



Annual Report 2006



CHEMPLAST SANMAR LIMITED

Chemplast Sanmar Limited



BOARD OF DIRECTORS

P.S. Jayaraman, Managing Director
M.K. Kumar
C.H. Mahadevan
S.V. Mony
B. Natraj
V.K. Parthasarathy
M.N. Radhakrishnan
M.S. Sekhar

REGISTERED OFFICE

9, Cathedral Road
Chennai 600 086

MANUFACTURING LOCATIONS

Mettur Dam

PVC

Chlorochemicals:

Caustic Soda, Chlorine,
Chlorinated Solvents,
Refrigerant Gases and
Silicon Wafers

Krishnagiri & Panruti

Industrial Alcohol

Vedaranyam

Industrial Salt

Karaikal

Caustic Soda and Chlorine

BANKERS

ICICI Bank Limited
Indian Overseas Bank
State Bank of India
Standard Chartered Bank

AUDITORS

Price Waterhouse & Co.
Chartered Accountants
Chennai

Chemplast Sanmar Limited

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Information Regarding Listed Securities as required under Clause 32 of the Listing Agreement

NAME AND ADDRESS OF THE STOCK EXCHANGES	DETAILS OF SECURITIES LISTED
1) Madras Stock Exchange Limited Exchange Buildings, New No.30 (Old No.11), Second Line Beach, Chennai 600 001	Equity Shares
2) Bombay Stock Exchange Limited Phiroze Jeejeebhoy Towers, Dalal Street, Fort, Mumbai 400 001	Equity Shares
3) National Stock Exchange of India Limited Exchange Plaza, Plot No. C/1, G Block Bandra-Kurla Complex, Bandra (E), Mumbai 400 051	Equity Shares

The listing fees to these Stock Exchanges have been paid.



Directors' Report

The Directors have pleasure in presenting their report along with the accounts for the year ended 31st March 2006.

Corporate Results

	2005-06 Rs. Crores	2004-05 Rs. Crores
Sales and other income	699.49	612.37
Profit before interest, depreciation and taxes	98.50	81.16
Interest	16.47	24.25
Depreciation	36.01	26.31
Profit before tax	46.02	30.60
– Current tax	(12.84)	(4.90)
– Deferred tax	3.86	(0.02)
– Fringe benefit tax	(0.33)	–
Profit after tax	36.71	25.68
Profit brought forward	83.41	73.54
Transfer from Debenture Redemption Reserve	–	5.13
	<u>120.12</u>	<u>104.35</u>
Appropriations:		
Capital Redemption Reserve	–	20.50
Preference Dividend	–	0.39
Tax on Dividend	–	0.05
Profit carried to Balance Sheet	<u>120.12</u>	<u>83.41</u>

The company continued to maintain its all-round good performance during the year under review. Sales and other income increased by 14% over the previous year. The Profit before tax for the year at Rs.46.02 crores inclusive of Montreal Protocol compensation receipts of Rs.18.40 crores registered a healthy growth of 50% over the previous year. The performance of the company could have been substantially better but for the increase in the fuel cost due to steep increase in oil prices which had a negative impact of Rs.35 crores on the profits for the year. The company has drawn up plans to address this issue. With a view to conserving resources to meet the capital expenditure programmes of the company, the Directors do not recommend payment of dividend on equity shares for the year 2005-06.

MANAGEMENT DISCUSSION AND ANALYSIS

The year under reference was a representative year demonstrating the cyclical nature of the businesses your company is engaged in.

The uptrend seen in the realizations for the products manufactured such as Poly Vinyl Chloride (PVC), Caustic Soda and Chloromethanes witnessed a reversal of trends in the second half of the year. With escalating feedstock prices, the margins came under pressure during this period. The focus laid by the management in recent years on strengthening the backward integration strategy, the acquisition of the Caustic soda facility at Karaikal which made available low cost chlorine for operations, and the continuous investments being made to bring in more flexibility in feedstock management, are all steps in the right direction to manage efficiently the cyclical nature of the business. Several investment proposals, discussed elsewhere in this report, are now under implementation and these initiatives will further strengthen the fundamentals of the company.

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PVC Business

The company has an integrated facility at Mettur Dam to produce 64,000 TPA of PVC. Ethylene Di-chloride (EDC), the feedstock required to manufacture PVC is also produced in this location.

The company continues to be the only manufacturer with capability to produce four major PVC product groups. This has given it the flexibility to quickly change its product mix based on comparative contribution.

Suspension Resin:

Demand for Suspension resin in the country peaked to nearly 11.5 lac tons in the year 2005-06, registering a high growth of 25% over the previous year. During this year, the country imported nearly 2.50 lac tons of Suspension resin. The main driver for PVC demand continues to come from the Pipes & Fittings sector where nearly 70% of Suspension PVC is consumed in the country. Implementation of several irrigation, water supply and sewerage schemes by various Governments, and the boom in the housing, construction and infrastructure sectors will continue to drive Pipes and PVC demand in the coming years.

Paste Resin:

Demand for Paste resin (a speciality resin) in India is at present around 65,000 MT and growing at a modest rate of 5% per year. Leather cloth production consumes a major portion of Paste resin. With the growth in the automobile sector, increase in leather cloth production is expected to result in higher demand for Paste resin. The Paste resin produced by your company continues to remain the preferred grade and is in good demand.

Battery Separator Resin (BSR):

The country's BSR demand continues to be around 6000 MT per year. Your company continues to be the sole manufacturer of BSR in India.

Copolymer Resin:

Growth in demand for Copolymer resins in the major sectors – inks and adhesives – continues to remain modest. Your company is the only manufacturer of Copolymer resin in South Asia.

Raw Materials and Intermediates:

EDC is the key intermediate to produce PVC. Though the company has an EDC production facility at Mettur Dam to meet its entire requirement to produce PVC, actual production of EDC depends on the price/ cost of raw materials i.e., Denatured Spirit (DNS) and Chlorine. While the cost of chlorine has been minimised with the enhanced captive production at the Karaikal facility, the cost of DNS depends upon the vicissitudes of the sugar industry, which determines availability of molasses for alcohol production, demand of alcohol from the potable sector and the Gasohol programme of the Government of India. These factors have posed a question mark on the availability of DNS to the industrial sector on a sustained basis at affordable prices. Also, the international price of DNS has increased to high levels making imports prohibitive. To find a long-term solution to this problem and ensure availability of EDC at an appropriate cost, the company, as informed, is setting up an 84,000 TPA EDC production facility at Karaikal to produce EDC from imported ethylene, using the chlorine available at this location. Towards this end, Ethylene storage and Marine Terminal facilities are under construction. The project to be completed by end of 2006 will make available about 84,000 tonnes of EDC at a low cost for the PVC production at Mettur Dam. The balance requirement of EDC of around 25,000 TPA will be met from the Oxychlorination facility operating at Mettur Dam, for which the required DNS will come from the company's Industrial Alcohol plant.



As regards the Caustic soda facility at Karaikal, a shore based location in the Union Territory of Pondicherry acquired in August '03, your company has taken several initiatives. The capacity of Caustic soda was ramped up to 100 TPD last year and has been further expanded to 150 TPD in March '06. Power is the predominant raw material in the manufacture of Caustic soda, and the company has installed an 8.5 MW power plant with natural gas as fuel. The captive power source through natural gas is being further augmented. Thus, Chlorine is made available at this location for captive consumption at an attractive low cost.

Risks and concerns:

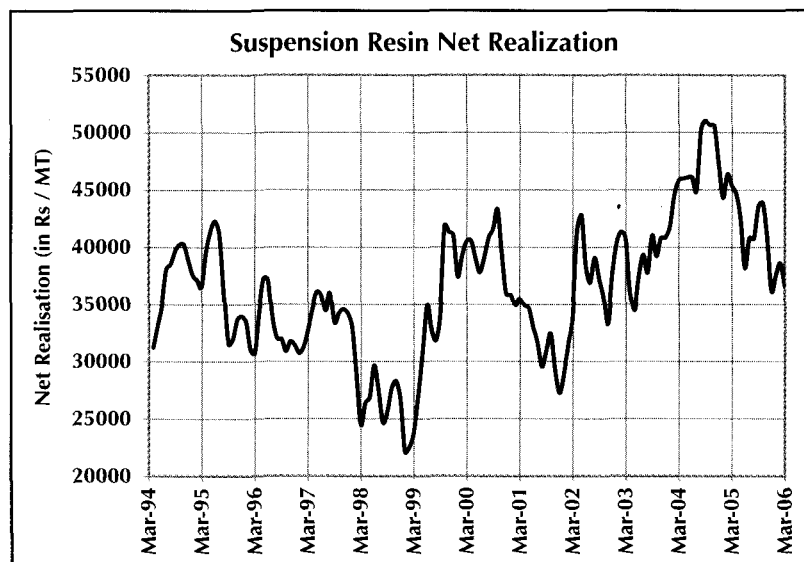
- a) The Government of India has been continuously reducing the customs duty on PVC imports and the spread between import duty on PVC and the intermediate (EDC) has reduced substantially as under:

Year	Month	Import Duty %		Spread %
		PVC	EDC	
2002	March	30	15	15
2003	March	25	15	10
2004	January	20	15	5
2004	September	15	10	5
2005	March	10	5	5
2006	March	5	2	3

- b) Imported DNS prices have increased to unviable levels. The company is now forced to depend on domestic DNS at least till commissioning of the EDC facility at Karaikal.
- c) High cost of power mainly due to increase in LSHS cost, which follows the trend of International crude oil prices is putting pressure on margins.

Review of operations:

PVC production during the year 2005-06 was 60,177 MT. During the beginning of the year, PVC production was moderated by availability of EDC. However, with the imported parcels of EDC landing from June '05, PVC production volume was maintained to the capacity. In line with the international price of Suspension PVC, domestic prices started falling substantially from October '05. Such a drop in selling price and increase in feedstock cost affected the margins during the year.



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As stated earlier, the PVC Division was benefited by the low cost chlorine from Karaikal facility and the timely import of DNS and EDC, but for which the operations of the Division would have been severely affected.

Chlorochemicals Business

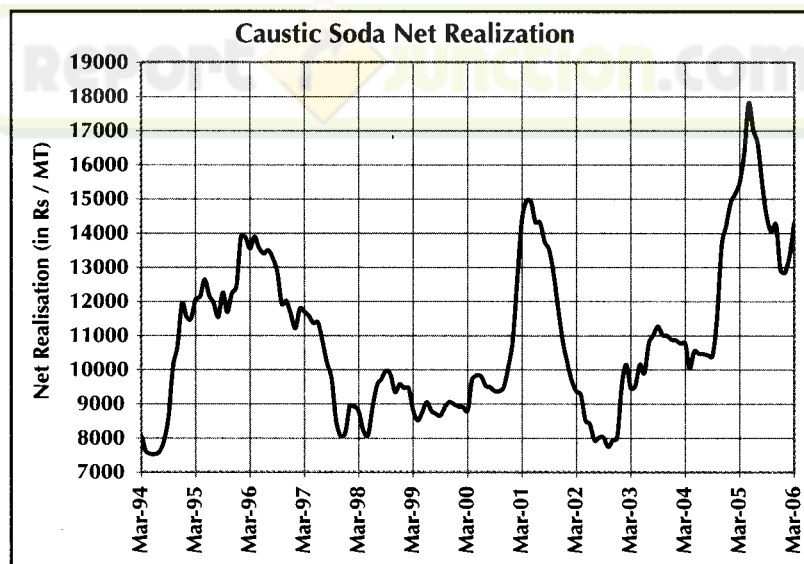
The Chlorochemicals business is again a highly integrated operation. The company produces at Mettur Dam, Caustic soda, Chloromethane products, Silicon Wafers and Refrigerant gases (CFC and HCFC). The salt and power required for Caustic production are available from captive sources. Chlorine produced in the Chloralkali plant in this location is used for making Chloromethane products. Some of these products find application in the manufacture of Refrigerant gases.

Caustic Soda:

The highly buoyant market for Caustic soda prevalent in the year 2004-05 encouraged several capacity additions coming on stream not only in India, but also in the entire Asian region. In India alone, almost 2.60 lac MT of capacity was added during the year 2005-06.

Consequently, even though demand remained quite strong, the surplus capacity resulted in pressure on realization. With import prices, especially from China, falling drastically during the year, there was a continuous downward movement on realization.

The trend in net realization of Caustic soda is shown below:



Solvents:

The sustained growth in the pharmaceutical sector in India helped in demand for Chloromethane Solvents growing at a nominal 6%. However, the removal of the antidumping duty on import of Methylene Chloride from Europe in December '05 and the falling international prices for HCFC from October '05 resulted in realization on Chloromethanes coming under severe pressure in the last two quarters of the year.

The escalating energy price and the global shortage of gas have resulted in Methanol price going up steeply affecting the margins on Chloromethane sales.

The company is phasing out the production of Carbon Tetrachloride (CTC) for non-feedstock applications in line with the Montreal Protocol guidelines. As a compensation towards the same, the company received a sum of Rs.16.71 crores from the Montreal Fund during the year.



Mettron:

The CFC production is in line with the phase out schedule agreed under the Montreal Protocol arrangement.

The robust growth in demand in the white goods sector in the country is propelling demand for air-conditioner and HCFC-22 in the Asian region. Both in India and rest of Asia the demand for HCFC-22 is expected to grow at 20% per annum in the medium term. In order to take advantage of this growth opportunity, the company would produce HCFC-22 at its Mettur Plant.

The company is also in the process of implementing a CDM (Clean Development Mechanism) project in incinerating the by-product HFC-23 that arises during the manufacture of HCFC-22 at cost of Rs.9 crores. The project when completed by end 2006 will enable the company to earn Certified Emission Reductions (CERs), which are tradable. The company has already obtained Host Country approval and is in the process of obtaining the final approval from the United Nations Framework Convention for Climate Change (UNFCCC).

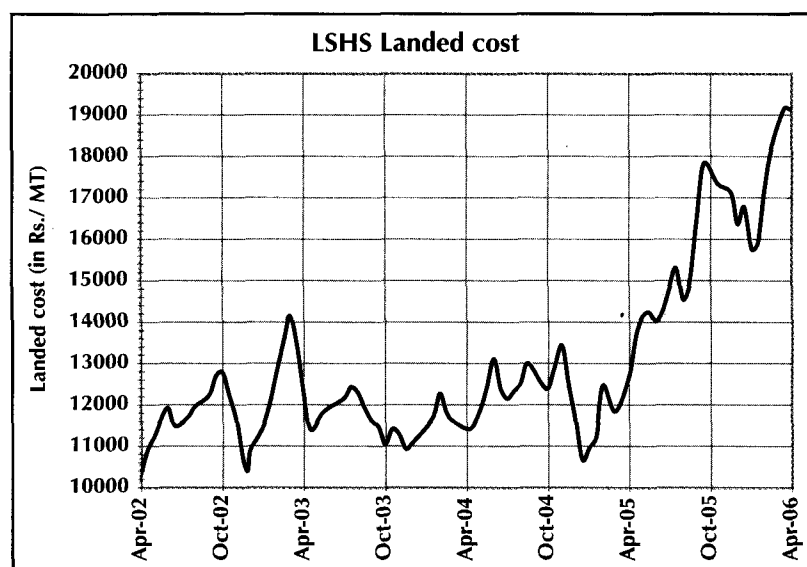
Metkem:

The international photovoltaic market is characterized by severe scarcity of raw material polysilicon. Despite this, the company has been quite successful in operating this division at full capacity. The strong growth in photovoltaic demand in several European countries like Germany, Italy and Spain has resulted in improved prices for wafer sales for the company. This trend is expected to continue in the medium term.

To address the raw material shortage, the company's Polysilicon facility at Mettur Dam is being revamped, with the adaptation of a more energy efficient process, to produce 30 TPA of Polysilicon at a cost of Rs.11.5 crores. This initiative will be completed by March '07. The capacity of the plant will be sufficient to meet the raw material requirements of the division. This project is once again a demonstration of the company's strong belief in the backward integration strategy.

Risks and concerns:

- (i) The huge spike in international crude prices is a matter of extreme concern as this directly affects captive generation cost in the form of high fuel cost.



- (ii) Sale volume of both CFC and CTC will continue to shrink on account of phase out schedule under the Montreal Protocol.

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Review of operations:

The Chlorochemicals business continued to operate at 100% capacity during the year. The division has been the beneficiary of low cost captive Chlorine. The drop in realization for the products following the international trend and the increase in methanol prices witnessed in the second half of the year placed a pressure on margins. Despite an increase in overall cost, contributed essentially by the increase in captive power generation cost consequent to high international crude oil prices and increased methanol cost, the Chlorochemicals business achieved satisfactory results. With good demand coming from the pharma sector, the demand for the Chloromethane products is expected to remain steady in the medium term.

PROJECTS

Karaikal:

The expansion of the Caustic Soda plant at Karaikal from 100 TPD to 150 TPD was successfully completed in March '06 without any cost or time overrun. The company has also commissioned a desalination plant, based on the Reverse Osmosis technology, with a capacity to produce 1200 m³/ day of treated water to meet the needs of the expanded Caustic Soda facility and the EDC project under implementation.

As discussed earlier, work on the 84,000 TPA EDC plant at Karaikal using imported Ethylene and a marine terminal facility is in progress. The project completion is expected by end of 2006.

The company has acquired the assets including 77 acres of land located adjacent to the existing Chloralkali facility at Karaikal from Kothari Sugars and Chemicals Limited.

The company is also evaluating various other projects at Karaikal to leverage on the port infrastructure being set up there.

Mettur:

The company's Chloralkali facility at Mettur Dam has been operating with the Mercury Cell process for more than six decades. In line with the Corporate Responsibility for Environment Protection (CREP) guidelines issued by the Ministry of Environment and Forests, the company has, in the past couple of years, carried out several improvements in the plant operations. However, in line with the Sanmar group's philosophy of 'care for the environment' and as a responsible corporate citizen, the company has, decided to convert to Membrane Cell technology at Mettur Dam well ahead of time. However, to make this project viable, the captive power cost, which has gone up quite significantly has to be brought down now. The company has therefore decided to convert the LSHS based power generation to coal based power generation. Both these conversion projects when completed would contribute significantly to the bottom line.

Cuddalore:

All the necessary statutory approvals for setting up the greenfield PVC project of 170,000 TPA capacity, with VCM as feedstock have been obtained. Land required for the project has been allotted. Technology sourcing agreements are being concluded. The project, estimated to cost around Rs.450 crores, is likely to be completed in twenty four months.

Environment

The company lays great emphasis in integrating its business objectives with a clean environment. This is realized through a continuous focus on the exploration and implementation of pollution prevention measures, resource conservation as well as recycle and reuse initiatives. Towards this end, over a period of time, the company has invested in a number of infrastructure projects aggregating over Rs.50 crores resulting in effective management of air emissions as well as solid and hazardous wastes.



The programme to implement the 'Zero Discharge' project at Mettur Dam is receiving considerable attention. Technology selection for this purpose is expected to be completed shortly. Chloralkali plant at Karaikal has already achieved 'Zero Discharge' of process effluents. Water required at this plant is largely being met from the desalination plant set up in this facility.

Both the PVC and the Chlorochemicals plants at Mettur Dam are the recipients of ISO 14001 certification.

Green belt development is a major focus area for the company with more than 40% green cover in place.

The Karaikal facility was awarded the first prize for its industrial garden in Farm Fest 2006 conducted by the Agricultural Department of the Pondicherry Government.

The Chlorochemicals plant at Mettur and the Salt Works at Vedaranyam were the recipients of the Tamil Nadu State Safety Awards for the years 2001 and 2002 that were distributed in March '05.

Personnel

Industrial relations with employees remained cordial during the year. Human Resource Development activities received considerable focus. The emphasis was on imparting training and development of the skill-set of the employees to enable them to face the challenges in the work environment.

Internal Control Systems

Your company has adequate internal control procedures commensurate with the size and nature of its operations. The audit committee constituted by the Board of Directors is functioning effectively. Internal audit for the year 2005-06 was carried out by Deloitte Haskins & Sells covering all areas of operations. All significant audit observations were discussed in the audit committee, which met four times during the year under review.

FINANCE

Your company has established a good track record with the bankers and financial institutions, thereby enjoying their confidence fully. The increase in interest cost in recent period is a matter of concern, however with good standing of your company with the lenders, the company is confident of securing loans at optimum costs.

With a view to enhance liquidity of company's shares on the stock exchanges and facilitate easier accessibility to the company's equity shares by small investors, during the year, the company carried out a stock split by sub-dividing each equity share of Rs.10 of the company into 10 equity shares of Re.1 each.

DIRECTORS

During the year, Mr M S Sekhar, Mr M N Radhakrishnan, Mr S V Mony and Mr B Natraj were co-opted to the Board and Mr V V Subramanian resigned from the Board. The Directors place on record their appreciation of Mr Subramanian's services during his tenure.

Mr C H Mahadevan, Director, retires by rotation at the ensuing Annual General Meeting and is eligible for re-appointment.

Mr V K Parthasarathy and Mr M S Sekhar who were appointed in casual vacancies caused by the resignations of Mr N Kumar and Mr Vijay Sankar, respectively, hold office up to the date of the ensuing Annual General Meeting. Mr M N Radhakrishnan, Mr S V Mony and Mr B Natraj who were appointed as additional directors hold office up to the date of the ensuing Annual General Meeting.