"Sterlite Technologies Business Update Conference Call on acquisition of IDS Group"

September 25, 2019

MANAGEMENT: MR. ANAND AGARWAL – CHIEF EXECUTIVE OFFICER
MR. ANUPAM JINDAL – CHIEF FINANCIAL OFFICER
MR. VISHAL AGGARWAL – HEAD (M&A AND INVESTOR RELATIONS), STERLITE TECHNOLOGIES LIMITED

Moderator: Good day, ladies and gentlemen and a very warm welcome to the Sterlite Technologies business update call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing * then 0 on your touchtone phone. Please note that this conference is being recorded. I know hand the conference over to Mr. Vishal Aggarwal – Head M&A and Investor Relations, Sterlite Technologies. Thank-you and over to you, sir.

Vishal Aggarwal: Good evening everyone and thank you for taking the time to join us at a short notice for today's conference call, to give you an update on STL's acquisition of IDS Growth. Joining me today are Dr. Anand Agarwal – CEO, and Anupam Jindal – CFO of Sterlite Tech. We will be spending time introducing you to the IDS Group and walking you through the strategic rationale of the acquisition, and its economy contours after which we will be happy to take your questions.

We have also made the presentation public for those who cannot access it live. Before we proceed with this call, I would like to add that some elements of this presentation may be forward-looking in nature and must be viewed in relation to the risk pertaining to our business. The safe harbor clause indicated in our presentation also applies to this conference call.

With that, I turn over the call to Anand.

Anand Agarwal: Thank you, Vishal and good evening, everyone. We are extremely excited to announce acquisition of IDS Group, a European data center network infrastructure design and development specialist, which is based in the United Kingdom.

Slide 3:

And as you all know, it is our clear endeavor to be more and more relevant to our customers' data network relation across the globe. The massive growth that we see in data transmission as well as high bandwidth applications, are driving a large need for data centers which are becoming closer and closer to the point of consumption, which are these edge compute and localized data centers, and which makes this an extremely attractive state for investment. Hyper scale customers have been on our focus in recent times due to the kind of network creation that they are doing across the globe. And this acquisition that we have of IDS is aligned to our stated strategy of strengthening our solutions to our cloud provider customer segments.

Slide 4:

Alright, so now I would like to introduce you to the new member of the STL family. IDS is a niche datacenter design and deployment company based out of UK. It has an incredible talented team of 21 people, led by their CEO, Ben Parker; and founders, which Tracy and Robbie Williams. The IDS team focuses on designing network infrastructure solutions for datacenter customers in Europe and the UK, with a dedicated partner ecosystem for flawless execution. IDS has an extremely attractive financial profile with the current calendar 2019 revenues estimated to be in the range of GBP 10 million to GBP 12 million, and EBITDA margin of almost 20%, with no debt on its books.

Slide 5:

As part of the overall transaction structure, STL will acquire 100% stake in UK based Impact Data Solutions Limited (IDS) and its affiliates, together represented as IDS Group. As part of the first tranche closing, 80% has been acquired now, and the balance 20% will be on an earn-out model over the next few years. It is an all cash transaction, financed by a combination of internal accruals and foreign currency debt instruments, at an enterprise value of almost GBP 12 million, representing 100% of share capital of IDS Group. The acquisition is EPS positive from year one and fits well into its financial and strategic criteria for M&A, that has been shared earlier.

Slide 6:

The strategic rationale, as you can see IDS fits beautifully into STL. While on one hand STL has a strong foothold into network services in India, global connectivity solutions for outside data center market, and entrenchment into two of the top four global cloud provider. IDS on the other hand brings geographic access to Europe and UK for network service and business. These relationship engagements with two of the top four global cloud providers, and expertise in inside datacenter network infrastructure solution. So with this, I am extremely proud to share that combined STL and IDS will now have access to three of the top four global cloud providers, with an integrated datacenter connectivity offerings across Europe and India.

Slide 7:

So, IDS' solutions include design and deployment of network infrastructure, electrical design and installation services, and hot and cold isle containment products. We believe that combined STL-IDS will significantly accelerate our growth strategy for our network services by serving our cloud provider customer segments with niche design and deployment solutions, as well as for hyper-scale datacenters, wherever they are built or deployed.

Slide 8:

IDS serves global cloud provider, colocation providers, as well as large enterprises. IDS is a key partner to two of the top four global cloud companies for their datacenter connectivity needs, with one relationship extending continuously for over the last ten years. 80% of the revenues come from cloud providers, off which 65% come from one of the top four cloud provider customers, which was not a existing customer for STL prior to the transaction. So this acquisition provides access to fresh coveted customer that provides an opportunity to upsell our relationship.

Slide 9:

With IDS' offerings which are pan-Europe and with this I can gladly say that STL's network services business has now gone global with strong presence in India, as well as strong presence in Europe.

<u>Slide 10:</u>

This slide we have shared with you earlier; with the capability acquisition which brings STL one step closer towards his journey of expanding its addressable market to $75 billion by 2022.

<u>Slide 11:</u>

Now coming specifically to the integration strategy, IDS will be completely integrated into our network services business unit. Ben Parker, who's the CEO, will continue to lead the group and report to KS Rao, who is the CEO of the STL Network Services Business. To realize the synergies further, we will work towards expanding the combined network services solution to geographies like India and elsewhere, cross leveraging customers and adding new offerings to upsell our end-to-end data network solutions.

<u>Slide 12:</u>

IDS' acquisition clearly is in line with our stated strategy as the niche design and deployment capability to our end to end data networking and competencies.

With this, we come to the end of our opening commentary. And would be happy to take questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Neerav Dalal from Maybank. Please go ahead.

Neerav Dalal: I wanted to understand the rationale of the sellers to sell the business to STL, because it's been since 2009 and so just wanted to understand that.

Anand Agarwal: Surely. So this essentially has been run by the founders and they have brought it to a current level. And it is a founding family with a professional CEO. And the founding family essentially was involved in initially scaling the business, and got a professional CEO last couple of years, because, I mean, due to age and other reasons they wanted to get out of the current business and let the professionals to run it. And looking at the overall growth, they were finding to look at the larger platform. And they continue to hold a stake in the balance 20%, because they are very excited with the potential that STL provides in scaling up the Company.

Neerav Dalal: Right. So the decision making will now be housed in STL, right?

Anand Agarwal: Absolutely. They will not have decision making authority.

Neerav Dalal: Okay. And any opportunities for margin improvement in that business? And how do we see the entire services business then move for SOTL?

Anand Agarwal: So, this Neerav, in terms of scale is small, it's like GBP 10 million to GBP 12 million. So we are clearly a capability acquisition for us to combine what we are doing in India, combined what we are doing in datacenter space, and bringing it together. So I think more than margin improvement, it will provide us great access to a new market segment, which will; and as we normally do, once we get scale, once we get revenues, there will always be opportunities for margin enhancement.

Moderator: Thank you. The next question is from the line of Pranav Kshatriya from Edelweiss. Please go ahead.

Pranav Kshatriya: Sir, firstly, can you give us some color on who are the customers or the number of customers from which this revenue is derived? And you talked about you would almost, 30% odd kind of revenue growth expectation in CY19. You think this kind of growth is sustainable? And, some color on how much is leverage in the business, and also the scalability? So, can you give us how should we see this two, three years down the line?

Anand Agarwal: Pranav, it is a very focused Company addressing large datacenter providers. So 80% of our revenue comes from two of the largest four datacenter providers. And because of disclosure requirements, we cannot disclose those names. The balance 20% comes from enterprise segment who are hosting or co-locating their own private cloud in an existing datacenter. So, it includes real large marquee names globally. As regards growth, I mean, clearly the growth in small numbers what we have seen between 2018 and 2019 has been there. And this growth is in line with the datacenter capex that we are seeing globally. As I said earlier, this for us is an extremely strong capability acquisition, and if I see in terms of overall market share for this Company, it's some 1% of the total global datacenter connectivity creation that is happening. So, I see big opportunity for growth as we move forward. In terms of leverage, the Company has no leverage. And we will be glad to run it in a very, very asset light model.

Pranav Kshatriya: The second question is on, are there any clause in terms of the key employee retention, considering some of the acquisitions are done by other companies, the key employees leaving has had impacted on future growth? And also even the revenue from some other accounts started falling down because of that, so any policies like that which have been implemented?

Anand Agarwal: Yes, absolutely. Some of the key employees have continued to have stake in the Company, in the balance 20%. We are also covering them through some contracts, as well as stock options. So all those, you are absolutely right, so all those provisions have been provided as we have done the transaction.

Moderator: Thank you. The next question is from the line of Mukul Garg from Haitong Securities. Please go ahead.

Mukul Garg: Thanks. Anand, just a couple of clarifications. Can you share the revenue of IDS in 2016 and 2017, is that number something you can share?

Anand Agarwal: Mukul, I don't have the numbers immediately, it's the Company which has grown over the last several years. Separately with the IR team if you can get in touch, then we can share whatever is disclosable.

Mukul Garg: Sure. And also, I guess, it would be helpful if you can shed some light on the breakup between the installation part and the consulting part in the datacenter space. Where is a key strength, what is the mean growth driver till now for IDS?

Anand Agarwal: So there is no separate consulting which the company provides, everything is being provided as an integrated design and deployment. So typically, whenever a datacenter is getting designed and getting built-up, so that inside datacenter connectivity requirements are IDS' core products, and gets involved in the design phase itself, and is accountable and responsible for the deployment piece as end-to-end. Very, very similar to what we do for our network pieces in India for servicing. And they have like pan-European installation partners where they manage the processes, manage the program management, manage the quality with an end-to-end accountability.

Mukul Garg: So should we assume that this GBP 8 million to GBP 12 million revenues includes the commission paid to the partners or is that something which generally comes on top of it?

Anand Agarwal: There is no commission paid to the partners. So it's essentially design and deployment job. So this includes the total revenues of the jobs. And based on whatever needs to be done, by say, subcontractors or installation partner is job down to them. After all, taking all that into account, the Company makes close to 20% EBITDA, and pretty high gross margins which are there. So that aspect is something which is completely leverageable and has that good amount of operating margins end-to-end.

Mukul Garg: Anand, what I was kind of, I was finding it difficult to compare when you look at the size of the workforce which you are taking over, it's about 21 employees, which kinds of does not correlate to the revenue which they have reported, about GBP 8 million, that's almost like a GBP 400 thousand per person and that includes the top brass as well. So is it something which there is kind of scale we should expect in this business?

Anand Agarwal: Yes. And Mukul, that's the model even how we are running the services business in India today. We reported revenues of more than Rs. 1,500 crore, Rs. 1,600 crore with less than 400 people. So that's the model, we do not do any construction, we do not do any installation, Focus is on design, focus is on processes, focus is on program management, and focus is on end-to-end accountability. And we looked at capability for partners who provide that complementarity in an alternative area of the network.

Mukul Garg: Understood. And just in relation to this, is this knowledge skills easy to transfer or easy to kind of add workforce and target a much bigger portion of the market? I would assume its additional 1% market share within Europe as well, I think they are probably targeting a very small portion of the client business, even though clients are big?

Anand Agarwal: Yes, so that's absolutely right. We are going to augment the skills that the Company has, we are going to add STL processes in terms of growth, in terms of scale, in terms of control, in terms of management, in terms of access to a global platform, and we will add capabilities and the IDS team to take it forward.

Moderator: Thank you. The next question is from the line of Tejas Seth from Reliance Nippon Asset Management. Please go ahead.

Tejas Seth: What is the typical revenue model of this Company? Is there any AMC to it, does it work on the order book size, how does do the revenue and the business development sourcing is done?

Anand Agarwal: Tejas, currently it is mostly in terms of design and build, there is no post-build AMC which the Company currently is doing. And we are also thinking about whether, we also understanding what the model in terms of how the AMC part works in Europe. So the way it typically works, whenever say an existing customer wants to extend their more datacenter build, they would have a series of qualified partners, which IDS is one of the qualified partner, they will call them, they would involve them in the designing process, and then in an RFQ for bidding process. And they would take a part of the contract, do the bid, and post bid all the revenues get accounted for in a project fashion. Currently there is no AMC, but it is an area for us to explore as we move deeper into the Company.

Tejas Seth: And typically does this Company have some order book over next two years, three years on the designing part, or it’s a very short cycle product?

Anand Agarwal: So, typically what we see is they have a decent funnel size, good visibility, but order book visibility typically is six to seven months, and it must be moved on.

Tejas Seth: Okay. If you can also explain how fragmented is this industry, who are key players, is this service offered on a pure single services basis or it is combined with other services by our competitors, some knowledge on that area?

Anand Agarwal: Yes. So, Tejas, there are two kinds of providers, there are companies who own datacenters, and there are companies who integrate end-to-end datacenters. So that complexity of inside datacenters is also increasing. It used to be only power connectivity, now things like storage, compute, IT part is also coming in strongly. So there are companies who will do the end-to-end part of it. Whenever, say, a datacenter owner gives a job to a full integrator, a Company like IDS would be at level two, but it needs to be still approved by the datacenter owners. So, to an extent it is clearly a very specialized space, because it operates in inside datacenter connectivity, which is a very, very critical space, both in design and in execution for the ultimate owners of datacenter.

Tejas Seth: Okay. And who are the key players? How fragmented is this industry?

Anand Agarwal: At the integrated level, it's not fragmented. But at the expertise level, based on the expertise, it will be many providers. But for connectivity in which IDS is, again, it becomes very concentrated. So it's more geography concentration, it's more capability oriented concentration, but different people offer different kinds of solutions.

Tejas Seth: Okay. And who would be top three players in this industry, if you can name them? And what would be the size of their revenue?

Anand Agarwal: So, there will be people like a clinic, there will be people like who would be both integrators as well as part owners as well. There would be people called, there would be a Company called Excel, Redstone, there's a Company called LNG, there's a company called NG Valley. So these are companies between GBP 60 million to GBP 500 million.

Tejas Seth: Okay. And just lastly, why this Company is Europe centric? Is this business very region centric, and why they are not there in, let's say, U.S, or even in LATAM or even other parts of the globe?

Anand Agarwal: So, as I said, this Company was started only about 10 years ago by the existing founders and they were concentrated initially on UK. And then gradually with the relationship that they built with the large cloud provider, they started moving along with them. They got the professional CEO about two and a half years ago. So it was more essentially an evolution, no reason why they could not move.

Tejas Seth: Okay. And is there any contingent liability to this business towards the performance of some datacenter over two years, three years?

Anand Agarwal: In projects, you get everything paid off, there would be some stated warranty for a period of one year for the performance of that, but there is no money which are due for that part.

Moderator: Thank you. The next question is from the line of Rajesh Kothari from Alpha Accurate Advisors. Please go ahead.

Rajesh Kothari: My question is with reference to this acquisition; how do you see the current and new Company? So combined business how do you plan to further aggressively capture the market size? So can you just share some highlights of the new business planned as far as this vertical goes?

Anand Agarwal: So essentially, Rajesh, this currently in terms of scale is very less, it's GBP 10 million. So we are seeing it not as a revenue acquisition, it's essentially a capability acquisition. And we are looking at it more from a macro towards our addressable market increase. I don't think fundamentally it would change significantly our revenues or business plans for the current financial year. But it provides, it's all in the direction of increasing our addressable market size.

Rajesh Kothari: So let's assume, my question was more with reference to next three to five years perspective. So how this acquisition fits your business strategy, and how aggressively it can help you turn your capability perspective, as well as reaching the clients, because you kept mentioning from the strength that they will be covering the top five customers, top three, the world leaders and so on and so forth. So can you just give a little bit more color on that?

Anand Agarwal: Sure, Rajesh. So as we have mentioned, see we have four customer segments, one is telco, one is the citizen network, which is large enterprises, and the fourth one is cloud providers. Cloud providers till date was just less than 1% of our revenues. So to address cloud provider segment, this Company provides us capabilities to go and address that segment in a larger way. And if you see the current slide, which is on there, our stated strategies is to address market which will be size of $75 billion by 2023, where cloud providers will be a significant part of it. So with this capability acquisition, we move closer to addressing that at the current market.

Rajesh Kothari: And the key things what you have mentioned in terms of the competitors, typically the average margins of this industry is similar levels or there is a major difference between the different players?

Anand Agarwal: So it is between 15% to 20% margins, I mean, as the design component increases the margin is better. And as it moves more and more towards construction and installation, the margin comes down. And there are various companies who have different models.

Rajesh Kothari: I see. And this part of the business is not done by your customers now as well? It is always outsourced or there is a good part which is also done captive?

Anand Agarwal: I didn't get, outsourced or captive, by who, sorry?

Rajesh Kothari: I mean, I am saying from a customer perspective, this part of the business what right now this Company is doing, whether are there customers who are also doing with captive rather than outsourcing to companies like the Company we acquired?

Anand Agarwal: Yes, so typically what we are seeing, most of our customers are focusing on the build part of datacenters to rely on their partner ecosystem. On the manage part, on the IT part, they do it on their own. But datacenter build part, they are relying more on a partner ecosystem.

Rajesh Kothari: I see. So, this is called the build part of it and which was basically what we have acquired. Understood. So there is no much AMC capital employed which is involved in the long-term?

Anand Agarwal: Absolutely.

Rajesh Kothari: So it is an asset light business?

Anand Agarwal: Yes.

Rajesh Kothari: And the typical working capital of this business is, generally how it works?

Anand Agarwal: The typical working capital would be 65 to 70 days, it gets done between the customer advances, between the payment cycle as well as the contractor payment cycle?

Moderator: Thank you. That was the last question. I know how the conference over to Dr. Anand Agarwal for closing comments.

Anand Agarwal: So at this point I would also like to bring out the contribution of the entire team from both sides involved in the acquisition, and once again extend a very warm welcome to the IDS team. Also, I want to thank everyone for attending this call at a short notice and for showing interest in our Company. For any further clarification and discussion, you can feel free to contact our IR team, including myself and Anupam. And we hope to continue our association and dialogue in the future. Thank-you and good-evening.

Moderator: Thank you. Ladies and gentlemen, on behalf of Sterling Technologies, that concludes this conference call for today. Thank you for joining us. And you may now disconnect your lines.