

STERLITE TECHNOLOGIES

RESULT UPDATE

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	249
12 month price target (INR)	302
Market cap (INR bn/USD bn)	99/1.3
Free float/Foreign ownership (%)	45.8/5.1
What's Changed	
Target Price	↓
Rating/Risk Rating	—

QUICK TAKE

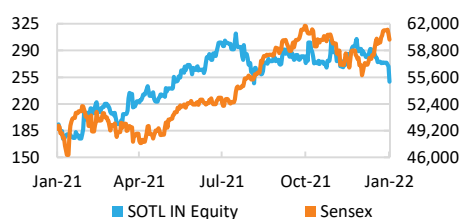
	Above	In line	Below
Profit			●
Margins			●
Revenue Growth			●
Overall			●

FINANCIALS

(INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Revenue	48,252	59,084	71,997	84,658
EBITDA	8,107	7,218	12,960	15,239
Adjusted profit	2,712	1,642	6,144	7,976
Diluted EPS (INR)	6.8	4.1	15.4	19.9
EPS growth (%)	(50.7)	(38.9)	272.7	29.3
RoAE (%)	14.6	9.3	26.8	29.6
P/E (x)	36.9	60.4	16.2	12.5
EV/EBITDA (x)	14.7	17.6	9.6	7.9
Dividend yield (%)	1.0	0.8	2.2	2.8

PRICE PERFORMANCE



Explore:



Financial model



Podcast



Corporate access



Video

Execution challenges mar quarter

Sterlite Technologies (Sterlite) reported weak Q3FY22 results due to execution challenges in the UK services business and a one-off provision in domestic services. Order book is strong, but a conducive external environment is necessary for its translation to revenue.

We believe the products business will continue to see strong traction considering rising demand for digital connectivity. The company is also seeing good adoption of optical interconnect products. However, considering the execution challenges in the services business, we are slashing FY23 earnings estimate by 21% and cutting the target multiple from 20x to 18x. Retain 'BUY' with a revised TP of INR302 (INR386 earlier).

Weak results; strong order book drives confidence

Sterlite's revenues declined 10.1% QoQ, well below Street's estimate of 4.2% growth. There was an overall provision impact of INR0.63bn on revenue and INR1.8bn on other costs (total impact of INR2bn on profitability). Apart from the provisions, margins were impacted by a change in system integration project mix and additional investment in growth areas. EBITDA margin slid by 2,110bp QoQ to -3.7%, again well below Street's estimate of 16.4% (12% on like-to-like basis). Order book expanded again, to INR117bn, from INR115bn in Q2FY22, 52% of which is executable FY24 and beyond. In terms of revenue contribution, telcos contributed to 74% in 9MFY22 compared with 64% in 9MFY21. By geography, contributions from the US and EMEA increased substantially YoY.

Some volatility expected; overall demand story intact

While the overall demand story is intact, considering that the company is still ramping up project execution capabilities and the inherent lumpiness in the business, profitability might be a volatile affair for the company. This coupled with customer-specific issues, like the one in the current quarter, might further affect quarterly growth. While we do expect profitability to stabilize in the long run, such bouts of volatility cannot be ruled out in this kind of business.

Outlook and valuation: Blip in growth; retain 'BUY'

We are reducing FY22/FY23 EPS estimate by 63%/21% to factor in execution challenges and heightened investments. The stock is trading at an attractive 16.2x FY23E EPS. Maintain 'BUY/SO' with a revised TP of INR302 (from INR386) while reducing our target to 18x and rolling forward the valuation to Q1FY24E.

Financials

Year to March	Q3FY22	Q3FY21	% Change	Q2FY22	% Change
Net Revenue	13,555	13,144	3.1	15,075	(10.1)
EBITDA	(507)	2,301	(122.0)	2,628	(119.3)
Adjusted Profit	(1,371)	865	(258.4)	1,057	(229.7)
Diluted EPS (INR)	(3.5)	2.2	(264.3)	2.5	(240.1)

Financial Statements

Income Statement (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Total operating income	48,252	59,084	71,997	84,658
Gross profit	24,303	30,188	37,439	44,022
Employee costs	6,474	8,942	10,080	11,852
Other expenses	9,722	14,027	14,399	16,932
EBITDA	8,107	7,218	12,960	15,239
Depreciation	2,853	3,089	2,845	2,886
Less: Interest expense	2,030	2,095	2,002	1,762
Add: Other income	430	334	216	254
Profit before tax	3,909	2,369	8,328	10,845
Prov for tax	1,113	682	2,249	2,928
Less: Other adjustment	(36)	75	0	0
Reported profit	2,861	1,897	6,144	7,976
Less: Excp.item (net)	(149)	(256)	0	0
Adjusted profit	2,712	1,642	6,144	7,976
Diluted shares o/s	401	398	399	401
Adjusted diluted EPS	7	4	15	20
DPS (INR)	2.4	1.9	5.4	7.0
Tax rate (%)	28.5	28.8	27.0	27.0

Important Ratios (%)

Year to March	FY21A	FY22E	FY23E	FY24E
Direct cost as % of rev	49.6	48.9	48.0	48.0
Staff cost as % of rev	13.4	15.1	14.0	14.0
Other exp as % of rev	20.1	23.7	20.0	20.0
EBITDA margin (%)	16.8	12.2	18.0	18.0
Net profit margin (%)	5.6	2.8	8.5	9.4
Revenue Growth (%)	(6.4)	22.4	21.9	17.6
EBITDA growth (% YoY)	(24.2)	(11.0)	79.5	17.6
Adj. profit growth (%)	(51.5)	(39.5)	274.2	29.8

Assumptions (%)

Year to March	FY21A	FY22E	FY23E	FY24E
GDP (YoY %)	(8.0)	9.5	7.0	6.5
Repo rate (%)	4.0	4.0	4.3	5.3
USD/INR (average)	75.0	74.5	76.0	75.0
Tax rate	28.5	28.8	27.0	27.0
Capex (INR mn)	4,571.1	4,611.3	3,500.0	3,500.0
Inventory days	82.2	85.3	84.1	85.3
Receivable days	114.0	90.2	82.8	85.0
Payable days	153.4	109.1	78.8	79.9
Cash conversion cycle	42.8	66.4	88.1	90.4

Valuation Metrics

Year to March	FY21A	FY22E	FY23E	FY24E
Diluted P/E (x)	36.9	60.4	16.2	12.5
Price/BV (x)	5.0	4.7	4.0	3.4
EV/EBITDA (x)	14.7	17.6	9.6	7.9
Dividend yield (%)	1.0	0.8	2.2	2.8

Source: Company and Edelweiss estimates

Balance Sheet (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Share capital	793	796	799	802
Reserves	19,081	20,327	23,883	28,499
Shareholders funds	19,874	21,122	24,681	29,301
Minority interest	981	902	864	830
Borrowings	24,897	31,111	29,701	29,055
Trade payables	19,437	11,583	13,908	16,481
Other liabs & prov	13,245	15,293	17,750	20,698
Total liabilities	80,726	82,515	89,654	99,395
Net block	27,828	29,742	30,749	31,680
Intangible assets	3,912	3,521	3,169	2,852
Capital WIP	2,272	2,272	2,272	2,272
Total fixed assets	34,012	35,535	36,189	36,804
Non current inv	1,223	1,223	1,223	1,223
Cash/cash equivalent	4,293	2,963	4,267	7,761
Sundry debtors	14,514	14,703	17,956	21,460
Loans & advances	172	172	172	172
Other assets	13,298	14,705	16,632	18,762
Total assets	80,726	82,515	89,654	99,395

Free Cash Flow (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Reported profit	2,861	1,897	6,144	7,976
Add: Depreciation	2,853	3,089	2,845	2,886
Interest (net of tax)	1,452	1,491	1,461	1,286
Others	838	467	476	417
Less: Changes in WC	(1,619)	(7,189)	(154)	169
Operating cash flow	6,385	(245)	10,773	12,734
Less: Capex	(4,571)	(4,611)	(3,500)	(3,500)
Free cash flow	1,814	(4,856)	7,273	9,234

Key Ratios

Year to March	FY21A	FY22E	FY23E	FY24E
RoE (%)	14.6	9.3	26.8	29.6
RoCE (%)	12.9	9.0	19.1	22.0
Inventory days	82	85	84	85
Receivable days	114	90	83	85
Payable days	257	196	135	136
Working cap (% sales)	(8.0)	6.0	5.5	4.8
Gross debt/equity (x)	1.2	1.4	1.2	1.0
Net debt/equity (x)	1.0	1.3	1.0	0.7
Interest coverage (x)	2.6	2.0	5.1	7.0

Valuation Drivers

Year to March	FY21A	FY22E	FY23E	FY24E
EPS growth (%)	(50.7)	(38.9)	272.7	29.3
RoE (%)	14.6	9.3	26.8	29.6
EBITDA growth (%)	(24.2)	(11.0)	79.5	17.6
Payout ratio (%)	33.7	39.7	35.0	35.0

Exhibit 1: Quarterly financial snapshot (INR mn)

Year to December	Q3FY22	Q2FY22	QoQ	Q3FY21	YoY	FY22E	FY23E	FY24E
Total revenues	13,555	15,075	(10.1)	13,144	3.1	59,084	71,997	84,658
Direct costs	7,207	7,284	(1.1)	6,630	8.7	28,896	34,559	40,636
Gross profit	6,348	7,791	(18.5)	6,515	(2.6)	30,188	37,439	44,022
SG&A expenses	6,855	5,163	32.8	4,214	62.7	22,969	24,479	28,784
EBITDA	-507	2,628	(119.3)	2,301	(122.0)	7,218	12,960	15,239
Depreciation	901	745	20.9	682	32.1	3,089	2,845	2,886
EBIT	-1,408	1,884	(174.7)	1,619	(187.0)	4,129	10,114	12,353
Less: Interest expense	661	569	16.2	498	32.7	2,095	2,002	1,762
Other Income	154	62	147	77	102	334	216	254
Add: Share of net profits/(loss) from JV	-2	-10	(77.7)	-5	(53.1)	75	0	0
Less: Minority Interest	-32	-1	4,428.6	-6	456.1	-136	-65	-59
PBT	-1,914	1,377	(239.0)	1,197	(259.9)	2,369	8,328	10,845
Provision for taxation	-481	358	(234.4)	333	(244.7)	682	2,249	2,928
Reported profit	-1,433	1,019	(240.6)	865	(265.7)	1,687	6,080	7,917
Adjusted profit	-1,371	1,057	(229.7)	865	(258.4)	2,078	6,144	7,976
Diluted EPS (INR)	-3.5	2.6	(230.7)	2.2	(260.5)	4.8	15.4	19.9
as % of net revenues								
Direct costs	53.2	48.3		50.4		48.9	48.0	48.0
Gross margin	46.8	51.7		49.6		51.1	52.0	52.0
SG&A costs	50.6	34.2		32.1		38.9	34.0	34.0
EBITDA margin	(3.7)	17.4		17.5		12.2	18.0	18.0
EBIT margin	(10.4)	12.5		12.3		7.0	14.0	14.6
Adjusted profit	(10.6)	6.8		6.6		2.9	8.4	9.4
Tax rate	25.1	26.0		27.8		28.8	27.0	27.0

Source: Company, Edelweiss Research

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 50mn and 33mn FKM, respectively. It has manufacturing plants in Aurangabad, Silvassa, 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). The company has seen its TAM grow 5x over the last five years.

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

Downturn in global economy

Alternate connectivity technology

Telecom capex dip

Currency risk

Additional Data

Management

MD	Ankit Agarwal
CFO	Mihir Modi
Chairman	Anil Agarwal
Vice Chairman	Pravin Agarwal
Auditor	E&Y

Holdings – Top 10*

	% Holding	% Holding
Twin Star int.	52.68	
Nippon Fund	3.29	
DSP AMC	2.56	
Vedanta	1.20	
Ankit Agarwal	0.21	

*Latest public data

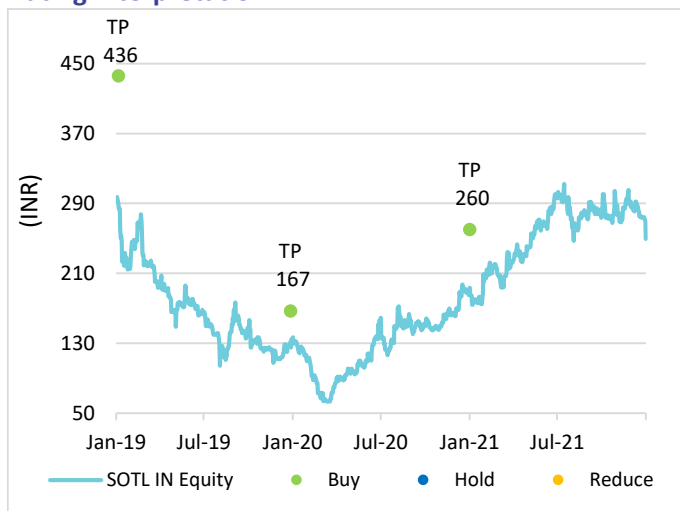
Recent Company Research

Date	Title	Price	Reco
26-Nov-21	Growth prospects lighting up; <i>Company Update</i>	276	Buy
21-Oct-21	Strong demand driving growth; <i>Result Update</i>	276	Buy
08-Oct-21	New MD at the helm; <i>Edel Flash</i>	303	Buy

Recent Sector Research

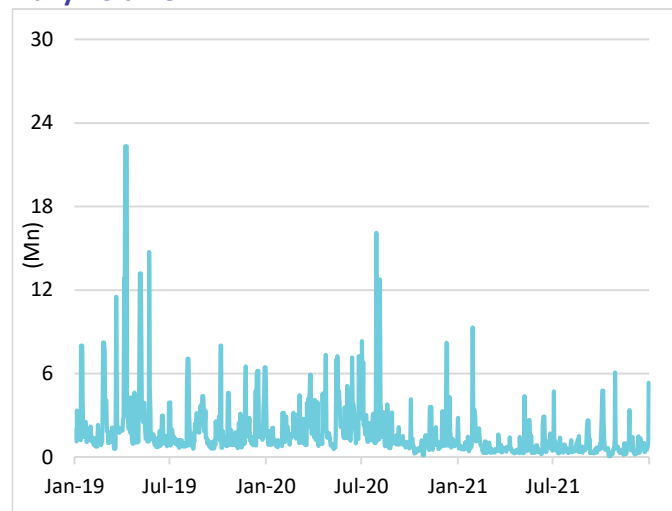
Date	Name of Co./Sector	Title
11-Jan-22	Vodafone Idea	Government on the line; <i>Edel Flash</i>
22-Nov-21	Telecom	Finally tariff hike in key segments; <i>Sector Update</i>
15-Nov-21	Vodafone Idea	Good results; tariff hike awaited; <i>Result Update</i>

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	189	53	18	261
	>50bn	>10bn and <50bn	<10bn	Total
Market Cap (INR)	236	38	4	278

*1 stocks under review

Rating Rationale

Rating	Expected absolute returns over 12 months
Buy:	>15%
Hold:	>15% and <-5%
Reduce:	<-5%

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