

Sterlite Technologies Ltd

BUY

CMP Rs131

Target Rs160

Upside 22%

Subdued quarter

Weak demand for fibre impacts performance

Sterlite Technologies Ltd (STL) reported topline de-growth of ~10% yoy to Rs.12.0 bn owing to lower offtake in its fibre business. The increasing contribution from relatively lower margin services business has translated into further moderation in operating margin, which stood at 20.1% during the quarter (22.0% in Q3 FY19). During Q3 FY20, the company recognized a one-time provision related to disputed excise duty case of 2005-06 for Rs.507 mn. Sharp rise in interest costs saw net profit (adjusted for one-time excise related provision) decline 39% yoy to Rs.910 mn. On the back of recent order flows, the order book remained decent at Rs.85.4 bn (~1.5x TTM revenues). The demand environment is expected to be weak in the near term and management expects flattish volume growth in the products business for the year.

Demand for fibre to pick-up in FY21; realizations likely to stabilize

There has been demand slowdown for fibre globally which has impacted capacity utilization. However, the demand is expected to pick-up from Q1 FY21. Also, there has been a sharp correction in fibre prices over last few quarters with realizations now being at ~\$6 per fkm (\$7-\$8 earlier). Despite the decline in prices and higher contribution from low margin services segment, the Company has been able to maintain its operating margins at ~20% levels. Realizations are expected to stabilize now as some capacities are being shut globally. The Company expects operating margins to stabilize at 18-20% levels going forward.

Valuation attractive at current levels

STL is significantly banking on the expected increase in demand for high-speed data across the globe. Additionally, projects like Governments BharatNet and smart city development are expected to add to the demand. With the increased capacity in place and integrated business model, STL is better placed than some of its peers. We roll forward our estimates to FY22 and maintain a Buy rating on the stock for target price of Rs.160.

Exhibit 1: Result table (Consolidated)

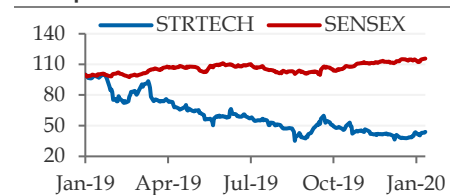
Y/e 31 Mar (Rs m)	Q3 FY20	Q3 FY19	yoy(%)	Q2 FY20	qoq (%)
Revenue	12,027	13,349	(9.9)	13,597	(11.5)
Operating Profit	2,414	2,939	(17.9)	2,885	(16.3)
OPM (%)	20.1	22.0	-194 bps	21.2	-114 bps
Other Income	60	104	(42.3)	91	(34.1)
Depreciation	(701)	(512)	36.8	(750)	(6.6)
Interest	(557)	(274)	103.4	(597)	(6.7)
Exceptional item	(525)	(21)	-	(18)	-
PBT	691	2,236	(69.1)	1,611	(57.1)
Tax	(191)	(760)	(74.9)	(33)	473.9
PAT	500	1,476	(66.1)	1,578	(68.3)
Reported PAT	500	1,476	(66.1)	1,578	(68.3)
Adjusted PAT*	910	1,497	(39.2)	1,596	(43.0)

Source: Company, YES Sec - Research; Adjusted* for exceptional item net of tax

Stock data (as on Jan 15, 2020)

Sensex:	41,873
52 Week h/l (Rs)	302 / 97
Market cap (Rs/USD mn)	52,735/748
Outstanding Shares (mn)	403
6m Avg t/o (Rs mn):	218.9
Div yield (%):	2.7
Bloomberg code:	SOTL IN
NSE code:	STRTECH

Stock performance



	1M	3M	1Y
Absolute return	14.1 %	-4.3%	-54.3 %

Shareholding pattern (As of Dec'19 end)

Promoter	53.7%
FII+DII	11.0%
Others	35.3%

Δ in stance

(1-Yr)	New	Old
Rating	BUY	BUY
Target Price	182	160

Δ in earnings estimates

	FY20e	FY21e	FY22e
EPS (New)	13.7	15.7	17.7
EPS (Old)	14.3	18.2	-
% change	(4.3)	(13.8)	-

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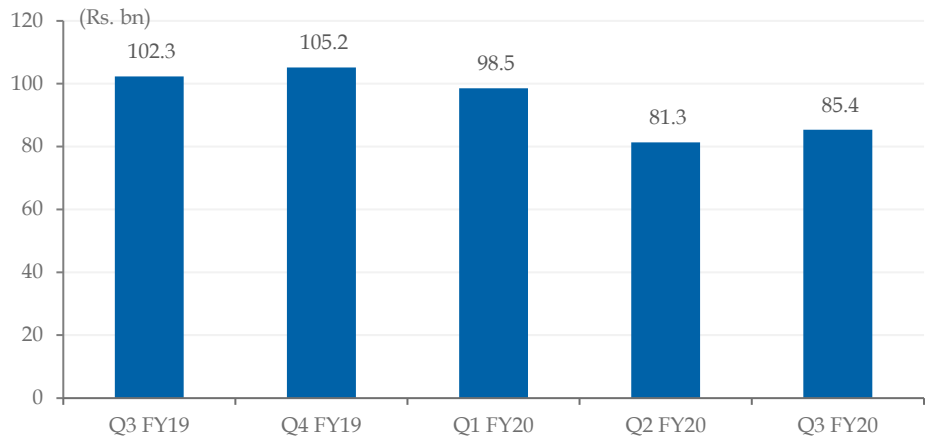
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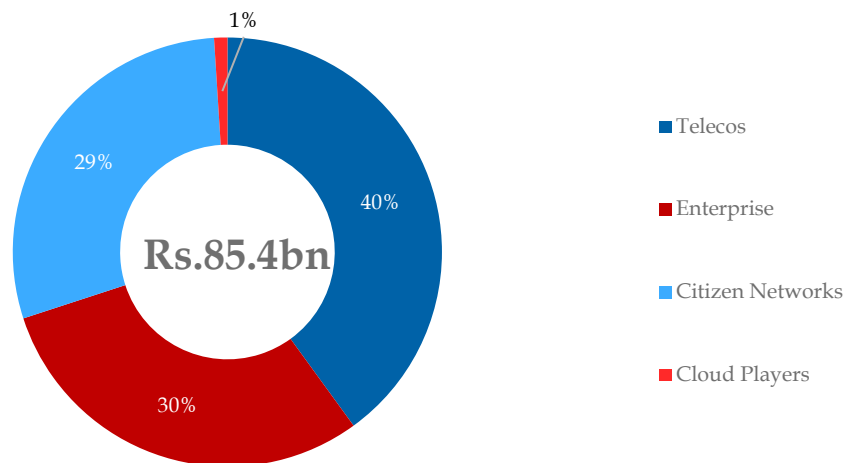
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Exhibit 2: Order book at the end of Q3 FY20 improved on qoq basis



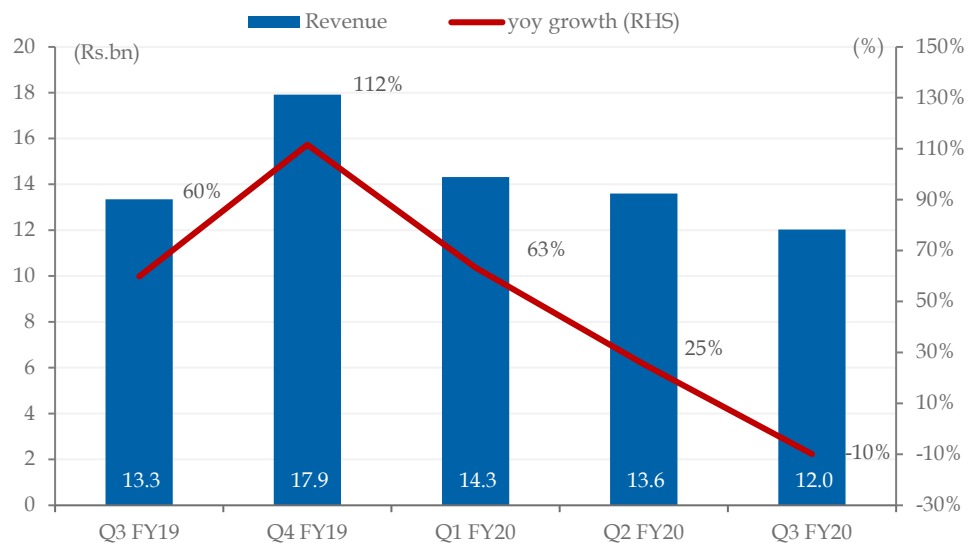
Source: Company, YES Sec - Research

Exhibit 3: Telcos continues to dominate overall order book



Source: Company, YES Sec - Research

Exhibit 4: Revenue growth declines due to weak offtake



Source: Company, YES Sec - Research

CONFERENCE CALL HIGHLIGHTS

- ✓ STL' topline de-grew ~10% yoy during Q3 FY20, largely impacted by overall decline in optical fibre/cable demand from major global telecoms players. During CY19, global fibre demand witnessed de-growth of 7% whereas de-growth of 13%/29% was seen in China/India respectively.
- ✓ The management expects fibre demand to improve in CY20 backed by a) 5G commercial launches across major markets such as China, Europe and the US, b) deployment of fibre by large edge datacenter, and c) tower fiberisation and broadband connectivity.
- ✓ STL's capacity utilization at the end of Q3 FY20 for fibre/cable stood at ~46%/~76% respectively. With expected pickup in demand and company's entry in the newer geographies, the management expects utilization to improve to ~75% in both the segments on increased capacity.
- ✓ STL's capacity expansion program is on track. The fibre capacity has enhanced to 50mn fkm whereas the management expects cable capacity to improve to 33 mn km by Jun'20.
- ✓ The management believes fibre/cable realization in the industry has bottomed out with current prices at US\$5-6/ US\$15 respectively. STL's average realization for fibre during Q3 FY20 stood at ~US\$6. Going forward, the management expects improvement in realization supported by demand growth across key geographies. Also shut down of some capacities would support prices.
- ✓ Operating margin during Q3 FY20 stood at 20.1% (down 194bps yoy). With higher contribution from comparatively lower margin services business, the guidance for blended operating margin stood in the range of 18-20% going forward.
- ✓ STL's order book has improved to Rs.85.4bn at the end of Q3 FY20, largely supported by Rs.11bn T-fibre project. The scope is to deliver digital infrastructure to 6 mn rural citizens of Telangana.
- ✓ STL has completed ~65% of Indian Navy project and established Data Centre for Navy's seamless transition to new-age applications. Also, ~55% of Mahanet project has been delivered with network infrastructure deployment to 2,000+ gram panchayats.
- ✓ STL has recently acquired a 12.8% stake in ASOCS (a developer of virtualized Radio Access Network solutions). The acquisition is likely to help company in creating cutting edge solutions mainly for 5G network.
- ✓ Capex guidance for FY20 remains at <Rs.5.5bn. However, no major capex is likely to be incurred in FY21. The tax rate is likely to be ~25% levels for FY20 and FY21.

Exhibit 5: Financial Summary (Consolidated)

Y/e 31 Mar (Rs m)	FY19	FY20E	FY21E	FY22E
Revenues	50,873	57,995	66,694	74,697
yoy growth (%)	60.1	14.0	15.0	12.0
Operating profit	11,272	12,116	13,267	14,369
OPM (%)	22.2	20.9	19.9	19.2
Reported PAT	5,628	5,000	6,316	7,143
Adjusted PAT	5,703	5,507	6,316	7,143
yoy growth (%)	68.3	(11.1)	26.3	13.1
EPS (Rs)	14.0	12.4	15.7	17.7
P/E (x)	9.4	10.5	8.3	7.4
EV/EBITDA (x)	6.1	5.7	4.8	3.9
Debt/Equity (x)	1.1	0.9	0.7	0.6
RoE (%)	38.9	26.5	27.8	25.0

Source: Company, YES Sec – Research

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