

The South India Paper Mills Ltd

62nd Annual General Meeting, 23rd September 2021

Chairman's Address

Ladies and Gentlemen

A very Good Morning to all of you on this virtual 62nd Annual General Meeting of our Company.

I am sure all of you have received a copy of the 62nd 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, to put it mildly, unusual.

The CoVid 19 Pandemic has been disrupting - not only in terms of slowing down Global business activity but also, in terms of setting new paradigms for how businesses operate and indeed, spawning completely new businesses whilst reshaping the growth trajectory of existing ones.

Every person on the planet has been affected in ways that are common and in ways that are unique. I do not propose to dwell on these. I would nevertheless like to appraise you about how the Pandemic has affected our Company, its Industry and of the new opportunities and threats that have emerged in the new circumstances.

Operations in the year that was – Better than expected:

Coming first to how our operations were affected, I am happy to say, in a nutshell, that we were more fortunate than many others in the industry, especially because we are forward integrated into packaging, particularly that of essential fast moving consumer goods where demand has remained consistent through the Pandemic. Although many other sectors in which we supply paper to converters such as Garment Exports and Auto Components were quite severely affected by Lockdowns, the impact was set off by higher volumes in the essential goods FMCG segment.

Whilst the Packaging Division operated through the first lockdown in March and April 2020, albeit at around 30% capacity due to a disruption in transport

logistics, the Paper Division remained completely shut for April 2020 and for about 10 days in May 2020.

Incoming containers piled up at ports in March April and May 2020 during the lockdown as inland transport came to a complete halt whilst cargoes on the water landed. Most importers in our industry incurred huge detention and demurrage charges. I am happy to say that we were, with the help of our very efficient Clearing and Forwarding Agents at Tuticorin port, able to warehouse, at a reasonable cost, our incoming cargoes and clear all the incoming consignments without incurring these charges. These cargoes were later moved to the factory when transportation resumed.

I am happy to report that we have had very few Covid cases amongst the workforce due to a strict enforcement of Covid protocols and Covid appropriate behaviour. It is heartening to note that there have been no deaths in the workforce and that the few who were infected have recovered well.

Two vaccination drives were conducted by the Company and more than 1200 people from the workforce and the adjoining villages where most of our workforce resides, were vaccinated free of

cost. Donations of medicines and supplements were made to several District Health Centres for free supply to the local population. Our workforce is now fully vaccinated.

Due to the lower operating volume, for the various reasons cited, the first quarter of the year was relatively poor.

Operating volumes were restored to the pre-lockdown levels during June and July 2020.

The remaining three quarters went well, and we were able to recover the losses of the first quarter to register an operating profit of about Rs. 38 Cr for the year as compared to Rs.35 Cr in the previous year.

Expansion Project – Further delay due to Covid Lockdowns and delayed receipt of machinery, Addition to the Scope of the Project:

As you are aware, your Company is in the process of expanding its paper manufacturing capacity to 500 MT/day. A new state of the art Paper Machine (PM6), of 330-380MT/day is under installation.

Supporting infrastructure like the new Cogeneration Power Plant and ETP were commissioned much earlier and are working well.

Last year, we had expected to start up the new machine in the first quarter of the current financial year. Shipment of imported machinery that was originally scheduled for October-November 2020 was delayed to March and April 2021 due to a massive shortage of containers and cancelled sailings by major shipping lines. The complete stoppage of construction activities and non-availability of oxygen for steel fabrication work during the Pandemic Second Wave Lockdowns over April and May and June 2021 exacerbated the situation.

Installation work resumed in July-August 2021. We now expect to start up the new capacity towards the end of December 2021 provided there are no further lockdowns.

Over the year, with further availability of funds from Internal Accruals, the scope of the project was modified to include various automation systems to improve productivity, cut water usage and

particularly to add new grade capabilities to the paper machine and pulp line.

More specifically, the following Systems have been added:

Automated In-process Wet and Dry Broke Handling,

Automatic Roll Handling & Packing,

Vacuum Pumps & Process Equipment Seal Water Recirculation System,

Closed Loop Cooling Water Systems for Airconditioning, Hydraulic Loading and Lubrication Systems,

Recovered Water Purification and Reuse System

Dense Phase Starch Unloading Storage and Supply System.

Additional Pulp Line from Voith, Germany to extend the grade capability of the new paper machine

Solids Rejects Handling System to efficiently handle and compliantly dispose solid waste from the new process from MERI – Germany.

Closed loop Colour Monitoring and Control System from Xrite – Germany.

With these additions, the project cost has moved up from 190 Cr to 260 Cr inclusive of GST.

The incremental cost of the Project is proposed to be funded by additional debt of 40 Cr and the balance by Internal Accruals. The total debt component in the project cost, earlier 110 Cr, will now be 150Cr.

Till mid-September, about INR 207 Cr. has been incurred on the Project. This has been funded by Term loan drawn down to the extent of 91 Cr, Creditors of about 10 Cr and, 106 Cr by Internal Accruals.

The Status of the Global Containerboard Industry, Recycled Paper Demand and Supply and its impact on the Indian Industry:

The Global Scenario in the Containerboard (referred to a “Kraft Paper” in India) has undergone a huge change over the last three years.

A major factor that has influenced the global production, demand and supply situation has been the introduction of progressively stringent standards on imports of various grades of Wastepaper by the Chinese Government. The restrictions on imports of lower grades of wastepaper began in 2018 and culminated in a complete ban on imports of all grades of wastepaper into that country from 1st January 2021.

The Chinese ban has had a significant effect on the Indian market as indeed, it has had on other global markets.

The China Effect:

To put the current situation in perspective, I must first draw your attention to some facts about various Global Markets for Containerboard.

The Chinese Containerboard Industry is the largest in the world with about 55 million MT production per year and is dependent almost completely on recycled paper for its fibre furnish. The US Containerboard Industry is a distant second at around 35 million MT/year and the EU zone is third at 30 million MT/year. Demand for Containerboard in the Indian market estimated at about 7 million MT/year is 1/8th the size of the Chinese market. Installed capacity for Containerboard in India is estimated to be about 11 million MT.

China is the largest exporter of manufactured Consumer Goods in the world and exports constitute a large proportion of its GDP. Chinese exports of common Consumer Goods such as electronics, toys, household goods, shoes, garments and so on, are paper packaging intensive. Paper, as boxes and cartons is shipped out with the goods that are packed in them.

Even with a high recovery rate of domestic recycled fibre, replenishment of the fibre basket, requires the import of wastepaper or pulp.

The Containerboard Industry in China depends on imported fibre to the extent of at least 30% of its total requirement to fill its furnish basket.

The complete ban by the Chinese Government of all kinds of scrap including wastepaper since the beginning of 2021 has left a gaping hole in the supply of recycled fibre for Containerboard production in China and limited its output.

The fallout of this situation has been a sharp and high rise in wastepaper and finished paper prices in the Chinese market. Exports of Virgin Kraft Pulp, Recycled Pulp Rolls and Finished Paper to China have constituted attractive opportunities for players outside China since mid-2018. Global prices of Kraft Linerboard and Virgin Pulp have soared to record highs on the back of Chinese imports.

Capacities in some Southeast Asian economies such as Indonesia, Vietnam, Thailand, and Malaysia were diverted to fill the gap in Chinese demand for Recycled Containerboard during 2019 and 2020 resulting in local price increases in these economies.

The demand and Supply scenario continues to evolve - Large Chinese groups operating in the Containerboard space in China have also been setting up new capacities outside China, in Southeast Asia and in excess recycled paper zones such as the USA since 2018 to fill the fibre requirements of their mills in China.

Impact on the Indian Scenario:

Overall Exports of Containerboard and Recycled Pulp Rolls by Indian mills increased from around 0.67 million MT in 2019-20 to about 1.25 million MT in 2020-21 and to average of 2 Lakhs MTs per month in the first quarter of current year 2021-22 as against average 1 Lakh MTs per month in the previous year. Most of the material exported was to China even as demand and pricing in India remained lacklustre due to excess capacity and Covid effects.

The poor quality of finished paper in terms of strength, runnability and odour has kept Indian mills out of the prime Recycled Containerboard segment and confined them mostly to the Recycled Pulp Rolls and low grade Fluting Medium segments.

Notwithstanding these limitations, Indian mills, particularly in and around Morbi, Gujarat have been setting up new capacities to cater to the Chinese demand.

This is likely to exacerbate the excess capacity/supply scenario in India should the export demand falter. It is also important to note that the current steep rise in global container freight rates is also a limiting factor and exports out of India have dropped substantially from July onwards this year.

The gap in demand for higher priced grades in the Chinese market has been filled by Southeast Asian and European mills who are equipped with better machinery and can easily meet global standards.

Current Operations:

Notwithstanding strong headwinds in terms of intensified competition, poor demand growth and a steep rise in input costs we have been able to weather the year so far quite well.

We closed the first quarter of FY 2021-22 with an operating profit of Rs. 11.56 Cr as against Rs 6.58 Cr. during FY 2020-21 which was a lockdown quarter.

All - Rs Crores

	Q1 2021-22	Q4 2020-21	Q1 2020-21	Full year 2020-21
Revenue from Op	69.42	71.04	34.63	226.78
Operating Profit	11.56	11.53	6.58	38.17
Cash Profit from Operations	10.30	10.17	5.50	33.71
PBT	10.48	7.29	3.10	26.63
PAT	8.91	5.13	2.20	19.05

Outlook - Rapidly rising cost of key Inputs, Stagnant Demand and Excess Capacity in the Industry – Matters of Concern:

Costs of major inputs - Wastepaper and Fuel were stable to down immediately after the lockdown in March and April 2020 was lifted and gave a boost to the earnings in the remaining part of FY2020-21.

However, I must inform you with some concern, that costs of these inputs have risen very rapidly over the last 7-8 months and that it has been difficult to stay ahead of the cost increases in terms of recovering them in selling prices of paper and corrugated boxes.

Imported RB2 Coal, in consonance with Global prices has risen from 7,200 Rs/MT delivered in May 2021 to 10,800 Rs/MT in August 2021 and currently quoted at 13,400 Rs/MT. Imported wastepaper (AOCC) at \$330-340, up from around \$300 in March 2021 is now at a historical peak.

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.

I am happy to inform you that whilst we have counted Nestle, Asian Paints, Britannia Industries, Reckitt Benckiser, HUL and many other reputed brand owners amongst our business partners, our marketing team has added a new feather in its cap in terms of Amazon. Besides the business of supplying boxes to one of their largest Fulfillment Centres in India, this association is expected to present us with the opportunity to supply paper grades that will substitute plastics.

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.

Future Prospects:

Our medium to long term prospects depend heavily on the successful implementation and start-up of the new paper machine.

In configuring this machine and its associated pulping line, your Management has 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 currently do not operate in.

A successful start-up of the new machine will enable us to exploit more lucrative segments of the Paper Industry and, enter new geographic markets in 2022 and onwards.

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

Gratitude:

At this time of much uncertainty, I have to 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.

