

Re-rating warranted – BUY with target Rs365

21st October, 2009

BUY

Price	Target Price
Rs313	Rs365

Sensex	17,223
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Price Performance

(%)	1M	3M	6M	12M
Absolute	10	52	266	354
Rel. to Sensex	7	34	132	169

Source: Bloomberg

Stock Details

Sector	Cables
Reuters	STOP.BO
Bloomberg	SOTL@IN
Equity Capital (Rs mn)	323
Face Value (Rs)	5
No of shares o/s (mn)	65
52 Week H/L (Rs)	332/41
Market Cap (Rs bn/USD mn)	20/434
Daily Avg Vol (No of shares)	186988

Shareholding Pattern (%)

(30st Jun '09)

Promoters	43.6
FII/NRI	3.8
Institutions	14.1
Private Corp.	9.9
Public	28.6

Sterlite Technologies (STL) reported Q2FY10 net profit at Rs547mn, slightly ahead of our estimate of Rs526mn led by strong margin expansion and reduced interest expenses. Although revenues fell by 30% yoy to Rs4,658mn (v/s our estimate of 15% decline), EBIDTA at Rs888mn was in line with estimate, helped by very healthy conversion margin of ~Rs17000/MT in power conductors business v/s Rs13,000-14,000/MT guided by the management. The revenue decline was mainly due to lower than expected revenues from copper cables business and lower realization of conductors due to fall in aluminum prices. The EBIDTA margins for the quarter at 19.1% was highest in last 7 years led by increased optic fiber realizations (Rs430/fkm in v/s Rs400/fkm in Q1FY10) and higher conversion margin in conductors business.

Considering lower than expected revenues from copper cables business and delay in capacity expansion from Q3FY10 to Q4FY10, we have reduced our revenue estimates by 8.3% and 1.4% for FY10E and FY11E respectively. **We however increase our EBIDTA estimates by 6-8% for FY10-12E mainly due to higher conversion margin in conductors, resulting in EPS upgrade of ~11% each for FY10E/FY11E/FY12E.** Our revised EPS estimates of Rs32.7, Rs36.5 and Rs45.3 for FY10E, FY11E and FY12E respectively imply an EPS CAGR of 49% over FY09-12E. **Given the improving margin profile, strong earnings growth and improving ROCE (from 16% in FY09 to 24% in FY12E) we believe that the stock is due for further re-rating.** We retain BUY rating with revised price target of Rs365 (v/s Rs328 earlier).

Optic fiber realizations strong at Rs430/fkm

Optic fiber realization for Q2FY10 was healthy at Rs430/fkm v/s Rs400/fkm in Q1FY10 driven by strong fiber demand and favorable exchange rate. Since optic fiber realizations are at import parity, rupee appreciation negatively impacts the profitability of the company. However improved US\$ realizations (similar to Q2FY10) would be positive and could nullify the currency impact. We highlight that Sterlite management remains confident of maintaining the current level of EBIDTA margins (40% in Q2FY10) in optic fiber business despite currency impact due to room for cost reduction on new capacity expansion. We however conservatively model optic fiber realizations at Rs391 for FY11E and FY12E.

Power conductor conversion margin strong at ~Rs17000/MT

With focus on HV and EHV conductors, Sterlite's conductor' conversion margins have increased to ~Rs17,000/MT v/s guidance of Rs13,000-14,000 as maintained by the management. Considering continued high margin order in-flows from PGCIL (70% of Rs12bn order book in conductors) and focus on EHV segment, we have increased our EBIDTA/ton estimate from Rs12,750 to Rs14,000/MT, which is the primary reason for the current earnings upgrade of ~11% for FY09-12E.

Retain BUY with revised price target of Rs365

Post Q2FY10 results we have increased our earnings estimates by ~11% for FY10-12E. We increase our price target on the stock to Rs365 (from Rs328 earlier) based on 10x FY11E EPS of Rs36.5. With 49% earnings CAGR over FY09-12E, healthy balance sheet (D/E at 0.6x for FY10E) and improving return profile (ROCE improving from 16% in FY09 to 24% in FY12E), we believe that the stock is due for further re-rating.

	Net Sales	EBITDA (Core)	EBITDA (%)	PAT	ROE (%)	EV/EBITDA	P/BV	Div Yld (%)	EPS (Rs)	P/E
FY08	16,858	2,071	12.3	1,007	18.7	14.6	3.7	0.3	15.6	20.0
FY09	22,892	2,342	10.2	880	14.2	12.2	3.3	0.4	13.6	22.9
FY10E	24,216	3,847	15.9	2,319	26.4	7.3	2.5	0.6	32.7	9.6
FY11E	31,282	4,623	14.8	2,854	22.8	5.9	2.0	0.8	36.5	8.6
FY12E	37,363	5,590	15.0	3,547	22.4	4.5	1.5	0.8	45.3	6.9

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EPS estimates increased by ~11% each for FY10E, FY11E & FY12E

We have reduced our revenue estimates by 8.3% and 1.4% for FY10E and FY11E respectively on lower revenues from copper cables business and on a quarter's delay in new capacity rollout. We however increase our EBIDTA estimates in the range of 6-8% and EPS estimates by ~11% for FY09-12E respectively mainly on account of increase in power conductors conversion margin from Rs12,750/MT earlier to Rs14,000/MT. **Our revised EPS estimates at Rs32.7, Rs36.5 and Rs45.3 for FY10E, FY11E and FY12E respectively imply an EPS CAGR of 49% over FY09-12E.**

	FY09		FY10E		FY11E		FY12E		FY09-12E		
	Actual	Old	New	% change	Old	New	% change	Old	New	% change	CAGR
Revenues	22,892	26,403	24,216	-8.3%	31,737	31,282	-1.4%	36,940	37,363	1.1%	17.7%
EBIDTA	2,342	3,644	3,847	5.6%	4,332	4,623	6.7%	5,190	5,590	7.7%	33.7%
EBIDTA %	10.2	13.8	15.9	209 bps	13.7	14.8	113 bps	14.1	15.0	91 bps	
PAT	880	2,082	2,319	11.4%	2,562	2,854	11.4%	3,180	3,547	11.6%	59.1%
EPS	13.7	29.4	32.7	11.4%	32.8	36.5	11.4%	40.7	45.3	11.6%	49.1%

Key takeaways from conference call

- Optic fiber realizations at Rs430/fkm v/s Rs400/fkm in Q1FY10E mainly due to higher demand for fiber during the quarter.
- Conversion margin in power conductor business increased from ~Rs5,600/MT in Q2FY09 to Rs 17,000/MT in Q2FY10. Management attributed higher conversion margins to few high margin contracts & focus on EHV conductors and maintained its stand for sustainable conversion margins at Rs13000-14000/MT
- Order book position at the end of Q2FY10 was Rs 17.25bn v/s Rs16bn in Q1FY10. Out of this Rs 12bn was for power conductors segment in which Rs8.5bn orders are from PGCIL.
- Total international revenue was Rs 1700mn of which 17% was from European countries, indicating improving revenue traction from developed economies.
- The capacity expansion program scheduled to be on stream in early 2HFY10 would come on stream by Q4FY10 and full benefit of the same would be available for FY11E.
- Debt at the end of the quarter was ~Rs5bn which is totally towards working capital requirements. All the debt is rupee denominated and the company doesn't have any forex debt outstanding.
- As per the company management, PGCIL is expected to buy conductors worth Rs45bn in FY11E.
- Management remains confident of maintaining current level of 40% EBIDTA margins in optic fiber business despite unfavorable Re/US\$ exchange rate due to the operating efficiencies that would fall through on increased volumes.

Volume and realization	Q2FY10		Q2FY09	
	Volume	Realization (Rs)	Volume	Realization (Rs)
Optic fiber (mn fkm)	2.1	430	1.6	345
Optic fiber cables (mn fkm)	0.6	977	0.7	981
Conductor (mt)	29,000	113,579	27,000	143,681

Source: Company

Quarterly financials

	Q109	Q209	Q309	Q409	Q110	Q210	YoY
Revenues							
Power conductors	2,571.1	3,879.4	4,270.4	4,007.1	2,960.4	3,293.8	-15%
Telecom	1,470.8	2,776.2	2,149.5	1,767.9	1,401.4	1,364.5	-51%
Total operating revenues	4,041.9	6,655.6	6,419.9	5,775.0	4,361.8	4,658.3	-30%
(Inc)/ dec in stock in trade	(653.4)	463.5	570.0	169.7	(149.0)	(148.8)	-132%
Consumption of raw materials	3,555.1	4,836.3	4,259.0	3,875.0	2,772.2	3,004.0	-38%
Staff cost	92.9	134.0	128.7	135.7	140.2	139.8	4%
Other exp	661.5	737.4	756.2	829.2	821.9	775.0	5%
Total optg exp	3,656.1	6,171.2	5,713.9	5,009.6	3,585.3	3,770.0	-39%
EBIDTA	385.8	484.4	706.0	765.4	776.5	888.3	83%
Depreciation	105.0	108.0	112.7	99.5	114.1	119.0	10%
EBIT	280.8	376.4	593.3	665.9	662.4	769.3	104%
Interest	87.2	147.4	188.5	109.2	118.7	99.7	-32%
Forex (gain)/ loss	105.2	159.0	41.7	41.7	0	0.0	-100%
PBT	88.4	70.0	363.1	515.0	543.7	669.6	857%
Other income	12.9	5.1	2.3	16.5	26.1	22.6	343%
Taxes	13.1	14.3	50.9	114.6	115.0	145.5	917%
PAT	88.2	60.8	314.5	416.9	454.8	546.7	799%
EPS	1.4	0.9	4.9	6.8	7.1	8.5	799%
APAT	193.4	219.8	356.2	458.6	454.8	546.7	149%

% of sales							Chg bps
Raw material costs	71.8	79.6	75.2	70.0	60.1	61.3	(1,834)
Staff costs	2.3	2.0	2.0	2.3	3.2	3.0	99
Other expenses	16.4	11.1	11.8	14.4	18.8	16.6	556
EBIDTA	9.5	7.3	11.0	13.3	17.8	19.1	1,179
EBIT	6.9	5.7	9.2	11.5	15.2	16.5	1,086
PAT	2.2	0.9	4.9	7.2	10.4	11.7	1,082

Segmental EBIDTA	Q109	Q209	Q309	Q409	Q110	Q210	YoY
Power conductor	226.9	152.1	435.2	469.7	443.4	487.6	221%
Telecom	171.7	337.4	273.1	312.2	359.2	423.1	25%
Total	398.6	489.5	708.3	781.9	802.6	910.7	86%

Segmental EBIDTA %							Chg bps
Power conductor	8.8	3.9	10.2	11.7	15.0	14.8	1,088
Telecom	11.7	12.2	12.7	17.7	25.6	31.0	1,885
Total	9.9	7.4	11.0	13.5	18.4	19.6	1,220

Source: Company, Emkay Research

Financials

Profit & Loss

	FY08	FY09	FY10E	FY11E	FY12E
Net Sales	16,858	22,892	24,216	31,282	37,363
Growth (%)	41%	36%	6%	29%	19%
Operating expenses	2,246	2,984	20,369	26,660	31,773
% to sales	13.3%	13.0%	84.1%	85.2%	85.0%
EBITDA	2,071	2,342	3,847	4,623	5,590
% of Sales	12.3%	10.2%	15.9%	14.8%	15.0%
Depreciation	372	425	495	612	695
EBIT	1,700	1,916	3,352	4,011	4,896
% of Sales	10.1%	8.4%	13.8%	12.8%	13.1%
Interest charges	437	880	419	405	385
Other Income	41	37	60	75	75
PBT	1,304	1,073	2,992	3,682	4,585
Taxes	297	193	673	827	1,038
PAT	1,007	880	2,319	2,854	3,547
Growth (%)	105.9%	-12.6%	163.5%	23.1%	24.3%

Balance Sheet

	FY08	FY09	FY10E	FY11E	FY12E
Equity Capital	322	323	355	391	391
Reserves & surplus	5,073	5,887	8,427	12,111	15,429
Net worth	5,395	6,209	8,781	12,502	15,820
Total Debt	6,632	4,966	4,904	4,904	3,904
Def tax liability	381	560	560	560	560
Capital Employed	12,408	11,735	14,244	17,965	20,283
Gross Block	9,189	9,762	12,241	14,941	15,941
Less Depreciation	3,950	4,309	4,804	5,416	6,111
Net Fixed Assets	5,239	5,453	7,437	9,525	9,830
CWIP	362	1,114	200	100	100
Investments	60	920	920	920	920
Inventory	2,194	1,004	1,659	2,143	2,559
Debtors	5,191	5,459	5,308	6,856	8,189
Cash and Bank	891	779	1,339	2,039	3,408
Loans & Advances	1,689	2,012	2,012	2,012	2,012
Total Curr. Assets	9,965	9,253	10,317	13,050	16,168
Current Liab	3,035	4,791	4,215	5,099	6,205
Provisions	182	214	414	531	531
Total Cur Liab & Prov	3,218	5,005	4,629	5,630	6,736
Net Current Assets	6,747	4,248	5,687	7,420	9,433
Total Assets	12,408	11,735	14,244	17,965	20,283

Cash Flow Statement

	FY08	FY09	FY10E	FY11E	FY12E
PAT	1,007	880	2,319	2,854	3,547
Depreciation	372	425	495	612	695
interest	437	880	419	405	385
Change in WC	(1,415)	2,387	(880)	(1,032)	(644)
Tax	297	193	673	827	1,038
Others	(38)	(10)	(673)	(827)	(1,038)
CFO	659	4,755	2,354	2,838	3,983
Capex	(1,101)	(1,325)	(1,565)	(2,600)	(1,000)
Net Investments	28	860	0	0	0
Others	(211)	(1,588)	0	0	0
CFI	(1,284)	(2,053)	(1,565)	(2,600)	(1,000)
Change in equity	252	12	419	1,095	0
Change in debt	765	(1,666)	(62)	0	(1,000)
Dividend paid	(53)	(94)	(166)	(229)	(229)
interest	(446)	(880)	(419)	(405)	(385)
Others	867	(78)	0	0	0
CFF	1,385	(2,707)	(229)	462	(1,614)
Incr/(decr) in cash	760	(112)	560	700	1,369
Cash beginning	131	891	779	1,339	2,039
Cash ending	891	779	1,339	2,039	3,408

Ratios

	FY08	FY09	FY10E	FY11E	FY12E
EBITDA %	12.3	10.2	15.9	14.8	15.0
EBIT %	10.1	8.4	13.8	12.8	13.1
NPM %	6.0	3.8	9.6	9.1	9.5
ROCE %	13.7	16.3	23.5	22.3	24.1
ROE %	18.7	14.2	26.4	22.8	22.4
EPS	15.6	13.6	32.7	36.5	45.3
Cash EPS	21.4	20.2	39.7	44.3	54.2
Book Value	83.7	96.2	123.8	159.8	202.3
Debtors days	112	87	80	80	80
Creditors days	66	76	64	59	61
Working capital TO	146	68	86	87	92
Total Debt: Equity	1.2	0.8	0.6	0.4	0.2
Asset Turnover (adj)	1.4	2.0	1.7	1.7	1.8
PE (x)	20.0	22.9	9.6	8.6	6.9
Cash PE (x)	14.6	15.5	7.9	7.1	5.8
P/BV (x)	3.7	3.3	2.5	2.0	1.5
EV/Sales (x)	1.8	1.3	1.2	0.9	0.7
EV/EBITDA	14.6	12.2	7.3	5.9	4.5
Dividend yield	0.3	0.4	0.6	0.8	0.8

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