

Apollo Micro Systems Limited

IPO Note (CAUTIOUS)

Analyst:

Vaibhav Joshi

Rohit Rai

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IPO details

Key Data	
Issue Opens	10-Jan-18
Issue Closes	12-Jan-18
Equity Shares Offered (in mn.)	5.67
QIB	Up to 50%
NIB	Min 15%
Retail	Min 35%
Face Value (₹)	10
Price Band (₹)	270-275
Max. Issue Size (₹ mn)	1,560
Lot Size (Eq. Shares)	50 and multiple thereof

Valuation	@ ₹270 per share	@ ₹275 per share
Market Cap (₹ mn)	5,582	5,685
Net Debt (₹ mn)	703	703
Enterprise Value (₹ mn)	6,285	6,388
EV/ Sales	3.0	3.0
EV/ EBITDA	15.5	15.7
P/B	7.3	7.5
P/E	28.1	28.6

Source: Red Herring Prospectus, Destimoney Research

	Pre Issue		Post Issue [^]	
	# mn Shares	% Holding	# mn Shares	% Holding
Promoters	13.3	88.5%	13.3	64.2%
Public	1.7	11.5%	1.7	8.4%
Fresh Issue			5.7	27.4%
Total	15.0	100.00%	20.7	100.0%

Object of Offer for sale

- To meet additional working capital requirement of the Company
- General corporate purposes

Recommendation

The company has established strong credentials in the field of Defense equipments by supplying electronic and electro-mechanical products and engineering designs solutions to Ministry of Defense. With its diverse and need based offerings, technological prowess and strong R&D capability enables it to generate recurring orders. With the government's focus on increasing indigenization of defense capabilities the emerging company is likely to benefit fairly.

With 4.5x growth in revenue, expansion of PAT margin to ~9% over the last four years and above 20% ROE reflect the strong financial performance. On Valuation front, the upper issue price of Rs.275 at 28.6x post issue FY17 earnings is fairly priced compared to its closest peers like Astra Microwave Products Ltd and Bharat Electronics Ltd. It leaves limited for further upside on listing. **Therefore, we are CAUTIOUS on the issue. However, long term investors may bet on strong financials.**

Issue Highlights

- ❑ Incorporated in 1997, Apollo Micro Systems Ltd. (AMSL) is a Hyderabad based company engaged in electronic, electro-mechanical, engineering designs, manufacturing and supplies company. It designs, develops and sells high-performance, mission and time critical solutions to Defence, Space and Home Land Security for Ministry of Defence, government controlled public sector undertakings and private sectors.
- ❑ AMSL's customised solutions are developed using common hardware and software technology IP's which can be re-configured to suit the end application and domain requirements of end customer. The huge repository of knowledge and technology base that company has developed since inception is a strong base to outperform the competition and be abreast in the market. This supports Company to constantly upgrade the technologies to meet present and futuristic requirements of its customers.
- ❑ AMSL offers custom built COTS (Commercially off-the shelf) solutions based on specific requirements to defence and space customers. As the systems are exclusively developed for a programme, the developed systems enjoy proprietary status. Thus specially developed and approved systems have no competition.
- ❑ Company has its participation in several Indigenous Missile programmes, underwater electronic warfare, underwater missiles, surface to air missiles, nuclear missile programmes, surface to surface missile programmes, indigenous submarine programmes UAV's long and short endurance, ships, space programmes.
- ❑ The defence and space solutions require expertise in advanced technology development and engineering knowledge to make the systems withstand harsh environmental conditions. AMSL has proven track record of executing projects which are qualified in several programmes.
- ❑ For the six months period ended September 30, 2017 and Fiscal 2017, Fiscal 2016, Fiscal 2015 Fiscal 2014 and Fiscal 2013, its total income, was ₹10,947.41 lacs, ₹ 21,179.98 lacs, ₹ 15,953.17 lacs, ₹ 10,876.83 lacs, ₹ 7,288.18 lacs and ₹ 3,745.81 lacs respectively and its profit after tax, was ₹ 711.15 lacs, ₹ 1,857.11 lacs, ₹ 1,000.05 lacs, ₹ 744.76 lacs, ₹ 534.39 lacs and ₹ 295.95 lacs respectively. The Company's Order Book (as Defined hereinafter) is ₹ 9,750.11 lacs excluding GST as of November 25, 2017.
- ❑ The company has established strong credentials in the field of Defense equipments by supplying electronic and electro-mechanical products and engineering designs solutions to Ministry of Defense. With its diverse and need based offerings, technological prowess and strong R&D capability enables it to generate recurring orders. With the government's focus on increasing indigenization of defense capabilities the emerging company is likely to benefit fairly.

Source: Red Herring Prospectus, Destimoney research

Classification of verticals and the solutions offered

- ❑ **Defence Avionic Systems:** AMSL offers Avionic Systems which are integrated in Aircrafts or UAV. The Avionic systems are safety critical equipment as it involves human involvement in driving the vehicle in airspace. Hence the qualification levels are very stringent for both On-Board as well as ground support equipment.
- ❑ **Defence –Aerospace Systems:** AMSL offers On-Board Weapon System Electronics solutions and Ground Checkout and Launcher Controller Systems for Missile System requirements. The qualification requirements of weapon system electronics vary for different types of missiles. The On-Board solutions offered by it includes On-Board Computer, Missile Interface Unit, Seeker Signal Processor, RPF-DSP, Actuator Controller for Missile Fins, Integrated Avionics Modules, PCM Encoder and many more. The ground support equipment solutions offered by it includes Launcher Interface Unit, Missile Launcher Command System, Ethernet Controller, Platform Levelling & Launcher Controller to name a few.
- ❑ **Defence-Naval Systems:** AMSL offers On-Board Weapon system electronics and Ground Support Systems for Under Water Missiles (Torpedoes), Anti Torpedo Decoys and Jammers, Submarines and Ships. The On-Board solutions offered includes On-Board Computer, System Manager Card, Five Processor DSP Board, Gyro Actuation Interface Box, Homming System, Front End Cage Electronics, SPU Section, Instrumentation Section, Signal Analyzer Card, Indigo Modules, Abhay Transmitter System, Turret Control System, Turret Power Systems to name a few.
- ❑ **Satellite Space Systems:** AMSL offers Ground Checkout Systems and Earth Station acquisition systems for Space applications. It's solutions are configured for communication and other satellite programmes.
- ❑ **Homeland Security & Telematics:** AMSL offers telematic and integrated surveillance systems like GPS based vehicle tracking system, integrated surveillance systems consisting of CCTV and boom barriers. It has developed live tracking solutions for cargo carriers and transport vehicles and for effective productivity monitoring for Ore Mining companies.
- ❑ **Transportation:** In Transportation sector, it has worked on solutions related to telematics, data handling systems and automotive electronics. Its solutions are configured for Indian railways for applications such as Coach Guidance Display Systems, Tyre Pressure Monitoring Systems for Off Road vehicles such as Dumpers in mining, Token Display System, Arrival/ Departure Information Display System, Destination Display Boards, Advertising Displays, Station Announcement Systems (Digital Tape Recorder).

Source: Red Herring Prospectus, Destimoney research

Strengths

- ❑ **Proven track record in developing new technological systems and order execution:** Company is aided with specialized technical skills, strong research and development expertise and a competent management, has developed the ability to design, develop and manufacture complex electronic control systems and associated digital electronics.
- ❑ **Recurring orders from existing programs:** Over last two decades, it has developed an established brand name, acceptance and recall value in the defence ESDM Sector. Its ability to provide end to end solutions to clients helps in getting repeat orders from them, further it also helps in adding new clients and its ability to develop new platform helps in serving clients in more efficient manner, which helps in getting repeat and larger orders from its clients.
- ❑ **Strong R&D Capabilities:** AMSL has a strong R&D team of 56 engineers with core competencies in development of Embedded Hardware and Software along with engineering designs team. Its R&D professional has varied experiences in electronics and electro - mechanical engineering. It undertakes dedicated R&D in existing services and solutions primarily with a focus to improve yields and process efficiencies. It spent Rs.678.59 lacs, Rs.1,286.46 lacs, Rs. 865.01 lacs, and Rs.146.81 lacs towards R&D activities during the six months period ended September 30, 2017 and financial years 2017, 2016, and 2015 respectively.
- ❑ **Qualified and experienced workforce and senior management:** Company has qualified and trained manpower working in Embedded Systems, FPGA Based Systems, Firmware and Application Software Development. Its management team has considerable experience in the defence ESDM industry. The members of its senior management have diverse skills which has helped it to grow and develop solution faster.
- ❑ **Quality control:** It has undertaken various initiatives and adopted various systems and processes in order to augment its commitment to focus on quality which is crucial for it and the industry it operates. Its manufacturing unit is well equipped with modern quality checking and testing equipment's for quality assurance. Its customers also require it to maintain extremely rigorous and strict checks on compliance with all necessary quality and safety standards.

Source: Red Herring Prospectus, Destimoney research

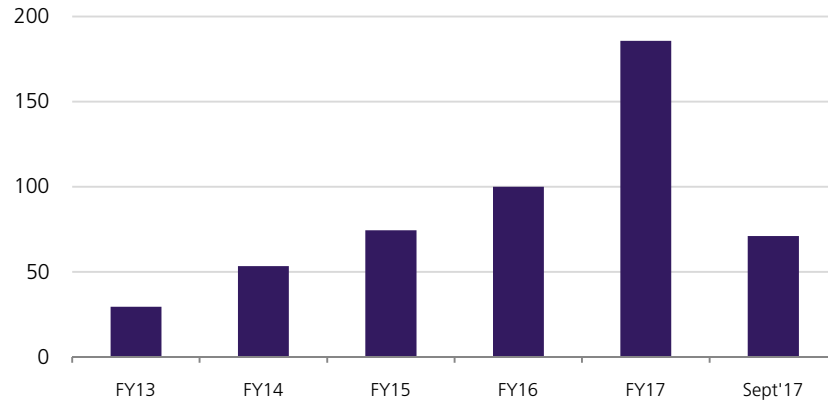
Future road ahead

- ❑ **Focus on R&D to develop complete systems to enhance the long-term prospects of Company:** To continue to identify various strategic initiatives to improve its operational efficiencies and invest in modern technology and equipment's to upgrade the quality and functionality of its solutions to address changing industry trends and customer requirements.
- ❑ **Improving productivity and competitiveness:** Intends to increase the efficiency and competitiveness of its operations by continuously investing in state of the art machinery and equipment and related operating methods, in order to maximize efficiency of labour, material and reduce costs and the time taken to execute projects.
- ❑ **Leverage Build To Print opportunity:** Build To Print (BTP) business means customer produces work instructions, assembly drawings, and calls out specific and detailed manufacturing practices used in building the parts along with the specification of the component's functional requirements. BTP business vertical got built in Company with the existing infrastructure and skills sets which helps in generating incremental revenue and profits with low working capital cycle.
- ❑ **Expand business and geographical footprint through selective acquisitions:** Intends to augment growth by continuing to pursue selective acquisitions and strategic alliances that provide it with access to better infrastructure, industry knowledge, technology expertise and geographical reach. It has historically expanded business through organic growth and henceforth intends to grow through acquisitions and strategic alliances also.
- ❑ **Continue to grow its overall market share by leveraging its presence in existing business verticals:** The aim of market penetration is to effectively use the product, enter the market as quickly as possible and seize a large market share. In order to penetrate the market, it is leveraging already designed and developed technologies to increase the sale of strategic projects for the customers. It will continue to focus on improving its market share across all its business verticals.
- ❑ **Business Diversification:** It intends to diversify its services and solution categories into other industries or marketplaces. Although its focus has always been defence sub-systems / systems development and manufacturing including space, defence, aerospace, strategic electronics, it intends to develop technologies for railways, homeland security to expand its roots in non-defence sectors.

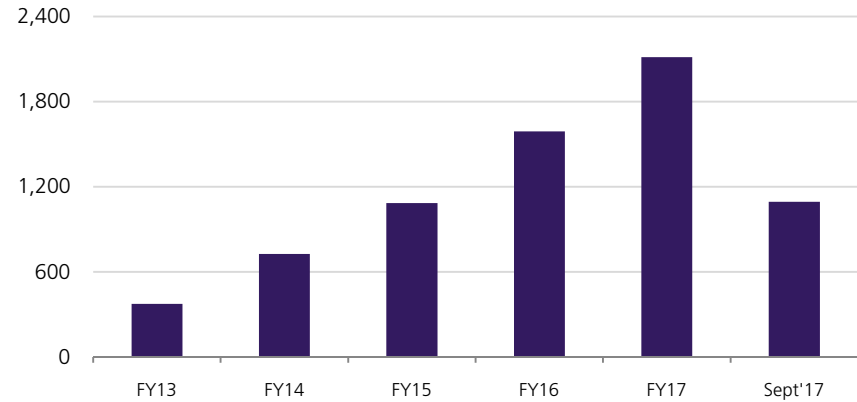
Source: Red Herring Prospectus, Destimoney research

Financials

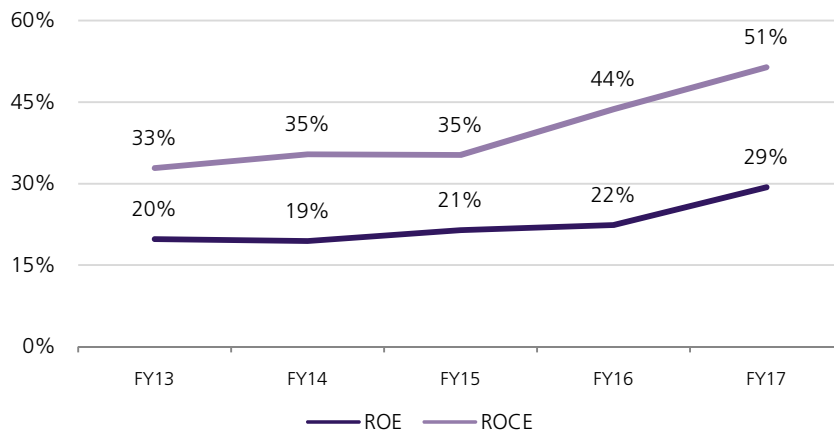
Continuous Net Profit growth



Strong Revenue growth



Improving ROE & ROCE



Source: Red Herring Prospectus, Destimoney research

Consolidated Summary Financials

Income Statement

₹ mn	Sept'FY17	FY17	FY16	FY15	FY14
Total Income	1,093	2,113	1,590	1,084	727
Operating Expense	900	1,706	1,338	903	625
EBIDTA	193	407	252	181	101
Depreciation	30	39	27	39	4
Other Income	1	5	5	4	2
Finance Costs	58	114	81	51	27
Exceptional and prior period item	-	13	-	-	-
PBT	106	271	148	94	73
Tax	35	85	48	20	19
PAT(Before exceptional items)	71	186	100	74	53
Less : Exceptional items	-	-	-	-	-
Net Profit	71	186	100	74	53

₹ mn	Sept'FY17	FY17	FY16	FY15	FY14
EBIDTA Margin	17.7%	19.2%	15.8%	16.6%	13.9%
Net Margin	6.5%	8.8%	6.3%	6.8%	7.3%
ROE	9.3%	29.3%	22.3%	21.4%	19.4%
ROCE	18.7%	51.4%	43.7%	35.3%	35.4%

Balance Sheet

₹ mn	Sept' FY17	FY17	FY16	FY15	FY14
Liabilities					
Share capital	140	137	137	137	137
Reserves and surplus	622	497	311	211	138
Share Application Money	-	-	-	-	-
Long-Term Borrowings	299	135	157	188	77
Deferred tax liabilities(Net)	103	82	39	8	2
Other Long Term Liabilities	20	93	65	10	3
Long term provisions	4	4	3	2	2
Short term borrowings	670	656	490	344	254
Trade payables	902	679	716	334	183
Other current liabilities	130	135	83	83	26
Short term provisions	55	42	29	30	27
Total Liabilities	2,947	2,459	2,030	1,347	849
Assets					
Net Block	313	300	211	229	55
Intangible assets	-	-	-	-	-
Capital work in progress	197	129	101	15	124
Non current Investments	-	-	-	-	-
Long Term Loans & Advances	-	-	-	-	-
Other non current assets	34	-	-	-	-
Inventories	1,368	1,141	726	425	228
Trade receivables	888	715	863	612	401
Cash and cash equi.	59	88	69	37	23
Short Term Loans & Advances	87	85	56	30	19
Other Current Assets	0	2	2	0	0
Total Assets	2,947	2,459	2,030	1,347	849

Source: Red Herring Prospectus, Destimoney research

Key Risks

- ❑ Its business is significantly dependent on various Public Sector Undertakings and Government entities for their projects undertaken by OEM or other system integrator companies and could be materially and adversely affected if there are adverse changes in the policies of such Government entities.
- ❑ Its business is working capital intensive. If it is unable to generate sufficient cash flows to allow it to make required payments on its debt or fund working capital requirements, there may be an adverse effect on its results of operations.
- ❑ Its work with government clients exposes it to additional risks inherent in the government contracting environment.
- ❑ Its business will suffer if it fails to anticipate and manage increasingly large and complex projects, or develop new services and enhance existing services in order to keep pace with rapid changes in technology and the industries on which it focuses.
- ❑ Its revenue depends to a large extent on a limited number of customers, and its revenue could decline if it loses a major customer.
- ❑ It is dependent on a few suppliers for supply of raw materials and any major disruption to the timely and adequate supplies of its raw materials could adversely affect its business, results of operations and financial condition.

Source: Red Herring Prospectus, Destimoney research

Destimoney Securities Private Limited

Plot No. A356/357, Road No.26,Wagle Industrial Estate, Thane (West), Maharashtra - 400 604.

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