

Need of the hour



Balrampur Chini Mills Limited
Annual Report 2007-08

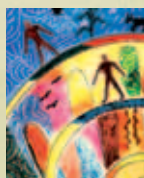
Forward-looking statement

Statements in this report that describe the company's objectives, projections, estimates, expectations or predictions of the future may be 'forward-looking statements' within the meaning of the applicable securities laws and regulations. The company cautions that such statements involve risks and uncertainty and that actual results could differ materially from those expressed or implied. Important factors that could cause differences include raw materials' cost or availability, cyclical demand and pricing in the company's principal markets, changes in government regulations, economic developments within the countries in which the company conducts business, and other factors relating to the company's operations, such as litigation, labour negotiations and fiscal regimes.

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Contents

Our performance in 2007-08	2
Our strengths	13
MD's review	14
Five-year operational summary	16
Five-year financial summary	17
Financial Ratios	18
How we enhanced shareholder value	20
Report of the Board of Directors	22
Corporate Governance Report	33
Management Discussion and Analysis	48
Auditor's Report	57
Balance Sheet	60
Profit and Loss Account	61
Cash Flow Statement	62
Schedules forming part of the accounts	64
Consolidated Accounts	91
Subsidiary Accounts	120



In this annual communication to our shareholders, it would be needless emphasising some of the corporate realities that you already know.

For instance, the fact that we are the second largest integrated sugar company in India today.

The fact that we have nine sugar mills across Uttar Pradesh with an aggregate crushing capacity of 73,500 tonnes of cane per day.

The fact that we cater to India's growing fuel and energy demand through the manufacture of ethanol in our distilleries (cumulative capacity of 320 KLPD), power cogeneration in our bagasse-based units (cumulative capacity of 179.85 MW) and organic manure (cumulative capacity of 58000 MT).

Instead, this annual report focuses on how India's sugar industry needs to be strengthened, so that it can play its rightful role as an economy driver in the regions of its presence.

**For the benefit of consumers,
companies, industry and the country.**



We are pleased to report an improved performance in 2007-08 following a net loss in 2006-07.

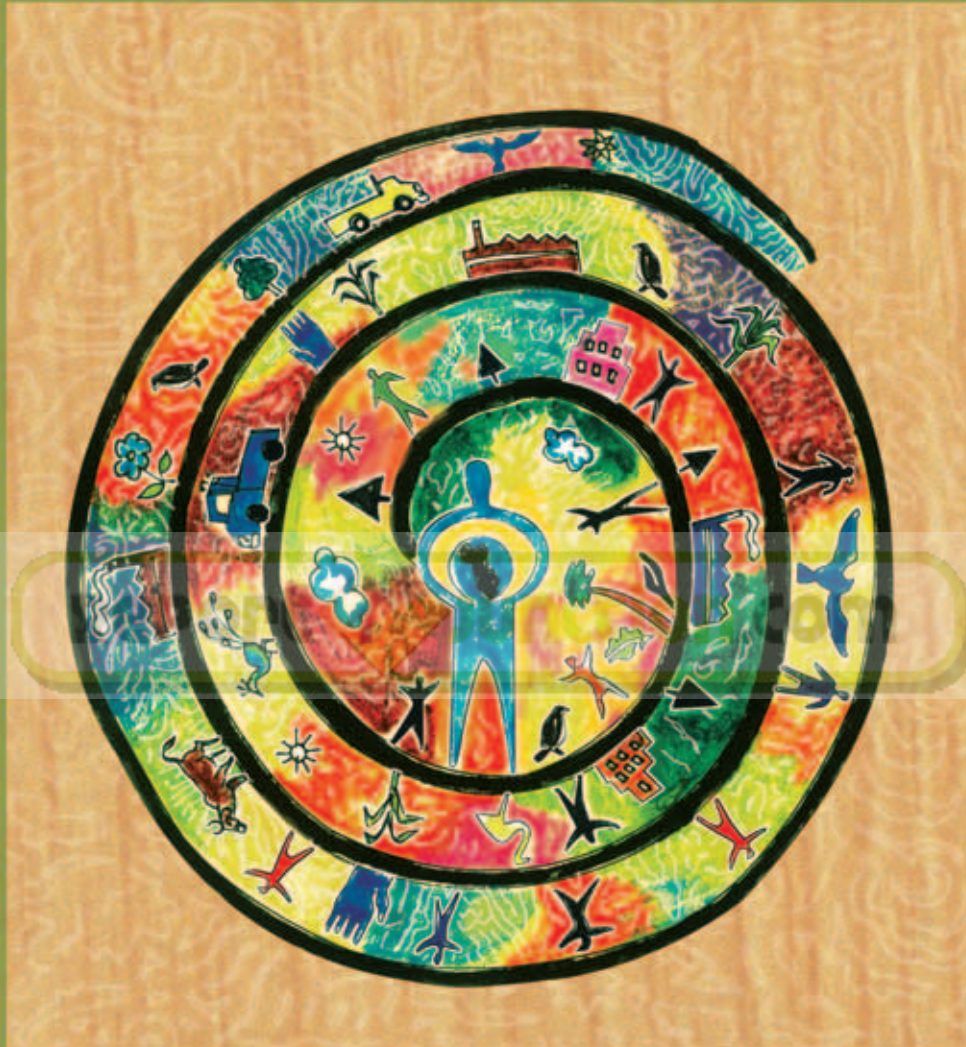
This is how we performed in 2007-08

- We produced 8.19 lac tonnes of sugar in the current year, compared with 9.15 lac tonnes in previous year. The average realisation was Rs. 14.97 per kg in current year, compared to Rs. 14.56 per kg in the previous year.
- We manufactured 17433 KL of ethanol. The average realisation was Rs. 21.97 per litre for ethanol; the Company's distilleries generated revenues of Rs. 168.26 crores against Rs. 122.57 crores in 2006-07. The EBIDTA reported by our distilleries increased 29.36% from Rs. 56.58 crores in 2006-07 to Rs. 73.20 crores in 2007-08.
- We generated 7906.88 lac units of power, of which 5735.35 lac units were marketed to the state power grid for an average realisation of Rs. 3.03 per unit. This increased the revenues of the power division to Rs. 175.52 crores, a 20.23% growth over 2006-07, contributing 11.91% to our aggregate revenues.

Our Capacities

Units	Sugar Crushing Capacity (in TCD)	Distillery (KLPD)	Cogeneration (MW)	Organic Manure (MT)
Balrampur	12,000	160	24.55	30,000
Babhnan	10,000	60	3.00	18,000
Tulsipur	7,000	–	–	–
Haidergarh	5,000	–	23.25	–
Akbarpur	7,500	–	18.00	–
Rauzagaon	8,000	–	25.75	–
Mankapur	8,000	100	34.00	10,000
Kumbhi	8,000	–	20.00	–
Gularia	8,000	–	31.30	–
Total	73,500	320	179.85	58,000





The government, cyclicalality and the consumer

Over the last few decades, the terms – government, cyclicalality and the consumer – have become increasingly inter-linked. The synonymity has transpired for some important reasons: despite relative monsoonal predictability, the Indian sugar industry has seen more crests and troughs than most other nature-based sectors in India. In turn, this has impacted industry viability, consumer pricing and farmer income consistency.

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Interestingly, the cyclicalality of this nature-dependent industry was completely man-made. More specifically, the rise and decline in industry fortunes were the result of erratic government policies. Despite playing a crucial role in the country's economy and being an effective employment generator supporting over 50 million farmers and their families, India's sugar industry continues to be hostaged by adverse government policies.

One of the principal reasons behind this cyclicalality was the government's arbitrary determination of raw material pricing. A sustained non-alignment of cane costs on the one hand and sugar prices on the other, got reflected in an overriding reality: high cane costs and low sugar realisations leading to cane arrears, industry defaults, farmer misery, bank illiquidity and

general industry gloom.

There are a number of institutionalised government interventions that affected industry viability over the last several years, affecting the interests of all industry stakeholders.

- The sugar manufacturers must allocate 10% of their produce to the government at low levy prices that are generally unremunerative for manufacturers.
- Sugar sale is regulated by the government every month, affecting the free interplay of marketplace economics.
- There is a need to prevent government intervention in raw material pricing mechanics, with the objective to align cane and sugar prices in line with other major sugar-producing geographies of Brazil, Thailand and Australia.

Price differential

Inspite of a predominantly unfettered industrial scenario, the country's sugar industry continues to be regulated. For instance, the raw material purchase policy of the Indian sugar industry is characterised by the Statutory Minimum Price (SMP), where the cane prices payable by the industry to farmers are determined by the Central Government.



There are two aberrations at this point:

- Going beyond the SMP, the respective state governments also fix a State Advised Price (SAP), that is usually higher than the SMP and payable to cane farmers in respective states.
- The cane prices fixed by the state government are not linked with downstream sugar realisations, and are therefore fixed more in line with the prevailing political climate than economical considerations.

These consistently higher cane prices benefit farmers during industry upturns. However, when sugar manufacture itself becomes unviable, these farmers suffer extensively, despite higher affixed prices, for the simple reason that millers are unable to pay on time and in full proportion. This one-sided policy in letter turns out to be no-sided in reality; it induces a sharp cyclicity, marked by arrears, a need for government-support packages and irregular industry revenues.

This is precisely what transpired in 2006-07. UP-based mills were mandated to pay Rs. 125 per quintal of cane in line with the SAP declared by the UP government,

13.64% higher than the previous year. This may have been justified and reasonable in an environment of rising sugar prices, making it possible for millers to cover their costs. However, sugar prices declined to one of the lowest points in a decade, making it impossible for mill owners to even recover the cane cost and leading to large arrears in farmer payment.

The sugar industry sought legal redress in response to this arbitrary pricing. The Uttar Pradesh Sugar Mills Association and a few other private sugar mills challenged the government's unfairly high SAP for 2007-08. Eventually, the Supreme Court in its interim order dated 8th September, 2008, fixed the price of cane at Rs. 110 per quintal in the sugarcane arrears case, subject to further detailed scrutiny.

In the opinion of the sugar manufacturers, an arbitrary increase in cane price without factoring the recovery and sugar price variations aggravated the industry inequity. In view of this, the sugar industry highlighted the immediate need for a cane-pricing system that would be fair to all industry stakeholders, which

would be essentially linked to the sugar price and be uniform across the country.

For equitable industry treatment, sugar manufacturers requested the government for the following:

- A formula-based pricing system wherein the cane price would be linked to the realisations of sugar and primary by-products (molasses and surplus bagasse) on the one hand and average recovery on the other

- Prices to be determined using a fixed formula based on region-specific variations

- Incentives to be given for varieties with high sucrose content and for early and late maturing varieties

In the opinion of the Indian sugar industry, these are not unreasonable demands. They are in line with the best international industry practices and, if implemented, will enhance the country's competitiveness among sugar-manufacturing nations.



Government impetus

India is a net petroleum importer; its average daily energy consumption is around 24,50,000 bbl and is growing 3.6% annually. Needless to say, a large amount of India's forex is expended in international crude purchases, which aggravates the country's forex position in times of currency depreciation.

