



# STERLITE TECHNOLOGIES

## Transcending concerns

India Equity Research | Telecom



Sterlite Technologies (Sterlite) reported strong 63.3% YoY revenue growth in Q1FY20. Higher contribution of product business (~60% versus ~52% QoQ) and sticky OF realisation (~USD7/fkm) led to robust 22.6% EBITDA margin—up 500bps QoQ. We believe, the Street has been concerned about fall in OF realisation leading to lower product margin. However, Q1FY20 performance demonstrates Sterlite's ability to manage OF realisation, and consequently product EBITDA margin, with superior product mix and cost control. With more product capacity coming on stream and strong execution in services business, we believe Sterlite is well placed to sustain growth momentum. Maintain 'BUY' with revised target price of INR296 (INR285 earlier) as we roll forward to Q3FY21E.

### Product business bolstered by OF realisation boosts margin

The change in business mix in favour of higher-margin products business (with average USD7 plus OF realisation) led to 500bps QoQ jump in EBITDA margin from 17.6% in Q4FY19 to 22.6% in Q1FY20. The products to services mix changed from 52:48 in Q4FY19 to 60:40 in Q1FY20. However, since majority of the execution of the Navy order as well as the *MahaNet* project will be in FY20, management expects EBITDA margin to stabilise at ~20% for FY20. We believe, sustenance of OF prices is crucial for maintaining current margin level.

### 20mn fkm expansion: Revenue contribution Q3FY20 onwards

The company successfully commissioned 20mn fkm capacity, which will come on stream from Q3FY20. Sterlite operated at 100% utilisation level during the quarter and envisages robust demand environment going forward as well led by deepening penetration of FTTx and densification of networks for 5G. India business is expected to drive revenue growth considering significantly lower fiber penetration.

### Outlook and valuation: Sustaining momentum; maintain 'BUY'

We believe Sterlite is well placed to capture growth in the optical fibre cable business and its expansion in services is further fueling growth. Order book at INR98.5bn signals healthy revenue visibility for ensuing quarters. The stock is trading at 9.7x FY21E EPS. We maintain 'BUY' with revised TP of INR296 (18x Q3FY21E EPS).

#### 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 164   |
| Target Price                 | : INR 296   |
| 52-week range (INR)          | : 400 / 144 |
| Share in issue (mn)          | : 403.1     |
| M cap (INR bn/USD mn)        | : 66 / 985  |
| Avg. Daily Vol.BSE/NSE('000) | : 2,010.8   |

#### SHARE HOLDING PATTERN (%)

|   | Current | Q4FY19 | Q3FY19 |
|---|---------|--------|--------|
| Promoters *   | 53.8    | 53.8   | 53.8   |
| MF's, FI's & BK's                                   | 10.8    | 10.8   | 12.1   |
| FII's   | 6.0     | 6.0    | 6.2    |
| Others  | 29.4    | 29.4   | 27.9   |
| * Promoters pledged shares<br>(% of share in issue) | :       |        | NIL    |

#### PRICE PERFORMANCE (%)

|          | Stock  | Nifty | EW<br>Telecommunication<br>Index |
|----------|--------|-------|----------------------------------|
| 1 month  | (15.1) | (3.2) | (3.6)                            |
| 3 months | (19.1) | (0.1) | (2.3)                            |
| 12       | (47.5) | 5.8   | (14.0)                           |

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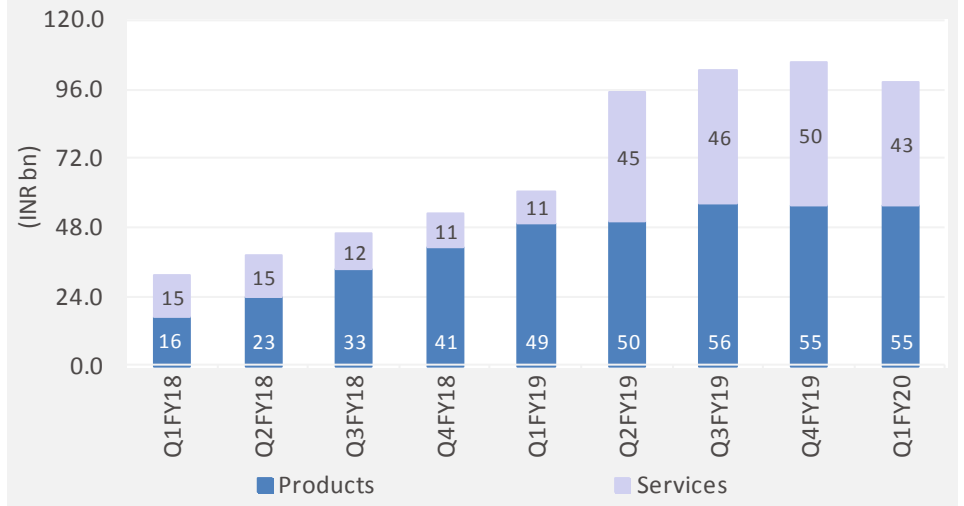
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#### Financials

(INR mn)

| Year to March     | Q1FY20 | Q1FY19 | % Chg | Q4FY19 | % Chg  | FY19   | FY20E  | FY21E  |
|-------------------|--------|--------|-------|--------|--------|--------|--------|--------|
| Net revenues      | 14,320 | 8,769  | 63.3  | 17,912 | (20.1) | 50,873 | 67,811 | 75,092 |
| EBITDA            | 3,234  | 2,449  | 32.1  | 3,151  | 2.6    | 11,272 | 13,664 | 15,018 |
| Adjusted Profit   | 1,457  | 1,217  | 19.7  | 1,676  | (13.1) | 5,703  | 6,653  | 7,415  |
| Diluted EPS (INR) | 3.5    | 3.2    | 9.4   | 4.1    | (14.5) | 13.8   | 15.4   | 16.8   |
| Diluted P/E (x)   |        |        |       |        |        | 11.8   | 10.6   | 9.7    |
| EV/EBITDA (x)     |        |        |       |        |        | 7.9    | 6.3    | 5.4    |

Chart 1: Order book: Sustained momentum



Source: Company, Edelweiss research

## Financial snapshot

(INR mn)

| Year to March          | Q1FY20 | Q1FY19 | % change | Q4FY19 | % change | FY19   | FY20E  | FY21E  |
|------------------------|--------|--------|----------|--------|----------|--------|--------|--------|
| Net revenues           | 14,320 | 8,769  | 63.3     | 17,912 | (20.1)   | 50,873 | 67,811 | 75,092 |
| Direct costs           | 7,070  | 3,339  | 111.8    | 10,897 | (35.1)   | 24,872 | 32,746 | 35,392 |
| Gross profit           | 7,250  | 5,430  | 33.5     | 7,015  | 3.4      | 26,000 | 35,065 | 39,700 |
| SG&A                   | 4,016  | 2,981  | 34.7     | 3,864  | 3.9      | 14,729 | 21,400 | 24,682 |
| EBITDA                 | 3,234  | 2,449  | 32.1     | 3,151  | 2.6      | 11,272 | 13,664 | 15,018 |
| Depreciation           | 683    | 448    | 52.6     | 498    | 37.3     | 1,950  | 2,468  | 3,073  |
| EBIT                   | 2,550  | 2,001  | 27.5     | 2,653  | (3.9)    | 9,322  | 11,197 | 11,945 |
| Interest               | 463    | 231    | 100.8    | 307    | 50.9     | 1,055  | 1,567  | 1,396  |
| Other income           | 87     | 73     | 20.6     | 132    | (33.8)   | 369    | 248    | 375    |
| Add: Exceptional items | (13)   | (10)   | NA       | (25)   | NA       | (76)   | (13)   |        |
| Profit before tax      | 2,177  | 1,756  | 24.0     | 2,473  | (12.0)   | 8,409  | 9,930  | 10,991 |
| Tax                    | 733    | 548    | 33.7     | 822    | (10.7)   | 2,782  | 3,290  | 3,576  |
| Reported net profit    | 1,444  | 1,207  | 19.6     | 1,652  | (12.6)   | 5,628  | 6,640  | 7,415  |
| Exceptional items      | 13     | 10     | 33.7     | 25     | (47.0)   | 76     | 13     | -      |
| Adjusted Profit        | 1,457  | 1,217  | 19.7     | 1,676  | (13.1)   | 5,703  | 6,653  | 7,415  |
| Diluted EPS (INR)      | 3.5    | 3.2    | 9.4      | 4.1    | (14.5)   | 13.8   | 15.4   | 16.8   |
| Diluted P/E (x)        | -      | -      |          | -      |          | 11.8   | 10.6   | 9.7    |
| EV/EBITDA (x)          | -      | -      |          | -      |          | 7.9    | 6.3    | 5.4    |
| EV/Revenues (x)        | -      | -      |          | -      |          | 1.8    | 1.3    | 1.1    |
| Direct costs           | 49.4   | 38.1   |          | 60.8   |          | 48.9   | 48.3   | 47.1   |
| Gross profit           | 50.6   | 61.9   |          | 39.2   |          | 51.1   | 51.7   | 52.9   |
| SG&A                   | 28.0   | 34.0   |          | 21.6   |          | 29.0   | 31.6   | 32.9   |
| EBITDA                 | 22.6   | 27.9   |          | 17.6   |          | 22.2   | 20.2   | 20.0   |
| EBIT                   | 17.8   | 22.8   |          | 14.8   |          | 18.3   | 16.5   | 15.9   |
| Reported net profit    | 10.1   | 13.8   |          | 9.2    |          | 11.1   | 9.8    | 9.9    |
| Tax rate               | 33.7   | 31.2   |          | 33.2   |          | 33.1   | 33.1   | 32.5   |

### 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 fibre cable manufacturer with OF and OFC capacity of 30mn and 15mn FKM, respectively. The company has plans to enhance production of OF to 50mn FKM by June 2019. It has manufacturing plants in Aurangabad, Silvasa, China (through joint venture (JV) with Tongguang) and Brazil (through JV with Condu spar). 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 INR41.4bn.

### Investment Theme

We believe that Sterlite will be the key beneficiary of strong demand for fiber optic cables, leveraging its capacity expansion; It's 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         | FY18   | FY19   | FY20E  | FY21E  |
|-----------------------|--------|--------|--------|--------|
| <b>Macro</b>          |        |        |        |        |
| GDP(Y-o-Y %)          | 7.2    | 6.8    | 6.8    | 7.1    |
| Inflation (Avg)       | 3.6    | 3.4    | 4.0    | 4.5    |
| Repo rate (exit rate) | 6.0    | 6.3    | 5.3    | 5.0    |
| USD/INR (Avg)         | 64.5   | 70.0   | 72.0   | 72.0   |
| <b>Company</b>        |        |        |        |        |
| Product revenues      | 26,346 | 33,640 | 39,022 | 45,328 |
| Employee benefit exp. | 10.9   | 10.0   | 10.4   | 10.5   |
| Other exp             | 25.3   | 18.9   | 21.1   | 22.4   |
| Receivable (days)     | 89     | 80     | 78     | 83     |
| Payable days          | 82     | 118    | 128    | 126    |

## Income statement

(INR mn)

| Year to March            | FY18   | FY19   | FY20E  | FY21E  |
|--------------------------|--------|--------|--------|--------|
| Net revenue              | 32,055 | 50,873 | 67,811 | 75,092 |
| Cost of revenues         | 12,954 | 24,872 | 32,746 | 35,392 |
| Gross profit             | 19,101 | 26,000 | 35,065 | 39,700 |
| Total SG&A expenses      | 11,608 | 14,729 | 21,400 | 24,682 |
| EBITDA                   | 7,494  | 11,272 | 13,664 | 15,018 |
| Depreciation             | 1,822  | 1,950  | 2,468  | 3,073  |
| EBIT                     | 5,671  | 9,322  | 11,197 | 11,945 |
| Add: Other income        | 392.7  | 368.6  | 247.87 | 375.46 |
| Profit Before Tax        | 4,982  | 8,560  | 9,865  | 10,925 |
| Less: Provision for Tax  | 1,332  | 2,782  | 3,290  | 3,576  |
| Reported Profit          | 3,343  | 5,628  | 6,640  | 7,415  |
| Exceptional Items        | 44     | (76)   | (13)   | -      |
| Adjusted Profit          | 3,387  | 5,703  | 6,653  | 7,415  |
| Shares o /s (mn)         | 401    | 408    | 421    | 428    |
| Adjusted Basic EPS       | 8.4    | 14.0   | 15.8   | 17.3   |
| Diluted shares o/s (mn)  | 408    | 413    | 432    | 441    |
| Adjusted Diluted EPS     | 8.3    | 13.8   | 15.4   | 16.8   |
| Adjusted Cash EPS        | 13.0   | 18.8   | 21.7   | 24.5   |
| Dividend per share (DPS) | 0.1    | 2.0    | 3.9    | 5.2    |
| Dividend Payout Ratio(%) | 2.4    | 17.0   | 29.7   | 35.8   |

## Common size metrics

| Year to March      | FY18 | FY19 | FY20E | FY21E |
|--------------------|------|------|-------|-------|
| Cost of revenues   | 40.4 | 48.9 | 48.3  | 47.1  |
| Gross margin       | 59.6 | 51.1 | 51.7  | 52.9  |
| SG&A expenses      | 36.2 | 29.0 | 31.6  | 32.9  |
| EBITDA margins     | 23.4 | 22.2 | 20.2  | 20.0  |
| EBIT margins       | 17.7 | 18.3 | 16.5  | 15.9  |
| Net Profit margins | 11.5 | 11.5 | 9.7   | 9.8   |

## Growth ratios (%)

| Year to March   | FY18 | FY19 | FY20E | FY21E |
|-----------------|------|------|-------|-------|
| Revenues        | 23.6 | 58.7 | 33.3  | 10.7  |
| EBITDA          | 44.4 | 50.4 | 21.2  | 9.9   |
| PBT             | 91.5 | 71.8 | 15.2  | 10.7  |
| Adjusted Profit | 68.2 | 68.4 | 16.7  | 11.5  |
| EPS             | 67.2 | 66.3 | 11.4  | 9.3   |

| Balance sheet            |               | (INR mn)      |               |               |  |
|--------------------------|---------------|---------------|---------------|---------------|--|
| As on 31st March         | FY18          | FY19          | FY20E         | FY21E         |  |
| Share capital            | 802           | 805           | 842           | 855           |  |
| Reserves & Surplus       | 10,951        | 16,388        | 21,043        | 25,781        |  |
| Shareholders' funds      | 11,753        | 17,193        | 21,886        | 26,636        |  |
| Minority Interest        | 820           | 954           | 908           | 866           |  |
| Def. Tax Liability (net) | 222           | 744           | 744           | 744           |  |
| <b>Sources of funds</b>  | <b>26,184</b> | <b>44,826</b> | <b>43,277</b> | <b>45,181</b> |  |
| Gross Block              | 21,128        | 21,979        | 35,167        | 40,367        |  |
| Net Block                | 11,351        | 23,175        | 26,388        | 26,000        |  |
| Capital work in progress | 3,570         | 4,194         | 4,194         | 4,194         |  |
| Intangible Assets        | 901           | 1,504         | 1,023         | 839           |  |
| Total Fixed Assets       | 15,822        | 28,873        | 31,606        | 31,033        |  |
| Non current investments  | 285           | 353           | 553           | 1,553         |  |
| Cash and Equivalents     | 2,935         | 3,339         | 2,690         | 4,412         |  |
| Sundry Debtors           | 8,713         | 13,566        | 15,463        | 18,615        |  |
| Loans & Advances         | 350           | 427           | 427           | 427           |  |
| Other Current Assets     | 5,634         | 17,669        | 18,062        | 18,710        |  |
| Current Assets (ex cash) | 18,076        | 37,558        | 41,449        | 46,619        |  |
| Trade payable            | 6,562         | 19,128        | 18,943        | 22,401        |  |
| Other Current Liab       | 4,372         | 6,170         | 14,078        | 16,034        |  |
| Total Current Liab       | 10,933        | 25,297        | 33,021        | 38,435        |  |
| Net Curr Assets-ex cash  | 7,142         | 12,261        | 8,429         | 8,183         |  |
| <b>Uses of funds</b>     | <b>26,184</b> | <b>44,826</b> | <b>43,277</b> | <b>45,181</b> |  |
| BVPS (INR)               | 28.8          | 41.6          | 50.6          | 60.4          |  |

| Free cash flow        |              | (INR mn)       |              |              |  |
|-----------------------|--------------|----------------|--------------|--------------|--|
| Year to March         | FY18         | FY19           | FY20E        | FY21E        |  |
| Reported Profit       | 3,343        | 5,628          | 6,640        | 7,415        |  |
| Add: Depreciation     | 1,822        | 1,950          | 2,468        | 3,073        |  |
| Interest (Net of Tax) | 761          | 712            | 1,044        | 939          |  |
| Others                | 2,561        | (14,307)       | (4,256)      | 1,074        |  |
| Less: Changes in WC   | 688          | (7,791)        | (2,363)      | 342          |  |
| Operating cash flow   | 7,800        | 1,773          | 8,259        | 12,160       |  |
| Less: Capex           | 4,595        | 8,438          | 5,200        | 2,500        |  |
| <b>Free Cash Flow</b> | <b>3,205</b> | <b>(6,665)</b> | <b>3,059</b> | <b>9,660</b> |  |

## Peer comparison valuation

| Name                  | Market cap<br>(USD mn) | Diluted P/E (X) |       | EV / EBITDA (X) |       | ROAE (%) |       |
|-----------------------|------------------------|-----------------|-------|-----------------|-------|----------|-------|
|                       |                        | FY20E           | FY21E | FY20E           | FY21E | FY20E    | FY21E |
| Sterlite Technologies | 985                    | 10.6            | 9.7   | 4.9             | 4.4   | 32.2     | 29.2  |
| Bharti Airtel         | 25,847                 | 1,096.7         | 61.7  | 6.0             | 5.0   | 1.4      | 3.6   |
| Bharti Infratel       | 7,104                  | 17.2            | 16.3  | 7.9             | 7.6   | 19.7     | 21.3  |
| Tejas Networks        | 183                    | 9.8             | 7.8   | 4.0             | 3.3   | 9.6      | 11.2  |
| Vodafone Idea         | 4,996                  | (3.4)           | (3.2) | 16.6            | 11.5  | (0.1)    | (0.1) |
| Median                | -                      | 10.6            | 9.7   | 6.0             | 5.0   | 9.6      | 11.2  |
| AVERAGE               | -                      | 226.2           | 18.5  | 7.9             | 6.4   | 12.6     | 13.1  |

Source: Edelweiss research

| Cash flow metrics   |  | FY18    | FY19     | FY20E   | FY21E   |
|---------------------|--|---------|----------|---------|---------|
| Year to March       |  |         |          |         |         |
| Operating cash flow |  | 7,800   | 1,773    | 8,259   | 12,160  |
| Financing cash flow |  | (5,848) | (11,721) | (5,898) | (5,000) |
| Investing cash flow |  | (1,999) | 10,239   | (3,508) | (6,937) |
| Net cash Flow       |  | (48)    | 291      | (1,147) | 223     |
| Capex               |  | (4,595) | (8,438)  | (5,200) | (2,500) |
| Dividend paid       |  | (81)    | (968)    | (1,978) | (2,653) |

## Profitability and efficiency ratios

| Year to March         | FY18 | FY19 | FY20E | FY21E |
|-----------------------|------|------|-------|-------|
| ROAE (%)              | 33.8 | 38.1 | 32.2  | 29.2  |
| ROACE (%)             | 25.9 | 27.7 | 26.4  | 28.3  |
| Inventory Days        | 95   | 68   | 75    | 84    |
| Debtors Days          | 89   | 80   | 78    | 83    |
| Payable Days          | 82   | 118  | 128   | 126   |
| Cash Conversion Cycle | 101  | 30   | 24    | 42    |
| Current Ratio         | 1.9  | 1.6  | 1.3   | 1.3   |

## Operating ratios

| Year to March        | FY18 | FY19 | FY20E | FY21E |
|----------------------|------|------|-------|-------|
| Total Asset Turnover | 1.4  | 1.4  | 1.5   | 1.7   |
| Fixed Asset Turnover | 2.2  | 2.3  | 2.2   | 2.4   |
| Equity Turnover      | 2.9  | 3.3  | 3.3   | 3.0   |

## Valuation parameters

| Year to March           | FY18 | FY19 | FY20E | FY21E |
|-------------------------|------|------|-------|-------|
| Adj. Diluted EPS (INR)  | 8.3  | 13.8 | 15.4  | 16.8  |
| Y-o-Y growth (%)        | 67.2 | 66.3 | 11.4  | 9.3   |
| Adjusted Cash EPS (INR) | 13.0 | 18.8 | 21.7  | 24.5  |
| Diluted P/E (x)         | 19.7 | 11.8 | 10.6  | 9.7   |
| P/B (x)                 | 5.7  | 3.9  | 3.2   | 2.7   |
| EV / Sales (x)          | 2.4  | 1.8  | 1.3   | 1.1   |
| EV / EBITDA (x)         | 8.5  | 5.7  | 4.9   | 4.4   |
| Dividend Yield (%)      | -    | 1.2  | 2.4   | 3.2   |

## 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 Tadarwal        | 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   | 52.01         | Dsp blackrock invest | 2.29          |
| Life insurance corp  | 1.87          | Aditya birla sun lif | 1.57          |
| Reliance capital tru | 1.54          | Aditya birla sun lif | 1.19          |
| Vedanta ltd          | 1.18          | Dimensional fund adv | 1.1           |
| Vanguard group       | 0.84          | Investor education & | 0.83          |

*\*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 |
| 30 Nov 2018    | Amitabh Hajela        | Sell | 18500.00   |
| 20 Aug 2018    | Anand Agarwal         | Sell | 50000.00   |

*\*in last one year*