

Stock Update

# Zen Technologies Ltd.

Sept 25, 2023





Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Aerospace & Defence	Rs. 720.20	Buy in the Rs 710-730 band & add more on dips to Rs. 639-653	Rs. 795	Rs. 854	2-3 quarters

HDFC Scrip Code	ZENTEC
BSE Code	533339
NSE Code	ZEN TEC
Bloomberg	ZEN IN
CMP Sept 22, 2023	720.20
Equity Capital (Rs cr)	8.4
Face Value (Rs)	1.0
Equity Share O/S (cr)	8.4
Market Cap (Rs cr)	6,052.2
Book Value (Rs)	39.8
Avg. 52 Wk Volumes	747,312
52 Week High	912.6
52 Week Low	175.5

Share holding Pattern % (June 30, 2023)	
Promoters	57.5
Institutions	4.4
Non Institutions	38.1
Total	100.0



HDFCsec Retail research  
stock rating meter

for details about the ratings, refer at the end of the report

\* Refer at the end for explanation on Risk Ratings

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### Our Take:

Zen Technologies Ltd (ZTL) is a leading company in designing, manufacturing and developing land-based military training simulators, driving simulators, live-range equipment, and anti-drone systems. ZTL has its own training platform to provide a realistic battle experience by integrating its entire range of product offerings. The company has applied for over 130+ patents, of which 50 have been granted. It has shipped more than 1,000 training systems around the world. Its demonstration center at Abu Dhabi is progressing as per plans and will be operational soon. Going forward, the company will also focus on products that use Artificial Intelligence(AI) to ramp up its product portfolio. The company's employee strength stood at 611+, including contract employee of ~320 people.

ZTL's order book has been robust, and stood at Rs 1275 crore as on Sept 05, 2023; it is 4.1x TTM revenue. This is mainly led by Simulators and anti-drone systems. On Sept 22, 2023, it received another order from the Ministry of Defence of Rs 227.65 crore. Order inflow is expected at Rs 200-300 crore for the balance FY24E as per the current order pipeline and ZTL has a success rate of around 80% in winning orders. Its robust outlook depends on the potential opportunities owing to government's thrust on indigenization and the company expects to be a prime beneficiary of the same given its level of expertise, technical abilities and successful track record of execution. ZTL expects significant growth in the next four to five years and targets to achieve aspirational revenue guidance of Rs 1,000 crore in the next five years.

ZTL has a strong position in the anti-drone systems market, with most competitors relying on imported products while the company is fully utilizing its manufacturing capacity for anti-drone systems and has a network of vendors for manufacturing. The company expects to win a majority of the orders in the anti-drone systems market due to its ability to make software and hardware changes to tackle evolving threats. Besides, the Agnipath Pravesh Yojana initiative by the Indian government has accelerated the procurement of simulators for the armed forces. The market size for military training simulators is estimated to be around Rs 15,000 crores. However, in the simulator market, ZTL is facing competition, especially in specialized products like tank simulators and air defense simulators.

We had issued an Initiating Coverage report on June 05, 2023 on Zen Technologies Ltd. ([Link](#)) and recommend to buy the stock in the Rs 394-403 band and add more on dips to Rs. 341-349 band for the base target of Rs. 441 and bull case target of Rs. 475 over the next two to three quarters and stock achieved targets before expiry of the call. Given healthy growth outlook and strong deal intake in Q2FY24, we have now revised earnings and increased target price for the stock.



### Valuation & Recommendation:

ZTL has continually focused on innovation-led growth and delivering long-term value for its stakeholders over the years. The foray into anti-drone technology marked the beginning of a new chapter in the company’s growth story. The company is also diversifying its business to explore areas other than training simulators, and as such, it is participating in the design and developmental projects of the Ministry of Defence under the MAKE categorisation. With this, ZTL has positioned itself to capitalise on emerging market opportunities by leveraging its inherent capabilities. The company is expected to report strong performance in the future, led by its strong indigenization capabilities, healthy order book, promising order inflow pipeline, and strong execution capabilities.

**Based on the Q1FY24 numbers and the fresh order inflow post the issue of our report we have revised upwards the estimates for FY24E and FY25E and upped the target price. Though the valuation of the company is not as attractive as at the time of our previous report, given the large order inflow since then and the revenue visibility for the next few years, we feel that some more rerating is possible. We feel investor can buy the stock in the Rs 710-730 band and add more on dips to Rs. 639-653 band (32.5x FY25E EPS) for the base target of Rs. 795 (40x FY25E EPS) and bull case target of Rs. 854 (43x FY25E EPS) over the next two to three quarters. At a CMP of Rs 720, the stock is trading at 36.3x FY25E EPS.**

### Financial Summary (Consolidated)

Particulars (Rs cr)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)	FY21	FY22	FY23	FY24E	FY25E
Total Operating Income	132.4	37.1	257.3	95.9	38.1	54.6	69.8	218.8	581.9	693.7
EBITDA	68.9	10.8	538.1	35.2	95.9	7.4	4.3	72.6	222.0	249.4
Depreciation	1.9	1.6	17.2	1.5	25.7	5.0	4.8	6.1	7.1	8.1
Other Income	2.7	2.2	23.7	0.0	-	3.0	5.4	7.2	11.6	14.6
Interest Cost	0.4	0.7	-35.0	0.6	-32.6	1.1	1.5	4.1	1.9	2.0
Tax	20.8	3.7	468.9	9.6	115.8	1.6	0.7	21.8	68.5	75.4
Reported PAT	48.4	7.0	589.0	23.4	107.2	2.8	2.6	48.0	156.1	178.5
Adjusted PAT	47.1	7.5	531.2	20.2	133.1	3.1	2.2	42.7	145.9	166.9
Diluted EPS (Rs)	5.6	0.9	531.2	2.4	133.1	0.4	0.3	5.2	17.4	19.9
RoE-%						1.6	0.9	14.3	38.0	31.5
P/E (x)						1,946.0	2,738.5	138.5	41.5	36.3
EV/EBITDA (x)						814.9	1,397.9	81.1	26.8	23.5

(Source: Company, HDFC sec)



### Q1FY24 Result Update

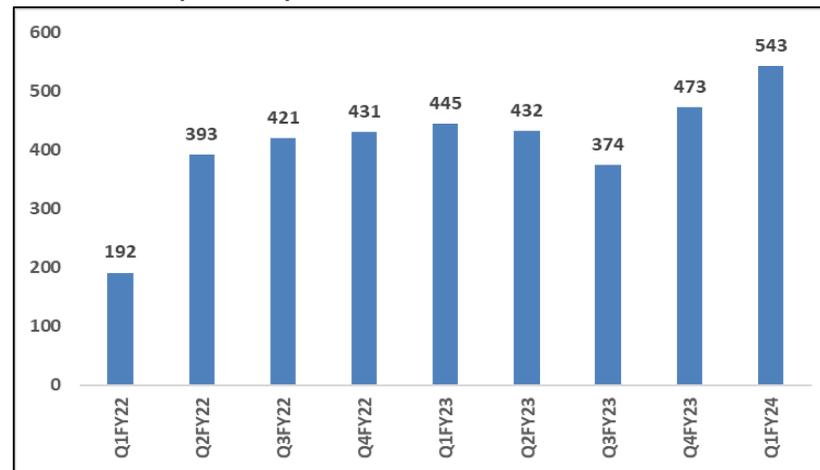
- ZTL reported robust performance with strong execution and secured multiple orders. It reported robust performance, secured multiple orders, strong executions, and all time high liquidity position. Revenue grew by 257.3% YoY to Rs 132.4 crore in Q1FY24 led by strong order execution in the quarter.
- EBITDA was at Rs 68.9 crore in Q1FY24 vs. Rs 10.8 crore in Q1FY23, supported by robust operating income in the quarter. Net profit stood at Rs 47.1 crore vs. Rs 7.5 crore in same quarter previous year. EBITDA margin and PAT margin ramped up to 52% and 35.6% in Q1FY24, respectively.
- Total order book stood at Rs 543 crore as on June 30, 2023, 1.5x TTM sales.

### Key Updates

#### Strong order book brings better earning visibility going forward

The company's unexecuted order book stood at Rs 1275 crore as of Sept 05, 2023 (Simulator product Rs.590.99 cr, Simulator AMC Rs.228.3 cr and anti-drone systems Rs.456.1 cr) vs. Rs 543 crore as of June 30, 2023 (Simulator product Rs.240.2 cr, Simulator AMC Rs.145.6 cr and anti-drone systems Rs.157 cr). The order book stands at 4.1x of TTM Sales, which provides adequate revenue visibility over the medium term. Post Q1FY24, the company has reported robust order inflow at Rs 732 crore including both equipment and AMC components, providing strong revenue visibility over the coming few years. ~91-92% of the order book is on nomination basis from the government and the rest is through bidding process. On Sept 22, 2023, it received another order from the Ministry of Defence of Rs. 227.65 crore.

### Order Book (Rs in Cr)



### New order received in Q2FY24 till Sept 05, 2023

Descriptions	Month	Order Size, Rs in Cr
Supply of Anti Drone System to MoD	Jul-23	160
Significant order win in the Export Market	Jul-23	340
Supply of Training Equipment to MoD	Aug-23	55
Supply of Training Equipment to MoD	Aug-23	72
Supply of Training Equipment to MoD	Sep-23	105

(Source: Company, HDFC sec)



Order inflow for the balance of FY24 is expected at Rs 200-300 crore as per the current order pipeline and ZTL has a success rate of around 80% in winning orders. Its robust outlook depends on the potential opportunities owing to government's thrust on indigenization and the company expects to be a prime beneficiary of the same given its level of expertise, technical abilities and successful track record of execution.

### **Expectation of huge growth opportunity in AMC business**

ZTL has been an industry leader with over three decades of expertise in delivering cutting-edge military training and counter-drone solutions. The company is engaged in manufacturing state-of-the-art land-based military training simulators, driving simulators, live range equipment, and counter-drone systems.

The global military simulation and training market is expected to grow at a 5.6% CAGR over 2022-2027 to US\$ 12.2bn by 2027E from an expected US\$ 9.2bn in 2022. Increasing defence spending across the world for development of new technologies to strengthen the defence efficiency and military and training capabilities has led to this buoyancy. Increasing demand for unmanned systems for defence is expected to derive the demand for simulators and drone/anti drone systems.

Taking the Indian context, there is an addressable market of around Rs 15,000 crores for army training simulators. The annual spend on simulators by the armed forces is approximately Rs 1,000 crores. Recently announced Agnipath Pravesh Yojna (APY) on June 14, 2022, could bring an opportunity for the youth of the country to serve in the Armed Forces as Agniveers for a tour-of-duty of 4 years could add more demand going ahead.

ZTL is one of the largest player in the training and ground simulators in India. ZTL's supply of simulators carry a warranty period of 36 months. The company receives 10% of order value as AMC (Annual Maintenance Contracts) after the expiry of warranty period of 36 months. The AMC business not only offers high margin but also removes lumpiness of new equipment orders. The company generated ~22% of overall revenue from AMC business in FY23. The lifecycle of a simulator is 15 years and it provides lifetime revenue potential of 120% of product sale. ZTL's AMC revenue stood at Rs ~40 crore as of now and it could increase to ~ Rs 70 crore, as per current order execution by 2025 and Rs 150 crore by 2027-28.

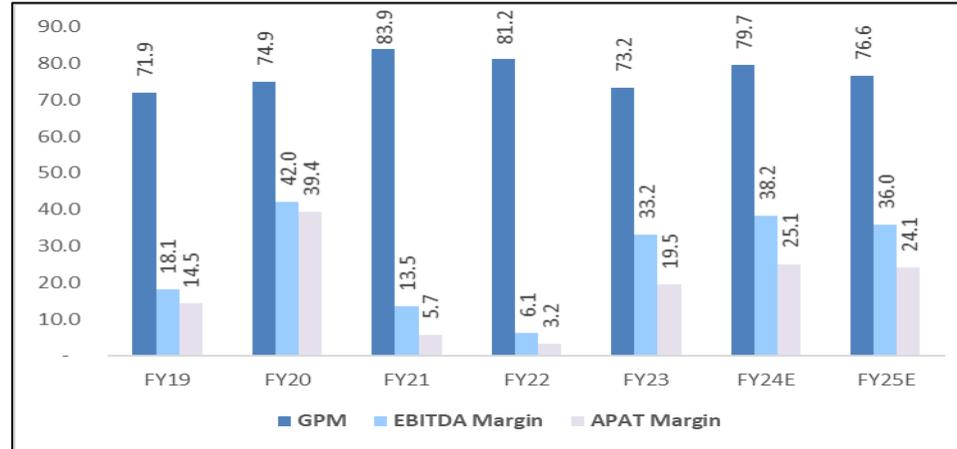
### **Expectation of margins stability**

ZTL's profitability has been volatile over the past due to high input cost and other expenses led by R&D expenses. Now, its story has turned into growth phase on account of robust revenue growth and cost rationalisation efforts. The company expects significant growth in the next four to five years and is optimistic about the current and next financial year's performance. The company expects to maintain a gross margin of the current level, with some variability based on product mix. The EBITDA margins are expected to be sustainable, and the company



anticipates strong revenue and profitability growth in the next few years. The company expects to report a sustainable net margin of around 25% going forward.

### Margins



### Robust financial profile led by healthy profitability supported by cost control measures and return ratio

- ZTL's financial profile has been volatile over the past due to tender based nature of operation and dependence on government orders. However, profitability and return indicators, zero debt, superior liquidity and strong debt coverage metrics look sound as of FY23.
- ZTL reported revenue CAGR over a decade (from FY12 to FY23) stood at ~26%. We expect, the company could report revenue CAGR at ~78% over the FY23 to FY25E.
- ZTL's net profit has been volatile over the last one decade, the company reported net profit at Rs 42.7 crore in FY23 vs. Rs 2.2 crore in FY22. We expect, the company could report ~98% PAT CAGR over the FY23 to FY25E.
- ZTL has focused on cost-control measures and extensive indigenisation efforts to improve profitability. ZTL has met its entire working capital requirement through internal accruals over the last 5 years. The company has also sufficient liquidity with healthy cash and bank balance of about ~Rs 275 crore on consolidated basis, as on July 31, 2023.
- ZTL is debt free company and liquidity profile is superior, supported by comfortable cash flow from operations, which are expected to be adequate to meet the capital expenditure outlay and dividend outflows. Besides, the company continues to invest heavily on R&D at 12-14% of revenue which is charged to the P&L account from year to year. It has made R&D spend of ~Rs 73 crores in the last 5 years.



## What could go wrong?

- Any changes in the procurement policy of the defence forces or a significant reduction in defence spending could impact its revenue and order book position. Besides, any adverse change in government policy/terms from Defense units could impact ZTL's operation over the longer term.
- Defence sector has been opened up to the private sector, and the ZTL has a competition threat from big private players like Adani Defence and Aerospace, L&T, Bharat Forge, Data Patterns etc and PSU players like BEL and BDL etc.
- Due to the high concentration of the Government sector orders, ZTL's revenue generation and cash flows are vulnerable to delays in project execution or final payment clearance in some cases. ZTL is looking to tap the opportunity in non-defence business going forward including exports.
- Most of the Company's simulators are built in accordance with specific feedback from the clients, without any guarantee of buying the resultant end-product, putting the Company at a significant risk financially.
- The Government's standard policy of buying from the lowest bidder could be potentially harmful to the company. Sometimes other vendors, whose development costs are already amortized, provide cheaper solutions due to their greater bandwidth.
- Any large debt funded capital expenditure and/or any further stretch in working capital cycle could impact its business and future capex plan going forward.
- Due to continuous change in the business, geo political and external environment, the company is exposed to a variety of risks which are dynamic in nature.
- In standalone entity, ZTL made exports of Rs 55.5 crore in FY23, mainly of simulators to Govt entities abroad. This results in risk of adverse change in regulations by importing countries and forex fluctuations.
- Promoter's holding declined by 2.69% in Q1FY24. Atluri family and Head of R&D Division and Whole Time Director, Mr. Ravi Midathala made the biggest insider sale in the last 12 months. Further sale of promoters' holding could hit the sentiment of investors.
- Q1FY24 had a good in executions and margins. This may not be repeated in Q2, though, momentum could pick up in later quarters. Improvement and sustainability of the revenue growth will remain a key monitorable over the medium term.

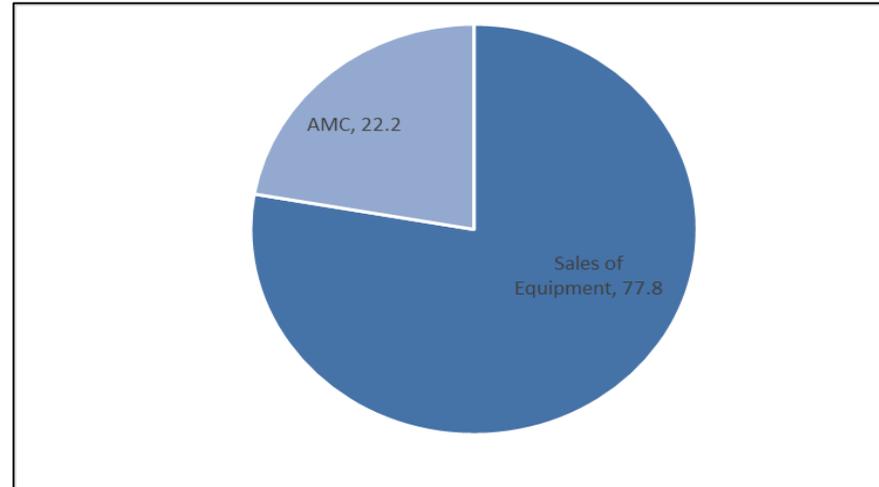
## About the company

Zen Technologies Ltd. (ZTL) is the sole manufacturer of training base Simulator in India and the company designs, develops and manufactures state-of-the-art combat training solutions for the training of defence and security forces worldwide. The company manufactures land based military training simulators, driving simulators, Live range equipment and Anti Drone Systems. ZTL produces over 40 different Live Fire, Live Instrumented, Virtual and Constructive training systems to support individual and collective training capabilities.

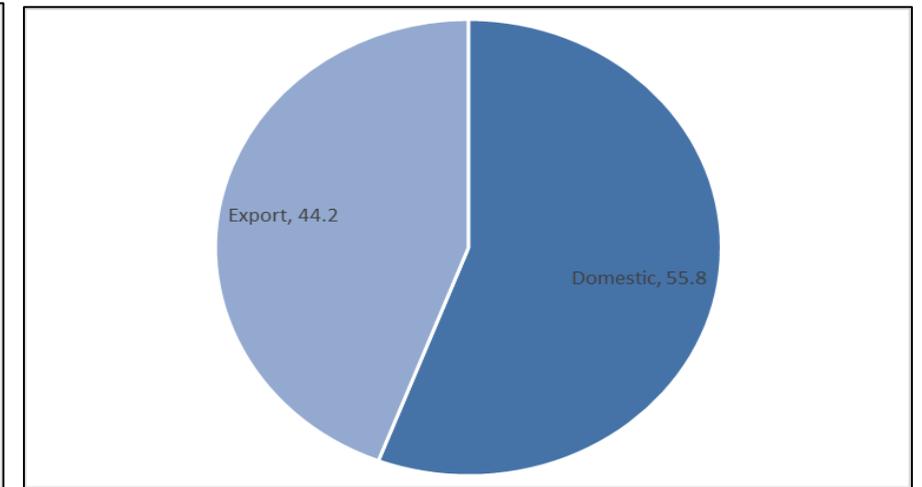


With a dedicated R&D (recognized by the Ministry of Science and Technology, Government of India) and production facility in Hyderabad, the company has applied for over 130 patents and shipped more than 1,000 training systems around the world. ZTL’s headquarter office is in Hyderabad, India with offices in India and USA. The company has employee strength of ~611, including contract labour of 320 and 120+ employees are dedicated to R&D services, ZTL has built strong R&D capabilities.

**Revenue Mix (FY23)-%**



**Sales of Equipment (FY23)-%**



(Source: Company, HDFC sec)



## Financials – Consolidated Income Statement

(Rs Cr)	FY21	FY22	FY23P	FY24E	FY25E
<b>Net Revenues</b>	<b>54.6</b>	<b>69.8</b>	<b>218.8</b>	<b>581.9</b>	<b>693.7</b>
Growth (%)	-63.4	27.7	213.8	165.9	19.2
Operating Expenses	47.3	65.5	146.2	359.9	444.3
<b>EBITDA</b>	<b>7.4</b>	<b>4.3</b>	<b>72.6</b>	<b>222.0</b>	<b>249.4</b>
<b>Growth (%)</b>	<b>-88.2</b>	<b>-42.0</b>	<b>1596.5</b>	<b>205.7</b>	<b>12.4</b>
<b>EBITDA Margin (%)</b>	<b>13.5</b>	<b>6.1</b>	<b>33.2</b>	<b>38.2</b>	<b>36.0</b>
Depreciation	5.0	4.8	6.1	7.1	8.1
Other Income	3.0	5.4	7.2	11.6	14.6
<b>EBIT</b>	<b>5.5</b>	<b>4.8</b>	<b>73.8</b>	<b>226.5</b>	<b>255.9</b>
Interest expenses	1.1	1.5	4.1	1.9	2.0
<b>PBT</b>	<b>4.4</b>	<b>3.3</b>	<b>69.7</b>	<b>224.6</b>	<b>253.9</b>
Tax	1.6	0.7	21.8	68.5	75.4
<b>RPAT</b>	<b>2.8</b>	<b>2.6</b>	<b>48.0</b>	<b>156.1</b>	<b>178.5</b>
Minority Interest &EOI	-0.3	0.4	5.2	10.1	11.6
<b>APAT</b>	<b>3.1</b>	<b>2.2</b>	<b>42.7</b>	<b>145.9</b>	<b>166.9</b>
Growth (%)	-94.7	-28.9	1833.9	241.5	14.4
EPS	0.4	0.3	5.2	17.4	19.9

## Balance Sheet

As at March	FY21	FY22	FY23P	FY24E	FY25E
<b>SOURCE OF FUNDS</b>					
Share Capital	8.0	8.0	8.0	8.4	8.4
Reserves	196.5	275.1	308.2	443.7	598.0
<b>Shareholders' Funds</b>	<b>204.4</b>	<b>283.0</b>	<b>316.2</b>	<b>452.1</b>	<b>606.4</b>
Long Term Debt	1.2	4.2	0.0	0.0	0.0
Net Deferred Taxes	0.0	0.0	0.0	0.0	0.0
Long Term Provisions & Others	1.8	2.9	3.3	3.4	3.6
<b>Minority Interest</b>	<b>6.3</b>	<b>6.9</b>	<b>14.1</b>	<b>24.3</b>	<b>35.9</b>
<b>Total Source of Funds</b>	<b>213.6</b>	<b>297.0</b>	<b>333.5</b>	<b>479.7</b>	<b>645.8</b>
<b>APPLICATION OF FUNDS</b>					
Net Block & Goodwill	69.6	66.2	75.2	90.0	96.8
CWIP	0.0	2.5	1.9	3.0	3.1
Other Non-Current Assets	23.6	24.0	20.0	22.0	24.2
<b>Total Non Current Assets</b>	<b>93.2</b>	<b>92.7</b>	<b>97.2</b>	<b>114.9</b>	<b>124.0</b>
Current Investments	0.0	0.0	0.0	0.0	0.0
Inventories	14.7	25.0	49.0	119.6	133.0
Trade Receivables	18.6	31.7	85.4	223.2	269.9
Cash & Equivalents	40.3	82.9	167.4	106.7	210.6
Other Current Assets	56.5	136.7	74.8	78.5	82.5
<b>Total Current Assets</b>	<b>130.1</b>	<b>276.2</b>	<b>376.5</b>	<b>527.9</b>	<b>696.0</b>
Short-Term Borrowings	0.7	9.7	5.9	10.9	10.9
Trade Payables	3.2	3.9	6.7	17.5	20.9
Other Current Liab & Provisions	5.8	58.3	127.5	134.7	142.4
<b>Total Current Liabilities</b>	<b>9.7</b>	<b>72.0</b>	<b>140.2</b>	<b>163.2</b>	<b>174.2</b>
Net Current Assets	120.4	204.2	236.4	364.8	521.7
<b>Total Application of Funds</b>	<b>213.6</b>	<b>297.0</b>	<b>333.5</b>	<b>479.7</b>	<b>645.8</b>

(Source: Company, HDFC sec)



## Cash Flow Statement

(Rs Cr)	FY21	FY22	FY23P	FY24E	FY25E
Reported PBT	4.4	3.3	71.7	224.6	253.9
Non-operating & EO items	0.4	0.2	-5.5	-11.6	-14.6
Interest Expenses	-1.5	-3.0	3.5	1.9	2.0
Depreciation	5.0	4.8	6.1	7.1	8.1
Working Capital Change	0.5	-47.5	55.1	-195.6	-54.8
Tax Paid	-2.8	-2.2	-14.4	-68.5	-75.4
<b>OPERATING CASH FLOW ( a )</b>	<b>5.9</b>	<b>-44.3</b>	<b>116.4</b>	<b>-42.1</b>	<b>119.2</b>
Capex	-1.4	-4.3	-13.1	-22.6	-15.0
Free Cash Flow	4.5	-48.6	103.2	-64.7	104.2
Investments	0.0	0.0	0.0	-0.2	-0.2
Non-operating income	-8.4	-39.3	9.4	11.6	14.6
<b>INVESTING CASH FLOW ( b )</b>	<b>-9.8</b>	<b>-43.6</b>	<b>-3.7</b>	<b>-11.2</b>	<b>-0.7</b>
Debt Issuance / (Repaid)	-0.2	87.2	-7.6	5.0	0.0
Interest Expenses	1.5	3.0	-3.5	-1.9	-2.0
FCFE	5.8	41.7	92.2	-61.6	102.2
Share Capital Issuance	0.0	0.0	-9.7	0.0	0.0
Dividend	-5.7	-4.8	-0.8	-10.5	-12.6
Others	13.4	2.5	-0.4	0.0	0.0
<b>FINANCING CASH FLOW ( c )</b>	<b>9.0</b>	<b>88.0</b>	<b>-21.9</b>	<b>-7.4</b>	<b>-14.6</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>5.1</b>	<b>0.1</b>	<b>90.8</b>	<b>-60.7</b>	<b>103.9</b>

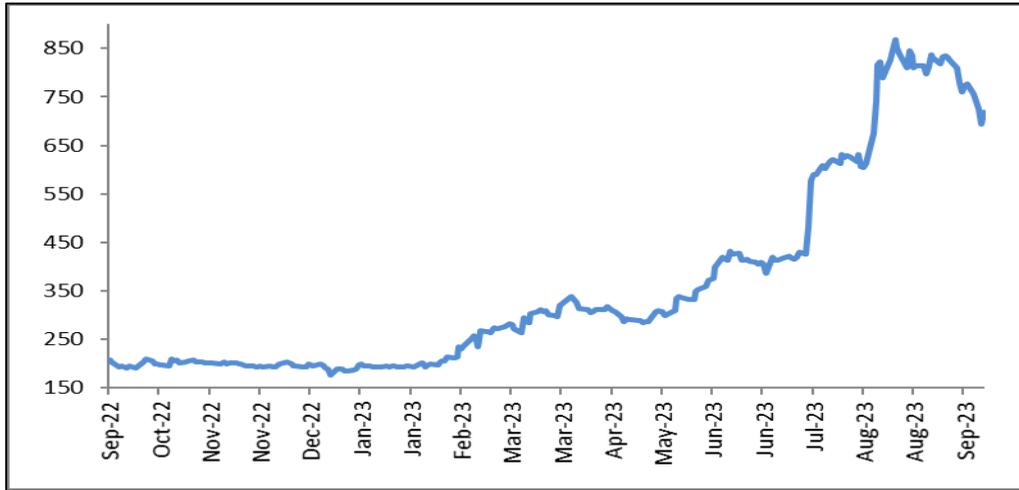
## Key Ratios

Particulars	FY21	FY22	FY23P	FY24E	FY25E
<b>Profitability Ratio (%)</b>					
EBITDA Margin	13.5	6.1	33.2	38.2	36.0
EBIT Margin	10.0	6.9	33.7	38.9	36.9
APAT Margin	5.7	3.2	19.5	25.1	24.1
RoE	1.6	0.9	14.3	38.0	31.5
RoCE	3.0	3.0	30.8	43.2	43.6
<b>Solvency Ratio (x)</b>					
Net Debt/EBITDA	0.3	3.3	0.1	0.0	0.0
Net D/E	0.0	0.0	0.0	0.0	0.0
<b>Per Share Data (Rs)</b>					
EPS	0.4	0.3	5.2	17.4	19.9
CEPS	1.0	0.8	5.8	18.2	20.8
Dividend	0.1	0.1	0.2	1.3	1.5
BVPS	24.3	33.7	37.6	53.8	72.2
<b>Turnover Ratios (days)</b>					
Debtor days	124	166	142	140	142
Inventory days	98	131	82	75	70
Creditors days	21	21	11	11	11
<b>Valuation (x)</b>					
P/E	1946.0	2738.5	138.5	41.5	36.3
P/BV	29.6	21.4	19.1	13.4	10.0
EV/EBITDA	814.9	1397.9	81.1	26.8	23.5
EV / Revenues	110.1	85.8	26.9	10.2	8.4
Dividend Yield (%)	0.0	0.0	0.0	0.2	0.2
Dividend Payout (%)	27.0	38.0	3.8	7.2	7.6

(Source: Company, HDFC sec)



## One Year Price Chart



(Source: Company, HDFC sec)

### HDFC Sec Retail Research Rating description

#### Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

#### Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

#### Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicity of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

**Disclosure:**

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