



**GRASIM INDUSTRIES LIMITED
ANNUAL REPORT 1999-2000**

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The Chairman's Letter to Shareholders



Dear fellow shareholders,

GRASIM – IN FOCUS

Operational Review

It was a satisfactory year for Grasim operationally. Its key businesses namely, viscose staple fibre (VSF) and cement demonstrated significant improvement benefiting from a turnaround in the economy, aggressive marketing, brand promotion efforts and the positive impact of the restructuring initiated last year. Sponge iron also put in a commendable performance during the year.

The VSF division reported improved volumes due to better export of VSF based downstream products and concerted marketing efforts. The pickup in the economic and industrial activity as well as a turnaround in the housing and construction sectors proved advantageous for the cement division. Despite weak prices, the margins remained stable due to gains from cement restructuring. The sponge iron division did a smart turnaround aided by a positive industry environment, subdued competition and benefits of several strategic moves made earlier. It remained a challenging year for the textile business, which suffered from sluggish demand, intense price competition and a rise in input costs.

Gross revenues have grown 16% year-on-year to Rs.4,982 Crores in 1999-2000. Operating margins remained flat, despite serious cost reduction measures, on account of higher input costs and lack of pricing power in the VSF and cement businesses. Operating profits have gone up 13% from Rs.678 Crores to Rs.756 Crores while net profits soared by 42% year-on-year to Rs.233 Crores in 1999-2000.

Strategic Focus

It was a year of consolidation strategically. Grasim completed the cement restructuring process and concentrated on reaping its benefits. The 900,000 TPA cement plant in Tamil Nadu has commenced trial operations during the year. Commercial production went on stream in April 2000.

The Company has decided on the permanent closure of its pulp and fibre plants at Mavoor, Kerala consequent to continuing problems of raw material availability, increasing dependence on heterogeneous woods and the resultant adverse impact on fibre quality, cost and realisation. The plant operations remained suspended from May 1999. Its permanent closure will enable Grasim prevent any further erosion in shareholder value.

Financial restructuring has been accomplished. Aggregate debts worth Rs.631 Crores were re-negotiated and coupons reset at around 11%-14.5% as against 15%-18.5% earlier. The positive impact of this move is partly reflected in the current year. Its benefits will accrue over the next 3 years.

Outlook

As mentioned in my letter last year, Cement, and Fibre will be the focus areas going forward. The cement business will continue to be the platform for building shareholder value in future.

Cement

We are excited about the growth opportunities in the cement industry. The positive outlook for the economy, accelerating levels of industrial activity and the expected augmentation in the housing sector augurs well. The growing focus on development of infrastructure will further strengthen long-term prospects of the industry. Our strategy for cement is three pronged: Improve capital productivity, enhance margins and reduce costs further.

Improving capital productivity and optimising use of physical, brand and distribution assets is the first leg of our strategy. We will achieve this by increasing market share in profitable regions, focusing on the retail segment and value added products and by expanding capacities cost effectively. To ensure profitable growth in future, we will move close to customers.

"It was a year of consolidation strategically. Grasim completed the cement restructuring process and concentrated on reaping its benefits".

We will strengthen our logistics management to reduce freight costs and concentrate on further lowering of energy costs in future. To do so, use of alternative energy sources, increasing share of imported coal and better process control is the route chosen by us.

Grasim will aim to retain its brands as “brand leaders” in their respective markets to ensure higher realisation and better margins. It will also look for opportunities emerging from the industry consolidation process, leverage its market position and strong cash flows to ensure profitable growth in future.

Fibre

The outlook for the fibre business is positive and is predicated on the rising trend in the export of VSF based yarns, fabrics, made-ups and garments as well as increasing preference for VSF rich blends in the local markets. Regardless of this positive outlook, industry volumes are expected to grow only modestly due to the mature nature of the VSF industry. Profitability then will depend on improved asset utilisation and ability to pass on cost increases to customers. Given such an environment, Grasim’s strategy is to maintain its cost leadership and improve asset utilisation through market enlargement and application development in future.

Grasim is the market leader and is amongst the lowest cost manufacturers in the world. It will focus on process improvements, input cost reduction and improvement in consumption norms to increasingly tighten cost structure. It will beef up its marketing and distribution network and concentrate on improvement in blend ratio to ensure higher volumes in future. Energies will be channelised on development of new applications by leveraging superior properties of VSF in terms of better feel, hygiene and comfort. These measures will enable Grasim improve asset utilisation and margins in future.

Textiles

The outlook for the textile sector remains challenging. The branded fabrics market is likely to remain stagnant and suffer from price competition even in the future. The domestic over-capacity, commoditisation of the suiting fabrics market and increasing preference for ready-to-wear products will heighten the pressure. In such an environment, Grasim will lay stress on improving efficiency and leveraging brand equity for stable returns. Our strategy is to enhance market share, strengthen distribution network and improve efficiency.

We will invest in our existing strong brands, “Graviera” and “Grasim suitings”, through aggressive marketing and brand promotion. Product innovation and design development will be focused on for improved market share and better volumes. Amplifying our distribution network and better management of show rooms will be a priority to maximise the benefits of the brand building efforts. Efficiency improvement for cost reduction and enhanced margins will be another area of attention going forward.

Summary

In essence, the Company’s growth will be driven by the cement business and VSF will remain a key contributor to earnings in future. The expected positive outlook for the cement and VSF coupled with well crafted strategies will ensure improved volumes and profitability in our core area of operations and enable us deliver enhanced value in future.

At this juncture, I would like to take the opportunity of placing on record my appreciation of the employees and the management team at Grasim. Their dedication and commitment have enabled us reap the benefits of the upturn in the economy and our core sectors optimally and better realise synergies of the restructuring efforts initiated last year. Our employees are, and will continue to be, integral to our success even in future.

THE ADITYA BIRLA GROUP – IN PERSPECTIVE

I would now like to brief you on some of the measures taken by us at the Group level. As you are aware, tectonic shifts are changing the very contours of the economic and business environment, regardless of geographic boundaries. Digitalisation, deregulation, globalisation and investor activism have altered the corporate landscape and ushered in an era of discontinuity. Organisations have had to reconstruct their business architecture and we, at the Aditya Birla Group, are no exception. To face these challenges, we have been constantly re-inventing our Group over the last few years.

"The Company's growth will be driven by the Cement business and VSF will remain a key contributor to earnings in future. The expected positive outlook for the Cement and VSF businesses coupled with well crafted strategies will ensure improved volumes and profitability in our core area of operations".

Our objective is to ensure success and deliver sustained value for our shareholders, customers, employees and the community at large.

A slew of proactive measures have been unveiled, riding on our renewed strategic thrust, innovative structural initiatives and contemporary systems adoption. In my letter last year, I had shared several of these. Today, I wish to keep you abreast of the progress achieved in these areas and the growth trajectory that we will traverse in this new millennium.

Renewed Strategic Thrust

Fundamental value creation and a razor-sharp business focus continue to be the pillars of our strategic thrust. Consequent to the in-depth review of the business portfolio by the Boston Consulting Group, we have identified the core business for each of our Companies. Businesses have been evaluated against stringent value-creation criteria. We have made a conscious decision to build and grow only those businesses that have high value creation potential.

While in the past, our portfolio focused heavily on capital-intensive manufacturing businesses, the future may see us move increasingly into knowledge-based, brand-management and service sectors, where again we will scout for a premium position – a position of leadership. At the portfolio level, we will continue to look into some of the businesses that are futuristic and add to enhancing shareholder value.

Knowledge-based industries offer enormous growth. This sunrise sector is far less capital intensive and has the advantage of enhanced value creation in a much shorter time frame. Acquiring management control in Learning Byte International by the overseas companies of the Group and the strategic alliance with Lawson for setting up the Lawson Competency Centre by Birla Consultancy and Software Services, a division of Grasim Industries Limited – are forward steps in this direction. Similarly, the acquisition of Madura Garments by Indian Rayon & Industries Limited has overnight catapulted the Group to the top-of-the-league in the branded apparels sector. Importantly, these strategic moves have significantly enhanced value for shareholders of Indian Rayon and Grasim.

In the new economy, cellular services offer a significant growth platform in the telecom sector that is rapidly consolidating. Our strategic alliance with Tata Telecommunications is a move that will help take our telecom business ahead.

To bring in sharper business focus in each of our businesses, so as to realise better synergies, we have resorted to restructuring, where necessary. Restructuring of the cement business has not only created synergies and simplicity of operations, but has given us one resounding voice in the market place, propelling our growth from one strong platform vis-à-vis fragmented units in operation.

Structural Initiatives

To institutionalise enabling processes that help us benchmark with the best in the world, to align the interest of shareholders and employees, and to better manage capital, we have chosen CVA (Cash Value added) as our measurement metric. It is the cornerstone of the “value management” architecture, to which I am personally committed. CVA helps us focus on the three key aspects of value creation, i.e., profitability, asset productivity and growth. Simply put, CVA is a structured, exhaustive process that entails understanding business variables in depth and quantifying their effect on value creation. This process enables us put our finger on the key value drivers in every single activity that we do.

In response to the changing times, we are continuously striving to make the Aditya Birla Group as market-driven and agile as possible. To do so, we are doing our utmost to create an organisational ambience where talent can bloom. Unleashing people power in a planned manner through a focus on their growth, development and learning is our priority.

"While in the past, our portfolio focused heavily on capital-intensive manufacturing businesses, the future may see us move increasingly into knowledge-based, brand-management and service sectors, where again we will scout for a premium position – a position of leadership".

Our thrust is on developing the Group's intellectual capital. Infusion of fresh blood and talent at all levels coupled with the creation of "thought leaders" has gained momentum.

Six directors have been inducted at the Corporate level and professionals of high calibre have been recruited. The retirement policy has been implemented and succession plans are in place. Building, developing and upgrading competencies across the Group through training continues as an ongoing activity. These steps will not only help us nurture leaders, but capable, self-assured colleagues across all levels. The push on growing intellectual capital in the Group will propel it to new heights of value-creation in future.

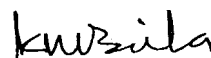
Contemporary Systems Adoption

We are institutionalising processes to realise better value for our shareholders. To create a wired organisation, which will accentuate the quality of communication and information flow throughout the Group, we have set up the "Aditya Birla Information Highway". "Gyanodaya" our temple of learning has gone on-stream. It will help us constantly upgrade our knowledge base.

These proactive measures, in my view, will help weave our Group into one seamless organisation, with the singular aim of creating value for our shareholders in 21st century and beyond.

Thank you,

Yours sincerely,



Kumar Mangalam Birla

Mumbai
28th April, 2000

"Our thrust is on developing the Group's intellectual capital. Infusion of fresh blood and talent at all levels coupled with the creation of "thought leaders" has gained momentum".

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Management's Discussion and Analysis

OVERVIEW

It was a satisfactory year for Grasim operationally. Its key businesses demonstrated substantial improvement on the back of an economic recovery and improved demand for key products namely, Viscose Staple Fibre (VSF), Cement and Sponge Iron. Aggressive marketing efforts, relentless focus on efficiency improvement and cost control measures contributed towards improved performance during the year.

The Viscose Staple Fibre (VSF) business reported improved volumes benefiting from the rising trend in deemed exports, increase in prices of substitute fibres and concerted marketing efforts taken by the Company. The Cement business improved volumes following a pick-up in the economy and with the benefits of restructuring initiated last year. The Sponge Iron business reported turnaround in operations consequent to the modest recovery in the steel sector, subdued competition and reduced threat of cheaper substitute imports.

Reflecting these, gross revenues grew by 15% year-on-year (YoY) to Rs.4,982.3 Crores in 1999-2000. Operating margins remained flat despite improved asset utilisation. The lack of pricing power in VSF and Cement businesses offset the impact of serious cost reduction measures taken by the Company. Operating profits grew from Rs.678 Crores in 1998-99 to Rs.756 Crores in 1999-2000, while net profits soared 42% YoY from Rs.164 Crores to Rs.233 Crores during this period.

STRATEGIC MOVES TO ENHANCE SHAREHOLDER VALUE

Strategically, it was a year of consolidation. The Company successfully completed the cement restructuring process initiated last year and concentrated on realising its benefits at the Cement division. Other strategic moves made by the Company to enhance value included the commissioning of a new cement plant in Tamil Nadu, restructuring of the existing debt, closure of pulp and VSF plants at Mavoor, Kerala.

Cement Restructuring

The Company completed the cement restructuring process during this year. The necessary approvals from the High Courts of Gujarat and Madhya Pradesh for the acquisition of the cement division of Indian Rayon and Industries Limited were received and equity shares were issued directly to the shareholders of Indian Rayon. Grasim concentrated on realising synergy gains by realigning resources, centralising marketing and procurement activities and rationalising the marketing and distribution structure. The realised benefits were in excess of its initial estimates and had telling impact on the divisional volumes and profitability in 1999-2000.

Commenced Trial Runs at "Grasim South"

The Company completed the construction of a new 900,000 tpa cement plant in Tamil Nadu during the year. The plant was set up at the cost of Rs.315 Crores, including the cost of a 12 MW diesel generating set and modvat benefits. Trial runs at the plant commenced during mid-March 2000. Commercial production started during April 2000. The new plant is equipped with an auto/robot lab system to ensure uniform and consistent quality of cement produced. This together with Grasim's existing strong brand equity will enable it to strengthen its presence in the high growth, profitable markets of Tamil Nadu and Kerala.

Restructured Existing High Cost Debt

The Company focused on financial restructuring as well. Given the high cost nature of its existing debt and risk associated with the commodity nature of its businesses, Grasim took serious efforts in this regard. It successfully restructured Rs.630.7 Crores of debt during the year.

- The Company pre-paid debts worth Rs.327 Crores carrying a coupon of 15%-18.5% and refinanced the same at 14.5% as a composite package. This resulted in a savings of Rs.11.5 Crores during the year under review and will result in a further savings of Rs.10 Crores during the next three years.
- The coupon on XII Series Non-Convertible Debentures of Rs.26.67 Crores was reset at 13.25% against original coupon of 18%, effective July 1999. These debentures are due for redemption in June 2000 and the coupon reset will thus result in net savings of Rs.1.10 Crores over the remaining life of these debentures.
- Debts worth Rs.277 Crores were re-negotiated and coupon reset at 11% by making certain upfront payments. These debts carried a coupon of around 17%-18%, besides redemption premium in one case. The reset of coupon, net of upfront payment made, will result in an interest saving of Rs. 11 Crores over the remaining life of the debt. The new rates will be effective 1st April 2000 and the impact of reduced coupon will be seen during the current financial year.

Suspended Operations at Mavoor

The Company suspended operations at the pulp and fibre plants at Mavoor, Kerala from 15th May 1999 and have filed an application for the permanent closure. This was due to continuing poor availability of committed quantities of quality wood from the State Government and increasing dependence on heterogeneous wood, which impacted the quality of dissolving pulp and VSF therefrom and resulted in increased cost of production.

The Company received less than 60% of contracted wood supplies during last 6 years, despite a subsisting agreement with the Kerala Government. As a result, the Company was compelled to procure even unsuitable raw material from neighbouring states paying huge transportation and other costs. The use of heterogeneous wood affected the quality of pulp and fibre adversely and forced Grasim to liquidate inventory at discounted rates. The pulp and fibre units incurred huge losses leading to significant erosion of Shareholders value.

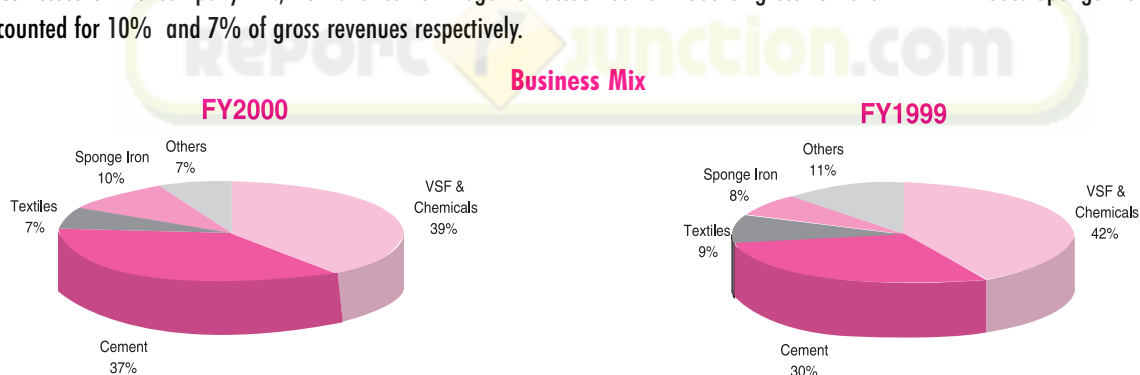
There appeared no definite signs of improvement in wood supplies from the Kerala Government to sustain operations, to produce quality pulp and disposal of poor quality VSF, produced at higher costs, was posing a serious problem. Grasim therefore decided to suspend operations in May 1999 and opted for permanent closure of Mavoor plants. The State Government has rejected Grasim's application for permanent closure during October 1999 and a review petition has been filed already. The operations at the pulp and fibre units, in the meantime, remain suspended.

Rationalisation of Work Force at the Fibre Division

To improve margins through productivity improvements, a voluntary retirement scheme (VRS) was introduced at the VSF divisions in Nagda and Harihar as well as at the Engineering division in Nagda. The Scheme was opted by 748 employees, which together with on-going VRS at the textile division enabled the Company reduce employee strength by 854 at a total cost of Rs.18 Crores. The Company has decided to write-off the entire cost in one year and has thus taken a non-recurring charge of Rs.18 Crores in the revenue account in 1999-2000.

SEGMENTAL ANALYSIS AND REVIEW

The key businesses of the Company viz., VSF and Cement together accounted for 76% of gross turnover in 1999-2000. Sponge iron and textiles accounted for 10% and 7% of gross revenues respectively.



VISCOSE STAPLE FIBRE (VSF)

	1999-00	1998-99	% Change
Installed Capacity (TPA)	246,775 *	246,775	—
Production (Tonnes)	188,002	164,355	14.4
Sales Volume (Tonnes)	192,452	164,130	17.3
Gross Divisional Turnover (Rs. Crores)	1,688.2	1,614.1	4.6
- Viscose Staple Fibre & Allied Chemicals	1527.7	1360.6	12.3
- Pulp**	160.5	253.5	(-)36.7
Net Divisional Turnover (Rs. Crores)	1451.4	1388.8	4.5
- Viscose Staple Fibre & Allied Chemicals	1290.9	1135.3	13.7
- Pulp**	160.5	253.5	(-)36.7
VSF Realisation (Rs./Kg)	64.5	66.1	(-)2.4
Operating Margins before employee separation costs (%)@	31.4	33.4	—

* Includes 26,000 TPA capacity at Mavoor plant, which remains suspended

** Inter-divisional transfers

@ Operating margins calculated on the Divisional Net Turnover, excluding pulp, which is meant for captive consumption; Operating margins after employee separation costs is 30.5% vis-à-vis 33.4% last year.

Review of Operations

It was a satisfactory year for the VSF division, which reported improved capacity utilisation, higher sales volumes and revenues. Divisional operating margins suffered due to lower realisation, increased costs and fixed overheads of the Mavoor plant, which remained suspended from 15th May 1999.

Improved volumes

The sales volumes rose sharply from 164,130 tonnes to 192,452 tonnes in 1999-2000, reflecting an increase of 17% YoY. The upturn in volumes, after two years of sluggish growth, was due to improved export of VSF based yarns and textiles from India, availability of international quality VSF from the Company's Kharach plant and a favourable blend ratio in the domestic market.

The Company, in addition to its focus on greater field penetration and improvement in quality of service, endeavoured to segment the markets for warding off competition from cheaper substitute fibres. The Company divided user industry in smaller segments based on usage profile and developed specific marketing strategies for individual segments. These approaches enabled Grasim better market its produce to user segments and create a sustainable demand for its products. To improve service to customers and strengthen brand equity further, several regional and branch offices were setup.

Concurrently, efforts are being made to "Customaries the Commodity" for the first time in the global VSF industry by covering the entire value chain and establishing strategic alliance with the manufacturers of several VSF based end products on the merit of superior properties of VSF in terms of feel, comfort and hygiene. The strong growth in sales volumes, up 17% at 192,452 tonnes, is the reflection of the market acceptance of this new strategy and increased recognition of Grasim's focus on product quality and customer service.

Profitability under pressure

Despite buoyant market conditions, the Company followed a cautious pricing strategy to induce a favourable change in blend ratio (i.e., viscose rich PV blends) and higher volumes. This necessitated offering of appropriate incentives and promotional rebates for specific user segments, which in turn affected the overall realisation during the year. The average realisation declined from Rs.66.1/Kg in 1998-99 to Rs.64.5/Kg in 1999-2000, reflecting a fall of around 2% YoY.

Operating margins fell marginally from 33% in 1998-99 to 31% in 1999-2000, due to a marginal fall in the realisation and fixed overheads of the Mavoor plant. The Company's average cost of VSF production increased by 1.7% YoY due to increase in input costs and fixed costs of Rs.2.3 Crores per month associated with the Mavoor plant. The impact would have been even larger but for better asset utilisation, reduction in consumption norms and lower manufacturing costs.

Sector Outlook

The outlook for VSF industry is positive and is predicated on the likely strong growth in export of VSF based yarns, fabrics, made-ups and garments as well as a favourable trend of VSF rich blends in the domestic market. The recovery in Indian economy is likely to boost demand for textiles in the domestic market while recovery in the Asian economies is likely to strengthen prospects of direct as well as deemed exports of VSF based downstream textile products. This augurs well for the domestic VSF industry.

The forecast firm outlook for global petrochemical prices and resultant likely stabilisation of PSF prices at a higher level in the local markets will also contribute towards improved VSF demand locally. The reduction in gap between prices of VSF and PSF, together with the superior properties of VSF in terms of feel, comfort and hygiene is likely to induce viscose rich PV blends. Consequently we expect a healthy growth in VSF consumption and forecast demand to grow 4-5% annually over the next few years. This is significant considering the mature nature of the VSF industry globally.

The profitability of domestic VSF manufacturers rests on improved asset utilisation, cost cutting and the ability to pass on the increase in pulp prices to customers. VSF prices are likely to firm up during the year on the back of increasing prices of rayon grade wood pulp globally.

Outlook for Grasim's VSF Business

Grasim is the market leader with over 90% share of the domestic industry and is also amongst the lowest cost manufacturers in the world. Going forward, Grasim will focus on maintaining cost leadership and improving asset utilisation through market enlargement and application development.

Maintaining cost leadership

Grasim's strategy for improving cost competitiveness is two pronged: Focus on process improvements for reduced consumption norms and reduce cost of key inputs.

The Company successfully implemented a zinc free process, developed in-house, in the VSF manufacture at its Nagda and Harihar plants. This has enabled it to reduce consumption of pulp, zinc and effluent treatment chemicals and eventually result in lower manufacturing costs in future. The Company ensured better control over supply and cost of key input i.e., rayon grade wood pulp, by acquiring a 33% share of output from A V Cell Inc., Canada. The acquisition, made along with other VSF manufacturing units of the Aditya Birla Group last year has enabled Grasim source quality wood pulp at competitive prices. The benefits of these measures are already reflected in the operations and will accrue to the Company in future as well. The Company is continuously looking for such opportunities with the objective of improving process efficiencies and reducing costs further.

Improving asset utilisation

The Company's strategy for improving asset utilisation is pegged on three critical areas: Expanding the market through greater field penetration, applications development and strengthening of exports.

Greater field penetration

The Company will augment its marketing and distribution network and re-orient them towards segmented marketing approach to improve volumes. Concurrently, it is concentrating on improving quality of support to customers.

Application development

Given the declining trend in VSF consumption in traditional areas, identification of new application becomes critical for sustainable volume growth in future. To leverage superior properties of VSF in terms of better feel, comfort, hygiene and aesthetics, Grasim has established an Application Development Centre. The Company is exploring possibilities of strategic alliances with large manufacturers of downstream textile product manufacturers for commercial exploitation of such new applications and is confident of achieving positive results in the near future.

Strengthening of exports

The prospects of VSF exports are brightening due to the erosion of developed countries' cost competitiveness in the textile industry and continuance of DEPB incentives. The Company is promoting speciality fibres, such as spun dyed, micro and macro denier fibres as well to strengthen their direct and deemed exports. Energies will be concentrated on creating a brand equity for the Company's products in the International markets, leveraging on its wide product range, logistics, technical support and application development efforts.

CEMENT

	1999-00	1998-99	% Change
Grey Cement			
Installed Capacity (TPA)	82,00,000	82,00,000	—
Production (Tonnes)	83,96,110	58,23,378	44.2
Sales Volume (Tonnes)	84,15,088	58,77,704	43.2
Gross Divisional Turnover (Rs. Crores)*	1,757.5	1,246.0	41.1
Net Divisional Turnover (Rs. Crores)	1,461.3	1,041.3	40.3
Average Ex-Factory Realisation (Rs./Ton)	1,179	1,234	(-)/4.5
White Cement			
Installed Capacity (TPA)	360,000	360,000	—
Production (Tonnes)	240,492	131,979	82.2
Sales Volume (Tonnes)	240,014	133,660	79.5
Gross Divisional Turnover (Rs. Crores)	149.4	80.1	86.5
Net Divisional Turnover (Rs. Crores)	120.8	64.4	87.6
Average Ex-Factory Realisation (Rs./Ton)	4,577	4,495	1.8
Gross Divisional Turnover (Rs. Crores)	1,906.9	1,326.1	43.8
Net Divisional Turnover (Rs. Crores)	1,582.1	1,105.7	43.0
Operating Margins (%)**	13.3	13.5	—

Note: Figures for the current year are not strictly comparable with those of previous year. The figures for 1999-2000 includes performance of erstwhile cement division of Indian Rayon for the full year whereas the figures for 1998-99 include performance for only 7 months since the acquisition was effective only from 1st September 1998.

* Includes turnover of Rs.10.49 Crores (previous year -Rs.1.93 Crores) from ready-mix concrete

** Calculated on Net Divisional Turnover