"Sterlite Technologies Limited Business Update Conference Call"

July 06, 2018

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Moderator: Ladies and gentlemen, good day and welcome to the Sterlite Technologies Business Update Conference Call. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then 'o' on your touchtone phone. Please note that this conference is being recorded. Along with this call, we are also running a live webcast of the presentation covering the strategic aspects of acquisition of Metallurgica Bresciana. I now hand the conference over to Dr. Anand Agarwal, CEO, Sterlite Tech. Thank you and over to you.

Dr. Anand Agarwal: Thank you. Good Evening, ladies and gentlemen and thank you for joining us on a short notice. We welcome you all to this call and are extremely excited to share our recent corporate development in our company. Earlier today we announced the signing of a definitive agreement for 100% acquisition of a European optical fiber cable manufacturer, Metallurgica Bresciana based out of Italy. The acquisition is being done in an all-cash basis for our consideration of around €47 million.

As most of you are aware that our unique silicon to software capabilities are unparalleled in the world and we continue to become more and more relevant for our customers with our data network focused offerings.

I would like to set a context to our long-term strategy where we believe in having control on all key elements on the fiber manufacturing value chain which derive high value for the company. The newer network that are being currently planned and built which driven by exponential growth in data and new customer-centric application, require much higher throughput and lower latency in widening strong fiber consumption which will become an integral part of tomorrow's connectivity. Based on this fundamental belief, we have strategized preform business model which is centralized in India with the best talent that is focused on high end glass research. In our operational excellence-led model for fiber drawing is strategically located in India and China, which are two large markets from fiber deployment perspective.

And with our growing innovative and advanced cabling solutions, design for specific applications such as fiber to the antenna, bend insensitive fiber, fiber-to-the-home, coupled with various other specialized products for network operators. Customer proximity is becoming very important. This acquisition aligns with our global supply chain strategy of having cable facilities in close proximity to our key markets for cabling products. Europe as well as India and this is in addition to our facility in Latin America. We have created a strong impact on the global telco network. Our solutions are best-in-class and power various networks across geographies. We continue to expand a global footprint and commensurate market share. Our footprint is further entrenched with this acquisition in Europe.

As you would know, our export profile reflects a continuous structured growth trend whereas strategy of focus market access and global supply chain platform creation has shown strong results in the growth of the company. This acquisition will bring new Tier-1 customers, augment our product portfolio and enhance our flexibility and ability to better serve the European market and further enhance our addressable market in Europe.

Let me now provide you some color on Metallurgica. The company designs and manufactures special precision optical fiber cables and specialty cables for various communication applications. It is based out of Italy with customers across Europe and China. It brings with it a set of new products in niche segments and capabilities which we can leverage in a much bigger way through the synergy of both companies. The company has a strong financial profile, with its revenue growing year-on-year at healthy rates and EBITDA margin in the north of 15%.

As I walk you through our largest strategic context in the previous slides, the deal rationale is aligned to our strategy of acquiring new capabilities with high value-added product lines which enhances our market share in existing and new Tier-1 accounts. As a company, we remain aggressively focused on the flawless customer excellence model by increasing and value add to our existing and prospective customers.

In terms of transaction-specific, we are acquiring 100% stake in this company through an all-cash deal of about €47 million. We have already executed the transaction documents and expect the closing procedures to be completed in about two weeks from now. We expect the acquisition to be EPS-accretive from day one. We will be completely integrating this asset with our cabling business vertical. The acquisition provides instant market access with the European manufacturing base. Apart from market and product value proposition, we have also identified synergies on the sourcing and financial front. So in essence, we believe it is a great fit from both strategic and financial point of view. Also, the acquisition has capacity of about 3 Million Kms of cabling with local manufacturing platform in Europe and which may further be expanded to 5 Million Kms with debottlenecking initiative and minimal CAPEX. This platform will be Sterlite Tech’s largest platform outside India focus on serving the European market.

In this slide, we have created a combined financial picture of both the companies on the pro forma basis, and as you would observe the financial impact of the deal is EPS-accretive from day one. The funding for this transaction will be done through a combination of internal accruals as well as Euro debt instruments.

Finally, we have over the years continue to work towards creating value for our shareholders. Our net profits have doubled from FY’16 to FY’18. We are well on our growth trajectory and with this acquisition we expect to expedite our earlier strategic guidance of 100 million bag by FY’20 which would effectively mean more than doubling of process from FY’18 to FY’20.

The outlook for your company remains bullish backed by strong macro demand indicators and our growing and this engagement with our customers who value our partnership over the years.

With this, I come to the end of our opening commentary and both me and Anupam would be happy to take any questions.

Moderator: Sure, thank you very much. We will now begin the question-and-answer session. We will take the first question from the line of Anubhav Gupta from Emkay Global. Please go ahead.

Anubhav Gupta: I have got two questions; the first is what is the IRR and payback expectations from this particular acquisition?

Dr. Anand Agarwal: IRR of this acquisition is north of 20%, Anubhav and the payback is between four to five years.

Anupam Jindal: Anubhav, just to add a few more things on this, this opportunity provides very good scope for us to expand capacity at the Brownfield level itself and that is how we will be looking at lot of synergical benefits which we are looking at in this and direct customer access to some of the marquee names which would have taken some time, so, if you look at from that perspective, it could be much earlier also. Those are the things we need to still work out but on its own it is looking like five-year kind of return.

Anubhav Gupta: What does this company ROC as of now, does this match with your existing ROC?

Anupam Jindal: ROCs are mid-20s and as we are looking at our ROC expansion will work, as I said lot of untapped opportunity within this company because it was a standalone cable company with us coming in it will become integrated fiber cable and fiber company and that will also create a lot of opportunity directly in the minds of a customer.

Anubhav Gupta: Second question, if you were to set up a 5 million kilometre Greenfield cabling unit in Europe, how much CAPEX do you think it would have taken and so what is the intrinsic value for this acquisition and how much you are paying for all the synergies and relationships and existing business which comes on the table?

Anupam Jindal: Anubhav, it is difficult to compare basis Greenfield manufacturing set up in Europe versus cost of acquisition. Cable definitely comes at a lower CAPEX but with the current capacity also it would have been at least half of what we are doing here in this transaction. But we need to look at as a running business which would have taken at least three years to start from Greenfield and come to this stage maybe more. So it will be difficult to have that comparison in any acquisition very frankly from Greenfield versus running enterprise.

Dr. Anand Agarwal: It is not a capacity acquisition, it is an acquisition which has necessary relationship, has necessary certification, accreditation from key customers, has necessary product portfolio and as Anupam said it gives us a head start. So, capacity is only a certain part of the overall deal. It is a package which would be difficult to replicate in a short time.

Moderator: Thank you. We will take the next question from the line of Mukul Garg from Haitong Securities. Please go ahead.

Mukul Garg: First of all, Anupam, can you help us with the breakup in terms of how much of the 3 million is fiber and how much is cable here?

Anupam Jindal: This entire 3 million is actually fiber cable capacity. In addition to that they have specialized copper cable production, so that is a different thing.

Mukul Garg: How much incrementally would be coming in from copper?

Anupam Jindal: Copper, we do not see it in parallel kilometer. I am not having the number in terms of exact quantity but in terms of the revenue breakup, 60, 65% comes from the fiber cable business out of this €48 million and balance comes in from copper cable.

Mukul Garg: The second question was as you mentioned earlier that this is the standalone cable company. So most likely they do not have a drawing capability and there will be opportunities from value addition from Sterlite side. So, a) where do you see the profitability of Metallurgica in a couple of years timeframe, is that a low hanging fruit given that you will be providing the value chain to them for them to increase the profitability and second, do they have any product portfolio which can actually increase the higher value and for Sterlite group as a whole?

Dr. Anand Agarwal: Pankaj, the company already has about 15% EBITDA margin currently which is pretty similar to what we make in India at about 12-13%. So the average scale and added leveraging and the synergy that we provide will only add to that. We have created certain scenarios and at this point till we get in and start working on those scenarios we would not like to make any numbers in terms of profitability, but we can definitely say that it would be in the same zone as what we do but with creating this extra scale that we have now in the European market, there are definitely several synergies of combined go-to-market of higher supply chain benefits, the 3 to 5 million operating leverage benefits and all that will accrue and maybe we will inform of you as we go along further. At this point of time, we would like the scale to happen from the company and the profitability maintained in the 13-15% range.

Mukul Garg: The other question in terms of their IP which can be used across the organization to supply higher value-added optical fiber cable?

Dr. Anand Agarwal: As we said, it provides entry into some other segments also like Railways, etc., and metros where the company has a full portfolio. We have to take a call whether we expand that or we let the company run on the portfolio that they have currently with the market and we focus on the optical side. So there is clearly about 30% of the company has a portfolio which we do not have today.

Mukul Garg: Are they running at full capacity right now or would there be some incremental I think small benefit to your European customers that they can be supplied from Italy?

Dr. Anand Agarwal: Absolutely, that is the short-term benefit which we will immediately accrue. The company is not running at full capacity because of lack of availability of fiber. So they are running at about 60% of their current capacity and we think we should be able to take it to 100% pretty soon with our European orders which we already are having and with the lead time and local presence, we would be able to access opportunities which we earlier were not accessing because we were based out from India.

Moderator: Thank you. We will take the next question from the line of Depesh Kashyap from Equirus Securities. Please go ahead.

Depesh Kashyap: So the revenue growth of Metallurgica was just 4% in CY'16 which accelerated to 18% in CY'17. Just wanted to understand the reason for this growth acceleration, so were there any capacity addition that happened in CY'17 in the company?

Dr. Anand Agarwal: Depesh, it happened more in terms of the utilization, so the company is utilizing the fiber capacity more and we have been collaborating with this company for over a year, year and a half right now, they were both our customer as well as our OEM manufacturer for us in Europe for some specialized products. It happens more with better capacity utilization and we believe that with us coming in we will be able to further leverage that.

Depesh Kashyap: Can you give graphical split that this company has that how much revenue comes from Europe and how much from China please?

Dr. Anand Agarwal: About 85% is Europe and about 15% is China.

Depesh Kashyap: Did we have a presence at least supplying mainly to UK before this acquisition?

Dr. Anand Agarwal: No manufacturing presence in Europe before this. So we were just distributing from the plants in India. So this would …

Depesh Kashyap: Not manufacturing but customers like we had in Italy before or it was just a new?

Dr. Anand Agarwal: Nothing sustainable, I mean, we had some off and on sales. So this would provide us a sustainable sales in Italy as well.

Depesh Kashyap: How much debt are we estimating from this, any color there?

Anupam Jindal: So this 47 million will be a mix of euro debt primarily and some part from internal accruals which is already getting tied up and we expect the entire transaction to be closed within three weeks, so before end of July we will have it closed.

Depesh Kashyap: Till now we are understanding that US and China are the main markets which are driving the fiber growth in the world. So now we are mainly focusing on Europe. So can you give some color like how the Europe market are growing and what is the driving force for that?

Dr. Anand Agarwal: Depesh, if you see our revenue, our order book, Europe is also very-very strong growth market and we have seen in Europe through distribution and customer engagement for the last eight, nine years. So for us the last year was close to 27% of the sales and we are seeing strong global surge happening and we realize that Europe is the market where we have good customer engagement, good presence and it made sense for us to have a manufacturing presence. We already have manufacturing presence by the way of fiber in China.

Depesh Kashyap: This cabling facility was the main competitor operational in Italy. So will there be synergies that now they will be getting the fiber from Sterlite, anything on that?

Dr. Anand Agarwal: They were buying fiber from Europe and we were also earlier supplying some fibers to them as I said earlier. So there will be synergies more in terms of higher capacity utilization and better access to the market.

Moderator: Thank you. We will take the next question from the line of Pranav Kshatriya from Edelweiss. Please go ahead.

Pranav Kshatriya: I was just trying to understand the breakup of the €47 million, what will be the cash infusion in the company and how much debt you will be assuming from the company? Is that €47 million what you are paying for the equity or it is debt plus equity of the company?

Anupam Jindal: This €47 million is for the 100% equity buyout and the debt in the company is about $10 million and we do not expect significant infusion in the company at this point of time. As we mentioned that CAPEX which will be required to increase the capacity from 3 to 5 is not material.

Pranav Kshatriya: That €47 million you will be partly funding through debt and partly through internal accrual. Can you give a break up of that, how much will be the debt…?

Anupam Jindal: Largely, I will say it will be local Euro-based debt which will be funded locally in Italy and balance will be funding let us say about 20% from here.

Pranav Kshatriya: Then this company will not have any issues with the operating cash flow generation and all?

Anupam Jindal: Yes, this company is generating good amount of cash flow. It does not have any significant CAPEX plan on its own and the cost of Euro debt is also not significant. So we have done that working, we have lined up the credit and it will be able to serve the entire loan on its own.

Moderator: Thank you. We will take the next question from the line of Alok Devra from IIFL Wealth. Please go ahead.

Alok Devra: Just a couple of questions; this 47 million is the enterprise value or the price you are paying for the equity part?

Anupam Jindal: 47 million is equity. The company has about €10 million debt on its own books.

Alok Devra: We were looking forward to some announcement on the cable part considering that the utilization had increased. So now with this coming through, would there be any change in plans in terms of cable expansion?

Anupam Jindal: Yes, this definitely provides immediate opportunity to increase our capacity, as I said 15 plus 3, 18 and then maybe becoming 20 in a short period of time. We are also working our internal India capacity to increase, that we will come up maybe once we finalize that in a month or so.

Alok Devra: So before this supplying fiber to the cable manufacturing for this company or it was …?

Dr. Anand Agarwal: Some part of it, Alok, as we said, they were about 60% utilized, about after fiber was going from us, it was not significant but it now provides a high opportunity to make it significant.

Moderator: Thank you. We will take the next question from the line of Srinivas Rao from Deutsche Bank. Please go ahead.

Srinivas Rao: Just two questions; one, you are buying out the firm completely, is that a family owned business and would any of the existing management remain in the business, what is the plan or visibility on that? Second, if you could just throw some light on how the global fiber capacity looking is, do you see chances of prices kind of getting weaker over the next two to three years on account of increase in global capacity?

Dr. Anand Agarwal: Srinivas, this company as I said was 100% owned by a family but run by a professional management with the strong structure, so the CEO has been running the company for over 20-years right now and we intend to clearly have the same CEO run the company while empowering the person with whatever is required to make him more successful for growth as is aligned to our philosophy. In terms of the second part what you said about global capacity, there is no shift that we see in terms of the supply/demand that we have globally, the demand has been growing at about 13, 14% annually and we believe in the next two to three years at least 100-120 million kilometers of demand would get added and the supply addition is in commensurate largely with that. How we are shielding ourselves is essentially making sure that we are doing longer-term order book, longer-term clarity and we will have a great amount of orders booked for FY'19 and some for FY'20 as well.

Srinivas Rao: Just to clarify, after the acquisition, this company would be taking the entire fiber from your operations?

Dr. Anand Agarwal: Absolutely, other than maybe if they have some pending contracts with others, but it will be entirely post conclusion of any pending contracts that they have, it will be fully fiber.

Srinivas Rao: Does that change the impact on the COGS as in, landed cost of fiber was involved there current sourcing cost is?

Dr. Anand Agarwal: No, the fiber pricing is pretty global, and it is pretty similar. So, I would not think any significant impact on COGS because of fiber pricing.

Moderator: Thank you. We will take the next question from the line of Sanjay Laddha from Perfect Research. Please go ahead.

Sanjay Laddha: Sir, my question will be it is a one-off acquisition, or we will continue to look for acquisition in future?

Dr. Anand Agarwal: Sanjay, we will continue to look for opportunities which essentially augment either our market access or our cable delivery. So a couple of years ago, a) we did acquisition on the software side which increase our capability and portfolio. This essentially increases our market access, increases our product portfolio and increases our capacity. We have our acquisition philosophies clearly laid out and if there is something consistent with that, we will look at that, but it is not needed that we are actively looking for acquisition nor that we are completely going to be….

Moderator: Thank you. We will take the next question from the line of Mukul Garg from Haitong Securities. Please go ahead.

Mukul Garg: Anand, just one follow up question. In terms of your fiber capacity, you are currently running pretty close to 100% utilization on the fiber side as well as your in-house Indian cable manufacturing facility and on top of that you will be adding 3-5 million shares, you are also planning to increase production on the cable side in India. Do you think you have excess capacity on the fiber side in the intermediate term till you increase if everything comes onboard to manage it through internal supply?

Dr. Anand Agarwal: Mukul, at a fundamental level, we had 30 million kilometers of fiber and 50% of that was cable, 15 million and 30 million is running at 100% and 15 million is also running close to 100% capacity. We are moving 30 million to 50 million kilometers for fiber by June '19 with the capacity coming onboarding steps and we have been maintaining, we have been booking that part of the capacity with the expanded capacity in place as well. With that 50 million of fiber, we intend to have 25 million of cable. So this acquisition is in that direction. We will eventually have 50 million fiber and 25 million cable. Clearly, the order books and everything that we are doing for that capacities in that direction only. So there may be a quarter or two typically where everything will not be perfect or match but we are not worried about because it is a directional call that we have taken and we are moving in that direction.

Mukul Garg: Just to reconfirm, in one to two quarters, you believe that your internal manufacturing capability of optical fiber will be sufficient to supply all cable in-house capacities?

Anupam Jindal: Mukul, just to reiterate, anyway the existing cable capacity is getting supplies from our existing fiber facility and this particular Metallurgica also is getting supplies from us and some other local players. As far as the expanded capacity from three to five or even better utilization, this will also happen over next three to six months and as we have mentioned we are expecting from Q1 of calendar '19, some supplies coming in from expanded capacity. I think with that we will be having very good balance of fiber as well as cable. In the interim for a quarter or two, there may be some mismatch we will be able to procure cable facility from outside.

Moderator: Thank you very much. That was the last question in queue.

Dr. Anand Agarwal: Thank you, everyone for joining us on this Friday evening. We would like to reiterate that this acquisition is strategic in the direction and we expect to surpass our earlier strategic guidance of 100 million bagged by FY'20. Thank you for your interest and continuing association with us. If you have any other questions or clarifications, you can get in touch with me, Anupam or Vishal. Thanks, and have a great weekend.

Anupam Jindal: Thank you.

Moderator: Thank you very much. On behalf of Sterlite Technologies that concludes this conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.