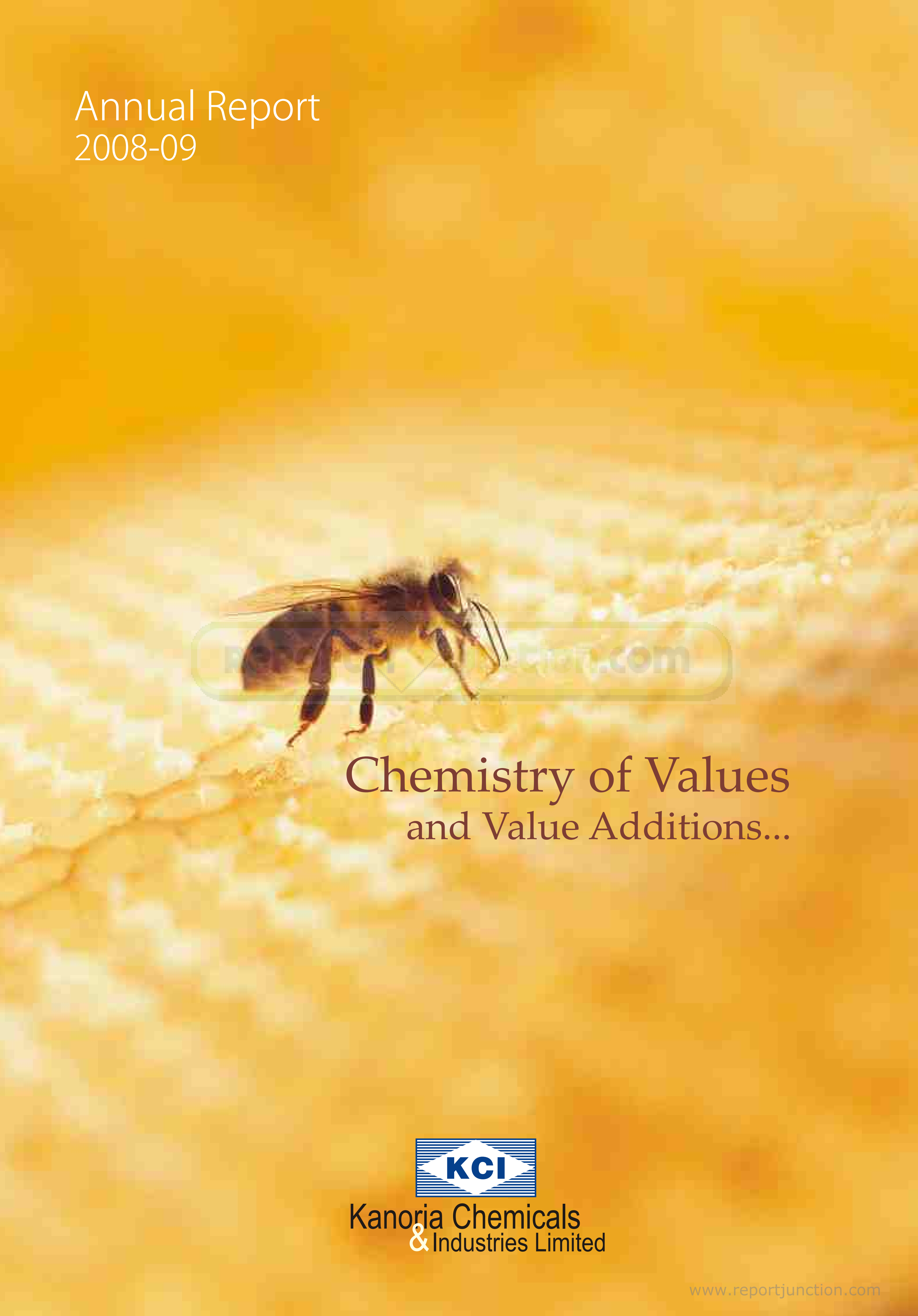
Annual Report
2008-09



Chemistry of Values
and Value Additions...

KCI

Kanoria Chemicals & Industries Limited

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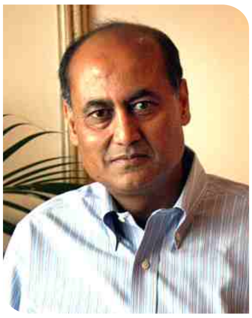
Board of Directors

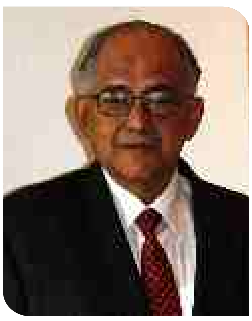

R V Kanoria

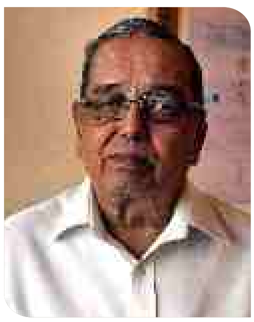

H K Khaitan


Amitav Kothari


Ravinder Nath


G Parthasarathy


S L Rao


B D Sureka


A Vellayan


J P Sonthalia


T D Bahety

CHAIRMAN'S STATEMENT

When I initially started writing this report it was with a certain amount of trepidation and uncertainty. The global economy had collapsed and the aftershocks of this metaphoric "earthquake" were being felt by all nations and the "ripples" included countries like ours where fortunately prudent monetary policy had effectively thwarted a major financial crisis. India in fact became a victim of the global financial meltdown, as the real economy got affected as global trade imploded.

On the 17th May 2009, however, I chose to revisit what I had already penned, as suddenly, India had awakened to a new dawn. The country had voted for stability and a clear mandate had emerged out of the Lok Sabha elections. The confidence attributable to a stable government has brought about new hope and belief.

In an increasingly integrating world, India cannot stay isolated and must rethink and fine tune its development policies. Targeted public spending is essential. History shows that the US used this as an effective measure to deal with the vagaries of the Great Depression. The Chinese development policy also had the central focus on infrastructure spending and attracting FDI into the sector.

The most important task at hand in my opinion is channelization of investment into infrastructure. The performance of the manufacturing sector is closely connected to physical infrastructure. Development of facilities such as roads, ports and electricity, will provide the desired stimulus to further investment in the manufacturing sector.

Over the last decade there has been a great deal of focus on the services sector in the Indian economy. The sector has posted impressive growth and currently constitutes more than half of the country's GDP. It is important that India emerges as a manufacturing base. A strong services sector and positive economic outlook is not enough to sustain a holistic employment oriented growth. The share of manufacturing in India's GDP needs to be boosted considerably.

The economic slowdown witnessed during the second half of 2008 in India was largely because of supply side problems, compounded by high inflation and interest rates. Stepping up investments, therefore, is critical without which these problems are likely to persist.

The other area of concern is the climbing deficits and worsening terms of trade. Both the trade and current account deficits have been rising and may reach a situation when they become extremely difficult to manage. The present phase of optimism at the back of political stability and expectation of a pro reforms approach, and looking forward to complete recovery from the ills of the global economic downturn need caution and prudence. It is also essential that the balance of payment should not get distorted with short term volatile funds, which will have a consequential impact on the value of the rupee and thereby on trade. Both inward and outward flows of capital to that extent need prudent regulation.

Towards re-strengthening the growth impetus in the Indian economy, it will be necessary not only to boost investment but also stimulate demand by increasing the purchasing power of the public and of corporates. Over the past few years, tax rates have been allowed to peak up and new taxes like Minimum Alternate Tax, Dividend Distribution Tax and Fringe Benefit Tax have been introduced along with numerous surcharges and cesses.

There is a strong case for lowering direct taxes so as to provide more money to consumers. Without adequate availability of monies, planned investments may get hit leading to more problems two years down the line. The role played by erstwhile Development Finance Institutions cannot be underestimated. There is need for access to cheap funds judiciously channelized to build infrastructure. Targeted interest subsidy is a thought which merits consideration. Other measures that could stimulate investments are reintroduction of investment allowance, accelerated and differential depreciation, removal of dividend distribution tax (DDT) and minimum alternate tax (MAT).

Driven by an exceptionally good last quarter, KCI continued its good performance track record over the years and reported higher operating profitability in 2008-09. This is despite the fact that as a manufacturer of commodity chemicals largely used by industries for their manufacturing processes, we witnessed some lack of demand, impacted by reduction in manufacturing activity in the economy during the second half of the fiscal.

A continuous vigil on the cost structure and associated cost saving measures provide KCI insulation against depressed economic conditions. Streamlining logistics and distribution, procurement and ensuring speedier realisations are components of KCI's response to such a situation. I am pleased to note that our measures proved effective and the company made strong comeback in the last quarter of fiscal 2008-09 despite an extremely poor third quarter.

During the last year, the focus was on strengthening our Chlorine derivative products. Brownfield capacity in the Chlorinated Paraffin production was added, where the company proposes to increase exports. At the time of writing this report, the company had also purchased the Renukoot located Chlorinated Paraffin manufacturing facilities of Prajapati Chemicals and Allied Limited.

Our strategic agreement with the Uttar Pradesh Power Corporation Limited (UPPCL) in January 2009 for sale of surplus power from our power plants at Renukoot proved effective to offset losses of lower capacity utilisation in the chemicals business.

Our Alco Chemicals division faced difficulties throughout the year on account of rising raw material costs, declining product prices and slackening of export demand for Pentaerythritol. Our strategic response in reshuffling the product mix, partially offset low realizations in this segment.

Last year, I had mentioned about the company's plan to consolidate our position in the Alco Chemicals sector by way of a Greenfield project at Vizag in Andhra Pradesh. I am happy to report that the project is progressing well and we expect to complete the installation of a 105,000 TPA Formaldehyde Plant and a 5,600 TPA Hexamine Plant by July 2010.

Now at the threshold of almost five decades of manufacturing activities, we at KCI are poised to look ahead with confidence. The path so far has been of continuous learning and being able to meet contemporary business needs. I am sure that our ethical business practices and focus on sustainable development will hold us in good stead in future too. Even during this phase of slow economic growth, our plans are on schedule and we would continue to overcome challenges to sustain our position as a leading player in the Indian chemicals industry.

I am sad to report that one of our illustrious members of the Board of Directors, Mr. Supriya Gupta passed away on 7th February 2009. We lost a good colleague and we will miss his financial acumen and vast experience that he brought to the Board for several years. May his soul rest in peace.

R V Kanoria

Chairman & Managing Director

CONSOLIDATION

In about 18 months Kanoria Chemicals & Industries Limited (KCI) from its date of incorporation would turn 50. Since the first plant commenced production only in 1964 the Company shall celebrate its fifty years of operations only in the year 2014. It is a period of looking back with satisfaction, consolidating achievements and continuously realigning operations as per the fast changing market dynamics. Forward looking policies have always helped the Company in riding the ups and down associated with commodity markets. In keeping with its basic ethos of sustainability, KCI has evolved good practices in all spheres of operations.

KCI started its activities in 1964 by commencement of production of Caustic Soda at Renukoot, a relatively remote location in District Sonebhadra in eastern Uttar Pradesh. In subsequent years the Company added several chlorine derivative products including Stable Bleaching Powder, Lindane, Aluminium Chloride, Polyaluminium Chloride and Chlorinated Paraffin. Presently, this manufacturing facility spread over 350 acres, also hosts two 25MW thermal power plants and all other facilities that make it a model industrial township.

In the year 1983, KCI commissioned another chemical complex at Ankleshwar in the state of Gujarat for manufacture of Ethanol and Methanol based chemicals. The Company's Alco Chemicals complex that includes a distillery has emerged as a highly integrated manufacturing facility and is recognised for its manufacturing and environment management practices some of which have become industry standards. The Company is winner of several awards in this category.

The increase in KCI's manufacturing capacities has been steady. It has taken the Company from its humble beginning of a single-product, single-location entity to being a major player in the Indian chemicals industry. The Company's portfolio includes at least six products where KCI has market leadership in India, namely Caustic Soda, Aluminium Chloride, Poly Aluminium Chloride, Pentaerythritol, Hexamine and Formaldehyde.

In the Chloro chemicals segment, Caustic Soda capacity has increased nearly eight times from 16,500 TPA to the current 128,000 TPA. Similarly the capacity for Stable Bleaching Powder has increased six times from 5,000 TPA to 30,000 TPA. In the Alco chemicals segment, Pentaerythritol capacity increased five times from 1,200 TPA to 6,000 TPA, and that of Formaldehyde increased nearly five times from 16,500 TPA to 75,000 TPA.

Apart from expansions in its manufacturing activities and product range, the Company has made important strides in inculcating best practices in corporate governance, ethical business conduct, environment management and meeting its social responsibility. The past fifty years have only re-strengthened the Company's resolve to maintain its sustainable approach in all operations. Its Vision Statement (See box) demonstrates its desire to be "responsible and respected" with a global outlook.

Good practices have earned KCI GVC Level 3 rating, which indicates the Company's strong capability with respect to wealth creation for all its stakeholders while adopting sound corporate governance practices.

Apart from continuously increasing stakeholder value, KCI has also steadily demonstrated its social responsibility by undertaking socially useful investment and remaining proactive in community development programmes. A brief description of the activities of the Company in this area is given in the section titled 'Beyond Business…'.

The KCI Vision

"To be a responsible and respected player in Basic, Fine and Speciality Chemical manufacturing with a Global Footprint"

- Achieving globally benchmarked standards of excellence in all our operations and by being system driven.
- Institutionalizing a Knowledge Management System that enables generation, retention and sharing of knowledge across the corporation appropriately.
- Exploring and seizing opportunities in emerging and developing economies.
- Nurturing an R&D mindset and fostering innovation.
- Broadening our product base through a judicious mix of organic and inorganic means.
- Establishing a High Performance Work Culture and achieving highest levels of employee engagement.
- Following Principles of Corporate Governance and being socially responsible.
- Deploying cost effective and appropriate technology.

THE YEAR IN REVIEW

The second half of the year under review witnessed sharp declines in the rate of growth across sectors as a result of the global economic and financial slowdown. With rising input costs and slack demand on account of depressed manufacturing activity in the economy, KCI continued its vigil on costs and drawing on its experience of riding the troughs of the commodity market business cycles. The measures were largely successful and the low growth during the year was reversed in the last quarter of the year. The Company was able to successfully offset part of the losses on account of lower production by entering into a renewed agreement with Uttar Pradesh Power Corporation Limited (UPPCL) to sell surplus power which became available as a result of lower capacity utilization of the Chlor Alkali plants.

During the year, the Chlorinated Paraffin production capacity was expanded by adding a 32 TPD line in August 2008. Initial problems with the Stable Bleaching Powder capacity enhancement taken up during 2007-08 were resolved and production stabilized. The Company continues with its focus on developing Chlorine derivative products as an effective forward integration process.

With user industries like paints, automobiles and construction witnessing stagnation, the demand for Pentaerythritol also remained depressed. Coupled with rising raw materials prices, the Alco Chemicals Division faced difficulty during the last year. However, with signs of an economic recovery becoming visible, KCI is expected to forge ahead in the coming year and continue to fortify itself against economic uncertainties.

MANAGEMENT DISCUSSION & ANALYSIS

Financial Performance with respect to Operational Performance

The past year was extremely challenging with unprecedented economic volatility triggered by sub-prime crisis, the impact of which was felt even in strongly growing economies like India. However, the focus of the Company in taking proactive measures to gain market share and keeping continuous vigil on the cost structure insulated the operations of the Company to a great extent and resulted in higher volumes both domestically and internationally as also higher operating and cash profits and margins during the year under review.

The Net Sales of the Company increased by 14% from Rs. 4,322 million in the previous year to Rs. 4,918 million in the current year. In line with its vision, KCI continued to enter markets in newer geographical segments for its downstream Chlorinated derivatives resulting into a growth of 67% in exports, over the 75% growth achieved during the previous year. This has happened despite lower international demand on the backdrop of global slowdown in economic activities. Exports now contribute more than 11% to the Company's topline.

The year also witnessed significant increase in raw materials cost which increased from 38% to 43% as a percentage of net sales. However improved realizations in the Chloro Chemicals segment as also constant efforts towards achieving savings in other associated costs resulted in the Company posting a higher Operating Profit (PBIDT) which increased from Rs. 964 million to Rs. 1,150 million and higher operating margin which improved from 22.31% in the previous year to 23.38% in the year under review despite significant increase in input costs. The Cash Profit also increased from Rs. 710 million to Rs. 855 million, an increase of 20%.

The Indian Rupee during the year depreciated by over 27% against the US Dollar. Your Company raised funds through Foreign Currency Convertible Bonds aggregating US $ 20 million in May 2006 and is also making proportionate provision for premium that may be payable on the redemptions of bonds in the eventuality of the same being not converted into equity shares. The depreciation of Indian Rupee resulted into an uncrystallized loss of Rs. 243 million on revaluation of the FCCBs and premium thereon which as per the recent notification issued by the Ministry of Corporate Affairs could have been capitalized/amortized. However following the fair value accounting concept the Company chose to charge the entire amount to current year's profitability. This has driven the Net Profit down from Rs. 305 million in the previous year to Rs. 146 million in the current year. The Basic EPS stood at Rs. 2.59 per equity share. The Company has recommended a dividend of 30% on the equity capital.

Chloro Chemicals Segment

Industry structure and development

- The Chlor Alkalis business segment includes the production of Caustic Soda and Chlorine as well as various Chlorine derivatives that cater to a wide range of user industries, such as aluminium, paper, textiles, soaps & detergents, petroleum refining and pharmaceuticals.

Opportunities

- Caustic Soda has extensive application in a wide range of user industries. This ensures a steady demand for the product even if a few of the user industries witness stagnant growth. With signs of economic recovery spearheaded by the manufacturing sector, higher demand for the product is expected in 2009-10.
- Company positioned well to meet the higher demand through expanded production capacity.
- Strong forward linkages of the Company to commercially utilise Chlorine for production of downstream derivatives like Stable Bleaching Powder and Aluminium Chloride add considerable value to the revenue stream.
- Continuous focus on environment friendly technologies and sustainable development initiatives enables the Company to conform to best standards.

Threats

- Cheaper imports and increasing input costs could distort markets and margins.
- Excessive environmental activism could impact the usage of Chlorine in downstream products.

Performance

- The Chloro Chemicals Division of the Company reported production of 94,207 MT of Caustic Soda in 2008-09 as against 78,516 MT in the previous year, an increase of 20%.
- The production of Poly Aluminium Chloride was 28,925 MT compared to 23,443 MT in 2007-08. The production of Chlorinated Paraffin increased nearly 57% to 11,803 MT in 2008-09 up from 7,522 MT in the previous year. The production of Stable Bleaching Powder improved to 21,160 MT from 18,069 MT in the previous year registering a growth of over 17%.
- The two captive 25 MW thermal power plants, which are part of the Chloro Chemicals complex of the Company, reported stable generation of electricity. The twin plants provided flexibility in operations and net power generation during the year under review was 314.68 MW/MU. During the year the average Plant Load Factor (PLF) for Unit 1 was 81.67% and for Unit 2 it was 80.09%. This was possible as a result of the agreement to sell power to UPPCL.

Outlook

- With augmentation of Caustic Soda capacity, KCI is poised to service the growth in demand for Caustic Soda. Higher economic activity with a resurgence of the manufacturing sector augurs well for the Chlor Alkali industry.
- Increased investment activity in the metals and mining sector as well as in paper and textiles is expected to further augment Caustic Soda demand. The other products of the Company also expect robust demand over the medium term.
- The Division is particularly insulated to downturn because of its ability to offset revenue loss through sale of electricity.

Alco Chemicals Segment

Industry structure and development

- The Alco Chemicals Division located at Ankleshwar, Gujarat comprises the production of ethanol from molasses and Formaldehyde from methanol, which is further synthesized into several products for industrial applications. These products include Pentaerythritol, Sodium Formate, Acetaldehyde, Hexamine and others.

Opportunities

- The technological expertise and market leadership in several products provides the Division a competitive edge in the market.
- The Division is located in close proximity to both sources of raw materials as well as markets for finished products, thus positioning it strongly to cater to steady demand from its user industries such as paints, resins and laminates.
- The highly integrated nature of the Division and the pioneering work it has done in treatment and recycling of distillery effluent and other waste enables it to sustain a low cost structure and thus makes the products of the Division competitive in both domestic and international markets.

Threats

- Cheaper imports and dumping of Pentaerythritol and Hexamine.
- Uncertain market conditions in a depressed economy.
- Erratic price and supply of molasses and its diversion to distilleries catering to the Ethanol for fuel programme and expanding potable alcohol market can lead to difficulties in procurement of molasses, the main raw material for the Division.

Performance

- The operations of the Alco Chemicals Division remained stable during the year. Production of Pentaerythritol during 2008-09 was 6,225 MT compared to 6,334 MT in the previous year. Production of Hexamine was higher at 4,491 MT compared to 3,939 MT in 2007-08. Production of Formaldehyde also improved and the Division produced 72,404 MT of Formaldehyde compared to 69,424 MT in the previous year.

Outlook

- Stable growth of user industries such as the paints industry indicates a sustainable growth for the Division once the global and particularly the Indian economy recovers from the downturn.
- Technological expertise and market leadership position in several products provides the Division a competitive edge in the market.
- Low cost structure as a result of backward and forward integration of products and processes, and the innovative use of waste with positive commercial impact.

CAPACITY EXPANSION DURING THE YEAR

During the year, KCI commissioned a 32 TPD Chlorinated Paraffin plant.

KCI's Greenfield project in Vizag for the production of 105,000 TPA of Formaldehyde and 5,600 TPA of Hexamine is progressing well and is expected to be commissioned by July 2010.

INITIATIVES DURING THE YEAR

Chloro Chemicals

Chlorinated Paraffin:

- Plant commissioned in August 2008
- Installation of two degassers
- Installation of tail gas tower
- Installation of degassing system in HCL storage tank
- Installation of mixing tray for reprocessing of product to meet customers' specification
- Stabilization of Reactor 5

Cell House:

- Improvement in Chlorine purity from 90% to 95%
- Reduction in Hydrogen percentage from 1.5% to 0.6%
- Reduction in brine turbidity from 2 NTU to less than 1 NTU

Chlorine Plant:

- Both Chlorinated Paraffin plants connected to old vaporizer system, thus eliminating the need to use tonners for transportation
- Chilled water temperature maintained by 'steaming' during stoppages, thus saving energy by eliminating the need for stopping cooling tower pump and water recovery pump
- Chlorine storage tanks fitted with double equalizer valve for greater safety
- White Hydrochloric Acid production started after minor modification resulting in energy saving
- Modification in supply line for lime transfer enabled energy saving and eliminating the need for pump, agitator and tank