AGC Networks Limited

September 23, 2019

Ratings

Facilities	**Amount (Rs. crore)**	**Ratings**[1]	**Rating Action**
Long term Bank Facilities (Term Loan)*	21.37	CARE D (Single D)	Removed from credit watch with developing implications; Rating revised from CARE BB+ (Double B Plus)
Long term Bank Facilities (Fund-based facility)	100.00 (reduced from 103.00)	CARE C; Stable (Single C; Outlook: Stable)	Removed from credit watch with developing implications; Rating revised from CARE BB+ (Double B Plus)
Short term Bank Facilities	38.70	CARE A4 (A Four)	Removed credit watch with developing implications; Rating revised from CARE A4 (A Four)
Total	**160.07 (Reduced from 163.07) (Rupees One hundred Sixty crore and Seven lakh only)**		

Details of instruments/facilities in Annexure-1

**As confirmed by the management, the term loan has been fully repaid in July 2019. However, No Dues Certificate has not been received by CARE.*

Detailed Rationale & Key Rating Drivers

The revision in the rating assigned to the bank facilities (term loan above) of AGC Networks Limited (AGC) factors in the delays in debt servicing on the working capital term loan rated by CARE. Consequently the ratings of the other bank facilities have also been revised. The ratings are constrained by the weakened capital structure and coverage indicators on account of acquisition of Black Box Corporation Inc. (BBC), elongated collection period with high utilisation of working capital limits, significant decline in the profitability due to the one-time extraordinary expense of Rs.78.79 crore incurred towards the acquisition of BBC, and corporate guarantee extended to a group company although the amount of guarantee has reduced. The ratings also factor in the foreign exchange risk faced by the company and competitive nature of the IT/ITes industry.

The ratings continue to be supported by the experience of the promoters (viz. Essar group) and management, sound technical know-how and domain expertise of AGC, strong and diverse client based across various verticals and diversified capabilities in Information and Communication Technology (ICT) solutions. The ratings also factor in the significant improvement in the scale of operations post BBC's acquisition, and the turnaround of the operating loss into operating profit in Q1FY20 (refers to the period from April 01 to June 30).

Going forward, the ability of the company to improve its capital structure and profitability margins will be the key rating sensitivities. Further, any large sized debt-funded capex, mergers or acquisitions or unrelated diversification adversely impacting the capital structure would be crucial from the credit perspective.

Detail description of the key rating drivers

Key Rating Weaknesses

Delays in debt servicing

As per the annual report for FY19, the company has defaulted in repayment of some term loan instalments. As confirmed by the management, the term loan has been fully repaid in July 2019.

Significant decline in the profitability on account of BBC's acquisition in FY19

On a consolidated basis, AGC's total income from operation registered a growth of 153% primarily on account of acquisition of BBC in January 2019. However, the profitability margins of the company declined substantially mainly because BBC was a loss making company. Due to this acquisition, the AGC had incurred net loss of Rs.78.77 crore and

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

cash loss of Rs.64.41 crore during FY19 mostly on account of one-time extraordinary expense of Rs.78.79 crore incurred towards the acquisition of BBC. AGC has earned net profit of Rs.13.56 crore and cash profit of Rs.37.92 crore in Q1FY20 post-acquisition of BBC and COPC in January 2019 as compared to the net loss of Rs.98.02 crore and cash loss of Rs.91.64 crore in Q4FY19.
On Standalone basis there was drop in PBILDT level and margins in FY19. The PBILDT margin declined by 620 bps in FY19, from 10.00% in FY18 to 3.80% in FY19, primarily due to the waiver of rental expense to AGC in FY18. The total operating income (on standalone basis) grew by 10.89% yearly and 11.47% quarterly during Q1FY20. The revenue improved on account of new orders through BBC (as a result of acquisition of BBC).

Weakened capital structure and coverage indicators on account of BBC's acquisition
AGC reported net loss and cash loss in FY19 on account of one-time extraordinary expense of Rs.78.79 crore incurred towards the acquisition of BBC, which resulted in erosion of the networth as on March 31, 2019. Accordingly the capital structure and debt coverage indicators weakened. Interest coverage ratio deteriorated from 1.37 times in FY18 to 1.12 times in FY19. However, due to the improvement in the profitability levels in Q1FY20, the interest coverage ratio improved to 2.44 times in Q1FY20.

Elongated collection period with high utilisation of working capital limits
On a consolidated basis for FY19, AGC's collection period is at 104 days. AGC's collection period remains high primarily due to milestone based projects. Further, the projects executed were of long gestation period. The collection period is also high on account of credit extended to Indian customers is for 60-90 days, as against US customers from whom they take payment in advance. Stretched receivable cycle over the years has led to moderation in liquidity position and higher dependence on working capital borrowings. The average month-end utilisation of the fund based working capital limits was around 92% in the twelve months ended July 2019.

Foreign exchange risk
On a standalone level AGC is a net importer with major portion of third party equipment requirement being imported by the company. However, on a consolidated level AGC is net exporter wherein the major part of its earnings are in dollars from its US and Singapore subsidiaries (which contribute 83% of the consolidated revenue in FY19). Hence, on consolidated level the revenue from US and other subsidiaries acts as a natural hedge for its foreign exchange exposure. The company incurred forex loss of Rs.2.18 crore in FY19 as against the forex gain of Rs.0.45 crore in FY18.

Corporate guarantee extended to subsidiary company
During FY14 AGC had extended a corporate guarantee of Rs.108.20 crore (USD 18 Million) towards the financial obligation (working capital borrowings of USD 15 Mn) of AGC Networks Pte. Limited, Singapore (ANPL). The amount guaranteed has reduced to around Rs.35.74 crore as on March 31, 2019 (USD 5.16 million) and further to Rs.33.63 crore (USD 4.88 million) as on June 30, 2019. The reduction in exposure was on account of scheduled repayment of the term loan by ANPL.

Competitive nature of the business
The managed IT services market is highly competitive with competition from Tier I domestic IT service providers, global IT service providers, large telecommunication companies, telecommunication service providers as well as small and midsize IT services companies. Moreover, the managed IT solutions market has seen significant capacity expansion over the past few years to tap into the potential of the growing domestic IT solutions market. The presence of large industry players, increasing number of smaller firms, robust capacity expansion for the industry together with the rapidly changing business dynamics of the IT industry have resulted in increased competition within the IT solutions market leading to subdued revenue growth and pressure on profit margins.

Key Rating Strengths
Experienced Promoters
AGC is a part of the Essar group through Essar Telecom Ltd (ETL) which is subsidiary of Essar Global Fund Limited ("EGFL"). ETL was holding company of AGC till January 04, 2019. As on March 31, 2019, ETL holds 46.69% of the paid-up capital compared to 74.90% as on March 31, 2018. ETL has transferred its shares to other subsidiaries of EGFL (Onir Metallics Limited holding 14.46% shares of the paid-up capital).

Sound technical know-how and domain expertise

AGC has been operating in telecommunication & networking related business for nearly three decades. Over the period, AGC has developed sound technical know-how and domain expertise, helping it to diversify into related businesses with relative ease as well as to adapt to any technological developments in its existing domain of operations. This expertise has enabled AGC to offer customised solutions/services to its customers, thereby giving it a competitive advantage.

Strong and well diversified client base

AGC's clientele is spread across a broad spectrum of verticals such as banking, financial services and insurance, government, PSUs and defence, healthcare, travel and hospitality, IT/ITes, manufacturing, energy and utilities, etc. In addition, customer concentration risk has been moderate, with the top 10 customers contributing around 73.98% to the total sales. The well diversified client base insulates the company's revenue stream from any industry specific risks of business cycles.

Diversified capabilities in ICT solutions

Over the period, AGC has evolved as one of the major solutions integrators in the enterprise communication space. The company offers services across the lifecycle of the solution, spanning design, deployment and management of communication solutions for enterprises to interact with the customers, employees, suppliers, etc. AGC also provides maintenance activities through its customer care segment required periodically for the hardware set up by the company.

Liquidity Analysis: On a consolidated basis for FY19, AGC's collection period is at 104 days. AGC's collection period remains high primarily due to milestone based projects. Further, the projects executed were of long gestation period. The collection period is also high on account of credit extended to Indian customers is for 60-90 days, as against US customers from whom they take payment in advance. Stretched receivable cycle over the years has led to moderation in liquidity position and higher dependence on working capital borrowings. The average month-end utilisation of the fund based working capital limits was around 92% in the twelve months ended July 2019.

Analytical approach: CARE has considered consolidated financials of AGC and its group companies on account of significant operational and financial linkages. The consolidated results include the following subsidiaries:

Serial No.	Name of the Entity	% of holding as on March 31, 2019
1	AGC Networks Australia Pty Ltd	100
2	AGC Networks Pte. Ltd	100
3	AGC Networks Inc. and its subsidiaries (consolidated)	100
4	AGC Networks Philippines, Inc.	100
5	AGC Networks and Cyber Solutions Ltd	100
6	AGC Solutions Pte Ltd	100
7	AGC Networks L.L.C., Dubai	100
8	AGC Networks L.L.C., Abu Dhabi	100
9	AGC Networks New Zealand Limited	100
10	Black Box Main Inc.	100
11	BBC and its subsidiaries (consolidated)	100
12	COPC Holdings Inc. and its subsidiaries (consolidated)	100

Applicable Criteria

Criteria on assigning 'Outlook' and 'Credit Watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology: Factoring Linkages in Ratings
Short-term Instruments
Financial ratios – Non-Financial Sector
Rating Methodology - Service Sector Companies

About The Company

AGC Networks Ltd. (AGC), incorporated in 1986 by Tata Telecom Pvt. Ltd. to manufacture telecommunication equipment, was acquired by the USA based Avaya Inc in 2004. In August 2010, Essar group acquired 79.13% stake in the company which

was transferred to a group company Aegis Ltd. Aegis Ltd. transferred the investment in AGC to another group company (viz., Essar Telecom Ltd) effective from March 28, 2014.
Over the years, AGC evolved into an information and communication (ICT) solutions provider and integrator with a differentiated vertical approach in business communication systems, applications and services mainly within India. The company provides server based converged networking platform for voice, data and video including IP telephony, multimedia call centre and Customer Relationship Management (CRM) solutions, unified communications and customer service.
AGC has been undergoing major expansion in its international operations. The company has consistently increased its global footprint through foray into multiple geographies such as Middle East, Africa, North America, Australia, New Zealand, Singapore, Philippines and UK servicing over 8000+ customers. Further, to expand its global presence AGC completed the acquisition of Black Box Corporation Inc. (BBC) on January 07, 2019. Further, AGC Networks Pte. Ltd. (ANPL; a Singapore based wholly owned-subsidiary of AGC) and AGC Networks Inc. (AGC US; a USA based wholly owned-subsidiary of ANPL) had jointly entered into a share purchase agreement with COPC Holdings Inc.(COPC) and Global Quality Assurance Limited (Seller) for acquisition of 100% stake in COPC for a purchase consideration of USD 5.5 million (approximately Rs.38.04 crore). The acquisition was effective from January 01, 2019.

Brief Financials (Rs. crore)-Consolidated	FY18 (A)	FY19 (A)
Total operating income	734.33	1856.18
PBILDT	34.24	50.02
PAT	14.93	-78.72
Overall gearing (times)	2.08	NM
Interest coverage (times)	1.37	1.12

A: Audited

Status of non-cooperation with previous CRA: ICRA suspended its ratings on AGC vide press release dated June 21, 2013 as ICRA was unable to carry out a rating surveillance in the absence of the requisite information from the company.

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	100.00	CARE C; Stable
Non-fund-based - ST-BG/LC	-	-	-	38.70	CARE A4
Fund-based - LT-Term Loan	-	-	May 5, 2019*	21.37	CARE D

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Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Cash Credit	LT	100.00	CARE C; Stable	1)CARE BB+ (Under Credit watch with Developing Implications) (03-Apr-19)	1)CARE BB+ (05-Apr-18)	1)CARE BB; ISSUER NOT COOPERATING* (02-Feb-18)	1)CARE BB (07-Jul-16)
2.	Non-fund-based - ST-BG/LC	ST	38.70	CARE A4	1)CARE A4 (Under Credit watch with Developing Implications) (03-Apr-19)	1)CARE A4 (05-Apr-18)	1)CARE A4; ISSUER NOT COOPERATING* (02-Feb-18)	1)CARE A4 (07-Jul-16)
3.	Fund-based - LT-Term Loan*	LT	21.37	CARE D	1)CARE BB+ (Under Credit watch with Developing Implications) (03-Apr-19)	1)CARE BB+ (05-Apr-18)	1)CARE BB; ISSUER NOT COOPERATING* (02-Feb-18)	1)CARE BB (07-Jul-16)

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Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:
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