Sterlite Technologies Ltd.

Cables-Telephone

STOCK IDEA

Rating: Buy

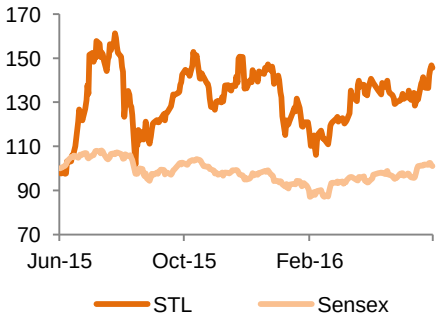
Date	**June 13, 2016**
CMP (Rs.)	96
Target (Rs.)	134
Potential Upside	39%
BSE Sensex	26,636
NSE Nifty	8,170

Scrip Code	
Bloomberg	SOTL IN
Reuters	STTE.BO
BSE Group	B
BSE Code	532374
NSE Symbol	STRTECH

Market Data (*Mcap adjusted for pref sh of Rs 22.5)	
M Cap (Rs. Cr)	2,910*
Current M Cap (Rs Cr)	3,808
Equity Sh. Cap. (Rs Cr)	79.04
52 Wk High/Low	109.9/63.5
Avg. Quarterly Volume	6,74,394
Face Value (Rs.)	2

Shareholding Pattern	
(As on 31st Mar 2016)	
FII	3.93
DII	12.11
Promoters	54.71
Public & Others	29.25
Total	**100.00**

Comparative Price Chart



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Sterlite Technologies Limited (STL) is one of the largest integrated manufacturers of optical fiber in the world. The company offers a complete range of end-to-end optical fibers for a variety of applications. STL is set to ride the new digital wave of Government of India (GoI). With world-class manufacturing units with state-of-the-art technology in India, China and Brazil, STL is uniquely positioned to cater to buyers in the telecom and power sectors both in India and overseas and well placed to serve burgeoning global demand. STL is pioneering Fiber-to-the-Home (FTTH) deployment in the country to enable high speed broadband connectivity. With leadership position, STL will be the key beneficiary of rollout of NOFN, establishment of 100 Smart Cities, rollout of 3G and 4G services by various MSO's and envisaged investment in fiber optic network from Indian Railways and Ministry of Defense. In past few years, STL has transformed from a manufacturing play to a specialty business model straddling the entire telecom value chain by significantly expanding its presence in solutions. Recent acquisition of Elitecore is strengthening its approach further. On the back of these efforts, we expect service revenue of STL to grow at a CAGR of 39% from FY16 to FY18.

Acquisition of Elitecore to strengthen approach from manufacturer to complete solutions provider elevating differentiation of offering:

With a capacity of ~22 Mn fiber kilometers (fkm), STL is the largest producer of fiber optic in the country. STL has been in the transformation phase for the last few years from a manufacturing play to a specialty business model straddling the entire telecom value chain by significantly expanding its its presence in solutions, software and services. Recent acquisition of Elitecore is strengthening its approach from manufacturer to complete solutions provider elevating differentiation of entire offering. Elitecore was awarded a Smart City project in Gandhinagar and Jaipur under Digital India and scope of work includes providing Wi-Fi connectivity, smart street lighting, environment censors, IP surveillance, and smart transport solutions. Services revenue contributed ~22% to total revenue in FY16 (just 5% in FY15). With all these initiatives, we expect service revenues of STL to grow at a CAGR of 39% from FY16 to FY18.

Demerger to simplify business model, enhance transparency and unlock shareholders value:

STL was operating in three different business verticals namely telecom, power conductors and power transmission. STL demerged its power business into Sterlite Power Transmission Ltd effective from the appointed date of April 1, 2015 and the record date for the demerger is 16th June 2016. STL became a pure-play Telecom Products & Solutions provider. STL's shareholders will continue to retain their equity share of Rs 2 in STL (pure-play telecom company). Additionally, for every five equity shares of Rs 2 each held in STL, the shareholders will have three options

- Receive one equity share of Rs. 2 each of SPTL issued at a premium of Rs 110.3.
- Receive one Redeemable Preference Share (RPS) of Rs 2 each issued at a premium of Rs 110.3 each and redeem the same in 30 days.
- Receive RPS of Rs 2 each issued at premium of Rs 110.3 and redeem the same in 18 months at value of 125.8. RPS will be listed on exchanges to provide interim liquidity.

Capacity Expansion coupled with burgeoning growth in demand to drive volume growth:

OF volume for STL has grown at a CAGR of 15% through FY12-FY16. With new government in centre focusing heavily on improving digital infrastructure, the company registered ~14% growth in fiber optic off-take in FY16. STL has expanded its cabling capacity from 8 Mn km to 15 Mn km. with burgeoning demand from government and private telecom operators We believe that STL would be key beneficiary with OF volume growing at a CAGR of 11% through FY18.

Valuation & Outlook:

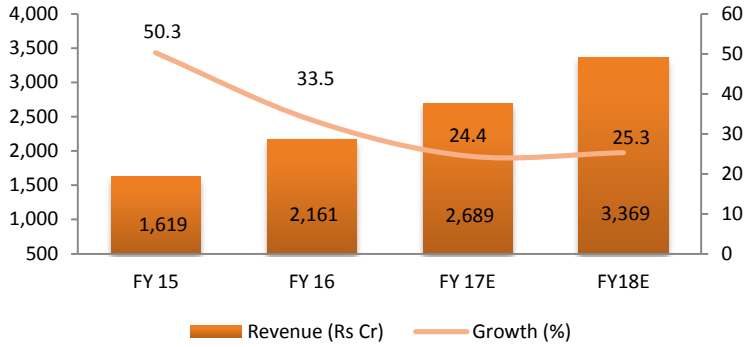
At the current price (after adjusting for Rs 22.5/Sh) of Rs 73.85, the stock trades at 10.64x FY18E EPS of Rs 6.94. With restructuring of business we expect multiples to expand unlocking shareholders value. We value the company at 16x its FY18E EPS and recommend buy with a target of Rs. 134, an upside of 39% in 12 months.

Factor (*P/E adjusted for preference share of Rs 22.5)	Revenue (Cr)	EBITDA (Cr)	EBITDAM (%)	PAT (Cr)	PATM (%)	EPS (Rs)	P/E (x)
FY16*	2,161	452	20.9	151	7.0	3.83	19.26
FY17E	2,689	548	20.4	203	7.5	5.14	14.35
FY18E	3,369	669	19.9	274	8.1	6.94	10.64

Story in charts

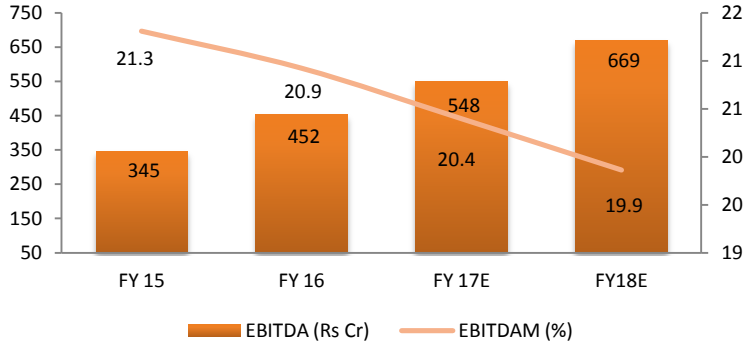
Revenue (Rs Cr)

Revenue expected to grow with a CAGR of 25% from FY16 to FY18



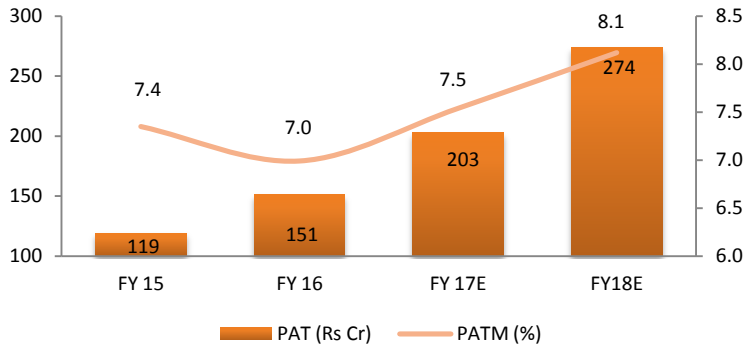
EBITDA (Rs Cr)

On the back of growth in cabling division and services business, EBITDA is expected to grow with a CAGR of 21.7% from FY16 to FY18



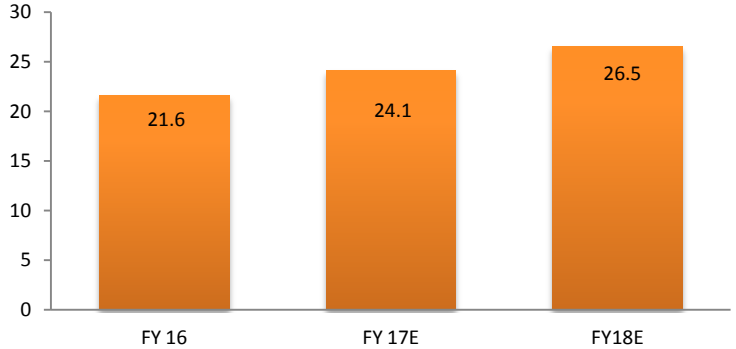
PAT (Rs Cr)

PAT is expected to grow at a CAGR of 35% through from FY16 to FY18. PATM is expected to improve to 8.1% in FY18 from 7% in FY16



Trend in ROE

ROE is expected to improve to 26.5% in FY18 compared to 21.6% in FY16.



Industry Overview

3G/4G to become mainstream mobile broadband:

According to the study conducted by Nokia, overall mobile data traffic in India grew by 50% in 2015, with 3G traffic outpacing 2G across all circles for the first time. 3G penetration reached 32% last year driven by increased affordability of smartphones. The booming 4G handset market is expected to further boost data traffic in near future. Since a 3G & 4G connection leads to more traffic and requires a wider bandwidth. This increase in the consumption of 3G and 4G will in turn scale up the demand for optical fibers for backhauling network. An efficient and robust mobile backhaul network is very critical for any telecom player. In India, less than 20% sites are fiberized compared to 70-80% sites in developed countries. Fiberization of the remaining telecom sites is urgently needed to support the overhaul requirements. Mega trend in Internet and communication with fast changing consumer behavior are driving incumbent telecom operators to change their business model and forcing them to invest more on CAPEX & OPEX. Optical fiber remains as the most viable medium for high speed data communication and even wireless access will need to have fiber based backhaul networks. While China and USA have installed about 900 Mn fkm and 500 Mn fkm of fiber network, India today has only 80 Mn fkm. We expect that there will be a large demand of optical fiber over the next decade in India's effort towards matching global standards of communication.

Government initiatives in network expansion

Digital India

Digital India is an initiative of Government of India to integrate the government departments and the people of India. It aims at ensuring the government services are made available to citizens electronically by reducing paperwork. The initiative also includes plan to connect rural areas with high-speed internet networks.

Pillars supporting digital India

40-50 Mn fkm of OF will be required to build rural broadband network

1) Broadband Highways

2,50,000 village Panchayats would be covered under the National Optical Fiber Network (NOFN) by December 2016. Mandatory communication infrastructure in new urban development and buildings.

2) Universal access to mobile connectivity

This initiative focuses on network penetration and filling the gaps in connectivity in the country. There are around 55,619 villages in the country without mobile coverage. Mobile coverage to these villages would be provided in a phased manner. Rs 16,000 Cr will be spent over 2015-18.

3) Public internet access program

A total of 150,000 Post Offices are proposed to be converted into multi service centers.

4) e- Governance- Reforming government through technology

Form simplification and field reduction, Online applications and tracking, use of Online repositories and Integration of services and platforms like UIDAI and payment gateways.

5) e-Kranti

Focus on implementation of technology in financial inclusion, cyber security, farming and education.

6) Information for all

Open Data platform to facilitate proactive release of datasets in an open format by the ministries/departments for use, reuse and redistribution.

7) Electronics manufacturing

This pillar focuses on promoting manufacturing of electronics in the country with the target of NET ZERO Imports by 2020. With striking demonstration of intent, we expect helping hand such as incentives or favourable taxation policies for the local manufacturing.

8) IT for Jobs

Focus on providing training to the youth in smaller towns and villages and setting up BPOs in every north-eastern state. Taking IT to rural area will require huge investment in networking infrastructure.

Company Background

STL is leading player in communication, power conductors and power transmission business.

Sterlite Technologies Limited (STL) develops & delivers solutions for high speed data communication and power transmission networks, globally. STL is among the global leaders in all its business areas through its operations in India, China & Brazil. It is India's only fully integrated Optical Fiber producer and one of the largest suppliers of Optical Fibers to overseas markets in China, Europe and South East Asia. The Company has an optical fiber manufacturing plant located at Aurangabad, India and Telecom Cable & Power Transmission Conductor plants at Silvassa, Pune & Haridwar India

STL is developing several network projects across India including secure communication network creation in Jammu & Kashmir for Indian army, enabling Bharatnet, establishing urban high speed fiber to the home (FTTH) networks and multiple interstate ultra mega power transmission projects. The company has recently announced a demerger of its power products and transmission business into a new company. Sterlite Technologies to remain a pureplay telecom focused company.

Post demerger, STL to remain pure-play telecom focused company

STL is integrated with Government of India's Digital India vision of enabling digital infrastructure as a utility to every citizen. STL today has become a preferred partner to deliver high speed data based end to end networks with a comprehensive suite of products, network design, installation and managed services

STL is building an intrusion proof communication network for the Indian Army in Jammu & Kashmir under the NFS Project and is deploying highly specialized optical fiber and cable for this network creation. The NFS installation has witness an increased pace of deployment over the last quarter. Sterlite has also pioneered last mile connectivity in dense urban centers by connecting more than 160,000 homes in 6 cities with FTTH network capable of handling upto 100 Mbps of speed.

With robust participation in FTTH, NFS and smart cities initiative, STL has became backbone of telecom infrastructure.

Keeping industry trends in mind, over the last few years, STL heavily invested in plant capacities. The fiber capacity has been increased to 22 Mn fkm per annum from 12 Mn. The optical fiber cables capacity is being doubled to 15 Mn fkm per annum with an investment of Rs. 150 Crores in FY16.

Key Management Personnel :

Name & Designation	Brief profile
Mr. Anil Agarwal	Chairman
Dr. Anand Agarwal	Chief Executive Officer
Mr. Anupam Jindal	Chief Financial Officer
Mr. K. S. Rao	Chief Operating Officer

Key Risk:

- Delay in executing initiatives envisaged by government in center may dampen revenue growth.
- Adverse change in competitive scenario by entry of foreign players in domestic market could suppress margins.
- Aggressive pricing or dumping from China could put pressure on realization.
- Currently STL operates at near full utilization. We expect company to come up with expansion plan soon. Any delay in capacity expansion may lead to loss of market share.

Comparison with peers

FY16	CMP (Rs)	M-Cap (Rs Cr)	Revenue (Rs Cr)	EBITDA (Rs Cr)	PAT (Rs Cr)	EBITDAM (%)	PATM (%)	PE (x)	PBV (x)	ROE (%)
STL*	73.85	2,910	2,161	452	151	20.9	7.0	19.3	4.2	21.6
Himachal Futur.	17.70	2,194	2,611	165	126	6.3	4.8	17.4	2.0	11.7
Finolex Cables	359.90	5,721	2,543	352	332	13.8	13.1	17.2	3.5	20.4

*Price and Market Cap adjusted for redeemable preference share of Rs 22.5

Financial Performance

PROFIT & LOSS			(Rs Cr)
Particulars	**FY16**	**FY17E**	**FY18E**
Revenue	2,161	2,689	3,369
Raw material cost	970	1,216	1,533
Employee cost	211	264	333
Other operating expenses	528	661	833
EBITDA	**452**	**548**	**669**
Depreciation	131	148	168
Other Income	13	14	16
EBIT	334	415	516
Interest Expenses	113	102	97
Profit Before Tax	221	313	419
Tax	64	103	138
Minority Interest	6	7	7
PAT	**151**	**203**	**274**

BALANCE SHEET			(Rs Cr)
Particulars	**FY16**	**FY17E**	**FY18E**
Share Capital	79	79	79
Reserves & Surplus	620	762	953
Total Shareholder funds	**699**	**841**	**1,032**
Minority Interest	31	31	31
Non Current Liabilities	**653**	**510**	**394**
Longterm Borrowings	469	300	150
Deferred Tax Liabilities	49	49	49
Other LT Liabilities	107	133	167
LT Provisions	28	28	28
Current Liabilities	**1,258**	**1,565**	**1,961**
Trade Payables	370	461	577
Other Current Liabilities	462	574	720
ST Borrowings	357	445	557
ST Provisions	69	86	107
TOTAL LIABILITIES	**2,640**	**2,947**	**3,418**
Non Current Assets	**1,398**	**1,398**	**1,383**
Net Block	1,318	1,301	1,262
LT Loans and Adv.	74	92	115
Other NC Assets	6	6	6
Current Assets	**1,239**	**1,548**	**2,033**
Inventories	216	268	336
Sundry Debtors	698	869	1,088
Cash and Bank	81	106	228
Other Current Assets	135	169	211
ST Loans and Advances	109	136	170
TOTAL ASSETS	**2,640**	**2,947**	**3,418**

RATIO ANALYSIS			
Particulars	**FY16**	**FY17E**	**FY18E**
General			
EPS	3.83	5.14	6.94
BVPS	17.73	21.34	26.19
ROE	21.6%	24.1%	26.5%
Growth			
Revenue	33.5%	24.4%	25.3%
EBITDA	31.0%	21.3%	22.0%
PAT	26.9%	34.2%	34.9%
Profitability			
EBITDA Margin	20.9%	20.4%	19.9%
EBIT Margin	15.5%	15.4%	15.3%
PAT Margin	7.0%	7.5%	8.1%
Stability			
Debt/Equity	1.2	0.9	0.7
Current Ratio	1.0	1.0	1.0
Interest Coverage	2.9	4.1	5.3

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