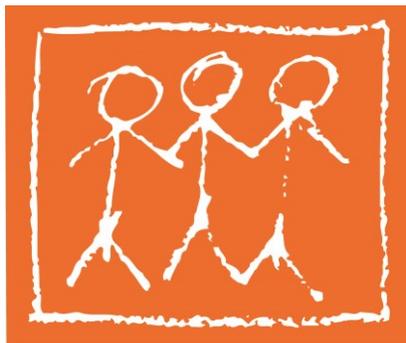


ITPCL - Financially Viable or Not?

Financial Health Analysis of ITPCL, Cuddalore



Citizen consumer and civic Action Group (CAG)

August 2019

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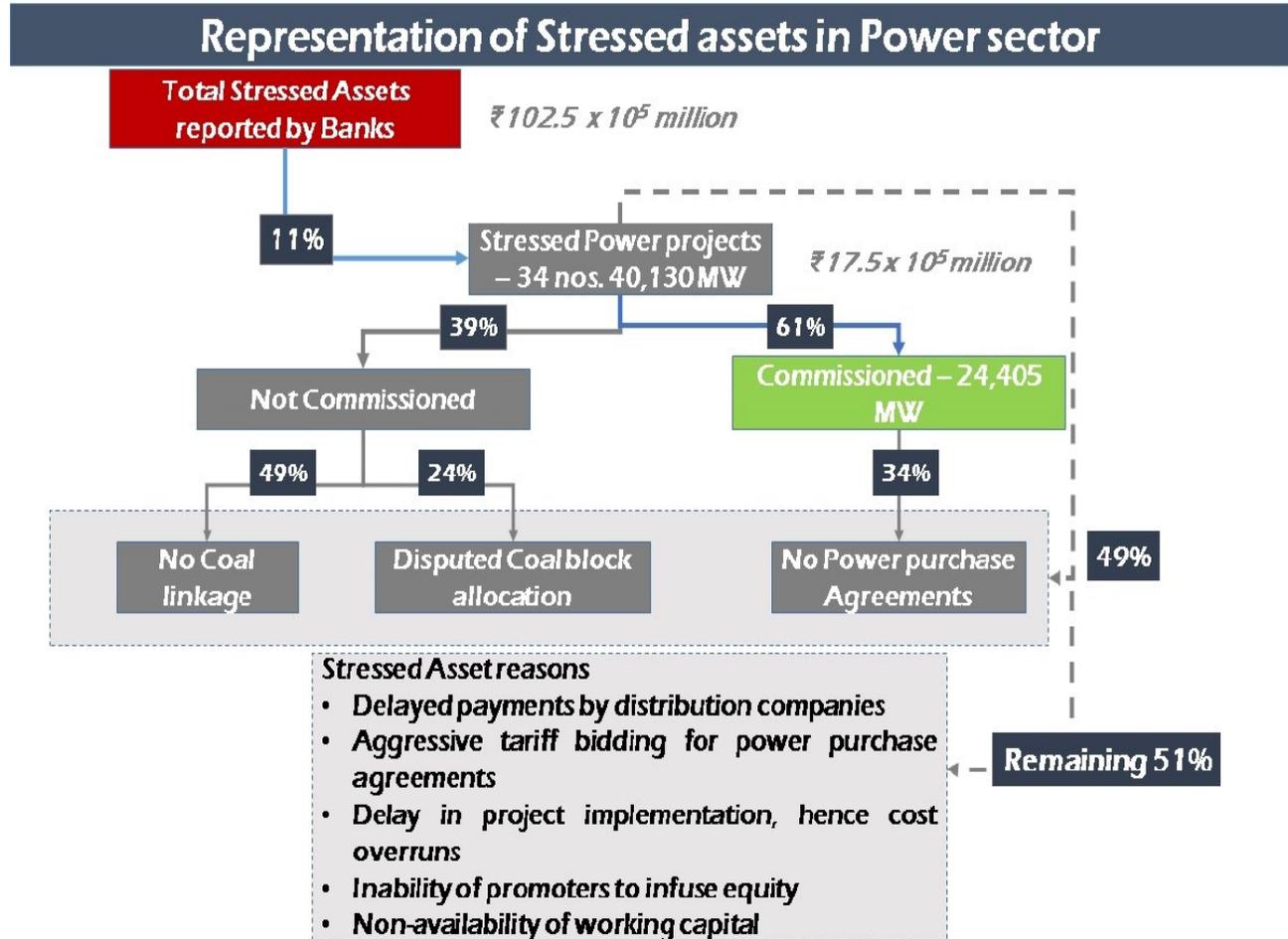
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Rationale for this study:

In March 2018, Parliamentary Standing Committee's report on Stressed/ Non-Performing Assets in the Electricity Sector was laid in Rajya Sabha. Following flow chart lists the key findings from the report.



Above classification makes it imperative to understand the financial position of power companies, especially those which do not have long-term PPAs for their entire capacities.

The trigger for a financial analysis of IL&FS Tamil Nadu Power Company Limited (ITPCL) came about by reports of environmental pollution in the nearby villages due to the power plant’s operation¹ and media reports on the financial crisis of the parent group, IL&FS², that had sent shockwaves through the Indian markets last September.

¹<http://www.newindianexpress.com/states/tamil-nadu/2018/jul/19/a-fishing-village-enveloped-in-black-dust-1845501.html>

²<https://economictimes.indiatimes.com/industry/banking/finance/banking/everything-about-the-ilfs-crisis-that-has-india-in-panic-mode/articleshow/66026024.cms>



The 1,200 MW plant, which has a long-term PPA only for 600 MW (50% of installed capacity), has an Environmental Clearance for 3,180 MW, valid until May 31, 2020.

For IL&FS, first sign of financial trouble was detected when IL&FS Transport Network Limited (ITNL), in June 2018, defaulted on repaying ₹1,000 million Commercial Paper (CP). Credit ranking companies did not assign it a default ranking then, owing to the credibility of the 30 year-old group. However, in September 2018, the parent company (IL&FS) itself took the industry by surprise by defaulting on a CP repayment of ₹10,000 million that led to chaos in the markets. Late in September 2018, a consortium of banks led by State Bank of India (SBI) filed bankruptcy proceedings against ITPCL, after ITCPL defaulted on payments of its dues. In February this year, as part of the resolution process, IL&FS had invited Expression of Interest (EOI) for sale of, among other subsidiaries, ITPCL and its assets³.

³ <https://www.ilfsindia.com/asset-divestment/thermal-and-related-assets/>



Methodology:

To assess the financial health of ITPCL, starting point was the publicly available information and hence we started with ITPCL's annual reports for the last two financial years (FY'17 and FY'18) to arrive at variables that signify different aspects of the company's functioning and finances. The data for generating these variables is adopted from the consolidated financial statements and the associated notes in the two annual reports. The data for calculating the variables for the subsidiaries of ITPCL were taken from their respective annual reports available in the public domain.

Some of the important financial ratios considered while evaluating the annual reports are-

Profitability ratios

- Profit after tax (PAT) margin (profit/loss margin) - it is the ratio of profit after tax to total revenue. PAT margin tells us the total profitability of the company.
- Return on equity (RoE) - it is a measure of the rate of return that the stock owners of the company receive on their shareholdings. Return on equity signifies how good the company is in generating returns on the investment it received from its shareholders.
- Return on assets (RoA) - it reflects the efficiency of asset utilisation towards generation of profits.
- Return on capital employed (RoCE) - it is the earnings as a proportion of overall capital (equity + short term debt + long term debt) employed, and is required by a business to continue its normal operations. In the long run, this ratio should be higher than the investments made through debt and shareholders' equity, as diminishing RoCE could render the business unsustainable. This is a better measure of financial health of a company than RoE, because it takes into account the contribution of debt while showing the company's return.

Leverage ratios

- Interest coverage ratio - it tells us about the entity's earnings relative to its interest burden.
- Debt to equity ratio - it is the total debt to total equity of the company. This financial tool gives an idea of how much of the borrowed capital (debt) can be fulfilled in the event of liquidation, using shareholder contributions. Hence, lesser debt is favourable from an investors' perspective. It is used to assess the financial leverage and soundness of a firm, and is typically calculated using previous fiscal year's data.
- Debt to asset ratio - it shows us how much of the assets have been financed through debt.

Operating ratios

- Fixed asset turnover ratio - it is the revenue generated compared to investments in fixed assets. It tells us about the effective utilisation of equipment.
- Working capital turnover ratio - it is the capital required by a firm to run its day-to-day operations. It tells us that a good company should finance its current assets though current liabilities.



- Total assets turnover ratio - it is the ratio of operating revenue by total assets. It tells us about the entity's ability to generate revenue with given assets.
- Receivables turnover ratio - it is the number of times the company receives money from its debtors.

Looking at core variables for ITPCL (debt to equity ratio, profit/loss margin, working capital turnover ratio, interest coverage ratio and receivables turnover ratio), it was observed that the business has failed in many performance indicators (financial ratios). We begin with a brief introduction of IL&FS, ITPCL and its subsidiaries before moving in to the financial health analysis of ITPCL for the study period.



Introduction to IL&FS

History & shareholding:

Infrastructure Leasing and Financial Services, formed in 1987, was promoted by Central Bank of India, HDFC, and Unit Trust of India. It began functioning as a core investment company, to finance infrastructure projects. With time, the company's shareholding pattern changed, and today includes LIC, SBI, ORIX Corporation, Japan, and Abu Dhabi Investment Authority. Its current shareholding has a public sector enterprise, Life Insurance Corporation (LIC) of India, as the biggest shareholder at 25% followed by ORIX Corporation of Japan (24%). These two firms together command almost 50% of the stock of IL&FS. The original promoters today have less than 20% stake in the IL&FS group. The table below lists the top 10 shareholders of IL&FS as last reported by the group⁴.

Areas of work:

IL&FS group, headquartered in Mumbai, consists of 24 direct and 135 indirect subsidiaries, 6 joint ventures and 4 associate companies⁵. After the dissolution of the existing board of IL&FS for reported inconsistencies in financial dealings, the government appointed a completely new board, led by the banker Mr. Uday Kotak. The new board reported that the company has over 348 subsidiaries, associates and joint ventures. Some of their areas of work include energy, transport, maritime, and urban assets, besides financial services. They operate in 22 states, besides having offices in Singapore, Spain, London, and Dubai.

Fully Paid-up Equity Shares of Rs.10/- each

<u>No</u>	<u>Name of Shareholder</u>	<u>Number</u>	<u>%</u>
1	Life Insurance Corporation of India	32,541,123	25.34
2	ORIX Corporation, Japan	30,227,509	23.54
3	Abu Dhabi Investment Authority	16,129,252	12.56
4	IL&FS Employees Welfare Trust	15,407,658	12.00
5	Housing Development Finance Corporation Ltd	11,587,194	9.02
6	Central Bank of India	9,843,386	7.67
7	State Bank of India	8,237,967	6.42
8	UTI - Unit Linked Insurance Plan	1,051,111	0.82
9	India Discovery Fund	1,104,211	0.86
10	Others	2,273,865	1.77
	Total	128,403,276	100.00

⁴ <https://www.ilfsindia.com/media/1960/ilfs-shareholding-pattern-december-31-2017.pdf>

⁵ <https://www.ilfsindia.com/media/2022/annual-report-fy-2018.pdf>



The company has several infrastructure projects to its credit, and is seen as a pioneer in the Public-Private Partnership (PPP) model. Some of its prestigious projects include building the Delhi Noida Direct Highway, financing a 9-km road tunnel in Jammu and Kashmir (Chenani Nashri Tunnel), and until recently (October 2018) it was developing the controversial Gujarat International Finance Tec-City (GIFT) Company Limited, with Gujarat Urban Development Company Limited (GUDCL) as equal partner⁶.

IL&FS group has two subsidiaries registered in Tamil Nadu, the IL&FS Tamil Nadu Power Company Limited (ITPCL) and the Tamil Nadu Water Investment Company Limited (TWIC). ITPCL is a majority owned step-down subsidiary of IL&FS while TWIC is a joint venture between IL&FS and Government of Tamil Nadu (GoTN)⁷.

Shareholding and Structure:

The flowchart⁸ below lists the holding company, subsidiaries of ITPCL, country and year of incorporation/acquisition by the parent.

IL&FS Energy Development Company Limited (holding company)

IL&FS started its energy business in 2008 through its subsidiary IL&FS Energy Development Company Limited (IEDCL). Through IEDCL, the group has forayed into power generation projects using wind energy, solar energy, thermal (coal) energy and waste-to-energy. IL&FS Tamil Nadu Power Company Limited (ITPCL) was registered in 2006 and brought under IEDCL in 2008.

ITPCL was incorporated in 2006 as a Special Purpose Vehicle (SPV) for implementing a coal-based power project in Cuddalore. Phase I of the ITPCL project was to commission 1,200 MW out of a total planned 3,180 MW. Unit 1 of Phase 1, with 600 MW capacity, was commissioned in September 2015. The company entered into a 15-year Power Purchase Agreement (PPA) with Tamil Nadu Generation and Distribution Company (TANGEDCO) on December 12, 2013, much ahead of the start of operations in Unit 1. However, this agreement was only for 540 MW, which is 17% of the total planned capacity. The initial quote was ₹6.134/kWh but the price under this agreement was 20% less, which is ₹4.91/kWh. The company went ahead and commissioned another unit of 600 MW in April 2016, which until October 2018 did not have a long-term Power Purchase Agreement (PPA).

As part of its efforts towards backward integration, in the year 2011, ITPCL invested and hence acquired coal mining and logistics companies registered in Indonesia and Singapore respectively.

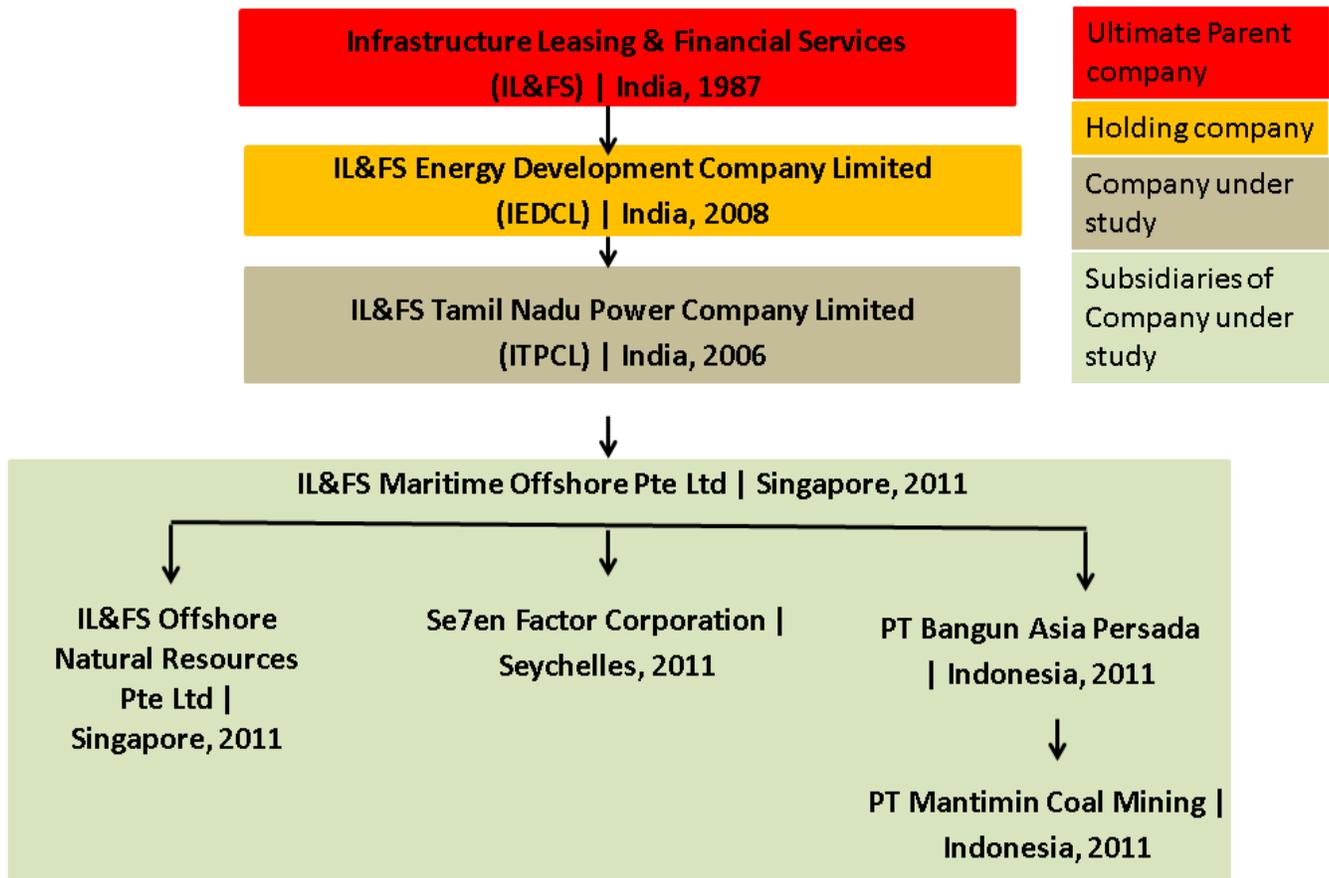
⁶ <https://thewire.in/political-economy/gujarat-buying-crisis-hit-ilfs-stake-gift-city-vijay-rupani>

⁷ <http://www.twic.co.in/index.php/about-twic/shareholders.html>

⁸ Information Collected from ITPCL Annual reports of FY'17 and FY'18



IL&FS Tamil Nadu Power Company Limited (ITPCL)

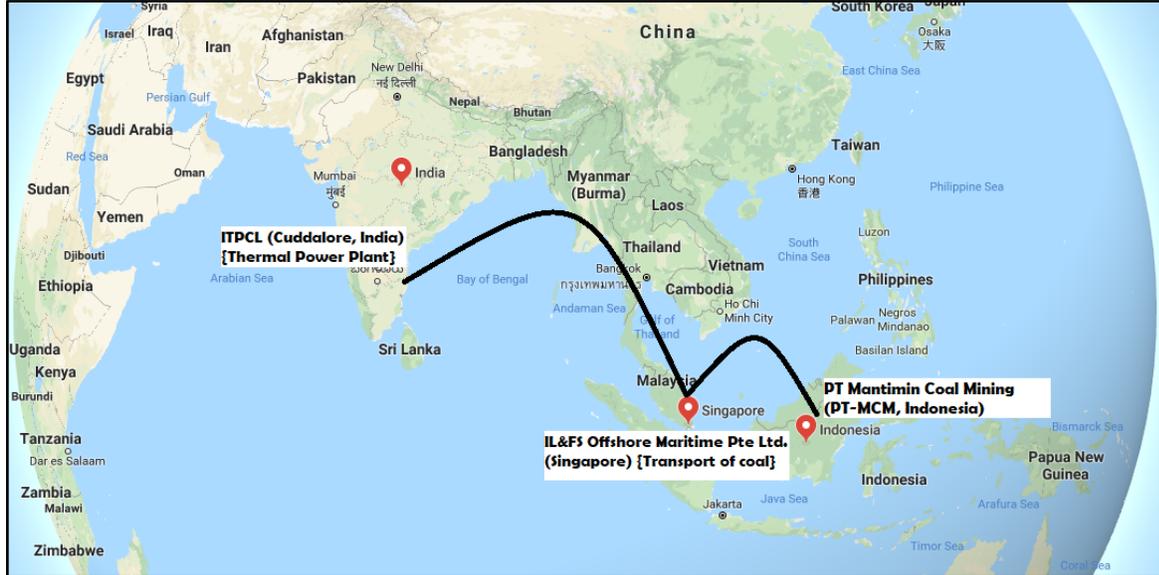


IEDCL is the largest shareholder of ITPCL with 91.38% ownership. The remaining 8.62% is held by A S Coal Resource Pte Limited, Singapore. This Singapore-registered company, owned by a British citizen Mr. Jaimin Vyas, is involved in a few other business dealings with IEDCL. Apart from a website with limited information and unverifiable contact details, no other details of this organisation can be found on the internet. This lack of information raises questions about the company and its owner. Mr. Vyas and IEDCL have together set up Valu Investments, which has business dealings with African coal miners Resgen. Valu Investments has 4% shareholding in Resgen. In July 2013, Resgen signed an offtake agreement with Valu under which Valu has the right to build and operate two new coal-fired power stations near the Boikarabelo coal mines in Africa. Resgen has a contract to supply coal mined from Boikarabelo coal mines to unknown Indian buyers.

There is not much information available in the public domain about ITPCL's Seychelles-based subsidiary, Se7en Factor Corporation, apart from that it is a marketing company. The actual operation of this company, sitting in a tax haven because it provides asset protection, zero/reduced tax liability and, opacity in transactions, is again a matter of further exploration.



Operational flow of ITPCL:



1. PT Mantimin Coal Mining (PT-MCM, Indonesia) was initially supposed to be the source of coal. The company, however, obtained a mining permit only in December 2017.
2. IL&FS Offshore Maritime Pte Ltd. (Singapore) transports the coal, through sea, from Indonesia to India.
3. ITPCL (India) uses this coal for the generation of power.

Management:

A trend commonly seen in private companies, especially in the IL&FS group, is of hiring retired bureaucrats with experience in ministries relating to the work-area of the company. The same was observed in ITPCL as well. ITPCL appointed Mr. M S Srinivasan, a retired IAS officer, as chairman in November 2008, four months after he retired as Secretary of the Ministry of Petroleum & Natural Gas (MoP&NG). He was ITPCL's chairman from 2008 and had become whole time director from 2011. He resigned from his posts in November 2018. Prior to joining ITCL, he served as an officer of the Indian Administrative Service (Tamil Nadu cadre), from 1971 to 2008. While in service, he has served as the District Collector of Dharmapuri and Ramanathapuram, besides holding key posts in the Government of India. ITPCL got registered as a company in 2006, when he was serving as Secretary, MoP&NG. Later in July 2008, the month he retired, the company was awarded Terms of Reference by the MoEF for conducting EIA for the project. During his stint in MoP&NG, he had launched a marker system (developed by a British company called Authentrix Limited) to ensure quality of petrol and diesel, and was charged⁹ by the CBI in this case for corruption.

Two independent directors and one director of the company had resigned after the IL&FS crisis first became public.

⁹<https://beyondheadlines.in/2012/11/why-was-murli-deora-removed/>

Financials of ITPCL:

As on 31 March 2018, ₹1,06,400 million has been invested in the company. Of this, ₹60,800 million was financed in the form of loans from public sector banks (PSBs) and ₹45,600 million in equity from IEDCL, its holding company¹⁰.

Extent of borrowing (Debt-to-Equity ratio):

The debt-to-equity ratio is a good indicator of how leveraged the company is- or how much it has borrowed. In the three years considered for this study, the debt-to-equity ratio of ITPCL has increased from 1.94 in FY'16 to 2.47 in FY'18, showing an increasing reliance on borrowings. Figure 1 shows the change in debt-to-equity ratio for these years for ITPCL in comparison to Tata Power (standalone basis). For ITPCL, equity for all the three years remained the same while only the debt rose. This debt is being used to run operations as well as create assets (this can be understood by seeing their debt-to-asset ratio, which has increased to 57% in FY'18 from 53% in FY'16). Reducing debt-to-equity ratio of Tata Power from FY'17 to FY'18 indicates reducing debt and high capital investment by the shareholders, whereas in the case of ITPCL, the debt to equity ratio grew, which indicates more debt or borrowings in relation to equity or shares.

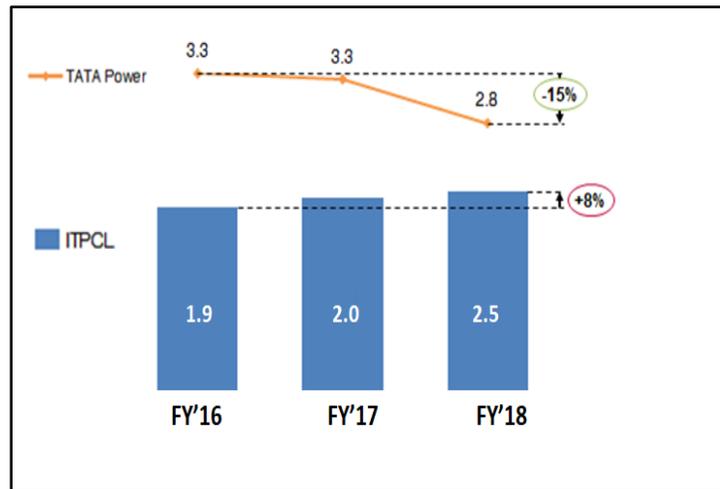


Figure 1

Attractiveness of the company to investors- Profit/Loss margin:

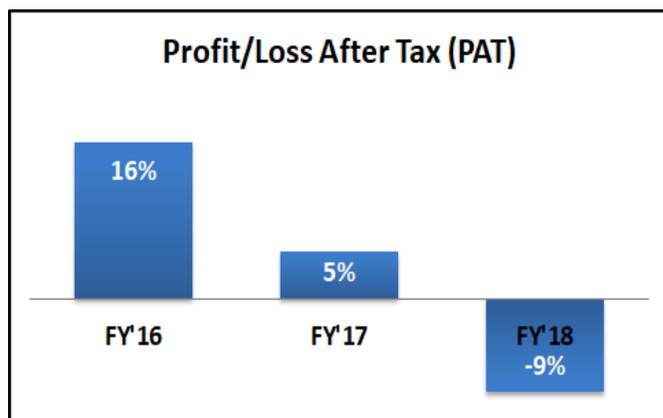


Figure 2

It is observed that the company's profits have been reducing for these three years. The profit for the company after tax was ₹1,464 million for FY'17 and ₹1,722 million for FY'16, which shows a clear decrease in profit margin. In FY'18, it registered a 9% loss (₹2,839 million). Figure 2 represents the profit/loss after tax for the last three years.

¹⁰ https://www.business-standard.com/article/companies/lenders-take-il-fs-unit-to-nclt-118092000845_1.html



Where is the borrowed money going? (Working Capital turnover ratio):

To meet the day-to-day expenses of the company, it seems! Working capital is the money required to run the day-to-day activities of a company. ITPCL's working capital turnover ratio (revenue/average working capital) has consistently been negative and has deteriorated by 48% from FY'16 to FY'18 which is shown in Figure 3. A negative working capital indicates dependence on external funding to meet the company's day-to-day expenses. This shows that the company's borrowings are being used to meet its daily expenditure.

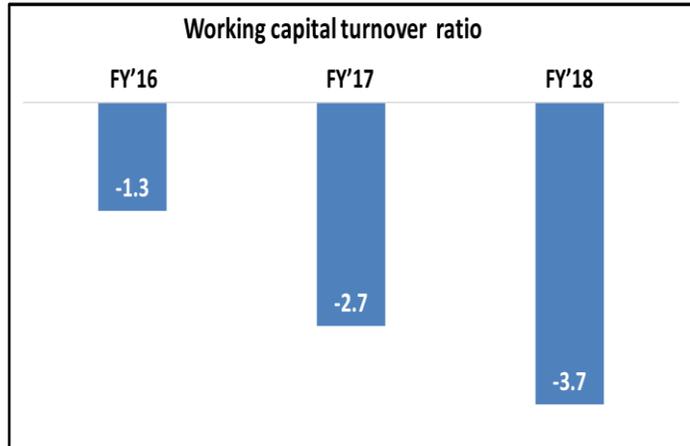


Figure 3

Although the power generation capacity has doubled from FY'16, the growth in revenue (year-on-year basis) from operations is merely 10%. There could be two causes for this:

1. The company is not utilising its full capacity or has not significantly stepped up generation; and
2. Power from Unit 2 is being sold at a very low price.

ITPCL generated 5,724 Million units during FY'18, with a Plant Load Factor (PLF) of 54% while the plant availability was 92%. As mentioned in the annual report of FY'18, lack of long-term PPA for Unit-2 might be a reason for lower PLF.

How is the interest on loans paid?

In the last 3 years, the interest coverage of ITPCL has decreased from 0.64 in FY'16 to - 0.45 in FY'18, as shown in Figure 4. This means that for every ₹100 of interest due, they were able to earn ₹64 in FY'16. This had fallen to just ₹7 in FY'17, but had plunged in the last year to become negative. This means that for every ₹100 of interest due, they are unable to earn even one rupee towards interest repayment, and are having a deficit of ₹45. This has led to the company defaulting on repayments.

In the latest credit rating rationale report for ITPCL released in January 2019, credit rating agency ICRA has downgraded ITPCL's rating to [ICRA] D from its previous rating of [ICRA] BBB+ (stable) in April 2018. This rating takes into account the weakening of the financials and lender actions of taking ITPCL to NCLT. ICRA has

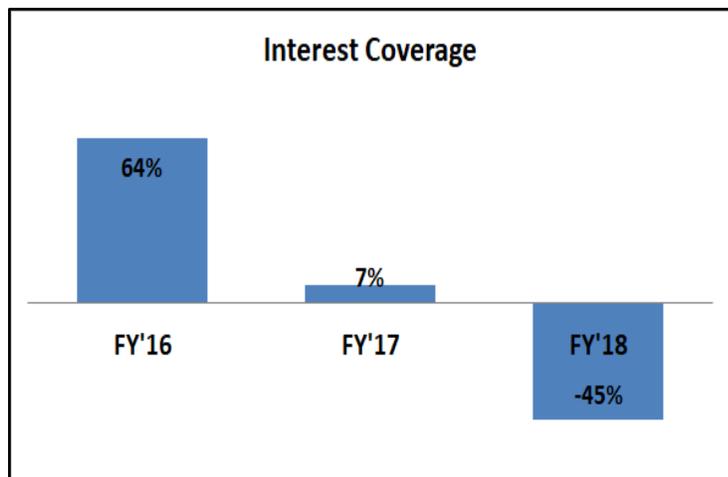


Figure 4

identified irregularities in debt servicing obligations as a key credit challenge to ITPCL. ICRA has also identified ITPCL's PLF of 57% as against the national average of 61% as a credit challenge. In June this year, ICRA changed the rating to 'Issuer Not Cooperating' due to non-disclosure of 'No Default Statement' by ITPCL. For a company that is unable to pay even its interest on time, repaying debt will be an uphill task.

*Income stability of the company-
Receivables turnover:*

Receivables turnover ratio tells us how many times in a year the company is receiving payments from their clients (discoms, power trading companies). ITPCL has a PPA with TANGEDCO for 540 MW for 15 years. In FY'16, they received money 4 times a year. For FY'17 and FY'18, this has decreased to only 3 times a year, putting more strain on the company's financials. Figure 5 shows the receivables turnover ratio of ITPCL.

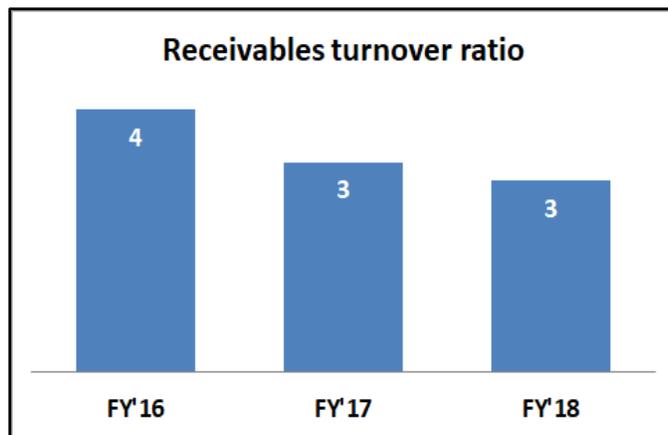


Figure 5

All of the five subsidiaries of ITPCL have been ailing since their incorporation/acquisition by ITPCL. As against bolstering the parent company's revenues, the subsidiaries seem to be draining ITPCL's resources. None of the subsidiaries have commenced operations, as per ITPCL's latest annual report. Let us now look at the key performance indicators of a few of the companies' subsidiaries.

IL&FS Offshore Maritime Pte Ltd (IOMPL)

IOMPL is a direct subsidiary of ITPCL and a parent of 4 subsidiaries. Money is being pumped into it by the parent, as equity, and short-term and long-term loans. It has been noted in its financial report that the company is dependent on its parent company for continued financial support. The working capital of IOMPL is not only negative but also has gone down by 78% in FY'17 (as compared to FY'16) as is shown in Figure 6. This significant decrease in working capital indicates that the companies' liabilities are increasing at a higher rate than the creation of current assets.

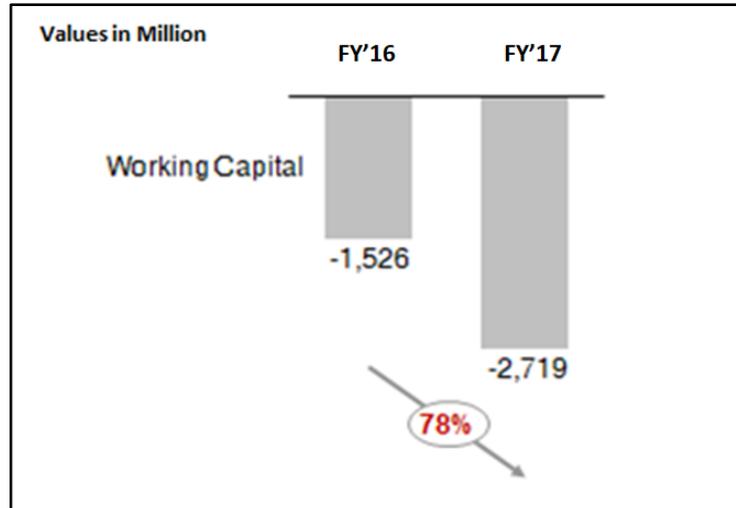


Figure 6

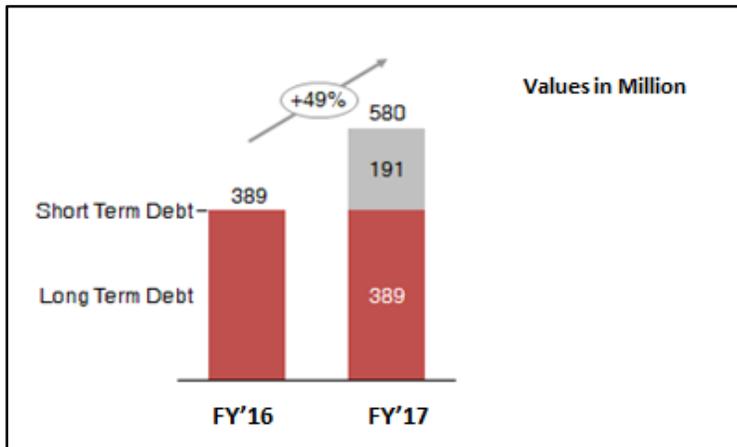


Figure 7

Although the short term debt in FY'17 was nil, it suddenly shot up in FY'18. This means that the company is not able to financially service its day-to-day operations and hence is forced to borrow for the same. There has been no reduction in long term debt. The overall debt increased by 49% in two years, which is borrowed from the immediate holding company as current and non-current liabilities as shown in Figure 7.

PT Bangun Asia Persada (PT-BAP)

PT-BAP is an investment holding company with a 95 percent controlling stake in PT-MCM. Working capital for this company has been negative for the last 3 years, which is shown in Figure 8. This clearly indicates that it is dependent on the parent company and external sources of funding to meet its day-to-day expenditure. However, these external sources are SFC and ITNL which are other entities under IL&FS group only.

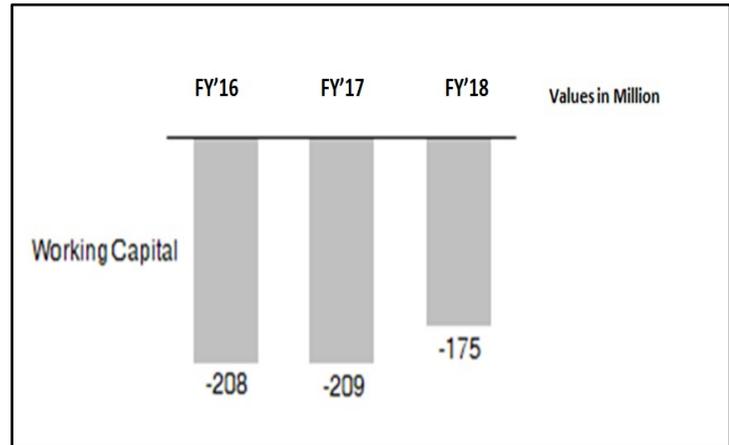


Figure 8

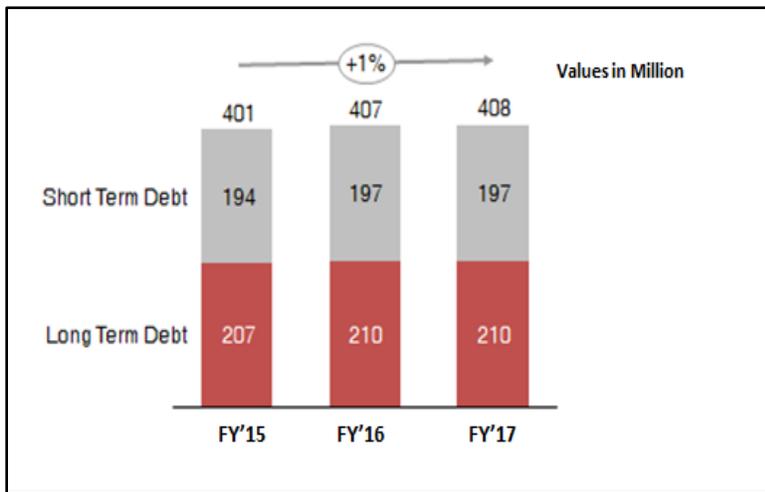
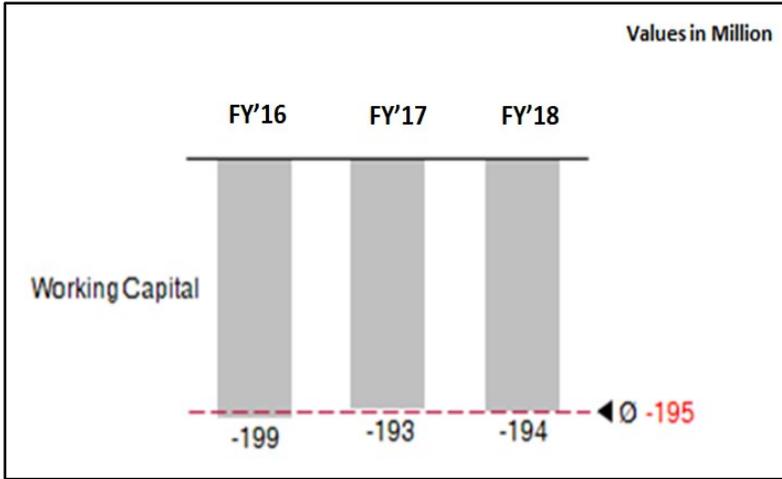


Figure 9

One interesting fact that we found out while going through its annual report is that its current liabilities for FY'17 stand at 309 times of current assets. In FY'16, it was 277 times. Short term and long term debt is shown in Figure 9. It clearly shows 1% CAGR in short term debt which indicates borrowings are increasing over the years.

PT Mantimin Coal Mining (PT-MCM, Indonesia)



For the study period, the company has had a negative working capital, as observed in Figure 10. This means that the company has inadequate funds to meet even day-to-day operations and relies on borrowings for the same.

Figure 10

Further, the debt condition has worsened by 9% CAGR in the study period. Both short-term and long-term debt are increasing, as shown in Figure 11. This means that the company is refinancing its debt and is kept alive by debt infusion alone, as its revenue from operations has decreased by 42% from ₹3,76,18,973 in FY'16 to ₹2,64,87,281 in FY'17.

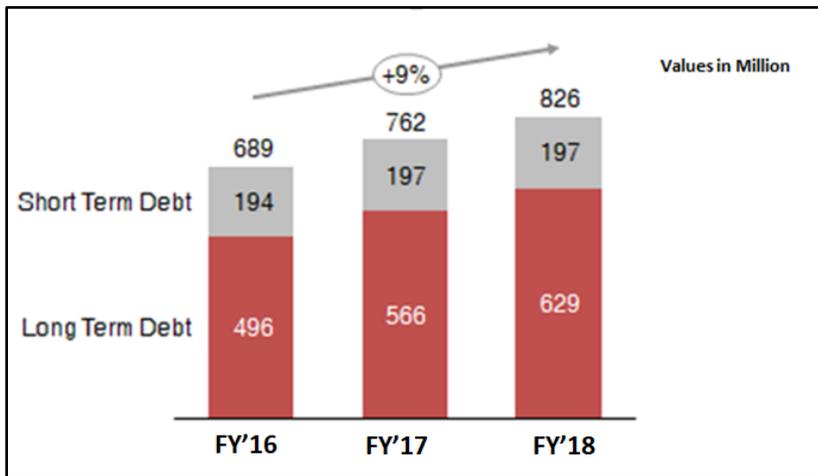


Figure 11

A Reuter’s report mentioned that ITPCL would import coal from Indonesia, Australia and South Africa to fuel the plant, and that it has acquired a mine in Indonesia to supply the generators. Its step-down subsidiary PT-MCM, which holds mines in Indonesia, is facing stiff opposition by the locals where it has been accused of ‘shady business dealings’ and completely sidestepping the local communities’ concerns in the Indonesian Borneo island¹¹, as mentioned in this report. A lawsuit was also filed against the mining licence given to PT-MCM by Walhi (an environmental NGO in Indonesia).

¹¹ Indonesian Borneo is home to ancient rainforest having critically endangered orangutans and clouded leopards as its inhabitants.



Concluding remarks:

Despite ITPCL's PPA at 20% lower than its initial quote for unit 1, the unit 2 was commissioned without signing a PPA. ITPCL is one of the biggest subsidiaries of IL&FS, contributing to the current financial crisis of the whole group. As part of Central government's initiative to bail out the 34 stressed thermal power projects, ITPCL was, in November 2018, given a contract to supply 550 MW of power to TANGEDCO for 3 years at ₹4.24 per unit¹². However, the company is yet to sort out its coal procurement issues and has proposed to use a blend of indigenous lignite and imported coal in the ratio of 25:75¹³. Because of fundamental differences in the quality of the two¹⁴, the existing machinery of the plant may not be suitable for this new fuel blend for power generation. This would mean the company may need more funding to bring in new equipment suitable for this blended coal, further stretching already worse financials of the company, which is over reliant on debt for its survival. The reason for ITPCL to go for blended coal is to reduce their dependence on imported coal as their subsidiary in Indonesia, PT-MCM, which is responsible for supplying raw material (coal), is cash-strapped and is kept alive by refinancing debt by IL&FS via different routes. Along with uncertainty in imported coal procurement, international coal prices also have seen more volatility in the past few years. IOMPL, which transports the coal from Indonesia to India, is under heavy debt and is continuously making losses, and ITPCL itself is under continuously rising debt without a credible steady source of revenue. All these confirm that the current assets and operations of the company are under stress and need to be consolidated instead of going for any fresh investment or expansion of the plant.

ITPCL, its parent companies IEDCL and IL&FS, and all of ITPCL's subsidiaries are all loss making as per the information in their latest annual reports (Figure 12). In such a scenario, it is pernicious to further fund the plant activities and plans for expansion. All the resources that ITPCL has should be put to use in correcting their operability and consolidating the activities to minimise further loss. It should also actively look at securing capital from the market and get listed as that could bring in more accountability to the company.

¹²<https://www.thehindu.com/news/national/tamil-nadu/centre-allots-550-mw-of-power-to-tn/article25510914.ece>

¹³http://environmentclearance.nic.in/writereaddata/modification/Amendment/Attach_file/01_102018O9MOUJR6ITPCLTechnicalNoteonUseofBlendedCoalConsolidatedReduced.pdf

¹⁴ Indigenous coal has higher ash and sulphur content as compared to imported coal.

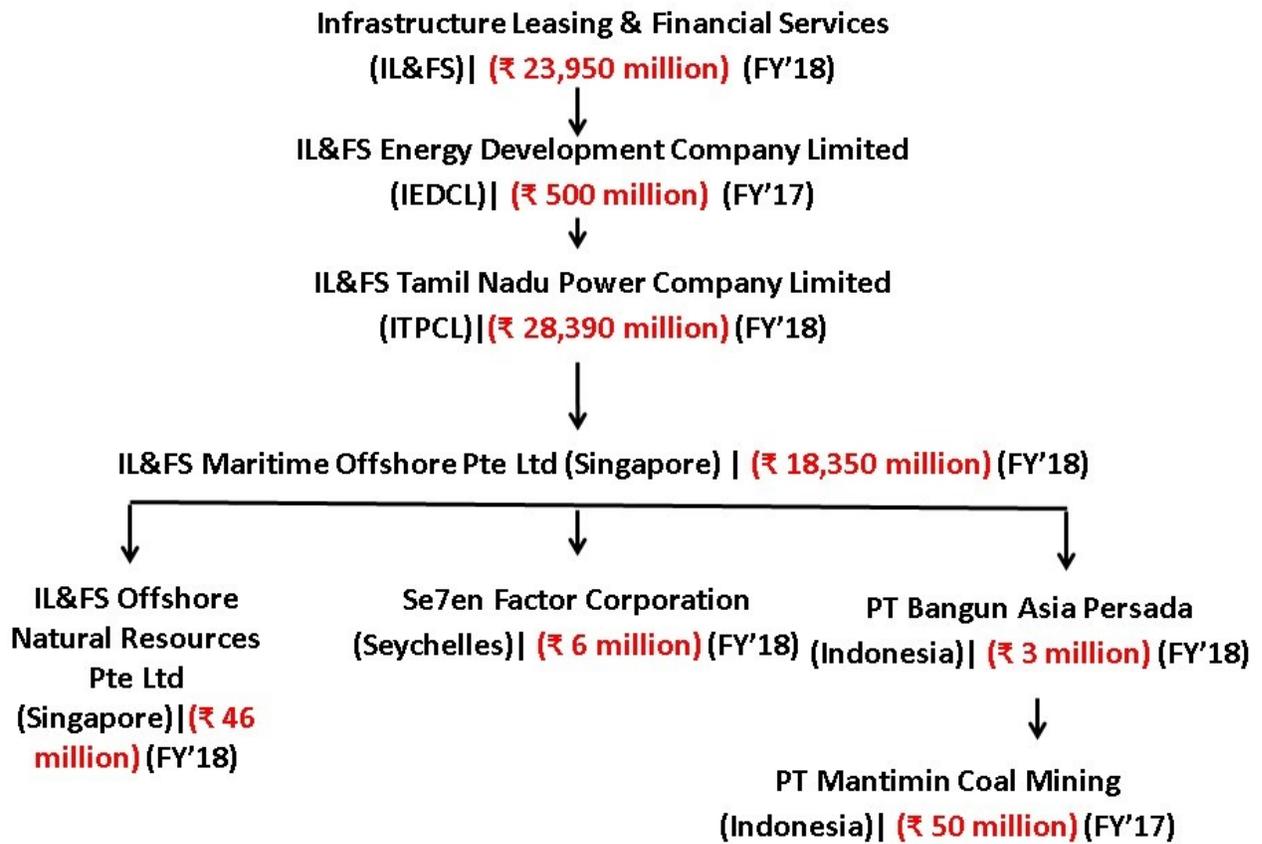


Figure 12