

*For internal discussion*

## Suryachakra Power Corporation Ltd.

## CRISIL IPO Grade 2.0 / 5.0

Public Issue of 34,000,000 equity shares of face value Rs 10 at a price band of Rs 15 to Rs 18 per share.

Bid/Offer Opens	*
Bid/Offer Closes	*
Shares Offered	34,000,000
As % of post issue equity	44%
Shares Outstanding (post issue)	76,632,665
<b>Lead Manager</b>	
Karvy Investor Services Ltd.	
SREI Capital Markets Ltd.	
<b>Registrar to the Issue</b>	
Karvy Computershare Pvt. Ltd.	
<b>Bankers</b>	
State Bank of India	

Shareholding Pattern	Prior to issue		Post issue	
	No. of shares	%	No. of shares	%
Promoters	38,579,160	90.5	38,579,160	50.3
Others	4,053,800	9.5	38,053,800	49.7
Total	42,632,960	100.0	76,632,960	100.0

		SPCL-Consolidated	
		2004-05 <sup>1</sup>	2005-06
Operating income	Rs. Million	656.3	891.0
Operating margins	Per cent	20.7	15.3
Net profits	Rs. Million	20.2	17.2
Net margins	Per cent	3.1	1.9
ROCE	Per cent	8.4	8.0
RoE	Per cent	5.4	3.3
No. of equity shares	Million	32.0	42.6
Networth	Rs. Million	410.6	623.2
EPS	Rs.	0.6	0.4
Book value	Rs per share	12.8	14.6
Gearing	Times	1.4	1.1

<sup>1</sup> Shown for the purpose of comparison with 2005-06.  
(Audited consolidated accounts are made in 2005-06)

### Overall Assessment

CRISIL has assigned a CRISIL IPO Grading “2/5” (pronounced “two on five”) grade to the proposed initial public offer of Suryachakra Power Corporation Ltd. (SPCL), indicating “below average fundamentals” of the company in relation to other listed equity securities. The grading reflects the revenue inflows from SPCL’s 20MW DG based power plant in Port Blair, Andaman & Nicobar (A&N) islands, under a 15 year power purchase agreement signed with the A&N Administration effective in 2003 and the revenue growth potential from its planned biomass based power plants of about 20MW each in Chattisgarh and Maharashtra.

The grading is constrained by the promoters’ past track record of dabbling in many different business ventures, by the fact that the promoters do not have any prior experience in setting up and operating a biomass based power plant, significant raw material price uncertainty associated with biomass based power and the fact that the presently very high costs of the company’s DG based power in A&N would provide a strong incentive to the A&N Administration to look for cheaper alternatives. CRISIL notes the chequered track record of the promoters in running businesses in the past – specifically that two of their companies that were engaged in the aquaculture business are now defunct. These companies, which had been listed on the Bombay and Hyderabad stock exchanges since 1993-1994, had large defaults on their debt obligations in 1996-1997 and were delisted from BSE on January 14, 2004. It may also be noted that the timing of the proposed IPO is influenced by the company’s arrangement with

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Opulent Venture Capital Trust, which currently holds a 4.7 per cent equity stake in SPCL, is a part of SREI group. SREI Capital Markets Ltd. is one of the Book Running Lead Managers for the proposed IPO.

In order to arrive at overall grade, the company has been evaluated on 3 broad parameters:

- Business prospects and financial performance
- Management capability
- Corporate governance

### **Business prospects**

#### ***Revenues from DG operations are assured under the PPA, but they may not be sustainable over the long-term***

SPCL is a sole private IPP in A&N, supplying electricity to Port Blair and surrounding villages from its 20MW diesel power plant, under a 15 year PPA with the A&N Administration effective 2003. Following the signing of the PPA in November 1997, the company took longer time to achieve the financial closure (August 2000), which is attributed to financial problems in SPCL's other group companies in aqua-culture business. Subsequently, the project was commissioned in April 2003. There are over 35 diesel power stations in A&N islands, aggregating to the total installed capacity of about 65MW. The geographical topography of A&N islands has resulted in fragmented installed capacities of small diesel sets supplying power to each island. This PPA was signed in 1997, when oil prices were very low. However, with present high cost of generation for diesel based power, there could be a shift from diesel based power to other cheaper alternatives of power generation.

A&N Administration's purchase cost of power (around Rs 8.3/kwh in 2005-06) from SPCL is significantly higher as compared with its final tariff to its consumers (Rs 2-3/kwh). With the expected rise in energy requirement coupled with increase in diesel prices, budgetary support from the central government to fund this gap would continue to rise. This creates a strong incentive for the A&N Administration to look for cheaper alternatives to reduce its purchase cost of power. Some of the alternative sources of power being considered in A&N include wind energy systems, solar power plants, mini/micro hydro power stations, biomass power plants. For instance, if A&N Administration were to shift from SPCL's existing diesel plant to a new biomass plant, there will be about 30-40 per cent savings in A&N Administration's purchase cost, even after taking into account minimum annual fixed charges payable to SPCL over the PPA period of 15 years (from 2003 onwards). Thus, complete substitution of SPCL's existing DG plant at Bamboo Flat is possible in near future.

Further, SPCL's actual project cost is higher at about Rs 851 mn as compared with approved amount of Rs 631 mn under the PPA. The improvement in SPCL's RoCE (currently low at around 8 per cent) is subject to approval of revised project cost by A&N Administration. Thus, there is a risk of under-recovery of fixed charges, in both the events viz. on-going operations of SPCL or shift from SPCL's diesel based plant to some other alternative.

***Biomass projects can double revenue, but significant challenge must be overcome***

Biomass based power generation is being encouraged and supported by the Government of India. The estimates by Ministry of Non-conventional Energy (MNES) indicate that about 16000 MW of power could be generated (10 per cent of expected installed capacity by 2009-10) from surplus biomass fuel available in India. In end March 2005, about 54 biomass power projects aggregating to 302 MW have been commissioned in India and another 39 projects aggregating to 272 MW are under implementation.

However, the bunching up of the planned biomass power plants has the potential to significantly impact the availability and prices of biomass. A large number of biomass projects have been approved in the states of Chattisgarh (31 projects aggregating to 262 MW capacity) and Maharashtra (38 projects aggregating to 369MW capacity). The aggregate capacities of the approved projects in Chattisgarh and Maharashtra alone are considerably higher in relation to the existing commissioned capacity or projects under implementation in India. In addition, multiple projects in same districts (especially in Chattisgarh) could result in unhealthy competition for sourcing the biomass fuel.

Further, the standard tariff structure for biomass power takes into account maximum raw material price escalation of 5 per cent. Hence, higher than 5 per cent increase in the biomass fuel would strain SPCL's profitability.

**Financial performance**

***SPCL's financial performance to be moderate***

The growth in SPCL's consolidated revenues in the steady-state, after all its subsidiaries become operational by 2007-08, is expected to be at moderate pace driven mainly by gradual rise in PLF of SPCL's DG plant in A&N and biomass plants of its subsidiaries.

The higher operating margins for biomass projects would be largely offset by lower operating margins for SPCL's DG set based operations. The returns on biomass projects are likely to be constrained by biomass prices and availability. The recovery of fixed costs with approval of revised project cost would determine profitability of DG operations in A&N. On overall, SPCL's consolidated RoNW performance would be moderate, as higher operating margins for biomass projects would be offset by high capital intensity.

**Management capability**

***Management needs to bring focus to make new ventures successful***

In the past, the promoters have tried out various business ventures like rice milling, merchant shipping, aqua-culture, marine food and power generation. While this indicates above average risk taking ability of promoters, they have not persistently continued some of these ventures. The management does not have any prior experience in setting up and operating biomass based power plants. Though promoters' past experience in DG power and rice milling may be useful, their ability in sourcing biomass at viable prices on sustained basis is yet to be seen.

The past track record of the promoters in running businesses raises concerns. Specifically that two of their companies that were engaged in the aquaculture business – namely Cocanada Fisheries Ltd., Kalyan Marine & Agro Products Ltd. – are now defunct with substantial erosion of their net worth. These companies, which had been listed on the Bombay and Hyderabad stock exchanges since 1993-1994, had large defaults on their debt obligations and were delisted from BSE on January 14, 2004. The respective companies have cleared the significantly written down debt obligations.

## Corporate Governance

### *Significant scope for improvement in the company's corporate governance practices*

In the past, most significant decisions related to the company's operations have been primarily taken by the promoters. There is a significant scope for improvement in company's corporate governance practices from present levels in terms of board's involvement in the company's key decisions, and board processes to exercise management oversight.

There are eight directors on the Board of SPCL, of which 2 are promoters, 4 are independent directors, and 2 are non-executive directors. As most of the board members were appointed in last 1 year, they have attended about 3-4 board meetings each.

Independent/ Non-executive directors	Qualification	Experience
P V Rao (Chairman)	B Com, LLB, IAS professional	On the boards of Kakinada SEZ and Kakinada Refinery & Petrochemicals Ex-Chief secretary of AP Govt., Ex-Chairman of Infrastructure Authority of AP
Mahesh Chand	BE (Electricals)	Technocrat. Involved in setting up of various ventures of Reliance group in refinery, petrochemicals, telecom and now Mumbai metro railway
Supriya Gupta	BA, CAIIB Professional	Banker. On the boards of 10-11 other listed companies Ex-CMD of UTI Bank and State Bank of Bikaner & Jaipur
K B Trehan	Engineer	Technocrat with experience in sectors like mining, power and steel.
T Sree Rama Krishnayya	B Com	Ex-Secretary of East Godavari Rice Millers Association, and Almuru Taluka Rice Millers Association
V Madhava Naidu	M Com	Associated with SPCL and on the board of SPCL group company SAAIL

**Source: Company prospectus**