

Sterlite Technologies (SOTL IN)

Target Price **Rs465.0**
 Current Price **Rs290.7**
 % Upside **60%**

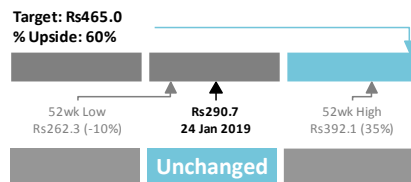
The Scoop: Impressive Revenue Growth on Acceleration in Services Vertical

Technology Hardware

India

25 Jan 2019

BUY

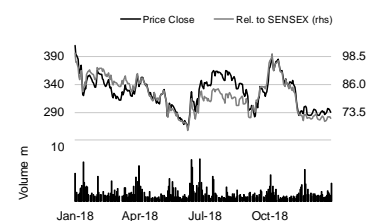


Basic Share Information

Market cap	Rs117.0b / US\$1.65b
Daily traded value (3mth)	US\$6.21m
Shares outstanding	406.4m
Free float	48%
Net debt-to-equity	63.2%
1 yr high	Rs392.1
1 yr low	Rs262.3
Foreign shareholding	7%

Note: Share price and market data as of 24 January 2019

Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	2.3%	-10.3%	-29.1%
Absolute USD	1%	-7.7%	-36.5%
Relative to SENSEX	0.3%	-16.6%	-29.2%

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What event has happened?

Sterlite Technologies reported Q3 FY3/19 results on 24 January 2018. Revenue was Rs13.3bn, up by 60% YoY versus our estimate of 43% YoY, helped by high growth in its services segment. The EBITDA margin was 22% (down by 320bp QoQ), missing our estimate by 220bp, mainly on a rising contribution from low-margin services (30% of revenue, which we estimate rose by about 150% YoY) hindering the GPM (down by 720bp QoQ). The Q3 order book was Rs102.3bn (up by 8% QoQ) with a 2.5x trailing book to bill.

Why is it significant?

We were impressed by the strong Q3 revenue growth. We expected good performance in the product business (70% of revenue, up by 40% YoY) due to the contribution from the Metallurgica unit, but were surprised by the strong pick-up in services, supported by the Indian Navy order starting and projects at telco operators. The Q3 OPM was worse than we expected, mainly due to an improving services segment, which we already expected from Q4 as the Navy and MahaNet projects ramped up. We expect the OPM to remain muted in FY3/20 due to a rising contribution from services (40% of revenue), but subsequently improve as optical fiber (OF) and optical fiber cable (OFC) capacity expansion (OF at 50mn fiber kilometers (fkm) and OFC at 33mn fkm annually) is completed in late FY3/20. Management expects a tender from China Mobile (941 HK) in the current quarter and this to be a catalyst for it to lift OF pricing. We however see OF pricing remaining muted through 2019 and picking up once early 5G capex starts in 2020. We expect earnings growth to remain strong and forecast a 36% EPS CAGR over FY3/19–21.

Implications for our earnings forecast?

We revise up our FY3/19–21 forecasts by 1–7% for revenue and 1–9% for EPS post the Q3 results beat.

How do valuations look now?

The shares trade at 16x our FY3/20 EPS forecast, which we see as attractive. We maintain our BUY rating and target price of Rs465, based on 25x our FY3/20 EPS forecast. Our multiple is one standard deviation above Sterlite's median 12-month forward PER over the past two years, which we see as appropriate given the improving business environment. The main risks to our rating and the attainment of our target price are global oversupply of OF, a drop in China demand, and delays in 5G rollout across major geographies.

What is distinctive about our stock view?

Our FY3/19–21 EPS forecasts are 6–13% above the Bloomberg-consensus estimates as we expect higher revenue growth than the consensus. It appears to us that the Street has still not factored the India Navy contract into its revenue estimates.

	Mar-17A	Mar-18A	Mar-19E	Mar-20E	Mar-21E	Trend
Total turnover (Rsm)	24,489	31,771	48,123	73,744	78,179	▬ ▬ ▬ ▬ ▬
Operating profit (Rsm)	3,597	5,671	9,336	12,094	13,525	▬ ▬ ▬ ▬ ▬
Pre-tax profit (Rsm)	2,574	5,026	8,566	10,994	12,352	▬ ▬ ▬ ▬ ▬
Net income to ord equity (Rsm)	2,014	3,396	5,832	7,616	8,594	▬ ▬ ▬ ▬ ▬
Net profit growth	31.0%	68.6%	71.7%	30.6%	12.8%	▬ ▬ ▬ ▬ ▬
P/E (x)	58.40	35.23	20.42	15.64	13.86	▬ ▬ ▬ ▬ ▬
Adj EV/EBITDA (x)	25.55	17.03	11.64	8.37	7.08	▬ ▬ ▬ ▬ ▬
P/B (x)	13.36	9.52	7.30	5.28	4.02	▬ ▬ ▬ ▬ ▬
ROE	24.6%	31.8%	40.4%	39.2%	33.0%	▬ ▬ ▬ ▬ ▬
Dividend yield	0.5%	0.7%	1.5%	1.0%	1.1%	▬ ▬ ▬ ▬ ▬
EPS HTI old (Rs)	4.98	8.25	13.37	18.48	19.30	▬ ▬ ▬ ▬ ▬
EPS HTI New (Rs)	4.98	8.25	14.23	18.59	20.97	▬ ▬ ▬ ▬ ▬
Consensus EPS (Rs)	4.80	8.33	12.59	16.51	19.86	▬ ▬ ▬ ▬ ▬
HTI EPS vs Consensus	3.7%	(1.0%)	13.1%	12.6%	5.6%	▬ ▬ ▬ ▬ ▬

Source: Company data, Bloomberg, HTI estimates

Click [here](#) to download the working model

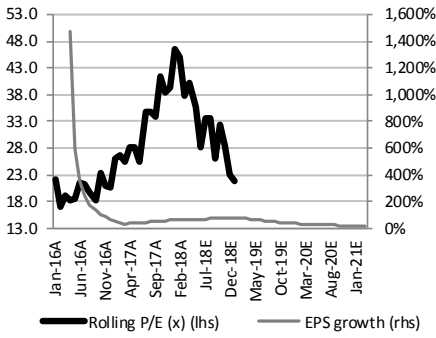
We revise up our FY3/19–21 forecasts by 1–7% for revenue and 1–9% for EPS post the Q3 results beat

Current Estimates versus Consensus and Previous Estimates

	Revenues			Operating margin (EBITDA)			EPS (GAAP)		
	FY 2019e	FY 2020e	FY 2021e	FY 2019e	FY 2020e	FY 2021e	FY 2019e	FY 2020e	FY 2021e
Haitong est. (INR, mn)	48,123	73,744	78,179	23.7%	21.6%	22.5%	14.23	18.59	20.97
YoY change	51.5%	53.2%	6.0%	11bps	-210bps	90bps	72.5%	30.6%	12.8%
Consensus (INR, mn)	44,253	59,573	72,055	24.9%	23.5%	23.5%	12.59	16.51	19.86
YoY change	39.3%	34.6%	21.0%	131bps	-135bps	-7bps	52.6%	31.1%	20.3%
Haitong vs. consensus	8.7%	23.8%	8.5%	-119bps	-195bps	-98bps	13.0%	12.6%	5.6%
Haitong (previous est.)	46,937	72,931	73,053	24.5%	21.9%	22.5%	13.37	18.48	19.3
YoY change	47.7%	55.4%	0.2%	91bps	-260bps	60bps	64.4%	41.1%	5.3%
Current vs. previous	2.5%	1.1%	7.0%	-80bps	-30bps	0bps	6.4%	0.6%	8.7%

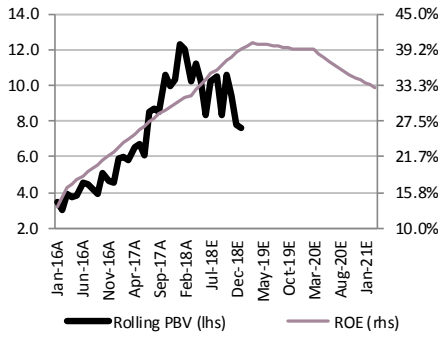
Source: Company data, Bloomberg, HTI estimates

P/E (x) vs EPS Growth (%)



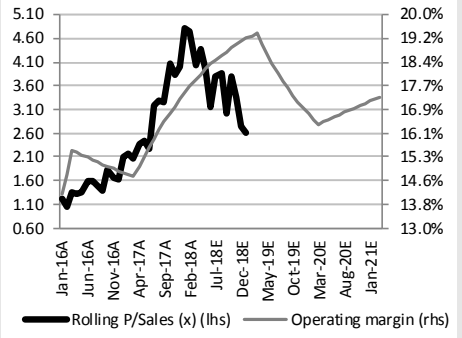
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



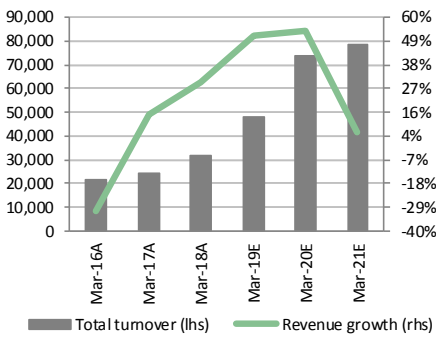
Source: Company data, Bloomberg, HTI estimates

PSR (x) vs OPM (%)



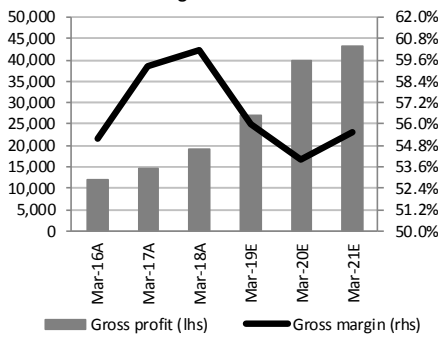
Source: Company data, Bloomberg, HTI estimates

Turnover and Growth



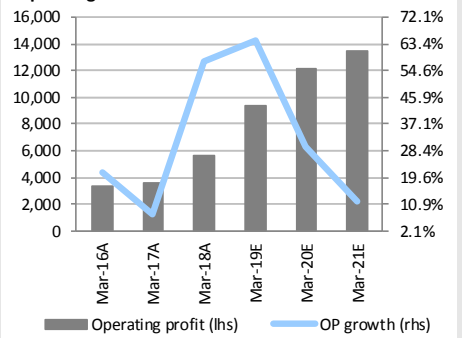
Source: Company data, Bloomberg, HTI estimates

Gross Profit and Margin



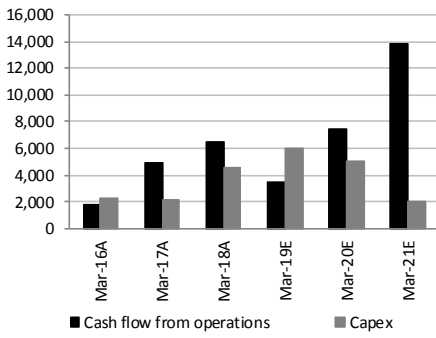
Source: Company data, Bloomberg, HTI estimates

Operating Profit and OP Growth



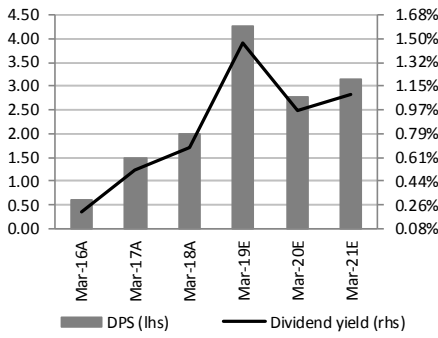
Source: Company data, Bloomberg, HTI estimates

CF from operations vs Capex (Rsm)



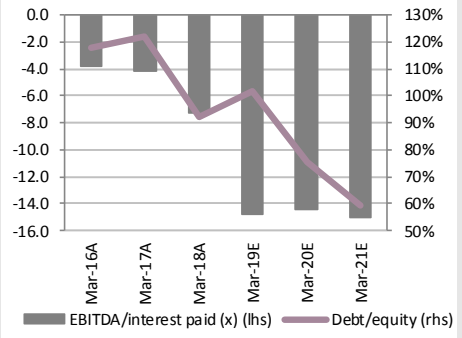
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield (Rs)



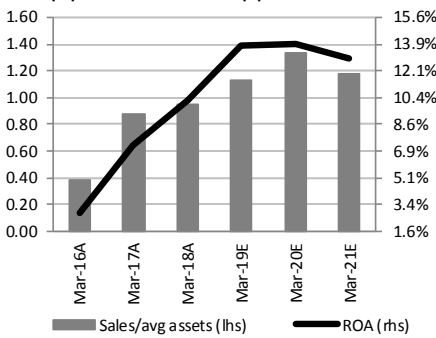
Source: Company data, Bloomberg, HTI estimates

Debt to Equity (%) and Interest Cover (x)



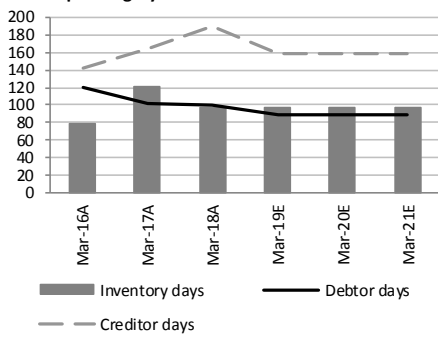
Source: Company data, Bloomberg, HTI estimates

ROA (%) and Asset Turnover (x)



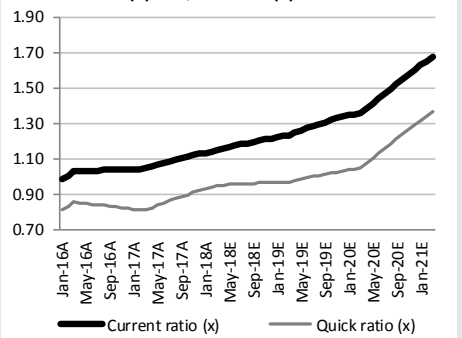
Source: Company data, Bloomberg, HTI estimates

Cash Operating Cycle



Source: Company data, Bloomberg, HTI estimates

Current Ratio (x) vs Quick Ratio (x)



Source: Company data, Bloomberg, HTI estimates

APPENDIX

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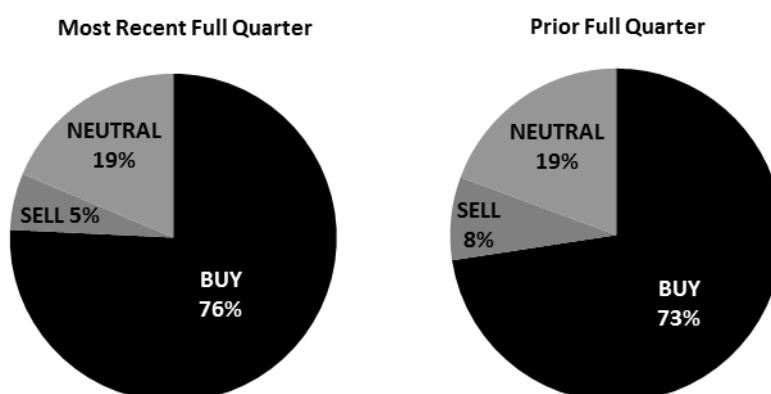
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*Percentage of investment banking clients in each rating category.

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Recommendation Chart



Date	Recommendation	Target (Rs)	Price (Rs)
2018-11-30	Buy	465.0	347.7
2018-10-25	Buy	535.0	326.4
2018-07-20	Buy	525.0	330.9
2018-02-26	Buy	500.0	364.3
2018-01-18	Buy	440.0	389.5
2018-01-08	Buy	400.0	348.3

Source: Company data, Bloomberg, HTI estimates

Definitions for Key Investment Metrics

Business Growth

This is the metric which matches the top line in our report.

Business profit

This is the metric which best represents operating profit in our report

Shareholder Returns

Return on Equity

Balance Sheet Risk

Net Debt to Equity