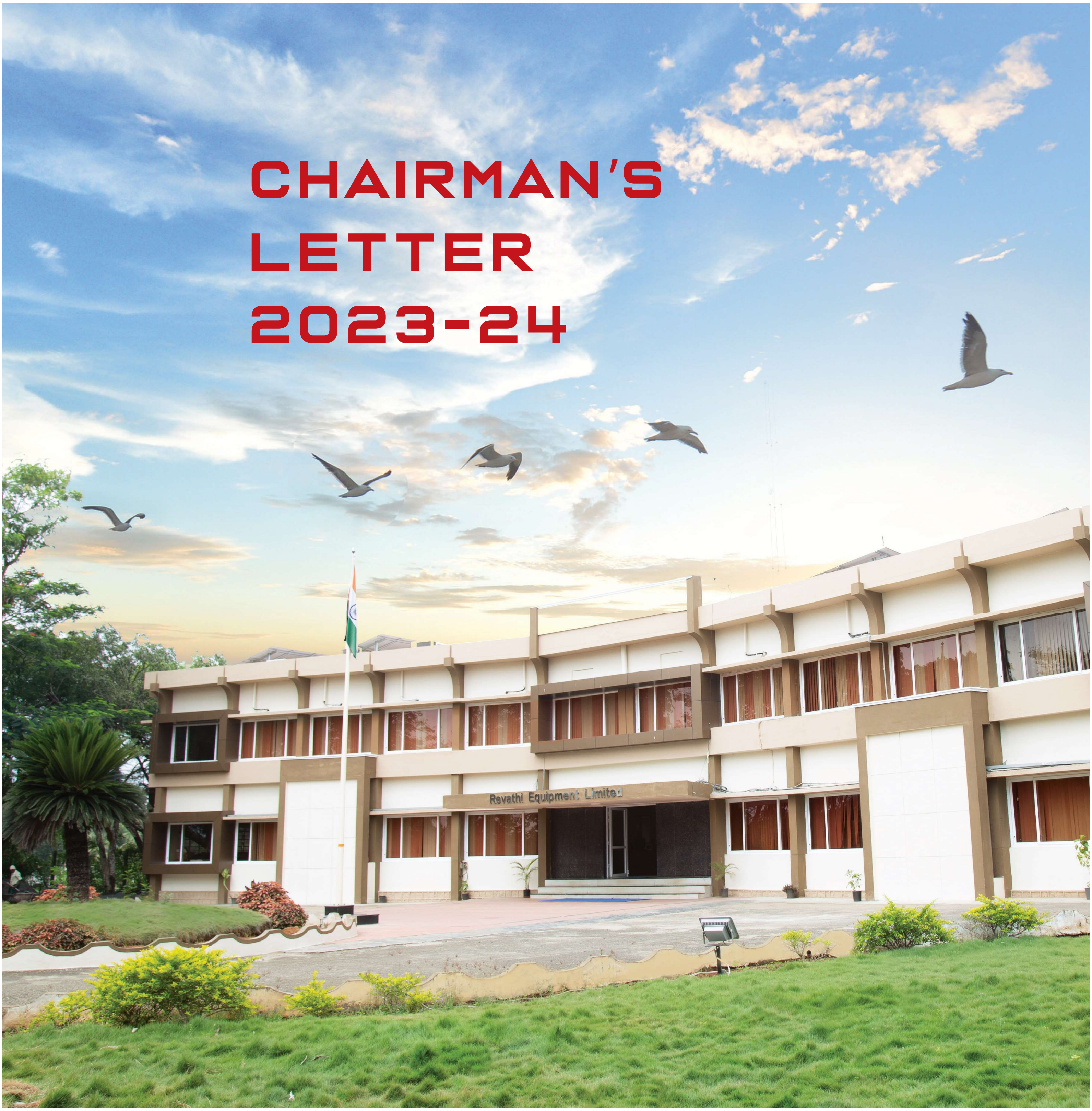
CHAIRMAN'S LETTER 2023-24



During the year, our consolidated net worth increased by Rs.31 crores, which increased the per share book value by forty-one per cent. Over the last twenty two years (that is, since the present owners took over) per share book value, has grown from Rs.151 to Rs.347, which, after factoring in dividend paid during this period, works out to a rate of four per cent compounded annually. For what its worth, the corresponding figures since FY18, when I took over as CEO of Revathi, are as follows. Over the past six years, since I started running the business, the per share book value, has grown from Rs.158 to Rs.347, which, after factoring in dividend paid during this period, works out to a rate of fourteen per cent compounded annually.

A small note on how the above figures have been recalculated after the demerger of the Revathi business from the erstwhile Revathi Equipment Limited. Section 49 of the Income Tax Act, 1961 specifies how the net worth of a company is to be split into the net worth of two companies when a company is split into two independent businesses. Following the prescribed guidelines, thirty two point five per cent of the net worth of the combined businesses is to be allocated towards Revathi shares and the balance sixty seven point five per cent is to be allocated to Semac shares. We have gone back to FY03 and recalculated the gain in book value per share for Revathi.

As you know, we have just been through a corporate restructuring exercise at a group level. A brief commentary on the key reasons behind this decision follow.

Over the years, Revathi's balance sheet (and the Profit & Loss statement) had got impacted due to the capital invested (and subsequently written off) in the Concrete Equipment business, the investment made in the real estate project in Mumbai (which got demerged into Semac) and acquiring two businesses, Potential and Semac (which later got merged into a single entity, Semac). This was camouflaging the inherent quality of Revathi's core Drilling Equipment business. We felt it would serve Revathi's shareholders well if we could create a clean, standalone balance sheet for Revathi.

Having two independent businesses would allow each business to pursue their own journeys, including taking decisions relating to things like capital allocation, strategic partnerships, etc.

It would also give minority shareholders, at the Group level, an exit from previously unlisted entities.

Our investors gave us a big thumbs up, indicating that this was a good idea. The market cap of Revathi has grown 5x from the time work on this plan was initiated (and 10x from its historical range), due to the restructuring exercise, which was strongly supported by improved financial results.

It has taken an inordinate amount of time to get Revathi listed, post the restructuring but by the time you get the annual report for FY24, we would have finally crossed the finish line.

The journey, which was long and arduous has been both, rewarding and educative. We dealt with several institutions that keep investors safe, including SEBI, NCLT, NSDL and of course the stock exchanges, NSE and BSE. We learnt that our country's financial system is very robust and has lots of checks and balances to prevent, even the slightest deviation from defined protocol. At many points in our journey, we felt the concerned officers were being too heavy handed and bureaucratic, delaying simple and obvious matters. In retrospect, I am glad we have such officers manning such institutions. They keep all investors safe.

The quality of the Drilling Equipment business has been rock solid ever since the time we bought it about two decades ago. Despite all the vicissitudes of life, and there have been one too many in our journey, the quality of the business has ensured that we withstood the shocks thrown at us and were still left with enough ammunition to have another go at building the business. The vast majority of businesses would perhaps have crumbled at the onslaught of the several terrible capital allocation decisions (for which I am solely responsible) that Revathi was subjected to. The fact that Revathi's balance sheet withstood them all is a tribute, not only to the team that never gave up, but also to the inherent quality of the business.

Over many decades the drilling equipment industry has consolidated globally. Most of the players have either succumbed to competitive pressures or have got acquired by one of the survivors. New players that were lured to enter the business found out that the total size of the industry is not large enough to support too many players. They also realized that not much money is made in equipment sales. Which means, you need to be prepared to make very little money, if any, for at least a decade or more, until you have enough machines on the ground, from which you can earn some money offering maintenance contracts, selling spares, etc. So far, this has deterred large players (relatively small addressable market) and tripped up smaller players (who usually do not have the balance sheet and the patience to play the long game).

Even within the mining industry, drilling is the smallest activity in terms of capital employed and operating expenditure. Drilling is the first, in a series of activities, required to extract ore from Mother Earth. Though it is a relatively small activity, it impacts all downstream costs including scooping up the blasted material using shovels (larger boulders reduce the fill rate in the bucket), transporting them in dump trucks (fill rate of the bowls is a function of the fragmentation of the blasted material), uneven roads (post excavation of material) increase the wear and tear of the dump trucks as they take material from the mine face to the crushers, blasted material larger than crusher capacity requires secondary blasting before the material is fed into crushers, etc. One could argue that all these issues can be solved by deploying more (than needed) explosives to blast the hell out of the mine face. That creates its own problems. Blasting too much not only increases explosives costs, it could also fragment the deposit too much, making it difficult to scoop up and put onto dump trucks, not to mention losses due to wind.

In fact, drills are such an insignificant part of the overall mining capex that some of the global mining equipment manufacturers offer drills free as a package, if you buy shovels and dumpers from them. This creates a problem and an opportunity for a player like Revathi. The problem is obvious – how do you compete with someone who is willing to sell drills for free? The opportunity is a bit nuanced. When an equipment manufacturer is focusing on selling shovels and dump trucks, drill sales is obviously not moving the needle for their P&L. Which means, they are unlikely to invest in R&D to constantly upgrade their drilling rigs. They are also unlikely to optimize the cost of the drill since the organization is focused on making the best shovel and/or dump truck, which means they rarely make money selling drills. Finally, they are also not nimble in after sales service, when it comes to drills, since they make far less money supporting drills than they make supporting their shovels and dump trucks.

All these factors are obviously outside Revathi's control. But they combine to create a sweet spot for a player like Revathi, which has been in business long enough to have several hundred drills operating around the world and for whom the drilling rigs opportunity is large enough to create a worthwhile runway in the foreseeable future.

The results you see are not the outcome of superlative management. They are the outcome of the quality of the business. As Peter Lynch once said, "Invest in businesses any idiot could run because someday one will." For the reasons mentioned above, Revathi is a unique business in a unique industry. This is what delivers the financial outcomes that have been produced by the team in recent years.

The results have progressively gotten better since FY19, but the team really hit it out of the park in FY24, which was a banner year for Revathi in many ways. Some of the metrics we track to gauge the health of the business include order booking, sales and profit after tax. All three metrics, measured in an absolute sense were the highest in Revathi's forty-seven-year history. Order booking in FY24 surpassed FY23, which itself delivered our highest ever order booking in a single year. Revenues almost doubled over FY23 leading to a more than a hundred percent growth in profit after tax. The return on equity (using average net worth during the year) was at a healthy thirty four percent. This is also the highest in the twenty plus years that my family has owned a controlling stake in this company. It was in the high twenties when we acquired the business but then got decimated as a result of some poor capital allocation decisions.

I have taken two major capital allocation decisions since 2003 (when we acquired Revathi). The first one was the Construction Equipment business, in 2004. Counting the capex incurred to set up the business, the operating losses incurred during its life with us, the eventual write offs of unusable inventory, bad debts, etc. and the interest paid on working capital, we lost over Rs.100 crores over the fourteen-year period between FY05 (when we started that business) and FY18 (when we were able to finally cleanse the Revathi balance sheet off this capital allocation "sin" I had committed). To read what led to this error, read my letters of FY05 and FY16.

The second major capital allocation decision I took was our entry into the Construction industry through the acquisition of Potential Service Consultants (FY07), Semac Consultants (FY08) and Semac Construction Technologies (FY20). Combined, we have invested about Rs.115 crores in the Construction business. Till the time Revathi was demerged from Semac (FY22), Revathi shareholders had not been rewarded from this capital allocation decision either. To read about the circumstances in which this decision was taken, read my letter of FY16.

On a standalone basis, Revathi's FY24 numbers wash away a lot of the pain that shareholders have had to go through over a prolonged period of time. The only consolation I can offer to our long-term shareholders is that my family, being the largest shareholder of both, Revathi and Semac, has suffered the most. Despite these errors, our market cap has grown at a CAGR of about 12.8% over the twenty-one-year period between FY04 and FY24. Over the same period, the Nifty 50 index has delivered a CAGR of 14.2%. Comparing more recent periods, Nifty delivered a CAGR of 15.3% between FY19 and FY24 and Revathi has delivered a CAGR of 42.6% over the same time period.

The worst seems to be behind us. The performance over the last five years has consistently been getting better. The team has risen to the occasion not only to expand the size of the opportunity that we are going after (addressable market) but has also executed well so that the "potential opportunity" is converted to "financial outcomes" for our shareholders. We will continue to work hard to make up for lost time.

A word about our team. Of course, getting people to work together towards a common goal is never easy. Until everyone internalizes that we are all one team and have a singular goal. Getting the right team in key positions takes time. This took me a few years to get right. Getting them aligned and functioning as a unit takes time. This has begun to fall in place, as is evident from the consistent results being produced. Don't get me wrong. People will always have points of view and differences of opinion. It is the job of the leader to help people rise above personal agendas to focus on the common agenda.

Of course, appropriately structured incentives do help. As the philosopher Arthur Schopenhauer said, "No one ever convinced anybody by logic. To convince a man, you must appeal to his self-interest..." This is what we learn from any arena where you observe great teamwork, whether it is a pack of lions hunting down a prey or a high performing sports team. The incentives of everyone on the team are aligned. The greater the alignment, the easier the cooperation among team members. It is this incentive that led to an eighty eight percent jump in staff costs. If the team delivers the desired outcomes, it is only fair that they share in the rewards that their efforts have produced. I sincerely hope that they get suitably rewarded every year.

Finally a word of thanks to all those who have supported us in our journey – our people, business partners (suppliers, subcontractors, distributors, agents, etc.), our consultants (who always solve the problems we are unable to fund a solution to) and our bankers, who constantly watch our back and share innovative solutions to reduce our finance costs (which grew only forty five percent, though our activity level almost doubled).

I would also like to thank the Central Government which has created the buzzing macro environment in which we find ourselves in today, various government and other agencies who helped us in completing the group reorganisation exercise and the tax authorities which have been very fair with us over the years.

MR. ABHISHEK DALMIA
Chairman and Managing Director
DIN: 00011958

PLACE : 27th August 2024
DATE : Coimbatore