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RESULT REVIEW Q2FY07

November 17, 2006

STERLITE INDUSTRIES INDIA LIMITED (RS.512) — NEUTRAL

Market Cap. : Rs. 571.7 bn	Free float: 21.6%	Sensex: 13429.48	Sector: Non Ferrous Metals

Q2FY07 RESULT REVIEW

The Q2FY07 results of Sterlite Industries India Limited (SIIL) were better than our expectations on account of higher than anticipated Tc/Rc margins. Net Sales grew by 92.2% yoy on account of higher realisations and better output; operating profit grew by 168% yoy while PAT before extraordinary items grew by 233.2%. Debottlenecking of the copper cathode plant by the end of this calendar year is expected to boost output by 33% and result in improvement in topline and bottomline. The aluminium and zinc businesses of the company carried on through its subsidiaries have also performed well and capacity expansion is underway in these businesses as well. We assign a Neutral rating to the stock with a price target of Rs 546.

Standalone Financial Summary

Amount in Million Rupees

Particulars	Q2FY07	Q2FY06	% Growth YoY	Q1FY07	% Growth QoQ	H1FY07	H1FY06	% Growth YoY	FY06	FY07E	FY08E
Net Sales	33091	17216	92.2	23748	39.3	56839	28352	100.5	75039	106456	101429
Operating Profit	3754	1401	168.0	3131	19.9	6885	2213	211.1	8114	12906	12176
Profit After Tax	2702	811	233.2	2235	20.9	4937	1202	310.9	5152	8070	7404
Extraordinary Item	-1337	0		0		-1337	0		0	-1337	0
Net Profit	1366	811	68.4	2235	(38.9)	3600	1202	199.6	5152	6733	7404
Equity Share Capital	1117	1111		1117		1117	1111		1117	1735	1735
EPS (in Rs. non annualised)	2.4	1.5		4.0		6.4	2.2		9.2	7.8	8.5

Highlights

Increased volumes, improved realisations boost topline

For Q2FY07, copper cathode and copper rods output increased by 10.5% and 8.8% respectively on a yoy basis. This coupled with higher LME prices, which increased from 162.3 USc/lb to 338.6 USc/lb an increase of 108.6% yoy, enabled the company to post a 92.2% growth in topline.

Healthy Tc/Rc boost operating profits, Tc/Rc to soften going forward

Tc/Rc margins for the half-year were at 37.1 cents/lb as against 15.7 cents/lb for the corresponding quarter of the previous year. Per Unit Treatment and refining costs for the half year reduced from 6.5 USc/lb to 5.2 USc/lb on a yoy basis. These factors enabled the company; improve its operating profits by 168% yoy.

Write off of investments and loans impact bottomline

During the quarter, the company has written off a sum of Rs. 516.4 mn in respect of investment and loans in India Foils Limited (IFL). A further sum of Rs. 784 mn. has been provided for on account of possible liability for guarantees given to banks and financial institutions for loans taken by IFL. These items have been written off as an exceptional item in the profit and loss account for the quarter.

Business Update

Maiden Foray into commercial energy business

The company would venture into the commercial energy business in India through a wholly owned subsidiary. The first phase of the project would involve setting up of a 2400 MW green field coal based thermal power plant in Jharsuguda, Orissa at a cost of $1.9 billion. The equity contribution amounting to 30% of the total cost i.e. $0.57 bn would be met through a $2bn. ADS offering. The plant would comprise of 4 units of 600 MW each. The first unit is expected to become operational by Q1FY09 and an additional unit would become operational every subsequent quarter thereafter. The company proposes to apply for coal blocks and would venture into coal mining to cater to the fuel requirements of the power plants.

Stake increase in HZL, will it be a smooth ride?

Besides its investment in commercial energy, the company proposes to utilise the remaining portion of the amount raised through ADS to exercise the call option in respect of shares of HZL. Considering the amount at the disposal of SIIL after the ADR issue and meeting the equity requirement of the commercial energy project, our calculation shows that SIIL would be able to exercise the call option at a price of Rs.586 per share of HZL, which is much below the market price at which the stock is currently trading. If, the proposed residual stake sale of the share of GoI in BALCO were to be considered as a precedent, we do not expect the stake sale in HZL to go through smoothly. On this account, we have not incorporated the increase in HZL stake in our sum of parts valuations.

Further equity dilution - preference shares to be converted into equity

Further, the company proposes to convert the 21.82 million preference shares of Rs. 10 each into 109.1million equity shares of Rs. 2 each. These preference shares carrying a coupon rate of 1% were issued in March 2004, and were to be redeemed at a premium of Rs.83 per share in March 2007. After the proposed conversion and ADS offering, the estimated fully diluted equity would stand at 867.5 mn shares (approx).

Business Outlook - Growth story of SIIL and subsidiaries remains intact

Debottlenecking of the copper smelter would take the capacity from the current level of 300 ktpa to 400 ktpa. Increased output from the smelter is expected to come in from January 2007 onwards. Phase I expansion at Korba smelter of BALCO in which SIIL has a 51% stake is expected to be fully operational by the end FY07, which would take the total capacity to 345 ktpa. The alumina refinery of Vedanta Alumina, in which SIIL has a 30% stake, is expected to be commissioned by March 2007. The 170-ktpa Chanderiya Hydro smelter of HZL in which the company has a 64% stake is on schedule for completion by early 2008.

Valuations

We have upgraded our FY07E and FY08E estimates incorporating higher Tc/Rc margins for FY07 and higher output for FY08 on account of debottlenecking of the copper smelter. We expect the company to post a fully diluted EPS of Rs.7.8 and Rs. 8.5 for FY07E and FY08E respectively. We value the standalone value of the company at Rs.102.4, which translates to 12X FY08E EPS. Stake in HZL contributes Rs. 305.4 per share of SIIL (based on our fair value estimates of Rs. 966 per share of HZL), while share in BALCO contributes Rs. 45.4 per share of SIIL. We have not assumed increased stake in HZL and have instead added the surplus net cash available with the company at the end of FY08E at Rs. 92.3 per share. We have thus arrived at a consolidated value of Rs. 546 per share. This represents 7% upside from the current market price of the stock and hence we assign a Neutral rating.

Standalone Financials

Amount in Million Rupees

Particulars	Q2FY07	Q2FY06	% Growth YoY	Q1FY07	% Growth QoQ	H1FY07	H1FY06	% Growth YoY	FY06	FY07E	FY08E
Net Sales	**33091**	**17216**	**92.2**	**23748**	**39.3**	**56839**	**28352**	**100.5**	**75039**	**106456**	**101429**
Expenditure	**29337**	**15815**	**85.5**	**20617**	**42.3**	**49954**	**26139**	**91.1**	**66925**	**93551**	**89253**
Raw Material Consumed	27349	13732	96.5	23695	57.2	51043	25121	95.4	63299	86733	82315
(Inc)/Dec in Finished Goods	577	479		-5935		-5358	-1744		0	0	0
Remuneration to Employees	120	129	(6.7)	146	(17.7)	267	240	11.2	465	534	588
Admin, Sales and Other Expenses	1292	1475	(12.5)	2710	(52.3)	4002	2522	58.7	3162	6284	6350
Operating Profit	**3754**	**1401**	**168.0**	**3131**	**19.9**	**6885**	**2213**	**211.1**	**8114**	**12906**	**12176**
Operating Profit %	***11.3***	***8.1***		***13.2***		***12.1***	***7.8***		***10.8***	***12.1***	***12.0***
Other Income	215	178	20.4	289	(25.9)	504	443	13.9	1160	1002	1227
EBITDA	**3969**	**1579**	**151.3**	**3421**	**16.0**	**7389**	**2656**	**178.3**	**9274**	**13907**	**13404**
EBITDA %	***12.0***	***9.2***		***14.4***		***13.0***	***9.4***		***12.4***	***13.1***	***13.2***
Depreciation and Ammortisation	321	319	0.5	332	(3.3)	652	627	4.1	1282	1185	1185
EBIT	**3648**	**1260**	**189.5**	**3089**	**18.1**	**6737**	**2029**	**232.0**	**7991**	**12723**	**12219**
EBIT%	***11.0***	***7.3***		***13.0***		***11.9***	***7.2***		***10.6***	***12.0***	***12.0***
Interest	435	243	79.1	405	7.2	840	526	59.6	1204	1221	1041
Profit Before Tax	**3214**	**1018**	**215.8**	**2683**	**19.8**	**5897**	**1503**	**292.5**	**6788**	**11502**	**11178**
PBT%	**9.7**	**5.9**		**11.3**		**10.4**	**5.3**		**9.0**	**10.8**	**11.0**
Taxes	511	207	147.6	449	14.0	960	301	219.0	1636	3432	3774
Profit After Tax	**2702**	**811**	**233.2**	**2235**	**20.9**	**4937**	**1202**	**310.9**	**5152**	**8070**	**7404**
PAT %	***8.2***	***4.7***		***9.4***		***8.7***	***4.2***		***6.9***	***7.6***	***7.3***
Extraordinary Item	-1337	0		0		-1337	0		0	-1337	0
Net Profit	**1366**	**811**	**68.4**	**2235**	**(38.9)**	**3600**	**1202**	**199.6**	**5152**	**6733**	**7404**
Equity Share Capital	**1117**	**1111**		**1117**		**1117**	**1111**		**1117**	**1735**	**1735**
EPS (in Rs. non annualised)	**2.4**	**1.5**		**4.0**		**6.4**	**2.2**		**9.2**	**7.8**	**8.5**

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