

KERNEX MICROSYSTEMS (INDIA) LIMITED

THIRTEENTH ANNUAL REPORT

2004-2005

REGISTERED OFFICE

**“THRUSHNA ”, PLOT NO.7,
SOFTWARE UNITS LAYOUT,INFOCITY
MADHAPUR, HYDERABAD - 500 081, A.P.**

KERNEX MICROSYSTEMS (INDIA) LIMITED

BOARD OF DIRECTORS

Sri. S.V. SUBBA RAJU	CHAIRMAN
Sri SRI R SANKARAN	DIRECTOR
Sri. COL L.V. RAJU (Retd.)	MANAGING DIRECTOR
Sri. COL.S.S.RAJAN	DIRECTOR
Sri S NANDAKUMAR	DIRECTOR
Sri. B MURALI MOHAN	DIRECTOR (TECHNICAL)
Ms. JYOTI RAJU	DIRECTOR
Dr. ANJI RAJU	DIRECTOR

COMPANY SECRETARY

I SRINIVAS

BANKERS

STATE BANK OF HYDERABAD
OVERSEAS BRANCH, SOMAJIGUDA
HYDERABAD - 500 082

REGISTERED OFFICE

“TRUSHNA”, PLOT NO.7
SOFTWARE UNITS LAYOUT
MADHAPUR, HYDERABAD – 500 081

DEVELOPMENT CENTRES

SYSTEMS DIVISION

“TRUSHNA”, PLOT NO.7
SOFTWARE UNITS LAYOUT
MADHAPUR, HYDERABAD – 500 081

PROJECTS DIVISION

PLOT NO. H, AVANTHI COLONY
MAIN KARKHANA ROAD
SECUNDERABAD

OVERSEAS SUBSIDIARY

AVANT-GARDE INFOSYSTEMS INC
#39158, PASEO PADRE PARKWAY
#230, FREMONT, CALIFORNIA, USA - 94538

AUDITORS

GMK ASSOCIATES
CHARTERED ACCOUNTANTS
607, RAGHAVA RATNA TOWERS
CHIRAG ALI LANE, ABIDS HYDERABAD - 500 001

KERNEX MICROSYSTEMS (INDIA) LIMITED

NOTICE

Notice is hereby given that the Thirteenth Annual General Meeting of the members of the company will be held on Friday the 17th June' 2005 at 11.00 A.M. at the Registered Office at Plot No.7, Software units Layout, Madhapur, Hyderabad - 500 081 to transact the following business.

ORDINARY BUSINESS

- 1) To receive, consider and adopt the Balance Sheet as at 31st March, 2005 and the Profit and Loss account for the year ended on that date and the reports of the Director's and Auditors thereon.
- 2) To declare dividend for the year ended 31st March, 2005.
- 3) To appoint a Director in place of Sri. S V Subba Raju who retires by rotation and being eligible offers himself for re-appointment.
- 4) To appoint a Director in place of Ms. Jyoti Raju who retires by rotation and being eligible offers himself for re-appointment.
- 5) To appoint Auditors and fix their remuneration.

M/s GMK Associates, Chartered Accountants, Hyderabad retire at the conclusion of this Annual General Meeting and are eligible for re-appointment.

SPECIAL BUSINESS

- 6) To consider and if thought fit to pass with or without modification the following resolution as an ordinary resolution.

“RESOLVED THAT Sri R Sankaran, who was appointed by the Board as an additional director of the company on 2nd February'2005 and who holds office up to the date of the annual general meeting and in respect of whom a notice in writing pursuant to Section 257 of the Companies Act, 1956 was received proposing his candidature for the office of the director be and is hereby appointed as a director liable for retirement by rotation.

- 7) To consider and if thought fit to pass with or without modification the following resolution as an ordinary resolution.

“RESOLVED THAT Sri Sankaran Nandakumar, who was appointed by the Board as an additional director of the company on 2nd February'2005 and who holds office up to the date of the annual general meeting and in respect of

whom a notice in writing pursuant to Section 257 of the Companies Act, 1956 was received proposing his candidature for the office of the director be and is hereby appointed as a director liable for retirement by rotation.

- 8) To consider and if thought fit to pass with or without modification the following resolution as an ordinary resolution.

“RESOLVED THAT Sri Anji Raju, who was appointed by the Board as an additional director of the company on 20th May‘2005 and who holds office up to the date of the annual general meeting and in respect of whom a notice in writing pursuant to Section 257 of the Companies Act, 1956 was received proposing his candidature for the office of the director be and is hereby appointed as a director liable for retirement by rotation.

- 9) To consider and if thought fit to pass with or without modification the following resolution as an ordinary resolution.

RESOLVED that in pursuance of provisions of Section 198, 269, 309 and 311, Schedule XIII and other applicable provisions of Companies Act’ 1956 (including any statutory modifications thereof for the time being in force) Col. L V Raju (Retd.) be and is hereby reappointed as the Managing Director of the Company for a period of 5 years with effect from 1st July’ 2005 as per the revised principal terms and conditions hereunder.

1. Remuneration:

a) Salary:

On a salary of Rs.1,50,000/- per month with authority to the Board of Directors and/or a Committee of the board, to fix his salary from time to time up to a maximum of Rs.2,50,000/-. The annual increments will be merit-based and take into account the Company’s performance.

b) Perquisites & Allowances:

I. In addition to the salary and commission payable, Col LV Raju (Retd.) shall also be entitled to perquisites and allowances like medical reimbursement, Club fees up to a maximum of 2 clubs, leave travel concession for him self and family, personal accident insurance and such other perquisites and allowances in accordance with the rules of the Company or as may be agreed to by the Board of Directors and/or Committee of the Board, and Col. L V Raju (Retd.). Such perquisites and allowances will be restricted to 50% of his salary.

II. For the purpose of calculating the above ceiling, perquisites shall be evaluated as per the Income-tax rules, wherever applicable. In the absence of any such rules, perquisites shall be evaluated at actual cost.

Provision for use of the Company’s car for official duties and telephone at residence (including payment for local calls and long distance official calls) shall not be included in the computation of perquisites for the purpose of calculating the said ceiling.

III. Company's contribution to Provident fund and Superannuation Fund or Annuity Fund, to the extent these, either singly or together are not taxable under the Income-tax Act, Gratuity payable as per rules of the Company and encashment of leave as per rules of the Company, shall not be included in the computation of limits for the remuneration or perquisites aforesaid.

IV. In addition, he shall be entitled to reimbursement of entertainment expenditure actually and properly incurred for the business of the Company.

c) Commission:

Such remuneration by way of commission, in addition to the salary and perquisites and allowances payable, as may be determined by the Board of Directors of the Company at the end of each financial year, subject to the overall ceilings stipulated in section 198 and 309 of the Companies Act' 1956, and subject to amendments, therein if any. The specific amount of commission payable to the Managing Director would be between half and twice his annual salary, will be based on certain performance criteria to be laid down by the Board of Directors and/or a Committee of the Board and will be payable annually after the Annual accounts have been approved by the Board of Directors and adopted by the shareholders.

2. Minimum remuneration: Notwithstanding any thing to the contrary herein contained, if in any financial year during the currency of the tenure of Col. L V Raju (Retd.), the Company has no profits or its profits are inadequate, the Company will pay remuneration by way of salary, perquisites and allowances as specified above, subject to the limits specified in Part II in Section II to the Schedule XIII of the Companies Act' 1956 including amendments made thereto.
3. The terms and conditions of the appointment and /or Agreement may be altered or varied from time to time by the Board of Directors and/or a Committee of the Board as it may, in its discretion, deem fit, within the maximum amount payable to Col. L V Raju (Retd.) in accordance with Schedule XIII to the Companies Act' 1956, subject to amendments, if any, or any amendments made hereinafter in this regard.

**BY ORDER OF THE BOARD
For KERNEX MICROSYSTEMS (INDIA) LIMITED**

Place : Hyderabad
Date : 20-05.2005

**COL. L.V. RAJU (RETD)
MANAGING DIRECTOR**

NOTES

1. A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote instead of himself and the proxy need not be a member of the company. The proxy form duly completed and signed should be deposited at the registered office of the company not later than 48 hours before the commencement of the meeting.
2. An explanatory statement pursuant to section 173(2) of the Companies Act, 1956 in respect of the special business is annexed hereto.
3. Dividend if declared at the Annual General Meeting, will be paid to those share holders whose names appear on the Company's register of members as on 20th May' 2005.

EXPLANATORY STATEMENT
(Pursuant to Section 173(2) of the Companies Act,1956)

Item No. 6,7 & 8:

The board of directors of the company have appointed Sri R Sankaran, Sri. Sankaran Nandakumar and Sri. M. Anji Raju as additional directors of the company at their meetings held on 2nd February' 2005 and 20th May' 2005 respectively. Pursuant to the provisions of Section 260 of the Companies Act, 1956 they hold office up to this annual general meeting. In terms of Section 257 of the Companies Act, 1956 the company has received notices from members proposing their candidature for the offices of director. Your board feels that it is in the best interest of the company to have them as directors and recommends the resolutions for your approval.

None of the directors of the company may be deemed to be concerned or interested in the resolution.

Item No. 9:

Col. L V Raju (Retd.) has been reappointed as the Managing Director of the Company by the shareholders in their Extraordinary General Meeting held on 2nd May' 2005 for a period of 3 years with effect from 1st July' 2005. However, the Board, in terms of improved financial performance of the Company based on the audited accounts for 2004-05, reviewed the principal terms and conditions of the reappointment and decided to revise the same in their meeting held on 20th May' 2005. The said revision requires the approval of shareholders and as such the matter is included in the notice. Your board recommends the resolution for your approval.

None of the Directors of the Company, except Col. L V Raju (Retd.) and Ms. Jyoti Raju, being related to him may be deemed to be concerned or interested in the Resolution.

BY ORDER OF THE BOARD
For KERNEX MICROSYSTEMS (INDIA) LIMITED

Place : Hyderabad
Date : 20-05-2005

COL. L.V. RAJU (RETD)
MANAGING DIRECTOR

DIRECTOR'S REPORT

To
The Members

Your directors have great pleasure in presenting the Thirteenth Annual Report together with the audited accounts of the company for the year ended 31st March, 2005.

FINANCIAL RESULTS:

Rs. in lakhs

	2004-2005	2003-2004
Sales and Other Income	5312.91	1626.88
Profit before interest and depreciation	1673.76	616.77
Interest	87.19	79.83
Depreciation	126.80	50.10
Profit before Tax	1459.77	486.84
Provision for Taxation Current Year	561.37	178.71
Profit after Tax	898.40	309.59
Add: Balance brought forward from previous year	223.87	74.11
Profit available for appropriation	1122.27	383.74
Transfer to General Reserve	50.00	50.00
Proposed Dividend	74.03	68.38
Income Tax on proposed Dividend	9.67	8.93
Utilised on Issue of Bonus Shares	34.19	32.56
Earnings Per Share (Rs.)		
- Basic	12.14	4.52
- Diluted	12.55	4.75

Dividend

Your Directors are pleased to recommend a Dividend of 10 % on the Paid up capital of the Company for the Financial Year 2004-05. The Dividend if approved at the ensuing annual general meeting will be paid to those shareholders, whose name appear on the register of members of the Company as on 20th May' 2005. The Dividend would be tax free for the shareholders.

Appropriations:

Your Company proposes to transfer Rs. 50.00 lacs to the General Reserve. An amount of Rs. 954.37 lacs is proposed to be retained in the profit and loss account.

Equity Share Capital:

During the year under review your Company has issue and allotted 58,155 equity shares of Rs.10/- each at a premium of Rs.190/- per share to the promoters, their friends, relatives and associates, in addition to 3,41,892 equity shares as Bonus Shares and 1,65,000 equity shares as a Sweat Equity to identified employees and working Directors. As a result the issued, subscribed and paid up capital of the Company is increased from 68,37,879 equity shares of Rs.10/- each to 74,02,879 equity shares of Rs.10/- each.

Review of Markets

Global Markets:- The year under review has witnessed a reasonable growth of software, Electronic and System Integration markets. The cost cutting measures like outsourcing and using BPO techniques are in full force. Time appears ripe for medium size players to plunge in. However, the man month's costs continue to tumble on outsourced projects with heavy competition. No new technologies have appeared in horizon. This is again time to go and establish overseas offices, sign partnership deeds, acquiring companies, mergers or work on segmentation markets to beat competition and low prices by volumes on the whole. The markets are reasonable for product delivery or consulting services, therefore, time to start overseas operations.

Domestic Markets:- Domestic markets have been fully operational with heavy competition and volume barriers. However, owing to specialized vertical segment being undertaken by KMIL, in the fields of, Embedded Systems, comprising of Data Acquisition Systems, Telemetry applications, SCADA, Railway Collision prevention Systems and electronic systems like TAWS, Hot Box Detectors, ACDs, SPAD and other applications, It has become easy to penetrate the market and conduct profitable operations in domestic markets especially in railway related fields.

Review of Operations

Exports:- During the year, as explained above, owing to competitive export markets and concentration on long range R&D projects, the Company with a focus on Domestic markets has not ventured in to export markets. However, the company intends to explore new export markets in the technological areas in which the Company has already established.

Domestic Sales:- In domestic sales, Kernex has achieved around 340% growth over the last year. This is possible due to successful completion of ACD deployment over 736 KMS in Konkan Railways segment and 1736 KMS in NF Railways wherein about 80% work is completed during the year under review. This involved supply of ACDs, Erection and Installation & Commissioning of Net Worked ACD Systems and customization of the same. The total value of the commercial agreements entered during the year with KRCL for the ACDs, Erection, Installation & Commissioning and Incubation amounts to Rs. 74 corers.

Kernex is expected to sign shortly MOU on providing technology to Sky Bus project in the form of Auto Driving Devices and automation control software for the same.

R&D Work

Kernex is moving forward in a big way for developing Safety Application Systems that has social relevance which are of state-of the art-technology.

Kernex in the year under review completed the modifications essential for ACDs and Application Software as required by KRCL, the technology partner keeping in view the Functional Requirements. The Company Integrated the Inclinometer switches for protection against land slides, in the ACD network and also designed Portable ACDs, Test ACDs and Guard ACDs for Goods trains to operate on the roof top at 70°C.

Kernex has made strides as a technology partner of Konkan Railways, in developing the Auto Driving Devices and Anti-Collision System related software and station consoles for the Sky Bus Metro Project. The pilot project was tested at 70 KM speed on 1.5 KM test track at Margaon, Goa and was declared successful. The use of RFID technology for identifying the distance traveled along track has also been completed. Now, the technology is ready for deployment, after required safety certification.

Kernex has also been working on the State of Art of technology project, in replacing the existing Signaling systems with Advanced Signal system called Satdham Safety

System in each station. The pilot project has been completed and ready for testing and validation.

The company has identified new R&D projects like up gradation of ACD to International Standards, ADD Sky Bus Metro Up gradation for obtaining safety certification, TAWDS for Manned Level Crossing Gates and SPAD as at Railway Stations, Hot Box and vibration detector for wagons/coaches. With the railways planning in a big way the introduction of train up to 150Kms speed, the above equipment and devices have become important and essential for railways.

Project Expansion and Proposed public issue

The company, having consolidated its operations has embarked upon expansion of the activities as well as diversification in to intelligence transport technology, simulation testing and development, advanced railway signaling systems, control and automation system for metro sky bus, ACD and Sky bus international marketing etc. at an out lay of Rs. 99.21 crores and to finance the project cost the Company is planning for a Public Issue. In this direction the Company has increased the authorized capital of the Company from Rs.10.00 crores to Rs.15.00 crores and appointed BOB Capital Markets Ltd., Mumbai as Book Running Lead Managers to the issue.

Sweat Equity:

The Company has issued 1,65,000 Equity shares pursuant to section 79-A of the Companies Act' 1956 and the unlisted Companies (Issue of Sweat Equity) Rules' 2003 to the Working Directors and identified permanent employees working in India on the recommendations made by the Remuneration Committee of the directors in view of the value addition made by them as per the report of the Independent valuer. The shares were issued at Rs.5/- against the fair price of Rs.14.16 as per the Audited Balance Sheet as at 31St March' 2004. The Company has realized Rs 8.25 lacs besides significant growth in turnover and profitability. The Basic and diluted earnings per share calculated as per accounting standards is Rs. 4.92 and 4.85 respectively.

Overseas 100% Owned Subsidiary:

Your Company has one wholly Owned Subsidiary in USA as on 31st March' 2005. The members may refer to the Statement under section 212 of the Companies Act, 1956 for further information on this Subsidiary. The Balance Sheet of the said Company is also attached herewith as required under section 212 of the Companies Act' 1956

ISO Certification:

The company is an ISO 9001:2000 certified and continues to maintain its quality management systems in the entire gamut of operations.

Directors Responsibility Statement:

As required under Section 217 (2AA) of the Companies Act, 1956 it is hereby stated that:

- a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
- b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that 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 and of the profit or loss of the company for that period;
- c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities; and
- d) the directors had prepared the annual accounts on a going concern basis.

Audit Committee of the Board:

The Audit Committee of the company has been reconstituted with Sri R Sankaran, Col S S Rajan, independent Directors and Col. L V Raju (Retd.), Managing Director. During the year, it met three times and the chairman of the committee was present at the previous Annual General Meeting. The terms of reference of the Audit Committee included review of financial statements presented to the Board, adequacy of the internal controls safe guarding the assets of the company, compliance of accounting standards and statutory liabilities, etc. The board of directors approved the annual

accounts of the company for the year ended 31st March, 2005 as recommended by the Audit Committee.

Other Committees of the Board:

The Company has reconstituted the remuneration Committee consisting of Sri. Sri R Sankaran, Chairman and Col. S S Rajan, Sri S Nandakumar as members to decide the remuneration of Directors as well as constituted Share holders/Investor Grievance Committee consisting of Sri. S V Subba Raju, Chairman and Col. S S Rajan, Sri S Nandakumar as members.

Fixed Deposits:

The company has not accepted any fixed deposits from the public and therefore, the provisions of section 58A of the Companies Act, 1956 are not applicable.

Conservation of Energy, Technology Absorption, etc.,

The particulars prescribed under 217 (1) (e) of the Companies Act,1956 read with the Companies (Disclosure of particulars in the Report of Board of Directors) Rules 1988, in respect of technology absorption, foreign exchange earnings and outgo are set out in the annexure forming part of this report.

Personnel:

The company has built an excellent team of Software / Electronics professionals and the board records its appreciation for the valuable contribution made by the employees at all levels. Several programs were conducted to enhance the skills of all employees besides family get together of employees to promote togetherness and positive feeling of bonding to facilitate friendly work environment.

Particulars of Employees:

None of the employees of the company is drawing remuneration equal to or more than the prescribed limit to furnish the particulars of employees as required under Section 217 (2A) of the Companies Act, 1956.

Directors

During the year, Sri. Amarnath Sambasivan resigned as a director of the Company due to his pre-occupations and your Board appreciates the valuable contributions made by him, during his tenure as a Director of the Company. As per the Articles of Association of the Company, Sri. S V Subba Raju and Ms. Jyoti Raju retire by rotation and being eligible offers themselves for re-appointment. Sri R Sankaran, Sri S Nandakumar and Sri M. Anji Raju were appointed as additional directors of the company. Col L. V. Raju was re appointed as Managing Director of the Company for a further period of five years with effect from 1st July, 2005

Auditors:

M/s. GMK Associates, Chartered Accountants, Hyderabad, the Statutory Auditors of the company retire at the conclusion of this Annual General Meeting and are eligible for Re-appointment.

Acknowledgements:

The Directors take this opportunity to thank all investors, business partners, clients, Technology partners, The Company's Bankers, State Bank of Hyderabad, Central and State Government Authorities for their continued support during the year.

Your Directors would like to place on record their appreciation of the contribution made by employees at all levels for their commendable team work, dedicated and whole hearted efforts made during the year.

For KERNEX MICROSYSTEMS (INDIA) LIMITED

Place: HYDERABAD
Date : 20.05.2005

**S.V.SUBBA RAJU
CHAIRMAN**

ANNEXURE TO THE DIRECTOR'S REPORT

Particulars pursuant to Companies (Disclosure of Particulars in the Report of Board of Directors) Rules,1988.

A. Conservation of Energy:

The activities of the company do not result in significant consumption of energy. However the company takes all the necessary steps to conserve energy at the offices and work places on an ongoing basis.

B. Technology absorption Adaptation and Innovation:

There is no imported technology involved in the operations of the company. The company continues to focus its attention towards the rapid technological changes in the fields of its activity and train the man power continuously to improve the productivity. The technologies being used are indigenous and the company has evolved a training methodology to measure the extent of adaptation by its personnel and training needs are identified accordingly.

C. Foreign exchange earnings and out go: (Rs. In lakhs)

Foreign Exchange Earned	52.84
Foreign Exchange Used	648.41

**for and on behalf of the Board
For KERNEX MICROSYSTEMS (INDIA) LIMITED**

Place: HYDERABAD
Date: 20.05.2005

**S.V.SUBBA RAJU
CHAIRMAN**

AUDITORS' REPORT

**To the members of
KERNEX MICROSYSTEMS (INDIA) LIMITED**

We have audited the attached Balance Sheet of *Kernex Microsystems (India) Limited*, as at March,31, 2005 and also the Profit and Loss Account for the year ended on that date annexed thereto. These financial statements are

the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An Audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An Audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As required by the Companies (Auditor's Report) Order,2003,(the Order) issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Companies Act,1956, we enclose in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the said Order .

Further to our comments in the Annexure referred to above, we report that:

- (i) We have obtained all the information and explanations, which to the best of our Knowledge and belief were necessary for the purpose of our audit;
- (ii) In our opinion, proper books of account as required by law have been kept by the Company so far as appears from our examination of those books;
- (iii) The Balance Sheet, Profit and Loss Account dealt with by this report are in agreement with the books of accounts;
- (iv) In our opinion , the Balance Sheet, Profit and Loss Account dealt with by this report comply with the accounting standards referred to in sub-section (3C) of Section 211 of the Companies Act,1956 ;
- (v) On the basis of written representations received from the directors as on March 31,2005 and taken on record by the Board of Directors , we report that none of the directors is disqualified as on March 31 , 2005 from being appointed as a director in terms of Clause (g) of sub-section (1) of Section 274 of the Companies Act,1956;
- (vi) In our opinion and to the best of our information and according to the explanations given to us , the said accounts give the information required by the Companies Act,1956, in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India ;
 - (a) In the case of Balance Sheet, of the state of affairs of the Company as at 31st March, 2005;
 - (b) In the case of Profit and Loss Account, of the Profit for the year ended on That date.

For GMK ASSOCIATES.,
Chartered Accountants

G.Satyanarayana Murty
Partner
Membership No.:29919

Place: Hyderabad
Date: 20.05.05

GMK ASSOCIATES

Annexure to the Auditor's report of even date to the Members of Kernex Microsystems (India) Limited

- (I)
 - (a) The Company has maintained proper records showing full particulars, Including Quantitative details and the situation of its fixed assets;
 - (b) A Major portion of fixed assets have been physically verified by the

Management during the year. In our opinion, the frequency of verification of the fixed assets by the management is reasonable having regard to the size of the Company and the nature of its assets. The discrepancies noticed have been properly dealt with in the books of account;

- (c) None of the major fixed assets of the Company are disposed off during the year;
- (II) (a) The Inventory has been physically verified by the management at reasonable intervals;
- (b) In our opinion and according to the information and explanations given to us, the procedures for physical verification of inventory followed by the management were reasonable and adequate in relation to the size of the Company and the nature of its business;
- (c) In our opinion the Company has maintained proper records of inventory. There are no discrepancies between the physical stocks and the book stocks;
- (III) During the year, the Company has not taken or granted any loans to parties listed in the register maintained under Section 301 of the Companies Act, 1956;
- (IV) In our opinion and according to the information and explanations provided to us there are adequate internal control systems commensurate with the size of the Company and the nature of its business with regard to purchase of inventory, fixed assets and for sale of goods and services. During the course of our audit, no major weakness has been noticed in the internal control;
- (V) Based on the audit procedures applied by us and according to the information and explanations provided by the management, we are of the opinion that the transactions entered that need to be entered into the register maintained under Section 301 have been made at prices which are reasonable with regard to the prevailing market prices at the relevant time;
- (VI) The Company has not accepted any deposits from the public;
- (VII) The Company has an in-house internal audit department, which, in our opinion is to be strengthened;
- (VIII) According to the information, explanations and records provided to us, the company has to strengthen the records to be maintained under section 209(1) (d) of the Companies Act, 1956.
- (IX) According to the records, information and explanations provided to us, the Company is generally regular in depositing with appropriate authorities undisputed amount of provident fund, employee's state insurance, income-tax, sales-tax, wealth-tax, Service tax, customs duty, excise duty, cess and other statutory dues applicable to it and no undisputed amounts payable were outstanding as at 31st March, 2005 for a period of more than six months from the date they became payable ;
- (X) The Company neither has accumulated losses at the end of the financial year nor has incurred cash losses during the year, and in the immediately year preceding;
- (XI) Based on our audit procedures and on the information and explanations given by the management, the Company has not defaulted in repayment of dues to any financial institution or bank;
- (XII) Based on our examination and according to the information and explanations given to us, the Company has not granted loans and advances on the basis of security by way of pledge of shares, debentures and other securities ;
- (XIII) The Company is not a chit/nidhi/mutual benefit fund/society and clause (xiii) of the Order is not applicable.
- (XIV) The Company is not dealing or trading in shares, securities, debentures and other investments;
- (XV) On the basis of our examination of the books of accounts and the information and explanation given to us the Company has not given any guarantee for loans by others from bank or financial institutions ;

- (XVI) No term loans have been taken by the Company during the year under report.
- (XVII) On the basis of our examinations of the books of accounts and the information and explanation given to us , in our opinion, the funds raised on short-term basis have not been used for long-term investment and vice versa ; except permanent working capital.
- (XVIII) During the year, the Company has not made any preferential allotment of shares to parties and companies covered in the Register maintained under Section 301 of the Act ;
- (XIX) The Company has not made issue of debentures during the year;
- (XX) The Company has not raised any money by public issues during the year ;
- (XXI) Based on the audit procedures performed and information and explanations given to us by the management , we report that no fraud on or by the Company has been noticed or reported during the course of our audit .

For GMK ASSOCIATES.,
Chartered Accountants

G.Satyanarayana Murty
Partner
Membership No.:29919

Place: Hyderabad
Date: 20.05.05

KERNEX MICROSYSTEMS (INDIA) LIMITED
" Thrushna ", Plot.No.7 , Software Units layout.
Madhapur, Hyderabad-081 , Andhra Pradesh , INDIA

BALANCE SHEET AS AT 31st MARCH,2005

	<i>Schedule</i>	<i>AS AT</i>	<i>AS AT</i>
	<i>No.</i>	<i>31.03.2005</i>	<i>31.03.2004</i>
I. SOURCES OF FUNDS			
<i>(1) Shareholders' funds :</i>			
(a) Capital	A	74,028,790	68,378,320
(b) Reserves and surplus	B	172,190,294	83,915,203
(c) Deferreed Tax Liability		-	940,647
<i>(2) Loan funds :</i>			
(a) Secured Loans	C	21,532,563	71,021,120
(b) Unsecured Loans	D	-	-
TOTAL		267,751,647	224,255,290
II. APPLICATION OF FUNDS			
<i>(1) Fixed Assets :</i>			
(a) Gross block	E	122,019,669	116,488,190
(b) Less : Depreciation		38,695,398	26,014,973
(c) Net block		83,324,271	90,473,217
(d) Capital Work-in-progress		-	-
<i>(2) Investments :</i>			
	F	11,830,950	11,830,950
<i>(3) Current Assets, Loans and advances</i>			
(a) Inventories	G	54,114,513	32,991,408
(b) Sundry Debtors	H	108,855,800	67,493,562
(c) Cash and bank balances	I	91,208,867	71,238,114
(d) Loans and advances	J	50,920,025	49,959,272
Less :		305,099,205	221,682,356

Current Liabilities and Provisions	K		
(a) Current Liabilities		54,367,252	68,919,933
(b) Provisions		79,462,392	30,811,300
Net current assets		171,269,561	121,951,123

(4) (a) Miscellaneous expenditure to the extent not written off or adjusted	L	-	-
(b) Deferred Tax Asset		1,326,865	-
TOTAL		267,751,647	224,255,290
Notes on Accounts	S	-	-

Schedules form part of the Accounts
As Per our report of even date
for GMK ASSOCIATES,
Chartered Accountants

for and behalf of the board
for KERNEX MICROSYSTEMS (INDIA) LIMITED

(**G.SATYANARAYANA MURTY**)
Partner

S.V.SUBBA RAJU
Chairman

Co.L.V.Raju (Retd)
Managing Director

Membership No. 29919
Place : Hyderabad
Date : 20.05.05

I.Srinivas
Company Secretary

KERNEX MICROSYSTEMS (INDIA) LIMITED
 " Thrushna ", Plot.No.7 , Software Units layout.
 Madhapur, Hyderabad-081 , Andhra Pradesh , INDIA
 PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31st MARCH,2005

	<i>Schedule</i>	<i>For the Year ended</i>	<i>For the Year ended</i>
	<i>No.</i>	<i>31.03.2005</i>	<i>31.03.2004</i>
INCOME			
<i>Sales and Services</i>	M		
(a) Exports		-	-
(b) Domestic		524,817,768	153,288,560
<i>Other Income</i>	N	6,473,015	9,400,426
TOTAL		531,290,783	162,688,986
EXPENDITURE			
Cost of Sales and Services	O	263,263,727	50,493,322
Personnel Expenses	P	38,069,876	25,745,588
Operating,Admn and Selling Expenses	Q	62,580,579	24,772,122
Finance Charges	R	8,719,010	7,983,623
Depreciation	E	12,680,423	5,010,299
TOTAL		385,313,615	114,004,954
Profit before Tax		145,977,168	48,684,032
Less : Provision for Taxation :			
(a) Current Year		58,404,776	17,854,139
(b) Deferred Tax		(2,267,513)	(129,698)
Profit after Tax		89,839,904	30,959,591
Add : Profit brought forward from			
Previous year		22,386,840	7,414,809
Profit Available for Appropriation		112,226,744	38,374,400

Less : Provision for Dividend	7,402,879	6,837,832
Less : Tax on distributed Profits	967,464	893,619
Less : Utilised on Issue of Bonus Shares	3,418,920	3,256,110
Less : Transfer to General Reserve	5,000,000	5,000,000
Balance Carried to Balance Sheet	95,437,481	22,386,840

Schedules form part of the Accounts
As Per our report of even date
for GMK ASSOCIATES,
Chartered Accountants

for and behalf of the board
for KERNEX MICROSYSTEMS (INDIA) LIMITED

(G.SATYANARAYANA MURTY)
Partner
Membership No. 29919
Place : Hyderabad
Date : 20.05.05

S.V.SUBBA RAJU
Chairman

Col.L.V.Raju (Retd)
Managing Director

I.Srinivas
Company Secretary

KERNEX MICROSYSTEMS (INDIA) LTD

AS AT
March 31, 2005

AS AT
March 31, 2004

SCHEDULE A
SHARE CAPITAL

AUTHORISED CAPITAL

1,00,00,000 Equity Shares of Rs.10/- each	100,000,000	100,000,000
---	-------------	-------------

ISSUED SUBSCRIBED AND PAID UP CAPITAL

7,402,879 EQUITY SHARES OF RS.10/- each (68,37,832 Equity Shares Previous Year)		
--	--	--

(Of the above shares , 43,85,845 number of Eq.shares of Rs.10 each were allotted by way of bonus shares by capitalising free reserves of the Company)	74,028,790	68,378,320
--	------------	------------

	74,028,790	68,378,320
--	-------------------	-------------------

SCHEDULE B
RESERVES AND
SURPLUS
Securities Premium

As at the commencement of the year	48,714,732	48,714,732
------------------------------------	------------	------------

Add : received during the year	11,049,450	-
Less: Utilised for Sweat Equity		

Issue	825,000	10,224,450
-------	---------	------------

	58,939,182	48,714,732
--	------------	------------

General Reserve

At the commencement of the year	12,813,631	7,813,631
---------------------------------	------------	-----------

Add: Transfer from the profit & Loss account	5,000,000	5,000,000
--	-----------	-----------

	17,813,631	12,813,631
--	------------	------------

Balance in Profit & Loss A/c	95,437,481	22,386,840
------------------------------	------------	------------

	172,190,294	83,915,203
--	--------------------	-------------------

SCHEDULE C
SECURED LOANS

Term loan from SBH	-	26,128,416
Cash Credit from SBH	21,532,563	5,385,187
Vehicle loan	-	107,517
Loan against Deposits	-	39,400,000
	21,532,563	71,021,120

SCHEDULE D
UNSECURED LOANS

NIL	NIL
-	-

SCHEDULE F

INVESTMENTS(At Cost)		
Long Term, Trade (Unquoted)		
35,80,000 equity shares of US\$0.02		
and	11,830,950	11,830,950
17,99,240 equity shares of Us\$0.10 in		
Avant-Garde Infosystems inc.USA (Fully Paid)		
100% subsidiary	11,830,950	11,830,950

SCHEDULE G

INVENTORIES (As certified by Management)

Work in progress	23,016,780	21,545,439
Closing Stock of Components	31,097,733	11,445,969
	54,114,513	32,991,408

SCHEDULE H

Sundry Debtors

(Unsecured and considered good)
Outstanding for a period

exceeding six months	18,808,560	11,134,168
Other Debts	90,047,240	56,359,394
	108,855,800	67,493,562

SCHEDULE I

CASH AND BANK BALANCES

Cash in		
Hand	312,312	216,898
Cash at Bank :		

in current Account with scheduled Banks	1,636,555	24,819
in Fixed Deposits	89,260,000	70,996,397
	91,208,867	71,238,114

SCHEDULE J

LOANS AND ADVANCES

(Considered good, recoverable in cash or
in kind or for value to be received)

Advances given for Suppliers	4,214,535	19,274,395
Deposits - Government	1,119,966	2,491,075
Deposit - Others	3,587,043	5,928,584
Advance for Expenses	4,722,236	2,078,718
Advance Tax/TDS	24,093,375	7,659,424
Deffered Interest	-	6,922
Loan to Avant-Garde InfoSystemens inc. (USA 100% WOS)	13,182,870	12,520,154
	50,920,025	49,959,272

SCHEDULE K

CURRENT LIABILITIES AND PROVISIONS

(A)CURRENT LIABILITIES

Creditors for Supplies- SSI	555,550	362,080
- Others	13,253,089	11,528,159
Creditors for Expenses	10,979,998	7,482,852
Taxes and other duties payable	4,402,430	576,342
Advance Received Against Supplies from KRCL	25,176,185	48,970,500
	54,367,252	68,919,933

(B)PROVISIONS

Provision for taxation	58,590,771	18,212,804
provision for dividend	7,402,879	6,837,832
provision for dividend		

Tax	967,464	893,619
Provision for gratuity	1,757,035	758,366
Product warranty costs	10,744,243	4,108,679
	79,462,392	30,811,300

SCHEDULE L

Miscellaneous expenditure to the extent
not written off or
adjusted

Preliminary expenses	-	-
LESS: Written off	-	-
	-	-

SCHEDULE M SALES AND SERVICES

(A) Sales Exports	NIL	NIL
	-	-
(B) Sales Domestic	434,867,326	112,951,377
Service Income	89,950,442	40,337,183
	524,817,768	153,288,560

SCHEDULE N OTHER INCOME

Notice salary received from employees	1,040,647	652,915
Interest Received : Banks	4,599,648	4,649,606
Others	662,716	94,032
Long Term Capital Gain	-	4,003,873
Rental Income	170,004	-
	6,473,015	9,400,426

SCHEDULE O Cost of Sales & Services

Consumption of rawmaterials and bought-out items

Opening Stock of raw materials	11,445,969	1,955,364
--------------------------------	------------	-----------

Add : Purchases	135,176,117	41,569,160
Less: Closing Stock	31,097,733	11,445,969
Material consumed	115,524,353	32,078,555
Accessories purchased	65,503,831	14,438,939
Taxes & Duties Paid On Purchases	52,878,371	9,076,213
Direct Expenses For Project Execution	30,828,513	11,276,494
	264,735,068	66,870,201
Add: Opening Work in progress	21,545,439	5,168,560
Less: Closing work in progress	23,016,780	21,545,439
Net Cost of Sales & Services	263,263,727	50,493,322

SCHEDULE P
PERSONNEL EXPENSES

Salaries and Other Benefits	33,000,568	22,905,883
Contribution to PF & Other funds	1,971,361	1,297,606
Consultancy Charges	247,520	701,462
Staff Welfare	2,850,427	840,636
	38,069,876	25,745,588

SCHEDULE Q

OPERATING, ADMINISTRATIVE AND SELLING EXPENSES

Rent	1,901,458	2,798,770
Rates and Taxes	790,146	44,576
Printing & Stationery	650,689	313,233
Directors Remuneration	4,560,000	2,885,000
Communication Expenses	2,005,458	904,050
Repairs and Maintenance :		
Garden Maintanance	144,279	30,000
Generator Maintance Charges	48,335	77,490

Computer Consumables	218,906	106,963
Vehicle Maintenance Expenses	334,741	134,235
Repairs&Maint Bldgs	3,397,235	-
Repairs and Maintenance-general	660,159	361,498
Office Maintenance Expenses	952,050	240,343
Electricity Charges	1,997,031	264,656
Product Warranties costs	7,144,792	4,108,679
Consultancy Fees	349,626	254,611
Sundry Balances Written off	88,934	62,728
Security Charges	1,706,553	655,379
Books and Periodicals	212,762	89,539
Travelling & Conveyance Expenses	1,491,138	1,322,447
Insurance on Fixed Assets	305,349	108,452
Business Promotion	404,602	1,299,628
General Expenses	85,075	560,802
Bank Charges	1,198,830	1,740,741
Legal & Other Charges	-	12,900
Audit Fees	490,390	207,420
Sales Tax Paid	15,922,824	3,464,228
Service Tax paid	3,778,899	2,076,494
Entry Tax Paid	857,185	-
Works Contract Tax paid	986,522	-
Freight on Sales	6,163,751	-
Insurance on ACD /Accessories/Projects	3,732,860	647,261
	62,580,579	24,772,122

SCHEDULE R

FINANCE CHARGES

Interest on term Loan	2,936,710	3,023,011
Interest on Working Capital	2,751,902	3,851,057
Bank Commission & Other Financial Charges	2,336,509	351,755
Foreign Exchange Fluctuation	693,889	757,800
	8,719,010	7,983,623

KERNEX MICROSYSTEMS (INDIA) LIMITED

SCHEDULE "E"

FIXED ASSETS

Amount in Rupees

Name of the Asset	Gross Block			Depreciation				Net Block		
	As on 4/1/2004	Additions during the Year	Deductions /Deletions	As on 3/31/2005	Upto 4/1/2004	During The year	Adj.	Upto 31-03-2005	As on 31-03-05	As on 3/31/2004
Land & Land development	12,544,246	-	-	12,544,246	-	-	-	-	12,544,246	12,544,247
Building	43,671,920	-	-	43,671,920	666,110	4,300,581	-	4,966,691	38,705,229	43,005,811
Software Division Plant & Machinery including Computers	39,495,790	4,716,173	-	44,211,963	21,629,433	5,371,756	-	27,001,189	17,210,774	17,866,358
Office Equipment	7,888,000	442,265	1,323	8,328,942	263,720	1,099,594	-	1,363,314	6,965,628	7,624,281
Furniture	10,164,097	187,734	-	10,351,831	2,418,716	1,417,650	-	3,836,366	6,515,465	7,745,381
Vehicles	2,724,137	186,632	-	2,910,769	1,036,996	490,842	-	1,527,838	1,382,930	1,687,141
Total	116,488,190	5,532,802	1,323	122,019,669	26,014,975	12,680,423	-	38,695,398	83,324,271	90,473,217
As On 31.3.04	42,274,455	74,213,735	-	116,488,190	21,004,676	5,010,299	-	26,014,975	90,473,215	21,269,779

SCHEDULE ' S '

Significant accounting policies and notes on accounts :

Company Overview :

Kernex Microsystems (india) Limited is engaged in the Manufacture and sale of Safety Systmes like Anti-Collision Devices for Railways and Software Services .

A Significant accounting policies :

1 Basis of preparation of financial statements

The accompanying financial statements are prepared in accordance with Indian Generally Accepted Accounting Principals (GAAP) under historical cost convention on the accrual basis . GAAP comprises mandatory accounting Standards issued by the Institute of Chartered Accountants of India (ICAI) , and the provisions of the Companies Act,1956.

These accounting polocies have been consistently followed, except where a newly issued accounting standard is initiallly adopted by the Company.

Management evaluates the effect of accounting standards issued on an on-going basis and ensures they are adopted as mandated by the ICAI . There are no recently issued Accounting Standards that management believes have a material impact on the financial statements of the Company .

The financial statements are prepared in accordance with the principles and procedures required for the preparation and presentation of consolidated financial statements as laid down under the accounting standards on consolidated financial statements issued by the ICAI. The financial statements of the Parent Company Kernex Microsystems (india) Limited ,have been combined with 100% WOS Avant-Garde Infosystmes Inc, USA on a line -by-line basis by adding together bookvalues of like items of assets,liabilities,income and expenses after eliminating intra-group balances and transactions and resulting un-realised gain / loss .

2 Revenue Recognition :

Income from software development and services is accounted for on the basis of software development and billed to client on acceptance and / or on the basis of man-days/man-hours as per the terms of contract .

Revenue from product sales is stated exclusive of returns , and applicable trade discounts but inclusive of Duties and Taxes collected on the same .

Service Income is recognized as per the terms of Contracts with the Customer, when the related services are performed.

3 Retirement Benefits to Employees :

3 Gratuity :

In accordance with the payment of Gratuity Act,1972 KMIL provides for gratuity , covering all the Employees based on the Service of Years rendered to the Company , in excess of 6 Months on a consistent calculation as per The Gratuity Act,1972 .

3 Provident Fund :

All the eligible employees of the company are covered under PF and Misc.provisions Act, both Employee and the Company make monthly contributions to the PF plan equal to specified percentage of the Covered Employees salary.

4 Foreign Currency Transactions :

Expenditure in foreign currency is accounted at the exchange rate prevalent when such expenditure is incurred . The exchange difference arising on foreign currency transactions are recognised as income or Expenses in the period in which the payment is made.

5 Income Tax :

5 Current Tax :

Provision for current tax is made and retained in the Accounts on the basis of estimated tax liability as per the applicable provisions of the income-tax Act,1961.

5 Deferred Tax :

Deferred tax has been accounted in accordance with Accounting Standard - 22 " Accounting for Taxes on Income" issued by the ICAI , under the liability method.

A provision is made for Income tax annually based on the Tax Liability computed. The difference that result between the profit offered for income taxes and the Profit as per the Financial Statements are identified and thereafter a deferred tax asset or deferred tax liability for timing differences,namely the difference that originate in one accounting period and reverse in another, based on the tax effect of the aggregate amount being considered.

The tax effect is calculated on the accumulated timing differences at the end of an accounting period based on prevailing enacted regulations.

Deferred tax assets are recognised only if there is reasonable certainty that they will be realised and are reviewed for the appropriateness of their respective carrying values at each balance sheet date .

6 Fixed Assets

Fixed assets are valued at original cost including incidental expenditures, taxes and duties net of cenvat credit availed

7 Depreciation

Depreciation has been charged on fixed assets on WDV method as per the rates specified in Schedule XIV of the Companies Act,1956.

8 Inventories

Inventories of Components are valued at cost or realisable value which ever is less. Work in progress is valued at cost of materials and services used .

9 Warranty Expenses

Anticipated product warranty costs for the period of warranty are provided for in the year of sale.

10 Segment Reporting :

Since the Company has only one Business and Geographic Segement namely Sales, Service and Software for Anti-Collision Devices, "Segment Reporting " under "Accounting Standard 17" issued by the "ICAI" is not applicable .

11 Related Party Disclosures:

a) . There are no related parties where control exists other than 100% Wholly Owned subsidiary.

b) . Other related parties with whom transactions have taken place during the year are :

Krisn Information Technologies Ltd	Enterprise managed by relative of Managing Director Hardware Consultancy to Kernex for Different Projects (Total Transaction during the year Rs.11,60,035 /-)
Cova Technologies Inc, USA	Enterprise owned by relative of Managing Director Consultancy services on Procurement & Inspection of goods in USA . (Total Transaction during the year Rs.30,01,009 /-)

The Company entered into related party transactions with Avant-Garde Infosystems Inc, USA.

a 100 % Wholly owned Subsidiary with regard to :

Particulars	Year ended March,31 ,		
	2005	2004	
1.Capital Transactions :			
Working Capital Loan	Nil	US\$ 40,000	
2.Revenue Transactions :			
Interest receivable	Rs.6,62,716.00	Nil	
3.Sale of Services :	Nil	Nil	
<u>Key Management Personnel :</u>		04-05	03-04
Col. L.V.Raju (Retd) - Managing Director	Remuneration	30.00	16.25
B. Murali Mohan - Whole Time Director	Remuneration	15.60	12.60

12 Impairment Of Assets :

The Management of the Company is on the opinion that there are no Fixed Assets to be impaired for the period,as identified by the sources of Information,mentioned in the Accounting Standard -28 " Impairment of Assets " issued by the ICAI.

B Notes to Accounts :

- 1 All Amounts in the financial statements are presented in Rupees.
The Previous Year's figures have been regrouped / reclassified, wherever necessary to confirm to the current year's presentation .
Figures are rounded off to the nearest rupee.
- 2 Estimated amount of contracts remaining to be executed on capital account and not accounted are Rs.5.00 lakhs-net of Advances . (2004: Rs.20.00 lakhs)

3 Contingent Liabilities in respect of :

- a) Claims against the Company not acknowledged as debt Rs. **8 lakhs** in respect of Income Tax for the Assessment Year 1998-99 for which department preferred appeal against the Order of Commissioner Appeals in favour of the Company.
- b) Claims against the Company not acknowledged as debt Rs. 2.4 lakhs in respect of CENVAT Claim.
- c) Bank guarantees outstanding **Rs.161.00 lakhs (2004 : Rs.500.00 lakhs)**

4 Term Loans and Cash Credits:

Rupee Term Loan is prepaid in full by the company during the financial year .
Cash Credit Account from SBH is secured by first charge on the Fixed Assets and personal guarantees of M.D, Directors .

5 Auditors remuneration relates to :

	<u>04-05</u>	<u>03-04</u>
Statutory and Tax Audit :	4.41	1.83
Sales Tax Audit	0.28	0.15
Other Services :	0.22	0.09

6 Directors remuneration relates to :

	<u>04-05</u>	<u>03-04</u>
Managing Director :	30.00	16.25
Whole Time Director :	15.60	12.60

7 Dues to Small Scale Industrial Undertakings :

The Following is the list of dues outstanding for a period of more than 30 days to Small Scale Industries (SSI's).

Name of the Party	Amount Outstanding
M/s. Geeta Industries	Rs.1,67,703 /- (as at March,31st 2004 - Nil)

8 Loans and Advances :

Loans and advances include Rs.1,31,82,869.64 working capital loan to Avant-Garde Infosystems Inc, a 100% subsidiary in USA. Including Interest Rs.6,62,715.83

9 Issue Of Sweat Equity Shares :

During the Financial Year the Company has issued 1,65,000 Sweat Equity Shares of Rs.10 /- each to the Identified Employees / Working Directors ,at an exercising option of Rs.5 /- per share .

10 Earning Per Share :

Earning / Diluted Earning Per Share of the Company has been calculated as per the Accounting Standard 20 " Earning Per Share " Issued by ICAI .

	<u>04-05</u>	<u>03-04</u>
Earning Per Share	12.14	4.52
Diluted Earning Per Share	12.55	4.75

11 Additional Information pursuant to paragraphs 3,4(c) and 4(d) of Part II of Schedule VI of the Companies Act,1956.

(I) Installed Capacity

4200 ACD's p.a.*

(* as certified by the management as on date)

(II) Production and Sales :

Item Description	Unit	<u>For The Year 2004-05</u>			<u>For The Year 2003-04</u>		
		<u>Production</u>	<u>Sales</u>		<u>Production</u>	<u>Sales</u>	
		Quantity	Quantity	Rs.in lakhs	Quantity	Quantity	Rs.in lakhs
Anti-Collision Devices	No's	1445	1445	3,566.52	241	241	552.89
Radio Survey Units	No's	-	-	-	24	24	64.11
GPS Data Collection Units	No's	21	21	18.48	27	27	30.41
Remote Units	No's	59	59	110.76	-	-	-
Charge Control Units	No's	660	660	39.93	-	-	-
Heavy Duty RF Tags/ Reader	No's	152	152	6.50	-	-	-

(III) Purchases For Trading :

Item Description	Unit	<u>For The Year 2004-2005</u>			<u>For The Year 2003-2004</u>		
		Quantity	Rs.in lakhs		Quantity	Rs.in lakhs	
Towers	No's	965	173.95		No's	146	83.77
Location Boxes	No's	296	35.27		No's	315	26.67
Solar Panels	No's	649	145.73		No's	171	17.21
Battery	No's	816	79.83		No's	297	11.59
Battery chargers	No's	333	15.67		No's	14	3.92
Others *	No's	*	83.22		No's	*	1.22

* It is not practicable to give quantitative information in the absence of common expressible unit.

(IV) Raw material Consumed :

Item Description *	Unit	<u>For The Year 04-05</u>		<u>For The Year 03-04</u>	
		Quantity	Rs.in lakhs	Quantity	Rs.in lakhs
Radio Modems - 5 watts	No's	693	247.00	169	84.73
Radio Modems - 2 watts	No's	719	216.00	141	65.86
GPS Receivers	No's	471	24.37	417	21.15
GPS Antennae	No's	471	10.92	410	7.47
Disk On chip	No's	1268	10.51	695	8.76
RS 232 Module / 48 Chanel dio	No's	549	8.09	191	5.55
CPU Boards	No's	941	36.77	701	33.48
VF Displays	No's	549	16.62	399	9.56
Noise Filters	No's	1424	13.57	705	0.55
LCD"s	No's	383	2.24	285	2.26
Others *		*	726.53	*	81.41

(V) Value of Imported and Indegenous materials consumed :

	%	Rs.in lakhs	%	Rs.in lakhs
<u>Raw Material</u>				
Imported	54.14%	710.67	76.46%	245.27
Indegenous	45.86%	601.94	23.54%	75.51

	Value (Rs in lakhs)	
	04-05	03-04
(VI) <u>Opening Stock :- *</u>		
Work-in-progress	215.45	51.69
Components	114.46	19.55
Finished Goods	-	-
(VII) <u>Closing Stock :- *</u>		
Work-in-progress	230.16	215.45
Components	310.97	114.46
Finished Goods	-	-

* Inventory values at the year end are as certified by the Management of the Company.

	Rs.in lakhs	
(VIII) CIF value of Imports :	04-05	03-04
Raw materials/Components:	726.52	339.72
Consumables :	-	-
Capital Goods :	-	-

(IX) Foreign Exchange :	Rs.in lakhs	
	04-05	03-04
a) Earnings in Foreign Exchange :		
(On receipt basis)	52.84	102.05
b) Expenditure in Foreign Exchange : (On payment basis)		
Travelling & Other Expn	-	0.45

Capital Goods	-	-
Components / Materials	580.50	341.19
Dividends	24.52	-
Loans to 100% Subsidiary	-	17.85
Consultancy Fees	43.39	9.72

(X) Deferred Taxation :

Particulars	AS ON	
	31.03.05	31.03.04
Provision for Gratuity	- 630,336	- 272,058
Provision for Warranties	3,854,497	1,473,989
Professional Charges u/s 40 ot IT Act.	-	35,586
Total Deferred Tax Asset	4,484,833	1,781,633
Deferred Tax Liability		
Difference in Block of Assets	3,157,967	2,722,280
Total Deferred tax liability	3,157,967	2,722,280
Net Deferred tax (Asset) / Liability	(1,326,866)	940,647

Note :

As per the Accounting Standard-22 " Taxes on Income " issued by ICAI ,
The Net deferred tax liability for the year Rs.22,67,514 /- is Credited to P&L A/c.

Signatories to Schedule A to S
As per our report of even date
For GMK ASSOCIATES
Chartered Accountants

For and on behalf of the Board
for KERNEX MICROSYSTEMS
(INDIA) LIMITED.

(G.Satyanarayana Murty)
Partner
Hyderabad, 20.05.05

S V Subba Raju
Chairman

Col.L.V.Raju (Retd.)
Managing Director

I.Srinivas
Company Secretary

BALANCE SHEET ABSTRACT AND COMPANY'S GENERAL BUSINESS PROFILE

KERNEX MICROSYSTEMS (INDIA) LIMITED

Registration No. 01-13211/1991-92

State Code: 01

Balance sheet Date: 31.03.2005

Capital raised during the year		(Amount in Rs. Thousands)	
Public Issue	Nil	Bonus Issue	3419
Rights Issue	582	Private Placement	Nil
Sweat Equity	1650		

Position of Mobilization and Deployment of Funds:

Total Liabilities	267752	Total Assets	267752
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Sources of Funds:

Paid up Capital	74029	Reserves & Surplus	172190
Secured Loan	21533	Unsecured Loans	Nil
Deferred Tax Liability	Nil		

Application of Funds:

Net Fixed Assets	83324	Investments	11831
Capital Work in Progress	Nil	Misc.Expenditure	Nil
Net Current Assets	171270	Deferred Tax Asset	1327

Performance of Company:

Total Revenues	531291	Total Expenditure	385314
Profit Before Tax	145977	Profit after Tax	89840
Earning Per Share	Rs.12.14	Dividend	10%

Generic Names of three Principal Products / Services of Company

Item Code	85249009.10
Product Description	Computer Software

Item Code	-
Product Description	Electronic Safety Devices for Indian Railways

For KERNEX MICROSYSTEMS (INDIA) LIMITED

Place: Hyderabad
Date: 20.05.05

S.V.Subba Raju
Chairman

Col.L.V.Raju (Retd)
Managing Director

I.Srinivas
Company Secretary

STATEMENT PURSUANT TO SECTION 212 OF THE COMPANIES ACT,1956.

1.	Name of Subsidiary Company	Avant – Garde Infosystems Inc.,
2.	Financial Year of Subsidiary Company	Ended on 31-03-2005
3.	Holding Company's Interest	100%
4.	Number of Shares held by Kernex Microsystems (India) Limited in the Subsidiary Company	35,80,000 Ordinary Shares of US \$ 0.02 each and 17,99,240 Equity Shares of US \$ 0.10 each
5.	The net aggregate of Profits for the current financial year of Subsidiary Company, so far it concerns to the members of the Company: a).Dealt with in the accounts of Holding Company b).Not Dealt with in the accounts of Holding Company	 NIL US \$ 2,710
6.	The net aggregate of losses for the previous financial years of the Subsidiary Company, so far it concerns to the members of the Holding Company: a).Dealt with in the accounts of Holding Company b).Not Dealt with in the accounts of Holding Company	 NIL US \$ 60,867

Notes:1. Avant – Garde Infosystems Inc, USA was incorporated on 25th September' 2000 as a 100% subsidiary of Kernex Microsystems (India) Limited.

2. The Financial Year of the Holding Company and the Subsidiary ended on 31/03/2005.

for and on behalf of Board of Directors

S.V.SUBBA RAJU
Chairman

COL L V RAJU(RETD)
Managing Director

I Srinivas
Company Secretary

Place: Hyderabad
Date: 20.05.2005

AUDITORS' REPORT

To the Board of Directors on the Consolidated Financial Statements of KERNEX MICROSYSTEMS (INDIA) LIMITED AND ITS SUBSIDIARY.

We have audited the attached Consolidated Balance Sheet of *Kernex Microsystems (India) Limited, (the Company) and Avant-garde Info systems inc, USA (subsidiary)* as at March,31, 2005 and also the Consolidated Profit and Loss Account for the year ended on that date annexed thereto. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An Audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An Audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We did not audit the financial statements of 100% wholly owned overseas subsidiary, whose financial statements reflect total assets of US \$ 2,11,,13,908 as at 31st March 2005, the total profit before tax of US \$ 21,076 for the year ended on that date. These financial statements and other financial information have been compiled by other auditors whose compilation report has been furnished to us, and our opinion is based solely on the compilation report of other auditors.

We report that the consolidated financial statements have been prepared by the Company's management in accordance with the requirements of Accounting Standard (AS) 21, Consolidated Financial Statements, issued by the Institute of Chartered Accountants of India.

In our opinion and to the best of our information and according to the explanations given to us, the consolidated financial statements give a true and fair view in conformity with the accounting principles generally accepted in India:

- (i) in the case of the consolidated balance sheet, of the state of affairs of the kernex Microsystems (India) Limited
- (ii) in the case of the consolidated profit and loss account, of the profit of the kernex Microsystems (India) Limited

For GMK ASSOCIATES.,
Chartered Accountants

G.Satyanarayana Murty
Partner
Membership No.: 29919

Place: Hyderabad
Date: 20.05.05

KERNEX MICROSYSTEMS (INDIA) LIMITED
" Thrushna ", Plot.No.7 , Software Units layout.
Madhapur, Hyderabad-081 , Andhra Pradesh , INDIA
CONSOLIDATED BALANCE SHEET AS AT 31st MARCH,2005

	<i>Schedule</i>	<i>AS AT</i>	<i>AS AT</i>
	<i>No.</i>	<i>31.03.2005</i>	<i>31.03.2004</i>
I. SOURCES OF FUNDS			
<i>(1) Shareholders' funds :</i>			
(a) Capital	A	74,028,790	68,378,320
(b) Reserves and surplus	B	168,767,714	80,695,352
(c) Deferreed Tax Liability		-	940,647
<i>(2) Loan funds :</i>			
(a) Secured Loans	C	21,532,563	71,021,120
(b) Unsecured Loans	D	-	-
TOTAL		264,329,067	221,035,439
II. APPLICATION OF FUNDS			
<i>(1) Fixed Assets :</i>			
(a) Gross block	E	123,162,715	117,631,238
(b) Less : Depreciation		39,688,185	26,887,480
(c) Net block		83,474,530	90,743,758
(d) Capital Work-in-progress		-	-
<i>(2) Investments :</i>			
	F	-	-
<i>(3) Current Assets, Loans and advances :</i>			
(a) Inventories	G	54,114,513	32,991,408
(b) Sundry Debtors	H	108,855,800	

			67,493,562
(c) Cash and bank balances	I	91,648,687	71,238,114
(d) Loans and advances	J	37,804,968	37,506,373
<i>Less :</i>		292,423,968	209,229,457
<i>Current Liabilities and Provisions :</i>	K		
(a) Current Liabilities		54,367,252	73,063,531
(b) Provisions		79,462,392	30,811,300
<i>Net current assets</i>		158,594,324	105,354,626
(4) (a) Miscellaneous expenditure to the extent not written off or adjusted	L	98,221	103,540
(b) R & D Expenses		20,835,127	24,833,515
(c) Deffered Tax Asset		1,326,865	-
TOTAL		264,329,067	221,035,439
<i>Notes on Accounts</i>	S	-	-

Schedules referred above and notes thereon form part of Consolidated balance sheet.

This is the consolidated Balance sheet referred to in our report of even date

**for GMK ASSOCIATES,
Chartered Accountants**

**for and behalf of the board
for KERNEX MICROSYSTEMS (INDIA) LIMITED**

(G.SATYANARAYANA MURTY)

Partner

Membership No. 29919

Place : Hyderabad

Date : 20.05.05

S.V.SUBBA RAJU

Chairman

I.Srinivas

Company

Secretary

KERNEX MICROSYSTEMS (INDIA) LIMITED
" Thrushna ", Plot.No.7 , Software Units layout.
Madhapur, Hyderabad-081 , Andhra Pradesh , INDIA

CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31st MARCH,2005

	<i>Schedule</i>	<i>For the Year ended</i>	<i>For the Year ended</i>
	<i>No.</i>	<i>31.03.2005</i>	<i>31.03.2004</i>
INCOME			
<i>Sales and Services</i>	M		
(a) Exports		-	-
(b) Domestic		525,558,458	153,543,989
 <i>Other Income</i>	 N	 5,810,299	 10,694,609
		-	-
TOTAL		531,368,757	164,238,598
 EXPENDITURE			
Cost of Sales and Services	O	263,263,727	50,493,322
Personnel Expenses	P	38,069,876	25,745,588
Operating, Admn and Selling Expenses	Q	62,737,458	26,187,242
Finance Charges	R	8,807,581	7,983,623
Depreciation & Amortization	E	12,806,024	5,248,527
		-	-
TOTAL		385,684,666	115,658,302
Profit before Tax		145,684,091	48,580,296
Less : Provision for Taxation :			
(a) Current Year		58,404,776	17,854,139
(b) Deferred Tax		(2,267,513)	(129,698)

Profit after Tax	89,546,827	30,855,855
Add : Profit brought forward from		
Previous year	22,158,120	7,289,825
Profit Available for Appropriation	111,704,947	38,145,680
Less : Provision for Dividend	7,402,879	6,837,832
Less : Tax on distributed Profits	967,464	893,619
Less : Utilised on Issue of Bonus Shares	3,418,920	3,256,110
Less : Transfer to General Reserve	5,000,000	5,000,000
Balance Carried to Balance Sheet	94,915,685	22,158,120

Schedules referred above and notes thereon form part of Consolidated Profit and Loss Account.

This is the consolidated Profit and Loss Account referred to in our report of even date

**for GMK ASSOCIATES,
Chartered Accountants**

for and behalf of the board
for KERNEX MICROSYSTEMS (INDIA) LIMITED

(G.SATYANARAYANA MURTY)

Partner

Membership No. 29919

Place : Hyderabad

Date : 20.05.05

S.V.SUBBA RAJU

Chairman

I.Srinivas
Company
Secretary

SCHEDULES TO THE CONSOLIDATED BALANCE SHEET
AS AT
March 31, 2005

AS AT
March 31, 2004

SCHEDULE A
SHARE CAPITAL

AUTHORISED CAPITAL

1,00,00,000 Equity Shares of Rs.10/- each	100,000,000	100,000,000
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ISSUED SUBSCRIBED AND PAID UP CAPITAL

7,402,879 EQUITY SHARES OF RS.10/- each (68,37,832 Equity Shares Previous Year)		
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(Of the above shares , 43,85,845 number of Eq.shares of Rs.10 each were allotted by way of bonus shares by capitalising free reserves of the Company)	74,028,790	68,378,320
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	74,028,790	68,378,320
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SCHEDULE B

RESERVES AND SURPLUS

Securities Premium

As at the commencement of the year	48,714,732	48,714,732
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Add : received during the year	11,049,450	-
Less: Utilised for Sweat Equity		

Issue	825,000	10,224,450
-------	---------	------------

	58,939,182	48,714,732
--	------------	------------

General Reserve

At the commencement of the year	12,813,631	7,813,631
---------------------------------	------------	-----------

Add: Transfer from the profit & Loss account	5,000,000	5,000,000
--	-----------	-----------

	17,813,631	12,813,631
--	------------	------------

Less : Foreign Currency translation adjustment	2,900,784	2,991,131
--	-----------	-----------

Balance in Profit & Loss A/c	94,915,685	22,158,120
------------------------------	------------	------------

Total	168,767,714	80,695,352
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SCHEDULE C

SECURED LOANS

Term loan from SBH	-	26,128,416
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Cash Credit from SBH	21,532,563	5,385,187
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Vehicle loan	-	107,517
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Loan against Deposits	-	39,400,000
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	21,532,563	71,021,120
--	-------------------	-------------------

SCHEDULE D

UNSECURED LOANS

	NIL	NIL
--	-----	-----

SCHEDULE F

INVESTMENTS :

	-	-
	Nil	Nil
	-	-

SCHEDULE G

INVENTORIES (As certified by Management)

Work in progress	23,016,780	21,545,439
Closing Stock of Components	31,097,733	11,445,969
	54,114,513	32,991,408

SCHEDULE H

Sundry Debtors

(Unsecured and considered good)

Outstanding for a period

exceeding six months

Other Debts

18,808,560	11,134,168
90,047,240	56,359,394
108,855,800	67,493,562

SCHEDULE I

CASH AND BANK BALANCES

Cash in Hand	312,312	216,898
Cash at Bank :		
in current Account with scheduled Banks	2,076,375	24,819
in Fixed Deposits	89,260,000	70,996,397
	91,648,687	71,238,114

SCHEDULE J

LOANS AND ADVANCES

(Considered good, recoverable in cash or
in kind or for value to be received)

Advances given for Suppliers

Deposits – Government

Deposit – Others

Advance for Expenses

Advance Tax/TDS

Deffered Interest

4,214,535	19,274,395
1,119,966	2,491,075
3,654,856	5,995,839
4,722,236	2,078,718
24,093,375	7,659,424
-	6,922
37,804,968	37,506,373

SCHEDULE K

CURRENT LIABILITIES AND PROVISIONS

(A)CURRENT LIABILITIES

Creditors for Supplies- SSI	555,550	362,080
- Others	13,253,089	11,528,159
Creditors for Expenses	10,979,998	11,626,450
Taxes and other duties payable	4,402,430	576,342
Advance Received Against Supplies from KRCL	25,176,185	48,970,500
	54,367,252	73,063,531

(B)PROVISIONS

Provision for taxation	58,590,771	18,212,804
provision for dividend	7,402,879	6,837,832
provision for dividend Tax	967,464	893,619
Provision for gratuity	1,757,035	758,366
Product warranty costs	10,744,243	4,108,679
	79,462,392	30,811,300

SCHEDULE L

Miscellaneous expenditure to the extent not written off or adjusted

Research & Development Expenses	20,835,127	24,833,515
Organisational Costs	143,039	143,039
Start-Up Costs	244,872	244,872
Computer Software	71,488	71,488
Less : Amprtsed During the Year	5,319	95,087
Less : already Amortised	355,859	260,772
	98,221	103,540

SCHEDULE M

SALES AND SERVICES

(A) Sales Exports	NIL	NIL
	-	-
(B) Sales Domestic	434,867,326	112,951,377
Service Income	90,691,132	40,592,612
	525,558,458	153,543,989

SCHEDULE N

OTHER INCOME

Notice salary received from employees	1,040,647	652,915
Interest Received : Banks	4,599,648	4,649,606
Others	-	94,032

Long Term Capital Gain	-	4,003,873
Rental Income	170,004	-
Foreign Exchange Fluctuation on consolidation		1,294,183
	5,810,299	10,694,609

SCHEDULE O

Cost of Sales & Services

Consumption of rawmaterials and bought-out items		
Opening Stock of raw materials	11,445,969	1,955,364
Add : Purchases	135,176,117	41,569,160
Less: Closing Stock	31,097,733	11,445,969
Material consumed	115,524,353	32,078,555
Accessories purchased	65,503,831	14,438,939
Taxes & Duties Paid	52,878,371	9,076,213
Direct Expenses For Project Execution	30,828,513	11,276,494
	264,735,067	66,870,201
Add: Opening Work in progress	21,545,439	5,168,560
Less: Closing work in progress	23,016,780	21,545,439
Net Cost of Sales & Services	263,263,727	50,493,322

SCHEDULE P

PERSONNEL EXPENSES

Salaries and Other Benefits	33,000,568	22,905,883
Contribution to PF & Other funds	1,971,361	1,297,606
Consultancy Charges	247,520	701,462
Staff Welfare	2,850,427	840,636
	38,069,876	25,745,588

SCHEDULE Q

OPERATING, ADMINISTRATIVE AND SELLING EXPENSES

Rent	1,913,004	3,348,397
Rates and Taxes	795,237	59,311
Printing & Stationery	650,689	313,235
Directors Remuneration	4,560,000	2,885,000
Communication Expenses	2,005,458	921,781
Repairs and Maintenance :		
Garden Maintenance	144,279	30,000
Generator Maintained Charges	48,335	77,490
Computer Consumables	218,906	106,963
Vehicle Maintenance Expenses	334,741	134,235
Repairs & Maint Bldgs		-

	3,397,235	
Repairs and Maintenance-general	660,159	361,498
Office Maintenance Expenses	952,050	240,343
Electricity Charges	1,997,031	264,656
Product Warranties costs	7,144,792	4,108,679
Consultancy Fees	452,052	364,484
Sundry Balances Written off	88,934	62,728
Security Charges	1,706,550	655,382
Books and Periodicals	212,762	94,578
Travelling & Conveyance Expenses	1,491,138	1,322,447
Insurance on Fixed Assets	305,349	108,452
Business Promotion	404,602	1,299,628
General Expenses	85,075	1,242,552
Bank Charges	1,208,372	1,740,741
Legal & Other Charges	-	12,900
Audit Fees	490,390	207,420
Sales Tax Paid	15,951,101	3,500,588
Service Tax paid	3,778,899	2,076,494
Entry Tax Paid	857,185	-
Works Contract Tax paid	986,522	-
Freight on Sales	6,163,751	-
Insurance on ACD /Accessories/Projects	3,732,860	647,261
	62,737,458	26,187,242

SCHEDULE R

FINANCE CHARGES

Interest on term Loan	2,936,710	3,023,011
Interest on Working Capital	2,751,902	3,851,057
Bank Commission & Other Financial Charges	2,336,509	351,755
Foreign Exchange Fluctuation	782,460	757,800
	8,807,581	7,983,623

CONSOLIDATED STATEMENT OF FIXED ASSETS

SCHEDULE "E"

FIXED ASSETS

Amount in Rupees

Name of the Asset	Gross Block			As on 3/31/2005	Depreciation			Net Block		
	As on 4/1/2004	Additions during the Year	Deductions /Deletions		Upto 4/1/2004	During The year	Adj.	Upto 31-03-2005	As on 31-03-05	As on 3/31/2004
Land & Land development	12,544,246	-	-	12,544,246	-	-	-	-	12,544,246	12,544,246
Building	43,671,920	-	-	43,671,920	666,110	4,300,581	-	4,966,691	38,705,229	43,005,810
Software Division Plant & Machinery including Computers	39,913,546	4,716,172	-	44,629,718	21,962,132	5,419,659	-	27,381,791	17,247,927	17,951,414
Office Equipment	8,182,535	442,264	1,323	8,623,476	507,351	1,133,514	-	1,640,865	6,982,611	7,675,184
Furniture	10,594,854	187,733	-	10,782,587	2,714,891	1,456,109	-	4,171,000	6,611,587	7,879,963
Vehicles	2,724,137	186,631	-	2,910,768	1,036,996	490,842	-	1,527,838	1,382,930	1,687,141
Total	117,631,238	5,532,800	1,323	123,162,715	26,887,480	12,800,705	-	39,688,185	83,474,530	90,743,758
As On 31.3.04	43,417,503	74,213,735	-	117,631,238	21,734,040	5,153,440	-	26,887,480	90,473,215	21,269,779

SCHEDULE 'S'

Significant accounting policies and notes on accounts :

Company Overview :

Kernex Microsystems (india) Limited is engaged in the Manufacture and sale of Safety Systmes like Anti-Collsiion Devices for Railways and Software Services . and its 100% WOS Avant-Garde Infosystems Inc, USA is engaged in Development of Software products and consultancy services.

A Significant accounting policies :

1 Basis of preparation of Consolidated financial statements

The accompanying consolidated financial statements are prepared in accordance with Indian Generally Accepted Accounting Principals (GAAP) under historical cost convention on the accrual basis . GAAP comprises mandatory accounting Standards issued by the Institute of Chartered Accountants of India (ICAI) , and the provisions of the Companies Act,1956.

These accounting polocies have been consistently followed, except where a newly issued accounting standard is initiallly adopted by the Company.

Management evaluates the effect of accounting standards issued on an on-going basis and ensures they are adopted as mandated by the ICAI . There are no recently issued Accounting Standards that management believes have a material impact on the financial statements of the Company .

The Consolidated Financial statements have been prepared on the follwing basis :

- a** The financial statements are prepared in accordance with the principles and procedures required for the preparation and presentation of consolidated financial statements as laid down under the accounting standards on consolidated financial statements issued by the ICAI. The financial statements of the Parent Company Kernex Microsystems (india) Limited ,have been combined with 100% WOS Avant-Garde Infosystmes Inc, USA on a line -by-line basis by adding together bookvalues of like items of assets,liabilities,income and expenses

after eliminating intra-group balances and transactions and resulting un-realised gain / loss .

- b** The excess/deficit of cost to the parent company of its investment in the subsidiary over its portion of equity in the subsidiary at the respective dates on which investment in such subsidiary was made is recognised in the financial statements as goodwill/capital reserve.
- c** The Parent company's portion of equity In such subsidiary is determined on the basis of the Investment made as on the date of transaction as per the financial statements of the subsidiary .
- d** The consolidated financial statements are presented, to the extent possible, in the same format as that adopted by the parent company for its separate financial statements.
- e** The consolidated financial statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances.

2 Fixed Assets ,Depreciation and Amortization

Fixed assets are carried at the cost of acquisition less accumulated depreciation.

Fixed assets are valued at original cost including incidental expenditures, taxes and duties net of cenvat credit availed.

Depreciation has been charged on fixed assets on WDV method as per the rates specified in Schedule XIV of the Companies Act,1956.

Depreciation is calculated on the computer Equipment, Office Equipment and Furniture and Fixtures over their estimated useful lives for the Subsidiary .

Start-up and Organisational Costs and Computer Software are Amortized over a period of its useful life.

3 Investments :

Investments in subsidiary is accounted under the equity method of accounting which were initially recorded at cost.

4 Inventories

Inventories of Components are valued at cost or realisable value which ever is less. Work in progress is valued at cost of materials and services used .

5 Research & Development Expenditure :

Research & Development expenditure incurred for Software products by Avant-Garde Infosystems Inc, USA is treated as Diferred Revenue Expenditure, to be Amortized over a period, till the product is viable in the market.

6 Retirment Benefits to Employees :

6.1 Gratuity :

In accordance with the payment of Gratuity Act,1972 KMIL provides for gratuity , covering all the Employees based on the Service of Years rendered to the Company , in excess of 6 Months on a consistant calculation as per The Gratuity Act,1972 .

6.2 Provident Fund :

All the eligible employees of the company are covered under PF and Misc.provisions Act, both Employee and the Company make monthly contributions to the PF plan equal to specified percentage of the Covered Employees salary.

7 Revenue Recognition :

Income from software development and services is accounted for on the basis of software development and billed to client on acceptance and / or on the basis of man-days/man-hours as per the terms of contract .

Revenue from product sales is stated exclusive of returns , and applicable trade discounts but inclusive of Duties and Taxes collected on the same .

Service Income is recognized as per the terms of Contracts with the Customer, when the related services are performed.

8 Foreign Currency Transactions :

Expenditure in foreign currency is accounted at the exchange rate prevalent when such expenditure is incurred . The exchange difference arising on foreign currency transactions are recognised as income or Expenses in the period in which the payment is made.

The financial statements of the foreign subsidiary is translated into indian rupees as follows :

- a** Revenue items, except opening and closing inventories and depreciation are translated at the respective monthly average rates. Depreciation is translated at the rates used for the translation of the values of the assets on which depreciation is calculated.
- b** Monetary items are translated using the closing rate.
- c** Non-monetary items, other than inventories and fixed assets, are translated using the exchange rate at the date of transaction i.e, the date when they were acquired.
- d** Fixed assets are translated using the exchange rate at the date of their acquisition.
- e** The net exchange difference resulting from the translation of items in the financial statements of foreign subsidiary is recognised as income or as expense for the year.

9 Income Tax :

9.1 Current Tax :

Provision for current tax is made and retained in the Accounts on the basis of estimated tax liability as per the applicable provisions of the income-tax Act,1961.

9.2 Deferred Tax :

Deferred tax has been accounted in accordance with Accounting Standard - 22 " Accounting for Taxes

on Income" issued by the ICAI , under the liability method.

A provision is made for Income tax annually based on the Tax Liability computed. The difference that result between the profit offered for income taxes and the Profit as per the Financial Statements are identified and thereafter a deferred tax asset or deferred tax liability for timing differences,namely the difference that originate in one accounting period and reverse in another, based on the tax effect of the aggregate amount being considered.

The tax effect is calculated on the accumulated timing differences at the end of an accounting period based on prevailing enacted regulations.

Deferred tax assets are recognised only if there is reasonable certainty that they will be realised and are reviewed for the appropriateness of their respective carrying values at each balance sheet date .

10 Warranty Expenses

Anticipated product warranty costs for the period of warranty are provided for in the year of sale.

11 Segment Reporting :

Since the Company has only one Business and Geographic Segement namely Sales, Service and Software for Anti-Collision Devices, "Segment Reporting " under "Accounting Standard 17" issued by the "ICAI" is not applicable .

12 Related Party Disclosures:

a) . There are no related parties where control exists other than 100% Wholly Owned subsidiary.

b) . Other related parties with whom transactions have taken place during the year are :

Krisn Information Technologies Ltd

Enterprise managed by relative of Managing Director

Hardware Consultancy to Kernex for Different Projects
(Total Transaction during the year Rs.11,60,035 /-)

Cova Technologies Inc, USA

Enterprise owned by relative of Managing Director
Consultancy services on Procurement & Inspection of
goods in USA .
(Total Transaction during the year Rs.30,01,009 /-)

The Company entered into related party transactions with Avant-Garde Infosystems Inc, USA.
a 100 % Wholly owned Subsidiary with regard to :

Particulars	Year ended March,31 ,		
	2005	2004	
1.Capital Transactions :			
Working Capital Loan	Nil	US\$ 40,000	
2.Revenue Transactions :			
Interest receivable	Rs.6,62,716.00	Nil	
3.Sale of Services :	Nil	Nil	
<u>Key Management Personnel :</u>		04-05	03-04
Col. L.V.Raju (Retd) - Managing Director	Remuneration	30.00	16.25
B. Murali Mohan - Whole Time Director	Remuneration	15.60	12.60

13 Issue Of Sweat Equity Shares :

During the Financial Year the Company has issued 1,65,000 Sweat Equity Shares
of Rs.10 /- each to the Identified Employees / Working Directors ,at an exercising option of Rs.5 /- per share .

14 Earning Per Share :

Earning / Diluted Earning Per Share of the Company has been calculated as per the

Accounting Standard 20 " Earning Per Share " Issued by ICAI .

	<u>04-05</u>	<u>03-04</u>
Earning Per Share	12.10	4.51
Diluted Earning Per Share	12.51	4.74

15 Deferred Taxation :

Particulars	AS ON	
	<u>31.03.05</u>	<u>31.03.04</u>
Provision for Gratuity	630,336	272,058
Provision for Warranties	3,854,497	1,473,989
Professional Charges u/s 40 ot IT Act.	-	35,586
Total Deferred Tax Asset	4,484,833	1,781,633
Deferred Tax Liability		
Difference in Block of Assets	3,157,967	2,722,280
Total Deferred tax liability	3,157,967	2,722,280
Net Deferred tax (Asset) / Liability	(1,326,866)	940,647

Note :

As per the Accounting Standard-22 " Taxes on Income " issued by ICAI ,

16 Impairment Of Assets :

The Management of the Company is on the opinion that there are no Fixed Assets to be impaired for the period,as identified by the sources of Information,mentioned in the Accounting Standard -28 " Impairment of Assets " issued by the ICAI.

17 Description of the Group :

Kernex Microsystems (india) limited , is having a 100% Wholly owned Subsidiary in Fremont, USA engaged in Software development and consultancy.

B Notes to Accounts :

- 1 All Amounts in the financial statements are presented in Rupees. The Previous year's figures have been regrouped / reclassified, wherever necessary to confirm to the Current year's presentation. Figures are rounded off to the nearest rupee.
- 2 The Balance Sheet and Profit & Loss Account for the year ended 31.03.2005 of Avant-Garde a 100% WOS are prepared based on the Financial Statements duly certified by C.P.A.
- 3 Estimated amount of contracts remaining to be executed on capital account and not accounted are Rs.5.00 lakhs-net of Advances . (2004: Rs.20.00 lakhs)

4 Auditors remuneration relates to :

	<u>04-05</u>	<u>03-04</u>
Statutory and Tax Audit :	4.41	1.83
Sales Tax Audit	0.28	0.15
Other Services :	0.22	0.09

5 Term Loans and Cash Credits:

Rupee Term Loan is prepaid in full by the company during the financial year .
Cash Credit Account from SBH is secured by first charge on the Fixed Assets and personal guarantees of M.D, Directors .

6 Exchange Differences :

Other Income includes Exchange difference of Rs.nil (2003-2004 Rs.12,94,183)
Finance Charges includes Exchange Fluctuaion of Rs.7,82,460/- (2003-2004 Rs.7,57,800/-)

7 Contingent Liabilities in respect of :

- a)** Claims against the Company not acknowledged as debt Rs. **8 lakhs** in respect of Income Tax for the Assessment Year 1998-99 for which department preferred appeal against the Order of Commissioner Appeals in favour of the Company.
- b)** Claims against the Comapany not acknowledged as debt Rs. **2.4 lakhs** in respect of CENVAT Claim.
- c)** Bank guarantees outstanding **Rs.161.00 lakhs (2004 : Rs.500.00 lakhs)**

Signatories to Schdule A to S
As per our report of even date
For GMK ASSOCIATES
Chartered Accountants

For and on behalf of the Board
for KERNEX MICROSYSTEMS
(INDIA) LIMITED.

(G.Satyanarayana Murty)
Partner
Hyderabad, 20.05.05

S V Subba Raju
Chairman

Col.L.V.Raju (Retd.)
Managing Director

I.Srinivas
Company Secretary

AVANT – GARDE INFOSYSTEMS INC, U.S.A.

REPORT OF THE DIRECTORS

To
The Members

The Board of Directors of Avant-Garde Infosystems Inc has pleasure in submitting the **FIFTH ANNUAL REPORT** in respect of the period from 01st April'2004 to 31st March'2005.

DIRECTORS

The Names of the Directors in office during or since the end of the Financial Year are

<i>Names</i>	<i>Position</i>
COL L V RAJU (RETD)	Director and President
KISHORE B GOTTIMUKKALA	Director , Chief Financial Officer and Secretary

PRINCIPAL ACTIVITY

The principal activity of the Company during the financial year was developing, marketing software services and products in American Continent.

FINANCIAL YEAR

The Financial Year of the company is from 01st April' to 31st March to align with Kernex Microsystems (India) Limited, the Holding Company.

FINANCIAL RESULTS

The net Profit of the company for the financial year was US\$ 2,710. During the year under review Research and Development Expenditure incurred for Software Products is treated as Deferred Revenue Expenditure to be amortized over a period, till the product is viable in the market.

OPERATIONS

During the year the Company received an income of US \$ 17,000 towards consulting.

FUTURE PROSPECTS

Your Company will be completing the balance work of pending “ Patient Medical Documentation Tracking System “, (An ERP) after receipt of additional functional requirements from its Technology partner , Wolverine systems, Detroit. And the later will be embarking on marketing the product to the corporate hospitals in USA by November, 2005. The trials are expected to complete by the end of 2005-06 and marketing the product will start in 2006-07.

For AVANT – GARDE INFOSYSTEMS, INC.,

**COL L V RAJU (RETD)
DIRECTOR**

Date : 05-05-2005

AVANT – GARDE INFOSYSTEMS INC, U S A

BALANCE SHEET AS AT 31ST MARCH, 2005

	SCH	(Amount in Rs.) Year ended 31-Mar-05	(Amount in Rs.) Year ended 31-Mar-04
SOURCES OF FUNDS:			
Share Capital	I	10,971,477	10,971,477
Reserves and Surplus	II	-	-
Secured Loans		-	-
Un-secured Loans	III	10,142,431	10,058,974
TOTAL SOURCES		21,113,908	21,030,450
APPLICATION OF FUNDS:			
Fixed Assets (Net Block)			
Gross Block	IV	1,143,048	1,143,048
Less: Depreciation		992,787	872,505
Net Block		150,261	270,543
CURRENT ASSETS, LOANS & ADVANCES			
Sundry debtors		-	-
Cash and bank balances	V	439,820	-
Advances & Deposits	VI	67,813	67,255
TOTAL CURRENT ASSETS		507,633	67,255
LESS: Current liabilities	VII	1,012,506	4,800,652
NET CURRENT ASSETS		(504,874)	(4,733,397)
Miscellaneous Expenditure (To the extent not written off)			
Organisational Costs and Start-Up Costs	VIII	98,221	103,540
Research and Development Costs		20,835,127	24,833,515
Debit Balance in Profit & Loss Account		535,173	556,249
Notes on accounts Forming part of accounts	IX	21,113,908	21,030,450

for AVANT-GARDE INFOSYSTEMS INC.,

COLL.V.RAJU(RETD)
DIRECTOR

Place: Fremont

Date : 05.05.2005

AVANT – GARDE INFOSYSTEMS INC, U S A

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDING 31ST MARCH, 2005

	SCH	(Amount in Rs.) Year ended 31-Mar-05	(Amount in Rs.) Year ended 31-Mar-04
INCOME			
Fee – Consulting		740,690	255,429
Misc.Income			
Sales			
Total		740,690	255,429
EXPENDITURE			
Rent		11,546	549,627
Telephone Charges		-	17,731
Accounting		102,426	109,873
Bank Charges		9,542	-
Auto Expenses			
Office Supply			
Postage			
Penalties		-	5,039
Dues & Subscriptions			
Meals & Entertainment			
Licence & Fees		5,091	14,735
Interest		348,560	327,533
Depreciation		120,282	143,141
Amortisation Expenses		5,319	95,087
Outside Services		-	681,750
Taxes		28,277	36,360
Total Expenses		631,042	1,980,877
Profit / (Loss) before Tax and extraordinary items		109,648	(1,725,448)
Add / (Less) : Net Exchange Difference		(88,571)	1,294,183
Profit / (Loss before Tax)		21,076	(431,265)
Provision for Tax		-	-
Profit after Tax		21,076	(431,265)
Profit / (Loss) brought forward from earlier years		(556,249)	(124,984)
Profit / (Loss) carried to Balance Sheet		(535,173)	(556,249)

for AVANT-GARDE INFOSYSTEMS INC.,

COL.L.V.RAJU(RETD)
DIRECTOR

Place: Fremont

Date : 05.05.2005

AVANT – GARDE INFOSYSTEMS INC, U S A
SCHEDULES FORMING PART OF BALANCE SHEET

	31-Mar-05	31-Mar-04
SCHEDULE 'I'		
SHARE CAPITAL		
Authorised Capital		
Common Shares at no par value	50,000,000	50,000,000
	Shares	Shares
Issued, Subscribed and Paid-up Capital	10,971,477	10,971,477
	10,971,477	10,971,477
SCHEDULE 'II'		
Reserves and Surplus	-	-
	-	-
SCHEDULE 'III'		
Unsecured Loans :-		
Loan from Kernex Microsystems (India) Ltd	10,142,431	10,058,974
	10,142,431	10,058,974
SCHEDULE 'V'		
Cash and Bank Balances		
California Pacific Bank	439,820	-
	439,820	-
SCHEDULE 'VI'		
Loans and Advances (Considered Good unless otherwise stated)		
Rent Deposit	67,813	67,255
Accounts Receivables	-	-
Pre-Paid Taxes	67,813	67,255
SCHEDULE 'VII'		
Current Liabilities and Provisions		
Credit Cards payable	-	145,209
Bank Accounts Payable	-	3,998,389
Accounts Payable	1,012,506	657,055
Interest Payable	1,012,506	4,800,652
SCHEDULE 'VIII'		
Miscellaneous Expenditure to the Extent not written off or Adjusted		
Research & Devolpment Expenses	20,835,127	24,833,515
	-	-
Organisational Costs	143,039	143,039
Start-up Costs	244,872	244,872
Computer Software	71,488	71,488
Total	459,399	459,399
Less:Already Amortised	355,859	260,772
Less Amortised during the year	5,319	95,087
Balance	98,221	103,540

SCHEDULE "IV"

2004-2005

PARTICULARS

GROSS BLOCK
Additions

DEPRECIATION

NET BLOCK

PARTICULARS	GROSS BLOCK		DEPRECIATION			NET BLOCK		
	As on 01-04-2004	during the year	As on 31-03-2005	Up to 01-04-2004	During the year	As on 31-03-2005	As on 01-04-2004	
Computer Equipment	417,756	-	417,756	332,699	47,903	380,602	37,154	85,057
Equipment - Others	294,535	-	294,535	243,631	33,920	277,551	16,983	50,904
Furniture & Fixtures	430,757	-	430,757	296,175	38,459	334,634	96,124	134,582
	1,143,048	-	1,143,048	872,505	120,282	992,787	150,261	270,543
Computer Software	143,039	-	143,039	143,039	-	143,039	-	-
Start-Up costs	244,872	-	244,872	159,204	5,319	164,523	80,349	85,668
Organisational Costs	71,488	-	71,488	53,616	-	53,616	17,872	17,872
	459,399	-	459,399	355,859	5,319	361,178	98,221	103,540

Schedule-IX

Notes to Accounts - March 31, 2005

SIGNIFICANT ACCOUNTING POLICIES

1 Basis of Accounting

The accounts expressed in equivalent Indian Rupees are prepared in accordance with the historical cost convention.

2 PRINCIPAL ACTIVITIES

The Principal activities of the company are that of provision of computer consultancy, software development and related services.

3 SHARE CAPITAL

	No of Shares as on
Authorised	3/31/2005
Common shares at no par value	50000000

4 HOLDING COMPANY

The company is wholly owned Subsidiary of Kernex Microsystems (India) Limited.

5 ACCOUNTING PERIOD

The Financial Statements are prepared for the period from 1st April, 2004 to 31st March, 2005

6 RELATED PARTY TRANSACTIONS

The company has received the share capital and working capital loan from Kernex Microsystems (India) Limited a related Company.

7 Fixed Assets ,Depreciation and Amortization

Fixed assets are carried at the cost of acquisition less accumulated depreciation.

Depreciation has been charged on fixed assets on WDV method as per the rates specified in Schedule XIV of the Companies Act,1956.

Depreciation is calculated on the computer Equipment, Office Equipment and Furniture and Fixtures over their estimated useful lives for the Subsidiary .

Start-up and Organisational Costs and Computer Software are Amortized over a period of its useful life.

8 Foreign CurrencyTransactions :

Expenditure in foreign currency is accounted at the exchange rate prevalent when such expenditure is incurred . The exchange difference arising on foreign currency transactions are recognised as income or Expenses in the period in which the payment is made.

The financial statements of the foreign subsidiary is translated into indian rupees as follows :

- a Revenue items, except opening and closing inventories and depreciation are translated at the respective monthly average rates. Depreciation is translated at the rates used for the translation of the values of the assets on which depreciation is calculated.
- b Monetary items are translated using the closing rate.
- c Non-monetary items, other than inventories and fixed assets, are translated using the exchange rate at the date of transaction i.e, the date when they were acquired.
- d Fixed assets are translated using the exchange rate at the date of their acquisition.
- e The net exchange difference resulting from the translation of items in the financial statements of foreign subsidiary is recognised as income or as expense for the year.

- 9 The Accounts are reclassified to conform as near as to the Schedule VI of the Companies Act, 1956.

- 10 The Financial Statements are the responsibility of the Company's Management and are not required to be Audited as per the existing US Laws.
- 11 Previous Years Figures were re-grouped and re-arranged Wherever necessary.
- 12 The Balance Sheet and Profit & Loss Account for the year ended 31.03.2005 are prepared based on the Financial Statements duly certified by C.P.A. instead of the Compilation done as per Tax Statements in earlier Years.

For AVANT - GARDE INFOSYSTEMS, INC.,

**COL L V RAJU(RETD)
DIRECTOR**

Place : Fremont
Date : 05.05.05