CHAIRMAN'S LETTER

Our gain in consolidated net worth during FY10 was ₹43 million, which increased the per share book value by 3.6%. Over the last seven years (that is, since the present owners took over) per share book value, has grown from ₹151 to ₹403, which, after factoring in dividend paid during this period, works out to a rate of 13.9% compounded annually.

Our core business of Drills improved significantly over FY09 and even outperformed our internal expectations. However, the overall result was dragged down by everything else in our portfolio, which is a play on the infrastructure and real estate industries. The infrastructure industry started to increase the utilization of its huge population of equipment, built up during the go-go years leading up to FY08, leading to subdued fresh equipment sales for most of the construction equipment industry. Though the real estate industry started recovering during the year, as mentioned in last year's report, much of it was fuelled by sale of existing inventory and project restarts. Unfortunately, design activity for newly conceived projects continued to stay staid. If India has truly decoupled from the global economy, as is apparent in recent months, then the worst is behind us and I expect strong performance in all our businesses. However, we will only find out the truth if the West goes into a double dip, which has become a growing fear among astute observers. This statement by a member of European Parliament succinctly summarises the expectations from the global economy at this point: “You cannot spend your way out of a recession or borrow your way out of debt.”

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After that gloomy paragraph, I would like to share my optimism about the future, which arises out of the work we have done in bringing in several people across various levels at Revathi.

Last year, our Managing Director and the Head of our Drilling business retired. Their contribution to the company over the two plus decades they were with us cannot be overstated. However, there comes a time when people give in to the demands of their families and hang up their boots. We were able to find capable people to take up the mantle from these old hands. From my interactions with our new leadership over many months, I feel confident about the decision I, with active participation of our Board members, made. Though a lot of work needs to be done to build an exciting future, I think the business is in good hands.

Similarly, in the Construction Equipment business, we parted ways with a key executive. When the environment is tough, people tend to become jittery about the future. Some work with the business to make it better. Others find greener pastures and decide to move on. Our Marketing Head chose the latter path. I am happy to report that the people we have brought in to build the business have significant industry experience and an enviable track record. The new team has demonstrated that experience in building a national sales and service network in a matter of a few months after the close of FY10.

Changes at senior levels are always stressful. The bad news is that we had to undergo that stress at the worst possible time from the business perspective – when the business environment was most challenging. The good news is that both, the external and internal environments, have changed for the better. I do expect that our new team will bring fresh ideas and new energy into the business, which will translate into stronger financial results in the coming years.

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As briefly indicated above, our core Drilling business performed very well this year with a fifty percent jump in equipment volumes over last year. Fuelled by this surge, the EBIDTA grew fifty eight percent. Unfortunately, much of the good work done in the Drilling business was neutralized by the poor performance of the Construction Equipment business. Overall, our performance, though significantly better than last year, was still a touch below our performance in the years preceding FY09. I do expect this track record to show significant improvement in the years following FY10.

I would like to comment on two other developments that are imminent in our Drilling business. As the size of the industry in India grows, more competitors will want a piece of the action. That will obviously impact the market share of the two existing players. Also, our agreement with Bucyrus for global marketing is coming to an end in October 2010. Prima facie both these developments put together sound quite unsettling. However, we have put in motion an action plan to not only counter the effects of these developments but to improve our results despite them.

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This year was the most challenging year in Potential's two-decade history. For majority of the year, market slowdown continued and it severely hit the Indian construction industry. Potential was faced with many stalled projects, some cancelled orders, and very few new projects. This was further compounded with significant changes in the leadership of the Company, when all the founders retired. Again, while this was known, the timing could not have been worse. All these effects caused revenues to shrink to less than half their previous peak. To ensure the Company paid salaries on time, which it did, it was forced to make savage cost costs, primarily by reducing headcount and scaling back compensation. The bad news did not end there. In continuation of significant bad debt write offs last year, we had an even bigger write-off this year. Put together the total write offs over two years add up to ₹9 crores. Keep in mind that the highest profit ever earned by this company was ₹ 8 crores.

Thankfully, the year ended with a gradual turnaround of the market. To capitalize on the new opportunities, Potential has built a national Business Development team. This team, supported with more local design offices is our best bet in ensuring we get geographical diversification, the lack of which nearly killed us over the past eighteen months.

As the market picks up and more work starts coming through the door, retaining good people and bringing in talented people will be an important variable to keep our eyes on. Of course we are not the only ones thinking this way and with more work, competition too would be looking to hire smart people. This would lead to higher staff costs as the demand supply balance shifts in their favor.

Semac, our other company in the engineering design space, once again fared much better, relatively speaking, though even here revenues and profits fell from last year's levels while still remaining in positive territory.

On a combined basis, Potential + Semac probably had its toughest year. The headcount went down from its highest point of 803 attained in October 2008 to 578 by the close of this year, eighty per cent of the drop being accounted for by Potential. In a people driven business, this single statistic says a lot about the health of the business. The good news is that after the close of the year, we have started hiring again, at every single office.

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Monarch, the catalyst company, did admirably in a continuing tough environment. In this business, the selling price is linked to the raw material cost and hence Sales is a misleading number for examining financial health. I focus instead on the operating gross profit. Consider that while volumes picked up by about fifty percent, Sales was up only seventeen percent and operating gross profit climbed thirty two percent. Part of the volume jump came as a result of aggressive pricing to enter new markets, which is the reason the growth in operating gross profit did not move in step with rise in volumes. Expenses stayed more or less at last year's levels as a result of which, profit before extraordinary write-offs and taxes, climbed from ₹96 lacs to ₹623 lacs.

The team leading Monarch is dynamic and have done a remarkable job in producing such results in a tough environment. More importantly, while dealing with the present set of challenges, they have also prepared a blueprint for capturing the opportunities that lie ahead. The plan includes capacity debottlenecking, bringing in key people to help with new product development, opening up new markets to attain higher volumes, etc. All in all a praiseworthy turnaround after last year's dire results.

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Turning now to our real estate investment in Mumbai. After deferring construction activity for about a year, we finally moved ahead with our plans. If we decide to rent the office space, based on present market rent per square foot, we are looking at an eighteen percent pre-tax rent yield. If however, we choose to sell out towards the end of next financial year, at current market prices, we would have compounded our capital at a mid-twenties rate over the three years the capital stayed invested. Life is full of tough choices!

Abhishek Dalmia
Chairman of the Board