

**STERLITE TECHNOLOGIES**

Muted quarter

### ■ Subdued growth in revenues and earnings

Sterlite Technologies (SOTL) reported lacklustre Q2FY11 results, in line with our estimate. Revenues grew 9.4% Y-o-Y, to INR 5.1 bn, primarily driven by 31.2% Y-o-Y growth in the telecom segment to INR 1.8 bn. Growth in power was, however, flat at 0.3% Y-o-Y, to INR 3.3 bn. On the volume front, power conductors de-grew marginally by 3.4% Y-o-Y to 28,000 MT, whereas optical fibre grew 4.8% to 2.2 mn fkms; optic fibre cables though grew strong to 0.9 mn fkms, up 50% Y-o-Y. Slower execution in the conductor segment is owing to lack of new orders from Power Grid Corporation (PGCIL). Marginal decline in demand from China has hampered volume growth in optical fibre to some extent.

### ■ Margin constrained owing to higher raw material & staff costs

EBITDA growth was flat at 1.9% Y-o-Y, to INR 906 mn, as the company reported 129bps decline in EBITDA margin. The decline in EBITDA margin is owing to increase in raw material cost (up 98bps, to 62.3% of sales) besides higher employee costs (up 108bps to 4.1% of sales), which we believe, is due to expanded capacities. Both power and telecom recorded decline of 198bps and 226bps Y-o-Y in EBITDA margins, to 12.8% and 28.8%, respectively. Lower tax rate, along with increased other income, helped SOTL raise PAT at 5.3% Y-o-Y, to INR 576 mn.

### ■ Improved order book position

SOTL's order backlog grew 27.5% Y-o-Y, to INR 22.0 bn (0.9x FY10 revenues), with INR 16 bn (increase of 33% Y-o-Y) backlog in power conductors and the balance INR 6 bn (increase of 14% Y-o-Y) in telecom. With the bulk tendering of PGCIL expected in H2FY11 and increased spending from SEBs & private players, SOTL's order book position is expected to improve in the ensuing quarters. On the telecom business, increased bandwidth requirement and favourable regulatory changes in several countries is expected to help telecom order flows.

### ■ Outlook and valuations: Positive; maintain 'BUY'

We remain positive on the company on the back strong demand drivers in both Power and Telecom segment, with PGCIL's order for conductors expected to flow from H2FY11 and higher fibre demand (driven by mobile users and increase demand for bandwidth in India and other geographies) respectively. The stock is trading at 13.3x FY11E and 10.3x FY12E earnings. We maintain our 'BUY' recommendation on the stock.

October 21, 2010

Reuters : STTE.BO Bloomberg : SOTL IN

**EDELWEISS RATING**

Absolute Rating BUY

**MARKET DATA**

CMP	:	INR 93
52-week range (INR)	:	124 / 51
Share in issue (mn)	:	356.2
M cap (INR bn/USD mn)	:	33.1/ 745.1
Avg. Daily Vol. BSE/NSE ('000)	:	1,489.3

**SHARE HOLDING PATTERN (%)**

Promoters*	:	50.1
MFs, FIs & Banks	:	15.0
FIIIs	:	3.8
Others	:	31.1

\* Promoters pledged shares : Nil  
(% of share in issue)

**RELATIVE PERFORMANCE (%)**

	Sensex	Stock	Stock over Sensex
1 month	0.4	0.8	0.4
3 months	11.8	(15.2)	(27.0)
12 months	16.0	51.1	35.1

**Financials (standalone)**

Year to March	Q2FY11	Q2FY10	% Change	Q1FY11	% Change	FY10	FY11E
Rev. (net) (INR mn)	5,094	4,658	9.4	4,918	3.6	24,316	27,121
EBITDA (INR mn)	906	888	1.9	830	9.1	3,810	4,264
Adj. net profit (INR mn)	576	547	5.3	556	3.5	2,461	2,735
Diluted EPS (INR)	1.5	1.5	(4.5)	1.4	3.5	6.3	7.0
Diluted P/E (x)						14.8	13.3
EV/EBITDA (x)						8.8	7.7
ROAE (%)						32.0	26.2

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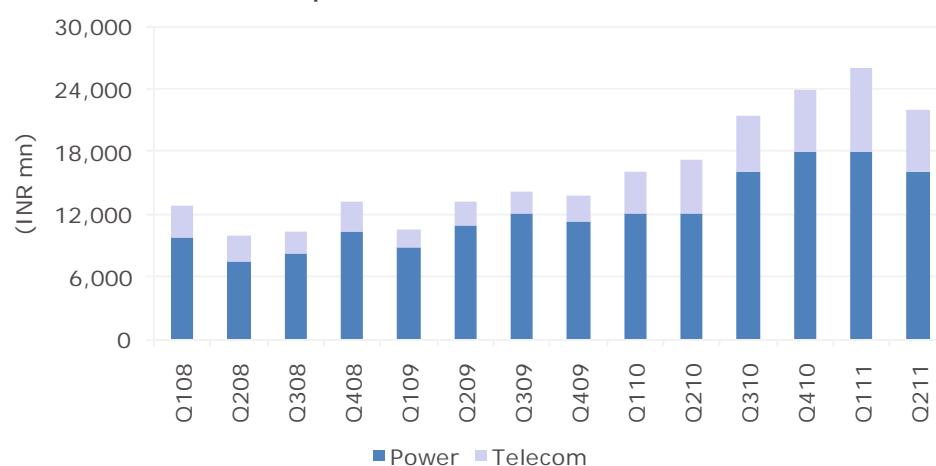
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Table 1: Segmental snapshot

Year to March	Q2FY11	Q2FY10	% change Y-o-Y	H1FY11	H1FY10	% change Y-o-Y
<b>Revenue (INR mn)</b>						
Power	3,304	3,294	0.3	6,700	6,254	7.1
Telecom	1,790	1,365	31.2	3,313	2,766	19.8
<b>Total</b>	<b>5,094</b>	<b>4,658</b>	<b>9.4</b>	<b>10,012</b>	<b>9,020</b>	<b>11.0</b>
<b>Revenue mix (%)</b>						
Power	64.9	70.7		66.9	69.3	
Telecom	35.1	29.3		33.1	30.7	
<b>EBIT (INR mn)</b>						
Power	424	488	(13.1)	871	931	(6.5)
Telecom	515	423	21.6	953	782	21.8
<b>Total</b>	<b>938</b>	<b>911</b>	<b>3.0</b>	<b>1,823</b>	<b>1,713</b>	<b>6.4</b>
<b>EBIT mix (%)</b>						
Power	45.2	53.5		47.8	54.3	
Telecom	54.8	46.5		52.2	45.7	
<b>Volume</b>						
Power Conductor (MT)	28,000	29,000	(3.4)	55,000	55,206	(0.4)
Optical Fibre ('000 f kms)	2,200	2,100	4.8	4,700	4,000	17.5
Fibre Optic Cables ('000 f kms)	900	600	50.0	1,600	1,200	33.3
<b>Realisation</b>						
Power Conductor (INR/MT)	118,007	113,579	3.9			
Optical Fibre ('000 f kms)	360	430	(16.3)			
Fibre Optic Cables (INR/fkm)	1,100	977	12.6			

Source: Company, Edelweiss research

Chart 1: Order book break-up



Source: Company, Edelweiss research

## Financials snapshot (standalone)

(INR mn)

Year to March	Q2FY11	Q2FY10	% Change	Q1FY11	% Change	FY10	FY11E	FY12E
Revenues (net)	5,094	4,658	9.4	4,918	3.6	24,316	27,121	34,428
Raw material	3,172	2,855	11.1	3,116	1.8	18,131	20,772	26,507
Staff cost	208	140	48.9	196	6.1	580	624	792
Other operating expenses	808	775	4.3	775	4.3	1,796	1,462	1,819
Total expenditure	4,189	3,770	11.1	4,088	2.5	20,507	22,858	29,117
EBITDA	906	888	1.9	830	9.1	3,810	4,264	5,311
Depreciation	133	119	12.1	131	2.0	483	581	638
EBIT	772	769	0.4	699	10.4	3,327	3,682	4,673
Interest	92	100	(7.5)	71	29.5	381	312	321
Other income	33	23	44.7	55	(40.2)	229	219	186
PBT	713	692	3.0	683	4.4	3,175	3,590	4,538
Tax	137	146	(5.7)	127	8.0	714	854	1,042
Core profit	576	547	5.3	556	3.5	2,461	2,735	3,497
Extraordinary items	-	-	NA	-	NA	0	0	0
Adjusted net profit	576	547	5.3	556	3.5	2,461	2,735	3,497
Equity capital (FV: INR 2)	711	711	0.0	784	(9.3)	711	711	711
# of shares (mn) Diluted	392	356	10.3	392	0.0	392	392	392
Diluted EPS (INR)	1.5	1.5	(4.5)	1.4	3.5	6.3	7.0	8.9

## As % of net revenues

Raw material	62.3	61.3		63.4		74.6	76.6	77.0
Staff cost	4.1	3.0		4.0		2.4	2.3	2.3
Other operating expenses	15.9	16.6		15.8		7.4	5.4	5.3
EBITDA	17.8	19.1		16.9		15.7	15.7	15.4
Depreciation	2.6	2.6		2.7		2.0	2.1	1.9
Interest cost	1.8	2.1		1.4		1.6	1.2	0.9
Other income	0.6	0.5		1.1		0.9	0.8	0.5
Adjusted net profit	11.3	11.7		11.3		10.1	10.1	10.2
Tax rate (%)	19.3	21.0		18.6		22.5	23.8	23.0

### ■ Company Description

SOTL, incorporated in 2000 (Sterlite Optical Technologies), was formed post the demerger of telecom business of Sterlite Industries. Spearheaded by Dr. Anil Agarwal, SOTL provides transmission solutions for telecom and power industries. With footprint in 70 countries, the company is India's only fully integrated optical fiber producer and amongst the Top 5 producers of power conductors globally.

Its business activity comprises:

- Manufacture and supply of optical fibers, fiber optic cables, copper telecom cables, structured data cables, ADSL2+ modems.
- Manufacture and supply of power transmission conductors, aluminum & alloy rods.
- Telecom integration projects & managed services.

### ■ Investment Theme

SOTL is likely to grow significantly over the next few years (led by strong demand drivers and capacity expansion) as its core business operations are poised to enjoy best of both worlds - strong demand for optical fiber with expanding wireless subscriber base & increasing internet usage and large spending on power T&D. SOTL's core earnings are likely to post a 38% CAGR over FY09-12E (on revenue-mix shift, economies of scale and lower financing cost) with return ratios in excess of 20% and INR 8.5 bn CFO (over FY10-12E). We believe SOTL has an advantage over its global and local peers because of its lowest cost structure (integrated manufacturing facilities), competitive technology and continued thrust on technology up-gradation, which enable it to earn better EBITDA margins relative to peers. Integrated manufacturing operations, in our view, are likely to be the biggest strength that SOTL can leverage over the medium term.

### ■ Key Risks

**Currency fluctuations risk:** SOTL's earnings in FY09 were severely impacted by adverse foreign currency movements on its foreign denominated debt. Given that ~30% of its revenues come from exports and one-third of its current debt is foreign denominated, the company's operations are exposed to international currency movements.

**Technology up-gradation:** Optical fiber, at least, currently is the most efficient way of transferring high bandwidth data. Any technological innovation that could lead to more efficient and better quality transfer of data will severely impact SOTL's business operations.

- **Commodity risk:** Being largely a processor/convertor on power conductor business where ~80% costs are related to commodity, SOTL's power business is exposed to adverse commodity price fluctuations.

## Financial Statements

### Income statement

(INR mn)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Income from operations	16,858	22,892	24,316	27,121	34,428
Direct costs	13,491	18,687	18,131	20,772	26,507
Employee costs	414	491	580	624	792
Other expenses	986	1,372	1,796	1,462	1,819
Total operating expenses	14,891	20,551	20,507	22,858	29,117
EBITDA	1,967	2,342	3,810	4,264	5,311
Depreciation and amortisation	372	425	483	581	638
EBIT	1,595	1,916	3,327	3,682	4,673
Interest expenses	332	560	381	312	321
Other income	41	37	229	219	186
Profit before tax	1,304	1,393	3,175	3,590	4,538
Provision for tax	297	193	714	854	1,042
Core profit	1,007	1,200	2,461	2,735	3,497
Extraordinary items		(320)			
Adjusted net profit	1,007	560	2,461	2,735	3,497
Basic shares outstanding (mn)	322	322	356	356	356
EPS (INR) basic	3.1	3.7	6.9	7.7	9.8
Diluted equity shares (mn)	322	322	392	392	392
EPS (INR) fully diluted	3.1	3.7	6.3	7.0	8.9
CEPS (INR)	5.2	5.6	7.9	8.5	10.5
Dividend per share (INR)	0.2	0.3	0.5	0.5	0.5
Dividend payout (%)	7.5	7.9	8.5	7.6	6.0

### Common size metrics- as % of net revenues

Year to March	FY08	FY09	FY10	FY11E	FY12E
Direct cost	80.0	81.6	74.6	76.6	77.0
Employee expenses	2.5	2.1	2.4	2.3	2.3
S G & A expenses	5.8	6.0	7.4	5.4	5.3
Operating expenses	88.3	89.8	84.3	84.3	84.6
Depreciation and Amortization	2.2	1.9	2.0	2.1	1.9
Interest expenditure	2.0	2.4	1.6	1.2	0.9
EBITDA margins	11.7	10.2	15.7	15.7	15.4
EBIT margins	9.5	8.4	13.7	13.6	13.6
Net profit margins (adjusted)	6.0	5.2	10.1	10.1	10.2

### Growth metrics (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Revenues	40.7	35.8	6.2	11.5	26.9
EBITDA	74.3	19.1	62.7	11.9	24.6
PBT	145.9	6.8	127.9	13.1	26.4
Net profit	98.0	19.2	105.0	11.2	27.8
EPS	89.2	19.2	68.6	11.2	27.8

<b>Balance sheet</b>						<b>(INR mn)</b>
As on 31st March	FY08	FY09	FY10	FY11E	FY12E	
Equity capital	645	645	711	711	711	
Employee stock options	57	53	39	39	39	
Reserves & surplus	4,693	5,513	8,139	10,666	13,955	
Shareholders funds	5,394	6,210	9,160	11,688	14,976	
Secured loans	6,327	4,679	3,579	3,679	3,779	
Unsecured loans	305	287	3	3	3	
Borrowings	6,632	4,966	3,582	3,682	3,782	
<b>Sources of funds</b>	<b>12,026</b>	<b>11,176</b>	<b>12,742</b>	<b>15,369</b>	<b>18,758</b>	
Gross block	9,189	9,762	10,946	13,016	14,016	
Depreciation	3,950	4,309	4,682	5,263	5,901	
Net block	5,239	5,453	6,264	7,753	8,115	
Capital work in progress	362	1,114	570	-	-	
Total fixed assets	5,601	6,567	6,834	7,753	8,115	
Investments	60	920	1,061	1,061	1,061	
Inventories	2,193	1,004	1,709	1,486	2,453	
Sundry debtors	5,191	5,459	6,290	6,687	9,055	
Cash and equivalents	891	779	2,097	3,067	4,371	
Loans and advances	1,689	2,012	1,567	2,737	3,474	
Total current assets	9,964	9,253	11,663	13,977	19,353	
Sundry creditors and others	3,035	4,791	5,703	5,247	6,347	
Provisions	182	214	511	1,573	2,823	
Total CL & provisions	3,218	5,005	6,214	6,820	9,170	
Net current assets	6,747	4,248	5,449	7,157	10,184	
Net deferred tax	(381)	(560)	(602)	(602)	(602)	
<b>Uses of funds</b>	<b>12,026</b>	<b>11,176</b>	<b>12,742</b>	<b>15,369</b>	<b>18,758</b>	
Adjusted BV per share (INR)	15	17	26	33	42	

<b>Free cash flow</b>						<b>(INR mn)</b>
Year to March	FY08	FY09	FY10	FY11E	FY12E	
Net profit	1,007	560	2,461	2,735	3,497	
Depreciation	372	425	483	581	638	
Deferred tax	287	176	151	0	0	
Gross cash flow	1,665	1,161	3,095	3,316	4,135	
Less: Changes in WC	1,445	(2,386)	(118)	738	1,723	
Operating cash flow	220	3,547	3,213	2,578	2,412	
Less: Capex	1,098	1,325	640	1,500	1,000	
<b>Free cash flow</b>	<b>(878)</b>	<b>2,223</b>	<b>2,573</b>	<b>1,078</b>	<b>1,412</b>	

<b>Cash flow metrics</b>						<b>(INR mn)</b>
Year to March	FY08	FY09	FY10	FY11E	FY12E	
Operating cash flow	220	3,867	3,213	2,578	2,412	
Financing cash flow	2,141	(54)	(1,474)	(108)	(108)	
Investing cash flow	(1,095)	(2,185)	(781)	(1,500)	(1,000)	
Net cash flow	1,266	1,628	958	970	1,304	
Capex	(1,098)	(1,325)	(640)	(1,500)	(1,000)	
Dividends paid	(76)	(94)	(208)	(208)	(208)	
Share issuance / (buyback)	1,451	1,706	119	0	0	

**Profitability & liquidity ratios**

Year to March	FY08	FY09	FY10	FY11E	FY12E
ROAE (%) (on adjusted profits)	21.1	20.7	32.0	26.2	26.2
ROACE (%)	14.5	16.5	27.8	26.2	27.4
Debtors days	103	85	88	87	83
Inventory days	46	31	27	28	27
Fixed assets t/o (x)	3.5	4.3	4.2	3.9	4.3
Debt/equity (x)	1.2	0.8	0.4	0.3	0.3
Interest coverage (x)	4.8	3.4	8.7	11.8	14.6
Payable days	68	76	106	96	80
Cash conversion cycle (days)	81	40	10	19	31
Current ratio (x)	3.1	1.8	1.9	2.0	2.1
Debt/EBITDA (x)	3.4	2.1	0.9	0.9	0.7
Adjusted debt/Equity (x)	1.2	0.8	0.4	0.3	0.3

**Operating ratios**

Year to March	FY08	FY09	FY10	FY11E	FY12E
Total asset turnover (x)	1.5	2.0	2.0	1.9	2.0
Fixed asset turnover (x)	3.5	4.3	4.2	3.9	4.3
Equity turnover (x)	3.5	3.9	3.2	2.6	2.6

**Du pont analysis**

Year to March	FY08	FY09	FY10	FY11E	FY12E
NP margin (%)	6.0	5.2	10.1	10.1	10.2
Total assets turnover (x)	1.5	2.0	2.0	1.9	2.0
Leverage multiplier (x)	2.3	2.0	1.6	1.3	1.3
ROAE (%)	21.1	20.7	32.0	26.2	26.2

**Valuation parameters**

Year to March	FY08	FY09	FY10	FY11E	FY12E
EPS (INR) fully diluted	3.1	3.7	6.3	7.0	8.9
Y-o-Y growth (%)	89.2	19.2	68.6	11.2	27.8
CEPS (INR)	5.2	5.6	7.9	8.5	10.5
Diluted P/E (x)	29.8	25.0	14.8	13.3	10.4
Price/BV (x)	6.1	5.3	3.6	2.8	2.2
EV/Sales (x)	2.1	1.5	1.4	1.2	0.9
EV/EBITDA (x)	18.1	14.2	8.8	7.7	5.9
Dividend yield (%)	0.2	0.3	0.5	0.5	0.5

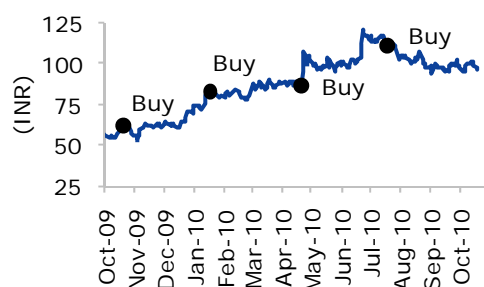
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### Coverage group(s) of stocks by primary analyst(s): Miscellaneous

Sterlite Technologies

#### Sterlite Technologies



#### Recent Research

Date	Company	Title	Price (INR)	Recoms
19-Jul-10	Sterlite Technologies	Slower quarter; Result Update	112	Buy
22-Apr-10	Sterlite Technologies	Strong telecom margin drives PAT; Result Update	95	Buy
18-Jan-10	Sterlite Technologies	Strong telecom execution drives PAT; Result Update	419	Buy

#### Distribution of Ratings / Market Cap

##### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	116	45	12	176

\* 3 stocks under review

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	110	53	13

#### Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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