



# Management Discussion and Analysis

## Indian Economy

FY2018 has been big year for Indian economy due to introduction of some of the major policy reforms. Government took number of key structural initiatives to build strength across macro-economic parameters for sustainable future growth. Policy reforms like Goods and Service Tax and Insolvency and Bankruptcy code are major reforms to strengthen the momentum of Indian Economic growth.

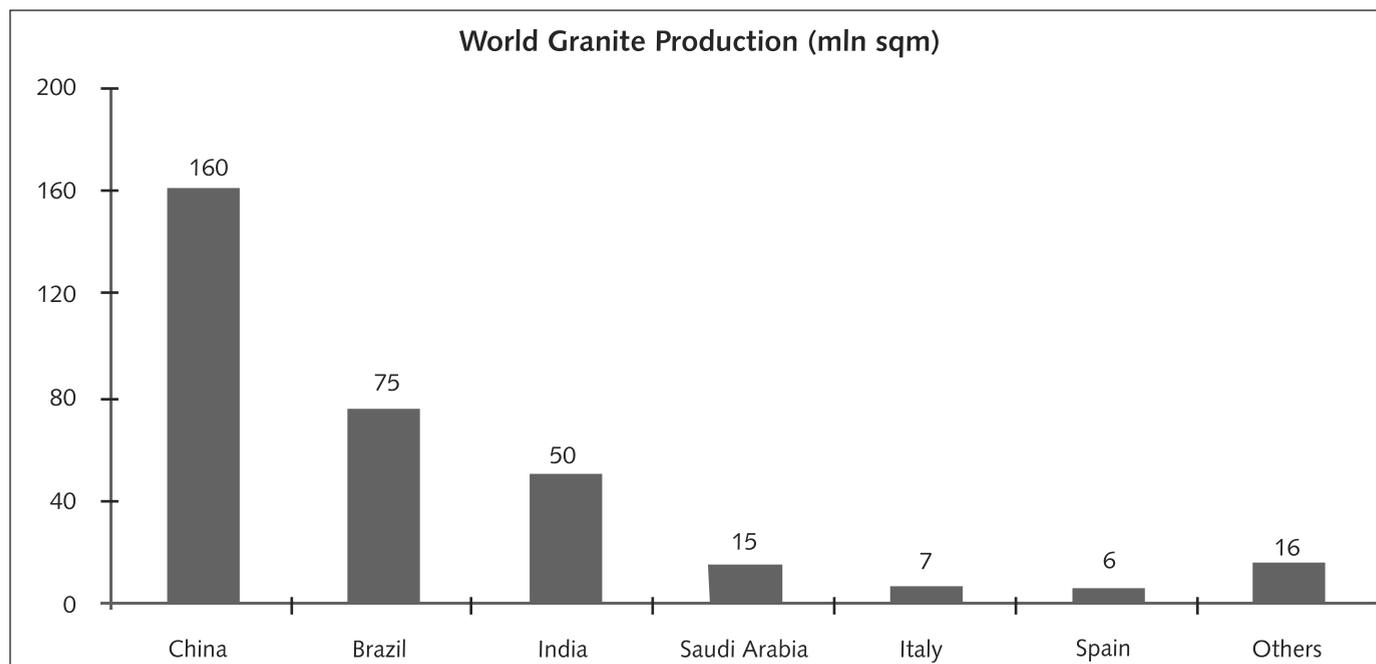
Growth in the first half of the FY2018 suffered due to lingering effects of demonetization despite of global tailwinds of higher growth. The GDP growth was muted at 5.6% and 6.3% in Q1FY18, Q2FY18 respectively. In the second half the growth was back on track and Indian GDP grew by 7.00% and 7.7% in Q3FY18 and Q4FY18 respectively. Overall as per estimates of CSO India, Indian economy has grown by 6.7% during FY18. The GDP growth of India has averaged 7.3% for the period from FY2015-2018, which is the highest among major economies in the world. The changes brought about the new GST Tax regime and the lingering NPA issues of PSU banks have impacted the overall growth of the organised sector and with limited private sector CAPEX, the Indian Economy is yet to see the demand led growth that powered its economy a decade back.

## Global Granite industry

Granite is one of the oldest building materials in the world. Granite has been one of the most popular and premium stone used in buildings since thousands of years. Invention of modern tools which can mould and polish granite slabs better has further increased the use of granite. Together with high compressive strength and longevity it is also used for interior designing.

As per India Mineral yearbook 2018, world's granite production was estimated to be around 329 million sqm in 2014. Top five producing countries were China, Brazil, India, Saudi Arabia and Italy. These top five countries accounted for 93% of global production. Brazil has the largest granite reserves of the world, and is largest granite exporter in USA. India is largest granite exporter in terms of volume. 75% of Indian granite is exported in raw block and only 25% comprises of polished granite. China is largest exporter of granite in the world. It imports raw granite block to process from India, Brazil and other countries.

As per world Natural stone association India was third largest producer of Granite with a production of around 50 million sq mtr in 2014.



Source - World Natural stone association

## Threat from Quartz

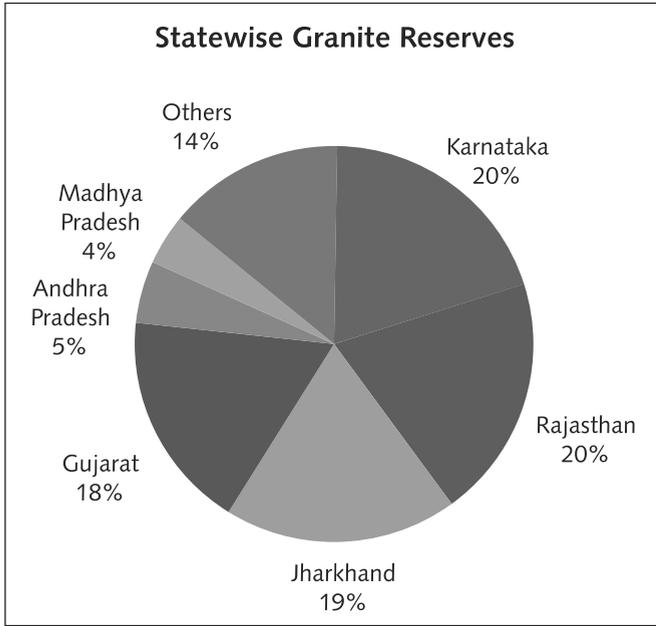
Global granite industry is facing stiff competition from rising popularity of engineered stone like Quartz. Quartz is manmade stone and comprises of quartz aggregate chips, resin binder, pigments and additives. It is taking market share from material like granite, ceramic tiles, laminate, marble, limestone and concrete. It mainly finds its application in interior designing and used largely for countertops. In recent times the trend for countertops has changed. Color basket has reduced to only white, grey and black from more than 20 colors. Quartz is manmade material and has wide variety of colors and shades, on the other hands Granite and other natural stones are unique and vary from quarry to quarry.

Quartz in some countries like USA, Australia, Canada and Israel have captured substantial market share. In Quartz stone Chinese players are dominant players. In USA, the value of Chinese imports of quartz products surged from \$6 million a year in 2010 to nearly \$460

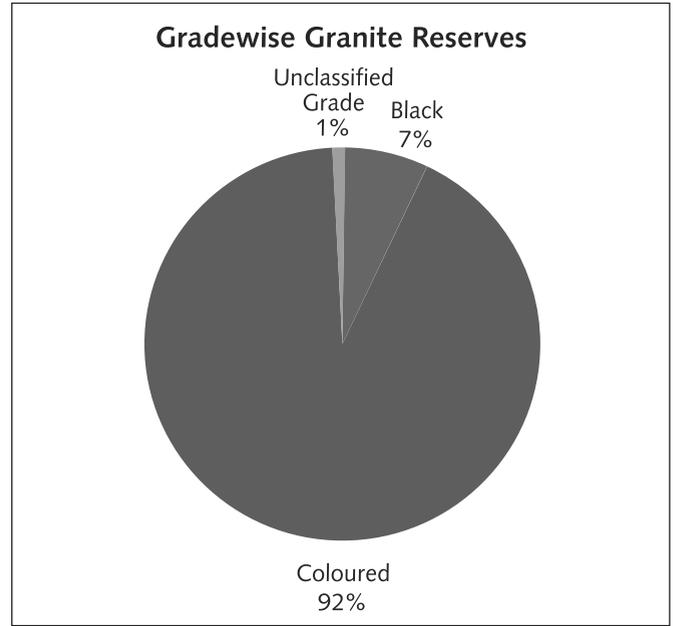
million a year in 2017. Chinese producers benefit from more than 20 subsidy programs provided by the Chinese Government, including grants, loans, tax breaks, and the provision of land, electricity, and raw material inputs at below-market prices. The heavy exports from China have impacted Quartz industry in USA, and prices have substantially declined in past years. Cheaper competitive products have impacted demand of Granite in its largest market in USA.

### Granite Industry in India

India is one the richest country in Granite resources. It is endowed with abundant resources of wide variety of granite comprises over 200 shades. India accounts for 20% of granite reserves in the world. Total reserves of Granite dimension stone of all types in India have been estimated at 46,320 million cubic meters, of which 99% are under resource category.



Source - India Mineral yearbook 2018



Source - India Mineral Yearbook 2018

India regardless of having huge granite reserves facing stiff competition from China and Brazil in granite exports. Granite industry in India face challenges in terms of government export unfriendly policies and competition from other countries. Granite is a minor mineral under the MMDR Act 1957. The respective states governments have all the powers to make rules and regulations for leasing and operating of quarries. The state governments had earlier granted licenses without standard procedures. The poor licensing policies have led to illegal mining in various states. In recent times, state governments in Tamil Nadu and Andhra Pradesh has taken action against illegal quarrying and closed many operational quarries. Also in second half of 2017 large numbers of quarries were closed due to their inability to secure environmental clearances. Raw material shortage has been biggest concern for the industry. It has forced players to source from import or other states.

Exporters of processed granite slabs and tiles are facing stiff competition from China and Brazil. China has substantial market share in low value processed granite. It imports raw block and exports after processing. China has an advantage because of huge economies of scale and government support through various subsidies. The Indian granite exporters are unable to compete with China in terms of pricing in exports market for similar product lines. So they focus on unique high value products that are in demand in the developed markets. In USA processed granite slabs from China are so cheap that local companies have filed for Anti Dumping Duty.

Brazil has one of the largest granite reserves in world and also one of the largest exporters of granite globally. It has huge reserves of granite with large varieties of colors and textures which has helped it in becoming a major player in USA. It has a significant market share in USA granite import. It scores over China in terms good quality and exotic range of granite reserves and geographical proximity the US Mainland. India faces major competition from Brazil from its wide variety of colors and shades. Also Brazil has gained significant market shares due to fall in its currency by 47.22% from April 2014 to Mar 2018. Fall in Brazilian currency has given room to reduce their prices and remain competitive in the USA market.

### GST

Implementation of GST was considered as an opportunity by Indian granite processors. It was expected to open new business opportunities in India by removing unorganised players and make a level playing field. The way GST has been implement on the other hand has become a big challenge for the Indian granite exporters in FY18. Since exports EOU were enjoy exemption from domestic taxes while on paper there is no impact of taxes, but in reality it has resulted in blocking large amounts of money as refunds. The exporter has to pay tax on input material and services upfront. Under GST, refund mechanism has been very slow. The Government is unable to process the refunds timely, due to the complexity involved and confusion around the amount and timings of refunds. Huge amount of working capital of granite exporter have stuck with government. This has resulted in serious working capital issue for the industry.



## Our Company

Aro granite is the largest processed granite exporter in India. It has 100% EOU plant located in Hosur, Tamil Nadu. The Company has a vast experience of more than 35 years in granite industry. The Company has exports in more than 50 countries. Company has received the “Star Export House” certification from the ministry of commerce and industry. It has also been awarded with “Special Export Award” by CAPEXIL for 7 years in a row.

It has strong relationship with its customers spread across the globe. It commands premium over competition due to vast experience and knowledge of best quality material, timely delivery, ethical and transparent dealing. It has very good relationship with customers and has able to maintain very strong relationships for more than 25 years with some customers.

Aro has granite processing plant in Hosur, near granite hub of India, as well as Chennai Port. In its plants it has processing facilities for Granite slabs, Granite Tiles and Cut to Size blocks. It has state of the art Machines imported from world class suppliers. The Company has a installed capacity of 7,35,000 sq mtr for Granite slabs and 3,60,000 sq mtr for Granite tiles. It has also an 11,000 sqm warehouse near to its current processing unit in Hosur. This warehouse has a storage capacity of 20,000 slabs. It is equipped with 8 state of the art cranes for material movement and inspection and 4 loading bays for dispatch. Over the last few years the granite industry in India has shifted to stock & sell model. The buyers place and order only for product in stock, to cut down on the delay in dispatches. The warehouse has proven to be good investment as it has enabled the Company to display entire product portfolio. During the previous year Company started its Cut-To-Size segment under its tile segment. It bought 2 CNC machines and 1 edge polishing machine.

## Performance during the year

Previous year was challenging for the Company, with multiple headwinds impacting the overall business. Our Company faced challenges in procuring raw material due to mines closure in Tamilnadu, liquidity crunch created by GST implementation, and enhanced scrutiny of export payments triggered by PNB Bank LOA scam. We also faced challenges in our key market USA from rising popularity of Quartz and other engineered stones.

## GST and liquidity crunch

GST has been a ground breaking tax reform in India. It subsumed multiple taxes and removed cascading effect by smooth flow of input credit tax. But for export oriented units it has created its own challenges. Due to confusion around the various provision of GST, government is unable to process input tax credit properly for export oriented units. Our business was significantly impacted by implementation of GST. With over 95% of our revenue coming from exports market, this blocking of refunds has created a big working capital issue for us. Under the GST regime, Exports are exempt from local taxes. Exporters need to pay tax upfront on material and services they consume. Our Company being a processor of granite buys all its raw material from market and pay taxes on purchases. Large part of our working capital was stuck in taxes paid and due to be refunded. Furthermore PNB LOA scam increased the compliance requirements in banks which in turn lead to delay in processing our export remittances. Due to extra documentation and approval from back offices the banks were taking 5-7 days in processing our payments which earlier used to be processed in 1 day. Our business faced severe crunch in liquidity and in turn we were forced to limit our raw material procurement. This in turn impacted our Sales, as we were constrained to make payments in a spot market for procuring raw granite blocks.

## Closure of Granite Quarries

Our Company is a processor of granite. We buy granite blocks from quarries for processing. Company sources granite block from India and other countries. Around 60% of the raw material requirement is sourced from Indian quarries. During the current year, our business was further impacted due to closure of additional quarries in Tamil Nadu. A large number of quarries were closed in second half of the year due to their inability to secure environmental clearances. Over the past decade, Rajasthan has emerged as a big source of various natural stones in India, and over the last few years a large number of granite quarries have opened which have shades that in demand globally. We have started sourcing raw blocks from Rajasthan which is more than 1500 km away from our processing unit. The transportation cost from Rajasthan accounts for 40% of material cost. The increased transportation cost has led to increase in cost procurement and thus squeezed our margins.

## Competition from Quartz

On the selling front, our major market USA remained challenging throughout the year. USA accounts for 15% of our total revenue and is largest market for building material in world. Engineered stone like Quartz are becoming popular and market share of granite is constantly shrinking. As per Freedonia, demand for quartz-surface/engineered-stone countertops grew 28% per year from 2012-2017. The Quartz has significantly impacted our sales in USA, UK and Australia.

Chinese players are dominant in the engineered stone market. Chinese quartz is Cheaper due to low cost manufacturing and huge government subsidies. Dumping of Cheap Chinese quartz in USA has led to sharp fall in realisations. Quartz being substitute of Granite has impacted granite demand significantly. Realisations and demand of granite has declined. In USA, local quartz producers are hugely impacted by the cheap Chinese exports and have filed for anti dumping duty on cheap value exports from China. We expect the anti dumping duty will curb the excessive supply from China, which in turn will improve demand for natural Granite slabs.

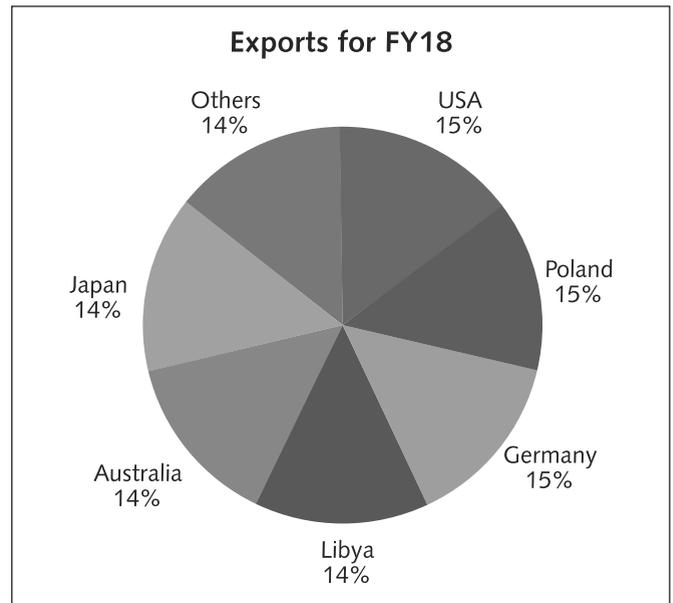
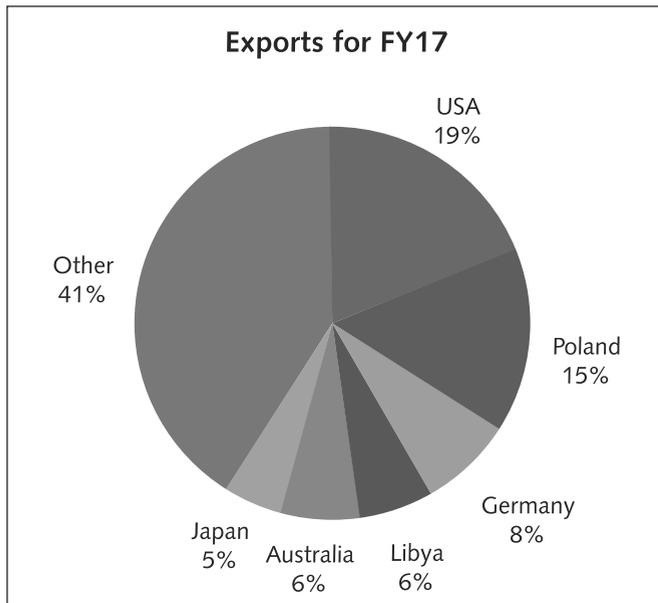
Granite is a premium, unique and durable natural product. Unlike Quartz which is environmentally degrading and difficult to dispose. Granite designs and colors are unique, where each slab is unique with its subtle shade variations and design intricacies unlike Quartz, which is manmade and have similar designs. Given the recent architectural trends, colors like Black, white and Grey are in demand. The

colors and shades for Blacks, white and Grey found in India are unique and cannot be found anywhere in world. We think that its innate feature and uniqueness makes it a product which can never go out of style.

### Exports

Our Company is export oriented unit and exports accounts for 95% of our revenue. We exports to more than 50 countries around the world. Our major markets are USA, Poland, Germany, Libya, Australia and Japan. USA being our largest market remained challenging due to rising popularity of Quartz. We during the year forayed in Asian Markets. We regularly participate in stone fares which helps us to showcase our product portfolio and win new clients. We participated in Xiamen stone fare in China and the Moscow fair.

Europe is becoming major market for us. Top 6 countries in Europe accounts for 40% of revenue. The popularity of Quartz is waning in Europe after a significant rise. This is a trend that can help us gain more market share in Europe over time. We are continuously focusing on Europe market and increasing our penetration to capture more market.

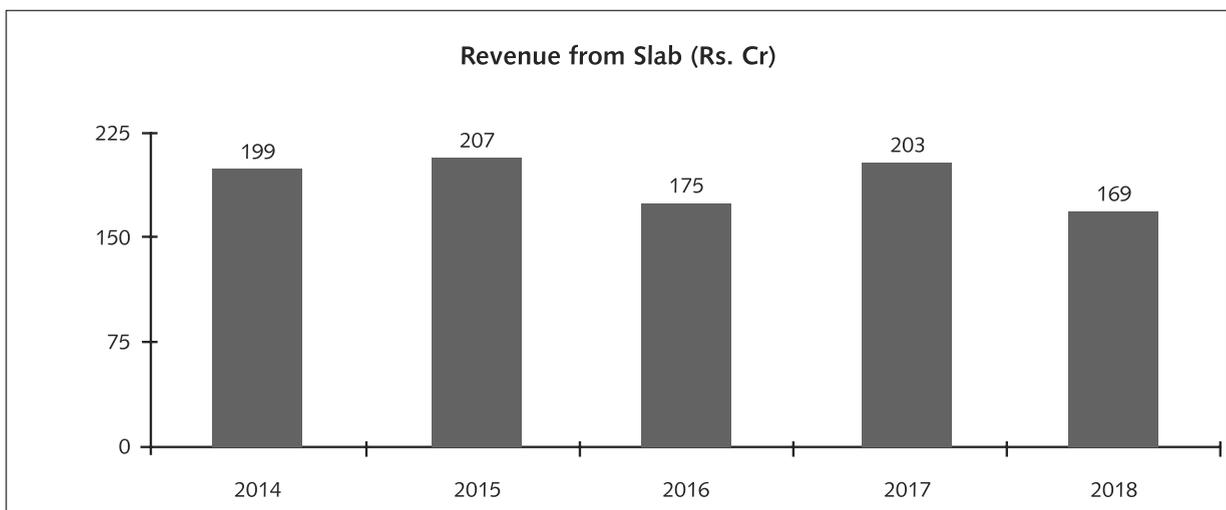


### Financial performance during the year

During the year our operations were impacted due to many macro headwinds. Revenue of the Company declined to Rs. 200.72Cr in FY2018 from Rs.238.65Cr in FY2017. Our sales volume declined by 6.08% from 6.20 lakh sqm to 5.70 lakh sqm. Increased competition from Quartz impacted our realisations and margins. Our EBITDA declined by 55.08% from Rs.30.68 Cr in FY17 to Rs.13.78 Cr in FY18. Our Net Profit declined from Rs 12.62 Cr in FY17 to Rs 1.17 Cr in FY18.

### Slabs

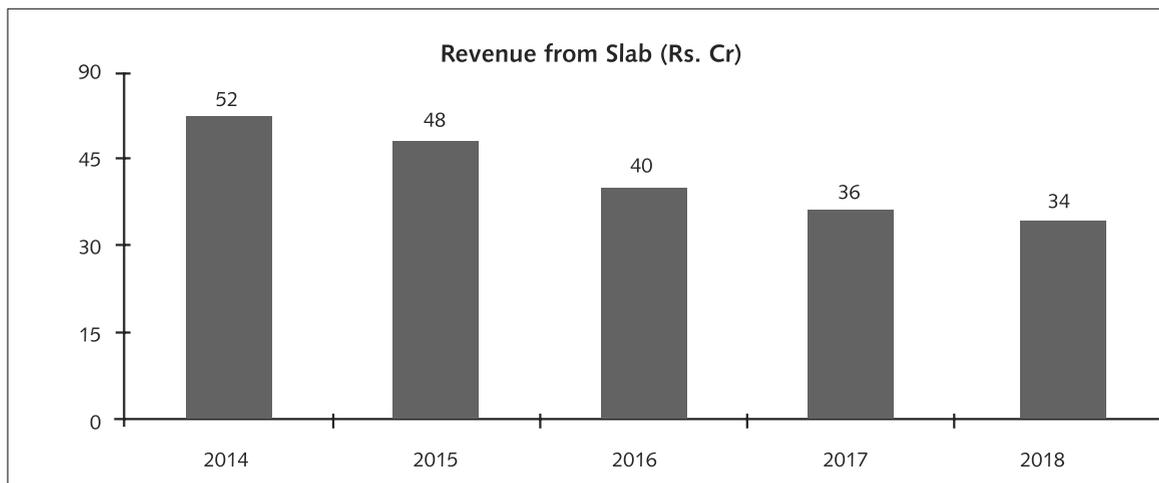
Slabs are major part of our business and contributed 83.74% of our revenue. We have installed capacity of 7,35,000 sq mtr for Granite slabs. Our realisation declined by 9.70% to Rs.3,960 per sq mtr due to increase in competition.





## Tiles

Tiles are relatively smaller part of our business and contributes 16.26% of our revenue. The Company has a installed capacity of 3,60,000 sq mtr for Granite tiles.



Cut to Size is small and new segment so we include Cut-To-Size segment in the tiles segment. This segment is project based, and we participate in tenders for large construction projects like hotels, malls, resort and airports etc. In this segment granite slabs are cut in specific size and shape as per customer requirements at our processing unit and dispatched for use without need for further processing.

With the every improving processing technology and more importantly better developed epoxies processing difficult and felspar materials has become easier. With many Felspar quarries in White shade popping up all over Rajasthan, there is a gap in the processing sector.

Rajasthan is the traditional home of Marble supply and thus the factory and quality standards there are for marbles being supplied into the domestic markets. Hence there is room for an established and well connected (Infrastructure, and supply chain) player. With an investment of Rs 55-60 cr we propose to set up a factory with a single multi wire ie 1,50,000 m<sup>2</sup> per annum production. This factory will help reduce the cost of transport (per container - Inland and FOB Costs) by more than half. This with the ever increasing diesel (transport) cost will make our offering more competitive.

Further being located in an SEZ we will get the benefits on Income Tax for 15 years. The benefits of having a zero rated supply when it comes to GST. The later is a factor that is currently affecting cash flows of our EOU unit.

## New Initiatives During the year

### Quartzite

During the year Company has planned to process one new products "Quartzite". It is harder and denser than Granite. Natural Quartzite stones are typically white, brittle, hard, and resistant to acid and other corrosive materials and require very little maintenance. It is more expensive than marble or granite. Because of its brittleness and high costs of raw blocks it needs high quality cutting machines and skilled workforce to process. It commands a much higher premium than Granite. Sale value of Quartzite is 3 times of granite with better margins.

We bought 1 Multi-wire cutting machine which is a relatively new technology and use diamond wire to cut raw blocks. We currently have capacity of processing 50,000 sqm of quartzite slabs with the current installed Multi-wire cutter. (The capacity of a multi wire is 150,000 m<sup>2</sup> per annum cutting granites. While for cutting quartzite the capacity is only 50,000 or 1/3<sup>rd</sup> of granite capacity). We are working to establish our credentials in the quartzite export market and expect this part of the business to grow over the coming years.

### New processing plant in Jaipur

The raw material availability remained concern for the Company which escalated cost and squeezed margins. We are sourcing our raw material requirement from Rajasthan. Transportation cost of sourcing raw material from Rajasthan is as high as 40% of cost of material. In this competitive environment we felt the need to make our products more competitive in pricing and achieve better turnaround times. To reduce the transportation costs and enhance margins we are aiming to establish a new granite slab processing plant in Jaipur, Rajasthan. This plant shall have capacity of 1,50,000 sq mtrs slabs per annum. This plant shall reduce the transportation cost by more than half and make our prices and offering more competitive in the market. The Planned Capex for this project is Rs.55-60 Cr which shall be funded by mix of internal accrual and borrowings. This project shall take another 18 months from ground breaking ceremony to become operational.

## Outlook

The current environment remains full of challenges. We are continuously making efforts to keeps our cost minimum, increasing our offerings to remain competitive. We have been in the industry for more than 35 years and have faced many down cycles. The initiatives taken in the past years and this year shall strengthen the position of the Company and help us to remain profitable.