

The South India Paper Mills Ltd

64th Annual General Meeting, 21st September 2023

Chairman's Speech

Ladies and Gentlemen

A very Good Morning to all of you on this virtual 64th Annual General Meeting of our Company.

I am sure all of you have received a copy of the 64th Annual Report with the Accounts and Auditors' Report and hope you have had time to study it carefully and cast your votes electronically on the Resolutions proposed.

In this address, I would now like to report on how the year went, the Current situation and Future Prospects.

The financial year that went by was extraordinary. We incurred a loss for the first time in the last 35 years and therefore it is necessary for us to explain the underlying causes in some depth.

I will begin by discussing the operations of the Paper Division.

This was the year when we transitioned our paper making operations from production on three old, antiquated machines to a single, modern, highly automated paper machine with state-of-the-art water loops and pulping system. The transition is now completed and the results in terms of quality, energy consumption and productivity are encouraging.

There were delays in stabilizing the output of the machine as foreign technicians were unable to visit due to CoVid restrictions. European technicians could only visit in August 2022 and Chinese technicians have, even to date, not been able to obtain visas. Therefore, most of the output during the year was on the old paper making machinery. A complete transition of production to the new paper machine was possible only in late December 2022 after obtaining the 66kV grid connection in late November 2022.

The transition of production to the new Paper Machine also had the expected pains in terms of re-training personnel to operate a machine with far more advanced technology than they were used to. We also had to juggle output between the old machines and the new one during the third quarter of the year to meet customer delivery requirements. This resulted in frequent starts and stops of both the old and new equipment resulting in a loss of production of about 4000 MT and higher process wastage and energy consumption per MT of paper.

What exacerbated the situation, however, was a confluence of detrimental external factors that impacted the direct cost of production.

In a nutshell, the loss incurred during the year was on account the following major factors:

1. A steep increase in energy cost per unit of paper due to a steep rise in global coal prices.
2. Non recovery of an increase in raw material cost due to an inventory overhang and a very steep drop in the prices of imported wastepaper in the second and third quarter of the year.
3. Higher Interest and Depreciation charges on commissioning of the new Paper Machine.

The most significant impact on direct costs was on the energy cost per unit of output. Cost of imported coal went up from an average of 1.90 Rs/kcal in 2021-22 to an average of 2.65 Rs/kcal in 2022-23 due to the steep rise in global energy prices due to the war in Ukraine.

Energy cost per MT of paper rose from an average of about 8,000/- Rs/MT in 2021-22 to an average of about 12,500/- Rs/MT in 2022-23. To put these numbers in perspective, consider that the cost of energy per MT of paper from 2014-15 till 2020-21 ranged between 4,000 and 5,750 Rs/MT.

In so far as the ability to pass on such a steep increase in energy cost goes, it is important to note that the impact on kraft paper manufacturers in India was uneven. Those depending on Cogeneration for energy production and using imported fuel, as we do, were the worst affected.

Many of the smaller kraft paper capacities that source electricity from the grid remained less affected as the cost of grid electricity, being largely dependent on Government controlled domestic coal prices, rose much less.

Some manufacturers depending on wheeling and banking of captive/owned solar/wind power facilities fared the best as they substituted costlier purchased electricity with energy from their own facilities. The need to pass on costs to buyers by the different players in the industry thus varied and the rise in finished product prices for us who are 100% dependent on Cogenerated energy from imported coal was far short of the requirement based on the rise in fuel cost.

The other major factor affecting direct costs was the poor recovery of the increase in wastepaper cost in selling prices. We were particularly affected as we had placed large orders for imported raw material in anticipation of the startup of the new machine when prices were high due to supply and shipping constraints.

The sudden relieving of shipping constraints and the collapse in prices of imported raw material from \$315 to \$160 in the second quarter of the year left us saddled with expensive inventory and little scope of recovery as other producers in the same market segment effected rapid and steep product price reductions to secure business even as local and export demand slowed down.

In comparison to the previous year, the cost of energy and raw materials together was higher by about 7,800 Rs/MT whilst selling prices remained flat. These two factors alone constituted a differential of about Rs. 40 Cr in the bottom lines of the two years.

Looking at the performance of peer companies in this segment of the paper industry, I daresay that the year would have been a loss year even if there were no expansion project and the entire output was from the old plant.

I would now like to turn to a brief review of our Box Plant operations before I discuss Current Prospects.

Quite simply, the operations at the Box Plant constituted a silver lining to the dark clouds of this extraordinary year. The Box Plant contributed an Operating Profit of about Rs. 18 Cr and absorbed some of the operating loss of the Paper Division.

New capacities in various geographical markets have intensified and localised competition even as growth in demand is tepid. Timely delivery, flexibility in production and consistent quality continue to be the key factors for retaining and growing business share with the top brands in the FMCG and Consumer Goods segments. The sophistication of our production machinery and captive supply of quality paper continue to be our strengths in delivering value to our box customers.

Current Operations:

The new paper machine is now fully operational. The operating personnel are trained now and more familiar with the process and its control. During the first half of the current year there was a critical breakdown in the Size Press in May and again in August which caused some loss in output due to the delay in delivery of the spare rolls that were ordered in March 2023.

Some teething issues were faced both in the pulping system as well as the paper machine and are being resolved by the vendors to meet their performance guarantees.

The paper machine drive control system had to be reprogrammed to operate smoothly across the large operating speed range of the paper machine. A new state of the art system was ordered with Siemens to achieve this. The hardware and software has just been delivered and, with a short downtime to implement the system, we expect to achieve the target speeds for higher output of lightweight value-added grades soon.

I am happy to report that various value-added grades targeted in the product mix have been successfully manufactured and well received in the market. All efforts are on to improve the overall sales volume with an immediate target of at least 30% of value-added grades.

On the energy front, energy cost per MT of paper have come down substantially as fuel prices have fallen to a level Rs 1.90 per kcal which is still above the pre-Covid level. We expect further reduction in energy cost as productivity, uptime, and output on the new machine increases. However, further reductions in coal prices are unlikely in the short term due to the recent resurgence of oil and energy prices.

Imported OCC prices that had fallen to as low as \$160 per MT in last quarter of 2022-23 have gradually risen once again to around \$200 per MT currently. This is due to demand from new Southeast Asian capacities in Vietnam, Laos and Malaysia that were set up to meet the gap in Containerboard supply in the Chinese market created by the 100% ban on imported wastepaper by the Chinese Government. In view of the reduced collections due to recessionary conditions in the overseas supply markets, these prices are likely to remain firm for foreseeable future.

Thus far, we have been able to pass on the recent increase in costs of imported raw material.

The export market for Indian producers remains lacklustre due to poor growth in demand and the improved supply from new Southeast Asian Containerboard Manufacturers.

Outlook – Poor Demand Growth and Excess Capacity in the Industry – Matters of Concern:

Excess capacity in paper manufacturing capacity as well as converting are keeping a lid on pricing for most common grades of paper and boxes to FMCG majors.

Recovery of cost increases in higher grades that substitute imports like high priced Kraft Liners are much better. It is a matter of some relief that a large part of our production range is in this space.

Moving away from merely expressing relief, I must state that the pandemic and, increased Environmental consciousness are presenting new opportunities for our segment of the industry as new paper based packaging and plastic substitution initiatives gather momentum. We have initiated some steps in our Printing and Packaging Division to develop substitute containers for the Food Service/Delivery business.

At this stage, I would like to try and reassure you by simply stating that your Company has included in its product capability mix, for the expanded capacity, grades that will address the opportunities in these 'other' segments of the industry.

Prospects:

Our medium to long term prospects depend heavily on the successful scaling up of output with a higher proportion of value-added grades on the new paper machine.

In configuring this machine and its associated pulping line, your Management had factored in not only the evolving market conditions in the domestic Corrugated Case Raw Material market but also, looked at lucrative opportunities in other segments of the industry to fill the capacity of the new plant.

The Pulping System, the Paper Machine and the Finishing and Packing System have been designed with a product mix in mind that includes many new segments that we earlier did not operate in.

Besides new market opportunities, I would also like to mention that this machine is delivering significant savings in terms of fibre and energy costs which are imperative as the prices of key inputs rise.

Gratitude:

To begin with, I must place on record our appreciation for the timely infusion of fresh capital by Mr. Harshad Modi and Family. Despite the poor showing in 2022-23, they have recognized the “perfect storm” situation that resulted in a poor financial performance during the year. Being in the industry, they have been able to assess what is possible with the new investment and have expressed their faith in our company and its future by investing in its equity.

At this time of much uncertainty, I must state that the mood of the Operating Personnel and the Company Management is one of cautious optimism and this gives me much hope and confidence that we will achieve all our objectives in due course.

I take this opportunity to thank all the employees of the Company who have strived hard to beat the odds in these troubled times.

We have been privileged to enjoy the wholehearted support of our Bankers in our ventures over the years and I thank them for supporting us on this new growth plan.

It is a strong testimony to our ethos of building win-win partnerships that many of our customers and vendors have worked with us continuously over a few decades. I would like to extend my thanks to them as we continue to seek their support.

I would like to thank all my colleagues on the Board of Directors for their help and guidance over the years.

Finally, I would like to thank all of you, the members, for your patience and wholehearted support of our Company.

Thank you All for attending this Meeting.

Manish M. Patel

Chairman & Managing Director,

The South India Paper Mills Ltd.

