Mahindra Forgings

Mahindra Forgings Ltd.

8th Annual Report 2006-07

DIRECTORS

Anand G. Mahindra — Chairman
Hemant Luthra
V. K. Chanana
Fali P. Mama
Mohit Burman
R. R. Krishnan
Zhooben Bhiwandiwala
Nikhilesh Panchal
Harald Korte
Sankaran Ravindran — Managing Director

CHIEF FINANCIAL OFFICER

Manoj Jain

COMPANY SECRETARY & GM-LEGAL

Krishnan Shankar

REGISTERED OFFICE

Mahindra Towers, P. K. Kurne Chowk
Worli, Mumbai - 400 018.

FACTORY

Gat No. 856 to 860
Chakan Ambethan Road
Tal. Khed, Dist. Pune - 410 501.

COMMITTEES OF BOARD

Audit Committee

V. K. Chanana
Fali P. Mama
Mohit Burman
R. R. Krishnan
Nikhilesh Panchal

Remuneration / Compensation Committee

Mohit Burman
Anand G. Mahindra
Hemant Luthra
V. K. Chanana
Nikhilesh Panchal

Share Transfer and Shareholders' / Investors' Grievance Committee

R. R. Krishnan
V. K. Chanana
Fali P. Mama

AUDITORS

B. K. Khare & Co.
Chartered Accountants
706/708, Sharda Chambers
Mumbai - 400 020

BANKERS

State Bank of India
UTI Bank Limited
HDFC Bank Limited

REGISTRAR AND SHARE TRANSFER AGENTS

Karvy Computershare Private Limited
Karvy House , 46, Avenue 4
Street No. 1, Banjara Hills
Hyderabad - 500 034

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DIRECTORS' REPORT TO THE SHAREHOLDERS

To The Members,
Mahindra Forgings Limited

Your Directors have pleasure in presenting the 8th Annual Report of the Company together with the audited statement of accounts of your Company for the year ended 31st March, 2007.

Financial Highlights

(Rs. in Lakhs)

	2006-2007	2005-2006
Gross Income	**21,701**	20,426
Profit before Interest, Depreciation, Goodwill Contingency and tax	**2,390**	1,143
Less : Depreciation	**841**	535
Profit before Interest, Goodwill, Contingency and tax	**1,549**	608
Less : Interest and Finance cost	**753**	872
Profit/(Loss) before Goodwill, Contingency and tax	**796**	(264)
Less : Goodwill	**1,739**	–
Less : Contingency provision	**45**	919
Loss before tax & before prior period expenses	**988**	1,183
Less : Provision for tax including FBT and Deferred Tax	**230**	12
Loss after tax & before prior period expenses	**1,218**	1,195
Less : Prior Period Expenses	**35**	–
Loss for the year	**1,253**	1,195
Add : Brought forward losses from earlier years	**1,195**	–
Loss carried to Balance Sheet	**2,448**	1,195

Change of Name

With a view to signify the true character and nature of business activity undertaken by the Company, the name of the Company was changed from 'Mahindra Automotive Steels Limited' to 'Mahindra Forgings Limited' with effect from 26th September, 2006.

Operations

During the year under review, your Company registered a total income of Rs.21,701 Lakhs and an operating profit of Rs.2,390 Lakhs. The net loss before taxes stood at Rs.988 Lakhs. The non operating expenses during the year include amortisation of Goodwill of Rs.1,739 Lakhs and amortisation of non compete fees of Rs.50 Lakhs paid to Amforge Industries Limited and its Promoters.

The gross income of the Company has grown by 6.24% over previous year with export revenue witnessing a growth of 55% and operating profit growing by 109%. This was achieved through value engineering, increased export, optimisation of plant capacity utilisation and cost competitiveness.

The Company received a prestigious award from Benteler AG for being the 'Best Supplier' for Castings and Forgings components for the year 2006.

Management Discussion and Analysis

A detailed analysis of the Company's performance is contained in the Management Discussion and Analysis Report which forms part of the Annual Report.

Dividend

Your Directors have not recommended a dividend in view of net loss during the year.

Shareholding

Pursuant to the order of the Hon'ble High Court of Judicature at Bombay approving the Scheme of Arrangement with Amforge Industries Limited and its shareholders, the Company allotted 1,48,20,206 Equity Shares of Rs. 10 each and 1,48,20,206, 4%

Non-Cumulative, Redeemable, Non-Convertible Preference Shares of Rs. 31/- each to the shareholders of Amforge Industries Limited and also allotted 49,78,444 Equity Shares of Rs. 10/- each at a premium of Rs. 87.42 per share to Mahindra & Mahindra Limited (M&M). Consequent upon allotment of equity shares by the Company the shareholding of M & M now stands at 47.11% of the Company's enlarged equity capital. The Company as a result ceased to be subsidiary of M & M.

During the year, the Company redeemed 1,48,20,206, 4% Non-Cumulative Redeemable Non-Convertible Preference Shares of Rs.31/- each out of the proceeds of the fresh issue of shares to M&M.

Directors' Responsibility Statement

Pursuant to section 217(2AA) of the Companies Act, 1956, your Directors, based on the representation received from the Operating Management, and after due enquiry, confirm that:

(i) in the preparation of the annual accounts, the applicable accounting standards have been followed ;

(ii) they have, in the selection of the accounting policies, consulted the Statutory Auditors and these have been applied consistently and reasonable and prudent judgments and estimates have been made so as to give a true and fair view of the state of affairs of the Company as at 31st March, 2007 and of the loss of the Company for the year ended on that date;

(iii) proper and sufficient care has been taken for the maintenance of adequate accounting records in accordance with the provisions of the Companies Act, 1956 for safeguarding the assets of the Company and for preventing and detecting fraud and other irregularities;

(iv) the annual accounts have been prepared on a going concern basis.

Directors

Mr. Romesh Kaul resigned as a Director of the Company with effect from 27th July, 2006. The Board has placed on record its appreciation of the services rendered by Mr. Romesh Kaul during his tenure as the Director of the Company.

Mr. Sankaran Ravindran was appointed as an Additional Director at the Meeting of the Board of Directors held on 27th July, 2006. He holds office up to the date of the forthcoming Annual General Meeting. A Notice has been duly received from a Member proposing the candidature of Mr. Ravindran for the office of Director at the said Meeting.

Mr. Ravindran was also appointed as Managing Director of the Company with effect from 27th July, 2006 for a period of 3 years, subject to approval of the members of the Company.

Mr. Harald Korte has been appointed as an Additional Director at the Meeting of the Board of Directors held on 26th April, 2007. He holds office up to the date of the forthcoming Annual General Meeting. A Notice has been duly received from a Member proposing the candidature of Mr. Korte for the office of Director at the said Meeting.

Mr. Anand G. Mahindra, Mr. Mohit Burman and Mr. R. R. Krishnan, Directors of the Company, retire by rotation and, being eligible, offer themselves for re-appointment.

Auditors

Messrs. B. K. Khare & Co., Chartered Accountants retire as Auditors of the Company at the forthcoming Annual General Meeting and have given their consent for re-appointment. The shareholders will be required to elect Auditors for the current year and fix their remuneration.

As required under the provisions of section 224(1B) of the Companies Act, 1956, the Company has obtained a written certificate from Messrs. B. K. Khare & Co., Chartered Accountants to the effect that their re-appointment, if made, would be in conformity with the limits specified in the said section.

Industrial Relations

Industrial Relations remained cordial during the year under review.

Safety, Health and Environment Performance

The Company has undertaken various initiatives on safety, health and environmental issues to ensure optimum safety of the employees and plant & equipment of the Company. The Company has also taken steps for imparting training to employees, carrying out safety audits of the various facilities of the Company, conducting regular medical checkups for its employees and promoting eco-friendly activities.

The requirements relating to various environment legislations and environment protection have been duly complied with by the Company.

Public Deposits and Loans/Advances

The Company has not accepted any deposits from the public or its employees during the year under review.

The Company has not made any loans/advances which are required to be disclosed in the Annual Accounts of the Company pursuant to Clause 32 of the Listing Agreement.

Corporate Governance

Pursuant to Clause 49 of the Listing Agreement with the Stock Exchange, Corporate Governance Report form part of the Annual Report.

Scheme of Arrangement

Your Company has been identified as the vehicle to pursue the Mahindra Group's vision to become a global forgings major. In its meeting held on 26th April, 2007, the Board of Directors of the Company considered a proposal to amalgamate Mahindra Stokes Holding Company Limited ('MSHCL') (which owns 99.8% stake of Stokes Group Limited), Mahindra Forgings Overseas Limited ('MFOL') (which ultimately owns 100% stake of JECO Holding AG) and Mahindra Forging Mauritius Limited ('MFML') (which ultimately owns 100% stake (90.47% voting power) in Schoneweiss & Co. GmbH) with your Company. Your Board has taken preparatory steps which inter alia include appointment of valuers, legal experts and investment banker to assist in determining the share swap ratio and preparation of a Scheme of Arrangement.

Conservation of Energy & Technology Absorption and Foreign Exchange Earnings and Outgo.

The particulars relating to energy conservation, technology absorption, foreign exchange earnings and outgo, as required under Section 217(1)(e) of the Companies Act, 1956 read with the Companies (Disclosures of Particulars in the Report of Board of Directors) Rules, 1988 are provided in the Annexure I to this Report.

Particulars of Employees

As required under section 217 (2A) of the Companies Act, 1956 and Rules thereunder a statement containing particulars of Company's employees who are in receipt of remuneration not less than Rs.24,00,000/- during the year ended 31st March, 2007 or not less than Rs.2,00,000/- per month during any part of the said year is given in the Annexure II to this report.

Acknowledgement

Your Directors wish to place on record their sincere appreciation to the financial institutions and consortium of banks led by State Bank of India and Company's customers, vendors and investors for their continued support during the year.

The Directors also wish to place on record their appreciation for the dedication and contribution made by employees at all levels and look forward to their support in future as well.

For and on behalf of the Board

Anand G. Mahindra
Chairman

Mumbai, 26th April, 2007

ANNEXURE I TO DIRECTORS' REPORT

PARTICULARS AS PER THE COMPANIES (DISCLOSURE OF PARTICULARS IN THE REPORT OF BOARD OF DIRECTORS) RULES, 1988 AND FORMING PART OF THE DIRECTORS' REPORT FOR THE YEAR ENDED 31ST MARCH, 2007.

A. Conservation of Energy

(a) During the year, the Company has taken the following initiatives for conservation of energy:

Electrical Energy

1. Centralised Air Management.
2. Installing Energy efficient screw compressors in place of existing ones.
3. Different coil for different diameter installed for low power consumption.
4. Ircon temperature controller installed for optimum power consumption.
5. Control on continuous running of DM water pump and fast extraction motor installed for power saving.
6. Auto start arrangement for heat treatment agitation pump motor for power saving.
7. Auto switch off for equipments when not in use.
8. Energy conservation team is formed, identified the potential for further energy saving, various corrective measures have been worked out and actions are in process.

(b) Additional investments and proposals, if any, being implemented for reduction of consumption of energy:

a) Replacing old shot blasting machines with new Rosler shot blasting machine from Germany.
b) Underground flash conveyer.
c) Overhead conveyer to transfer forging from press shop to heat treatment shop. No forklift movement – diesel saving.
d) Energy efficient 3T gas fired heat treatment furnace is planned and in process.

(c) Impact of the measures taken / to be taken at (a) & (b) above for reduction of energy consumption and consequent impact on the cost of production of goods :

The measures taken as mentioned in (a) & (b) above have resulted in lower energy consumption.

(d) Total energy consumption and energy consumption per unit of production as per Form-A of the Annexure to the Rules in respect of Industries specified in the Schedule.

Power & Fuel consumption

			2006-07	2005-06
1	**Electricity Purchased**			
	Quantity (KWH in Lakhs)		289.55	272.99
	Total Amount (Rs. in Lakhs)		1336.81	1016.02
	Average Rate Per Unit (Rs.)		4.62	3.72
2	**Furnace Oil***			
	Quantity (Lakhs of Litres)		0.99	1.12
	Total Amount (Rs. in Lakhs)		19.34	22.27
	Average Rate per Litre (Rs.)		19.57	19.94
	* used for part of the year.			
3	**Light Diesel Oil**			
	Quantity (KL.)		2115.55	2209.47
	Total Amount (Rs. in Lakhs)		627.09	597.21
	Average Rate per KL.(Rs.)		29641.94	27030.00
4	**Consumption per unit of Production**			
	Production (Tons)		23674	23761
	Fuel Used	**Units**		
	Electricity	KWH/Ton	1223.08	1149.00
	Furnace Oil	Lit/Ton	4.17	13.60
	Light Diesel Oil	Lit/Ton	89.36	94.81

B. TECHNOLOGY ABSORPTION

I Research & Development :

Areas in which Research & Development is carried out :

- Control cooling conveyor installed for micro alloy forging for all units.
- Implementing of H11/H14 dies for better die life.
- Eddy current inspection for material sorting.

II Benefits derived as a result of the above efforts :

- Better quality of dies / increased no. of Forged parts per Die is ensured.
- Bend free forgings, customer satisfaction and better productivity.

III Future plan of action :

- Understanding better technology like flashless forging for better yield product and more die life.
- Automation of Production process.
- Better product-mix.
- Pollution free gas fired HT furnace.

IV Expenditure on R&D :

(a)	Capital	Nil
(b)	Recurring	Nil
(c)	Total	Nil
(d)	Total R&D expenditure as a percentage of total turnover	Nil

V Technology absorption, adaptation and innovation :

- Fully automated line for crankshaft having descaler, auto transfer system, robots and vertical cooling systems.

VI Imported Technology for the last 5 years :

NIL

C. FOREIGN EXCHANGE EARNINGS AND OUTGO :

(Rs. in Lakhs)

	2006 – 07
Total Foreign Exchange earned	687.87
Total Foreign Exchange used	975.47

For and on behalf of the Board
Anand G. Mahindra
Chairman

Mumbai, 26th April, 2007

ANNEXURE II TO THE DIRECTORS' REPORT

ADDITIONAL INFORMATION AS REQUIRED UNDER SECTION 217 (2A) OF THE COMPANIES ACT, 1956 READ WITH COMPANIES (PARTICULARS OF EMPLOYEES) RULES, 1975 AND FORMING PART OF THE DIRECTORS' REPORT FOR THE YEAR ENDED 31ST MARCH, 2007

Name	Designation	Qualification	Date of Commencement of Employment	Age/ (Experience) in years	Remuneration (Subject to tax)	Last Employment held (Designation / Organisation)
Mr. S. Ravindran	Managing Director	BE & PGDBM	27th July, 2006	59 (37)	Rs.45,22,222	Managing Director/ GKN Driveline Limited
* Mr. V. V. Raghavan	Chief Operating Officer	BE (Mechanical)	1st April, 2005	60 (41)	Rs.4,77,459	Vice President - Order Management/ Mahindra & Mahindra Limited (Automotive Sector)

* employed for part of the year.

Notes :

1. Nature of employment is contractual, subject to termination on one month's notice on either side.
2. None of the above employees is related to any Director of the Company.
3. Gross remuneration received as shown in the statement includes salary, house rent allowance or value of perquisites for accommodation, car perquisite value/allowance, as applicable, employers' contribution to Provident Fund, Leave Travel facility, reimbursement of medical expenses, performance pay and all other allowances/perquisites and terminal benefits.
4. No employee holds by himself or alongwith his spouse and dependent children 2% or more of the equity shares of the Company.
5. Terms and conditions are as per the Company's rules.

For and on behalf of the Board
Anand G. Mahindra
Chairman

Mumbai, 26th April, 2007

MANAGEMENT DISCUSSION & ANALYSIS

Overview

The management of Mahindra & Mahindra's (M&M's) SysTech Sector had enunciated a vision of creating one of the leading forging companies in the world by 2010. That ambitious goal seems to be within reach earlier than had been anticipated.

There have been two remarkably distinctive phases in the affairs of Mahindra Forgings Limited ('Mahindra Forgings', 'MFL' or 'the Company'). With effect from 1st April, 2005, Mahindra Automotive Steels Limited – which subsequently became Mahindra Forgings Limited, acquired the Chakan unit of Amforge Industries Limited with all its assets and liabilities. For the financial year which ended on 31st March, 2007, MFL with a single forgings plant at Chakan (Maharashtra) had net sales of Rs.2,114 million and operating profit of under Rs.239 million.

In the second phase, as part of its quest to become a global automotive forgings player, M&M , through its SysTech division began a process of systematic international acquisitions. The focus was on acquiring companies that had excellent manufacturing facilities, high technological content, complementary product portfolios, strong management, healthy order books especially from marquee clients and a track record of consistent growth.

With these objectives in mind, M&M first acquired a 98.6% stake in the Stokes group in UK in January 2006 which was subsequently increased to 99.5%. Stokes manufactures ring gears, pinions, hubs / wheel blanks, focuses on the passenger car segment, and sells to major global OEMs and Tier 1 suppliers. For 2006-07, Stokes had turnover of around £27 million.

The second acquisition occurred in November 2006, when M&M, through its closely held subsidiaries, bought out a 67.9% stake in JECO Holding AG, a forging company in Germany. JECO enjoys lasting partnerships with all the German OEMs. It has a highly diversified product and customer base and caters to the truck market. Over 15% of JECO's turnover comes from exports. More significantly, 20% of JECO's sales comprise non-automotive products and more than 50% of its production is machined. For the calendar year ended December 2006, JECO's turnover was around €190 million.

A month later, in December 2006, M&M acquired a 90.47% stake in Schöneweiss Co. & GmbH, another forging unit in Germany. Schöneweiss also enjoys excellent relationships with German OEMs; caters to both the truck and automobile segments; and specialises in suspensions, power trains and engine parts. This is a highly technological driven company which regularly partners with its OEMs in developing automotive products right from the design stage to final testing, validation and commercial manufacture. Interestingly, almost a fifth of the world's front axles for commercial vehicles are supplied by Schöneweiss. For the calendar year ended December 2006, Schoneweiss's turnover was €94 million.

MFL has been identified as the vehicle to pursue the Mahindra Group's vision to become a global forgings major. In its meeting held on 26th April, 2007, the Board of Directors of the Company considered a proposal to amalgamate Mahindra Stokes Holding Company Limited ('MSHCL') (which owns 99.8% stake of Stokes Group Limited), Mahindra Forgings Overseas Limited ('MFOL') (which ultimately owns 100% stake (90.47% voting power) of JECO Holding AG) and Mahindra Forging Mauritius Limited ('MFML') (which ultimately owns 100% stake in Schoneweiss & Co. GmbH) with your Company. Your Board has taken preparatory steps which inter alia includes appointment of valuers, legal experts and investment banker to assist in determining the share-swap ratios and preparation of a Scheme of Arrangement to be approved by the Board of Directors.

We begin with the performance of Mahindra Forgings as a standalone Company for the year 2006–07. Thereafter, we shall elaborate the plans for MFL as a consolidated global player in the forging space.

Industry Structure and Industry Development

The period between 2005-06 and 2006-07 has seen very impressive growth in the domestic sales of both passenger and commercial vehicles. The former has grown at an average 13% per year over the last three years, while the latter has grown at more than 22% per annum over the same period. In fact, the automobile industry witnessed a significant growth spurt in 2006-07 over the previous year. The number of passenger vehicles sold in India increased by 18% to 1.54 million; and sales of commercial vehicles grew by 33% to 520,000. Table 1 below gives the data.

Table 1: Growth of automobiles in India (in numbers)

				Growth	
Category	2004-05	2005-06	2006-07	2005-06	2006-07
Passenger Cars	960,487	1,046.133	1,238,032	8.9%	18.3%
Utility Vehicles	182,018	196,506	222,111	8.0%	13.0%
MPVs	67,371	66,661	84,707	-1.1%	27.1%
Total Passenger Vehicles	1,209,876	1,309,300	1,544,850	8.2%	18.0%
M&HCVs	214,807	219,295	294,266	2.1%	34.2%
LCVs	138,896	171,788	225,734	23.7%	31.4%
Total Commercial Vehicles	353,703	391,083	520,000	10.6%	33.0%

The sharp increase in interest rates over the last twelve months has impacted the growth of commercial vehicle segment but the overall demand for automobiles, especially passenger vehicles, is expected to remain robust over the next few years and expected to grow between 10-13%.

The growth of forgings has far outstripped that of automobiles. This is mainly due to a significant growth in exports – driven by both the technological capabilities of Indian companies and competitive cost advantages. According to a McKinsey study, production of forgings in India grew by an average of over 25% per annum, from 600,000 metric tons (MT) in 2003-04 to 929,000 MT in 2005-06. The study estimates that by 2009-10 total forgings production in India will be 1.85 million MT, of which over 40% will be slated for exports. Chart below plots the data from the McKinsey study.

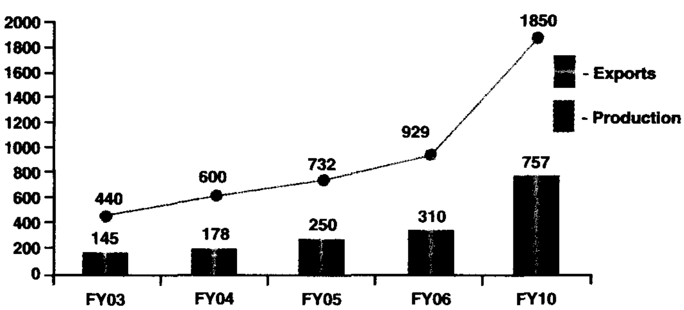

Chart: Growth of Indian forgings production & exports ('000 MT)

One of the key drivers of MFL growth will be exports. The Company is exporting to Germany and Italy and has large order from a European Auto Major. In fact, in its very first year of supply of engine parts to one of the leading Tier I suppliers in Europe , MFL has received a prestigious award from them recognising MFL as Best in Class in the Castings and Forgings Category for the Year 2006.

Going forward, the Company is working towards substantially increasing its machining capacities for crankshafts and axle parts, with the objective of increasing the share of exports of these high value added items.

For the year under review, the Company's exports were 3.3% of net sales. However, considering current order position, Mahindra Forgings expects the exports to rise to 10% in 2007-08.

Opportunities and Threats

MFL's Chakan plant produces mainly light weight forgings of three broad types. The first is crankshafts for cars, multi-utility vehicles (MUVs), tractors and light commercial vehicles (LCVs). The second main product category is stub axles, which are supplied to manufacturers of MUVs, LCVs and HCVs. The third category of products constitutes steering knuckle, which are sold to OEMs that manufacture MUVs.

Mahindra Forgings has very close association with leading Indian passenger car manufacturers, and is the single source supplier for several of them. Because of its building strong and lasting relationships, the Company enjoys the largest market share for passenger crankshafts in India. With the Indian economy attaining a higher growth trajectory, the growth in the automobile sector is expected to remain healthy and drive domestic demand. As we start delivering the new export orders, the increased exposure and global brand presence is expected to open up several opportunities to provide cost effective forgings solutions in the international markets.

While focusing on developing these opportunities, we are conscious of the threats facing the Company. First, is the threat of overdependence on a particular customer, product group or geography. Consequently, we are consciously working on a de-risked business model that stresses on diversification. The stress on exports and growing our international presence is also a step in this direction. Another example of our de-risked business strategy is with regard to our dealings with M&M. While MFL clearly benefits from the demand generated by M&M, there has been a conscious decision to maintain arms length relationship with group companies to ensure the highest standards of Corporate Governance. As Mahindra Forgings grows organically and through the M&A process, we expect that its dependence on business from M&M will be even less than the current level of 20% of total sales.