

Weak global fibre demand weighs on performance...

Sterlite Tech's (STL) Q3FY20 performance was weak on the operating front on account of fibre demand slowdown. Revenue came in at ₹ 1,203 crore, down ~10% YoY. The decline was owing to weak export revenues (largely products and forming ~31% of overall revenue), which declined 30% YoY. Domestic revenues, forming 69% of the topline, witnessed growth of 4% YoY, driven by decent execution in the services segment. EBITDA was at ₹ 241.4 crore, down ~18% YoY, impacted by negative operating leverage on account of revenue decline with margins at 20.1%, down 194 bps YoY. Reported PAT came in lower at ₹ 52.6 crore, down 63.9% YoY, on account of the weak operating performance and higher depreciation & interest costs from new OF capacity. There was an exceptional item of ₹ 50.7 crore, relating to settlement of disputed excise matter in prior years under government scheme. Adjusted PAT, at ₹ 91 crore, was down 37.5% YoY.

Fibre demand weakness hits product revenues

STL indicated that global OFC demand came down in 2019 as China and India witnessed 13% and 29% de-growth, respectively, while North America & Europe were up 4% YoY. The company expects a demand and pricing recovery from H2FY21E onwards and has guided for an improvement in performance sequentially driven by strong services revenues and foray into new geographies. We lower our revenue forecast for FY20 to ~9% and expect FY21 revenues to witness a spurt (up 18% YoY) with new market foray that will improve capacity utilisation as well as continued network services traction. We build in margins of 21% and 19% for FY20E and FY21E, respectively, as lower OF/OFC realisation and higher services revenues mix would result in a margin decline.

Order book robust; services segment visibility improves...

The total order book was at ₹ 8535 crore (vs. ₹ 8132 crore in Q2FY19), of which network services order book is ₹ 4792 crore (~56% of total). Recently the company was awarded T-Fibre project (order size ₹ 1100 crore) to deliver digital infrastructure to 6 million rural citizens of Telangana. The company has termed network services as the strategic growth engine wherein it aims to penetrate into new customer segments such as cloud & telcos to further increase the scope of services.

Valuation & Outlook

We highlight that STL's capacity expansion amid such muted demand will weigh on the bottomline in FY21E and meaningful earnings growth is expected to be seen from FY22. The continued traction in network services is, however, heartening and a partial hedge in a volatile product demand scenario. We assign a **HOLD** rating (vs. REDUCE earlier) on the stock, valuing it at ₹ 120/share (implying 5x FY21E EV/EBITDA and 10x FY21 P/E).



Particulars

Particular	Amount
Market Capitalization (₹ crore)	5,041.9
Total Debt (FY19) (₹ crore)	2,102.1
Cash (FY19) (₹ crore)	333.9
EV (₹ crore)	6,810.2
52 week H/L (₹)	399/ 96
Equity capital (₹ crore)	80.2
Face value (₹)	2.0

Key Highlights

- Topline decline of 10% YoY was owing to weak exports revenues (largely products and forming ~31% of overall revenue) which declined 30% YoY
- The company has guided for improvement in performance sequentially driven by strong services revenues and foray into new geographies
- We assign a HOLD rating (vs. REDUCE earlier) on the stock, valuing it at ₹ 120/share (implying 5x FY21E EV/EBITDA and 10x FY21 P/E)

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Key Financial Summary

(Year-end March)	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Net Sales (₹ crore)	2,593.6	3,205.5	5,087.3	5,314.8	6,266.1	11.0
EBITDA (₹ crore)	518.9	749.3	1,127.2	1,117.4	1,190.6	2.8
Net Profit (₹ crore)	201.4	337.5	567.9	501.9	484.1	(7.7)
EPS (₹)	5.1	8.3	14.0	11.4	12.0	
P/E (x)	24.8	15.0	9.0	11.0	10.4	
Price / Book (x)	5.7	4.3	2.9	2.5	2.2	
EV/EBITDA (x)	11.6	7.9	6.0	6.3	5.7	
RoE (%)	22.9	28.7	33.0	24.9	20.8	
RoCE (%)	20.8	29.7	27.8	21.8	22.4	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q3FY20	Q3FY20E	Q3FY19	Q2FY20	YoY (%)	QoQ (%)	Comments
Revenue	1,202.7	1,355.4	1,334.9	1,359.7	-9.9	-11.5	The decline was owing to weak exports revenues (largely products and forming ~31% of overall revenue), which declined 30% YoY. Domestic revenues, forming 69% of the topline, witnessed growth of 4% YoY, driven by decent execution in the services segment
Other Income	6.0	9.0	10.4	9.1	-42.3	-34.1	
Cost of raw material	562.8	616.7	661.6	622.7	-14.9	-9.6	
Purchase of traded goods	-0.5	27.1	16.7	2.1	NA	NA	
Employee Expenses	164.8	162.6	149.3	166.7	10.4	-1.1	
(Increase) / decrease in inventories	6.7	13.6	-48.4	27.7	-113.8	-76.0	
Other Expenses	227.5	250.7	261.7	252.0	-13.1	-9.7	
EBITDA	241.4	284.6	293.9	288.5	-17.9	-16.3	EBITDA was impacted by negative operating leverage on account of revenue decline
EBITDA Margin (%)	20.1	21.0	22.0	21.2	-194 bps	-114 bps	
Depreciation	70.1	75.0	51.2	75.0	36.8	-6.6	
Interest	55.7	60.1	27.4	59.7	103.4	-6.7	
Total Tax	19.1	39.9	76.0	3.3	-74.9	473.9	
PAT	52.6	116.3	145.6	159.6	-63.9	-67.0	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY20E			FY21E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	5,837.5	5,314.8	-9.0	6,246.1	6,266.1	0.3	Realigned our estimates post 9MFY20 numbers
EBITDA	1,214.0	1,117.4	-8.0	1,218.0	1,190.6	-2.3	
EBITDA Margin (%)	20.8	21.0	22 bps	19.5	19.0	-50 bps	
PAT	558.7	458.7	-17.9	522.5	484.1	-7.3	
EPS (₹)	13.9	11.4	-18.0	13.0	12.0	-7.5	

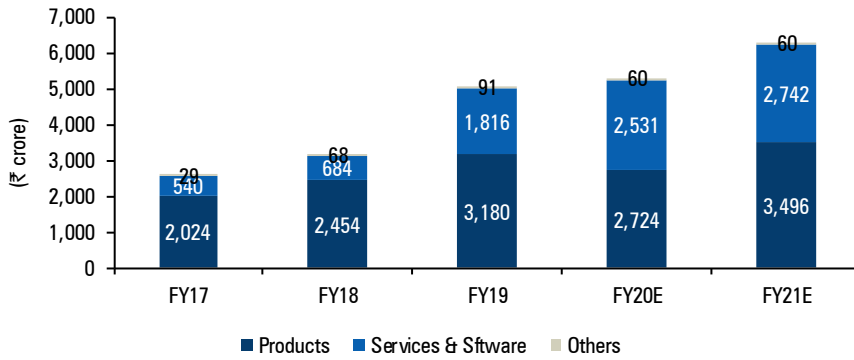
Source: Company, ICICI Direct Research

Business Highlights

- **Global fibre demand:** Global fibre demand declined 7% YoY in 2019 (from 511 mn fkm to 478 mn fkm), on account of China slowing down after a massive 4G build. China & India witnessed 13% and 29% de-growth, respectively, while North America & Europe were up 4% YoY. India's weak demand is due to the new operator's pause in capex as well as other incumbents deferring their capex investments. Globally, most telcos have paused capex and are delaying their investments. Once the 5G investment cycle starts, demand is likely to pick up from H2FY21
- **Capacity utilisation:** Optic fibre capacity utilisation is 46% including the new capacity (total fibre capacity is ~50 mn fkm). The cabling capacity is operating at ~76% utilisation at a current capacity of 18 mn fkm (including Mettallurgica). The same is slated to expand to 33 mn fkm by June 2020. The utilisation (commercial offtake) from the new cable capacity will pick up only post a demand revival
- **Margins:** The management has guided for overall margins in the 18-20% range on the back of a further increase in network services mix and continued decline in fibre prices impacting product margins. Network services margins are expected at 15-17% while product margins are expected to be in the 20-22% range
- **ASOCs acquisition:** STL acquired a 12.8% stake in ASOCS, a developer of open, disruptive and virtualized radio access network (vRAN) solutions, delivering 4G and 5G for cellular networks. ASOCS is a pioneer in virtual radio access networks (vRAN) and a provider of fully virtualised base station solutions for enterprise and telco-networks. The valuations were not shared
- **Project status:** Project NFS has completed an Indian Army project in J&K and is moving into O&M. Project Varun (Indian Navy project) is 65% complete. Mahanet is 55% complete. Furthermore, it has rolled out 5500 km fibre for Indian telcos in FY20YTD
- **Other highlights**
 - Capex will be below the guided levels of ₹ 550 crore in FY20E. Net debt is currently at ₹ 2078 crore while the company expects it to decline from here on
 - O&M pie of the network services order book (₹ 4792 crore) is growing and forms 37% or ₹ 1770 crore
 - Fibre realisation has fallen to \$6/fkm (vs. US\$6-6.5/fkm in Q2). Globally, fibre prices are between \$5 and \$6/fkm

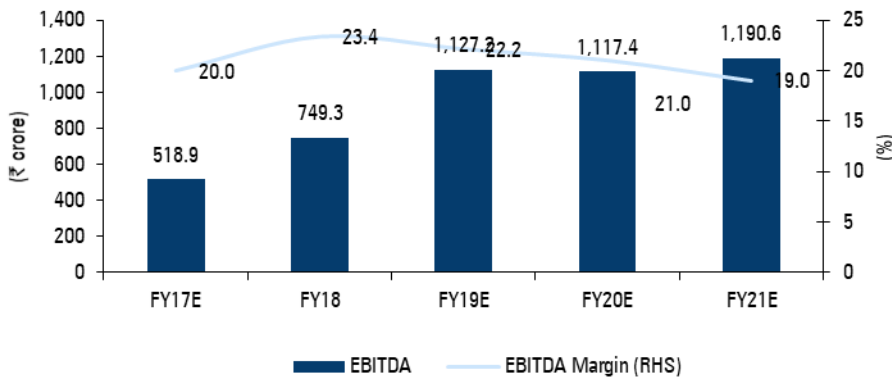
Financial story in charts

Exhibit 3: Topline growth trend



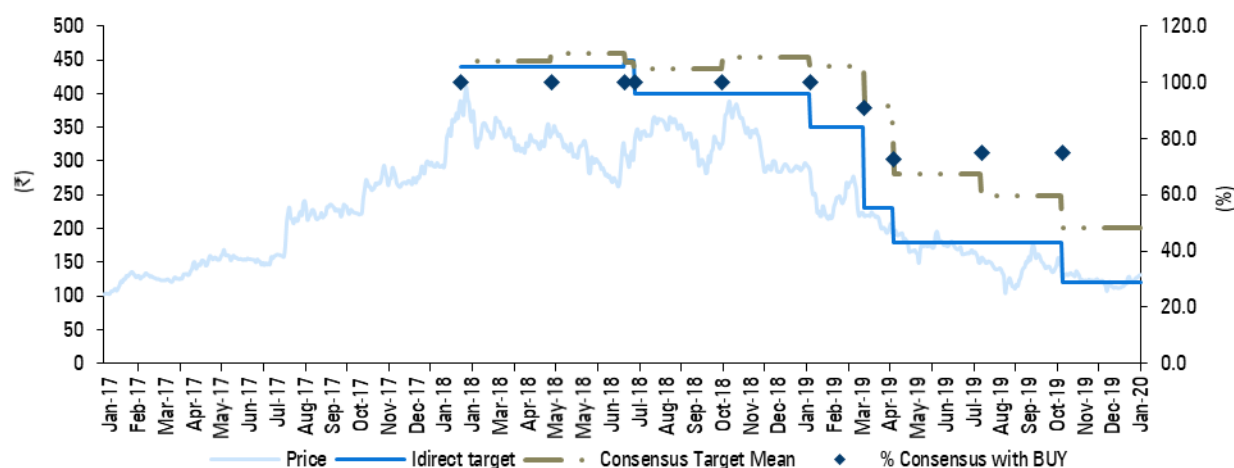
Source: Company, ICICI Direct Research

Exhibit 4: Margins to decline ahead



Source: Company, ICICI Direct Research

Exhibit 5: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 6: Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Position Change (m)
1	Twin Star Overseas, Ltd.	30-Jun-19	51.9	209.4	0.0
2	DSP Investment Managers Pvt. Ltd.	31-Dec-19	2.7	10.9	0.0
3	Reliance Nippon Life Asset Management	30-Nov-19	1.4	5.7	-0.3
4	Aditya Birla Sun Life AMC Limited	30-Nov-19	1.3	5.3	-0.3
5	Vedanta Ltd	30-Jun-19	1.2	4.8	0.0
6	Life Insurance Corporation of India	30-Jun-19	1.2	4.7	-2.8
7	Dimensional Fund Advisors, L.P.	30-Nov-19	1.1	4.4	-0.2
8	Franklin Templeton	30-Sep-19	1.0	4.0	0.0
9	The Vanguard Group, Inc.	31-Dec-19	0.9	3.4	0.1
10	BlackRock Institutional Trust Company	13-Jan-20	0.5	1.8	0.0

Source: Bloomberg, ICICI Direct Research

Exhibit 7: Shareholding Pattern

(in %)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Promoters	53.83	53.82	53.83	53.68	53.65
FII	6.20	6.01	5.58	5.73	4.94
DII	13.23	10.56	7.33	7.03	5.94
Others	26.74	29.61	33.26	33.56	35.47

Source: BSE, ICICI Direct Research

Financial summary

Exhibit 8: Profit and loss statement				
	₹ crore			
(Year-end March)	FY18	FY19E	FY20E	FY21E
Total operating income	3,205.5	5,087.3	5,314.8	6,266.1
Growth (%)	23.6	58.7	4.5	17.9
Cost of raw materials	1,267.0	2,487.2	2,542.4	2,976.4
Employee Expenses	350.2	511.2	649.4	720.6
Administrative Expenses	838.9	961.7	1,005.5	1,378.5
Total Operating Expenditure	2,456.1	3,960.1	4,197.4	5,075.6
EBITDA	749.3	1,127.2	1,117.4	1,190.6
Growth (%)	44.4	50.4	-0.9	6.5
Depreciation	182.2	195.0	287.0	319.6
Interest	103.8	105.5	217.5	252.8
Other Income	39.3	36.9	30.9	30.0
Exceptional Items	4.4	7.6	55.6	-
PBT	498.2	856.0	588.2	648.2
Minority Interest	29.8	15.0	(1.9)	1.0
Profit from Associates	(0.9)	-	-	-
Total Tax	133.2	278.2	131.5	163.1
PAT	334.3	562.8	458.7	484.1
Growth (%)	66.0	68.3	-18.5	5.5
EPS (₹)	8.3	14.0	11.4	12.0

Source: Company, ICICI Direct Research

Exhibit 9: Cash flow statement				
	₹ crore			
(Year-end March)	FY18	FY19E	FY20E	FY21E
Profit after Tax	334.3	562.8	458.7	484.1
Add: Depreciation	182.2	195.0	287.0	319.6
Add: Interest paid	103.8	105.5	217.5	252.8
(Inc)/dec in Current Assets	-389.9	-1,986.9	-272.1	-541.5
Inc/(dec) in CL and Provisions	414.9	1,314.2	69.1	423.6
Others	0.0	0.0	0.0	0.0
CF from operating activities	645.4	190.6	760.1	938.6
(Inc)/dec in Investments	-125.5	39.1	0.0	0.0
(Inc)/dec in Fixed Assets	-424.3	-1,457.8	-550.0	-250.0
Others	-16.1	490.1	-6.7	-7.4
CF from investing activities	-565.9	-928.6	-556.7	-257.4
Issue/(Buy back) of Equity	0.5	0.3	0.0	0.0
Inc/Dec in Minority Interest	36.8	13.5	1.5	-1.8
Issue of Preference Shares	0.0	0.0	0.0	0.0
Inc/(Dec) in loan funds	27.7	944.0	0.0	-100.0
Interest paid	-103.8	-105.5	-217.5	-252.8
Others	-39.6	-19.1	-166.3	-166.3
CF from financing activities	-78.4	833.2	-382.2	-520.8
Net Cash flow	1.1	95.2	-178.9	160.4
Opening Cash	137.4	138.4	233.7	54.8
Closing Cash	138.4	233.7	54.8	215.2

Source: Company, ICICI Direct Research

Exhibit 10: Balance sheet				
	₹ crore			
(Year-end March)	FY18	FY19E	FY20E	FY21E
Liabilities				
Equity Capital	80.2	80.5	80.5	80.5
Preference Share Capital	0.0	0.0	0.0	0.0
Reserve and Surplus	1,095.1	1,638.8	1,931.2	2,249.1
Total Shareholders funds	1,175.3	1,719.3	2,011.7	2,329.6
Total Debt	1,158.1	2,102.1	2,102.1	2,002.1
Others	468.8	1,000.6	1,002.0	1,000.2
Total Liabilities	2,802.2	4,822.0	5,115.9	5,332.0
Assets				
Gross Block	2,359.3	3,754.7	4,404.1	4,654.1
Less: Acc Depreciation	1,199.2	1,394.1	1,681.1	2,000.7
Net Block	1,160.2	2,360.5	2,723.0	2,653.4
Capital WIP	357.0	419.4	320.0	320.0
Goodwill	73.9	107.4	107.4	107.4
Total Fixed Assets	1,591.1	2,887.3	3,150.3	3,080.7
Investments	248.5	242.8	242.8	242.8
Inventory	337.9	589.7	538.8	635.2
Debtors	871.3	1,356.6	1,601.7	1,888.4
Loans and Advances	35.0	42.7	44.6	52.6
Other Current Assets	457.7	1,699.7	1,775.7	1,926.1
Cash	138.4	233.7	54.8	215.2
Total Current Assets	1,840.3	3,922.4	4,015.6	4,717.5
Creditors	656.2	1,912.8	1,965.7	2,317.6
Provisions	83.8	67.2	69.0	81.4
Other current liabilities	243.5	317.7	331.9	391.4
Total Current Liabilities	983.5	2,297.6	2,366.7	2,790.3
Net Current Assets	856.8	1,624.7	1,648.9	1,927.2
Other non current assets	105.7	67.1	73.9	81.2
Application of Funds	2,802.2	4,822.0	5,115.9	5,332.0

Source: Company, ICICI Direct Research

Exhibit 11: Key ratios				
	₹ crore			
(Year-end March)	FY18	FY19E	FY20E	FY21E
Per share data (₹)				
EPS	8.3	14.0	11.4	12.0
Cash EPS	12.9	18.8	18.5	20.0
BV	29.3	42.7	50.0	57.9
DPS	2.4	2.4	4.1	4.1
Cash Per Share	29.9	34.6	41.8	49.7
Operating Ratios (%)				
EBITDA Margin	23.4	22.2	21.0	19.0
EBIT Margin	17.7	18.3	15.6	13.9
PAT Margin	10.5	11.2	9.4	7.7
Inventory days	38.5	42.3	37.0	37.0
Debtor days	99.2	97.3	110.0	110.0
Creditor days	74.7	137.2	135.0	135.0
Return Ratios (%)				
RoE	28.7	33.0	24.9	20.8
RoCE	29.7	27.8	21.8	22.4
RoIC	26.5	22.7	17.7	18.2
Valuation Ratios (x)				
P/E	15.0	9.0	11.0	10.4
EV / EBITDA	7.9	6.0	6.3	5.7
EV / Net Sales	1.8	1.3	1.3	1.1
Market Cap / Sales	1.6	1.0	0.9	0.8
Price to Book Value	4.3	2.9	2.5	2.2
Solvency Ratios				
Debt/EBITDA	1.5	1.9	1.9	1.7
Net Debt / Equity	0.7	1.0	1.0	0.7
Current Ratio	2.3	1.9	1.9	1.9
Quick Ratio	1.8	1.6	1.7	1.6

Source: Company, ICICI Direct Research

Exhibit 12: ICICI Direct Coverage Universe (Telecom)

Sector / Company	CMP (₹)	TP (₹)	Rating	M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
					FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Bharti Airtel	470	550	Buy	241,157	1.0	-64.0	8.7	458.8	NM	54.0	13.8	9.2	6.9	2.1	4.1	7.5	-3.5	-3.4	7.4
Bharti Infratel	243	295	Hold	45,029	13.5	18.4	16.5	18.1	13.3	14.8	7.4	5.9	5.9	21.1	21.2	20.2	14.7	17.2	25.4
Vodafone Idea	6	9	Buy	17,529	-5.1	-22.3	-5.3	NM	NM	NM	33.6	8.0	6.1	-5.0	-4.7	-3.0	-25.9	-95.9	-81.1
Sterlite Tech	125	120	Hold	5,032	14.0	11.4	12.0	8.9	11.0	10.4	6.0	6.2	5.6	29.7	27.8	21.8	28.7	33.0	24.9
Tata Comm	442	370	Hold	12,597	-2.9	10.0	14.9	NM	NM	29.6	7.8	6.4	6.0	5.9	5.4	8.3	9.4	127.7	-201.4

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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