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GRASIM INDUSTRIES LIMITED
ANNUAL REPORT 1998-99



RE Very early in his career, long before the word globalization came into our everyday lexicon, he had foreseen the winds of change and staked the future of his business on a competitive, free market driven economic order. At a time when India's economy was glued with bureaucracy and taped with controls, his was a rather lone voice. But it was a voice that not only spoke, but also acted - decisively and with conviction.

For him, though globalization meant more than just geographic reach. He believed that a business could be global even whilst being based in India. Therefore, back in home territory, he drove single - mindedly to put together the building blocks to make his Indian businesses a global force.

It is this vision which, we believe, will prove to be one of his enduring legacies to Indian business. It is a vision which prompts the Indian entrepreneur to take a longer stride; it is a vision which makes the Indian entrepreneur dare - and maybe even dream; it is a vision that makes all of us proud to be a part of the new India in the making. Today let us pay homage to Shri Aditya Vikram Birla.



ADITYA BIRLA GROUP

ADITYA VIKRAM BIRLA, NOVEMBER 14, 1943 ~ OCTOBER 1, 1995

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Letter from the Chairman



"Going forward, Grasim will focus on the three business: Cement, Fibres and Textiles."

— Kumar Mangalam Birla,
Chairman, The Aditya Birla Group.

Dear fellow Shareholders,

GRASIM - IN FOCUS

The year 1998-99 was a landmark year in the history of Grasim strategically. The Company consolidated its cement businesses by acquiring the cement operations of Indian Rayon and Industries Limited (IRIL). In return, Grasim assumed a portion of IRIL's debt associated with these assets and issued equity to shareholders of IRIL.

Additionally, Grasim acquired fresh cement capacities in the Southern and Western regional markets during the year. It acquired a strategic 62.42% stake in Shree Digvijay Cement Company Limited in Western India and a 100% stake in Dharani Cements Limited in South India.

These acquisitions, together with a planned 9 lacs tonnes per annum green field cement capacity in Tamil Nadu, elevates Grasim to the 3rd largest producer of cement in India. With this consolidation, Grasim now has grown into a leading national player with a formidable market position and better logistics management. This will ensure enhanced margins and increased value to shareholders.

Operating Performance

It was a challenging year for us operationally. The continued slow down in the economy and melt down of the Asian markets affected the performance of all our major businesses viz., cement, fibre and sponge iron.

The sluggishness in the economy and lack of any pick-up in the infrastructure sector led to a severe demand contraction in the cement and steel sectors. In turn, this resulted in pressure on prices in these sectors. Meanwhile, the fibre business suffered on account of a downturn in the textiles business and increased price competition from substitute fibres. Keeping this difficult environment in mind, Grasim focused on improving operational efficiencies and reducing costs to ensure a satisfactory performance for the year.

Revenues grew by 7.5% year-on-year to Rs.4,325 Crores, including income from the cement operations of IRIL transferred to the Company with effect from 1st September, 1998. Operating profits declined marginally by 1.8% year-on-year to Rs.563.9 Crores. Margins declined due to lower sales volume and realisation in the viscose staple fibre and sponge iron businesses. The cement division, however, reported a sharp improvement in operating margins due to improvements in operational efficiencies and focus on cost reduction. Better realisation of synergies with the consolidation of cement business during the year also contributed towards improved margins at the cement division.

Outlook

Going forward, Grasim will focus on three businesses: Cement, Fibres and Textiles. The cement business is the platform on which Grasim plans to build shareholder value in future.

Cement

Grasim is now a major player in the Indian cement industry. Our strategy for the cement business is three-fold: improve asset utilisation, control costs and capitalise on opportunities that emerge as a result of the consolidation taking place in the cement industry.

The Company's national presence and strong brand equity will allow it to improve utilisation of its existing cement assets. Importantly, the consolidation has realised better economies of scale, improved logistics and operational synergies. Grasim intends to fully utilise these benefits to reduce costs meaningfully. The on-going consolidation in the cement industry will throw-up opportunities for the Company. With its national presence and access to strong cash flows from the fibre business, Grasim is uniquely positioned to leverage off the opportunities thrown up in the consolidation process.

Fibre

Grasim's fibre business is a significant cash generator. The Company is one of the largest and lowest cost manufacturers of viscose staple fibre (VSF) globally. Substitute fibres and changing fashion trends have resulted in slow growth in the VSF industry. Given such an environment, the Company's strategy is two fold: (1) improve volumes through application development and tapping of new export markets and (2) maximise long-term cash flows through continued cost control. The Company's recent investments in R&D and Kharach plant assets will contribute significantly towards this end.

Textiles

Grasim has built significant brand equity in the suiting fabrics market. Grasim's "Gwalior Suitings" and "Graviera" brands have been successfully built on a distribution network that spans over 185 franchisee showrooms. Grasim plans to push value-added products through the distribution network built over the years. The Company intends to sharpen its focus on the premium end of the suiting fabrics market, given the fiscal advantages and resultant competition from the unorganised sector in the lower end of the market. Lastly, the Company is exploring opportunities in the ready-made segment to further exploit its brand and distribution assets consciously built over the years. In so doing, we expect to deliver increased value for the shareholders.

THE ADITYA BIRLA GROUP - IN PERSPECTIVE

Turning to the challenges for the group as a whole, the coming millennium brings with it unprecedented change. A more liberal economic environment has dramatically altered the scenario. The forces of liberalisation and consequent competition will only accelerate in future, more so with India being a member state of the WTO. It will also mean that there will be a shift of focus from suppliers to consumers. Such a scenario has resulted in a different set of expectations. Strategies, hitherto thought as exemplary, may or may not work going forward. We recognise that for sustained growth and maintaining excellence different strategies are required.

As we are not insulated from such forces of change, we are embracing fundamental changes within the Group to prepare ourselves for the coming millennium. We are embracing an ethos that focuses on value-added growth and not just growth for the sake of asset growth. To attain this objective, we have redefined our business approach. We have taken a number of measures, which are broadly categorised along three dimensions, namely, strategic thrust, structural initiatives and systems adoption.

Strategic Thrust

The two elements of our strategic thrust are fundamental value creation and sharper business focus.

Fundamental value creation

During the last year, we embarked upon an in-depth review of our portfolio of businesses. We are close to concluding our analysis. Our intent is to move out of businesses that do not create value, restructure existing businesses for enhanced focus so as to realise better synergies, and build businesses with value creation potential. Towards this end, we have temporarily shut down the Sea Water Magnesia plant of Indian Rayon and have closed one of the Caustic Soda plants of Grasim Industries Limited.

Towards a sharper business focus

We are in the process of restructuring all our businesses towards enhanced focus, better synergies and improved operational efficiencies.

"Grasim is one of the largest and lowest cost manufacturer of VSF globally"

We will not, in future, diversify into unrelated areas in our companies. This is in line with the ethos of value added growth that we spoke about earlier. Each company will focus on its core businesses. If growth opportunities are not found in such businesses, we will use cash generated from such businesses in a manner that increases shareholder value. This would include aggressive pay-out policies and/or buyback programmes.

In addition to not having any unrelated diversification in the future, we are firm that we will not invest in companies that do not further the core businesses of the investor company. To this extent, we are actively exploring possibilities to unwind investments already made by operating companies in unrelated ventures. The unwinding process, however, is arduous on account of tax and fiscal ramifications. Despite being successful in unwinding investments made by the Group's operating companies in the financial services business, tax and fiscal constraints may slow the progress on this front.

Our Structural Initiatives

It is essential that we align the energies of the group with the expectations of our shareholders and to this end, our focus is on re-energising the organisation and internalising the concept of value creation. This will mean that we will be continuously benchmarking ourselves against global best practices with the ability to monitor the results on an ongoing basis.

We feel that large organizations such as ours need to be "nimble-footed" to compete in the market place. Towards this end, we are aggressively pushing programs to attract and retain fresh talent and nurture existing intellectual capital across the organization. Among these are the Group Management Trainee Scheme which enlists MBAs, engineers and Chartered Accountants from premier institutions; secondments abroad, international recruitment and management succession plans.

Additionally, we have recruited some of the best people from professionally managed corporations to head senior positions within the Group. More than 50 professionals, including two Senior Directors, have joined our Group in the last two years. They have helped strengthen our intellectual capital base.


The Systems Front

Our business approach focuses on institutionalizing formal processes and procedures for realizing better value for our shareholders. The systems approach will complete the virtuous circle that we have adopted to create value for our shareholders.

These changes, in our view, will enable us to step proactively into the new millennium taking the challenges head on and seizing emerging opportunities towards achieving our group vision - **To be a premium conglomerate with clear business focus at the corporate level.**

Thank you.

Yours sincerely,



Kumar Mangalam Birla

Management Discussion and Analysis

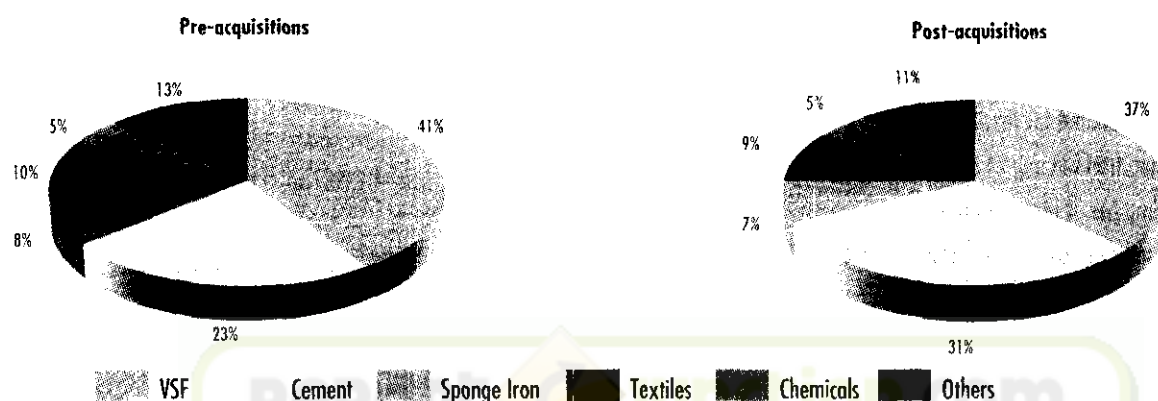
OVERVIEW

The continued slowdown in the economy and melt down of the Asian economies had an adverse impact on **Grasim Industries Limited** during 1998-99. The cement and sponge iron businesses witnessed sluggish demand and pressure on prices due to the lack of a pick-up in the infrastructure sector. The fibre business came under pressure due to a downturn in the textiles business and increased price competition from substitute fibres. Viewed in such a challenging business environment, the Company's performance is satisfactory and was primarily due to improvements in operational efficiencies and realisation of meaningful synergies with the consolidation of core businesses.

Gross revenues went up 7.5% year-on-year (YoY) to Rs.4,325.1 Crores in 1998-99. This includes income from the cement operations of Indian Rayon and Industries Limited (IRIL) which were transferred to the Company effective 1st September, 1998. However, operating profit declined by 1.8% YoY to Rs.563.9 Crores in 1998-99, due to lower sales volume and realisation in the sponge iron and viscose staple fibre (VSF) businesses. The cement division reported sharp improvement in operating margins during the year.

STRATEGIC MOVES TO ENHANCE SHAREHOLDER VALUE

Business mix



It was a landmark year in the history of Grasim strategically. The Company consolidated its cement operations, acquired fresh cement capacities and commissioned the second phase of its VSF plant at Kharach, Gujarat during the year. The criteria for this was single - "Enhancement of Shareholder Value".

CONSOLIDATED CEMENT OPERATIONS...

The Company consolidated its cement business by acquiring the cement division of Indian Rayon. Under the Scheme, the largest ever in India, Grasim acquired the cement business of IRIL along with a portion of debt associated with the business. In return, Grasim issued equity to shareholders of IRIL. With this acquisition, Grasim has a strong platform to grow on a national basis and become a leader in the cement industry. The consolidation improves the Company's market position, ensures better logistics and eliminates duplication. These, in turn, should result in improved margins and enhanced value in future.

... ACQUIRED FRESH CAPACITIES

Through a strategic 62.42% stake in Shree Digvijay Cement Company Limited (SDCCL), Grasim has enhanced its cement capacity by another 12.5 lac tonnes per annum (tpa) during the year. The stake gives Grasim access to SDCCL's captive port at Sikka, Gujarat. The port access will allow Grasim to import high quality coal for its cement operations. In turn, this is expected to improve energy efficiency and reduce costs for Grasim's cement operations.

The Company has commenced construction of a new 900,000 tpa cement plant in Tamil Nadu during the year. This new plant is expected to go on stream during the last quarter of 1999-2000. Grasim's capacity, including the capacities of SDCCL, Dharani Cement Limited and the new plant at Tamil Nadu, will stand at 107.2 lac tpa elevating Grasim to the 3rd largest cement producer in India.

COMMISSIONED SECOND PHASE OF VSF PLANT

The Company commissioned the second phase of its VSF plant at Kharach, Gujarat during March 1999. The second phase of the plant has an installed capacity of 30,000 tpa. This state-of-the-art plant enables Grasim to enhance its product quality and give it a strong competitive edge in the market.

SEGMENTAL REVIEW AND ANALYSIS**VISCOSE STAPLE FIBRE****Review of Operations**

	1998-99	1997-98	% Change
Production (Tonnes)	164,355	174,281	(-) 5.7
Capacity Utilisation (%)	79.0	94.5	(-) 16.4
Sales Volumes (Tonnes)	164,130	171,148	(-) 4.1
Gross Turnover (Rs. Crores)	1,296.0	1,350.5	(-) 4.0
Average Net Realisation (Rs./Kg.)	66.1	66.7	(-) 0.9
Operating Margin (%)	32.2	35.9	(-) 8.6

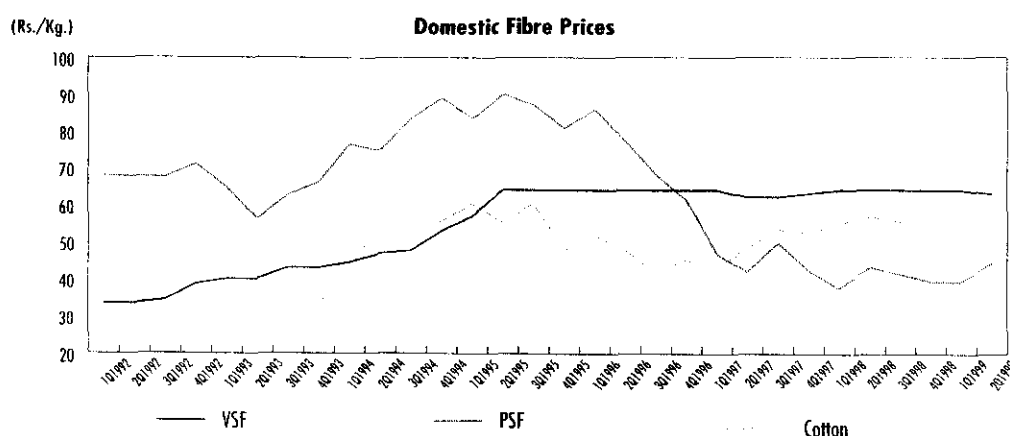
The operations of the VSF business remained under pressure for the second consecutive year, primarily due to

- Sluggish demand for textiles
- Declining trend in export of VSF based yarn and textiles
- Huge imports of blended textiles
- Increased price competition from substitute fibres

The slowdown in the economy led to poor demand for textiles in the country. Further, a slowdown in global trade and increased price competition from South East Asia affected export of VSF based yarns, fabrics, made-ups and readymade garments. These factors together put pressure on domestic off-take of VSF during the year.

The fibre business suffered also on account of intense price competition from substitute fibres, mainly from polyester staple fibre (PSF). Given weak global PSF prices and continued domestic surplus, PSF manufacturers in India cut prices by about 8% during 1998-99. Taking advantage of this, manufacturers of polyester-viscose yarn changed the blend ratio in favour of PSF. In so doing, they affected the domestic off-take of VSF during the year.

Consequently, domestic VSF consumption dropped by 5% in 1998-99. Grasim, being the market leader, was also impacted by the demand contraction. The Company's sales volumes dropped by 4.1% YoY to 164,130 tonnes in 1998-99.



The Company maintained its average realisation at Rs.66/Kg. (down only 0.9% YoY), along with prices throughout the year barring some promotional rebates offered towards the year-end. This was deliberately done to generate additional volumes following the commissioning of second phase of VSF plant at Kharach, Gujarat.

Costs and profitability

Reflecting lower volumes, marginally lower realisation and higher pulp prices, operating margins dropped from 35.9% in 1997-98 to 32.2% in 1998-99. The Company's average cost of VSF production moved up 4.2% YoY in 1998-99 on account of a 4.3% rise in the cost of rayon grade pulp and lower asset utilisation. The rise in production costs would have been even higher but for further improvements in the consumption norms of key inputs and rationalisation of manpower costs. The pulp consumption ratio has been brought down from 1.040 tonnes per ton of VSF in 1997-98 to 1.034 tonnes in 1998-99.

SECTOR OUTLOOK

The outlook for the VSF industry appears positive. Signs of improvement in the domestic off-take are evident. Overall volumes have been on the rise since the first quarter of the calendar year 1999.

The price of PSF, in both domestic and global markets, is on the rise due to a sharp rise in the international prices of crude oil and other petroleum products. It has resulted in narrowing the gap between VSF and PSF prices. This augurs well for the VSF industry since an increase in the price of PSF is likely to incentivise polyester-viscose yarn manufacturers to change the blend ratio in favour of VSF. Further, with a pick-up in the economic activity in Asia, exports of VSF based yarns, fabrics, made-ups and readymade garments are likely to improve as well.

VSF prices, however, are expected to remain under pressure. The ongoing sluggishness in the domestic textiles industry and threat of cheaper imports and substitution is expected to put continued pressure on VSF prices. The profitability of domestic VSF manufacturers will thus depend on improved asset utilisation and ability to cut costs further.

OUTLOOK FOR GRASIM'S FIBRE BUSINESS

Grasim is a major player in the VSF industry and has one of the lowest cost structures in the world. Going forward, the Company will focus on maintaining its cost competitiveness and embark on an aggressive strategy to improve asset utilisation. A more focused marketing strategy aimed at enlarging the market for VSF and penetrating existing markets better has been evolved.

Cost focus

Grasim has successfully implemented a zinc free process in the manufacturing of VSF at Nagda and Harihar. This will reduce the cost of production due to reduction in the consumption of pulp, zinc and other effluent treatment chemicals. Additionally, the Company has ensured better control over the supply of its key input, Rayon Grade Wood pulp, through a 33% share of output in AV Cell Inc., the Company's joint venture in Canada. The acquisition ensures sustained supply of quality pulp at an attractive international price. Alongside its continued focus on improvements in consumption norms should enable the Company to bring down costs further.

Improved asset utilisation

The Company's strategy for improving volumes and asset utilisation focuses on expanding the market through applications development and export volumes.

- **Application development**
Given the declining trend in VSF consumption in traditional areas, identification of new applications, capitalising on VSF's superior properties of better feel, comfort and hygiene, assumes significance.
- **Strengthening of exports**
The prospects for VSF exports are brightening due to the erosion of developed countries' cost effectiveness in this industry. The Company is promoting speciality fibres, such as spun dyed, micro and macro denier fibres to increasingly strengthen its leading position in these areas.

CEMENT**Review of Operations**

	1998-99	1997-98	% Change*
Production (Tonnes)			
- White Cement	131,979	—	—
- Grey Cement	5,823,378	4,709,469	23.6
- Grasim Cement Division	4,286,832	4,709,469	(-) 9.0
- Indian Rayon's transferred business	1,536,546	—	—
Sales (Tonnes)			
- White Cement	133,660	—	—
- Grey Cement	5,877,704	4,696,473	25.1
- Grasim Cement Division	4,332,329	4,696,473	(-) 7.8
- Indian Rayon's transferred business	1,545,375	—	—
Average Ex-factory Realisation (Rs./Ton)			
- Grey Cement	1,234	1,118	10.4
- White Cement	4,495	—	—
Turnover (Rs. Crores)			
- Grey Cement	1,238.2	955.6	29.6
- White Cement	80.1	—	—
	1,318.3	955.6	38.0
Operating Margin (%)			
- Grey Cement	11.2	4.0	—
- White Cement	34.0	—	—

* Figures for the current year are not comparable with those of previous year. The transfer of IRIL's cement business was effective from 1st September, 1998 and hence previous year's figures do not include that of IRIL.

The performance of the cement division has been encouraging. The Company improved operating margins despite pressure on volumes, rise in input costs and pressure on prices. Improved consumption norms and better realisation of synergies through consolidation of the cement business enabled it perform better.

Improved volumes, but lower asset utilisation

The Company has reported a 25.1% YoY growth in cement sales volumes at 58.8 lac tonnes in 1998-99, largely due to the addition of 15.5 lac tonnes of cement to the Company's sales following the transfer of IRIL's cement business effective 1st September, 1998. Grasim's cement division has reported a 7.8% YoY drop in sales volumes at 43.3 lac tonnes as against 47.0 lac in 1997-98. Reflecting this, average plant utilisation dropped from 90.56% in 1997-98 to 83.79% in 1998-99 mainly because of :

- **A slowdown in the domestic consumption**
Domestic demand grew by 7.9% in 1998-99 as against 8.4% in 1997-98. The reduced growth is on account of a slow down in construction activities, lower project investments by corporates and a cut in Government spending during the year. The growth in real gross capital formation was only 2.5% in 1998-99 as against 3% and 9.5% in the last two years. Net project investments by corporates were lower by 34% YoY at Rs.56,000 Crores in 1998-99.
- **Sharp rise in domestic capacities**
The cement industry witnessed an addition of 74.5 lac tpa capacity during 1998-99, an increase of 9.5% to the industry capacity. More importantly, Grasim's key markets, viz., the South and West, witnessed an addition of 41 lac tpa and 33.5 lac tpa capacities respectively