
Finolex
Industries Limited
24th Annual Report 2004-05

Five Year Financial Highlights

(Rs in million)

	2004-05	2003-04	2002-03	2001-02 (8 months)	2000-01
PROFIT AND LOSS ACCOUNT DATA					
Gross Revenue	**10012.602**	8652.398	7557.185	4446.992	7013.211
Materials and manufacturing cost (including excise duty)	**7282.728**	5873.975	4962.181	2834.712	5266.647
Personnel expenses	**231.873**	218.387	238.245	119.925	154.201
Administration and selling expenses	**584.189**	591.024	556.194	334.923	400.008
Finance charges	**122.808**	134.944	163.746	143.264	381.596
Depreciation	**443.572**	429.337	421.711	276.061	408.251
Profit before tax	**1347.432**	1404.731	1215.108	738.107	402.508
Taxation	**388.262**	503.111	411.219	145.698	30.935
Profit after tax	**959.170**	901.620	803.889	592.409	371.573
Dividend (including tax on dividend if applicable)	**424.300**	419.722	285.530	258.437	234.313
BALANCE SHEET DATA					
Share capital	**1239.847**	1239.808	1265.082	1291.837	1444.620
Reserves and surplus	**3814.646**	3406.286	2992.257	2529.305	3252.426
Net worth	**5054.493**	4646.094	4257.339	3821.142	4697.046
Deferred tax (net)	**1062.966**	1064.979	1032.701	853.332	0.000
Long term Loans	**1462.504**	706.820	975.000	950.000	1245.990
Short term Loans	**4110.557**	2474.819	2741.483	1668.114	1996.827
Total liabilities	**11690.520**	8892.712	9006.523	7292.588	7939.863
Gross block	**8902.703**	8658.694	8503.569	8389.258	8311.647
Net block (including CWIP)	**5430.179**	5085.176	5212.856	5474.048	5673.859
Investments	**4131.900**	2724.455	2444.670	1043.762	1542.253
Net current assets	**2128.441**	1083.081	1348.997	774.778	723.751
Total assets	**11690.520**	8892.712	9006.523	7292.588	7939.863
KEY INDICATORS					
Return on net worth (%)	**18.98**	19.41	18.88	15.50	7.91
Earnings per share (Rs.)	**7.73**	7.25	6.25	4.29	2.51
Long term debt to equity	**0.29**	0.15	0.23	0.25	0.27
Dividend payout (%)	**44.24**	46.55	35.52	43.62	63.06
Interest coverage	**11.97**	11.41	8.42	6.15	2.05
Book value per share (Rs.)	**40.76**	37.46	33.64	29.57	32.51

Notes : 1. Key indicators in respect of accounting year 2001-02 have been annualised, wherever required.

2. Earning per share is calculated on the share capital as on the date of Balance Sheet except for the years 2000-01 to 2003-04, which is calculated after considering the weighted average effect of the changes in the share capital due to fresh issue and/or buy-back of shares during the year.

Chairman's Message

Dear Stakeholders,

I am happy to present before you yet another year of growth.

The increase in the income and net profit is commendable on the backdrop of decline in agro-sector growth, erratic monsoon and hardening of oil prices.

Three years ago while recapitulating our decade of PVC resin manufacturing, I had dwelt upon the hurdles and stumbles of the backward integration project of manufacture of PVC resin. Not only have we succeeded in managing the petrochemical industry's cyclical nature but have grown from strength to strength. Enthused by the success over the years, we have undertaken to double the PVC resin manufacturing capacity. The expansion project is progressing as per schedule and we expect to have part of the production from the expansion on stream during the current year.

Our distribution network for PVC pipes is spreading wider and deeper, across the length and breadth of India. With the renewed thrust on agriculture, irrigation and construction, the potential for growth in business of PVC pipes as well as PVC resin is very high.
Overall I see a bright future for the company in the years to come. We are aware of the threats posed by the vagaries of weather and fluctuating cost of crude but our past performance gives us the confidence to forge ahead.

P.P.CHHABRIA
Chairman

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Board of Directors

Mr. P.P. Chhabria
Non-executive Chairman

Mr. K.N. Atmaramani
Independent Director

Mr. M.G. Bhide
Independent Director

Mr. S.N. Inamdar
Independent Director

Dr. N.A. Kalyani
Independent Director

Mr. S.S. Marathe
Independent Director

Mr. K.P. Chhabria
Managing Director

Mr. Prakash P. Chhabria
Deputy Managing Director

Mr. J.S. Arora
Wholetime Director

Mr. S.S. Dhanorkar
Wholetime Director

Mr. P. Subramaniam
Wholetime Director

Secretary
Mr. Anil Atre
Company Secretary &
General Manager (Admn.)

Bankers
Bank of India
Bank of Baroda
The Bank of Nova Scotia
Bank of Maharashtra
Citibank N.A.
Corporation Bank
ICICI Bank Limited

Auditors
B.K. Khare & Co.
Chartered Accountants

Solicitors & Advocates
Crawford Bayley & Co.

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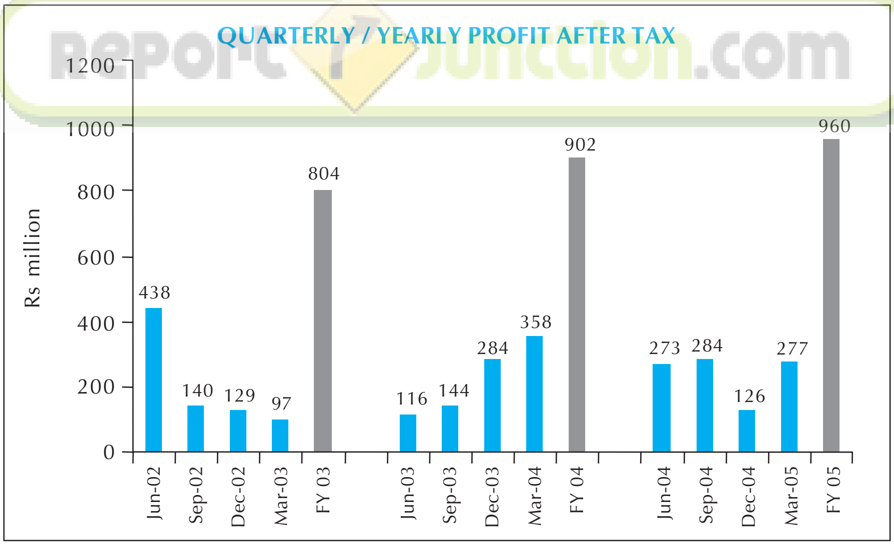
Management Discussion and Analysis

Introduction

The year under review has been yet another satisfactory year for your Company. The gross income has shown a robust growth of 15.72 %, whereas the net profit for the year saw a growth of 6.38 %.

Financial review

The year began on a very positive note. The results for the first half-year reflected very strong profitability. However, during the second half-year the feedstock prices witnessed a steep increase on the back of spiraling oil prices. It was difficult to pass on the increase in feedstock costs completely in the selling prices of the Company's products. This affected the profitability for the second half-year. The polyvinyl chloride [PVC] resin prices as well as the prices of feedstocks in the international market are prone to cyclical fluctuations. The quarterly profits are, therefore, subject to variations. However, on a year on year basis these variations tend to get evened out. This can be seen from the chart given below where despite variations in quarterly profits, the yearly profits have been stable.



The domestic PVC demand was affected to some extent during the second half year because of the high prices. Despite this, your Company has posted a significant increase in sales for both of its products PVC resin and PVC pipes. This has been possible only due to your Company's strong distribution network and appropriate marketing strategies.

While preparing the accounts for the year under review, the Company has shown income from operations and expenditure without interdivisional transfers. This is in line with AS 9 issued by The Institute of Chartered Accountants of India.

Economic Value Added:

The focus of your Company's management is always on creating value for all its stakeholders over the years. This is reflected in the Economic Value Added (EVA) calculation, which shows that the Company has consistently increased the economic value of the business. EVA is an estimate of true economic value creation. Positive EVA indicates value creation by a company while negative EVA indicates the amount of value destroyed by a company.

(Rs in million)

EVA Analysis	31.03.05	31.03.04
Earnings before interest & tax (EBIT)	1470.240	1539.675
Less: Tax on EBIT *	433.201	519.245
Net operating profit after tax (a)	**1037.039**	**1020.430**
Shareholders' funds	5054.493	4646.094
Add: Long term debt **	706.820	723.993
Total capital employed	5761.313	5370.087
Weighted average cost of capital (%)	8.72	7.95
Capital Charges (b)	**502.386**	**426.922**
EVA (a-b)	**534.653**	**593.508**

Economic Value Added (EVA) is a registered trademark of Stern Stewart & Co.

Notes :

1. *Taxes on EBIT calculated as the effective tax rate (excluding deferred taxes).
2. **Excludes loans taken for PVC resin expansion project which is under execution.

Indian economy and its effect on the Company

India's GDP growth for F.Y. 2005 is estimated at 7%. The main catalyst behind this industry led growth is the construction and the manufacturing sectors. The performance of the agricultural sector has been low on the back of an erratic monsoon.

It is expected that a growth of 6% to 8% in real GDP will continue over the next few years. A demographic transition in the income and population dynamics, with increasing number of people with better purchasing power now coming under the middle class bracket is expected to add to the growth of the economy. This will have a direct spillover effect in the business of your Company, which touches the lives of people in almost all the sectors of the economy. Government of India's ongoing focus on rural development programmes with particular emphasis on agriculture, irrigation and drinking water schemes will augur well for both the PVC pipes and the PVC resin business of your company in the future.

During F.Y. 2004-2005, your Company witnessed significant growth in sales for both of its products - PVC resin and PVC pipes.

Industry outlook

PVC resin business

The Indian PVC manufacturing capacity remains static at around 800,000 t.p.a. against the global capacity of about 34 million t.p.a. However, during 2004-05, the PVC resin demand in India remained static. This was due to a combination of lower demand for PVC pipes because of an erratic monsoon and the historical high prices of PVC resin prevailing especially during the second half of the year. Despite this negative sentiment in the market, your Company managed to increase its PVC resin sales both in value and volume terms. It is noticed that the market has now accepted the higher prices of PVC resin and its applications and the demand is expected to grow during the later part of 2005-06. It is estimated that the domestic demand for PVC resin will grow by more than 7-8% per annum in medium term.

PVC pipes business

The PVC pipes industry in India is almost equally divided between organized sector and unorganized sector. Your Company continues to be the market leader in the industry.

After a good start, the monsoon was erratic in most parts of India during 2004 and the year ended with a below average monsoon. This resulted in a slightly negative growth in agriculture GDP. Despite this situation, your Company managed to post a handsome growth in the PVC pipes sales. This was possible due to the Company's strong distribution network and appropriate marketing policies. The Company has, as a strategy, decided to spread its product portfolio over different segments of the economy. The renewed focus on the construction market for its Sewerage, Waste and Rainwater (SWR) and plumbing pipes is paying dividends, as the growth in this segment is very high. Considering the huge investments currently underway in the construction sector, the Company expects this sector to give a further fillip to the demand for PVC pipes and fittings. Your Company's strategy to widen the distribution network all over India also helps in ironing out the effect of poor monsoon in some states.

The Union Budget for 2005-06 has given a renewed thrust on agriculture, with a substantial increase in allocation to Rural Development Programmes and Irrigation. Various State Governments like Andhra Pradesh, Gujarat and Maharashtra have taken up large Micro Irrigation Schemes, which are expected to give a further boost to the demand for PVC pipes. The easy availability of credit to the farmers by way of Kisan Credit Cards and similar pro-agriculture schemes will also drive the growth for farm implements like PVC pipes from rural India. Your Company continues to widen its distribution network to more and more geographical areas. In order to support the new dealers coming into Finolex family, your Company also continues to increase the number of its marketing personnel in the field. This is yielding positive results.

Value Added Tax [VAT]

VAT has been implemented in Maharashtra and most of the other States of India w.e.f. 1st April, 2005. Though there is no immediate impact on the operations of the Company, the introduction of VAT is expected to be beneficial for players like your Company in the organized sector.

Impact of WTO commitment

In line with the commitment made by the Government of India to World Trade Organization [WTO], the peak level of customs duty has been steadily brought down from a high of 65% in 1994-95 to 20% in 2003-04. During the year under review, the customs duty on PVC resin was brought down to 15% in September 2004 and further reduced to 10% w.e.f. 1st March 2005. With this reduction, the duty protection on PVC resin in India is one of the lowest in Asia. The customs duty on raw materials i.e. Ethylene Di-Chloride [EDC] and ethylene has also been brought down to 5%.

The Government of India has already signed a Free Trade Agreement (FTA) with Thailand and is also in the process of finalizing FTAs with various other countries like Chile, Singapore and Malaysia. Though polymers are not currently included in the list of products proposed to be covered by FTAs, it is likely that a few years later Polymers may be included. Your Company is fully geared up to operate in this highly competitive environment. The management is looking at these developments positively in the sense that these FTAs will open up new markets for your Company's products in the long run.

Progress on PVC expansion project

PVC expansion project is progressing as per schedule. Civil work is in the last stage of completion. More than 85% of the equipments have been ordered. Equipments are arriving at site as per schedule. Erection contracts have been awarded.

Risk management

As is inevitable for any business , your Company's operations are also subject to some risks that can affect its business performance. Your Company has a clearly documented risk management policy. The management team of the Company regularly identifies, reviews and assesses such risks and decides appropriate guidelines for mitigating the same.

The Company's main raw materials namely, EDC and ethylene are imported and therefore, are exposed to currency risk. However, the Company enjoys a natural hedge on the revenue side as the domestic selling price of its finished product, i.e. PVC resin is directly linked to the import parity. Yet, the time lag between the import of raw material and selling of finished product leads to foreign exchange risk, which is constantly monitored. The Company is also exposed to interest rate risks on the foreign currency borrowing for funding the raw material imports. The Company actively manages these risks by making use of hedge / derivatives products from time to time.

During the course of its business, the Company generates surplus cash. The Company also has active treasury operations to manage such surplus. The management has laid down detailed guidelines for investment of such surplus and a senior team monitors the same regularly.

The Company has received various awards for its excellent safety record. During the year under review, your Company received Prashansa Patra from National Safety Council of India. This is the second year in succession that your Company has received safety award.

The Company has taken adequate insurance policies to cover not only its plant and machinery and other assets but also third party liabilities. The management periodically reviews the adequacy of the insurance cover.