

Recommendation	Subscribe
Price Band	Rs 197 – 207
Bidding Date	31 st Oct – 02 nd Nov
Book Running Lead Manager	Axis Capital, Edelweiss Financial, Saffron Capital
Registrar	Link Intime
Sector	Defence

Minimum Retail Application- Detail At Cut off Price

Number of Shares	72
Minimum Application Money	Rs 14904
Discount to retail	0
Payment Mode	ASBA

Consolidated Financials (Rs Cr)	FY21	FY22
Total Income	641	1102
EBITDA	10	84
Adj PAT	30	66

Valuations(FY22)	Upper Band
Market Cap (Rs Cr)	2002
Adj EPS	6.7
PE	30.8
EV/ EBITDA	20.6
Enterprise Value (Rs Cr)	1725

Post Issue Shareholding Pattern

Promoters	73.6%
Public	26.4%

Offer structure for different categories

QIB (Including Mutual Fund)	75%
Non-Institutional	15%
Retail	10%
Post Issue Equity (Rs. in cr)	19.34
Issue Size (Rs in cr)	500
Face Value (Rs)	2

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BACKGROUND

DCX Systems Ltd (DCX) is among the leading Indian players for the manufacture of electronic sub-systems and cable harnesses in terms of manufacturing capability in the defence and aerospace sector. With commencement of operations in 2011, DCX Systems is primarily engaged in system integration and manufacturing a comprehensive array of cables and wire harness assemblies and are also involved in kitting.

Objects and Details of the Issue:

The public issue consists of fresh Issue of Equity shares aggregating upto ₹ 400 Cr and Offer for sale of Equity Shares aggregating upto ₹ 100 Cr. The company proposes to utilise the Net Proceeds of the Fresh Issue towards funding the following objects: Repayment/ prepayment, in full or part, of certain borrowings; funding working capital requirements; Investment in their wholly owned Subsidiary, Raneal Advanced Systems Private Limited, to fund its capital expenditure expenses.

Investment Rationale:

- Preferred Indian Offset Partner for the defence and aerospace industry
- Technology enabled and scalable end-to-end capabilities
- Business model with visibility of cash flows and ability to mitigate operational and technology risk
- Strategically located in aerospace SEZ with an advanced and modern manufacturing facility
- Strong Financials
- Strong, experienced and dedicated senior management team

Valuation and Recommendation:-

DCX is a proxy play on growth in defense expenditure in India via the offset route. DCX has demonstrated its scalability and execution by growing at 57% CAGR over FY20-22 and has scaled revenue of Rs. 1102 Cr in FY22. Core profitability for DCX in terms of ROCE is similar to listed peers while its historical growth has been higher. With an order book of Rs. 2564 Cr (2.3x FY22 revenue) executable over FY23-25, we expect DCX's strong growth trajectory to continue. We believe DCX is being offered at reasonable valuations at 30.8x FY22 earnings considering peer valuations and future growth opportunities in the defense industry. **We recommend subscribing to the issue.**

Financials (Rs Cr)	FY20	FY21	FY22
Net Revenues	449	641	1102
Growth	50%	43%	72%
EBITDA	31	10	84
EBITDA Margins	6.8%	1.6%	7.6%
PBT	13	40	76
Adjusted PAT	10	30	66
EPS	1.0	3.1	6.7
ROCE	14%	27%	14%
EV/Sales	-	-	1.6
EV/EBITDA	-	-	20.6
P/E	-	-	30.8

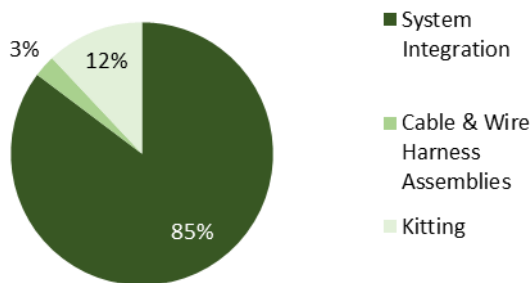
Source: Company data, NBRR

Company Background

DCX Systems Ltd (DCX) is among the leading Indian players for the manufacture of electronic sub-systems and cable harnesses in terms of manufacturing capability in the defence and aerospace sector. With commencement of operations in 2011, DCX Systems is primarily engaged in system integration and manufacturing a comprehensive array of cables and wire harness assemblies and are also involved in kitting. The company is a preferred Indian Offset Partner (IOP) for foreign OEM for executing aerospace and defence manufacturing projects. DCX Systems is also one of the largest IOP for ELTA Systems Ltd and Israel Aerospace Industries Ltd, System Missiles and Space Division (together, the "IAI Group"), Israel, for the Indian defence market for manufacture of electronic sub-systems and cable and wire harness assemblies.

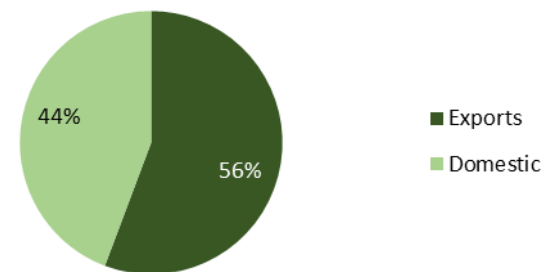
The growing Indian landscape for defence and aerospace serves as a key opportunity for DCX Systems. The Indian aerospace and defence sector is poised to attain a value of \$70 billion by 2030. Recent initiatives like increase in foreign direct investment ("FDI") in the Indian defence sector from the current 49% to 74% under the automatic route is anticipated to be a key driver and growth opportunity for the market. The Defence Research and Development Organization ("DRDO") has announced the indigenous development of roughly 108 systems and sub-systems which is expected to generate demand for cables and connectors across the Indian defence environment. The Indian government has also banned approximately 101 items within the defence-based imports segment and have also introduced the 3rd positive indigenization list that bans the import of 780 LRU/components. These initiatives are expected to boost indigenous manufacturing within India. The instating of defence industry corridors across Uttar Pradesh and Tamil Nadu is also poised to improve the market growth dynamics by broadening the opportunities offered to the private sector. All of these in turn, serve as an opportunity for the company to capitalize on the expected growth in this space.

Revenue Mix (FY22: Rs. 1102 Cr)



Source: NSK

Revenue Mix (FY22: Rs. 1102 Cr)

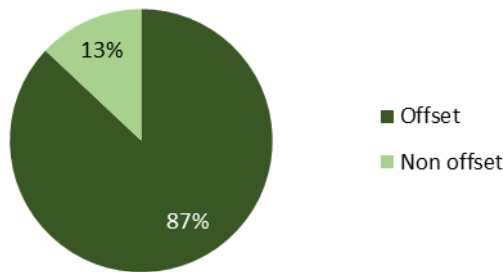


Source: Company

Company's competitive advantages include their efficiency in operations resulting in timely delivery to their customers, maintaining quality control and product security. This has enabled them to develop long-term and entrenched relationships with their OEM customers that has resulted in growth in their operations and sizeable order book. Given the nature of their operations and industry that they operate in, projects have long lead times and, as such, visibility and predictability of their revenues is high. Company's order book has increased from ₹ 1,941.31 Cr, as of March 31, 2020 to ₹ 2,369 Cr, as of March 31, 2022. As of June 30, 2022, the order book was ₹ 2,563.63 Cr to be executed in the FY23 to FY25.

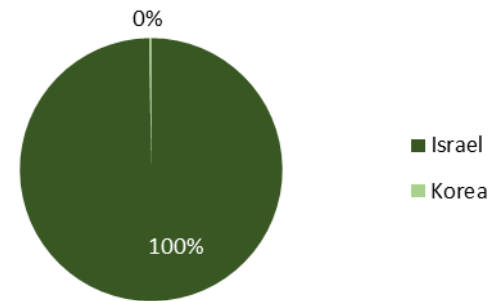
As of June 30, 2022, they had 26 customers in Israel, United States, Korea and India, including certain Fortune 500 companies, multinational corporations and start-ups. Their customers include domestic and international OEMs, and private companies and public sector undertakings in India across different sectors, ranging from defence and aerospace to space ventures and railways.

Offset/Non offset Mix (FY22: Rs. 1102 Cr)



Source: NSK

Exports Mix (FY22: Rs. 612 Cr)

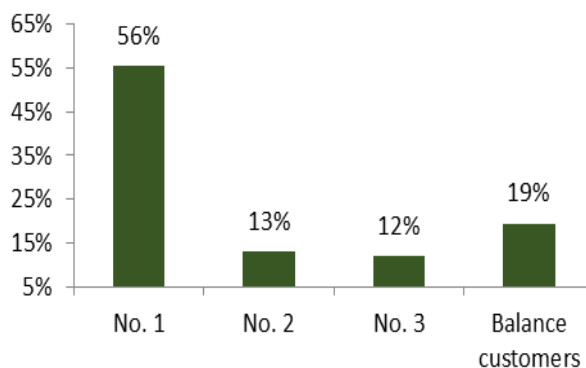


Source: Company

The company operates through their manufacturing facility located at the Hi-Tech Defence and Aerospace Park SEZ in Bengaluru, Karnataka. Their facility is spread over an area of 30,000 square feet and is set up for complete in-house environmental and electrical testing and wire processing.

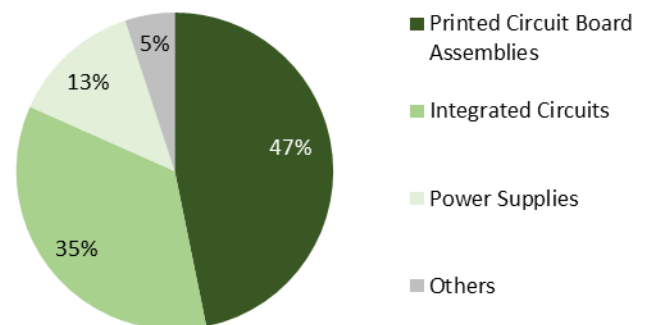
DCX Systems's primary raw materials are electronic assemblies and sub-systems such as printed circuit board assemblies, power supplies, radio frequency cables and wires, radio frequency connectors, circular connectors, integrated circuits and mechanical enclosures. Their electronic components either procured locally from or are imported from the suppliers approved by their customers. Due to the nature of defence and aerospace business vertical, a certificate of conformance for all the components used in their products is required. They also maintain records with information on batch name and other information to allow defect investigation and rectification. All metal parts are manufactured and supplied by suppliers approved by their customers based on their designs.

Customer concentration risk



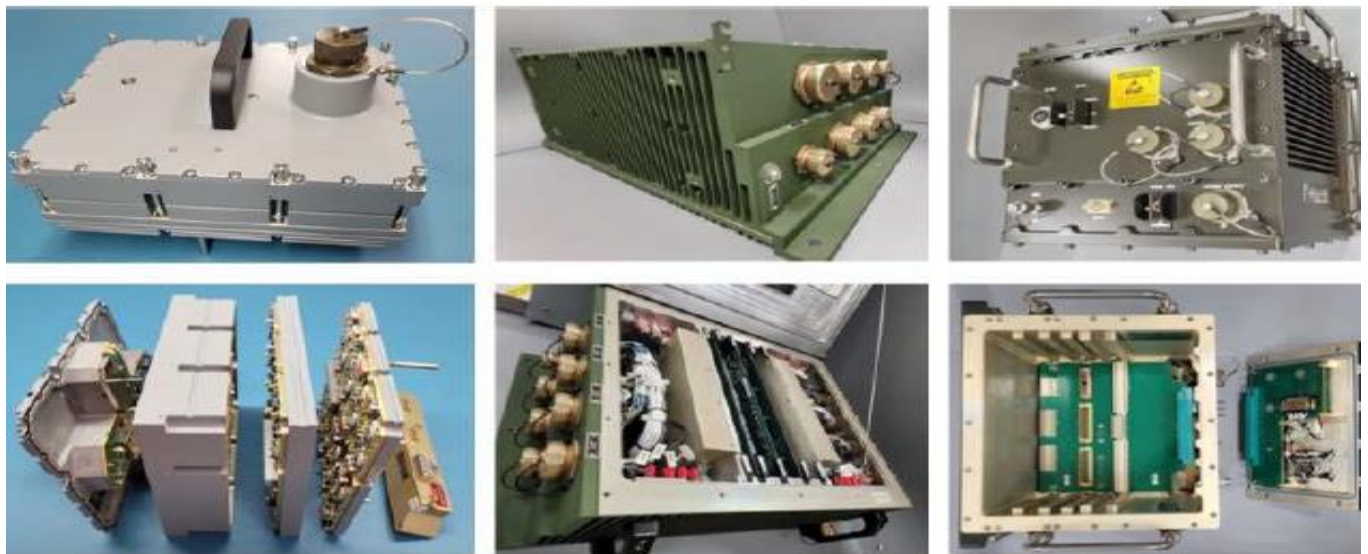
Source: RHP

Raw Material Mix



System Integration: DCX Systems undertake system integration in areas of radar systems, sensors, electronic warfare, missiles, and communication systems. The company provides product assembly and system integration services to address customers' requirements. System integration services are part of a comprehensive array of electronics and electro-mechanical assembly and enclosure assembly. Their purchasing, logistics, inventory control and production engineering groups work together, supported by engineering expertise in both electrical and mechanical assembly. As part of the system integration services, DCX also does in-house testing, including vibration and environmental stress testing of complex radio frequency products to ensure the quality of final products to be shipped to their customers, and reliability of their products' functioning under varying environmental conditions.

Company Products



Source: RHP

Cable and Wire Harness Assemblies: DCX Systems manufactures a comprehensive array of cables and wire harnesses assemblies such as radio frequency cables, co-axial, mixed signal, power, and data cables for a variety of uses including communication systems, sensors, surveillance systems, missile systems, military armoured vehicles, and other electronic warfare systems for the aerospace and defence industries as per their customers' requirements. **Fine cables** are light weight, high temperature resistant, radiations resistance, low smoke and zero halogen and strong. Fine wire cable assemblies are extensively used in robotic, aerospace, marine, space and medical applications to obtain high performance. Designed for board-to-board interconnections, **flexible flat cable** is a type of cable that is flat in shape and flexible enough to manoeuvre within tight spaces. Flex cable applications are usually used in small and tight spaces. **Electromagnetic Interference Shielded Cable Harness** are designed to meet electromagnetic pulses, electromagnetic compatibility, nuclear, biological and chemical and telecommunications electronics material protected from emanating spurious transmissions or TEMPEST solutions, and their shielded solutions have been used in certain commercial airliner landing gear systems, secure communication systems and others. **Electrical conduits** surround electrical wiring to protect from impact, moisture and chemical vapours. A conduit simplifies a wiring installation by providing an unobstructed path for the wiring to run through. The company produces high reliability backplane assemblies, and **wired enclosures** for the defence and aerospace and industrial market. They specialize in complete turnkey custom electronic wired enclosures, sub-racks, system cabinets, and subsystem chassis.

Kitting: DCX Systems supply assembly ready kits of electronic and electro-mechanical parts and undertake all aspects of procurement including sourcing components from suppliers approved by their customer along with a 'Certificate of Compliance' for traceability, controlled storage of moisture sensitive devices to ensure that customers receive complete, assembly-ready kits when required when they are needed for production.

Investment Rationale

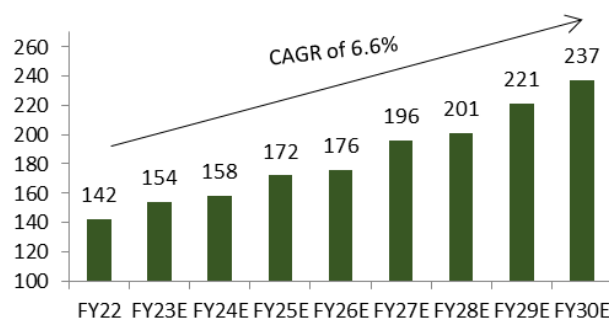
Preferred Indian Offset Partner for the defence and aerospace industry with global accreditations

DCX Systems is a preferred Indian Offset Partners (IOP) for foreign OEMs for executing defence manufacturing projects. They undertake “build-to-print” system integration and manufacture cable and wire harness assemblies for both domestic and international OEMs. They are also one of the largest IOP for the IAI Group, Israel, for the Indian defence market for manufacture of electronic sub-systems and cable and wire harness assemblies.

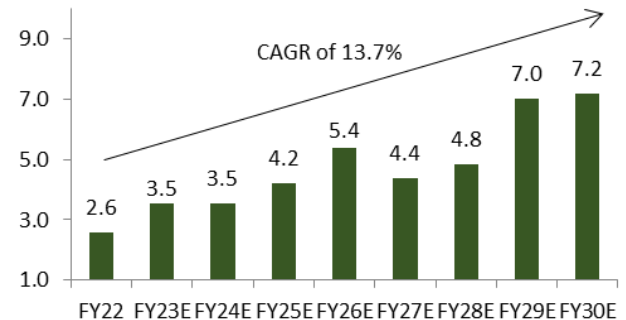
As part of their system integration services, their strength includes the manufacturing of complex microwave modules and sub-systems such as transmit receiver modules, receiver subsystems, and antennas used in military applications, space technology and aerospace. They are also engaged in manufacturing a comprehensive array of cables and wire harnesses assemblies such as radio frequency co-axial, mixed signal, power, data and communication cables for a variety of uses including communication systems, sensors, surveillance systems, missile systems, military armoured vehicle, and other electronic warfare systems.

DCX has invested strategically in processes- and physical infrastructure - to develop its manufacturing facility and has become a leading player in the cable and wiring - harness domain in aerospace and defence sectors. Around 56% of the revenues for FY22 were from Israeli based customers and about 44% are from the domestic market. Private players like DCX play an important role in meeting the offset obligations and helping the goals set by the Government of India with reference to be a US\$ 5 billion export country by 2025. In 2022 DCX exported \$76 million worth of equipment accounting for 4.7% of the overall defence exports from India.

Global Defence Electronics Market (USD Bn)



Indian Defence Electronics Market (USD Bn)



Source: RHP

Technology enabled and scalable end-to-end capabilities

As part of their system integration services, DCX Systems also do in-house testing to ensure the quality of their final products, and reliability of their products’ functioning under varying environmental conditions. They also specialise in manufacturing assemblies that are used in applications for land, underwater and airborne use. They also manufacture test cables, large mechanical jigs and fixtures, and testing programs to meet desired requirements of customer in testing and qualifying the product. In addition, their products are also subjected to various quality assurance tests.

The company provides 12 months warranty to their customers for their system integration and cable and wire harness services. They have supplied over 10,000 units in the last 3 Fiscals and in the 3 months ended June 30, 2022 and have to date not incurred any warranty claims.

Business model with visibility of cash flows and ability to mitigate operational and technology risk

Company's manufacturing activity is obsolescence-proof as the technology coupled with intellectual property rights, both vest with their OEM customers. Further, their in-house team monitors the obsolescence factor and provides feedback to their OEM customers for suitable action including drop-in replacements.

Their product portfolio backed by their system integration and manufacturing capabilities has led to their order book growing from 45 orders aggregating ₹ 1,941.31 crore, as of March 31, 2020 to 48 orders aggregating ₹ 2,369 crore, as of March 31, 2022. As of June 30, 2022, their order book comprised 42 orders and was ₹ 2,563.63 crore with orders from several customers for projects to be executed in Fiscal 2023 and Fiscal 2025.

Company's customers typically reimburse them for costs incurred to maintain all buyer furnished equipment to use in manufacturing and qualifying the products in serviceable condition. As of June 30, 2022, DCX held ₹93.24 crore worth of equipment provided to them by their customers, and such equipment can be used for similar projects, subject to approval from such customers. Suppliers of their raw materials for a particular project are approved and determined by their customers prior to commencement of the project. The company and their customer jointly monitor and ensure the quality of items. Their customers also provide technical training to their employees to ensure efficient project execution.

Strategically located in aerospace SEZ with an advanced and modern manufacturing facility

In 2020, DCX Systems commissioned their new manufacturing facility at the Hi-Tech Defence and Aerospace Park SEZ in Bengaluru, Karnataka. Their facility is spread over an area of 30,000 square feet and is located in the same city as their key domestic customers which ensures shorter delivery times. The facility is secured by digital security cameras coupled with alarm systems with restricted access control for individual manufacturing divisions. Their facility is situated within a SEZ that offers them duty free imports, exemption from GST and supplies that are zero rated under extant regulations. Being situated in an SEZ ensures that they are also not subject to levies imposed by the state government and their operations are eligible for single-window clearance by the relevant authority.

Company's facility is equipped with advanced machinery and equipment including laser wire maker, automatic wire cutting and stripping machine, coaxial stripping machine, crimp tools, controlled torque tools, vacuum pump and desiccator, tinned welding machine and temperature controlled soldering station. Their facility is set up for complete in-house environmental and electrical testing and contains the latest inspection and testing equipment. Their manufacturing line and equipment meets the standards prescribed by the Institute for Printed Circuit ("IPC").

Strong and consistent financial performance

DCX has significantly been working on improving its financial profile with debt-equity ratio improving from 7.8x in FY20 to 4.27x in FY22. Top-line and bottom-line have grown at a CAGR of 57% and 157% respectively over FY20-22 despite the impact of covid. ROE is at a healthy level of 56% in FY22. DCX Systems is a free cash flow generating company. The strong financial performance reflects the efficacy of the manufacturing and supply-chain management protocols implemented, while steady operating cash flows enables them to meet the present and future needs of their customers and develop new value-added products.

Strong, experienced and dedicated senior management team and qualified workforce

DCX Systems possesses a qualified senior management team with considerable industry experience. Their Promoter, Chairman and Managing Director, Dr. H.S. Raghavendra Rao, is an industry veteran with over 2 decades of experience in electronic manufacturing and in the defence and aerospace sectors. Their Non-Independent and Non-executive Director, Neal Jeremy Castleman, has been involved in the electronics industry since 1997 and possesses extensive electronics manufacturing experience. Their Key Managerial Personnel team includes a combination of management executives who bring in significant business expertise including in the areas of finance and accounts, supply chain management, logistics, production, quality, and human resources, which positions them well to capitalize on the current and future growth opportunities.

Concerns

High dependence on offset defence contracts.

The company derived 87% of revenue from offset defense contracts in FY22 and expects to continue to derive most of the revenue from work performed under such offset contracts. Any changes in the government policy in connection with offset defence contracts could have an adverse impact.

High dependence on top 3 clients

The company derived 85.7% of revenue from top 3 clients in FY22. Loss of sales to any of them due to loss of contracts, loss of market share of these clients, adverse change in financial condition of such customers, including due to possible bankruptcy or other financial hardships could have an adverse impact on the business of DCX Systems.

Forex volatility could result in losses

Based on the geographical presence and business operations worldwide, DCX primarily deals in USD. While DCX partly hedges foreign currency risk, it may still suffer losses in the event of a sharp depreciation in INR against USD. DCX System's net foreign exchange (loss) for FY22/21/20 was Rs. 16.88 Cr/ 0 Cr / Rs. 24.30 Cr.

Valuation and Recommendation

DCX is a proxy play on growth in defense expenditure in India via the offset route. DCX has demonstrated its scalability and execution by growing at 57% CAGR over FY20-22 and has scaled revenue of Rs. 1102 Cr in FY22. As bulk of the business involves system integration (85% mix) which is relatively an asset light activity, it has lower margins and higher asset turns than other listed defense companies which are mainly into manufacturing. Core profitability for DCX in terms of ROCE is similar to listed peers while its historical growth has been higher. With an order book of Rs. 2564 Cr (2.3x FY22 revenue) executable over FY23-25, we expect DCX's strong growth trajectory to continue.

We believe DCX is being offered at reasonable valuations at 30.8x FY22 earnings considering peer valuations and future growth opportunities in the defense industry. **We recommend subscribing to the issue.**

Listed Private Defence Players

FY22 Figures	BEL	Astra Micro	Centum Elec.	Paras Defence	Data Patterns	Average	DCX
Revenue	15,368	750	780	183	311	3,478	1,102
CAGR (FY20-22)	9%	27%	-6%	12%	41%	16%	57%
Order Book / Revenue	3.6	2.2	1.4	1.6	1.5	2.1	2.3
EBITDA Margin	21.8%	11.6%	9.0%	28.4%	45.4%	17.7%	7.6%
Asset Turns (x)	1.2	1.1	1.5	0.4	0.5	1.0	1.8
Wkg Cap Days	-11	197	97	351	402	207	137
Pretax CFO/EBITDA (FY2C)	148%	52%	128%	29%	57%	83%	174%
ROCE	26%	11%	5%	11%	24%	15%	14%
ROE	20%	6%	NA	10%	16%	13%	56%
Debt/Equity	0.0	0.1	1.6	0.1	0.0	0.4	4.3
EV/EBITDA	20.7	38.4	14.5	47.8	48.5	34.0	20.6
P/E	31.9	70.9	NA	93.7	74.5	67.7	30.8

Source: Company, NBRR

Financials

P&L (Rs. Cr)	FY19	FY20	FY21	FY22
Net Revenue	300	449	641	1102
% Growth		50%	43%	72%
Raw Materials	280	408	618	1001
% of Revenues	93.5%	90.8%	96.5%	90.8%
Employee Cost	5	6	5	9
% of Revenues	1.7%	1.2%	0.9%	0.8%
Other expenses	4	5	7	9
% of Revenues	1.3%	1.2%	1.1%	0.8%
EBITDA	11	31	10	84
EBITDA Margin	3.5%	6.8%	1.6%	7.6%
Depreciation	1	1	2	2
Other Income	9	16	22	22
Interest	6	8	10	11
Forex gain/(loss)	(6)	(24)	20	(17)
PBT	7	13	40	76
Tax	3	3	10	10
Tax rate	37%	24%	26%	13%
Adj. PAT (norm. Tax)	5	10	30	66
% Growth		113%	203%	122%
EPS (Post Issue)	0.5	1.0	3.0	6.7

Ratios & Others	FY19	FY20	FY21	FY22
Debt / Equity	14.6	7.8	2.9	4.3
EBITDA Margin (%)	3.5%	6.8%	1.6%	7.6%
PAT Margin (%)	1.5%	2.2%	4.6%	6.0%
ROE (%)	62%	57%	63%	56%
ROCE (%)	11%	14%	27%	14%

Turnover Ratios	FY19	FY20	FY21	FY22
Debtors Days	122	71	7	23
Inventory Days	8	63	115	9
Creditor Days	90	122	74	43
Asset Turnover (x)	0.6	0.6	0.8	1.2

Valuation Ratios	FY19	FY20	FY21	FY22
Price/Earnings (x)				30.8
EV/EBITDA (x)				20.6
EV/Sales (x)				1.6
Price/BV (x)				17.2

Source: Company Data, NBRR

Balance Sheet (Rs. Cr)	FY19	FY20	FY21	FY22
Share Capital	4	4	4	15
Reserve & Surplus	4	14	43	102
Networth	7	17	47	118
Total Loans	109	134	136	503
Other non-curr liab.	2	1	1	1
Trade payable	74	151	130	97
Other Current Liab	297	396	479	225
Total Equity & Liab.	489	699	793	943
Fixed Assets & CWIP	3	13	12	11
Right-of-use-asset & Oth	5	4	4	4
Other Tax Assets	0	0	1	4
Inventories	6	77	202	27
Other non Curr. assets	0	1	0	0
Cash	87	56	86	188
Bank	172	360	463	612
Debtors	100	88	12	69
Other Current assets	114	99	13	27
Total Assets	489	699	793	943

Cash Flow (Rs. Cr)	FY19	FY20	FY21	FY22
EBITDA	11	31	10	84
Provisions & Others	(7)	(26)	15	(21)
Op. profit before WC	3	5	25	63
Change in WC	119	129	93	(184)
Less: Tax	(1)	(4)	(3)	(13)
CF from operations	121	130	114	(134)
Addition to assets	(3)	(10)	(1)	(1)
(Purchase)/Sale of invst.	0	4	0	
Int & Div Received	9	15	22	22
CF from Investing	7	8	21	21
Proceeds from issue of Shares		(0)		5
Proceeds	43			
Long term borrowings	(0)	25	2	366
Int & Div Paid	(4)	(5)	(5)	(7)
CF from Financing	38	19	(2)	364
Net Change in cash	166	157	133	251
Cash & Bank at beginning	93	259	417	549
Cash & Bank at end	259	417	549	800

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