

CMP: ₹ 177

Target: ₹ 220 (24%)

Target Period: 12 months

BUY

November 23, 2022

Recovery begins!

About the stock: Sterlite Technologies (STL) is a leading telecommunication infrastructure player with offerings in optical fiber and cables, hyper-scale network design, and deployment and network software.

Update: Recovery was led by operating profits improvement after 3 quarters of losses

- Revenue came in at ₹ 1768 crore in Q2FY23, up 12.3% QoQ, led by 15% QoQ growth in optical (product) business at ₹ 1313 crore. Services revenues at ₹ 463 crore was up 11% QoQ, driven by India execution.
- EBITDA came in at ₹ 173 crore, up 51.8% QoQ, with margins at 9.8%, up 255 bps QoQ, led by improvement in products margins at 20% vs. 14.2% in Q1. Services margin at 2.6% (down 550 bps QoQ) was depressed owing to UK business losses.
- PAT was at ₹ 44 crore, vs. ₹ 20 crore loss in Q1, led by superior EBITDA

What should investors do? STL share price has grown by ~22% over last 5 years.

- STL is uniquely positioned to benefit from 5G/ FTTH deployment cycle both domestically and globally. We believe that with renewed focus on ramping down/exiting loss making segment and focussing on improving services segment profitability, STL will likely see improvement earnings momentum ahead. Thus, we upgrade to BUY from HOLD earlier

Target Price and Valuation: We value STL at ₹ 220 (₹ 295, earlier), at 18x FY24 P/E.

Key triggers for future price performance:

- Transition into solution provider from product/services currently
- Demand offtake from expanded and overall fiber/cable pricing trajectory
- Improvement in leverage which has gone up due to expansion and stretched working capital in services business

Alternate Stock Idea: Apart from STL, in our coverage we like Bharti Airtel.

- A play on favourable industry structure and superior digital play
- BUY with target price of ₹ 960

Key Financial Summary

(Year-end March)	FY20	FY21	FY22	5 yr CAGR (FY17-22)	FY23E	FY24E	2 yr CAGR (FY22-24E)
Net Sales (₹ crore)	5,154.4	4,825.2	5,754.3	17.3	7,171.7	8,476.1	21.4
EBITDA (₹ crore)	1,069.3	810.7	534.8	0.6	784.7	1,271.4	54.2
Net Profit (₹ crore)	433.9	275.5	62.0	(21.0)	161.0	480.3	178.4
EPS (₹)	10.8	6.9	1.6		4.0	12.1	
P/E (x)	16.5	25.6	114.1		43.9	14.7	
Price / Book (x)	3.7	3.5	3.6		3.3	2.9	
EV/EBITDA (x)	8.4	11.7	18.4		12.9	7.8	
RoE (%)	25.0	14.0	2.0		7.6	19.7	
RoCE (%)	20.9	12.9	5.7		9.4	17.1	

Source: Company, ICICI Direct Research



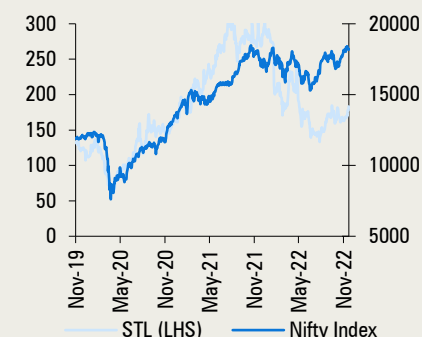
Particulars

Particular	Amount
Market Capitalization (₹ crore)	7,029
Total Debt (FY22) (₹ crore)	3,311
Cash & Inv (FY22) (₹ crore)	530
EV (₹ crore)	8,999
52 week H/L (₹)	317/ 129
Equity capital (₹ crore)	80
Face value (₹)	2

Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoters	54.2	54.2	54.2	54.1
DII	7.1	8.0	7.2	3.8
FII	7.0	6.1	6.0	7.9
Other	31.7	31.7	32.6	34.2

Price Chart



Key risk

- continued leverage
- volatility in margins

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Key business highlights

Improving Outlook...

STL has stated that OFC capacity utilisations are at 88% (based on capacity of ~37 million sq metres). **STL market share (ex-China) grew to ~11% in H1FY23 vs. ~9% in FY22, led by sharp increase in OFC market share in Americas, where it enjoyed ~14% market share in H1FY23 vs. ~7% in FY22.** The company has also maintained that, going ahead, growth should be driven by growing OFC volumes (increasing market share, increasing Optical Interconnect attach rate and developing new products) and Consolidate the services business (focus on profitable growth and reduce working capital). We highlight that this is a complete shift from earlier stance of expanding services business, which has had stretched working capital cycle history. **We bake in revenues CAGR of ~21.4% in FY22-24E. We expect H2FY22 revenues to remain healthy driven by continued robust capacity utilisation in the product segment as well as improved traction in services business. We build in margins to recovery to 15% in FY24 with improved margins in services (led by project mix) and reduced losses led by exit from wireless software business.**

Strong order inflows; short closes low margins orders...

The order book was at ~₹ 11697 crore (vs. ₹ 11207 crore in Q3), of which O&M portion was 22%. The company **secured new orders of ~₹ 3199 crore, the highest order intake in the last 3-1/2 years. It has also short closed an order book of ₹ 941 crores majorly in services and wireless business, in line with its focus of executing projects at desired level of profitability.** The orders were closed after discussion agreement with the respective customers. The key order wins in Q1 such as a) Multi-million dollar, multi-year contract with a leading North American broadband connectivity player for optical fibre cable, b) Multi-million dollar, multi-year contract with a European telco for optical interconnect, c) Optical Interconnect solutions for a leading European Alt-net player, d) Collaboration with Vocus group, Australia to provide Optical fibre cables, e) National Long distance roll out in multiple states for a leading Indian telco and f) Fibre roll out for a leading Indian telco

Divesting/ramping down the non-core/loss making segments...



In line with its strategy to focus on selective segments, the **company has divested the IDS business in Q2FY23 to Hexatronic Group. IDS operated in a niche segment of inside data center connectivity and containment solutions. The initial consideration for 80% stake is about ~9 million pounds.** The earn out consideration is based on actual EBITDA achieved for the year ending CY22. **The company recognized a gain of ₹ 25 crore in Q2 over ₹ 117 crore of book value.** The company has also have ramped down the Wireless business with no additional investments in capital and manpower from Q4FY23. The company expects operating profit to go up by ~₹ 40-50 crore per quarter from Q4FY23 onwards

Other highlights

- The company indicated that net capex during the H1 was ₹ 247 and it expects capex of ₹ 500 crore for FY23
- Net debt stood at over ₹ 3239 crore vs. ₹ 2782 crore in FY22 owing to increased working capital from services business. It expects to release of working capital with completion in certain projects. Going ahead, the company expects services working capital to come down to 180 days from 270 days currently.
- Company targets to be profitable in UK with execution ramp up by H1FY24.

STL is uniquely positioned to benefit from 5G/ FTTH deployment cycle both domestically and globally. We believe that with renewed focus on ramping down/exiting loss making segment and focussing on improving services segment profitability, STL will likely see improvement earnings momentum ahead. Thus, we upgrade to BUY from HOLD earlier and assign at target price of ₹ 220, valuing the company at 18x FY24 P/E.

Exhibit 1: Variance Table

	Q2FY23	Q2FY22	Q1FY23	YoY (%)	QoQ (%)	Comments
Revenue	1,768.0	1,507.5	1,575.0	17.3	12.3	
Other Income	29.0	6.2	5.0	364.7	480.0	
Cost of raw material	742.0	718.8	903.0	3.2	-17.8	
Purchase of traded goods	2.0	0.2	0.0	NA	NA	
Employee Expenses	292.0	203.7	232.0	43.3	25.9	
(Increase) / decrease in inventories	120.0	9.4	-152.0	1,173.9	-178.9	
Other Expenses	439.0	312.5	478.0	40.5	-8.2	
EBITDA	173.0	262.8	114.0	-34.2	51.8	
EBITDA Margin (%)	9.8 	17.4 	7.2	-765 bps	255 bps	
Depreciation	82.0	74.5	82.0	10.1	0.0	
Interest	78.0	56.9	69.0	37.1	13.0	
Total Tax	4.0	35.8	-8.0	-88.8		
PAT	44.0	105.7	-20.0	-58.4	LP	

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 2: Profit & loss statement (₹ crore)				
(Year-end March)	FY21	FY22	FY23E	FY24E
Total operating Income	4,825.2	5,754.3	7,171.7	8,476.1
Growth (%)	-6.4	19.3	24.6	18.2
Cost of raw materials	2,394.9	2,864.6	3,452.8	3,983.8
Employee Expenses	647.4	870.7	1,136.6	1,271.4
Administrative Expenses	972.2	1,484.2	1,797.6	1,949.5
Total Operating Expenditure	4,014.5	5,219.4	6,386.9	7,204.7
EBITDA	810.7	534.8	784.7	1,271.4
Growth (%)	-24.2	-34.0	46.7	62.0
Depreciation	285.3	325.5	344.2	385.7
Interest	203.0	241.4	304.7	294.7
Other Income	43.0	59.3	44.0	24.0
Exceptional Items	3.6	(30.2)	-	-
PBT	361.8	57.4	179.7	615.1
Minority Interest	(10.1)	(14.6)	(13.0)	(12.0)
Profit from Associates	14.9	4.7	7.0	8.0
Total Tax	111.3	14.7	38.7	154.7
PAT	275.5	62.0	161.0	480.3
Growth (%)	-36.5	-77.5	159.9	198.3
EPS (₹)	6.9	1.6	4.0	12.1

Source: Company, ICICI Direct Research,

Exhibit 3: Cash flow statement (₹ crore)				
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit after Tax	275.5	62.0	161.0	480.3
Add: Depreciation	285.3	325.5	344.2	385.7
Add: Interest paid	203.0	241.4	304.7	294.7
(Inc)/dec in Current Assets	-720.7	-410.3	-1,070.2	-1,008.3
Inc/(dec) in CL and Provisions	386.2	228.6	767.6	706.4
Others	0.0	0.0	0.0	0.0
CF from operating activities	429.2	447.1	507.4	858.8
(Inc)/dec in Investments	30.1	211.1	0.0	0.0
(Inc)/dec in Fixed Assets	-323.8	-400.8	-450.0	-200.0
Others	-106.8	-102.1	-16.9	-18.6
CF from investing activities	-400.5	-291.8	-466.9	-218.6
Issue/(Buy back) of Equity	-1.5	0.2	0.0	0.0
Inc/Dec in Minority Interest	-5.1	-12.4	-3.0	-4.0
Issue of Preference Shares	0.0	0.0	0.0	0.0
Inc/(Dec) in loan funds	391.1	472.3	100.0	-100.0
Interest paid	-203.0	-241.4	-304.7	-294.7
Others	-178.2	-76.8	-39.8	-159.1
CF from financing activities	3.4	142.0	-247.5	-557.8
Net Cash flow	32.1	297.3	-207.1	82.3
Opening Cash	244.5	276.6	573.9	366.8
Closing Cash	276.6	573.9	366.8	449.1

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet (₹ crore)				
(Year-end March)	FY21	FY22	FY23E	FY24E
Liabilities				
Equity Capital	79.3	79.6	79.6	79.6
Preference Share Capital	0.0	0.0	0.0	0.0
Reserve and Surplus	1,908.1	1,877.1	2,042.7	2,363.9
Total Shareholders funds	1,987.4	1,956.7	2,122.2	2,443.4
Total Debt	2,839.1	3,311.4	3,411.4	3,311.4
Others	650.7	656.8	653.8	649.7
Total Liabilities	5,477.2	5,924.9	6,187.4	6,404.6
Assets				
Gross Block	4,602.8	5,095.4	5,545.4	5,745.4
Less: Acc Depreciation	1,720.9	2,053.4	2,397.7	2,783.3
Net Block	2,881.9	3,042.0	3,147.7	2,962.1
Capital WIP	227.2	142.4	142.4	142.4
Goodwill	292.1	296.0	296.0	296.0
Total Fixed Assets	3,401.2	3,480.4	3,586.2	3,400.5
Investments	595.3	388.2	388.1	388.1
Inventory	626.4	920.2	884.2	1,045.0
Debtors	1,451.4	1,706.5	2,357.8	2,786.7
Loans and Advances	33.9	131.6	164.0	193.8
Other Current Assets	1,951.4	1,715.1	2,137.5	2,526.3
Cash	248.4	529.6	366.8	449.1
Total Current Assets	4,311.4	5,002.9	5,910.3	7,000.9
Creditors	1,943.7	2,420.0	3,016.1	3,564.7
Provisions	11.0	25.3	31.5	37.3
Other current liabilities	932.9	670.8	836.0	988.1
Total Current Liabilities	2,887.5	3,116.1	3,883.6	4,590.0
Net Current Assets	1,423.9	1,886.8	2,026.7	2,410.9
Other non current assets	56.9	169.5	186.4	205.0
Application of Funds	5,477.2	5,924.9	6,187.4	6,404.6

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	6.9	1.6	4.0	12.1
Cash EPS	14.1	9.7	12.7	21.8
BV	50.1	49.2	53.4	61.4
DPS	3.5	2.0	1.0	4.0
Cash Per Share	43.4	51.6	60.3	70.0
Operating Ratios (%)				
EBITDA Margin	16.8	9.3	10.9	15.0
EBIT Margin	10.9	3.6	6.1	10.5
PAT Margin	5.8	0.7	2.2	5.7
Inventory days	47.4	58.4	45.0	45.0
Debtor days	109.8	108.2	120.0	120.0
Creditor days	147.0	153.5	153.5	153.5
Return Ratios (%)				
RoE	14.0	2.0	7.6	19.7
RoCE	12.9	5.7	9.4	17.1
RoIC	10.3	4.1	7.7	14.8
Valuation Ratios (x)				
P/E	25.6	114.1	43.9	14.7
EV / EBITDA	11.7	18.4	12.9	7.8
EV / Net Sales	2.0	1.7	1.4	1.2
Market Cap / Sales	1.5	1.2	1.0	0.8
Price to Book Value	3.5	3.6	3.3	2.9
Solvency Ratios				
Debt/EBITDA	2.3	3.5	6.2	4.3
Net Debt / Equity	1.0	1.2	1.4	1.4
Current Ratio	2.3	2.1	1.8	1.8
Quick Ratio	2.0	1.8	1.5	1.5

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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