

Company Flash

12 March 2008 | 7 pages

Sterlite Industries (India) (STRL.BO)

Citi India Conference 2008: Day 2 Takeaways

- Conference takeaways** — Sterlite spoke with investors at the Citi India Investor Conference 2008. Here are some of the highlights of that presentation
- Copper operations** — Sterlite's net cost of production fell from ~USc6/lb to almost nil in 3QFY08, largely due to higher free metal recovery and credits from by-product sales. The company expects the net cost for FY08 to settle at ~USc5/lb. Average TC/RC margins are expected to be ~USc15-16/lb in FY08 and ~USc11-12/lb in FY09. Sterlite expects mine supply to come in by 2H FY09, which would help TC/RC margins (current spot rate are ~USc7-8/lb) towards the end of FY09.
- Zinc** — Hindustan Zinc's (HZL) zinc and lead capacity is expected to go up by 88,000 tpa to ~750,000tpa by June 08. According to Brook Hunt, HZL's current cash cost is ~US\$830/t compared to the global average of ~US\$1,650/t. HZL hopes to bring this cost down to ~US\$680/t as its capacity gets fully ramped up.
- Aluminium business** — The ramping up of alumina production would help bring down the cost of alumina production from ~US\$250/t to ~US\$125/t. This would benefit Balco as well since it sources alumina from Vedanta Alumina (VAL) for its new smelter. The company will also benefit as VAL is expected to commission the first phase of 250,000tpa of its aluminium smelter by June 2008, one year ahead of schedule (see page 2 for more takeaways).

Buy/Low Risk	1L
Price (12 Mar 08)	Rs787.70
Target price	Rs1,123.00
Expected share price return	42.6%
Expected dividend yield	0.5%
Expected total return	43.1%
Market Cap	Rs558,081M US\$13,828M

Price Performance (RIC: STRL.BO, BB: STLT IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	16,781	30.05	153.1	26.2	7.3	32.3	0.2
2007A	44,841	80.29	167.2	9.8	4.4	55.9	0.5
2008E	44,832	63.28	-21.2	12.4	1.8	21.5	0.5
2009E	61,655	87.02	37.5	9.1	2.1	21.2	0.6
2010E	46,746	65.98	-24.2	11.9	1.8	16.1	0.6

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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- **Acquisition of stakes** — Sterlite is hopeful of exercising its call option in HZL in the next few weeks and completing the acquisition process within 60 days thereafter. It hopes to acquire the government's balance stake in Balco by 1QFY09, perhaps at a premium to the original valuation of Rs11bn.
- **Commercial power** — Through its 100% power subsidiary, Sterlite plans to commission ~9600MW of commercial power by 2012. It has already been allocated coal reserves of ~320m tonnes and hopes to build a coal portfolio of ~1bn tonnes over the next 3-4 years. Assuming coal usage of 40-45m tpa for 9600MW, the 1bn tonnes of reserves should meet the requirements for at least 20 years.

Sterlite Industries (India)

Company description

Sterlite is a non-ferrous metals major with a presence in aluminium, zinc and copper. It is a custom copper smelter (capacity 400,000 tpa) with treatment and refining charges (TC/RCs) driving profit. Sterlite is in the lowest-cost quartile of worldwide copper smelting operations. Its aluminium revenues and profits come from its 51% ownership of Bharat Aluminium Co (Balco), with smelter capacity of 345,000 tpa. It has access to 810MW power, the most important cost component in aluminium manufacturing. Sterlite's zinc and lead revenues come from its 64.9% holding in Hindustan Zinc Ltd (HZL), an integrated zinc producer with a 60% domestic share. It is among the lowest-cost producers in the world largely due to the low cost of mining ore at the Rampura Agucha mine which meets about 90% of its requirement. HZL is expanding its zinc capacity by 63% to 669,000 tpa by 1Q FY09, accompanied by expansion in captive power capacity by 85% to 349MW. Sterlite is now buying out the minority government stake in HZL (29.5%) and Balco (49%).

Investment strategy

We rate Sterlite shares Buy/Low Risk (1L). Zinc (Hindustan Zinc) is the biggest contributor to Sterlite's EBITDA (70% of total) and should continue to benefit from strong volume growth. Sterlite is expected to soon raise its holding in HZL to 94.4%, making it an alternate investment vehicle for investors looking to participate in Hindustan Zinc. Sterlite is also 4x more liquid than HZL. In the aluminium business, lower costs and some volume growth should help compensate for lower domestic prices in FY08. Sterlite's shareholding in Balco is also expected to soon reach 100%. Copper has a difficult outlook due to the lower TC/RC margins expected in FY08-09 vs. FY07. We expect Sterlite's attributable net income to rise 38% yoy in FY09E due to higher profits in zinc and aluminium and completion of the minority stake acquisition of Hindustan Zinc (29.5%) and Balco (49%) over the next few months. Sterlite has just been allocated coal mines for Balco, which should result in cost savings in the long term. Commissioning of the first phase of the power project being set up by its 100% power subsidiary from Dec 2009 onwards is on track.

Valuation

Since April 2006, the stock has re-rated to a P/E range of 6-10x due to positive trends in its three major businesses. We expect this re-rating to continue based on volume growth for zinc and steady profits in aluminium, with triggers coming from progress in acquiring the balance minority stakes from HZL and Balco. Based on this we maintain our target multiple at 12.5x, yielding a price of Rs1,088/share. To this we add the value of the power business (at book value of the equity investment) to arrive at our target price of Rs1,123. The stock has also crossed its 4-year average EV/EBITDA of 3.5x in the past few months, largely driven by these factors. Based on these triggers, we expect the EV/EBITDA upside to continue. At our target price, the stock would trade at an EV/EBITDA of 8.1x.

Risks

Risk factors that could prevent the shares from reaching our target price are: 1) Any delays in completion of Hindustan Zinc minority stake acquisition; 2) Any delays in acquisition of Balco minority stake; 3) Weaker-than-expected commodity prices or TC/RC margins; 4) Delays in expansion plans for zinc and power; 5) Substantial dependence on the Rampura Agucha mines in case of zinc; and 6) Trends in exchange rates.

Appendix A-1

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Analyst: Pradeep Mahtani (covered since July 31 2007)



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Sterlite Industries (India) (STRL.BO)

12 March 2008

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