

Ambitious target to double revenues in three years!

Sterlite Tech's (STL) performance in Q1FY21 was weak on the operating front as expected, which is reflective of demand slowdown/pricing pressure in product segment and Covid-19 impact. Revenues came in at ₹ 876 crore, down ~39% YoY as projects execution was significantly impacted due to lockdown, while production and delivery was hurt due to logistic challenges. EBITDA was at ₹ 122 crore, down ~62% YoY, with margins at 13.9%, down 870 bps YoY, impacted by negative operating leverage on account of revenues decline. Reported PAT came in lower at ₹ 6 crore, down 95.8% YoY, on account of weak operating performance.

Company spells out ambitious medium term guidance...

STL has set an ambitious three years target of doubling revenues to ₹ 10,000 crore by FY23, riding on higher digital infra needs owing to increased data usage and transforming into a solution provider from products company. Given the transformation into solutions based player, it expects the addressable market to expand to US\$75 billion vs. US\$30 billion. It has also set a target to cut down on debt equities ratio to 0.5x (in 3 years) from 1x currently, and maintain RoCE and dividend payouts of 20%+ and ~30%, respectively. On the overall fibre demand perspective, the company perceives that 5G investment cycle on cusp of beginning and demand is likely to pick up from H2CY20, with decade long expected growth cycle. We bake in decline of 2% YoY FY21 revenues, notwithstanding expanded OF capacity, given the weak H1FY21 on account of Covid-19. We expect FY22 revenues to witness a spurt (up ~25% YoY) driven by improved capacity utilisation as well as continued traction in solutions based business. We build in margins of 18%, 19% for FY20E, FY21E, respectively based on management guidance of margin band of 18-20%, going ahead.

Order book provides decent visibility...

The total order book was at ₹ 10300 crore (vs. ₹ 10035 crore in Q4), of which O&M portion was ₹ 2000 crore. The company expects outstanding order execution worth ₹ 3200 crore in 9MFY21 with remaining in FY22 and thereafter. The company received orders worth ~₹ 1000 in Q1. 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 while long term target is attractive, the fibre pricing weakness persists. Moreover, we would await meaningful traction in demand before turning constructive. Post ~40% run up since our last update, we downgrade our rating to **REDUCE** (vs. HOLD, earlier). We value it at ₹ 125/share (implying 6x FY22E EV/EBITDA and 11x FY22E P/E).

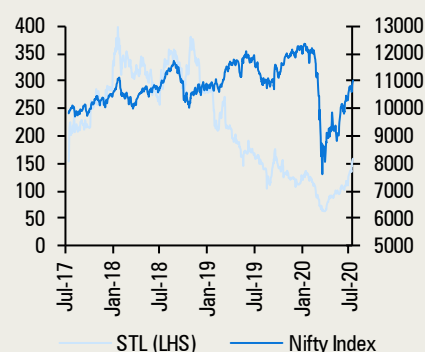


Particulars	
Particular	Amount
Market Capitalization (₹ crore)	5,474.7
Total Debt (FY20) (₹ crore)	2,448.0
Cash & Inv (FY20) (₹ crore)	477.6
EV (₹ crore)	7,445.1
52 week H/L (₹)	198/ 60
Equity capital (₹ crore)	80.2
Face value (₹)	2.0

Key Highlights

- Over the next-three year, STL has guided to (a) double the revenue to ₹ 10,000 crore, (b) reduce the net debt to equity by half to 0.5, and (c) deliver RoCE above 20%
- Post ~40% run up since our last update, we downgrade our rating to **REDUCE** (vs. HOLD, earlier). We value it at ₹ 125/share (implying 6x FY22E EV/EBITDA and 11x FY22E P/E)

Price Chart



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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	5,044.5	6,327.5	10.8
EBITDA (₹ crore)	749.3	1,127.2	1,069.3	907.1	1,203.8	6.1
Net Profit (₹ crore)	334.3	562.8	433.9	327.5	460.0	3.0
EPS (₹)	8.3	14.0	10.8	8.1	11.4	
P/E (x)	16.3	9.7	12.6	16.7	11.9	
Price / Book (x)	4.6	3.2	2.9	2.6	2.3	
EV/EBITDA (x)	8.5	6.4	7.0	8.3	6.3	
RoE (%)	28.7	33.0	25.1	15.8	19.4	
RoCE (%)	29.7	27.8	20.9	15.8	19.9	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q1FY21	Q1FY21E	Q1FY20	Q4FY20	YoY (%)	QoQ (%)	Comments
Revenue	876.2	859.6	1,432.0	1,160.1	-38.8	-24.5	The lower revenues were on account of impact of Covid-19 and weak product demand
Other Income	9.5	7.0	8.7	10.4	9.0	-8.4	
Cost of raw material	396.5	386.8	666.3	516.0	-40.5	-23.2	
Purchase of traded goods	0.3	8.6	0.1	0.4	NA	NA	
Employee Expenses	147.1	133.2	146.3	152.0	0.6	-3.3	
(Increase) / decrease in inventories	21.5	12.9	40.6	22.7	-47.0	-5.0	
Other Expenses	189.1	153.9	255.3	253.0	-25.9	-25.2	
EBITDA	121.7	164.2	323.4	216.0	-62.4	-43.7	EBITDA was impacted by negative operating leverage on account of revenue decline
EBITDA Margin (%)	13.9	19.1	22.6	18.6	-870 bps	-473 bps	
Depreciation	74.2	72.0	68.3	76.8	8.6	-3.4	
Interest	50.1	60.6	46.3	59.3	8.1	-15.6	
Total Tax	4.1	9.7	73.3	13.1	-94.4	-68.6	
PAT	6.0	28.3	141.4	80.3	-95.8	-92.6	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY21E			FY22E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	5,295.2	5,044.5	-4.7	6,212.5	6,327.5	1.8	Realign after management commentary and Q1 results
EBITDA	1,006.1	907.1	-9.8	1,181.9	1,203.8	1.8	
EBITDA Margin (%)	19.0	18.0	-102 bps	19.0	19.0	0 bps	
PAT	343.8	327.5	-4.7	444.0	460.0	3.6	
EPS (₹)	8.5	8.1	-4.7	11.0	11.4	3.6	

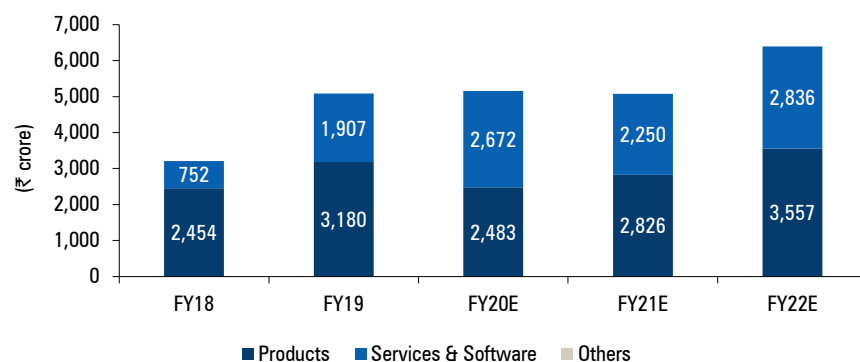
Source: Company, ICICI Direct Research

Business Highlights

- **Global fibre demand:** Global fibre demand contracted 9% in H1 2020, on account of China slowing down after a massive 4G build. On the overall fibre demand perspective, the company perceives that 5G investment cycle on cusp of beginning and demand is likely to pick up from H2CY20 (~6% YoY growth expected in H2), with decade long expected growth cycle. For its own business growth, the company expects the factors such as adoption of open source standard and software defined networking, isolation of Chinese vendors as some of the drivers of growth as company aims transformation into solutions based player vs. a product company, earlier
- **China fibre order:** Recent China mobile's order of 119 fkm was ~13% higher than last year but the pricing was ~20-25% lower than last year. While it will have some impact on overall global pricing, the company expects pricing to be unsustainable. Furthermore, it expects value added product at its own end coupled with lower cost structure will enable it to have better profitability than peers
- **Capacity utilisation:** Optic fibre capacity utilisation is ~47-48% including new capacity (total fibre capacity is ~50 mn fkm). We believe that there is 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 ~70% utilisation at a current capacity of 18 mn fkm. We highlight that 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
- **Project status:** Project Varun (Indian Navy project) is 81% complete. Mahanet is 82% complete. Key new projects under execution are T-Fibre project (order size ₹ 1100 crore), which is 5% completed (to be executed largely over FY21 with some residual in FY22) and FTTH rollout for a large telco, which is just 2% complete
- **Other highlights**
 - In broader terms, Covid-19, led to 1 month of manufacturing impact and approximately two months of project levels impact
 - The manufacturing is back to pre-covid levels. While Q2 is likely to be a transient quarter, company expects H2FY21 to be better than H2FY20
 - R&D expenses have gone up from less than 0.5% to ~2% of the topline

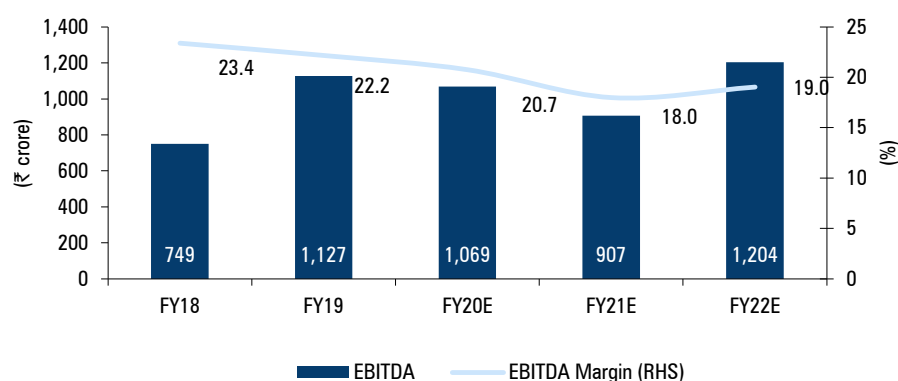
Financial story in charts

Exhibit 3: Topline growth trend



Source: Company, ICICI Direct Research

Exhibit 4: Margins to be in the range of 18-20%.



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	5,044.5	6,327.5
Growth (%)	58.7	1.3	-2.1	25.4
Cost of raw materials	2,487.2	2,467.5	2,399.4	3,004.0
Employee Expenses	511.2	629.8	631.9	727.7
Administrative Expenses	961.7	987.8	1,106.2	1,392.0
Total Operating Expenditure	3,960.1	4,085.1	4,137.5	5,123.7
EBITDA	1,127.2	1,069.3	907.1	1,203.8
Growth (%)	50.4	-5.1	-15.2	32.7
Depreciation	195.0	290.3	287.5	335.4
Interest	105.5	221.0	233.6	279.1
Other Income	36.9	34.3	35.0	32.0
Exceptional Items	7.6	59.0	0.6	-
PBT	856.0	533.3	420.3	621.4
Minority Interest	15.0	(9.5)	(14.8)	5.0
Profit from Associates	-	-	-	-
Total Tax	278.2	108.9	107.6	156.3
PAT	562.8	433.9	327.5	460.0
Growth (%)	68.3	-22.9	-24.5	40.5
EPS (₹)	14.0	10.8	8.1	11.4

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	327.5	460.0
Add: Depreciation	195.0	290.3	287.5	335.4
Add: Interest paid	105.5	221.0	233.6	279.1
(Inc)/dec in Current Assets	-1,986.9	319.3	30.3	-849.2
Inc/(dec) in CL and Provisions	1,314.2	-576.8	-36.7	376.8
Others	0.0	0.0	0.0	0.0
CF from operating activities	190.6	687.7	842.3	602.1
(Inc)/dec in Investments	39.1	-197.9	150.0	0.0
(Inc)/dec in Fixed Assets	-1,457.8	-580.9	-500.0	-250.0
Others	490.1	203.1	-9.7	-10.7
CF from investing activities	-928.6	-575.7	-359.7	-260.7
Issue/(Buy back) of Equity	0.3	0.0	0.0	0.0
Inc/Dec in Minority Interest	13.5	7.8	-14.8	5.0
Issue of Preference Shares	0.0	0.0	0.0	0.0
Inc/(Dec) in loan funds	944.0	345.8	0.0	-100.0
Interest paid	-105.5	-221.0	-233.6	-279.1
Others	-19.1	-233.7	-169.8	-169.8
CF from financing activities	833.2	-101.1	-418.2	-543.8
Net Cash flow	95.2	10.9	64.4	-202.4
Opening Cash	138.4	233.7	244.5	308.9
Closing Cash	233.7	244.5	308.9	106.5

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	1,996.7	2,287.0
Total Shareholders funds	1,719.3	1,919.5	2,077.2	2,367.5
Total Debt	2,102.1	2,448.0	2,448.0	2,348.0
Others	1,000.6	1,270.1	1,255.3	1,260.3
Total Liabilities	4,822.0	5,637.6	5,780.5	5,975.8
Assets				
Gross Block	3,754.7	4,619.5	5,119.5	5,369.5
Less: Acc Depreciation	1,394.1	1,681.7	1,969.2	2,304.6
Net Block	2,360.5	2,937.8	3,150.3	3,064.9
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	3,404.8	3,319.5
Investments	242.8	455.1	305.1	305.1
Inventory	589.7	451.8	483.7	606.7
Debtors	1,356.6	1,563.1	1,529.8	1,918.9
Loans and Advances	42.7	36.6	35.8	44.9
Other Current Assets	1,699.7	1,317.9	1,289.8	1,617.8
Cash	233.7	244.5	308.9	106.5
Total Current Assets	3,922.4	3,614.0	3,648.0	4,294.8
Creditors	1,912.8	1,430.3	1,399.8	1,755.8
Provisions	67.2	10.9	10.7	13.4
Other current liabilities	317.7	279.6	273.7	291.8
Total Current Liabilities	2,297.6	1,720.9	1,684.2	2,061.0
Net Current Assets	1,624.7	1,893.1	1,963.9	2,233.8
Other non current assets	67.1	97.0	106.7	117.4
Application of Funds	4,822.0	5,637.6	5,780.5	5,975.8

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	8.1	11.4
Cash EPS	18.8	18.0	15.3	19.8
BV	42.7	47.7	51.6	58.8
DPS	2.4	4.2	4.2	4.2
Cash Per Share	34.6	41.8	48.9	57.2
Operating Ratios (%)				
EBITDA Margin	22.2	20.7	18.0	19.0
EBIT Margin	18.3	15.1	12.3	13.7
PAT Margin	11.2	9.3	6.5	7.3
Inventory days	42.3	32.0	35.0	35.0
Debtor days	97.3	110.7	110.7	110.7
Creditor days	137.2	101.3	101.3	101.3
Return Ratios (%)				
RoE	33.0	25.1	15.8	19.4
RoCE	27.8	20.9	15.8	19.9
RoIC	22.7	15.7	12.0	15.6
Valuation Ratios (x)				
P/E	9.7	12.6	16.7	11.9
EV / EBITDA	6.4	7.0	8.3	6.3
EV / Net Sales	1.4	1.4	1.5	1.2
Market Cap / Sales	1.1	1.1	1.1	0.9
Price to Book Value	3.2	2.9	2.6	2.3
Solvency Ratios				
Debt/EBITDA	1.9	2.3	2.7	2.0
Net Debt / Equity	1.0	1.0	1.0	0.9
Current Ratio	1.9	2.3	2.4	2.4
Quick Ratio	1.6	2.0	2.0	2.0

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	559	700	Buy	305,214	1.0	-59.0	7.3	546.1	NM	76.1	16.3	11.6	8.7	2.1	3.5	7.1	-3.5	-4.7	5.2
Bharti Infratel	196	175	Hold	36,197	13.5	17.8	16.3	14.5	11.0	12.0	4.6	4.7	4.5	21.2	18.1	19.4	17.2	24.4	23.3
Vodafone Idea	8	UR	UR	28,937	-5.1	-25.7	-7.5	NM	NM	NM	36.4	9.5	8.1	-5.0	-5.7	-4.7	NM	NM	NM
Sterlite Tech	136	125	Hold	5,475	14.0	10.8	8.1	9.7	12.6	16.7	6.4	7.0	8.3	27.8	20.9	15.8	33.0	25.1	15.8
Tata Comm	636	600	Hold	18,130	-2.9	-3.0	13.0	NM	NM	49.1	9.8	8.3	7.8	5.9	5.4	7.8	9.4	127.7	-22.2

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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