

Press Release

Apollo Micro Systems Limited

August 05, 2022



Rating Assigned and Upgraded

Product	Quantum (Rs. Cr)	Long Term Rating	Short Term Rating
Bank Loan Ratings	122.50	ACUITE BBB Stable Upgraded	-
Bank Loan Ratings	15.00	ACUITE BBB Stable Assigned	-
Bank Loan Ratings	72.50	-	ACUITE A3+ Upgraded
Total Outstanding Quantum (Rs. Cr)	210.00	-	-
Total Withdrawn Quantum (Rs. Cr)	0.00	-	-

Rating Rationale

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

Acuite has assigned its long-term rating of '**ACUITE BBB**' (read as **ACUITE triple B**) on the Rs.15 Cr bank facilities and of Apollo Micro Systems Limited (AMSL). The outlook is '**Stable**'.

The rating upgrade follows the significant improvement the healthy revenues growth in FY2022 backed by the continued healthy operating margin and the operating profit margin is also expected to remain healthy going forward. The revenues have improved significantly grew by 20% yoy to Rs. 243.19 Cr during FY2022 from Rs. 203.07 Cr in FY2021, and is expected to achieve Rs. 300 Cr in FY2023. AMSL had sustained, healthy EBITDA Margin (FY22: 18.77%, FY21: 18.98%, FY20: 19.79%). The rating also draws comfort the company has a track record of more than three decades in the defence and aerospace electronics industry and extensive experience of management team, strong research and development (R&D), AMSL operates in a niche segment of a high entry barrier Defence and Aerospace industry, the client profile comprises of mostly government organizations with repeat orders received over the years, which mitigates the counter party credit risk to a large extent. The ratings also factors in its healthy financial risk profile backed by healthy capital structure.

The rating, however, continues to remain constrained by the working capital-intensive nature of operations of the company due to a high inventory holding and a long receivable cycle. Going forward, the company's ability to alleviate its working capital intensity, while scaling up its revenues, will be a key rating monitorable.

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 Aerospace, Defence, Space & Homeland 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

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

Key Rating Drivers

Strengths

Experience of management team; established relationships with reputed clientele

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. The major customers include the Ministry of Defence (MoD), Defence Research and Development Organisation (DRDO), BrahMos Aerospace Private Limited, Bharat Electronics Limited (BEL), Hindustan Aeronautics Limited (HAL), and units operated by the Indian Space Research Organisation (ISRO) among others. Acuité believes that similar growth trajectory is likely to continue over the medium term too.

Healthy financial risk profile

AMSL financial risk profile is healthy, marked by a healthy networth, conservative capital structure and comfortable debt protection metrics. The net worth of the company stood at Rs.319.14 Cr. as on 31 March, 2022 as against Rs.304.97 Cr as on 31 March, 2021. This improvement is on the account of healthy accretion to reserves. The gearing (debt/Equity) and TOL/TNW (Total outside liabilities/Total net worth) level (debt-equity) stood at 0.36 times and 0.87 times as on 31 March, 2022 vis-à-vis 0.38 times and 0.74 times as on 31 March, 2021. AMSL's has comfortable debt protection metrics marked by its interest coverage ratio (ICR) and NCA/TD (Net cash accruals to total debt) stood at 2.70 times and 0.20 times respectively in FY2022 vis-à-vis 2.45 and 0.16 times respectively in FY2021. Acuite expects the financial risk profile to remain healthy over the medium term on account of healthy capital structure and stable operations of the company.

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, 2022, AMSL has an unexecuted order book position of Rs. 280 Cr. Acuité believes, with high entry barrier coupled with long term nature of contracts of the order book provides revenue visibility over the medium term. Further, AMSL's growth prospects remain healthy, supported by the Indian Government's focus towards indigenisation in the defence sector amid the Make in India thrust.

Weaknesses

Working capital intensive nature of operations marked by high GCA Days

AMSL's working capital cycle is significantly high marked by its Gross Current Asset (GCA) days to 706 days as on March 31, 2022 from 747 days as on as on March 31, 2021 account of stretched receivables and sizeable inventory. These high GCA days emanates from high inventory days of 547 days as on March 31, 2022 as compared to 501 days for as on March 31, 2021. 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, 2022 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 205 days as on March 31, 2022 as compared to 305 days for as on March 31, 2021. 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 97 percent over the past 12 months ends with June, 2022. Moreover, the debt levels increased significantly owing to high working capital requirements. Acuité 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.

ESG Factors Relevant for Rating

Not Applicable

Rating Sensitivities

- 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 24 Cr during the last 3 years through FY2020-22, 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.4-5 Cr during the same period. AMSL's operations are high working capital intensive as marked by Gross Current Asset (GCA) days of 543-747 days over the last 3 years ending March 31, 2022 led to highly utilized its working capital at ~97 per cent during the last 12 months period ended June 2022. It has a free cash and bank balance of Rs. 0.31 Cr as on March 31, 2021 and current ratio of 1.88 times as on March 31, 2022. Acuité 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.

Other Factors affecting Rating

Not Applicable

Key Financials

Particulars	Unit	FY 22 (Actual)	FY 21 (Actual)
Operating Income	Rs. Cr.	243.19	203.07
PAT	Rs. Cr.	14.62	10.25
PAT Margin	(%)	6.01	5.05
Total Debt/Tangible Net Worth	Times	0.36	0.38
PBDIT/Interest	Times	2.70	2.45

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>
- Entities In Manufacturing Sector - <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

Date	Name of Instruments/Facilities	Term	Amount (Rs. Cr)	Rating/Outlook
29 Oct 2021	Cash Credit	Long Term	40.00	ACUITE BBB- Stable (Reaffirmed)
	Cash Credit	Long Term	25.00	ACUITE BBB- Stable (Reaffirmed)
	Working Capital Demand Loan	Long Term	15.00	ACUITE BBB- Stable (Assigned)
	Cash Credit	Long Term	42.50	ACUITE BBB- Stable (Reaffirmed)
	Letter of Credit	Short Term	35.00	ACUITE A3 (Reaffirmed)
	Bank Guarantee	Short Term	12.50	ACUITE A3 (Reaffirmed)
	Bank Guarantee	Short Term	25.00	ACUITE A3 (Reaffirmed)
09 Sep 2020	Bank Guarantee	Short Term	12.50	ACUITE A3 (Assigned)
	Cash Credit	Long Term	30.00	ACUITE BBB- Stable (Assigned)
	Letter of Credit	Short Term	30.00	ACUITE A3 (Assigned)
	Bank Guarantee	Short Term	17.50	ACUITE A3 (Assigned)
	Cash Credit	Long Term	25.00	ACUITE BBB- Stable (Assigned)
	Cash Credit	Long Term	42.50	ACUITE BBB- Stable (Assigned)

Annexure - Details of instruments rated

Lender's Name	ISIN	Facilities	Date Of Issuance	Coupon Rate	Maturity Date	Quantum (Rs. Cr.)	Rating
State Bank of India	Not Applicable	Bank Guarantee/Letter of Guarantee	Not Applicable	Not Applicable	Not Applicable	25.00	ACUITE A3+ Upgraded
Axis Bank	Not Applicable	Bank Guarantee/Letter of Guarantee	Not Applicable	Not Applicable	Not Applicable	12.50	ACUITE A3+ Upgraded
State Bank of India	Not Applicable	Cash Credit	Not Applicable	Not Applicable	Not Applicable	42.50	ACUITE BBB Stable Upgraded
HDFC Bank Ltd	Not Applicable	Cash Credit	Not Applicable	Not Applicable	Not Applicable	25.00	ACUITE BBB Stable Upgraded
Axis Bank	Not Applicable	Cash Credit	Not Applicable	Not Applicable	Not Applicable	30.00	ACUITE BBB Stable Upgraded
State Bank of India	Not Applicable	Letter of Credit	Not Applicable	Not Applicable	Not Applicable	35.00	ACUITE A3+ Upgraded
Not Applicable	Not Applicable	Proposed Long Term Bank Facility	Not Applicable	Not Applicable	Not Applicable	10.00	ACUITE BBB Stable Upgraded
Not Applicable	Not Applicable	Proposed Long Term Bank Facility	Not Applicable	Not Applicable	Not Applicable	15.00	ACUITE BBB Stable Assigned
Bajaj Finserv Limited	Not Applicable	Working Capital Demand Loan (WC DL)	Not available	Not available	Not available	15.00	ACUITE BBB Stable Upgraded

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About Acuité Ratings & Research

Acuité is a full-service Credit Rating Agency registered with the Securities & Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI) for Bank Loan Ratings under BASEL-II norms in the year 2012. Acuité has assigned ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

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