

February 18, 2020

Alpha Design Technologies Private Limited: [ICRA]BBB+(Stable) assigned for enhanced amount

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term – Cash Credit	101.00	101.00	[ICRA]BBB+ (Stable) outstanding
Long Term – Term Loan	45.00	61.30	[ICRA]BBB+ (Stable); outstanding/assigned
Short Term – Bank Guarantee	102.00	102.00	[ICRA]A2; outstanding
Non-fund Based – Interchangeable	(30.00)	(20.00)	[ICRA]A2; outstanding
Total	248.00	264.30	

*Instrument details are provided in Annexure-1

Rationale

The ratings take into consideration the sizeable equity investment received from Adani Defence Systems and Technologies Private Limited recently through the acquisition of a 26% stake in Alpha Design Technologies Private Limited (ADTPL¹). This has led to a significant improvement in ADTPL's capital structure, enabling the company for the aggressive growth targeted over the next 18 to 24 months. The ratings continue to factor in the favourable exports and domestic growth prospects for the Defence industry arising from the Defence Procurement Policy and offset requirements. The ratings benefit from ADTPL's unexecuted order book position, which provides healthy revenue visibility over the medium term. The ratings continue to derive comfort from the established project execution track record of the company in the Defence industry. The ratings also take into consideration its diversified product profile across segments and technical collaboration with various foreign Defence majors. The ratings continue to favourably factor in the company's established research and development (R&D) capabilities, its highly qualified employee base and its established relationship with a reputed clientele in the domestic and international Defence industry.

The ratings, however, continue to be constrained by the working capital-intensive nature of the business. The working capital intensity, as measured by NWC/OI, increased to 75.3% in FY2019 from 55.5% in FY2018, owing to the sizeable billing towards the end of the year as well coupled with high inventory holding. Further, the ratings consider the seasonality of cash flows, which are highly concentrated in the third and fourth quarters, and project deferrals due to procedural delays, which lead to revenue deferment. ICRA also takes into consideration the long gestation cycle of investments towards the designing and development of products, which is inherent in the Defence industry. ICRA also takes note of the delay in the commissioning of ADTPL's simulator projects, which are critical for its cash flows and profitability. ICRA also notes the company's high reliance on the Elbit Group for the majority of its revenues, though its established relationship with the Elbit Group provides comfort, to an extent.

¹ Hereafter, ADTPL represents the consolidated performance of Alpha Design Technologies Private Limited, its subsidiaries (Alpha-Tocol Engineering Services Pvt Ltd, Alpha Elettronica Defence Systems Pvt Ltd, Reline Thermal Imaging and Software Pvt Ltd, Microwave & Optronics Systems Pvt Ltd) and its joint venture – Alpha-Elsec Defence & Aerospace Systems Pvt Ltd
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The Stable outlook on the [ICRA]BBB+ rating reflects ICRA's opinion that ADTPL will continue to benefit from the extensive experience of its promoters, established project execution track record and reputed clientele in the domestic and international Defence industry.

Key rating drivers and their description

Credit strengths

Capital infusion from Adani Defence resulting in improved capital structure and debt coverage metrics – In December 2018, Adani Defence Systems and Technologies Limited acquired a 26% stake in ADTPL for a total acquisition value of Rs. 400.0 crore. Out of this, ADTPL received Rs. 175.0 crore in FY2019, and another Rs. 150.0 crore in FY2020 till date. The remaining Rs. 75.0 crore is expected to be received by March 2020.

Backed by the equity infusion, the company's capital structure improved to 0.2 times as on March 31, 2019 from 0.6 times as on March 31, 2018. Other debt coverage metrics also improved significantly with Total Debt/OPBDITA of 1.8 times, TOL/TNW of 0.8 times and NCA/TD of 38.8% as on March 31, 2019 compared to 3.8 times, 1.3 times and 19.6%, respectively, as on March 31, 2018.

Established track record of more than 15 years in Defence industry – ADTPL has an established track record of more than 15 years in the designing, development and manufacturing of electronic, electrical, optical and telecommunication equipment for strategic Defence programmes for the Indian Armed Services and international Defence majors. Its management team consists of personnel from an engineering and technical background with experience in various Defence organisations. The company's technical competence, as reflected by its successful track record of designing, developing and executing various prestigious Defence projects, has aided in getting repeat business from existing customers.

Diversified product profile across segments – ADTPL offers a wide range of products and services across its segments. Over the years, it has developed expertise in R&D, manufacturing, quality assurance, evaluation and system integration for various Defence products such as battle tanks, fighter aircraft, helicopters, unmanned aerial vehicles, avionics equipment including missile launch detection systems (MILDS), IFF, optronics, LRF-based products, laser target designators (LTD), thermal imagers & fire control systems (TIFCS), navigation, tactical communication, software defined radios (SDR), image conversion, data & image fusion, radar, RF seekers, C3I systems, electronic warfare, simulators, microwave components and RF units for Indian and international markets.

Established relationships with reputed Defence organisations – ADTPL has established relationships with reputed Defence organisations in the domestic and overseas market. Under its Defence segment, major domestic customers include the Ministry of Defence (MoD), various Defence laboratories under Defence Research and Development Organisation (DRDO), Defence PSUs such as Bharat Electronics Limited (BEL) and Hindustan Aeronautics Limited (HAL) and units operated by Indian Space Research Organisation (ISRO), etc. ADTPL has also benefitted from its association with foreign partners like Elbit Security Systems Limited and Israel Aerospace Industries in Israel, European Aeronautic Defence and Space Co. in Germany, Elettronica S.p.A in Italy, MBDA Missile Systems in France, Rosoboronexport in Russia, etc, by gaining access to foreign markets, orders through offset agreements and advanced technical know-how.

Healthy unexecuted order book position provides medium-term revenue visibility – The company's unexecuted order book position remains high. This, coupled with the expected orders, provides revenue visibility over the medium term. However, the timely execution of orders would remain critical for achieving revenue growth and profitability on the expected lines.

Credit challenges

Moderate scale of operations – The operating income (OI) of ADTPL remained moderate and stood at Rs. 268.0 crore in FY2019 compared to Rs. 212.9 crore in FY2018, limiting its operational and financial flexibility to an extent. The company reported lower-than-estimated OI, primarily on account of the deferment of deliveries for certain orders and delays in the commissioning of its simulator projects.

High working capital intensity due to high debtor and inventory days – The company's working capital cycle and liquidity position continued to be impacted by the long receivables cycle, resulting in high working capital borrowings. The working capital intensity, as measured by NWC/OI, increased to 75.3% in FY2019 with a further increase in the receivables position. The inventory holding is high as the company needs to maintain high raw material inventory for ongoing projects due to high lead times for several critical components. The project billing and delivery schedule for the Defence business is usually concentrated towards the third and fourth quarters, which results in skewed working capital requirements and high debtors towards the end of the year.

High customer concentration though established relationship provides comfort – ADTPL's customer concentration remained high in FY2019 with significant reliance on the Elbit Group for most of its revenues. Moreover, the top five customers accounted for 72.3% of the company's revenues compared to 87.0% in FY2018. However, ADTPL's long-term association with reputed customers provides stability to its business.

Long gestation periods in Defence segment – The R&D cycle of Defence products and solutions is long and could stretch for several years. Moreover, ADTPL offers products and solutions that form a part of the larger delivery system manufactured by other system integrators with the end customer being the MoD. This elongates the cycle further.

Seasonality in order execution cycle and project-related risks – The order execution cycle faces seasonality, leading to uneven cash flows throughout the year and exposure to cost and time overruns, especially for high-valued projects with long-term execution cycles. This could make it difficult to sustain margins for such contracts.

Liquidity position: Adequate

ADTPL's liquidity position remains adequate, as reflected by the average working capital utilisation of around 70% between April 2018 and January 2020. The company also had free cash and bank balance of over Rs. 20.0 crore as on January 31, 2020. Going forward, the liquidity position is expected to improve with the commissioning of the simulator centres and the receipt of the remaining Rs. 75.0-crore equity investment from Adani Defence Systems and Technologies Private Limited. ADTPL's operational cash accruals are expected to be adequate to meet its debt repayment obligations.

Rating sensitivities

Positive triggers – ICRA could upgrade ADTPL's ratings if it demonstrates a sustained improvement in its scale of operations and profitability through the timely execution of its order book, leading to improved return indicators and debt protection metrics, while improving its working capital intensity. Specific credit metrics that could lead to a rating upgrade include RoCE of more than 12.0%.

Negative triggers – Negative pressure on the company's ratings could arise if its profitability and cash flows deteriorate from the current levels. ICRA could also downgrade ADTPL's ratings if the working capital intensity remains high on a sustained basis. Specific credit metrics that could lead to a rating downgrade include a DSCR of <1.8 times.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated performance of Alpha Design Technologies Private Limited, its subsidiaries (Alpha-Tocol Engineering Services Pvt Ltd, Alpha Elettronica Defence Systems Pvt Ltd, Reline Thermal Imaging and Software Pvt Ltd, Microwave & Optronics Systems Pvt Ltd) and its joint venture, Alpha-Elsec Defence & Aerospace Systems Pvt Ltd, given the strong operational and financial synergies between the companies

About the company

Alpha Design was founded in 2003 by Retired Col. H. S. Shankar (ex-Director of R&D at BEL) and Vasaka Promoters and Developers Private Limited, holding a stake of 56.77% (earlier 85.8%). Vasaka is a special purpose vehicle (SPV) that was founded by the promoters of the Murugappa Group and the Karvy Group for investment in ADTPL. In December 2018, Adani Defence Systems and Technologies Limited, a wholly-owned subsidiary of Adani Enterprises Limited, acquired a 26% stake in ADTPL. While Col. Shankar spearheads the operations and management of the company, the seed capital for the venture was mainly provided by Vasaka. The company designs and manufactures electronic, electrical, optical and telecommunication devices for the Defence sector. Col. Shankar has held senior positions in the Army and has spearheaded several indigenous development projects at BEL as a Director (R&D).

In FY2019, the company reported a net profit of Rs. 6.5 crore, on a consolidated basis, on an OI of Rs. 268.0 crore compared to a net profit of Rs. 9.1 crore on an OI of Rs. 212.9 crore in the previous year.

In FY2019, the company reported a net profit of Rs. 6.5 crore, on a standalone basis, on an OI of Rs. 232.6 crore compared to a net profit of Rs. 10.8 crore on an OI of Rs. 200.9 crore in the previous year.

Key financial indicators (audited)

	FY2018 (Standalone)	FY2019 (Standalone)	FY2018 (Consolidated)	FY2019 (Consolidated)
Operating Income (Rs. crore)	200.9	232.6	212.9	268.0
PAT (Rs. crore)	10.8	6.5	9.1	6.5
OPBDIT/ OI (%)	12.8%	12.0%	14.6%	13.6%
RoCE (%)	13.9%	10.7%	-	8.8%
Total Debt/ TNW (times)	0.8	0.2	0.6	0.2
Total Debt/ OPBDIT (times)	4.4	2.0	3.8	1.8
Interest Coverage (times)	2.8	2.0	3.0	2.4

Source: ADTPL and ICRA research

Status of non-cooperation with previous CRA: NA

Any other information: None

Rating history for last three years

Instrument		Current Rating (FY2020)			Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on March 2019 (Rs. crore)	Date & Rating in FY2020		FY2019 11-Sep-2018	FY2018 27-Sep-2017	FY2017 11-Jan-2017
					18-Feb-2020	17-Oct-2019			
1	Cash Credit	Long Term	101.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB+ (Stable)
2	Term Loan	Long Term	61.30	10.00	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)		
3	Bank Guarantee	Short Term	102.00	-	[ICRA]A2	[ICRA]A2	[ICRA]A3+	[ICRA]A3+	[ICRA]A2
4	Interchangeable	Short Term	(20.00)		[ICRA]A2	[ICRA]A2	[ICRA]A3+	[ICRA]A3+	[ICRA]A2

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as “Simple”, “Complex” and “Highly Complex”. The classification of instruments according to their complexity levels is available on the website [click here](#)

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	-	-	-	101.00	[ICRA]BBB+ (Stable)
NA	Term Loan	FY2018	-	FY2024	61.30	[ICRA]BBB+ (Stable)
NA	Bank Guarantee	-	-	-	102.00	[ICRA]A2
NA	Interchangeable				(20.00)	[ICRA]A2

Source: Alpha Design Technologies Private Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership (%)	Consolidated Approach
Subsidiaries		
Alpha-Tocol Engineering Services Pvt Ltd	100%	Full Consolidation
Alpha Elettronica Defence Systems Pvt Ltd	80%	Full Consolidation
Reline Thermal Imaging and Software Pvt Ltd	100%	Full Consolidation
Microwave & Optronics Systems Pvt Ltd	100%	Full Consolidation
Joint Venture		
Alpha-Elsec Defence & Aerospace Systems Pvt Ltd	51%	Proportionate Consolidation

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About ICRA Limited:

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