# Zen Technologies (BBB/Positive - CRISIL)

**(Analysis on 24th March 2023)**

**ABOUT THE COMPANY**

**Product profile:** Simulation training equipment (design to after sales) for Defence (Army, Para military and mining). Anti drone systems is a recent offering

**Business mix:** TTMFY23 revenue (Dec 2022) of Rs 110 cr:

- Equipment sales (70%)

- AMC (Annual Maintenance Contract) - 30% of sales; Rs 40 cr annual run rate). AMC is used to fund R&D expenses and cover fixed operating expenses. AMC : 1.2x the product value sold, over the product life. High margin and lucrative business

**Revenue in FY22:** Domestic – 95%/Exports – 5%: No ITAR restrictions on exports (International Traffic in Arms Regulations)

**INVESTING THESIS**

*Mega Trend: Defence Electronics*

*Competitive Advantage:*

1) Sole manufacturer of simulation training equipment for defence (Market share of over 95% in tank simulators) and anti drone systems

2) 112 patents filed and 27 have been granted

3) Over 10% of cumulative sales spent on RnD in last 5 years (R&D written off in P&L).

*Whats New?*

**Strong Order book:** as on Dec 2022: Rs 404 cr (of which Rs 136 cr in AMC) vs TTM revenues of Rs 151 cr ie 2.7x TTM revenues. Net margins are 20% or earnings can potentially increase to 20%\*404 = 80 cr assuming order book to be completed within a year.

**New offering:** The company has recently come out with Anti-Drone system technology and is making further investments in development of Air Defence Gun Simulators

Scale is critical and its impact on operating margins: If scale crosses Rs 100 cr; net margins can increase to upto 30%

Beneficiary of the recent Defence Procurement Policy (companies in end-end provider of defence equipment preferred; single vendor allowed)

**PS:** Promoter stake at 60%; no pledging; 32% was pledged in FY18. Zen Technologies bought the 10% stake of Rakesh Jhunjhunwala @ Rs70, under its buyback offer ~ 2013.

**RISKS**

1) Low reported ROCE at 2% from Screener ; Calculated Operating ROCE is 11.7% (36 /308); ROCE (including other income) is 15.6% (48/308)

2) Profits supported by other income (TTM FY23 - Other income of Rs 12 cr vs PBT of Rs 44 cr). Part of the income is insurance proceeds

3)Cash conversion cycle is long - over 680 days with money stuck in inventory

4) Tender based business - leading to lumpy/volatile revenues and margins. Revenues have ranged between Rs 70 to Rs 140 cr in last 3 years. Operating margins have fluctuated from 7 to 28% in the last 3 years (FY20, operating margins were 42%)

5) Does the management walk the talk - In FY18, also spoke about large orders of Rs 500 cr could materialise. Order book currently is Rs 400 + cr

**Monitorables**

1. Growth of its Order book and its execution
2. Operating margins and ROCE
3. Working capital