

RESULTS REVIEW
Sterlite Industries Ltd
Buy
Share Data

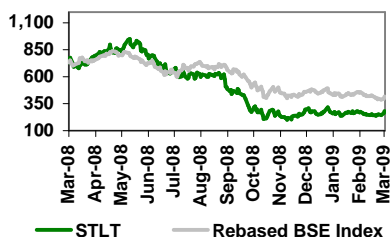
Market Cap	Rs. 200.5 bn
Price	Rs. 283.00
BSE Sensex	8,756.61
Reuters	STRL.BO
Bloomberg	STLT IN
Avg. Volume (52 Week)	0.7 mn
52-Week High/Low	Rs. 954.8/164.5
Shares Outstanding	708.6 mn

Valuation Ratios

Year to 31 March	2009E	2010E
EPS (Rs.)	48.5	38.9
EPS Growth (%)	(23.8)%	(19.8)%
PER (x)	5.8x	7.3x
EV/ Sales (x)	1.3x	1.6x
EV/ EBITDA (x)	5.0x	6.5x

Shareholding Pattern (%)

Promoters	61
FII's	7
Institutions	8
Public & Others	24

Relative Performance

Strong fundamentals to drive growth

In Q3'09, Sterlite Industries Ltd. (SIL)'s net sales declined 15.1% yoy to Rs. 44.5 bn and EBITDA tumbled 65.2% yoy to Rs. 5.7 bn, primarily on the back of a steep fall in non-ferrous metal (Al, Cu, Zn) realisations. Though our near-term outlook on the non-ferrous metal industry remains weak, we believe SIL's aggressive foray into the commercial power business (the Company has secured projects to install ~10,000 MW of power plants), supported by its strong balance sheet (cash and cash equivalents of ~Rs. 190 bn), will provide significant inorganic growth opportunities. Further, we believe that the current market price (CMP) more than factors the current negatives. Thus, we reiterate our Buy rating on the stock.

Power business brightens growth prospects: SIL forayed into the power business with its subsidiary Sterlite Energy Ltd. (SEL), which has bagged projects to set up power plants with ~10,000 MW of capacity. The first unit of the 2,400 MW (4x600) power plant will be commissioned in December 2009; thereafter, SEL will commission one additional unit in each subsequent quarter. Further, a majority (~75%) of the proposed off-take of power will be on merchant basis through short-term power purchase agreements (PPAs), which command a high realisation of Rs. 6–8 per unit. Thus, we believe that power business will be a major revenue driver for the Company in the near future and should cushion it from the cyclical nature of the metals business.

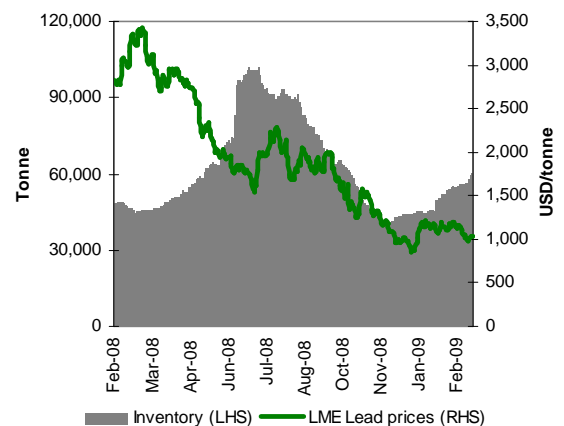
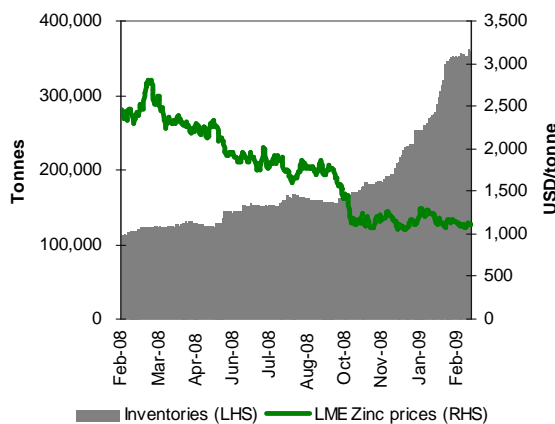
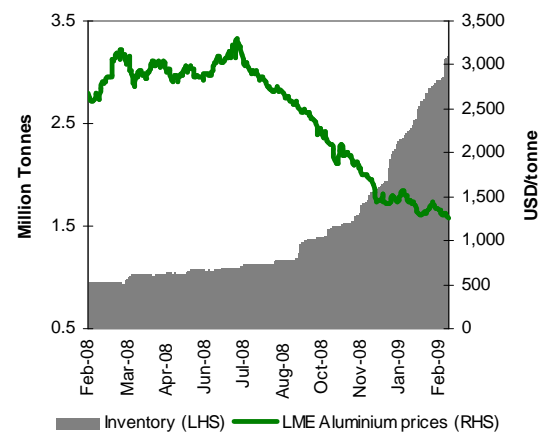
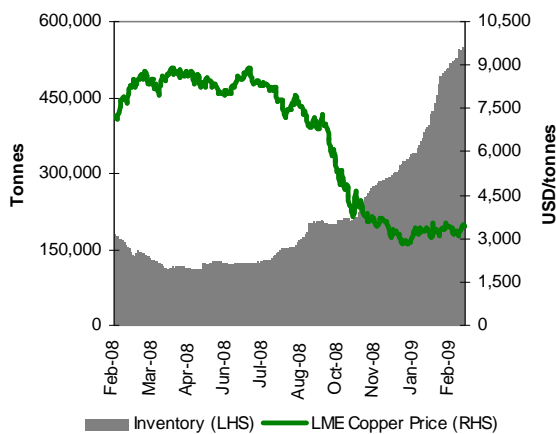
Healthy balance sheet to help tackle headwinds: SIL has a strong balance sheet with a net cash position of ~Rs. 12.2 bn (as on December 31, 2008), which translates into a net cash per share of ~Rs. 172 per share. Given the strong cash position, SIL looks well positioned to pursue inorganic growth opportunities. Furthermore, this robust cash balance can protect the Company in the current economic slowdown scenario.

Key Figures (Consolidated)

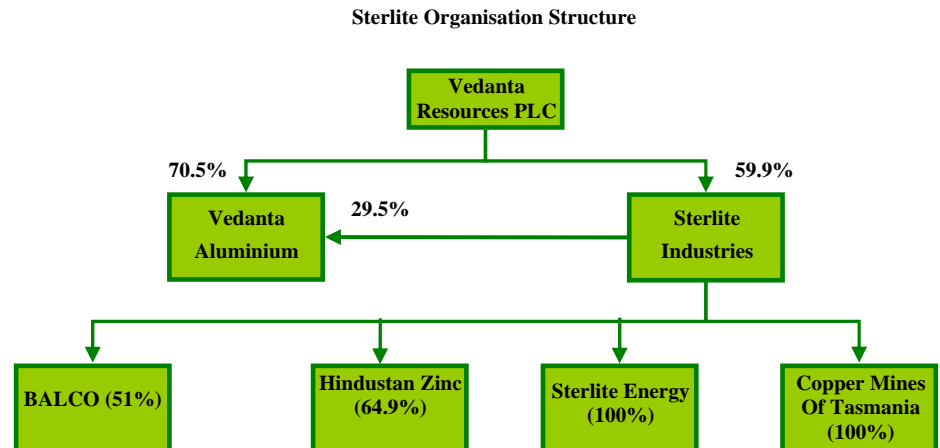
Quarterly Data	Q3'08	Q2'09	Q3'09	YoY%	QoQ%	9M'08	9M'09	YoY%
(Figures in Rs. mn, except per share data)								
Net Sales	52,332	65,938	44,456	(15.1)%	(32.6)%	179,395	168,094	(6.3)%
EBITDA	16,246	18,522	5,653	(65.2)%	(69.5)%	57,926	42,441	(26.7)%
Adj. Net Profit	8,553	12,855	5,263	(38.5)%	(59.1)%	30,810	29,629	(3.8)%
Margins(%)								
EBITDA	31.0%	28.1%	12.7%			32.3%	25.2%	
NPM	16.3%	19.5%	11.8%			17.2%	17.6%	
Per Share Data (Rs.)								
Adjusted EPS	12.1	18.1	7.4	(38.5)%	(59.1)%	43.5	41.8	(3.8)%

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Metal segment likely to be under pressure: Metal prices have fallen steeply in the last six months, primarily due to the decline in the demand from the core sectors. In Q3'09, average LME prices of Aluminium (Al), Copper (Cu), and Zinc (Zn) declined 40.9%, 55.8%, and 36.5%, respectively. In addition, their inventory levels have increased substantially due to falling demand, despite the heavy production cuts across the globe. Further, as developed economies are in recession and developing economies are slowing down, we do not expect metal prices to revive in the near term. Thus, we expect Al, Cu, and Zn realisations in FY10 to be USD 1,800–1,900 per tonne, USD 4,200–4,300 per tonne, and USD 1,400–1,500 per tonne, respectively.



Valuation



SIL is a diversified Company with operations in non-ferrous metals and the Power sector. Thus, we have valued SIL by using the Sum-Of-The-Parts (SOTP) methodology.

We have valued Hindustan Zinc, BALCO, and Sterlite Industries (standalone business) by using the DCF methodology. SEL has been valued by using the Return on Equity (ROE) method, and Vedanta Aluminium Ltd. (VAL) has been valued by using the estimated book values.

SOTP Valuation	Rs./Share	Valuation Method
Sterlite Industries (standalone)	98	DCF Valuation
BALCO	16	DCF Valuation
Hindustan Zinc	172	DCF Valuation
SEL	113	ROE Method
VAL	8	1x estimated book value
Total Value Per Share	407	

Our SOTP-based valuation of Rs. 407 suggests a potential upside of 43.8% from the CMP of Rs. 283. At the CMP, SIL's stock is trading at a forward P/E of 5.8x and 7.3x for FY09 and FY10 earnings, respectively. Given the growth potential of its power business and our valuation, we maintain our Buy rating on the stock.

Result Highlights

In Q3'09, the SIL's net sales declined 15.1% to Rs. 44.5 bn, primarily on the back of the steep decline in non-ferrous metal realisations. Average Al, Cu, and Zn LME prices during the quarter plunged by 40.9%, 55.8%, and 36.5%, respectively.

EBITDA plunged 65.2% yoy to Rs. 5.7 bn, and the EBITDA margin declined by 18.3 pts to 12.7% due to lower realisations and a sharp increase in power & fuel expenses (40% yoy). In addition, the adjusted net profit decreased by 38.5% yoy to 5.3 bn. Even then, the decline in the net profit was restricted due to a 136% yoy increase in other income (largely due to the sale of power from its captive power plant at BALCO).

Production (in '000 tonnes)	Q3'08	Q2'09	Q3'09	YoY%	QoQ%	9M'09	9M'08	YoY%
Aluminium	89	106	92	3.4%	(13.2)%	272	266	2.3%
Copper								
Mined metal content	7	5	7	0.0%	40.0%	19	22	(13.6)%
Cathode	77	81	76	(1.3)%	(6.2)%	225	249	(9.6)%
Zinc								
Mined metal content	136	167	171	25.7%	2.4%	476	413	15.3%
Refined zinc	104	122	152	46.2%	24.6%	401	291	37.8%

Segmental Highlights

Zinc: In Q3'09, the zinc segment's (HZL) top line declined 38.4% yoy to Rs. 10.2 bn. Though Zinc production volume increased 25.7% yoy to 171,000 tonnes, the top line declined primarily due to the steep falls in the LME Zinc and Lead prices. In addition, the cost of production (USD 780 per tonne) increased on account of higher input costs of coal and petroleum products. Consequently, EBIT declined 77.4% yoy to Rs. 2.3 bn, and the EBIT margin reduced 39.6 pts yoy to 22.9%.

Aluminium: Aluminium production from BALCO for Q3'09 increased 3.4% yoy to 92,000 tonnes. However, the top line declined 11.4% yoy to Rs. 8.4 bn, mainly on account of declining realisations (LME Aluminium prices fell 40.9% in Q3'09). Further, EBIT declined 24.6% to Rs. 1.1 bn, and the EBIT margin reduced 230 bps yoy to 13.1%.

For Q3'09, cost of production at BALCO was USD 1,642 per tonne.

Copper: For Q3'09, the Copper segment's top line declined 11.8% yoy to Rs. 22.9 bn, mainly on account of the 55.8% fall in LME Copper prices. The segment's EBIT declined by a whopping 46.3% to Rs. 1 bn, and the EBIT margin fell 280 bps to 4.4% due to a decline in the TC/RC margins and the sharp fall in by-product realisations.

Segment details	Q3'08	Q2'09	Q3'09	YoY%	QoQ%	9M'08	9M'09	YoY%
Sales (Rs. Mn)								
Copper	26,000	34,585	22,933	(11.8)%	(33.7)%	90,408	85,133	(5.8)%
Aluminium	9,439	11,172	8,362	(11.4)%	(25.2)%	30,449	31,208	2.5%
Zinc & Lead	16,507	17,212	10,174	(38.4)%	(40.9)%	55,917	43,559	(22.1)%
EBIT (Rs. Mn)								
Copper	1,858	4,692	998	(46.3)%	(78.7)%	6,547	6,948	6.1%
Aluminium	1,452	2,269	1,095	(24.6)%	(51.7)%	6,321	7,351	16.3%
Zinc & Lead	10,320	9,040	2,332	(77.4)%	(74.2)%	39,651	20,594	(48.1)%
EBIT Margin (%)								
Copper	7.1%	13.6%	4.4%			7.2%	8.2%	
Aluminium	15.4%	20.3%	13.1%			20.8%	23.6%	
Zinc & Lead	62.5%	52.5%	22.9%			70.9%	47.3%	

Key Events

Sterlite announces the acquisition of Asarco

SIL signed a new agreement with ASACRO LLC to acquire all of the latter's operating assets. The purchase considerations comprise a cash payment of USD 1.1 bn and secured non-interest bearing promissory notes for USD 600 mn, payable over a period of nine years. The deal is expected to be completed in the next six months, subject to the required approvals.

Key Risks

The following factors can pose a threat to our rating:

- Any significant delay in the commissioning of new capacities at Hindustan Zinc, SEL, and VAL
- A slower-than-expected recovery of the global economy

Key Figures (Consolidated)

Year to March	FY06	FY07	FY08	FY09E	FY10E	CAGR
(Figures in Rs mn, except per share data)						(FY08-10E)
Net Sales	125,427	241,733	247,054	216,172	178,378	(15.0)%
EBITDA	37,607	96,474	78,682	56,101	43,835	(25.4)%
Adj. Net Profit	16,141	43,988	42,422	34,365	27,548	(19.4)%
Margins(%)						
EBITDA	30.0%	39.9%	31.8%	26.0%	24.6%	
NPM	12.9%	18.2%	17.2%	15.9%	15.4%	
Per Share Data (Rs.)						
Adjusted EPS	29.2	78.8	59.9	48.5	38.9	(19.4)%
PER (x)	12.0x	5.9x	11.9x	5.8x	7.3x	

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