



AXISCADES Engineering Technologies Ltd

Conference Call Transcript November 17, 2015

Moderator Good Day, Ladies and gentlemen and welcome to Q2FY16 Earnings Conference Call for AXISCADES Engineering Technologies Ltd. As a reminder, all participant 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 this conference call, please signal an operator by pressing '*' 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 Good day everyone and thank you for joining us on AXISCADES Engineering Technologies Q2 FY16 results conference call. We have with us today Mr. Sudhakar Gande – Vice Chairman, Mr. Valmeeka Nathan – CEO and Mr. Kaushik Sarkar – CFO.

Before we begin, I would like to state that some statements made in today's discussions maybe forward looking in nature and may involve risks and uncertainties. A detailed statement in this regard is available on the Q2 FY16 results presentation that has been sent to you earlier. This conference call will be archived and the transcripts will be made available on AXISCADES' corporate website www.axiscades.com.

I now request Mr. Sudhakar Gande to begin the proceedings of this call.

Sudhakar Gande Good afternoon everyone, and thank you for joining the conference call. This is our first earnings call and we intend to carry out this exercise on a regular basis going forward keeping in mind our interest of establishing the best practices in investor relations. I hope you had time to go through the results presentation which was shared earlier which provides details of our operating and financial performance.

We are also happy to report that the transformation journey is progressing well for the company and yielding good results. The total operating revenue in terms of dollars grew by 6.6% sequentially to \$14.5 million in Q2 FY16. We continue to effectively control our expenses. EBITDA margin stood at 14.5% during Q2 FY16 given that, we rolled out wage hikes during the quarter and also added to our employee headcount, with net additions of 74 employees.

Our pipeline continues to be strong and good and we expect to carry on the momentum. We are confident that the measures we are undertaking will drive sustainable growth.



Further, in line with our commitment to deliver above industry growth, we continue to invest in sales and marketing. We have added two key new members to our leadership in sales which includes a Global Head of Sales based out of US and Director of Business Development & Strategy based out of Paris.

A quick background of the Global Head of Sales, he has more than 20 years' experience primarily in engineering services and most of it based out of US and he has joined us from HCL technologies and has also worked with Cyient earlier and Bajaj Kawasaki, so he has got a strong engineering experience in three companies, Bajaj Kawasaki, Cyient in the initial days and HCL Technologies. And the second person we have hired is out of Paris for Business Development and Strategy, a person of Indian origin but almost moved to Paris when he was two years old, so he is like French for all practical purposes. He had a long association with Thales almost 25 years and with Bull Systems and he was heading the business development for Asia and he was also based in Singapore and Paris for a long time and he will help us cracking further European market. Both these gentlemen are fairly respected and well equipped and understand those markets and these are the two additions in line with our overall strategy of aggressive growth in days to come.

During the quarter, we have set up an offshore development center for Siemens Wind Power in Hyderabad with a headcount of 50 employees. It is a long-term relationship, we continue to deepen our relations with Siemens Wind Power. It is also in line with our strategy of building overseas development centers for global OEMs like we have done in the past for Airbus and other companies and now we are doing for Siemens.

We are also excited with the proposed merger of Axis Aerospace and Technologies (ACATL) along with Axis Engineering Technology during this quarter. The transaction is highly synergistic, given ACATL's systems development capability, system integration capability, presence in promising aerospace and defense sectors with very high entry barrier and high pedigree clientele. The merger is pending statutory approvals and is progressing in the right direction in line with our expectations.

In the last one year we have laid out framework to deliver above industry growth and expand our margins. We are transforming our go to market strategy and our investment in key accounts and increasing penetration into US which will serve as growth and profit levers going forward.

With these few words, I would like to hand over to our CEO S.Valmeeka Nathan who will take you through the technology development of the company and the markets.

S.Valmeeka Nathan

Thank you Sudhakar, Good afternoon everybody. This has been a good quarter for us. It reflects positively on the changes we have been executing so far. We are laying the foundation for building sustainable growth through innovation, investment and domain expertise and thought leadership. These are in line with the change in customer demands.

The opportunity for growth is huge. We are putting in place best-in-class processes and systems. We are confident these measures will help build predictability in growth, increase the quality of revenues and help us drive growth which is above the industry growth over the next three to five years.

In addition, to enhancing sales leadership, during the quarter we beefed up our technical leadership as well. Our key focus is to create new competency and solution offerings in all dimensions of engineering services in the verticals we are present and we aspire to participate in. While we continue to invest in building competencies,

during the quarter we got into partnership with couple of players who compliment our offering and enhance the same.

We believe in building an ecosystem in engineering services market to cater to all opportunities coming from our existing clients as well as new clients. We will continue to invest in the business for entry into select areas like embedded electronics and digital automation, product lifecycle management, knowledge based engineering, etc to expand our solution offerings and business models.

Thank you. And I will hand it over to Kaushik, our CFO to take you through the numbers.

Kaushik Sarkar

Thank you Val, good afternoon everyone. Q2 FY16 has been an exciting quarter for all of us. I will take you through the financials which has been uploaded on our website.

Now moving to Slide #6 which is the consolidated P&L, total operating revenue for the quarter is Rs. 957 million, up 11% quarter-on-quarter and 21% year-over-year. Growth in revenues is led by strong growth in Heavy Engineering and Aerospace verticals. Our employee cost increased by 15% quarter-over-quarter due to wage hike and investment in new hiring and in leadership, which Sudhakar spoke about.

EBITDA for Q2 FY16 was Rs. 139 million, up 8% quarter-over-quarter and 39% year-over-year. We have been able to negate most of the cost impact by improving operational efficiencies and various productivity enhancement measures we have undertaken in the past.

Profit after tax for Q2 is up 40 basis points quarter-over-quarter to 7.6%. Excluding onetime item, which is the proposed merger of Axis Aerospace Technologies, PAT margins stood at 8.2% for the quarter. The exceptional item for Q2 pertains to the proposed merger which we have mentioned few minutes back.

Moving to Slide #7, our gross margin in the business improved 190 basis points year-over-year, we continue to focus on margin improvement through increasing realization per employee and reduction in subcontracting cost. We continue to invest in sales to drive growth. Selling expenses accounted for around 6% of revenue in Q2 FY16. Sales expenses have increased in the last few quarters as we continue to strengthen our leadership team and will continue to grow as we continue to invest in growth. Our G&A expenses is around 14% of total operating revenue. Earnings per share grew by 16% year-over-year at Rs. 2.68 per share, up Rs.0.4 per share quarter-on-quarter, up Rs.1.09 per share year-over-year.

Moving to Slide #8 of our presentation, I will now provide some insight about our balance sheet. We continue to have a strong balance sheet position. Our net worth has improved 12% in H1 FY16 to around Rs. 141 crore. We have a strong cash balance spread across geographies and subsidiaries in order to account our investment for growth. We are focused on growth and we will continue to use all the resources available including cash for organic and inorganic growth.

Moving to Slide #9, I will provide an update on various industries segment we are present. Aerospace is our largest segment of our business contributing around 49% in Q2. For others we are seeing a good demand and expect to bag new orders in the upcoming quarters. The other major portion of our business is Heavy Engineering accounting for 29% of our revenue in Q2. We saw a strong uptick in revenue this quarter with strong contribution from our key clients.

In closing, this has been a strong quarter for us. We are laying the foundation for building sustainable growth through innovation and investment in leadership, domain expertise and in sales. Our size provides the required agility to drive change and build scale.

On this note, I thank you all again for your participation and now request the moderator to open up for questions.

Moderator Thank you very much sir. Ladies and Gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Lakshmi Narayanan from Catamaran. Please go ahead.

Lakshmi Narayanan Couple of questions I have. First, in terms of the receivables, I see that receivables have actually gone up when I compare to March end number on consolidated basis, if you can just help me understand what is the band in which you like to operate? And second is pertaining to the trade payables, I just wanted to understand, do we actually end up subcontracting some of our work and hence there is a payable thing that is actually built in? That's the first question on receivables and payables. The second question is, in terms of what is the guidance for employee cost, I see that employee cost on a blended basis from a consolidated balance sheet comes to around 64% end of last year and it is around 61%, what is the guidance on that? And the third is, what percentage of revenue comes from India? These are the three questions I had.

Kaushik Sarkar The first question I will take, when you talk about receivables, receivables for Q2 have been cyclical for us. The revenue has gone up. Generally we have the DSOs in the range of 90 to 100 days and there is one-off in this quarter and we are addressing it and it has been taken care of. We will see a range between 90 to 100 days in the next quarter. On the payables side, one of the payments, we have not received some of the bills from one of our outsourcing partner that's why it has gone up, but that is a normal part of the business. On the employee side, the employee cost we are doing a lot of productivity improvements, offshore-onshore mix, roll ratios and we see a gradual decrease in the overall cost structure of employees, however we are investing in a lot of strategic people in that business for fueling our growth. So overall we see a range of 50-60% as the employee cost..

S.Valmeeka Nathan Just to add to what Kaushik said, our intention is to continue to increase value and operating efficiency which essentially means by investing in key people and creating an enhanced revenue productivity we will be able to bring down the employee cost over a period of time, and that is certainly in line with our intention.

Lakshmi Narayanan And the last in terms of the domestic revenues?

Sudhakar Gande Domestic revenues is around 10%.

Lakshmi Narayanan And sir do you actually give something like fact sheet which a lot of IT companies in general give, do you have that somewhere in your website, talking about utilization, revenue productivity, attrition, various other things, do you have some format which I can take it up from your website?

Sudhakar Gande Gentlemen, this is our first earnings call and each call we will improve and come to perfection.

Lakshmi Narayanan No, no problem, I thought something maybe there I am not, this is also my first call of your company so coincides that it's also your call.

Moderator	Thank you. Our next question is from the line of Anirban Shah from Pisquare Investments. Please go ahead.
Anirban Shah	I wanted to know that the two to three new clients that you have added are in which verticals, Aviation side or your Heavy Engineering side? And my second question goes, the Heavy Engineering side your basic clientele was Caterpillar, so have you seen any further addition on that side or is it that Caterpillar is now doing well so you might see good amount of business from that side?
Sudhakar Gande	Your first question on new clients, all these clients are predominantly in the Aerospace sector. They are the suppliers to one of the largest manufacturer of the aircraft in the world. Two logos are there, one client is from Europe which is again linked to a large OEM relating to Aerospace. That's for question number one. Question number two, as far as Heavy Engineering is concerned, yes we have Caterpillar and we also have one more customer which I cannot share the name but we are doing some work with again one of the large global OEMs.
Anirban Shah	And sir can you give us a little guidance on what would be FY17 from here on like 20% growth or 30% growth?
Sudhakar Gande	See, on the guidance part, I do not want to give specific numbers at this stage, as we move forward, yes, but only thing I want to clearly say is, our growth will be above industry growth and we are very clear on that. The industry is growing at about 12-15% as you may be aware. We expect our growth to be definitely more than industry for the next three to five years.
Moderator	Thank you. Our next question is from the line of Amar Maurya from India Nivesh. Please go ahead.
Amar Maurya	Sir, my question is firstly on the revenue growth trajectory. I mean the kind of momentum which we had shown in this particular first half, is it likely to sustain in second half or we also have that traditional IT space like cycle where second half is going to be slightly lower than the first half?
Sudhakar Gande	See, I do not want to go to specifics of quarter-to-quarter, but as I said we have built a strong base on which we are building this company. So at the end of the day the company will be growing more than the industry, but quarter-to-quarter I do not want to comment on that, but year-to-year yes, by and large.
Amar Maurya	No sir I do not want any guidance, what I am trying to understand here is that given that in traditional IT business first half is always better than the second half, so is this also applicable for our kind of industry given that third quarter is going to be a holiday season and all those things?
Sudhakar Gande	See, there is some link between Engineering Design Services to Software to some extent. But at the same time it is a smarter and more efficient business, so it does not need to 100% follow software trends, but some places it may, others it may not.
S.Valmeeka Nathan	There could be some alignments, just that over a period of time this is program spend as against the expense spend in the IT space, IT would have a very different trajectory. But our intent here is to develop models which are hopefully quarter-to-quarter growth agnostic, will have a sustained growth and over a period of time you will get to see that. At this moment you might probably experience similarities but over a period of time it will become dissimilar.

Sudhakar Gande See, only one clue I want to tell you is, given that 90% of our clients are abroad, US, Europe etc, a lot of people do not work in Christmas and New Year at times, but you can keep that in mind.

Kaushik Sarkar So just to answer that, there is always a small impact in Q3 because we have global customers, but if I see holistically, our pipeline is very strong, and we are confident the measures we have taken will drive sustainable growth for this company.

Amar Maurya And secondly sir, about this acquisition which we did, I mean the integration of Defense business which we did, by what time we will be seeing that actually, I mean obviously there are a lot of legal hurdles, like court approval and all, so by when we see that consolidating into our actual numbers?

Sudhakar Gande It is in line, we have to follow the normal process of stock exchange approvals, SEBI, High Court etc, but our plan is in the Q1 of next financial year, that is, April to June quarter, most likely in the month of June, give and take a few months here and there.

Moderator Thank you. Our next question is from the line of Avinash Sharma from Dalal & Broacha. Please go ahead.

Avinash Sharma Sir, we know that AXISCADES' strong point is having very good clientele, so just wanted to understand what kind of repeat business and what kind of traction are we seeing from existing customers from a three to five year horizon?

Sudhakar Gande See, as I said earlier that we will continue to grow above the industry and as far as the clients are concerned, we have built a strong base of more than 15-16 global customers, OEMs. And out of them, only few clients we have penetrated to some extent, rest of the clients we are still working with them. So at the end of the day the client base is strong and the ability to penetrate is reasonably good, so this is what offers us a kind of a growth. And second point is, when I deal with the one OEM, then the learning and experience what we learn from that customer, when we go to OEM two, then OEM three will be lot-lot more effective, there will be more maturity in our delivery mechanism etc and even customers like that. Just to give an example, when we were working to win the ODCs, Offshore Development Centers for Airbus, it was a long-term process. But whatever learning's we have done by that were very useful when we were presenting our case to Siemens to sign an ODC with us. So from our experience I can say that moving forward ability to penetrate the customers and the ability to get a customer is far better and far more easier compared to earlier.

Avinash Sharma And sir, are we reaching maturity levels across the verticals, right, or is it like specifically for the Aerospace and Heavy Engineering vertical?

Sudhakar Gande No, there is a room everywhere.

Avinash Sharma Everywhere, right?

Sudhakar Gande Yes.

S.Valmeeka Nathan There is a lot of spend that we have still not addressed in any of these programs in the customer's organization. What we do is one or two service lines and there is lot more opportunity to diversify our offerings and that's why we are hiring technical leadership and also change of business model. And it is not just the customer and the customer program ecosystem, so it is about program and going beyond the customer organization to their suppliers as well. So there is enormous opportunity for growth in each customer and that's something we believe we can replicate across multiple sectors and geographies.

Moderator	Thank you. Our next question is from the line of Sanjay Fular who is an investor. Please go ahead.
Sanjay Fular	My first question is this merger with Axis Aerospace will create what kind of revenue base, post consolidation what will be the total revenue and how much will it add to profits? Second question is, have we seen any pricing improvement in our business in last two, three quarters? Third question is, what is the reason for 2020, have we set any target like \$300-\$500 million revenue achievement? And the last question is, what is the CAPEX for two years and how do you expect to fund it.
Sudhakar Gande	I will answer your questions in the reverse order, as far as CAPEX is concerned, whatever requirement will be addressed by the internal cash flows, so we do not need to do any dilutions or anything like that for the CAPEX part for next couple of years, that is one. Second, next three to five years as I have mentioned earlier, our growth will be higher than the industry growth which is growing around 12-15%. So if we take next three to five years timeframe, that is what we will be growing. And the second question on price improvement, see price improvement cannot be across all the clients and all the sectors, so depending on the maturity level we achieve with the customer where we improve the internal efficiencies, the price margin will increase. So it is a constant process which we need to do and we continue to do it to get the optimal pricing. As far as the merger with AXISCADES Aerospace and Technology is concerned, it is going on track but you look at the information we already shared earlier. The consolidated revenues on proforma basis, is about Rs. 530 crore, as at 31 st March 2015.
Avinash Sharma	What would be promoters holding post-merger?
Sudhakar Gande	All the information is available on our website as well as SEBI site, it is about 70.56%.
Avinash Sharma	And what kind of EBITDA margin you see going forward and what will be your containment for margins, you are seeing good amount of improvement, in the last two three quarters it has gone up to 14.5%, do you see going up further to 16- 17%?
Sudhakar Gande	See, in this industry the EBITDA margin will generally get stabilized at 18%, by and large, it could be 1-2% more if you are doing more complicated Aerospace work and it could be 1-2% less if you are doing less complicated Automotive kind of work, but net-net let's say it is about 18% that is the right number to look at and we are running around 14.5-15% right now. So our aim is to reach this in the next two years to reach in line with the industry, so we will be constantly working on this and next two to three years we should be able to reach a number like 18%.
Avinash Sharma	And one last question sir, what will be the top five customers account for the total revenue, I mean which are they, can you please name those customers?
Sudhakar Gande	I cannot give the client names due to confidentiality clauses.
Kaushik Sarkar	See, I can tell around top 10 customers account for around 87% of our revenue for this quarter.
Avinash Sharma	And sir why cannot we be transparent about names of these companies, clients?
Sudhakar Gande	Because there are some confidentiality agreements with customers where we cannot reveal, except I can say Airbus is a customer of mine because we made a joint press release and I guess Siemens is a customer of mine because we have made a joint press release.

Avinash Sharma	Because Infosys, TCS they all share all their customer engagements also when analysts ask and request.
Sudhakar Gande	They may have some flexibility on that but we do very highly confidential kind of work on Engineering design, a lot of guys do not even want to know the name, as you know this is more than software kind of a company, it is a product development space, not all companies are keen on sharing their partnership and where they have been and what they are doing. So wherever we have agreements with the customer we share, in fact many customers are also very cautious as to not mention, even if we mention not even talk about the kind of work we do. So it is customer confidentiality and that is very important for us.
S.Valmeeka Nathan	I can only tell you that 90-95% of our customers are among the top five in the world in their respective areas, in fact most of them are top three, but three to five all of them, 90% of let's say our customers are in that segment.
Avinash Sharma	And what is the value of Siemens business, Siemens Wind Power we have hired 50 people for overseas development center, offshore development center, what is the value you put?
Sudhakar Gande	We have press release on that, see our aim is to start with 50 people and go up to 500 people in next three to five years, 300 to 500 people in next three to five years.
Avinash Sharma	And would we like to put any figures, I mean what kind of business you see?
Sudhakar Gande	Sorry, I will not be able to share that.
Moderator	Thank you. Our next question is from the line of Amish Kanani from JM financials. Please go ahead.
Amish Kanani	Sir, is it possible to share the first half numbers of ACAT, the company which we are proposing to merger?
Sudhakar Gande	No, as a policy we would not like to share those numbers, when everything, all approvals come through we will give all the information.
Amish Kanani	But if you can directionally tell us whether the growth is similar to what the growth is in the first half YoY or QoQ growth that company is also growing in the similar growth or it is flat or declining?
Sudhakar Gande	I can only say that the company is very similar to this company in terms of technology, in processes and systems as we look at this company, so I cannot say anything more at this stage but we will share all the information once we get the final approvals, we will have meeting with all the analysts we will share all the data.
Amish Kanani	And sir, if you can just give us the breakup of this QoQ growth of 6.6% in some volume and pricing wise and also in constant currency if you can give, because we have a large European exposure, maybe my guesses are constant currency growth would have been a little higher also.
Sudhakar Gande	Rupee growth is about 11%, dollar growth was 6.6%.
Amish Kanani	No, I was wondering in a constant currency term, in the sense because of our exposure to Europe maybe our volume growth, say underlying volume growth would have been higher?

Kaushik Sarkar See, we are giving the numbers in dollars right, and 84% of our revenues comes from USD, so there is question about whether to translate into constant currency or not, so that should answer your question.

Amish Kanani So are you saying that our pricing is in dollar for our European clients?

Kaushik Sarkar Exactly., 84% of our revenue comes in USD.

Sudhakar Gande Even our billing in Airbus happens in dollars because they are also one of international companies, we get 84% of our revenues in dollars.

Amish Kanani Okay, I was looking at the breakup in terms of geography and I saw a larger portion of our business coming from Europe.

Sudhakar Gande Maybe next time we will add the currency breakup.

Moderator Thank you. Our next question is from the line of Raj Gala from Edelweiss. Please go ahead.

Raj Kala Sir, my question pertains to the top five clients and the top clients, how they have been faring in this quarter and how has been the growth for the top client?

Sudhakar Gande See, client-wise breakup it is difficult to give, obviously if you have grown reasonably well our business of top 5 or 10 customers must be growing in same direction. So net-net, as I said, our growth will continue to be good, more than the industry but I do not want to go into specifics of clients in the industry.

Raj Gala But sir top client has been stabilized or is it still not contributing?

S.Valmeeka Nathan Of course, see in any business or in our business the contributions from the new accounts will take time, it takes about anything between 12 to 18 months to have a significant impact on the revenue and the revenue growth, so clearly the growth that you have seen this time, the top clients have certainly contributed and they are in the right direction, we are very happy with our contribution in the growth rates.

Sudhakar Gande One piece of information I want to share is, see even if one of our top client is not doing well, let us say for a minute, we see this as an opportunity with them and there are instances we have done it and we see in future also opportunities coming up. So being a company based out of India with operations abroad as well as India, we have that flexibility which lot of foreign vendors will not have it. So even in bad times yes, we have a good opportunity for business.

Moderator Thank you. Our next question is from the line of Girish Gulati from Quality Capital. Please go ahead.

Girish Gulati Sir you have mentioned in one of the investor presentations about ACATL which we are about to merge, that the global OEM opportunity size is around \$75 billion over the period of next 10 years and \$100 million opportunity in terms of the Indian defense program. If you could just sir elaborate on that, what kind of opportunity we are talking about?

Sudhakar Gande See, if you look at India defense programs, various segments, for example you have Indian Navy, Indian Air Force, Indian Army, all of that; so today all the global OEMs when they are bidding for these projects, 30% of them should be minimum offset, that means any deal with more than Rs. 300 crore, 30% has to be given to Indian entity, that means a company registered in India, a company under management of

India, a company where foreign ownership is not more than 26%, it can go 49% subsequently. So this is the government policy under defense procurement policy. So any large project or product sale whether they are buying an aircraft or submarine or army or tank or gun everything, this policy is relevant. So the way we look at it, if you look at the India defense program the opportunity will be about \$75 billion minimum, if put together if you look at various government projection, etc.

- Girish Gulati** But this \$75 billion is an offset opportunity for India for the whole or even for us only.
- Sudhakar Gande** No, \$75 billion is an opportunity for defense companies, OEMs into Indian market in the next 10 years.
- Girish Gulati** Okay, for us it is only \$100 million no?
- Sudhakar Gande** Yes, so out of that technically 30% is offset for everybody including me, that is close to \$22.5 billion.
- Girish Gulati** But we would not be present in all that \$75 billion?
- Sudhakar Gande** Yes, that's why I am saying we are looking at \$100 million maybe in the next few years.
- Girish Gulati** And sir I was reading about the merger, and first of all sir the merger has been excellent sir, very value positive for the shareholders, more value should be created for the shareholders. I was reading about that in FY12 ACATL had a sales of Rs. 50 crore and eventually it jumped to Rs. 200 crore, the next year and it was flattish the last year. Any particular reason for that or is it the nature of the defense industry?
- Sudhakar Gande** See, what happens in these businesses, the contract sizes are big when you win, for example if you try for four deals, deals will be earn you into \$50-60 million. So first is, you have to run those contracts along with the foreign OEMs, when the foreign OEM wins the contract let us say then I will win my contract. So if you look at Rs. 50 crores growing to Rs. 200 crore, what happened is that Rs. 50 crore was the normal business we were doing and one of the big wins we succeeded which normally what happens it gets implemented over a period of five to six years, so that kind of growth continues for five years.
- Girish Gulati** Any particular order sir we have for ACATL business as of now or have we received any new orders?
- Sudhakar Gande** No, right now we are in a stage where there is a good possibility, but I cannot share too much of information, but I will only say yes we are on the right track, we made some very strong bids with the global OEMs.
- Girish Gulati** Yes, because I see the opportunity being very large for that company because I am a regular visitor at your stall whenever the defense expo happens, one of largest stalls we see in the defense expos which is AXISCADES. So thank you sir, I think thank you for the merger, I think it has been amazing, it was my duty to say thank you.
- Moderator** Thank you. Our next question is from the line of Lakshmi Narayanan from Catamaran. Please go ahead.
- Lakshmi Narayanan** Just in the previous question you mentioned regarding the lumpiness of the orders or how the orders come in, so if you can just help me understand your consolidated business and see how much is in for annuity business base and how much is on a

product base one where customer is actually trying to implement something and then after that it may not be recurring revenues. So I see that Siemens is one which is recurring ODC, so broad number on how are you thinking about it, what is the current scenario?

Sudhakar Gande See, basically if you look at our combined entity business, one will be Engineering Services which includes all Airbus, Siemens etc, this is almost like an annuity business because it will keep on growing year-on-year for a fairly long time to come. So one piece of business engineering design services which is the ACETL, the current listed entity.

Lakshmi Narayanan How much it is broadly?

Sudhakar Gande This quarter we have done \$14.5 million.

Lakshmi Narayanan Oh, the same thing, okay fine.

Sudhakar Gande So this piece of business as I said we continue to grow above industry and this will be all like annuity because the amount of business which is being outsourced to India is far less than what it could be over a period of time. So it is like what happened in software industry 20 years back, maybe this industry in the future to come, you can see the NASSCOM report for details. As far as other business is concerned, that is ACATL, the defense and aerospace business, that business depends on contracts but the way we look at it is, if I bid for x number of contracts I expect to win one or two out of that, let's say. So our model is eventual over a period of time, we will have enough pipeline so that we will make this also in our annuity business of sort of, it will take a little time because remember one thing, even recent guidelines government has announced, I do not whether you have been tracking or not, very good for our company, they have announced engineering services is an offset business now, unlike in the past, not the software, engineering services is an offset; that is one. Secondly, when you win a project, you win a project with a global OEM, you work with them for 5-6 years because each win, for example, one of the contracts we signed earlier which is under implementation, it is a \$100 million contract we won with a global OEM which will implement about 5-6 years, so you get clear revenue forecast 5-6 year from that contract. And when you do a good job with global OEM which we worked very hard, they will take you as a partner on global basis, that means the same product worldwide and not for India. So the moment you become a partner of a global supply chain that is like an annuity business. That is point number one. Point number two, that means a partner's business can move to annuity the moment we become part of global supply chain which we already are with one of our customers which we worked last five years. But if we are have a series of projects which we are bidding and I can develop a model, over a period of time it also becomes almost like annuity because I will forecast how many wins they will have, and again remember one thing, this is not something which can be replicated by everybody, you cannot have hundreds of companies doing this. At the end of the day whoever is a global OEM, whether is an American or British or European, there are 15, 20 companies who are active in the defense and industrial space and all of them come to India, they will only deal with x number of clients, they do not have too much of choice, they will have some choice, in our line of business they do not have much choice.

Lakshmi Narayanan Sir and the second question on your revenue mix or effort mix, what is the onsite-offshore mix for you in your consolidated entity?

S.Valmeeka Nathan Consolidated entity we will not be able to answer, we will only talk about the listed entity, CFO will answer.

Kaushik Sarkar	So onsite is around 52% and offshore is around 48% for this quarter, it is improving quarter-over-quarter, we are moving more to offshore model.
Lakshmi Narayanan	This is on an effort man hour's basis?
Kaushik Sarkar	It is on billing.
Lakshmi Narayanan	And on an effort basis what was that number?
Kaushik Sarkar	Effort basis it should be around 70% offsite and 30% onsite.
Lakshmi Narayanan	And what is your utilization now sir?
Kaushik Sarkar	Utilization is around 70%, we have hired a lot of people that's why it has gone down a little bit, but overall we are targeting around 75% utilization going forward.
Moderator	Thank you. Our next question is from the line of Anirban Shah from Pisquare investments. Please go ahead.
Anirban Shah	There is a land bank you have near Hyderabad or Bangalore airport if I am not wrong, so what are the future plans for that? Are you developing any center or something over there?
Sudhakar Gande	See, we have land next to international airport, which is part of the Aerospace park in Bangalore, and our idea is to build this facility into a global facility for one of the OEMs or couple of OEMs, so we are currently negotiating and in discussion. Of course this will take a little time but at the same model the first guys are most difficult to get, the moment we get the first guy the rest will follow, if we are on a job we hire some consultant to work on this, but yes that's our idea.
Anirban Shah	Sir, my next question is on the revenue breakup, can you give me your revenue breakup on your design, system integration, and manufacturing side, how has it come up?
Sudhakar Gande	Right now everything is engineering and design services because information of only listed entity is being shared. When the merger account gets complete we will give all the data for the combined entity.
Anirban Shah	So right now if you talk about engineering and design, everything is into design, there is no system integration or manufacturing from that?
Sudhakar Gande	No, not in this company, when the merger gets effective, yes.
Anirban Shah	The last question is on the renewable energy, Siemens, you have worked on the wind energy project, now any further projects you are looking forward in next two years on a renewable energy any other company?
Sudhakar Gande	See, we just started with Siemens now, 50 people, and as I said our aim is to go to 300 to 500 people in three to five years. Once we do this right, it throws two opportunities, I do not know how much you know about Siemens Wind Power, Siemens Wind Power is a \$5 billion business, one of the biggest manufacturers in the world, we deal with them. They came to our facility, they did several round of discussions, checks before signing with us, they are also very happy with what we have done with Airbus then they signed off. But once we do this right with them they throw two opportunities for us, one is, Siemens as a company because from wind

power I can go to Siemens electrical, Siemens biomedical, electronic, etc. Second thing is, it will throw other clients in energy sector, so now we have to work maybe six months or one year properly then we start marketing other sectors, that is the reason we hired these two very-very important additions, one guy based in US and one guys based in Europe, one guys is strong backed in American markets, with experience of 15-17 years, other guys is extremely strong in European markets. So these are the guys who can link up to those companies far better than we sitting here, that is the idea of hiring these two gentlemen to push aggressively the sales.

Anirban Shah

My question was actually on the energy sector, if you see looking for wind energy, are you coming into any other segment like if you say oil and gas or something you are providing automation on that side, some sort of design that you do it for...

Sudhakar Gande

The wind power is of course part of the engineering, could be a part of their product development and maintenance as well. As per business plan we continue to explore all verticals which could leverage our current expertise and whatever we have done, so long as there is no anti-competition or no conflict with existing customer, we will question all opportunities. So oil and gas certainly is in our radar and power generation is also in our radar, just we will build up our credentials and go to market and create value, that is always there. Obviously, getting to any vertical means how do we scale in the vertical, we will start with one and then we will scale up.

Anirban Shah

And then last question is on the stage-wise your revenue, like if there is a specific deal that happens like for example it happened with Siemens, how do we recognize the revenue, if there is a \$200 million deal and it is a five year deal so 20-20-20 that...?

Sudhakar Gande

It would not work like that with Siemens, etc., what happens is they will give you specific work, they allocate resources and complete the work, or they give you a specific project, we will price the project and put our resources to implement it.

Anirban Shah

So it is a project wise revenue, small-small sub-projects are given to you and accordingly the revenue is being generated and recognized?

Sudhakar Gande

Yes absolutely, it is project and milestone based.

Moderator

Thank you. Our next question is from the line of Amar Maurya from Indianivesh. Please go ahead.

Amar Maurya

Sir just wanted to understand more about this global supply chain, when we talk about the global supply chain are we saying that the piece which we did with Thales similarly we can also take this to some global players and we can be a part of a global supply chain rather than the offset player?

Sudhakar Gande

No, I will tell you. See two things happen here, for example in our own case we developed a very complicated test bench it involves electrics, electronics and mechanical. We worked with 18 Indian suppliers to build that, but this was built as part of India program, that means offset for a global OEM for India project. But once the global OEM is satisfied with our capability and ability to deliver high quality products he will take me to his global supply chain because he will be for example, he may have touched benches of \$100 million as a part of this program. But annually, he may buy \$0.5 billion or \$1 billion test benches worldwide, so he will recognize it as a part of global supply chain and certify me that you can bid for our projects. So then we will bid for a Boeing contract test bench out of France. So the important point what I am saying is, the India deal what you do maybe small, it could be maybe \$100 million, but this will take you to global supply chain which has two characteristics, one, it is far bigger, it could be \$1 billion every year and it can be on a continuous

basis, every year they keep buying those global supply chain. So you get access to that, afterwards how you win, how you price is all up to you and the reason we hired this gentleman in France is going to help us because when I do it for client A or client B he will go and talk. So this will give us two opportunities, one, partner of global supply chain for the same OEM, second, I can go to other OEM saying that, I had been on test bench for this can I do for you, even they look at us. So this throws two great opportunities.

Amar Maurya

So sir this is one example, other than that would we also be a part of manufacturing also, like outsourced manufacturing like what we had built the whole ecosystem in India?

Sudhakar Gande

See, it is too early to comment on this thing, but I can only tell you there is huge opportunity because there is a lot of manufacturing side, mid-size companies which are not able to grow up to be in line with global supply chain, global standards of OEMs. See, what we learnt in this one specific example is, we worked with 18 suppliers, these 18 suppliers together had a manpower of more than 1,000 people which is far ahead than my team in the business and they are far more experienced than us.

Amar Maurya

But they are far more smaller than you.

Sudhakar Gande

Yes, all of them are, everybody 100 people, Rs. 10-20 crore turnover, they cannot scale up because they are scared. And the guys in global OEMs, he is not bothered, if you are ready he will take you, or if you have a roadmap readymade he will take you. So people like us will exactly fill the gap because then I become the system integrator, so I will get all these guys work under me. As far as the global OEM is concerned they only deal with me. Of course, they will look at each one of them before signing with me because we made a point to be on the right side, I do not mind, even this is fine with us. Finally at the end of the day legally I am liable for him and all these guys are subcontractors to me. And once I do this I can tell you one thing today, 9 large global OEM will quickly get that model, there is an opportunity in this space.

Amar Maurya

So sir is this only possible in the defense piece or is it possible also on other verticals?

Sudhakar Gande

What do you mean other verticals?

Amar Maurya

Like for example, Caterpillar has some defense offering, so that I clearly understand that there is a lesser number of competitiveness amongst local vendors and you have that edge and you have created that edge, but when talking about test bench for say Mercedes Benz, I think there is a huge competition into that, right?

Sudhakar Gande

Yes, correct. See what happens through this, first is, the civilian side of business is lot less complicated, lot less regulated, on any civilian business what I do must be civilian. When I do for Airbus commercial it is civil, when I do for Airbus military it is defense. Fundamentally issue is, one, anything to do with defense etc is highly regulated, highly complicated, highly secretive, entry to barrier is very-very high. Because just for example, we are one of the few companies certified by Government of India, Ministry of Defense with a license for manufacturing and system integration and all that, we will have all kind of people built in that facility, we will have the Army coming one day and say I want to check this, one day some IB guys will come saying that we want to see your facility. So at the end of the day the entry barrier is high, it not what everybody can do.

Amar Maurya So basically what we are trying to say here is that our area would be mostly focused on the regulated side of the business even in the global supply chain?

Sudhakar Gande Yes, mostly global OEMs and defense.

Amar Maurya But then the opportunity is even this space also is very huge and it can certainly change the overall DNA of the company if these things happen.

Sudhakar Gande See, next 10 years this opportunity is very huge because 10-15 years the Government of India is going to place so many orders for defense, I do not know what will happen after 15 years, but 10 years is good enough for any company to plan its future. One point I want to leave with you also is, in these defense contracts actually it is a perpetuity business, sometime when you develop a product and give it to them you have to maintain for next 15 years, some places 17 years, some places three years for which they have to give you AMC, annual maintenance contract.

Amar Maurya Okay, so that is our additional business.

Sudhakar Gande But once you get in it is very difficult for them to get it out, you can get it out on your own, it is mutually beneficial for both, have to work together that's why they would like to deal, once they deal with customer A they will prefer to deal with same customer, both OEM point of view or even India defense point of view. Today it will be hard to be one of those few names acceptable to people.

Amar Maurya So sir, do you see this is easy to replicate for a company like you who is already having such experience into this business?

Sudhakar Gande Replicate what?

Amar Maurya Like already we are almost prepared for this whole opportunity and like other than Thales are we seeing some dialogues are going on with some global OEMs like existing client base where we are pitching for them the global supply chain?

Sudhakar Gande There are a lot of good things happening but I cannot give any names at this point of time.

Amar Maurya But then the things are on, dialogues are on, right?

Sudhakar Gande Of course, we are also looking at few of the global supply chain companies also based on our past experience. And the only thing I can tell you is there is a lot of interest by global OEMs in companies like ours.

Amar Maurya Yes, because it is a unique offering and I believe it would be one amongst kind of offering in India primarily from the Indian counterpart point of view.

Sudhakar Gande Yes, only thing I can tell you, I feel sometimes sad with my management team with the number of foreign visitors keep coming here, see right now this call is going on and we have some guys from Japanese Aerospace industry something has come in, tomorrow somebody comes in from helicopters. So it is both good and bad, good because people just leave and go have look at that, so the number of foreign visitors is increasing is a good sign.

Moderator Thank you. Our next question is from the line of Bharat J who is an investor. Please go ahead.

Bharat J Sir I have just few questions, the first question is, what kind of EBITDA margin you expect to see in coming quarters? And what is the CAPEX of our next two years? Can you please give me the detail client wise business or outstanding of top five clients individually? And what is the business investment with Siemens Wind Power, what is the value in the business you see?

Sudhakar Gande See, most of these questions I already answered, but just to repeat, that our EBITDA currently is around 14.5-15%. We will continue to grow the margin and our aim is, as I mentioned that industry average is about 18%, our aim is to reach that in next two to three years as far as EBITDA is concerned. As far as the client specific information like Siemens contract value etc, I cannot share at this point of time.

Bharat J Sir what is the CAPEX for the next two years?

Sudhakar Gande CAPEX will not be very significant, but in any case that will be financed by internal accruals, so we would not be diluting anything for CAPEX.

Kaushik Sarkar See, most of our CAPEX our hardware, software and some licenses and all facilities are well geared to take additional around 30% load, so I do not see a lot of investment and whatever we need to do can be from an internal accruals and cash what we have.

Bharat J And sir what is the business investment with Siemens Wind Power and what is the value of the business you see?

Sudhakar Gande I cannot share that information, it is client-specific information. We only mention that we start with 50 people, our aim is to have between 300-500 people in next three to five years.

Bharat J And sir would you like to address dividend to shareholders?

Sudhakar Gande We will address the issue when the Board meets on this.

Moderator Thank you. Ladies and Gentlemen, that was the last question. I now hand over the conference over to the management for their closing comments.

Sudhakar Gande I would like to thank all the analysts who came to this conference call. And as I said this is our first earnings call, so in every call we will try to improve and we welcome you in all our meetings and also whenever you happen to be in Bangalore please do visit us and thanks for all the support and guidance. Thank you.

Moderator Thank you very much members of the management. Ladies and Gentlemen, on behalf of AXISCADES Engineering Technologies that concludes this conference call. Thank you for joining us and you may now disconnect your lines.