SRF Limited

Annual Report 2005-06

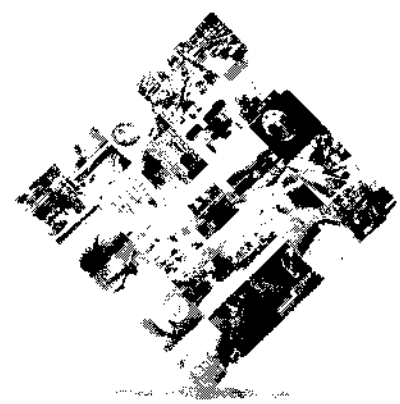
Inside:

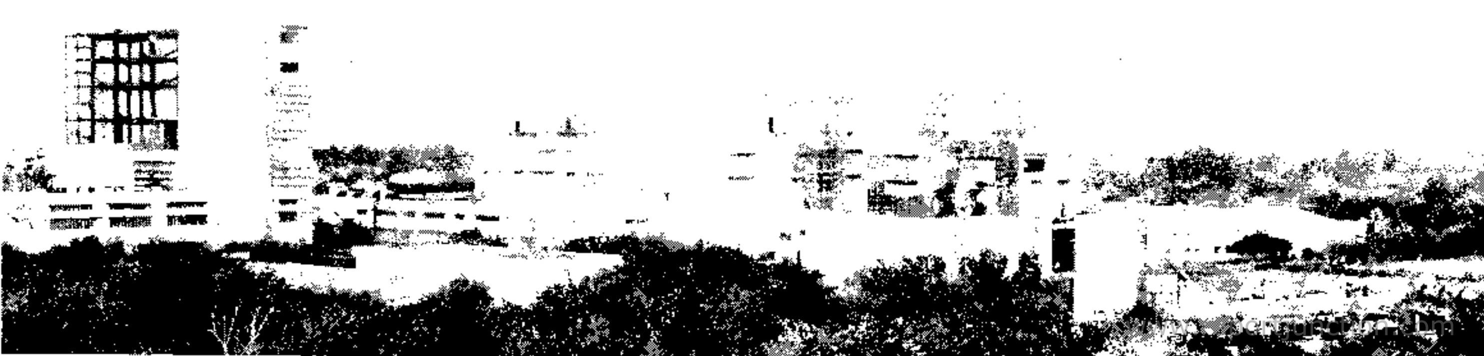
Universe of opportunities is infinite,
so is our **new identity**

SRF

Making our nation proud.

Infinity signifies excellence, progression and dynamic nature of SRF. Blue, which is the corporate colour of SRF, stands for universal efficiency - an important cornerstone as SRF marches ahead. It also reflects SRF's values of global leadership, continuous innovation in products and processes, challenging and setting new benchmarks in productivity and constantly enhancing organisational capability.





Chairman's Letter

Dear Shareholder,

2005-06 has been another excellent year for the Indian economy. Quick Estimates of the Central Statistical Organisation point to a real GDP growth of 8.4 per cent. This is a great achievement in itself. But, coming as it does after two successively good years - 8.5 per cent growth in 2003-04 and 7.5 per cent in 2004-05 - I believe we are witnessing a fundamental transformation of the Indian economy to a higher growth trajectory.

To be sure, the country still faces many constraints. The quality of infrastructure is an important cause of concern. Power supply is the single greatest problem facing Indian manufacturing - which requires virtually every unit in the country to invest in captive generation facilities. With an 11 per cent shortfall between peak power demand and availability in 2005-06, and international crude oil prices ruling at over $70 per barrel, all power intensive manufacturers faced severe cost increases. While much has happened in the road sector, especially in modernising the National Highway network, there is still a great deal left to be done before we can claim to have road systems like the highways in Southern and South-Eastern China. Similarly, notwithstanding some improvements in port efficiencies, we have a long way to go before having best-in-class ports integrated with first rate road and rail transport networks.

Given the importance that the present government places on infrastructure, I am confident that we shall see greater investment and progress on these fronts. If so, there is no reason why India cannot ramp up its decadal growth rate to the region of 8.0-8.5 per cent. Therefore, let me reiterate two things: first, that India is at a point of inflexion which can easily trigger faster economic growth; and second, the business opportunities in this country are greater than ever before.

Let me now move on to the performance of your Company during 2005-06.

- Net sales from operations grew by over 22 per cent to Rs.1,298 crore.
- Profit before depreciation, interest and tax increased by 61 per cent to Rs.259 crore.
- Profit after tax grew by almost 75 per cent to Rs.105 crore.
- Return on capital employed increased by 6.6 per cent to 23.8 per cent.
- Return on net worth rose by 6.8 per cent to 21.7 per cent.

These are very creditable results, and have increased your Company's fully diluted earnings per share from Rs.9.31 last year to Rs.15.43 in 2005-06.

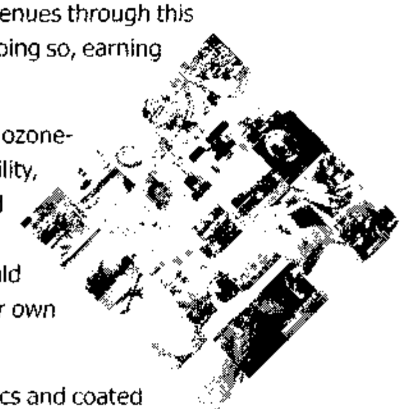
While the performance of each of the businesses of your Company are given in detail in the chapter on Management Discussion and Analysis, let me share with you some of the key developments that occurred during the year and my perceptions of the future.

The most heartening feature of your Company's performance in 2005-06 has been the growth and profitability of its chemicals business, the bulk of which is accounted for by refrigerant gases. Even without accounting for Rs.94 crore generated by the transfer of CERs (Carbon Emission Reductions, also known as carbon credits), sales of this business grew by 19 per cent to Rs.256 crore; and profit before interest and taxes to Rs.66 crore. At almost 26 per cent, the chemicals business generates the highest profitability ratio (PBIT to revenue) of your Company. Today, SRF sells refrigerant gases to more than 55 countries, and exports account for 80 per cent of the volume.

In the context of the chemicals business, I need to share with you the developments that have occurred regarding CERs. Working under the guidelines of the United Nations Framework Convention on Climate Change (UNFCCC), your Company's Bhiwadi plant incinerates HFC-23, a greenhouse gas that is harmful to the environment in the long term. This plant is the first in India and second in the world under the UNFCCC's Clean Development Mechanism (CDM) initiative. In addition to helping reduce environmental emissions, the CDM initiative issues CERs, which can be traded with other companies. During 2005-06, 1.83 million units of CERs were issued to SRF. Of these, 1.4 million were traded in the fourth quarter and fetched your Company a revenue of Rs.94 crore.

Given that Bhiwadi has the potential to generate at least 3.8 million CERs per year, and an active and buoyant international market for trading such credits, I expect your Company to continue earning healthy revenues through this process. This is a unique case of SRF contributing to sustainable development and, by doing so, earning healthy revenues.

Last year I had mentioned to you about the setting up of a manufacturing facility for ozone-friendly refrigerants, specifically HFC-32, HFC-134a. This 3,500 TPA manufacturing facility, entirely developed in-house by your Company's R&D team is under commissioning, and the early results are highly promising. A dedicated captive power plant in Bhiwadi has been commissioned last year and the benefit will be felt from this year onwards. I would also like to inform you that pharma chemicals, in which we have developed through our own process know how, complex chemical intermediates, is now running stably.



Your Company's technical textiles business comprises tyre reinforcements, belting fabrics and coated fabrics and contributes 62 per cent to SRF's total sales. An area of concern in this business is nylon tyre cord fabric (NTFC). Despite being one of the most cost efficient producers in the world and having global scales of operations, this business faces cut throat international competition, especially from China. Although there is an anti-dumping duty levied on Chinese manufacturers, they still manage to offload their output at prices that simply cannot be covering costs. For 2005-06, the technical textiles business earned a PBIT margin of 9.4 per cent on revenue of Rs.799 crore.

While your Company will make every effort to increase this margin, I wish to reiterate what I wrote in my letter last year: "significantly high EBITDA or EBID margins protected by double-digit tariff barriers will soon be things of the past." NTCF industry is heavily dependent on availability of efficient and low cost power, and a key strategy is to generate our own power at the competitive costs. This will enable us to compete even with artificially low priced imports from China.

Your Company is also diversifying technical textiles business into other product segments to de-risk itself from NTCF. In the belting fabrics business, it has already achieved dominance in the domestic market, and is in a position to leverage the current upswing in global demand.

Currently, India has a very low per capita consumption of technical textiles. As the economy continues to grow, India's per capita consumption of technical textiles to grow several folds in the coming years. Your Company is actively evaluating possibilities of entering into new segments in the years to come to tap these opportunities.

Revenue from your Company's packaging films business grew by 89 per cent to Rs.149 crore in 2005-06. At present, SRF is one of the leaders in this business and accounts for 13 per cent of the domestic market. For most part of the year, there was considerable pricing pressure due to large excess capacities in India. That, coupled with additional fixed costs because of expansion of the Indore facility, contributed to an operational loss of Rs.19 crore. The good news is that prices have begun to improve; and if these continue on an upward trend, the packaging films business ought to start generating profits from 2006-07.

Overall, your Company has done well in 2005-06. The chemicals business has performed well and I expect it to do even better in the coming years. In particular, I envisage rapid growth of the new pharma chemicals business, which is in the process of developing higher value added derivatives and introducing more products required by manufacturers of bulk drugs and agrochemicals. Moreover, by entering higher value added segments and introducing new generation products, your Company's chemical business should earn greater revenues and profits in the coming years. Packaging films, too, ought to perform significantly better in the future. The real test, however, will be to increase profitability margins for the technical textiles business in an environment of rising raw material costs and intense Chinese competition. To my mind, dealing with this challenge will be the primary task of your Company.

Income from CERs will continue - indeed increase - in the foreseeable future. Your Company has begun to strategise on different types of value enhancing investments that it could make with this income stream. I will share these with you at an appropriate time, after the Board of Directors makes it decision on such investment proposals.

To achieve better co-ordination and greater synergies in our businesses the company has shifted its various offices located in New Delhi to a new corporate office in Gurgaon. The registered office is also being shifted to a new location in New Delhi.

Let me take this opportunity to thank all the employees of your Company for their continued dedication and their hard work, and its customers for their long-standing support. And to you, SRF's shareholders, for your faith in the company.

Yours sincerely,

Arun Bharat Ram
Chairman and Managing Director

Company Information

Board of Directors

Dr. Bharat Ram - Chairman Emeritus
Mr. Arun Bharat Ram - Chairman & Managing Director
Mr. Ashish Bharat Ram - President & Executive Director
Mr. S. P. Agarwala
Mr. K. Ravichandra - Director (Safety & Environment)
Mr. M. V. Subbiah
Mr. Satish K. Kaura
Mr. Vinayak Chatterjee
Mr. Subodh Bhargava
Dr. Omkar Goswami
Mr. Kartikeya Bharat Ram - President & Executive Director

Auditors
Thakur, Vaidyanath Aiyar & Co., New Delhi

Company Secretary
Anoop K. Joshi

Bankers
• ICICI Bank Ltd. • State Bank of India • State Bank of Patiala
• Standard Chartered Bank • Citibank N. A.

Registered Office

Express Building, 9-10, Bahadur Shah Zafar Marg, New Delhi - 110 002
w.e.f. 1st July 2006: A-16, Aruna Asaf Ali Marg, Qutab Institutional Area, New Delhi - 110 067

Corporate Office
Block - C, Sector - 45, Gurgaon (Haryana) - 122 003

Technical Textiles Business

Plants
- Manali Industrial Area, Manali, Chennai (Tamil Nadu) - 600 068
- Industrial Area, Malanpur, Dist. - Bhind (M.P.) - 477 116
- Plot No 1, SIPCOT Industrial Area Complex, Gummidipoondi Dist. - Thiruvallur (Tamil Nadu) - 601 201
- Viralimalai, Dist. - Pudukottai (Tamil Nadu) - 621 316

Chemicals Business/Pharma Chemicals Business

Plant
- Village & PO - Jiwana, Tehsil - Tijara Dist. - Alwar (Rajasthan), 301 018

Packaging Films Business

Plants
- SEZ Indore, Sector - 3, Pithampur, Dist. Dhar (M. P.)
- Plot No. 12, Rampura, Ramnagar Road, Kashipur Dist. - Udham Singh Nagar, Uttranchal

Management Discussion and Analysis

2005-06 was yet another year of excellent performance of the Indian economy. On the back of two consecutive years of high growth — 8.5 per cent in 2003-04 and 7.5 per cent in 2004-05 — the economy is expected to grow at 8.4 per cent in 2005-06. This translates into an unmatched compounded annual growth rate of over 8 per cent during the last three years, not only in comparison to India experience over time, but also across economies of comparable size with the exception of China.

This growth is even more commendable as it is driven by good performance across sectors in manufacturing and services and is much more broad-based. As a result, there has been substantial buoyancy in investments made by businesses and demand of goods and services from consumers.

SRF was well positioned to benefit from this favourable market situation with the expansion plans initiated during the previous year starting to bear fruits in 2005-06. This coupled with the company's commitment to the principles of Total Quality Management (TQM) for continuous improvements of its business processes and operational efficiencies, has enabled the company to achieve a much better performance for the year under review. The highlights of SRF's financial performance in 2005-06 are:

- Net sales from operations increased by 22.5 per cent - from Rs.1059 crore in 2004-05 to Rs.1298 crore in 2005-06.
- Profit before depreciation, interest and tax rose by 60.9 per cent - from Rs.161 crore in 2004-05 to Rs.259 crore in 2005-06.
- Profit before depreciation and tax (PBDT) grew by 62.4 per cent - from Rs.136 crore in 2004-05 to Rs.221 crore in 2005-06.
- Profit after tax (PAT) also increased by 74.5 per cent - from Rs.60 crore in 2004-05 to Rs.105 crore in 2005-06.
- Return on capital employed (ROCE) increased from 17.2 per cent in 2004-05 to 23.8 per cent in 2005-06.
- Return on net worth (RONW) increased from 14.9 per cent in 2004-05 to 21.7 per cent in 2005-06.
- Earnings per share on a fully diluted basis (EPS diluted) rose by 65.7 per cent from Rs.9.31 in 2004-05 to Rs.15.43 in 2005-06.

In the remainder of the chapter, we will review the performance of SRF's business — their market, operations and outlook; initiatives taken by the company and its overall financial performance in 2005-06.

Businesses

SRF has a portfolio of established businesses in industrial intermediates. In the last few years, the company has also developed new businesses in packaging films and pharma chemicals as a part of its long-term strategy for growth. During the year under review, the company regrouped its businesses to reflect this change in its portfolio and to position them in line with the