MANAGEMENT DISCUSSION AND ANALYSIS

OVERVIEW

1. Building and capitalising on its consolidated resources and activities, the Company has successfully entered into a phase of active growth. In this endeavour, it draws on the positive results of earlier consolidation efforts, namely (a) restructuring and reorganisation (b) technology acquisition (c) business alliances and (d) enhancement of operational efficiency through IT and HR practices.

2. The above consolidation, especially the setting-up of self-independent cluster groups, had a direct impact on the directions and nature of growth. There has been (a) growth in all major existing and established domestic businesses (b) growth in the Company's thrust into the international arena (c) higher cost-savings from greater efficiencies and synergies and (d) growth in productivity of newly-streamlined resources.

3. One of the benefits of the consolidation measures is an increase in the Company's agility, and in responsiveness to changing market and economic conditions and new opportunities.

ELECTRO-MECHANICAL PROJECTS AND SERVICES

4. The Indian Heating, Ventilation, Air conditioning and Refrigeration (HVACR) market had a Compound Annual Growth Rate (CAGR), of over 5% during the last three-year period. Different market segments have shown different growth trends. Industrial air conditioning segment has shown a steep decline; steel, power, petroleum, fertilizer and chemical sectors had no major investments whereas sectors like pharma, cement and textile have shown promise of investments. In the Service sector the need for central air conditioning is steadily rising particularly in the shopping malls, multiplexes, show rooms, departmental stores, banks, insurance and software parks.

5. The Company's Air conditioning & Refrigeration business, with a CAGR of 7.6% over the last three years in order booking, has out-performed the industry by approximately 2%. Revenue growth during the year was 12% in all product segments. In terms of unit sales, the Ductable Split Units have grown by 15% and have sizeably exceeded the Conventional Floor Mounted Package Units. Package Chillers, including Reciprocating and Scroll Chillers, have grown by 31% over last year. The Screw Chiller segment has grown by 28%. Electric Chillers have been preferred over Vapour Absorption Chillers, primarily due to steep rise in fuel costs as against a stable electricity tariff. The Vapour Absorption business nevertheless shows promise, particularly in the co-generation segment as well as in industrial waste heat recovery applications.

6. In the new lines of businesses, which consists of Low Temperature Refrigeration, Process Cooling and Indoor Air Quality Improvement through controlled ozone injection, revenue has doubled. The Company now has entered into energy management in the HVACR field, another potential growth area.

7. The investment in IT for development and implementation of both Project Management System and Service Management System customised for HVAC operation, is showing positive trends. Apart from better Customer Relationship Management, IT has facilitated cutting costs through better controls and lean manpower structure. It is also geared to handle larger volumes of business without increase in manpower.

8. A long standing dispute regarding the duty base of central air conditioning plants has been resolved in favour of the air conditioning industry following certain Supreme Court judgements, thereby bringing substantial relief to the industry, including the Company. The high incidence of Sales Tax/Entry Tax renders imports of high value capital equipment cheaper than Indian manufactured goods. The Company has tied up with some leading overseas manufacturers for distribution of their products in Indian market, to take advantage of this new opportunity.

9. The outlook for the HVACR industry seems very positive particularly due to good growth in the Service Sector requiring large capacity air conditioning systems. The selected Industrial segments are showing signs of revival.

10. The Company's performance in the overseas electro-mechanical contracts continues to be good and the contribution of this business in terms of turnover and profits was significantly better than the previous year. The execution of mega electro-mechanical fast track projects has been commendable. The Company secured the project to build a central cooling plant and infrastructure for the Conference Palace Hotel, from the Government of Abu Dhabi Emirate, and the execution is progressing as per the contractual milestone targets. The Company also commissioned on time the District Cooling projects undertaken by it in Abu Dhabi. The execution of Metro Railway projects in Hong Kong and Air Base project in Qatar were also satisfactory. The carry-forward order book position of electro-mechanical projects under execution continues to be healthy, over Rs.500 crores.

11. With this track record the Company is now pursuing overseas market diversification and bidding for large electro-mechanical projects. The Company is also actively pursuing opportunities for reasonably large size domestic electro-mechanical projects with the involvement of international contractors/consultants and in which, the specifications and standards, call for global sourcing.

MANAGEMENT DISCUSSION AND ANALYSIS, continued

12. The slowdown of the economy and consequent deferment of investments in infrastructure projects witnessed during the previous year, adversely affected the performance of the Pumps and Projects business of the Company. However, the Company sustained its thrust towards turnkey pumping projects and engineering service business in the core sector – water supply pumping projects and treatment, power sector, irrigation sector, sewage/drainage treatment and effluent treatment. The Company has orders of over Rs.50 crores for Pumps and Projects business. The Company is aggressively exploring markets in the Middle East and Far East regions to step up its exports of Pumps as well as Water Pollution Control projects.

ENGINEERING AGENCY AND SERVICES

13. Following an earlier phase of slowdown, the manufacturing and capital goods sector of the Indian engineering industry has shown encouraging signs of revival. This was especially apparent in the Automobiles sector. The Company's realigned Machine Tools business was able to take advantage of these emerging opportunities. There was an all-round improvement in performance, in terms of order booking, working capital and cost reduction. The upswing provides ground for optimism for all existing lines of business in the next financial year, as well as the planned entry into Food Processing machinery.

14. The Company continued to face paucity of orders for mining equipment due to delay of major investment projects in the mining sector. The focus of Coal India Limited, as well as other mining companies, was on sourcing equipment from indigenous manufacturers. The availability and performance of the electric mining shovels and dump trucks supplied by the Company to Coal India under the World Bank contract was higher than the committed levels with high quality service/product support at the mine sites. The Company has established depot facilities at mine sites which will provide opportunities for spare parts business for these large fleet of equipment.

15. The Company also took on the distribution of large capacity hydraulic excavators from Terex O&K Mining, Germany, as well as Hot Mix Plants from Gencor International, UK. It is exploring future opportunities through its thrust into diverse construction equipment for the road sector, as well as through local assembly of selected products.

16. There was good demand for crushing plants in the ongoing road construction programme and the Company captured substantial market share in mobile crushing equipment. There was a slowdown in demand in the second half due to delays in project execution. However, the trend indicates revival in the first quarter of the current year, which would boost demand for equipment.

17. The textile industry staged a good recovery during the year, after a three-year spell of recession. Most of the spinning units revived their operations, with both export and indigenous markets on the upswing. The restored levels of confidence, as well as revenue growth, encouraged a drive towards modernisation, resulting in satisfactory performance and order-booking for the Textile Machinery business. The business also posted improved performance in spinning machinery, accessories and knitting equipment. It is expected that this positive trend will be sustained in all sectors of the textile industry, with continuing opportunities for the business.

UNITARY COOLING PRODUCTS FOR COMFORT AND COMMERCIAL USE

18. The Cooling Appliances business registered exponential growth of over 46% in sales in room air conditioners, with maximum growth in the highly competitive retail segment. Today, the Company's market share has risen to No.2 position and its presence in the retail segment has substantially grown in terms of both, reach and strength.

19. The growth of business is the result of a multi-pronged strategy launched in the previous year, and sustained in the year under review. The key elements of these are (a) accelerated thrust in the growing home cooling segment (b) introduction of the world-class Vertis range of room air conditioners and split products, offering value, performance, economy and style (c) significantly enhanced spending on advertising, communications and brand-building to popularise the new line as 'ACs with IQ' (d) backing up the products with a comprehensive package of customer care measures under the brand name 'Crystal Care' and (e) various initiatives and incentives to increase dealer motivation and relationships.

20. The high growth in sales in cooling appliances suffered a set-back during the second half, due to (a) discontinuation of Sales Tax benefits at Dadra (b) high incidence of Sales Tax and Entry Tax in Southern and Western markets, ranging from 15% - 22% and (c) severe price competition from MNCs.

21. The Company pioneered and introduced the 'Sensicool' range of air conditioners, specially addressing the needs of telecom, IT, banking and pharma research. The range is designed to maintain a steady temperature when the heat-load varies with fluctuating equipment usage. Capitalising on the first-comer advantage, the Company has achieved leadership in these segments.

22. Water coolers and dispensers were an area of focus due to increasing demand in the service sector. Manufacturing base has been shifted from Dadra to Hyderabad, to help improve quality as well as to achieve economies of scale.

23. The Hyderabad plant has achieved 28% growth in the manufacture of refrigerators. The added volumes cater to the Company's tie-up with Samsung for refrigerator supply, for which three new models have been developed. The new tie-up helped offset the reduced off-take from LG, which has set up its own manufacturing unit.

24. In commercial refrigeration products, the Company has retained its leadership position, and continued as the preferred choice of customers such as Pepsi, Cadbury's, Amul, Nestle, Mother Dairy and Britannia. The Coldcel brand is the fastest growing in the segment, with overall market share of 28%. A newly-introduced range of chest freezers helped increase market share from 6% to 15%. The Company is also developing Eutectic Freezers to cater to rural and semi-urban areas faced with erratic power supply.

25. Other initiatives have been made operational at the Hyderabad Unit to retain competitiveness and remain one of the low-cost producers in the price-sensitive contract manufacturing business. These include value-engineering, 5S, Mind Innovation and Quality Circles.

OTHER BUSINESSES

26. The domestic market for forklift trucks has remained stagnant; nevertheless, the Company has improved its market share with a 10% increase in sales volumes. This has been achieved through introduction of new models in heavy-duty and electric forklifts, as well as a high degree of customisation. The business has entered new markets, primarily in the Middle East, with an encouraging response in repeat orders.

27. Three prestigious orders were executed in high-value Hydraulic Mobile Cranes, representing further inroads into this market. The new product lines of warehousing equipment and racking systems showed an upward trend in sales, spelling a promising future outlook in this segment.

28. The Company has, in all its segment of the Materials Handling business, retained its price-competitive edge through cost reductions by means of value engineering, alternative sourcing and working capital reduction.

29. The Company's performance in Chemicals trading activities was satisfactory. There was 30% growth in the pigment business, which caters to plastic and rubber industries. With the new agency lines secured during the year, from manufacturers in Korea, China and United Kingdom, there is every likelihood of continued growth in performance.

30. Civil Construction business of the Company had a difficult year, both in terms of execution of various ongoing projects and the order book position. The Company has strategically shifted its focus in this segment from small value residential/commercial projects to high value turnkey projects, including electrical/mechanical works in its niche segment, so as to achieve more efficient utilisation of available resources. The Company has completed Phase I of a prestigious project for a leading educational institute in Karnataka. The Company is pursuing with its plans to further enlarge its operations by undertaking projects in conjunction with Pumps and Projects business to serve as an EPC Contractor providing total solutions. This would help the Company to achieve cross-disciplinary synergies between its varied businesses and consolidate the position of Civil Construction business.

HUMAN RELATIONS

31. In order to build a robust organisation, various initiatives have been taken in the areas of Leadership Development and Succession Planning. The Company continues to focus on development of its Human Capital and imparts training to employees to enhance their skills and capabilities. The training process has been customised to suit the specific needs of the Company, its customers and also all-round development and growth of employees. The On-line Performance Management System of the Company helps in monitoring and encouraging individual and organisational performance.

32. Industrial Relations during the year remained satisfactory. As part of the restructuring exercise and the need to rightsize manpower, the Company had, with the permission of the concerned government authorities, closed down certain inactive units attached to the Company's establishment at Chinchpokli namely, Compressor Repair Shop, Service Station and Warehouse. The employees attached to these units were retrenched and compensation due to them has been paid. The Union has referred the matter to the Industrial Tribunal and is pending final disposal.

33. During the year under review, 204 employees separated under VRS. This coupled with retrenchment and natural attritions, has brought down the overall number of employees from 4329 to 3935 as on 31st March, 2003. The Company still has excess manpower in some of its operations at Thane Main Plant and Chinchpokli establishment. This situation needs to be corrected to safeguard the overall viability of operations at these locations. The Management has time and again expressed its concern to the Union/ Federation and sought their co-operation/suggestions for

MANAGEMENT DISCUSSION AND ANALYSIS, continued

reduction of surplus staff cost, to which no positive response has been received. However, with the joint efforts of the Management and the Union, the Hyderabad Unit of the Company has signed a Productivity Linked Wage Settlement which has improved the performance of the Unit in terms of quality and productivity.

34. The Company continues to make efforts to upgrade the skills and effectiveness of all its employees irrespective of their cadre, through various training and development initiatives. Employee Satisfaction Surveys are conducted and actions taken to improve the employee satisfaction levels.

INTERNAL CONTROLS AND SYSTEMS

35. The Company has a proper and adequate internal control procedure commensurate with the nature of its businesses and size of operations. The Internal Audit Department conducts audits to review the adequacy and effectiveness of internal controls, suggest improvements for strengthening them and ensure adherence to laid-down procedures and systems. The annual Audit Plan also includes review of risk management system for the Company's overseas operations.

36. Audit is conducted at regular intervals at all the locations and covers key areas of operations including overseas operations. Summary of important audit observations and follow-up thereon are reported to the Board Audit Committee, which comprises of four Non-Executive Independent Directors. The Committee also reviews the risk management and internal control systems apart from periodically monitoring the position of outstandings and inventory levels.

OUTLOOK, OPPORTUNITIES AND THREATS

37. The renewed plans and allocations for infrastructure development over 5-7 years in the current national and state budgets offers a significant opportunity in Construction equipment. These include the Rs.58,000 crores budget for national highway construction and Rs.2,500 crores allocation for State road development in Karnataka, Gujarat and Kerala. Sizeable opportunities for Mining equipment lie in the Rs.14,000 crores allocation for developing the Coal mining sector. With its strong tie-ups with world-renowned principals, the Company is in a position of strength to exploit these openings. The Company's expectations in all these areas are contingent on allocation and disbursement of the proposed funds and securing of the relevant contracts.

38. In Electro-mechanical projects, opportunities await in the continued thrust in new overseas markets and in high-value contracts. Some specific opportunities are increasing construction activity in (a) Qatar for the Asian Games in 2006 (b) China for the Olympic Games in 2008 (c) Iraq for post-war reconstruction and (d) UAE. Other new overseas markets being sought are Africa, Europe and Egypt. The Company is well placed to realise these prospects, due to its record of successful execution of such projects. However, exploiting these opportunities will depend upon (a) expanding the Company's skilled manpower base (b) enhancing present capabilities for assessing risks and implementing processes and systems for their mitigation and (c) detailed understanding of, and compliance with local, legal, social, environmental and cultural requirements.

39. The market for household and commercial/institutional air conditioners continues to represent a large opportunity, especially the former segment. Growth in the overall market stands at 20% respectively, with a potential rise to 40% in household air conditioners. The optimistic outlook is based on (a) low current market penetration of 2% (b) upwardly mobile lifestyles and income levels and (c) the prevalence of climatic heat and pollution, along with a growing market emphasis on maintaining a healthy environment. The Company's prospects have been substantially strengthened by its strong leadership presence and the growing awareness and popularity of its brands. The key requisites for capitalising on these opportunities are strategies for growth in a crowded and competitive market, coupled with measures to constantly lower per unit costs.

40. The revival of the manufacturing sector in India, and especially its growing importance as an off-shore manufacturing base, represents opportunities in capital goods, primarily Machine Tools and Textile Machinery.

41. The Finance Act, 2003 has included in the ambit of service tax new areas of services and has also increased the rate of service tax from 5% to 8%. The additional burden of service tax may have to be absorbed by the Company.

CAUTIONARY STATEMENT

42. Statements in the Management Discussion and Analysis describing the Company's objectives, projections, estimates and expectations may be "forward-looking statements" within the meaning of applicable securities laws and regulations. Actual results could differ materially from those expressed or implied. Important factors that could make a difference to the Company's operations include economic conditions affecting demand/supply and price conditions in the domestic and overseas markets in which the Company operates, changes in the Government regulations, tax laws and other statutes and other incidental factors.