

Performance remain weak, however witnessed margin improvement.

CMP: INR 150

Rating: BUY

Target Price: INR 183

Stock Info

BSE	532374
NSE	STLTECH
Bloomberg	SOTL:IN
Reuters	STTE.NS
Sector	Cables
Face Value (INR)	2
Equity Capital (INR mn)	800
Mkt Cap (INR mn)	60,000
52w H/L (INR)	193 / 142
Avg Yearly Volume (in 000')	1,222

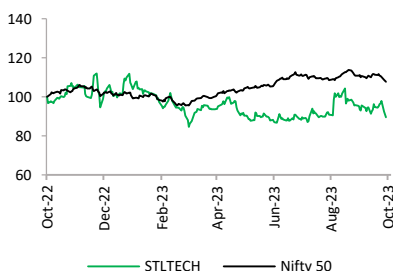
Shareholding Pattern %

(As on Sep, 2023)

Promoters	53.99
Public & Others	46.01

Stock Performance (%)	3m	6m	12m
STLTECH	-1.3	-4.2	-10.4
NIFTY	-0.7	7.6	7.8

STLTECH vs Nifty



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Sterlite Technologies Ltd reported numbers, Q2FY24 revenue de-grew by 15.5% YoY (-1.8% QoQ) to INR 14,940mn, below our estimates of INR 18,984mn due to muted performance in Optical networking and global services business. Gross Profit stood at INR 8,150mn (-9.8% YoY/-11.4% QoQ); below our estimates of INR 9,720mn. Gross margins improved by 342 bps YoY (down by 590bps QoQ) to 54.6% vs 51.1% in Q2FY23. The margin improvement was backed by a decrease in raw material cost in terms of sales. The raw material cost in terms of sales stood at 47.6% vs 48.9% in Q2FY23. EBITDA stood at INR 2,130mn (+23.1% YoY/-0.5% QoQ), below our estimates of INR 2,411mn. EBITDA margin improved by 447 bps YoY (up by 20 bps QoQ) to 14.3% vs 9.8% in Q2FY23. EBITDA margin improvement backed by lower RM costs and other expenses. PAT stood at INR 260mn (-35% YoY/-40.9% QoQ), below our estimates of INR 691mn. PAT margin contracted by 52 bps YoY (down by 115 bps) to 1.7% vs 2.3% in Q2FY23.

Key Highlights

Optical networking business remains under pressure: Optical networking business revenue stood at INR 10,840mn (-17.4% YoY/-2.5% QoQ); due to lower volume on a YoY basis and partially offset by improvement in realizations. The volume de-growth is majorly attributed to international markets, especially North America. The company was able to increase the prices to customers. EBIT Stood at INR 2,110mn (-19.5% YoY/-14.2% QoQ). EBIT margin contracted by 49 bps YoY (down by 266 bps QoQ) to 19.5% vs 20% in Q2FY23. The increase in optical interconnect attach rate (13% in Q2FY24) would improve the margins further. The company is working with consultants for cost reduction initiatives and cost reduction is expected going forward. Inventory correction will continue in a few more months and is expected to liquidate in Q1FY25E will improve the business going forward.

Global services business is expected to de-merger by Q1FY25E: Global service business revenue stood at INR 3,750mn (-19% YoY/+6.2% QoQ); EBIT Stood at INR 210mn (-43.2% YoY/-25% QoQ). EBIT margin contracted by 239 bps YoY (down by 233 bps QoQ) to 5.6% vs 8% in Q2FY23. In the Global services business, the company is very selective on order intake and execution. The global services business is expected to de-merger by Q1FY25E. The company is evaluating the UK services business and looking to scale up going forward.

Digital and Technology solutions breakeven is expected Q4FY24E: Digital and technology solutions revenue stood at INR 780mn (+95% YoY/+25.8% QoQ); EBIT Stood at INR -170mn vs INR -1,020mn in Q2FY23. STL digital order book stood at INR 7.8bn. The orders are executable in 3-5 years' time. Digital and technology solutions EBITDA breakeven is expected in Q4FY24E. The investment is expected around INR 1.2bn towards digital business.

Strong order book leads to better business visibility: The Order book stood at INR 105.16bn (-10.1% YoY/-3.9% QoQ) in Q2FY24. Around INR 18.18bn of the order book is expected to be executed in H2FY24 and the remaining INR order book of INR 86.98bn is expected to be executed post FY25E onwards.

Outlook & Valuation: Sterlite Technologies has a strong order book (~1.5x of FY23 TTM revenue) and the BEAD program would lead to further opportunities. The optical networking business is expected to grow, post inventory liquidation in North American markets, and continue to maintain ~20% margins, and increasing the interconnect attach rate would improve the margins further. The selective order intake and execution will improve the global service business and the digital business is expected to be breakeven in Q4FY24E. We believe telecom capex for 5G and the upcoming 6G would provide business visibility. We have a "BUY" rating at a Target Price of INR 183 per share based on DCF; an upside of 21.8%.

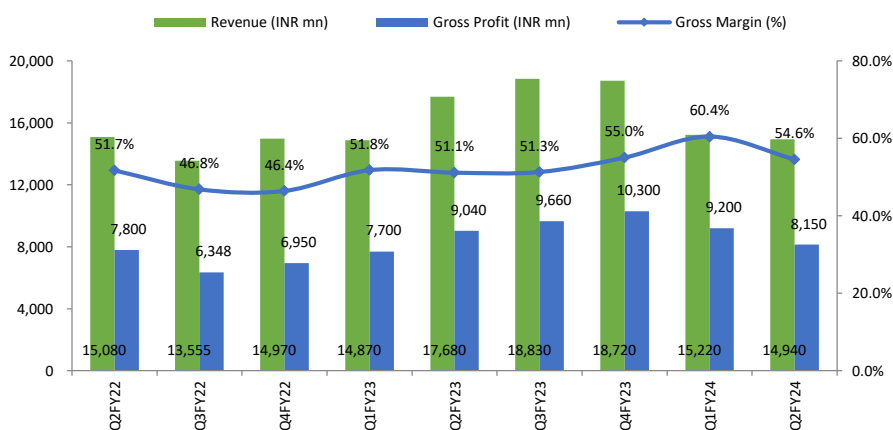
Q2FY24 Results

Income statement summary

Particular (INR mn)	Q2FY23	Q1FY24	Q2FY24	YoY (%)	QoQ (%)
Revenue	17,680	15,220	14,940	-15.5%	-1.8%
Net Raw Materials	8,640	6,020	6,790	-21.4%	12.8%
Employee Cost	2,920	2,530	2,430	-16.8%	-4.0%
Other Expenses	4,390	4,530	3,590	-18.2%	-20.8%
EBITDA	1,730	2,140	2,130	23.1%	-0.5%
EBITDA Margin (%)	9.8%	14.1%	14.3%	+447 bps	+20 bps
Depreciation	820	810	850		
Interest expense	780	920	950		
Other income	290.0	210.0	30.0		
Share of profits associate & JV	20	10	20		
Profit before tax	440	630	380		
Taxes	40	190	120		
PAT	400	440	260	-35.0%	-40.9%
PAT Margin (%)	2.3%	2.9%	1.7%	-52 bps	-115 bps
EPS (INR)	1.0	1.1	0.7		

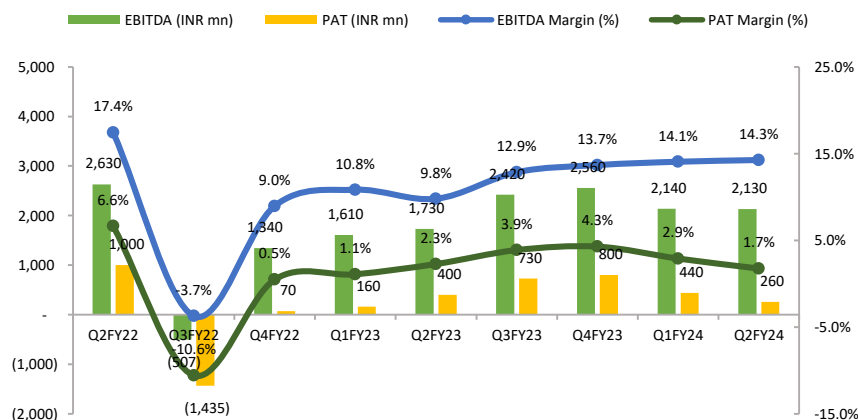
Source: Company Reports, Aриhant Capital Research

Exhibit 1: Gross margins improved by 342 bps YoY (-590 bps QoQ) to 54.6% in Q2FY24 due to lower RM costs.



Source: Company Reports, Aриhant Capital Research

Exhibit 2: EBITDA Margin improved by 447 bps YoY (+20 bps QoQ) to 14.3% in Q2FY24 due to reduction RM and other expenses.



Source: Company Reports, Aриhant Capital Research

Q2FY24 Concall Highlights

Revenue and Margins

- Revenue is expected to de-grow in FY24E.
- Optical margins are around 19.5% Q2FY24. The increase in optical interconnect attach rate would improve the margins further. The company is working with consultants for cost reduction initiatives and cost reduction is expected going forward.

Market share

- Global OFC-ex China market share stood at 11% in H1CY23.

Capex & Utilization

- The plant's average utilization was ~60% in H1FY24.
- Chinese plant is majorly used to send Optical Fibres to global facilities to make Optical Fibre cables.
- Around ~INR 2.5bn capex is expected in FY24E. The company has reduced capex guidance from INR 3.5bn to INR 2.5bn in FY24E.
- The major capex towards increasing capacity in the US plant is based on demand and remaining maintenance capex.
- North America is expected to grow from Q1FY25 onwards. The US factory is fully ready and able to supply the demand.

Order book

- Order book stood at INR 105.16bn (-10.1% YoY/-3.9% QoQ) in Q2FY24. Around INR 18.18bn of the order book is expected to be executed in H2FY24 and the remaining INR order book of INR 86.98bn is expected to be executed post-FY25 onwards.

Digital business

- STL digital order book stood at INR 7.8bn. The orders are executable in 3-5 years' time.
- The company has strategic partnerships with SAP & Google and has more than 43 active technology partners.
- Digital and technology solutions EBITDA breakeven is expected in Q4FY24. The investment is expected around INR 1.2bn towards digital business.

Optical Networking business

- Optical networking business revenue stood at INR 10,840mn (-17.4% YoY/-2.5% QoQ); due to lower volume on a YoY basis and partially offset by improvement in realizations. The company was able to increase the prices to customers.
- The volume de-growth is majorly attributed to international markets, especially North America.
- Around 90% of sales come from India, Europe, and the Americas.

Q2FY24 Concall Highlights**Services business**

- In the Global services business, the company is very selective on order intake and execution. The global services business is expected to de-merger by Q1FY25E.
- The company is evaluating the UK services business and looking to scale up going forward.
- Global services business debt is around INR 5.5bn to INR 6bn.

Bharat Net

- Bharat Net project is estimated at around INR 1.4 lakh cr. The project mix is ~50% Capex and ~50% Opex. The project execution period is around 3-3.5 years and maintenance for 7 years.

Inventory

- Inventory correction will continue in a few more months and is expected to liquidate in Q1FY25E.

Debt

- The company has reduced by INR 1.11bn in H1FY24 (FY23-H1FY24). The company is focused on reducing the debt from INR 2bn to INR 2.5bn in FY24E.

Attach rate

- The interconnect attach rate stood at 13% in Q2FY24. The company has witnessed some improvement in Europe markets and focused on North America. The approval cycle is longer for large telcos for interconnects.

Fundraising

- The company got approval for fundraising up to INR 10bn and the decision is under evaluation.

Other highlights

- The working capital days are around 65-75 days.
- Optical fibre working capital is around INR 7bn
- Around 20% of the fund is expected to be released in early FY24E and ~80% of the fund is expected to be released in early FY25E for the BEAD program.

Outlook & Valuation

Sterlite Technologies has a strong order book (~1.5x of FY23 TTM revenue) and the BEAD program would lead to further opportunities. The optical networking business is expected to grow, post inventory liquidation in North American markets, and continue to maintain ~20% margins, and increasing the interconnect attach rate would improve the margins further. The selective order intake and execution will improve the global service business and the digital business is expected to be breakeven in Q4FY24E. We believe telecom capex for 5G and the upcoming 6G would provide business visibility. We have a "BUY" rating at a Target Price of INR 183 per share based on DCF; an upside of 21.8%.

DCF Valuation

Valuation Assumptions

g (World Economic Growth)	3%
Rf	7%
Rm	13%
Beta	1.2
CMP	150

Valuation Data

Total Debt (long term borrowings) (2023)	16,809
Cash & Cash Equivalents (2023)	5,296
Number of Diluted Shares (2023)	400
Tax Rate (2024)	27%
Interest Expense Rate (2024)	10%
MV of Equity	60,000
Total Debt	16,809
Total Capital	76,809

WACC

We	78.1%
Wd	21.9%
Ke	14.5%
Kd	6.9%
WACC	12.9%

FCFF & Target Price

FCFF & Target Price Particular (INR mn)	Explicit Forecast Period						Linear Decline Phase					Terminal Yr
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
EBIT * (1-Tax Rate)	4,240	5,081	6,168	6,994	7,989	9,446	10,928	12,365	13,678	14,783	15,602	16,070
Dep	3,274	3,400	3,489	3,543	3,598	3,652	4,225	4,781	5,289	5,716	6,033	6,214
Purchase of Assets	(2,845)	(2,917)	(884)	(917)	(924)	(922)	(1,067)	(1,207)	(1,335)	(1,443)	(1,523)	(1,569)
Changes in Working Capital	2,017	(1,835)	(3,345)	(4,888)	(3,846)	(4,214)	(3,825)	(4,328)	(4,787)	(5,174)	(5,461)	(5,624)
FCFF	6,686	3,729	5,428	4,733	6,816	7,961	10,262	11,612	12,844	13,882	14,650	15,090
Terminal Value												152,847
Total Cash Flow	6,686	3,729	5,428	4,733	6,816	7,961	10,262	11,612	12,844	13,882	167,498	

Enterprise Value (INR mn)	84,581
Less: Debt (INR mn)	16,809
Add: Cash (INR mn)	5,296
Equity Value (INR mn)	73,069
Equity Value per share (INR)	183

% Returns	21.8%
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Rating	BUY
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Sensitivity Analysis

		Terminal Growth (%)								
183		2.0%	2.3%	2.5%	2.8%	3.0%	3.3%	3.5%	3.8%	4.0%
WACC (%)	11.8%	198	202	207	211	216	221	226	232	237
	12.0%	191	195	199	203	208	212	217	222	228
	12.3%	185	188	192	196	200	204	209	214	219
	12.5%	179	182	185	189	193	197	201	205	210
	12.8%	173	176	179	182	186	190	194	198	202
	13.0%	167	170	173	176	179	183	187	190	194
	13.3%	162	164	167	170	173	177	180	184	187
	13.5%	157	159	162	165	167	170	174	177	181
	13.8%	152	154	157	159	162	165	168	171	174

Source: Company reports, Arihant Capital Research

Financial Statements

Income statement summary

Y/e 31 Mar (INR mn)	FY20	FY21	FY22	FY23	FY24E	FY25E
Revenue	51,544	48,252	57,543	69,250	63,239	71,538
Net Raw Materials	24,675	23,949	28,646	32,990	28,655	33,408
Employee Cost	6,298	6,474	8,707	9,120	9,426	9,729
Other Expenses	9,878	9,722	14,842	18,240	16,076	18,041
EBITDA	10,693	8,107	5,348	8,900	9,083	10,359
EBITDA Margin (%)	20.7%	16.8%	9.3%	12.9%	14.4%	14.5%
Depreciation	(2,903)	(2,853)	(3,255)	(3,090)	(3,274)	(3,400)
Interest expense	(2,121)	(2,030)	(2,414)	(3,110)	(3,728)	(3,553)
Other income	254	430	593	410	406	506
Profit before tax	5,416	3,802	482	3,150	2,487	3,912
Taxes	(1,089)	(1,113)	(147)	(840)	(717)	(1,056)
PAT	4,327	2,690	334	2,310	1,770	2,856
PAT Margin (%)	8.4%	5.6%	0.6%	3.3%	2.8%	4.0%
Other Comprehensive income	(367)	415	107	(140)	-	-
Total Comprehensive income	3,961	3,105	441	2,170	1,770	2,856
EPS (INR)	10.7	6.8	0.8	5.8	4.4	7.1

Source: Company Reports, Arianth Capital Research

Balance sheet summary

Y/e 31 Mar (INR mn)	FY20	FY21	FY22	FY23	FY24E	FY25E
Equity capital	808	793	796	800	800	800
Reserves	18,390	19,081	18,771	20,110	21,349	23,348
Net worth	19,198	19,874	19,567	20,910	22,149	24,148
Minority Interest	1,032	981	857	40	40	40
Provisions	109	110	253	660	173	196
Debt	33,033	35,279	37,857	41,030	38,430	36,370
Other non-current liabilities	1,190	1,567	1,303	980	949	1,073
Total Liabilities	54,561	57,811	59,837	63,620	61,741	61,827
Fixed assets	28,403	27,828	28,554	28,540	28,056	27,501
Capital Work In Progress	1,328	2,272	1,424	1,290	1,345	1,417
Other Intangible assets	975	991	1,866	1,670	1,670	1,670
Goodwill	1,218	2,921	2,960	2,250	2,250	2,250
Investments	1,152	1,319	1,096	1,070	949	1,073
Other non current assets	965	569	1,695	1,740	1,455	1,645
Net working capital	15,216	17,251	15,849	20,410	18,393	20,228
Inventories	4,518	6,264	9,202	8,320	7,694	8,604
Sundry debtors	15,631	14,514	17,065	18,220	17,846	19,207
Loans & Advances	366	148	45	30	253	286
Other current assets	12,230	19,240	17,151	18,870	18,019	18,815
Sundry creditors	(14,303)	(19,437)	(24,200)	(21,520)	(22,256)	(23,466)
Other current liabilities & Prov	(3,226)	(3,479)	(3,413)	(3,510)	(3,162)	(3,219)
Cash	2,445	2,484	5,296	5,070	6,043	4,255
Other Financial Assets	2,858	2,177	1,096	1,580	1,581	1,788
Total Assets	54,561	57,811	59,837	63,620	61,741	61,827

Source: Company Reports, Arianth Capital Research

Du-Pont Analysis

Y/e 31 Mar	FY20	FY21	FY22	FY23	FY24E	FY25E
Tax burden (x)	0.8	0.7	0.7	0.7	0.7	0.7
Interest burden (x)	0.7	0.7	0.2	0.5	0.4	0.6
EBIT margin (x)	0.2	0.1	0.0	0.1	0.1	0.1
Asset turnover (x)	0.8	0.7	0.7	0.9	0.8	0.9
Financial leverage (x)	3.6	3.5	3.9	4.0	3.8	3.5
RoE (%)	23.8%	13.8%	1.7%	11.4%	8.2%	12.3%

Source: Company Reports, Arianth Capital Research

Financial Statements

Cashflow summary

Y/e 31 Mar (INR mn)	FY20	FY21	FY22	FY23	FY24E	FY25E
Profit before tax	5,416	3,802	482	3,150	2,487	3,912
Depreciation	2,903	2,853	3,255	3,090	3,274	3,400
Tax paid	(1,089)	(1,113)	(147)	(840)	(717)	(1,056)
Working capital Δ	(3,539)	(2,034)	1,401	(4,561)	2,017	(1,835)
Change in Goodwill	(144)	(1,703)	(40)	710	-	-
Operating cashflow	3,547	1,805	4,951	1,550	7,061	4,421
Capital expenditure	(5,264)	(3,222)	(3,133)	(2,942)	(2,845)	(2,917)
Free cash flow	(1,718)	(1,417)	1,818	(1,392)	4,216	1,504
Equity raised	(834)	(687)	29	(990)	-	(0)
Investments	(463)	(167)	223	26	121	(124)
Others	(2,196)	1,062	(920)	(333)	285	(398)
Debt financing/disposal	6,624	2,246	2,578	3,173	(2,600)	(2,060)
Dividends paid	(1,411)	(1,378)	(794)	(794)	(531)	(857)
Other items	107	378	(121)	84	(518)	147
Net Δ in cash	109	38	2,812	(226)	973	(1,788)
Opening Cash Flow	2,337	2,445	2,484	5,296	5,070	6,043
Closing Cash Flow	2,445	2,484	5,296	5,070	6,043	4,255

Source: Company Reports, Arianth Capital Research

Ratio analysis

Y/e 31 Mar	FY20	FY21	FY22	FY23	FY24E	FY25E
Growth matrix (%)						
Revenue growth	1.3%	-6.4%	19.3%	20.3%	-8.7%	13.1%
Op profit growth	-5.1%	-24.2%	-34.0%	66.4%	2.1%	14.1%
Profitability ratios (%)						
OPM	20.7%	16.8%	9.3%	12.9%	14.4%	14.5%
Net profit margin	8.4%	5.6%	0.6%	3.3%	2.8%	4.0%
RoCE	13.4%	7.5%	3.3%	7.6%	7.2%	9.0%
RoNW	23.8%	13.8%	1.7%	11.4%	8.2%	12.3%
RoA	7.9%	4.7%	0.6%	3.6%	2.9%	4.6%
Per share ratios (INR)						
EPS	9.8	7.8	1.1	5.4	4.4	7.1
Dividend per share	3.5	3.5	2.0	2.0	1.3	2.1
Cash EPS	17.9	14.0	9.0	13.5	12.6	15.6
Book value per share	47.5	50.1	49.2	52.3	55.4	60.4
Valuation ratios (x)						
P/E	15.3	19.2	135.3	27.6	33.9	21.0
P/CEPS	8.4	10.7	16.6	11.1	11.9	9.6
P/B	3.2	3.0	3.0	2.9	2.7	2.5
EV/EBITDA	8.4	11.2	17.0	10.7	10.1	8.8
Payout (%)						
Dividend payout	32.6%	51.2%	237.5%	34.4%	30.0%	30.0%
Tax payout	20.1%	29.3%	30.6%	26.7%	28.8%	27.0%
Liquidity ratios						
Debtor days	103	114	100	93	104	95
Inventory days	77	82	99	97	102	89
Creditor days	149	153	153	138	148	136
WC Days	31	43	46	52	59	47
Leverage ratios (x)						
Interest coverage	3.7	2.6	0.9	1.9	1.6	2.0
Net debt / equity	1.6	1.7	1.7	1.7	1.5	1.3
Net debt / op. profit	2.9	4.0	6.1	4.0	3.6	3.1

Source: Company Reports, Arianth Capital Research

Story in Charts

Exhibit 3: Revenue is expected to de-grow in FY24 due to inventories in North American Markets and expected to normalize in Q1FY25E.

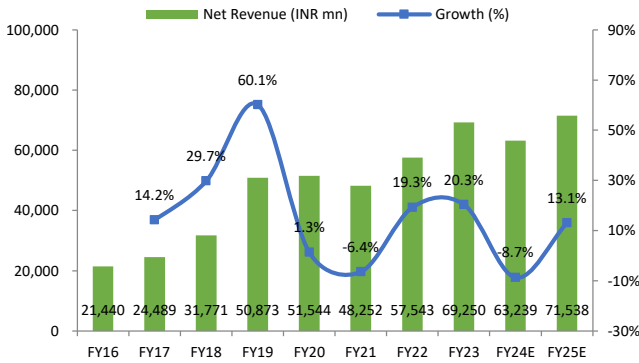


Exhibit 4: Softening of RM costs will lead to improvement in gross margins.

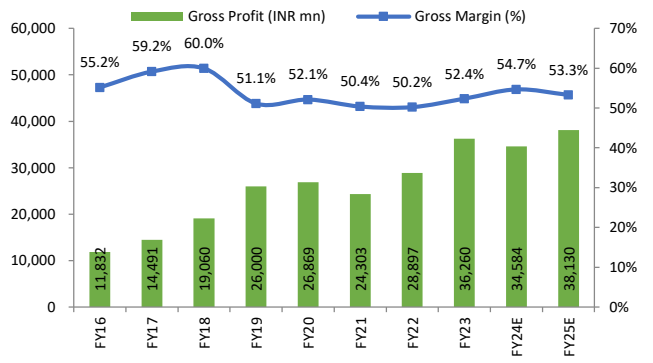


Exhibit 5: Growth in EBITDA & PAT levels

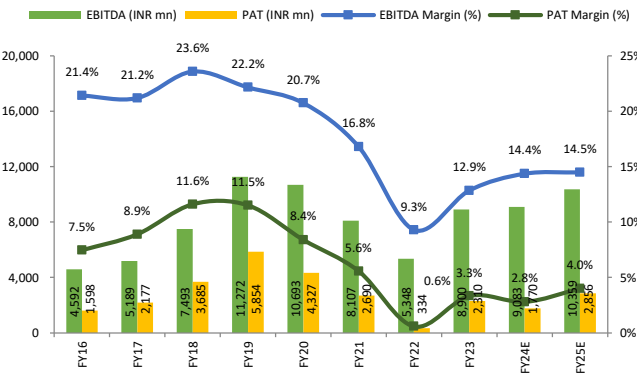


Exhibit 6: Return ratios to be improve

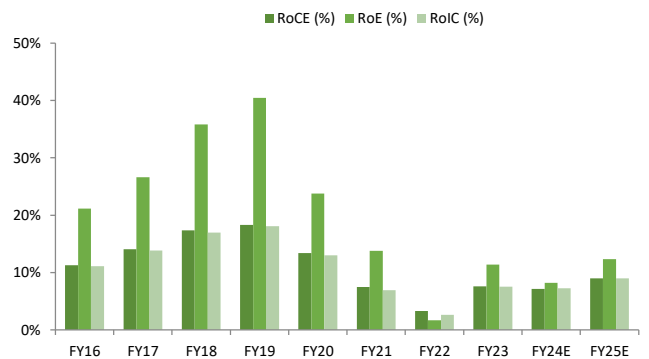


Exhibit 7: Working capital days to be improve

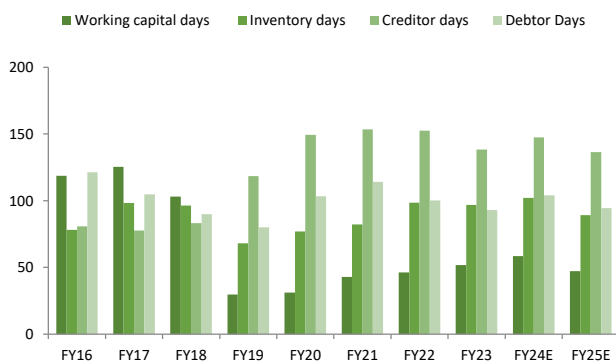
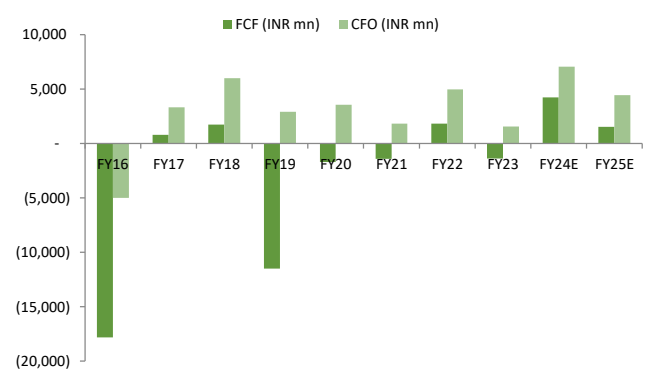


Exhibit 8: Cash flows to be improve



Source: Company reports, Arianth Capital Research

Story in Charts

Exhibit 9: Working capital in-terms of sales is expected to reduce going forward.

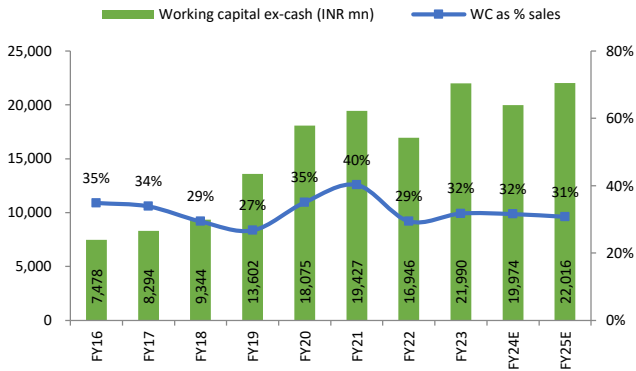


Exhibit 10: Interest cost as % of EBIT is expected to reduce going forward.

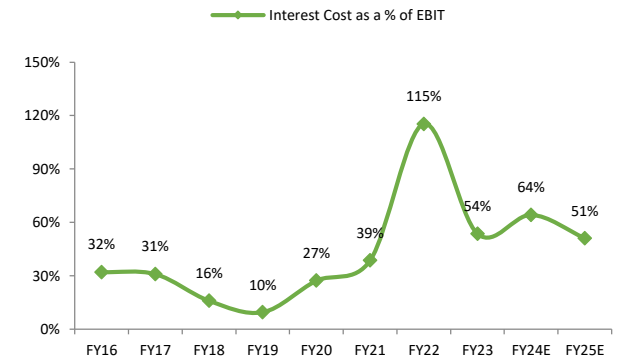


Exhibit 11: The inventory build-up in North America is expected to liquidate in Q1FY25E. Post that, Optical networking business is expected to pick-up.

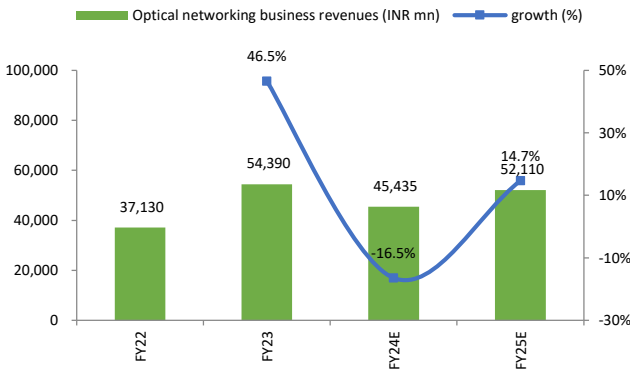


Exhibit 12: Selective order intake and execution will improve global service business going forward.

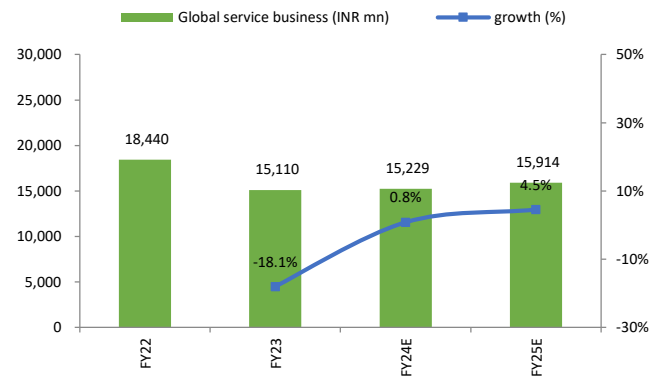


Exhibit 13: Digital and Technology solutions has strong order book of INR 7.8bn shows potential revenue visibility.

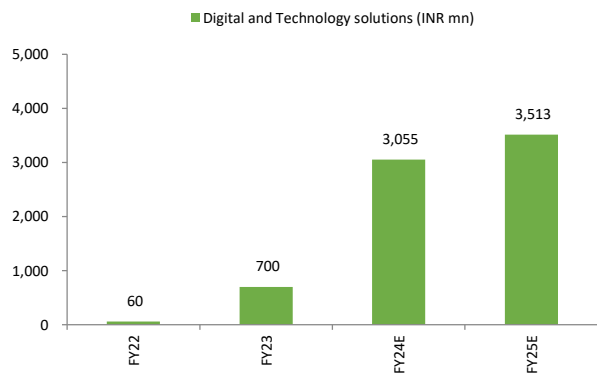
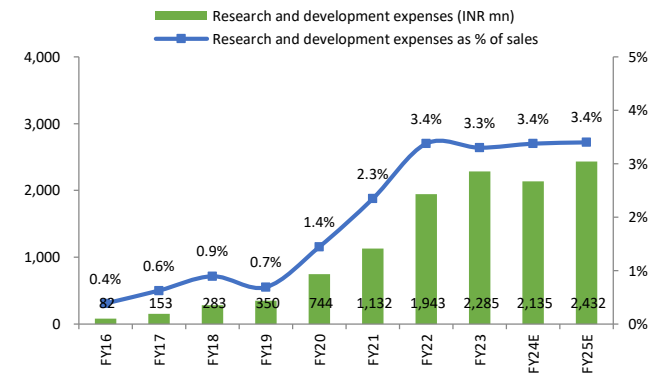


Exhibit 14: R&D expenses are expected to be 3.3%-3.4% of sales going forward.



Source: Company reports, Arianth Capital Research

Story in Charts

Exhibit 15: Sterlite Technologies is maintaining above INR 100bn order book in past few quarters.



Exhibit 16: Optical networking margins were maintained ~20% in past few quarters. Increase in interconnect attach rate would improve the margins going forward.

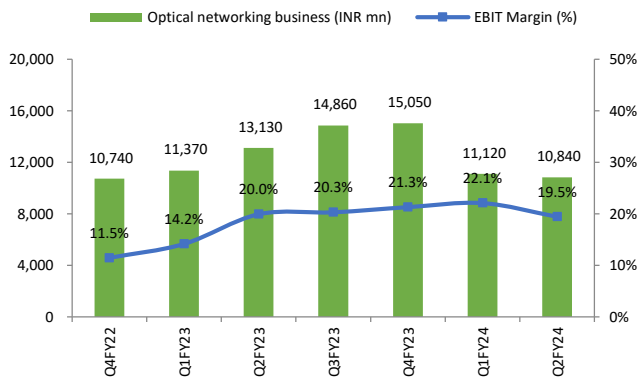


Exhibit 17: Global services margins are expected around 8% going forward.

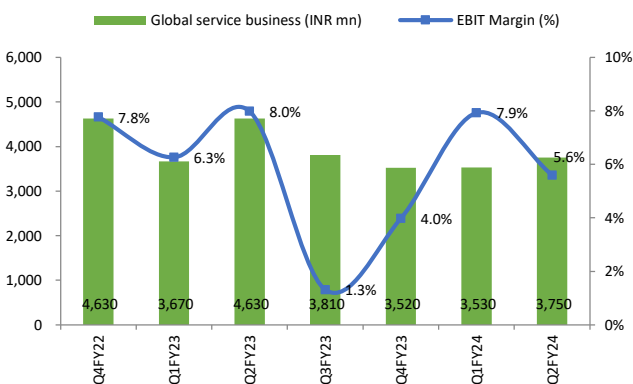


Exhibit 18: Digital and Technology services are expected to be breakeven in Q4FY24E.

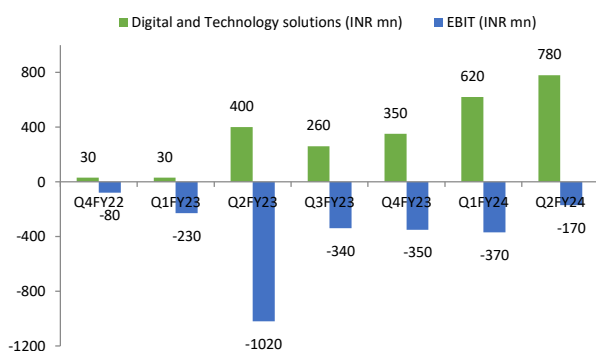


Exhibit 19: Employee cost is expected to be 13%-15% of sales going forward.

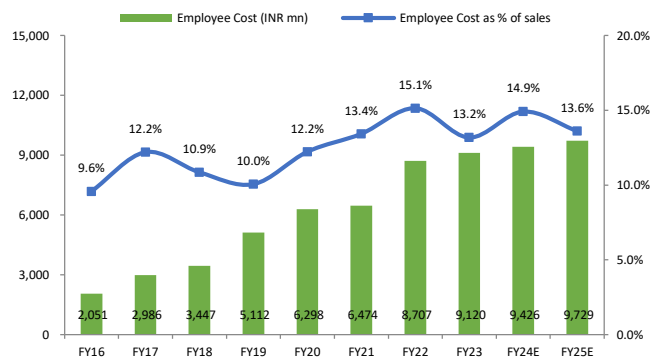
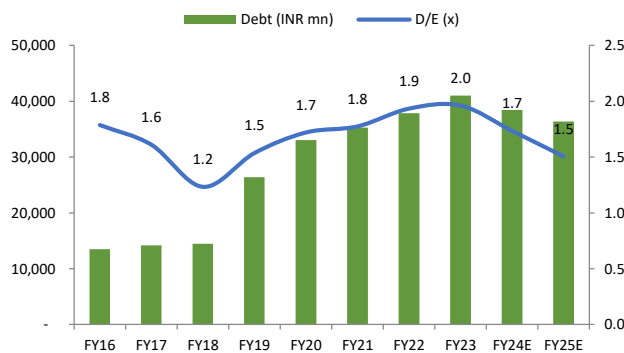


Exhibit 20: Post capex, debt is expected to reduce gradually going forward.



Source: Company reports, Arianth Capital Research

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Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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