



LANCO
INDUSTRIES
L I M I T E D

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BOARD OF DIRECTORS

| | |
|-------------------------------|-------------------|
| Shri Gowrishankar Tekriwal | Managing Director |
| Shri G. Bhaskara Rao | Director |
| Shri Haigreave Khaitan | Director |
| Shri L. Madhusudhan Rao | Director |
| Shri G. Maruthi Rao | Director |
| Shri S. Y. Rajagopalan | Director |
| Shri P. S. Raman | Director |
| Shri Shiv Shankar Poddar | Director |
| Shri Suresh Chukkapalli | Director |
| Shri L. Sridhar | Director |
| Shri Shravan Kumar, IAS (Rtd) | Nominee Director |

COMPANY SECRETARY

Shri D. Rama Prasad

AUDITORS

M/s K. R. Bapuji & Co., Hyderabad.

BANKERS

ICICI Bank Ltd
R. N. Mukherjee Road, Kolkata
HDFC Bank Ltd.
Sarat Bose Road, Kolkata

REGISTERED OFFICE

"Lanco House", 141, Avenue # 8,
L. V. Prasad Marg, Banjara Hills,
Hyderabad – 500 034.

FACTORY

Rachagunneri Village,
Shrikalahasti Mandal, Chittoor District,
Andhra Pradesh.

SHARE TRANSFER AGENTS & REGISTRARS

M/s Karvy Consultants Limited
Karvy House, 46, Avenue # 4, Street # 1,
Banjara Hills, Hyderabad - 500 034.

ELECTRONIC REGISTRARS

M/s Aarthi Consultants Pvt. Ltd.,
1-2-285, Domalguda, Hyderabad - 500 029.

MANAGEMENT

DISCUSSION AND ANALYSIS

Background

The Lanco group promoted Lanco Industries Limited (LIL) in 1992, in the Chittoor District of Andhra Pradesh. LIL set up a mini blast furnace (MBF) in 1994 with an installed capacity of 90,000 tpa to manufacture and sell pig iron to the castings and foundry units across India.

Value addition

The Company manufactures the following products. Pig Iron with an installed capacity of 90,000 tpa. Cement with an installed capacity of 90,000 tpa. In view of falling pig iron prices, LIL protected its value proposition by entering into an arrangement in 1998 to supply molten iron and pig iron to Lanco Kalahasthi Castings Limited (LKCL), a company within the same campus engaged in the business of iron castings and forgings. During 1999-2000, LIL further reduced its exposure to the highly competitive and price sensitive open pig iron market, by supplying additional molten metal to LKCL as the latter forayed into making cast iron pipes (CIP). During 2001-02, LKCL added high-technology Ductile Iron Pipes (DIP) to its portfolio.

The Problem

The anticipated value that could be derived from the companies downstream integration could not be realised following the unsatisfactory performance by LKCL. The latter could not realise its payments from the market, following which it failed to pay for the molten metal supplied. In turn, LIL failed to meet its payment obligations to vendors and lenders.

The Solution- strategic alliance

In March 2002, India's leading DI pipe manufacturer,

Electrosteel Castings Limited (ECL) entered into a strategic alliance with LIL and LKCL by acquiring 46.43 percent and 48.89 percent of stake in the Companies, respectively. Electrosteel Castings Limited possessed the requisite technological expertise to manufacture DI pipes and was competently placed to solve the technical and financial problems of the two Companies. Electro steel Castings Limited also infused fresh funds into LIL by way of equity participation and restructured the capital, thus reducing interest costs.

Present scenario

Operations of the Company improved considerably post ECL participation. Sales increased by 2.73 percent to Rs.93.34 crores and net loss was Rs.9.33 crore for the financial year under review, as compared to a loss of Rs.24.29 crores in 2001-02. The Company has suspended the production of portland slag cement in view of adverse market conditions.

Industry structure

The Pig Iron industry is a highly competitive and price sensitive one, influenced by many factors.

- Bargaining power of suppliers: Major raw materials in the manufacture of pig iron are coke and iron ore. The Iron Ore is extracted from mines while the coke is imported as these raw materials are non renewable in nature, suppliers exert considerable pressure during bargaining.
- Bargaining power of Buyers: Castings and foundry units further process pig iron and, in turn, supply it to a host of industries like automobile, textile, pumps and other engineering applications. The fact that large steel making units in India sell pig

iron at discounted prices has increased the bargaining power of buyers.

- **Entry Barriers:** Though it is a capital intensive industry, technological knowhow is available. Hence barriers to entry are only moderate.
- **Threat from Substitutes:** Metals like aluminum have replaced use of iron in the high value added

products segment.

- **Intra Segment rivalry:** At present, there is a supply overhang in the industry, resulting in intense inter-segment rivalry.
- **Competition:** Companies with downstream capabilities are more likely to perform better in the given industry scenario.

Production and demand related data of pig iron clearly indicates that there has been a glut in the market since 1996-97.

| Year | 1996-97 | 1997-98 | 1998-99 | 1999-00 | 2000-01 |
|------------|---------|---------|---------|---------|---------|
| Production | 3346 | 3416 | 3060 | 3193 | 3398 |
| Demand | 2910 | 2637 | 2782 | 2910 | 3177 |

(All figures in '000 tpa, source: IndiainfoLine)

The demand for pig iron started to look up in 2002-03 for a brief period following a rise in steel prices. But creation of fresh capacity and resumption of pig iron supplies from prime producers of steel again led to a fall in prices. Prices did rise in the last quarter of 2002-03, but that was due to a sharp increase in prices of coke. The latter outpaced the growth in pig iron prices. The following table indicates the trend in pig iron prices.

| Quarter | Average Price- Basic (Rs./ MT) |
|---------|---------------------------------|
| First | 6933 |
| Second | 6890 |
| Third | 7527 |
| Fourth | 8145 |

Business

Lanco Industries Limited (LIL) is in the business of manufacturing pig iron and cement. The Company sells pig iron in the market of South India and North India. It sources Iron Ore from the Bellary region, which is 400 Km away and imports coke mainly from China. It sources Lime Stone, the main raw material for cement, from its captive mines in Khazipet and Tippalur, 160Km away from the plant.

Highlights in 2002-03

Raw material: The Company worked with a stable base of vendors. It was in a position to negotiate on its terms of trade, as its operations improved and vendors were paid on time. The Company is in a

position to source additional raw materials as the requirement increases with capacity expansion.

MBF Operations: The Company's MBF possessed an installed capacity of 90,000 tpa in 2002-03. LIL recorded the highest ever production of 98,976 tpa of pig iron and molten metal. This transpired due to uninterrupted supply of good quality raw material and power. More than 50 percent of the production was sold to LKCL, and the rest was sold in the open market.

The Company is in the process of raising the capacity to 1,50,000 tpa during the current fiscal.

Downstream Operations: Since LIL will be supplying a major part of molten metal to LKCL for downstream processing, the latter's operations in the manufacturing of DI pipes will continue to be of crucial importance to LIL's financial health. LKCL has invested considerable resources to upgrade technology, improve pipe handling and raise capacities. As a result, rejects have fallen sharply and realisations have improved. In the present fiscal, LKCL plans to raise its capacity from 60,000 tpa to 1,00,000 tpa. It has suspended production of general castings and is concentrating on DI pipe production.

Cement Production: The Company produced 61425 tones of cement but realisation fell sharply due to intense competition. It has now decided to re-engineer the cement division and use the plant to produce ground slag which is used for concrete mixes.

The Company is taking various initiatives to optimise the utilisation and allocation of its resources.

- The MIS system is being revamped for better-informed decision making.
- A culture for promoting efficiency is being created.
- It has started practising TQM to further improve the quality of its product and to extent the culture of quality to its vendors.
- The health, safety and the environment department has been strengthened, to support the Company's endeavor towards becoming a responsible corporate citizen.

The Company expects to achieve ISO 9002 (version 2000), an international certification of quality management, by December 2003.

Segmentwise performance

The following table reflects the performance of the company during 2002-03, across different segments of its businesses.

| Segment | (Rs. In crores) | |
|----------|-----------------|---------------|
| | Revenue | Profit/(Loss) |
| Pig Iron | 80.28 | (6.92) |
| Cement | 10.69 | (2.41) |

The Company has closed down its construction division with effect from 2002-03.

Opportunities and threats

The sluggish prices of pig iron and the rising prices of coke represent a threat to the Company. Capacity enhancement and technology improvements at LKCL will enable it to better protect margins on its end product.

Outlook

The Company is taking various steps to streamline production, increase capacity, reduce cost and promote efficiency. The Company has a stable base for sourcing Iron Ore, and plans to install a coke oven to reduce

its dependence on imported coke and increase the capacity of its MBF.

LKCL and the main customer of LIL's Molten Metal, is also upgrading the production capacity for value added down stream production of DI Pipes. Consequently, LIL will be able to reduce its exposure to the open market of pig iron where prices are sluggish. The Molten Metal from the Company will be used for making value added products, like DI Pipes. This will translate into a guaranteed order booking and healthy margins for the Company.

Risks and concerns

Please refer to risk management section appearing elsewhere in the Annual Report.

Internal Control System and its adequacy

The Company's Internal Control systems are well established. It undertakes an internal audit that assesses them, while the statutory auditor and the audit committee regularly review them. Any change that is recommended is assessed and implemented.

Human Resources

The Company undertook several steps towards the optimisation of manpower. Industrial relations were cordial through out the year. Measures for safety of employees, their training and development received top priority.

Cautionary Statement

Statements in this report on management discussion and analysis, describing the Company's objectives or projections, may be forward-looking statements within the meaning of applicable laws or regulations. Actual results could, however, differ materially from those expressed or implied.

RISK MANAGEMENT

Vision risk

The possible lack of vision on the part of Lanco's Management could restrict growth and value enhancement for shareholders.

Risk Mitigation

The Company expects to achieve operational efficiency through organic growth, use of the pig iron / molten metal for value addition at LKCL and higher than average realisation. The Company has already embarked on those initiatives and expects that the value unleashed from these activities will be attractive and sustainable. The vision has been articulated across the various management tiers of the organisation under the able guidance of Electrosteel Castings Limited.

Industry Risk - Pig Iron

The industry may cease to be attractive.

Risk Mitigation

Falling international prices and supply overhang in the domestic market have made the pig iron market unattractive. The Company supplies the pig iron / molten metal to LKCL's spun pipe unit and to ECL's Elavur CI Spun Pipe unit for the use of Pipe making. Thus the Company avoids the exposure in the unattractive domestic pig iron market.

Technology risk

The Company's investment in assets or infrastructure runs the risk of technological obsolescence.

Risk Mitigation

Under ECL's guidance the Company is restructuring its asset base. Also, the Company is taking care of balancing factors like supply of raw material, efficient utilisation of the intermediate products and maintenance and upgradation of the assets.

Cost Risk

The upward revision in the number of inputs and raw materials used by Lanco may dent margins and bottomline.

Risk Mitigation

For the raw material coke, the requirement has been clubbed with ECL's requirement, which gives the Company better bargaining power and availability. With the improvement of technology and intelligent debottlenecking of operations is expected to increase productivity and reduce costs.

Environment Risk

The Company's operation is energy intensive, which might pose a threat to the environment.

Risk Mitigation

The Company has invested and also it is in the process of investing further in pollution control equipment. Complying with the statutory norms is considered to be the minimum achievement by the Company.

Location Risk

Lanco's plant may be potentially in the wrong location.

Risk Mitigation

Lanco is attractively located. The Company supplies molten metal to LKCL which is located in the same campus.

Finance Risk

The Company is required to pay out large debt installments which could result in a liquidity squeeze.

Risk Mitigation

LKCL has paid LIL back for the raw material supplied. The Company has also issued equity worth Rs. 22 Crore on a preferential basis in March 2002. The debt equity ratio by the end of 2002-03 has come down to a comfortable level of 0.9 from 1.10 in 2001-02. With the inflow of cash the company has retired high cost debt and has been able to arrange working capital at a reasonable cost. The company expects to generate requisite cash flow to meet the debt obligation in 2003-04.

DIRECTORS REPORT

To

The Members

Your Directors have pleasure in presenting the Eleventh Annual Report on the business and operations of the Company and the Audited Accounts for the year ended 31st March 2003 and the Auditors' Report thereon.

FINANCIAL RESULTS

(Rs. In lakh)

| | Year ended 31.3.2003 | Year ended 31.3.2002 |
|--|-------------------------|-------------------------|
| Sales | 9333.97 | 9085.60 |
| Other Income | 21.88 | 21.59 |
| Profit/ (Loss) before Interest and depreciation | (268.83) | (1054.83) |
| Interest | 314.83 | 1022.93 |
| Depreciation | 349.42 | 351.07 |
| Net Profit/(Loss) before Tax | (933.08) | (2428.83) |
| Net Profit/(Loss) after Tax | (933.08) | (2428.83) |
| Balance b/f from previous year | (2381.55) | (302.72) |
| Balance to be carried to the Balance Sheet | (3314.63) | (2731.55) |

There has been improvement in the operations. The Company's efforts to reduce cost through better efficiency in operation and financial charges have largely borne fruit. Overhead expenses have been contained. Considering the provisions for bad debts at Rs.307.47 lakh, the working of the Company should be considered satisfactory.

OPERATIONS

Pig Iron

The production of pig iron was 98976MT as against 83058 MT in the previous year and the sale at 94238 MT as against 85671MT in the previous year. Interest and financing charges at Rs.3.75 crore is less by Rs.7.08 crore than the previous year. There was a shutdown of the plant from 7.4.2003 to 8.6.2003 for relining and increasing the capacity of Mini Blast Furnace. The capacity of the furnace has been increased to 450 tonnes per day while production is presently limited to 350 tonnes for reasons explained hereunder.

Cement

61425 MT of cement was produced during the year as against 71118 MT in the previous year. During the year, your Company dispatched 61442 MT as against 71652 MT in the previous year. The market for cement is not favourable and the working of mini cement plants in general does not appear to be viable under present conditions. The Company has suspended production since 12.4.2003 for the time being.

Market

Under the present situation of production exceeding the demand particularly in Southern region the price for pig iron has moved downwards. Coupled with the increase in cost of production due to steep increase in the price of coke in international market the margins have eroded and the outlook in the near term does not appear promising. However the offtake of liquid metal to Lanco Kalahasthi Castings Ltd (LKCL) plant has increased to 5000 tons per month.

OUTLOOK

The current outlook for your Company has to be viewed in the light of the present market conditions. In spite of the adverse conditions prevailing, the Company hopes to achieve break-even levels in the current year.

All instalments and interest to the financial institutions on the loans borrowed from them are up-to-date.

DIVIDEND

On the account of operating losses, your Directors regret their inability to recommend any dividend for 2002-03.

MERGER

Your Company has, subject to all approvals and sanction of Hon'ble High Court, decided to merge Lanco Kalahasthi Castings Limited (LKCL) with your Company. The merger will be most advantageous for both the Companies in view of the close business dependence of one to the other. A large part of pig iron in liquid form is consumed by LKCL in the manufacture of pipes. The swap ratio for the merger was referred to Ernst & Young Pvt. Ltd (EY) for their recommendation. EY have reported the SWAP ratio of 3 equity shares of your Company for every share of LKCL. Keeping in view the large capital base of both the companies, the board of your Company has decided to recommend reduction of share capital of your Company to one fourth of its present capital and consolidating the shares of Rs.2.50 each (as reduced) into face value of Rs.10 each and based on such reduction and consolidation to issue 3 shares of your Company for every 4 shares of LKCL, which maintains the swap ratio recommended by EY. All necessary formalities are being taken up towards this end.

DIRECTORS

Shri L. Rajagopal, Chairman of the Board has resigned from the Board on 05.02.2003. He has been the founder member of the Board and during his tenure he has guided the Company well at difficult times.

The Directors record their appreciation of the valuable services rendered by Shri L. Rajagopal during his tenure.

Shri L.Sridhar has been appointed as director in the vacancy caused by the resignation of Shri L.Rajagopal.

In accordance with the provisions of the Companies Act, 1956 and article 105 of Articles of Association of the Company, Shri Suresh Chukkapalli, Shri P. S. Raman and Shri Shiv Shankar Poddar, retire by rotation and they being eligible offer themselves for re- appointments.

CORPORATE GOVERNANCE

The Corporate Governance report is set out as Annexure to this Report.

MANAGEMENT DISCUSSION AND ANALYSIS

Please refer to the management discussion and analysis section appearing elsewhere.

INDUSTRIAL CLIMATE

Most harmonious Industrial relations prevailed during the year and no man-days have been lost on this account.

AUDITORS

M/s. K.R.Bapuji & Co., Chartered Accountants, Auditors of the Company retire at the conclusion of the Annual General Meeting and are eligible for re-appointment. They have conveyed their willingness to accept re-appointment and confirmed their eligibility under Section 224(1-B) of the Companies Act, 1956.

PARTICULARS OF EMPLOYEES

None of the employees was employed throughout the financial year under review who was in receipt of remuneration for the financial year in aggregate of more than Rs.24,00,000/- or Rs.2,00,00/- per month or part thereof.

STATUTORY INFORMATION

Information regarding conservation of energy/ technology absorption, foreign exchange earnings and outgo required to be disclosed under Section

217(i)(e) of the Companies Act, 1956 is enclosed in Annexure "A".

DIRECTORS RESPONSIBILITY STATEMENT

Your Directors hereby confirm:

- i) That in preparation of annual accounts containing financial statements for the year ended 31st March 2003 the applicable accounting standards have been followed.
- ii) That the accounting policies are consistently followed and your Directors have applied them to give a true and fair view of the state of affairs of the Company and the profit/loss for that period.
- iii) That 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.

- iv) The annual accounts have been prepared on a going concern basis.

ACKNOWLEDGMENTS

Your Directors would like to express their grateful appreciation for the assistance and co-operation received from the Financial Institutions, Banks and the Government Authorities and Shareholders during the year under review. Your Directors wish to place on record their deep sense of appreciation for the sincere services of the Executives, Staff and Workers of the Company.



or and on behalf of the Board

Place: Chennai

Date: 31 July, 2003

Gowrishankar Tekriwal

Managing Director