

INDIA

# Sterlite Industries

29 April 2009

## STLT IN Outperform

Stock price as of 28 Apr 09	Rs	382.85
12-month target	Rs	518.00
Upside/downside	%	+35.3
Valuation	Rs	518.00
- Sum of Parts		

GICS sector		materials
Market cap	Rs m	271,218
30-day avg turnover	US\$m	8.0
Market cap	US\$m	5,397
Number shares on issue	m	708.4

### Investment fundamentals

Year end 31 Mar		2008A	2009E	2010E	2011E
Total revenue	bn	245.6	206.7	158.5	194.5
EBIT	bn	65.8	41.9	23.5	33.6
EBIT Growth	%	-18.6	-36.4	-43.8	42.5
Recurring profit	bn	80.2	57.5	38.9	48.8
Reported profit	bn	42.3	35.3	25.2	28.3
Adjusted profit	bn	42.3	35.3	25.2	28.3
EPS rep	Rs	59.74	49.89	35.63	39.92
EPS rep growth	%	-19.9	-16.5	-28.6	12.0
EPS adj	Rs	59.74	49.89	35.63	39.92
EPS adj growth	%	-19.9	-16.5	-28.6	12.0
PE rep	x	6.4	7.7	10.7	9.6
PE adj	x	6.4	7.7	10.7	9.6
Total DPS	Rs	4.00	4.50	5.00	5.50
Total div yield	%	1.0	1.2	1.3	1.4
ROA	%	21.6	10.3	5.5	7.3
ROE	%	26.2	15.0	9.8	10.1
EV/EBITDA	x	1.4	2.2	3.5	2.5
Net debt/equity	%	-42.2	-52.1	-51.1	-49.2
Price/book	x	1.2	1.1	1.0	0.9

### STLT IN rel SENSEX performance, & rec history



Source: FactSet, Macquarie Research, April 2009 (all figures in INR unless noted)

### Analyst

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## Redefining costs

### Event

- **Strong finish to FY09:** Sterlite declared FY09 results which were in line with our estimates. However, the current run rate of costs and higher prevailing LME provides upside risks to our FY10E.

### Impact

- **4Q results – in line:** Net sales at Rs44bn are down 3% QoQ. EBITDA at Rs8.3bn is up 48% QoQ. Net profit at Rs5.9bn is up 16% QoQ. The lower profitability of aluminium was offset by higher volumes at copper business.
- **Copper smelting – stable earnings:** This division reported EBITDA of Rs2.9bn in 4Q. Our FY10E of Rs8.2bn looks easily achievable as TC/RCs have been contracted at 60% higher than last year. And can out our estimate if sulphuric acid prices recover (currently near US\$0/t).
- **Aluminium – expect recovery:** Profitability hit near zero here in this quarter, but exit cost of production is at US\$1,172/t (\$200/t lower than 4Q average). Also, the company proposes closing down Balco 1 and plans to sell around 250MW of power on merchant basis. Our EBITDA estimate of this division for FY10E at Rs82mn is at risk for significant upward revision.
- **Zinc business – on track for margin expansion:** We are building in an LME zinc price of US\$1,254 and a rupee/US\$ exchange rate of Rs46.5. At current levels, this represents around 20% upside in realisation and 18% to net profit.
- **Power business – new driver of earnings:** The first phase of 600MW of the under construction 2,400MW merchant power plant will be operational in 3Q FY10. This could add marginally to our numbers in FY10, but by 20%+ in FY11.

### Earnings and target price revision

- No change.

### Price catalyst

- 12-month price target: Rs518.00 based on a Sum of Parts methodology.
- Catalyst: Stable LME and possible earnings upgrades as Street builds in lower cost.

### Action and recommendation

- **Maintain Outperform:** Sterlite remains our top pick in the metal space with its strong balance sheet (net cash of Rs173/sh), low cost structure (among lowest deciles globally for zinc and copper smelting) and, in our opinion, the best growth profile (50% capacity expansion in zinc and upcoming lucrative power business). We strongly reiterate our Outperform.

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## 4Q results – strong comeback

**Fig 1 Hit by lower LME but redefining costs**

Rs mn	Q409	Q408	% chg YoY	Q309	% chg QoQ
Net Sales	44,060	67,659	-35%	45,362	-3%
EBITDA	8,392	21,746	-61%	5,653	48%
EBITDA Margin %	19%	32%		12%	
Depreciation	2,032	(269)	-856%	1,654	23%
Interest	1,312	908	44%	1,220	8%
PBT (Operations)	5,048	21,107	-76%	2,779	82%
Other income	3,940	5,918	-33%	5,852	-33%
PBT (Recurring)	8,988	27,025	-67%	8,632	4%
Exceptionals	(799)	528		145	
PBT (Reported)	9,786	26,497	-63%	8,486	15%
Tax	664	7,177		1,163	
Profit After Tax	9,122	19,320	-53%	7,323	25%
Minority interest	2,057	6,092	-66%	1,720	20%
Profit attributable to consolidated company	5,983	13,228	-55%	5,137	16%
EPS (Rs)	8.44	18.66	-55%	7.25	16%

Source: Macquarie Research, April 2009

## In line with our full-year estimates

**Fig 2 Depreciation – had one-offs**

Rs mn	FY09	FY09E	YoY%
Net Sales	214,484	206,193	4%
EBITDA	50,083	48,636	3%
EBITDA Margin %	23%	24%	-1%
Depreciation	7,007	7,253	-3%
Interest	3,973	2,975	34%
PBT (Operations)	39,104	38,408	2%
Other income	18,501	18,553	0%
PBT (Recurring)	57,604	56,961	1%
Exceptionals	(553)	145	
PBT (Reported)	58,158	56,816	2%
Tax	8,550	8,339	3%
Profit After Tax	49,607	48,477	2%
Minority interest	12,671	13,094	-3%
Profit After Tax and minority	36,936	35,383	4%
EPS (Rs)	49.93	49.32	1%

Source: Macquarie Research, April 2009

## Zinc and copper rebound

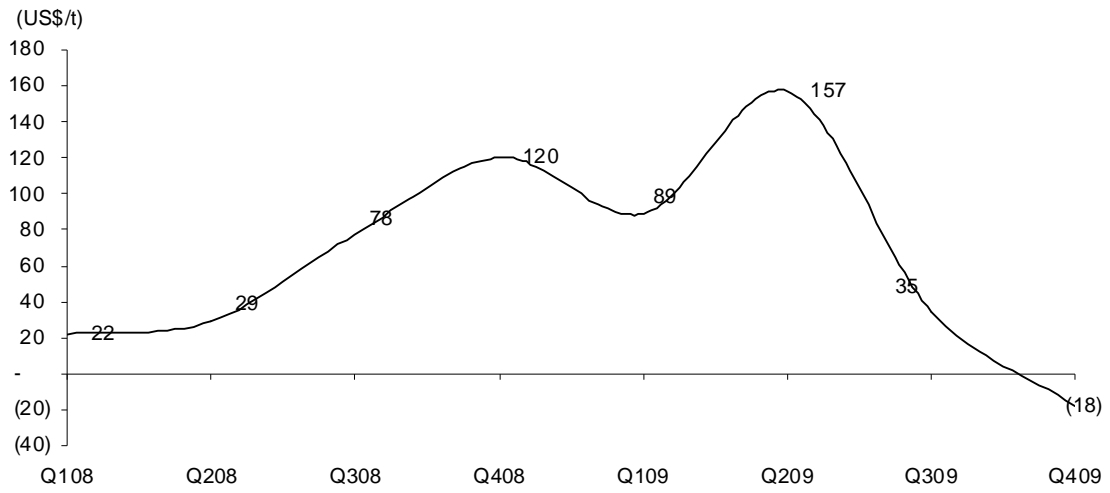
**Fig 3 Aluminium – will be next on recovery**

Rs mn	4Q09	4Q08	% chg YoY	3Q09	% chg QoQ
<b>Copper Division</b>					
Gross revenue	22,600	33,761	-33%	25,780	-12%
EBITDA	2,900	7,035	-59%	980	196%
EBITDA margin	12.8%	20.8%		3.8%	
<b>Aluminium Division</b>					
Rs mn					
Revenue	8,130	11,267	-28%	8,360	-3%
EBITDA	30	4,181	-99%	1,620	-98%
EBITDA margin	0.4%	37.1%		19.4%	
<b>Zinc Division</b>					
Revenue	12,627	22,660	-44%	10,314	22%
EBITDA	5,551	14,810	-63%	2,673	108%
EBITDA margin	44%	65%		26%	

Source: Macquarie Research, April 2009

### Sulphuric acid – rebound can lead to better copper smelting margins

**Fig 4 Sulphuric acid realization**



Source: Macquarie Research, April 2009

**Sterlite Industries (STLT IN, Outperform, Target price: Rs518.00)**

Quarterly Results					Profit & Loss						
		3Q/09A	4Q/09E	1Q/10E	2Q/10E		2008A	2009E	2010E	2011E	
<b>Revenue</b>	bn	45	35	36	32	<b>Revenue</b>	bn	246	207	158	194
<b>Gross Profit</b>	bn	8	8	9	8	<b>Gross Profit</b>	bn	81	56	38	51
Cost of Goods Sold	bn	38	28	28	24	Cost of Goods Sold	bn	165	150	120	144
<b>EBITDA</b>	bn	6	7	7	6	<b>EBITDA</b>	bn	74	49	31	42
Depreciation	bn	2	2	2	1	Depreciation	bn	8	7	7	9
Amortisation of Goodwill	bn	0	0	0	0	Amortisation of Goodwill	bn	0	0	0	0
Other Amortisation	bn	0	0	0	0	Other Amortisation	bn	0	0	0	0
<b>EBIT</b>	bn	4	4	5	5	<b>EBIT</b>	bn	66	42	24	34
Net Interest Income	bn	-1	-0	-1	-1	Net Interest Income	bn	-3	-3	-3	-3
Associates	bn	0	0	0	0	Associates	bn	0	0	0	0
Exceptionals	bn	0	0	0	0	Exceptionals	bn	0	0	0	0
Forex Gains / Losses	bn	0	0	0	0	Forex Gains / Losses	bn	0	0	0	0
Other Pre-Tax Income	bn	6	5	4	4	Other Pre-Tax Income	bn	17	19	18	19
<b>Pre-Tax Profit</b>	bn	9	9	9	8	<b>Pre-Tax Profit</b>	bn	80	57	39	49
Tax Expense	bn	-1	-1	-2	-1	Tax Expense	bn	-19	-8	-7	-12
<b>Net Profit</b>	bn	7	8	7	6	<b>Net Profit</b>	bn	61	49	32	37
Minority Interests	bn	-2	-3	-2	-1	Minority Interests	bn	-19	-14	-7	-9
<b>Reported Earnings</b>	bn	5	6	6	5	<b>Reported Earnings</b>	bn	42	35	25	28
<b>Adjusted Earnings</b>	bn	5	6	6	5	<b>Adjusted Earnings</b>	bn	42	35	25	28
EPS (rep)		7.46	8.00	8.19	7.13	EPS (rep)		59.74	49.89	35.63	39.92
EPS (adj)		7.46	8.00	8.19	7.13	EPS (adj)		59.74	49.89	35.63	39.92
EPS Growth yoy (adj)	%	-50.1	-46.4	-49.6	-60.8	EPS Growth (adj)	%	-19.9	-16.5	-28.6	12.0
						PE (rep)	x	6.4	7.7	10.7	9.6
						PE (adj)	x	6.4	7.7	10.7	9.6
EBITDA Margin	%	12.5	18.7	19.6	19.6	Total DPS		4.00	4.50	5.00	5.50
EBIT Margin	%	8.8	12.4	14.9	14.9	Total Div Yield	%	1.0	1.2	1.3	1.4
Earnings Split	%	14.9	16.0	23.0	20.0	Weighted Average Shares	m	709	709	709	709
Revenue Growth	%	-26.1	-42.2	-36.8	-53.5	Period End Shares	m	709	709	709	709
EBIT Growth	%	-75.7	-73.2	-67.4	-72.1						
Profit and Loss Ratios					Cashflow Analysis						
		2008A	2009E	2010E	2011E		2008A	2009E	2010E	2011E	
Revenue Growth	%	1.0	-15.9	-23.3	22.7	<b>EBITDA</b>	bn	74	49	31	42
EBITDA Growth	%	-16.0	-34.0	-36.7	36.0	Tax Paid	bn	-19	-8	-7	-12
EBIT Growth	%	-18.6	-36.4	-43.8	42.5	Chgs in Working Cap	bn	2	26	-1	8
Gross Profit Margin	%	33.0	27.3	24.2	26.0	Net Interest Paid	bn	-3	-3	-3	-3
EBITDA Margin	%	30.3	23.7	19.6	21.7	Other	bn	6	18	18	19
EBIT Margin	%	26.8	20.3	14.9	17.3	<b>Operating Cashflow</b>	bn	60	82	38	54
Net Profit Margin	%	24.9	23.7	20.2	19.0	Acquisitions	bn	0	0	0	0
Payout Ratio	%	6.7	9.0	14.0	13.8	Capex	bn	-15	-15	-20	-27
EV/EBITDA	x	1.4	2.2	3.5	2.5	Asset Sales	bn	0	0	0	0
EV/EBIT	x	1.6	2.6	4.6	3.2	Other	bn	-116	0	0	0
<b>Balance Sheet Ratios</b>						<b>Investing Cashflow</b>	bn	-131	-15	-20	-27
ROE	%	26.2	15.0	9.8	10.1	Dividend (Ordinary)	bn	-1	-3	-3	-4
ROA	%	21.6	10.3	5.5	7.3	Equity Raised	bn	80	0	0	0
ROIC	%	44.3	22.1	12.9	15.3	Debt Movements	bn	5	2	10	10
Net Debt/Equity	%	-42.2	-52.1	-51.1	-49.2	Other	bn	0	0	0	0
Interest Cover	x	22.8	14.1	8.0	9.9	<b>Financing Cashflow</b>	bn	84	-2	7	6
Price/Book	x	1.2	1.1	1.0	0.9	<b>Net Chg in Cash/Debt</b>	bn	13	66	25	32
Book Value per Share		314.8	350.4	378.9	410.4						
					Balance Sheet						
		2008A	2009E	2010E	2011E		2008A	2009E	2010E	2011E	
Cash	bn	169	216	236	255	Cash	bn	169	216	236	255
Receivables	bn	16	11	10	12	Receivables	bn	16	11	10	12
Inventories	bn	33	27	22	26	Inventories	bn	33	27	22	26
Investments	bn	0	0	0	0	Investments	bn	0	0	0	0
Fixed Assets	bn	124	115	127	145	Fixed Assets	bn	124	115	127	145
Intangibles	bn	0	0	0	0	Intangibles	bn	0	0	0	0
Other Assets	bn	52	47	45	47	Other Assets	bn	52	47	45	47
<b>Total Assets</b>	bn	394	417	440	485	<b>Total Assets</b>	bn	394	417	440	485
Payables	bn	0	0	0	0	Payables	bn	0	0	0	0
Short Term Debt	bn	0	0	0	0	Short Term Debt	bn	0	0	0	0
Long Term Debt	bn	51	52	62	72	Long Term Debt	bn	51	52	62	72
Provisions	bn	30	16	5	6	Provisions	bn	30	16	5	6
Other Liabilities	bn	33	34	33	36	Other Liabilities	bn	33	34	33	36
<b>Total Liabilities</b>	bn	115	102	100	115	<b>Total Liabilities</b>	bn	115	102	100	115
Shareholders' Funds	bn	223	248	268	291	Shareholders' Funds	bn	223	248	268	291
Minority Interests	bn	56	66	72	79	Minority Interests	bn	56	66	72	79
Other	bn	0	0	0	0	Other	bn	0	0	0	0
<b>Total S/H Equity</b>	bn	279	314	340	370	<b>Total S/H Equity</b>	bn	279	314	340	370
<b>Total Liab &amp; S/H Funds</b>	bn	394	417	440	485	<b>Total Liab &amp; S/H Funds</b>	bn	394	417	440	485

All figures in INR unless noted.

Source: Company data, Macquarie Research, April 2009

## Important disclosures:

<p><b>Recommendation definitions</b></p> <p><b>Macquarie - Australia/New Zealand</b>          Outperform – return &gt;5% in excess of benchmark return          Neutral – return within 5% of benchmark return          Underperform – return &gt;5% below benchmark return</p> <p><b>Macquarie – Asia/Europe</b>          Outperform – expected return &gt;+10%          Neutral – expected return from -10% to +10%          Underperform – expected return &lt;-10%</p> <p><b>Macquarie First South - South Africa</b>          Outperform – expected return &gt;+10%          Neutral – expected return from -10% to +10%          Underperform – expected return &lt;-10%</p> <p><b>Macquarie - Canada</b>          Outperform – return &gt;5% in excess of benchmark return          Neutral – return within 5% of benchmark return          Underperform – return &gt;5% below benchmark return</p> <p><b>Macquarie - USA</b>          Outperform (Buy) – return &gt;5% in excess of benchmark return (Russell 3000)          Neutral (Hold) – return within 5% of benchmark return (Russell 3000)          Underperform (Sell)– return &gt;5% below benchmark return (Russell 3000)</p> <p><b>Recommendations</b> – 12 months</p> <p><b>Note:</b> Quant recommendations may differ from Fundamental Analyst recommendations</p>	<p><b>Volatility index definition*</b></p> <p>This is calculated from the volatility of historical price movements.</p> <p><b>Very high–highest risk</b> – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p><b>High</b> – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p><b>Medium</b> – stock should be expected to move up or down at least 30–40% in a year.</p> <p><b>Low–medium</b> – stock should be expected to move up or down at least 25–30% in a year.</p> <p><b>Low</b> – stock should be expected to move up or down at least 15–25% in a year.</p> <p>* Applicable to Australian/NZ/Canada stocks only</p>	<p><b>Financial definitions</b></p> <p>All "Adjusted" data items have had the following adjustments made:          Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives &amp; hedging, IFRS impairments &amp; IFRS interest expense          Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends &amp; minority interests</p> <p><b>EPS</b> = adjusted net profit / <i>efpowa</i>*  <b>ROA</b> = adjusted ebit / average total assets  <b>ROA Banks/Insurance</b> = adjusted net profit / average total assets  <b>ROE</b> = adjusted net profit / average shareholders funds  <b>Gross cashflow</b> = adjusted net profit + depreciation          *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>																												
<p><b>Recommendation proportions – For quarter ending 31 March 2009</b></p> <table border="1"> <thead> <tr> <th></th> <th>AU/NZ</th> <th>Asia</th> <th>RSA</th> <th>USA</th> <th>CA</th> <th>EUR</th> </tr> </thead> <tbody> <tr> <td>Outperform</td> <td>40.44%</td> <td>49.55%</td> <td>44.83%</td> <td>38.49%</td> <td>67.19%</td> <td>43.84%</td> </tr> <tr> <td>Neutral</td> <td>38.60%</td> <td>15.57%</td> <td>39.66%</td> <td>46.43%</td> <td>28.12%</td> <td>39.04%</td> </tr> <tr> <td>Underperform</td> <td>20.96%</td> <td>34.88%</td> <td>15.52%</td> <td>15.08%</td> <td>4.69%</td> <td>17.12%</td> </tr> </tbody> </table>				AU/NZ	Asia	RSA	USA	CA	EUR	Outperform	40.44%	49.55%	44.83%	38.49%	67.19%	43.84%	Neutral	38.60%	15.57%	39.66%	46.43%	28.12%	39.04%	Underperform	20.96%	34.88%	15.52%	15.08%	4.69%	17.12%
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