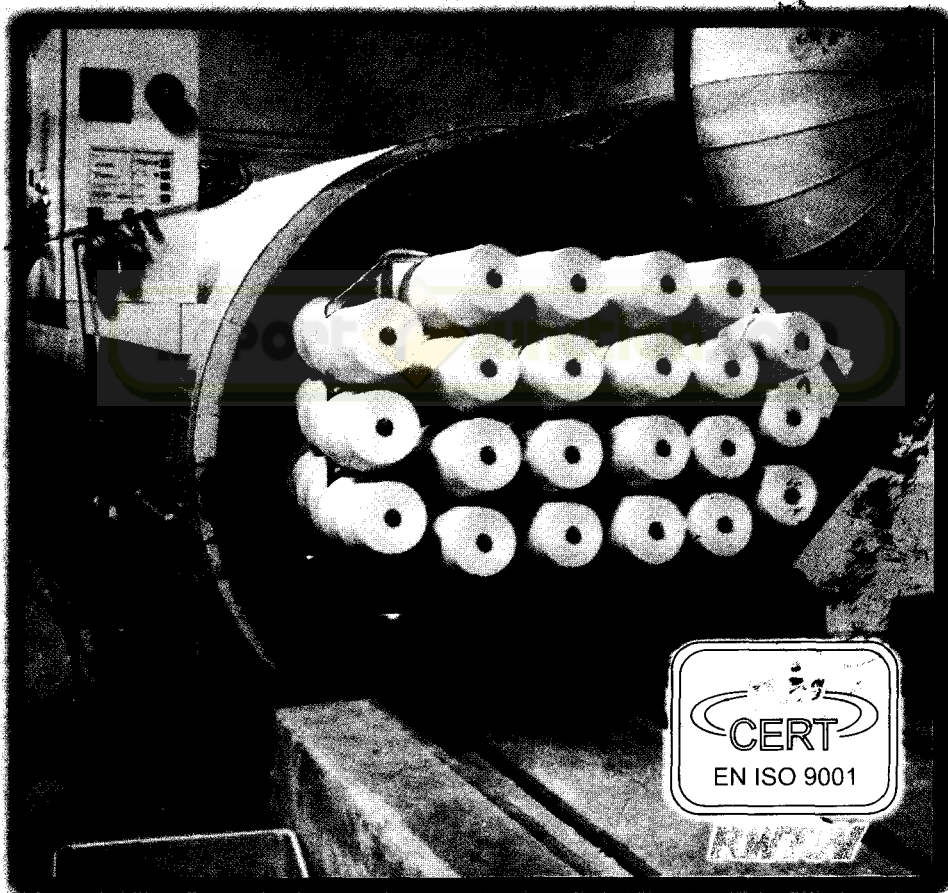


ANNUAL REPORT

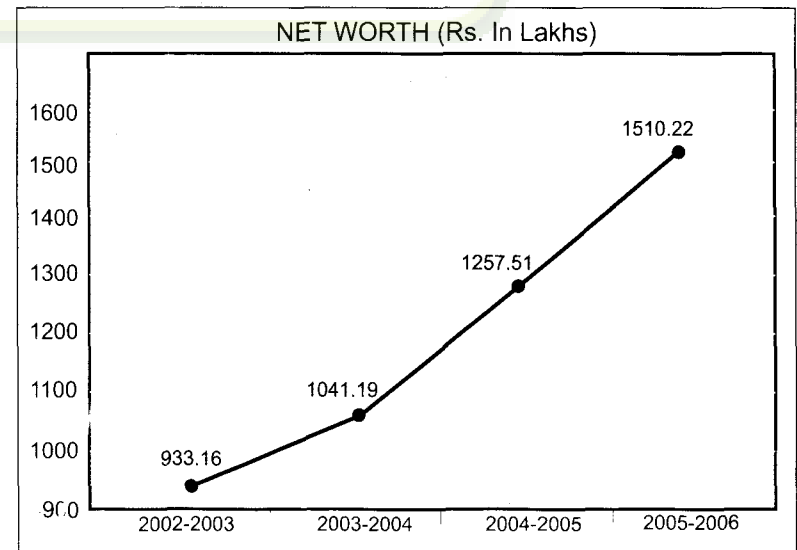
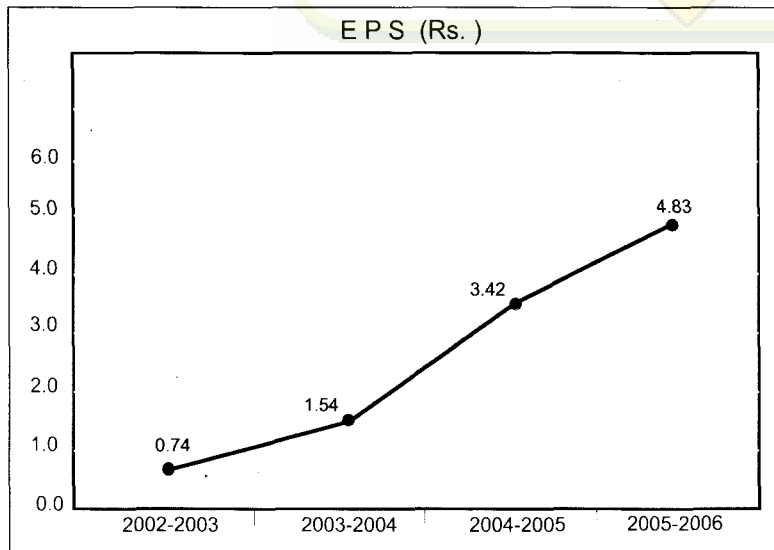
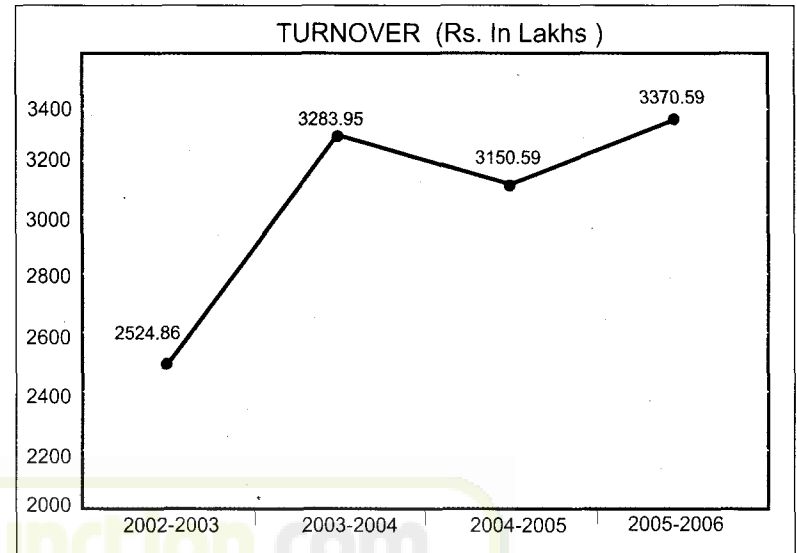
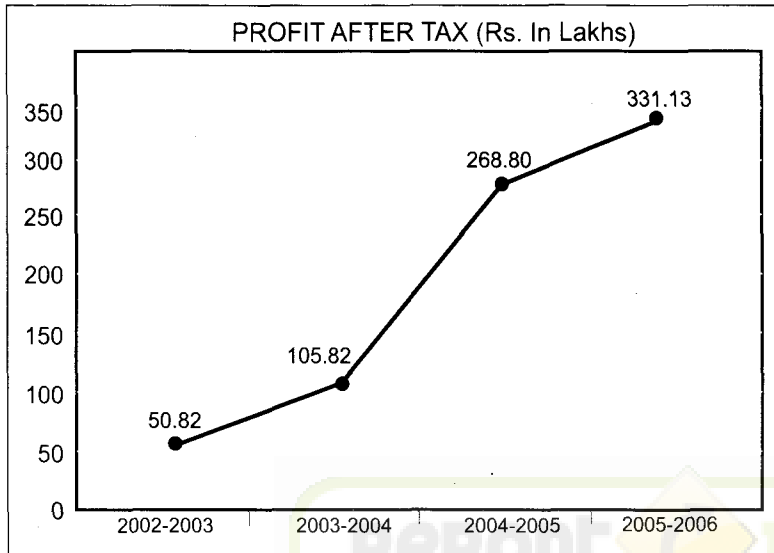
2005 - 2006



KALLAM SPINNING MILLS LIMITED

NH 5, CHOWDAVARAM, GUNTUR. AP - 522 019

Performance at a Glance



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KALLAM SPINNING MILLS LTD.

COMPANY INFORMATION

BOARD OF DIRECTORS

Sri K. Haranadha Reddy, Chairman
Sri P. Venkateswara Reddy, Managing Director
Sri G.V. Krishna Reddy, Joint Managing Director
Sri M.V.Subba Reddy, Whole Time Director
Sri M.R.Naik, Director
Sri N. Prabhakara Rao, Director
Sri V.S.N. Murthy, Nominee Director of IREDA
Sri A. Krishna Murthy, Director

LISTED WITH

The Stock Exchange, Mumbai
The Hyderabad Stock Exchange Ltd.,

BANKERS

Andhra Bank
Main Branch, Kothapet
Guntur - 522 001.

AUDITORS

M/s. BRAHMAYYA & CO.,
Chartered Accountants,
10-3-21, Sambasivapet,
Guntur - 522 001.

COST AUDITORS

P. Srinivas,
Off.: # 1-1-180/18, Dharani Andalu Complex
Room No.: 4, 1st Floor, Opp Sudershan,
35mm Gate, Jawahar Nagar, RTC 'X' Road,
Hyderabad - 500 020

REGISTERED OFFICE & FACTORY

N.H.5, Chowdavaram.
Guntur - 522 019.
Phones: 2512004, 2512005, 2512006.
Fax : 0863 - 2512001
E-mail : kallamsp@sancharnet.in

**REGISTRARS &
SHARE TRANSFER AGENTS**

BIGSHARE SERVICES PVT. LTD.,
G-10, Left Wing, Amruthaville,
Opp. Yasodha Hospital, Rajbhavan Road,
Somajiguda, HYDERABAD - 500082.
Ph.: 040 - 23374967, Fax : 040-23370295.

KALLAM SPINNING MILLS LTD.**NOTICE TO SHAREHOLDERS**

NOTICE is hereby given that the Fourteenth Annual General Meeting of the Members of **KALLAM SPINNING MILLS LIMITED** will be held on Monday the 25th day of September, 2006 at 3.00 P.M. at the Registered Office of the Company at NH-5, Chowdavaram, Guntur 522 019 to transact the following business.

Ordinary Business

1. To receive, consider and adopt the Profit and Loss Account for the financial year ended March, 31 2006 and the Balance Sheet as at that date together with the reports of the Board of Directors and Auditors.
2. To declare dividend on Equity Shares.
3. To appoint a Director in place of Sri M.R. Naik, who retires by rotation and being eligible, offers himself for re-appointment.
4. To appoint a Director in place of Sri M.V.Subba Reddy, who retires by rotation and being eligible, offers himself for re-appointment.
5. To re-appoint M/s. Brahmayya & Co., a firm of Chartered Accountants, as Statutory Auditors of the Company, for the period commencing from conclusion of this meeting till the conclusion of the next Annual General Meeting on such remuneration as may be fixed by the board of Directors plus out of pocket expenses.

Place: Chowdavaram
Date: 26th June, 2006

By order of the Board of Directors
P. Venkateswara Reddy
Managing Director

NOTES:

1. A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend, and vote on a poll, instead of himself / herself and such proxy need not be Member. The proxy form is enclosed which should be deposited at the Registered Office of the Company duly completed and signed, not later than 48 hours before the commencement of the Meeting.
2. An explanatory statement pursuant to Section 173 of the Companies Act, 1956 in respect of item no. 4 & 5 of the notice as set out above is annexed herewith.
3. The Register of Members and Share Transfer Books of the Company will remain closed from 21st September 2006 to 25th September 2006 (both days inclusive).
4. The accounts, the reports and all other documents required under the law to be annexed thereto will be available for inspection during working hours at the Registered Office of the Company on any working day prior to the date of the Annual General Meeting.
5. Dividend recommended by Directors, if approved by the Members at the Annual General Meeting, will be paid on or after 1st October 2006 to those members whose names appear on the Register of Members as on 25th September 2006. In respect of shares held in electronic form, the dividend will be payable on the basis of beneficial ownership as at the close of 21st September 2006 as per the details furnished by National Securities Depository Limited / Central Depository Service (India) Limited for the purpose as on that date.
6. Members desiring to seek any information on the Annual Accounts to be explained at the meeting are requested to send their queries in writing to the Company at the Registered Office so as to reach at least 7 days before the date of the meeting to make the required information.

KALLAM SPINNING MILLS LTD.

7. Members holding shares in physical form are requested to notify / send the following to the Company's Registrar and Transfer Agent at : Bigshare Services Private Limited, G-10, Left Wing, Amruthaville, Opp. Yashoda Hospital, Rajbhavan Road, Somajiguda, HYDERABAD - 500 082 at the earliest not later than 21st September 2006.

- any change in their address / mandate / Bank details; and
- Particular of their Bank Account, in case the same has not been sent earlier.

Members holding shares in the electronic form are advised to inform change in address / bank mandate directly to their respective Depository Participants. The address / bank mandate as furnished to the Company by the receptive Depositories viz., NSDL and CDSL will be printed on the dividend warrant.

**INFORMATION UNDER CLAUSE 49 OF THE LISTING AGREEMENT
REGARDING RE-APPOINTMENT OF DIRECTORS**

Item No. 3

Sri M.R. Naik, aged about 67 years, is retired IAS Officer. He served the community in various capacities in Central and State Government Organizations. He also served as a member in the consumer forums constituted by the Government of Andhra Pradesh. His knowledge and experience will be of great help to the Management in complying with various governmental and other institutional rules Procedures and regulations.

Sri M.R.Naik is not a Director or Member on any other company's Board / Committees. He is a members of Audit Committee and shareholders grievances committee constituted by the Company.

Item No.4.

Sri M.V. Subba Reddy is a Post Graduate in Commerce. He is associated with the company since its inception and was on the Board for the last 8 years. He has rich experience in purchase of Cotton and selling of the products. His knowledge and experience in field of Cotton will be of great help to the Company for procuring the quality of Cotton.

Sri M.V. Subba Reddy is not a Director or Member on any other company's Board / Committees. He is a member of share transfer committee constituted by the Company.

By order of the Board of Directors

P. Venkateswara Reddy
Managing Director

Place: Chowdavaram
Date: 26th June, 2006

DIRECTORS' REPORT**TO THE MEMBERS OF THE KALLAM SPINNING MILLS LIMITED,**

Your directors have pleasure in presenting the Fourteenth Annual Report of the Company together with the Audited statements of accounts for the year ended 31st March 2006.

I. FINANCIAL RESULTS:

The financial results for the year ended 31st March 2006 are summarized below:

| S.No. | Particulars | 2005-2006 (Rs.in lacs) | 2004-2005 (Rs. in lacs) |
|-------|--|---------------------------|----------------------------|
| 01 | Sales | 3370.59 | 3150.59 |
| 02 | Other income | 38.87 | 44.20 |
| 03 | Expenditure | 2568.25 | 2435.67 |
| 04 | Profit before Interest, Depreciation & Tax | 841.21 | 759.12 |
| 05 | Depreciation | 184.77 | 176.22 |
| 06 | Interest | 209.77 | 240.65 |
| 07 | Profit before tax | 446.67 | 342.25 |
| 08 | Provision for income tax | | |
| | i) Current Year Tax | 53.70 | 29.00 |
| | ii) Deferred Tax | 61.84 | 45.31 |
| 09 | Profit after tax | 331.13 | 267.94 |
| 10 | Earning per share | 4.83 | 3.92 |

KALLAM SPINNING MILLS LTD.

Transfers & appropriation from the profit are as detailed below:

| | | | |
|----|---|--------|--------|
| 11 | Profit After Tax | 331.13 | 267.94 |
| 12 | Excess provision made for Income Tax in earlier years | 0.00 | 0.86 |
| 13 | Balance brought forward from previous Year | 553.85 | 339.74 |
| 14 | Profit for appropriations | 884.98 | 608.54 |

Appropriations

| | | | |
|----|---------------------------------|--------|--------|
| 15 | Proposed Equity Dividend | 68.51 | 47.96 |
| 16 | Tax on Proposed Equity Dividend | 9.61 | 6.73 |
| 17 | Balance carried forward | 806.86 | 553.85 |
| | Total | 884.98 | 608.54 |

The sales of the Company for the period under review increase to Rs. 3,370.59 Lakhs as compared to Rs. 3,150.59, registering a growth of 7 percent on annualized basis. The Profit before interest and taxes of the Company has grown by 11 percent on annualized basis from Rs. 759.12 lakhs in previous year to Rs. 841.21 lakhs in the period under review. However, the Net Profit margin was increased by 23 percent on annualized basis to Rs. 331.13 lakhs from Rs. 267.94 lakhs.

The paid up capital of your company remained unchanged at Rs. 685.11 lakhs. Earning per share was Rs. 4.83 and Cash Earning per share was Rs. 7.50.

II. DIVIDEND :

In view of the Company's profitable performance, your Directors are pleased to recommend for approval of the shareholders a Final Dividend of Rs. 1.00 per share on 68,51,100 equity shares of the Company in respect of the financial year 2005 - 2006. The Final dividend, if declared as above, would involve an outflow of Rs. 68.51 Lakhs towards dividend and Rs. 9.61 lakhs towards dividend tax, resulting in a total outflow of Rs. 78.12 lakhs.

III. EXPANSION & MODERNISATION :

During the period under review, Your Company has added 2208 spindles out of the 11040 spindles under the expansion programme of Phase - I increasing the installed capacity to 24816 spindles. The Balance of 8832 spindles under Phase - I expansion will be commissioned before 30th September 2006. Phase - II of the expansion programme envisaging the adding of additional 11040 spindles is under implementation and is likely to be operative by the end of the current financial year i.e. 31st March, 2007. The total capital outlay of the scheme (both Phase - I & Phase - II) is Rs. 40.5 crores. Out of the total project cost the Andhra Bank is financing Rs. 32.2 Crores and balance of Rs. 8.3 is from internal accruals. The total installed capacity after the expansion is increased to 44712 Spindles.

IV. FINANCE :

During the year under review, the Andhra Bank has sanctioned a Term Loans of Rs. 1780.00 lakhs under TUFS for the expansion of the capacity of the spinning division under Phase - II. The Andhra Bank has reset the interest rate to 9.00% p.a for the new term loan and working capital loans. IREDA has also reduced its interest rates at 0.5% on the existing loans. This will reduce the cost of debt of your Company substantially in coming years. The Company has not defaulted in payment of interest and / or repayment of loans to any of the financial institutions and / or banks during the period under review.

V. FIXED DEPOSITS :

The Company has not accepted any public deposits from the public, except some of the unsecured loans brought by Promoters, Directors and their relatives, and as such no amount on account of principal or interest on public deposits was outstanding on the date of the Balance Sheet.

VI. FUTURE OUTLOOK:

Your Company is looking for increasing the size and scale and thereby proposed to increase the spindles capacity from current 24816 spindles to 44712 spindles. Your company is upgrading its

KALLAM SPINNING MILLS LTD.

technology from time to time, which is very essential to meet the global competition. The Company will continue to produce high quality cotton yarn. Your company will continue to optimum utilize its material, machines, men and money there by increase the productivity.

Your Company is using the power generated by Hydel Power Projects for captive consumption. There by saving the power cost considerably. Your company is looking for all round saving in the costs and producing high quality products with lower costs.

VII. DIRECTORS:

In accordance with the provisions of the Companies Act, 1956 and Articles of Association of the Company your Company, Sri M.R. Naik and Sri M.V. Subba Reddy retires by rotation at the ensuing Annual General Meeting and being eligible offers themselves for re-appointment.

None of the Directors of the Company are disqualified for being appointed as Directors as specified in Section 274 of the Companies Act, 1956.

VIII. ENERGY, TECHNOLOGY AND FOREIGN EXCHANGE:

Additional information on conservation of energy, technology absorption, foreign exchange earnings and outgoings as required to be disclosed in terms of 217(1) (e) of the Companies act, 1956 read together with the Companies (Disclosure of particulars in the Report of Board of Directors) Rules, 1988 is annexed herewith and forms part of this report.

IX. PARTICULARS OF EMPLOYEES:

There were no employees coming under the purview of Section 217 (2A) of the companies Act, 1956.

X. AUDITORS:

M/s.Brahmayya & Co., Chartered Accountants, who are the statutory auditors of the Company hold office in accordance with the provisions of the Companies Act, 1956 upto the conclusion of the forthcoming Annual General Meeting and are eligible for re-appointment.

XI. COST AUDITORS:

Pursuant to the provisions of Section 233B of the Companies Act, 1956, the Board of Directors of your company have re-appointed, subject to the approval of the Central Government, Sri. P. Srinivas, Cost Accountant, to carry out an audit of cost accounts of the Company in respect of textiles for the accounting year ending March 31st, 2006.

XII. CORPORATE GOVERNANCE:

Your Directors are pleased to inform that your Company has implemented all the stipulations prescribed under clause 49 of Listing agreement with the stock exchange(s). A report on Corporate Governance and Certificate from the Statutory Auditors of the Company in line with Clause 49 are annexed to and forms part of the Directors Report.

XIII. REGISTRAR'S AND SHARE TRANSFER AGENTS

During the period under review, the Company has changed its Registrar's and Share Transfer Registry from M/s IKON Visions Private Limited, 33, Sanali Heavens, Ameerpet, Hyderabad - 500 073 to M/s Bigshare Services Private Limited, G-10, Left-Wing, Amrutha Ville, Opp. Yashoda Hospital, Rajbhavan Road, Somajiguda, Hyderabad - 500 082.

XIV. INSURANCE

Adequate Insurance cover has been taken for the properties of the Company including Building, Plant & Machinery and Stocks. The Insurance Company has appointed an arbitrator for arriving at balance claim of Rs. 151.81 lakhs and not yet finalized.

XV. CASH FLOW ANALYSIS:

In conformity with the provisions of Clause 32 of the Listing agreement the Cash Flow Statement for the year ended 31-03-2006 is annexed hereto.

XVI. DIRECTORS RESPONSIBILITY STATEMENT:

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

- (a) in the preparation of the annual accounts, the applicable Accounting standards have been followed, in the opinion of the Board of Directors, along with proper explanations for material departures if any;

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- (b) the directors have 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 the profit or loss of the Company for that period.
- (c) the directors have 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;
- (d) the directors have prepared the annual accounts on a 'going concern' basis.

XVII. ACKNOWLEDGEMENTS:

Your Directors would like to express their grateful appreciation for the assistance and co-operation received from Andhra Bank, IREDA and various other Departments of both State and Central Governments. Your directors wish to place on record their appreciation of the devoted and dedicated services rendered by all employees of the company from time to time. Shareholders appreciation of the managements efforts at the General Meeting of the Company and otherwise is also a great fillip to strive for better performance year after year.

For and on behalf of the Board of Directors

P.Venkateswara Reddy,
Managing Director.

PLACE: Chowdavarani
DATE: 26th June, 2006.

ANNEXURE - I TO DIRECTORS REPORT:

Disclosure of particulars with respect to conservation of Energy, Technology absorption and foreign exchange earnings and outgo as required under the Companies (Disclosure of particulars in the Board of Directors' Report) Rules, 1988.

A. CONSERVATION OF ENERGY:

Conservation of energy continues to be accorded high priority. Our R&D team continuously reviews ongoing processes.

Form A: (Form for disclosure of particulars with respect to conservation of energy)

a) POWER AND FUEL CONSUMPTION

| S.No. | Particulars | Current Year | Previous Year |
|-------------------------------------|--------------------------|--------------|---------------|
| 1. Electricity | | | |
| a) | Purchased units (KWH) | 41,57,799 | 60,98,022 |
| | Total amount in Rs. | 1,60,25,460 | 2,20,46,601 |
| | Rate per unit Rs. | 3.85 | 3.62 |
| b) | Own Generation | | |
| i) | Through Diesel Generator | | |
| | Units Generated (KWH) | 15,934 | 4,830 |
| | Total amount Rs. | 1,85,790 | 28,789 |
| | Cost per unit Rs. | 11.66 | 5.96 |
| ii) | Through Steam Generation | -- | -- |
| iii) | Through Hydel Generation | | |
| | Units generated KWH | 90,37,200 | 48,58,600 |
| | Units consumed KWH | 56,29,509 | 32,16,252 |
| | Total Cost Rs. | 2,08,29,186 | 1,19,00,133 |
| | Cost per KWH Rs. | 3.70 | 3.70 |
| 2. Coal | | -- | -- |
| 3. Furnace Oil | | -- | -- |
| 4. Other Internal Generation | | | |

KALLAM SPINNING MILLS LTD.**b). CONSUMPTION PER UNIT OF PRODUCTION (NO. OF UNITS/KG.)**

| | | |
|----------------|------|------|
| 1. Electricity | 4.39 | 4.16 |
| 2. Coal | -- | -- |
| 3. Furnace Oil | -- | -- |
| 4. Hydel | -- | -- |

B. TECHNOLOGY ABSORPTION, ADAPTION AND INNOVATION:

- Efforts, in brief made towards technology absorption, adaptation and innovation :
Continuous efforts are being made towards technology absorption, adaptation and innovation. Quality being the thrust area, the company has taken effective steps to continue to improve quality to compete with international quality standards.
- Benefits derived as a result of the above efforts:
Improved capability and productivity to meet the customer requirements
- Imported Technology:
--- Nil ---

C. FOREIGN EXCHANGE EARNINGS AND OUTGOINGS:

Foreign exchange earnings during the year under review amounted to Rs. 133.64 lakhs. The foreign exchange utilized during the year amounted to Rs.4.50 lakhs.

MANAGEMENT DISCUSSION AND ANALYSIS:**1. INDUSTRY STRUCTURE & DEVELOPMENT:**

The Textile industry occupies a place of prominence in the Indian economy. India has the largest capacity of installed spindles and looms in the world. India's competitiveness in the business is derived from its long term edge as the lowest cost grower of cotton in the world, at approximately \$ 0.70 per kilogram, on the basis of an International Cotton Advisory Committee survey 2005. This advantage has been derived through low land rent, varied seed usage and the lower cost of fertilizers and irrigation. For instance, the average cost of producing a kilogram of seed cotton in India was estimated at \$0.27 (world average of \$ 0.33/kg) and the net cost per kilogram of lint was estimated at the lowest level of \$0.70/kg.

In spite of this cheap and easy availability of raw materials, the Indian textile industry represents a significant under penetration, reflected below:

- Of the global textile trade - estimated at around \$309 billion - India accounts for a mere four percent (textiles) and sub-three percent (apparels) share.
- Ironically, India is the second largest producer of cotton yarn and silk and the third largest producer of cotton and cellulose fibre / yarn in the world.
- India's exports suffer from a modest rupee realization due to low value addition.

The reasons identified are pure investments in modern capacity / infrastructure and archaic labour laws. However, with the removal of the quantitative restrictions from 2005 onwards incentivising increasing capacity and upgradation investments. India's share of the global textile industry is expected to increase significantly accompanied by attractive value - addition.

At Kallam, we have, recognizing the importance of globalization, started an upgradation of spinning facilities through automation and value - addition and adding of more spindles approximately 22080 spindles with a capital outlay of Rs. 40.5 Crores before the end of the current financial year.

2. OPPORTUNITIES AND THREATS:

A SWOT Analysis

Strengths

India is one of the largest producers of natural and manmade fibres, it accounts for 12 percent of the world's cotton harvest.

India's abundant raw material availability allows the industry to control costs and reduce overall lead-times across the value chain.