Management discussion and analysis

Global economic overview

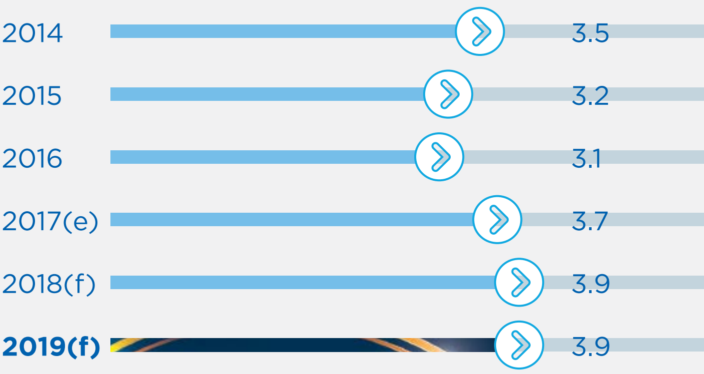
In 2017, a decade after the global economy collapsed, a revival manifested: ongoing Euro-zone growth, modest growth in Japan, late revival in China and improving realities in Russia and Brazil. The result was an estimated 3.7% global economic growth in 2017, some 60 bps higher than the previous year. It would be relevant to indicate that crude oil prices increased in 2017 from $54.13 per barrel at year-start to a low of $46.78 per barrel in June 2017 and year-close at $61.02 per barrel, the highest since 2013.

Outlook

Global growth forecasts for 2018 and 2019 were revised upward by 20 bps to 3.9%. (Source: WEO, IMF)

Global economic growth

Real GDP growth (%)



[Source: World Economic Outlook, January 2018] e: estimated f: forecasted]

3.9%
Global growth forecast for 2018 and 2019

Indian economic overview

After registering GDP growth of over 7% for the third year in succession in 2016-17, the Indian economy reported slower growth of 6.7% in 2017-18 (7.7% growth in the last quarter). The year under review was marked by structural reforms by the Government. In addition to GST introduction, the year witnessed progress in the resolution of problems associated with bank non-performing assets, FDI liberalisation, bank recapitalisation and privatisation of coal mines. After remaining in negative territory for a couple of years, export growth rebounded in 2016-17 and strengthened in 2017-18; foreign exchange reserves rose to USD 426 billion as on April 2018. (Source: CSO, Economic Survey 2017-18)

Outlook

World Bank projects India's economic growth to accelerate to 7.3% in 2018-19 and 7.5% in 2019-20. Strong private consumption and services are expected to support economic activity. Private investment is expected to revive as soon as the corporate sector adjusts to GST. (Source: IMF, World Bank)

Global automobile overview

Global automobile sales are expected to rise 3.6% in 2018, up from an estimated 3.3% growth in 2017 with emerging markets contributing the bulk of growth, while sales in major developed states could slow or even contract. Europe's growth is expected to slow in 2018 and the US too is likely to face downward sales. Sales in Asia are expected to grow by 4.7% in 2018, slower than the previous estimate of 5%. (Source: BMI)

Impact of GST on the automobile sector

GST levies on the two-wheelers sector were fixed at 28% (engines <350 cc) and 31% (on engines >350 cc). Since the segment was charged 30.2% earlier, there was no adverse sales impact. Earlier, the commercial vehicle segment was paying a tax of 30.2%. Following GST implementation, the fiscal charges applicable for the segment declined by 2.2%. The economy car section was levied a base rate of 28% and a cess of 1% and 3% less than the erstwhile 31.4% to 33.5%. Bigger sedans and SUVs (≥1,500 cc or more, ≥4,000 millimetres in length and ≥170 millimetres in terms of ground clearance) were levied with a GST of 28% (+15 % cess), far lower than the earlier rate of 46.6% to 55.3%.

(Source: Masters India)

The Indian tyre industry

Riding the back of rising demand for tyres fueled by a surge in auto sales, the Indian tyre industry emerged as a USD 8.5 billion-dollar industry, contributing approximately Rs. 90 billion to the national exchequer. There was significant investment in capacity creation as the industry invested more than Rs. 420 billion in recently completed and ongoing greenfield/brownfield projects, which represent an all-time high. The domestic tyre industry is expected to post volume growth of 7-8% to 1,805 Lakhs tyres during FY2018. The export volumes were estimated to grow 10-12% for FY2018 and approximately 8-9% between 2019 and 2022 with favourable demand outlook and rising competitiveness of Indian tyre makers, in terms of quality and pricing. Import volumes declined by 31% post-demonetisation and re-imposition of anti-dumping duty on import of Chinese truck and bus radials for five years (effective from 18th September 2017). In a boost to domestic truck and bus radial manufacturers, the customs duty on imports increased from 10% (effective duty on imports from several countries under various free trade agreements resulting in a lower rate of approximately 0-9%) to 15%. Consequently, tyre manufacturers invested approximately Rs. 25,000 crore in incremental capital expenditure over the past five years.

Corporate overview

The Company is a globally-competitive manufacturer of special steel wires, specialising in bead wire and high-carbon content steel wires. The Company possesses manufacturing facilities in India and Thailand. The Indian facility had an installed capacity of 31,000 tonnes per annum of bead wire and 5,000 tonnes per annum of high carbon steel wires. The Thai facility had an installed capacity of 26,000 tonnes per annum of bead wire. The capacity at the Indian facility is being doubled to 72,000 tonnes per annum (to be completed by March 2019) and the Thailand capacity is being expanded as well.

Achievements, FY2017-18

- Strengthened product quality
- Grew customer wallet share
- Added customers
- Improved market share
- Outperformed market growth
- Embarked on capacity expansion

Highlights, FY2017-18

- Revenues increased by 14% (Rs. 348 crore during FY2017-18 vis-à-vis Rs. 304 crore during FY2016-17)
- EBIDTA declined to Rs. 38.22 crore during FY2017-18 vis-à-vis Rs. 43.15 million during FY2016-17
- Increased capacity utilisation at the Pithampur facility from 83% to 99%
- Increased aggregate output volumes (India and Thailand) by 10%

Post-Balance Sheet development

- Proposed capacity expansion with an investment of Rs. 60 crore

Anti-dumping duty on tyres in India

The Indian Government imposed an anti-dumping duty on the import of certain radial tyres used in buses and trucks to protect domestic manufacturers from Chinese imports for a period of five years. The anti-dumping duty was imposed in the range of USD 245.35-452.33 per tonne.

Why Thailand is the new centre of the tyre manufacturing universe...

- Thailand is the source of 37% of the world's raw rubber supply.
- Thailand is the world's largest rubber exporter.
- Thailand can already produce every category of tyre except flat tyres.
- The Thai Government plans to increase tyre production from 530,000 tonnes per annum to >1 million tonnes over the next couple of years. The US is playing a role in making that happen. The long-running battle against low-priced Chinese tyres being dumped into the US has seen tariffs introduced and raised on various classes of imported tyres. Tyres made in Thailand are not subject to these anti-dumping and countervailing duties, so some companies are moving investments into Thailand.
- The world's tenth-largest tyre maker (and China's largest) Hagzhou Zhongce Rubber has built a new facility in Thailand, as did Linglong Tyre and Double Coin.
- Thailand's government-operated Board of Investment announced it would be investing USD 100 million to build a major automotive tyre-testing facility.
- Bridgestone Corporation, Shandong Linglong Tyre Company and Goodyear Thailand would be investing >USD 312 million to turn the country into an ASEAN hub for aircraft tyre manufacture.
- Most of the major global tyre players such as Bridgestone, Michelin, Sumitomo, Yokohama, Goodyear, among others, have production facilities in Thailand.
- The Thai tyre market is projected to cross the USD 5.6-billion mark by 2022.

(Source: Traction News, Tech Sci Research)

Risk management

01 Raw material risk

Challenge: Ensuring access to adequate quantities of raw material is imperative especially during times of raw material shortage

Response: The Company has forged strong ties with raw material suppliers. The consistency of these engagement and the growing quantities of raw material procured has allowed the Company to emerge as a preferred customer.

Result: Despite raw material supply dwindling during FY2017-18, the Company enhanced capacity utilisation and reported the highest-ever production volumes in its history.

02 Quality risk

Challenge: In a business where bead wire addresses critical downstream sectors, there is an onus on the need to enhance qualitative consistency at all times.

Response: The Company strengthened its quality management, substantially moderating wire breakage, enhancing adhesion value and delivering a higher overall product efficiency on the customer's equipment.

Result: The Company enhanced consolidated revenues 14% during the year under review, validating its high-quality standard.

03 Client attrition risk

Challenge: In a business where customers buy for extended tenures, a relationship break could mean a setback for the business.

Response: The Company works closely with the technical teams of customer companies, customising bead wire in line with precise requirements. The Company progressively invested in manufacturing capacities in line with the expansion plans of its downstream customers, ensuring proactive availability.

Result: Approximately 86% of the revenues derived during FY2017-18 were from customers associated with the Company for five years or longer.

Material developments on the human resources/industrial relations front, including the number of people employed

At Rajratan, our vision drives our ambition; our people define our culture of excellence. During the year under review, industrial relations remained cordial across our facilities. The Company initiated a number of programs related to enhanced people skills. Besides, the Company continued to invest in initiatives enhancing productivity.

The Company continued to strengthen its workplace culture resulting in enhanced motivation and successful target management. The details of the number of people employed during the year under review have been provided in the Board's report.

Internal control systems and their adequacy

The Company's internal audit system has been continuously monitored and updated to ensure that assets are safeguarded, established regulations are complied with and pending issues are addressed promptly. The audit committee reviews reports presented by the internal auditors on a routine basis. The committee makes note

04 Debt risk

Challenge: In a business where expansion could warrant debt, a high cost of external funds could affect the long-term sustainability of the business.

Response: The Company has progressively achieved its present scale by allocating a large part of its investable surpluses from within, kick-starting a virtuous cycle where every successive capacity expansion can be funded internally.

Result: Approximately 25% of the capacity doubling outlay of the Indian operations will be funded through accruals. Borrowed funds have been sourced at an average cost of 9.2%, reinforcing organisational liquidity.

05 Product approval risk

Challenge: The business is marked by extended gestation periods as a result of the time taken by prominent tyre companies to approve products and processes.

Response: The Company enjoys approvals (first-time and repeat) from some of the largest and most prestigious tyre companies operating around the world, transforming one-off transactions into enduring relationships.

Result: The Company worked with >25 customers who had approved its products, resulting in repeat orders.

06 Capital cost risk

Challenge: Greenfield investments in the manufacture of bead wire could take an extended period to break even.

Response: The Company has been engaged in the business of bead wire manufacturing for two decades. This has made it possible for the Company to enhance capacity at a cost lower than the prevailing average. Besides, the high capital cost per installed tonne serves as a moat, restricting the number of new entrants.

Result: The Company's capacity doubling is being carried out at 40% of the cost of commissioning a greenfield bead wire unit today.

of the audit observations and takes corrective actions, if necessary. It maintains constant dialogue with statutory and internal auditors to ensure that internal control systems are operating effectively.

Cautionary statement

The management discussion and analysis report containing your Company's objectives, projections, estimates and expectation may constitute certain statements, which are forward looking within the meaning of applicable laws and regulations. The statements in this management discussion and analysis report could differ materially from those expressed or implied. Important factors that could make a difference to the Company's operation include raw material availability and prices, cyclical demand and pricing in the Company's principal markets, changes in the governmental regulations, tax regimes, forex markets, economic developments within India and the countries with which the Company conducts business and other incidental factors.