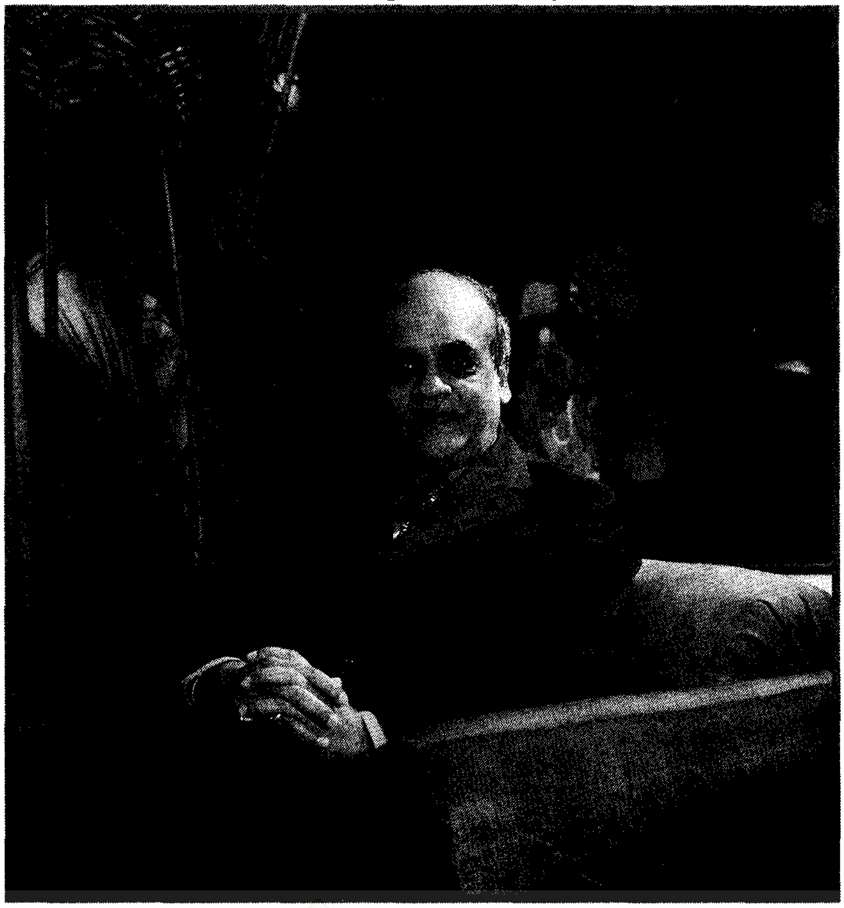
SRF


SANSCO SERVICES

SRF
ANNUAL REPORT 03·04



CHAIRMAN'S LETTER

Dear Shareholder

I write to you after India has voted in the 14th Lok Sabha and, with it, a new government in Delhi.

We are fortunate in having a highly respected person like Dr. Manmohan Singh as the 13th Prime Minister of the country. Dr. Singh has always been a committed reformer — one who believes in driving economic reforms and growth with greater employment and social and human development. He is going to be assisted by Mr. P. Chidambaram as his Finance Minister, who is no less passionate about sustained reforms and all-round economic growth. Even in an era of occasionally unpredictable coalition politics, you will agree that this is a great team at the helm.

Hence, I believe that reforms will proceed smoothly and that India will definitely transit to a higher growth path.

With the expectations of normal-to-good monsoons, I think India will achieve a GDP growth of somewhere between 6.5 per cent and 7 per cent in 2004-05. And with sustained reforms, this growth rate can be ramped up to an average of over 7.5 per cent in the next five years.

Therefore, at the overall economic level, I continue to have an optimistic outlook for the next few years. Let's now move on to matters relating to your Company. Here are the financial highlights of SRF's performance in 2003-04:

- **Net sales** grew by 10 per cent from Rs. 745.9 crore in 2002-03 to Rs. 820.2 crore in 2003-04.
- **Profit before tax** increased by 32 per cent from Rs. 54.9 crore in 2002-03 to Rs. 72.5 crore in 2003-04.
- **Profit after tax** increased by almost 30 per cent from Rs 31.9 crore in 2002-03 to Rs. 41.6 crore in 2003-04.
- **Financial expenses** decreased by 48 per cent from Rs. 42.2 crore to Rs. 21.8 crore in 2003-04.
- **Return on net worth** increased by 1.5 percentage points from 10.2 per cent in 2002-03 to 11.7 per cent in 2003-04.

In the last seven years, the management team of your Company have been making great efforts to transform SRF into a lean and efficient manufacturing organisation.

We have adopted Total Quality Management (TQM) as our way of life – not only for routine operations but also for long term planning. It has helped in improving quality, raising the skills of people at all levels, reducing wastage, significantly increasing productivity and in sharply bringing down costs.

Your Company's ongoing TQM improvements have resulted in making it one of the lowest cost producers in the world in almost all our businesses, despite the many infrastructural handicaps faced in India. It has provided SRF with the operational strength to overcome difficult market conditions and to seize growth opportunities in expanding markets.

Let me now quickly touch upon some of the salient features of SRF's businesses. These are discussed in much greater detail in the chapter on Management Discussion and Analysis.

In the tyre cord business, your Company continues to be the leader accounting for 37 per cent of the market, and remains the preferred supplier to the Indian tyre industry. Moreover, SRF has established a significant presence in the international markets of Europe, Middle-East, South and South-East Asia. Nevertheless, it has been facing a paradoxical situation where, while demand is steadily rising, margins are gradually falling because of intense competition, especially from the Chinese. During 2003-04, the global price of caprolactum, a key raw material, increased considerably due to shortages in the supply of benzene. Despite this, the Chinese producers – most of whom are far less efficient than SRF – continued to cut prices of tyre cord. We, therefore, believe that this is unfair competition and unnatural pricing, which could constitute dumping.

Going forward, your Company is developing strategies to increase its capacities to meet growing domestic and international demand, as well as to further bring down costs. SRF is also developing long-term supplier-of-choice relationships with international tyre companies.

Belting fabrics has been identified as a growth sector, and SRF is planning to double its capacity. SRF continues to be the domestic market leader with a share of 67 per cent. More significantly, your Company now accounts for a market share of over 10 per cent in Asia-Pacific. Overall, export of belting fabrics increased by 30 per cent – and now accounts for around 38 per cent of the Company's sales in this category. We are planning to execute strategies that will make SRF one of the major global producers of belting fabrics.

Coated fabrics is potentially a large business in India and rest of the world. The strategy for the coated fabrics business is to build capabilities in developing cost competitive products and applications for domestic and international markets. In India, the focus will be on design and development of new products, and SRF aims to build a powerful brand for this business. Globally, your Company is implementing a strategy of leveraging the advantages of low costs in the design, production and fabrication of customised products to increase its market coverage.

In chemicals, SRF continues to be leader in the refrigerant gas business, and supplies gases to 55 different countries. At present, your Company is implementing a project to produce new generation gases, called HFC-134a and HFC-32. I am proud to say that these have been developed through in-house R&D, and should be in commercial production by third quarter of 2004-05. SRF has also been granted a process patent by the US Patent & Trademark Office for the production of difluoromethane (HFC-32).

We consider pharma chemicals – products catering to the needs of pharmaceutical companies – as an exciting new area of growth. In 2003-04, your Company developed three products, which are now under trial production runs and will be marketed in 2004-05. More new products are under development, some of which will be commercialised by middle of next year. SRF recognises the importance of R&D in this business. Therefore, your Company commissioned a state-of-the-art R&D centre in Bhiwadi in 2003-04, and is in the process of setting up another R&D centre at Chennai. It is expected that some 50 scientists will be employed in these R&D centres by the end of 2004-05.

Polyester films has become an exciting area of business. The Indian packaging market has grown at 15 per cent per annum over last five years, and is expected to grow at the same pace in the next five years. This will make India the second largest market in the world for polyester films by 2007, second only to the US. To leverage this, your Company is commissioning a new 20,000 tonnes per annum manufacturing facility at the special economic zone in Indore, which should be in production by October 2004. Moreover, your Company's proposed purchase of SRF Polymers' film plant will put it in an even stronger competitive position. We have already started building business with numerous international customers, and plan a quick ramp up in this fast growing market.

Taken together, therefore, I see a good future for your Company in 2004-05 and beyond. In the difficult years during the late 1990s and early 2000s, we did what we needed to do to ruthlessly pare costs, improve throughput and productivity and raise operational efficiencies. These have borne fruit. While we shall continue to sweat capital wherever we can, time has now come to take advantage of the new growth opportunities. Thus, we are building capacities wherever needed; focusing on R&D; and aggressively widening our global footprint.

I must take this opportunity to record my great appreciation for the efforts of Mr. Ravi Sinha, who was the CEO of your Company until the middle of 2003-04. Ravi was instrumental in tightening the belts and paring costs in the difficult years, and in gradually turning the company around. He also put in place the building blocks for our future growth. We at SRF will miss him, and wish him well in his various consulting and advisory endeavours.

2003-04 has been a satisfactory year. But I can assure you that we at SRF will not rest easy until we become the best-in-class in everything that we do. With the support of our motivated employees and our customers, and given the loyalty of each of you as a shareholder, I am sure we will together chart an even better tomorrow.

Arun Bharat Ram
Chairman & Managing Director

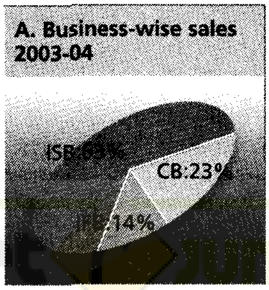
COMPANY INFORMATION

Board of Directors	Dr Bharat Ram *Chairman Emeritus* Mr. Arun Bharat Ram *Chairman & Managing Director* Mr. S P Agarwala Mr. K Ravichandra *(Director-Safety & Environment)* Mr. V R Mehta Mr. M V Subbiah Mr. Satish K Kaura Mr. Vinayak Chatterjee Mr. Subodh Bharagava Dr. Omkar Goswami
Auditors	Thakur, Vaidyanath Aiyar & Co, New Delhi
Company Secretary	Anoop K Joshi
Bankers	ICICI Bank Ltd State Bank of India State Bank of Patiala The Hongkong and Shanghai Banking Corporation Ltd Citibank N A Punjab National Bank
Registered Office	Express Building, 9-10, Bahadur Shah Zafar Marg, New Delhi 110 002
Industrial Synthetics Business	PLANTS • Manali Industrial Area, Manali, Chennai 600 068, Tamil Nadu • Industrial Area, Malanpur, Dist Bhind, Madhya Pradesh 477 116 • Plot No 1, SIPCOT Industrial Area Complex, Gummidipoondi 601 201, Dist Thiruvallur, Tamil Nadu OFFICE Manali Industrial Area, Manali, Chennai 600 068, Tamil Nadu
Industrial Fabrics Business	PLANT & OFFICE Viralimalai, Dist Pudukottai, Tamil Nadu
Chemicals Business	PLANT Village Jhiwana, Tehsil Tijara, Dist. Alwar, Rajasthan 301 018 OFFICE A 16, Aruna Asaf Ali Marg, Qutab Institutional Area, New Delhi 110 067
Polyester Films Business	PLANT Plot No. C 1-8, C 21-30, Indore Special Economic Zone, Pitampur, Dist. Dhar, Madhya Pradesh OFFICE C-8, Commercial Complex, Safdarjung Development Area, New Delhi 110 016

AGEMENT DISCUSSION
NALYSIS

The Indian economy has performed very well, and our GDP is poised to grow at an impressive rate of 8.1 per cent in 2003-04. This will be the best performance of the economy in the post-liberalisation era. It will also be one of the highest growth rates in the world during 2003-04 – second only to China. While this growth has been led by a revival of Indian agriculture, especially after the drought of 2002-03, it is important to note that it marks the second consecutive year of good industrial performance – 6.4 per cent in 2002-03 and over 6.5 per cent in 2003-04.

SRF is primarily engaged in the production of industrial intermediates. The Company has three main businesses: the Industrial Synthetics Business (ISB), the Industrial Fabrics Business (IFB), and the Chemicals Business (CB). Also, the Company is in the process of developing two new businesses – pharmaceutical intermediates and polyester films – which are related to its current business segments. **Chart A** gives the share of the Company's businesses during 2003-04.



A. Business-wise sales 2003-04

The strong performance of the economy benefited SRF in the form of increased demand from the end-users. For instance, products of the Industrial Synthetics Business are used in the manufacture of tyres, which grew by 7 per cent during the year. Likewise, Chemicals Business, which includes manufacturing of refrigerant gases, benefited from double-digit growth in the consumer durables segment.

On the other side of the coin, the latter half of 2003-04 also witnessed substantial increase in prices of important raw materials. Moreover, the Company experienced a decline in sales realisation for Nylon Tyre Cord Fabric (NTCF), the principal product of SRF's Industrial Synthetics Business, due to cheap imports from manufacturers in China, who have huge excess capacities. These two sets of developments put severe pressure on margins.

Your Company has, however, withstood these pressures and achieved impressive sales growth. Because of its constant efforts at improving operational efficiencies, SRF was able to contain the impact of adverse large raw material price hikes and softening end-product prices to a relatively small reduction of operating profit margins. Additionally, by achieving substantial reduction in non-operating expenses, the Company registered an impressive growth in net profits. The highlights of SRF's financial performance in 2003-04 are:

- Net sales grew by 10 per cent, from Rs.745.9 crore in 2002-03 to Rs.820.2 crore in 2003-04
- While the operating profit margin deteriorated by 2.0 percentage points, PBT increased by 32 per cent from Rs.54.9 crore in 2002-03 to Rs.72.5 crore in 2003-04
- Profit after tax (PAT) increased by 30.4 per cent from Rs.31.9 crore in 2002-03 to Rs.41.6 crore in 2003-04
- Financial expenses decreased by 48.3 per cent from Rs.42.2 crore to Rs.21.8 crore in 2003-04
- RONW based on average net worth increased by 1.5 percentage points from 10.2 per cent in 2002-03 to 11.7 per cent in 2003-04

In the remainder of the chapter, we will review the markets and operations of each business, and the financial performance in 2003-04.

INDUSTRIAL SYNTHETICS BUSINESS (ISB)

The principal product of the Company's ISB portfolio is nylon tyre cord fabric (NTCF), which is used as a reinforcement material in all categories of tyres. SRF also manufactures nylon chips and nylon industrial yarn, which are intermediate products in the production of NTCF. Currently, bulk of the nylon chips and nylon industrial yarn manufactured by the Company is meant for captive consumption in the production of NTCF.

Sales of SRF's ISB grew by 5.8 per cent, from Rs. 489.6 crore in 2002-03 to Rs. 517.9 crore in 2003-04. Overall, the ISB accounted for 63 per cent of the Company's sales during the year under review.

MARKET SCENARIO

In 2003-04, global demand for nylon 6 tyre cord fabric was estimated to be around 368,000 tonnes – a growth of approximately 3 per cent over the previous year. This growth came largely from the Asian economies, especially India, China and South East Asia.

India is the second largest nylon 6 tyre cord fabric market in the world after China, and accounts for nearly one-fifth of global consumption. Due to the strong industrial performance during 2003-04, there was a significant increase in tyre production across all segments. Consequently, demand for NTCF increased by over 7 per cent, from 74,000 tonnes in 2002-03 to 79,000 tonnes in 2003-04.

We had mentioned in our previous annual report, that Chinese NTCF manufacturers, with huge excess capacities, have been actively targeting the Indian market by offering their products at irrationally low prices. These competitive pressures were accentuated with a further reduction of basic import duty on NTCF from 25 per cent to 20 per cent in 2003-04. In addition, price of caprolactum – an important raw material – increased considerably due to shortages in the supply of benzene. Since the selling price of NTCF could not be increased in proportion to the rise in the cost of raw materials, there was an erosion of conversion margins.

Constrained by its existing capacity, SRF's sales volumes grew by 2 per cent during 2003-04 and the demand-supply gap was filled largely by Chinese imports. Despite full utilisation of existing capacity, market share of the Company came down marginally to 37 per cent. Even so, SRF remains the market leader and preferred supplier to the Indian tyre industry.

Apart from being the leader in India, SRF has a significant presence in the international markets in Europe, Middle-East, South and South-East Asia through its wholly owned subsidiary, SRF Overseas Limited. Sales to the highly competitive and quality conscious European market increased by 25 per cent during the year. Also, the Company improved its shares in the Middle-East and South Asian markets.

In 2002-03, SRF had received approvals from Bridgestone for supplying to their plants in South-East Asia. Bulk supplies commenced during the year under review. In addition, your Company also developed new businesses in Russia, Italy and Sweden. These new businesses contributed almost 10 per cent to the total international sales of ISB during 2003-04. Overall, the international business in NTCF recorded an impressive growth of over 30 per cent, from 5,770 tonnes in 2002-03 to 7,500 tonnes in 2003-04.

OPERATIONS

The Industrial Synthetics Business of SRF consists of four manufacturing facilities at Manali, Gummidipoondi (Tamil Nadu), Malanpur (Madhya Pradesh) and Jebel Ali (Dubai). The plant in Dubai, which is under SRF Overseas Limited, concentrates on supplies to Europe, Middle-East and other countries in South Asia.

Even as the Company faced capacity constraints in meeting the increased demand for NTCF in the domestic market, utilisation of existing capacities was maximised during 2003-04. In fact, all manufacturing facilities recorded their highest monthly production levels during the year. In addition, the Manali plant won the "Best Manufacturing Unit" award in Q-Quest, jointly conducted by Anna University and TVS; and the Gummidipoondi unit received the Commendation Award from CII in "Leadership and Excellence in Safety Health & Environment".

During 2003-04, SRF took several initiatives to control overheads, improve operational efficiencies and reduce wastage. It successfully completed the design of its yarn capacity expansion at Gwalior, and also upgraded its weaving technology at Manali. The Company also completed a pilot project at Dubai for modification of its machinery, which is expected to result in significant savings in energy costs.

Although the measures taken to improve operating efficiencies and streamline cost structures partly neutralised the impact of increasing raw material prices, the Company was not able to sufficiently insulate itself from pressures on sales realisation due to cheap imports from Chinese manufacturers. As a result, operating profit margin of the Industrial Synthetics Business came down by 2.4 percentage points during the year.

STRATEGY AND OUTLOOK

As most of the demand for the Industrial Synthetics Business of SRF comes from the domestic tyre industry, growth prospects of the business are inextricably linked with the developments in the tyre industry. Given that growth in the domestic economy is pegged at 8.1 per cent during 2003-04, and that the Reserve Bank of India has forecast between 6.5 per cent and 7 per cent GDP growth for 2004-05, the Company expects the domestic tyre industry to do well in the future. Therefore, the outlook for 2004-05 remains positive.

The bus and truck tyres segment accounts for 70 per cent of total tyre cord consumption. A possible threat to the NTCF business comes from radialisation of this segment. Currently, radialisation level in bus and