Fullerton Securities

Result Update

January 27, 2012

STERLITE INDUSTRIES LTD — BUY

Sterlite Industries Ltd (SIL) reported results for the third quarter ended December 2011, which was below the street expectation. On a Y-o-Y basis, consolidated revenue edged up by 24% to Rs. 103bn, whereas net profit declined to Rs. 9bn due to foreign exchange losses.

The key takeaways from the result are

- Increase in revenue was aided by strong segmental growth in zinc and power business. Zinc segmental revenue increased by 37% and power segment revenue increased by 347% on Y-o-Y basis. Its main business copper revenue increased by 9% Y-o-Y.
- Total operating expenditure increased by 26% Y-o-Y, leading to decline in EBITDA margin by 126bps to 22%. Increase in operating expenditure was due to higher employee cost, power & fuel expenses and foreign exchange losses.
- During the quarter, the company successfully commissioned 350tpa silver refinery. This has lead to highest silver production reported by the company, which increased by 37% on Y-o-Y basis. The company is expected to ramp up the silver production to the rated capacity and its effect may be reflected in coming quarters.
- In Aluminum segment, 325 tonne aluminum capacity addition is progressing well and is expected to be commissioned by Q2FY13. Besides this, it also has a captive power plant of 1.2GW and its first unit of 0.3GW is expected to be synchronized by Q1FY13. In Zinc business, the company is planning to ramp up production at its silver rich SM Mine. For power segment, the company is setting up 2.6GW power project at Talwandi Sabo and the first unit is expected to be operational by Q4FY13.

Based on a consolidated FY13 EV/EBITDA multiple of 2, the fair value for the company works out to Rs. 134.

Recommendations	<= 1 year	1 - 2 yrs	2 - 5 yrs
Strong Buy			
Buy			
Hold			
Reduce			
Sell			

Strong Buy – *Expected Returns > 20% p.a.*
Buy – *Expected Returns from 10 to 20% p.a.*
Hold – *Expected Returns from 0 % to 10% p.a.*
Reduce – *Expected Returns from 0 % to 10% p.a. with possible downside risk*
Sell – *Returns < 0 %*

STOCK DATA	
BSE / NSE Code	500900 / STER
CMP Rs (25th January 12)	114
Market Cap (Rs mn)	382,842
52 Week High-low	190/ 86

STOCK RETURN (%)

	30D	3M	6M	1Y
Sterlite Industries Ltd	24%	-6%	-34%	-36%
Sensex	9%	-1%	-10%	-10%
Nifty	9%	-1%	-9%	-9%

During the quarter, the company has commissioned 350 tonne per annum silver refinery

The company continues to maintain a strong and liquid balance sheet, with cash and liquid investments in excess of Rs. 215bn

Financial Snapshot

Projections (Rs. Mn)	Q3FY11	Q3FY12	% chg	FY10A	FY11A	% chg	FY12E	FY13E
Net Revenue	83,325	103,037	*24%*	244,103	302,481	*24%*	381,272	419,952
Operating Expenditure	63,579	79,918	*26%*	188,337	230,016	*22%*	284,177	313,007
EBIDTA	19,746	23,119	*17%*	55,767	72,465	*30%*	97,095	106,945
EBIDTA %	24%	22%		23%	24%		25%	25%
PAT after MI	11,044	9,184	*-17%*	37,437	50,425	*35%*	55,499	63,754
NPM %	13%	9%		15%	17%		15%	15%
EPS Rs	3	3	*-17%*	11	15	*35%*	17	19
BVPS Rs				135	154	*14%*	177	203
ROE %				8%	10%		9%	9%
PER x							6.9	6.0
P/B Ratio							0.6	0.6
EV/ EBIDTA							1.9	1.4

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OTHER HIGHLIGHTS

Copper Segment: During Q3FY12, copper cathode production at the Tuticorin smelter was 7% higher at 84,000 tonnes compared with the corresponding prior quarter. Segmental revenue and EBITDA stood at Rs. 51bn and Rs. 4bn, an increase of 11% and 76% respectively, compared with the corresponding prior quarter, primarily on account of higher (treatment charge and refining charge) TcRcs, better margins on phosphoric acid sales, and positive impact of rupee depreciation. Contribution from Copper business to consolidated gross revenue declined to 48% during the quarter as compared to 54% in the same quarter last year.

Copper segment revenue increased by 11% Y-o-Y due to higher TcRc and higher by-product realization

Aluminum Segment: The Aluminum business is contributed by its subsidiary BALCO and associate Vedanta Aluminum Ltd (VAL). SIL owns 30% stake in VAL. The BALCO aluminum smelter continues to operate at its rated capacity, with production of 63,000 tonnes during the quarter. Revenue and EBITDA during the quarter were Rs. 8bn and Rs. 0.3bn respectively. EBITDA was lower on account of higher costs of production and lower LME prices, partly offset by the rupee depreciation. During the quarter, the cost of production (CoP) of hot metal produced was at Rs. 98,234 per tonne, representing an increment of 22% Y-o-Y. The increase in cost was primarily due to increase in costs of coal, alumina and carbon. VAL's alumina and hot metal production was higher by 61% and 4% Y-o-Y respectively and stood at 236 tonnes and 107 tonnes. Revenue and EBITDA for the quarter were Rs. 14bn and Rs. 1bn respectively. The CoP of hot metal stood at Rs. 0.1mn per tonne, which was 9% higher than the corresponding prior quarter due to higher coal and carbon costs. However, the CoP of hot metal was lower by 22% compared to Q2FY12 due to improved operational performance. VAL reported a net loss of Rs. 9bn on account of compressed margins and higher finance cost due to mark to market loss on foreign exchange fluctuation on borrowings. Segmental revenue contribution to gross revenue declined to 8% from 10% in same quarter last year.

Aluminum CoP increased due to higher cost of coal, alumina and carbon cost

Aluminum revenue contribution to gross revenue declined to 8% from 10% in Q3FY11

Zinc India Segment: Refined zinc production was up 7% at 190,946 tonnes, compared with the corresponding prior quarter primarily on account of improved throughput and operational efficiencies. Refined lead production was highest ever at 28,804 tonnes, up 102%, compared with the corresponding prior quarter. The increase in production was due to volume contribution from the newly commissioned 100kt Dariba Lead smelter. Refined silver production was highest ever at 57,595 kg, up 37% compared with the corresponding prior quarter. This was mainly attributable to higher input from the mines and volume contribution from the new 350tpa silver refinery commissioned during the quarter. Revenues and EBITDA for the quarter were Rs. 27bn and Rs. 14bn respectively. The decrease in EBITDA was mainly on account of lower LME prices, higher coal costs and manufacturing expenses, which more than offset the benefit of higher volumes and higher realization on account of rupee depreciation.

Zinc India business segment was the main driver of SIL's quarterly performance

Zinc International Segment: During Q3FY12, the international zinc assets produced 71,000 tonnes of mined metal and 34,000 tonnes of refined Zinc. Revenues and EBITDA were Rs. 10bn and Rs. 3bn respectively, a decrease of 11% and 35% respectively, compared with the immediately preceding quarter. EBITDA is lower on account of lower zinc and lead LME, partly offset by decrease in the production costs.

SIL is expected to have silver production of 500 tonnes for FY12

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OTHER HIGHLIGHTS (CONTD…)

Power Segment: From its subsidiary Sterlite Energy Ltd (SEL), power sales were 1,559mn units compared to 245mn units in the corresponding period last year. Higher power sales were mainly on account of sales from two 600MW units at the 2,400MW Jharsuguda power plants. Average power sales realization during the quarter increased by 27% on Y-o-Y basis to Rs. 3.4 per unit. Revenue from this segment was up by 365% to Rs. 6bn and contribution to consolidated gross revenue more than doubled to 6%.

Power segment revenue increased 347% Y-o-Y to Rs. 6bn due to higher sales volume and realization per unit

FUTURE OUTLOOK AND VALUATION

Future Outlook: SIL's future earnings are expected to be driven by SEL's power business and the zinc & lead business. It is expected that merchant power rate will increase due to poor condition of SEBs and lower capacity addition due to regulatory delays. Zinc & Lead business segment will lead the segmental growth due to capacity expansion in Lead and Silver capacity. Concern for SIL is basically the declining LME base metal prices, unfavorable currency movement and fuel security for the power plants. SEL has the coal linkage for the power supplies to grid but has no coal linkage for the other supplies. The newly announced Mines and Minerals Development and Regulation (MMDR) Bill, 2011 will have negative impact on SIL as the act proposes to pay 100% of the royalty on their production to project-affected people.

325 tonne aluminum capacity is expected to be added by Q2FY13 at BALCO

Valuation: Taking into consideration the domestic demand from infrastructure spending, Copper, Zinc, Lead and Aluminum segment are expected to perform well. We estimate SIL's revenues to grow at a CAGR of 18% over FY2011-13 to Rs. 420bn. We further estimate that PAT would grow at a CAGR of 12% over the same period to Rs. 64bn. **Based on a consolidated FY12 EV/EBITDA multiple of 2, the fair value for the company works out to Rs. 134.** Due to 34% correction in the stock in the last six months, we have upgraded our recommendation from HOLD to **"BUY"** rating for the stock.

Zinc, Lead and Silver segment is expected to drive revenue ahead

Financial Analysis and Projections

Particulars (Rs Mn)	FY09A	FY10A	FY11A	FY12E	FY13E
Net Revenue	211,442	244,103	302,481	381,272	419,952
Operating Expenditure	161,060	188,337	230,016	284,177	313,007
Depreciation	7,007	7,498	10,301	12,587	14,783
EBIT	43,375	48,269	62,164	84,508	92,162
EBIT Margin (%)	21%	20%	21%	22%	22%
Interest Expenses	3,973	3,424	3,012	7,526	2,063
Other Income	18,755	21,575	32,185	34,119	39,416
Profit Before Tax	58,158	66,420	91,337	111,101	129,515
Less: Tax	8,550	12,330	18,116	21,943	25,580
PAT after MI	35,400	37,437	50,425	55,499	63,754
PAT Margin (%)	17%	15%	17%	15%	15%
ROE (%)	11%	8%	10%	9%	9%
EPS (Rs)	11	11	15	17	19
BVPS (Rs)	96	135	154	177	203

Valuation Ratios (x)	FY12E	FY13E
P/E	6.9	6.0
P/B	0.6	0.6
EV/ EBIDTA	1.9	1.4