

## **Chairman's Speech at Annual General Meeting on July 18, 2009**

### ***Welcome***

Good morning Ladies and Gentlemen,

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

I am pleased to introduce you to three new members on the Board of Directors of your Company. Mr. A N Alawani has been inducted into the Board of Directors as Additional Director with effect from 21<sup>st</sup> January 2009. Mr. M Laxminarayan and Mr. Nihal Kulkarni have also joined the Board with effect from 24<sup>th</sup> April 2009 as Additional Directors.

Before speaking on Company specific highlights, I will briefly comment on the Economic and Industrial scenario during the financial year 2008 – 09 and on the proposals of the recently announced Union Budget.

### ***Economy and Industry:***

Upto the first quarter of 2008-09, the only thing managements worried about were issues pertaining to rapid growth, growth opportunities and the rapidly rising commodity costs. In some cases, even figuring out how to meet the ever – rising demand for their products or services was the big issue. All this changed dramatically with the bankruptcy of Lehman Brothers, which turned the world of finance and business upside down. The crisis, which started in the US, quickly spread to all parts of the world. Demand in everything from apparel to minerals and metals plunged across the globe.

Dozens of banks were on the verge of bankruptcy. Liquidity and credit dried up completely. Borrowers started defaulting on loans. Customers stopped buying, leading to downward pressure on prices, as Companies sought to liquidate inventories and generate cash to sustain operations.

When the global economy melted, Indian economy too felt the heat of the meltdown. The overall growth of GDP at factor cost for the Indian Economy at constant prices in 2008-09, as per the revised estimates of Central Statistical Organisation was 6.7%. The growth rate of 6.7% represents a deceleration from high growth of 9% and 9.7% in 2007-08 and 2006-07 respectively. The deceleration of growth has spread across all sectors except mining and quarrying and community social and personnel services.

Growth of agriculture and allied activities decelerated from 4.9% in 2007-08 to 1.6% in 2008-09, mainly on account of high base effect of 2007-08 and due to a fall in the production of non food crops including oilseeds, cotton, sugarcane and jute.

Manufacturing growth decelerated to 2.4% from 8.2% in 2007-08. India's export growth during 2008 – 09 dropped sharply to 3.4% from 28.4% during 2007 – 08. This was the direct result of the global economic crisis and drop in external demand. The slowdown in manufacturing could be attributed to the combined impact of a fall in exports followed by a decline in domestic demand, especially in the second half of the year. The growth of manufacturing sector was also adversely affected by the impact of rise in costs of inputs at the beginning of the year and cost of credit for most of the year, which reduced manufacturing margins and profitability.

Having touched upon the major economic events of the past year, I would also like to briefly speak on the recently announced Union Budget and its broad impact on the operations of your Company.

***Union Budget and its impact on Operations:***

The Union Budget announced in Parliament on 6<sup>th</sup> July 2009 has proposed dramatic increase in allocations for projects relating to development of urban and rural infrastructure for the year 2009-10.

Allocation to National Highway Authority of India has increased by 23% over 2008-09. Similarly, allocation under JNNURM (Jawaharlal Nehru National Urban Renewal Mission) was increased by 87% over 2008-09. Allocation under NREGS (National Rural Employment Guarantee Scheme) increased by 87% and allocation under Accelerated Power Development and Reform Programme increased by 160% over 2008-09.

The Government has also proposed giving greater flexibility to IIFCL, which is a special purpose vehicle of the Government for financing public – private partnerships in the infrastructure sector, for refinancing upto 60% of the borrowings of infrastructure projects.

The increase in expenditure on infrastructure is a positive measure and is likely to give a boost in demand to several key industrial sectors, thereby ensuring a quick recovery from the deceleration in growth witnessed over the past few quarters.

Other positive measures from the perspective of your Company, are the abolition of the Fringe Benefit Tax with effect from 1<sup>st</sup> April 2009, downward revision in the Customs duty on bio diesel (to 2.5% from 7.5%), and the weighted deduction for in house research and development. Further, the emphasis on development of urban and rural infrastructure and on the power sector are likely to have a positive impact on the Company's operations.

Having reviewed the major economic events and the impact of the Budget on your Company, I now turn to the major financial highlights of your Company for the financial year 2008 – 09.

***Financial Highlights:***

The performance of your Company has to be viewed in the backdrop of the challenging times under which it operated during the year under review.

Total Sales declined marginally by 2.2% from Rs. 2157 crores in 2007-08 to Rs. 2110 crores in 2008-09.

Export Sales declined by 12% from Rs. 165 crores in 2007-08 to Rs. 145 crores in 2008 – 09.

Export of Engines declined by 13% to Rs. 128 crores and Export of Auto Components increased by 3% to Rs. 17 crores during the year 2008 – 09.

Engine revenue increased to Rs. 2078 crores in 2008-09 from Rs. 2049 crores in 2007-08. ( Small Engines – Rs. 266 crores (decline of 22%);

Medium Engines – Rs. 1556 crores ( increase of 2.4%) Large Engines – Rs. 257 crores (increase of 37.4%). The revenue for the year includes revenue of Valves division of Rs. 13.6 crores for the period upto 31<sup>st</sup> July 2008

Profit before tax for the year, declined by 3% and was Rs. 181 crores as against Rs. 187 crores for the year 2007-08. The decline in Profit before tax was primarily due to the increase in interest cost to Rs. 38 crores during the year 2008-09 from Rs. 20 crores for the year 2007-08 and increase in depreciation to Rs. 80 crores for 2008-09 from Rs. 44 crores for 2007-08. The interest cost pertains to Interest on External Commercial Borrowings (ECB's). Increase in depreciation was on account of full year depreciation on fixed assets at Kagal.

***Operational Highlights:***

As a major player in the off highway engines, your Company was affected by the unprecedented downturn in the Global economy in general and its effects on the Indian Economy in particular.

During the first half of 2008-09, the steadily increasing inflation and rising commodity prices were a matter of concern. Your Company began to take corrective actions to mitigate the effects of the rise in input costs by undertaking measures for cost control on the input side and negotiation of prices with the customers for improving Sales realizations. However, with the sudden developments in the US economy in September 2008 and its effect on liquidity and credit, your Company faced a sudden drop in demand.

In order to mitigate the effect of the sudden drop in business, your Company scaled down production and concentrated on improving liquidity. With close monitoring of working capital, especially inventory and receivables, and control over the Capital Expenditure, your Company has managed to minimize the adverse effects of the economic crisis.

As a long term measure for improving operational efficiencies, specific committees consisting of senior management representatives have been formed with the task of bringing about changes in the operational and administrative setup and to identify opportunities for product and business development.

Last year, I had spoken on the restructuring process being implemented to improve market response on the basis of clearly defined roles and responsibilities. During the year, the marketing organization has been recast to bring greater focus on target customer segments, namely the Power generation and Industrial and Agricultural engine segments. The managers in charge of these segments are responsible to service the customers both in the domestic and export markets for their respective business segments. The Power generation and Industrial and Agricultural engine marketing organization is supported by dedicated manufacturing units at Khadki, Kagal, Rajkot and product support organization to service the post sale customer requirements.

On the export front, your Company has focused on new business opportunities in Africa and Middle East markets. The objective of the focus has been to explore mining industry applications for the Company products,

especially in the African market. The initial results have been encouraging and beyond the expectations of customers in these markets, in terms of the quality of products delivered and their performance. While this positive customer sentiment has not resulted in a positive impact on the export turnover for the financial year, the strategies adopted are likely to result in better realizations for your Company's products in these markets and also generate greater revenue in the medium and long term.

As mentioned last year, your Company has commenced production from the newly setup plant at Kagal. Management has taken steps to ensure that best industry practices in terms of production processes and systems are implemented and that manpower is trained in the implementation of these processes. While the plant is currently not operating to optimum capacities due to the general economic slowdown, with the superior production processes and trained manpower already in place, it is likely to generate better returns once the capacity utilization improves after the likely economic turnaround later in the third/ fourth quarter of the current financial year.

***New Product Development:***

During the year under review, your Company has successfully started Bulk production of the diesel pumpset named "Varsha". The initial response has been encouraging and the plant is currently ramping up production capacity to meet demand.

Company has also successfully completed development and has commenced production of "DV" series of Engines in 2009-10. The Engines have a range

of 400 to 625 KVA for the Power-generation, fire pump and industrial applications.

Your Company has also developed complete range of engines between 76HP to 330 HP range for diesel fire pump application. We are in the process of obtaining certification from Factory Mutual/ Underwriters Laboratory for the fire pump application. The final certification and launch of the product is expected during the financial year 2009-10. This is likely to generate significant revenues to both in the domestic and export markets.

Your Company has further undertaken the development of appropriate technology to make its engines compatible for using bio diesel and gas. We are committed in our focus on Research and Development activities for developing new products using renewable energy and on making appropriate investments to achieve this objective.

***Demerger of Kirloskar Oil Engines Limited:***

The scheme envisages Demerger of Engines and Bearings business, including all the assets and liabilities relating to these businesses, to a separate Company (Resulting Company), which will ultimately be known as Kirloskar Oil Engines Limited. The existing Company will continue the activity of managing the investments and windmills and will be renamed suitably. The existing Company will also retain the freehold land at Khadki and Kothrud and lease the land at Khadki to the Resulting Company.

The shareholders have approved the scheme of Demerger at the meeting held on 13<sup>th</sup> June 2009 and the same is now subject to the approval of the

Honourable High Court at Mumbai. The appointed date for the Demerger is 1<sup>st</sup> April 2009 and will be effective from the last date of the month in which all the conditions mentioned in the scheme are fulfilled and after approval of the scheme by the Honourable High Court at Mumbai is filed with the Registrar of Companies at Pune.

***Quarterly Results, Q1, FY 09-10:***

The Sales for the quarter ended 30th June 2009, have declined by 18.6% to Rs. 461 crores as against Rs. 566 crores for the corresponding quarter of 2008-09. However, the Profit before tax for the quarter was higher by 46.5% at Rs. 63 crores against Rs. 43 crores for the corresponding quarter of 2008-09.

The Khadki plant has been recommended for OHSAS 18001 certification by TUV Nord auditors after extensive audit in the first week of July 2009. The Company plans to obtain certification for its plants at Nashik, Ahmednagar, Kagal and Rajkot during the current financial year.

The delay in arrival of the monsoon and possible drought like conditions in some parts of the country is a matter of concern, as it is likely to exert further upward pressure on the Commodity prices in the next few quarters of the financial year. The external environment therefore continues to be challenging in the short term. However, with the initiatives taken by your Company and the continued strength of the Indian Economy, it hopes to emerge stronger by the end of this financial year.

*Acknowledgements:*

The last financial year has been a challenging one, both from the perspective of the Company and its stakeholders. Our customers, suppliers, vendors, lenders and employees have supported initiatives taken by the Company during the year. I would like to thank them for their support in ensuring that the Company was able to negotiate the difficult period and am confident that the goodwill built over the past several years of our association with them will continue into the future.

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

Thank you!