

Management discussion and analysis

Post the financial crisis in 2008, most of the economies took the stimulus route to bring growth on track. On the back of these strong stimulus measures, the world economy staged a smart turnaround in 2009 and 2010. However, since 2011, the world economy is getting weighed down by the financial crisis in Europe and general slowdown in developed countries including United States. In India, while the external causes did trigger the slowdown, internal dynamics impacted the economy much more. Indian economy started feeling the heat from 2011 due to inflation increasingly going out of control. The stimulus led domestic consumption coupled with supply side constraints led to high inflation in the country. While, monetary policy was tightened to control the runaway inflation, the external headwinds as well as political bottlenecks and lack of infrastructure investments continued to put pressure on growth. The slowdown especially in 2012-13 has been across the board, with no sector of the economy remaining unaffected.

With growth coming down sharply, the most visible impact has been felt on the government finances. Fiscal deficit and Current Account deficit have gone beyond the budgetary targets. Several steps announced recently have been with a view to control government spending and bring the deficits under control.

Demand conditions have been subdued, more so in the later part of the year. Commodity prices however, have corrected as demand has started falling down. The impact of lower commodity prices has been partly negated by the weak Indian rupee. The rupee remained weak for most part of the year. On the positive side, Inflation has started coming down and in response to this, the RBI has also started on monetary easing gradually.



A view of the Colour Ideas Store

Inspite of the challenges being faced, India still remains one of the fastest growing economies of the world. Short-term blips apart, the longer term trend seems to be intact.

The performance of your Company during the financial year 2012-13 is detailed below:

PRODUCTS AND MARKETS

Your Company operates in Decorative Coatings and Industrial Coatings segments across India and in the geographies of Asia, Middle East, Caribbean and South Pacific Islands through its subsidiaries and joint ventures.

The Paint market in India during 2012-13 witnessed slowdown owing to the reasons mentioned earlier. The Industrial paints market including both automotive and non-automotive market was under pressure due to the slowdown.

International markets were impacted due to continuing political unrest in the Middle East especially in Egypt and a slowdown in Caribbean islands. Asian operations also felt the pressure of slowdown during the year.

However, compared to the slowdown seen in other industries, the paint market performed better.

DECORATIVE INDIA BUSINESS

Decorative paints account for over 75% of the overall paint market in India and include wall finishes for interior and exterior use, enamels, wood finishes and ancillary products such as primers, putties, etc.

The overall slowdown in the economy impacted the retail demand for decorative paints. However, in spite of this, your Company increased its market presence in most parts of the country.

Value growth remained healthy due to higher realisations over the previous year. The product mix offered by your

Company continues to get richer with higher growth in emulsions. Your Company has successfully strengthened its presence in the premium segment over the last few years. The growth in interior emulsions was led by the Royale brand and its variants (Royale, Royale Shyne and Royale Lustre). Teflon co-branding continued to give the Royale brand a performance and perception edge in the market. Royale today, is becoming most preferred brand at premium end in most markets. The launch of new ultra-luxury Royale Aspira in some markets led to significant excitement in the premium end of the market.

The exterior emulsion category continued to grow well. At the top end, Apex Ultima grew extremely well due to the successful advertising campaign and several field marketing activations. Significant efforts were made to drive the usage of correct painting system on exteriors. As a result, there has been good growth in sale of Exterior Primer and Asian Wall Putty.



An inside view of the Colour Ideas Store

The 'SmartCare' range comprising of water proofing and crack bridging products were launched in several parts of the country during the year and received an excellent response from consumers.

Wood finish market has been an area of great focus. Your Company has worked to position itself as a 'trusted expert' in the area by offering a complete range of wood finishes. Polyurethane and Polyester products in collaboration with Renner of Italy were launched in key wood finish markets with reasonable success.

Your Company continued to broaden its network by installing more than 2900 Colour Worlds, taking the tally of Colour World dealers to over 24000 across the country. At the top of retailing hierarchy, your Company increased Colour Ideas Stores to almost 100 by installing a record 54 new Stores during the financial year. The Colour Consultancy service at these Colour Ideas Stores has made a huge impact with more than 28000 consumers approaching for the consultancy services during the year. The Stores are successful in promoting premium, smooth and texture paints to their customers.

Your Company continues to drive innovative marketing initiatives to help brand 'asianpaints' to be a responsible and caring brand. The 'Beautiful Homes Guide' advertising campaign received excellent response from customers.

Hassle-free painting solutions offered through the Asian Paints Home Solutions (APHS) service was used across 13 cities. The service experience was enhanced by introducing mechanisation in painting. Customer satisfaction scores and customer feedback continue to guide the APHS operations. Colour Next (annual



'SmartCare' water proofing products



A view of the new paint plant at Khandala, Maharashtra

colour trend forecast) has become a strong brand amongst Architects and Interior Decorators (AIDs).

Lower inflation in most of the key raw materials as compared to previous years, especially during the later part of the year was a key feature in the financial year 2012-13. Overall, there was no major concern on availability of raw materials. However, the increase in diesel prices and shortage of power did impact prices on some of the domestic raw materials and packing materials. The increase in diesel prices had an adverse impact on your Company and availability of grid power has been a concern in some of your Company's manufacturing facilities.

Your Company's seventh and largest decorative paint manufacturing facility in Khandala (Maharashtra) was commissioned as scheduled in February 2013. The installed capacity of this new state-of-the-art manufacturing facility is 300,000 KL per annum. The production from this facility will be ramped up progressively going forward. As informed last year, the manufacturing capacity at the plant at Rohtak, Haryana was increased from 150,000 KL per annum to 200,000 KL per annum in first quarter of the year under review.

INTERNATIONAL OPERATIONS

Global slowdown continued to impact the international markets where your Company operates. The political turmoil in Egypt and Bahrain continues to affect growth in these markets. Egypt was also impacted by sharp currency depreciation.

Initiatives like improving customer centricity, increasing the number of dealer tinting systems, introduction of new products, expanding the dealer network, increasing exports,

focussing on protective and industrial coating segments and improving service level to minimise loss of sale due to stock outs, were undertaken in the international markets of the group to strengthen the position in the market place. All these steps coupled with tight control on expenses, material cost and capital employed have helped the international operations of the group to deliver a strong performance despite difficult market conditions.

All subsidiaries continued to focus on reducing environmental impact of their operations through initiatives to minimise waste generation and energy usage. All overseas manufacturing subsidiaries with the exception of the subsidiary in Bangladesh, have ISO 9001 and ISO 14001 certification. The subsidiary in Bangladesh is expected to obtain both the certifications during the financial year 2013-14.

Revenues from paint sales of the overseas operations of the group have increased by 23% to ₹ 1,400.6 crores. Adjusted for foreign exchange rate impact, the revenue from paint sales of the overseas operations of the group during the current year is ₹ 1,286.4 crores resulting in a growth of 13% over the previous year.

Material price inflation during the year was moderate. The impact of inflation was mitigated by formulation re-engineering, sourcing gains, reducing material losses in manufacturing and product price increases wherever feasible.

Profit after tax for the overseas subsidiaries of the group during the year is ₹ 104.9 crores as compared to ₹ 72.3 crores during the previous year.



A view of the paint plant in Nepal

The dividends from overseas subsidiaries during the year amounted to ₹ 24.9 crores as compared to ₹ 24.3 crores during the previous year.

Royalty received during the year from overseas subsidiaries amounted to ₹ 20.6 crores as compared to ₹ 15.2 crores during the previous year.

The revenues from paint sales of Berger International Limited, a subsidiary listed on the Singapore Stock Exchange has increased by 6% to S\$ 113 million (equivalent to ₹ 496.7 crores). The subsidiary has earned a profit after tax of S\$ 4.75 million (₹ 20.85 crores) as compared to S\$ 1.84 million (₹ 7.1 crores) during the previous year.

The region-wise performance is detailed below:

Caribbean Region (Barbados, Jamaica, Trinidad and Tobago)

During the year under review, the revenue from paint sales has increased by 15% to ₹ 197.2 crores from ₹ 171.8 crores. Adjusted for exchange rate impact, the revenue from paint sales has increased by 6%. PBIT (profit before interest and tax) for the region is ₹ 11.2 crores as compared to ₹ 7.6 crores during the previous year. Continuing economic slowdown in all the Caribbean economies, impacted demand conditions.

Middle East Region (Egypt, Oman, Bahrain and UAE)

During the year under review, the revenue from paint sales has increased by 26% to ₹ 726.7 crores from ₹ 578.4 crores during the previous year. Adjusted for exchange rate impact, the revenue from paint sales has increased by 14%. PBIT for the region is ₹ 73.9 crores as compared to ₹ 61.5 crores during the previous year.

The Middle East region is the largest operating region for the group outside India. The region contributes 52% of the revenue from overseas operations. Demand conditions in all economies and particularly in U.A.E., continued to be challenging. Continuing political turmoil in Bahrain and Egypt further impacted the business environment in these countries. The subsidiary in Oman has acquired land at Sohar for setting up a new plant.

Asia Region (Bangladesh, Nepal, Sri Lanka and Singapore)

During the year under review, revenue from paint sales has increased by 21% to ₹ 380 crores from ₹ 314.7 crores during the previous year. Adjusted for exchange rate impact, the revenue from paint sales has increased by 17%. The PBIT for the region is ₹ 35.6 crores as compared to ₹ 24.6 crores during the previous year.

Expansion of the manufacturing capacity in Bangladesh to 24,000 KL per annum is proceeding on schedule and is expected to be completed during the financial year 2013-14. Expansion of manufacturing capacity in Nepal to 20,000 KL per annum has been completed.

South Pacific Region (Fiji, Solomon Islands, Samoa, Tonga and Vanuatu)

During the year under review, revenue from paint sales has increased by 25% to ₹ 113.4 crores from ₹ 90.6 crores. Adjusted for exchange rate impact, the revenue from paint sales has increased by 12%. The PBIT for the region is ₹ 15.4 crores as compared to ₹ 12.2 crores during the previous year.

HOME IMPROVEMENT AND DÉCOR

Your Company reviews its strategy and plans on a continuous basis. Home Improvement and Décor is one such area which offers tremendous growth opportunity and also can be synergistically combined with the Decorative business of your Company. Your Company therefore amended its object clause in the Memorandum of Association to include businesses relating to Home Improvement and Décor.

In January 2013, your Company's Board granted in-principle approval to enter into an arrangement with the promoters of the Sleek Group for acquiring a 51% stake in the Sleek Group, subject to due diligence, necessary approvals and documentation. This work is being carried out currently.

Sleek Group is a major player in the organised modern kitchen space and is engaged in the business of manufacturing, selling and distribution of modular kitchens as well as kitchen components including wire baskets, cabinets, appliances, accessories, etc, with a pan India presence. It has a retail network of more than 30 showrooms including shop-in-shops and a network of 250+ dealers.

This acquisition of the Sleek Group has a strategic fit and is a step in the Company's foray into Home Improvement. Your Company has chosen to enter the modern kitchen "space", as it believes that the modern kitchen space is currently undergoing an inflection, has very few organised pan India players and is growing rapidly.

INDUSTRIAL COATINGS

Non-Auto Industrial Coatings: Asian Paints PPG Private Limited

Asian Paints PPG Private Limited (AP-PPG), your Company's second 50:50 joint venture with PPG Industries Inc., USA (PPG) was incorporated in August 2011. A Composite Scheme of Restructuring was filed with the Hon'ble High Court of Judicature at Bombay in February 2012, whereby AP Coatings Limited and PPG Coatings India Private Limited merged with PPG Asian Paints Private Limited (first joint venture with PPG). The Scheme then provided for the demerger of the Liquid Protective, Powder, Floor and Road Marking Coatings' businesses from PPG Asian Paints Private Limited into AP-PPG. This Scheme was approved by the Hon'ble High Court of Judicature at Bombay on 6th July, 2012.

Pursuant to the above scheme, the Industrial Liquid Paints and Powder Coatings business carried on by AP Coatings Limited and Protective Coatings business carried on by PPG Coatings India Private Limited got transferred to AP-PPG.

The demand for industrial coatings continued to remain weak due to the industrial slowdown in the economy. AP-PPG's strategy to focus on the high-end Protective Coatings business resulted in improvement in the product mix and margins. The year under review saw a sharp rise in the prices of raw materials from the twin impact of rising input costs and increase in the value of the US Dollar vis-à-vis the Indian Rupee. Simultaneously, continuing efforts by customers to cut costs limited the scope for improved price realisation. This posed a serious challenge to the ability of coatings' suppliers to sustain margins and manage earnings growth.



Mr. Michael Horton, President - Asia Pacific, PPG Industries & Mr. K.B.S. Anand, MD & CEO, Asian Paints on signing of agreements for both the Joint Ventures

Automotive Coatings: PPG Asian Paints Private Limited

PPG Asian Paints Private Limited (PPG-AP), 50:50 joint venture of your Company and PPG Industries, Inc., formed in the year 1997, for manufacturing Automotive, OEM, Refinish and certain Industrial Coatings is the second largest automotive coatings supplier in the country.

Rising fuel prices and high interest rates impacted the growth of the automobile market. Growth in the two-wheeler market slowed down to 1.9% during the financial year 2012-13. The commercial vehicle and three wheelers segment registered negative growth over last year.

In the Auto OEM Business, price increases were secured during the later half of the year. This could not fully cover the cost increases in raw materials and therefore severely impacted the business on profitability.

The Industrial Business grew its market share over the year. The business was successful in passing on cost increases to its customers during the later part of the year.

In the Auto Refinish business, PPG-AP was able to pass on the cost increases to its customers. PPG-AP acquired Kruppa Paints (Pvt.) Limited in the month of November 2012. This acquisition will enable PPG-AP's business to localise products currently imported from PPG and will support the growing market requirements.

Expansion of the existing relationship with PPG – a leading global player in coatings – has helped both the Joint Venture Companies to leverage the partnership and achieve synergies in objectives. Integration of the capabilities of both your Company and PPG will create market-leading solutions for the customers in the Automotive Coatings as well as Non-Auto Industrial Coatings businesses.

Others

Your Company's two chemicals businesses, Phthalic Anhydride, manufactured at Ankleshwar, Gujarat and Pentaerythritol, manufactured at Cuddalore, Tamil Nadu, were set up as backward integration initiatives in the late eighties, primarily to cater to the in-house demand for these chemicals. During the financial year 2012-13, 66% of Phthalic Anhydride produced was transferred for internal consumption. Catalyst change was successfully completed in third quarter of the financial year 2012-13. During the year, raw material prices showed an increasing trend.



A view of the Company's Phthalic Plant at Ankleshwar, Gujarat

The profits from the Phthalic Anhydride business were in line with expectations. With respect to Pentaerythritol business, 42% of Pentaerythritol production during the financial year 2012-13 was transferred for internal consumption. Prices of key raw materials continued to increase. Production at the Plant and profit from the business were in line with expectations.

HUMAN RESOURCES (HR)

People are central to your Company. The HR function of your Company has been structured and aligned in line with the business needs and requirements.

The development of people in your Company has many facets. At a basic level, focus has been to ensure all employees at different managerial grades are aware of what is expected of them from a people management angle, through an initiative titled 'Learnscape'.

Also, Digitisation of HR processes have been initiated to provide efficient and effective HR process management.

A variety of learning methodologies have been deployed to ensure that development requirements are addressed

appropriately and effectively. These include online business simulation, classroom sessions, e-learning tools, on the job learning, coaching etc. These have been offered both as independent units of learning and blended solutions.

In your Company, employee engagement is also actively driven through an inclusive process of dialogue and articulation of collective dreams. This was facilitated in the Sales and Research & Technology (R&T) functions. There is also a strong emphasis on building employee ownership at the shop floor level through effort in the direction of ensuring 'inclusive growth and participation'. Building people development capabilities in line managers is also another initiative by which internal trainers, coaches and facilitators have been developed.

The international units of your Company also saw an increased focus on Learning and Development. Development and training for improving functional capabilities in the areas of Technology, Marketing, Finance and IT were completed with action plans for implementation.

ENVIRONMENT, HEALTH & SAFETY

Environment, Health and Safety (EHS) is one of the primary focus areas for your Company. Your Company's EHS policy is to consider compliance to statutory EHS requirements as the minimum performance standard and is committed to go beyond and adopt stricter standards wherever appropriate.

Your Company's seven paint manufacturing facilities and the two chemical factories have the ISO 14001 environmental certification. All the seven paint manufacturing facilities (including the recently commissioned Khandala factory) and one chemical factory are 'Zero Discharge outside the factory' and also have rainwater harvesting capabilities. Minimisation of hazardous waste through reduction at source has been a key focus area in all the factories of your Company. This has resulted in reduction in specific generation of effluents and hazardous waste.

Your Company's newly commissioned paint plant at Khandala, Maharashtra, has been built considering contemporary environment and safety standards. Based on the British Safety Council safety standards, several safety features have been incorporated in the design of the factory. The design of the plant has included various features such as adherence to world class

safety standards, 'Zero Discharge' outside of the factory for all effluents, water conservation, rainwater harvesting and green belt at the periphery of the premises.

The paint manufacturing facilities at Ankleshwar, Gujarat and Sriperumbudur, Tamil Nadu have undergone Safety Gap Assessment exercises in line with the ISRS (International Safety Rating System) 8th edition guidelines of Det Norske Veritas (DNV).

Your Company also appreciates the need to monitor and reduce emission of Green House Gases (GHGs) which are responsible for global warming and climate change. Your Company has institutionalised a mechanism to monitor GHGs emissions across the Company as per Green House Gas (GHG) protocol [A Corporate Accounting and Reporting Standard by World Business Council for Sustainable Development].

INFORMATION TECHNOLOGY

Your Company continues to be in the forefront of leveraging relevant Information Technology trends to better facilitate the business and enhance the value proposition to customers.

This year a variety of initiatives were rolled out to better manage the 'Customer'. In today's digital economy, a customer can contact your Company and avail services through multiple channels – the call centre, website or by visiting your Company's Signature or Colour Ideas Stores. Your Company's revamped corporate website has been launched recently, enabling an additional channel for the customer.



A snapshot of Company's new website

Your Company continued to deploy the 'Mobile First' strategy for key customer facing processes. Company's sales officers are now equipped with Android tablets to manage the dealer network efficiently. Emerging customer facing roles in your Company's services business like Colour Consultants and Relationship & Sales Associates for your Company's Home Solutions business will be able to offer a better end-consumer experience with interactive mobile applications.

The decision-making capability has been raised within the organisation to next level by investing in cutting edge In-Memory Database technology from SAP called HANA. This has provided the managers with powerful and faster analysis capabilities.

During the year, your Company successfully managed the complex transition of key information systems for the Joint Venture Companies.

Your Company continues to modernise its plants with increasing automation in core production and material handling processes, the latest being the plant at Khandala.

Your Company continues to invest in improving the resiliency of its IT systems. It is rolling out an Information Security program based on leading international standards. The detailed design for a comprehensive disaster recovery plan for IT systems was completed during the year.

RESEARCH & DEVELOPMENT

Your Company is executing an integrated strategy for technology development and deployment. The technology function is supporting your Company's strategy around technology development, development of substantially new products, extension and modifications of existing products and productivity improvement and cost reduction. In the financial year 2012-13, technology efforts have been focussed on greening of your Company's products portfolio. Green Seal Standard GS-11 was used as a framework. Green Seal's GS-11 standard recommends VOC (Volatile Organic Compounds) levels in paints and restrict the use of some specific toxic materials. Phase I of the Green plan has been completed, with Royale, Royale Shyne and Apex Ultima now compliant to the GS-11 standard.

Royale Aspira, launched this year as a high end interior product, is designed with calculated VOC levels and extremely low odour. This product is in the same league as some of the

globally leading interior products with respect to performance and eco friendliness.

Your Company's Research & Technology (R&T) function continues to increase its presence in international forums through publications in peer review journals. This year, your Company's scientists have been recognised with "The Roon Award". The Roon Award is designed to recognise technical papers representing original scientific and innovative research directly related to the protective coatings industry and presented by an individual associated with the organic coatings industry. This award is considered as one of the highest technical achievements in the coatings industry.

INTERNAL CONTROL SYSTEMS AND THEIR ADEQUACY

Your Company continued its commitment to carry out its operations within a well-defined control and governance framework. The framework covers sound policies, robust processes, automation wherever possible, periodic reviews at various levels and supported by an independent internal audit function.

This framework is adequately supported by a vigilant accounts and finance function which verifies compliance not just to laid out policies but also the need for the spend itself.

During the year, the Company took up initiatives to further strengthen the control of the environment. Some of the significant ones are listed below:

1. Online tool to improve awareness of people and facilitate compliance was implemented during the year and people at all locations were trained on the same.
2. A solution for vehicle tracking and managing transportation costs was launched at a few locations providing valuable insights into the drivers of costs, thus helping them have better control over costs and accuracy of accounting.
3. Large spends were audited by the internal audit department during the year to provide comfort on compliance to laid out procedures, adherence to the budget, compliance to tax laws and appropriate accounting of the same.
4. Investment in the Governance Risk and Compliance software were augmented to plan, execute and track all internal audits.
5. Self-certification on controls related to financial closure has been rolled out to key functions within the Company. This has strengthened the financial closure process in the Company.

Audit findings along with management response and action plan are periodically presented to the Audit Committee of the Board for their review.

OUTLOOK

The macroeconomic environment and growth prospects of India and the world at large have only deteriorated during the course of 2012-13. There are concerns of the country getting back to the low growth era witnessed before the year 2004. Internationally, the euro financial crisis continues to pose significant challenges. China has started witnessing demand slowdown which has led to correction in commodity prices across the globe. There are indications of growth revival in US, however, these are very early signs and don't command much confidence from economists. However, recent corrections in commodities and crude oil provide optimism as it can lead to better demand conditions which in turn can revive the growth prospects. India, especially can expect a much better macroeconomic environment in

such a situation as lower crude prices will keep the deficit under control and lead to allocation of resources on more developmental activities. This in turn will provide a fresh impetus to the Indian economy and raise its growth prospects.

Your Company has significant presence outside India in Middle East, Asia, Caribbean and South Pacific. Global slowdown has impacted the demand conditions in many of these countries and they continue to face challenging macroeconomic conditions. Political uncertainty in Egypt continues to be a cause of concern. Depreciation of currency in Bangladesh and Egypt as well as other countries can also be an area of concern going forward.

But as always, your Company remains cautiously optimistic and hopes for an inclusive growth in this volatile and exciting environment.