



## **AXISCADES Engineering Technologies Ltd.**

### **Q1 FY '18 Earnings Conference Call Transcript**

#### **September 15, 2017**

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**Moderator** Good Day, Ladies and Gentlemen and a very warm Welcome to the AXISCADES Engineering Technologies Ltd. Q1 FY '18 Earnings conference call. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, you may signal an operator by pressing '\*\*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Gavin Desa from CDR India. Thank you and over to you, Sir.

**Gavin Desa** Thank you. Good day everyone and thank you for joining us on AXISCADES Engineering Technologies Q1 FY '18 Earnings Call. We have with us today Mr. Sudhakar Gande – Vice Chairman and Mr. Kaushik Sarkar – CFO. Before we begin, I would like to state that some statements made in today's discussion may be forward looking in nature and may involve risks and uncertainties. A detailed statement in this regard is available on the Q1 FY '18 results presentation that has been sent to you earlier. I now request Mr. Gande to begin the proceedings of this call.

**Sudhakar Gande** Good afternoon everyone. Thank you for joining this conference call. I hope you have gone through the results and presentation shared earlier with you which provides details of our operation and financial performance. Let me begin by providing an overview of our business and outlook, while our CFO, Kaushik, will provide the highlights on the quarterly performance. We have commenced the year encouragingly with sequential growth of 4.6% to US\$ 17.1 million for Q1 FY '18. What is more encouraging is that we are beginning to see some green shoots that promise growth revival over a period of next few quarters in some of our key strategic accounts which have been combating macro headwinds in the last two years. We continue to make progress in our chosen areas. We are building a strong team of domain experts with extensive experience and efforts have started showing results, be it the customer traction, project in new areas, and our sales pipeline across segments.

Before we get into performance details for Q1 FY '18, I would like to mention the following: We have set out to build a unique company. As part of the journey, we acquired niche companies, integrated, acquired, and developed specific skill sets. In the process, we have acquired 12 marquee customers. We differentiate ourselves by partnering with our marquee customers in the entire product life-cycle including design and development. Today, the company is better positioned to reap the benefits of synergy and to mine the existing customer base leading to revenue growth. Going forward, the focus of the management team shall be on to deliver earnings growth in our existing operations. We continue to look for inorganic growth opportunities focusing on acquiring either niche technologies or customers which



besides adding value to our product solution portfolio also help us scaling earnings growth. Further, we are looking at acquisitions which would be earnings accretive.

Now coming back to key operational developments for this quarter:

It has been a fairly productive quarter for us with progress in most of the different verticals. Firstly, we have signed an engineering services contract with a Chinese subsidiary of European aerospace OEM during the quarter, thus deepening our relationship and strengthening our presence in Asia-Pacific region. Further, we have been chosen by a global supplier to supply and partner with a large US defense system manufacturer. The relation has a potential to grow to multi-million dollar, multi-year engagement. We have also successfully added a large off-highway and aviation customer. Additionally, we have started working on one of the largest companies in embedded software. Further, in continuation of our efforts on the embedded and electronic domain, we are working on a pilot project with a North American OEM on vehicle automation. I am also pleased to highlight that our efforts on expanding energy vertical from wind to conventional energy and nuclear has started showing results. We have won a long-term contract with a global OEM in this space.

We will continue to invest in building our competencies that will provide us with the agility and technical competence to deliver offerings and stay in the path of relevance of our customers. We continue to develop an ecosystem around technical partnerships, which over a period of time translates into additional in-house capabilities. These investments have worked well for us and are imperative to our growth prospects going forward. With regard to our proposed joint-venture with ASSYSTEM, the teams are working on a business plan and we hope to complete this process over next week and start the operation in New Year.

To conclude, we are seeing positive trends in our business and expect FY '18 to be promising. The focus will continue to be on enhancing our value proposition to our customers and driving operational excellence. With that, I now hand over to our CFO, Mr. Kaushik Sarkar, who will take you through the financial performance of the quarter. Thank you.

**Kaushik Sarkar**

Thank you, Mr. Gande and Good Afternoon everybody. I will briefly take you through the financial performance for the quarter ended June 30 following which we can start the question and answer session. Our consolidated revenue from operation was Rs. 1,102 million as against Rs. 1,087 million in the previous quarter, higher by 1.4% in INR terms. In USD terms, the growth was 4.6% on a sequential quarter basis. Engineering design vertical contributed Rs. 915 million while the revenue from strategic technology solutions segment remain steady at Rs. 188 million during the quarter as against 189 million reported in Q4 '17. Total expenses for the quarter stood at Rs. 1,045 million as against Rs. 1,066 million reported during Q4 '17, a decline of 2%, primarily owing to tighter and more efficient operation.

Gross margin stood at 31.1% and operating margins were 7.4%. Net operating income for the quarter stood at Rs. 83 million as against Rs. 115 million during Q4 '17. The decline was primarily owing to an adverse exchange rate. The impact of appreciation of Rupee against Dollar is INR 20 million since a majority of our revenue is dollar denominated. At PAT level, there is a decline primarily because of one-time exceptional item of Rs. 16.1 million because of stamp duty paid on the merger with Axis Aerospace. Excluding this item, our PAT is Rs. 11.13 million translating to an EPS of Rs. 0.27. Slide 10 provides an optic on the various industry segment and geographies where we are present. 83% of our revenue contributed in Q1 '18 was from engineering design services while the remaining is from strategic technology solutions.

In terms of the verticals, aerospace, our largest segment contributed around Rs. 408 million, which is around 37% of our revenue in Q1 '18 as against 38.1% in Q4 '17. Heavy engineering and strategic technology solutions accounted for 33.5% and 17%, respectively, of our revenue in Q1 '18.

To conclude, I would like to state that we have made good progress operationally during the quarter. The financials were largely impacted by one-off exceptional merger-related expenses and adverse exchange rate. We are delighted with the deal wins in this quarter and believe many of these have significant potential. Going ahead, we believe that our strategic initiatives and improving business environment, we will be able to deliver steady and consistent growth. On this note, I once again thank you for your participation and now request the moderator to open up for questions.

**Moderator** Thank you very much. Ladies and Gentlemen, we will now begin the question and answer session. We will take the first question from the line of Jaykant Kasturi from Dolat Capital. Please go ahead.

**Jaykant Kasturi** Sir, I have three questions, first one is I can see the operating margins are falling, so I just wanted to know any particular reasons for it and do you have any stable margins lined up for this year, if you can give me any margin guidance? Second one, can you brief us on any new order or large order which you can see this fiscal year and as well as the potential size of that order?

**Kaushik Sarkar** On the operating margin side, if you see Q4 versus Q1, there are some exceptional items on the other income which is much lower in Q1, plus in Q1 we have one-time stamp duty expenses for merger which I have explained as well. We generally do not give guidance on the margins, but generally we are in a very steady state which will reflect in Q2 onwards.

**Jaykant Kasturi** Sir, regarding any new orders?

**Sudhakar Gande** There are two large order wins basically. One is a largest European missile company which has a revenue of \$4 billion and is one of the top two or three players in the world, who have been evaluating us, finally they placed an order last quarter, so that order size I would not like to exactly explain to you, but it is a multi-million dollar order, but this is just the start. Just to explain to you there are four teams of 6 to 15 that visited our office and we went to their office in Europe, finally they have placed the order. We are professionally very, very happy about it. It took us time, but this is what we have achieved. Secondly, a large American energy company, which is again one of the top global players in the world, they started working with this through our European operation and also now starting shortly in India. It is again a multi-billion dollar company, I cannot share the name, but it is one of the most respected names in the world. In addition to that, we also got an order from a global heavy engineering company, which is one of the biggest from US, their Indian subsidiary, they also just started working with us in their Pune facility, and we hope to expand work with them in the days to come.

**Moderator** Thank you. The next question is from Ankur Dhingra, an Individual Investor. Please go ahead.

**Ankur Dhingra** You have been talking on many of your past conference call, regarding offset orders, AXISCADES has been expected to win and we have invested and waiting very patiently, so what is the latest update, is something going to happen in the offsets space or not?

**Sudhakar Gande** Definitely something will happen, we are working on it. As you know, some of the these things take time, but I am very positive and I am pretty sure it will happen in a matter of time. Just to give you an example, one of the largest European electronics company, they have sent a 20-member team to us to evaluate our capabilities and understand what we are capable of. This 20 member team came to India, spent three days with us, have gone through what we are doing with other customers as well as our capabilities and we are pretty sure that should translate to a fairly good orders, I am very confident. Apart from that, of course we are getting some smaller deals from the global supply chain for some of the offset contracts we have done earlier. So hopefully in the days to come, they will be more aggressive and they should start sending more orders into India, and as you know once you get in the global supply chain for a large OEM, the work is generally for a long duration, but it takes some time for them to evaluate. But now we are already with one of the large global players, we are doing about \$3-5 million this year, which will be continuing for eternity, for a long time to come.

**Ankur Dhingra** Will we expect something to happen like in the next quarter, can we expect something to happen?

**Sudhakar Gande** As I mentioned last time also, we are working on two large orders of \$75 million and two smaller projects of \$20-25 million, and all these will go on track, of course, there is a bit of delay but I am fairly confident this financial year we should be signing at least one contract.

**Moderator** Thank you. We will take the next question from the line of Kashyap Jhaveri, an Individual Investor. Please go ahead.

**Kashyap Jhaveri** In one of the remarks, you mentioned that the margins are now getting into steady state trajectory, could you throw some more light on, does it mean that the margins will remain where they are, which is a single digit or do you believe that margins could go back to our earlier trajectory of double-digit number?

**Kaushik Sarkar** On the margin side, as I have explained, let me tell you first, one is that exchange rate was adverse to us and around 85% of our business are in US dollars, so that is one. Number two, there was a one-time stamp duty expenses pertaining to the merger that in Q1. Now if you see the gross margin, as we are entering into new business, there might be a little hit on the margins of the gross margin. Once we stabilize, the margins will be more prominent, once the relationship matures, because we start with onsite and then move the work offshore, and slowly will move to steady state.

**Kashyap Jhaveri** You said that there will be probably more onsite work as the new deal orders come in, so if you look at versus some of the previous quarters and let us say last couple of quarters that would also be one of the reason because onshore to offshore split is now tilting more towards onshore, would that be one of the reasons for last couple of quarters?

**Kaushik Sarkar** Yes, if we have to grow, we will start with onsite and then move to offshore as we acquire capabilities, but it is the investment for the future as well.

**Sudhakar Gande** One important thing I want to bring to everybody's attention is as a company, we have been working last several years, in terms of acquiring skills etc., so today the company's consolidation is completed, I can say this. Now, we have created a very strong platform for growth. Today, the management team is fully focused on earnings growth in the future and that when I say consolidation means, we have acquired several businesses / companies in the last few years and integrated them. Then we

build a strong technical capability in several areas, like a strong delivery mechanism and geographical presence. We also built a strong leadership team, talent, all of which resulted in a strong customer base of 12 large global multi-billion dollar companies, all of them having huge potential, for us to deepen the relationship. For example, we were working on one large global OEM, we were working on one product line, after three years of our viewing, now they said okay you are shortlisted for two more lines. So when we are shortlisted for two more, there is a high probability that we should win it hopefully in the next quarter or so, resulting in tripling of our revenue from that customer. I am not saying that with everybody, but the point I am trying to make is that we build a strong customer base where deepening the relationship potential is very, very high. So today the management is fully focused on earnings growth and we as a company, I can say we are now slowly reaching an inflection point for growth, earnings growth. So in the coming quarters, our entire endeavor is to work on that particular aspect, driving earnings growth.

**Kashyap Jhaveri** You mentioned about additions of marquee clients in your opening remarks as well as to one of the earlier participants. Leaving aside what could happen to gross margins in terms of onsite offshore, at least on revenue front can one expect a fairly strong double-digit CAGR at least dollar terms?

**Sudhakar Gande** You are absolutely right, that is our endeavor, today. You look at first quarter we have done 4.6% sequential growth in dollar terms. As I have explained to you, as a company, we are working towards, we want to double our revenue in next three years and triple our earnings. We are working on that, the platform is strongly created, at least we have the base to look for that, our management team is focused on this one particular point.

**Kashyap Jhaveri** In terms of revenue by industry, heavy engineering has been growing very strong and some of the clients that you mentioned in your remarks largely they also belong to engineering segments, so one can expect this segment to be key driver of revenues at least for next two years?

**Sudhakar Gande** Quite possible because in heavy engineering we had a setback last couple of years, one of the large customers was not growing, but now in that large customer we see the maturity and the traction towards growth, so definitely heavy engineering is one of the sectors which will be growing and we did a detailed analysis with customer and our view in next coming quarters, we will be growing because they have addressed all the issues what is required now, so heavy engineering is one of our growth area, definitely.

**Kashyap Jhaveri** In terms of this revenue across industry, your gross margins would remain same or they would be different between aerospace, heavy engineering, automotive?

**Sudhakar Gande** In this business, the margins will sometimes keep modifying, sometime a very specialized skill margins got higher, but historically if you ask me automotive will be slightly on the lower side and heavy engineering will be on the higher side and aerospace and medical electronics will be somewhat still higher, so this is the general trend.

**Kashyap Jhaveri** My last question is that you also mentioned about inorganic opportunities, question number one is that target of doubling revenue and tripling earnings, does it include anything on inorganic and within inorganic what other verticals and geographies that you would look at?

**Sudhakar Gande** When we are looking at doubling the revenue and increasing the earnings, we want to do it organically, maybe some small percentage may come from inorganic side

and today I can tell you with pride there are companies who approach us and at the Board level we appointed a committee of directors to evaluate these opportunities and one thing I can tell you with certainty, we will focus on companies which will be earning accretive, that means whichever companies we are acquiring, the earnings should be either above ours or something close to ours, with specified skills and customer base.

**Kashyap Jhaveri**

Vertical?

**Sudhakar Gande**

Vertical will be across but maybe in areas like electronics, embedded electronics, very specialized design, these are the areas we will be looking at it.

**Moderator**

Thank you. We will take the next question from the line of Gautam Behal from Mauryan Capital. Please go ahead.

**Gautam Behal**

Sir, your commentary is very optimistic, but there is a big contrast between the commentary and the printed numbers and unfortunately that has been true for a few quarters now, what would you say has changed from the sort of hey days of two years ago the stock is on 60%, as investors what do you think has changed so that the market can start recognizing it and the numbers would start flowing, can you just give me some light on that?

**Sudhakar Gande**

If you look at before two years our growth was very fairly aggressive and fairly good. Last year, the growth was flat because as I mentioned in my earlier call, we had issue with our largest revenue and customer, and we also saw some re-pricing of one contract with one of our large aerospace customers. So last year was a flat year, I agree our performance is definitely not upto the desired level. Now looking back one, the issue relating to that heavy engineering customer is resolved because for first-time in the last four or five quarters, we have shown a growth and they have started engaging more with us and first time I see more number of people are required by them, that is a clear indication of the last quarter and also over the next two to three quarters, the same requirement has been indicated to me. They have also put a smart and new management team and board in place and one of the things we are working on is what they call centralizing their entire mining operations in one of the states in US, so they get lot of benefits from the state, centralizing all the offices and moving it there, and we are proud to say that we have been selected as one of the engineering partners for this entire initiative that means if you take the state of Texas and California into another states all the employees who have moved, these are engineers. We expect 30% to 40% may not move, so they need a quick filling of that, so we have been selected as one of the partners and I am very proud to say we are opening an office in the same building where the customer is opening their office, but we are working with them so this will give me some definite traction on heavy engineering side.

On aerospace side, the work is more relatively because last time we had re-priced, but the re-pricing it was very hard to make sure the margins improved, efficiencies are forced and built-in. With another aerospace customer, we see some clear growth because we are moving possibly from one division to hopefully three divisions. Additionally, for another large global OEM as I mentioned earlier, we have begun the partnership in China beating six to seven global and Indian companies, and we are also working with them to be a partner in US, so all this will add to bits and pieces to the business. Another thing is medical electronics which we worked for last one year to build the base, we got certification done which we did for any client to look at it and we are very happy to tell you we just won the first client in medical electronics which is one of the largest global companies in the world, so hopefully that also will add something plus our joint-venture with the ASSYSTEM, which would be operational by early next year. But we are working closely with, pending the

commencement of the JV, why do not we work together, so we gave a proposal to them in terms of moving about 20 jobs from Eastern Europe to India and another 10 jobs from other European countries, so if everything goes well, we should be able to start with anywhere 30 to 50 people in the first quarter either immediately on joint-venture or directly with us which will eventually go to the joint-venture, plus I must also say that last few years has been a learning for us in terms of seeing where growth can go wrong, so as a company also I can say, we are probably a little more mature now of doing lot more analysis to see how to address some slowdown in one in one segment and not affecting others, so I can say probably maturity of management team is little better, so when we are saying something we will think twice to say that with data, at the end of the day you have the actual data, I may say anything, but the numbers have to reflect that. It is interesting learning and I see we are little more mature now.

**Gautam Behal** Sir, when you say double revenue and triple earnings, I do not have the exact numbers with me, but what is the base on that, it is like Rs 500 crore top line and Rs 50 crore EBITDA, this will double?

**Sudhakar Gande** Last year, if you look at our numbers, we had above Rs 500 crore turnover, so I am talking about growing from Rs 500 crore to Rs 1,000 crore, we are working on a plan. Once we are ready, we will have a proper meeting and share with you, you can ask us questions on that, that is the revenue part. As far as EBITDA is concerned, we were doing an EPS of 3.5, so three times which is 10.5, which is what we have done two years back when we had a large contract in distribution, so we want to make sure these are objectives we are working on, but at some point of time once we are very ready, we will have a detailed discussion and we welcome you to help us, guide us and anything that needs to be improved upon.

**Gautam Behal** Sir, in the past you said that the steady state EBITDA margin should be 15% to 18% and for aerospace 20% plus if I remember correct?

**Sudhakar Gande** EBITDA margins generally overall industry is 15%, for aerospace could be 17-18% depending on the kind of work you do, but the industry is between 15-18%, and some cases it could be even 20%, but overall industry that could be a fair way to look at it.

**Gautam Behal** I am just saying assuming the third year is sort of normalized earnings on a Rs 1,000 crore top line of 15% sort of corporate margin is realistic?

**Sudhakar Gande** At the end of the day some of these things, we have to go in to lot more detailed to go to the last penny, but I will not be surprised we will definitely be in the range of 10% to 15%, absolutely sustainable. Whether it is 10% or 11% or 12%, I do not know, but I am sure we will be in the direction, but we will present the case once we are ready and this is not being overambitious, this is being reasonable and at the end of the day, I would discuss with you every quarter, so I better be realistic.

**Moderator** Thank you. We will take the next question from the line of Faisal Hawa from H. G. Hawa and Company. Please go ahead.

**Faisal Hawa** My question is regarding the CEO, we have been now without a CEO for the last one year or so and would it make sense to appoint now a CEO who is more like from the execution side because we have been paying like consultancy charges quarter on quarter which is always the north of Rs 12 crore, how far we will be able to run an organization where a CEO has not been appointed?

**Sudhakar Gande** We are without a CEO for about six months, I think he resigned in the month of February, and this consultancy charges is nothing related to CEO. This consultancy

charges are more to do with building skills and initially where we have to take help from the foreign suppliers and foreign consultants, which gets acquired to the Indian manpower over a period of time. The update on CEO is as we know last year we have informed we have formed a committee of the board to look into CEOs and we also looked at lot of candidates and we have put an international search firm to assist with the process and I am very happy to tell you that the number of people have shown interest, this really is heartfelt and we are very, very encouraged by the response, kind of people who want to join the company compared to three years back, this is definitely an positive development. We have now shortlisted two names, we are in the final process, once we are ready, we will announce the name, once we close all the loose ends, but I can only assure you we are definitely trying to get the best in the industry and across the globe and not only confined to India.

**Faisal Hawa**

Secondly, defense offset order that you talked about which was I think in the range of some \$4 to \$5 million, is it a part of the Rafael offset and since you said the missile development company, I think MBDA also will be the biggest missile component supplier to Rafael, is it MBDA? My second question is related to the nuclear power JV that we are supposed to be starting with ASSYSTEMS, I think you had committed that it will be taking place in July or probably September to December quarter, is that on track, and last question is regarding the acquisitions, will the acquisition be funded by debt or will we be looking out for further equity dilution and if at all the acquisition will take place, can it take place in this financial year itself?

**Sudhakar Gande**

I will answer your question in the reverse order, the acquisitions as we are looking at some acquisitions, as I said at board level we have appointed a committee of directors and we have lot of interesting proposals available from investment bankers etc. and we will hopefully definitely announce by the end of this year, and we are considering few of them, but at the end of the day, it could be a mix depending on what is the size of the acquisition, if it is a very small acquisition of \$5-\$10 million, we will not even dilute anything, we will only do a debt, but if it is a large size which could bring in a really strong customer growth as well as sustainable business and strong revenue base, in which case we may look at a combination of these two, may be part cash and part shares, but certainly for smaller acquisitions, no, we will not dilute the equity. We should be announcing one acquisition this year we are working on few of them, and as far as ASSYSTEM is concerned as I mentioned, they have appointed three-member business team and three members from our side, they are working to develop a final business plan, so our estimate is the business plan should be completed by end of December. First quarter we should be able to operationalize the JV and pending that as I told you we are already working on how do we start working on without building all these paper work and processes, etc., so we have spotted two opportunities, one is about team from Eastern Europe which has been outsourced to India and a 10 member in one more country in Europe, so our estimate is in the first quarter or second quarter, we should be building a ~50-member team and by that time for the fourth quarter, you will have a nuclear agreement signed in India etc. will take off, so this will be a pipeline to the nucleus coming into the joint venture, so realistically you can say first quarter it will be operationalized, by second quarter we should have a manpower of at least 50, if not 100.

Your first question was on who are the clients, Faisal, you are always right but I cannot tell you are right this time or not, but that is a large company and it has nothing to do with India program, they have evaluated us and finally they have given an order, which is a very prestigious thing because when they are taking us for a global program it is very, very important for us and it was a very herculean task as I said, we had three to four meetings and team starting with five, six to 10-15, but my team specially involved with them, finally we won the order and of course for them the client will also be a part of the global deals in India, we will be their offshore partner. Since the offshore was getting delayed, I was after their life to start the business or

they at least started given a chance for us to bid so we have bid along with other European companies and won this contract.

- Moderator** Thank you. We will take the next question from the line of Ravi Nagda, an Individual Investor. Please go ahead.
- Ravi Nagda** Sir, by when can we see the improved performance of the company from next quarter onwards or third or fourth, because we have seen continuous decline in profits regularly?
- Sudhakar Gande** As I explained to you, we already started working on earnings growth etc., so I cannot comment on a quarter to quarter, but I can only promise you we are moving in the right direction, I cannot be specific at this point of time, but we are definitely moving in the right direction, it is one of the important issues for us.
- Ravi Nagda** Sir, can we see this year better than last year?
- Sudhakar Gande** Of course, we are going to be better than last year. You can see the evidence, revenue has already grown by 4.6% and margins we are working on, so end of the year definitely our revenues will be higher and margins also hopefully improve, we are working on it.
- Ravi Nagda** Sir, any submarine contracts that were going on, have you participated?
- Sudhakar Gande** This basically we partnered with one of the largest companies in the world, we are the Indian partner and they are also bidding for the existing new submarine program as you are aware, Government of India is announcing four submarines under what you call P75I-class submarine scheme, so if they win the contract of course they should have some great news for us, so we are working on that and our team and their team is looking at various aspects. For example, it could be design work jointly, it could be part of a maintenance contract and part of setting up a facility to help them to manage the submarines because we have already part of that, yes we will be very much one of the important Indian companies to be in this space.
- Ravi Nagda** Sir, you have not got any contracts on the Rafael deal that the Reliance defense has signed?
- Sudhakar Gande** In the case of Rafael deal what happens is, they are evaluating direct suppliers, we are one of the members and recently they have sent a 20-member team to meet some of our people, they have selected very few companies to look at that and we are one of them, so hopefully next six months something should finalize and I am very confident we should definitely get some part of this space.
- Moderator** Thank you. As there are no further questions from the participants, I now hand the conference over to the management for their closing comments.
- Sudhakar Gande** I would like to thank all of you once again for your participation and support. We look forward to interacting with you soon. Thank you very much.
- Moderator** Thank you. Ladies and Gentlemen, on behalf of AXISCADES Engineering Technologies Ltd., that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.