

STERLITE TECHNOLOGIES

Global fiber demand weakness hurts

India Equity Research | Telecom

Sterlite Technologies (Sterlite) posted a 10% YoY dip in revenue (Street estimate: 1.5% growth) beaten down by underwhelming optical fiber (OF) demand and low realisations. EBITDA margin slid 110bps QoQ to 20.1%, but it is ahead of Street's 18.8% estimate due to margin improvement in the services business. Management highlighted that OF prices have stabilised and 5G rollout would spur demand. The company is expanding the services business to tackle the slowdown in OF. Order book rose to INR85bn, from INR81bn in Q2FY20. Factoring in a delay in demand recovery and the weak Q3FY20, we are cutting revenue by 10.7%/2.6% for FY20E/21E, yielding an earnings cut of 13.4%/16.1%. That said, given the company's strong returns profile and attractive valuation (9.4x FY21E EPS), we retain 'BUY' with a revised TP of INR167 (INR189 earlier).

Order book improves, margins to sustain

Despite disappointing on the revenue front, Sterlite managed a 70bps QoQ jump in gross margin. Employee expenses though dragged EBITDA margin by 110bps QoQ. The order book increased to INR85bn – from INR81bn in Q2FY20 – bolstered by the Telangana T-Fiber project. We believe Sterlite is well positioned to benefit from the impending 5G rollout as well as state-level digital transformation projects.

Capacity utilisation likely to pick up

While Sterlite recorded muted capacity utilization in both OF and OFC at 46% and 76%, respectively, we believe the utilization should pick up sooner rather than later as overall demand improves. The Indian OF market, which contracted 29% in 2019, is expected to pick up in the wake of the increase in tariffs and clarity on AGR dues. Globally, in light of inventory depletion, we believe pricing would normalise from H2FY21, followed by pickup in capacity utilisation. However, not losing sight of risks to demand pickup, we are cutting FY20/FY21E revenue and EBITDA by 10.7%/2.6% and 8.1%/8.6%, respectively. This drives down our FY20/FY21E EPS by 13.4%/16.1%.

Outlook and valuation: Attractively priced; maintain 'BUY'

Although its revenue and earnings growth are likely to ease up a bit, Sterlite is well placed to capture growth in optical fiber business as demand in China revives. The stock is trading at an attractive 9.4x FY21E EPS. We maintain 'BUY' with a revised TP of INR167 (12x Q1FY22E EPS).

Financials

Year to March	Q3FY20	Q3FY19	% Chg	Q2FY20	% Chg	FY19	FY20E	FY21E
Net revenues	12,027	13,349	(9.9)	13,597	(11.5)	50,873	55,629	64,056
EBITDA	2,414	2,939	(17.9)	2,885	(16.3)	11,272	11,372	12,318
Adjusted Profit	910	1,497	(39.2)	1,596	(43.0)	5,703	5,332	5,489
Diluted EPS (INR)	1.3	3.6	(64.1)	3.9	(67.1)	13.8	13.7	14.0
Diluted P/E (x)						9.6	9.6	9.4
EV/EBITDA (x)						6.8	6.6	5.8

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Equalweight

MARKET DATA (R: STTE.BO, B: SOTL IN)

CMP	: INR 131
Target Price	: INR 167
52-week range (INR)	: 302 / 97
Share in issue (mn)	: 403.9
M cap (INR bn/USD mn)	: 53 / 749
Avg. Daily Vol.BSE/NSE('000)	: 2,218.4

SHARE HOLDING PATTERN (%)

	Current	Q2FY20	Q1FY20
Promoters *	53.7	53.7	53.8
MF's, FI's & BK's	7.0	7.0	7.3
FII's	5.7	5.7	5.6
Others	33.6	33.6	33.3
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Telecommunication Index
1 month	(3.2)	7.0	1.8
3 months	(3.8)	7.9	(5.0)
12	(64.0)	12.4	(9.2)

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Financial snapshot

(INR mn)

Year to March	Q3FY20	Q3FY19	% change	Q2FY20	% change	YTD20	FY21E	FY22E
Net revenues	12,027	13,349	(9.9)	13,597	(11.5)	39,943	64,056	72,149
Direct costs	5,689	6,300	(9.7)	6,525	(12.8)	19,284	30,426	34,442
Gross profit	6,337	7,049	(10.1)	7,072	(10.4)	20,659	33,629	37,707
SG&A	3,923	4,110	(4.5)	4,187	(6.3)	12,126	21,311	23,981
EBITDA	2,414	2,939	(17.9)	2,885	(16.3)	8,533	12,318	13,726
Depreciation	701	512	36.8	750	(6.6)	2,135	2,881	3,055
EBIT	1,713	2,427	(29.4)	2,135	(19.7)	6,399	9,437	10,672
Interest	557	274	103.4	597	(6.7)	1,617	2,357	2,310
Other income	60	104	(42.3)	91	(34.1)	239	128	144
Add: Exceptional items	(409)	(21)	NA	(18)	NA	(441)		
Profit before tax	718	2,216	(67.6)	1,629	(55.9)	4,523	7,303	8,600
Tax	191	760	(74.9)	33	473.9	958	1,814	2,141
Reported net profit	500	1,476	(66.1)	1,578	(68.3)	3,566	5,489	6,459
Exceptional items	507	21	2,314.8	18	2,733.0	538	-	-
Adjusted Profit	910	1,497	(39.2)	1,596	(43.0)	4,007	5,489	6,459
Diluted EPS (INR)	1.3	3.6	(64.1)	3.9	(67.1)	8.8	13.7	14.0
Diluted P/E (x)	-	-	-	-	-	9.6	9.4	8.0
EV/EBITDA (x)	-	-	-	-	-	6.6	5.8	4.8
EV/Revenues (x)	-	-	-	-	-	1.4	1.1	0.9
Direct costs	47.3	47.2		48.0		48.3	47.5	47.7
Gross profit	52.7	52.8		52.0		51.7	52.5	52.3
SG&A	32.6	30.8		30.8		30.4	33.3	33.2
EBITDA	20.1	22.0		21.2		21.4	19.2	19.0
EBIT	14.2	18.2		15.7		16.0	14.7	14.8
Reported net profit	4.2	11.1		11.6		8.9	8.6	9.0
Tax rate	26.6	34.3		2.0		21.2	24.8	24.9

Change in Estimates

	FY20E			FY21E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	55,629	62,314	(10.7)	64,056	65,769	(2.6)	Factoring lower demand and realisations
EBITDA	11,372	12,379	(8.1)	12,318	13,483	(8.6)	Higher proportion of low margin services business impact margin
EBITDA Margin	20.4	19.9		19.2	20.5		
Adjusted Profit After Tax	5,332	6,152	(13.3)	5,489	6,544	(16.1)	Lower revenue and margins impact earnings
Net Profit Margin	9.4	9.9		8.4	10.0		
Capex	5,200	5,200	0.0	1,500	2,500	(40.0)	Lower management guidance

Company Description

Sterlite Technologies (Sterlite) is a global technology player engaged in designing, building and managing telecom broadband networks. Its offerings include optical products, system and network integration services and telecom software. Sterlite is India's largest and only fully integrated optical fiber cable manufacturer with OF and OFC capacity of 30mn and 15mn FKM, respectively. The company has enhanced production of OF to 50mn FKM and is in the process of testing. It has manufacturing plants in Aurangabad, Silvasa, China (through joint venture (JV) with Tongguang) and Brazil (through JV with Condustar). In services business, Sterlite is developing several network projects, such as, secure network for the armed forces, rural broadband through BharatNet, Smart Cities, and high-speed Fiber-to-the-Home (FTTH). It also offers customisable OSS & BSS software solutions suite through Elitecore, which it acquired in FY16. The company has TTM revenue of INR59.2bn.

Investment Theme

We believe that Sterlite will be the key beneficiary of strong demand for fiber optic cables, leveraging its capacity expansion; Its superior cost structure due to integrated operations will lead to high EBITDA margins improving return ratios, despite planned capex. The company is strategically expanding its portfolio of services leveraging its knowhow of complex network and relationships from the fiber business.

Key Risks

- China is the largest consumer of the OFC (57.5% of global consumption) and hence demand fluctuation can impact the capacity utilisation
- Downturn in global economy
- Alternate connectivity technology
- Telecom capex dip
- Currency risk

Financial Statements

Key Assumptions

Year to March	FY19	FY20E	FY21E	FY22E
Macro				
GDP(Y-o-Y %)	6.8	5.0	5.8	6.5
Inflation (Avg)	3.4	4.3	4.8	5.0
Repo rate (exit rate)	6.3	5.2	4.5	5.0
USD/INR (Avg)	70.0	71.5	71.0	70.0
Company				
Product revenues	33,640	29,427	33,817	40,351
Employee benefit exp.	10.0	12.5	13.3	13.2
Other exp	18.9	19.0	20.0	20.0
Receivable (days)	80	92	88	89
Payable days	118	123	79	78

Income statement

(INR mn)

Year to March	FY19	FY20E	FY21E	FY22E
Net revenue	50,873	55,629	64,056	72,149
Cost of revenues	24,872	26,735	30,426	34,442
Gross profit	26,000	28,894	33,629	37,707
Total SG&A expenses	14,729	17,522	21,311	23,981
EBITDA	11,272	11,372	12,318	13,726
Depreciation	1,950	2,836	2,881	3,055
EBIT	9,322	8,536	9,437	10,672
Add: Other income	368.6	270.37	128.11	144.3
Profit Before Tax	8,560	6,093	7,208	8,506
Less: Provision for Tax	2,782	1,363	1,814	2,141
Reported Profit	5,628	4,793	5,489	6,459
Exceptional Items	(76)	(538)	-	-
Adjusted Profit	5,703	5,332	5,489	6,459
Shares o /s (mn)	408	383	385	387
Adjusted Basic EPS	14.0	13.9	14.2	16.7
Diluted shares o/s (mn)	413	389	391	393
Adjusted Diluted EPS	13.8	13.7	14.0	16.4
Adjusted Cash EPS	18.8	21.3	21.7	24.6
Dividend per share (DPS)	2.0	3.8	5.0	5.8
Dividend Payout Ratio(%)	17.0	31.9	41.4	41.5

Common size metrics

Year to March	FY19	FY20E	FY21E	FY22E
Cost of revenues	48.9	48.1	47.5	47.7
Gross margin	51.1	51.9	52.5	52.3
SG&A expenses	29.0	31.5	33.3	33.2
EBITDA margins	22.2	20.4	19.2	19.0
EBIT margins	18.3	15.3	14.7	14.8
Net Profit margins	11.5	9.4	8.4	8.8

Growth ratios (%)

Year to March	FY19	FY20E	FY21E	FY22E
Revenues	58.7	9.4	15.1	12.6
EBITDA	50.4	0.9	8.3	11.4
PBT	71.8	(28.8)	18.3	18.0
Adjusted Profit	68.4	(6.5)	2.9	17.7
EPS	66.3	(0.9)	2.4	17.1

Balance sheet		(INR mn)			
As on 31st March	FY19	FY20E	FY21E	FY22E	
Share capital	805	767	771	774	
Reserves & Surplus	16,388	19,989	23,165	26,903	
Shareholders' funds	17,193	20,755	23,936	27,678	
Minority Interest	954	902	847	793	
Def. Tax Liability (net)	744	744	744	744	
Sources of funds	44,826	42,141	42,462	46,209	
Gross Block	21,979	35,167	40,367	41,867	
Net Block	23,175	26,020	24,823	23,427	
Capital work in progress	4,194	4,194	4,194	4,194	
Intangible Assets	1,504	1,023	839	679	
Total Fixed Assets	28,873	31,237	29,856	28,301	
Non current investments	353	553	1,553	1,553	
Cash and Equivalents	3,339	(5,132)	(4,547)	869	
Sundry Debtors	13,566	14,607	16,413	18,676	
Loans & Advances	427	427	427	427	
Other Current Assets	17,669	18,062	18,710	19,207	
Current Assets (ex cash)	37,558	40,165	43,380	47,196	
Trade payable	19,128	10,604	11,746	13,329	
Other Current Liab	6,170	14,078	16,034	18,381	
Total Current Liab	25,297	24,682	27,780	31,710	
Net Curr Assets-ex cash	12,261	15,483	15,601	15,486	
Uses of funds	44,826	42,141	42,462	46,209	
BVPS (INR)	41.6	53.3	61.2	70.4	

Free cash flow		(INR mn)			
Year to March	FY19	FY20E	FY21E	FY22E	
Reported Profit	5,628	4,793	5,489	6,459	
Add: Depreciation	1,950	2,836	2,881	3,055	
Interest (Net of Tax)	712	1,688	1,764	1,729	
Others	(14,307)	(17,891)	456	944	
Less: Changes in WC	(7,791)	(9,417)	(21)	228	
Operating cash flow	1,773	844	10,611	11,958	
Less: Capex	8,438	5,200	1,500	1,500	
Free Cash Flow	(6,665)	(4,356)	9,111	10,458	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Sterlite Technologies	749	9.6	9.4	5.0	4.5	26.4	23.2
Bharti Airtel	33,896	(114.3)	34.9	6.4	5.0	(1.0)	8.7
Bharti Infratel	6,451	13.5	15.0	6.9	6.5	26.4	27.3
Tejas Networks	120	15.4	9.3	5.8	3.5	4.3	6.8
Vodafone Idea	2,434	(1.0)	(1.3)	10.2	7.2	(0.5)	(1.6)
Median	-	9.6	9.4	6.4	5.0	4.3	8.7
AVERAGE	-	(15.4)	13.5	6.8	5.3	11.1	12.9

Source: Edelweiss research

Cash flow metrics					
Year to March	FY19	FY20E	FY21E	FY22E	
Operating cash flow	1,773	844	10,611	11,958	
Financing cash flow	(11,721)	(5,898)	(4,000)	498	
Investing cash flow	10,239	(3,915)	(7,526)	(5,043)	
Net cash Flow	291	(8,969)	(915)	7,414	
Capex	(8,438)	(5,200)	(1,500)	(1,500)	
Dividend paid	(968)	(1,701)	(2,272)	(2,681)	

Profitability and efficiency ratios

Year to March	FY19	FY20E	FY21E	FY22E
ROAE (%)	38.1	26.4	23.2	23.9
ROACE (%)	27.7	20.6	23.0	24.8
Inventory Days	68	89	89	89
Debtors Days	80	92	88	89
Payable Days	118	123	79	78
Cash Conversion Cycle	30	58	99	99
Current Ratio	1.6	1.4	1.4	1.5

Operating ratios

Year to March	FY19	FY20E	FY21E	FY22E
Total Asset Turnover	1.4	1.3	1.5	1.6
Fixed Asset Turnover	2.3	1.9	2.1	2.5
Equity Turnover	3.3	2.8	2.8	2.7

Valuation parameters

Year to March	FY19	FY20E	FY21E	FY22E
Adj. Diluted EPS (INR)	13.8	13.7	14.0	16.4
Y-o-Y growth (%)	66.3	(0.9)	2.4	17.1
Adjusted Cash EPS (INR)	18.8	21.3	21.7	24.6
Diluted P/E (x)	9.5	9.6	9.4	8.0
P/B (x)	3.2	2.5	2.1	1.9
EV / Sales (x)	1.5	1.4	1.1	0.9
EV / EBITDA (x)	4.5	5.0	4.5	3.7
Dividend Yield (%)	1.5	2.9	3.8	4.4

Additional Data

Directors Data

Anil Agarwal	Chairman	Pravin Agarwal	Director
Dr. Anand Agarwal	CEO and Director	Dr. AR Narayanaswamy	Independent Director
Sandip Das	Independent Director	Arun Todarwal	Independent Director
Kumud Srinivasan	Independent Director	Pratik Agarwal	Non-Executive Director

Auditors - S.R.B.C. & Co. LLP

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Twin star intl ltd	51.85	Dsp blackrock invest	2.7
Reliance capital tru	1.54	Reliance capital tru	1.42
Aditya birla sun lif	1.32	Vedanta ltd	1.18
Life insurance corp	1.16	Aditya birla sun lif	1.1
Dimensional fund adv	1.09	Franklin resources	0.99

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
28 May 2019	Pravin Agarwal	Buy	57000.00
26 Apr 2019	BNP PARIBAS ARBITRAGE	BUY	2439689.00

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Bharti Airtel	BUY	SO	L	Bharti Infratel	HOLD	SP	L
Sterlite Technologies	BUY	SO	M	Tejas Networks	BUY	SO	M
Vodafone Idea	REDUCE	SU	M				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



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Coverage group(s) of stocks by primary analyst(s): Telecom

Bharti Airtel, Bharti Infratel, Vodafone Idea, Sterlite Technologies, Tejas Networks

Recent Research

Date	Company	Title	Price (INR)	Recos
30-Dec-19	Telecom	TRAI subscriber data: Broadband subscriber addition inching up; <i>Sector Update</i>		
24-Dec-19	Bharti Infratel	Lengthening shadows: Merger delayed, yet again ; <i>EdelFlash</i>	255	Hold
06-Dec-19	Telecom	Daylight's here, finally; <i>Sector Update</i>		

Distribution of Ratings / Market Cap

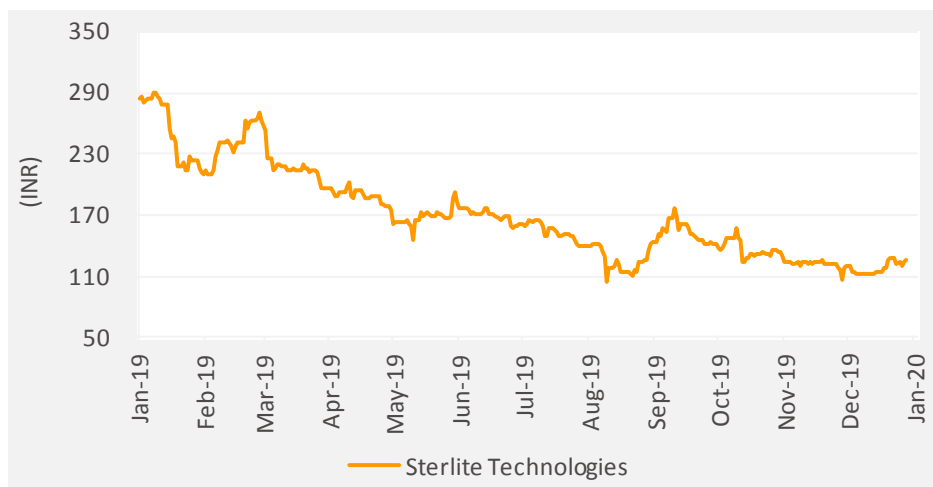
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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