

April 27, 2010

Sterlite Industries (STEIND)

Rs 829

WHAT'S CHANGED...

PRICE TARGET	Unchanged
EPS (FY11E)	Changed from Rs 54.2 to Rs 56.8
EPS (FY12E)	Changed from Rs 96.8 to Rs 100.7
RATING.....	Unchanged

Surging ahead smartly...

Sterlite industries (SIIL) reported strong numbers for Q4 and FY10 with consolidated net sales registering YoY growth of ~64% and ~15%, respectively, on the back of record production (particularly zinc operations). The consolidated PAT was higher than our estimates (as well as consensus) at ~Rs 1381 crore for Q4FY10, propped up by higher other income (part of which was on account of FCCB gain and so non-recurring). EBITDA margin for FY10 came in at a healthy 26%, showing a growth of 230 bps YoY on the back of 57-96% YoY increase in LME base metal realisations. We are maintaining our positive stance on the company on the back of i) low cost of operations through efficient and integrated structure ii) positive long-term outlook for zinc operations that happens to be the highest profit contributor for SIIL iii) expansion activities on the fast track resulting in strong volume growth across products and v) strong balance sheet (cash/share of ~Rs 254) leaving ample opportunities for inorganic growth.

■ Volumes remain strong, expansions on fast track

The company has maintained strong volume growth across all product categories with YoY production increase of 5.5%, 7%, 34% and 514% in refined zinc & lead, copper, silver and surplus power sales, respectively, in FY10. Expansion activities continued to remain on the fast track across all metals with zinc operations already commissioned three months ahead of schedule.

Valuation

At the CMP of Rs 829, the stock is trading at FY12E PE of 8.2x and FY12E EV/EBITDA of 3.0x on a consolidated basis. We expect a significant jump in earnings in FY12E on the back of increased volumes from expansion across all product categories and control on costs through operational efficiencies and economies of scale. We value the stock on SOTP basis and arrive at a target price of Rs 918. We assign a **BUY** rating to the stock.

Exhibit 1: Performance Highlights

(Rs Crore)	Q4FY10	Q4FY10E	Q4FY09	Q3FY10	YoY (Chg %)	QoQ (Chg %)
Net Sales	7110.8	7035.0	4336.1	6677.0	64.0	6.5
EBITDA	2185.5	1962.4	839.2	1772.2	160.4	23.3
EBITDA Margin (%)	30.7	27.9	19.4	26.5	+ 1130 bps	+ 420 bps
Depreciation	224.6	178.2	203.2	178.2	10.5	26.0
Interest	120.6	92.9	131.2	92.9	-8.1	29.8
Attributable PAT	1380.9	1035.0	598.3	731.3	130.8	88.8
Attributable EPS (Rs)	16.4	12.3	8.4	8.7	94.6	88.8

Source: Company, ICICIdirect.com Research

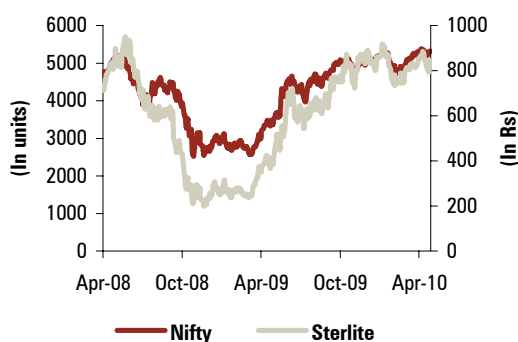
Rating matrix	
Rating	: Buy
Target	: Rs 918
Target Period	: 12-15 months
Potential Upside	: 11%

Annual performance				
(Rs Crore)	FY09	FY10	FY11E	FY12E
Net Sales	21144.2	24410.3	28240.7	40235.5
EBITDA (Core)	5008.3	6343.9	8312.8	13223.1
Net Profit (Attrib.)	3540.0	3743.7	4775.5	8466.7

Valuation summary				
	FY09	FY10	FY11E	FY12E
PE (x)	16.6	18.6	14.6	8.2
Target PE (x)	18.4	20.6	16.1	9.1
EV/EBITDA (x)	8.7	7.5	5.7	3.0
P/BV (x)	2.3	1.9	1.7	1.4
RoNW (%)	14.8	12.1	12.3	18.9
RoCE (%)	16.4	15.1	15.0	20.2

Stock data	
Market Capitalisation	Rs 69669.2 Crore
Debt (FY10)	Rs 9260 Crore
Cash & Invst (FY09)	Rs 21313 Crore
EV	Rs 57616.2 Crore
52 week H/L	929/375
Equity capital	Rs 168.1 Crore
Face value	Rs 2
MF Holding (%)	8
FII Holding (%)	14.3

Price movement (Stock vs. Nifty)



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The company reported its highest ever refined metal production at ~6,50,000 tonne in FY10. Silver production also scaled its new high at ~176 tonne. EBIT margins from the zinc business in FY10 expanded to ~56%, up ~1000 bps from ~46% in FY09. The zinc business continued to remain the highest profit contributor for Sterlite

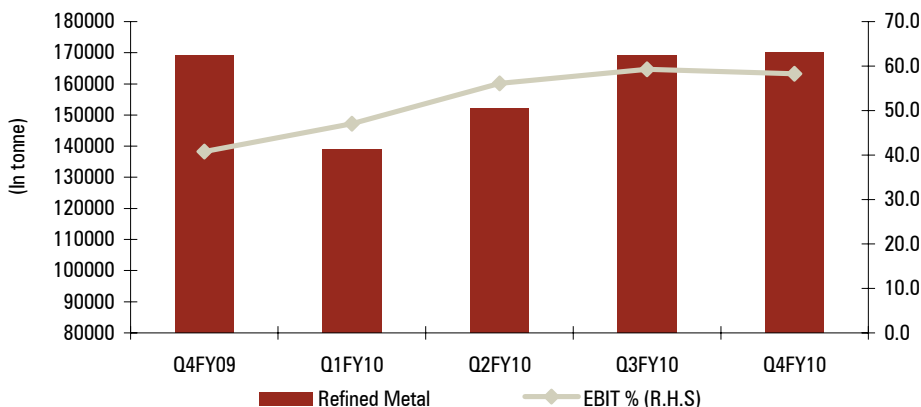
The company reported record aluminium production at ~2,50,000 tonne for Balco II, above its rated capacity. Production in VAL continued to increase with stabilisation of the first 250 ktpa aluminium smelter complete and the second smelter commissioning under way. EBIT margins from the aluminium business stayed at ~13.8% in FY10

Copper production increased 7% to 3,34,000 tonne in FY10 and EBIT margins came in at a subdued 5.1% as TC/RCs remained subdued at 13.5 c/lb and CoP increased to 10.5 c/lb due to lower by-product realisations during the year

Result Analysis

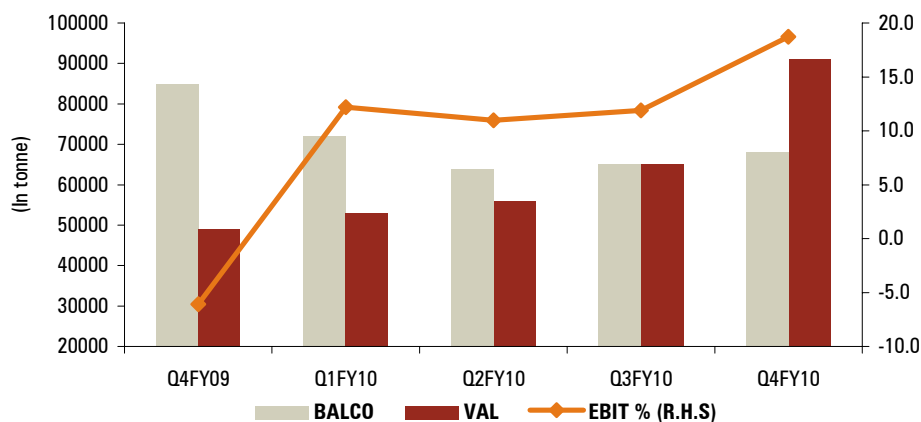
The company reported record production across all metals in FY10 on account of i) operational efficiencies leading to higher productivity ii) robust demand growth in the domestic market iii) low cost integrated model across base metals ensuring robust margins and operational capability even at lower price levels. A bounce-back in base metal prices during FY10 helped the company to improve margins (particularly zinc operations).

Exhibit 2: Zinc and lead production and EBIT margins



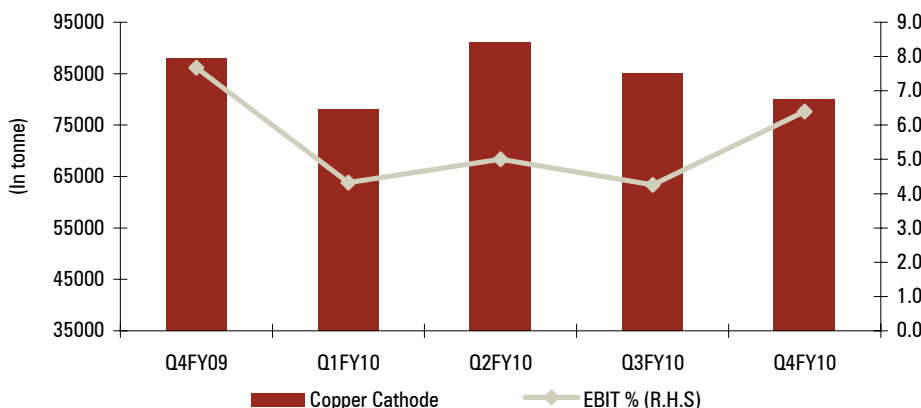
Source: Company, ICICIdirect.com Research

Exhibit 3: Aluminium operations production and EBIT margins



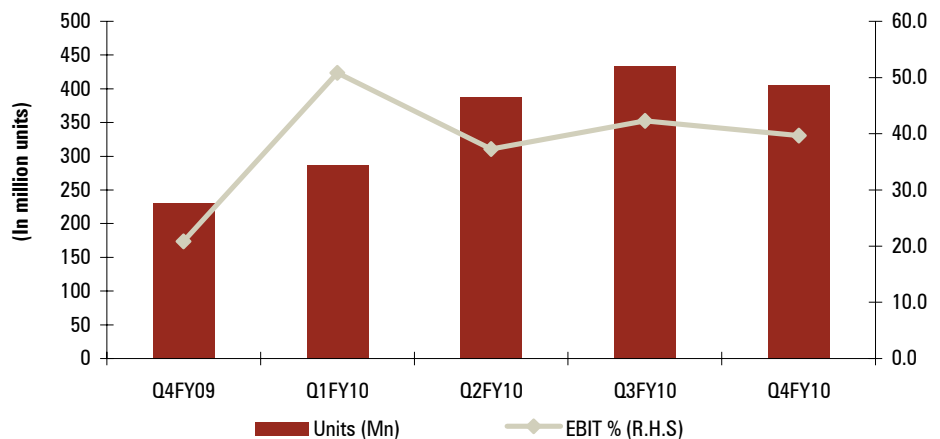
Source: Company, ICICIdirect.com Research

Exhibit 4: Copper production and EBIT margin



Source: Company, ICICIdirect.com Research

The company decided to shut down its high cost Balco I smelter during Q1FY10 and started selling surplus power from its 270 MW Balco I CPP. It sold ~1,416 million units of surplus power in FY10, up 514% YoY and achieved robust realisation of Rs 5.7/unit on the same. The EBIT margin from the power business was at ~42% for FY10

Exhibit 5: Power production and EBIT margin


Source: Company, ICICIdirect.com Research

Conference call highlights and major developments

- The company commissioned its 210 ktpa zinc smelter at Dariba and 1 mtpa concentrator at Rampura Agucha three months ahead of schedule. It became the largest integrated zinc producer in the world controlling ~8% of the world's zinc production. Expansion activities at the lead smelter, 160 MW CPP and high content silver mine at Sindesar Khurd remained on track for scheduled completion
- Aluminium production from Balco II continued at more than 100% of its rated capacity. The first 250 ktpa smelter at VAL, Jharsuguda, has been stabilised and progressive commissioning of the second 250 ktpa smelter is under way. Expansion activity in aluminium operations at both Balco and VAL are progressing well and are expected to be commissioned on schedule
- Copper production was higher by 7% YoY but margins remained subdued due to lower TC/RC and higher CoP on account of subdued acid realisations. Benchmark settlement for TC/RCs for 2010 has been done at 46/4.6, which is lower than last year's 75/7.5. Copper expansion to 8 lakh tonne is progressing well and the company's copper mines in Australia have regained rated production levels in Q4FY10 with 7,000 tonnes of mined metal production
- Hearing related to the Balco call option has been set in August. The company expects the same to be the final step in acquiring a residual stake in Balco. Post completion of arbitration in Balco, the company would proceed for a residual stake purchase in HZL
- The company is still awaiting final clearance from the government for mining bauxite ore from Niyamgiri hills mines and expects the approval within a few months post completion of due diligence from the government. With current purchased bauxite from outside sources, it can produce 1.5 MT of alumina/year at VAL
- Sterlite Energy's first 600 MW is expected to start operations from June, 2010 while the other three units of 600 MW each would be progressively commissioned by the end of FY11
- The board of the company has proposed a bonus issue in the ratio of 1:1 and also a stock split of its equity share of Rs 2 each into equity shares of Re 1 each. A dividend of Rs 3.75 per equity share of Rs 2 was announced for FY10

- The company had a consolidated debt of Rs 9260 crore and cash (including liquid investments) of Rs 21313 crore as at FY10 end. The current inter corporate loans to VAL from SIIL stood at ~Rs 10,000 crore.

Outlook & earnings revision

LME prices across all base metals have sustained at high levels through most of CY10 till date after showing a strong recovery in H2CY09 on the back of sustained global economic recovery, improvement in underlying demand of base metals globally, inventory restocking and China's strong appetite for base metals. We believe there remains a strong chance of a mild correction in the short-term in base metals (particularly zinc, lead and aluminium) on account of inventory destocking and slowdown in demand. However, our long-term stance remains positive on the pricing front as supply from ores in the world's major mines would gradually reduce, going forward, due to the gradually reducing remaining life of some of the world's biggest mines.

Exhibit 6: Revised LME price assumptions

(US\$/t)	FY11E			FY12E		
	Current	Previous	% Chg.	Current	Previous	% Chg.
Zinc	2200.0	2250.0	-2.2	2354.0	2407.0	-2.2
Lead	2100.0	2000.0	5.0	2247.0	2140.0	5.0
Aluminium	2200.0	2100.0	4.8	2354.0	2247.0	4.8
Copper	7200.0	6500.0	10.8	7704.0	6955.0	10.8

Source: Company, ICICIdirect.com Research

We have revised our LME zinc realisations lower by 2.2% for FY11E and FY12E each and our LME lead realisations upwards by 5% for FY11E and FY12E each. LME aluminium and copper realisations have been revised upwards by 4.8% and 10.8% for FY11E and FY12E, respectively, factoring in the current LME prices and the future outlook.

Exhibit 7: Revised financials

(Rs Crore)	FY11E			FY12E		
	Current	Previous	% Chg	Current	Previous	% Chg
Net Sales	28240.7	27667.6	2.1	40235.5	39557.6	1.7
EBITDA	8312.8	8234.4	1.0	13223.1	13000.9	1.7
EBITDA Margin (%)	29.4	29.8		32.9	32.9	
Attributable PAT	4775.5	4551.1	4.9	8466.7	8134.7	4.1
Attributable EPS (Rs)	56.8	54.2	4.9	100.7	96.8	4.1

Source: Company, ICICIdirect.com Research

We have revised our EPS estimates for FY11E and FY12E by 4.9% and 4.1%, respectively

Valuations

At the CMP of Rs 829, the stock is trading at FY12E PE of 8.2x and FY12E EV/EBITDA of 3.0x on a consolidated basis. We expect a significant jump in earnings in FY12E on the back of increased volumes from expansion across all product categories. We have valued the stock on an SOTP basis and arrived at a target price of Rs 918. We are assigning a **BUY** rating to the stock. We believe the company is in a much better position as compared to global players as it has achieved higher margins on the back of low cost integrated operations and productive assets and also made significant progress in its expansion activities without putting too much pressure on its balance sheet.

Exhibit 8: SOTP valuation

Company	FY12E EBITDA	EV/EBITDA Multiple	EV	Implied Equity Value	SILL Stake	Attributable Equity Value	Value/Share
Hindustan Zinc Standalone - Copper (Incl. Cash)	6974.1	5.5	38357.4	58930.0	64.9%	38245.6	455.1
BALCO	855.4	6.0	5132.4	17704.6	100%	17704.6	210.7
VAL	2694.6	6.5	17515.1	15938.1	51%	8128.4	96.7
Others	3672.9	6.5	23874.0	9891.1	29.5%	2917.9	34.7
Total							120.1
							917.2

Source: Bloomberg, ICICIdirect.com Research

ICICIdirect.com coverage universe (Metals & Mining)

Adhunik Metaliks				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)	
Idirect Code	ADHMET	CMP (Rs)	129.3	FY09	1270.3	5.1	25.3	11.1	13.3	9.1
		Target (Rs)	149.0	FY10E	1457.9	10.9	11.9	7.0	16.9	14.0
MCap (Rs Cr)	1544.0	Upside (%)	15.3	FY11E	1746.1	16.6	7.8	5.7	20.9	17.5
				FY12E	1849.2	17.9	8.3	5.3	18.8	16.7
JSW Steel				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)	
Idirect Code	JINVIJ	CMP (Rs)	1,204.8	FY09	16081.5	14.7	82.0	12.3	3.5	9.3
		Target (Rs)	800.0	FY10E	18617.3	77.2	15.6	10.1	16.3	11.4
MCap (Rs Cr)	22535.8	Upside (%)	-33.6	FY11E	22841.6	102.8	11.7	7.5	18.4	14.1
Usha Martin				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)	
Idirect Code	USHBEL	CMP (Rs)	97.5	FY09	2949.8	6.6	14.8	8.1	14.6	13.9
		Target (Rs)	105.0	FY10E	2722.2	6.5	14.9	7.7	16.0	13.1
MCap (Rs Cr)	2977.7	Upside (%)	7.7	FY11E	3793.3	10.4	9.3	5.6	20.9	17.8
Visa Steel				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)	
Idirect Code	VISST	CMP (Rs)	45.0	FY09	1035.0	-6.1	NA	NA	NA	NA
		Target (Rs)	52.0	FY10E	1072.0	4.4	10.2	7.6	14.8	14.2
MCap (Rs Cr)	495.0	Upside (%)	15.6	FY11E	1443.8	8.5	5.3	5.7	22.1	12.8
				FY12E	1966.9	15.4	3.4	4.2	28.7	17.1
Tata Steel - Cons				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)	
Idirect Code	TISCO	CMP (Rs)	647.5	FY09	145686.3	67.8	9.5	4.9	17.0	15.0
		Target (Rs)	450.0	FY10E	103553.3	-35.7	-18.1	13.5	-12.1	3.4
MCap (Rs Cr)	57413.8	Upside (%)	-30.5	FY11E	123265.8	47.7	13.6	7.2	13.8	11.0
				FY12E	130357.3	58.1	11.2	6.3	14.9	12.1
SAIL				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)	
Idirect Code	SAIL	CMP (Rs)	227.6	FY09	43639.7	14.9	15.2	7.2	32.7	37.4
		Target (Rs)	235.0	FY10E	40638.3	16.0	14.2	9.2	22.1	21.0
MCap (Rs Cr)	93987.3	Upside (%)	3.3	FY11E	49225.3	18.2	12.5	8.5	20.0	17.0
				FY12E	58787.2	21.5	10.6	6.5	19.5	17.2
Sesa Goa				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)	
Idirect Code	SESGOA	CMP (Rs)	431.2	FY09	4959.1	25.3	17.1	11.7	42.2	51.9
		Target (Rs)	524.0	FY10	5858.3	31.6	13.6	9.7	32.6	30.1
MCap (Rs Cr)	35828.4	Upside (%)	21.5	FY11E	10362.7	55.8	7.7	4.5	33.3	40.5
				FY12E	11127.5	57.9	7.4	3.7	26.1	31.4
Hindustan Zinc				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)	
Idirect Code	HINZIN	CMP (Rs)	1,225.0	FY09	5680.3	64.6	19.0	14.7	20.8	19.8
		Target (Rs)	1,395.0	FY10	8017.0	95.6	12.8	8.5	24.7	27.2
MCap (Rs Cr)	51759.9	Upside (%)	13.9	FY11E	9322.1	110.3	11.1	6.6	22.6	25.1
				FY12E	11261.4	137.7	8.9	4.5	22.8	25.7
Sterlite Industries *				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)	
Idirect Code	STEIND	CMP (Rs)	829.1	FY09	21144.2	50.0	16.6	8.7	14.8	16.4
		Target (Rs)	918.0	FY10	24410.3	44.5	18.6	7.5	12.1	15.1
MCap (Rs Cr)	69677.6	Upside (%)	10.7	FY11E	28240.7	56.8	14.6	5.7	12.3	15.0
				FY12E	40235.5	100.7	8.2	3.0	18.9	20.2
GPIL				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)	
Idirect Code	GODPOW	CMP (Rs)	306.4	FY09	1092.0	22.8	13.4	8.7	14.6	13.6
		Target (Rs)	254.0	FY10E	799.3	17.9	17.1	9.2	10.2	10.6
MCap (Rs Cr)	825.5	Upside (%)	-17.1	FY11E	967.1	36.9	8.3	5.2	18.4	17.6
				FY12E	1010.2	42.5	7.2	4.2	17.9	17.3

* The announcement of bonus and split not factored in as record date is not announced till now

Source: Company, ICICIdirect.com Research

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 Add: Up to 10%;
 Reduce: Up to -10%
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