

# ANNUAL REPORT 2014-15



### THE POWER OF COLLABORATION

The past year has been a challenging one for us at Godfrey Phillips India.

The ever-changing business environment presented hurdles that we strove to overcome with a combination of teamwork and grit.

Harnessing this spirit of collaboration has played a major role in enhancing productivity. Our story, as laid out in this Annual Report, is a testament to that.

With a continued focus on workplace synergy and partnership, as well as, the support of our stakeholders, we look forward to reaching greater heights of success in the years to come by.

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# **Corporate Information** Board of Directors

Mr. R. A. Shah Chairman Mr. K. K. Modi Mr. R. Ramamurthy Mr. Samir Kumar Modi Ms. Bing Modi Dr. Lalit Bhasin Mr. Anup N. Kothari Mr. Atul Kumar Gupta

President & Managing Director Whole-time Director **Executive Director** 

CHIEF FINANCIAL OFFICER Mr. Sunil Agrawal

#### COMPANY SECRETARY Mr. Sanjay Gupta

#### **REGISTERED OFFICE**

'Macropolo Building', Ground Floor, Next to Kala Chowky Post Office, Dr. Babasaheb Ambedkar Road, Lalbaug, Mumbai - 400 053

CORPORATE OFFICE 49, Community Centre, Friends Colony, New Delhi – 110 025

#### OTHER OFFICES

Ahmedabad, Baramati, Chandigarh, Chennai, Ghaziabad, Hyderabad, Kolkata, Mumbai, New Delhi, Rabale, Singapore

LEAF DIVISION Guntur (Andhra Pradesh)

STATUTORY AUDITORS Deloitte Haskins & Sells, Chartered Accountants

**INTERNAL AUDITORS** Lodha & Co., Chartered Accountants

**REGISTRAR AND TRANSFER AGENT** Sharepro Services (India) Pvt. Ltd., 13 AB, Samhita Warehousing Complex, Second Floor, Sakinaka Telephone Exchange Lane, Off Andheri (East), Mumbai – 400 072

SOLICITORS

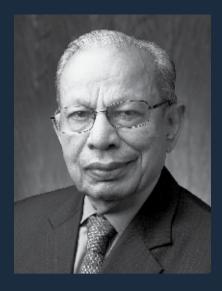
Crawford Bayley & Co.

#### BANKERS

- State Bank of India Bank of Baroda Bank of India Citibank N.A. State Bank of Hyderabad
- State Bank of Travancore The Hongkong and Shanghai Banking Corporation Union Bank of India

CORPORATE IDENTITY NUMBER LI6004MHI936PLC008587

www.godfreyphillips.com



# R. A. Shah Chairman's Message

Dear Shareholder,

2014 proved to be yet another year marked with modest global economic growth. While the economic recovery was visible in the advanced and developed economies, the emerging market and developing economies slowed down further. And there is no silver lining for the year 2015 either. As per IMF estimates released in July, global growth is projected at 3.3% in 2015 against 3.4% in 2014. That leaves a world awash in excess supply, with weak commodity prices and deflation, and a growing risk of export dumping. Nevertheless, the underlying drivers for a gradual acceleration in economic activity in advanced economies – easy financial conditions, more neutral fiscal policy in the euro area, lower fuel prices, and improving confidence and labor market conditions – remain intact. At the same time, there is an expectation of a rebound in activity in a number of distressed economies in emerging markets in 2016.

Indian economy, however, has grown at 7.3% in 2014-15 compared to 6.9% in 2013-14, riding on improved macro-economic indicators, and aided by collapse of global oil prices. However, the rate of growth is unlikely to move northbounds steeply in the short term given that the actions of the Modi Government will take time to shore up business confidence which can then translate into higher levels of capital investment and in turn stimulate private consumption expenditure. The decisiveness and determination displayed by the Modi government augurs well for all of us.

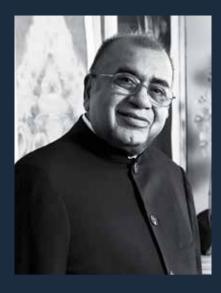
Over the years, policy makers in India seem to have chosen taxation as the tool to control consumption of tobacco products but with little success. Your Company shall continue to engage with the concerned government authorities to drive home the point that moderate tax rates alone can maximise the revenue potential from the tobacco sector.

Despite an uncertain path for the GST bill in Parliament's upper house, the government is preparing for GST implementation next April. This new tax system could prove to be an economic game changer and therefore, the political class must not derail its legislative journey.

I would also like to take this opportunity to extend my heartfelt gratitude to all our consumers, business partners, shareholders and employees for their relentless support, faith, and commitment. I reassure that your Company is strongly positioned to take up many new challenges going forward to drive a balanced and sustainable growth. As always, your unwavering support will help to achieve the goals in a faster and better manner.

With best wishes and warm regards,

R.A. Shah



## K. K. Modi President's Message

Dear Shareholder,

I am delighted to write to you once again to update you on the performance of your Company. Despite challenging macro-economic and regulatory environment, your Company delivered a healthy topline of Rs.4453 crore with a growth of 6% over last year. I am pleased to announce that your Directors have yet again recommended a Dividend of 400% for the year ended 31st March, 2015.

Over the last 3 years, the incidence of both Excise Duty and VAT on cigarettes, at a per unit level, has almost doubled up cumulatively. This sharp increase is not only exerting pressure on the cigarette sales volumes but also leading to suboptimisation of the revenue potential from the tobacco sector.

In a country where only 5 per cent of adult male tobacco users consume cigarettes, the share of cigarettes in the total tobacco excise revenue is as high as 85 per cent. This anomaly neither helps in tobacco control nor provides higher revenue to the Government. High incidence of taxation on cigarettes, over the years, has led to a significant shift in tobacco consumption to relatively less taxed or tax escaped tobacco products.

Your Company's strategy revolves around creating a "focused approach" on three fronts – markets, brands and people. This structural change will help grow the business, drive profits and innovation. Your Company will maximize focus in selected markets to generate higher sales volume by increasing market share. Extending this focused approach to brands, your Company has done significant work towards strengthening brand equity, developing contemporary product offerings for the young and diverse Indian population. On the people front, your Company has identified high potential employees who have been allocated stretched goals aimed at achieving our business objectives.

The International Business Division of your Company is on a faster growth trajectory. In the fiscal year 2014-15, this Division reported a growth of 24% to exceed Rs.600 crore in terms of sales turnover for the year. The Company continues its focus in key markets of Latin America, the Middle East, Africa and SAARC nations. Your Company is also leveraging its partnerships for developing and promoting Indian leaf tobacco within global brands. Besides cigarettes and unmanufactured tobacco, the Division will also be focusing to build the chewing products and tea businesses in key geographies. I am fairly confident of reasonably good growth coming from our International Business Division in the next 3 years.

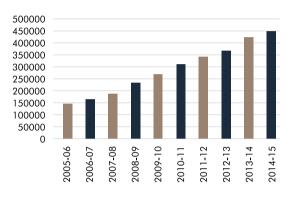
As the domestic cigarette business continues to face the uphill task of maintaining volumes in a declining industry, we shall have to focus on gaining market share. This requires us to upgrade our selling and distribution processes and work in this regard is already underway. Your Company's plan to diversify in the chewing products business aims to attract consumers from other tobacco products and thereby generate higher sales revenues with better margins. Our tea business is focusing on developing contemporary products such as green tea that will provide the next stage of growth for the business. In addition, sales and distribution infrastructure of the tea business is being pivoted across new geographies and trade channels.

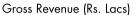
I offer my sincere gratitude to all the shareholders and stakeholders for continuing to place their confidence in the Company. It is this support that helps us create long term value for all stakeholders.

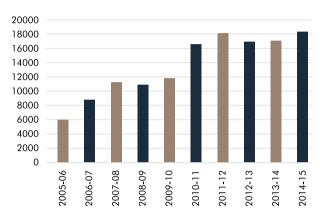
Warm regards,

K. K. Modi

# Financial Highlights Trends

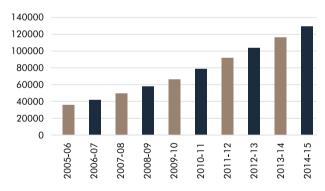




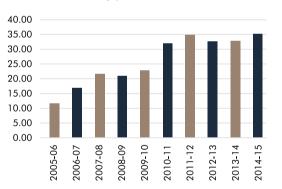


#### Profit After Tax (Rs. Lacs)

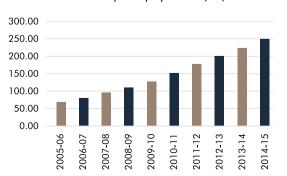
Shareholders Funds (Rs. Lacs)



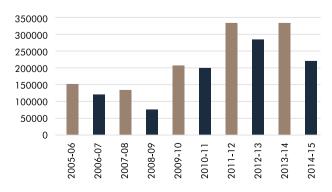




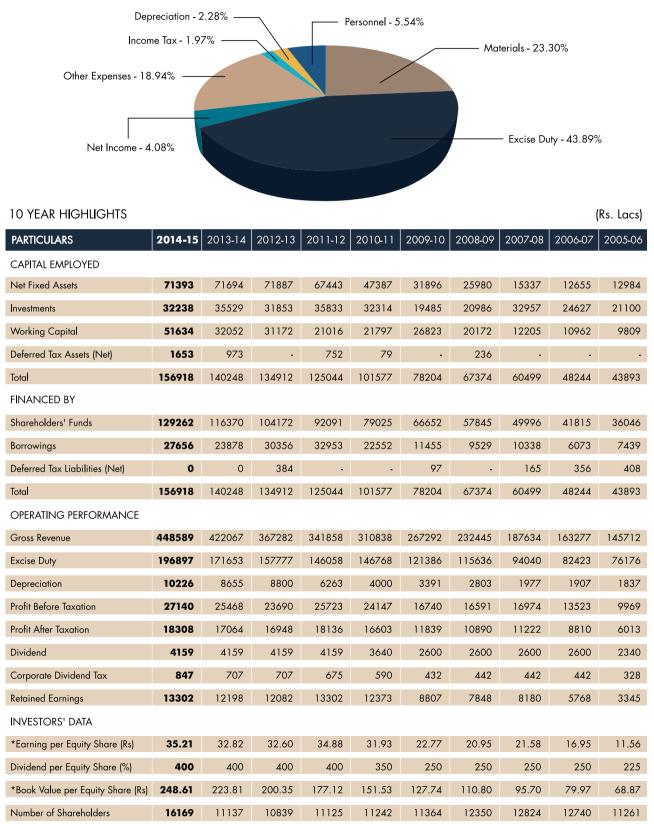
Book Value per Equity Share (Rs.)



Market Capitalization (Rs. Lacs)



# Financial Highlights Revenue Distribution



\*Restated for face value @ Rs.2/- per share post split.



**DIRECTORS'** REPORT

### DIRECTORS' REPORT & MANAGEMENT DISCUSSION AND ANALYSIS

Your Directors feel privileged to present the 78th Annual Report on the business and operations of the Company along with the Audited Accounts for the financial year, ended March 31, 2015.

### **ECONOMIC ENVIRONMENT**

The global economic recovery continued to be uneven during 2014-15, with low inflation turning to deflation in many countries, while advanced economies reported a pick-up in growth and emerging and developing economies continued to slow down resulting in modest global economic growth of 3.4% in 2014. Geopolitical tensions, stagnation and deflationary conditions and continued slowdown in China with its consequent adverse impact on commodity prices, represents some of the key challenges to global economic growth for 2015 at 3.3%. Later in the year, it is expected that the US Fed and Bank of England will reverse the interest rate cycle leading to flight of capital to these regions. This is likely to further impact the emerging economies negatively.

Compared to the trends of other emerging and developing economies, the Indian economy showed some resilience with a growth of 7.4% in 2014-15 based on the new GDP series as compared with 6.9% in 2013-14. There was room for cheers on some counts, as there was a 2.8% growth in IIP, robust 10.6% growth in the services sector, declining rate of inflation (both CPI and WPI), containing fiscal deficit within the target at 4% of GDP, narrowing current account deficit at 1.3% of GDP, improved investor sentiment, healthy foreign exchange reserves at over \$ 350 billion, stable Rupee and rising stock markets. IMF has estimated that India will grow at 7.5% in 2015-16 and therefore, India shall continue to remain, one of the fastest growing economies in the world. However, if India has to live up to its true potential, there is an urgent need to focus on job creation and skill up-gradation to address the issue of unemployment, especially among the youth. And, for this the manufacturing sector needs to get the required boost and the Modi government's call for 'Make in India' should travel beyond the realms of mere sloganeering.

### **TOBACCO INDUSTRY**

The global tobacco industry accounted for a 4 % growth with a value of USD 816 billion in 2014; likewise the global cigarette industry saw a growth of 3 % i.e. USD 744 billion, keeping the value growth intact. Global cigarette volumes declined by about 0.4 % in 2014 which were driven by volume decline in North America and Europe by 4 % and 5 %, respectively. The industry's growth engine – Asia Pacific grew by 1 % in 2014.

New generation products such as electronic vaping devices (EVD) and nicotine gums are gaining global acceptance. Sales of e-cigarettes grew by 60 % globally in 2014 as consumers perceive this segment to be less harmful. Taking a cue from this, your Company has also forayed into the same category with the test marketing of "ZESTT" brand in Delhi – NCR.

The Indian cigarettes industry is passing through tough times. A significant part of the cigarettes value is comprised of excise and VAT, unlike other tobacco products. In the last 4 fiscal years, the weighted excise increased at about 18% year-over-year. Consequently, all companies are facing pricing and margin pressures. Yet, the industry has been successful in maintaining a value growth albeit at the cost of volume decline.

India's taxation policy and regulatory regime is somewhat skewed against cigarettes over the years. This has led to the share of legal cigarettes in overall tobacco consumption progressively declining from 21% in 1981-82 to about 12% in 2014-15 even as overall tobacco consumption has increased in India. According to a study by Euromonitor International, India is now the 5<sup>th</sup> largest market for illegal cigarette industry in the world and that the illegal cigarette trade accounts for nearly one-fifth of the overall cigarette industry in India.

# DIRECTORS' REPORT



Initially it was felt that the cigarette segment of 'length not exceeding 65mm' will rope in tobacco consumers from categories like bidi, khaini, chewing tobacco, gutkha, etc., but cumulative increase of 115% in excise duty in July 2014 and February 2015 has belied those hopes completely.

A dominant industry trend in India is that of polarization, wherein cigarette consumers are drifting from regular size towards either kings size segment or 64mm. This is also reflected in price bands where the premium and popular segments are being diluted with movement toward economy segment.

Indian leaf tobacco exports in 2014-15 fell way short of the target and were pegged at Rs. 5600 crore, even lower than last year's actual of Rs. 6100 crore.

### **Regulation and Taxation**

The regulatory environment is getting stricter by the day. For the fourth consecutive year, the Union budget in February 2015 hiked excise rates for cigarettes in the range of 12-22 per cent; the hike was even steeper in the range of 11-72 per cent as presented in the July 2014 budget.

The state government controlled VAT rates are also moving upwards. Share of VAT within total taxes to the cigarettes industry, has increased from 28 per cent in 2010-11 to 43 per cent in 2014-15. It is imperative that GST comes in to play from April 1, 2016 and streamlines the varied tax structure. It is imperative that revenue sensitive goods like cigarettes are subjected to uniform standard rates of tax applicable to general category of goods to ensure revenue buoyancy and rein in the growth of illicit trade. A multi-VAT regime promotes arbitrage and cross border trade which hurts the state governments and legal business infrastructure in receiving states.

There are several proposals under consideration by the government concerning regulations of tobacco sector. One such proposal relates to increase in size of graphic health warnings to cover 85% of the surface area of both sides of the pack as compared to the current requirement of covering 40% of the area of one side of the pack. This was originally mandated to be effective from 1<sup>st</sup> April, 2015, but is currently being examined by the Parliament Committee on Subordinate Legislation and therefore its implementation stands deferred. Others relate to amendments to COTPA to regulate in-shop and on-shop displays. It is also rumoured that the government is contemplating ban on sale of loose cigarettes.

Your Company, however, remains committed to regulatory adherence as a responsible corporate entity. Our endeavour is to seek harmony between legal compliance and efficient realizations from the business.

### **SEGMENTWISE PERFORMANCE IN 2014-2015**

### Cigarettes

The domestic cigarette industry continues to reel under pressure of increased indirect taxes with volumes declining by over 9% in 2014-15. Though your Company has witnessed decline in volume, it still was able to register a growth of 4.2% in terms of operating revenue from Rs. 3263 crore in previous year to Rs. 3400 crore. We have been able to increase volume in the 64 mm segment despite aggressive competitive moves, but kept a balanced mix of the lower margin 64 mm and the higher margin 69 mm segments.

Despite the challenging scenario faced by it, your Company is aiming for steady growth through balanced brand portfolio, consumer engagement programs, quicker response to environmental changes and datadriven decision making process. Multiple cross-functional integrated projects are currently underway towards making our brands consumer centric in the market place to gain market share.

In view of the pricing pressure on consumers, your Company has already enhanced its focus on more economical price points to regain volume growth. We are offering increasingly superior products at multiple price points which are affordable to various sections of society. Our effort will be to improve consumer satisfaction with our brands through quality and innovation, using the latest techniques in consumer research, R&D and manufacturing excellence.

### Tea

Domestic tea business remained subdued during the year with income lower at Rs. 102 crore against Rs.116 crore last year. Efforts were made towards premiumization of brand portfolio, leading to value