January 11, 2024

Embee Software Private Limited: Ratings downgraded to [ICRA]BBB (Stable)/ [ICRA]A3+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based Limits – Working Capital Facilities	119.30	105.50	[ICRA]BBB (Stable), downgraded from [ICRA]BBB+ (Stable)
Long-term/ Short-term – Non-Fund based Limits – Working Capital Facilities	62.40	39.50	[ICRA]BBB (Stable)/ [ICRA]A3+, downgraded from [ICRA]BBB+ (Stable)/ [ICRA]A2
Total	**181.70**	**145.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings downgrade considers the sharp drop in the profits and cash accruals of Embee Software Private Limited (Embee) in FY2023 despite a substantial increase in revenue, primarily due to a significant payout of management fees to its parent Group and other extraordinary expenses. The same accentuated further due to write-off of a sizeable inventory in FY2023. This, in turn, has adversely impacted the debt coverage indicators of the company. Although, ICRA expects some improvement in its operating margin (OPM) and coverage indicators in FY2024 on a YoY basis, the extent of improvement would depend on management fee payout and extraordinary expenses, if any.

Meanwhile, the ratings continue to factor in the established operational track record of Embee as an information technology (IT) service provider to reputed institutional clients and relationship with globally renowned vendors in the IT space. The ratings also draw comfort from Embee's strategic engagement with its key supplier, Microsoft. Around 80-90% of Embee's revenues, over the past few years, has been derived from sales of Microsoft products. ICRA notes that the top line of the company witnessed a robust growth of around 57% in FY2022 over the previous fiscal and again recorded a significant growth of around 45% in FY2023 on a YoY basis, majorly driven by an increasing sale of cloud-based products.

The ratings, however, are constrained by the limited pricing flexibility due to the competitive nature of the business, which keeps Embee's operating margin under check. ICRA also notes the entity's high receivable level, which exerts pressure on its liquidity position, and its high total outside liabilities relative to the tangible net worth due to significant dependence on creditor funding. However, a consistent increase in the credit limit by Microsoft supports the sustainability of such creditor funding. Going forward, the company's ability to improve its margins, while growing volumes over a moderate working capital cycle, will be the key determinants of its financial risk profile. Currently, the proposed merger plan of Embee with its parent/ holding company – Noventiq Services India Private Limited – has been kept on hold. ICRA would continue to monitor the developments in this regard and review the company's performance, as and when further clarity emerges.

The Stable outlook on the long-term rating reflects ICRA's opinion that Embee will continue to benefit from its established operational track record and relationship with globally renowned vendors in the information technology space.

Key rating drivers and their description

Credit strengths

Established operational track record and relationship with globally renowned vendors in the information technology space – Embee has an operational track record of more than 30 years as an IT solution provider. It has established working relationships with leading IT vendors like Microsoft, Adobe, Cisco, HP, Epson, Trend Micro, Oracle, SAP, Dell etc. It has long experience in reselling of software and hardware, and as a solution provider to corporate customers.

Significant growth in the scale of operations over the past two years – The turnover of Embee witnessed a robust growth over the past two years, primarily driven by the increasing off-take in the cloud segment. The top line of the company rose to Rs. 1,673 crore in FY2023 from Rs. 1,151 crore in FY2022, registering a growth of around 45%. With an increasing demand for cloud-based products, the company's revenue from the cloud segment registered a robust expansion in the recent years. The cloud segment contributed around 77% to the company's turnover in FY2023 vis-à-vis around 64% in FY2021. While revenue from the service segment moderated to an extent in FY2023, the revenues from the networking as well as the software segments witnessed a steep growth compared to FY2022. Although Embee registered a turnover of around Rs. 786 crore in 7M FY2024, (against around Rs. 752 crore in 7M FY2023), ICRA expects the top line growth to remain muted in FY2024.

Strategic engagement with Microsoft strengthens Embee's business profile – Embee generates the major portion (80-90%) of its revenues from sale of Microsoft products. The company has been designated as a licensing solutions partner (LSP) of Microsoft for volume licensing of software, which is the highest level of channel partnership that Microsoft offers at the national level. This status helps Embee to sell Microsoft products directly to large institutional customers through enterprise agreements (EA). Embee is one of the few LSPs of Microsoft in the country at present. In addition, Embee is also a cloud service provider (CSP) of Microsoft. The company won Microsoft India Area Award 2021 – Cloud Innovation Partner of the Year. The company also won the Microsoft MWP – Partner of the Year Award, India 2022. Embee's strategic engagement with Microsoft strengthens its market position and helps expand its customer base. Also, the company is able to get benefits in the form of higher credit without any security coverage (based on global corporate guarantee of the Noventiq Group) for being a part of the Noventiq Group.

Credit challenges

Highly competitive business segment; limited pricing flexibility exerts pressure on margins – Competitive nature of the business and trading nature of a significant portion of the revenues limit the company's pricing flexibility, keeping the operating margin under check.

Sharp decline in profitability over the past three years, adversely impacting debt protection metrics – The operating profit margin (OPM) of the company is inherently low due to the nature of the industry in which it operates, characterised by intense competition among players in a high volume-low margin trading business. Embee's OPM in FY2020 stood at around 3.5% (around 3.9% in FY2019). Significant payout of management fees to its parent Group, retention bonus and other extraordinary expenses resulted in a gradual decline in the OPM over the past three years. The same accentuated further due to the write-off of a sizeable inventory in FY2023. The net margin also stood low at around 0.2% in FY2023. Although ICRA expects some improvement in OPM in FY2024 on a YoY basis, the extent of the same would depend on management fee payout and extraordinary expenses, if any.

Aggressive capital structure; high total outside liabilities relative to tangible net worth due to substantial creditors funding – The gearing of the company stood low at around 0.8 times as of March 2023 owing to low reliance on external debt. However, significant credit availed from the vendors kept the company's total outside liabilities relative to the tangible net worth (TOL/TNW) high at 7.7 times as on March 31, 2023 (5.7 times as on March 31, 2022). A consistent increase in the credit limit by Microsoft supports the sustainability of such creditor funding. Owing to a decline in profits and cash accruals from the business, the debt protection metrics were adversely impacted in FY2023. Nevertheless, with a likely improvement in the profits and cash accruals, the overall capital structure and coverage indicators of the company are estimated to improve to some extent in FY2024 compared to the previous fiscal.

Large receivables position necessitates high working capital requirement – Embee's receivable level remained high in the recent years due to significant credit period offered to its customers and a sizeable billing towards the year-end. Moreover, a part of the receivables for project-based revenues has a long recovery schedule post implementation, which increases the receivable level further, exerting pressure on liquidity. These are backed by the credit period offered by vendors and working capital borrowings. Nonetheless, the counterparty credit risk remained low, as reflected by low delinquency in the past.

Liquidity position: Adequate

The company generated positive cash flow from operations over the past three years, supported by a decline in the working capital intensity of operations. However, the working capital requirement continued to remain high with increasing scale of operations, which was funded through creditors as well as working capital borrowings. The company's debt repayment obligation remains at a high level. The average utilisation of the working capital limits of the company remained at around 72% during the last 15 months ended in October 2023. The company's cash flow from operations may turn negative in FY2024, with an increase in the working capital intensity of operations. Nevertheless, absence of any planned capital expenditure programme, undrawn working capital limits and availability of unencumbered cash/ bank balance (around Rs. 130 crore as on March 31, 2023) would be sufficient to meet the additional working capital requirement. ICRA expects the overall liquidity position of the company to remain adequate, in the near term at least.

Rating sensitivities

Positive factors – ICRA may upgrade Embee's ratings if the entity demonstrates a significant improvement in profitability along with a sizeable reduction in receivables, easing its liquidity position.

Negative factors – Pressure on Embee's ratings may arise if its revenues and profitability decline significantly. Besides, a stretch in the receivables, exerting pressure on the liquidity position, will also be a credit negative. Specific credit metrices that may trigger ratings downgrade include an interest coverage of less than 2.8 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology IT - Software & Services
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financial statements of the entity

About the company

Incorporated in 1988, Embee Software Private Limited (Embee) was originally promoted by Mr. Sudhir Kothari based in Kolkata. The company mainly acts as an information technology (IT) solution provider to corporate customers through consulting, systems integration, managed services etc. In 2011, the company was awarded the large account reseller (LAR) status by Microsoft for volume licensing business. The company won the Microsoft MWP – Partner of the Year Award, India 2022 and SAP Emerging Partner of the Year Award 2023. The company generates around 85% of its revenue from Microsoft products and continues to have strategic tie-ups with other globally renowned principals like SAP, Adobe, HP, Cisco, Epson etc.

Noventiq Group Inc. (formerly known as Softline Group Inc.), through its Indian arm, Noventiq Services India Private Limited (formerly known as Softline Services India Private Limited), acquired a 94.71% stake in Embee Software Private Limited in FY2021. The balance 5.29% stake was acquired by Noventiq Holding PLC from Embee Consulting Services Pte. Ltd in FY2023. Noventiq Group is a licensing solution partner of Microsoft at a global level. Earlier, it was planned that Embee would get merged with its parent company, Noventiq Services India Private Limited. However, the same has been kept on hold, at present.

Key financial indicators (audited)

Embee, Standalone	FY2022	FY2023
Operating income	1,151.4	1,672.6
PAT	13.1	4.0
OPBDIT/OI	1.8%	0.9%
PAT/OI	1.1%	0.2%
Total outside liabilities/Tangible net worth (times)	5.7	7.7
Total debt/OPBDIT (times)	3.1	5.6
Interest coverage (times)	3.4	1.3

Source: Embee Software Private Limited, ICRA Research; 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

	Instrument	Current rating				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as on Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	
					Jan 11, 2024	Nov 30, 2022	Aug 19, 2021	Feb 3, 2021	May 29, 2020
1	**Fund-based – Working Capital Facilities**	Long Term	105.50	50.08	**[ICRA]BBB (Stable)**	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	**Non-Fund based – Working Capital Facilities**	Long term/ Short term	39.50	-	**[ICRA]BBB (Stable)/ [ICRA]A3+**	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]BBB+ (Stable)/ [ICRA]A2
3	**Fund-based/ Non-Fund based bank facilities**	Long term/ Short term	-	NA	-	-	-	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]BBB+ (Stable)/ [ICRA]A2

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term – Fund-based Limits – Working Capital Facilities	Simple
Long-term/ Short-term – Non-Fund based Limits – Working Capital Facilities	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
-	**Inventory Funding**	-	-	-	20.00	[ICRA]BBB (Stable)
-	**Invoice Discounting**	-	-	-	20.00	[ICRA]BBB (Stable)
-	**Cash Credit/ WCDL 1**	-	-	-	18.50	[ICRA]BBB (Stable)
-	**Cash Credit/ WCDL 2**	-	-	-	30.00	[ICRA]BBB (Stable)
-	**Channel Finance**	-	-	-	17.00	[ICRA]BBB (Stable)
-	**Bank Guarantee 1**	-	-	-	24.50	[ICRA]BBB (Stable)/ [ICRA]A3+
-	**Bank Guarantee 2**	-	-	-	15.00	[ICRA]BBB (Stable)/ [ICRA]A3+

Source: Embee Software Private Limited

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

Annexure II: List of entities considered for consolidated analysis

Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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