Chairman's letter

Our *decrease* in consolidated net worth during FY14 was Rs.140 million, which decreased the per share book value by 10.9%. Over the last twelve years (that is, since the present owners took over) per share book value, has grown from Rs.151 to Rs.379 (Rs.463 after ignoring the effect of goodwill write-offs), which, after factoring in dividend paid during this period, works out to a rate of 8.6% (10.2%) compounded annually.

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Economic activity overall almost ground to a halt owing to a combination of low business confidence arising out of bureaucratic paralysis and government apathy. This manifested in project delays arising out of delays in land acquisition and securing environment clearances. Expansion projects conceived just a year ago by even bellwether FMCG companies were put on hold. This hurt all kinds of industries including metals, power, etc. and of course the capital goods and the architecture and engineering design (AE) industries, both of whose fortunes are closely tied to the capex cycle. The stock market indices pertaining to these sectors reveal the state of these industries since 2008, when the global economy went into a slumber.

Index	On 1/4/08	On 31/3/14	CAGR	Absolute performance FY14 over FY08
S&P BSE Metals	13,517	10,100	-4.7%	-25.3%
S&P BSE Power	3,153	1,725	-9.6%	-45.3%
S&P BSE Capital Goods	14,009	11,973	-2.6%	-14.5%
S&P BSE Realty	7,501	1,483	-23.7%	-80.2%

The silver lining is that the country elected a decisive leader in May this year. That should mean that FY14 was the nadir and two powerful forces would work to make things better in the period starting FY15. One of course is decisive leadership at the national level and the second is turning of the business cycle.

Encouraging signs are beginning to surface. But given the deep hole that the country has dug for itself over the past five years, it will perhaps take another twelve to eighteen months of concerted effort to start seeing an economic revival. Unfortunately, there is no silver bullet that can cure India's ills overnight. Having said that, it does seem that the worst is now behind us.

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The Drilling Solutions business recorded its worst performance in terms of operating profitability since the present management took over. It felt like our ship was tossed about mercilessly in the stormy waters of the turbulent ocean we were trying to navigate. We derived some sense of security by looking around us to find that our ship had plenty of company. The big daddy of the mining world, Caterpillar saw its global revenues drop 16% over previous year. Atlas Copco, which is regarded as perhaps the most focused player in our industry, saw its worldwide Revenues drop by 7%. Sandvik's Revenues fell 18% and Joy Global's 12%.

Closer home, we rely heavily on coal and iron ore producers in the country. Our major customers put a cap on capital spending hoping to increase production through higher productivity of the existing equipment. Leading steel producers put their expansion plans on hold until they had better visibility about how the future might unfold.

We had been working on some important tenders for several years. The expectation was that we will see closure of these tenders early in the year to be able to despatch the equipment during the year. Unfortunately, this was also not to be. Had some of these tenders materialized, it would have offset some of the loss of business from our regular customers.

We find that customers are now taking fifty per cent to a hundred per cent more time to take capex decisions than they used to earlier. This has elongated the already long decision cycle. What little business is out there, is taking much longer to close. This is as clear a reflection of the state of business confidence as one will see.

Last year I had written about the inability of customers in parts of Africa to arrange a satisfactory line of credit. We spent another whole year in trying to secure our credit, but could not close it. South East Asia continued to be slow.

The net result of these varied factors was that order booking was at its lowest in many years. I had written many years ago that in our industry, a capex decision can get delayed, but rarely gets cancelled. So we live in hope that the almost visible turn in the business cycle will melt the state of suspended animation we have been witnessing over the past few years and things will start moving again.

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I have been writing about the nature of the Concreting Solutions business for the past few years. We have worked hard at trying to become a serious player in the industry. It has been a very tough ride so far. I had written about how the market leader with almost a two-thirds market share, with Sales exceeding Rs.7.5 billion earns low single digit net margins.

After continuing with an organization structure (and therefore fixed costs) built on the assumption of the market turning supportive, we decided to revisit our decision. One of the outcomes was that we decided to shift manufacturing back to the mother plant at Coimbatore. This will shrink our fixed costs materially and therefore help become more competitive.

While I have started seeing light at the end of the tunnel in terms of a pick up in infrastructure projects, I do not expect the concreting equipment market to get better for another year at least. It will easily take that long for the overcapacity to wind itself down. It could easily be two years as well.

Since we have scaled back our presence in this industry, this will be the last report from me on this segment until this segment becomes a meaningful contributor to our overall results, both in terms of Revenues and Profits.

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Here I would like to give a brief commentary about our balance sheet. If we add up all the investments we made into the Concreting Solutions business and the operating losses we incurred over the years, it would add up to the current debt on our balance sheet.

This year we started the process of restructuring our balance sheet to bring it back to the health it used to have till 2008. Towards this end, we got a part refund of the loan advanced to Panch Tatva Realty during the year. We also initiated the sale of the land we have at Gummidipondi, which we had acquired for the Concreting Business. We expect to bring our debt down from its peak of Rs.1 billion in FY09 to about half that by the end of the next financial year.

Hindsight is always 20/20 vision. We have been having internal discussions about selling off assets to restructure the balance sheet. However, it is never easy to sell off assets, which were created painstakingly. It is even harder to scale down a business, when the team has put in heart and soul to create something out of nothing.

We waited as long as we could, hoping that the operating performance will become strong enough to help restructure the balance sheet. Now that we have principally decided to restructure the balance sheet through asset sales, we will work to find the right price to offload some of our non-core assets.

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The current year results were also affected by two one-time charges. We wrote down the inventory of our Concreting Solutions business by 30 million to bring it in line with what we presently deem as its realizable value. We also wrote off our investment of Rs.49 million in Satellier Inc. The Satellier investment was made expecting to leverage their international client base for Semac. However, the company never really recovered from the shock it got in the 2008-2010 period. Despite bringing in three different CEOs after our investment in 2010, the business never regained its vitality and had to be eventually shut down. Just one more example of the maxim, turnarounds seldom turn. I should have heeded Mr. Buffett's advice before I pulled the trigger on this one.

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If I were to summarise the year, I would say this was the year when we started the process of nursing the company back to health. We did a lot of work on restructuring our Concreting Solutions business. We also did a lot of work on taking a hard look at our overheads. We started the process of liquidating some of our non-core assets to reduce the debt burden on the balance sheet. All these actions should lead to our standalone results bouncing back strongly after three tough years.

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Semac Consultants performance continues to get better. This year, like last year, was a year of fine-tuning business processes and keeping a tight watch on our cost structure. As a result, we were able to improve our profit after minority interest by about forty per cent, despite no growth in Revenues.

As the market turns, it will become tougher to keep costs under the same strict control that we have been able to do over the past two years. The other real risk that we face is that as more business opportunities come up, competitors will try hard to poach people from one of the market leaders. And that includes us.

Though there were no immediate threats, the Board felt that our company should not expose itself to the liability of torts, which is a potential threat in the business of Renaissance Construction Technologies. Accordingly, we retired as partners from this business at the end of the third quarter. In some ways, it was a good thing since the business performance dropped significantly from the previous year. Profits shrank to about forty per cent of FY13 levels.

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The real estate project in Mumbai continues to run behind schedule. As opposed to coming to an end towards end of FY15, it could go well into FY16. As mentioned in past letters, while this does have an impact on cashflow, it does not have any impact on the project IRR. As Chembur becomes better connected to South Mumbai, the existing airport and the city of Navi Mumbai, this entire micro market will likely get rerated as the market picks up.

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I would like to thank our bankers for being very understanding and standing by our side during these tough times. Normally, one hears of bankers being fair weather friends – they are most eager to lend to businesses that have no need for money. In our case, I have to say that though the business at its core is strong and though our track record is impeccable, the balance sheet has been strained for a few years now. And yet, our bankers have been very supportive. I am confident that we will justify their trust. I am also sure that their patience will not be forgotten as we get back to delivering strong performance.

I would also like to assure our shareholders that we will bring back the company you had invested in. The journey has started and you will start seeing positive results soon. I know these have been testing times but they are slowly but surely coming to an end. I look forward with confidence to cheerier times ahead.