

VED

GBP £25.48

Core

HIGH

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Strong growth ahead at a cheap price

We an initial look at Vedanta in FAT-EUR-140 when we placed the stock at a Stoplight. Since then there has been further evidence of stronger economic activity outside of North America and Western Europe. Vedanta has also announced a massive increase in 4Q09 profit and, in our view, has the potential for strong growth which is not being recognised by the market.

The stock is cheap compared to its peer group. We have changed our view of the company from Stoplight to BUY.

When we first reviewed the company in FAT-EUR-140 the stock was trading at around £24 in October 2009. Since then the company almost reached £29 before pulling back sharply to nearly £23. The company has recovered to £25.48 and is being supported by the outlook for a 30-40% hike in the price of iron ore and firm metal prices.

The US economy is recovering slowly. The US is expected to accelerate over the course of 2010, and going into 2011. In some other countries, a strong recovery in industrial output is underway.

Let's have a look at how some economies were rebounding at the end of 2009. From a raw materials perspective we are far more interested in industrial production than changes in GDP.

Changes in industrial production for some countries have been remarkable.

Last December Taiwan recorded growth in production of 47.3% on a year ago. This was followed by Thailand with 35.7% and South Korea with 33.9%. There was also strong growth in production in Turkey, Brazil and Singapore, which recorded increases of 25.2%, 18.9% and 14.4% respectively. Poland and Russia were laggards with 7.4% and 2.7% growth on a year ago.

Just for the record, the world's two fastest growing economies in terms of GDP, China and India, recorded increases in industrial output of 18.5% and 11.7% on a year ago.

Although the big increases in industrial output are coming off a low base, the thing to bear in mind is that positive growth in industrial production means increasing consumption of raw materials.

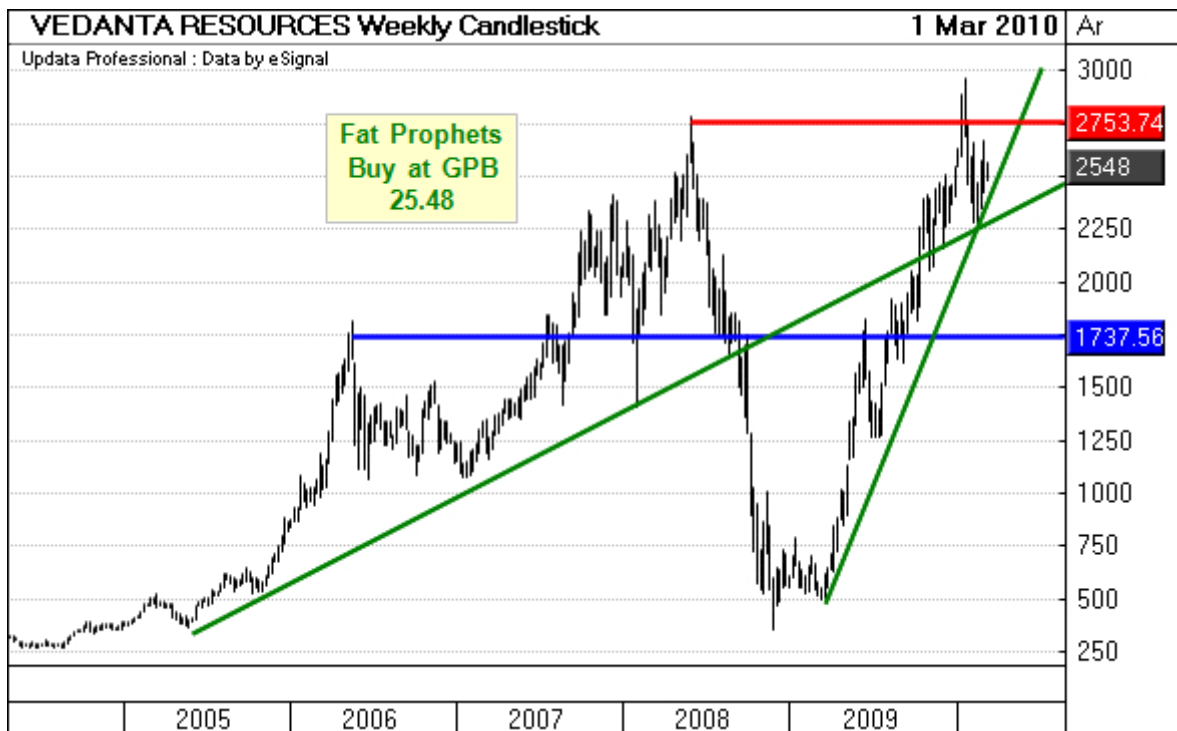
The market seems to be waking up to the fact that although there are big risks for the global economy should Europe not save Greece and a chain reaction takes out Spain and Portugal etc. But elsewhere in the world in key emerging markets things are pretty good.

A change in sentiment is buoying the share prices of stocks like Vedanta and other metal leveraged plays. The world is only at the first step of this business cycle. The last step is hopefully 5-6 years

away.

SHARE PRICE CHARTS AND COMMENTS:

Looking at the long term weekly chart of Vedanta we can see that it is one of a small number of equities that has managed to fully retrace the sell off that occurred in the latter half of 2008. The stock managed to trade above the level of the prior high but has recently ducked back below this resistance level.



Looking at the daily chart of VED we can see that the recent uptrend has been broken as the share price has started to consolidate sideways. The 2250p level is currently acting as support for prices.



STATE OF PLAY

Members might recall that one of the things we like about Vedanta is that it serves a ready made market. The company is highly leveraged to the price of iron ore and zinc. The company is also leveraged to copper and aluminium, and has a power generating division.

Development of the India's economy has lagged that of China because of the Coalition Government consisting of so many parties that common agreement was difficult.

In the past the socialist parties held sway over sensible decision making. There were positive changes in the nature of the Coalition Government elected last May. Today the Government of India seems focussed on making reforms and reviving growth across all sectors.

There is a push from some quarters within India to slowly change the structure of the economy. The services sector dominates India but there is a growing call to build a manufacturing based economy and compete with China.

The only way that India can achieve strong growth is to invest heavily in infrastructure. In the five years to 2012, the plan is to spend US\$512Bn on infrastructure which includes US\$167Bn for power generation. The demand for raw materials will remain very robust. Nearly 80% of India's GDP is internally derived.

Vedanta reported a very strong increase in EBITDA for 4Q09 (3QFY10) with a whopping rise of 6,459% to US\$662.5M on a year ago. EBITDA was only US\$10.1M for 4Q08 when metal prices had collapsed and demand for power was savaged.

The company's most profitable business was zinc, which accounted for 44% of EBITDA in 4Q09. Iron accounted for 33% of EBITDA.

Mine production of lead and zinc was a record of 200,000t for the quarter, and production of lead and zinc was stable at 169,000t. Production of by-product silver increased by 48% to 1.38M oz. The financial performance of the zinc division was much stronger with EBITDA rising from US\$44.3M in 4Q08 to US\$290.6M in 4Q09.

Group production of iron ore was 5.4Mt in 4Q09 against a rise in sales of iron ore of 6.79Mt. Iron ore contributed US\$216.1M to EBITDA compared with US\$85.8M a year ago.

Copper production was increased at the Tuticorin smelter by 12% to 85,000t, despite treating lower grade concentrates that are expected to return to normal in 1Q10.

The Zambian copper business is ramping up and aided by stronger copper prices recorded a modest profit of US\$35.6M compared with a loss of US\$159.4M a year ago.

Output of aluminium increased by 7% to 130,000t, despite the closure of two smelters. The BALCO-II smelter is operating above capacity and only 448 pots are in operation from a total of 608 pots. EBITDA increased from US\$31.1M to US\$45.1M.

The energy business sold 589M units of power compared with 42M units in 4Q08. The increase in sales lifted the contribution in EBITDA from US\$3.5M to US\$36.7M.

Construction of the new thermal powered 2,400 MW (4X600 MW) generator at Jharsuguda in Orissa continues, with the first unit expected to be commissioned soon. The other units will be commissioned over the course of 2010. Demand for electricity is rising apace and the new thermal power forms the basis for a solid business.

Vedanta is expected to exhibit strong earnings growth for the next few years and probably beyond.

From a valuation perspective, Vedanta's forward price earnings multiples are very undemanding. The consensus forecasts for price earnings multiples are 9.5X for 2011 and 6.1X for 2012. The price to cash flow multiples are very low at 3X and 2X respectively. Looking ahead to 2013, the PER falls to only 5.5X, and the cash flow multiple is unchanged at 2X.

These are very low multiples compared with the average for mid-cap diversified/metal miners trading on a PER of 9X for 2011 and a cash flow multiple of 6.3X.

Vedanta Resources PLC (LSE: VED) is cheap and set to benefit from strong industrial growth in India and from a recovery in the global economy.

Accordingly, the stock is recommended as a BUY for all Members.

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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: GBP 7.05Bn

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