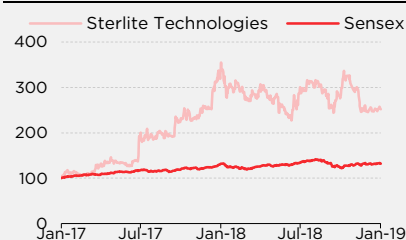


**24 January 2019**
**BSE Sensex: 36195**
**Sector: Telecom**
**Stock data**

CMP (Rs)	291
Mkt Cap (Rs bn/USD m)	117.0 /1,642
Target Price (Rs)	370
Change in TP (%)	NA
Potential from CMP (%)	27.3
Earnings change (%)	
FY19E	9.9
FY20E	0.7

Bloomberg code	SOTL IN
1-yr high/low (Rs)	415/255
6-mth avg. daily volumes (m)	1.4
6-mth avg. daily traded value (Rsm/USDm)	446.0/6.3
Shares outstanding (m)	402.4
Free float (%)	46.2
Promoter holding (%)	53.9

**Price performance - relative & absolute**


(%)	3-mth	6-mth	1-yr
SOTL IN	(10.3)	(16.4)	(29.1)
BSE Sensex	6.3	(1.7)	0.1

**Q3FY19 result highlights**

- **Strong earnings momentum continues:** Revenue of Rs13.5bn (IDFCe: Rs11.4bn) was up 23% qoq and +60% yoy driven by strong mix in products & services business. Revenues were 17% above our estimates due to strong growth in international market in Q3FY19. EBITDA margins decreased by 318bps QoQ to 22.0% (IDFCe: 24.3%) this was mainly due to change in product mix towards the service portfolio. Reported PAT came at Rs.1460mn (IDFCe:Rs.1364mn) ahead than our estimates by 7%.
- **Order book improves growth visibility:** Q3 FY19 performance showed sustained growth, backed by a strong open order book, which stands at an all-time high of around INR 102bn bn. This includes the INR 35 bn multi-year system integration contract to design Indian Navy's digital networks. SOTL expects majority revenue from Navy contract to be recognized in FY20 and FY21.
- **Highlights from Concall:** SOTL management mentioned that optical fiber pricing long term contract will be settled at \$7.5 per km as compared to higher end \$8.0 per km in last quarters. EBITDA margin will settle around 22%-23% due to higher product mix towards service portfolio. The cost of goods sold is higher on the services, because there is a component of high bought-out material as well as compared to the products and manufacturing business. International business accounts to 40% of the revenues. Current Debt is around Rs.18bn and capex till Q3FY19 was Rs.7.5bn & for FY19E Rs.10bn. China mobile postponement of the tender has created a pressure on spot prices of optical fiber but they can announce tender in this quarter.

**Key positives:** Strong order book

**Key negatives:** Margin Miss due to product mix.

**Impact on financials:** FY19/FY20 EPS changed by 10% & 0.7%.

**Valuations & view**

SOTL reported a strong revenue performance but margin miss was below our expectations. Margin miss was mainly due to change in product mix towards the service portfolio and they management guided range of 22%-23%. SOTL strong order book gives us confidence of strong momentum going forward. Due to delay in China mobile tender announcement, we expect the pressure to remain in spot pricing of OF and expect long term contract of OF to be at \$7.5 per km (\$8.5 per km last year). Strong growth visibility (27%/30% EBITDA/EPS CAGR over FY18-20E) and healthy RoCE (27% in FY20E) should help SOTL sustain premium valuations. We maintain Outperformer rating with unchanged target price of Rs370 (25x FY20E EPS).

**Key financials (quarterly)**

(Rs m)	3Q18	2Q19	3Q19	% change QoQ	% change YoY	% var from est
Revenue	8,352	10,843	13,349	23%	60%	16.8%
EBITDA	2,017	2,733	2,939	8%	46%	5.7%
EBITDA margin (%)	24.10%	25.20%	22.0%	(318bp)	(208bp)	(228bp)
Reported PAT	944	1,313	1,456	11%	54%	6.7%
Reported FD EPS (Rs)	2.22	2.97	3.23	9%	45%	0.0%

*Source: Company, IDFC Securities Research*

**Exhibit 1: Snapshot of Q3FY19 results**

Rs m	3Q18	4Q18	1Q19	2Q19	3Q19
<b>Revenue</b>	<b>8,352</b>	<b>8,466</b>	<b>8,769</b>	<b>10,843</b>	<b>13,349</b>
Cost of materials (net)	3,351	3,259	3,339	4,337	6,300
Employee expense	908	946	925	1,343	1,493
Other expense	2,076	2,058	2,056	2,430	2,617
<b>EBITDA</b>	<b>2,017</b>	<b>2,203</b>	<b>2,449</b>	<b>2,733</b>	<b>2,939</b>
EBITDA margin(%)	24.1%	26.0%	27.9%	25.2%	22.0%
Depreciation	448	413	448	492	512
EBIT	1,569	1,791	2,001	2,241	2,427
EBIT margin (%)	18.8%	21.2%	22.8%	20.7%	18.2%
Interest Cost	257	285	231	244	274
Other income	67	68	73	60	104
<b>Profit before tax</b>	<b>1,379</b>	<b>1,573</b>	<b>1,843</b>	<b>2,057</b>	<b>2,257</b>
Provision for taxation	387	255	548	652	760
Net income	992	1,318	1,295	1,406	1,497
Minority interest	91	72	78	73	20
Profit from associates	43	-7	21	20	21
<b>Reported profit</b>	<b>944</b>	<b>1,239</b>	<b>1,238</b>	<b>1,354</b>	<b>1,498</b>
Reported EPS (Rs)					
- basic	2.25	1.52	3.01	3.27	3.62
- diluted	2.22	1.49	2.97	3.23	3.23

Source: Company, IDFC Securities Research

## Maintain Outperformer with target price of Rs370

Sterlite Technologies reported in line operating performance with continued traction in product business order book. Management commentary remained optimistic with increasing demand for fiber across domestic and international markets. Strong growth visibility (27%/33% EBITDA/EPS CAGR over FY18-20E) and healthy RoCE (27% in FY20E) should help SOTL sustain premium valuations (24x one-year forward PE). We maintain with an Outperformer rating and target price of Rs370 (25x FY20E EPS).

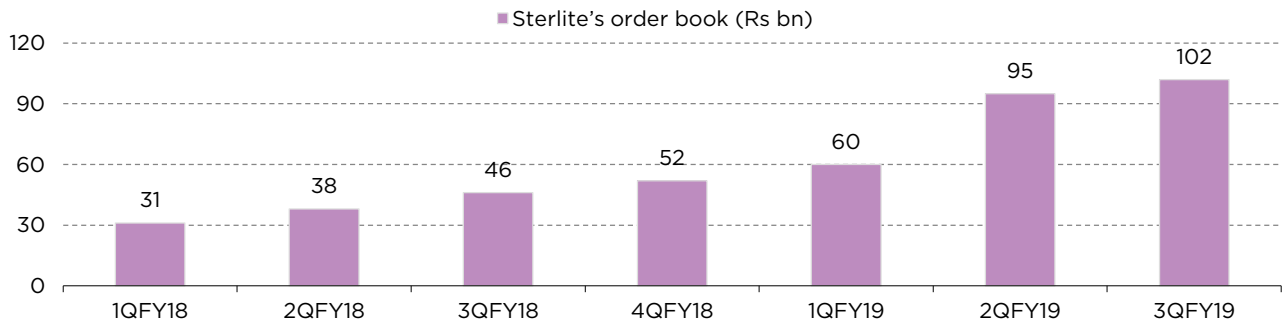
**Exhibit 2: Change in estimates**

YE March	FY19E	FY20E
<b>Revenue (Rs m)</b>		
- New	44,587	50,564
- Old	43,561	53,968
<i>Change (%)</i>	<i>2.4</i>	<i>(6.3)</i>
<b>EPS (Rs)</b>		
- New	13.25	14.50
- Old	12.05	14.40
<i>Change (%)</i>	<i>9.9</i>	<i>0.7</i>

Source: Company, IDFC Securities Research

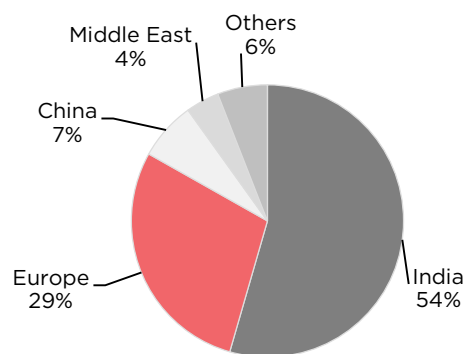
## Other key result tables

**Exhibit 3: Strong growth in order book (Rs.bn)**



Source: Company, IDFC Securities Research

**Exhibit 4: Revenue contribution H1FY19**



Source: Company, IDFC Securities Research

**Income statement**

Year to 31 Mar (Rs m)	FY16	FY17	FY18	FY19E	FY20E
<b>Net sales</b>	<b>22,749</b>	<b>25,936</b>	<b>32,055</b>	<b>44,587</b>	<b>50,564</b>
% growth	(26.5)	14.0	23.6	39.1	13.4
Operating expenses	18,157	20,747	24,561	33,802	38,849
<b>EBITDA</b>	<b>4,592</b>	<b>5,189</b>	<b>7,494</b>	<b>10,785</b>	<b>11,715</b>
% change	(0.3)	13.0	44.4	43.9	8.6
Other income	162	235	393	317	173
Net interest cost	1,192	1,229	1,038	1,018	1,080
Depreciation	1,256	1,592	1,822	2,056	2,256
Pre-tax profit	2,250	2,574	4,962	8,085	8,522
Deferred tax	0	0	0	0	0
Current tax	652	397	1,332	2,465	2,519
<b>Profit after tax</b>	<b>1,598</b>	<b>2,177</b>	<b>3,631</b>	<b>5,620</b>	<b>6,002</b>
Preference dividend	0	0	0	0	0
Minorities	(61)	(163)	(298)	(189)	(205)
<b>Adjusted net profit</b>	<b>1,537</b>	<b>2,014</b>	<b>3,333</b>	<b>5,431</b>	<b>5,797</b>
Non-recurring items	0	0	0	(41)	0
<b>Reported net profit</b>	<b>1,537</b>	<b>2,014</b>	<b>3,333</b>	<b>5,390</b>	<b>5,797</b>
% change	NM	31.0	65.5	61.7	7.5

**Balance sheet**

As on 31 Mar (Rs m)	FY16	FY17	FY18	FY19E	FY20E
<b>Paid-up capital</b>	<b>790</b>	<b>797</b>	<b>802</b>	<b>802</b>	<b>802</b>
Preference capital	0	0	0	0	0
Reserves & surplus	6,756	8,004	10,951	14,398	19,113
<b>Shareholders' equity</b>	<b>7,859</b>	<b>9,253</b>	<b>12,573</b>	<b>16,215</b>	<b>21,134</b>
Total current liabilities	8,486	8,181	12,412	14,714	16,541
<b>Total debt</b>	<b>8,220</b>	<b>10,181</b>	<b>10,933</b>	<b>13,750</b>	<b>15,000</b>
Deferred tax liabilities	382	397	222	222	222
Other non-current liabilities	1,299	1,495	980	2,229	2,406
Total liabilities	18,387	20,254	24,547	30,915	34,168
<b>Total equity &amp; liabilities</b>	<b>26,245</b>	<b>29,507</b>	<b>37,119</b>	<b>47,130</b>	<b>55,303</b>
Net fixed assets	11,571	12,490	14,921	17,093	19,141
Investments	164	232	89	421	421
Cash	777	1,374	1,385	2,453	5,519
Other current assets	11,580	13,354	18,416	23,195	26,009
Deferred tax assets	0	0	0	0	0
Other non-current assets	2,153	2,057	2,309	3,969	4,213
Net working capital	3,871	6,547	7,389	10,934	14,988
<b>Total assets</b>	<b>26,245</b>	<b>29,507</b>	<b>37,119</b>	<b>47,130</b>	<b>55,303</b>

**Cash flow**

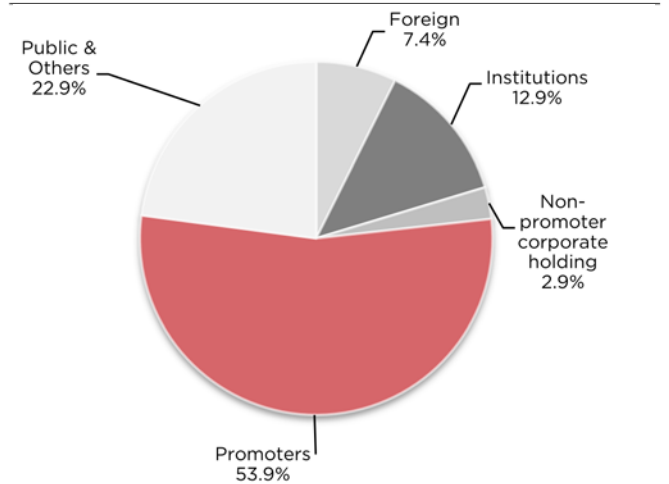
Year to 31 Mar (Rs m)	FY16	FY17	FY18	FY19E	FY20E
Pre-tax profit	2,250	2,574	4,962	8,085	8,522
Depreciation	1,256	1,592	1,822	2,056	2,256
Chg in Working capital	(2,986)	(1,949)	10	(3,610)	(901)
Total tax paid	(652)	(397)	(1,332)	(2,465)	(2,519)
Net Interest	1,192	1,229	1,038	1,018	1,080
Others	(25)	197	(515)	1,209	177
<b>Operating cash flow</b>	<b>1,036</b>	<b>3,246</b>	<b>5,986</b>	<b>6,294</b>	<b>8,613</b>
Capital expenditure	48,129	(2,195)	(3,949)	(5,334)	(4,304)
<b>Free cash flow (a+b)</b>	<b>47,973</b>	<b>(179)</b>	<b>1,000</b>	<b>(59)</b>	<b>3,229</b>
Chg in investments	(164)	(67)	143	(332)	0
Debt raised/(repaid)	(42,357)	1,960	752	2,817	1,250
Net interest	(1,192)	(1,229)	(1,038)	(1,018)	(1,080)
Capital raised/(repaid)	2	6	5	0	0
Dividend (incl. tax)	(462)	(597)	(962)	(1,083)	(1,083)
Other items	(8,490)	(169)	401	(861)	0
<b>Net chg in cash</b>	<b>(2,982)</b>	<b>597</b>	<b>10</b>	<b>1,145</b>	<b>3,077</b>

**Key ratios**

Year to 31 Mar	FY16	FY17	FY18	FY19E	FY20E
EBITDA margin (%)	20.2	20.0	23.4	24.2	23.2
EBIT margin (%)	14.7	13.9	17.7	19.6	18.7
PAT margin (%)	6.8	7.8	10.4	12.2	11.5
RoE (%)	13.7	24.6	32.4	40.3	33.0
RoCE (%)	7.8	18.4	24.6	30.6	26.6
Gearing (x)	0.9	0.9	0.6	0.6	0.4
Net debt/ EBITDA (x)	1.6	1.6	1.0	0.9	0.7
FCF yield (%)	41.9	(0.2)	0.9	(0.1)	2.8
Dividend yield (%)	0.3	0.4	0.7	0.8	0.8

**Valuations**

Year to 31 Mar	FY16	FY17	FY18	FY19E	FY20E
<b>Reported EPS (Rs)</b>	<b>3.9</b>	<b>5.1</b>	<b>8.3</b>	<b>13.4</b>	<b>14.5</b>
Adj. EPS (Rs)	3.9	5.1	8.3	13.5	14.5
PE (x)	74.5	57.1	34.7	21.4	20.1
Price/ Book (x)	15.2	13.1	9.8	7.7	5.8
EV/ Net sales (x)	5.4	4.8	3.9	2.9	2.5
EV/ EBITDA (x)	26.6	23.9	16.6	11.8	10.7
EV/ CE (x)	6.9	5.8	5.0	3.9	3.2

**Shareholding pattern**

As of Sep 18

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