


Rating system revised. Refer last page

 CMP : Rs 163
 Potential Upside : 19%

MARKET DATA

 No. of Shares : 403 mn
 Free Float : 46%
 Market Cap : Rs 66 bn
 52-week High / Low : Rs 399 / Rs 144
 Avg. Daily vol. (6mth) : 2.6 mn shares
 Bloomberg Code : SOTL IB Equity
 Promoters Holding : 54%
 FII / DII : 6% / 11%

Revenue miss, margin strong

Sterlite Tech reported strong EBITDA number (+2.6% QoQ; 10% beat), though revenue growth disappointed (-20.1% QoQ; 13% miss) as Q4FY19 was strong due to execution of Navy order. Higher depreciation and interest cost led to marginal beat (4%) on profit.

See signs of stability: As services contribution (~45% of order book) remains elevated, we expect EBITDA margin to remain restricted to ~20%. We expect revenue CAGR of 17% to translate into only 9% earnings CAGR over FY19-21. We cut EBITDA estimate by 6%/8% as we expect moderation in services revenue once the Navy/MahaNet projects are executed; we also factor in risks of soft OF & OFC demand/pricing pressure. However, at CMP, the stock trades at 13x/12x FY20E/ FY21E EPS – which implies correction has been overdone. **Maintain BUY** with TP of Rs 195 (14x FY21E EPS) vs. our previous TP of Rs 230.

Order book still strong at Rs 98.5 bn despite challenges to product business

Products may remain under pressure; working capital to remain elevated: As per management, pricing trend (due to glut in China) would have limited impact in near term as it has no exposure to spot market. However, we believe, if pricing pressure sustains, there would be challenges for long-term contracts also. We see the pressure to restrict growth outlook of products business in FY20/21. Also, increasing share of services in revenue would compress margin to 19-20% from low 20s earlier as EBITDA margin of services business is in low teens (11-12%). Moreover, services would have higher working capital requirement. We believe the change in business mix would restrict any margin upside in near term.

Moderating revenue trajectory, a concern: We believe revenue trajectory would continue moderation through FY20, but recovery likely in FY21 as (i) volumes from 10 x 2 mn fkm OF capacity expansion becomes operational; & (ii) additional volumes from optical fiber cable (OFC) expansion to 33 mn km (by June-20 in phased manner) starts to kick in. Delays in 5G related capex along with change in capex plan of Chinese telcos pose key risk for the stock as it may lead to pricing and volume pressure. We expect near term pressure on stock price due to moderation in revenue.

Financial summary (Consolidated)

Y/E March	FY18	FY19	FY20E	FY21E
Sales (Rs mn)	32,055	50,873	61,069	69,321
Adj PAT (Rs mn)	3,387	5,703	5,096	5,665
Con. EPS* (Rs)	-	-	15.7	18.3
EPS (Rs)	8.3	14.1	12.6	14.0
Change YOY (%)	66.8	68.6	(10.7)	11.2
P/E (x)	19.6	11.6	13.0	11.7
RoE (%)	33.0	39.4	27.0	25.2
RoCE (%)	24.6	29.5	22.9	22.9
EV/E (x)	10.2	7.4	7.0	6.2
DPS (Rs)	2.0	3.5	3.5	4.0

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

	FY19	FY20E	FY21E
OF (fkm mn)	30.9	34.7	44.0
Realization (\$/fkm)	8.0	7.2	7.1
OFC (fkm mn)	16.2	21.9	28.7
Realization (\$/fkm)	17.8	16.5	16.5

Price performance

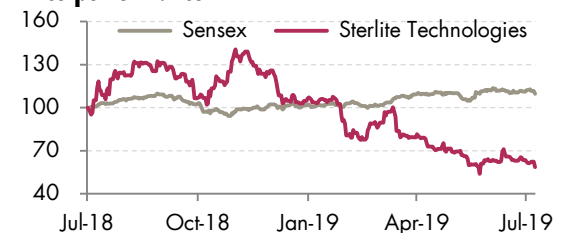


Exhibit 1: Results update

(Rs. mn)	Quarter ended					12 months ended		
	Jun-19	Jun-18	% Chg	Mar-19	% Chg	FY20E	FY19	% Chg
Net Sales	14,320	8,769	63.3	17,912	(20.1)	61,069	50,873	20.0
EBIDTA	3,234	2,449	32.1	3,151	2.6	12,303	11,272	9.2
PBIDT	3,234	2,449	32.1	3,151	2.6	12,303	11,272	9.2
Depreciation	683	448	52.6	498	37.3	2,833	1,950	-
Interest	375	158	137.6	175	114.9	1,535	686	-
PBT	2,175	1,843	18.0	2,478	(12.2)	7,936	8,635	(8.1)
Tax	733	548	33.7	822	(10.7)	2,675	2,782	-
Minority Interest	15	78	(80.8)	(20)	(174.5)	165	150	9.6
Adjusted PAT	1,427	1,217	17.3	1,676	(14.9)	5,096	5,703	(10.7)
Extra ordinary income/ (exp.)	13	10	-	25	(47.0)	13	76	-
Reported PAT	1,414	1,207	17.1	1,652	(14.4)	5,082	5,628	(9.7)
No. of shares (mn)	406	406	-	406	-	406	406	-
EBIDTA margin (%)	22.6	27.9	-	17.6	-	20.1	22.2	-
PBIDT margin (%)	22.6	27.9	-	17.6	-	20.1	22.2	-
EPS - annualized (Rs.)	14.1	12.0	17.4	16.5	(14.9)	12.6	14.1	(10.7)

Source: Company, Axis Capital

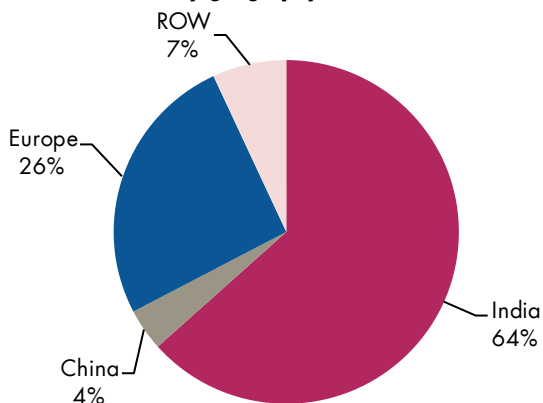
Q1FY20 key highlights - EBITDA beat only silver lining

- ◆ Reported revenue decline of 20.1% QoQ (+63.3%YoY) to Rs 14,320 mn (AxisCap/ Cons.: Rs 16,463 mn/ Rs 14,914 mn), below our/ consensus estimates. Revenue decline was largely on account of order execution of Navy deal in Q4FY19. 60% of revenue was from products, while services were 40% of revenue that included revenue from Navy projects as well as from telco project.
- ◆ EBITDA was Rs 3,234 mn (+2.6% QoQ; +32.1% YoY). EBITDA margin was up 500 bps QoQ to 22.6% (AxisCap/Cons: 17.8%/19.1%), due to improved revenue mix as share of low margin services reduced.
- ◆ Interest cost was Rs 463 mn vs. Rs 307 mn in Q4 (Rs 231 mn in Q1FY19), primarily due to rise in debt for expansion activities.
- ◆ Adjusted PAT (after minority) at Rs 1.43 bn was up 17.3% YoY (-14.9% QoQ).
- ◆ Reported EPS was down 14.5% QoQ (+16.8% YoY) to Rs 3.47 (AxisCap/Cons.: Rs 3.38/Rs 3.38).
- ◆ Order book was down 6% QoQ to Rs98.5 bn (Rs 105.2 bn in Q4FY19).
- ◆ Company reported ROCE at 28% vs. all-time-high 34% for FY19.
- ◆ Patent portfolio was up at 273 from 271 at end of FY19.

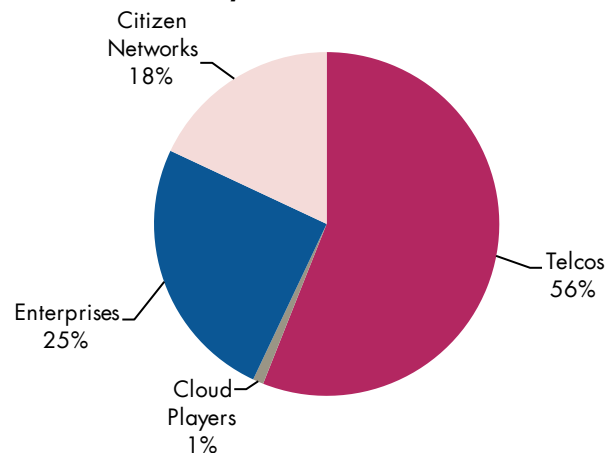
Takeaways from conference call

- ◆ **OF demand to pick up in China by FY21:** China fiber demand was flat in FY19 (-1% YoY growth). Q1FY20 OF demand was also flat in China while it was up globally. Management expects OF demand to grow moderately globally, but flat in China in FY20. However, it expects OF demand to pick up in FY21 as capex for 5G starts to gain pace in China. Early 5G commercial launches across major markets have already started, including in South Korea, China and USA.
- ◆ **OF prices over USD 7/fkm for SOTL:** OF business operates at USD 7-8 fkm. OF prices have softened. However, it is still over USD 7 fkm for the company. OF price correction has remained largely localized and has not widely impacted in Europe and USA. As per management, OF prices in China has already bottomed out and OF demand has started to come in again.

- ◆ **Elevated order book:** Order book of Rs 98.5 bn as of Jun-2019 was down 6% QoQ, which gives visibility of ~1.7x order book to TTM revenue. Order book split was 55%:45% for products and services.
- ◆ **Services share to remain high in revenue:** Services' share in revenue was ~40% in Q1 vs. 52% in Q4 (37% for FY19). Execution of Naval project (~50% complete) and Mahanet (~30% complete) remains on track.
- ◆ **EBITDA margin guidance of ~20% for FY20E:** Company expects EBITDA margin of ~20% for FY20 due to higher mix of services in revenue. Services' EBITDA margin is expected at ~11-12%, while products' EBITDA margin is expected at 25-26%. Moreover, company plans to maintain RoCE of over 25% as the services business operates at higher RoCE.
- ◆ **OF and OFC expansion on track:** OF expansions are on track. Commissioning of OF expansion is still underway. Commercial production is expected from Q3FY19 now (earlier Q2). Management expects to end FY20 with 40 to 45 mn fkm OF capacity and is booking orders accordingly. OFC capacity is expected to be around 23 to 24 mn fkm by end of FY20 and reach 33 mn fkm by Q1FY21.
- ◆ **Capex of Rs 5.5 bn for FY20 maintained:** It has maintained its capex guidance of Rs 5.5 bn for FY20 (including maintenance capex) and some OFC related capex in FY21. Earlier guidance for FY21 was Rs 2 to 2.5 bn. Net debt at end of Q1 was Rs 19.8 bn and it plans to maintain net debt to EBITDA at 1x.
- ◆ **Working capital elevated:** Working capital remains elevated due: (i) to high share of services in revenue leading to increase in collection out-standing; and (ii) new capacity under commissioning (Rs 9 bn gross block capitalized in the quarter).

Exhibit 2: Revenue by geography (Q1FY20)


Source: Company, Axis Capital

Exhibit 3: Revenue by customer base (Q1FY20)


Source: Company, Axis Capital

Change in estimates

We cut our FY20/21 revenue estimate by 18%/16% as we expect moderation in services revenue once the Navy/ManaNet projects are executed. We also factor in risks of soft OF & OFC demand and pricing pressure amid slower-than-expected pickup in 5G related capex. We also increase our depreciation and interest expense leading to net profit cut of 16% each for FY20/21.

Exhibit 4: Change in estimates

YE March	FY20E	FY21E
Revenue (Rs m)		
- New	61,069	69,401
- Old	74,588	82,673
Change (%)	(18.1)	(16.1)
EBITDA (Rs m)		
- New	12,303	13,354
- Old	13,106	14,601
Change (%)	(6.1)	(8.5)
Net profit (Rs m)		
- New	5,096	5,665
- Old	6,063	6,717
Change (%)	(16.0)	(15.7)

Source: Axis Capital

Valuation & recommendation – revenue growth moderation, a concern

Sterlite Tech reported beat to EBITDA estimates, but it did not translate into earnings momentum. Structural change in margin profile and working capital could be a concern. However, revenue growth will still remain strong as SOTL (1) adds 20 mn fkm capacity by June 2019; (2) plans to add 15 mn fkm cable capacity by June 2020 and (3) executes strong order book. We expect ~17% revenue CAGR over FY19-21 aided by strong volume growth. However, we expect ~9% EBITDA CAGR over FY19-21 (EBITDA margin of ~19%).

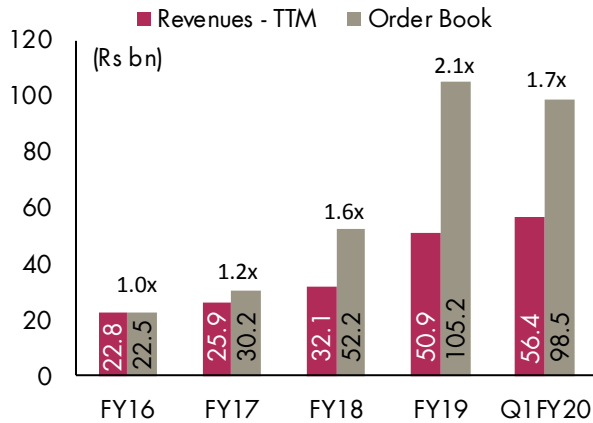
We cut our FY20/21 EBITDA estimate by 6.1%/8.5%. However, at CMP, the stock trades at 13x/12x FY20E/ FY21E EPS – which implies correction has been overdone. We have **BUY** rating on the stock with revised TP of Rs 195 (Rs 230 earlier).

Exhibit 5: Results table

(Rs m)	1Q20	4Q19	QoQ	1Q19	YoY	Consensus	AxisCap('E)	(AxisCap vs actual)
Revenue	14,320	17,912	(20.1)	8,769	63.3	14,914	16,463	(13.0)
EBITDA	3,234	3,151	2.6	2,449	32.1	2,845	2,934	10.2
EBITDA margin (%)	22.6	17.6	499bp	27.9	(534bp)	19.1	17.8	476bp
EBIT	2,550	2,653	(3.9)	2,001	27.5	2,286	2,391	6.7
Interest Cost	463	307	50.9	231	100.8		352	31.6
Other income	87	132	(33.8)	73	20.6		100	(12.6)
PBT	2,175	2,478	(12.2)	1,843	18.0	1,894	2,140	1.7
Income tax	733	822	(10.7)	548	33.7		717	2.3
Minority + JVs	15	(20)	(174.5)	78	(80.8)		50	(70.2)
Net profit (Ex-one offs)	1,427	1,676	(14.9)	1,217	17.3	1,373	1,373	3.9

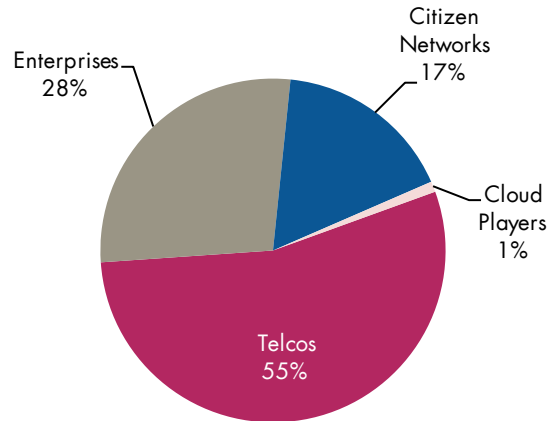
Source: Company, Axis Capital

Exhibit 6: High order book provides revenue visibility



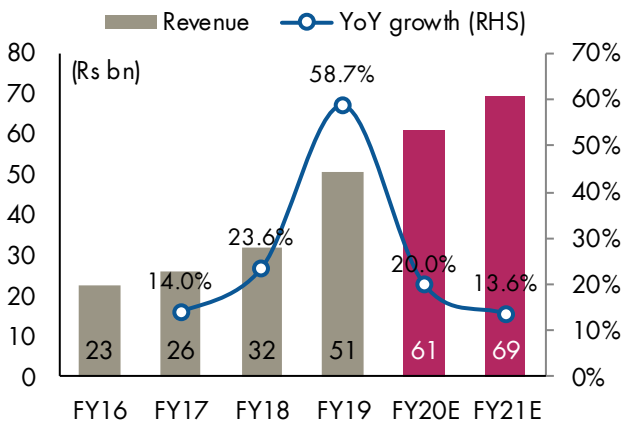
Source: Company

Exhibit 7: Order-book mix



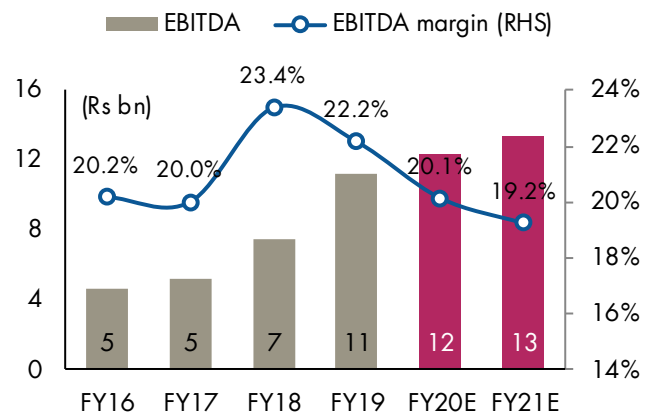
Source: Company

Exhibit 8: Revenue growth to remain at high levels



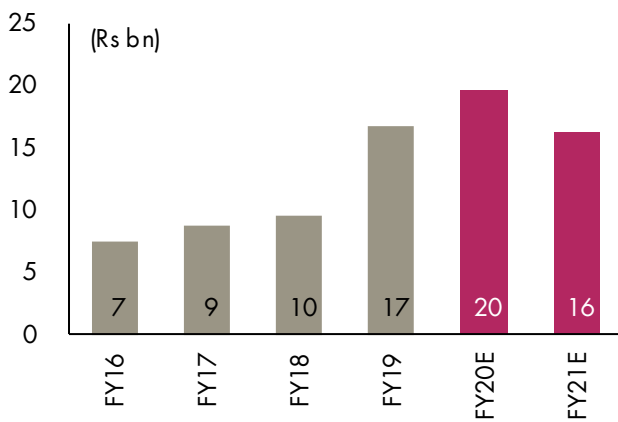
Source: Company, Axis Capital

Exhibit 9: EBITDA to grow led by volume growth



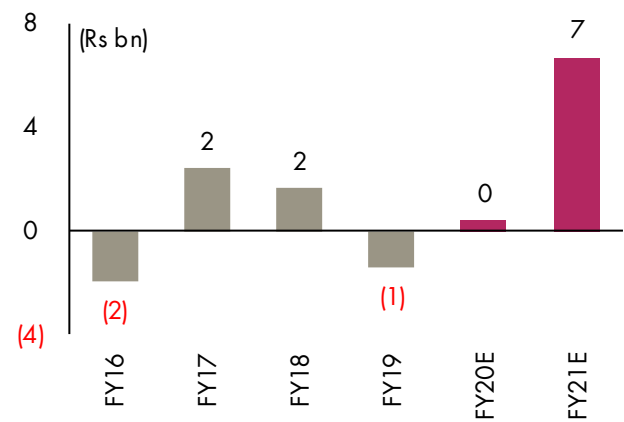
Source: Company, Axis Capital

Exhibit 10: Net debt to decline from FY21



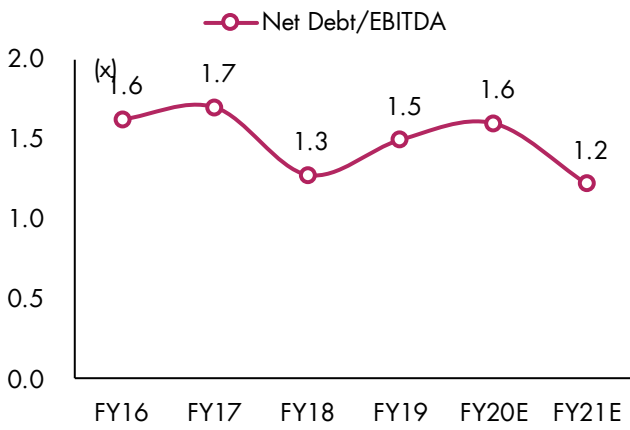
Source: Company, Axis Capital

Exhibit 11: FCF to turn positive



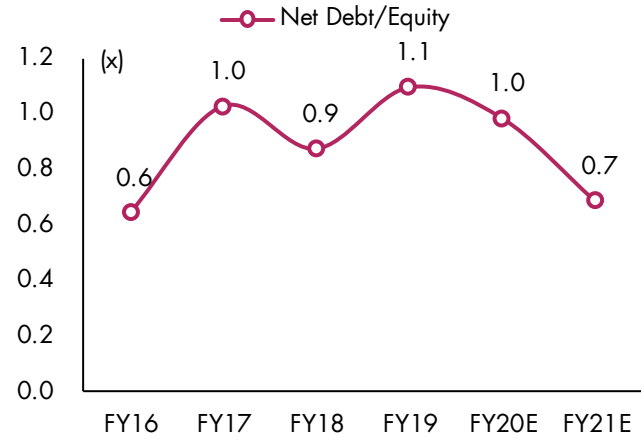
Source: Company, Axis Capital

Exhibit 12: Net debt/EBITDA to decline



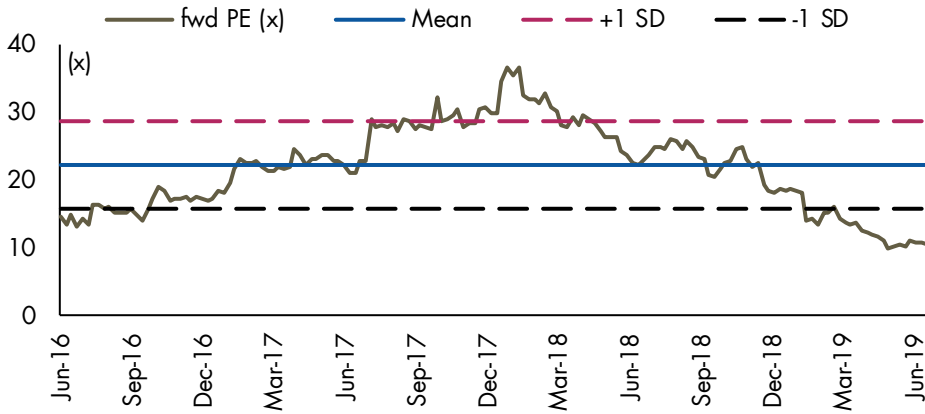
Source: Company, Axis Capital

Exhibit 13: Net debt/Equity to decline from FY20E



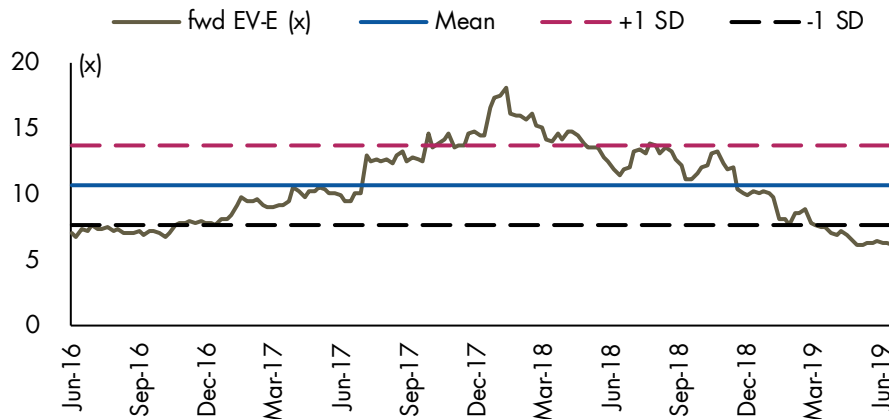
Source: Company, Axis Capital

Exhibit 14: 1-Yr Forward P/E band



Source: Bloomberg, Axis Capital

Exhibit 15: 1-Yr Forward EV/EBITDA band



Source: Bloomberg, Axis Capital

Financial summary (Consolidated)
Profit & loss (Rs mn)

Y/E March	FY18	FY19	FY20E	FY21E
Net sales	32,055	50,873	61,069	69,321
Other operating income	-	-	-	80
Total operating income	32,055	50,873	61,069	69,401
Cost of goods sold	(12,670)	(24,872)	(31,660)	(36,636)
Gross profit	19,385	26,000	29,409	32,764
<i>Gross margin (%)</i>	<i>60.5</i>	<i>51.1</i>	<i>48.2</i>	<i>47.3</i>
Total operating expenses	(11,891)	(14,729)	(17,106)	(19,410)
EBITDA	7,494	11,272	12,303	13,354
<i>EBITDA margin (%)</i>	<i>23.4</i>	<i>22.2</i>	<i>20.1</i>	<i>19.3</i>
Depreciation	(1,822)	(1,950)	(2,833)	(3,119)
EBIT	5,671	9,322	9,471	10,235
Net interest	(646)	(686)	(1,535)	(1,440)
Other income	-	-	-	-
Profit before tax	5,026	8,635	7,936	8,795
Total taxation	(1,332)	(2,782)	(2,675)	(2,946)
<i>Tax rate (%)</i>	<i>26.5</i>	<i>32.2</i>	<i>33.7</i>	<i>33.5</i>
Profit after tax	3,694	5,854	5,260	5,849
Minorities	(298)	(150)	(165)	(183)
Profit/ Loss associate co(s)	(9)	-	-	-
Adjusted net profit	3,387	5,703	5,096	5,665
<i>Adj. PAT margin (%)</i>	<i>10.6</i>	<i>11.2</i>	<i>8.3</i>	<i>8.2</i>
Net non-recurring items	(44)	(76)	(13)	-
Reported net profit	3,343	5,628	5,082	5,665

Balance sheet (Rs mn)

Y/E March	FY18	FY19	FY20E	FY21E
Paid-up capital	802	805	802	802
Reserves & surplus	10,951	16,388	19,786	23,527
Net worth	11,753	17,193	20,588	24,329
Borrowing	10,933	19,175	21,175	18,175
Other non-current liabilities	1,200	1,226	1,355	1,437
Total liabilities	24,705	38,548	44,237	45,243
Gross fixed assets	11,351	23,175	25,649	24,955
Less: Depreciation	-	-	-	-
Net fixed assets	11,351	23,175	25,649	24,955
Add: Capital WIP	3,570	4,194	4,194	4,194
Total fixed assets	14,921	27,369	29,843	29,150
Total Investment	285	353	353	353
Inventory	3,379	5,897	7,328	8,318
Debtors	8,672	13,549	16,731	18,992
Cash & bank	1,385	2,337	1,521	1,868
Loans & advances	-	-	-	-
Current liabilities	12,412	31,574	33,588	38,126
Net current assets	7,150	8,207	11,315	12,850
Other non-current assets	2,349	2,620	2,725	2,891
Total assets	24,705	38,549	44,237	45,243

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY18	FY19	FY20E	FY21E
Profit before tax	5,026	8,635	7,936	8,795
Depreciation & Amortisation	1,822	1,950	2,833	3,119
<i>Chg in working capital</i>	<i>(1,722)</i>	<i>(17,837)</i>	<i>(6,043)</i>	<i>(5,892)</i>
Cash flow from operations	7,316	6,311	5,727	9,138
<i>Capital expenditure</i>	<i>(4,501)</i>	<i>(8,324)</i>	<i>(5,307)</i>	<i>(2,426)</i>
Cash flow from investing	(5,848)	(11,721)	(4,957)	(2,026)
<i>Equity raised/ (repaid)</i>	<i>15</i>	<i>3</i>	<i>(3)</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>(184)</i>	<i>7,747</i>	<i>2,000</i>	<i>(3,000)</i>
Cash flow from financing	(1,515)	5,702	(1,572)	(6,765)
Net chg in cash	(48)	291	(802)	347
	-	-	-	-

Key ratios

Y/E March	FY18	FY19	FY20E	FY21E
OPERATIONAL				
FDEPS (Rs)	8.3	14.1	12.6	14.0
CEPS (Rs)	12.7	18.7	19.5	21.6
DPS (Rs)	2.0	3.5	3.5	4.0
Dividend payout ratio (%)	24.0	24.9	27.6	28.3
GROWTH				
Net sales (%)	25.1	58.7	20.0	13.5
EBITDA (%)	44.4	50.4	9.2	8.5
Adj net profit (%)	68.2	68.4	(10.7)	11.2
FDEPS (%)	66.8	68.6	(10.7)	11.2
PERFORMANCE				
RoE (%)	33.0	39.4	27.0	25.2
RoCE (%)	24.6	29.5	22.9	22.9
EFFICIENCY				
Asset turnover (x)	1.6	1.8	1.6	1.7
Sales/ total assets (x)	1.0	0.9	0.8	0.9
Working capital/ sales (x)	0.2	0.1	0.1	0.1
Receivable days	98.7	97.2	100.0	100.0
Inventory days	50.2	54.3	54.9	54.2
Payable days	-	-	-	-
FINANCIAL STABILITY				
Total debt/ equity (x)	1.0	1.2	1.1	0.8
Net debt/ equity (x)	0.9	1.1	1.0	0.7
Current ratio (x)	1.6	1.3	1.3	1.3
Interest cover (x)	8.8	13.6	6.2	7.1
VALUATION				
PE (x)	19.6	11.6	13.0	11.7
EV/ EBITDA (x)	10.2	7.4	7.0	6.2
EV/ Net sales (x)	2.4	1.6	1.4	1.2
PB (x)	5.6	3.9	3.2	2.7
Dividend yield (%)	1.2	2.1	2.1	2.4
Free cash flow yield (%)	2.5	(2.1)	0.6	10.2

Source: Company, Axis Capital

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New Rating system effective 12 April, 2019

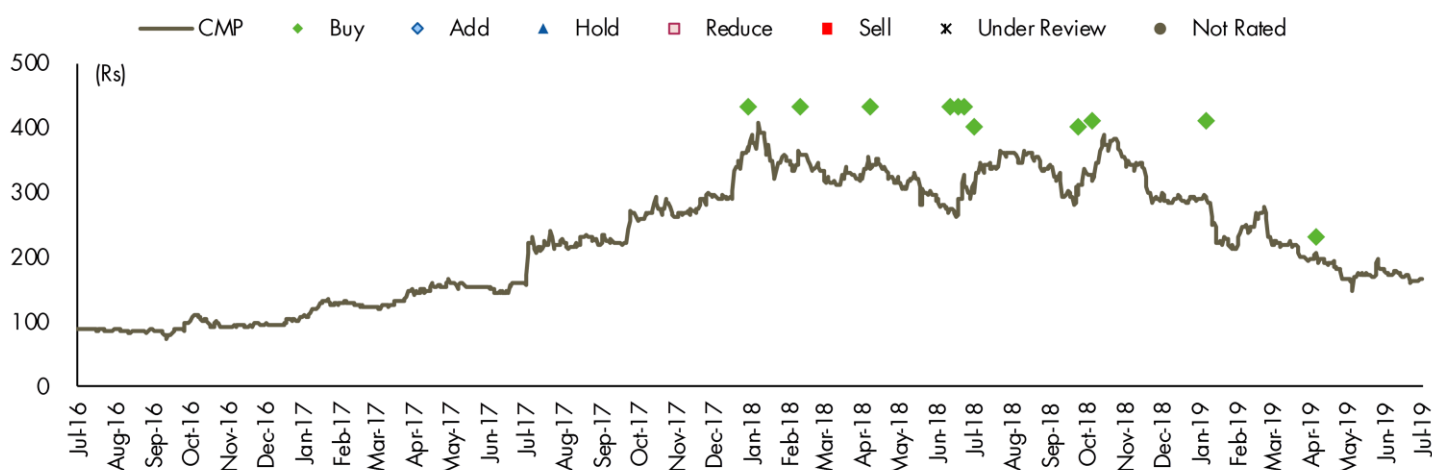
DEFINITION OF RATINGS	
Ratings	Expected absolute returns over 12 months
BUY	More than 15%
ADD	Between 5% to 15%
REDUCE	Between 5% to -10 %
SELL	More than -10%

Previous Rating system

DEFINITION OF RATINGS	
Ratings	Expected absolute returns over 12 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	More than -10%

Note: For a transitory period from 12 April 2019 until 30 June 2019, the new rating system and the previous rating system will be used in parallel. New research will be published under the new rating methodology, but existing recommendations will only be changed to the new rating system as and when new research is published in ordinary course of business.

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



Date	Target Price	Reco
17-Jan-18	430	Buy
28-Feb-18	430	Buy
25-Apr-18	430	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

Source: Axis Capital