

Management Discussion & Analysis

The Business

Eveready Industries India Limited (EILL) 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', 'Powercell' and 'Shakti'.
- Packet tea under brands 'Tez', 'Jaago', 'Premium Gold', 'Classic'.
- Insect repellents under brand 'Eveready Poweron'.
- Compact Fluorescent Lamps (CFL) under the brand 'Eveready'

The operations started in India through import of dry cell batteries and then marketing the same across major 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 and marketing of flashlights - a leading device category consuming batteries.

Over time, the Company evolved into the largest dry cell battery player in India with a market share of 51.1 per cent (Source: AC Nielsen) and a very dominant flashlights player with over 76 per cent share in the organised market (Source : Company estimate).

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 the packet tea market is limited. However, this product category provides a sustainable turnover thereby adding scale to the Company's operations. It is also expected that the business can and will be run in a profitable manner.

Insect repellents were launched by the Company in the recent past. 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 previous year. While the current year was spent in tackling the various dynamics of this new business, the Company remains excited over the business prospects and plans to be a significant player in this product category. As a measure of expansion of range, GLS bulbs are being launched in the next financial year.

With a robust product outlook and a proactive management, EILL expects

to strengthen its presence across these products through increasing value and volumes in the future.

India Economic Overview

The off-take of the Company's products is naturally influenced by the health of the Indian economy.

According to reports, the country's economy was estimated to have grown at 6.5 per cent during the year under review. This was lower than growth recorded in the immediate past few years. However, this may be considered a reasonably healthy growth in the midst of serious global down turn where almost all major economies have turned negative.

The country faced the challenges of down turn like the rest of the world. However, India could take the problem in its stride – albeit a slightly lower growth rate for the year. This was possible due to strong domestic demand and relatively lower dependence on exports. Given the usual positives & negatives - in the overall - the economy could be considered resilient. Signs are already visible that the recovery process has started and India's return to its usual high growth pattern will take place even before many other economies recover from the down turn.

Indians will continue to experience the power of higher income levels and affluence. This in turn will ignite 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 resilience and health of the economy will finally have 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 2.2 billion pieces by volume and Rs. 14 billion by value. The battery market has only a few players. Out of which EILL has a market share of 51.1 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 earlier years' pricing actions to neutralize unprecedented rise of the input material costs, particularly that of zinc. 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. Volumes were also affected by a contraction in consumer demand on account of the economy's growth slowing down somewhat compared to the recent previous years.

This resulted in a market de-growth of about 8 per cent in battery volumes during the year, which came serially after de-growth in the previous 2 years.

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. Other battery categories had marginal growth or remained stagnant.

Latest trends however, indicate that the volumes are getting back to normal pattern and the market seems poised to stabilize.

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	28.7
C	0.7
AA	65.1
AAA	5.5
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 remaining stagnant.

Consumption of batteries is driven 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 8

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 51.1 per cent. (Source: AC Nielsen).

EIL's product mix is quite similar to that of the market. In the year under review, 'D' size had a share of 31.9 per cent, and 'AA' at 61.3 per cent, 'AAA' at 6.2 per cent and 'C' at 0.6 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 65 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 like the new generation 'LED' flashlights across both rural and urban India. 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 batteries continue 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 8 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 14 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

Raw material prices have come off their peaks. With the recovery of the global economy being on the anvil, it is likely that prices will again escalate – though these may not reach the impractical levels seen during the boom of the recent past years. Thus, possibility of material cost increase represents an area of concern.

Normal cost increases can be easily absorbed – mainly by passing the same to the market. It is only when quantum of such increase goes to kind of levels seen about 2 years back it poses a risk to the business. This should be read in the perspective of the distressing effect high material costs had on this market in the recent past. However, having gone through that experience, EIL is now in a much better position to tackle this risk. Also, this will be a general phenomenon, not limited to EIL alone.

There has, however, not been any change in the basic fundamentals of the business till now. 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.

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.

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 shaped by EIL because of its dominant market share position at over 76 per cent (Source : Company estimate) in the organized segment.

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 volumes started de-growing significantly over the last 3 years.

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.

This development has breathed new life to this business with volumes making major strides both in number and growth since last year. Even in the current year, EIL notched up volume and value growth of 84 per cent and 63 per cent respectively.

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.

'LED' flashlights now occupy 88 per cent of the total volume sold by EIL. The incandescent bulb flashlights across all segments – brass, aluminum & plastics – account for the balance 12 per cent.

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

Performance review

During 2008-09, flashlights volume of EIL grew by 84 per cent. Value growth was at 66 per cent. This business segment is now the most profitable of all businesses run by the Company.

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.

Growth in urban areas – where flashlight ownership is less common – is the other opportunity area. Vast parts of urban areas now face periodic power cuts and flashlights provide a lighting solution in those times.

The recently launched 'Homelite' products meant to give lighting solutions in the absence of electricity also provide great opportunity for growth.

Risks and concerns

Volumes which have been growing at a significant pace over the last 2 years have already created a large base. There is a concern whether such growth rate is possible to be sustained over a longer term. The mitigation measure lies in how EIL handles consumer communication and value offers.

There remains a vast potential in terms of numbers who do not but can own flashlights. This needs to be tapped through innovative marketing.

Packet 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.

The Company's existing share of the packet tea market is limited. However, this product category provides a sustainable turnover thereby adding scale to the Company's operations. It is also expected that the business can and will be run in a profitable manner.

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 have been on a rise in a significant manner. Organized players - such as EIIL - are set to gain from this.

During the year under review, accent was kept on profitability and as such marginal sales were avoided. Thus packet tea sales volumes came down by 7 per cent – yet there was value growth of 5 per cent.

It is expected that the business will provide steady turnover with decent profitability.

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 from June 2007 – initially in a marketing arrangement with a producer and then from April 2008 on its own.

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.

However, the results of the current year did not show improvement from the previous year mainly due to supply problems faced as supply sources got finalized and stabilized during the year.

Overall market conditions were also disturbed during the last part of the current year due to anti-dumping being imposed against Chinese & Vietnamese products and due to certain proposed changes in mandatory specifications. The market is however now returning to normalcy.

It is expected that in the next financial year the full potential offered by this business will be optimally harnessed. EIIL will now focus in increasing level of this business segment. As a measure of range expansion, the ordinary GLS bulbs are set to be launched in the next financial year.

The current year's turnover was at Rs.36.38 crores against Rs.44.22 crores in the previous year.

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 / Mosquito Repellents

The market for mosquito repellants 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 repellant 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, EIIL 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 3 per cent in the various states. Current year's turnover was at Rs.12.18 crores against Rs.9.65 crores in the previous year.

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 maintained all its major applications across all locations on the Oracle Business Suite as an ERP solution in a stable environment. The processes are sound and are well internalized within the organization.

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 2500 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 2008-09. Human resource management system at EIL puts accent on rewarding merit based

performance and raising the skill level of employees.

Outlook

The financial results for the year under review were distinctly encouraging. There was a 200 per cent positive swing from a loss position in the previous year to a position of profitability in the current year. It may be noted that this improvement came in the midst of a slowing economy.

Despite the difficulties faced by the batteries and flashlights businesses in the recent past, 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 battery market seems to be gradually coming back to the consumption levels determined by fundamental demand. The flashlights market, as explained before, has been seeing some unprecedented growth on the back of new product offerings from EIL. The momentum seems to be unstoppable for the moment.

The newly introduced 'Homelite' products will spur turnover growth and profitability.

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

Input costs have eased out expanding margins. While these may firm up during the next financial year as the overall economy recovers, it is not expected that these will do so in a very significant manner. Thus, no big threat to the margins is seen in the immediate future on this count.

As the economy starts its move to gradual improvement, overall benefit should also percolate to volumes.

All these factors are expected to combine for a further improved 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.