

Restructuring appears negative

Earnings and PO cut; maintain Neutral

Sterlite's restructuring proposes to transfer the high quality aluminum (Balco) and merchant power to Vedanta and inject in the low quality copper asset (Konkola) effective April 2009. We have cut our EPS by 13.6% in FY10 and 12% in FY11 to reflect this. We have cut our PO from Rs655 to Rs606. This comprises of base business at Rs406 and SAL at Rs200. Post the sharp recent fall including yesterday's 8% decline, we believe the restructuring negative is largely priced in.

Konkola (32% of Gr EBITDA) acquisition appears over priced

We estimate Sterlite has acquired Konkola at EV/EBITDA of 9x FY10E vs peers at <4x and much higher than 2.2x paid for additional 28% stake earlier this year. Konkola offers significant volume growth post the recent capex but is a high cost asset with a chequered past. Hence we model cash cost higher than management guidance.

Malco, rechristened SAL, appears overvalued

Post restructuring, Sterlite shareholders own 92% in SAL. This implies that a Sterlite shareholder for every one share, owns 1.75 shares of SAL. At today's market price of Rs215, this would amount to Rs376 worth of SAL. We estimate fair price of SAL is Rs114 implying a value of Rs200 for Sterlite shareholder. Our fair value of Rs114 SAL comprises aluminum business at Rs86 and Rs28 for energy.

Complex group structure remains a key risk

We appreciate management's efforts to streamline the business under Sterlite & Vedanta. But there are many operating entities & ownerships that can change again as the group strategy evolves over time. The promoter family owns 54% in Vedanta & 36% in Sterlite and hence the additional risk for Sterlite minority shareholders.

Estimates (Mar)

(Rs)	2007A	2008A	2009E	2010E	2011E
Net Income (Adjusted - mn)	45,823	44,639	38,670	52,066	51,056
EPS	82.04	63.01	54.58	48.57	47.63
EPS Change (YoY)	172.6%	-23.2%	-13.4%	-11.0%	-1.9%
Dividend / Share	4.00	4.00	4.09	3.64	3.57
Free Cash Flow / Share	68.92	28.93	66.60	31.90	53.91
ADR EPS (US\$)	1.81	1.56	1.22	1.09	1.07
ADR Dividend / Share (US\$)	0.088	0.099	0.092	0.082	0.080

Valuation (Mar)

	2007A	2008A	2009E	2010E	2011E
P/E	7.01x	9.13x	10.54x	11.85x	12.08x
Dividend Yield	0.695%	0.695%	0.711%	0.633%	0.621%
EV / EBITDA*	3.83x	4.61x	5.46x	4.92x	4.96x
Free Cash Flow Yield*	9.44%	5.03%	11.58%	8.39%	14.18%

* For full definitions of *iQmethod*SM measures, see page 6.



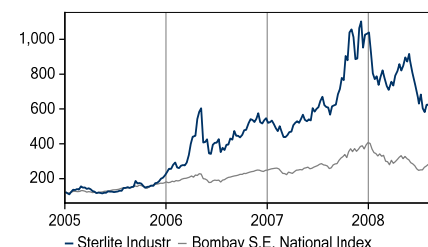
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Stock Data

Price (Common / ADR)	Rs575.35 / US\$11.20
Price Objective	Rs655.00 to Rs606.00/ US\$14.80 to US\$13.60
Date Established	9-Sep-2008 / 9-Sep-2008
Investment Opinion	C-2-8 / C-2-8
Volatility Risk	HIGH / HIGH
52-Week Range	Rs549.90-Rs1,150
Market Value (mn)	US\$9,094
Shares Outstanding (mn)	708.5 / 708.5
Average Daily Volume	2,358,744
ML Symbol / Exchange	XTNDF / BSE
ML Symbol / Exchange	SLT / NYS
Bloomberg / Reuters	STLT IN / STRL.BO
ROE (2009E)	16.1%
Net Dbt to Eqty (Mar-2008A)	-42.2%
Est. 5-Yr EPS / DPS Growth	-8.6% / -5.5%
Free Float	40.0%



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Refer to important disclosures on page 7 to 9. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5.

*iQprofile*SM Sterlite Industries India Ltd.

Key Income Statement Data (Mar)

(Rs Millions)	2007A	2008A	2009E	2010E	2011E
Sales	243,868	247,054	240,595	295,583	266,633
Gross Profit	94,589	78,682	66,385	73,674	73,120
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	86,550	72,732	60,161	65,240	63,843
Net Interest & Other Income	3,026	12,475	12,475	12,475	12,475
Associates	NA	NA	NA	NA	NA
Pretax Income	89,576	85,207	72,635	77,715	76,318
Tax (expense) / Benefit	(24,707)	(21,935)	(17,432)	(20,983)	(20,606)
Net Income (Adjusted)	45,823	44,639	38,670	52,066	51,056
Average Fully Diluted Shares Outstanding	559	708	708	1,072	1,072

Key Cash Flow Statement Data

Net Income (Reported)	45,823	44,639	38,670	52,066	51,056
Depreciation & Amortization	8,039	5,950	6,224	8,434	9,277
Change in Working Capital	(15,668)	(874)	(398)	(9,272)	(1,498)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	20,018	3,920	16,388	4,666	4,655
Cash Flow from Operations	58,212	53,635	60,885	55,894	63,491
Capital Expenditure	(19,718)	(33,141)	(13,700)	(21,700)	(5,700)
(Acquisition) / Disposal of Investments	(1,314)	(15,958)	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(21,031)	(49,099)	(13,700)	(21,700)	(5,700)
Shares Issue / (Repurchase)	(1,936)	80,509	0	0	0
Cost of Dividends Paid	(2,748)	(3,442)	(3,306)	(4,452)	(4,365)
Cash Flow from Financing	(11,245)	81,709	(3,306)	(4,452)	(4,365)
Free Cash Flow	38,494	20,494	47,185	34,194	57,791
Net Debt	(14,283)	(117,806)	(161,685)	(191,427)	(244,853)
Change in Net Debt	(31,485)	(81,604)	(43,879)	(29,743)	(53,426)

Key Balance Sheet Data

Property, Plant & Equipment	97,176	124,367	131,843	145,109	141,532
Other Non-Current Assets	2,967	18,925	18,925	18,925	18,925
Trade Receivables	16,521	15,623	16,842	18,622	18,664
Cash & Equivalents	60,387	168,551	212,430	242,173	295,599
Other Current Assets	62,939	66,476	63,758	76,852	71,991
Total Assets	239,990	393,942	443,798	501,680	546,711
Long-Term Debt	46,103	50,745	50,745	50,745	50,745
Other Non-Current Liabilities	36,411	43,996	43,996	43,996	43,996
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	21,399	19,941	18,045	23,647	17,331
Total Liabilities	103,913	114,683	112,786	118,388	112,072
Total Equity	136,076	279,259	331,012	383,292	434,639
Total Equity & Liabilities	239,990	393,942	443,798	501,680	546,711

*iQmethod*SM - Bus Performance*

Return On Capital Employed	33.8%	18.2%	11.4%	10.5%	9.3%
Return On Equity	57.1%	27.7%	16.1%	18.5%	15.5%
Operating Margin	35.5%	29.4%	25.0%	22.1%	23.9%
EBITDA Margin	38.8%	31.8%	27.6%	24.9%	27.4%

*iQmethod*SM - Quality of Earnings*

Cash Realization Ratio	1.3x	1.2x	1.6x	1.1x	1.2x
Asset Replacement Ratio	2.5x	5.6x	2.2x	2.6x	0.6x
Tax Rate (Reported)	27.6%	25.7%	24.0%	27.0%	27.0%
Net Debt-to-Equity Ratio	-10.5%	-42.2%	-48.8%	-49.9%	-56.3%
Interest Cover	22.8x	22.8x	18.9x	20.5x	20.0x

Key Metrics

* For full definitions of *iQmethod*SM measures, see page 6.

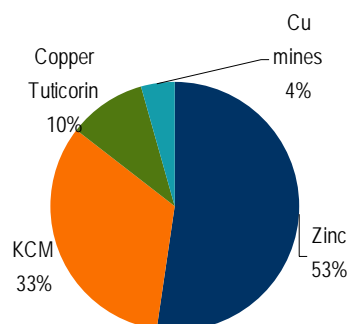
Company Description

Sterlite is India's largest non-ferrous metals and mining company based on net sales. It is also one of India's most diversified metals company with presence in zinc, aluminum, copper and in the near future merchant power generation.

Investment Thesis

Assessing risk reward for Sterlite we conclude negative news is likely priced in but positive catalysts are unlikely in the near term. Injection of Konkola add earnings volatility to the business given its high cost structure and hence higher leverage to the copper price. Probability of minority stake buyout in zinc has reduced materially owing to political compulsions. However, on the positive side we believe zinc prices have likely bottomed out.

Chart 1: EBITDA Mix FY10E



Source: Sterlite, Merrill Lynch

Stock Data

Shares / ADR	1.00
Price to Book Value	1.6x

Restructuring details

Vedanta / Sterlite have announced a plan to reorganize their businesses along three lines: Copper and Zinc-Lead, Aluminum and power and iron ore. Sterlite Industries will own the copper/zinc business; VAL/Sterlite Aluminum will be the aluminum/power business and Sesa Goa will remain the iron ore business.

What comes in?

- Konkola – 79% ownership in an integrated copper business with expected volume of 425kt in FY12
- Sterlite shareholders own 39% of SAL, the rechristened Malco.

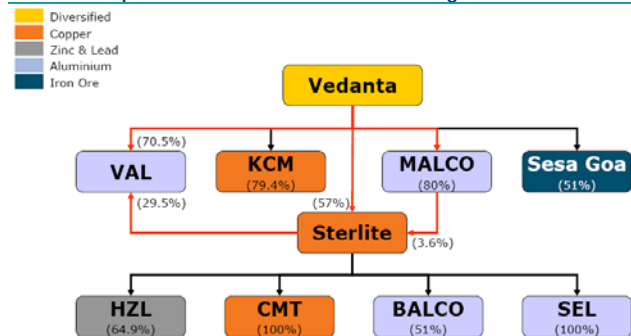
What goes out?

- Balco – 51% stake goes to SAL
- Merchant power (SEL) – 100% ownership of this asset goes to SAL
- VAL – Sterlite gives away the 29.5% stake. This implies that Sterlite has virtually no participation in Vedanta's massive aluminum growth projects

Under the restructuring plan

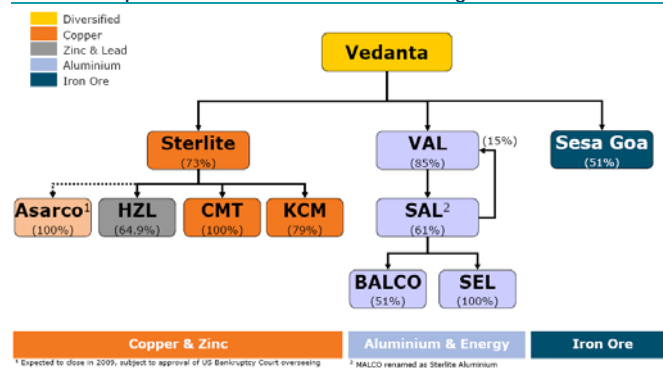
- Sterlite will transfer its aluminum and energy business to MALCO which will be renamed as Sterlite Aluminum (SAL). Sterlite share holders will receive MALCO shares in the ratio of 7:4.
- Also MALCO shareholders will receive Sterlite shares in the ratio of 1:51 in order to eliminate cross holdings between businesses arising out of MALCO's holding in Sterlite.
- Konkola copper mines (KCM), the high cost Zambian copper asset will be transferred to Sterlite to be part of Sterlite's copper and zinc business. Sterlite will issue one share in exchange for one share of KCM. Sterlite's share count increases to 1072mn shares from 708mn shares as a result of the transaction.

Chart 2: Corporate Structure : Pre Restructuring



Source: Vedanta,

Chart 3: Corporate Structure: Post Restructuring



Source: Vedanta

Estimated value of each of the businesses

Table 1 gives our estimate of each of the businesses with the Vedanta/Sterlite group

Table 1: Estimated value of businesses with Vedanta/Sterlite

Rs bn for FY10	EBITDA FY10E	EV/EBITDA	EV - Rs bn	Net Debt (Rs Bn)	Equity Value (Rs bn)	Comments
Copper Tuticorin	7.2	4.0	29	-75	103.7	
HZL	39.6	4.0	158	-90	248.4	
Malco	1.0	3.6	3.6	-2	5.6	
Balco -100%	18.7	6.7	125	11	113.8	
CMT	3.2	4.0	13	-5	17.4	
KCM	23.7	3.5	83	0	83.0	
Asarco	37.5			0	109.2	Based on acquisition cost
SEL					38.4	NPV for Sterlite Energy 2400MW
VAL					327.6	DCF as of April 2009
Sesa Goa					116.3	Mkt Cap based on Rs147.7 / share

Source: Sterlite, Vedanta, Merrill Lynch Estimates

Price objective basis & risk

Sterlite Industr (XTNDF / SLT)

Our PO of Rs606 (USD 13.6) is based on sum of parts for the metals business and Sterlite shareholders' 92% stake in the newly formed SAL. We value the base metals business at 12 month DCF value of Rs405.6/share. Our DCF builds in long term metal prices from FY16E onwards and we take a WACC of 12% and perpetuity growth of 0%. We forecast long term zinc prices of \$1654/t and long term copper price of \$3418/ton. Near term our zinc price forecast is \$1912/t for FY09E and \$1985/t for FY10E. We value SAL at Rs200 which is based on fair value of Rs114 and Sterlite shareholders ownership of 1.75 share of SAL for every 1 share of Sterlite. Our SAL valuation includes both the aluminum and energy business. Upside risks to our PO are - higher than forecast metal prices. Downside risks are lower metals prices and lower than expected production at Konkola.

Analyst Certification

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APR - Metals & Mining Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY	Banpu Pcl	BPULF	BANPU TB	Komsun Suksumrun
	Bumi Resources	PBMRF	BUMI IJ	Daisy Suryo
	China Shenhua-H	CUAEF	1088 HK	Alexander Latzer
	Gloria Material	GLMTF	5009 TT	Albert Hsu
	Hindalco	HNDF	HNDL IN	Vandana Luthra
	Intl Nickel In	PTNDF	INCO IJ	Daisy Suryo
	Jiangxi Copper-A	JIXAY	JIXAY US	Alexander Latzer
	Jiangxi Copper-H	JIAXF	358 HK	Alexander Latzer
	NALCO	NAUDF	NACL IN	Vandana Luthra

10 September 2008

APR - Metals & Mining Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
	Tambang Batubara	PBATF	PTBA IJ	Daisy Suryo
	Tata Steel	TAELF	TATA IN	Vandana Luthra
	Zijin Mining - H	ZIJMF	2899 HK	Alexander Latzer
NEUTRAL				
	Chalco	ACH	ACH US	Alexander Latzer
	Chalco	ALMMF	2600 HK	Alexander Latzer
	JSW Steel	XJWJF	JSTL IN	Bhaskar.N.Basu,CFA
	Steel Authority	SLAUF	SAIL IN	Vandana Luthra
	Sterlite Industr	XTNDF	STLT IN	Vandana Luthra
	Sterlite Industries India Limited	SLT	SLT US	Vandana Luthra
	Yanzhou Coal	YZCHF	1171 HK	Alexander Latzer
	Yanzhou Coal -A	YZC	YZC US	Alexander Latzer
UNDERPERFORM				
	Aneka Tambang	XANEF	ANTM IJ	Daisy Suryo
	Angang	ANGGF	347 HK	Alexander Latzer
	Baosteel	BAOSF	600019 CH	Alexander Latzer
	China Steel	CISXF	CISXF US	Albert Hsu
	China Steel Corp	CISEF	2002 TT	Albert Hsu
	Dongkuk Steel	DKUSF	001230 KS	Chris Kim
	Maanshan I & S-H	MISCF	323 HK	Alexander Latzer
	Wuhan Steel	WHNIF	600005 CH	Alexander Latzer
RESTRICTED				
	POSCO	PKXFF	005490 KS	Alexander Latzer
	POSCO -A	PKX	PKX US	Alexander Latzer
REVIEW				
	China Oriental	CUGCF	581 HK	Alexander Latzer
	Guangzhou Ship	GSHIF	317 HK	Irene Ye

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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SLT Price Chart



Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of August 31, 2008 or such later date as indicated.

Investment Rating Distribution: Non-Ferrous Metals/Mining & Minerals Group (as of 01 Jul 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	71	52.99%	Buy	13	20.63%
Neutral	30	22.39%	Neutral	9	39.13%
Sell	33	24.63%	Sell	5	19.23%

Investment Rating Distribution: Global Group (as of 01 Jul 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1664	47.42%	Buy	441	29.46%
Neutral	803	22.88%	Neutral	224	31.46%
Sell	1042	29.70%	Sell	217	22.84%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	$\geq 10\%$	$\leq 70\%$
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