

1QFY20 Result Update

Sterlite Technologies

Pricing pressure still poses risk

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CMP (Rs): 166

Market cap. (Rs bn): 67

Target price (Rs): 210

Maintain Hold

First Cut Feel of the Results

- Revenue growth of 63% YoY led by higher contribution of products as compared to service business. After almost three quarters of double digit QoQ growth driven by services business, 1QFY20 witnessed QoQ revenue declined due to services business timing issue. Capacity utilisation for optic fibre and cable remained at ~100% during the quarter.
- Margin outperformance was led by higher contribution of higher margin products business as compared to low margin services business. Management retained EBITDA margin guidance of ~18-20% for FY20 based on strong order book and balanced revenue mix.
- Promoter holding stood at 53.8% as of March 2019. 96.6% of promoter stake which was pledged earlier has entirely been released on 10 June 2019.

Financial highlights

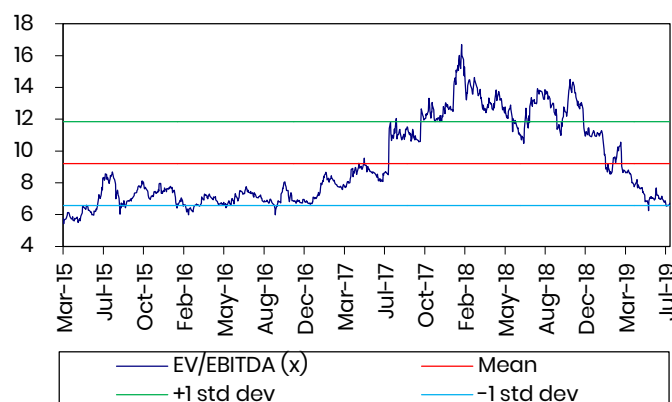
(Rs mn)	1QFY19	1QFY20	YoY (%)	4QFY19	QoQ (%)
Net Sales	8,769	14,320	63.3	17,912	(20.1)
EBITDA	2,449	3,234	32.0	3,151	2.6
EBITDA margins	27.9	22.6	-	17.6	-
Other Income	73	87	20.6	132	(33.8)
Interest	231	463	-	307	-
Depreciation	448	683	52.6	498	37.3
PBT	1,843	2,175	18.0	2,478	(12.2)
Tax	548	733	33.7	822	(10.7)
PAT	1,217	1,414	16.1	1,652	(14.4)
Adjusted PAT	1,217	1,414	16.1	1,652	(14.4)
EPS (Rs)	3.0	3.5	0.2	4.1	(14.6)

Key variables

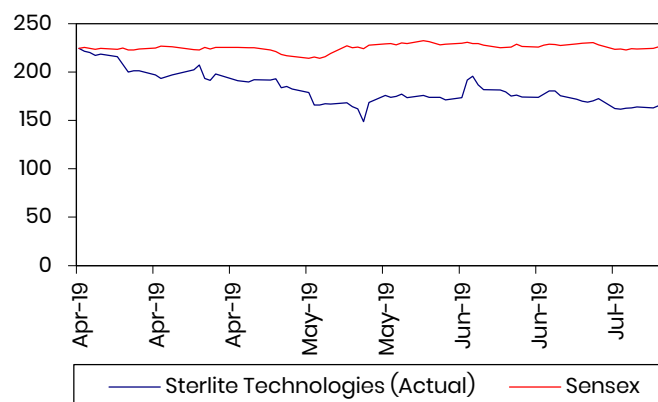
	Improvement on (%)	
	B&K est.	Consensus
Net Sales	(9.9)	(13.0)
EBITDA	8.9	10.2
Adj PAT	3.6	3.0

	FY19	FY20E	FY21E
Valuations			
PER (x)	15.6	12.0	10.5
PBV (x)	5.2	3.2	2.6
EV/EBITDA (x)	9.3	6.7	5.9
Key Ratios			
RoE (%)	39.4	29.1	27.5
Liquidity			
Net D/E (x)	0.87	0.85	0.57

One-year forward EV/EBITDA



Relative performance



Source: B&K Research

Is it in the Price?

Stock to react positively in medium-term led by sustained growth in order book coupled with revenue traction anticipated from new optic fibre capacity in 2HFY20 which enjoys higher margins as compared to services business. We expect consensus earnings to revise higher for FY20/21 to factor in strong 1QFY20 margin outperformance.

Connecting the Dots

Products business contributed ~56% versus ~48% of revenue in 4QFY19 led overall growth. Navy project (~50% complete) and Mahanet project (~30% complete) are progressing as per schedule and will further drive revenue growth in the coming quarters. Upcoming optic fibre capacity will drive products business majorly from 2HFY20 onwards. We expect revenue ~20% over FY20-21 led by conversion of order book.

On LTM basis, order book stood at Rs 98.5 bn versus Rs 105 bn in 4QFY19 with product comprising ~55% and rest from services. Order book comprises 55% from Telcos, 28% from Enterprises, 17% from citizen networks and 1% from cloud players. 1.7x book-to-bill coupled with mega opportunity anticipated from cloud provider lends visibility for future growth.

Culmination of new age technologies like IoT and smart home applications along with momentum in 5G, data centre connectivity and virtualised disaggregated networks will drive demand for optic fibre space and hence for Sterlite Technologies (SOTL).

1QFY20 EBITDA margins improvement was driven by products business. Stronger contribution from customised value-added fibre products commanding higher margins have helped in better realisation for optic fibre. Quarterly volatility in margins could be witnessed in the coming quarters based on contribution of service or products mix but we expect post 1QFY20 performance coupled with contribution from incremental capacity of optic fibre in 2HFY20. SOTL could report margins at higher end of guided range of ~18-20%.

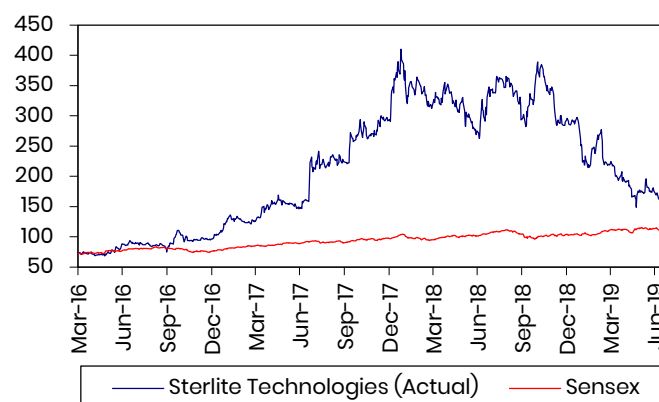
Outlook and Recommendation

Stock is trading at PE of ~12.1x FY20/~11x FY21 and EV/EBITDA of ~7x FY20/~6x FY21. SOTL's strong order book, anticipated big opportunity from cloud providers coupled with end-to-end service offerings will continue to drive revenue growth. We believe margins could be at higher end of guidance of ~18-20% due to ramping up of optic fibre capacity from 2HFY20 though quarterly volatility can't be ruled out due to intermittent higher services contribution to revenue which has lower margins. Persisting macro headwind led by trade war, slowing global growth coupled with weakness in optic fibre prices in China poses risk.

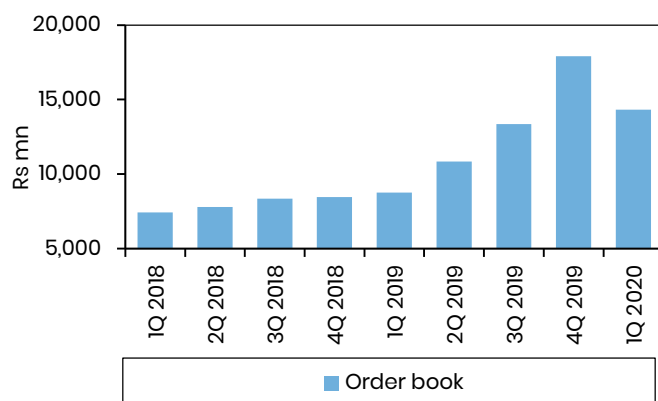
Major shareholders (%)

	Dec 18	Mar 19	Change
Promoters	53.8	53.8	(0.0)
GOI	0.0	0.0	-
FII's	6.2	6.0	(0.2)
MFs	9.9	9.3	(0.6)
BFSI's	2.2	1.6	(0.6)
Public & Others	27.9	29.3	1.5
Pledge	96.7	96.7	0.0

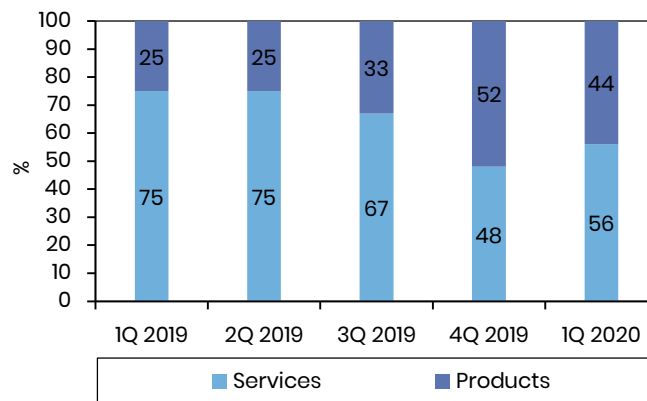
Relative to Sensex 3 Years



Order book



Order book composition



Source: Company, B&K Research

Concall highlights

- Revenue of Rs 14,320 mn (+63% YoY, -20.1% QoQ) – below our estimate of Rs 15,885 mn primarily driven by lower revenue from services segment (~40% versus ~48% in 4Q19). Exports contributed ~36% to revenue.
- Capacity utilisation for optic fibre and cable remained at 100%. Expect incremental 10 mn fkm optic fibre capacity to start contributing from 3QFY20 onwards.
- Management guided that the strong mix between standard products and value-added products complimented by a marquee customer base is protecting its net realisations of around ~US\$ 7-7.5.
- Order book stood at Rs 98,530 mn in 1QFY20 versus Rs 105,000 mn in 4QFY19 – comprising ~56% from products versus ~50% in 4QFY19. Of the current order book, ~55% is from Telcos, 28% from enterprise and 17% from citizen networks.
- SOTL's major projects – Navy, Mahanet are completed to the extent of 50%/30%, respectively, and are both ongoing as per schedule. Kakinada Smart City Project is now complete and all contribution from this project for the next five years will be in the nature of network management.
- SOTL is engaging with a top global cloud provider for data network interconnect solutions and expects good opportunities in the coming period.
- EBITDA margins came in at 22.6% (+535 bps YoY, +499 bps QoQ) – better than our estimate of 18.7% driven by higher contribution from products segment and operational efficiency. Management retains EBITDA margin of 18-20% guidance for FY20.
- Depreciation and interest expense spiked 37%/51% owing to higher asset base on commissioning of new capacity (~Rs 9,000 mn) as well as capitalisation being Right of Use Assets.
- Net debt as at end of 1QFY20 stood at Rs 19,800 mn versus Rs 17,330 mn in 4QFY19.

Income Statement

Period end (Rs mn)	Mar 18	Mar 19	Mar 20E	Mar 21E
Net sales	32,055	50,873	63,924	72,010
Growth (%)	23.6	58.7	25.7	12.6
Operating expenses	(24,561)	(39,602)	(51,278)	(58,036)
Operating profit	7,493	11,271	12,646	13,974
EBITDA	7,493	11,271	12,646	13,974
Growth (%)	44.4	50.4	12.2	10.5
Depreciation	(1,822)	(1,950)	(2,653)	(3,024)
Other income	384	369	384	432
EBIT	6,055	9,690	10,376	11,381
Finance cost	(1,038)	(1,055)	(1,854)	(1,656)
Profit before tax	5,017	8,635	8,523	9,725
Tax (current + deferred)	(1,332)	(2,782)	(2,812)	(3,209)
P/(L) for the period	3,685	5,853	5,710	6,516
P/L of Associates, Min Int, Pref Div	(319)	(150)	(158)	(166)
Reported Profit/(Loss)	3,366	5,703	5,552	6,350
Adjusted net profit	3,366	5,703	5,552	6,350
Growth (%)	67.2	69.4	(2.6)	14.4

Balance Sheet

Period end (Rs mn)	Mar 18	Mar 19	Mar 20E	Mar 21E
Share capital	802	805	805	805
Reserves & surplus	10,951	16,388	20,163	24,481
Shareholders' funds	11,753	17,193	20,969	25,287
Minority Interest and others	820	954	1,049	1,154
Non-current liabilities	7,505	10,575	13,466	12,687
Long-term borrowings	6,305	9,348	10,751	9,676
Other non-current liabilities	1,200	1,226	2,716	3,011
Current liabilities	17,040	41,401	46,250	50,200
ST borrowings, Curr maturity	4,627	9,827	11,792	10,613
Other current liabilities	12,412	31,574	34,458	39,587
Total (Equity and Liab.)	37,117	70,123	81,734	89,327
Non-current assets	17,555	30,342	34,449	34,633
Fixed assets (Net block)	15,172	27,800	31,773	31,795
Non-current Investments	196	353	353	353
Long-term loans and advances	350	427	427	427
Other non-current assets	1,838	1,763	1,897	2,058
Current assets	19,562	39,781	47,285	54,694
Cash & current investment	2,935	3,339	3,886	5,096
Other current assets	16,627	36,442	43,399	49,598
Total (Assets)	37,117	70,123	81,734	89,327
Total debt	10,933	19,175	22,543	20,289
Capital employed	24,705	38,549	47,276	49,741

Cash Flow Statement

Period end (Rs mn)	Mar 18	Mar 19	Mar 20E	Mar 21E
Profit before tax	5,017	8,635	8,523	9,725
Depreciation	1,822	1,950	2,653	3,024
Change in working capital	351	(971)	(4,070)	(1,066)
Total tax paid	(1,076)	(2,259)	(2,664)	(3,031)
Others	655	686	1,470	1,224
Cash flow from oper. (a)	6,768	8,040	5,912	9,877
Capital expenditure	(4,243)	(14,578)	(6,626)	(3,047)
Change in investments	(1,255)	-	0	0
Others	(366)	1,169	249	271
Cash flow from inv. (b)	(5,864)	(13,409)	(6,376)	(2,776)
Free cash flow (a+b)	905	(5,368)	(465)	7,101
Equity raised/(repaid)	(155)	3	0	0
Debt raised/(repaid)	752	8,243	3,368	(2,254)
Dividend (incl. tax)	(1,077)	(1,804)	(1,777)	(2,032)
Others	(414)	(122)	(579)	(1,604)
Cash flow from fin. (c)	(894)	6,320	1,012	(5,890)
Net chg in cash (a+b+c)	11	952	547	1,211

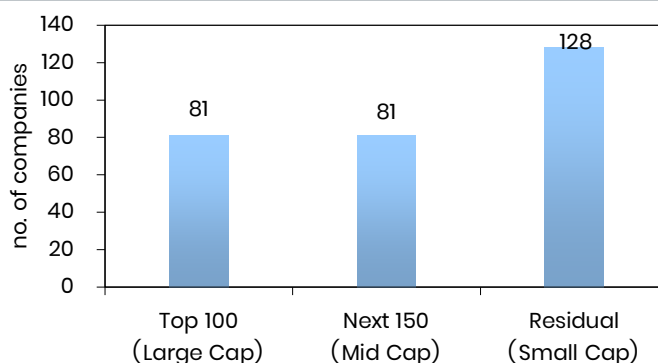
Key ratios

Period end (%)	Mar 18	Mar 19	Mar 20E	Mar 21E
Adjusted EPS (Rs)	8.43	14.02	13.6	15.6
Growth	66.3	66.3	(2.6)	14.4
CEPS (Rs)	13.0	18.8	20.2	23.0
Book NAV/share (Rs)	29.4	42.3	51.5	62.2
Dividend/share (Rs)	2.7	4.4	4.4	5.0
Dividend payout ratio	32.0	31.6	32.0	32.0
EBITDA margin	23.4	22.2	19.8	19.4
EBIT margin	18.9	19.0	16.2	15.8
Tax rate	26.5	32.2	33.0	33.0
RoCE	26.6	30.6	24.2	23.5
Total debt/Equity (x)	0.9	1.1	1.0	0.8
Net debt/Equity (x)	0.6	0.9	0.8	0.6
Du Pont Analysis - ROE				
Net margin	10.5	11.2	8.7	8.8
Asset turnover (x)	1.0	0.9	0.8	0.8
Leverage factor (x)	3.2	3.7	4.0	3.7
Return on equity	32.8	39.4	29.1	27.5

Valuations

Period end (x)	Mar 18	Mar 19	Mar 20E	Mar 21E
PER	37.1	15.6	12.0	10.5
PCE	24.0	11.6	8.1	7.1
Price/Book	10.6	5.2	3.2	2.6
Yield (%)	0.9	2.0	2.7	3.0
EV/EBITDA	17.7	9.3	6.7	5.9

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