
Pre-Feasibility Study

SOFTWARE HOUSE



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Ministry of Industries & Production
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1 DISCLAIMER

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2 EXECUTIVE SUMMARY

Pakistan has a huge potential to attract IT-enabled services market by providing software applications to various developed countries. The demand is expected to flourish in the upcoming years. Many countries prefer outsourcing from Pakistan because of the lower cost of manpower and advanced technological infrastructure. It enables the IT sector to bring in good investment opportunities in the country as well as to create of more job opportunities in Pakistan.

This pre-feasibility study provides information on key aspects of establishing a software house that will cater to both local and export markets and can be located in any big city of Pakistan. The software house will offer a wide range of software applications relating to data bases and creation of animations. The applications mainly encompass technology outsourcing, systems integration, application development, processes consulting, business intelligence consulting, and information security consulting among others. Background knowledge and technical qualification of the entrepreneur and key staff is extremely important in success of the proposed venture.

The estimated cost of the project is Rs.6.80 million out of which Rs. 4.76 million would be capital investment and remaining Rs. 2.05 million would be for working capital. The project is proposed to be financed through 50% debt and 50% equity. The project NPV is around Rs. 6.68 million, with an IRR of 38% and payback period of 3.23 years. The project will provide employment opportunities to 13 people including owner manager. The legal business status of this project is proposed as 'Sole Proprietorship'.

3 INTRODUCTION TO SMEDA

The Small and Medium Enterprises Development Authority (SMEDA) was established in October 1998 with an objective to provide fresh impetus to the economy through development of Small and Medium Enterprises (SMEs).

With a mission "to assist in employment generation and value addition to the national income, through development of the SME sector, by helping increase the number, scale and competitiveness of SMEs" , SMEDA has carried out 'sectoral research' to identify policy, access to finance, business development services, strategic initiatives and institutional collaboration and networking initiatives.

Preparation and dissemination of prefeasibility studies in key areas of investment has been a successful hallmark of SME facilitation by SMEDA.

Concurrent to the prefeasibility studies, a broad spectrum of business development services is also offered to the SMEs by SMEDA. These services include identification of experts and consultants and delivery of need based capacity building programs of different types in addition to business guidance through help desk services.

4 PURPOSE OF THE DOCUMENT

The objective of the pre-feasibility study is primarily to facilitate potential entrepreneurs in project identification for investment. The project pre-feasibility may form the basis of an important investment decision and in order to serve this objective, the document / study covers various aspects of project concept development, start-up, production, marketing, finance and business management.

The purpose of this document is to facilitate potential investors in **Software House** business by providing them a general understanding of the business with intention of supporting potential investors in crucial investment decisions.

The need to come up with pre-feasibility reports for undocumented or minimally documented sectors attains greater imminence as the research that precedes such reports reveal certain thumb rules; best practices developed by existing enterprises by trial and error and certain industrial norms that become a guiding source regarding various aspects of business set-up and it's successful management.

Apart from carefully studying the whole document, one must consider critical aspects provided later on, which shall form the basis of any investment decision.

5 BRIEF DESCRIPTION OF PROJECT & PRODUCT

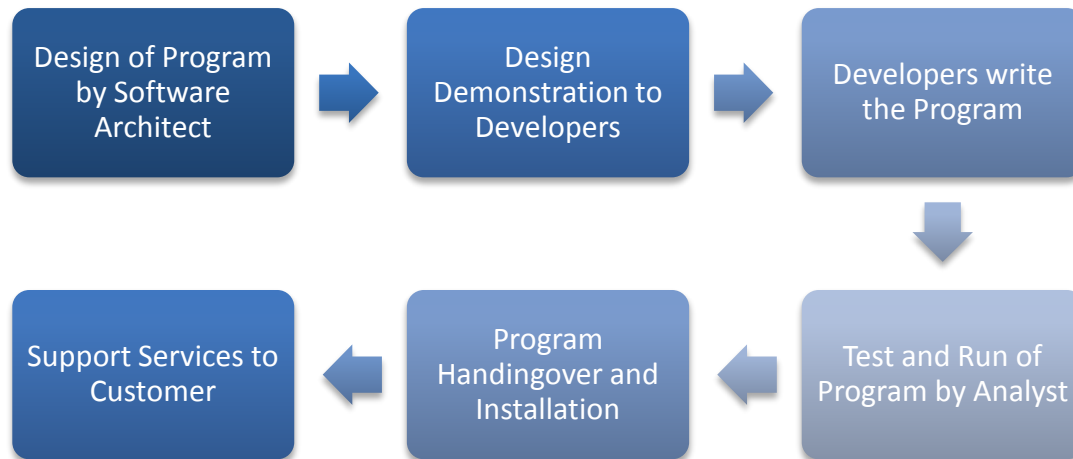
The pre-feasibility study provides information on two of the main sub sectors of software development industry in Pakistan; namely Database Development and Animations. These sub sectors offer aspiring entrepreneurs a compelling opportunity to establish business in one of the top export oriented sectors of Pakistan. Easy and sustained access to highly trained professionals coupled with availability of required infrastructure makes this sub sector an attractive opportunity for entrepreneurs to venture into software development in Pakistan.

This project mainly focuses on potential investment opportunity in the area of software development and more precisely data base development and animation creation. However, other products and services related to various sectors such as finance, insurance, human resource etc. can also be offered under the project, without any additional equipment.

The proposed software house is based upon two divisions, each consisting of a software architect, an analyst and two developers working on an 8 hour shift and generating around 4,160 value hours for customers. In order to set-up a Software House, the entrepreneur needs to get a high bandwidth internet connection from a renowned service provider.

5.1 Process Flow of Services

The process flow of software house services mainly entails the following sequence of activities:



5.2 Installed & Operational Capacities

This pre-feasibility is based on Two (2) parallel project teams; comprising of one (01) software architect, one (01) software analyst and two (02) developers working on 8 hours single shift daily. Total number of value hours to serve customers is 4,160. However, it is assumed that employees would work at 65% efficiency level during first year of operation with 2,704 value hours.

6 CRITICAL FACTORS

Following are the factors critical for the success of this business venture;

- ⇒ Background knowledge and technical qualification of the entrepreneur and key staff.
- ⇒ Thorough understanding of international regulations related to piracy and copyright protection.
- ⇒ Hiring and retention of competent and trained manpower
- ⇒ Higher return on investment and a steady growth of business is closely associated with regular training and capacity building of the entrepreneur and key staff.
- ⇒ Stringent supervision of the development process at every level.
- ⇒ Continuous flow of exports orders through aggressive marketing (website & social media) and international networking.
- ⇒ Formulation and implementation of customer follow up and feedback systems
- ⇒ Make effective use of facilitation agencies like P@SHA, PITB and PESB etc.

7 GEOGRAPHICAL POTENTIAL FOR INVESTMENT

The recommended location for establishing a software house is a commercial plaza of any large metropolitan city of Pakistan due to the easy availability of required labor and IT infrastructure.

In this regard, Pakistan Software Export Board (PSEB) has established Software Technology Parks (STPs) in Islamabad, Karachi, and Lahore to facilitate the IT and IT-enabled Services (ITeS) companies operating in Pakistan. Designed with a view to getting business ventures up and running in the shortest possible time, these STPs provide office space with all the modern conveniences in prime business locations in these major cities. These dedicated premises provide a comfortable working environment, high-speed international data connectivity, and an uninterrupted power supply, with minimal regulatory overheads and paperwork, to its registered companies.

Additionally, STPs in all these cities have facilities for conferences/seminars, business centers, adequate security arrangements, and ample parking space. Investors can lease out office space in an existing Software Technology Park (STP).

8 POTENTIAL TARGET MARKETS

In local market there is great trend towards automation of business processes and a lot of small, medium and large organizations are converting their processes from paper-pencil methodology to IT based processes.

Whereas, in export market, United States of America is the largest buyer of Pakistan IT-enabled services followed by UK, Australia, Canada, Thailand, UAE and others countries.

9 PROJECT COST SUMMARY

A detailed financial model has been developed to analyse the commercial viability of Software House. Various costs and revenue related assumptions along with results of the analysis are outlined in this section.

The projected Income Statement, Cash Flow Statement and Balance Sheet are also attached as annexure.

9.1 Project Economics

This project has capacity to generate 4,160 value hours, which would be utilized at 65% efficiency in project's life.

The following table shows Internal Rate of Return (IRR), Payback Period and Net Present Value (NPV).

Table 1: Project Economics

Description	Details
Internal Rate of Return (IRR)	38%
Pay Back Period	3.23 Years
Net Present Value (NPV)	Rs. 6,675,900

Returns on the scheme and its profitability are highly dependent on acquiring and maintaining export orders, adhering to the schedules. Quality assurance and adherence to international standards are other considerations.

9.2 Project Financing

Following table provides the details of required equity and variables related to bank loan:

Table 2: Project Financing

Description	Details
Total Equity (50%)	Rs. 3,401,526
Bank Loan (50%)	Rs. 3,401,526
Annual Markup to the Borrower– Long Term Loan	12%
Tenure of the Loan (Years)	5

9.3 Project Cost

Following fixed and working capital requirements have been identified for operations of the proposed business.

Table 3: Project Investment

Capital Cost	Amount Rs.
Office Equipment	2,264,000
Furniture and Fixtures	2,208,750
Pre-operating Cost	270,530
Training Costs	14,000
Total Capital Cost	4,757,280
Working Capital	
Building Rent	744,000
Cash	1,301,772
Total Working Capital	2,045,772
Total Project Cost	6,803,052

9.4 Office Equipment Requirement

Following tables provides list of office equipment required for setting-up an average size software house.

Table 4: Office Equipment

Description	Quantity	Unit Cost (Rs.)	Total Cost (Rs.)
Laptop (Window Based)	4	100,000	400,000
Laptop (IOS Based)	5	125,000	625,000
Computer Server (Refurbished)	1	1,000,000	1,000,000
Multipurpose Machine (Printing/Scanning/Coping/Fax)	2	30,000	60,000
Desktop PCs	2	40,000	80,000
Telephone	7	2000	14,000
Thumb Impression Device	1	35,000	35,000
Telephone exchange	1	50,000	50,000
Total			2,264,000

9.5 Furniture and Fixture Requirements

The details of required furniture and fixture for the proposed software house are provided in the following table:

Table 5: Furniture and Fixture Required

Description	Quantity	Unit Cost (Rs.)	Total Cost (Rs.)
CEO Office	1	150,000	150,000
Fixtures Including Renovation	1	250,000	250,000
Presentation Equipment	1	100,000	100,000
Architect Office	1	200,000	200,000
Analysts Office	1	200,000	200,000
False Ceiling	1,125	85	95,625
Wooden Flooring	1,125	185	208,125
Developers Work Stations	1	160,000	160,000
Lighting and Allied Equipment	1	100,000	100,000
Conference Room Furniture Set	1	175,000	175,000
Reception	1	150,000	150,000
Air Conditioner (1.5 ton Split)	6	70,000	420,000

Description	Quantity	Unit Cost (Rs.)	Total Cost (Rs.)
Total			2,208,750

9.6 Space Requirement

The proposed software house will be set-up in a rental premises. In this regard office space may be acquired in a commercial plaza or existing Software Technology Parks in any of the metropolis city of Pakistan. An estimated covered area of 1,550 sq. ft. will be required for the proposed venture; this space requirement has been calculated on the basis of proposed manpower and other official engagements. Following table provide the details of space requirement:

Table 6: Space Requirement

Space Requirement	Covered Area Sq. ft.
CEO Office	200
Analysts Area	150
Architects Area	150
Developers Area	200
Reception	425
Conference Room	425
Total Area	1,550

The estimated rent of required office space in a commercial plaza or Software Technology Parks in a large city is assumed at Rs. 80 per sqft per month with back-up electricity, i.e. Rs. 124,000 per month for the proposed software house.

9.7 Human Resource Requirement

Following table provides details of human resource required for the project along with monthly salaries:

Table 7: Human Resource Requirement

Description	No. Of Employees	Salary per Employee Per Month (Rs)
CEO	1	200,000
Software Architect	2	150,000
Analysts	2	100,000
Developers	4	50,000
Accountant	1	25,000

Receptionist	1	25,000
Office Boy	1	15,000
Security guard	1	15,000
Total	13	

The CEO will focus on export marketing, monitoring products along with overall management of the unit. Whereas, business operations and other responsibilities will be managed by respective project staffs. Salaries of all employees are estimated to increase at 10% annually.

9.8 Revenue Generation

Following table provide assumption for revenues and generation of the proposed software house during first year of operation:

Table 8: Revenue Generation in First Year

Product Description	Unit	Sales Price (Rs./Unit)	First Year Sales Quantity (Hours)	First Year Sales Revenue (Rs)
Value Hours (65% Efficiency)	Hour	8,000	2,704	21,632,000
Total Sales Revenue				21,632,000

9.9 Other Costs

Other essential costs to be borne by the company are; promotional expenses equal to 10% of revenue and communication expenses of 240,000 per annum due to the export orientation of the business.

10 CONTACT DETAILS

Contact Details of Institutions	
Pakistan Software Houses Association for IT & ITES (P@SHA) Secretariat Room 310, 3rd Floor, Business Center, Block 6, PECHS, Main Shahrah-e-Faisal, Karachi, Pakistan Phone: +92-21-35418121, +92-21-36061051, +92-21-32008251	Pakistan Software Export Board (PSEB) Islamabad - Head Office 2nd Floor, Evacuee Trust Complex, F-5, Islamabad UAN: +92-51-111-333-666, Telephone: +92-51-9204074, Fax: +92-51-9204075

11 USEFUL LINKS

Small and Medium Enterprises Development Authority	www.smeda.org.pk
Government of Pakistan	www.pakistan.gov.pk
Ministry of Industries & Production	www.moip.gov.pk
Government of Punjab	www.punjab.gov.pk
Government of Sindh	www.sindh.gov.pk
Government of Khyber Pakhtunkhwa	www.khyberpakhtunkhwa.gov.pk
Government of Balochistan	www.balochistan.gov.pk
Government of GilgitBaltistan	www.gilgitbaltistan.gov.pk
Government of Azad Jamu & Kashmir	www.ajk.gov.pk
Trade Development Authority of Pakistan (TDAP)	www.tdap.gov.pk
Federation of Pakistan Chambers of Commerce and Industry (FPCCI)	www.fpcci.com.pk
Pakistan Software Export Board	www.pseb.org.pk
Pakistan Software Houses Association for IT and ITEs	www.pasha.org.pk

12 ANNEXURES

12.1 Income Statement

Calculations										SMEDA
Income Statement										
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Revenue	21,632,000	23,795,200	26,174,720	28,792,192	31,671,411	34,838,552	38,322,408	42,154,648	46,370,113	51,007,124
<i>Cost of sales</i>										
Operation costs 1 (direct labor)	8,400,000	9,240,000	10,164,000	11,180,400	12,298,440	13,528,284	14,881,112	16,369,224	18,006,146	19,806,761
Operating costs 3 (direct electricity)	480,000	528,000	580,800	638,880	702,768	773,045	850,349	935,384	1,028,923	1,131,815
Total cost of sales	8,880,000	9,768,000	10,744,800	11,819,280	13,001,208	14,301,329	15,731,462	17,304,608	19,035,069	20,938,575
Gross Profit	12,752,000	14,027,200	15,429,920	16,972,912	18,670,203	20,537,224	22,590,946	24,850,040	27,335,045	30,068,549
<i>General administration & selling expenses</i>										
Administration expense	3,372,000	3,709,200	4,080,120	4,488,132	4,936,945	5,430,640	5,973,704	6,571,074	7,228,181	7,951,000
Administration benefits expense	337,200	370,920	408,012	448,813	493,695	543,064	597,370	657,107	722,818	795,100
Building rental expense	1,488,000	1,636,800	1,800,480	1,980,528	2,178,581	2,396,439	2,636,083	2,899,691	3,189,660	3,508,626
Electricity expense	120,000	132,000	145,200	159,720	175,692	193,261	212,587	233,846	257,231	282,954
Water expense	60,000	66,000	72,600	79,860	87,846	96,631	106,294	116,923	128,615	141,477
Softwares updation, purchase and Licencing renewal expenses	260,000	275,000	302,500	332,750	366,025	402,628	442,890	487,179	535,897	589,487
International Travelling expense	865,280	951,808	1,046,989	1,151,688	1,266,856	1,393,542	1,532,896	1,686,186	1,854,805	2,040,285
Communications expense (phone, fax, mail, internet, etc.)	240,000	264,000	290,400	319,440	351,384	386,522	425,175	467,692	514,461	565,907
Office expenses (stationary, entertainment, janitorial services, etc.	750,000	825,000	907,500	998,250	1,098,075	1,207,883	1,328,671	1,461,538	1,607,692	1,768,461
Insurance expense	-	-	-	-	-	-	-	-	-	-
Professional fees (legal, audit, consultants, etc.)	216,320	237,952	261,747	287,922	316,714	348,386	383,224	421,546	463,701	510,071
Depreciation expense	975,542	975,542	975,542	1,094,496	1,094,496	1,094,496	1,232,201	1,232,201	1,232,201	1,391,611
Amortization of pre-operating costs	54,106	54,106	54,106	54,106	54,106	-	-	-	-	-
Amortization of legal, licensing, and training costs	2,800	2,800	2,800	2,800	2,800	-	-	-	-	-
Subtotal	10,904,448	11,880,648	12,965,468	14,277,724	15,590,356	16,977,346	18,703,335	20,450,449	22,372,273	24,645,691
Operating Income	1,847,552	2,146,552	2,464,452	2,695,188	3,079,847	3,559,878	3,887,611	4,399,592	4,962,771	5,422,858
Gain / (loss) on sale of office equipment	-	-	1,358,400	-	-	2,251,718	-	-	2,946,245	-
Gain / (loss) on sale of Furniture & Fixtures	-	-	-	-	-	-	-	-	-	-
Earnings Before Interest & Taxes	1,847,552	2,146,552	3,822,852	2,695,188	3,079,847	5,811,596	3,887,611	4,399,592	7,909,016	5,422,858
Interest expense on long term debt (Project Loan)	265,559	218,712	165,924	106,442	39,415	-	-	-	-	-
Interest expense on long term debt (Working Capital Loan)	133,701	111,015	84,941	54,973	20,529	-	-	-	-	-
Subtotal	399,260	329,728	250,865	161,415	59,944	-	-	-	-	-
Earnings Before Tax	1,448,292	1,816,825	3,571,987	2,533,773	3,019,903	5,811,596	3,887,611	4,399,592	7,909,016	5,422,858
Tax	139,744	210,865	615,496	355,943	477,475	1,265,978	694,402	842,377	1,990,655	1,149,357
NET PROFIT/(LOSS) AFTER TAX	1,308,548	1,605,960	2,956,490	2,177,830	2,542,427	4,545,617	3,193,208	3,557,215	5,918,361	4,273,501

12.2 Balance Sheet

Calculations											SMEDA
Balance Sheet											
	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Assets											
<i>Current assets</i>											
Cash & Bank	1,301,772	2,158,094	4,079,393	4,594,418	6,962,813	9,574,164	11,936,239	16,093,179	20,587,279	23,900,787	31,138,311
Accounts receivable		888,986	933,436	1,026,779	1,129,457	1,242,403	1,366,643	1,503,307	1,653,638	1,819,002	2,000,902
Pre-paid building rent	744,000	818,400	900,240	990,264	1,089,290	1,198,219	1,318,041	1,449,846	1,594,830	1,754,313	-
Total Current Assets	2,045,772	3,865,480	5,913,068	6,611,461	9,181,560	12,014,786	14,620,923	19,046,332	23,835,747	27,474,102	33,139,213
<i>Fixed assets</i>											
Furniture & fixtures	2,208,750	1,987,875	1,767,000	1,546,125	1,325,250	1,104,375	883,500	662,625	441,750	220,875	-
Office equipment	2,264,000	1,509,333	754,667	2,620,863	1,747,242	873,621	3,033,977	2,022,651	1,011,326	3,512,207	2,341,471
Total Fixed Assets	4,472,750	3,497,208	2,521,667	4,166,988	3,072,492	1,977,996	3,917,477	2,685,276	1,453,076	3,733,082	2,341,471
<i>Intangible assets</i>											
Pre-operation costs	270,530	216,424	162,318	108,212	54,106	-	-	-	-	-	-
Legal, licensing, & training costs	14,000	11,200	8,400	5,600	2,800	-	-	-	-	-	-
Total Intangible Assets	284,530	227,624	170,718	113,812	56,906	-	-	-	-	-	-
TOTAL ASSETS	6,803,052	7,590,313	8,605,453	10,892,261	12,310,958	13,992,782	18,538,400	21,731,608	25,288,823	31,207,184	35,480,685
Liabilities & Shareholders' Equity											
<i>Current liabilities</i>											
Total Current Liabilities	-	-	-	-	-	-	-	-	-	-	-
<i>Other liabilities</i>											
Long term debt (Project Loan)	2,378,640	2,009,260	1,593,034	1,124,020	595,523	-	-	-	-	-	-
Long term debt (Working Capital Loan)	1,022,886	870,978	696,384	495,716	265,080	-	-	-	-	-	-
Total Long Term Liabilities	3,401,526	2,880,239	2,289,419	1,619,736	860,603	-	-	-	-	-	-
<i>Shareholders' equity</i>											
Paid-up capital	3,401,526	3,401,526	3,401,526	3,401,526	3,401,526	3,401,526	3,401,526	3,401,526	3,401,526	3,401,526	3,401,526
Retained earnings		1,308,548	2,914,508	5,870,999	8,048,829	10,591,257	15,136,874	18,330,082	21,887,297	27,805,658	32,079,159
Total Equity	3,401,526	4,710,074	6,316,034	9,272,525	11,450,355	13,992,782	18,538,400	21,731,608	25,288,823	31,207,184	35,480,685
TOTAL CAPITAL AND LIABILITIES	6,803,052	7,590,313	8,605,453	10,892,261	12,310,958	13,992,782	18,538,400	21,731,608	25,288,823	31,207,184	35,480,685

12.3 Cash Flow Statement

Calculations											SMEDA
Cash Flow Statement											
	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
<i>Operating activities</i>											
Net profit		1,308,548	1,605,960	2,956,490	2,177,830	2,542,427	4,545,617	3,193,208	3,557,215	5,918,361	4,273,501
Add: depreciation expense		975,542	975,542	975,542	1,094,496	1,094,496	1,094,496	1,232,201	1,232,201	1,232,201	1,391,611
amortization of pre-operating costs		54,106	54,106	54,106	54,106	54,106	-	-	-	-	-
amortization of training costs		2,800	2,800	2,800	2,800	2,800	-	-	-	-	-
Accounts receivable		(888,986)	(44,449)	(93,344)	(102,678)	(112,946)	(124,240)	(136,664)	(150,331)	(165,364)	(181,900)
Pre-paid building rent	(744,000)	(74,400)	(81,840)	(90,024)	(99,026)	(108,929)	(119,822)	(131,804)	(144,985)	(159,483)	1,754,313
Cash provided by operations	(744,000)	1,377,610	2,512,118	3,805,571	3,127,528	3,471,955	5,396,051	4,156,940	4,494,100	6,825,715	7,237,525
<i>Financing activities</i>											
Project Loan - principal repayment		(369,380)	(416,226)	(469,014)	(528,497)	(595,523)	-	-	-	-	-
Working Capital Loan - principal repayment		(151,908)	(174,594)	(200,668)	(230,636)	(265,080)	-	-	-	-	-
Additions to Project Loan	2,378,640	-	-	-	-	-	-	-	-	-	-
Additions to Working Capital Loan	1,022,886	-	-	-	-	-	-	-	-	-	-
Issuance of shares	3,401,526	-	-	-	-	-	-	-	-	-	-
Cash provided by / (used for) financing activities	6,803,052	(521,287)	(590,820)	(669,682)	(759,133)	(860,603)	-	-	-	-	-
<i>Investing activities</i>											
Capital expenditure	(4,757,280)	-	-	(2,620,863)	-	-	(3,033,977)	-	-	(3,512,207)	-
Acquisitions											
Cash (used for) / provided by investing activities	(4,757,280)	-	-	(2,620,863)	-	-	(3,033,977)	-	-	(3,512,207)	-
NET CASH	1,301,772	856,322	1,921,298	515,025	2,368,395	2,611,351	2,362,075	4,156,940	4,494,100	3,313,508	7,237,525

13 KEY ASSUMPTION

13.1 Operating Assumptions

Description	Details
Administration Benefit Expenses	10% of Administration Cost
Office Expenses (Stationery, Entertainment etc.)	Rs. 62,500 per month
Communication Expenses	Rs. 20,000 per month
Professional Fee	1% of revenue
Depreciation Method	Straight Line depreciation
Depreciation Rate	10% on Machinery 33% on Office Equipment 10% on Furniture & Fixture
Inflation Growth Rate	10%
Electricity Price Growth Rate	10%
Salaries Growth Rate	10%

13.2 Revenue Assumptions

Starting capacity utilization	65%
Annual Installed Capacity (lines)	4,160
Annual Operational Capacity	2,704
Price per hour (Rs.)	8,000

13.3 Financial Assumptions

Project Life	10 Years
Debt	50%
Equity	50%
Debt Tenure	5 Years
Interest Rate	12%