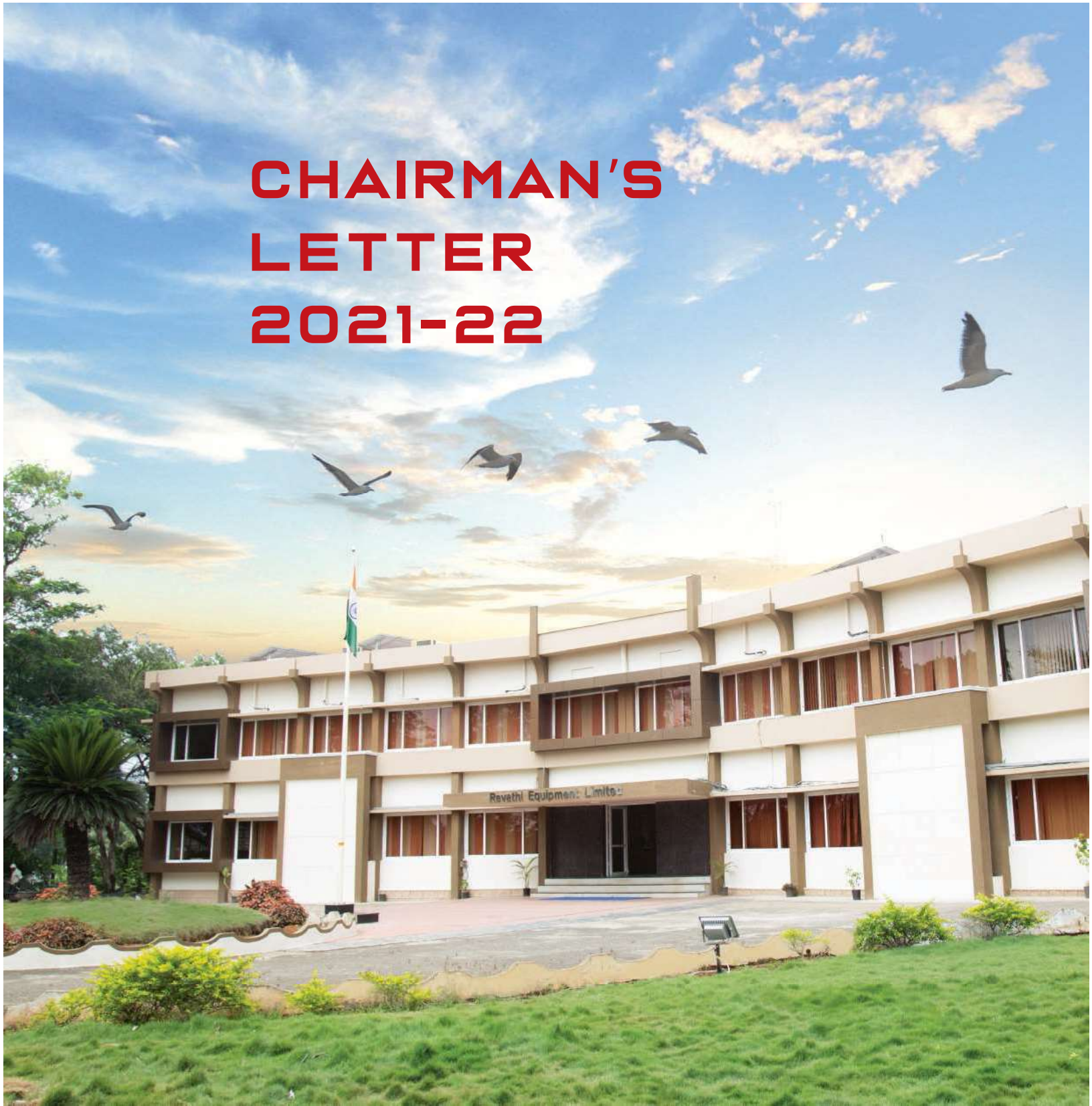


CHAIRMAN'S LETTER 2021-22





During the year, our consolidated net worth increased by Rs.13 million, which increased the per share book value by 7%. Over the last twenty years (that is, since the present owners took over) per share book value, has grown from Rs.151 to Rs.638 (Rs.715 after ignoring the effect of goodwill write-offs), which, after factoring in dividend paid during this period, works out to a rate of 10.2% (11%) compounded annually.

The Drilling Solutions business has had several CEOs over the past couple of decades. Our best performance was in the years immediately after we acquired the company from Atlas Copco. This was under the leadership of Mr. Rajanarayanan, who was a Revathi veteran before he assumed the CEO role in 2003. Until he stepped down in 2010, he delivered an average profit before tax of Rs.16 crores annually.

After his retirement, three different CEOs ran Revathi between FY11 and FY18. Over this period, owing mainly to the Concrete Equipment business and the significant leverage we took on to acquire Potential Consultants and Semac Consultants, our profitability fell dramatically to an average annual profit before tax of Rs.2.7 crores. During this period, we had taken on a peak debt of Rs.100 crores, on which we paid an average interest of Rs.10 crores annually between FY09 and FY16. In addition, we incurred an average annual loss of Rs.7 crores on account of the Concrete Equipment business. Halfway through this period, in FY14, we shut down the Concrete Equipment business. However, it still took several more years to repair the balance sheet and we ended FY18 with a debt of Rs.26 crores.

We finally became debt free in FY19 (though we ended the current financial year with a debt of Rs.28 crores). Over the past four years, since I assumed the role of CEO in FY19, I am happy to report that our profit before tax has once again stabilized around Rs.16 crores, which is where it was when we acquired the business from Atlas Copco. Of course, after adjusting for time value of money, we are significantly below the Rs.16 crore mark. Assuming an average annual inflation of six per cent, the time adjusted profit before tax should have been Rs.51 crores to equate to Rs.16 crores in FY03. Some more work is needed to get there but I am hopeful that, on a consolidated basis, we will get there over the next few years.

I had mentioned in last year's letter that we had created three verticals in the Drilling Solutions business – Public Sector, Private Sector and Exports. The Public Sector business has been rock solid through the entire journey over the past two decades and continues to be so. That said, much of this business is dependent on fossil fuels and no one knows how many years we have left before this business folds. I do not expect a gradual demise. When it happens, it could be fairly abrupt. As such, we will need to build alternate profit streams before we get to that point. The other two verticals are meant to address exactly this.

The Private vertical had seen a healthy growth since its inception in FY18. Of course, it is still too small and its contribution to the profitability of the Drilling Solutions business is not moving the needle much yet. However, I am confident that as we create critical mass of population of machines working in the cement and steel industries, this vertical will contribute quite meaningfully in future years.

The Exports vertical is taking longer than anticipated to start firing but these are teething troubles only to be expected in entering new markets and convincing new customers to buy our products. Every passing year only strengthens our resolve to try harder and I know success is lurking around the corner. I do expect order booking to become robust in next year or two. Sales growth will inevitably follow, as will profitability. I expect Exports to contribute meaningfully to the Drilling Solutions business sooner than the Private vertical.

To achieve the above goals, a lot of work is required to be done on succession planning, upgrading quality, finding new business opportunities within the chosen domains, etc. I am confident that we will make meaningful progress on all these dimensions over the next few years. With the balance sheet repaired and the P&L stable, the worst is behind us and I am sure we will beat our historical performance consistently in the coming years.

Before I move on to Semac, a brief note on the health of our balance sheet, which reflects the quality of the underlying business. If the quality of a business (or the business model) is weak, Michael Porter's five force analysis predicts that you will not be able to capture much value inside your company. Most of the value will be taken away by either the suppliers or customers or competitors. Conversely, if the business model is robust, you will get a growing cash pile.

When we acquired the business in FY03, the company was sitting on about Rs.37 crores of cash (there was no debt). From there, we have been to hell and back – from a healthy cash pile, we went to a peak debt (net of cash) of Rs.72 crores in FY09 (a negative delta of about Rs.110 crores) and ended the current year with a cash balance (net of debt) of Rs.120 crores, including investments in Semac (c.Rs.120 crores) and the Chembur project (Rs.17 crores). Excluding these investments, our year end debt stood at about Rs.4 crores. In effect, the business has thrown off about Rs.190 crores of cash between FY10 and FY22, after paying for all the losses and write offs of the Construction Equipment business, which amounted to roughly Rs.100 crores.

Prima facie, our capital allocation seems to have been highly sub-optimal so far. After paying off debt, capital invested, mainly into Semac, seems to have produced almost nothing in incremental market cap of Revathi. However, I am confident that a combination of business performance in the years ahead and the demerger and subsequent listing of Semac over the next financial year should at least double the combined valuation of both businesses in the short-term.

Now turning to Semac Consultants, the journey in this business has been a bit of heartbreak for shareholders. So far, we acquired the two businesses, Potential and Semac at their peak combined profit before tax of Rs.10-12 crores. Over the years, we have invested about Rs.120 crores in this business.

The vast majority of the Principals who sold the two businesses to us, gradually left to set up their own competing firms (despite signing non-compete agreements) and took away clients and staff. As a result, we just about broke even during the three years, FY16 through FY18, after the Principals had left, under the watch of two different CEOs.

Like in the Drilling Solutions business, I assumed responsibility as CEO of Semac in FY19. Our average profit before tax over the period FY08 (when we bought the business) and FY15 (the last year under the leadership of the erstwhile founders), was Rs.5.5 crores. Over the last four years since FY19, our average profit before tax was close to break even.

The results have been terrible and were exacerbated by the two covid hit years, when the capex cycle ground to a halt across most industries, depressing our Revenues (with much of our cost structure being fixed). We also used the down cycle to clean up our books, which included massive write-offs from our failed experiments, including investments made to grow the business in new markets such as Dubai, Qatar, Kenya, Uganda, etc. That is where the bad news finally ends.

This year, we hired an industry veteran as our Chief Operating Officer. The Sales Team was also strengthened and reoriented to dramatically shrink our playing field to doing industrial projects for a handful of carefully chosen clients. When we are not winning enough business, shrinking the playing field is counter intuitive, but I have always believed that focus is powerful. This hypothesis bore fruit and we booked orders worth over Rs.200 crores during the year, making it our best ever year in the history of the company from the perspective of order booking. All these orders, to the extent not executed during the current year will get executed in the next financial year. This means that the next financial year will be our best ever year in terms of Revenues and profitability. Further, we feel quite confident that the order booking done this year is not a one off and next year should be even better.

Now that the sales engine is finally humming along predictably, we plan to shift our attention to delivering projects cheaper and faster. Like with everything else, delivering on such a simple promise means doing a lot of things right – a more qualified team – that focuses not only on optimizing designs for safety but also on optimizing for cost, better sourcing to reduce procurement costs, better network of trusted partners to execute projects fast, without compromising on quality, etc.

A small note on our Treasury. We ended the year with Rs.48 crores in cash and bank balances, some of which has been invested, some has been parked in FDs to secure bank guarantees issued against mobilization advances received from customers for their projects and the balance sits in liquid mutual funds. During the year, we added Rs.28 crores to our Treasury. We do not expect that a significant part of our profits will go towards funding the increasing working capital, as business expands. As such, gradually this figure should grow further, in line with growth in profits after tax. Just for perspective, the company was founded in 1969 and all the way upto FY12 (a decade ago), the company was sitting on Nil cash balance. The Founders used to only collect as much as needed to pay the bills (including their own salaries). Everything else used to sit in Receivables. Over the years, despite losing significant money, we have managed to create a fairly

healthy cash surplus, which will help us in sustaining shocks when the going gets tough as well as scaling our business when the going is good.

As always, I would like to end this year's letter by thanking our people in both companies who have been relentless in delivering the budgets for the year, regardless of the external environment. While Revathi has been doing well for some time now, Semac has had more than its fair share of struggles. To keep your head high and not let professional losses bring you down, takes a lot of character. Over the years, when the going was really tough, our team has shown that character in spades. The result is that the company has finally turned the corner and is looking to deliver results we will all be proud of in the coming years.

PLACE : Coimbatore

DATE : 13.08.2022

MR. ABHISHEK DALMIA

Chairman and Managing Director

DIN: 00011958

ACQUISITION CRITERIA

We use this space to communicate with potential sellers and their representatives, what we look for in a potential acquisition. If you, the reader, have no personal connection with a business that might be of interest to us but have a friend who does, perhaps you could pass this message on to him.

Here's the sort of business we are looking for:

1. Enterprise value in the region of ₹ 100 crores (₹ 1 billion),
2. Demonstrated consistent earning power (future projections are of little interest to us, nor are "turnaround" situations),
3. Businesses earning good returns on equity while employing of no dept
4. Management in place,
5. Simple businesses,
6. An offering price.

We will not engage in unfriendly takeovers. We can promise complete confidentiality and a very fast as to whether we are interested. We prefer to buy for cash, but will consider issuing stock when we receive as much in intrinsic business value as we give.

Our favorite form of purchase is one where the company's owner-managers generate significant amounts of cash, sometimes for themselves, but often for their families or inactive shareholders. At the same time, these managers wish to remain significant owners who continue to run their companies just as they have in the past. We think we offer a particularly good fit for owners with such objectives. We invite potential sellers to check us out by contacting people with whom we have done business in the past

