

December 14 2021

Fastest growing player in defence & electronics space

About the Company: Data Patterns Ltd (DPL) is among the few vertically integrated defence and aerospace electronics solution providers catering to the indigenously developed defence industry.

- Design capabilities across the entire spectrum of strategic defence and aerospace electronics solutions including processor, power, radio frequencies (RF) and microwave, embedded software and firmware
- Fastest growing player in defence & electronics space with proven in-house design and development capabilities

Key triggers/Highlights:

- Focused on developing complete systems and sub-system solutions in domains like radars, electronic warfare, communication systems, RF and microwave, military COTS (digital receivers, processor boards, modules), avionics, missile and torpedo electronics, fire control systems, etc
- Strong order book of ₹ 581.3 crore across product categories supplying customers in the defence and aerospace industry
- Current manufacturing facility consists of a ~100000 sq ft factory built on ~5.7 acres of land in Chennai. It is in the process of upgrading and expanding its facility with doubling of available floor area and facility
- Beneficiary of shifting procurement trends and in defence- Atmanirbhar Bharat, Make in India, new defence acquisition policies among others

What should investors do? DPL's innovation focused business model, large market opportunities in Indian defence & aerospace, strong order book across product categories, consistency in profitable growth due to scalable business model are likely to help improve its growth and margins in the long run. At the upper end of the price band, it is valued at ~56x P/E for FY21.

- We assign **SUBSCRIBE** rating to the IPO

Key risk & concerns

- Largely dependent on contracts from Govt and its associates
- Concentrated business with select number of customers
- The company may not qualify or win bids to expand its business
- Promoters have pledged ~53% of promoter holding after the offer for sale

DATA PATTERNS

IPO Details

Issue Details

Issue Opens	December 14, 2021
Issue Closes	December 16, 2021
Issue Size	~ ₹ 588 crore
Issue Type	Offer for Sale
Price Band	₹ 555 - ₹ 585
No of shares	~ 0.59 crore
Market Lot	25 shares
Face Value	2.0
QIB (%)	50.0
Non-Institutional (%)	15.0
Retail (%)	35.0

Shareholding Pattern

	Pre-offer	Post-offer
Promoter	57.0	41.0
Public	43.0	59.0
Total	100.0	100.0

Objects of issue

Objects of the issue

Prepayment or repayment of all, or a portion, of certain outstanding borrowings availed by our Company, Funding working capital requirements, Upgrading and expanding its existing facilities at Chennai and General corporate purposes.

Research Analyst

Chirag Shah
shah.chirag@icicisecurities.com

Amit Anwani
amit.anwani@icicisecurities.com

Key Financial Summary

₹ crore	FY19	FY20	FY21	6MFY22
Net Sales	131.1	156.1	224.0	96.4
EBITDA	25.5	43.2	92.0	37.8
PAT	0.3	0.3	0.3	0.0
Diluted EPS	1.4	3.9	10.4	4.3
P/E (x)	407.4	149.1	56.5	
EV/EBITDA (x)	125.2	74.1	34.4	
Mcap/Sales (x)	23.9	20.1	14.0	
RoCE (%)	10.9	19.5	36.9	
RoE (%)	5.8	13.7	26.7	

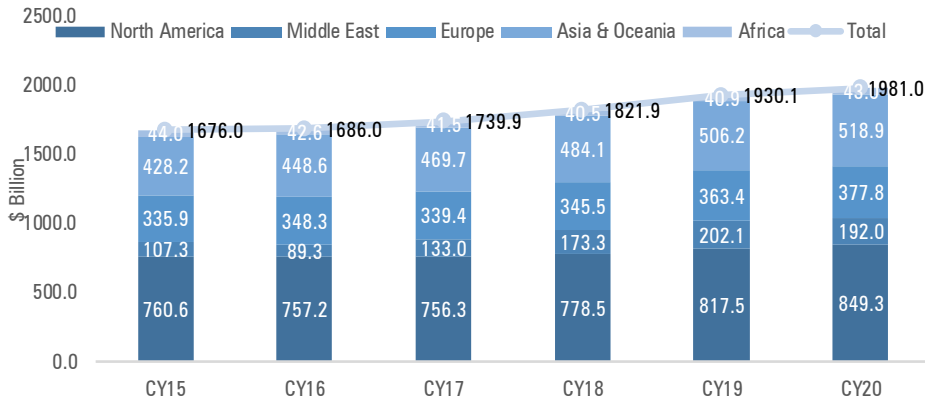
Source: RHP, ICICI Direct Research

Industry Background

Global defence spending

Global defence expenditure is expected to grow to \$2031 billion (bn) by 2025 due to increased geopolitical uncertainty even though countries face economic pressures due to Covid-19 disruption. The global defence spending rose to \$1981 bn in 2020, up 2.6% YoY. Global defence expenditure has grown at ~3.6% CAGR in the last five years.

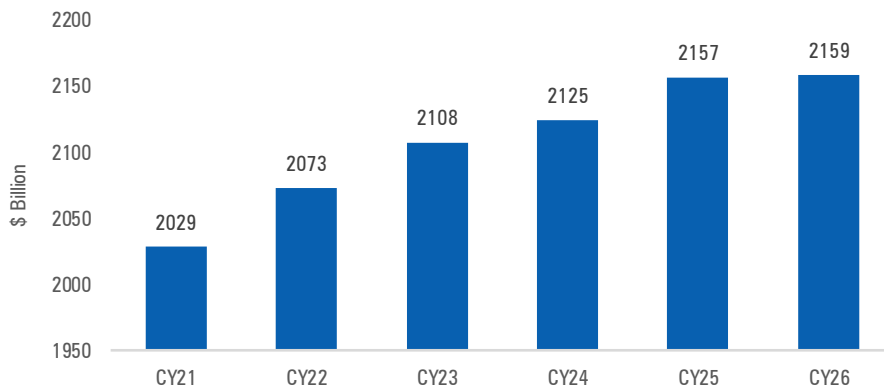
Exhibit 1: Global defence spending (CY15–20)



Source: RHP, ICICI Direct Research

Frost & Sullivan estimates that defence expenditure will continue to rise in the medium term at a rate of 1.5% to \$2130 bn in 2026, largely influenced by the top 15 spenders even though some areas/countries from the rest of the world may see a reduction in defence spending.

Exhibit 2: Global defence spending forecast (CY21–26)

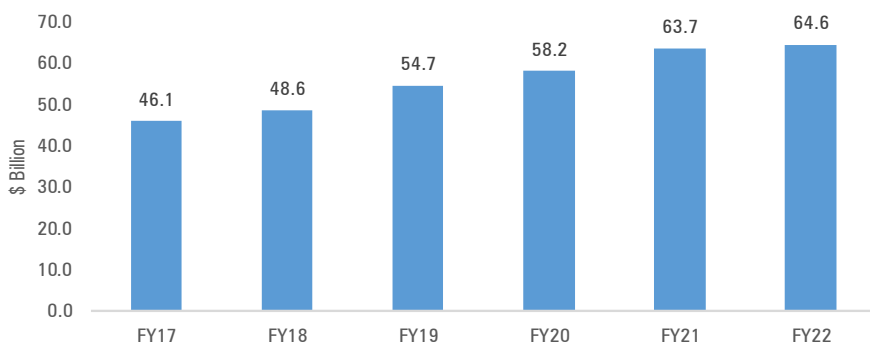


Source: RHP, ICICI Direct Research

Indian defence budget brief and forecast

There has been a structural shift in the defence budget with increased allocation for modernisation funds and approval of non-erasable fund. The fund available to the defence industry participants during FY22-31 is estimated at \$339 bn. The Indian defence budget has been growing at ~7% in the past five years.

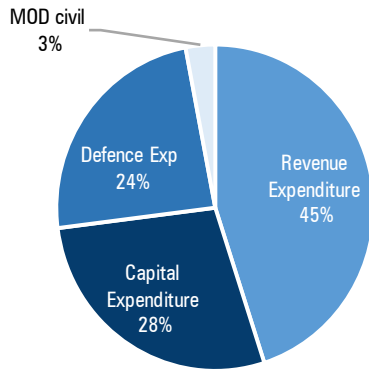
Exhibit 3: Indian defence budget



Source: RHP, ICICI Direct Research

The defence budget has four main components: MoD (Civil), defence services revenue, defence capital outlay, and defence pensions, examination of the allocation for different code heads for defence budget of FY22 (\$64.6 bn).

Exhibit 4: Defence Budget Components – FY22

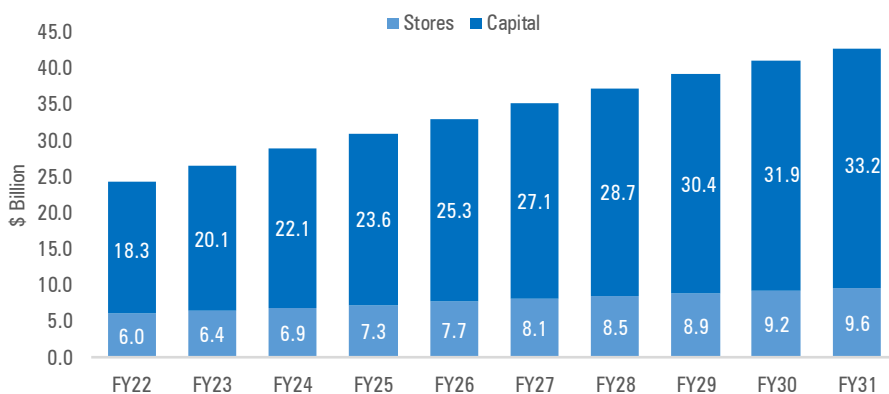


Source: RHP, ICICI Direct Research

The Indian defence industry is at an inflection point, with increased private sector participation being the way forward. The initial model was designed with enhancing the production of low technology weapons in mind, with production and manufacture being led by DPSUs.

During the early years, as defence spending and R&D capability was low, major military programmes were executed with help from foreign OEMs. India continued to rely on foreign support. However, the onus shifted towards licensed production—especially of more technologically advanced platforms. In the 1980s and 1990s, the Government of India wanted to bolster self-reliance and embarked on programmes led by the DRDO such as the Light Combat Aircraft (LCA) programme and the Integrated Guided Missile Development programme. A joint venture, which became BrahMos, was also set up between India and Russia to develop and produce advanced cruise missiles. This model of “joint venture led development” was pursued in other ventures such as the Long-Range Surface to Air Missile (LRSAM) programme, initialised between DRDO and Israel Aerospace Industries.

Exhibit 5: Capital and store allocation growth



Source: RHP, ICICI Direct Research

Defence industry drivers

The government’s latest policies seek to build greater self-reliance in Indian defence R&D and manufacturing through a combination of the Atmanirbhar Bharat mission, DAP 2020, Offsets and the upcoming Defence Production and Exports Policy. The Government of India’s approach to promoting more indigenous industry inclusion has been becoming more calibrated in the last few years. While the onus has been on increasing prioritisation for Indian companies led procurement mechanisms, several other policies have also been initiated to simplify entry into the defence sector and devolving more freedoms in avenues such as export selection to Indian companies.

Exhibit 6: Indigenous defence industry drivers



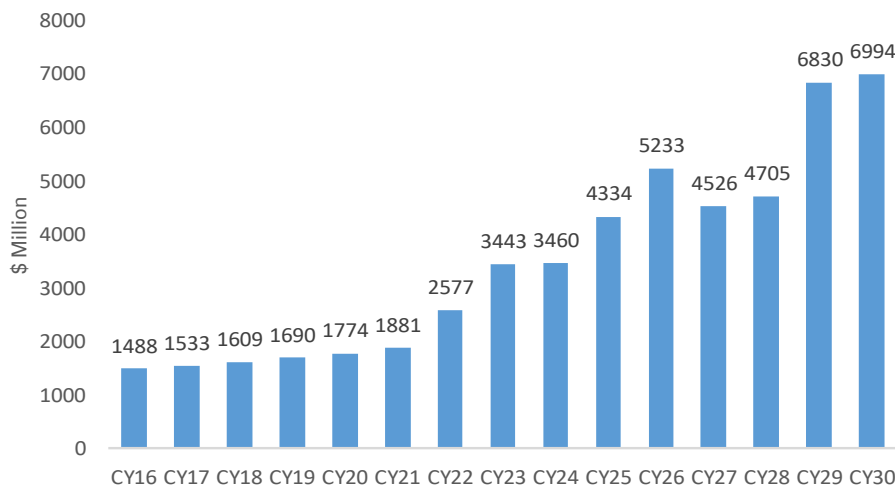
Source: RHP, ICICI Direct Research

Indian defence electronics market

The Indian defence electronics segment is expected to witness large scale indigenisation efforts over the next decade leading to improved manufacturing and quality standards. This will further increase the presence of Indian components in global supply chains, which are already being used in Israeli UAS and European combat aircraft. At present, defence electronics make up only 25-35% of the cost of platforms used by the Indian armed forces. This is expected to increase in future. However, at present over 60% of the electronic components used are supplied by foreign OEMs. As indigenisation efforts continue, future procurement will see a large portion of defence electronics sourced locally while platform recapitalisation programmes across all three forces such as new combat aircraft acquisition, submarine building and T-72 replacement will be key contributors to future market valuation of this product segment.

The defence electronics market was cumulatively worth ~\$8.1 bn in 2016-20 and grew at a CAGR of 4.5% during the period. At present, the market is believed to be worth ~\$1.9 bn in 2021 and is expected to grow to ~\$7 bn in 2030 with a cumulative market opportunity for this segment in the order of ~\$44 bn and a CAGR of 15.7% during the period.

Exhibit 7: India defence electronics market



Source: RHP, ICICI Direct Research

Indian space industry expenditure and forecast

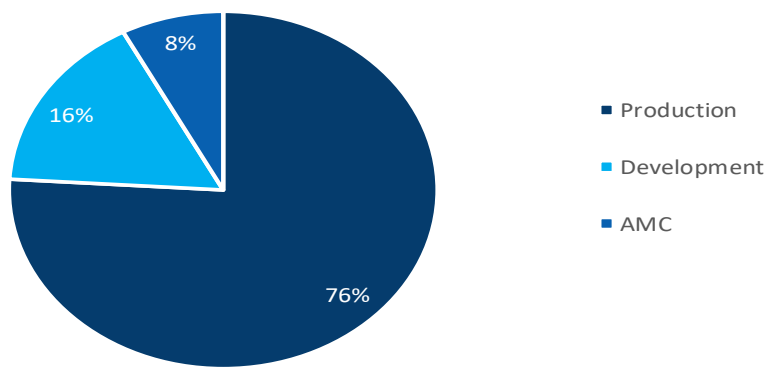
The Indian space industry has evolved with Isro outsourcing manufacturing to the private industry. The evolution has helped private players like Data Patterns to evolve their technical capability to address domestic and global demand. Isro’s revenue expenditure is forecast to increase to \$2,085.7 million (mn) in FY26 on the back of increased missions. Isro’s establishment expenditure has been increasing due to the incorporation of NSIL and IN-SPACe. About \$132.1 mn has been allocated as part of the budget for establishment expenditure in FY19-21. The creation of these entities has led to new opportunities for Indian private players through technology transfer and contract manufacturing opportunities through NSIL and regulating bodies like IN-SPACe.

Company Background

Data Patterns is a vertically integrated defence and aerospace electronics solutions provider catering to the indigenously developed defence products industry. The company has proven in-house design & development capabilities and experience of more than three decades in the defence and aerospace electronics space. Data Patterns caters to the entire spectrum of defence and aerospace platforms like space, air, land and sea.

Data Patterns has design capabilities across the entire spectrum of strategic defence and aerospace electronics solutions including processors, power, radio frequencies and microwave, embedded software and firmware and mechanical engineering. The company’s core competencies include electronic hardware design and development, software design and development, firmware design and development, mechanical design and development, product prototype design and development, functional testing and validation, environment testing & verification and engineering opportunities.

Exhibit 8: Revenue mix (%)-FY21

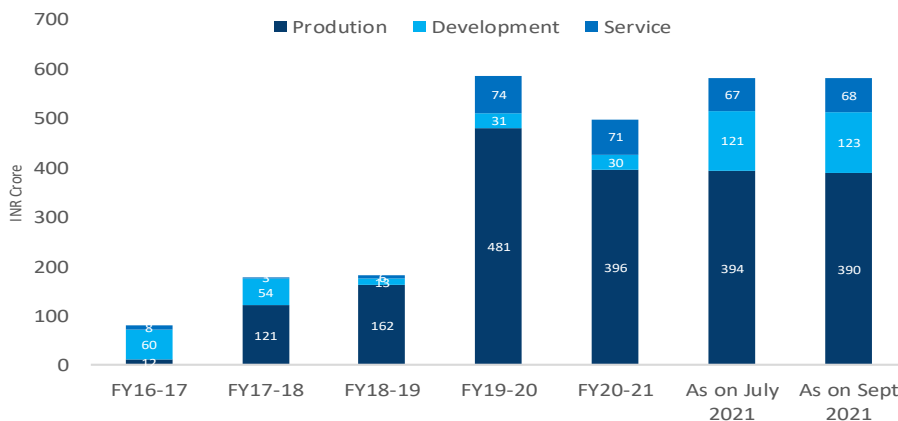


Source: RHP, ICICI Direct Research

Data Pattern’s electronic solutions are developed by specialist teams working on areas including complex 20+ layer printed circuit board (PCB) designs, field-programmable gate arrays (FPGA) based firmware algorithms, all layers of software including operating system porting, device drivers, networking layers, application software, graphical user interface, cartography, signal processing, streaming protocols and waveform engineering. The company’s design and development capabilities have allowed it to develop complete systems as well as sub-systems for various strategic defence and aerospace electronics solutions.

These systems have found applications on various platforms and programmes such as the Tejas Light Combat Aircraft (LCA), the Light Utility Helicopter (LUH), BrahMos missile programme, precision approach radars and various communications intelligence (COMINT) and electronic intelligence (ELINT) systems.

Exhibit 9: Company’s order book in last five years



Source: RHP, ICICI Direct Research

Exhibit 10: Notable achievements



Indigenously developed fire control system for the BrahMos missile programme



Designed and developed the second launch pad countdown system for delivery to the Indian government space organization



Designed and developed Primary Surveillance Radar for coastal surveillance for the Indian government space organization



Developed Seaking automated test equipment for INS Shikra



Laser guided bomb kit tester



Satellite bus management system



Digital flight control computer

Source: RHP, ICICI Direct Research

Data Patterns' manufacturing facility consists of a 100,000 square feet (sq ft) factory built on 5.75 acres of land in Chennai, which has facilities for design, manufacturing, qualification and life cycle support of high reliability electronic systems used in defence and aerospace applications.

The company is in the process of upgrading and expanding their facility, with a proposed doubling of available floor area & manufacturing capacity as well as addition of capability of handling large and heavy equipment, integration of large radars and mobile electronic warfare systems, satellite integration facility.

It is proposing to acquire an additional 2.81 acres of adjacent land for further expansion. The company believe its investment in infrastructure will enable it to cater to the growing demand from its customers and enhance its product portfolio. In turn, this is expected to result in an increase in its revenue and profit.

Exhibit 11: Data Patterns' product segments

Particulars	No. of Orders	Value (₹ Crore)
Radar	20	362.8
Service	53	68.4
Avionics	7	41.0
Communication	2	31.0
Electronic Warfare Suite	4	25.5
ATE	10	24.3
BrahMos missile programme	3	18.7
Small Satellite	2	5.3
Naval system	4	4.3
Total	105	581.3

Source: RHP, ICICI Direct Research

Investment Rationale

Well positioned to benefit from Make in India opportunity

The Indian defence industry is rapidly evolving into a self-sustaining one with companies and DPSUs moving towards specialising in defence primes, integrators and component suppliers. Similarly, the space industry is expanding with new space participants offering services that were previously offered by the Government of India space organisation such as launch services, satellite operations and downstream services. Data Patterns' competency and focus of the Government of India to enhance indigenisation, makes it well positioned to rapidly commercialise or scale-up a number of its existing products or building blocks to end systems or complete solutions, thereby garnering significant benefits from the Make in India programme. The company successfully bid for and won a ~₹ 380 crore contract from the Ministry of Defence for nine precision approach radars for the Navy and Air Force, which are currently in the delivery stage.

Innovation focused business model

The company has focused on in-house development and manufacturing capabilities led by innovation and design & development efforts. In the past Data Patterns had initiated development of several projects, such as military grade processor modules, cockpit displays, actuator controllers for missiles and torpedoes, flight control computers, digital receivers and up/down converters for radars. The company designs and develops a number of building blocks similar in specifications to imported modules to allow them to compete in local tenders of DRDO for military commercial-off-the-shelf (COTS) products. Some of their present programmes include: (i) airborne phased array radar, (ii) frequency hopping radio relays, (iii) next generation EW products, (iv) integrated EW solution for national security, etc.

Across product categories provider in defence & aerospace

As on September 30, 2021, the company has an order book of ₹ 581 crore, with orders from several marquee customers in the Indian defence ecosystem, including the Defence Ministry, BrahMos, DRDO, the Government of India's space organisation, HAL, BEL and a DPSU involved in the missile space. Data Patterns is currently engaged in the supply of products to several prestigious defence projects in India, including the LCA, the HAL Dhruv, LUH and the BrahMos missile programme. In each of the above projects, its products form critical components, such as the launch systems for the ground based BrahMos missile launcher, flight and safety critical "take me home" displays for Tejas.

Certified manufacturing facility of international standards

The company's in-house design and development capabilities are complemented by their 100,000 square feet manufacturing facility located on 5.75 acres of land at the SIPCOT Information Technology Park, Siruseri, Chennai, which has facilities for design, manufacturing, qualification and life cycle support of high reliability electronic systems used in defence and aerospace applications. Its facility allows it to be self-sufficient in its requirement of high quality and high complexity production while ensuring functional testing for all its products using internally developed automatic testing equipment. certified for or follow various standards across product life cycles, including for aerospace systems under AS9100D by TUV-SUD, IPC Standards for PCB design, DO 178B for software for airborne systems, software life cycle processes and environment standards MIL-STD-810, JSS-55555 and EMI-EMC standard MIL-STD-461.

Key Risk

Largely dependent on contracts from Gol and its associates

The company's business is dependent on projects and programmes undertaken by Gol and associated entities such as defence public sector undertakings and government organisations involved in space research (collectively, the "GOI entities"). Data Patterns derives a significant portion (~45-50%) of its total sales from contracts with Gol entities and they will continue to cater to Gol entities. Any decline or reprioritisation of the Indian defence or space budget, reduction in orders, termination of existing contracts, delay of existing or anticipated contracts or programmes or any adverse change in the Gol entities' defence or space requirements and geopolitical circumstances, may have a material adverse impact on its business and profitability.

Concentrated business with select number of customers

A significant portion of the company's revenue comes from a limited number of customers such as DRDO and other government and private agencies. Any adverse development associated with such customers or significant reduction in business from them, may result in the company experiencing a significant reduction in its cash flows and liquidity. If its customers are able to fulfil their requirements through any of its existing or new competitors, providing products with better quality and/or cheaper cost, it may lose significant portion of its business.

Company may not qualify or win bids to expand its business

Data Patterns' business and growth depends on its ability to qualify for and win bids undertaken by Gol entities for awarding contracts. The company obtains a majority of its business through a competitive bidding process in which it competes for project awards based on, among other things, pricing, technical and technological expertise, reputation for quality, financing capabilities and track record. Any increase in competition during the bidding process or reduction in its competitive capabilities could have a material adverse effect on its market share.

Availability, import of raw materials

Data Patterns' operations are impacted by the availability and cost of import and acquisition of raw materials utilised in its production process. The company purchases its raw materials from domestic as well as international markets. Any change in cost and availability of such raw materials for any reason, including change in the approved suppliers, change in law or applicable governmental policies relating to imports, would adversely affect its business. Data Patterns is not significantly dependent on any single raw material supplier. Raw material supply and pricing can be volatile due to a number of factors beyond its control, including global demand and supply, economic & political conditions, transportation & labour costs, disruption during transportation, labour unrest, natural disasters, import duties, tariffs or a cumulative effect of factors affecting all its suppliers and currency exchange rates.

Financial summary

Exhibit 11: Profit and loss statement				
	₹ crore			
(Year-end March)	FY19	FY20	FY21	6MFY22
Net Sales	131.1	156.1	224.0	96.4
Growth (%)	-	19.1	43.5	-
Total Raw Material Cost	48.9	56.1	70.4	21.0
Gross Margins (%)	62.7	64.1	68.6	78.2
Employee Expenses	37.6	42.3	48.4	28.1
% to sales	28.7	27.1	21.6	29.2
Other Expenses	18.9	14.6	13.1	9.5
% to sales	14.4	9.3	5.9	9.8
Total Operating Expenditure	105.5	112.9	132.0	58.6
EBITDA	25.5	43.2	92.0	37.8
EBITDA Margin (%)	19.5	27.6	41.1	39.2
Interest	10.8	13.3	14.5	4.8
Depreciation	5.9	5.5	5.6	3.0
Other Income	1.4	4.1	2.6	0.7
PBT	10.4	28.4	74.5	30.8
Total Tax	2.7	7.4	19.0	7.6
Profit After Tax	7.7	21.0	55.6	23.2

Source: RHP, ICICI Direct Research

Exhibit 12: Cash flow statement				
	₹ crore			
(Year-end March)	FY19	FY20	FY21	6MFY22
Profit Before Tax	10.4	28.4	74.5	30.8
Add: Depreciation	5.9	5.5	5.6	3.0
Add: Finance Cost	10.8	13.3	14.5	4.8
Others	-1.4	-2.7	-2.3	-0.7
Net (Increase)/decrease in WC	-28.9	-26.4	-19.0	-27.4
Tax paid	1.1	2.8	19.0	0.3
CF from operating activities	-4.5	15.2	54.3	10.1
(Inc)/dec in Fixed Assets	-1.0	-1.4	-5.7	-9.2
Others	1.4	2.9	2.9	-1.3
CF from investing activities	0.4	1.4	-2.7	-10.5
Inc / (Dec) in Equity/preference sl	0.0	0.0	0.0	-3.3
Inc / (Dec) in Borrowings	15.5	0.4	-27.3	19.2
Others	-13.2	-15.9	-16.9	-16.6
CF from financing activities	2.2	-15.4	-44.3	-0.8
Net Cash flow	-1.8	1.2	7.3	-1.1
Opening Cash	2.1	0.3	1.5	8.8
Closing Cash	0.3	1.5	8.8	7.7

Source: RHP, ICICI Direct Research

Exhibit 13: Balance sheet				
	₹ crore			
(Year-end March)	FY19	FY20	FY21	6MFY22
Equity Capital	1.7	1.7	1.7	9.3
Preference shares	-	-	-	-
Reserve and Surplus	131.2	151.8	206.1	207.3
Total Shareholders funds	132.9	153.5	207.8	216.6
Minority interest	-	-	-	-
Total Debt	60.1	60.6	33.2	52.4
Non Current Liabilities	32.0	18.9	30.6	30.7
Source of Funds	225.1	233.0	271.6	299.7
Net Fixed Assets	29.4	27.8	29.2	35.5
Capital WIP	-	-	-	2.0
Intangible assets	0.2	0.2	0.6	1.2
Right of use assets	6.8	5.4	3.2	2.5
Investments & bank balance	-	-	-	-
Inventory	86.7	79.4	73.7	86.8
Cash	0.3	1.5	8.8	7.7
Debtors	102.9	115.6	155.9	134.5
Loans & Advances & Other CA	12.0	19.0	22.8	25.7
Total Current Assets	201.9	215.5	261.3	254.7
Creditors	15.9	17.3	12.0	10.1
Provisions & Other CL	36.5	45.1	44.8	46.1
Total Current Liabilities	52.4	62.4	56.8	56.1
Net Current Assets	149.6	153.2	204.6	198.6
LT L& A, Other Assets	39.0	46.5	34.1	59.9
Other Assets	-	-	-	-
Application of Funds	225.1	233.0	271.6	299.7

Source: RHP, ICICI Direct Research

Exhibit 14: Key ratios				
(Year-end March)	FY19	FY20	FY21	6MFY22
Per share data (₹)				
Diluted EPS	1.4	3.9	10.4	4.3
Cash EPS	2.5	4.9	11.4	4.9
BV	24.8	28.6	38.7	40.4
Cash Per Share	0.1	0.3	1.6	1.4
Operating Ratios (%)				
EBITDA margins	19.5	27.6	41.1	39.2
PBT margins	7.9	18.2	33.3	31.9
Net Profit margins	5.9	13.5	24.8	24.1
Inventory days	646	517	382	
Debtor days	287	270	254	
Creditor days	118	112	62	
Return Ratios (%)				
RoE	5.8	13.7	26.7	
RoCE	10.9	19.5	36.9	
Valuation Ratios (x)				
P/E	407.4	149.1	56.5	
EV / EBITDA	125.2	74.1	34.4	
EV / Sales	24.4	20.5	14.1	
MCap / Sales	23.9	20.1	14.0	
Price to Book Value	23.6	20.4	15.1	
Solvency Ratios				
Debt / Equity	0.5	0.4	0.2	
Debt/EBITDA	2.4	1.4	0.4	
Current Ratio	3.9	3.5	4.6	
Quick Ratio	2.2	2.2	3.3	

Source: RHP, ICICI Direct Research

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Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com**

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