BUY

Tejas Networks

Emkay
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Operational scale-up continues; margin concerns persist

Telecommunications ▸ Result Update ▸ **January 20, 2024**

TARGET PRICE (Rs): 1,025

Tejas Networks reported broadly in-line revenue growth of 41% QoQ, led by BSNL's 4G project execution. But margins disappointed, as Tejas shipped primarily low-margin products in Q3; this is likely to improve from Q4, though. We see Tejas benefits chiefly from: 1) GoI emphasis on domestic manufacturing and the PLI scheme; 2) large spends on BSNL, BharatNet, and the Railways; 3) references from TCom and TCS, thus adding new clients; and 4) global move towards replacing Chinese telecom equipment. We cut our EBITDA margin by 100-300bps, as Tejas missed Q3 margin estimates on mix change, though we expect this to marginally reverse in coming quarters. Based on DCF valuation (WACC: 10.5%; terminal growth rate: 6%) we revise down our TP to Rs1,025 (19% upside, implying Dec-24E P/E of 21x) from Rs1,050 earlier; retain BUY.

Tejas Networks: Financial Snapshot (Consolidated)

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	5,506	9,196	21,171	100,223	67,273
EBITDA	(135)	140	796	20,585	13,378
Adj. PAT	43	(279)	(414)	11,471	11,529
Adj. EPS (Rs)	(6.0)	(2.5)	(2.4)	67.6	68.0
EBITDA margin (%)	(2.4)	1.5	3.8	20.5	19.9
EBITDA growth (%)	(125.2)	0.0	467.1	2,485.2	(35.0)
Adj. EPS growth (%)	(249.7)	0.0	0.0	0.0	0.5
RoE (%)	0.3	(1.1)	(1.4)	31.9	24.3
RoIC (%)	0.9	(5.5)	(2.4)	58.0	35.8
P/E (x)	2,110.3	(350.3)	(353.1)	12.7	12.7
EV/EBITDA (x)	(647.7)	658.3	184.2	6.5	9.1
P/B (x)	4.7	3.3	4.8	3.5	2.7
FCFF yield (%)	(1.6)	(12.1)	(6.1)	12.0	12.3

Source: Company, Emkay Research

Revenue in-line (up 41%QoQ); miss on margin, on mix-change

Tejas Networks reported revenue growth of 41% QoQ in Q3 (only 2% miss on our estimate), led by healthy order-book execution. The Wireless business continued to ramp up the BSNL 4G RAN shipments. Gross margins sprung a negative surprise (-1,050bps QoQ to 25.9%), owing to change in product mix, as: i) the wireless segment achieves lower margins; and ii) with Company shipping more low-margin products in Wireline in Q3. As a result, EBITDA margin stood at -1.3% vs 3.3% in Q2FY24 (a 912bps miss vs. our estimate). Working capital increased, along with inventory, as the company secured key long-lead components for expediting delivery of large orders. The order book remains elevated at Rs90.28bn as of end-Q3 vs. Rs92.71bn at end-Q2.

Multiple growth levers to aid in scale-up; margin key concern; maintain BUY

We see Tejas scaling up on the basis of: i) the GoI's spending plan for BSNL, BharatNet-3, Railways' Kavach upgradation, etc which is likely to furnish orders worth ~Rs300bn; ii) international revenue gaining pace, with the BSNL project being used as a reference and the US Rip & Replace program granting new opportunities; iii) the PLI scheme likely generating incentive of Rs15.6bn in 5 years; iv) the expanding product line, including wireless, likely leading to TAM of ~USD87bn by CY28. Tejas is set to benefit from: a) cost-competitive R&D vs. peers, b) asset-light model with EMS partners, c) the acquisition of Saankhya Labs for wireless solutions; and d) new reference opportunity from Tata Group companies (TCS, TCom). We think Tejas can generate ~Rs300bn/Rs55bn revenue/EBITDA during FY24-28E, though margin remains the key concern with no guidance from the management. We expect the company to clock ~20% margin, as it scales up operations. We cut our EBITDA margin by 100-300bps, as Tejas missed the Q3FY24E margin due to mix change, though we expect this to marginally reverse from next quarter. **Our DCF-based valuation (WACC: 10.5%; Terminal growth rate: 6%) determines a lower TP, of Rs1,025/share (19% upside; implying Dec-24E P/E of 21x) than Rs1,050 earlier; retain BUY.**

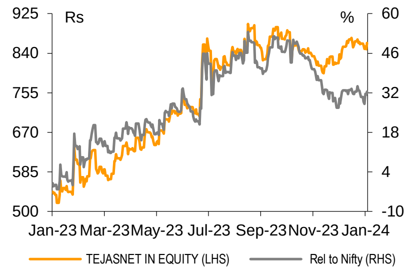
Target Price – 12M	Dec-24
Change in TP (%)	**(2.4)**
Current Reco.	BUY
Previous Reco.	BUY
Upside/(Downside) (%)	18.9
CMP (19-Jan-24) (Rs)	861.9

Stock Data	Ticker
52-week High (Rs)	940
52-week Low (Rs)	510
Shares outstanding (mn)	170.1
Market-cap (Rs bn)	147
Market-cap (USD mn)	1,765
Net-debt, FY24E (Rs mn)	464
ADTV-3M (mn shares)	-
ADTV-3M (Rs mn)	336.1
ADTV-3M (USD mn)	4.0
Free float (%)	-
Nifty-50	21,622
INR/USD	83.1
Shareholding, Dec-23	
Promoters (%)	55.8
FPIs/MFs (%)	11.3/4.4

Price Performance

(%)	1M	3M	12M
Absolute	4.2	(3.1)	55.8
Rel. to Nifty	3.4	(12.1)	30.5

1-Year share price trend (Rs)



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Q3 Results: Revenue broadly in-line; margin miss on mix change

- **Consol. revenue at Rs5.6bn, up 41.4% QoQ/104% YoY** (broadly in line with our estimates; at only a 2% miss), as the wireless business continued to ramp up the BSNL 4G RAN shipments.
  - International business declined 53% QoQ to Rs0.37bn. As a result, the segment's revenue share dropped to 15% from 23% in Q2.
  - The BSNL/BBNL business surged 3.6x QoQ, led by its strong order book. Hence, the segment's revenue share increased to 10% from 5% in Q2.
  - India private also registered a healthy growth, of 87%QoQ, led by ramp up in the BSNL 4G RAN shipments.
- **Gross margin sprung a negative surprise** with decline of 1050bps QoQ to 25.9%. This was owing to change in product mix, as: i) the wireless segment achieves lower margins; and (ii) in Q3, the company shipped more low-margin products in Wireline.
- With weakness in gross profit on account of the change in mix, EBITDA turned negative at -Rs75mn, falling sharply from the Rs130mn in Q3 and considerably below our estimate of Rs443mn.
  - EBITDA margins contracted by 462bps QoQ to -1.3% (912bps below our est. of 7.8%).
- **Losses widened further** to Rs449mn from Rs126mn QoQ (vs. our est. of Rs113mn profit).
  - Depreciation was up 15.6% QoQ at Rs482mn. Finance charge was up 17.9% QoQ to Rs83mn. Other income was down 15.6% QoQ.
  - ETR stood at 8% in Q3 vs. 28.7% in Q2.
- **Cash & Cash Equivalents stood at Rs5.6bn as end-Q3** vs. Rs13.71bn at end-Q2.
- **Inventory increased to Rs26.8bn in Q3** from Rs14bn as of end-Q2, mainly attributable to securing key long-lead components for expediting delivery of several critical large orders – primarily BSNL 4G RAN and backhaul network. This also led to working capital increasing to Rs13.4bn from Rs6.7bn in Q2.

Exhibit 1: Tejas Networks – Q3FY24 results

(Rs mn)	3QFY23	2QFY24	3QFY24	YoY	QoQ
Revenue from operations (net) (A)	2,746	3,960	5,600	104.0%	41.4%
Cost of materials consumed	1,678	2,518	4,151	147.4%	64.8%
Employee benefits expense	687	794	839	22.2%	5.7%
Other expenses	301	518	685	127.5%	32.2%
Total expenses (B)	**2,665**	**3,830**	**5,675**	**112.9%**	**48.2%**
Adj. EBITDA (A - B)	**80**	**130**	**(75)**	**N/A**	**N/A**
Finance Cost	47	70	83	74.1%	17.9%
Depreciation and amortization expense	294	417	482	64.1%	15.6%
Other Income	210	180	152	-27.8%	-15.6%
Restated Profit / (Loss) before exceptional items and tax	(51)	(177)	(488)	N/A	N/A
Restated Profit / (Loss) before tax	(51)	(177)	(488)	N/A	N/A
Tax expense	58	(51)	(39)	N/A	N/A
Profit / (Loss) for the year	(109)	(126)	(449)	N/A	N/A
Adj. Profit	**(109)**	**(126)**	**(449)**	**N/A**	**N/A**
(a) Reported EPS – Basic (Rs)	(0.71)	(0.75)	(2.59)	N/A	N/A
(b) Reported EPS – Diluted (Rs)	(0.71)	(0.75)	(2.64)	N/A	N/A
(c) Adjusted EPS – Diluted (Rs)	(0.71)	(0.75)	(2.64)	N/A	N/A
Costs as a % of sales					
Gross Profit	38.9	36.4	25.9	-1302 bps	-1054 bps
EBITDA margin	2.9	3.3	-1.3	-426 bps	-462 bps
Cost of materials consumed	61.1	63.6	74.1	1301 bps	1053 bps
Employee benefits expense	25.0	20.0	15.0	-1003 bps	-506 bps
Other expenses	11.0	13.1	12.2	126 bps	-86 bps
Total expenses	97.1	96.7	101.3	425 bps	461 bps

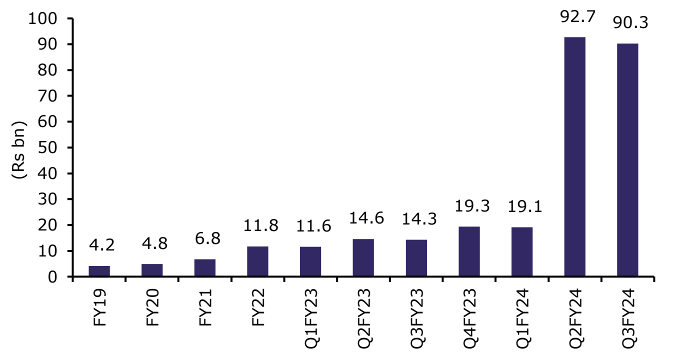
Source: Company, Emkay Research

Order book

Order book at the end of Q3 stood at Rs90.28bn vs. Rs92.71bn as of end-Q2

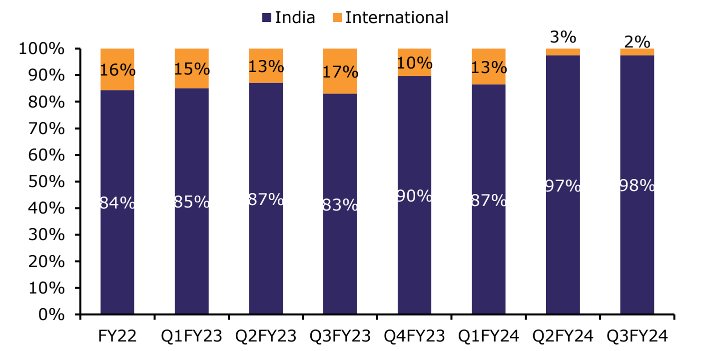
- Company received an additional PO of Rs1.08bn from TCS, to supply RAN equipment for BSNL's 4G/5G rollout.
- Saankhya Labs received a Rs0.96bn provisional purchase order from NSIL (Department of Space), for deployment of two-way Satcom Xponders for the communication and support system on marine fishing vessels.
- Company successfully deployed over150 100G/200G DWDM channels on the alien wave network. It received an add-on order for pan-India deployment.

Exhibit 2: Order book remains elevated for Tejas



Source: Company, Emkay Research

Exhibit 3: Much of the backlog is related to India



Source: Company, Emkay Research

Key call takeaways

- **Margin impact from mix change:** Change in product mix towards lower-margin products in Q3 resulted in the lower margins. Lesser contribution from exports was another deterrent for margins. Further, the wireless segment clocked lower margins than the wired segment. This will, though, be compensated going ahead, as the scale of the wireless business increases. Next quarter is likely to see improvement, with increase in shipment of high-margin products in the wireline business.
- **Increase in working capital:** Increase in revenue led to higher trade receivables in Q3. Inventory also shot up in Q3, in order to manage the lead time of key components required for execution of the order pipeline and for capturing any potential opportunity.
- **International business:** The International business is moving at a slow pace, albeit is expected to gain momentum in the long run. The company is likely to be benefitted by the partnership with Tata group companies, in gaining access to various players and projects across the globe. Focus remains on both, developed and developing countries.
- **BharatNet:** The project authorities and DoT are finalizing the project, its scope, specifications of equipment, etc. Tejas has the requisite technology and products to receive allocation from the project. Company is expecting the tender to be rolled out in the next few months.
- **Others:**
  - Working capital requirement can be managed with short-term borrowings. Incremental equity funding will not be warranted for this requirement.
  - Forex management is in place, to hedge exposure arising from raw-material procurement.
  - Continued investments in scaling up R&D teams and operations would accelerate product development for driving growth, and executing large projects. Investment in R&D would continue for the next few years, before the company starts seeing pay back.

- Inventory increased for the company, as it secured key long-lead components for expediting delivery of several critical large orders – primarily BSNL 4G RAN and backhaul network. This also led to increase in its working capital.
- Trade receivables for the company have increased, with increase in deliveries/revenue.
- Borrowings stood at Rs2.7bn at end-Q3 (nil at end-Q2) for working capital purposes.

Changes in estimate

We have cut our revenue by 1-3% on account of the marginal miss on our revenue estimate. We have also pruned our EBITDA margin by 100-300bps, as Tejas missed Q3FY24E margin due to change in mix which we expect to marginally reverse from next quarter.

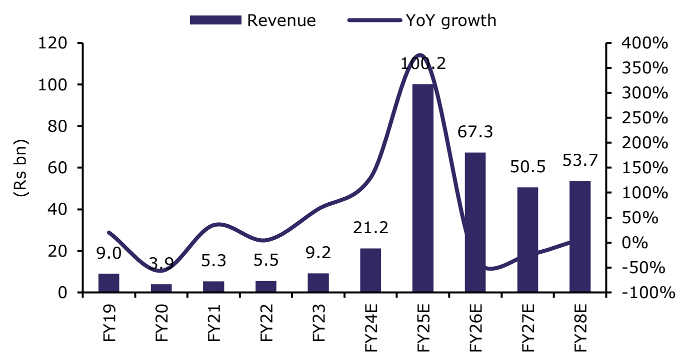
Exhibit 4: Changes in estimate

Particulars (Rs mn)	FY24E			FY25E			FY26E		
	Old	Revised	Change	Old	Revised	Change	Old	Revised	Change
Revenue	21,390	21,171	-1.0%	103,192	100,223	-2.9%	69,664	67,273	-3.4%
EBITDA	1,574	796	-49.4%	22,575	20,585	-8.8%	14,590	13,378	-8.3%
EBITDA Margin (%)	7.4	3.8	-360 bps	21.9	20.5	-134 bps	20.9	19.9	-106 bps
APAT	814	-414	-150.9%	16,013	11,471	-28.4%	13,765	11,529	-16.2%
EPS (Rs)	4.8	-2.4	-150.9%	94.4	67.6	-28.4%	81.1	68.0	-16.2%

Source: Company, Emkay Research

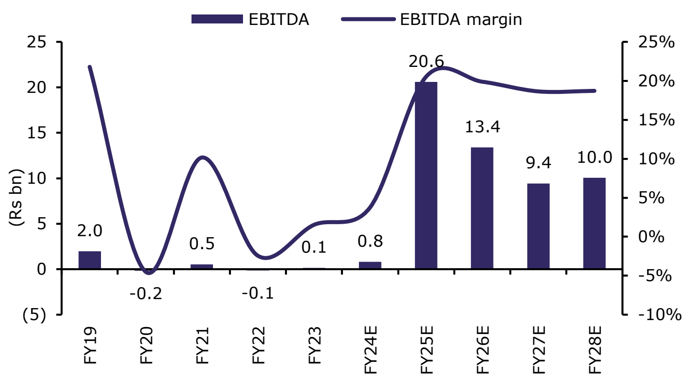
We revise down our TP to Rs1,025/share (19% upside; implying 21x P/E for Dec-2024) vs. Rs1,050 earlier, based on the DCF nmwthodology (WACC: 10.5%; Terminal growth rate: 6%). We retain our BUY rating.

Exhibit 5: Tejas to generate ~Rs293bn in revenue…



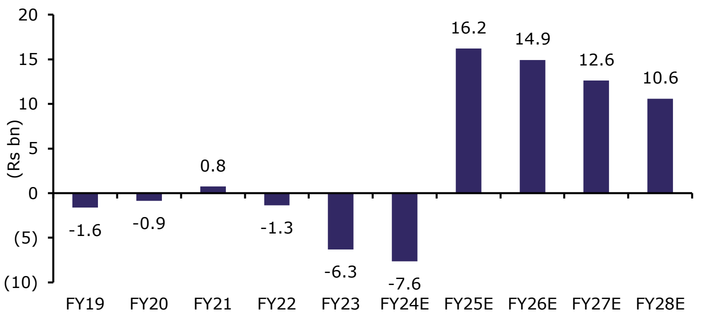
Source: Company, Emkay Research

Exhibit 6: …and ~Rs54bn in EBITDA, over FY24-28E



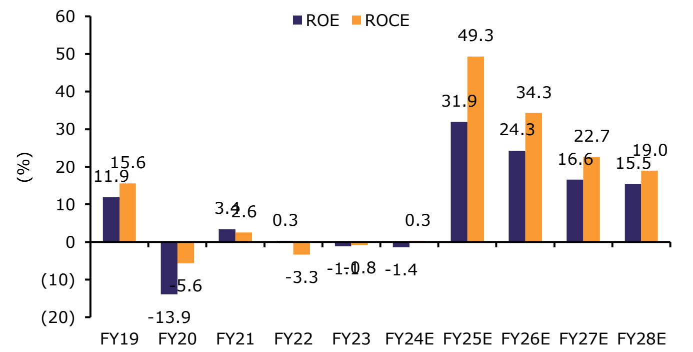
Source: Company, Emkay Research

Exhibit 7: Tejas to generate ~Rs47bn in FCF over FY24-28E…



Source: Company, Emkay Research

Exhibit 8: …and returns to improve to >15% over the same period



Source: Company, Emkay Research

Tejas Networks: Consolidated Financials and Valuations

Profit & Loss

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	**5,506**	**9,196**	**21,171**	**100,223**	**67,273**
Revenue growth (%)	4.6	67.0	130.2	373.4	(32.9)
EBITDA	**(135)**	**140**	**796**	**20,585**	**13,378**
EBITDA growth (%)	(125.2)	0.0	467.1	2,485.2	(35.0)
Depreciation & Amortization	768	1,140	1,754	2,258	2,528
EBIT	**(902)**	**(1,000)**	**(958)**	**18,327**	**10,850**
EBIT growth (%)	(6,639.1)	0.0	0.0	0.0	(40.8)
Other operating income	0	0	0	0	0
Other income	433	810	1,048	1,815	6,906
Financial expense	32	152	849	4,847	2,384
PBT	**(501)**	**(342)**	**(759)**	**15,295**	**15,372**
Extraordinary items	(670)	0	0	0	0
Taxes	(544)	(62)	(345)	3,824	3,843
Minority interest	0	0	0	0	0
Income from JV/Associates	0	0	0	0	0
Reported PAT	**(627)**	**(279)**	**(414)**	**11,471**	**11,529**
PAT growth (%)	(267.0)	0.0	0.0	0.0	0.5
Adjusted PAT	**43**	**(279)**	**(414)**	**11,471**	**11,529**
Diluted EPS (Rs)	**(6.0)**	**(2.5)**	**(2.4)**	**67.6**	**68.0**
Diluted EPS growth (%)	(249.7)	0.0	0.0	0.0	0.5
DPS (Rs)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Dividend payout (%)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
EBITDA margin (%)	(2.4)	1.5	3.8	20.5	19.9
EBIT margin (%)	(16.4)	(10.9)	(4.5)	18.3	16.1
Effective tax rate (%)	108.6	18.3	45.4	25.0	25.0
NOPLAT (pre-IndAS)	**77**	**(817)**	**(523)**	**13,745**	**8,137**
Shares outstanding (mn)	105.0	113.5	169.7	169.7	169.7

Source: Company, Emkay Research

Balance Sheet

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	1,178	1,716	1,734	1,734	1,734
Reserves & Surplus	18,124	28,013	28,495	39,966	51,495
Net worth	**19,303**	**29,730**	**30,229**	**41,700**	**53,229**
Minority interests	0	0	0	0	0
Deferred tax liability (net)	(1,470)	(738)	(1,447)	(1,447)	(1,447)
Total debt	**124**	**2,027**	**5,797**	**6,797**	**4,797**
Total liabilities & equity	**17,957**	**31,019**	**34,579**	**47,050**	**56,579**
Net tangible fixed assets	0	0	0	0	0
Net intangible assets	0	0	0	0	0
Net ROU assets	0	0	0	0	0
Capital WIP	396	1,536	2,725	2,400	2,612
Goodwill	0	2,118	2,118	2,118	2,118
Investments [JV/Associates]	0	0	0	0	0
Cash & equivalents	**7,490**	**10,041**	**8,074**	**21,026**	**32,176**
Current assets (ex-cash)	10,367	17,238	36,254	62,060	46,644
Current Liab. & Prov.	1,674	4,264	21,630	47,672	33,841
NWC (ex-cash)	**8,693**	**12,974**	**14,625**	**14,388**	**12,803**
Total assets	**17,957**	**31,019**	**34,579**	**47,050**	**56,579**
Net debt	(3,348)	(5,391)	464	(11,487)	(24,637)
Capital employed	17,957	31,019	34,579	47,050	56,579
Invested capital	**10,071**	**19,442**	**23,780**	**23,625**	**21,792**
BVPS (Rs)	183.8	261.9	178.2	245.8	313.8
Net Debt/Equity (x)	(0.2)	(0.2)	0.0	(0.3)	(0.5)
Net Debt/EBITDA (x)	24.9	(38.4)	0.6	(0.6)	(1.8)
Interest coverage (x)	(0.1)	(0.8)	9.4	0.2	0.1
RoCE (%)	**(3.3)**	**(0.8)**	**0.3**	**49.3**	**34.3**

Source: Company, Emkay Research

Cash flows

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
PBT	(501)	(342)	(759)	15,295	15,372
Others (non-cash items)	0	0	0	0	0
Taxes paid	544	62	345	(3,824)	(3,843)
Change in NWC	(2,547)	(3,550)	(2,359)	236	1,585
Operating cash flow	**(173)**	**(3,803)**	**(3,311)**	**18,206**	**17,420**
Capital expenditure	(1,187)	(7,370)	(5,630)	(2,015)	(2,492)
Acquisition of business	0	0	0	0	0
Interest & dividend income	242	522	557	606	606
Investing cash flow	**(8,278)**	**(5,813)**	**3,918**	**(1,408)**	**(1,886)**
Equity raised/(repaid)	213	538	17	0	0
Debt raised/(repaid)	(53)	1,903	3,770	1,000	(2,000)
Payment of lease liabilities	0	0	0	0	0
Interest paid	(32)	(152)	(849)	(4,847)	(2,384)
Dividend paid (incl tax)	0	0	0	0	0
Others	8,266	7,700	(927)	0	0
Financing cash flow	**8,394**	**9,989**	**2,011**	**(3,847)**	**(4,384)**
Net chg in Cash	(57)	373	2,618	12,951	11,150
OCF	(173)	(3,803)	(3,311)	18,206	17,420
Adj. OCF (w/o NWC chg.)	(2,720)	(7,353)	(5,670)	18,443	19,005
FCFF	(1,361)	(11,173)	(8,941)	16,191	14,928
FCFE	(1,151)	(10,802)	(9,234)	11,951	13,150
OCF/EBITDA (%)	128.8	(2,708.8)	(415.8)	88.4	130.2
FCFE/PAT (%)	183.5	3,869.1	2,230.2	104.2	114.1
FCFF/NOPLAT (%)	**(1,762.0)**	**1,367.4**	**1,710.7**	**117.8**	**183.5**

Source: Company, Emkay Research

Valuations and key Ratios

Y/E Mar	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	2,110.3	(350.3)	(353.1)	12.7	12.7
P/CE(x)	111.7	113.6	109.1	10.6	10.4
P/B (x)	4.7	3.3	4.8	3.5	2.7
EV/Sales (x)	15.8	10.1	6.9	1.3	1.8
EV/EBITDA (x)	(647.7)	658.3	184.2	6.5	9.1
EV/EBIT(x)	(96.6)	(92.5)	(153.2)	7.4	11.2
EV/IC (x)	8.7	4.8	6.2	5.7	5.6
FCFF yield (%)	(1.6)	(12.1)	(6.1)	12.0	12.3
FCFE yield (%)	(1.3)	(11.0)	(6.3)	8.2	9.0
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
DuPont-RoE split					
Net profit margin (%)	0.8	(3.0)	(2.0)	11.4	17.1
Total asset turnover (x)	0.4	0.4	0.6	2.5	1.3
Assets/Equity (x)	0.9	1.0	1.1	1.1	1.1
RoE (%)	**0.3**	**(1.1)**	**(1.4)**	**31.9**	**24.3**
DuPont-RoIC					
NOPLAT margin (%)	1.4	(8.9)	(2.5)	13.7	12.1
IC turnover (x)	0.0	0.0	0.0	0.0	0.0
RoIC (%)	**0.9**	**(5.5)**	**(2.4)**	**58.0**	**35.8**
Operating metrics					
Core NWC days	576.2	515.0	252.1	52.4	69.5
Total NWC days	**576.2**	**515.0**	**252.1**	**52.4**	**69.5**
Fixed asset turnover	0.7	0.8	1.3	5.1	3.1
Opex-to-revenue (%)	46.0	37.5	28.8	15.4	18.2

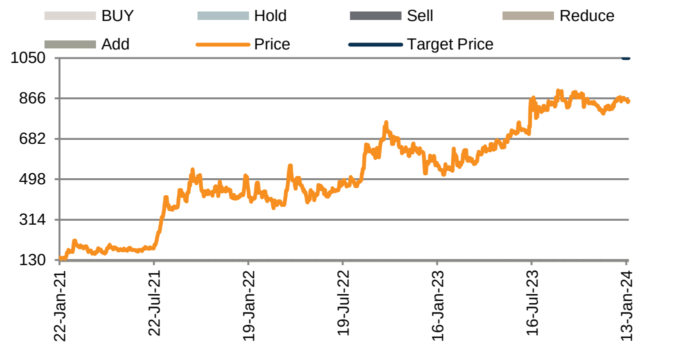
Source: Company, Emkay Research

RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
07-Jan-24	866	1,050	Buy	Santosh Sinha

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



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ADD	5-15% upside
REDUCE	5% upside to 15% downside
SELL	<15% downside

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