

Management Discussion & Analysis

The Business

Eveready Industries India Limited (EIL) is one of India's most renowned and enduring FMCG companies, with the operations entrenched in the country for over 100 years. Over the decades, it has strengthened its position as the leader of the dry cell batteries and flashlights markets in the second most populous country in the world.

The Company's contemporary product portfolio comprises the following:

- Dry cell batteries, flashlights and rechargeable batteries under brand 'Eveready'.
- Packet tea under brands 'Tez', 'Jaago', 'Premium Gold', 'Classic'.
- Insect repellents under brand 'Eveready Poweron'.
- Compact Fluorescent Lamps (CFL) under the brand 'Eveready'

The Indian operations started through import of dry cell batteries and then marketing the same across major Indian cities. This led to setting up of manufacturing facilities and a distribution network across India. Subsequently, this manufacturing presence was integrated forward into the manufacture of flashlights - leading device category consuming batteries.

Over time, the Company evolved into the largest dry cell battery player in India with a market share of 52.7 per cent (Source: AC Nielsen) and virtually the only organized flashlights player in the market.

The company possesses one of the widest and deepest distribution networks among FMCG companies in India, reflected in its premium brand equity and customer loyalty. To leverage the growth of this pan-national distribution pipeline, the Company extended its product category to the marketing of packet tea, lighting products and insect repellents.

The Company's existing share of packet tea market is limited. However, the Company expects that quality level of its product and its strength of retail penetration will eventually translate into a significant market share over the foreseeable future.

Insect repellents were launched by the Company in the previous year. The operation is still in its learning phase, but the Company expects to garner a reasonable share in this market within a foreseeable time frame based on its rural reach and tangible differentiation from other products available in the market.

The Company entered the lighting products market with CFLs during the year under review. The market response to this initiative has been very enthusiastic and EIL plans to be a significant player in this product category.

Given the buoyant Indian economy, robust product outlook and a proactive management, EIL expects to strengthen its presence across these products through increasing value and volumes.

India Economic Overview

The off-take of the Company's products is influenced by the health of the Indian economy. According to the Economic Survey 2007-08, the country's economy was estimated to have grown at 8.7 per cent during the year under review. This was somewhat lower than growth recorded in the immediately two preceding years - yet by all counts a reasonably healthy one.

The country faced the challenges of rising input material costs of ferrous & non-ferrous metals and petroleum, but generally took these in its stride. The agriculture sector grew at a modest 2.5 per cent. Given the usual positives & negatives - in the overall - the economy was healthy. It has been strong in the recent past and people have been experiencing the power of higher income levels and affluence. This in turn has resulted in growing consumerism. The FMCG sector is set to take full advantage of this.

FMCG Industry In India

The past proved to be challenging for India's FMCG sector on account of volatility in agricultural incomes, increased competition, price discounts and the growing affordability of lifestyles and durable products. This led to concerns on retaining the share of consumer wallet for FMCG goods.

However, this trend has significantly changed during recent times, with many FMCG categories showing healthy growth. The sectoral outlook continues to be positive on account of the projected increase in per capita income. It is now firmly believed that the positive factors of the economy is finally having its impact on per capita consumption pattern. All parameters seem to indicate that this trend is sustainable over the coming years.

Batteries

Industry size and structure

The Indian market for dry cell batteries is now estimated at 2.4 billion pieces by volume and Rs. 14 billion by value. The battery market has only a few players. Out of which EIL has a market share of 52.7 per cent between Eveready and Powercell brands (Source: AC Nielsen), and the next player lags by more than 20 per cent points.

During the year under review however, the market continued to suffer under the adverse impact of a very aggressive rise of the input material costs, particularly that of zinc. These adverse impacts were passed on to the consumer. A significant part of the dry battery market is in the rural and poorer segments of the economy, which are resistant to stiff price increases. The consumers reacted adversely to these price increases and resorted to reducing or deferring consumption. This resulted in a market de-growth of about 2 per cent in battery volumes during the year, which came serially after de-growth of 8 per cent in the previous year.

This phenomenon was most significant in the 'D' size battery segment, which had to bear the highest impact of the cost push. These batteries are predominantly used in the price-resistant rural sections of the society and saw the largest quantum of volume drop. 'D' segment continued to shrink in the year under review – at about 20 per cent. On the other hand, the AA batteries which have historically been the growth champions had a positive growth of 12 per cent. Growth was also seen in the newly emerging 'AAA' segment - by about 10 per cent.

Latest trends however, indicate that the volumes are getting back to normal pattern and the market seems poised for growth once again for the first time in 3 years.

The segment pattern within the market underwent change on account of the relative growth phenomenon as explained above. The share of the principal battery categories ended at the year-end as per the table below.

Battery category	% of market
D	32.9
C	0.7
AA	61.7
AAA	4.7
Total	100.0

The above is quite similar to the pattern seen globally. To that extent it may be said that the recent phenomenon has resulted in the Indian market in aligning itself to the global trend as far as segment share is concerned.

The split of technology within the dry batteries market remained constant with zinc carbon batteries virtually possessing the entire market with 99 per cent share. The alkaline batteries have minimal share of the market at 0.5 per cent and are present in only some premium urban outlets. Rechargeable batteries, which have the balance 0.5 per cent of the market seems to have made its mark on a loyal customer base but growing slowly.

Offtake of batteries is driven largely by growth in the offtake of its applications. A growing need for portable power and the advent of a number of battery-operated gadgets catalyse consumption. Since these address everyday use, batteries have enjoyed a non-cyclical demand and have been largely untouched during the past general downturns. The phenomenon of consumption reducing on account of large-scale price increases is unique to the immediate past. This phenomenon is expected to be only a temporary one.

Performance review

Volume in the battery market in India was estimated to have reduced by 2 per cent. Sales volume of EIL also reduced by a similar margin. As a result, the market share pattern remained by and large consistent with the previous year – with EIL remaining at 52.7 per cent. (Source: AC Nielsen).

In the product mix of EIL in the year under review, 'D' size had a share of 34 per cent and 'AA' at 61 per cent, in keeping with the market pattern. During the year, the 'D' segment de-grew by 23 per cent and 'AA' grew 15 per cent.

Marketing and distribution

The Company continued to put emphasis in strengthening its distribution network. Of the total FMCG universe of 7.3 million outlets, penetration of batteries stocking universe was at 70 per cent. Eveready batteries were stocked in 66 per cent of such outlets, higher than any other battery brand by a wide margin.

Eveready's brand campaign featuring continued to add positive qualities to its brand value. EIL will persist with these efforts to further strengthen its brand salience.

Opportunities and threats

India has a low per capita consumption across a number of product groups, batteries included, indicating an inherent potential for growth. Since dry cell batteries represent the cheapest source of portable power, consumption is expected to increase over time. Besides, growing income levels, changing lifestyles and an increased need for convenience have resulted in proliferation of gadgets (remote controls, torches, toys, cameras, FM radio sets and portable music systems) run by batteries.

The 'D' segment batteries are driven primarily by a need for light (flashlights) and entertainment (radio) in rural India. The proven durability and quality assurance of the Company's brand will continue to capitalize on this longstanding opportunity. Growth in the 'AA' segment will continue to be fuelled by proliferation of clocks, remote control devices and growth of newer devices across both rural and urban India. Growth in this segment in the year under review was spurred by the new generation 'LED' flashlights, which have been popularized by the Company. The new 'AAA' segment will take higher share of the battery market, with introduction of smaller size devices.

Besides, the introduction of high drain equipment (digital cameras and CD players) is expected to enhance the demand for more powerful rechargeable batteries. The Company made its presence felt in this segment by becoming the first organized entrant. Rechargeable continues to be one of the drivers of the Company's revenues.

Batteries do not face any serious threat because they are items of recurring use, providing portable energy at an affordable cost. EIL is adequately protected from competition due to its enduring brand equity, tangible quality and ease of availability due to its deep distribution.

Cheap imports have also not proved to be a threat because of their inherently poor quality. Initially – about 7 years back - these low cost products did invite first-time use on the basis of the price differential but could not garner repeat consumption on account of poor quality.

Alkaline batteries, popular in the West, also do not pose a threat because of price-sensitive nature of the Indian consumer leading to a mere 0.5 per cent share of the market despite being present for over 13 years. In any case, EIL has presence in this segment and will be able to participate if the market provides indication of an opportunity.

Given the overall positive scenario, a tangible threat to battery consumption lies in making the product unaffordable to poorer segments of the economy, as was evidenced in the year under review and in the previous year (explained more fully in the next section).

Risks and concerns

Aggressive raw material price increase represents an area of concern. A key raw material, zinc, grew manifold in the recent past. This of course is a general phenomenon, not limited to EIL alone. The company mitigated the adverse impact by passing this to the market through a series of price increases. Yet, there were time-lags between incurring of the increased cost impact and implementation of the price increase. This kept margins under continuous pressure.

The more disturbing side to this phenomenon was the products becoming unaffordable to large sections of the consuming class due to the aforesaid price increases. There was finally stiff resistance to these and consumers decided to reduce or defer consumption.

There has, however, not been any change in the basic fundamentals of the business. The demand drivers continue to be the same and the Indian market continues to offer major potential for growth being a consumer of perhaps the lowest number of batteries in the world. The recent downturn related to a severe cost push and consequential price hikes which the consumers were not able to absorb immediately.

As was expected, after the initial difficulty of adjusting to the new high cost regime, the market is gradually coming back to consumption levels as determined by fundamental demand.

While zinc prices have softened considerably in the recent past, input costs continue to put pressure as other commodity prices have been steadily rising – fuelled by strong petroleum prices. However EIL has already taken adequate pricing measures. Moreover, given the high quantum of zinc usage in batteries - in the overall - input prices are likely to be favorable in the immediate future.

The Company has a well documented Risk Management System, which is reviewed by an active Steering Committee appointed by the Board of Directors. The risk registrar does identify a few risks, which are purely routine in nature and none of any significant impact. There is a mitigation system in place which addresses these risks as part of routine management process.

Flashlights

The flashlight market is determined by EIL because it is virtually the only organized player in the market – the other organized players being too small in comparison.

The segments in the flashlights market were traditionally determined by the material used for manufacturing the flashlight viz., Brass, Plastic, and Aluminum.

Historically, the 'brass' segment was the most popular among consumers – especially in the rural areas. However, in the recent past, prices of brass flashlights had to be increased manifold on account of the cost push of the underlying base metals – zinc and copper. This was thoroughly resisted by the consumers and brass flashlights volume de-grew by a significant 50 per cent in the year under review, on the back of de-growth of 40 per cent in the previous year.

As a mitigation measure and with a view to giving consumers a value-for-money option, the year under review saw the advent of the new generation 'LED' flashlights, so named popularly due to usage of LED bulbs being used as the light source. EIL has been at the forefront of introduction of this new segment and has encouraged consumers to take to it due to the advantage of lower battery consumption in these flashlights. While 'LED' flashlights may not fully meet all functionalities of the traditional flashlights, this new segment has been taken on enthusiastically by the price conscious segment of consumers.

This development has breathed new life to this business with volumes making major strides both in number and growth since Quarter 2 of the year under review – roughly the period when these were effectively launched. The growth in sales numbers of 'LED' flashlights is leading EIL to believe that these products are growing user-ship. Also, the in-use period of these flashlights being considerably lower than the traditional metal flashlights, replacements will be more frequent. As a result, these factors will also provide boost to battery demand.

In the 3 quarters 'LED' flashlights have been sold, these have come to occupy 52 per cent of the total volume sold by EIL. The incandescent bulb flashlights across all segments – brass, aluminum & plastics – account for the balance 48 per cent. With time the former is expected to grow further.

As mentioned earlier, the industry is dominated by EIL. There are a few marginal players, none of whom have any significant position and no new trend seems to be emerging in this respect.

Performance review

During 2007-08, flashlights volume of EIL grew by 4 per cent. As mentioned earlier, 'LED' flashlights were introduced effectively from Quarter 2 of the year. The growth in the last 3 quarters was 32 per cent over the corresponding period of the previous year.

Opportunities and threats

There was a temporary setback for this product category in the recent past caused by assignable reasons already explained. India's flashlights market is expected to grow at a steady pace. A vast dormant population (almost 45 million rural households) of non-users represents a large opportunity for flashlights, which the Company expects to use over the foreseeable future.

Risks and concerns

Possible future high prices of zinc and copper continue to be an area of concern in the manufacture of brass flashlights. However, brass flashlights have become a very miniscule part of the market – hence this no longer amounts to a major risk.

As a mitigation measure, the new generation 'LED' flashlights were introduced for the price-sensitive consumers. The product met with tremendous success and has single-handedly swung the business to its earlier profitability.

Packet Tea

Tea is the staple Indian beverage, sold either in loose, unbranded or packaged branded forms. In India, consumption is hugely skewed towards loose tea with a 60 per cent market share. India's packet tea industry is fragmented with a few large players occupying a significant share and several localized players accounting for regional competition.

EIIL is leveraging its distribution pipeline to market this product and thus growing additional revenues on virtually no additional costs. EIIL has not really put any advertising money behind the four brands viz. Tez, Jaago, Premium Gold and Classic, which are positioned for different consumer segments. Yet these brands have gradually grown in consumer acceptance due to a tangible differentiation in quality, which has been a hallmark of EIIL's packet tea branding strategy.

Given the industry's potential, fragmented nature and limited number of national players, EIIL is confident that it will soon emerge as one of the larger Indian players in this category. Besides, the Company is confident that its superior quality at a competitive price will accelerate demand, strengthen its presence in potentially attractive markets and emerge as a significant revenue driver.

Price of packet tea is a function of loose tea prices, the latter being the main cost. Small & unorganized players occupy a large part of the packet tea market. It has been established historically that these small players go out of the market during periods when loose tea prices rise, as they have very little pricing power. Loose tea prices seem to be on a rise in a significant manner. Organized players - such as EIIL - are set to gain from this.

During the year under review, packet tea sales were in line with the previous year. On account of pricing factor explained above, volumes are expected to rise in the foreseeable future.

Lighting Products

A compact fluorescent lamp (CFL), also known as a compact fluorescent light bulb (or less commonly as a compact fluorescent tube (CFT) is a type of fluorescent lamp. CFLs are designed to replace incandescent lamps and can fit in the existing light fixtures formerly used for incandescents.

Compared to general service incandescent lamps giving the same amount of visible light, CFLs use less power and have a longer rated life, but generally

have a higher purchase price. A CFL can save over Rs.1000 in electricity costs over the lamp's lifetime compared to an incandescent lamp and save 2000 times its own weight in greenhouse gases. CFLs radiate a different light spectrum from that of incandescent lamps.

India is seeing a large-scale conversion from incandescent lamps to CFLs on account of saving potential for the consumers. The Government is actively supporting such conversion on account of economic and environmental reasons. The market is seeing significant growth buoyed by these favorable factors.

EIIL started distributing compact fluorescent lamps (CFL) through its distribution network during the year under review. It was initiated as a marketing arrangement with Phoenix Lamps Limited (PLL), a reputed manufacturer of CFL, for the products to be distributed through EIIL's distribution network, under the dual brands of 'Eveready' and 'Halonix' (the latter belonging to PLL). The launch of the products took place in June 2007. The products were received quite enthusiastically by the market.

The Company's distribution which is at a tangible differentiation from usual trade for this product segment, and brand 'Eveready' is set to create a long term value-enhancing proposition in this business. In recognition of this, the Company has recently disengaged from the marketing arrangement it had with PLL. This will enable the company to use its own branding, distribution and sourcing strategies to harness the full potential offered by this business.

In its first year of operation (effectively 9 months), EIIL notched up turnover of Rs.44.22 crores and is poised to improve on it in the immediate future. Considering the dynamics involved, EIIL will like to be a long-term player in this market.

At this point of time the risk to CFLs appears to exist in the form of LED lamps. However, considering the pricing equation, there seems to be a reasonable time-lag before such risk factor can come into play. In any case, having entered into this product category, EIIL will obviously be part of any such market change – since it is not encumbered by any technological constraints at this point of time.

Insect Repellents

The market for insect repellents is significantly large in India, which has a perennial problem in a large mosquito population and the serious diseases that mosquitoes inflict on mankind. The repellent market is primarily divided into the following segments :

1. Coils
2. Vaporizers
3. Skin cream

Coils seemed immediately attractive because it is more used in the rural sectors, where EIIL's distribution set up is particularly strong. EIIL has thus started this diversification effort with coils and has thereafter entered the vaporizer market and perhaps later the niche skin cream segment.

The coils market is dominated by a few dominant players. Given the overwhelming dependence of these players on the wholesale channel, EIL is confident that it will be able to break into the market successfully through its direct penetration in the rural areas.

The coils market is unique in the sense that all the large players routinely outsource their products and there is really not much tangible differentiation across the products offered by the various companies. The larger players have been successful in establishing their franchise essentially through brand spending. While EIL also is outsourcing the product, it is confident of gaining consumer acceptance through consciously thought-out product differentiation values.

The business is still in a nascent stage with a market share varying between 1 per cent and 4 per cent in the various states. Turnover of Rs.10 crores was achieved during the year under review. However, EIL is confident that it is in a position to emerge as one of the larger players in this product category.

Information Technology

EIL has traditionally invested in Information Technology (IT) to provide effective business solutions amenable to informed decision making.

The IT process at EIL is one of continuous improvement. During the year, EIL stabilized all its major applications across all locations on the Oracle Business Suite as an ERP solution. The process seems to have been internalized well within the organization. Needless to state, the ERP system is bringing expected benefits associated with it.

Internal Control and Systems

The Company has adequate internal control procedures commensurate with the Company's size and nature of business. The objective of these procedures are to ensure efficient use and protection of the Company's resources, accuracy in financial reporting and due compliance of statutes and Company procedures.

The existing system provides for structured work instructions, clearly laid down procedures of authorisations and approvals for purchase and sale of goods and services, reserved responsibility of custodial control with identified personnel, and use of computerized systems to ensure controls at source. The Company has an in-house full fledged Internal Audit Department manned by trained professionals. The pre-audit and post-audit checks and reviews are carried out to ensure follow up on the observations made by the Audit teams. The Internal Audit reports, the progress in implementation of recommendations contained in such reports and the adequacy of internal control systems are reviewed by the Audit Committee of the Board in its periodic meetings.

Human Resources

People power is one of the pillars of success at EIL. The Company employs nearly 2800 individuals across its various plants and branch locations, who share a passion for excellence. The key attributes of human capital at EIL are a rich knowledge base, expertise and experience.

Employee-management relations remained cordial through 2007-08. Human resource management system at EIL puts accent on rewarding merit based performance and raising the skill level of employees.

Outlook

While the financial results for the year under review were disappointing, these have to be read in the perspective of the severe challenging environment of somewhat unique cost push and consequent market shrinkage of the two main product categories. However, all pointers seem to indicate that these difficulties have been adequately tackled.

It is firmly believed that there has not been any change in the basic fundamentals of the market. The demand drivers and the potential offered by the presently low-consuming Indian market will continue to offer major potential for growth. Also, after the consumer's initial difficulty in adjusting to the new high cost regime, the market seems to be gradually coming back to the consumption levels determined by fundamental demand.

Though the challenge of high input costs remain, softening price trend of zinc – a major input to dry cell batteries – has resulted in margin expansion. The outlook with respect to overall input costs is set to be favorable in the foreseeable future.

Other products like packet tea, insect repellents and lighting products (CFLs) are poised for a success in the future. These new products leverage your Company's existing brand and distribution and will play a key role in improving scale and profitability of your Company's business.

All these factors are expected to combine and pave the way for a quick revival and thereafter a sustained performance.

Cautionary Statement

Statements in the Management Discussion and Analysis Report in regard to projections, estimates and expectations have been made in good faith. Many unforeseen factors may come into play and affect the actual results, which could be different from what the Directors envisage in terms of future performance and outlook. Market data and product information contained in this Report, have been based on information gathered from various published and unpublished reports, and their accuracy, reliability and completeness cannot be assured.