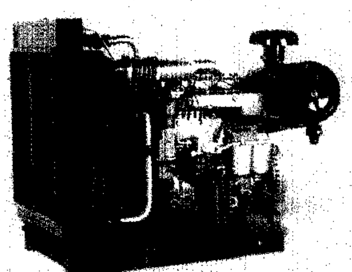
KIRLOSKAR OIL ENGINES LIMITED

ANNUAL REPORT 2001-2002

Kirloskar

Enriching Lives

There's a way we do business today. A way we measure growth. And performance. By a smile. Be it on the face of customers or shareholders, business for us, is bringing happiness in their lives. Giving them more space. And peace of mind. After all, it's the Kirloskar way of working that gives a new perspective to business. For when you have century-old specialists caring for your business interests, you are bound to fetch impressive dividends.



Kirloskar R1040 Series Engines - Conforming to US Tier I & Tier II emission standards for off-road use and European COM Stage I & II emission norms.

ANNUAL REPORT FOR THE FINANCIAL YEAR ENDED ON 31 MARCH 2002

BOARD OF DIRECTORS:

Mr. Atul C. Kirloskar	Chairman and Managing Director
Mr. Sanjay C. Kirloskar	Vice Chairman
Mr. Gautam A. Kulkarni	Joint Managing Director
Mr. Rahul C. Kirloskar	Director (Exports)
Mr. V. K. Bajhal	
Dr. N. A. Kalyani	
Mr. H. M. Kothari	
Air Marshal Y. V. Malse (Retd.)	
Mr. P. G. Pawar	
Ms. Anupama Ranade	ICICI Nominee - Upto 1-7-2002
Mr. U. V. Rao	With effect from 6-5-2002
Dr. R. J. Rathi	
Dr. K.R.Chandratre	Director (Legal and H.R.) and Secretary
Mr. A. N. Alawani	Director (Finance)
Mr. D. R. Swar	Director (Medium and Small Engines)
Mr. S. G. Chitnis	Director (Auto Components and Large Engines) Upto 1-7-2002

AUDITORS:

M/s. Dalal & Shah
Chartered Accountants

REGISTERED OFFICE :

Laxmanrao Kirloskar Road,
Khadki, Pune 411 003

LOCATION OF FACTORIES:

Pune
Ahmednagar
Nasik
Solapur

BANKERS:

State Bank of India
Bank of Baroda
Bank of Maharashtra
The United Western Bank Ltd.
HDFC Bank Ltd.
The Cosmos Co-Operative Bank Ltd.
The Shamrao Vitthal Co-Operative Bank Ltd.

Information for shareholders

Annual General Meeting Date	:	Saturday, 14 September 2002
Time	:	4.00 p.m.
Venue	:	Registered office of the Company.
Proposed Dividend	:	35%(Rs. 3.50 per share of Rs. 10/- each)
Dates of Book closure	:	5 September 2002 to 14 September 2002 (both days inclusive)

Contents **Page No.**

A DECADE AT A GLANCE

(Rupees in Million)

	31st March									
Particulars	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Gross fixed assets	1000.62	1263.83	1499.72	2112.42	2366.66	2556.98	3291.16	3503.44	3609.95	3715.83
Net fixed assets	579.86	781.06	1170.08	1469.01	1583.59	1518.80	1731.41	1654.92	1537.63	1391.69
Net current assets	691.49	720.37	897.43	1304.72	2635.31	3614.32	1995.19	2022.57	1236.49	1280.68
Total capital employed	1435.49	1805.09	2498.21	3714.05	5147.94	6558.38	5458.11	5315.51	4661.83	4795.31
Shareholders' funds	504.47	725.05	862.49	1566.89	2000.63	3475.73	2919.46	3665.01	3508.06	3637.05
Sales	2269.59	2938.23	4073.09	6138.96	6158.42	6313.52	7133.76	7447.95	7941.59	7444.60
Profit before tax	73.01	103.14	124.25	213.38	576.93	1716.87	159.19	890.93	417.03	274.00
Retained earnings	40.99	75.69	87.00	157.20	429.67	1421.30	72.41	745.22	210.97	118.76
Dividend –										
Equity & Preference	15.96	29.29	30.13	41.80	42.71	60.65	66.55	67.07	67.07	67.07
Equity Dividend%	25	25	25	25	25	35	35	35	35	35
FOB value of exports	154.30	109.99	220.99	193.56	150.80	169.14	293.43	306.99	443.31	353.07

NOTES :

In the above chart the figures for the years 1993 and 1994 relate to erstwhile Kirloskar Oil Engines Ltd., prior to its merger with Prashant Khosla Pneumatics Ltd.

Preference shares were redeemed during the Financial Year 1996-97.

DIRECTORS' REPORT

To the Members,

The Directors have pleasure in presenting their Report together with the audited accounts of the Company for the year ended on 31st March 2002.

Financial Performance:

	(Rupees in 000s)	
	2001-2002	*2000-2001*
Total Income	7,632,433	*8,337,551*
Total Expenditure	7,358,473	*7,920,525*
Profit before tax	273,960	*417,026*
Provision for tax (including Deferred Tax)	87,639	*3,700*
Net Profit	186,321	*413,326*
Surplus (After other adjustments)	312,401	*600,485*

Appropriations :
Your Directors propose to appropriate the available surplus as follows:

	(Rupees in 000s)
Proposed Dividend	67,073
Transfer to Contingency Reserve	20,000
Transfer to General Reserve	100,000
Balance carried to Balance Sheet	125,328
	312,401

Dividend:

The Directors recommend a dividend of 35% (Rs.3.50 per equity share) for the year (previous year 35%). The dividend for the Financial Year 2001-2002 shall be subject to deduction of tax at source, if applicable.

Management Discussion and Analysis:

The operations of the Company comprises of Engines and Engine Bearings and Valves. This business segmentation forms the basis for review of operational performance by the management.

A. Industry Overview:

During the year under review, the Indian economy, and specially the manufacturing sector experienced a slow down, and also pressures on selling prices. As your Company is in the business of manufacture and supply of intermediate products to the manufacturers of equipments and automobiles where growth was negative, which put pressure on price realisation in some sectors.

Analysis for both the segments - Engines and Engine Bearings and Valves is presented below.

B. Company Performance:

The Company achieved lower sale of Rs. 7,430 million (previous year Rs. 7,908 million) due to sluggish market conditions resulting in a drop in sales by 6 % over the previous year. The profit before tax is at Rs. 274 million (previous year Rs. 417 million) after providing for the depreciation of Rs. 278 million (previous year Rs. 290 *million*).

In spite of the lower sales, the Company could achieve these results due to good cost control and lower interest cost. In view of the accounting standard AS22, the Company has to provide for Rs. 86 million towards deferred tax liability.

C. Segment-wise Operational Performance:

Engines:

The engines upto 20 hp are used in the farm machinery, generating sets and construction machinery. In this range, the Company faces competition from several domestic players, and your Company's strategy is to expand market share by in-depth effective marketing activities in the potential villages, and offer products for each use while improving distribution network in depth and quality. The result in the year under review is – increase in sales of the Slow Speed Engines that were launched two years ago.

The total Indian market for engines up to 20 hp registered a drop of 5-7 % in Agriculture market, and 2-3% in Power Generation market. In spite of such drop in the market, your Company was able to maintain previous year's volume by effective marketing activities in Madhya Pradesh, Uttar Pradesh, Rajasthan and Bihar.

Engines in 20 to 300 hp range are predominantly sold for Agriculture (Farm tractors), Power generation, and Construction and Material Handling Equipment.

The Farm Tractor market registered a drop of 19% in the year under review. The reduction in the market size of two large states – Haryana and Uttar Pradesh was high at 23.8% and 35%. Moreover, the distribution chain of tractors continues to carry large stocks. In spite of such market conditions, the drop in sales was restricted to 17% due to superior market positioning of engines, and success of Company's OEM customer – Punjab Tractors.

Your Company has successfully embarked on development of new engines that specifically meet the requirements of the OE customers and end users of farm tractors. The engines developed by your Company not only surpass Indian emission norms, but are also certified for off road use in United States to Tier I norms. The engine designs are capable of Tier II certification in US as it becomes necessary after 2004. This initiative by the Company is now opening doors for Indian tractor manufacturers to explore worldwide markets.

The Power Generation market experienced a marginal increase in the year under review mainly due to demand from telecommunication sector. But, the demand from sectors like Information Technology and export oriented units was lower.

In the year under review, the competitive pressures have resulted in a drop of about 5% in sales in Power Generation market. To improve the competitive position, your Company has significantly up graded the engines. The up graded engines develop higher output while maintaining the earlier sizes and weights. For example, the 6SL9088 engine now gives output for 250 kVA genset by superior turbo charging and after-cooling, while the base engine was providing output of only 125 kVA. This has also enabled the Company to price the products competitively while maintaining the margins. The entire range of engines for the Power Generation market is now up graded, and customers have welcomed the new designs.

Your Company continued to consolidate its position in the 1600 hp to 7200 hp range for power generation. The reliability of the gensets has improved substantially due to design upgrades, and customer confidence is improving.

The Construction and Material Handling Equipment market has good potential in coming years. Specially, due to the infrastructure projects like Golden Quadrilateral Highways project. However, in the year under review the market was depressed. Thus, the sales to Construction and Material Handling Equipment market dipped by 6%. This sector is now showing signs of an up swing. But, it is necessary to watch closely whether the trend continues.

In the Construction and Material Handling Equipment market, your Company was successful in securing business on the strength of engineering capability for two more equipments – 7 Ton Excavators and Mechanical Pavers.

Your Company is an established supplier for decades of engines and engine based systems like generating sets to the Indian Armed Forces. In the year under review, your Company has received noteworthy orders for re-power of defence vehicles, and also for supply of engines for Indian Navy ships. Additionally, your company has been awarded a contract to study the feasibility of re-powering certain Naval ships.

Engine Bearings and Valves:

The depressed conditions in tractor and automobile sector in the year under review, and the increased life of the engines before first overhaul has adversely affected the engine bearings and valves market. The fall in the market was about 20%. Moreover, the pressures on prices have marginally reduced the realisation in the year under review.

In the adverse market conditions the sales of Bearings and Valves were at Rs. 726 million (previous year Rs. 796 million)

Specific gains were, increased supply to Maruti Udyog, Mahindra and Mahindra, and Tata Engineering and Locomotive Co. Ltd. (for Indica car). These customers have increased purchases from us due to superior service, near zero defects, and quicker product development. A new entrant to the car market - Fiat Palio – has started buying its entire requirement from your Company.

Cost Control:

Your Company believes that costs have to be continuously brought down. Towards this objective, several initiatives have started delivering results. Noteworthy amongst the cost control initiatives are – self empowered teams on manufacturing lines, sourcing and value engineering to reduce costs, improve logistics and single piece flow concepts to cut inventories, and all round efficiency improvement.

D. Exports:

Your Company exports engines upto 20 hp to Africa, Middle East, and Asian Region and has recently stepped up efforts to export engines and generating sets in 20 to 300 hp range as well.

Building stable long term exports requires good distribution and service network in the destination markets besides products of international standard. While Company's 20 to 300 hp range of engines are up graded to meet international market expectations, the building of distribution and service networks, and discussions with customers in the destined markets continues.

The efforts to increase exports of engine bearings, bushes and valves have resulted in a significant rise in sales. The focus for this product group is to increase the share of the purchases by present customers and develop new products targeted at precise needs of the foreign markets.

The exports amounted to Rs. 353 million (previous year Rs. 443 million). Though, the Company has not registered growth in exports, the determination to increase exports by systematic and ceaseless efforts continues.

E. Concerns and threats:

As in other industries, there are challenges due to lowering of the entry barriers to national markets, and the country joining the World Trade Organisation. The Company continues to prepare to face the challenge by technology up gradation, cost reduction, and improved distribution and service internationally and nationally.

In the year under review, the products have been improved to meet the customers' expectations and to comply with the regulatory emission standards.

F. Prospects for the current year:

The Agricultural machinery market, except for farm tractors, is showing few signs of buoyancy. Moreover, your Company has secured an order funded by the World Bank for 15,000 pump sets for Assam. This order will be executed in the current fiscal year.

The Power Generation market is also showing signs of buoyancy driven mainly by demand from telecom sector. Barring unforeseen developments, the Power Generation market, and Company's sales to this market will grow in the current year.

To ensure that quality end products – the "Kirloskar Green Power Ideas" gensets – reach the customers, in the 20 to 250 kVA range, the Company has started offering AC generators to the genset manufacturers, in addition to the supply of engines. This has also resulted in reduction in inventories of the genset manufacturers as they receive the engines and AC generators from one source – your Company.

The automobile and tractor manufacture in the country is expected to remain subdued. Thus, your Company does not anticipate significant changes in the sales of engine bearings and valves.

G. Internal Controls, System Improvements, and their adequacy:

The Company's operations are IT enabled for last few years by use of the world renowned Enterprise Resource Planning (ERP) system. In the year 2000, the entire Supply Chain from dealers to factories, to suppliers was internet enabled for on-line eCommerce transactions. These systems have adequate internal controls which are extensively used by your Company.

Additionally, in the year under review, auditing firms were appointed to conduct Internal Audit of the Strategic Business Units, Corporate Services, and Area Offices of the Company. The system weaknesses noticed during the audits have been attended.

Two noteworthy system and process improvements are as under:-

On-line functioning of Warehouses:

The warehouses have been brought on-line in the Company's ERP system. This has resulted in automating and improving several processes, and better audit trails of the transactions at warehouses.

Advance Shipping Notice from Suppliers:

The suppliers are now required to log-on via internet to the Company's on-line solution and provide information on the shipments. The information is validated on-line resulting in efficient process. The benefits of the process have been appreciated also by the suppliers.

H. Personnel and Human Resources:

The employee relations during the year under review were harmonious, and the productivity has improved in all areas.

302 employees took benefit of the Voluntary Retirement Scheme in the year.

I. Environment:

Your Company has to deal with the environmental issues on two fronts. One, the Company's products (that is, engines) are inherently polluting. Thus, research and technology upgradation to meet the stringent emission standards is necessary. The Company's products meet the emission standards up to 2004 in target markets. The research is nearly complete to meet the expected emission norms beyond 2004. Two, the Company's operations have to be non-polluting. The Company has in place TUV certified Environmental Management System to ISO-14001 since November 1999.

Subsidiary:

Kirloskar Kisan Equipment Limited (KKEL) is a wholly owned subsidiary of your Company. The operations of the subsidiary remained closed during the year under report.

Pursuant to Section 212 of the Companies Act, 1956, the audited accounts of KKEL are annexed to the Balance Sheet as at 31st March 2002. In addition, consolidated accounts are also annexed as required under the Listing Agreement with the Stock Exchanges.

Joint Venture activities:

Your Company had promoted an equal partnership joint venture company named Kirloskar Briggs & Stratton Power Equipment Limited [KBS]. The joint venture and technology partner was Briggs and Stratton International, Milwaukee, Wisconsin, USA. The main business of the joint venture was to manufacture Kerosene and Petrol generating sets and pump sets for domestic market.

The operations of KBS commenced from 1998. However, the subsequent developments like rupee depreciation against US Dollar, increase in customs duty and the changes in the Indian regulations concerning the Kerosene and Petrol generating sets made the business unviable. It was therefore decided to cease the operations of the company, and take KBS to voluntary liquidation after completing the necessary actions and complying with the applicable regulations. The operations at KBS were ceased with effect from June 2000. The Joint Venture agreement was terminated with effect from 31st December 2001.

The Company had also entered into a joint venture agreement with Mahle Filtersysteme GmbH (erstwhile Knecht Filterwerke GmbH) (MAHLE) and Kirloskar Mahle Filter Systems Pvt. Ltd. (as the confirming party) (KMFSPL). The Joint Venture was operating since then till date. With a view to reorganise the business activities, it was decided to terminate the Joint Venture Agreement. Accordingly, Termination Agreement (TA) was entered into with effect from 18th May 2002.Under the agreement, the Company will sell its shareholding in KMFSPL to MAHLE and the management of KMFSPL will rest with MAHLE.

Directors:

Dr. N. A. Kalyani, Dr. R. J. Rathi, Mr. Sanjay C. Kirloskar and Mr. A. N. Alawani, the Directors of the Company, retire by rotation at the ensuing Annual General Meeting. They are eligible for re-appointment.

Mr. U. V. Rao was appointed as an additional Director on the Board with effect from 6th May 2002. He holds office up to the date of the ensuing Annual General Meeting. He is eligible for appointment.

Mr. S. G. Chitnis resigned from the Board with effect from 1st July 2002. The ICICI Bank Ltd. has withdrawn its nominee Ms. Anupama Ranade from the Board with effect from 1st July 2002. The Board places on record its appreciation for their valuable services during their tenure.

The brief resume and other details relating to the Directors who are to be appointed/reappointed are furnished along with the explanatory statement to the notice convening the ensuing Annual General Meeting.

Directors' Responsibility Statement:

Pursuant to Section 217(2AA) of the Companies Act, 1956 the Directors state that:

In the preparation of the annual accounts, the applicable accounting standards had been followed along with the proper explanation relating to material departures;

The Directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the Company at the end of the financial year and of the profit or loss of the Company for that period;

The Directors had taken proper and sufficient care 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;

The Directors had prepared the annual accounts on a going concern basis.

Corporate Governance:

Your company conforms to the norms of Corporate Governance as envisaged in the Companies Act, 1956 and in the Listing Agreement with the Stock Exchanges. Necessary measures were taken during the year under report to implement the code of Corporate Governance. A report on the Corporate Governance, along with the certificate of compliance from the Auditors, forms a part of this report.

Auditors:

You are requested to appoint Auditors for the current year. The retiring Auditors, M/s. Dalal & Shah, Chartered Accountants, are eligible for re-appointment.

M/s P.G. Bhagwat, Chartered Accountants, the Branch Auditors appointed to audit the accounts maintained at the Company's branch at Solapur, would retire at the ensuing Annual General Meeting. They are eligible for re-appointment.

Statutory Disclosure:

The information relating to conservation of energy, technology absorption and foreign exchange earnings and outgo as required under section 217(1)(e) of the Companies Act, 1956 read with the rules thereunder is given in Annexure forming part of this report.

During the year under report there were no employees drawing remuneration in excess of the limits specified under section 217(2A) of the Companies Act, 1956.

Acknowledgement:

Your Directors would like to place on record their appreciation of the contribution made and support provided to the Company by the shareholders, employees, bankers, suppliers and customers during the period under report.

FOR AND ON BEHALF OF THE BOARD OF DIRECTORS

Pune
22 July 2002

ATUL C. KIRLOSKAR
Chairman and Managing Director

ANNEXURE
to the
Directors' Report to the Members for the year ended on 31st March, 2002 and forming part thereof

A. CONSERVATION OF ENERGY:

Energy conservation measures taken include:

— Recycling of treated effluent water for gardening.

— Provided energy savers to AC units and electronic ballast to tube lights.

Additional proposals include:

— Replacement of high watt lamps with low watt lamps for street illumination.

— Installation of energy savers to cooling towers.

— Testing of engines by energy saving method.

As a result of the various measures taken, the Company could save 1.5 lac units of electricity during the year.

B. TECHNOLOGY ABSORPTION:

(a) Research and Development (R & D):

(i) Specific areas in which R & D carried out by the Company:

— The activities of combustion, upgrading the present engines to meet the forthcoming emission norms and to improve kVA/liter, swept volume, development of new engine designs to meet international quality levels, were continued during the year under report also.

— Activity to develop engines to work on alternate fuels like CNG, Ethyl/ Methyl alcohol.

(ii) Benefits derived as a result of the above R & D:

— Engines meeting forthcoming emission norms have given an edge over the competition.

— This has brought new demands from tractor OEMs who are interested in export of tractors.

— Upgradation of existing engines has improved the cost effectiveness.

(iii) Future plan of action:

— The focus will be to design engines for tractor application for specific customer requirement.

— Develop engines for RTV and LCV.

— Upgrading the existing engines for compliance with CPCB emission norms.

— Development of engines for specific OE customer application.