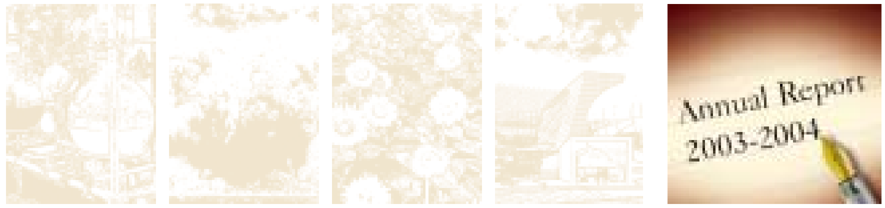

Looking Beyond : From a Strategic Perspective

An Annual Report tends to overload its readers with data, write-ups and facts - sometimes in rather a dry fashion in view of various statutory, perfunctionary and age-old traditional needs. On the other hand, the reader of an Annual Report is looking forward to data he can see in co-relation with trends, figures tied-up to read a story, analysis which can reach to conclusions. While these expectations are indeed a tall order, with a view to help the process, we drew questions from various analysts and shortlisted those which avoid a straight repetition of what is already in the Management Discussion and Analysis or elsewhere in the Annual Report. Below is an attempt to respond to these queries in the hope that it will bring an interesting and contextual perspective to the pages that follow.

Q. As you look at the year that ended, tell us the major positive and negative happenings which have impacted the F.Y. 2003-04.

A. At the outset let us examine the year ended from a trend perspective and then on its own. Last year's total sales of our manufactured products as a part of a five year trend shows a fair degree of stability. This, despite continuous lowering of customs duties on the imported product indicates a distinct undercurrent of resilience and customer loyalty developed.

Taking a look at last year per se, among the positive happenings were a 8.75% hike in net profit despite a 15% cut in gas availability over the previous year. Looking deeper, a volume growth of 15% in Acids and 14% in Ammonium Nitrate combined with a value growth of 11% in Acids and 23% in Ammonium Nitrate indicates

(a) Growing markets
(b) Customer loyalty
(c) Synergistic product-mix

Above all, the Chemical Sector contributed to 60% of the total turnover making a distinct statement that Deepak Fertilisers is more than fertilisers !

Among the major negative happening was the gas shortage which dampened the operations.

Q. Till there is an improvement in the gas availability, what will be your survival strategy? Post-abundant availability what are your growth strategies ?

A. As you may be aware, the GAIL-Petronet LNG terminal at Dahej has already been commissioned and is operational. Shell's LNG terminal will also be operational shortly. With this, the current year itself will see fair size additions to the gas availability in Western India. While its indirect positive impact would reach us faster, its direct impact will emerge once the Dahej-Uran-Pune pipeline is laid as per already approved/announced plans. This is expected to reach Uran by the middle of next year - which will finally remove the perennial gas shortage problems faced by us.

In the meanwhile, where possible, we have resorted to conversion of some utilities and fuel applications to dual fuel to allow naphtha usage. Additionally, we have developed three good sources of ammonia supplies which will ensure that our down-stream products based on ammonia, do not suffer. However, both these options, being higher cost options, would erode the contributions on the additional production based on these options. In the short run, we are also hoping that our fair request to the Petroleum Ministry for higher gas allocation, would bear fruits.

In the two-three year time horizon, once the national gas grid linking KG Basin to the West Coast is laid, gas supplies will be available in abundance. Keeping in view these developments, we have already begun implementing since last year, retrofits in each of our plants to extract another 10-15% capacities with marginal investments. A brown field expansion could be considered as we see the situation unfold.

Q. The fertiliser segment continues to lose heavily, what's the way forward; closure, spin-off, change ?

A. At the root of the problems in the fertiliser segment is the under-utilisation of the capital assets and human assets arising out of the shortage of gas/ammonia. The subsidy policy also adds fuel to the problems with under-recovery of fixed costs as also not supporting the higher out-sourced ammonia prices. These issues should be behind us once the gas availability improves.

Further, with the integrated production facilities built to draw synergy, spin-off etc would not make financial sense. We will see the light at the end of the tunnel in the next year or two and thus will be turning around this segment too. At the macro level, India's demand for fertilisers will continue to grow. In the long run, if the total industry is decontrolled with zero subsidies, fair feedstock pricing and market determined fertiliser prices, the industry in general and our company in particular would thrive based on quality products and brand loyalty built over the last two decades.

Q. What has been the strategy behind the growth plans taken up today ?

A. Our growth strategy is based on three drivers namely :

- Maximise the present performance through retrofits, energy saving schemes and improved productivity measures.
- Expanding on the present product base building on the strengths built over the last two decades.
- Diversify from the present by entering into new sunrise sectors.

The projects on hand envisage a capital outlay of over Rs 400 Cr. Further details on this have been given in the Management Discussion and Analysis (MDA) section of this Annual Report.

Q. Don't you feel a Mall is a risky proposition away from your core competency ?

A. Firstly, let me clarify that what we are developing is a Speciality Mall focused on a specific need which is quite distinct from a general mall selling merchandise like apparel and personal use items. There are many general malls opening up in various cities. Our focused Speciality Mall for its product range and size would be unique.

Secondly, I would also clarify that our role would be predominantly restricted to construction/development of the space. The actual retailing will be done by our domestic and global tenants who will be hand-picked based on their vast experience in marketing and well-known brands.

Thirdly, in terms of the construction/development activity the Group comes with wide project management experience including building and marketing value-added real estate such as IT/software ventures.

Fourthly, with over 189 million sq ft of residential and 14 million sq ft of commercial construction coming up within 3-4 hours of driving distance from the Speciality Mall site, all the surveys done indicate a strong demand base.

Lastly, a specific survey feedback from over 500 potential tenants have confirmed the need for the Speciality Mall, the buoyancy of the sector as well as the specific interest in taking up space in our Mall.

A further reading of the details in the MDA will throw more light on why we feel comfortably placed as regards the risks associated with the project.

Q. Will the funding of the new projects not put a severe load on the current operations ?

As you would have noticed, the Company has been generating around Rs 75 Cr cash since some years now and expects to continue doing so based on the operational trends. As the Annual Report reflects, more than Rs 100 Cr are sitting parked in Mutual Funds. On the other hand, the Company today has extremely healthy ratios of debt/equity (0.4:1) and interest coverage ratio of over 7.74 times.

Keeping the above facts in mind, while each project can stand up on its own merit for project funding, the overall Balance Sheet of the Company provides ample scope for comfortable funding.

Lastly, since the projects are a mix of acquisition (with returns from day one), super track projects (Co-gen Power Plant in 9 months) and fast track projects (IPA in 22 months) the spread and the low gestations would ensure no undue strain on the operations.

Q. On a longer-time horizon, where do you see the Company going ?

A. As we look ahead, the growth directions the Company will take will be based on the following strategic drivers :

(a) Enlarge current areas of operation by expansion / acquisitions domestically/globally to reach capacities and economies of scale at global levels in our areas of strength.

(b) Strengthen by way of investments/strategic tie-ups each link in the supply-chain from raw material-storage-shipping etc. to ensure cost competitiveness.

(c) Climb up the value-chain moving from Basic Chemicals to Performance Chemicals, Ammonium Nitrate to Explosives to Mining, Fertilisers to Agri Inputs to Contract Farming to Food Processing

Thus in the years ahead I see exciting growth unfolding on the foundation of the strengths built over last two decades.

Smehta

S. C. MEHTA
Managing Director