

STERLITE TECHNOLOGIES LIMITED

BSE: 532374 | Sector: Telecom Products

Position: **Close**

CMP : Rs. 78

Target Price: Rs. 135 (In next 12 mths)

BUSINESS BACKGROUND

Sterlite Technologies Limited designs, builds and manages smarter networks. STL is a pure play telecom focussed business that develops & delivers optical communication products, network & system integration services and software solutions for telecoms globally. STL is among the leaders in all its business areas and has operations on a global scale with manufacturing presence in India, China and Brazil.

STL is India's only fully integrated provider of optical fibre preforms, optical fibres and cables. With a strong portfolio of over 125 patents and projects undertaken by the company include intrusion-proof secure network for the Armed Forces, rural broadband for BharatNet, Smart Cities' development, and establishing high-speed Fibre-to-the- Home (FTTH) networks.

INVESTMENT HIGHLIGHTS

Strong H1FY17 Performance –

STL reported revenues for H1FY17 were at Rs 1154 crs, against Rs 1065 crs in H1FY16, and EBITDA was placed at Rs 215 crs, as compared to Rs 204 crs in Q1FY16, and Profit after Tax (PAT) registered a strong growth with PAT for H1FY17 placed at Rs 97 crs, from Rs 74.52 crs in H1 last year.

For FY16 the company has recorded a topline of Rs 2160 crs from Rs 1619 crs, a EBIDTA of Rs 452 crs from Rs 345 crs while PAT is placed at Rs 151.1 crs from Rs 119 crs last year. STL paid a dividend of 50% for FY16.

STL's Growth Drivers look very strong –

STL's growth drivers are 1. Mobile data broadband infrastructure requirements for 4G/LTE by Telcos 2. Smart Cities requiring basic broadband infrastructure for smart applications 3. Rural broadband initiatives like BharatNet 4. Broadband infrastructure for Defence and other utilities and 5. Global Data Growth, served through presence in China, Brazil and Europe.

STL is positioned uniquely to play an integral role in designing, building and managing the optical-fibre based broadband infrastructure.

Sterlite Tech's offerings include High-quality Optical Communication Products through India's only fully integrated

Optical Fibre facility – System Integration offering end-to-end services – from infrastructure to applications – for Smart Cities, Defence and other Utility networks.

Software services to manage billing and operations support for broadband networks

KEY DATA

FACE VALUE	Rs	2.00
DIVID YIELD %		1.26
52 WK HI/LOW		95/59
NSE CODE		STRTECH
BSE CODE		STRTECH
MARKET CAP	RS	3688 CRS

SHAREHOLDING PATTERN

PROMOTERS	-	55%
BANKS, MFs & DII	-	12%
FII	-	4%
PUBLIC	-	29%

KEY FUNDAMENTALS

YE	FY16	FY17	FY18
Rev Gr%	33	24	25
EBIDTA Gr%	31	22	25
PAT Gr%	26	27	44
EPS Gr%	27	29	43
Roe %	24	25	29
Roce %	16	17	20
EPS (Rs)	3.8	4.9	7.0
P/E (x)		16	11

STL is a pure play on data consumption growth –

STL has a dominant leadership position in the optic fibre market (India-40%, global- 6%). We expect that the Indian fiber market will rise significantly due to increased rollout by private telco operators (due to rising data demand and fast paced fiber roll out by R-Jio), Government initiatives like Bharat Net and smart city projects by various state governments

Globally also demand is expected to remain strong, driven by continued spends by China. The Chinese government is targeting high broadband penetration. It has a planned CAPEX of \$112bn for the next two years. This would boost fiber demand in China. SOTL is set to benefit, as exports to China contribute 25% to its sales volumes

Domestic factors also positive and will drive optic fiber demand in India

Key drivers for fiber demand in India are 1) Big projects like Bharat Net, 2) New 4G network roll out by Reliance Jio, 3) aggressive network expansion by other telco operators and 3) ongoing NFS project (Network for Spectrum from Government of India). Hence increasing data demand will drive network expansion and up gradation by telecom service providers, which will in turn, benefit optic fiber companies.

Globally also Fiber market seeing high double-digit growth; But, change in landscape favors India

Global data consumption is still in explosive stage. We see strong growth coming from 3 areas like huge traffic in mobile Internet from the fast growing penetration of smartphones; deployment of FTTH and overall upgrades in broadband speed and global Internet data centers (IDCs) need fast connections between themselves & metro networks and internal transmission. India is gaining market share, and now accounts for around 5% of global demand for fiber

Bharat Net project can be the game changer for Indian optic fiber demand –

The broadband infrastructure is the backbone of the Government's 100 Smart Cities, BharatNet and Digital India missions. The thrust of the government towards the successful completion of these projects has opened up various opportunities for STL. BharatNet project is a very ambitious project with a vision to create a national broadband network. It has moved into a different format in the last couple of years, and brings last-mile connectivity between gram panchayat and block levels. The government has budgeted Rs 700 bn for the implementation of this project.

The government's plans to implement Bharat Net envisages laying of 39m fkm of optic fiber cables under the 'Digital India' program, to connect 250lac village blocks with broadband connectivity.

SOTL amongst few global players to manufacture optic fibre (only one in India) –

STL's telecom business involves the manufacturing of optic fibres and cables. It has capacity for 22m km, which includes 15m km for cables. It is the largest manufacturer in the country. It also undertakes government projects to lay down broadband networks in cities and rural areas. Although its product business forms the bulk of its revenue, its solutions business has a strong backlog for execution over the next two years.

Globally, there are only 12 manufacturers, who have the ability to manufacture optic fiber out of basic raw material silica. Among preform, fiber and cable, the first makes the most profit, while the latter two are commodities. There are three major products in the fiber value chain which include

Preform: The first step in making optical fiber is to make solid glass rods—fiber preform— using ultra-pure chemicals like SiCl₄ and GeCl₄. This is the most complicated and technologically intensive part of producing fiber.

Optical fiber: This involves the drawing process of fiber preform, which utilizes the manufacturing know-how of vendors.

Fiber cable: A cable containing one or more optical fibers is used to carry light. Each fiber is individually coated and then contained in a protective tube.

Increasing data demand to trigger continued fiber roll out by private telecom operators –

Indian optical fiber cables (OFC) market is expected to grow robustly on the back of expansion of telecom infrastructure throughout the country, increasing penetration of smartphones and growing demand for broadband services, thereby creating significant demand for OFC installations, and higher demand for internet services for HDTV, video on demand and high-speed file sharing.

Majority of incremental capex spends of telecom service providers is towards fiber network roll out and backhaul. This will continue to drive demand for STL. In FY15, there was a surge in demand for Optic Fiber Cables largely fueled by the introduction of next generation technologies and upgradation of existing 2G networks to make them 3G and 4G compatible. With rising demand for greenfield sites and more in the pipeline with operators preparing to launch 4G services, we expect this trend to continue, with steady increase in Optic Fibers Cables use over the next 2-3 years. As such in India, Optic Fibres account for not more than 20% of the telecom towers as to 50-60% in China and 80-90% in developed countries like USA and Japan.

Acquisition of Elitecore also to benefit STL going ahead –

Elitecore Technologies, a global provider of real-time monetisation, subscriber management and customer experience solution to CSPs improved its position in the niche player quadrant of 2015 Gartner Magic Quadrant (MQ) for Integrated Revenue and Customer Management (IRCM) for CSPs

STL has completed the 100% acquisition of Elitecore Technologies Private Limited, a global telecom software product company from First Carlyle Ventures Mauritius Elitecore IRCM platform supports open standards and is network agnostic, enabling operators to save on infrastructure cost resulting in reduced TCO. The modular architecture facilitates the operators to plug in new modules on demand without affecting the legacy systems, thereby seamlessly integrating with complex network architecture for new roll outs. Elitecore supports various Industry-accepted delivery models including Built-Operate-transfer (BOT), Managed services, Operations and maintenance and cloud-based hosted model.

Recent Business Developments –

STL has advanced its optical fibre manufacturing capacity expansion target of 30 million fkm to FY18. Bulk of this expansion will be accomplished through de-bottlenecking with minimal capex.

STL has launched its future-ready Smarter Network that assures reliability, longevity, scalability and traceability with lower Total Cost of Ownership and lowest impact on environment.

The current phases of Smart City Projects in Gandhinagar and Jaipur are close to completion.

STL has been appointed on the Board of Directors of FTTH Council APAC, where it will play a key role to drive standardisation in Smart City development.

Order book stands at Rs 2,100 crs.

Solid financial performance – Revenue growth and margin expansion to continue –

We estimate STL's earnings to witness a CAGR of 30-33% over FY16-18E. This will be driven by steady revenue growth (18-20% CAGR over FY16-18E) and a steady EBITDA margin expansion over the same period.

We expect a significant improvement in both ROCE and ROE over the next 2 years as we expect the domestic market to grow at a healthy clip where there is good scope for margin improvement and revenue growth.

Business Outlook & Stock Valuation –

On a rough cut basis, in FY17, Topline will see a steady rise wherein Topline is expected to touch Rs 2690 crs.

On the bottomline level we expect the company to record a PAT of Rs 192 crs in FY17E. Thus on a conservative basis, STL should record a EPS of Rs around Rs 5 for FY17E. For FY18E our expectation is that earnings traction for STL would continue to be strong wherein we expect a EPS of Rs 7 respectively.

The company is moving up the value chain by providing: 1) network integration services and, 2) software products through acquisition of Elitecore. STL aspires to generate telecom revenue of USD 1bn FY20 with 50% from products and 50% from services/solutions.

Also the debt-laden power business of STL was spun-off in June 2016. The existing listed entity has telecom business operations. This led to a significant improvement in SOTL's cash flow visibility, balance sheet, and return ratios. For STL, post the power spin-off the D/E is down to 1.1x from 4.6x secondly EBITDA margins improved to 18.8% from 15% while ROE improved to 29.5% and ROCE improved to 23% from 4%. The Power business had been a drag on STL's performance as it was sucking the telcom FCF to meet its CF shortfalls.

SOTL is now a pure play on domestic/global data consumption growth A dominant leadership position in the optic fibre market(India-40%, global-7%) gives it strong visibility for revenue/earnings

Hence looking at STL's steady financial track record, strong product domain and dominant market share and strong promoters we expect the stock to get re rated in future.

Hence we believe that the STL stock should be purchased at the current price for a price target of around Rs 126 over the next 12 months.

FINANCIALS

For the Year Ended March RsCrs	FY15A	FY16A	FY17E	FY18E
Net Sales	1619.1	2160.81	2690.1	3354.2
EBIDTA	345.0	452.0	550.0	690.0
EBIDTA %	21.31	20.92	20.45	20.57
Interest	75.0	113.3	115.1	111.1
Depreciation	96	131.0	145.0	159.0
Non Operational Other Income	0.0	12.8	14.0	15.0
Profit Before Tax	174.0	220.8	303.9	434.9
Profit After Tax	119.0	151.1	192.0	277.0
Diluted EPS (Rs)	3.0	3.8	4.9	7.0
Equity Capital	79.0	79.0	79.0	79.0
Reserves	498.0	620.0	773.0	1010.0
Borrowings	854.0	1088.0	1050.0	990.0
GrossBlock	982.0	1326.0	1450.0	1550.0
Investments	1.6	1.6	1.6	1.6

Source Company Estimates

KEY CONCERNS

Postponement in government expenditure for Bharat Net project, which is expected to boost optic fibre demand.

Pressure on global optic fibre pricing, and increased competition from Chinese companies.