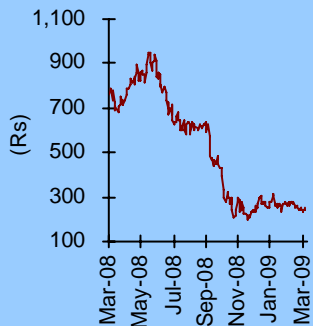


## Shareholding pattern

	Jun '08	Sep '08	Dec '08
Promoters	62.5	60.6	60.9
Institutional investors	13.3	13.6	14.7
MFs and UTI	2.7	3.6	3.9
Insurance Cos.	2.9	3.5	3.8
FIs	7.6	6.3	6.8
Others	24.2	25.8	24.4

Source: NSE

## Price chart



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## Sterlite Industries

**BUY**  
**Maintained**  
**Rs245**

## Striking a balance

Reason for report: Company update

**Sterlite Industries (SIL)** has entered a definitive agreement with ASARCO LLC to acquire its operating assets at US\$1.1bn upfront cash payment, with US\$0.6bn staggered payment over nine years. Till date, this is the largest US acquisition by any Indian company. This will add integrated copper operations to SIL's portfolio with ASARCO's annual production at ~200,000te and copper metal reserves of 5mnte. SIL expects to complete the transaction in 5-6 months, with funding through cash from its books. We expect the acquisition to: i) be earnings-dilutive in the short-to-medium term (with consolidated FY10E earnings dilution of 2%), ii) generate an IRR of 12.7%, iii) expose SIL to potential creditor-secured claims of US\$34mn against ASARCO's assets (as quoted in restructuring filing on November 11, '05), iv) have uncertainties regarding reorganisation plans involving US\$6-8bn EPA liabilities and US\$2.5bn asbestos liabilities (against which the management claims to be ring fenced) and v) be expensive with long term EV/EBITDA of 9x. Though short-term concerns persist, given the expertise of SIL to turn around distressed operations and increase capacities in a cost effective manner, we are positive on the future potential of the acquisition. Reiterate BUY.

- ▶ **Though long-term strategy in place...** ASARCO's operations are fully integrated with current production of 237,000tpa, which includes 37,000te tolling and mine production of 200,000tpa (cash cost for refining at US\$1.4/lb). The current mine life is 25 years, which SIL expects to increase to 40 years through further exploration. Given SIL's proven track record of cost optimisation, the management expects to reduce costs further by US\$10-15/lb in ASARCO. We believe the acquisition is driven by long-term management philosophy of acquiring distressed assets and turning them around irrespective of short-term financial pressure.
- ▶ **...short-term concerns persist.** The acquisition is marginally earnings-dilutive in the short term. With US\$1.1bn of upfront cash payment being financed from SIL's books, we expect SIL's consolidated and standalone earnings to decrease 9% and 5% respectively in FY10E provided the deal goes through. We estimate the acquisition to generate 12.7% IRR vis-à-vis 16% as guided by the management.
- ▶ **Valuations.** Given long-term EBITDA estimate of US\$188mn for ASARCO, the EV/EBITDA of ~9x at US\$1,700mn looks expensive considering the current global EV/EBITDA average of 5-6x (of Teck Cominco and Xstrata). We estimate SIL's new sum-of-the-parts (SOTP) fair value to be Rs306/share (vis-à-vis earlier price target of Rs317/share) with 25% upside from the current levels provided the deal goes through. Reiterate BUY.

Market Cap	Rs173.7bn/US\$3.3bn
Reuters/Bloomberg	STRL.BO/STLT IN
Shares Outstanding (mn)	709
52-week Range (Rs)	1104/180
Free Float (%)	39.1
FII (%)	6.8
Daily Volume (US\$'000)	25,790
Absolute Return 3m (%)	0.2
Absolute Return 12m (%)	(66.9)
Sensex Return 3m (%)	(9.1)
Sensex Return 12m (%)	(47.9)

Year to March	2008	2009E	2010E	2011E
Revenue (Rs mn)	247,419	225,723	136,528	182,585
Net Income (Rs mn)	44,522	33,367	23,868	41,318
EPS (Rs)	62.8	47.1	33.7	58.3
% Chg YoY	(0.7)	(25.1)	(28.5)	73.1
P/E (x)	4.2	5.6	7.8	4.5
CEPS (Rs)	71.2	57.5	45.2	75.8
EV/E (x)	0.6	1.0	2.2	1.3
Dividend Yield	1.5	1.7	1.9	2.1
RoCE (%)	33.1	17.4	9.0	12.9
RoE (%)	27.6	14.2	9.3	14.2

## Though long-term strategy in place...

ASARCO is the third largest copper producer in the US. Its copper mines include three open-pit mines at Mission, Ray and Silver Bell in Arizona, and SX/EW plants at Ray and Silver Bell. The company also owns a copper smelter in Hayden, Arizona and a copper refinery in Amarillo, Texas. The operations of ASARCO are fully integrated with current production at 237,000tpa, which includes 37,000te tolling, and mine production of 200,000tpa (cash costs for refining at US\$1.4/lb). The current mine life is 25 years, which SIL expects to increase to 40 years through further exploration. ASARCO is slightly long on the refinery side, thereby consuming all its concentrate production. Given SIL's proven track record in cost optimisation – with the cost in KCM mines in Zambia reduced from US\$2.8/lb to US\$1.5/lb and net negative costs (ex concentrate) in Indian refinery – the management expects to further reduce costs by US¢10-15/lb in ASARCO. We believe the acquisition is driven by long-term management philosophy of acquiring distressed assets and turning them around irrespective of short-term financial pressure.

### **ASARCO, the third largest copper producer in US with access to markets**

Together with Freeport MacMoran and Kenecott Utah (controlled by Rio Tinto), ASARCO contributes 92% of North American copper mining capacity. Hence, the acquisition of an entrenched player in US markets opens the entire geography to SIL. On a consolidated basis, Vedanta now controls ~4% of the global copper capacity.

## ...short-term concerns persist

The acquisition is marginally earnings-dilutive in the short term. With US\$1.1bn of upfront cash payment being financed from SIL's books, we expect the acquisition to be earnings dilutive in FY10. Reduction of ~Rs4.9bn treasury income and Rs3.2bn increase in depreciation will more than offset the EBITDA accretion at Rs5.5bn. We expect SIL's consolidated and standalone earnings to decrease 2% and 5% respectively in FY10E provided the deal goes through.

### **IRR of 12.7% vis-à-vis management guidance of 16%**

Under our assumptions of metal prices and costs, we arrive at a long-term IRR of 12.7% vis-à-vis 16% as guided by the SIL management. This is based on our long-term copper realisation and price assumptions of US¢1.7/lb and US¢1.4/lb respectively. The current payment structure ensures positive RoIC (with cost of capital at 9%) up till copper realisations of US¢1.6/lb.

## Valuations

Given long-term EBITDA estimate of US\$188mn for ASARCO, EV/EBITDA of ~9x at US\$1,700mn looks expensive compared with the current global EV/EBITDA average of 5-6x (Teck Cominco and Xstrata). We estimate the new SOTP-based fair value to be Rs306/share for SIL with 25% upside from the current levels provided the deal goes through. Reiterate BUY.

**Table 1: Revised SOTP valuations***(Rs mn)*

SOTP	SIL stake (%)	Valuation basis	Total Equity value	SIL's stake	Value per SIL Rs/share	Proportion (%)
Sterlite – Standalone copper business (including ASARCO)	100	5x FY10 EV/E	55,386	55,386	78	20.4
Hindustan Zinc	64.9	4.7x FY10 EV/E	174,276	113,140	159.7	41.8
BALCO	51	8x FY10E P/E	20,244	10,324	14.6	3.8
Sterlite Energy	100	FCF to Equity	68,773	68,773	97	25.4
Vedanta Aluminium	29.5	20% discount to investments by SIL	22940	18,352	26	6.8
Tasmania Copper Mines	100	FY09E Book value		5,190	7	1.8
<b>Total Fair value</b>			<b>397,004</b>	<b>326,550</b>	<b>382</b>	<b>100</b>
Holding company discount					20%	
SIL Target price					306	

Source: Company data, I-Sec Research

**Table 2: DCF estimates for ASARCO***(US\$ mn)*

	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16
Copper Production (te)	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000
Copper price (US\$/te)	3,857	3,747	3,747	3,747	3,747	3,747	3,747	3,747
<b>Sales</b>	<b>639</b>	<b>617</b>	<b>617</b>	<b>573</b>	<b>573</b>	<b>573</b>	<b>573</b>	<b>573</b>
EBITDA	132	144	144	188	188	188	188	188
Payment	(1,100)	(20)	(20)	(20)	(20)	(20)	(20)	(480)
FCF	(827.4)	105.3	104.1	137.2	137.2	137.2	137.2	(322.8)
Current IRR (%)	12.7							

Source: Company data, I-Sec Research

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**ANALYST CERTIFICATION**

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