

## Company Flash

28 July 2008 | 8 pages

# Sterlite Industries (India) (STRL.BO)

## Buy: 1Q FY09 – Offsetting Factors Result in a Muted Quarter

- Flat 1QFY09 PAT** — PAT of Rs11.5bn came inline with our estimates. EBITDA (incl. other income) fell 11% to Rs22.3bn. Strong aluminium LME, zinc volume growth, higher by-product sales realizations, higher other income and lower tax were offset by a decline in zinc LME, lower TC/RCs and high power costs .
- Copper betters expectations** — On a standalone basis, the copper division reported a 78% rise in PAT (Rs3.6bn) despite TC/RCs falling to ~13USc/lb. This rise is largely due to the surge in by-products sales realizations (sulphuric acid and phosphoric acid) and higher other income earned on proceeds of the ADS issue. Production fell 16% to 68k tonnes due to a planned shutdown.
- Zinc hit by falling LME** — Zinc volumes rose 38% to 128k tonnes and lead volumes rose 27% to 17k tonnes. The benefit of higher volumes was more than offset by a 42% fall in zinc LME to US\$2,115/t. EBITDA fell 31% to Rs11.9bn. Hindustan Zinc also gained from a surge in by-product sales realizations.
- Aluminium EBITDA grew 10% yoy** — Aluminium EBITDA came in at Rs4.6bn driven by a 6% increase in LME to US\$2,940/t but was affected by a rise in energy costs. Volumes were almost flat at 89,000 tonnes.
- Sterlite Energy wins bid** — Sterlite Energy has won a 1,980MW power project in Punjab. The project has coal linkages & is likely to be completed in 56 months.
- Acquisition of balance stakes** — Sterlite expects to complete the acquisition of government stakes in Balco and Hindustan Zinc during this fiscal.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (28 Jul 08)	Rs582.25
Target price	Rs777.00
Expected share price return	33.4%
Expected dividend yield	0.8%
<b>Expected total return</b>	<b>34.2%</b>
Market Cap	Rs412,521M
	US\$9,785M

### 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 (%)
FY05	7,962	14.5	-8%	40.1	25.2	18%
FY06	16,781	30.0	107%	19.4	11.6	28%
FY07	46,217	82.8	175%	7.0	4.6	46%
FY08E	44,521	62.8	-24%	9.3	4.4	14%
FY09E	59,448	83.9	34%	6.9	4.6	23%
FY10E	72,310	102.1	22%	5.7	3.4	22%

Source: Company Reports and Citi Investment Research. Price as on 28 July 2008.\* FY08 is still shown as estimate as full Annual Report details are not available yet.

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

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## Sterlite Industries (India) – 1Q FY09 Results

Figure 2. Sterlite Industries (India) – 1QFY09 Results

Rs m	1QFY09	1QFY08	% chg
<b>Net Sales</b>	<b>57,701</b>	<b>61,391</b>	<b>-6%</b>
Total operating expenses	39,435	39,830	-1%
<b>Operating Profit</b>	<b>18,266</b>	<b>21,561</b>	<b>-15%</b>
<b>Operating Profit margin (%)</b>	<b>32%</b>	<b>35%</b>	
Other Income	4,025	3,501	15%
<b>EBITDA</b>	<b>22,290</b>	<b>25,062</b>	<b>-11%</b>
Depreciation	1,655	2,031	
EBIT	20,636	23,031	-10%
Interest	874	955	
<b>PBT</b>	<b>19,761</b>	<b>22,076</b>	<b>-10%</b>
Tax paid	3,808	5,247	-27%
Effective tax rate (%)	19%	24%	
<b>Net profit after tax</b>	<b>15,954</b>	<b>16,829</b>	<b>-5%</b>
Minority interest	4,470	5,400	
Share in profit of associates	27	0	
<b>PAT attributable to Consolidated Group</b>	<b>11,511</b>	<b>11,429</b>	<b>1%</b>
<b>Segmental Revenue (Rs m)</b>			
Copper	29,618	32,175	-8%
Aluminium	13,167	11,834	11%
Zinc and Lead	17,763	21,813	-19%
Others	2,985	1,164	156%
Gross Sales	63,533	66,986	-5%
Less: Intersegment Revenues	727	185	293%
External Sales	62,805	66,801	-6%
Less: Excise Duty	5,104	5,409	-6%
<b>Net Sales</b>	<b>57,701</b>	<b>61,391</b>	<b>-6%</b>
<b>Segment Results (Rs m)</b>			
Copper	2,541	2,613	-3%
Aluminium	3,988	2,930	36%
Zinc and Lead	9,309	15,411	-40%
Others	1,343	365	268%
Other unallocable income	3,456	1,712	102%
<b>Total</b>	<b>20,636</b>	<b>23,031</b>	<b>-10%</b>
Less: Interest	874	955	-8%
<b>PBT</b>	<b>19,761</b>	<b>22,076</b>	<b>-10%</b>
<b>EBITDA (Rs m)</b>			
Copper	5,840	3,825	53%
Aluminium	4,580	4,179	10%
HZL	11,870	17,058	-30%
<b>Total</b>	<b>22,290</b>	<b>25,062</b>	<b>-11%</b>

Source: Company Reports and Citi Investment Research

## Sterlite Industries (India)

### Company description

Sterlite is a non-ferrous metal 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. 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 among the lowest-cost 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 capacity rose 63% to 669,000 tpa in the past five months in two phases, both ahead of schedule, taking total zinc-lead capacity to 755,000 tpa. HZL has announced further capex of Rs36bn (US\$900m) 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 Buy/Low Risk (1L). Zinc (Hindustan Zinc) is the biggest contributor to Sterlite's EBITDA (55% of total) and should continue to benefit from strong volume growth in FY09e. The aluminium business should benefit from the energy crisis. Our international aluminium forecasts to US\$3,600/t in FY09 and US\$4,500/t in FY10. This is on the back of a deficit in aluminium in 2008-10 based on robust demand growth and supply curtailments induced by high power costs and shortages. We expect limited volume growth for Bharat Aluminium but expect EBITDA to grow 65% in FY09E and 28% in FY10E. Sterlite's shareholding in Balco should increase soon and reach 100%. Copper has a difficult outlook due to subdued TC/RC margins expected in FY09-10 vs. FY07-08. We expect Sterlite's attributable net income to rise 34% YoY in FY09E due to higher profits in aluminium and completion of the minority stake acquisition of Hindustan Zinc (29.5%) and Balco (49%) over the next few months. Sterlite has been allocated coal mines for Balco, driving cost savings in the long term. Commissioning 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 on a 12-month forward P/E to which we add the value of its power business. We use a target P/E of 8x, at the lower end of the trading range of 7-13x over the past year to reflect the more cautious outlook for zinc. The P/E multiple is at a premium to the 6.5x multiple we have applied to Hindustan Zinc, reflecting the substantially greater liquidity that Sterlite enjoys relative to Hindustan Zinc, the strong outlook for the aluminium business, and the greater level of attributable earnings for Sterlite's investors when Sterlite completes acquisition of the balance minority government stakes in Balco and Hindustan Zinc. Based on 8x 12-month forward P/E, we get a target price of Rs708 for Sterlite. To this we add the value of the power business (at 2x book value of the equity investment) to arrive at our target price of Rs777. At our target price, the stock would trade at an adjusted EV/EBITDA of 5.9x.

## **Risks**

We rate the stock Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Risk factors that could prevent the shares from reaching our target price are: 1) Delays in acquiring minority stakes in Hindustan Zinc and Balco; 2) Weaker-than-expected commodity prices or TC/RC margins; 3) Lower capacity utilization than we assume; 4) Substantial dependence on the Rampura Agucha mines in case of zinc; 5) Trends in exchange rates; and 6) Cut in import duties.

# Appendix A-1

## Analyst Certification

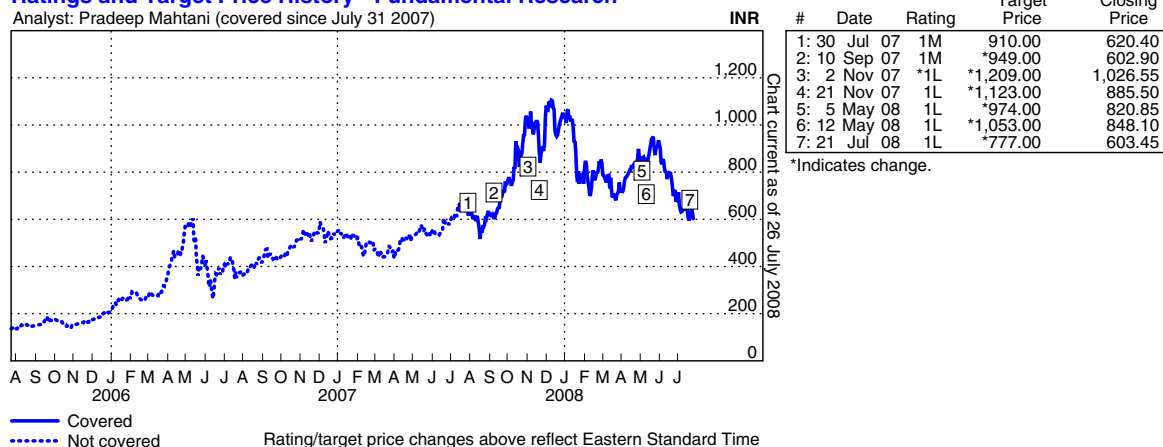
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## Sterlite Industries (India) (STRL.BO)

28 July 2008

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