

CMP: Rs 76

Rating: BUY

Target: 113

(NR-Not Rated)

Stock Info

INDEX	
BSE	532395
NSE	AXISCADES
Bloomberg	AXET IN
Reuters	AXIT.BO
Sector	IT - Software
Face Value (Rs)	5
Equity Capital (Rs Mn)	189
Market Cap (Rs Mn)	2,872
52w H/L (Rs)	100 /44
Avg Weekly Vol (BSE+NSE)	1,054,670

Shareholding Pattern

	%
(As on June, 2019)	
Promoters	66.7
Public & Others	33.3

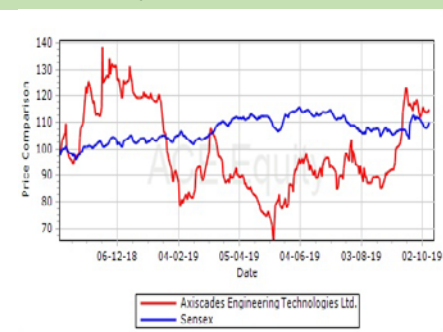
Source: NSE, Arihant Research

Stock Performance (%)

	3m	6m	12m
AXISCADES	26.3	28.0	20.1
SENSEX	-1.4	-2.0	11.3

Source: ACE Equity, Arihant Research

AXISCADES v/s SENSEX



Source: ACE Equity, Arihant Research

Monami Manna

Sr. Research Analyst

Tel: +91 22 42254817

monami.manna@arihantcapital.com

AXISCADES Engineering Technologies is a leading engineering solutions provider to companies in diverse industries. With higher Engineering R&D (ER&D) spend and greater outsourcing budget of the global clients, AXISCADES is well positioned to capitalize on this increased market opportunity. Concerted efforts from the management to improve the operating performance augur well for AXISCADES. We expect a 15.3% CAGR in its revenue over FY19-21E with 2.5x growth in PAT and 380 bps expansion in its EBITDA margin. We are bullish on AXISCADES from longer-term perspective and initiate coverage on the stock with a Buy rating and a target price of Rs 113, giving an upside potential of 48.7%.

Investment Rationale

- **Well positioned to benefit from higher ER&D spend & outsourcing**
AXISCADES operates in the US\$ 232 bn ER&D services market. The market size for AXISCADES is around US\$ 30 bn principally comprising US\$ 24 bn of India's ER&D opportunity, and sizeable opportunity in Defense R&D and spend in Offsets to Defense and Global OEMs totalling US\$ 5-6 bn.
- **Expansion of sales talent, focus on account mining**
In last 4-6 quarters, the company has invested in deepening its sales team. Also the management is now consciously focusing on mining existing clients. These measures are expected to improve the company's chances of winning future deals in ER&D.
- **Transition from services to solutions organisation to boost revenue**
Over the last few years, AXISCADES has evolved from a services organisation to a solutions organisation where it provides complete end to end solutions to businesses. This transition was effected by both organic and inorganic approach and has potential to increase the revenue stream for the company going forward.

Valuations

At CMP of Rs 76, AXISCADES is trading at FY20E and FY21E, EV/EBITDA multiples of 9.3x and 6x respectively, which is attractive considering the turnaround path the company has charted out with all-round concerted effort from the senior management. **We have valued AXISCADES at a target EV/EBITDA multiple of 9x its FY21E estimates, which yields a target price of Rs 113 per share. We initiate coverage on AXISCADES with a BUY rating and a target price of Rs 113, which gives an upside potential of 48.7%.**

Financial Performance

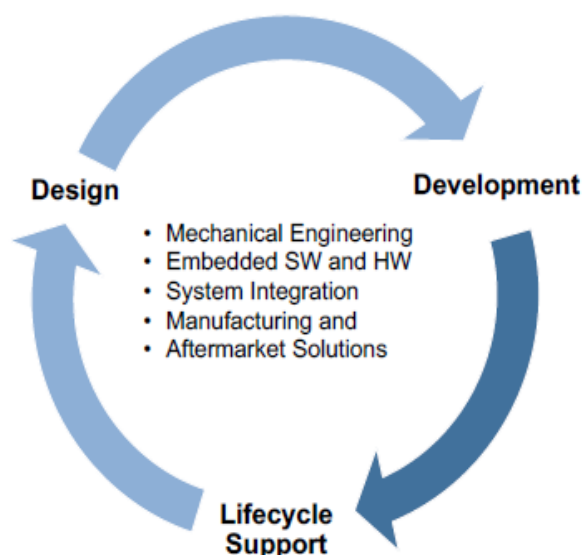
YE March (Rs Mn)	Net Sales	EBITDA	PAT	EPS (Rs)	EBITDA Margin %	RoE (%)	EV/EBITDA (x)
FY18	5,192	176	-82	-2.2	3.4	-2.8	20.6
FY19	6,077	119	-81	-2.2	2.0	-2.9	30.2
FY20E	7,022	351	55	1.4	5.0	1.9	9.3
FY21E	8,084	469	124	3.3	5.8	4.0	6.0

Source: Company, Arihant Research

■ Company Background

AXISCADES Engineering Technologies Limited (ACET) is a leading engineering solutions provider to companies in diverse industries such as Aerospace, Defence & Homeland Security, Automotive, Heavy Engineering, Industrial Products, Energy, Semiconductor and Medical & Healthcare.

AXISCADES is a preferred engineering partner for many global leaders in these verticals with complex supply chains, mission-critical applications, and highly advanced technologies. Some of the major global clients of the company are the leading OEMs in aerospace, automotive, industrials and defense sector. AXISCADES supports its customers' across their entire value chain from concept design to manufacturing to aftermarket solutions throughout the Product Lifecycle.



Source: Company, Arianth Research

Incorporated in 1990 as Axis-IT&T, the company was initially engaged in software solutions for automotive and heavy engineering companies. With a series of mergers and acquisitions over the years, the company was rebranded as "AxisCades".

Currently, the company has about ~2,300 employees including 1,500+ engineers with Mechanical domain expertise and 350+ professionals in Embedded Engineering with 100+ commercially deployed designs.

Headquartered in Bangalore, AXISCADES has delivery centres across the globe viz. US, China, France, UK and Germany. Out of its total delivery professionals, 20% of the employees are onsite and the remaining ~80% are offshore.

■ **Growth trajectory of AXISCADES over the years**

Over the years since its incorporation, AXISCADES has successfully acquired and integrated various businesses to expand its product offering in different domains. These acquisitions have given access to broad spectrum of sectors to which the company can cater to and leverage its existing capabilities.

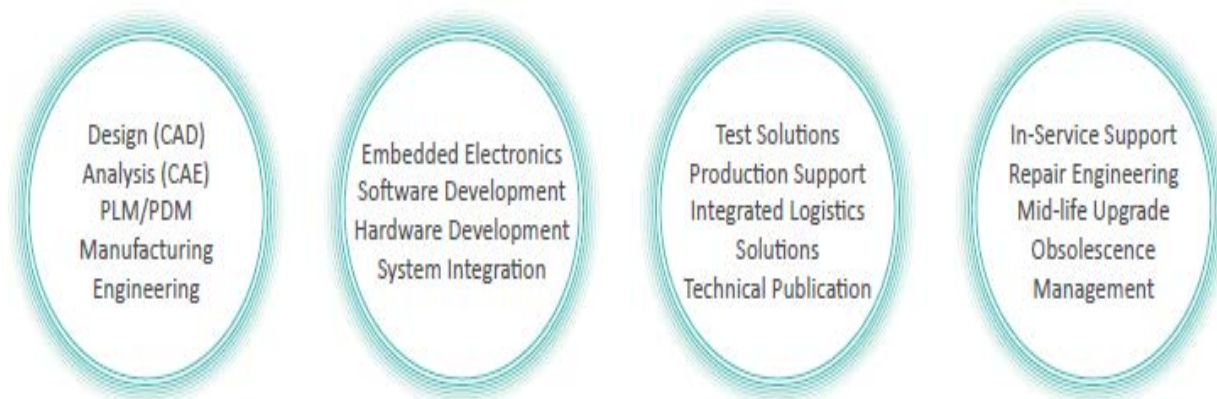
2017	Acquisition of Mistral Solutions, engaged in embedded electronics catering to defense and engineering clients
2014	Merger of AAT, Axis IT&T and CADES into one brand. Launch of AXISCADES brand
2013	CADES acquired 76% stake in STUDEC Technologies India Pvt. Ltd.
2011	Strategic Initiative; AAT forays into manufacturing with the acquisition of 75 acres land in Special Economic Zone (SEZ) in Bangalore, India
2009	Axis-IT&T acquires majority stake in CADES Niche Automotive, Aerospace & Defense engineering solutions company
2008	AAT acquires majority stake in Axis-IT&T, a 20 year old public listed company in Indian Stock Exchange; Focus on Automotive & Heavy engineering solutions; Acquires Raaga Associates, a RF and Microwave products development company
2005	Incorporated as Private Company (AAT)

Source: Company, Arianth Research

■ **Business Verticals**

AXISCADES has several partners to enable it to be a one-stop-shop solution provider by developing an ecosystem that can be leveraged to address internal competency gaps. The company’s license for defense manufacturing and being a preferred India offset partner further enables it to collaborate with global OEMs for manufacturing or sourcing from India either in defense or other verticals.

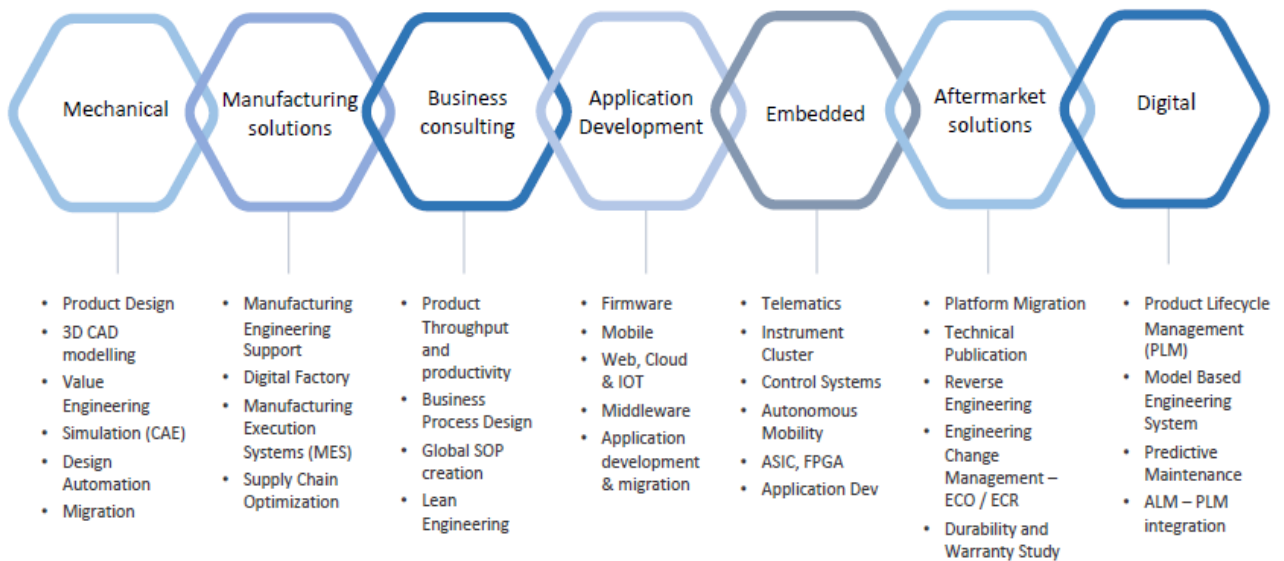
AXISCADES – One stop shop solution provider



Source: Company, Arianth Research

AXISCADES provides comprehensive engineering capabilities and a diverse suite of offerings like:

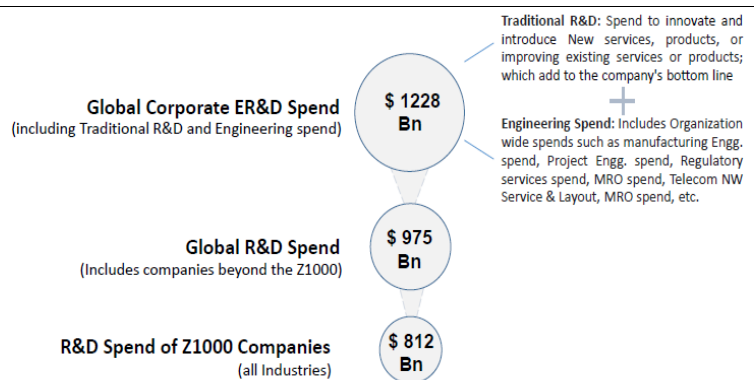
- Mechanical & Electrical Engineering Solutions
- Electronics and Embedded Systems
- Manufacturing Solutions
- Digital Solutions
- Business Consulting
- Aftermarket Solutions



Source: Company, Arianth Research

■ **Engineering R&D (ER&D) Market and Opportunity**

As per Zinnov Zones 2018 report, the Global Corporate ER&D spends in 2018 were more than US\$ 1228 bn with the Corporate R&D spends by companies worldwide topping at US\$975 bn. Zinnov also expects the total ER&D spends to touch US\$ 1722 bn mark by 2023.



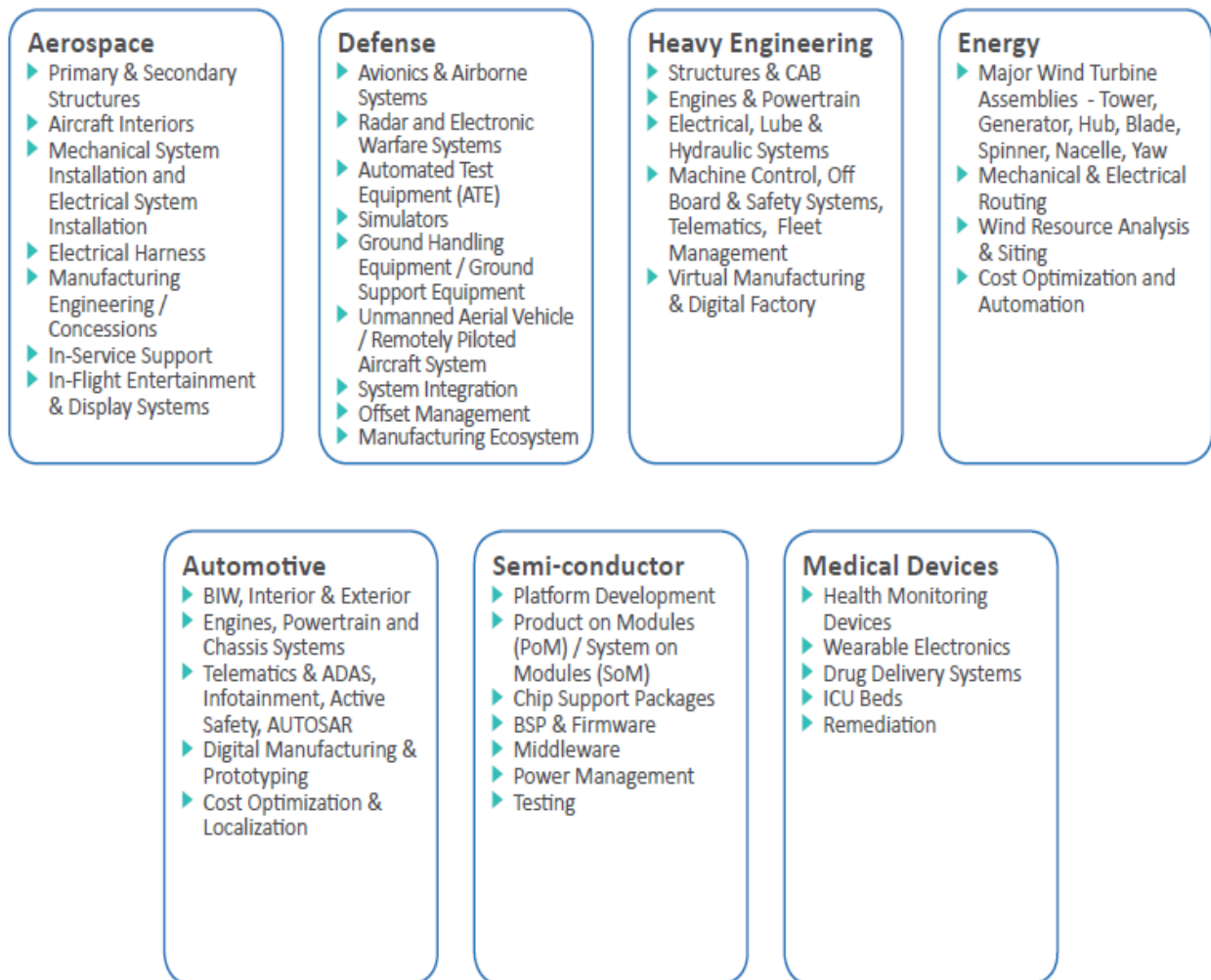
The Indian ER&D Market is expected to reach \$42 billion by FY22 from \$28 billion at present

Source: Zinnov Zones ER&D Services, Dec'2018

Source: Company, Arianth Research

The Global ER&D services outsourcing industry is pegged to grow at 14–16% to reach a size of US\$ 145–155 bn by 2020 from the 2017 levels of more than US\$ 100 bn. Considering the verticals that AXISCADES is active in, the total addressable Global ER&D market is over US\$ 300 bn. The ER&D spend outsourced to India is expected to reach US\$ 42 bn by 2022. AXISCADES is strongly placed to address both the global and Indian industry needs and capture a large share of this ER&D pie.

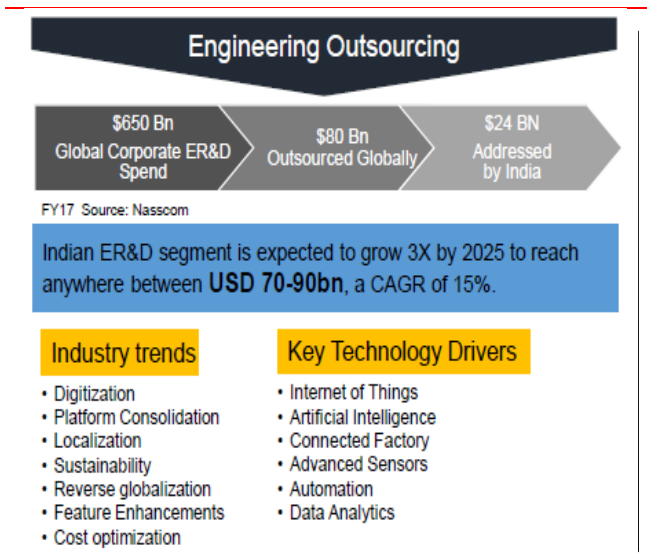
The company is having scope of its work in following diverse industries,---



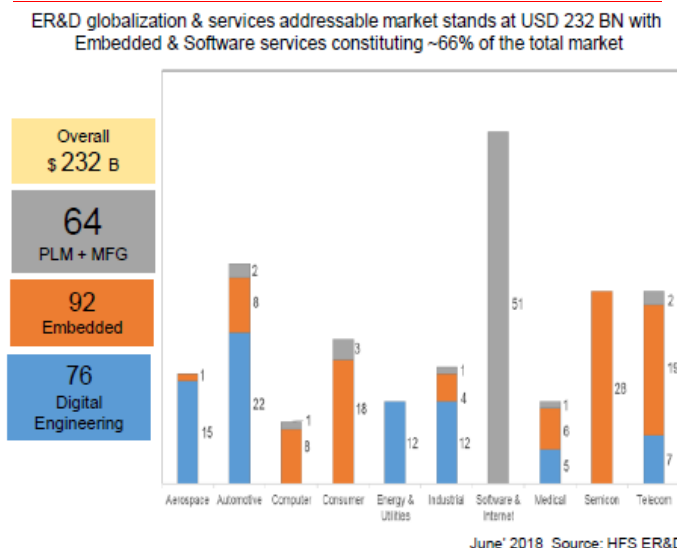
Source: Company, Aриhant Research

Investment Rationale

- Well positioned to benefit from higher ER&D spend & greater outsourcing**
 AXISCADES operates in the US\$ 232 bn ER&D services market, which is split into PLM & Manufacturing, Embedded and Digital Engineering with individual market sizes of US\$ 64 bn, US\$ 92 bn and US\$ 76 bn respectively. Outsourced service is US\$ 80 bn market within which India’s market share is currently US\$ 24 bn. This is expected to grow 3x to US\$ 70-90 bn by 2025. The market size for AXISCADES is approximately US\$ 30 bn, principally comprising US\$ 24 bn of India’s ER&D opportunity, as well as the sizeable opportunity in Defense R&D and spend in Offsets to Defense and Global OEMs totalling US\$ 5-6 bn.



Source: Company, Arihant Research

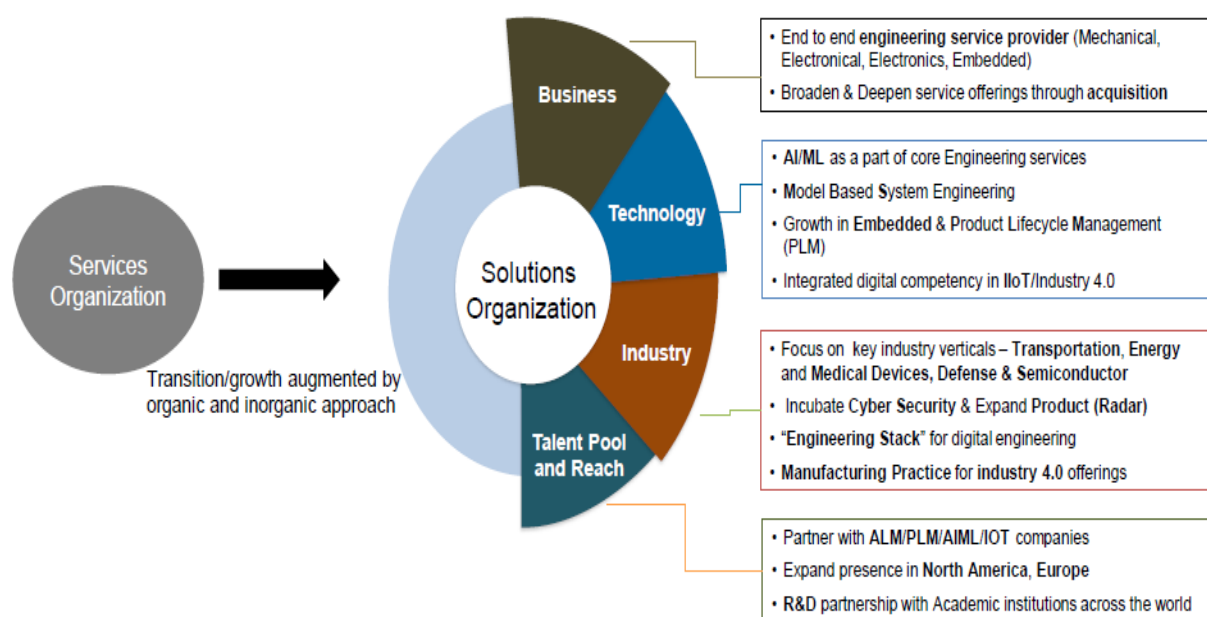


Source: Company, Arihant Research

- Expansion of sales talent, focus on account mining**
 AXISCADES has grown its large accounts portfolio from just a single customer in FY08 to 14 in FY18 and has added 7 new logos in FY19. In last 4-6 quarters, the company has invested in deepening its sales team. Also the management is now consciously focusing on mining existing clients. These measures are expected to improve the company’s chances of winning future deals in ER&D. Since in ER&D business clients are sticky, so client mining presents an opportunity to tap into the large ER&D budgets of global OEMs and is likely to give boost to the gross margin of the company.

■ **Transition from services to solutions organisation to boost revenue stream**

AXISCADES has formulated its business strategy to seamlessly align with the transformation and disruption being faced by companies that operate in the verticals that it caters to. In line with this approach, the company has embarked on a journey of change from being a Services Organisation to being a Solutions Organisation that is the partner of choice and leading ER&D partner for all marquee OEMs, Tier 1 and Tier 2 suppliers in its target verticals. This transitional journey of AXISCADES was carried out by both organic and inorganic means and has potential to increase the revenue stream for the company going forward.



Source: Company, Arianth Research

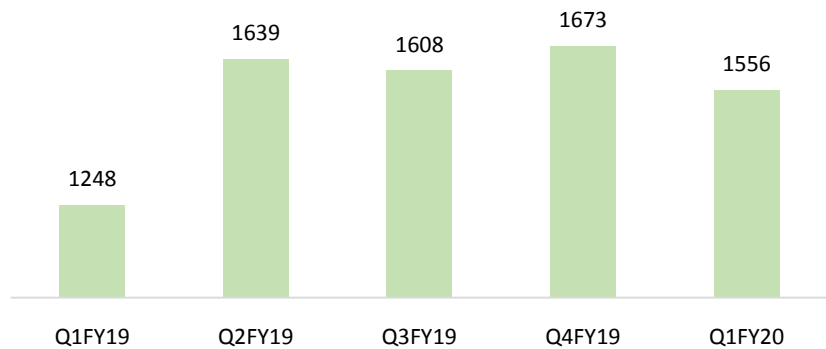
■ **Mistral acquisition to augment defense revenue with greater predictability**

In 2017, AXISCADES acquired Bengaluru-based defence electronics firm Mistral Solutions for Rs 1750 mn to enhance its competence in the embedded electronics space. Mistral exposure to India defense is on the design front. Once a component's design is approved and goes into production, Mistral's revenue is highly predictable as opposed to the usual lumpiness in the broader defense sector. Mistral's embedded engineering capabilities can be leveraged by AXISCADES in its effort towards client mining. It will also offer better cross-selling opportunities and help deepen relations with existing customers for AXISCADES.

■ **Performance to improve in coming quarters**

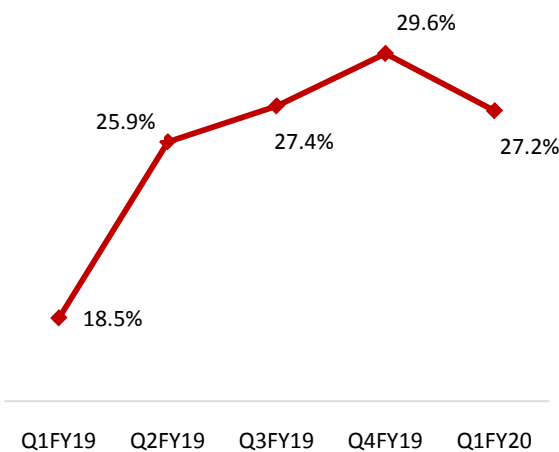
The financial performance of AXISCADES suffered in past two years FY18 and FY19 due to several factors ranging from investments in embedded and medical devices, delay in awarding of offset contracts and one-time merger expenses related to Mistral. However the company’s financial performance started improving from Q3FY19 onwards and it was able to maintain its improved performance for last three quarters in a row (see below figures).

Quarterly Revenue Trend (Rs Mn)



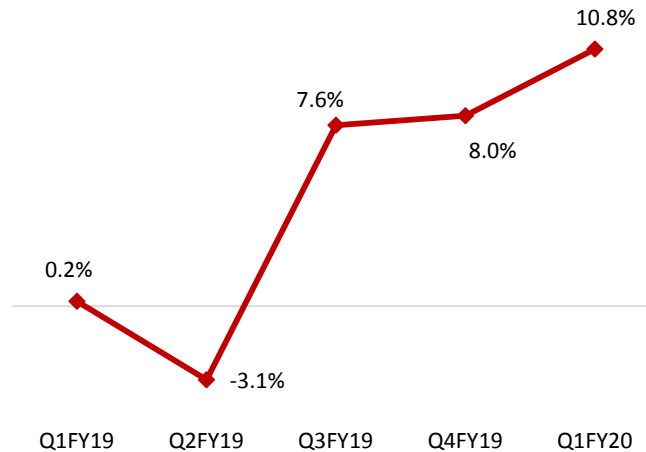
With concerted efforts taken by the management in improving the company’s performance, we believe the improved financial performance will likely to continue in the future. Thus going forward in subsequent quarters focus on revenue growth and cost optimization will drive cash flow generation for the company.

Quarterly Gross Margin Trend



Source: Company, Arianth Research

Quarterly EBITDA Margin Trend



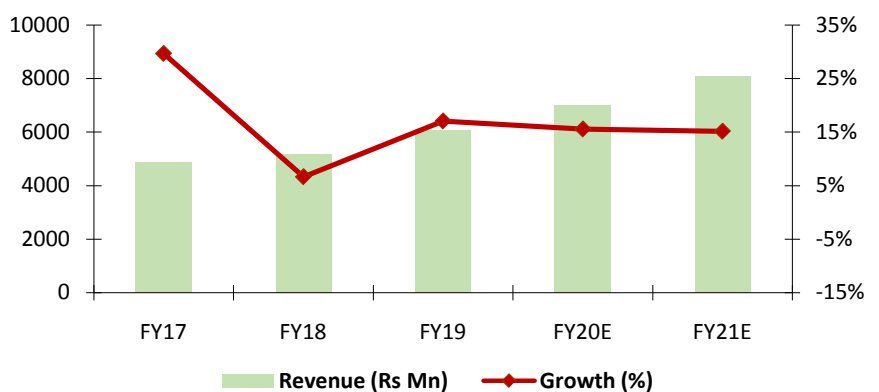
Source: Company, Arianth Research

Financial Performance Analysis

■ **Revenue to grow at a CAGR of 15.3% over FY19-21E**

AXISCADES has good revenue visibility over the next few years due to strong pipeline of orders in the ER&D and defense space. The addressable market size for AXISCADES is around US\$ 30 bn, comprising of US\$ 24 bn of domestic and US\$ 5-6 bn of global business pie. With this strong and expanding business opportunity, we expect the company to report revenues of Rs 7,022mn and Rs 8,084mn respectively in FY20E and FY21E, which implies a revenue CAGR of 15.3% over FY19-21E.

Revenue growth trend of AXISCADES over the years

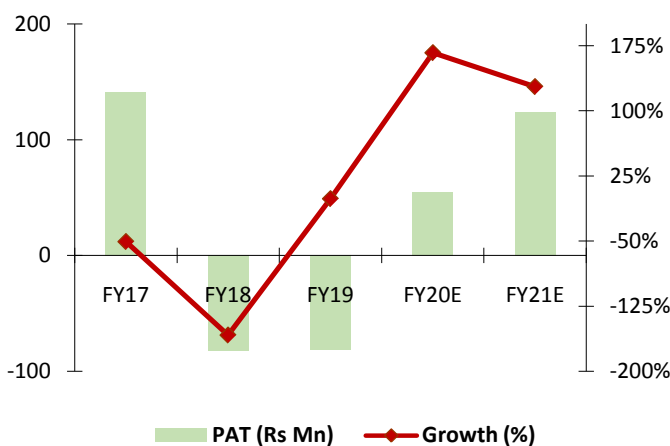


Source: Company, Arianth Research

■ **PAT to grow nearly 2.5x over FY19-21E with 380 bps expansion in margin**

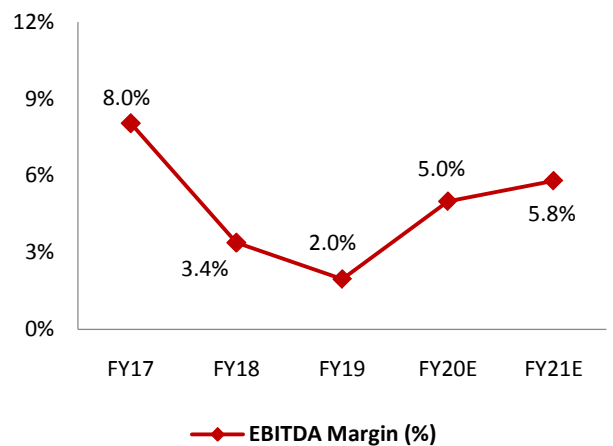
We believe, going forward, AXISCADES’ stable revenue growth coupled with improving margin profile would help the company to ramp up its earnings over the next few years. We expect AXISCADES to grow its PAT nearly 2.5x over FY19-21E with 380 bps expansion in EBITDA margin.

AXISCADES’ PAT trend over the years



Source: Company, Arianth Research

EBITDA margin trend of AXISCADES



Source: Company, Arianth Research

Q1FY20 Financial Performance

Rs Mn (consolidated)	Q1FY20	Q4FY19	Q1FY19	Q-o-Q	Y-o-Y
Net Revenue	1,544	1,624	1,226	-5.0%	25.9%
Raw Material Cost	294	324	199	-9.4%	47.7%
Employee cost	853	907	795	-5.9%	7.4%
Other Expenses	241	308	251	-21.8%	-4.0%
EBITDA	156	85	-18	83.0%	-946.0%
EBITDA margin %	10.1%	5.2%	-1.5%	+485bps	+1160bps
Other Income	13	49	21	-74.0%	-40.7%
Depreciation	74	48	52	52.9%	42.6%
EBIT	94	85	-49	10.5%	-
Finance cost	70	77	55	-9.6%	26.9%
Exceptional Item	-	-	-		
PBT	24	8	-104	205.8%	-
Tax Expense	14	-5	-25	-	-
Effective tax rate %	58.5%	-68.1%	23.9%	-	+3460bps
PAT	10	13	-79	-24.5%	-
MI & Associates	-1	-7	-1	-	-
Consolidated PAT	9	7	-80	40.4%	-
<i>PAT margin %</i>	<i>0.7%</i>	<i>0.8%</i>	<i>-6.5%</i>	<i>-17bps</i>	<i>+712bps</i>
EPS (Rs)	0.3	0.2	-2.1	40.4%	-

Source: Company, Arianth Research

Valuations

At CMP of Rs 76, AXISCADES is trading at FY20E and FY21E, EV/EBITDA multiples of 9.3x and 6x respectively, which is attractive considering the turnaround path the company has charted out with all-round concerted effort from the senior management. We have valued AXISCADES at a target EV/EBITDA multiple of 9x its FY21E estimates, which yields a target price of Rs 113 per share. We initiate coverage on AXISCADES with a BUY rating and a target price of Rs 113, which gives an upside potential of 48.7%.

Peer Comparison (On FY21E basis)

Company	Price (Rs)	Sales (Rs Mn)	EBITDA (Rs Mn)	EBITDA Margin (%)	PAT (Rs Mn)	EPS (Rs)	P/E (x)	EV/EBITDA (x)	ROE (%)
L&T Tech	1530	66,223	12,849	19.4	9,199	88.6	17.3	11.8	27.8
AXISCADES	76	8,084	469	5.8	124	3.3	23.1	6.0	4.0
Cyient	456	51,109	7,813	15.3	5,222	47.4	9.6	5.9	18.0

Source: Company, Ace Equity, Arianth Research

■ Top Management

AXISCADES has qualified and experienced industry professionals to lead its management team and has the following key managerial personnel.

Name	Title	Career Snapshot
David Bradley	Chairman	Executive Vice-President of Global Product Solutions and Member of the Management Board of Assystem managing a business of USD 750mn. He was also the CEO of Assystem UK Ltd.
Sharadhi Babu	Chief Executive Officer	An Aeronautical Engineer, a Software Professional and an Entrepreneur with over 25 years of industry experience. He has served as an Aeronautical Engineering Officer in the IAF handling technology and operations of Radar, Communication.
A. Srinivas	Chief Financial Officer	25 years experience in banking, software companies. Associated with company since 9 years in various key roles.
Anees Ahmed	Executive Director	Co-founder of Mistral, actively involved in the strategic planning and new business initiatives of the company. Active member of Entrepreneurs Organisation (EO) and Young Presidents Organisation (YPO).

■ Key Risks

Though we believe AXISCADES is likely to improve its performance in the coming quarters, our investment thesis suffers from the following risks,---

➤ Churn in senior management

AXISCADES had three CEOs in last 4 years, such a frequent change in leadership is likely to impact company's strategy and focus areas. Primary reason for this churn was the diverse nature of businesses that the company operates in (engineering, defense, outsourcing), thereby presenting a challenge for the CEO to drive broad based growth. However to address this issue, the company has brought in new leadership (David Bradley as Chairman and Sharadhi Babu as CEO) to bring stability at the board level.

➤ Debt burden

The company has a debt of Rs 1300 mn which results in significant cash outgo towards interest payment, thereby impacting PAT.

➤ Integration of Mistral

Unless Mistral is closely integrated with AXISCADES, the expected synergies will not fructify.

Consolidated Financials

Income Statement

Y/E March (Rs Mn)	FY17	FY18	FY19	FY20E	FY21E
Revenues	4,868	5,192	6,077	7,022	8,084
Change (%)	29.7%	6.7%	17.1%	15.5%	15.1%
Raw materials	670	549	945	1,053	1,293
Stock Adjustments	0	0	0	0	0
Employee costs	2,511	2,837	3,501	3,862	4,446
Other expenses	1,263	1,630	1,512	1,755	1,875
Total Expenses	4,476	5,016	5,958	6,671	7,615
EBITDA	392	176	119	351	469
Other Income	146	151	90	105	81
Depreciation	122	188	197	187	177
Interest	133	137	236	193	198
PBT	283	2	-224	76	175
Extra-ordinary	-5	30	-145	0	0
PBT after ext-ord.	288	-28	-78	76	175
Tax	143	50	-7	17	38
Rate (%)	49.5%	-180.6%	9.2%	22.0%	22.0%
PAT	146	-78	-71	60	136
MI & Associates	-4	-4	-10	-5	-12
Consolidated PAT	141	-82	-81	55	124
Change (%)	-50.6%	-158.4%	-1.4%	167.0%	127.8%

Source: Company, Arianth Research

Balance Sheet

Y/E March (Rs Mn)	FY17	FY18	FY19	FY20E	FY21E
Sources of Funds					
Share Capital	189	189	189	189	189
Reserves & Surplus	2,826	2,728	2,658	2,726	2,916
Net Worth	3,015	2,917	2,847	2,915	3,105
Loan Funds	812	1,378	1,315	1,285	1,235
Deferred Tax & other liabilities	92	1,035	973	973	973
Capital Employed	3,949	5,365	5,172	5,212	5,352
Application of Funds					
Gross Block	2,626	3,741	3,748	3,550	3,350
Less: Accumulated Depreciation	103	291	489	676	853
Net Block	2,523	3,450	3,259	2,874	2,496
CWIP	59	5	6	6	6
Other non current assets	64	377	446	446	446
Deferred tax assets	0	162	255	255	255
Net fixed assets	2,646	3,994	3,966	3,581	3,204
Investments	4	63	299	299	299
Debtors	842	1,660	1,529	1,731	2,215
Inventories	20	301	202	202	301
Cash & bank balance	719	619	583	891	1,273
Loans & advances & other CA	1,710	951	998	1,154	1,329
Total current assets	3,291	3,532	3,312	3,978	5,118
Current liabilities	1,386	3,683	3,876	4,117	4,740
Provisions	605	188	189	189	189
Net current assets	1,300	-339	-753	-327	189
Total Assets	3,949	5,365	5,172	5,212	5,352

Source: Company, Arianth Research

Cash Flow Statement

Y/E March (Rs Mn)	FY17	FY18	FY19	FY20E	FY21E
PBT	288	-28	-78	76	175
Depreciation	122	188	197	187	177
Interest & others	-18	-18	135	82	105
Cash flow before WC changes	393	142	254	346	457
(Inc)/dec in working capital	-81	1,449	378	-118	-134
Operating CF after WC changes	312	1,591	633	228	322
Less: Taxes	-143	-50	7	-17	-38
Operating cash flow	169	1,540	640	211	284
(Inc)/dec in F.A + CWIP	-287	-2,995	20	200	200
(Pur)/sale of investment	277	-59	-237	0	0
Cash flow from investing	-10	-3,054	-217	200	200
Free cash flow (FCF)	-118	667	835	411	484
Loan raised/(repaid)	99	566	-63	-30	-50
Equity raised	0	0	0	0	0
Interest & others	125	848	-396	-74	-52
Dividend	0	0	0	0	0
Cash flow from financing activities	225	1,414	-459	-104	-102
Net inc / (dec) in cash	383	-100	-36	308	382
Opening balance of cash	335	719	619	583	891
Closing balance of cash	719	619	583	891	1,273

Source: Company, Arihant Research

Key Ratios

Y/E March (Rs Mn)	FY17	FY18	FY19	FY20E	FY21E
Per share (Rs)					
EPS	3.7	-2.2	-2.2	1.4	3.3
CEPS	7.0	2.8	3.1	6.4	8.0
BVPS	79.8	77.2	75.3	77.1	82.2
DPS	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Valuation (x)					
P/E	20.3	-34.8	-35.3	52.7	23.1
P/CEPS	10.9	27.3	24.7	11.9	9.5
P/BV	1.0	1.0	1.0	1.0	0.9
EV/EBITDA	7.6	20.6	30.2	9.3	6.0
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Return Ratio (%)					
EBIDTA Margin	8.0%	3.4%	2.0%	5.0%	5.8%
PAT Margin	2.9%	-1.6%	-1.3%	0.8%	1.5%
ROE	4.7%	-2.8%	-2.9%	1.9%	4.0%
ROCE	6.8%	-0.2%	-1.5%	3.1%	5.4%
Leverage Ratio (%)					
Total D/E	0.3	0.5	0.5	0.4	0.4
Net D/E	0.0	0.3	0.3	0.1	0.0
Turnover Ratios					
Asset Turnover (x)	1.2	1.0	1.2	1.3	1.5
Inventory Days	10	200	78	70	85
Receivable Days	63	117	92	90	100
Payable days	149	272	244	214	214

Source: Company, Arihant Research

Arihant Research DeskEmail: research@arihantcapital.com

Tel. : 022-42254800

Head Office

#1011, Solitaire Corporate Park ,
 Building No. 10, 1st Floor,
 Andheri Ghatkopar Link Road
 Chakala, Andheri (E).
 Mumbai – 400093
 Tel: (91-22) 42254800
 Fax: (91-22) 42254880

Registered Office

Arihant House
 E-5 RatlamKothi
 Indore - 452003, (M.P.)
 Tel: (91-731) 3016100
 Fax: (91-731) 3016199

Stock Rating Scale Absolute Return

BUY	>20%	
ACCUMULATE	12% to 20%	
HOLD	5% to 12%	
NEUTRAL	-5% to 5%	
REDUCE		-5% to -12%
SELL	<-12%	

Research**Analyst****Registration No.**

INH000002764

Contact

SMS: 'Arihant' to 56677

Websitewww.arihantcapital.com**Email Id**research@arihantcapital.com

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Arihant Capital Markets Ltd.

1011, Solitaire Corporate park, Building No. 10, 1st Floor,
 Andheri Ghatkopar Link Road Chakala, Andheri (E)
 Tel. 022-42254800 Fax. 022-42254880