

STERLITE TECHNOLOGIES

Revenue mix changes

India Equity Research | Telecom

Sterlite Technologies (Sterlite) reported stellar 112% YoY revenue growth to INR17.9bn (consensus: INR13.6bn) in Q4FY19 driven by ahead-of-schedule execution of the navy order. Consequently, contribution of the low-margin services business spiked to 52%, which dragged EBITDA margin by 440bps QoQ. Management expects the contribution of services to continue to increase and EBITDA margin to moderate to 18–20% from its earlier expectation of 22–24%. We are now building in 12% higher revenue growth each in FY20 and FY21, but lower margins. Therefore, we are cutting the earnings estimate by 0.8%/0.6% for FY20/21. Although the services business increases Sterlite's top line, we understand this business is riskier given execution challenges. On balance, we maintain 'BUY' with a revised target price of INR285 (earlier INR288).

Services business driving growth

Sterlite has been consistently broadening the portfolio of services to expand its addressable market to USD75bn by 2023 from USD20bn in 2017. The services business will be the key growth driver and its contribution is expected to rise to ~50% over the next two years from ~37% in FY19 and 26% in FY18. The order book for this segment remains strong at INR50bn; the company has secured a large order for rural broadband connectivity in Maharashtra. Although the services business can be a growth driver, it is riskier than the product business, in our view, due to project-specific issues.

Product business steady; marginal impact on realisation

Management highlighted that it is not seeing meaningful impact of the issues in China on its product business volume, adding that the segment is running at full capacity. Although OF realisation remains in the USD7–8 band, they are now trending more towards the lower end. We remain confident of strong volume growth backed by capacity expansion and ~INR55bn product order book. However, marginally lower realisation may weigh on margins.

Outlook and valuation: Sustaining momentum; maintain 'BUY'

We believe that Sterlite is well placed to capture growth in the optical fibre cable business, and its expansion in services is further fueling growth. The stock is trading at 12.8x FY21E EPS. Maintain 'BUY' with a revised TP of INR285 (18x Q1FY21E EPS).

Financials

(INR mn)

Year to March	Q4FY19	Q4FY18	% Chg	Q3FY19	% Chg	FY19	FY20E	FY21E
Net revenues	17,912	8,466	111.6	13,349	34.2	50,873	65,382	72,182
EBITDA	3,151	2,203	43.0	2,939	7.2	11,272	13,992	15,519
Adjusted Profit	1,676	1,168	43.5	1,477	13.5	5,703	6,578	7,730
Diluted EPS (INR)	4.1	3.0	34.0	3.6	13.1	13.8	14.4	16.2
Diluted P/E (x)						15.0	14.4	12.8
EV/EBITDA (x)						8.9	7.7	6.7

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 207
Target Price	: INR 285
52-week range (INR)	: 400 / 181
Share in issue (mn)	: 402.5
M cap (INR bn/USD mn)	: 83 / 1,196
Avg. Daily Vol.BSE/NSE('000)	: 1,676.2

SHARE HOLDING PATTERN (%)

	Current	Q3FY19	Q2FY19
Promoters *	53.8	53.8	53.8
MF's, FI's & BK's	12.1	12.1	13.0
FII's	6.2	6.2	6.6
Others	27.9	27.9	26.6
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Telecom Index
1 month	(9.3)	6.2	3.3
3 months	(22.2)	6.5	5.4
12 months	(30.4)	12.8	(23.9)

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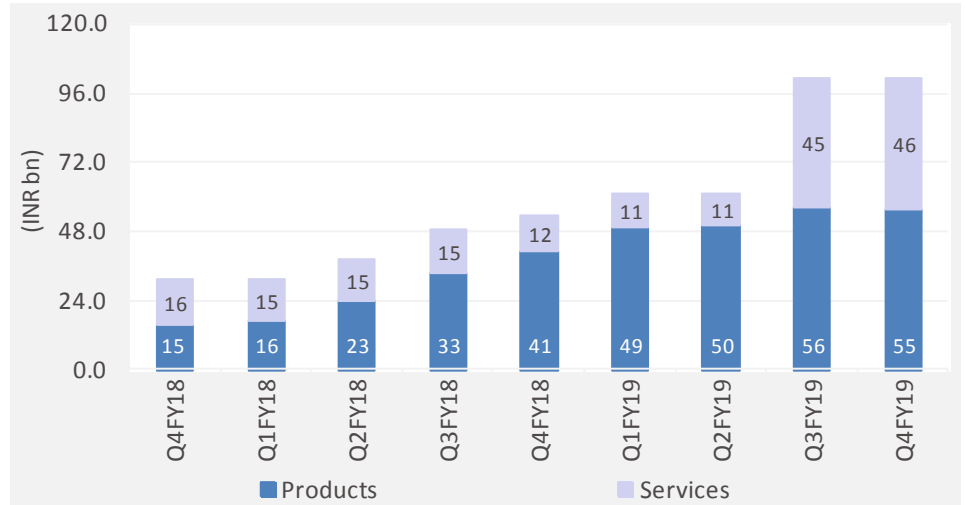
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Chart 1: Order book: Rapid expansion



Source: Company, Edelweiss research

Table 1: Change in estimates

	FY20E			FY21E		
	New	Old	% change	New	Old	% change
Net revenue	65,382	58,377	12.0	72,182	64,691	11.6
EBITDA	13,992	14,070	(0.6)	15,519	15,720	(1.3)
EBITDA margin (%)	21.4	24.1		21.5	24.3	
PAT	6,578	6,632	(0.8)	7,730	7,779	(0.6)
PAT margin (%)	10.1	11.4		10.7	12.0	
Capex	5,200	5,200	0.0	2,500	4,600	(45.7)

Source: Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q4FY19	Q4FY18	% change	Q3FY19	% change	FY19	FY20E	FY21E
Net revenues	17,912	8,466	111.6	13,349	34.2	50,873	65,382	72,182
Direct costs	10,897	3,259	234.3	6,300	73.0	24,872	29,160	32,193
Gross profit	7,015	5,207	34.7	7,049	(0.5)	26,000	36,222	39,989
SG&A	3,864	3,004	28.6	4,110	(6.0)	14,729	22,230	24,470
EBITDA	3,151	2,203	43.0	2,939	7.2	11,272	13,992	15,519
Depreciation	498	525	(5.1)	512	(2.8)	1,950	2,824	3,054
EBIT	2,653	1,679	58.0	2,427	9.3	9,322	11,167	12,465
Interest	307	253	21.3	274	11.9	1,055	1,580	1,430
Other income	132	172	(23.1)	104	26.6	369	196	361
Add: Exceptional items	(25)	(44)	NA	(21)	NA	(76)		
Profit before tax	2,473	1,486	66.4	2,216	11.6	8,409	9,611	11,262
Tax	822	362	126.9	760	8.1	2,782	3,033	3,533
Reported net profit	1,652	1,124	46.9	1,456	13.4	5,628	6,578	7,730
Exceptional items	25	44	(43.6)	21	17.6	76	-	-
Adjusted Profit	1,676	1,168	43.5	1,477	13.5	5,703	6,578	7,730
Diluted EPS (INR)	4.1	3.0	34.0	3.6	13.1	13.8	14.4	16.2
Diluted P/E (x)	-	-		-		15.0	14.4	12.8
EV/EBITDA (x)	-	-		-		8.9	7.7	6.7
EV/Revenues (x)	-	-		-		2.0	1.6	1.4
Direct costs	60.8	38.5		47.2		48.9	44.6	44.6
Gross profit	39.2	61.5		52.8		51.1	55.4	55.4
SG&A	21.6	35.5		30.8		29.0	34.0	33.9
EBITDA	17.6	26.0		22.0		22.2	21.4	21.5
EBIT	14.8	19.8		18.2		18.3	17.1	17.3
Reported net profit	9.2	13.3		10.9		11.1	10.1	10.7
Tax rate	33.2	24.4		34.3		33.1	31.6	31.4

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 and 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
Macro				
GDP(Y-o-Y %)	6.7	7.1	7.1	7.3
Inflation (Avg)	3.6	3.7	4.0	4.5
Repo rate (exit rate)	6.0	6.3	5.8	5.8
USD/INR (Avg)	64.5	70.0	72.0	72.0
Company				
Product revenues	26,179	32,598	41,658	44,643
Employee benefit exp.	10.9	10.0	10.9	10.9
Other exp	25.3	18.9	23.1	23.0
Receivable (days)	89	80	80	84
Payable days	82	189	231	215

Income statement

(INR mn)

Year to March	FY18	FY19	FY20E	FY21E
Net revenue	32,055	50,873	65,382	72,182
Cost of revenues	12,954	24,872	29,160	32,193
Gross profit	19,101	26,000	36,222	39,989
Total SG&A expenses	11,608	14,729	22,230	24,470
EBITDA	7,494	11,272	13,992	15,519
Depreciation	1,822	1,950	2,824	3,054
EBIT	5,671	9,322	11,167	12,465
Add: Other income	392.7	368.6	196.15	360.91
Profit Before Tax	4,982	8,560	9,783	11,396
Less: Provision for Tax	1,332	2,782	3,033	3,533
Reported Profit	3,343	5,628	6,578	7,730
Exceptional Items	44	(76)	-	-
Adjusted Profit	3,387	5,703	6,578	7,730
Shares o /s (mn)	401	408	435	442
Adjusted Basic EPS	8.4	14.0	15.1	17.5
Diluted shares o/s (mn)	408	413	456	478
Adjusted Diluted EPS	8.3	13.8	14.4	16.2
Adjusted Cash EPS	13.0	18.8	21.6	24.4
Dividend per share (DPS)	2.1	3.5	3.8	5.3
Dividend Payout Ratio(%)	2.4	30.9	30.9	36.7

Common size metrics

Year to March	FY18	FY19	FY20E	FY21E
Cost of revenues	40.4	48.9	44.6	44.6
Gross margin	59.6	51.1	55.4	55.4
SG&A expenses	36.2	29.0	34.0	33.9
EBITDA margins	23.4	22.2	21.4	21.5
EBIT margins	17.7	18.3	17.1	17.3
Net Profit margins	11.5	11.5	10.3	10.9

Growth ratios (%)

Year to March	FY18	FY19	FY20E	FY21E
Revenues	23.6	58.7	28.5	10.4
EBITDA	44.4	50.4	24.1	10.9
PBT	91.5	71.8	14.3	16.5
Adjusted Profit	68.2	68.4	15.3	17.5
EPS	67.2	66.3	4.5	11.9

Balance sheet		(INR mn)			
As on 31st March	FY18	FY19	FY20E	FY21E	
Share capital	802	816	870	883	
Reserves & Surplus	10,951	14,936	19,535	24,473	
Shareholders' funds	11,753	15,752	20,405	25,357	
Minority Interest	820	925	1,045	1,131	
Def. Tax Liability (net)	222	222	222	222	
Sources of funds	24,705	36,618	41,486	43,734	
Gross Block	21,128	21,979	35,403	40,603	
Net Block	11,351	23,175	25,821	25,489	
Capital work in progress	3,570	4,194	4,194	4,194	
Intangible Assets	901	1,504	1,233	1,011	
Total Fixed Assets	15,822	28,873	31,249	30,694	
Non current investments	285	442	642	1,642	
Cash and Equivalents	2,935	3,606	2,685	3,629	
Sundry Debtors	8,713	13,559	15,170	17,943	
Loans & Advances	350	350	350	350	
Other Current Assets	5,634	16,690	18,140	20,531	
Current Assets (ex cash)	18,076	36,507	40,692	46,809	
Trade payable	6,562	19,172	17,764	20,171	
Other Current Liab	5,851	13,638	16,017	18,869	
Total Current Liab	12,412	32,810	33,781	39,040	
Net Curr Assets-ex cash	5,663	3,697	6,911	7,769	
Uses of funds	24,705	36,618	41,486	43,734	
BVPS (INR)	28.8	38.1	44.8	53.0	

Free cash flow		(INR mn)			
Year to March	FY18	FY19	FY20E	FY21E	
Reported Profit	3,343	5,628	6,578	7,730	
Add: Depreciation	1,822	1,950	2,824	3,054	
Interest (Net of Tax)	761	712	1,090	986	
Others	1,594	1,644	(5,578)	(917)	
Less: Changes in WC	204	261	(3,120)	(747)	
Operating cash flow	7,316	9,673	8,035	11,600	
Less: Capex	4,595	15,001	5,200	2,500	
Free Cash Flow	2,721	(5,328)	2,835	9,100	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Sterlite Technologies	1,196	14.4	12.8	6.3	5.7	35.4	32.8
Bharti Airtel	18,155	380.7	71.2	6.2	5.0	1.1	2.5
Bharti Infratel	7,795	18.7	17.6	7.7	7.4	15.0	15.7
Tejas Networks	240	13.3	10.6	5.9	5.0	9.6	11.2
Vodafone Idea	2,988	(5.1)	(4.8)	18.1	11.8	(0.1)	(0.1)
Median	-	14.4	12.8	6.3	5.7	9.6	11.2
AVERAGE	-	84.4	21.5	8.8	7.0	12.2	12.4

Source: Edelweiss research

Cash flow metrics					
Year to March	FY18	FY19	FY20E	FY21E	
Operating cash flow	7,316	9,673	8,035	11,600	
Financing cash flow	(5,848)	(15,603)	(5,350)	(5,000)	
Investing cash flow	(1,515)	5,438	(3,557)	(7,156)	
Net cash Flow	(48)	(492)	(872)	(556)	
Capex	(4,595)	(15,001)	(5,200)	(2,500)	
Dividend paid	(81)	(1,763)	(2,031)	(2,839)	

Profitability and efficiency ratios

Year to March	FY18	FY19	FY20E	FY21E
ROAE (%)	33.8	40.0	35.4	32.8
ROACE (%)	26.7	31.8	29.3	30.3
Inventory Days	95	68	81	85
Debtors Days	89	80	80	84
Payable Days	82	189	231	215
Cash Conversion Cycle	101	(41)	(70)	(46)
Current Ratio	1.7	1.2	1.3	1.3

Operating ratios

Year to March	FY18	FY19	FY20E	FY21E
Total Asset Turnover	1.4	1.7	1.7	1.7
Fixed Asset Turnover	2.2	2.3	2.2	2.3
Equity Turnover	2.9	3.5	3.4	3.0

Valuation parameters

Year to March	FY18	FY19	FY20E	FY21E
Adj. Diluted EPS (INR)	8.3	13.8	14.4	16.2
Y-o-Y growth (%)	67.2	66.3	4.5	11.9
Adjusted Cash EPS (INR)	13.0	18.8	21.6	24.4
Diluted P/E (x)	25.0	15.0	14.4	12.8
P/B (x)	7.2	5.4	4.6	3.9
EV / Sales (x)	2.9	2.0	1.6	1.4
EV / EBITDA (x)	10.8	8.9	7.7	6.7
Dividend Yield (%)	1.0	1.7	1.8	2.5

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	52.02	L&t mutual fund	2.96
Dsp blackrock invest	2.27	Life insurance corp	1.87
Aditya birla sun lif	1.57	Aditya birla sun lif	1.54
Reliance capital tru	1.22	Vedanta ltd	1.18
Dimensional fund adv	1.1	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
30 Nov 2018	Amitabh Hajela	Sell	18500.00
20 Aug 2018	Anand Agarwal	Sell	50000.00

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Bharti Airtel	BUY	SO	L	Bharti Infratel	HOLD	SP	L
Sterlite Technologies	BUY	SO	M	Tejas Networks	HOLD	SU	M
Vodafone Idea	HOLD	SU	M				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



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Coverage group(s) of stocks by primary analyst(s): Telecom

Bharti Airtel, Bharti Infratel, Vodafone Idea, Sterlite Technologies, Tejas Networks

Recent Research

Date	Company	Title	Price (INR)	Recos
23-Apr-19	Tejas Networks	Ebbing government business a concern; <i>Result Update</i>	182	Hold
15-Apr-19	Telecom	Daylight Again; <i>Sector Update</i>		
20-Mar-19	Vodafone Idea	Rights issue to lead to significant dilution; <i>Company Update</i>	33	Hold

Distribution of Ratings / Market Cap

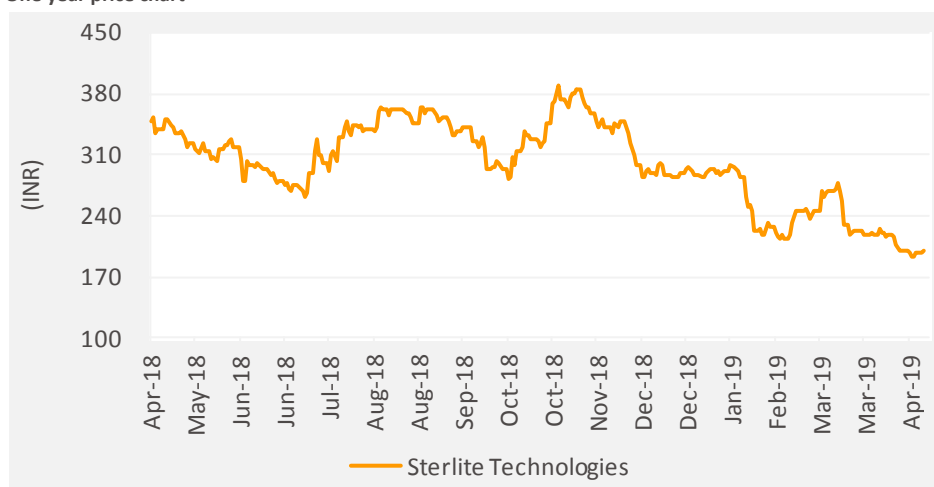
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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