Sterlite Technologies Limited Q3 FY23

Earnings Conference Call Transcript

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Pankaj Dhawan: Ladies and gentlemen, good day and welcome to the STL Q3 FY23 earnings conference call. I am Pankaj Dhawan – Head, Investor Relations, STL. To take us through the quarter 3 results and to answer your questions, we have Ankit Agarwal – Managing Director, STL and Tushar Shroff – Group CFO, STL.

Please note that all participants' lines are in the listen-only mode as of now. There will be an opportunity for you to ask questions after the presentation concludes. Please note that this call is being recorded. You can also download a copy of the presentation from our website at www.stl.tech.

Before we proceed with this call, I would like to add that some elements of today's presentation may be forward looking in nature and must be viewed in relation to the risks pertaining to the business. The safe harbor clause indicated in the presentation also applies to this conference call.

For opening remarks, I now hand over the call to Ankit Agarwal. Over to you, Ankit.

Ankit Agarwal: Thanks Pankaj! Good day to everyone. Thank you for joining us for our Q3 FY23 and also wishing all of you a very Happy Republic Day. I look forward to our conversation and discussions and your questions as well at the end.

In line with our expectations, strong investment momentum is continuing in 5G, fiber-to-the-home, fiber-to-the-X, datacenter, and citizen network deployments. 5G is becoming the fastest growing technology in the world today. Operators are expected to invest more than $500 billion in 5G from 2022 to 2025. Even recently, Mr. Sunil Mittal, Chairman of Bharti Enterprises also indicated that the industry will also be spending this quantum of money.

As per Ericsson, 228 service providers have now launched 5G commercial services globally and the number of subscribers of 5G is projected to go up from 870 million to 5 billion by 2028. Leading the 5G deployments is China which plans to increase its base stations from 2.2 million to 3.7 million by 2025. FTTx is also becoming all pervasive. In the US, for example, Frontier has reached halfway to reach its target of 10 million home pass locations. Similarly, Windstream is targeting 3 million homes by 2030. In the UK, BT Openreach plans to reach 25 million fiber-to-the-home locations by 2026. Deutsche Telekom is building FTTP networks to pass 2.5 million to 3 million premises in 2023. And similarly, Open Fiber in Italy is targeting to reach 24 million homes by 2031.

Data center deployments are also increasing. Datacenter CAPEX is set to actually increase from $263 billion globally to $377 billion by 2026. Particularly in India, the data center investments are expected to surpass over $20 billion by 2025. As an example, NTT India has earmarked $2 billion for the next 3 to 5 years for IT and communication infrastructure in India.

Lastly, on the citizen network side, we are seeing significant investments by the governments globally. For example, the US is investing $97 billion in broadband through multiple programs like RDOF, BEAD, Middle Mile programs, etc. Similarly, the UK, Germany, France, and Austria are countries where cumulatively about $8 billion, $14 billion, $24 billion, and $2 billion respectively under various programs are being utilized to build digital programs to connect the unconnected. The Indian government similarly is looking to move forward on the Phase III of BharatNet to connect all the villages and over $10 billion is expected to be invested.

As we listen to the leadership of the leading global telecom companies, they are unequivocal on the importance of fiber investments in the overall network build-out. In this regard as an example AT&T has recently signed a definitive agreement to form a joint venture with BlackRock that will operate a commercial fiber platform. The JV plans to deploy a multi-gig fiber network to 1.5 million customer locations across the nation. It is important to note that these customer locations will be outside of AT&T's traditional 21 states service footprint and in addition to the 25 million to 30 million home passes that already AT&T has targeted by 2025.

All of these deployments are leading to a sustainable growth of OFC volumes and optical interconnect. As per CRU, the leading research house in this space, the global OFC demand is expected to reach 624 million fiber kilometers by 2025 from 534 million fiber kilometers in 2022 last year.

The optical interconnect demand in the global market, ex-China, is also expected to grow from $7.5 billion in 2021 to close to $10 billion by 2025, and STL has a strong presence in its key focus markets which are North America, Europe, and India.

Coming specifically to India, 5G deployments are clearly picking up pace. The top two telecom operators are rolling approximately 3,500 sites per week cumulatively. Bharti Airtel, for example, launched 5G services in more than 30 cities and Jio has launched 5G services in more than 130 cities. Both operators have aggressive plans to cover India broadly between now and March 2024. Telecom operators are expected to invest between $18 billion to $22 billion in non-spectrum CAPEX between now and 2025. And out of this, we expect the operators to spend between $1.5 billion to $2 billion for fiber rollout specifically in the next 2 to 3 years in preparation of the 5G.

As we have shared before, we broadly believe the tower connectivity has to grow from about 30% to close to 70% and this is where significant fiber will also be required. In terms of cable kilometers, we expect telcos to deploy more than 2 lakh cable kilometers in the next 18 to 24 months.

With favorable industry tailwinds, we have deployed a focused strategy to propel us forward. In the following section, we will talk about our strategy in detail. Essentially, our strategy is straightforward and includes 2 levers. Firstly, we focus on growing the optical business.

Secondly, we look to consolidate our services business. We are allocating capital to tap into strategic growth opportunities offered by these levers and we shall talk about our progress in each of these in detail in the subsequent slides.

If you look at the optical business, particularly the optical fiber cable business, as you can see from the chart, we are consistently gaining market share. In 9 months FY23, we have reached an estimated 12% market share globally, which is up from just 5% in FY20, if we subtract the China's share. We are also very pleased to announce that we have received additional orders in the multiyear multimillion-dollar contract with a leading North American broadband connectivity company. Our intent is to increase the long-term contracts in order books and we are moving forward in that direction.

In line with the expectation, commercial production has started in our optical fiber facility in China in quarter 3 FY23. In the US, commercial production shall start in the current quarter – Q4 FY23. We are working hard to reach to full utilization by the first half of FY24.

We have increased our optical interconnect attach rate from 3% in FY21 to 10% in the 9 months of FY23. The first step we have taken to grow this business is to offer optical interconnect solutions to our existing accounts, particularly in the European market. As a next step, we are also going through a product approval cycle in new markets such as the Middle East and APAC. We expect to continue to increase our rate of optical interconnect products and plan to reach the attach rate to 40% by Q4 of FY25.

Coming to the services business, we are focused on building a profitable order book by picking up projects in our India Private segment. If you look at the services revenue split, revenue from India Private has gone up from 31% in FY22 to 42% in 9 months FY23. We are looking to build sustainable revenue streams, including O&M as well. Moving forward in the services business, our focus is on cash and profitability rather than chasing revenue growth.

As you can see, our project execution is on track. Among India Public projects, our BharatNet projects in the state of Telangana is 61% complete, including all packages and the network modernization project for Indian PSU is 63% complete. For the Indian Private side, fiber rollout for a large Indian telco operator is 100% complete for Phase I and 99% complete for Phase II. Phase III is yet to start. Fiber rollout for a modern optical network for yet another private operator is 29% complete, and specifically in the UK, the fiber-to-the-home rollout for all our UK projects combined is 6% complete.

As you would recall, we had entered the network software business in FY16 through the acquisition of Elitecore. We continue to remain a niche player in this business. Moving forward, we are working to pivot from this telecom software business to digital business. The strategy is still in works and we shall come back to you in Q4 with some more detailed plans. In line with what we shared last quarter, we have ramped down the wireless business with no further

investments in capital and manpower from Q4 of FY23. In the last quarter, we enabled specialized engineering talent of the wireless business to move on to other relevant organizations. We expect STL EBITDA to go up on account of ramp down of the wireless business from Q4 FY23 onwards.

In terms of capital allocation, our clear priority is investments in the optical business. We are investing in the optical fiber cable capacity expansion, optical interconnect expansion and new product development. We have improved margins and working capital cycle in the optical business. We are working to improve margins and working capital cycle also in the services business. We have ramped down the wireless business, as I mentioned, and which shall help in improving the cash flow from operations. We shall also continue to divest sub-scale assets. We have divested IDS in the current year, as you would recall. In FY22, we sold our interest in Metis Eduventures and MTCIL. Through all of these actions, as we start to generate higher cash from operations, our priority will be to reduce net debt and to bring along with adequate investments in the optical business.

STL's endeavor is to be a responsible leader in ensuring a connected and inclusive world. This focus reflects in the way we have designed and implemented our ESG agenda. We have diverted over 2 lakh plus metric tons of waste away from landfills from FY19 to November 2022. We have reduced emissions of 21,000 tons of carbon dioxide emissions through various initiatives in the plants from FY21 to Q3 FY23. We have also announced our commitment to become a carbon-neutral company by 2030 and we have recycled 6 lahks metric cube of water from FY19 to November 2022. We are also very happy to announce that we have become the world's first optic fiber manufacturer to be zero-liquid discharge certified. Through our various initiatives in education and women empowerment, more than 7,90,000 lives have been positively impacted from FY19 to Q3 FY23. We have also positively impacted 2.15 million lives through our various initiatives in healthcare from FY19 to qQ3 FY23. In our work, we have won 84 ESG awards. I am very proud of the team for their achievements from FY20 to Q3 FY23.

At this juncture, I am delighted to introduce Tushar who has joined us as Group CFO. Just to give you some brief on Tushar, he is a qualified chartered accountant and a cost accountant with an experience of close to 3 decades in the fund-raising capital structure, mergers & acquisitions, treasury management, taxation, financial accounting & planning, investor relations, and business partnering; all the facets of the finance function. As the CFO of STL, he will work closely with me and the leadership team to bolster the company's strategy to deliver consistent shareholder value and profitable growth.

I will now hand over to Tushar to discuss the company's financials with you.

Tushar Shroff: Thank You Ankit for your kind introduction. Good day, ladies and gentlemen. Our financials continue to improve. We shall now discuss this in detail. Before discussing on the financials, I would like to state that in accordance with Indian Accounting Standard, Ind-AS 105, non-

current assets held for sale and discontinued operation which is related to IDS, wireless business, and telecom software business are reported as discontinued operations, and accordingly for like-to-like comparatives, respective period financials are restated. For further details, you can also refer note 4 to the financial result.

Our open order book, i.e., order backlog at the end of Q3 FY23 has gone up to INR 12,054 crores. This is a reflection of strong demand in the industry and our dominant position and focus, particularly on optical fiber business. Our order book is well diversified across customer segments, also across our business areas. We also have a significant O&M order book which is already yielding revenue from this year.

Our revenue mix is shifting to the customer segment and geographies of our choice. We are increasing our share in telco segment. In terms of geographies, we are increasing our shares in American and European markets. In line with our strategy, as compared to last year, we have increased the revenue share in the American market from 11% to 37%. Again, this is a reflection of our product innovation and the reward of investment in R&D over the years.

In terms of notable order wins in this quarter, apart from the additional order in the multimillion-dollar contracts for cables in North America, we have secured a multimillion-dollar order for optical fiber cable and optical interconnect solution from European customers. On the service side, we have secured new orders for Pan-India fiber rollout from leading Indian telcos.

In line with our expectation, quarterly revenue grew 12% quarter-on-quarter to INR 1,882 crores. EBITDA from continued operations went up by 8% on a quarter-on-quarter basis to Rs. 252 crores. Net profit grew by 17% on a quarter-on-quarter basis to Rs. 77 crores for Q3 FY23. Revenue growth was driven by strong growth in optical business, margin improvement is mostly on the back of improvement in margins in optical business.

For 9MFY23, revenue grew by 28% on a year-on-year basis to Rs. 5,050 crores and EBITDA from continued operations went up by 17% on a year-on-year basis to Rs. 651 crores. Net profit from continued operations is at Rs. 162 crores for 9Mperiod FY23.

In order to increase the transparency, we have started reporting segmental financials from the last quarter. Starting with optical business, we delivered revenue from our continued operations of Rs. 1,486 crores, which is 13% higher on a quarter-on-quarter basis. This is due to increase in our volume and better price realization and the favorable revenue mix. We delivered EBITDA from the continued operations of Rs. 302 crores, which is 15% higher on a quarter-on-quarter basis. Key drivers for the margin improvement were product mixture to higher-margin products and reduction in logistics cost, while increased raw materials particularly helium, has dragged the margins relatively.

In the global services business, we have delivered revenue from continued operations of Rs. 380 crores, which is 8% lower on a quarter-on-quarter basis. As we have said initially that we are focused on cash and profitability over our revenue growth, we are being selective in new project intake. Despite lower revenue, EBITDA is relatively flat due to better project management and focused execution. As we said earlier, we are working to ramp up UK revenue to be profitable by H1 FY24.

Coming to digital technology solutions, revenue from continued operations grew 380% to Rs. 24 crores in Q3 FY23. As we have spoken earlier that we are building a new business in this segment and we shall come back to you in Q4 to explain the business in detail. We have placed an abridged version of quarterly reported numbers for your perusal.

In summary, I would like to say that our profitable growth journey in the optical business continues. We continue to gain market share across the focused markets, increase the optical interconnect attach rate and improve the margins. We are consolidating towards the strategic segments in the services business. We are working to build a profitable order book from Indian private telcos and aim to reduce the capital deployed in this segment.

In line with the stated strategy, we have discontinued the wireless business and exited from IDS and other sub-scale businesses. We aim to reduce our debt as we move forward. The debt has peaked and going forward, we see the progressive reduction in our debt over a period of time.

Now if there are any specific questions, we would be happy to take your questions.

Pankaj Dhawan: We will take the first question from the line of Mukul Garg.

Mukul Garg: Hi, Ankit. Two questions from my side, first on the America's business. The pace of growth in that market is extremely sharp, and I think it has become your largest region this quarter. How should we think about America going forward? Will it be more of a case that America will take the sales away from your other segments or how are you looking at tradeoffs between different regions? And second, on the profitability side, your margins, at least the optical margins, are flattish compared to last quarter whereas the raw material prices including helium have corrected very meaningfully. So, how should we think about given that the volumes also were higher this quarter and operating leverage benefits also have started flowing off?

Ankit Agarwal: Probably on the US market, I think we are generally quite bullish on the market demand. We continue to see pretty strong investments both by large operators, Tier-2 players as well as very large investments from the government. As I called out, there is just one project which is the $40 billion program of BEAD is expected to come in by mid of this calendar year, as an example. So, we fundamentally see a fairly strong demand over the next 3 to 5 years. I think our own position in that market has been strengthened in terms of our team and product

portfolio, and now with the facility coming up, our overall brand and positioning in the market has improved quite positively. We are under the stage of commissioning the factory, setting up our processes and systems and getting certain technical approvals which will enable us to serve that market better. I think at a macro level, the way to think about it is that, yes, it will continue to be either our number 1 or number 2 market going forward. We also see that this is a future growth area for our interconnect solutions as well over the next 2 to 3 years. And I think the way we are looking at it is that we would serve that market both from the operations that we would have locally as well as from the operations in India. That's how we look to serve the market.

In terms of the profitability of the optical business, I think, we have guided that we will be north of 20% and that's something that we continue to be committed towards. We will see broadly over the next between now and H1 of next year improvements coming in into the numbers because of the volume. We are talking about going from 33 million to 42 million. That will come in. The China fiber factory has restarted and as we scale that up, those benefits of volume will come in.

We largely believe the realizations have peaked or largely will peak between now and Q4. So, the upsides will now come from the volume on the cable part as well as growth of our optical interconnect. We have talked about going from 10% attach rate to 40% attach rate by Q4 FY25. That's really the priority and focus for us.

Just one comment – one different view – Mukul, on the raw materials. While I think we have seen some kind of now flat lining or benefit of polyethylene and container costs, the helium prices are still very high, I would say exceptionally high. Both availability and pricing has been a challenge and at least our current visibility is that it will continue for probably the next 6 months.

Mukul Garg: Just one follow-up on the US market. Will that business kind of operate at a different profitability level versus India and Europe or net-net higher prices will be compensated by higher operating costs due to transportation and other expenses?

Ankit Agarwal: I don't want to comment on the realization in that market for competitive reasons, but I think broadly, as I said, it's a very important market for us, it's a fast-growing market. We have invested a lot in R&D, innovation, and intellectual property to serve that market and we will continue to do that, and so, for us, it is definitely an important market. And going forward, we will address that market, both through our operations there as well as a good portion of sales will come from our Indian operations into that market.

Pankaj Dhawan: We will take the next question from the line of Mr. Mohit Motwani.

Mohit Motwani: I wanted to understand the jump in the other expenses quarter on quarter. I think this is a reflection of the fact that you stated container costs continue to remain high. Is this completely driven by that or there is something else also to it?

Tushar Shroff: If you see Q3 FY22, other expenses were about 32.55% of the overall revenue. Q2, I think it went down to 23.8% and currently, this quarter, we are at 24.9%, which is in line with the increase in the revenue that we have seen for this particular quarter, largely on account of the variable cost in terms of transportation and logistics costs that we have. And the second part is there are a couple of expenses like one-time expenses on professional and legal services that we have taken as well as the plant operation in the US, which is related to operating expenses which is a time cost, which is impacting other expenses for this particular quarter. But however, our guidance in terms of the operating expenses or other expenses should be in the range of 23% to 25% going forward.

Mohit Motwani: One other question would be around the wireless business ramp down. Is the benefit of that completely done in Q3 or we could expect some incremental benefit in Q4 as well?

Ankit Agarwal: In fact, we had the costs for that business in Q3. So, the benefit will actually come in Q4. There are 2 parts to it. Largely, the people cost that we had — we really put a lot of effort to ensure that they were placed with partner companies, and we are so very happy with that outcome. And we don't expect those costs to be there in Q4 onwards. So, that benefit will start coming in Q4. There are certain assets that are there with STL in terms of R&D equipment, etc. Those, we will run probably a sale process or something to ensure that we maximize the value from that.

Mohit Motwani: Actually, I just meant that above EBITDA, there is no wireless business cost, as everything is flowing through profit from discontinuing operations, right?

Ankit Agarwal: That's correct.

Pankaj Dhawan: We will take the next question from the line of Mr. Bhupendra Tiwari.

Bhupendra Tiwari: My question is more on…. We thought about raising fund in the form of rights issue. But I just wanted to understand the purpose behind this issue. Is it a growth-driven fund-raise or in terms of the capacities that maybe we would like to add in the product thing or is it basically for deleveraging? I just wanted your thoughts around that first.

Ankit Agarwal: I think, Bhupendra, it's really in line with our conversations we have had and we have been sharing with the market. Fundamentally, on the one hand, we are clearly positive about the growth of the business. But I think more important for us is to really make sure our capital structure is in the right place. That is really the core of the fund-raise through the rights issue. The total capital amount will be up to Rs. 500 crores and further details will be decided with

the committee. The intent is really to use the capital to get the capital structure in a better place and really in line with our previous discussions on capital allocation and make sure that the balance sheet improves essentially.

Bhupendra Tiwari: Thank You. That was very useful. The second question was largely on the services thing. I think you alluded to that saying that you are focusing more on the private side of the services and that was seen also in the 9Mrevenues that we have. When we say private side of the business and the opportunity that we talked about was 2 lakh cable kilometers of fiber that will come around in India because of the 5G, how much is your sense or rather what has been your historical market share of fiber layout in India? I just wanted you to throw some light there.

Ankit Agarwal: Maybe some context here, historically, the fiber rollout was done by a lot of local companies. It was a very local way of running the business. And our whole premise for STL was that we can consolidate and be a large tier-1 professional company in this space. We can bring in innovation and technology. We can use apps, tools, and other means to improve both the service quality as well as operational maintenance. That's being the efforts, we have worked with the 2 large operators in the country. I won't be able to share market share, but I can share that certainly with both operators, we are probably one of their largest partners in the country. And there is a real interest from both sides to see how we can further support them both for their 5G as well as for their fiber-to-the-home rollout. But as I said, what's important for us at the same time is not to grow the revenue for the sake of it. We are really focusing on getting any of these opportunities, whether government or private, at the right margins and in the right fund involvement structure. That's really the focus for this business.

Pankaj Dhawan: We will take the next question from the line of Mr. Krish Mehta.

Krish Mehta: I just wanted to ask what the loss for this quarter was for OSS and BSS as well as for Q2 FY23.

Tushar Shroff: For 9M period, it was about Rs. 53 crores.

Krish Mehta: And what was it for this quarter specifically and last quarter?

Tushar Shroff: I am talking about the EBITDA impact of OSS and BSS business to the extent of Rs. 53 crores. This quarter, it was about Rs. 15 crores. The previous quarter, it was about Rs. 26 crores.

Pankaj Dhawan: We will take the next question from the line of Mr. Saket Kapoor.

Saket Kapoor: Firstly, as you mentioned that the Chinese entity would be now contributing since now the utilization levels have gone up. If you could give us the trajectory, what kind of contribution will be there from the Chinese for the remaining half and for the full year as a whole going ahead?

Ankit Agarwal: Saket, we are not disclosing volumes by facility for competitive reasons. What I can share is that, as you would have seen in the pictures and some of the data, we do have the team there. The operations have started. It's actually a world-class asset. So, we do believe the fiber manufactured from there will both be competitive as well as able to serve our global requirements. At a macro level, what's important to understand is that a large portion of our fiber will now be utilized for our own cable operations, especially as we are expanding from 33 million to 42 million. Similarly, a good portion of the fiber made from our China factory would be utilized for our global cable operations. By and large, we believe that quarter on quarter, we will see volumes scale up and we do believe that these will be made competitively and whatever investment we have made to acquire the balance 25%, that will be a positive investment as well as one of the areas that is also positive is now — because it's an R&D facility – we will be targeting to run this at 15% tax rate, which will also be beneficial for the company.

Saket Kapoor: Sir, how much more do we need to spend to ramp up the production there? I was just trying to understand that last year, I think, there was a negative impact of around Rs. 80 crores to Rs. 90 crores from the Chinese subsidiary. Going ahead, what would be the run rate? How will that go down? That's the understanding. And what was the price we paid for the balance acquisition, sir? How much have we spent?

Ankit Agarwal: I think, a ballpark, in the range of Rs. 50 crores to Rs. 60 crores. We can come back with the specific number. I think the main message was that essentially, while during COVID, we were negotiating with our JV partner on the terms, and the operations weren't running at that time. Since then, we have acquired the 25% successfully. The transaction is closed. We have also successfully got the business license to operate and so we are quite well set up now. Quarter on quarter, we will see the improvement in the production. And we can probably update you more into the next quarter on how that is scaling up.

Saket Kapoor: Sir, when you mentioned it as an R&D, it is an operating asset. I did not understand.

Ankit Agarwal: Sorry, what I meant was that from the government's perspective if you are doing technology manufacturing, you are given a special tax rate of 15%. I didn't mean R&D in that sense.

Saket Kapoor: So, more updates we will get in the 4th quarter.

Ankit Agarwal: Yes.

Saket Kapoor: Sir, in terms of the net debt level, and I think so the road map ahead for reduction, rights issue has been, as you earlier commented. So, what's the road ahead in terms of how the net debt is going to look like? Whether we have peaked out? And just more thoughts on the same, sir.

Tushar Shroff: The rights issue proceeds that we are expecting maybe in the FY24 because of the documentations and everything, that procedural part that we will have to complete. So, the

rights issue proceeds will come in the next year. However, for this particular year-end, what we are targeting is that we will be at a net debt of about Rs. 3,200 crores based on the earlier guidance Ankit had given. So, all our efforts are moving towards Rs. 3,200 crores at year-end debt levels.

Saket Kapoor: Rs. 3,200 will be the closing for March 2022?

Tushar Shroff: That's the target, yes.

Pankaj Dhawan: We will take the next question from Mr. Tejas Sheth.

Tejas Sheth: On the Optotec side, when you said the attach rate of 10%, is it on the cable and fiber combined revenue or it is only on the cable side?

Ankit Agarwal: This is the attach rate of interconnects. That's what I was sharing last time also. For a dollar of cable sold, today we sell 10 cents of interconnect at a company level. And just to be clear, it is a combination of the Optotec that we have, we have a setup in Dadra as well and so it's a combination of everything in the interconnect business that we have.

Tejas Sheth: Is there any element of INR depreciation towards the increase in the order book level?

Tushar Shroff: FX impact if you see this quarter, like-to-like basis is about 2% to 3% in the dollar terms. However, the very specific number in terms of what were some adjustments due to the FX rate which has moved from Q2 to Q3, which Pankaj will provide you separately.

Ankit Agarwal: I don't see it being meaningful. That's what we have been sharing some of the details. These are some of the contracts in the US, there are some contracts in India, etc. So, it's a mix from a geography perspective.

Tejas Sheth: Because, when I see your optical order book, in a way, obviously, it has been executed well on the quarterly basis, but at the quarter-end basis, it's more or less quite flat over the last 4-5 quarters.

Ankit Agarwal: Yes, that said, directionally, we have been overall of open order book in this range of, say, 11,000 to 11,500 or so. And I think what's also important is that to measure that versus our revenue run rate, we have been at say 1500 to 1600 and now it's going up. At the same time, we are booking over Rs. 2,700 crores per quarter. That's an important measure for us in terms of what is our order booking vis-a-vis our quarterly revenue, which will then help us and place us well for the next year's growth onwards.

Tejas Sheth: Just last question. On the digital side where we are burning capital, how do you see that trajectory changing as well as on the global services side where the margins are much lower

single-digit, how do you see the margin trajectory there also – not from a quarter basis but more so from, let's say, FY24 or FY25 basis?

Ankit Agarwal: The UK services is on the back of the acquisition we had done for Clearcomm. The intent is clearly, when we look at the model, we need to scale up that business and execute on a quarter-on-quarter basis. We believe that probably by the end of H1 of next year, we should at least get to a breakeven level versus the losses right now and then we see how to improve the EBITDA probably to 10% range. That's really the focus for the services business and the UK team out there.

On the digital business, one part of it, we have called out that these are assets held for sale. And then we have Raman, who has come in, and he is really relooking at our business, our portfolio, and seeing how do we scale it up in the right profitable segments. There, I would say, give us about 3 to 6 months. We will come back with more details of how we want to drive the business. But it looks exciting. We are definitely seeing positive trends in that.

Tejas Sheth: Just one last bookkeeping question. Are we capitalizing any of the finance cost considering that the interest cost is quite steady despite our debt increasing as well as the interest rate increasing at the global level as well as in India?

Tushar Shroff: For our US plant which is under construction and which is under WIP, which is whatever the borrowing that we have to the extent of the capital employed for that particular plant, we are capitalizing it, which is required as per the accounting standard.

Pankaj Dhawan: We will take the next question from the line of Sunny Gosar.

Sunny Gosar: Congratulations on an improvement of your financial performance. My first question is, if you can highlight what is the net debt levels of the company currently? And in terms of the guidance, what's the net debt that…. either net debt-to-EBITDA or some ratio or some guidance you can give of net debt in the next 18 to 24 months?

Tushar Shroff: Currently, we are at about Rs. 3,400 crores in terms of net debt at the close of the Q3. We are expected that we should be able to close this particular financial year with Rs. 3,200 crores. That's how we would be able to generate positive cash. As we discussed in Ankit's presentation that the way we are looking at this particular business, we want to run this particular business in a disciplinary manner and that's why we are looking at targeting debt-to-EBITDA level of 2.5 to EBITDA. That's the journey that we will be embarking on over a period of next 6 to 12 months.

Sunny Gosar: And in terms of the CAPEX, any guidance on CAPEX for the next 2 years? This year, I believe, it is Rs. 500 crores overall. What will be the CAPEX per annum for the next 2 years?

Ankit Agarwal: Broadly, we are looking at around Rs. 350 crores for the next year. We are still kind of in the finalization of our business plan. But it will be largely focused on the cable and, to some extent, the interconnect.

Sunny Gosar: My next question is on the system integration business. We are doing about 1% margin on the system integration business currently. How should we look at the business going forward? You mentioned about the focus on the private side and focusing on orders which are profitable and have the working capital which is under control. Whether the current revenue base on a quarterly basis is the base or it can go down further? And how should we look at margins for this business at least for the next few quarters and then maybe in the medium term?

Ankit Agarwal: I think at a macro level…. One is, just at a fundamental level, we believe that one of the drags on the profitability is the UK business, what we just spoke about. I think that is quite critical for us to turn that around, get it to at least break even and then grow that. That is something that we are looking to execute. The orders are there; the market is positive. I think it's for us to execute and build that right model to get it to breakeven and profitable. So, I would say that's one directionally that we are looking to do.

In India, as we said, directionally, we are not chasing revenues per se. We are focused on whatever orders we pick up going forward, both from private and government, to both look at very closely the right profitability margins as well as the right fund involvement.

And then I think the third part clearly is on projects where we are either executing or have executed like Maharashtra, Telangana, and other projects is to make sure that we complete execution, complete the milestones, and then collect the cash. That's really the priority of the system integration business. We do expect the profitability to improve, but it will take time to get the new projects on one side in India with the right margins. And second is this 6-9 months' period will take to get the UK services into the right profitability level.

Sunny Gosar: If I can conclude, is the current quarter profitability in that sense, the ways and things improve from here on or there could be a couple of quarters where you have remained at breakeven or even have some kind of small losses in this segment?

Ankit Agarwal: Again, it's going to be touch and go. It's really a function of how do we make the shift happen, as I said, in both the UK and in India. So, I wouldn't comment. I think directionally, as I said, as you can already see quarter on quarter, probably some of the revenues have started coming down for services. So, we are really not even setting very specific targets on revenue going forward. It's just whatever we have on our plate, execute in the best way possible, and anything new we pick up, we do it at better margins. I think it will just take some time, but probably it will take us that period of 6 to 9 months to improve the business performance.

Sunny Gosar: And if I may, I have one last question. On the new digital business that you are focusing on, say, in this quarter, you had EBITDA losses of, say, about Rs. 30 crores to Rs. 35 crores. Going forward, till the business stabilizes and breaks even, is this the peak level of loss on a quarterly basis or there could be again a period where for a few quarters these losses go up?

Ankit Agarwal: As I said, directionally we will give more details of the business, what we are looking to do, customers, etc., probably in a quarter's time. But directionally, we are excited about the business. We have a global leader, Raman Venkatraman, who has come in from TCS, who leads this business. We are really working with him to see how do we scale this business up, how do we do it profitably, etc., and with the right customers. I would just leave it at that to say that give us another quarter to share more details. Broadly, we are investing in this, but we are also conscious of making sure that at the right point of time, this business also starts generating profit and cash for the company.

Pankaj Dhawan: Due to the paucity of time, we will take maybe the last few questions. The next question we will take from the line of Mr. Pritesh Chheda.

Pritesh Chheda: Just a few questions. When you said that from here, it is largely volume, I want to know what is the headroom in volumes that you have from the current levels. Is it 20% or 30% if you could share that? My second question is, we have our interconnect rate today of 10%, right?

Ankit Agarwal: Yes.

Pritesh Chheda: That we aspire to reach to about 50% in some years' time.

Ankit Agarwal: 40%.

Pritesh Chheda: What is the value addition on account of the interconnect rate on your overall business run rate that you have today when you reach that 40%? And what are the margins in that incremental business? These are my 2 broader questions.

Ankit Agarwal: What we shared was that the cable capacity is what will come on stream. From 33 million to 42 million, about a 9 million addition of volume will come through broadly in the next 6 to 9 months. That's the major volume trigger. As a subpart….

Pritesh Chheda: What is it in the percentage terms of that 9 million? That's 30% extra?

Ankit Agarwal: Yes, 9 over 33, about 30-odd percent. That's on the cable essentially. On the interconnect, basically, what we see, just to give you a perspective, globally, the cable market is about $8 billion to $9 billion and the interconnect is similar, $8 billion to $9 billion. So, the global benchmark for us when we see at a macro level is 1:1 which means 100% attach rate. That's where we are already in conversations with customers. But there's a typical longer time cycle to build the products, get the intellectual property approved, get the customer approval and

also to supply. This is where there is some period of time, probably even more than what it takes for cable supply to really scale this up. But once you are in there, typically, customers really like to depend on you for the long term, directionally, because this is much more solution oriented than even cable. The typical EBITDA margins on interconnect are 30% compared to cable being at 20%. That's really what we are driving in terms of growth. And also, this is typically less CAPEX investment or CAPEX intensive than what is required for cable. So, that's really where our focus is. We do have global teams. We do have global customer connects. So, the focus is now to build the product portfolio and get this moving over the next 2 years.

Pritesh Chheda: And how much business do you add from moving 10% to 40% on your current quarterly revenues that we see?

Ankit Agarwal: I won't be able to share the exact number. But directionally at least Rs. 1,000 crores to Rs. 1,500 crores can be an addition over the next 2 to 3 years.

Pankaj Dhawan: We will take one more question from the line of Mr. Subrata Sarkar.

Subrata Sarkar: A few questions; first on the India side of the business. Apparently, it is appearing like we are more gung-ho on the external market than India. Can I try to understand the reason behind that? Is the Indian market too competitive? What is the exact reason? Is it because of the margin? Is it because of operational difficulty in implementation or is it because of the working capital issue? This is the first question from my side.

Ankit Agarwal: Subrata, I think, one, just at a macro level, I don't think we have a negative view on India.

Subrata Sarkar: Relatively, we are muted. That's what I mean.

Ankit Agarwal: I will come to that. Fundamentally, I think, India will have a 10-year digital network build-out, whether it's from the government's side, from defense' side, data center side, etc. I think it's a great opportunity, and STL has built strong capability over the last 7 to 10 years. So, we are quite well placed to take it on. What we are simply saying is that this is where we look at the business today. We are largely doing a lot of services today both to the private sector and government sector. Based on our experiences, particularly on some of our execution challenges for government projects or cash collection or fund involvement which has been longer on the government side; based on some of those experiences, we are saying we want to pivot more to the private sector in India. So, we are still committed to the Indian market and we want to make sure that we support the growth, especially at this time of 5G deployment in India.

The other part we are looking at very closely is that there is probably a $10 billion investment funded by the government on fiber rollout to the villages as part of Phase 3 of BharatNet. That is obviously a very exciting national project which would be great for STL to be part of. Having

said that, we have to ensure that if and when we look at any of these projects, it has to be at the right terms and right norms so that there is complete visibility on both profitability as well as the fund involvement. These are the parts that we are just taking lessons from our past experiences and I would say being more mindful of which projects we are part of, which projects do we say yes to and sometimes we have to say no to.

Subrata Sarkar: My second question is on the capital structure side. As you announced this year, we will have a Rs. 500 crores CAPEX. Next year, we will have Rs. 350 crores of CAPEX. And our operation is also growing, which will require higher working capital. Given all this context, whatever debt reduction or rationalization that we are planning for, is it mainly from the external source like funding through rights issue or whatever source or internally from operational cash flow also, we are planning to reduce the debt to that extent? What's the strategy?

Tushar Shroff: If you would have looked at the service business which is working capital heavy, and as we continue to execute some of the projects, we tend to release a lot of retention money which gets involved in this kind of a tender business. As we execute better and better, the opportunity of releasing cash is much more. So, we are more focused in terms of ensuring that we are able to generate more on the operational side of cash flow as well.

Subrata Sarkar: Sir, lastly a small question. On the optical fiber side, we are above 20% margin which is more or less the peak margin vis-a-vis our overall company-level margin we are operating at 13% only. My point is at service level, that's also a strategic decision like how much we want to penetrate at the service level because service is a much lower kind of a business, you are guiding for 10% margin. From a strategic point of view, what kind of overall company-level margin we are targeting given the mix of optical fiber interconnect as well as service?

Ankit Agarwal: The way I would put it is, the optical today is at 20%, we are confident of that. I think it's important, as we talked about, there will be improvement coming from the volume increase. There is also both a focus on volume as well as profitability improvement coming from the interconnect. As I said, the margins in interconnect are closer to 30% typically. So, it's important for us to keep pushing that forward, getting all the technology, getting the innovation, and pushing that to the customers. That is something that we are positive about and that is work cut out for us.

In terms of the services part, as we stated in our last results as well, directionally, we want to improve the profitability at EBITDA level of the services business, take it at least to 10% levels from very low levels currently. One big part of that is to sort out the UK services margin so that overall services improves as well as in India focus more on the private sector going forward so that we have both good margins as well as better fund involvement. The combination of these two, we believe, should help us improve the EBITDA margin. But as I said, this is probably a 6- to 9-month process.

Subrata Sarkar: But are we targeting any optimal level of mix like the way our intention is to reach 40% in interconnect? So, service to optical fiber interconnect mix are we targeting anything? Do we have any optimal mix in our mind?

Ankit Agarwal: Nothing specific. Already as you can see, directionally we are broadly at, say, 70% of optical business, 25% -27% of services, and then balance is the digital business. So, as I said, we are not consciously driving any top line growth in services. We are much more focused on taking select projects at the right profit and cash level. I am comfortable at the split. More than the split for me is making sure whatever business we are in is coming at the right terms. We are positive when we look at the market trends of optical. We are fully committed on that. Services require some sort of change in improvement from where it is. That's the second part. And in digital, as I said, we will share more details by next quarter. But clearly, lot of opportunities here for us to improve from here.

Pankaj Dhawan: With this, we come to the end of the Q&A session and I now hand it over back to Ankit Agarwal for closing remarks.

Ankit Agarwal: I would like to thank everyone for attending this call and showing your interest in our company. I hope we were able to address and clarify all your queries and comments. For any further questions and discussions, please feel free to contact the Investor Relations team which includes myself and Tushar. We really look forward to continuing the conversation with you in the future. Thank you. Jai Hind.

Tushar Shroff: Jai Hind.