Sterlite Technologies Limited Q2 FY23

Earnings Conference Call Transcript

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Pankaj Dhawan: Ladies and gentlemen, good day and welcome to the STL Quarter 2 FY23 Earnings Conference Call. I am Pankaj Dhawan - Head, Investor Relations at STL. To take us through the quarter 2 results and to answer your questions, we have Ankit Agarwal - MD, STL and Lakshmi Iyer - Head, M&A and Corporate Development at STL.

Please note that all participant lines are in the listen-only mode as of now. There will be an opportunity for you to ask questions after the presentation concludes. Please note that this call is being recorded. You can also download a copy of the presentation from our website at www.stl.tech.

Before we proceed with this call, I would like to add that some elements of today's presentation may be forward-looking in nature and hence must be viewed in relation to the risk pertaining to the business. The Safe Harbor clause indicated in the presentation also applies to this conference call.

For opening remarks, I now hand over the call to Ankit Agarwal. Over to you, Ankit.

Ankit Agarwal: Thank you, Pankaj. Good day to everyone. Thank you for joining us for our quarter 2 FY23 Earnings Conference Call. The Telco CAPEX was estimated at close to $330 billion for the period of 12 months ending June 2022. I think this is a very interesting chart which really demonstrates the growing CAPEX intensity of the Telecom operators and I think as you can see on the chart almost at about 17.8% close to 18% is actually the highest in the last 10 years and really I think lot of the demand that was pent up because of lack of deployment during COVID, obviously 5G picking upstream around the world and then also fiber to the home. Combination of multiple factors I think is where we see the CAPEX growing. Also, in our conversations with some of our key customers globally, we continue to see a strong demand scenario from them and we believe quite comfortably that it will continue despite some of the current economic headwinds.

In line with our expectations, strong investment momentum is continuing across these four levers, 5G, fiber-to-the-home, ready fiber-to-the-x, datacenters as well as citizen networks. 5G is becoming clearly the fastest growing technology in the world today. Operators are expected to invest more than $500 billion in 5G between 22 and 2025. One interesting data point is as per Ericsson more than 210 service providers around the world have launched 5G services globally and the number of 5G subscribers are expected to go from a 700 million currently to almost 4.5 billion by 2027. So, massive jump clearly in number of subscribers and really leading the charge in terms of 5G deployments is China which also plans to invest significantly in 5G and fiber and increases 5G pay stations from about 2 million today to almost doubling to over 3.7 million by 2025.

In addition to that, FTTX really is becoming all pervasive and by that you would look at fiber to the home, fiber to the enterprise, fiber to small cell, fiber for smart city applications. Just one example, about $125 billion has been earmarked for fiber to the home just in North America over the next 5 years. If you look at last Telecom operators in the US like AT&T for example, they plan to almost double its fiber coverage to about 30 million locations by 2025. Another example like Frontier-is targeting about 10 million homes and so many other cases like that if it is Telecom, Orange, also operators in India as well as when we look at Australia. Similarly, datacenter deployment is also increasing. The datacenter CAPEX is expected to grow by almost 10% CAGR over the next 5 years to a massive $350 billion by 2026. Again, as an example, Google has announced about $9.5 billion in building office in datacenters just in the US in 2022. Equally, India as well, we are starting to see pretty strong push to datacenter buildout, not only by some of the global players, but also by Indian players like Yota and Adani.

Lastly, on the Citizen Network side, US is implementing close to $65 billion project to connect particularly rural parts of America connecting the unconnected essentially. Similarly, the United Kingdom has program to connect nationwide by 2030 and of course we are familiar with BharatNet in India which is to connect the 6 lakh villages in India over the next 3 years.

So, these are some data points from CRU. As you can see, we have forecasted as per CRU between 2021 and 2024, both in terms of the optical fiber cable demand. Globally, we have also shared what is the CAGR expected across the regions and also very importantly looking at ex-China, the Optical Interconnect demand which is very important area for our growth and development. As you can see in the CRU, the optical cable demand is expected to close to about 606 million fiber kilometers by 2024 which is quite a significant increase from about 500 million in 2021 and equally I think very importantly, the Optical Interconnect market is expected to grow from about $7.5 billion to about $9.8 billion and as we have been sharing as well, cumulatively this creates addressable market for us across cable and interconnect of close to about $20 billion.

So, we all are very proud and very excited with the launch of 5G in India by Honorable Prime Minister at the India Mobile Congress. It was truly incredible movement, I think in the history of our country and we will create a tremendous impact, not just with the Telecom or with the retail user, but I think even more so probably with the enterprises as we start providing these services to large corporations, to airports and also of course the public sector units.

In terms of the operators, we did hear very I would say strong and aggressive announcements particularly by Airtel and Jio as you would know, Bharti Airtel plans to launch across 8 cities immediately and also Jio in four cities and of course they have all laid out their plants. Broadly, Jio looks to cover India by about December 23 and Airtel plans to cover India by about March 24. So, those are I would say very aggressive plans by global standards, but clearly a massive network buildout would need to happen to enable that kind of 5G services and coverage. Our own expectations are that between $1.5 billion and $2.5 billion, we will get invested on fiber buildout. This will be a positive driver both for our cable and interconnect, but equally for our services business and in terms of cable kilometers, probably around 200,000 cable kilometers I expected to be deployed over this period as well.

So, with favorable industry tailwinds, we have deployed a very focused strategy to propel us forward. In the following section, we will talk about in detail what are really our core areas of focus, what is our right to win and also how we look into exit some of our noncore areas. So, essentially, our strategy is fairly simple and is focused on two levers, firstly, we want to grow the optical business. Secondly, we look into consolidate our services business and essentially we are allocating capital to tap into the strategic growth opportunities offered by these two levers and we shall talk about our progress in each of these in detail in the subsequent slides.

If you look at the optical business, particularly optical fiber cable business, you can see from the chart that we are consistently gaining market share. In H1 of FY23, we are very proud that now as an Indian multinational, we have gained 11% share globally if we exclude the China market which was just 5% in FY20. Equally something that we are proud of is that in America, we have now reached 14% market share for H1 FY23 and if you really see, even just a couple of years ago, that was we were almost nonexistent, so it has been a very impressive growth I think in that market and all of this really caters towards our ambition to becoming a world top 3 player in the optical domain and we are very proud of the team that we now build to enable this growth. Also, privy to announce that we have secured multiyear, multimillion dollar contract with a leading North American Broadband connectivity company, our intent is to increase our long-term contracts and order books as we move forward in this direction.

So, in line with what we have been sharing in our previous calls as well, again very proud of this facility, especially the one in the US that has come up now, which will really be a world class optical fiber cable facility and similarly in China, we are actually restarting the operations and we plan to scale these up within this quarter and we do believe that they will reach full capacity utilization by quarter 1 of FY24. Something that is clearly very important and strategic to us is to increase the Optical Interconnect attach rate just for people for whom this might be new, the attach rate is essentially for every dollar of cable that we sell, how many cents or dollars do we sell of the Optical Interconnect. As we have seen currently at FY22, we have got 11%; in H1, even with a growing base on the cable were currently at about 9% and this is on the back of couple of customers that pushed out some of the orders and the revenues to H2 FY23. So, we are confident of these orders coming through and this attach rate growing in the near and medium term.

We are very pleased to announce that we have also done a breakthrough innovation in the optical fiber by developing India's first multicore fiber and cable, developed at STL Center of Excellence in India. We launched this product at India Mobile Congress 2022. Essentially, a simple way to think about this is that the multicore fiber has 4 times the transmission capacity than a normal fiber with essentially the same diameter and other parameters. This is a greenest ever optical fiber which reduces cable surface area by 75% in plastic and the plastic in the ground by around 10%. Apart from this, we earned some very interesting solutions such as the 5G Cosmos as well as the Gram Galaxy Solutions at the India Mobile Congress. The 5G Cosmos is a tower fiberization and small cell solution for 5G networks and Gram Galaxy in India is focused on solutions for rural fiberization. We continue to invest in R&D as of quarter 2 FY20, the number of patents including granted and applied stands at 742.

Coming to the Services business, we are building a profitable order book by picking our projects in our focus segments. Our India business margin is inching up to the targeted range of profitability. Our revenue is also much more sustainable with the increasing share from O&M contracts. As the industry really kicks off its 5G rollout, we expect the revenue to ramp up in the near future. As stated earlier that we had secured a good order book in UK and increasing the execution pace in the UK, we plan to be profitable in the UK services by H1 of FY24.

So, overall, our product execution is on track. Among the India public projects, our BharatNet project in the state of Telangana is 57% complete including all packages and the network modernization project for the Indian PSU is 57% complete. On the India private side, fiber rollout for large Indian Telco is 100% completed for the first phase and 62% completed for the second phase. The third phase is yet to start. In addition, the fiber rollout for the modern optical network for yet another private customer in India is 15% complete and coming to the UK, fiber to the whole rollout in UK for all our projects combined is 4% complete.

In line with our strategy to focus on selective segments, we have now divested the IDS business in Q2 FY23 and sold our stake to Hexatronic Group. IDS operate in a niche segment of inside datacenter connectivity and containment solutions. The initial consideration for 80% stake is about 9 million pounds. The earn out consideration is based on actual EBITDA achieved for the year ending December 2022. We have recognized a gain of Rs. 25 crores over Rs. 117 crores of book value.

As you would recall, we had entered network software business in FY16 through acquisition of Elitecore. We continue to remain a niche player in the business. Moving forward, we are working to pivot from our network software business to digital business. The strategy is in the works and we shall come back to you in quarter 3 with our detail plans. We also want to share with you that we have ramped down the Wireless business with no additional investments in capital and manpower from quarter 4 of FY23. This is in line with what we had been sharing over the last couple of quarters. We envisioned a disruption in the RAN market through open based aggregator and programmable solutions and in that regard, we had developed products and validated it through POC trials. With both of these types, we expect STL operating profit to go up by Rs. 40 to Rs. 50 Cr per quarter from quarter 4 of FY23 onwards.

In terms of capital allocation, our clear priority is investments in the optical business. We are investing in OFC capacity expansion, Optical Interconnect expansion and new product development. We have improved margins and working capital cycle in the optical business. We have ramped down investments in the wireless business and we shall help in improving the cash flow from the operations. We have also continued divest noncore assets. We have just divested IDS in the current year. As you would recall in FY22, we also sold our interest in Metis Eduventures as well as MTCIL.

Our financials continue to improve. We shall discuss this in detail in the current session. Our open order book at the end of quarter 2 FY23 has gone up to Rs. 11,697 crores. In quarter 2, we secured a new order book of close to Rs. 3,200 crores, the highest order intake in the last 3-1/2 years. This is a reflection of strong demand in the industry and the dominant position and focus particularly in the optical business. We have also shortly closed an order book of Rs. 941 crores majorly in services and wireless business. This is completely in line with our focus of executing projects at desired level of profitability. The orders were closed after discussion agreement with the respective customers. Our order book is well diversified across customer segments and across our businesses. We also have a significant O&M order book which is already yielding revenue from this year.

Our revenue mix is shifting to customer segments and geographies of our choice. We are increasing our share in Telco and Cloud segment in particular. In terms of geography, it is very visible that we are now increasing our share in the North America and European markets. What is heartening to note is that in line with our study in the last 3 years, we have increased our revenue share of STL in the North America market, the most premium market in the world from almost being negligible to almost 33% currently. Again, this is a reflection of our product innovation and a reward the significant R&D over the years.

In terms of notable wins in the quarter, apart from the multimillion dollar contract of cables in North America and for Optical Interconnect in Europe, we have also secured multiple other new orders. In the European market, we have secured new orders for the Optical Interconnect solutions from an alternate player. We are very pleased to announce that we are collaborating with Vocus Group in Australia to provide optical fiber cables. On the services side, we continue to win orders from long distance rollout from a leading Telecom operator in India. We have also secured new orders for fiber rollout from another leading Indian Telecom operator.

In line with our estimates, quarterly revenue grew 12% quarter-on-quarter to Rs. 1,768 crores. EBITDA went up by 70% quarter-on-quarter to Rs. 202 crores. I would like to note that this includes a Rs. 25 crores gain which is the IDS stake sale. The revenue growth was driven by strong growth in the optical business. We also grew in the services business in our focus segments. Margin improvement is mostly on the back of improvements in margins in the optical business. In terms of net profit, we delivered Rs. 44 crores for quarter 2 FY23.

In order to increase transparency and really by popular demand, we have started to report segmental financials. Starting with our optical business, we have delivered revenue of Rs. 1,313 crores which is 15% higher quarter-on-quarter. This is due to an increase both in volume as well as realization. The OFC realization has gone up due to the price increase and better product mix in favor of the North American market. We delivered EBITDA of 20% for quarter 2 FY23, one quarter before that was promised. Key drivers for margin improvement for product mix shift to higher margin products, price increase flowing through and some reduction in logistics cost.

In terms of capacity utilization, the OFC or cable was at 88% utilization based on production volume and capacity of about 37 million fiber kilometers. In global services, we delivered revenue of Rs. 463 crores which is 11% higher quarter-on-quarter. This is due to the increase in execution of our projects in India. The India business is inching towards desired profitability. Loses in the UK has lowered the overall segment profitability. As we have said earlier that we are working to ramp up UK revenue to be profitable by first half of FY24. We also expect the India business to increase revenue quarter-on-quarter due to 5G rollout in the upcoming quarters.

Coming to the digital and technology solutions, revenue was flat around Rs. 40 crores, the combined operating loss for this segment was Rs. 102 crores for quarter 2 FY23. The loses have gone up in quarter-on-quarter due to higher initial manpower cost in the digital business. We expect operating profit to improve by Rs. 40 to Rs. 50 crores in quarter 4 of FY23 in this segment. We have already spoken about ramp down of all investments in capital manpower in the wireless business from quarter 4 onwards. Also, as we pivot from network software to digital business, we aim to be profitable in FY24.

In terms of cash flow, as you can see the net debt has gone up by about Rs. 457 crores mostly due to increase in contract assets of ongoing projects in the services business. The cash generated from operations and net investment inflow helped in payment of CAPEX and dividends. Optical business has funded its growth itself by improving margins and working capital days. As we move forward, we shall work to release cash from working capital, particularly from services. With the completion of large existing public projects like T-Fiber and collection of completed projects coming through, this can be achieved. Our target is to reduce net debt to EBITDA by quarter 4 of FY23. Also, as we ramp up in the US and China production, we don't see any significant debt increase from these levels. In terms of credit rating, we have a stable credit rating at AA.

We have placed an abridged version of our quarterly reported numbers for your pursue. STL's endeavor to be a responsible leader in ensuring a connected inclusive world, this focus reflects in the way we have designed and implemented our ESG agenda. We have diverted more than 175,000 metric ton waste away from landfills in FY19 to FY22. I am also proud that we have reduced emissions of 15,000 tons of carbon dioxide equivalent to various initiatives in the plant from FY21 to quarter 2 FY23. We have also announced the commitment to become carbon neutral company by 2030. I think we will be one of the first in the industry to achieve this. We have recycled 5,000,000 metric cube of water from FY19 quarter to FY23. We are also very happy to announce that we have become the world's first optical fiber manufacturer to be zero liquid discharge certified. Through our various initiatives in education in women empowerment, over 765,000 lives have been positively impacted from FY19 to quarter 2 FY23. We have also positively impacted 2.1 million lives through our various initiatives on healthcare from FY19 to quarter 2 FY23. For our work, we have won 80 ESG awards from FY20 to quarter 2 FY23.

So, in summary, I would like to say that we see a multiyear network build cycle which is in full swing, especially in our focus markets of North America, Europe and India. Our global OFC volume is also expected to grow sustainably. We are aiming for global leadership in the optical business. We continue to gain strong market share in North America and Europe, increase our attach rate in optical interconnect and develop industry leading new products and solutions.

We are focusing on strategic segments in the service business. We are working to build profitable order book in India and ramping up execution in the UK. In terms of capital allocation, we are allocating capital to the optical business and actioning to release capital from the services business. Simultaneously, as we shared, we are divesting from noncore businesses.

With this, we come to the end of our opening commentary and we shall now move to Q&A.

Pankaj Dhawan: Thanks Ankit. Ladies and gentlemen, please note that if you want to ask the question, you can click on Raise Hand and we shall take your questions one by one. Alternatively, you can send us your questions through Chat also. So, we will take the first question from the line of Mr. Pranav Kshatriya. Pranav, you can go ahead and ask your question, please.

Pranav Kshatriya: I have three questions, my first question is regarding the cost, the optical fiber business has been sort of hit by cost inflation especially the helium gas prices and the oil related prices, so can you please give some color on how those cost are trending, I understand that logistics cost have sort of come down, but what about the other raw material prices, that is my first question? Secondly, on the macroeconomic environment if you look at, we are seeing the interest rate raising, typically fiber optic is the product which has a very long period uses and to that extent it is reasonably sensitive to interest rate, so how do you see this panning out because even some of the customers which you mentioned, for example, Google is also sort of looking to cut cost and so lot of other tech giants, so how do you see this in the medium to long-term impacting the optical fiber business? And my last question is on the ramp down of the wireless business, so it is good to know that it will save around Rs. 40 to Rs. 50 crores, but if you can just elaborate what exactly is the reason behind taking this step because I remember you being fairly optimistic on expanding the addressable market and basically addressing the wider need of the Telco, so just wanted to understand that?

Ankit Agarwal: Absolutely, good questions, Pranav. So, I think first question on the cost inflation, I think you are right, we continue to still see cost pressures particularly with some gases like helium, there are still challenges with supply chain on that globally. We worked a lot on creating alternate suppliers, etc., that is still a cost increase for us and supply chain risk for us. The other one is still polyethylene and etc., which are linked to the oil prices that is still something that continues to stay high and impacts our cost. Logistics have come down probably in the range of 15 to 20%, say over some period of time now. That is something that has benefited us and will continue to benefit us as we continue to shift from say India to Europe and US and other parts. I think the path has been positive for us is that we have been able to pass on some of the cost increases to customers in quarter 2 and we will continue to see some of that further come through in quarter 3 and quarter 4 and that you would have seen also then linked to our EBITDA for this optical business now where we have been able to showcase 20% EBITDA. We are quite happy with that we have been able to pull that off, probably about a quarter earlier that what we had earlier communicated.

In terms of macroeconomics, I think I touched a little bit on that through my presentation. I think what has been interesting in our conversations with the customers is that they really see fiber as a very central and core to their strategy if you look at some of the comments of operators like AT&T, Verizon, operators in Europe, China, across the board and even really in India. You really see that the CAPEX investment simply has to continue or even grow to have a meaningful 5G experience for the customers. On top of that, most of the operators are doubling down in terms of fiber to the home network buildout. We share the example of AT&T and others. Where we are seeing is that they are looking at other means to probably reduce the CAPEX and so there is really a doubling down of fiber that we are seeing and probably various operators having other plans on how to reduce some investments on other parts of the network.

To your third question, in terms of ramp down of the wireless business, I think there are two parts to it, one I think at a very fundamental level what we have been sharing is that we really want to focus the company into few areas and become world class at that. So, we clearly see an opportunity here given what I had just shared on global demand for fiber. That itself is a $20 billion opportunity and where we are hardly $500, $600 million, so there is a huge opportunity for us to grow there and also take a world top three position which is what we have stated. I think that is one really at the core of it. The second part is I think probably from where we started out, we had certain assumptions that we had also shared of where we believe some of the wireless solutions particularly on open RAN and how that uptake will happen. Probably, what we are seeing is that that is getting pushed out to some extent and we felt that even the capital allocation we want to do between our core optical versus other places, we felt it is probably better to reduce these costs for STL, find an alternate partner for this business and bring our focus back to the core.

Pankaj Dhawan: Thanks, Pranav. We will take the next question from the line of Mukul Garg. Mukul, you can ask your question now.

Mukul Garg: I just wanted to focus a bit on the North American market, you guys have grown quite predominantly there, your revenue this quarter is equal to what you generated there in the full of FY22, how should we see the growth in the market, was there something which kind of scaled up revenue this quarter and is not sustainable or do you expect the North American market to continue to scale up and be your largest market in a few quarters and the associated things here is how to look at the profitability of this market, the prices are usually a bit higher, but at the same time, you need to do transportation of preform and everything while your factory is coming on board, how should we see the respective profitability of the North American versus your optical business profitability?

Ankit Agarwal: Yes, good questions, Mukul, so couple of things, I think we are obviously quite excited about our growth in the North America market. It is probably one of the fastest growing market globally both for cables as well as interconnect, so there has been a real strategy for us, it has not happened overnight. We have been focusing on R&D and product development probably over the last 3 to 4 years and been in continuous communication with our potential customers in that region at that time. We have really worked a lot on the product development, ensured that we are not just one more supplier in the market, but really creating pretty innovative solutions for the market there, both on the cable and we believe over the next few quarters on the interconnect as well where we should start seeing some success. So, that is our view of the market. We continue to see strong interest from tier-1, tier-2 telecom operators and in line with our overall global key account strategy, we are also focusing on certain large accounts, one of them we were able to conclude in North America and we shared that which is a multiyear contract. Similarly, with other customers in the US, we are working towards multiyear contracts and that part of our strategy also has been then to further cement our presence in the market and continue to be there for long term. We have also invested in the factory there. It is really a world class factory for the cable as well as some R&D that we will do there and again the whole intent is not just to supply out of a brochure but work in a very collaborative way with our customers there, build solutions for them locally and then be able to supply them. One correction I would like to make Mukul is that we will not be supplying preforms to that market because it is a cable factory, so we will actually be making the fiber in India or China and then making sure that we supply the fiber to the US cable factory which is of course very easy to transport and fairly low cost and really from the profitability of the market, definitely it is a good market, it is a strong market, but again I would reiterate that the key lies in creating those solutions and innovative products rather than something that is standard and as long as you can keep doing that for a selected group of focused customers, we believe that the nature of the market is that you can enjoy long-term relationships.

Mukul Garg: And the other question was on the investment ramp down which you are doing, how much of the revenue impact this wireless ramp down will have for you and are there any other areas where you are looking to optimize to kind of refocus on relatively higher profitable businesses?

Ankit Agarwal: Yes, absolutely, Mukul, good question, I think currently wireless for us was largely, I would say, on R&D mode, so that is where we were incurring the losses that we add on the P&L. So, by and large there will be practically no impact on the top-line. In terms of other areas, I would break it into two parts, one is services as we have said structurally we are looking to focus on few projects which had the right margins, both in India and the UK. So, that is the structural part that you continue quarter-on-quarter and then I think the second part is what we shared, we have a telecom software business. So, that we are looking at how do we pivot that towards digital and give us probably a quarter, we will share more update on that.

Mukul Garg: Just one again clarification, on the path to kind of profitability which you used to enjoy earlier, just far away from that with about 8% EBITDA margin this quarter, how do you see the path moving back to that 17 to 20% type of an EBITDA margin and is that something which will take a few years or is that something which is in sight?

Ankit Agarwal: I will answer it in slightly differently, one is, I think one part, we should recognize is that we have largely been in the range of about Rs. 5,000 crores topline for the last 3 years, now we are seeing a meaningful shift towards Rs. 7,000-Rs. 7,200 crores range that we have been sharing for this year, so I think that itself is one good shift that we are finally making and then at the same time we are very consciously exiting or ramping down noncore businesses which would further help the bottom-line. So, I think both of those are something that we are confident off and then particularly I would say very strong focus on the optical business where we really believe we have the right to win and we see strong market growth. So, that is something that we are really clear that we will scale up. As you are aware, we are already scaling up our cable capacity going from 33 million to 42 million cable and we have also talked about our OI attach rate which we are targeting to go towards 40% by FY25. So, these are probably some metrics that I can share, we are not really guiding in terms of 2 to 3 years out, but we are very clear in which areas we will invest, which areas we will grow and I think one overarching theme will be we will continue to invest in R&D, but that will be focused largely on the optical part.

Mukul Garg: Best of luck for the rest of the year.

Ankit Agarwal: Thanks Mukul.

Pankaj Dhawan: We take the next question from the line of Sunny Gosar. Sunny, you can go ahead and ask your question.

Sunny Gosar: I have multiple questions, so first being on the margin, so on the optical segments your margins have come back to about 20% in the quarter, so what is the outlook here in terms of is this the peak that you have achieved or there is still further scope to improve margins here on in terms of price hike, operating leverage and how should we look at that for the coming quarter?

Ankit Agarwal: I guess we will just answer them one by one. So, I think broadly what we feel is that there are 2-3 levers here, one is absolute volume itself that we are sharing, we are adding the capacities, US factory coming up, China factory scaling up, so as all of these happened, I think one, of course in short term there might be some scale up or say startup cost, but beyond that as these start operating that will give you at the very least, the volume gain. On top of that what we are really looking at is rather than just increasing more and more volume overtime, we are looking at increasing our Optical Interconnect attach rate and that we have shared historically also is the better margin profile than the cable. So, I think we will not be able to guide where we will end up at, but really as we are able to execute on this Optical Interconnect attach rate growing that will lead to improvement in margins.

Sunny Gosar: Sir, if I can read what you are saying correctly, the near term this could be the range in terms of 20% margins, but as your optical attach rate increases and both your US and China facilities improve utilization to higher levels, we could see margins trending upwards, say over the next few, like beyond 3-4 quarters?

Ankit Agarwal: Yes, I would say, yes, the bigger trigger for the margin will really be the optical interconnect, right because we are already selling a good portion of cable today. So, that is how I would split what you have said.

Sunny Gosar: In terms of the China factory, if you can help us understand like what is the status there and how much utilization are we operating at and what is the scope to take the utilization up at that plant?

Ankit Agarwal: So, ballpark, I will just give you some context, it is a facility where we had 10-year joint venture with Tongguang, this is in Heiman and basically at the end of 10 years, that period actually coincided with COVID and shut down and other challenges during that period, but we also used that period to renegotiate with the JV partner to buy the 25% balance, so now it is a 100% owned entity of STL with fiber draw operations, so essentially the glass gets manufactured in India, we draw the fiber in China and then we use that for our global cable operations. So, that is something that has just kicked off because we have to get certain permissions and close some elements of this transaction. So, that is I would say in early stage, we largely believe the capacities will come on stream or full stream between quarter 1 and quarter 2 of next year.

Sunny Gosar: And how much is the withdrawing capacity in China?

Ankit Agarwal: We don't typically give a breakup, but out of say about 50 million that would contribute to about say 7 to 9 million.

Sunny Gosar: My next question is on the wireless segment, so the company in the last 2 years would have invested Rs. 200 crores in terms of R&D and IP generation, so although we going forward have decided to scale this down in terms of further investment, but there would be some value of the IP and whatever work has already gone into it, so what is the thought process or strategy in terms of monetizing that and does this mean that wireless becomes completely defocused or we look for alternative strategies there?

Ankit Agarwal: Good question, so I would say that yes, definitely we have invested significant amount, we actually built a fantastic team, we also launched, I think between 8 to 9 products that were available, so I think there has been a good momentum, there has been some good IP that we have also already been awarded or has been filed, that is something that we are very mindful of. The way we are looking at it is that clearly as we have decided is noncore, we are looking at ramping it down. We are also looking at discussions with partners whether members of which parts of the business may be useful to other players in the industry, so those are the conversations that are going on. We will probably update you in about a quarter's time. Either way, what we are clear is, from an impact to P&L, we will not have these loses in Q4.

Sunny Gosar: But basically there is potential to monetize this IP in some form, whether through a strategic partner or some other way?

Ankit Agarwal: Yes, putting it very simply, there are other players who continue to be focused on and scaling up say on the open RAN space or broadly on the wireless space and those are the players we are in conversations with and I think it is a bit early to say if how much value could be ascribed to the IP that is probably what we will be able to share with you in a quarter's time.

Sunny Gosar: And if I may, I have one last question, so basically in the last few quarters, you have sold some smaller businesses including IDS, so are there any similar identified pieces of business which would be noncore and there is further potential to monetize any of those businesses?

Ankit Agarwal: Yes, so broadly, I think we are sticking to what we have shared in terms of what is core and what is noncore, right, so at a very macro level, we have talked about optical being the main driver in the core, we have talked about services business where we have focused on certain markets and certain profitability and then we have talked about this conversion from the network software business to digital, so I would say these are the three that our team and management bandwidth is going. Everything else that is in the company is what we have described in noncore. So, I would say the wireless is where some of our work is there for the current quarter, but apart from that there would be maybe very small items that we would continue to look at, but nothing there would be as meaningful as probably IDS was of that size.

Pankaj Dhawan: Thanks Sunny. We take the next question from the line of Prateek Singhania. Prateek, you can ask your question.

Prateek Singhania: So, firstly, what would be the breakup between the margins in the cable business versus the interconnect business of this blended margin of 20%?

Ankit Agarwal: Prateek, there was some noise, but we understand it correctly, you are trying to understand what is the cable margins and the optical interconnect margins, is that correct?

Prateek Singhania: Correct.

Ankit Agarwal: Prateek, we don't typically break it out for competitive reasons, but at a macro level, we have largely given our say 90:10 ratio on cable OI right now. Largely, you can take that guidance of about 20% margins on the cable, but the Interconnect is higher than that and that is where we are focusing on growing that part. Basically, the point was to determine that how much has been the improvement in terms of the fiber cable business for us in this quarter.

Prateek Singhania: So, basically I was trying to ask that where did the margin improvement come from in this quarter versus the previous quarter in the optical business?

Ankit Agarwal: So, that largely came from both volume increase as well as price increases largely linked to the cable as well as some amount of product mix improvement on the cable. So, good portion of what you are asking is, large portion of it has come from the cable part.

Prateek Singhania: And in terms of attach rate, we just wanted to understand that when we say attach rate, so if you are selling say fiber cable worth $100 million, in that scenario if you are talking about 10% attach rate, that means you are talking about $10 million worth of sales in Optical Interconnect?

Ankit Agarwal: That is right.

Prateek Singhania: So, based on the guidance like if 40% is the attach rate, then we would be talking about almost $800 million worth of sales in the product business for FY25, fair to assume that?

Ankit Agarwal: When you say product business, you are saying the optical business as a whole?

Prateek Singhania: Yes, the fiber, cable plus interconnect?

Ankit Agarwal: I think the way to look at Prateek is that we have not given any guidance in terms of revenue of the segment, so one is obviously as the cable capacity comes up, the revenues would grow to the full utilization of that and every quarter we will update you on as the Optical Interconnect attach rate is growing as you would see in the last 2-3 years it has already grown from 3% to now close to 9% and the idea is that can we take it up to 40%.

Prateek Singhania: Can you throw some light on how do you plan to increase this attach rate from 10% to 40% in like 10 quarters?

Ankit Agarwal: So, basically I think there are two parts to it. One is, we have had a successful acquisition and capability built through Optotec, which we had acquired in Italy. That has actually served as a very strong platform in terms of the product portfolio they have, particularly for the Europe market. In addition to that, we have started building out the product portfolio particularly again now for US as well as Australia kind of markets and Middle East, so I think where we are at is that given we had a very small share of global market which is say, close to $8 to $10 billion, there is a tremendous opportunity where the value lies as two parts. If you see we already have great relationship with Telecom operators globally, but probably only selling cable today. So, part of where we are, we see positive momentum is going back to the customers and being able to sell OI to them where the real value lies or say the key to the success will be to ensure that for these customers we are able to create some unique solution for them and able to create value to them compared to the incumbents that they are buying from. That is something in terms of design capability and knowledge, we have been able to bring on board through Optotech as well as now build a pretty strong base in India as well. So, this gives me the confidence on top of our conversation with the existing customers that we will be able to scale this up both in Europe as well as in US.

Prateek Singhania: And in terms of the wireless business, after ramping down like what kind of quarterly loses would be there after like reducing this by Rs. 40 to Rs. 50 crores?

Lakshmi Iyer: Sorry, you are talking about the quarterly losses that because of the wireless business got improvement this year or what further loses will continue?

Prateek Singhania: Yes, what further loses that will continue the business?

Lakshmi Iyer: So, that would be minimal, just to answer your question because significantly the other businesses will ramp up, so this would be like not more than Rs. 20-Rs. 30 crores, it may be cutting down all of the losses.

Prateek Singhania: So, is there anything which is lying in the balance sheet which would require any write-off from our end with respect to this business?

Lakshmi Iyer: Only on the wireless you are talking about?

Prateek Singhania: Yes.

Lakshmi Iyer: To the extent, we have been doing that on a quarter-on-quarter basis, but that we keep evaluating, but nothing significant because we are also looking at in terms of as Ankit was explaining in terms of how do we monetize the IP, so that is something that we are evaluating.

Ankit Agarwal: And one also part, we have also shared that, we have written-off close to Rs. 950 crores in our order book and some part of that was also some orders on the wireless side. So, we have been able to discuss with the customers and close those out simultaneously.

Prateek Singhania: Thank you so much Ankit, really pleasure to see such a good disclosure on the investor presentation this time around, thank you so much.

Ankit Agarwal: Yes, thanks to all your inputs.

Pankaj Dhawan: Thanks Prateek. So, Ankit, we will take some questions from the Chat which has come. So, Neerav wants to understand that our working capital continues to increase despite a decline in India business and so he wants to understand going forward, does this mean that the working capital requirements will go up versus historical levels?

Ankit Agarwal: So, I think the one part to remember is that especially coming to the services business, the T-Fiber project which we have been sharing that is really at its peak and as we continue to execute on that really the working capital requirements will come down and cash will get released. Also, there is certain amount of projects that we shared have been completed. So, again as we are able to successfully get the collection on those projects that will also lead to an improvement in the working capital. Currently, we have about 270 days of networking capital in the services which we want to bring down to around 180 days. So, that is something that we are very focused on. Again, probably, in another quarter, 4 to 5 months from now, we should be able to get some of these developments to showcase.

Pankaj Dhawan: Thanks Ankit. The second question is that CAPEX for the first half was Rs. 247 crores, can you give us the CAPEX for the rest of the year?

Ankit Agarwal: So, that is actually quite in line with what we have been sharing, for the year we have talked about Rs. 500 crores CAPEX where about half of that right now, so that still continues our visibility on the Rs. 500 crores. Again, the key part is that it is very much focused on the optical part, largely scaling up our cable and we are able to some smaller extent, the interconnect.

Pankaj Dhawan: Thank you so much. I think Darshil Jhaveri wants to understand what is the sustainable EBITDA margin that the company can expect and are we doing any more divestments that we are planning going forward?

Ankit Agarwal: I think we touched on it. Really, I think one is the optical today as we shall be quite proud to have reached probably industry leading 20% EBITDA. That is something that as we continue to grow on the interconnect in particular from a percentage basis, that should improve, but that will take few quarters and then really on the services part, we are really at 7%-8% EBITDA margin that we are very clear has to move towards the 10% to 12% range with the kind of projects we are now taking and the ratio that we have broadly add is about 70% of revenue coming from the optical and 30% services, so as we improve profitability of these business units in particular that should improve the overall EBITDA margin.

Pankaj Dhawan: Thanks. Pritesh wants to understand the pricing trend in fiber and cable as we move forward?

Ankit Agarwal: One, I think just to reiterate a big part of the STL strategy has been very consciously to move away from sale of commoditized fiber or bare fiber, the more and more cable and interconnect solutions and that is something that we have really moved very aggressively on. Even a few years ago, we would have probably been 50% of our sales was bare fiber, 50% was cable, now almost 90% plus of our fiber that we manufacture is supplied to our own cable units which then provide unique solutions to our customers as well as the interconnect which is almost always we spoke for our Telecom operators along with our cable. So, to that extent, I truly believe on the back of all of these, back of our key account engagement and increasing customer signing long-term contracts with us were probably less acceptable than before to ups and downs of the bare fiber market and particular dependence on say China and those factors. So, having said that the market continues to be stable and obviously with the demand growing particularly in US and in some pockets in Europe we continue to see stable fiber prices. On China itself, the demand continues to be strong, we are expecting some tender results from China Mobile where the general consensus is the demand should actually increase. So, that is something that we are watching, but we do continue to see, at least in the short term, the prices continue to be stable.

Pankaj Dhawan: Thanks Ankit. We will take the last question from the line of Saket Kapoor. Saket, you can ask your question now.

Saket Kapoor: Sir, if you could explain the reason for increase in the employee cost, on a Q-o-Q basis also and on a yearly basis also that has gone up from 204 crores to 292 crores?

Ankit Agarwal: I think one of the critical parts has been actually the employees that we have added as part of our network services business as well as over last few quarters on the wireless business, so as you can imagine these are largely software centric kind of businesses where people is the majority cost and having said that we are very conscious that at least some of these businesses will not be core for us going forward, so we do expect these cost should start coming down as well as wherever we see some of these businesses like I spoke of network business that we will re-pivot to digital business. So, very conscious of our employee cost having increased and we are also now taking active steps to make sure that employee cost as a percentage of revenue and also relative to our profitability comes in better control.

Saket Kapoor: Sir, looking forward, what it should be? And today's percentage it is significantly higher, so what are we looking forward, when we have taken recruitment for new employees and taken the cost which is significantly higher, what is the percentage you are looking going forward and then I could forward my next question?

Ankit Agarwal: Directionally, today we are at about 15 to 16% of our employee cost as percentage of revenue and one way to look at it is if you are pure play manufacturing and probably the global benchmark is somewhere 9% to 10% and if you look at services business, we would have a slightly different ratio, so I think if we largely focus on the businesses that will remain as core for STL, certainly it should come down from 16%, I won't be able to give a specific number right now, but give us probably another quarter, we are working actively to improve this percentage.

Saket Kapoor: And sir, can you put forward a number, how much CAPEX we have done for China and USA since the capacity will be operational and we will start contributing and what should be there likelihood contribution revenue when they will work at optimum level?

Ankit Agarwal: Maybe, let us share the CAPEX part, what we have spent on the JV acquisition.

Lakshmi Iyer: So, essentially just to clarify, right now in terms of the China JV operations that we started operations and just the initial operating cost what we spent mainly on the China was in terms of the acquisition cost of the 25% share that we got from the JV partner. So, that is now close to around Rs. 79 crores is what we have spent.

Saket Kapoor: I was looking for the total figure?

Lakshmi Iyer: So, that is what I am saying, so Rs. 79 crores with the balance 25% and there is very minimal operating cost, so as we are ramping as Ankit was saying we have been at better position, so we have just started operations in the China factory and as we ramp up operations we are doing the first by the end of November, we will get some kind of data in terms of what further cost that we need to incur to reach that desired level of production.

Ankit Agarwal: And US also.

Lakshmi Iyer: And also just to add the US essentially is around Rs. 60 crores is what you get now considered for the US plant because these were also some of the cost that you were seeing in terms of CAPEX, US will come more in terms of as we go into H2, but what you see in some of the expansions that we have already undertaken, that is the cost that you are reflecting or you are seeing in terms of the CAPEX that we have so far disclosed in terms of H1.

Pankaj Dhawan: Saket, due to paucity of time, we may have to end it here. We can connect offline and will answer your queries.

Saket Kapoor: Sir, the last question is, you gave us an understanding that post the first half, you would be guiding us how the second H2 would be looking like in terms of our revenue guidance and how likely the business going to shape up, so just to conclude sir, is the worst over for organization in terms of the lead that we have gone through and now it is only we will be building on what we have reported for this quarter, so what should we expect for H2 in terms of revenue and profitability?

Ankit Agarwal: Firstly, I would say Saket there is no grief, there is only learning and there is experience. So, I think in any business, you have to take calculated risk and I think there has been lot of learnings for us. I think what we have stated stays very much on the same. We are guiding towards the

Rs. 7,000-Rs. 7,200 crore revenue for the year. I think we are quite confident of reaching those levels. We have talked about our focus on the optical business in terms of investments and profitability. That we are confident that we have already demonstrated in Q2 itself about the 20% margin and as we said as we continue to grow in the coming quarters on the optical interconnect, we will see how to improve the margins. Services as well we are really focusing on a few profitable projects as well as whatever projects we have completed to ensure we do the cash collection. So, this is what I can guide for H2, very focus, lot of learnings, wherever things are noncore, we are exiting that, bringing the cash and to that extent we look to reduce the debt.

Pankaj Dhawan: Thanks Saket. With this, we come to an end of Q&A session and I now hand it over back to Ankit Agarwal for closing remarks.

Ankit Agarwal: So, I would like to thank everyone for attending this call and for showing interest in our company and I hope we were able to address and clarify all your queries and comments. For any further questions and discussions, please feel free to contact the Investor Relations team which includes myself. We really look forward to continue the conversation with you in the future. Thank you.

Pankaj Dhawan: Thanks Ankit. Thank you everyone.