

Key takeaways from Sterlite site visit

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We recently visited Sterlite Energy (SEL), VAL operations in Jharsuguda, Orissa and Zinc op in Rajasthan. We see better visibility around ramp up of commercial ops. (Unit 1 & 2) at SEL as evacuation infra. related issues for these units are likely resolved. We expect fuel supply issues to persist & are factoring higher power costs vs. guidance. In HZL, faster ramp up of silver output could drive upsides. Overall, our FY12e EPS of Rs22.7 appear achievable. We maintain our Buy due to strong EPS growth in FY12 led by Zn/power & reasonable valuations.

Power: Commercial ops of unit 1 & 2 expected in 1QFY12

Inadequate power evacuation infrastructure has led to delay in commercial ops. at the first two power units (600MW each) at SEL. This has been likely resolved as a new 600MW transmission line (LILO-1) for evacuation of power from unit 2 has been commissioned. STLT has guided to over 80% PLF at unit 1 & 90% PLF in unit 2 in 1QFY12. Unit 3 & 4 (600MW each) are (delayed by ~3mnths) & expected to be synchronized in 2Q & 3QFY12 respectively. The 1000MW transmission line for evacuating power from these units is expected to be completed by Oct 11.

SEL power costs to improve; fuel supply issues to persist

Mgmt expects power cash cost to reduce to ~Rs1.8/kwh (well over Rs2/Kwh at present) at steady state PLF, based on revised coal prices. Expected coal sourcing mix in FY12 is 1) linkage coal -65%; 2) e-auction -25-30% & imported coal 5-10%. We understand SEL is getting linkage coal, but see risks to linkage coal supply given production issues at MCL. Our linkage coal supply forecasts are lower at 50% of requirement. We est. cash cost of Rs2.1/Kwh (gross) in FY12.

HZL: Zn utilizations to improve, silver is a focus area

STLT expects Zn utilization of 90-95% in FY12 (80% in FY11e) as water shortage issues have been resolved. Ore output at silver (Ag) rich S.K. mines is ramping up. STLT expects Ag output of ~12mn oz in FY12 (FY11e 6mn oz). Time line for 100ktpa lead expansion (pre requisite for Ag ramp up) by 4QFY11 is unchanged. Strip ratio at Rampura Agucha mines is 12 at present (avg. of 10.5 over mine life). We think mining costs may remain elevated near term due to higher pre-stripping costs. This is likely to reduce in medium term and will offset higher haulage costs.

VAL capex continues, still hopeful of getting Bauxite mines

Cost of production at the 0.5mtpa Al smelter unit remains high at ~US\$2000/t. VAL sees scope for US\$100-150/t cost reduction led by efficiency gains. Around 80% of the 1.25mtpa VAL smelter project has been completed. The scale of the asset base is impressive, but commissioning is unlikely until VAL secures bauxite mines. VAL is hopeful of being allocated alternate bauxite mines (eg. Karlapet) by Orissa Mineral Corporation as part of its commitment under an MOU with VAL.

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Stock Data

Price (Common / ADR)	Rs166.35 / US\$14.93
Price Objective	Rs207.00 / US\$18.40
Date Established	15-Nov-2010 / 15-Nov-2010
Investment Opinion	C-1-7 / C-1-7
Volatility Risk	HIGH / HIGH
BofAML Ticker / Exchange	XTNDF / BSE
BofAML Ticker / Exchange	SLT / NYS
Bloomberg / Reuters	STLT IN / STRL.BO

Other Key Takeaways

Table 1: Other Key takeaways from site visit

Sterlite Energy	<ul style="list-style-type: none"> • Sterlite is committed to sell power from first 600MW unit to Orissa Gridco at OERC rates. However, Orissa Gridco has been off taking only 300MW vs. unit 1 capacity of 600MW and dedicated Gridco transmission link capacity of 450MW due to softer power demand. Sterlite plans to sell excess power thru short term open access. • Unit 3 & 4 (600MW each) are (delayed by ~3mnths) & expected to be synchronized in 2Q & 3QFY12 respectively. Unit 3 is at the turbine generator installation stage. Unit 4 is still at the erection commissioning stage. Hence some delays are possible in our view. • The 1000MW transmission line (LILO-2) for evacuating power from these units is expected to be completed by Oct 11. Total transmission capacity post the expansion will be 2050MW. • In addition to rail, a large proportion of coal required for SEL/ VAL CPP is also being transported thru trucks. Around 2000 trucks per day are being used to transporting coal. However Sterlite plans to reduce dependence on road transportation of coal. It is now investing in 5 rail projects to augment its railways infrastructure to increase rail transportation of coal. It plans to set up a 85KM merry go round rail project connecting Jharsuguda to Mahanadi Coalfields' Vasundhara coal mines which has large coal reserves.
Vedanta Aluminum	<ul style="list-style-type: none"> • As per VAL, OMC is committed to allocate 150mn tons of bauxite reserves (Niyamgiri reserves was ~60mn tons). Management remains hopeful of getting alternate mine allocation such a Karlapet mines (reserves of ~200mn tons). However, environment and forest clearance from these mines could take around 2 years. Hence, production from these mines is unlikely to commence before 2 years (after allotment). • For its 0.5mtpa Al smelter at Jharsuguda, VAL is sourcing ~50% of requirements from imports and remaining is being sourced from Lanjigarh.
Hindustan Zinc	<ul style="list-style-type: none"> • In HZL, production at silver rich Sindesar Khurd mines is ramping up fast. STLT expects to produce 1.5mtpa of ore in FY12 and 2mn ton of ore in FY13. As a result it expects silver (Ag) production to increase to ~12mn oz in FY12e. We believe Ag production also hinges on timely commissioning of 1) 100ktpa lead smelter (expected in March 2011); 2) commissioning of silver refinery in Pant nagar. • Strip ratio at HZL's low cost Rampura Agucha mines is running at 12 higher than average of 10.5 (over mine life). We think mining costs may remain elevated near term due to higher pre-stripping costs (additional overburden removal to expose ore body at lower level). This is likely to reduce in medium term offsetting higher haulage costs.

Source: Sterlite, BofAML Research

Price objective basis & risk

Sterlite Industries India Limited (XTNDF / SLT)

Our PO of Rs207 (US\$18.40/ADR) is based on an SOTP valuation of Sterlite's metals and power businesses. Our PO implies Rs 175 for the metals business and Rs32 for the power business. At our PO Sterlite would trade at 9.5x FY12 EPS and 5.2x FY12 EBITDA.

Our NPV for the metals business is Rs175share based on WACC of 12.5% and perpetuity growth of 0%. We forecast long-term zinc price of US\$1,962/t and long-term aluminum price of US\$2,271/ton.

Our valuation of the power business implies Rs32 for Sterlite Energy (including Rs5 for Talwandi Sabo project). Our power valuation is based on merchant tariff forecast of Rs6/unit in FY11E and Rs5/unit in FY12E.

Upside risks: Higher-than-forecast metal prices and higher-than-forecast power capacity over the next two years. Downside risks: Lower metals prices and continuing hurdles in minority stake increase.

Link to Definitions

Basic Materials

Click [here](#) for definitions of commonly used terms.

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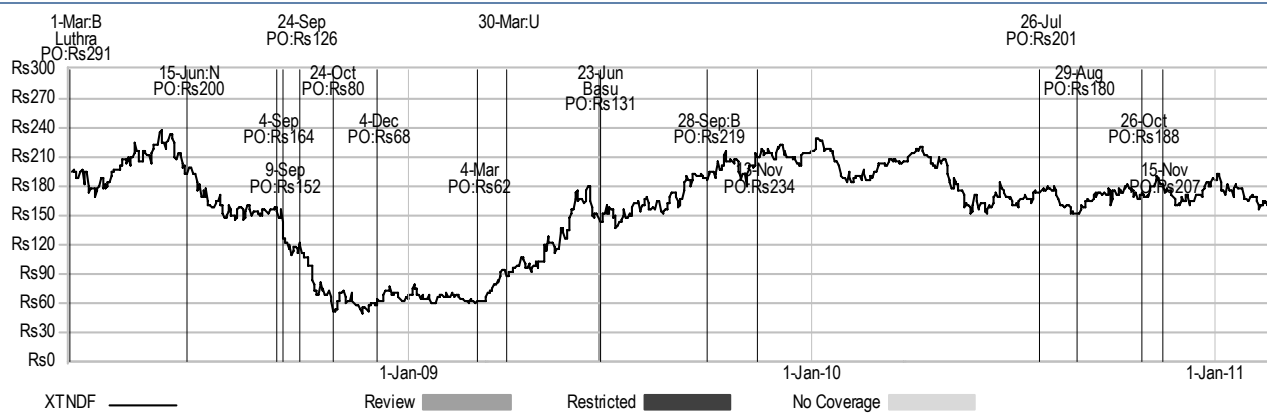
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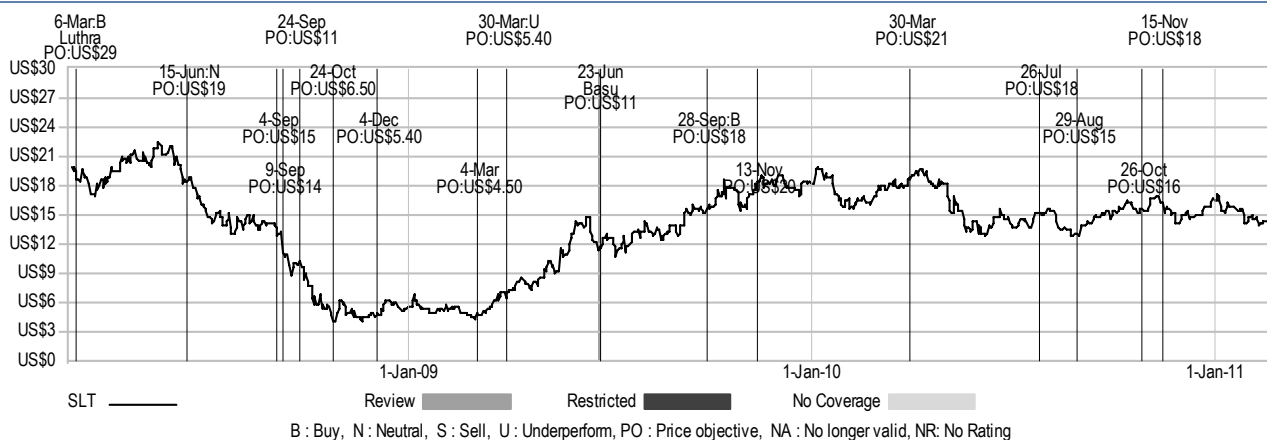
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SLT Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	112	67.07%	Buy	40	42.55%
Neutral	31	18.56%	Neutral	8	28.57%
Sell	24	14.37%	Sell	1	4.55%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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