

ZICOM ELECTRONIC SECURITY SYSTEMS

INR 146

Secure yourself

BUY



* Electronic security systems: Secured growth prospects

The Indian electronic security systems market, valued at INR 5.8 bn (2005), is expected to grow at a CAGR of 25-30% for the next five years. The concept of electronic security is still in its nascent stage with limited consumer awareness, especially in the home and retail sector. Demand is likely to emanate on account of emergence of premium apartments, growth in organized retailing, technological enhancements, and falling hardware prices.

* Consumer service group to be the growth driver

Zicom has ventured into home, retail, and SME segments through its new business segment 'Consumer Service Group'. With 1.8 mn apartments expected to come up over the next 12-15 months all over India, we believe Zicom can scale up its volumes with strategic alliances with prominent builders. It proposes to set up company-owned retail stores in the top 100 towns across India in the next three years. With its first-mover advantage, Zicom will be able to capture the lower end of the security systems market and combat future competition in this segment. We expect revenues from consumer service group to be INR 480 mn in FY07E and INR 783 mn in FY08E.

* Service income to expand margins

Globally, services contribute 27% of the total income from electronic security systems market. Since standalone security systems do not fulfill the desired objective, i.e., safety, we expect similar trends to emerge in India. Zicom is the only company in India that offers a 360 degrees approach to electronic security. This gives it an edge over its competitors, who sell standalone electronic security systems without offering services. For Zicom, we expect services to contribute 17% of the consumer service group's revenues in FY08E, thereby expanding EBITDA margins from 13.5% in FY06 to 16.7% in FY08E.

* Valuations

We expect Zicom's revenue and profits to grow at a CAGR of 61% and 86% respectively from FY06-FY08E. Since Zicom is the only listed company in India offering electronic security solutions, we have compared it with global players like Secom (Japan) and Alsok (Japan) which are significantly larger in size, trade at 20-25x one-year forward earnings.

At the CMP of INR 146, the stock trades at 15.8x FY07E EPS of INR 9.3 and 9.3x FY08E EPS of INR 15.6. With high growth prospects, strong brand equity, pan India presence and experienced management, we initiate coverage with a **'BUY'** recommendation on the stock.

Financials

Year to March	FY05	FY06	FY07E	FY08E
Revenues (INR mn)	577	751	1,402	1,940
EBITDA (INR mn)	92	101	192	324
Net profit (INR mn)	54	56	98	192
EPS (INR)	6.6	6.5	9.3	15.6
EPS growth (%)	73.1	(2.4)	42.8	69.0
PE (x)	22.0	22.5	15.8	9.3
EV/EBITDA	14.2	14.1	7.0	3.7
Dividend yield (%)	0.7	0.8	1.0	1.4
ROE (%)	16.1	13.4	12.5	16.0

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Reuters : ZICO.BO
Bloomberg : ZSS IN

Market Data

52-week range (INR) : 262 / 108
Share in issue (mn) : 85.9
M cap (INR bn/USD mn) : 1.25 / 27.2
Avg. Daily Vol. BSE ('000) : 75.4

Share Holding Pattern (%)

Promoters : 30.8
MFs, Fls & Banks : 6.1
Fls : 9.4
Others : 53.8



Risks

- Execution risk.
- Competition emanating from new technologies and new entrants.
- Slowdown in the economy.

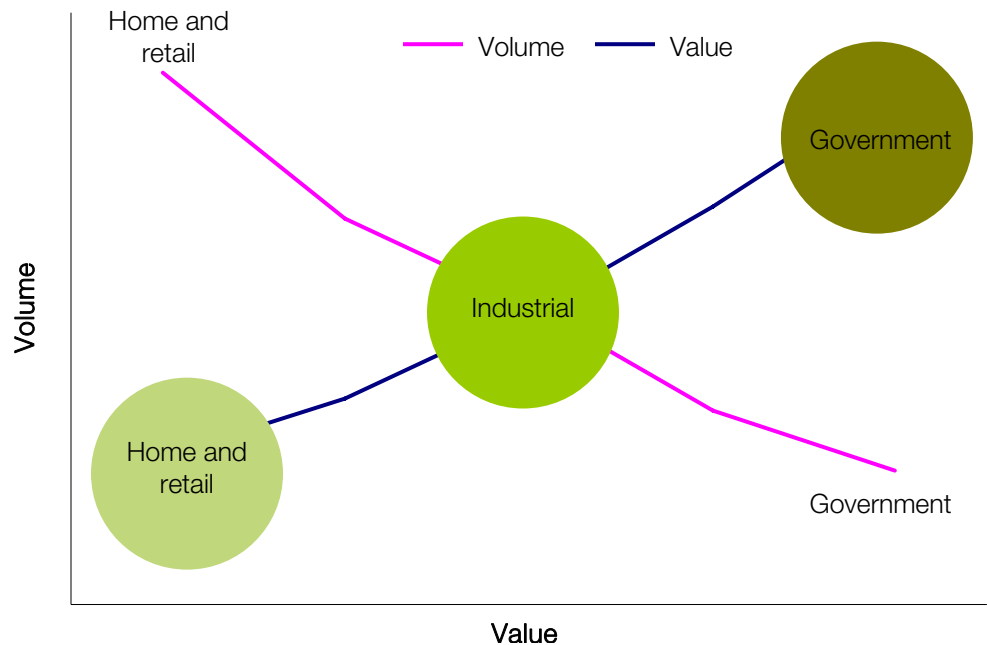
Industry overview

The 9/11 attacks on the World Trade Center in New York have changed the face of the electronic security industry. The global electronic security industry has been growing at about 8% p.a. post September 11, 2001, as compared to 4% p.a. earlier. US accounts for ~40% of the USD 60 bn global electronic security market. The Indian electronic security market is estimated at INR 5.8 bn (2005) and is expected to grow at a CAGR of 25-30% over the next five years.

The electronic security industry in India is a new age industry, not more than 10-12 years old. Historically, electronic security has been a concern of only government bodies and industrial set ups. But the lifestyle boom in the past few years has opened the doors for electronic security in residential and retail segments as well.

The Indian electronic security market is dominated by organized players like Zicom, Honeywell, Tyco, Siemens, Johnson Controls & Godrej, who account for 65% of the total market. The home and retail segments are largely dominated by unorganized players who mainly deal in standalone products and not solutions.

Fig. 1: Value chain of security industry in India



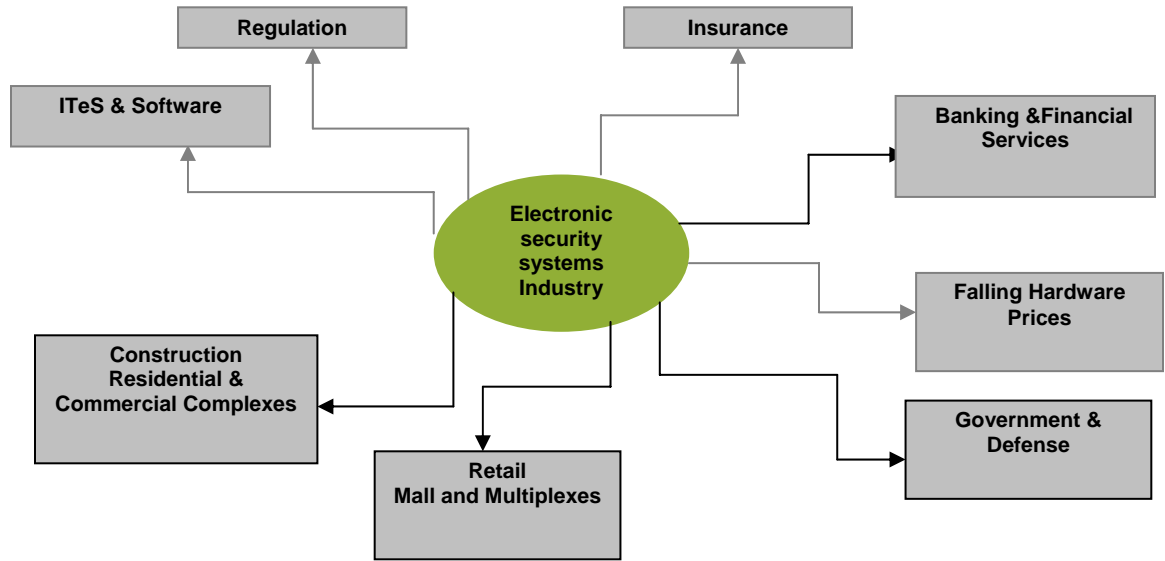
Source: Company

In India, this market is expected to grow through demand from private and public sectors, increasing construction activity, falling hardware prices and growth in the residential segment.

Currently, 80% of Zicom’s revenues flow from the industrial sector, whereas the balance 20% is from the government sector.

The competition in the security industry is mainly concentrated in the government & industrial sector. Although the home and retail sector has huge potential, they are yet to be exploited. With its recent foray in the home and retail sector through its consumer service group, we believe Zicom will have the first-mover advantage and it will be in a unique position to penetrate the lower end of the electronic security market.

Fig. 2: Market drivers of electronic security industry



Source: Company

Business Overview

Unlike the conventional functioning of the electronic security industry, Zicom has branched out into two business verticals: security solutions group (SSG) catering to the government and industrial segments; and the consumer service group (CSG) targeted towards the home and retail consumer segment.

Security solutions group: Zicom caters to government and industrial sectors through the 'Security Solutions Group'. Each project is treated on its own merit, which ensures high level of customization. The industrial sector accounted for 80% of Zicom's revenues and the balance 20% was contributed by the government sector. This group has been growing at a CAGR of 33.5% since FY03 and is likely to grow at 25-30% per annum for the next five years.

Its clientele includes NTPC, ONGC, RBI, the Ministry of Defense, HDFC Bank, ICICI Bank, Standard Chartered Bank, UTI Bank, IDBI Bank, HSBC Bank, Motorola, Hutch, VSNL, Coca Cola, Pfizer, Oracle, LG, HLL, among others.

Consumer service group: Zicom launched its consumer service division in May 2006 to cater to the rapidly growing home and retail sector. The company expects this group to contribute 60% of revenues, i.e., INR 3 bn by 2010. Increasing construction activity, retail boom and increasing electronic security awareness among residents is likely to drive growth in this segment.

Due to its vast untapped potential, the company expects the consumer service group to grow at a faster rate, ~50% per annum, as compared to the security solutions group's rate of ~30%.

Zicom has developed expertise across vertical segments, has a customer base spread across government and private sectors, which ensures that its business model is de-risked and there is no client concentration.

Zicom's vision is to become an INR 5 bn company over the next five years, primarily led by the consumer service group. It is eyeing a pan India presence in the top 100 towns in the next three years and is setting up company-owned retail stores across the country. These 'concept' stores will display a wide array of Zicom products enabling the customer to have a look and feel of the product prior to its purchase. They will play an important role in demonstrating and educating customers about hi-tech products like biometric locks and home automation systems which are to be launched in the near future. Zicom is also selling its products through major white goods retailers like Vijay Sales, Alfa, Sony Mony etc.

To fund its expansion plans Zicom raised USD 11mn through an FCCB at a price of INR 150 per share which was solely subscribed by DE Shaw.

The promoters have subscribed to 8,00,000 warrants at INR 121 per share of which 4,00,000 warrants have already been converted, while the balance 4,00,000 warrants are entitled for conversion at INR 121 per share by FY08. Our FY08 estimates take into account the entire conversion of the FCCB and the promoter's conversion of the balance 4,00,000 warrants.

Products and services umbrella

* Zicom's products

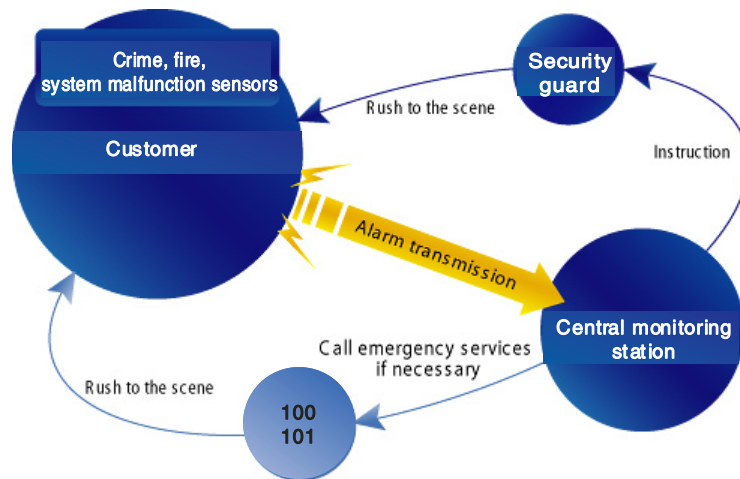
Access control systems, intruder detection systems and video door phone, fire detection systems, gas leak sensors, CCTV surveillance systems (close circuit TV) with digital video recorder, perimeter protection systems, law enforcement products and biometric access control systems.

* Zicom's services

- ♦ **Video monitoring station (VMS):** which employs CCTV and burglar alarm system to help spot any danger before it strikes.
- ♦ **Central monitoring station (CMS):** is remote monitoring via a central control room that automatically connects with your home every time you activate the system.
- ♦ **Emergency response:** is a service wherein the CMS automatically contacts emergency numbers in case of any emergency through professional services like Tops line, the police and fire brigade. The emergency response service is committed to respond in the fastest time possible.
- ♦ **Insurance:** In the rare event that in spite of the first three barriers, a burglary takes place, Zicom insures against losses.

* Consumer services to be the growth driver

Standalone security systems are a preventive measure against crisis, but they fail to offer any cure in case of a debacle. Central monitoring station (CMS) and video monitoring station (VMS) fill in this gap and activate an emergency response which helps mitigate the risk arising out of any unforeseen event.

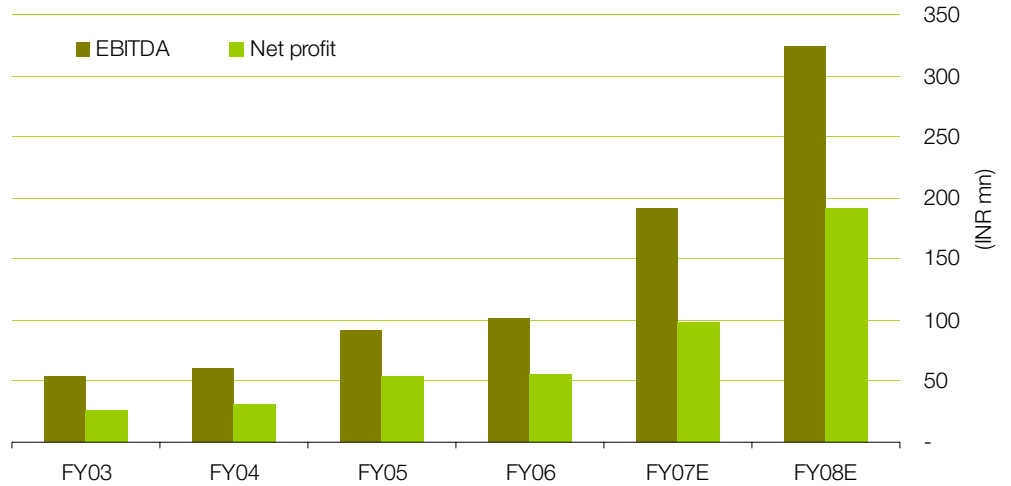


CMS and VMS contribute 27% of the revenues in the global market. Costing INR 300-400 per month, we believe that CMS and VMS services by Zicom are useful for householders, retailers and SMEs in securing their valuables at affordable prices.

In the event of a security breach, the security system automatically alerts CMS personnel, who in turn immediately notify the situation to entities assigned by the customer, like relatives, neighbours, paramedics, office, or local authorities.

With service income coming on stream from FY07 onwards, we expect Zicom's operating margins to improve from 13.5% in FY06 to 16.7% in FY08E.

EBITDA and net profit expected to grow substantially



Source: Edelweiss research

*** Zicom: Emerging a global player**

Zicom has bid for big projects in the Middle East jointly with its UAE-based joint-venture partner the Bin Jabr Group. The commencement of the joint venture is the first step towards establishing a global presence. To increase its global presence, it is also looking at the inorganic route for growth. We have not factored in any potential upside from these acquisitions in our estimates.

Financial statements

Income statement					(INR mn)
Year to March	FY04	FY05	FY06	FY07E	FY08E
Total revenues	408	577	751	1,402	1,940
Raw material cost	284	403	520	958	1,274
Employee cost	25	32	54	98	131
Selling & Administrative exp	29	37	50	108	147
Miscellaneous exp	10	13	26	46	64
Total operating expenses	348	485	650	1,210	1,616
EBITDA	60	92	101	192	324
Other income	0	0	7	5	5
Interest expense	1	6	13	26	13
Depreciation	15	13	18	30	42
Profit before tax	44	74	77	140	274
Provision for tax	13	19	21	42	82
Net profit	31	54	56	98	192
Earnings per share	3.8	6.6	6.5	9.3	15.6
Shares outstanding (mn)	8.2	8.2	8.6	10.6	12.3
Dividend (INR/share)	0.5	1.0	1.2	1.4	2.0

Common size metrics as % on revenues

Year to March	FY04	FY05	FY06	FY07E	FY08E
Operating expenses	85.2	84.0	86.5	86.3	83.3
Depreciation	3.7	2.2	2.4	2.2	2.2
EBITDA margins	14.8	16.0	13.5	13.7	16.7
Net profit margins	7.7	9.4	7.4	7.0	9.9

Growth metrics (%)

Year to March	FY04	FY05	FY06	FY07E	FY08E
Revenues	29.4	41.3	30.1	86.7	38.3
EBITDA	10.7	53.1	9.5	90.0	68.5
PBT	6.8	67.1	4.7	82.2	95.0
Net profit	18.1	73.1	2.4	76.7	95.0
EPS	18.1	73.1	(2.4)	42.8	69.0

Cash flow statement

Cash flow statement					(INR mn)
Year to March	FY04	FY05	FY06	FY07E	FY08E
Cash flow from operations	47	67	74	129	234
Cash for working capital	(41)	(92)	(111)	(165)	(159)
Net operating cash flow- A	5	(25)	(37)	(37)	75
Net purchase of fixed assets	(31)	(42)	(105)	(161)	(121)
Net cash flow from investing- B	(31)	(42)	(105)	(161)	(121)
Proceeds from equity	0	0	48	288	245
Proceeds/Repayments from borrowings	15	55	491	(245)	(245)
Dividend payments	(5)	(9)	(12)	(17)	(28)
Net cash flow from financing- C	10	46	528	27	(27)
Net cash flow (A+B+C)	(16)	(21)	386	(171)	(74)

Balance sheet					(INR mn)
As on 31st March	FY04	FY05	FY06	FY07E	FY08E
Equity capital	82	82	86	106	123
Warrant Subscription Money			5		
Reserves & surplus	238	256	326	680	1,073
Shareholders funds	320	338	416	787	1,196
Secured loans	46	100	113	113	113
Unsecured loans			490	245	
Net Deferred tax liability	28	24	23	23	23
Source of funds	393	462	1,042	1,167	1,332
Gross block	173	186	287	448	569
Depreciation	45	57	76	106	148
Net block	129	129	211	342	421
Capital work in progress	-	-	1	1	1
Net fixed assets	129	129	212	343	422
Investments	4	4	6	6	6
Cash, bank bal & deposits	66	45	429	258	185
Inventory	73	100	118	242	335
Sundry debtors	139	190	254	310	391
Loans & advances	83	67	119	134	154
Total current assets	362	402	920	945	1,065
Sundry creditors	36	39	51	76	100
Others	63	23	32	32	32
Provisions	5	9	13	18	29
Proposed dividend	5	9	12	17	28
Others			1	1	1
Total current liabilities	103	72	96	126	161
Net current assets	259	330	824	819	904
Misc Expenditure not written off	2	-	-	-	-
Application of funds	393	462	1,042	1,167	1,332
Book value (BV) per share	39	41	48	74	98

Ratios

Year to March	FY04	FY05	FY06	FY07E	FY08E
ROE (%)	9.8	16.1	13.4	12.5	16.0
ROCE (%)	8.3	13.2	6.6	10.7	15.4
Inventory days	65	63	63	63	63
Debtor days	125	120	120	81	74
Fixed assets t/o	3.2	4.5	3.6	4.1	4.6
Debt /Equity	0.1	0.3	1.4	0.5	0.1

Valuation parameters

Year to March	FY04	FY05	FY06	FY07E	FY08E
EPS (INR)	3.8	6.6	6.5	9.3	15.6
YoY growth (%)	18.1	73.1	(2.4)	42.8	69.0
CEPS (INR)	5.7	8.2	8.6	12.1	19.1
PE (x)	38.1	22.0	22.5	15.8	9.3
Price/BV (x)	3.7	3.5	3.0	2.0	1.5
EV/sales (x)	3.0	2.3	1.9	1.0	0.6
EV/EBITDA (x)	20.4	14.2	14.1	7.0	3.7

Technical analysis

(Weekly Chart)



Zicom has seen huge volatility in the last six months. The stock price of Zicom had corrected to INR 115 recently which is ~ 60% fall from its recent high of INR 262, but bounced back from its multi-year support around INR 108 and is currently struggling to cross the strong resistance around INR 155.

Over the last few trading sessions the volumes and volatility has come down drastically. The oscillators are coming out of the oversold territory but the buy signal has not yet emerged. This indicates the upside could be INR 190 which will be a relief rally and should be taken as an exit opportunity.

As per the daily charts the stock might rally in the short term up to INR 175 and should be taken as an exit opportunity as the stock is expected to move in a range of INR 130 to INR 175 for next 2-3 months. On the down side if prices falls below INR 115 than might test INR 95.

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Hold	Expected to appreciate up to 20% over a 12-month period
Sell	Expected to depreciate more than 10% over a 12-month period		
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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