

STERLITE TECHNOLOGIES

Margin gets utilisation boost

India Equity Research | Telecom



Sterlite Technologies (Sterlite) reported strong Q1FY19 numbers—revenue jumped 17.8% YoY (Street estimate 22.5%) and EBITDA margin expanded 190bps QoQ to 27.9% (Street estimate 24.4%). This led to PAT catapulting 99.7% YoY to INR1.2bn. Key highlights: 1) OFC utilisation at over 90% & the Metallurgica Bresciana acquisition provides access to additional 3mn fkm capacity, which can be expanded to 5mn fkm; 2) management expects EBITDA margin to remain at 24-25% on higher utilisation & higher contribution of product business; 3) highest-ever order book—INR60.3bn, up ~92% YoY; 4) Metallurgica acquisition likely to expedite USD100mn plus net income target by FY20; and 5) INR35bn naval order to further bolster order book in Q2FY19. We believe, Sterlite is well positioned to capture the robust global growth in fibre consumption. Maintain 'BUY' with TP of INR425 (25x FY20E EPS).

Strong product demand drives margin

Sterlite's OFC capacity utilisation rose to 90%, driving margin expansion of 190bps QoQ. The company increased its targeted EBITDA margin range to 24-25%, from 20-22%, on higher capacity utilisation. It is seeing strong fiber demand, reflected in higher order book—up 92% YoY—largely due to ~201% YoY spurt in product order book to INR49bn. We expect demand for fiber to remain strong in light of expected 5G rollout.

Acquisition to be earnings accretive

The Metallurgica acquisition will give Sterlite access to 3mn fkm cabling capacity, which can be ramped up to 5mn fkm at minimal capex. It will help to expand its presence in Europe, tap new tier-1 customers, augment product portfolio and improve prospects due to customer proximity. This, coupled with attractive financing from Europe will lead to 12.1% higher earnings in FY20. However, given the backdrop of increasing protectionism and execution risk, we cut our target multiple to 25x from 28x earlier.

Outlook and valuations: Building momentum; maintain 'BUY'

We believe, Sterlite is well positioned to cater to the burgeoning demand for fibre optic cables. Moreover, its capacity addition and superior cost structure led by integrated operations will sustain strong earnings growth (51.4% CAGR over FY17-20E) and high return ratios (31% RoCE in FY20E). The stock is trading at 17.7x FY20E EPS. We maintain 'BUY/SO' with INR425 target price.

Financials

(INR mn)

Year to March	Q1FY19	Q1FY18	% Chg	Q4FY18	% Chg	FY18	FY19E	FY20E
Net revenues	8,769	7,444	17.8	8,466	3.6	32,055	42,833	57,727
EBITDA	2,449	1,571	55.9	2,203	11.1	7,494	10,658	14,319
Adjusted Profit	1,217	606	100.8	1,168	4.2	3,387	4,793	6,992
Diluted EPS (INR)	3.2	1.5	112.8	3.0	4.7	8.3	12.7	17.8
Diluted P/E (x)						36.3	25.8	17.7
EV/EBITDA (x)						17.3	12.9	9.7

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Equalweight

MARKET DATA (R: STTE.BO, B: SOTL IN)

CMP	: INR 302
Target Price	: INR 425
52-week range (INR)	: 415 / 159
Share in issue (mn)	: 401.5
M cap (INR bn/USD mn)	: 121 / 1,754
Avg. Daily Vol.BSE/NSE('000)	: 2,211.2

SHARE HOLDING PATTERN (%)

	Current	Q4FY18	Q3FY18
Promoters *	53.9	54.0	54.1
MF's, FI's & BK's	11.2	11.2	12.2
FII's	8.5	8.5	7.1
Others	26.2	26.2	26.6
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Telecommunication Index
1 month	(1.4)	1.1	(6.8)
3 months	(8.4)	3.9	(13.7)
12 months	82.0	10.6	(20.6)

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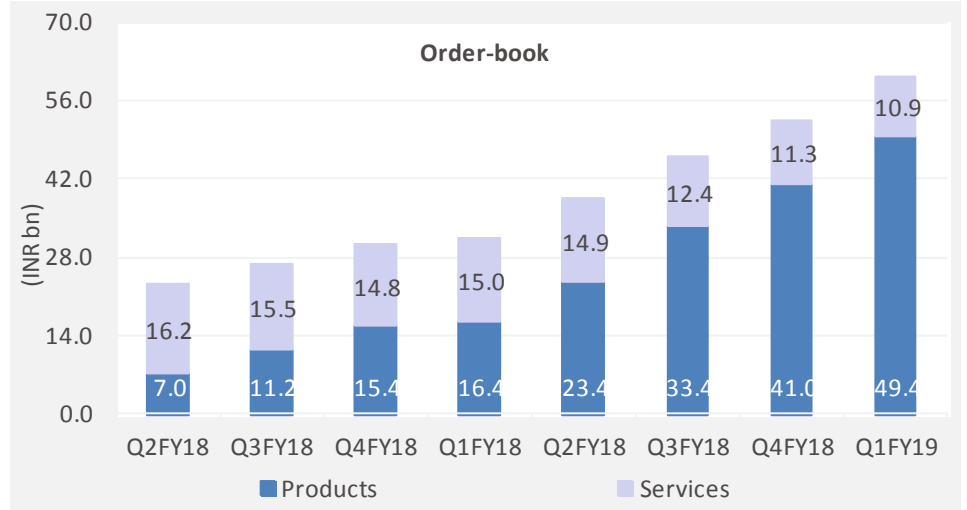
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Chart 1: Order-book expanding rapidly



Source: Company, Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q1FY19	Q1FY18	% change	Q4FY18	% change	FY18	FY19E	FY20E
Net revenues	8,769	7,444	17.8	8,466	3.6	32,055	42,833	57,727
Direct costs	3,339	3,211	4.0	3,259	2.4	12,954	16,794	22,802
Gross profit	5,430	4,233	28.3	5,207	4.3	19,101	26,039	34,925
SG&A	2,981	2,663	12.0	3,004	(0.7)	11,608	15,381	20,605
EBITDA	2,449	1,571	55.9	2,203	11.1	7,494	10,658	14,319
Depreciation	448	413	8.6	525	(14.7)	1,822	2,464	2,905
EBIT	2,001	1,158	72.8	1,679	19.2	5,671	8,195	11,415
Interest	231	285	(19.2)	253	(8.8)	1,038	1,301	1,618
Other income	73	68	6.9	172	(57.8)	393	277	346
Add: Exceptional items	(10)			(44)	NA	(44)	(10)	
Profit before tax	1,756	861	103.9	1,486	18.1	4,675	6,850	9,832
Tax	548	255	114.9	362	51.5	1,332	2,067	2,840
Reported net profit	1,207	606	99.2	1,124	7.4	3,343	4,784	6,992
Exceptional items	10	-		44	(77.6)	44	10	-
Adjusted Profit	1,217	606	100.8	1,168	4.2	3,387	4,793	6,992
Diluted EPS (INR)	3.2	1.5	112.8	3.0	4.7	8.3	12.7	17.8
Diluted P/E (x)	-	-		-		36.3	25.8	17.7
EV/EBITDA (x)	-	-		-		17.3	12.9	9.7
EV/Revenues (x)	-	-		-		4.0	3.2	2.4
Direct costs	38.1	43.1		38.5		40.4	39.2	39.5
Gross profit	61.9	56.9		61.5		59.6	60.8	60.5
SG&A	34.0	35.8		35.5		36.2	35.9	35.7
EBITDA	27.9	21.1		26.0		23.4	24.9	24.8
EBIT	22.8	15.6		19.8		17.7	19.1	19.8
Reported net profit	13.8	8.1		13.3		10.4	11.2	12.1
Tax rate	31.2	29.6		24.4		28.5	30.2	28.9

Change in Estimates

	FY19E			FY20E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	42,833	45,008	(4.8)	57,727	55,779	3.5	
EBITDA	10,658	9,992	6.7	14,320	13,067	9.6	
EBITDA Margin	24.9	22.2		24.8	23.4		
Adjusted Profit After Tax	4,793	4,395	9.1	6,992	6,240	12.1	
Net Profit Margin	11.9	10.3		12.7	11.8		
Capex	9,276	5,000	85.5	5,200	5,200	0.0	

Company Description

Sterlite Technologies (Sterlite) is a global technology player engaged in designing, building and managing telecom broadband networks. Its offerings include optical products, system and network integration services and telecom software. Sterlite is India's largest and only fully integrated optical fibre cable manufacturer with OF and OFC capacity of 30mn and 15mn FKM, respectively. The company has plans to enhance production of OF to 50mn FKM by June 2019. It has manufacturing plants in Aurangabad, Silvasa, China (through joint venture (JV) with Tongguang) and Brazil (through JV with Condu spar). In services business, Sterlite is developing several network projects, such as, secure network for the armed forces, rural broadband through BharatNet, Smart Cities, and high-speed Fiber-to-the-Home (FTTH). It also offers customisable OSS & BSS software solutions suite through Elitecore, which it acquired in FY16. The company has TTM revenue of INR33.4bn.

Investment Theme

We believe that Sterlite will be the key beneficiary of strong demand for fiber optic cables, leveraging its capacity expansion; It's superior cost structure due to integrated operations will lead to high EBITDA margins improving return ratios, despite planned capex. The company is strategically expanding its portfolio of services leveraging its knowhow of complex network and relationships from the fiber business.

Key Risks

China is the largest consumer of the OFC (57.5% of global consumption) and hence demand fluctuation can impact the capacity utilisation

Downturn in global economy

Alternate connectivity technology

Telecom capex dip

Currency risk

Financial Statements

Key Assumptions

Year to March	FY17	FY18	FY19E	FY20E
Macro				
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.8	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
USD/INR (Avg)	67.1	64.5	66.0	66.0
Company				
Product revenues	20,116	26,179	36,043	44,894
Employee benefit exp.	11.5	10.8	10.5	10.0
Other exp	24.4	26.5	26.5	26.1
Receivable (days)	99	86	84	88
Payable days	72	119	96	96

Income statement

(INR mn)

Year to March	FY17	FY18	FY19E	FY20E
Net revenue	25,936	32,055	42,833	57,727
Cost of revenues	11,444	12,954	16,794	22,802
Gross profit	14,491	19,101	26,039	34,925
Total SG&A expenses	9,302	11,608	15,381	20,605
EBITDA	5,189	7,494	10,658	14,319
Depreciation	1,592	1,822	2,464	2,905
EBIT	3,597	5,671	8,195	11,415
Add: Other income	234.5	392.7	276.89	346.36
Profit Before Tax	2,602	4,982	7,171	10,143
Less: Provision for Tax	397	1,332	2,067	2,840
Reported Profit	2,014	3,343	4,793	6,992
Exceptional Items	-	44	-	-
Adjusted Profit	2,014	3,387	4,793	6,992
Shares o /s (mn)	398	401	403	404
Adjusted Basic EPS	5.1	8.4	11.9	17.3
Diluted shares o/s (mn)	405	408	409	411
Adjusted Diluted EPS	5.0	8.3	11.7	17.0
Adjusted Cash EPS	9.1	13.0	18.0	24.5
Dividend per share (DPS)	1.5	2.1	3.0	4.3
Dividend Payout Ratio(%)	35.2	2.4	32.0	31.4

Common size metrics

Year to March	FY17	FY18	FY19E	FY20E
Cost of revenues	44.1	40.4	39.2	39.5
Gross margin	55.9	59.6	60.8	60.5
SG&A expenses	35.9	36.2	35.9	35.7
EBITDA margins	20.0	23.4	24.9	24.8
EBIT margins	13.9	17.7	19.1	19.8
Net Profit margins	8.4	11.5	11.9	12.7

Growth ratios (%)

Year to March	FY17	FY18	FY19E	FY20E
Revenues	14.0	23.6	33.6	34.8
EBITDA	27.6	44.4	42.2	34.3
PBT	15.7	91.5	43.9	41.4
Adjusted Profit	33.7	68.2	41.5	45.9
EPS	32.8	67.2	41.0	45.3

Balance sheet		(INR mn)			
As on 31st March	FY17	FY18	FY19E	FY20E	
Share capital	797	802	805	808	
Reserves & Surplus	8,004	10,951	14,305	19,193	
Shareholders' funds	8,801	11,753	15,110	20,002	
Minority Interest	452	820	1,037	1,254	
Def. Tax Liability (net)	(34)	222	222	222	
Sources of funds	20,894	24,705	35,518	40,783	
Gross Block	18,006	21,128	21,979	29,104	
Net Block	11,830	11,351	16,444	19,263	
Capital work in progress	659	3,570	3,570	3,570	
Intangible Assets	1,206	901	2,621	2,097	
Total Fixed Assets	13,696	15,822	22,635	24,930	
Non current investments	232	285	285	285	
Cash and Equivalents	1,724	2,935	2,864	2,293	
Sundry Debtors	6,912	8,713	11,325	15,194	
Loans & Advances	71	350	350	350	
Other Current Assets	3,106	5,634	5,251	6,178	
Current Assets (ex cash)	13,424	18,076	21,409	27,688	
Trade payable	4,486	6,562	4,890	6,509	
Other Current Liab	3,695	5,851	6,784	7,903	
Total Current Liab	8,181	12,412	11,675	14,412	
Net Curr Assets-ex cash	5,243	5,663	9,734	13,276	
Uses of funds	20,894	24,705	35,518	40,783	
BVPS (INR)	21.7	28.8	36.9	48.7	

Free cash flow		(INR mn)			
Year to March	FY17	FY18	FY19E	FY20E	
Reported Profit	2,014	3,343	4,793	6,992	
Add: Depreciation	1,592	1,822	2,464	2,905	
Interest (Net of Tax)	1,042	761	926	1,165	
Others	664	1,594	(9,197)	(5,790)	
Less: Changes in WC	427	204	(4,941)	(3,277)	
Operating cash flow	4,885	7,316	3,927	8,549	
Less: Capex	2,151	4,595	9,276	5,200	
Free Cash Flow	2,734	2,721	(5,349)	3,349	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Sterlite Technologies	1,754	25.8	17.7	11.2	8.4	35.5	39.1
Bharti Airtel	19,971	68.5	33.8	4.2	3.4	3.9	6.6
Bharti Infratel	7,642	18.7	20.0	7.2	7.4	15.6	13.6
Idea Cellular	3,182	(5.1)	(6.7)	10.9	9.2	(17.1)	(15.6)
Tejas Networks	348	16.5	13.3	8.4	6.4	11.9	13.1
Median	-	18.7	17.7	8.4	7.4	11.9	13.1
AVERAGE	-	24.9	15.6	8.4	7.0	10.0	11.3

Source: Edelweiss research

Cash flow metrics					
Year to March	FY17	FY18	FY19E	FY20E	
Operating cash flow	4,885	7,316	3,927	8,549	
Financing cash flow	(2,323)	(5,848)	(9,374)	(5,308)	
Investing cash flow	(1,869)	(1,515)	4,212	(3,812)	
Net cash Flow	693	(48)	(1,235)	(571)	
Capex	(2,151)	(4,595)	(9,276)	(5,200)	
Dividend paid	(709)	(81)	(1,533)	(2,197)	

Profitability and efficiency ratios

Year to March	FY17	FY18	FY19E	FY20E
ROAE (%)	25.4	33.8	35.5	39.1
ROACE (%)	20.0	26.7	28.3	31.0
Inventory Days	86	95	85	84
Debtors Days	99	89	85	84
Payable Days	72	82	124	91
Cash Conversion Cycle	113	101	46	76
Current Ratio	1.9	1.7	2.1	2.1

Operating ratios

Year to March	FY17	FY18	FY19E	FY20E
Total Asset Turnover	1.3	1.4	1.4	1.5
Fixed Asset Turnover	1.9	2.2	2.2	2.4
Equity Turnover	3.0	2.9	3.0	3.1

Valuation parameters

Year to March	FY17	FY18	FY19E	FY20E
Adj. Diluted EPS (INR)	5.0	8.3	11.7	17.0
Y-o-Y growth (%)	32.8	67.2	41.0	45.3
Adjusted Cash EPS (INR)	9.1	13.0	18.0	24.5
Diluted P/E (x)	60.8	36.3	25.8	17.7
P/B (x)	13.9	10.5	8.2	6.2
EV / Sales (x)	5.0	4.0	3.2	2.4
EV / EBITDA (x)	22.9	15.9	11.2	8.4
Dividend Yield (%)	0.5	0.7	1.0	1.4

Additional Data

Directors Data

Asdsadsdf
No Data Available

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*as per last annual report

Holding – Top10

	Perc. Holding		Perc. Holding
Twin star intl ltd	52.16	Life insurance corp	3.3
L&t mutual fund	2.86	Dsp blackrock invest	2.77
Aditya birla sun lif	1.59	Macquarie emerging m	1.55
Dimensional fund adv	1.48	Reliance capital tru	1.35
Vedanta ltd	1.19	Vedanta limited	1.19

*in last one year

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
12 Oct 2017	Serum Institute Of India Pvt Ltd	Buy	4046732	263.63
12 Oct 2017	Adar Cyrus Poonawalla .	Sell	4046732	263.63
21 Jul 2017	Adar Cyrus Poonawalla	Buy	2057000	230.09

*in last one year

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
14 Feb 2018	Pravin Agarwal	Sell	53250.00
12 Feb 2018	Pravin Agarwal	Sell	150000.00
24 Jan 2018	PRATIK AGARWAL	Sell	130000.00
01 Aug 2017	ANKIT AGARWAL	Buy	25000.00
01 Aug 2017	Pravin Agarwal	Buy	46500.00

*in last one year

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Bharti Airtel	BUY	SO	L	Bharti Infratel	HOLD	SP	L
Idea Cellular	HOLD	SP	M	Reliance Communication	HOLD	SU	H
Sterlite Technologies	BUY	SO	M	Tejas Networks	BUY	SO	M

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Telecom

Bharti Airtel, Bharti Infratel, Idea Cellular, Reliance Communication, Sterlite Technologies, Tejas Networks

Recent Research

Date	Company	Title	Price (INR)	Recos
10-Jul-18	Net Neutrality	Telcos' moment of truth ; <i>Techweiss (Global Pulse)</i>		
06-Jul-18	Sterlite Technologies	Strategic acquisition augments capacity; <i>EdelFlash</i>		
18-Jun-18	Tejas Network	Expanding bandwidth; <i>Visit Note</i>	308	Buy

Distribution of Ratings / Market Cap

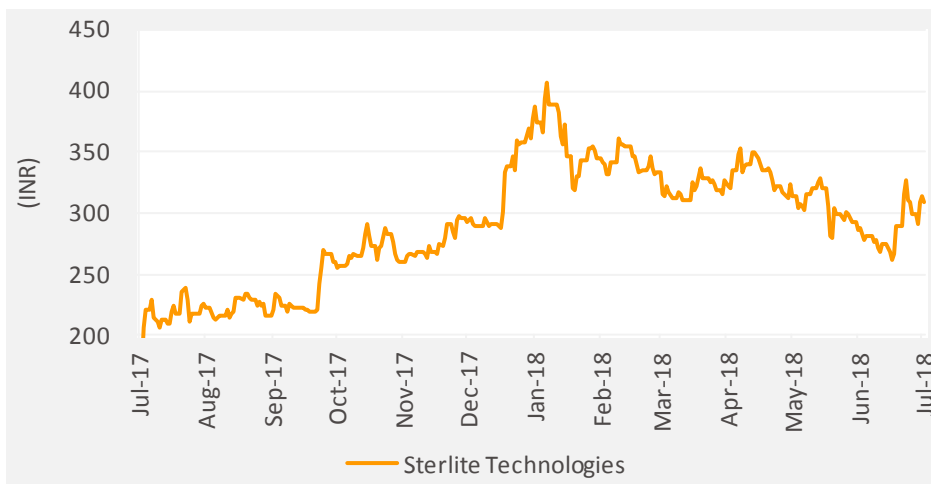
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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