

KINETIC

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KINETIC ENGINEERING LTD.

Annual Report 2005 - 06

KINETIC ENGINEERING LIMITED

Automotive Components: Opportunity for Growth

The opportunity for us:

Kinetic Engineering Limited has recently completed major restructuring of business and disposed off its Two Wheeler business. Thus, the Company will now focus 100% on Auto Component business.

The Indian auto components industry is predicted to expand nearly five-fold to \$33-40bn by 2015, including \$20-25bn in exports. Kinetic Engineering is already established as a leading provider of high quality, cost effective engineering and manufacturing services to companies in India and around the world in diverse industries such as automotive, off highway applications, outdoor equipment, recreational products, etc.

With over 35 years of experience in automotive engineering, Kinetic has emerged as a center of engineering excellence and first choice for corporations requiring a quality focus and attractive value. Having designed and manufactured a diverse range of products such as two-wheelers, engines, transmissions, special purpose machines to auto-electricals for over thirty years, Kinetic is synonymous with pioneering activities in the Indian automobile industry. Kinetic has manufactured 6 million engines and vehicles which have been sold in India, Europe, USA, Canada, Australia, Middle-east, Latin America, Africa and South Asia.

Kinetic has fundamentally strong engineering capabilities with over 3 decades of experience and hundreds of engineers employed in cross functional areas. Through strong engineering, we have designed and developed from concept to production, several scooters, motorcycles and mopeds to cater the diverse requirements. Our engineering achievements include engines across various platforms and a range of specifications. It has been proven that Kinetic engines are the most fuel efficient in India as our vehicles meet stringent emission norms.

Our automotive components offerings:

For auto components, we are harnessing our expertise, skills and infrastructure in technology and engineering to partner with global corporations to offer them comprehensive solutions from design to manufacturing. Inherent strengths in the Supply Chain Management are being leveraged for seamless execution across three key requirements: Components Sourcing, QCD for Production and Inventory & Logistics Management. We offer our clients the benefit of our expertise in manufacturing, engineering, research & development, state-of-the-art facilities and a strong quality focus.

We offer our clients exceptional value from:

- An ISO certified Research & Development center
- TS 16949 certified manufacturing systems
- An expert engineering development team of 300 engineers
- Dedicated facilities for rapid prototyping, state-of-the-art design and analytical software, engine dynamometers, flow bench, emission lab, chassis dynamometer and test rigs for power-pack testing
- Single window solution for digitizing, tool design and tool manufacturing
- Extensive testing and validation facilities

Manufacturing capabilities:

Kinetic has two state-of-the-art manufacturing plants along with well equipped tool design center, tool rooms, R&D facilities, etc. The manufacturing facilities meet world-class standard with dedicated expertise in manufacturing engines, gears and shafts, starter motors, AC generators, auto-electronics; and the required facilities for heat treatment, fabrication, machining centers, crank case lines, support (tool cutter & resharpening) and machine tool building.

Solutions and products offered:

We are harnessing our skills and infrastructure in technology and engineering to partner with global corporations to offer them comprehensive solutions from design to manufacturing.

Our products include small, upto 500 cc engines ideal for two-wheelers, recreational products such as ATVs and Snowmobiles and outdoor turf care products such as lawn mowers and chainsaws, complete gear boxes for automobiles, earth moving equipment and commercial vehicles; as well as a wide array of engine and transmission components.

Our USP is: Not only do we make machined precision components, but we also move up to provide complete assembly solutions to our customers such as a gear box and complete engines.

Our Major Investors/Financers:

Reliance Capital Limited

Reliance Capital Limited has acquired a 13.79% equity stake in the company, aimed at enhancing Kinetic's focus on manufacturing of automotive components for Indian and global automotive companies.

Clearwater Capital

Clearwater Capital Partners (India) Private Limited has financed the company by way of subscribing to Non-Convertible Debentures of Rs. 100 each aggregating to Rs. 750 million.

KINETIC ENGINEERING LIMITED**Board of Directors**

Mr. A. H. FIRODIA	Chairman
Dr. N. A. KALYANI	
Mr. S. C. SHAH	
Dr. K. H. SANCHETI	
Mr. S. R. SANGHI	
Mr. S. R. KOTECHEA	
Mrs. SULAJJA FIRODIA MOTWANI	
Mr. M. K. KHERA	Managing Director

Auditors

M/s. P G BHAGWAT
Chartered Accountants, Pune

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Cost Auditors

M/s. DHANANJAY V. JOSHI & CO.
Cost Accountants, Pune

Registered Office

D1 BLOCK, PLOT NO. 18/2,
CHINCHWAD, PUNE - 411 019.

KINETIC ENGINEERING LIMITED

DIRECTOR'S REPORT 2005-06

To,
The Members,
KINETIC ENGINEERING LIMITED

Your Directors present their Report on the business and operations of your Company for the 15 months period ended on 31st December 2006.

FINANCIAL YEAR

The Accounting Year of the Company is for a period of 15 months ending 31st December 2006 as compared to previous Accounting Year of 18 months period ended on 30th September 2005. The Statement of Accounts is prepared accordingly.

FINANCIAL HIGHLIGHTS

	(Rs. in Lakhs)	
	For the 15 months period ended on 31 st December 2006	For the 18 months period ended on 30 th September 2005
Gross Sales and Other Income	21,949	24,289
Loss for the period	(4,329)	(5,496)
Profit / (Loss) carried forward		
Last Year	(2,831)	2,665
This Year	(7,160)	(2,831)

MANAGEMENT DISCUSSION & ANALYSIS REPORT

Business Restructuring

Your Company has been advised to take advantage of growing opportunities in auto-component business and to dispose off its surplus assets for effective utilization of Company's resources. Accordingly on 31st December 2006, the Board of Directors have disposed off Company's Two Wheeler manufacturing Unit, Supa Undertaking on slump sale basis to Kinetic Motor Company Limited (KMCL) for consideration of Rs. 53.50 crores. KMCL, towards discharge of a part of purchase consideration, allotted Convertible / Optionally Convertible / Redeemable Preference shares to KEL of an aggregate amount of Rs. 30 crores. With this transfer of Two Wheeler Business, your Company will now focus on auto component business which is a promising and profitable line of business.

Financial Restructuring

As members of the Company are aware, your Company was going through difficult phase during last three financial years due to lower utilization of capacities coupled with increased cost of raw materials, manpower cost etc. The losses have resulted into erosion of networth. The business growth was also hampered on account of acute cash crunch. The management being aware of urgent need for business and financial restructuring for turnaround, explored and evaluated various models for business and financial restructuring. The Company entered into negotiations with Banks and Financial institutions for Debt restructuring / One Time Settlement (OTS), approached new financial investors to raise fresh funds. In this process the Promoter's Group Companies also lent support to the Company.

Highlights of the funds raised for Financial restructuring:

- On 31st December, 2005, Micro Age Instruments Private Limited (MAIPL), a Company from Promoter Group converted 2,30,000 Warrants of Rs. 178 each into 2,30,000 fully paid-up Equity shares of Rs. 10 each at a premium of Rs. 168 per share.
- On 7th August, 2006, the Company entered into agreement with Clearwater Capital Partners (India) Private Limited (CCPIL) for issue of 75,00,000 Non-Convertible Debentures (NCDs) of face value of Rs. 100 each. In the first tranche, CCPIL subscribed to 20,00,000 NCDs of aggregate amount of Rs. 20 crores.
- On 30th September, 2006, Clearwater Capital Partners (Cyprus) Limited (CCPCL) subscribed to Company's 7,50,000 Warrants of Rs. 156 each. Each such Warrant is convertible into one fully paid up Equity share of Rs. 10 each at a

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premium of Rs.146 per share within 18 months from the date of allotment at option of the allottee. CCPCL paid 10% Warrant amount to the Company and balance 90% is payable on the date of conversion of the Warrants into Equity shares.

- On 30th December, 2006, the Company entered into One Time Settlement (OTS) with most of its lenders consisting of 6 Banks and 1 Public Financial Institution (hereinafter referred to as "Old lenders"). Company settled the outstanding term loans and working capital loans of the Old lenders and to part finance OTS, raised Term Loan of Rs. 30 crores. This has resulted into substantial benefits to the Company.
- On 30th December, 2006, CCPIL subscribed to second tranche of 55,00,000 NCDs amounting to Rs. 55 crores to part finance OTS and meeting long term working capital requirements of Company.
- On 30th December, 2006, MAIPL subscribed to 3,20,500 Redeemable Cumulative Preference Shares of Rs.156 each against conversion of a part of the existing Inter-corporate Deposit given by MAIPL to the Company.
- On 30th December, 2006, MAIPL subscribed to 5,76,923 Optionally Convertible Cumulative Preference Shares (OCCPS) of Rs.156 each. Each OCCPS is convertible into one fully paid-up Equity share of Rs.10 each at a premium of Rs.146 per share, within 18 months from date of allotment, at the option of the allottee.
- On 11th January, 2007, MAIPL subscribed to 65,077 Optionally Convertible Cumulative Preference Shares (OCCPS) of Rs.156 each. Each OCCPS is convertible into one fully paid-up Equity share of Rs.10 each at a premium of Rs.146 per share, within 18 months from date of allotment, at the option of the allottee.
- On 17th March 2007, Reliance Capital Limited (RCL) subscribed to 6,00,000 Warrants of Rs. 156 each. Each such Warrant is convertible into one fully paid up Equity Share of Rs.10 each at a premium of Rs.146 per share within 18 months from the date of allotment at option of the allottee. RCL paid 99% Warrant amount to the Company and balance 1% is payable on date of conversion of the Warrants into Equity shares.
- On 17th March, 2007, Ambit Corporate Finance Private Limited (Ambit) subscribed to 1,00,000 fully paid-up Equity shares of Rs.10 each at a premium of Rs.146 per share.
- On 26th March, 2007, MAIPL converted 25,000 Warrants of Rs. 178 each into 25,000 fully paid-up Equity shares of Rs.10 each at a premium of Rs.168 per share.

The financial restructuring has helped the Company to meet requirement of funds for OTS, long term working capital requirements, capital expenditures apart from receiving benefits of write offs and strengthening network of the Company.

Company's Performance

Two Wheelers:

During the 15 months period ended 31st December, 2006 ('period under review'), the Company produced 48313 nos. two-wheelers as against 60761 nos. in the 18 months period ended 30th September, 2005 ('previous period'). During the period under review, Company sold 50860 nos two-Wheelers as against sale of 77509 nos two-wheelers in the previous period. The Company adopted strategy of lower advertising spends, increased exports of motorcycles and mopeds, building on the good response received from overseas markets.

Auto Components:

Company already has expertise, skilled manpower and well equipped facilities for manufacturing of auto-components. During the period under review, the Company received prestigious order for manufacture of Gearbox from Tata Motors Limited. Company also supplied Gearboxes to Force Motors Limited. Company has also received orders from Fortune 500 companies viz. Bombardier Recreational Products (BRP).

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Opportunities, Threats, Risks And Concerns

The Company has restructured itself into an Auto-component manufacturing Company. India's auto-component manufacturing industry enjoys significant global advantages on account of availability of a vast pool of skilled labour and qualified engineers with knowledge of English language at comparatively lower cost. Realising vast potential of Indian market and benefits of low cost, many MNCs have established their production base in India and their number is also growing. Your Company already has rich experience in auto-component business from the stage of designing to manufacturing and is having in-house facilities and skilled manpower. In view of these inherent strengths, auto-component manufacturing business would help the Company to turn around and become a profitable business.

Business Outlook And Overview

Realising high growth potentials of Auto-component business, many established players have increased capacities by investing huge amount of funds in this business. Your Company has vast experience in manufacture of components, especially engines, engine parts like gears, variators etc in addition to design and manufacture of complete vehicles. There is also large design strength and a well-equipped tool-engineering center. Company's auto-component business is growing and expected to provide stability, profitability and strength to the Company compared to intense and cut throat competition in two-wheeler manufacturing business.

Internal Control System

The Company has adequate internal control system commensurate with its size and nature of business for ensuring efficiency of operations and protection of Company's assets. The Company's Audit Committee periodically reviews compliance with Company's policies, procedures and laws.

Financial Performance With Reference To Operational Performance

Gross Sales and other income in the period under review were Rs.219 crores as against Rs. 243 crores in the previous year. Net Loss for the period under review is Rs. 43 crores as against Rs. 55 crores in the previous period.

Human Resource Development

The Company continues to invest in development of human resources. Annually, training requirements are identified, mapped and correspondingly, training sessions are organized with a view to promote continuous learning. Special attention is provided to good health and safety of employees. Kinetic's HR team organizes on job enrichment, job rotation, transfer, re-deployment, training, promotion and compensation revision. The Company has rationalized its manpower. During the year, the Company has announced Voluntary Retirement Scheme (VRS) for its Employees at Ahmednagar Plant. 308 Employees have opted for VRS. There were 1276 number of employees on roll of the Company as on 31st December, 2006 as compared to 1675 Employees in the last period.

Cautionary Statement

The Management Discussion and Analysis Report contains 'forward looking' estimates and expectations. Actual future results, however, might differ from expectations, as the same depend upon many uncertainties.

RESEARCH & DEVELOPMENT AND TECHNOLOGY ABSORPTION

For growing auto-component business, the Company designed various kinds of engines for international customers viz. Carraro India, Visteon India and Gear Boxes for Tata Motors Limited and Force Motors Limited as per the requirement of customers of auto-component business.

Total investment in R&D during the period under review was Rs. 103 lakhs which represents 0.69% of the Company's turnover.

CONSERVATION OF ENERGY

Some of the measures for conservation of energy undertaken during the period under review were:

- Installed Electronic ballast in paint shop / administration and Offices;

- Maintained Unity Power Factor through out the year and got incentives in electricity bill;
- Implemented PU tubing for air connections against hose pipes in various shops and for machines;
- Installed CFL M/C lamps on machine instead of 40w bulb.

These measures taken by your Company have resulted in savings in the Energy Cost of approx. Rs. 12 lakhs.

FOREIGN EXCHANGE EARNINGS AND OUTGO

The information on foreign exchange earnings and outgo is contained in Schedule 15, Notes to the Accounts (Point Nos. 12, 13 and 14).

SUBSIDIARY COMPANY

During the period under review, Kinetic Motor Company Limited ceased to be the Subsidiary of your Company consequent upon KMCL's Capital restructuring and alteration in Articles of Association.

DIRECTORS' RESPONSIBILITY STATEMENT

As required under section 217(2AA) of the Companies Act, 1956, your Directors hereby confirm that:

- In the preparation of the Accounts for the period under review, the applicable Accounting Standards have been followed;
- Appropriate Accounting Policies have been selected and applied consistently and the judgments and estimates made are reasonable and prudent so as to give a true and fair view of the state of affairs of the Company as on 31st December 2006;
- 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;
- The annual accounts for the period under review have been prepared on a 'going concern' basis.

CORPORATE GOVERNANCE

Pursuant to Clause 49 of the Listing Agreement with the Stock Exchanges, a Report of Corporate Governance with Auditors Certificate on Compliance with the conditions of Corporate Governance is given as annexure to the Director's Report.

FIXED DEPOSITS

30 Deposits amounting to Rs. 3.95 lakhs were matured and unclaimed as on 31st December 2006, out of which 4 Deposits amounting to Rs. 0.51 lakhs have since been claimed and refunded. During the period under review, your Company has not accepted any Deposits from the Public within the meaning of provisions of Section 58A and 58AA or any other provisions of the Companies Act, 1956 and the Companies (Acceptance of Deposits) Rules, 1975.

DIRECTORS

Mr. S. C. Bhawe, who was nominated by State Bank of India as the Director on the Board of Company, ceased to be the Director of the Company with effect from 20th July 2006, consequent upon withdrawal of his nomination by State Bank of India. The Board of Directors place on record appreciation of services rendered by Mr. S. C. Bhawe during his tenure as Director of the Company.

The term of appointment of Mrs. S.F. Motwani as Joint Managing Director of the Company expired on 3rd May, 2006. She is appointed as Managing Director of Kinetic Motor Company Limited. w.e.f 4th May, 2006 for a period of 5 years. She will continue as Non-Whole time Director of your Company, liable to retirement by rotation.

Mr. M. K. Khera has been elevated as Managing Director of the Company for a term of 5 years with effect from 5th March 2007. His last term of appointment as Joint Managing Director expired on 4th March 2007.

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The term of appointment of Mr. A. H. Firodia as Chairman of the Company will expire on 30th June, 2007. The Remuneration Committee and Board of Directors have passed necessary Resolutions for his re-appointment as Chairman of the Company for a further period of 5 years w.e.f 1st July, 2007, subject to approval of Members and Central Government. Resolutions for appointment of and payment of remuneration to Chairman and Managing Director are contained in Special Business of Notice of ensuing Annual General Meeting. The Board of Directors recommend the same for approval by members.

Mr. S. C. Shah and Mrs. Sulajja Firodia Motwani retire by rotation at the ensuing Annual General Meeting and being eligible, offer themselves for re-appointment.

AUDITORS

Your auditors, M/s. P. G. Bhagwat, Chartered Accountants, retire at the ensuing Annual General Meeting and being eligible, have given their consent for re-appointment.

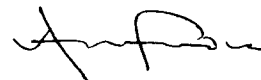
PARTICULARS OF EMPLOYEES

Particulars of Employees as required under Section 217(2A) of the Companies Act, 1956 read with Companies (Particulars of Employees) Rules, 1975 form part of this report. However, as per provisions of Section 219(1)(b)(iv) of the Companies Act, 1956, the report and the accounts are being sent to the Shareholders of the Company, excluding the Statement of Particulars of Employees under Section 217(2A) of the Companies Act, 1956. Any Shareholder interested in obtaining a copy of said Statement may write to the Company at the Registered Office of the Company.

ACKNOWLEDGEMENT

Your directors express their sincere thanks to new financial investors for the confidence reposed in the Company's management and business prospects. Your Directors also thank suppliers, dealers and old lenders and wish to place on record their appreciation of the dedicated services rendered by the employees and thank shareholders for their continued support and co-operation.

For and on behalf of the Board of Directors



A. H. FIRODIA
Chairman

Place : Pune
Date : 31st March 2007

REPORT ON CORPORATE GOVERNANCE FOR THE 15 MONTHS PERIOD ENDED ON 31ST DECEMBER, 2006.

1. Corporate Governance Philosophy

Corporate Governance, in essence, is a set of systems and procedures which aims to ensure that the Company is managed to suit the best interest of all its stakeholders with an objective to maximize their wealth. The stakeholders may be Promoters, Shareholders, Customers, Lenders, Dealers, Vendors, Government or Employees. The concept of Corporate Governance hinges on total transparency, integrity and accountability of the Management. Kinetic Engineering Limited (KEL) believes in total transparency in sharing all relevant information with all its stakeholders and the Company is quite confident that the information shared would in turn contribute to improve the overall performance of the Company and further would strengthen relationship of the Company with all above.

2. Board of Directors

2.1 Presently, the Board of the Company comprises eight members, out of which six are Non-Executive Directors. Out of such six Non-Executive Directors, five are Independent Non-Executive Directors. The Non-Executive Directors of the Company are highly experienced professionals in their fields and in the Corporate world. The Board is headed by Executive Chairman. The Composition of Directors on the Board of the Company is as under:

Category	No. of Directors	No. of Directors required under clause 49
Executive Directors	02	--
Non-Executive Directors	06	04
Non-Executive Independent Directors	05	04

2.2 The Category of Directors on the Board of the Company is as under:

Name of the Director	Category	No. of other Directorships in Public Ltd. Companies as on 31/12/2006	Committee Membership of Other Companies as on 31/12/2006	
			Member	Chairman
Mr. A. H. Firodia	Executive Director, Not Independent & Promoter	6	Nil	Nil
Dr. N. A. Kalyani	Non-Executive Independent Director	6	3	2
Mr. S. C. Shah	Non-Executive Independent Director	Nil	Nil	Nil
Dr. K. H. Sancheti	Non-Executive Independent Director	Nil	Nil	Nil
Mr. S. C. Bhavé*	Non-Executive Independent Director	Nil	Nil	Nil
Mr. S. R. Sanghi	Non-Executive Independent Director	3	2	2
Mr. S. R. Kotecha	Non-Executive Independent Director	Nil	Nil	Nil
Mr. M. K. Khera	Executive Director, Not Independent	Nil	Nil	Nil
Mrs. Sulajja Firodia Motwani	Non-Executive Not Independent Director	2	1	Nil

*Ceased to be a Nominee Director w.e.f. 20.07.2006 upon withdrawal of nomination by State Bank of India.

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2.3 None of the Directors of the Company holds membership of more than 10 Board Committees or holds Chairmanships of more than 5 Board Committees.

2.4 Attendance of Directors at Board Meetings and at the last Annual General Meeting:

During the 15 months period ended 31st December, 2006 (hereinafter referred to as 'the period under review'), 12 Board Meetings were held on 13th October 2005, 24th October 2005, 21st November 2005, 30th December 2005, 30th January 2006, 27th March 2006, 6th May 2006, 29th July 2006, 17th August 2006, 28th September 2006, 30th October 2006 and 22nd November 2006. The maximum time gap between any two Board Meetings was not more than four months. The details of Attendance of Directors at the Board Meetings and at the last Annual General Meeting is as follows :

Name of the Director	Board Meetings held during the tenure of the Director	Board Meeting Attended	Attendance at the last AGM held on 22/03/2006
Mr. A. H. Firodia	12	11	Present
Dr. N. A. Kalyani	12	01	Absent
Mr. S. C. Shah	12	12	Present
Dr. K. H. Sancheti	12	01	Absent
Mr. S. C. Bhave*	07	05	Absent
Mr. S. R. Sanghi	12	05	Absent
Mr. S. R. Kotecha	12	12	Absent
Mr. M. K. Khera	12	09	Absent
Mrs. Sulajja Firodia Motwani	12	11	Present

*Ceased to be a Nominee Director w.e.f. 20.07.2006 upon withdrawal of nomination by State Bank of India.

The Board reviews Compliance Report of all laws applicable to the Company prepared by the Company as well as steps taken by the Company to rectify instances of non-compliance.

2.5 Pecuniary relationship or transactions of Non-Executive Directors

1. Mr. Shashikant C Shah, brother of Mr. Shantilal C Shah, is a Tax Consultant for Sales Tax purposes. For the period ended on 31st December 2006, payment made to Mr. Shashikant C Shah amounted to Rs. 41,250 which has been in the ordinary course of business;
2. Dr. N. A. Kalyani is a Director of Kalyani Forge Ltd. Purchase of goods from Kalyani Forge Ltd. has been in the ordinary course of business and, for the period ended on 31st December 2006, amounted to Rs. 1,27,872; and
3. Mr. S. R. Kotecha is a partner of Achal Industries. Purchase of goods from Achal Industries have been in the ordinary course of business and, for the period ended on 31st December 2006, amounted to Rs. 46,89,866.

2.6 Code of Conduct

The Board has laid down a Code of Conduct for all Board members and senior management of the Company. The Code of Conduct has also been posted on website of the Company.

All Board Members and Senior Management has affirmed compliance with the Code of Conduct on an annual basis and the Annual Report contains declaration to that effect signed by the Managing Director.

The Company has laid down procedures to inform Board about risk assessment and minimization procedures. These procedures are periodically reviewed by executive management to control the risks.

CEO/CFO Certification

Certificate from Managing Director and General Manager (Finance) in terms of clause 49(V) of the Listing Agreement with the Stock Exchanges for the period under review was placed before the Board of Directors of the Company at their meeting held on 31st March 2007.