MANAGEMENT DISCUSSION AND ANALYSIS

GLOBAL ECONOMIC SCENARIO

A recovery in global manufacturing and investment leading to increased trade has created economic growth in all major world economies since the financial crisis. This improvement comes against the backdrop of benign financial conditions, accomodative policies, rising consumer confidence and firming of commodity prices resulting in global GDP growth of 3% which is the highest since 2011. 80% of this growth comes from emerging markets and developing economies which now act as not just centres of production or trade but also final destinations of goods and services.

Meanwhile, USA, China and Europe have rebounded despite naysayers. New investments are made in long term growth areas like education, health care, climate impact control and digitisation. All included, the world is more productive today than it has ever been in the past.

In 2017, the global economy grew at 3.8% as against 3.2% in 2016. The performance of advanced economies improved from 1.7% in 2016 to 2.3% in 2017, whereas, emerging market economies grew at 4.8% in 2017 vis-à-vis 4.4% a year ago. This sharp rebound in the global economy has been encouraging, and is evident in the improvement in employment data and consumer confidence seen in the developed nations. But it is envisaged that economic growth, especially in the advanced nations may not continue at the same momentum in future. Hence, it is important to seize the opportunities to bolster growth. *(Data source: International Monetary Fund)*

While the advanced economies may suffer on account of monetary tightening and a partial withdrawal of fiscal stimulus, emerging market economies may have to deal with the challenges, such as inflation and currency fluctuations and possible downturn.

As the world's largest economy is slated to renegotiate the trade terms with its long-time trade partners in an attempt of curtailing trade deficits, its protectionist policies may throw the trade equations of many export-oriented nations in complete disarray. Geopolitical uncertainties in the middle-east and rising crude oil prices might work against the prospects of the world economy.

INDIAN ECONOMIC SCENARIO

India's growth in FY 2017-18 is targeted at 6.5%, down from 7.1% last year as a result of the implementation of Goods and Services Tax (GST) and the lingering impact of demonetisation. However, there are already signs that this number will be surpassed to 7.3% in FY 2018-19 and 7.5% in FY 2019-20 with our renowned ability to bounce back from adversity. Despite a recent uptick, inflation remains within the RBI's target band of 2% - 6%, following a steady decline over the past year to 1.3% in July. *(Data source: International Monetary Fund)*

Through concerted efforts, the Government and RBI have been trying to decisively resolve the banking sector problems. The Government has devised a plan to infuse the capital of ₹ 2.11 Lakhs Crores to revive the wholesale lending activity. On the other hand, RBI has tightened up the norms for early identification and resolution of stressed assets. Implementation of on-going and wide-ranging fiscal and banking sector reforms would help gradually ease the Government's debt burden.

In FY 2017-18, India witnessed its first sovereign rating upgrade in last 14 years. Acknowledging Government's commitment to implementing some of the toughest and most crucial reforms such as GST, Insolvency and Bankruptcy Code, Moody's not only upgraded India's rating from Baa2 from Baa3 earlier, it also raised the outlook to positive from stable. It would help address key credit challenges.

GST has made India's 29 States and 7 Union Territories a unified market as it subsumed indirect taxes. The implementation of GST has also streamlined operations due to limited scope for the involvement of bureaucratic machinery in the GST compliance system. It is expected to create a level playing field for the manufacturers thereby improving the prospects for Government's ambitious 'Make in India' programme.

Moreover, India's ranking on the World Bank's list of ease of doing business improved to 100th in FY 2017-18 from 130th a year before.

In FY 2018-19, Government's focus on rural development and higher budgetary support to infrastructure development is likely to accelerate growth and help India regain its status as the fastest growing economy of the world, among major economies.

INDUSTRY OUTLOOK AND TRENDS

The Indian chemical industry is an integral part of the Indian economy. It is a knowledge based industry and touches lives in many ways. India is the 3rd largest producer of chemicals in Asia and 7th largest in the world. As revealed by the National Accounts Statistics 2017, chemical industry constitutes 2.4% of India's Gross Value Added (GVA). Growth of the chemical industry is linked to economic growth. The industry is a critical component of the Index of Industrial Production (IIP) and has 7.9% weight in the index. Its extensive portfolio of more than 80,000 products, makes Indian chemical industry one of the most diversified chemical industries in the world. According to a report jointly published by FICCI and Tata Strategic Management Group, India ranks 14th in exports and 8th in imports of chemicals.*(Source: India Brand Equity Foundation Report, and a report by FICCI and Tata Strategic Management Group).*

Based on properties and applications, India's chemical industry can be classified into 7 major segments—bulk chemicals, speciality chemicals, petrochemicals, pharmaceuticals, fertilisers, agrochemicals and bio-tech chemicals.

The $4.5 trillion global chemical industry is expected to grow at 5.5% in the medium term. Profitability remains a challenge for many companies, leading to significant M&A action, business remodelling and digitisation. Bayer will sell a large part of its agricultural-business to BASF, Linde and Praxair. Merger talks continue with the likelihood of asset sale, LyondellBasell may take over Braskem, Dow and DuPont are merging and there is the possibility of a merger between Chemchina and Sinochem, Bayer is acquiring century old Monsanto.

India's chemical industry is projected to double in size to $300 billion by 2025, growing at nearly 10% annually with speciality and agrochemical sectors leading the pace. The Government has put in place several initiatives like 'Make in India' and accelerative policies for textile intermediates that will support this growth. 'Make in India' targets duty rationalisation for raw materials, improved infrastructure, tax incentives for R&D investment and skill development and easing of regulations for the set up of 'Reverse SEZs'.

Agrochemicals, dyes and pigments companies will enjoy further tailwinds because of an expansive Government crackdown on companies that violate emission standards in China. Small scale and unorganised units in China have been particularly hit. Consequently, international demand for such products has moved to India and leading players are building up capacity to cater to these requirements for the increased demand from their own consumer base. This expansion will ensure that Indian companies have lower cost overheads and volume resilience in the long term.

The Indian Speciality Chemicals industry is in a positive situation. Growing demand from the consumer-facing industries, need for innovation, capacity rationalisation in China—the most prominent player in the chemical industry thus far, coupled with the requirement to maintain cost-effective production will open up multi-year growth opportunities for India's chemical industry. India is perceived to be the closest substitute to China in the production of fine and speciality chemicals.

The Government of India has been facilitating the growth of the sector through various policy initiatives. The Government has adopted an integrated approach to foster growth of the chemical sector. Coupled with India's improving performance on ease of doing business, Government's thrust on developing Petroleum, Chemicals and Petrochemicals Industrial Region (PCPIR) may prove to be instrumental in the industry achieving higher growth. Moreover, factors such as the implementation of GST, rationalisation of duties on feedstock, higher infrastructure spends and development of single-window compliance system, reverse SEZs augurs well for the growth of the chemical industry.

PERFORMANCE OF YOUR COMPANY

In FY 2017-18, revenue including other income grew to ₹ 1467 Crores, a growth of 18% from FY 2016-17. EBITDA came in at ₹ 214 Crores, up by 40% from the previous year and PBT was ₹ 122 Crores, an improvement of 65% from last year. PAT was ₹ 83.50 Crores which was an improvement of 60% compared to previous year, excluding exceptional items. The Fine and Speciality Chemicals Division which had encountered production issues last year has regained normal operation.

Domestic Revenues represent 65% of your Company's turnover, while exports brought in the rest 35%. Domestic revenue saw a YoY growth of 14% because of robust demand from leading domestic firms. Exports grew at 9% YoY due to encouraging trends in your Company's existing geographical reach as well as in agro-chemicals, basic chemicals, paper and personal care segments.

As you may recall, your Company faced an accidental fire incident at its Roha facility which impacted last year's performance. Your Company lodged an insurance claim for the same and has recovered ₹ 7.50 Crores as interim payment against a claim for ₹ 18.33 Crores which shall be accounted for upon final settlement. This year, all units at Roha resumed full production, and your Company has entirely recovered from the one-off incident. In spite of several challenges, such as heightened volatility in raw material prices (₹ 844 Crores, an increase of 19% YoY), supply disruption in some Chinese feedstock, your Company was able to achieve prominent performance.

Your Company has received regulatory clearance for commencing operations on backward integration in FSC segment and has planned several capacity enhancements which will position it well to capture emerging opportunities. This is done keeping environmental regulations in mind as an accredited member of Responsible Care, thereby improving your Company's confidence and reputation with leading global and domestic customers.

As your Company always has, it continues to reward the trust of its shareholders. In FY 2017-18, your Company declared a Dividend of ₹ 1.30 per Equity Share on a face value of ₹ 2/- (65%). The Dividend rate has been increased from ₹ 1.20 per Equity Share on an expanded capital base.

PERFORMANCE OF BUSINESS UNITS

Basic Chemicals

Basic Chemicals are moderate margin high volume products with heightened price sensitivity, a high dependence on sustainable raw material availability and plant utilisation. They enjoy an entry barrier due to the high cost of putting up large scale operations but require very efficient chemical process and logistics management. They are building blocks, each goes into a variety of end applications. Your Company's Basic Chemicals business unit comprises of dyes and pigments, rubber, fuel additives, pharmaceutical, agrochemicals, explosives.

Basic Chemicals brought in sales of ₹ 747 Crores, a YoY growth of 7%, despite a negligible increase in volume and contributed to half of your Company's total revenues and an EBIT of 14%.

Fine and Speciality Chemicals

Fine and Speciality Chemicals (FSC) are knowledge based, specialised molecules that are created from strong process competency and technical skills in handling potentially hazardous reactions. FSC can see its value intrinsically tied to long term strategic relationships with a few customers and is less affected by raw material prices, requires stringent monitoring of quality and timely supply. Products in FSC cater to agrochemicals, pigment pharmaceutical and personal care end segments.

Your Company began the year with a commitment to resume plant operations at Roha which had seen an accidental fire incident last year. It took confident steps toward restoring production and customer delight in the ensuing quarters without losing a single customer. It has further fortified itself by increasing manufacturing integration (which has also been given an approval by regulators).

Revenue from FSC came in at ₹ 463 Crores, an improvement of 24% YoY and an EBIT of 25% in FY 2017-18.

Performance Products

Performance Products (PP) are chemicals that are valued for the specific characteristic they impart to the end product. These products have stringent requirements in terms of performance as desired. Your Company's PP products go into paper, detergent and textiles end applications. Your Company is the only fully integrated manufacturer of Optical Brighteners (OBAs) which is backward integrated up to the feedstock of toluene. In this segment, your Company caters to 75% of the domestic requirement of brighteners and has expanded its footprint internationally as well. Your Company has a wide network of global clientele for Performance Products supplies and it enjoys competitive advantage over peers due to the integration. This helps your Company to benefit from steady demand in the end-use industry, with better customer acceptance. Your Company expects a better FY 2018-19.

PP represented 20% towards total revenue with ₹ 299 Crores, and a growth of 14% YoY.

EXPANSION PLANS AND INITIATIVES

Your Company is setting up a project through its wholly owned subsidiary, Deepak Phenolics Limited, to manufacture 200,000 MT of Phenol and 120,000 MT of Acetone annually, supported by production of 260,000 MT of cumene. This is a mega greenfield project located at Dahej, aligned with the Government's 'Make in India' initiative.

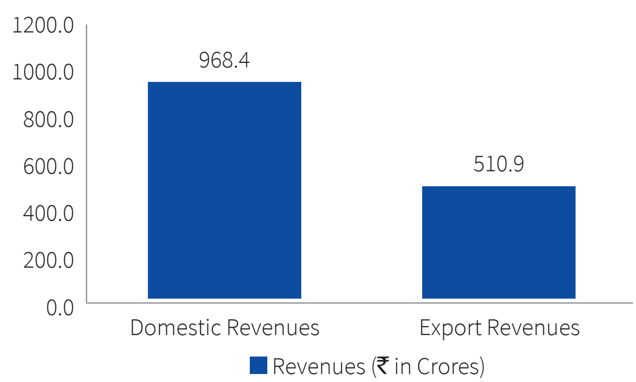
The capital expenditure for this project is ₹ 1400 Crores with a debt equity ratio of 60:40. Saliently, this is being built on cutting edge technology, and is resource and energy efficient, well supported by its technology providers, Kellogg Brown & Root International, Inc. (for Phenol and Acetone) and UoP Honeywell (for Cumene).

Phenol and Acetone are organic compounds that are basic building blocks for a variety of end applications. Phenol goes into laminates, paints, automotive lining, adhesives and pesticides and is expected to grow at around 10% - 12% CAGR. Acetone is required by the healthcare, paints, acrylic and inks segments and is expected to grow at 6% CAGR. Since the domestic production capacity is much lower than demand, imports have been forced to grow at a CAGR of 15% over the last 6 years.

In order to understand the market scenario, overall logistics challenges and customer requirements better, your Company began seed marketing activities which resulted in the domestic market becoming familiar with its imminent entry. The ensuing financial year will be a defining one for your Company as it begins commercial production at its world-class production plant, opening new avenues for future growth.

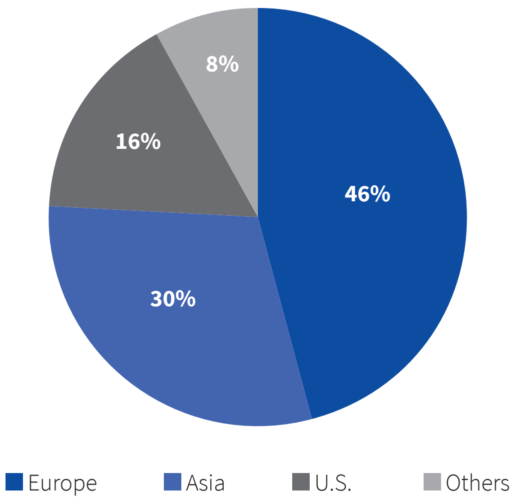
Geographic Performance

For FY 2017-18, the revenue mix between the domestic and the export market stood at 65% and 35% respectively. Domestic revenues stood at ₹ 968.38 Crores, while export revenues amounted to ₹ 510.85 Crores in FY 2017-18.



This year, export performance was supported by encouraging demand trends in key geographies as well as higher product realisation enabling your Company to grow volumes across SBUs. Europe continues to be the largest export market for your Company, contributing close to 46% to the total export revenues, while Asia took the next lead contributing 30%. Contribution from the U.S. came in at 16%.

Contribution of various markets in world exports



SWOT ANALYSIS

Strengths

Technical Expertise: Your Company focuses on managing complicated operations in an efficient manner with high plant utilisation. Its special competency is in the areas of Nitration, Hydrogenation, Oxidation, and Diazotization at batch with continuous operations.

Product Portfolio: Your Company has a diverse portfolio which caters to several end applications. This insulates it against volatility in the industry and allows it to change focus at short notice on accelerated segments.

Global Footprint: While it is a strong domestic player, your Company has also expanded its global footprint. Bolstered by membership of coveted accreditations like Responsible Care, Nicer Globe, and Together for Sustainability, your Company is a Supplier of Choice for several chemical multinationals like BASF, Bayer, Lanxess, Eastman and others.

Focus on Innovation

Experienced Management Team: Your Company's move into the SBU structure has opened up new opportunities for specialisation and an increased attention to delivering high productivity throughout the year. Management in your Company is a collaborative meritocracy where good performers at all levels are encouraged to lead new and dynamic initiatives. Succession planning, learning and development programs ensure consistent employee growth and motivation.

Weaknesses

Non availability of alternative energy sources: Chemical manufacturing requires significant energy in the manufacturing and effluent management process which in turn has an impact on the environment. Greener sources of energy will soon be a viable option but are still at a nascent stage. Keeping this in mind, your Company has received several steps to recognise its efforts to minimise its impact on the planet.

Raw Materials: Increased volatility in prices and availability of raw materials have become the new challenges for the chemical industry. Your Company regularly navigates many intra-year challenges on these front. Your Company gives raw material sustainability a significant weightage in its Risk Management strategy.

Currency Fluctuation: A strong rupee is good for the economy, but hurts exporters; conversely a weak rupee affects domestic suppliers. Your Company has significant exports and domestic sales and therefore, it always works to manage currency risk on a dynamic basis.

Opportunities

Import Substitution: Your Company's flagship products (now with the inclusion of Phenol and Acetone) are import substitutes, giving domestic customers comfort with an easily accessible source available at short notice and without the stress of import costs. As India's production of chemical downstream grows, your Company's brand name, will continue to enjoy favourable tailwinds.

Make in India: This initiative, launched by the Central Government focuses on improving India's capability as a manufacturing hub. This scheme involves accelerating regulatory clearances, improving infrastructure with the ease of doing business in India. This increases your Company's attraction to global players looking for dependable partners to collaborate with, in India.

Scope for Exports: A raft of measures intended on improving India's international trade have recently been enacted, simultaneously using trade analytics to identify markets. Beside this, India's well known respect for intellectual property and the recent pollution crackdown in China have opened new vistas for established players with proven capabilities and values.

Government Policies: The Government has introduced several measures at various levels to improve productivity in the chemical sector. It has allowed 100% FDI under the automatic approval route, launched by the Draft National Chemical Policy aiming to enhance the share of the chemical industry in our GDP. This has increased focus on R&D and technology.

Threats

Obsolescence of products or processes: As in other fields, products or processes going obsolete is always a threat in the chemical industry., It can arise because of changes in international regulations, substitutions or even cost escalations. Fortunately Your Company has a diversified portfolio and manufacturing flexibility which helps it tide over a large part of this risk.

Scarcity of Skilled Labour: Dedicated employees are any company's most valuable resource. Your Company is constantly improving its development and training programs to encourage talent and retain consistent performers who may be sought for by industry.

OUTLOOK

Factors such as global competitiveness of India's chemical industry, Government's policy support and the closure of capacities in China are likely to create multi-billion dollar growth opportunities for the domestic industry. Your Company is well-positioned to reap the benefits of this trend.

Basic Chemicals business to remain strong

Going forward, your Company's Basic Chemicals business is expected to remain strong on the back of demand-supply disruptions and projected capacity closures in China. Your Company is likely to benefit from the multi-product approach which may help it address market demands for a specific product.

Strong product portfolio of FSCs and significant market share

Your Company enjoys a leadership position in some of its key product offerings such as Xylidines, Oximes and Cumidines. It addresses the demand of some high growth industries such as agrochemicals, pharmaceuticals, personal care, to name a few. At present, the contribution of FSC business to your Company's top line is close to 31% which is slated to improve in the future. Your Company is exploring growth opportunities to further strengthen its product portfolio in the pharmaceutical business.

Performance product segment - expected to turnaround

Performance Products segment, which comprised of a wide range of products, is expected to record an uptick in the foreseeable future. With OBAs receiving better acceptance, the Performance Products segment is likely to record higher capacity utilisation which is expected to improve its contribution to the bottom line.

Steering towards higher growth trajectory with Phenol and Acetone

Latest market trends suggest that, in India, the demand for Phenol and Acetone has been around 3,20,000 MTPA and 1,70,000 MTPA respectively, which is expected to grow at 10%-12% CAGR. Existing Indian manufactures meet about 15% of domestic demand while rest is imported. To meet the demand-supply gap, India imports largely from Thailand, Korea, China, USA, Taiwan, Singapore and Malaysia.

To facilitate substitution of imports and future demand growth, your Company has invested ₹ 1,400 Crores in a greenfield project at Dahej to install capacity of 2,00,000 MTPA for the production of Phenol and 1,20,000 MTPA for Acetone. Further, this facility will be integrated backwards with 2,60,000 MTPA capacity of Cumene.

At the completion of the on-going capacity expansion, your Company should be able to increase supplies to the tune of around 60% in the Phenol market and 67% of the Acetone market. At present, the global demand for Phenol and Acetone stands at 10,060 KTPA and 5,936 KTPA respectively.

Phenol finds applications in high-growth industries such as laminates, automobiles, paints, pharmaceuticals, agrochemicals etc. Given the rising demand-supply mismatch in the global phenol market on account of capacity closure in USA and growing demand in China, your Company is likely to benefit immensely by capacity additions. The demand growth forecast is expected to revolve around 10-12% in the foreseeable future.

India has been an importer of Phenol and Acetone. Your Company is expected to help India reduce this import dependence.

RISK MANAGEMENT

Creating long-term value for shareholders, shielding its employees from potential hazards and protecting the environment are the three critical goals of your Company. To achieve them, your Company has laid down a well-defined Risk Management framework and a set of stringent SOPs and monitoring practices.

Through its robust Risk Management protocols, your Company ensures that its plants and machinery are monitored on a real-time basis. Through regular maintenance and assessment practices, your Company ensures that the machinery is in the groove and the risk of accidents is brought down to a minimum possible degree. Your Company also encourages its employees to follow behavioural safety measures which form the basis for creating safe working conditions.

Your Company has an equally effective Risk Management mechanism to deal with the financial and credit risks. It regularly monitors the financial health of its customers and based on its observations grants the credit terms. Similarly, through effective inventory management and sound hedging practices, your Company significantly minimises the risks to financials stemming from currency fluctuations, fluctuation in the raw material prices, and that in the prices of its finished products as well. Your Company also protects its margins by adopting formula-based pricing practices wherein price fluctuations in the raw material prices are passed on to the customers.

Your Company is committed to protecting the environment and public health and livelihood. Through process excellence, your Company reduces its emission count and ensures that effluents are adequately treated before releasing them in the environment.

Overall, your Company endeavours to improve predictability in its processes, reduce operational risks and enhance the quality of product that leads to superior performance of the organisation on all fronts.

INTERNAL CONTROL FRAMEWORK

Your Company believes that internal control is a necessary concomitant of the principle of governance that freedom of management should be exercised within a framework of appropriate checks and balances. Your Company remains committed to ensuring an effective internal control environment that, inter alia, provides assurance on orderly and efficient conduct of operations, security of assets, prevention and detection of frauds / errors, accuracy and completeness of accounting records and the timely preparation of reliable financial information. Your Company's independent and robust Internal Audit processes, both at the Business and Corporate levels, provide assurance on the adequacy and effectiveness of internal controls, compliance with operating systems, internal policies and regulatory requirements. Your Company always adheres to set guidelines and adheres to all Accounting Standards prescribed for maintenance of books of accounts and reporting of financial statements. Summary observation of the Internal Audit is submitted to the Audit Committee of Board of Directors and corrective measures are taken. The Audit methodology is designed to validate effectiveness of critical IT controls that are embedded in the business systems, leading to greater alignment with the business process environment.

HUMAN RESOURCES

Your Company operates in a knowledge-intensive industry. In the business of chemicals, quality and competency of talent-pool is closely linked to the success of a company. While your Company has been investing heavily in capacity additions, it's creating a strong foundation for the future growth of its manpower by handpicking and retaining the best talent.

As on March 31, 2018, there were 1392 permanent employees in your Company.

On an average, every employee has spent 9 years with your Company which speaks well of the exceptionally high level of satisfaction among employees.

Your Company is committed to offer level-playing opportunities to all employees. Your Company regularly organises training programmes for its employees and meticulously tracks their performance which then becomes the basis for placing them in more prominent roles. Your Company encourages its employees to maintain a healthy work-life balance at all its units.

In FY 2017-18, your Company's relations with all its employees and unions remained cordial and no untoward incidents were reported.

DISCLAIMER

This Report contains forward-looking statements that involve risks and uncertainties. When used in this Report, the words 'anticipate', 'believe', 'estimate', 'expect', 'intend', 'will' and other similar expressions as they relate to the Company and/or its Businesses are intended to identify such forward-looking statements. Your Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. Actual results, performances or achievements could differ materially from those expressed or implied in such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements that speak only as of their dates. This report should be read in conjunction with the financial statements included herein and the notes thereto.