

# Sesa Sterlite

*Higher EBITDA at Copper & HZL more than offset disappointment at Cairn*

**OUTPERFORMER**

29 October 2014

BSE Sensex: 27098

Sector: Metals

## Stock data

CMP (Rs)	255
Mkt Cap (Rsbn/USD bn)	757.0 / 12.3
<b>Target Price (Rs)</b>	<b>329</b>
Change in TP (%)	-3
<b>Potential from CMP (%)</b>	<b>+29</b>
<b>Core earnings change (%)</b>	
FY15E	-2
FY16E	+8
Bloomberg code	SSLT IN
1-yr high/low (Rs)	318/169
6-m avg. daily volumes (m)	8.25
1-yr avg. daily traded value (Rsm /US\$m)	2216.5 / 36.15
Shares outstanding (m)	2,964.7
Free float (%)	40.8
Promoter holding (%)	59.2

## Q2FY15 result highlights

- Consolidated EBITDA at Rs63.2bn came above, led by operational surprise at copper (Rs4.7bn) and HZL (Rs20bn, +48% qoq), more than offsetting disappointment at Cairn (Rs26.6bn, -15% qoq) and aluminum (Rs5.8bn, +10% qoq). Operating margins were down 65bps qoq at 32.4% (est. 31%).
- Adj. PAT at Rs17.1bn (-15% qoq) came above estimates of Rs14.2bn, on higher EBITDA and lower tax rate 15.1% (down 600bps qoq), even as minority interest was up 55% qoq at Rs15.3bn.
- Metal tapping at 84 pots at 0.325m tpa Korba III smelter was commenced, commissioning of 1,200MW CPP was delayed to H2FY15. Odisha state govt. has granted (PL) for 3 laterite deposits of bauxite to VAL. Consol net debt was flat qoq at Rs324.1bn.

**Key positives:** Higher than expected premium at aluminum and zinc international business; better power realization; lower conversion costs at copper smelter

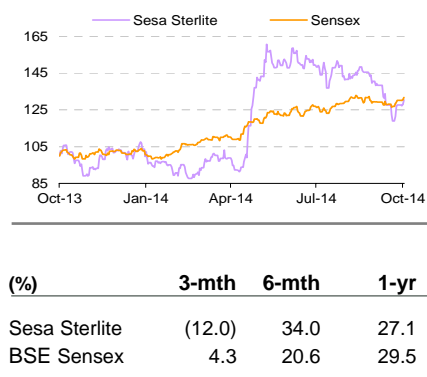
**Key negatives:** higher coal costs at aluminum and SEL; lower power sales

**Impact on financials:** We revise our FY15/FY16 EPS to Rs27.3/35, from Rs28/32.4. We introduce our FY17 EPS at Rs40.

## Valuations & view

We expect a 21% EBITDA CAGR over FY14-17E, on the back of (a) commissioning of aluminum capacity (both at BALCO & VAL), (b) improving PLF at power business, (c) restart of iron ore mining in Goa and ramp-up at Karnataka. Improving fungibility of cash (post HZL merger with SSLT) within the group, availability of captive bauxite mines and resumption of goa mining will be re-rating triggers. While rising coal costs is a near term headwind, we see operational efficiencies offsetting the same. Maintain Outperformer with a revised SoTP price target of Rs329/share.

## Price performance – relative and absolute



## Key financials

(Rs m)	Q2FY14	Q1FY15	Q2FY15	% ch qoq	% ch yoy	% var from est
<b>Net Sales</b>	<b>1,80,260</b>	<b>1,71,866</b>	<b>1,95,494</b>	<b>13.7</b>	<b>8.5</b>	<b>(1.7)</b>
<b>EBITDA</b>	<b>69,550</b>	<b>56,734</b>	<b>63,269</b>	<b>11.5</b>	<b>(9.0)</b>	<b>3.3</b>
OPM (%)	38.6	33.0	32.4	(60 bps)	(620 bps)	160 bps
Other inc.	4,590	12,803	9,461	(26.1)	106.1	45.8
Interest	14,730	15,371	14,716	(4.3)	(0.1)	(6.1)
Depreciation	13,980	20,644	20,033	(3.0)	43.3	(4.9)
PBT	45,430	17,248	37,078	115.0	(18.4)	19.7
Adjusted PAT	20,316	20,042	17,096	(14.7)	(15.8)	19.6
<b>Reported PAT</b>	<b>20,316</b>	<b>3,756</b>	<b>16,194</b>	<b>331.2</b>	<b>(20.3)</b>	<b>13.3</b>
EPS (Rs)	5.89	5.81	4.95	(14.7)	(15.8)	19.6

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## Quarterly results: Detailed

Particulars (Rs m)	Q4FY13	Q1FY14	Q2FY14	Q3FY14	Q4FY14	Q1FY15	Q2FY15
<b>Net Sales</b>	<b>1,95,230</b>	<b>1,43,610</b>	<b>1,80,260</b>	<b>1,94,143</b>	<b>2,08,944</b>	<b>1,71,866</b>	<b>1,95,494</b>
Growth (% yoy)	90.5	33.4	70.2	76.0	7.0	19.7	8.5
Total Expenditure	1,29,509	88,820	1,10,710	1,29,509	1,41,602	1,15,132	1,32,225
<b>EBITDA</b>	<b>65,721</b>	<b>54,790</b>	<b>69,550</b>	<b>64,635</b>	<b>67,342</b>	<b>56,734</b>	<b>63,269</b>
Non-operating other income	3,899	6,000	4,590	3,899	7,637	12,803	9,461
Interest	15,298	15,710	14,730	15,298	15,367	15,371	14,716
Depreciation	20,041	13,020	13,980	20,041	19,932	20,644	20,033
<b>PBT</b>	<b>34,281</b>	<b>32,060</b>	<b>45,430</b>	<b>34,281</b>	<b>38,008</b>	<b>17,248</b>	<b>37,078</b>
Tax	(1,385)	3,100	5,010	(1,385)	3,278	3,616	5,601
Reported Profit After Tax	35,666	28,960	40,420	35,666	34,730	13,631	31,477
Extra-ordinary Items +						16,273	902
Minority Interest	16,980	17,826	20,104	16,980	18,518	9,878	15,283
Share of profit from Associates	(3)	-	-	(3)	4	3	-
<b>Reported Profit After Extra-ordinary item</b>	<b>18,683</b>	<b>11,134</b>	<b>20,316</b>	<b>18,683</b>	<b>16,216</b>	<b>3,756</b>	<b>16,194</b>
Adjustments	19,643	-	-	-	2,210	16,287	902
<b>Adjusted Profit After Extra-ordinary item</b>	<b>38,326</b>	<b>11,134</b>	<b>20,316</b>	<b>18,683</b>	<b>18,426</b>	<b>20,042</b>	<b>17,096</b>
Growth (% yoy)	178.9	(17.5)	69.4	50.2	(51.9)	80.0	(15.8)

## Other highlights

- ♦ **Copper – lower CoP drives operational surprise:** Reported EBITDA came significantly higher at Rs4.7bn (up Rs3.7bn) led by higher TcRc at US\$20.8/lb (+10% qoq) and significantly qoq lower conversion costs which came at US\$3.1/lb (against US\$8.9/lb in Q1FY15). While copper cathode production at the Tuticorin smelter was in line at 100kt (+52% qoq), Australian mines continue to remain shut due to a mud-rush. Power sale from Tuticorin CPP was up 26% qoq at 183m units with a PLF of 94%.
- ♦ **Aluminum – cost pressure more than offset higher metal premium:** Total EBITDA came below at Rs5.8bn (+10% qoq), even as total aluminum production came above at 0.22mt (+10% qoq) and higher than expected metal premium which came at US\$563/t (est. US\$516). The above was led by higher power costs both at Korba and VAL, attributable to tapering linkage at BALCO and temporary power purchases at higher costs. Production at Lanjarh refinery was down 3%qoq at 226kt (+90% utilization) and is expected to achieve its optimal capacity in FY15. Sterlite expects H2FY15 CoP to come down from current levels due to higher linkage availability, given seasonal impact at CIL's production.
- ♦ SSLT has started the first phase of 50 pots of the 1.25 mtpa Jharsuguda-II smelter with the available surplus power from the 1,215 MW power plant, and subsequently plans to ramp up further capacity with power from the 2,400 MW power plant. However, SSLT needs to convert 2,400MW IPP at Jharsuguda from an IPP status to CPP status, which will facilitate power requirements of the smelter.
- ♦ Public hearing for Lanjarh refinery expansion (from 1m tpa to 6m tpa) has been completed and company is awaiting ruling from MoEF. Meanwhile govt. Of Odisha has granted PL for 3 laterite deposits of bauxite to VAL.
- ♦ Production at the 325kt Korba-II smelter continues to ramp up and produced around 19,000 tonnes during Q2 with 84 pots capitalized. The balance pots will be started subject to commissioning of 1,200MW CPP which has been again deferred and the company is working on the final stages of regulatory approvals. The SC's judgement in Sep-14 resulted in cancellation of 214 coal blocks (including BALCO).
- ♦ **Zinc India – higher production drives operational gain:** HZL's Q2FY15 adj. PAT (announced earlier), at Rs21.8bn (+35% qoq) came significantly above estimates of Rs17.6bn, on higher mined metal (Zn + Pb) volumes which came at 213kt (-3% yoy). The company guided for total mined metal production of 505kt (implying a ~20% growth) in H2FY15 (implying a flat yoy growth in FY15), against our conservative estimates of 490kt. Similarly, the company has guided for total silver sales of ~300t (flat yoy), against our estimates of ~290t.

- ♦ **Zinc International – in line:** Total EBITDA at Rs3.3bn (+42% qoq) came largely in line, with EBITDA/t up 51% qoq at Rs41,646/t (flat qoq). While metal sales came at 79kt (-6% qoq), average realization/t was up 21% qoq at Rs124,810 (est. Rs118,594). The company is in final stages of review of detailed feasibility studies at Gmasberg and studies at Skorpion and BMM to increase mine life and also evaluating to install a roaster at Skorpion refinery to treat sulphide ores is underway.
- ♦ **Power – higher fuel costs more than higher tariff:** Reported EBITDA came below at Rs2.6bn (-23% qoq), even as blended realization/unit positively surprised at Rs3.89 (+16% qoq). The negative surprise was led by (a) lower power sales at 2bn units (-22% qoq), attributable to operational issues at 4\*600MW Jharsuguda units (which have been rectified) and lower offtake by Tamil Nadu electricity board, (b) higher generation costs which came at Rs2.27 (+9% qoq), against estimates of Rs1.8. 4. The first unit of 660MW at Talwandi Sabo has been deferred by 3 months to Q3FY15.
- ♦ **Iron ore – awaiting for restart at Goa:** Reported EBITDA came above at Rs960m (+Rs490m qoq), even as sale of iron ore came below at 0.6mt (est. 1mt). The positive surprise was led by better than expected performance at pig iron business. Production and selling of iron ore in Karnataka remains shut since Aug-14, as it is awaiting forest clearance and mining lease renewal, which is expected to come in Q3FY15. At Goa operations remain suspended, Goa Government is working towards formulation of its mining policy following the Supreme Court order of March 2014, and SSLT expects operations to start in the second half of FY15 after obtaining the necessary approvals.

#### Sterlite – Production volumes

Production Qty	Q1FY14	Q2FY14	Q3FY14	Q4FY14	Q1FY15	Q2FY15	% qoq	% yoy
<b>Alumina</b>								
Lanjigarh -- VAL	-	1,16,000	1,81,000	2,27,000	2,33,000	2,26,000	(3)	95
<b>Aluminium</b>								
BALCO	61,000	63,394	63,394	65,000	71,000	84,000	18	33
Jharsuguda -- VAL	1,34,000	1,37,000	1,36,000	1,35,000	1,32,000	1,38,000	5	1
Copper - India/Australia					-			
Minned metal content	6,000	6,000	5,000	1,000	-		n.a	n.a
Copper Cathode	16,000	83,025	99,000	98,000	66,000	1,00,000	52	20
Refined Zinc	1,74,038	1,94,814	1,96,000	1,82,000	1,39,000	1,74,000	25	(11)
Refined Lead	33,000	28,978	25,000	38,000	20,311	24,238	19	(16)
Zinc International - AAL	90,000	1,06,000	84,000	83,000	84,000	79,000	(6)	(25)
Silver (kg)	77,000	83,000	72,000	68,000	56,000	67,000	20	(19)

## Income statement

Year to 31 Mar (Rs m)	FY13	FY14	FY15E	FY16E	FY17E
<b>Net sales</b>	<b>717,800</b>	<b>661,524</b>	<b>811,806</b>	<b>1,001,333</b>	<b>1,090,917</b>
% growth	75.2	(7.8)	22.7	23.3	8.9
Operating expenses	465,480	465,279	541,258	678,462	746,202
<b>EBITDA</b>	<b>252,320</b>	<b>196,246</b>	<b>270,549</b>	<b>322,871</b>	<b>344,715</b>
% change	150.7	(22.2)	37.9	19.3	6.8
Other income	29,530	20,735	46,954	44,503	49,962
Net interest	(48,180)	(50,944)	(67,456)	(75,998)	(75,478)
Depreciation	49,480	68,823	81,996	98,481	108,197
Pre-tax profit	156,600	108,032	168,050	192,896	211,003
Current tax	10,240	(8,469)	26,589	30,438	35,494
<b>Profit after tax</b>	<b>146,360</b>	<b>116,501</b>	<b>141,461</b>	<b>162,458</b>	<b>175,509</b>
Minorities	(73,730)	(51,228)	(60,432)	(58,588)	(57,224)
Net profit after n					
on-recurring items	72,630	65,273	81,029	103,870	118,284
% change	26.4	(10.1)	24.1	28.2	13.9

## Balance sheet

As on 31 Mar (Rs m)	FY13	FY14	FY15E	FY16E	FY17E
Paid-up capital	2,965	2,965	2,965	2,965	2,965
Reserves & surplus	677,162	727,122	844,514	870,287	893,153
Total shareholders' equity	1,013,920	1,068,059	1,287,729	1,359,840	1,427,551
Total current liabilities	156,205	184,087	207,763	235,355	262,555
Total debt	689,104	805,660	761,165	767,351	750,475
Deferred tax liabilities	41,199	41,813	69,899	70,271	70,718
Other non-current liabilities	41,199	41,813	69,899	70,271	70,718
Total liabilities	927,707	1,073,374	1,108,727	1,143,248	1,154,466
<b>Total equity &amp; liabilities</b>	<b>1,941,627</b>	<b>2,141,433</b>	<b>2,396,456</b>	<b>2,503,088</b>	<b>2,582,017</b>
Net fixed assets	986,572	910,948	1,158,219	1,184,197	1,184,946
Investments	61,866	2,084	109,723	69,362	19,417
Total current assets	364,062	635,099	599,387	720,401	848,526
Other non-current assets	529,128	593,302	529,128	529,128	529,128
Working capital	207,857	451,012	391,624	485,046	585,971
<b>Total assets</b>	<b>1,941,628</b>	<b>2,141,433</b>	<b>2,396,456</b>	<b>2,503,088</b>	<b>2,582,017</b>

## Ratio analysis

Year to 31 Mar (Rs m)	FY13	FY14	FY15E	FY16E	FY17E
Pre-tax profit	156,600	108,032	168,050	192,896	211,003
Depreciation	49,480	68,823	81,996	98,481	108,197
Chg in Working capital	169,169	(190,514)	84,725	(35,329)	(10,997)
Total tax paid	(10,240)	8,469	(26,589)	(30,438)	(35,494)
Ext ord. Items & others	41,199	612	28,089	372	447
Operating cash Inflow	406,209	(4,578)	336,271	225,981	273,155
Capital expenditure	(1,439,113)	39,506	(361,972)	(124,459)	(108,945)
Free cash flow (a+b)	(1,032,904)	34,928	(25,701)	101,522	164,210
Chg in investments	6,264	59,782	(107,639)	40,360	49,945
Debt raised/(repaid)	635,770	116,557	(44,495)	6,185	(16,876)
Capital raised/(repaid)	(396)	18,694	-	-	-
Dividend (incl. tax)	(4,581)	(15,404)	(19,123)	(24,513)	(27,915)
Misc	663,155	(65,036)	125,415	(65,462)	(79,436)
Net chg in cash	267,308	149,520	(71,543)	58,093	89,928

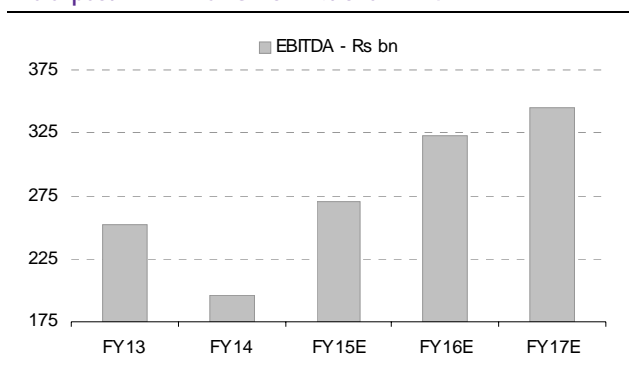
## Key valuation metrics

Year to 31 Mar	FY13	FY14	FY15E	FY16E	FY17E
EBITDA margin (%)	35.2	29.7	33.3	32.2	31.6
EBIT margin (%)	28.3	19.3	23.2	22.4	21.7
PAT margin (%)	10.1	9.9	10.0	10.4	10.8
RoE (%)	11.5	6.3	6.9	7.8	8.5
RoCE (%)	19.4	6.8	9.1	10.1	10.3
Gearing (x)	0.4	0.3	0.3	0.2	0.2

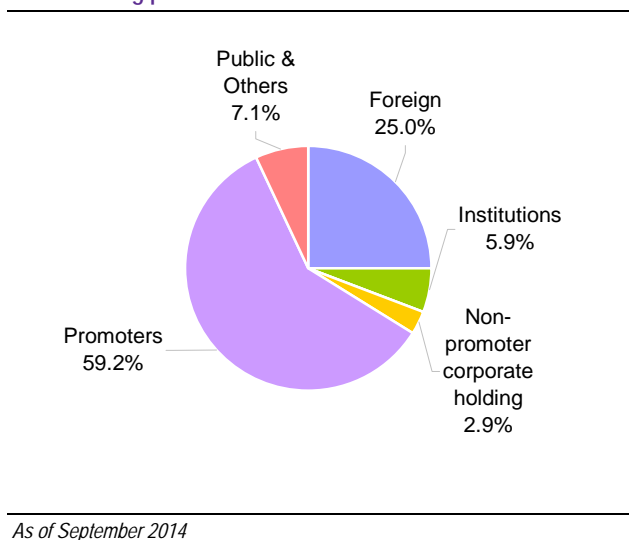
## Key valuation metrics

Year to 31 Mar	FY13	FY14	FY15E	FY16E	FY17E
Reported EPS (Rs)	24.5	22.0	27.3	35.0	39.9
Adj. EPS (Rs)	24.5	22.0	27.3	35.0	39.9
PE (x)	10.4	11.6	9.3	7.3	6.4
Price/ Book (x)	0.7	0.7	0.6	0.6	0.5
EV/ Net sales (x)	2.1	2.2	1.9	1.6	1.4
EV/ EBITDA (x)	5.8	7.4	5.8	4.9	4.4
EV/ CE (x)	0.8	0.7	0.7	0.7	0.7

## We expect EBITDA CAGR of 21% over FY14-17E



## Shareholding pattern



As of September 2014

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- |                   |   |   |
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