Chairman's Speech

Annual General Meeting on August 10, 2018

Good morning, ladies and gentlemen. On behalf of the Board of Directors, it is my pleasure and privilege to welcome you to this 9th Annual General Meeting of your company.

ECONOMIC AND INDUSTRIAL SCENARIO

The global economy is growing at its fastest pace since 2010, in spite of the pressures of the trade war, with the upturn increasingly synchronised across countries. The world economy is expected to strengthen further in 2018 and 2019, with growth projected to rise to about 4% and India contributing the most as the world's fastest growing economy at a projected rate of 7.5% in FY 2018-19.

In India, FY 2017-18 began uncertainly with the economy coming to terms with the impact of demonetisation. In the second quarter, it saw considerable disruption due to the rollout of the Goods and Services Tax (GST). The slowdown, as compared to the last fiscal, could be attributed to subdued growth in the 'agriculture and allied' and 'industry' sectors.

Additionally, average crude oil prices have risen by around 14% this year over the previous year with resulting pressure on the rupee.

With the focus on infrastructure growth and increase in per capita consumption in spite of these headwinds, your company continues to bring innovative offerings to the customer at competitive prices and is contributing to the 'Make in India' initiative.

FINANCIAL HIGHLIGHTS, FY 2017-18

Despite an extremely challenging macroeconomic environment, your company posted its highest net sales.

On a standalone basis…

- Total sales for the year at Rs 2,804 crores was higher, by 7%, than the PY's figure of Rs 2,614 crores.
- Profit from operations before tax for the year before exceptional items was Rs 222 crores as compared to Rs 252 crores in the previous year. It is pertinent to note that the Industrial Promotion Subsidy, which the company was availing of for operations in Kagal, ended on March 31, 2017. In the previous year, the amount availed was approximately Rs 36 crores
- Profit after tax for the year was Rs 150 crores as compared to Rs 174 crores in the previous year

On a consolidated basis…

- Additional sales revenue from our American subsidiary for the fiscal ended March 31, 2018, was $37,30,142 (Rs 24 crores). Profit from operations before tax was $1,51,319 (Rs 0.98 crores.). Profit after tax was $1,12,222 (Rs 0.73 crores).
- Additional sales revenue from La-Gajjar Machineries Private Limited for the period from August 1, 2017, to March 31, 2018, was Rs 214 crores. Loss from operations before tax was Rs 11 crores. The net loss was Rs 8 crore. The focus has been to align accounting policies like inventory valuation, debtors provisioning, etc, in line with KOEL's and this resulted in several one-time hits to the P&L. The effect of demonetisation and GST introduction also negatively affected sales and profits. Details of the La-Gajjar acquisition follow later

On the dividend front, the board has declared an interim dividend of 125%, which is Rs 2.50 per equity share and a final dividend of 125%, which Rs 2.50 per equity share during FY2017-18.

Your company held on to its dominant market share and leadership position in low and medium kVA segments and took aggressive strides in the high kVA segment. The 750-1010 kVA was introduced by your company in 2016 and all three nodes, i.e. 750, 900 and 1010, have been very well accepted in the market as is evident from the 50% growth over the previous year and the significant gain in market share. The unique 910 kVA genset was successfully installed and commissioned for the Chennai Metro. That led to several inquiries from other states commissioning Metro projects. A great product, coupled with a sound marketing strategy and backed by a dependable service network, gives us the confidence of accelerated growth in this segment in the coming years.

Improvement in rural electrification is resulting in demand shift from diesel to electric pump sets. The combined effect of destocking by dealers on account of GST and also lack of subsidy, affected sales of the traditional agri crop irrigation business which comprised diesel pump sets. We hope that the Direct Benefit Transfer scheme of the government is rolled out at the earliest, ensuring seamless flow of subsidy to farmers.

The industrial engines business has been on the upswing and for the first time the company’s industrial business crossed the Rs 500-crore mark. This vertical grew 18% over the previous year with the help of new applications developed in the past few years and a conducive environment that witnessed the commencement of various infra and road construction projects, triggering growth in industrial, off-highway and agricultural equipment.

With 430-plus service outlets pan-India and an extremely proactive service team, KOEL boasts of the best after-sales service support in the industry. Despite relatively lower DG set usage resulting from a negligible power deficit, innovative offerings and solutions have ensured that the customer support segment continues to delight our customers with optimum uptime.

International business remains a key strategic focus area and growth driver. Despite a tough macroeconomic environment, efforts to penetrate new markets and geographies paid off, resulting in a 20% growth over the previous fiscal. The focus in FY2018-19 will continue to be on entry into new markets and new products.

New product and application development remained the focus area for growth of the large engines business, which caters to a niche segment where demand is based on the launch of large government projects, and defence, power and propulsion requirements. Last year the company developed variants for auxiliary power units for the railways, which have been commissioned this year. A special a-magnetic engine was developed for mine sweeper boats for the Indian Navy, making KOEL the first Indian company and the third globally with the capability to develop such an engine.

Continuing our focus on sustainable operational excellence the company released its 6th Corporate Sustainability Report, which focuses on being future-ready at every level of business.

STRATEGIC INITIATIVES

Acquisition

The company entered into a share purchase agreement for acquisition of La-Gajjar Machineries Private Limited (LGM), a leading submersible and mono block pump manufacturer based in Ahmedabad, Gujarat, with established brands 'Varuna' and 'Raindrop' and a pan-India distribution setup. These brands stand for proven quality and robustness in domestic and international markets. This is a strategic acquisition made to consolidate our position in the diesel and electric pump segment. We are confident that synergies will play out and we will attain leadership in the complete pump segment.

As part of the share purchase agreement, signed on August 1, 2017, the company acquired 76% of equity shares of LGM with a clear understanding that the balance 24% would be acquired over a five-year period. LGM is now a subsidiary of the company.

In the first eight months of operation, the focus has been to establish processes and policies in line with KOEL's, set direction and integrate operations wherever needed to extract synergies going forward. What we have been able to achieve so far has been supply chain and financial integration. Improved supply chain results have already shown improvement in export sales, and we hope to cross Rs 100 crore in exports this financial year. The effects of improvements in operational efficiency and implementation of ERP will be seen over the next year. We also expect improvement in the working capital cycle leading to reduced borrowings. The cumulative result of these initiatives will be improved financials.

Financial services

Over the past few years, resulting from good working capital management, cash generation has been reasonably good. However, our conservative policy on investments yields only marginal and often sub-optimal returns on surplus cash. We have been looking at more efficient ways to deploy the accumulating cash. Part of the cash was utilised to fund the LGM acquisition. Increasingly, however, a need for a more structured and beneficial long-term approach was felt, and there was a financial need from the supply chain and the distribution channel.

After examining several options, it was decided that we foray into financial services. Accordingly, changes were made to the Memorandum of Association and approval sought of the company members by postal ballot. The company has since promoted and incorporated a wholly owned subsidiary, Kirloskar Capital Limited (KCL), on April 20, 2018, to commence the financial services business. KCL has filed an application with the Reserve Bank of India (RBI) to obtain registration for commencement of a NBFC.

A respected thought leader in this space is helping with RBI approvals. He has a proven and admired track record and will head KCL once we have all the approvals, which are expected by October-end.

We will commit roughly Rs. 1,000 crore over the next two to three years to this business. Given the fundamentals, our cost of borrowing would be lower, giving us great competitive advantage. The choice is supported by the unique opportunity presented by the Indian economy. Firstly, there is the country's fundamental growth. Structural reforms such as GST have widened and deepened the market even as technology and modern tools allow for a more penetrative approach.

We will start with loans to mid-sized and large corporations as well as SME lending (secured loans and channel financing) and then spread our wings into other sectors: retail, MSME, specialised lending in the corporate sector and loans against property. We will leverage the existing KOEL ecosystem to disburse loans and lending to our suppliers and channel partners.

New product and technology development

We understand that this is the beating heart of our business, which is why we are committing 4% of sales to research and development (R&D). It is in line with our relentless endeavour to enhance value for customers. Over the years, KOEL's R&D has focused on expanding the product and solutions range keeping in mind changing market needs and staying ahead on emission standards for sustainable growth.

This has resulted in significant achievements. One of these is the culmination of a three-year effort to get US Environmental Protection Agency certification for 30, 40 and 60 KWe engines for genset drive and industrial applications. With this, we can sell in the US market. The 100 kWe engine is in the process of getting approved this year.

After a similar three-year effort, we also received the FM-approved and UL-listed certification for a full portfolio of 55 HP to 350 HP engines up to 3,000 RPM for fire-fighting pumpsets, which we can now sell in the Middle East, Europe and the US. This is a very wide portfolio, covering 80% of the listed fire-fighting engines. We are only the fourth company in the world to have achieved this certification.

This year, the company developed a full range of heat exchanger cooled DG sets required for specific applications in industries as well as for placing DG sets in lower basement areas. In the last few years, there has been an environmental ban on sand mining in many parts of the country, which has created a demand in DG sets for the stone crushing. Technically, this is a very demanding application for which you need a special design.

The railways, meanwhile, are continuously upgrading and expanding their portfolio, creating new demand in the higher HP DG set segment. Your company has developed a range of DG sets specific to railway needs and garnered a good order board last year. Your company has set a new trend in the industry by establishing a completely new 900 kVA node, which is an extremely economic solution.

In farm mechanisation, based on customer feedback and insight, we chose to cater to unfulfilled demand by creating a new 15 HP power tiller called ‘Mega T’ and captured 50% of the market. This is likely to step up growth significantly in the current financial year. All competitors have now entered this segment but we continue to maintain our dominance. This tiller received the coveted Golden Peacock Innovative Product/Service Award for 2018. At the end of last year, we also introduced our new 12 HP power tiller for the mass segment.

For KOEL, embracing the digital platform is yet another way to provide value-added differentiated products and services. Some noteworthy value additions during the year include:

- The **Electronic Field Service Report** system for the 3,000+ service engineers on a pan-India basis provides real-time last-mile connectivity with the product, the customer and KOEL’s central system. The progress of every single customer request is tracked online till closure. This real time digital system is integrated with the KOEL’s Dealer Management System, Pulse. KOEL is the first company to cover all customers through this mechanism. This has also helped channel partners improve productivity of their service teams

- We launched a **separate online portal** for purchase of an annual maintenance contract for even a single small DG set like 5 kVA or a large one like 1010 kVa. We are the only ones in the industry to offer these services online. This product is aptly called 'Bandhan', meaning a service obligation
- In the agri space, through Agrifast we have digitally connected the last mile retailer with production in the plant on a real time basis. Consumption at each stage triggers supply from the next level and in the end triggers production at the plant. This has improved delivery lead time.

PERFORMANCE OF Q1, 2018-19

Sales revenue for the quarter ended June 30, 2018, stands at Rs. 820 crore as against Rs. 709 crore (Net of Excise Duty of Rs 55.3 crore, Gross revenue Rs. 764.6 crore) for the corresponding quarter of 2017-18.

Profit before tax for the quarter is Rs. 74 crore as against Rs. 54 crore for the corresponding quarter of 2017-18.

CHALLENGES AND OPPORTUNITIES GOING FORWARD

On the back of sustained demand from the infrastructure and telecom segments, and revival of the realty segment, it is expected that the improved market situation of FY 2017-18 will continue in FY 2018-19.

The railways power car segment holds promise for KOEL, as the Indian Railways plans to offer increased passenger amenities and comfort with air-conditioned coaches.

The company's project to complete the range of gensets up to 2,000 kVA and a single-cylinder modular design engine are progressing well. These products are expected to be rolled out in the coming financial year. This will further leverage gains in the HHP range to strengthen its volume and value share as well as offer the most fuel efficient solution to industrial off-highway customers.

While the agri business is never insulated from the vagaries of the monsoon, the company will continue to focus on the introduction of value-added products at affordable prices together with diversification of the product portfolio in farm mechanisation and by scaling up the electric pump business.

The company sees good opportunities for further expansion internationally for the Varuna brand of electric pumps.

The government is focused on infrastructure, road construction and mining, as is evident by the healthy fund allocations of various projects. With a focused approach and continued array of new application development, the industrial business is expected to continue growing.

With the development of new lightweight and compact DG sets, and the meeting of stringent product quality requirements in the large engines business segment, the company will continue to work on new products and applications in the defence, marine power and propulsion segments.

ACKNOWLEDGEMENTS

To conclude, I thank all stakeholders for their support. Our customers, suppliers, vendors, lenders and our motivated employees have supported initiatives undertaken by the company during the year. I look forward to your continued support.

Thank you very much.