

Sterlite Industries

STOCK INFO.	BLOOMBERG
BSE SENSEX: 19,978	STLT IN
	REUTERS CODE
S&P CNX: 5,906	STRL.BO

29 October 2007

Buy

Previous Recommendation: Buy

Rs958

Equity Shares (m)	708.7
52-Week Range	1,009/415
1,6,12 Rel. Perf. (%)	12/40/31
M.Cap. (Rs b)	678.9
M.Cap. (US\$ b)	17.2

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
3/07A	243,868	45,005	80.6	34	11.9	5.4	45.8	48.7	2.2	5.6
3/08E	237,960	43,500	61.4	-24	15.6	3.1	19.6	23.9	2.2	6.5
3/09E	270,247	45,406	64.1	4	15.0	2.6	17.4	21.2	1.8	5.6

Consolidated

- 2QFY08 PAT declined 7.1% YoY to Rs10.9b, which is higher than our estimate of Rs10.5b. EBITDA declined 23.6% YoY to Rs19.7b (v/s our estimate of Rs19.6b) despite higher volumes, due to lower metal prices (zinc -4% YoY, Aluminium +3% YoY, and lower TcRcs of 18.1USc/lb v/s 33.7USc/lb), 13% rupee appreciation against the dollar, and lower duty protection (import duty of 5% against 7.5%, last year). Interest expense was lower due to repayment of foreign borrowings while other income increased due to interest income on Rs75b of unutilized ADR proceeds.
- The Supreme Court decision on bauxite mines for Vedanta Alumina (VAL) is expected soon; the last hearing has already been conducted. Thereafter, it will take a few months to get the mines operational due to relatively simple surface mining requirements. This will improve the profitability of VAL substantially, as the cost of alumina production is expected to be one of the lowest. The management is in discussions with relevant authorities to proceed with the buying of 29.5% in Hindustan Zinc and 49% in Balco, and expects the process to be completed before March 2008.
- Sterlite is a play on Indian mineral resources, with fully integrated zinc and aluminum facilities. Sterlite Energy is foraying into merchant sale of power through a 2,400MW power project in Orissa, which is likely to get operational by 2010 and is also planning further projects in this business (already bid for one of UMPP). The company has surplus cash of Rs75b (unutilized proceeds of ADR) besides over US\$1b of surplus cash on the books of Hindustan Zinc. The stock trades at 5.6x FY09E EV/EBITDA and 2.6x FY09E P/BV. Maintain **Buy**.

QUARTERLY PERFORMANCE (Consolidated)

(RS MILLION)

Y/E MARCH	FY07				FY08				FY06	FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			
Net Sales	46,030	67,180	68,143	62,516	61,391	65,671	54,597	56,301	131,026	243,868	237,960
Change (YoY %)	146.3	153.8	94.1	22.6	33.4	-2.2	-19.9	-9.9	80.7	86.1	-2.4
Total Expenditure	27,531	41,434	40,515	39,799	39,830	46,013	35,101	35,664	94,148	149,280	156,608
EBITDA	18,499	25,746	27,628	22,716	21,561	19,658	19,495	20,637	36,878	94,589	81,352
Change (YoY %)	379.1	392.4	215.7	19.3	16.6	-23.6	-29.4	-9.2	139.8	156.5	-14.0
As % of Net Sales	40.2	38.3	40.5	36.3	35.1	29.9	35.7	36.7	28.1	38.8	34.2
Interest	898	1,163	856	874	955	643	500	500	2,353	3,791	2,598
Depreciation	1,834	1,871	1,888	2,446	2,031	2,046	1,996	1,996	5,269	8,039	8,070
Other Income	1,355	1,112	1,864	2,485	3,501	3,233	3,863	3,863	3,363	6,817	14,460
PBT (before XO item)	17,122	23,825	26,749	21,881	22,076	20,202	20,862	22,003	32,619	89,576	85,144
Extra-ordinary Exp.	(122)	(1,362)	(25)	(63)	-	-	-	-	(172)	(1,572)	-
PBT (after XO item)	17,000	22,463	26,724	21,818	22,076	20,202	20,862	22,003	32,447	88,004	85,144
Total Tax	4,790	6,862	7,763	4,702	5,247	4,465	6,610	6,610	10,236	24,118	22,932
% Tax	28.2	30.6	29.0	21.5	23.8	22.1	31.7	30.0	31.5	27.4	26.9
Reported PAT	12,209	15,600	18,960	17,117	16,829	15,737	14,252	15,393	22,211	63,887	62,211
Minority interest	3,419	4,890	6,030	5,683	5,400	4,911	4,200	4,200	5,568	20,023	18,711
Adjusted PAT	8,878	11,656	12,948	11,483	11,429	10,826	10,052	11,193	16,760	45,005	43,500
Change (YoY %)	435.7	348.2	226.3	41.0	28.7	-7.1	-22.4	-2.5	43.8	247.6	278.8

E: MOSt estimate

Zinc mine production posted strong growth

Segmental revenue declined 14.3% YoY to Rs22b due to lower zinc prices (4% YoY) at LME, lower duty protection (import duty of 5% v/s 7.5% last year), 13% rupee appreciation (Rs40.5/US\$ v/s Rs46.4/US\$). Sales volumes of refined zinc metal remained flat YoY at 94,000 ton and zinc concentrate declined just 5% YoY to 84,800 ton (as against our estimate of 70,000 ton). Segmental EBIT declined 22% YoY to Rs14.4b and is the largest contributor to the earnings. The production of zinc MIC grew 18.1 YoY to 143,219 ton due to expansions. New zinc smelter of 170,000 ton capacity is expected to get commissioned three months ahead of schedule by December 2007.

ZINC: QUARTERLY TRENDS

	FY07				FY08	
	1Q	2Q	3Q	4Q	1Q	2Q
LME AVG. (US\$/ton)	3,358	3,359	4,142	3,441	3,679	3,221
Chg. (YoY %)	151.7	155.1	152.2	51.8	13.6	-4.1
Gross						
Rev. (Rs m)	17,503	25,762	26,679	22,260	21,813	22,068
Production (tonnes)						
MIC	131,526	124,474	127,699	121,301	134,000	143,219
Chg. (YoY %)	0.6	44.6	1.9	15.1	12.2	18.1
Refined Zinc	83,000	78,000	93,000	95,000	93,000	94,000
EBIT (Rs m)	12,043	18,477	18,764	13,795	15,411	14,399
Share in						
Total EBIT (%)	67	74	68	61	67	69

Source: Company/ Motilal Oswal Securities

Steep fall in Copper TcRc, as expected

Segmental revenues increased 7.1% YoY to Rs35.4b driven by 13.8% YoY growth in volumes, while prices remained flat YoY at the LME (US\$7,624/ton). Copper EBIT declined 53.4% YoY to Rs2b due to softening of Tc/Rc margins by 51.2% YoY to USc18.1/lb (v/s USc37.1/lb in 2QFY07), lower duty differential, and a 13% YoY rupee appreciation against the dollar. Other income increased substantially due to Rs75b remaining unutilized from the proceeds of the recently concluded ADR issue. The copper business contributes just 10% to the consolidated earnings.

COPPER: QUARTERLY TRENDS

	FY07				FY08	
	1Q	2Q	3Q	4Q	1Q	2Q
LME AVG. (US\$/ton)	7,627	7,628	7,096	5,975	7,578	7,624
Gross						
Rev. (Rs m)	22,159	33,783	32,623	30,431	32,175	35,883
Production (tonnes)						
Mined Metal						
Content	8,000	7,000	7,000	6,000	7,000	8,000
Cathode	57,000	80,000	86,000	89,000	81,000	91,000
EBIT (Rs m)	3,714	4,456	3,750	2,867	2,613	2,076
of Copper Segment						
Share in						
Total EBIT (%)	21	18	14	13	11	10
EBIT of Indian						
smelter (Rs m)	2,730	3,468	2,611	1,753	2,009	463
(USc/lb)	50.1	43.2	31.3	20.2	27.3	5.7
Tc/Rc	35.0	37.1	34.8	22.0	23.0	18.1

Source: Company/ Motilal Oswal Securities

Aluminum: volume gains offset by lower realization

The Korba smelter's production increased 30% YoY to 90,000 ton. During the quarter, the smelters produced higher than their rated capacity as a result of ongoing improvement initiatives. Segmental revenue increased 8% YoY to Rs11.7b due to strong volume growth, which was offset by lower realization. The realization declined despite stronger metal prices (3% YoY) at LME due to lower duty protection (import duty of 5% v/s 7.5% last year) and 13% rupee appreciation. Segment EBIT increased 29% YoY to Rs1.9b; however it declined 35% QoQ due to falling metal prices.

ALUMINUM: QUARTERLY TRENDS

	FY07				FY08	
	1Q	2Q	3Q	4Q	1Q	2Q
LME AVG. (US\$/ton)	2,530	2,531	2,726	2,748	2,802	2,610
Chg. (YoY %)	49.5	36.9	31.7	12.3	4.4	3.1
Gross						
Rev. (Rs m)	9,766	10,912	12,906	14,173	11,834	11,764
Prodn. (tons)	67,000	69,000	89,000	89,000	88,000	90,000
Chg. (YoY %)	148	92	75	48	31	30
EBIT (Rs m)	1,604	1,503	4,324	4,552	2,930	1,939
Share in						
Total EBIT (%)	9	6	16	20	13	9

Source: Company/ Motilal Oswal Securities

Favorable Lanjigarh verdict to bring down production cost of aluminum

The Supreme Court decision on bauxite mines for VAL is expected soon; the last hearing has already been conducted. Thereafter, it will take a few months to get the mine operational due to relatively simple surface mining requirements. This will improve the profitability of VAL substantially, as the cost of alumina production is expected to be one of the lowest. The management is in discussions with relevant authorities to proceed with the buying of 29.5% in Hindustan Zinc and 49% in Balco, and expects the process to be completed before March 2008.

Commercial Energy on schedule

Work on the 2,400MW (4X600MW) coal based independent thermal power is on schedule for progressive commissioning

from early 2010. Sterlite is expecting a favorable decision on the allocation of a coal block in the next 4-6 weeks.

Valuation and view

Sterlite is a play on Indian mineral resources, with fully integrated zinc and aluminum facilities. Sterlite Energy is foraying into merchant sale of power through a 2,400MW power project in Orissa, which is likely to get operational by 2010 and is also planning further projects in this business (already bid for one of UMPP). The company has surplus cash of Rs75b (unutilized proceeds of ADR) besides over US\$1b of surplus cash on the books of Hindustan Zinc. The stock trades at 5.6x FY09E EV/EBITDA and 2.6x FY09E P/BV. Maintain **Buy**.

Sterlite Industries: an investment profile

Company description

Sterlite is a diversified play on three base metals. It is ramping up capacities to 400,000 ton of aluminum, 400,000 ton of copper and 660,000 ton of refined zinc, which would fuel volume CAGR of 13%, 13%, and 26%, respectively over FY07-09. The company is setting up a 2,400MW power project in Orissa. The first phase of 600MW is likely to become operational in December 2009. The project is in close proximity to coal mines and Sterlite would soon replace coal linkages with coal from its captive mines. Given its low cost production and strong demand, the project would drive up earnings. Sterlite has raised US\$2b largely to fund the exercise of call options in Hindustan Zinc, enabling it to acquire the remaining 29.5% government stake in the company. We believe this will be substantially value-accretive for shareholders of Sterlite.

Key investment arguments

- ✎ It is ramping up capacities to 400,000 ton of aluminum, 400,000 ton of copper and 660,000 ton of refined zinc.
- ✎ Successful exercise of call options on Hindustan Zinc and Balaco will be value accretive to the share holders.
- ✎ Outlook on metal prices remains positive due to strong demand from developing countries.

COMPARATIVE VALUATIONS

		STERLITE IND.	NACL	HIND. ZINC
P/E (x)	FY08E	15.6	9.5	8.1
	FY09E	15.0	9.1	8.0
P/BV (x)	FY08E	3.1	2.0	3.0
	FY09E	2.6	1.8	2.3
EV/Sales (x)	FY08E	2.2	3.0	3.4
	FY09E	1.8	2.8	2.8
EV/EBITDA (x)	FY08E	6.5	5.5	4.8
	FY09E	5.6	5.1	4.2

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	62.5	62.5	79.1
Domestic Inst	3.6	3.6	4.9
Foreign	27.7	27.5	6.3
Others	6.2	6.4	9.7

Key investment risks

- ✎ Unexpected fall in zinc, aluminum or copper prices may adversely impact profitability.

Recent developments

- ✎ Reported highest production of Zinc mine.

Valuation and view

- ✎ The stock trades at 5.6x FY09E EV/EBITDA and 2.6x FY09E P/BV. Maintain **Buy**.

Sector view

- ✎ The demand fundamentals for metals remain strong due to robust economic growth in most of the world, led by developing countries, where zinc usage is still low. Inventories at the LME too are at low levels. We believe that metal prices would remain stable/strong in the next few years.

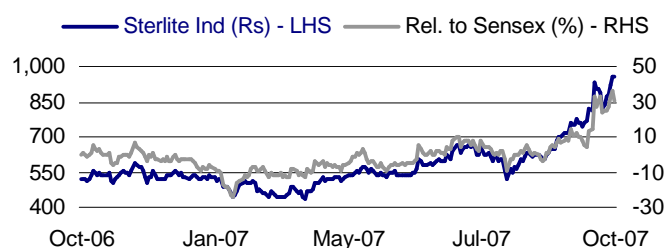
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	61.4	-	-
FY09	64.1	-	-

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
958	-	-	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						RATIOS					
(Rs MILLION)											
Y/E MARCH	2005	2006	2007	2008E	2009E	Y/E MARCH	2005	2006	2007	2008E	2009E
Net Sales	72,527	131,026	243,868	237,960	270,247	Basic (Rs)					
Change (%)	26.9	80.7	86.1	-2.4	13.6	EPS	28.5	60.1	80.6	61.4	64.1
Total Expenses	57,150	94,148	149,280	156,608	186,062	Cash EPS	39.3	78.9	94.9	72.8	75.0
Raw materials	29,781	65,189	108,812		130,530	BV/Share	154.8	214.3	175.8	312.4	368.6
Power & Fuel	7,612	12,256	26,710		34,808	DPS	1.2	2.5	2.5	2.5	2.5
Employee Cost	4,094	4,518	5,495		6,199	Payout (%)	4.2	4.2	3.1	4.1	3.9
Other Manufacturing Exp	15,664	12,186	8,262	156,608	14,525	Valuation (x)					
EBITDA	15,377	36,878	94,589	81,352	84,185	P/E		15.9	11.9	15.6	15.0
% of Net Sales	21.2	28.1	38.8	34.2	31.2	Cash P/E		12.1	10.1	13.2	12.8
Depn. & Amortization	2,977	5,269	8,039	8,070	7,778	P/BV		4.5	5.4	3.1	2.6
EBIT	12,400	31,609	86,550	73,282	76,407	EV/Sales		2.4	2.2	2.2	1.8
Net Interest	1,266	2,353	3,791	2,598	1,650	EV/EBITDA		8.4	5.6	6.5	5.6
Other income	2,895	3,363	6,817	14,460	16,163	Dividend Yield (%)		0.3	0.3	0.3	0.3
PBT before EO	14,029	32,619	89,576	85,144	90,920	Return Ratios (%)					
EO income	-1,731	-101	-1,572			RoE	18.4	28.0	45.8	19.6	17.4
PBT after EO	12,298	32,518	88,004	85,144	90,920	RoCE	10.9	23.1	48.7	23.9	21.2
Tax	3,147	10,236	24,118	22,932	26,128	RoIC	21.4	34.0	86.3	70.2	68.4
Rate (%)	25.6	31.5	27.4	26.9	28.7	Working Capital Ratios					
Reported PAT	9,151	22,282	63,887	62,211	64,792	Fixed Asset Turnover (x)	0.9	1.1	1.9	1.6	1.7
Minority interests	2628	5568	20023	18711	19386	Asset Turnover (x)	0.6	1.0	1.4	0.8	0.7
Adjusted PAT	7,811	16,783	45,005	43,500	45,406	Debtor (Days)	36	38	25	26	26
Change (%)	12.5	114.9	168.2	-3.3	4.4	Inventory (Days)	52	54	39	43	43
						Creditors (Days)	42	39	25	37	36

BALANCE SHEET						CASHFLOW STATEMENT					
(Rs MILLION)						(Rs MILLION)					
Y/E MARCH	2005	2006	2007	2008E	2009E	Y/E MARCH	2005	2006	2007	2008E	2009E
Share Capital	549	559	1,117	1,417	1,417	Pre-tax profit	12,298	32,518	88,004	85,144	90,920
Reserves	42,693	59,974	98,236	221,398	261,253	Depreciation	2,887	4,737	7,784	8,070	7,778
Share holders funds	43,242	60,532	99,353	222,815	262,671	(Inc)/Dec in Wkg. Cap.	-4,658	-7,069	-2,305	5,746	-2,649
Minority Interest	11,379	16,948	33,431	52,151	71,546	Tax paid	-2,667	-8,251	-23,275	-22,932	-26,128
Loans	53,529	51,872	35,729	22,729	17,729	Other operating activities					
Deferred tax liability (net)	5,098	7,511	9,097	9,097	9,097	CF from Op. Activity	7,860	21,934	70,208	76,027	69,922
Capital Employed	113,247	136,862	177,610	306,792	361,043	(Inc)/Dec in FA + CWIP	-28,247	-12,116	-13,532	-12,273	-12,400
Gross Block	81,542	114,400	127,152	145,022	157,422	(Pur)/Sale of Investments	-7,505	-6,461	-26,315	-125,793	-45,979
Less: Accum. Deprn.	31,776	36,513	44,297	52,367	60,145	Others					
Net Fixed Assets	49,766	77,887	82,855	92,655	97,277	CF from Inv. Activity	-35,751	-18,577	-39,847	-138,066	-58,379
Capital WIP	28,353	7,611	8,390	2,793	2,793	Equity raised/(repaid)	190	10	559	300	
Investments	18,491	24,952	51,267	177,060	223,038	Debt raised/(repaid)	5,906	-1,657	-16,142	-13,000	-5,000
Curr. Assets	34,946	60,422	79,812	87,047	93,799	Dividend (incl. tax)	-299	-445	-797	-1,597	-2,073
Inventories	10,356	19,507	26,132	28,260	31,630	Other financing activities	20097	1545	-4773	78909	-2869
Sundry Debtors	7,203	13,475	16,653	16,828	19,209	CF from Fin. Activity	25,894	-547	-21,154	64,612	-9,942
Cash and Bank	8,342	11,153	17,633	22,565	23,566	(Inc)/Dec in Cash	-1,998	2,811	9,208	2,573	1,601
Loans and Advances	9,045	16,287	19,394	19,394	19,394	Add: opening Balance	10,340	8,342	11,153	17,633	22,565
Curr. Liability & Prov.	18,517	34,113	44,718	52,767	55,869	Closing Balance	8,342	11,153	17,633	22,565	23,566
Sundry Creditors	8,396	13,917	16,885	23,818	26,417						
Other Liabilities & prov.	10,122	20,196	27,832	28,949	29,451						
Net Current Assets	16,429	26,309	35,094	34,280	37,930						
Misc. Exp. (not w/off)	209	105	4	4	4						
Application of Funds	113,247	136,863	177,610	306,792	361,042						

E: Most estimates



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Disclosure of Interest Statement	Sterlite Industries
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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