April 10, 2023

Tejas Networks Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based limits	68.0	68.0	[ICRA]A+(Stable)/[ICRA]A1+; reaffirmed
Non fund-based facilities	140.0	140.0	[ICRA]A+(Stable)/[ICRA]A1+; reaffirmed
Unallocated limits	351.86	351.86	[ICRA]A+(Stable)/[ICRA]A1+; reaffirmed
Total	**559.86**	**559.86**	

**Instrument details are provided in Annexure-I*

Rationale

The reaffirmation of Tejas Networks Limited's (TNL) ratings factors in the financial flexibility emanating from the strong parentage of Panatone Finvest Limited (PFL), which is a subsidiary of Tata Sons Private Limited (TSPL) and an investment holding company of the Tata Group for investment in telecommunication. Further, the ratings draw comfort from TNL's healthy order book, strong track record in the industry and its long-term relationship with some large clients, which has helped it to maintain a healthy market share in the optical networking space in India.

TNL's financial risk profile is marked by strong capital structure and debt protection metrics and a healthy liquidity position with nil debt and unencumbered cash and liquid investments of ~ Rs. 1,215.7 crore as on December 31, 2022. The Atmanirbhar Bharat Abhiyan of the Government of India (GoI), which is aimed at limiting import dependence and increasing the demand for indigenous products, also provides better growth opportunities for the company. Further, TNL's application for the design-led production linked incentive (PLI) scheme for manufacturing telecom and networking products has been approved by the Department of Telecom, Government of India.

The ratings, however, are constrained by modest profitability in the last two years on account of a reduction in the gross margin and high fixed expenses. The gross margins were impacted by rising input costs and depreciating exchange rates. Further, despite a healthy order book, the revenue in FY2022 and 9M FY2023 was impacted by supply chain challenges caused by the global semiconductor component shortage. Consequently, TNL was not able to absorb the fixed cost base because of which the profit margin continued to be under pressure. TNL's profitability and cash flows are also exposed to foreign exchange rate fluctuation risks.

Further, TNL continues to face delays in the realisation of receivables, which has put pressure on its cash flows. Additionally, the increased inventory holding has elongated as certain shipments were deferred due to shortage of critical components. However, going forward, the cash flow position is expected to improve, supported by improved collections and liquidation of inventory. The ratings continue to be constrained by stiff competition from global players such as Nokia, Ciena, and Huawei, among others, who have a more diversified product offering and the advantage of economies of scale. TNL needs to continuously invest in research and development (R&D) to stay competitive in a technologically intensive industry. TNL's long-term revenue prospects will be linked to the capital expenditure cycles of its customer base.

The Stable outlook on the [ICRA]A+ rating reflects ICRA's opinion that TNL will continue to benefit from its extensive track record in the industry, financial flexibility as part of the Tata Group along with its strong capital structure and liquidity profile. The company's ability to generate improved revenue and profitability through sustained growth in business from domestic and international segments while improving its overall collection cycle period will remain the key rating sensitivities.

Key rating drivers and their description

Credit strengths

Financial flexibility from strong parentage of Tata Group; strategic importance in telecommunication business – TNL enjoys considerable financial flexibility for being a part of the Tata Group. It has a strong promoter profile as PFL is a subsidiary of Tata Sons Private Limited (TSPL) and the investment holding company of the Tata Group's investment in telecommunication. PFL, as of February 2023, acquired a 56.4% stake in TNL, leading to an inflow of ~ Rs. 1,850 crore in FY2022 and FY2023.

Technically qualified management and established relationship with customers – TNL has a technically qualified management team and a diversified product offering, evident from its strong intellectual property portfolio and a healthy market share in the optical networking market in India. Also, its long-term relationship with some large clients enables it to generate repeat business, thus supporting the revenue profile. Further, TNL acquired majority stake in Saankhya Labs (P) Ltd. to enhance its wireless products offering.

Robust liquidity profile – Notwithstanding the weak profitability in 9M FY2023 and FY2022 compared to FY2019, the company's liquidity profile has remained strong, reflected in ~ Rs. 1,215.7 crore of unencumbered cash and liquid investments as on December 31, 2022, following the investment proceeds from PFL in FY2022 and FY2023. Going forward, TNL will use the proceeds for organic and inorganic growth. However, the liquidity profile is likely to continue to be strong, supported by the recovery of the overdue receivables and liquidation of its current inventory. The strong liquidity provides TNL the ability to compete with global peers who are much larger, besides providing flexibility to expand its market presence.

Strong capital structure- Despite its high working capital intensity, TNL continues to have nil bank debt as on December 31, 2022, against a net worth of around Rs. 2,667.2 crore. The current debt-free status imparts a high degree of financial flexibility to the company.

Credit challenges

Modest operating profitability, exposed to movement in raw material prices and foreign exchange fluctuation risk - The company's operating profitability continues to be modest and lower in FY2022 and 9M FY2023 vis-à-vis the highs of FY2019 on account of a reduction in the gross margin and high fixed expenses. The gross margins were impacted by rising input costs and depreciating exchange rates. Further, despite a healthy order book, the revenue in FY2022 and 9M FY2023 was impacted by the global semiconductor component shortage. Consequently, TNL was not able to absorb the fixed cost base because of which the operating profit margin continue to be stressed.

The company is exposed to foreign exchange risk through its sales and services in foreign countries, and purchases from overseas suppliers in foreign currencies. However, the risk is mitigated to an extent through a natural hedge between export receivables and import payables. TNL also enters into forward exchange contracts to mitigate the risk of fluctuations in foreign currency rates.

High working capital intensity – TNL's financial profile has historically been characterised by high inventory holding and high collection days. TNL continues to face delays in the realisation of receivables, which has put pressure on its cash flows and a high provision of Rs. 87.8 crore for expected credit loss in FY2022. However, in 9M FY2023, with the recovery in receivables, some of the provision were written back. Additionally, the increased inventory holding in 9M FY2023 due to the deferment of certain shipments along with higher component procurement has further elongated the working capital cycle. Certain shipments were deferred due to critical component shortage. Further, to address the critical component shortage and the associated high lead time, the company has procured higher components to enable timely execution of existing orders and expected ramp-up in order book position.

Stiff competition from globally reputed players – The company is exposed to stiff competition from other global players such as Nokia, Huawei, and Ciena, among others, who have a long-standing presence and a more diversified product portfolio. TNL needs to continuously invest in R&D to stay competitive in a technologically intensive industry.

Environmental and social risks

TNL is exposed to the risks of tightening regulations on environment and safety. There were no pending show cause/legal notices from the Central Pollution Control Board (CPCB)/State Pollution Control Board (SPCB) at the end of FY2022. This indicates that TNL has been able to mitigate the regulatory risks by demonstrating a sound operational track record and ensuring regulatory compliance.

TNL designs and manufactures wireline and wireless networking products, with focus on technology, innovation and R&D. The business is characterised by rapid technological changes, customer requirements, evolving industry standards and launch of new products and services. Further, intellectual property (IP) is a critical element of the business. The patent rights may be overturned by its competitors which may adversely affect business and reputation. The ongoing global semiconductor chip shortage has increased lead times and costs for many components. Therefore, while TNL remains exposed to the aforementioned social risk, it does not materially affect its credit profile as of now.

Liquidity position: Strong

The company's liquidity profile continues to be strong, aided by unencumbered cash and liquid investments of around Rs. 1,215.7 crore as on December 31, 2022, and availability of sanctioned undrawn fund-based working capital limits from banks. As on December 31, 2022, the company had nil debt on its books. Going forward, TNL will utilise the proceeds from PFL investment towards organic and inorganic growth. However, the liquidity profile is likely to continue to be strong, supported by recovery of the overdue receivables and liquidation of its current inventory.

Rating sensitivities

Positive factors – The ratings could be upgraded if there is a demonstration of stronger linkages with the parent group than currently envisaged. Further, ICRA could upgrade TNL's ratings if it demonstrates a strong and sustained growth in revenue and profitability along with better working capital management, resulting in an improvement in the financial risk profile.

Negative factors – Pressure on TNL's ratings could arise if a volatility in revenue and profitability adversely impacts the financial risk profile, or a stretch in the working capital cycle weakens the liquidity profile. Also, pressure on TNL's ratings could arise in case of sizeable debt-funded acquisitions, which could significantly impact the financial profile and the liquidity position. Further, any weakening of support or linkages with the parent can result in a rating revision.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	[Corporate Credit Rating Methodology] [Rating Approach – implicit support from parent or group]
Parent/Group support	Parent Company: Panatone Finvest Limited (PFL; 99.99% stake in PFL held by Tata Sons Private Limited). ICRA expects PFL to be willing to extend financial support to TNL, should there be a need, given its strategic importance to the Tata Group, and out of its need to protect its reputation.
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of TNL.

About the company

TNL, incorporated in 2000, designs and manufactures wireline and wireless networking products, with a focus on technology, innovation and R&D. TNL carrier-class products are used by telecom service providers, utilities, governments, and defence networks in 75+ countries. TNL has an extensive portfolio of telecom products for building end-to-end telecom networks. The company completed its IPO in 2017 and is currently a part of Panatone Finvest Limited (a subsidiary of Tata Sons Private Limited).

Key financial indicators

TNL Consolidated	FY2021	FY2022	9M FY2023*
Operating income	527.9	554.2	622.2
PAT	37.5	-62.7	-16.4
OPBDIT/OI	10.6%	-13.9%	4.2%
PAT/OI	7.1%	-11.3%	-2.6%
Total outside liabilities/Tangible net worth (times)	0.1	0.0	0.2
Total debt/OPBDIT (times)	0.4	-0.3	1.5
Interest coverage (times)	15.2	-24.1	2.5

*Source: Company, ICRA Research ; *Provisional; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; All ratios as per ICRA calculations; Total Debt includes current and non-current lease Liability*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Dec 31, 2022 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Apr 10, 2023	Apr 7, 2022	Aug 9, 2021	June 22, 2020
1	Fund-based limits	Long-term and short term	68.0	--	[ICRA]A+(Stable) /[ICRA]A1+	[ICRA]A+(Stable) /[ICRA]A1+	[ICRA]A- %/ [ICRA]A2+%	[ICRA]A- (Stable)/ [ICRA]A2+
2	Non fund-based facilities	Long-term and short term	140.0	115.5	[ICRA]A+(Stable) /[ICRA]A1+	[ICRA]A+(Stable) /[ICRA]A1+	[ICRA]A- %/ [ICRA]A2+%	[ICRA]A- (Stable)/ [ICRA]A2+
3	Unallocated limits	Long-term and short term	351.86	--	[ICRA]A+(Stable)/ [ICRA]A1+	[ICRA]A+(Stable)/ [ICRA]A1+	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]A- (Stable)/ [ICRA]A2+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based limits	Simple
Non fund-based facilities	Very Simple
Unallocated limits	Not applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Fund-based limits**	NA	NA	NA	68.0	[ICRA]A+(Stable)/[ICRA]A1+
NA	**Non fund-based facilities**	NA	NA	NA	140.0	[ICRA]A+(Stable)/[ICRA]A1+
NA	**Unallocated limits**	NA	NA	NA	351.86	[ICRA]A+(Stable)/[ICRA]A1+

Source: Company;

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Company Name	TNL Ownership	Consolidation Approach
Tejas Communication Pte. Limited	100.00%	Full Consolidation
Tejas Communications (Nigeria) Limited	100.00%	Full Consolidation
Saankhya Labs Private Limited	64.4%*	Full Consolidation

*Source: TNL annual report FY2022; Tejas Communications (Nigeria) Limited (wholly owned subsidiary of Tejas Communication Pte. Limited and stepdown subsidiary of Tejas Networks Limited); *TNL has acquired 64.4 in Saankhya Labs Private Limited in July 2022*

ANALYST CONTACTS

Sabyasachi Majumdar
+91 124 4545 304
sabyasachi@icraindia.com

Prashant Vasisht
+91 124 4545 322
prashant.vasisht@icraindia.com

Kushal Kumar B
+91 40 45474829
Kushal.kumar@icraindia.com

Sankalpa Mohapatra
+91 40 45474829
sankalpa.mohapatra@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches