MANAGEMENT REVIEW & OUTLOOK

OVERVIEW

Y2005 personified uncertainty and in every sense was an eventful year.

Y2005 began against the backdrop of a historically unprecedented increase in prices of polymers and other downstream petrochemical products experienced from June 04 to Sep 04, the impact of which, customers flatly refused to absorb in significant proportions. This had impacted the top line; and bottom line in the second half of Y2004. In Y2005, we faced the full year impact of the input price increases. And, in continuation of the trend witnessed in the 2^{nd} half of Y2004, the 1^{st} quarter of 2005 also witnessed a similar pressure on the top line and the bottom line.

Simultaneously, the expansion programme of Y2004, which involved de-bottlenecking at Silvassa plant, a new tandem line at Silvassa plant adding new packaging structures to our portfolio and a new comprehensive printing and conversion line at Hyderabad added about 15% to our production capabilities. The impact of these investments on operating costs was fully felt in the first quarter of Y2005.

Given that the general outlook on raw material pricing was of firmness and the expectation of continued pressure on our selling prices, it was clear to us from the beginning that Y2005 was going to be a challenging year. The market challenges intensified as large and giant customers took their tactics of 'commoditising' customized flexible packaging to new levels driving prices of packaging material to new lows.

To meet the challenge, we moved with focused actions, which included increasing internal targets of NASP Sales, an all out effort on the 'small is beautiful' customer campaign, selective price management and pushing exports in current and new markets. At the same time, we also focused on specific cost control initiatives. Overall, our endeavor was to delight our customers, to help them grow their businesses, and to grow with them. By Q2 05, we started seeing beneficial results of our efforts.

PBT for H1 2005 was 25% above H2 2004, though this was helped by settlement of an outstanding claim for Rs.18 million. But even excluding this Rs.18 million, the sequential growth in PBT was 11.6%. The beneficial results from our focused actions could be clearly seen and we were confident of maintaining the positive momentum for the rest of Y2005 and beyond.

On 26^{th} July 2005, the Mumbai/Thane region recorded the highest rainfall in a century – over one metre of rainfall recorded, resulting in floods that paralyzed the entire city. Our Thane plant also witnessed flooding in the premises. This impacted operations of the Thane plant and caused damage to inventory, equipment and property at Thane. Due to the wholehearted and unstinted effort of our team (including managers, staff and workmen, many of whom also suffered personal losses in terms of damage to personal property), few of the affected machines commenced production within a week of the calamity. It took great effort and time to put more machines back into production. Certain key equipment is still lying damaged/under repair and the Thane plant capability is still below pre-flood levels. However, inventory and fixed assets were insured against flood and insurance claims have been filed. The detailed process of claim assessment and settlement is going on. A charge of Rs. 8 million has been taken in books, representing our estimate of loss of stocks and fixed assets damaged (net of estimated insurance claim).

During this crisis, Silvassa and Hyderabad Plants went all out to make up for Thane shortfalls and turned in record production – that on occasion even exceeded rated capacity levels. Increased Export volumes, and sales from earlier NASP developments improved the product mix. Amidst steep increase in power and fuel costs and distribution costs, other expenses were kept in tight control. In the last quarter of 2005, we also realised a profit of Rs.18 million on sale of Transferable Development Rights received as compensation for compulsory acquisition of a portion of vacant land at Thane Plant by Thane Municipal Corporation. Consequently, in spite of the impact on the operations of Thane plant, we were able to show an improved H2'05 result with Net Sales at Rs. 2192 million and PBT at Rs.207 million.

Amidst the impact of floods, we did not lose sight of our strategic initiatives. We announced our decision to embark on a major expansion plan of setting up a new Greenfield production facility for consumer packaging in North India. The project is scheduled to be implemented in a phased manner over two years at an estimated total investment of Rs.650 million. Construction of a building for the new plant started in the last quarter of Y2005, and commercial production of the initial phase is scheduled to commence in Q3 of Y2006.

The next few paragraphs will narrate, in more detail, the events of Y2005 and touch upon the outlook for Y2006 and beyond.

OPERATIONS REVIEW

Sales & Market Commentary

Market commentary

The demand for consumer packaging materials continued to grow in double digits. The demand growth for consumer packaging was driven, firstly, by growth in the fast moving consumer goods (FMCG) sector. Secondly, advent of supermarkets replacing the traditional corner store across urban India has fuelled the need for adoption of attractively presented consumer packs, not only in traditional end use areas such as detergents, personal care, foods and beverages, but also in new emerging areas of staple foods, pharamaceuticals, pesticides, and many many more.

Strong GDP growth in India for 3 consecutive years has sustained strong double digit growth in overall FMCG demand. A noteworthy feature has been that after a period of flat to marginal growth, the leading FMCG players have started experiencing strong growth patterns.

Despite this growth, the leading FMCG players continued to remain cost-focused. The practices of e-auction/tendering introduced in previous years were reinforced. Fully exploiting the fragmented nature of the packaging industry structure, these strategies drove down prices to unprecedented new lows. We also witnessed instances where the buyers deliberately pushed for a “price-war” by approving lower level quality suppliers. We believe that this is totally contrary to the long term interest of customers – as it renders unfeasible any investment in technological upgradation, quality and innovation needed for world class products.

However, we are already seeing nascent signs of customers looking to move from the ‘price obsession’ to seeking innovative opportunities. Value in quality packaging is once again being seen to be important. We firmly believe that as our customers see ‘value’ in good quality packaging, there will be a fillip in the quality of packaging business in India.

Sales Revenues

Y2005 Gross Sales were at Rs.4984 million compared to Rs. 4539 million in Y2004. Net Sales grew by 9.9% to Rs. 4329 million in Y2005 from Rs. 3940 million in the previous year.

Within sales, the sale of Flexibles and Labelling materials, which form the bulk of our consumer packaging business grew by 12%. However, in terms of tonnage the volume growth was even higher at 18%, showing a drop in sales value per tonne of 4.7%. As explained in previous reports, given the diversity in the range of products and material structures, any attempt at analyzing volume to value relationship would be purely “arithmetical”. Even so, it is relevant to mention that the sales value was influenced by strategic price reductions necessitated in the market place partially offset NASP aided improvement in product mix. The small specialized cartons range suffered a break in sales growth, primarily due to shift in the pack form of certain key large volume brands. The remaining small proportion of about 2% of our sales comprises coated paper based packaging from our Nagpur plant, which showed marginal growth of 1%.

The above businesses include exports, which grew well by 38.5% to Rs.736 million from Rs. 532 million the previous year.

Looking at net sales revenues in terms of manufacturing locations — Thane plant sales dropped by 12.7%, Silvassa plant increased by 18.3%, Hyderabad plant increased by 24.3%, and the small Nagpur plant increased by 1.3%.

International Business

In the last annual report, we had mentioned of plans to increase our export business closer to 20% of our total sales revenues, despite the stress involved in servicing difficult and exacting international markets in the face of international competition. In Y2005, we had strong offtakes of our NASP products. We also successfully entered new markets. We also made our maiden foray in the sale of specialized cartons and packaging machines in the export markets. All these contributed to the strong 38.5% growth in exports in Y2005. Exports now comprise 18.5% of our net external sales.

NASP programme update & Awards

As detailed extensively in earlier reports our innovation programme is termed as NASP (New Applications, Structures, Products and Processes). Impacted by the Thane floods, innovations, NASP and systems/organisational improvements took a back seat – as all efforts were on client /crisis management and damage limitation.

Even so, aided by momentum of the NASP initiatives, which had been successfully implemented by H1 of 2005, our NASP% in Y2005 surpassed 30%. We also won a “Worldstar Award” 2005 from the World Packaging Organisation.

One of our key customers selected us as one of the four of their suppliers across all products/ services for “Excellent performance in 2005 which contributed significantly to their business performance”. Further, exclusively one of our senior key account managers was given a unique award for "Excellent Customer Relationship Management". This award has been a matter of immense delight and we greatly value such appreciation.

Other Income

During Y2005, other Income was Rs.95 million (Rs. 55 million in the previous year). This included Rs. 18 million of profit realized on sale of Transferable Developmental Rights (TDR) received on compulsory acquisition of a portion of vacant land at Thane Plant by Thane Municipal Corporation. Further, Miscellaneous income included Rs. 18 million of compensation received on settlement of a claim. Dividend Income from Mutual Funds contributed about Rs.7.3 million; and profit on sale of assets Rs.9.1 million. The remaining Rs. 33 million was primarily from sale of scrap.

Raw Materials

As mentioned earlier, Y2005 saw the full year impact of increase in Raw Material prices witnessed in mid 2004. After a brief period of softening of some of the polymer and film prices, we saw a renewed rise in input prices, driven by a fresh surge in crude prices in the 2nd half of 2005. Further, with metal prices reaching record highs, price of Aluminium Foil rose steeply.

We continued with our strategies of "optimal buying", "forward buying", development of alternate sources and seeking substitutes to contain the 'cost push'. As a result we did succeed in limiting the full impact of the "market price" increase in raw materials.

We continued with our ongoing efforts to control waste. Further, with the Thane Plant machines operating at sub-optimal levels, it has been a struggle to significantly improve waste figures.

Expenditure

Overall, expenditure in Y2005 was under good control.

Expenditure in Y2005 has to be seen in the light of commissioning of the Brownfield expansion project at Hyderabad and augmentation of extrusion capability in Silvassa in Y2004. This brought about consequent increase in personnel costs, manufacturing and operating expenses and charge for depreciation.

In addition, Y2005 witnessed almost 40% rise in domestic fuel prices, directly impacting power and fuel costs and selling and distribution costs.

Given this backdrop, our "total costs" i.e. all expense items in 2005 P&L statement, were 24.7% of our net sales revenues. Of this, the impact of extraordinary items was 0.2%, and depreciation and financial expenses was 5.9%, leaving 18.6% of other expenses.

Of this 18.6%, total personnel costs were 7.4% of net sales, leaving 11.2%.

Of this 11.2%, power and fuel comprised 3.5%; total administration expenses were 2.7%; selling and distribution i.e. mainly freight, including freight on exports, comprised 2.3%; Repairs and Maintenance 1.7%; and Miscellaneous expenses comprised 1%.

Total expenses, after raw material input costs and before depreciation, extraordinary items and financial expenses, in Y2005 were Rs.807 million or 18.6% of net sales, as against Rs. 738 million or 18.7% of net sales the previous year. To analyse key elements —

Power and fuel expenses, were at Rs.153 million or 3.5% of net sales, as against Rs. 124 million or 3.1% of net sales the previous year. In addition to the steep rise in fuel prices, as the quality of power supply deteriorated, we were also compelled to resort to high cost DG power generation.

Personnel expenses increased by 8.2% to Rs.321 million (7.4% of net sales), as against Rs. 297 million (7.5% of net sales) in the previous year. Part of this increase was due to the settlement of the wage agreements with unionized workers at the Thane and Hyderabad Plants.

Administration and Sales expenses increased by 6.3% to Rs.216 million (5% of net sales), compared to Rs. 208 million (5.3% of net sales) in the previous year. **Selling and distribution** expenses increased by 27% to Rs.99 million (2.3% of net sales) compared to Rs. 78 million (2% of net sales) in the previous year. This was mainly due to increase in exports increasing freight costs, clearing and forwarding expenses and foreign agent commissions, combined with steep increase in transport fuel prices. **Administration** expenses were limited to Rs.117 million or 2.7% of sales compared to Rs. 130 million or 3.3% of sales the previous year.

Depreciation & Amortisation

Depreciation and Amortisation for Y2005 was Rs.249 million, an increase of 13% over Rs. 221 million the previous year mainly due to new equipment commissioned in Q4 of Y2004.

Financial Expenses

Net financial expenses decreased by 12.9% to Rs.5.4 million from Rs.6.2 million the previous year, caused by reduction in leasing charges from Rs.2.0 million to Rs.0.06 million. There were no working capital borrowings during the year.

PBT, Tax, PAT, Cash Profit

Profit before tax for Y2005 was Rs.379 million as against Rs. 336 million in Y2004.

Tax liability (net of deferred tax) is estimated at Rs.99.3 million and Fringe benefits tax at Rs.3.4 million.

Net Profit after tax for Y2005 was Rs.277 million as against Rs. 241 million for Y2004.

Cash Profit i.e Profit after tax but before depreciation and amortisation was Rs.526 million against Rs. 462 million the previous year.

Earnings Per Share

Earnings per share (including extraordinary items) increased to Rs.22.07 per share from Rs.19.23 during the previous year. Cash earnings per share (including extraordinary items) increased to Rs.41.96 per share from Rs.36.85 during the previous year.

Dividend

Dividend on equity shares has been proposed at 70% i.e.Rs.7.00 per share against dividend of 60% i.e.Rs.6.00 per share for the previous year.

The proposed dividend of Rs.7.00 per share will absorb Rs.100.8 million, including dividend distribution tax. The dividend distribution tax includes Rs.0.7 million towards education cess levied by the Finance Act, 2004.

Share Capital

There were no changes in Equity Share Capital during the year.

Reserves & Surplus

After maintaining a balance of Rs.439.6 million in Profit and Loss account a sum of Rs.27.7 million has been transferred to general reserve.

Book value of the equity share has increased to Rs.156.95 from Rs.143.18 at the end of Y2004.

Borrowings

The long term borrowings increased to Rs.163 million on 31st Dec '05 from Rs. 130 million on 31st Dec '04, purely due to increase in interest free sales tax deferred loan (under sales tax deferment scheme availed in the State of Andhra Pradesh). The short-term borrowings for working capital for the current year also were nil as in the previous year.

There was a marginal increase in the company's total debt equity ratio (including short term debt and excluding revaluation reserve) as on 31st Dec '05 at 0.08:1 as compared to last year at 0.07:1.

Capital Expenditure & Fixed Assets

During Y2005 the company added Rs.93 million to its Gross Block. The additions being mainly purchase of land for the North India Greenfield Project costing Rs.25.7 million and a specialized pouching machine at Hyderabad Plant, besides normal capital maintenance capex across all plants. The gross block increased to Rs.2969 million and net block to Rs.1166 million. Capital work in progress as at 31st Dec '05 was at Rs.185 million compared to Rs. 27 million as at 31st Dec '04. This includes down payments made for machinery for the North India Greenfield Project.

The above capital expenditure was funded out of internal accruals.

Trade Investments

During the year surplus funds were invested judiciously in Mutual Funds, and the balance at year end was Rs.82 million.

Inventory

Mainly due to forward buying strategies to postpone the impact of input price increases, the inventory levels have increased, with a total inventory level of Rs.529 million as at 31 Dec '05, as compared to the previous year level of Rs. 379 million.

Debtors

Sundry debtors as at 31st December 2005 were at Rs.776 million (net of provision for bad and doubtful debts) vis a vis Rs. 729 million during the previous year. The average collection period of external sales dropped to 61 days as against 63 days in the previous year. This is inspite of market compulsions forcing increase in credit periods selectively with some of our leading customers.

A total provision of Rs.31 million towards doubtful debts is available in the accounts.

Creditors

Sundry creditors as at 31 December 2005 were at Rs.570 million vis-à-vis Rs.525 million as at 31 December 2004.

Loans & Advances

Loans and Advances as at 31st December 2005 increased to Rs.136 million as against Rs. 99 million at 31 December 2004.

Cash Flow From Operations

During the current year PPL generated operational cash flow of Rs.469 million as compared to Rs. 516 million during the previous year.

OUTLOOK

Market Outlook

As we start off with 2006 there is optimism in the Indian Economy. 2005 saw growth in GDP at over 7%. The world looks at India as the next major market after US and China.

Y2006 and the years ahead promise to be exciting in terms of growth and challenges.

Modern retailing concepts and the culture of supermarkets has today taken strong roots in cities, big and small. This has exposed consumers to a wide variety of goods from which they can pick and choose. Entry of global retailers and forays by large industrial Indian houses in this sector will further boost consumerism and empower consumers with the knowledge to choose the right and value driven product.

The overall FMCG sector continues to grow in double digits.

After a period of flat and marginal growth among some of the major FMCG companies, we are finally seeing signs of resurgence in their sales in the latter part of 2005.

Market reports suggest that segments like soaps, personal health care, Cosmetics, Oil, Shampoos, etc are poised for a double digit growth. Growth in the major end use FMCG segments should in turn bolster demand for packaging products. These are areas, which form a bulk of the segments we service.

The domestic food processing industry has recently emerged as a focus area. The Union Budget 2006 has given added fiscal incentives to the food processing industry. We see that this would further drive need for quality food packaging. Needless to say, food packaging demands the highest level of hygiene and food safety standards. Consumers too are increasingly becoming conscious of the needs of hygiene and food safety. As highlighted in previous reports, we had proactively initiated various measures on meeting global standards in best manufacturing practice and had received accreditations of BRC-IoP, HACCP and ISO 9001:2000, as certified by the reputed certifying body - Lloyds Register of Quality Assurance. We are ready to participate in the growing needs of food packaging in domestic and international markets.

Packaging is the first handshake the brand has with the consumer. This will come to be increasingly acknowledged as various products compete each other for shelf space in the supermarkets.

Our drive on maintaining and upgrading our products to global packaging standards should go a long way in this scenario. We are confident that our continuing focus on NASP would result in our products offering better value for money to the consumer. All these initiatives would consequently contribute to increasing offtake by our customers.

In this, we stand steadfast with providing our valued customers with innovative and value driven packaging solutions.

Our Business Outlook

Given the expectations of double digit growth for Consumer Packaging, we would also have to grow to maintain our market position. In simple terms, this would entail continuous augmentation of production capacity.

North India is the second largest market region for Flexible Packaging. North India is also the fastest growing region being the “food basket” of India. There has been rush of major FMCG companies setting up manufacturing facilities in North India. Strategically, therefore, the need for setting up of a production facility in North India was imperative. As a step in this direction, we made the announcement of implementation of the North India Greenfield Project at an estimated total investment of Rs.650 Million.

Our plans of setting up a production facility in North India will enable us to participate in the overall business growth in the region. While some of the payments have been made in 2005, major cash flow for the project will happen in 2006. Full benefit of sales revenue will be seen only in the later part of 2007 when the entire facility goes into full operation.

On 'value addition', as in 2005, 2006 will also be a challenging year. The general outlook on raw material pricing is of firmness. We also expect continued pressure on our selling prices.

We have vigorously resumed implementation of the NASP initiatives, which took a back seat in the 2nd half of 2005 because of Thane floods.

Thane Plant Revival

As mentioned earlier, the operations of the Thane Plant were impacted by the July 26 floods. Being the oldest plant of the company, Thane Plant possesses a skill base, which has been nurtured over number of years. The Corporate office and the R&D center of the company is also housed at Thane. Development of major NASP initiatives is critically dependent on Thane Plant facilities. Given its strategic geographical location, major exports are also from Thane Plant. It is therefore clear that a limping Thane Plant poses a serious business risk.

We are in the process of drawing up a detailed plan to replace some machines which were damaged by floods, repair/refurbish other damaged equipment. We are also looking to find a sustainable solution for the flooding problem and upgrading of the Thane Plant to improve productivity and efficiency.

Other Strategic Capex plans for 2006 include augmentation of specialized pouching capability, investment in a specialised labels and cartons line and implementation of a sustainable cost effective solution for rising power and fuel costs. The Capex budget for 2006 is Rs. 535 million.

Our People

At the outset, we would like to take this opportunity to pay a tribute to the team that rallied around when the deluge occurred. They worked tirelessly not only to control the damage but also to get the plant back on its feet. The team worked extraordinarily long hours week after week with no break, to repair machines and to ensure that customer needs were met, as best as possible. This they did inspite of 45 members having suffered personal losses with their houses and property getting damaged. The team also contributed by working on a Sunday and donating wages to provide relief to affected families, matched by an equal amount from the company, and a donation from Huhtamaki Group Headquarters.

We continue to re-emphasise our philosophy that "it is people who face and overcome challenges. Their approach, knowledge, commitment and actions are what finally deliver. An open hands on culture, which involves and empowers, which believes in sharing and training, and inculcates pride in knowledge. All this is our philosophy. We need to continuously ensure that it is also our practice".

The relentless challenges of the past 2 years are showing on our people. Hence, we are in the process of putting in place specific HR initiatives to address issues and re-invigorate them for the coming challenges. In keeping with our core philosophy, we have worked towards implementing the concept of self-evaluation. A place where each member can suggest improvements in product / process and he also serves as a quality analyst for his own work. We also continue to fine tune the process of developing and improving competencies of each member of our team.

Finally

As we look back to the uncertain times we have weathered over the past 2 years, we look to 2006 and beyond with a sense of confidence in our ability to handle uncertainties.

Our strategy on placing our belief in the value discerning consumer, and our focus on innovations should see us emerging strong in the premier packaging segment.

The strategic plans should see us break new grounds in the coming year. And we are committed to bringing the Thane Plant back to full normalcy in the shortest possible time.

All this would stand us in good stead in the midst of the continuously changing market paradigm.

The margin pressures faced in 2005 continue into 2006. While we are cautious in our outlook, we expect to close the year with an acceptable financial performance. The North India Greenfield plant will significantly contribute to the top line and the bottom line in the later half of 2007. On the long term, we have a firmly positive outlook.

Cautionary statement

Statements in the Management Review and Outlook describing the Company's objectives, projections, expectations and estimates regarding future performance may be "forward-looking statements" and are based on currently available information. The management believes these to be true to the best of its knowledge at the time of preparation of this report. However, these statements are subject to future events and uncertainties, which could cause actual results to differ materially from those that may be indicated by such statement.