Getting its act together

The RPG Group has consolidated its businesses to become leaner and more profitable

PHOTOS: SAJAL BOSE

Harsh and Sanjeev Goenka are reorganising their business empire

In the capacious lounge of Ceat Mahal, the unusual inversely-designed corporate headquarters of the R.P. Goenka Group in Mumbai, there is one painting of the famed RPG art collection that is sure to catch your attention. Titled *Indie Ascensus* – chairman Harsh Goenka informs us that it was painted by artist Baiju Parthan and him at one of the social dos last year – it shows a pacing figure with a backdrop of soaring doves to depict India's surge towards global leadership in the coming years. Goenka could well be painting the churn, the same quest that's been going on in his own Rs12,000-crore RPG Group over the last four years.

After floundering through a period of unrelated diversification when most of the major group companies could barely keep their heads above water, Harsh Goenka and Sanjiv Goenka, scions of 'takeover tycoon' Rama Prasad Goenka – the sobriquet he had earned for setting a scorching pace of acquisitions during the 1980s – have been busy doing something quite contrary to what RPG's legacy has been. The brothers are reorganising their business empire, shedding all that is not 'core' and consolidating the balance – in short, injecting a method, sharpening business focus. "We took a little longer in responding to changes," says Harsh Goenka. "But, today, there is optimism and ambition not just towards attaining leadership in the Indian market, but globally too."

To be sure, that's not just rhetoric. All the major group companies – CESC, KEC, Ceat, Zensar, Philips Carbon Black, Saregama, *et al* – have scripted strong turnaround stories. The company balance sheets are sporting a much cleaner look, with crossholdings being untangled and investment arms being hived off to unlock value. The group today is concentrating only on six sectors, as against 18-odd in 1996-97.

The job of consolidation over and operational efficiencies having gotten underway, growth in each is kicking in now. Nilanjan Dey of SKP securities is bullish about the group, albeit with certain riders: "With its investment in power (Rs16,000 crore capex plan), eventual scale-up in retail (which is not yet in market) and monetising of real estate assets, the RPG Group looks set to go places." These could well be the proverbial three aces up RPG's sleeve.

All the three are being spearheaded out of CESC House. And sitting in the

equally aesthetic ambience of the other corporate headquarters of the group based out of Kolkata, vice-chairman Sanjiv Goenka does not flinch from conceding today the mistakes the group had committed earlier – how their focus got dissipated by getting into many different businesses, work culture became a little 'clubbish', while reasons for non-performance was accepted readily, even as business confidence was nothing to write home about. In short, one of the premier business houses of the country badly needed to be pulled into shape – a recurring theme recounted by each of the group company CEOs to *Business India*.

There has been only one RPG mantra over the last four years – to move into areas of core competencies and critical mass. Further, "Everything we do henceforth would either have to give us cash profits or market cap," says the vice-chairman. The brothers aim to make RPG a Rs33,000-crore group by turnover and $10 billion by market cap by 2012.

While that may seem a little aggressive – Sanjiv insists it is perfectly achievable and jury may be out on that – RPG's overhaul is being appreciated. "Today, there is a huge change in attitude," says Utsav Parikh, CEO of Kolkata-based Smifs Capital Markets and also an investor in the group's retail and tyre business. "Even proposals that gave the Goenkas an opportunity to treble investment haven't been taken up unless it meant bringing value to the businesses they are already in. Consolidation with steadfast focus has been the cornerstone of RPG Group over the last four years." According to an executive of a big name in audit and consulting, the group is turning the corner and each of the major group businesses has drawn up plans to be $2 billion by market cap. "They are doing a lot to increase market share and shareholders' value," agrees Rajesh Agarwal, director, CD Equisearch. "But the way forward is packed with riders."

A look at how the group scrips, which were never the darlings of the stock market, are faring, shows an upsurge that can't be missed. Till mid October, market capitalisation of the group's 12 major companies had risen nearly 58 per cent, beating the Sensex showing 41 per cent rise and a 42 per cent gain in Nifty. Their year-on-year growth looks even more impressive. There was a 66 per cent growth in the combined market cap of the RPG Group companies from Rs5,714 crore in first half of last fiscal to Rs9,503 crore in the first half of this year. That once again beats the y-o-y growth of about 40 per cent in both Sensex and Nifty. In fact, market cap had peaked in December to a record Rs15,000 crore, far outdoing the gains of both Nifty and Sensex, though that figure had fallen by 20 per cent at the end of January, as markets tanked. "Promoters have understood the importance of market cap by following the best practices," says Apurva Shah, head of research at Prabhudas Lilladher.

However, a more substantive indication of the turnaround in perceptions of the group is that institutional investors, including FIIs, mutual funds and insurance companies, have been pouring money in the group companies stocks over the last four years. That's the time when the restructuring in most companies was happening, indicating that the most savvy of market movers and shakers were taking note of it.

Take power utility CESC, now a conglomerate, for example. Institutional holdings have gone up from 29.6 per cent in March 2004 to 37 per cent by January-end. Likewise, the figure has moved up from 25.2 per cent to 34 per cent in the case of tyre company Ceat. EPC (engineering procurement contracts) player KEC Infrastructure (now a new merged entity) and Zensar, the software company in the group portfolio, have been even bigger gainers, with the big boys upping their stake from 27.6 per cent to 42 per cent and 0.97 per cent to 28 per cent respectively. As Shah points out, "Whoever says it's a 'babu group with suspect figures' has got it all wrong."

FINANCIAL SNAPSHOT OF LISTED COMPANIES (Rs crore)

Company	Revenues 2007	EBIDTA 2007	Net profit 2007	Revenues 9m 2008	Net profit 9m 2008	Current Mcap
CESC	2,577	669	300	2,206	268	6,224
KEC International	2,093	251	104	1,783	111	2,754
CEAT Tyres	2,159	152	39	1,700	71	827
PCBL	1,127	97	23	764	70	46
Zensar Technologies	614	90	57	589	42	330
RPG Transmission	372	43	25	NA	NA	434
Harrisons Malayalam	210	29	14	144	6	140
SAREGAMA	148	20	13	101	4.5	303
RPG Cables	210	22	1.8	224	0.08	160
RPG Life Sciences	120	26	8.2	195	4.1	112

High profile takeovers

Somewhere down the road of relentless acquisitions, the group is widely believed to have made the mistake of unbridled expansion, thinning out resources for its sustenance in the process. Ever since Goenka senior set out on a course independent of his two brothers in 1979, he sealed a clutch of high profile takeovers, starting off with Phillips Carbon Black the same year. Then came Ceat in 1981 and KEC a year later. Bagging Dunlop, HMV (now Saregama), CESC, plantation company Harrison Malayalam and Spencer's showed him to be the ablest negotiator of all or better still, a 'takeover artist'. "RPG could think big," says an old-timer. "It could also take over without being hostile." In those days, takeovers provided an opportunity for growth, thanks to the MRTP regime, which discouraged expansion.

Apart from the prolific acquisitions, a number of JVs had also been

forged. RPG had signed no less than 14 JVs with *Fortune* 500 companies. The list included such names as Sulzar and Beninger of Switzerland, Bayer of Gemany, NTT of Japan, Sprint, Ricoh, Star Paging, Goodyear, Searle Pharma and others. For anybody looking to enter India, RPG would be the obvious choice, considering its track record. "JVs were like marriages, not to be abandoned while Indian partners in the alliance functioned no more than like an escort agency working on getting all the regulatory approvals for the foreign entrant," says a bemused Harsh. Today's scenario is a total contrast, with every newcomer looking for a more collaborative partnership, be it for market access, production facility or knowledge of the consumer – which is why alliances forged in today's scenario are more meaningful, he adds.

By 1991, when RPG had handed over the reins of the business empire to Harsh and Sanjiv, it had become a motley mix of business interests. McKinsey & Co was brought on board – RPG was the first company to have hired an MNC consultant in 1993 – which helped identify a prescriptive recipe of a few things. Among them were opportunities in future, the core competencies of the country and the group. The most crucial one, however, related to which of the existing businesses would give RPG a crucial mass, based on which a rationalisation of the portfolio was suggested.

By 1998, the group began to shed businesses, starting with those in engineering, textiles and chemicals. So, out went Beninger, Sulzar, Spentex, BTP Datacraft, Bayer, Goodyear (JV called South Asian Tyres), agro businesses of RPG Lifesciences, Wilkinson, RPG Cellucom (the mobile business in Chennai) and others, either through outright sale or divestment of holdings to specific investors. "It was a heart-wrenching decision for RPG, which had made a name in takeovers," says Harsh. Today, the only JV that remains is the one with Tyco in the form of Raychem. However, despite selling off businesses and freeing up resources, the performance of the companies was just about average and there was still a lot to be done to nurse the group to health.

Turnarounds begins

Even by 2001-02, most of the group companies were still posting heavy losses. The brothers had their job cut out over the next few quarters: pull these out of the red. What's fascinating is that there are almost identical elements to each of the turnaround stories – mounting losses and poor cash flows, high borrowings and interest costs resulting in default, delayed salary payments and a culture of 'satisfactory underperformance'. KEC, for example, had losses of Rs85 crore in 2001-02, Ceat closed financial year 2001 with a loss of Rs66 crore and CESC had accumulated losses to the tune of Rs700 crore at one point. It's almost a joke today when Ramesh Chandak, Paras Chowdhury and Sumantra Banerjee, heads of the transmission, tyre and power sectors respectively, have a tough time deciding who was the worst off and whose company was closest to the brink.

COMPARISON OF UTILITIES (2006-07)

Company	Average tariff	EBIDTA (as % of sales)
Reliance Power (Mumbai)	498	(power) 8.6% (overall) 20.7%
Tata Power (Mumbai)	513	21.5%
CESC (Kolkata)	376	26.8%

There were also problems distinct to each. KEC was quoting for projects at low margins or losses just to maintain revenue leadership, says Chandak. The company's cost structure with higher fixed content became unmanageable and control began to slip away on overhead expenses and project execution. Ceat had low capacity utilisation, poor operational efficiencies, low employee morale, an incomplete top management team and a balance-sheet weighed down by unrelated investments of the order of Rs650 crore. The two men began damage control in right earnest.

Chandak took a slew of initiatives. An SBU structure with clear accountability was implemented and increasing components of costs were made variable. Minimum expected margins commensurate with risk were laid out and timely completion of projects was given paramount importance to reduce operating costs and avoid liquidation damages. The result today is that KEC has added 12 geographies – and is now looking to establish a base in the developed world including the US – developed telecom business and entered distribution. Its order book has moved up from Rs1,300 crore in 2002 to an estimated Rs5,000 crore currently.

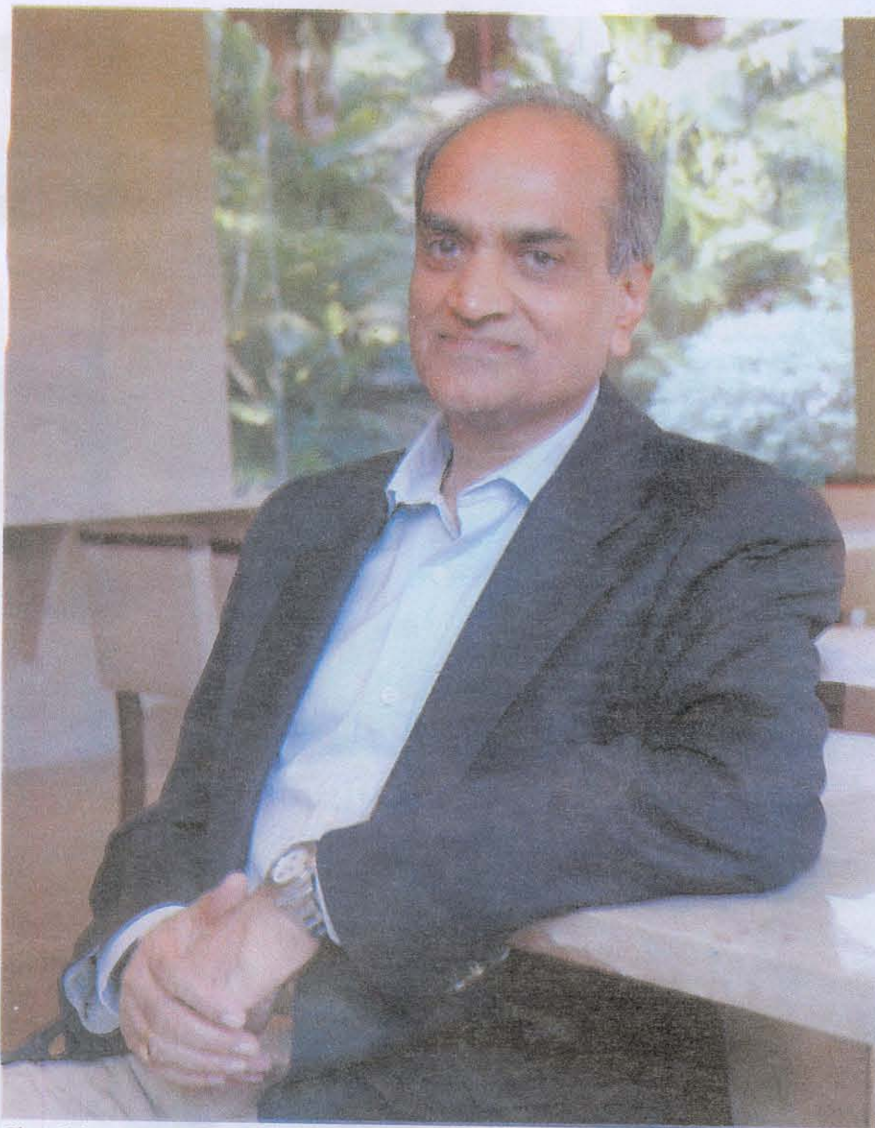
Ceat followed more or less the same trail. Chowdhury talks about how manufacturing was geared to produce at full capacity and an aggressive 20 per cent reduction in cost of conversion (of rubber into tyres). The result was that there was 70 per cent increase in production with nominal capex. Simultaneously, product acceptability was taken close to industry benchmarks by improving the structural strength of tyres on lower weight. Not surprisingly, there has been a sea-change in the scenario during the last six years – operating margins have almost doubled from 5.7 per cent to over 10 per cent (the gap between Ceat and the top three companies has narrowed down to less than 1 per cent), turnover has more than doubled and the company is heading to be a Rs3,000 crore outfit, and a green-field expansion at an investment of Rs800 crore is being planned.

But the most fascinating by far is the CESC story. The company's worst phase was during the financial years 1998-2002, when there was no national electricity policy and no tariff policy. "It was a Wild West," says Banerjee. Consistent dropping down of tariffs in the face of increasing fuel and power purchase costs, high transmission and distribution (T&D) losses and low PLF (plant load factor) of its old power plants and high employee cost all contributed to the company's woes. Also compounding the problem was that CESC was regulated by the state electricity board, which was their competitor and supplier of

power and put a ban on export of power. A long legal battle with the regulator in High Court and Supreme Court eventually allowed them to charge higher tariffs and recover dues by tariff adjustment.

But, instead of getting bogged down by things beyond their control – according to managing director Banerjee, revenues are a function of what the consumer uses, multiplied by tariff set by the regulator – CESC decided to get generation of top efficiency. Having worked at improving efficiency parameters consistently over the last six years, PLF went up from 76 per cent in 2002-03 to 99.8 per cent in 06-07 (for which it got the prime minister's award), T&D losses are down to less than 15 per cent, one of the lowest in the country (the national average is 40 per cent) and export of power stands considerably increased today. All of that makes CESC one of the most efficient providers of electricity (*see table*). And when an efficiency-based tariff system is allowed to be levied, as CESC is clamouring for, there is no doubt that it would be the biggest beneficiary.

The end result is that there is a sharp growth in net profit from Rs7 crore in 2002-03 (when the first positive break-even came about) to Rs301 crore in 2006-07, even though tariff is down by 10 per cent. It also has positive implications for the financial health of the company – its debt-equity ratio at 0.8 today is a far cry from 5.4 in 2002-03, borrowings are down to Rs1,798 crore from Rs3,308 crore, the finance cost is down from 21 per cent of revenues to 8 per cent and EPS is up at Rs36 from Re1.



SANJAY BORADE

Chandak: quoting for projects at low margins to maintain revenue leadership

Banerjee is candid enough to admit that, if power pilferage could be cut down by 60 per cent, it was largely due to the anti-theft law passed by West Bengal – amongst the first states to do so. Other states are only now moving in that direction. The enabling environment makes it possible for them to book an FIR every time there is theft. Another less highlighted fact that helped CESC get back into its own was the lay-off of about 3,000-odd employees out of a total workforce of 12,000. That this could happen in a land where retrenchment is considered a dirty word, is a tribute to the manner in which it was handled. All that Banerjee did for six months was to hold meetings with unions – there were as many as 62 meetings with the three unions.

Zensar did quite the same thing. When Ganesh Natarajan assumed charge in March 2001, he cut down staff strength by as much as 20 per cent, something that was probably attempted for the first time in the RPG Group. In fact, as much as half of the workforce was not utilised, mainly because the US market was in doldrums. But cutting down flab and the move to back off from onsite bodyshopping and make offshore business its mainstay were two crucial factors that helped the company turn the corner.

Extraordinary cost-cutting

What comes across clearly is that none of the turnaround stories would have happened, if the unusual cost-cutting measures had not been initiated. All the group heads talk of keeping a tight lid on all overheads including making all travel mandatory only by economy class and banning even overseas travel for some time. "More than saving money, such measures create the right ambience and credibility," says Banerjee. An equal emphasis was placed on inculcating a strong commercial discipline. That meant keeping working capital management tight,

One of the areas the Goenkas are excited about is power

extraordinary control on operational cost and restructuring high-cost debt. Chandak talks about winding up all but big liabilities. He had declared that KEC was not a borrower outside the banking system. In CESC's case, one executive director was just tracking the restructuring package. "So much is *about getting people rally to a cause,"* says the power head Banerjee.

Clearly, as Parekh points out, "It's only when the going is rough that the utmost can be accomplished in cost-cutting." RPG did just that and how! Putting a lid on losses, however, is just *the beginning – the first step towards* taking RPG to the next level. Individual roadmaps for each of the portfolios have been charted out, but the two areas the Goenkas are most excited about are power and retail. After parting ways with Dairy Farm International in 2005, the group had changed tacks on retail and brought in more entrepreneurship. It was decided that retail wasn't going to be small niche play. Raghu Pillai had left in mid-2005 and Sumantra Banerjee had been asked to hold fort. A few months later, however, he took over full-time.

After six months of precious market research and the realisation that the value box had been successfully claimed by Kishore Biyani's Big Bazaar, it was decided to take up the space of 'masstige', or mass with prestige. The target audience was the well-heeled woman in the big cities. Shopping in the lifestyle retail space the aim was to see to it that she did not have to step down for the 'foods' retailing in the value box.

Having decided the space, it was necessary to interpret the brand in terms of store ambience and merchandise. The attempt all along has been on differentiation and keeping the focus on the experience. So, in addition to the finest varieties of cheese, of which there could be as many as 45 to choose from, another 27 of the daily baked bread, 300 kinds of wines, French baguette, David Hofs cigars, or Californian grapes across seven verticals, there are live cooking sessions where the store chefs would educate and hopefully indoctrinate in all that is the best. Clearly, Spencer's stores are no neighbourhood 'kirana' stores even though the fare may vary with the format – Hyper, Super, Daily and Express. It's perhaps a tribute to Vijay Mallya that Sanjiv talks about being the 'Kingfisher' in retail.

The rollout plans are massive. Sanjiv talks about opening as many as 500 stores by March 2008 – the 400th store was unveiled in Kolkata only last fortnight – and another 1,000 by March 2009. That would mean an addition of two million sq ft to the already contracted 1.5 million sq ft of retail space today – all at an investment of just Rs1,200 crore, thanks to the lease model. If money had to be sunk in real estate, then it would have taken at least an investment of about Rs5,000 crore. "For building a presence in retailing," says Sanjiv, "ownership of property is not necessary." Retail has already raked in an annualised turnover of Rs1,000 crore which is expected to go to Rs2,200-2,500 crore by March 2009.

Verticals ramped up

Specialty verticals in the format of Music World, Books & Beyond and RPG Cellucom are being ramped up just as aggressively – about 340 of the first, 11 of the second and 500-odd of the last will be launched in the next calendar year. Additional specialty stores, perhaps as JVs with or franchises of international players, are being explored and there should be some action on that front in the new financial year.

A Citi Investment research report, while putting out a 'buy' recommendation two months ago, says, "From a pure play electric utility, CESC is morphing into a conglomerate with electric utility, retailing and real estate business. After the first phase where CESC achieved growth by improving operating efficiencies from PLF and T&D losses, it is now embarking on

the second phase which involves: trying to give its electric utility business a national footprint; monetising the value inherent in its idle real estate assets; and growing retailing at rapid pace and turning it profitable (it made losses of Rs46 crore, on sales of Rs520 crore) by FY 2009E/2010E."

The third ace referred to earlier in the story pertains to this national footprint policy mentioned by Citi. CESC currently has an installed capacity of 1,000 MW that services 2.1 million consumers. It is now gearing up to build an additional 4,000 MW capacity – 250 MW at Budge Budge by September 2009; 2,000 MW at Haldia in two phases; 1,000 MW in Jharkhand in two phases and 1,000 MW in Orissa. Coal linkages for Budge Budge and Haldia Phase I are in place. Also on the anvil is work on enhancing transmission capacity.

Banerjee: power pilferage cut-down due to West Bengal's anti-theft law

All that should burn a Rs16,000-crore hole in the RPG pocket. That's one-fourth more than the group does as a whole in business currently. Funds would come from internal accruals, equity and debt placement, QIP (qualified institutional placement), meaning placement with institutional buyers, being one option. What's important though, says Banerjee, is that a distributed risk approach would be followed for the green-field expansion, be it multiple-fuel, multiple-location or multiple-funding options.

One thing is certain – RPG is pulling out all stops to reach the target it has set for itself over the next five years. KEC is a case in point. It is moving from Afghanistan, Ethiopia and Kazakhastan to the developed world. Having forged a JV with Power Engineers of the US a few months back, it will now take up EPC work in the North American market. Since the transmission business has limitations, alternative growth engines are being built. Building power sub-stations, creating railway infrastructure, rural electrification business are some options, for which another group company RPG Transmission is being merged with KEC, making it the largest transmission company in the world. Another group company NITEL, which is into the business of telecom towers is also being merged with KEC.

The road ahead

Clearly, the wherewithal for growth is all there within the company; the trick now is to build volumes and the Goenkas are doing it by consolidation, as in the above case. Greenfield capacity expansion is being seen as the growth option in the case of Ceat and PCBL (the first carbon black company to have received carbon credits). Even outsourcing is actively tapped as a growth option. Ceat, for example, is looking to up its production from outsourcing from about 12 per cent at present to about 20 per cent. Why, even the inorganic growth routed is being considered an option for the way forward. Zensar, for example, having acquired US-based SAP firm OBT Inc and New York-based Thought Digital and having forged a JV with Tokyo-based EZA, is looking at similar possibilities in Europe now. However, they realise its limitations too. "We realise we can't be the Ciplas of the world," says Harsh. "So, we are going to focus on global generics and me-too formulations."

Also being taken up is a great clean-up of the companies' books. The financial restructuring exercise that began about two years ago is being taken forward. All operating arms of the group companies are being delinked from the investment and other non-business assets with the eventual aim of listing both the investing and operating arms separately. The aim is simply to unlock shareholders' value based purely on the performance of the company and make a case for re-rating. The exercise has been completed in the case of Ceat, KEC and CESC.

SRF Polymers, Mahindra & Mahindra and Reliance have done it in the past, says an analyst. The flip side is that group investment arms do offer a vehicle to promoters to increase shareholding at a lower valuation, he adds.

There is a view that RPG is still a lot more diversified than it ought to be. Harsh says so himself. The cases in point are the laggard businesses like Zensar, Saregama, Harrison Malayalam and RPG Lifesciences, which should ideally be wrapped up. An audit and consulting executive says that the Goenkas have the mindset of not letting go of the assets, even if the cash flow from the business is not good. But Harsh apparently keeps an open mind on that. "Today, we are in six sectors but that is by no means a constant."

Businesses and partnerships may have been sacrosanct for the Goenkas in the past. But they would now like to walk only on the high street of profitability and market-leadership.

◆ AARTI GUPTA