April 05, 2024

# Paras Defence & Space Technologies Limited: Ratings reaffirmed; outlook revised to Negative from Stable; rated amount enhanced

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| **Long-term – Cash credit** | 39.00 | 39.00 | [ICRA]A-(Negative); Reaffirmed; outlook revised to 'Negative' from 'Stable' |
| **Long-term/Short-term – Bank guarantee & LC** | 71.00 | 157.75 | [ICRA]A-(Negative)/[ICRA]A2+; Reaffirmed; outlook revised to 'Negative' from 'Stable'; assigned for enhanced amount |
| **Long-term – Fund-based – Overdraft** | 0.00 | 5.00 | [ICRA]A-(Negative); Assigned |
| **Total** | **110.00** | **201.75** | |

**Instrument details are provided in Annexure-I*

## Rationale

The revision in outlook of Paras Defence & Space Technologies Limited (PDSTL) to Negative for the long-term rating reflects the deterioration in its operating margins, increase in the working capital intensity and the consequent moderation in liquidity position in 9M FY2024. The operating margins declined to 22.3% at a consolidated level in 9M FY2024 due to a rise in employee costs and change in revenue mix towards relatively lower profitable products/segments. The company has made substantial investments in workforce expansion to execute upcoming orders, thereby resulting in a significant increase (+45% YoY) in 9M FY2024. Further, the contribution from defence electronics and heavy engineering were higher, which have relatively lower margins compared to the optics segment. The company's working capital intensity further increased in H1 FY2024 (NWC/OI at 114.8%) due to a stretch in receivable. This has weakened the company's liquidity cushion with unencumbered cash balance declining to ~Rs. 8 crore as on December 31, 2023 (against ~Rs. 37 crore as on March 31, 2023), and high fund-based utilisation at ~92% as on December 31, 2023. Going forward, the company's ability to judiciously manage its working capital and improve its liquidity position remains crucial from the credit perspective.

The ratings continue to favourably factor in the healthy order book position as on December 31, 2023, which translates to a comfortable Order Book/Operating Income (OB/OI) ratio of 2.4 times of the OI in FY2023, providing medium-term revenue visibility. The ratings continue to favourably consider the company's low leverage with TOL/TNW of 0.3 times as on September 30, 2023. The interest coverage stood at 12.2 times in 9M FY2024 due to limited dependence on external borrowings to fund its working capital. The ratings draw comfort from the extensive experience of the management team with more than three decades of experience in designing, developing, and manufacturing a wide range of engineering products and solutions for the defence and space sector in the domain of optics, heavy engineering and electronics. PDSTL's long presence in the defence and space sector has helped it to establish strong relationships with its customers as well as suppliers. The company has developed a strong management and execution team comprising several ex-employees of Bharat Electronics Limited (BEL) and Defence Research and Development Organisation (DRDO), among others.

The ratings remain constrained by the company's working capital-intensive nature of operations with NWC/OI of 88.3% and 114.8% in FY2023 and H1 FY2024, respectively, due to the high inventory holding period and long receivables cycle. The inventory levels are high because of the additional stocking of critical raw materials to avoid any disruption in the delivery schedules and high work in progress due to elongated manufacturing cycle. The ratings are constrained by PDSTL's moderate scale of operations. The client concentration risk remains high with top three clients contributing to 46% of the total order book as on December 31, 2023. The Government's thrust on 'Make in India' in the defence sector and the strong credit profile of its principal customers augur well for PDSTL. PDSTL's client profile mostly comprises Government organisations with sustained repeat orders, largely mitigating the counterparty credit risk. Going forward, the company's ability to alleviate its working capital intensity, while scaling up its revenues and improving its operating margins, will be the key rating monitorable.

## Key rating drivers and their description

### Credit strengths

**Healthy order book provides medium-term revenue visibility** – The company's fresh order inflows over the past four fiscals remained adequate, with orders worth ~Rs. 621 crore added in the last 21 months ending December 31, 2023. The pending order book of Rs. 526.3 crore as on December 31, 2023 (OB/OI ratio of 2.4 times of the OI in FY2023) provides medium-term revenue visibility.

**Comfortable capital structure and healthy coverage indicators** – The company's capital structure remains comfortable with TOL/TNW of 0.3 times as on September 30, 2023, supported by equity infusion of Rs. 162.3 crore during FY2021-FY2022 and low debt levels. The interest coverage stood at 12.2 times in 9M FY2024 due to the limited dependence on external borrowings to fund its working capital. Going forward, ICRA expects the coverage indicators to remain comfortable, benefitting from the scale-up in operations, given the strong order pipeline.

**Extensive experience of management team** – PDSTL's promoters have more than three decades of experience in designing, developing and manufacturing a wide range of engineering products and solutions for the defence and space sector in the domain of optics, heavy engineering and electronics. Its long presence in the defence and space sector has helped to establish strong relationships with its customers as well as suppliers. It has developed a strong management and execution team comprising several ex-employees of BEL and DRDO, among others.

### Credit challenges

**High working capital intensity due to elongated receivables cycle** – The business is working capital intensive with NWC/OI of 88.3% and 114.8% in FY2023 and H1 FY2024, respectively, owing to the high inventory holding period and long receivables cycle. The inventory levels are high because of additional stocking of critical raw materials to avoid any disruption in the delivery schedules and high work-in-progress due to elongated manufacturing cycle. PDSTL has been partly managing its working capital cycle by stretching its trade payables by more than three months as it has a longstanding relationship with most of its suppliers and availing mobilisation advance for part orders. Going forward, the company's ability to alleviate its working capital intensity while scaling up its revenues and improving its operating margins will be the key rating monitorable.

**Moderate scale of operations** – Though the company reported a robust YoY revenue growth of 21% and 10% in FY2023 and 9M FY2024, respectively, supported by healthy order book and the timely execution of orders, the scale of operations still remains moderate. Given the Government's thrust on 'Make in India' in the defence sector, PDSTL has been mainly catering to domestic demand (~84% of OI contributed by domestic orders in FY2023). Driven by the healthy order book status, ICRA expects the company to sustain its revenue growth in FY2024 and FY2025.

**High customer concentration risk, though largely mitigated by reputed customer base and repeat orders** – The company faces client concentration risk with top three clients contributing 46% to the total order book as on December 31, 2023 and top five clients accounting for 51% of the revenue in FY2023. The client profile mostly comprises government organisations with repeat orders received over the years, largely mitigating the counterparty credit risk. A major part of PDSTL's clientele included reputed government organisations, namely Laboratory for Electro-Optics Systems (a unit of ISRO), BEL, Instruments Research and Development Establishment (a unit of DRDO) and private companies like RRP S4E Innovation Private Limited and Unifab Engineering Project Private Limited. The company has long standing relationships with most of its clientele. PDSTL also exports to companies based in Israel, Singapore and USA.

## Environment and Social Risk

**Environmental considerations** – PDSTL is operating in the defence equipment manufacturing industry, which requires various raw materials and also entails sizeable energy and water requirements for running its multiple facilities. To safeguard the environment against the impact of its operations, and possible regulatory action for violation of applicable environmental laws, the company has tied up with State Pollution Control Board (PCB) authorities for appropriately disposing/recycling solid hazardous waste at its manufacturing sites.

**Social considerations** – PDSTL is dependent on human capital and hence, retaining talent, maintaining healthy employee relations, as well as supplier ecosystem remains essential for disruption-free operations. Going forward, the company's ability to manage risks related to safety in the areas of process, and occupational health, while developing safety leadership capabilities, will remain a key factor from the social consideration perspective.

## Liquidity position: Adequate

PDSTL has adequate liquidity, with an unencumbered cash and bank balance of ~Rs. 8 crore as on December 31, 2023. Further, it had no long-term debt as on December 31, 2023. The average working capital utilisation during the 12-month period that ended in December 31, 2023 remained at 66%, with adequate cushion available in non-fund based limits (utilisation being ~64% as on December 31, 2023).

## Rating sensitivities

**Positive factors** – The outlook will be revised to Stable if the company demonstrates a material improvement in its working capital cycle and liquidity position, along with improvement in earnings and scale of operations.

**Negative factors** – Pressure on PDSTL's ratings could arise if lower-than-anticipated billing or a deterioration in the operating profitability or inability to improve working capital cycle impacts the company's liquidity.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable rating methodologies** | [Corporate Credit Rating Methodology]() |
| **Parent/Group support** | Not Applicable |
| **Consolidation/Standalone** | Consolidated; the list of companies that are consolidated to arrive at the ratings are given in Annexure II |

## About the company

Set up in 1971 by Mr. Sharad Shah, PDSTL designs, develops and manufactures a wide range of engineering products and solutions for the defence and space sector in the domain of optics, heavy engineering and electronics. It has two manufacturing facilities – one in Ambernath (Thane) and the other in Nerul (Navi Mumbai). Reputed government organisations, namely Laboratory for Electro Optics Systems (a unit of ISRO), BEL, Instruments Research and Development Establishment (a unit of DRDO), and private companies like FFS Industries Private Limited and SEC Industries Private Limited, form a major part of the company's clientele. Its day-to-day operations are currently managed by Mr. Munjal Shah (son of Mr. Sharad Shah).

## Key financial indicators (audited)

| Consolidated | FY2022 | FY2023 | 9M FY2024* |
|---|---|---|---|
| **Operating income** | 183.5 | 222.8 | 173.8 |
| **PAT** | 27.1 | 36.1 | 20.5 |
| **OPBDIT/OI** | 29.1% | 26.3% | 22.3% |
| **PAT/OI** | 14.8% | 16.2% | 11.8% |
| **Total outside liabilities/Tangible net worth (times)** | 0.2 | 0.3 | - |
| **Total debt/OPBDIT (times)** | 0.6 | 0.3 | - |
| **Interest coverage (times)** | 6.4 | 7.6 | 12.2 |

*Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. crore*

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation*

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for past three years

| S. No. | Instrument | Current Rating (FY2025) | | | | Chronology of Rating History for the Past 3 Years | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Rated (Rs. crore) | Amount Outstanding as on Dec 31, 2023 (Rs. crore) | Date & Rating in FY2025 | Date & Rating in FY2024 | Date & Rating in FY2023 | Date & Rating in FY2022 | |
| | | | | | Apr 05, 2024 | - | Jan 27, 2023 | Oct 27, 2021 | Sept 30, 2021 |
| 1 | **Cash credit** | Long term | 39.0 | - | [ICRA]A- (Negative) | - | [ICRA]A- (Stable) | [ICRA]A- (Stable) | [ICRA]A- (Stable) |
| 2 | **Term loan** | Long term | 0.0 | - | - | - | - | [ICRA]A- (Stable) | - |
| 3 | **Bank guarantee & LC** | Long term/ Short term | 157.75 | - | [ICRA]A- (Negative)/ [ICRA]A2+ | - | [ICRA]A- (Stable)/ [ICRA]A2+ | [ICRA]A- (Stable)/ [ICRA]A2+ | - |
| 4 | **Invoice discounting** | Short term | 0.0 | - | - | - | - | [ICRA]A2+ | - |
| 5 | **Overdraft** | Long Term | 5.00 | - | [ICRA]A- (Negative) | - | - | - | - |

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| **Long-term – Fund-based - Cash credit** | Simple |
| **Long-term – Fund-based - Overdraft** | Simple |
| **Long-term/Short-term - Bank guarantee & LC** | Very Simple |

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here.

## Annexure I: Instrument details

| ISIN | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | Cash credit | NA | NA | NA | 39.00 | [ICRA]A-(Negative) |
| NA | BG & LC | NA | NA | NA | 157.75 | [ICRA]A-(Negative)/ [ICRA]A2+ |
| NA | Overdraft | NA | NA | NA | 5.00 | [ICRA]A-(Negative) |

*Source: Company*

*Please click here to view details of lender-wise facilities rated by ICRA*

## Annexure II: List of entities considered for consolidated analysis

| Company Name | Ownership | Consolidation Approach |
|---|---|---|
| Paras Aerospace Pvt Ltd | 60.00% | Full Consolidation |
| Paras Green Optics Pvt Ltd | 100.00% | Full Consolidation |
| Paras Anti Drone Technologies Private Limited | 55.00% | Full Consolidation |
| Ayatti Innovative Private Limited | 58.02% | Full Consolidation |
| OPEL Technologies PTE Ltd | 100.00% | Full Consolidation |
| Krasny Paras Defence Technologies Private Limited | 47.50% | Equity Method |

*Source: Company*

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## About ICRA Limited:

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