

New debt versus tax shield and possible synergy

Given that the London-based Vedanta's share prices rose 2.9% since it restructured its group companies last week while the shares of the India-based Sterlite and Sesa Goa fell 2.5% and 10.4%, respectively, it's pretty obvious who the market thought was the winner and who the loser of the complex deal that saw Vedanta transfer its shareholdings in companies like Sterlite, Sesa Goa, Cairn India (all listed firms) as well as those in Vedanta Aluminium Ltd (VAL is unlisted) to a new company SesaSterlite. Sterlite's holdings in firms like Hindustan Zinc and Balco have also been transferred to SesaSterlite. The reasons for the restructuring are obvious. One, it helped Vedanta clean up its vastly leveraged balance sheet and, two, the group's firms in need of cash or with large amounts of debt were different from the ones generating the cash. In that sense, apart from creating the world's seventh-largest natural resources company (BHP Billiton's earnings of \$23.1 billion are the top versus SesaSterlite's \$2.4 billion), the restructuring gives the group a much cleaner operating structure which will make decision making faster—in addition, the management feels R1,000 crore of tax synergies created by the losses of Vedanta Aluminium will help lower tax outgo.

The big worry for shareholders of Sesa, despite the 3:5 swap (Sesa will issue 3 shares for every 5 shares of Sterlite) is the large amounts of debt taken on due to the restructuring. Vedanta has, for instance, transferred its 38.8% stake in Cairn India to SesaSterlite at \$1, but this comes along with a debt of \$5.9 billion taken on to fund the Cairn acquisition. In addition, Vedanta has transferred its 70.5% stake in Vedanta Aluminium to SesaSterlite for R2,330 crore—apart from the valuation being a source of concern given the Orissa project continues to remain stuck in all manner of environment issues (the application for the bauxite mine at Niyamgiri has been rejected and the expansion of the alumina refinery has been stopped), the company has accumulated losses of around R5,000 crore. This, the management says, will actually help as it is a tax shelter that SesaSterlite can use immediately. While broking firm CLSA seems to feel the restructuring has been broadly done in a fair manner and will not raise the kind of concerns the proposed 2008 restructuring did, Kotak has been a lot more negative in saying "Sterlite and Sesa's loss is VED's (Vedanta) gain". Kotak computes the value loss to Sterlite at R18 per share or R6,100 crore and says Vedanta Aluminium can't hope to make profits for around 3-5 years. For shareholders who have to give their assent to the deal, it's a call between immediately greater debt levels and servicing concerns versus the long-term vision promised based on synergies and tax shields. Given how the group took over 18 months to sort out its problem with the government over the Cairn acquisition, and only after both it and Cairn took a big hit, the management's timeline for getting the Competition Commission of India's

approval seems a bit optimistic.