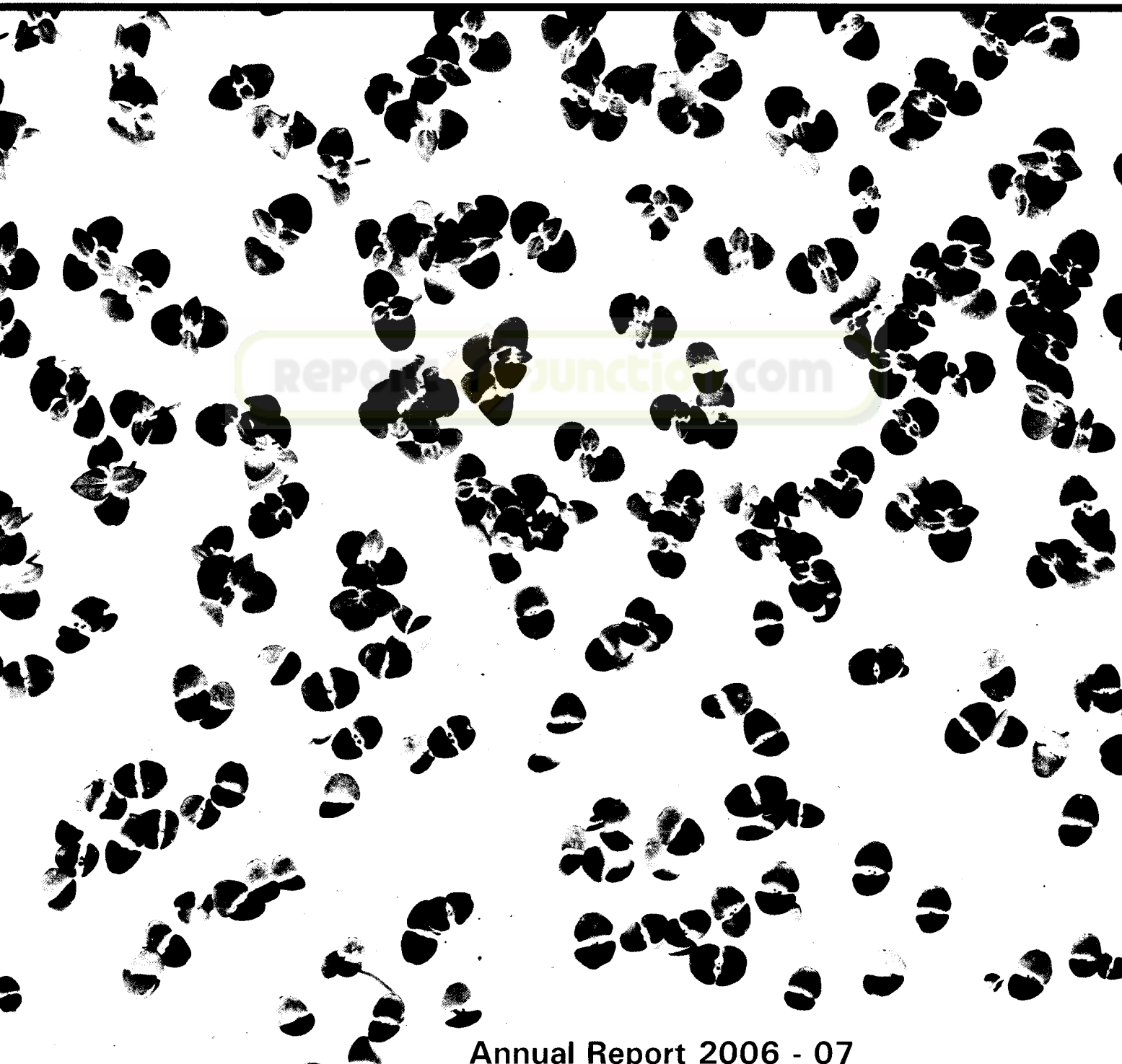




KIRLOSKAR OIL ENGINES LIMITED

Enriching Lives



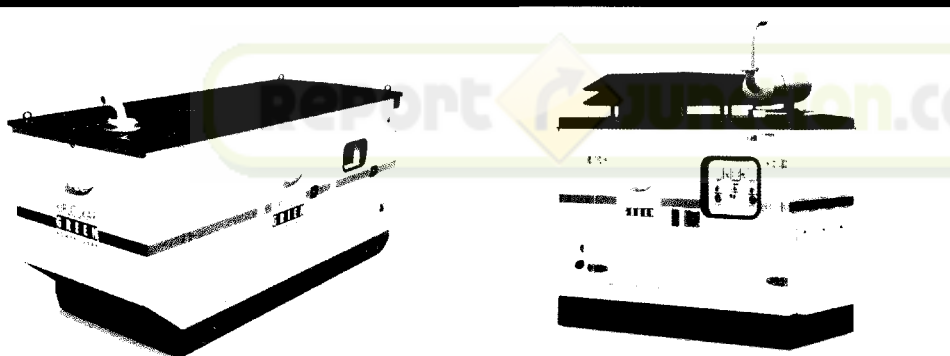
Annual Report 2006 - 07

growth in harmony with the environment

Committed to the environment

While we meet our energy needs for today, we must not turn off the tap for tomorrow's generation. At Kirloskar we believe in responsible industry leadership, creating profitable growth in harmony with the environment.

Our Green Technologies Cell has taken on the challenge of developing engines that run on alternative fuels that are renewable. Our mission is to ensure that there is renewable, reliable and affordable energy for all.



Gensets that run on bio diesel /vegetable oils and natural /petroleum/ sewage gases



As a company in the business of power solutions, at KOEL we have framed our strategic response to global environment concerns. We are developing engines which can run on a variety of fuels like blends of vegetable oil and diesel, straight vegetable oils, and natural, petroleum or sewage gases. We have also invested in wind energy to generate green power for our captive use. We shall create better value for our stakeholders by aligning our products and processes towards the goals of sustainable power solutions.

KIRLOSKAR OIL ENGINES LIMITEDAnnual Report
2006-07
**Annual Report for the
financial year ended on 31 March 2007**
Board of Directors

Mr. Atul C. Kirloskar	Chairman & Managing Director
Mr. Sanjay C. Kirloskar	Vice Chairman
Mr. Gautam A. Kulkarni	Joint Managing Director
Mr. Rahul C. Kirloskar	Director (Exports)
Mr. D.R. Swar	Director (Corporate Services) [ceased w.e.f. 19 April 2007]
Mr. R. R. Deshpande	Director (Operations)
Mr. Vikram S. Kirloskar	
Mr. U.V. Rao	
Mr. H.M. Kothari	
Dr. N.A. Kalyani	
Mr. P.G. Pawar	
Mr. V.K. Bajhal	
Mr. R. Srinivasan	
Air Marshal Y.V. Malse (Retd.)	[ceased w.e.f. 15 May 2006]
Dr. Naushad Forbes	[appointed w.e.f. 22 July 2006]

Chief Financial Officer

Mr. Sanjay Parande

Company Secretary

Ms. Aditi Chirmule

AUDITORS

M/s Dalal & Shah, Chartered Accountants

BANKERS

State Bank of India
Bank of Maharashtra
HDFC Bank Ltd.
The Cosmos Co-operative Bank Ltd.
ICICI Bank Ltd.

Registrars & Transfer Agents**Intime Spectrum Registry Limited****Mumbai Office**

C-13, Pannalal Silk Mills Compound,
Lal Bahadur Shastri Marg,
Bhandup (West), Mumbai 400 078

Pune Office

Block No. 202, 2nd Floor,
Akshay Complex, Near Ganesh Temple,
Off Dhole Patil Road, Pune 411 001

REGISTERED OFFICE

Laxmanrao Kirloskar Road, Khadki, Pune - 411 003

LOCATION OF FACTORIES

Pune, Ahmednagar, Nasik, Solapur, Hospet & Kagal (proposed)

Information for shareholders

Annual General Meeting	
Date	: Thursday, 19 July 2007
Time	: 11.00 A.M.
Venue	: Hotel Le Meridien RBM Road, Pune - 411001
Proposed Dividend	: 100% (Rs. 2 per share of Rs. 2 each) [This is in addition to 100% (Rs. 2 per share of Rs. 2 each) paid as Interim Dividend]
Dates of Book Closure	: 7 July 2007 to 19 July 2007 (Both days inclusive)

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DECADE AT A GLANCE

(Rupees in Millions)

Sr No	Particulars	2006-07	2005-06	2004-05	2003-04	2002-03	2001-02	2000-01	1999-00	1998-99	1997- 98
1	Net Sales	18,830	13,953	11,486	10,025	8,639	7,430	7,908	7,284	7,031	6,143
2	Profit Before Tax	2,395	2,460	2,013	1,056	383	274	417	891	159	1,717
3	Profit After Tax	1,784	2,006	1,739	708	415	186	413	820	158	1,496
4	Dividend Amount	388	388	243	194	97	67	67	67	67	61
5	Dividend (%)	200	200	125	100	50	35	35	35	35	35
6	Earning Per Share (Rs)*	18	21	18	7	4	2	4	9	2	16
7	Book Value Per Share (Rs)*	88	74	58	43	38	38	37	38	31	37
8	Share Capital	194	194	194	194	194	192	192	192	192	190
9	Reserves and Surplus	8,319	6,990	5,427	3,963	3,476	3,445	3,316	3,473	2,728	3,286
10	Shareholders' Funds	8,513	7,184	5,621	4,157	3,670	3,637	3,508	3,665	2,920	3,476
11	Loan Funds	1,063	670	517	297	370	1,082	1,154	1,651	2,539	3,083
12	Total Capital Employed	9,577	7,854	6,138	4,454	4,040	4,719	4,662	5,316	5,459	6,559
13	Gross Block	5,305	4,834	4,215	3,864	3,902	3,716	3,610	3,503	3,291	2,557
14	Net Block	3,322	1,922	1,447	1,295	1,414	1,392	1,538	1,655	1,731	1,519
15	Net Current Assets	1,245	1,030	974	1,195	914	1,281	1,236	2,023	1,995	3,614

* The equity share of Rs. 10 each was sub-divided into 5 equity shares of Rs. 2 each w.e.f. 18 August 2005. Previous years' figures have been reworked to make them comparable.

KIRLOSKAR OIL ENGINES LIMITEDAnnual Report
2006-07**Directors' Report**

To the Members,

The Directors have pleasure in presenting this Report with audited annual accounts of the Company for the year ended 31 March 2007.

Financial Performance

	2006-2007	(Rupees in 000's) 2005-2006
Total Income	19,824,279	14,712,073
Total Expenditure	17,653,450	13,227,319
Profit before exceptional items & taxation	2,170,829	1,484,754
Profit / (Loss) on sale of investments	190,899	974,941
Profit / (Loss) on sale of undertaking	33,292	-
Profit before taxation	2,395,020	2,459,695
Provision for tax (including Deferred Tax)	610,930	453,821
Net Profit	1,784,090	2,005,874
Surplus (After other adjustments)	2,942,949	3,607,437

Appropriations

Your Directors propose to appropriate the available surplus as follows:

	(Rupees in 000's)
Proposed Dividend	194,173
Interim Dividend	194,173
Corporate Tax on dividend	60,233
Transfer to General Reserve	1,000,000
Balance carried to Balance Sheet	1,494,370

Dividend

In addition to the Interim Dividend of 100% (Rs. 2 per share) paid in February 2007, the Directors recommend a final dividend of 100% (Rs. 2 per share) for the year, totalling to yearly dividend of 200% (Rs. 2 per share) (*previous year dividend 200%*).

Management Discussion and Analysis

The operations of your Company comprise of Engines and Auto Components. This business segmentation forms the basis for review of operational performance.

Industry Overview

During the year under review, the growth in the Indian economy continued. Some sectors like services and construction grew more than the average economic growth. As a result, the capital goods sector continued to grow steadily.

The Central and State Governments continued to give priority to agriculture, road construction, housing and other infrastructure development. The effect of such investments was noticeable in the economy.

This vibrant economic scenario generated good demand for power. As supply from the grid was inadequate and with frequent interruptions, users were required to rely on standby power from generating sets. The rising living standard in semi-urban and rural areas is also resulting in demand for generating sets. The telecom industry's need for power increased remarkably and the industry will continue to require standby generating sets. The demand for construction and material handling machinery and automobile components will also continue to be robust.

The demand for irrigation pumpsets was stagnant in last two years. However, the year under review saw the demand grow by 12%. The portable and compact pumpsets at affordable prices are driving the growth of the sector. New product development targeted at this growing segment is nearly complete and launch of these new products is scheduled in near future.

The revised emission and noise regulation issued by Ministry of Shipping, Road Transport and Highways concerning diesel engine driven Construction Equipment Vehicles is scheduled to come in effect starting 1 October 2007. The industry is required to complete the development of engines and obtain certification for its products by conducting tests of engines as fitted on Construction Equipment Vehicles.

The overall demand from all sectors of economy in which your Company operates, continues to grow robustly. However, one needs to be watchful of the impact of the rising interest rates.

Company Performance

During the year under review your Company achieved sales of Rs. 18,830 Million (*Rs. 13,953 million*) resulting in increase in sales by 35% over the previous year.

The profit before tax is Rs. 2,395 million (*Rs. 2,460 million*) after providing for depreciation of Rs. 318 million (*Rs. 280 million*).

Analysis for both segments, Engines and Auto Components is presented below.

Segment-wise Operational Performance

Engines

The sales of engines registered an increase of 45 % at Rs. 16,500 million in the year under review (*Rs. 11,412 million*), crossing the Rs. 15 billion mark for the first time.

In the agricultural sector, the engines are used in the farm machinery and farm tractors. In the lower end of the range, there is competition from domestic players and from Chinese imports, while in the upper end of the range, the Company faces competition from the domestic players. Your Company continues to expand its market share by in-depth and effective marketing activities in the potential villages, and offer products for each user segment while improving distribution network in depth, as well as quality and service. Your Company's sales grew in line with the market at 12%.

Your Company introduced two new engines and pumpsets in this market. These were very successful and captured share of 19% in the very first year of the market introduction.

Affordable, compact and portable pumpsets drive the growth in this market. Thus, two years ago your Company had started the design of less material intensive products to meet the price levels desired by farmers. These products are being tested in field for market launch in near future.

The Farm Tractor market grew by 8% in the year under review. However, the market share of your Company's principal customer, Punjab Tractors Ltd., stagnated. As the supply of engines to other tractor manufacturers has also started in previous year, sales to this segment are expected to grow in coming years.

Your Company is the leading player in the Power Generation segment with the widest range in the industry - 3 to 6300 kVA. The growing economy is pushing up the demand for power but the grid is already starved of power. Thus, there is growing dependence on standby power from Diesel Generating Sets. As a result, the Power Generation market experienced high growth in the year under review mainly due to demand from manufacturing, telecommunication, retail, Information Technology Enabled Services (ITES), and services sector, resulting in an increase in sales to the power generation segment by over 66% as compared to the previous year.

The "Kirloskar Green" brand under which gensets are marketed continues to be the most preferred brand in India, and is also selling in selected countries. In the year under review, the Company introduced "Kirloskar Green" generating sets in 3 potential countries. The exports of generating sets also grew in the year under review.



Due to its intense marketing and sales efforts, your Company sold 7 generating sets in 1600 to 6300 kVA range in the year under review, and the Company has a healthy order board for these.

The engines are also used for industrial and construction machinery. The Directors assess that the manufacture of the Construction and Material Handling Equipment has good growth prospects in the country. The exports of these equipments by OEM customers have also started. In the year under review, there was robust demand from this sector. While the market grew by about 40%, your Company's sales to this sector grew by 52%.

Your Company is an established supplier to the Indian Armed Forces for decades and the sales to the Armed Forces continue to register steady increase.

The engines in the output range 2400 to 11000 hp are sold for marine propulsion and marine power generation applications in addition to land based power-generating sets in 1600 to 6300 kVA. Your Company has healthy order board from marine sector as a result of the order worth Rs. 2,500 million received in the year under review. This order is to be executed in 3 years.

Your Company manufactured for the first time, a 20 cylinder, model PA6STC engine for Offshore Vessel of Indian Coast Guard. The engine delivers 11,000 hp and the first ship set consisting of 2 engines was delivered to the shipyard ahead of schedule.

Another engine model manufactured with the latest technology, 12 cylinder, model PA6STC was successfully tested in presence of representatives of Indian Navy, Garden Reach Shipbuilders and Engineers, Kolkatta and DCN, France. This is the first of the 16 engines on order, and stringent tests included recording of structure borne and air borne noise at various power outputs and speeds.

A significant breakthrough was achieved by your Company in securing orders for standby diesel generating sets for Nuclear Power Plants being installed by Nuclear Power Corporation Ltd. This breakthrough is expected to provide growing business in coming years due to the Nuclear Power programme of the Government of India.

The implementation of the world class Customer Relationship Management (CRM) solution at Service Dealers and field service personnel has now reached large percentage of Indian population of the engines. The CRM has started resulting in increased satisfaction of customers with your Company's products and services, which in turn will lead to sustainable long-term market leadership.

Coupled with the CRM initiative, your Company made specific efforts to improve spare parts availability and also took focussed programmes to improve service network and customer contact. Due to these efforts, the sales on engine spare parts grew by 28% as compared to the previous year.

Auto Components

The buoyant automobile market, especially commercial vehicle and car markets, grew robustly in the year under review. However, the "after-market" continues to stagnate. Thus, your Company's sales to OEM market increased by 37% as compared to industry growth of 15% and sales to "after-market" reduced due to reduced overhauling activity of heavy and light commercial vehicles. The overall growth in sales was 17% at Rs. 1,292 million over the previous year (Rs. 1,103 million).

It is noteworthy that seven leading Automotive OEM customers have increased purchases from your Company due to superior service, near zero defects, and quicker product development. Additionally, your Company has secured orders for four new vehicles.

The sales of engine valves registered a growth of 17% in the year under review. Three new OEM customers were also secured in the year.

Other Businesses

Your Company is also in the business of trading in oil and power generation and was in the business of manufacture of grey iron castings for part of the year under review.

The oil trading business caters to engine and furnace users who require fuel oil and also lubricants. The volatile oil prices in the year impacted this business, and it registered a decrease of 9% in the year under review.

The casting business is in need of new technology and has synergy with the business of Kirloskar Ferrous Industries Ltd. Thus, effective 1 January 2007, your Company exited gray iron casting business by selling it to Kirloskar Ferrous Industries Ltd. for a consideration in cash of Rs. 210 million.

The Power business is being de-emphasized for last few years, as it is not viable.

Investments in Engines Segment

On 26 March 2007, your Company executed a Memorandum of Understanding with Government of Maharashtra to set up an engine manufacturing plant and Export Oriented Unit (EoU) for generating sets at MIDC Kagal in Kolhapur district. The capacity of the plants will be 100,000 engines and 12,000 generating sets per year. This capacity addition to the engine manufacturing capacity of 80,000 engines per year at Khadki, Pune will result in total capacity to manufacture 180,000 engines in 20 to 720 hp range. Your Company expects to fully utilise the engine and generating set manufacturing capacity in 3 to 4 years.

The total investment of Rs. 5,500 million at Kagal is funded from internal accruals and debt.

Research and Engineering

Your Company keeps the engines up to the mark by meeting emission norms required for domestic and export markets. Starting January 2007, new emission norms are applicable for the power generation engines in Europe. Your Company has successfully upgraded select families of engines to the required emission standards and will continue to export to Europe.

The revised emission and noise regulation by Ministry of Shipping, Road Transport and Highways concerning diesel engine driven Construction Equipment Vehicles is scheduled to come in effect starting 1 October 2007. Your Company is well prepared to obtain the required certification in time.

To meet requirements of new high performance diesel engines and 'lead free' legislative norms coming up in different parts of world, new bearing materials are to be developed. The required infrastructure for development of such materials is being put in place and will be operational soon.

You will be happy to know that your Company has been selected as design partner for a new engine valve development initiated by one of the big three automobile manufacturers in the world. This partnership starts from engine's conceptual design stage.

Formation of Green Technologies Cell

In 1998, your Company spelt out its Environmental Policy that stated, "We at KOEL, Pune, manufacturers of diesel engines and auto components, are committed to protect World environment through our products and processes". Today, your Company uses solar hot water systems and makes use of biogas generated from its canteen waste. In December 2006, your Company's 5.6 MW wind machines have also come online. To carry out actions based on its policy in focused manner, and to provide additional thrust to its "environmental business", your Company has set up the Green Technologies Cell (GTC). GTC will focus on biomass-based energy, use of bio-fuels in engines, solar power, wind energy and other appropriate sustainable technologies to provide decentralized energy solutions.

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 up-gradation is necessary to meet the stringent emission standards. Your Company's products already meet the emission standards in target markets in India and abroad. With the investment in the emission centre, and development of in-house capability, your Company is poised to keep developing products to meet future standards.



Two, your Company believes that operations have to exceed the regulatory norms concerning pollution. Towards this objective, your Company has in place, TUV certified Environmental Management System to ISO-14001 since November 1999.

Amongst others, the following are some noteworthy initiatives taken to conserve energy during the year under review.

- Installation of synchronised invertors to use power generated during generating set testing in factory.
- Installation of 5.6 MW of Wind Energy generators.

The above-mentioned projects resulted in saving of 1.2 million kWh energy during the year under review. The Wind Energy generators contributed 1 million kWh energy to the grid, in the year under review.

Your Company is committed to conserving energy in all its operations, and several projects are now conceptualised and are in implementation.

Processes

The Company embarked on a project to re-engineer two important processes, Order Fulfillment and New Product Development. An external consultant was engaged for this project, and Company's selected managers were committed full time. The progress is satisfactory, and your Company intends to start implementing the re-engineered processes in the current year.

Personnel and Human Resource

With an objective to enhance the quality of human resources in the organisation, a special endeavour in this direction was the Leadership Development Program for your Company's identified talent in the senior management cadre. The talent pool is undergoing a series of development programme specially designed for the group. A special feature of the design is the Management Development Programme, which has been customized in partnership with a leading B-school in Mumbai. It has been developed to empower each participant with enhanced contemporary management and business practices that will eventually meet the futuristic demands of the organisation. It will also enable the participants to step higher on to the corporate ladder.

A similar developmental initiative has also been extended to talent pool down the line. An identified group was put through the development centre. They will also be developed to meet the future needs of the organization.

With a view to attract and retain talent, the Compensation Structure of the managers was restructured to bring it at par with that of the market. This was based on the findings of the Compensation survey report submitted by Mercer Consulting.

The employee engagement survey for managers was conducted to understand the pulse of the organization. The survey findings were shared with all the managers and initiative undertaken to improve the employee engagement level. A major initiative in this direction has been the implementation of Work Planning and Review process. The process aims at perpetual measurement and appraisal of the performance of the people and improving the communication and relationship among the working teams.

Your Company continues to cultivate healthy and harmonious Industrial Relations during the year. A unique initiative in this area is the process of institutionalisation of Industrial Relations in order to maintain continuity in the philosophy of the Workers' Union. The Union evolved its values and these were launched on 23 April 2006, at the hands of Justice D. G. Karnik of the Mumbai High Court in the presence of Hon'ble Deputy Chief Minister of Maharashtra, Mr. R. R. Patil. The values are adopted by all Team Members of your Company.

Your Company continues to enjoy healthy and productive relationship with employees. For the fifth successive time, the Union and your Company executed a wage agreement on 31 March 2007, prior to the expiry of the previous agreement. As a result of the wage agreement, there will be an increase in the employee expenses. However, with increased sales and improved productivity, we expect the employee related expenses to reduce as a ratio of sales in coming years. The total number of employees as on 31 March 2007 is 2,858.

Corporate Social Responsibility

In the year under review, your Company has contributed to various social causes to the extent of approximately Rs. 6.2 million.

Your Company continues the following initiatives:

- Free Health and Yoga awareness campaigns and free health check-ups organised for the nearby communities
- Free Spectacle Distribution done for the nearby communities
- Free Computer Literacy Programmes conducted for woman and children from the nearby communities
- Tree plantation drive conducted in nearby schools
- Awards given to meritorious students from nearby schools
- Environment awareness camps and free PUC camps conducted for students in nearby colleges
- Save the Girl Child campaign organised
- Free raincoats distributed in nearby communities
- Study visits organised for school children and women group from the nearby communities
- Workshops on self-employment and creation of self help groups, organised for women from nearby communities
- Public Newspaper stand created for nearby communities
- Conducting Cricket Matches in surrounding communities

Cost Control

Your Company believes that costs have to be continuously brought down while improving product performance. Towards this objective, several initiatives started in previous years have delivered results in the year under review. However, due to competitive pressures, the full impact of increased cost was not passed on the market. Thus, the raw material consumption increased as a percentage to sales during the year under review.

There is continued emphasis on reducing costs, and one such initiative is reduction in use of power used in manufacturing processes. Significant savings of power was achieved in the year under review.

Your Company has formed a focussed cell of empowered managers to work on Value Addition and Value Engineering (VA/VE) projects. This initiative has started giving results.

Exports

In the year under review, there was growth of 8% at Rs. 1,390 million (*Rs. 1,286 million*) in exports of your Company. The dip in export growth was due to certain Institutional Orders not materialising in time. Your Company believes that growth momentum in exports established by the Cumulated Annual Growth Rate (CAGR) of 32% over last 3 years will continue.

While the Institutional Orders were delayed, your Company's initiative to increase exports by developing OEM customers continues and the growth in sales to OEM customers was 88% in the year under review over the previous year. In the coming years, sales to OEMs will form a larger share of exports.

The sales through distributors in the traditional markets of your Company grew by 8% in the year under review as compared to the previous year.

Your Company sees good opportunities for growth in sales of Kirloskar GREEN branded generating sets. These products are now selling in 42 countries. Telecom segment is one of the targets of your Company to sell generating sets. The sales have already started to customers in South East Asia, Africa and the Indian Sub-Continent. An Export Oriented Unit (EoU) with capacity to manufacture 12,000 generating sets per year is being set up to cater to the growing sales.

While sale of engines to OEM Customers and sales of generating sets increase, the essential and time-consuming activity of creating after - sales service network in chosen overseas markets continues. In the year under review, your Company strengthened its presence in South Africa, Saudi Arabia, Iran, Nigeria and United Arab Emirates.

The Auto component business recorded a growth of 40% over the previous year and increased its presence in the after market segment in Middle East Asia and Europe.