

**Vedanta Ltd.****Delisting- Making the most out of the adversity****MARKET DATA – Vedanta Ltd.**

Networth (₹Cr)	54,635
P/BV Ratio (FY20) (x)	0.7
EBITDA FY20 (₹Cr)	20,687
Market Price (₹)	108
Enterprise Value (₹Cr)	60.367
Market Capitalisation (₹Cr)	41,300
EV/EBITDA	2.9X

AVERAGE MONTHLY VOLUME (in lakhs)

BSE	16.6
NSE	116.2

SHAREHOLDING PATTERN POST IPO

Promoters	50.1
FII	19.6
DII	17.3
Others	13.0

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The promoters of the commodity behemoth Vedanta Ltd. surprised the Street by announcing its intention to de-list its shares from the bourses amidst the peak of Covid-19 pandemic. However, on taking a closer look it can be deduced that this exercise does make sense, but for the promoters of the company. Here we are trying to gauge the underlying motives of the company to go for a de-listing during this time of crises.

Making the most out of this adversity:

Due to the Covid-19 pandemic, prices of metals and commodities like Brent Oil, Natural Gas etc. has seen significant erosion in their prices. In the month of March-April, when the lock down was at its peak globally, the prices of these commodities had plummeted to extraordinarily low level as shown in the below table.

Commodity	Price in Jan'20	Price in 15 th June	Change	Bottom in Mar'20	Change from Jan to Mar
Brent Oil	\$69/bbl	\$41/bbl	-40.5%	\$16/bbl	-76.8%
Aluminium	\$1819/MT	\$1590/MT	-12.6%	\$1450/MT	-20.2%
Steel	Rs.42,500/MT	Rs.37500/MT	-10.7%	Rs.35,000/MT	-17.6%
Zinc	\$2450/MT	\$2075/MT	-15.3%	\$1809/MT	-26.1%

- Along with the price erosion, the commodities company will also see their volumes declining by 30-40% during Q1FY20 and ~15-20% during Q2FY20 due to slowdown in activities across all sectors viz. automobile, infrastructure & construction, aerospace, etc. This will have a predictable adverse impact on the financials of these companies, which was reflected in their share price, which took a heavy beating.
- Vedanta's share price declined from Rs. 160 in the month of January to Rs. 60 in a span of two months, before it recovered to Rs. 80. We believe that the promoters are taking advantage of this fall to lap up the shares in their company at the bottom of the cycle valuations.

New dividend tax structure beneficial for the promoters of Vedanta Ltd.:

- The Union Budget of 2020 introduced new dividend tax structure in which the Dividend Distribution tax (DDT) was withdrawn, and dividend was made taxable in the hands of the recipient. This new dividend tax policy is beneficial to the promoter entity of Vedanta which is based in the UK.
- Earlier, when Vedanta declared dividends, it had to deduct DDT at 20.56% for which the Vedanta Resources (promoter entity) did not get tax credit in their country (UK). Further, as per the India-UK DTAA, the dividend between two countries is taxed at 10% in the hands of the recipient. Therefore, the effective tax rate for promoter entity was ~28.5%.
- Under the new tax structure, the DDT is withdrawn and Vedanta will deduct withholding tax at the rate of 20% while paying dividend to its promoter entity.
- However, Vedanta will be able to take credit of 10% for the dividend tax it has to pay in the UK, thereby reducing the effective tax incidence to only 10% compared to earlier 28.5%.



- Therefore, post the de-listing, Vedanta will be able to increase the dividend pay-out significantly as the tax burden on the same has come down.
- The promoter entity which is based in the UK is expected to borrow money to fund the buying of shares for de-listing. The idea is that they can borrow at a significantly lower rate in the UK whereas the dividend yield of Vedanta is ~10-12%. Thus, the dividend received from Vedanta will be enough for them to service their debt obligations.

Q4FY20 results makes promoters' intention clear

- A closer look at the Q4FY20 result highlights promoter's intention to drive down its book value:
 - Vedanta took an impairment of ~Rs. 17,300 cr for its Oil & Gas business unit (Cairn India). This brought down the company's book value by Rs. 46 per share.
 - We don't think this write off was warranted given that company ended FY20 with revenues of Rs. 12,661 cr and EBIT of Rs. 4,557 cr in its Oil & Gas BU.
 - Based on only one quarter of low oil price (Brent fell from ~\$50 to ~\$16 in Q1FY21), the company made this huge write down of nearly 45% of its investment value.
 - The management further stated that they were being conservative, and there is possibility of write-back in the future.
 - Further, the management also partly wrote off loan (amounting Rs. 200 cr) made to one of its promoter entities. It was only in Q3FY20, that the management had stated that it would recover the entire amount. Therefore, partly writing off this loan amount can only have one inference.
- The current book value of Vedanta is Rs. 146, and this can further come down post Q1FY21 results where the company is expected to post a loss. Since it is expected to be the worst quarter for a commodity company due to low prices and dismal sales volume.

Our View:

- We believe that the promoter's offer would settle anywhere Rs. 120-130 per share which is ~12-22% premium from CMP of Rs. 107, and it might be agreeable to even the shareholders. This price would be ~38-50% higher than the current offer of Rs. 87.5 per share.
- The Company couldn't risk to drive the prices much lower, else it might risk the failure of the de-listing exercise. And given the above motives which we have highlighted, we believe they wouldn't risk a failure and would settle for a price which would be agreeable to minority shareholders.

Valuation:

Particulars	Rs. cr
Hind Zinc FY22 consensus EBITDA	10,592
6.5X EV/EBITDA	68,850
Add: Net Cash	18,050
Total Equity Value	86,898
Vedl's 64.9% stake	56,414
Value after 25% holdco discount (A)	42,310
Value per share	Rs. 113.7/-
Vedl FY21E consensus EBITDA excluding HZL	9,860
6X EV/EBITDA	59,160
Net Debt	52,400
Vedl Equity Value ex HZL (B)	6,760
Value per share	Rs. 18.2/-
Combined equity value (A + B)	41,811
Value per share	Rs. 131.8/-

- The Mutual Funds, LIC and FII together make up for almost ~38% of Vedl's shareholding and they are unlikely to tender their shares at Rs. 87.5. And without their participation, the promoters, who hold 50.1% stake, cannot take their



shareholding to 90%. Therefore, we believe that the final counter offer by the company would be much above their indicated price.

- Even if the buy-back doesn't go through, we still believe that at this price Vedl is a good investment, and once the commodity cycle turns, it'll see sharp spike in its profitability.

Vedanta Ltd: Timeline for the proposed de-listing of shares:

- On May 18, Vedanta Limited's board approved the proposal by the promoter to delist the company.
- The promoter entity, Vedanta Resources (headquartered in the UK), has made an indicative offer of Rs 87.50 to buy out all the public shareholders in the company.
- Post this, the promoters will seek shareholder's approval (of 2/3rd of public shareholder) for the de-listing of shares. This is only for approval of de-listing and has nothing to do with the price. Accordingly, the promoters have sent postal ballot notice on May 25, 2020 and it'll take 4-5 weeks to complete the process.
- Once they get approval, they will file for reverse book building (RBB) process with the exchanges which takes another 2-3 weeks.
- After Exchanges accord their approval, the reverse book building exercise starts on the Exchange platform (5 working days). Shareholders quote a price at which they are willing to tender their shares, till a price is discovered that takes the promoter's shareholding to up to 90%.
- The promoter can accept or reject this price, and then can make a counter-offer within 2 working days.
- Within five working days from the closure of bid period, the promoters will make an announcement whether the de-listing process was successful or not.
- If the Delisting Offer is successful, the Promoter will be required to pay the consideration to shareholders within 10 working days of the closure of the bidding period.

De-listing guidelines in a glance:

- The floor price is fixed by the promoter based on 26 weeks' average traded price quoted on the stock.
- The offer price then shall be determined through book building process.
- The promoter is not bound to accept the price discovered through book building process and can make a counter offer within two working days of the price discovered.
- The counter offer price shall not be less than the book value of the company as certified by the merchant banker
- If the offer fails then no equity shares shall be acquired by the promoter and the shares deposited by the shareholder shall be returned back.



About the Company

Vedanta Limited is a natural resource company engaged in the business of exploration and production of aluminium, iron ore, zinc, copper, commercial power and oil and gas.

Description	FY18			FY19			FY20		
	Revenue	EBIT	EBIT M%	Revenue	EBIT	EBIT M%	Revenue	EBIT	EBIT M%
Total	92429	25470	27.6%	90901	16003	17.6%	83545	12173	14.5%
Aluminium	23409	2904	12.4%	29208	399	1.4%	26577	175	0.7%
Copper	24975	1308	5.2%	10739	-438	-4.1%	9053	-509	-5.6%
Iron Ore	3148	460	14.6%	2903	474	16.3%	3463	777	22.4%
Oil and Gas	9536	5429	56.9%	13223	5164	39.1%	12661	4557	36.0%
Others	268	27	10.1%	4978	584	11.7%	4782	-1	0.0%
Power	5500	1669	30.3%	6456	832	12.9%	5860	979	16.7%
Zinc, Lead & Silver	22147	12258	55.3%	20656	8719	42.2%	18159	6448	35.5%
Zinc International	3446	1415	41.1%	2738	269	9.8%	3128	-253	-8.1%

Updates on recent operating performance:

- Aluminium cost reduced which helped in containing losses due to sharp fall in LME prices:
 - Linkage to coal and availability of bauxite helped in reducing cost of aluminium production. With the commodity prices trending lower and reforms in the coal sector, the availability of bauxite and coal will continue to remain abundant.

Aluminium	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20
Cost per tonne (\$)	2025	1810	1764	1852	1691	1693
Average ASP (\$)	2135	1989	2043	1949	1957	1823
Spread	110	179	279	97	266	130
Volume	503,000	481,000	470,000	476,000	483,000	474,000

- Besides input cost, efficiency in production and savings in logistics cost also helped in bringing down cost/tn. Thus, recovery in aluminium prices will trickle down straight to company's contribution.
- Ramp up in Zinc to hit because of Covid-19 slowdown:
 - Surplus in zinc market has lead to sharp correction in Zinc LME prices from \$3587 per MT to \$1880 per MT from Dec 18 to Mar 20. (Even till Jan 20 the prices were \$2400)
 - Zinc Int'l: Company had targeted producing 20,000 MT p.m. (240,000 MT p.a.) in its Gamesberg mines, but it's run-rate was stuck at 8000-9000 MT and this might further go down post March leading to lower cost savings which the company anticipated on higher volume.
 - Zinc Volume

Particulars	FY19	FY20	YoY%
Zinc India (MT)	696,000	688,000	-1.1%
Zinc Int'l (MT)	108,000	178,000	64.8%

- Zinc Int'l qtrly run-rate had increased from 27,000 MT to 46,500 MT post increase in Gamesberg mine capacity from Q4FY19. Further ramp-up will be hindered now.

- Zinc operating metrics:

Q/E	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20
Zinc ASP per \$/tn	2,957	3,012	2,589	2,583	2,335
Zinc cost per \$/tn	987	1,067	1,048	1,077	997
Spread	1,970	1,945	1,541	1,506	1,338



- Oil & Gas:

- Operating metrics:

Q/E	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20
Daily production (bopd)	118,000	115,000	115,000	172,000	161,000
Avg crude price per bbl (\$)	62	67	61	55	49

- Company's current cost of production is \$7-7.5/bbl which it expects to bring down to \$6-6.5/bbl if it is able to scale further (more than Q3FY20 daily run-rate)
 - The recent OPEC-Russia-USA deal would provide much required cushion on the downside risk crude, and post the Covid recovery, we might see crude trending back upto \$40-45.
 - Wrote off Rs. 17,100 cr on conservative basis, which is ~45% of investments made in this business. Possibility of write back going ahead.

- Copper Smelter at Tuticorin: The case is pending at Madras HC. The matter has been argued by both sides and the judgment has been reserved. The company expects favourable judgment.

Risks & Concerns:

- Corporate Governance issues: Over the years, many Corporate Governance issues have emerged in Vedanta Ltd:
 - During the e-listing of Sesa Goa.
 - In the past, the group has undertaken related party transactions bypassing shareholder approval:
 - Related party transaction worth Rs. 8000 cr between Cain India and Sesa Sterlite.
 - In 2018, Vedanta paid cash worth \$200 mn to promoters who sold their personal investments to the company to get an exit.
- Price of the shares may languish if the de-listing offer fails and promoter resorts to poor Corporate Governance standards to keep its intentions alive. It'll create an uncertainty and overhang on the stock. Essar Oil took seven years to de-list since its first offer and during that tenure its share price under-performed starkly.



Financial Highlights:

Vedanta Ltd. Financial Highlights -Consolidated					
Particulars	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20
Net Sales	64261.8	72225.0	91866.0	92048.0	86957.0
EBITDA	15064.3	21331.0	24862.0	23070.0	20687.0
EBITDA Margin	23.4%	29.5%	27.1%	25.1%	23.8%
Other Income	4530.9	4582.0	3205.0	4051.0	2510.0
Interest	5778.1	5855.0	5112.0	5689.0	4977.0
PBT before exceptional item	5244.6	13766.0	16672.0	13240.0	9123.0
Exceptional Items	-33784.7	-114.0	2897.0	320.0	-17382.0
PBT post exceptional item	-28540.2	13652.0	19569.0	13560.0	-8259.0
Tax Rate	37.4%	17.1%	30.0%	28.5%	NA
PAT	-17862.6	11319.0	13692.0	9698.0	-4744.0
Net Worth	44039.2	60345.0	63135.0	62048.0	54635.0
Total Debt	67777.8	71569.0	58159.0	66226.0	56321.0
Cash & Investments	57094.8	61085.0	33916.0	41434.0	37254.0
Cash Flow from Operations	20376.9	18083.0	17366.0	23754.0	19298.0
Cash Flow from Investing activities	-7862.8	2711.0	15396.0	-10530.0	-5894.0
Cash Flow from Finance activities	-11303.0	-12425.0	-39255.0	-10242.0	-15547.0
Debt to Equity(x)	1.5	1.2	0.9	1.1	1.0
ROCE (incl OI)	-18.7	16.0	19.5	15.4	13.9
RONW(%)	-36.6	21.7	22.2	15.5	NA
Close Price (Rs. per share)	89.9	274.7	278.3	183.8	106.0
Market Capitalization	26655.4	102188.4	103527.6	68355.0	37953.0
Adjusted EPS	-41.4	18.7	27.8	19.0	NA
BV per share	148.5	162.2	169.7	166.8	146.9
Price / Book Value(x)	0.6	1.7	1.6	1.1	0.7
Equity Dividend %	350.0	1945.0	2120.0	1885.0	NA
Dividend Yield %	3.9	7.1	7.6	10.3	NA
PE (x)	-2.2	14.7	10.0	9.7	NA



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