Sterlite Technologies Ltd.

02 Feb 2015

MONEYORE RESEARCH

Turnaround visible, Re-rating to unlock value

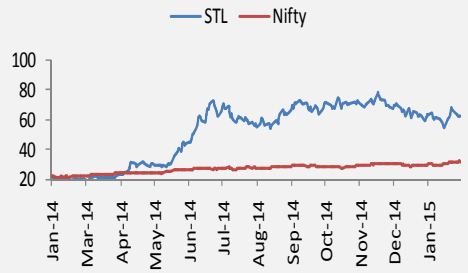
CMP: Rs 62

Strong Buy

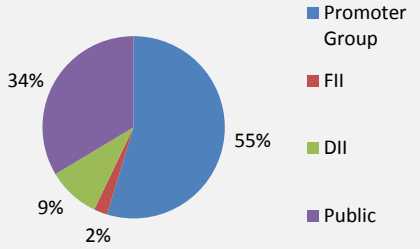
Target Price: Rs 105

Sector	Cables- Telephone
Market Cap	Rs. 2,435 Cr
52 Weeks Low/High	Rs. 19/79
Daily Avg. Volume	16,53,730
Shares in issue	39.4 Cr
Face Value	Rs. 2
Beta	1.55
Pledged Shares	0%
Year End	March
BSE Scrip Code	532374
NSE Scrip Code	STRTECH
Nifty	8,834
Sensex	29,254

Price Performance



Share Holding Pattern



Analyst-

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Company Background

Sterlite Technologies Limited (STL) is a leading global provider of transmission solutions for the telecom and power industries. It is India's only fully integrated optical fibre manufacturer and the 5th largest, globally. The Company is also the 3rd largest global manufacturer of power conductors. The Company shares a common lineage with Vedanta Resources plc a globally diversified natural resources group.

With world-class manufacturing units with state-of-the-art technology in India, China and Brazil STL is uniquely positioned to cater to buyers in the telecom and power sectors both in India and overseas and well placed to serve burgeoning global demand. STL is pioneering Fibre-to-the-Home (FTTH) deployment in the country to enable high speed broadband connectivity.

Sterlite Power Grid Ventures Ltd (SPGVL), a subsidiary of STL, focused on the development and operations of power transmission projects, has a portfolio of six projects on Build, Own, Operate and Maintain (BOOM) basis spread across the country.

Investment Rationale

Fibre optic (Telecom) business fuelling growth:

Telecom segment recorded revenue of Rs 1,077 Cr in FY 14 (~41% of total standalone revenue). The segment has grown with a CAGR of ~18% in last three years. Company is expected to reap the benefit of higher OFC volumes owing to the following factors.

1) National Optic Fibre Network (NOFN) (4 lakh Kilometers), Defence Optic Fibre Network/NFS (60,000 Kms),

2) Increasing volumes for FTTH (Fibre to the Home) due to digitization of cable services.

3) Increasing data usage which is expected to get an increased boost by the roll-out of 3G & 4G networks supported by increasing rollout of Wi-Fi hotspots thus increasing the need for FTTA (Fiberization of Telecom towers as a part of the back haul network).

These domestic market dynamics coupled with export demand from Europe, Middle East and Latin America will support the growth of optical fibre and optical fibre cable. On the back of above mentioned factors, we expect this segment to grow with a CAGR of 30% till FY 17.

Fibre optic business is technology intensive hence margins are high. EBITDA margin in this segment currently stands at 21% compared to 3-5% in power conductor business. We expect EBITDA margin of the standalone business to improve to 13-14% from current level of 11% owing to burgeoning growth in high margin telecom business.

Green-shoots visible in power conductor business:

Power conductor volumes were subdued for last three years because of sluggish demand from the largest client Power Grid Corporation India Limited (PGCIL) owing to weak operating environment. After consistent decline for last three years, STL reported 61% YoY growth in 3Q FY15. STL added new accounts in the European markets for power conductors and in India for optical ground wire (OPGW) products. Probability of PGCIL order inflow recovery is high going forward as the inventory of conductors with PGCIL is expected to come down and thus we expect increased order inflow from PGCIL.

Going ahead, the power conductors business is expected to report higher volume of sales on the back of order book visibility, higher international market penetration and an expected demand revival in the domestic market on the back of higher expected ordering from PGCIL. Demand growth coupled with positive operating leverage, will increase EBITDA margin of the power conductor business to 5% from current level of 3%.

Monetization of grid business to strengthen consolidated business:

SPGVL, a subsidiary of STL, is the largest private developer of power transmission systems in the country, has a portfolio of six projects on BOOM basis spread across 10 states. Of this, the first three projects with over 2,000 Km of transmission lines and two high voltage substations have been successfully completed. After stabilizing operations in these three projects, we expect fixed annual revenue of Rs 575 Cr. irrespective of utilization of the grid line. We expect this business to generate free cash of Rs 222 Cr. /year from FY16 increasing gradually over a life of project. The other three projects will start operating sequentially from FY17.

Returns in this business are predictable over very long periods hence pension funds and insurance companies are willing to back such infrastructure projects. The management is in discussions with multiple potential buyers for selloff of the three operational projects. We expect the deal to reap at least Rs 1,400 Cr.

Valuation Compelling:

We have valued STL using SOTP because of diverse nature of its business verticals. We expect STL's standalone revenues to grow with CAGR of ~20% till FY17 while EBITDA is expected to grow with CAGR of 33% during the same period. We expect an EPS of Rs 5.3 and 5.8 in FY16 and FY17 respectively. STL standalone business is valued using DCF method. In our DCF model, we have assumed a weighted average cost of capital (WACC) of 12% and a terminal growth rate of 2% following explicit free cash flow forecasts through FY 2022. We arrived at standalone business value of Rs 2,717 Cr.

We have added investment in grid businesses with value of Rs. 1,400 Cr. With aggregate value of Rs 4,117 Cr, we arrive at a target price of Rs 105, which generates a 69% upside potential from current levels. Therefore, we initiate coverage on STL with a 'Strong Buy' rating.

Financial Statements

Exhibit 1:

Income statement

Figures In Rs Cr	FY 12	FY 13	FY 14	FY 15E	FY 16E	FY 17E
Net Sales	2,727	3,354	2,726	3,309	4,126	4,660
Operating Expenses	2,528	3,108	2,474	2,888	3,570	4,061
EBITDA	200	246	252	421	556	599
Depreciation	71	86	101	101	91	99
Operating Profit	128	160	151	320	464	500
Non Operating Income	24	42	75	16	20	22
EBIT	152	201	226	336	484	522
Interest Expense	95	133	153	153	170	183
EBT	57	69	73	183	314	339
Taxes	13	21	23	60	104	112
PAT	44	47	50	123	210	227
Diluted EPS	1.1	1.2	1.3	3.1	5.3	5.8

Source: Company Data, Moneyore Research

Exhibit 2:

Balance Sheet

Figures In Rs Cr	FY 12	FY 13	FY 14	FY 15E	FY 16E	FY 17E
Shareholder's Funds	1,149	1,183	1,218	1,310	1,468	1,638
Minority Interest	-	-	-	-	-	-
LT Debts	-	207	683	683	683	683
Deferred Tax Liabilities	74	87	87	94	117	133
Other LT Liabilities & LT Provisions	40	15	5	5	5	5
Total Non Current Liabilities	**1,282**	**1,494**	**1,994**	**2,093**	**2,274**	**2,460**
A/C Payables	521	619	619	740	1,075	940
ST Borrowings	664	832	560	609	760	858
Other CL	329	341	374	405	554	531
Total Current Liabilities	**1,515**	**1,793**	**1,553**	**1,754**	**2,388**	**2,330**
Total Liabilities	***2,797***	***3,286***	***3,546***	***3,847***	***4,662***	***4,789***
Net Block	967	1,001	1,006	1,006	1,134	1,135
Capital Work in Progress	41	29	16	100	220	100
Investments	176	189	229	229	229	229
Intangible Assets Under Development	-	-	-	-	-	-
LT Loans & Advances	342	746	895	356	1,203	558
Total Non Current Assets	**1,527**	**1,965**	**2,148**	**1,692**	**2,788**	**2,024**
Inventories	273	292	299	352	431	478
Sundry Debtors	667	640	671	802	1,008	1,148
Cash and Bank	185	196	44	572	(45)	629
OCA and Current Investments	8	1	211	208	209	210
Loans and Advances	137	193	173	219	270	300
Total Current Assets	**1,270**	**1,322**	**1,399**	**2,155**	**1,874**	**2,765**
Total Assets	***2,797***	***3,286***	***3,546***	***3,847***	***4,662***	***4,789***

Source: Company Data, Moneyore Research

Exhibit 3:

Cash Flow Statement

Figures In Rs Cr	FY 12	FY 13	FY 14	FY 15E	FY 16E	FY 17E
Net Cash From Operating Activities	493	370	(318)	196	600	50
Net Cash From Investing Activities	(312)	(506)	(271)	355	(1,187)	665
Net Cash From Financing Activities	90	165	450	(23)	(29)	(42)
Net Change in Cash and Cash equivalents	271	29	(139)	528	(617)	674
Opening cash and cash equivalent	49	185	196	44	572	(45)
Closing Cash And Cash Equivalent	320	214	57	572	(45)	629

Source: Company Data, Moneyore Research

Guide to Moneyore's research approach

Valuation methodologies

We apply one absolute valuation methodology and two relative valuation methodologies to triangulate the 'fair value' for the stock assessed fundamentally. The following are the most frequently used valuation methodologies in our research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

The target price derived from each methodology is then weighted, based on industry characteristics, to provide a weighted average target or 'fair value' for the stock.

Stock ratings

Strong Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Market-perform recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

Underperform recommendations are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

MONEYORE

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