How the cookie crumbled for CG Power

Once the cash cow of the debt-stressed Avantha Group, the electrical machinery major is fighting to keep its business going, amid scrutiny over allegations of cash-stripping by the promoter group

SUDIPTO DEY
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It all began in April. An innocuous looking demand by a private bank for reissuance of a dated cheque landed up at the desk of V R Venkatesh, then CG Power chief financial officer (CFO). But he was on leave that day. The letter ended up with chief executive and managing director K N Neelkant.

Neelkant could not figure out why such a demand was being made by the bank in the first place. He asked the finance team to check the antecedents of the cheque. The investigation that followed triggered the unravelling of several unauthorised transactions — not approved by the board — whose trail led to firms owned directly or indirectly by the promoter group. A third-party investigation has pegged the initial losses to CG Power at ₹3,000 crore.

Last month, Gautam Thapar was forced to resign as chairman of the board. This was followed by sacking of the CFO. Then Sebi stepped in. Through an interim order, Sebi barred Thapar and three former CG Power executives from the capital markets. That move is currently being legally contested by Thapar and others. Sebi has also asked for a forensic investigation of CG Power's accounts.

The Securities Appellate Tribunal (SAT) on Friday reserved its order in the appeal filed by Thapar. His counsel argued the order was passed based on incomplete findings as a forensic audit is to be conducted. Sebi counsel contested the claim stating that natural justice was not denied to Thapar as the regulator had relied on the disclosures made by the firm.

Tale of two board meetings

To capture the slide in the fortunes of CG Power and Industrial Solutions, the Avantha Group-promoted power machinery maker that is battling the after-effects of suspected fraud transactions by the promoter group, one needs to go through what happened in two board meetings in August — though two years apart.

On August 19, the CG Power board met to review operations. The meeting at CG Powers' Mumbai headquarters started on schedule at 3 pm. Those waiting outside the boardroom realised something was not right. The meeting went on till 4 am the next day. The stock exchanges were then informed of certain unauthorised transactions involving the promoter group and a group of employees. The board made public key findings from an independent investigation by a law firm.

Ten days later the board met again. Through a majority resolution, the board decided to remove Thapar as chairman of the board of CG Power, a company with British heritage dating back to 1878. Thapar has contested the claims by the board and claims no promoter or promoter entity derived any undue benefit. The next day, August 30, the board met again to review FY19 results. Venkatesh, already serving his notice period, was absent. "We came to know he will not attend the meeting only in the morning. That blew our top," said a board member, on condition of anonymity. The board subsequently decided to terminate his services with immediate effect.

Another board meeting, in August 2017, relates to Venkatesh's appointment as CFO. This followed Madhav Acharya, then CFO, moving to larger role within the Avantha Group. "The board needed a lot of convincing to appoint Venkatesh as CFO," a source privy to the discussion said. The board eventually relented, and Venkatesh was to report to Neelkant.

However, in due course, Venkatesh took charge of corporate finance functions and worked closely with the promoter group, said sources close to the management. The CEO and MD's role was relegated to running day-to-day operations, they said. This marked the beginning of a period of CG Power's financial stress.

Sources close to the promoter group counter allegations around Venkatesh's close working relationship with Thapar. "The information is false and factually incorrect, and meant to malign Thapar's reputation," a source said. Being the non-executive chairman of the board, Thapar was not involved in the day-to-day functioning, the source said.

THE CHAIN OF EVENTS

APRIL 2019

- Whistle-blowers flag dubious transactions to CG Power board's operations committee
- Independent legal firm appointed to investigate

MAY 2019

- Statutory auditors flag more suspect transactions
- CEO sent on leave

AUGUST 2019

- Initial findings cite nine suspect transactions
- Board informs exchanges of the suspected fraud by the promoter group and some employees
- Gautam Thapar (*pictured*) resigns as board chairman; CFO sacked

SEPTEMBER 2019

- CG Power gets time till Nov to for FY19 and Q1 FY20 results
- Sebi orders forensic investigation and bars Thapar, 3 former CFOs from accessing securities market
- Thapar, the others challenge Sebi order at Securities Appellate Tribunal (SAT)
- SAT reserves order in Thapar's appeal on 27 September

INITIAL ESTIMATED LOSS TO CG POWER

- ₹3,000 crore
- In the past 6 months, CG Power scrip on the NSE slid from ₹42.25 (Mar 27) to ₹14.85 (Sept 27)

Looming financial trouble

Sources close to CG Power say they got an inkling of the looming trouble only over the past 12-18 months. Red flags were raised with repeated instance of stress in working capital requirements, said a source in the company. "We were surprised why a profitable business should face working capital issues but never got convincing responses," corroborated a board member.

The situation turned grim by March when creditors to Avantha Holdings, the holding company of CG Power, began invocation of pledged CG shares. The growing stress coincided with Thapar's reducing stake in CG Power. In an analyst report, the company noted that promoter's shareholding was 34.42 per cent as of December 31, 2018. This dropped to 0.01 per cent as of June 30. Thapar just had 8,574 shares in June. The board then decided to up the ante.

Repairing the damage

After nudging by lenders in April, a three-member operations committee was set up to look at ways to improve the operation matrix. While the cheque claim issue alerted the management and the board, this led to other revelations. Whistle-blowers alerted the board of the presence of more similar transactions. The statutory auditor, too, reported coming across other unaccounted transactions.

A board-mandated investigation by Vaish Associates, with help from Deloitte, revealed nine suspect transactions between related and unrelated parties that allegedly benefited the promoter group. While taking stock of the damage, the board assessed that the consolidated liability of the company in previous FY18 had ballooned to ₹7,976 crore against the previously announced ₹6,405 crore. The board then sought time till November to re-state results for FY19 and Q1 of FY20.

At present, a board-appointed Special Situation Committee (SSC) is focused on streamlining operational issues, raise working capital and deal with regulatory scrutiny. A key focus of the board is to avoid a situation where the company is forced into insolvency proceedings.

Since August, the board meets almost every week to take stock. "The board would have met more than a dozen times," said sources close to the board.

The plan is to make the company board-driven. "This company does not need to be promoter-run. It has the ability to come out of this crisis," said another board member. Expanding the size of the board and bringing in fresh talent are priorities. But repairing the damage will be time consuming. According to Shriram Subramanian, founder and managing director, InGovern Research Services, CG Power seems to be a case of massive deleveraging at a holding company level where the impact of debt at holding company and other group company level has a cascading effect on a promoter holding at a cash-generating firm.

Proxy advisory firms feel there are larger corporate governance issues that need to be fixed. "CG Power is a classic case of failure of internal controls. There has been a failure on part of the auditors and the audit committee in asking hard questions," said Hetal Dalal, COO, Institutional Investors Advisory Services (IiAS). Subramanian agreed that the role of the auditors needs to be examined. "They seem to have let some transactions go un-noticed by shareholders."

Dalal said the company needs to separate itself from the promoter or the promoter group. "The promoter, by sitting on the board, still continues to enjoy disproportionate influence," she said. A recent IiAS note summed the issue up, saying, "The buck stops with the board; it is also the starting point from which to rebuild the company."