July 16, 2019

Apollo Micro Systems Limited: Ratings revised to [ICRA]BBB-(Negative)/[ICRA]A3

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based-Term Loan	7.40	2.00	Rating revised to [ICRA]BBB- from [ICRA]BBB; outlook revised to Negative from Stable
Fund based- Working Capital Facilities	84.50	92.50	
Non-fund based-Working Capital Facilities –BG	17.50	17.50	
Unallocated	0.60		
Non-fund based-Working Capital Facilities –LC	32.00	30.00	Rating revised to [ICRA]A3 from [ICRA]A3+
Total	**142.00**	**142.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings revision factors in the significant deterioration in Apollo Micro Systems Limited's (AMSL) working capital cycle in FY2019 owing to an increase in debtor days, high inventory holding, and low creditors, leading to faster-than-expected deployment of funds raised through the company's IPO in January 2018. Moreover, the debt levels increased significantly owing to high working capital requirements. The rating action factors in its stretched liquidity position as indicated by a high average utilisation of 86% of the sanctioned limits during April 2018 to April 2019. The ratings consider long gestation periods and competition in the defence segment, which accounts for a predominant share of AMSL's revenues. ICRA notes the exposure of its margins to exchange rate fluctuations, given that the entire raw material requirement is imported.

The ratings, nevertheless, draw comfort the company's established presence in the electronic system design manufacturing (ESDM) segment with significant experience of the promoters and the management in the industry. The ratings consider AMSL's strong research and development (R&D) team, which works in collaboration with the Defence Research and Development Organisation (DRDO) for new products development. The company witnessed healthy revenue growth over the past five years, aided by healthy order inflow on the back of strong R&D investments.

Outlook: Negative

The Negative outlook reflects the consistent deterioration in the company's working capital cycle, weakening its liquidity position. The outlook may be revised to Stable if better working capital management and healthy accruals improve its liquidity position. The ratings may be downgraded if working capital cycle continues to remain stretched constraining its liquidity and impacting its financial profile.

Key rating drivers

Credit strengths

Established presence in the ESDM segment – AMSL is an established player in the ESDM segment with significant experience of the promoters in the industry and an experienced management team.

Strong R&D team with focus on developing new products – AMSL has a strong R&D team focussed on developing new products. The company works with the DRDO for research on strategic defence missions, developing commercially off-the shelf solutions, which are the proprietary products of AMSL. Its focus on R&D is reflected by the increasing spend on the same over the years.

Healthy revenue growth – AMSL witnessed a significant revenue growth of 19% in FY2019 and at a CAGR of 25% for the period FY2014-FY2019, supported by a healthy order inflow on the back of strong R&D investment over the previous years. The company's revenue visibility is limited given its order book of Rs. 181.4 crore as on March 31, 2019, which is 0.7 times in FY2019. However, it receives short-term contracts throughout the year.

Credit challenges

Working capital intensive nature of operations – AMSL's working capital cycle deteriorated significantly with working capital intensity increasing to 116% in FY2019 from 55% in FY2017 owing to an increase in debtor days, high inventory holding, and lower creditors. This resulted in faster-than-expected deployment of funds raised through the company's IPO in January 2018 and lower liquidity buffer. Moreover, the debt levels increased significantly owing to high working capital requirements.

Susceptibility of margins to exchange rate fluctuations – AMSL imports a predominant share of its raw material requirements, either directly or through agents. With limited ability to pass on the hike in raw material costs especially for long-term contracts, the company's margins are exposed to volatility in exchange rates. The company's margins declined to 18.4% in FY2019 from 22.4% in FY2018 owing to adverse exchange rates.

Long gestation periods in defence segment – The R&D cycle of defence products and solutions is long, which could stretch over several years. Moreover, AMSL offers solutions that form a part of the larger delivery system made by other system integrators with ultimate usage by the Ministry of Defence (MoD), which elongates the cycle further. Successful R&D of systems (for MoD) by AMSL is critical for its revenue growth.

Intense competition in defence ESDM segment – AMSL faces competition from defence PSUs, global firms, and other players in the local market. So, the company's ability to improve technological know-how and offer superior services, at competitive rates to its customers are critical.

Liquidity position

AMSL's liquidity position is stretched owing to its high cash burn rate. The company's average working capital utilisation was high at 86% of the sanctioned fund-based limits during April 2018 to April 2019. While it does not have any major capacity expansion plans, going forward, it would incur capex towards R&D.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation / Standalone	The standalone financial statements have been considered for the analysis

About the company

AMSL, started as a proprietary concern in 1985 and incorporated as a private limited company in March 1997 by Mr. Karunakar Reddy, is involved in electronic system design and manufacturing (ESDM. It provides electric and electronic hardware and software solutions for mission critical applications to defence, aerospace, navy, and home-land security.

AMSL was converted into a public limited company and came out with an IPO in January 2018. The company's manufacturing unit is located in Hyderabad with its lab area confirming with electrostatic discharge requirements with ESD-safe furniture and controlled environment. AMSL is ISO 9001:2015 and CEMILAC certified.

Key financial indicators

	FY2018	FY2019
Operating Income (Rs. crore)	220.5	263.0
PAT (Rs. crore)	19.2	29.2
OPBDIT/ OI (%)	22.4%	18.4%
RoCE (%)	18.5%	13.1%
Total Debt/ TNW (times)	0.3	0.4
Total Debt/ OPBDIT (times)	1.8	2.2
Interest Coverage (times)	4.1	3.7

Source: AMSL, Annual reports and ICRA research

Status of non-cooperation with previous CRA: NA

Any other information: None

Rating history for last three years:

S. No.	Instrument	Current Rating (FY2020)				Chronology of Rating History for the past 3 years @		
		Type	Amount Rated (Rs. crore)	Amount Outstanding	Date & Rating	Date & Rating in FY19	Date & Rating in FY18	Date & Rating in FY17
					July 2019	May 2018	-	-
1	Term Loans	Long-term	2.00	2.00	**[ICRA]BBB- (Negative)**	[ICRA]BBB (Stable)	-	-
2	Fund-based	Long-term	92.50	NA	**[ICRA]BBB- (Negative)**	[ICRA]BBB (Stable)		
3	Non fund-based	Long-term	17.50		**[ICRA]BBB- (Negative)**	[ICRA]BBB (Stable)		
4	Unallocated	Short-term		NA	**[ICRA]BBB- (Negative)**	[ICRA]BBB (Stable)		
5	Non-Fund-based	Short-term	30.00	NA	**[ICRA]A3**	[ICRA]A3+		

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loans	June - 2013	NA	September 2019	2.00	[ICRA]BBB- (Negative)
NA	Fund-based	NA	NA	NA	92.50	[ICRA]BBB- (Negative)
NA	Non fund-based	NA	NA	NA	17.50	[ICRA]BBB- (Negative)
NA	Unallocated	NA	NA	NA		[ICRA]BBB- (Negative)
NA	Non-Fund-based	NA	NA	NA	30.00	[ICRA]A3

Source: AMSL

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About ICRA Limited:

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