

## **Chairman's Speech at Annual General Meeting on July 17, 2008**

### ***Welcome***

Good morning Shareholders and Shareholders Representative, Ladies and Gentlemen,

It gives me great pleasure to welcome you on behalf of my colleagues on the Board and the management of Kirloskar Oil Engines Ltd.

The Annual Report has been with you for sometime now and I am sure you have had the opportunity to go through the progress of the Company in the year under review.

### ***Economy and Industry Structure***

Last year I had spoken about the manner in which the Indian economy had developed since the Company started business and how it has responded to the changes in the economy in recent times.

In the year under review, the economy was impacted by global concerns as well as by structural Indian issues. While the GDP grew at an estimated rate of about 9% (as against 9.6% in the preceding year), a steady rise in inflation, which has now grown to alarming levels, has been a cause of concern. While the services sector continued to grow strongly, the industrial sector reported a slowdown in growth. Industrial growth at 8.5% in 07– 08 was significantly lower as compared to the 11% growth recorded in 06–07. Similarly the growth in the manufacturing sector was lower at 8.8% in comparison with the 12% growth registered in 06-07. The growth in the construction sector too was lower at 9.8% as compared to 12% in 06-07.

The loss of confidence of the investors in the stock markets and rapidly increasing oil prices have slowed down the steady growth in the GDP, at least in the near term outlook for the economy. The rupee, which was gaining strength over the dollar in the earlier part of the year, is now again becoming weak against the dollar and other currencies.

Inflation, which had remained more or less steady for most of last year, started rising rapidly since January 2008. Currently inflation is at 11.9%. This steep rise in inflation came mainly on account of the sharp jump in prices in commodities like fuel, iron, coke, steel, cement, as well as an increase in the food prices. The present level of inflation is a challenge to the Indian economy. Since it is also largely driven by a mismatch between demand and supply, my view is that there is not much that the government can do about it in the short term, and we need to see how to manage things on the basis that inflation is not going to go away in a hurry.

Having said this, I would like to comment on the performance of the Company.

The year under review has generally been a good one for power generation. However, the increase in the prices of pig iron and steel, which are the major contents in the manufacture of our engines, affected profitability. Exports profitability too took a hit as a result of a stronger rupee. Nevertheless, to a large extent the customers were in a position

to absorb the increasing inflation and its impact. The months of February and March showed signs of slowdown as a result of the liquidity crunch which adversely affected the demand for automobiles, industrial products and infrastructure development.

The Annual Report has been with you for sometime. As such, please allow me to take the liberty of not repeating all the figures from the Annual Report.

The financial highlights are:

Sales have increased by 14.5%.

Domestic Engines sales increased by 26%, Auto Components increased by 10% while others (Fuel Oil etc.) decreased by 80%.

Export of Engines sales increased by 21% and of Auto Components by 2%.

Engine revenue increased to Rs 2,049 crores (crossed Rs. 2,000 crores for the first time) from Rs 1,650 crores of previous year.

Profit before exceptional items decreased by 13.7% to Rs. 187 crores. This is mainly on account of reduction in dividend income by Rs.28 crores over the previous year. The dividend income for the year includes one-time arrears of Preference Shares dividend of Rs.23 crores received from Kirloskar Ferrous Industries Ltd. Additional contribution on incremental sales of Rs.273 crores was mostly off set by increase in expenditure of Rs.75 crores (other than raw material cost) which includes an increase in interest cost by Rs.5 crores. Consequentially, Cash Profit (EBDIT) before Exceptional items and Tax at Rs 251 crores was also adverse by 12.1%.

Return on Capital Employed (ROCE) was 16.1% as compared to 25.9% of last year. This reduction is on account of increased capital employed base due to Fixed Assets additions of Rs.378 crores during the year.

Shareholders funds have increased by 7.5% to Rs. 915 crores as a result of transfer of profits of Rs. 64 crores to the reserves in the current year.

Operational highlights:

In the last meeting I had mentioned that the company had been developing a compact diesel pumpset named “Varsha”, to target the compact pumpset market. I am happy to say that the sample batch of “Varsha” pumpsets introduced in the market has received good response. Bulk production of these engines will commence in 08 - 09.

Tractor engine sales were affected due to the decrease in demand from Punjab Tractors Ltd. In order to utilize the capacity at Swaraj Engines Ltd. better, the management of SEL decided to manufacture engines to its fullest capacity for supply to PTL. PTL now sources only its balance requirement from KOEL.

The order fulfillment process for engines has commenced in the reference year. Training sessions have been conducted for suppliers, and are showing encouraging results. In the current year, we expect to make a transition to a consistent daily fulfillment of customer orders to specified lead times.

Last year I briefly talked about processes for new product development. The Company has manufacturing plants for engines at different locations and therefore the engineering data access to these sites is very important for quicker resolution of issues and operational efficiency of those plants. To address this issue, a product lifecycle management software has been acquired and implemented. This system has enabled the Company manage most of engineering database on the web with adequate security.

As we added capacity at Kagal due to the increase in demand, the need was felt to have a strong vendor base, which would support manufacturing and help deliver as per commitments. Towards this end, a cell was formed for strategic sourcing, which works on ensuring quality and capacity and delivery at competitive rates from suppliers.

During the year under review, the Company entered into a Technology Transfer Agreement with Waukesha Engines, USA. The technology transfer for the Diesel Engines under this agreement has been completed and the gas engine technology transfer is expected to be over in the current year. The KOEL team has already uploaded all the data on PLM and this is being used by the appropriate team members. KOEL has also received an Engine and a DG Set from Waukesha as the research and development units for further research. Vendor development for these engines has started on the prioritized items to be indigenised. Discussions about the marketing tie up for the gas engines and other products of Waukesha are still in progress. We are in the process of a final financial review and derisking of the required manufacturing capacity investment before committing funds to its creation.

As you are aware, a greenfield project for expansion for manufacture of engines has been set up at Kagal, south of Kolhapur. The ground – breaking ceremony for this plant took place on 1 September 2006. As planned, the commercial production began in April 2008 and the project implementation being on track, full-scale manufacturing is expected to commence from the fourth quarter. I am happy to mention here that we have stayed within the budgeted projected cost.

The construction of the plant at Kagal has now been completed. The total area of the two plants and the office area is 43,300 square meters, which is approximately 466,000 square feet. The machines for the crankshaft, crankcase, camshaft, cylinder head and connecting rod were installed and commissioned last year. In addition, the equipment for assembly, testing, painting and packing were also installed and commissioned. Against an installed capacity of 5,500 engines a month, the plant produced 2,600 engines in June 08. In the coming months, it will achieve its installed capacity.

Last year we also shifted our small engines manufacturing plant from Phursungi to Rajkot. The shifting of the plant was completed in January this year. We have now moved nearer the vendors, which has resulted in reduction in lead-time to fulfill customer orders. This has also resulted in reduction of conversion costs, leading to a reduction in manufacturing costs by 3 %.

Senior Managers groomed through our Leadership Development Programme have been inducted into key leadership roles, allowing them to pursue career growth opportunities at KOEL.

Our expansion into a world class manufacturing organization has employed 700 people in Kagal. Six percent are women and twenty two percent belong to the underprivileged categories. Around five hundred of the team associates are fresh Science graduates selected from different parts of Maharashtra and trained in-house in various technical and functional areas.

***Alternate and sustainable energy:***

Sustainable development holds the key to a brighter future. This year we signed a pledge to abide by the CII Code for Ecologically Sustainable Growth. Sustainable business must be economically viable, environmentally friendly, technologically feasible, and socially acceptable. To achieve such sustenance, we need to develop relevant technologies. To begin with, one needs a firm belief in the cause. Further, all new technologies need support and incubation. Over time, the technologies become economically viable. The viability comes through relentless development to reduce the costs. In the present context, environment friendly technologies are becoming viable due to increasing costs of the competing conventional technologies.

I am glad to let you know that the Green Technologies initiative we began last year has started showing results. We now are in a position to give 100% biodiesel compatibility in our entire small and medium engines range. We have converted our internal backup generation entirely to biodiesel.

We have also developed patented technology for biogas production. Some of our engines, which are converted to work on 100% biogas, have yielded very encouraging results.

The large windmills totalling to 5.6 MW capacity, which we have installed, have now started producing electricity.

Our efforts on energy conservation and energy efficiency have also been recognized. We received first prize in a State level competition on energy conservation held by the Maharashtra Energy Development Agency.

I strongly believe that it is possible to create profitable businesses that encompass and address the environmental issues. Ultimately, businesses cannot flourish by degrading the environment. The Company will continue to invest efforts, money and energy in environment friendly “Green Technologies” with a view to develop business by providing sustainable energy solutions.

***Quarterly Results, Q1, FY08-09***

The sales have increased by 15% to Rs. 566 crores over the same period last year (Rs. 492 crores).

The Profit before tax is at Rs. 43 crores (Rs. 41 crores), which is higher by 5% as compared to the corresponding quarter of the previous year.

The Company is faced with rising procurement costs for input material, while the current softening in the market environment for its products means that these increases cannot all be passed on to its customers. Even where this is possible, there is a lag between the input cost impact and its recovery from customers. This is the reason why growth in profits has lagged growth in sales in the first quarter of the current year.

However, efforts will be taken to ensure that the focus will remain on improving profitability and margins for the full year.

We remain concerned about the economic environment that currently carries significant uncertainty in the short term. While the India growth story remains strong, we are aware of the need to negotiate the occasional speed breakers that will inevitably be encountered, with all necessary care.

***Some significant developments in the current year***

***Sale of Valves Business***

As you know, the company has entered into an agreement with Eaton Industrial Systems Pvt. Ltd. and Eaton Corporation, USA, to sell its Valves Business to Eaton for a consideration not exceeding Rs. 900 million. The deal is expected to be completed by the end of this month and the company will be receiving Rs. 888 million for the sale of the Valves business, being the amount due after adjusting the unfunded retirement liabilities of the business.

***Restructuring of Business***

To improve market response on the basis of clearly defined roles, responsibilities and accountability of managers, we have restructured KOEL into separate businesses for engines and gensets by combining and restructuring the erstwhile product based SBUs. This is will also allow us to focus on building functional skills in manufacturing and sourcing at the speed we need to in order to remain competitive.

*Dr. N. A. Kalyani*

Dr. Kalyani who was associated with the Company since 1987, resigned from the Board of Directors on 23 April this year. His contribution in shaping the strategies and business decisions of the Company is of high order. His guidance as a senior member of the Board over 20 years has benefited the Company. I would like to take this opportunity to place on record our deep appreciation of the services rendered and guidance given by Dr. Kalyani to the Company.

***Acknowledgements:***

I am happy to inform that the customers in each market have appreciated our products, responsiveness and service. As a result, the company's market shares in domestic markets have gone up in key markets, and exports are increasing. I would therefore like to thank all our customers for the business with which they favour us. We do recognise that we still have a lot of work to do to meet their expectations in terms of timely delivery, improved quality and in the after sales service that they expect from us, in order for them to be successful in their businesses and their endeavours. In each of these areas we have plans to take a significant step forward in meeting their expectations of us.

I am grateful for the support given to us by you, the shareholders, our bankers, our suppliers, and our employees.

***Thank you!***