

Tejas Networks Limited

Tejas Networks Ltd (TNL) is an optical and data networking products company. It designs, develops and sells products to telecommunications & internet service providers, utility companies, defense companies and government entities in India and over 60 countries. TNL derives 63% of its revenues from domestic markets, while rest comes from international markets. As of May 15, 2017, the company had 313 employees in its R&D team and had filled 333 patents applications across the globe, out of which 56 patents have been granted.

Rise in optical network capex expected: Less than 20% of cell towers in India are connected with fibre, as compared to 70-80% in developed countries. In our view, the optical network capex in India is likely to grow at 14% CAGR over FY2014-20. Further, evaluation of high speed internet technologies would require existing telcos to upgrade network capacities for higher data traffic domestically as well as globally.

Government's push for 'Digital India' to further strengthen business: We believe that government's push for 'Digital India' through projects such as the National Optical Fibre Network (BharatNet, where 250,000 gram panchayats would be connected through optical fibres), and Smart Cities will provide better growth opportunities for business. In addition, policies such as 'Make in India' and 'Preferential Market Access Policy' would further benefit TNL's business prospects.

Favorably placed to capture the industry growth: We believe that TNL would benefit from the industry growth owing to - (1) Leadership position in the fast growing Indian optical equipment market (2nd, 15% market share); (2) Strong professional team with significant industry experience; (3) High product reliability, as it delivered <15 min down time a year since 2008; (4) Expanding exports into markets with similar economic pattern as India i.e. South East Asia, Latin America, Africa, etc. (5) Less competition owing to high entry barriers related to huge initial investment in R&D; and (6) An end-to-end portfolio of optical networking products for access, metro and long-haul networks.

Strong operating leverage with asset light business: Going forward, we expect TNL to benefit from operating leverage, as the company has achieved necessary scale required in R&D. Further, company is adopting an asset light strategy by outsourcing most of its manufacturing to reputed electronics manufacturing services companies. Therefore, its ROE has improved from 8% in FY2016 to 12.9% for FY2017, and we believe it will strengthen going ahead.

Outlook and Valuation: TNL has reported strong revenue CAGR of 24.2% CAGR over FY2013-17 and PAT of ₹64cr in FY2017 (loss of ₹79cr in FY2013). The RoE improved from 8% in FY2016 to 12.9% in FY2017, primarily owing to ongoing capex on Optical Network by Telcos, strong operating leverage with asset light business and strong professional team with significant industry experience. At the upper end of the price band, the pre-issue P/E works out to be 29.3x its 2017 earnings, 3.7x of FY2017 Book Value. Moreover, the company's debt free balance sheet post IPO coupled with the government's push for digital India would support the growth momentum. Thus, we recommend a **SUBSCRIBE** on the issue.

Key Financials

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017
Net Sales	423	387	627	878
% chg	14.6	(8.6)	62.2	40.0
Net Profit	3	(18)	29	64
% chg	-	-	-	122.4
EBITDA (%)	22.4	17.7	18.0	19.8
EPS (Rs)	0.4	(2.5)	4.0	8.8
P/E (x)	667	(104)	64	29
P/BV (x)	5.7	5.6	5.1	3.7
RoE (%)	0.9	(5.4)	8.0	12.9
RoCE (%)	6.7	3.6	12.2	16.2
EV/Sales (x)	4.9	5.2	3.2	2.3
EV/EBITDA (x)	22.0	29.5	18.0	11.5

Source: Company, Angel Research; Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

SUBSCRIBE

Issue Open: June 14, 2017
 Issue Close: June 16, 2017

Issue Details

Face Value: ₹10
Present Eq. Paid up Capital: ₹74cr
Offer for Sale: **1.27cr Shares
Fresh issue: ₹450 cr
Post Eq. Paid up Capital: ₹91.52cr
Issue size (amount): *₹755cr -**776 cr
Price Band: ₹250-257
Lot Size: 55 shares and in multiple thereafter
Post-issue implied mkt. cap: *₹2239cr - **₹2301cr
Institutional Investor Pre-Issue: 100%

*Calculated on lower price band

** Calculated on upper price band

Book Building

QIBs	75% of issue
Non-Institutional	15% of issue
Retail	10% of issue

Post Issue Shareholding Pattern

Institutional Investor	66%
Others	34%

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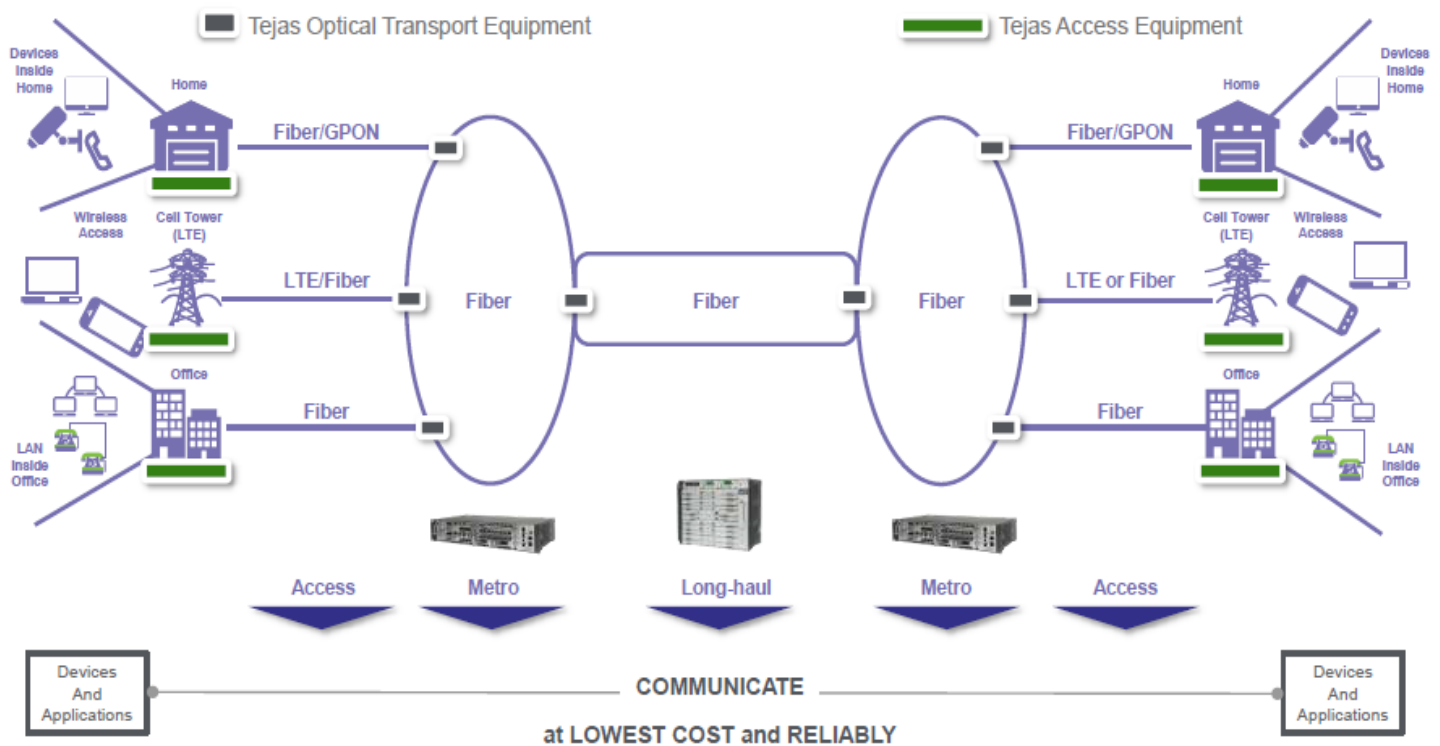
Company background

Tejas Network Ltd is an India based optical and data networking products company with customers in over 60 countries. TNL designs, develops and sells high performance and cost competitive products to telecommunication service providers, internet service providers, utility companies, defence companies and government entities (collectively, "Communication Service Providers"). The products are used to build high-speed communication networks that carry voice, data and video traffic from fixed line, mobile and broadband networks over optical fibre. The products use programmable software-defined hardware architecture with a common software code-base that delivers an app-like ease of development and upgradation of new features and technology standards. Currently, India is the largest geographic segment (in terms of revenue) and we believe TNL is well positioned to take advantage of the growth opportunities arising out of 'Digital India' and 'Make-in-India' programs of the Indian Government.

For the year ended March 31, 2016, TNL was the second largest optical networking products company in terms of market share in India, with a market share of 15% in the overall optical networking market. (Source: Ovum Market Share Spreadsheet: 1Q16 ON Subregional EMEA and AP, published in June 2016).

Exhibit 1: Tejas Network products get used at

Tejas' Products Enable Telecommunication Networks that carry Voice, Data and Video Traffic from Fixed Line, Mobile and Broadband Networks over Optical Fiber



Source: Company, Angel Research, RHP

The current product portfolio targets access networks (i.e. the outer perimeter of a telecommunications network, which connects to the end consumers), metro networks (i.e. networks that aggregate and distribute traffic collected from access networks within a large city or region) and long-haul networks (i.e. networks that interconnect metro networks using high bandwidth transmission).

As of April 30, 2017, TNL had filed 333 patent applications, with 203 filings in India, 89 filings in the United States and 6 filings in Europe, out of which 56 patents have been granted and the company has also filed 35 patent applications under the Patent Co-operation Treaty.

Exhibit 2: Geographical Segmentation of revenue (%)

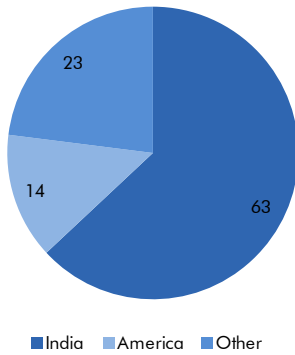
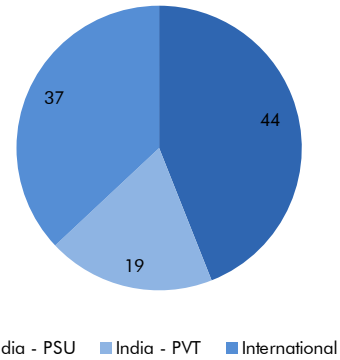


Exhibit 3: Customer Segment of revenue (%) FY17



Source: Company, Angel Research

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Issue details

The company is raising ₹450cr through a fresh issue of equity shares in the price band of ₹250-257. The fresh issue will constitute ~19.55% of the post-issue paid-up equity share capital of the company, assuming the issue is subscribed at the upper end of the price band. The company is offering 1.27cr shares that are being sold by certain exiting investors and management.

Investors selling shares in the IPO include Cascade Capital Management Mauritius, India Industrial Growth Fund (Frontline Strategy), Intel Capital and Sandstone Capital.

Exhibit 4: Pre and Post-IPO shareholding pattern

	No. of shares (Pre-issue)	(%)	No. of shares (Post-issue)	(%)
Institutional Investors	7,20,38,130	100%	5,93,26,525	66.2%
Public/DII/FII	0	0%	3,02,21,333	33.8%
	7,20,38,130	100%	8,95,47,858	100%

Source: RHP, Angel Research; Note: Calculated on upper price band

Objects of the offer

More than 65% of the proceeds will go towards working capital (₹303cr), a part of it will be spent on capital expenditure and towards payment of salaries and wages of Research & Development team (₹45cr). The remaining will be set aside for general purposes (₹102cr).

Key Management Personnel

Sanjay Nayak: Managing Director and Chief Executive Officer – Mr. Nayak has been with TNL since the company's inception. He has spent his career in the area of Information Communication Technology and Electronics Manufacturing. He is the co-chairman of the Telecom Equipment and Services Export Promotion Council. Prior to joining TNL, he was the managing director of Synopsys (India) Private Limited.

Balakrishnan V.: He is the Non-Executive, Independent Director and Chairman of the Company. He has been a Director of TNL since November 9, 2009. Mr. Balakrishna has served as the group's Chief Financial Officer and member of the board of directors of Infosys Limited.

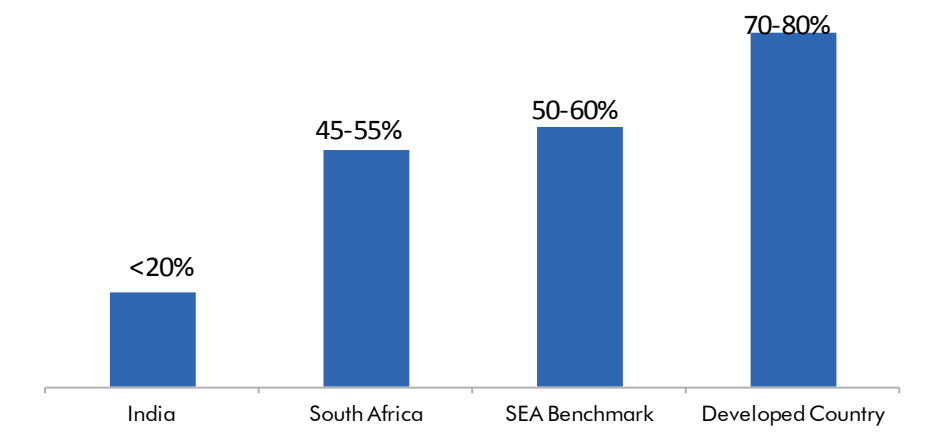
Kumar N. Sivarajan: Chief Technology officer – Mr. Sivarajan has been associated with TNL since year 2000. He holds a PHD from California Institute of Technology.

Investment Rationale

Rise in Optical Network capex expected

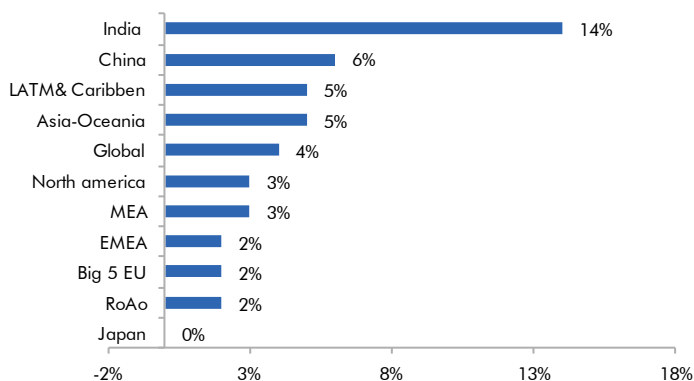
The Indian network operators have under invested in optical fiber transmission as compared to their peers in China and the United States. This under investment is due to the initial focus on voice offering services and challenges in getting laying optical fiber in the crowded cities. Less than 20% of cell towers in India are connected with fibre as compared to 70-80% in developed countries (according to Delloite). In our view, Indian optical capex is likely to grow at 14% CAGR over FY2014-20. Further, considering factors such as evaluation of high speed internet technologies, proliferation of powerful networking devices & Smartphone's, growth in enterprise cloud services & data, and games & HD videos would require existing telcos to upgrade network capacities for higher data traffic domestically as well as globally.

Exhibit 5: Proportion of network sites around the world in 2015



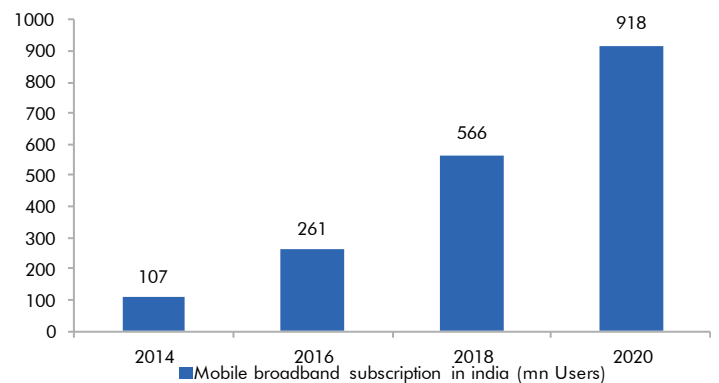
Source: Company, Angel Research, Delloite

Exhibit 6: Growth in optical capex from FY2014-20



Source: Company, Angel Research

Exhibit 7: Increased use of Smartphones drives data



Source: Company, Angel Research, Ovum

Government's push for 'Digital India' to further strengthen business

We believe that government's push for 'Digital India' through projects such as the National Optical Fibre Network (BharatNet, where 250,000 gram panchayats would be connected through optical fibres), and Smart Cities will provide better growth opportunities for business. In addition, policies such as 'Make in India' and 'Preferential Market Access Policy' would further benefit TNL's business prospects.

Exhibit 8: Government schemes supporting 'Make in India' & 'Digital India'

Make In India

Preferential Market Access (PMA): In government procurement for domestic products

Fiscal Incentives : Supports domestic manufacturing in the form of Capital Subsidy, Tejas is approved under M-SIPS(2)

Anti-Dumping Duties: On imports of SDH transmission equipment from China & Israel

Merchandise exports from India scheme: For enhancing India's export competitiveness

Karnataka (State) ESDM Policy: Providing research and development grant

Digital India

National Optical Fiber Network (BharatNet): Connecting 250,000 gram panchayats (villages) using GPON (FTTX) technology

Smart Cities: Robust IT connectivity and digitalization for 100

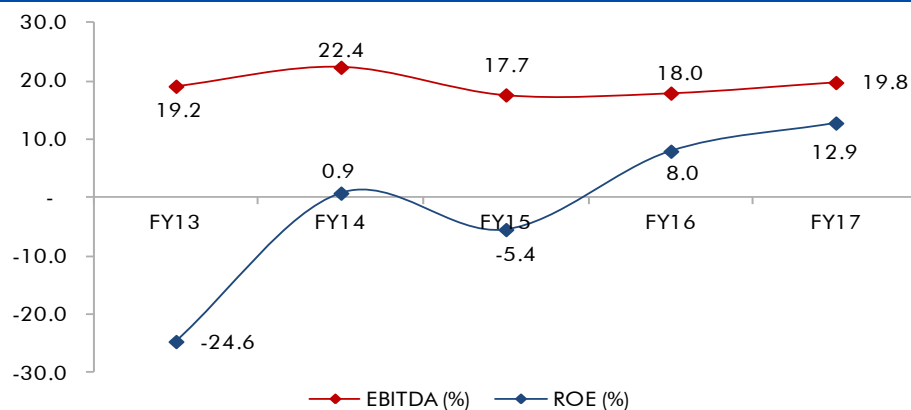
Right-of-Way: New rules to ease right of way for faster optical fibre and mobile tower infrastructure rollouts

Source: Company, Angel Research

Favorably placed to capture the industry growth: We believe that TNL would benefit from the industry growth owing to - (1) Leadership position in the fast growing Indian optical equipment market (2nd, 15% market share); (2) Strong professional team with significant industry experience; (3) High product reliability, as it delivered <15 min down time a year since 2008; (4) Expanding exports into markets with similar economic pattern as India i.e. South East Asia, Latin America, Africa, etc. (5) Less competition owing to high entry barriers related to huge initial investment in R&D; and (6) An end-to-end portfolio of optical networking products for access, metro and long-haul networks.

Strong operating leverage with asset light business: Going forward, we expect TNL to benefit from operating leverage, as the company has achieved necessary scale required in R&D. Further, company is adopting an asset light strategy by outsourcing most of its manufacturing to reputed electronics manufacturing services companies. Therefore, its ROE has improved from 8% in FY2016 to 12.9% for FY2017, and we believe it will strengthen going ahead.

Exhibit 9: Improving EBITDA margin & ROE



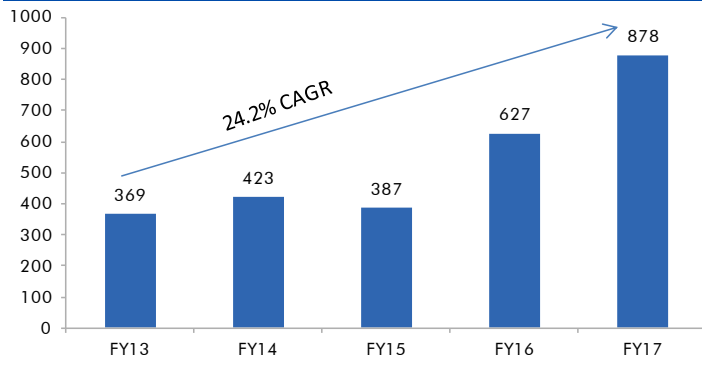
Source: Company, Angel Research

Financial performance track record

TNL is consistently reporting improved numbers on the fronts of revenue, EBITDA and return ratios. The revenues have grown from ₹369cr in FY2013 to ₹878cr in FY2016, showing a 4 year CAGR of 24.2%. For FY2017, the company reported PAT of ₹63cr (after considering onetime expenses of ₹30cr) from loss of ₹79cr in FY2013.

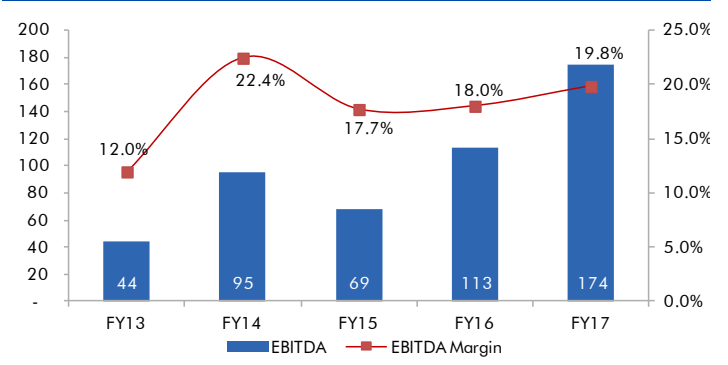
EBITDA margins have improved from 12% in FY2013 to 19.8% in FY2017, largely owing to better operating leverage. The company has made basic investments in R&D and professional man power in order to achieve the necessary scale. Hence, except cost of material, which is linked to revenue, majority of the operating costs are almost fixed. Therefore, we believe that the company would continue to report higher EBITDA margins and return ratios going ahead. From a loss making company in FY2013 it has been able to report RoE of 12.9% in FY2017, which is commendable.

Exhibit 10: Historical revenue Trend



Source: Company, Angel Research

Exhibit 11: Historical EBITDA trend



Source: Company, Angel Research

Outlook and Valuation: TNL has reported strong revenue CAGR of 24.2% CAGR over FY2013-17 and PAT of 64cr in FY2017 (loss of ₹79cr in FY2013). The RoE improved from 8% in FY2016 to 12.9% in FY2017, primarily owing to ongoing capex on Optical Network by Telcos, strong operating leverage with asset light business and strong professional team with significant industry experience. At the upper end of the price band, the pre-issue P/E works out to be 29.3x its 2017 earnings, 3.7x of FY2017 Book Value. Moreover, the company's debt free balance sheet post IPO coupled with the government's push for digital India would support the growth momentum. Thus, we recommend a SUBSCRIBE on the issue.

Key risks

Client concentration

In FY2017, the company has generated 58% of the revenue from 5 customers however, any customer back out could severely impact revenue growth.

Outstanding legal & Tax proceedings

Total number of Tax proceedings against TNL is 40 and the amount involved is ₹159cr. The amount involved in civil cases is ₹19cr. Unfavorable verdict could disturb the financial condition of the company.

Fluctuations in currency exchange rates

As of Fiscal Years 2015, 2016 and 2017, US Dollar-denominated revenues represented 57.66%, 30.23% and 33.65% of total revenues respectively. Hence, any adverse or volatile movement in Currency could impact the financials of the company.

Consolidated Income Statement

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016	FY2017
Total operating income	369	423	387	627	878
% chg	-	14.6	(8.6)	62.2	40.0
Total Expenditure	325	328	318	514	704
License fees	226	209	198	351	514
Personnel	45	45	50	67	76
Others Expenses	54	75	71	97	114
EBITDA	44	95	69	113	174
% chg	(145.9)	115.0	(27.8)	65.0	54.1
(% of Net Sales)	12.0	22.4	17.7	18.0	19.8
Depreciation & Amortisation	48	56	49	38	56
EBIT	(4)	39	20	74.8	118
% chg	-	-	(49.0)	274.8	57.5
(% of Net Sales)	(1.0)	9.2	5.2	11.9	13.4
Interest & other Charges	36	46	47	49	32
Other Income	9	10	9	4	9
(% of PBT)	(31.7)	347.1	(51.1)	12.1	13.5
Extraordinary Items	49	-	-	-	30
Share in profit of Associates					
Recurring PBT	(30)	3	(18)	29	64
% chg		-	-	-	122.4
Tax	0	-	-	-	1.3
PAT (reported)	(30)	3	(18)	29	64
% chg		-	-	-	
(% of Net Sales)	(8.2)	0.7	(4.6)	4.6	7.3
Basic & Fully Diluted EPS (Rs)	(11.0)	0.4	(2.5)	4.0	8.8
% chg		-	-	-	118.0

Consolidated Balance Sheet

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016	FY2017
SOURCES OF FUNDS					
Equity Share Capital	101	101	126	67	74
Reserves & Surplus	220	223	206	294	427
Shareholders Funds	321	324	331	361	501
Total Loans	220	262	220	253	228
Total Liabilities	541	586	551	614	729
APPLICATION OF FUNDS					
Net Block	77	65	51	94	92
Capital Work-in-Progress	71	84	88	52	19
Investments	-	-	0	0	0
Current Assets	459	509	532	605	659
Inventories	214	209	221	232	182
Sundry Debtors	138	223	208	254	358
Cash	58	23	50	69	71
Loans & Advances	43	38	32	34	42
Other Assets	5	16	22	15	7
Current liabilities	115	159	177	225	188
Net Current Assets	344	350	355	380	472
Other Non Current Asset	50	88	58	88	146
Total Assets	541	586	551	614	729

Note – Net block includes Intangible Asset

Consolidated Cash Flow Statement

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016	FY2017
Profit before tax	(79)	3	(18)	29	64
Depreciation	48	56	49	38	56
Change in Working Capital	2	(84)	(14)	1	(95)
Interest / Dividend (Net)	(4)	11	18	2	56
Direct taxes paid	0.2	(3)	(2)	(2)	(6)
Others	58	44	43	59	7
Cash Flow from Operations	25	27	76	127	83
(Inc.)/ Dec. in Fixed Assets	(23)	(56)	(39)	(46)	(51)
(Inc.)/ Dec. in Investments	23	(18)	10	(5)	(90)
Cash Flow from Investing	(0)	(74)	(29)	(50)	(141)
Issue of Equity	39	0	0	0	0
Inc./(Dec.) in loans	5	61	(16)	9	(5)
Others	(36)	(46)	(23)	(49)	46
Cash Flow from Financing	8	15	(40)	(41)	40
Inc./(Dec.) in Cash	34	(32)	8	36	(18)
Opening Cash balances	3	37	5	13	49
Closing Cash balances	37	5	13	13	31

Key Ratios

Y/E March	FY2013	FY2014	FY2015	FY2016	FY2017
Valuation Ratio (x)					
P/E (on FDEPS)	(23.4)	666.7	(103.6)	63.8	29.3
P/CEPS	(74.2)	39.3	75.0	34.2	19.2
P/BV	5.8	5.7	5.6	5.1	3.7
EV/Sales	5.5	4.9	5.2	3.2	2.3
EV/EBITDA	45.6	22.0	29.5	18.0	11.5
EV / Total Assets	3.7	3.6	3.7	3.3	2.8
Per Share Data (Rs)					
EPS (Basic)	(11.0)	0.4	(2.5)	4.0	8.8
EPS (fully diluted)	(11.0)	0.4	(2.5)	4.0	8.8
Cash EPS	(3.5)	6.5	3.4	7.5	13.4
Book Value	44.6	45.0	46.0	50.0	69.5
Returns (%)					
ROCE	(0.7)	6.7	3.6	12.2	16.2
Angel ROIC (Pre-tax)	(0.8)	6.9	4.0	13.7	17.9
ROE	(24.6)	0.9	(5.4)	8.0	12.9
Turnover ratios (x)					
Inventory / Sales (days)	212	180	208	135	76
Receivables (days)	136	193	196	148	149
Payables (days)	102	118	130	116	58
** Working capital cycle	246	254	274	167	166

Source: Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band ** (ex-cash) (days)

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Disclosure of Interest Statement

Company Name

1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)