

Press Release

Apollo Micro Systems Limited

October 29, 2021

Rating Reaffirmed, Assigned



Total Bank Facilities Rated*	Rs.195.00 Cr (Enhanced from Rs.157.50 Cr)
Long Term Rating	ACUITE BBB- / Outlook: Stable (Reaffirmed)
Short Term Rating	ACUITE A3 (Reaffirmed)

* Refer Annexure for details

Rating Rationale

Acuite has reaffirmed its long-term rating of '**ACUITE BBB-**' (read as **ACUITE triple B minus**) and short-term rating of '**ACUITE A3**' (read as **ACUITE A three**) on the Rs.195.00 Cr bank facilities of Apollo Micro Systems Limited (AMSL). The outlook is '**Stable**'.

The ratings reaffirmed factors in its established presence in electronic system design manufacturing (ESDM) segment with significant experience of the promoters and the management in the industry over three decades. The ratings considers AMSL's strong research and development (R&D) team and long standing presence in the defence and space sector which has helped it to establish strong relationships with its customers as well as suppliers for repeated business. The ratings also factors in its healthy financial risk profile backed by healthy capital structure.

The rating is, albeit, constrained by its working capital-intensive nature of operations, its declining scale of operations over the last 2 years and moderate order book of Rs.216 Cr as on June 30, 2021. The rating is also constrained by revenue concentration in defence sector and susceptibility of margins to exchange rate fluctuations.

About the Company

Incorporated in 1985, Apollo Micro Systems Limited (AMSL) is promoted by Mr. Karunakar Reddy. The Company is listed in Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). AMSL is an electronic, electromechanical and engineering design, manufacturing and supplies company. It designs, develops and sells high performance, mission and time critical solutions to Defence, Space and Home Land Security for Ministry of Defence, government controlled public sector undertakings and private sectors. It offers custom built COTS (Commercially off the shelf) solutions based on specific requirements to defence and space customers. The company's manufacturing unit is located in Hyderabad with its lab area conforming with electrostatic discharge requirements with ESD-safe furniture and controlled environment. AMSL is ISO 9001:2015 and CEMILAC (Centre for Military Airworthiness and Certification) certified organization.

Analytical Approach

Acuite has considered the standalone business and financial risk profiles of AMSL to arrive at the rating.

Key Rating Drivers

Strengths

- **Established presence and extensive experience of promoters in the defense and aerospace and industry**

AMSL is an established player since 1985 in the electronic system design manufacturing (ESDM) segment with significant experience of the promoter Mr. B Karunakar Reddy in aerospace and defense industry over 30 years. AMSL has a strong R&D team focused on developing new products. The company works with the DRDO for research on strategic defence missions, developing commercially off the shelf solutions, which are the proprietary products of AMSL. Its focus on R&D is reflected by the increasing spend on the same over the years. Mr. C V S Prasad, one of the directors, has over 20 years' of experience in defence electronic systems manufacturing, particularly critical systems and has worked with organisations like Indian Space research Organization (ISRO) and Semi-Conductor Laboratory (SCL) in

research department. The company is providing electric and electronic hardware and software solutions for mission-critical applications to defence, aerospace, navy, and home land security among others. AMSL derives significant benefit from its promoter experience and established strong relationships with its customers as well as suppliers for repeated business. Acuite believes that similar growth trajectory is likely to continue over the medium term too.

- **Healthy financial risk profile**

AMSL's financial risk profile is healthy marked by healthy capital structure and comfortable debt protection metrics. AMSL's net worth is healthy at Rs. 304.97 Cr as on March 31, 2021 as compared to Rs. 295.84 Cr as on March 31, 2020. Gearing is healthy at 0.38 times as on March 31, 2021 as against 0.28 times as on March 31, 2020. Total outside liabilities to total net worth (TOL/TNW) TOL/TNW is healthy at 0.74 times as on March 31, 2021 vis-à-vis 0.57 times as on March 31, 2020. Its debt protection metrics are comfortable marked by interest coverage ratio (ICR) and net cash accruals to total debt (NCA/TD) at 2.45 times and 0.16 times in FY2021 vis-à-vis 3.33 times and 0.29 times in FY2020, respectively. Acuite believes the company will be able to maintain its financial risk profile in the absence of any major debt-funded capex plan over the medium term.

- **High Entry barriers and moderate order book position**

AMSL operates in a niche segment of a high entry barrier Defence and Aerospace industry. The company is 'Centre for Military Airworthiness and Certification (CEMIAC)' certified, whereby it is an approved design house for design and development of software and equipment for military aircraft application. This certification is based on technical experience and past record of such authorized design houses. AMSL deals with reputed clientele like Bharat Dynamics Limited, Bharat Electronics Limited, Defence Research and Development Organisation (DRDO) among others. As of June 30, 2021, AMSL has an unexecuted order book position of Rs. 216 Cr. Acuite believes, with high entry barrier coupled with long term nature of contracts of the order book provides revenue visibility over the medium term.

Weaknesses

- **Working capital intensive nature of operations marked by high GCA Days**

AMSL's working capital cycle deteriorated significantly with high working capital intensity marked by increasing Gross Current Asset (GCA) days to 747 days as on March 31, 2021 from 543 days as on as on March 31, 2020 account of stretched receivables and sizeable inventory. These high GCA days emanates from high inventory days of 501 days as on March 31, 2021 as compared to 385 days for as on March 31, 2020. AMSL primarily caters to domestic defence establishments that usually have long production cycles due to very long time given scrutiny and inspection involved in every stage of production, starting from raw material procurement to delivery of the systems and also manufactures various kinds of products customized led to with long cycle time which varies across segments and the R&D cycle of defence products and solutions is long, which could stretch over several years. Further, the sharp increase in inventory levels as on March 31, 2021 is attributable to additional stocking of critical raw materials.

Moreover, the systems need to be tested by its customers after delivery, only after which they release the payments. This results in high debtor days at 305 days for FY2021 as compared to 201 days for FY2020. The company meets a part of its working-capital requirements by stretching payments to creditors; however, the same are backed by LCs. Moreover, AMSL offers solutions that form a part of the larger delivery system made by other system integrators with ultimate usage by the Ministry of Defence (MoD), which elongates the cycle further. Successful R&D of systems (for MoD) by AMSL is critical for its revenue growth. Its working capital limits are highly utilised at 94 percent over the past 6 months ends with July 2021. Moreover, the debt levels increased significantly owing to high working capital requirements. Acuite believes that the company's operations are expected to remain high working capital intensive, over the medium term and going forward, the company's ability to alleviate its working capital intensity will be a key rating sensitivity.

- **Decline in Revenues and Revenue concentration in Defence sector**

ASML's revenues declined in FY2021 (Rs. 203.07 Cr against Rs. 245.90 Cr in FY2020 due to adverse impact of the pandemic and slower execution of some ongoing projects; lower order inflow. Despite the declined revenues, the operating profit margin is maintained healthy at 18-20 percent over the past 3 years and expected to be remain healthy at 18-20 % over the medium term too. Defence sector contributes to 80-90% of revenues. Most of the Defence projects are initiated, designed, and developed by Defence establishments, and are driven by government policies and priorities. Thus, as the short-term dynamics of the market are not under the company's control, it faces the risk of uncertain revenue from the Defence segment.

Rating Sensitivity

- Steady improvement in scale of operations supported by healthy order inflows along with an improvement in its profitability
- Further stretch in the working capital cycle leading to increase in working capital borrowing and weakening of financial risk profile.

Material covenants

None

Liquidity Position: Adequate

Liquidity of AMSL is adequate marked by adequate cash accruals to its miniscule repayment obligations; albeit constraint by high working capital intensive nature of its operations. AMSL generated cash accruals of Rs.19 to 35 Cr during the last 3 years through FY2019-21, while its maturing debt obligations were miniscule during the same period. The cash accruals of the company are estimated to remain around Rs.20-25 Cr during 2022-24 while their repayment obligations are estimated to be around Rs.5-6 Cr during the same period. AMSL's operations are high working capital intensive as marked by Gross Current Asset (GCA) days of 502-747 days over the last 3 years ending March 31, 2021 led to highly utilized its working capital at 94 per cent during the last 6 months period ended July 2021. It has a free cash and bank balance of Rs. 0.13 Cr as on March 31, 2021 and current ratio of 2.06 times as on March 31, 2021. Acuite believes that the liquidity of the AMSL is likely to remain adequate over the medium term on account of adequate cash accruals against its repayment obligations.

Outlook: Stable

Acuite believes that AMSL will continue to benefit over the medium term from its promoters' extensive industry experience, and its strong research and development capabilities and healthy financial risk profile. The outlook may be revised to 'Positive' in case of higher-than-expected revenue growth while maintaining profitability and capital structure, or sustained improvement in the working capital cycle. Conversely, the outlook may be revised to 'Negative' in case of a steep decline in profitability margin, or significant weakening in capital structure caused by large, debt-funded capital expenditure or stretched working capital cycle.

About the Rated Entity - Key Financials

	Unit	FY21 (Actual)	FY20 (Actual)
Operating Income	Rs. Cr.	203.07	245.90
PAT	Rs. Cr.	10.25	14.01
PAT Margin	(%)	5.05	5.70
Total Debt/Tangible Net Worth	Times	0.38	0.28
PBDIT/Interest	Times	2.45	3.33

Status of non-cooperation with previous CRA (if applicable)

None

Any other information

None

Applicable Criteria

- Default Recognition - <https://www.acuite.in/view-rating-criteria-52.htm>
- Manufacturing Entities - <https://www.acuite.in/view-rating-criteria-59.htm>
- Application of Financial Ratios and Adjustments - <https://www.acuite.in/view-rating-criteria-53.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/view-rating-criteria-55.htm>

Rating History (Upto last three years)

Date	Name of Instrument / Facilities	Term	Amount (Rs. Cr.)	Ratings/Outlook
09-Sept-2020	Cash Credit	Long Term	42.50	ACUITE BBB-/ Stable (Assigned)
	Cash Credit	Long Term	25.00	ACUITE BBB-/ Stable (Assigned)
	Cash Credit	Long Term	30.00	ACUITE BBB-/ Stable (Assigned)
	Bank Guarantee	Short Term	17.50	ACUITE A3 (Assigned)
	Bank Guarantee	Short Term	12.50	ACUITE A3 (Assigned)
	Letter of Credit	Short Term	30.00	ACUITE A3 (Assigned)

***Annexure – Details of instruments rated**

Lender Name	Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
State Bank of India	Cash Credit	Not Applicable	Not Applicable	Not Applicable	42.50	ACUITE BBB-/Stable (Reaffirmed)
HDFC Bank	Cash Credit	Not Applicable	Not Applicable	Not Applicable	25.00	ACUITE BBB-/Stable (Reaffirmed)
Axis Bank	Cash Credit	Not Applicable	Not Applicable	Not Applicable	40.00	ACUITE BBB-/Stable (Reaffirmed)
Bajaj Finserv	Working Capital Demand Loan	Not Applicable	Not Applicable	Not Applicable	15.00	ACUITE BBB-/Stable (Assigned)
State Bank of India	Bank Guarantee	Not Applicable	Not Applicable	Not Applicable	25.00	ACUITE A3 (Reaffirmed)
Axis Bank	Bank Guarantee	Not Applicable	Not Applicable	Not Applicable	12.50	ACUITE A3 (Reaffirmed)
State Bank of India	Letter of Credit	Not Applicable	Not Applicable	Not Applicable	35.00	ACUITE A3 (Reaffirmed)

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About Acuité Ratings & Research:

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