



AXISCADES Engineering Technologies Limited Q2 FY 2017 Earnings Conference Call Transcript November 15, 2016

Moderator

Ladies and gentlemen, good day and welcome AXISCADES Engineering Technologies Q2 FY 2017 Earnings Conference Call. 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 the conference call, please signal an operator by pressing “*” then “0” on your touchtone telephone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Varun Divadkar from CDR, India. Thank you and over to you, Mr. Divadkar.

Varun Divadkar

Thank you. Good afternoon, everyone and thank you for joining us on AXISCADES Engineering Technologies Q2 FY 2017 Earnings Conference Call.

We have with us today Mr. Sudhakar Gande -- the Vice Chairman; Mr. Valmeeka Nathan -- the CEO; and Mr. Kaushik Sarkar -- the CFO.

Before we begin, I would like to state that some statements made in today's discussion maybe forward looking in nature and may involve certain risks and uncertainties. A detailed statement in this regard is available on the Q2 FY 2017 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 invite Mr. Sudhakar 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 Presentation shared earlier, which provide details of our operational and financial performance.

The High Court order for merger of AXISCADES Aerospace and Technologies with the listed entity is expected in a week to ten days' time. This merger of two entities will result in a deeper technology platform leveraging on processes, R&D, talent, partnership, and customer relationships.

The initiatives taken in embedded during the last two quarters have started yielding results. The coming quarters we expect to see good traction. We continue to invest in acquiring high-end technical capabilities to address the forthcoming requirements in aerospace, defence, in emerging areas like cyber security, etc. Additionally, we are also expanding servicing offerings which will enable us to be of more relevance to our customers in making the product better and in their digital journey.



The revenue in Q2 was impacted moving to developments at a key customer. However, we see signs of performance uptick the coming quarter. As and when turnaround of the company happens, we are best position to capital around the situation.

Further, our robust balance sheet provides flexibility to scout for inorganic growth opportunities. We are constantly evaluating various transactions in area of like medical devices, embedded electronics, high technology, product lifecycle management, which will help us move the value chain. We will definitely update when we come closer to the anything concrete.

To conclude, we are focused on creating strong domain expertise and in expanding our scope of services so, that we remain in right area of client spending, all our efforts are on building predicable and sustainable growth, and generating long-term shareholder investment. This is a huge opportunity and we want to be well positioned to capitalize on that.

With this, I would like to hand over to our CEO -- Mr. Valmeeka Nathan, who will take you through some of the key business development during the quarter.

Valmeeka Nathan

Thanks, Mr. Gande. Good afternoon, everybody. Let me begin by providing some of the key developments during the quarter. Even in this demanding business environment, we see significant traction in expanding sales pipeline in both U.S. and European geographies. As we leverage our investment in sales and technical leadership. As we increase our breath of dialog with our prospects and customers across these geographies, we are convinced that sustained growth in this rapidly evolving business must include differentiation. We will continue this through investment in organic and inorganic components building and acquiring product expertise.

In our aerospace business, we have started executing two new projects; one for a new geography to our existing customer and other in rotary wing business of this customer.

We added five new customers during Q2 FY17 of which two are renowned names in India and three are in the North American geography.

Early evidence of the outcomes reinforces our confidence that our deliberate efforts will deliver growth faster than the industry. We will continue to be focused on business model innovation and increasing the share of higher value offerings contributing to profitable growth.

With that, I now hand over to our CFO -- Mr. Kaushik Sarkar who will take you financial performance of the quarter.

Kaushik Sarkar

Thank you, Val. Good afternoon, everybody. I will like to take you through the financial performance for the quarter ending 30th September, 2016.

Starting with slide 6, which captures our performance for Q2 FY17, total income stood at Rs. 937 million, down by 5.6% QoQ and 2.2% YoY. EBITDA for Q2 FY17 stood at Rs. 80 million as compared to Rs. 100 million in Q1 FY17 and Rs. 139 million in Q2 FY16. We have minimized impact of revenue loss on EBITDA through operational efficiencies. Profit after tax stood at Rs. 34 million.

To quickly summarize the performance of H1 FY17 as can be seen on slide 7, net revenue was up 6.1% YoY to Rs. 1,929 million. EBITDA stood at Rs. 180 million as compared to Rs. 268 million in H1 FY16. Profit after tax stood at Rs. 80 million as compared to Rs. 135 million in H1 FY16.

Moving to the key ratios on slide 8, gross margin stood at 30.3% compared to 31.4% in Q1 FY17 and 34.5% in Q2 FY16. Our EBITDA margins were at 8.5%, down around 160 bps QoQ mainly due to lower revenue. EBITDA margins were down 600 bps YoY mainly due to lower revenue and higher project consultancy costs. As explained earlier, in previous conference calls, we continue to make investment to widen our solution offering and acquire domain expertise which will enable us to grow faster than the market going forward. These costs will be non-recurring in nature and have started to taper off and eventually enable the company to transition to an offshore model over a period of time. We have used this model successfully in the past and are confident of its benefits in the medium-term to long-term. EPS for Q2 FY17 stood at Rs. 1.26 as compared to Rs. 1.69 in Q1 FY17 and Rs. 2.68 in Q2 FY16.

Let me now move to slide 9, which provides a snapshot of our balance sheet. The balance sheet continues to remain robust with a cash balance of Rs. 302 million at the end of the quarter.

Slide 10, provides an update on the various industry segments which we are present, aerospace our largest segment contributed to around 52.4% of our revenue in Q2 FY17. Heavy Engineering accounted for 36.5% of our revenue as compared to 37.4% in Q1 FY17.

To conclude, our sustained investment in people and acquiring new competencies along with our strong customer connect and relationships will enable us to drive above industry growth and expand our margin profile going forward.

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

- Moderator** Thank you. Ladies and gentlemen, we will now begin with the Question-and-Answer Session. We take the first question from the line of Sagar Lele from Motilal Oswal Securities. Please go ahead.
- Sagar Lele** Just wanted to get a sense of the amount of visibility you would have in the heavy engineering customer which resulted in the decline in this quarter. Have they started improving there already or do you see that taking some more time?
- Sudhakar Gande** Yes, the specific customer actually, the work is more or less over because they reorganized the company and the signals we are getting is very clearly that from next quarter onwards there will be traction. So, as far as we are concerned, I think the customer is only improving in the coming quarters.
- Sagar Lele** All right, and could you highlight the situation in the other top customers are you seeing any issues there or all of them are pretty much stable?
- Sudhakar Gande** We do not see any issue in any of the top customers.
- Sagar Lele** All right, perfect. And also on the operating margins you have seen that a decline that is probably in tandem with the revenue decline. But could you talk a little about what kind of levers you have going forward, if you could highlight what your utilization

levels probably are at the moment which they would be affected by the decline that you have seen, just some color in terms of how you expect the margins going forward?

Kaushik Sarkar

See, our blended utilization is around 72%, on site and off shore, it has come down by 2.5% to 3% because we have built capacity and some of the projects were delayed. Now to answer your second part of the question, we have a lot of levers role ratios, utilization, third is utilization the facilities more by shifts, how to re-deploy the licensees more by increasing the number shift. As of today, we still have a capacity of around 20% to grow without investment in the facilities so, over a period of time we are confident that the cost will go down. You are already seeing the decrease in the project consultancy cost around 19% QoQ so, while we insourced a lot of services, we are on the job to drive operational efficiency.

Sudhakar Gande

Operational efficiency will continue to be focus. Naturally, based on the pipeline that we generate, we also plan our resources to be deployed so, we have to plan in advance. We may have a couple of percent more in anticipation of business that needs to be executed if that business gets delayed by a month or two, we probably will be left with some inventory but that is probably only very short-term, which will get covered in the subsequent quarter. So, we are investing for the future and the group.

Moderator

Thank you. We take the next question from the line of Amish Kanani from JM Financial. Please go ahead.

Amish Kanani

Sir, if you can tell, excluding the client that is in problem, what is your growth on Q-o-Q or a Y-o-Y basis? And this project consultancy cost clearly it is high Y-o-Y but lower on a Q-o-Q basis, if you can give some color how is it panning out? I think the gross margin decline from say 35% last year to closer to 30% this year, how do you see that going forward in the second-half?

Sudhakar Gande

See, the project consultancy primary requires to create some kind of manual systems process in line with top global OEMs, okay, this will help us in the long run for building this business and expand the business and also, by expanding this business I mean other vertical within the company, so it is very essential for us and this will put us ahead of a lot of other companies who they are working with. So, this will be continued for some time but the returns are far higher in the coming days.

Amish Kanani

So, is it the investment in the new vertical or new business development or it is an investment in the current project which we cannot do onshore or offshore?

Sudhakar Gande

It is an investment in technical capabilities to implement current project which will also help you to get more projects in the same line of business, there are more verticals in the same company, in a way it multiplies the business opportunity.

Valmeekanathan

So, to clarify that it all reflects on the relationship with the customer, some of the customers are open to working with us in the area that we have not touched before or we do not have the confidence before, so, we leverage our partnership ecosystem and supported by our customer to get into new areas and eventually once we build up competencies in delivering, we will probably have inherent capability, internal capability and we can reduce the cost of that. So, this is an opportunity for us to leverage the existing relationship and getting into new areas, new competencies, new programs that we have not delivered and the past, this actually is a reinforcement of the richer relationship and the client confidence with us.

Kaushik Sarkar

See, as mentioned in my opening remarks that it has gone down quarter-over-quarter, right we have started in-sourcing as we build the competency in-house. So,

over a period of time what we told earlier also, it will go down and it is going down that is reflected in the numbers.

- Amish Kanani** Sure. And sir, excluding the clients that is in trouble what is the growth and/or de-growth for the quarter on a Q-o-Q and a Y-o-Y basis sir?
- Sudhakar Gande** There is a marginal growth in the quarter if you take the client out but as I said, clearly, even for that particular client the worst is over and our expectation in the coming quarters it will only on the higher side.
- Kaushik Sarkar** See, if we take that out there is a 4% or 5% growth quarter-over-quarter to answer your question specifically.
- Amish Kanani** Okay. And Y-o-Y also it will be decent quarter that we can...
- Kaushik Sarkar** We have not calculated it.
- Amish Kanani** Okay. And sir, can you also tell us the directionally where the company is heading, margins, whether there is attraction there or there is a kind of stability and/or what kind of aligned business trends if you can just tell us something?
- Sudhakar Gande** Yes, sure. As mentioned in the presentation, we are expecting the merger to complete the final process in a week to 10 days' timeframe. Everything has to tied-up when the merger is completed, okay that is point number one. And point number two, the company which is getting merged into this company there is a good traction on that company at this point of time, I cannot share more information but definitely, we are planning a detailed Analyst Meet post-merger to delve into complete details of the company and how beneficial it will be but just to give a simple example, both of these companies together worked on one important project for one of the top names in the world in the aerospace sector. Top five names will be there and they were very impressed with the combined capability and they have given a small order for us but that can get the multi-fold increase in the coming days, okay that is one. We are already working on synergies between both these companies, okay. So, we will share a lot more information when we have a Meet.
- Moderator** Thank you. Next question is from the line of Veeral Bansali, an Individual Investor. Please go ahead.
- Veeral Bansali** Recently, we had an announcement on the exchanges that the promoter company has pledged some of our holdings around 6% any reason for this, sir?
- Sudhakar Gande** See, this is a question which will be answered by promoter companies. To best of our knowledge it is a part of their ongoing financing thing they should have done this.
- Veeral Bansali** So, this is basically not for our company requirements?
- Sudhakar Gande** No.
- Moderator** Thank you. We have the next question from the line of Gumere Radak, an Individual Investor. Please go ahead.
- Gumere Radak** My question is as far as your business is concerned, what sort of competitive advantages are you working on right now as far as strengthening them is concerned in order to word of competition, while trying to acquire new customers in the future.

Valmeeka Nathan

This is what I mentioned briefly in my speech, differentiation is the key and based on our various client conversations it is coming across that they are being driven by the digital enterprise initiative within the organization and engineering is no different from that initiative. But it is a very different business. Most of the digital enterprise initiatives are peripheral to the core of product engineering. So, we are contributing to the core of the business and any initiative in that space is what we are aligned to. So, some of the areas that we build of course in the embedded electronics, industrial automation is something that we are exploring, early stages, product lifecycle management, knowledge based engineering, engineering analytics, so, these are some of the few that we are currently exploring but there is a long laundry list of what things we need to build up, this is fundamentally to make sure our customers are a lot more driven by the digital needs in their market space and making their products a lot more intelligent than it has been in the past.

Moderator

Thank you. We have a follow-up question from the line of Veeral Bansali. Please go ahead.

Veeral Bansali

Sir, we have guided earlier also in the investor conference that we will be growing higher than the industry rate. Now judging from the first six months we have managed to clock around Rs. 180 crore of top-line whereas last year it was around Rs. 375 crore so, if we go by the same standards we may actually be seeing degrowth in the for the full year or do we expect further growth in the next coming two quarters like December and the March quarter?

Sudhakar Gande

See, to grow beyond industry level is the target, we are all working on that target and I am sure we will be reaching the target. Specifically, quarter-wise I will not able to answer because specific number I cannot share with you; but when we have Investors Meet we will able to address both the company's merged entity how it looks like and good information will share with you. The other company, AXISCADES Aerospace and Technologies is in the final stages of three large deals as part of offset of global OEM. Almost last four to five years we have worked according to that, they are in final stages, okay and we are forerunner in three specific projects and when the OEMs wins the projects, all these OEMs are multi-billion dollar companies, they are not less than \$10-15 billion kind of companies, and we are there the principal or one of the key offset partners. So, each of these sizes are anywhere between US\$ 75-100 million each, so, we are pretty confident that we should win one of these in this year itself, this is the agenda for the company in the future. So, some of these information is interesting and we will share with you in the Meet and a lot of focus on this and one of the specific projects where we have ecosystem of 18 Indian companies working with us, they are all working for last 10-20 years in various lines of business. But all of them worked as international Tier-I or Tier-II to deliver this product and what we have planned. So, that is an interesting development which we will share with you in detail.

Veeral Bansali

So, will this business be like partnership agreement for few years or something that comes on a regular basis?

Sudhakar Gande

Let me just explain how it works, okay, let us say there is a contract of US\$ 1 billion for buying a plane or a trailer aircraft or mainly whatever our Indian defense requires, okay. The OEM sign it off under law 30% with an offset partner, that means 30% will be with an Indian company, we come in that category of 30%. So, there is a lot of evaluation before picking up and this is where we are either a principal partner or one of the important partners for them. So, when they get the contracts of US\$ 1 billion or whatever is signed, I will get the contract, okay. So, job signed are delivered and documented, that means, the day he wins the contract I automatically get it, no further discussion. So, we are fairly in advance stage of one of the contract which we expect before December to happen but this is a capability not many companies

can acquire. This needs a lot of understanding a lot of people work. In one particular project I am very proud to say we have more than 50 technical specialists from various defense organizations like HAL, DRDO and all worked with us. it is simple that kind of team has worked and this is a very long drawn process, we have spent almost 4-4.5 years on this. Actually, global OEM is very-very happy. They wanted to work with us and best part what happens here is once we do an India project for them, they know our systems and we know their system and a similar product they can give it to some other client worldwide, the moment there is a product A for Indian business so, that product can be given worldwide, so that is the advantage of global supply chain then it is business for a very long-term.

Veeral Bansali

Okay. So, then we have a long-term relationship with them?

Sudhakar Gande

Let us taken an example of we get a \$50 million offset contract, we implement in five years, I am just giving an explanation, so, that with every year I deliver \$10 million, okay next five years I am covered fully. Now for this global OEM, India is only part of their business, the moment I convinced them, I can do the work at an optimal cost and with the good deliverables, parameters, etc., they will take me as a part of global supply chain that means they do analysis for five years, okay, product X can be bought from AXISCADES, okay. So, I am eligible to bid anywhere in the world in that system. We have one particular instance with global OEM, we worked on India program, now we became part of global supply chain to sometime, this is of course small, if you may have \$4-5 million work as part of the global supply chain. But I know the moment we go ahead in one or two years it is like \$10 million for a very long time because it is very difficult to get in and also it is very difficult to get out. So, we will all be working on, for this you need a lot of people to work with you, a lot of technical expertise, you need to put money, financial transaction, you need to hire advisors, technical experts, not only in India but in abroad, in one of the global supply chains I have had to hire a guy who worked for a global OEM for 25 years to help me how to put this whole thing together, we have come a long way, both in short-term and long-term.

Veeral Bansali

Yes, thank you. And my next question is regarding the company that is going to be merged into our company AXISCADES Aerospace, are we seeing growth in that company?

Sudhakar Gande

Very difficult answer to answer but I can tell you do not ask me quarter wise and this and that.

Veeral Bansali

No, not quarter wise I am talking about FY 2016, for FY 2016.

Sudhakar Gande

No, I do not know about specific years but I can tell you that there will be significant growth.

Veeral Bansali

Will it be higher than the listed entity or slightly?

Sudhakar Gande

All these specific questions I cannot answer.

Moderator

Thank you. Since, that was the last question. I now hand the conference over to the management for their closing comments. Over to you, sir!

Varun Divadkar

Yes, I would like to thank all of you again for the participation support, we look forward to interacting with you soon. Thank you very much.

Moderator

Thank you. On behalf of AXISCADES Engineering Technologies, that concludes this conference. Thank you for joining us and you may now disconnect your lines.