"Sterlite Technology Limited
Q2 FY20 Earning Conference Call"

October 24, 2019

MANAGEMENT: **DR. ANAND AGARWAL - CEO, STERLITE TECHNOLOGIES LIMITED**
MR. ANUPAM JINDAL – CFO, STERLITE TECHNOLOGIES LIMITED
MR. VISHAL AGGARWAL – HEAD (INVESTOR RELATIONS), STERLITE TECHNOLOGIES LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the Sterlite Technology Limited Q2 FY20 earning conference call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal the operator by pressing * then 0 on your touchtone telephone. Please note that this conference is being recorded.

I would now like to hand the conference over to Mr. Vishal Aggarwal, Head M&A and Investor Relations, Sterlite Technologies. Thank you and over to you, Vishal.

Vishal Aggarwal: Good evening, everyone, and thank you for taking the time to join us today for this conference call and review of our business results for the second quarter of FY '20. Joining us today are Dr. Anand Agarwal, CEO; and Anupam Jindal, CFO of STL.

Let me quickly outline the agenda for today's call. Anand and Anupam will give a brief overview of the company's business performance for the first half of the year and our yearly outlook, followed by a Q&A session.

We have uploaded the presentation on our website for those who cannot access it live. Before we proceed with this call, I would like to add that some elements of this presentation may be forward-looking in nature and must be viewed in relation to the risks pertaining to our business. The safe harbor clause indicated in our presentation also applies to this conference call. With that, I will turn the call over to Anand.

Anand Agarwal: Thank you, Vishal, and good evening, everyone, and thank you for joining us for our Q2 results.

Slide 4:

Our Q2 results have marked a strong end to a great first half of the year, and we have delivered significant innovation across the entire portfolio. Our teams have executed well through an extremely dynamic environment. We have made an entry into the inside data center space through the IDS acquisition, which we did brief you about a month ago. And we are now focusing our resources and investments into being 5G ready. I will touch upon all of these parameters as we progress with the presentation.

Slide 5:

So our technology is getting fundamentally aligned to the redefined data architectures and to help our customers manage the complexities of the future through our integrated solutions approach. Let me cover some recent highlights across our portfolio. I will start with the programmable network. So Intellza, which is an AI-powered, big data, next-gen business intelligence solution helps analyze teleco user data to make real-time network and customer targeting decisions. Then is PODS, which is programmable, open, disaggregated software that we have. So these networks have been built by static, large vertically integrated boxes with monolithic codes and proprietary interfaces. These have been expensive to procure, maintain and they haven't allowed too much flexibility to launch new services quickly using automation, open and software principles. This aspect of the network, PODS, resolves this by providing specific solutions to different business needs. PODS is Programmable, Open, Disaggregated Solutions developed through a combined network of open community STL own IP and collaboration of global partners.

On the Network Services side, we had 3 launches, Lead 360 degree 2.0, FTTx Mantra and iCore. These culminated into an end-to-end solution that empowers the ESPs to swiftly roll out data networks at massive scale, near-zero response time, great agility as well as and at optimized costs.

Coming to the connectivity solutions, we launched cutting-edge products such as Tru Ribbon and Stellar Fibre. Stellar is one of a kind in the current industry to have a bend insensitive fiber design that has the mode field diameter of the size of a legacy fiber. This feature enables service compatibility with existing networks, which are provisioned with the legacy fiber while bringing in the next-gen advantages of macro bend insensitivity, which makes Stellar Fibre an ideal choice for an existing network's capacity enhancement or new network provisioning for Metro as well as Long Haul or Fibre to the X (FTTx) application.

Slide 6:

With this, I come to the inroads that we have made into the new customers and geographies. We continue to see strong inroads across the majority of our portfolio. As compared to the previous quarter, we have added 26 new customers organically, due to new inorganically through ideas and entered 2 new countries through our connectivity products. The geographic mix for this quarter has been largely similar to Q1 with international customers accounting for close to 40% of our revenues.

Slide 7:

Just sort of recalling the IDS acquisition wherein we did this acquisition to acquire new capabilities. We had spoken to you about the IDS acquisition in our last call but as I recap, IDS is a great capability addition to our “inside” data services with access to global hyperscale cloud customers. The integration is progressing very well, and we are starting to see synergy opportunities, which will unfold in the coming few quarters.

Slide 8:

We also are very excited, and we take pride on seeing our R&D investment and patent count rise every quarter. I'm extremely proud of what our teams have developed and innovated and continue to focus extensively on our preparedness towards 5G for next-gen technology solutions to drive greater impact and success. In that direction, we have accelerated our investments in R&D in second half of this year towards investment in new solutions offering on programmable network as well as passive connectivity products.

Slide 9:

And this has resulted in tangible outcomes. We are seeing increased customer traction and have added almost 7,000 crore of additional sales funnel at the end of H1 of FY '20. We are attracting global best-in-class industry experts, which are highlighted here. And it is our constant endeavor to continue to provide growth platform and opportunities for our employees, which is recognized through multiple industry recognitions.

Slide 11:

Now, talking about the state of the industry and the outlook for the next half as well as beyond that. So far, what we see is our teams have executed well despite the volatility and dynamic business environment that most of you are aware of. What is now clearly coming out looking at global telco CAPEX trend is that 2019 seems to be a sort of year where most telcos are taking a pause in terms of an investment point of view. I think it is more of a deferment and time delay in capex investments driven by some macro trends like asset sharing as well as 4G to 5G transition that we are witnessing in the current year. We have had multiple customer interactions through tech parks or summit across India, Europe, Asia in the last quarter, and believe that while there is some cautiousness about the economy and geopolitical developments, which is leading to the telcos delaying their macro CAPEX investments by a few quarters. At the same time, these discussions also reinforce our belief that the structural demand drivers for our industry remain intact and we see the telco CAPEX growing from a long-term perspective, as they start their 5G investment cycle.

Slide 12:

Coming specifically to the optical fiber demand, it is estimated that the global consumption of fiber will be muted as compared to last year. The dip is largely on account of China slowing down after a massive 4G build out but we are seeing signs of revival in China, evidenced by the China telecom tender. Coming to India, we are seeing signs of slowing demand on account of Jio spending pause and other incumbents deferring their CAPEX investment. India forms a significant part of our business, and hence we expect it to impact our business in the coming time. On the positive side, we are seeing Europe growth continuing, which after India has been our strongest geography.

Slide 13:

While as a Company we do not provide any yearly guidance or estimates, but I would like to apprise you of the potential impact of the above-mentioned trends. As per our current visibility, we expect flattish volumes for fiber is stable, coupled with lower than expected network creation for Indian telecos will impact the H2 FY '20 against our own initial plan. A large part of it is attributed to low order booking in our last quarter and evident signs of our customers delaying pickup of further existing order book. We also expect some pricing pressures on contract renegotiations for 2020 because of short-term oversupply situation, which has been created in the industry to address the expected 5G demand. Taking both these factors into consideration, on a conservative basis, we see lower growth in revenues in FY '20 as compared to FY '19. And we see, as a result, H2 profitability would be weaker than H1. And this would also include the impact of the additional 5G-related R&D investment in H2 of the current year, which are over and above our original plan.

Slide 14:

As I look ahead though, I cannot be more confident about our unique position in the market and the tremendous opportunity in front of us. With new age networks characterized by both densification, deep fiberization, vendor neutral as well as disaggregation and with compute and storage moving closer and closer to the edge, we continue to have the most compelling portfolio and a very-very credible and robust roadmap for future development, which has been made possible by our continued investment in capacity and capability as well as an end-to-end solutions based offering.

Slide 15:

Talking briefly about 5G, 5G is now a clear reality, and it is moving fast with almost 25 countries will have multicity commercially available 5G services by the end of this year itself and a whole lot of them continuing to do the rollout by 2020.

Slide 16:

Our strategy, which we have shared with you in the past several quarters, we are geared towards this 10-year deployment cycle with our 4 pronged strategy of continued investment in technology with deep customer engagement, continue to build the talent pool from the world class people and eyeing clearly addressable market of $75 billion by 2023. Our addressable market with these strategies continues to grow year-on-year, and we are now going full throttle to further enhance our capability to capture the 5G opportunity, which will start to service from 2020 onwards.

With this, I now come to an end of the business overview and hand over to Anupam.

Anupam Jindal: Thanks, Anand, and good evening, everyone.

Slide 18:

Coming to the financial performance, we have delivered a good quarter with more than 25% Y-o-Y growth in revenue, 7% Y-o-Y growth on EBITDA and 22% Y-o-Y growth on PAT, which includes a positive effect of the change in corporate tax rate. Our order book stands at a healthy level of Rs. 8,100 crore and new product to revenue ratio of about 20%. ROCE as at the Q2 end stands at 23%, a dip from our earlier levels on account of low integration of enhanced capacity.

Slide 19:

On a Q-on-Q basis, the revenues have been flattish with a slight dip of 5%, mainly on account of lower cable volumes. Our realization for the quarter on fiber side has remained stable, driven by a good mix of high value-add fiber. On the cable side, while the realizations have remained the same as compared to the last quarter, the volume was about 80% of the last quarter. Going forward, we expect the volume to be in similar range for H2, which to an earlier point of Anand, is indicative of an order deferment from our customers.

Slide 20:

Our customer base is expanding and diversifying. Telcos, which earlier would account for a majority of our business today account for about 56%. This is clearly demonstrative of our strategy to cater to the larger pool of customers who are investing in creating data networks. The share of citizen networks has increased from 12% last year to now at 20%. You would also see that we have now started seeing traction from the global cloud players which were absent from our revenue until last year, and today they are at about 2% of our revenue. As I said earlier, our endeavor will be to keep diversifying our customer base and add new marquee clients to our list of customers globally.

Slide 21:

The order book for the business stands at Rs. 8,132 crore, as we close the first half of the year. Our order booking result from the last quarter was quite low as compared to our initial estimates. The customer segment split of the current order book is fairly balanced. The telcos at about 47%, enterprises at about 33%, citizen networks at 19% and cloud providers at about 1%.

Slide 22:

STL focuses strongly on good Corporate Governance practices as key to sustainable corporate growth and long-term shareholder value creation. STL's approach towards growth, earnings and capital allocation are well chartered to help it grow in a value-accretive manner for all its stakeholders. The company's success will continue to be backed by a strong formation that will enable its sustainable growth going ahead.

Slide 23:

For your reference, we have captured an abridged version of the P&L and a simplified version of balance sheet. Our EBITDA margin has been largely consistent with that of FY '19 and Q1 of FY '20 is standing at roughly about 22%. Based on the visibility that we have today for FY '20 for both, overall volumes of fiber and cable would be mostly flattish. This supports the deferment of some of the orders of high value-added fiber to translate into lower average fiber pricing for the second half. On the revenue front, we are confident of growth this year a bit driven by more system integration and software business. The profitability will be impacted mainly on account of lower utilization of our new capacity, higher interest and depreciation costs and incremental investment in 5G-related R&D investment. As for our current visibility, H2 profitability would be weaker than H1. As we progress further into the second half of the year, we will keep you apprised on any new developments.

Slide 24:

On the cash flow front, we are very happy to share that we have generated strong positive cash flow of Rs. 260 crore in H1 of the current year, and net debt-to-equity has been consistent at less than 1. We could bring down our debt levels by around Rs. 300 crore as compared to the previous quarters through a strong cash flow management.

Slide 25:

As we reach towards the end of the opening remarks, we would also like to update you of our continued focus on environment, sustainability and governance initiatives, of which, one of the most important developments in H1 of the current year was making our optical fiber cable plant in Silvassa the first Zero Waste to Land certified plant.

With this, we come to the end of our opening commentary and will be happy to take questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. We take the first question from the line of Mukul Garg from Haitong Securities. Please go ahead.

Mukul Garg: Before I start with the questions, Anupam, can you please help us with the couple of bookkeeping numbers, the utilization in the OFC business and the pricing, which you saw this quarter.

Anupam Jindal: In terms of utilization, the fiber plant was broadly about 100% capacity. We had about 7 million of volume in terms of fiber. But in terms of cable, we were close to 80% of utilization of the capacity at 18 million. So this is how the numbers have panned out in the current quarter.

Mukul Garg: And the pricing?

Anupam Jindal: In terms of realization, the Q2 realizations were broadly in line with the Q1, $7 close to that.

Mukul Garg: Okay. And just given your guidance, how should we look at the growth in the second half and the margins? Your earlier margin guidance was 18% to 20%. So is it possible to give some indication of exactly where would margins stabilize given the commentary on lower utilization and an increased R&D spending? And if you can just quantify that as well a bit?

Anand Agarwal: Sure. In terms of, I think, from volume perspective, as we said that as compared to the previous estimate, we are now looking at flattish revenue, flattish volume number for the full year. And in terms of the margin, we are looking at close to 21%-22%. So I think for full year, we are still looking at some impact will be there because of lower realization and some R&D impact, but I think we are still looking at maybe plus 20%.

Mukul Garg: Sir, you said the margins will be 21% to 22%.

Anand Agarwal: I mean; we have done H1 with about 22% in totality. And from what we see, we are still looking at 20% plus.

Mukul Garg: Understood. And just a clarification, again, on the cable volume number. If you look at the installed capacity after the new capacities came on board, both OF and OFC capacities are up 40% Y-o-Y to about 43 and 24 million. So can you just help understand how the volumes will be flat?

Anupam Jindal: Mukul, the capacity will come in June 2020. And the fiber capacity is still getting deployed and installed right now. As we said, by Q4, we expect the capacity availability at the run rate of 40 million. Q2 right now is in the process of just getting commissioned and trials are happening.

Mukul Garg: Okay. So I was including the 'Metallurgica' capacity also from also from Q1…

Anand Agarwal: That is included, 18 million on the cable side also. So, 18 million is the current capacity including the 'Metallurgica' capacity.

Mukul Garg: Okay. So can you just help us with the total capacity right now in OF and OFC?

Anand Agarwal: Yes. So OF, as we have largely completed this CAPEX, so it is about 50 million and cable is about 18 million, which we are taking it to 33 million by June 2020.

Mukul Garg: So at 50 million OF, you still think that you will be able to get about 30 million type of volume?

Anand Agarwal: Yes.

Moderator: Thank you. The next question is from the line of Neerav Dalal from Maybank. Please go ahead.

Neerav Dalal: I have a few questions on the India business. I wanted to understand on the services and solutions business. What is the outlook there? How are the 2 large projects going on? And the second question is on the tax rate. What do we expect the tax rate for the full year?

Anand Agarwal: On the services business, Neerav, we are continuing to be extremely bullish on and our outlook for the year on the services business is better than when we had started off the year. Both these current projects, the Navy project as well as MahaNet, the large project that we have, are fully on schedule and we are looking at ways to expedite them so that we are able to finish them earlier. At the same time, the funnel that we have added for almost 7,000 crore in H1 is extremely strong some on the product side but very high also on the services end. So that service and solution part, we are extremely happy and bullish with the way it is progressing. On the tax rate, Anupam.

Anupam Jindal: On the tax rate, Neerav, so one is that we are offering for the new rate of tax, which is 25.17% and some accounting gain on account of deferred tax liability, that's about, I would say, 15 crore. So broadly, we will be close to 24%-25% for full year. Going forward, it will be 25.17%.

Neerav Dalal: Okay. And just quickly, a follow-up on the first answer. The 7,000 crore funnel that you're seeing, would you have a split of how and when do you see these orders coming in?

Anand Agarwal: For this funnel, everything will not flow in that order, but these are new opportunities that we have secured during the first half. So we see a good amount of precision should happen in H2; some amount will flow in. This is a new funnel, which we have added, and that should propel into increasing our order book into H2 and that's a great degree of confidence and comfort that we have.

Neerav Dalal: Okay. And just finally, the services and solutions funnel would be largely in India at the moment?

Anand Agarwal: We have added some international geographies as well that we have spoken about that in the current year, there will be an international project that we will acquire and start.

Neerav Dalal: Okay. And any specific geography that one should look at?

Anand Agarwal: We are looking at a couple of them so let us come back once it has been finalized.

Neerav Dalal: Sure. And so sorry, the size of that opportunity?

Anand Agarwal: The international ones will be small that we will start with not more than Rs. 100 crore to Rs. 200 crore.

Moderator: Thank you. The next question is from the line of Rishabh Chudgar from Enam Holdings. Please go ahead.

Rishabh Chudgar: I just have a quick question regarding, since we have already indicated that H2 was expected to be soft on the back of lower volumes because of softer demand from telcos. In FY '20, we had guided a CAPEX estimate of close to Rs. 550 crore, which will take our capacity of optic fiber to 50 million. So I was just wondering, are you planning to delay this CAPEX a little bit, given the current demand environment?

Anupam Jindal: Rishabh, most of the CAPEX in terms of fiber is already done. The Rs. 550 crore is the cash flow part, which we talked about, and we still maintain that. And the other part on the CAPEX side, we are running a cable expansion, which we will continue because we continue to believe that there will be some short-term blips in terms of demand, but the kind of projects we have taken, we want to continue rather than holding them in between because we know that when the capacity, the demand comes in, which we are very confident of, we need to have the capacities and the kind of engagement we are having with the customers, we don't really see that the capacities will remain unutilized for a long period of time.

Rishabh Chudgar: Okay. So we have no plans on delaying this?

Anupam Jindal: Yes.

Rishabh Chudgar: So basically, you are expecting demand environment to revive in FY '21?

Anupam Jindal: Yes. So sooner, I mean, we continue to be bullish on the overall demand side driven by the various drivers, including 5G and various other initiatives. So definitely, in some time, we expect that driver to happen.

Rishabh Chudgar: I missed out on the earlier question, where you have indicated. So what was the capacity utilization for the optic fiber business?

Anupam Jindal: Optic fiber, the existing capacity is 30 million broadly, 100%.

Rishabh Chudgar: 100% utilization.

Anupam Jindal: Yes. The expanded capacity is still not getting utilized.

Rishabh Chudgar: Okay. So we are at, currently our capacity is at 30 million, you're saying?

Anupam Jindal: Yes.

Rishabh Chudgar: Okay. And by Q4 FY '20, we will reach 50?

Anupam Jindal: Yes. I mean, capacity will be 50.

Rishabh Chudgar: Okay. And how are we seeing the current realization for optic fiber, sir? I know you mentioned that it remained at 7, but how are we seeing in terms of when you're going and talking to clients right now, are we seeing some of the...?

Anupam Jindal: So for us, Rishabh, we are still looking at in terms of mandate realization close to $6 - $6.50.

Rishabh Chudgar: So in new contracts, you're looking at $6.5 kind of realization.

Anupam Jindal: $6 to $6.5. They have come down a bit, but that's the kind of things we are looking at.

Moderator: Thank you. The next question is from the line of Gaurav from Systematix Shares. Please go ahead.

Gaurav: I just want to know about the market updates on Chinese, like in China, what is the market outlook and how it will impact our price, the fiber price?

Anand Agarwal: Fiber price part, Gaurav, we just talked about and the market outlook for China, as we said, China Mobile tenders are out, the China telecom tenders are out. China Mobile has been awarded 5G license. So the decrease what had happened in China market in 2019 versus 2018, we do not believe it will decrease any further from all the market reports. Whether it remains flat or it grows from 2020 is early for us to comment on. But China market, from what we understand, I believe, is at its lowest levels than what it had been in 2018.

Moderator: Thank you. The next question is from the line of Abhishek Shah from Valcore Capital. Please go ahead.

Abhishek Shah: Sir, most of my questions have been answered. Just one clarification. You said that for the growth guidance for the entire year would be flat. So that is we did Rs. 5,100 crore approximately in the last year and in first half itself, we have done Rs. 2,800 crore. So does that mean that second half will be a de-growth that we are looking at?

Anupam Jindal: So let me clarify, Abhishek, we said that volume will be flattish, revenue will be growing.

Anand Agarwal: Essentially, we talked about the fiber and cable business volumes being flat but at the same time, we are having great growth in the services and solutions business. We essentially talked about the fact that the growth percentage of FY '20 over FY '19 might be lower than the growth. We have had a CARGR revenue growth of almost 35% year-on-year. We are essentially saying that FY '20 may not be at that rate.

Abhishek Shah: Fair enough. Understood. And is there a specific R&D expense as a percentage of revenue that would be worth tracking? As you said, at this time, R&D expenses will be much higher.

Anupam Jindal: So essentially, what we are saying is that we are preparing and investing for the 5G products and solutions. Therefore, the technology investment, we call it R&D or technology, that's going up. We are not measuring it as a percentage of revenue, because until we have that as a sustainable number, we don't want to really talk about that. So definitely, the investment in technology is going to be much higher than what we have done in the past few years.

Abhishek Shah: So how much would that be? Would it be possible to quantify it?

Anand Agarwal: In the past, we used to do about Rs. 50 crore- Rs. 55 crore. This year, it would be closer to Rs. 85 crore to Rs. 90 crore.

Moderator: Thank you. The next question is from the line of from Sangam Iyer from Subhkam Ventures. Please go ahead.

Sangam Iyer: Hi, this is Sangam Iyer from Consilium Investment. So actually, I just wanted to check with you, sir. When you mentioned that the China Mobile and China Telecom 5G license have been received and the tenders are out, are the tenders for the next financial year also out for optical fiber?

Anand Agarwal: These are tenders which have been out for the current financials. China Mobile came in Q1; China Telecom came in Q2.

Sangam Iyer: Okay. So whatever price dips that we are talking about because, in the initial comments, we did mention about the slowdown, because of the fact that China is slowing down. So is it a slowdown on the volume front that we are witnessing from China? Or is it more because of the kind of tenders and the pricing in the tenders, which is resulting in a slowdown?

Anand Agarwal: Yes. So volumes have been lower in the current year. China, after almost 10 odd years, in China there is a 13% volume de-growth, which is happening in 2019 and that volume de-growth is coupled with the supply side economics which has happened and which has led to a price dip within the year that we have seen and we have talked about that with the early participant.

Sangam Iyer: Got it. And sir, when we mentioned that the realization based on the negotiations for the renewals of contracts have happened close to maybe $6 to $6.50 per fiber kilometer, does this apply to or what percentage of the overall order book would this apply to?

Anand Agarwal: This is essentially the average realization, which we have seen as we start moving forward. So our average utilization was closer to $7, which was a mix of our order book of standard fiber and value added. Right now, we are seeing it to be closer to $6.50 to between $6 and $6.50 as we move forward.

Sangam Iyer: Got it. So for the second half, when we look at the flattish revenues, this is the kind of realization that one should have.

Anupam Jindal: Right.

Moderator: Thank you. The next question from the line of Rajesh Kothari from AlfAccurate Advisors. Please go ahead.

Rajesh Kothari: Sir, my question is, can you give break up about what is your total services revenue in Q1 and Q2?

Anupam Jindal: In the current quarter, broadly, we had 50% revenue coming in from the services and software business.

Rajesh Kothari: 50%?

Anupam Jindal: Yes.

Rajesh Kothari: And what about quarter one?

Anupam Jindal: I think it was about 40%-45%. I'm not having the number right here, but it was about that, 40%-45%. So we have increased services revenue in the current quarter.

Rajesh Kothari: So basically, that's about roughly about Rs. 950 crore. So for the full year, do you think there also you have a revision of guidance? Because I think last year, full year revenue was Rs. 1,800 crore in this year first half is...

Anupam Jindal: Yes, we also have growth in the current year in terms of services, that's what just Anand mentioned that full year revenue will be growing of basis as there will be flattish revenue, but revenue at the Company level will still grow driven by the growth we are seeing in services and software businesses.

Rajesh Kothari: So I'm slightly confused because your services business execution, whether that is on track with what originally you have estimated, or narrows in this quarter?

Anand Agarwal: Services business, as we said, is moving better than what we had estimated. We'll have a much stronger growth in services business compared to how we have grown in the previous year. As we said, over 1,800, and we are already running at a run rate of Rs. 1,900 crore. We continue to have good order book on services on the parts side as well as funnel is getting stronger. The muted revenue and the flattish revenue that we are talking about is more on the product side on the pipeline thing.

Rajesh Kothari: So overall, again, there is a confusion because there are different lines, which we are still not able to understand. One, whether your total revenue is going to be flat for FY '20? Or is it your product revenue is going to be flat FY '20?

Anand Agarwal: On a totality basis, FY '20 growth would be lower than the growth that we have seen in the previous years. The product revenue would be close to flattish, services revenue will grow. And the growth rate for the year will be lower than the growth rate in the previous year.

Rajesh Kothari: Got it. Any impact on your service revenue margins?

Anand Agarwal: No, it is actually better than what we have anticipated what it is now.

Rajesh Kothari: And would you like to comment on cable realization? Any impact on cable realization?

Anand Agarwal: Cables we don't track by realization, we track by margins and stable margins are, currently cable is a pass through for us and cable margins continue to be strong.

Rajesh Kothari: Okay. And can you give us full year interest and depreciation in your estimate?

Anand Agarwal: We do not give out guidance for line items for the full year. I think you can estimate based on how we have turned current H1 performance.

Rajesh Kothari: My question is with reference to the total CAPEX, what has been capitalized and which will commence in the second half, what would be that amount?

Anupam Jindal: So I think this capitalization of the CAPEX for capacity expansion is largely complete. So we don't really expect much impact on depreciation going forward. Interest also large impact has come, and in fact, we are looking at lowering interest going forward, but maybe run rate wise, we can have a similar number.

Moderator: Thank you. The next question is from the line of Ravi Mehta from Deep Financial. Please go ahead.

Ravi Mehta: Most of the questions are answered. Just one question on the service business margin, what would it be around?

Anupam Jindal: About 14% to 15%.

Ravi Mehta: Okay. And we have already clocked Rs. 1,250 crore kind of revenue. So can we actually annualize that number, looking at the order book size or...?

Anupam Jindal: Basically, this is the kind of margin profile we have started getting in services business, significantly higher than about 11%, which we had last year.

Ravi Mehta: And on this top line run rate, Rs. 1,200 crore plus in first half, so can we repeat that?

Anand Agarwal: As I said, it is higher than 1,500 crore in the first half. Out of the total sales, 3,300 crore, we are almost 47%-48% is services and parts. And we believe we'll do better than that in the second half.

Ravi Mehta: Okay, both on the top line and margins?

Anupam Jindal: Definitely on the top line, margins will be in this.

Moderator: Thank you. We take the next question from the line of Saket Kapoor from Kapoor & Company.

Saket Kapoor: Sir, if you could please specify the increase in the employee benefit expense on a Q-on-Q basis, also on a year-on-year basis, that has gone up from 134 to 166 and 146 to 166 if we take June '19 to September '19.

Anupam Jindal: Yes. I think, largely, it is in line with growth we have shown in terms of revenue. We continue to expand our services and software business, the volume, which the capacity we have set of fiber and cable plus impact on a Q-on-Q basis, largely, our revision cycle starts from July. So the impact comes in Q2 as compared to Q1.

Saket Kapoor: So for the full year, this is going to be the run rate now every quarter?

Anupam Jindal: Run rate wise, we still continue to have more talent coming in as we continue to talk about it. So we really don't put any specific number or the run rate on that.

Saket Kapoor: Okay, sir. And sir, secondly, the segment wise reporting was not available. What could be the reason for that?

Anupam Jindal: Essentially, we are having more and more business getting transformed into integrated business while we do have the fiber and cable business, but as we see more and more business, the Company is getting into integrated solution provisioning mode. And we are finding that it is becoming increasingly difficult to feed. So some parts are tangible, which we can talk about volume realization and some margins. But from an overall perspective, we are seeing more of integration happening.

Saket Kapoor: And for the receivable front, sir, anything due from the BSNL or the Government enterprises, the 1,700?

Anupam Jindal: So BSNL, I would say that normal revenue on the project side, we are getting timely collection. In terms of the overdue, we have close to about 300-odd crore essentially for the supplies of fiber cable done, which are now more than six months due. We see early resolution of that happening maybe in Q3 itself. All that is happening, while we see good development happening where we can collect even the old dues which are there for our product supplies.

Moderator: Thank you. The next question is from the line of Rishabh Chudgar from Enam Holdings. Please go ahead.

Rishabh Chudgar: Sir, just a quick question. What would be the margins from the product business in Q2 FY '19?

Anupam Jindal: FY '19? You are saying last year?

Rishabh Chudgar: Yes, last year, last quarter, right. Q2 FY'19 last year.

Anupam Jindal: I think last year it was definitely higher. I'm just trying to get the number, but yes, last year was close to about 30%. This quarter is about 25%-26%.

Rishabh Chudgar: Okay. And sir, just earlier when you eluded to the point that the other new contracts, the realization in optic fiber is close to $6 to $6.50 per SKM. So going forward then, will that lead to further margin pressures in the product business?

Anupam Jindal: To some extent, yes, but we are also offsetting frankly offset by operating cost-reduction plan. So we are working on the cost side since last 7 months-8 months. So some results have started coming in. That's why our profitability has not got significantly impacted as compared to the realization drop we have seen and we want to continue working on that. So there are still some opportunities we still see on cost side. How do they materialize, we will see, but we see such realization impact getting partly offset by now the more cost correction programs.

Rishabh Chudgar: Okay, but still around 100 bps kind of margin pressure you can expect from the current levels in the product business?

Anupam Jindal: Yes, there will be some margin pressure.

Rishabh Chudgar: Okay. And just, sir, another book-keeping question. Regarding the order book, could you just give the split of the product and software services like product will be 47% of the order book currently?

Anupam Jindal: Currently, it is about 50-50 broadly, out of 8,000, it is 4,000 and 4,000.

Moderator: Thank you. The next question is from the line of Mukul Garg from Haitong Securities. Please go ahead.

Mukul Garg: Anupam, I just wanted to understand the levers for margin, which you have in H2. What we are hearing today is that the utilization will have some amount of impact. There will be higher share, which will be there from the services in the second half. And given the lower pricing, there will be a bit of a hit from product margin as well. So what are the levers we have, which will help us kind of keep margin pressure under check?

Anupam Jindal: Yes. So essentially, what we are looking at is that how we can improve on the operating side of the costs, which we talked about in the previous question. That is how we can have more of value-added, particularly in the cable side, how we can have more of value-added products coming in and some saving in cost in general. So those are the things which we are looking at to offset some of the impact on high investment in technology and some of the realization actually we'll be getting in Q2. So that's why instead of 22%, maybe we'll have some correction in H2, but we are still looking at maintaining about 20 for full year.

Mukul Garg: I understand. And this includes pressure from R&D investment, about an incremental 40 crore-50 crore coming in, you are confident that you will be able to manage that as well?

Anupam Jindal: Yes. So basically, you're looking at that we need to invest for future for sure. So how we sort of have this investment spread out and how we start getting some benefit on immediate basis, those are the things we will still work on. But yes, I mean, we are factoring in these numbers as well.

Mukul Garg: Great. And just a few questions on the order book. In the presentation, you mentioned that there was a bit of a deferment of the order book. Can you give us some sense of out of the 8,100 crore, how much was executed this quarter and how much was deferred? There's almost 2,000 crore decline in the order book from Q1 to Q2?

Anupam Jindal: Yes, basically, Mukul, in terms of the overall order book, we have sort of 8,100 crore which we are having at the end of Q2 and it also has the new order book, which you have received over Q1-Q2. And also some of the orders which we continue to have, but we don't see good visibility in terms of, that is why I am not listing, we actually knocked them out of the order book, which we have focused here. And that's why you see a drop of almost 1,700 crore versus revenue, which we did 1,360 crore. So in fact, we have cleaned up some of the order book while contracting, but we still have those order book in place. But we are not seeing a timeline or delivery commitments from the customer. Therefore, we have taken certain orders out of our order book.

Mukul Garg: Can you give a number is like, how many...?

Anupam Jindal: I think close to Rs. 600 crore or so we have deferred, where we have taken out from the order book.

Mukul Garg: And is there a risk that this might continue in the second half, given the industry is...?

Anand Agarwal: Based on a fair assessment based on what we are hearing from customer confirmation from them. What we could see on a conservative basis, we have taken them out. We'll continue to see, we don't see any more correction happening, but I mean, the market is quite dynamic. As we are talking, our realization still continues to be far above what we have seen in China. We continue to have broadly similar volume we have done. So the market is settling, in spite of that we are doing all these things. So I mean, we continue to have good confidence based on the remaining order book, which we have, and we'll continue to monitor that.

Mukul Garg: Got it. If I may, I will just ask one final question. You mentioned about the funnel of 7,000 crore. Is it possible to break up between the product and services? Because we heard recently, there was a number of Bharatnet projects, which got approved by the Central cabinet. So any breakup between the 7,000 crore between what is there in product and services?

Anand Agarwal: Mukul, right now, it is a good fair mix. We are seeing some part of the funnel being annual global contracts for products as well as multi-year contract, which is a part of the funnel. And some of them, as you rightly said, are some contracts Bharatnet as well as some incumbent telcos in India as well. So we would not have the breakup in that matter. And some of these actual funnel is that we are doing products and services together as part of one contract.

Moderator: Thank you. The next question is from the line of Neerav Dalal from Maybank. Please go ahead.

Neerav Dalal: Just on the India business, last week, we had the Reliance Jio presentation and they were talking about increasing their fiber route kilometers from 700,000 that they have currently to about 1.1 million route kilometers. So just wanted to understand how do you see this? And when do you see this happening? How should you benefit out of this? Would you benefit out of this?

Anand Agarwal: Clearly part of Jio final phase of rollout for city and tower connectivity has happened. And now they are moving in an aggressive manner in creating the Jio fiber access connectivity. We are extremely strongly associated with that and part of that, and we would definitely, as the rollout happens, we will be beneficiary of that.

Neerav Dalal: But no indications at the moment, right?

Anand Agarwal: There are discussions, there are engagements currently, but over the last few months they were busy with moving the assets through the invest structure which they had done. Now the engagement is back on in the rollout for the Jio fiber as well.

Moderator: Thank you. With that, we end the conference. I would now like to hand the conference over to Dr. Anand Agarwal for closing comments. Over to you, sir.

Anand Agarwal: 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, you can feel free to contact the IR team, which includes myself and Anupam, and we really look forward to continuing the conversation with you in the future. And all the very best wishes for a very happy Diwali to everyone attending the call. Thank you.

Moderator: Thank you very much. On behalf of Sterlite Technologies, that concludes today's conference. Thank you all for joining us. You may now disconnect your lines now.