Chairman's letter FY 2012-13

Our increase in consolidated net worth during FY13 was `36 million, which increased the per share book value by 2.8%. Over the last eleven years (that is, since the present owners took over) per share book value, has grown from `151 to `426 (`510 after ignoring the effect of goodwill write-offs), which, after factoring in dividend paid during this period, works out to a rate of 10.5% (12.1%) compounded annually.

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The state of the economy has been no secret. For five years now, since mid-2008, the S&P BSE Capital Goods index and the S&P BSE Small Cap index have tread water. The S&P BSE Realty Index, which tracks the other industry we are exposed to, is down to half of where it was when the Lehman crisis hit the global economy. The broader market as measured by the S&P BSE 500 index has compounded at 2.4% since April 2008. As against this, your company has compounded book value at an annualized rate of 4.5% over the same period. Obviously this performance is not satisfactory, but it is good to keep things in perspective.

The good news is that with every passing year of the economy being in a mess, the time when it will recover is getting shorter. The other good news is that tough times are the best times to revisit your business model, your strategy, your team, your served markets. Basically such times force you to revisit every underlying assumption and make sure they are still valid. And if they are not, tough times are the best times to convince people that something needs to change to make things better.

We have been on that journey ever since the crisis hit the global economy in October 2008. In some of our businesses, progress is better than in some other businesses. But still, the overall results are certainly less than satisfactory. I know we can do better and the striving will not stop.

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Coming first to the Drilling Solutions business, we made some progress along two important dimensions.

Before I elaborate on the areas where we made some progress, a quick recap of our overall direction. The usual growth strategies focus on developing new products to serve existing markets, finding new markets for existing products or finding new uses for existing products. Of these, we have bee working on the first two approaches.

A typical product development process goes through several stages before a new product becomes available for commercial production. These stages are designing – building a prototype – internal testing – design modification based on results of internal testing – modifying the prototype – further internal testing – field testing – design modification based on feedback from field testing – commercial production. This process typically takes three to four years.

Since 2004, we have developed eleven new products. Of these, four have become important contributors to our financial results and two are in the final stages of commercialization. We expect to start commercial exploitation of these two products during the next financial year. Though we now have a wider product basket, we have not fully exploited the market potential of these products. As the market picks up, we hope that these new products will give our Revenues a meaningful boost.

After getting into the South East Asia market last year, we were able to win business from the African continent during this year. But given the state of the global economy, things continue to be tough. The South East Asian market got affected due to the discovery of shale gas in the US and parts of the African market has had challenges in arranging acceptable lines of credit to buy goods. There will always be some surprises but the hope is that as we diversify our product basket and our exposure to multiple markets, these vagaries will even out.

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The Concreting Solutions business has been the kind of business where you spend most of your time praying that there will be some redemption around the corner. It has been the kind of industry that reminds you of the maxim – the market can stay irrational longer than you can stay solvent.

Despite the industry consolidation, the market conditions have been so tough that the leader has found it hard to set rational prices for its products. As a result, their net margins have sunk to somewhere between two and three per cent. When the market leader who, despite controlling about two thirds of the market, finds it hard to make money, that tells you something about the state of the market.

To survive in such an unforgiving market, we rationalized our cost structure further and also changed some key members of the management team. The market being what it is, we may decide to further restructure the business during the next financial year.

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Semac Consultants (erstwhile Potential Semac) turned out a satisfactory performance in a tough year. A combination of Revenues growth and tight control over costs allowed us to post a profit after tax and minority interest of Rs.70 million as compared with a small loss last year.

Additionally, our wholly-owned subsidiary, Renaissance Construction Technologies, which was spawned around Q4FY12 as a direct result of our exposure to Semac, earned a profit of Rs.40 million in its first full year of operation.

In many ways, this was a year of consolidation of the various initiatives we had taken last year. The leaders of each of our offices contributed in their own way, by either showing growth in Revenues or by clamping down on costs or some combination thereof. The net result was that we were able to grow year-on-year Revenues by fourteen percent while bringing costs down by almost five percent over the previous year.

Of course, finally it is the people who make or break a business. However, one should not underestimate the role of strong processes. After we took over the business, we found that most of the decision-making was based on "experience" and not much was based on hard data. What was more confounding was that beyond the data required statutorily, there was very little data available to take day-to-day business decisions. As an example, anyone who has run a business would appreciate the need to have historical data to guide him/her in forecasting Revenues, based on the order book on hand. Without an accurate prediction of Revenues, one could build a cost structure, which may throw profitability out of kilter with even a slightly lower level of Revenues.

Gradually, over the years, we have worked hard to create systems to capture data to help decision-making at each office. With each passing year, the quality of data improves, thereby enhancing our ability to build greater predictability into our business. This is the journey of transforming a business, which was historically run by first generation technocrats, who undoubtedly were very good at the core of the business to a more robust business. There are lots of areas still to be improved but I think the basic building blocks are now in place.

One other important change that was initiated at some of the offices was to bring about cultural change through shared responsibility. Historically, almost all the important decisions were taken by the leader of that office. The rest of the office was only expected to deliver a quality drawing on time. Gradually, we have started giving more people a voice in how that office is run. I am sure this will be a positive over the coming years.

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After the Municipal Commissioner laid down the new rules, real estate projects in Mumbai, including ours have got moving after total suspension of activity for about fifteen months. After we acquired the neighboring land last year, the project size increased three times the original size. Based on current projections, the project should get completed towards the end of FY15.

Some positive developments that will have an upward impact on realisations follow. The Eastern Express Highway, intended to reduce commute time between South Mumbai and the Eastern suburbs was opened to traffic in June 2013. This has reduced the travel time from Chembur to South Mumbai from over an hour earlier to only fifteen minutes. Another road connecting Chembur to the Santa Cruz airport is also under construction and that is also likely to be completed before our project comes on to the market. By avoiding going through Sion, this is expected to significantly cut down travel time to the airport. There are a few other infrastructure projects, which are expected to cause Chembur as a micro market to be rerated in the coming years.

Based on the recent estimates, our investment of Rs.200 million has more than trebled.

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As I mentioned towards the beginning of this letter, with every passing year, we are getting closer to the recovery of the economy. More importantly, we have started to find ways to deliver better performance even if the economy stays soft for a while longer. After enduring lots of pain over the past half decade, let us hope for better times over the coming half.