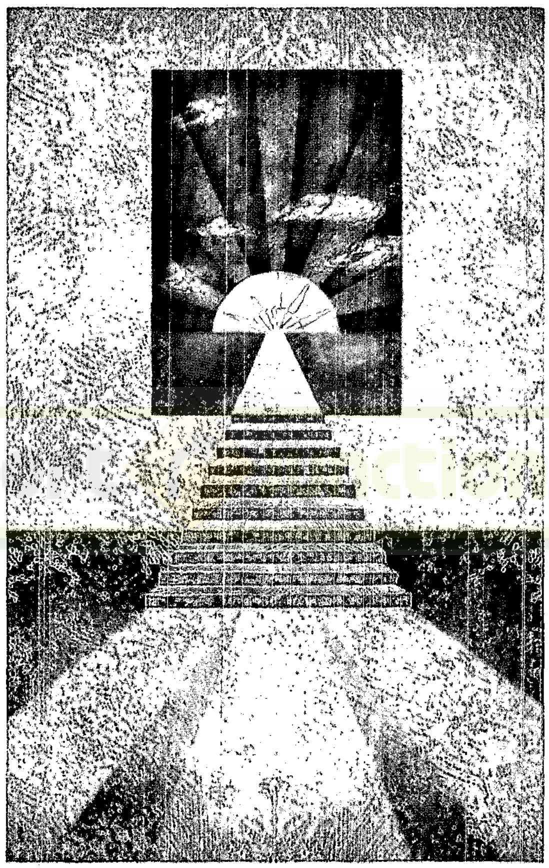
# ANNUAL REPORT
# 2002-2003



INDO GULF
ADITYA BIRLA GROUP

Indo Gulf Fertilisers Limited

# IN HOMAGE TO A LEGEND

"My vocation, is to strive continuously, to reach excellence in all spheres of management, by weaving the threads of enterprise, knowledge, experience, ideas and tasks into a fabric that can be called "management". My job is to motivate, to bring together and fuse human talent, so that they act in harmony and in unison as one team, directed towards a single purpose, a single goal.

In our Group, our first and foremost objective is to satisfy our larger family, our family comprising of our shareholders, our customers and our employees.

Towards this objective, our credo is, 'strive for excellence and perfection in all spheres of management, through continuous improvement.'

For our shareholder, it is our job, and our commitment to create wealth for him, and to amply reward the faith that he has reposed in us.

For our customers, we believe, that, 'the customer is always right'. Our motto is to give him total satisfaction, in terms of quality and service.

For our colleagues and employees, our motto is 'your growth is our concern'."

We follow in his footsteps.

ADITYA BIRLA GROUP

ADITYA VIKRAM BIRLA

*November 14, 1943 - October 1, 1995*

# INDO GULF FERTILISERS LIMITED

| | |
|---|---|
| CHAIRMAN | Mr. Kumar Mangalam Birla |
| DIRECTORS | Mrs. Rajashree Birla<br>Mr. M.C. Bagrodia<br>Mr. Sanjiv Nair<br>Mr. V.T. Purswani<br>Mr. V.N. Nadkarni<br>Mr. D.C. Gami<br>Mr. A.R. Gandhi |
| MANAGING DIRECTOR | Mr. D. Bhattacharya |
| MANAGEMENT | Mr. N.L. Jain<br>*Executive President*<br><br>Mr. R.K. Malhotra<br>*Sr. Vice President (Finance & Commerce)*<br><br>Mr. C.K. Datta<br>*Sr. Vice President (Manufacturing Operations)*<br><br>Mr. J.R. Mohan<br>*Sr. Vice President (HRD & Personnel)*<br><br>Mr. Vishnu S. Sharma<br>*Vice President (Marketing)* |
| | COMPANY SECRETARY<br>Mr. Suresh C. Dad |
| REGISTERED OFFICE | P.O. Jagdishpur Industrial Area,<br>Dist. Chhatrapati Shahuji Maharaj Nagar,<br>Pin – 227 817 (U.P.), India |
| AUDITORS | M/s. Lodha & Co.<br>Chartered Accountants, Kolkata |
| SOLICITORS | M/s. Mulla & Mulla & Craigie Blunt & Caroe,<br>Mumbai |

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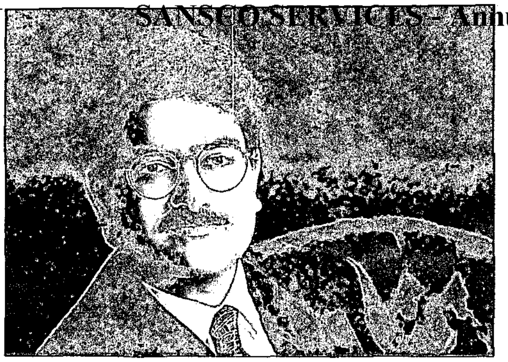

# The Chairman's Letter To Shareholders

Dear Fellow Shareholders,

In a year characterised by a dim economic environment, overshadowed by geo-political issues and a significant lowering of consumer spends, your Company has managed to keep its earnings buoyant.

Attaining revenues of Rs.675.2 crores and earnings of Rs.172.8 crores, as a stand-alone fertiliser player, is indeed an accomplishment, for which your Company deserves plaudits.

The decision to demerge the fertiliser business and amalgamate the erstwhile Indo Gulf Corporation Limited's copper business with Hindalco Industries Limited, has been a major strategic move, fundamentally aimed at enhancing shareholder value.

As a consequence of this move, your Company, Indo Gulf Fertilisers has emerged fully focused on fertilisers, commanding strong brand equity, steady cash flows and a leadership position in the fertiliser industry.

Moving on to the operational aspects, regrettably even as your Company's production of urea at 8.65 lakhs MT, reflects a 100 percent capacity utilization, its' full potential has not been unleashed. The cap on production at assessed capacity, determined by the Government, has limited its true production capacity.

In this sector, the Group Concession Scheme, which has replaced the retention price regime, is a forward-looking step. Given your Company's credentials and by virtue of it being among the more efficient urea producers, it stands to benefit from the Scheme.

*"Indo Gulf Fertilisers has emerged fully focused on fertilisers, commanding strong brand equity, steady cash flows and a leadership position in the fertiliser industry."*

Eventually a pragmatic Fertiliser Policy will entail complete deregulation of the sector, given its criticality to food production. In the event of a decontrolled scenario your Company is well positioned to face it.

Even as of now, your Company's work amidst farmers - who are its ultimate customers, has made a long-lasting impact. The "Shaktiman" brand is a trusted nutrient that enables superior farm productivity. Your Company's customer service innovation processes are unrelenting, leveraging every opportunity to further build on "Shaktiman's" impeccable reputation, and brand power.

If our business is sustainable through constantly challenging times, it is because of our high-performing, motivated workforce. I wish to record my heartfelt appreciation of their contribution without which your Company would not have come this far. They are fully attuned to your Company's abiding commitment to create and enhance shareholder value.

**The Aditya Birla Group – In Perspective**

I would like to take this opportunity to retrace the direction of our Group over the past four years. If one were to encapsulate it in a single word - the dominant strategic theme over the past four years has been consolidation. This is in line with our vision of being a premium conglomerate, with a clear business focus at each business level, relentlessly pursuing value creation. The logic underpinning consolidation is the push for market leadership, economies of scale, productivity gains and operational efficiencies, coalescing to create value-adding growth.

Let me recount some of the major steps that we have taken in our drive towards consolidation.

The acquisition of a 74.6% equity stake in Indal, from Alcan, at an investment of a little over Rs.1000 crores, has been a milestone. Bringing Indal into the Group's fold has helped us position ourselves along every link in the value-addition chain of the business, from metal to downstream products, where the Hindalco-Indal combine now accounts for over 70% of the market share in India.

*"Your Company's work amidst farmers - who are its ultimate customers, has made a long-lasting impact. The "Shaktiman" brand is a trusted nutrient that enables superior farm productivity. Your Company's customer service innovation processes are unrelenting, leveraging every opportunity to further build on "Shaktiman's" impeccable reputation, and brand power."*

Moving on to the other metal in the Group's stable, it is commendable that Birla Copper has attained a leadership status, commanding a market share of over 45 percent – within a short span of 3 years from its first commissioning. The de-bottlenecking of the Copper Smelter at Dahej last year has resulted in enhancing the smelter capacity by 50%, to 150,000 TPA cost efficiently, last year, and the ramp-up achieved has truly set a new global benchmark.

Yet another landmark restructuring move has been the decision to consolidate the copper business of Indo Gulf with Hindalco. Subsequently, Hindalco made a second open offer for the shares of Indal. Its stake in Indal has increased from 74.48% to 96%. All these moves take us ahead on the road towards unifying the Group's non-ferrous metals businesses, and transforming Hindalco into a globally competitive non-ferrous metals power house.

The acquisition of the Nifty mines in Australia from Straits (Nifty) Pty Ltd., has elevated Birla Copper to an integrated Copper producer. Nifty currently has a production capacity of 27,500 tonnes per year of Copper Cathodes and a large undeveloped sulphide resource. The project has a total resource of 148 million tonnes of ore grading 1.3% of copper. We have rights to explore in the richly mineralized Paterson province. Additionally, we have acquired a 50% interest in the Maroochydore exploration project.

*"If one were to encapsulate it in a single word - the dominant strategic theme over the past four years has been consolidation. This is in line with our vision of being a premium conglomerate, with a clear business focus at each business level, relentlessly pursuing value creation."*

The decision to demerge the Insulator Division and transfer it to a separate 50:50 joint venture with NGK of Japan has been a crucial move. NGK is the undisputed world leader in the manufacturing and marketing of all types of Insulators for overhead transmission lines and sub station equipment. It controls 60% share of the world's Ultra High Voltage Insulator market. The partnership with NGK will help to build on and strengthen the leadership position we already enjoy in the domestic market, because of the access we will have to the latest in product and manufacturing technology. In addition, there will be opportunities for getting plugged in into a global marketing network. Through this route we will take the Insulator business to new heights.

A slew of initiatives have also been taken to consolidate the operations of Grasim – among them the closure of the Pulp and Fibre plants at Mavoor, and the sale of the loss-making fabric operations at Gwalior. Over the past four years, Grasim has become much leaner and stronger – with the debt/equity ratio improving from 0.93 to 0.58, interest charges falling from Rs.292 crores to Rs.168 crores, operating profit rising from Rs.678 crores to Rs.1142 crores, and workforce rationalization taking the manpower strength from 24,400 to 16,600.

In the Telecom business, we joined hands with the Tata Group. Beginning in 2 states, we have expanded to 7 states. Our subscriber base has reached 1.3 million. Our footprint covers 40 percent of the cellular market in India, with a 31 percent market share in the circles where we operate, and a 9 percent market share nationally.

We have recently divested the Group's stake in MRPL to ONGC. This strategic decision of the Group was based on lack of leadership position in the sector, no presence in marketing of petroleum products, especially transportation fuels, and no significant synergies with other Group businesses, apart from losses incurred due to regulatory changes. Although the sale of the Group companies' equity stakes in MRPL does have a one-time impact on their profits, the exit from MRPL indicates our firm resolve to rationalise the Group's portfolio of businesses with a view on the future. It also bears testimony of our commitment to a key group of stakeholders i.e. our lenders.

The Birla Sun Life joint venture, which started off 3 years ago, has developed a major presence in the insurance and mutual funds sectors. Birla Sun Life is perceived as a leading quality market player, recognised for its superior service levels and we consider this as a core business with immense growth potential in the years ahead.

From all of this, a clear trend emerges. Our strategy dictates that we get out of businesses where we are bit players, and strengthen the businesses where we have clear competencies, so that we get to the top of the league, or consolidate our position there, as the case may be. This leads to a sharper and tighter business portfolio with our fire-power getting better targeted.

I do believe that our decision to consolidate – and the way we have gone about implementing that – has been sound. Firstly, we have operated our existing assets efficiently. Secondly, the assets we have built and acquired have been quality assets, complementing our existing strengths. Thirdly, the asset growth has been funded largely through internal accruals. As a result, every one of the companies in our Group has emerged with a stronger balance sheet. Fourthly, save for the IT and garments businesses, which are still at an incubation stage, the consolidation measures have started yielding the results that we had envisaged.

***"Our strategy dictates that we get out of businesses where we are bit players, and strengthen the businesses where we have clear competencies, so that we get to the top of the league, or consolidate our position there, as the case may be. This leads to a sharper and tighter business portfolio with our firepower getting better targeted."***

## Performance Measures

What has it meant in terms of performance? As you are aware, we adopted CVA or Cash Value Added – as a performance metric 3 years ago, which is in consonance with our Group's focus on value addition. CVA, by itself, is a punishing measure in that it calls for superior returns on assets created and equity invested. Our Group CVA has been positive. Given the stringent performance standards set by the CVA metric, and that, in fact, not too many companies in India, actually have consistently delivered even a positive CVA, I believe that this is a commendable performance.

I must add that the market capitalisation of the Group correlates very weakly with the sharp increase in value addition, as measured by CVA during the same period. This is a source of disappointment. Even as I do not think that we need to be drawn into the expectations game as fueled by analysts, over a period of time, we hope that the market valuations will reflect our underlying strengths and performance.

## Focus on People

Having said that, I must add that the course of shrinking the business portfolio, while placing larger bets in a few industries, is a higher risk strategy, albeit with the promise of higher returns. Continuing to deliver superior performance whilst factoring in this potentially higher risk profile, takes us to what I believe is our most important asset, one that is not reflected in any of our balance sheets – our people. Over the last several years, our focus as regards people has been, in a nutshell, to build a meritocracy. We have taken several initiatives which I would classify under 3 broad heads – Learning and Relearning, Performance Management and Organisational Renewal.

Our Organisational Health Survey (OHS), which is a well-regarded mode globally of tracking employee satisfaction, has thrown up very encouraging results this year, based on the tracking of 8,670 managers across the Group.

*"We are pushing even harder on the people front, building on the significant progress we have made so far, and press on with the task of building a meritocracy – not just of brainpower, but also of entrepreneurial power, dedication power, vision power, go-getter power and ambition power."*

Whilst commendable work has been done at Gyanodaya, our internationally acclaimed Centre of Management Learning, we are taking the process to an even higher plane.

We are pushing even harder on the people front, building on the significant progress we have made so far, and press on with the task of building a meritocracy – not just of brainpower, but also of entrepreneurial power, dedication power, vision power, go-getter power and ambition power.

Best regards,

Yours sincerely,

Kumar Mangalam Birla

Date: 6th May, 2003

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OVERVIEW

The year under review has been the first year of the Company's operations. Its performance has been exemplary aided by enhanced efficiencies, stringent cost control efforts and continued brand building.

Indo Gulf Fertilisers Limited is the resultant company of the de-merger process carried out by erstwhile Indo Gulf Corporation Limited, through a Scheme of Arrangement, under Sections 391 to 394 of the Companies Act, 1956. The Scheme was approved by the Hon'ble High Courts and came into effect from 12th February, 2003. The appointed date for the de-merger was the close of business on 31st March, 2002. Therefore, the performance of the Company for the year under review reflects the performance for the 12 months ended 31st March, 2003.

The Company has achieved a turnover of Rs.675.2 Crores and a net profit of Rs.172.8 Crores in 2002-03 (FY03). Given that this was the first year of operations, the previous year's figures are unavailable and hence not provided in the report.

## CHALLENGING OPERATING ENVIRONMENT

The near drought across several parts of the country had an adverse impact on agricultural production and on farm nutrient consumption, both of which were at their lowest levels in the last five years. Initial forecasts indicate a 13.6% drop in food grain production at 183 million tonnes and a 7.1% drop in fertilizer consumption in FY03. In line with the trend, urea demand too fell by over 5.6%. This put undue pressure on urea producers in the country.

## LONG TERM FERTILISER POLICY ANNOUNCED

On the positive side, the finalisation of the Retention Pricing Scheme (RPS) for the VIth , VIIth and VIIIth pricing periods as well as the announcement of the long-term fertiliser policy by the Government augured well for this sector. For Indo Gulf, this has led to the payment of subsidy arrears to the tune of Rs.179.98 Crores.

Based on the recommendations of the Group of Ministers under the Chairmanship of the Deputy Chairman of the Planning Commission, the Government has announced a Long Term Fertiliser Policy in the form of Group Concession Scheme (GCS). The new scheme will be effective from fiscal 03-04 and will be implemented in three phases.

In the first phase (to be in force during fiscal 03-04), the Policy aims to neutralise the cascading impact of subsidy. So the subsidy will be paid on the basis of Group weighted average retention price as on 1st April, 2003 or the actual retention price, whichever is lower. However, those units which have very high retention price defined as 'Outliers' are accorded special treatment and concessions will be made to outliers.

In the second phase (to be in force for two years - from April 2004 to March 2006), the Policy intends to reward efficient units and discontinue the special treatment for outliers. The group concession rates will be modulated by energy norms to be stipulated by the Gokak Committee Report.

In the final phase, commencing April 2006, the Government proposes to decontrol the urea sector fully. The Government has clarified that the modus-operandi of such an operation will be dependent on the success of the GCS in the first two phases.

The recently announced Group Concession Scheme impacts the Company in a positive way, in the long term. The policy envisages encouragement of efficient operations and low-cost production. In a decontrolled scenario, Indo Gulf may emerge as a major beneficiary. However, in the short term, the Company's Retention Price is higher than its group average, hence it faces a reduction in subsidy support. However, the Company's on-going cost reduction and energy improvement initiatives should enable it to tide over the situation and remain profitable.

## REVIEW OF OPERATIONS

Even as the Company has gained from the finalisation of the RPS for the VIth, VIIth and VIIIth pricing periods, it's operations have been constrained due to the cap on production and the disallowance of exports by the Government. To optimise revenues and profitability along with strengthening of its brand "Shaktiman" and distribution infrastructure, the Company continues to bolster efficiencies and tighten costs.

## SALES MATCHED OPTIMISED PRODUCTION

The Company produced 8.65 lac tonnes of urea, which is a 100% utilisation of its re-assessed capacities, limiting production in line with the regulatory requirements. In fact, the Company had planned for higher urea production in view of the export potential and possible sale to domestic NPK manufacturers. Nevertheless, it decided to restrict volumes to the levels prescribed by the Government, since exports as well as sale to domestic NPK manufacturers were un-remunerative and there were uncertainties over treatment of costs associated with additional volumes under the RPS.

Sales volumes matched production at 8.67 lac tonnes. Considering the slump in the allocated markets and a significant drop in urea consumption, this is noteworthy. This strong performance is attributed to the strength of its "Shaktiman" brand equity, developed over the years through a relentless focus on quality, farmer service and marketing efforts.

## STRENGTHENING ITS BRAND

The Company's ongoing well-crafted brand strategy has paid off. Concerted marketing and brand promotional efforts in the target markets, with a special emphasis on the Command Area, which is located within an economic freight zone of about a 200 km radius from the plant, formed an integral part of this strategy. Expanding the retail network and increasing "Shaktiman Krishi Sewa Kendras" helped enormously. Aggressively merchandising Shaktiman, and enhancing its visibility at the marketing and service outlets enabled boost the brand further.

The success of our continuing efforts is also reflected in the pre-eminent position enjoyed by the "Shaktiman" brand consistently over the years. Our claim was vindicated once again in the Brand and Communication Assessment Study carried out by TNS Mode in November 2002, wherein "Shaktiman" was rated again as the "Most Preferred Brand" of the farmers and the "Most Frequently Selling Brand" when benchmarked with competitors. The farmers have an emotional equity with the brand. This will go a long way in ensuring dominance in the decontrolled environment, likely with the implementation of the 3rd phase of the Long-Term Pricing Policy announced earlier.

## FEED STOCK AVAILABILITY

Natural gas supplies from GAIL (India) Limited remained unstable during the year. The erratic quantity and quality of supplies was an area of concern.

## FINANCIAL REVIEW AND ANALYSIS

Highlights (Rs. Crores)

| | 2002–2003 |
|---|---|
| Net Sales | 675.2 |
| Other Income | 25.7 |
| Total Expenditure | 381.2 |
| Operating Profit (PBDIT) | 319.7 |
| Interest | 2.5 |
| Gross Profit | 317.2 |
| Depreciation | 43.5 |
| Profit Before Current Tax | 273.7 |
| Provision for Current Tax | 105.5 |
| Profit After Tax | 168.2 |
| Provision for Deferred Tax | (–)4.6 |
| Net Profit | 172.8 |

### Revenues

The Company reported net sales revenues of Rs.675.2 Crores in FY03, inclusive of Rs.179.98 Crores arising from the difference in RPS for the earlier years.

### Operating Profit

Factoring of enhanced efficiencies and other income of Rs.25.7 Crores, operating profits reached an impressive level of Rs.319.7 Crores.

### Interest and Depreciation

Interest charges were at Rs.2.5 Crores, which constitutes only 0.4% of net revenues in FY03. This was the result of a tight control over working capital and the 'zero-debt' balance sheet of the Company. Depreciation charges for the year remained low at Rs.43.5 Crores, about 6.4% of net revenues in FY03.

### Provision for Current and Deferred Taxes

Consequent to the above, the Company has reported a good pre-tax profit of Rs.273.7 Crores. A provision for Rs.105.5 Crores towards current taxes in FY03 has been made. In line with the Accounting Standard 22, the deferred tax assets work out to Rs.4.6 Crores and the credit for the same has been taken in accounts for FY03.

### Net Profit

Notwithstanding, the high current tax provision of Rs.105.5 Crores, the Company has notched up a net profit of Rs.172.8 Crores. The Earning Per Share (EPS) stands at Rs.38.3 in FY03, while Cash Earning Per Share (CEPS) is at Rs.47.9.

### Dividend

For the current year, the Board has recommended a dividend of Rs.2.6 per share. On approval, it would lead to a cash outflow of Rs.11.7 Crores in addition to corporate tax on dividend of Rs.1.5 Crores.

## RISK MANAGEMENT

The Company is engaged in the manufacturing and selling of Urea, a nitrogenous fertiliser. This is a highly regulated sector and hence fortunes are intrinsically linked to the Government policy on pricing and controls.

The Fertiliser Policy is slated to move from a regulatory regime to deregulation. Towards this end, the Government has already drawn a roadmap with the implementation of the Group Concession Scheme being the first step. The Company will eventually benefit from the de-regulation given its enviable financial strength and cost structure. However, in the interim there could be volatility in earnings and profitability.

The continuing restriction on production at 100% of reassessed capacities is an additional risk on growth in the future. The Company is operating at 100% of reassessed capacities for the past three years and there is little scope for significant growth in volumes, at least till the Government decides on a favourable change in the policy.

Finally, the Company also faces risk on account of poor availability of natural gas on the HBJ pipeline. Though the new discoveries are encouraging developments, these are yet to materialise and there is no significant progress on the implementation of LNG terminals as well.

## INTERNAL CONTROL SYSTEMS

Management Information Systems (MIS) constitutes the backbone of the Company's control mechanism. Clearly defined roles and responsibilities down the line for all managerial positions have been institutionalised. All operating parameters are monitored and controlled. Regular internal audits and checks ensure that responsibilities are executed effectively and that the MIS is flawless among a well-conceived annual planning and budgeting system.