Kanoria Chemicals & Industries Limited

Chemistry of values and of value additions

Annual Report
2010-11

Kanoria Chemicals & Industries Limited

COMPANY SECRETARY
N.K. Sethia

AUDITORS
Singhi & Co.
Chartered Accountants
1-B, Old Post Office Street
Kolkata - 700 001

BANKERS
Allahabad Bank
UCO Bank

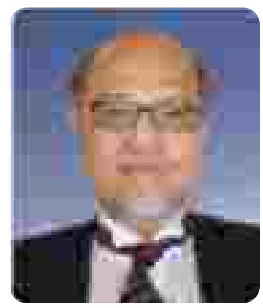
REGISTERED OFFICE
'Park Plaza'
71, Park Street
Kolkata - 700 016

Board of Directors

R V Kanoria

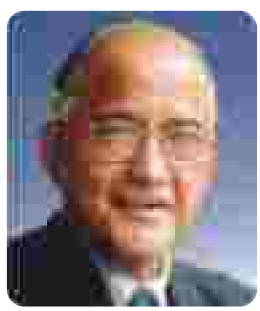
H K Khaitan

Amitav Kothari



Ravinder Nath

G Parthasarathy



S L Rao

B D Sureka

A Vellayan

J P Sonthalia

T D Bahety

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Chairman's Statement

The global economy continues to remain in a flux with no signs of getting out of the sluggishness caused by the slowdown in 2009. While a series of stimulus packages in the United States and Japan had taken the growth trajectory close to the pre-crisis levels, the momentum has weakened since middle of 2010 and is predicted to remain modest at best till 2012. Much of this drag in growth is caused by imbalances as a result of sluggish developed economies and significant increase in net private capital flows into the developing ones. Volatility in exchange rate and commodity prices and unemployment levels are manifestations of the situation. The world will continue to look towards the developing countries to prop up global economic growth.

The past year was marked by important developments that are expected to have long term impact. The economic uncertainties were compounded by the continuing tension in North Africa and the Middle East against the monarchy and authoritarian regime.

The massive devastation caused in Japan by the earthquake and tsunami in March 2011 has already sent ripples across the globe with many economies directly or indirectly getting adversely affected. More importantly the spectre of nuclear fallout has raised questions about safety, especially in countries like India that have energy shortfalls and future plans of greater reliance on nuclear power.

In a period of turmoil and volatility, both developed and developing countries need rule based frameworks for conducting business. Differences continue to hamper development in this respect such as the future course of the WTO remaining in limbo. Political will for concluding the Doha agenda is lacking and domestic issues override priorities for multilateral rule based trading systems. After years of hard work, it is important not to miss the 2011 timeline and the Doha talks must succeed to ensure the viability of rule-based multilateral trading system. Failure to do so could lead to national governments to seek other means to approach trade and investment. Some may pursue protectionist measures impeding flow of import into their markets; others will focus more on bilateral and regional trade agreements. This would result in a proliferation of rules and business confusion - a veritable 'spaghetti bowl'. The Dispute Settlement mechanism could come under strain with the WTO having to resort more to adjudication rather than negotiation. There is also a need for a regulatory body to monitor exchange rate fluctuations and cross border flow of capital.

In the Indian context, the fiscal 2010-11 witnessed high inflation and the perennial debate on balancing economic growth with rising prices. Monetary policy is being used to keep a control on inflation. The tight money policy of the Reserve Bank of India, however, has led to a slowdown in investments, and thus a check on growth. Unless there is growth stimulus, we will face supply constraints 2-3 years from now. The monetary policy is therefore only a temporary solution, if at all.

Currently inflation is more pronounced in primary commodities. Lack of growth impetus may widen the impact on other areas. There is an urgent need to stimulate incentivised investments. The policy must enhance availability of inexpensive funds for expansion and growth. At the same time there is a need for review of the Minimum Alternate Tax (MAT) and the Dividend Distribution Tax (DDT) that discourage investment. The policy should also reconsider introduction of Investment Allowance and other measures that provide a fillip to investment.

Double digit inflation, firming interest rates and a slowdown in the manufacturing sector can significantly impact economic well being of the country in the coming months. The supply side factors need close scrutiny. Rising input costs for industry because of inadequate transportation and other physical infrastructure need urgent redress. In this connection, the focus on supply in the 12th Plan approach paper is heartening and may lead to a mechanism that enables a more comprehensive check on prices. The question is whether we have the time to wait that long.

A particularly worrying trend is the slowdown in the manufacturing sector which is plagued with rising input costs. The larger issue of fiscal integration and removal of the plethora of local and state taxes continue to hamper growth. The sector's capability to create employment and leveraging opportunities in world trade remain constrained. Rapid implementation of the Goods & Services Tax (GST) is particularly important. With a political deadlock on several issues on the reforms agenda, the progress on GST has slowed down considerably. The

Government has recently introduced a Constitutional Amendment Bill in the Parliament to pave the way for GST. In its present form, however, the proposals are general in nature and sometimes miss the spirit behind such a move. Key sectors such as petroleum, real estate and electricity that have extensive forward linkages and costs have been kept in abeyance. There is also no clear indication on how the local and state levies would be eliminated or reconciled.

The recently announced national manufacturing policy seeks to increase the share of manufacturing sector to 25% of GDP in fifteen years from the current share of about 16%. This certainly is a welcome step with desirable objectives. Several steps have been enunciated in the policy such as the creation of National Investment & Manufacturing Zones and flexibility in labour laws. Much, however, would depend on the spirit, pace and depth of implementation, which can only be facilitated by a consensual political environment.

Although a comprehensive manufacturing policy is just what India needs, the underlying objective has to be raising the competitiveness of the sector. There are several fundamental reforms that are needed for such a policy to be effective. The first and the foremost is adequate infrastructure. Shortfalls in areas such as roads, ports, airports and other logistics, availability of electricity, suitable guidelines for land acquisition and water supply have acted as a drag on the growth of manufacturing. While India has developed a commendable virtual infrastructure with development of the telecommunication sector, creation of physical infrastructure has remained limited and has failed to keep pace with the economic growth in the past two decades.

A manufacturing policy would remain incomplete if the role of private sector is not factored in. Resource requirement for leapfrogging in manufacturing capability has to be kept in perspective. Development finance institutions in the country have given way to universal banking and affordable funds to private sector are difficult to come by. Reforms in the pension and insurance sectors that free up locked funds are imperative in this context.

Efficiency of the manufacturing sector depends a great deal on energy security and availability. There have been large distortions by way of subsidising the energy needs of agriculture with the burden passed on to industry. The approach in this direction needs urgent review and the new manufacturing policy does not mention a possible solution in this respect.

The new manufacturing policy needs to be juxtaposed with labour reforms that provide greater flexibility in the movement of skilled labour. This has to be beyond just an Exit policy. With the labour force attaining higher levels of literacy, the labour policy has to shed its rigidities based on subsistence and move on towards facilitating higher productivity and wider skill base. Legislation such as Payment of Wages Act and the Bonus Act therefore need review.

The Government must relinquish ennui and shift the focus from the current negative feeling to a positive one through bold initiatives, without getting bogged down with an outcry of corruption or a demand for partisan populist policies.

The year gone by has been an eventful one for us. Although not strictly pertaining to the year under review, in April 2011 the Company entered into an agreement with Aditya Birla Chemicals (India) Limited, a part of the Aditya Birla Group and a subsidiary of Hindalco Industries Limited, for divesting its Chloro Chemicals business. The transaction by way of a slump sale at a value of Rs. 830 crore was concluded on 23 May 2011. The divestment allows us to move in other areas including higher value added products.

The Company also exited from the joint venture with Soluciones Extractivas Alimentarias of Spain where it was a minority shareholder.

Our Greenfield project at Vizag in Andhra Pradesh commenced production of Formaldehyde in the month of December 2010. Activities are going according to plan and production is stable. Meanwhile we are developing new markets and remain optimistic about the future of our Vizag operations. The addition of capacity consolidates the Company's leadership position as a Formaldehyde manufacturer in India.

The new R&D Centre at Ankleshwar is expected to provide a major fillip to developing downstream products, as well as other fine chemicals. Apart from creating an in-house repository of products and processes, the Centre is expected to become a net revenue generator through outsourcing its services.

The Company has always laid stress on alternative forms of energy. The biogas energy generated from distillery effluents at our Ankleshwar plant under the highly successful 'Waste to Wealth' programme has received wide recognition. KCI has plans to enter the renewable energy segment especially in solar power generation. It has made some initial progress in this direction and we hope to strengthen our endeavours in this area in the days to come.

At KCI we are currently in an active mode to chalk out future business strategy. The commissioning of our Vizag facility provides us a strong avenue for forward integration and setting up capacities for production of downstream products. I believe that this along with opportunities in other value added products including fine and speciality chemicals would steer the company in the next decade.

After an eventful year, the Company is now poised to enter the next growth phase. We are confident that our successful operations in the last five decades and the recent business restructuring post our divestment of the Chloro Chemicals business would provide us with greater focus. I would like to thank all our stakeholders for not only making this journey possible but also making it meaningful and satisfying. I look forward to your continued support.

R V Kanoria
Chairman & Managing Director

Over the years …

We at Kanoria Chemicals & Industries Limited (KCI) believe that excellence is a continuous process. The process includes consolidating the strengths that the Company has developed over the years, as well as leveraging external opportunities.

A vital component of this growth has been the Company's policies on sustainability and transparency. As stated in the Company's Vision Statement (See next page), KCI adheres to best practices in corporate governance and environment management. KCI's environment management practices have been recognized by way of several awards (See below) including the coveted TERI Award for Corporate Excellence in Environment Management.

Investing in the best available technology is yet another pillar in the framework of the Company's growth strategy. This has not only provided a competitive edge in terms of product quality, but has also facilitated good manufacturing practices. The latest addition in this sphere is the high technology Formaldehyde plant at Vizag in the state of Andhra Pradesh that was commissioned during the year.

As a result of this strategy, the Company is not only one of the lowest cost manufacturers in the country, but one of the most environment friendly companies in the industry as well. Despite its modest size, KCI currently is a market leader in India in three of the several products it manufactures, namely Pentaerythritol, Hexamine and Formaldehyde.

Innovation and the willingness to learn from past mistakes have made the Company industry leaders and a pioneer in many areas. A notable example of these attributes is the Company's 'Waste to Wealth' programme run at its Alco Chemicals Division at Ankleshwar in Gujarat. The programme is based on the treatment of distillery effluent in a three pronged approach. First the water content is extracted thorough a reverse osmosis process that was deployed for such an application for the first time in the country. In the second phase, anaerobic reaction releases biogas which is directly used to generate up to 2 MW of electricity. Finally, the remaining sludge is dried and treated to make it into nutritional organic manure.

Sustainable development, ethical business practices, transparency of operations, sensitivity towards protecting the environment and catalysing growth in the community are cherished objectives that have stood the Company in good stead over the past decades. The 'beyond business' initiatives of the Company have enriched KCI's technology and manufacturing capability along with generating goodwill of all business associates.

KCI is now poised towards further expansion and leveraging new growth opportunities to consolidate its strong position in the Indian industry. In the months ahead intense activity is anticipated that would drive KCI to the next growth level.

Awards received by KCI

- ICMA Award for Water Resource Management
- ICMA D.M. Trivedi Award for Introducing Advancement in Technology having a Widespread Impact on Chemical Industry
- TERI Award for Corporate Excellence in Environment Management
- World Environment Foundation Golden Peacock Award for Environment Management and Eco-Innovation
- Gold Award for Outstanding Achievement in Environment Management in Chemicals Sector by the Greentech Foundation
- National Award for Flyash Utilization by Department of Science & Technology, Ministry of Power and Ministry of Environment & Forests, Government of India
- ICC Award for Social Responsibility by the Indian Chemical Council (ICC)

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 year 2010-11 witnessed strong inflationary pressures and a tight monetary policy. This has created a negative impact on growth, particularly in the manufacturing sector.

KCI, however, forged ahead with its investment commitments and its Greenfield project at Vizag in Andhra Pradesh for manufacture of Formaldehyde and Hexamine. Commercial production of Formaldehyde started in January 2011. Progress in on schedule and new markets are being currently developed. The capacity addition in Formaldehyde production strengthens KCI's leadership position in the country.

In line with the Company's continuous focus on technology and for strengthening its research and development base, an R&D Centre was set up during the year at KCI's Alco Chemicals facility at Ankleshwar. The Centre is envisaged to provide necessary testing and is to be equipped with synthesis and analytical facilities. It is also expected to impart vital capability in product and process development and act as a facilitator for forward integration of the Company's present business through new downstream derivatives. The Centre is also expected to soon develop capability of pilot plant facility for scale up and initial supply, as well as HAZOP study for safe processes.

Although the development took place after the year in review, KCI divested its Chloro Chemicals business to Aditya Birla Chemicals (India) Limited by way of a slump sale. After five decades of profitable operations, the Company decided to diversify in higher value added products including fine and speciality chemicals.

KCI also exited the joint venture with Soluciones Extractivas Alimentarias S.L.A., Spain where it was a minority shareholder, to consolidate its core business experience.

MANAGEMENT DISCUSSION & ANALYSIS

Financial Performance with respect to Operational Performance

During the year under review, the Net Sales increased by 15.2% at Rs. 4,852 million as compared to Rs. 4,212 million in the previous year. The export sales at Rs. 466 million contributed to 9.6% of the Net Sales. The PBDIT was marginally lower at Rs. 859 million as against Rs. 877 million in the previous year. The operating margin, however, reduced from 20.8% to 17.7% mainly due to higher input costs, both in respect of materials consumed and fuel used in generating electricity. The materials costs were 42.7% as against 40.3% of Net Sales in the previous year.