

1st April, 2008**BUY**

Price	Target Price
Rs163	Rs245
Sensex	15,644

Price Performance

(%)	1M	3M	6M	12M
Absolute	(20)	(51)	(32)	(11)
Rel. to Sensex	(10)	(37)	(25)	(25)

Source: Bloomberg

Stock Details

Sector	Cables
Reuters	STOP.BO
Bloomberg	SOTL@IN
Equity Capital (Rs mn)	308
Face Value (Rs)	5
52 Week H/L	381/143
Market Cap (Rs bn)	10/250
Daily Avg Vol. (No of shares)	273204
Daily Avg Turnover (US\$ mn)	1.5

Shareholding Pattern (%)(31st Dec.'07)

Promoters	43.6
FII/NRI	9.1
Institutions	12.1
Private Corp.	9.6
Public	25.6

Getting into the big league

We spoke with the management of Sterlite Technologies Ltd (STL) to update ourselves on the company's business developments.

The legacy, optic fiber business is seeing a continued increase in the demand, with the global demand reaching an all time high of 115mn kms in FY07. The Company expects strong demand to continue on the back of an increasing global demand for bandwidth. STL has recently completed its capacity expansion raising optic fibre capacity to 6mn fkm and plans to increase it ~2x to 12mn fkm by June'09 at a cost of US\$35mn, to be funded through debt and internal accruals. Cost rationalization measures continue to remain an area of focus for the company. The focus on cost reduction and improving efficiencies through vertical integration is expected to improve the margins in the optic business. On doubling of capacity to 12mn fkm, STL expects the cost of producing optic fiber to reduce from US\$6.2 per fkm to US\$4.5 per fkm. The management also indicated that it has recently seen 1-2% increase in the optic fiber realizations.

In the power conductors business, STL recently (Q3FY08) commissioned its Haridwar facility increasing its capacity from 75,000 MT to 115,000 MT. The company plans to further increase the capacity to 200,000 MT by FY10 (our current estimates do not fully factor the increased capacity).

The management continued to maintain its vision of attaining US\$1bn in revenues by FY10 and being among the top 3 players in all the business segments globally. We estimate revenue and earnings CAGR of 24% and 30% respectively for STL over FY08-10E. With our revenue estimate at ~Rs25bn for FY10E, and the management's firm plans of achieving US\$1bn in revenues in FY10E, an inorganic growth potential cannot be ruled out. We maintain BUY recommendation with a revised price target of Rs245 (+50%), based on 10x FY10E earnings of Rs 24.5.

Key highlights

Optic fiber business: The Company has recently witnessed a 1-2% increase in the optic fiber realizations on the back of robust demand. STL continues to focus on cost reduction and improving efficiencies, which would result in improving margins in the business. On doubling capacity to 12mn fkm, the management expects the cost of producing optic fiber to reduce by ~27%, from US\$6.2 per fkm to US\$4.5 per fkm.

Power conductor business: The Company does not face any cost pressures due to fluctuation in the raw material prices as the entire cost increase is passed on to the customers. The capacity expansion at the Uttaranchal facility would result in higher profitability due to the applicable tax benefits.

Valuation & Recommendation

Post discussion with the management, we have revisited our estimates. We expect the revenues to grow by CAGR 24% to Rs25bn and PAT to grow by CAGR 30% to Rs1580mn over FY08-10E resulting in an EPS of Rs18.2 and Rs24.5 for FY09E and FY10E respectively. We maintain our bullish view on the stock and recommend BUY with a price target of Rs245 based on 10x FY10E earning of Rs24.5 per share offering an upside of 50%.

	Net Sales	EBITDA (Core)	EBITDA (%)	RoE (%)	EV/ EBITDA	P/BV	Div Yld (%)	AEPS (Rs)	P/E (Diluted)	
YE-Mar				APAT						
FY07	11,982	1,120	9.3	489	11.7	13.9	2.4	0.7	7.9	20.5
FY08E	16,141	2,006	12.4	939	18.0	7.7	2.0	0.9	14.6	11.2
FY09E	20,727	2,291	11.1	1173	18.8	6.9	1.7	1.2	18.2	8.9
FY10E	24,998	2,917	11.7	1580	20.6	5.6	1.4	1.2	24.5	6.6

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Optic fiber demand at all time high

The global optic fiber demand has increased from 99mn fkms in 2006 to 112mn fkms in 2007, which is the all time high, surpassing the demand during the boom of 2000-01. The optic fiber demand is further expected to grow by 8-10% annually over the next few years. Post the completion of the recent expansion of fiber optic capacity to 6mn fkms and considering the continued global demand, Sterlite has planned to double its capacity to 12mn fkms by June 2009. With the demand for optic fiber at an all-time high, the likelihood of increase in the realizations cannot be ruled out. In our estimates we have factored a 3% increase in the realizations for FY09 and FY10 respectively. Any further increase in the realizations would lead to an upside to our estimates. We expect the revenues from the optic fiber business to grow by 38% CAGR over FY08-FY10E to Rs4955mn.

Other key highlights of the business

- By commissioning a facility to manufacture silicon tetrachloride, Sterlite has fully integrated facility from silicon mineral to optical fiber cable. This has helped STL bring efficiencies and improve margins despite the decline in the realizations due to the appreciating rupee.
- The management commentary indicates a significant reduction (approx 27%) in the cost of optic fiber production from US\$6.2 to US\$4.5 per fkm driven by vertical integration and economies.
- The US slowdown would not significantly impact the business of Sterlite as the focus and the export geographies for the company has traditionally been India, China, Middle East, Africa and South-East Asia.
- The copper cables and access businesses are expected to grow at a moderate growth rate of 5-10%.

Power conductor

Post the acquisition of the power conductors business from Sterlite Industries; the power conductors division has been the major contributor to the revenue (70%) and profitability of the company. The company is amongst the 5th largest power transmission conductor manufacturer and the market leader in India with 77% market share.

The robust growth in the Indian power sector with an expected investment of Rs1,400bn in the transmission part of the sector over the 11th plan period, offers STL a significant opportunity for growth. Of the Rs1,400bn, approximately 25% would be spent on power conductors offering an opportunity of Rs350bn over the 11th plan only from the domestic market. Almost 40% of the revenues in the power conductors business are generated through exports to countries in Africa, Middle East and South East Asia, which provide an additional growth opportunity for STL.

The company has recently expanded the capacity of the power conductors business from 75,000 tons to 115,000 tons at Uttaranchal where the company would benefit from tax exemptions. We expect the revenues from the power conductors business to grow by 26% CAGR over FY08-10E to Rs15.9bn. In our estimates, we have factored a margin contraction resulting in a 15% growth in the EBIDTA over FY08-10E.

Order book at Rs10.4bn

The order book for the company at the end of the quarter was at Rs10.4bn, which includes Rs8.2bn from the power business and Rs2.2bn from telecom business, with ~50% of the orders being executable in Q4FY08.

Q3FY08 result update

STL reported good set of results for Q3FY08. The net sales for the quarter grew by 60% yoy to Rs5020mn. The growth was mainly driven by the significant rise in the revenues from the access business, which was on account of the BSNL order. The revenues from the access business grew by 242% yoy to Rs1453mn. The EBITDA for the quarter grew by 75% yoy to Rs584mn. The EBITDA margins expanded by 100bps yoy to 11.6%. The margin expansion was mainly on account of lower raw material costs. The PAT for the quarter grew by 105% yoy to Rs263mn. The EPS for the quarter stood at Rs4.1, up 78% yoy.

Quarterly results

	Q3FY07	Q3FY08	% Change	9mFY07	9mFY08	% Change
Segmental sales						
Power conductors	2,153.3	2,847.7	32.2%	4,913.4	6,927.0	41.0%
Optic fiber	561.3	719.3	28.1%	1,709.5	1,847.8	8.1%
Copper cable	424.9	1,453.3	242.0%	1,284.7	2,646.9	106.0%
Net sales	3,139.5	5,020.3	59.9%	7,907.6	11,421.7	44.4%
Expense	2,806.4	4,436.0	58.1%	7,112.2	9,981.0	40.3%
(Inc)/Dec in stocks	(413.0)	(27.0)	-93.5%	(71.8)	(411.0)	472.4%
Consumption of RM	2,777.7	3,729.3	34.3%	5,948.0	8,541.9	43.6%
Staff Cost	72.3	116.6	61.3%	187.4	323.9	72.8%
Other exp	369.4	617.1	67.1%	1,048.6	1,526.2	45.5%
EBITDA	333.1	584.3	75.4%	795.5	1,440.7	81.1%
Operating Margin (%)	10.6	11.6		10.1	12.6	
Interest	100.2	119.2	19.0%	189.5	288.7	52.3%
Depreciation	70.8	94.9	34.0%	203.1	265.4	30.7%
Other Income	0.1	1.7		34.9	26.7	
PBT	162.2	371.9	129.3%	437.8	913.3	108.6%
Tax	0.3	2.2		3	13.8	
Deferred Tax	33.2	105.8	218.7%	74.4	235.4	216.4%
Total Tax	33.5	108.0		77.4	249.2	
PAT	128.7	263.9	105.1%	360.4	664.1	84.3%
Net Margin (%)	4.1	5.3	28.2%	12.1	5.8	-51.8%
Net Profits	128.7	263.9	105.1%	953.8	664.1	-30.4%
Shares	55.9	64.4		64.4	64.4	
EPS (Rs not annualized)	2.3	4.1	78.3%	5.6	10.3	84.3%

	Q3FY07	Q3FY08	% Change	9mFY07	9mFY08	% Change
Revenues						
Power	2,153.3	2,847.7	32.2%	4,913.5	6,927.0	41.0%
Optic	561.3	719.3	28.1%	1,709.5	1,847.8	8.1%
Copper/access	424.9	1,453.3	242.0%	1,284.7	2,646.9	106.0%
Total Rev	3,139.5	5,020.3	59.9%	7,907.7	11,421.7	44.4%
PBIT						
Power	205.5	256.5	24.8%	359.3	764.1	112.7%
Optic	33.4	58.5	75.1%	132.6	175.7	32.5%
Copper/access	23.5	176.3	650.2%	111.4	262.3	135.5%
Total PBIT	262.4	491.3	87.2%	603.3	1,202.1	99.3%
PBIT %			chg bps			chg bps
Power	9.5	9.0	(54)	7.3	11.0	372
Optic	6.0	8.1	218	7.8	9.5	175
Copper/access	5.5	12.1	660	8.7	9.9	124
Total PBIT %	8.4	9.8	143	7.6	10.5	290

Financials

Profit & Loss

Y/E March	FY07	FY08E	FY09E	FY10E
Net Sales	11,982	16,141	20,727	24,998
Growth (%)		35%	28%	21%
Raw materials	9,082	11,622	14,965	17,999
% to sales	75.8%	72.0%	72.2%	72.0%
Personnel cost	298	444	518	575
% to sales	2.5%	2.8%	2.5%	2.3%
Admin & other exp	1,481	2,070	2,953	3,507
% to sales	12.4%	12.8%	14.2%	14.0%
EBITDA	1,120	2,006	2,291	2,917
% of Sales	9.3%	12.4%	11.1%	11.7%
Depreciation	316	382	464	544
EBIT	804	1,624	1,827	2,373
% of Sales	6.7%	10.1%	8.8%	9.5%
Interest charges	345	425	360	394
Other Income	52	34	40	40
PBT	511	1,233	1,507	2,019
Taxes	22	294	334	439
PAT	489	939	1,173	1,580
Growth (%)		92.0%	87.4%	34.7%
ETR	4.3%	23.8%	22.2%	21.7%

Balance Sheet

	FY07	FY08E	FY09E	FY10E
Equity Capital	308	322	322	322
Reserves & surplus	3,858	4,908	5,931	7,360
Networth	4,166	5,230	6,253	7,682
Total Debt	5,867	5,967	5,967	5,967
Def tax liability	102	102	102	102
Capital Employed	10,135	11,299	12,322	13,752
Gross Block	7,925	8,953	10,153	11,663
Less Depreciation	3,580	3,962	4,426	4,970
Net Fixed Assets	4,345	4,990	5,726	6,692
CWIP	528	100	10	10
Investments	63	63	63	63
Inventory	1,200	1,769	2,271	2,740
Debtors	4,332	4,864	5,679	6,849
Cash and Bank	789	1,022	689	254
Loans & Advances	1,213	1,213	1,213	1,213
Total Cur. Assets	7,534	8,867	9,852	11,055
Current Liabilities	1,998	2,439	3,011	3,750
Provisions	336	282	318	318
Total Cur Liab & Prov	2,334	2,722	3,329	4,069
Net Current Assets	5,200	6,146	6,523	6,986
Total Assets	10,135	11,299	12,322	13,752

Cash Flow Statement

	FY07	FY08E	FY09E	FY10E
PAT	489	939	1,173	1,580
Depreciation	316	382	464	544
Other income	(52)	(34)	(40)	(40)
Others	19	-	-	-
Change in WC	(2,542)	(764)	(741)	(899)
CFO	(1,770)	523	856	1,186
(Inc)/Dec in fixed assets	(2,731)	(600)	(1,110)	(1,510)
Net Investments	88	-	-	-
Others	-	-	-	-
CFI	(2,644)	(600)	(1,110)	(1,510)
Inc/(dec) in Equity	280	280	-	-
Inc/(dec) in pref capital	28	28	-	-
Net Borrowings	3,489	100	-	-
Dividend paid	34	83	109	151
Other income	52	34	40	40
others	366	(216)	(227)	(301)
CFF	4,248	309	(78)	(111)
Incr/(decr) in cash	(165.4)	232	(333)	(435)
Cash beginning	955	789	1,022	689
Cash ending	789	1,022	689	254

Ratios

	FY07	FY08E	FY09E	FY10E
EBITDA %	9.3	12.4	11.1	11.7
EBIT %	6.7	10.1	8.8	9.5
NPM %	4.1	5.8	5.7	6.3
ROCE %	7.9	14.4	14.8	17.3
ROE %	11.7	18.0	18.8	20.6
EPS	7.9	14.6	18.2	24.5
Cash EPS	13.1	20.5	25.4	33.0
Book Value	67.6	81.2	97.1	119.3
Debtors days	132	110	100	100
Creditors days	61	55	53	55
Working capital TO	158	139	115	102
Total Debt: Equity	1.4	1.1	1.0	0.8
Asset Turnover (adj)	1.2	1.4	1.7	1.8
PE (x)	20.5	11.2	8.9	6.6
Cash PE (x)	12.5	7.9	6.4	4.9
P/BV (x)	2.4	2.0	1.7	1.4
EV/Sales (x)	1.3	1.0	0.8	0.6
EV/EBITDA	13.9	7.7	6.9	5.6
Dividend yield	0.7	0.9	1.2	1.2

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