

3QFY20 Result Update

Sterlite Technologies

Tepid outlook in the near-term

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CMP (Rs): 125

Market cap. (Rs bn): 50

Target price (Rs): 140

Maintain Hold

First Cut Feel of the Results

- Net revenue decline 9.9% YoY (down 11.5% QoQ) to Rs 12,027 mn in 3QFY20 due to volume and realisation decline in 3QFY20. The lower realisation for optic fibre is due to excess supply and muted demand from telecom operators. Globally, telcos are in pause phase as far as capex is concerned, adversely impacting the demand for optic fibres. Capacity utilisation for optic fibre was ~46% while cable was ~76% during the quarter.
- Margin declined QoQ/YoY due to higher contribution from low margin services business mix, pricing pressure in the optic fibres. Management expects profitability to improve in medium-term on the back of rising utilisation of the product business and operational efficiency.
- Promoter holding stood unchanged at 53.7% as of December 2019. No stake has been pledged.

Financial highlights

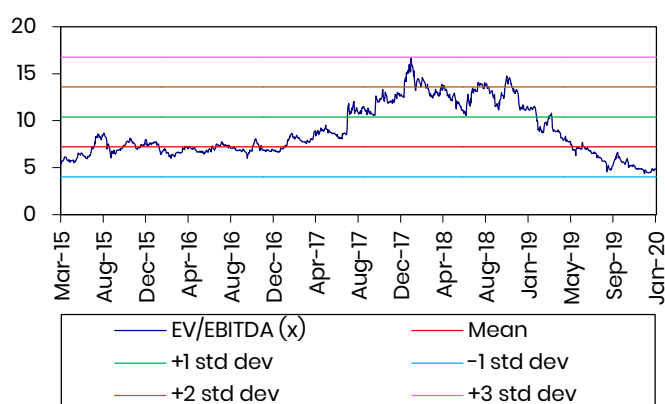
(Rs mn)	3QFY19	3QFY20	YoY (%)	2QFY20	QoQ (%)
Net sales	13,349	12,027	(9.9)	13,597	(11.5)
EBITDA	2,938	2,414	(17.8)	2,885	(16.3)
EBITDA margin (%)	22.0	20.1	-	21.2	-
Other income	104	60	(42.3)	91	(34.1)
Interest	274	557	-	597	-
Depreciation	512	701	36.8	750	(6.6)
PBT	2,256	1,216	(46.1)	1,629	(25.3)
Tax	760	191	(74.9)	33	473.9
PAT	1,456	1,052	(27.8)	1,614	(34.8)
Adjusted PAT	1,456	1,052	(27.8)	1,614	(34.8)

Key variables

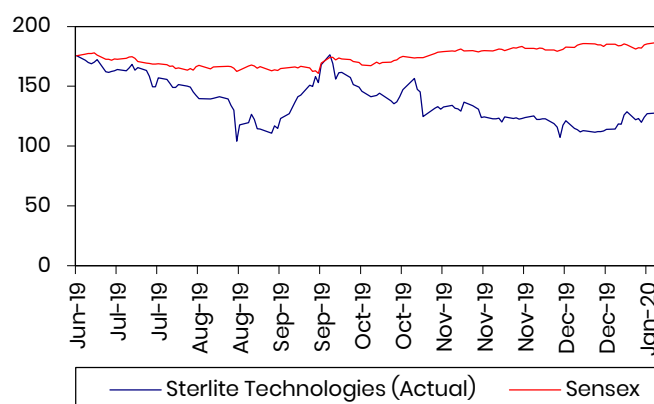
	Improvement on (%)	
	B&K est.	Consensus
Net sales	(25.8)	(11.7)
EBITDA	(13.4)	(6.0)
Adjusted PAT	(6.4)	(8.2)

	FY19	FY20E	FY21E
Valuations			
PER (x)	15.4	10.1	9.5
PBV (x)	5.1	2.6	2.2
EV/EBITDA (x)	9.2	6.1	5.3
Key Ratios			
RoE (%)	39.4	28.2	25.2
Liquidity			
Net D/E (x)	0.87	0.72	0.47

One-year forward EV/EBITDA



Relative performance



Is it in the Price?

We expect Sterlite Technologies (SOTL) to be under pressure in the medium-term led by tepid outlook since it will take time to ramp-up the utilisation in products business while higher contribution from services mix to restrict significant improvement in margins. We expect consensus earnings to revise lower for FY20/21 to factor in weak performance in 3QFY20.

Connecting the Dots

Services business contributed ~56% versus ~50% of revenue in 2QFY20 led overall growth. Navy project, Mahanet project are progressing as per schedule and will continue to drive revenue growth in the coming quarters but low order intake in 9MFY20 in products business will drive weak volumes in the medium-term. We expect revenue of ~15% over FY20-22 led by conversion of order book, largely from services mix.

On LTM basis, order book stood at Rs 85.3 bn versus Rs 81.3 bn in 2QFY20 with product comprising ~44% and rest from services business mix. Order book comprises 40% from telcos (versus 47% in 2QFY20), 30% from enterprises (versus 33% in 2QFY20), 29% from citizen networks (versus 19% in 2QFY20) and 1% from cloud players. Growth visibility continues to be sluggish at 1.4x book-to-bill though management highlighted strong pipeline in progress coupled with mega opportunity anticipated from cloud provider in future could revive order book trend.

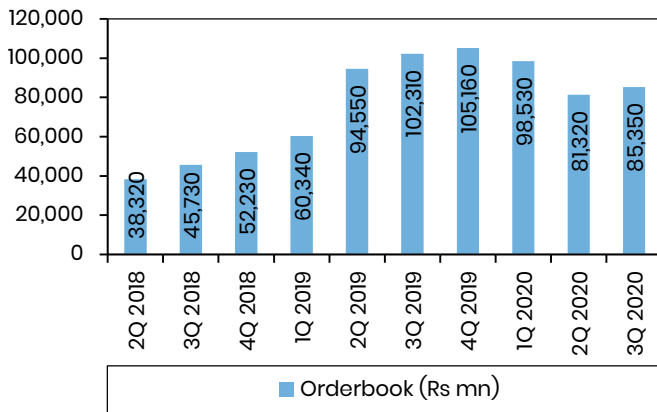
3QFY20 EBITDA margins declined by 115 bps QoQ led by higher contribution from low margin services mix and continuing pricing pressure in optic fibre prices. Management expects connectivity business solutions (OF and OFC) absolute EBITDA to improve in the medium-term on the back of incremental volume as well as cost reduction. Products business will continue to maintain between 20% to 22% EBITDA margins, services segment will be between 15-17% EBITDA mix and the overall EBITDA margin will be in 18% to 20% range. We anticipate average 20% EBITDA margins over FY21-22 versus average 21.4% over FY16-19.

Uptick in 5G roll out, data centre connectivity, culmination of new age technologies like IoT, smart home application, autonomous vehicle, etc. will drive higher demand for optic fibre and cable thereby long-term growth potential for SOTL's solutions remain intact.

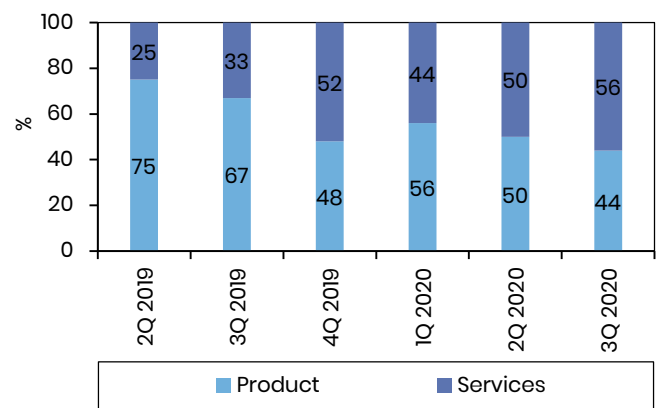
Outlook and Recommendation

The stock is trading at PE of 8x FY22 and EV/EBITDA of ~5x FY22. SOTL's order book grew at moderate pace (5% QoQ in 3QFY20), led by citizen networks, but yet to see any major uptick. SOTL's changing revenue mix profile towards services business and continuing pressure in optic fibre prices coupled with low utilisation will keep margins under pressure. Persisting macro headwind led slowing global growth coupled with weakness in optic fibre prices poses risk.

Order book improved moderately



Order book composition

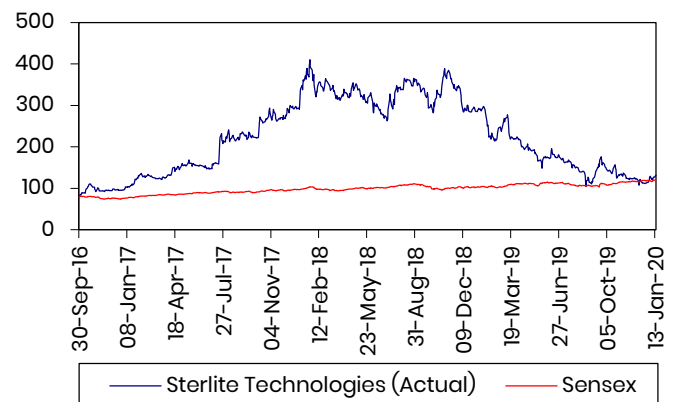


Source: Company, B&K Research

Major shareholders (%)

	Sep 19	Dec 19	Change
Promoters	53.7	53.7	(0.0)
GOI	0.0	0.0	-
FII's	5.8	4.9	(0.8)
MF's	5.5	4.7	(0.9)
BFSI's	1.5	1.5	(0.1)
Public & Others	33.6	35.3	1.8
Pledge	0.0	0.0	0.0

Relative to Sensex 3 Years



Concall highlights

- 2019 is a year of pause for telco industry globally due to macro headwinds, weak profitability and transition from 4G to 5G. Globally, fibre demand came down by 7% which was largely led by fall in China by 13% while US and Europe demand growth was ~4% in 2019. Expect demand for fibre to revive in 2H of 2020 led by pick-up in 5G deployment activity.
- 2020 will witness higher pace of commercial 5G roll out and large data centres will be deployed with their own network connectivity will drive demand for optic fibre. Improvement in profitability from tariff hike in India will drive fibre usage.
- AT&T and Verizon have expanded 5G services to 20 and 30 cities, respectively, by end of 2019 while China launched 5G services in around 50 cities. In Shanghai alone, 12,000 5G base stations have been activated to support 5G coverage. 3 state run Chinese operators are offering 5G plans at US\$ 18 for 30 GB data per month.
- Massive hyper scale and edge data centres being built by global cloud companies will drive capex higher by 20% in 2020 to US\$ 103 bn as per management and going forward continuing spend from cloud companies will significantly impact optical fibre demand.
- Ambitious projects by government to provide broadband access to all villages by 2022 will drive laying almost 3 mn route fkm which involves fibreisation of towers from 30% to 70% and increasing tower density from 0.42 to 1 tower per thousand population.

- Volume in 3Q in OF came down but cable volume remained intact. 46% utilisation for 50 mn km in OF and 76% utilisation for 18 mn fkm of OFC. Expect OFC will go up to 33 mn fkm by June 2020.
- Expect volume for SOTL to revive led by growth from new market entry.
- New product innovations now contribute ~19% to revenue versus ~10% in FY16.
- Focus on cost reduction possibilities across raw material, manufacturing as well as fixed cost to continue which will drive margins improvement.
- Globally, witnessing some shut down of fibre plants and if further capacity shut downs continues, it could lead to stability in OF prices.
- Expect connectivity business solutions (OF and OFC) absolute EBITDA to improve in medium-term on the back of incremental volume as well as cost reduction.
- Network services business continues to be strategic growth engine for SOTL (Rs 3,500 mn in FY16 to Rs 26,000 mn annualised in FY20). Network services business is ~50-51% of revenue for 3Q and YTD FY20.
- 38% of almost Rs 50 bn order book from services is from O&M segment (execution cycle will be around seven years). Overall, order book is further expected to improve in 4QFY20.
- Realisation for optic fibre was US\$ 6 and for cable around US\$ 15.
- 4QFY20 revenue is expected to improve on back of strong growth from services business mix and volume growth in products segment.
- As part of entering new market, SOTL is looking at South-east Asia, Middle East and North America.
- Net debt as on December 2019 stands at Rs 20,780 mn (Rs 17,250 mn in 2QFY20).

Income Statement

Period end (Rs mn)	Mar 19	Mar 20E	Mar 21E	Mar 22E
Net sales	50,873	53,904	62,401	71,227
Growth (%)	58.7	6.0	15.8	14.1
Operating expenses	(39,602)	(42,579)	(49,921)	(56,981)
Operating profit	11,271	11,325	12,480	14,245
EBITDA	11,271	11,325	12,480	14,245
Growth (%)	50.4	0.5	10.2	14.1
Depreciation	(1,950)	(2,787)	(2,914)	(3,326)
Other income	369	301	267	301
EBIT	9,690	8,840	9,833	11,220
Finance cost	(1,055)	(2,175)	(2,229)	(2,229)
Profit before tax	8,635	6,665	7,604	8,991
Tax (current + deferred)	(2,782)	(1,372)	(1,914)	(2,263)
P/(L) for the period	5,853	5,293	5,690	6,728
P/L of Associates, Min Int,	(150)	19	(50)	(66)
Prof Div				
Reported Profit/(Loss)	5,703	5,313	5,640	6,662
Adjusted net profit	5,703	5,313	5,640	6,662
Growth (%)	69.4	(6.8)	6.2	18.1

Balance Sheet

Period end (Rs mn)	Mar 19	Mar 20E	Mar 21E	Mar 22E
Share capital	805	805	805	805
Reserves & surplus	16,388	19,622	23,458	23,458
Shareholders' funds	17,193	20,427	24,263	24,263
Minority interest and others	954	1,049	1,154	1,270
Non-current liabilities	10,575	13,466	12,687	12,075
Long-term borrowings	9,348	10,751	9,676	8,708
Other non-current liabilities	1,226	2,716	3,011	3,367
Current liabilities	41,401	43,148	47,225	52,000
ST borrowings, Curr maturity	9,827	11,792	10,613	9,552
Other current liabilities	31,574	31,356	36,612	42,448
Total (Equity and Liab.)	70,123	78,091	85,329	89,607
Non-current assets	30,342	34,315	36,610	41,855
Fixed assets (Net block)	27,800	31,639	33,772	38,824
Non-current Investments	353	353	353	353
Long-term loans and adv.	427	427	427	427
Other non-current assets	1,763	1,897	2,058	2,251
Current assets	39,781	43,776	48,719	47,752
Cash & current investment	3,339	7,055	8,269	6,232
Other current assets	36,442	36,720	40,449	41,520
Total (Assets)	70,123	78,091	85,329	89,607
Total debt	19,175	22,543	20,289	18,260
Capital employed	38,549	46,735	48,717	47,159

Cash Flow Statement

Period end (Rs mn)	Mar 19	Mar 20E	Mar 21E	Mar 22E
Profit before tax	8,635	6,665	7,604	8,991
Depreciation	1,950	2,787	2,914	3,326
Change in working capital	(971)	(493)	1,531	4,771
Total tax paid	(2,259)	(1,223)	(1,735)	(2,049)
Others	686	1,874	1,962	1,928
Cash flow from oper. (a)	8,040	9,609	12,276	16,968
Capital expenditure	(14,578)	(6,626)	(5,047)	(8,378)
Others	1,169	167	106	107
Cash flow from inv. (b)	(13,409)	(6,459)	(4,941)	(8,271)
Free cash flow (a+b)	(5,368)	3,150	7,334	8,697
Equity raised/(repaid)	3	0	0	0
Debt raised/(repaid)	8,243	3,368	(2,254)	(2,029)
Dividend (incl. tax)	(1,804)	(1,522)	(1,805)	(2,132)
Others	(122)	(1,279)	(2,061)	(6,574)
Cash flow from fin. (c)	6,320	567	(6,120)	(10,734)
Net chg in cash (a+b+c)	952	3,717	1,214	(2,037)

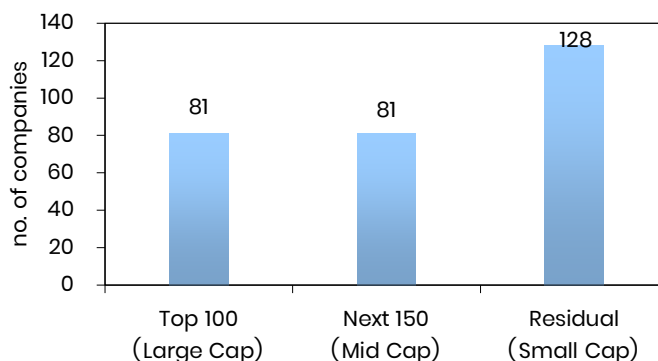
Key Ratios

Period end (%)	Mar 19	Mar 20E	Mar 21E	Mar 22E
Adjusted EPS (Rs)	14.23	13.1	13.8	16.3
Growth	68.8	(8.3)	5.9	18.1
CEPS (Rs)	19.1	19.9	21.0	24.5
Book NAV/share (Rs)	42.9	50.2	59.5	59.5
Dividend/share (Rs)	4.5	3.7	4.4	5.2
Dividend payout ratio	31.6	28.6	32.0	32.0
EBITDA margin	22.2	21.0	20.0	20.0
EBIT margin	19.0	16.4	15.8	15.8
Tax rate	32.2	20.6	25.2	25.2
RoCE	30.6	20.7	20.6	23.4
Total debt/Equity (x)	1.1	1.0	0.8	0.7
Net debt/Equity (x)	0.9	0.7	0.5	0.5
Du Pont Analysis – RoE				
Net margin	11.2	9.9	9.0	9.4
Asset turnover (x)	0.9	0.7	0.8	0.8
Leverage factor (x)	3.7	3.9	3.7	3.6
Return on equity	39.4	28.2	25.2	27.5

Valuations

Period end (x)	Mar 19	Mar 20E	Mar 21E	Mar 22E
PER	15.4	10.1	9.5	8.0
PCE	11.4	6.6	6.3	5.4
Price/Book	5.1	2.6	2.2	2.2
Yield (%)	2.1	2.8	3.4	4.0
EV/EBITDA	9.2	6.1	5.3	4.6

B&K Universe Profile – by AMFI Definition



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