PRAJ

smarter stronger higher

Praj Industries Limited

20th annual report 2005-2006

Company Information

Board of Directors

Pramod Chaudhari - Chairman
Shashank Inamdar - Managing Director
Ajit Lele - Joint Managing Director
Venkatachala Datar
Berjis Desai
Sivaramakrishnan Iyer
Rakesh Jhunjhunwala
Dr. R. V. Chaudhari
Anil Joshi

Registered Office

"PRAJ HOUSE",
Bavdhan, Pune 411 021

R & D Centre

Matrix - The Innovation Center
"PRAJ HOUSE', Bavdhan, Pune 411 021

Manufacturing Facility

S. No. 748, Sanaswadi, Pune 412 207
Gat No. 745, Sanaswadi, Pune 412 207

Export Oriented Unit

Gat No. 105, Taluka Khed, Dist. Pune,
Alandi Markal Road, Dhanori, Pune 412 105.

Bankers

Bank of Maharashtra
State Bank of India
ABN Amro Bank N. V.
HSBC Ltd.

Solicitors

J. Sagar Associates
Vakils house,
18, Sprott Road, Ballard Estate,
Mumbai 400 001

Company Secretary

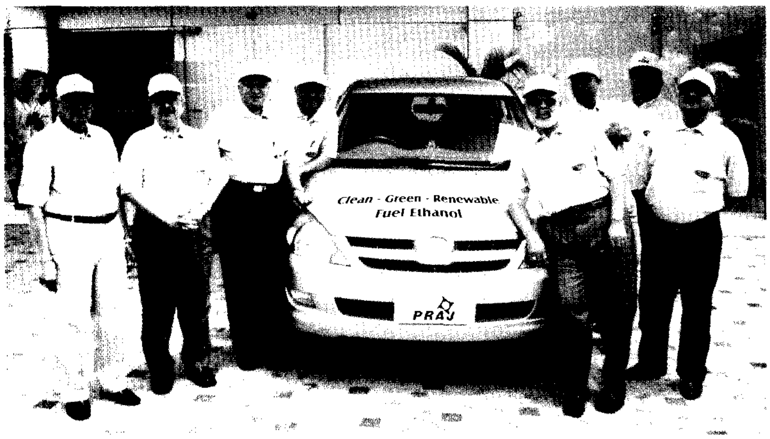
Deepak Mogal

Auditors

B. K. Khare & Co.
Chartered Accountants,
706/708, Sharda Chambers,
New Marine Lines, Mumbai 400 020

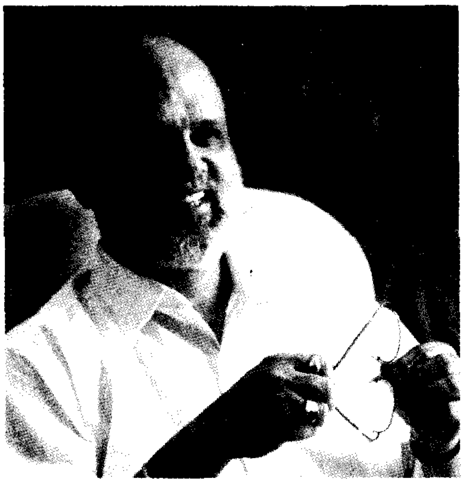
Internal Auditors

G. D. Apte & Co.
Chartered Accountants,
1202/17E, Shivajinagar,
Off Apte Road, Pune 411 004.



L to R : Venkatachala Datar, Berjis Desai, Anil Joshi, Dr. R. V Chaudhari, Pramod Chaudhari, Sivaramakrishnan Iyer, Rakesh Jhunjhunwala, Shashank Inamdar,

Chairman's
Note



There are many queries and questions in the minds of various investors and public. I have tried to reproduce answers to some of these queries in this note to all shareholders so that everyone gets an insight into the Company.

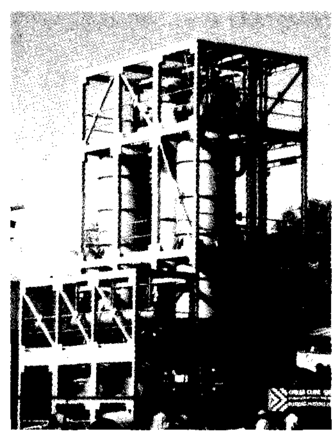
Ofcourse, I welcome any other queries you might have. Please do write in to me at info@praj.net

You have mentioned that the Year 2005-06 has been a year of consolidation. What do you mean by that?

Against the backdrop of rapid growth in the previous years, we had undertaken a study to re-validate our understanding of the prospective quantum of growth in our markets, determine entry strategies for new markets as well as to identify resources and infrastructure necessary for the growth. The study corraborates that the growth is likely to be exponential and will have to be managed very early on so as not to disturb the trajectory. Hence, Praj management decided to take action in terms of building up resources and the necessary addition to infrastructure and new geographies. Also, market related activities including identifying people for new markets has been undertaken . Consequently, we have seen addition to manufacturing capacity, R & D and manpower strength.

How would you describe the next phase for Praj?

We see the growth phase beginning with expansion in terms of geographies. We will call it geographical expansion, which is currently being pursued. We have already made a beginning with a breakthrough order in UK, our first step into EU. We are now looking at opportunities in the remainder of Europe. Our next stop is USA. Our tie-up with various construction companies will create advantages in our efforts to increase our reach.



We still have to cover a lot of grounds in our existing markets. For example, in Thailand and in Australia where we have been working for some time, the ethanol programme is still under partial implementation. We have got some good orders from these countries. We are executing a skid mounted unit for ethanol production for a leading ethanol producer in Australia. On Africa front too, we should be able to see some good developments. We are executing a project in Swaziland in southern Africa and have another order from Nigeria for alcohol production.

The second phase of our expansion will come from capacity growth. In India, we already see a move towards large capacity plants. Whilst smaller capacity plants pose its own challenges in terms of cost of production etc., an expertise we have already proven many times over, larger capacity plants require a different engineering mind set. The successful commissioning of five plants in Colombia has proven our mettle in scaling up. We have already moved on to higher capacities and we continue to scale up in this respect.

What visibility do you see for this growth phase for the Company in terms of market, business volume and resources- in the immediate future?

Markets like USA and Europe will gain momentum and there is a clear visibility that capacities will get added. Africa and Asia are yet to unfold in a big way. We will have to wait out another crop season to understand how the markets will develop. Also, the true impact of EU-ACP accord change will be more visible then.

As of end May, we have pending orders of over Rs. 4.5 billions. These orders are at various levels of execution.

In newer markets, we have to factor in the lag time for orders to become executable. Last year, we have also seen a new trend emerging in the market wherein clients want to go in a phased manner in the development of projects. This involves pre-order engineering and a lot of options development which takes its own time. Also, the scale of investment being higher, until the options are frozen, the execution cannot be undertaken. On the other hand, it has its own advantages. The project, once taken up for execution, has a smoother run.

What are the challenges in front of you for the coming year? Would you be able to scale up? How do you plan to overcome these challenges?

Challenges on the external front are in terms of handling the rising material and input cost. Steel forms 35% part of our overall cost structure. Although we have now built in a system which tracks this cost on almost daily basis and is also factored into the proposal, the project cycle being on the higher side, these costs do alter the margins.

Yet another factor is the sugar-ethanol relationship. Although not a challenge, it will create its own dynamism in the market and influence the ethanol policies of smaller nations.

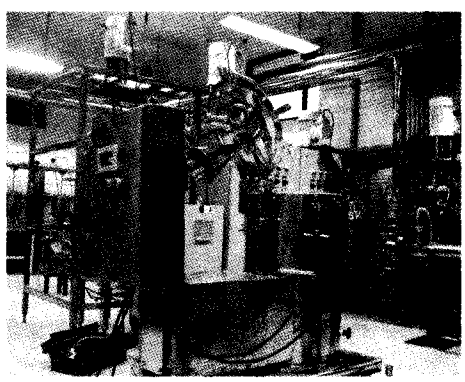
Internal challenges are more to do with work flow and execution smoothness in short, scaling up. As mentioned, in our consolidation phase we have already put several action plans into motion. What remains is the constant upgradation. Almost like learning to change the wheel while the vehicle is in motion.

Scaling up has several dimensions. As mentioned, in terms of expertise, we have already done so. Ofcourse, there are newer possibilities and we are making a note of that and preparing for such challenges. Another dimension is capacity. Manufacturing capacity is already up. Engineering capacity is being constantly upgraded. Being a specialized field, we have to constantly refresh our talent pool and our HR initiatives in terms of addition of manpower at entry level and strengthening our middle level will help to overcome short term capacity demand whilst for the long term various retention policies are being put into place.

We expect the implementation of ERP system to add to efficiency levels thus saving on certain work load.

Where does R & D fit into your strategy of growth?

R & D is a generator of new processes and carries out optimization of existing processes. This gives us the edge in the market. Hence, we will continue to hold it at the center of all our strategies.



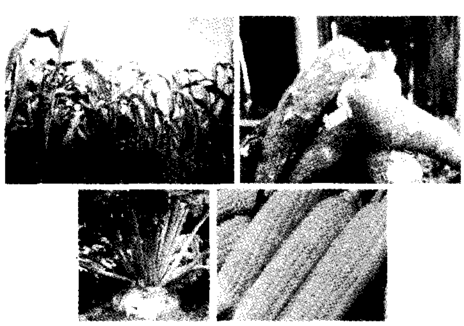
Last year, we invested over 1% of our turnover in R&D. This included bioreactors and instrumentation for various laboratories. We have intensified our work with various enzymes and microorganisms so that we can understand its behaviour of different grains and sugar substrates better.

Apart from new developments, R & D facilities assist with testing and optimizing designs based on its vast data bank.

We are also considering a move in the direction of advanced research (in addition to applied research being done today). The chosen area will lead to industrial biotechnology. This would include, apart from cellulosic biomass to ethanol, exploring the role of micro-organism for bio-degradables and bio-remedials. The Board of Directors have approved the proposal to invest into a new R & D facility. We are currently detailing out the plans.

What about ethanol feedstock challenges Praj has been concerned about? What is the status on that?

Very early on, Praj had foreseen feedstock challenges. Our work with sweet sorghum and with multi-feed ethanol plants was prompted by this realization. Today, we see sugar and starch being on equal footing. More and more grains/tubers are being looked at for expanding the basket of raw materials. The central theme is on customizing for different climatic conditions and improving the yields. Cellulosic biomass will provide the new paradigm in ethanol production and Praj is readying itself for this opportunity.



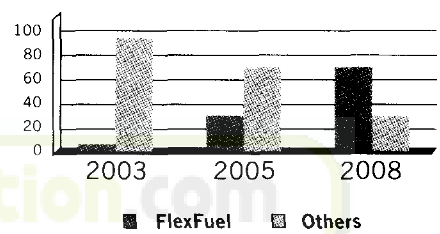
What is the trend in the ethanol industry worldwide?

Earlier, it was predicted that ethanol production will double in the year 2012. As it seems today, it might double by 2010 itself. The big push has come because of the rising oil prices and the passage of Renewable Fuels Bill in USA which has not only created a capacity demand within USA but also in nearby countries like the Central American nations. Many other countries are also embarking on Ethanol blending programmes.

Many EU countries are still trying to meet up with the biofuels guidelines.

With the EU-ACP accords under change, we will see some emerging trend in countries which were traditionally supplying sugar and ethanol to EU. A large number of these countries lie in Africa.

Growth of Flex-Fuel Cars in Brazil (%)



We see bio-ethanol going from strength to strength. The strongest point about ethanol as a transport fuel is that it is established, it is easily produced and miscible into gasoline/petrol. With flex fuel (FFVs) car purchase out numbering normal fuel cars in Brazil, and the recent trend in promotion of FFVs in USA and Europe, ethanol's importance as fuel is likely to increase.

Energy security is on top of everyone's mind. India is no exception. While we look at newer sources of fossil fuel, renewables will have to form an intrinsic part of our policy framework. The challenge is in making it workable. We see technology Companies like ours contributing to this with better options for production processes.

Also, the ecological aspect cannot be ignored. Ethanol is a proven environment friendly fuel. Reduction in levels of Nitrogen Oxide and in Carbon Monoxide go a long way in making the environment cleaner and greener.

What is your edge in these newer markets? How do you see competition in these markets?

We see our large pool of engineering talent and our application oriented approach a major competitive strength which cuts across markets. In USA, we are already being recognized for our engineering strengths and our vast experience and reference base across a wide spectrum of raw materials does contribute to what we can deliver. Our research driven approach with the necessary R & D back-up is yet another plus point.

In USA and in Europe, the model for execution is different and we have made necessary arrangements for operating in these markets.

What position do you see Praj taking on in the global ethanol industry? How far can the ethanol rally go? What growth drivers do you see for ethanol?

We see Praj as a very strong player in the ethanol technology front. We are flexible and more fleet footed and hence our response to market is one of our advantages. Today, Praj has around 6-8% of global market share, which we are attempting to grow to 10-12% in the coming three years.

We have positioned Praj as a solution provider which is a 'ONE STOP SHOP' for ethanol technology. We will strengthen that position in the coming years for different streams of feedstock, sugar & starch.

Today, global ethanol production is at 42 bln litres and likely to climb to 80 bln litres by 2010. The doubling of capacity is likely to happen two years in advance. This gives us an indication of how ethanol is likely to shape up.

Apart from Oil prices, the main growth driver for ethanol remains its renewable potential. As also its close relationship to farm economy (agrarian economy). It will go a long way in the inclusive growth, people at policy levels talk about. Ethanol creates jobs. It creates an industry in terms of logistics and services. It creates demand for talent in rural areas.

Also, ethanol is environment friendly and most important it is easy to adopt. We see ethanol rally lasting beyond 2010.

What role do you see new investors like Vinod Khosla and Marubeni Corporation playing in the future?

In his own words (see page 96) Vinod Khosla has aptly described his role as an enabler and as a facilitator for Praj to launch itself in a different orbit.

We also see Marubeni as being complementary to Praj's activities.

What are the goals you would set for Praj?

By 2009...

We want to be number one ethanol technology provider, worldwide.

We wish to achieve a global marketshare in excess of 10% !

We aim to achieve Rs. 10 billion in sales.

Lastly, Praj will continue to explore ascending paradigms for Smarter, Stronger and Higher performance in the coming years.

Directors' Report

To The Members of Praj Industries Limited,

Your Directors are pleased to present the 20th Annual Report and the Audited Statements of Accounts for the year ended 31st March, 2006, together with the notice of Annual General Meeting.

Performance

In the year under review, your Company has recorded a total income of Rs. 2700 million (previous year Rs. 2383 million). This represents an increase of 14% when compared to the previous financial year. Profit Before Tax also increased from Rs. 279 million in FY 2004-05 to Rs. 325 million in FY 2005-06. The performance level has been commensurate with various consolidation activities undertaken by your Company in order to be in readiness for the coming years as the market shows a definite signs of quantum growth .

(Rs. in million)

	2005-06	2004-05
Turnover	**2675**	2352
Other Income	**25**	31
Total Income	**2700**	2383
Total Expenses	**2375**	2104
PBT	**325**	279
PAT	**244**	218

Operations

The note on operations of the Company is included in Management Discussion & Analysis.

Dividend

Your Company has declared an Interim Dividend of 63% (Rs. 1.26 per share) which has already been paid out. Your Directors are of the opinion that the said dividend should be treated as final dividend for the year 2005-2006.

Preferential issue of shares / warrants

Post the year under review, in the month of May 2006, your Company has successfully placed its equity Shares / warrants with specified overseas Investors and Promoters / Director of your Company. The proceeds on account of placement of these shares will be utilised for upgrading R&D facilities, setting up of pilot plant facility for ethanol industry and resource mobilization including overseas facilties, etc.

Accordingly, your Company has allotted 1,622,250 shares and 6,489,000 warrants to Mr. Vinod Khosla, a well known venture capitalist based in USA and 811,125 shares to M/s. Marubeni Corporation, Japan, who are active in promotion of ethanol projects. Warrants to promoters / Director account for 811,125 nos.

Consequent upon the placement of equity shares, the paid-up share capital of the Company stands enhanced to 83,545,895 equity shares of Rs. 2/- each.

Corporate Business

a) Listing Fees :

Since SEBI has stipulated electronic filing of Annual Report, Corporate Governance Report, Financial Results, Shareholding Pattern etc. on its website, www.sebiedifar.nic.in, statements of your Company can be accessed at this website.

The Company's shares are listed on National Stock Exchange of India Ltd. and Bombay Stock Exchange Ltd. The Annual Listing Fees for (2006-2007) have been paid to both the Stock Exchanges.

c) Registrar & Transfer Agents :

Your Company has appointed Intime Spectrum Registry Ltd., C - 13, Pannalal Silk Mills Compound, L. B. S. Marg, Bhandup (West), Mumbai 400 078 as Registrar & Transfer Agents.

d) Electronic Shareholding & Trading :

As on 2nd June 2006, 96.56% of the Company's equity was in electronic mode. SEBI has directed the trading of the Company's script in electronic mode only, w.e.f. 15th March, 2000.

e) Subsidiary Company :

Pacecon Engineering Projects Ltd. (PEPL), Praj Far East Pte Ltd. (PFE), Yaan e Sites Ltd. (YES) and Process IT LLC are subsidiaries of your Company. Process IT LLC is engaged in development and marketing of IT enabled plant information system and related engineering packages for the ethanol industry. The revenue model is based on product sales and licence thereof.

As required under section 212 of the Companies

Act, 1956, the accounts for the year ended 31st March, 2006 of the Subsidiary Companies are attached herewith together with statement under that section. Pursuant to Accounting Standard No. 21 the consolidated results of your Company after incorporating the results of its subsidiaries viz. PEPL, YES, PFE and Process IT LLC are enclosed.

f) Share Capital

In terms of the resolutions passed by the shareholders in the 19th Annual General Meeting of the Company, the Equity Shares of your Company were sub-divided from Rs. 10/- each to Rs. 2/- each and also your Company has issued bonus shares in the ratio of 1 : 1. Resultant, the issued and paid-up capital of your Company as on 31st March, 2006 is Rs. 162, 225,040/-

g) Employee Stock Option Plan

In order to attract and retain the best talents, your Company has Employee Stock Option Plan (ESOP) to recognize and reward performance. The information to be disclosed as per SEBI (Employees Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 is annexed to this Report.

Accounts

In conformity with the mandatory accounting standards, the significant accounting policies have been included in Schedule 18 (Item 1) of the accounts.

Particulars of Employees

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

Energy Conservation, Technology Absorption, Adaptation, Innovation :

a) Conservation of Energy :

The operations of your Company are not energy intensive as the operations are limited to machining, metal working and finishing of a variety of equipment.

b) Technology Absorption, Adaptation, Innovation :

This is covered in Management Discussion & Analysis while discussing R & D activities of the Company.

Foreign Exchange Earnings & Outgo

Particulars regarding foreign exchange earnings are presented in Schedule 18 (Item 19) and outgo are presented in Schedule 18 (Item 17 & 18) of the Audited Accounts. Your Company has retained its status as a net forex earner.

Directors

Mr. Anil Joshi was appointed as Additional Director with effect from 18th January, 2006. He holds office upto the date of the ensuing Annual General Meeting. He is eligible for appointment.

Mr. Sivaramakrishnan Iyer retires by rotation in terms of Article 82 of the Articles of Association of the Company and being eligible offers himself for re-appointment.

Dr. R. V. Chaudhari retires by rotation in terms of Article 82 of the Articles of Association of the Company and being eligible offers himself for re-appointment.

Directors Responsibility Statement

In accordance with the requirements of Section 217(2AA) of the Companies Act, 1956, the Board of Directors confirm that :

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

The accounting policies which have been selected have been applied consistently and 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 at the end of the financial year 2005-06 and of the profit of the Company for that period;

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 have been prepared 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. A report on Corporate Governance, along with the certificate of compliance from the Auditors (attached separately), forms part of this report.

Auditors

a) Internal Auditors

The Internal Auditors, M/s G. D. Apte & Co., Chartered Accountants, Pune have conducted the audits periodically and submitted reports which have been considered while finalizing the accounts of the Company by Statutory Auditors and Audit Committee.

b) Statutory Auditors

The Auditors, M/s B. K. Khare & Co., Chartered Accountants, 706/708, Sharda Chambers, New Marine Lines, Mumbai 400 020 retire at the conclusion of the 20th Annual General Meeting. They are eligible for re-appointment and have expressed their willingness to continue as Auditors, if re-appointed.

Acknowledgments

Your Directors wish to place on record their appreciation towards all associates including Customers, Collaborators, Government Agencies, Financial Institutions, Bankers, Suppliers, Shareholders, Employees and others who have reposed their confidence in the Company.

For and on behalf of the Board of Directors
PRAMOD CHAUDHARI
Chairman

Date : 3rd June, 2006
Place : Pune

ANNEXURE TO THE DIRECTORS' REPORT, 2006

Disclosure pursuant to the provisions of Securities and Exchange Board of India
(Employee Stock Option Scheme and Employee Stock Purchase Scheme)
Guidelines, 1999

Sr. No.	Particulars	ESOP 2005-06
1.	Options granted	1,743,000
2.	Pricing formula	Closing market price prior to the date of meeting of the Compensation Committee in which the options were granted 12-10-2005 Rs. 93.30 per share
3.	Options vested	N. A. since options not exercisable before the expiry of one year from the date of grant of option
4.	Options exercised	N. A.
5.	Total number of options granted and in force as on 31/03/2006	1,743,000

Management Discussion & Analysis

Overall Review

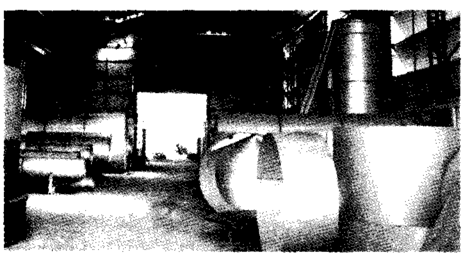
We see the Year 2005-06 as the year of consolidation for Praj. We have been on a growth path since 2001. In order to build our reserves for the coming growth phase, which could be quite significant, we need to invest into growth assets which includes markets, infrastructure and manpower.

The pace has already been set by the market. As a Company we have to be on top of events. We have to be SMARTER and STRONGER to move into the next orbit which could be at a HIGHER plane. And, we will always keep the customer at the centre of the orbit.

This has meant up-scaling in terms of internal resources manpower, manufacturing, R & D and IT systems. This call was taken, after a study for evaluation of markets was conducted, and the growth prospects in our selected markets ascertained.

Operating Environment & Performance

During the year, we saw prices of various inputs shoot up further.



Against this rise in prices of steel, the Company's primary raw material, Company has been able to keep margins steady because of prudent purchase and execution methods employed during the year.

Ethanol/Alcohol Technology continues to drive growth for your Company. Around 85% of the revenues are from the distillery sector which also includes related wastewater treatment systems. Other business lines including brewery and customized engineering account for the balance 15%. However, certain indications in the brewery and customized engineering sector also suggest an increase in activity and hence attractive business potential in the years to come.

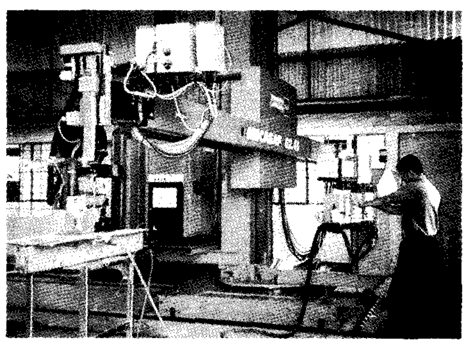
Growing awareness of India as a base for quality products has added to overseas recognition of Indian Companies. Praj continues to promote Brand India very strongly in newer markets.

Resources

Quantum growth requires a paradigm change in the way Companies would engage and apply resources. What are these paradigm changes and how will we apply them:

Smarter working methods can deliver 20-25% more in terms of efficiency. In terms of market reach, we have already forged an alliance for European region. We will be looking at more such models to enter into newer regions. Another alliance in the making is with Marubeni Corporation, Japan.

We have augmented our manufacturing facility further with another workshop added to the previous two workshops. This workshop is equipped with state of the art automated tools and machinery which will streamline workflow.



Our R & D facility, Matrix-The Innovation Center, has also been expanded in response to growing need for identifying newer energy crops and newer processes to improve yields and efficiencies in the industry. It will also take into account raw materials of newer regions.