

## CHAIRMAN'S LETTER

Our decrease in consolidated net worth at the end of FY18 was Rs.91 million, which decreased the per share book value by 5.7%. Over the last sixteen years (that is, since the present owners took over) per share book value, has grown from Rs.151 to Rs.491 (Rs.569 after ignoring the effect of goodwill write-offs), which, after factoring in dividend paid during this period, works out to a rate of 8.5% (9.5%) compounded annually.

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Last year, I had shared my perspective on the macro environment in which Revathi's Drilling Solutions business operates. This year, I would like to delve into the key risks to this business and how we have been dealing with them. This would give you a good appreciation of the overall environment of Revathi.

The first source of risk is market risk. I wrote quite extensively about this in last year's report. While it is a clear long-term risk, I do not perceive this as a risk in the short- to medium-term. A second aspect of market risk arises out of business cycles. Since much of our exposure is to coal, which has been the primary energy source for India over the past several decades, we do not see much gyration owing to business cycles. It is true that our business is not even year-to-year but that is due to factors at Coal India, which are typically short-term in nature. Over the course of three to five years, the business is fairly stable and predictable.

The next source of risk is concentration risk. The bulk of our business comes from one client – Coal India. This leads to two risks – low rate of growth, reflecting rate of growth at Coal India as well as client concentration risk. To address markets outside Coal India, we have, over the years, developed new products for the mining, water well and construction industries. The products developed for mining were higher capacity machines, which expanded our range to cover a broader spectrum of applications. These drills are much larger in size and value and do not have an annual demand.

We continue to develop new models, which would help us penetrate deeper into some of the other markets like cement and steel. Towards, this we have already developed some models, which were introduced into the market recently. The product has been well received and we hope to gain market share in this business in the future.

We also developed products for the water well industry, which are supplied to customers like Central Ground Water Board. Like the larger drills for mining, these drills also do not have an annual demand. The products developed for the construction industry were much smaller in unit value and as such did not turn out to be very attractive from a profitability perspective. As such, this range was discontinued several years ago.

Another initiative we have taken has been to open up some new markets for our products. Much of the work here has been within Asia, though we have also supplied some equipment to Europe, South America and Africa.

The annual business from Coal India approximates Rs.50 crores. Anything above and beyond that comes from other customers and/or geographies.

The next source of risk is competitive intensity. So far, there have been two major players in Atlas Copco and us. Sandvik has been supplying some machines to Coal India as well but is not yet a major player. The other players are Komatsu, which acquired Joy Global in 2017 and Caterpillar, which acquired Bucyrus in 2011. However, none of these players have even tried to get into the Indian market in the product range that competes with ours. Perhaps the small and slow growing market size makes it unattractive for larger players to attempt to get in.

Then there is balance sheet risk, to which we were exposed for a few years when our leverage had gone up significantly. Over the last few years however, we have successfully brought it down to very manageable levels. As a result of the significant reduction in debt last year, this year our interest cost shrunk by half over last year. Over the next couple of years, we should-be able to make Revathi a zero-debt company, though we will continue to have non-fund based limits. With this, we would have completed eliminated risk arising out of the balance sheet.

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This year was one of the rare years when Coal India placed almost no orders for any equipment. The rollout of GST triggered a massive exercise of reorienting all internal systems to become compliant with the new law. The delays that resulted meant that we got almost no equipment orders from Coal India.

The other highlight of the year was that we finally shut down the concreting equipment business. This resulted in an asset impairment of Rs.7 crores. With this, the cost of the mistake made in 2006 is fully recognized in our books. Though it is a non-cash charge today, it is shareholders' money that was spent many years ago.

The net result of all the above factors was that while we made a cash profit of Rs.2.2 crores, we had an accounting loss of Rs.5.9 crores for the year under consideration.

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Last year I had shared my detailed perspective on the macro environment facing Revathi's core business. This year, I would like to share a more detailed perspective on our journey at Semac. Most people usually focus much more on the future and do not spend much time thinking about the past. We have all heard that change is always painful and still we all hope that we don't have to deal with the pain that comes with change! It is a strange aspect of human nature. We want things to change for the better and yet we wish it is painless. This has been my personal journey as well.

Every people decision I made created unique positives for the medium- to long-term, though with a lot of short-term pain. Likewise, letting some senior people go would have entailed short-term pain to the business, though would have been good for the long-term. These motivations (of avoiding short-term pain) led to delays in making some of these decisions. However, when I look back and reflect, I find that the changes that were brought in by some of our senior hires were momentous in our journey. So while they fell short of producing the desired financial results, they were important in shaping Semac's future in a meaningful way. I am reminded of the commencement address given by the legendary Steve Jobs at Stanford in 2005, where he said, "You can't connect the dots looking forward; you can only connect them looking backwards. So you have to trust that the dots will somehow connect in your future. You have to trust in something – your gut, destiny, life, karma, whatever."

The hiring of our first CEO back in 2007 did not produce the desired financial results. However, without his coming on board, the founding Principals of Potential Service Consultants would never have left. Their leaving caused short-term pain as they took away clients and staff. However, their departure forced us to build a new line of leadership with the talent we had. This was an important building block in building today's Semac, though at the time, it didn't feel that way.

The hiring of the second CEO in 2015 also did not produce the desired financial results. However, he introduced some seemingly minor changes like video conferencing in the organization, which were the starting point of building a culture of collaboration across offices at Semac. He also got us a marquee global client like Alstom for their high profile Madhepura project, where they are going to manufacture all electric locomotives in a joint venture with the Indian Railways under the Make in India initiative. He was also the reason that the remaining Semac founders moved out. While these Principals were keeping things stable and profitable, given their ages and experience in the industry, they were big barriers to change.

Our last CEO, who joined in April 2017 and stayed with us for a little over a year, also brought in some important changes such as bringing in cloud computing into the company, which again was an important building block in building One Semac. It was also during his tenure that we had a major shift in our strategy to focus only on industrial clients. Prior to that, we were doing all kinds of buildings including townships, hotels, hospitals, retail malls, residential towers, etc. As a result of this tight focus, we have been able to make a more solid case to potential clients to give us work. This has helped us to win some large new customers against competition from global players. Finally, we had another significant shift in our staffing policy from having a large inhouse team to having only a core team and outsourcing the surplus work to other consultants.

Our experience in the consulting business in this industry has not been very different from the multinationals like AECOM, Jacobs, Mott MacDonald, etc. who got into this industry in India. Most of them, who acquired local firms as their entry strategy, have done one of two things. Either they have focused their energies on large infrastructure projects in areas like Oil & Gas, Roads, Airports, etc. or they have converted their India practice to an offshore delivery center serving their international operations, much like the IT industry.

In a way, the Semac now is healthier than the Semac then – our business strategy is more focused and crisp, new leadership has developed from within the organization, clients have stopped believing the negativity spread about us by the people who left us to start competing firms, the teams are more aligned, etc. These changes make for a stronger core business, though it is not visible in the financial results yet.

In the FY14 letter, I had written about a company that was wholly owned by Revathi – Renaissance Construction Technologies. That company was into the business of providing project management services. Post our exit, it also got into the business of construction of projects. At the time, the business was quite new and there were a lot of risks involved in the business, including the liability of torts. Having been in the business for about five years now, I feel comfortable that the business has become stable and the initial risks have been addressed. It is therefore, no longer a startup.

So far, they have been a standalone business, mostly offering project management services to clients like Ford, Alstom, Ashoka University, etc. with very little overlap with Semac's business of providing architecture and engineering design services. However, as we go forward, there is a case to be made for greater collaboration between the rechristened Semac Construction Technologies and Semac. Now that Semac's core business and core team have become stable, we are evaluating how the two business can derive synergies from each other. We are also examining possibilities of reorganizing the businesses in the interest of Revathi shareholders. It is too early to say what the outcome of this exercise will be and I hope to share more details in next year's letter.

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Revathi had invested Rs.20 crores into a joint development real estate project in Mumbai between 2008 and 2011. Of this, we have recovered Rs.17 crores over 2014 and 2015. Effectively, we have Rs.3 crores invested in the project at historical cost. The project has been in stall mode for several years now. Reasons are several including the softness in the Mumbai market, a financially over extended partner, introduction of RERA, etc. This has prompted us to find a different way to exit from this investment. Some initial steps have been taken towards this but the windscreen is a bit hazy at this point to say when we will be able to exit and at what valuation. Here again, I expect something positive to develop during the next twelve months and I will keep you posted as I find out more.

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I would like to thank the families of our staff who stood by their spouse or parent, at a time when very few believed Semac's ability to survive the departure of the Founders and some key clients. Without your support and faith, our team would not have stayed strong, steadfast and focused on the job at hand to bring us to where we are today. The rear view mirror is not a pretty picture, but the windshield is beginning to seem quite nice now. Big thank you Team Semac for making this happen.