

Press Release

Zen Technologies Limited (ZTL)

December 10, 2019

Ratings

| Sl. No | Instrument/ Facility | Amount (Rs. Crore) | Ratings | Rating Action |
|---------------|---|---------------------------|--|----------------------|
| 1 | Long Term Bank Facilities – Term Loans | 10.26 | IVR BBB+ /Stable Outlook (IVR Triple B plus with Stable Outlook) | Assigned |
| 2 | Long Term Bank Facilities – Cash Credit | 30.00 | IVR BBB+ /Stable Outlook (IVR Triple B plus with Stable Outlook) | Assigned |
| 3 | Long Term Bank Facilities / Short Term Bank Facilities – Bank Guarantee | 72.00 | IVR BBB+ /Stable Outlook (IVR Triple B plus with Stable Outlook); IVR A2 (IVR A Two) | Assigned |
| 4 | Short Term Bank Facilities – Letter of Credit | 15.00 | IVR A2 (IVR A Two) | Assigned |
| | Total | 127.26 | | |

Details of Facilities are in Annexure 1

Detailed Rationale

The aforesaid rating assigned to the bank facilities of Zen Technologies Limited (ZTL) derives comfort from its Strong promoter group with experienced management team, Strong product portfolio, Asset light business model, Regular revenue visibility in the form of Annual Maintenance Contract (AMC), Strong Technical Base, Comfortable capital structure with healthy debt protection metrics. However, the rating strengths are partially offset by Medium Scale of revenue with volatility; Moderate order book, Volatile profitability, Industry Risk:

Key Rating Sensitivities

Upward revision factors:

Procurement of new orders providing medium term revenue visibility along with a substantial and sustained improvement in the revenue while maintaining the debt protection metrics.

Downward revision factors:

Any decline in the revenue & profitability leading to deterioration of the debt protection metrics.

Key Rating Drivers with detailed description

Key Rating Strengths

Strong promoter group with experienced management team

The promoters of the Zen group have been in the defence training simulators industry since 1993. The group is headed by Mr. Ashok Atluri, who is the Chairman and Managing Director. The company has benefited from his long established track record in the training simulators segment and the vast industry network developed over the years. The company has a team of experienced and capable professionals, having over a two decade of experience in the segment, to look after the overall management. The day-to-day operations of the company are looked after by the senior management having considerable experience with technological background and having worked in training simulators space.

Strong product portfolio

The company manufactures simulators used by the defence as well as civilian institutions. The company has a strong product portfolio and the products of the company are divided into 3 major categories viz. Live Ranges (Smart target system, Containerised tubular shooting range, tank targets etc.), Live Simulation (Indoor tracking system and armor combat training system) and Virtual Simulation (Anti-tank guided missile simulator, Anti-aircraft air defence simulator, UAV Mission Simulator etc.). The company is a prime contractor to Indian Defence and has supplied over 1000 training systems around the world. The industry is relatively concentrated as there are entry barriers in the form of technology involved, long gestation period from conceptualization to implementation and stiff qualification norms for defence tenders. These act as deterrents for new players looking to enter this market. However, ZTL has established its market position and is one of the leading players in the segment.

Asset light business model

Over the years, the Company has strengthened its business around asset-lightness. This approach makes it possible to ramp up its production with reasonable flexibility without a corresponding increase in the capex. The Company's business growth has been facilitated by a robust eco-system of component and sub-system vendors in and around Hyderabad. More than 85 per cent of the Company's manufacturing functions can be outsourced, transforming a fixed cost into a variable expense. Besides, this dependable eco-system possesses adequate spare capacity, making it possible for the Company to accept large orders while adhering to customer schedules.

Regular revenue visibility in the form of Annual Maintenance Contract (AMC)

The after-sales support constitutes a major part of the company's business as the products are highly specialized and tailor made based on the requirements of the customers. A training simulator has a warranty of 1-2 years on an average, after which the company provides regular annual maintenance to the products sold. AMCs typically become operational after 2 years from the date of installation. The life cycle of the product can range from 10-15 years. AMCs potentially generate revenues equivalent to 120% of the initial product sales value generally extended across a 15-year horizon. Thus, the AMCs are expected to last for a long time period providing a long term revenue visibility.

Strong Technical Base

Research & Development (R&D) is the backbone of the company and it has to continuously invest in R&D activities to cater to the varied demands of the clientele which includes coming out with new simulators or modify the existing ones. The company has filed or received over 90 patents. It has invested around Rs.65 crore in the last 5 years ended FY19 in R&D (Around 20% of the last 5 years revenue). The company has been mainly financing R&D activities through profits generated in the normal course of business and some time, if required by taking term loans. Company has been able to achieve this high technical competence due to constant investment in R&D and man power, which has made ZTL one of the leading players in their field. Further with management being healthy mix of technocrats and ex-military officials they understand the importance of being ahead of times and always make investments keeping in mind not only the immediate but even the future needs of its customers, this has helped the company is getting repeat orders.

Comfortable capital structure with healthy debt protection metrics

Zen's capital structure remained comfortable in the last four years ended FY19 except FY18. The overall performance deteriorated in FY18 due fall in sales resulted from spillover of one major order to FY19 & FY20. The overall gearing ratio was 0.31 as on March 31,2019 driven by scheduled repayment of term loans and retention of profit to reserves. Moreover, the interest coverage ratio & Long term debt/GCA remained healthy at 4.71x & 0.68 years respectively in FY19.

Key Rating Weakness

Medium Scale of revenue with volatility; Moderate order book

Zen revenue remains quite volatile in the past four years ended FY19. The volatility was attributed mainly to volatile orders flows. However, even with the volatility revenue grew at a CAGR of 20.5% 7 in the last four years ended FY19. ZTL has an outstanding order book of around Rs.222crore as on July 31, 2019, pertaining to equipment orders of Rs.115 crore and AMC order book of Rs.107 crore (for next 5 years) indicating moderated revenue visibility for short to medium term. Company is trying to diversify its client profile by bidding for tenders globally. Further with increased focus of Make in India company expects good revenue visibility in the coming years.

Volatile profitability

Profitability remains high, however volatile. The lower EBITDA margin in FY18 resulted from decline in sales leading to lower absorption of fixed cost and at the same time continuous R&D expenditure. Infomerics expects profitability to remain comfortable in short to medium term due to economies of scale.

Industry Risk

Some of the other risks that industry faces are dependence on Government for substantial portion of business, high R&D costs with no certainty that the product will be accepted by the customer, stricter user acceptance, high marketing costs & competition from other foreign players.

Analytical Approach & Applicable Criteria:

Standalone Approach

Rating Methodology for Manufacturing Companies

Financial Ratios & Interpretation (Non-Financial Sector)

Liquidity

The current ratio & quick ratio of the company remains strong as on March 31, 2019. The liquidity of the company is expected to remain adequate in the near to medium term in absence of any significant term debt repayment coupled with absence of any major debt led capex. Furthermore, average working capital utilisation in the last twelve months ended August 2019 was comfortable at around 60%.

The company had cash & cash equivalents of Rs.3.69 crore (FY18: Rs.11.80 crores) as on 31 March 2019. It also had other bank balances of Rs.8.59 crore (Rs.31.21 crore) which includes unclaimed dividend, deposit against BG & OD and other fixed deposits.

About the Company

Incorporated in 1993, Zen Technologies Limited designs, develops and manufactures combat training simulator/solutions for the training of defence and security forces. Zen Technologies is headquartered in Hyderabad, India with offices in India and USA. Zen Technologies Limited is an ISO 9001:2015 (QMS), ISO 14001:2015 (EMS), ISO/IEC 27001:2013 (ISMS) and CMMI Maturity Level 5 company.

Zen Technologies is publicly listed on Bombay Stock Exchange and the National Stock exchange.

Financials:

| For the year ended* / As On | 31-03-2018 (Audited) | 31-03-2019 (Audited) |
|-----------------------------|-------------------------|-------------------------|
| Total Operating Income | 38.96 | 92.22 |
| EBITDA | -1.86 | 22.55 |
| PAT | -0.39 | 19.24 |
| Total Debt | 10.10 | 41.80 |
| Tangible Net-worth | 116.12 | 132.89 |
| EBITDA Margin (%) | -4.77 | 24.45 |
| PAT Margin (%) | -0.90 | 20.18 |
| Overall Gearing Ratio (x) | 0.09 | 0.31 |

* Classification as per Infomerics' standards

Infomerics Valuation and Rating Pvt. Ltd.



Status of non-cooperation with previous CRA: Not applicable

Any other information: N.A

Rating History for last three years:

| Sl. No. | Name of Instrument/ Facilities | Current Rating (Year 2019-20) | | | Rating History for the past 3 years | | |
|---------|---|-------------------------------|--------------------------------|-------------------------------------|---|---|---|
| | | Type | Amount outstanding (Rs. crore) | Rating | Date(s) & Rating(s) assigned in 2018-19 | Date(s) & Rating(s) assigned in 2017-18 | Date(s) & Rating(s) assigned in 2016-17 |
| 1. | Long Term Bank Facilities – Term Loan | Long Term | 10.26 | IVR BBB+ /Stable Outlook | -- | -- | -- |
| 2. | Long Term Bank Facilities – Cash Credit | Long Term | 30.00 | IVR BBB+ /Stable Outlook | | | |
| 3. | Long Term/Short Term Bank Facilities – Bank Guarantee | Long Term/Short term | 72.00 | IVR BBB+ /Stable Outlook/ IVR A2 | -- | -- | -- |
| 4. | Short Term Bank Facilities – Letter of Credit | Short Term | 15.00 | IVR A2 (IVR A Two) | | | |

Note on complexity levels of the rated instrument: Infomerics has classified instruments rated by it on the basis of complexity and a note thereon is available at www.infomerics.com.

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About Infomerics:

Infomerics commenced rating & grading operations in April 2015 after having spent over 25 years in various segments of financial services. Infomerics is registered with the Securities and Exchange Board of India (SEBI) and accredited by Reserve Bank of India. Company's long experience in varied spectrum of financial services is helping it to fine tune its product offerings to best suit the market.

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Annexure 1: Details of Facilities

| Name of Facility | Date of Issuance | Coupon Rate/ IRR | Maturity Date | Size of Facility (Rs. Crore) | Rating Assigned/ Outlook |
|---|-------------------------|-------------------------|----------------------|-------------------------------------|----------------------------------|
| Long Term Bank Facilities – Term Loans | NA | NA | March 2022 | 10.26 | IVR BBB+ /Stable Outlook |
| Long Term Bank Facilities – Cash Credit | | | | 30.00 | IVR BBB+ /Stable Outlook |
| Long Term Bank Facilities / Short Term Bank Facilities – Bank Guarantee | NA | NA | NA | 72.00 | IVR BBB+ /Stable Outlook/ IVR A2 |
| Short Term Bank Facilities – Letter of Credit | | | | 15.00 | IVR A2 (IVR A Two) |