

# MANAGEMENT DISCUSSION & ANALYSIS

## Forward looking statements

*In this Annual Report, we have disclosed forward looking information to enable investors to comprehend our prospects and take informed investment decisions. This report and other statements - written and oral - that we periodically make, contain forward looking statements that set out anticipated results based on the management's plans and assumptions. We have tried wherever possible to identify such statements by using words such as 'anticipate', 'estimate', 'expects', 'projects', 'intends', 'plans', 'believes', and words of similar substance in connection with any discussion of future performance.*

*We cannot guarantee that these forward looking statements will be realized, although we believe we have been prudent in assumptions. The achievement of results is subject to risks, uncertainties and even inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Readers should bear this in mind.*

*We undertake no obligation to publicly update any forward looking statements, whether as a result of new information, future events or otherwise.*

## 1. Operating Environment

*Indian Economy, Global Paper Industry & Indian Paper Industry*

### 1.1 Indian Economy

The Indian economy grew at 6.7 per cent in 2017-18. Though economic growth remained subdued in the first half of the year due to demonetization and GST implementation, it recovered in the second half on the back of robust consumer demand and buoyancy in urban and rural spending. The 7.7% growth rate achieved during Q4 FY18 puts India as one of the fastest growing economies in the world. With private consumption picking up, rural economy recovering and investments reviving as reflected in IP capital growth index and gross fixed capital formation (GCF), India's growth should remain positive with both the World Bank and IMF predicting a higher growth trajectory in the years ahead., For FY18-19 the economy is projected to grow at 7.4%.

The demand drivers for paper consumption comes from a combination of factors such as increasing numbers of professional office workers, expanding access to education and increasing access to broadband internet and use of computers and printers.

### 1.2 Global Paper Industry

Globally over 400 million tonnes of paper and paper products are consumed. The world's three largest paper producing countries are China, the United States, and Japan (these three countries account for approximately half of the world's total paper production), while India accounts for a small but growing share of the global market. The global paper and pulp industry has contracted slightly over the past five years, primarily due to disrupting technology, and shift in customer demand. However, the decline in growth in developed markets are expected to be offset by the demand growth in India, Middle East, Africa and Asia.

### 1.3 Indian Paper Industry

The domestic demand of paper and packing is ~14 Million metric tonnes, which accounts for ~4% of the world's consumption. The estimated turnover of the industry is ₹ 50,000 crores, contributes ₹ 4,500 crores to the exchequer and provides employment to more than 0.5 Million people and 1.5 Million people indirectly. The Indian paper industry is highly fragmented with ~ 750 paper mills, of which ~6% have capacity of 50,000 MT and above.

The paper industry is classified into four segments, Packaging, Paper & Board, Printing & Writing (P&W), Newsprint and Specialty Papers & Others.

## 1.4 Outlook

The per capita consumption of paper in India is ~10 Kg as opposed to a global average of 56 kg. We believe India is in the early stages of the demand cycle and expect continued growth in all paper segments.

For the Indian paper industry, strong economic growth has been accompanied by equally robust demand for paper. The demand for paper is largely driven by:

- **Education:** Efforts to improve the primary and higher education is driving the students enrolment and continuance of education.
- **Publications:** The demand for high quality printing and writing paper.
- **E-commerce:** Internet penetration is creating new business models and demand for industrial packaging, consumer packaging and printing & writing paper.
- **Economic activity:** The increase in economic activity is expected to open up more avenues (Manufacturing sector, Office space) for paper demand.
- **Consumerism:** Higher disposable income coupled with urbanisation is expected to drive new and different consumer behaviours and drive demand for paper products.

As per the industry estimates, Printing and Writing segment demand is expected to grow at a CAGR of ~4%, Paperboard at a CAGR of ~9% and speciality paper at ~8%.

## 1.5 Major Industry Challenges

### a Access to quality and cost competitive raw material

India is a wood fibre deficient country as the Government of India does not permit industrial plantations in the country. Inadequate raw material availability domestically is a major constraint for the paper industry. Additionally, the recovery rate of wastepaper in India is quite low (~30%) due to lack of an effective collection mechanism. With issues like availability of quality raw material at competitive prices, many players depend on the imports of pulp, wastepaper and even pulpwood to meet their raw material needs and often have to pay premium for availing them thereby impacting profitability and capacity addition.

IP APPM has implemented a strategy that develops free saplings and clonal species, partners with farmers and government to supply 100% of Company's fibre needs within 300 Kms of the Mills.

### b Imports

The reduction of import duties (10% to Nil) on paper and paperboard from ASEAN countries pose a challenge to India paper industry. During the year FY18 the imports of paper and paper boards touched 1.9 MT which is ~ 35% higher than FY17. The higher cost of fibre and capital in India affects the competitiveness of the Indian players and could potentially impact the relevance of local players.

## 2. About IP APPM

*About IP APPM, Strategy, competitive strengths, products and manufacturing.*

### 2.1 About IP APPM

International Paper APPM Limited (formerly known as The Andhra Pradesh Paper Mills Limited) is one of the largest integrated paper and pulp manufacturers in India. The Andhra Pradesh Paper Mills was established in the year 1964. In 2011, The Andhra Pradesh Paper Mills Limited was acquired by International Paper (IP), a USD 22 billion American packaging, pulp and paper company founded in 1898. In the first significant domestic acquisition by a foreign paper company, IP bought 75% stake in the Company. IP, headquartered

in Memphis, Tennessee, USA is the largest packaging, pulp and paper company in the world, with approximately 55,000 employees operating in 24 countries.

In December 2013, the Company was renamed as International Paper APPM Limited. The name change was intended to recognize the parentage of International Paper, while maintaining the link to the history and positioning of the Andhra Paper brand. This is also to ensure that future investments in brand-building are directed around the IP brand leveraging the Group's global presence and technology. IP APPM employs ~1900 employees and is headquartered in Hyderabad, Telangana.

IP APPM is focused on serving customers with high quality printing and writing papers.

IP APPM is also focused on people safety, efficiency enhancements and social and community programs backed up with its own pioneering work in raw material generation through social farm forestry. Across the Company, there is a strong strategic focus to drive future growth through building on the organization strengths to produce the highest in quality, ramping up of volumes and be a cost effective producer of paper.

The Company has always been conscious of its corporate responsibilities and follows a strict environmental policy. Investments continue to be made in achieving benchmarks to remain ahead of compliance standards. Such efforts have helped protect and regenerate the natural resources, conserve energy and water, improve productivity and set a good environmental track record at the mills.

## 2.2 Products

The Company produces writing, printing and cut-size papers for foreign and domestic markets and offers a wide range of high quality specialty grade products for a diverse range of applications. These products are designed to provide outstanding performance, functional excellence and exceptional finish quality.

The well-known cut-size papers of the Company offer a wide range of office documentation and multipurpose papers, from economy to premium grades, ideal for both home and commercial use. The papers are available in best-in-class brightness and produced with Elemental Chlorine Free (ECF) pulp technology. The range is perfect for high volume photocopying and high-quality color printing needs and engineered to run flawlessly on all types of photocopiers, laserjet and inkjet printers, fax machines and multi-functional devices.

## 2.3 Manufacturing

Our Rajahmundry Mill is an integrated wood-based paper mill with a rated capacity to produce 174,000 MT of finished paper and 181,500 MT of bleached pulp annually. The unit manufactures uncoated writing and printing paper - mainly cut-sizes, industrial papers and posters using Casuarina, Eucalyptus and Subabul as main sources of pulp wood.

Our Kadiyam Mill has a rated capacity to produce 67,000 MT per annum of finished paper such as cream wove, azurelaid, colored cut-sizes and kraft liner using recycled fiber and purchased pulp as base raw materials.

The Company holds ISO 14001, ISO 9001 and OHSAS 18001 certifications as well as the Forest Stewardship Council (FSC) Chain Of Custody (COC) certification.

The paper industry is capital intensive with a large gestation period. Payback is partly earned through better product characteristics and value realization and partly by improving productivity. In its endeavor to match global standards, IP APPM has invested in environment friendly technologies that facilitate increasing the overall quality of products and demonstrating productivity gains. In addition, IP APPM

has invested in technology to reduce water consumption, energy consumption and control air emissions.

All the investments are directed to improve the systems and processes to ensure consistent pulp quality with high strength properties, low consumption of utilities and chemicals and offer economies of scale. The Company has improved the economics of production in the mill and exceeded current environmental norms applicable in the country.

## 3. Review of Operations

The Company's operations strategies are aimed at enhancing the overall performance. During the year the Company further fine tuned its customer support processes and systems to add excellence in delivery.

During the year, sales volume was 2,30,900 MT as compared to 2,20,900 MT in 2016-17. Of the revenues, 19% were from exports (previous year 20%) with domestic sales accounting for the balance 81%.

IP APPM produced 2,28,900 MT of paper in the year ended March 2018 as against 2,15,700 MT in 2016-17. Capacity utilization remained above 95% during the year.

Our continued efforts in manufacturing excellence initiatives helped in improving pulp productivity and Overall paper Machine Efficiency (OME). The Company made significant gains in fiber, energy and chemical costs. As in the earlier years, deliberate and continuous efforts were made to become a low cost producer, raising the operating efficiencies and optimizing material consumption. Overall, the manufacturing excellence initiatives helped improve the mill reliability, increase the productivity, reduce the overall cost and improve profitability.

While focussing on improving the reliability, our initiatives in production planning and scheduling helped secure continuous runs and lower down time. This helped improving our On – Time – In – Full (OTIF) performance above 90% and delight our customers.

## 4. Financial Performance

During FY18 the Company's financial performance improved by earning the highest recorded EBITDA and PAT. These results were driven by higher sales volume, higher selling prices as well as record production levels and improved efficiency and manufacturing cost. While EBITDA registered an increase of ~29%, Profit after Tax improved by 156% supported by decrease in finance costs, depreciation and exceptional items. The Company continued to focus on important initiatives for improving employee safety and environmental compliance as well as improving the customer experience and operational efficiencies. Debt was reduced from ₹ 360 crore in March 2017 to ₹ 208 crore in March 2018, with the result, the debt-equity ratio was lower at 0.37:1 Interest cost as a percentage of revenue came down significantly.

The Company generated ₹ 215 crore cash from operations in the year under review as compared to ₹ 172 crore in 2016-17. The net profit for the year was ₹ 83.1 crore while the previous year had ended with a net profit of ₹ 32.4 crore.

## 5. Internal Financial Control

The management of IP APPM is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is the process designed by, or under the supervision of, our Chairman & Managing Director and Chief Financial Officer, and effected by our Board of Directors, Audit Committee, Management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes.

All internal control systems have inherent limitations, including the possibility of circumvention and overriding of controls, and therefore can provide only reasonable assurance of achieving the designed control objectives. The Company's internal control system is supported by written policies and procedures, contains self-monitoring mechanisms, and is audited by Independent Auditors.

Appropriate actions are taken by Management to correct deficiencies as they are identified. The Company has a process in place to continuously monitor the processes and identify gaps, if any, and implement new and/or improved controls wherever the effect of such gaps would have a material effect on the Company's operations. The Company performed an evaluation and made an assessment of the adequacy and effectiveness of the Company's internal financial controls as at March 31, 2018. Based on this assessment, the management believes that, as of March 31, 2018, the Company's internal control over financial reporting was effective and our Statutory Auditors have expressed an unmodified opinion on the adequacy and operating effectiveness of the Company's internal financial control over financial reporting in page 53 of this annual report. The internal control environment includes an enterprise-wide attitude of integrity and control consciousness that establishes a positive 'tone at the top'. This is exemplified by our ethics program that includes long-standing principles and policies on ethical business conduct that require employees to maintain the highest ethical and legal standards in the conduct of International Paper business, which have been distributed to all employees; a toll-free telephone helpline whereby any employee may anonymously report suspected violations of law or Company's policy; and an office of ethics and business practice.

The internal control system further includes careful selection and training of supervisory and management personnel, appropriate delegation of authority and division of responsibility, dissemination of accounting and business policies throughout the company, and an extensive program of internal audits with management follow-up.

The Board of Directors, assisted by the Audit Committee, monitors the integrity of the Company's financial statements and financial reporting procedures, the performance of the Company's internal audit function and independent auditors, and other matters set forth in its charter. The Committee, which consists of independent directors, meets regularly with representatives of management, and with the independent auditors and the Internal Auditor, with and without management representatives in attendance, to review their activities.

The Committee has reviewed and discussed the financial statements for the year ended March 31, 2018, including critical accounting policies and significant management judgments, with management and the independent auditors.

## **6. Information Technology (IT)**

IT Department continued its focus on enabling business processes and systems through strategic adoption of IT. These covered all the operating areas including manufacturing, sales and marketing, human resources and forestry. The IT department has begun using data analytics and digital automation tools to enhance productivity, reduce manual work and increase accuracy. The focus areas include Sales, Marketing, Forestry and Manufacturing. New process automation in our Farm Forestry operation has enhanced our capability to track saplings from production to delivery. Further process automation within our Environmental management operation has reduced

manual work and improved our data management and our ability to ensure that we operate in compliance to the regulations. We have provided new analysis and report tools for our commercial team to better understand key market and customer trends, thus leading to better decisions. The Company is also focusing on innovation within IT to further reduce the costs and introduce new tools.

## **7. Our People**

IP APPM has ~ 1,900 employees and an additional 3,200 contract workers. People are the foundation of our Company, so investing to develop capabilities is important to achieve our goals. We have robust talent management processes that include individual performance & development plans, organization assessments and succession planning for leadership positions. We use a balance of approaches to develop our teams including engagement plans, training & skill development, career planning and health & wellness programs to build a strong organization and strong individuals.

With safety as a top priority, we make extensive investments in training and skill development to raise awareness of risks and certify knowledge for procedures and conditions. Our Manufacturing Excellence program trains and certifies expertise in techniques using 6-sigma, Lean, RCFA and process improvement. We have ~ 90 certified green and black belts who take on improvement projects to make our operations better. We introduced a medical insurance policy for all workmen/women and their spouses. The Company conducted work-life balance programs to raise awareness of job and life balance stress. We provide management development training for our front-line leaders, so they learn how to engage and lead our employees to perform to their fullest potential. We invite our top 100 leaders to an annual leadership conference to challenge their thinking and seek alignment on our goals and expectations. We utilize International Paper's global training platform to develop leaders with their international colleagues across various disciplines including strategy, commercial excellence and best practice sharing.

We advocate diversity and inclusion including diversity of experience, background, gender and race. People with diversity of background and experience bring new ideas, challenge the old norms and better prepare us to compete and serve our diverse customers and markets.

## **8. Outlook**

The Indian economy is currently strong and the confident economists predict continued near term growth. The global economies are steadily growing, but facing many challenges such as increasing interest rates, rising oil prices, growing trade wars and shifting currency exchange rates. The global pulp markets have tightened during 2017 and 2018 and prices have increased substantially. The pulp price increases have helped to push paper prices up around the globe and have influenced a shift in trade flows. The shift in trade flows has an impact on India and our main export markets of Africa and the Middle East. These changing dynamics occurred over a short period and it is hard to predict the direction of future trends. We are optimistic about the outlook for paper demand in India, but realize many factors can affect growth. The global influences are more difficult to predict. Therefore, we stay focused on the things that we control. We focus on safety, serving our customers, developing our people and improving our operations, cost and profits. We are optimistic about the outlook and confident that we can continue on the path to improve.

## 9. Risk & Risk Mitigation

Risks and uncertainties are an inherent part of every business, and yet it is important to identify the risks and take proactive steps to mitigate and minimize them. IP APPM identifies and evaluates risks as early as possible and limits business losses by taking suitable measures. The Company aims to avoid risks that pose a threat to its sustainable growth.

IP APPM understands that risks can negatively impact fruition of both short-term operational and long-term strategic goals. Risk management is a part of the Company's business planning and controlling process.

The Company operates a framework created in line with its parent organization, customizing to fit into the local requirement, through which financial risks have been identified based on their severity. These risks are identified on a continuous basis through business process studies, internal audits, financials reviews etc. IP APPM understands certain inherent financial risks which are imperative due to the environment in which it operates.

Depending on the dynamics and severity, risks are documented and prioritized for assessment of their impact. Various financial

risks such as credit risks, treasury risks, finance transactional risks, reporting risks are measured vis-à-vis regulatory risks. Compliance risks are embedded into IP APPM's overall enterprise risk framework depending on their severity and are reviewed for their impact on the business objectives of the Company.

IP APPM proactively manages finance risks to maintain prudent operations. These risks are classified as short to medium to long depending upon their impact and remedial options. They are reported and reviewed at appropriate managerial level. Depending upon severity of such risks, they are further reported to the Audit Committee and Board of Directors as applicable. IP APPM effectively uses management reporting tools to report material financial risks at appropriate levels. The following factors are considered for determining the materiality:

- Some events may not be material individually but may be found material collectively;
- Some events may have material impact qualitatively instead of quantitatively;
- Some events may not be material at present but may have material impact in future.

The industry specific risks are broadly discussed below:

Risk	Risk Definition	Risk Impact (Low, Medium, High)	Risk Mitigation
Raw Materials	The paper industry requires a sustainable supply of wood to survive and flourish. Wood accounts for approximately 40% of the cost of production. Any threat in supplies would adversely affect the survival of the paper industry.	High	IP APPM encourage land owners in the vicinity of the mill to grow more than twice the number of trees than that are required. They are also counselled on nurturing the trees so that availability is guaranteed.  Subabul, Casuarina and Eucalyptus are the three varieties majorly used by IP APPM as raw materials for paper production.  At present Company has ensured 100% supply of wood from the social farm forestry initiatives of the Company.
General Economic Factors	Adverse business developments could have a negative effect on the demand for paper products, financial conditions and results of operation. The paper industry has a positive co-relation to economic development and lower GDP growth could affect business fortunes.	High /Medium	Strong management and leadership capabilities in forecasting. Strong focus on market penetration, sales training and product innovations.
Cyclicality of Industry	Cyclical demand for paper could have an adverse impact on sales. The reduction in sale prices will affect IP APPM's operations. The cyclicality of the business could depress margins or growth.	Medium	IP APPM has continuously rationalized and strived to improve efficiencies to lower its costs, added to its scale of operations and stepped up its volume of value-enhancing products. Efforts are being made to scale up the operating leverage as well as by lowering the fixed costs per ton of paper to protect margins.

Risk	Risk Definition	Risk Impact (Low, Medium, High)	Risk Mitigation
Heightened Competition in the Industry	There is increased competition from manufacturers and addition to capacities by many of them will add to pressures in the market. It's a highly competitive field with several peers seeking to improve their market presence.	High	IP APPM has grown into one of the most competitive producers of pulp and paper, and with its product development, investment in quality and branding, the Company retains a significant competitive edge in the market. IP APPM has been recognized for the branding and quality of its grades and the newly introduced varieties have been received well by the market. Leadership positions in terms of product quality have been earned over the decades in some of the key segments such as cut-size and high-grade writing and printing papers and the Company is rated amongst the top three in terms of quality in almost all its product segments.
Product Substitution	Electronic medium has reduced the archiving needs that were met by lower grades of paper which could impact demand pull within the cream wove category.	Low	Growth in demand and consumption of both lower and high-grade writing and printing papers has outpaced the threats with higher usage in the copier and stationery segments.  IP APPM sees no threat in the short and medium term within its product categories since all of them are growing, especially given the low base in paper usage and consumption.
Technology	Failure to keep pace with production technology can lower the competitive edge indigenously and globally	High/medium	Efforts are ongoing to enhance its processes and optimize on resources to meet the needs of the market. The Company is committed to consistently reduce its cost of production by adopting the latest in technology while improving the quality of its end product.
Utilities	The paper industry needs large quantities of power, fuel and water to operate. Lack of availability of any of these utilities can add to the cost sensitivities of the industry.	Medium /High	IP APPM has minimized its risk by investing in a recovery boiler, a coal fired boiler and a 34 MW turbine that supplements the power drawdown from the grid. Availability and quality of coal supplies have improved. The Company salvages the residual lignin in wood in its pulping process to fire the boiler and hence uses every part of the wood. IP APPM has considerably reduced its need for fossil fuels and made adequate plans to protect its needs. There is adequate availability of coal for IP APPM as the Company has ties with producers such as Singareni Collieries and Mahanadi Coalfields Limited for uninterrupted supplies.  Unit:Rajahmundry is adjacent to the River Godavari which has copious availability of water. Yet, the mill has invested in suitable processes to recycle water and strives to conserve the use of precious natural resource. As far as possible, the Company recycles water and, more important, minimizes wastages. Over the years, IP APPM has been consistently reducing energy and water costs per MT of product manufactured.

Risk	Risk Definition	Risk Impact (Low, Medium, High)	Risk Mitigation
Exchange Rate	Currency exchange rates could undergo changes with the Indian rupee turning volatile for most part of the year. This could have a potential impact on the export earnings of the Company.	Low	IP APPM is conscious and watchful of the rupee's movements. Hedging is done wherever necessary and forward covers are taken to protect the Company's interests. The Company is also conservative in booking the unfavorable impact of exchange fluctuations as soon as the impact is determined. Prudential accounting norms are followed in line with the Accounting Standards.
Interest Rates	The Company's operations are subject to high working capital requirements. Inability to obtain and/or maintain sufficient cash flow, credit facilities and other sources of funding, in a timely manner, could adversely affect operations, financial condition and profitability. Interest rate risk resulting from changes in prevailing market rates can cause an impact on the financials of the Company.	Medium	Risks from cash flow fluctuations are recognized in a timely manner as part of the liquidity planning. IP APPM is conscious of the dynamics of the market, and has taken effective steps to not only reduce costs and improve margins but also be in a position to report higher post tax profits. Generating free cash flow will remain a priority.
Environment	The pulp and paper industry has a commitment to the environmental protection, and it would be essential to remain sensitive to the needs of the planet.	High	<p>As a responsible corporate citizen, IP APPM has hugely minimized the impact of mill operations by taking a proactive role. The Company encourages planting twice the number of trees than it harvests and reduces water consumption year after year.</p> <p>The latest technology has been adopted for elemental chlorine-free bleaching of pulp and recycling of water. Efficiency of the effluent treatment plant has been improved with diffused aeration system and by installing a cooling tower. IP APPM installed a Non-Condensable Gases (NCG) system, both for the collection and incineration of high volume low concentration and low volume high concentration gases. This has made the mill and surrounding environment odor free. IP APPM also installed high efficiency ESPs to contain suspended particulate matter to less than 50 ppm.</p> <p>Several such initiatives have been taken to ensure IP APPM meets high standards much before the standards are laid down or implemented by all regulatory authorities.</p>