

# Sterlite Industries



<b>BSE Sensex</b> 19,504	<b>S&amp;P CNX</b> 5,930
Bloomberg	STLT IN
Equity Shares (m)	3,361.2
M.Cap. (INR b)/(USD b)	319.3/5.9
52-Week Range (INR)	123/83
1,6,12 Rel. Perf. (%)	-2/-10/-23

**CMP: INR95****TP: INR114****Buy****Financials & Valuation (INR b)**

Y/E March	2013	2014E	2015E
Sales	451.6	473.3	467.0
EBITDA*	75.9	76.8	78.9
NP	61.6	59.5	52.5
Adj. EPS (INR)	18.3	17.7	15.6
EPS Gr(%)	9.9	-3.5	-11.7
BV/Sh. (INR)	139.5	153.1	164.6
RoE (%)	13.9	12.1	9.8
RoCE (%)	13.9	13.7	12.0
Payout (%)	14.0	15.9	16.6

**Valuations**

P/E (x)	5.2	5.4	6.1
P/BV	0.7	0.6	0.6
EV/EBITDA (x)*	3.7	3.4	3.0
Div. Yield (%)	2.3	2.5	2.7

\* Attributable

- Sterlite Industries' (STLT) 4QFY13 consolidated EBITDA increased 42% QoQ to INR33b (v/s est of INR30.3b) due to strong performance across segments. Adjusted PAT increased 57% QoQ to INR19.6b. Superior performance (v/s est) was largely driven by improved operating parameters of recently commissioned 80MW CPP at Tuticorin and improved quality and lower cost of coal for Bharat Aluminium (Balco), Vedanta Aluminium (VAL) and Sterlite Energy (SEL) for generation of power and aluminum smelting.
- Uncertainty regarding restart of copper smelter persists but we are optimistic that the smelter will eventually come back to operations.
- SEL's fourth unit of 600MW was commissioned on March 31, 2013. Lack of PPA for 1,800MW, transmission bottlenecks and fluctuating quality of coal and prices will keep SEL's profitability volatile.
- Both VAL and Balco's aluminum smelters are operating at full capacity and are now fully non-integrated for alumina. Balco is in advanced stages of signing the mining lease for coal block, which could improve cash flows and cost structure of its 245ktpa smelter and 325ktpa expansion.
- Although production at Zinc International will decline ~5% in FY14, Hindustan Zinc (HZL) will more than compensate with higher mine production.
- STLT has a debt of INR190b (standalone INR100b + Balco INR43b + TSPL INR38b). Sesa-Sterlite (SS) merged entity will have a consolidated debt of INR730b. Standalone SS will have a debt of INR650b, while EBITDA will be only INR35-45b. We are concerned about the servicing of debt as the surplus funds with cash cows (HZL and Cairn India) are not fungible. Management continues to evade answering queries regarding the same. We believe SS will have to undergo another round of group restructuring to avail cash from its cash cows for servicing debt. The high leveraged position of standalone-merged entity continues to concern us and drag SS' valuation.
- SS trades at attractive FY15E PE of 5.1x and EV/EBITDA of 5x. Maintain **Buy**.

**Quarterly Performance (Consolidated for Sterlite Inds.)**

Y/E March	FY12				FY13				FY12	FY13	4QE	vs Est (%)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Copper cathode ('000 tons)	74	87	84	80	88	87	92	86	325	353	86	0
Aluminum (BALCO, '000 tons)	61	60	63	62	60	63	62	62	246	260	62	0
Aluminum (VAL, '000 tons)	112	89	107	115	124	134	135	133	423	500	133	0
<b>Net Sales</b>	<b>98,630</b>	<b>101,968</b>	<b>103,037</b>	<b>108,189</b>	<b>106,484</b>	<b>111,026</b>	<b>107,375</b>	<b>126,738</b>	<b>411,823</b>	<b>451,623</b>	<b>117,540</b>	<b>8</b>
<b>EBITDA</b>	<b>27,512</b>	<b>24,065</b>	<b>23,312</b>	<b>27,054</b>	<b>23,083</b>	<b>25,270</b>	<b>23,269</b>	<b>33,067</b>	<b>101,943</b>	<b>104,689</b>	<b>30,304</b>	<b>9</b>
As % of Net Sales	27.9	23.6	22.6	25.0	21.7	22.8	21.7	26.1	24.8	23.2	25.8	1.2
Interest	1,643	2,372	1,790	3,280	2,419	1,777	2,269	2,758	9,085	9,222	2,655	4
Depreciation	4,200	4,459	4,575	5,072	5,182	5,221	5,382	4,534	18,306	20,318	5,619	-19
Other Income	8,391	8,010	8,768	7,035	9,484	8,476	8,590	7,984	32,205	34,532	8,744	-9
<b>PBT (before XO item)</b>	<b>30,059</b>	<b>25,244</b>	<b>25,715</b>	<b>25,737</b>	<b>24,966</b>	<b>26,748</b>	<b>24,208</b>	<b>33,759</b>	<b>106,756</b>	<b>109,681</b>	<b>30,774</b>	<b>10</b>
Extra-ordinary gain (loss)	-44	-2,760	-4,231	-1,005	-2,174	2,188	-625	-397	-8,039	-1,007	0	
<b>PBT (after XO item)</b>	<b>30,015</b>	<b>22,485</b>	<b>21,484</b>	<b>24,733</b>	<b>22,792</b>	<b>28,936</b>	<b>23,583</b>	<b>33,363</b>	<b>98,717</b>	<b>108,674</b>	<b>30,774</b>	<b>8</b>
Total Tax	6,137	5,049	5,053	4,867	3,339	5,109	3,555	4,180	21,106	16,184	5,847	-29
% Tax	20.4	22.5	23.5	19.7	14.7	17.7	15.1	12.5	21.4	14.9	19.0	-34.1
<b>Reported PAT</b>	<b>23,878</b>	<b>17,436</b>	<b>16,431</b>	<b>19,866</b>	<b>19,453</b>	<b>23,827</b>	<b>20,028</b>	<b>29,183</b>	<b>77,611</b>	<b>92,490</b>	<b>24,927</b>	<b>17</b>
- Minority int.	6,420	5,030	4,660	5,499	5,771	5,793	5,853	7,872	21,609	25,289	7,072	11
+ share in associates profit	-1,061	-2,428	-2,636	-1,598	-1,666	-607	-2,261	-2,064	-7,723	-6,598	-1,276	62
<b>Adjusted PAT</b>	<b>16,442</b>	<b>12,738</b>	<b>13,366</b>	<b>13,774</b>	<b>14,190</b>	<b>15,239</b>	<b>12,539</b>	<b>19,643</b>	<b>56,318</b>	<b>61,610</b>	<b>16,579</b>	<b>18</b>

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### Sterlite Inds 4QFY13 consolidated EBITDA increased 42% QoQ to INR33b (v/s est INR30.3b) due to strong performance across segments

- Adjusted PAT increased 57% QoQ to INR19.6b (v/s est of INR16.6b).
- Superior performance (v/s est) was largely driven by improved operating parameters of recently commissioned 80MW captive power plants of copper smelter at Tuticorin and lower cost and better quality of coal to Balco, VAL and SEL for generation of power, and aluminum smelting from Coal India's linkage and e-auction.
- Uncertainty regarding restart of copper smelter still persists. We are optimistic that the smelter will eventually come back to operations but are not sure of the timeline.
- SEL's 2,400MW power plant is now fully commissioned. Volumes are expected to ramp up in FY14E. In the absence of PPA for 1,800MW, bottlenecks in transmission and fluctuating quality of coal and prices, profitability too is expected to remain volatile.
- Both VAL and Balco's aluminum smelters are now fully non-integrated for alumina. VAL has already achieved full operating efficiencies as CU has already crossed 100%. Similarly, Balco is operating at full capacity utilization. Energy cost remains the key to cost of production of aluminum, which is likely to remain volatile due to fluctuating quality and price of domestic coal.
- Although zinc-lead production at international mines will decline ~5% in FY14E, HZL will more than compensate with a higher mine production.

#### Segmental Results (INR m)

	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13	3QFY13	4QFY13	4QFY13E
Copper	2,909	3,450	3,260	2,728	2,006	2,765	1,603	3,343	2,016
Aluminium	1,523	210	-230	234	37	433	89	290	75
Zinc & Lead (RHS)	18,126	16,502	14,857	17,053	14,015	15,123	16,340	23,059	22,743
Zinc India	12,479	10,900	10,169	11,159	8,627	8,592	7,462	15,592	14,442
Silver India	1,930	2,201	2,334	3,680	3,510	4,109	5,985	4,549	5,499
Zinc International	3,718	3,401	2,353	2,215	1,878	2,422	2,893	2,918	2,802
Power	867	527	533	1,516	1,897	1,903	341	2,077	937
Others	162	282	297	1	79	112	43	-129	
<b>Total EBIT</b>	<b>23,587</b>	<b>20,970</b>	<b>18,716</b>	<b>21,532</b>	<b>18,035</b>	<b>20,336</b>	<b>18,415</b>	<b>28,639</b>	<b>25,771</b>

### Copper: Good performance helped by TcRc and CPP; Smelter still shut, awaits clearance from NGT

- The segmental EBIT was up 109% QoQ to INR3.3b due to improvement in TcRc (from US\$12.4/lb to US\$14.8/lb) and marginal reduction in net cost (from US\$10.8/lb to US\$10.7/lb). Volume declined 6% QoQ to 86kt. Commissioning of 80MW CPP helped in reduction of net CoP despite a sharp fall in realization of by-product -- sulphuric acid from INR2,675/t to INR1,604/ton. Start-up expenses of CPP had negatively impacted the margin in 3QFY13.
- Copper MIC production at Australian mines too improved by 1kt to 7kt. The R&R has been increased by a net amount of 2.9m tons to 8.9m tons. The mine life has been extended to four years.
- Smelter remains shut since March 29, 2013 under the instruction of TNPCB. An expert committee constituted by the National Green Tribunal (NGT) has submitted its report and the matter is now being heard by NGT.

- In a separate order, the Supreme Court has upheld STLT's appeal filed in 2010 against the Madras High Court regarding closure of smelter. INR1b has been provided as per SC order dated April 2, 2013 for improvement of environment around the smelter.

#### Quarterly performance (Sterlite Inds standalone)

Y/E March	FY12				FY13				FY12	FY13	4QE	vs Est (%)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Net Sales	41,726	48,018	45,841	45,343	45,611	48,636	45,364	49,599	180,928	189,210	46,197	7
Change (YoY %)	30.4	65.2	4.6	-6.1	9.3	1.3	-1.0	9.4	18.1	4.6	1.9	398.8
Total Expenditure	39,046	45,227	42,912	42,598	44,335	45,803	43,975	46,578	169,782	180,691	44,477	5
EBITDA	2,681	2,791	2,929	2,745	1,276	2,833	1,389	3,021	11,146	8,519	1,720	76
Change (YoY %)	48.4	96.0	115.0	16.2	-52.4	1.5	-52.6	10.1	60.2	-23.6	-37.3	-126.9
As % of Net Sales	6.4	5.8	6.4	6.1	2.8	5.8	3.1	6.1	6.2	4.5	3.7	63.6
Interest	1,287	1,541	1,471	1,730	1,506	1,150	1,448	2,049	6,029	6,154	1,463	40
Depreciation	378	375	364	508	360	367	435	465	1,625	1,627	437	6
Other Income	6,639	3,935	8,279	3,616	3,481	5,741	7,785	3,929	22,469	20,936	3,655	7
PBT (before XO item)	7,655	4,809	9,373	4,124	2,891	7,057	7,290	4,436	25,962	21,674	3,475	28
Extra-ordinary Exp.	-21	-1,043	-1,224	-3,596	-2,195	1,611	-924	-856	-5,883	-2,364	0	
PBT (after XO item)	7,634	3,767	8,149	529	696	8,668	6,366	3,580	20,078	19,310	3,475	3
Total Tax	1,462	1,195	1,181	-335	243	1,620	948	727	3,504	3,538	1,103	-34
% Tax	19.2	31.7	14.5	-63.4	34.9	18.7	14.9	20.3	17.4	18.3	31.7	-36.0
Reported PAT	6,172	2,571	6,968	864	453	7,048	5,418	2,853	16,575	15,773	2,372	20
Adjusted PAT	6,189	3,283	8,014	2,763	1,883	5,738	6,205	2,972	22,458	18,137	2,328	28
Change (YoY %)	97.7	-18.1	153.3	-2.4	-69.6	74.8	-22.6	7.6	76.3	-19.2	-15.7	-148.1

#### Zinc: Strong performance helped by HZL

- Zinc-lead India EBIT increased 109% QoQ to INR15.6b due to sharp ramp-up of mine production (+12% QoQ) and liquidation of 61kt concentrate.
- Silver EBIT declined 24% QoQ to INR4.5b due to a fall in prices.
- Zinc-international EBIT remained flat QoQ at INR2.9b. CoP increased 8% QoQ and was offset by higher revenue. EBITDA remained flat at INR4.4b.

#### Zinc-International (INR m)

	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13	3QFY13	4QFY13	4QFY13E
Volumes (ZN + PB)	119	114	105	106	106	114	104	102	102
Revenue	10,600	11,600	10,300	10,070	10,120	11,250	10,650	11,300	11,244
Expenditure	5,430	6,850	6,570	6,380	6,750	7,330	6,260	6,960	6,978
CoP (USD/ton)	1,189	1,242	1,188	1,240	1,111	1,053	1,095	1,181	1,261
EBITDA	5,170	4,750	3,730	3,690	3,370	3,920	4,390	4,340	4,267
EBIT	3,718	3,401	2,353	2,215	1,878	2,422	2,893	2,918	2,802
PAT	3,170	3,420	2,350	1,740	1,900	2,100	2,260	2,670	2,196

#### Aluminum: Balco's performance improved helped by lower energy cost; Getting closure for captive coal mining

- Aluminum production remained flat QoQ at 62kt.
- The premium in realization over LME increased by 18pp to 42% due to stronger physical premiums and better market for rods.
- Cost of production declined (as reported for hot metal) by USD65/t QoQ to USD1,930/ton due to fall in energy costs helped by superior quality of coal from linkage and fall in e-auction prices.
- EBITDA increased 33% QoQ to INR850m.

- Coal block received two forest clearances. State government is now diverting forest land for mining. Balco expects to sign the mining lease very soon. This will pave the way for coal mining and significant improvement in cash flows. The 1,200MW CPP is still awaiting a revoking of factory licence suspension.
- Meanwhile, Balco has started to commission pots at the 325kt smelter. During 1QFY14, 84 of the 336 pots have been commissioned. Until the 1,200MW CPP and coal mine become operational, the 325ktpa smelter will draw power from 270MW existing surpluses.

**Aluminum business (Balco)**

	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13	3QFY13	4QFY13	4QFY13E
<b>Revenue (INR m)</b>	<b>7,567</b>	<b>6,855</b>	<b>8,009</b>	<b>8,000</b>	<b>7,800</b>	<b>8,590</b>	<b>8,320</b>	<b>9,540</b>	<b>8,282</b>
Volumes (tons)	61,000	60,000	63,000	62,000	60,000	63,000	62,000	62,000	62,000
LME Premium(%) calculated	6.7	4.9	19.3	18.3	21.3	28.8	24.0	41.7	23.0
Aluminum CoP (USD/ton) reported (INR/ton)	1,981	2,133	1,880	1,918	1,910	1,970	1,995	1,930	
				96,857	103,542	108,800	108,000	104,532	
<b>EBITDA (INR m)</b>	<b>1,910</b>	<b>560</b>	<b>320</b>	<b>950</b>	<b>570</b>	<b>950</b>	<b>640</b>	<b>850</b>	<b>654</b>
<b>PAT (INR m)</b>	<b>1,268</b>	<b>112</b>	<b>-170</b>	<b>460</b>	<b>-70</b>	<b>320</b>	<b>-80</b>	<b>200</b>	<b>52</b>

**Aluminum (VAL): cost of production down but may not sustain**

- Aluminum production remained flat QoQ at 133kt, which continues to operate above rated capacity.
- Cost of production declined (as reported for hot metal) by USD129/t QoQ to USD1,799/ton due to fall in energy costs helped by superior quality of coal from linkage and fall in e-auction prices. This however may not sustain in FY14 as the coal linkage (%) in total coal mix will decline as power generation ramps up.
- EBITDA increased 5% QoQ to INR2.6b.
- At PAT level, VAL continues to make losses due to forex fluctuations.

**VAL (INR m)**

	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13	3QFY13	4QFY13	4QFY13E
<b>Revenue</b>	<b>14,980</b>	<b>11,980</b>	<b>14,750</b>	<b>16,630</b>	<b>16,810</b>	<b>18,190</b>	<b>17,130</b>	<b>17,090</b>	<b>19,501</b>
Volumes (tons)	112,000	89,000	107,000	115,000	124,000	134,000	135,000	133,000	
Reported CoP (USD/ton)	2,344	2,554	2,004	1,930	1,845	1,905	1,928	1,799	
Premium(%)	15.1	14.7	26.2	31.2	30.5	28.2	17.2	18.3	35.0
Expenditure	12,850	11,950	13,500	14,410	14,180	15,940	14,650	14,480	16,956
Aluminium - CoP (USD/ton) calculated	2,564	2,743	2,407	2,468	2,191	2,155	2,002	2,007	2,350
<b>EBITDA</b>	<b>2,130</b>	<b>30</b>	<b>1,250</b>	<b>2,220</b>	<b>2,630</b>	<b>2,250</b>	<b>2,480</b>	<b>2,610</b>	<b>2,545</b>
<b>PAT</b>	<b>-3,600</b>	<b>-8,230</b>	<b>-8,930</b>	<b>-5,420</b>	<b>-5,650</b>	<b>-2,060</b>	<b>-7,660</b>	<b>-7,000</b>	<b>-4,325</b>
ICD from Sterlite	89,390	89,390	96,120	100,070	105,050	106,920	117,030	121,360	117,030
ICD from Ved Plc	40,970	45,860	22,990	20,900	37,650	36,800	22,440	19,360	22,440
External Debt	151,280	156,030	156,530	180,980	185,710	184,700	182,100	177,650	182,100
Working Capital Loan			15,000	15,000					
<b>Total Debt</b>	<b>281,640</b>	<b>291,280</b>	<b>290,640</b>	<b>316,950</b>	<b>328,410</b>	<b>328,410</b>	<b>321,570</b>	<b>318,370</b>	<b>321,570</b>

**Power: SEL fully commissioned; Operating performance boosted by lower price, better quality of coal**

- The performance of power segment was stronger due to more than expected reduction in cost of power generation helped by better quality of coal and a lower price in Coal India's e-auction.
- Despite average realization falling by INR0.19/kwh QoQ to INR3.16, EBITDA per kwh improved by INR0.55/kwh largely due to lower costs.



**Power business summary**

A. (SEL) + B. (Balco CPP+WPP)	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13	3QFY13	4QFY13	4QFY13E
Merchant Sales (M kwh)	1,652	1,748	1,997	2,166	2,458	2,474	1,916	2,433	2,433
Reported avg. COP (INR/kwh)	2.57	2.59	2.47	2.16	2.02	2.22	2.29	1.81	2.10
Rep. Avg. Realization (INR/kwh)	3.55	3.37	3.44	3.39	3.44	3.45	3.35	3.16	3.07
<b>Revenue (INR m)</b>	<b>5,920</b>	<b>6,010</b>	<b>5,740</b>	<b>7,970</b>	<b>8,570</b>	<b>8,850</b>	<b>5,200</b>	<b>8,470</b>	<b>7,466</b>
Realization (INR/kwh) , excl. tri	3.91	3.76	3.66	4.07	3.80	3.79	3.56	3.81	3
<b>EBITDA (INR m)</b>	<b>1,660</b>	<b>1,340</b>	<b>1,470</b>	<b>2,390</b>	<b>3,290</b>	<b>3,000</b>	<b>1,550</b>	<b>3,300</b>	<b>2,345</b>
Average EBITDA (INR/kwh)	1.00	0.77	0.74	1.10	1.34	1.21	0.81	1.36	0.39
Depreciation (INR m)	794	813	937	874	1,393	1,098	1,209	1,223	1,407
<b>EBIT (INR m)</b>	<b>867</b>	<b>527</b>	<b>533</b>	<b>1,516</b>	<b>1,897</b>	<b>1,903</b>	<b>341</b>	<b>2,077</b>	<b>937</b>
Average EBIT (INR/kwh)	0.52	0.30	0.27	0.70	0.77	0.77	0.18	0.85	0.39
<b>PAT (INR m)</b>	<b>500</b>	<b>230</b>	<b>350</b>	<b>540</b>	<b>830</b>	<b>1,130</b>	<b>-280</b>	<b>1,100</b>	

- SEL volumes improved 32% QoQ to 2,073kwh (including 209 Mkw under trial run of fourth unit) due to improvement in PLF and evacuation facilities.
- Although realization declined by 22 paise QoQ to INR3.09/kwh, EBITDA per unit improved by 90 paise QoQ to INR1.1/kwh, largely due to improved operating efficiencies and reduction in cost of coal as discussed above.
- The fourth unit of 600MW has been commissioned on March 31, 2013. With 2,400MW is commissioned fully. This will lead to a higher volume in FY14E. However, CoP will depend on the quality of coal and price.

A. SEL	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13	3QFY13	4QFY13	4QFY13E
<b>Revenue (INR m)</b>	<b>3,434</b>	<b>3,801</b>	<b>3,947</b>	<b>5,025</b>	<b>6,097</b>	<b>6,163</b>	<b>3,714</b>	<b>5,760</b>	<b>6,170</b>
Capacity (MW)	600	1200	1200	1800	1800	1800	1800	1800	2400
Reported realization (INR/kwh)	3.49	3.40	3.49	3.43	3.51	3.42	3.31	3.09	3.3
Volume (M kwh), incl. trial run	1,123	1,267	1,559	1,674	1,938	1,940	1,578	2,073	2,073
Trial run (M kwh)	139	149	428	209	201	138	456	209	209
Reported COP (INR/kwh)	2.86	2.88	2.64	2.28	2.14	2.31	2.22	1.76	2.2
PLF (%)	85	48	59	42	49	49	40	53	39
<b>EBITDA (INR m)</b>	<b>222</b>	<b>152</b>	<b>-169</b>	<b>1,208</b>	<b>1,950</b>	<b>1,681</b>	<b>211</b>	<b>2,111</b>	<b>1,658</b>
Average EBITDA (INR/kwh)	0.2	0.1	-0.1	0.8	1.1	0.9	0.2	1.1	0.9

B. (Balco CPP + WPP)	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13	3QFY13	4QFY13	4QFY13E
<b>Revenue (INR m)</b>	<b>2,486</b>	<b>2,209</b>	<b>1,793</b>	<b>2,945</b>	<b>2,473</b>	<b>2,687</b>	<b>1,486</b>	<b>2,710</b>	<b>1,296</b>
Volume (kwh)	529	481	438	492	520	534	337	360	360
Balco 270MW Power Sales	424	387	382	412	338	346	275	282	282
HZL Wind Power (257MW)	105	94	56	80	182	188	62	78	78
Realization (INR/kwh)	4.7	4.6	4.1	6.0	4.8	5.0	4.4	7.5	3.6
Cost (INR/kwh)]	3.8	4.1	4.8	3.9	3.4	3.2	2.2	5.3	3.3
<b>EBITDA (INR m)</b>	<b>1,438</b>	<b>1,188</b>	<b>1,639</b>	<b>1,182</b>	<b>1,340</b>	<b>1,319</b>	<b>1,339</b>	<b>1,189</b>	<b>686</b>
(INR/kwh)	2.7	2.5	3.7	2.4	2.6	2.5	4.0	3.3	1.9

**High debt in merged entity concern us; Maintain Buy**

- STLT has a debt of INR190b (standalone INR100b + Balco INR43b + TSPL INR38b). Post merger with VAL and Sesa, the combined entity will have a consolidated debt of INR730b. The standalone-merged entity will have a debt of INR650b, while EBITDA will be only INR35-45b. We are concerned about the servicing of debt as the surplus funds with cash cows (HZL and Cairn India) are not fungible. Management continues to evade answering queries regarding the same. We believe SS will have to undergo another round of group restructuring to avail cash from its cash cows for servicing debt.

- STLT has high quality zinc, lead, silver, aluminum and power assets in strategic locations in India. The operating efficiencies are high. Setback in sourcing coal and bauxite has suppressed RoI of aluminum and power assets. Although the bauxite mine still remains a dream, the coal mine for Balco may be a positive trigger in the near term. The highly leveraged position of standalone-merged entity continues to concern us and drag SS' valuation.
- SS trades at attractive FY15E P/BV of 0.5x, PE of 5.1x and EV/EBITDA of 5x. We value the stock at INR114 (20% upside) based on SOTP. Maintain **Buy**.

**Sum-of-the-parts Valuation: SESA-STERLITE**

(INR Billion)

	Net Sales	EBITDA (A)	PAT	Net Debt (G)	Net Worth	Valuations Basis (B)	EV C=(AxB)	CWIP Disc(%) (D)	Equity Value (F) {C-G+D*(1-F)}	Stake Attrib. (%) Equity	INR/ share		
Stand-alone #	345	49	-13	703	372	5.0 x EBITDA	243	191	51	-367	100	-367	-124
Hindustan Zinc	129	61	66	-312	276	5.0 x EBITDA	307	4		624	64.9	405	137
Balco	43	7	3	56	25	5.0 x EBITDA	37	94	51	27	51	14	5
CMT+TSPL+inter seg.	19	5	-6	92	-559	5.0 x EBITDA	24	101	51	-19	100	-19	-6
Zinc International	45	13	10	-73	112	3.5 x EBITDA	44			117	100	117	39
Cairn India	164	91	64	-169	627	370 =Cairn TP(INR/sh)		93		704	59.0	415	140
	<b>745</b>	<b>226</b>	<b>124</b>	<b>298</b>	<b>852</b>			<b>483</b>			<b>SOTP</b>	<b>565</b>	<b>190</b>

Implied TP for Sterlite Inds (at Conv. Ratio of 3:5 ratio) 114 ; Implied TP for Sesa 190

Aluminium prices USD2,100/ton, Zinc = USD2,000/ton, lead prices = USD2,100/ton Silver = USD25/oz, USD/INR = 53; FY15 estimates

Source: MOSL # (VAL, copper TcRc, SEL, Sesa) TP = Target Price

### Conference call highlights: question regarding debt servicing of merged entity still unanswered

- **Sesa-Sterlite merger:** Sesa-Sterlite's proposed merger has been approved by the High Court of Bombay/Goa on April 3, 2013. The Madras High Court hearing is complete and order is expected soon.
- **Hindustan Zinc:** Reserves and resource base of HZL has increased, with a gross addition of 24.6mt of R&R, while depletion was 8.6mt. Total R&R of 348.3mt in FY13 will give more than 25 years of mine life. Cost of production is expected to remain stable due to higher targeted output in FY14. HZL is planning to produce 1mt MIC and 360tonnes of saleable integrated silver.
- **Zinc International:** Zinc and lead production was 102kt in 4QFY13. Improved realization and translation gain led to improved revenue and operating performance. Zinc International is targeting to produce 390-400kt zinc and lead in FY14 (426kt in FY13), lower than FY13 due a fall in production from Lisheen. Cost of production is expected to be USD1,100-1,200/t. Gamsberg project is still at evaluation stage and management will be better placed to disclose information in the next quarter.
- **Copper India:** 80MW captive power plant at Tuticorin was commissioned in 3QFY13 and has stabilized. The second 80MW CPP is expected to be commissioned in the current quarter. Tuticorin plant was shut on March 29, 2013 due to public complaints on emission. A two-member expert committee of NGT carried out inspection of the plant and is awaiting the verdict of the principal bench in New Delhi. Power plant is operating normally as it is not part of public complaints on emission. Separately, SC upheld STLT's appeal filed against HC order for Tuticorin smelter closure. It has to deposit INR1b with the Collector of Tuticorin for environment improvement.

- **CMT:** Australian copper mine added 5.4 million tonnes to their R&R, prior to depletion of 2.5 million tonnes. With a total R&R of 8.9 million tonnes of copper ore as on March 31, 2013, the mine life has been extended to around four years.
- **Aluminum - Balco:** The smelter produced 62kt of aluminum in 4QFY13. Revenue was higher due to higher premium and better product mix. Cost of production was higher YoY due to tapering coal linkage. 211mt coal block is in the process for diversion of forest. Expect to commence mining in end-2QFY14. 4x300 MW plant did not make any progress QoQ and is awaiting consent to operate.
- **Aluminum - VAL:** OMC is challenging the forest clearance cancellation by MoEF. SC has directed the state government to place the issue in front of Gram Sabha. The Gram Sabha would consider these claims and communicate to MoEF through the government of Orissa within three months. On conclusion of Gram Sabha's proceedings, MoEF shall take a final decision for grant of stage II forest clearance for the Niyamgiri mining project of OMC within two months.
- **SEL:** 4Q sales were higher due to higher power generation from the fourth unit, which was capitalized on March 31. It expects all four units to operate at 50-60% PLF, going forward. CoP declined QoQ due to higher linkage coal in the consumption mix and lower prices for e-auction coal. E-auction coal prices declined by 8-10% QoQ. Power realization suffered due to continued evacuation restriction on bilateral trade. SEL sold nearly 10-15% of power volumes through exchanges. It expects to commission the 1,000MW transmission line by 2QFY14. SEL's PAT was INR2.05b and EBITDA was INR8.26b for FY13.
- **Others:** Aluminum consumption is rising 6-7% pa globally, while it is registering a double digit growth in India. Company's aluminum operations are in the second quartile of global cost curve. STLT is targeting INR75b of capex in FY14 (INR10b contingent on VAL expansion).
- STLT has a debt of INR190b (standalone INR100b + Balco INR43b + TSPL INR38b). Post merger with VAL and Sesa, the combined entity will have a consolidated debt of INR730b. The standalone-merged entity will have a debt of INR650b, while EBITDA will be only INR35-45b. We are concerned about the servicing of debt as the surplus funds with cash cows (HZL and Cairn India) are not fungible. Management continues to evade answering queries regarding the same. We believe SS will have to undergo another round of group restructuring to avail cash from its cash cows for servicing debt.

## Sterlite Industries: an investment profile

### Company description

Sterlite Industries is a diversified play on three base metals. It has ramped up refined zinc and lead capacities to 1.06mtpa, which will fuel significant volume growth. Company is setting up a 2,400MW power project in Orissa, of which three units of 600MW each have already been commissioned, while the fourth unit is at synchronization stage. The project is in close proximity to coal mines and STLT will soon replace coal linkages with coal from its captive mines. Given its low cost of production and strong demand, the project will drive earnings. STLT has planned aggressive expansion in the aluminum business through its 51% stake in Balco and 29.5% stake in VAL.

### Key investment arguments

- STLT's earnings are likely to be driven by volume growth in the zinc and lead business. Zinc and lead smelting capacity, after expansion in FY12, is 1.064mtpa, and STLT is planning to expand its mining capacity to 1.2mtpa over the next six years. The 350tpa silver refinery that was commissioned in 3QFY12 is also adding to margins.
- Balco's 1,200MW power plant and 325ktpa Korba-III smelter will get commissioned in the next few quarters. Also, it received stage-II forest clearance for the 211mt captive coal block. Expanded aluminum capacity with captive coal block will also boost profitability, going forward.

### Comparative valuations

		Sterlite	Hindalco	HZL
P/E (x)	FY14E	5.4	4.6	7.7
	FY15E	6.1	4.8	7.8
P/BV (x)	FY14E	0.6	0.8	1.4
	FY15E	0.6	0.7	1.2
EV/Sales (x)	FY14E	0.6	0.7	1.9
	FY15E	0.5	0.6	1.6
EV/EBITDA (x)	FY14E	3.4	6.0	3.8
	FY15E	3.0	5.4	3.2

### Shareholding Pattern (%)

	Mar-13	Dec-12	Mar-12
Promoter	53.3	53.3	53.3
Domestic Inst	9.3	9.4	9.5
Foreign	27.7	27.5	24.8
Others	9.7	9.8	12.4

2 May 2013

### Key investment risks

Unexpected fall in base metal prices may affect profitability, as STLT derives significant profits from its mining business.

### Recent developments

The board declared a second interim dividend of INR1.2/share on April 29, 2013. The total interim dividend for FY13 is INR2.3/share, while there was no final dividend.

### Valuation and view

SS trades at attractive FY15E P/BV of 0.5x, PE of 5.1x and EV/EBITDA of 5x. We value the stock at INR114 (20% upside) based on SOTP. Maintain **Buy**.

### Sector view

**Zinc:** Zinc is our most preferred base metal due to favorable demand outlook and constraints in supply growth due to shortage of large scale low cost mines in the world. The current surplus in zinc capacity is expected to turn into deficit in two to three years due to a supply shortfall resulting from mine closures and lack of quality mine additions. We factor zinc and lead prices of USD2,000/t and USD2,100/t respectively for FY14E.

**Aluminum:** Aluminum prices were flat QoQ, while spot premium shot up to all-time high levels. Weak LME and high operating cost resulted in shutdowns of 2-3mt of smelter capacities recently. More than 30% of smelters are still making cash losses. Thus, we expect LME prices to improve from current levels. We factor aluminum prices of USD2,100/t in FY14E.

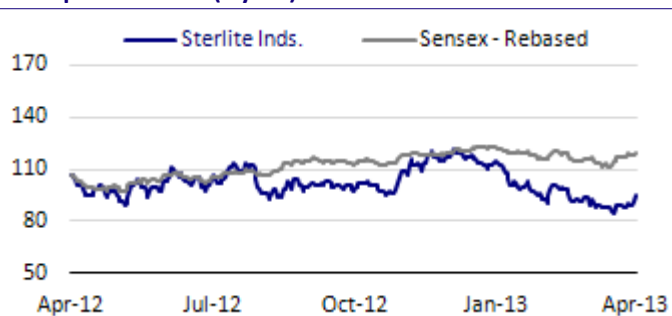
### EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY14	17.7	19.0	-6.6
FY15	15.6	21.1	-26.1

### Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
95	114	20	Buy

### Stock performance (1 year)







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