HINDALCO

ADITYA BIRLA GROUP

HINDALCO INDUSTRIES LIMITED
ANNUAL REPORT 1998-99

Contents

Financial Highlights

(Rs. in Million)

	1998-99	1997-98	1996-97	1995-96	1994-95
Gross Sales	20,131	16,707	13,083	14,222	11,307
Net Sales	17,670	14,733	11,571	12,518	9,563
Operating Profit	7,775	6,057	4,262	5,603	3,836
Net Profit	5,668	4,962	3,903	4,011	2,919
Net Worth	32,559	27,424	22,892	19,357	14,868
Capital Employed	39,429	35,223	28,405	24,640	19,253
Operating Margin (%)	44.00	41.11	36.84	44.76	40.11
Gross Margin (%)	47.45	44.86	47.77	54.00	48.40
Net Margin (%)	32.08	33.68	33.73	32.05	30.53
ROAE (%)	18.90	19.72	18.48	23.44	24.53
ROACE (%)	21.36	20.61	21.09	32.02	30.60
Debt-Equity (x)	0.20	0.27	0.21	0.22	0.25
Interest Cover (x)	11.02	10.13	12.31	11.98	10.76
EPS (Rs.)	76.11	66.64	52.50	80.79	60.81
CEPS (Rs.)	92.85	77.06	58.18	87.81	67.67
DPS (Rs.)	6.50	5.25	4.50	6.00	5.50
Book Value (Rs.)	437.24	368.27	307.41	389.92	309.72

Highlights

- Production volumes up 20% year-on-year
- Sales of higher margin value added products up 15.4%
- Operating margins up from 41% to 44%
- Operating costs up only 14% despite 16.5% rise in sales volumes
- Average realisation improved despite international aluminium prices at a five year low
- Smelter capacity utilisation up to over 99%
- Return on capital up from 20.61% to 21.36%
- Debt-to-equity ratio down from 27% to 20.4%
- First integrated aluminium smelter to be ISO 14001 certified, the highest accolade for international environmental compliance
- Received the "Good Corporate Citizen Award" for 1998-99 from the Bombay Chamber of Commerce & Industries

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

Letter from the Chairman to Shareholders and Employees

Dear fellow shareholders and employees,

HINDALCO - IN FOCUS

Hindalco had yet another excellent year in 1998-99. We defeated the prevailing winds of a business dogged by slowing consumption, rising inventories and declining prices. Total sales volume grew on the back of increased capacity, reflecting the fruits of a well-timed growth strategy implemented over the past four years. At the same time, we kept operating expenses in check and consequently improved our operating margins. We achieved better prices, better asset utilisation and better captive power generation.

The market for aluminium in India is nascent. There is significant scope for growth in most product segments. In value added products, this fact is particularly pertinent. From our position as market leader, Hindalco has been carefully laying the foundations to capture this potential. This year our sales of downstream products kept pace with our overall growth. Emerging applications present further new opportunities for Hindalco. Our reputation with our customers for reliability in quality and delivery give us a head start over competitors to capitalise on these emerging opportunities. We place great emphasis on enhancing this profile. As a world class player, we will continue to ensure that our customers see us as service and solutions provider as well as a producer of high quality products. Therefore we have consciously decided to re-orient our product lines towards arming the customers with solutions for their business problems. In so doing we strive to transform ourselves into a total solutions provider to add to our strengths as a powerful commodity player.

We have the largest single location integrated aluminium facility in the world. A key factor in our success has been, and will continue to be, our control over key inputs. The result: we are amongst the lowest cost producers in the world with a cost structure that can sustain significant cyclical declines in the LME levels – a competitive edge that few of our competitors can boast of. We plan to continue to build aggressively upon this enviable value creating position in this industry by maintaining our cost leadership and emphasising further value added products. Outstanding asset productivity will continue to be a crucial objective in achieving further gains for shareholders – we are always seeking new ways of making our existing assets work harder and better. The coming year will be no exception.

"As a world class player, we will continue to ensure that our customers see us as service and solutions provider as well as a producer of high quality products"

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

For us at the Aditya Birla Group, aluminium is a growth business. Our strategic intent is to broaden our reach substantively through related downstream value adding products. Towards this end we have initiated certain important measures which signal a well-planned product rollout. We are working single-mindedly to increase the output of foils at our plant at Silvassa. Additionally we have ventured into aluminium alloy wheels. We expect the plant to go onstream in early FY 1999-2000. We are also looking at other potentially interesting product options such as aluminium cans and castings. These will lead to increased value addition through forward integration.

We will continue to work towards altering the composition of our export products with a greater emphasis on value added products. With imminent trade liberalisation, we recognise that overseas markets are a reality which we must embrace. We believe that our existing competitive strengths will serve us well. At the same time we will endeavour to broaden the penetration of our existing and new value added products, building on our strong brand name, internationally as well as in the domestic markets.

Kaiser-Bechtel, a reputed international consultant, is currently engaged in preparing the techno-economic feasibility report for our proposed greenfield project called Aditya Aluminium. We expect their report to be ready by the end of June. The outcome of this study is critical as it will enable us to assess the value creation potential of this mega project. A comprehensive assessment of the long-term benefits of this project for shareholders is a priority and we should hopefully arrive at a decision by end July. To consolidate further our pre-eminent position in the Indian market, we are examining the possibility of a brownfield expansion at Renukoot. A feasibility study of this project is underway.

We will proceed with both these projects only if they deliver value for our shareholders.

At this juncture, I would like to take the opportunity of placing on record my admiration for our employees and our team at Hindalco. Their dedication and commitment have been and continue to be an invaluable asset.

THE ADITYA BIRLA GROUP - IN PERSPECTIVE

Turning to the challenges for the Group as a whole, the coming millenium 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 may be 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 millenium. We are adopting 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 into three dimensions, namely, strategic thrust, structural initiatives and systems adoption.

"We are adopting an ethos that focuses on value added growth and not just growth for the sake of asset growth"

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* and 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 and have closed one of the Caustic Soda plants.

- Sharper business focus

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

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 future, we would 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.

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. We will be benchmarking ourselves against global best practices with the ability to monitor results on an ongoing basis in the pursuit of value creation.

"We will be benchmarking ourselves against global best practices with the ability to monitor results on an ongoing basis in the pursuit of value creation"

We feel that large organisations such as ours need to be "nimble-footed" to compete in the market place. Towards this end, we are aggressively pushing programmes to attract and retain fresh talent and nurture existing intellectual capital across the organisation. 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 professionals in industry to head senior positions within the Group. More than 50 professionals, including two Directors, have joined our Group in the last two years. They have helped to strengthen our intellectual capital base.

Systems Adoption

Our business approach focuses on institutionalising formal processes and procedures for realising better value for our shareholders.

Adoption of appropriate systems will complete the virtuous circle that we have embarked upon to create value for our shareholders.

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

Thank you.

Yours sincerely,

Kumar Mangalam Birla

From the President - Management Discussion and Analysis

A. K. Agarwala

Hindalco delivered significant value to shareholders in 1998-99 primarily due to its strategic strengths.

LOW COST COMPETITIVE ADVANTAGE

Hindalco is amongst 15 percent of the lowest cost producers of aluminium in the world. Constant process improvements through technology upgradation and optimisation has helped Hindalco to reduce consumption norms and improve yields. However, the critical factor that drives Hindalco's enviable cost advantage is its strategic control over key inputs, which include:

- access to good quality and low cost bauxite reserves
- captive power generation to meet most of Hindalco's needs
- alumina and smelting facilities
- downstream production plants that span several products
- strategic joint venture companies to ensure uninterrupted supply of other key inputs, viz. caustic soda and aluminium fluoride

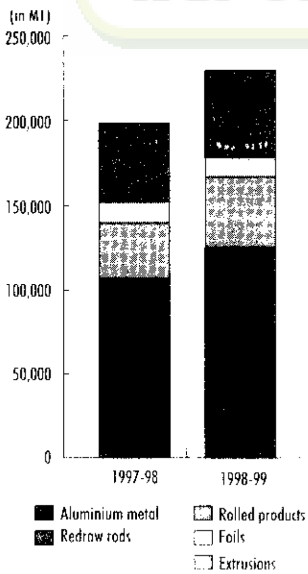
STRONG MARKET POSITION

During 1998-99, Hindalco had a 44 per cent share of Indian Primary Aluminium production. The Company has dominance in a market that grew 3 per cent in 1998-99, as against global consumption growth of 0.2 per cent. The domestic market is expected to gain further momentum with emerging applications as well as improvement in economic fundamentals.

TIMELY INVESTMENT IN TECHNOLOGICAL UPGRADATION AND CAPACITY

Implemented over the past four years, Hindalco's significant capital investment has been completed and has begun to yield results during 1998-99. The investment programme has led to an increase in overall volumes with consequent cost advantages, while simultaneously ensuring better realisations through capacities built in primary metal and downstream products.

Product Mix



RESULTS OF OPERATIONS

Hindalco's performance is the outcome of excellence across most operational parameters. Its volumes have risen significantly. Through an emphasis on higher value added products, Hindalco has improved its price realisations, albeit marginally. It achieved better asset utilisation as well.

SALES VOLUME AND PRODUCT MIX

Sales volume grew by over 16.5% on the back of increased capacity - the result of the capital expenditure programme implemented over the past four years.

- *ALUMINIUM METAL*

Aluminium ingots and billets increased by 17.4 percent to 125,407 MT in 1998-99.

Significantly, our downstream product sales also kept pace with our overall growth. Hindalco continues its focus to further build its downstream products, moving away from its profile of being primarily a seller of aluminum metal.

Note : This discussion and analysis should be read in conjunction with the Company's Financial Statements and attached notes which are contained in this Annual Report.

- *ROLLED PRODUCTS*

Rolled products saw an exceptional growth of over 25 percent. Consolidation in existing markets and introduction of new products resulted in successfully acquiring a higher market share. Hindalco's sales to electrical, packaging and building construction sectors grew whereas sales to the transportation, consumer durables and machinery components sectors came under pressure.

Emphasis on new product applications took the form of :

- lamp cap stock to the electrical sector
- panelling sheets and stucco embossed sheets (a new product in India) to the transportation sector
- alclaol sheets for car radiators (under trial)
- special grade circles for light reflectors
- auto header stock in the auto sector

Some of these new products helped substitute for products that are currently being imported with consequent higher margins to the Company. In so doing, Hindalco is saving valuable foreign currency for India.

- *EXTRUSIONS*

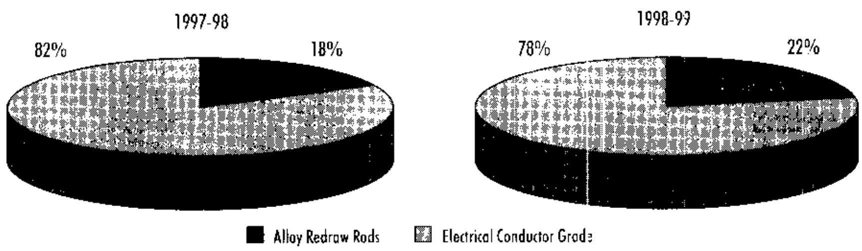
Extruded products was the only segment where we experienced a decline in volumes. Demand for extruded products comes primarily from the transport, electrical and construction sector. Demand slackened due to a lower industrial growth and a decline in infrastructure spending. Due to lower off-take, numerous secondary manufacturers intensified competition with aggressive pricing strategies. Total volumes dipped by 6.7 percent.

We continued our emphasis on market and product development for extrusions. We developed and sold new sections in curtain walling for the building and construction sectors and new profiles for various components in the auto sector. We also ventured into making car air-conditioning tubes. Some of the new profiles, namely heat sinks in the electronics sector and auto components, contributed to import substitution with higher price realisations.

- *REDRAW RODS*

A healthy growth of nearly 11 percent was experienced for redraw rods used in the electrical sector. The shift of focus to a higher contribution product mix allowed this product segment to enhance the value added thrust of the Company. Sales volume of alloy redraw rods increased faster than that of electrical conductor grade rods (the average price realisation of alloy redraw rods is higher by 9 percent than that for electrical conductor grade rods).

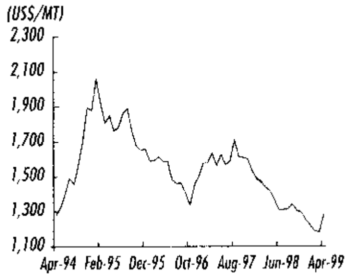
Redraw Rods - Product Mix



- FOIL

  1998-99 was effectively the first year for sales of aluminium foil from our Silvassa plant. The year saw Hindalco progressing fairly well in this segment. Despite a decline in foil demand and increased competition from imports and substitutes, we were able to sell 97 percent of what we produced. We expect to improve considerably with our strong metal base in the years ahead.

LME Cash Prices



- PRICES

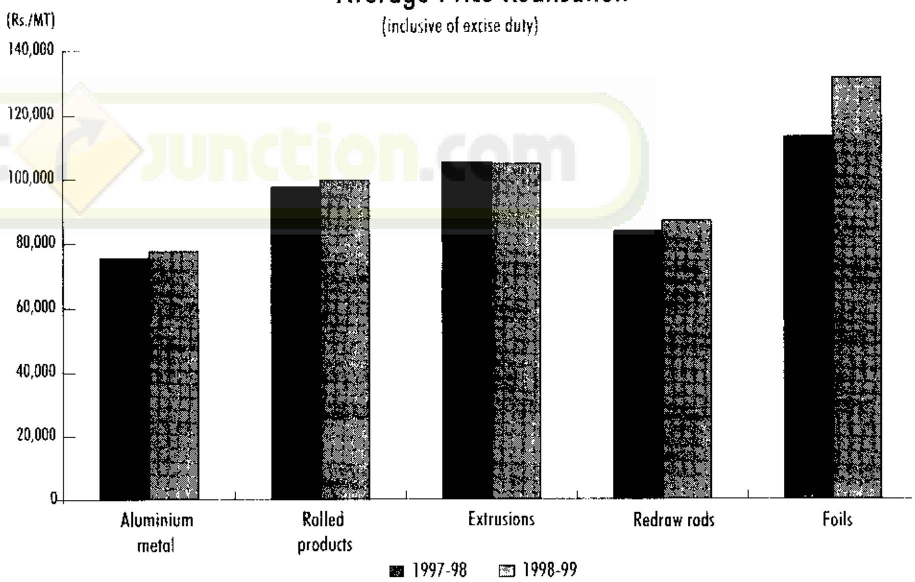
  On an average, the prices we realised for 1998-99 were 3 percent higher than those in 1997-98. What makes this commendable is that international prices of aluminium on the London Metal Exchange, fell 18 percent, in the same period.

  1998-99 was a year that saw a five-year low in aluminium prices. This had its impact on Indian prices as well. Indiscriminate imports of aluminium scrap added to the pressure on domestic prices. We reduced our aluminium metal prices twice in the 2nd half of 1998-99 by a cumulative 10.5 percent. Our strategy in this environment of declining prices entailed emphasising:

  - A product mix that focused on value added products, thus helping to bolster up average prices. As average realisations were under pressure from declining aluminium prices, our well-timed strategy of laying focus on the sales of value added products strengthened us
  - A higher proportion of value added products in the export product mix.

Average Price Realisation

(inclusive of excise duty)



- EXPORTS

  Our export revenues fell to Rs. 1,654 million, marginally lower than Rs. 1,702 million in 1997-98. This was the result of additional domestic demand arising from the production shortfall of a large Indian aluminium producer and our corporate policy of according priority to domestic demand.