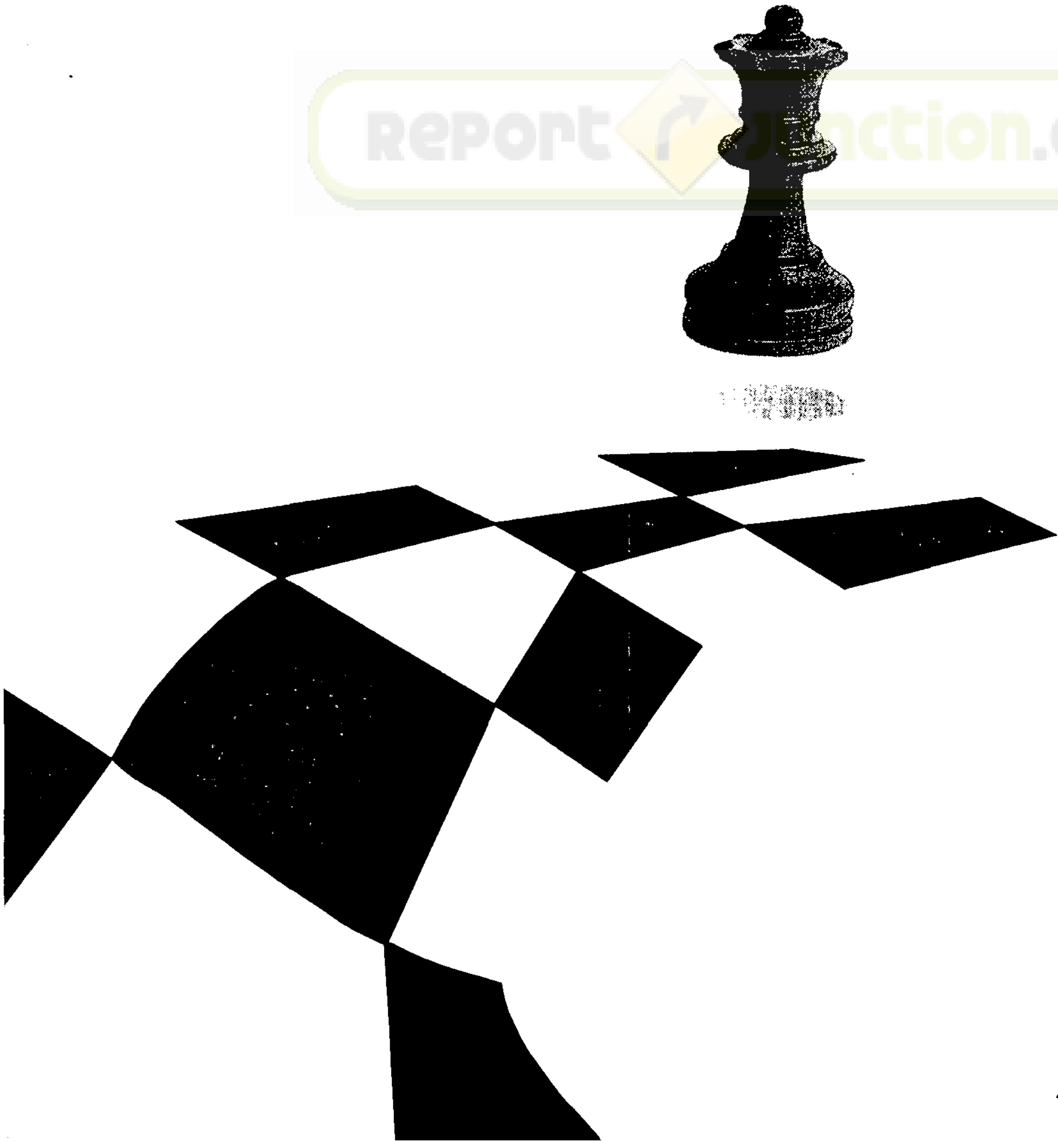
ALL THE RIGHT MOVES



SRF

ANNUAL REPORT 1997-98

MANAGEMENT REVIEW

SRF is committed to value creation for all its stakeholders. It is our sincere endeavour to transform ourselves to achieve global standards in quality, service, cost and scale of operations.

A good corporate practice followed by many a well known Indian and multinational company has been to share with their stakeholders a review of the company's past performance, challenges posed by the environment, the emerging opportunities and the management strategies adopted to meet the challenges and realise these opportunities.

In line with the above, we commence the publication of a formal Management Review of the company to keep you apprised of progress made in the past and the future outlook. This, we believe, brings greater transparency into our relationship with all our stakeholders.

ECONOMIC ENVIRONMENT

The Indian economy became sluggish in 1997-98 with a GDP growth rate of 5% as compared to the previous year's growth rate of 7.5%.

The equity market remained dull and liquidity was extremely tight. The rupee was largely stable as compared to some of the other Asian currencies. This created intense pressure on volumes and margins for many industries due to inflow of cheap imports.

The Asian economy went through a turmoil with steep depreciation of currencies of Indonesia, Thailand, South Korea etc. This coupled with the financial crisis in Japan and economic anxiety in China led to recession in several economies.

The South East Asian crisis has created huge capacity surpluses in several industries and pushed many large and growing business houses of the region to bankruptcy. With their increased focus on exports to countries such as India, the Indian industry faces an unprecedented challenge.

CORPORATE PRIORITIES

SRF is committed to strengthening the core businesses of the company identified as industrial yarn, fabrics and refrigerants. We are already in a leadership position in these businesses domestically and are among the top ten players in the field of industrial fabrics world-wide. We believe we can be cost competitive globally by, inter alia, building a strong financial structure that is capable of sustaining growth and tiding over difficult economic and market conditions.

The year 1997-98 was expected to be a tough year with economic slowdown imminent and increasing competition. Added to this was the urgent need of the company to make rapid progress on the financial restructuring exercise.

Accordingly, some of the corporate priorities chosen were

- Financial Consolidation
- Cost and Working Capital reduction
- Divestment of non-core businesses
- Improvement in the performance of the chloromethanes division

ACHIEVEMENTS IN 1997-98

Financial Consolidation

The four steps of financial consolidation, namely (i) divestment of stake in SRF Finance, (ii) refixation of payment schedule of outstanding loans with ICICI, IFCI, IDBI, (iii) raising of foreign currency loans and (iv) concluding the rights issue, are now complete. This financial restructuring exercise was with the objective of reducing interest costs, increasing the average tenure of debt and reducing the overall debt. The beneficial impact of these measures would be realised 1998-99 onwards leading to higher profits.

Cost and Working Capital Reduction

The various businesses of the company took stringent measures to minimise operating costs. The benefit during the year was more than Rs 10 crores which substantially neutralised inflationary and other input cost increases and selling price reduction.

To augment cash flows, the company also launched an intensive working capital reduction programme this year, achieving significant Gross Current Asset reduction in the fourth quarter of 1997-98. Besides leading to interest cost reduction, it signified a fundamental improvement of management processes.

Divestment of non-core businesses

The divestment of stake in SRF Finance Limited was timely, given the current status of Non-Banking Financial Companies. This was done with a view to giving impetus to core businesses in a changed economic environment.

SRF decided to restructure its Vision Care business into two separate joint-venture companies. The cashflow which will accrue to the company on account of restructuring of Vision Care business will be used to retire debts.

Performance of chloromethanes plant

The chloromethanes plant enhanced capacity utilisation to 105% through stable operations and further increase of capacity as a result of de-bottlenecking. Despite intense competition, SRF more than doubled its chloromethanes sales in the domestic market from 3000 MT to 6700 MT. The division has added several new names like Ranbaxy, Lupin, Ciba and Cheminor to its list of customers.

Operational Improvements

Certain initiatives have been taken in order to enhance our production capacities in the industrial yarn and fabrics business. These are:

- de-bottlenecking yarn capacities by reconfiguring production equipment
- addition in twisting and weaving capacities
- improvement in plant operating efficiencies through TQM teams

Significant economies and efficiencies will be realised from these initiatives.

REVIEW OF BUSINESSES

Our business units have demonstrated strong resilience and responsiveness in the face of adverse market conditions — lower demand, falling international prices, increasing imports and rising costs. In the face of the adverse environment, quick initiatives were taken towards cost reduction and better working capital management, reducing gross current assets and utilising the resulting cash flow for paying off short-term liabilities.

We were also able to increase market shares for some of our major products and maintained it for others.

Industrial yarn, fabrics and engineering plastics

The automobile sector faced difficult times. Production/sales of medium and heavy commercial vehicles (bus and truck tyres) which forms the major market for nylon tyre cord fabric declined by 38%. Domestic consumption for nylon tyre cord fabric (excluding exports) declined by 4%. Due to cheap imports, however, domestic demand declined by 18%.

As a market leader in nylon tyre cord fabric, the company could meet the challenge. Capacity utilisation for nylon tyre cord fabric was 95% as against the industry average of 67%. Domestic market share improved from 38% to 42%.

On the export front major development efforts were made with the company gaining approvals from prominent international players such as BridgeStone, Yokohama Rubber and others.

SRF entered into a technical know-how agreement with M/s Goodyear, USA with the objective of upgrading dipping facilities at the Madras plant. There would thus be a higher offtake of value added product and the company would be able to access international markets for dipped fabric.

SRF maintained market leadership in belting fabrics, coated fabrics, cycle tyre cord fabric and fishnet yarn/ twine.

The upgradation of manufacturing facilities and improvements in processes in belting fabrics and coated fabrics businesses have started showing results. The cost competitiveness in this business segment once again helped the company step up the volume of exports of coated fabrics by 180% in 1997-98.

The engineering plastics division faced low demand in the light of recession in the automobile sector and intense competition from multinationals. However, it maintained its market share by meeting the challenge through innovative methods of cost reduction and productivity improvements.

Fluorochemicals

The economic slowdown and Montreal Protocol regulations resulted in a stagnant refrigerant gases market. SRF continues to dominate the Indian market with nearly 40% market share in the refrigerant gases business. Price increases were effected to counter inflationary cost increases.

The international refrigerant gases market witnessed severe competition leading to depressed prices. Export volumes from India were adversely affected due to the South East Asian crisis.

The operating profits have grown by 35% in 1997-98 and are expected to improve further in 1998-99.

SRF launched a new environment-friendly refrigerant, R-23, with the help of indigenous R & D. The new product is used in very low temperature applications. SRF is exploring the possibility of exporting this ozone-friendly speciality refrigerant. The company has also initiated trading of HFC134a (substitute for CFC-12). Debottlenecking of the chloromethanes plant resulted in capacity enhancement of 4000 tonnes per annum towards the end of the year.

The manufacturing facility for the fluorochemicals business received ISO 9002 certification recently. Thus, all plants for SRF's core businesses have achieved ISO certification.

Polyester films

The huge surplus domestic capacity during the year resulted in erosion in price realisation and consequently profitability. However, volumes were maintained at previous year's levels. Major upgrades were carried out leading to greater stability and higher production. Exports commenced during the year.

Vision Care

The Vision Care business is being restructured into two separate companies. SRF will have a 10% equity stake in the manufacturing company while Essilor of France and Sola of USA will have a 45% stake each. SRF will have 26% stake in a marketing company in collaboration with Essilor of France. Joint venture agreements have been signed and necessary FIPB approvals have been received.

Efforts are under way to relocate the remaining high index lenses and mould making facilities.

TQM - TRANSFORMATION OF PEOPLE & PROCESSES

A successful organisation is the result of motivated, skilled and competent members. We aim to develop our employees in terms of their skills, knowledge and attitude through the adoption of principles, methods, systems and tools of Total Quality Management.

The focus is on making improvements in both manufacturing and non-manufacturing processes. Personnel have been trained on problem-solving methodology and team-working capability to equip them to solve cross-functional problems and improve the capability of our processes.

A drive has been launched in some of the divisions to achieve 4-sigma standards of quality in manufacturing processes. This is to be achieved, inter alia, by daily management system on which significant progress was made. Key components of daily management are 5-S (housekeeping), standardisation, training and discipline to follow standards and the system of control and checkpoints. Benefits are visible through world class housekeeping standards, improved quality consistency, better equipment efficiency and higher morale.

CONTRIBUTION TO SOCIETY

SRF has been contributing towards various community welfare activities around its manufacturing plants such as providing drinking water facilities, relief to flood affected areas, funding health clinics and conducting literacy programmes, creating community centres, provision of vocational training and self-employment opportunities for destitute women, etc.

The Shri Ram School and the SRF Vidyalaya, provide comprehensive education with an appropriate emphasis on imbibing the right values apart from academics as well as co-curricular activities. Scholarships are provided to meritorious and needy students. High quality of education was evident in the results of the first batch of class X students of The Shri Ram School, announced in June 1998. 100% of the students passed with first division with many students scoring marks in the 90s.

SAFETY, HEALTH AND ENVIRONMENT

SRF is a highly safety conscious company. A number of safety training programmes have been conducted for employees. Safety contests are held to improve safety consciousness. In line with the significance we attach to safety, the company has appointed a Director (Safety).

In our fluorochemicals division, the Overall Safety Index was at the ideal score of 1.0 for eleven months last year. The number of first aid injuries has been consistently reduced. A safety audit was conducted at Corporate Office, New Delhi. The findings from this are currently under implementation.

THE ROAD AHEAD

Indian industry will increasingly feel the challenges of globalisation, high volatility in business and intense competition from focused players. The response therefore will have to be one of engineering dramatic change or facing slow death. Weaker players would stand little chance in this scenario.

The Asian economy seems to show little hope for revival in 1998-99, with stagnant or negative growth rates expected in several countries.

India's GDP growth for 1998-99 is expected to stay at 5%. The domestic market for our core businesses — industrial yarn & fabrics and refrigerants — is estimated to remain static.

In the Union Budget of 1998-99, effective import duties registered an increase on inputs while those on imported fabrics declined by 5% points to fulfil GATT obligations. This anomaly has been brought to the attention of the government and it is hoped that there will be an integrated approach in carrying out duty reduction on finished goods, raw materials, capital goods together with a parallel reduction of interest cost for the domestic industry in future.

The devaluation of the rupee has offset to some extent the effect of a sharp decline in the prices of imported nylon tyre cord fabric. However, margins will come under pressure due to cost push. The industry is working on an anti-dumping application to the Central Government.

SRF is gearing up to face a situation when duties would fall to international levels by effecting substantial efficiency improvements in manufacturing and managerial processes. We hope that the inequalities caused by inadequate and poor infrastructure and high cost of capital in India will be corrected in consonance with import duty reduction.

We will continue to maintain domestic market leadership in our core businesses of industrial yarn & fabrics (including nylon tyre cord) and refrigerants. SRF is committed to enhancing the size of its operations by fully participating in the growth of the domestic market and through strategic alliances. International market development will be a key strategy for growth as well as defence.

SRF's corporate priorities for 1998-99 are:

- Thrust on Competitiveness

  We will continue to focus on improving competitiveness through intensified current asset and cost reduction, quality improvements, fostering a closer relationship with our customers and improving service levels — all based on TQM. Institutionalisation of daily management system will continue to be a focus area.

  Cost consciousness is being adopted in all parts of the company as a way of life — the attempt will be to innovate and engineer ways by which our cost standards are best in the world. We aim to attain quality standards which match competition and meet customer needs.

- Further financial consolidation

  Work will continue to further strengthen the financial structure that is capable of sustaining growth and tiding over difficult economic and market conditions.