CHAIRMAN'S LETTER 2020-21

Our increase in consolidated net worth at the end of FY21 was Rs.78 million, which increased the per share book value by 4.4%. Over the last nineteen years (that is, since the present owners took over) per share book value, has grown from Rs.151 to Rs.596 (Rs.673 after ignoring the effect of goodwill write-offs), which, after factoring in dividend paid during this period, works out to a rate of 9.8% (10.6%) compounded annually.

The Drilling Solutions business had a decent year despite all the disruptions caused by the ongoing pandemic. Though we would have liked to push our plans forward a bit more than we actually did, under the circumstances, I do not feel disappointed with the overall outcome.

Old timers would know that the public sector business, which has been our mainstay, has been a cash cow. While it creates most of our profit, it does not grow at all. However, there has been the concentration risk of depending too much on a few customers as well as strategic risk of focusing too much on fossil fuels.

Historically, we tried a few different things to diversify away from these risks. Unfortunately, those experiments did not go very well. Those experiments were mainly around a whole new business (concreting equipment, about which I wrote in some detail in the FY16 letter) or around developing new products for new markets (again a bit riskier than selling existing products into new markets). This strategy should have worked better than it did. The main reason it did not was that we spent more effort on product development than on selling the products that were developed. Until FY19, we were mainly focused on generating cash to clean up the balance sheet. The pain from carrying and servicing large amounts of debt was just too high to think about anything else in a meaningful way.

After turning debt free in FY19, we turned our gaze back towards growing the business. To pursue that agenda, we created three verticals namely Public Sector, Private Sector and Exports, each headed by a seasoned Revathi hand. These new leaders have done a lot of work to create new growth engines for our company. A brief commentary on some of the work done follows.

The Exports team has been preparing the foundation to build our exports business. These steps include upgrading our marketing collaterals, participating in trade fairs, appointing dealers in multiple target markets, etc. Like any new initiative, developing new markets is a journey which involves getting multiple things right. These include, product specifications and quality (which may be different from the domestic market that we have been used to serving), finding the right target markets (which have significant mining activity, light regulation, relatively low competitive intensity, etc.), appointing the right dealers (who have an understanding of the industry and have relevant customer relationships), finding the right customers (who deal honestly and fairly and who have the money to pay for our equipment), etc.

It is not easy to walk into a new market and expect a new customer to start trusting a new supplier. This task becomes doubly difficult when meeting customers becomes impossible due to pandemic induced travel bans. Despite these challenges, our team won an order from the largest cement producer in Africa. After getting stuck en route to the port in March 2020, these machines were finally dispatched during the year. Additionally, several ongoing conversations with potential customers makes me confident that we will win many more orders in the coming years.

While the sales team has been busy with the above work, we have also been working to upgrade product quality and add technical specifications to meet expectations of global customers. We have also hired and trained service engineers to make sure our equipment delivers the performance that the customers expect at a cost cheaper than what they end up paying for machines supplied by our competitors.

The Private vertical is mainly focused on two industries, which have a large mining component – cement (limestone) and steel (iron ore). We have had Tata Steel as a long-standing customer. During the year, we added an international player in the Indian cement industry. This is just a start and at the close of the year, we had several ongoing conversations with potential clients. We hope to convert some of these dialogs to orders in the next year. We are also talking to some mining contractors working for cement companies as well as some steel companies. Breaking into new customers for capital goods takes time but we are quite hopeful of making inroads into some clients very soon.

Both, the Export and Private verticals, should help us in achieving our objectives of growth, diversification out of a single customer and diversifying out of fossil fuels.

I would also like to mention a few “startup costs” associated with some of these new initiatives. The export markets usually expect fast deliveries after placing orders. As a result, we have to build inventory in anticipation of order booking unlike our public sector customers. Given we are new to this game, often a customer delays placing orders or delays in closing the financing for the order, etc. This leads to us holding inventories in anticipation. Similarly, if we draw pre-shipment credit from the bank for exports but are unable to export within the time limit specified in the facility, the concessional rate of interest does not apply. Both these are material to our Balance Sheet and P&L statements. We have suffered on both these counts but are hopeful that as things get streamlined, both these issues will fade away.

Following on from FY20, Semac had another soft year. In the middle of a pandemic, most put their capex plans on hold, which significantly impacted our business this year.

I had mentioned in last year’s letter that our wins in Design Build had been stalling. I had also mentioned that slowing wins has a direct impact on Revenues, with a lag of a quarter or two and that this would mean that we will have a tough year in FY21. Unfortunately, my prediction came true this year.

Several additional factors made things even worse than I had anticipated. The pandemic shock meant that most industries went into cash preservation mode and mothballed even their ongoing capex plans. That meant the jobs we had on hand got executed slower, leading to lower billing. The recurring lockdowns meant that prospecting for new clients to rebuild the order book became tougher. Convincing new clients to try a new service provider over their existing provider is as it is hard. Trying to do this without being able to meet them in person is even harder.

The slowing pipeline even before we got hit by the pandemic followed by the new normal of trying to win new clients without a physical meeting forced us to revisit our sales approach. A brief commentary follows.

When we acquired the business, each office was a standalone office, with no collaboration happening across offices. After the last Principal left in 2016, we gradually reorganized the company by business vertical (India Design – designing the project and, in some cases, project management; Design Build – turnkey execution including design and construction and Oman Design). One person was responsible for the P&L of each vertical. This worked well for a period of time and we were able to build a robust Design Build business from scratch in a short span of four years.

This organization structure ran its course and we started to stall as new Design Build orders started to shrink last year. In response, during the year, we reorganized a second time to create a corporate structure. Under this structure, we had one person take charge of Operations and another take charge of Sales, with the Oman operation remaining unchanged. This meant that each person would now focus on what they are best at doing, without worrying about other aspects of the business. Of course, each shift in role does mean some disruption. Humans are humans and require a bit of time to adapt to the new role. While this new organization structure should hold us in good stead over the next few years, the short-term pain created by a drying pipeline and the team adjusting to the new role will have to be borne.

We also made a few strategic shifts during the year. The Dubai market was never an industrial market. In the Indian market, we had decided to become a player focused on only industrial projects in 2017. But we continued the Dubai office due to legacy reasons. Applying the 80/20 principle of focusing on fewer things that deliver most of our profits and which will be our growth driver, we decided to shut our Dubai office after over a decade of being there. We also decided to discontinue the pure play Project Management business, where we took up project management for clients like Ashoka University, BITS Pilani, IIM Bangalore, etc. It is never easy to shut down profit making divisions. But in our quest to create ever tighter focus on what matters the most for our results, we decided to minimize our distractions.

This rejig led to some senior level exits, mostly expected. I would like to place on record the contributions of the seniors who decided to move on. Though such departures create a temporary void, I firmly believe that this helps in organizational renewal. Everyone contributes till the point they can. When sometimes, the role outgrows the capability of someone, it is best that they move on. It is also good for the organization, since this allows us to find new talent who would do justice to the new requirements of the role.

We also used the difficult year to clean up our books. This included writing off the money invested in building the Africa business several years ago. While we are still doing some projects in parts of Africa, we had shut our Africa office down some years ago. These investments were made by the Oman office to open up a new market for its own growth. Unfortunately, it didn't work as planned and we had to shut it down. Similarly, the investments made in the Dubai office were written off during the year. Both these write-offs totaled to Rs.7.31 crores. We also provided for and wrote-off some old receivables adding up to Rs.5.5 crores. These were accumulated over several years. We had been trying to collect these old receivables for some time now and were able to collect some of it. Whatever we could not collect we decided to write off.

After taking out these non-cash charges debited to this year's P&L, our cash loss for the year was Rs.97 lacs. This compared with a cash profit of Rs.5.68 crores last year. We have had a few tough years at Semac but each crisis just makes our resolve stronger.

I will leave you with some good news. Despite all, our treasury grew by Rs.9 crores during the year. This was the outcome of tight collections and also getting some long pending tax refund. During the pandemic year, though our P&L was in bad shape, we still managed to grow our treasury.

The treasury has been invested in multiple products, most of which deliver high single-digit to low double-digit pre-tax returns. The intent is to build some cushion on the balance sheet that gives us some options to grow the business as and when an opportunity arises. Until then, the plan is to use the treasury to earn some money for our shareholders.

It has been a difficult year for everyone, but especially for our people. Staying focused, despite massive disruptions to "life as usual" requires sincere effort. Semac adopted the digital life in 2017, which made the transition from coming to office, to working from home, a bit smoother. But it took some getting used to nevertheless. I would like to thank our people for their commitment to keeping the engine running.