Emkay Research

Sterlite Industries India Ltd.

Event Update

Restructuring called off

26th Sep 2008

BUY

Price	Target Price
Rs477	637

Sensex – 13,547

Vedanta Resources has called off the Sterlite restructuring exercise in the wake of criticism from global investors. With the restructuring called off, we are now back to the same holding structure for the time being till a new scheme is announced. We understand, the management is likely to announce a new restructuring scheme which will merge all aluminum assets in one roof. With this, Sterlite minority shareholders will enjoy the proportionate benefit of the entire expansion under VAL as earlier. We are now rolling our valuation for Sterlite from FY09 to FY10 and factoring in the downturn in the base metals cycle. We maintain BUY on Sterlite due to the strong volume growth in zinc and lead business and likely closure of ASARCO deal by Dec as the matter is up for hearing on Nov 17 by the bankruptcy court of Texas. We have reduced our target price from Rs953 to 637 as global base metal valuation multiples have declined significantly over the last few months. At our target price, Sterlite will trade at EV/EBITDA of 3.2x FY10E, a discount of around 15% to the global base metals stocks.

Price Performance

(%)	1M	3M	6M	12M
Absolute	(22)	(33)	(34)	(33)
Rel. to Sensex	(17)	(29)	(22)	(17)

Source: Bloomberg

Stock Details

Sector	Metals & Mining
Reuters	STRL.BO
Bloomberg	STLT@IN
Equity Capital (Rs mn)	1417
Face Value (Rs)	2
Number of shares o/s (mn)	708
52 Week H/L (Rs)	1,140/405
Market Cap (Rs bn/USDmn)	338/7,322
Daily Avg Vol (No of shares)	2806523
Daily Avg Turnover (US$ mn)	34.7

Shareholding Pattern (%)

	30/6/08	31/03//08	31/12/07
Promoters	62.5	62.5	62.5
FII/NRI	24.6	23.5	24.2
Institutions	5.7	6.4	6.0
Private Corp.	1.6	1.9	1.7
Public	5.6	5.7	5.6

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Zinc cycle likely to bottom out ….

Over the last 3 months, zinc prices have dropped by 4%. Prices have slumped by 23% from the beginning of the fiscal year. Due to the depressed prices and expectation of zinc metal to continue in surplus in FY09 through FY10, many zinc miners have already announced closure of operations.

OZ Minerals Ltd., world's second largest zinc miner has announced a production cut of almost 50,000t of zinc metals due to falling prices. During the beginning of the year, International Lead and Zinc Supply (ILZSG) Group had forecasted a surplus of 215,000t for Zinc for CY08. Brook Hunt had similarly identified zinc metal to be in surplus to the tune of 251,000t. However, for the first seven months of the year from Jan to July, ILZSG has computed zinc metal to be in surplus of 77,000t. On an annualized basis, the surplus could be much lower than originally estimated by ILZSG. We believe at this rate, the surplus in the zinc market might wipe out faster than previously thought. However, the metal at LME might remain in the range of USD 1800 – 2000/t in order to discourage restarting of closed mines and/or smelters and keep the surplus in check.

But Aluminum likely to go down further…..

Aluminum at shanghai have hit 4yr low due to declining demand in China and rising stockpiles. Stockpile in Chinese warehouses have doubled since Jan '08 and demand continues to deteriorate. It is expected that there is a possibility of a large amount of production cut in China if aluminum prices are maintained at the current level. Aluminum prices in China are currently at 15,200yuan/t whereas a large number of custom smelters have production costs in excess of 17,000yuan/t. With the onset of winter season, energy costs are likely to shoot further and availability of cheap hydro electricity in the Sichuan province (which has a production capacity of 400,000t in its province) will also dry up further driving costs for the mini-smelters, triggering a wave of shut down, which will likely revive aluminum prices. Till then, we expect aluminum prices to continue to slide in the Chinese markets and consequently at LME also. For the period Jan to Aug 2008, China has produced 8.9mt of aluminum (yoy up 13%). One of the smelters in China, Aostar, has already announced shutdown of one-third of its smelting capacity of 125,000t. Aostar is one of the highest cost producers of aluminum in China.

We have factored average aluminum price of USD2,200/t for FY10 in our assumptions

ASARCO still not factored in our valuation

Sterlite will pay USD2.6bn in cash to buy out ASARCO. We have not factored the benefits arising out of this acquisition, as the matter is pending before bankruptcy court of Texas. The matter is due for hearing on 17th Nov '08.

Key changes in our assumptions are as under:

	Unit	Original Estimates		Revised Estimates		% change		Remarks
		FY09E	FY10E	FY09E	FY10E	FY09E	FY10E	
Price Assumptions								
Copper	USD/t	6,500	6,000	6,500	5,500	0.0%	-8.3%	negative outlook on copper prices
Zinc	USD/t	2,800	2,300	1,800	1,900	-35.7%	-17.4%	zinc cycle already in downturn
Aluminum	USD/t	2,400	2,300	2,500	2,200	4.2%	-4.3%	high inventory build up could lead to depressed prices
Volume Assumptions								
Copper	'000t	380	392	380	392	0.0%	0.0%	No change
Zinc	'000t	577.2	635.6	577.2	637.5	0.0%	0.3%	earlier than expected ramp up can lead to better utilization
Aluminum	'000t	333	343	333	343	0.0%	0.0%	No change
Net sales	Rs mn	219,789	205,406	215,736	201,203	-1.8%	-2.0%	
EBITDA	Rs mn	61,226	52,978	52,808	50,480	-13.7%	-4.7%	
Attributable PAT	Rs mn	38,833	35,130	37,554	36,486	-3.3%	3.9%	

Source: Emkay Research estimates

Key changes in valuations

Valuation Multiple	Valuation Parameter	Original Estimates		Revised Estimates		Remarks
		FY09E	FY10E	FY09E	FY10E	
Sterlite Standalone	EV/EBITDA	5.5x	5.5x	4.0x	4.0x	Based on the global peerset EV/EBITDA multiple
Hindustan Zinc	EV/EBITDA	7.0x	7.0x	3.5x	3.5x	EV/EBITDA multiple has fallen for zinc companies globally
BALCO	EV/EBITDA	6.5x	6.5x	4.0x	4.0x	Similar situation persists in Aluminum business also

Source: Emkay Research estimates

SoTP valuation

	Original estimates based on FY09E numbers	Revised estimates based on FY10E numbers	Remarks
Sterlite Standalone	177	149	Declining global valuation multiples
Hindustan Zinc	548	293	Declining global valuation multiples
BALCO	93	63	Declining global valuation multiples
Copper mines of Tasmania	13	14	DCF
Vedanta Alumina	19	15	Investment value per share
Sterlite Energy	103	103	DCF
Target Price	**953**	**637**	

Source: Emkay Research estimates

Valuation

Currently Sterlite is trading at EV/EBITDA of 2.4x our FY10 estimates, which includes assumptions of buyout of HZL and BALCO stake. We have not factored in Asarco buyout in our assumptions so far. The bankruptcy court will put forward the restructuring plan of ASARCO submitted by the management of ASARCO (along with Sterlite Ind) and Grupo Mexico (the erstwhile parent company of ASARCO) separately for voting by the creditors. The creditors will have the choice to either accept either of the two or reject both the plans. The court will start hearing from Nov 17, 2008 on the case.

At our target price, Sterlite will trade at EV/EBITDA of 3.2x FY10 estimates, a discount of almost 15% to the global base metal companies. We maintain BUY on the stock with revised target price of Rs637 with an upside of 34% from the current level.

Global base metals valuation

Name of the company	CMP in local currency	Net Sales	EBITDA	EBITDA Margin	Net Profit	Net Margin	Net Debt	total equity	EV	EV/EBITDA	Est. Forward P/E	Price/Book	RoE
CY08/FY09													
Alcoa	26	29,694	4,740	16.0%	1,984	6.7%	7,615	16,581	28,455	6.0x	10.3x	1.3x	12%
Antofagasta	491	2,445	1,707	69.8%	776	31.7%	-1,641	2,778	3,014	1.8x	6.2x	1.7x	27%
BHP Biliton	38	79,976	49,742	62.2%	29,124	36.4%	-10,748	67,567	199,925	4.0x	7.1x	3.1x	44%
CHALCO	5	90,264	15,018	16.6%	6,325	7.0%	30,738	17,397	49,085	3.3x	11.6x	1.1x	9%
Grupo Mexico	14	73,879	42,195	57.1%	19,238	26.0%	-11,780	58,417	90,854	2.2x	5.3x	1.8x	33%
Hindalco	110	738,123	72,016	9.8%	25,805	3.5%	191,643	239,272	382,460	5.3x	7.5x	0.8x	11%
Kagara	3	486	214	44.0%	115	23.7%	-20	414	666	3.1x	6.4x	1.7x	26%
Korea Zinc	111,000	2,405	619	25.7%	382	15.9%	-322	1,946	1,773	2.9x	5.4x	1.1x	20%
NALCO	416	61,021	30,134	49.4%	20,925	34.3%	-31,541	103,930	238,650	7.9x	13.0x	2.6x	20%
Rio Tinto	4,023	31,005	14,279	46.1%	7,353	23.7%	19,297	23,286	77,376	5.4x	7.6x	2.5x	33%
Southern Copper	23	5,960	3,516	59.0%	2,173	36.5%	-113	4,205	19,737	5.6x	9.1x	4.7x	52%
Sumitomo	1,216	980	151	15.4%	92	9.4%	75	668	782	5.2x	7.7x	1.1x	14%
Teck Cominco	36	7,891	4,015	50.9%	2,255	28.6%	76	9,360	15,757	3.9x	7.0x	1.7x	24%
Vedanta	1,527	5,358	1,833	34.2%	585	10.9%	-922	263,232	438,854	2.4x	7.7x	1.7x	0%
Xstrata	2,235	18,112	7,044	38.9%	3,625	20.0%	6,431	16,457	27,129	3.9x	5.7x	1.3x	22%
Average including Indian Cos				**23.4%**		**13.0%**				**4.4x**	**8.0x**	**1.8x**	
Average Ex-Indian Companies				**41.7%**		**21.3%**				**4.0x**	**7.7x**	**1.8x**	
Sterlite	477	215,736	52,808	24.5%	37,554	17.4%	-24,677	254,958	372,220	5.7x	9.0x	1.1x	13%
HZN	483	61,555	32,366	52.6%	27,138	44.1%	-27,958	142,730	175,977	5.4x	7.5x	1.4x	21%

Name of the company	CMP in local currency	Net Sales	EBITDA	EBITDA Margin	Net Profit	Net Margin	Net Debt	total equity	EV	EV/EBITDA	Est. Forward P/E	Price/Book	RoE
CY09/FY10													
Alcoa	26	30,913	5,897	19.1%	2,631	8.5%	6,398	19,130	27,237	4.6x	8.0x	1.1x	14%
Antofagasta	491	2,117	1,346	63.6%	643	30.4%	-1,723	3,091	2,933	2.2x	7.2x	1.5x	21%
BHP Biliton	38	73,872	39,774	53.8%	26,329	35.6%	-22,930	0	187,744	4.7x	7.4x	0.0x	0%
CHALCO	5	92,987	18,473	19.9%	7,336	7.9%	28,712	18,830	47,059	2.5x	9.9x	1.0x	10%
Grupo Mexico	14	83,647	48,065	57.5%	23,656	28.3%	-18,635	66,474	83,999	1.7x	4.4x	1.5x	35%
Hindalco	110	763,033	79,103	10.4%	28,662	3.8%	171,978	248,776	362,795	4.6x	6.9x	0.8x	11%
Kagara	3	460	218	47.4%	128	27.8%	-154	514	532	2.4x	5.4x	1.3x	25%
Korea Zinc	111,000	2,274	617	27.1%	413	18.2%	-571	2,313	1,524	2.5x	5.0x	0.9x	18%
NALCO	416	72,102	36,711	50.9%	23,909	33.2%	-49,445	125,189	220,746	6.0x	11.6x	2.2x	19%
Rio Tinto	4,023	33,345	16,802	50.4%	8,713	26.1%	12,474	32,141	70,553	4.2x	6.1x	1.8x	30%
Southern Copper	23	6,954	4,034	58.0%	2,455	35.3%	-217	5,018	19,633	4.9x	7.6x	4.0x	52%
Sumitomo	1,216	994	147	14.8%	94	9.5%	63	739	771	5.2x	7.1x	1.0x	14%
Teck Cominco	36	8,333	5,345	64.1%	3,174	38.1%	-1,120	11,747	14,561	2.7x	5.1x	1.3x	26%
Vedanta	1,527	6,571	2,135	32.5%	841	12.8%	-66	348,480	439,710	2.1x	5.1x	1.3x	24%
Xstrata	2,235	19,253	8,871	46.1%	4,952	25.7%	2,853	21,048	23,550	2.7x	4.2x	1.0x	23%
Average				**24.1%**		**13.6%**				**3.9x**	**7.2x**	**1.3x**	
Average Ex-Indian Companies				**21.6%**		**10.8%**				**3.8x**	**7.4x**	**1.3x**	
Sterlite	477	201,203	50,480	25.1%	36,486	18.1%	58,581	284,813	348,855	5.4x	9.3x	1.0x	11%
HZN	483	65,411	33,623	51.4%	28,702	43.9%	-47,585	167,971	156,350	4.7x	7.1x	1.2x	18%

Average prices over the last 9 quarters at LME (usd/t)

	Zinc	Copper	Aluminum	Lead
1QFY07	3,275	7,228	2,655	1,100
2QFY07	3,344	7,665	2,487	1,189
3QFY07	4,185	7,056	2,729	1,618
4QFY07	3,462	5,970	2,798	1,781
1QFY08	3,685	7,635	2,769	2,176
2QFY08	3,235	7,715	2,402	3,143
3QFY08	2,649	7,235	2,447	3,242
4QFY08	2,434	7,786	2,739	2,888
1QFY09	2,123	8,465	2,951	2,307
2QFY09 till date	1,788	7,755	2,814	1,912

Source: Bloomberg

Average inventory over the last 9 quarters at LME (t)

	Zinc	Copper	Aluminum	Lead
1QFY07	249,571	109,980	761,869	103,620
2QFY07	180,902	110,527	716,692	88,325
3QFY07	102,431	146,513	683,176	45,224
4QFY07	97,666	201,428	759,753	35,956
1QFY08	87,067	144,508	826,047	42,838
2QFY08	66,935	118,527	896,498	31,773
3QFY08	74,361	171,635	927,171	38,310
4QFY08	113,545	157,113	963,810	47,346
1QFY09	134,611	118,778	1,052,791	66,280
2QFY09 till date	157,879	158,316	1,154,523	87,379

Source: Bloomberg

While zinc inventory show signs of improvement, aluminum inventory continues to sell.

Base Metals –price performance at LME

	Current price (USD/t)	Fiscal ytd change		Calendar ytd change	
		Abs change	% change	Abs change	% change
Zinc	1,762	-535	-23%	-592	-25%
Copper	6,927	-1,547	-18%	286	4%
Aluminum	2,450	-460	-16%	92	4%
Lead	1,981	-781	-28%	-565	-22%

Source: Bloomberg

Base Metals – inventory levels at LME

	Current inventory (t)	Fiscal ytd change (Since 1st Apr '08)		Calendar ytd change (Since 1st Jan '08)	
		Abs change	% change	Abs change	% change
Zinc	156,625	32,650	26%	67,475	76%
Copper	201,050	89,700	81%	3,600	2%
Aluminum	1,363,225	331,175	32%	433,200	47%
Lead	67,575	18,250	37%	22,100	49%

Source: Bloomberg

Base Metals – inventory levels at Shanghai

	Current inventory (t)	Fiscal ytd change (Since 1st Apr '08)		Calendar ytd change (Since 1st Jan '08)	
		Abs change	% change	Abs change	% change
Zinc	71,214	145	0.2%	15,656	28%
Copper	17,072	-38,535	-69%	-8,525	-33%
Aluminum	194,765	17,318	10%	91,787	89%

Source: Bloomberg

Consolidated Financials

Income Statement Rs Mn

	FY07	FY08E	FY09E	FY10E
Gross Sales	261,930	268,723	230,995	215,566
Less: Excise	18,062	21,669	15,259	14,363
Net Sales	243,868	247,054	215,736	201,203
Other Income	6,817	15,661	12,611	13,762
Total Income	250,685	262,715	228,348	214,966
Raw Material Cons	137,152	153,545	150,105	137,361
% of Sales	56.2%	62.2%	69.6%	68.3%
Staff Cost	5,495	6,592	6,909	7,255
Other Expenses	6,632	8,234	5,914	6,107
Total Exp	149,280	168,371	162,928	150,724
EBIDTA	101,406	94,343	65,420	64,242
EBIDTA margin	41.6%	38.2%	30.3%	31.9%
Depreciation	8,039	5,950	9,267	10,014
EBIT	93,367	88,393	56,152	54,228
Interest	3,791	3,186	3,169	2,606
Extra ordinary exp.	1,572	528	0	0
PBT	88,004	84,679	52,983	51,622
Tax	24,733	21,027	12,824	12,713
ETR (%)	28.1%	24.8%	24.2%	24.6%
Minority Interest	19,042	19,500	2,606	2,423
Pref Div	1	0	0	0
Adj. PAT	44,229	44,152	37,554	36,486

Balance Sheet Rs Mn

	FY07	FY08E	FY09E	FY10E
Equity Capital	1,117	1,417	1,417	1,417
Res & Surplus	134,959	277,842	312,380	344,658
Networth	136,076	279,259	313,797	346,075
Total Debts	46,103	50,745	96,098	109,508
Net deferred lib	12,729	20,415	21,147	22,152
Capital Employed	194,909	350,420	431,042	477,735
Gross Block	126,414	145,637	151,239	161,739
Less Depreciation	-43,235	-45,883	-55,151	-65,165
CWIP	13,997	24,613	672	663
Net Fixed Assets	97,176	124,367	96,760	97,237
Inv & Associates	2,967	18,925	197,570	207,170
Inventory	28,092	33,341	27,787	26,614
Debtors	16,521	15,623	14,534	14,357
Cash	11,134	24,536	11,728	50,927
Marketable Sec.	49,252	144,016	109,047	109,047
Loans & Advances	34,846	33,135	20,279	18,308
Total Cur. Assets	139,846	250,650	183,374	219,253
Current Liabilities	21,399	19,941	23,080	22,344
Provisions	23,681	23,581	23,581	23,581
Total Cur. Lia. &Prov.	45,081	43,522	46,661	45,925
Net Current Assets	94,766	207,128	136,712	173,328
Total Assets	194,909	350,420	431,042	477,735

Cash Flow Statement Rs Mn

	FY07	FY08E	FY09E	FY09E
Pre-tax profit	88,004	84,679	52,983	51,622
Depreciation	8,039	5,950	9,267	10,014
Net Chg in WC	-38,142	-20,854	10,727	-9,125
Others	101	542	0	0
CFO	58,002	70,317	72,978	52,511
Capex	-19,718	-33,141	18,340	-10,492
Net Inv made	0	0	-178,645	-9,600
Others Inv Activities	-27,268	-110,721	34,969	0
CFI	-46,985	-143,863	-125,336	-20,092
Change in Sh cap	-1,441	80,620	0	0
Change in Debts	-5,499	5,117	45,353	13,410
Div. & Div Tax	-4,451	-387	-5,802	-6,631
Others	356	1,597	0	0
CFF	-11,035	86,947	39,551	6,779
Net Change in Cash	-18	13,401	-12,807	39,199
Cash Op Bal	11,153	11,134	24,536	11,728
Cash Cl Bal	11,135	24,535	11,728	50,927

Ratios

	FY07	FY08E	FY09E	FY10E
EBIDTA margin %	41.6	38.2	30.3	31.9
EBIT margin %	38.3	35.8	26.0	27.0
NPM %	18.1	17.9	17.4	18.1
Adj ROCE (%)	38.9	24.1	10.8	8.9
Adj ROE (%)	42.9	21.5	12.7	11.1
ROIC (%)	66.2	59.7	22.2	14.5
Adj EPS	79.2	62.3	53.0	51.5
Cash EPS	96.4	71.5	66.1	65.6
Book Value	243.6	394.2	442.9	488.5
DPS	5.8	4.0	7.0	8.0
Payout Ratio (%)	7.3	6.4	13.2	15.5
Debt Equity (x)	0.3	0.1	0.3	0.2
PE (x)	5.8	7.6	9.0	9.3
P/BV (x)	2.0	1.2	1.1	1.0
EV/Sales (x)	1.2	1.2	1.7	1.7
Div Yield (%)	1.2	0.8	1.5	1.7

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