



# Sterlite Industries

BSE SENSEX	S&P CNX	CMP:INR172	TP:INR219	Buy
18,871	5,680			
Bloomberg	STLT IN			
Equity Shares (m)	3,361.2			
52-Week Range (INR)	196/149			
1,6,12 Rel. Perf. (%)	4/-2/-5			
M.Cap. (INR b)	579.6			
M.Cap. (USD b)	13.1			

Consolidated

- Sterlite Industries' (STLT) adj. cons. PAT declined 12% QoQ to INR15.3b (vs. est. of INR16.2b). Higher other income due to INR648m gain towards AS30 accounting and INR770m forex gain boosted PAT to INR16.4b. Higher than estimated losses at VAL, higher depreciation at Zinc International and higher tax rate led to below estimates results.
- The zinc segment's EBIT declined 17% QoQ to INR18.1b on higher raw material and stripping costs at the Indian business. Higher mined metal production by Zinc International contributed INR5.17b to the consolidated EBITDA.
- Aluminum production at Balco and VAL were 61kt (down 2% QoQ) and 112kt (up 4% QoQ) respectively. Both Balco and VAL cost of production (CoP) increased to USD1,981/ton (up USD200 QoQ) and USD2,344/ton (up USD255 QoQ) respectively due to higher coal costs.
- Sterlite Energy capitalized its second 600MW unit from 1 May 2011, thus volumes increased 97% QoQ to 1,123m kWh. However operating costs rose 36% QoQ to INR2.86/kWh due to a lower share of linkage coal.

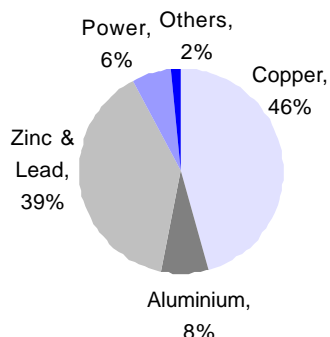
**Downgrading FY13 EPS by 7%; Sterlite Energy and VAL mounting losses cause concern:** (1) Though the generation and PLF of Sterlite Energy improved QoQ, profitability is uncertain due to rising coal costs and a weak merchant power market. (2) Rising coal cost and no visibility of bauxite mines continue to push COP of aluminum upwards, squeezing VAL's margins. (3) Upgraded FY12 EPS by 4% to INR20 due to stronger performance of Hindustan Zinc in 1QFY12. However we are cutting FY13 EPS by 7% to INR19.9 from INR21.5 due to (a) the reduction of the share of linkage coal assumption for Sterlite Energy from 55% to 25% (b) rising cost of production of alumina and aluminum at VAL due to higher bauxite and coal procurement costs and (c) possible delay in starting a captive coal mine at Balco. Maintain **Buy**.

Quarterly Performance (Consolidated)										(INR Million)	
Y/E March	FY11				FY12				FY11	FY12E	
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			
Copper cathode ('000 tons)	77	68	79	80	74	76	81	82	304	312	
Aluminum (BALCO, '000 tons)	63	65	65	62	61	66	67	63	255	257	
Aluminum (VAL, '000 tons)	77	97	103	108	112	119	122	124	385	477	
<b>Net Sales</b>	<b>59,703</b>	<b>60,844</b>	<b>83,325</b>	<b>100,561</b>	<b>98,607</b>	<b>97,540</b>	<b>100,326</b>	<b>104,755</b>	<b>304,432</b>	<b>401,227</b>	
Change (YoY %)	30.4	-0.7	23.5	39.1	65.2	60.3	20.4	4.2	23.3	31.8	
Total Expenditure	44,729	45,554	63,538	69,976	71,024	69,523	70,342	74,175	223,797	285,063	
<b>EBITDA</b>	<b>14,974</b>	<b>15,289</b>	<b>19,787</b>	<b>30,585</b>	<b>27,583</b>	<b>28,017</b>	<b>29,984</b>	<b>30,580</b>	<b>80,635</b>	<b>116,164</b>	
Change (YoY %)	46.7	12.0	11.7	39.9	84.2	83.2	51.5	0.0	27.1	44.1	
As % of Net Sales	25.1	25.1	23.7	30.4	28.0	28.7	29.9	29.2	26.5	29.0	
Interest	1,409	-3	705	776	1,740	1,864	1,864	2,077	2,887	7,545	
Depreciation	2,170	2,123	2,488	3,520	4,200	4,324	4,324	4,537	10,301	17,386	
Other Income	5,455	5,567	4,776	4,756	7,646	7,826	8,197	8,623	20,554	32,292	
<b>PBT (before XO item)</b>	<b>16,850</b>	<b>18,736</b>	<b>21,370</b>	<b>31,046</b>	<b>29,289</b>	<b>29,655</b>	<b>31,992</b>	<b>32,589</b>	<b>88,001</b>	<b>123,526</b>	
Extra-ordinary Exp.	1,460	212	-41	1,917	726	0	0	0	3,548	726	
<b>PBT (after XO item)</b>	<b>18,310</b>	<b>18,948</b>	<b>21,329</b>	<b>32,963</b>	<b>30,015</b>	<b>29,655</b>	<b>31,992</b>	<b>32,589</b>	<b>91,549</b>	<b>124,251</b>	
Total Tax	3,685	4,555	4,214	5,663	6,137	5,931	6,398	6,518	18,117	24,985	
% Tax	20.1	24.0	19.8	17.2	20.4	20.0	20.0	20.0	19.8	20.1	
<b>Reported PAT</b>	<b>14,625</b>	<b>14,392</b>	<b>17,115</b>	<b>27,300</b>	<b>23,878</b>	<b>23,724</b>	<b>25,594</b>	<b>26,071</b>	<b>73,432</b>	<b>99,267</b>	
Minority interest	3,756	3,853	5,081	7,255	6,420	6,132	6,951	7,043	19,945	26,546	
Loss/(profit) of Associates	785	247	1,023	795	1,061	887	871	854	2,850	3,672	
<b>Adjusted PAT</b>	<b>8,624</b>	<b>10,080</b>	<b>11,052</b>	<b>17,333</b>	<b>15,672</b>	<b>16,705</b>	<b>17,772</b>	<b>18,174</b>	<b>47,089</b>	<b>68,323</b>	
Change (YoY %)	28.2	2.6	10.0	25.5	81.7	65.7	60.8	4.9	16.5	45.1	
Avg LME Aluminium (USD/T)	2,122	2,110	2,357	2,531	2,618	2,500	2,500	2,500	2,280	2,500	
Avg LME Copper (USD/T)	7,042	7,180	8,674	9,500	9,163	9,000	8,500	8,500	8,099	9,000	
Avg LME Zinc (USD/T)	2,052	2,043	2,330	2,395	2,271	2,200	2,200	2,200	2,205	2,200	

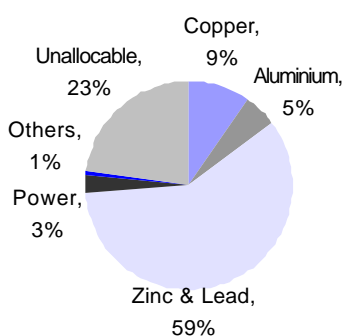
E: MOSL Estimate

STLT's 1QFY12 adjusted consolidated PAT declined 12% QoQ to INR15.3b (against our estimate of INR16.2b). Higher other income due to a INR648m gain towards AS30 accounting and INR770m from forex gains boosted PAT to INR16.4b. Higher than estimated losses at VAL, higher depreciation at Zinc International and higher tax rate led to below estimates results.

### 1QFY12 Revenue composition



### 1QFY12 EBIT composition



Source: Company/MOSL

### Revenue down 2% QoQ at INR98.2b, PBT down 9% QoQ at INR30b

- Zinc and lead contributed 39% to revenue and is the largest contributor to the EBIT with 59% share.
- Other income is the second largest contributor to EBIT with 23% share.
- Copper contributed 46% to revenue but only 9% to EBIT.
- Contribution from aluminum and power was 8% and 6% respectively to the top line and 5% and 3% to the EBIT respectively.
- Gross cash was INR230b and gross debt was INR130b.

### Zinc: EBIT down 17% QoQ at INR18.1b, largest contributor to profit

- Zinc International's zinc production increased 8% QoQ to 39k tons due to higher capacity utilization. Mined metal production at Black Mountain and Lisheen increased 82% QoQ to 80k tons.
- Zinc International's EBITDA increased 18% QoQ to INR5.17b due to higher mined metal production.
- The Indian zinc business EBITDA declined 19% QoQ to INR16b due to rising raw material costs (mainly coal) and higher stripping costs.

### Copper: Smelter margins superior, but mine profits down QoQ

- Copper cathode production declined 8% QoQ due to lower concentrate grade and reduced plant availability due to an unscheduled maintenance shutdown. Net cost of production was lower due to higher by-product credits and free metal.
- The copper smelter's EBITDA increased 14% QoQ to INR2.7b as net cost of production declined to -2.9US cents/lb due to higher by-product credits and improved metal recovery credit. TcRc on concentrate purchase improved 23% QoQ to 13.9US cents/lb. Realization EBITDA improved 31% QoQ to 38US cents/lb.
- Consolidated EBIT declined 2% QoQ to INR2.9b due to lower margins at Australian mines. Mine production however increased by 1,000 tons to 6,000 tons of MIC.

### Aluminum (Balco): Cost of production up USD200 at USD1,981/ton

- Balco's aluminum production declined 2% QoQ to 61,000 tons. Cost of production increased USD200 to USD1,981/ton due to higher coal costs.
- EBITDA fell 17% QoQ to INR1.9b and EBIT declined 18% QoQ to INR1.6b.
- First metal tapping from Balco's 325ktpa aluminum smelter line is expected by 4QFY12.

### Power: Sterlite Energy commissions 600MW unit, high coal prices eat into profits

- Revenue from power increased 176% QoQ to INR6.1b due to volume ramp up at Sterlite Energy. Average power rates rose 19% QoQ to INR3.6/kWh. Total power sales rose 140% QoQ to 1,652m kWh.

- Sterlite Energy capitalized its second 600MW unit on 1 May 2011. Consequently, power sales rose 97% QoQ to 1,123m kWh. Average PLF at 1,200MW was 47% in 1QFY12. The average rate was INR3.5/kWh and operating costs (at the EBITDA level) rose 36% QoQ to INR2.86/kWh due to higher coal prices. In 1QFY12 Sterlite Energy received 30% of coal through the linkage and it broke even at PBT level.

#### **VAL: Aluminum CoP increases; Quasi equity/debt at STLT up**

- Aluminum production rose 4% QoQ to 112,000 tons and was short of full capacity due to power outage. Production is likely to be impacted in 2QFY12, as well. STLT expects USD2m in costs for the repair of pots.
- Cost of production increased by USD255/ton QoQ to USD2,344/ton due to higher coal costs. Cost of production of alumina rose 9% QoQ to USD347/ton.
- EBITDA declined 15% QoQ to INR2.1b and loss before tax increased 33% to INR3.6b. Attributable to STLT, the losses were INR1.1b.
- Loans and advances from STLT in the form of quasi equity/debt to VAL increased 11% QoQ to INR89.4b to facilitate the return of INR10b ICD to Sesa Goa. Sterlite's loans and advances are higher than double its proportionate share.

#### **Downgrading FY13 EPS by 7%; Sterlite Energy and VAL mounting losses cause concern; maintain Buy**

- Although the generation and PLF of Sterlite Energy improved sequentially, profitability is uncertain due to rising coal costs and a weak merchant power market.
- Rising coal costs and no visibility of bauxite mines continue to raise cost of production of aluminum, squeezing VAL's margins.
- The other income was artificially boosted by interest income from loans and advances given to VAL. Since VAL's cash flows are unlikely to improve in near future, the risk of restructuring is mounting. VAL's reduction of its funding of quasi equity from STLT last year was a positive step towards equitable proportionate contribution. However, the reversal of this action in 1QFY12 with further funding of Rs9b to repay INR10b ICD to Sesa is concerning especially when Vedanta plc's ability to provide equitable quasi equity is reduced due to Cairn's acquisition.
- We have upgraded FY12 EPS by 4% to INR20 due to stronger performance of Hindustan Zinc in 1QFY12. However we are cutting FY13 EPS by 7% to INR19.9 from INR21.5 due to
  - (a) Reduction of share of linkage coal assumption for Sterlite Energy from 55% to 25%. Thus operating cost of power generation is expected to increase to INR2.38/kWh from INR2/kWh earlier and Sterlite Energy's PAT is cut from INR5.5b to INR1.8b.
  - (b) Rising cost of production of alumina and aluminum at VAL (due to higher bauxite and coal procurement costs) resulting in reduction of FY13 attributable PAT from INR1.2b to -INR919m.
  - (c) Possible delay in starting of captive coal mine at Balco. We have revised cost of power generation to INR2.2/kWh from INR2/kWh, cutting attributable PAT by INR1b to INR3.1b.
- The stock trades at a PE of 8.5x FY12E EPS and an EV of 6.2x FY12E EBITDA. **Maintain Buy.**

## Sterlite Industries: an investment profile

### Company description

Sterlite is a diversified play on three base metals. It is ramping up capacities to 1.06mtpa of refined zinc and lead, which will fuel significant volume growth. The company is setting up a 2,400MW power project in Orissa of which two units of 600MW each were commissioned in FY11. 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 production and strong demand, the project will drive up earnings. STLT plans to expand its aluminum business through its 51% stake in Balco and 29.5% stake in Vedanta Aluminium (VAL). STLT had cash of INR230b across the group as at June 2011.

### Key investment arguments

- STLT's earnings are likely to be driven by volume growth in zinc and lead business. Zinc capacity expanded by 200ktpa to 869ktpa, which will drive production of refined metal in FY12. Another 100ktpa lead smelter is expected to be commissioned in 2QFY12, which will drive lead and silver volumes.
- Balco's 1200MW power plant will be commissioned in FY12 along with a captive coal mine, which will lead to a quantum jump in profits because of low cost of production.
- Sterlite Energy's remaining two units will be commissioned in FY12, which will drive earnings.

### Comparative valuations

		Sterlite	Hindalco	Nalco
P/E (x)	FY12E	8.5	9.5	15.7
	FY13E	8.7	9.9	13.3
P/BV (x)	FY12E	1.2	1.7	1.7
	FY13E	1.1	1.5	1.5
EV/Sales (x)	FY12E	1.2	0.7	2.7
	FY13E	1.0	0.7	2.3
EV/EBITDA (x)	FY12E	6.2	6.4	10.0
	FY13E	4.9	6.3	7.9

### Shareholding Pattern (%)

	Jun-11	Mar-11	Jun-10
Promoter	53.2	52.8	52.8
Domestic Inst	8.3	8.6	8.0
Foreign	26.4	26.7	27.6
Others	12.2	11.9	11.7

### Key investment risks

- Unexpected fall in metal prices may adversely impact profitability.
- A delay in getting approvals for mining bauxite and coal may hamper earnings growth.

### Recent developments

- The board of directors of STLT approved a dividend of INR1.10/share (110% on face value of INR1 per share) for FY11.

### Valuation and view

- The stock trades at a P/E of 8.5x FY12E and EV/EBITDA of 6.2x FY12E. Maintain **Buy**.

### Sector view

- Base metal prices have been firm over the past few months due to expectation of improved demand from developed nations, strong demand from China and rising input costs. Rising energy costs are increasing costs of production of marginal players, which support high LME prices. Global surplus in zinc and lead narrowed in May, according to the figures from ILZSG. Zinc surplus declined from 43.6kt in April to 34.7kt in May and lead surplus declined from 46.1kt in April to 6.8kt in May. The expected additional quantitative easing in developed markets to support slow recovery will support base metal prices in the medium term.

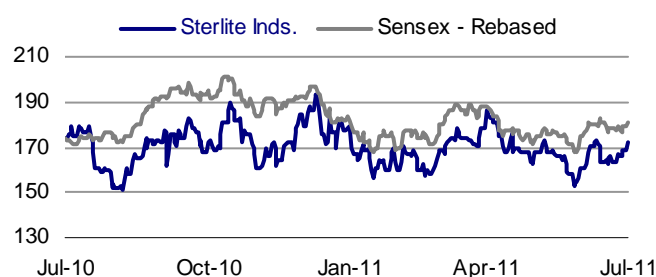
### EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	20.3	20.6	-1.2
FY13	19.9	24.3	-18.2

### Target Price and Recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
172	219	27.0	Buy

### Stock performance (1 year)



## Financials and Valuation

Income Statement (Consolidated)		(INR Million)			
Y/E March	FY10	FY11	FY12E	FY13E	
<b>Net Sales</b>	<b>244,103</b>	<b>302,481</b>	<b>401,227</b>	<b>433,418</b>	
Change (%)	15.4	23.9	32.6	8.0	
Total Expenses	183,386	223,790	285,063	303,688	
<b>EBITDA</b>	<b>60,718</b>	<b>78,690</b>	<b>116,164</b>	<b>129,730</b>	
Change (YoY %)	29.1	29.6	47.6	11.7	
As % of Net Sales	24.9	26.0	29.0	29.9	
Depn. & Amortization	7,498	10,301	17,386	19,945	
<b>EBIT</b>	<b>53,220</b>	<b>68,389</b>	<b>98,778</b>	<b>109,785</b>	
Net Interest	3,424	3,012	7,545	12,602	
Other income	19,594	26,528	32,292	26,490	
Dividend from subs.	-1,674	-2,743	-3,292	-3,840	
Dividend to minority	916	1,482	1,779	2,075	
<b>PBT</b>	<b>69,390</b>	<b>91,905</b>	<b>123,526</b>	<b>123,674</b>	
Current tax	11,083	15,041	20,981	21,661	
Deferred tax	1,247	3,075	3,672	3,894	
Tax	12,330	18,116	24,985	25,555	
Rate (%)	17.8	19.7	20.2	20.7	
<b>PAT</b>	<b>57,060</b>	<b>73,789</b>	<b>98,541</b>	<b>98,119</b>	
EO Income	2,970	568			
<b>Adj. PAT</b>	<b>54,091</b>	<b>73,220</b>	<b>98,541</b>	<b>98,119</b>	
Minority interests	17,241	19,945	26,546	30,349	
Share in Asso.	588	-2,850	-3,672	-919	
<b>Attrib. PAT</b>	<b>40,407</b>	<b>50,993</b>	<b>68,323</b>	<b>66,851</b>	
Change (YoY %)	16.0	26.2	34.0	-2.2	

Balance Sheet (Consolidated)		(INR Million)			
Y/E March	FY10	FY11	FY12E	FY13E	
Share Capital	1,681	3,361	3,361	3,361	
Reserves	368,439	410,993	476,103	539,265	
<b>Net Worth</b>	<b>370,120</b>	<b>414,355</b>	<b>479,465</b>	<b>542,626</b>	
Minority Interest	84,096	102,913	127,080	152,451	
Total Loans	92,600	117,287	147,287	147,287	
Deferred Tax Liability	15,524	21,736	25,408	29,302	
<b>Capital Employed</b>	<b>562,340</b>	<b>656,291</b>	<b>779,240</b>	<b>871,666</b>	
Gross Block	181,789	311,886	341,826	425,138	
Less: Accum. Deprn.	59,133	97,912	112,049	131,038	
<b>Net Fixed Assets</b>	<b>122,656</b>	<b>213,974</b>	<b>229,777</b>	<b>294,099</b>	
Capital WIP	110,844	121,501	144,166	78,634	
Investments	203,045	129,553	193,297	273,018	
Subsidiaries					
Associates	4,762	2,251	7,722	6,803	
Liquid invest.(of above)	198,283	127,302	185,575	266,214	
<b>Curr. Assets</b>	<b>175,114</b>	<b>279,391</b>	<b>288,080</b>	<b>308,631</b>	
Inventory	29,827	51,547	43,881	47,365	
Account Receivables	5,709	15,950	17,694	19,050	
Cash and Bank Balance	33,378	99,124	113,571	127,880	
Loans and advances	106,200	112,770	112,934	114,336	
<b>Curr. Liability &amp; Prov.</b>	<b>49,319</b>	<b>88,128</b>	<b>76,080</b>	<b>82,716</b>	
Account Payables	28,827	55,246	41,804	46,773	
Provisions & Others	20,492	32,883	34,276	35,943	
<b>Net Curr. Assets</b>	<b>125,795</b>	<b>191,263</b>	<b>212,000</b>	<b>225,916</b>	
<b>Appl. of Funds</b>	<b>562,340</b>	<b>656,291</b>	<b>779,241</b>	<b>871,667</b>	

E: MOSL Estimates

Ratios		(INR Million)			
Y/E March	FY10	FY11	FY12E	FY13E	
<b>Basic (Rs)</b>					
<b>EPS</b>	<b>12.0</b>	<b>15.2</b>	<b>20.3</b>	<b>19.9</b>	
Cash EPS	14.3	18.2	25.5	25.8	
BV/Share	110.1	123.3	142.6	161.4	
DPS	1.9	1.1	1.2	1.3	
Payout (%)	15.6	7.3	5.9	6.5	
<b>Valuation (x)</b>					
P/E	14.3	11.4	8.5	8.7	
Cash P/E	12.1	9.5	6.8	6.7	
P/BV	1.6	1.4	1.2	1.1	
EV/Sales	1.9	1.7	1.2	1.0	
EV/EBITDA	11.7	9.5	6.2	4.9	
Dividend Yield (%)	1.1	0.6	0.7	0.8	
<b>Return Ratios (%)</b>					
EBITDA Margins	24.9	26.0	29.0	29.9	
Net Profit Margins	22.2	24.2	24.6	22.6	
RoE	10.9	12.3	14.2	12.3	
RoCE	9.5	10.4	12.7	12.6	
RoIC	17.6	13.5	17.8	16.7	
<b>Working Capital Ratios</b>					
Fixed Asset Turnover (x)	1.3	1.0	1.2	1.0	
Asset Turnover (x)	0.4	0.5	0.5	0.5	
Debtor (Days)	9	19	16	16	
Inventory (Days)	45	62	40	40	
Working Capital (Days)	188	231	193	190	
<b>Leverage Ratio (x)</b>					
Current Ratio	3.6	3.2	3.8	3.7	
Interest Cover Ratio	15.5	22.7	13.1	8.7	
Debt/Equity	-0.2	0.0	-0.1	-0.2	

Cash Flow Statement		(INR Million)			
Y/E March	FY10	FY11	FY12E	FY13E	
EBITDA	60,718	78,690	116,164	129,730	
Non cash expenditure (inc)	1,135	357			
(Inc)/Dec in Wkg. Cap.	-8,487	-3,154	-7,519	128	
Tax paid	-11,549	-17,346	-20,981	-21,661	
<b>CF from Op. Activity</b>	<b>41,817</b>	<b>58,548</b>	<b>87,664</b>	<b>108,198</b>	
(Inc)/Dec in FA + CWIP	-61,819	-126,923	-52,605	-17,779	
(Pur)/Sale of Investments	-36,725	99,054	-63,744	-79,721	
Interest & Dividend Income	12,279	14,114	22,605	18,543	
Loans and advances	-65,445	4,827	1,229	265	
<b>CF from Inv. Activity</b>	<b>-151,710</b>	<b>-9,038</b>	<b>-120,837</b>	<b>-72,830</b>	
Equity raised/(repaid)	76,248	-16			
Debt raised/(repaid)	21,795	25,671	30,000		
Dividend (incl. tax)	-4,352	-5,018	-4,719	-5,112	
Interest paid	-5,469	-4,400	-7,545	-12,602	
Other financing activities			29,885	-3,344	
<b>CF from Fin. Activity</b>	<b>88,222</b>	<b>16,237</b>	<b>47,621</b>	<b>-21,059</b>	
<b>(Inc)/Dec in Cash</b>	<b>-21,671</b>	<b>65,747</b>	<b>14,448</b>	<b>14,309</b>	
Add. Opening Balance	55,048	33,378	99,124	113,571	
<b>Closing Balance</b>	<b>33,378</b>	<b>99,124</b>	<b>113,572</b>	<b>127,880</b>	

## Disclosures

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- |   |    |
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