

Sterlite Industries

STOCK INFO. BLOOMBERG
BSE SENSEX: 8,701 STLT IN
REUTERS CODE
S&P CNX: 2,584 STRL.BO

24 October 2008

Buy

Rs209

Previous Recommendation: Buy

Equity Shares (m)	708.5
52-Week Range	1,140/205
1,6,12 Rel. Perf. (%)	-18/-27/-24
M.Cap. (Rs b)	147.8
M.Cap. (US\$ b)	3.0

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	243,768	45,985	82.3	37.1	2.5	1.2	64.0	45.2	0.5	2.1
3/08A	247,054	45,372	64.0	-22.2	3.3	0.7	28.5	21.2	0.2	1.0
3/09E	252,077	46,247	65.3	1.9	3.2	0.6	24.6	14.9	0.1	0.3
3/10E	234,328	28,352	40.0	-38.7	5.2	0.6	13.4	7.0	0.0	0.2

Consolidated

- 2QFY09 PAT increased 19% YoY to Rs12.9b, above estimates of Rs12b. PAT was boosted due to higher other income (accumulated net cash of Rs12b) and lower depreciation (change of depreciation policy for Balco).
- Consolidated net sales remained flat YoY at Rs66b. Volume growth in zinc by 30% of refined zinc and lead metal compensated for 44% YoY lower zinc prices on the LME.
- EBITDA declined 17% YoY to Rs16.4b. EBIT of copper segment increased 126% YoY to Rs4.7b due to higher prices of by product. EBIT of aluminium segment increased 17% YoY to Rs2.3b due to lower depreciation rate. Lower prices of zinc and lead dragged the segmental EBIT 37% YoY to Rs9b.
- Company has cancelled the agreement to purchase ASARCO at US\$2.6b and is working out another agreement at new purchase price. If nothing works out, Sterlite will lose the break fee of US\$50m.
- Sterlite has surplus cash of Rs120b (standalone Rs78b and Hindustan Zinc US\$2b), which is equivalent to Rs170/share. The stock trades at P/E of 5.2x FY10. We have revised our estimates to factor zinc prices of US\$1,200/ton and aluminium prices US\$2,000/ton. Thus, FY10 EPS is revised to Rs40 (earlier Rs57.2). Sterlite is the lowest cost producer of zinc and copper TcRc. Surplus cash of Rs120b, low cost of production, and strong volume growth are the key strength, which is going to be extremely useful (over competition) in present difficult market condition to fuel its long term growth and sustainability. We maintain **Buy** with new target price of Rs391 based on SOTP.

QUARTERLY PERFORMANCE (CONSOLIDATED)

(RS MILLION)

Y/E MARCH	FY08				FY09				FY08	FY09E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	61,391	65,671	52,332	67,659	57,701	65,938	64,790	63,648	247,054	252,077
Change (YoY %)	33.4	-2.2	-23.2	8.2	-6.0	0.4	23.8	-5.9	1.3	2.0
Total Expenditure	39,830	46,013	36,616	45,913	39,435	49,588	49,984	51,572	168,372	190,579
EBITDA	21,561	19,658	15,717	21,746	18,266	16,350	14,807	12,076	78,682	61,498
Change (YoY %)	16.6	-23.6	-43.1	-4.3	-15.3	-16.8	-5.8	-44.5	-16.8	-21.8
As % of Net Sales	35.1	29.9	30.0	32.1	31.7	24.8	22.9	19.0	31.8	24.4
Interest	955	643	681	908	874	581	598	616	3,186	2,668
Depreciation	2,031	2,046	2,142	(269)	1,655	1,667	1,733	1,793	5,950	6,847
Other Income	3,501	3,233	3,009	5,918	4,024	6,121	4,189	4,360	15,661	18,694
PBT (before XO item)	22,076	20,202	15,904	27,024	19,761	20,224	16,665	14,027	85,206	70,676
Extra-ordinary Exp.	-	-	-	(528)	-	(100)	-	-	(528)	(100)
PBT (after XO item)	22,076	20,202	15,904	26,496	19,761	20,124	16,665	14,027	84,678	70,576
Total Tax	5,247	4,465	4,138	7,177	3,808	2,916	2,333	2,038	21,027	11,094
% Tax	23.8	22.1	26.0	27.1	19.3	14.5	14.0	14.5	24.8	15.7
Reported PAT	16,829	15,737	11,766	19,319	15,953	17,208	14,332	11,989	63,651	59,482
Minority interest	5,400	4,911	3,213	6,135	4,443	4,439	3,005	3,157	19,659	15,043
Adjusted PAT	11,429	10,826	8,553	13,569	11,510	12,855	11,327	8,833	44,389	44,524
Change (YoY %)	28.7	-7.1	-33.9	18.2	0.7	18.7	32.4	-34.9	-1.4	0.3

E: MOST Estimate

Consolidated topline remained flat YoY

Net sales remained flat YoY to Rs66b as the decline in revenue from the copper business by 8% to Rs33b, zinc and lead business by 22% to Rs17b, and aluminium business by 5% to Rs11.2b was compensated by 3x YoY growth in revenues from the by products division. Copper cathode production declined by 11% to 81,000tons, while the production of Cu-MIC declined by 25% to 6,000tons. Production of aluminum increased marginally to 91,000tons. Refined zinc production increased 29% YoY to 121,556tons. Increase in by-product segment revenue was primarily due to higher prices of sulphuric acid. Copper LME average prices remained flat YoY at US\$7,571/ton, aluminum LME average prices increased 9% YoY to US\$2,839/ton, while zinc LME average prices declined 44% YoY to US\$1,798/ton.

PRODUCTION (TONS)

	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08	1QFY09	2QFY09
Copper								
Mined Metal Content	7,000	6,000	6,000	8,000	7,000	6,000	6,000	6,000
Cathode	86,000	89,000	81,000	91,000	77,000	90,000	68,000	81,000
Aluminium Balco	89,000	89,000	88,000	90,000	89,000	90,000	89,000	91,000
Aluminium (VAL)								7,000
Zinc								
MIC	127,699	121,301	134,339	143,219	135,891	137,846	138,278	166,998
Change (YoY %)	0.6	44.6	2.1	15.1	6.4	13.6	2.9	16.6
Refined Zinc	93,000	95,000	93,000	94,000	104,000	135,491	127,889	121,556

Source: Company/MOSL

EBITDA declined 16.8%

EBITDA declined 16.8% YoY to Rs16.4b. Copper EBIT increased 2.3x YoY to Rs4.7b, while EBIT of the zinc segment declined 37% to Rs9b. A 17% YoY growth in aluminum segment EBIT to Rs2.3b and 2x YoY growth in by products EBIT to Rs1.1b partially offset the decline in the copper and the zinc segmental EBIT.

SEGMENT RESULTS (R S M)

	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08	1QFY09	2QFY09
a) Copper	3,750	2,867	2,613	2,076	1,858	3,670	2,541	4,692
b) Aluminium	4,324	4,552	2,930	1,939	1,452	5,473	3,988	2,269
c) Zinc & Lead	18,764	13,795	15,411	14,399	10,320	13,777	9,309	9,040
d) Others	25	-42	365	550	638	-901	1,343	1,101
Other Unallocable income/expenses			742	1,583	1,712	1,882	2,316	5,914
Total EBIT	27,605	22,755	23,031	20,845	16,584	27,933	20,636	20,804
Less : Interest Paid	856	874	955	643	681	908	874	581
Profit before Tax & EO	26,749	21,881	22,076	20,202	15,904	27,025	19,761	20,224
Less: Extra ordinary Items	25	63	0			528	0	100
Profit before Tax	26,724	21,818	22,076	20,202	15,904	26,497	19,761	20,124

Source: Company/MOSL

Refined zinc production will be ramped up in 2HFY09

Zinc and lead smelter is presently running at full capacity, which will lead to higher production in second half. Capex of US\$900m to raise capacity to 1mtpa is on track to be completed

by mid-2010. This will also raise silver production from 120tons to 600tons in next three years.

Vedanta Aluminum projects ahead of schedule

- ✍ 250ktpa (304pots) aluminium smelter will be fully commissioned by March 2009. Currently, 180pots are commissioned.
- ✍ Further 250,000tpa capacity will be commissioned by March 2010.
- ✍ Bauxite mines will be operational with the help of trucks by April 2009 and with the help of conveyors by September 2009.
- ✍ Second stream of 1.4mtpa alumina refinery has started operations.

ASARCO purchase is being renegotiated

The company has cancelled the agreement to purchase ASARCO at US\$2.6b and is working out another agreement at new purchase price. If nothing works out, Sterlite will lose its break fee of US\$50m. Copper prices have declined steeply from its highs of US\$8,323/ton in 1QFY09 to the current prices of US\$3,900/ton.

Attractive valuations; value pick

Sterlite has surplus cash of Rs120b (standalone Rs78b and Hindustan Zinc US\$2b), which is equivalent to Rs170/share. The stock trades at P/E of 5.2x FY10E. We have revised our estimates to factor in zinc prices of US\$1,200/ton and aluminium prices US\$2,000/ton. Thus, FY10 EPS is revised to Rs40 (earlier Rs57.2). Sterlite is the lowest cost producer of zinc and copper TcRc. Surplus cash of Rs120b, low cost of production, and strong volume growth are the key strengths, which will give the company competitive edge. We maintain **Buy** with new target price of Rs391 based on SOTP.

SUM OF THE PARTS VALUATIONS

	FY10	FY10	FY10	FY11	FY11	
	ST-ALONE	HZL	BALCO	VAL *	SEL *	CMT
EBITDA	11,929	19,631	6,348	18,621	21,431	
EV/EBITDA multiple (x)	5.0	5.0	5.0	4.0	4.0	DCF
EV	59,644	98,154	31,741	74,482	85,725	
Net Debt	-53,811	-101,408	19,603	43,393	47,199	
Residual Equity Value	113,455	199,563	12,137	31,089	38,526	22,072

* FY11 will be first full year of commissioning => lower multiple used

Sterlite Industries Ltd (SIL -Existing structure) valuation							SOTP
Economic Interest (%)	100	64.5	51.0	29.5	100	100	
(a) Equity Value (attributable)	113,455	128,718	6,190	9,171	38,526	22,072	318,133
(b) Subsidiary discount @ 20%		25,744	1,238	1,834	7,705	4,414	40,936
Target Mkt Cap (a-b)	113,455	102,974	4,952	7,337	30,821	17,658	277,197
Sterlite no. of shares	708.5	708.5	708.5	708.5	708.5	708.5	708.5
Target price (Rs/share)	160	145	7	10	44	25	391

Source: Company/MOSL

Sterlite Industries: an investment profile

Company description

Sterlite is a diversified play on three base metals. It is ramping up capacities to 400,000 tonnes of aluminum, 400,000 tonnes of copper and 1mtpa of refined zinc and lead, which would fuel significant volume growth. The company is setting up a 2,400MW power project in Orissa. The first phase of 600MW capacity is likely to be operational in September 2009. The project is in close proximity to coal mines and Sterlite would soon replace coal linkages with coal from its captive mines. Given its low cost production and strong demand, the project would drive earnings up. Sterlite has raised US\$2b mainly to fund the exercise of call options in Hindustan Zinc, enabling it to acquire the remaining 29.5% government stake in the company. We believe this will be substantially value accretive for shareholders of Sterlite.

Key investment arguments

- Strong volume growth in both zinc and aluminium due to capacity expansions. Successful exercise of call options on Hindustan Zinc and BALCO will be value accretive to the shareholders.

Key investment risks

- Unexpected fall in zinc, aluminum or copper prices may adversely impact profitability.

Recent developments

- Company has cancelled the agreement to purchase ASARCO at US\$2.6b and is working out another agreement at new purchase price. If nothing works out, Sterlite will lose the break fee of US\$50m.

Valuation and view

- The stock trades at P/E of 3.2x FY09E. Re-iterate **Buy**.

Sector view

- Zinc prices have trended lower due to easing of global supply and rising energy costs. Higher cost of production for most miners is forcing mines shutdown. We believe the downside risks to zinc prices are limited. Price and demand outlook for based metals remain weak amidst recessionary fears.

COMPARATIVE VALUATIONS

		STERLITE	NALCO	HINDALCO
P/E (x)	FY09E	3.2	5.8	9.0
	FY10E	5.2	7.2	6.4
P/BV (x)	FY09E	0.6	1.0	0.8
	FY10E	0.6	0.9	0.7
EV/Sales (x)	FY09E	0.1	1.5	0.6
	FY10E	0.0	1.3	0.6
EV/EBITDA (x)	FY09E	0.3	3.3	5.1
	FY10E	0.2	3.3	5.0

SHAREHOLDING PATTERN (%)

	SEP-08	JUN-08	SEP-07
Promoter	60.6	62.5	62.5
Domestic Inst	7.3	5.7	3.6
Foreign	21.5	24.6	27.7
Others	10.6	7.2	6.3

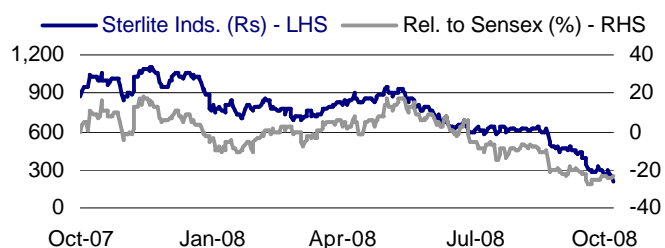
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY09	65.3	57.4	13.8
FY10	40.0	60.4	-33.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
209	391	87.4	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs MILLION)					
Y/E MARCH	2006	2007	2008	2009E	2010E
Net Sales	131,026	243,768	247,054	252,077	234,328
Change (%)	80.7	86.0	1.3	2.0	-7.0
Total Expenses	94,148	149,180	168,372	190,579	199,403
EBITDA	36,878	94,589	78,682	61,498	34,925
% of Net Sales	28.1	38.8	31.8	24.4	14.9
Depn. & Amortization	5,269	8,039	5,950	6,847	6,674
EBIT	31,609	86,550	72,731	54,651	28,251
Net Interest	2,353	3,791	3,186	2,668	2,003
Other income	3,363	6,817	15,661	18,694	21,777
PBT before EO	32,619	89,576	85,206	70,676	48,025
EO income	-101	-1,572	-528		
PBT after EO	32,518	88,004	84,678	70,676	48,025
Tax	10,236	24,117	21,027	11,094	12,617
Rate (%)	31.5	27.4	24.8	15.7	26.3
Reported PAT	22,282	63,887	63,651	59,582	35,408
Minority interests	5568	20023	19659	15043	8120
Share in Asso.	-4	980	983	1707	1064
Adjusted PAT	16,779	45,985	45,372	46,247	28,352
Change (%)	114.8	174.1	-1.3	19	-38.7

BALANCE SHEET					
(Rs MILLION)					
Y/E MARCH	2006	2007	2008	2009E	2010E
Share Capital	559	1,117	1,417	1,417	1,417
Reserves	59,974	98,701	221,609	240,355	263,469
Share holders funds	60,532	99,818	223,026	241,772	264,886
Minority Interest	16,948	36,259	56,233	66,470	74,594
Loans	51,872	46,103	50,745	47,023	53,023
Secured	37,995	19,154	10,688	12,953	18,953
Unsecured	13,877	26,949	40,057	34,071	34,071
Deferred tax liability (net)	7,511	9,174	13,537	12,663	13,543
Capital Employed	136,862	191,354	343,541	367,928	406,046
Gross Block	114,400	126,414	145,637	168,268	199,748
Less: Accum. Deprn.	36,513	43,235	45,883	59,734	66,409
Net Fixed Assets	77,887	83,179	99,754	108,534	133,339
Capital WIP	7,611	13,997	24,613	9,225	9,225
Investments	24,952	52,219	162,941	194,094	204,681
Curr. Assets	60,422	90,594	106,634	103,704	105,574
Inventories	19,507	28,092	33,341	28,146	26,966
Sundry Debtors	13,475	16,521	15,623	16,913	16,167
Cash and Bank	11,153	11,134	24,536	39,416	43,213
Loans and Advances	16,287	34,846	33,135	19,229	19,229
Curr. Liability & Pro	34,113	48,636	50,401	47,629	46,774
Sundry Creditors	13,917	9,078	13,554	19,887	19,032
Other Liabilities & pro	20,196	39,558	36,847	27,742	27,742
Net Current Assets	26,309	41,958	56,233	56,075	58,800
Misc. Exp. (not w/of	105	0	0		
Application of Fund	136,863	191,354	343,541	367,928	406,046

E: MOST estimates

RATIOS					
Y/E MARCH	2006	2007	2008	2009E	2010E
Basic (Rs)					
EPS	60.1	82.3	64.0	65.3	40.0
Cash EPS	78.9	96.7	72.4	74.9	49.4
BV/Share	216.3	178.7	314.8	341.2	373.9
DPS	2.5	4.0	4.0	4.0	4.0
Payout (%)	4.2	4.9	6.2	6.1	10.0
Valuation (x)					
P/E		2.5	3.3	3.2	5.2
Cash P/E		2.2	2.9	2.8	4.2
P/BV		12	0.7	0.6	0.6
EV/Sales		0.5	0.2	0.1	0.0
EV/EBITDA		2.1	1.0	0.3	0.2
Dividend Yield (%)		1.9	1.9	1.9	1.9
Return Ratios (%)					
RoE	36.8	64.0	28.5	24.6	13.4
RoCE	23.1	45.2	21.2	14.9	7.0
RoIC	34.0	75.9	55.3	43.7	19.0
Working Capital Ratios					
Fixed Asset Turnover (x)	11	19	17	15	12
Asset Turnover (x)	10	13	0.7	0.7	0.6
Debtor (Days)	38	25	23	24	25
Inventory (Days)	54	42	49	41	42
Creditors (Days)	39	14	20	29	30
Leverage Ratio (x)					
Debt/Equity	0.7	0.4	0.1	0.0	0.0

CASHFLOW STATEMENT					
(Rs MILLION)					
Y/E MARCH	2006	2007	2008	2009E	2010E
Pre-tax profit	32,518	88,004	84,678	70,676	48,025
Depreciation	4,737	6,722	2,648	13,851	6,674
(Inc)/Dec in Wkg. Cap.	-7,069	-15,668	-874	15,039	1,071
Tax paid	-8,251	-23,274	-18,555	-11,094	-12,617
Other operating activities		646	4760	-18,158	8264
CF from Op. Activit	21,934	56,430	72,658	70,314	51,417
(Inc)/Dec in FA +CWIP	-12,116	-18,401	-29,839	-7,242	-31,480
(Pur)/Sale of Investment	-6,461	-27,268	-110,721	-31,154	-10,587
Others				-6000	-5000
CF from Inv. Activit	-18,577	-45,669	-140,561	-44,396	-47,067
Equity raised/(repaid)	10	558	300		
Debt raised/(repaid)	-1,657	-5,768	4,642	-3,722	6,000
Dividend (incl. tax)	-445	-797	-2,547	-3,316	-3,316
Other financing activities	1545	-4773	78909	-2869	-2868
CF from Fin. Activit	-547	-10,780	81,303	-9,907	-184
(Inc)/Dec in Cash	2,811	-19	13,401	16,012	4,167
Add: opening Balance	8,342	11,153	11,134	24,536	39,416
Closing Balance	11,153	11,134	24,536	39,416	43,213



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Disclosure of Interest Statement	Sterlite Industries
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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