

Margins remain lower on high offset contracts...

About the Company: DCX Systems (DCX) is among the leading Indian players for manufacturing electronic sub-systems and cable harnesses in terms of manufacturing capability.

- The company is primarily engaged in system integration and manufacturing a comprehensive array of cables and wire harness assemblies and is also involved in kitting
- DCX commenced its operations in 2011 and has been a preferred Indian offset partner for foreign original equipment manufacturers (OEMs) for executing aerospace and defence manufacturing projects. Revenue from operations has grown at a CAGR of 56.6% in FY20-22

Key triggers/Highlights:

- With defence public sector undertakings focusing on specialisation and integration and sub-component manufacture being outsourced to the private sector, there are significant opportunities for private sector companies like DCX Systems
- DCX is a preferred Indian offset partner for foreign OEMs for executing defence projects. It undertakes system integration & manufacture cable/wire harness assemblies for both domestic & international OEMs
- DCX is one of the largest IOP for the IAI Group, Israel, for the Indian defence market for electronic sub-systems and cable/wire harness assemblies
- DCX has established a leadership position in the Indian aerospace and defence industry amongst other companies, in the segment of "system integration" business

What should investors do? During FY20-22, DCX registered CAGR revenue, EBITDA, PAT growth of 56.6%, 228.3%, 159.5%, respectively. Its order book has increased from ₹ 1941 crore in FY20 to ₹ 2369 crore in FY22. However, considering the low margin on higher exposure towards contract manufacturing through offsets, significant improvement in margins needs to be seen in future. Post issue P/E at 30.5x FY22 EPS looks fair as compared to peers like Data Patterns and Paras Defence.

- We assign a **UNRATED** rating to the IPO

Key risk & concerns

- Dependence on offset defence contracts
- Delay or disruption in the supply of raw materials
- Dependence on the performance of the electronic subsystems
- High level of working capital requirement



IPO Details

Issue Details

Issue Opens	31st Oct 2022
Issue Closes	2nd Nov 2021
Issue Size (₹ crore)*	500
Price Band (₹)	₹ 197 - ₹ 207
No. of Shares on Offer (in crore)	2.42
QIB (%)	75
Retail (%)	10
Face Value (₹)	2
Listing price Market Cap @ Upper Price (₹ Crore)	2002
Minimum lot size (no of shares)	72
* based on upper price band of ₹ 207	

Shareholding pattern

	Pre-Issue	Post-Issue
Promoter Group	98.2	73.6
Public	1.8	26.4

Objects of the issue

Objects of issue	₹ crore
Repayment/Prepayment of certain borrowings	110.0
Funding working capital requirements	160.0
Investment in wholly owned subsidiary (Raneal Advanced Systems)	44.9
General Purposes	*

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Key Financial Summary

₹ crore	FY20*	FY21*	FY22#	Q1FY23	CAGR FY20-22 (%)
Total Revenues	449.3	641.2	1102.3	213.3	56.6%
Adjusted EBITDA	6.2	10.1	67.0	4.9	228.3%
EBITDA Margins (%)	1.4%	1.6%	6.1%	2.3%	
PAT	9.7	29.6	65.6	5.6	159.5%
EPS (₹)	1.4	4.2	9.2	0.7	
P/E (x)	148.9	49.1	22.5		
P/B (x)	12.1	4.4	1.8		
RoE (%)	56.8	63.2	55.8		
P/S	4.5	3.1	1.8		

Source: RHP, ICICI Direct Research * Standalone Financials # Consolidated Financials

Industry Overview

Global defence spending

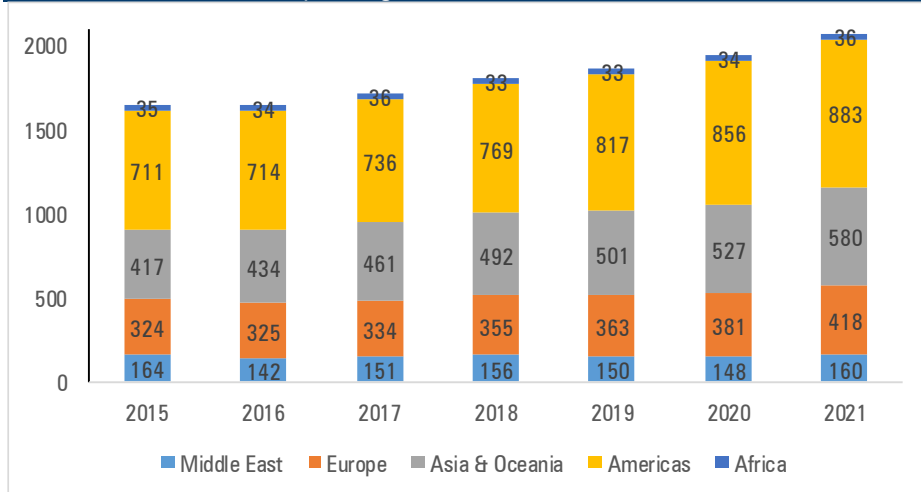
As per industry data from Frost & Sullivan on the global defence industry, the global defence spending has already surpassed US\$2 trillion in 2022. The global defence spending touched US\$2.07 trillion in 2021 as per industry data from SIPRI (Stockholm International Peace Research Institute) and was up 6.7% YoY. After a brief period of declining military spending between 2011 and 2014, global spending has increased for seven consecutive years.

The global defence spending looks set to rise further led by rise in geopolitical tensions such as the ongoing dispute between the US & China, Russia’s invasion of Ukraine, European countries beefing up their armed forces in response to Russia-Ukraine war and India’s tensions with Pakistan & China.

The US, China, India, Russia, and the UK have been the five largest spenders, accounting for 62% of the total global spend. The US reached the highest military spending of US\$800 billion in 2021, which constituted 38.5% of the total military spending worldwide during the year. US military expenditure as percentage of GDP was at 3.5% in 2021. China’s military expenditure accounts for the second-highest position in the world and accounted to US\$293.30 billion in 2021, i.e. 14% of global military spending. India’s military spending ranked third globally in 2021 and was at US\$76.6 billion (up 5% YoY) which was 3.7% of global military spending. This rise is attributed to India’s existing tensions with Pakistan and increasing border tensions with China. In 2021, Russia’s military spending increased by 6.7% to US\$65.9 billion (3.2% of global military spending).

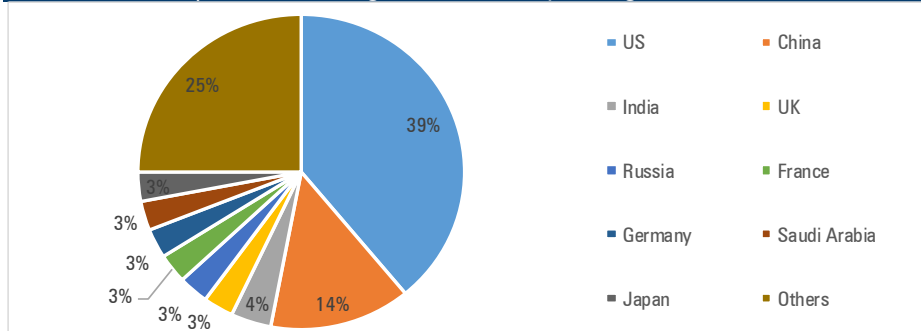
The Americas accounted for 42.5% of world total expenditure in 2021 while Asia and Oceania accounted for 27.9% of total global expenditure. Europe contributed 20% of worldwide military spending during the year, making it the third-largest spender. In the wake of the full-scale invasion of Ukraine, several European governments have pledged a spending overhaul to boost their forces’ capabilities.

Exhibit 1: Global defence spending (2015-21) - US\$ billion



Source: SIPRI, RHP, ICICI Direct Research

Exhibit 2: Country wise share of global defence spending -2021



Source: SIPRI, RHP, ICICI Direct Research

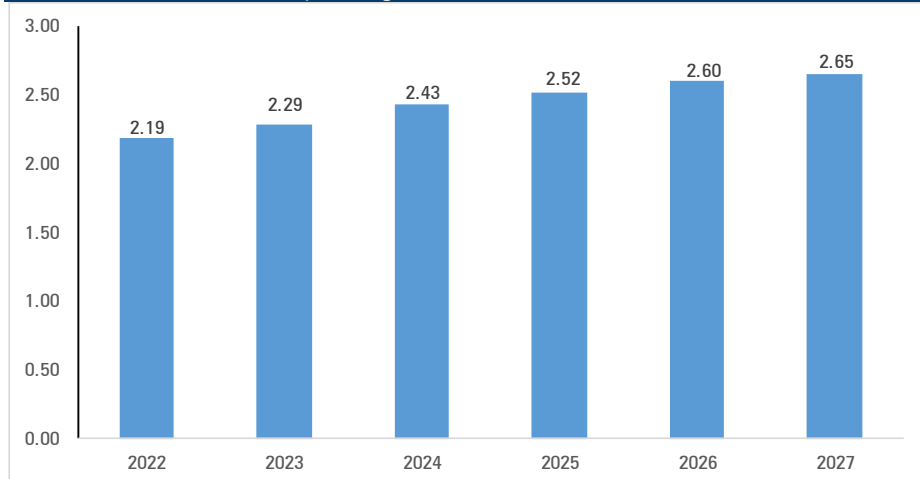
According to Frost & Sullivan, global defence spending is expected to grow at ~4% CAGR over 2022-27. The expected increase is based on a review of global GDP forecasts, as well as the expectation of ongoing political tension for the next two years. Any increase in geopolitical uncertainty on account of rising tensions between the US and China, India and China, India and Pakistan, Russia and Nato, China and Taiwan, Ukraine, Israel and Palestine, is likely to result in significant upsides to the forecast.

The US and China are becoming increasingly competitive. China's increasing military prowess is reshaping the Western Pacific power balance. As a result, the US is fortifying Pacific alliances, the most recent of which is the Australia-UK-US security pact (AUKUS). Russia and Turkey are demonstrating more competence and readiness to project influence abroad as evident from the S-400 deal.

Economic tensions are escalating on account of geopolitical conflicts. During the pandemic, Japan and India implemented protectionist laws. Western corporations in sensitive sectors such as technology are having growing difficulties doing business in China and Russia as well as western countries that are prohibiting investment in vital sectors from geopolitical competitors.

The Russia-Ukraine war is hitting Eastern European countries very severely. The multiple spillover effects are propelling the region to another recession, with risks of instability and insecurity. The European Council granted Ukraine and Moldova candidate status and has also sent Georgia positive signals regarding membership: it should be granted candidate status once a number of priorities have been addressed.

Exhibit 3: Global defence spending forecast (US\$ trillion)



Source: RHP, ICICI Direct Research

Global Defence Industry and its Trends

Modernisation of armed forces: The increase in defence budget has accelerated the modernisation programmes across countries. These are in terms of new equipment and upgradation of older equipment. The global programmes are focussed on increase of air missile defence systems and unmanned platforms in countries where their assets are relatively in the mid-life stage. In countries like India the priority is on modernisation of air assets, which includes fighters and rotary platforms. The Indian defence market has been primarily an import dependent market. However, the increased focus on self-reliance in defence is expected to create more opportunities for the domestic industry in the future.

Technology trends: In future battles, technological superiority will become increasingly important. With the impact of new and developing technologies during the last two decades, particularly in the sectors of electronics, miniaturisation, materials, and computation, warfare has already undergone rapid changes. This has

had a significant impact on the creation of more adaptable systems in a variety of applications, from communications to sensors and guided weaponry.

5G, Quantum Technology and Electronic Warfare are noted to be some of the key technology trends within this market. 5G technology plays a crucial part in the future battle network with the potential to connect millions of transceivers within a given region simultaneously.

Impact of Covid-19 on defence industry: The defence industry is a critical sector that can withstand economic downturns. The geopolitical circumstances, political position, and national strategic plans have a larger effect on defence spending rather than the economy. The impact of Covid on the defence sector was minimal from a defence budgetary perspective. However, the defence manufacturing companies did feel the pressure due to supply chain related issues.

Worst of supply chain, programme disruptions behind: Due to the pandemic-related lockdowns, defence manufacturers experienced early supply chain and delivery delays. For instance, in 2020, due to supply chain interruptions caused by the Covid-19 epidemic, the Ministry of Defence (MoD) had extended the delivery period associated with existing capital acquisition contracts by four months.

Indian defence industry

As stated earlier, India's military spending ranked third globally in 2021 and was at US\$76.6 billion (up 5% YoY), which was 3.7% of global military spending. This rise can be attributed to India's existing tensions with Pakistan and increasing border tensions with China.

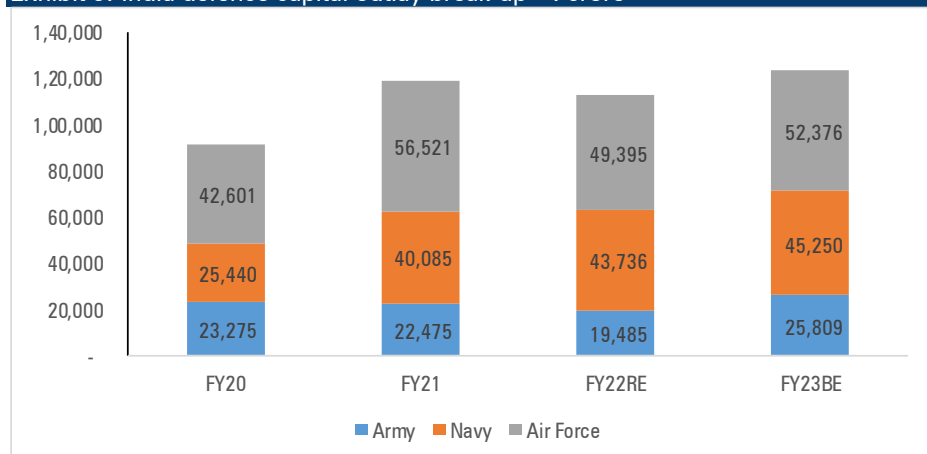
India's defence budget outlay for FY23 was at ₹ 5.25 lakh crore, which is ~10% YoY increase over the budget of ₹ 4.78 lakh crore in FY22. The Indian Defence Budget has grown at ~14% CAGR over FY17-23. The India defence budget has four main components: MoD (Civil), Capital Outlay on Defence Services, Defence Services Revenue and Defence Pensions. Capital expenditure constitutes ~29% of the total defence budget while revenue expenditure and pensions constitutes majority of the budget i.e. ~44% and ~23%, respectively.

Exhibit 4: India defence budget (FY17-23) – ₹ lakh crore



Source: RHP, ICICI Direct Research

Exhibit 5: India defence capital outlay break-up - ₹ crore



Source: RHP, ICICI Direct Research

The Indian defence industry is a mix of public sector undertakings (PSUs), large private players and smaller but niche suppliers. There are roughly 16 public sector undertakings under the administrative control of the Department of Defence Production, MOD.

The DPSUs fuel the growth of private sector players (Tier 2 and Tier 3 companies). While the origin of Indian DPSU was tied to India's ambitions to indigenise production of major defence platforms, the path taken had several drawbacks. DPSUs were driven to cover the entire spectrum of defence manufacturing, including development of platforms and production of all tiers of subsystems and components. This led to inefficiencies within the system and a lack of specialization, due to which India lagged behind on the development of several key "critical technologies" (jet propulsion and naval engines for example), and the development of air and land platforms.

The current political dispensation seeks to address these deficiencies, by containing the focus of DPSUs to platform development, while leaning on several private defence companies to fulfil tier 2 and tier 3 roles. Several DRDO projects such as Design and Development of Integrated Active Circular Antenna, DSP Design for FMCW Radar, Wideband antenna and RF front end for transceiver module, etc., could lead to product production plans with a high involvement of indigenous private companies.

Indian defence electronics market

The Indian market is currently focused on the indigenous development of defence electronics among other segments. The country plans to increase the value add for each step in the integration and manufacturing process for defence equipment. India has a strong IT and software industry. As of 2021, the number of people who are directly employed in the IT-BPM sector was about 4.5 million. The indirect job creation for this market is estimated to be about 12 million. The use of this manpower to increase local development of defence electronics is poised to create additional job opportunities as per the multiplier effect.

In 2019, the Government of India undertook financial initiatives that are likely to benefit offset disability. The government also took initiatives to promote the electronics manufacturing clusters to support the design and manufacturing of electronics manufacturing units.

Modernisation drive in India including major programmes of Indian Army, Navy, Air Force

India has begun a comprehensive military modernisation programme that includes the purchase of new rifles, combat aircraft, ammunition, carbines, and artillery, rotary-wing aircraft, and force multipliers such as electronic warfare suites, network-

centric warfare, and air-defence systems, among others. Military modernisation programmes are poised to account for US\$130 billion in the coming five years.

The Indian Army has lagged in terms of modernisation and numerous projects are planned to be completed in the coming three to seven years. The Abhay Infantry Fighting Vehicle (IFV), Arjun MKIII, and Tata Kestrel are the three key indigenous defence platforms being developed by the Indian Army. At present, the T-72 and the T-90 tanks, both procured from Russia and assembled in India, are the mainstay of the Indian Army. However, a chunk of this arsenal consists largely of T-72 tanks, which have lived their life and are in the process of being upgraded extending their life till 2022. A request for information was sent to 12 Main Battle Tank manufacturers to acquire 1,700 with partly local production to replace the T-72 tank.

For air operations, 36 Rafale fighter jets were recently purchased, with intentions to purchase another 100+ fighter jets under the strategic partnership concept. This is in addition to the 83 indigenous Tejas Mk1 A aircraft that are under production phase. Boeing has recently completed procurement of AH-64 Apache and Chinook helicopters for the IAF and Army. India's new aircraft carrier will be equipped with MiG-29K fighter jets. However, the Indian Navy is already hunting for multi-role naval fighters for INS Vikrant with the navy being interested in procuring a twin-engine aircraft. At present Boeing's F/A-18E/F Super Hornet and Dassault's Rafale-M are being considered.

Indian Air Force (IAF) major Programmes

- Advanced Medium Combat Aircraft (AMCA) – six squadrons planned
- Tejas Mk I A Light Combat Aircraft (LCA) – 83 units
- Medium Multi-Role Combat Aircrafts (Global RFI) -114 units planned
- Tejas Mk2 LCA – six squadrons planned
- Transport aircraft (C-295)
- AEW&C Aircraft

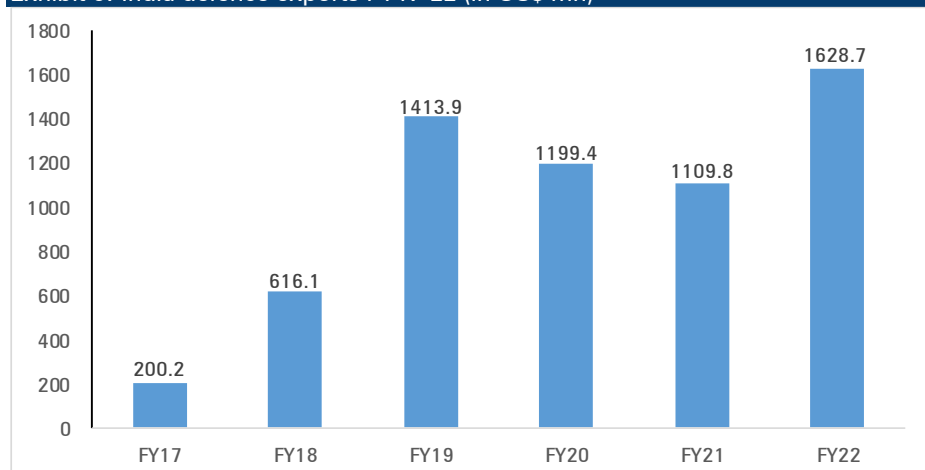
Indian Navy (IN) major Programmes

- Aircraft carrier programme (new indigenous aircraft carrier under planning phase)
- Project 17A frigates
- Project 15B destroyers
- Anti-submarine warfare (ASW) corvettes
- Next generation destroyers, frigates, corvettes
- Landing platform dock
- Shallow water ASW crafts
- Fleet support ships

Defence Exports of India

Due to the relaxation of export limitations and policy changes, Indian defence exports are expected to rise rapidly. This is supported by the expanding capabilities of Indian defence suppliers. In comparison to defence public sector entities, the private sector now dominates Indian defence exports, which is expected to drive income prospects. The Gol has set a target for US\$25.00 billion for defence production by 2025, which includes US\$5 billion in exports. Additionally, the value of India's defence exports in FY20 was US\$1,199.4 million. This moderated to US\$1109.8 million in FY21. A dip in exports for FY21 is largely attributed to manufacturing disruptions and supply chain, which have eased now. In FY22, the defence exports from India touched US\$1628.7 million.

Exhibit 6: India defence exports FY17-22 (in US\$ mn)



Source: RHP, ICICI Direct Research

Export target countries are South Africa, Thailand, Azerbaijan, Singapore, Sweden, Seychelles, Indonesia, Estonia, The Philippines, Guinea, Lebanon, Qatar, Iraq, Uruguay, Ecuador, Japan, Egypt, The US, Finland, Australia, France, Germany, the Netherlands, and Israel. The exports from India to Israel between 2017 and 2021 has grown at 7.6% CAGR.

Defence Offsets

Though India has pursued defence offsets aggressively since enacting an official policy in 2005, previous policies did not focus on technology and R&D capability transfer from foreign to Indian defence businesses. The Defence Acquisition Policy 2020 seeks to address these shortcomings by moving the focus away from “components” and toward “technology investments” as well as “platform export.” The DAP 2020 has extended avenues for extending offsets, providing foreign businesses direct credit for transferring vital technologies to the Indian economy. Though certain essential technologies, like electromagnetic rail guns, and hypersonic flight-related technology were formerly only available to DPSUs and DRDO, the large number of innovations utilised in defence equipment are now available to private entities.

Another significant improvement in India’s offset policy is the abolition of “offset banking,” which allowed foreign corporations to claim credits for undertaking regular business activities in the country. The government has attempted to strike a compromise between the interests of foreign investors in the country by allowing them to permit their vendors to discharge offsets on their behalf. To give the Indian industry greater chances, the baseline indigenous component mandates for Buy (Indian) and Buy (IDDM) categories have been enhanced by 10%. Overall, the new adjustments are aimed at encouraging indigenous firms’ technological advancements while also reserving a larger opportunity share for them in military contracts, hence driving the expansion of India’s defence industry. India signed as many as 21 defence offset contracts worth US\$5.67 billion in 2016-19.

Company Background

DCX Systems (DCX) is among the leading Indian players for the manufacture of electronic sub-systems and cable harnesses in terms of manufacturing capability and revenue in FY22 in the defence and aerospace sector. The company 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 commenced its operations in 2011 and has been a preferred Indian Offset Partner (IOP) for foreign original equipment manufacturers (OEMs) for executing aerospace and defence manufacturing projects. Revenue from operations have grown at a CAGR of 56.64% in FY20-22.

DCX is one of the largest Indian Offset Partner (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.

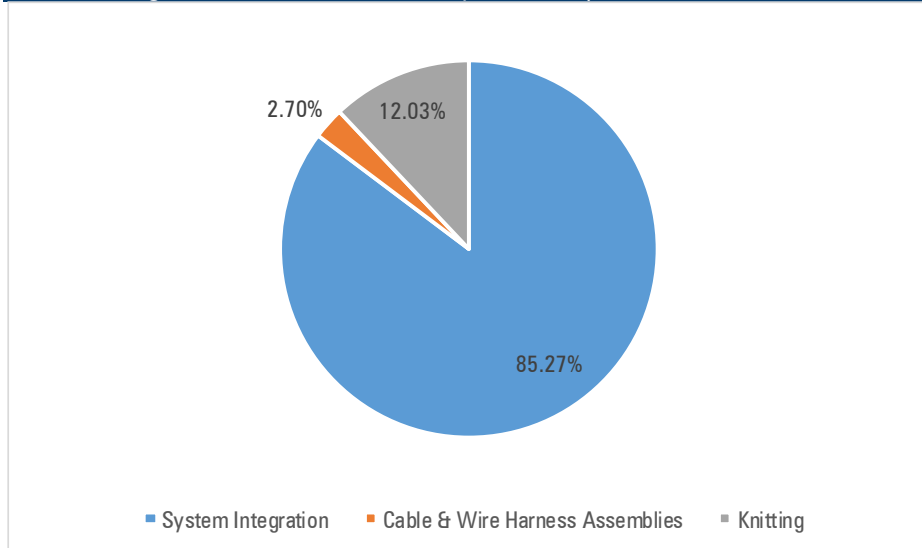
The company's operations can be classified under the following business verticals:

System Integration: The company undertakes system integration in areas of radar systems, sensors, electronic warfare, missiles, and communication systems. It provides product assembly and system integration services of various complexities to address customers' requirements. System integration services are part of a comprehensive array of electronics and electro-mechanical assembly and enclosure assembly. The company also provide product repair support for the parts that it manufactures.

Cable and Wire Harness Assemblies: The company manufacture 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 customers' requirements.

Kitting: The company supplies assembly ready kits of electronic and electro-mechanical parts and undertake all aspects of procurement including sourcing components from suppliers approved by 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.

Exhibit 7: Segment wise revenue break-up of DCX Systems – FY22



Source: RHP, ICICI Direct Research

The company operates through its manufacturing facility at the Hi-Tech Defence and Aerospace Park SEZ in Bengaluru, Karnataka. The 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. Location of the facility is in the same city as certain of its key domestic customers like Bharat Electronics, Alpha Design Technologies Pvt Ltd, Alpha Elsec Defence and Aerospace Systems Pvt Ltd and Centum Adeno India Pvt Ltd.

As of June 30, 2022, the company had 26 customers in Israel, US, Korea and India, including certain Fortune 500 companies, multinational corporations and start-ups. The company's 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.

The company has a mix of domestic and international customers and certain of its key customers include Elta Systems, Israel Aerospace Industries– System Missiles and Space Division, Bharat Electronics, Astra Rafael Comsys Pvt Ltd, Alpha-Elsec Defense and Aerospace Systems Pvt Ltd, Alpha Design Technologies Pvt Ltd, Astra Microwave Products, Kalyani Rafael Advanced Systems Pvt Ltd, SFO Technologies Pvt Ltd and DCX-Chol Enterprises Inc.

Management Profile

DCX Systems is led by experienced promoters and a qualified senior management team with significant experience in the aerospace and defence manufacturing industry. Dr H.S. Raghavendra Rao, individual promoter, Chairman and Managing Director, has over two decades of experience in electronics manufacturing and in the defence and aerospace sectors. Neal Jeremy Castleman, Non-Independent and Non-Executive Director, has vast experience of more than two decades in the field of electronic manufacturing sectors. The other senior management team have demonstrated ability to anticipate and capitalise on changing market trends, manage and grow our operations and leverage and deepen customer relationships.

Investment Rationale

Well-positioned to capitalise on industry tailwinds

There is a strong focus and various initiatives by the Government of India in the aerospace and defence sectors and in particular for private players including micro, small and medium enterprises. India's defence budget outlay for FY23 is ₹ 5,250 billion, the annual budget representing a 10% increase over the budget of ₹ 4,780 billion in FY22.

The Indian defence private sector witnessed substantial growth owing to the implementation of government reforms. In FY22, FY21 and FY20, private players in the Indian defence sector accounted for 70%, 86% and 88%, respectively, of the exports generated. Private players like us 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 FY22, DCX exported US\$76 million worth of equipment accounting for 4.7% of the overall Defence Exports from India. The Defence Acquisition Policy 2020 (DAP 2020) has extended avenues for extending offsets, providing foreign businesses direct credit for transferring vital technologies to the Indian economy. The DAP 2020 ensures that large number of innovations utilised in defence equipment are now available to private entities. With defence public sector undertakings focusing on specialisation and integration and sub-component manufacture being outsourced to the private sector, there are significant opportunities for the private sector.

Exhibit 8: Various initiatives by Government of India

Measure	Description
Positive Indigenisation List	To incentivise domestic production and limit imports, the Defence Ministry has banned the import of 209 defence related equipment and components. Services can only source the listed equipment from Indian vendors. Equipment covered includes segments such as electronic warfare, sensors, radars, unmanned aerial systems, amongst others. The Government has also introduced the 3rd positive indigenisation list that bans the import of 780 LRU items that will go forward have to be procured from the domestic industrial base. This will drive further development of the domestic Indian defence industry. (Source: Company Commissioned F&S Report).
Budget Allocations	68% of capital procurement budget has been earmarked for domestic defence procurement for Fiscal 2022 to 2030. (Source: Company Commissioned F&S Report).
Corporatisation of Ordnance Factory Board ("OFBs")	The government aims to corporatize OFBs in a bid to improve production efficiency and transparency. There are 41 ordnance factories in India, which source components from Tier 2 and Tier 3 suppliers (Source: Company Commissioned F&S Report).
FDI	The FDI limit under the automatic route has been increased from the current 49% to 74%. The increase will encourage foreign manufacturers to invest in India with confidence as they will have a controlling stake in a joint venture (Source: Company Commissioned F&S Report).
Indian Offset – Self Reliant	This measure encompasses design, development, and manufacture as part of its mandate, and encourage OEMs and design firms to form long term partnerships with India's defence sector (Source: Company Commissioned F&S Report).

Source: RHP, ICICI Direct Research

Amongst preferred Indian offset partners for defence & aerospace industry

DCX Systems is a preferred Indian Offset Partner (IOP) for foreign OEMs for executing defence manufacturing projects. It undertakes "build-to-print" system integration and manufacture cable and wire harness assemblies for both domestic and international OEMs. The company is 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.

DCX holds a number of key certifications for quality management systems for aviation, space and defence products manufacturing and Defence Industrial License from the government for the manufacture of defence subsystems that includes microwave components, modules for radar and electronic warfare subsystems, microwave submodules, for command and guidance units for missile subsystems only. DCX adheres to global standards and have obtained various global certifications. The company's global certifications help it to serve its customers' stringent quality specifications and assists in new customer acquisition.

As part of its system integration services, the company's 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. It is 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.

Exhibit 9: Various projects where DCX is involved as of June-22

Product/Description	Vertical	Ofset Value (₹ mn)
MRSAM / LRSAM - Transmit receiver group module	System Integration	14,447
PIDS – Dual transmit receiver module	System Integration	4,020
Air Defence Fire Control Radar - Antenna unit / radar processing unit	System Integration	1,008
High Power Radars - Dual transmitter receiver module	System Integration	518
Thermal Imager Fire Control System	Cable & Wire Harness	178
Long Range Reconnaissance and Observation System	Cable & Wire Harness	91
Thermal Imager Standalone Kit	Cable & Wire Harness	66
Barak-1 and Barak-8 Missile Systems	Cable & Wire Harness	51
Commander Open Architecture Panoramic Sight	Cable & Wire Harness	35

Source: RHP, ICICI Direct Research

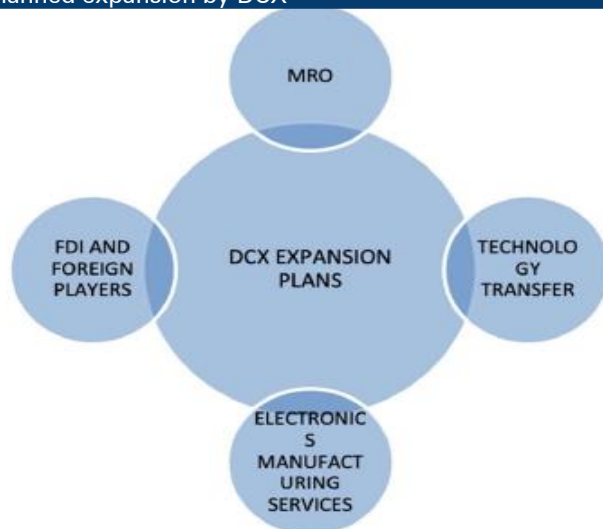
The company has submitted its acceptance to act as the IOP for upcoming projects for several electronic assemblies, automatic missile detection radars, HERON unmanned aerial vehicle systems, Barak systems, medium range maritime reconnaissance aircraft and short range surface to air missile. It has established and refined agile assembly, configuration, and testing processes to maintain its focus on quality products and timing of delivery to its customers.

The company is focussed on providing its customers with quality products that are manufactured to meet their specifications. The value of customer orders has been increasing and increased from an order size of ₹ 1941 crore in FY20 to an order size of ₹ 2369 crore in FY22 and was ₹ 2563 crore as of June 30, 2022. The company has established long-term relationships with its key customers and the average period of business relationship with its top three customers is over five years.

Strategic focus on expansion towards product centric business model

DCX has established a leadership position in the Indian aerospace and defence industry among other companies, in the segment of - System Integration Business - as a result of long operating history and the experience of its management team. The company’s in-depth knowledge base and understanding of the aerospace and defence industry, particularly in India positions DCX to take advantage of the growth in these sections.

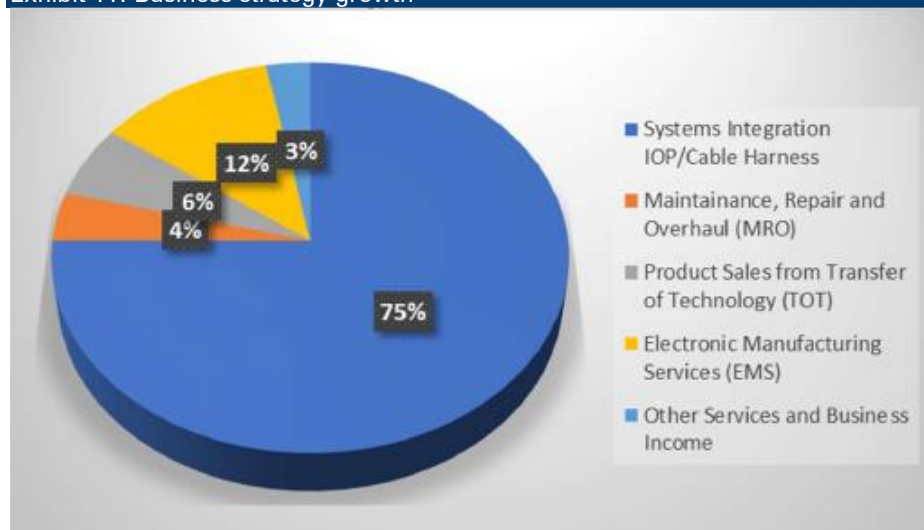
Exhibit 10: Planned expansion by DCX



Source: RHP, ICICI Direct Research

DCX has planned its cumulative revenue stream for the years FY22-26 based on the above segments. System Integration and Cable Harness is expected to account to 75% of their total cumulative revenue in the next four to five years. This is expected to be followed by Defence Electronics Manufacturing Services (EMS), which is expected to account to 12% of its future revenue. MRO is expected to account for ~4%. The market forecast for all these segments has been discussed in detail. However, business segments like ToT cannot be quantified on a yearly basis.

Exhibit 11: Business strategy growth



Source: RHP, ICICI Direct Research

Resilient business model with strong visibility of cash flows, ability to mitigate operational and technology risk

The company’s manufacturing activity is obsolescence-proof as the technology coupled with intellectual property rights, both vest 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. Its product portfolio backed by its 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, its order book comprised 42 orders and was ₹ 2,563.63 crore with orders from several customers for projects to be executed in FY23-25.

The company’s customers typically reimburse it 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, it held ₹ 93.24 crore worth of equipment provided to them by its customers, and such equipment can be used for similar projects, subject to approval from such customers. Suppliers of its raw materials for a particular project are approved and determined by their customers prior to commencement of the project. The company and its customer jointly monitor and ensure the quality of items. Its customers also provide technical training to its employees to ensure efficient project execution.

Uniquely positioned with strong capabilities

DCX is uniquely positioned to partner with major government and private Indian/global defence entities, and to independently seize future defence manufacturing and integration related opportunities because of its strong capabilities across the five inter-related segments – System Integration, Cable and Wire Harness Assembly and Electro Mechanical Assembly. The company also plans to expand into MRO and EMS segments in the short term.

This broad-based capability mix is highly sought after, especially by foreign OEMs looking for strong offset partners in India for major defence contracts, and is one of

the reasons why global defence primes continue to seek out DCX as a key partner to tap the Indian defence market.

Exhibit 12: DCX capabilities

SL.No	Peer Entity/Capability Matrix	System Integration	Cable & Wire Harness Assembly	MRO	EMS	Electro-Mechanical Assembly
1	DCX SYSTEMS LIMITED	✓	✓	✓	✓	✓
2	ASTRA MICROWAVE PRODUCTS LIMITED	✓	✗	✓	✓	✓
3	ALPHA DESIGN TECHNOLOGIES PVT LTD	✓	✗	✓	✗	✓
4	BHARAT ELECTRONICS LIMITED -BANGALORE	✓	✗	✓	✗	✓
5	CENTUM ELECTRONICS	✗	✗	✗	✓	✓
6	CYIENT DLM PVT LTD	✓	✓	✗	✓	✓
7	SASMOS HET TECHNOLOGIES	✗	✓	✗	✗	✗
8	AIMPHENOL INTERCONNECT INDIA PVT LTD	✗	✓	✗	✗	✗
9	DATA PATTERNS PVT LTD	✓	✗	✗	✓	✓
10	HELA SYSTEMS PVT LTD	✓	✗	✓	✗	✓
11	KAYNES TECHNOLOGY INDIA PVT LTD	✗	✗	✗	✓	✗
12	ROSSEL TECHSYS	✓	✓	✗	✓	✓
13	APOLLO MICRO SYSTEMS	✗	✗	✗	✓	✓
14	PARAS DEFENCE	✓	✗	✗	✓	✓

Source: RHP, ICICI Direct Research

Strategically located in aerospace SEZ with advanced, modern manufacturing facility

In 2020, DCX Systems commissioned its new manufacturing facility at the Hi-Tech Defence and Aerospace Park SEZ in Bengaluru, Karnataka. The facility is spread over an area of 30,000 square feet and is located in the same city as its 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 it duty free imports, exemption from GST and supplies that are zero rated under extant regulations. Being situated in an SEZ ensures that it is also not subject to levies imposed by the state government and its operations are eligible for single-window clearance by the relevant authority.

The 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. Its facility was set up for complete in-house environmental and electrical testing and contains the latest inspection and testing equipment. Its manufacturing line and equipment meets the standards prescribed by the Institute for Printed Circuit (IPC).

Key Risks

Dependence on offset defence contracts

A significant portion of the company's revenue from operations are generated from the offset defence contracts. In FY20, FY21 and FY22, revenue from the offset defence contracts were 97.86%, 94.23%, 87.00%, respectively, of its total revenue from sale of products and services. Going forward also, the company expects to derive most of its revenue from operations from work performed under such offset contracts. Any changes in the government policy in connection with offset defence contracts could have an adverse impact on its sales, earnings and cash flows.

Delay or disruption in supply of raw materials

The company's operations are dependent on the availability of raw materials that it requires for the manufacture of its products in the defence and the aerospace industry. Its primary raw materials are electronic assemblies and subsystems such as printed circuit board assemblies, power supplies, integrated circuits, cables and wires, connectors, integrated circuits and mechanical enclosures. Significant shortages of, or delay or disruption in the supply of raw materials could affect its estimated costs, expenditures and timelines which may have a material adverse effect on company's business, financial condition, results of operations and cash flows.

Dependence on performance of electronic subsystems market

The company derives a significant portion of its revenue from operations from system integration business which involves the manufacture and supply of electronic sub-systems involved in the defence and aerospace sector. Any adverse changes in the conditions affecting the electronic subsystems market can adversely impact company's business, financial condition, results of operations, cash flows and prospects.

High level of working capital requirement

The company is required to maintain a high level of working capital on account of its business activities that are characterised by inventory holding periods and production cycles. DCX usually finances its working capital requirements mainly through arrangements with banks. The scope and quantity of its transactions with the overseas OEM customers has, from time to time, increased working capital requirements because of increases in projects and programmes. Delays in payment under on-going contracts or in disbursements under its financing arrangements and/or in particular, reduction of advance payments due to lower order intake could adversely affect company's working capital, lower cash flows and materially increase the amount of working capital to be funded through external debt financings.

Financial summary

Exhibit 11: Profit and loss statement				₹ crore
Revenue (₹ crore)	FY20	FY21	FY22	
Revenue from operations	449.3	641.2	1,102.3	
Other income	16.0	42.1	22.1	
Total revenue	465.2	683.2	1,124.3	
Raw Material Expenses	431.2	660.4	929.3	
Changes In Inventory	-23.2	-42.0	71.2	
Employee expense	5.6	5.5	8.7	
Other expenses	29.5	7.1	26.0	
Total Expenses	443.0	631.1	1,035.3	
Adjusted EBITDA	6.2	10.1	67.0	
Finance costs	7.9	9.9	11.3	
Depreciation and amortisation expense	1.4	2.4	2.2	
Profit before tax and exceptional items	12.9	39.8	75.6	
Exceptional items	0.0	0.0	0.0	
Profit before tax	12.9	39.8	75.6	
Total Tax	3.1	10.2	9.9	
Profit after tax before Minority interest	9.7	29.6	65.6	
Profit after tax	9.7	29.6	65.6	

Source: RHP, ICICI Direct Research

Exhibit 12: Cash flow statement				₹ crore
Cash Flow (₹ crore)	FY20	FY21	FY22	
PBT	12.9	39.8	75.6	
Operating profit before working capital changes	5.0	24.6	62.9	
Changes in working capital	129.1	92.6	-184.4	
Income tax paid	-4.1	-3.2	-12.6	
CF from operating activities	130.0	114.0	-134.03	
(Purchase)/Sale of Fixed Assets	-10.3	-1.4	-1.2	
Interest Received	14.7	22.4	22.0	
Investment in bank deposits	4.0	0.1	0.0	
CF from investing activities	8.4	21.1	20.8	
Adj. of Loan	24.9	2.4	371.5	
Interest Paid	-5.9	-4.7	-7.2	
CF from financing activities	19.0	-2.3	364.2	
Net Cash Flow	157.4	132.7	251.0	
Opening Cash	259.2	416.6	549.3	
Closing Cash Flow	416.6	549.3	800.3	
FCF	119.7	112.6	-135.3	

Source: RHP, ICICI Direct Research

Exhibit 13: Balance sheet				₹ crore
Balance Sheet (₹ crore)	FY20	FY21	FY22	
Equity and liabilities				
Shareholders' funds				
Share capital	3.5	3.5	15.5	
Reserves and surplus	13.7	43.3	102.1	
Non-current liabilities				
Long-term borrowings	0.0	0.0	35.4	
Other non-current liabilities	0.8	0.8	1.0	
Current liabilities				
Short-term borrowings	134.0	136.4	467.2	
Trade payables	150.7	129.8	96.5	
Dues to micro and small enterprise	0.2	1.0	45.3	
Dues to others	150.5	128.8	51.3	
Other current liabilities	396.1	479.3	224.8	
Total	698.8	793.2	942.6	
Assets				
Fixed assets				
Tangible assets	16.5	15.4	14.6	
Deferred tax assets (net)	0.3	0.5	3.8	
Other financial assets	0.6	0.3	0.3	
Current assets				
Inventories	77.2	201.7	27.3	
Trade receivables	88.0	12.3	69.5	
Cash and bank balances	416.6	549.3	800.3	
Other current assets	99.4	13.4	26.7	
Total	698.8	793.2	942.6	

Source: RHP, ICICI Direct Research

Note: FY20 and FY21 are standalone financials while FY22 is consolidated

Exhibit 14: Key ratios			
Ratio Sheet	FY20	FY21	FY22
Per share data (₹)			
Diluted EPS	1.4	4.2	9.2
BV per share	4.9	9.4	21.2
Cash Per Share	118.6	110.0	144.6
Operating Ratios (%)			
Gross Profit Margins	4.0	-3.0	15.7
EBITDA Margins	1.4	1.6	6.1
PAT Margins	2.2	4.6	6.0
Inventory days	62.7	114.8	9.0
Debtor days	71.5	7.0	23.0
Creditor days	122.4	73.9	32.0
Return Ratios (%)			
RoE	56.8	63.2	55.8
Valuation Ratios (x)			
EV / Sales	3.8	2.5	1.5
EV/EBITDA	276.6	157.7	25.4
Market Cap / Sales	4.5	3.1	1.8
P/E	148.9	49.1	22.5
Price to Book Value	12.1	4.4	1.8
Solvency Ratios			
Debt / EBITDA	21.6	13.5	7.5
Debt / Equity	7.8	2.9	4.3
Net Debt/ Equity	-16.5	-8.8	-2.5
Current Ratio	1.0	1.0	1.2
Asset Turnover	27.1	41.1	75.2

Source: RHP, ICICI Direct Research

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