Company Flash

28 April 2009 | 8 pages

Sterlite Industries (India) (STRL.BO)

Results

Sell: Disappointing 4Q Especially for Aluminium and Copper

- **4QFY09 PAT 22% below estimates** — Sterlite's adj 4Q PAT at Rs3.4bn fell 75% yoy on weak performance by all divisions – affected by the sharp fall in metal prices and decline in byproduct realizations. 4Q EBITDA margin (incl other income) came in at 28% vs 41% last year. FY09 adj PAT fell 26% to Rs32.7bn.
- **Copper has a difficult quarter** — Sterlite's standalone adj PAT fell 84% yoy to Rs577m (below est). Although volumes declined only 2% yoy to 88,000 tonnes, operating profit collapsed by 92% to Rs203m due to low TC/RCs and sharp decline in byproduct realizations. The silver lining – Rs2.4bn of other income.
- **Zinc hit but best relative performance** — HZL's 4Q EBITDA margins came in at 61% vs. 73% last year, affected by a 52-60% decline in zinc-lead LME prices and lower byproduct realizations. EBITDA decline was relatively lower vs other divisions due to lower costs, higher volumes (+11% yoy) and concentrate sales.
- **Aluminium worst hit** — Aluminium operating profit margins came in at 0.4% (vs 36% last year) on a 50% decline in LME prices. Balco's old smelter has higher than average costs and has been forced to partly shut its capacity, making available unutilized power for commercial sale. The company is considering closing down the entire old smelter if costs remain unviable.
- **Sell** — Copper TC/RCs better, but weak copper & byproduct prices cap upside. ~9% of global zinc supply cut in 2009, but a price upturn could be capped by restarts. Though aluminium prices have cut deep into the cost curve, persisting oversupply & inventories (3.6mt) leave little room for near-term price uptrend.

Sell/Medium Risk	3M
Price (28 Apr 09)	Rs383.20
Target price	Rs235.00
Expected share price return	-38.7%
Expected dividend yield	1.0%
Expected total return	**-37.6%**
Market Cap	Rs271,495M US$5,416M

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

Figure 1. Sterlite Industries (India) – Statistical Abstract

YE 31 Mar	Net Profit (Rsm)	EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)	ROE (%)
FY06	16,781	30.0	107%	12.8	7.7	28%
FY07	46,215	82.7	175%	4.6	3.0	46%
FY08	45,547	64.3	-22%	6.0	2.7	20%
FY09E	33,423	47.2	-27%	8.1	3.3	10%
FY10E	19,400	27.4	-42%	14.0	7.0	6%
FY11E	32,862	46.4	69%	8.3	4.0	10%

Source: Company Reports and Citi Investment Research and Analysis. Price as on 28th April 2009. Note – FY09 numbers are still estimate as full annual report details are not available yet. Actual number s are in Figure 2.

Pradeep Mahtani[1]
+91-22-6631-9882
pradeep.mahtani@citi.com

Raashi Chopra[1]
raashi.chopra@citi.com

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

[1]Citigroup Global Markets India Private Limited

4QFY09 and FY09 Results

Figure 2. Sterlite Industries (India) – 4QFY09 and FY09 Results (Consolidated)

(Rs m)	FY09	FY08	% chg	4QFY09	4QFY08	% chg
Net Sales	**211,442**	**247,054**	**-14%**	**43,361**	**67,659**	**-36%**
Total operating expenses	164,401	168,372	-2%	35,669	45,913	-22%
Operating Profit	47,041	78,682	-40%	7,693	21,746	-65%
Operating Profit margin	22%	32%		18%	32%	
Other Income	21,543	15,661	38%	4,639	5,918	-22%
EBITDA	**68,584**	**94,343**	**-27%**	**12,331**	**27,664**	**-55%**
EBITDA margin (%)	**32%**	**38%**		**28%**	**41%**	
Depreciation	7,007	5,950	18%	2,032	-269	
EBIT	61,577	88,393	-30%	10,300	27,933	-63%
Interest	3,973	3,186	25%	1,312	908	44%
Profit before tax & extraordinary items	57,604	85,207	-32%	8,988	27,025	-67%
Extraordinary items	-553	528		-799	528	
PBT	**58,158**	**84,679**	**-31%**	**9,786**	**26,497**	**-63%**
Tax paid (adjusted for write back of provision)	10,255	21,027	-51%	1,941	7,177	-73%
Effective tax rate (%)	18%	25%		20%	27%	
Net profit after tax and extraordinary items	47,902	63,652	-25%	7,845	19,320	-59%
Minority interest	12,671	19,616	-35%	2,057	6,092	-66%
Share in profit/(loss) of associates	-1,536	-42		-1,082	-43	
PAT attributable to Consolidated Group	**33,695**	**43,994**	**-23%**	**4,705**	**13,184**	**-64%**
Income attributable to consolidated group (adjusted for exceptional items)	**32,651**	**43,963**	**-26%**	**3,416**	**13,712**	**-75%**
Segmental Revenue						
Copper	106,163	123,636	-14%	21,031	33,228	-37%
Aluminium	39,336	41,696	-6%	8,128	11,247	-28%
Zinc and Lead	56,030	78,455	-29%	12,471	22,536	-45%
Others	12,883	4,987	158%	1,767	1,327	33%
Gross Sales	214,412	248,774	-14%	43,396	68,338	-36%
Less: Intersegment Revenues	2,970	1,720	73%	35	679	-95%
Net External Sales	**211,442**	**247,054**	**-14%**	**43,361**	**67,659**	**-36%**
Segment Results						
Copper	11,297	10,217	11%	4,349	3,670	19%
Aluminium	6,857	11,793	-42%	-495	5,473	-109%
Zinc and Lead	25,677	54,037	-52%	5,083	13,777	-63%
Others	2,682	652	311%	333	-901	-137%
Other unallocable income/expenses (net)	15,065	11,693	29%	1,030	5,914	-83%
Total	61,577	88,393	-30%	10,300	27,933	-63%
Less: Interest	3,973	3,186	25%	1,312	908	44%
Profit before tax and extraordinary items	57,604	85,207	-32%	8,988	27,025	-67%
Less: Extra ordinary items	-553	528	-205%	-799	528	-251%
PBT	**58,158**	**84,679**	**-31%**	**9,786**	**26,497**	**-63%**

Source: Company Reports and Citi Investment Research and Analysis

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 355,000 tpa. It has access to 810MW power, the most important cost component in aluminium manufacturing. Aluminium capacity will rise to 680,000 tpa giving it the benefit of volume growth in FY11. 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 amongst the lowest-cost zinc producers in the world largely due to the low cost of mining ore at the Rampura Agucha mine, which meets 90% of its requirement. Zinc-lead capacity is currently 755,000 tpa. HZL has announced further capex of Rs36bn that will hike zinc capacity by 210,000 tpa and lead capacity by 100,000 tpa taking the total to 1.07m tpa by 2010, together with mining and captive power capacities. Sterlite hopes to soon complete buying out the minority government stake in HZL (29.5%) and Balco (49%).

Investment strategy

We rate Sterlite shares Sell/Medium Risk (3M) with a target price of Rs235. Hindustan Zinc (HZL) is the biggest contributor to Sterlite's EBITDA (55% of total). The zinc market surplus is expected to continue until FY13. Our global commodity analyst expects average prices to fall sharply by 36% from US$1,550/t in FY09E to US$998/t in FY10E. Despite announced production cuts in 2009 (1m tpa or 13% of supply), there could be restarts in case there is any sustained price recovery, effectively capping global zinc prices. We expect average global aluminium prices to remain range-bound at US$1,300-1,380/t in FY10-11E. While downside to prices is limited, we expect continuing oversupply and little likelihood of prices recovering before 2010. Chinese high cost smelters (a third of global production) continue to operate due to a reduction in export taxes and power subsidies offered by provincial governments. Balco accounts for ~15% of Sterlite’s consolidated EBITDA. The main reasons for the recent trend of rising TC/RCs (which benefit copper smelters) are (1) an easing in the copper concentrate demand supply balance as production cuts for smelters are being implemented more rapidly than concentrate production cuts, and (2) falling trend in sulphuric acid prices which are an important by-product credit for smelters. We have assumed delayed completion of the minority stake acquisition of Balco (49%) to September 2009 and HZL (29.5%) to Dec 2009. Commissioning of the first phase of the power project being set up by its 100% power subsidiary from Sep 2009 onwards is on track.

Valuation

We value Sterlite using sum-of-the-parts. For the zinc business (HZL), we apply a P/E of 5x to its March 2010 core earnings (giving a value of Rs112). The HZL valuation is near the top end of its six year P/E trading band of 3-6x. Adding on the HZL cash per share of Rs192, gives us a target price of Rs304 for HZL. This translates into a value of Rs171 per Sterlite share. We value the non-zinc businesses at 4x March 2010 EPS. We use a slightly lower valuation for the non-zinc businesses as the zinc business has a relative competitive advantage and earns higher EBITDA margins compared to Sterlite's non-zinc businesses. The non-zinc value works out to Rs29 giving a total value of Rs200 per Sterlite share. To this we add the value of the power business (at 1x book value of the equity investment) to arrive at our target price of Rs235. At our target price, the stock would trade at an adjusted P/E of 8.6x and EV/EBITDA of 3.7x. Our valuations assume that the acquisition of the minority stake of Balco and HZL are completed by Sep 2009 and Dec 2009 respectively.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, suggests a High Risk rating for Sterlite shares. However, based on its diversified business lines and low cost of production in both zinc and copper, we feel a rating of Medium Risk is more appropriate for Sterlite. Upside risks that could cause the shares to continue to trade above our target price include: (1) Stronger-than-expected commodity prices or TC/RC margins; (2) Quicker acquisition of minority stakes in Hindustan Zinc and Balco than we assumed; (3) Higher capacity utilization than we assume; (4) Trends in exchange rates; and (5) An increase in import duties for zinc and lead.

Appendix A-1

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Sterlite Industries (India) (STRL.BO)

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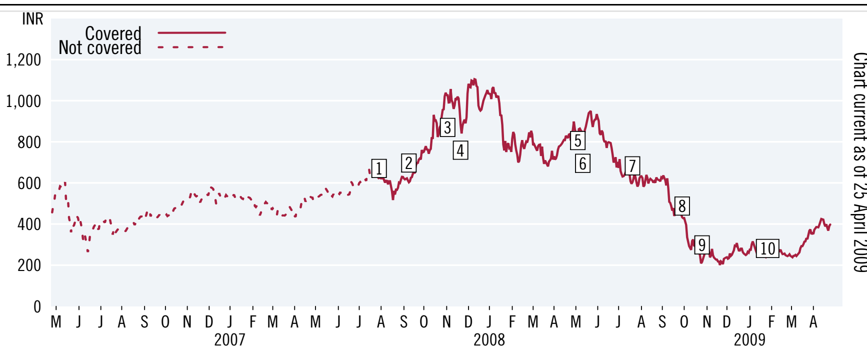
Fundamental Research

Analyst: Pradeep Mahtani
Covered since July 31 2007



	Date	Rating	Target Price	Closing Price
1	30-Jul-07	*1M	*910.00	620.40
2	10-Sep-07	1M	*949.00	602.90
3	2-Nov-07	*1L	*1,209.00	1,026.55
4	21-Nov-07	1L	*1,123.00	885.50
5	5-May-08	1L	*974.00	820.85
6	12-May-08	1L	*1,053.00	848.10
7	21-Jul-08	1L	*777.00	603.45
8	29-Sep-08	*1M	*566.00	432.85
9	27-Oct-08	1M	*345.00	215.75
10	27-Jan-09	*3M	*235.00	267.80

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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