**ITEMS MARKED IN YELLOW ARE PART OF THE TEMPLATE, with Notes available in each section to support the information marked in Yellow**

**Company: AXTEL Industries**

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| **Business Slotting**  🗹 B2B 🞏 B2C 🞏 Asset Heavy 🗹 Asset Light 🞏 Intellectual Prop 🗹 Price Taker 🞏Price Setter 🞏Oligopoly  🗹 Monopoly/ Duopoly 🗹 Customer Capex Led |

**Company Background:**

Axtel is over 25 years old company (revenue Rs. 100 Cr.), which operates in consulting, designing and manufacturing of food processing machines for the various food/FMCG clients (e.g. ITC, HUL, Heinz, Nestle, GSK etc.). The company is based out of Gujarat and operates its whole business from single factory site at Halol. The company has collaborated with Wenger Inc., USA for food/feed extrusion systems and AnuTec GmbH, Switzerland for powder handling systems.

The machines manufactured helps clients in raw material storage & discharge, size reduction, sieving, straining, mixing as may be applicable and as each of the manufacturer have different other machines and equipment in their factory, the machines manufactured by Axtel are customized for each of the client based on their requirements. Due to the customization requirements:

1. Manufacturers are likely to have a preferred/select list of vendors who have provided good machines in the past (e.g. European and American players like Buhler, SPX, GEA Group, Russell Finex, Rockwell, CM-OPM etc.)
2. The orders given by the manufacturer’s is given based on the project basis and thus is a B2B business having lumpy revenues
3. As the machines are manufactured against an order, the working capital requirements are lowered as the customer provides an advance to start the manufacturing and the company doesn’t need to maintain an inventory leading to a working capital efficient as well as asset light model
4. The majority of the costs for the manufacturer is managing the raw-materials, supply chain and marketing etc. and the cost of the machines is not expected to be the most critical factors, rather the quality, stability of machines matter more as manufacturer can’t afford a breakdown of machines affecting production

The company needs to work closely with the manufacturers and thus the pricing of the machinery, components, spares etc. is know to the manufacturers as well, thus limiting Axtel’s ability to earn higher margins on the machines manufactured.

The company seems to have turned around successfully where-in in FY 14 the company went under a transformation journey and invested in capacities, manpower and other capabilities and has been able to improve capability and capacity and deliver machines in much less time. The company currently operates three verticals:

1. Snack – Supplies machinery for all process except cooking
2. Spice – Supplies machinery for everything
3. Confectionary – Chocolate everything except 2 equipment (where Buhler has deep expertise), Fragnance and Flavour – End to end

The company specialises in food processing machinery, and is present across all major food segments (apart from above also services Instant Mixers, Beverages, Dairy Products, Bakery, Malted Drinks etc.) except liquids (which the management is not to keen to enter)

There are no known food processing machinery companies based out of India which provides end-to-end process euipment, and services the kind of prestigious customers that Axtel services, thus acting like a soft monopoly in the Indian market.

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| **Customer Industry Trend/Outlook ->** 🗹 Tailwinds  Headwinds 🗹 Secular |

Due to the nature of product provided, Axtel revenues are critically linked to the capex spends of the Food manufacturer, and thus understanding the capex plans of the Food manufacturers becomes critical in understanding the growth potential and run-way available for Axtel.

**Food Industry Capex plans:**

1. Underlying drivers of the customer industry: India is a fast growing, consumption driven economy with a large middle income population who are aspirational in nature, more urbanization driving consumption and thus there is a large run-way for Food Industry where we can expect increasing consumption of all types of food items from basic snacks and chocolates to higher value products in the food-snacks chain. The customer industry i.e. food industry is growing at 10-15%.
2. Capex Plans: The Food Industry while fragmented by large number of regional brands, is dominated by large players like HUL, ITC, Nestle, P&G, GSK, Amul, Balaji, Haldiram etc. who have Pan-India footprint. Driven by dynamics of each of the products and management ambitions, players are planning to expand business capacities, as highlighted from the capex plans:
   1. Nestle: Nestle plans to invest Rs 700 crore (US$ 100.16 million) to open a new plant in Sanand for Maggi
   2. ITC: 10,000 crore capex in food business ([link](https://www.thehindu.com/business/Industry/itc-to-invest-10000-crore-to-set-up-food-processing-units/article19975935.ece)) announced in 2017, for setting up integrated manufacturing units
   3. HUL: 800 crore capex announced to take benefit of the corporate tax rate cuts ([link](https://www.livemint.com/companies/news/hul-announces-plan-to-set-up-new-arm-to-invest-rs-2-000-crore-11582546420557.html))
   4. Dabur: Dabur to invest Rs 250-300 crore (US$ 37.29-44.75 million) in FY19 for capacity expansion and is also looking for
   5. acquisitions in the domestic market.
   6. Pratap Snacks: 100-150 crore planned over the next 2-3 years ([link](https://economictimes.indiatimes.com/markets/expert-view/prataap-snacks-to-invest-rs-150-200-crore-in-next-2-3-years-amit-kumat/articleshow/63012028.cms?from=mdr))
   7. Future Consumer: In August 2018, Fonterra announced a joint venture with Future Consumer Ltd which will produce a range of consumer
   8. and foodservice dairy products
   9. M&A: The sector has seen multiple M&As and it can be expected that the acquirer’s would plan to expand the businesses, thus leading to multiple other capex & investments.

  
**Source: IBEF**

* 1. New Product launches:
     1. Marico’s Coco Soul introduces a range of three 100 per cent natural-infused oil variants.
     2. India’s first kids cooking oil launched by Mother Sparsh in 2019.
     3. In June 2019, ITC launches dairy beverage range “Sunfeast Wonderz Milk” in four variants
     4. In May 2019, Naturell (India) Pvt Ltd, innovator of power snacking launched RiteBite Max protein chips
     5. Nestle and Danone are planning to introduce new products in India ([Link](https://economictimes.indiatimes.com/industry/cons-products/food/danone-nestle-launching-a-slew-of-new-products-in-health-and-nutrition-segment/articleshow/70799489.cms?from=mdr))

1. Of the above players mentioned, Axtel has worked with multiple of the Pan-India players like Adani, Amul, Bikaji, Britannia, DS Group, ITC (multiple), HUL (multiple), Mondolez (multiple), Marico (multiple), Nestle (multiple). Refer list of clients ([link](https://www.axtelindia.com/ourclients))

Therefore Axtel is present in an industry which is undergoing big capex plans by its customers. However at a macro level, the business is expected to grow in line with the secular food industry’s growth. Additional growth, or non-linear growth can be expected to come from market share gain rather than accelerating market pie.

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| **Elevator Pitch –** *“Company is run by experienced technocrats and is playing on the on the import substitution theme for Food sector’s manufacturing machinery requirements. The company manufactures its machinery for the leading Food players in India eg. ITC, Nestle, Mondelez, Kraft, Hershey’s etc. and has also been able to gain repeat orders from these players. Given the scale of business (Revenue ~ 100 Cr.) and the fact that the company has been supplying to such reputed players, points towards a differentiated business model, which is also supported by the fact that some of the players have taken Axtel to their international plants as well as the company is invited for competitive bids (DMF Foods, Balaji, Pratap Snacks)) reflecting the quality of product delivered by Axtel to its clients. In the past three years, the company has also started looking at export business primarily within the Asian market”* |

Background of promoter and business theme:

Technocrat Promoters: The current ED Mr. Parikh established Axtel in 1992. However before starting Axtel, Mr. Parikh had set up two more companies which worked closely with milk (Amul) and cattle feed, dairy and powder units working on the theme of import substitution and Axtel has also been playing on this theme while working with Food Industry players. Post developing in-house technology in product design and manufacturing, the company has started exporting its products (to subsidiaries and sister companies of Indian/MNC companies as well as standalone players)

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | FY 12-13 | FY 13-14 | FY 14-15 | FY 15-16 | FY 16-17 | FY 17-18 | FY 18-19 |
| Revenue (in Cr.) | 60 | 48 | 39 | 66 | 76 | 82 | 110 |
| Domestic | N.A. | 46 | 32 | 65 | 59 | 65 | 91 |
| Export | N.A. | 2.15 | 7 | 0.90 | 17 | 17 | 18.8 |

**(Source: Annual Reports)**

Quality of product:

1. Prestigious Indian and Global clients: The company has provided its products to leading Food players who are both Indian as well as Foreign player.
   1. Indian: ITC, HUL, Britannia, Adani, Amul, Bikaji, Bikanervala, Cadbury, DS Group, Everest Spice, Godrej Agrovet, Haldiram, CCL, GSK, Jubilant Food, Marico, Nestle, Pepsi, Tata Coffee etc.
   2. Foreign: Heinz, Givaudan, MARS, Nestle, Puratos etc.
2. As machines are critical for the manufacturers and they would typically rely on existing list of approved vendors, thus breaking into the market is difficult for a new player. However Axtel, has been able to win orders from these players as well as gotten repeat business from them. List of such players includes: ITC, HUL, GSK, Mondolez; in addition Axtel has been able to establish its presence in the sister companies of these clients in international locations e.g., Nestle, Cadbury, Mondolez, Unilever
3. The quality is appreciated by the manufacturers to such an extent that the companies are inviting them for competitive bids (DMF Foods, Balaji & Pratap Snacks) as well as taking them to their factories abroad (eg. Nestle -> Sri Lanka, Bangladesh, Malaysia, Morocco, Russia, Philippines, Vietnam, Columbia, Switzerland), other players where Axtel is present in multiple locations in India and abroad includes Mondelez (India, Singapore, Nigeria, Vietnam), Puratos (India, Peru, Brazil, Greece, China, South Korea, Indonesia, Philippines)

Having serviced international clients (eg. Mondelez, Puratos, Hershey’s, Mars, Nestel etc.) helps the company establish credentials of its products as well as makes it visible for other MNCs operating in this domain. The management in the AGM had mentioned the following:

“*It takes years to build relationship with clients like Mondelez, Nestle, Givaudan etc. However, we have now reached a stage where lot of new MNCs are looking at us. The key is to get into supply chains of these MNCs and start being considered for more and more orders because of our capabilities. A success at one large customer drives its competitor to look at us, a success at one location drives a customer to take us along to other locations.*

*We have become more critical to our customers’ supply chains. We are present across companies like Mondelez, Puratos, Hershey’s, Mars. Nestle etc at their multiple plants across globe.*”

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| **BUSINESS ATTRACTIVNESS** |

1. **Strongly differentiated business model -> High**
   1. As mentioned earlier, the company is playing on the import substitution theme and has been able to break into the market and has also won repeat orders
   2. Breaking into the list of approved vendors is difficult due to the quality control requirements of the vendors, dependence on the continuity of operations. Upon establishing an entry, it makes it difficult for new players to dislodge the existing players. Therefore Axtel has access to customers whereas it is difficult for any new player to take away market share (however competition from existing player always exists)
   3. Players like Mondelez, Nestle, Puratos, Hershey’s are taking Axtel to their other international markets and due to this, the company is able to get orders without/with limited business development from existing clients, as well as provides visibility to other clients operating in those countries
   4. No other known Indian player operating in this domain who supplies end-to-end process requirements, and has such a reputed client base
   5. The company has also provided machines for baby food/infant formulation manufacturer in Europe, which reflects that the company has the ability to meet high quality standard demands of both European countries for a health sensitive industry such as baby food.
   6. As the entry of any player among the food manufacturers list of approved vendors/empanelled vendors takes a few years, dislodging Axtel would be difficult for a new comer
2. **Competitive Position getting stronger/weaker -> Can’t say**
   1. Not enough information available to suggest if Axtel is able to strengthen its competitive position
   2. There are two collaboration with Wenger Inc., USA for food/feed extrusion systems and AnuTec GmbH, Switzerland for powder handling systems; however limited information available on the progress or the expected benefits from these collaborations
   3. For domestic competition manufacturing standalone equipment, Axtel has moved far ahead being able to supply end-to-end process equipment for Snacks (all machinery except cooking), Spices (all machineries), Confectionery (all except two where Buhler has deep expertise), Fragrance and Flavor (end-to-end)
3. **Next Level of business -> High**
   1. Should become the default/standard choice of food manufacturers for standard machinery requirements of Food Industry players, as Axtel is able to meet the quality requirements at significantly lower cost than MNC Competitors
4. **Value Migration Curve -> Can’t say**
   1. Axtel potentially has the opportunity to expand its product offerings and move into critical machineries required by Food players (eg. Mixing machines for Chocolates), however limited information available on the extent of such provided by Axtel or plans to enter in the domain. Therefore can’t say
5. **Quality of earnings -> Low**
   1. Limited bargaining power -> Supplies products to players multiple of its size
   2. Lumpy Sales -> Wins order through competitive bidding process on a project basis
   3. Limited pricing power -> Provide customized solutions, but needs to work closely with clients who have good grip on pricing of the materials, and typical Axtel Margins
   4. With a differentiated business model, the GM at 50% don’t seem to be high and impact of steel prices may need to be looked at if the GM increase is incidental (current steel prices) or structural in nature.
6. **Key growth drivers** 
   1. Planned capex -> Capex plans have been announced by several players in the food industry. Axtel can certainly grow at the secular growth rates of Food Industry. But higher trajectory growth for Axtel will be dependent on large Capex Orders by its Customers ***-> Medium***
   2. Export Order -> Company has started focussing on export sales, however appears to be dependent on the existing clients who are expanding internationally; therefore ***-> Medium***
   3. Indian Snack manufacturing -> Company is serving Bikanervala & Haldiram therefore reflecting company’s capability to design machinery for Indian snacks (fried snacks vs European and American baked snacks). Can be a differentiator for the company to service the demands of the snack manufacturers. Therefore **-> High**
7. **Intellectual Property – Low**

The good thing is that Axtel has always proved capable of meeting custom design requirements of its customers, and is a key attribute MNC customers look for in Axtel. The company relies on the quality of machine produced and has mentioned that some of its clients tried Chinese manufacturers (for economical pricing) but came back to Axtel to lack of product quality. The company doesn’t own’s any patents. Most of its products are import substitutes, and probably reverse-engineered.

1. **Profitability Drivers**

P&L Overview:

|  | **Mar-16** | **Mar-17** | **Mar-18** | **Mar-19** | **CAGR %** |
| --- | --- | --- | --- | --- | --- |
| Revenue from Operations | 66.93 | 76.11 | 81.5 | 110.75 | 18.3% |
| Other Income | 0.22 | 1.17 | 0.68 | 1.59 | 93.3% |
| Total Revenue | 67.15 | 77.28 | 82.18 | 112.34 | 18.7% |
|  |  |  |  |  |  |
| Raw Material | 31.56 | 36.44 | 42 | 54.36 | 19.9% |
|  |  |  |  |  |  |
| Gross Margin % | 53% | 52% | 48% | 51% |  |
|  |  |  |  |  |  |
| Employee | 13.93 | 16.02 | 17.29 | 20.36 | 13.5% |
| Finance | 1.37 | 0.75 | 0.5 | 0.48 | -29.5% |
| Depreciation & Amortization | 3.45 | 2.78 | 2.39 | 2.8 | -6.7% |
| Other Expenses | 11.31 | 12.95 | 13.55 | 16.15 | 12.6% |
| Labour & job work | 2.44 | 2.74 | 3.4 | 3.9 | 16.9% |
| Erection & Commissioning | 3.35 | 4.55 | 3.14 | 4.14 | 7.3% |
| Legal & Professional | 1.24 | 1.17 | 1.44 | 1.93 | 15.9% |
| Power | 0.64 | 0.65 | 0.71 | 0.65 | 0.5% |
|  |  |  |  |  |  |
| Tax | 0.92 | 1.49 | 1.96 | 5.24 | 78.6% |
|  |  |  |  |  |  |
| PAT | 4.61 | 6.85 | 4.49 | 12.95 | 41.1% |

**(Source: Annual Report)**

As the company is engaged in delivering customized machinery to its clients, designing (thus employee and professional charges) and manufacturing (raw material i.e. steel, components) are critical cost components. Along with this, operating leverage becomes critical to drive the overall profitability.

* 1. **Raw Material – Can’t say**

While steel prices have been volatile in the last four years, the RM have ranged between 48-52%, so a 50% GM may be par for course for the company, however the fact that there is some dependence on steel prices can’t be ruled out.

The company on its part mention that they negotiate with the steel vendors in case of fluctuations which means that there is no formal hedging or contracting framework followed by the company and neither the company has mentioned that there is any price benefit/escalation clause, therefore in any sharp spike in prices, there may be a downside risk on the margins and profitability. *(Needs to be confirmed/checked with mgmt. or other stakeholders, if the gross margin increase is incidental or something structural is happening at the company)*



**Source: Phreakonomics (**[**Link**](https://phreakonomics.in/export-import/micro?type=exports&commodity=158)**)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | FY 16 | FY 17 | FY 18 | FY 19 |
| Raw Material | 31.56 | 36.44 | 42 | 54.36 |
| Steel | 8.55 | 11.01 | 15.21 | 20.91 |
| Steel % of Raw Material | 27% | 30% | 36% | 38% |

Steel prices are increasingly contributing to the raw-materials and thus leaves the company exposed to the volatility of the prices of steels and associated metals.

Also the total purchase value is Rs. 50 crore therefore in the immediate future the company may not be able to get any volume discounts/benefits and lumpy nature of business may limit the companies ability to get into long term contracts for pricing benefits.

* 1. **Employees - Med**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | FY 16 | FY 17 | FY 18 | FY 19 |
| Employee | 147 | 154 | 152 | 147 |
| Salaries (Cr.) | 13.93 | 16.02 | 17.29 | 20.36 |
| Avg. Salaries (Lakhs) | 9.48 | 10.6 | 11.3 | 13.6 |
| Legal & Professional (Cr.) | 1.24 | 1.17 | 1.44 | 1.93 |
| Labour & job work (Cr.) | 2.44 | 2.74 | 3.4 | 3.9 |
|  |  |  |  |  |
| Total Manpower Costs | 17.6 | 19.9 | 22.1 | 26.2 |

As the product delivery and design is a customization led/differentiated, skills of the employees as well as retention becomes critical. However from the above it appears that the company has been focusing outsourcing low-skill activities while trying to retain higher quality talent.

The growth in the employee costs (CAGR 13.5%) is lower than the revenues, and even with the combined manpower costs (CAGR 14%) is lower, therefore reflecting that the company can scale revenues while employee costs may rise at a lower pace.

* 1. **Operating Leverage - High**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Mar-10** | **Mar-11** | **Mar-12** | **Mar-13** | **Mar-14** | **Mar-15** | **Mar-16** | **Mar-17** | **Mar-18** | **Mar-19** |
| Sales | 27.05 | 54.09 | 58.41 | 60.03 | 48.01 | 39.23 | 66.93 | 76.11 | 81.5 | 110.75 |
| EBIT | 1.39 | 4.76 | 5.39 | 5.71 | 6.34 | -5.95 | 7.09 | 9.07 | 8.38 | 18.67 |
| Operating Leverage |  | 2.43 | 1.66 | 2.14 | -0.55 |  | -3.10 | 2.04 |  | 3.42 |

With an operating leverage of 3.42 (in FY 19) reflects that the company has been able to realize higher incremental profitability which is expected of a manufacturing company, but the company has been able to realize higher operating leverage compared to other manufacturing business. The higher operating leverage reflects that the company can generate high amount of cash if the revenues grow at a fast pace.

**Operating Leverage led by** 🗹 **Gross Margin** 🗹 **Asset Turns** 🗹 **Product Mix** 🗹 **Employee Costs**

1. **Gross Margin**

Company has been increasing its Gross Margins consistently, up from 23% in FY 10 to 50% in FY 19 (except the blip in FY 14-15 due to the cancellation of Nestle order).

1. **Asset Turns**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Mar-10** | **Mar-11** | **Mar-12** | **Mar-13** | **Mar-14** | **Mar-15** | **Mar-16** | **Mar-17** | **Mar-18** | **Mar-19** |
| Fixed Asset Turns | 4.23 | 8.28 | 8.22 | 3.52 | 1.97 | 1.84 | 3.59 | 4.60 | 4.75 | 6.99 |

FA Turns has been consistently increasing post the big capex undertaken by the company in FY 14-15

1. **Product Mix (Slightly)**

Higher Value orders are expected to play slight role in increase in margins (e.g., the company was able to win a big order of 13-15 Cr from Hershey’s), however there is limited information available on the change in product mix that the company has been able to realize.

* 1. **Employee Cost**

The employee costs grow at a slower pace than sales (refer section b above)

1. **Capital Intensity – Low**

|  | **Mar-10** | **Mar-11** | **Mar-12** | **Mar-13** | **Mar-14** | **Mar-15** | **Mar-16** | **Mar-17** | **Mar-18** | **Mar-19** |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Fixed Asset Turns | 4.23 | 8.28 | 8.22 | 3.52 | 1.97 | 1.84 | 3.59 | 4.60 | 4.75 | 6.99 |
|  |  |  |  |  |  |  |  |  |  |  |
| Net Block | 6.39 | 6.53 | 7.11 | 17.06 | 24.39 | 21.32 | 18.63 | 16.56 | 17.15 | 15.84 |
| CWIP | 0.15 | 1.39 | 3.45 | 2.91 | 0.35 | 0.31 | - | 0.23 | - | 0.20 |

The company did a major capex during FY 12-14 post which it has been able to improve its business and has been able to consistently increase its fixed assets turn. On a standalone basis, it can be seen that the operations are not capital intensive in nature.

The above is also reflected by the very low incremental fixed assets investments made by the company to realize incremental sales (10 Yr FA Investment Rate – 11.35%), similarly working capital requirements are very low (10 Yr Incr WCap Invest Rate – 13.84%).

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| **KEY MONITORABLE** |

1. Growth -> The transformation journey has played out well since FY 14, and therefore tracking the progress of the transformation and growth becomes critical. While the company is 30 years old, it has been able to achieve a revenue of only 110 Cr. which appears too low for such vintage and majority of this growth has also come in the last 4-5 years, therefore tracking growth in top-line become all the more critical.
2. Gross Margins -> As mentioned earlier, there is dependence on steel which comprises ~ 50% of the costs, and therefore any volatile movement in steel prices can affect the company’s performance significantly.
3. Order Book -> As the projects are won on a project basis, there is no mention of the order book that the company has and thus needs to be verified through discussion with stakeholders/scuttlebutt.

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| **MANAGEMENT QUALITY** |

1. **DNA of business**

The company has been growing by playing on the import substitution theme and has been able to provide quality products to win new and repeat orders. Being run by technocrat promoters has enabled the company to meet every opportunity/demand of the customers, including customer asking them to do custom designs.

* 1. **Cost Efficiency Focus – Low**

As Axtel’s business model is a people skills driven, business scale up would require Axtel to hire people to deliver the solutions (design and manufacture) to the customers, and therefore scale up business is unlike a traditional manufacturing business (establish plant, buy in bulk, bargain for inputs etc.) and thus Axtel will keep hiring, skilling and scaling up expertise to deliver solutions. Thus having limited cost efficiency led business.

* 1. **Production Efficiency – High**

High Fixed Asset Turnover of 6.5 and Operating Leverage of 3.42

* 1. **Capital Efficiency/Allocation – Low**

|  | **Mar-10** | **Mar-11** | **Mar-12** | **Mar-13** | **Mar-14** | **Mar-15** | **Mar-16** | **Mar-17** | **Mar-18** | **Mar-19** |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Sales/Fixed Assets= Fixed Asset Turns | 4.23 | 8.28 | 8.22 | 3.52 | 1.97 | 1.84 | 3.59 | 4.60 | 4.75 | 6.99 |
| Sales/Total Assets= Asset Turns | 0.91 | 1.16 | 1.22 | 0.96 | 0.72 | 0.57 | 1.08 | 1.18 | 0.98 | 1.31 |

From the above table it can be seen that while the company has very high fixed asset turns, total asset turns are very low. Therefore it means that there are other assets that the company holds which may or may not be directly related to the business. Following is the concise balance sheet of the company for the last four years.

|  | **Mar-16** | **Mar-17** | **Mar-18** | **Mar-19** |
| --- | --- | --- | --- | --- |
| **Liabilities** |  |  |  |  |
| Equity + R&S | 30 | 37 | 43 | 52 |
| Borrowings | 10 | 5 | 4 | 1 |
| Other Liabilities | 22 | 23 | 36 | 31 |
| **Assets** |  |  |  |  |
| Net Block + CWIP | 18.6 | 16.8 | 17.2 | 16.0 |
| Investments | 0.0 | 3.5 | 14.2 | 14.9 |
| Cash | 0.8 | 3.4 | 4.4 | 5.5 |
| Other Assets | 42.7 | 40.8 | 47.7 | 47.9 |

Post FY 14’s capex, the company has been paying down its debt (FY 14 Debt: 16 Cr., FY 15 Debt: 12.7 Cr.) and based on the operational turnaround has been able to generate cash. However, in the recent past years, the company has not returned the cash generated to investors through dividend or deployed back the cash in business, but has kept ~ 21 Cr. as cash and investments, which on a revenue base of Rs. 110 Cr. seems disproportionately high. The management on its part has explained the cash and investment as an optionality for inorganic growth (not a priority) and maintaining liquidity (in case of any liquidity crisis)

* 1. **Innovation – Medium**

As the company plays on the import substitution theme, the product/machines are largely a result of reverse engineering. As the company is run by technocrats who have been in the business for long, they have shown ability to meet each and every demand of the customers who have even asked to do custom designs.

* 1. **New Revenue Stream/ Geography – Low**

The company is present in majority of its processes and hasn’t mentioned any plans of increasing the scope of industries, rather the management has already mentioned that they don’t intend to enter into the liquid segment.

The international/export growth seems to be driven by the existing clients taking them abroad with them, rather than they themselves pursuing such growth outside India.

* 1. **Value Chain Migration – Med**

Similar to the point above, the company has capabilities to produce machines for majority of processes, therefore there can be a chance of increasing share of customer wallet by providing more machineries, but consistently similar gross margins don’t reflect the company’s ability to move to higher value added machines

* 1. **Strategic Thinking – Low**

The company has been in existence for over 30 years operating as a soft monopoly, however it hasn’t been able to scale up the business till 2014. While post 2014 the business has started to perform (without management change), the following remains a question why these things were not targeted by the company:

1. Lack of growth till 2014: The company has been in existence for so-long as a soft monopoly playing on the import substitution theme, however it hadn’t grown till 2014
2. Not targeting the smaller players – Axtel has shown competence by delivering products to the large players. However while servicing these customers, Axtel looses pricing power, but it had an opportunity to target the smaller players (eg. Regional food, snack, spice) manufacturers where it could have been able to exhibit pricing power and earn higher margins.
3. Not developing a services line of business – From the AGM discussions and VP thread, it is understood that large food manufacturers have their own in-house services team which might not to be true for the smaller players (eg. Pratap Snacks, DFM Foods) additionally if the company had targeted the regional players (mentioned above) it could have provided these services to the customers covering their machines as well as others.
4. The company could have expanded presence beyond the food manufacturer and targeted other players which use assembly line manufacturing (e.g. Pharma players). While they might have approached such industries, there are no clients which it has been able to win/convert.
5. Loss of Amul’s business: The management said that Amul’s expectation did not been Axtel’s expectation and the company didn’t partake negotiation with Amul; Amul was their first client as well as India’s largest dairy player and loosing such a prestigious and large client instead of working with Amul to maintain and grow business might reflect short-sightedness or lack of strategic thinking
   1. **Ability to manage downturns – Med**

The company has been in existence for over 30 years, which means it has seen multiple downturn cycles and thus demonstrates resilience. However given the bulky nature of business, there is heavy dependence on individual clients. Case in point, in 2014-15 when Nestle was facing the Maggi crisis, Nestle had to cancel an existing order placed with Axtel which led to profitability as well as Gross Margin taking a big hit. Refer RoE and GM table below.

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|  | **Mar-10** | **Mar-11** | **Mar-12** | **Mar-13** | **Mar-14** | **Mar-15** | **Mar-16** | **Mar-17** | **Mar-18** | **Mar-19** |
| RoE | 4% | 13% | 14% | 14% | 10% | -29% | 16% | 19% | 14% | 25% |
| Gr Margin | 25% | 32% | 37% | 49% | 51% | 32% | 57% | 56% | 47% | 50% |

However it may also be noted, that the company learnt the lesson and started diversifying its customer base so as to reduce dependencies on few players.

* 1. **Walking the Talk – Can’t say**

There isn’t much forward guidance that the company has given in the past (expected for a small company like Axtel) and also there is no visibility on the order book that the company has been able to maintain/grow. Therefore limited information to comment on the walking the talk aspect of the business.

1. **Execution Skills**
   1. **Workforce Handling – Med**

Promoter Salary – Rs. 3 crore (1.5 Cr. each to MD and WTD) and additional commission earned by the promoters which is also driven by the fact that the salary of the WTD and MD is equal to the ceiling as per the Companies Act. Of 1.5 Cr

Avg. Salary of employee ex-Promoter = 11 Lakhs, which implies that the employees are fairly paid

* 1. **Customer Trust/Win – High**

The company has been able to win order among MNCs, able to win repeat orders as well as has delivered machineries to the European market

* 1. **Deeper/Broader customer penetration – Med**

The company has access to clients which are in multiple categories of food products, and thus is possible for the company to increase its share of wallet among its client. For e.g. the company appears to have provided machinery to GSK and now HUL for Horlicks; It has Cadbury as its client who manufactures Bournvita; Similarly BRU for HUL capabilities can be provided to Nestle for Nescafe etc.

Therefore there is scope for the company to penetrate deeper within existing customer base as well as approach new customers for similar product range. One case where it has happened Cadbury PERK and Nestle KITKAT (both are wafer based chocolate)

However the company also faces competition from the existing established players and lost an order of Amul (Axtel promoter company’s first client) to an European competitor. This implies that the competition is focusing on the Indian market and is willing to let go profitability to win orders, thus can limit Axtel’s ability to increase presence.

* 1. **Successful Project – High**

The company has done multiple projects across multiple locations as mentioned above as well as reflected in the clients list.

1. Reputation
   1. **Family Business – High**

The company has been set-up by first generation technocrats, who have been found to be passionate about the products that they manufacture. They have been able to develop the business to current level, and therefore appears to be a believable credible story.

* 1. **Minority Shareholder Treatment - Med**

Dividend paying company, resolving investor complaints; No action to suggest any actions which are non-beneficiary for minority investors.

Apart from the promoter holding ~ 50% shareholding, there seems to be some family groups which hold good chunk of shares (Pathak ~ 6.5%, Bubber ~6.3%) therefore it can be assumed that the management will not do anti-minority shareholder actions.

* 1. **Corp. Governance – Med**

Nothing adverse found against the board or the corporate governance practices. High Salaries in such a small business is seen as an irritant.

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| **GROWTH/SCALABILITY** |

1. **Linear Growth - Low**
2. Industry – Growth closely linked to the capex of the manufacturers, which is expected to grow linearly
3. Market Share – Gains Possible, but difficult to dislodge existing players, and thus market share gain expected to grow linearly; Also the business is employee driven and therefore cannot be grow exponentially (additionally employee would need training to keep developing solutions while at the same time are susceptible to poaching)
4. Margin – Limited as the customers also know the pricing of the products as well as emerging competition
5. Price Increase – Limited pricing power with Axtel
6. **Expansionary Growth - Low**
7. Value Migration – Possible, however the company is present in majority of the processes, and therefore value migration would have to be realized through market share gain rather than product range expansion leading to value migration
8. New Geography – Possible, however the company has relied more on existing clients taking it to international markets where they are expanding
9. New Revenue Stream – Limited, company trying to provide consulting/project services, AMC is difficult as per management as the manufacturer have internal spare and services team

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| **Business Vulnerability / Strength** |

1. **Vulnerability:**
2. Nature of business – The business is driven based on the internal knowledge and experience of the high-skilled manpower which is difficult to scale and retain. Requirements are mostly for customized products, which makes the business difficult to scale
3. B2B business with players who are multiples of Axtel’s size therefore limited bargaining power
4. Import substitution theme: Therefore limited pricing power
5. **Strengths/opportunities:**
   1. Product quality has been established and company has won repeat orders
   2. Opportunity exists in targeting the Indian Snack players who have different requirements than the European & American customers (fried vs baked) and thus Axtel may be able to differentiate itself and thus higher margins. This segment is low on the priority list of Competition as they probably have to go through the learning curve.

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| **VALUATION** |

**Undervaluation : 🞏 Screaming 🞏 High** 🗹 **Fair**

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**Source: Screener**

From P/E perspective, historically the stock had been trading at P/E of ~15 for last few years (pre-covid crash) and has come to ~ 11, therefore the stock doesn’t seems likely to be a case of Screaming undervaluation, and rather points to Fair valuations.

If we can get more clarity/see evidence of accelerating growth trajectory, these valuation ratings can change rapidly, and one can buy at the current price as well as higher (in case of big order wins).

**Valuations to be led by:**

1. **Earnings Trajectory**
2. Management has guided for a revenue of Rs. 200 Crore in the next 2-3 years, given the operating leverage that the company enjoys, the earnings can be expected to more than double. Therefore in the short-term valuations may be led by earnings growth only.
3. However it may be noted that the earnings are lumpy in nature as well as being in B2B industry may not be of high quality with respect of sustainability
4. **Value Migration**
5. No visibility if the business is moving upwards in the value chain, however has the potential
6. **Re-rating**
7. Unlikely, as the business is not moving upwards in the value chain

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| **Valuation Overhang**  🗷 PSU 🗷 Not Understood 🗷 Sector Apathy 🗷 Regulatory 🗷 Political 🗷 Corp. Governance 🗹 Succession Planning 🗹 High Salaries |

1. Succession Planning: Mr. Desai and Mr. Parikh have been engaged with the company since 1991 (therefore atleast 50-60 years old), and there is no visibility of the next generation getting involved in the business
2. High Salaries: The management salaries is equal to the ceiling of salaries as per the Companies Act therefore on the higher side, however the following may be noted:
   1. Salary raise of 71% happened this year when the company started performing better
   2. As the company is operating at a small scale, due to base effect itself the salary would appear higher

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| **Valuation Support**  🗷 Dividend 🗹 Low Float 🗷 Capital Allocation |

* **Dividend:** Company has started paying dividend in the last two years, and even though the company has been generating cash profits, dividend yield is only 1.65%
* **Low Float**: Promoter shareholding is 50% and some families control additional 12%; therefore 38% is available for general public, therefore not a case of low float.
* **Capital Allocation**: As mentioned earlier, the company has approx. 22 Cr. in cash & investments on revenue of 110 Cr. and Asset base of 90 Cr.; Funds not being deployed back in business which might be a concern (limited opportunity to grow/re-deploy funds)

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| **Risk and Mitigations** |

1. **Business Risks**
2. **Supply and/or demand disruption - High**

No diversification across industries - The company is highly dependent on the Food industry and any disruption in the industry dynamics can significantly impact the company.

1. **Single Point of Failure - High**

The company operates all its business through a single facility based out of Halol. Any geographical impact or disruption in business can significantly impact the company.

1. **Environmental – No/Low**

Not involved in chemicals production or environmental negative discharge activities

1. **Regulatory – No/Low**

Regulations are applicable on the Food players, which may pass down the requirements to the machineries however no direct regulatory risks

1. **Buyer Power - High**

As mentioned earlier, buyers are of multiples by size of Axtel, thus the company doesn’t have bargaining power

1. **Competition - Med**

New Player entering will take a lot of time to gain approvals/empanelment with the manufacturers, therefore limited competition from new players; However among existing players, the competition is there

1. **Sustainability - Med**

The company is able to compete and win orders from clients, however revenues are lumpy in natures, linked to player’s capex thus even if the company is able to achieve 200 Cr. revenue in 2-3 years, one can’t say that the company will be able to sustain it on an on-going basis as project business is tough in general.

Additionally, the company isn’t able to provide value added services such as AMCs due to presence of internal teams at the manufacturer’s site for spare and service requirements.

1. **Valuation Risks**

**Risk covered in the valuation multiples** 🗷 Everything 🗹 20% Downside 🗷 2-3X upside in 2-3 years

The business valuations don’t necessarily capture all the possible downsides or risks mentioned above as the avg. P/E was 15 before Covid led fall.

From 2014 (post capex), the company has been able to grow its revenue at a CAGR of ~ 15% and while the business as such requires lower capex, the relatively slower growth rate is an indicator of the following:

1. Orders are won through the bidding process and therefore presence of good customer relationship doesn’t necessarily translates into orders and needs to compete with other players
2. While repeat sales is possible, there is no certainty that the company will be able to consistently realize repeat business

Thus, there is no certainty that the company would be able to realize the management guidance of Rs. 200 Cr. In the next 2-3 years and on the contrary the company can face the situation of orders completely drying up (either due to inability to win projects, or an external shock like Covid which leads to food manufactures to stop/pause capex plans). Therefore from a valuation perspective it’s not that the valuation are depressed so as to reflect all the possible -ve things or there is any certainty that the company can give 2-3X in the next 2-3 years.

The key question with respect to valuation is not whether the company can grow at 20-25% but when can it realize this growth. The jump in 2-3x can happen if there is a big sale/order realized by the company and the picture or view towards the company can change dramatically.

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| **Liquidity Stress Test: Can sit tight for 1-2 years despite:**  🗹 **Execution Delay** 🗹 **Business Temporary Issues** |

Due to the fall in stock price and the valuation at which it is trading, and business dynamics one can hold on to the business if:

* 1. The business can maintain the current run-rate of Rs. 25 Cr per quarter
  2. Exit if the company is not able to realize this run rate for two consecutive quarters
  3. Staying in the company driven by the future potential of the company (big capex plans of FMGC manufacturer, company empanelled/has relation with these players, company trying to grow)

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| **MEDIUM TERM VISIBILITY – NOT HIGH** |

* + - 1. Earnings - 🗷 Capex Completion. 🗷 Order Book/Sales. 🗹 Mgmt. Guidance
         1. Company enjoys high operating leverage and management believes that sales of Rs. 300 Cr. can be done through very low additional capex. Therefore limited capex expected/required.
         2. Order Book - > No information. Compnay at the moment does not release Orderbook information
         3. Guidance -> Management expects to increase revenues to Rs. 200 cr. in the next 2-3 years

* + - 1. Margins – 🗷 Pricing 🗷 Raw Material 🗹 Employee Costs
         1. Pricing: Clients have a good grip on the materials and margins of Axtel therefore limited scope of increasing bottom line through margins, neither is the company getting into any new higher margin activities (e.g. AMC servicing)
         2. Raw Material: Dependence on steel prices, however no mention of pass through pricing benefits or long term contracts; recent fall in steel prices due to Covid can potentially benefits subject to company subject to demand for projects being there (unlikely) or company buying steel in bulk (unlikely as the company seems to be practicing buying raw materials against orders)
         3. Employee Costs: Increase in revenue is being realized with lower increase in employee expenses, any increase in revenues is going to provide the operating leverage benefits to the company with respect to slower ramp of employee costs.
      2. Efficiency – 🗹 Asset Turns 🗷 Capital Turns
         1. The company has higher fixed asset turns (6.99) and as guided by the management, higher sales (upto 300 Cr.) can be realized with minimal additional capex, therefore if additional orders are won by the company, the fixed asset turns can be expected to jump even higher and earnings can increase at a faster pace vis-à-vis revenues.

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| **INVESTMENT RATIONALE**  🗷 **Strategic** 🗷 **2-3x in 2-3 years** 🗷 **10x in 10 years** 🗹 **Opportunistic (50-100% pop)** |

Demand for items not expected to increase exponentially, therefore not a 10x kind of opportunity, similarly 2-3X returns also not expected esp. over medium term of 2-3 years

While the company has a unique model, the company is operating in a very small niche and even if growth is realized the company may not be very large, therefore not a strategic investment

If the management realizes its goal of Rs. 200 Cr revenues, then there can be a short burst in the price of the company driven by earnings growth.

**Sources referred:**

1. Deep-Dive template shared by Donald
2. Balance sheet and Financial schedules of the company for breakup of expenses
3. Management Discussion and Analysis
4. VP Thread on Axtel
5. Industry aggregator reporting website (IBEF for FMCG/Food Industry) covering capex plans, M&As
6. Axtel’s website showcasing products and clients to understand nature of industry and buyers

Appendix A.

NOTES WHILE POPULATING THE DEEP-DIVE TEMPLATE**:**

**Background to the template image shared by Donald:**

The template notes are the quick summary of the discussion that Donald had with people/analyst who have been tracking/analysing/investing in that particular company for a few years and have deep understanding about it. Donald tries to capture in short-hand, short-code format exactly what the Analyst discusses/shares as substantiation for his conclusions. There may be aspects available in VP thread, in AGM Notes that are implied/referred (common knowledge among those tracking/invested) and therefore not explicitly noted down. However by going through the template one gets an idea of all the different kinds of discussion/analysis angles, typically used by Seniors..

**What is the objective of the transcribing request**:

In order for us to better understand the business as well as the Analyst views on the company, we are required to go to the next level of each of the points to find data points which are either supportive/aligned to the analysts view or find disconfirming evidence. The objective is to add data-backed evidence for the various points being covered in the template and have data points/trends to support a rating for any particular point in question.

Donald has mentioned that similar takes on the company will be recorded and transcribed for 3-4 analysts including a skeptic view. Once we have 3-4 takes transcribed well, we may see that while probably the data/information sets are common, only 70-80% of the Analyst conclusions are similar. There may be important differences in insights drawn about overall Business Attractiveness/Vulnerabilities, Scalability, Management Quality, and/or Undervaluation aspects.

He has said that post all views being transcribed including the Skeptic one, it will be time for VP official Stock Story to be written, which will be a more precise, more compact, but data-rich, substantitaion rich version. It will have sections separately with Bullish viewpoints, Bearish viewpoints, Interesting viewpoints to drive the main issues to focus on. Forensics comments will get included. (Please refer Stock Story 2.0 Template) on details.

It’s a good idea for us involved in the transcribing exercise, to start thinking on Bearish/Bulish/Interesting Arguments/Viewpoints in preparation for the VP Stock Story. Some of us may get the Rights, if we work hard and are found otherwise capable.

How to go about researching for the data points:

1. In case of any regulated industry there are always some industry body which provides at an aggregate level information about the players, revenues, trends etc. (e.g. SIAM for Auto, RBI/IRDAI/SEBI for BFSI companies, NASSCOM for IT etc.) and each of the sites usually refers to some other research/white paper which provide more information.
2. Independent of the above sites, the management discussion and analysis section of the Annual Report of any company provides visibility on the SWOT of the company/industry, emerging trends & drivers etc.
3. Screener.in provides a lot of data points with respect to the financial ratios, and how they inter-link with each other (e.g. Dupont analysis for RoA/RoE analysis)
4. Look at the P&L to identify the big chunks of fixed and variable costs, and to the best extent possible try to find unit costs to figure out the scaling up of the business would impact the profitability (e.g. in Axtel’s case Steel prices, employee costs were the biggest items, therefore unit cost of employees, % of contribution of steel to the raw materials etc.; apart from this the job-work and commissioning of machinery are other variable costs)
5. Also don’t forget VP threads on the business. Usually they will have rich data points, AGM Notes, and other scuttlebutt information which are very important to assimilate into the substantiation data points.