

September 04, 2020

Afablez Semiconductor Private Limited: [ICRA]BB+(Stable) assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	16.50	[ICRA]BB+ (Stable); Assigned
Overdraft facility	6.50	[ICRA]BB+ (Stable); Assigned
Total	23.00	

*Instrument details are provided in Annexure-1

Rationale

For arriving at the rating, ICRA has consolidated the financials of FLDEC Systems private Limited (FLDEC) and Afablez Semiconductor Private Limited (Afablez), hereinafter referred as the Group. Both the companies are managed by the same promoter group and operate in similar line of business.

The rating draws comfort from the the Group's established presence in the electronic system design and manufacturing (ESDM) segment for the defence sector, along with the experience of the promoters and the management. The rating takes into consideration the significant scale up in operations in the recent past with healthy order flow from various defence organisations on the account of its established relationships with them over the years. The rating favourably considers its healthy profitability in FY2020, which has resulted in comfortable coverage indicators. That apart, the equity infusion in the last fiscal and improvement in accretion to reserves led to a healthy capital structure as witnessed from gearing of 0.8 times as on March 31, 2020 at the Group level.

The rating, however, is constrained by the working capital-intensive nature of operations that has resulted in high average utilisation of the sanctioned limits of the Group during the past 12 months. However, ICRA takes note of the expected equity infusion in the current fiscal and the proposed enhancement, which is likely to support its liquidity in the near term. Further, any stretch in working capital cycle might result in incremental working capital requirements and will remain a key rating monitorable. The rating factors in the revenue exposure of the Group to regulatory risk as most of the orders in hand are from Government organisations. The rating is constrained by intense competition in the ESDM industry, which can restrict its scope of margin expansion in the long term.

The Stable outlook on the [ICRA]BB+ rating reflects ICRA's opinion that the Group will continue to benefit from the extensive experience of the promoter, management, the qualified technical team and its established relationships with the defence organisations for future order flow.

Key rating drivers and their description

Credit strengths

Extensive experience of promoter and management – The promoter has more than a decade of experience in the electronics design and manufacturing segment. The top management is actively involved in the day-to-day operations of the Group and has extensive experience in their respective fields.

Established relationships with reputed defence organisations – The Group shares established relationships with reputed defence organisations as witnessed from its certified vendor status and increase in the orders in the recent past. Major

customers include various defence laboratories under the Defence Research and Development Organisation (DRDO), Bhabha Atomic Research Centre (BARC), Indian Air Force (IAF), Hindustan Aeronautics Limited (HAL), etc. The top 10 customers contributed to about ~60% of the total revenues of FLDEC in FY2020.

Improvement in scale of operations signifies Group's ability in defence electronics segment – The Group's scale of operations improved to Rs. 147.8 crore in FY2020 from Rs. 50.0 crore in FY2019 on account of healthy order flow from the defence organisations. About 56% of the revenues of Afablez was from FLDEC in FY2020.

Healthy profitability at Group level and comfortable coverage indicators – The Group's profitability has improved drastically as witnessed from increase in operating margins (to 20.2% in FY2020 from 14.5% in FY2019) and improvement in RoCE (to 25.3% in FY2020 from 14.8% in FY2019). This has resulted in healthy coverage indicators as reflected by interest coverage, NCA/Total Debt and Total Debt/OPBITDA at 5.0 times, 34.7% and 1.8 times, respectively, in FY2020.

Credit challenges

High near-term incremental working capital requirement – For the expected increase in order execution in the near term, the incremental working capital requirements are likely to be met through equity infusion of Rs. 9.00 crore and proposed enhancement of Rs. 23.50 crore from the bank at the Group level. Any stretch in the working capital intensity or higher-than-expected order execution in the near term might result in additional funding requirements, which remains a key rating sensitivity.

High execution risk with large portion of unexecuted order book position in initial phase – The top 20 orders contribute to about 68% of the total order outstanding of Rs. 734.7 crore as on June 30, 2020 for FLDEC. The Group is exposed to high execution risk, as a large number of the top 20 orders of FLDEC are in various stages of the initial phase such as design, design review, prototype development and prototype testing.

Receivables position and future order inflow are subject to regulatory risk – The working capital intensity has remained high due to the inherent nature of the industry. However, with a major portion of its revenues derived from the Government orders, the Group is exposed to the regulatory risk. Further, the order flow in the future for FLDEC is likely to depend mainly on various Government schemes and budgets rolled out year after year. Nonetheless, the high revenue exposure to Government organisations is likely to be mitigated, to some extent, by the expected orders from private players for Afablez in the medium term.

Liquidity position: Stretched

The Group's liquidity is **stretched** given the high utilisation of working capital limits with limited buffer during the last 12 months that ended in July 2020. Though the cash flow from operations, proposed enhancement in working capital limits and expected equity infusion in the current fiscal are likely to support its liquidity in the near term, any stretch in working capital intensity or higher-than-expected ramp-up in order execution can result in incremental working capital requirements. Nevertheless, ICRA takes some comfort from the buffer available in the drawing power of the Group.

Rating sensitivities

Positive triggers – ICRA could upgrade the Group's rating if there is an improvement in its liquidity position demonstrated by adequate buffer in the working capital limits, timely funding tie-up and no major stretch in working capital intensity.

Negative triggers – Negative pressure on the Group's ratings could arise if there is deterioration in the coverage indicators (with TD/OPBITDA more than 3.0 times) or its liquidity position.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Consolidation and Rating Approach
Parent/Group Support	NA
Consolidation/Standalone	Consolidated financials of FLDEC and Afablez was taken into consideration for the rating exercise

About the company

Incorporated in July 2018, Afablez Semiconductor Private Limited is involved in designing and manufacturing semiconductor hardware. It is a fabless semiconductor manufacturing company. Mr. Vanchinathan Thangavel is the company's promoter, CEO and Managing Director. Its manufacturing unit is in Chennai, Tamil Nadu.

Established as a proprietorship firm in 2008 in the name of Femto Logic Designs Systems, the company was converted into a private limited company in 2013 in the name of Femto Logic Design Private Limited. It was renamed to FLDEC Systems Private Limited in September 2018. The company is involved in ESDM catering to industries such as defence, aerospace, navy etc. Its manufacturing unit is in Chennai with about 250 design and development engineers. Mr. Vanchinathan Thangavel is the company's promoter, CEO and Managing Director.

Key financial indicators (audited)

	Standalone		Consolidated	
	FY2019	FY2020	FY2019	FY2020
Operating Income (Rs. crore)	2.2	36.0	50.0	147.8
PAT (Rs. crore)	0.1	3.5	3.3	14.2
OPBDIT/OI (%)	44.9%	25.2%	14.5%	20.2%
RoCE (%)	5.6%	22.8%	14.8%	25.3%
Total Outside Liabilities/Tangible Net Worth (times)	39.4	1.9	11.1	1.3
Total Debt/OPBDIT (times)	22.4	2.5	10.1	1.8
Interest Coverage (times)	2.5	3.6	5.2	5.0
DSCR	2.3	1.0	4.4	2.0

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument		Rating (FY2021)			Rating	Rating History for the Past 3 Years		
	Type	Amount Rated	Amount Outstanding as on Mar 31, 2020			FY2020	FY2019	FY2018
1	Term Loan	Long term	16.50	16.00	4-Sep-2020 [ICRA]BB+ (Stable)	-	-	-
2	Overdraft facility	Long term	6.50	6.42	[ICRA]BB+ (Stable)	-	-	-

Amount in Rs. Crore

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 www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	Dec-18	-	Dec-28	16.50	[ICRA]BB+ (Stable)
NA	Overdraft facility	-	-	-	6.50	[ICRA]BB+ (Stable)

Source: Afablez Semiconductor Private Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
FLDEC Systems Private Limited	-	Full consolidation
Afablez Semiconductor Private Limited	-	Full consolidation

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