The South India Paper Mills Ltd

65th Annual General Meeting, 19st September 2024

Chairman's Speech

Ladies and Gentlemen

A very Good Morning to all of you on this virtual 65th Annual General Meeting of our Company.

I am sure all of you have received a copy of the 65th 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. I will not dwell too much on specific numbers as the details are with you in the Annual Report. Instead, I would like to give you a feel for the underlying factors.

Financial Position:

I would like to begin this address on a positive note by saying that, in the financial year that went by, we fared much better than in the preceding year when we had made our first ever operating and book loss.

Having said this, I must hasten to add that we are still some distance away from achieving the steady operating activity level required to achieve the level of financial comfort that we have historically enjoyed. During the year, we generated operating profits adequate to meet finance costs but insufficient to meet repayment obligations and normal capital expenditure requirements.

We have, however, been able to meet scheduled loan repayments due to the timely infusion of fresh equity capital and to that extent there is a reduction in outstanding Term Debt.

We have also put on sale old plant and machinery to sustain liquidity as we work on our strategy of building volumes and populating our paper product mix with a higher proportion of high contributing, value added grades. I would like to add that even as we progress with this strategy, the going is slow but steady and encouraging.

Operations:

In a sort of reversal in contributing roles, the Paper Division did better than the Box Division in terms of Operating Profit. The Paper Division which incurred an operating loss of Rs.23 Cr in the previous year due to extraordinary factors, achieved an operating profit of Rs.11 Cr and the Box Division that achieved an operating profit of Rs. 18 Cr. last year, achieved much less, at about 8 Cr.

The reduction in operating margin at the box Division can be attributed primarily to the intense push back by large brand owners on prices that had risen in the previous year on the back of a steep increase in paper prices. The push back in the year under review came on the back of a steep decline in Finished Paper prices.

Historically, changes in prices for boxes based on changes in cost of paper have been sticky both upwards and downwards -rising slowly and falling slowly but not as much – leaving a slightly larger margin for the box maker.

With over capacity in both the paper and corrugated container businesses, competition has intensified, and this situation has completely changed. Box price reversals are now, not only rapid and steep but, often reduce operating margins below pre-increase levels.

In a situation where box prices are already at optimum levels due to intense competition, further, genuine savings can be provided to box buyers only by re-engineering box designs using lighter but stronger paper. We are channelling our efforts to demonstrate sustainable cost and quality benefits from lightweighting that our grades of paper provide to box makers and ultimately to large brand owners.

As a parallel strategy, to meet the competition head on, and increase our box business, we also plan to utilize outsourced lower grade material to supply the lower quality box market where the volume, at about 70% of the total box demand, is higher. This will enable a higher utilisation of box plant capacity and add to the box plant overall output and contribution.

Paper marketing efforts for other value-added grades are directed towards convincing customers who use imported material to divert their paper requirements to us. This, understandably, is taking time given the lower quality of Indian material that most customers have experienced thus far.

I must also state that, where we have gained traction, the response has been positive, and we have gained many new and steady customers. For most of these grades, we are also in direct competition with duty free imports from countries in Southeast Asia under Free Trade Agreements.

This was also the first year when our entire paper output came from the new RCP Pulping line and Paper Machine. The production team at SIPM is getting more and more comfortable with the new technically sophisticated Pulping Line and Paper Machine as they progress up the learning curve. Downtime on account of insufficient training and experience with advanced machinery has been practically eliminated.

Whilst there was some downtime due to breakdowns, particularly in the Size Press and some machinery upgradation activities during the year, the largest reason for the less than the desirable capacity utilization was an insufficiency of orders.

The low volumes of orders on hand forced short runs with frequent grades changes. This resulted in higher energy and raw material costs – above budgeted standard costs.

Therefore, having adequate orders on hand and a steady inflow is imperative to smooth and cost-effective operations.

It is our plan to address the issue of order insufficiency by adding a few new grades and accessing distant markets for some grades at marginal cost with freight compensating pricing.

The average realisation per MT of paper produced by us in 2023-24 dropped from 51,270 Rs/MT to 41,361 Rs/MT and was set-off by an almost like reduction in raw material costs. This is illustrative of the fact that pass through of cost reductions is rapid in the prevalent environment of intense competition. The operating profit in the Paper Division was achieved both by a higher volume and a sharp reduction in Energy Costs.

The Current Raw Material and Energy Cost Scenario:

Wastepaper and Energy constitute the largest two components of direct manufacturing cost for us. A close third is the cost of Starch. I would like to highlight some important changes in the factors that affect the supply and cost of these main inputs.

Raw Materials:
A new and significant change that we observe in the cost of raw materials is the disconnect between the cost of Domestic OCC and the closest imported equivalents such Euro OCC and imported Hard Mixed Waste. I would like to elaborate on the impact of this change as it has significantly altered the market dynamics and costs for the most common grades of paper used for producing boxes for domestic consumption.

Domestic OCC is used by the industry to produce the most common, lower grades of Containerboard – commonly referred to as “kraft” paper in the 16-22BF category. When the supply of domestic OCC does not meet the demand, the shortfall is made up with equivalent imported grades of wastepaper.

These lower grades of paper constitute about 70% of the total paper consumed for production of corrugated boxes in India. Therefore, the cost of this raw material directly affects the cost of most of the “kraft” paper produced in India.

An important development that has had a direct impact on the demand for domestic OCC is that Indian mills have recently lost the export market for Fluting Paper and Roll Pulp.

Exports of these grades constituted a significant source of demand in 2021-22 and 2022-23. In servicing this market, Indian mills used domestic OCC creating a demand-supply gap in the domestic market. This gap was filled by equivalent imported grades of wastepaper.

The main reason for the recent loss of the export market for Indian mills is mainly poor quality, much below global standards. Moreover, new capacities that have come up in SE Asia and the Gulf are filling the supply gaps in the Middle East, Africa and Asia that were served by Indian mills. These factors together are likely to continue to adversely affect demand for Indian paper in the international market in the medium term.

In contrast to conventional wisdom in the industry that holds the view that the efficiency of collection of wastepaper in India is very poor and necessitates imports, it is our belief that the collection of Domestic OCC at least, is very efficient.

Given these two factors, it would be reasonable to assume that the supply of Domestic OCC will be sufficient to meet the current domestic demand for producing lower grade flutings and liners if exports of “kraft” paper from India continue to be limited.

The huge overcapacity in both, paper manufacturing and box making, is unlikely to drive up the raw material prices. Periodic and short spikes are seen when new capacities come on stream, but these spikes are small and short lived. This scenario is likely to continue until domestic demand for boxes grows sufficiently to fill the capacity.

This is also the reason for the large disconnect between delivered cost of equivalent imported material and the domestic OCC.

Currently, the delivered cost of imported Euro OCC at about 20,000 Rs/MT is 3,000/- Rs/MT higher than Domestic OCC. This difference used to be limited to about 1,000 Rs. per MT when Fluting and Roll Pulp exports from India were high.

The usage of imported OCC and other prime recycled grades is now mostly limited to higher grades of Containerboard being produced in India. Our product mix is comprised mainly of these higher grades and our costs are therefore affected by the developments and the dynamics in the global market.

The scenario for supply, demand and logistics for wastepaper in global markets has also changed and is quite different from what it was a year ago. I would like to highlight some of the most significant developments that are likely to affect the cost of our raw material.

Due to various factors such as the huge growth in demand for e-commerce shipping containers, that are not very demanding in terms of mechanical strength, we see that use of recycled fibre within the USA is increasing.

We also see higher recycled fibre exports from the USA to new, rapidly growing markets like neighbouring Mexico, one of the “China plus one” nations that has significantly benefited from the policy.

Coupled with the upheaval in Global shipping brought about by the Israel-Hamas war, costs and delivery lead times for shipments to Asia and India have risen significantly.

So, how does the disconnect between Domestic and Imported wastepaper costs affect us?

As mentioned earlier, the domestic wastepaper market is effectively disconnected from the global one. Upward price changes in the global market are not expected to affect domestic prices whilst they will affect our raw material costs.

So, our ability to pass on increase in cost of imported raw material could be impacted. On a more positive note, imports that we compete against would also become more expensive due to their like dependence on imported fibre.

Energy:
The most significant impact on direct costs and profitability over the past few years has come from changes in the cost per unit of energy purchased. Whilst cost of imported coal had risen 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, in 2023-24 it dropped to 2.00 Rs/kcal as the impact of embargoes on the use of Russian fuels has petered off.

Consequently, in 2023-24, the energy cost per MT of Paper dropped to about 7,750/- from 12,500/- Rs/MT in 2022-23. The reduction in energy cost per MT is more than the pro-rata reduction in fuel cost on account lower specific energy consumption both for steam and electricity in the new plant.

In the current year (2024-25) the energy cost per MT of paper is further down to about 6,800/- with energy priced at Rs1.85 Rs/kcal. Further reduction is expected to be achieved with a better capacity utilization.

In June 2024 we invested Rs.13.20 lacs in the equity of an existing Group Captive Power Generation Project promoted by Green Infra Wind Power Generation Limited (a subsidiary of Sembcorp, Singapore) for supply of 11 MU/year at a price of Rs.5.67 per kWh at Generator Bus including Open Access Charges. The landed cost including demand charges and electricity tax payable to the DISCOM is about Rs 7.45 Rs/kWh as against approximately 10.00 Rs/kWh for supplies from the DISCOM.

Energy supplies from this source began in August 2024. The savings are about Rs.15.0 lacs/month and since the annual contracted quantity covers our entire requirement of outsourced energy our environmental footprint will be greatly reduced.

As the world benefits from green energy both in commercial terms as well as environmental terms, the impact on pricing of conventional fossil fuels is likely to be significant and, it would be reasonable to expect a further reduction in cost per unit of energy going forward.

New capacities in various domestic geographical markets have intensified and competition is highly localized 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:

<u>Outlook</u> – 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 mix grades that will address the opportunities in these 'other' segments of the industry.

<u>Prospects:</u>

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.

<u>Gratitude:</u>

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.