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Morgan Stanley India Company Private Limited+

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Stock Rating
Overweight

Industry View
Attractive

Initiation

Sterlite Industries (India) Limited

Mining Powerhouse; Initiating with Overweight

Conclusion: We are initiating coverage on India's most diversified mining company with an Overweight rating. Our price target of Rs742 implies 21% potential upside. Key reasons for our positive stance are well chalked-out growth plans, captive sources of raw materials and our forecast of firm nonferrous metals prices.

Impressive growth plan to build on raw materials advantage: We estimate Sterlite's production CAGR in the next three years of 9% for copper, 22% for zinc, 14% for aluminum, and from zero to 922,000 tons for alumina in F10. The company is undertaking a cost-cutting program, aided by process enhancements and improved raw material links for its various businesses.

Consolidation of minorities in HZL and Balco could be value-accretive: Sterlite has already exercised the option to purchase the government's 49% stake in Balco and is in the process of doing so for its 25% stake in HZL. We believe that the stake purchases have a high probability of taking place and can be strong positive triggers for stock performance.

Strong metals prices: With the froth removed, metals prices now look firm from a medium-term perspective, although some short-term volatility is still possible. Our view is based on greater demand growth and supply constraints.

Valuations suggest strong upside potential: At a F08E P/E of 8.3x, Sterlite is trading at a discount of 14% to peers. The market doesn't appear to recognize the company's multi-faceted growth opportunities, or its strong project execution track record.

Our bullish view would change on signs of problems with the planned stake purchases, undisciplined output in the industry, increasing metals surplus in China, and further delays in the bauxite mine allocation.

Key Ratios and Statistics

Reuters: STRL.BO Bloomberg: STLT IN
India Nonferrous Metals & Mining

Price target	Rs742.00
Shr price, close (Aug 8, 2007)	Rs611.00
52-Week Range	Rs682.00-370.00
Mkt cap (08e) (mn)	Rs420,479

Fiscal Year (Mar)	2007	2008e	2009e	2010e
ModelWare EPS (Rs)*	80.26	75.24	80.65	93.13
Revenue, net (Rs mn)	243,868	278,143	308,628	304,511
ModelWare net inc (Rs mn)	44,841	51,851	55,577	64,177
P/E	5.8	8.1	7.6	6.6

***** = Please see explanation of Morgan Stanley ModelWare later in this note.
e = Morgan Stanley Research estimates

Financial Summary

Profit and Loss Statement

Rs. Million	F2006	F2007	F2008E	F2009E	F2010E
Sales	**131,272**	**243,868**	**278,143**	**308,628**	**304,511**
Raw Material	61,580	104,978	118,717	134,715	131,301
Power & Fuel	12,256	13,738	15,536	17,630	17,183
Other Manufacturing	13,338	18,437	20,849	23,659	23,059
Personnel	4,518	5,495	6,214	7,051	6,873
Selling & Distribution	2,566	3,849	4,353	4,939	4,814
Administration & General	2,681	3,243	3,668	4,162	4,056
Operating Costs	96,939	149,739	169,337	192,157	187,286
EBITDA	**34,333**	**94,129**	**108,806**	**116,471**	**117,225**
Other income	3,343	6,817	10,111	13,756	10,093
Interest	2,353	3,791	1,494	1,499	2,411
Pre-operative expenses	-2,545	-460	-	-	-
Depreciation	5,269	8,039	8,360	9,094	14,180
Extraordinary Expenses	101	1,572	-	-	-
PBT	**32,498**	**88,004**	**109,063**	**119,633**	**110,728**
Tax	10,166	24,120	31,083	35,890	34,326
Minority Interest (MI)	5,991	20,023	25,928	27,770	12,006
MI in proposed divi. of subsidiary & tax thereon	423	981	-	-	-
PAT	**16,764**	**44,842**	**52,051**	**55,974**	**64,395**

Balance Sheet

Rs. Million	F2006	F2007	F2008E	F2009E	F2010E
Equity Share Capital	1,117	1,117	1,418	1,418	1,418
Preference Share Capital	219	-	-	-	
Reserves & Surplus	59,413	98,698	228,423	280,704	340,174
Deferred Govt Grants	3	2	2	2	2
Net Worth	**60,751**	**99,818**	**229,844**	**282,124**	**341,594**
Minority Interest	16,948	36,259	62,187	89,957	43,841
Secured Loans	24,145	15,258	10,258	5,258	30,258
Unsecured Loans	27,508	30,845	22,545	27,656	22,661
Deferred Tax Liability	7,511	9,174	9,174	9,174	9,174
TOTAL	**136,862**	**191,354**	**334,008**	**414,168**	**447,528**
Goodwill	9,735	9,735	9,735	9,735	67,981
Gross Fixed Assets	103,874	116,679	145,376	180,799	331,121
Accumulated Depreciation	35,723	43,235	51,595	60,689	74,869
Net Fixed Assets	**68,152**	**73,444**	**93,781**	**120,110**	**256,252**
Capital WIP	7,611	13,997	20,697	50,807	70,813
Investments	**24,952**	**52,219**	**52,967**	**47,967**	**27,967**
Inventories	19,507	28,092	30,156	31,587	30,787
Debtors	13,475	16,521	17,527	17,757	16,686
Cash & Bank	11,153	11,134	128,131	161,162	6,636
Loans & Advances	16,287	34,846	36,159	37,035	33,496
Acceptances	-	-	2,320	2,632	2,566
Creditors	13,917	9,078	8,351	15,794	15,393
Others	5,001	12,321	12,937	13,260	13,592
Provisions	15,195	27,237	31,538	30,307	31,538
Misc. Expenditure	105	0	0	0	0
TOTAL	**136,862**	**191,354**	**334,008**	**414,168**	**447,528**

Cash Flow Statement

Rs. Million	F2006	F2007	F2008E	F2009E	F2010E
PAT	16,784	44,841	52,051	55,974	64,395
Depreciation	5,269	8,039	8,360	9,094	14,180
Minority Interest	5,991	20,023	25,928	27,770	12,006
Change in Inventories	-9,150	-8,586	-2,064	-1,431	801
Change in Debtors	-6,273	-3,046	-1,006	-230	1,071
Change in Loans	-7,242	-18,559	-1,312	-877	3,539
Change in Acceptances	-665	0	2,320	313	-67
Change in Creditors	6,186	-4,838	-728	7,443	-400
Change in Other Liab.	22	7,320	616	323	332
Change in Provisions	10,052	12,042	4,301	-1,231	1,231
Capex	-12,648	-19,718	-35,397	-65,533	-170,327
Change in Investments	-6,461	-27,268	-748	5,000	20,000
Change in Misc Exp	105	104	0	0	0
Change in Goodwill	0	0	0	0	-58,245
Issue of Shares	20	-219	301	0	0
Change in Reserves	1,708	-3,362	82,598	0	0
Change in MI	-423	-712	0	0	-58,122
Change in Secured Loans	-6,964	-8,887	-5,000	-5,000	25,000
Change in Unsec.Loans	5,307	3,338	-8,300	5,110	-4,994
Change in Deferred Tax.	2,413	1,663	0	0	0
Dividends Paid	-1,221	-2,194	-4,924	-3,693	-4,925
Change in Cash	**2,811**	**-18**	**116,997**	**33,031**	**-154,526**

Source: Company data, Morgan Stanley Research

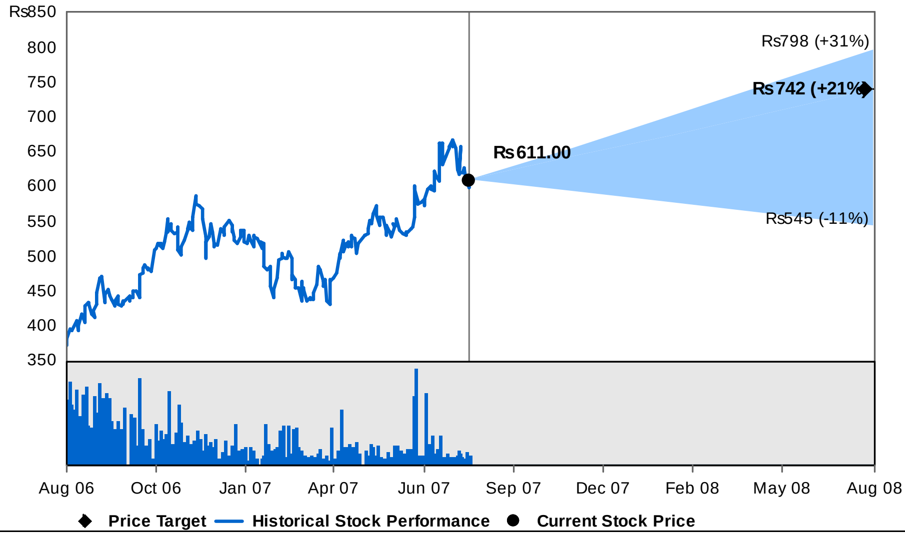
Ratio Analysis

Rs. Million	F2006	F2007	F2008E	F2009E	F2010E
ModelWare EPS	30.0	80.3	73.4	78.9	90.8
Book Value per Share	108.3	178.7	324.1	397.8	481.7
Valuation					
P/E	11.7	7.6	8.3	7.7	6.7
EV/EBITDA (Adjusted)	7.5	4.8	4.0	3.5	4.6
EV/Sales	1.6	1.3	1.0	0.8	1.5
Price to Book Value	3.2	3.4	1.9	1.5	1.3
Dividend Yield (%)	0.4	0.2	0.7	0.5	0.7
Profitability Ratios (%)					
EBIDTA Margins	26.2	38.6	39.1	37.7	38.5
Avg RoE	32.2	55.9	31.6	21.9	20.6
Avg RoCE	15.3	29.6	20.4	15.4	15.5
Growth (%)					
Sales	81.0	85.8	14.1	11.0	-1.3
Operating Profit	129.7	174.2	15.6	7.0	0.6
Net Profit	157.2	167.5	16.1	7.5	15.0
Net debt /Equity (x)	0.7	0.4	-.04	- 0.5	0.1

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

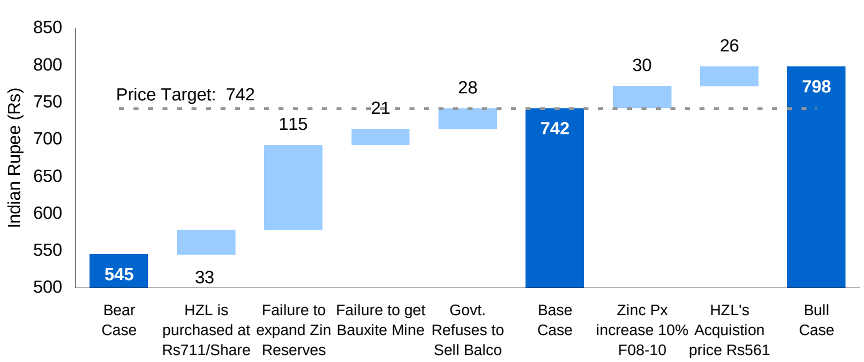
Risk-Reward Snapshot: Sterlite Ind. (STRL.BO, Rs611, OW. PT Rs742)

Risk-Reward View – Beneficial Call Option to Purchase HZL & Balco



Price Target Rs742		
Bull Case Rs798	9.9x Base Case F09E EPS	Assumes zinc prices in F08-F10E are 10% higher than in our base case. Assumes the HZL acquisition takes place at the 24-month average price of Rs561 per share.
Base Case Rs742	9.2x Base Case F09E EPS	Assumes a WACC of 12.9% with terminal growth rate of 3% each for zinc and copper businesses, 2% for Vedanta alumina, and 4% for Balco. Assumes a long-term average price of US$2,094/ton for aluminum, US$254/ton for alumina, and US$1,675 for zinc, and long-term copper TC/RC of 15c/lb. Assumes the HZL stake is purchased at the 12-month avg. price of Rs711/share.
Bear Case Rs545	6.8x Base Case F09E EPS	The company fails to expand its zinc reserves and to get a bauxite mine, leading to external dependence for raw materials. The government refuses to sell its Balco stake to Sterlite. The HZL stake is purchased at our calculation of fair value of 865/share for the zinc business.

From Bear to Bull – Stake purchases, new mines, reserves are the keys



Source: FactSet, Morgan Stanley Research

Investment Thesis

- Sterlite is pursuing a low-cost volume growth strategy. In the next three years, we estimate CAGR of 14%, 22% and 9% for attributable output in aluminum, zinc and copper.
- Options to increase stakes in HZL and Balco imply substantial value-creation potential.
- We expect sentiment to improve toward nonferrous metals on continued strong demand (e.g., China, India, Russia) and constrained supply.

Key Value Drivers

- Firm zinc and aluminum prices – Sterlite is highly sensitive to aluminum prices.
- Robust volume growth – captive sources of zinc and bauxite are key for Sterlite's value-creation path.

Potential Catalysts

- Favorable news flow on HZL and Balco stakes; resolution of bauxite mines issue.
- Street perceives strength in nonferrous metals prices.

Key Risks

- Further increase in Chinese aluminum surplus, coupled with slump in global demand, putting downward pressure on zinc and aluminum and prices.
- Global economic slowdown and/or sustained correction in Indian stock market.
- Issues escalate with GoI over HZL and Balco stake purchases.
- Allotment of bauxite mine further delayed.

Investment Case

Summary & Conclusions – Overweight

We initiate coverage on Sterlite with an Overweight rating and a price target of Rs742, which implies potential upside of 21%. We are encouraged by the company's strong growth pipeline, cost-reduction initiatives and the possibility of value-accretive stake acquisitions in its zinc and aluminum subsidiaries (Hindustan Zinc and Balco). Higher demand growth than the market expects and continued supply-side bottlenecks should keep nonferrous metals prices strong, in our view.

At a F08E P/E of 8.0x and F08E EV/EBITDA of 4.0x, the stock looks inexpensive in the context of its strong growth profile and increasing raw materials advantage. We forecast EBITDA CAGR of 7.6% over F07-10, and on this basis we think the stock deserves a better valuation than that currently accorded. At our price target of Rs742, which is derived from a two-phase DCF valuation, the stock would trade at a F08E P/E of 10.1 x and an EV/EBITDA of 5.3x. Sterlite's current enterprise value of Rs287bn (based on the current market price and our projected net debt at F08 end) includes Rs142bn from its stake in Hindustan Zinc (HZL). This leaves a valuation of just Rs145bn for all the other businesses of the company (copper, Balco stake and Vedanta Alumina stake), which we think doesn't fully reflect the growth opportunities in these businesses.

Risks to our target price include a greater-than-expected slowdown in Chinese aluminum demand combined with undisciplined expansion in production, triggering a collapse in prices; extensive expansion in copper smelting capacity; a major slump in zinc demand, or a sustained global economic downturn.

Investment Thesis

Low-cost volume growth strategy: Sterlite is adding low-cost capacity to tap raw material resources and growing markets in Asia. We estimate that, in the next three years, the company's zinc, copper, aluminum production will display CAGR of 22%, 9%, 14%, respectively, and that alumina will increase to 922,000 from zero in F10.

Stake purchases imply substantial value accretion: Sterlite's option to purchase an additional 25.1% stake in HZL (contributing an estimated 29% to the company's attributable EBITDA of Rs67.3bn for F08) is, in our opinion, a strong potential trigger for the stock. In view of HZL's recent stock price movements, we estimate that this purchase, which would raise Sterlite's stake in HZL to 90%, could be value-accretive for Sterlite. With respect to Balco too, where the company has exercised its option to purchase the government's remaining stake of 49%, we see substantial benefits for Sterlite.

High degree of diversification: Sterlite's diversified business provides a strong shield against metal price fluctuations compared with Indian metals and mining companies: copper constituted 24%, aluminum 11%, and zinc 64% of attributable EBITDA.

Metals prices in a strong groove Not withstanding recent volatility, prospects for metals prices are favourable in view of low inventory levels plus robust demand growth and supply constraints.

Areas of Concern

Bauxite mine issue yet to be resolved: The upcoming alumina refinery could face relatively high production costs if delays in mine allotment continue. This would remove some of the aluminum business's cost advantage.

Copper business lacks sustainable advantages: The copper smelting business has low returns and poor margins, especially in view of the shortage of copper resources in India.

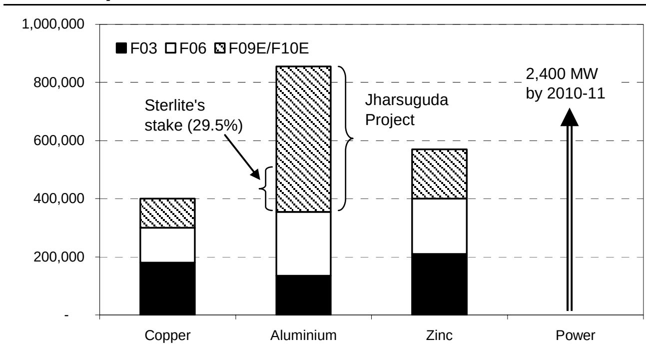
Close correlation to movements in metal prices: The stock could come under pressure despite good earnings performance if metals prices drop sharply – even temporarily.

Investment Positives

Low-Cost Volume Growth Strategy
Sterlite is undertaking an attractive scale enhancement program to build on its raw materials advantage of captive sources and to tap the growing market for copper, aluminum, and zinc in Asia, as well as to increase its cost competitiveness. Sterlite has managed to upgrade its capacity at reasonably low capital costs.

The recently expanded aluminum and copper facilities are in the ramp-up phase and are thus contributing to the earnings upswing, while the next stage of the planned expansion has begun for alumina and zinc. For aluminum, the group has announced plans to set up a 0.5 million tons per annum (tpa) smelter by 2010. Sterlite also plans to add 50,000 tons of smelting capacity through de-bottlenecking at its Balco smelter. For zinc, the company is in the process of setting up a smelter of 170,000 tpa capacity while two other smelters are being upgraded to enhance their capacity by a combined 88,000 tpa. The company's vision is to attain levels of 1 million tpa for each of the three metals in which it has an interest – copper, zinc, and aluminum (Exhibit 1).

Exhibit 1
Sterlite: Capacity Expansion Plans (Copper, Aluminum, and Zinc)



Source: Company data, Morgan Stanley Research

Planned Stake Purchases in HZL and Balco Imply Substantial Value Accretion
We estimate Sterlite would gain to the tune of Rs40.0, Rs33, and Rs59 per share, respectively, if it managed to buy government's stake in HZL on the basis of HZL's average stock price performance in the past six, 12, or 24 months. For Balco, we calculate the gain for Sterlite would be about Rs28 per share, based on the agreed purchase price. In addition, consolidation of the minority positions in these two subsidiaries would also enhance strategic clarity for Sterlite's aluminum and zinc businesses.

High Level of Diversification
Demonstrated by the move into the copper rods business, management has always displayed keen foresight in grasping opportunities that have emerged in nonferrous metals. In F2007, 11% of its EBITDA came from the aluminum business, 24% from the copper business and 64% from the zinc business. This diversification smoothes earnings volatility and, on this score, Sterlite ranks highest among the Indian metals stocks in our coverage.

Metals Price Trend Remains Strong
Against a backdrop of higher long-term price assumptions, companies like Sterlite with low-cost structures and robust volume growth should emerge as strong stock performers.

We think prospects for nonferrous metals prices are brighter than the street expects because of continued strength in demand. Moreover, greater difficulty in accessing mines, growing capital costs, and employee and equipment constraints are dampening the growth in output for these metals.

From a fundamental perspective, the supply constraints that had been pushed off centre stage by the huge upswing and subsequent dramatic slump in prices will return to haunt the market, in our view. Moreover, we suspect demand growth from China and the West is underestimated. As demand-related concerns subside, low inventory levels are likely to nudge up aluminum, copper and zinc prices again. For copper TC/RC (treatment and refining charges), we do not expect further declines, even in spot markets, although at the same time we are not calling for a material improvement in the coming 12 months. For alumina, we think the current stability in the market can be maintained over the next 12 to 18 months with strong support from high aluminum prices and tightening bauxite dynamics in China.

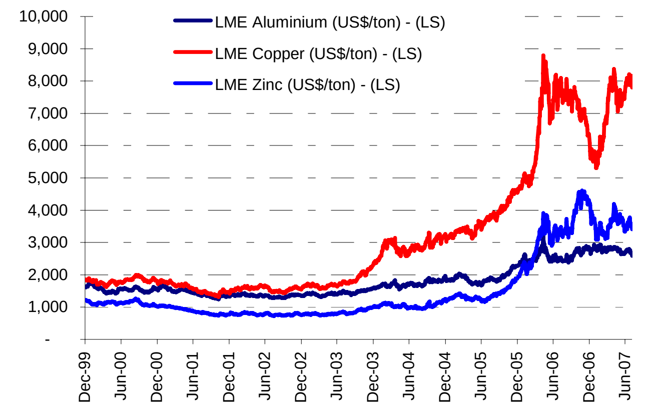
Investment Concerns

High Correlation to Metals Prices

Metals prices on the LME have recently been extremely volatile (Exhibit 4). Fluctuations in metals prices have a meaningful impact on Sterlite's business, and if prices drop significantly, even temporarily, the stock generally comes under pressure. Continued volatility on the LME could dampen Sterlite's stock performance.

Exhibit 2

LME: Zinc, Copper and Aluminum



Source: Bloomberg, LME, Morgan Stanley Research

Delayed Allotment of Bauxite Mines

Although Sterlite is pushing ahead with its Lanjigarh alumina project (originally planned on cost advantages from access to a bauxite mine), which it expects to be commissioned in F2Q08, it is still awaiting the verdict on bauxite mine allotment for the project. The mine allotment has been delayed due to objections from environmental pressure groups. The company believes that it will receive the mine lease in the near future. We are confident that, even if the Niyamgiri bauxite mines are not allocated to Vedanta Alumina (the group company of which 29% is held by Sterlite and 71% by Vedanta), another mine will be given. However, we believe that such an eventuality would prolong the low profit period for the refinery, during which it would have to rely on purchased bauxite, depriving it of a substantial proportion of its cost advantage.

Copper Business Remains Overhang, Lacking Sustainable Advantages

The copper smelting business with its low returns and poor margins does not seem to be a good business for Indian companies, especially in view of the shortage of copper resources in the country. We note that, in the current copper value chain, only about 3-4% copper price realizations go to smelters with the rest retained by the miners. Even last year, when the TC/RC rate was hovering around US$0.35/lb, smelters were able to corner only about 10% of the copper price chain. As a result, merchant smelting companies often end up with dismal profits even when copper prices are strong. Against such a backdrop, owning a copper concentrate mine seems to be the only way to improve margins.

Holding Structure – Simpler Is Better

The promoters hold Sterlite via Vedanta, which is listed in London and, in turn, has stakes in HZL, Balco and copper mines in Australia. We believe that on occasions this has confused investors in both companies regarding the distribution pattern of various new initiatives between the two. However, we think that, as the company sets out a clear road map in this regard, these concerns would ease.

Company Description

Sterlite Industries (India) Ltd. (a subsidiary of London-listed Vedanta Resources) is the leading non ferrous metals producer in India, with interests in zinc, aluminum, copper and lead. The company also owns a copper mine in Australia. Its zinc and aluminum businesses are fully integrated, while it is largely a custom smelter in copper.

India Nonferrous Metals & Mining

Industry View: Attractive

We think Indian companies will be able to further exploit their cost advantage with well planned scaling-up initiatives as nonferrous metal prices remain strong.

MSCI Country: India

Asia Strategist's Recommended Weight: 2.3%
MSCI Asia/Pac All Country Ex Jp Weight: 6.9%

Valuation: Bull, Bear and Base Cases

Attractive Valuations

Even after the recent run-up in the price, the stock trades at a F2008E P/E of 8.3x and F2008E EV/EBITDA of 4.0, discounts of 14% and 26% to the average multiples of global peers. This valuation seems unjustifiably low for a company that is on an active growth track and has a sustainable competitive edge that could widen further. We estimate that the per share value of cash and liquid investments alone at end-F2008E will be Rs136 (about 22% of the current stock price).

We expect the valuation discount with global peers to narrow, for three reasons:

- Growth plans are well dispersed over time and product range, and the company has displayed good project execution in the past 24 months.
- The company is on track to achieving reasonable scale for aluminum and zinc products. Its lack of scale has been regarded as a negative in the past.
- The business focus should increase following consolidation of minority positions in Balco and HZL.

We think Sterlite stock is a re-rating candidate under a scenario whereby nonferrous metal prices should maintain a firm trend from a long-term perspective.

Price Target and Risks

We base our price target of Rs742 on a sum-of-parts model, in which we value the five divisions – Vedanta Alumina, Zinc, Sterlite, Balco, and Power – separately on two-phase DCF models. This yields Rs681 per share. We then assume that Sterlite is able to purchase a 25.1% stake in HZL from the government at Rs711 per share (last 12 months' average price) and the remaining 49% stake in Balco at Rs18bn as per the agreement terms between Sterlite and the GoI. These transactions add Rs33 and Rs28 per share, respectively, leading to our price target of Rs742.

Our DCF-based valuation for HZL's business (based on a long-term zinc price assumption of US$ 1,675 per ton) as of 31 July, 2008, works out to be Rs320bn. However, since we are ahead of consensus on our long-term zinc price assumption, we assume that for the remaining stake purchase (25.1%) by Sterlite, the agreed valuation will be lower than the valuation based on our DCF based methodology. Accordingly, we calculate our valuation of 25.1% stake purchase in HZL by Sterlite, assuming an effective acquisition price per share as determined by taking the average of last 12 months' price of HZL stock (i.e. Rs711). Another assumption that we are making here is that as negotiations with the government get prolonged, this stake purchase will happen only at the end of F09 (i.e. on April 1, 2009). Thus for the 25.1% stake, we derive a benefit of Rs23.4bn for Sterlite that works out to Rs33 per share.

For Balco, our DCF-based valuation suggests a value of Rs128bn for the entire business. However as per the agreement terms, Sterlite has to pay the government Rs18bn for the remaining 49% stake in Balco. Here, we have assumed that the stake transfer takes place on April 1, 2009. As per the agreement, Sterlite will have to pay interest for this period at 14% per annum compounded half yearly, beginning F02, over the price paid to purchase 51% stake in F02. Thus, we derive a gain of Rs19.9bn from the 49% stake purchase in Balco, which is equivalent to Rs28 per share.

Our price target of Rs742 implies upside potential of 21% from current levels. Our two-phase DCF valuation assumes a WACC of 12.9% (based on a cost of equity of 13.6% and a cost of debt of 5.9%), with our long-term price assumption for aluminum at US$2,094 per ton and that for zinc at US$1,675. Our long-term assumption for copper TC/RC is 15c/lb.

Exhibit 3

Sterlite: Sum-of-the-Parts Valuation

Rs Millions	Sterlite share	Total	Sterlite's Share	Rs per share
Vedanta Alumina (Orissa)	30%	104,008	30,682	43
Zinc	65%	320,175	207,858	293
Sterlite	100%	57,617	57,617	81
Balco	51%	127,702	65,128	92
Power	100%	25,255	25,255	36
Net (Debt)/Cash	66%	145,328	96,194	136
DCF value		**780,084**	**482,733**	**681**
Gain from acquiring 25.1% stake in HZL in per/Share				33
Gain from acquiring 49% stake in Balco in per/Share				28
Total Value/Share				**742**

Source: Company data, Morgan Stanley Research

Exhibit 4

Valuation of 25.1% stake in HZL*

Our DCF based EV of cash flows as on April 1, 2009	290,887
Net (Debt)/Cash as on April 1,2009	141,529
Equity value of HZL on April 1, 2009 (A)	432,416
Assuming last 12 months Avg. as the acquisition price	711
Acquisition Equity Value (B)	339,074
Difference between the equity values from two valuation methods(C)	93,342
Gain due to Acquisition of 25.1% stake = C*.251	23,429
Gain per share for Sterlite due to 25.1% Acquisition in HZL	**33**

*Assuming the stake is acquired on April 1 , 2009 at Rs711/share ;Source: Company data, Morgan Stanley Research

Exhibit 5

Valuation of 49% stake in Balco*

Our DCF based EV of cash flows as on April 1, 2009	111,002
Net (Debt)/Cash as on April 1, 2009	9,770
Equity value at April 1, 2009 (A)	120,772
Equity value of 49% stake B = A*.49	59,178
Acquisition Equity Value for 49% stake (C)	39,253
Gain from acquisition = B-C	19,925
Gain per share for Sterlite due to 49% Acquisition in Balco	**28**

*Assuming the stake is acquired on April 1, 2009 for a consideration of Rs18b; Source: Company data, Morgan Stanley Research

Exhibit 6

WACC

Equity market risk premium (%)	7.0
Equity beta	1.02
10-year risk-free rate (%)	6.50
Cost of equity (%)	**13.64**
Marginal corporate tax rate (%)	30.5
Post-tax cost of debt (%)	**5.91**
Debt/EV (target capital structure) (%)	10
Equity/EV (%)	90
WACC (%)	**12.87**

Source: Company data, Morgan Stanley Research

On the basis of our DCF methodology, we peg the value of Vedanta Alumina at Rs104 billion, the zinc business at Rs320 billion, the copper business (Sterlite standalone and Australian mines) at Rs58 billion, Balco at Rs128 in billion, and the Power business at Rs25 billion (Exhibits 3 and 5). The above valuations look fair compared to peer-group valuations and give us confidence in our price target.

Exhibit 7

What Is Reflected in Our Price Target

Business	Value of the Business as per our price target (Rsm)	Effective EV/EBITDA on MS F09 estimates
Vedanta Alumina (Orissa)	104,008	12.8
Zinc	320,175	4.3
Copper (Sterlite & Aus. mines)	57,617	4.2
Balco	127,702	4.7

Source: Morgan Stanley Research

At our price target of Rs742, Sterlite would trade at P/E multiples of 10.1x and 9.4x, and EV/EBITDA multiples of 5.3x and 4.7x on our F2008 and F2009 estimates, respectively.

Risks to our target are primarily those factors that would put pressure on metal prices, such as a slump in Chinese demand or an economic slowdown in Western markets, causing metals consumption in those markets to cool. Excessive speculation activity in the metals space could potentially scare away genuine metal market participants, thus deflating the prices and putting our price target at risk. Negative developments with respect to the planned stake purchases in HZL or Balco could also pose a risk for our price target.

Bull- and Bear-Case Scenarios

Our bull-case scenario assumes higher zinc price forecasts versus those in our base case on Chinese demand turning out to be higher than we expect. In this scenario, we build in a zinc price that is 10% higher than in our base case for F08-F10E. In addition, for the HZL stake purchase, we assume a purchase price of Rs561 based on the average stock price for HZL in the past 24 months. We would like to mention here that this scenario would be realized in case of a perceived weakness (though a temporary one) in the zinc market, which would lead to lower acquisition valuation for the business . Our assumptions are that the valuers will take the average of the last 24 months' average price (i.e. Rs511) to determine the acquisition price (as per the agreement, this is one of the parameters to be used for determining the acquisition value). However, this will lead to a bigger benefit for Sterlite, we feel, since our DCF-based fair value for HZL business (at Rs865 per share) is higher than this value. Our bull-case scenario implies a valuation of Rs798 (31% potential upside from current levels) for Sterlite.

In our bear case, we assume Sterlite purchases the remaining HZL stake from the GoI at the fair enterprise value we calculate for the zinc business of Rs320bn or Rs865 per share, which is derived from our DCF based model based on our long term zinc price assumption of US$ 1,675 per ton. We assume Sterlite is unable to buy the Balco stake due to strong political resistance, which forces the government to refuse to honor the agreement to sell Balco stake. In addition, the company fails to expand its zinc reserves and, as a result, is unable to increase zinc concentrate production. For our bear-case scenario, we also assume the company is not allocated a bauxite mine for its Lanjigarh alumina project. Together, these factors lead us to a bear-case valuation of Rs545, implying 11% downside from current levels.

Exhibit 8

Nonferrous Valuations, 2006-2009E

Non Ferrous	P/E				P/B				EV/EBITDA				ROE (%)			
Company Name	2006	2007e	2008e	2009e	2006	2007e	2008e	2009e	2006	2007e	2008e	2009e	2006	2007e	2008e	2009e
Sterlite	11.7	7.6	8.3	7.7	3.2	3.4	1.9	1.5	7.5	4.8	4.0	3.5	28%	45%	23%	20%
Alumina Limited	14.4	15.7	14.2	12.4	4.4	4.2	3.8	3.4	8.1	9.4	8.4	7.1	35%	30%	30%	30%
Antofagasta	6.8	10.1	10.8	13.8	3.1	3.4	2.8	2.5	3.0	4.7	5.0	6.6	71%	43%	32%	20%
BHP Billiton (Australia)	12.6	12.4	10.2	8.6	5.3	5.5	4.1	2.8	7.9	8.2	6.3	4.9	58%	56%	55%	48%
BHP Billiton (UK)	11.5	11.7	9.0	7.5	4.8	5.2	3.6	2.5	7.3	7.8	5.5	4.2	58%	56%	55%	48%
Century Aluminum	7.1	7.0	7.3	8.5	11.4	2.7	2.1	1.7	7.7	6.5	5.9	7.0	120%	197%	41%	25%
Companhia Vale do Rio Do	10.8	8.9	7.5	6.9	3.7	3.4	2.6	2.1	9.6	7.1	5.3	4.7	54%	65%	46%	38%
DOWA Holdings	14.5	13.2	13.3	12.5	2.8	2.5	2.1	1.9	7.5	6.8	6.5	6.0	22%	22%	19%	17%
Freeport-McMoRan	8.3	8.4	7.7	7.9	9.4	2.2	2.0	1.7	4.4	5.6	4.0	3.9	192%	291%	32%	24%
Grupo Mexico	6.2	7.7	6.6	7.1	2.4	3.3	2.5	2.1	3.0	3.8	3.4	3.4	48%	54%	49%	36%
Kazakhmys	7.2	7.3	8.2	10.0	2.6	2.3	1.9	1.7	3.7	3.4	3.7	4.1	54%	41%	28%	19%
Mitsubishi Materials	9.3	13.1	14.0	NA	1.8	1.8	1.6	NA	8.3	9.6	9.6	NA	24%	16%	13%	NA
Mitsui Mining & Smelting	11.3	9.8	10.4	NA	2.0	1.4	1.3	NA	7.3	5.7	5.5	NA	20%	16%	13%	NA
National Aluminium	12.3	6.3	9.3	10.2	3.2	1.9	1.8	1.6	6.5	3.4	4.8	5.1	33%	40%	23%	18%
Norilsk Nickel	6.3	5.4	6.3	7.6	2.0	2.0	1.6	1.4	3.6	3.0	3.1	3.2	43%	51%	32%	21%
Rio Tinto Plc	9.1	11.0	8.6	7.6	3.8	3.8	2.7	2.1	6.0	6.7	5.1	4.1	51%	41%	43%	36%
Sesa Goa	9.0	10.6	12.2	9.2	4.5	4.0	3.4	2.7	5.4	6.1	6.7	4.5	76%	56%	35%	37%
Southern Copper Corp.	7.8	10.8	9.8	10.7	4.3	6.7	5.2	4.4	4.9	6.8	6.0	6.3	61%	76%	68%	49%
Sumitomo Metal Mining	10.9	12.1	13.3	NA	2.7	2.4	2.1	NA	6.6	7.1	7.2	NA	32%	24%	18%	NA
Xstrata PLC	9.8	8.9	8.3	9.1	2.3	2.1	1.8	1.5	5.9	5.2	4.8	5.0	63%	31%	26%	19%
Zinifex Limited	4.6	6.8	7.6	7.7	2.2	3.3	2.8	2.5	3.8	4.4	4.0	4.2	88%	61%	42%	37%
Average	***9.9***	***9.9***	***9.7***	***9.2***	***4.0***	***3.3***	***2.6***	***2.3***	***6.2***	***6.0***	***5.4***	***4.9***	***59%***	***63%***	***36%***	***31%***
Median	***9.5***	***10.0***	***9.1***	***8.6***	***3.2***	***3.3***	***2.3***	***2.1***	***6.5***	***6.2***	***5.2***	***4.7***	***54%***	***48%***	***32%***	***30%***

Source: Company data, Morgan Stanley Research. E = Morgan Stanley Research Estimates
ModelWare data, as on August 8, 2007

Financial Performance: Solid Earnings Growth

Earnings Drivers

We expect good earnings performance for Sterlite over the next three years, aided by graded improvements in (i) production volumes; (ii) realizations; and (iii) cost reductions.

Exhibit 9
Sterlite: Attributable Revenues, F06-F10E

Rs. Mn	F06	F07A	F08E	F09E	F10E
Copper	67,039	113,321	127,080	143,951	130,740
Aluminum	11,347	21,371	22,667	24,598	47,567
Alumina	-	-	2,132	3,614	9,069
Zinc	25,236	55,240	62,172	65,242	82,522
Others	3,111	3,554	3,625	3,698	3,771

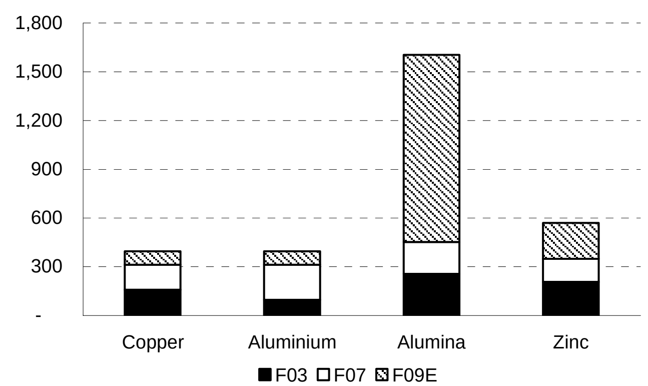
Source: Company data, E = Morgan Stanley Research Estimates

Exhibit 10
Sterlite: Attributable EBITDA, F06-F10E

Rs. Mn	F06	F07A	F08E	F09E	F10E
Copper	9,661	17,610	11,314	13,719	12,473
Aluminum	3,147	8,392	11,590	13,769	26,810
Alumina	-	-	1,311	2,388	6,081
Zinc	15,361	43,973	50,296	48,239	57,138
Others	(5,139)	(7,671)	(7,151)	(6,647)	(6,159)

Source: Company data, E = Morgan Stanley Research Estimates

Exhibit 11
Sterlite: Production ('000 Tons) by Business



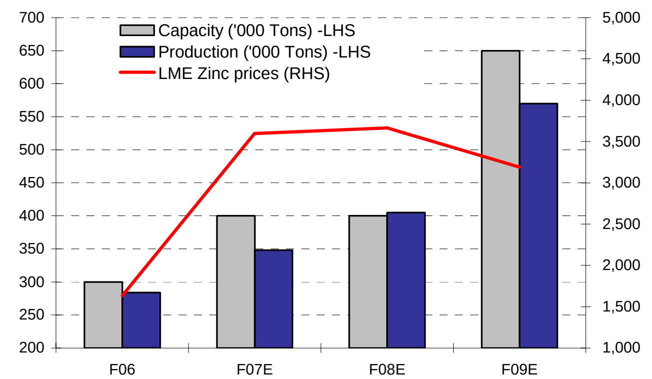
Source: Company data, E = Morgan Stanley Research Estimates

Our expectations for the company's three divisions are presented in the following section.

Zinc

The zinc business should bulk up with full stabilization of the new 170,000 tpa smelting capacity in F2008E. In F2009E, the company should reap further benefits from the next stage of its 170,000 tpa expansion, while in F10E a further 88,000 tpa capacity will likely come on stream. However, for F2009 we expect increased production to be offset by a 13% fall in realizations owing to increased supply of the metal in CY2008.The company is also looking to enhance its zinc mining capacity in synch with its metal producing capacity. We project a 13% CAGR in zinc concentrate output in F07-F10 . However, the company's surplus concentrate, which it sold to other smelters, will likely come down as smelting capacity of HZL is scaled up. We estimate that concentrate sales volume, which stood at 133 kt in F07, will come down to less than 10 kt by F10 .

Exhibit 12
Sterlite: Zinc Business Expanding



E= Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

The company aims to lower its production costs to US$500/ton from US$606//ton currently from better asset optimization of the expanded facilities, curtailed coke consumption as hydro technology's share increases, and reduced power costs through a higher proportion of captive power. The targeted cost level of US$500/ton seems to be on the aggressive side; we think US$600/ton could be realistic upon the commissioning of the next stage of the smelter expansion.

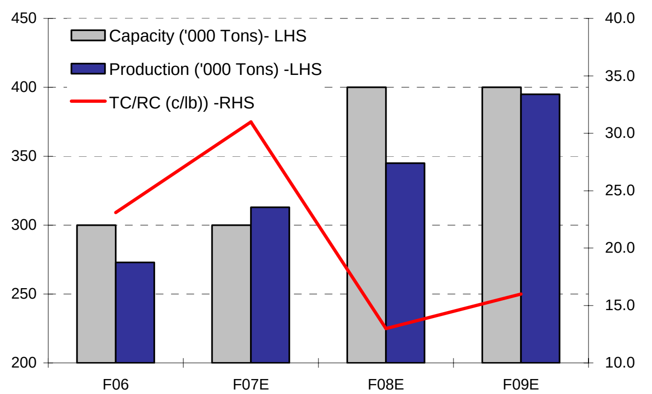
We assume Sterlite will be able to purchase a further 25.1% stake in HZL from the government by the end of F2009. This would add about Rs9.9b (15.4% of attributable PAT) to after-tax profit in F2010. We think this is a fair assumption in light of the possible difference in views between the two parties on the timing and valuation for the stake purchase.

Copper

We expect the performance of Sterlite's copper smelting business in F2008E to be marked by a decline of about 58% in TC/RC over the F2007 level of 31 c/lb with small improvements in volume growth (10%) and production costs. However, EBITDA at copper mines should improve substantially because of strong copper prices. Overall, we forecast a 35% drop in copper division EBITDA in F2008E.

For F2009E, we expect some improvement in the company's average TC/RC to 16c/lb. This, coupled with our 15% growth estimate for copper cathode production, should push up EBITDA for the division by 21% YoY in F2009E.

Exhibit 13
Sterlite: Copper Business - Weakening TC/RC



E= Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Aluminum
In the aluminum business, we estimate that the Balco complex will gain from a further uptick in realizations (4% in F2008 and 2% in F2009) while benefits from stabilization of the new smelter should be visible in both F08 and F09. We project volume growth of 19% and 6% in the respective years. We expect the Lanjigarh refinery also to contribute 900,000 tons to production in F2008. We assume that bauxite mine allotment will not occur until F09 and that, in the meantime, the refinery will work without the cost advantage associated with the bauxite mine.

Exhibit 14
Sterlite: Alumina-Aluminum Business

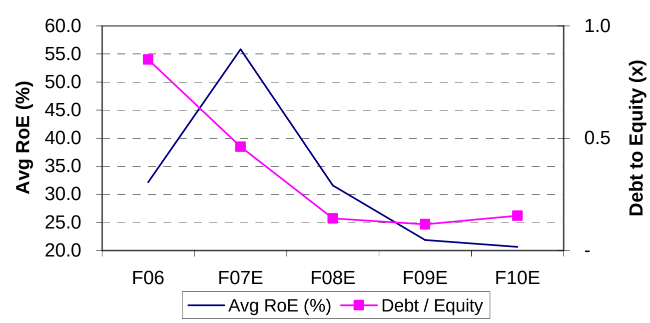
	F05	F06	F07E	F08E	F09E
Alumina Capacity ('000 Tons)	-	-	150	1,000	1,500
Aluminum Capacity ('000 Tons)	150	150	300	400	500
Alumina Production ('000 Tons)	-	-	-	485	845
Aluminum Production ('000 Tons)	100	174	313	372	395
Alumina Prices (US$/Ton)	384	496	374	376	327
Aluminum Prices (US$/Ton)	1,771	2,028	2,658	2,774	2,838

Source: Company Data E= Morgan Stanley Research estimates

We assume Sterlite will not exercise its option to purchase the remaining 49% stake in Balco from the government until the end of F2009 . This would add about Rs9.1bn (14% of attributable PAT) to after-tax profit in F2010. In our view, Sterlite will not rush to take up the matter with the government until issues relating to purchase of the remaining stake in HZL are closer to resolution, since the Balco stake is larger than the HZL one.

Strong Returns, Solid Balance Sheet
Sterlite has consistently displayed strong returns on equity, and we expect the trend to continue. Although a major part of the increase in returns can be attributed to cyclical factors such as high prices and strong TC/RC, structural improvements in the form of shrinking costs and rising production levels also play a part, we believe.

Exhibit 15
Sterlite: Debt to Equity vs. RoE



E= Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Despite its ongoing expansion plans, Sterlite's balance sheet does not seem to be stretched, especially following the recent ADS offering, which generated US$1.98 billion for the company at a price of US$13.4 per share . While this equity dilution lowered EPS, it also gave the company flexibility to leverage its balance sheet if the need arises. We estimate the debt:equity ratio will remain below 0.1 until F2009.

Exhibit 16
Sterlite's Earnings Sensitivity

		EPS changes by (in %)
For every 10% change in	Zinc price	7.6
	Aluminum price	3.3
	TC/RC	0.5
	Zinc concentrate production	7.3
	Balco' aluminum production	3.0
	Copper cathode production	1.1

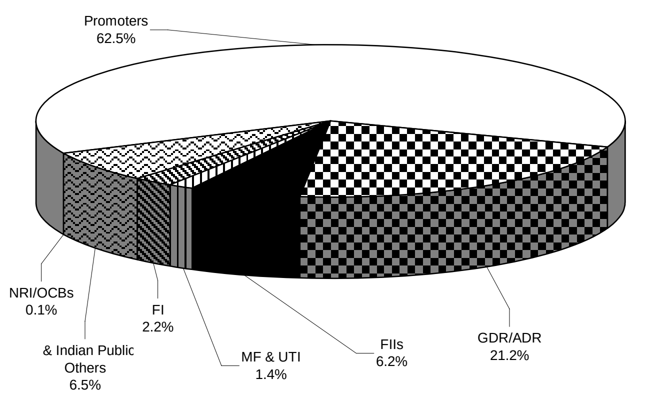
Source: Company data, Morgan Stanley Research

Company Background

Sterlite Industries (India) Ltd (SIIL) is the second largest copper producer in India. It is the Indian subsidiary of the UK-based metals and mining major, Vedanta Resources. Sterlite holds stakes of 64% in Hindustan Zinc, the largest zinc player in India (sixth largest globally), and 51% in aluminum manufacturer Balco. The company also has international interests through its wholly owned copper mining subsidiaries in Australia, Copper Mines of Tasmania Pty Limited and Thalanga Copper Mines Pty Limited.

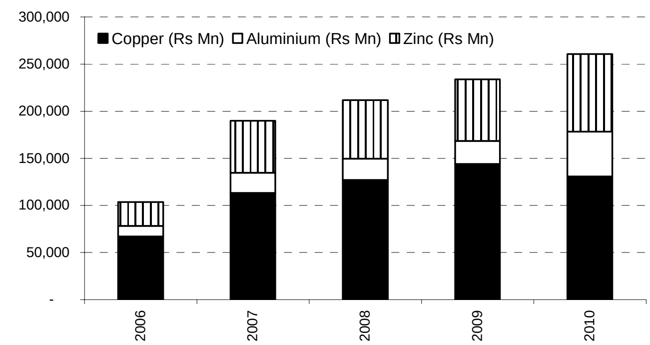
Vedanta owns 72.3% of Sterlite directly and has an additional stake through 80%-owned Malco, which holds about 4.6% of Sterlite. Indian public ownership is only about 6.5% currently. The company had a free float of 37% as of June 31, 2007.

Exhibit 17
Sterlite: Shareholding Pattern, June 2007



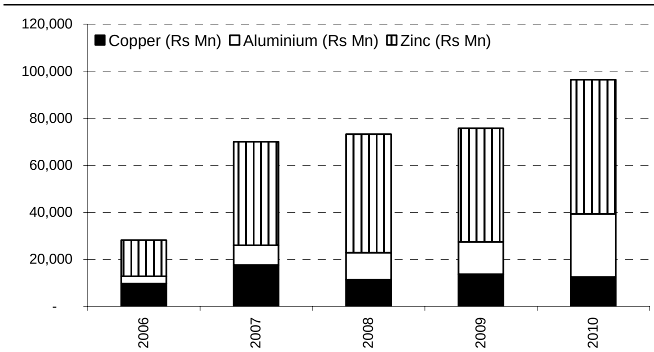
Source: Company data, BSE, Morgan Stanley Research

Exhibit 18
Sterlite: Revenue Breakdown, 2006-2010E



Source: Company data, E = Morgan Stanley Research Estimates

Exhibit 19
Sterlite: EBITDA Breakdown, 2006-2010E



Source: Company data, E = Morgan Stanley Research Estimates

Exhibit 20

Sterlite: History of Attractive Acquisitions

	Balco	At effective valuation for the full company (Rsm)	At price (Rs per share)
March 01	51% stake purchased from GoI	10,847	
March 04	Call option to buy the remaining 49% stake exercised by Sterlite		
	HZL		
April 02	46% stake purchased (26% from GoI, balance from open-market offer)	16,904	40
Nov 03	Further 19% acquired from GoI by exercising the call option	17,138	40.6
April 11, 2007	Sterlite's option to buy the remaining 30% stake of GoI became live		

Source: Company data, Morgan Stanley Research

Stake Acquisitions in HZL (Hindustan Zinc Limited) and Balco (Bharat aluminum company): Past and Future

Sterlite had purchased a 51% stake in Balco from the government of India at a consideration of Rs5.5bn in March 2001. The government also granted Sterlite an option to purchase the remaining shares in Balco (at the original price plus interest at 14% compounded six monthly beginning March 2, 2001, minus dividends received in the period), which was exercised by Sterlite on Mach 19, 2004. However, the government has disputed the proposed sale. Sterlite has sought legal relief and has requested the court to appoint an independent arbitrator to resolve the issue.

On HZL, Sterlite purchased the first 46% stake from the government of India at a payment of Rs7.8bn. The government also granted two call options to Sterlite to acquire the remaining HZL stake held by the government. Sterlite exercised the first call option in August 2003, and purchased another 18.9% stake at a consideration of Rs3.2bn. The second option to buy a 25.1% stake of the government of India became live in April, 2007 and Sterlite has stated its intention to exercise this option. The price will be determined by an independent valuer.

To give a sense of the potential earnings upside, if HZL and Balco stakes are acquired in F08, positive EPS impacts could be 22% and 11% respectively.

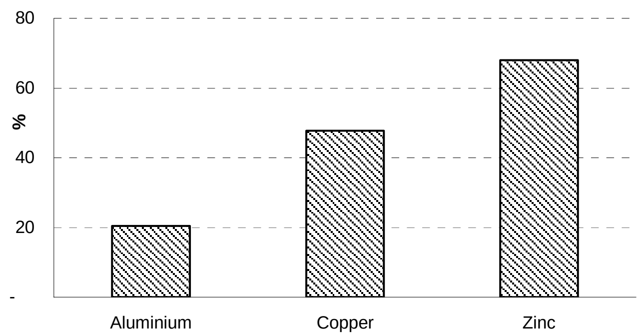
Operations – Diversified by Metal

Company Operations

Sterlite's business mainly consists of the mining, smelting and refining of copper, aluminum (through subsidiaries Balco and Malco) and zinc (through subsidiary HZL). The company is also making forays into the power business via its 100%-owned subsidiary, Sterlite Energy Limited, with a plan to set up a 2,400-coal-based power plant by 2010.

Exhibit 21

Sterlite: Leading Market Share in India F2007



Source: Company data, Morgan Stanley Research

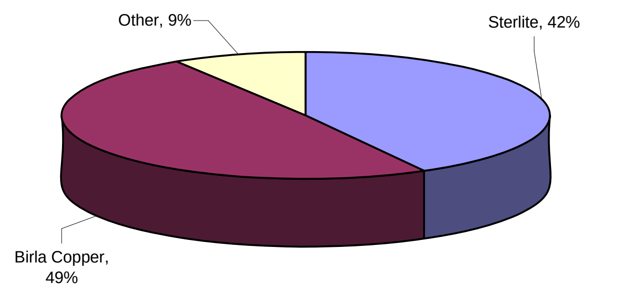
1. Copper Operations

Sterlite is a custom smelter of copper, purchasing copper concentrate from miners and refining it to copper cathode. The copper business contributed 24% of the company's attributable EBITDA and 59% of revenues in F07. Sterlite controls about 42% of the domestic copper market.

Earnings depend upon the treatment and refining charges (TC/RC) that it receives from the concentrate miners. Sterlite also benefits from by-product sales. Custom smelting in India used to be a heavily protected business, supported by the government through duty protection and export incentives. However, both forms of protection have now been reduced drastically. The company also operates a small copper mine in Australia.

Exhibit 22

Sterlite: Domestic Copper Market Share



Source: Company data, Morgan Stanley Research

Mining

Sterlite-owned Copper Mines of Tasmania Pty Limited (CMT) operates the Mt Lyall mine in Western Australia. The underground mine has a reserve base of about 14.2 million tons (average grade 1.3% of copper) and a mine life of about four years, as estimated by the company. In F2007, the mine produced about 28,000 tons of mined metal content.

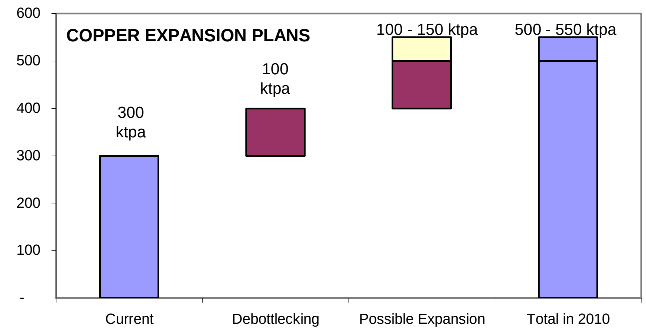
Smelting and Refining

Sterlite's smelter (at Tuticorin in Tamilnadu) and refinery (at Silvassa in Gujrat), which were set up in 1997 with capacity of 180,000 tpa of copper cathode, are based on the Isasmelt process. In F2006, capacity at the Tuticorin smelter was upgraded to 300,000 tons per annum (tpa), and a refinery of 120,000 tpa has been commissioned at the same location. Low-cost debottlenecking has allowed capacity to be boosted to 400,000 tpa of copper cathode. Sterlite also has capacity to produce about 240,000 tpa of copper rods, which is a value-added item relative to copper cathode.

Sulphuric Acid and Phosphoric Acid Plants

Sterlite has a sulphuric acid plant, with designed capacity to produce 1,600 tons of sulphuric acid per day. The company also has a phosphoric acid plant with production capacity of 600 ton per day. These facilities aid Sterlite in monetizing its by- products and at the same time avoid the disposal cost of highly polluting by-products.

Exhibit 23
Sterlite: Good Growth in Copper Pipeline



Source: Company data, Morgan Stanley Research

2. Zinc Operations

The zinc business contributed 64% of attributable EBITDA and 29% of revenues in F07. The company plans to enhance its zinc metal production by a CAGR of 22.1% in the coming three years to build upon its rich raw material advantage. The company falls into the top quartile on the global cost curve for zinc production, with a cost of US$607/ton.

Hindustan Zinc

Sterlite holds about 64% of Hindustan Zinc (HZL), the largest zinc player in India, controlling about 62% of the domestic market. HZL has a capacity of 400,000 tpa of zinc and 36,000 tpa of lead. HZL is the only integrated zinc manufacturer in India and owns captive zinc mines that supply its smelters with their entire requirement of zinc concentrate.

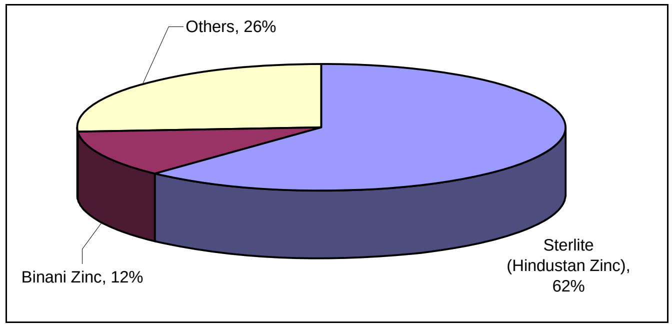
HZL has operations at Rajpura Dariba (mine), Zawar (mine), Chanderiya (smelter), Debari (smelter), Vizag (smelter) and Rampura Agucha (mine).

Exhibit 24
Zinc and Lead Reserves Summary

	Proved & Probable Reserves (MT)	Zinc Grade (%)	Lead Grade (%)
Hindustan Zinc	68.6	11.2	1.9

Source: Company data, Morgan Stanley Research

Exhibit 25
Sterlite: Share of the Domestic Zinc Market

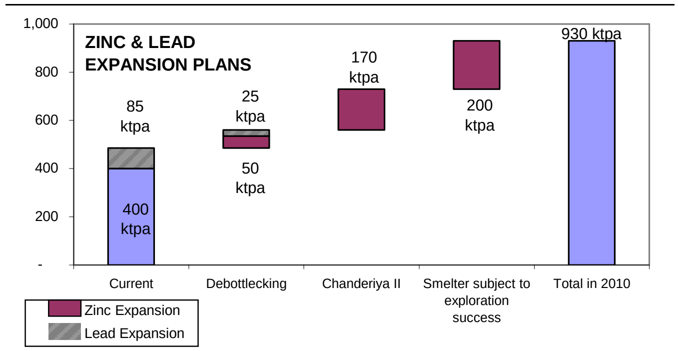


Source: Company data, Morgan Stanley Research

In May 2005 HZL's zinc smelting capacity was raised by 170,000 tpa to the current level of 400,000 tpa. The expansion plan included the addition of a 154 MW-capacity captive power plant, which allows its dependence on grid power to be reduced, thus lowering its zinc smelting costs. The company has already started work on its next expansion stage for zinc, whereby zinc capacity will be increased to 650,000 tpa and lead capacity to 54,000 tpa. It expects to complete the project by mid-2008.

HZL was created from the former Metal Corporation of India (MCI) in 1966 as a Public Sector Undertaking (PSU). In April 2002, the Government of India (GoI) divested its majority stake in HZL, and it became a part of the Sterlite group. Sterlite Industries, through its 100%-owned subsidiary, Sterlite Opportunities, and Ventures Limited (SOVL), holds a 64% stake in the company while the GoI retains a 30% stake.

Exhibit 26
Sterlite: Zinc and Lead Expansion Plans



Source: Company data, Morgan Stanley Research

3. Aluminum Operations

The aluminum business contributed 11% of Sterlite's EBITDA and 12% of revenues in F2007. Sterlite's aluminum business interests lie in Balco and Vedanta Aluminium Ltd (VAL).

Exhibit 27
Bauxite Mines

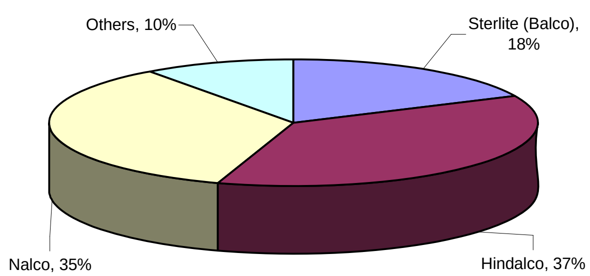
	Proved & Probable Reserves (MT)	Aluminium Grade (%)
Balco	11.7	48.1
VAL - Lanjigarh *	77.7	46.5

* - Lanjigarh mine has still to be allotted to the company
Source: Company data, Morgan Stanley Research

Bharat Aluminum Company Limited (Balco)

Sterlite owns about 51% of Balco, an aluminum producer with some vertically integrated operations through a captive bauxite mines, an alumina refinery, a captive power plant and an aluminum smelter.

Exhibit 28
Sterlite: Domestic Aluminum Market Share



Source: Company data, Morgan Stanley Research

Balco was incorporated in 1965 as a PSU. Until 2001, Balco was a public sector enterprise, 100%-owned by the GoI. In 2001, the GoI divested 51% of the equity and management control in favour of Sterlite Industries.

Balco has alumina production capacity of 200,000 tpa, smelting capacity of 350,000 tpa and captive power plant capacity of 810 MW. Of the 350,000 tpa smelting capacity and 810 MW power capacity, 250,000 tpa and 540 MW, respectively, were added in F06. According to the company, the production cost at the earlier smelter of 100,000 tpa was US$1,510 /ton while that for the new smelter of 250,000 was US$1,687/ton in F07. The second smelter (Balco plant II) incurred a high cost because of the external purchase of alumina to feed into that smelter. Excluding that factor, the conversion cost of Balco II was an attractive US$740/ton in F07, according to the company. As alumina is being increasingly sourced from the group's own refinery in Lanjigarh, the production cost of this smelter will likely decline materially in the coming two years.

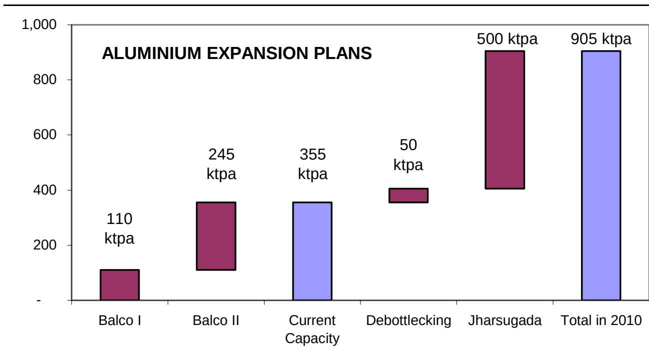
Vedanta Alumina (VAL)

VAL is currently commissioning the recently built Lanjigarh alumina refinery (with targeted capacity of 1.4 million tpa) in Orissa. VAL is also building the Jharsuguda aluminum smelter nearby with a planned capacity of 500,000 tpa. The refinery will serve as the captive alumina source for Balco's enhanced aluminum smelting operations. Beyond this, the project will also fulfill the needs of the 500,000-tpa Jharsuguda smelter. The cost of the refinery will be about Rs34.5 billion and that for the smelter will be Rs91 billion, as estimated by the company.

The refinery also envisages captive bauxite sourcing from the nearby Niyamgiri mines, which would imply quite attractive bauxite costs in alumina production. However, mine allotment has run into an environment-related controversy and could face delays. As a result, we think the Lanjigarh refinery may initially have to operate with purchased bauxite, which could cap the profitability of the project. However, once the mine is allotted to the company and becomes operational, the company expects the refinery to become one of most cost-effective refineries in the world.

The Jharsuguda smelter will come on stream in two phases of 250,000 tpa each with the first unit to be commissioned in 2009 and the other planned for 2010.

Exhibit 29
Sterlite Group: Aluminum Expansion Plans



Source: Company data, Morgan Stanley Research

4. Merchant Power Business

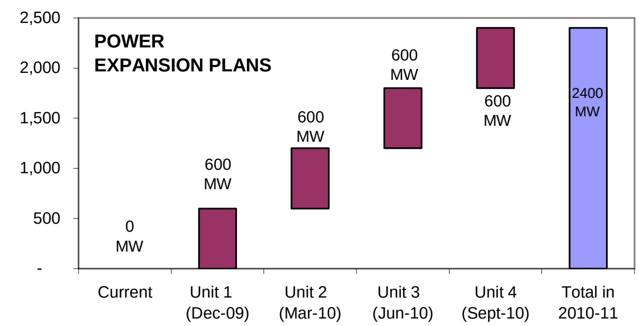
Sterlite Energy Limited, the 100%-held subsidiary of Sterlite, plans to set up a 2,400 MW-capacity merchant power plant in Orissa at a projected cost of US$1.9 billion. Funds for this project are to be raised in a debt:equity mix of 70:30. Thus Sterlite's contribution towards this project will be about US$570 million, to be spent over the next three years.

The 2,400 MW plant is being set up at Jharsuguda in Orissa. There will be four coal-based units of 600 MW each. Coal for this plant will be sourced from Mahanadi Coalfields Limited (65 kms from the plant). Pre-construction activity is under way for the project and EPC contracts have been awarded. The company plans to commission the first unit of 600 MW in December 2009 and the other three units of 600 MW each will be commissioned every three months thereafter.

The company is already one of the largest power producers in the private sector in India with a generating capacity of more than 1,050 MW. However, this power is for captive consumption only.

Exhibit 30

Strong Foray into Merchant Power Business



Source: Company data, Morgan Stanley Research

Metals Prices – Fundamentals Point to Sustained Strength

Zinc Prices Stabilizing, If Not Rising

While we do not expect significant upside in zinc prices from here, the market is likely to remain relatively tight in CY2008 on continuing strong demand growth. We forecast the stocks/consumption ratio will stay at a record low of 2.3 weeks, below the historical critical inventory level of 4.0 weeks. However, we expect the zinc market to show a slight surplus in 2008, assuming continuing high export volume from China. The zinc price has recently been stronger than we expected, as China reverted to net importer status in April and May.

Exhibit 31

Zinc Prices

US$/ton	2007e	2008e	2009e	2010e	2011e	(or LT)
Zinc	3,631	3,307	2,756	2,205	1,984	1,653
YoY (%)	11.3	-8.9	-16.7	-20.0	-10.0	

Source: Company data, Morgan Stanley Research

Supply Response Taking Form

The zinc market has been in deficit since mid-2004, resulting in a large reduction in LME zinc stocks and consequent price appreciation. A price-driven, supply-side response is now in effect, which should result in a slight surplus in 2008, increasing further into 2009. We expect the tightness in both the zinc concentrate and refined metal markets to ease. In the concentrate market, new mine supply is due to come on line from a broad range of producers, reflecting the fragmentation in the zinc industry. On the smelting side, new capacity is coming on line in Asia, especially in China but also in India.

Chinese Exports Could Be the Main Threat

China reverted to a net import position for zinc in April/ May 2007, after a four-month period of being a net exporter. We expect China to be approximately net neutral for the balance of 2007, with some risk that the country reverts to a net export position in view of the following:

1. Ramp-up of Chinese mining and smelting capacity, and

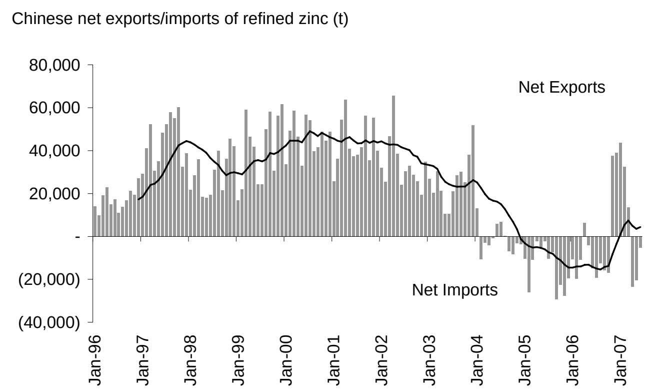
2. Tax rebate on zinc products of 5%.

China's Zinc Export Tax Rebate Encourages Exports

To control exports of products with high energy consumption and heavy pollution, the Chinese government recently raised export taxes on some metal exports. Interestingly, zinc was

Exhibit 32

China Net Importer in April & May; This Could Change Due to LME/Shanghai Price Differentials



Source: Company data, Morgan Stanley Research

excluded from the list of newly taxed metals, and instead continues to attract a 5% rebate. We think this is more likely to encourage exports of the metal rather than imports over time.

Low Inventory Levels to Keep Zinc Prices Strong

Even though we project a zinc surplus – albeit modest – in CY2008, we expect inventory levels of 2.3 days of consumption to continue, too low to cause the market concern. Even in CY09, we project only 2.6 days of inventory, which should keep prices above US$2,500 /ton.

Aluminium Prices Look Firm …

We think the Chinese dynamics that have driven aluminium prices in the past three to four years are set to turn favorable for the sector in the coming four to five quarters.

Exhibit 33

Aluminum Prices: Two More Strong Years Expected

Prices in U$/ton	F04	F05	F06	F07	F08E	F09E	F10E
Aluminum prices	1,494	1,772	2,028	2,660	2,774	2,838	2,728
YoY change (%)	9.5	18.6	14.4	31.1	4.3	2.3	-3.9

Source: Company data, E = Morgan Stanley Research Estimates

In contrast to other metals like steel and copper, an aluminium surplus has been recorded in China for the past five years. The consequent threat – real on some occasions, exaggerated on others – of a surge in exports of the metal from China has caused the aluminum price to underperform peer metals on the LME in the past four years.

Exhibit 34

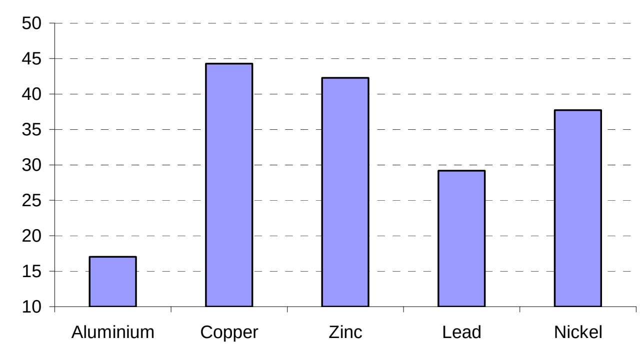
Zinc: Supply & Demand Model, 2004–10E

Production (kt)	2004	2005	2006	2007e	2008e	2009e	2010e
N America	1,500	1,440	1,404	1,424	1,464	1,477	1,504
% chg	4.5	-4.0	-2.5	1.5	2.8	0.9	1.8
S&C America	496	480	492	504	518	523	532
% chg	-0.6	-3.2	2.5	2.4	2.8	0.9	1.8
Australia	474	480	450	504	518	523	532
% chg	-14.3	1.3	-6.2	12.0	2.8	0.9	1.8
W Europe	2,174	2,080	1,918	2,031	2,087	2,107	2,145
% chg	0.3	-4.3	-7.8	5.9	2.8	0.9	1.8
NC Asia	1,733	1,765	1,841	1,938	2,071	2,131	2,178
% chg	0.2	1.8	4.3	5.2	6.9	2.9	2.2
Africa	255	280	286	293	301	304	309
% chg	32.0	9.9	2.1	2.4	2.8	0.9	1.8
W World	6,631	6,525	6,391	6,694	6,959	7,064	7,202
% chg	0.8	-1.6	-2.0	4.7	4.0	1.5	2.0
C&E Europe	311	275	245	319	335	347	345
% chg	6.5	-11.6	-11.0	30.3	5.1	3.6	-0.6
CIS	588	605	685	794	855	913	920
% chg	-2.0	2.9	13.3	15.9	7.6	6.8	0.8
China	2,665	2,865	3,295	3,650	3,940	4,175	4,280
% chg	13.9	7.5	15.0	10.8	7.9	6.0	2.5
North Korea	44	45	40	45	50	50	50
% chg	10.0	2.3	-11.1	12.5	11.1	0.0	0.0
Total Former E. Bloc	3,608	3,790	4,265	4,808	5,180	5,485	5,595
% chg	10.3	5.0	12.5	12.7	7.7	5.9	2.0
Total World	**10,239**	**10,315**	**10,656**	**11,502**	**12,139**	**12,549**	**12,797**
% chg	4.0	0.7	3.3	7.9	5.5	3.4	2.0
World ex-China	7,574	7,450	7,361	7,852	8,199	8,374	8,517
% chg	0.9	-1.6	-1.2	6.7	4.4	2.1	1.7
Consumption							
NC Asia	2,744	2,777	2,776	2,818	2,922	3,031	3,136
% chg	3.2	1.2	0.0	1.5	3.7	3.7	3.5
China	2,475	2,900	3,300	3,663	3,956	4,193	4,403
% chg	19.3	17.2	13.8	11.0	8.0	6.0	5.0
Other	50	50	54	57	62	67	72
% chg	-2.0	0.0	8.0	5.0	9.1	8.3	7.7
W Europe	2,287	2,233	2,255	2,276	2,321	2,378	2,435
% chg	1.6	-2.4	1.0	0.9	1.9	2.5	2.4
C&E Europe	209	213	200	206	221	236	251
% chg	6.1	1.9	-6.1	3.0	7.4	6.5	6.6
N America	1,665	1,560	1,547	1,557	1,579	1,602	1,625
% chg	5.0	-6.3	-0.8	0.7	1.4	1.4	1.4
S&C America	439	442	420	415	422	436	449
% chg	14.6	0.7	-5.0	-1.1	1.6	3.4	3.0
CIS	282	285	294	307	315	320	325
% chg	-8.4	1.1	3.2	4.5	2.6	1.6	1.6
Africa	188	188	202	204	207	209	213
% chg	11.2	0.0	7.4	1.1	1.6	1.0	1.5
W World	7,323	7,200	7,200	7,271	7,451	7,657	7,857
% chg	3.9	-1.7	0.0	1.0	2.5	2.8	2.6
Former E. Bloc ‡	3,018	3,450	3,850	4,235	4,556	4,818	5,054
% chg	14.6	14.3	11.6	10.0	7.6	5.8	4.9
Total World	**10,341**	**10,650**	**11,050**	**11,506**	**12,007**	**12,475**	**12,911**
% chg	6.8	3.0	3.8	4.1	4.4	3.9	3.5
World ex-China	7,866	7,750	7,750	7,843	8,051	8,282	8,508
% chg	3.4	-1.5	0.0	1.2	2.7	2.9	2.7
US Stockpile Sales	32	30	40	8	0	0	0
World Balance	**(70)**	**(305)**	**(354)**	**(89)**	**150**	**95**	**(72)**
Western world stocks	1,022	810	473	384	534	629	557
Weeks of consumption	**5.1**	**4.0**	**2.2**	**1.7**	**2.3**	**2.6**	**2.2**

e = Morgan Stanley Research estimates Source: CRU, Brook Hunt, Morgan Stanley Research

Exhibit 35

LME Price CAGR in 2002-2006 (%): Aluminum Has Lagged



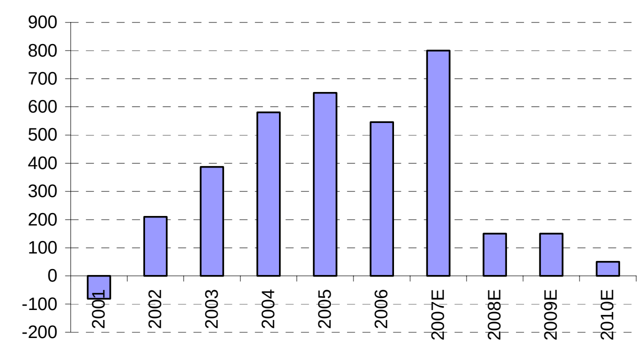
Source: Company data, Morgan Stanley Research

We expect aluminum prices to be strong because the Chinese aluminum surplus should peak in CY07. In fact, we are calling for a sharp decline in the surplus in CY08, which will likely lead to further erosion of global aluminum inventories in the event of muted production growth in the world excluding China.

As Exhibit 41 shows, even as demand is set to maintain its five-year growth trend in the next two years, production growth is likely to falter as export restrictions tighten further in China.

Exhibit 36

Chinese Aluminium Surplus – Turning Supportive for Prices ('000 tons)



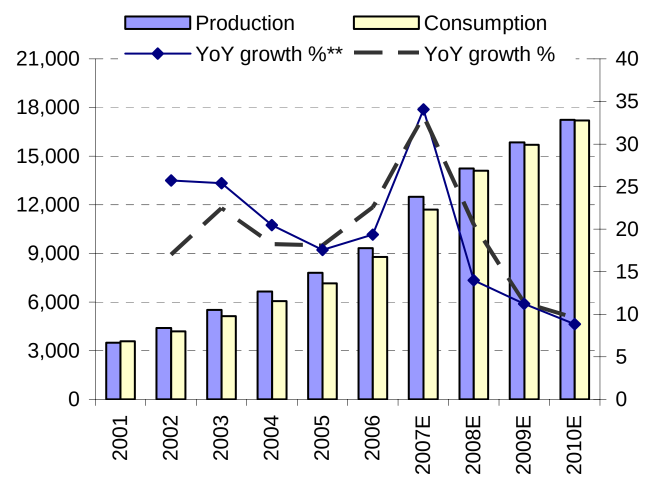
Source: CRU, Industry data, E = Morgan Stanley Research Estimates

Aluminum production growth in China to ease in CY08
Output of aluminum production in China increased 34% YoY in January-April 2007, but we expect growth to ease to 5.9% YoY in CY08. This view is based on the following factors:

(i) Reining in capacity additions – The Chinese government is increasing its focus on curbing export-oriented production of energy-intensive products. As aluminum smelting requires high energy levels, the government seems to be looking at this

Exhibit 37

Receding Chinese Aluminum Production Growth



** Production YoY Growth; Source: Company data, E = Morgan Stanley Research Estimates

industry as a key focus area, indicated by recent initiatives to remove tax rebates on exports of finished and semi-finished aluminum.

(ii) Smelting capacity utilization edging up - As aluminum production in China is likely to increase 34.1% in CY07, the industry could hit a capacity utilization levels closer to 90%, further inhibiting incremental growth in production.

(iii) Threat of severe raw material shortage: China's self-sufficiency in alumina has increased with the commissioning of new alumina refineries. At the same time, however, China has become highly dependent on imported bauxite since most of the new refineries are designed to use only good quality bauxite as feed, which is not available in China. So far, Indonesian suppliers (Indonesia contributes 95% of Chinese bauxite imports) have gladly supplied these refineries' bauxite needs. However, with a further surge in Chinese bauxite demand, Indonesia's bauxite mining and logistics systems are becoming strained. We think this bauxite constraint could begin to affect aluminum production growth in China.

… As Demand Still Seems Solid
We think the current strength in aluminum demand will be maintained for the next two to three years as China continues to invest heavily in building up its infrastructure, an aluminum-intensive exercise. Our Chinese utilities team forecasts investment of more than US$340 billion will be made during 2006-2010 to improve the power generation and distribution infrastructure. In addition, we expect China to increase its investments in rail and road infrastructure to extend the benefits of economic reforms to the inland regions and to extract the natural resources from these areas.

Exhibit 38

Global Aluminum Supply/Demand Balance, 2006–11e

'000 t	2006	2007e	2008e	2009e	2010e	2011e	CAGR (%)
Production							
North America	5,333	5,700	5,820	5,830	5,800	5,800	1.7
	-0.9%	6.9%	2.1%	0.2%	-0.5%	0.0%	
Latin America	2,494	2,600	2,750	2,760	3,000	3,350	6.1
	4.3%	4.3%	5.8%	0.4%	8.7%	11.7%	
Western Europe	4,544	4,700	4,900	4,900	4,800	4,750	0.9
	-3.6%	3.4%	4.3%	0.0%	-2.0%	-1.0%	
Eastern Europe	472	480	480	480	620	620	5.6
	-4.2%	1.7%	0.0%	0.0%	29.2%	0.0%	
CIS	4,284	4,500	5,100	5,200	5,250	5,300	4.3
	2.4%	5.0%	13.3%	2.0%	1.0%	1.0%	
China	9,324	12,500	14,250	15,850	17,250	18,250	14.4
	19.4%	34.1%	14.0%	11.2%	8.8%	5.8%	
Asia (ex-China)	1,398	1,550	1,600	1,800	2,000	2,100	8.5
	12.7%	10.9%	3.2%	12.5%	11.1%	5.0%	
Middle East	1,919	2,020	2,250	2,600	3,300	4,150	16.7
	9.6%	5.3%	11.4%	15.6%	26.9%	25.8%	
Australasia	2,274	2,330	2,340	2,350	2,350	2,350	0.7
	1.0%	2.5%	0.4%	0.4%	0.0%	0.0%	
Africa	1,864	1,830	1,860	1,970	2,050	2,360	4.8
	6.3%	-1.8%	1.6%	5.9%	4.1%	15.1%	
plus unallocated creep	0	0	115	124	219	232	
less disruption allowance	0	-50	-50	-50	-50	-50	
Total World Production	**33,906**	**38,160**	**41,415**	**43,814**	**46,589**	**49,212**	**7.7**
Consumption							
North America	7,263	7,150	7,430	7,610	7,830	8,050	2.1
	1.4%	-1.6%	3.9%	2.4%	2.9%	2.8%	
of which US	6,228	6,100	6,300	6,450	6,630	6,800	1.8
	0.5%	-2.1%	3.3%	2.4%	2.8%	2.6%	
N America ex-US	1,035	1,050	1,130	1,160	1,200	1,250	3.8
	7.7%	1.4%	7.6%	2.7%	3.4%	4.2%	
South & Central America	1,245	1,300	1,370	1,450	1,513	1,580	4.9
	5.1%	4.4%	5.4%	5.8%	4.3%	4.4%	
Europe	7,887	8,110	8,350	8,550	8,750	9,000	2.7
	4.2%	2.8%	3.0%	2.4%	2.3%	2.9%	
of which Western Europe	6,992	7,160	7,300	7,450	7,600	7,800	2.2
	4.4%	2.4%	2.0%	2.1%	2.0%	2.6%	
of which Eastern Europe	895	950	1,050	1,100	1,150	1,200	6.0
	2.5%	6.1%	10.5%	4.8%	4.5%	4.3%	
CIS	916	980	1,100	1,150	1,200	1,250	6.4
	9.0%	7.0%	12.2%	4.5%	4.3%	4.2%	
Asia	16,255	19,450	22,280	24,350	26,300	28,250	11.7
	13.5%	19.7%	14.6%	9.3%	8.0%	7.4%	
of which China	8,778	11,700	14,100	15,700	17,200	18,700	16.3
	22.6%	33.3%	20.5%	11.3%	9.6%	8.7%	
of which Japan	2,479	2,500	2,580	2,650	2,700	2,750	2.1
	2.9%	0.8%	3.2%	2.7%	1.9%	1.9%	
Asia ex-Jap/China	4,998	5,250	5,600	6,000	6,400	6,800	6.4
	5.2%	5.0%	6.7%	7.1%	6.7%	6.3%	
Australasia	354	370	380	390	400	410	3.0
	-1.1%	4.5%	2.7%	2.6%	2.6%	2.5%	
Africa	472	500	520	550	580	610	5.3
	15.1%	5.9%	4.0%	5.8%	5.5%	5.2%	
Total World Demand	**34,392**	**37,860**	**41,430**	**44,050**	**46,573**	**49,150**	**7.4**
Surplus/(deficit)	**(486)**	**300**	**(15)**	**(236)**	**16**	**62**	

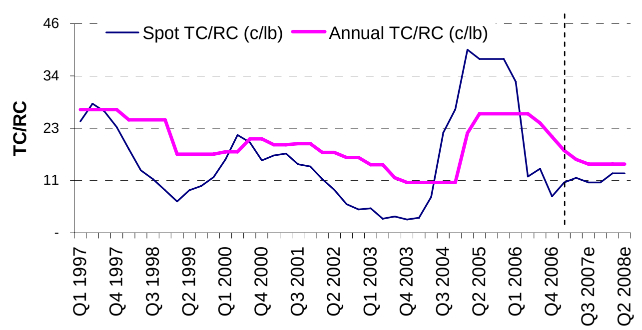
Source: CRU, Brook Hunt, Antaike, Morgan Stanley Research
e = Morgan Stanley Research estimates

Copper Concentrate – Seems Close to Bottom But Unlikely to Rebound Sharply

In the past 18 months, the spot copper concentrate market has tightened sufficiently to squeeze TC/RC down to close to 9c/lb in May 2007 from almost 45c/lb prevalent at the beginning of CY2006. Uncertain supply of concentrate has been the prime driver of the tight situation, exacerbated by increased imports by Chinese smelters in the past year.

Exhibit 38

Copper TC/RC: Spot vs. Contract



E= Morgan Stanley Estimates., Source: CRU, Morgan Stanley Research

Similarly, contract TC/RC rates have been fixed at 15.1 c/lb for CY07 versus earlier levels of 33 c/lb (including price participation). However, we do not expect TC/RC to worsen from here since many of the independent smelters would be forced to curtail production in the event of a material drop in TC/RC from current levels. We think the current market situation is the reason for Hindalco keeping its Copper II smelter (capacity of 70,000 tons per annum) closed for the past five to six months. If TC/RC were to fall further, we could see some more marginal smelters being forced to shut down operations.

We are therefore building in an average TC/RC for Sterlite of 13c/lb in F2008 (from 31c/lb in F2007) and 16 c/lb for F2009.

Exhibit 39

Sterlite: Production Summary

('000 Tons)	F06	F07E	F08E	F09E	F10E
Aluminium	174	313	372	395	464
Alumina	296	452	1,199	1,603	1,708
Copper	273	313	345	395	400
Zinc	284	348	405	570	635
Lead	24	45	56	70	78

Source: Company data, E = Morgan Stanley Research Estimates

Exhibit 40

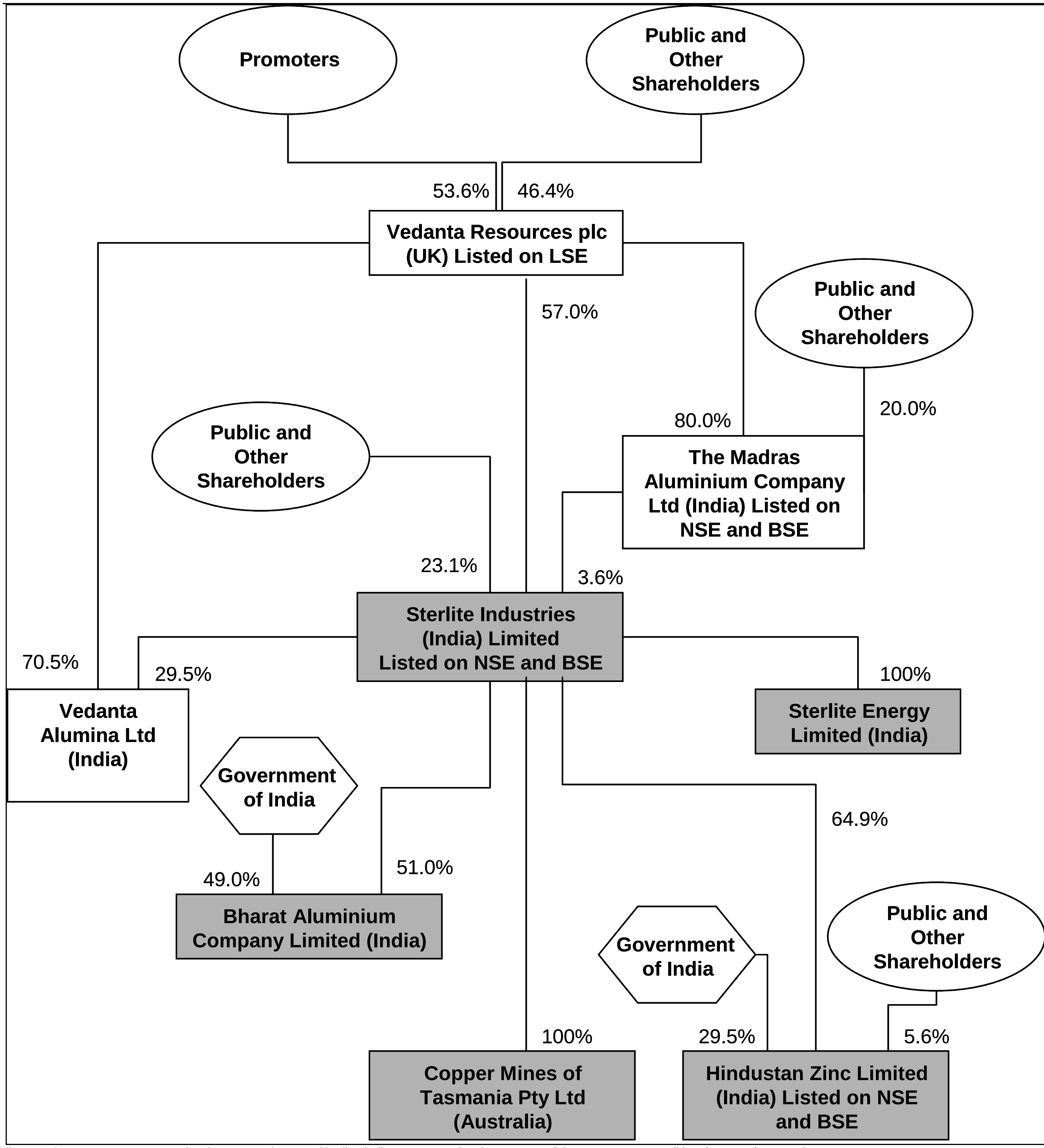
Sterlite: Key Assumptions

	Unit	F06A	F07E	F08E	F09E	F10E	LT
LME Aluminium Price	US$/ton	2,028	2,658	2,774	2,838	2,728	2,278
Aluminium Production Volume	('000 Tons)	174	313	372	395	464	
Alumina Spot Price	US$/ton	323	360	365	355	331	254
Alumina Production Volume	('000 Tons)	296	452	1,199	1,603	1,708	
LME Copper Price	US$/ton	4,095	7,011	7,447	7,385	6,586	3,527
Copper Production Volume	('000 Tons)	273	313	345	395	400	
Copper Tc/Rc	c/lb	23.1	31.0	13.0	16.0	15.0	15.0
LME Zinc Price	US$/ton	1,633	3,597	3,666	3,191	2,640	1,675
Zinc Production Volume	('000 Tons)	284	348	405	570	635	
LME Lead Price	US$/ton	1,042	1,421	1,921	1,571	1,240	882
Lead Production Volume	('000 Tons)	24	45	56	70	78	

Source: Company data, E = Morgan Stanley Research Estimates

Exhibit 41

Sterlite Industries :Holding Pattern



Source: Company Data, Morgan Stanley Research; Note: Shading indicates companies that are part of the company's consolidated group of companies. Note:

MORGAN STANLEY ModelWare	**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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	Coverage Universe		Investment Banking Clients (IBC)		
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	**908**	**40%**	**332**	**44%**	**37%**
Equal-weight/Hold	**1021**	**45%**	**327**	**44%**	**32%**
Underweight/Sell	**358**	**16%**	**90**	**12%**	**25%**
Total	**2,287**		**749**		

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Industry Coverage:India Nonferrous Metals & Mining

Company (Ticker)	Rating (as of)	Price (08/09/2007)
Vipul Prasad		
Sterlite Industries (India) Limited (STRL.BO)	O (08/09/2007)	Rs610.15
Hindalco Industries (HALC.BO)	O (08/08/2007)	Rs156
National Aluminium (NALU.BO)	E (08/24/2005)	Rs258.95
Sesa Goa (SESA.BO)	O (05/11/2007)	Rs1,826.8

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