Vedanta Resources Plc 27/01/2011 **FAT-UK-371**

VED GBP £24.00 Core **HIGH** B

India Resource giant in the making

With its move into oil Vedanta Resources is seeking to become a diversified resources firm in the model of BHP Billiton. The group now stretches from precious metals to energy which given the volatility of commodity prices is no bad thing. As such the strong growth profile for Vedanata and the relatively low rating ensure we rate the stock a buy.

While the major mining houses – Rio Tinto, BHP Billiton, Xstrata and Anglo American – get the bulk of investor attention it is the stocks further down the scale which are often more successful at boosting output. One such group is Vedanta Resources which, although no minnow, has a market cap that is about ten times smaller than Rio Tinto.

Looking at the weekly chart of Vedanta we can see that the share price has pulled back recently but looks to have found support at its long term uptrend. The weekly MACD has give a bullish signal while the price action is one again trading above the 50 day moving average.

Now, moving on to the daily chart of Vedanta we can see that the recent downtrend has been broken. The 50 day moving average has completed a bullish golden cross above the 200 day MA which is a strong signal that the move higher will continue.

Vedanta is a business which has its roots in India but has started to diversify overseas with copper operations in Zambia and Australia. Its acquisition of a significant stake in Cairn India takes it into oil and highlights the group's ambition to expand. Despite this scope for output growth the company is lowly rated compared to peers and therefore is a compelling investment proposition.

The reasons for the low rating relate firstly to the complex structure of the business and the reliance on the Indian operating environment. Starting with the structure and Vedanta owns stakes in various resource companies which is a product of the way business is done in India. Some subsidiaries, for example, have minority stakes in them held by the Government of India (GoI).

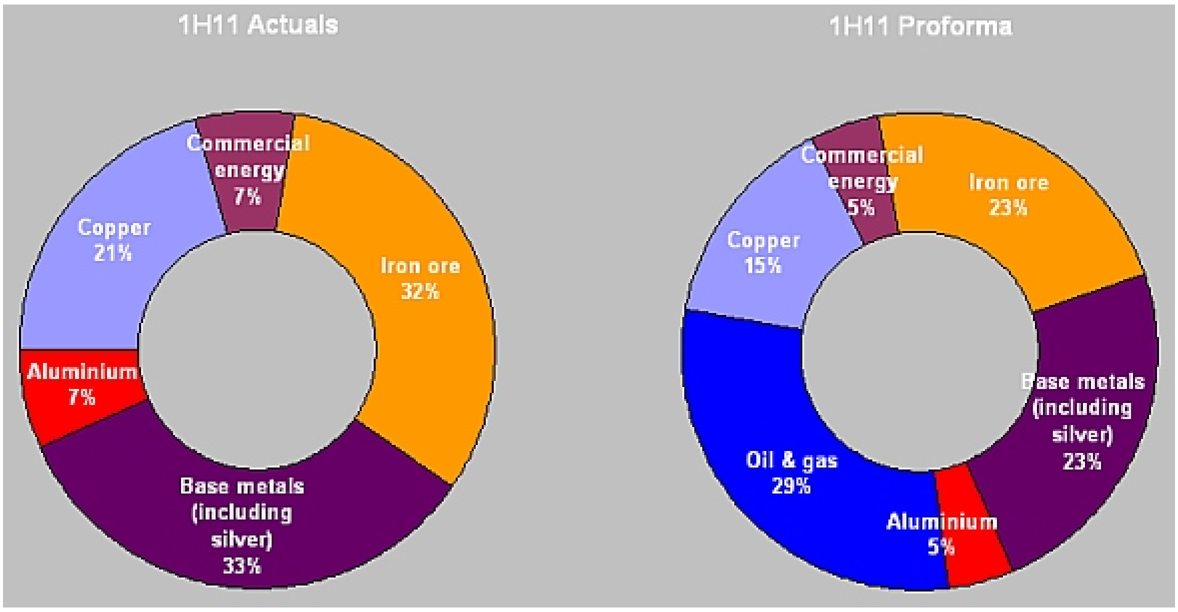
In the medium-term this complex structure looks likely to remain but it need not deflect from the potential for the group. Furthermore, Vedanata has effective control of its subsidiaries and so is able to operate them as it deems appropriate and the Government of India may well look to sell its minority stakes in future.

The focus of Vedanta principally on India also clearly helps increase the risk perceptions for investors. This is highlighted by talks of a new local mining tax the aim of which would be to require resource companies in India to return 26% of profits to the local districts where the revenue was generated.

With this rate being over and above regular taxes and royalties it has attracted heavy criticism from the Indian mining industry. The tax changes are part of a new mining law which would be in place sometime in 2011 and also seeks to attract investment. As such any fiscal changes may well be watered down.

Moving on from these concerns and the attractions of Vedanta are that the group is emerging as a diversified resources business which is growing strongly. The company's ambition is highlighted by the purchase of more than half of Cairn India giving it a significant stake in oil production. This deal isn't sealed yet as it needs regulatory approval but Vedanta's own stockholders have approved it.

The significance of the Cairn India acquisition is underlined by how the EBITDA contribution for each resources area would change had it been owned by Vedanta for the six months to the end of September 2010. The below chart illustrates this and shows that at a stroke oil and gas would become one of the biggest profits contributors to the group.



In our view, Vedanta has to some extent taken advantage of Indian tax uncertainty to buy a stake in Cairn India at an attractive price. The deal would be immediately EPS accretive and cost between US$8.5bn-9.6bn. Gearing would increase but would still come in at less than 40% and strong cash generation would reduce this figure rapidly. We believe oil exposure will serve resource companies well as the commodity looks set to perform well on emerging marked demand.

Vedanta is also completing the acquisition of Anglo-American's Zinc assets. These stretch across Namibia, South Africa and Ireland and boost the company's position as the world's largest integrated Zinc-Lead producer.

Looking at the recent half-year results (six months to the end of September 10) and in line with other mining firms profits rebounded strongly due to higher commodity prices. EBITDA was up 81% compared to the first half of 2010 coming in at US$1.3bn with EBITDA margins came in at an impressive 61%. This boosts cashflow just as the group is undertaking major deals.

In the group's third quarter production update (three months to 31st December 10) the indicators were also robust. There were record production volumes at the Zinc-Lead and Copper-Zambia operations while quarterly EBITDA was also at a record $895m.

Looking on a valuation basis and this is where the business stands out. The price earnings ratio for the current year (which finishes at the end of March) stands at around 10.8X. However, it falls to around half this level at 5.4X for the 2012 financial year. Catalysts for the company would be the completion of the Cairn India purchase which is awaiting approval but even without this the stock is inexpensive.

Accordingly, we recommend Vedanta Resources as a buy to all members.

AGO, AJA, AMP, ANZ, APA, APG, AVG, BCI, BHP, BKN, BOQ, BRL, BRU, BTR, BWP, CBA, CCL, CDD, CFE, CGL, CKF, CNQ, CVO, CWN, DLS, DNX, DUE, ELD, ENV, EVN, FID, FMG, FXJ, GJT, GMG, GNS, GOR, GPT, GXL, HUB, IAU, IFL, ILU, IMF, JHX, MFG, MGR, MML, MMS, MND, MNF, MPL, MTR, MTU, NAB, NCM, NMG, NUF, OBS, ORE, OSH, OVH, POS, PPS, PRG, PRT, PXG, QAN,QBE, RIO, RXL, RRS, S32,SDG, SFR, SGP, SIV, SLR, SPK, STO, SUN, SYD, TAM, TEN, TLS, TME, TTN, WBC, WFD, WES, WHC, WOW, WPL, WSA. International stocks 3i Group, Acacia Mining, Amec Foster Wheeler, Anglo American, Archipelago Resources, Arian Silver Corp, Aviva, Avocet Mining, Bank of China, Barratt Developments, BMW, Berkeley Energy, BG Group, BOLSAS Y MERCADOS ESPANOLES,SOCIEDAD, Bovis Homes, BP, Braemar Shipping Group, British American Tobacco, BT Group, Cairn Energy, Centamin Egypt, China Life Insurance, China Mobile, China Overseas, China Taiping, China Vanke, Country Garden, Daejan Holdings, Development Securities, Dragon, Enquest, Esure, Euronext, FedEx, Fresnillo, Ibiden, Infosys, Glaxosmithkline, Glencore International, Goldbridges Global Resources, Google (Alphabet), Grainger, Gulf Keystone Petroleum, Highland Gold Mining, HSBC,ICICI Bank, Ironveld, iShares Physical Metals, J Sainsbury, JKX Oil & Gas, John Wood Group, Kazakhmys, Legal & General, Lloyds, Low and Bonar, Market Vectors Junior Gold Miners, Market Vectors Oil Services, Market Vectors Vietnam, Marstons, Medusa Mining, Mitchells & Butlers, Mitsubishi Tokyo Financial, Mitsubishi UFJ, National Grid, Nippon Telegraph and Telephone, Panasonic, Paragon Group of Companies, Petra Diamonds, Petrofac, Petropavlovsk, PICC Property & Casualty, PPHE Hotel Group, Randgold Resources, Rank Group, Reckitt Benckiser, Royal Dutch Shell, Solgold, Sony Corporation, Standard Chartered, STV Group, Sylvania Platinum, Tata Motors, Tencent, Tertiary Minerals, Teva Pharamaceutical, Toyota Motor, Tullow Oil, Unilever, Vedanta Resources, Vodafone, Walt Disney, Zillow.

Snapshot VED

Vedanta Resources Plc

Vedanta Resources is the largest non-ferrous metals mining company in India. Vedanta is a holding company with various levels of ownership in its subsidiary companies. These range from 51% of Sesa Goa (iron ore), to 88.2% of Vedanta Aluminium (VAL). Sterlite (59.9% owned) has a strong growth profile and we briefly describe Sterlite's activities separately. The Group has key investments in copper, zinc, aluminium and iron ore. Most of the Group assets are in India. There are copper operations in Zambia and Australia.

Market Capitalisation:£6.4bn

	FY1	FY2
Price to Earnings	10.9	5.4
Dividend Yield (%)	1.2	1.5
Price to Book	1.8	1.4
Return on Equity (%)	19.2	32.9
EV/EBITDA		2.82