

Healthy show; maintain cautious stance...

Sterlite Tech reported an in-line topline performance (~63% YoY growth) in Q1FY20 driven by strong domestic revenues (~64% of pie), which witnessed a staggering ~87% YoY growth. Exports revenues, on the other hand, forming 36% of revenues, grew 33% YoY. Reported EBITDA margins came in higher at 22.6% (vs. our estimate of 19.5%) given the higher proportion of product revenues that command superior margins. PAT came in lower at ₹ 141.4 crore (vs. our expectation of ₹ 151.2 crore) despite higher EBITDA, on account of higher depreciation and interest costs owing to commissioning of new OF capacity. While, so far, the performance remains strong, we remain cautious on overall demand given the excess supply and pricing pressure thereof, which may impact the offtake from new capacity.

Affected less by pricing pressure

The company indicated that notwithstanding Chinese fibre prices of ~US\$4/fkm, it enjoys a superior realisations of ~US\$7/fkm (vs. ~US\$8/fkm earlier) mainly due to its value added component, long term nature of contract as well as addressing export demand. It also continues to enjoy healthy product margins of 26-28% (vs. 32% earlier). However, we believe that continued lower prices could have some impact on realisations, going ahead, while offtake from new capacity could also suffer if excess supply and pricing pressure thereof remain.

Order book healthy, aiming to become end to end tech partner

Out of total order book of ₹ 9853 crore, the services order book is ~₹ 4250-4450 crore. It is important to note that the company is aiming to transform into an end to end technology partner by offering system based integrated solutions to customers and capturing higher wallet share. We slightly raise our revenues forecast for FY20 and FY21E by ~3% and 3%, respectively, to build in superior execution in the services segment. We bake in margins of 20.2% and 19.5% for FY20E and FY21E, respectively.

Valuation & Outlook

Notwithstanding Sterlite's strong growth trajectory in the past couple of years driven by strong traction in global fibre demand, if pricing pressure continues that could be a key negative trigger. The shift of business mix towards services also runs the risk of working capital stress, especially for government projects. The recent announcement of promoters releasing pledged shares, however, is expected to provide some stability to stock prices. With ~19% stock price correction since our last update and removal of pledged shares overhang, we upgrade the stock to **HOLD** (vs. REDUCE, earlier), valuing it at 12x FY21E P/E at ₹ 180/share. Pricing recovery at industry levels remain a key upside risk to our stance.



Particulars

Particular	Amount
Market Capitalization (₹ crore)	6,815.2
Total Debt (FY19) (₹ crore)	2,102.1
Cash (FY19) (₹ crore)	333.9
EV (₹ crore)	8,583.5
52 week H/L (₹)	399/ 144
Equity capital (₹ crore)	80.2
Face value (₹)	2.0

Key Highlights

- Topline growth of ~63% driven by superior domestic revenues (~64% of the pie), which witnessed staggering ~87% YoY growth
- The company maintained its EBITDA margins guidance at 18-20% with more likely margin possibility of higher end of the band
- With 20% correction since our last update and removal of pledged shares overhang, we upgrade the stock to HOLD (vs. REDUCE, earlier), valuing it at 12x FY21E P/E at ₹ 180/share

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Key Financial Summary

(Year-end March)	FY17	FY18	FY19E	FY20E	FY21E	CAGR (FY19-21E)
Net Sales (₹ crore)	2,593.6	3,205.5	5,087.3	6,509.2	7,249.1	19.4
EBITDA (₹ crore)	518.9	749.3	1,127.2	1,313.4	1,413.6	12.0
Net Profit (₹ crore)	201.4	337.5	567.9	578.0	603.1	3.1
EPS (₹)	5.1	8.3	14.0	14.3	15.0	
P/E (x)	33.5	20.3	12.1	11.8	11.3	
Price / Book (x)	7.7	5.8	4.0	3.2	2.7	
EV/EBITDA (x)	15.0	10.2	7.6	6.5	5.6	
RoE (%)	22.9	28.7	33.0	27.1	23.5	
RoCE (%)	20.8	29.7	27.8	27.8	30.3	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q1FY20	Q1FY20E	Q1FY19	Q4FY19	YoY (%)	QoQ (%)	Comments
Revenue	1,432.0	1,428.5	876.9	1,791.2	63.3	-20.1	Revenue growth driven by domestic revenues growth of ~87% YoY while exports grew 33% YoY
Other Income	8.7	18.0	7.3	13.2	20.6	-33.8	
Cost of raw material	666.3	650.0	269.6	1,221.4	147.1	-45.4	
Purchase of traded goods	0.1	28.6	5.5	5.1	NA	NA	
Employee Expenses	146.3	142.8	92.5	135.0	58.0	8.3	
(Increase) / decrease in inventories	40.6	14.3	58.8	-136.7	-31.0	-129.7	
Other Expenses	255.3	314.3	205.6	251.4	24.2	1.6	
EBITDA	323.4	278.6	244.9	315.1	32.1	2.6	
EBITDA Margin (%)	22.6	19.5	27.9	17.6	-534 bps	499 bps	EBITDA margins came in higher given the higher proportion of product revenues, which command superior margins
Depreciation	68.3	50.0	44.8	49.8	52.6	37.3	
Interest	46.3	29.4	23.1	30.7	100.8	50.9	
Total Tax	73.3	65.1	54.8	82.2	33.7	-10.7	
PAT	141.4	151.2	120.7	165.2	17.1	-14.4	PAT came in lower despite higher EBITDA, on account of higher depreciation and interest costs owing to commissioning of new OF capacity

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY20E			FY21E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	6,337.6	6,509.2	2.7	7,105.7	7,249.1	2.0	Our topline estimates have been slightly raised to build in better traction in services segment
EBITDA	1,235.8	1,313.4	6.3	1,350.1	1,413.6	4.7	
EBITDA Margin (%)	19.5	20.2	68 bps	19.0	19.5	50 bps	Raise our margins based on management commentary
PAT	590.2	577.1	-2.2	604.8	603.1	-0.3	
EPS (₹)	14.7	14.3	-2.5	15.0	15.0	-0.1	

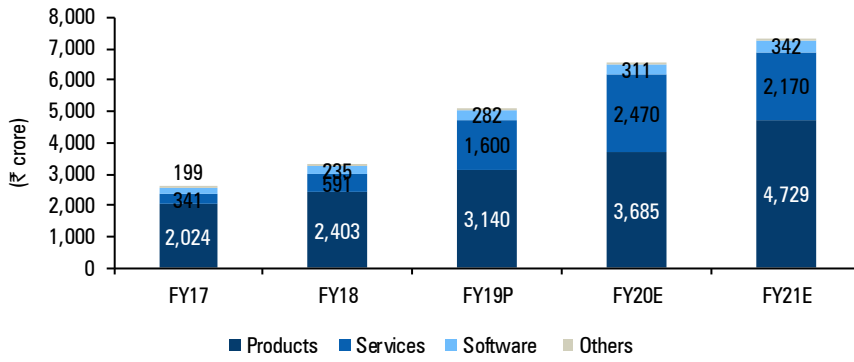
Source: Company, ICICI Direct Research

Other Highlights

- **Snapshot of company's integrated offering:** For one of its large global telco client, the company is providing algorithmic FTTx solutions of Sterlite FTTx mantra as well as I-CORE. For a hyper scale cloud customer, for their high capacity with extreme low latency demand, it is providing TruRibbon solutions, which provide faster installation compared to legacy high density fibre solutions. Furthermore, for two of the disruptive telcos in Asia, they are providing programmable, open, disaggregated solution for their seamless Wi-Fi offload
- **Capacity expansion status:** The new fibre capacity of ~20 mn Fkm is undergoing commissioning currently and would be gradually brought up to capacity by H1FY20. The volume from new fibre capacity is expected to pick up from Q3FY20 onwards. The gross block of ~₹ 900 crore was added due to new capacity added so far. The plan to increase optical fibre cable capacity from 18 million (mn) km to 33 mn km in a modular fashion is on track and expected to be completed by June, 2020. As part of the cabling expansion plant announced last year, the company is doubling the capacity of the Italy plant from 3 mn km to 7 mn km, mainly for a niche micro-module cable offering for European customers. The capex guidance for FY20 was maintained at ₹ 550 crore
- **Service order status:** The Navy project is almost 50% done while the MahaNet project is close to 30% completed. The quarter had services (and software) revenues run rate of close to ₹ 600 crore. The company remained confident of maintaining/improving on the run rate given the strong order book and visibility of new orders
- **Pledge removed:** During the quarter, promoters completely removed pledging of shares (~97% of their holdings), which were done to support M&A activity by promoter group in other business interests
- **Others:**
 - i. Order book was at ₹ 9853 crore as on Q1FY20, with product being 55-57% of the order book. In terms of clientele breakup, 55% of that is from telcos, 28% from enterprise segment, 17% is from citizen networks while 1% of the order book is from cloud players
 - ii. The patent portfolio was at 273, up 45% YoY
 - iii. Net debt increased from ₹ 1733 crore in FY19 to ₹ 1980 crore in Q1FY20
 - iv. Value added products now form 30% of product revenues

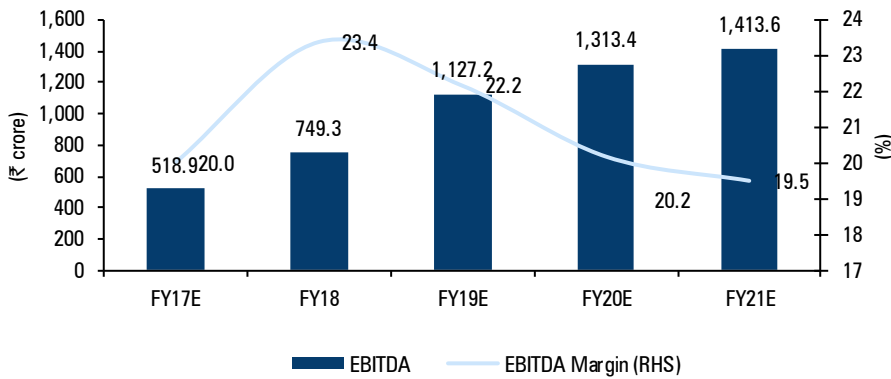
Financial story in charts

Exhibit 3: Topline growth driven by capacity expansion, service order book



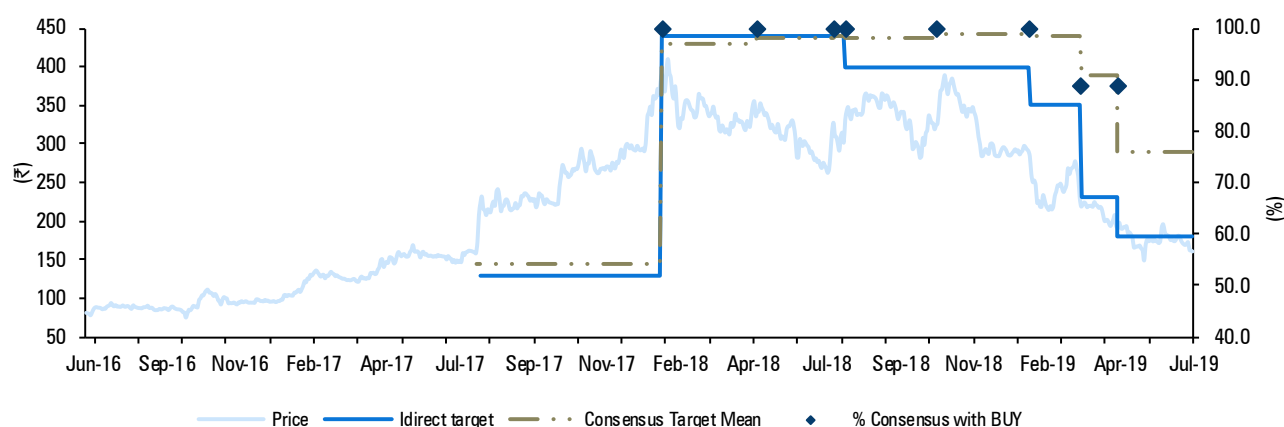
Source: Company, ICICI Direct Research

Exhibit 4: Margins to decline with higher mix of services revenues



Source: Company, ICICI Direct Research

Exhibit 5: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 6: Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Position Change (m)
1	Twin Star Overseas, Ltd.	31-Mar-19	52.0	209.4	0.0
2	L&T Investment Management Limited	31-Mar-19	3.0	12.1	-2.4
3	DSP Investment Managers Pvt. Ltd.	31-Mar-19	2.3	9.1	-3.9
4	Aditya Birla Sun Life AMC Limited	31-May-19	1.3	5.3	0.1
5	Reliance Nippon Life Asset Mgmt Limited	31-Mar-19	1.2	4.9	0.1
6	Vedanta, Ltd.	31-Mar-19	1.2	4.8	0.0
7	Life Insurance Corporation of India	31-Mar-19	1.2	4.7	-2.8
8	The Vanguard Group, Inc.	31-May-19	0.8	3.3	0.0
9	Dimensional Fund Advisors, L.P.	31-May-19	0.7	2.9	0.0
10	BlackRock Institutional Trust Company,	30-Jun-19	0.4	1.5	0.0

Source: Reuters, ICICI Direct Research

Exhibit 7: Recent Activity

Investor name		Investor name	
Buys		Sells	
Legato Capital Management LLC	+2.67M +0.85M	DSP Investment Managers Pvt. Ltd.	-12.32M -3.90M
J.P. Morgan Asset Management (Hong Kong) Ltd.	+1.25M +0.39M	Life Insurance Corporation of India	-8.93M -2.83M
Copper Rock Capital Partners LLC	+1.28M +0.30M	L&T Investment Management Limited	-7.52M -2.38M
Kotak Mahindra Asset Management Company Ltd.	+0.75M +0.24M	Aditya Birla Sun Life AMC Limited	-2.26M -0.72M
Samsung Asset Management Co., Ltd.	+0.81M +0.20M	LIC Mutual Fund Asset Management Company Ltd.	-1.50M -0.44M

Source: Reuters, ICICI Direct Research

Exhibit 8: Shareholding Pattern

(in %)	Dec-17	Jun-18	Sep-18	Dec-18	Mar-19
Promoters	54.24	53.96	53.85	53.83	53.82
FII	7.11	6.51	6.56	6.20	6.01
DII	11.82	12.07	12.69	13.23	10.56
Others	26.83	27.46	26.90	26.74	29.61

Source: Company, ICICI Direct Research

Financial summary

Exhibit 9: Profit and loss statement				
	₹ crore			
(Year-end March)	FY18	FY19E	FY20E	FY21E
Total operating income	3,205.5	5,087.3	6,509.2	7,249.1
Growth (%)	23.6	58.7	28.0	11.4
Cost of raw materials	1,267.0	2,487.2	3,169.5	3,479.6
Employee Expenses	350.2	511.2	628.6	724.9
Administrative Expenses	838.9	961.7	1,397.7	1,631.0
Total Operating Expenditure	2,456.1	3,960.1	5,195.8	5,835.5
EBITDA	749.3	1,127.2	1,313.4	1,413.6
Growth (%)	44.4	50.4	16.5	7.6
Depreciation	182.2	195.0	279.9	326.2
Interest	103.8	105.5	185.0	192.2
Other Income	39.3	36.9	34.8	40.0
Exceptional Items	4.4	7.6	1.3	-
PBT	498.2	856.0	882.0	935.2
Minority Interest	29.8	15.0	5.9	12.3
Profit from Associates	(0.9)	-	-	-
Total Tax	133.2	278.2	299.1	319.8
PAT	334.3	562.8	577.1	603.1
Growth (%)	66.0	68.3	2.5	4.5
EPS (₹)	8.3	14.0	14.3	15.0

Source: Company, ICICI Direct Research

Exhibit 10: Cash flow statement				
	₹ crore			
(Year-end March)	FY18	FY19E	FY20E	FY21E
Profit after Tax	334.3	562.8	577.1	603.1
Add: Depreciation	182.2	195.0	279.9	326.2
Add: Interest paid	103.8	105.5	185.0	192.2
(Inc)/dec in Current Assets	-389.9	-1,986.9	-718.9	-283.0
Inc/(dec) in CL and Provisions	414.9	1,314.2	642.2	334.1
Others	0.0	0.0	0.0	0.0
CF from operating activities	645.4	190.6	965.3	1,172.6
(Inc)/dec in Investments	-125.5	39.1	0.0	0.0
(Inc)/dec in Fixed Assets	-424.3	-1,457.8	-550.0	-250.0
Others	-16.1	490.1	-6.7	-7.4
CF from investing activities	-565.9	-928.6	-556.7	-257.4
Issue/(Buy back) of Equity	0.5	0.3	0.0	0.0
Inc/Dec in Minority Interest	36.8	13.5	1.5	1.3
Issue of Preference Shares	0.0	0.0	0.0	0.0
Inc/(Dec) in loan funds	27.7	944.0	0.0	-500.0
Interest paid	-103.8	-105.5	-185.0	-192.2
Others	-39.6	-19.1	-166.3	-166.3
CF from financing activities	-78.4	833.2	-349.8	-857.1
Net Cash flow	1.1	95.2	58.8	58.1
Opening Cash	137.4	138.4	233.7	292.5
Closing Cash	138.4	233.7	292.5	350.6

Source: Company, ICICI Direct Research

Exhibit 11: Balance sheet				
	₹ crore			
(Year-end March)	FY18	FY19E	FY20E	FY21E
Liabilities				
Equity Capital	80.2	80.5	80.5	80.5
Preference Share Capital	0.0	0.0	0.0	0.0
Reserve and Surplus	1,095.1	1,638.8	2,049.6	2,486.4
Total Shareholders funds	1,175.3	1,719.3	2,130.1	2,566.9
Total Debt	1,158.1	2,102.1	2,102.1	1,602.1
Others	468.8	1,000.6	1,002.0	1,003.3
Total Liabilities	2,802.2	4,822.0	5,234.3	5,172.4
Assets				
Gross Block	2,359.3	3,754.7	4,404.1	4,654.1
Less: Acc Depreciation	1,199.2	1,394.1	1,674.0	2,000.2
Net Block	1,160.2	2,360.5	2,730.1	2,653.9
Capital WIP	357.0	419.4	320.0	320.0
Goodwill	73.9	107.4	107.4	107.4
Total Fixed Assets	1,591.1	2,887.3	3,157.4	3,081.2
Investments	248.5	242.8	242.8	242.8
Inventory	337.9	589.7	659.8	734.8
Debtors	871.3	1,356.6	1,735.8	1,933.1
Loans and Advances	35.0	42.7	54.6	60.8
Other Current Assets	457.7	1,699.7	1,957.3	1,961.8
Cash	138.4	233.7	292.5	350.6
Total Current Assets	1,840.3	3,922.4	4,700.1	5,041.2
Creditors	656.2	1,912.8	2,447.4	2,725.6
Provisions	83.8	67.2	85.9	95.7
Other current liabilities	243.5	317.7	406.5	452.7
Total Current Liabilities	983.5	2,297.6	2,939.9	3,274.0
Net Current Assets	856.8	1,624.7	1,760.2	1,767.1
Other non current assets	105.7	67.1	73.9	81.2
Application of Funds	2,802.2	4,822.0	5,234.3	5,172.4

Source: Company, ICICI Direct Research

Exhibit 12: Key ratios				
	₹ crore			
(Year-end March)	FY18	FY19E	FY20E	FY21E
Per share data (₹)				
EPS	8.3	14.0	14.3	15.0
Cash EPS	12.9	18.8	21.3	23.1
BV	29.3	42.7	52.9	63.8
DPS	2.4	2.4	4.1	4.1
Cash Per Share	29.9	34.6	41.6	49.7
Operating Ratios (%)				
EBITDA Margin	23.4	22.2	20.2	19.5
EBIT Margin	17.7	18.3	15.9	15.0
PAT Margin	10.5	11.2	8.9	8.3
Inventory days	38.5	42.3	37.0	37.0
Debtor days	99.2	97.3	97.3	97.3
Creditor days	74.7	137.2	137.2	137.2
Return Ratios (%)				
RoE	28.7	33.0	27.1	23.5
RoCE	29.7	27.8	27.8	30.3
RoIC	26.5	22.7	22.3	23.9
Valuation Ratios (x)				
P/E	20.3	12.1	11.8	11.3
EV / EBITDA	10.2	7.6	6.5	5.6
EV / Net Sales	2.4	1.7	1.3	1.1
Market Cap / Sales	2.1	1.3	1.0	0.9
Price to Book Value	5.8	4.0	3.2	2.7
Solvency Ratios				
Debt/EBITDA	1.5	1.9	1.6	1.1
Net Debt / Equity	0.7	1.0	0.8	0.4
Current Ratio	2.3	1.9	1.7	1.7
Quick Ratio	1.8	1.6	1.5	1.4

Source: Company, ICICI Direct Research

Exhibit 13: ICICI Direct Coverage Universe (Telecom)

Sector / Company	CMP (₹)	TP (₹)	Rating	M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
					FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Bharti Airtel	341	400	Hold	174,967	1.0	-4.1	-1.0	332.9	NM	NM	11.2	9.7	8.8	5.6	2.1	2.7	2.7	-3.5	-2.3
Bharti Infratel	264	275	Hold	48,903	13.5	13.1	13.9	19.6	20.2	19.0	8.0	8.4	8.2	21.1	21.2	21.3	14.7	17.2	18.2
Vodafone Idea	11	12	Reduce	32,759	-16.7	-5.8	-5.3	NM	NM	NM	37.3	15.1	12.5	-2.3	-5.0	-3.9	-15.3	-25.9	-19.4
Sterlite Tech	169	180	Hold	6,803	14.0	14.3	15.0	12.1	11.8	11.3	7.6	6.5	5.6	29.7	27.8	27.8	28.7	33.0	27.1
Tata Comm	480	540	Hold	13,691	-2.9	6.8	12.9	NM	NM	37.1	8.2	7.9	7.1	5.9	5.4	5.9	9.4	127.7	-218.9

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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