

Sterlite Tech

Refer to important disclosures at the end of this report

Resilient

CMP	Target Price
Rs 208 as of (April 23, 2019)	Rs 417 (▼) 12 months
Rating	Upside
BUY (■)	100.8 %

Strong earnings/4Q beat, Maintain BUY

- Sterlite Tech reported a strong Rs1.6bn in net profit for 4Q, which came in 9% above forecasts. This is the eighth consecutive quarter of record profits, and, in our view, reflects a relatively manageable operating environment. Our earnings forecasts are unchanged.
- The stock has fallen 25% after China Mobile tender results were out in March. The fall in optic fiber cable (OF) prices in the Chinese market does not appear contagious as the demand in rest of the world is growing at 10%.
- SOTL's 4Q results stood out with rising contribution from the network designing business and long-term optic fiber supply contracts signed with clients. Management has maintained its FY20 net profit guidance of USD100mn on these strengths.
- Cutting TP to Rs417 as we now apply 20x FY21E PER vs. 29x FY20E PER due to the promoter share pledge overhang. Current valuations of 10x FY21E PER and EV/EBITDA of 6.1x FY21E do not factor in 22% FY19-21E EPS CAGR.

Network solutions revenue drives the beat

SOTL delivered a strong set of 4Q results in all aspects. Net profit surged 47% YoY/10% QoQ to Rs1.6bn, driven by 112% revenue growth and 43% EBITDA growth yoy. EBITDA declined by 844bps YoY due to a change in the revenue mix and lower realizations. The services business contributed 52% to revenues in 4Q vs. 25% a year ago. For FY20/21E, we have factored in lower realizations for OF; however, capacity ramp-up should drive product revenue growth of 38/16%. We expect this to contribute 64/75% to overall revenues.

USD75bn data solution opportunity by 2023

The ongoing disruption in traditional telco networks has created attractive opportunities for turnkey solution providers for data networks. SOTL is benefiting from this huge opportunity (by 2023). It has developed capabilities that will enable it to capture the full value chain in data network capex. The current orderbook of Rs50bn from Indian telcos and government verifies the potential. We expect services revenue to contribute 36/25% in FY20/21E. EBITDA margins are improving at the same time as the business is benefiting from operating leverage.

Outlook and valuations

We forecast EPS growth of 27% in FY20 and 16% in FY21 YoY. This is driven by OF capacity ramp-up and execution of network solutions orderbook. We maintain our BUY rating on SOTL as the stock is trading at an unjustified PER of 9.9x FY21E. Key risks include 5G rollout delays globally and technology disruption in data transmission.

Please see our sector EAP (page 8): [Emkay Alpha Portfolio – India SMID](#)

Financial Snapshot (Consolidated)

(Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Net Sales	24,489	31,771	50,873	68,949	80,796
EBITDA	5,189	7,494	11,272	14,404	16,280
EBITDA Margin (%)	21.2	23.6	22.2	20.9	20.2
APAT	2,014	3,324	5,712	7,185	8,368
EPS (Rs)	5.1	8.3	14.2	17.9	20.9
EPS (% chg)	29.2	63.9	71.8	25.8	16.5
ROE (%)	24.6	32.3	39.5	36.0	32.4
P/E (x)	41.1	25.1	14.6	11.6	10.0
EV/EBITDA (x)	17.7	12.3	8.9	7.2	6.1
P/BV (x)	9.4	7.1	4.8	3.7	2.9

Source: Company, Emkay Research

Change in Estimates

EPS Chg FY20E/FY21E (%)	-/-
Target Price change (%)	(19.8)
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

	EPS Estimates	
	FY20E	FY21E
Emkay	17.9	20.9
Consensus	15.7	18.7
Mean Consensus TP (12M)	Rs 366	

Stock Details

Bloomberg Code	SOTL IN
Face Value (Rs)	2
Shares outstanding (mn)	403
52 Week H/L	400 / 181
M Cap (Rs bn/USD bn)	84 / 1.20
Daily Avg Volume (nos.)	2,211,417
Daily Avg Turnover (US\$ mn)	7.3

Shareholding Pattern Mar '19

Promoters	53.8%
FIIIs	6.0%
DIIIs	10.8%
Public and Others	29.4%

Price Performance

(%)	1M	3M	6M	12M
Absolute	(7)	(29)	(35)	(41)
Rel. to Nifty	(8)	(34)	(43)	(46)

Relative price chart



Source: Bloomberg

This report is solely produced by Emkay Global. The following person(s) are responsible for the production of the recommendation:

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Exhibit 1: Actual vs. Estimates (Q4FY19)

(Rs mn)	Actual	Estimates		% variation	
		Emkay	Consensus	Emkay	Consensus
Sales	17,912	14,428	13,589	24%	32%
EBITDA	3,151	3,158	2,848	0%	11%
EBITDA Margin	17.6%	21.9%	21.0%	-430 bps	-337 bps
PAT	1,637	1,506	1,445	9%	13%

Source: Company, Emkay Research

Exhibit 2: Summary of quarterly results

Rs mn	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	YoY %	QoQ %	FY18	FY19	YoY %
Sales	8,466	8,769	10,843	13,349	17,912	34.2	111.6	31,771	50,873	60.1
Cost of Revenue	3,300	3,339	4,337	6,300	10,897	73.0	230.2	12,723	24,872	95.5
as % of sales	39.0	38.1	40.0	47.2	60.8			40.0	48.9	
Employee Cost	905	925	1,343	1,493	1,350	-9.6	49.2	3,506	5,112	45.8
as % of sales	10.7	10.6	12.4	11.2	7.5		0.0	11.0	10.0	
Other expenses	2,058	2,056	2,430	2,617	2,514	-3.9	22.2	8,049	9,617	19.5
as % of sales	24.3	23.4	22.4	19.6	14.0		0.0	25.3	18.9	
Total Expenditure	6,263	6,320	8,111	10,410	14,761	41.8	135.7	24,278	39,601	63.1
EBITDA	2,203	2,449	2,733	2,939	3,151	7.2	43.0	7,494	11,272	50.4
Depreciation	525	448	492	512	498	-2.8	-5.1	1,822	1,950	7.0
EBIT	1,679	2,001	2,241	2,427	2,653	9.3	58.0	5,671	9,322	64.4
Other Income	172	73	60	104	132	26.6	-23.1	393	369	-6.1
Interest	253	231	244	274	307	11.9	21.3	1,038	1,055	1.6
PBT	1,597	1,843	2,057	2,257	2,478	9.8	55.1	5,026	8,635	71.8
Tax	362	548	652	760	822	8.1	126.9	1,332	2,782	108.9
PAT before minority interest	1,235	1,295	1,406	1,497	1,656	10.6	34.1	3,694	5,854	58.5
(Profit)/loss from JV's/Ass/MI	106	73	92	(17)	(5)	-72.3	-104.5	370	142	-61.6
PAT before extra	1,130	1,222	1,314	1,514	1,661	9.7	47.0	3,324	5,712	71.8
Exceptional Items	(44)	(10)	(20)	(21)	(25)	17.6	-43.6	(44)	(76)	73.3
Reported PAT	1,086	1,212	1,294	1,493	1,637	9.6	50.7	3,280	5,636	71.8

Margins (%)						bps	bps				bps
EBIDTA	26.0	27.9	25.2	22.0	17.6	(443)	(844)	23.6	22.2		(143)
EBIT	19.8	22.8	20.7	18.2	14.8	(337)	(502)	17.9	18.3		47
EBT	18.9	21.0	19.0	16.9	13.8	(307)	(503)	15.8	17.0		116
PAT	14.6	14.8	13.0	11.2	9.2	(197)	(534)	11.6	11.5		(12)
Effective Tax rate	22.7	29.8	31.7	33.7	33.2	(52)	1,049	26.5	32.2		572

Source: Company, Emkay Research

Exhibit 3: Changes in earnings estimates

All fig in Rs mn (except % and EPS)	FY20E			FY21E		
	Old	New	% change	Old	New	% change
EBITDA	62,528	68,949	10%	67,311	81,754	10%
EBITDA margins, %	14,351	14,404	0%	16,244	16,280	0%
Net profits	23.0%	20.9%	-206 bps	24.1%	19.9%	-206 bps
EPS	7,185	7,185	0%	8,368	8,368	0%

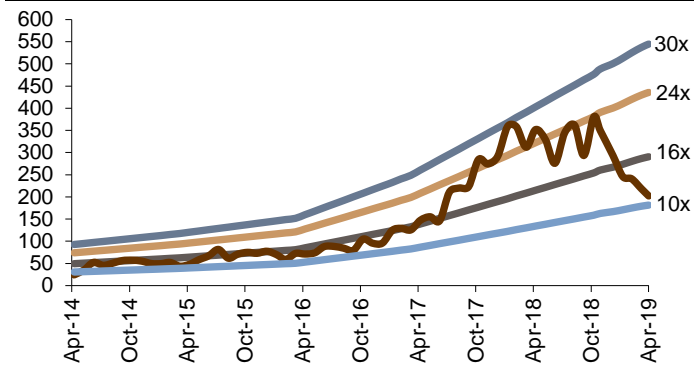
Source: Company, Emkay Research

Exhibit 4: Key assumptions

	FY16	FY17	FY18	FY19E	FY20E	FY21E
Optic fiber volume (mKM)	14	19	20	19	23	23
Optic fiber cable volume (mKM)	7	6	10	14	20	23
FTTH/Data Cables revenue	3,379	2,821	2,821	2,962	3,110	3,266
Solution revenue	4,000	3,400	5,210	15,983	22,300	28,098
Elitecore revenue	919	2,114	2,000	2,300	2,645	3,042

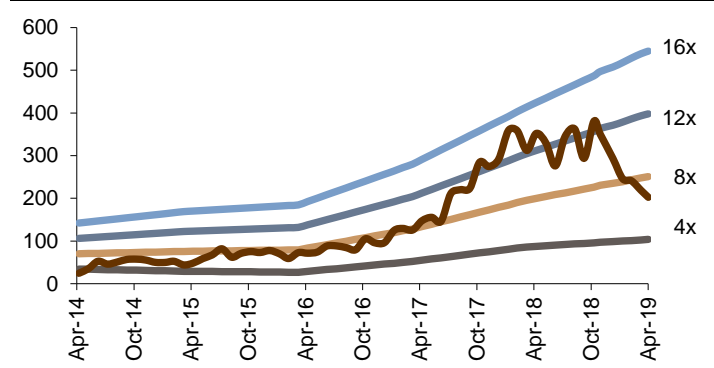
Source: Company, Emkay Research

Exhibit 5: 1-yr fwd P/E chart



Source: Company, Emkay Research

Exhibit 6: 1-yr fwd EV/EBITDA chart



Source: Company, Emkay Research

Exhibit 7: Peer comparison

Companies	Mcap (USD m)	Reco	TP (Rs)	PER (x)			EV/EBITDA (x)			ROE(%)		
				FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Optic fiber manufacturers												
Fujikura Ltd	1,272	NA	NA	34.9	9.5	8.5	6.1	5.8	5.4	1.7	6.2	6.9
Prysmian SpA	4,827	NA	NA	10.8	9.5	8.2	8.3	6.6	5.8	18.8	17.3	18.4
Corning Inc	27,412	NA	NA	19.7	17.2	15.5	9.9	9.1	8.7	11.3	13.7	14.9
Yangtze Optical Fibre	3,896	NA	NA	9.6	15.0	14.9	11.7	22.2	16.8	25.3	12.8	11.2
Hengtong Optic-electric Co Ltd	6,365	NA	NA	14.6	11.8	13.0	12.4	10.1	NA	24.7	29.5	17.8
Average				17.9	12.6	12.0	9.7	10.8	9.2	16.4	15.9	13.8
Network Solution providers												
Amdocs Ltd	7,546	NA	NA	12.9	12.1	10.8	8.9	8.3		16.7	17.8	
Ciena Corp	5,964	NA	NA	20.9	16.7	14.6	11.9	9.1	8.5	14.6	15.6	15.6
Infinera Corp	885	NA	NA	(13.0)	(9.0)	50.4	47.2	55.7	9.0	(13.0)	(23.2)	(3.5)
Dycom Industries Inc	1,535	NA	NA	15.2	20.4	14.7	8.8	7.0	6.1	11.3	8.8	11.9
Average				9.0	10.0	22.6	19.2	20.0	7.9	7.4	4.7	8.0
Sterlite Tech	1,131	BUY	417	14.6	11.6	10.0	8.9	7.2	6.1	39.5	36.0	32.4

Source: Company, Emkay Research, Bloomberg

Q4FY19 results highlights

Revenue

- 4Q revenue increased 112% YoY/34% QoQ to Rs17.9bn.
- FY19 revenue increased 60% YoY to Rs31.7bn.
- SOTL signed a new contract from one of the Top-5 cloud providers for end-to-end network solutions.
- Network solutions business contributed 52% to 4QFY19 revenues. For FY19, network solutions business contributed 37% of revenues.
- Order book to sales increased to 2x of FY19 sales as customers are booking capacities to secure fiber supplies.
- Order book increased to Rs105bn (+101% YoY, +3% QoQ).
- 70% of the order book is exports, driven by clients in Europe.

Margins

- EBITDA margin decreased 844bps YoY/443bps QoQ to 17.6%.
- Margins were lower due to 1) a change in revenue mix, 2) lower realization, and 3) cost of new capacity addition.
- Management believes that sustainable EBITDA margins are in the range of 18-20%.
- Management has guided EBITDA margin of 25-26% in the product business and 11% in the network solution business.

Profitability and balance sheet

- Interest cost increased 12% QoQ to Rs307mn amid an increase in debt due to an acquisition and capital expenditures.
- Net profit increased 47% YoY/9.7% QoQ to Rs1.6bn, driven by strong revenue beat.
- SOTL has maintained its USD100mn profit guidance for FY2020 despite the softening in OF prices.
- Balance sheet contains contract assets of Rs11bn. Majority of this is receivables, inventories and WIP for system integrated business.
- Net debt was Rs17bn (flat QoQ due to strong operating cash flow) as at Mar'19 (due to capex of Rs6bn and an acquisition worth Rs4.7bn).
- D/E reduced to 1.0x from 1x in Sep-18. Interest coverage is comfortable at 7.0x/9.3x for FY20E/FY21E.
- Management is confident of sustainable ROCE of 25% in the long term.
- The company has declared a dividend of Rs3.5/sh (payout ratio of 30% including DDT).

Update on Capex

- A 10mn KM optic fiber plant has commenced operations and another 10mn KM plant will begin operations by the end of 2QFY20.
- New capacities will meaningfully contribute to revenues from 2HFY20 onward.

Industry outlook

- Fiber prices globally and in India are at USD7/KM. Fiber prices in Europe are USD7.5/KM.
- SOTL's realization is currently in the range of USD7.2-7.5 due to higher exposure to Europe.
- Demand continues to improve with internet companies such as Facebook, Google, and Amazon creating their own data networks.
- India demand is currently driven by JIO (4G back-haul, 5G rollout, and FTTH) and Bharat Net phase-2.

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Net Sales	24,489	31,771	50,873	68,949	80,796
Expenditure	19,299	24,278	39,601	54,545	64,515
EBITDA	5,189	7,494	11,272	14,404	16,280
Depreciation	1,592	1,822	1,950	2,790	3,231
EBIT	3,597	5,671	9,322	11,615	13,050
Other Income	235	393	369	407	428
Interest expenses	1,229	1,038	1,055	1,693	1,494
PBT	2,602	5,026	8,635	10,329	11,983
Tax	397	1,332	2,782	2,944	3,415
Extraordinary Items	(11)	(135)	720	0	0
Minority Int./Income from Assoc.	0	0	0	0	0
Reported Net Income	2,003	3,190	6,431	7,185	8,368
Adjusted PAT	2,014	3,324	5,712	7,185	8,368

Balance Sheet

Y/E Mar (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Equity share capital	797	802	805	805	805
Reserves & surplus	8,004	10,951	16,388	21,884	28,090
Net worth	8,801	11,753	17,193	22,689	28,895
Minority Interest	452	820	954	1,154	1,354
Loan Funds	10,925	11,775	19,175	22,175	17,675
Net deferred tax liability	(34)	222	744	787	913
Total Liabilities	20,143	24,570	38,066	46,805	48,838
Net block	13,037	12,252	24,679	26,446	25,716
Investment	232	285	353	353	353
Current Assets	15,148	21,010	40,897	50,152	58,640
Cash & bank balance	1,648	2,746	2,435	1,121	1,301
Other Current Assets	3,182	5,823	7,637	8,227	9,526
Current liabilities & Provision	8,932	12,548	32,057	34,340	40,066
Net current assets	6,216	8,463	8,840	15,812	18,575
Misc. exp	0	0	0	0	0
Total Assets	20,143	24,570	38,066	46,805	48,838

Cash Flow

Y/E Mar (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
PBT (Ex-Other income) (NI+Dep)	2,368	4,633	8,267	9,921	11,555
Other Non-Cash items	0	0	0	0	0
Chg in working cap	110	(894)	(166)	(8,241)	(2,457)
Operating Cashflow	4,902	5,268	8,324	3,219	10,408
Capital expenditure	(2,194)	(3,949)	(15,001)	(4,558)	(2,500)
Free Cash Flow	2,708	1,320	(6,677)	(1,338)	7,908
Investments	(67)	(53)	(68)	0	0
Other Investing Cash Flow	0	0	0	0	0
Investing Cashflow	(2,027)	(3,609)	(14,700)	(4,150)	(2,072)
Equity Capital Raised	6	5	3	0	0
Loans Taken / (Repaid)	36	851	7,400	3,000	(4,500)
Dividend paid (incl tax)	(599)	(599)	(965)	(1,689)	(2,162)
Other Financing Cash Flow	(218)	220	683	0	0
Financing Cashflow	(2,005)	(562)	6,066	(382)	(8,156)
Net chg in cash	871	1,097	(311)	(1,313)	180
Opening cash position	777	1,648	2,746	2,435	1,121
Closing cash position	1,648	2,746	2,435	1,121	1,301

Source: Company, Emkay Research

Key Ratios

Profitability (%)	FY17	FY18	FY19	FY20E	FY21E
EBITDA Margin	21.2	23.6	22.2	20.9	20.2
EBIT Margin	14.7	17.9	18.3	16.8	16.2
Effective Tax Rate	15.2	26.5	32.2	28.5	28.5
Net Margin	9.0	11.6	11.5	10.7	10.6
ROCE	19.6	27.1	30.9	28.3	28.2
ROE	24.6	32.3	39.5	36.0	32.4
RoIC	21.2	31.9	38.0	32.2	31.0

Per Share Data (Rs)	FY17	FY18	FY19	FY20E	FY21E
EPS	5.1	8.3	14.2	17.9	20.9
CEPS	9.1	12.8	19.1	24.9	28.9
BVPS	22.1	29.3	42.9	56.6	72.1
DPS	1.3	2.0	3.5	4.5	5.2

Valuations (x)	FY17	FY18	FY19	FY20E	FY21E
PER	41.1	25.1	14.6	11.6	10.0
P/CEPS	22.9	16.2	10.9	8.3	7.2
P/BV	9.4	7.1	4.8	3.7	2.9
EV / Sales	3.8	2.9	2.0	1.5	1.2
EV / EBITDA	17.7	12.3	8.9	7.2	6.1
Dividend Yield (%)	0.6	1.0	1.7	2.2	2.5

Gearing Ratio (x)	FY17	FY18	FY19	FY20E	FY21E
Net Debt/ Equity	1.1	0.8	1.0	0.9	0.6
Net Debt/EBIDTA	1.8	1.2	1.5	1.5	1.0
Working Cap Cycle (days)	68.1	65.7	46.0	77.8	78.0

Growth (%)	FY17	FY18	FY19	FY20E	FY21E
Revenue	14.2	29.7	60.1	35.5	17.2
EBITDA	13.0	44.4	50.4	27.8	13.0
EBIT	7.8	57.7	64.4	24.6	12.4
PAT	30.2	59.2	101.6	11.7	16.5

Quarterly (Rs mn)	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19
Revenue	8,466	8,769	10,843	13,349	17,912
EBITDA	2,203	2,449	2,733	2,938	3,151
EBITDA Margin (%)	26.0	27.9	25.2	22.0	17.6
PAT	989	1,421	1,061	1,969	1,979
EPS (Rs)	2.5	3.5	2.6	4.9	4.9

Source: Company, Emkay Research

Shareholding Pattern (%)	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Promoters	54.0	54.0	53.9	53.8	53.8
FIs	8.5	6.5	6.6	6.2	6.0
DIs	11.2	12.0	12.9	12.0	10.8
Public and Others	26.3	27.5	26.7	28.0	29.4

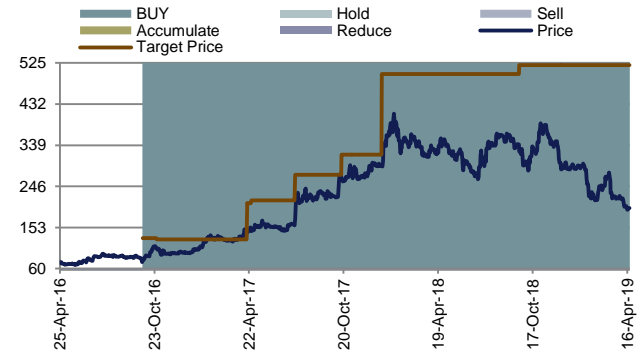
Source: Capitaline

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
24-Jan-19	291	520	12m	Buy	Anubhav Gupta
10-Jan-19	290	520	12m	Buy	Anubhav Gupta
14-Dec-18	289	520	12m	Buy	Anubhav Gupta
24-Oct-18	324	520	12m	Buy	Anubhav Gupta
21-Sep-18	325	520	12m	Buy	Anubhav Gupta
19-Jul-18	302	500	12m	Buy	Anubhav Gupta
06-Jul-18	290	500	12m	Buy	Anubhav Gupta
18-May-18	317	500	12m	Buy	Anubhav Gupta
25-Apr-18	336	500	12m	Buy	Anubhav Gupta
26-Feb-18	364	500	12m	Buy	Anubhav Gupta
01-Jan-18	294	500	12m	Buy	Anubhav Gupta
16-Oct-17	262	318	12m	Buy	Anubhav Gupta
19-Jul-17	173	272	12m	Buy	Anubhav Gupta
22-May-17	161	214	12m	Buy	Anubhav Gupta
26-Apr-17	151	214	12m	Buy	Anubhav Gupta
18-Apr-17	140	208	12m	Buy	Anubhav Gupta
18-Jan-17	109	126	12m	Buy	Anubhav Gupta
28-Nov-16	95	126	12m	Buy	Anubhav Gupta
04-Nov-16	92	126	12m	Buy	Anubhav Gupta
27-Oct-16	106	126	12m	Buy	Anubhav Gupta
30-Sep-16	80	129	12m	Buy	Anubhav Gupta

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

Emkay Alpha Portfolio – India SMID



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Sector

Midcaps

Analyst bio

Anubhav Gupta holds an MBA and brings in total 12 years of research experience. His team currently covers 10 midcap stocks across sectors.

Exhibit 8: EAP sector portfolio

Company Name	India SMID Weight (%)
APL Apollo Tubes	9
Bajaj Electricals	8
Cholamandalam Finance	3
City Union Bank	4
Cummins India	3
Delta Corp	4
Exide Industries	3
Granules India	3
Gujarat Gas	3
Jubilant FoodWorks	3
L&T Infotech	4
Max Financial	3
Mphasis	4
Orient Refractories	3
Persistent Systems	2
Radico Khaitan	9
SRF	4
Sterlite Tech	9
Sunteck Realty	8
V2 Retail	4
Varun Beverages	7
Cash	0

Since SMID is a discretionary portfolio it is benchmarked to the performance of BSE400 SMID Index

Source: Emkay Research

Exhibit 9: Sector portfolio NAV

	Base		Current		
	1-Apr-19	22-Apr-19	3m	6m	12m
EAP - SMID	100.0	95.1			
BSEMS400 Equal Weighted Portfolio (ETF)	100.0	97.5			

*Performance measurement base date 1st April 2019

Source: Emkay Research

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

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