

January 27, 2011

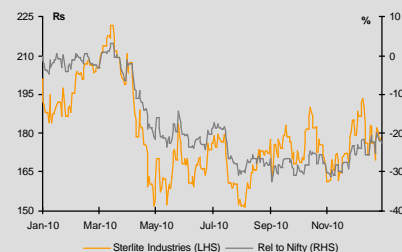
Reco	Previous Reco
Accumulate	UR
CMP	Target Price
Rs 179	Rs 205
EPS change FY11E/12E (%)	NA
Target Price change (%)	NA
Nifty	5,687
Sensex	18,969

Price Performance

(%)	1M	3M	6M	12M
Absolute	(3)	4	2	(11)
Rel. to Nifty	2	11	(3)	(21)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Metals & Mining
Bloomberg	STLT@IN
Equity Capital (Rs mn)	3361
Face Value(Rs)	1
No of shares o/s (mn)	3361
52 Week H/L	223/149
Market Cap (Rs bn/USD mn)	601/13,147
Daily Avg Volume (No of sh)	6447804
Daily Avg Turnover (US\$mn)	24.9

Shareholding Pattern (%)

	D'10	S'10	J'10
Promoters	52.8	52.8	52.8
FII/NRI	27.0	26.9	27.6
Institutions	8.3	8.3	8.0
Private Corp	5.8	5.5	5.2
Public	6.2	6.5	6.5

Source: Capitaline

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- **Sterlite Industry's Q3FY11 numbers remain mixed with topline, exceeding expectations grew by 24% and 37% respectively on YoY and QoQ basis to Rs 83.3 bn**
- **EBITDA remained in line with expectations at Rs 19.8 bn growing by 12% and 29% on YoY and QoQ respectively, margin however contracted by 269 bps YoY to 23.9%**
- **Though, APAT grew by 10% and 7% YoY and QoQ respectively to Rs 11.05 bn, it remained lower than expectations against our and street estimates**
- **Factoring in higher base metals prices and uncertainties related to different businesses our EPS estimates stand at Rs 13.5 and Rs 20.3 respectively for FY11E and FY12E**

Revenue exceeds expectations on higher LME, slime sales

During Q3FY11 prices of all the base metals led by copper rose sharply on LME due to recovery hopes in the developed markets and launching of ETFs in copper and aluminium. The average LME price (per tonne) for copper, aluminium, zinc and lead remained at US\$8674 (up 30% YoY and 18% QoQ), US\$2343 (up 17% YoY), US\$2315 (up 4.7% YoY) and US\$2390 (up 4.3% YoY) respectively. Higher sales volume in zinc and copper also helped topline growth. Another major contribution came from highest ever anode slime sales to the tune of Rs 9.24 bn (up by 66% YoY and 453% QoQ) during the quarter contributing 21% to the standalone topline

Margin contracts on higher costs

Despite stronger topline, the company witnessed margin contraction during the quarter in most of the businesses. In copper business the EBIT margin remained at 2.7%, lower by 73 bps and 94 bps on YoY and QoQ basis. This can mainly be attributed to the fall in Tc/ Rc charge to US\$11.2 against US\$14.7/ tonne in Q3FY10 and US\$11.8/ tonne in Q2FY11. Higher cost of coal and rise in stripping costs in zinc mines also increased zinc metals costs (without royalty) by 5% YoY to Rs 35500/ tonne (US\$792). In the aluminum business too the company continued to face challenges in controlling cost of production. In VAL the aluminium production costs remained at US\$2050/ tonne, while in Balco it was recorded at US\$1795/ tonne against US\$1667/ tonne in Q3FY10. In power business too higher cost of generation at Rs 1.82/ unit (Rs 1.73/ unit in Q3FY10) and lower realization at Rs 2.72/ unit (Rs 5.16 in Q3FY10) put further pressure on the margins. We believe, cost pressure to improve in zinc and copper businesses in near future, however, remain cautious on aluminium and power businesses.

Outlook and Valuations

At the CMP of RS 179, the stock is trading at 8.8x FY12E EPS and 3.6x FY12E EV/ EBITDA. We value the stock on SOTP method to come at a target price of Rs 205/ share valuing all the metals businesses on EV/ EBITDA basis and power business on DCF method. We assign ACCUMULATE rating on the stock.

Financials

(Rs mn)

YE-	Net	EBITDA		EPS	EPS	RoE		EV/		
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA	P/BV
FY09	214,484	50,083	23.4	34,847	12.5	-21.65	14.5	14.3	7.1	2.0
FY10	246,825	63,439	25.7	40,407	11.1	-10.84	13.0	16.1	7.1	1.6
FY11E	281,548	72,968	25.9	45,455	13.5	21.28	11.7	13.3	6.3	1.5
FY12E	381,495	108,033	28.3	68,351	20.3	50.54	14.9	8.8	3.6	1.3

Source: Company, Emkay Research

Key Financials – Quarterly (Consolidated)

(Rs mn)	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY (%)	QoQ (%)	YTD'11	YTD'10	YoY (%)
Revenue	67,467	72,278	59,703	60,844	83,325	23.5	36.9	203,871	174,547	16.8
Expenditure	(49,746)	(50,423)	(44,729)	(45,554)	(63,538)	27.7	39.5	(153,821)	(132,963)	15.7
<i>as % of sales</i>	73.7	69.8	74.9	74.9	76.3			75.5	76.2	
Consumption of RM	(38,481)	(39,661)	(32,374)	(33,449)	(49,708)	29.2	48.6	(115,531)	(101,560)	13.8
<i>as % of sales</i>	57.0	54.9	54.2	55.0	59.7			56.7	58.2	
Employee Cost	(2,398)	(2,353)	(2,837)	(2,225)	(2,579)	7.6	15.9	(7,642)	(6,186)	23.5
<i>as % of sales</i>	3.6	3.3	4.8	3.7	3.1			3.7	3.5	
Other expenditure	(8,867)	(8,409)	(9,518)	(9,880)	(11,250)	26.9	13.9	(30,648)	(25,217)	21.5
<i>as % of sales</i>	13.1	11.6	15.9	16.2	13.5			15.0	14.4	
EBITDA	17,722	21,855	14,974	15,289	19,787	11.7	29.4	50,050	41,584	20.4
Depreciation	(1,782)	(2,246)	(2,170)	(2,123)	(2,488)	39.6	17.2	(6,782)	(5,252)	29.1
EBIT	15,940	19,609	12,803	13,166	17,299	8.5	31.4	43,268	36,332	19.1
Other Income	3,715	5,486	6,915	5,779	4,776	28.5	(17.3)	17,469	11,386	53.4
Interest	(929)	(1,206)	(1,409)	3	(705)	(24.1)	(22,143.8)	(2,111)	(2,217)	(4.8)
PBT	18,726	23,890	18,310	18,948	21,370	14.1	12.8	58,627	45,500	28.8
Total Tax	(2,903)	(4,528)	(3,685)	(4,555)	(4,214)	45.1	(7.5)	(12,454)	(7,802)	59.6
Adjusted PAT	15,823	19,361	14,625	14,392	17,156	8.4	19.2	46,173	37,699	22.5
(Profit)/loss from JV's/Ass/MI	(5,774)	(5,552)	(4,541)	(4,100)	(6,104)	5.7	48.9	(14,745)	(11,101)	32.8
Adj.PAT after MI	10,049	13,809	10,084	10,292	11,052	10.0	7.4	31,428	26,598	18.2
Extra ordinary items	(2,735)	-	-	(212)	(41)	-	-	(253)	(2,970)	-
Reported PAT	7,313	13,809	10,084	10,080	11,011	50.6	9.2	31,175	23,628	31.9
Reported EPS	2.2	4.1	3.0	3.0	3.3	50.6	9.2	9.2	7.0	31.9

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	26.3	30.2	25.1	25.1	23.7	(252)	(138)	24.5	23.8	73
EBIT	23.6	27.1	21.4	21.6	20.8	(286)	(88)	21.2	20.8	41
EBT	27.8	33.1	30.7	31.1	25.6	(211)	(549)	28.8	26.1	269
PAT	23.5	26.8	24.5	23.7	20.6	(286)	(307)	22.6	21.6	105
Effective Tax rate	15.5	19.0	20.1	24.0	19.7	422	(432)	21.2	17.1	410

Segment result - Q3FY11

Segment Results	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Segment Revenue					
Copper	33879.2	35405.6	29059.1	29069.7	45301.7
Aluminium	6932.5	8095.8	6659.3	7179.7	8023.4
Zinc & Lead	22025.4	24837.8	19277.2	21455.4	27431.4
Power	2574.9	2057.1	2586.7	1627.6	1323.1
Others	1668.3	1462.5	2207.9	1409.1	1248.6
Total	67080.3	71858.8	59790.2	60741.5	83328.2
Less: Inter Segment revenue	310.7	750.8	545.2	451.7	385.0
Net Sales/Income from operations	66769.6	71108	59245	60289.8	82943.2
Segment Results (EBIT/PBIT)					
Copper	1443.7	2264.7	1877.5	1578.6	1942.8
Aluminium	825.3	1515.9	496.5	1257.7	1194.2
Zinc & Lead	13059.3	14473.4	9050.5	10028.8	14296.9
Power	1089.8	815.7	1174.9	567.2	191.5
Others	97.4	141	427	116.8	-70.6
Total	16515.5	19210.7	13026.4	13549.1	17554.8
Other unallocable income/expenses (net)	3139.3	5884.9	6691.6	5395.2	4520.4
Total	19654.8	25095.6	19718	18944.3	22075.2
Less: Interest & Financial charges	928.9	1206.1	1408.5	-3.2	705.4
Less: Exceptional charges	2735.3	0	0	211.6	41.0
Profit before tax (PBT)	15990.6	23889.5	18309.5	18735.9	21328.8
Copper EBIT %	4.3	6.4	6.5	5.4	4.3
Aluminium EBIT %	11.9	18.7	7.5	17.5	14.9
Zinc & Lead EBIT %	59.3	58.3	46.9	46.7	52.1
Power & Others %	42.3	39.7	45.4	34.8	14.5

Zinc led the volume growth

Among all the metals, zinc saw significant volume (both production and sales) growth YoY. On QoQ basis, while copper cathodes aided volume growth on QoQ basis only. Lead saw fall in both production and sales on YoY as well as QoQ basis due to planned maintenance shutdown at Ausmelt and Pyro smelters. Silver production sales also saw dip both on YoY and QoQ basis. Aluminium volume remained flat on the other hand both on YoY and QoQ basis.

Production and sales volume of different metals

(tonnes)	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY (%)	QoQ (%)
Production							
Zinc Saleable Metal	148126	150309	164519	176239	178254	20.3	1.1
Lead Saleable Metal	19191	18345	14144	14521	12521	-34.8	-13.8
Silver (Kg)	35632	43066	37176	35341	32777	-8.0	-7.3
Copper cathodes	85222	79533	77112	67721	78990	-7.3	16.6
Copper rods	39486	52532	54417	46795	38086	-3.5	-18.6
Aluminium (Balco)	65000	68000	63000	65000	65459	0.7	0.7
Sales							
Refined Zinc	147497	151294	164445	175309	178357	20.9	1.7
Refined Lead	19486	18450	14075	14458	12338	-36.7	-14.7
Silver (Kg)	37567	42399	35830	36879	29524	-21.4	-19.9
Copper cathodes	46225	27211	21926	22003	40684	-12.0	84.9
Copper rods	40499	52666	51967	47531	37690	-6.9	-20.7
Aluminium (Balco)*	65000	68000	63000	65000	65000	0.0	0.0

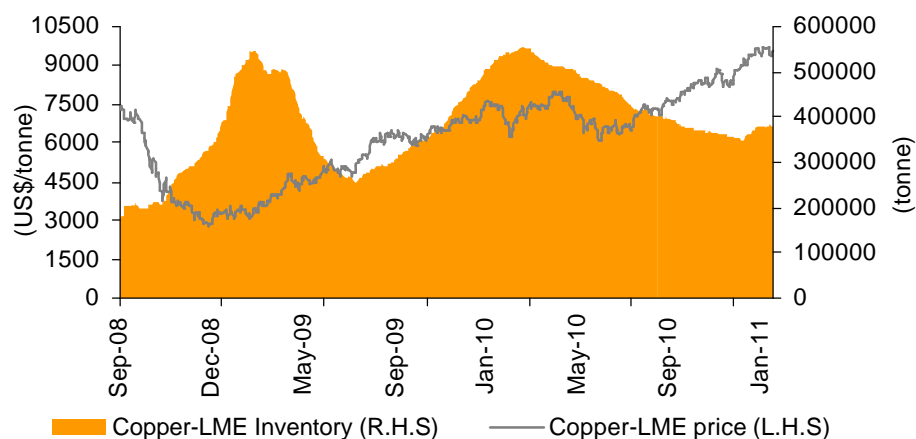
*Assumption

Source: Company release, Emkay Research

Topline boosted by sharp rise LME prices

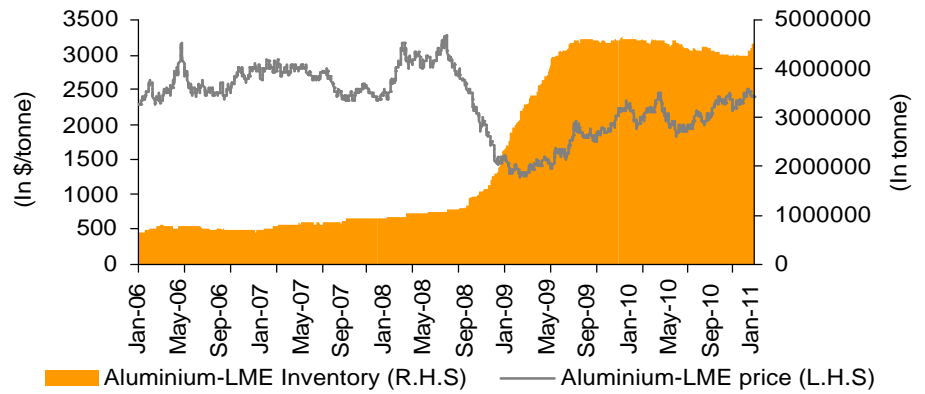
During the quarter, LME prices for all the base metals soared significantly led by copper due to some recovery hopes in the developed markets and launching of some ETFs in copper and aluminium. Inventory at LME for copper and aluminium also saw some depletion recently providing support the prices. For zinc and lead however, inventory pile continued to rise, however, prices mainly followed recovery in copper and aluminium. Silver prices on the hand rose sharply on strong investment demand following gold.

Copper price and inventory movement on LME



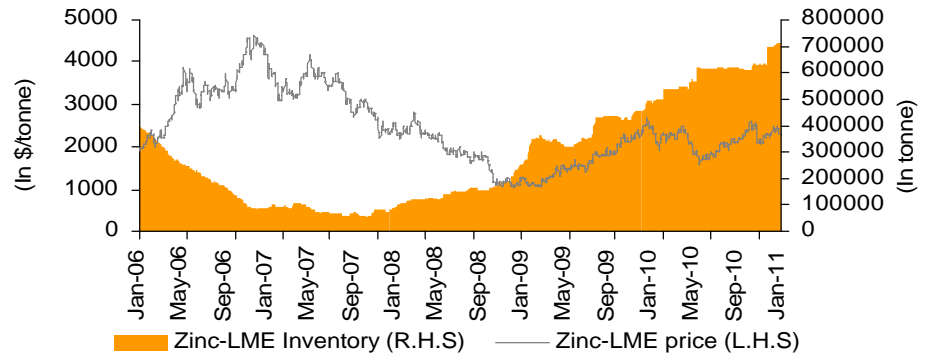
Source: Bloomberg, Emkay research

Aluminium price and inventory movement on LME



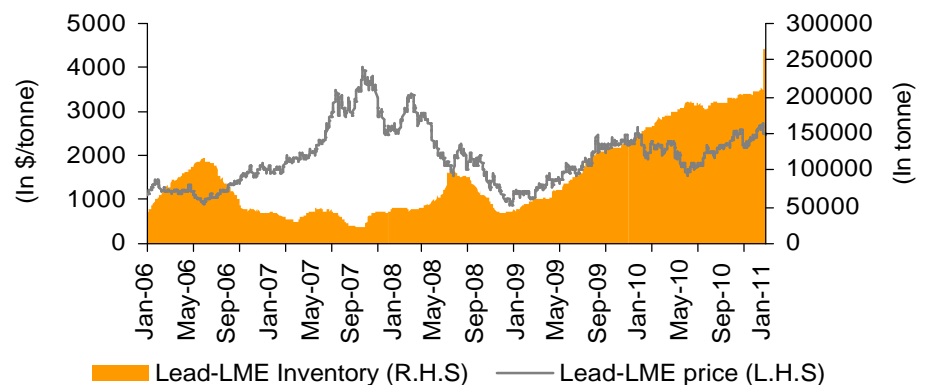
Source: Bloomberg, Emkay research

Zinc price and inventory movement on LME



Source: Bloomberg, Emkay research

Lead price and inventory movement on LME



Source: Bloomberg, Emkay research

Key takeaways

Zin/ Lead Business

- Robust performance at Zinc-lead mines with highest ever production at 222,250 tonnes
- Silver production flat however like to increase significantly to almost 500 tonnes by exit of FY 2012 (currently ~ 200 tonnes per annum)
- Costs under pressure (more than 5% QoQ) on account higher energy costs & stripping at mines
- Skorpion Zinc acquisition in December contributes to the EBITDA by Rs 620 mn; two other zinc assets of Anglo American coming into fold

Copper Business

- Production fell to 79,000 MT (vs. 85,000 MT in Q3FY10) on account temporary shutdown following court order
- Better by product (Sulphuric acid) realization and better operational efficiency however helped in reduction in net cost of production for Q3 to US\$1.24/ lb against US\$1.37/ lb in Q3FY10

Aluminium Business

- Production flat at 65,000 MT
- Cost of production remained at US\$1795 per tonne compared to US\$1667 per tonne in Q3FY10

Energy Business

- Generation at 454 Mn units (higher by 17% YoY), realization per unit Rs 2.72 per unit (lower by 47% YoY)
- First unit of 300 MW out of 1200 MW in Balco is likely to be commissioned in Q4FY11
- The first unit (600 MW) of 2400 MW (4x600 MW) IPP at Jharsuguda has been operational, however, its still under stabilization process. The second unit (600 MW) also has been commissioned during the quarter and is being synchronised

Balco arbitration update

Sterlite's buyout of residual 49% stake in Balco, which long under arbitration, has been decided against Sterlite. The decision is likely to be challenged by Sterlite in the High Court. We can see a similar fate in the case of Sterlite seeking the residual about 29% stake in HZL. The operational performance of Sterlite is unlikely to change as it continues to hold majority stake both in Balco & HZL. Major strategic decisions requiring Board approval, may see scrutiny of government nominees on HZL & Balco's Board.

Outlook and Valuation

We believe that the zinc business would continue to do well and would remain the key to Sterlite's overall performance. Ramp up in power business also is likely to aid business growth in the coming year. Copper on the other hand remains a concern due to pending decision on the Tuticorin smelter by the honourable Supreme court and also lower Tc/ Rc margin despite higher LME. We would also like to remain cautious on the aluminium business, due to lack of clarity on bauxite sourcing and expansion plans.

At the CMP of RS 179, the stock is trading at 8.8x FY12E EPS and 3.6x FY12E EV/ EBITDA. We value the stock on SOTP method to come at a target price of Rs 205/ share valuing all the metals businesses on EV/ EBITDA basis and power business on DCF method. We assign ACCUMULATE rating on the stock.

Valuation

Company	FY12E EBITDA	EV/EBITDA Multiple	EV	SIIL Stake	Attributable Equity Value	Value/ Share
Hindustan Zinc	6564.4	6.0	39386.1	64.9%	37060.6	110.2
Copper	793.3	6.0	4759.8	100%	14179.1	42.2
BALCO	1923.2	6.5	12500.5	51%	5174.1	15.4
VAL	1857.0	6.5	12070.8	29.5%	2644.2	7.9
SEL						29.0
Total						204.7

Financials (consolidated)

Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Net Sales	214,484	246,825	281,548	381,495
<i>Growth (%)</i>	-14.4	15.1	14.1	35.5
Expenditure	164,401	183,386	208,580	273,461
Raw Materials	149,767	121,686	133,082	177,750
Employee Cost	7,561	8,540	10,379	13,673
Other Exp	7073	33626	41600	49223
EBITDA	50,083	63,439	72,968	108,033
<i>Growth (%)</i>	-38.9	26.7	15.0	48.1
EBITDA margin (%)	23.4	25.7	25.9	28.3
Depreciation	7006.7	7497.9	9076.3	12354.3
EBIT	43,076	55,941	63,892	95,679
EBIT margin (%)	20.1	22.7	22.7	25.1
Other Income	18501	16872	23100	26423
Interest expenses	3973	3424	3786	6325
PBT	57,604	69,390	83,206	115,776
Tax	8550	12330	17450	23155
<i>Effective tax rate (%)</i>	14.8	17.8	21.0	20.0
Adjusted PAT	49,054	57,060	65,756	92,621
(Profit)/loss from JV's/Ass/MI	14207	16653	20301	24270
Adjusted PAT after MI	34,847	40,407	45,455	68,351
<i>Growth (%)</i>	-1.6	16.0	12.5	50.4
Net Margin (%)	16.2	14.1	14.3	15.1
E/O items	-553.1	2969.6	252.6	0
Reported PAT	34,294	43,377	45,708	68,351
<i>Growth (%)</i>	-3.1	26.5	5.4	49.5

Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
PBT (Ex-Other income)	39,104	52,518	60,106	89,353
Depreciation	7,007	7,498	9,076	12,354
Interest Provided	3,973	3,424	3,786	6,325
Other Non-Cash items	-6,109	-17,220	-21,445	-32,611
Chg in working cap	12,437	-73,157	-5,235	2,126
Tax paid	8,550	12,330	17,450	23,155
Operating Cashflow	64,962	-14,609	63,738	100,703
Capital expenditure	91,568	102,540	64,299	396
Free Cash Flow	156,530	87,931	128,036	101,099
Other income	53,291	73,491	71,000	30,500
Investments	-879	40,983	-378	0
Investing Cashflow	-52,635	-105,452	-70,622	-30,500
Equity Capital Raised	0	76,529	0	0
Loans Taken / (Repaid)	19,390	22,461	31,163	5,500
Interest Paid	-3,973	-3,424	-3,786	-6,325
Others	0	0	0	0
Financing Cashflow	19,390	98,990	31,163	5,500
Net chg in cash	31,717	-21,071	24,278	75,703
Opening cash position	27,713	59,430	38,359	62,637
Closing cash position	59,430	38,359	62,637	138,340

Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Equity share capital	1417	1681	3362	3362
Reserves & surplus	254,037	367,762	407,125	469,079
Net worth	255,454	369,443	410,487	472,440
Minority Interest	68546	85199	105500	129770
Secured Loans	17,201	18,107	23,107	23,607
Unsecured Loans	52,934	74,489	100,652	105,652
Loan Funds	70,135	92,596	123,759	129,259
Net deferred tax liability	14075.7	15524	14075.7	14075.7
Total Liabilities	408,213	562,765	653,824	745,547
Gross Block	167,462	228,944	290,868	309,014
Less: Depreciation	56,191	63,689	72,765	85,119
Net block	111,271	165,255	218,103	223,894
CWIP	69786	110844	113219	95469
Investment	162,062	203,045	202,667	202,667
Current Assets	120,741	180,095	211,720	301,295
Inventories	24,591	29,827	31,430	41,207
Sundry debtors	8,760	5,709	11,453	15,549
Cash & bank balance	59,430	38,359	62,637	138,340
Loans & advances	27,149	104,993	104,993	104,993
Other current assets	0	0	0	0
Current lia & Prov	42,051	49,319	51,431	67,429
Current liabilities	31,655	38,107	40,116	52,595
Provisions	10,397	11,212	11,315	14,834
Net current assets	78,690	130,776	160,289	233,866
Total Assets	408,213	562,765	653,824	745,547

Key Ratios

Y/E, Mar	FY09	FY10	FY11E	FY12E
Profitability (%)				
EBITDA Margin	23.7	26.0	26.2	28.6
Net Margin	16.0	17.6	16.2	17.9
ROCE	16.4	14.5	13.2	16.3
ROE	14.5	13.0	11.7	14.9
RoIC	27.0	32.4	25.3	31.1
Per Share Data (Rs)				
EPS	12.5	11.1	13.5	20.3
CEPS	17.4	15.6	16.2	24.0
BVPS	90.1	109.9	122.1	140.5
DPS	1.7	2.1	1.1	1.6
Valuations (x)				
PER	14.3	16.1	13.3	8.8
P/CEPS	10.3	11.4	11.0	7.5
P/BV	2.0	1.6	1.5	1.3
EV / EBITDA	7.1	7.1	6.3	3.6
Gearing Ratio (x)				
Net Debt/ Equity	0.0	0.1	0.1	0.0
Net Debt/EBITDA	0.2	0.9	0.8	-0.1

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