

# VEDANTA

## Partial closure of power plants: Marginal impact

India Equity Research | Metals and Mining

In our view, the temporary closure of Vedanta's (VEDL) 5 units of Jharsuguda power plant is unlikely to impact Q2FY18 production volume, though Cost of Production (CoP) of aluminum may be USD15-18/t higher due to external procurement of 200MW for balance quarter. Management stated that it has taken remedial measures and expects the plants to restart at the earliest. However, we will keep a close watch on events because if the closure extends, the impact could be material going ahead. Maintain 'BUY' with TP of INR350, implying exit multiple of 4.6x FY19E EBITDA.

### Impact on Q2FY18 EBITDA to be marginal

The State Pollution Control Board, Odisha (SPCB), has directed VEDL to close 3 units of 135MW each of 1,215MW power plant and 2 units of 600MW each of the 2,400MW power plant due to breach in the Ash Pond dyke wall in Jharsuguda in August end. We believe, the company can step-up PLF at remaining plants operating between 55% and 60% currently to 80-90% over balance quarter. This is likely to restrict the external power purchase to 200MW over this period, resulting in incremental impact of USD15-18/t on aluminium CoP.

### Quick resolution expected, but we remain watchful of events

The balance units of 1,215MW plant and 2,400MW plant have been permitted to operate until October 12, 2017, and September 20, 2017, respectively. VEDL has been directed to comply with certain conditions and submit an action plan within the next 5 days. We believe the company will be able to resolve the issue by Q2FY18 end and the plants will restart. However, if the closure extends beyond Q2FY18, the impact could be material as external power sourcing may be substantial and at elevated prices.

### Outlook and valuations: More sweeteners in store; maintain 'BUY'

We believe, the temporary partial closure of power plants at Jharsuguda will impact Q2FY18 EBITDA only marginally. We expect VEDL to maintain production volume as operating leverage benefits outweigh the impact of higher power cost in the short term. We will keep a close tab on events unfolding. We maintain 'BUY/SO' with target price of INR350/share.

### Financials

(INR mn)

Year to March	FY16	FY17E	FY18E	FY19E
Net revenue	679,927	761,713	837,870	932,456
EBITDA	151,516	213,319	272,234	303,359
Adjusted Profit	29,100	55,949	104,408	123,605
Diluted equity shares (mn)	2,965	2,965	3,717	3,717
Adjusted diluted EPS (INR)	9.8	18.9	28.1	33.3
EPS Growth (%)	(42.9)	92.3	48.8	18.4
EV/EBITDA (x)	9.4	6.1	5.2	4.3
ROAE (%)	(3.2)	12.8	15.4	15.3

### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

### MARKET DATA (R: VDAN.BO, B: VEDL IN)

CMP	: INR 320
Target Price	: INR 350
52-week range (INR)	: 335 / 159
Share in issue (mn)	: 3,717.2
M cap (INR bn/USD mn)	: 1,188 / 18,533
Avg. Daily Vol.BSE/NSE('000)	: 12,600.1

### SHARE HOLDING PATTERN (%)

	Current	Q4FY17	Q3FY17
Promoters *	50.1	62.9	62.9
MF's, FI's & BK's	13.3	7.0	7.0
FII's	17.7	16.3	16.8
Others	18.8	13.8	13.3
* Promoters pledged shares (% of share in issue)	:	NIL	

### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Metals Index
1 month	10.6	3.0	9.6
3 months	35.5	5.3	25.2
12 months	93.1	15.4	44.7

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### Company Description

VEDL is a subsidiary of Vedanta Resources, the London-listed metals and mining group. VEDL is a globally leading diversified resources company with presence in oil & gas, zinc-lead-silver (through 64.9% stake in HZL and 100% stake in erstwhile zinc-lead business of Anglo American), copper, iron ore, aluminium and commercial power (largely in standalone business but in subsidiaries as well). The company was formed through the merger of Sterlite Industries into Sesa Goa along with acquisition of additional 38.8% stake in Cairn which was consummated in August 2013 and announced in February 2012. Cairn has stakes in the following producing blocks: 70% in Rajasthan RJ-ON-90/1, 22.5% in Ravva and 40% in Cambay block CB-OS/2. In its largest field in Rajasthan, the gross proved & probable Hydrocarbons Initially In Place (HIIP) stands at 6 bnboe. The MBA fields have gross ultimate oil recovery of over 1 bnbbbls from primary, secondary and Enhanced Oil Recovery (EOR) methods. VEDL is the largest non-ferrous metals player in India with presence across all key base metals, viz. aluminium (0.8mtpa), copper (0.4mtpa) and zinc lead (1.0mtpa). The company entered the nonferrous metals sector as a pure play copper producer and through several strategic acquisitions acquired aluminium as well as zinc-lead assets. VEDL has ventured into commercial power generation business in India. It has a 2,400MW power plant (in Orissa) and is in the midst of adding another 1,980MW capacity (in Punjab). The company has iron ore mining assets in Goa and Karnataka (with reserves/resources of 433mt).

### Investment Theme

VEDL's portfolio of resources business provides advantages of scale, diversification and strong balance sheet. The company benefits from ownership of low cost, cash rich oil & gas (Cairn) and zinc-lead-silver (HZL) businesses. It has globally competitive unit production costs in zinc, led by its quality captive mines. This aspect will help the company better withstand margin pressures during price downturns. In addition, ramp-up of the 2,400MW power plant in Orissa and 1,980MW power plant in Punjab will boost power generation volumes. In FY17, we also expect iron ore volumes from Goa to ramp up post revocation of export duty and ramp-up in BALCO's aluminium business. Key potential triggers for the stock are the merger of Cairn, acquisition of Gol's residual stakes in BALCO and HZL (not considered in our estimates and valuation).

### Key Risks

- Fall in zinc prices or premiums.
- Decline in LME aluminium price or premiums
- Cairn: Exploration failure, reinvestment of cash generated into low return assets
- HZL: Lack of volume growth or increase in cash cost
- Lower than expected average tariffs.

## Financial Statements

### Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
<b>Macro</b>				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.0	67.5	66.0	66.0
<b>Sector</b>				
Aluminium LME (USD/t)	1,591.0	1,689.0	1,775.0	1,775.0
Zinc LME (USD/t)	1,829.0	2,366.0	2,600.0	2,650.0
Lead LME (USD/t)	1,768.0	2,368.0	2,200.0	2,250.0
Copper Tc/Rc (c/lb)	22.0	24.0	24.0	24.0
<b>Company</b>				
HZL-Zn production (tpa)	758,938	724,754	789,285	847,690
HZL-PB production (tpa)	145,000	153,550	160,950	166,500
HZL-Ag production (tpa)	425,000	488,750	513,188	525,000
SA-Cu production (tpa)	372,600	392,850	400,000	400,000
BALCO-Al production(tpa)	332,000	387,000	533,250	533,250
BALCO-Power sales (MU)	133	133	-	-
VAL-Al production (tpa)	592,000	786,000	785,000	950,000
Intl Zn production (tpa)	189	172	172	219
Intl PB production (tpa)	35	3	1	1
SEL-Power sales (MU)	7,319	5,803	5,803	5,803
HZL-Zn premium (USD/t)	214	359	357	350
HZL-PB premium (USD/t)	232	298	308	308
BALCO tariff (INR/unit)	3.5	3.5	3.5	3.5
SEL tariff (INR/unit)	3.1	3.2	3.3	3.3
HZL-mfg cost (INR/t)	52,060	69,742	67,117	67,927
BALCO-Power cost (INR/u)	3.3	3.5	3.5	3.5
VAL-Alumina cost (INR/t)	15,619	24,264	24,108	26,578
VAL-Smelting cost(INR/t)	64,560	75,928	74,734	86,296
Intl Zinc-cost (USD/t)	1,345	1,109	1,400	1,200
SEL-Fuel cost (INR/unit)	1.6	2.3	2.4	2.4
Employee exp growth (%)	(15.7)	(4.8)	5.0	5.0
Increase in SG&A exp (%)	17.4	8.3	(16.2)	8.0
Avg. Interest rate (%)	7.6	8.5	8.7	8.7
Depreciation rate (%)	7.6	4.3	4.9	4.4
Tax rate (%)	37.4	27.7	27.9	27.9
Dividend payout (%)	(11.8)	111.4	80.1	63.3
Net borrowings (INR mn)	107,318	218,131	62,190	(70,945)
Capex (INR mn)	54,119	54,360	75,169	75,169
Debtor days	16	14	14	14
Inventory days	138	147	139	139
Payable days	177	289	273	273
Cash conversion cycle	(22)	(127)	(120)	(120)

### Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Net revenue	679,927	761,713	837,870	932,456
Materials costs	217,931	231,085	284,431	326,215
Employee costs	24,583	23,393	24,563	25,791
Total operating expenses	528,412	548,393	565,636	629,097
EBITDA	151,516	213,319	272,234	303,359
Depreciation	85,724	62,915	78,459	77,173
EBIT	65,791	150,404	193,776	226,186
Add: Other income	44,435.6	45,805.9	35,348.12	33,303.22
Less: Interest Expense	57,781	58,550	57,144	57,978
Profit Before Tax	(285,402)	136,516	171,980	201,511
Less: Provision for Tax	(106,776)	37,783	47,942	58,438
Extraordinary item	(337,847)	(1,144)	-	-
Minority interest	(55,919)	43,584	19,630	19,468
Associate profit share	2	(27)	-	-
Reported Profit	(122,705)	55,122	104,408	123,605
Adjusted Profit	29,100	55,949	104,408	123,605
Shares o /s (mn)	2,965	2,965	3,717	3,717
Basic EPS (INR)	9.8	18.9	28.1	33.3
Diluted shares o/s (mn)	2,965	2,965	3,717	3,717
Adjusted Diluted EPS	9.8	18.9	28.1	33.3
Dividend per share (DPS)	4.1	17.7	18.0	18.0
Dividend Payout Ratio(%)	(11.8)	111.4	80.1	63.3
Tax rate (%)	37.4	27.7	27.9	27.9

### Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	77.7	72.0	67.5	67.5
Depreciation	12.6	8.3	9.4	8.3
Interest Expense	8.5	7.7	6.8	6.2
EBITDA margins	22.3	28.0	32.5	32.5
Net Profit margins	(3.9)	13.1	14.8	15.3

### Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	(7.8)	12.0	10.0	11.3
EBITDA	(31.3)	40.8	27.6	11.4
Adjusted Profit	(42.9)	92.3	86.6	18.4
EPS	(42.9)	92.3	48.8	18.4

## Metals and Mining

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	2,965	3,718	3,718	3,718	
Reserves & Surplus	437,427	601,284	699,029	822,634	
Shareholders' funds	440,392	605,001	702,746	826,351	
Minority Interest	365,611	139,279	158,909	178,377	
Short term borrowings	183,994	413,139	413,139	413,139	
Long term borrowings	493,784	302,551	269,551	236,551	
Total Borrowings	677,778	715,690	682,690	649,690	
Long Term Liabilities	56,100	75,340	106,099	106,099	
Def. Tax Liability (net)	32,508	20,837	20,837	20,837	
<b>Sources of funds</b>	<b>1,572,389</b>	<b>1,556,147</b>	<b>1,671,281</b>	<b>1,781,354</b>	
Gross Block	1,386,994	1,528,301	1,678,301	1,828,301	
Net Block	662,983	758,344	829,886	902,713	
Capital work in progress	279,260	176,709	101,878	27,046	
Intangible Assets	114,676	108,062	108,062	108,062	
Total Fixed Assets	1,056,918	1,043,116	1,039,826	1,037,822	
Non current investments	166,619	167,527	167,527	167,527	
Cash and Equivalents	570,460	610,119	733,060	833,195	
Inventories	80,117	96,279	120,837	128,174	
Sundry Debtors	25,279	34,093	31,215	41,466	
Loans & Advances	819	792	792	792	
Other Current Assets	52,100	38,370	38,370	38,370	
Current Assets (ex cash)	158,314	169,534	191,214	208,802	
Trade payable	161,624	184,591	241,547	247,193	
Other Current Liab	218,299	249,558	218,799	218,799	
Total Current Liab	379,923	434,149	460,346	465,992	
Net Curr Assets-ex cash	(221,609)	(264,615)	(269,132)	(257,190)	
<b>Uses of funds</b>	<b>1,572,389</b>	<b>1,556,147</b>	<b>1,671,281</b>	<b>1,781,354</b>	
BVPS (INR)	148.5	204.0	189.1	222.3	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	(122,705)	55,122	104,408	123,605	
Add: Depreciation	85,724	62,915	78,459	77,173	
Interest (Net of Tax)	36,164	42,346	41,214	41,816	
Others	127,565	1,429	(6,452)	2,327	
Less: Changes in WC	(77,021)	(17,959)	(4,517)	11,942	
Operating cash flow	203,769	179,770	222,147	232,978	
Less: Capex	54,119	54,360	75,169	75,169	
<b>Free Cash Flow</b>	<b>149,650</b>	<b>125,410</b>	<b>146,978</b>	<b>157,809</b>	

### Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Vedanta	18,533	11.4	9.6	5.2	4.3	15.4	15.3
Hindalco Industries	8,644	11.3	10.6	7.0	6.5	9.9	9.5
National Aluminium Co Ltd	2,439	17.4	15.4	9.7	8.1	8.5	9.1
Median	-	11.3	10.6	7.0	6.5	9.9	9.5
AVERAGE	-	9.6	8.7	7.2	6.3	11.3	11.3

Source: Edelweiss research

Cash flow metrics					
Year to March	FY16	FY17	FY18E	FY19E	
Operating cash flow	203,769	179,770	222,147	232,978	
Investing cash flow	(78,628)	27,106	38,460	36,415	
Financing cash flow	(113,081)	(123,490)	(168,425)	(169,259)	
Net cash Flow	12,061	83,386	92,182	100,135	
Capex	(54,119)	(54,360)	(75,169)	(75,169)	
Dividend paid	(32,218)	(96,726)	(78,281)	(78,281)	

### Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	(3.2)	12.8	15.4	15.3
ROACE (%)	7.0	13.3	15.3	16.2
Inventory Days	138	147	139	139
Debtors Days	16	14	14	14
Payable Days	177	289	273	273
Cash Conversion Cycle	(22)	(127)	(120)	(120)
Current Ratio	1.9	1.8	2.0	2.2
Gross Debt/EBITDA	4.5	3.4	2.5	2.1
Gross Debt/Equity	0.8	1.0	0.8	0.6
Adjusted Debt/Equity	0.8	1.0	0.8	0.6
Net Debt/Equity	0.1	0.1	(0.1)	(0.2)
Interest Coverage Ratio	1.1	2.6	3.4	3.9

### Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	0.4	0.5	0.5	0.5
Fixed Asset Turnover	0.9	0.9	0.9	1.0
Equity Turnover	0.8	1.0	1.0	1.0

### Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	9.8	18.9	28.1	33.3
Y-o-Y growth (%)	(42.9)	92.3	48.8	18.4
Adjusted Cash EPS (INR)	44.2	45.6	49.2	54.0
EV / Sales (x)	2.1	1.7	1.7	1.4
EV / EBITDA (x)	9.4	6.1	5.2	4.6

## Additional Data

### Directors Data

Anil Agarwal	Chairman Emeritus	Navin Agarwal	Executive Chairman
Kuldip Kaura	Interim CEO	Lalita D. Gupte	Non-Executive Independent Director
Ravi Kant	Non-Executive Independent Director	Naresh Chandra	Non-Executive Independent Director
Tarun Jain	Wholetime Director	Arun Kumar	Chief Financial Officer
Anuradha Dutt	Non-Executive Independent Director		

Auditors - Deloitte Haskins & Sells

### Holding – Top 10

	Perc. Holding		Perc. Holding
Life Insurance Corp of India	7.25	Birla Sun Life Asset Management	2.55
Dimensional Fund Advisors LP	1.90	HDFC Asset Management Co Ltd	1.57
Vanguard Group	1.50	Blackrock	1.34
Shalika Bhadram Janhit	1.19	HSBC	0.83
Reliance Capital Trustee Co Ltd	0.47	UTI Asset Management Co Ltd	0.46

*\*as per last available data*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

*\*in last one year*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
12 Apr 2017	Pravin Agarwal	Buy	18500.00
10 Nov 2016	Ankit Agarwal	Sell	36400.00

*\*in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Coal India	BUY	SO	M	Hindalco Industries	BUY	SO	M
Hindustan Zinc	BUY	SO	L	Jindal Steel & Power	BUY	SO	M
JSW Steel	REDUCE	SP	H	NMDC	HOLD	SP	M
Steel Authority of India	REDUCE	SU	M	Tata Steel	BUY	SO	M
Vedanta	BUY	SO	M				

### ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

### RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

### RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

### SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



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### Coverage group(s) of stocks by primary analyst(s): Metals and Mining

Coal India, Hindalco Industries, Hindustan Zinc, Jindal Steel & Power, JSW Steel, NMDC, Steel Authority of India, Tata Steel, Vedanta

#### Recent Research

Date	Company	Title	Price (INR)	Recos
12-Sep-17	Tata Steel	BSPS resolution: A potent value enabler; <i>Company Update</i>	683	Buy
08-Sep-17	Metals & Mining	Likely one-off surge in imports ; <i>Sector Update</i>		
04-Sep-17	Coal India	Robust volume spurt; <i>Company Update</i>	239	Buy

#### Distribution of Ratings / Market Cap

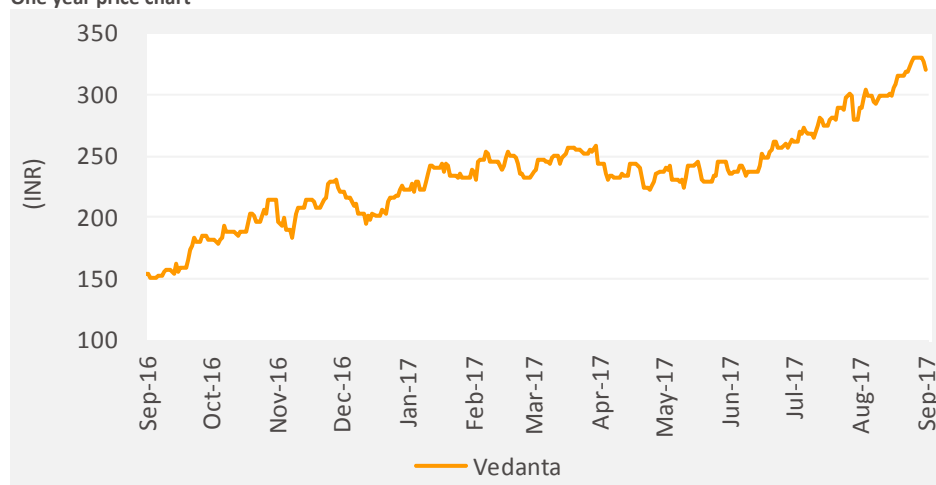
##### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

#### Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

#### One year price chart



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