



## Soft quarter; gradual pickup ahead

Q3FY20 was another soft quarter with disappointing revenue and EBITDA. Revenue declined 11.5% QoQ (10% miss) due to slow uptake from customers. EBITDA margin was down 114 bps QoQ at 20.1% (AxisCap: 18.8%). Lower interest cost/tax led to 29% beat on profit.

**Revenue to pick up gradually:** As pressure on products prices continues and services contribution (O&M ~37% of order book) remains elevated, we expect EBITDA margin at ~19%. We cut FY20/21 EBITDA estimate by 3%/11% as we factor in pricing pressure. However, we are building gradual revenue growth, as services revenue grows and 5G capex picks up. At CMP, it trades at 12.3x/9.6x FY21E/FY22E EPS, which implies that the correction is overdone. Maintain **BUY** with revised TP of Rs 165 (12x FY22E EPS) vs. Rs 175 earlier, as we roll forward to FY22E and cut multiple to 12x (vs. 14x) amid pricing pressure.

CMP : Rs 131  
 Potential Upside : 26%

### MARKET DATA

No. of Shares : 404 mn  
 Free Float : 46%  
 Market Cap : Rs 53 bn  
 52-week High / Low : Rs 302 / Rs 97  
 Avg. Daily vol. (6mth) : 1.8 mn shares  
 Bloomberg Code : SOTL IB Equity  
 Promoters Holding : 54%  
 FII / DII : 6% / 7%

## Revenue trajectory on decline; order book improves despite challenges to products business

**Products may remain under pressure; order book still strong:** The revenue has been declining amid soft OF/OCF prices (OF prices USD 6 fkm vs. > USD 7.0 fkm earlier). The management expects revenue to pick up from Q4 led by volume growth from strong order book execution (Rs 85.35 bn). We believe that if 5G capex does not pick up and pricing pressure sustains, there would be challenges for long-term contracts and in turn for products business which may restrict growth outlook of products business even in FY21. High share of services revenue (operating at 17%) and pressure on margin of products would restrict margin in the range of 19-20% from low 20s earlier.

**Moderation in revenue trajectory a near-term concern:** We believe that the declining revenue would be a near-term concern, though we expect gradual recovery from Q4 as (i) volumes from 10 x 2 mn fkm OF capacity expansion becomes operational, (ii) additional volume from OFC expansion to 33 mn km starts to kick in and (iii) prices for OF/OFC stabilizes with rising capacity shutdown and pickup in 5G capex. Delays in 5G related capex pose key risk for the stock. We expect near-term pressure on the stock price due to moderation in the revenue.

### Financial summary (Consolidated)

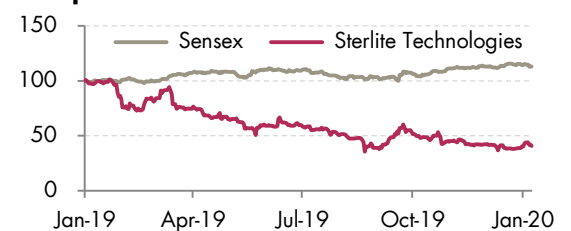
Y/E March	FY19	FY20E	FY21E	FY22E
Sales (Rs mn)	50,873	52,343	56,399	64,561
Adj PAT (Rs mn)	5,703	4,915	4,340	5,566
Con. EPS* (Rs)	-	14.4	16.5	20.1
EPS (Rs)	14.1	12.1	10.7	13.7
Change YOY (%)	68.6	(13.8)	(11.7)	28.2
P/E (x)	9.3	10.8	12.3	9.6
RoE (%)	39.4	27.6	22.1	24.6
RoCE (%)	29.5	21.1	20.6	24.8
EV/E (x)	6.3	6.4	6.2	5.2
DPS (Rs)	3.5	1.7	4.0	4.0

Source: \*Consensus broker estimates, Company, Axis Capital

### Key drivers

	FY20E	FY21E	FY22E
OF (fkm mn)	27.3	29.2	33.6
Realization (\$/fkm)	6.5	6.3	6.7
OFC (fkm mn)	17.2	20.9	26.5
Realization (\$/fkm)	16.0	15.8	16.0

### Price performance



**Exhibit 1: Results update**

(Rs. mn)	Quarter ended					12 months ended		
	Dec-19	Dec-18	% Chg	Sep-19	% Chg	FY20E	FY19	% Chg
<b>Net Sales</b>	<b>12,027</b>	<b>13,349</b>	<b>(9.9)</b>	<b>13,597</b>	<b>(11.5)</b>	<b>52,343</b>	<b>50,873</b>	<b>2.9</b>
EBIDTA	2,414	2,939	(17.9)	2,885	(16.3)	10,897	11,272	(3.3)
<b>PBITD</b>	<b>2,414</b>	<b>2,939</b>	<b>(17.9)</b>	<b>2,885</b>	<b>(16.3)</b>	<b>10,897</b>	<b>11,272</b>	<b>(3.3)</b>
Depreciation	701	512	36.7	750	(6.6)	2,854	1,950	-
Interest	497	170	192.9	506	(1.7)	1,857	686	-
<b>PBT</b>	<b>1,217</b>	<b>2,257</b>	<b>(46.1)</b>	<b>1,629</b>	<b>(25.3)</b>	<b>6,187</b>	<b>8,635</b>	<b>(28.4)</b>
Tax	191	760	(74.9)	33	473.9	1,252	2,782	-
Minority Interest	(26)	20	(231.3)	(18)	47.5	21	150	(86.3)
<b>Adjusted PAT</b>	<b>1,052</b>	<b>1,477</b>	<b>(28.8)</b>	<b>1,614</b>	<b>(34.8)</b>	<b>4,915</b>	<b>5,703</b>	<b>(13.8)</b>
Extra ordinary income/ (exp.)	525	21	-	18	2,834.6	556	76	-
<b>Reported PAT</b>	<b>527</b>	<b>1,456</b>	<b>(63.8)</b>	<b>1,596</b>	<b>(67.0)</b>	<b>4,358</b>	<b>5,628</b>	<b>(22.6)</b>
No. of shares (mn)	406	406	-	406	-	406	406	-
EBIDTA margin (%)	20.1	22.0	-	21.2	-	20.8	22.2	-
PBITD margin (%)	20.1	22.0	-	21.2	-	20.8	22.2	-
<b>EPS - annualized (Rs.)</b>	<b>10.4</b>	<b>14.6</b>	<b>(28.8)</b>	<b>15.9</b>	<b>(34.8)</b>	<b>12.1</b>	<b>14.1</b>	<b>(13.8)</b>

Source: Company, Axis Capital

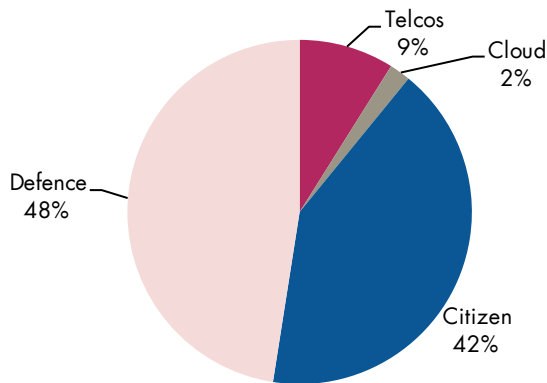
**Q3FY20 key highlights – another soft quarter**

- ◆ **SOTL reported revenue decline of 11.5% QoQ (-9.9%YoY)** to Rs 12,027 mn (AxisCap/ Cons.: Rs 13,055 mn/ Rs 13,618 mn), below our/ consensus estimate amid low fiber prices and slow uptake from its customers.
- ◆ **EBITDA was Rs 2,414 mn (-16.3%QoQ; -17.9%YoY)**. EBITDA margin was down 114 bps QoQ at 20.1% (AxisCap & Cons: 18.8%). QoQ decline in the margin possibly led by negative impact of operating leverage from lower fiber prices.
- ◆ **Interest cost declined QoQ to Rs 557 mn** vs. Rs 597 mn in Q2 (Rs 274 mn in Q3FY19). Reported EPS was down 67% QoQ (-64% YoY) at Rs 1.29 (AxisCap/Cons.: Rs 2.0/Rs 2.4), while adjusted profit declined 35% QoQ.
- ◆ **Increase in order book:** Order book was up 5% QoQ at Rs 85.35 bn (Rs 81.3 bn in Q2FY20). Company awarded multi-year deal worth about Rs 11 bn by T-Fiber to deliver digital infrastructure to 6 mn rural citizens of Telangana and selected by Telekom Albania for its multi-year, multi-million dollar digital transformation program.
- ◆ **Additional provision in quarter:** During Q3, the company has made an application under Sabka Vishwas (Legacy Dispute Resolution) Scheme, 2019 (SVLDRS), for settlement of the disputed excise matter of Rs 1,880 mn demanded by CESTAT in 2005-06 which Sterlite Tech was contesting at the Supreme Court, and also some other litigations under Central Excise Act, 1944. Based on the provisions of SVLDRS, the company has determined the duty payable in respect of all matters offered for settlement under the scheme and accordingly made an additional provision Rs 507.1 mn in Q3. This led to lower reported PAT in Q3. **Company expects its proposal to be accepted in 2 weeks and no new provisioning.**

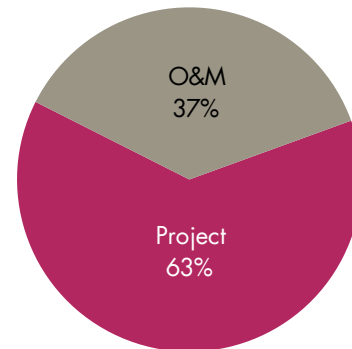
**Takeaways from conference call**

- ◆ **Update on projects:** Company has completed 65% of Indian Navy. 55% of Mahanet project delivered with network infrastructure deployment to over 2000 gram panchayats.

- ◆ **Demand declined in 2019; capacity shutdown to help in price stabilization:** Fiber demand came down in 2019 due to 4G to 5G transition. In 2019, global fiber demand came down by 7%. N. America/Europe demand was up 4% YoY. However, demand was down 13% YoY in China and 29% YoY in India. Sector is seeing some plants being mothballed and capacities shutting down. If further capacities shut down, it shall help in price stabilization.
- ◆ **Global OFC demand to pick up on the back of 5G deployment:** The management expects OF/OFC demand to pick up as the pace of 5G deployment increases across the globe. Its optimism stems from: (i) commercial 5G services launched in key economies globally; (ii) large Edge Datacentres deployments with network connectivity; (iii) share of data in revenue in increasing; (iv) Tower fiberisation & broadband connectivity continue to grow; and (v) Indian telecom industry profitability is likely to improve. It expects fiber demand and pricing scenario to pick up meaningfully from H2FY21 as 5G capex picks pace.
- ◆ **5G commercial services is starting to pick pace:** Expansion of 5G network in US with launch by AT&T (20 cities) and Verizon (30 cities), China rolling out 5G (big investment with ~6 mn base stations planned) and 5G rollout expected in all major cities of Europe.
- ◆ **Plans to enter new markets in a phased manner:** The company does not serve 25% of the world markets and plans to enter new markets that include South East Asia, the Middle East and South America. It is already seeing some traction and initial success in Latin America.
- ◆ **75%-80% utilization expected in FY21:** Utilization in Q3 was 46% for OF (on 50 fkm capacity) and 76% for OFC (on 18 fkm capacity). It expects utilization at 75%-80% of the expanded capacity for OF/OFC in FY21. Company expects Q4 revenue to improve QoQ led by price stabilization and volume improvement from order book execution.
- ◆ **Expects EBITDA improvement:** EBITDA to improve short term led by (i) additional volume from new markets entry and (ii) further cost reduction in OF. Medium-term EBITDA growth to come from (i) new products; (ii) increasing utilization; and (iii) improving pricing scenario from H2FY21.
- ◆ **Margin guided at 18-20%:** Services margin is improving and stands at 17% as it gains scale. It expects product margin at 20-21% and overall margin at 18-20% for the company (~20% earlier).
- ◆ **OF capex largely complete:** OF capex is largely complete and OFC capex is halfway through. It will complete the capex, as it expects revival in OF/OFC demand. It has no new capex plan for FY21.
- ◆ **Some overdues received:** It has trade receivable of 100 days. It received Rs 1.3 bn in Q3 and expects to receive remaining Rs 1.6 bn in 2 quarters.

**Exhibit 2: Revenue split YTD FY20: Customer segment**


Source: Company

**Exhibit 3: Order book split**


Source: Company

### Change in estimates

We cut our FY20/21 revenue estimate by 4%/10% and EBITDA by 3%/11% as we factor in risks of soft OF and OFC demand and pricing pressure amid slower-than-expected pickup in 5G-related capex. We also introduce FY22 estimates.

**Exhibit 4: Change in estimates**

YE March	FY20E	FY21E
<b>Revenue (Rs m)</b>		
- New	52,343	56,399
- Old	54,775	62,575
<i>Change (%)</i>	<i>(4.4)</i>	<i>(9.9)</i>
<b>EBITDA (Rs m)</b>		
- New	10,897	10,725
- Old	11,211	12,024
<i>Change (%)</i>	<i>(2.8)</i>	<i>(10.8)</i>
<b>Net profit (Rs m)</b>		
- New	4,915	4,340
- Old	4,941	5,134
<i>Change (%)</i>	<i>(0.5)</i>	<i>(15.5)</i>

Source: Axis Capital

### Valuation & recommendation

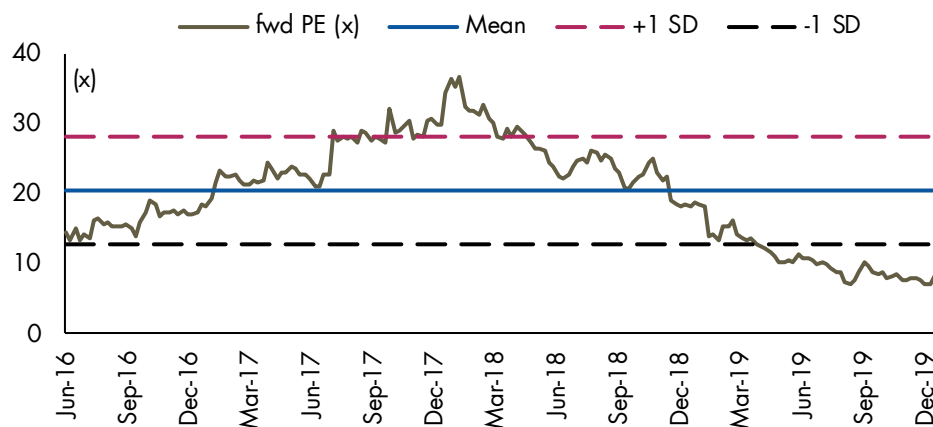
There is near-term concern on the stock due to revenue growth moderation in FY20, with trajectory start seeing reversal in FY21. We expect revenue growth at 8%/14% YoY for FY21/FY22 as SOTL **(1)** adds 20 mn fkm capacity, **(2)** adds 15 mn fkm cable capacity by June 2020; **(3)** executes order book of Rs 85.4 bn; and **(4)** demand picks gradually with picks up in 5G related capex. We expect ~8% revenue CAGR over FY19-22 aided by strong volume growth. However, we expect ~3% EBITDA CAGR over FY19-22 (EBITDA margin of ~19%). We cut our target multiple to 12x from 14x, as pricing is unlikely to improve in the near term.

We cut our FY20/21 EBITDA estimate by 3%/11% and introduce FY22 estimates. At CMP, the stock trades at 10.8x/12.3x/9.6x FY20E/ FY21E/ FY22E EPS, which implies correction has been overdone. Maintain **BUY** with TP of Rs 165 (12x FY21E EPS) vs. Rs 175 earlier.

**Exhibit 5: Results table**

(Rs m)	3Q20	2Q20	QoQ	3Q19	YoY	Consensus	AxisCap('E)	(AxisCap vs actual)
Revenue	12,027	13,597	(11.5)	13,349	(9.9)	13,618	13,055	(7.9)
EBITDA	2,414	2,885	(16.3)	2,939	(17.9)	2,567	2,448	(1.4)
EBITDA margin (%)	20.1	21.2	(114bp)	22.0	(194bp)	18.8	18.8	132bp
EBIT	1,714	2,135	(19.7)	2,427	(29.4)	2,228	1,678	2.1
Interest Cost	557	597	(6.7)	274	103.4		608	(8.4)
Other income	60	91	(34.1)	104	(42.3)		90	(33.1)
PBT	1,217	1,629	(25.3)	2,257	(46.1)	1,429	1,159	4.9
Income tax	191	33	473.9	760	(74.9)		292	(34.6)
Minority + JVs	(26)	(18)	47.5	20	(231.3)		50	(152.8)
<b>Net profit (Ex-one offs)</b>	<b>1,052</b>	<b>1,614</b>	<b>(34.8)</b>	<b>1,477</b>	<b>(28.8)</b>	<b>1,145</b>	<b>817</b>	<b>28.7</b>
Reported EPS - Diluted (Rs)	1.29	3.92	(67.1)	3.59	(64.1)	2.40	2.01	(35.9)

Source: Company, Axis Capital

**Exhibit 6: 1-year forward P/E band**


Source: Bloomberg, Axis Capital

## Financial summary (Consolidated)

### Profit & loss (Rs mn)

Y/E March	FY19	FY20E	FY21E	FY22E
Net sales	50,873	52,343	56,399	64,561
Other operating income	-	-	-	-
<b>Total operating income</b>	<b>50,873</b>	<b>52,343</b>	<b>56,399</b>	<b>64,561</b>
Cost of goods sold	(24,872)	(25,513)	(28,359)	(32,353)
Gross profit	26,000	26,830	28,039	32,207
<i>Gross margin (%)</i>	<i>51.1</i>	<i>51.3</i>	<i>49.7</i>	<i>49.9</i>
Total operating expenses	(14,729)	(15,932)	(17,314)	(19,820)
<b>EBITDA</b>	<b>11,272</b>	<b>10,897</b>	<b>10,725</b>	<b>12,387</b>
<i>EBITDA margin (%)</i>	<i>22.2</i>	<i>20.8</i>	<i>19.0</i>	<i>19.2</i>
Depreciation	(1,950)	(2,854)	(2,984)	(3,001)
<b>EBIT</b>	<b>9,322</b>	<b>8,044</b>	<b>7,741</b>	<b>9,387</b>
Net interest	(686)	(1,857)	(1,914)	(1,914)
Other income	-	-	-	-
<b>Profit before tax</b>	<b>8,635</b>	<b>6,187</b>	<b>5,827</b>	<b>7,473</b>
Total taxation	(2,782)	(1,252)	(1,468)	(1,883)
<i>Tax rate (%)</i>	<i>32.2</i>	<i>20.2</i>	<i>25.2</i>	<i>25.2</i>
Profit after tax	5,854	4,935	4,359	5,589
Minorities	(150)	(21)	(18)	(23)
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	5,703	4,915	4,340	5,566
<i>Adj. PAT margin (%)</i>	<i>11.2</i>	<i>9.4</i>	<i>7.7</i>	<i>8.6</i>
Net non-recurring items	(76)	(556)	-	-
Reported net profit	5,628	4,358	4,340	5,566

### Balance sheet (Rs mn)

Y/E March	FY19	FY20E	FY21E	FY22E
Paid-up capital	805	802	802	802
Reserves & surplus	16,388	17,627	20,042	23,684
Net worth	17,193	18,429	20,844	24,486
Borrowing	19,175	17,443	14,443	11,643
Other non-current liabilities	1,226	961	1,002	1,084
<b>Total liabilities</b>	<b>38,548</b>	<b>37,833</b>	<b>37,307</b>	<b>38,253</b>
Gross fixed assets	23,175	21,984	20,304	20,659
Less: Depreciation	-	-	-	-
Net fixed assets	23,175	21,984	20,304	20,659
Add: Capital WIP	4,194	1,539	1,539	1,539
Total fixed assets	27,369	23,522	21,842	22,198
Total Investment	353	354	354	354
Inventory	5,897	6,281	6,768	7,747
Debtors	13,549	14,340	15,452	17,688
Cash & bank	2,337	1,341	1,831	1,083
Loans & advances	-	-	-	-
Current liabilities	31,574	28,788	31,019	35,508
Net current assets	8,207	10,554	11,627	12,055
Other non-current assets	2,620	3,402	3,483	3,647
<b>Total assets</b>	<b>38,549</b>	<b>37,833</b>	<b>37,307</b>	<b>38,253</b>

Source: Company, Axis Capital

### Cash flow (Rs mn)

Y/E March	FY19	FY20E	FY21E	FY22E
Profit before tax	8,635	6,187	5,827	7,473
Depreciation & Amortisation	1,950	2,854	2,984	3,001
<i>Chg in working capital</i>	<i>(17,837)</i>	<i>(489)</i>	<i>(2,896)</i>	<i>(5,828)</i>
<b>Cash flow from operations</b>	<b>6,311</b>	<b>6,132</b>	<b>8,632</b>	<b>9,247</b>
<i>Capital expenditure</i>	<i>(8,324)</i>	<i>142</i>	<i>(1,303)</i>	<i>(3,356)</i>
<b>Cash flow from investing</b>	<b>(11,721)</b>	<b>471</b>	<b>(943)</b>	<b>(2,996)</b>
<i>Equity raised/ (repaid)</i>	<i>3</i>	<i>(3)</i>	-	-
<i>Debt raised/ (repaid)</i>	<i>7,747</i>	<i>(1,733)</i>	<i>(3,000)</i>	<i>(2,800)</i>
<b>Cash flow from financing</b>	<b>5,702</b>	<b>(4,764)</b>	<b>(7,199)</b>	<b>(6,999)</b>
Net chg in cash	291	1,839	490	(748)
	-	-	-	-

### Key ratios

Y/E March	FY19	FY20E	FY21E	FY22E
<b>OPERATIONAL</b>				
FDEPS (Rs)	14.1	12.1	10.7	13.7
CEPS (Rs)	18.7	17.8	18.0	21.1
DPS (Rs)	3.5	1.7	4.0	4.0
Dividend payout ratio (%)	24.9	16.1	37.0	28.8
<b>GROWTH</b>				
Net sales (%)	58.7	2.9	7.7	14.5
EBITDA (%)	50.4	(3.3)	(1.6)	15.5
Adj net profit (%)	68.4	(13.8)	(11.7)	28.2
FDEPS (%)	68.6	(13.8)	(11.7)	28.2
<b>PERFORMANCE</b>				
RoE (%)	39.4	27.6	22.1	24.6
RoCE (%)	29.5	21.1	20.6	24.8
<b>EFFICIENCY</b>				
Asset turnover (x)	1.8	1.5	1.6	1.8
Sales/ total assets (x)	0.9	0.8	0.8	0.9
Working capital/ sales (x)	0.1	0.1	0.2	0.2
Receivable days	97.2	100.0	100.0	100.0
Inventory days	54.3	55.3	54.1	54.2
Payable days	-	-	-	-
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	1.2	0.9	0.7	0.5
Net debt/ equity (x)	1.1	0.9	0.6	0.4
Current ratio (x)	1.3	1.4	1.4	1.3
Interest cover (x)	13.6	4.3	4.0	4.9
<b>VALUATION</b>				
PE (x)	9.3	10.8	12.3	9.6
EV/ EBITDA (x)	6.3	6.4	6.2	5.2
EV/ Net sales (x)	1.4	1.3	1.2	1.0
PB (x)	3.1	2.9	2.6	2.2
Dividend yield (%)	2.6	1.3	3.0	3.0
Free cash flow yield (%)	(2.7)	11.8	13.8	11.1

Source: Company, Axis Capital



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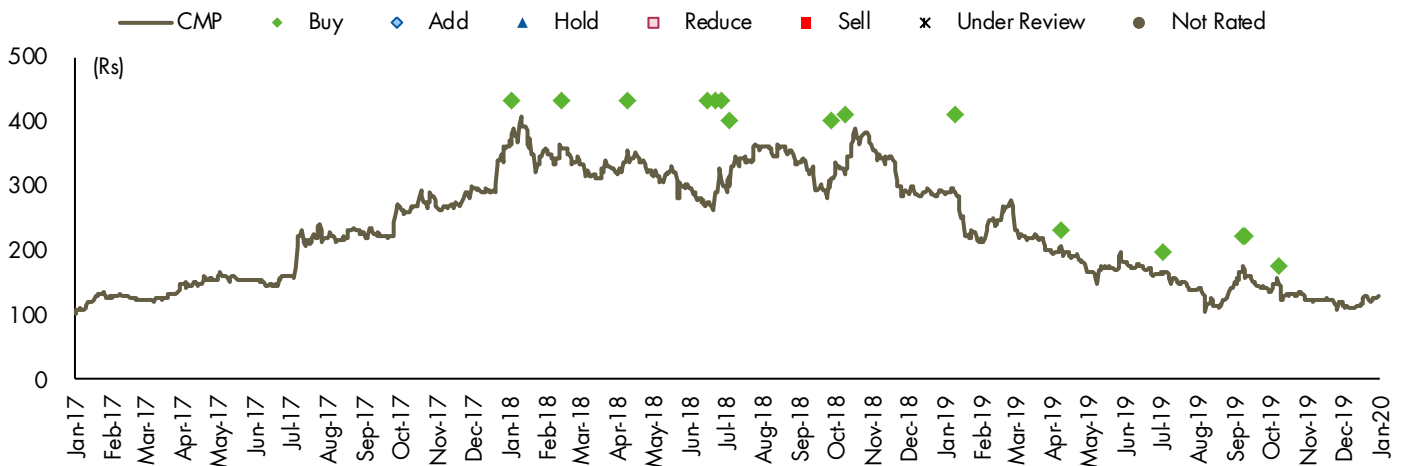
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#### DEFINITION OF RATINGS

Ratings	Expected absolute returns over 12 months
<b>BUY</b>	More than 15%
<b>ADD</b>	Between 5% to 15%
<b>REDUCE</b>	Between 5% to -10 %
<b>SELL</b>	More than -10%

#### Sterlite Technologies (STTE.BO, SOTL IN) Price and Recommendation History



Date	Target Price	Reco	Date	Target Price	Reco
17-Jan-18	430	Buy	23-Sep-19	220	Buy
28-Feb-18	430	Buy	25-Sep-19	220	Buy
25-Apr-18	430	Buy	24-Oct-19	175	Buy
30-Jun-18	430	Buy			
7-Jul-18	430	Buy			
12-Jul-18	430	Buy			
19-Jul-18	400	Buy			
12-Oct-18	400	Buy			
24-Oct-18	410	Buy			
24-Jan-19	410	Buy			
24-Apr-19	230	Buy			
18-Jul-19	195	Buy			

Source: Axis Capital