

Sterlite Industries

Coming out of a 'Perfect Storm', better times ahead?
We believe so

- FY11, a year of disappointments for STLT...: Operational issues** (zinc segment impacted by acute water crisis), **regulatory issues** (non approval of bauxite mine, copper smelter court case, alumina refinery expansion not approved, BALCO arbitration against STLT, Anglo Zinc acquisition not being done via HZL), **teething problems with the 2400MW power project** (instead of earlier expectation 2 units entering into commercial production by end March-11, we now expect only 1 unit to flow into P&L in FY11) and continued investor fears of **STLT's cash support to associate VAL** being higher than its stake of 29.5%, have all contributed to the massive underperformance in 2010 (STLT -14% v/s +18% for NIFTY and +54% for HNDL). We do not view the arbitration panel judgment as very negative for STLT.
- ...Operationally, zinc improvement, power project stabilization over next 4 qtrs to continue aiding earnings growth:** We expect refined zinc production to pick up current levels of 178KT/qtrr to +200KT/qtrr as the water problems are now resolved. The Anglo zinc assets acquisition should start flowing through (Skorpion mine EBITDA at \$14mn at 13KT prod for Dec-10) with the remaining 2 mines' potential acquisition over the next 2 qtrr likely. We estimate an EBITDA of \$383mn from all 3 mines in FY12. The power project stabilization, which admittedly has been delayed significantly, should also start contributing from the Sept qtrr as by then 2 units of 600MW each should have started commercial production.
- Coal an increasingly big headache for STLT, not much improvement expected in aluminum:** We have been surprised by STLT's lack of focus on coal acquisitions, given our view that domestic coal availability is only going to become tighter and STLT growth projects in power could be increasingly short of coal. A large part of the analyst conf call was devoted to coal issues. In this regard, we believe captive coal mine development in BALCO would be critical. We do not expect any material improvement in the aluminum segment given a) bauxite sourcing issues, and b) surge in imported alumina prices.
- Maintain OW, increase PT to Rs225:** We value STLT on 6x FY13E EV/EBITDA and revise our March-12 PT to Rs225 (Rs205 earlier), implying 25% upside from current levels. Key risks are a) continued delays in ramp up of power capacities; b) non receipt of linkage coal and c) sharp correction in Zn.

Sterlite (Bloomberg: STLT IN; Reuters: STRL.BO)

Rs in millions, year-end March	FY10	FY11E	FY12E	FY13E	52-wk range (Rs)	223 - 148.8
Net sales	244,103	289,506	405,029	433,583	Mkt cap. (Rs MM)	601,733
Net profit (pre-exceptional)	37,437	46,446	72,333	81,309	Mkt cap. (US\$ MM)	13,165
EPS (pre-exceptional) (Rs)	11.6	13.5	21.0	23.6	Avg. daily volume (MM)	6.5
ROE (%)	12%	12%	17%	18%	Average daily value (US\$ MM)	25.1
P/E (x)	15.5	13.3	8.5	7.6	Shares O/S (MM)	3361
EV/EBITDA (x)	12.0	10.7	5.8	4.6	Index (BSE Sensex)	18,969
P/BV (x)	1.6	1.5	1.4	1.3	Exchange rate	45.7

Source: Company reports, Bloomberg, J.P. Morgan estimates. Priced as of January 25, 2011.

Overweight

STRL.BO, STLT IN

Price: Rs179.05

▲ **Price Target: Rs225.00**
Previous: Rs205.00

India
Metals

Pinakin Parekh, CFA^{AC}

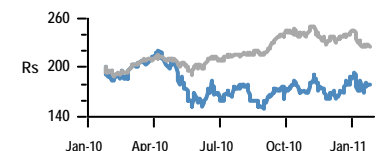
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Price Performance



	YTD	1m	3m	12m
Abs	-6.9%	-3.2%	3.8%	-10.8%
Rel	0.8%	2.3%	10.4%	-23.8%

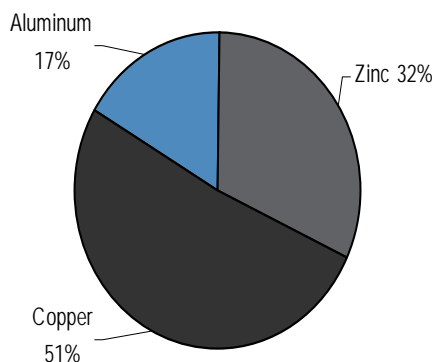
See page 9 for analyst certification and important disclosures, including non-US analyst disclosures.

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Company description

Sterlite Industries is one of the largest diversified non-ferrous metal companies in India with operations in aluminum copper and zinc. It is a subsidiary of Vedanta Group, a London-based company controlled by Anil Agarwal. The company is also expanding into the commercial power generation sector to leverage on its experience of operating captive power plants. Sterlite has significant size and scale in all the base metals. It is the third-largest aluminum company in India, second-largest in copper and the largest in zinc.

Figure 1: Sterlite—Revenue customer chart



Source: Company reports.

Table 2: EPS estimates—J.P. Morgan vs. consensus

Rs	J.P. Morgan	Consensus
FY11E	13.5	14.0
FY12E	21.0	21.5
FY13E	23.6	22.9

Source: Bloomberg, J.P. Morgan estimates.

Table 1: Sterlite—P&L sensitivity metrics

	EBITDA impact (%)	EPS impact (%)
Aluminum realization assumption		
Impact of each 1%	0.4%	0.8%
Zinc realization growth assumption		
Impact of each 1%	0.9%	0.9%
Copper realization assumption		
Impact of each 1%	0.1%	0.1%
Power costs assumption		
Impact of each 5%	1.4%	1.6%

Source: J.P. Morgan estimates.

Price target and valuation analysis

We remain OW on the stock with a revised PT of Rs225 based on 6x FY13E EV/EBITDA. We reduce our multiple to 6x from 6.3x to account for STLT increasing coal exposure, as we expect STLT to potentially have to source more coal from the open market. PT revised as we roll forward our target date from Sep-11 previously to Mar-12 (PT based on FY13E).

Key risks are a) continued delays in ramp up of power capacities; b) non receipt of linkage coal and c) sharp correction in Zn.

Update on key issues

Power projects: STLT is in the process of stabilization of the 2nd unit of 600MW and expects the 1st unit to start flowing through the P&L in the current quarter. The 1st unit had a trial production of 245mn units in the Dec quarter. Regarding BALCO's 1200MW power plant (300 X 4), STLT said work is on track, and expects to deliver the 1st unit of 300MW in one quarter's time. Regarding coal sourcing, management expects linkage coal delivery to be in sync with requirements, though there would be need of open market purchases.

JPM view: We expect the 1st of 600MW to partially flow through the P&L in the March quarter and fully in the June quarter, and the 2nd unit of 600MW to flow through in the Sept quarter. We expect coal costs for the company to remain elevated, given our view that Coal India is likely to face continued coal production/evacuation issues and hence STLT's coal costs for the power projects is likely to spike up.

Zinc, Anglo Zinc acquisition: STLT expects zinc production to pick up as the water issues are now resolved. The Skorpion mine contributed \$13mn to EBITDA in the Dec month. We expect refined zinc production to hit +200KT from current levels of 178KT and expect the remaining 2 Anglo Zinc acquisitions to also be completed over the next 2 quarters.

Aluminum likely to remain weak given bauxite, alumina issues: With Lanjigarh not producing at rated capacity given bauxite sourcing issues, aluminum CoP is likely to remain at elevated levels across BALCO and VAL.

Regulatory update- BALCO arbitration panel rules in favor of Govt: The BALCO arbitration panel, late last night, has ruled in favor of the Govt. We believe this would also apply to Hindustan Zinc call option. While we were not building in any upside on this front, sentiment wise it is negative for STLT and likely could result in a re-start of the legal process.

Investment view- Remain OW, would use weakness to build position

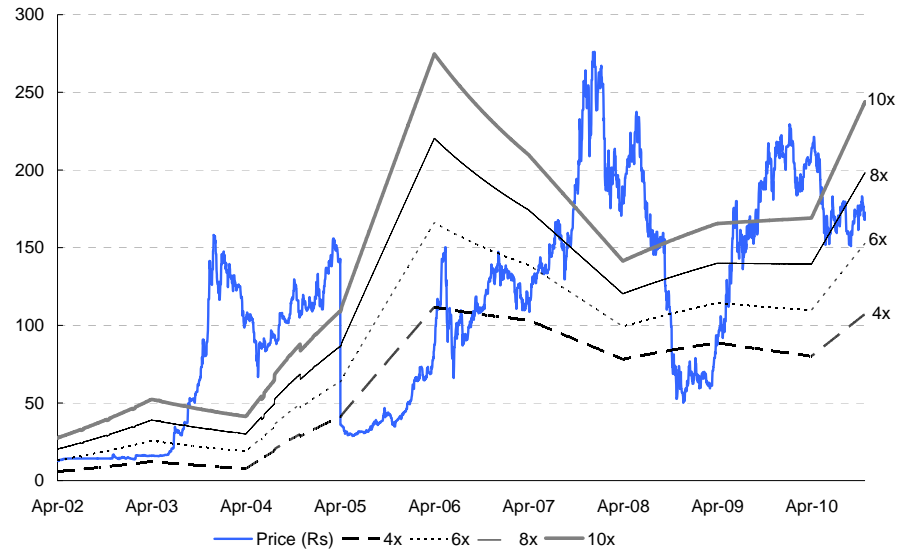
We remain OW on the stock with a revised PT of Rs225 based on 6x FY13E EV/EBITDA. We reduce our multiple to 6x from 6.3x to account for STLT increasing coal exposure, as we expect STLT to potentially have to source more coal from the open market. We cut our FY11E estimates by 17%, but maintain our FY12E estimates. Key risks are a) continued delays in ramp up of power capacities; b) non receipt of linkage coal and c) sharp correction in Zn.

Table 3: Sterlite - 3QFY11 Segmental Analysis

	3QFY10	2QFY11	3QFY11	% y/y	% q/q	Comments
Zinc and Lead						
Production (in Kt, except for silver)						
Mined Metal	200	205	222	11%	8%	210kt Dariba smelter contributed 46.5kt in Q3. Lead prodn lower due to planned maintenance shutdown at the Ausmelt and Pyro smelters
Refined Metal						
Silver (in 000's Kgs)	169	192	193	14%	1%	Silver prodn lower q/q
	43	44	42	-2%	-5%	
Revenue (Rs Mn)	22,030	21,460	25,890	18%	21%	Sales augmented by sales of surplus zinc and lead concentrate
EBITDA (Rs Mn)	13,700	11,020	14,970	9%	36%	Increased volume, higher LME prices and operational efficiencies. Skorpion prodn in Dec-10 13.2kt and EBITDA of Rs620MM
CoP with Royalty (\$/MT)	907	977	989	9%	1%	Impacted by higher coal costs and higher stripping costs at mines
Zinc LME (\$/MT)						Company indicated 100KT lead smelter on course for Q4FY11E commissioning; Exit prodn capacity of 500KT silver by FY12E
	2,211	2,013	2,315	5%	15%	
Copper						
Production (in Kt)						
Mined Metal	4	7	4	0%	-43%	Production impacted due to a temporary shutdown following HC order at the end-Sept 2010
Cathode	85	68	79	-7%	16%	
Revenue (Rs Mn)	35,480	30,230	46,260	30%	53%	
EBITDA (Rs Mn)	1,850	2,090	2,250	22%	8%	
Gross CoP – cathode (c/ lb)	10.37	19.78	1.24	-88%	-94%	Higher sulphuric acid realisation and improved operational efficiency
Tc/Rc (c/ lb)	15	12	11	-24%	-5%	
LME (\$/MT)	6,667	7,344	8,674	30%	18%	400Kt expansion put on hold rescheduled awaiting consent from HC
Aluminium						
Production (in Kt)						
BALCO	65	65	65	0%	0%	Production was higher than rated capacity
VAL	65	97	103	58%	6%	Commissioning of pots helped increase prod
Revenue (Rs Mn)	7,180	7,180	8,020	12%	12%	
EBITDA (Rs Mn)	1,120	1,440	1,580	41%	10%	
CoP (\$/MT)	1667	1748	1795	8%	3%	Higher LME prices offset by increased cost of alumina, coal & carbon
LME (\$/MT)	2,003	2,089	2,343	17%	12%	BALCO & 1.25MT VAL+Lanjigarh expansion deferred for the next 12-24months. 1200MW BALCO CPP to be sold on spot basis.
Power						
Wheeled (Mn units)						
	388	414	454	17%	10%	2400 MW plant sold 245MM units as part of trial run prod
Revenue (Rs Mn)	2,000	1,430	1,230	-39%	-14%	
EBITDA (Rs Mn)	1,240	740	370	-70%	-50%	
CoP (Rs/MT)	1.73	1.75	1.82	5%	4%	
Realization (Rs/MT)	5.16	3.45	2.72	-47%	-21%	Low demand by utility companies and addition in new power generating capacity
						2400MW PP: First 600MW unit is operational (in process of stabilization) and 2nd unit synchronized in Dec-10. Decided to add 150MW wind power capacity in 2 phases to be completed by 4QFY11 and 2QFY12

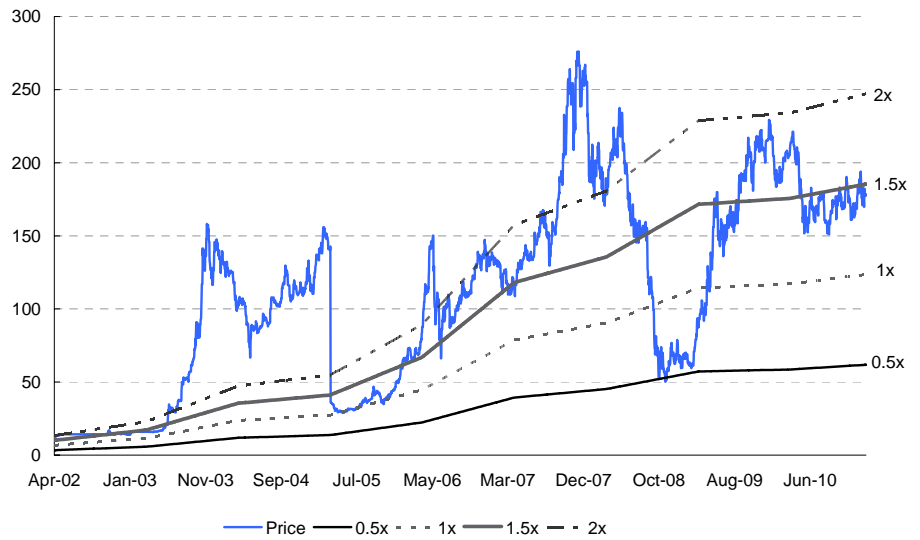
Source: Company reports and J.P. Morgan estimates.

Figure 2: Sterlite EV/EBITDA band



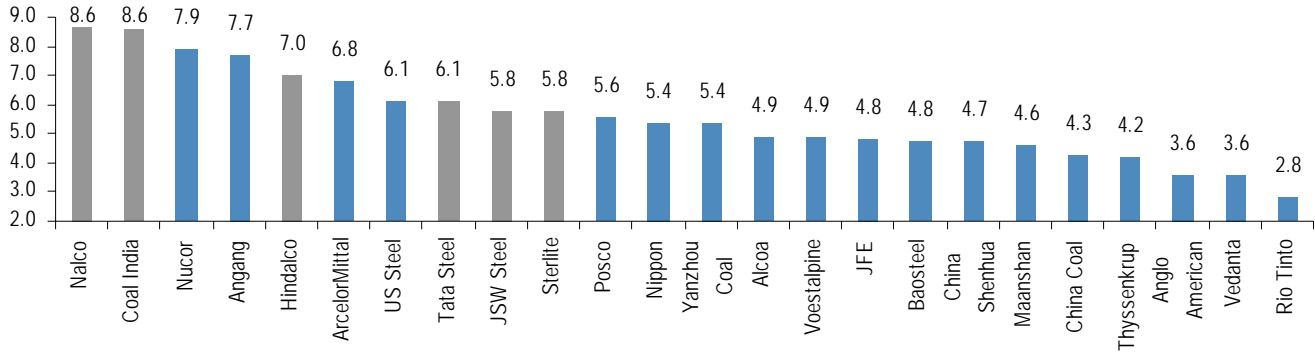
Source: Company reports, Bloomberg and J.P. Morgan estimates.

Figure 3: Sterlite P/BV band



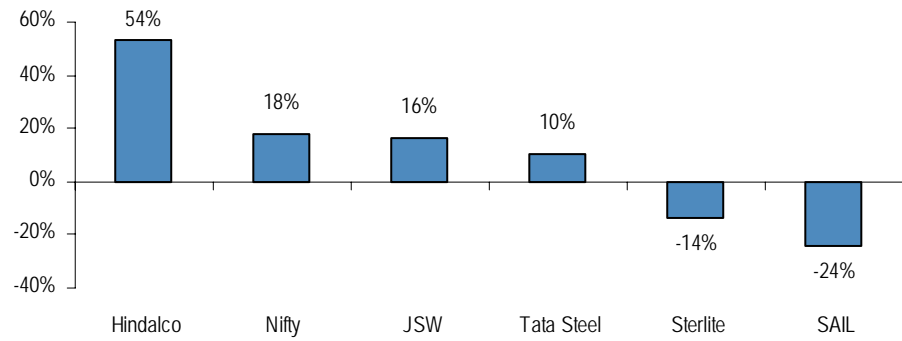
Source: Company reports, Bloomberg and J.P. Morgan estimates.

Figure 4: FY12E EV/RBITDA



Source: Company reports and J.P. Morgan estimates.

Figure 5: 2010 Stock Performances



Source: Bloomberg.

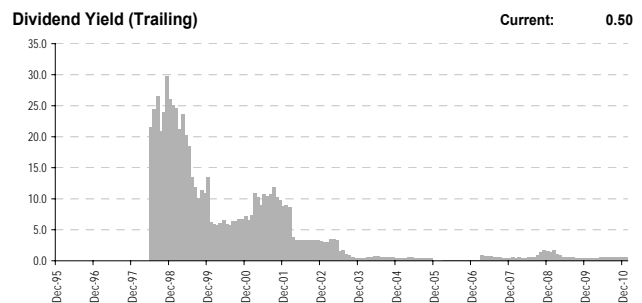
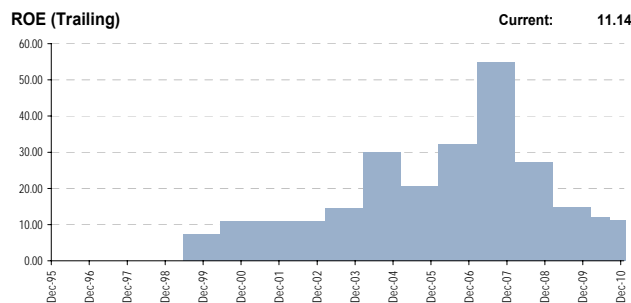
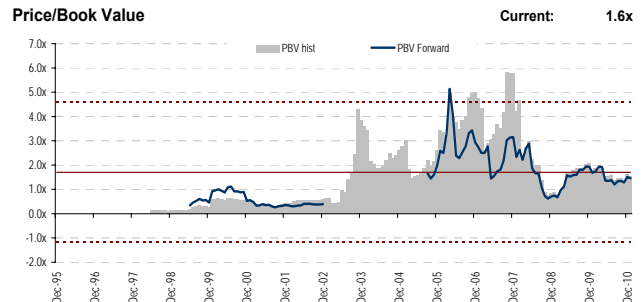
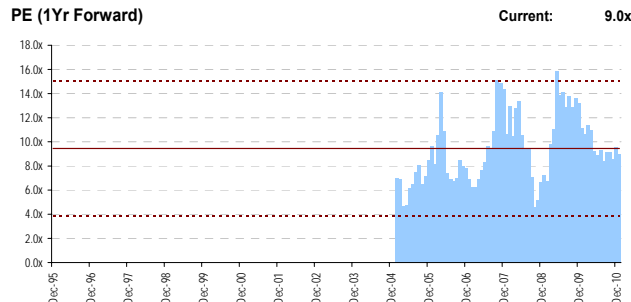
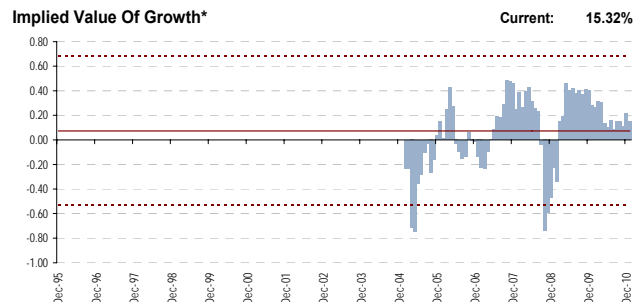
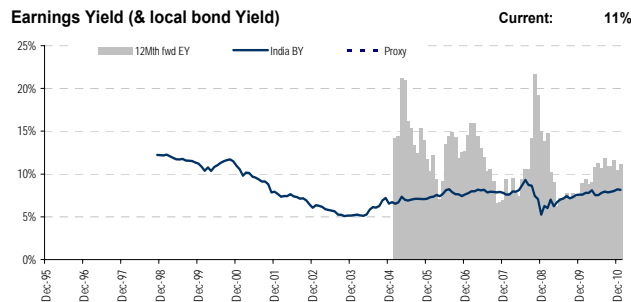
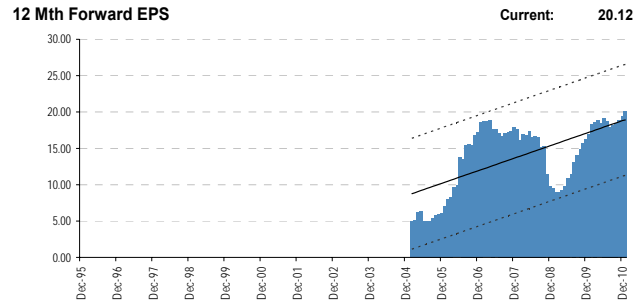
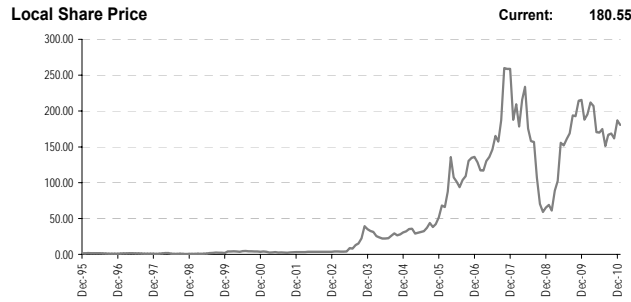
Sterlite Industries: Summary of financials

Profit and Loss statement					Cash flow statement				
Rs in millions, year-end Mar	FY10	FY11E	FY12E	FY13E	Rs in millions,	FY10	FY11E	FY12E	FY13E
Revenues	244,103	289,506	405,029	433,583	Net Income	57,060	60,277	99,146	111,459
% change Y/Y	15%	19%	40%	7%	Add: Depreciation	7,498	13,652	15,362	17,350
EBITDA	60,718	72,733	133,171	150,372	Workg. Cap change	(73,157)	67,382	8,186	772
% change Y/Y	29%	20%	83%	13%	Operational CF	(8,599)	141,311	122,694	129,581
EBITDA Margin (%)	25%	25%	33%	35%	Net Capex	(68,894)	10,885	(87,020)	(10,019)
EBIT	53,220	59,081	117,809	133,022	Free cash flow	(77,493)	152,195	35,674	119,563
% change Y/Y	33%	11%	99%	13%	Equity	60,021	(22,159)	(67,649)	(55,748)
EBIT Margin (%)	22%	20%	29%	31%	Debt raised/ (repaid)	22,465	3,510	(4,167)	(4,167)
Net Interest	3,424	7,535	8,548	10,593	Dividends paid	(3,093)	(4,325)	(4,325)	(4,325)
Earnings before tax	69,390	75,468	126,761	143,929	Beginning cash	55,048	33,378	126,691	100,109
% change Y/Y	20%	9%	68%	14%	Ending cash	33,378	126,691	100,109	172,416
Tax	12,330	15,191	27,614	32,470	DPS	0.77	1.10	1.10	1.10
as % of EBT	18%	20%	22%	23%					
Net Income (Pre Exceptional)	37,437	46,446	72,333	81,309					
% change Y/Y	1%	24%	56%	12%					
Shares Outstanding	3,236	3,449	3,449	3,449					
EPS (pre exceptional)	11.6	13.5	21.0	23.6					
% change Y/Y	-78%	16%	56%	12%					
Balance sheet					Ratio Analysis				
Rs in millions, year-end Mar	FY10	FY11E	FY12E	FY13E	% , year-end Mar	FY10	FY11E	FY12E	FY13E
Inventories	29,823	36,290	38,899	38,662	EBITDA margin	24%	25%	33%	35%
Debtors	6,235	14,485	18,650	18,154	Operating margin	22%	20%	29%	31%
Cash and bank balances	33,378	126,691	100,109	172,416	Net profit margin	15%	16%	18%	19%
Other Current Assets	0	0	0	0	Sales growth	15%	19%	40%	7%
Loans and advances	106,200	46,953	46,953	46,953	Net profit growth	1%	24%	56%	12%
Investments	203,045	240,879	242,879	244,879	EPS growth	-78%	16%	56%	12%
Net fixed assets	122,656	140,438	244,889	249,558	Interest coverage (x)				
Total assets	611,659	674,263	728,113	794,354	Net debt/total capital	14%	-8%	-2%	-21%
Liabilities					Net debt to equity	16%	-8%	-2%	-18%
Sundry Creditors	11,152	17,729	24,989	25,027	Sales/assets	46%	45%	58%	57%
Others	11,212	54,964	62,664	62,664	Assets/equity (x)	1.7	1.7	1.7	1.7
Total current liabilities	49,319	72,693	87,653	87,691	ROE	12%	12%	17%	18%
Total debt	92,600	96,110	91,943	87,775	ROCE	15%	14%	21%	22%
Other liabilities	84,096	89,327	105,212	124,196					
Total liabilities	241,539	270,350	297,028	311,883					
Shareholders' equity	370,120	403,913	431,085	482,471					
BVPS	114.4	117.1	125.0	139.9					

Source: Company reports, Bloomberg, J.P. Morgan estimates

JPM Q-Profile
Sterlite Industries (India) Ltd. (INDIA / Materials)
 As Of: 21-Jan-2011

Global Equity Quantitative Analysis
 Quant_Strategy@jpmorgan.com



Summary

Sterlite Industries (India) Ltd.					As Of: 21-Jan-11						
INDIA					Local Price: 180.55						
SEDOL B13TC37					EPS: 20.12						
Materials	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	8.98x	4.61	15.83	9.15	9.45	15.07	3.82	-49%	76%	2%	5%
P/BV (Trailing)	1.55x	0.11	5.81	1.51	1.70	4.58	-1.18	-93%	274%	-3%	10%
Dividend Yield (Trailing)	0.50	0.00	29.80	0.69	4.52	18.20	-9.16	-100%	5832%	38%	800%
ROE (Trailing)	11.14	7.39	54.97	14.78	20.74	47.20	-5.72	-34%	393%	33%	86%
Implied Value of Growth	15.3%	-0.75	0.48	0.15	0.07	0.68	-0.53	-588%	216%	0%	-52%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, J.P. Morgan Calcs

* Implied Value Of Growth = (1 - EY/Cost of equity) where cost of equity = Bond Yield + 5.0% (ERP)

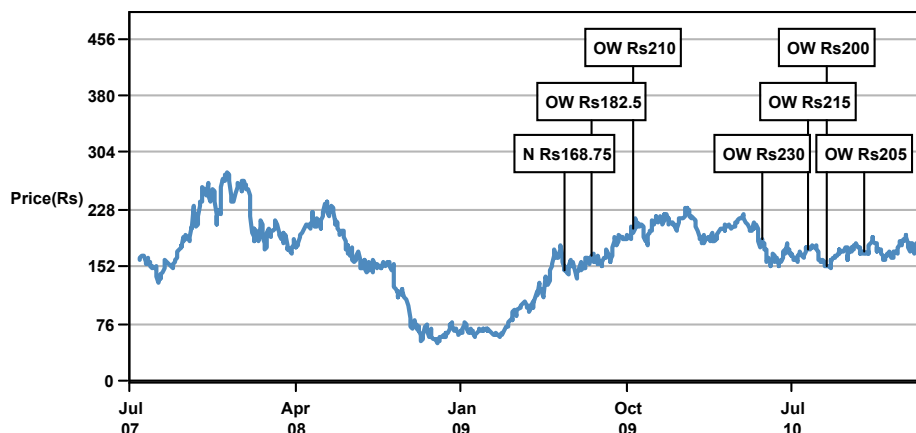
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Sterlite Industries (STRL.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
18-Jun-09	N	147.23	168.75
03-Aug-09	OW	167.68	182.50
11-Oct-09	OW	202.26	210.00
10-May-10	OW	188.94	230.00
27-Jul-10	OW	173.85	215.00
25-Aug-10	OW	152.15	200.00
27-Oct-10	OW	172.55	205.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jun 18, 2009. This chart shows J.P. Morgan’s continuing coverage of this stock; the current analyst may or may not have covered it over the entire period. J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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	Overweight (buy)	Neutral (hold)	Underweight (sell)
J.P. Morgan Global Equity Research Coverage	46%	42%	12%
IB clients*	53%	50%	38%
JPMS Equity Research Coverage	43%	49%	8%
IB clients*	71%	63%	59%

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