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Much of the information presented in this report was put together at the request of L. R. Blair prior to the arrival in Denver of Mr. V. N. Somani, of the Shree Digvijay Cement Company during the month of July, 1974.

As in the case of other Minority Investment reviews prepared by the Controller's Office, International LAFE, the objective of this report is simply to compare current results with projections made at the time of purchase, analyze variances from those plans, and outline possible alternative courses of action.

FINANCIAL REVIEW

SHREE DIGVIJAY CEMENT COMPANY

JM first considered purchasing an interest in the Shree Digvijay organization during the latter part of 1961. In September of that year P. C. Nikitovich prepared a financial analysis on the proposal to acquire a 10% interest in Shree Digvijay for $400,000. At that time, Shree Digvijay had set up a subsidiary company, Laxmi Asbestos, for the purpose of manufacturing asbestos cement products and had approached JM for technical assistance in addition to an offer to purchase a 45% interest in the new company. The 45% interest would have been purchased with technical assistance (for 15% equity) and $400,000 cash (for 30% equity).

A complication arose in that the license to import the necessary asbestos cement machinery had been granted to Shree Digvijay rather than to Laxmi Asbestos. The principals of Shree Digvijay, the Somani brothers, argued that difficulties existed in gaining government approval to transfer the license to Laxmi Asbestos and, therefore, they had made the decision that the asbestos cement operation would become part of the larger company. JM was then offered an opportunity to purchase a 10% interest in Shree Digvijay, in addition to a separate technical assistance agreement.

The technical assistance agreement provided for a royalty of 3% on domestic sales and 5% on exports and extended until the end of 1972.

One conclusion which may be reached after reading this report is that the history of our relationship with the Somani brothers has been relatively disadvantageous to JM. Many promises, implied or stated, made by the brothers were simply not kept. The situation by which JM purchased a share of Shree Digvijay rather than its subsidiary company, substantiates this. In his financial analysis report Mr. Nikitovich stated:

> "...we have recently insisted with Shree Digvijay that they divorce the asbestos cement operation and form a separate company as soon as possible but no later than the end of 1963. Also that at that time our 10% holdings in Shree Digvijay be converted to a 45% interest in the new asbestos

cement company. We have received personal assurances from Mr. Somani that he would try to comply. However, for legal reasons, he says, he could not make a contractual commitment.

The proposed share in Shree Digvijay is only half as attractive as a direct investment in the asbestos cement operation alone.

Digvijay argues that the government would not readily permit the transfer of the license back to the separate asbestos company. This may be true, or it may just be convenient. The Digvijay participation is more attractive to them to the same extent that we find it less attractive. Tax reasons advanced in support of the current proposal are not valid upon review.

The above further illustrates the need for our continuous efforts to have our proposed holding transferred from Shree Digvijay Cement to an asbestos cement company."

The transfer of JM's interest to the subsidiary company was never accomplished.

The Somani brothers also indicated a willingness to purchase from JM all the asbestos fiber needed in the operation. This was forecasted to amount to approximately $700,000 in FOB sales by the third year. At no time during the 13 year history of our participation in Shree Digvijay did sales exceed $486,000, however (Appendix III).

Mr. Nikitovich predicted that with only 1/3 of the estimated marginal asbestos profits to be generated from such sales, in addition to estimated dividends (after 20% withholding tax), the yield on JM's investment would be between 26% and 35%. Computation of this return was also based upon an annual after tax expenditure by JM of $2,000 for O.P.I.C. insurance to protect against currency inconvertibility and expropriation.

During the month of July, 1962 JM purchased 13,500 shares in Shree Digvijay for $425,250 ($31.50/share). Immediately thereafter, JM realized that it had not purchased the complete 10% interest it had intended to buy and in September, 1962 invested an additional $47,250 for 1500 shares to complete the transaction.

In 1963 Shree Digvijay increased its equity capital. JM, in order to maintain its 10% equity, invested an additional

$115,000 for a total cash investment of $588,000. During 1964 and again in 1966 JM received 5,000 bonus shares corresponding to stock dividends in each of those years. These receipts increased our share holding to 25,000, the number now held.

At the same time that JM purchased its initial interest in Shree Digvijay, it shipped asbestos fiber valued at $183,013.56 to the company. The amount owed for this shipment was treated as a loan at 6% simple interest and by September of 1971 all of the principal and more than $60,000 of the accrued interest on the loan had been paid, leaving an interest balance due JM of almost $50,000. Either through a misunderstanding on the part of JM or the conniving of the Somani brothers, Shree Digvijay insisted that an unwritten agreement existed between the two companies that would exempt Shree Digvijay from responsibility for the remaining interest (Appendix IV). After considerable haggling between Messrs. D. Poutiatine, D. G. Colwell, and the brothers Somani, JM agreed to waive the remaining interest, providing that Shree Digvijay remit to JM approximately $9,600 in foreign exchange which was to be generated by two export orders then in process.

JM's rationale for agreeing to the above arrangement was its fear of losing the asbestos fiber volume that was being supplied to Shree Digvijay (then about $120,000 annually). Shree Digvijay's argument in not being able to repay the interest was based upon their low export volume and an Indian regulation which permitted payment of non-Indian currency obligations only to the extent that foreign exchange was available to the company.

Whatever the case, however, no record exists of JM actually receiving the final $9,600 promised by Shree Digvijay.

Since 1962 JM has received $270,300 in dividends and $308,600 in royalties from Shree Digvijay. In addition, profits of $502,000 are estimated to have been generated from sales of asbestos fiber. The actual return on JM's investment, after deduction of $56,500 in after tax O.P.I.C. insurance premiums, has been only 7.6%.

This lower than expected return is attributable to various reasons: (1) Shree Digvijay has not been as profitable as had originally been forecasted, (2) withholding taxes on dividends had been, until recently, deducted at the rate of 80%, rather than 20%, (3) the level of asbestos fiber purchases has been far lower than that expected, (4) O.P.I.C. insurance premiums have been greater than that expected, and (5) the rupee has been twice devalued - 60% in 1966 and 10% in 1972.

SHREE DIGVIJAY SALES AND EARNINGS (Appendix II)

The earnings performance of this company has not been particularly successful. In the eleven year period 1962 to 1972 sales increased from 9.7 million rupees to 158.4 million rupees, an average annual increase of approximately 32%. Net earnings increased only 2.5 times over the same period, from 3.3 million rupees to 8.4 million rupees, for an average annual increase of 9.5%. Considering the fact that wholesale prices almost doubled at the same time, however, Shree Digvijay's earnings have just kept pace with inflation. When measured in terms of U.S. dollars, the performance looks even bleaker. In 1962 the company earned $696,900. By 1972, earnings had increased only 4% to $725,900, the small size of the increase due primarily to the two rupee devaluations.

INDIAN TAXES

When JM first entered India through the purchase of shares in Shree Digvijay, JM was classified as a "non-resident individual" rather than as a "resident company". Consequently, the withholding tax rate on remitted dividends was computed at a much higher rate (almost 80% compared to the 20% planned rate). Our legal department opposed JM's qualification of a "company" on the grounds that the possibility existed of the Indian Government taxing a portion of JM's total income. By 1971 these obstacles had been cleared and JM qualified as a "resident company" through the formation of JM India. JM's shares in Shree Digvijay were transferred to the new company and the withholding tax rate on remitted dividends immediately dropped to 25%.

In 1973 the Indian Government refunded $104,200 in excess taxes withheld from dividends paid to JM by Shree Digvijay Cement Company, 1963-1971.

ASBESTOS FIBER PURCHASES (Appendix III)

The level of asbestos fiber purchases by Shree Digvijay has fallen far behind that originally promised by the Somani brothers. While purchases were anticipated to reach $700,000 in the third year of JM participation, actual sales in 1964 were only $327,000. Total sales 1962-1974 will amount to approximately $2,875,000.

O.P.I.C. INSURANCE (Appendix III)

P. C. Nikitovich had estimated that the cost of O.P.I.C. insurance would amount to approximately $2,000 after tax per year. The actual after tax cost of insurance has been much greater, however, and in recent years has averaged over $6,000 per year, the increased cost due to higher rates and an expansion of coverage.

DEVALUATION OF THE RUPEE (Appendix I)

The two rupee devaluations since our purchase of Shree Digvijay in 1962 have cut, by almost 40%, the dollar value of dividends and royalties remitted to the U.S. Fortunately the dollar value of our share of the net worth has not suffered to a similar degree because of the company's policy of (1) minimizing working capital, (2) maximizing investment in fixed assets and (3) heavy reliance upon local currency long term debt.

At 12/72 the value of our share in Shree Digvijay's net worth had risen to approximately $1,450,000 or 147% more than our investment cost.

This value, however, overstates the amount which could be realized upon sale of our shares. Although we have not yet received a 1973 annual report, nor do we have any operating indicators relative to 1974 prospects, we have been informed that business has not and will not be good for some time to come. Several factors are basic to this outlook: (1) the non-asbestos cement business is price controlled by the government with no immediate price relief in sight, (2) the asbestos cement business is being hurt by a shortage of asbestos, and (3) an inability to generate enough foreign exchange through exports to purchase asbestos, which, even if exchange were available, is in short supply world-wide.

Considering both the problems which we have had in the past with Shree Digvijay and the Somani brothers and the poor earnings prospects for the future, it appears to be in our best interest to sell the shares. Unfortunately, JM agreed to a formal contract specifying the procedure by which the shares could be sold (Appendix V). The major points of that agreement are:

1. Shree Digvijay has the right of first refusal for sale of JM's shares.

2. Shree Digvijay has 45 days to consider the offer.

3. The selling price will be the closing price of stock on the Bombay exchange on the last trading day prior to the offer to sell.

4. Should Shree Digvijay refuse JM's offer, JM may then sell to another party at the same, but not lower or higher, price.

5. Should JM not be able to sell the shares in this manner, JM will have no choice but to offer the shares back to Shree Digvijay again, thus starting the process all over.

Shree Digvijay traded on the Bombay Exchange early in July at 140 rupees ($17.50) per share. This price is significantly lower than that quoted at the time of our purchase in 1962 (163 rupees or $34.00 per share). Sale of our shares at the recent price would place a total value on our holdings of $437,500, 25% lower than our purchase cost and 70% below book value.

To complicate matters further, a stock market crisis in India resulted from the government's decision to, in effect, outlaw dividends.* The stock market was closed early in July and, to the best of our knowledge, remains closed. Thus, should JM desire to sell its shares now, the price received would be set at distress levels.

Unfortunately, with profits and dividends restricted, future prospects for a recovery in stock price appear to be dim. Considering the relatively small amount of money involved in this decision, however, and the amount of managerial time and effort that has been and will be required to actively keep tabs on its development, the most viable decision may be simply to sell the shares at the recent price, take a loss, and concentrate on other matters.

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* The ordinance will remain in effect for two years and requires that all companies limit the amount of dividends to the lower of either 1/3 of net profits or the amount needed to pay a 12% dividend on the face value of the shares and the dividend on the preference shares.