

Risks and Uncertainties

The identification and management of risks is integral to Vedanta's strategy and to achieve its long-term goals.

Risks and risk management practices

Our businesses and operations are subject to a variety of risks and uncertainties which are no different from any other company in general and our competitors in particular. Such risks are the result of not only the business environment within which we operate but also of other factors over which we have little or no control. These risks may be categorised between operational, financial, environmental, health and safety, political, market-related and strategic risks. We have well documented and practised risk management policies that act as an effective tool in minimising various risks to which our businesses are exposed to during the course of their day-to-day operations as well as in their strategic actions.

Risks are identified through a formal risk management programme with the active involvement of business managers and senior management personnel at both the subsidiary level as well as at the corporate level. Each significant risk has an 'owner' within the Group at a senior level, and the impact to the Group if a risk materialises and its likelihood of crystallisation is regularly reviewed. A risk register and matrix is maintained, which is regularly updated in consultation with business managers. The risk management process is coordinated by our management assurance function and is regularly reviewed by our Audit Committee. Key business decisions are discussed at the monthly meetings of the Executive Committee and senior managers address risk management issues when presenting initiatives to the Executive Committee. The overall internal control environment and risk management programme is reviewed by our Audit Committee on behalf of the Board.

Internal controls

A strong internal control culture is pervasive throughout the Group. Regular management assurance visits to our operations and holding companies

are undertaken to ensure the Group's high standards of internal control are maintained. The strength of a business's internal control environment forms a component of senior managers' performance appraisals. Further details on the Group's internal control environment are provided in the annual Corporate Governance Report.

Treasury management

Our core philosophy in treasury management revolves around three main pillars, namely: (a) capital protection; (b) liquidity maintenance; and (c) yield maximisation. Treasury policies are approved by the Board and adherence to these policies is strictly monitored at our Executive Committee meetings. Day-to-day treasury operations of our Group subsidiaries are managed by the respective subsidiary finance teams within the framework of the overall Group treasury policies. Long-term fund raising including strategic treasury initiatives are handled by a central team while short-term funding for routine working capital requirements is delegated to subsidiary companies. Each of our subsidiaries has a strong internal control system including segregation of front office and back office functions with a separate reporting structure. We have a strong system of internal control which enables effective monitoring of adherence to Group policies. The internal control measures are effectively supplemented by regular management assurance audits.

We do not purchase or issue derivative financial instruments for trading or speculative purposes and neither do we enter into complex derivative transactions to manage our treasury and commodity risks. Derivative transactions in both treasury and commodities are normally in the form of forward contracts and interest rate swaps and currency swaps, which are subject to strict guidelines and policies. Interest rate swaps are taken to achieve a balance between fixed rate and

floating rate obligations (as described below under 'Interest rate risks') and currency swaps are taken primarily to convert the Group's exposure to non-US dollar currencies into US dollars.

Commodity risks

Our principal commodities are aluminium, copper, zinc, lead and iron ore. This diversified basket offers a partial hedging mechanism against volatility in the prices of individual commodities.

Of the Group's principal commodities, aluminium, copper, zinc and lead are priced with reference to LME prices. LME prices are influenced by global demand and supply for these metals which in turn is influenced by global economic scenarios, regional growth, infrastructure spending by governments and also by speculative activities.

In the case of iron ore, prices are not linked to any metal exchange but are generally influenced by all the factors enumerated above which is reflected in the benchmark prices agreed between major iron ore suppliers and steel makers. We sell iron ore under annual price contracts as well as at spot prices determined at the time of supplies. Price fluctuations can affect our business assumptions and hence our investment decisions, operational and financial performance.

While the Group aims to achieve average LME prices for a month or for a year, average realised prices may not necessarily reflect the LME price movements because of a variety of reasons including uneven sales during the year. Any fluctuation in the prices of the metals that we produce and sell will have an immediate and direct impact upon the profitability of our businesses.

As a general policy, we aim to sell our products at prevailing market prices. Hedging activity in commodities is undertaken on a strategic basis to a limited degree and is subject to both strict limits laid down by our Board and strictly defined internal controls and monitoring mechanisms. Decisions relating to hedging of commodities are taken at the corporate level and with clearly laid down guidelines for their implementation by the subsidiaries.

Our custom smelting operations of copper at Tuticorin enjoy a natural hedge except to the extent of a possible mismatch in quotational periods between the purchase of copper concentrate and the sale of finished copper. The Group's policy on custom smelting is to generate its margins

mainly from TC-RCs, premiums and sale of by-products. Hence quotational period mismatches are actively managed to ensure that the gains or losses are minimised. TC-RCs are a major source of income for the copper smelting operations in India and therefore are susceptible to fluctuations which are influenced by factors such as demand and supply conditions prevailing in the market for mine output. The copper smelting business actively reviews its procurement strategy to strike an appropriate balance between copper concentrate procured at spot TC-RCs and those which are sourced at long-term contractual TC-RCs. Approximately 60% of the copper concentrate consumed in FY 2009 came from long-term contracts and the balance from the spot market.

Our Australian mines in Tasmania supply c.9% of the concentrate requirement of the custom smelter at Tuticorin. This situation adversely impacts the profitability of the copper smelting business particularly at times when TC-RCs exhibit a declining trend. We insulate ourselves by constantly focusing on reducing unit cash costs at our smelting and refining operations.

KCM is largely an integrated copper producer and hence our Group strategy to protect it from copper price fluctuations is to focus on controlling its costs.

Set out below are the key commodity price sensitivities on EBITDA resulting from a change of US\$ 100 per tonne in LME prices.

| | Average market as price in FY 2009 (US\$/tonne) | Effect on EBITDA of US\$100/tonne change in LME (US\$ million) |
|-----------|---|--|
| Copper | 5,885 | 13.9 |
| Aluminium | 2,234 | 39.7 |
| Zinc | 1,563 | 57.9 |
| Lead | 1,660 | 8.9 |

The above sensitivities are based on FY 2009 volumes, costs and exchange rates and provide the estimated impact on EBITDA of changes in prices assuming that all other variables remain constant.

Political, legal, economic and regulatory risks

Our mining and smelting operations are located in India, Zambia and Australia and our holding and investment companies are located in jurisdictions including the United Kingdom, Mauritius and Cyprus.

The political, legal, fiscal and other regulatory regimes in these countries

may result in restrictions such as the imposition or increase in royalties, mining rights, taxation rates, legislation pertaining to repatriation of money and so on. Changes to government policies such as changes in royalty rates, reduction in import tariffs in India, reduction in assistance given by Government of India for exports and reduction or curtailment of income tax benefits available to some of our operations in India and Zambia are some of the examples of risks under this category.

The majority of our Group revenues and profits are derived from commodities sold to customers in India. The performance and growth of our businesses are dependent on the health of the overall Indian economy. Any downturn in the rate of economic growth in India, whether due to political instability or regional conflicts or economic slowdown may have a material adverse effect on demand for the metals produced and sold by us.

We may also be affected by the omissions and commissions of political acts of governments in these countries over which we have no control. We strive to maintain harmonious relationships with the governments in these countries and actively monitor developments in political, regulatory, fiscal and other areas which may have a bearing on our businesses.

Reserves and resources

The ore reserves stated in this report are estimates and represent the quantities of copper, zinc, iron ore, lead and bauxite that we believe could be mined, processed, recovered and sold at prices sufficient to cover the estimated future total costs of production, remaining investment and anticipated additional capital expenditures. Our future profitability and operating margins depend upon our ability to access mineral reserves that have geological characteristics enabling mining at competitive costs. Replacement reserves may not be available when required or, if available, may not be of a quality capable of being mined at costs comparable to the existing or exhausting mines.

Moreover, these estimates are subject to numerous uncertainties inherent in estimating quantities of reserves and could vary in the future as a result of actual exploration and production results, depletion, new information on geology and fluctuations in production, operating and other costs and economic parameters such as metal prices, smelter treatment charges and exchange rates, many of which are beyond our

control. We engage the services of independent experts normally once every three years to ascertain and verify the quantum of reserves and resources including ore grade and other geological characteristics.

Delivery of expansion projects on time and within budget

We have a strong pipeline of green field and brown field expansions projects and we have committed funds for these projects. These projects have achieved various stages of completion. Our plans to generate sufficient cash flows from these projects to repay our long-term debt and our ability to raise further debt are dependent upon the successful completion of these projects on time and under budgeted cost and a faster production ramp-up.

Our current and future projects may be significantly delayed by failures to receive regulatory approvals or renewal of approvals in a timely manner, failure to obtain sufficient funding, technical difficulties, human resources constraints, technological or other resource constraints or for other unforeseen reasons, events or circumstances.

As a result, these projects may incur significant cost overruns and may not be completed on time, or at all. We have the necessary resources in all the areas such as technology, financial and human resources and have successfully completed the majority of our Phase I projects on time and below their budgeted costs, demonstrating our ability to manage the successful completion of large green field and brown field projects.

Assets use continuity and insurance

Productive assets in use in mining and smelting operations and the associated power plants may face breakdowns in the normal course of operations or due to abnormal events such as fire, explosion, environmental hazards or other natural calamities. Our insurance policies may not cover all forms of risks due to certain exclusions and limitations. It may also not be commercially feasible to cover all such risks.

Consequently, our insurance coverage may not cover all the claims including for environmental or industrial accidents or pollution. We regularly carry out extensive work on the adequacy of our insurance coverage by engaging consultants and specialists and decide on the optimal levels of insurance coverage typical of our industry in India, Zambia and Australia.

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Safety, health and environment risks

We are engaged in mining activities which are inherently hazardous and any accident or explosion may cause personal injury or death, property damage or environmental damage at or to its mines, smelters, refineries or related facilities and also to communities that live near the mines and plants.

Such incidents may not only result in expensive litigation, damage claims and penalties but also cause loss of reputation. We also operate in Zambia which has a high incidence of HIV/AIDS – a threat to economic development. We accord very high priority to safety, health and environment matters.

Operational risks

Our operations are subject to conditions and events beyond our control that could, among other matters, increase our mining, transportation or production costs, disrupt or halt operations at our mines and production facilities for varying lengths of time or even permanently. These conditions and events include disruptions in mining and production due to equipment failures, unexpected maintenance problems and other interruptions, non-availability of raw materials of appropriate quantity and quality for our energy requirements, disruptions to or increased cost of transport services or strikes and industrial actions or disputes. While many of these risks are beyond our control, we have adequate and competent experience in these areas and have consistently demonstrated our ability to actively manage these problems proactively.

It is our policy to realise market prices for our commodities and therefore the profitability of our operations is dependent upon our ability to produce metals at a low cost which in turn is a factor of our commercial efficiencies and higher volumes. Prices of many of our input materials are influenced by a variety of factors including demand and supply as well as inflation.

Increase in the cost of such input materials would adversely impact our competitiveness. We have consistently demonstrated our ability to manage our costs and some of our operations have costs situated in the lowest quartile of the cost curve. We have a strong commercial function and we identify the best opportunities for cost reduction

and quickly implement them. We are highly focused on costs and volumes and all operational efficiencies and cost efficiencies are discussed regularly at the business review meetings as well as at the Group Executive Committee meetings. As metal prices have started reducing in recent months, we have been able to quickly adapt ourselves to the changing market conditions and reduce our costs significantly.

Financial risks and sensitivities

Within the areas of financial risk, our Board has approved policies which embrace liquidity, currency, interest rate, counterparty and commodity risks.

Liquidity Risks

We require funds both for short-term operational needs as well as for long-term investment programmes, mainly in growth projects. The recent global financial crisis has significantly restricted the supply of credit. Banks and financial institutions have tightened lending norms. If this situation continues, our ability to raise funds and at attractive rates may be significantly impacted.

We aim to minimise this risk by generating sufficient cash flows from our current operations which in addition to available cash and cash equivalents, and liquid financial asset investments, and sufficient committed funding facilities, will provide liquidity both in the short term as well as in the long term. At 31 March 2009, we had cash and liquid investments of US\$4.9 billion as well as US\$1.9 billion of committed funding facilities from our lenders. Long-term borrowings are supplemented by short- to medium-term project finance wherever required.

Our balance sheet is strong and gives us sufficient headroom for raising further debt should the need arise. We generally maintain a healthy debt-equity ratio as well as retain the flexibility in our financing structure to alter this ratio when the need arises. Our contractual cash obligations excluding the convertible bond (on an undiscounted basis) by remaining maturity of our financial liabilities arising in the ordinary course of business at 31 March 2009 are set out below.

| Remaining maturities (in US\$ million) | < 1 year | 1–2 years | 2–5 years | > 5 years | Total |
|--|----------------|----------------|----------------|----------------|----------------|
| Bank and other borrowings | 1,284.8 | 173.9 | 1,626.2 | 1,412.2 | 4,497.1 |
| Capital commitments | 2,413.7 | 1,260.3 | – | – | 3,674.0 |
| Total | 3,698.5 | 1,434.2 | 1,626.2 | 1,412.2 | 8,171.1 |

At 31 March 2009, we had access to funding facilities of US\$7,024.3 million of which US\$1,909.5 million was yet to be drawn as set out below.

| Funding facilities (in US\$ million) | Total facility | Drawn | Yet to be drawn |
|--------------------------------------|----------------|----------------|-----------------|
| Less than 1 year | 3,204.4 | 1,298.5 | 1,905.9 |
| 1–2 years | 173.9 | 173.9 | – |
| 2–5 years and above | 3,645.9 | 3,642.5 | 3.4 |
| Total | 7,024.2 | 5,114.9 | 1,909.3 |

The financial statements have been prepared in accordance with the going concern basis of accounting. The use of this basis of accounting takes into consideration the Group's current and forecast financing position.

Currency Risks

Our presentation currency is the US dollar. A majority of our assets are located in India where the Indian rupee is the functional currency for our subsidiaries. Operating costs are influenced by the currencies of those countries where our Group's mines and plants are located. A majority of our mines and plants are located in India and hence the Indian rupee is the currency in which most of our

costs are incurred and whose fluctuation may have a significant impact on our financial results. Currency exposures also exist in the nature of capital expenditure and services denominated in currencies other than the Indian rupee. KCM's functional currency is the US dollar with its cost base having a mix of the Zambian kwacha and the US dollar.

Our Group borrowings are predominantly denominated in US dollars while a large portion of cash and liquid investments are held in other currencies, mainly in the Indian rupee. Some financial assets and liabilities are not held in the functional currency of the respective subsidiary.

We also hold some intra-Group balances in currencies which are not the functional currency of the respective subsidiary and hence the Group is exposed to movements in the functional currency of those entities and the currencies in which these balances are held.

Consequently, currency fluctuations may have a large impact on our Group financial results. We are subject to currency risks affecting the underlying cost base in the operating subsidiary companies and also the translation of unit cash costs, income statement and the balance sheet (including non-US dollar denominated borrowings) in the consolidated financial statements, where the functional currency is not the US dollar.

Foreign currency exposures are managed through a Group-wide

hedging policy. The policy is reviewed periodically to ensure that the risk from fluctuating currency exchange rates is appropriately managed. Natural hedges available in the business are identified at each entity level and hedges are placed only for the net exposure.

Short-term net exposures are hedged progressively based on their maturity. A more conservative approach has been adopted for project expenditures to avoid budget overruns. Longer-term exposures are not hedged. Stop-loss and take-profit triggers are implemented to protect us from adverse market movements, while at the same time enabling us to take advantage of favourable market opportunities. Key foreign currency sensitivities on EBITDA resulting from a 10.0% movement in exchange rates are set out in the table below.

| (in US\$ million) | Closing US dollar exchange rate as at 31 March 2009 | Average US dollar exchange rate in FY 2009 | Impact of a 10% movement in currency on EBITDA |
|-------------------|---|--|--|
| Currency | | | |
| Indian rupee | 50.95 | 45.91 | 265.6 |
| Australian dollar | 35.02 | 36.14 | 8.2 |
| Zambian kwacha | 5,622 | 4,196 | 54.0 |

The above sensitivities are based on FY 2009 volumes, costs and prices and give the estimated impact on EBITDA of changes in exchange rates assuming that all other variables remain constant.

Interest Risks

At 31 March 2009, our net debt of approximately US\$201 million comprised cash and liquid investments of US\$4.9 billion offset by debt of US\$5.1 billion.

We are exposed to the interest rate risk on short- and long-term floating rate instruments and also on the refinancing of fixed rate debt. Our policy is to maintain a balance of fixed and floating interest rate borrowings. The proportion of fixed and floating rate debt is determined by current market interest rates. As at 31 March 2009, 49.3% of our total debt was at a fixed rate and the balance was at a floating rate.

Our floating rate debt is largely linked to the US dollar LIBOR. We also aim to minimise the average interest rates on our borrowings by opting for a higher proportion of long-term debt mainly to fund our growth projects. We have entered into cross currency interest rate swaps in order to convert fixed rate US dollar borrowings to floating rate US dollar borrowings. Cash and liquid investments are invested in short-term deposits and debt mutual funds to achieve the triple goal of maintaining liquidity,

carrying insignificant risk and achieving satisfactory returns. A majority of our investments of surplus cash is of short duration and is influenced by movements in interest rates.

Considering our net debt position at 31 March 2009 and our investments in bank deposits and debt mutual funds, any decrease in interest rates would result in a net gain and any increase in interest rates would result in a net loss. Based on our gross debt as at 31 March 2009, with all other variables remaining constant, a one percentage point increase in the US dollar LIBOR would impact our profit before tax by US\$25.9 million.

An analysis of the weighted average interest rates for debt and cash and current asset investments as at 31 March 2009 is given in the table below.

| Currency | Interest Paid fixed % | Investment income average yield % |
|--------------|-----------------------|-----------------------------------|
| Indian rupee | 10.6% | 11.1% |
| US dollar | 7.7% | 2.4% |

Some of the investments above generate a tax free return.

Counterparty Risks

We are exposed to counterparty credit risks on our investments and receivables. We have clearly defined policies to mitigate counterparty risks. Cash and liquid investments are held primarily in mutual funds and banks with good credit ratings. Emphasis is given to the security of investments. Limits are defined for exposure to individual counterparties in the case of mutual fund houses and banks. Most of the surplus cash is invested in banks and mutual funds in India where there is a well developed financial market. We also review the underlying investment portfolio of mutual fund houses to ensure that indirect exposures or latent exposures are minimised.

A large majority of receivables due from third parties are secured either through advance receipt of money or by use of trade financial instruments such as letters of credit. Moreover, given the diverse nature of our businesses, trade receivables are spread over a number of customers with no significant concentration of credit risk. Our history of the collection of trade receivables shows a negligible provision for bad and doubtful debts. Therefore we do not expect any material risk on account of non-performance by any of the counterparties.

Employees

People are one of our key assets and we derive our ability to maintain our competitive position from them. Therefore, people in general and key personnel in particular leaving the organisation is a risk. Additionally, our inability to recruit and retain good talent would adversely affect us.

Our vision is to build a fast, flexible and flat organisation with world class capabilities and a high performance culture across all of our businesses. We believe in nurturing leaders from within and providing opportunities for growth across all levels and geographies. We have robust processes and systems in place for leadership development, training and growth to deliver value to the organisation and society.

We provide superior rewards for outstanding performance and have a long-term incentive plan which covers a large number of employees in the Group. A large proportion of our workforces are members of a trade union. We actively communicate and enter into dialogue with our workforce and believe in maintaining a positive atmosphere by being proactive with respect to resolution of labour issues.

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