

KREBS BIOCHEMICALS LIMITED
Annual Report 1997-98

Value through Biochemistry

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*'I know of no more
encouraging fact than
the impressionable
ability of man to
elevate his life by a
conscious endeavour'*
– Henry David Thoreau



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Corporate description

Krebs Biochemicals Limited is a Hyderabad-based company manufacturing Ephedrine and Pseudoephedrine through the biochemistry process. The company is one of the few in the world to use this route to produce these bulk drugs. These bulk drugs are used to make remedies for respiratory ailments and infections. A principal component of the company's turnover (75 per cent) is exported to various countries.

Krebs went public with an IPO in 1994 to part finance an installed capacity of 60 tpa. The management expanded the capacity of the plant in subsequent years out of accruals and debt to its present status of 150 tpa.

Krebs is now intending to diversify into the manufacture of E-mycin and related products. This strategy, while expected to bring more stability into the Krebs bottomline, is expected to drive Krebs' profit growth in 1998-99 and beyond. The new products are expected to find large and growing markets in India and other developing countries.

The company has entered into a technical know-how collaboration with M/s. Raj Mehta Associates, U.S.A for the transfer of technology to manufacture a basket of fermentation products for its new plant coming up at Kothapalli Village, Kasimkota Mandal, Visakhapatnam district.

Krebs has been promoted by a technocrat entrepreneur Dr R.T. Ravi. The core management has a stake of 38 per cent in the company's equity. The Krebs stock has been listed on the Hyderabad, National and Mumbai stock exchanges. The market capitalisation of the company was around Rs 420 million towards the close of 1997-98.

The stated philosophy of the Krebs management is to deliver excellent long-term value to its equity owners.

Post-balance sheet date developments

- An Extra Ordinary General Meeting was held in June 1998 to approve the issue of share warrants to the core promoters entitling them to buy the Krebs equity at Rs 141.65 per share.
- After India's nuclear blast, buyers are beginning to negotiate prices, creating a mild pressure on prices in the last two months. Though actual prices have not fallen yet, the price fall will be less than 5 per cent for 1998-99. Though dollar prices may fall, Rupee prices will be better as the Rupee has depreciated by more than 5 per cent.
- Director Dr. T. V. Subbaiah resigned and Dr. T Kuchroo was appointed as the Additional Director.

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Chairman's Overview

I am glad to report yet another year of the good performance of your company in 1997-98. During the year under review the company increased the turnover to Rs. 36.18 crores from Rs. 26.95 crores in the previous year - a 34.20 per cent growth. The net profit has shown an increase of 47.9 per cent to Rs. 12.63 crores over the previous year.

I am particularly happy to report that your directors have recommended a much higher rate of dividend of Rs. 5 per share. This is specially commendable as the company spent most of the profits for the diversification

project at Kothapalli Village, Visakhapatnam District and in creating additional facilities at Regadichilaka Unit in Nellore District, in the establishment of effluent treatment plant to meet its needs. The new fermentation facility at Kothapalli is almost complete and trials are under progress.

On the whole 1997-98 was a year of satisfactory performance.

Although, the performance of your company over last four years has been showing a steady growth, it must not be forgotten that efforts must be directed to keep the company ever

vigilant to face the challenges of competition and technological obsolescence to achieve much sought-after growth and volume as well as to sustain the profitability of your business. A major step in this direction was taken by your company with the establishment of the new facility at Kothapalli, which will become operational during the first half of 1998-99.

Subsequent to the liberalisation and India becoming a member of the W.T.O., the Indian pharmaceutical industry is going through a series of changes like brand acquisitions, international merges of MNCs - and consequently the changes in their local outfits - new product launches and the restructuring of companies. Precisely, these happenings are in line with the international scenario where most pharmaceutical majors are involved in acquisitions and mergers. Along with the growing global generic market, the challenges for players has increased. Recognising these realities, your company has drawn up contingency plans. The focus in the near future is to build the organisation to enable it to maximise benefits from such changes.

In response to these requirements, your company is in the process of commissioning a multipurpose fermentation facility at Kothapalli, necessitated by a steep fall in South East Asian currencies and the sharp increase in the competition for the products in the market place.

The scenario also demands that Krebs grows from a managerial viewpoint. To respond to this requirement, the company is strengthening its compliance to the demands of an effective corporate governance and the clear enunciation of a profit distribution policy with its shareholders.

In the area of social responsibility your company has been actively participating in various Janmbhoomi programmes, especially in the surrounding villages of our plants at Regadichilaka and Kothapalli. The company has been contributing to various community development activities like the construction of

schools and roads. Your company is also committed to ensure that its facilities comply with both the letter and spirit of government regulations on environmental protection. The commissioning and the operation of the new effluent treatment systems at the plant sites demonstrates our resolve in this regard. Of more importance to the company is to meet or even to exceed the quality standards for the products it puts in the market.

The combination of sound business strategies and corporate initiatives will ensure a solid financial management of your company. I am confident that your company will continue to deliver handsome earnings. The management at Krebs is aware that the diversification counts for nothing if we cannot deliver value in the hands of our shareowners at the end of the day. The management is also committed to ensure that its strategic diversification delivers a return far in excess of its cost of capital - at least at par with the existing return enjoyed by the company. The corporate transparency is maintained to create confidence among the equity holders.

With strong commitment, dedicated hard work of the company's employees and a responsive management, I have every reason to believe that the future holds goods for Krebs Biochemicals Limited.

Dr. M. Venkataratnam,
Chairman



Managing Director's review of operations

During the year 1997-98 the company achieved a higher production, sale and profit, though the performance could have been better. Our results were considerably better than what we had announced to the public at the time of our IPO in 1994 and to this extent has more than vindicated the trust reposed in the management by its shareowners. But there is a stage when we must get past retrospective comparisons; it is in this respect that I was slightly disappointed with the performance of the company. We should have leveraged our insight into fermentation technology better. That alone would have delivered a significant increase in output. Besides, costs also could have dropped.

Operations

Out of 139 MT of Ephedrine produced during the year, 56.782 MT of pseudoephedrine was manufactured and 80.698 MT of Ephedrine was sold. This comprised 92% capacity utilisation. However, the expected increase in production due to process improvements could not be achieved. The focus for the current year is to achieve a higher productivity from Regadichilaka plant. Throughout the year, the raw material supply position had been comfortable and we enjoyed excellent support from suppliers. Molasses prices were firm whereas some solvents were cheaper during the year.

APSEB sanctioned the additional power of 431 KVA during the year for Regadichilaka Plant. An additional D.G.Set of 600 KVA was also installed during the year.

Notably, a new Effluent Treatment Plant (ETP) at Regadichilaka, constructed at a cost of Rs. 215 Lacs was commissioned. With proper stabilisation of its operations, the pollution problems are being effectively tackled. Also, in order to overcome the poor quality water problems at Nellore, a Reverse Osmosis plant was also installed at a cost of Rs. 25 Lacs and has become operational during the year.

A new project at Kothapalli has gone through certain changes in the product range. Alternate products were identified and necessary hardware and software for their manufacture had been procured in time. Currently commercial scale trials are in progress at the Kothapalli plant for the manufacture of Erythromycin Thiocyanate. This unit is expected to be in commercial production during the first half of 1998 and shall contribute to sales during the first half itself.

As mentioned in the previous year's report, we have procured several laboratory equipment costing Rs. 35 Lacs and installed at Regadichilaka to strengthen our quality control functions. This is an integral part of our operations as a number of our customers are in the US and other sophisticated markets, insisting on stringent quality control / assurance programming.

Markets:

During 1997-98 about 94% of our total exports went to the US market and 75% of the sales turnover was contributed by exports. Our consistent marketing policies have helped in obtaining long term contracts from our major customers abroad.

Krebs continued to deliver superior quality to its demanding customers. Over the last few years, Krebs has created a strong reputation among its buyers worldwide about its quality. In this case, quality goes beyond the pharmacopial benchmark. It extends to subjective parameters like whiteness of the product, the grain and the crystal clarity. This is where we score: Krebs now commands a strong reputation, the demand for our output is more than what we could deliver in 1997-98. That is quite an achievement for a four-year old company.

We continue to suffer from not having a USFDA-approved plant for Ephedrine & Pseudoephedrine. However the average realisation during the year remained constant and the Rupee devaluation benefits started coming only from January 1998 onwards.

The new markets accessed by Krebs during 1997-98 were Taiwan, Switzerland and Iran. Currently, the countries to which we export are US, UK, Hong Kong and Ghana. These constitute dollar earnings, the customers are repeat clients, and the quantities indented by them are increasing in tonnage.

Exports have gone up by 33.41% over the previous year. As the domestic prices of Ephedrine and Pseudoephedrine fall under DPCO, there was no change in realisation as far as the local sales are concerned. The largest single domestic customer (Glaxo Wellcome) has discontinued the usage of

Focus

Studies show that the average person has more than 50 colds in a life time. A cold may be complicated by bacterial complication of the sinuses, middle ear or upper airways.

Most colds run their course in a week to ten days, although most people feel better in four or five days.

Krebs Biochemicals makes quality products that are used in the manufacture of remedies addressing colds and respiratory problems sold in the vast OTC market in India and abroad

Pseudoephedrine formulations and therefore our local sales suffered during the year.

The large domestic market for Erythromycin which is being serviced by imports presently will offer a ready market for our own Erythromycin when we come into the market during the first half of the current year. I do not foresee any problems in marketing the entire output of this product over the next few years.

Personnel:

We owed the improved performance in 1997-98 to the dedicated hard work of the employees of the company. During the year, 106 new employees joined the roll of the company, while 64 employees left the company for various reasons. Most of the new additions were at the Kothapalli (Visakhapatnam) unit. The average cost per employee has gone up to Rs. 30576 from Rs. 25030 in the previous year. This has been mainly due to the recruitment of higher skilled work force. It is matter of satisfaction to me to report that employee productivity continues to be on the increase.

With Mr. M.R. Chowdary relinquishing the Executive Director's position due to personal reasons at the beginning of the second half of 1997-98 and Dr. T.V. Subbaiah following suit in May 1998, the company has inducted more qualified and experienced personnel at the operational level. The emphasis is on recruitment of talent in every aspect of the business with a suitable delegation of power and responsibilities.

The employee-employer relationship continues to be cordial. Certain misunderstandings cropped up between a section of workmen and the administration at Regadichilaka which resulted in a strike call by them for one day on 8th February and finally remedial measures taken by the management averted any further disruption of work. There is an increase in the employee welfare expenditure during the year from Rs.1.27 million in 1996-97 to Rs. 2.53 million during 1997-98.

New Project

The global risk for Krebs comes from the fact that ephedrine can hypothetically be converted into amphetamines and street drugs. Because of this risk of diversion from the legitimate use, the use of the bulk drug is strongly regulated the world over. Should these restrictions increase, it could affect Krebs' export procedure and possibly even exports.

The domestic risk for Krebs comes from the fact that Ephedrine and Pseudoephedrine are under the DPCO. Those wanting to buy the product cheaper in India would, in the face of a steady price, be more inclined to use alternative molecules which are not under the DPCO.

To reduce these risks, Krebs is diversifying its portfolio of products.

After 4 years of staying in the Ephedrine and Pseudoephedrine business, the management is of the view that instead of expanding the scale of operations further and keeping to a single product, it would serve the corporate interest better if we spread our risks.

The management's decision to establish the diversification project for the production of Monosodium Glutamate (MSG) at a cost of Rs.26.50 crores at Kothapalli is in line with its policy of adherence to the areas of core competence of the company. But once the Asian crisis broke and the Far East currencies weakened, the dumping of MSG into India increased substantially. We were still in the process of setting up the MSG plant. But as the dumping accelerated, we took a quick corporate decision to manufacture E-mycin instead.

We studied the markets for both products carefully and came to this conclusion: that it would be wiser to move up the value chain than get stuck in a commodity-driven market. This value option will help in another way. When Krebs wants to go in for technology collaborations with