

31 October 2022

DCX Systems – SUBSCRIBE

Investment Thesis

DCX Systems Ltd. (DCX Systems) is coming out with an initial public offering (IPO) on October 31, 2022. The issue comprises of fresh issue of equity shares worth Rs.4,000mn and offer for sale of equity shares worth Rs.1,000mn. The IPO proceeds will be utilized for pre-payment of debt, funding working capital requirements and capital expenditure for its wholly owned subsidiary, Raneal Advanced Systems Pvt. Ltd.

DCX Systems, a manufacturer of electronic sub-systems and cable harnesses, have been a preferred Indian Offset Partner (IOP) for foreign original equipment manufacturers (OEMs) for executing defence manufacturing projects. It operates through its manufacturing facility with complete in-house electrical testing and wire processing, located at the Hi-Tech Defence and Aerospace Park SEZ in Bengaluru. It has developed a relationship with 26 customers in Israel, United States, Korea and India, including certain Fortune 500 companies. As part of system integration services, DCX Systems has built the capability to manufacture complex microwave modules and sub-systems such as transmit receiver modules, receiver subsystems, and antennas used in military applications, space technology and aerospace. It also manufactures cables & wire harnesses assemblies for a variety of uses including communication systems, sensors, surveillance systems, missile systems, military armoured vehicle, etc.

Manufacturing activity of DCX Systems is obsolescence-proof as the technology is associated with intellectual property rights which are vested with its OEM customers. Further, its in-house team monitors the obsolescence factor and provides feedback to its OEM customers for suitable action including drop-in replacements. DCX Systems' product portfolio backed by its system integration and manufacturing capabilities has led to its order book growing from 45 orders aggregating Rs.19,413mn as of FY20 to 48 orders aggregating Rs.23,690mn by the end of FY22. As of June 30, 2022, its order book comprised 42 orders and was Rs.25,636mn to be executed in FY23-25E.

Revenue from business Verticals

- During the past 3 years, revenue of DCX Systems grew at a CAGR of 54.3% while PAT became a grew at CAGR of 142.8% in same period.

Consol. (Rs.Mn.)	FY20	FY21	FY22	FY23E	FY24E
Revenue	4,493	6,412	11,023	12,676	14,578
EBITDA	62	101	670	770	886
% growth	92.6	62.1	564.7	15.0	15.0
PAT	97	296	656	755	868
EPS (Rs.) #	1.0	3.1	6.8	7.8	9.0
P/E (x) *#	205.5	67.7	30.5	26.5	23.1
RoE (%) #	29.5%	47.2%	54.0%	57.3%	60.7%

* At highest price band # Post listing

IPO Details

Issue Open Date	31 October 2022
Issue Close Date	2 November 2022
Price Band (Rs.)	Rs. 197 – Rs. 207
Issue Size (Rs in Cr)	Rs. 5,000 Mn
Issue Size (Shares)*	24,154,589
Market Lot	72 Shares
Listing Exchanges	BSE and NSE
Face Value (Rs.)	Rs. 2/-

* At highest price band

Key Details

Fresh Issue	Rs. 4,000 Mn
Offer for Sales	Rs. 1,000 Mn
Issue Type	Book Building
Book Running Lead Manager	Axis Capital, Edelweiss Financial Services and Saffron Capital Advisors
Issue structure	QIB: 75% Non Institutional: 15% Retail: 10%
Credit of Shares to Demat Account	10 November 2022
Issue Listing Date	11 November 2022

* At highest price band

Key Business Highlights

- DCX Systems is a leading player for the manufacture of electronic sub-systems and cable harnesses for the defence and aerospace sector. It is primarily engaged in system integration and manufacturing a comprehensive array of cables and wire harness assemblies and are also involved in kitting.
- DCX Systems have been a preferred Indian Offset Partner (IOP) for foreign OEMs for executing defence manufacturing projects.
- DCX Systems is one of the largest IOP for IAI Group, Israel for the Indian defence market for manufacture of electronic sub-systems and cable and wire harness assemblies.

Valuation

- To expand within existing verticals, DCX Systems intend to collaborate with OEMs in Israel and the US that possess high-end technologies in areas such as radars, electronic warfare, missile systems, sensors and communication systems. It is also focusing on defence electronics and associated integration opportunities in India particularly in advanced intelligence, surveillance, reconnaissance solutions and radar systems. Several Indian combat aircraft continue to use passive radar solutions. Moving from passive to active radar solutions will provide opportunities for the manufacture, assembly and integration of electronic radar modules and related cabling which DCX Systems intends to capitalize on. It also intends to expand its existing cable and wire harness assembly operations to cater to global customers in telecom, medical, power, industrial and automotive sectors.
- DCX Systems is diversifying into adjacent industry verticals like EMS and maintenance, repair and overhaul (MRO) services. It planned to focus on the products identified in the positive indigenization list by the Ministry of Defence, which will provide opportunities to obtain transfer of technology. Transfer of technology is poised to be one of the key factors which is anticipated to drive the market for the hardware components vertical. Connectors and cables are also used across various turnkey & subsystems assembly, so increasing technology transfer contracts is poised to boost demand. Manufacturing companies in India such as DCX Systems is expected to gain opportunities to explore international markets through this.
- DCX Systems' customers typically reimburse for costs incurred to maintain all buyer furnished equipment to use in manufacturing and qualifying the products in serviceable condition. Suppliers of raw materials for a particular project are approved and determined by DCX Systems' customers prior to commencement of the project and DCX Systems along with its customer jointly monitor and ensure the quality of items. Its customers also provide technical training to its employees to ensure efficient project execution.
- With a preferred IOP for foreign OEMs for defence manufacturing projects, obsolescence-proof manufacturing activity, focus on defence electronics and associated integration and diversifying into adjacent industry verticals like EMS & MRO services, we are recommending **SUBSCRIBE** rating to the IPO of DCX Systems Ltd. for medium to long term perspective.

Risk & Concern

- DCX Systems is highly dependent on top-3 customers and generated over 85% of revenue in FY22, any loss of these major customers will adversely affect the business.
- Any major change in defence policy may adversely affect the future growth potential of DCX Systems going ahead.
- DCX Systems generates major revenue in dollar terms, any negative fluctuation in dollar rate may have negative impact on margins.

Graphs & Charts

Figure 1: Net Sales Trend

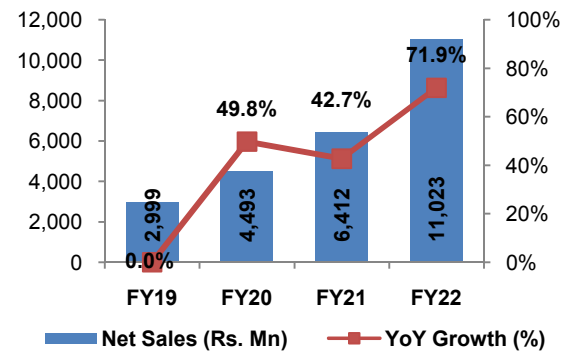


Figure 2: EBITDA & EBITDA Margin Trend

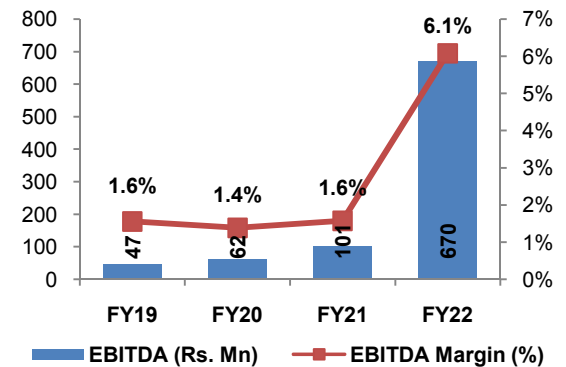


Figure 3: PAT & PAT Margins

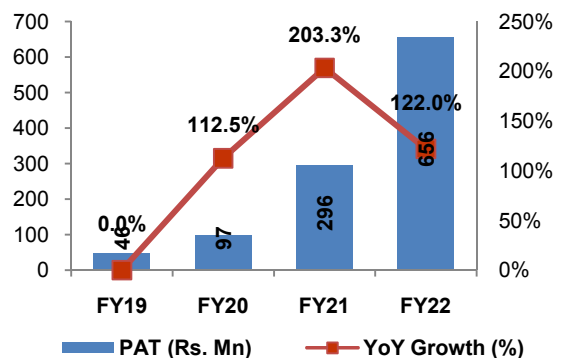
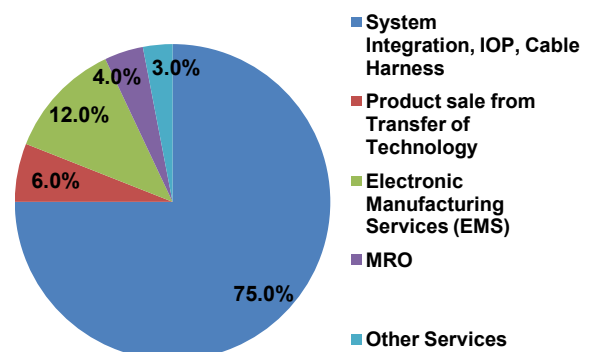


Figure 4: Segmental Revenue (FY22)



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