

New launches will drive telecom products and opportunities in BharatNet.

CMP: INR 97

Rating: HOLD

Target Price: INR 107

Stock Info

BSE	500183
NSE	HFCL
Bloomberg	HFCD:LI
Reuters	HFCL.NS
Sector	Cables
Face Value (INR)	1
Equity Capital (INR cr)	142.8
Mkt Cap (INR cr)	13,820
52w H/L (INR)	109 / 55.8
Avg Yearly Volume (in 000')	13,013

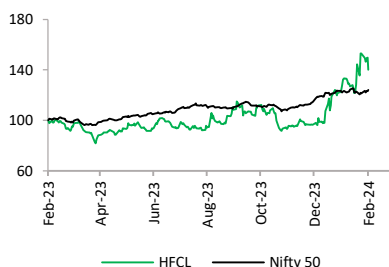
Shareholding Pattern %

(As on Dec, 2023)

Promoters	37.84
Public & Others	62.16

Stock Performance (%)	3m	6m	12m
HFCL	43.0	24.9	40.2
NIFTY	5.6	11.9	24.1

HFCL vs Nifty



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HFCL Ltd reported numbers, Q3FY24 revenue stood at INR 1,032cr (-4.9% YoY/-7.1% QoQ); below our estimates of INR 1,045cr due to lower sales in telecom products. Gross Profit stood at INR 277cr (-16% YoY/-1.2% QoQ); below our estimates of INR 306cr. Gross margins contracted by 353 bps YoY (up by 160 bps QoQ) to 26.9% vs 30.4% in Q3FY23. The raw material cost in terms of sales stood at 73.1% vs 69.6% in Q3FY23. EBITDA stood at INR 118cr (-37.3% YoY/-11.2% QoQ); below our estimates of INR 143cr. EBITDA margin contracted by 588 bps YoY (down by 53 bps QoQ) to 11.4% vs 17.3% in Q3FY23. PAT stood at INR 83cr (-17.9% YoY/+18.9% QoQ); above our estimates of INR 69cr. PAT margin contracted by 128 bps YoY (up by 177 bps QoQ) to 8.1% vs 9.4% in Q3FY23.

Key Highlights

Capacity expansion will drive business growth: HFCL is expanding optical fibre cable (OFC) capacities from 25 mn fkm to 35 mn fkm. As part of its backward integration, HFCL is expanding its optic fibre capacities from 12 mn fkm to 33.9 mn fkm. The plants are operating around 50% or less capacity utilization levels. The lower volume due to inventory build-up at customer and distributor levels and price erosion on OF & OFC has impacted the business. The inventory build-up is expected to normalize in the next couple of quarters. The capacity expansion would cater to the new applications, BharatNet and US subsidy programs.

Opportunity in BharatNet and US: BharatNet tender is expected in the next 2-3 weeks time. The demand is expected to be around 6 lakh km of cables and 1.6 lakh routers. Every year the requirement is around 2 lakh km of cables. The company has an opportunity for cables and is able to sell Optical fiber to other EPC players. The BharatNet 3 project is estimated around INR 1.4 lakh cr. Around INR 40,000cr to INR 50,000cr for capex and remaining for Opex which will be incurred over 10 years. The US government has announced a \$61bn subsidy for OFC to enable seamless broadband connectivity in homes and offices. The disbursement is expected to start in the middle of the current calendar year. The BharatNet and US subsidy program would be the biggest opportunity for HFCL.

New product launches will lead to additional revenue: Telecom Products revenue stood at INR 364cr (-47.5% YoY/-23.2% QoQ). EBIT stood at INR 35cr (-73.2% YoY/-9.1% QoQ); EBIT margin contracted by 931 bps YoY (up by 150 bps QoQ) to 9.7% vs 19% in Q3FY23. Telecom Products revenue share decreased to 35% vs 64% in Q3FY23. HFCL has launched 1728 high fiber IBR cables and is well positioned to capture data center markets. The new product launches are lined-up and the company is setting up a new facility in Delhi-NCR to manufacture telecom and networking products. 5G networking equipment and products revenue is expected around INR 800cr - INR 1,000cr by FY25E. The company is expecting more orders from BSNL and private players.

Outlook & Valuation: HFCL has a strong order book of INR 7,678cr (~1.7x of FY23 TTM revenue) and regular order inflows in Telecom products. The recent product orders will improve the revenue and profitability of the telecom product segment. New product launches will bring additional revenue of INR 800cr to INR 1,000cr in FY25E. The Capex for OF & OFC would bring additional revenue going forward. The BharatNet and US subsidy program would lead to great opportunities for the company. The revival of exports backed by inventory normalization, capacity expansion, product portfolio expansion, and a strong client base that would drive the business going forward. We reduce to a "HOLD" rating (earlier "BUY") with a Target Price of INR 107 per share based on DCF; an upside of 10.3%.

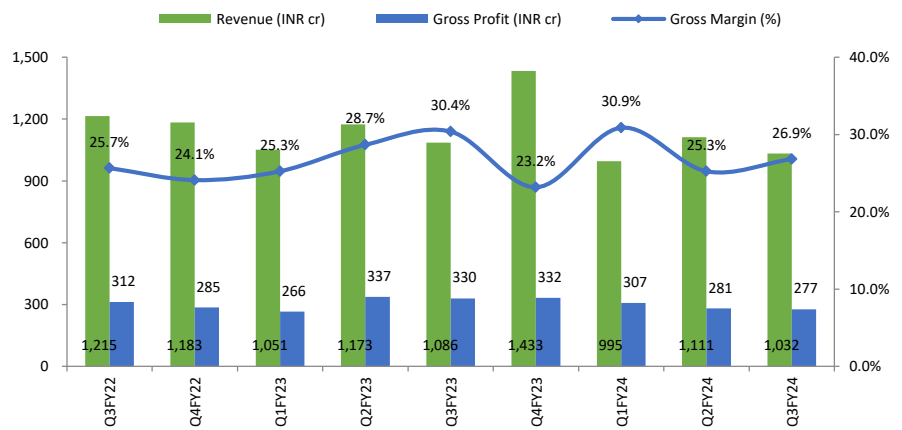
Q3FY24 Results

Income statement summary

Particular (INR cr)	Q3FY23	Q2FY24	Q3FY24	YoY (%)	QoQ (%)
Revenue	1,086	1,111	1,032	-4.9%	-7.1%
Net Raw Materials	756	831	755	-0.1%	-9.1%
Employee Cost	84	81	90	6.8%	10.5%
Other Expenses	58	67	69	19.6%	4.2%
EBITDA	188	133	118	-37.3%	-11.2%
EBITDA Margin (%)	17.3%	11.9%	11.4%	-588 bps	-53 bps
Depreciation	20	21	19		
Interest expense	37	35	37		
Other income	5.7	17.2	46.7		
Profit before tax	137	94	109	-20.5%	15.6%
Taxes	35	24	25		
PAT	102	70	83	-17.9%	18.9%
PAT Margin (%)	9.4%	6.3%	8.1%	-128 bps	+177 bps
EPS (INR)	0.7	0.5	0.6		

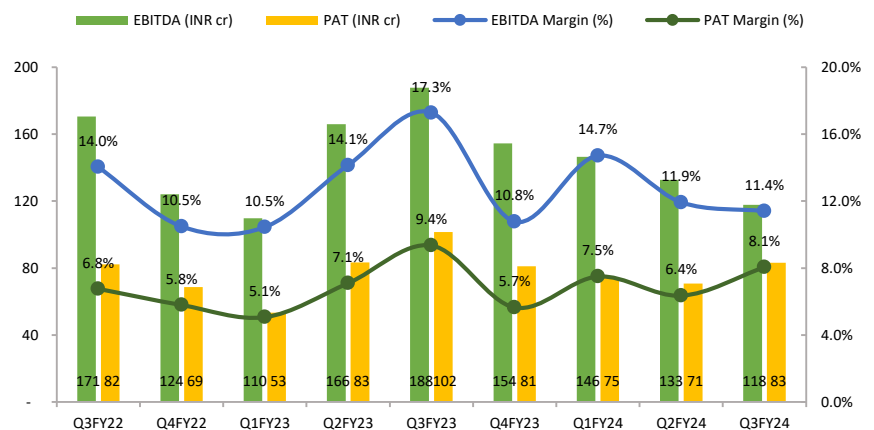
Source: Company Reports, Arianth Capital Research

Exhibit 1: Gross margins contracted by 353 bps YoY (+160 bps QoQ) to 26.9% Q3FY24 due to higher RM costs.



Source: Company Reports, Arianth Capital Research

Exhibit 2: EBITDA margin contracted by 588 bps YoY (+53 bps QoQ) to 11.4% in Q3FY24 due to higher employee & other expenses in-terms of sales.



Source: Company Reports, Arianth Capital Research

Q3FY24 Concall Highlights

Capacity expansion

- Optical fibre capacity is expected to increase from 12mn fkm to 33.9mn fkm and Optical Fibre Cable capacity is expected to increase from 25mn fkm to 35mn fkm going forward.

Capacity utilisation

- The capacity utilization is around 50% or less.

Order book

- The order book stood at INR 7,678cr. The order book break up are government -74.7%, Private – 25.3%.

Order inflows

- HFCL has received an order of INR 1,127cr from BSNL for optical transfer network infrastructure across the network.
- The company has received an order of INR 623cr from a leading telecom player for 5G telecom networking equipment.
- HTL has secured an order from a vehicle manufacturer for wire hardness.

Inventory buildup

- Inventory build-up with telcos and distributor levels which impacted the demand on global levels.
- Chinese demand was less than expected and inventory accumulated at operator levels.
- The Europe market is expected to normalize in 1-2 quarters.
- The US market is expected to recover in the next couple of quarters due to govt funding for fiber networks to accessible areas.

OF & OFC prices

- OFC prices came down INR 1,200/fkm (Q2FY24) to INR 1,000/fkm in Q3FY24. OF prices came down INR 350-380/fkm (Q2FY24) to INR 250-260/fkm in Q3FY24.

BharatNet

- BharatNet tender is expected in the next 2-3 weeks time. The demand is expected around 6 lakh km of cables and 1.6 lakh routers.
- Every year requirement is around 2 lakh km of cables. The company has an opportunity for cables and is able to sell Optical fiber to other EPC players.
- The BharatNet 3 project is estimated around INR 1.4 lakh cr. Around INR 40,000cr to INR 50,000cr for capex and remaining for Opex which will be incurred over 10 years.

Products and 5G Equipment's

- 5G networking equipment and products revenue is expected around INR 1,000cr by FY25E. The company is expecting more orders from BSNL and private players.

Q3FY24 Concall Highlights

New launches

- HFCL has launched 1728 high fiber IBR cables and is well positioned to capture data center markets.
- The company has designed surveillance radars that have high accuracy, lower power consumption, lightweight, and resistance to interference.

PLI benefits

- PLI benefits are available for telecom equipment products. The benefits are expected from FY24E onwards.

Product mix change

- The product orders of INR 1,800cr would change the revenue mix going forward. The company is focusing on a products and projects mix of 70:30 going forward.

Exports

- The company's export revenue is expected to cross INR 1,000cr in FY24E, however slowdown in global demand impacted exports.
- Exports revenue stood at INR 386cr as of 9MFY24 (12.3% of revenue). The exports are expected to improve from the next two quarters onwards.

R&D

- The company is developing new 5G and defence products. The R&D expenses are capitalized and amortized over a period of time.
- R&D expenses are expected around INR 80cr to INR 100cr.

Other highlights

- Lower sales in OFC have impacted telecom product revenue and margins.
- HFCL and Tejas are indigenously developed routers. There are no other domestic competitors.
- The US government has announced a \$61bn subsidy for OFC to enable seamless broadband connectivity in homes and offices. The disbursement is expected to start in the middle of the current calendar year.
- 5G application started growing and new applications are coming up.

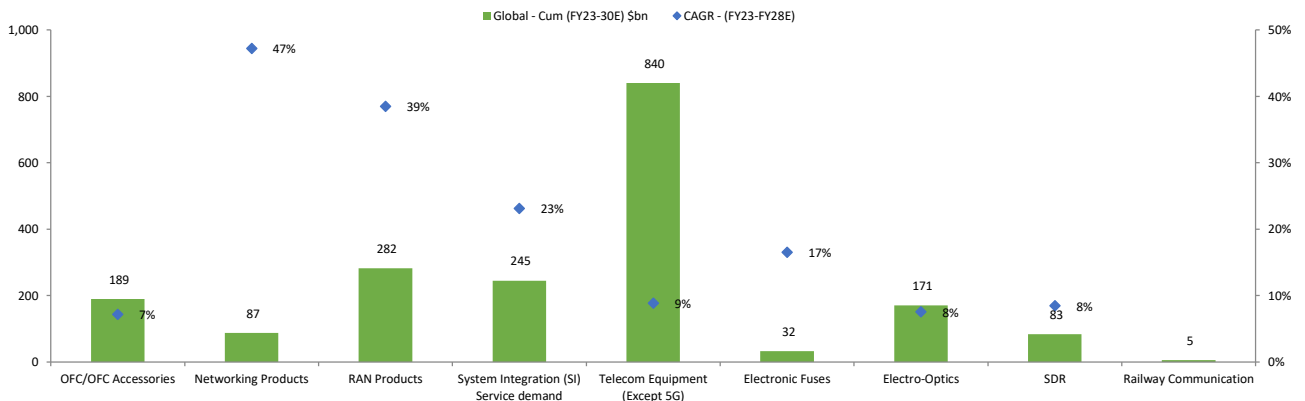
Products and Addressable markets

Exhibit 3: Product Offerings

Telecommunication Products	Defense Electronics Products	Optic Fiber/ Optical Fibers Cables	Passive Connectivity Solutions	Aerospace & Automotive - Wire Harness Portfolio	Products Under Development
<ol style="list-style-type: none"> Point to Point and Point to Multipoint backhaul radio Indoor & Outdoor Wi-Fi 5 and 6 Access Points Cloud based Network management system Ethernet L2/L3 Switches Home Mesh Router 5G Indoor & Outdoor FWA CPE Cell Site Router /Access Router, Aggregation Router 	<ol style="list-style-type: none"> Thermal Weapon Sights (TWS) Electronic Fuses High capacity radio relay VMS & Video Analytics Ground Surveillance Radar 	<ol style="list-style-type: none"> Optic Fiber Armoured and Unarmoured Cable Micro Cable Micro Module Cable Ribbon Cable FTTH Cable IBR Cable 	<ol style="list-style-type: none"> Cable Assemblies High Density Cabinets Fiber Termination Box PLC Splitters Joint Closures Aerial/ FTTH Accessories 	<ol style="list-style-type: none"> Aerospace and Defense cable assemblies Automotive and Industrial Parts 	<p>Telecommunication</p> <ul style="list-style-type: none"> 5G Macro Radio Unit Products (8T8R) 5G Indoor & Outdoor Small Cell (2T2R and 4T4R) Ultra High Capacity Point-to-point and Point-to-Multipoint UBRs Wi-Fi 7 Access Points <p>Defense Communication & Electronics</p> <ul style="list-style-type: none"> Software defined radio

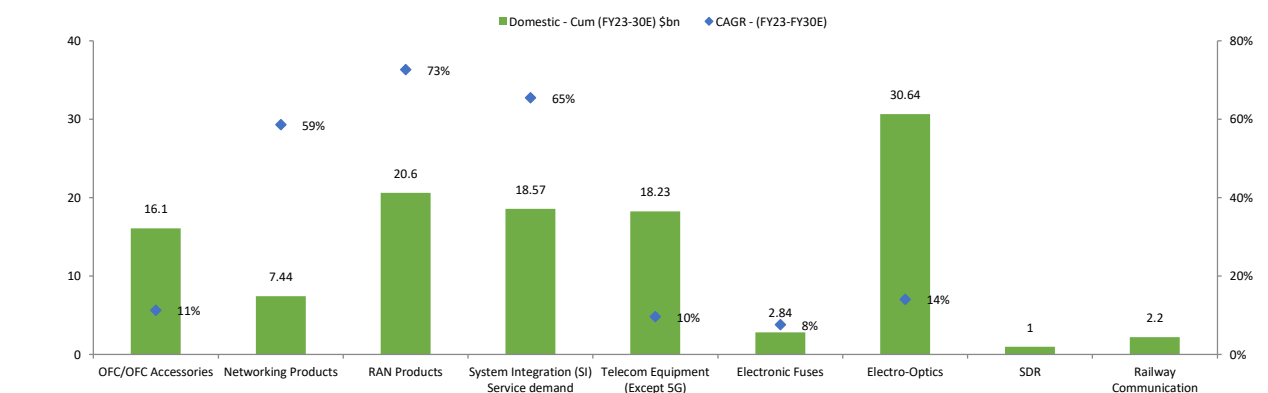
Source: Company reports, Arianth Capital Research

Exhibit 4: 5G segments such as Networking products and RAN products are expected to grow at faster rate over the period of FY23-FY30E. Global markets has more than 90% of addressable market.



Source: Company reports, Arianth Capital Research

Exhibit 5: Domestic addressable market is expected to grow faster than global markets. Networking and RAN products are expected higher growth rate over the period of FY23-FY30E.



Source: Company reports, Arianth Capital Research

Outlook & Valuation

HFCL has a strong order book of INR 7,678cr (~1.7x of FY23 TTM revenue) and regular order inflows in Telecom products. The recent product orders will improve the revenue and profitability of the telecom product segment. New product launches will bring additional revenue of INR 800cr to INR 1,000cr in FY25E. The Capex for OF & OFC would bring additional revenue going forward. The BharatNet and US subsidy program would lead to great opportunities for the company. The revival of exports backed by inventory normalization, capacity expansion, product portfolio expansion, and a strong client base that would drive the business going forward. We reduce to "HOLD" rating (earlier "BUY") with a Target Price of INR 107 per share based on DCF; an upside of 10.3%.

DCF Valuation

Valuation Assumptions

g (World Economic Growth)	3%
Rf	7%
Rm	12%
Beta	1.0
CMP	97

Valuation Data

Total Debt (long term borrowings) (2023)	117
Cash & Cash Equivalents (2023)	323
Number of Diluted Shares (2023)	143
Tax Rate (2024)	25%
Interest Expense Rate (2024)	12%
MV of Equity	13,820
Total Debt	117
Total Capital	13,937

WACC

We	99.2%
Wd	0.8%
Ke	11.9%
Kd	9.0%
WACC	11.8%

FCFF & Target Price

FCFF & Target Price Particular (INR cr)	Explicit Forecast Period						Linear Decline Phase					Terminal Yr
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
EBIT * (1-Tax Rate)	358	475	632	831	1,101	1,482	1,916	2,376	2,822	3,203	3,468	3,572
Dep	83	111	114	118	120	125	162	200	238	270	293	301
Purchase of Assets	(489)	(501)	(110)	(121)	(118)	(104)	(135)	(167)	(199)	(225)	(244)	(251)
Changes in Working Capital	333	(251)	(196)	5	(398)	(494)	(440)	(545)	(648)	(735)	(796)	(820)
FCFF	284	(167)	440	832	706	1,009	1,503	1,864	2,214	2,513	2,720	2,802
Terminal Value											31,725	
Total Cash Flow	284	(167)	440	832	706	1,009	1,503	1,864	2,214	2,513	34,446	

Enterprise Value (INR cr)	15,034
Less: Debt (INR cr)	117
Add: Cash (INR cr)	323
Equity Value (INR cr)	15,240
Equity Value per share (INR)	107

% Returns	10.3%
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Rating	HOLD
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Sensitivity Analysis

		Terminal Growth (%)								
		2.0%	2.3%	2.5%	2.8%	3.0%	3.3%	3.5%	3.8%	4.0%
WACC (%)	10.8%	115	118	121	124	127	131	134	138	143
	11.0%	111	113	116	119	122	125	129	132	136
	11.3%	107	109	112	114	117	120	123	127	130
	11.5%	103	105	107	110	112	115	118	121	125
	11.8%	99	101	103	106	108	111	113	116	119
	12.0%	96	98	100	102	104	106	109	112	114
	12.3%	92	94	96	98	100	102	105	107	110
	12.5%	89	91	93	95	97	99	101	103	106
	12.8%	86	88	90	91	93	95	97	99	101

Source: Company reports, Aриhant Capital Research

Financial Statements

Income statement summary

Y/e 31 Mar (INR cr)	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Revenue	3,839	4,423	4,727	4,743	4,487	5,429	6,648
Net Raw Materials	2,934	3,404	3,499	3,479	3,266	3,946	4,826
Employee Cost	224	253	311	348	361	402	485
Other Expenses	186	217	268	298	297	333	375
EBITDA	494	550	650	619	563	748	961
EBITDA Margin (%)	12.9%	12.4%	13.8%	13.0%	12.5%	13.8%	14.5%
Depreciation	(42)	(69)	(78)	(83)	(83)	(111)	(114)
Interest expense	(115)	(175)	(166)	(152)	(145)	(155)	(149)
Other income	22	35	43	47	109	201	210
Profit before tax	358	337	442	431	444	683	908
Taxes	(121)	(91)	(116)	(113)	(113)	(179)	(238)
PAT	237	246	326	318	332	504	670
PAT Margin (%)	6.2%	5.6%	6.9%	6.7%	7.4%	9.3%	10.1%
Other Comprehensive income	1	5	2	2	-	-	-
Total comprehensive income	238	251	328	319	332	504	670
EPS (INR)	1.9	2.0	2.4	2.2	2.3	3.5	4.7

Source: Company Reports, Arihant Capital Research

Balance sheet summary

Y/e 31 Mar (INR cr)	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity capital	128	128	137	138	143	143	143
Reserves	1,540	1,788	2,661	2,970	3,635	4,110	4,741
Net worth	1,668	1,916	2,798	3,108	3,778	4,253	4,884
Minority Interest	(0)	7	20	37	37	37	37
Provisions	43	49	45	53	25	30	22
Debt	1,218	1,348	1,172	1,137	1,272	1,207	1,182
Other non-current liabilities	-	-	-	29	27	33	40
Total Liabilities	2,929	3,320	4,035	4,363	5,138	5,558	6,164
Fixed assets	437	443	465	487	925	1,303	1,320
Capital Work In Progress	15	12	47	71	39	51	30
Other Intangible assets	40	42	74	215	285	285	285
Goodwill	26	26	26	26	26	26	26
Investments	87	46	87	102	90	109	133
Other non current assets	37	45	47	57	45	54	66
Net working capital	1,535	1,931	2,366	2,537	2,204	2,456	2,652
Inventories	344	435	573	758	770	886	1,031
Sundry debtors	1,730	3,056	2,492	2,309	1,783	2,008	2,186
Loans & Advances	21	18	37	31	18	22	27
Other current assets	341	318	401	548	541	625	692
Sundry creditors	(815)	(1,748)	(1,037)	(878)	(817)	(987)	(1,184)
Other current liabilities & Prov	(85)	(148)	(99)	(232)	(90)	(98)	(100)
Cash	192	306	528	323	986	650	920
Other Financial Assets	560	468	395	546	538	624	731
Total Assets	2,929	3,320	4,035	4,363	5,138	5,558	6,164

Source: Company Reports, Arihant Capital Research

Financial Statements

Cashflow summary

Y/e 31 Mar (INR cr)	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Profit before tax	358	337	442	431	444	683	908
Depreciation	42	69	78	83	83	111	114
Tax paid	(121)	(91)	(116)	(113)	(113)	(179)	(238)
Working capital Δ	(504)	(396)	(434)	(171)	333	(251)	(196)
Operating cashflow	(225)	(81)	(30)	230	747	363	588
Capital expenditure	(228)	(72)	(135)	(128)	(489)	(501)	(110)
Free cash flow	(452)	(153)	(166)	101	258	(138)	478
Equity raised	15	9	588	33	358	-	-
Investments	6	41	(41)	(15)	12	(19)	(24)
Others	47	81	39	(302)	(51)	(95)	(119)
Debt financing/disposal	422	130	(176)	(35)	135	(65)	(25)
Dividends paid	(15)	-	(19)	(24)	(19)	(29)	(39)
Other items	10	6	(4)	37	(31)	11	(1)
Net Δ in cash	32	115	222	(206)	663	(336)	270
Opening Cash Flow	159	192	306	528	323	986	650
Closing Cash Flow	192	306	528	323	986	650	920

Source: Company Reports, Aриhant Capital Research

Ratio analysis

Y/e 31 Mar (INR cr)	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Growth matrix (%)							
Revenue growth	-19.0%	15.2%	6.9%	0.3%	-5.4%	21.0%	22.5%
Op profit growth	18.9%	11.2%	18.3%	-4.8%	-9.1%	33.0%	28.5%
Profitability ratios (%)							
OPM	12.9%	12.4%	13.8%	13.0%	12.5%	13.8%	14.5%
Net profit margin	6.2%	5.6%	6.9%	6.7%	7.4%	9.3%	10.1%
RoCE	12.1%	12.1%	12.4%	10.3%	9.4%	11.7%	13.5%
RoNW	15.3%	13.7%	13.8%	10.8%	9.6%	12.6%	14.7%
RoA	8.1%	7.4%	8.1%	7.3%	6.5%	9.1%	10.9%
Per share ratios (INR)							
EPS	1.9	2.0	2.4	2.3	2.3	3.5	4.7
Dividend per share	0.1	-	0.1	0.2	0.1	0.2	0.3
Cash EPS	2.2	2.5	2.9	2.9	2.9	4.3	5.5
Book value per share	13.0	14.9	20.4	22.6	26.5	29.8	34.2
Valuation ratios (x)							
P/E	52.2	49.5	40.6	41.7	41.7	27.4	20.6
P/CEPS	44.5	39.5	32.9	33.3	33.4	22.5	17.6
P/B	7.5	6.5	4.8	4.3	3.7	3.2	2.8
EV/EBITDA	27.1	24.4	21.3	22.7	24.9	19.1	14.5
Payout (%)							
Dividend payout	6.5%	0.0%	5.8%	7.7%	5.8%	5.8%	5.8%
Tax payout	33.8%	26.9%	26.3%	26.2%	25.4%	26.2%	26.2%
Liquidity ratios							
Debtor days	157	197	214	185	166	127	115
Inventory days	38	42	53	70	85	77	73
Creditor days	92	121	125	85	79	70	70
WC Days	103	118	142	170	173	134	118
Leverage ratios (x)							
Interest coverage	3.9	2.8	3.4	3.5	3.3	4.1	5.7
Net debt / equity	0.6	0.5	0.2	0.3	0.1	0.1	0.1
Net debt / op. profit	2.1	1.9	1.0	1.3	0.5	0.7	0.3

Source: Company Reports, Aриhant Capital Research

Story in Charts

Exhibit 6: Revenue is expected to grow at 11.9% CAGR over the period of FY23-FY26E.

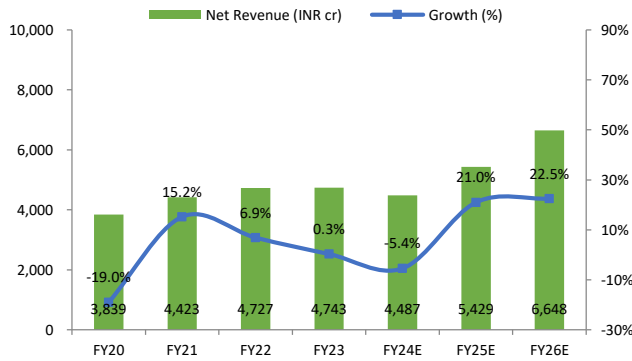


Exhibit 7: Softening of RM costs will lead to improvement in gross margins.

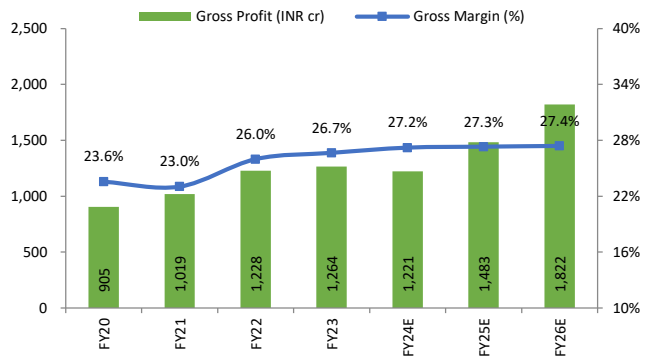


Exhibit 8: Growth in EBITDA & PAT levels

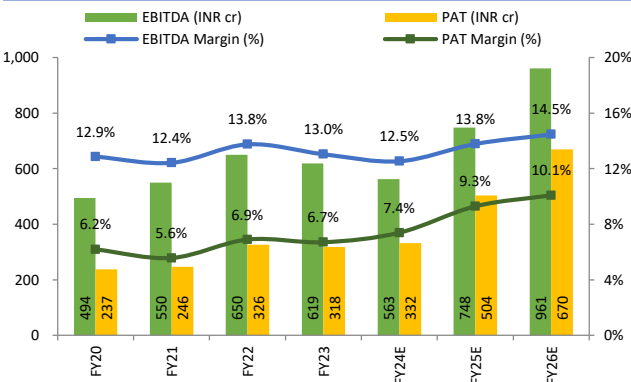


Exhibit 9: Return ratios to be improve

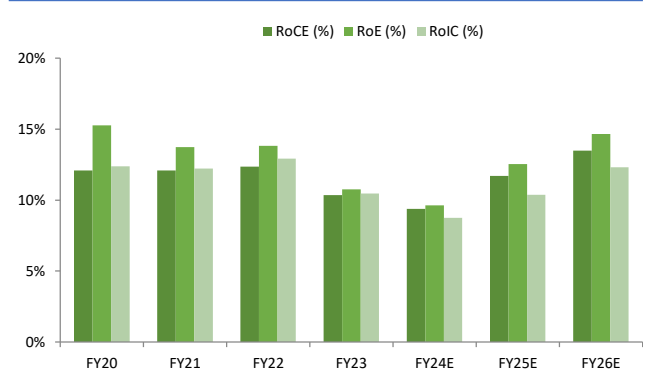


Exhibit 10: Working capital days to be improve

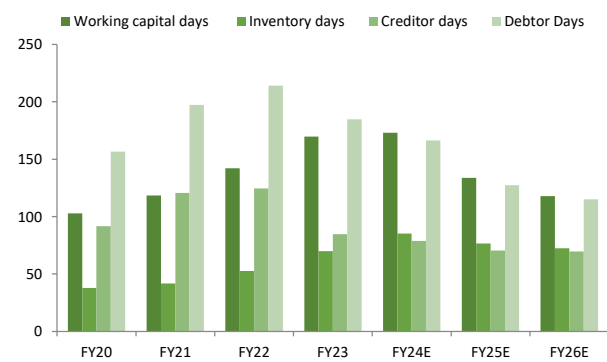
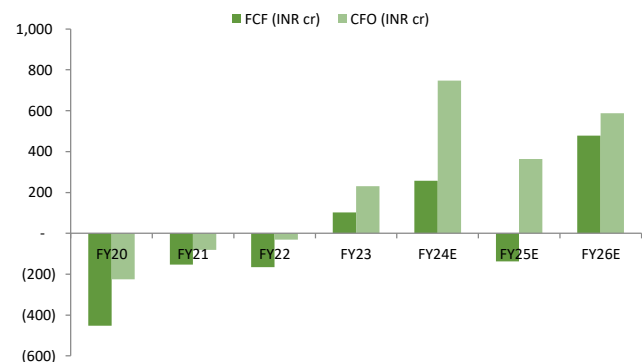


Exhibit 11: Cash flows to be improve



Source: Company reports, Arianth Capital Research

Story in Charts

Exhibit 12: Working capital in-terms of sales is expected to reduce going forward due to change in products mix.

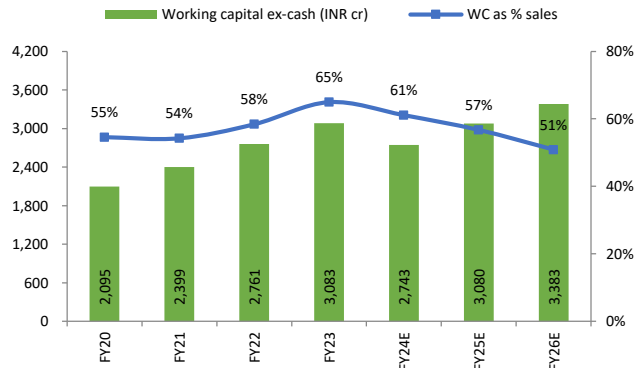


Exhibit 13: Interest cost as % of EBIT is expected to reduce going forward.

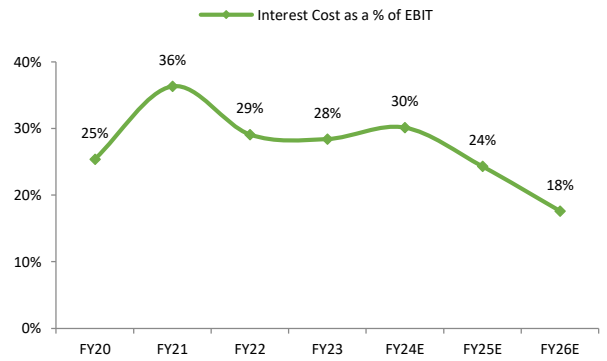


Exhibit 14: Exports are impacted due to inventory build-up. Exports are expected to normalize in the next couple of quarters.

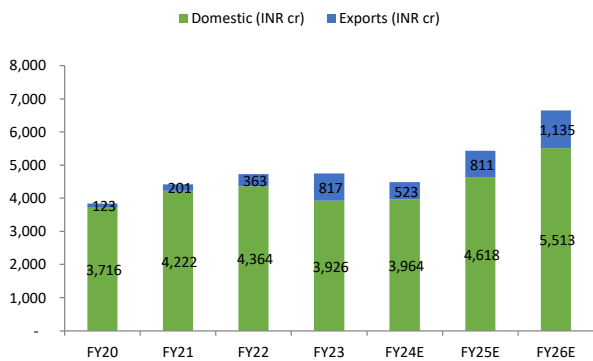


Exhibit 15: Exports revenue share is expected to be above 15% in the next 2-3 years.

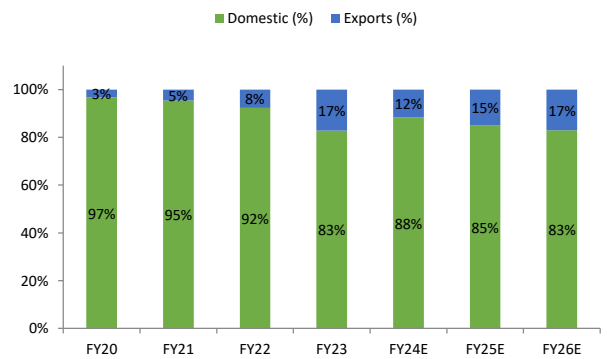


Exhibit 16: Telecom products growth is expected to be faster backed by new launches, while EPC revenue is expected to remain stagnant.

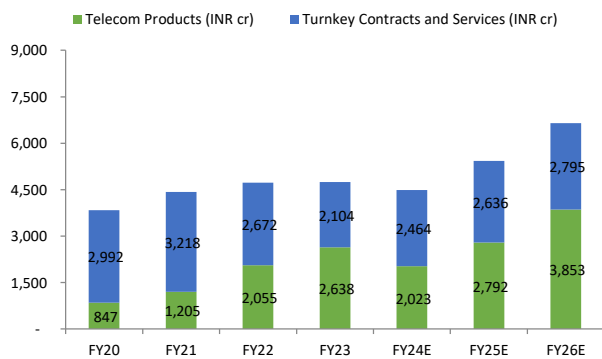
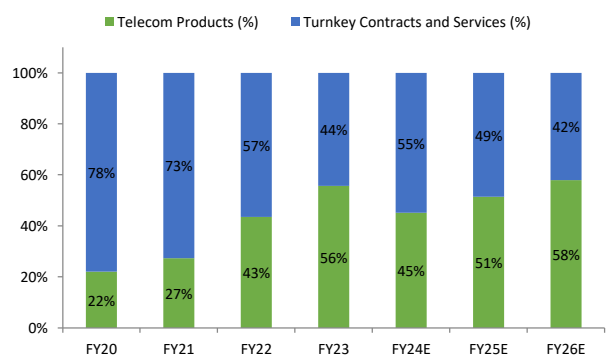


Exhibit 17: Telecom products share is expected to increase going forward.



Source: Company reports, Arianth Capital Research

Story in Charts

Exhibit 18: The order book stood at INR 7,678cr which shows revenue visibility going forward.

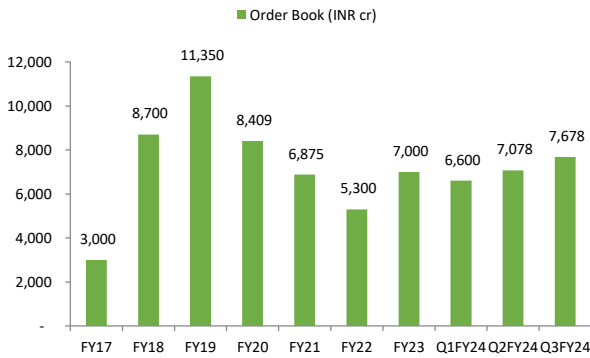


Exhibit 19: Public telecommunication revenue accounts 89% in Q3FY24.

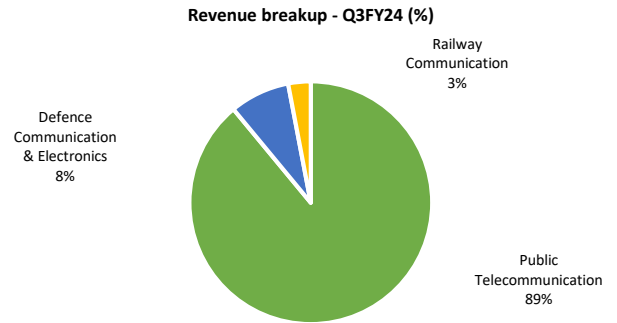


Exhibit 20: Network services order book is accounted for 67% as of Q3FY24. However, Telecom orders keep coming on regular basis.

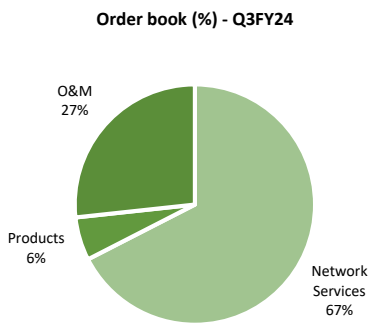


Exhibit 21: Telecom products business impacted due to lower volumes and realization in Q3FY24.

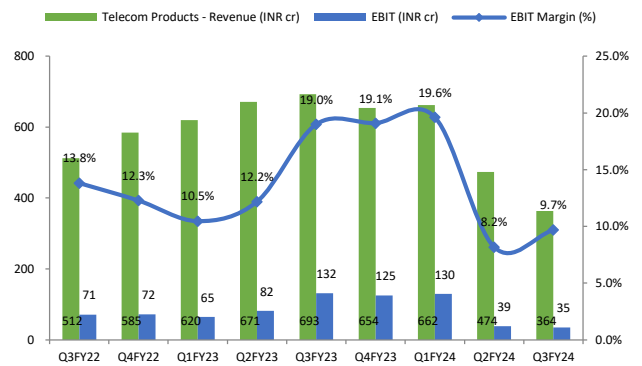


Exhibit 22: EPC margins reached above 15% in Q3FY24.

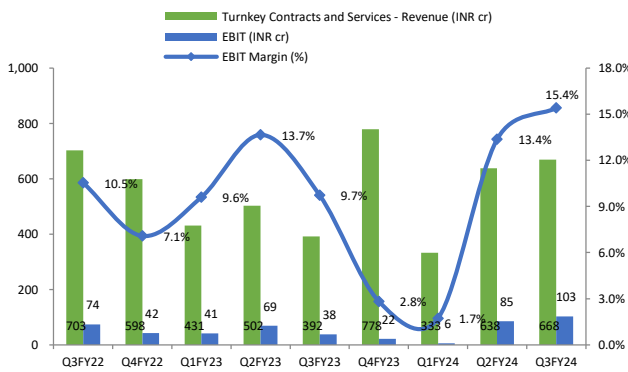
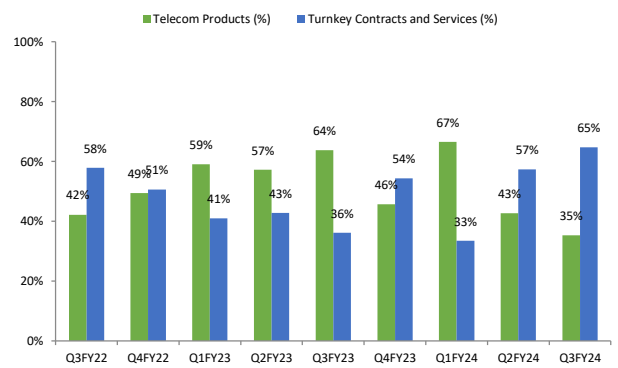


Exhibit 23: Telecom products revenue share stood at 35% as of Q3FY24. it's expected to reach 65%-70% going forward.



Source: Company reports, Arianth Capital Research

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Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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