



TM

Zen Technologies

18 June 2024

Targeting Rs 20bn revenue for FY27

VISIT NOTE

Sector: Aerospace & Defense Rating: NR

CMP: Rs 1,118 Target Price: NA

Stock Info

| | |
|--------------------|----------------------|
| Sensex/Nifty | 76,993/23,466 |
| Bloomberg | ZEN IN |
| Equity shares (mn) | 77 |
| 52-wk High/Low | 1,130 / 385 |
| Face value | Rs 1 |
| M-Cap | Rs 93.9bn/USD 1.12bn |
| 3-m Avg turnover | USD 10.81mn |

Financial Snapshot (Rs mn)

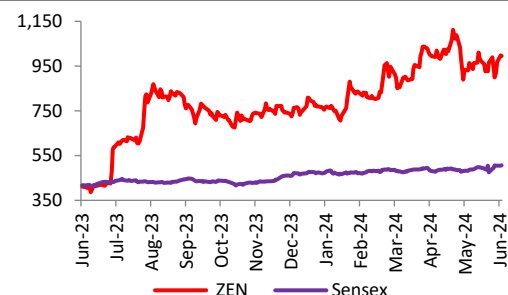
| Y/E Mar | FY22 | FY23 | FY24 |
|---------------|------|-------|-------|
| Net sales | 537 | 1,614 | 4,303 |
| EBITDA | 19 | 513 | 1,772 |
| EBITDA (%) | 3.6 | 31.8 | 41.2 |
| PAT | 20 | 376 | 1,292 |
| EPS | 0.25 | 4.88 | 16.75 |
| P/E (x) | NMF* | 80.7 | 58.7 |
| P/B (x) | 4.9 | 9.0 | 16.4 |
| EV/EBITDA (x) | NMF* | 54.4 | 41.9 |
| RoE (%) | 0.9 | 11.7 | 32.8 |
| RoCE (%) | 1.7 | 17.1 | 64.7 |

NMF: Not meaning full

Shareholding Pattern (%)

| | Mar'24 | Dec'23 | Sep'23 |
|-----------|--------|--------|--------|
| Promoter | 55.1 | 55.1 | 57.4 |
| - Pledged | - | 0.5 | 0.5 |
| FII | 3.8 | 4.7 | 4.7 |
| DII | 3.3 | 3.1 | 3.1 |
| Others | 37.8 | 37.1 | 37.1 |

Stock Performance (1-year)



We recently met Mr. Ashok Atluri, promoter and MD of Hyderabad-based Zen Technologies (ZEN IN). Established in 1993, Zen has emerged as India's largest training equipment and simulator company, having diversified into anti-drone systems. ZEN delivered 1,000+ simulators to 100+ customers across the 3 armed forces, State and Central police forces of India and of other countries.

Order book update: New order wins helped ZEN end FY24 with an order book (OB) of Rs 14.0bn. On the back of Rs 13.6bn (notably, include 3 training equipment orders totaling Rs 2.32bn in Aug/ Sep 2023, 1 export order worth Rs 3.4bn in Jul 2023) of order inflows in FY24, ZEN nearly tripled its YoY outstanding OB as of end FY24.

Training simulators/ anti-drone systems accounted for 56%/ 44% of the FY24 outstanding OB, respectively. Similarly, of its total OB, AMC/ Equipment accounted for 19%/ 81%, respectively.

ZEN is targeting to win ~Rs 12-13bn of order inflows in FY25 (most of which management believes would fructify by 3QFY25/ 4QFY25). These numbers may see some upside, if their initiative to partner with an international player materializes.

Update on revenues: On its expanded OB, ZEN reported 101% increase in its FY24 revenue to Rs 4.39bn. Management has guided Rs 9bn revenue for FY25 (reflects 91% YoY revenue growth). Management indicated this guidance excludes additional revenue opportunity from its new product pipeline that the company plans to launch.

Directionally in line with its FY25 revenue guidance, management has guided Rs20bn revenue for FY27 (exports would contribute ~35% of total revenue). Notably, this guidance excludes revenue from the targeted acquisitions.

As orders executed prior to FY21-FY22 need AMC support, ZEN expects share of AMC revenue to increase from ~Rs 332mn in FY24 (~7.8% of total FY24 revenue) to ~Rs700mn by FY25. ZEN management has set an AMC revenue target of ~Rs 1.5bn by FY28, considering it expects to ramp up execution).

Margin outlook: ZEN reported ~41%/~30% EBITDA margin / PAT margin, respectively, in FY24. The company attributes the higher FY24 EBITDA margin to its product mix. Margins in the simulator business tends to be higher than those in the anti-drones business. Further, margins in the export business too tend to be superior than in the domestic business. ZEN management has guided for FY25 EBITDA/ PAT margins of 35%/25%, respectively.

Outlook on net working capital (NWC): Going forward, ZEN management has indicated a sustainable NWC of 140-160 days.

Enables resolution to raise up to Rs 10bn for inorganic growth. The company has identified the target companies and is in the process of evaluating them.

Valuation: The stock has run up 140% over the last 12 months, on the back of a growing total addressable market (TAM), large ticket order wins, and uptick in execution. At CMP of Rs1,118, ZEN trades at FY24 P/E multiple of 58.7x. We do not have a rating on the stock.

Key Risks: Delays in awarding cycle, delays in pursuing inorganic growth.

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Understanding the ZEN's business

Early mover advantage

Zen Technologies started operations in 1993 with a single product, Small Arms Training Simulator (SATS), which was used by National Police Academy, Delhi Police. For all domestic opportunities during 1993-2005, ZEN used to compete against large foreign players like Thales, L3 Harris, Elbit, Rheinmetall. Thereafter, Ministry of Defense (MoD) introduced policies that favored local players, with emphasis on higher indigenization. Things changed dramatically after a high-level committee suggested that Indian Armed Forces increase the adoption of simulators. This led to the entry of new players in the domestic market. Now, 12 types of simulators (also made by ZEN) have been reserved to be procured only from domestic players. Early-mover advantage and continuous investments in R&D, have helped ZEN in building a robust portfolio of 35+ types of simulator and training equipment variants. Management believes an early-mover advantage coupled with the uptick in awarding cycle augur well for the company's growth prospects.

Focus on R&D and an asset-light model have helped ZEN build a strong portfolio

ZEN is heavily focused on R&D, evident from the fact the company had a total R&D staff of 120+ as of FY23 (~46% of total employee count). The company incurred R&D costs of Rs 245mn (5.6% of FY24 sales) in FY24. During FY18-FY24, ZEN cumulatively spent Rs 975mn towards R&D.

We also like ZEN's asset-light strategy (the company outsources 80-85% of its manufacturing work), which enables the company to focus on R&D work and expand its product portfolio.

Product quality and after-sales support

Continuous R&D and operating efficiency have aided ZEN in offering high-quality products at competitive prices. The product offering is augmented by after-sales support, which includes additional training as well as AMC contract, which provides the company with an additional source of income.

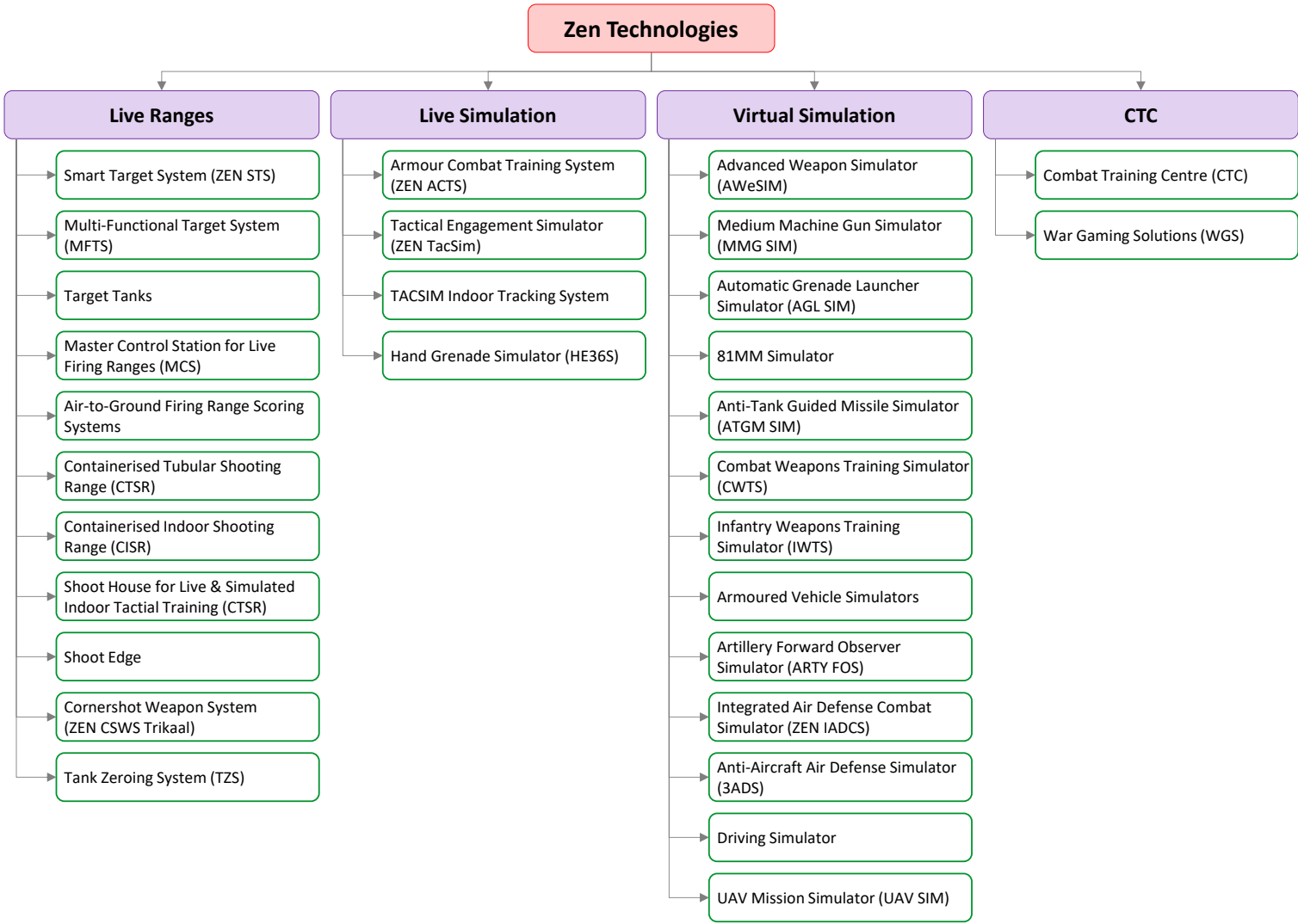
Core competencies

ZEN is a system engineering company with skill sets in areas of electronics, optics, system engineering, mechanical engineering, and software. ZEN being a prime contractor to the Indian army, is well positioned to consider JVs with any of the foreign players.

A strong track record of winning orders

ZEN management claims over 90% strike rate when it comes to winning orders in the domestic market. Despite new entrants in the Indian simulator space, most have not been able to clear the technical rounds, indicating the company holds a strong edge for all opportunities emanating in the near term.

Exhibit 1: Zen Technologies - Portfolio of offerings



Source: Company, Systematix Institutional Research

FINANCIALS (STANDALONE)

Income Statement

| YE: Mar (Rs mn) | FY21 | FY22 | FY23 | FY24 |
|----------------------------|------------|------------|--------------|--------------|
| Net Sales | 496 | 537 | 1,614 | 4,303 |
| Growth (%) | -66 | 8 | 201 | 167 |
| Operating Expenses | 418 | 518 | 1,102 | 2,530 |
| Operating Profit | 78 | 19 | 513 | 1,772 |
| Other Operating Income | 0 | 0 | 0 | 0 |
| EBITDA | 78 | 19 | 513 | 1,772 |
| Growth (%) | -88 | -75 | 2,551 | 246 |
| Depreciation | 40 | 37 | 44 | 73 |
| Other Income | 29 | 53 | 71 | 139 |
| EBIT | 67 | 35 | 540 | 1,838 |
| Finance Cost | 10 | 14 | 20 | 18 |
| Exceptional Item | 0 | 3 | -20 | -24 |
| Profit before tax | 57 | 18 | 539 | 1,844 |
| Tax (current + deferred) | 16 | -2 | 163 | 552 |
| Reported Net Profit | 41 | 20 | 376 | 1,292 |
| Adjusted Net Profit | 41 | 22 | 356 | 1,268 |
| Growth (%) | -93 | -45 | 1,493 | 256 |

Source: Company, Systematix Institutional Research

Cash Flow

| YE: Mar (Rs mn) | FY21 | FY22 | FY23 | FY24 |
|--------------------------------------|-------------|-------------|--------------|--------------|
| Profit before tax | 57 | 19 | 539 | 1,844 |
| Depreciation | 40 | 37 | 44 | 73 |
| Change in Working Capital | 78 | -455 | 537 | -1,405 |
| Total tax paid | -28 | -12 | -87 | -321 |
| Others (inc. Interest Income) | -14 | -27 | -40 | 22 |
| Cash Flow from Operations (a) | 132 | -438 | 993 | 214 |
| Capital expenditure | -16 | -36 | -121 | -260 |
| Change in investments | 0 | 0 | 0 | 0 |
| Others | -160 | -396 | 94 | -560 |
| Cash Flow from Investing (b) | -176 | -432 | -27 | -820 |
| Free cash flow (a+capex) | 116 | -474 | 872 | -47 |
| Equity raised/(repaid)/ (buyback) | 134 | 25 | -97 | 27 |
| Debt raised/(repaid) | -1 | 865 | -64 | -58 |
| Dividend (incl. tax) | -32 | -8 | -8 | -17 |
| Others | -10 | -9 | -15 | -14 |
| Cash Flow from financing (c) | 91 | 873 | -184 | -62 |
| Net change in cash (a+b+c) | 47 | 3 | 782 | -668 |
| Opening cash balance | 295 | 758 | 690 | 2,090 |
| Closing cash balance | 342 | 761 | 1,472 | 1,422 |

Source: Company, Systematix Institutional Research

Balance Sheet

| YE: Mar (Rs mn) | FY21 | FY22 | FY23 | FY24 |
|-------------------------------------|--------------|--------------|--------------|--------------|
| Share Capital | 80 | 80 | 80 | 84 |
| Reserves & Surplus | 2,052 | 2,838 | 3,112 | 4,447 |
| Net Worth | 2,132 | 2,917 | 3,192 | 4,531 |
| Minority Interest | 0 | 0 | 0 | 0 |
| Total Liabilities | 2,132 | 2,917 | 3,192 | 4,531 |
| Non-current Liabilities | 19 | 49 | 24 | 104 |
| Long-term borrowings | 1 | 30 | 0 | 0 |
| Deferred tax liabilities | 0 | 0 | 0 | 63 |
| Other Long-term liabilities | 1 | 1 | 1 | 10 |
| Long term provisions | 17 | 18 | 23 | 31 |
| Current Liabilities | 86 | 612 | 1,249 | 2,548 |
| Short-term borrowings | 7 | 91 | 58 | 0 |
| Trade Payables | 25 | 33 | 37 | 262 |
| Other Current Liabilities | 54 | 488 | 1,154 | 2,287 |
| Short term provisions | 1 | 0 | 0 | 0 |
| Total Liabilities and Equity | 2,236 | 3,579 | 4,465 | 7,184 |
| Non-Current Assets | 1,079 | 1,076 | 1,107 | 1,427 |
| Net Block | 621 | 616 | 693 | 892 |
| Goodwill | 0 | 0 | 0 | 0 |
| Non-current Investments | 241 | 243 | 243 | 263 |
| Long-term loans and advances | 10 | 15 | 11 | 0 |
| Deferred tax Assets | 206 | 201 | 134 | 0 |
| Other non-current Assets | 2 | 0 | 25 | 272 |
| Current Assets | 1,157 | 2,503 | 3,357 | 5,757 |
| Inventories | 92 | 142 | 411 | 1,334 |
| Sundry Debtors | 174 | 195 | 662 | 1,691 |
| Cash & Bank Balances | 342 | 761 | 1,472 | 1,422 |
| Other current Assets | 504 | 1,184 | 549 | 1,209 |
| Loans & Advances | 45 | 220 | 263 | 100 |
| Current Investments | 0 | 0 | 0 | 0 |
| Total Assets | 2,236 | 3,579 | 4,465 | 7,184 |

Source: Company, Systematix Institutional Research

Ratios

| YE: Mar | FY21 | FY22 | FY23 | FY24 |
|-------------------------------|------|------|-------|------|
| Adjusted EPS (Rs) | 0.5 | 0.3 | 4.6 | 16.4 |
| Growth (%) | -93 | -45 | 1,493 | 256 |
| Dividend/share (Rs) | 0.4 | 0.1 | 0.1 | 0.0 |
| Dividend payout ratio (%) | 77.6 | 35.5 | 2.2 | 0.0 |
| EBITDA margin (%) | 15.6 | 3.6 | 31.8 | 41.2 |
| EBIT margin | 13.5 | 6.5 | 33.4 | 42.7 |
| Adj. Net margin | 8.3 | 4.2 | 22.1 | 29.5 |
| Tax rate (%) | 27.9 | -8.9 | 30.2 | 29.9 |
| Debt/ Equity (x) | 0.0 | 0.0 | 0.0 | 0.0 |
| Inventory days | 67 | 96 | 93 | 113 |
| Sundry Debtor days | 128 | 133 | 150 | 143 |
| Trade Payable days | 18 | 23 | 8 | 22 |
| Du-Pont Analysis - ROE | | | | |
| Adj. Net margin (%) | 8.3 | 4.2 | 22.1 | 29.5 |
| Asset turnover (x) | 0.2 | 0.2 | 0.5 | 0.9 |
| Leverage factor (x) | 1.0 | 1.0 | 1.0 | 1.0 |
| ROE (%) | 2.0 | 0.9 | 11.7 | 32.8 |
| ROCE (%) | 2.5 | 1.7 | 17.1 | 64.7 |
| Valuation (x) | | | | |
| PER | | | 80.7 | 58.7 |
| PCE | | | 76.4 | 57.6 |
| Price/Book | | | 9.0 | 16.4 |
| EV/EBITDA | | | 54.4 | 41.9 |

Source: Company, Systematix Institutional Research

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