

September 7, 2018

Dear clients and colleagues,

Outsourcing is an important theme in our portfolio. A company may decide to outsource non-core operations, shifting focus back at its core competency, and avoid non-value-added distractions.

In a KPMG report on the outlook for global manufacturing, they anticipate that manufacturers will increase R&D spending dramatically over the next few years. In many ways, this does not come as a surprise as disruptive technologies are challenging the status quo and forcing manufacturers to innovate and change their products. Outsourced R&D firms will certainly benefit from this trend.

The automotive sector is anticipated to have the highest R&D spend compared to other industries. Electric cars, advanced driver-assist systems, autonomous driving, connectivity and electrical powertrain technology are all helping drive growth in this industry. According to the consultant firm Oliver Wyman, over 5,000 mobility patents were filed by 12 leading carmakers between 2012 to 2016. Not surprising as companies like Google, Apple, Uber, Tesla and now even Dyson are trying to enter the car market at some stage. According to Car magazine, the addressable market for internet-based functions in connected cars is expected to reach over US\$122.6 billion.

Akka Technologies, a leading engineering and technology consulting company in Europe, benefits from this outsourcing trend. It is among the four largest players in the highly fragmented European engineering services market. The company operates in 21 centres across the globe and supports clients with the conception of new products over the entire design cycle and value chain. As an example, Akka started to work on autonomous driving 10 years ago, and the mobility segment now represents more than 20% of its revenue. The company generates 42% of its sales in France, 36% in Germany and 22% in other international markets. For its 2017 fiscal year, the company reported sales of US\$1,598 million and an EBITDA of US\$104 million. The Ricci family owns 44% of the company.

Market size

- The global R&D outsourced market is estimated at US\$232 billion. This market is expected to grow 5%-6% from 2016 to 2021.
- From a geographical perspective, Western Europe is the largest market for R&D outsourced services, with over 38% of the global market compared to 20% for North America and 17% for India.

Growth strategy

- Increasing its footprint internationally within existing verticals (e.g. aerospace in the US) or developing new expertise in other verticals.
- Increasing its client base by rolling out its technology and expertise into new centres globally.
- The innovation trend impacts many end markets, so R&D spending will continue to rise.

Strengths

- Well-established company with a leading position in the mobility segment.
- Has built the track record and expertise in many verticals.
- Maintains excellent client relationships.
- Has experienced lower staff turnover than its peers (18% versus 25%).
- Combines a good growth profile with sound profitability.

Opportunities

- The outsourced R&D market remains supportive globally.
- There are significant business opportunities in the US and Asia.

Risks

- Economic cycle and pricing pressure in some of the more mature markets.
- The company faces some customer concentration risk (Daimler and Airbus).
- Major acquisitions or a rapid rollout of new centres could jeopardize the performance of the company.

Have a good weekend.

The Global Alpha Team