**From:** Jayachandran [mailto:jayan@jkmail.com] **On Behalf Of** vkmr@jkmail.com
**Sent:** Tuesday, April 29, 2014 12:53 PM
**To:** sanjayd@sebi.gov.in
**Cc:** harinib@sebi.gov.in; 'SC Gupta'
**Subject:** RE: Scheme of arrangement of JK Paper Ltd (JKPL

Sir,

Please refer to the telephonic discussions you had with our Company Secretary as on date. We are resending the message again to avoid any confusion.

Regards,
V. Kumaraswamy
CFO
JK Paper Ltd.

Dear Mr. Dhakite,

Thanks for writing to us.

As desired, attached is the detailed reply in response to your queries. If you require any further clarifications, please feel free to contact us.

Regards,
V. Kumaraswamy
CFO
JK Paper Limited

**From:** SANJAY DHAKITE [mailto:sanjayd@sebi.gov.in]
**Sent:** Friday, April 25, 2014 12:59 PM
**To:** S.C. Gupta
**Cc:** V Kumarswamy ; HARINI BALAJI
**Subject:** Scheme of arrangement of JK Paper Ltd (JKPL)

Dear Sir,
This has reference to the captioned scheme of arrangmenet.
In this regard, please submit in detail the rationale for two different valuations as explained by Mr. V Kumaraswamy in the meeting held on Marc 27, 2014.
You are also advised to submit a copy of the circular related to transfer pricing, as mentioned in the meeting and reference to the specific paras of the circular may be made in the explanation.

The explanation may also indicate approximate benefit (eg.tax savings) that would be derived pursuant to the scheme coming into effect.

The details may be submitted by April 28, 2014.

Regards,

Regards,
Sanjay Dhakite
Asst. General Manager,
Division of Issues and Listing-I,
Corporation Finance Department
Securities & Exchange Board of India
C4-A, G-Block, Bandra-Kurla Complex, Bandra (E)
Mumbai, India, Pin - 400 051
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Regards

JK PAPER

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**28th April 2014**

Dear Mr. Sanjay Dhakite:

This is in response to your email dated April 25, 2014 in connection with the application filed by us for procuring consent of the stock exchange(s) and SEBI under clause 24(f) of the Equity Listing Agreement read with the provisions of SEBI Circular No. CIR/CFD/DIL/5/2013 dated February 04, 2013 ("February 04 Circular"), as modified by SEBI Circular No. CIR/CFD/DIL/8/2013 dated May 21, 2013 ("May 21 Circular").

We have provided below the answers of your queries listed in the above mail with a brief background to the proposed Scheme of Arrangement

**<u>Reasons for setting-up JK Enviro-tech Ltd. (JKETL)</u>**

JK Paper Ltd. (JKPL) set-up JK Enviro-tech Lrd. (JKETL) to primarily establish and operate lime kiln plants at its units in the States of Gujarat and Odisha (Unit CPM in Gujarat and Unit JKPM in Odisha), to take care of its mandatory requirement from the Government of India to re-process lime sludge and stop waste discharge from its integrated pulp and paper plants. Since Debt/Equity ratio of JKPL was high at that time, JKPL had to invite equity participation from other group companies in JKETL.

Accordingly JKETL set up lime kiln plants with part funding through loan from IDFC Ltd. As per the terms between JKETL and its lender (IDFC Ltd.), JKETL entered into a conversion agreement with JKPL, which requires JKETL to raise invoices on JKPL for the full amount of the cost of purchase of any make-up limestone/lime, coal, water, furnace oil & other chemicals/materials by JKETL, and a fixed charge at the rate of Rs. 75 lac per month as capital cost (including depreciation, interest etc.).

Initially cost of lime produced by JKETL through reprocessing of lime sludge was competitive compared to open market purchase of lime. However during the last few years we have observed the following:

a) Loss due to Transfer Pricing Regulations:

   (i) In the last 4-5 years, changes in interpretations of some tax laws (like entry tax, excise, etc) make it more economical to have a single entity rather than 2 entities.

   (ii) With the introduction of transfer pricing rules (even for domestic transactions) which was not envisaged at all, it may be difficult to explain the difference between the open market purchase price of lime *vis-à-vis* the cost of lime purchased from JKETL by JKPL which is much more energy intensive. In-situ because of higher moisture content in the lime sludge, more Furnace Oil is required to burn & convert that into lime compared to the material from outsourced suppliers where energy cost is lower due to much lower moisture content of lime from the mines.

Energy costs have risen steeply in the last 3-4 years as is known. We apprehend that it may not be possible to continue with the aforesaid loan covenants of the lender given the changed scenario after introduction of transfer pricing rules. Charging prices as per the loan covenants may result in a price which is at least 30% more than the price payable by JKPL, if such lime is purchased from outside. This may result in a disallowance of approx. Rs. 4-5 Cr. per annum in the hands of JKPL.

b) Loss due to Other efficiencies:

(i) To operate the lime kiln we need coal, make up lime, furnace oil, besides spares. We also need logistics for loading, unloading coal and lime, besides water and some chemicals. In these JKPL (the parent company) has some efficiencies and volume discounts, which is being lost by JKETL.

(ii) There are some operating efficiencies when the lime kiln plant is seamlessly integrated with the pulp mill.

**Because of the above reasons JKPL reckons that there will be a net benefit of approx. Rs. 4-5 crore per annum to JKPL (based on current calculations).**

**<u>Reasons for Book Value being adopted for buying the Shares</u>**

i) From the view point of JKETL because of pricing stipulation from its lender, JKETL was earning profit on a continuous basis. Therefore erstwhile shareholders of JKETL may not have permitted the sale of the lime kiln undertaking at *anything less than the book value of the undertaking.*

ii) Further, the minority shareholders of Bengal & Assam Company Limited, a listed company, may have also questioned a sale at anything less than the book value of the lime kiln undertaking.

iii) As stated above, if the lime kiln business is not restructured, as contemplated in the Scheme, JKPL may loose approx. Rs. 4-5 Cr. per annum (based on current calculations)

*Please note that the consideration for purchase went to public limited companies and not to any individual promoters. Further, since shares of JKETL were acquired from promoter/promoter group companies, prior to the Scheme, clause 6.5 of the Scheme provides that JKPL shall comply with the provisions of*

*February 04 Circular and the May 21 Circular while inter alia procuring the approval of the public shareholders of JKPL and that it shall provide for voting by such public shareholders through postal ballot and e-voting.*

An independent valuation report dated May 18, 2013 from M/s KSMN & Co. (report already made available to you) which certified the equity valuation of JKETL as Rs. 15.55 per share, M/s KSMN & Co has followed the two different methods (Profit earning capitalization value - PECV method and Book value as per Income Tax Rule 11UA – fair value) to work out the above valuation.

**Reasons for adopting business valuation for purchase of the Lime Kiln Undertaking**

Post such acquisition of JKETL shares, the Board of JKPL, in its meeting dated July 19, 2013, approved the Scheme for acquisition of the lime kiln undertaking from JKETL for a net consideration of Rs. 1.59 crore. As stated in clause 4.1.2 of the Scheme, the purchase consideration was arrived at based on an independent valuation report dated July 15, 2013 of M/s SS Kothari Mehta & Co. M/s SS Kothari Mehta & Co., has also adopted two separate business valuation methods to work the net consideration in the report – DCF Method and the adjusted NAV method, on the basis of replacement value of the fixed assets worked out by another independent valuer M/s SR Jain & Associates. The valuation report of M/s SS Kothari Mehta & Co., and the fixed asset valuation report of M/s SR Jain & Associates., are already made to you.

**As the nature of the two transactions – acquisition of shares of JKETL to generate additional benefits for JKPL and business valuation of the lime kiln undertaking – are substantially different, there is bound to be a difference in the methods of valuation of each of them, and hence the difference in the value of the two transactions.**

**Issue of Transfer Pricing**

The Finance Act'2012 (applicable w.e.f. 2013-14) made amendments in Section 92 to 92CA of the Income Tax Act which specifies that where there is specified domestic transactions (SDT) between two or more associates enterprises for cost/expenses incurred, the aggregate value of which exceed Rs. 5.00 Cr in a year, the case has to be specifically refer to Transfer Pricing Officer (TPO) to determine the Arm Length Price (ALP) of such transactions.

Here is the relevant provision in the Income Tax Act on the above subject:

**92.** (1) Any income ........................

(2) Where in an international transaction [***or specified domestic transaction***], two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be.

**Meaning of associated enterprise.**

**92A.** (1) For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another enterprise, means an enterprise—

(*a*) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

(*b*) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

(2) [For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,—]

(*a*) ***one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or***

[**Meaning of specified domestic transaction.**

**92BA.** *For the purposes of this section and sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:—*

*(i) any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;*

*and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.*]

**Computation of arm's length price**

**92C.** (1) The arm's length price in relation to an international transaction [*or specified domestic transaction*] shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :—

(*a*) comparable uncontrolled price method;

(*b*) resale price method;

(*c*) cost plus method;

(*d*) profit split method;

(*e*) transactional net margin method;

(*f*) such other method as may be prescribed by the Board.

(2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed :

[**Reference to Transfer Pricing Officer.**

**92CA.** (1) Where any person, being the assessee, has entered into an international transaction [*or specified domestic transaction*] in any previous year, and the Assessing Officer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer the computation of the arm's length price in relation to the said international transaction [*or specified domestic transaction*] under section 92C to the Transfer Pricing Officer.