

August 19, 2021 ^(Revised)

Embee Software Private Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount(Rs. crore)	Rating Action
Long Term – Fund Based/Cash Credit	40.50	58.80	[ICRA]BBB+(Stable); Reaffirmed
Long Term/ Short Term – Non-Fund Based	30.50	55.90	[ICRA]BBB+ (Stable)/[ICRA]A2; Reaffirmed
Long Term/ Short Term – Fund Based/Non Fund-Based	20.90	-	-
Total	91.90	114.70	

*Instrument details are provided in Annexure-1

Rationale

The reaffirmation of the ratings considers the improvement in revenue to ~Rs. 730 crore in FY2021 (provisional) of Embee Software Private Limited (Embee), primarily driven by a consistent growth in the cloud segment. Moreover, the company's annuity contracts with various customers render revenue visibility in the medium to long term. The operating margin continued to remain range bound at ~4.5% in FY2021. The ratings continue to draw comfort from the established operational track record of Embee Software Private Limited (Embee) as an information technology (IT) service provider to reputed institutional clients and relationship with globally renowned vendors in the IT space. Microsoft has designated Embee as a licensing solution partner (LSP) for volume licensing of software and has also rendered it with the status of a cloud service provider (CSP), reflecting the company's strategic engagement with Microsoft, which accounted for a significant portion of Embee's turnover in FY2021. The company also won Microsoft India Area Award 2021 – Cloud Innovation Partner of the Year. Embee also has strategic tie-ups with other premier vendors of IT products such as Hewlett Packard Company (HP), IBM, SAP, Oracle, Cisco, Adobe, Epson etc. which lend operational strength to the company and enable it to acquire reputed institutional clients, leading to a continuous expansion of its customer base. The ratings also consider Embee's comfortable return on capital employed due to low fixed capital requirement of the business. ICRA also notes the recent change in the ownership structure with Softline Services India Private Limited (the Indian arm of the Softline Group) acquiring a ~95% stake in the company. The merger process has already commenced and is expected to be completed in the next one year. ICRA would continue to monitor the development and review the company's performance, as and when further clarity emerges.

The ratings, however, are constrained by the limited pricing flexibility due to competitive nature of the business, which keeps its operating margin under check. The operating profits improved with an improvement in turnover, but it continued to remain modest at an absolute level. The debt coverage indicators, despite improvement, remained moderate with an interest coverage of below 4.0 times in FY2021. ICRA also notes the entity's high receivable level, which exerts pressure on its liquidity position, and its high total outside liabilities relative to the tangible net worth due to its significant dependence on creditors' funding. However, a consistent increase in the credit limit by Microsoft supports the sustainability of such creditors' funding. Acquisition by the Softline Group would further enable the company to get benefits in the form of higher credit from Microsoft based on global corporate guarantee of the Softline Group. Besides, enhancement in duration of payment to a monthly basis would save cost. Going forward, the company's ability to improve its margins, while growing volumes over a modest working capital cycle, will be the key determinants of its financial risk profile.

The Stable outlook on the long-term rating reflects ICRA's opinion that Embee will continue to generate healthy cash flows relative to its debt service obligations and will get operational benefits due to a change in its ownership.

Key rating drivers and their description

Credit strengths

Established operational track record and relationship with globally renowned vendors in the information technology space

– Embee has an operational track record of more than 30 years as an IT solution provider. It has established working relationships with leading IT vendors like Microsoft, HP, IBM, Oracle, SAP, Cisco, Adobe, Epson etc. It has a long experience in reselling of software and hardware, and as a solution provider to corporate customers.

Consistent revenue growth in recent years, mainly driven by a robust expansion in the cloud segment; improvement in financial performance in FY2021

– The overall revenue further improved to Rs. 730 crore in FY2021 (provisional), registering a YoY growth of ~10%, primarily driven by the cloud segment. With an increasing demand for cloud-based products, the company's revenue from the cloud segment registered a robust expansion in the recent years and grew by around 15% to Rs. 471.98 crore in FY2021 from Rs. 411.46 crore in FY2020. The cloud segment contributed around 65% to the company's turnover in FY2021. While revenue from the software segment moderated to around 23% to the company's turnover in FY2021, the revenues from the audio visual and hardware segments improved in FY2021. The operating margin continued to remain range bound at ~4.5% in FY2021. With an improvement in turnover, the operating profits improved, but continued to remain modest at an absolute level. Also, certain one-off expenses as a part of the share purchase agreement further moderated the net cash accruals in FY2021. While debt coverage indicators improved in FY2021, with interest coverage below ~4.0 times, it continued to remain moderate. The company's ability to improve its margins, while growing volumes over a modest working capital cycle, will be the key determinants of its financial risk profile, going forward.

Strategic engagement with Microsoft strengthens Embee's business profile

– Embee generates the major portion (around 80-85% in the last few years) of its revenues from Microsoft products. The company is designated as a licensing solutions partner (LSP) of Microsoft for volume licensing of software, which is the highest level of channel partnership that Microsoft offers at the national level. This status helps Embee sell Microsoft products directly to large institutional customers through Enterprise Agreements (EA). Embee is one of the few LSPs of Microsoft in the country at present. In addition, Embee is also designated as a cloud service provider (CSP) of Microsoft. The company also won Microsoft India Area Award 2021 – Cloud Innovation Partner of the Year. It recognises demonstrated excellence in innovation and implementation of customer solutions based on Microsoft technology. Embee's strategic engagement with Microsoft strengthens its market position and helps expand its customer base. Acquisition by the Softline Group would enable Embee to get benefits in the form of higher credit from Microsoft based on global corporate guarantee of the Softline Group. Besides, enhancement in duration of payment to a monthly basis would save cost.

Credit challenges

Limited pricing flexibility keeps operating margin under check

– Competitive nature of the business and trading nature of a significant portion of the revenues limit the company's pricing flexibility, keeping the operating margin under check. While, the company is gradually improving the high-margin service related business, the margin is expected to be range bound, given the volume-based nature of business.

High receivable level exerts pressure on liquidity

– Embee's receivable level remained high in the recent years due to significant credit period offered to its customers and a sizeable billing towards the year end. Moreover, a part of the receivables for project-based revenues has a long recovery schedule post implementation, which increases the receivable level further, exerting pressure on liquidity. These are backed by the credit period offered from vendors and working capital borrowings. Nonetheless, the counterparty credit risk remained low, as reflected by lower bad debt in the past.

High total outside liabilities relative to tangible net worth due to substantial creditors funding –The gearing remained moderate at 0.57 times in FY2021, but significant credit availed from the vendors kept the company’s total outside liabilities relative to the tangible net worth (TOL/TNW) high at ~3.30 times as on March 31, 2021 (3.99 times as on March 31, 2020). A consistent increase in the credit limit by Microsoft supports the sustainability of such creditors’ funding. Going forward, these ratios will remain sensitive to the revenue growth pursued and the working capital management strategies adopted by the company.

Liquidity position: Adequate

The liquidity is adequate on account of cushion in the fund-based facilities. The cash accruals remained moderate at around ~Rs. 13 crore in FY2021. However, the working capital requirement continued to remain high, funded through creditors as well as working capital borrowings. The debt repayment, though remained high at Rs. 16.5 crore in FY2022, is regularly getting refinanced, which supports the liquidity to an extent.

Rating sensitivities

Positive factors – A significant improvement in profitability along with a sizeable reduction in receivables, easing the liquidity position, may trigger ratings upgrade.

Negative factors – Pressure on Embee’s ratings may arise if its revenues and profitability decline significantly. Besides, a further stretch in the receivables, exerting pressure on the liquidity position, may also trigger ratings downgrade. Specific triggers for downward revision in ratings would be interest coverage below 3.0 on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Information Technology (Services) Industry
Parent/Group Support	-
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company

About the company

Embee Software Private Limited (Embee), established in 1988 by Mr. Sudhir Kothari, mainly acts as an information technology (IT) solution provider to corporate customers through consulting, systems integration, managed services etc. It started business as a reselling partner of TCS for IBM Lotus Notes. The company was mainly involved in the packaged software licensing business till 1996 as reselling partners of various companies like Microsoft, Symantec Corporation, Autodesk Inc. etc. Later, the company started hardware reselling business as well. In 2011, the company was awarded the large account reseller (LAR) status by Microsoft for volume licensing business. With Microsoft’s increasing focus on cloud business, the LAR format was discontinued and Embee was designated as a licensing solution partner. It has also been designated by Microsoft as its cloud service provider. The company also won Microsoft India Area Award 2021 – Cloud Innovation Partner of the Year. Embee generates the major portion of its revenue from Microsoft products and continues to have strategic tie-ups with other globally renowned principals like IBM, HP, Oracle, SAP, Cisco, Adobe, Epson etc.

Key financial indicators (audited)

Embee	FY2019	FY2020	FY2021 Prov
Operating Income (Rs. crore)	552.82	663.50	729.92
PAT (Rs. crore)	10.35	13.01	11.88
OPBDIT/OI (%)	3.95%	3.48%	4.58%*
PAT/OI (%)	1.87%	1.96%	1.63%
Total Outside Liabilities/Tangible Net Worth (times)	3.64	3.99	3.30
Total Debt/OPBDIT (times)	2.03	2.81	1.49
Interest Coverage (times)	3.53	2.93	3.84

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + Repayments made during the Year); *adjusted for one-off items incurred for acquisition by Softline Group

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Type	Rating (FY2022)		Rating History for the Past 3 Years			
			Amount Rated	Amount Outstanding (March 31, 2021)	Current	FY2021	FY2020	FY2019
					August 19, 2021	May 29, 2020	-	November 01, 2018
1	Fund Based/Cash Credit	Long-Term	58.80	11.76	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	-	[ICRA]BBB+(Stable)
2	Non Fund Based	Long Term/ Short Term	55.90	46.32	[ICRA]BBB+(Stable)/[ICRA]A2	[ICRA]BBB+(Stable)/[ICRA]A2	-	[ICRA]BBB+(Stable)/[ICRA]A2
3.	Fund Based/Non Fund Based	Long Term/ Short Term	-	-	-	[ICRA]BBB+(Stable)/[ICRA]A2	-	[ICRA]BBB+(Stable)/[ICRA]A2

Complexity level of the rated instrument

Instrument	Complexity Indicator
Fund Based/Cash Credit	Simple
Non Fund Based	Very Simple
Fund Based/Non Fund Based	Simple/ Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
HDFC Bank Limited	Cash Credit	NA	NA	NA	11.50	[ICRA]BBB+(Stable)
ICICI Bank Limited	Cash Credit	NA	NA	NA	30.00	[ICRA]BBB+(Stable)
Citibank N.A.	Cash Credit	NA	NA	NA	13.80	[ICRA]BBB+(Stable)
HDFC Bank Limited	Bills Discounting	NA	NA	NA	3.50	[ICRA]BBB+(Stable)
HDFC Bank Limited	Non Fund-Based Facilities	NA	NA	NA	18.00	[ICRA]BBB+(Stable)/[ICRA]A2
ICICI Bank Limited	Non Fund-Based Facilities	NA	NA	NA	15.00	[ICRA]BBB+(Stable)/[ICRA]A2
Citibank N.A.	Non Fund-Based Facilities	NA	NA	NA	22.90	[ICRA]BBB+(Stable)/[ICRA]A2

Source: Company

Annexure-2: List of entities considered for consolidated analysis

NA

Corrigendum

Details of lenders have been updated in Annexure 1

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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