

# UBS Investment Research

## Sterlite Industries

### Reiterating Buy – best zinc play

#### ■ Bullish on Sterlite's exposure to zinc

Sterlite has augmented its zinc capacity through organic and inorganic routes. Dariba smelter added 210ktpa, Anglo's assets would add c.400ktpa taking the total zinc-lead capacity to 1,462ktpa; in all c.11% of the world's total zinc-lead capacity. We are bullish due to two emerging themes for the zinc market - China's robust concentrate imports, coupled with struggling global mine supply.

#### ■ Downward revision to our short term metal estimates

The UBS global commodity team has decreased its 2010 estimates for zinc from 105c/lb to 93c/lb (-12%) and aluminium from 103c/lb to 94c/lb (-9%). This is due to aggressive sell-downs in inventory on concerns over policy tightening in China, slower loan growth and industrial activity and the 'post-stimulus' slowdown. We incorporate lower metal prices into our estimates.

#### ■ Expect to catch up underperformance to metals index

We have revised our earnings estimates by -9.2%/ -7.3% for FY11/12 following the revision to our metal price estimates. Sterlite has underperformed the BSE Metals index by c.8% YTD; we believe it should catch up on the underperformance with the bullish outlook on zinc

#### ■ Valuation: Reiterate Buy; lower price target to Rs225

We reiterate our Buy rating with a lower price target of Rs225. We base our price target on a sum-of-the-parts valuation of individual businesses. The value of businesses is derived from an NPV valuation method using explicit mine life forecasts. We assume a WACC of 13.2% for the copper and zinc business and 12.1% for BALCO.

Highlights (Rsm)	03/09	03/10	03/11E	03/12E	03/13E
Revenues	208,655	246,085	334,214	484,635	567,333
EBIT (UBS)	40,035	53,220	94,773	136,603	138,307
Net Income (UBS)	34,647	40,407	58,637	76,868	77,209
EPS (UBS, Rs)	12.23	12.02	17.44	22.87	22.97
Net DPS (UBS, Rs)	1.09	1.18	1.38	1.50	1.70

Profitability & Valuation	5-yr hist av.	03/10	03/11E	03/12E	03/13E
EBIT margin %	24.7	21.6	28.4	28.2	24.4
ROIC (EBIT) %	44.1	21.8	24.8	28.3	27.1
EV/EBITDA (core) x	3.4	5.9	3.7	2.7	2.8
PE (UBS) x	8.1	14.6	10.1	7.7	7.7
Net dividend yield %	0.8	0.7	0.8	0.9	1.0

Source: Company accounts, Thomson Reuters, UBS estimates. (UBS) valuations are stated before goodwill, exceptional and other special items. Valuations: based on an average share price that year, (E): based on a share price of Rs176.00 on 22 Jul 2010 23:39 EST

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## Global Equity Research

India

Non-Ferrous Metals

12-month rating **Buy \***  
**Unchanged**

12m price target **Rs225.00/-**  
**Prior: Rs240.00/-**

Price **Rs176.00/US\$14.96 (GDR)**

RIC: STRL.BO BBG: STLT IB

23 July 2010

#### Trading data (local/US\$)

52-wk range	Rs228.99-151.95/US\$19.91-12.36
Market cap.	Rs592bn/US\$50.3bn
Shares o/s	3,362m (ORD)/559m (GDR)
GDR ratio	1 GDR:1 ORD
Free float	21%
Avg. daily volume ('000)	13,034/111
Avg. daily value (m)	Rs2,247.9/US\$1.6

#### Balance sheet data 03/11E

Shareholders' equity	Rs639bn
P/BV (UBS)	0.9x
Net Cash (debt)	(Rs159bn)

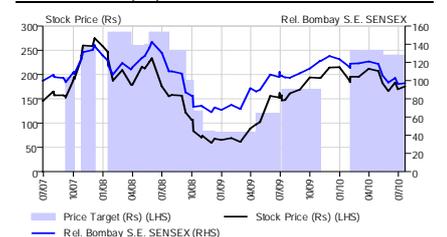
#### Forecast returns

Forecast price appreciation	+27.8%
Forecast dividend yield	0.8%
Forecast stock return	+28.6%
Market return assumption	12.7%
Forecast excess return	+15.9%

#### EPS (UBS, Rs)

	03/11E		Cons.	03/10 Actual
	From	To		
Q1E	0.00	0.00	-	2.37
Q2E	0.00	0.00	-	2.85
Q3E	0.00	0.00	-	2.99
Q4E	0.00	0.00	-	4.18
03/11E	19.20	17.44	19.20	
03/12E	24.67	22.87	24.67	

#### Performance (Rs)



Source: UBS

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**ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 18.** \* Exception to core rating bands; See page20  
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## Summary

We reiterate our Buy rating on Sterlite with an update on operations:

1. We incorporate lower estimates of metal prices into FY11-13 reflecting recent aggressive sell-downs in inventory due to concerns over policy tightening in China, slower loan growth and industrial activity and the 'post-stimulus' slowdown.
2. HZL's acquisition of Anglos' assets – make it the #1 zinc producer in the world.
3. Copper and aluminium expansions – continuation of the volume growth

## UBS metal price changes

The UBS global commodity team has revised short-term commodity price estimates to reflect recent aggressive sell-downs in inventory due to concerns over policy tightening in China, slower loan growth and industrial activity and the 'post-stimulus' slowdown.

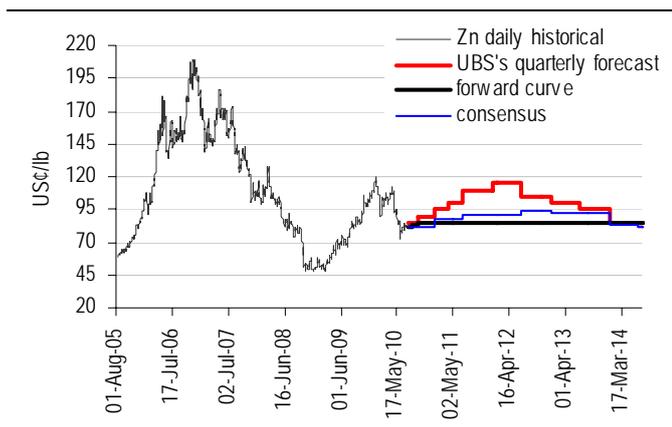
We have incorporated these lower metal prices for Sterlite, which is the reason for our lower FY11-13 estimates.

Table 1: Changes in metal price estimates

US\$/lb	New estimates			Old estimates			% Change		
	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E
Zinc	90	109	106	106	118	106	-14.9%	-7.6%	0.0%
Aluminium	93	108	111	104	114	115	-9.9%	-5.1%	-3.3%

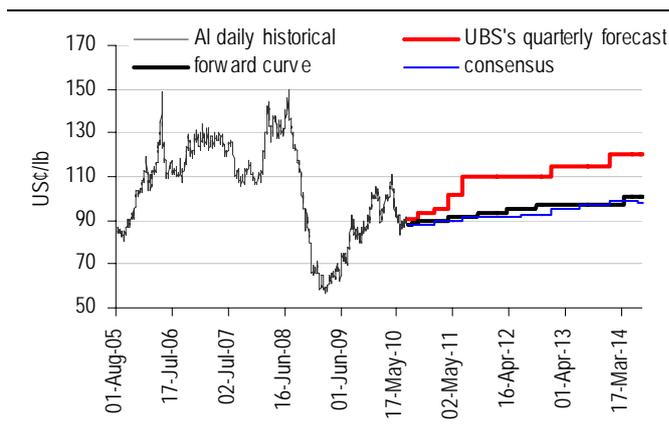
Source: UBS estimates

Chart 1: Zinc price



Source: UBS estimates

Chart 2: Aluminium price



Source: UBS estimates

## Zinc capacity ramp up

Sterlite, through its 65% owned subsidiary – Hindustan Zinc (HZL) remains one of the largest plays on zinc. HZL has total zinc-lead smelting capacity of

972ktpa currently which it intends to augment through organic and inorganic routes.

- Ramp-up of zinc smelter ahead of time – HZL commissioned the 210ktpa zinc smelter at Dariba and 1 mtpa concentrator at Rampura Agucha in March 2010, a month ahead of schedule. We believe that the planned 100ktpa lead smelter at Dariba will also be commissioned on time in Q2FY11.
- Anglo American's zinc assets buyout - Sterlite's announced acquisition of Anglo-American zinc assets will add 206mt (+76%) of zinc-lead reserves and resources. In terms of zinc-lead capacity, the acquisition would add c.400ktpa, bringing its total to 1.462mtpa (+37%), which is c11% of global zinc today. Given the short estimated mine lives of five to seven years for these assets, we believe mining activity needs to be extended through reserve additions post FY15. An extension of mine lives and commissioning of Gamsberg project would further augment capacity. Anglo's assets would be consolidated into HZL and further into Sterlite retrospectively from January 1, 2010; we are therefore ahead of the consensus on FY11 estimates.

Management states that the Anglo zinc assets are a good operational and strategic fit with Sterlite's existing zinc business, currently exclusively located in India. The acquisition would provide Sterlite with a stronger presence in the African and European markets given the location of the assets.

### Comparison of new and old zinc price estimates

The UBS global commodity team has lowered the zinc metal price estimates by 15%/8% in FY11/FY12. Our estimates for HZL reflect these lower metal price estimates, but have not fallen as much as the base metal estimates due to higher silver and sulphuric acid realization expectations.

Table 2: Changes in metal price estimates

US\$/lb	New estimates			Old estimates			% Change		
	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E
Zinc	90	109	106	106	118	106	-14.9%	-7.6%	0.0%

Source: UBS estimates

## Aluminium – the next growth driver

### Update on mine acquisition

The mining of bauxite for VALs' 1.4mtpa Lanjigarh alumina refinery from the proposed Niyamgiri Hills area in Orissa state has been held up. This is due to delays in statutory clearance from the Ministry of Environment and Forest. The proposed bauxite link requires c.660 hectares of forest land to be diverted for bauxite mining. The diversion of forest land has been opposed by the local people.

The Lanjigarh refinery is sourcing alumina from another mine in the neighbouring Chatisgarh state, in the absence of bauxite availability from Niyamgiri hills. We believe that this arrangement may not be economically viable in the long term and further ramp of the alumina refinery may be kept on hold till the clearances for bauxite mining are obtained.

## Volume growth built in for BALCO

We expect BALCO's 325ktpa aluminium smelter to commission in Q4FY11; we build in volume growth of c.76% in FY12 (on a low base in FY11, following phasing out of Balco's Plant -I) and 32% for aluminium in FY13.

**Table 3: BALCO's Capacity and production estimates**

tpa	FY10	FY11E	FY12E	FY13E
Capacity	528,000	636,333	853,000	853,000
Production	268,385	291,755	513,540	679,225
Growth		8.7%	76.0%	32.3%
Utilization	50.8%	45.8%	60.2%	79.6%

Source: UBS estimates, Company data

## New aluminium forecasts

The UBS global commodity team has lowered the aluminium metal price estimates by 3-10% over FY11-13.

**Table 4: Changes in metal price estimates**

US\$/lb	New estimates			Old estimates			% Change		
	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E
Aluminium	93	108	111	104	114	115	-9.9%	-5.1%	-3.3%

Source: UBS estimates

## Analysis of funding at entity level

We have done an analysis of the entity-wise net debt position at Sterlite, stripping out cash under the various heads to derive the eventual gaps in funding across each operating business unit. Since Sterlite's shareholding is complicated and buyback issues are still unresolved, we believe that the cash/debt at its subsidiaries and associate level may not be entirely inter - usable. Therefore, it is important to analyse the cash position at a subsidiary level to find the funding gaps.

**Sterlite Copper** - The stand-alone copper business has a strong balance sheet though we build in investments of c.Rs35bn in its 100% owned subsidiary in FY11. We expect net cash of c.Rs8bn at the end of FY11 (including liquid investments). We build in capex of c.Rs9bn for growth projects and maintenance capex.

Table 5: Cash position at Sterlite Copper level

Rs m	FY09	FY10	FY11E	Comments
Net Debt opening	-61,604	-62,190	-47,253	
Net operating cash	8,346	-84,447	11,349	
Capex	-1,040	-3,315	-8,847	
Dividends to shareholders	-2,901	-4,210	-5,798	
Investments	-3,369	1,290	-34,833	Investment in 100% subsidiary
Share issue / (buybacks)	-715	78,178	-847	
Other	266	-2,434	0	
Net Debt	-62,190	-47,253	-8,277	

Source: UBS estimates, Company data

HZL - We believe that the growth plans as well as acquisition of Anglo American's zinc assets are expected to be well funded internally at HZL. The net cash position (including liquid investments) at the end of FY11 is Rs108bn despite cash outflow of c.Rs61.5bn for the acquisition.

Table 6: Cash position at HZL level

Rs m	FY09	FY10	FY11E	Comments
Net Debt opening	-76,948	-96,393	-118,162	
Net operating cash	33,995	46,975	67,032	
Capex	-13,360	-23,980	-72,283	Anglo's zinc assets acquisition in FY11
Dividends to shareholders	-1,977	-2,956	-4,481	
Share issue / (buybacks)				
Other	787	1,730	0	
Net Debt	-96,393	-118,162	-108,430	

Source: UBS estimates, Company data

BALCO - The capex required for the 325ktpa aluminium smelter expansion at BALCO leads to a net debt position. We expect FY11 net debt/ equity ratio of 0.8x.

Table 7: Cash position at BALCO level

Rs m	FY09	FY10	FY11E
Net Debt opening	7,957	6,457	12,876
Net operating cash	13,065	9,527	10,741
Capex	-10,530	-15,190	-28,586
Dividends to shareholders	-65	-64	-198
Share issue / (buybacks)			
Other	-971	-691	-1,802
Net Debt	6,457	12,876	32,721

Source: UBS estimates, Company data

## Changes in Estimates

We have lowered our PAT estimates on expectations of lower zinc and aluminium prices and lower capacity utilization at Sterlite Copper due to lower availability of copper concentrate globally.

**Table 8: Comparison of PAT estimates**

(Rs m)	FY11E	FY12E	FY13E
PAT (new estimates)	58,637	76,868	77,209
PAT (old estimates)	64,545	82,930	79,775
% difference	-9.2%	-7.3%	-3.2%

Source: UBS estimates

**Table 9: Comparison of new estimates with old estimates**

	New estimates			Old estimates			Change in estimates		
	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E
Revenue	334,214	484,635	567,333	380,830	521,086	577,349	-12.2%	-7.0%	-1.7%
EBITDA	109,973	158,309	164,851	122,774	170,431	167,519	-10.4%	-7.1%	-1.6%
EBITDA margin	32.9%	32.7%	29.1%	32.2%	32.7%	29.0%			
Net profit	58,637	76,868	77,209	64,545	82,930	79,775	-9.2%	-7.3%	-3.2%
EPS	17.44	22.87	22.97	19.20	24.67	23.73	-9.2%	-7.3%	-3.2%

Source: UBS estimates

## Changes to subsidiary level estimates

### Sterlite Copper

**Table 40: Changes in Sterlite Copper estimates**

	New estimates			Old estimates			% Change		
	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E
Revenues	135,891	204,195	259,818	150,404	214,194	267,953	-9.6%	-4.7%	-3.0%
EBITDA	6,196	7,002	9,402	6,752	7,639	9,951	-8.2%	-8.3%	-5.5%
PAT	6,107	4,727	6,341	6,812	5,587	7,051	-10.3%	-15.4%	-10.1%

Source: UBS estimates

- We have built in lower capacity utilization through FY11-13 due to lower availability of copper concentrate globally.
- We have increased the realization expectations for sulphuric acid following an uptrend in its prices.
- We have built in interest costs on convertible senior notes issued in FY10, as well as higher gross debt expectations due to investment in its subsidiary.

## Hindustan Zinc

Table 11: Changes in Hindustan Zinc estimates

	New estimates			Old estimates			% Change		
	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E
Revenues	142,950	170,636	172,869	155,153	180,584	176,180	-7.9%	-5.5%	-1.9%
EBITDA	82,341	103,507	104,594	90,868	110,428	105,237	-9.4%	-6.3%	-0.6%
PAT	63,684	77,689	79,015	69,310	82,237	78,518	-8.1%	-5.5%	0.6%

Source: UBS estimates

- We have built in lower estimates to reflect lower zinc price through FY11-12.
- We have considered higher silver and sulphuric acid higher realizations to reflect the expected uptrend in their prices, which is the key reason for lower reduction in earnings than the underlying metal prices.

## Balco

Table 5: Changes in BALCO estimates

	New estimates			Old estimates			% Change		
	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E
Revenues	44,588	80,075	100,160	64,417	100,981	97,505	-30.8%	-20.7%	2.7%
EBITDA	15,569	31,185	33,971	19,220	37,827	33,579	-19.0%	-17.6%	1.2%
PAT	7,904	18,809	18,795	8,671	22,636	17,728	-8.9%	-16.9%	6.0%

Source: UBS estimates

- We have built in lower FY11 and FY12 revenues and EBITDA to reflect lower metal production due to phasing out of BALCO's 100ktpa Plant – I. Though we expect lower gross revenues in FY13, yet the net revenues are marginally higher as we rationalize our excise margin duty assumption based on FY10 excise duty.
- We have built in lower flow-through impact to FY11-13 PAT to reflect higher other income and lower interest costs incurred in FY10.

## UBS estimates versus Consensus

We are higher than the consensus on FY11 EPS as we build in consolidation of Anglo American's zinc assets through the entire FY11 rather than from Sep/Oct 2010, the expected time of completion of the acquisition. This is because the economic ownership of Anglo's assets will be passed on to HZL from January 1, 2010.

We are lower than the consensus on FY12/13 EPS due to expectations of lower metal prices.

Table 6: UBS estimates versus consensus

EPS (Rs)	FY11E	FY12E	FY13E
UBSe (Rs)	17.44	22.87	22.97
Consensus (Rs)	16.17	23.09	23.59
% difference	7.9%	-1.0%	-2.6%

Source: UBS estimates, Reuters (as on 22<sup>nd</sup> July, 2010)

## Valuation

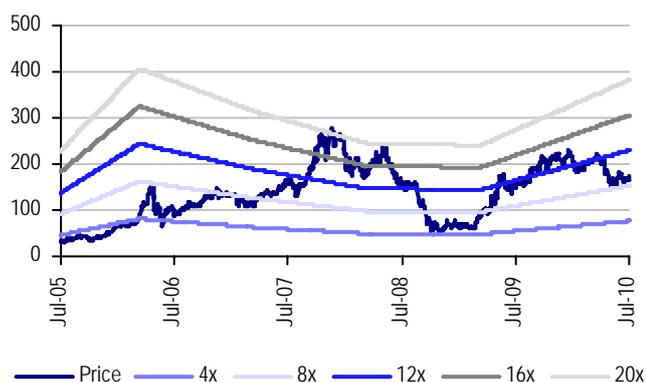
We derive a new price target of Rs225 based on our sum-of-the-parts valuation. The valuation of business units is based on NPV analysis. The NPV analysis of the business units assume a WACC of 13.2% for all units except BALCO - for which the WACC is 12.1% owing to the higher leverage due to capex investments across FY11-13.

Table 7: NPV-based price target (Rs)

	Equity value (Rs mn)	Sterlite stake (%)	Value per share (Rs)	Value derived (Rs)
Sterlite Copper	187,452	100%	56	56
Hindustan Zinc	521,921	65%	155	101
BALCO	181,298	51%	54	28
Vedanta Alumina	467,261	30%	139	41
Sum of the parts price target				225

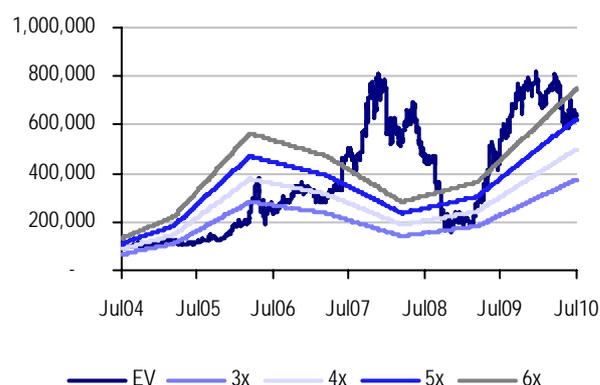
Source: UBS estimates; valuation excludes Sterlite Energy

Chart 3: One year forward PE chart



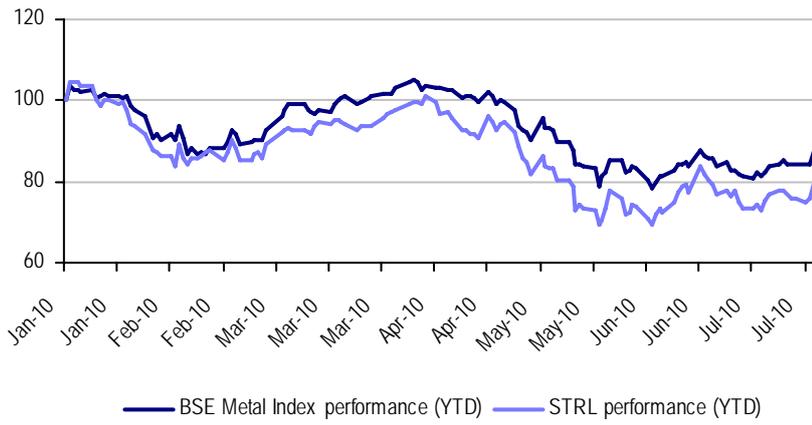
Source: UBS estimates

Chart 4: One year forward EV/EBITDA chart



Source: UBS estimates

Chart 5: Sterlite's YTD performance vis-à-vis BSE Metal Index



Source: Bloomberg

# Aluminium

## Production cuts loom large

The 3-month aluminium contract has traded between US\$84.7-92.0¢/lb throughout June and into July, and is currently trading at 89.4¢/lb. Industry leaders believe that up to 6Mt of Chinese capacity (~12% of global capacity) is operating at a loss. The heads of key aluminium producers at UC Rusal and Alcoa estimate that between 1Mt and 3Mt of production in China will move offline in the third quarter. This is equivalent to 2.4%-7.3% of global production, based on annualised June production figures.

### Supply-demand outlook

While our adjustments to supply and consumption forecasts were not large, together they result in the aluminium market moving to a slight oversupply in 2010 compared to our previous forecast of a mild tightening. Following our revisions, we expect to see a surplus of 1.2Mt in 2010, with supply of 40.9Mt exceeding demand of 39.7Mt. Note that if the June production figure is extrapolated over the second half of 2010, production would be 40.7Mt.

Our forecast Aluminium production for 2010 increased to 10.9% growth year on year, compared to our prior forecast of 7.5% growth. We now believe that the risk of power-shortage production cuts in South Africa has abated, as BHP and Eskom appear to be managing the issue without significant disruption to supply.

We continue to expect Chinese consumption will be driven by the affects of restocking. As illustrated in prior notes, de-stocking and subsequent re-stocking amplifies the changes in IP. Our economics team (Andrew Cates, et al) currently forecast China's industrial production to grow by 13.5% in 2010. We believe that the affects of restocking, combined with incremental intensity of use, will increase China's growth in aluminium consumption by ~20.5% in 2010.

At a global level, our forecast 2010 Industrial Production of 7.8% does not differ significantly from Brook Hunt's 7.4%. We do, however, significantly differ on the magnitude of the impact from restocking. As such, our growth in demand for 2010 at 14.3% is higher than Brook Hunt's 12.0%.

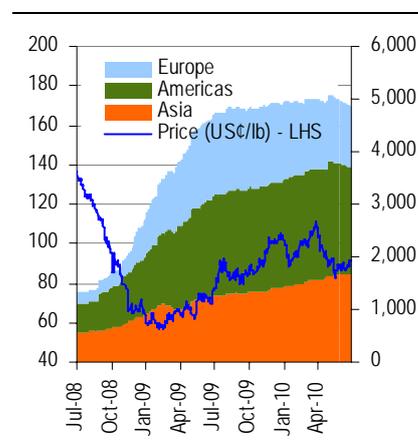
### UBS price forecast

We are currently forecasting an aluminium 3-month contract price of US\$96.4¢/lb for 2010 (US\$2,125/t), a 25.2% increase yoy. This is based on forecasts of 93.7¢ and 95.8¢ in the 3<sup>rd</sup> and 4<sup>th</sup> quarters of 2010 respectively, following a 1H10 average of 98.0¢. Current spot sits at 91.0¢. We expect aluminium to reach 113.3¢ by the end of 2011 after averaging 107.4¢ for that year.

### Market review

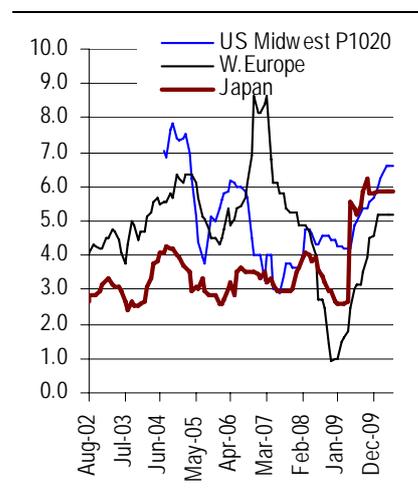
- Global exchange inventories (LME, SHFE, Comex) remain below 5Mt at 4.87Mt, after peaking at 5.08Mt on May 20<sup>th</sup>. Europe drew down 108kt of inventories, while Asia added 23kt over the last two months. Perhaps the most interesting movement was the 80kt fall in the Americas following a spike in May, resulting in a broader trend of flat-to-down inventories for this region.

Chart 6: Aluminium exchange inventories vs LME price (kt, US¢/lb)



Source: Bloomberg, LME, SHFE, Comex

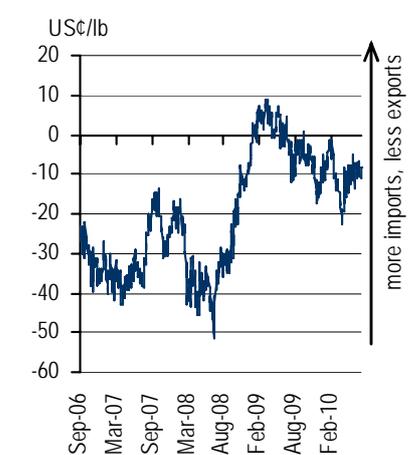
Chart 7: Al merchant premia (US¢/lb)



Source: Bloomberg, Metal Bulletin

- If a downward trend in the Americas was to materialise, this could add support to aluminium prices given that this region accounts for 43% of exchange inventories, and has been building inventories since late 2006.
- IAI inventories grew for the third month in a row in May, reaching 2.34Mt. While this is not positive for pricing, the historical stability in the IAI reading (relative to exchange inventories) and the 2 month lag in the data means that pricing is less sensitive to this figure. The inventory data for June is due for release in late July (~28<sup>th</sup>).
- Global aluminium production for June was 3.4Mt (41.1Mt annualised). This was a 53kt (1.5%) drop on May, although production is up 17.1% yoy. Growth of 6Mt in both China and the Gulf offset cuts in all other regions. The production growth in China continues to irritate Western producers (see below) who believe that significant capacity in China is operating at a loss.
- Industry leaders, including the head of UC Rusal (Oleg Deripaska) and Alcoa's CEO (Klaus Kleinfeld), have been quoted over the last two weeks stating their belief in stronger aluminium prices.
  - Deripaska expects a recovery in pricing to US\$2,400/t-US\$2,700/t (108¢/lb-123¢/lb) in 2011.
  - Kleinfeld estimates that ~6Mt (12% of current global capacity) of aluminium capacity in China is currently operating at a loss.
  - Kleinfeld expects 1.0Mt-1.5Mt to come offline in the third quarter, while Deripaska estimates that 2-3Mt will close due to smelter economics.
  - Our 2010 forecasts are in balance with current global production rates, so any cuts in production would present upside risk to our price forecasts.

Chart 8: SHFE 3m Al Prem/Disc to LME (US¢/lb; 3 months)



Source: SHFE, Bloomberg

Table 8: Global refined aluminium market

Mt	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E
<b>World Position</b>								
World Production	39.5	36.9	40.9	45.0	48.1	50.1	51.0	51.4
% change	3.8%	-6.6%	10.9%	10.1%	6.9%	4.0%	1.9%	0.7%
World Consumption	37.6	34.7	39.7	43.9	46.5	49.3	52.3	55.5
% change	-0.4%	-7.7%	14.3%	10.5%	6.0%	6.0%	6.1%	6.2%
World Balance	1.8	2.1	1.2	1.1	1.6	0.8	-1.2	-4.1
<b>World ex-China Position</b>								
World ex-China Production	26.3	23.9	24.6	25.2	27.1	28.3	28.7	28.4
% change	2.9%	-9.1%	2.7%	2.8%	7.5%	4.5%	1.1%	-0.8%
World ex-China Consumption	24.8	20.9	23.1	24.3	25.2	26.1	27.0	27.9
% change	-2.7%	-15.5%	10.2%	5.5%	3.6%	3.4%	3.4%	3.5%
World ex-China Balance	1.5	3.0	1.5	0.9	1.9	2.3	1.7	0.5
<b>China Position</b>								
China Production	13.2	13.0	16.3	19.8	21.0	21.7	22.4	22.9
YoY growth	5.5%	-1.6%	26.0%	21.0%	6.3%	3.3%	3.1%	2.5%
China Demand	12.9	13.8	16.6	19.5	21.3	23.2	25.3	27.6
YoY growth	4.5%	7.4%	20.5%	17.5%	9.0%	9.0%	9.0%	9.0%
China Balance	0.3	-0.8	-0.3	0.2	-0.3	-1.5	-2.9	-4.6

Source: UBS Research

# Zinc

## Lots of inventory (but need more mines)

China's robust concentrate imports, coupled with struggling global mine supply, are two emerging themes for the zinc market – presenting upside price risk over the medium-term (2-3 years). But short-term, the market's entirely focused on high LME inventory levels, which now weigh heavily on the metal's price.

The relentless lift in LME (620kt) and SHFE (250kt) inventories has finally eased, but with 865kt of material to work through, it's difficult to see short-term upside for the price. Short-covering has seen the price lift in starts over recent months, and excess smelting capacity in China has created tension in the concentrate trade – but all else appears subdued. The substantial lift in inventories is probably partly fed by galvanisers returning metal to the market to keep storage costs down.

The metal trade needs a sustained lift in China's steel sector (half of zinc supply goes to galvanisers) for short-term support; we expect little immediate support from the European & US steel and alloy markets.

### Supply-demand outlook

Our zinc fundamentals forecast has global refined metal demand out to 2015 lifting 5.4-6.5% per year, from 12.1Mt in 2010 to 16.1Mt in 2015. Forecast global refined supply lifts from 11.9MtMt in 2010 at 4.6-7% per year to reach 15.8Mt in 2015. We forecast deficits of 120-320kt/year (0.8-2.5% of demand) out to 2015.

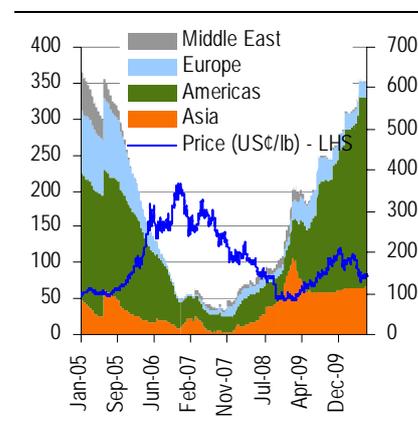
### UBS price forecast

We currently forecast an average global zinc price for 2010 of US\$0.93/lb (US\$2,050/t), a 23% y-o-y lift (vs. spot's US\$0.81/lb; \$1,785/t). We expect the zinc price to lift to over US\$1.1/lb by 2012, as China becomes increasingly dependent on imported concentrates & metal, and as under-funded western world mine supply struggles. Zinc's price is forecast to decline beyond 2012 to an unchanged long-term price of US\$0.75/lb.

### Market review

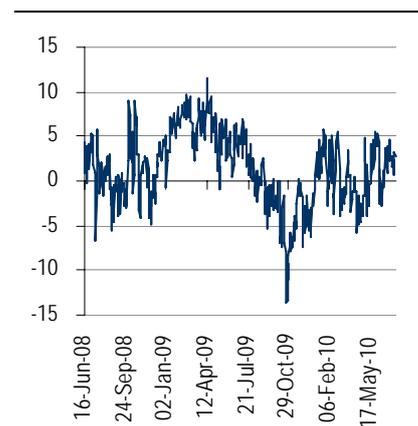
- Zinc exchange inventories have been lifting steadily over the last 12 months, easing recently largely because of an improving China trade. There is now 620kt of metal with the LME (+13% during Q2), and 250kt with the SHFE (stable over Q2). The greatest lifts on the LME are being reported in the US, reflecting general weakness in trade.
- The metal's price looks weak, but it's different in the supply chain: zinc spot treatment charges have been falling year-to-date, now a low US\$95/t conc., with realized TCs slipping to US\$242/t concentrate. What's the driver here? China's strong import flows this year have drawn down concentrate supplies; smelters in the region are charging less to process miners' concentrates. Note, the spot trade only represents 20% of the market; smelters depend more on contract TC to make money. But when contract talks start year's end, guided by the spot trade – some smelters will be concerned about revenues.

Chart 9: LME zinc stocks vs. price (kt, US\$/lb)



Source: Bloomberg, LME

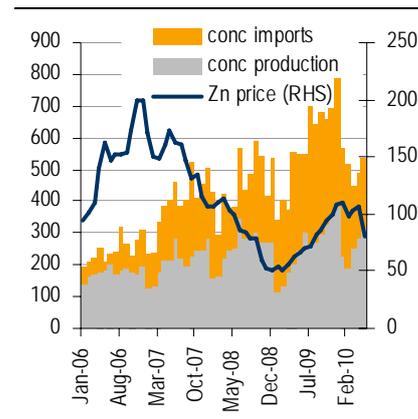
Chart 10: SHFE:LME 3mth price differentials (US\$/lb)



Source: Bloomberg, UBS

- China's dominance of the global zinc concentrate trade appears set to persist. Trade and production data to date reveals that China's domestic mine supply is highly price sensitive, lifting sharply when the metal's global price moves above US\$80/lb (>critical cost of production; SHFE:LME differential key for smelter trade too). By May, China imported, 1.3Mt ytd (260kt/month), slightly below 2009's debt-funded trade, but still robust. Also, the data suggests China's local output is capped at 300kt/mth. China dependency on imports is likely to increase.
- Where is all of China's zinc concentrates going? Record metal production. By May, China had produced 2.04Mt of metal, +35% yoy, with a record high of 452kt in May. It's unlikely this rate of output is sustainable (implies 12% yoy lift on a strong 2009 result), even though this output is partly offset by falling y-o-y import flows (total supply still +12% yoy). Expect lower production rates H2, falling concentrate imports.
- High profile zinc mine projects include Terramin's **Tala Hamza**, Algeria (DFS proceeding; M&I resource 51.1Mt 6.1% Pb+Zn; 2Mtpa output; more exploration targets in region); Kagara's **Vomacka**, Australia (Cu-Zn-Pb-Ag deposit); Jabiru Metals **Bentley**, Australia, underground 30ktpa zinc target; AGMK's **Khandiza**, Uzbekistan is a 33ktpa zinc operations.

Chart 11: China's zinc concentrate supply vs. price (kt/mth; US\$/lb)



Source: China Customs, Antaike

Table 9: Global zinc market

		2008	2009	2010	2011	2012	2013	2014	2015
Mine production (contained zn in conc)	mt	11.4	11.1	11.3	11.0	11.7	12.0	12.4	13.1
growth in mine production	%	3.2	-3.1	2.4	-2.7	5.6	2.7	4.0	5.2
Smelter capacity	mt	13.1	13.4	14.4	14.8	15.4	15.5	15.8	16.3
utilisation rate	%	88	84	81	82	86	93	96	98
Smelter production	mt	11.5	11.3	11.7	12.1	13.2	14.4	15.1	15.9
Secondary supplies	mt	0.9	0.7	0.8	0.8	0.9	0.9	0.9	0.9
Processing Losses	mt	0.6	0.6	0.7	0.8	0.8	0.8	0.8	0.8
Zinc Conc. Demand	mt	11.3	11.2	11.6	12.1	13.2	14.3	15.1	15.9
Zinc Conc. Market Balance	mt	0.2	-0.1	-0.3	-1.1	-1.5	-2.4	-2.6	-2.8
Implied Conc. Stocks	mt	3.4	3.3	3.0	1.9	0.4	-2.0	-4.6	-7.4
---days consumption		109	108	94	58	10	-51	-112	-170
Surplus/Deficit as % of total demand	%	1.5%	-0.7%	-2.5%	-8.9%	-11.7%	-16.5%	-17.4%	-17.4%
Refined zinc production	mt	11.5	11.3	11.7	12.1	13.2	14.4	15.1	15.9
Refined zinc demand	mt	11.5	10.7	12.1	13.0	13.8	14.6	15.4	16.2
growth in zinc demand	%	0.0	-6.4	13.2	7.1	6.1	5.7	5.6	5.5
World IP growth	%	0.2	-7.2	6.1	5.2	4.0	5.0	3.0	3.0
ratio of growth: demand/IP	x	-0.1	0.9	2.2	1.4	1.5	1.1	1.9	1.8
Refined Zinc Market Balance	mt	0.1	0.5	-0.4	-0.8	-0.5	-0.2	-0.3	-0.3
Implied Refined stocks	mt	-1.6	-1.1	-1.5	-2.4	-2.9	-3.1	-3.4	-3.8
---days consumption		-52	-37	-46	-67	-78	-78	-81	-84
LME stocks	mt	0.3	0.5	0.4	0.3	0.2	0.2	0.2	0.3
LME price average	US\$/lb	85	75	115	117	110	98	85	86
LME price average	US\$/t	1880	1662	2535	2579	2425	2161	1874	1896
LME price change y/y	%	-42.3	-11.6	52.5	1.7	-6.0	-10.9	-13.3	1.2
Surplus/Deficit as % of total demand	%	0.6%	5.1%	-3.7%	-6.5%	-4.0%	-1.4%	-1.9%	-2.1%

Source: UBS Research





# Sterlite Industries

Income statement (Rsm)	03/06	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
Revenues	135,395	247,702	248,043	208,655	246,085	334,214	35.8	484,635	45.0	567,333	17.1
Operating expenses (ex depn)	(98,517)	(153,524)	(169,361)	(161,613)	(185,367)	(224,242)	21.0	(326,326)	45.5	(402,482)	23.3
EBITDA (UBS)	36,878	94,179	78,682	47,041	60,718	109,973	81.1	158,309	44.0	164,851	4.1
Depreciation	(5,269)	(8,039)	(5,950)	(7,007)	(7,498)	(15,200)	102.7	(21,706)	42.8	(26,544)	22.3
Operating income (EBIT, UBS)	31,609	86,140	72,732	40,035	53,220	94,773	78.1	136,603	44.1	138,307	1.2
Other income & associates	3,363	6,817	15,661	21,543	19,594	14,055	-28.3	10,764	-23.4	11,341	5.4
Net interest	(2,353)	(3,791)	(3,186)	(3,973)	(3,424)	(9,382)	174.0	(12,380)	32.0	(14,618)	18.1
Abnormal items (pre-tax)	(30)	(1,572)	(528)	553	(2,970)	0	-	0	-	0	-
Profit before tax	32,589	87,594	84,679	58,158	66,420	99,446	49.7	134,986	35.7	135,030	0.0
Tax	(10,236)	(24,707)	(21,935)	(8,750)	(12,330)	(18,976)	53.9	(25,568)	34.7	(25,803)	0.9
Profit after tax	22,353	62,887	62,744	49,407	54,091	80,469	48.8	109,418	36.0	109,227	-0.2
Abnormal items (post-tax)	0	0	0	0	0	0	-	0	-	0	-
Minorities / pref dividends	(5,574)	(19,043)	(18,633)	(14,207)	(16,653)	(21,832)	31.1	(32,550)	49.1	(32,018)	-1.6
Net income (local GAAP)	16,778	43,845	44,111	35,200	37,437	58,637	56.6	76,868	31.1	77,209	0.4
Net Income (UBS)	16,808	45,417	44,639	34,647	40,407	58,637	45.1	76,868	31.1	77,209	0.4
Tax rate (%)	31	28	26	15	19	19	2.8	19	-0.7	19	0.9
Pre-abnormal tax rate (%)	35	30	32	24	25	22	-10.2	21	-7.4	21	1.4
Per share (Rs)	03/06	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
EPS (local GAAP)	7.51	19.62	15.57	12.42	11.14	17.44	56.6	22.87	31.1	22.97	0.4
EPS (UBS)	7.52	20.32	15.75	12.23	12.02	17.44	45.1	22.87	31.1	22.97	0.4
Net DPS	0.36	1.72	0.63	1.09	1.18	1.38	16.9	1.50	9.1	1.70	13.3
Cash EPS	9.88	23.92	17.85	14.70	14.25	21.96	54.1	29.32	33.5	30.86	5.3
BVPS	27.09	44.67	129.51	139.01	654.75	190.15	-71.0	210.69	10.8	230.54	9.4
Balance sheet (Rsm)	03/06	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
Net tangible fixed assets	85,497	97,176	124,367	172,104	233,500	367,701	57.5	406,125	10.4	401,712	-1.1
Net intangible fixed assets	0	0	0	0	0	0	-	0	-	0	-
Net working capital (incl. other assets)	15,156	30,824	31,698	19,260	92,418	103,173	11.6	118,780	15.1	125,523	5.7
Other liabilities	(7,406)	(9,174)	(13,536)	(14,076)	(15,524)	(15,524)	0.0	(15,524)	0.0	(15,524)	0.0
Operating invested capital	93,247	118,826	142,529	177,289	310,393	455,350	46.7	509,381	11.9	511,711	0.5
Investments	24,952	52,219	306,956	299,884	383,177	453,776	18.4	463,512	2.1	473,248	2.1
Total capital employed	118,199	171,045	449,485	477,173	693,571	909,126	31.1	972,893	7.0	984,958	1.2
Shareholders' equity	60,533	99,818	367,042	393,954	550,253	639,224	16.2	708,241	10.8	774,984	9.4
Minority interests	16,948	36,259	56,233	68,132	84,096	110,618	31.5	148,036	33.8	184,922	24.9
Total equity	77,480	136,076	423,275	462,086	634,348	749,842	18.2	856,277	14.2	959,906	12.1
Net debt / (cash)	40,719	34,969	26,210	15,087	59,222	159,284	169.0	116,615	-26.8	25,053	-78.5
Other debt-deemed items	0	0	0	0	0	0	-	0	-	0	-
Total capital employed	118,199	171,045	449,485	477,173	693,571	909,126	31.1	972,893	7.0	984,958	1.2
Cash flow (Rsm)	03/06	03/07	03/08	03/09	03/10	03/11E	% ch	03/12E	% ch	03/13E	% ch
Operating income (EBIT, UBS)	31,609	86,140	72,732	40,035	53,220	94,773	78.1	136,603	44.1	138,307	1.2
Depreciation	5,269	8,039	5,950	7,007	7,498	15,200	102.7	21,706	42.8	26,544	22.3
Net change in working capital	(7,069)	(15,668)	(874)	12,438	(73,157)	(10,846)	-85.2	(15,790)	45.6	(6,470)	-59.0
Other (operating)	3,333	5,514	16,517	21,323	15,347	14,055	-8.4	10,764	-23.4	11,341	5.4
Operating cash flow (pre tax/interest)	33,142	84,025	94,325	80,802	2,907	113,181	3793.5	153,283	35.4	169,723	10.7
Net interest received / (paid)	(2,353)	(3,791)	(3,186)	(3,973)	(3,424)	(9,382)	174.0	(12,380)	32.0	(14,618)	18.1
Dividends paid	(1,222)	(3,856)	(1,777)	(3,093)	(4,488)	(5,798)	29.2	(6,326)	9.1	(7,169)	13.3
Tax paid	(7,823)	(23,044)	(17,572)	(8,211)	(10,881)	(18,976)	74.4	(25,568)	34.7	(25,803)	0.9
Capital expenditure	(12,648)	(19,718)	(33,141)	(54,744)	(68,894)	(149,401)	116.9	(60,130)	-59.8	(22,132)	-63.2
Net (acquisitions) / disposals	0	0	0	0	0	0	-	0	-	0	-
Other	0	0	0	0	0	0	-	0	-	0	-
Share issues	1,732	(704)	80,875	998	81,040	(7,717)	-	(6,211)	-19.5	(8,438)	35.9
Cash flow (inc)/dec in net debt	10,828	32,912	119,523	11,780	(3,740)	(78,093)	1988.0	42,669	-	91,563	114.6
FX / non cash items	(6,360)	(27,163)	(110,763)	(657)	(40,396)	(21,969)	-45.6	0	-100.0	0	550.0
Balance sheet (inc)/dec in net debt	4,468	5,750	8,759	11,123	(44,136)	(100,062)	126.7	42,669	-	91,563	114.6
Core EBITDA	36,878	94,179	78,682	47,041	60,718	109,973	81.1	158,309	44.0	164,851	4.1
Maintenance capital expenditure	0	0	0	0	0	0	-	0	-	0	-
Maintenance net working capital	0	0	0	0	0	0	-	0	-	0	-
Operating free cash flow, pre-tax	36,878	94,179	78,682	47,041	60,718	109,973	81.1	158,309	44.0	164,851	4.1

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Note: For some companies, the data represents an extract of the full company accounts.

12-month rating

**Buy \***

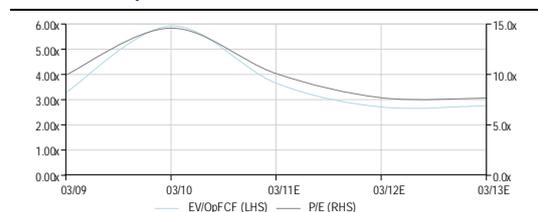
12m price target

**Rs225.00**

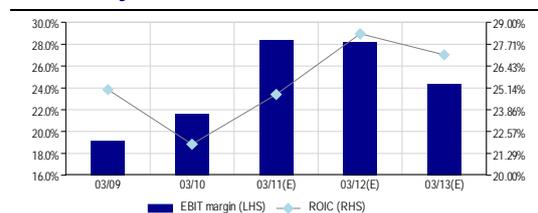
**Company profile**

Sterlite Industries, the flagship of the Agarwal group, owns a 400ktpa copper smelter in Tuticorin, India. It is the holding company for Hindustan Zinc (HZL, with a 65% stake), Balco (51%), Copper Mines of Tasmania (CMT, 100%), and Sterlite Power (100%) within the Vedanta group. HZL had 411ktps zinc smelting capacity at end-FY07, which the company expects to raise to 669ktpa by June 2008. Balco has increased its aluminium smelting capacity from 135ktpa to 345ktpa. Sterlite is setting up a 2,400 MW merchant power plant that should start operations by December 2009. Sterlite holds 30% of Vedanta Alumina.

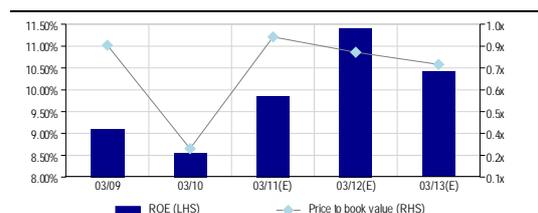
**Value (EV/OpFCF & P/E)**



**Profitability**



**ROE v Price to book value**



**Growth (UBS EPS)**



Valuation (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
P/E (local GAAP)	8.6	9.8	15.8	10.1	7.7	7.7
P/E (UBS)	8.1	10.0	14.6	10.1	7.7	7.7
P/CEPS	6.7	8.3	12.3	8.0	6.0	5.7
Net dividend yield (%)	0.8	0.9	0.7	0.8	0.9	1.0
P/BV	1.6	0.9	0.3	0.9	0.8	0.8
EV/revenue (core)	1.0	0.7	1.5	1.2	0.9	0.8
EV/EBITDA (core)	3.4	3.3	5.9	3.7	2.7	2.8
EV/EBIT (core)	3.8	3.9	6.8	4.2	3.1	3.3
EV/OpFCF (core)	3.4	3.3	5.9	3.7	2.7	2.8
EV/op. invested capital	1.7	1.0	1.5	1.1	0.9	0.9

Enterprise value (Rsm)	03/09	03/10	03/11E	03/12E	03/13E
Average market cap	345,082	569,238	591,642	591,642	591,642
+ minority interests	62,183	76,114	97,357	129,327	166,479
+ average net debt (cash)	25,388	(5,072)	(5,072)	(5,072)	(5,072)
+ pension obligations and other	0	0	0	0	0
- non-core asset value	(278,124)	(280,018)	(281,694)	(287,333)	(296,811)
Core enterprise value	154,529	360,262	402,232	428,564	456,238

Growth (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
Revenue	30.0	-15.9	17.9	35.8	45.0	17.1
EBITDA (UBS)	32.3	-40.2	29.1	81.1	44.0	4.1
EBIT (UBS)	34.0	-45.0	32.9	78.1	44.1	1.2
EPS (UBS)	34.3	-22.4	-1.7	45.1	31.1	0.4
Cash EPS	30.2	-17.7	-3.0	54.1	33.5	5.3
Net DPS	53.2	74.0	7.7	16.9	9.1	13.3
BVPS	63.0	7.3	NM	-71.0	10.8	9.4

Margins (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
EBITDA / revenue	28.1	22.5	24.7	32.9	32.7	29.1
EBIT / revenue	24.7	19.2	21.6	28.4	28.2	24.4
Net profit (UBS) / revenue	15.3	16.6	16.4	17.5	15.9	13.6

Return on capital (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
EBIT ROIC (UBS)	44.1	25.0	21.8	24.8	28.3	27.1
ROIC post tax	-	19.0	16.4	19.3	22.5	21.4
Net ROE	28.9	9.1	8.6	9.9	11.4	10.4

Coverage ratios (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
EBIT / net interest	18.8	15.5	21.3	11.6	11.9	10.2
Dividend cover (UBS EPS)	17.6	11.2	10.2	12.7	15.2	13.5
Div. payout ratio (% , UBS EPS)	6.3	8.9	9.8	7.9	6.6	7.4
Net debt / EBITDA	0.6	0.3	1.0	1.4	0.7	0.2

Efficiency ratios (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
Revenue / op. invested capital	1.7	1.3	1.0	0.9	1.0	1.1
Revenue / fixed assets	1.8	1.4	1.2	1.1	1.3	1.4
Revenue / net working capital	9.4	8.2	4.4	3.4	4.4	4.6

Investment ratios (x)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
OpFCF / EBIT	1.1	1.2	1.1	1.2	1.2	1.2
Capex / revenue (%)	16.3	26.2	28.0	NM	12.4	3.9
Capex / depreciation	5.1	7.8	9.2	9.8	2.8	0.8

Capital structure (%)	5Yr Avg	03/09	03/10	03/11E	03/12E	03/13E
Net debt / total equity	16.8	3.8	10.8	24.9	16.5	3.2
Net debt / (net debt + equity)	14.4	3.7	9.7	19.9	14.1	3.1
Net debt (core) / EV	19.4	16.4	(1.4)	(1.3)	(1.2)	(1.1)

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of Rs176.00 on 22 Jul 2010 23:39 EST Market cap(E) may include forecast share issues/buybacks.

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Analyst

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\* Exception to core rating bands; See page20

## ■ Sterlite Industries

Sterlite Industries, the flagship of the Agarwal group, owns a 400ktpa copper smelter in Tuticorin, India. It is the holding company for Hindustan Zinc (HZL, with a 65% stake), Balco (51%), Copper Mines of Tasmania (CMT, 100%), and Sterlite Power (100%) within the Vedanta group. HZL had 411ktps zinc smelting capacity at end-FY07, which the company expects to raise to 669ktpa by June 2008. Balco has increased its aluminium smelting capacity from 135ktpa to 345ktpa. Sterlite is setting up a 2,400 MW merchant power plant that should start operations by December 2009. Sterlite holds 30% of Vedanta Alumina.

## ■ Statement of Risk

We believe a sharp fall in zinc prices, which are linked to global economic growth, would be the key risk factor for Sterlite. The company may not, for whatever reason, be able to acquire the government stake in HZL and/or BALCO, which could affect the consolidation of operations into the future. Disruptions in power supply could lead to delays in projects and/or increases in capex requirements.

## ■ Analyst Certification

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### UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage <sup>1</sup>	IB Services <sup>2</sup>
Buy	Buy	54%	41%
Neutral	Hold/Neutral	37%	32%
Sell	Sell	9%	24%
UBS Short-Term Rating	Rating Category	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Buy	less than 1%	22%
Sell	Sell	less than 1%	0%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 June 2010.

### UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

**KEY DEFINITIONS**

**Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

**Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

**Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

**Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

**Equity Price Targets** have an investment horizon of 12 months.

**EXCEPTIONS AND SPECIAL CASES**

**UK and European Investment Fund ratings and definitions are:** Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Sell: Negative on factors such as structure, management, performance record, discount.

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**UBS Securities India Private Ltd:** Sunita Sachdev.

**Company Disclosures**

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Sterlite Industries <sup>1, 5, 16, 20</sup>	STRL.BO	Buy (CBE)	N/A	Rs176.00	22 Jul 2010

Source: UBS. All prices as of local market close.

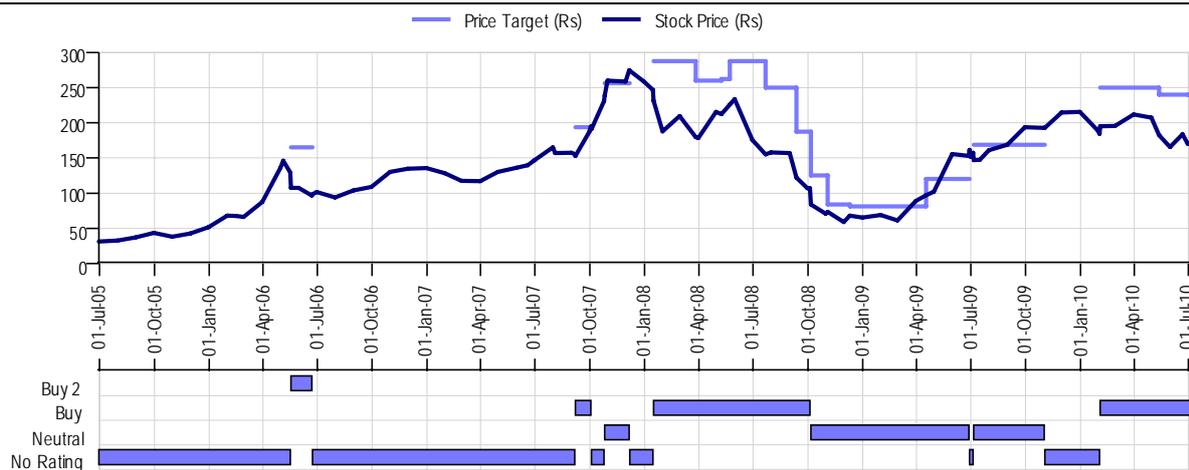
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Sterlite Industries (Rs)



Source: UBS; as of 22 Jul 2010

Note: On August 4, 2007 UBS revised its rating system. (See 'UBS Investment Research: Global Equity Rating Definitions' table for details). From September 9, 2006 through August 3, 2007 the UBS ratings and their definitions were: Buy 1 = FSR is > 6% above the MRA, higher degree of predictability; Buy 2 = FSR is > 6% above the MRA, lower degree of predictability; Neutral 1 = FSR is between -6% and 6% of the MRA, higher degree of predictability; Neutral 2 = FSR is between -6% and 6% of the MRA, lower degree of predictability; Reduce 1 = FSR is > 6% below the MRA, higher degree of predictability; Reduce 2 = FSR is > 6% below the MRA, lower degree of predictability. The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities. From October 13, 2003 through September 8, 2006 the percentage band criteria used in the rating system was 10%.

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