

Washout performance; focusing on growth recovery

Sterlite Tech's (STL) Q4FY20 performance was weak on the operating front on account of fibre demand slowdown and some impact of Covid-19 led disruption. Revenues came in at ₹ 1,160 crore, down ~35% YoY with Covid-19 led disruption impacting revenues by ~₹ 170 crore and OF pricing/demand accounting for remaining decline. EBITDA was at ₹ 216 crore, down ~31% YoY, impacted by revenue decline with margins at 18.6%, up 103 bps YoY. Reported PAT came in lower at ₹ 80.3 crore, down 51.4% YoY, on account of a weak operating performance and higher depreciation and interest costs from new OF capacity.

Expects fibre demand pick-up by H2FY21

STL indicated that global fibre demand declined 7% YoY in 2019 (from 511 mn fkm to 477 mn fkm), on account of China slowing down after a massive 4G build. Globally most telcos have taken a capex pause and are delaying their investments. Hence, overall global fibre demand is expected to decline by 4.5% in 2020. Once the 5G investment cycle starts, demand is likely to pick up from H2FY21, with expected growth cycle of eight to 10 years. STL has decided to push the capacity expansion of OFC by six to nine months given the Covid-19 led disruption and demand challenge. The company expects the Covid-19 led disruption to largely impact Q1FY21 and continues to rationalise fixed and other costs. We bake in muted 2.7% YoY growth in FY21 revenues, notwithstanding expanded OF capacity. We expect FY22 revenues to witness a spurt (up 17.3% YoY) driven by improved capacity utilisation as well as continued network services traction. We build in margins of 19% for FY20E and FY21E, as lower OF/OFC realisation and higher services revenues mix would result in some margins dilution.

Order book robust; Healthy services segment visibility ...

The total order book was at ₹ 10035 crore (vs. ₹ 8132 crore), of which network services order book is ₹ 4000 crore while O&M portion was ₹ 2000 crore. The company expects outstanding order execution worth ₹ 4000 crore in FY21 with remaining thereafter. STL continues to reorganise itself with network services being the strategic growth engine wherein it aims to penetrate into new customer segments such as Cloud & telcos to further increase the scope of services.

Valuation & Outlook

We highlight that Covid-19 led disruption coupled with demand challenge are expected to result in a washout FY21. Meaningful earnings growth is expected to be seen from FY22. The continued traction in network services is, however, heartening and remains a partial hedge in a volatile product demand scenario. We await a meaningful demand recovery before turning constructive. We maintain **HOLD** rating on the stock, valuing it at ₹ 95/share (implying 5x FY22E EV/EBITDA and 8.5x FY22E P/E).

Key Financial Summary

(Year-end March)	FY18	FY19	FY20	FY21E	FY22E	CAGR (FY20-22E)
Net Sales (₹ crore)	3,205.5	5,087.3	5,154.4	5,295.2	6,212.5	9.8
EBITDA (₹ crore)	749.3	1,127.2	1,069.3	1,006.1	1,181.9	5.1
Adj. Net Profit (₹ crore)	337.5	567.9	480.8	343.8	444.0	(3.9)
EPS (₹)	8.3	14.0	10.8	8.5	11.0	
P/E (x)	11.6	6.9	9.0	11.3	8.8	
Price / Book (x)	3.3	2.3	2.0	1.9	1.6	
EV/EBITDA (x)	6.3	5.0	5.5	5.9	5.0	
RoE (%)	28.7	33.0	25.1	16.4	18.8	
RoCE (%)	29.7	27.8	20.9	18.4	20.5	

Source: Company, ICICI Direct Research

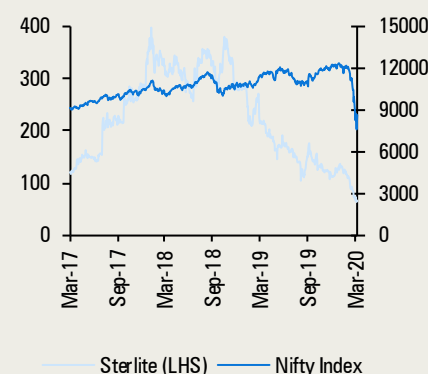


Particulars	
Particular	Amount
Market Capitalization (₹ crore)	3,892.7
Total Debt (FY20) (₹ crore)	2,448.0
Cash & Inv (FY20) (₹ crore)	477.6
EV (₹ crore)	5,863.0
52 week H/L (₹)	198/ 60
Equity capital (₹ crore)	80.2
Face value (₹)	2.0

Key Highlights

- Topline decline of 35% YoY owing to Covid-19 led disruption impacting revenues by ~₹ 170 crore and OF pricing/demand accounting for remaining decline
- Maintain **HOLD** rating on stock, valuing it at ₹ 95/share (implying 5x FY22E EV/EBITDA, 8.5x FY22E P/E)

Price Chart



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Exhibit 1: Variance Analysis

	Q4FY20	Q4FY20E	Q4FY19	Q3FY20	YoY (%)	QoQ (%)	Comments
Revenue	1,160.1	1,320.1	1,791.2	1,202.7	-35.2	-3.5	The lower revenues were on account of ₹ 170 revenue impact of Covid-19. Overall decline was attributable to weak product demand
Other Income	10.4	6.0	13.2	6.0	-21.2	72.8	
Cost of raw material	516.0	607.3	1,221.4	562.8	-57.8	-8.3	
Purchase of traded goods	0.4	0.0	5.1	-0.5	NA	NA	
Employee Expenses	152.0	171.6	135.0	164.8	12.6	-7.8	
(Increase) / decrease in inventories	22.7	6.6	-136.7	6.7	-116.6	240.1	
Other Expenses	253.0	270.6	251.4	227.5	0.6	11.2	
EBITDA	216.0	264.0	315.1	241.4	-31.4	-10.5	EBITDA was impacted by negative operating leverage on account of revenue decline
EBITDA Margin (%)	18.6	20.0	17.6	20.1	103 bps	-145 bps	
Depreciation	76.8	73.5	49.8	70.1	54.3	9.6	
Interest	59.3	55.7	30.7	55.7	93.4	6.4	
Total Tax	13.1	38.0	82.2	19.1	-84.0	-31.3	
PAT	80.3	101.8	165.2	52.6	-51.4	52.6	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY21E			FY22E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	5,425.2	5,295.2	-2.4	6,247.0	6,212.5	-0.6	Bake in lower growth given the challenging FY21
EBITDA	1,030.8	1,006.1	-2.4	1,186.9	1,181.9	-0.4	
EBITDA Margin (%)	19.0	19.0	0 bps	19.0	19.0	3 bps	
PAT	390.4	343.8	-11.9	479.5	444.0	-7.4	
EPS (₹)	9.7	8.5	-11.9	11.9	11.0	-7.4	

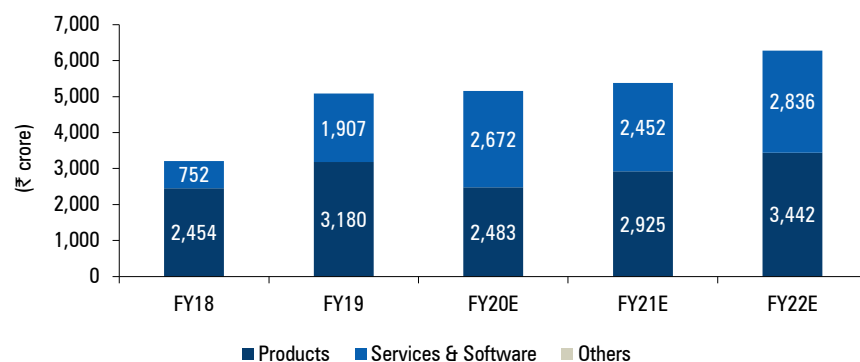
Source: Company, ICICI Direct Research

Business Highlights

- Global fibre demand:** Global fibre demand declined 7% YoY in 2019 (from 511 mn fkm to 477 mn fkm), on account of China slowing down after a massive 4G build. Globally, most telcos have taken a capex pause and are delaying their investments. Therefore, overall global fibre demand is expected to decline 4.5% in 2020. Once the 5G investment cycle starts, demand is likely to pick up from H2FY21. The 5G deployment cycle is expected to be an eight to 10 year cycle. Operators will invest \$1.1 trillion in their networks globally in the next five years with almost 80% (~\$800 bn) in 5G
- Capacity utilisation, expansion status:** Optic fibre capacity utilisation is ~60% including new capacity (total fibre capacity is ~50 mn fkm). Old capacity of ~30 mn fkm is running at 90-95% capacity utilisation with no meaningful contribution from new OF capacity. The meaningful utilisation (commercial offtake) from new fibre capacity will pick up only post demand revival. Cabling capacity is operating at ~80-85% utilisation at a current capacity of 18 mn fkm. The same was slated to expand to 33 mn fkm by June 2020. However, the company has decided to push the capacity expansion of OFC by six to nine months given the Covid-19 led disruption and demand challenge
- Margins:** Network services remained at 14% while product margins were at 24%
- Project status:** Project NFS is complete (Indian Army project in J&K) and is moving into O&M. Project Varun (Indian Navy project) is 76% complete. Mahanet is 74% complete. Key new projects under execution are T-Fibre project (order size ₹ 1100 crore), which is 3% completed (to be executed largely over FY21 with some residual in FY22) and FTTH rollout for a large telco, which is just 1% complete
- Capex:** Capex of ₹ 500 crore in FY22 on account of ₹ 225-250 (outflow on account of payment to vendor for fibre capex), ₹ 50-60 crore of maintenance capex and ₹ 200 crore for cable capacity expansion
- Buyback:** STL has announced a buyback through open market route (with no promoter participation). Maximum buyback size is ₹ 145 crore with maximum buyback price: ₹ 150/share. They have indicated that the objective is to seek fair value of stock price to improve shareholder return. STL also indicated that it has sufficient liquidity to support buyback in current uncertain times
- Other highlights**
 - Net debt is currently at ₹ 2078 crore with cash & cash equivalents of ₹ 478 crore
 - O&M pie of the order book is growing and is now at ₹ 2000 crore. In FY22, the company expects ₹ 200 crore of O&M revenues
 - Fibre realisation has remained at \$6/fkm similar to last quarter
 - The board has recommended final dividend of ₹ 3.5/share, subject to shareholders' approval
 - The revenue breakup for Q4 was ~60% services and ~40% product. For FY20, services contributed ~52% of revenues, while product formed the remaining 48%

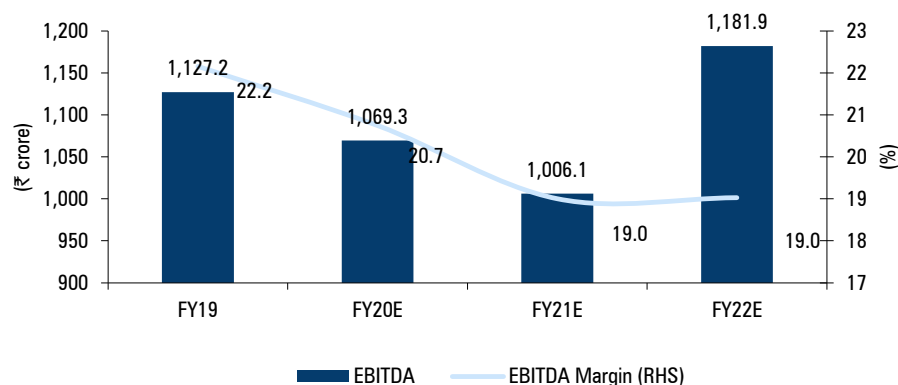
Financial story in charts

Exhibit 3: Topline growth trend



Source: Company, ICICI Direct Research

Exhibit 4: Margins to decline, going ahead



Source: Company, ICICI Direct Research

Financial summary

Exhibit 5: Profit and loss statement					₹ crore	
(Year-end March)	FY19	FY20	FY21E	FY22E		
Total operating Income	5,087.3	5,154.4	5,295.2	6,212.5		
Growth (%)	58.7	1.3	2.7	17.3		
Cost of raw materials	2,487.2	2,467.5	2,515.2	2,949.4		
Employee Expenses	511.2	629.8	608.9	714.4		
Administrative Expenses	961.7	987.8	1,164.9	1,366.8		
Total Operating Expenditure	3,960.1	4,085.1	4,289.1	5,030.6		
EBITDA	1,127.2	1,069.3	1,006.1	1,181.9		
Growth (%)	50.4	-5.1	-5.9	17.5		
Depreciation	195.0	290.3	270.1	316.8		
Interest	105.5	221.0	305.3	300.5		
Other Income	36.9	34.3	30.0	30.0		
Exceptional Items	7.6	59.0	-	-		
PBT	856.0	533.3	460.7	594.6		
Minority Interest	15.0	(9.5)	1.0	1.0		
Profit from Associates	-	-	-	-		
Total Tax	278.2	108.9	115.9	149.6		
PAT	562.8	433.9	343.8	444.0		
Growth (%)	68.3	-22.9	-20.8	29.1		
EPS (₹)	14.0	10.8	8.5	11.0		

Source: Company, ICICI Direct Research

Exhibit 6: Cash flow statement					₹ crore	
(Year-end March)	FY19	FY20	FY21E	FY22E		
Profit after Tax	562.8	433.9	343.8	444.0		
Add: Depreciation	195.0	290.3	270.1	316.8		
Add: Interest paid	105.5	221.0	305.3	300.5		
(Inc)/dec in Current Assets	-1,986.9	319.3	-125.7	-605.5		
Inc/(dec) in CL and Provisions	1,314.2	-576.8	101.3	282.0		
Others	0.0	0.0	0.0	0.0		
CF from operating activities	190.6	687.7	894.9	737.8		
(Inc)/dec in Investments	39.1	-197.9	150.0	0.0		
(Inc)/dec in Fixed Assets	-1,457.8	-580.9	-500.0	-200.0		
Others	490.1	203.1	-9.7	-10.7		
CF from investing activities	-928.6	-575.7	-359.7	-210.7		
Issue/(Buy back) of Equity	0.3	0.0	0.0	0.0		
Inc/Dec in Minority Interest	13.5	7.8	1.0	1.0		
Issue of Preference Shares	0.0	0.0	0.0	0.0		
Inc/(Dec) in loan funds	944.0	345.8	-100.0	-100.0		
Interest paid	-105.5	-221.0	-305.3	-300.5		
Others	-19.1	-233.7	-169.8	-169.8		
CF from financing activities	833.2	-101.1	-574.1	-569.3		
Net Cash flow	95.2	10.9	-39.0	-42.1		
Opening Cash	138.4	233.7	244.5	205.6		
Closing Cash	233.7	244.5	205.6	163.4		

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet					₹ crore	
(Year-end March)	FY19	FY20	FY21E	FY22E		
Liabilities						
Equity Capital	80.5	80.5	80.5	80.5		
Preference Share Capital	0.0	0.0	0.0	0.0		
Reserve and Surplus	1,638.8	1,839.0	2,013.0	2,287.2		
Total Shareholders funds	1,719.3	1,919.5	2,093.5	2,367.7		
Total Debt	2,102.1	2,448.0	2,348.0	2,248.0		
Others	1,000.6	1,270.1	1,271.1	1,272.1		
Total Liabilities	4,822.0	5,637.6	5,712.6	5,887.8		
Assets						
Gross Block	3,754.7	4,602.0	5,102.0	5,302.0		
Less: Acc Depreciation	1,394.1	1,664.2	1,934.2	2,251.1		
Net Block	2,360.5	2,937.8	3,167.7	3,050.9		
Capital WIP	419.4	132.8	132.8	132.8		
Goodwill	107.4	121.8	121.8	121.8		
Total Fixed Assets	2,887.3	3,192.4	3,422.3	3,305.5		
Investments	242.8	455.1	305.1	305.1		
Inventory	589.7	451.8	507.8	595.7		
Debtors	1,356.6	1,563.1	1,595.8	1,872.3		
Loans and Advances	42.7	36.6	37.6	44.1		
Other Current Assets	1,699.7	1,317.9	1,353.9	1,588.5		
Cash	233.7	244.5	205.6	163.4		
Total Current Assets	3,922.4	3,614.0	3,700.6	4,264.0		
Creditors	1,912.8	1,430.3	1,523.3	1,787.2		
Provisions	67.2	10.9	11.6	13.6		
Other current liabilities	317.7	279.6	287.3	303.3		
Total Current Liabilities	2,297.6	1,720.9	1,822.2	2,104.1		
Net Current Assets	1,624.7	1,893.1	1,878.5	2,159.8		
Other non current assets	67.1	97.0	106.7	117.4		
Application of Funds	4,822.0	5,637.6	5,712.6	5,887.8		

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios					₹ crore	
(Year-end March)	FY19	FY20	FY21E	FY22E		
Per share data (₹)						
EPS	14.0	10.8	8.5	11.0		
Cash EPS	18.8	18.0	15.2	18.9		
BV	42.7	47.7	52.0	58.8		
DPS	2.4	4.2	4.2	4.2		
Cash Per Share	34.6	41.3	48.0	55.9		
Operating Ratios (%)						
EBITDA Margin	22.2	20.7	19.0	19.0		
EBIT Margin	18.3	15.1	13.9	13.9		
PAT Margin	11.2	9.3	6.5	7.1		
Inventory days	42.3	32.0	35.0	35.0		
Debtor days	97.3	110.7	110.0	110.0		
Creditor days	137.2	101.3	105.0	105.0		
Return Ratios (%)						
RoE	33.0	25.1	16.4	18.8		
RoCE	27.8	20.9	18.4	20.5		
RoIC	22.7	15.7	14.1	15.9		
Valuation Ratios (x)						
P/E	6.9	9.0	11.3	8.8		
EV / EBITDA	5.0	5.5	5.9	5.0		
EV / Net Sales	1.1	1.1	1.1	0.9		
Market Cap / Sales	0.8	0.8	0.7	0.6		
Price to Book Value	2.3	2.0	1.9	1.6		
Solvency Ratios						
Debt/EBITDA	1.9	2.3	2.3	1.9		
Net Debt / Equity	1.0	1.0	1.0	0.8		
Current Ratio	1.9	2.3	2.3	2.3		
Quick Ratio	1.6	2.0	1.9	1.9		

Source: Company, ICICI Direct Research

Exhibit 9: 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	560	630	Buy	305,323	1.0	-50.2	8.3	546.3	NM	67.5	16.3	10.7	8.6	2.1	3.3	7.9	-3.5	-4.7	5.6
Bharti Infratel	190	175	Hold	28,114	13.5	17.8	16.3	14.1	10.6	11.7	4.6	4.7	4.5	21.2	18.1	19.4	17.2	24.4	23.3
Vodafone Idea	5	UR	UR	11,465	-5.1	-23.7	-5.4	NM	NM	NM	31.7	8.4	6.3	-5.0	-5.1	-3.3	-25.9	-120.8	-108.6
Sterlite Tech	97	95	Hold	3,893	14.0	10.8	8.5	6.9	9.0	11.3	5.0	5.5	5.9	29.7	27.8	20.9	28.7	33.0	25.1
Tata Comm	420	345	Buy	11,973	-2.9	8.1	12.2	NM	51.8	34.5	7.6	6.6	6.3	5.9	5.4	7.4	9.4	127.7	-118.8

Source: Company, ICICI Direct Research

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