Management Discussion and Analysis

Economic Overview prior to COVID-19

The fiscal 2019-20 witnessed a steady decline in Gross Domestic Product (GDP) growth of USA, EU and China whereas Japan recorded higher growth over previous year. Indian GDP declined sharply to around 5% resulting into challenging business environment. Depleted economic activity in the country affected businesses which normally follow GDP growth. Crude oil prices remained in the range of USD 55-60 per barrel till February, 2020.

The Indian economy experienced serious challenges on account of trade deficit, lower GDP growth, higher inflation, unemployment issues and other economic factors. INR continued to devalue from levels of 69 per USD to 74 per USD levels owing to the negative sentiments on the Asian markets and now on the back of depressing conditions and weaker growth forecasts.

The Indian Auto and auto component Industry witnessed a steep decline in demand right from second half of financial year 2018-19. This was largely on account of liquidity issues on the back of NBFC crisis, weak rural demand, higher insurance and fuel costs, new axle norms, transition phase on BS-VI norms, etc.

COVID-19 and its impact

In January 2020, China locked down Wuhan province due to Corona-Virus epidemic creating a panic in the world market to secure supply chain. However, most of the countries assumed it to be a China problem till it spread in EU, USA, and all over the world. WHO declared it as a pandemic and all countries including India resorted to partial/ complete lock downs to curb the spread of COVID-19.Not only did the economic activities in the world come to a grinding halt from March 2020, but also burdened the health services of all the countries.

Amidst this, while the demand was lowest due to COVID-19 pandemic, an unprecedented move by one of the OPEC members to pump in higher crude in the market, resulted into sharp decline in oil prices with WTI quoting at negative price for an unfulfilled derivative contract on April 20, 2020.

Though most of countries have lifted lock down in May /June 2020, the world is left with an unpleasant choice between life and livelihood. World economy has never faced such unprecedented challenge and each country is trying to boost its economic activity, while the threat of COVID-19 persists.

On the domestic front, the nation- wide lock down for around three (3) months has thrown up many challenges for domestic business. Lockdown in the country to reduce the spread of COVID-19 affected all sectors including automobile, real estate, textile, hotel, aviation, entertainment etc. Unemployment, pay cuts, lack of demand, liquidity concerns, debt servicing and inadequate health care systems will be key monitorable if one is to look at the economic growth prospects. The chemical industry too is no exception to the above and resolving the complex matrix will be a major challenge and is likely to take few quarters before it stabilises.

Chemical Industry is intricately woven to each other and any imbalance in demand-supply for a group of chemicals can threaten the manufacturing activities of several industries.

If the threat of COVID-19 continues or escalates, it could be detrimental to the business which is trying to come out of pandemic challenge.

The Indian government, to start with has announced several measures including support to the borrowers in the form of moratorium, financial sectors, support to MSME and other businesses. All businesses are asked to look at “self-reliant strategy”. If all these aspects are dovetailed in businesses with right spirit and if there is a decline in COVID-19 spread, Indian economy could show a substantial positive trend.

To summarise, the global economy, particularly the manufacturing sector which looked buoyant up to the first half of financial year 2018-19, experienced a prolonged recessionary situation for about six (6) quarters and is further expected to continue for few more quarters. Global growth is expected to be negative in financial year 2020-21. Global financing conditions have tightened, industrial production is subdued, trade tensions remain elevated, and health scare on account of COVID-19 continues to be a major issue. Faced with these headwinds, the recovery in emerging market and developing economies have lost momentum. However, the domestic business could show a positive trend after few quarters if spread of COVID-19 is arrested and business activities normalise.

Rubber Chemical Industry:

Global rubber consumption witnessed a de-growth of 1% for the calendar year 2019. Rubber chemicals demand essentially follow the trend of global rubber consumption. Rubber Chemicals are used by manufacturers to process Natural Rubber and / or Synthetic Rubber into finished products, like Tyres, Moulded Components for vehicles, Industrial Belts, Gloves and other latex applications, Hoses, Footwear, Active Pharmaceutical Ingredients etc. of these, the Tyre industry is clearly the single largest consuming industry for Rubber Chemicals.

The demand for automobiles which started slowing down in the second half of financial year 2018-19 due to higher fuel prices, interest rates and the NBFC crisis, continued to be impacted for the whole of financial year 2019-20. Demand of Radial truck and bus tyres segment is a direct reflection of the demand in the automobile sector.

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The major domestic non-tire segment, namely the moulded and extruded goods segment, largely depends on the automobile sector. Thus, this segment is expected to move in line with the corresponding operating trend in the automobile sector.

With declining demand and coupled with surplus availability of Rubber chemicals resulted into vertical drop in prices globally which were disproportionate with raw material price reduction.Thankfully, due to your company's wide range of products and through an optimum mix of inventory management and buying strategy, we could withstand this shock and generate cash profits.

Industry Structure and Developments

As stated earlier, the Rubber chemical industry essentially follows the trend of global rubber consumption.

Tire industry, largest consumer of rubber witnessed weak demand pattern in line with the prolonged slowdown in the auto sector.The domestic auto industry witnessed a de-growth of around 15% for financial year 2019-20.

The tire customers despite indicating larger pick up rate at the beginning of each quarter were not able to lift the agreed schedules as production cuts were experienced across the board in the domestic tire companies (degree of cuts varying across different plants/customers). Tire companies in line with the auto industry took regular shut down ranging between 5 to 7 days especially in the first nine months of the year to control high inventory.

Prolonged decline in demand as against the surplus capacities significantly impacted the international pricing parameters.

Further, continued trade war between USA and China adversely impacted domestic sales realisations. This is more severe as US is the second largest market in the world for our business. Products were increasingly dumped into non-USA markets including India. This enabled the Chinese and other exporters to dump more rubber chemicals in the Indian markets (being the third largest market) thereby increasing their market share.

The cessation of anti-dumping duty post July, 2019 compounded the problems for the domestic player. NOCIL being the largest domestic player was impacted by cessation of anti-dumping duty. It is understood that in this industry China with its large capacities and numerous direct and indirect export subsidies supported by currency management, continues to be the major supplier of rubber chemicals to the world.

Business Outlook: Opportunities & Threats

Opportunities:

Post recovery of pandemic linked recession will enable good players to come out stronger. We are one of the few non-Chinese rubber chemicals manufacturers who have gone for a substantial expansion. On approval of our facilities, we are bound to ramp up our capacity utilisation.

The normalisation of the Indian economy will enable the replacement tire market to operate at a higher rate and your company being a supplier to tires will benefit out of the same. The recent import restriction on various classes of tires into India will help the domestic tires operating rates. Since tire industry constitutes about 65% of the rubber chemicals consumption, any improvement at their end will benefit player like NOCIL.

The recent DGTR initiation notice on anti-dumping duty on one of our major products, where we have expanded, will help the Company in case the duty is levied on conclusion of findings.

During last three (3) years there were instances of pollution, explosion in chemical plants and the recent COVID-19 pandemic in China which raised a question on sustainability of supply chain.

China is currently contributing to 75% of global rubber chemicals supply although their domestic demand does not exceed 35% of the global demand. Given the concentration of rubber chemicals capacity in China along with the associated uncertainties, there is some sense of discomfort amongst international tire majors about over-dependence on a single source country. Any de-risking of this source will present an additional opportunity to your company's outlook.

It may be noted, that NOCIL is not only seen as a dependable and quality supplier, but also a player that offers almost a complete range of rubber chemicals. Moreover, NOCIL's strong R&D capabilities are considered a very important strength by these tire majors.

By virtue of its long association with most international tire majors, your company also enjoys a preferred-supplier status with their Indian operations. With increasing presence of these players in the Indian market, NOCIL stands to gain significant leverage as a domestic supplier to these plants as well. There are opportunities for expanding business in certain specialty chemicals and high value chemicals, where some customers are conducting advanced pre-commercial studies. This development augurs well for us. Your company is taking all the necessary steps for meeting these increased requirements.

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In line with the future trend of rubber growth over the next 7 to 10 years, auto sector growth and tyre industry growth, your company has invested ₹ 450 Crores to augment its capacities. It is expected that the entire expansion will be commissioned by October, 2020.

At the same time, we also continue to be selective in the choice of target customers and markets.

Threats:

The Rupee traded in the wide range of ₹ 69–76 per USD. The Company largely continued to mitigate the risk of this volatility by effecting payments towards our imports out of our Export Earnings in Foreign Currency and by taking adequate cover through forward/ option contracts.

Our competitors have for long been dumping their products in the Indian market at low prices.The possibility of competitors pursuing an irrational pricing approach cannot be ruled out. This may create pressure on our margins.

Sentiment-driven currency changes can also impact domestic prices and profitability.

The country is expecting a normal monsoon this year, any shortfall may lead to fall in the rural demand thereby unfavorably impacting some user segments.

Risks and Concerns:

Exchange rate fluctuations coupled with movement in prices of Crude Oil and down-stream petrochemicals, trade war between US and China, any government sanctions on supply chains etc. are all concern areas.

Any delay in normalisation of economic activities in the automobile and tire industry can impact the business prospects.

Recent findings of DGTR on some of the inputs may impact our input cost parameters if these recommendations get notified.

Operating and Financial Performance for the Year

The Financial Statements comply in all material aspects with Indian Accounting Standards (Ind AS) notified under Section 133 of the Companies Act, 2013 (the 'Act') [Companies (Indian Accounting Standards) Rules, 2015] and other relevant provisions of the Act.

The Company remains a zero-debt company. In view of the comfortable cash flows, the entire funding has been done through internal accruals. During the year CARE has reaffirmed ratings as CARE AA (Double A) (Stable) for long term Bank Facilities (Term loans as well as Fund Based facilities) and CARE A1+ (A One plus) rating for short term Non-Fund Based Bank facilities. The Company had also approached CRISIL Limited for review of its existing ratings, which had assigned CRISIL AA for its Fund based Bank Facilities and CRISIL A1+ (stable) for its Non-Fund-based Bank Facilities in the previous financial year.

The Company's performance about the domestic sales volumes, registered a de-growth of 9% for the year as against the automobile de-growth of 15%. On the export business front, despite stiff competition, especially from China, your company successfully exported to strategic accounts with wide range of products and thus achieved a growth of 6% as against the global rubber consumption de-growth of 1%.The Company had to sacrifice operating margins in the quest for maintaining volumes consistently quarter over quarter. The EBIDTA margins dropped on account of international price reductions, cessation of anti-dumping duty and operating at sub optimal capacities.

Summary of the financial performance of the Company is presented below:

(₹ In Crores)

Particulars	F.Y. 2019-20	F.Y. 2018-19
Revenue from Operations	846.29	1,042.90
Other Income	9.70	10.01
Total Income	855.99	1,052.91
Operating EBIDTA	176.45	290.28

During the year under review, the Company achieved a profit before tax of ₹ 152.41 Crores as compared to ₹ 276.69 Crores in 2018-19.

Pursuant to financial year the SEBI (Listing Obligations and Disclosure Requirements), (Amendment), Regulations, 2018, the key financial ratios viz., Debtors Turnover, Inventory Turnover, Current Ratio and Debt Equity ratios do not exceed the threshold of 25% or more as compared to the immediately preceding financial year. However, Operating Profit Margin (%), Net Profit (%), Return on Net Worth and Interest Coverage exceeded the threshold limits due to the reasons stated above.

Internal control systems

The Company has in place, adequate internal control systems and procedures covering all the financial and operating functions. These have been designed to provide adequate assurance to the management regarding compliance with the accounting standards by maintenance of appropriate accounting records, monitoring the economy and efficiency of operations, protecting the assets of the Company from losses and ensuring the reliability of financial and operational information through proper compliance with the statutory enactments and its rules and regulations. Some of the significant features of the internal control systems and procedures are as follows:

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- Appropriate delegation of authority limits with responsibility for incurring capital and revenue expenditures.
- Approval and monitoring of annual revenue budget for all operating and service functions.
- Procedure for approval of capital budget proposals and monitoring the expenditure on such acquisitions.
- Formulating and reviewing the annual and long-term business plans.
- A comprehensive code of conduct for ensuring the integrity of financial reporting, ethical conduct, regulatory compliances, and conflict of interest, if any.
- Review of the operations and financial plans in key business areas through monthly management meetings.
- Appointment of Internal Auditors to conduct periodical internal audits on operations, systems, internal control on financial reporting, etc. and issue reports to the management and the Audit Committee of the Board, regarding the adequacy and compliance with the internal controls and the efficiency and effectiveness of operations.
- An ERP system (SAP) connecting Plant, Regional Sales Offices and Head Office enables the management to evaluate and take decisions based on real time information systems.

The Audit Committee of the Board of Directors regularly reviews the findings of the internal auditors, adequacy of internal controls, financial controls, compliance with the accounting standards, as well as recommends to the Board, the adoption of the quarterly and annual results of the Company and appointment of auditors. The Audit Committee also reviews the related party transactions, entered by the Company during each quarter.

Further, the Secretarial Auditors review on periodical basis through their own systems and check lists the compliances part with respect to the Companies Act, 2013 and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended and other SEBI regulations as may be applicable to the Company.

Material developments in human resources

Talented and skilled manpower is an important enabler for a Company to grow and maintain competitiveness. Human resources are considered as most important and valuable assets of your Company.

Focus was kept on acquisition, retention and development of necessary skilled manpower keeping in view our current operations requirement as well as the future business expansion and growth plans, particularly the Dahej plant expansion project. Innovative incentive schemes are designed and implemented as a motivational and retention strategy.

Company continues to conduct employee trainings across several functions pertaining to technical, behavioral / general, health safety and environment and ISO standards.'Managerial Skill Development' training programs are conducted to enhance the soft skills of potential managers.

A regular employee performance evaluation system is in place to evaluate the individual performances as well as determining their development needs and future potential.

Your company has complied with all the regulations pertaining to Factory, Labour and other applicable laws and very cordial Industrial Relations are maintained with the recognised labour Union.

Cautionary statement

Certain statements in the Management Discussion & Analysis describing the Company's objectives, projections, estimates, expectations, or predictions may be 'forward looking statements' within the meaning of applicable securities laws and regulations. Actual results may differ from those expressed or implied. Important factors that could make a difference to the Company's operations include raw material availability and prices, cyclical demand and pricing in the Company's principal markets, fluctuation in forex rates, changes in Government regulations, tax regimes, economic developments within India and the countries in which business is conducted, and other incidental factors.