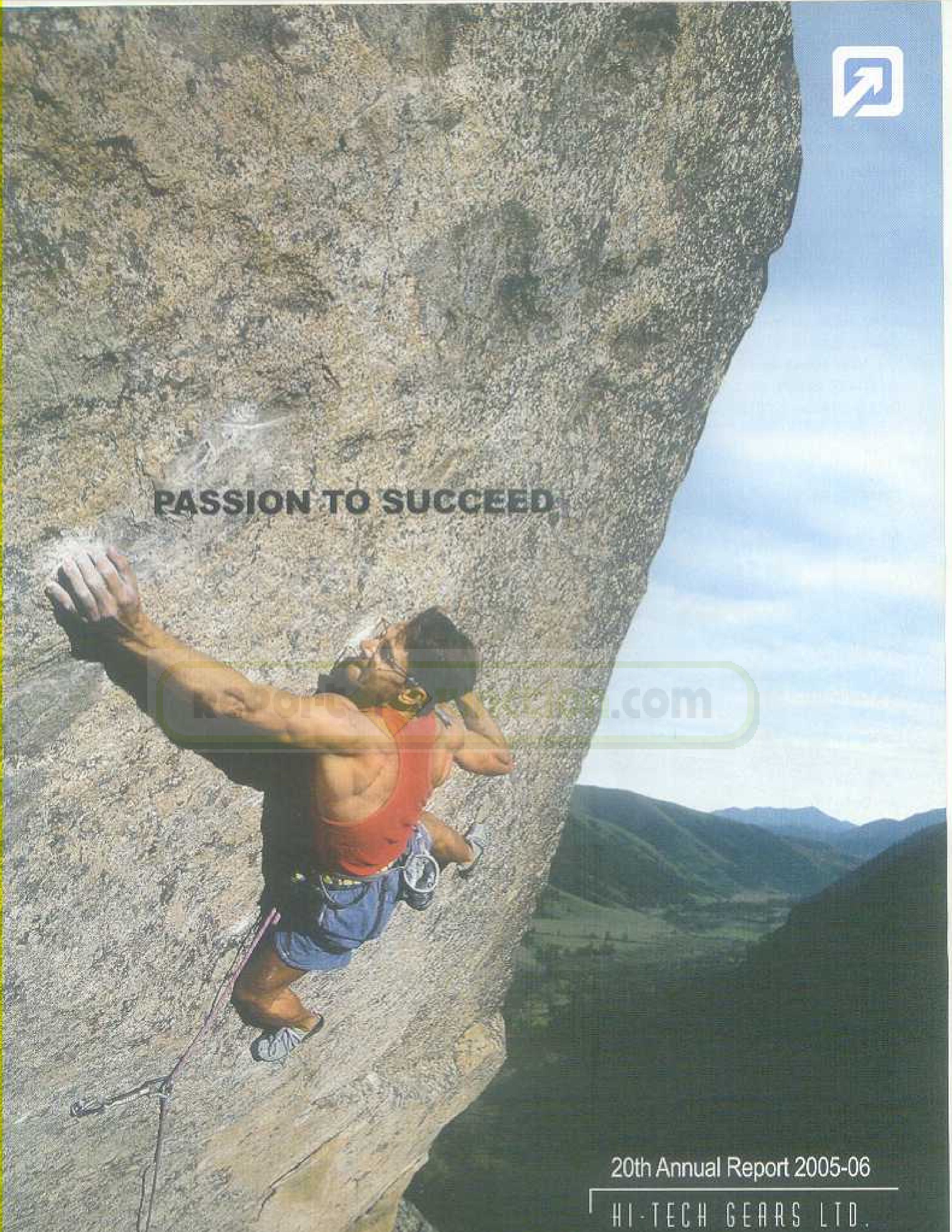
PASSION TO SUCCEED
20th Annual Report 2005-06
HI-TECH GEARS LTD.

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New Delhi-110001

Citi Bank N.A.,
Jeewan Bharati Building,
Parliament Street,
New Delhi-110001

Standard Chartered Bank,
Connaught Place, New Delhi-110001

REGISTRAR & TRANSFER AGENT

Mas Services Private Limited,
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New Delhi-110029
Tel: (011) 26104142 & 26104326,
Fax: (011) 26181081
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BOARD OF DIRECTORS

Mr. Deep Kapuria
Chairman & Managing Director

Mr. Anil Khanna
Director

Mr. K.L. Kalra
Director

Mr. Sandeep Dinodia
Director

Mr. Pranav Kapuria
Deputy Managing Director

Mr. Anuj Kapuria
Director

SENIOR EXECUTIVES

Mr. Sushant Jain
Vice-President (Operations)

Mr. Deepak Rai
Vice-President (Corporate Affairs)

Mr. Sanjeev Pandiya
CFO & Vice-President (Group Corporate Strategy)

Mr. Jitendra Chaudhary
Vice-President (HR)

PRINCIPAL OFFICER

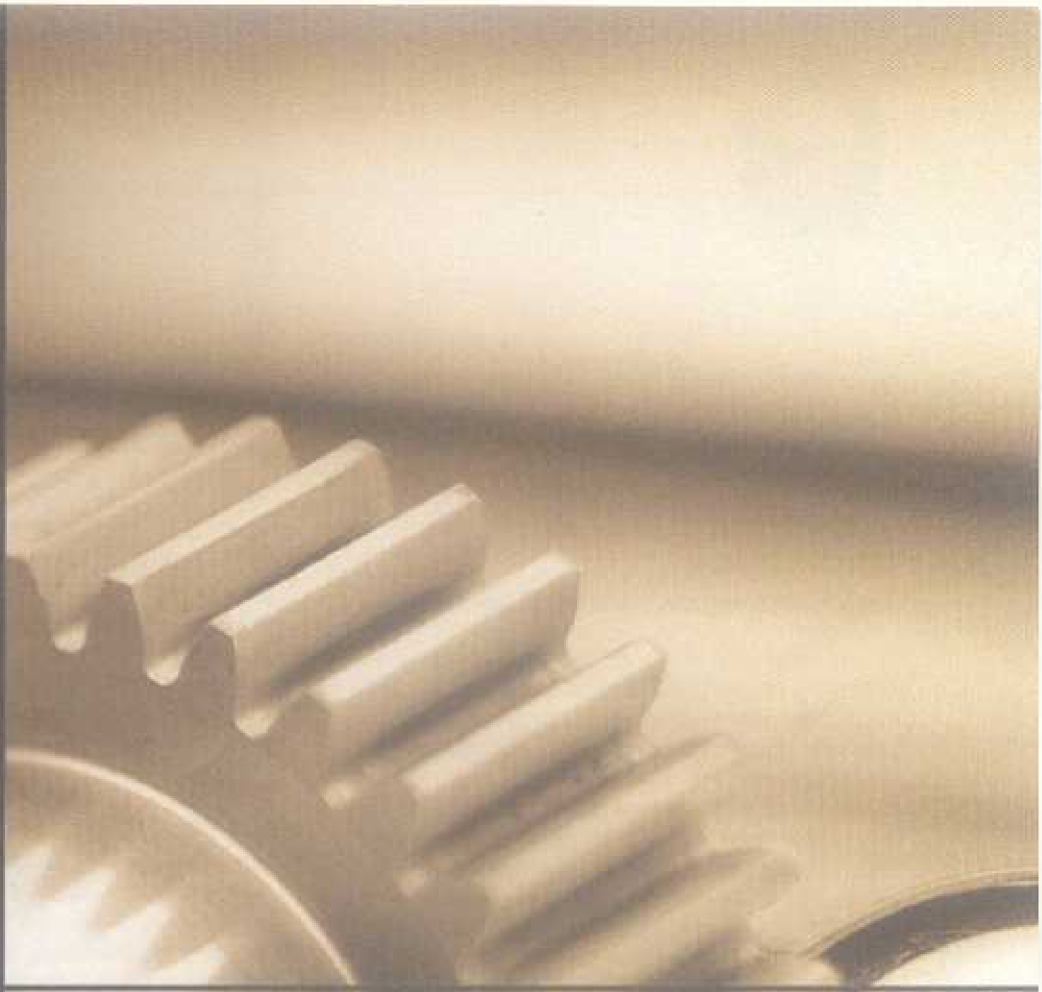
Mr. Praveen Jain
Company Secretary

AUDITORS

M/s. Gupta Vigg & Co.
Chartered Accountants
88, South Park Apartments,
Kalkaji, 'B' Block,
New Delhi- 110019

FORWARD LOOKING STATEMENT

In our report we have disclosed forward-looking information so that investors can better understand the company's future prospects and make informed decisions. This Annual Report and other written and oral statements that we make from time to time contain such forward-looking statements that set out anticipated results based on management's plans and assumptions. We have tried, wherever possible, to identify such statements by using words such as 'anticipate', 'estimate', 'expects', 'projects', 'intends', 'plans', 'believes', and words and terms of similar substance in connection with any discussion of future operating or financial performance. We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Investors should bear this in mind as they consider forward-looking statements. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.



CONTENTS

CHAIRMAN'S MESSAGE

Dear Shareholders,

The Link Between Organisation Design & Profit

We all know that the profit motive is at the centre of capitalism, the *raison d'être* of an organisation. So profit is the purpose of an organisation, and the shareholder (to serve whom the organisation exists) is the primary stakeholder.

The organisation uses various resources to generate a profit. In economic terms, it uses Land, Labour (human resources), Organisation & Capital (LLOC), i.e., all the resources it uses can be classified in some way or the other into the above heads. If we take the 4 M's: Man, Machine, Materials and Method, they are merely a re-statement of the above LLOC.

Yet, most organisations I know tend to confuse this balance, i.e., they tend to focus excessively on one or the other of the above baskets. At HGL, I notice an excessive focus on doing things, i.e., Labour.

We have customers who tell us what to make from time to time. Through the TQM/ TPM/ 6-Sigma mindset that flows up and down the auto value chain, we all have this huge focus on the 4 M's mentioned above. Most of our conversation is about machine productivity, labour standards, (material) wastage, Overall Equipment uptime or Line Efficiency (OLE), inventory control, etc. In other words, maximising throughput per unit of Capital Employed. So, either you reduce the Capital Employed for a given level of output (as in stagnating markets in the developed world, where they use outsourcing and innovation to do this), or you maximise throughput for a given level of Capital (as in developing countries, where demand is buoyant, but capital is expensive and scarce).

Now compare this to a bank, for example, as in, what does a Bank "do"? Is there any physical transformation in its product? A bank captures 'profit' by ensuring that it raises funds cheaper than what it lends at (assuming it gets back all the money it lent out in the first place).

But this 'work' produces profit, which comes from managing "Capital", one of the 4 economic resources mentioned above.

Similarly, look at Organisation, often called Management Quality, the ability to create knowledge and insight. At Berkshire Hathaway, a small group of wise men are brought together, they understand Risk and Opportunity better than anybody we know. Why (and How) do they stay together? I don't know, but this ability, which creates profit, must be put under the basket called "Organisation".

Under this head, I will also put the ability to handle Risk and the other side of the coin, Opportunity. A good Insurance company or an Investment Bank, for example, makes a profit because it charges more premium than it pays out, i.e., it estimates the probability of occurrence of an event better than its customers. And it keeps enough Risk Capital on standby (either on or off its Balance Sheet) to make sure that it never goes bust, especially during those sudden cataclysmic crises that happen every so often these days.

Last, let's come to Land. Don't take this term literally. In Ricardian terms, land used to mean anything whose supply was not controlled by human beings. The simplest example was land itself. In those days, if you owned land, you got to charge Rent, from which came the term, Economic Rent.

But to now get to the nub of my point. I don't think too many companies examine their Organisation Design, to see whether they are able to exploit all the sources of profit possible. Every external interface of the company creates an external stakeholder. Do we examine each such interface to see how it is losing money/ value or exploiting the relationship for profit?

We are one of the best-rated auto component companies, according to a recent poll by a leading TV channel. Yet, it is my personal opinion that we give away half our net profit, by choosing to stay with single-material/ supplier relationships, rather than convert to multiple sources.

I have often argued that perhaps we, as management, are averse to building "strategic sourcing" skills. How many material-substitution proposals have we given to our customers in the past 5 years, for example? So we have chosen to take the prices we are given, under the garb of 'customer interest'. But in making this compromise, we have sacrificed "shareholder interest".

"Companies create wealth/ value, but markets measure them". I have often seen that markets don't value the various streams of profit differently, i.e., the profits of an auto component company are measured on par with the profits of a bank/ insurance company. For a better understanding of the nature of profit, it is important to first analyse why (and how) the company makes money in the first place.

For example, an autocomp company makes its profits from "labour" after losing whatever it does to its suppliers, bankers, even employees. It makes money (as in case of HGL) after losing 'value' to its suppliers, bankers, etc. In economic terms, it loses its 'consumer surplus' to some stakeholders. The residual profits are real, and are less likely to be lost again. These profits are then redeployed into a set of real machines, plant, building, which will always have value, as long as the business has any role in society.

Compare this to a bank, which makes money during the boom because it borrows cheap and lends dear. The bank puts all its profits back into its Balance Sheet, leaving its past profits exposed to the same risk of default. Suddenly, after a recession hits, investors are left wondering how much of the past "profits" of the bank were real. The catch is that Risk levels have stayed constant (or have increased) in the bank's Balance Sheet, while Risk may have actually reduced in the autocomp co's Balance Sheet.

Yet, the market would value a typical Bank at a P-E level higher than that of the typical autocomp co.

So let me summarise: Profit is the objective of any organisation, and it comes from the 'management' of 4 key economic resources (LLOC). Most organisations are good at (managing) one or the other of the above (resources). Organisations need to grow in depth, i.e., learn to 'do' things better, manage one resource. And they need to grow in breadth, i.e., know enough about managing the other 3 resources better.

What they know is Wealth, what they don't is Risk.

INTERVIEW WITH DY. MANAGING DIRECTOR

Much was expected from the autocomp industry, but it seems to have belied expectations in general, at least in the short- run. How would you take stock of the industry as a whole, and maybe your sub-sector. Your comments on the recent past, and your expectations of the future.

Like I have said before, it is wrong to treat autocomp as a single, undifferentiated industry with the same generic patterns applicable to all. There are commodity players, with their own cyclical trends. There are technology players, who are attempting a scale change by opting for a new customer mix, especially with an export thrust. The dynamics of the international market are very different from that of the domestic market. Some of the disappointment comes from the fact that returns in the export market are very different from the domestic market.

Many companies are slowing down because they are learning new technologies, bringing in new people, systems and products, all together. You will see multiple trends in this sector, but on the whole, the broader story is on track. Topline will grow first, but bottomlines will also come, once the new products/ technologies referred to above are absorbed.

In our sub-sector (Gear & Transmission components), the basic story remains bullish. Growth in the domestic markets is available, so it would appear to be difficult to keep up with such spectacular growth in both domestic and export markets. The real challenge is to try and scale up so fast, over so short a time period.

What are the special features to be considered in tracking your company?

We have divided our business into 3 verticals: gears for two-wheelers, Engine Gears and Engine Components, primarily for exports. We also have a new business in Gear Shafts, entirely for exports. This is the first time we have prototyped a product for a global OE.

The 2-wheeler business is domestically focused, while Engine Gears, Engine components and Gear Shafts are primarily for exports. All our verticals sell only to top-of-the-line OEs; there are no retail sales. The relative mix between these verticals will drive our profitability.

Each of the above verticals has different levels of profitability, technology, throughput, investment requirements and growth potential. They also have different levels of investment in Working Capital, which impacts the Return on Investment.

Significantly, a reduced investment in Working Capital means a faster payback in cash terms, which is our current focus. Once we have a leaner Balance Sheet, we might go back to looking at Gross Profitability; for the time being, our Balance Sheet cannot bear the impact of the huge investment into Working Capital, needed in some verticals.

By changing our relative focus to quick-gestation projects, we hope to do much better this year.

What are your investment plans and growth strategy this year?

We will be focusing on the domestic market, where we have recently given up significant turnover and profits by growing exports too fast. Only balancing investments and normal capex is planned for this year.

We will be looking to extract maximum mileage from the investments into Manesar last year. This will be a year of consolidation. You will see us extract turnover growth with minimal expansion of our Balance Sheet.

How do you expect to fare this year?

Well, top line will continue with the same growth momentum that we have seen last year. In fact, I might even be adventurous enough to assert that this growth momentum may last even beyond the current year. Given our shift in product-mix, you can expect higher profitability than last year as our new investments start to produce at capacity. New product investments will slow down, resulting in lower development charges. Higher throughput per unit of capital will result in higher capital efficiency, which you will see in our bottomline.

Significantly, you will see a leaner Balance Sheet for our kind of turnover, more cash generation and better liquidity. As the excess leverage is worked away, you will see a far healthier company over the coming year.

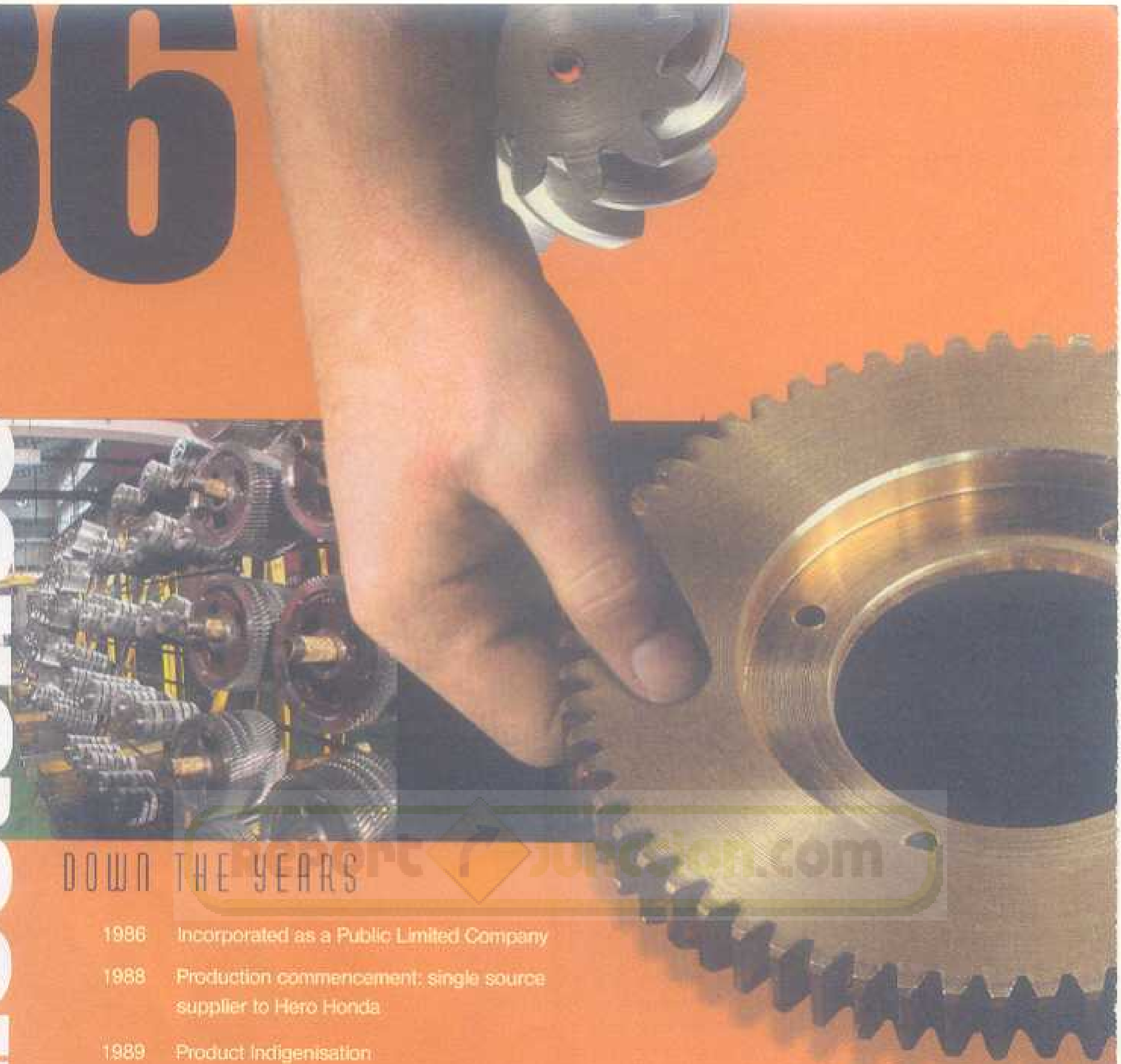
Longer-term, what is your outlook? Last year, you sounded pessimistic.....?!

The key challenge we have is to manage growth, without significantly straining our Balance Sheet. In the past, we have taken on long-gestation projects that exceeded our financial capabilities. Too much growth can give you indigestion.

Our core businesses remain profitable, but we need to shore up our competitiveness by enhancing scale and reducing costs in line with customer expectations. This is our strategic imperative for now.

Once this is done to our satisfaction, we will acquire newer segments: products, customers, technologies and markets (i.e., exports Vs domestic). But this will be done carefully, with an eye on the Balance Sheet. We have learnt recently that trying to do too much can strain our resources.

Subject to the above caveat, our growth prospects look very attractive. We are ahead of the Learning Curve, compared to our peers, both in India and in other emerging markets. We have excellent customer reputation, a technology partner who is a world leader and sole (or dominant)-supplier positioning in all our major products/ customers. The important thing is to make our commitments carefully, and then ensure that we do not fail on delivery. If we keep a steady reputation on that count, our shareholders have nothing to worry about.



DOWN THE YEARS

1986	Incorporated as a Public Limited Company
1988	Production commencement: single source supplier to Hero Honda
1989	Product Indigenisation
1992	Technical Tie-up with Kyushu Musashi, a subsidiary of Honda Motors, Japan
1993	Backward Integration into Precision Forgings
1995	Selected as single source supplier to Honda Power, Tata Cummins Ltd.
1996	Technology Agreement with GETRAG, US
1996	Certified as ISO 9002
1996	BPR launched
1997	Selected as a global source to Cummins, US
1997	Pilot Phase of BPR completed

2003 Environment Certification ISO 14001 : 1996

2003 Occupational Health & Safety Certification OHSAS 18001 : 1999

2004 Establishment of Hitech Robotic Systemz

2004 Prototyping/ productionising Precision Components for Robert Bosch, GM, Volvo and Daimler Chrysler

2005 State-of-the-art manufacturing facility set up at Manesar

1998 Certified as QS 9000

1999 Separate Division to handle high-end design and CAD services established, under the name of Hitech eSoft

2002 Launched initiative of Lean Manufacturing

2003 Certified for Integrated Quality Management Systems

2003 Certified for TS 16949

DIRECTOR'S ESSAY

HiTech Gears Ltd has always focused on acquiring technology as a differentiator. A dedicated Design Centre **HiTech eSoft** was set up in the year 2000 with the same objective of building a Centre of Engineering Excellence which not only provides cutting-edge engineering solutions and services to Hi-Tech Gears Ltd but also works with other manufacturing organisations to help them build their products faster, better and at a reduced cost.

The 60 engineers working in this environment are creating innovative solutions to practical shop floor problems, helping R&D in their research work and working with Product Development Departments in churning out new products at an accelerated pace.

Since its inception this Division has registered two copyrights for cutting-edge software products. These software products use technology to capture engineering information on very thin files and populate them on web pages which are also linked to engineering databases. The entire matrix of knowledge that is created is dynamically linked to the underlying CAD information.

These products have been installed at Cummins, Hero Honda, New Holland, Tata Cummins Eicher and Escorts apart from being used inhouse at Hi-Tech Gears Ltd. Our solution eCatalogue sucks out the 3D images and BOM dynamically from engineering data bases and populates a website used for spare part identification and instructions on the field for assembly and dismantling. Customers have been delighted with this tool. We have won awards from PTC (the authors of the CAD tool Pro e) for this solution. Cummins, New Holland and Hero Honda are already live on the World Wide Web with this solution and the rest are to follow suit in the very near future. We believe in connecting the Engineering enterprise in such a manner that the entire engineering information flows seamlessly in real time across the organization and is available to the entire value chain participants as and when needed. No one will ever have to duplicate or recreate information that has already been created by someone in the entire organization.

HES in also providing engineering and design support to its valuable customers in the discreet manufacturing segment where it has been serving not only the automotive majors like GETRAG, Cummins, New Holland but has also been embedded quite deeply into the R&D departments of various white good manufacturers like Whirlpool and the Medical Devices and Equipment manufacturers like Eastern Medikit. HES is looking at focusing more and more on non-automotive market space in order to become a complete engineering solutions company in the entire discreet manufacturing segment. HES has existing customer base in all across India, Western Europe and the US.

During the present year this Division is targeting a quantum jump in performance. E-Catalogue and the immense knowledge and experience of manufacturing processes will be the prime growth drivers for the division. The focus is to increase the offshore revenue for the