

Turn cautious on future pricing uncertainty...

The key highlight of Sterlite Tech's Q4FY19 performance was superior execution of Navy and other services orders, which led to a beat at topline levels with revenues at ₹ 1791 crore (up 1.1x YoY) vs. estimated topline of ₹ 1419 crore. Services and solutions formed 52% of the topline in Q4 (~37% in FY19) and were up ~3x. However, skewness towards services segment (that has ~11% margins vs. ~26% margins for products) and lower product margin led to a margin decline of ~440 bps YoY to 17.6%. With a shift of the revenue mix towards services and pricing impact, the company lowered its margins guidance to 18-20% vs. 22-23% earlier.

Services & solution share in revenues to expand

The company indicated that services and solution segment contribution increased to ~37% of topline in FY19 (vs. ~26% in FY18) given the superior execution in the Navy and other services projects. We also note that of the total order book of ₹ 10,516 crore, services order book is ~₹ 5,000 crore, which, as per management, is likely to contribute to ~50% of the topline, in the next couple of years. Therefore, we raise our revenue forecast for FY20 and FY21E by ~9% & 16%, respectively, to build in superior execution in the services segment. However, with the revenue mix tilt towards services, overall margins are expected to trend lower (services margins is at ~11%, while product margin is at ~26%, currently).

Product pricing pressure to persist

The company indicated that given the impact of China Mobile order, the realisations of fibre has trended lower to ~US\$7-7.5/fkm vs. ~US\$ 8/fkm earlier. During the quarter, partial impact of the same was seen with 150 bps impact on overall margins. We note that with further contracts coming up for price negotiations, the full impact will be seen, going ahead, in H2FY20. Moreover, aggressive addition of capacities are also likely to cap the price recovery in the near to medium term. We bake in margins of 19.5% and 19% for FY20E and FY21E, respectively.

Valuation & Outlook

Sterlite has demonstrated a strong growth trajectory in the past couple of years driven by strong traction in global fibre demand. The recent China Mobile pricing fiasco, however, has clouded overall sentiments. Moreover, huge capacity addition across the globe is also likely to cap the price recovery in near to medium term. The shift of business mix towards services also runs the risk of working capital stress & thin margin. Therefore, we downgrade the stock to **REDUCE**, valuing it at 12x FY21E (vs. 15x earlier) EPS to arrive at target price of ₹ 180/share. Our earnings multiple cut is reflective of lower growth outlook, changing business mix and overhang of pledged shares.

Key Financial Summary

(Year-end March)	FY17	FY18	FY19E	FY20E	FY21E	CAGR (FY19-21E)
Net Sales (₹ crore)	2,593.6	3,205.5	5,087.3	6,337.6	7,105.7	18.2
EBITDA (₹ crore)	518.9	749.3	1,127.2	1,235.8	1,350.1	9.4
Net Profit (₹ crore)	201.4	337.5	568.7	590.2	604.8	3.1
EPS (₹)	5.1	8.3	14.0	14.7	15.0	
P/E (x)	39.0	23.6	14.0	13.4	13.1	
Price / Book (x)	8.9	6.7	4.6	3.7	3.1	
EV/EBITDA (x)	17.1	11.7	8.6	7.8	6.8	
RoE (%)	22.9	28.7	33.1	27.5	23.4	
RoCE (%)	20.8	29.7	27.8	26.9	29.6	

Source: Company, ICICI Direct Research



Particulars

Particular	Amount
Market Capitalization (₹ crore)	7,809.5
Total Debt (FY19) (₹ crore)	2,102.1
Cash (FY19) (₹ crore)	333.9
EV (₹ crore)	9,577.8
52 week H/L (₹)	399/ 181
Equity capital (₹ crore)	80.2
Face value (₹)	2.0

Key Highlights

- Topline beat driven by superior execution of Navy and other services orders
- Skewness towards thin margin services segment and decline in product margin led to margin erosion of ~440 bps YoY to 17.6%
- The company lowered its margins guidance to 18-20% vs. 22-23% earlier
- Downgrade to REDUCE with target price of ₹ 180/share

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Exhibit 1: Variance Analysis

	Q4FY19	Q4FY19E	Q4FY18	Q3FY19	YoY (%)	QoQ (%)	Comments
Revenue	1,791.2	1,418.6	846.6	1,334.9	111.6	34.2	Revenues were boosted by execution of Navy and MahaNet orders
Other Income	13.2	12.0	17.2	10.4	-23.1	26.6	
Cost of raw material and components consumed	1,221.4	638.4	372.3	661.6	228.1	84.6	
Purchase of traded goods	5.1	14.2	9.2	16.7	NA	NA	
Employee Expenses	135.0	156.1	94.6	149.3	42.8	-9.6	
(Increase) / decrease in inventories of finished goods	-136.7	28.4	-55.6	-48.4	146.1	182.6	
Other Expenses	251.4	276.6	205.8	261.7	22.2	-3.9	
EBITDA	315.1	305.0	220.3	293.9	43.0	7.2	
EBITDA Margin (%)	17.6	21.5	26.0	22.0	-844 bps	-443 bps	EBITDA margins were lower than our estimates on account of higher proportion of services revenues, which have a lower margin profile
Depreciation	49.8	51.4	52.5	51.2	-5.1	-2.8	
Interest	30.7	27.1	25.3	27.4	21.3	11.9	
Total Tax	82.2	76.3	36.2	76.0	126.9	8.1	
PAT	167.6	159.9	112.4	145.6	49.1	15.1	PAT came in higher, aided by a beat at the EBITDA level

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

₹ Crore	FY20E			FY21E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	5,807.7	6,337.6	9.1	6,101.3	7,105.7	16.5	Our topline estimates have been raised to build in superior traction in services segment
EBITDA	1,306.7	1,235.8	-5.4	1,342.3	1,350.1	0.6	
EBITDA Margin (%)	22.5	19.5	-300 bps	22.0	19.0	-300 bps	We lower our margins estimates based on management guidance
PAT	609.1	590.2	-3.1	614.8	604.8	-1.6	
EPS (₹)	15.2	14.7	-3.4	15.3	15.0	-1.9	

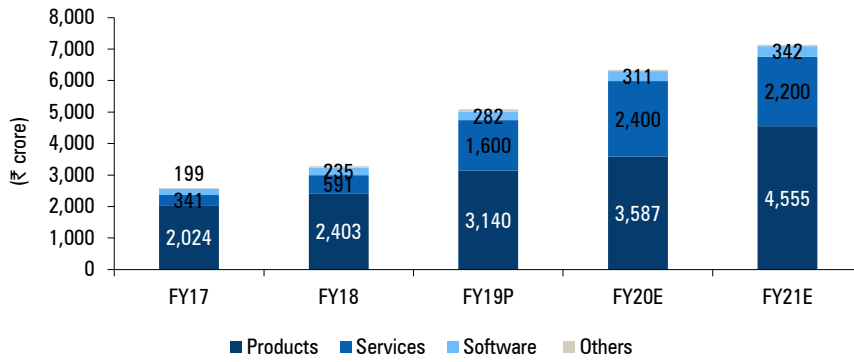
Source: Company, ICICI Direct Research

Conference Call Highlights

- Revenue growth for quarter aided by strong execution on services; margin guidance downward on revenue mix change:** The management indicated that healthy revenue growth for the quarter was aided by strong execution on the services side. The revenue mix of services has increased from 26% to 37% in FY18 to FY19. The management expects the revenue mix to be equal between revenue and services in two to three years. As per the management, out of 450 bps YoY margin decline, 300 bps could be attributable to revenue mix while the rest could be attributable to fibre price moderation. Management also guided for 18-20% range consolidated EBITDA margin for FY20 (vs. earlier guidance of 22-23%) on account of revenue mix skewed towards services which has thin margin
- China fibre pricing moderation has limited impact; do not foresee any risk open market share trading on pledge shares:** The management indicated that current global fibre pricing after the recent moderation is closer to \$7 while fibre pricing in India is also of a similar range. The management indicated that they do not foresee any cascading impact of recent fibre optic price moderation in the China Mobile tender on their contracts in other parts of the world. The management also informed that current loan amount on Vedanta group entity for which Sterlite shares has been pledged is in the range of US\$900 million. The management said the security cover is tested every quarter (the same has been tested in February 2019) and do not foresee any risk of open market trading
- Aurangabad plant to be operational in Q2FY20; capex of ₹ 500-550 crore in FY20:** The management indicated that current optical fibre capacity is at 40 mn fKm while the company is well on track to achieve its earlier guided timelines for 50 mn fKm fibre and 33 mn fKm fibre cable capacity as on June 2019 and June 2020. The management also informed that meaningful revenues are expected from expanded capacity from H2FY20. They guided for ₹ 500 to ₹ 550 crore capex, including maintenance capex in FY20. As per the management, capex is expected to moderate, in the range of ₹ 200-250 crore in FY21
- Demand drivers for products and services:** The management indicated that fibre deployment accelerated across Europe (13% YoY growth), India (16% YoY growth), Middle East (7% YoY growth), which were key demand drivers in product business during the year while China fibre demand was flattish (-1% YoY growth). Subsequently, China now contributes <5% of the topline. The demand drivers for services were national broadband initiatives such as "Bharat Net" and "Smart Cities" and Large Enterprises, mainly through network modernisation spend by defence and power & utilities
- New launches & partnership in FY19; translating to new customer wins:** The company designed and launched several network solutions such as FTTx Mantra (fully integrated, ready to implement FTTx solution) and TruRibbon (high-density optical fibre cable for high-capacity networks). The revenue mix across telcos, enterprises and citizen networks changed from 84:14: 1 in FY18 to 63:25:12
- Others:** i) The order book is at ₹ 10,516 crore as on FY19, ii) patent portfolio up from 234 to 271, iii) net debt increased from ₹ 884 crore in FY18 to ₹ 1,733 crore in FY19 and iv) the company declared a dividend of ₹ 3.5 per share

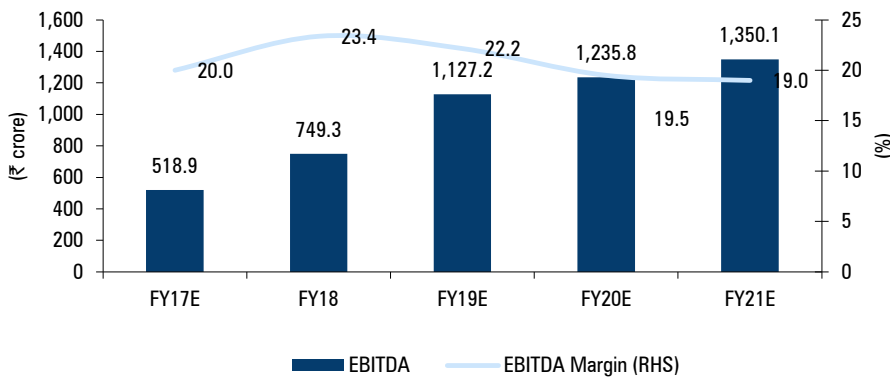
Financial story in charts

Exhibit 3: Topline growth driven by capacity expansion and service order book



Source: Company, ICICI Direct Research

Exhibit 4: Margins to decline with higher mix of services revenues



Source: Company, ICICI Direct Research

Exhibit 5: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 6: Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Position Change (m)
1	Twin Star Overseas, Ltd.	31-Mar-19	52.0	209.4	0.0
2	L&T Investment Management Limited	31-Mar-19	3.0	12.1	-2.4
3	DSP Investment Managers Pvt. Ltd.	31-Mar-19	2.3	9.1	-3.9
4	Aditya Birla Sun Life AMC Limited	31-Mar-19	1.6	6.5	-0.7
5	Reliance Nippon Life Asset Management	31-Mar-19	1.2	4.9	0.1
6	Vedanta, Ltd.	31-Mar-19	1.2	4.8	0.0
7	Life Insurance Corporation of India	31-Mar-19	1.2	4.7	-2.8
8	The Vanguard Group, Inc.	31-Mar-19	0.8	3.2	0.0
9	Dimensional Fund Advisors, L.P.	28-Feb-19	0.8	3.1	0.1
10	BlackRock Asset Management North Asia	31-Dec-17	0.5	2.2	0.1

Source: Reuters, ICICI Direct Research

Exhibit 7: Recent Activity

Investor name		Investor name	
Buys		Sells	
Legato Capital Management LLC	+2.67M +0.85M	DSP Investment Managers Pvt. Ltd.	-12.32M -3.90M
J.P. Morgan Asset Management (Hong Kong) Ltd.	+1.25M +0.39M	Life Insurance Corporation of India	-8.93M -2.83M
Copper Rock Capital Partners LLC	+1.28M +0.30M	L&T Investment Management Limited	-7.52M -2.38M
Kotak Mahindra Asset Management Company Ltd.	+0.75M +0.24M	Aditya Birla Sun Life AMC Limited	-2.26M -0.72M
Samsung Asset Management Co., Ltd.	+0.81M +0.20M	LIC Mutual Fund Asset Management Company Ltd.	-1.50M -0.44M

Source: Reuters, ICICI Direct Research

Exhibit 8: Shareholding Pattern

(in %)	Dec-17	Jun-18	Sep-18	Dec-18	Mar-19
Promoters	54.24	53.96	53.85	53.83	53.82
FII	7.11	6.51	6.56	6.20	6.01
DII	11.82	12.07	12.69	13.23	10.56
Others	26.83	27.46	26.90	26.74	29.61

Source: Company, ICICI Direct Research

Financial summary

Exhibit 9: Profit and loss statement					₹ crore
(Year-end March)	FY18	FY19E	FY20E	FY21E	
Total operating income	3,205.5	5,087.3	6,337.6	7,105.7	
Growth (%)	23.6	58.7	24.6	12.1	
Cost of raw materials	1,267.0	2,487.2	3,073.7	3,410.7	
Employee Expenses	350.2	511.2	602.1	710.6	
Administrative Expenses	838.9	961.7	1,426.0	1,634.3	
Total Operating Expenditure	2,456.1	3,960.1	5,101.7	5,755.6	
EBITDA	749.3	1,127.2	1,235.8	1,350.1	
Growth (%)	44.4	50.4	9.6	9.2	
Depreciation	182.2	195.0	242.9	272.3	
Interest	103.8	105.5	168.2	177.4	
Other Income	39.3	36.9	40.0	40.0	
Exceptional Items	4.4	5.1	-	-	
PBT	498.2	858.4	864.8	940.4	
Minority Interest	29.8	15.0	15.1	16.8	
Profit from Associates	(0.9)	-	-	-	
Total Tax	133.2	278.2	259.4	318.8	
PAT	334.3	565.2	590.2	604.8	
Growth (%)	66.0	69.1	4.4	2.5	
EPS (₹)	8.3	14.0	14.7	15.0	

Source: Company, ICICI Direct Research

Exhibit 10: Cash flow statement					₹ crore
(Year-end March)	FY18	FY19E	FY20E	FY21E	
Profit after Tax	334.3	565.2	590.2	604.8	
Add: Depreciation	182.2	195.0	242.9	272.3	
Add: Interest paid	103.8	105.5	168.2	177.4	
(Inc)/dec in Current Assets	-389.9	-1,986.9	-602.7	-306.4	
Inc/(dec) in CL and Provisions	414.9	1,314.2	564.7	346.9	
Others	0.0	0.0	0.0	0.0	
CF from operating activities	645.4	193.0	963.3	1,095.0	
(Inc)/dec in Investments	-125.5	39.1	0.0	0.0	
(Inc)/dec in Fixed Assets	-424.3	-1,457.8	-550.0	-250.0	
Others	-16.1	490.1	-6.7	-7.4	
CF from investing activities	-565.9	-928.6	-556.7	-257.4	
Issue/(Buy back) of Equity	0.5	0.3	0.0	0.0	
Inc/Dec in Minority Interest	36.8	13.5	3.6	3.6	
Issue of Preference Shares	0.0	0.0	0.0	0.0	
Inc/(Dec) in loan funds	27.7	944.0	0.0	-500.0	
Interest paid	-103.8	-105.5	-168.2	-177.4	
Others	-39.6	-21.5	-166.3	-166.3	
CF from financing activities	-78.4	830.8	-330.8	-840.0	
Net Cash flow	1.1	95.2	75.7	-2.4	
Opening Cash	137.4	138.4	233.7	309.4	
Closing Cash	138.4	233.7	309.4	307.0	

Source: Company, ICICI Direct Research

Exhibit 11: Balance sheet					₹ crore
(Year-end March)	FY18	FY19E	FY20E	FY21E	
Liabilities					
Equity Capital	80.2	80.5	80.5	80.5	
Preference Share Capital	0.0	0.0	0.0	0.0	
Reserve and Surplus	1,095.1	1,638.8	2,062.7	2,501.3	
Total Shareholders funds	1,175.3	1,719.3	2,143.2	2,581.8	
Total Debt	1,158.1	2,102.1	2,102.1	1,602.1	
Others	468.8	1,000.6	1,004.2	1,007.8	
Total Liabilities	2,802.2	4,822.0	5,249.5	5,191.7	
Assets					
Gross Block	2,359.3	3,754.7	4,404.1	4,654.1	
Less: Acc Depreciation	1,199.2	1,394.1	1,637.0	1,909.4	
Net Block	1,160.2	2,360.5	2,767.1	2,744.7	
Capital WIP	357.0	419.4	320.0	320.0	
Goodwill	73.9	107.4	107.4	107.4	
Total Fixed Assets	1,591.1	2,887.3	3,194.4	3,172.1	
Investments	248.5	242.8	242.8	242.8	
Inventory	337.9	589.7	642.4	720.3	
Debtors	871.3	1,356.6	1,690.0	1,894.9	
Loans and Advances	35.0	42.7	53.2	59.6	
Other Current Assets	457.7	1,699.7	1,905.7	1,923.0	
Cash	138.4	233.7	309.4	307.0	
Total Current Assets	1,840.3	3,922.4	4,600.8	4,904.8	
Creditors	656.2	1,912.8	2,382.8	2,671.6	
Provisions	83.8	67.2	83.7	93.8	
Other current liabilities	243.5	317.7	395.8	443.8	
Total Current Liabilities	983.5	2,297.6	2,862.3	3,209.2	
Net Current Assets	856.8	1,624.7	1,738.4	1,695.6	
Other non current assets	105.7	67.1	73.9	81.2	
Application of Funds	2,802.2	4,822.0	5,249.5	5,191.7	

Source: Company, ICICI Direct Research

Exhibit 12: Key ratios					₹ crore
(Year-end March)	FY18	FY19E	FY20E	FY21E	
Per share data (₹)					
EPS	8.3	14.0	14.7	15.0	
Cash EPS	12.9	18.9	20.7	21.8	
BV	29.3	42.7	53.2	64.1	
DPS	2.4	2.4	4.1	4.1	
Cash Per Share	29.9	34.6	40.7	47.4	
Operating Ratios (%)					
EBITDA Margin	23.4	22.2	19.5	19.0	
EBIT Margin	17.7	18.3	15.7	15.2	
PAT Margin	10.5	11.2	9.3	8.5	
Inventory days	38.5	42.3	37.0	37.0	
Debtor days	99.2	97.3	97.3	97.3	
Creditor days	74.7	137.2	137.2	137.2	
Return Ratios (%)					
RoE	28.7	33.1	27.5	23.4	
RoCE	29.7	27.8	26.9	29.6	
RoIC	26.5	22.7	21.5	23.4	
Valuation Ratios (x)					
P/E	23.6	14.0	13.4	13.1	
EV / EBITDA	11.7	8.6	7.8	6.7	
EV / Net Sales	2.7	1.9	1.5	1.3	
Market Cap / Sales	2.5	1.6	1.2	1.1	
Price to Book Value	6.7	4.6	3.7	3.1	
Solvency Ratios					
Debt/EBITDA	1.5	1.9	1.7	1.2	
Net Debt / Equity	0.7	1.0	0.8	0.5	
Current Ratio	2.3	1.9	1.7	1.7	
Quick Ratio	1.8	1.6	1.5	1.4	

Source: Company, ICICI Direct Research

Exhibit 13: 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
Vodafone Idea (IDECEL)	17	30	Hold		-16.3	-23.3	-21.6	NM	NM	NM	39.2	14.7	11.9	-2.3	-4.9	-4.1	-15.3	-27.1	-31.4
Sterlite Tech. (STETEC)	194	180	Reduce	7,809	14.0	14.7	15.0	13.8	13.2	12.9	8.5	7.7	6.7	29.7	27.8	26.9	28.7	33.1	27.5
Tata Comm. (TATCOM)	580	538	Hold	16,530	4.8	9.0	14.2	120.2	NM	40.8	9.0	8.7	7.5	5.9	5.6	6.5	9.4	-3.1	60.9

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: >-15%



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