HFCL Ltd. – Initiating Coverage

Market Data (INR) as on 21st May 2021	
RATING	OUTPERFORM
CMP	INR 49.10
TARGET PRICE	INR 86.00
UPSIDE	~75%
TTM P/E (x)	26.41
52 Week H/L	40.70 / 8.70
MCAP	INR 6,312 Cr
Free Float MCAP	INR 1,965 Cr
Book Value (INR)	14.9
Stock Price 1 Year CAGR	~445%
Current o/s shares	128.4 Cr
Price: Book Value	3.28
CAGR – 5 Years	
Revenue	8.27%
EBITDA	7.81%
PAT	8.30%
P:E (Median)	15.78
P:BV (Average)	2.08
EV:EBITDA (Average)	9.14

SHAREHOLDING PATTERN as on 31st March 2021	
PROMOTERS	42.05%
FII	2.18%
DII	0.07%
PUBLIC	55.7%

Right Place Right Time, the Indian telecom industry suppliers are at the perfect cusp of growth inflection with several tailwinds to boost their growth for the next decade. The growth is going to come from several key factors: 1) New 4G & 5G tower set up for upscaling existing network and managing load on existing network capabilities and Upgradation (Fiberisation) of existing 2G & 3G towers in the network to 4G & 5G towers. 2) The FTTH role out of private players like Jio & Airtel along with government impetus of providing high-quality fiber network across India 3) Impetus of government on providing Wi-Fi (Internet) access across the country including Rural India via PM-WANI & BharatNet schemes to ensure e-governance. These shall drive demand for HFCL's core portfolio offering of OFC (Fiber Cables & FTTH), Telecom Services outplay and newly developed 5G Network ancillary products such as Wi-Fi 6 & high frequency radios.

Strike on Hot Iron – Two recent developments have heated the growth environment 1) The recent 4G Auction concluded on 2nd March 2021 where we have seen some keen investment from Reliance & Airtel for becoming 5G ready and investing into their existing 4G capacities to add more subscribers for future growth. 2) India's focus on reducing imports and Atmanirbhar Bharat has further incentivized domestic producers like HFCL. With the recently announced PLI scheme from the government which allocated INR12,000 Cr for Telecom equipment manufacturers with FY20 as the base year for the production benchmark. This is going to benefit HFCL's decision in its product development initiative and investment into telecom and networking products.

A Bird in the Hand "AND" Two in the Bush – HFCL's Revenue growth is currently volume-driven backed by several tailwinds (The Bird in Hand) But the prices of OFC have bottomed out lately in Q2 & Q3 of FY21 and may move north from here, as per our research, which will further boost HFCL's margin performance (First Bird) HFCL is also investing heavily into innovation with a focus on R&D for New Product Development which has slowly started yielding results as two of the company's products are in the advanced stage for Defense Contract Approval. Company is continually innovating to increase its product pipeline. This will bring necessary product diversification, improve stability to Revenue, and increase margins.

Valuation point-of-view: We believe HFCL's growth and profitability levels are likely to improve significantly compared to its recent historical performance. Also, the quality of the revenue mix is set to improve as the share of product revenue is likely to go up. Also with easing out of cash flows with impending fund inflow and unpledging of promoter shares we shall see a significant rerating of the stock.

We Initiate our coverage on HFCL with an Overweight position based on our target price of INR 86 which we have derived from applying 25x PE multiple to FY23 earnings in our base case scenario forecast.

(INR Cr)	FY19	FY20	FY21	FY22 (E)	FY23 (E)	FY24 (E)	FY25 (E)
Operating Sales	4,738	3,839	4,423	4,943	5921	6,613	7,355
EBITDA	415	492	586	638	819	999	1,145
EBITDA Margin	*8.8%*	*12.8%*	*13.2%*	12.9%	13.8%	15.1%	15.6%
PAT	232	238	246	327	462	601	711
PAT Margin	*4.9%*	*6.2%*	*5.6%*	*6.6%*	*7.8%*	*9.1%*	*9.7%*
EPS	1.77	1.78	1.60	2.44	3.44	4.48	5.30
P/E		*23.3*	*25.9*	*17.0*	*12.1*	9.3	*7.8*

Source: Company, Moneycontrol.com, Screener.in, KSL Research

Analyst: Prathamesh Sawant, CFA

Investment Thesis……………………………………………………………..…………..........

- New 4G expansion and 5G roll out
- Upgrading existing 2G & 3G
- FTTH Role out momentum
- PM WANI & BharatNet
- PLI Scheme for Telecom equipment manufacturers
- New Product Development
- Bottomed out prices of OFC

New 4G & 5G tower set up for upscaling existing network and managing load on existing network capabilities

Demand from the existing 4G network, with the recent spectrum auction which concluded on 2nd March, 2021, it is very clear that the operators want to invest into their network infrastructure to add more subscribers to their customer base. In four years India has catapulted No.155 in the world to No.1 in terms of mobile data consumption, which shows the magnitude of demand and strain on current network infrastructure.

Reliance Jio was ready with its war chest arsenal fuelled up with the parent entity raising INR 1.52 Lakh Cr last year. And this had shown up in the bids at the auction where ***Reliance Jio bought radio airwaves worth INR 57,122.65 Cr,*** more than 73% of the total auctioned spectrum, Bharti Airtel Ltd purchased spectrum worth INR18,698.75 Cr, while Vodafone Idea Ltd's (VIL's) participation was limited with bids worth INR 1,993.40 Cr, largely for spectrum renewal.

One more interesting observation that was found post Covid 19 was that rural consumption now accounts for roughly 45% of overall mobile data usage and urban usage makes up 55%, compared with a 40:60 ratios before the Covid 19 outbreak. This shows the propensity of demand across the distributed customer base in the Indian telecom market. The next leg of user base growth is from these Rural segments which would require infrastructure & service investments from operators in these areas.

These significant investments in the spectrum would be obviously followed by investments in increasing tower network and network optimization in existing circles. Reliance which owns a strategic stake in HFCL has already awarded the entire North Indian network installation contract to HFCL. So it is very much likely for the company to get further contracts to increase the Reliance network in Northern circles as well as new network installation contracts in other circles. The demand also comes from other operators given HFCL is one of the three largest cable manufacturers in the country.

Understanding Telecom

The government sanctions the use of its airwaves for a limited period of time usually 20 years for carrying signals of data and voice to the telecom operators. These airwaves are sold via auction process in quantity measured as MHz, these airwaves also come in different bands which support different propagation characteristics for transmission of voice and data. For instance, lower bands like sub-1000 MHz, especially 700-800 MHz support good indoor coverage. Whereas the higher bands like 2300 MHz & above have a good carrying capacity.

In this year's auction, Anshu Prakash, Secretary DoT, said, "Of the total amount put up for auction in various bands, 65.22% was sold in 800 MHz, 38.87% was sold in 900 MHz, 42.87% in 1800 MHz, 8.57% in 2100 MHz, and 89.29% in 2300 MHz. However, in terms of contribution to the total government revenues from auction, 800 MHz contributed 48%, followed by 1800 MHz (24%), 2300 MHz (17%) and 900 MHz (10%). All these investments show the clear intent of players investing to be ready for 5G deployment.

Source: KSL Research

Upgradation (Fiberisation) of existing 2G & 3G towers in the network into 4G & 5G tower

Demand from existing 5G network There have been several examples in the recent history of the adoption of new technology all of which pinpoints to the fact that the adoption is never linear, rather it is exponential and so will be the growth for the 5G network infrastructure. And the growth is expedited with the catalytic black swan event of Covid 19 which has started new work & personal life culture which has caused a tremendous increase in consumption of Data (Internet) & Network services. The trend has been observed across several aspects.

Operators have also claimed that they are ready for 5G. India's premier communications solutions provider, Bharti Airtel ("Airtel") announcing that it has become the country's first telco to successfully demonstrate & orchestrate LIVE 5G service over a commercial network in Hyderabad city on Jan 28, 2021.

Airtel did this over its existing liberalized spectrum in the 1800 MHz band through the NSA (Non-Stand Alone) network technology. Using a first of its kind, dynamic spectrum sharing, Airtel seamlessly operated 5G and 4G concurrently within the same spectrum block. This demonstration has emphatically validated the 5G readiness of Airtel's network across all domains - Radio, Core, and Transport. Airtel 5G is capable of delivering 10x speeds, 10x latency and 100x concurrency when compared to existing technologies.

The timeline for the 5G auction has not been decided by DoT. According to a parliamentary standing committee report tabled on 8 February, the government will conduct a 5G spectrum auction in the next six months. In DoT's assessment, 5G will be rolled out by the end of 2021 but not on a pan-India basis. The next-generation wireless technology will be launched in "select areas where the demand would justify the CAPEX.

What does this mean for HFCL?
The industry competition and race to add more subscribers to their user base is expediting the transition to 5G. The OFC requirement in a 5G tower is 3x more than that of a 4G tower. So every new tower and up-gradation of existing tower would require ~3x more Optical Fiber Cables. This should tremendously boost the demand for OFCs. Put together both 4G & 5G are more than a INR 1,00,000 Cr market opportunity for the next 5-6 years.

The FTTH role out of private players like Jio and Airtel along with the export potential to foreign telecom players

The demand for FTTH cable has increased tremendously post Covid lockdown. According to DoT figures, the average Data Consumption has increased from 280-285 PB (1PB = 1mn GB) to 310-315 PB (~7-10% increase). This is attributable to increased consumption of streaming content, video conferencing, etc. The study, commissioned by handset maker Vivo and conducted by CMR, said the average time spent on smartphones in a day has been on the rise with average usage growing 11% to 5.5 hours in March 2020 (pre Covid 19) from about 4.9 hours on average in 2019. This has grown by another 25% to 6.9 hours April onwards (post Covid 19), the report titled 'Smartphones and their impact on human relationships 2020', said. The report noted that since lockdown, Indians have been spending more time on their smartphone for work from home (75% increase), calling (63% rise), and OTT (over the top services like Netflix, Spotify, etc.) that has seen 59% growth in time spent on smartphones. There has also been a 55% increase in time spent on social media, and a 45% rise in time spent gaming on smartphones.

The biggest beneficiary of this transition is HFCL, which is currently India's largest FTTH cable manufacturer. HFCL started its new factory unit in Hyderabad last year with 3.6 Lakh Fiber KM p.a. capacity and within three months decided to further increase capacity by 33% to 4.8 L FKM p.a. which will be operational from next quarter. ***The existing capacities are currently operating at full capacity utilization levels*** and new capacities would take 4-6 months to be brought up to these levels. These products can also be exported to foreign markets, but the management notified that they'll start focusing on export from FY22 onwards.

Source: KSL Research

Impetus of the government on providing Wi-Fi (Internet) access across the country including Rural India via PM-WANI & BharatNet (government impetus of providing high quality fiber network across 5 lakh Gram Panchayat across India schemes). All these things are going to massively add up to HFCL core portfolio offering of OFC (Fiber Cables & FTTH), Services outplay and newly developed Network ancillary products such as Wi-Fi & high-frequency radios

PM WANI

The government aims the development of Wi-Fi network in India through PM **W**i-Fi **A**ccess **N**etwork **I**nterface (PM WANI scheme). How is India's public Wi-Fi network envisaged?

At the bottom of the network's pyramid will be the PDO, which will establish, maintain, and operate compliantly Wi-Fi access points, or routers, and deliver broadband services to subscribers. Over a segment of PDOs, will be a PDO Aggregator (PDOA). This aggregator will perform the functions relating to authorization and accounting. Meanwhile, there will be an app provider that will develop the app for users to register on to the network, make payments to subscribe to the network, and discover nearby hotspots. Above all of these, there will be the central registry maintained by the Centre for Development of Telematics (C-DoT). In this registry, C-DoT will maintain the details of app providers, PDOAs, and PDOs.

Bharat Net

National Optical Fibre Network (NOFN) was launched in October 2011 and was renamed as Bharat Net Project in 2015. It was envisaged as an information superhighway through the creation of a robust middle-mile infrastructure for reaching broadband connectivity to Gram Panchayats. The is to facilitate universal and equitable access to broadband services across the country, especially in rural and remote areas.

Initially, it was under the Ministry of Communications and Information Technology. Whereas currently, it is being implemented by the Department of Telecommunication under the Ministry of Communications. BharatNet is a flagship mission implemented by Bharat Broadband Network Ltd. (BBNL). It is a Special Purpose Vehicle (SPV) set up by the Government of India under the Companies Act, 1956 with an authorized capital of INR 1,000 Cr.

Bharat Broadband Network Limited (BBNL) and Bharat Sanchar Nigam Limited (BSNL) is the main infrastructure companies under the government that are working on the project to connect 5 lakh GPs with high-speed internet to facilitate the delivery of e-governance, e-health, e-education, e-banking, Internet, and other services to rural India.

The entire project is being funded by the Universal Service Obligation Fund (USOF), which was set up for improving telecom services in rural and remote areas of the country. The project is A center-state collaborative project, with the states contributing free Rights for establishing the Optical Fiber Network.

The orders of the BharatNet project are currently executed at various state-level projects and HFCL has also achieved some orders for the same. Together PM – WANI and BharatNet put out together are a INR 40,000- INR 50,000 Cr opportunity over the period of next 5-7 years.

The INR 12,000 Cr Production Linked Incentive Scheme for the Telecom Sector

The government launched a production-linked incentive (PLI) scheme for manufacturing, India for telecommunications (telecom) and networking products, with an outlay of INR 12,195 crore over five years. The scheme includes core transmission equipment, 4G/5G next-generation radio access network and wireless equipment, access and customer premises equipment, Internet of Things-access devices, other wireless equipment, and enterprise equipment like switches, routers, etc.

The scheme will be operational from April 1 this year. The eligibility for the scheme will be subject to achieving a minimum threshold of cumulative investment and incremental sales of manufactured goods with 2019-20 will be treated as the base year for computation of cumulative incremental sales of manufactured goods net of taxes, said the Ministry of Communication and Information Technology in a statement.
The scheme is planned to outlay INR 12,195 Cr over the next 5 years which would draw investments over INR 3,000 Cr and lead to the production of more than INR 2.4 Lakh Crore of equipment. ***The scheme is supposed to offset the import of telecom equipment worth INR 50,000 Cr.***

Source: KSL Research

KHANDWALA SECURITIES LIMITED

The Futuristic aspect for HFCL (New Product Development Focus)

The company has invested in R&D centers; it has invested in innovative start-ups, it has signed JV's with other companies for R&D and product development. The company has planned to invest over INR 175 Cr over the next two years in R&D. These investments have already started yielding results as two kinds of equipment are lined up for a trial. One is electronic fuses which is already developed and HFCL is the only Indian company to their own design and IPR of electronic fuses. The company is waiting for Army to ask for sample against tenders for field testing.

The Company's in-house Centre for Excellence in Research located at Gurgaon & Bengaluru along with invested R&D Houses and other collaborators at different locations in India and abroad, innovate futuristic range of technology products and solutions. The Company has strengthened its portfolio of wireless solutions with the rollout of new dual band Wi-Fi 6 products in addition to the existing Wi-Fi 5 range of products. Keeping in mind at the opportunity, HFCL has established a new 5G business unit which will focus on developing the latest 5G compatible products.

The company R&D teams in Goa and Chennai have also developed various new types of cables for catering to upcoming demand for such cables in India and abroad. The company although investing in R&D has maintained its focus on telecom and networking, sticking to its core competencies. We believe these unified directional efforts should start yielding results from FY2022 onwards and start adding to the top line as well margins for HFCL.

Bottomed out OFC Prices

OFC prices were on free fall since H2 FY19 due to excess supply from China, these prices have now bottomed out and are stable for last few months; the prices are expected to improve with increased demand from domestic players. Also the demand for 5G towers would be 3x more than that of normal towers which should catalyze demand growth even faster.

Source: KSL Research

Company Overview……………………….....

HFCL Limited (formerly Himachal Futuristic Communications Limited) is a leading technology enterprise engaged in manufacturing of high-end Transmission and Access Equipment, Optical Fiber, Optical Fiber Cables (OFC) and is specialized in setting up modern communication network for Telecom Service Providers, Railways, Defense, Smart City and Surveillance projects. The Company has state-of-the-art Optical Fiber and Optical Fiber Cable manufacturing facilities at Hyderabad, Optical Fiber Cable manufacturing plant in Goa and in its subsidiary i.e. HTL Limited at Chennai along with FRP Rod manufacturing facility in its subsidiary at Hosur. It also has a telecom equipment manufacturing facility at Solan.

The Company's in-house Centre for Excellence in Research located at Gurgaon & Bengaluru along with invested R&D Houses and other collaborators at different locations in India and abroad, innovate futuristic range of technology products and solutions. Some of the newly developed products through R&D are Wi-Fi Systems, Unlicensed Band Radios, Switches, Electronic Fuses, Electro Optic Devices, Cloud Management Systems and Video Management Systems. There is a suite of products under development which include Software Defined Radios, Routers, PON, Small and Macro Cell for 5G, Intelligent Antenna Systems and Ground Surveillance Radars among others.

FY21 Business Highlights……………………….....

Technology-led enterprise focusing on innovation and development of best-in-class, cost competitive communications solutions	**Diversified Product Offering** OFC, OF, Wi-Fi systems, Microwave Radios, Routers, Ethernet Switches, Electronic Fuses, Electro Optic Devices, amongst many	**Wide Industries Served** Telecom, Defence, Railways, Security and Surveillance	**State-of-the-art Manufacturing Plants at** Goa, Hyderabad, Chennai, Hosur, Solan
Global Reach 30+ countries including UK, Australia, Spain, Itlay, Canada, Argentina, Egypt and UAE	**Team Strength 2,500+ employees ~175 MBAs & ~1,600 Engineers**	**Strong Order Book** Current Order Book: ~ INR 6,875 Cr incl. O&M Contracts: ~ INR 1,534 Cr	**Financial Strength** 8 Year Revenue CAGR: 25% 8 Year PAT CAGR: 20% FY21 ROCE: 19.80% D/E: 0.48x

Key Strengths……………………….....

The most integrated 'nextgen' communication products and solutions provider	Pole positions in India - largest producer of Wi-Fi systems, UBRs and FTTH cables; largest market share in OFC supplies, largest delivery of defence and public communication networks
Enviable portfolio and pipeline of innovative products through R&D. Accelerated scale up of technological capabilities – organic and R&D partnerships	The only Indian company to have developed electronic fuses for artillery ammunition with own IPRs and also selected for the development of Software Defined Radio (SDR) by Indian Army
Large scale manufacturing capacities backed by strong financials	Strong executable order book in hand
World class quality and cost competitive products suiting to customer's requirement	Accelerated organisation-wide capability ramp up – talent, digitalisation, sustainable development and technological collaborations

Source: Company, Moneycontrol.com, Screener.in, KSL Research

Q4-FY21 Result Highlights……………………………………………………………………………………………

- Completed 1.5 lakh units' shipment of Wi-Fi products within first year of commencement of production
- Won contract for setting up entire telecommunication systems for Kanpur Metro and Agra Metro Rail
- HFCL's subsidiary, HTL Ltd. has diversified into wiring interconnect solutions to cater to Aerospace & Defense, Automotive and Industrial markets
- Set up a model PM-Wani Village in Baslambi (Haryana), it will offer high speed broadband connectivity to the unconnected
- Established a new 5G business unit to develop rich portfolio of next generation 5G compatible products & services
- Capacity utilization remained at optimal levels at all manufacturing locations
- Accelerated innovation for ensuring sustainable growth

Total Income	EBITDA	EBIDTA Margins
INR 1,397.9 Cr	INR 187.8 Cr	13.50%
109.2 % YoY	146.1% YoY	+ 200 Bps YoY

PAT	PAT Margins	Diluted EPS
INR 86.5 Cr	6.22 %	0.66 INR
894.3 % YoY	+491 Bps YoY	

FY21 Result Highlights……………………………………………………………………………………………

- Order book remained intact with zero cancellations
- Launched and delivered 1.5 lakh units' shipment of Wi-Fi products within first year of commencement of production
- Commenced production of optical fiber cables for fiber-to-home (FTTH) applications from the company's Hyderabad facility
- HFCL's subsidiary, HTL Ltd. has diversified into wiring interconnect solutions to cater to Aerospace & Defense, Automotive and Industrial markets
- Established a new 5G business unit to develop rich portfolio of next generation 5G compatible products & services
- Accelerated innovation for ensuring sustainable growth
- 20% of the Promoters Holding was released from pledge

Total Income	EBITDA	EBIDTA Margins
INR 4,459.1 Cr	INR 585.7 Cr	13.24 %
15.5 % YoY	13.5 % YoY	(21) Bps YoY

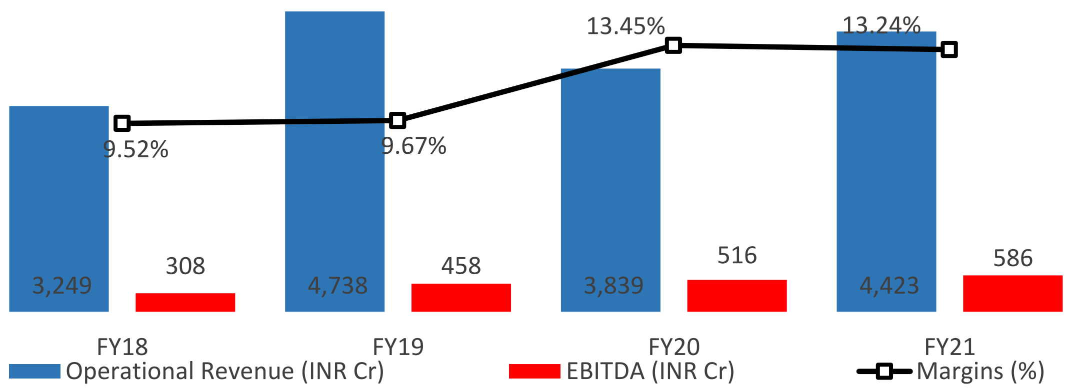
PAT	PAT Margins	Diluted EPS
INR 246.3 Cr	5.57 %	1.87 INR
3.8 % YoY	(61) Bps YoY	6.3 % YoY

Source: Company, Moneycontrol.com, Screener.in, KSL Research

Comparative Business Analysis……………………………..........

SALES ANALYSIS

HFCL reported sales of INR 4,423 Cr for the fiscal year ending March of 2021. This represents an increase of 15.2% versus FY20, when the company's sales were INR 3,839 Cr. Despite this increase, sales are still below the level achieved in FY19, when HFCL Ltd reported sales of INR 4,738 Cr.



PROFITABILITY ANALYSIS

On the INR 4,423 Cr in sales reported by the company in FY21, the cost of goods sold totaled INR 3,404 Cr, or 77.0% of sales (i.e., the gross profit was 23.0% of sales). This gross profit margin is slightly lower than the company achieved in FY20, when cost of goods sold is at 76.8% of sales. The company's earnings before interest, taxes, depreciation and amortization (EBITDA) were INR 586 Cr, or 13.2% of sales. This EBITDA to sales ratio is roughly on par with what the company achieved in FY20, when the EBITDA ratio was 13.4% of sales. HFCL achieved greater efficiencies in its selling, general and administrative (SG&A) expenses: it cut these expenses by INR 106 Cr, or about 29.6% in FY21, but was able to nonetheless increase its sales by 15.2%. This profit margin is lower than the level the company achieved in FY20, when the profit margin was 5.9% of sales. Earnings before extraordinary items have grown for each of the past 4 years (and since FY18, earnings before extraordinary items have grown a total of 42%). The company's return on equity in FY21 was 14.3%. This was a decline in performance from the 15.8% return that the company achieved in FY20. (Extraordinary items have been excluded).

INVENTORY ANALYSIS

As of March 2021, the value of the company's inventory stands at INR 435 Cr. Since the cost of goods sold was INR 3,404 Cr for the year, the company had 47 days of inventory on hand (another way to look at this is to say that the company turned over its inventory 7.8 times per year). This is an increase in days in inventory from March 2020, when the company had INR 344 Cr, which was only 43 days of sales in inventory.

FINANCIAL POSITION

As of March 2021, the company's long term debt was INR 269 Cr and total liabilities (i.e., all monies owed) were INR 3,286 Cr. The long term debt to equity ratio of the company is 0.14. The release of collection is milestone based and the same has also been impacted due to Covid 19 outbreak. As of March 2021, the accounts receivable for the company were INR 2,719 Cr, which is equivalent to 167 days of sales. This is an increase over the end of 2020, when HFCL had 133 days of sales in accounts receivable.

DIVIDEND ANALYSIS

During the 12 months ending 3/31/2021, HFCL paid dividends of INR 0.15. Since the stock is currently trading at INR 49.10, this implies a dividend yield of 0.2%. HFCL last raised its dividend during FY19, when it raised its dividend to INR 0.10 from INR 0.06. During the same 12 month period ended 3/31/2021, the Company reported earnings of INR 1.86 per share. Thus, the company paid 8.1% of its profits as dividends. Since the company is paying less than 10% of its earnings out in dividends, it is likely that this company believes that it has significant growth prospects, and has decided to pay only a modest dividend.

Source: Company, Moneycontrol.com, Screener.in, KSL Research

Conference call key takeaways……………………………………………..........................

- COVID-19 which again started showing uptrend in the fourth quarter of last financial year, quickly resulted into a widespread lockdown in various parts of the Country HFCL's actions have not only helped in ensuring smooth business operations but have also led to growth as is visible in the quarterly numbers.
- During the quarter under review, HFCL has won orders worth INR 221 Cr from Uttar Pradesh Metro Rail Corporation for Kanpur and Agra Metro Rail. The Company will set up telecommunication systems for 32.4 km of Kanpur metro rail and 14 km of Agra metro rail. These orders are to be executed over the next 33 months.
- HFCL Limited has now successfully completed shipment of 1.5 lakh units of indigenously developed wireless solutions comprising of Wi-Fi Access Points and Point to Point Unlicensed Band Radios to its customers.
- The company has strengthened the portfolio of wireless solutions with the rollout of new dual band Wi-Fi 6 products in addition to the existing Wi-Fi 5 range of products.
- The Company's subsidiary HTL Ltd., has diversified into electrical wiring interconnect solutions and has set up a production facility in its' Chennai plant to cater to Aerospace & Defence and Automotive & Industrial markets.
- HFCL has established a new 5G business unit which will focus on developing the latest 5G compatible products.
- HFCL's order book has been really strong even during this uncertain economic environment. As of 31st March 2021, consolidated order book stood at INR 6,875 Cr. On the back of a strong order book and execution the capacity utilization has also increased to optimum levels.
- The Board of Directors in its meeting has recommended a dividend of 15% i.e, INR 0.15 per equity share of face value of INR 1 each for the year end FY21.

Valuation and view……………………………………………………………………………………..

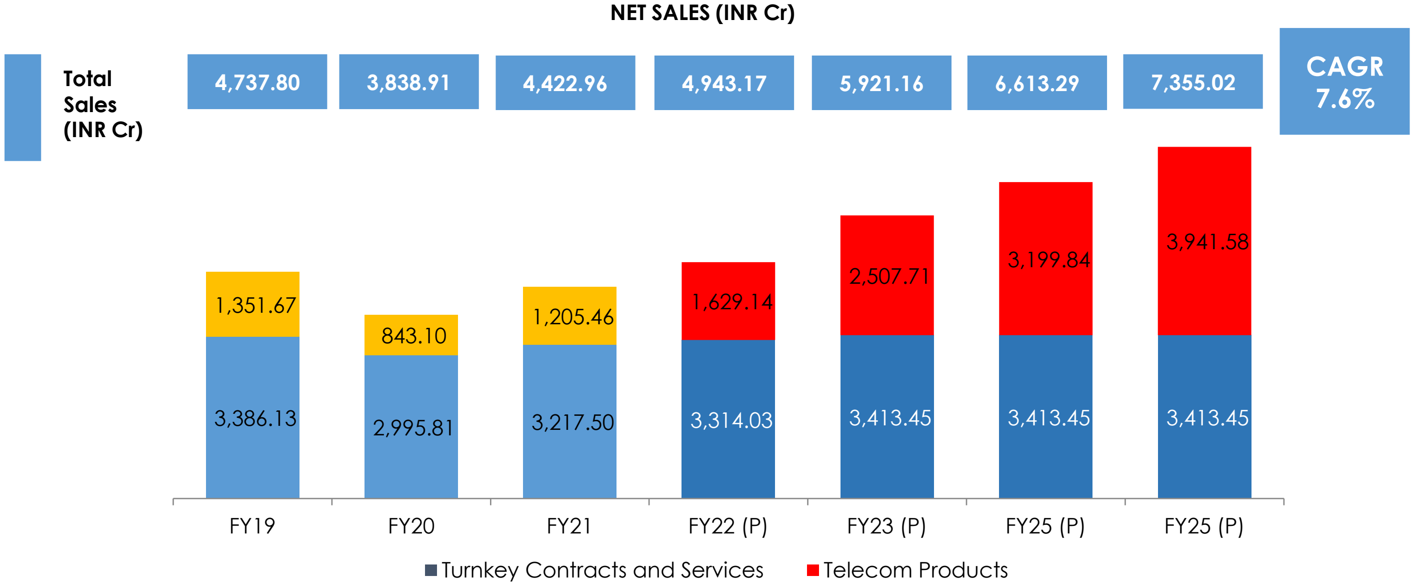
- The company reported good quarter numbers with a strong order book in hand and backed by a good growth in the telecom and turnkey segments. The management has portrayed an optimistic approach in terms of achieving its revenue targets from the exports market, opportunities that would come in from the defence and railway segments in times to come. With regard to future growth, for the telecom industry, there appears to be a great opportunity in terms of 5G demand that would be catered via huge deployments of OFC roll-outs. Additionally, the company's emphasis in order to design and develop new generation telecom and defence products with in-house R&D adds further impetus to opportunities from the telecom, railways and defence space.
- We believe HFCL's growth and profitability levels are likely to improve significantly compared to its recent historical performance. Also, the quality of the revenue mix is set to improve as the share of product revenue is likely to go up. Also with easing of cash flows with impending fund inflow and unpledging of promoter shares we shall see a significant rerating of the stock. ***We value HFCL at INR 86 (23x FY23 earnings) and initiate coverage on the stock with a BUY. For a longer term perspective the stock has the potential to go up to INR 130 in the best case scenario. AT CMP of INR 49, the price objective represents a potential upside of ~75% over the next 12-18 months.***

Key Risks………………………………………………………………………………………………

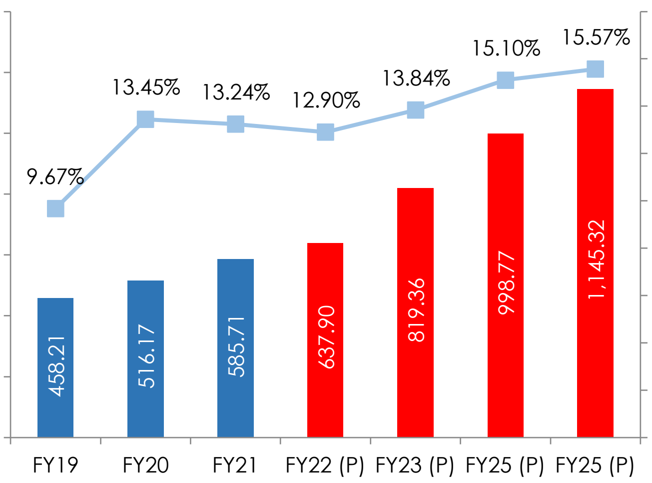
- If the telecom products business fails to scale up as per forecasts then revenue and profitability could be affected
- **Balance sheet strength of operators to incur additional capex:** Telecom operators Airtel and VI were facing troubles because of incumbent Jio slashing down prices, this leads to a drastic fall in their ARPUs, the situation was worsened with the Supreme Court verdict coming against telcos last year for the AGR case. Thus the debt levels of the industry have swelled, with the latest auction of the spectrum the total debt level of the industry would be in the north of Rs 5 trillion. Thus an impending ARPU hike is essential for telcos to survive and incur additional Capex for 5G investments. Jio on other hand has the balance sheet strength with the recent fundraising to invest in 5G infrastructure.
- **Lethargy of government to timely execute & implement its schemes:** In past, HFCL had setbacks as the government had canceled BharatNet orders, due to a lack of clarity on execution and mode of contract. Lately, the responsibilities for BharatNet are handed over to two entities BBNL & BSNL. Lack of clarity on role responsibilities between the two has created many delays in the implementation of the project. The government is currently deciding the mode of contracts at the center to issue these projects, which are expected to issue on a PPP basis
- **Other issues worth noting:** The company has a certain amount of receivables stuck with BSNL which are expected to be received over next 2-3 quarters

FINANCIAL AND OPERATIONAL HIGHLIGHTS ……………………………………………..……

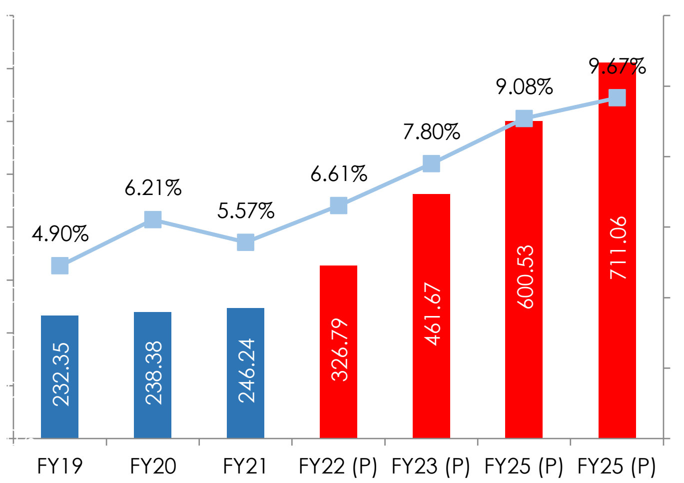
NET SALES (INR Cr)



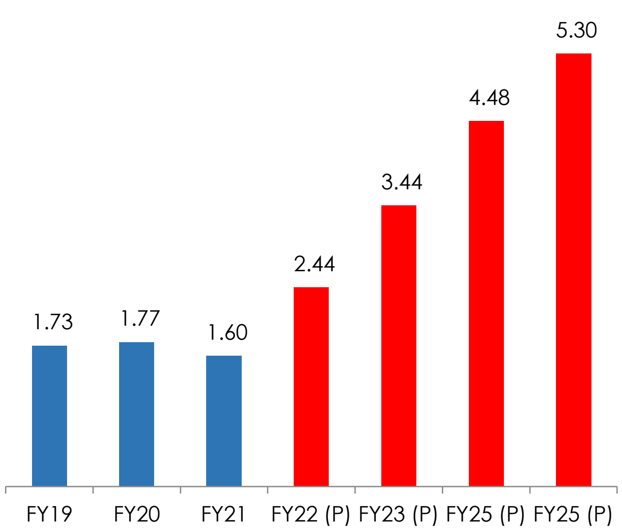
EBITDA (INR Cr) & EBITDA Margins (%)

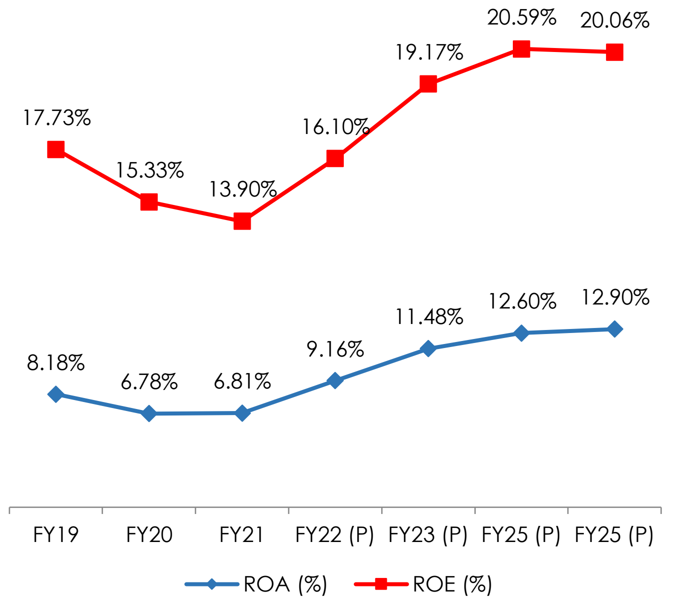


PAT (INR Cr) & PAT Margins (%)



EPS (INR)





Source: Company, Moneycontrol.com, Screener.in, KSL Research

Consolidated Profit and Loss (INR Cr)

Y/E March	FY20	FY21	FY22 (E)	FY23 (E)	FY24 (E)	FY25 (E)
Net Sales	**3,838.9**	**4,423.0**	**4,943.2**	**5,921.2**	**6,613.3**	**7,355.0**
Net Sales Growth (YoY)	-18.97%	15.21%	11.76%	19.78%	11.69%	11.22%
Expenses						
COGS	2,934.26	3,403.92	3,732.1	4,411.3	4,860.8	5,369.2
COGS / Sales	76.43%	76.96%	75.50%	74.50%	73.50%	73.00%
Gross Margin	23.57%	23.04%	24.50%	25.50%	26.50%	27.00%
Employee Cost	224.34	252.85	346.0	414.5	443.1	492.8
Employee Cost / Net Sales	5.84%	5.72%	7.0%	7.0%	6.7%	6.7%
Other Op. and Mfg. expenses	187.99	216.61	247.2	296.1	330.7	367.8
Other Op. and Mfg. expenses Margin	4.90%	4.90%	5.0%	5.0%	5.0%	5.0%
Total Expenditure	**3,346.6**	**3,873.4**	**4,325.3**	**5,121.8**	**5,634.5**	**6,229.7**
Total Expenditure Growth (YoY)	-22.57%	15.74%	11.67%	18.42%	10.01%	10.56%
Operating Profit (Excl OI)	**492.32**	**549.58**	**617.90**	**799.36**	**978.77**	**1125.32**
Operating Margin	12.82%	12.43%	12.50%	13.50%	14.80%	15.30%
Other Income	23.85	36.13	20.00	20.00	20.00	20.00
Operating Profit (Incl OI) EBITDA	**516.17**	**585.71**	**637.90**	**819.36**	**998.77**	**1145.32**
Depreciation	41.95	68.63	77	76	72	66
EBIT	**474.22**	**517.08**	**561.33**	**743.03**	**926.39**	**1,079.30**
Interest	114.82	176.09	94.49	83.49	68.49	63.49
PBT	**359.40**	**340.99**	**466.84**	**659.53**	**857.89**	**1015.80**
Exceptional items	0.00	-4.13	0.00	0.00	0.00	0.00
PBT	359.40	336.86	466.84	659.53	857.89	1015.80
Tax	121.02	90.62	140.1	197.9	257.4	304.7
Average tax Rate	33.7%	26.9%	30.0%	30.0%	30.0%	30.0%
PAT	**238.38**	**246.24**	**326.79**	**461.67**	**600.53**	**711.06**

Source: Company, Moneycontrol.com, Screener.in, KSL Research

Consolidated Balance Sheet (INR Cr)

Equities & Liabilities	FY21	FY20
(A) Share Capital	128.4	128.4
(B) Other Equity	1,787.8	1,540.0
Non Controlling Interest	7.3	-
Total -Shareholder Funds	**1,923.5**	**1,668.4**
Non Current Liabilities		
(A) Financial Liabilities		
(i) Borrowings	250.8	200.9
(ii) Lease Liabilities	18.5	16.9
(iii) Financial guarantee Obligations	-	-
(B) Provisions	36.5	32.0
Total - Non – Current Liabilities	**305.8**	**249.8**
Current Liabilities		
Financial Liabilities		
(i) Borrowings	587.6	467.6
(ii) Lease Liabilities	3.8	5.0
(iii) Trade Payables	1,748.0	815.2
(iv) Other Financial Liabilities	487.4	527.1
(B) Current Tax Liabilities	46.4	-
(C) Other Current Liabilities	71.2	51.9
(D) Contract Liabilities	30.1	33.2
(E) Provisions	12.1	10.7
Total – Current Liabilities	**2,986.6**	**1,910.7**
GRAND TOTAL - EQUITIES & LIABILITES	**5,215.9**	**3,828.9**

Assets	FY21	FY20
(A) Property plant & Equipment	443.4	436.9
(B) Capital Work in Progress	11.8	15.1
(C) Right-of-use-Assets	20.3	20.1
(D) Goodwill	26.2	26.2
(E) Other Intangible Assets	18.0	20.8
(F) Intangible Assets under development	24.2	18.7
(G) Investment in Associates/ JV		
(H) **Financial Assets**		
(i) Investment	34.8	55.7
(ii) Trade receivables	444.8	119.9
(iii) Loans	6.5	6.5
(iv) Others	11.0	31.5
(I) Deferred Tax (Net)	6.7	12.2
(J) Other Non Current Assets	18.3	4.3
Total - Non – Current Assets	**1,066.0**	**767.9**
Current Assets		
(A) Inventories	435.3	343.7
(B) Financial Assets		
(i) Investment	5.8	2.5
(ii) Trade Receivables	2,611.0	1,609.8
(iii) Cash & Cash Equivalents	21.3	16.4
(iv) Bank balances other than above	285.1	175.4
(v) Loans	11.9	15.0
(vi) Others-Advances	461.8	557.5
(C) Current Tax Assets (Net)	75.6	97.5
(D) Contract Assets	20.7	18.5
(E) Other Current Assets	221.4	224.7
Total – Current Assets	**4,149.9**	**3,061.0**
GRAND TOTAL – ASSETS	**5,215.9**	**3,828.9**

Source: Company, Moneycontrol.com, Screener.in, KSL Research

Key Ratios

Y/E March	FY19	FY20	FY21
OPERATIONAL			
Diluted EPS (INR)	1.75	1.76	1.87
Cash EPS (INR)	0.30	1.30	0.44
GROWTH			
Net Sales (%)	46.80%	-18.97%	15.21%
EBITDA (%)	48.94%	12.65%	13.47%
Diluted EPS (%)	30%	1%	6%
PERFORMANCE			
RoE (%)	17.95%	15.31%	13.71%
RoCE (%)	23.60%	21.50%	19.80%
EFFICIENCY			
Asset Turnover (x)	1.61	1.08	0.98
Sales / Total Assets	19.82	9.72	8.95
Working Capital / Sales (x)	0.22	0.33	0.36
Receivable days	91	133	167
Inventory Days	21	35	38
Payable Days	54	82	105
FINANCIAL STABILITY			
Total Debt / Equity (x)	0.41	0.43	0.48
Net Debt / Equity (x)	0.40	0.42	0.47
Current Ratio (x)	1.62	1.66	1.54
VALUATION			
PE (x)	12.97	5.11	13.52
EV / EBITDA (x)	7.63	3.60	7.06
EV / Net Sales (x)	0.74	0.48	0.94
PB (x)	2.04	0.70	1.68
Free Cash Flow Yield (%)	1.30%	14.40%	1.76%

Source: Company, Moneycontrol.com, Screener.in, KSL Research

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