

Tax Planning Opportunity
Sterlite Industries (India) Limited

Tax Structure on on Capital Gains & Losses

Long Term Capital Gains on unlisted shares and real estate

- Unlisted equity shares have to be held for atleast 12 months for the profits on sale of shares to be treated as long-term capital gains.
- Similarly the investment in real estate has to be held for atleast 36 months for the gains on sale of property to be treated as long-term capital gains.
- Long Term Capital gains on unlisted equity shares and real estate is taxable at 20%+ surcharge after taking into account indexation benefit

Short Term Capital Gains unlisted shares and real estate

- If unlisted equity shares are sold or transferred within 12 months of investments, then the gains generated will be treated as short-term capital gains.
- Similarly if the real estate investment is sold or transferred before 36 months, then the resulting profits will be treated as short-term capital gains.
- Short Term Capital gains on unlisted equity and real estate is taxable at marginal rate of 30% + surcharge after taking into account indexation benefit

Rules for Set Off of Capital Gains

- Short-term capital loss can be set off against any realised capital gain, whether short term or long term, in the same financial year
- Long-term capital loss can be set off only against long-term capital gain and not against short-term capital gain in the same financial year

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Concept – Bonus issue in equity shares

- Investments to be made in equity shares of a company which is declaring bonus after the announcement of the record date at a cum bonus price.
- The original shares should be sold after the stock becomes ex bonus on the stock exchange and stock price falls by close to 50%.
- In case the company declares 1:1 bonus, then the amount of initial investment should be twice the amount of capital gains.
- The resulting short-term capital loss can be set-off against existing or future long-term capital gains on unlisted equity or real estate.
- The bonus shares which will have zero cost for taxation should be held for more than 1 year, after which zero capital gains will be payable.

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Advantages and Risks

Advantages

- In case the company declares 1:1 bonus, then the quantum of short-term capital loss, will be higher at 50% of investment, so a lower amount of funds will have to be deployed.
- The tax liability can get reduced from 20% from zero in case of long-term capital gains from unlisted equity and real estate.
- Also in case of short-term capital gains from unlisted equity and real estate the tax liability can get reduced from 30% to zero.

Risks

- The exposure on a single stock might entail some amount of capital loss, if the stock is not completely hedged or due to improper hedge/rollover mismatch.

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Hedged Strategy- Stock Futures

- The endeavour is to manage the backwardation cost through dynamic hedging of Futures

Strategy

- The market risk of the stock to be hedged by selling the stock futures of equivalent amount of the month in which the stock is becoming ex bonus.
- After the ex date the stock futures position equivalent to the sale proceeds of the cash position should be reversed and the balance stock futures portion should be carried over for 12 months.
- The bonus shares which will have zero cost for taxation should be held for more than 1 year, after which zero capital gains will be payable.

Risks

- The investor will have to roll over the futures contract for 12 months which will entail transaction cost like brokerage, stamp duty and backwardation cost.
- Need for additional funds for the MTM in case the futures price increases post the acquisition.
- If post ex-date stock price falls then it would lead to business income on hedged stock future position.
- If post ex-date stock price rise then it would lead to business loss on hedged stock future position.

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Current Investment Opportunity

Sterlite Industries (India) Limited

- The endeavour is to manage the backwardation cost through dynamic hedging of Futures

- Sterllite Industries has approved the 1: 1 bonus and record date for bonus will be 22nd June 2010.
- Also the face value per share will be sub-divided into 10 equity shares of Re. 1.
- Post the (1:1) bonus and (10: 1) stock split the holder of 100 shares, will have 2000 shares.
- Assuming no change in current market price of around Rs 640 the post bonus price should be between Rs 31-32.

Strategy

- Purchase shares of Sterllite Industries before the record date.
- Hedge the market risk through shorting near month futures of Sterllite Industries
- Post ex date, sell the original shares and book loss of Rs 31 -32 per share post split
- Square off the Futures position equivalent to the cash position.
- Balance futures position to be carried forward for 12 months

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Financial Performance

Amount in Rs Crs

Year End	200903	200803	200703
Equity Paid Up	141.7	141.7	111.7
Networth	14039.84	13165.02	4457.93
Capital Employed	17869.88	16422.83	7267.68
Gross Block	2889.07	2765.34	2688.51
Net Sales	11536.28	12659.59	11716.35
Other Income	877.34	616.38	311.8
Value Of Output	11219.74	12790.39	12075.2
Cost of Production	10655.65	11793.45	10662.65
PBIDT	1709.1	1407.71	1228.35
PBDT	1505.18	1243.26	1045.36
PBIT	1542.92	1268.73	1095.15
PBT	1339	1104.28	912.16
PAT	1236.43	951.63	784.03
CP	1402.61	1090.61	917.23
Book Value (Unit Curr)	198.16	185.82	79.82
Market Capitalisation	25197.8	50565.65	26158.33
CEPS (annualised) (Unit Curr)	19.2	14.71	15.86
EPS (annualised) (Unit Curr)	16.86	12.75	13.48
Dividend (annualised%)	175	200	200
Key Ratios			
Debt-Equity Ratio	0.26	0.34	0.56
Current Ratio	2.33	2.05	2.13
Interest Cover Ratio	7.57	7.71	5.98
PBIDTM (%)	13.93	10.48	9.94
PBITM (%)	12.58	9.44	8.87
ROCE (%)	9	10.71	16.32
RONW (%)	9.09	10.8	18.32

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Bonus Issue Working

		Transaction with Leverage	Transaction without leverage
Current Date		14-Jun-10	14-Jun-10
Stock		SIIL	SIIL
Our Investment		200,000,000	400,000,000
Borrowing for Leverage		200,000,000	-
Total Cost		400,000,000	400,000,000
Margin for stock Futures		80,000,000	80,000,000
Total Funds Deployed		480,000,000	480,000,000
Current Price		640	640
No of Shares		625,000	625,000
Ex date for bonus shares		21-Jun-10	21-Jun-10
Interest Rate		11%	
Total Funding Period		7	
Total Cost of Funding		421,918	-
Transaction Cost Including Management fees		2.56%	2.56%
Amount of Transaction Cost		10,220,000	10,220,000
Total Amount Transaction Cost (Including Interest)		10,641,918	10,220,000
Total Transaction Cost (Including Interest) in %		2.66%	2.56%
Sale of Original Shares		200,000,000	200,000,000
Short Term Capital Loss		200,000,000	200,000,000
Applicable Long Term Capital Gains Tax		20.60%	20.60%
Tax Saving		41,200,000	41,200,000
Transaction Cost % of Tax Savings		26%	25%
Net Benefit After Transaction Cost		30,558,082	30,980,000
Total Benefit		30,558,082	30,980,000
Risk			No Stock & Market Risk
Return on Investment		15.28%	15.20%
Additional Benefit			
Dividend Rs .5/ ex bonus Share (Avg last 5 yrs)	2.8	1,743,750	1,743,750
Total Savings including tax benefit		32,301,832	32,723,750
Total Saving Percentage		16.15%	16.05%

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Transaction Cost

Particulars	Cash (Rs.)	Future(Rs)	Total Cost %	Total (Rs.)
Statutory Levies	0.40	0.26	0.66	1,310,000.00
Backwardation		-	0.00	-
Leverage		-	0.00	-
Brokerage	1	0.90	1.90	3,800,000.00
Total Cost			2.56	5,110,000

Details of Transaction Cost				
		Cash (Rs.)	Future(Rs)	Total
Brokerage	Buy	0.5000	0.0750	1.15
	Sell	0.5000	0.0750	
STT	Buy	0.1250	-	0.27
	Sell	0.1250	0.0170	
Exchange Transaction Cost	Buy	0.0035	0.0020	0.01
	Sell	0.0035	0.0020	
Stamp Duty	Buy	0.0100	0.0020	0.02
	Sell	0.0100	0.0020	
Service Tax @ 12.24% (10.2 % on Brokerage)	Buy	0.0600	0.0090	0.14
	Sell	0.0600	0.0090	
SEBI Turnover fees	Buy	-	-	-
	Sell	-	-	
		1.40	0.19	
No of Times Roll over		1.00	12.00	
Total		1.40	1.16	
Cost of Backwardation			-	
Total Cost including Backwardation		1.40	1.16	2.56

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Stock Price & Shareholding Pattern

Particular	One Year Period*	
	Avg. Daily Turnover (Rs Crs)	Avg. Daily Closing Price Is Rs
NSE	198	752
BSE	43	752
Future (NSE)	93	750

*One Year Period Starting 1st June 2009 to 11nd June 2010

Share Holding Pattern as of March 2010	No of Shares	% of Holding
Total Foreign	248304878	29.55
Total Institutions	66875127	7.96
Total Govt Holding	700	0
Total Non Promoter Corporate Holding	42358015	5.04
Total Promoters	437622694	52.07
Total Public & Others	45239008	5.38
Grand Total	840400422	100

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Analysis of Past Bonus Strategy

L&T Bonus Working

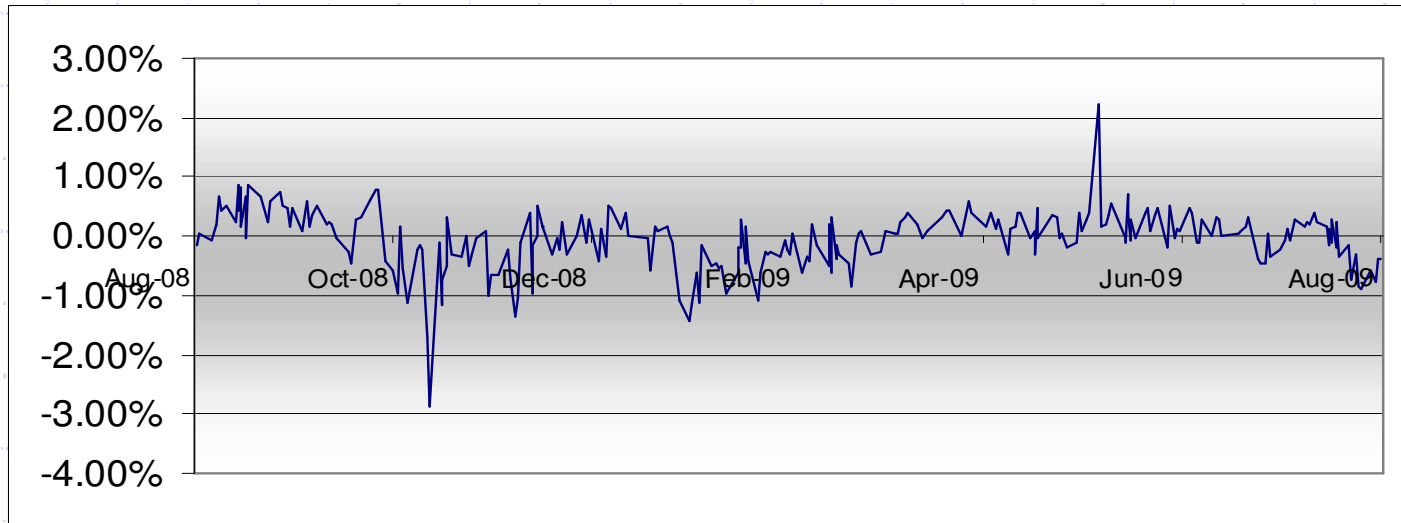
- Record Date for 1:1 bonus issue was 3rd Oct 2008

	Transaction with Leverage	Transaction without leverage
Current Date	03-Sep-08	03-Sep-08
Stock	L&T	L&T
Our Investment	100,000,000	200,000,000
Borrowing for Leverage	100,000,000	-
Total Cost	200,000,000	200,000,000
Margin for stock Futures	40,000,000	40,000,000
Total Funds Deployed	240,000,000	240,000,000
Current Price	2500	2500
No of Shares	80,000	80,000
Tentative Ex date for bonus shares	03-Oct-08	03-Oct-08
Interest Rate	14%	
Total Funding Period	30	
Total Cost of Funding	1,150,685	-
Total Transaction Cost Including Management fees	2.56	2.56
Amount of Transaction Cost	5,110,000	5,110,000
Total Transaction Cost	6,260,685	5,110,000
Sale of Original Shares	100,000,000	100,000,000
Short Term Capital Loss	100,000,000	100,000,000
Applicable Long Term Capital Gains Tax	22.66%	22.66%
Tax Saving	22,660,000	22,660,000
Transaction Cost % of Tax Savings	28 %	23 %
Net Benefit After Transaction Cost	16,399,315	17,550,000
Total Benefit	16,399,315	17,550,000
Return on Investment	16.40 %	16.22 %
Additional Benefit		
Dividend Rs 8.5/ ex bonus Share (Avg last 5 yrs)	680,000	680,000
Total Savings including tax benefit	17,079,315	18,230,000
Total Saving Percentage	17.08 %	16.85 %

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L&T Bonus Working

One year Cost of Carry Chart



Pre Bonus	
Avg Premium Discount	0.36%
Maximum Premium	0.86%
Maximum Discount	-0.27%
Post Bonus	
Avg Premium Discount	-0.10%
Maximum Premium	2.21%
Maximum Discount	-2.88%

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