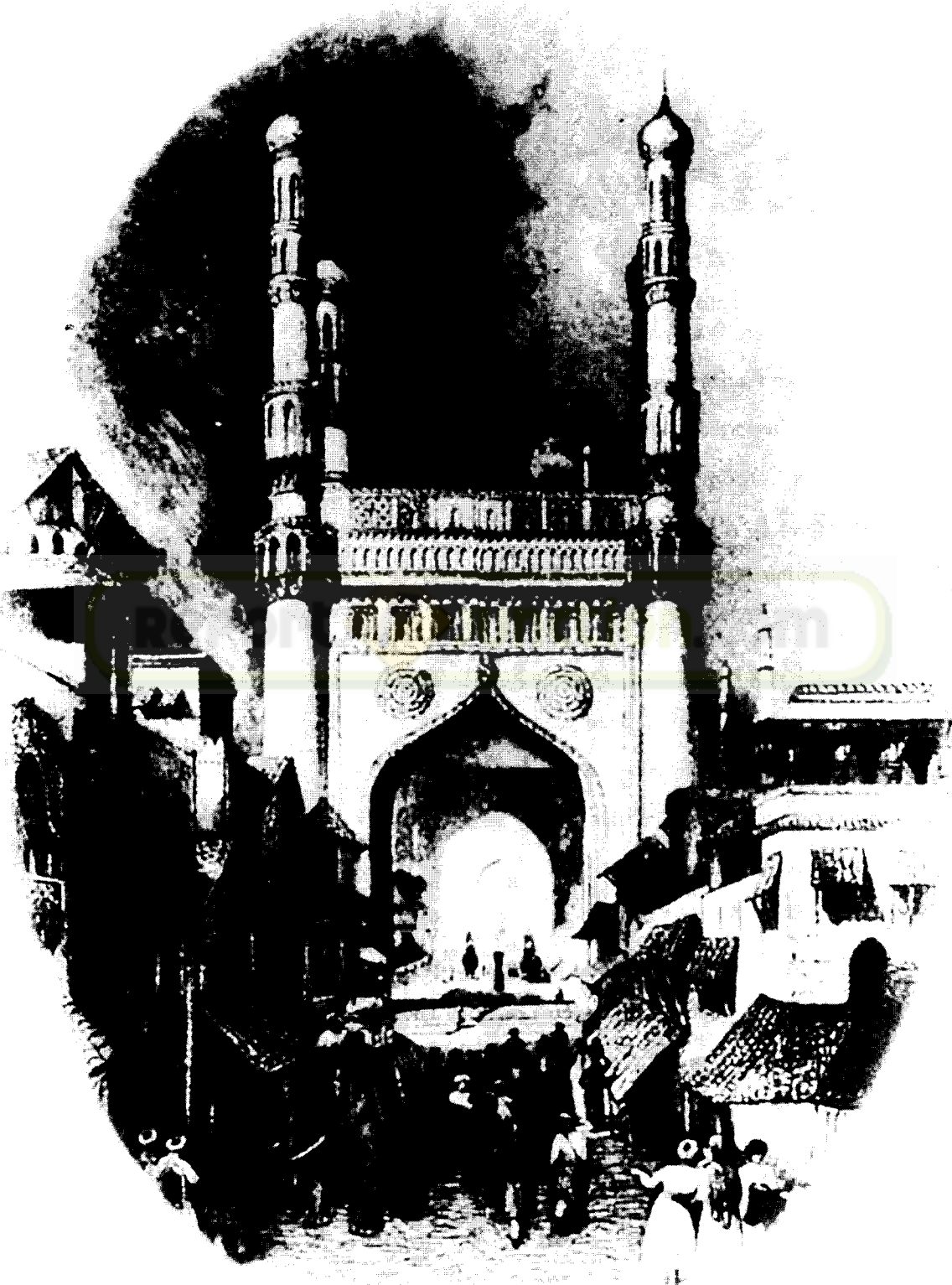


VST INDUSTRIES LIMITED

ANNUAL REPORT 2007





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BOARD OF DIRECTORS

Chairman

ABHIJIT BASU

Managing Director

RAYMOND S. NORONHA

Finance Director & Secretary

N. SAI SANKAR

Directors

ANDREW O'REGAN

AIR CHIEF MARSHAL IDRIS HASAN LATIF, P.V.S.M. (Retd.)

T. LAKSHMANAN

R.V.K.M. SURYARAU

S.THIRUMALAI

Auditors

Lovelock & Lewes

Chartered Accountants

Hyderabad - 500 082

Andhra Pradesh

Registered Office

1-7-1063/1065, Azamabad

Hyderabad - 500 020

Andhra Pradesh

Registrars & Share Transfer Agents

Sathguru Management Consultants Private Limited

Plot No.15, Hindi Nagar

Near Sai Baba Temple, Punjagutta

Hyderabad - 500 034

Phone : 040 - 2335 0586, 2335 6507, 2335 6975

Fax : 040 - 2335 4042

E-mail : sta@sathguru.com



VST Industries Limited

NOTICE OF MEETING

NOTICE IS HEREBY GIVEN THAT the Seventy Sixth Annual General Meeting of VST INDUSTRIES LIMITED will be held at Hotel Taj Krishna, Road No.1, Banjara Hills, Hyderabad - 500 034 on **Wednesday, 18th July, 2007 at 10.30 a.m.** for transaction of the following business:

1. To receive, consider and adopt the Audited Balance Sheet as at 31st March, 2007, the Profit and Loss Account, Auditors' Report and Directors' Report for the Company's year ended 31st March, 2007.
2. To declare a Dividend on the Ordinary Share Capital.
3. To elect Directors in place of those retiring by rotation.
4. To appoint Auditors and to fix their remuneration. In this connection to consider and, if thought fit, to pass the following Resolution which will be proposed as an Ordinary Resolution:

"RESOLVED that Messrs. Lovelock & Lewes, Chartered Accountants, be and are hereby appointed as the Auditors of the Company to hold such office until the conclusion of the next Annual General Meeting at a remuneration of Rs.14,00,000 (Rupees Fourteen lakhs only) payable in two equal instalments plus service tax as applicable and reimbursement of out-of-pocket expenses incurred."

SPECIAL BUSINESS

5. To consider and, if thought fit, to pass with or without modification(s), the following Resolution which will be proposed as an Ordinary Resolution:

"RESOLVED that Mr. Andrew O'Regan who was appointed a Director of the Company to fill the casual vacancy caused by the resignation of Mr. Emil Moskofian and who vacates office at the ensuing Annual General Meeting under Section 262 of the

Companies Act, 1956 and in respect of whom the Company has received a notice in writing from a Member proposing his candidature for the office of the Director be and is hereby appointed as a Director of the Company whose period of office shall be liable to determination by the retirement of Directors by rotation."

The Register of Members of the Company will remain closed from 16th July, 2007 to 18th July, 2007 (both days inclusive) for payment of dividend, if approved.

Transfer of shares received in order by the Company's Registrars and Share Transfer Agents, M/s. Sathguru Management Consultants Private Limited, Plot No.15, Hindi Nagar, Near Sai Baba Temple, Punjagutta, Hyderabad - 500 034, before the close of business on 14th July, 2007, will be registered in time for the transferees to become eligible for dividend, if declared.

Dividend, if approved, will be paid on or before 17th August, 2007 to those shareholders whose names appear in the Register of Members of the Company on 18th July, 2007 or to their Mandatees, subject however to the provisions of Section 206A of the Companies Act, 1956, or any amendment or modification thereof. In respect of dematerialised shares the dividend will be payable on the basis of beneficial ownership as per details to be furnished by National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) for this purpose.

By Order of the Board,

N. SAI SANKAR
Secretary

Dated this 18th day of April, 2007.
Azamabad, Hyderabad - 500 020,
Andhra Pradesh.



NOTES

1. **A Member entitled to attend and vote at the General Meeting may appoint a proxy, who need not be a Member, to attend and on a poll, to vote on his behalf. The proxies should be deposited at the Registered Office of the Company not less than forty eight hours before the commencement of the Meeting.**
2. In accordance with Section 173(2) of the Companies Act, 1956, an Explanatory Statement in respect of item 5 being item of Special Business is annexed to the Notice of the Meeting.
3. In accordance with the provisions of Article 93 of the Articles of Association of the Company, Mr. A. Basu and Mr. R.V.K.M. Suryarau will retire by rotation at this Annual General Meeting and being eligible offer themselves for re-appointment.
4. Shareholders should inform the Company's Registrars and Share Transfer Agents, M/s. Sathguru Management Consultants Private Limited of any change in their registered address, before 16th July, 2007.
5. Shareholders who have multiple folios in identical names or joint names in the same order are requested to intimate to the Registrars and Share Transfer Agents, M/s. Sathguru Management Consultants Private Limited, these folios to enable consolidation of all such shareholdings into one folio.
6. Shareholders are requested to refer to the "Shareholder Referencer" which inter-alia contains details regarding unclaimed dividend.
7. Shareholders are requested to bring their copy of the Annual Report to the Meeting.

Report Junction.com

EXPLANATORY STATEMENT

In accordance with Section 173(2) of the Companies Act, 1956, the following information is given in explanation of the items of Special Business set out in the attached Notice of the Seventy Sixth Annual General Meeting of the Company to be held at Hotel Taj Krishna, Road No. 1, Banjara Hills, Hyderabad - 500 034 on **Wednesday, 18th July, 2007.**

Item No. 5

Mr. Andrew O'Regan who was appointed as a Director of the Company on 27th July, 2006 to fill the casual vacancy caused by the resignation of Mr. Emil Moskofian in terms of Section 262 of Companies Act, 1956 and Article 98 of the Articles of Association of the Company, vacates office at this Annual General Meeting.

A notice has been received by the Company along with a deposit of Rs.500 from a Member under Section 257 of the Companies Act, 1956, proposing the appointment of

Mr. Andrew O'Regan as a Director at this meeting having filed his consent with the Company to act as Director.

Mr. Andrew O'Regan is a Science Graduate and has wide knowledge and experience of corporate management. Currently, he is Managing Director and CEO of Ceylon Tobacco Company Limited, Sri Lanka.

No Director of your Company other than Mr. Andrew O'Regan is concerned or interested in this Resolution.

The Board commends this Resolution for your approval.

By Order of the Board,

N. SAI SANKAR
Secretary

Dated this 18th day of April, 2007.
Azamabad, Hyderabad - 500 020,
Andhra Pradesh.



REPORT OF THE BOARD OF DIRECTORS & MANAGEMENT DISCUSSION AND ANALYSIS TO THE SHAREHOLDERS FOR THE YEAR ENDED 31ST MARCH, 2007

VST Industries Limited

The Directors of your Company have pleasure in presenting their Annual Report and Accounts for the year ended 31st March, 2007.

Financial Results

Rs. Lakhs

The Net Profit for the year, after deducting all charges, expenses and taxation but before extraordinary item amounts to

Adding thereto Profit brought forward from the previous year

The amount available for disposal was

Out of which the following appropriation has been made :

General Reserve

Leaving a balance of

Out of which your Board recommends

Should be distributed as Dividend on the Ordinary Share Capital at the rate of Rs.20 per share and inclusive of Dividend Tax

Leaving an undistributed amount of

in the Profit and Loss Account to be carried forward to the following year.

5509.17

5145.04

10654.21

600.00

10054.21

3613.25

6440.96

Market Scenario

Your Company after reversing the trend of declining volumes in 2004-2005, continued to maintain volumes in line with last year in spite of price changes of key filters and micros in 2006-2007. This was made possible primarily through expanding the consumer base in the micro segment, both in existing areas of operations, as well as in previously unrepresented geographies, and by successfully launching an extension of a key filter brand.

In the micro plain segment, distribution focus resulted in the growth of **Charminar Standard**. Your Company's second largest micro brand **Shaan** grew significantly, particularly in previously unrepresented areas of Uttar Pradesh and Madhya Pradesh. In addition, there has been a sizeable growth seen in the tipped micro segment with Ace Tipped and launch of a new brand **Gold Medal Tipped**.

In the regular sized filter segment, the **Special** trademark, through its two variants, **Special Filter** and **Special Extra Smooth**, continued its satisfactory performance. **Special Filter** continued to protect its consumer franchise from competitive threats. It showed significant improvement in disposition through a pack format change to fine edge pack for the first time in regular size filters in India. **Special Extra Smooth** meanwhile has built a loyal base among the value-seeking consumers in the state of West Bengal.

In the Charms family, its new variant **Charms Premium**, showed a sizeable presence primarily in markets with strong Charms equity, drawing its share from new entrants.

INDUSTRY STRUCTURE & DEVELOPMENT

The Indian economy has taken off with GDP recording growth in excess of 9% for the last 2 years. The cigarette industry has been growing albeit at a much lower rate. The primary reasons for this low growth are the discriminatory tax policies and severe restrictions imposed on smoking and advertisements. Laws have also been proposed to bring in graphic health warnings which could further curb smoking thereby affecting future growth patterns.

SEGMENT WISE PERFORMANCE

Your Company considers tobacco and related products as the primary segment for reporting. Geographical segments

considered for disclosure mainly consist of sales within India and sales outside India. The entire activity pertaining to sales outside India is carried out from India.

Industry Issues

The industry has been representing to the government about the need for an equitable tax policy for all tobacco products but with no success till date. The share of cigarettes which constitutes a mere 15% of the total tobacco consumption could erode further with Union Budget proposals for the year 2007-2008 levying a 6% increase across the board in all segments of the cigarette industry inclusive of 1% cess.

The introduction of Value Added Tax on tobacco products at the state level could



In keeping with your Company's commitment of expanding its brand range and establishing its presence in unrepresented and under represented geographies through new brand endeavours and brand extensions, two new brands namely, **XLS and Moments** in the regular sized filter segment were launched in the last quarter of 2006-2007. Further new brand developmental activities continue to be accorded high levels of priority and organizational focus.

Leaf Tobacco

We are happy to report that your Company has recorded Rs.44.90 crore leaf export turnover, which is 5% higher than the year 2005-2006, despite increasing competition.

Your Company has established special tobaccos for niche markets, which are being produced by the large farmer base of your Company. This has helped in optimizing the turnover and profit and also helped in economic upliftment of the backward regions. Your Company has entered into long term tie-ups with potential customers for Oriental Tobacco development and marketing, which has now attained commercial production levels. Established market with premium customers for Air Cured Burley exports will ensure steady export growth in the years to come. Your Company continues to retain the premier status in Sun/Air/Fire cured tobaccos.

You will be pleased to learn that your Company's farmers continue to grow tobacco with lowest pesticide residue levels and within international standards. Your Company is also actively promoting Vermi Compost units for organic farming among tobacco farmers.

As a social responsibility to conserve greenery, your Company is continuing social forestry through afforestation and Trees for Life and also actively discouraging child labour involvement in tobacco growing/processing.

PRODUCTION AND PLANT MODERNISATION

Primary Manufacturing Department (PMD)

New design tipper/holding band from Dickinson Fowler, Bangalore has been installed in stem conditioning line to reduce degradation and spillages.

New design roller sieve complex from Dickinson Fowler, Bangalore has been installed in lamina cutting line to ensure consistent sieving and less rejections.

Steam treatment of stems (STS) from Dickinson Legg, U.K. has been installed in stem drying line to improve consistency and fill values and to reduce rejections.

Tobacco utilization in the processing lines has increased by 0.3% over the last year.

Secondary Manufacturing Department (SMD)

As per ongoing modernisation plan of Secondary Manufacturing Department to improve productivity and quality, the following technology has been put in place -

- Four Molmac MK9 MTF machines speed has been increased from 5000 to 5500 cpm
- One Molmac MK9 MTF machine has been installed
- Direct transportation of corrugated fibre cartons (CFC) from SMD packing lines to the warehouse on the filter line.

Engineering

- Variable frequency drives (VFD) for SMD humidification system with speed modulation
- VFD for scrubber
- Soft Starters for band conveyors in PMD
- Harmonic audit was carried out
- 17 new earth pits

HUMAN RESOURCE DEVELOPMENT

Your Company's human resource management system aim is to have on a continuous basis, a talent pool ready to meet challenges in the highly competitive market and deliver results.

Development programmes have been undertaken at periodical intervals in order to build the requisite competencies as well as to improve knowledge and job content.

As on 31st March, 2007, your Company had a strength of 1072 employees, with 264 management staff and 808 workmen.

The Long Term Agreement was signed with the Company's recognized union for a period of 3½ years commencing 1st February, 2006.

During the year, 94 workmen opted for Voluntary Retirement Scheme framed by the Company.

CONSERVATION OF ENERGY, TECHNOLOGY ABSORPTION, FOREIGN EXCHANGE EARNINGS AND OUTGO

Information in accordance with clause (e) of sub-section (1) of Section 217 read with the Companies (Disclosure of Particulars in the Report of Board of Directors) Rules, 1988 is given in the Annexure to this Report.



ENVIRONMENT, HEALTH & SAFETY (EHS) AND COMMUNITY SERVICES

Your Company has been maintaining sustained safety performance for the last 10 months without any accidents and working over 1.88 million manhours till the end of the financial year. Behind this creditable achievement, there have been co-ordinated efforts by all employees.

During the year, your Company had installed automatic sprinkler alarm system integrating with existing sprinkler system for faster response time.

Gold Award for the year 2006 was given by Royal Society for Prevention of Accidents (RoSPA), U.K. for maintaining highest standards in Occupational Health and Safety.

Safety Innovation Award for the year 2006 was awarded to your Company by Safety & Quality Forum, Institute of Engineers (India) for implementing innovative Safety Management Systems.

Environment, Health and Safety (EHS) in day-to-day business operations is given very high priority by your Company. 510 employees and 14 contractors had undergone EHS training programme during the period to comply with the Company EHS guidelines. Involvement by workmen in quarterly EHS reviews along with staff members and periodical inspections have kept the performance monitoring on vigil. Quarterly and Annual EHS audits of the Company operations including leaf godowns was carried out to ensure compliance of EHS requirements to measure the EHS progress. EHS Road Map rating of your Company was assessed at 3.50 as against the scale of 4.0 for the year 2006.

Your Company had celebrated National Safety Day on 4th March, 2007 by conducting safety meetings, medical check up for workmen and also organized Castrol Road Safety Week for VST employees in association with Castrol by conducting Quiz and Slogan contests.

Surveillance Reviews of ISO 14001 : 2004 & OHSAS 18001 for the year 2006 by Registro Italiano Navale India (RINA) revalidated your Company's certifications.

In the environmental side, as a responsible corporate your Company continues to put in sustained efforts in the upkeep and improvisation of existing systems like scrubber, DRF systems, rain water harvesting pits, ETP with soil biotechnology, etc.

Statutory compliances are in place.

The thrust on EHS will continue while emphasizing the focus on best international work practices.

FINANCE

The Profit After Tax for the year at Rs.55.09 crore is the highest ever achieved in the history of the Company. This was done after charging in total an amount of Rs.9.25 crore incurred on account of Voluntary Retirement Scheme launched by your Company during the year.

The focus of the business continues to be in growing the traditional tobacco business. Profitability and cash flows continue to be healthy. Tight working capital management and cost control measures with specific emphasis on elimination of non-value added activities have enabled resources to be deployed in the most productive assets thereby enhancing profitability levels.

ENTERPRISE RESOURCE PLANNING (ERP)

Your Company is now planning to move into an upgraded version of Enterprise Resource Planning. This is expected to be completed within this financial year. The total information technology activity has been outsourced, between WIPRO Technologies / Lanco Global Solutions.

Further alignment of business process is also being contemplated.

FIXED DEPOSITS

As on 31st March, 2007, your Company does not have any deposits for the purpose of its business. Letters have been written to 7 depositors who did not claim their deposits (amounting to Rs.33,000), before and after the date of maturity for repayment.

Your Company has stopped accepting fresh deposits for the last several years.

RATING

The Credit Rating Information Services India Limited (CRISIL) have re-affirmed the rating of your Company to "FAAA" for Fixed Deposit Schemes and "AA+" for Long Term Non-convertible Debentures.

UNCLAIMED DIVIDENDS

Your Company had vide its letter dated 25th October, 2001 communicated to all the shareholders about the promulgation of Rules pertaining to the Investor Education and Protection Fund. Dividends which remain unpaid or unclaimed for a period of seven years would be deposited in the Investor Education and Protection Fund. The final dividend for the year ended 31st March, 2000 remaining unpaid would be deposited by 12th November,



2007 in accordance with Section 205C read with Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001.

SUBSIDIARY COMPANIES

It was reported last year that an application was being made for merger of Hallmark Tobacco Company Private Limited (HMTC) with VST Distribution, Storage and Leasing Company Private Limited (VSTDLS). A Court Order has since been received sanctioning the amalgamation of HMTC with VSTDLS with effect from 1st April, 2006.

CORPORATE GOVERNANCE

The Company's Report on Corporate Governance is annexed to this Report.

Certificate of the Auditors of your Company regarding compliance of the conditions of Corporate Governance as stipulated in Clause 49 of the Listing Agreement with stock exchanges is annexed to this Report.

Your Company has taken adequate steps for strict compliance with the Corporate Governance provisions including the revisions made.

INTERNAL CONTROL SYSTEMS

Your Company remains committed on improving the effectiveness of internal control environment which provides assurance on the efficiency of operations and security of its assets.

The internal audit process captures the control environment prevalent in the organization. Over a period of three years, the entire business process of your Company is reviewed, potential high risk areas identified and steps to mitigate these are put in place.

The Audit Committee of your Board met four times during the year. Review of audit observations covering the

operations, consideration of accounts on a quarterly basis and monitoring the implementation of audit recommendations were the key areas of focus. The Statutory Auditors were invited to attend all the Audit Committee meetings and share their views on adequacy of internal controls as well as present their audit plan for the year.

A self-evaluation system has been put in place on internal controls and comprehensive documentation has been done covering the various business processes. This would strengthen the control environment further.

Internal control guidelines covering the entire business process has been put in place. This will be reviewed on a continuous basis and would form an effective tool for improving internal controls on a continuous basis.

Risk Management

A Risk Management Committee comprising members from various functions has been set up and the Committee meets periodically to identify the potential risks as well as to take adequate steps for mitigating the risks so identified. These are subject to regular reporting to the Board.

DIRECTORS

Directors retiring by rotation

In accordance with Article 93 of the Articles of Association of your Company, Mr. Abhijit Basu and Mr. R.V.K.M. Suryarau retire from the Board and being eligible, offer themselves, for re-election. Your Board also recommends their re-appointment.

a. Mr. Abhijit Basu

Mr. Abhijit Basu was appointed a Director on the Board of your Company

with effect from 19th June, 1989. He was appointed under the provisions of Section 257 of the Companies Act, 1956 at the Annual General Meeting held on 20th July, 1990 and was last retired and re-appointed at the Annual General Meeting held on 22nd July, 2004. Mr. Basu is now due to retire by rotation at the forthcoming Annual General Meeting and being eligible, offers himself for re-appointment.

Mr. Basu is a Graduate in Physics from Oxford University. He has had about 34 years of experience in ITC Limited and held various positions in the areas of Personnel, Leaf, Printing and Packaging and Hotels. He retired as Deputy Chairman from ITC Limited in the year 1989 and joined your Company as Chairman. Your Company has been receiving his expert advice and guidance for over 18 years of his association with the Company. He is also a Member of Audit Committee and Committee of Directors of your Company. Mr. Basu is a nominee Director on the Board of VST Distribution, Storage & Leasing Company Pvt. Ltd., wholly owned subsidiary of the Company, in compliance with Clause 49 of the Listing Agreement with the Stock Exchanges.

b. Mr. R.V.K.M. Suryarau

Mr. R.V.K.M. Suryarau was appointed a Director on the Board of your Company with effect from 9th December, 1989. He was appointed under the provisions of Section 257 of the Companies Act, 1956 at the Annual General Meeting held on 20th July, 1990 and was last retired and re-appointed at the Annual General Meeting held on 22nd July, 2004. Mr. Suryarau is now due to retire by rotation at the forthcoming Annual General Meeting and being eligible, offers himself for re-appointment.