



INDIA

STLT IN **Outperform**

Close Price* 21 Feb 12 **Rs128.40**

12-month target **Rs 149.00**

Upside/Downside **% 16.0**

Valuation **Rs 149.00**

- Sum of Parts

GICS sector **Materials**

Market cap **Rsm 431,514**

30-day avg turnover **US\$m 10.3**

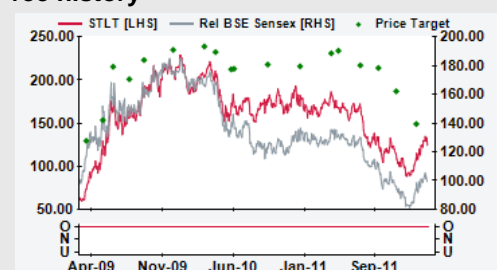
Market cap **US\$m 8,751**

Number shares on issue **m 3,361**

Investment fundamentals

Year end 31 Mar		2011A	2012E	2013E	2014E
Revenue	bn	298.5	389.4	498.0	619.4
EBITDA	bn	78.1	100.1	145.8	173.6
EBITDA growth	%	29.3	28.2	45.6	19.1
Reported profit	bn	53.2	52.9	67.5	69.5
EPS rep	Rs	15.83	15.74	20.07	20.69
EPS rep growth	%	32.3	-0.6	27.5	3.1
PER rep	x	8.1	8.2	6.4	6.2
Total DPS	Rs	1.10	1.25	1.25	1.25
Total div yield	%	0.9	1.0	1.0	1.0
ROA	%	10.2	10.5	13.4	14.0
ROE	%	13.9	12.4	13.8	12.7
EV/EBITDA	x	4.8	3.8	2.6	2.2
Net debt/equity	%	-18.3	-9.4	-12.9	-13.8
P/BV	x	1.1	0.9	0.8	0.7

STLT IN rel BSE Sensex performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, February 2012

(all figures in INR unless noted)

[Management press release](#)

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22 February 2012

Macquarie Capital Securities India (Pvt)

Ltd

Sterlite Industries

Restructuring Version 2.0e

Event

- **2nd Attempt at restructuring:** After an aborted attempt in 2008, Sterlite Industries seems to be getting close to attempting another restructuring. Management had highlighted its intent to resolve the equity holding of VAL by March'12. Instead of separate business verticals, this time management appears to be considering merging everything into one holding company, virtually creating a dual listing structure. Based on our scenario analysis, even in a worst case, Sterlite could have 25-30% upside. Maintain Outperform.

Impact

- **Dual listing structure in offing:** It is not difficult to see the rationale for this restructuring. Investors have been looking for a simpler structure, while Vedanta has been grappling with the mis-match of cash flows among its various businesses. This means Vedanta is likely looking to merge everything into one holding company, almost mirroring Vedanta PLC, except for perhaps Konkola Copper Mines (where it has a minority partner).
- **Vedanta Aluminium (VAL) – expected structure reduces risk for Sterlite:** VAL appears to be the prime trigger of this restructuring exercise as it is loss-making and has no near term solution. Investors have been concerned that the entire VAL stake would be passed on to Sterlite shareholders. However, under the proposed merger structure, if the liability is not assumed by Vedanta PLC, it will be distributed across all the merged entities.
- **Merger ratios – scenario analysis indicates Sterlite well below worst case:** We have assumed 3 scenarios, based on current stock prices, consensus target prices and the worst case for Sterlite. Assuming the market cap of the merged entity remains the same as the current sum of parts market cap of the entities to be merged (at US\$19bn, see Figure 12), even under our worst case assumption Sterlite's implied stock price comes to Rs157.
- **Proforma estimates of the merged co:** The merged company would have a consolidated Net Profit of US\$2.5bn and trade at around 9.5x PER based on the peer group valuation. This implies market cap of US\$24bn as compared to the current sum of parts market cap of US\$19bn. Some of this would be driven by reducing the holding company discount as minorities reduce.

Earnings and target price revision

- No change.

Price catalyst

- 12-month price target: Rs149.00 based on a Sum of Parts methodology.
- Catalyst: Clarity on merger ratios, streamlining the holdings

Action and recommendation

- **Maintain Outperform:** Given past experience, investors may find it tough to believe that the restructuring would not hurt minority shareholders. But our analysis does indicate undervaluation for Sterlite. In particular we would buy on any dips.

3 possible scenarios

- We believe that Vedanta is heading for a merger of Sterlite, Sesa, VAL and the holding of Cairn India into a new entity. Now the key question is around the merger ratios and valuation of VAL etc.
- We have built 3 possible scenarios for this merger, assuming different stock prices for Sesa, Sterlite, VAL and Cairn to see the impact and calculate the implied stock prices of both Sterlite Industries and Sesa. We have assumed consensus numbers for Sesa and Cairn India while we have assumed -US\$6.5bn (including debt) as NPV for VAL.
- **CASE 1:** In the first scenario, we have assumed current market prices for Sesa and Sterlite and Rs355/ share for Cairn (Vedanta's acquisition price) and have taken \$4.8bn of negative value for VAL, which is Vedanta's share at 70.5% of the total investment (which is based on our NPV calculations for VAL).

Fig 1 Case 1 : current market price for Sesa and Sterlite and no discount to VAL's value

Case 1 at market prices	Market cap (\$bn)	% contribution
Sesa at current market price	4.3	33%
Sterlite at current market price	8.2	63%
Vedanta - Cairn + VAL	0.5	4%
<i>Arrived at from the following assumptions -</i>		
Cairn India's 38.5% with Vedanta at Rs355/share	5.3	
VAL's 70.5% with Vedanta	-4.8	
Total	13	

Source: Macquarie Research, February 2012

- Having arrived at the proportion of entities being merged as above, we have tried to look at what the implied share price is. For this we have assumed the current market cap of the entities being merged, namely Sesa, Sterlite and Cairn India. This comes to US\$19bn. We have assumed that the negative value for VAL is already built into Sterlite's stock price.

Fig 2 Given these assumptions, Sterlite could see an upside potential of 46% from current levels

	Implied share price (Rs/share)	Implied market value (\$bn)
Sesa	354	6.3
Sterlite	175	12.0
Vedanta - Cairn + VAL		0.7
Sum of the parts valuation (please see figure 12)		19
Ratio of Sesa: Sterlite	0.49	

Source: Macquarie Research, February 2012

- **CASE 2:** In the second scenario, we have assumed (a) the consensus target price for Sesa, (b) the consensus target price for Sterlite at Rs149/share (c) Rs 405/share for Cairn – the acquisition price for Vedanta for promoters including the non compete fee and (d) have taken a write off for Vedanta's equity investment in VAL.

Fig 3 Case 2 : Street target price for Sesa and Macq target price for Sterlite and discount to VAL's value

Case 2 at target prices	Market cap (\$bn)	% contribution
Sesa at Street target price of Rs216/share	3.8	24%
Sterlite at our target price of Rs149/share	10.2	64%
Vedanta - Cairn + VAL	2	13%
<i>Arrived at from the following assumptions -</i>		
Cairn India's 38.5% with Vedanta at Rs405/share	6	
VAL's 70.5% write off Vedanta's equity to 0	-4	
Total	16	

Source: Bloomberg, Macquarie Research, February 2012

Fig 4 Given these assumptions, Sterlite could see an upside potential of 47% from current levels

	Implied share price (Rs/share)	Implied market value (\$bn)
Sesa	254	4.5
Sterlite	177	12.1
Vedanta - Cairn + VAL		2.4
Sum of the parts valuation (please see figure 12)		19
Ratio of Sesa: Sterlite	0.69	

Source: Macquarie Research, February 2012

- **CASE 3:** In the third scenario we have assumed current market prices for Sesa and Sterlite and Rs 405/share for Cairn – the acquisition price for Vedanta for promoters including the non compete fee, and have taken a write off for Vedanta's equity investment in VAL.

Fig 5 Case 3 : current market price for Sesa and Sterlite and discount to VAL's value

Case 3 at market price and discount to VAL	Market cap (\$bn)	% contribution
Sesa at current market price	4.3	30%
Sterlite at current market price	8.2	57%
Vedanta - Cairn + VAL	2	14%
<i>Arrived at from the following assumptions -</i>		
Cairn India's 38.5% with Vedanta at Rs405/share	6	
VAL's 70.5% write off Vedanta's equity to 0	-4	
Total	14.5	

Source: Macquarie Research, February 2012

Fig 6 Given these assumptions, Sterlite could see an upside potential of 31% from current levels

	Implied share price (Rs/share)	Implied market value (\$bn)
Sesa	317	5.6
Sterlite	157	10.7
Vedanta - Cairn + VAL		2.6
Sum of the parts valuation (please see figure 12)		19
Ratio of Sesa: Sterlite	0.49	

Source: Macquarie Research, February 2012

EXPECTED MERGER PROPOSAL

- Instead of separate business verticals, this time management appears to be considering merging everything into one holding company, virtually creating a dual listing structure.

Fig 7 Which companies could be merged - and stakeholders involved

Companies to be merged	Comments
Sterlite including VAL's 29.5% stake	Sterlite's Shareholders
Sesa Goa standalone+20% Cairn	Sesa's Shareholders
Cairn 38.5%	Vedanta's shareholders
VAL - 70.5% stake	Vedanta's shareholders

Source: Macquarie Research, February 2012

- Vedanta has been grappling with the issue of mis-match of cash flows among its various businesses, which means it may look to merge everything into one holding company, almost mirroring Vedanta PLC, maybe for perhaps Konkola Copper Mines (where it has a minority partner).

Fig 8 Cash flow mismatch is a big concern for the company, is increasing debt in some businesses and can't access cash in others

As of September 2011	Net Debt (\$mn)
Sterlite Energy	895
Sterlite Standalone including CMT	(135)
Zinc India	(3,384)
Anglo Zinc	(278)
Balco	592
Sterlite Consolidated	(2,258)
VAL	2,810
Sesa Goa	647
Copper Zambia	765
Malco	(1)
Vedanta Plc	5,204
Cairn	(1,458)
Vedanta Consolidated	5,709

Source: Company Data, Macquarie Research, February 2012

- **Vedanta Aluminium (VAL) – joker in the pack:** VAL appears to be the prime trigger of this restructuring exercise as it is a loss making unit and has no near term solution. Vedanta PLC, whose balance sheet has been under stress post the Cairn India acquisition, has been looking to offload its 70.5% equity here. The question is, who would fund this? Management has maintained that Sterlite will continue to hold only 30%. Since we are assuming that everything will get merged into a new entity, it means the VAL burden can't be loaded onto Sterlite alone; in the worst case, it will be distributed across the merged entity.

Fig 9 Investments in VAL - contributors

Investments by Sterlite in VAL	Rsmn	101,750	34%
Investments by Vedanta	Rsmn	36,900	13%
External	Rsmn	156,530	53%
Total	Rsmn	295,180	

Source: Macquarie Research, February 2012

- **Sesa Goa – to provide the currency to fund VAL:** Sesa Goa is trading at low valuations, driven by the holding company discount for its 20% holding in Cairn India. This holding company discount would narrow down under the merged entity as the holding in Cairn India would rise to 58.5%.
- **Proforma estimates of the merged company:** The merged company would have a consolidated Net Profit of US\$2.5bn and trade at around 9.5x PER based on peer group valuations.

Fig 10 The consolidated entity – P&L

Revenue- proforma	Rsmn	815,013
EBITDA - proforma	Rsmn	302,479
Depreciation	Rsmn	68,663
EBIT	Rsmn	233,816
Interest	Rsmn	26,006
Other Income	Rsmn	36,355
PBT	Rsmn	244,166
Tax	Rsmn	49,199
PAT before minority interest	Rsmn	194,967
Minority Interest	Rsmn	73,762
Proforma PAT	Rsmn	121,205

Source: Macquarie Research, February 2012

Fig 11 Diversifieds' multiples suggests that the consolidated entity should also trade at these multiples

FY13	PER	EV/EBITDA
BHP Billiton	9.8	4.9
Rio Tinto	9.4	5.4
Average	9.6	5.2

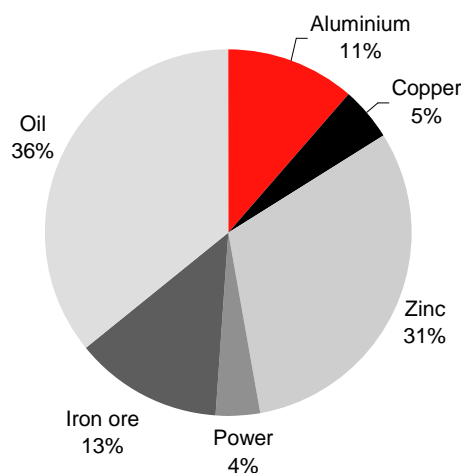
Source: Macquarie Research, February 2012

- This implies a market cap of US\$24bn as compared to the current sum of parts market cap of US\$19bn. This gives leeway for some positive valuation for VAL, which should benefit Sterlite.

Fig 12 The current market cap is at \$19bn and company can trade at US\$24bn

New shares	Current shares (mn)	Share price (Rs/share)	Market cap/ book value (Rsmn)
Sterlite	3,362	120	430,336
Sesa Goa	870	247	214,629
Cairn – 38.5% stake	1,903	391	286,683
VAL – book value			154,680
Current value of the combined entity			1,086,328
Current value of the combined entity (\$bn)			19

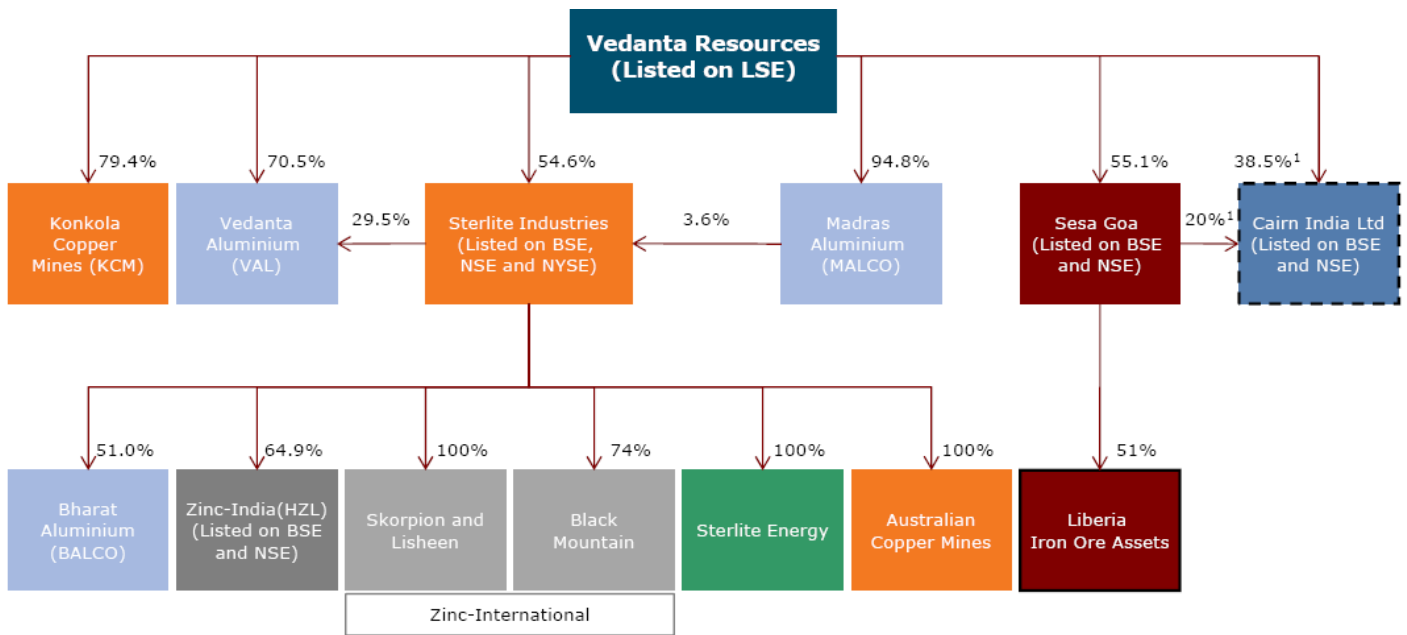
Source: Macquarie Research, February 2012, prices as of February 21,2012

Fig 13 EBITDA contribution - earnings well diversified

Source: Company Data, Bloomberg, Macquarie Research, February 2012

Current holding structure for Vedanta Plc.

Fig 14 Current structure leaves place on the table to streamline holdings



KEY

- Aluminium
- Copper
- Iron ore
- Power
- Zinc-India

Source: Company Presentation, February 2012

Stocks Mentioned:

Sesa Goa – Sesa IN, Not rated

Vedanta PLC – VED LN, Neutral, Alon Olsha, Target price £ 26, Current price £14.53

Cairn India – CAIR IN, Jal Irani, Outperform, Target price Rs390, Current price Rs391

Sterlite Industries (STLT IN, Outperform, Target Price: Rs149.00)

Quarterly Results					Profit & Loss						
	2Q/12A	3Q/12E	4Q/12E	1Q/13E		2011A	2012E	2013E	2014E		
Revenue	m	77,874	101,236	120,705	114,547	Revenue	m	298,536	389,369	498,032	619,354
Gross Profit	m	21,475	27,917	33,286	35,324	Gross Profit	m	85,055	107,375	153,585	182,131
Cost of Goods Sold	m	56,399	73,319	87,418	79,223	Cost of Goods Sold	m	213,482	281,995	344,448	437,223
EBITDA	m	20,020	26,026	31,031	33,527	EBITDA	m	78,094	100,101	145,770	173,632
Depreciation	m	3,547	4,612	5,498	5,765	Depreciation	m	10,388	17,737	25,065	28,361
Amortisation of Goodwill	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0	Other Amortisation	m	0	0	0	0
EBIT	m	16,473	21,415	25,533	27,762	EBIT	m	67,706	82,364	120,704	145,271
Net Interest Income	m	-2,884	-3,749	-4,470	-3,139	Net Interest Income	m	-4,083	-14,420	-13,647	-19,185
Associates	m	0	0	0	0	Associates	m	0	0	0	0
Exceptionals	m	0	0	0	0	Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0	Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	7,102	9,233	11,008	8,362	Other Pre-Tax Income	m	27,197	35,510	36,355	37,976
Pre-Tax Profit	m	20,691	26,898	32,071	32,985	Pre-Tax Profit	m	90,820	103,454	143,413	164,062
Tax Expense	m	-4,301	-5,591	-6,667	-7,311	Tax Expense	m	-17,129	-21,505	-31,788	-43,409
Net Profit	m	16,390	21,307	25,404	25,674	Net Profit	m	73,691	81,949	111,625	120,653
Minority Interests	m	-5,811	-7,554	-9,007	-10,158	Minority Interests	m	-20,485	-29,056	-44,165	-51,106
Reported Earnings	m	10,579	13,752	16,397	15,516	Reported Earnings	m	53,205	52,893	67,460	69,547
Adjusted Earnings	m	10,579	13,752	16,397	15,516	Adjusted Earnings	m	53,205	52,893	67,460	69,547
EPS (rep)		3.15	4.09	4.88	4.62	EPS (rep)		15.83	15.74	20.07	20.69
EPS (adj)		3.15	4.09	4.88	4.62	EPS (adj)		15.83	15.74	20.07	20.69
EPS Growth yoy (adj)	%	-0.6	-0.6	-0.6	27.5	EPS Growth (adj)	%	32.3	-0.6	27.5	3.1
						PE (rep)	x	8.1	8.2	6.4	6.2
						PE (adj)	x	8.1	8.2	6.4	6.2
EBITDA Margin	%	25.7	25.7	25.7	29.3	Total DPS		1.10	1.25	1.25	1.25
EBIT Margin	%	21.2	21.2	21.2	24.2	Total Div Yield	%	0.9	1.0	1.0	1.0
Earnings Split	%	20.0	26.0	31.0	23.0	Weighted Average Shares	m	3,361	3,361	3,361	3,361
Revenue Growth	%	30.4	30.4	30.4	27.9	Period End Shares	m	3,361	3,361	3,361	3,361
EBIT Growth	%	21.6	21.6	21.6	46.6						
Profit and Loss Ratios					Cashflow Analysis						
	2011A	2012E	2013E	2014E		2011A	2012E	2013E	2014E		
Revenue Growth	%	21.6	30.4	27.9	24.4	EBITDA	m	78,094	100,101	145,770	173,632
EBITDA Growth	%	29.3	28.2	45.6	19.1	Tax Paid	m	-1,846	-21,505	-31,788	-43,409
EBIT Growth	%	30.5	21.6	46.6	20.4	Chgs in Working Cap	m	-3,154	72,365	24,801	55,222
Gross Profit Margin	%	28.5	27.6	30.8	29.4	Net Interest Paid	m	-4,400	-14,420	-13,647	-19,185
EBITDA Margin	%	26.2	25.7	29.3	28.0	Other	m	26,841	35,510	36,355	37,976
EBIT Margin	%	22.7	21.2	24.2	23.5	Operating Cashflow	m	95,536	172,051	161,492	204,235
Net Profit Margin	%	24.7	21.0	22.4	19.5	Acquisitions	m	0	0	0	0
Payout Ratio	%	6.9	7.9	6.2	6.0	Capex	m	-140,754	-54,139	-56,571	-45,577
EV/EBITDA	x	4.8	3.8	2.6	2.2	Asset Sales	m	0	0	0	0
EV/EBIT	x	5.6	4.6	3.1	2.6	Other	m	65,354	0	0	0
						Investing Cashflow	m	-75,400	-54,139	-56,571	-45,577
Balance Sheet Ratios					Dividend (Ordinary)	m	-5,018	-4,916	-4,916	-4,916	
ROE	%	13.9	12.4	13.8	12.7	Equity Raised	m	1,680	0	0	0
ROA	%	10.2	10.5	13.4	14.0	Debt Movements	m	25,628	5,500	52,000	7,000
ROIC	%	16.5	16.1	17.9	18.3	Other	m	0	0	0	0
Net Debt/Equity	%	-18.3	-9.4	-12.9	-13.8	Financing Cashflow	m	22,291	584	47,084	2,084
Interest Cover	x	16.6	5.7	8.8	7.6	Net Chg in Cash/Debt	m	42,427	118,496	152,005	160,743
Price/Book	x	1.1	0.9	0.8	0.7	Free Cashflow	m	-45,218	117,912	104,921	158,658
Book Value per Share		117.2	135.8	154.1	171.9						
						Balance Sheet					
							2011A	2012E	2013E	2014E	
						Cash	m	208,294	176,935	261,377	287,460
						Receivables	m	15,950	14,089	15,894	19,272
						Inventories	m	51,547	43,627	52,732	64,657
						Investments	m	0	0	0	0
						Fixed Assets	m	335,475	374,795	411,477	433,734
						Intangibles	m	0	0	0	0
						Other Assets	m	133,205	215,707	239,100	296,358
						Total Assets	m	744,471	825,154	980,580	1,101,482
						Payables	m	0	0	0	0
						Short Term Debt	m	0	0	0	0
						Long Term Debt	m	117,287	122,787	174,787	181,787
						Provisions	m	20,590	14,472	16,520	19,615
						Other Liabilities	m	109,710	109,483	117,518	132,579
						Total Liabilities	m	247,587	246,742	308,825	333,981
						Shareholders' Funds	m	393,972	456,568	518,073	577,871
						Minority Interests	m	102,913	121,844	153,683	189,630
						Other	m	0	0	0	0
						Total S/H Equity	m	496,884	578,412	671,756	767,501
						Total Liab & S/H Funds	m	744,471	825,154	980,580	1,101,482

All figures in INR unless noted.

Source: Company data, Macquarie Research, February 2012

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand

Outperform – return >3% in excess of benchmark return
 Neutral – return within 3% of benchmark return
 Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie First South - South Africa

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
 Neutral – return within 5% of benchmark return
 Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
 Neutral (Hold) – return within 5% of Russell 3000 index return
 Underperform (Sell) – return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low-medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Australian/NZ/Canada stocks only

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / epowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 December 2011

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	56.59%	65.60%	54.55%	44.53%	75.28%	49.46%	(for US coverage by MCUSA, 10.53% of stocks covered are investment banking clients)
Neutral	33.45%	20.55%	38.96%	50.20%	22.47%	32.36%	(for US coverage by MCUSA, 10.96% of stocks covered are investment banking clients)
Underperform	9.96%	13.85%	6.49%	5.27%	2.25%	18.18%	(for US coverage by MCUSA, 0.44% of stocks covered are investment banking clients)

Company Specific Disclosures:

Important disclosure information regarding the subject companies covered in this report is available at www.macquarie.com/disclosures.

Analyst Certification:

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