Sterlite Industries Ltd

In line operating performance; maintain BUY

For Q3FY11, Sterlite Industries (STLT) reported an EBITDA of Rs 19.8bn (+11% YoY, +30% QoQ), in line with our estimate of Rs 19.6bn. PAT, at Rs 11bn (+60% YoY, +9% QoQ), however, was lower than our expectations due to a higher depreciation charge, below-expected other income and higher losses reported by associate companies. We maintain our positive view on STLT with a BUY rating and target price of Rs 240, given its strong business fundamentals, expanding capacities across businesses and a robust balance sheet.

A stellar zinc performance: STLT's zinc business reported strong operating numbers. Revenues/EBIT for Q3FY11 grew 25%/10% YoY on account of (1) higher zinc volumes (+21% YoY, +2% QoQ) as Hindustan Zinc (HZ) commissioned its 210ktpa Dariba smelter that contributed 46,500 tons in Q3, (2) higher zinc and lead realisations at US$ 2,473/ton (+3% YoY, +10% QoQ) and US$ 2,659/ton (+6% YoY, +14% QoQ) respectively (3) greater operational efficiencies (4) zinc/lead concentrate sales of 36kt/13kt and (5) higher contribution from the silver business as revenues grew 15% YoY. However, lead production declined due to a maintenance shutdown at its Ausmelt and ISF smelters. Cost of zinc production increased 5% to US$ 795/ton (excl. royalty) and US$ 989/ton (incl. royalty) on higher coal costs/stripping costs at its mines.

Aluminium business: Higher realisations (+16% YoY) led to a 300bps expansion in the EBIT margin, even as volumes remained flat YoY. Aluminium revenues increased 16% YoY/12% QoQ driven largely by improved realisations. Increase in coal/carbon prices and higher cost of aluminium pushed up BALCO's cost of production to US$ 1,795/ton compared to US$ 1,667/ton a year ago.

Higher by-product realisations help improve copper earnings: Copper revenues grew 34% YoY (+56% QoQ) to Rs 45.3bn on higher copper prices. This was despite a volume decline to 79kt (85kt in Q3FY10) due to a forced shutdown at the Tuticorin smelter, following a HC order. Copper TcRc declined to 11.2c/lb compared to 14.7 c/lb last year. However, higher sulphuric acid realisations and greater operational efficiencies led to a lower cost of production at 1.24 c/lb (10.3 c/lb in Q3FY10), resulting in strong EBIT growth of 35% YoY.

Maintain BUY, target at Rs 240: We maintain our BUY rating on STLT with a SOTP-based target price of Rs 240 that comprises (1) Rs 19 for BALCO's operations based on 6x FY13E EBITDA, (2) Rs 29 for STLT's copper smelting business, (3) Rs 137 for HZ, based on 6x FY13E EBITDA, (4) Rs 26 for Sterlite Energy (SEL) and (5) Rs 30 for other businesses including stake in Vedanta Aluminium (VAL) and copper mining business.

What's New?	Target	Rating	Estimates

CMP	TARGET	RATING	RISK
Rs 179	Rs 240	BUY	MEDIUM

BSE	NSE	BLOOMBERG
500900	STER	STLT IN

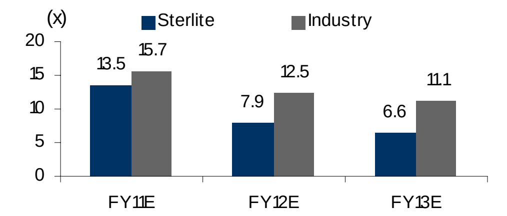
Company data

Market cap (Rs mn / US$ mn)	617,172 / 13,503
Outstanding equity shares (mn)	3,447
Free float (%)	42.7
Dividend yield (%)	0.52
52-week high/low (Rs)	223/ 149
2-month average daily volume	6,765,474

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Sterlite	179	(3.2)	3.8	2.9
BSE Metals	16,786	(2.8)	(2.5)	8.2
Sensex	18,969	(5.5)	(6.6)	4.6

P/E comparison



Valuation matrix

(x)	FY10	FY11	FY12E	FY13E
P/E @ CMP	15.3	13.5	7.9	6.6
P/E @ Target	19.6	17.4	10.1	8.5
EV/EBITDA @ CMP	8.2	5.9	3.4	2.4

Financial highlights

(Rs mn)	FY10	FY11	FY12E	FY13E
Revenue	244,103	284,804	361,889	429,984
Growth (%)	*15.4%*	*16.7%*	*27.1%*	*18.8%*
Adj net income	40,407	45,553	78,140	93,288
Growth (%)	*16.0%*	*12.7%*	*71.5%*	*19.4%*
FDEPS (Rs)	11.7	13.2	22.7	27.1
Growth (%)	*16.0%*	*12.7%*	*71.5%*	*19.4%*

Profitability and return ratios

(%)	FY10	FY11	FY12E	FY13E
EBITDA margin	24.9	25.3	33.3	34.8
EBIT margin	21.8	21.7	29.5	30.7
Adj PAT margin	22.2	22.8	28.3	28.6
ROE	10.9	11.0	16.0	16.2
ROIC	12.6	12.9	17.1	18.5
ROCE	7.8	7.6	11.0	11.8

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Result highlights

EBITDA was marginally ahead of our estimate while PAT was lower on higher depreciation/lower other income and losses from associates

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimate	% Variance
Revenue	83,325	75,987	9.7
EBITDA	19,787	19,579	1.1
Adj net income	11,011	13,590	(19.0)
FDEPS (Rs)	3.2	3.9	(19.0)

Source: RCML Research

Operating performance was driven by higher realisations/volumes across segments, especially zinc

Fig 2 - Quarterly performance

(Rs mn)	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Revenue	83,325	67,114	24.2	60,844	36.9
Expenditure	63,538	49,202	29.1	45,554	39.5
Operating profit	**19,787**	**17,912**	**10.5**	**15,289**	**29.4**
Other income	4,776	3,503	36.4	5,779	(17.3)
Depreciation	2,488	1,782	39.6	2,123	17.2
EBIT	**22,075**	**19,633**	**12.4**	**18,944**	**16.5**
Interest	705	1,498	(52.9)	(3)	(22,143.8)
Exceptional items	41	2,735	(98.5)	212	(80.6)
PBT	**21,329**	**15,399**	**38.5**	**18,736**	**13.8**
Tax	4,214	2,756	52.9	4,555	(7.5)
Minority interest	(5,081)	(4,803)	5.8	(3,853)	31.9
Share of profit from assoc.	(1,023)	(971)	5.4	(247)	314.0
PAT	**11,011**	**6,869**	**60.3**	**10,080**	**9.2**
EBITDA margin (%)	23.7	26.7	(11.0)	25.1	(5.5)
FDEPS (Rs)	**3.2**	**2.0**	**60.3**	**2.9**	**9.2**

Source: Company, RCML Research

Fig 3 - Key ratios

Key ratios	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
EBITDA margin (%)	23.7	26.7		25.1	
EBIT margin (%)	26.5	29.3		31.1	
PAT margin (%)	13.2	10.2		16.6	
EPS (Rs/share)	3.2	2.0		2.9	
ETR (%)	19.8	17.9		24.3	

Source: Company, RCML Research

Segmental performance details

HZ reported a strong operating performance on higher volumes/realisations and greater operational efficiencies

- **Zinc business:** HZ reported a strong operating performance for Q3FY11, led by higher volumes, increase in realisations and greater operational efficiencies. During Q3FY11, HZ reported net revenues of Rs 26bn (+17.4% YoY, +20.3% QoQ) led mainly by (1) higher zinc volumes (+21% YoY, +2% QoQ) as HZ commissioned its 210ktpa Dariba smelter that contributed 46,500 tons during the quarter, (2) higher zinc and lead realisations at US$ 2,473/ton (+3% YoY, +10% QoQ) and US$ 2,659/ton (+6% YoY, +14% QoQ) respectively (3) greater operational efficiencies (4) zinc/lead concentrate sales of 17.6kt/7.1kt and (5) higher contribution from the silver business as revenues grew 15% YoY.

Cost of zinc production increased 5% YoY to US$ 795/ton (ex-royalty) on account of (1) higher input costs and (2) higher stripping costs at HZ's mines. However, the increase in cost of production was offset by higher volumes, stronger realisations and greater operational efficiencies. Consequently, the Q3FY11 EBITDA margin expanded 600bps QoQ to 57.9%.

- **Aluminium business:** BALCO's aluminium business reported flat volumes YoY. However, EBITDA increased 41% YoY to Rs 1.6bn (+41% YoY) on account of (1) higher realisations led by a strong rally in aluminium prices and (2) sale of surplus power from its captive power plant (CPP 1). BALCO's cost of production increased sharply to US$ 1,795/ton from US$ 1,667/ton a year ago mainly due to (1) higher alumina costs and (2) rise in costs of coal and carbons—the key inputs for aluminium smelting. We note that BALCO continues to source high-cost alumina from external sources as VAL's Lanjigarh refinery continues to operate on purchased bauxite.

While VAL's aluminium production has increased to 103kt from 65kt last year, cost of production remains high at US$ 2,050/ton

For VAL, alumina production was 147kt compared to 181kt a year ago. According to the management, cost of alumina production was at US$ 320/ton largely on account of bauxite purchased from third parties. The management expects the cost of production to come down once VAL's mines become operational. The company produced 103kt of aluminium compared to 65kt a year ago, largely on account of increase in capacity. However, cost of production remains significantly high at US$ 2,050/ton.

- **Copper business:** STLT's copper business reported a standalone EBTIDA of Rs 1.4bn (-14% YoY, -4% QoQ) led largely by (1) lower cathode production as its Tuticorin smelter had to face a forced shutdown following a HC order, (2) lower TcRc YoY that dropped to 11.2 cents/lb compared to 14.7 cents/lb in Q3FY10. The copper smelting business benefitted from lower cost of production on account of higher sulphuric acid realisations and greater operational efficiencies.

- **Power business:** Power sales increased 17% YoY as it sold 454mn units in Q3FY11 compared to 388mn units in Q3FY10. On a QoQ basis, there was an increase of 10% mainly due to higher sales from BALCO CPP1. Average realisations declined sharply from Rs 5.1/unit in Q3FY10 to Rs 2.72/unit in Q3FY11 on lower demand from utility companies and increase in power capacity. We expect merchant power tariffs to pick up in the near term on account of seasonal factors. EBITDA from the power segment declined 70% YoY largely due to a sharp drop in realisations.

Fig 4 - Operating details for STLT

Operating matrix	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Volumes (tons)					
Copper mined metal content	4	4	-	7	(42.9)
Copper cathode	79	85	(7.1)	68	16.2
Aluminium ingots	65	65	-	65	-
Zinc mined metal content	222	200	11.0	205	8.3
Zinc cathode	193	148	30.4	192	0.5
Silver (tons)	42	43	(2.3)	44	(4.5)
Power (units)	454	388	17.0	414	9.7
Realisations (Rs/ton)					
Aluminium	123,437	106,654	15.7	110,457	11.8
Zinc and lead	142,132	148,820	(4.5)	111,747	27.2
Power (Rs/unit)	2.9	6.6	(56.1)	3.9	(25.9)
TcRc realised (cent/lb)	11.2	14.7	(24.1)	11.8	(4.9)

Source: Company, RCML Research

Segment-wise, copper was at the fore with revenues growing 34% YoY on higher copper prices

Fig 5 - Segment performance

Segment revenues	Q3FY11	Q3FY10	% chg YoY	Q2FY11	% Chg QoQ
Copper	45,302	33,879	33.7	29,070	55.8
Aluminium	8,023	6,933	15.7	7,180	11.8
Zinc and lead	27,431	22,025	24.5	21,455	27.9
Power	1,323	2,575	(48.6)	1,628	(18.7)
Others	1,249	1,668	(25.2)	1,409	(11.4)
Segment EBIT					
Copper	1,943	1,444	34.6	1,579	23.1
Aluminium	1,194	825	44.7	1,258	(5.0)
Zinc and lead	14,297	13,059	9.5	10,029	42.6
Power	192	1,090	(82.4)	567	(66.2)
Others	(71)	97	(172.5)	117	(160.4)
Segment EBIT margin (%)					
Copper	4.3	4.3		5.4	
Aluminium	14.9	11.9		17.5	
Zinc and lead	52.1	59.3		46.7	
Power	14.5	42.3		34.8	
Others	(5.7)	5.8		8.3	
Segment capital employed					
Copper	45,516	32,642	39.4	54,091	(15.9)
Aluminium	71,483	57,345	24.7	69,191	3.3
Zinc and lead	113,500	68,694	65.2	83,083	36.6
Power	76,422	60,438	26.4	68,084	12.2
Others	2,434	3,262	(25.4)	3,206	(24.1)
Unallocated	190,523	214,966	(11.4)	204,462	(6.8)

Source: Company, RCML Research

Estimates remain largely unchanged

Fig 6 - Revised estimates

Key parameters (Rs mn)	FY11E			FY12E		
	Old	New	% Chg	Old	New	% Chg
Revenue	283,014	284,804	0.6	360,364	361,889	0.4
EBITDA margin (%)	71,835	71,969	0.2	120,196	120,608	0.3
Net profit	49,296	45,301	(8.1)	77,545	78,140	0.8
FDEPS (Rs)	14.4	13.2	(8.0)	22.5	22.7	0.8

Source: RCML Research

Takeaways from management call

- The 100ktpa lead smelter at Dariba is on track for being commissioned in Q4FY11. Silver output at HZ will also be ramped up to 500mt by FY13. HZ has also increased its mining capacity at Sindesar Khurd mines to 1.5mtpa from 0.5mtpa currently. The 325ktpa smelter expansion at BALCO is progressing well with STLT taking the smelter construction ahead. However, metal tapping will be delayed till clarity on Lanjigarh/Niyamgiri emerges. BALCO's 1200MW CPP is also on track for commissioning with the first unit likely to come on stream by end-FY11.

- SEL has synchronised the second unit of 600MW in Dec '10. Both units have now stabilised with the company producing and selling 245mn units as part of a trial run.

- Liquidity remains strong with cash and equivalents of Rs 208bn.

Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	**244,103**	**284,804**	**361,889**	**429,984**
Growth (%)	*15.4%*	*16.7%*	*27.1%*	*18.8%*
EBITDA	**60,718**	**71,969**	**120,608**	**149,711**
Growth (%)	*29.1*	*18.5*	*67.6*	*24.1*
Depreciation & amortisation	(7,498)	(10,213)	(13,898)	(17,713)
EBIT	53,220	61,756	106,710	131,998
Growth (%)	*32.9*	*16.0*	*72.8*	*23.7*
Interest	(3,424)	(4,906)	(8,653)	(12,254)
Other income	19,594	25,150	29,718	32,666
EBT	66,722	81,747	127,775	152,409
Income taxes	(12,632)	(16,704)	(25,180)	(29,427)
Effective tax rate (%)	*-18.9%*	*-20.4%*	*-19.7%*	*-19.3%*
Extraordinary items	(2,970)	(253)	-	-
Min into / inc from associates	(16,653)	(19,742)	(24,455)	(29,694)
Reported net income	**37,437**	**45,301**	**78,140**	**93,288**
Adjustments	302	-	-	-
Adjusted net income	**40,407**	**45,553**	**78,140**	**93,288**
Growth (%)	*16.0%*	*12.7%*	*71.5%*	*19.4%*
Shares outstanding (mn)	3,446.9	3,446.9	3,446.9	3,446.9
FDEPS (Rs) (adj)	**11.7**	**13.2**	**22.7**	**27.1**
Growth (%)	*16.0%*	*12.7%*	*71.5%*	*19.4%*
DPS (Rs)	**3.8**	**0.9**	**0.9**	**0.9**

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	73,918	91,960	141,673	170,122
Non-cash adjustments	(23,614)	(34,764)	(44,816)	(48,113)
Changes in working capital	(8,487)	16,442	(1,637)	(6,182)
Cash flow from operations	41,817	73,638	95,219	115,827
Capital expenditure	(61,819)	(15,286)	(103,249)	(83,621)
Change in investments	(36,725)	(67,405)	(60,000)	(60,000)
Other investing cash flow	24,348	18,176	22,743	25,692
Cash flow from investing	(132,667)	(57,541)	(133,531)	(110,955)
Issue of equity	76,248	-	-	-
Issue/repay debt	21,795	73,124	58,725	35,971
Dividends paid	(4,352)	(3,687)	(3,687)	(3,687)
Other financing cash flow	(5,469)	(4,906)	(8,653)	(12,254)
Change in cash & cash eq	(2,628)	80,628	8,073	24,902
Closing cash & cash eq	2,144	114,006	122,079	146,980

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	33,378	114,006	122,079	146,980
Accounts receivable	5,709	8,615	12,786	16,885
Inventories	29,827	31,789	36,249	40,769
Other current assets	106,200	107,180	108,657	111,283
Investments	203,045	270,449	330,449	390,449
Gross fixed assets	181,789	224,884	320,433	361,754
Net fixed assets	122,656	155,538	237,189	260,797
CWIP	110,844	83,035	90,735	133,035
Intangible assets				
Deferred tax assets, net	(15,524)	(17,708)	(19,137)	(20,862)
Other assets	-	-	-	-
Total assets	**611,659**	**770,613**	**938,143**	**1,100,199**
Accounts payable	28,827	41,911	46,912	50,829
Other current liabilities	93,375	111,618	136,660	166,942
Provisions	11,212	20,418	23,887	25,034
Debt funds	92,600	165,724	224,448	260,419
Other liabilities	15,524	17,708	19,137	20,862
Equity capital	1,681	3,361	3,361	3,361
Reserves & surplus	368,439	409,872	483,738	572,751
Shareholder's funds	370,120	413,234	487,099	576,112
Total liabilities	**611,659**	**770,613**	**938,143**	**1,100,199**
BVPS (Rs)	107.4	119.9	141.3	167.1

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	24.9	25.3	33.3	34.8
EBIT margin	21.8	21.7	29.5	30.7
Net profit margin	22.2	22.8	28.3	28.6
ROE	10.9	11.0	16.0	16.2
ROCE	7.8	7.6	11.0	11.8
Working Capital & Liquidity ratios				
Receivables (days)	9	11	13	14
Inventory (days)	45	41	37	35
Payables (days)	57	72	71	66
Current ratio (x)	3.55	3.65	3.49	3.71
Quick ratio (x)	0.79	1.71	1.68	1.92
Turnover & Leverage ratios (x)				
Gross asset turnover	1.3	1.3	1.1	1.2
Total asset turnover	1.0	1.2	1.1	1.1
Interest coverage ratio	15.5	12.6	12.3	10.8
Adjusted debt/equity	0.3	0.4	0.5	0.5
Valuation ratios (x)				
EV/Sales	2.0	1.5	1.1	0.8
EV/EBITDA	8.2	5.9	3.4	2.4
P/E	15.3	13.5	7.9	6.6
P/BV	1.7	1.5	1.3	1.1

Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	67,114	72,278	59,703	60,844	83,325
YoY growth (%)	*48.0*	*64.0*	*29.8*	*(0.9)*	*24.2*
QoQ growth (%)	*9.27*	*7.69*	*(17.40)*	*1.91*	*36.95*
EBITDA (Rs mn)	17,912	21,855	14,974	15,289	19,787
EBITDA margin (%)	*26.7*	*30.2*	*25.1*	*25.1*	*23.7*
Adj net income (Rs mn)	9,605	13,809	10,084	10,292	11,052
YoY growth (%)	*82*	*166*	*50*	*5*	*15*
QoQ growth (%)	*(2)*	*44*	*(27)*	*2*	*7*

DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	59.1	56.1	55.4	61.2	61.2
Interest burden (PBT/EBIT)	149.5	125.4	132.4	119.7	115.5
EBIT margin (EBIT/Revenues)	18.9	21.8	21.7	29.5	30.7
Asset turnover (Revenues/Avg TA)	46.9	39.9	37.0	38.6	39.1
Leverage (Avg TA/Avg equtiy)	175.9	169.6	176.5	189.8	191.7
Return on equity	**13.8**	**10.4**	**10.4**	**15.8**	**16.3**

Company profile

Sterlite Industries, a subsidiary of Vedanta Resources Plc, is a metals and mining company. The company's main subsidiaries are Hindustan Zinc Ltd, BALCO and Sterlite Energy.

Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	52.8	52.8	52.8
FIIs	12.8	12.9	13.4
Banks & FIs	8.0	8.3	8.3
Public	26.5	26.0	25.5

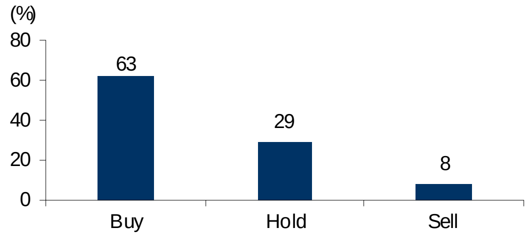
Recommendation history

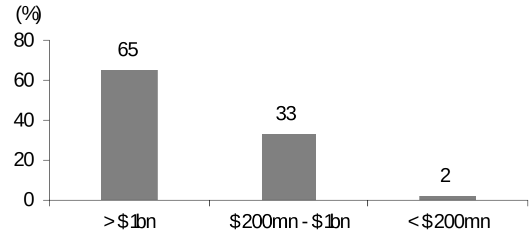
Date	Event	Reco price	Tgt price	Reco
6-Jan-11	Initiating Coverage	191	240	Buy
26-Jan-11	Results Review	179	240	Buy

Stock performance

Coverage Profile

By recommendation	By market cap (US$)





Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and –5%
Sell	Less than –5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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