

Uncertainty continues on iron-ore mining...

Quick Note

January 25, 2013

Rating Remains	Neutral
Target price Remains	INR 179
Closing price January 24, 2013	INR 178

SESA Q3FY13 results: complete ban on iron ore production

SESA's Q3FY13 results were weak as expected on account of the continued ban on iron-ore mining in both Karnataka and Goa. While the situation in Karnataka is close to a resolution, there is still no clarity on when the mining operations in Goa would re-start. While SESA has shared its capex and production targets with investors regarding its project in Liberia, we believe it is overly early to start getting positive on the project.

- SESA didn't produce any iron ore during the quarter and sales were just 30,000 tonnes from Karnataka through E-Auction.
- Revenues were largely on account of pig iron and coke sales- revenue down 91% YoY and 19.7% QoQ.
- EBITDA loss of INR1bn - primarily because most of the major costs (fixed costs) would continue even as the mining operations remain suspended.
- According to management, the fixed cost for the iron ore business is close to INR250mn per month.

Key takeaways from the post result conference call:

Karnataka: R&R plan approved, final order awaited...

- The company has received approval for its Rehabilitation and Resettlement (R&R) plan and 70-80% of the plan is already implemented.
- There are two items to be awaited in Karnataka: 1) approval by the Supreme Court to start B-category mines and 2) remaining pending approvals from the state government. The Supreme Court should take a final decision in the next hearing, in our view. At the same time, mining companies have petitioned the Court to direct the government to issue a faster approval.
- SESA's mining capacity has been capped at 2.29mtpa (from earlier capacity of ~3.5mtpa). However, as its mining lease expired in Oct 2012, SESA has to seek for fresh forest clearance before restarting the mining. While an approval from the Central Empowered Committee (CEC) implies most of the issues have already been resolved and the final clearance is more of a formality, the company still needs the clearance before starting production.
- SESA also indicates that it can start production within a week of getting the final clearance.

Goa: Not expecting an early resolution

- SESA expects the Goa state government to file the affidavit with the Supreme Court regarding the mining issues in a day or two – the Supreme Court will schedule the hearing dates after that.
- There have been interventions filed by employee unions, local Panchayats, etc., in the Supreme Court to allow mining operations. However, there has been no impact seen so far.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

- The state government, in its draft mineral policy, has recommended capping the mining capacity in Goa at 45mtpa from close to 60mtpa earlier. However, the final decision would be made by the Supreme Court.

Project in Liberia: capex and cost estimates shared, still early days

- SESA GOA has increased its stake in the Liberia project (Western Clusters Ltd) to 100% now (it acquired the remaining 49% stake in the company for USD35.5mn during the quarter).
- SESA, for the first time, has shared its capex plans and production targets with investors: It expects to start 4mtpa production by Q4FY14. Total capex in the next 18 months would be close to USD350-400mn.
- The mine is 70km from the port and initial transportation modes would be via roads – the company is building a road network for the same.
- The capex would be USD80-90/t and operational expenses would amount to USD30-35/t.
- SESA GOA plans to start mining 4mtpa iron ore in the first phase, increasing it to 10mtpa in the second phase and 230mtpa eventually.

Updates on SESA-Sterlite merger

- The hearing in the Chennai court has been completed and the final order is being awaited – the company does not expect any problem with the approval.
- The hearing in the High Court of Bombay at Goa is in progress but one of the company's minority shareholders has filed against the merger. SESA has presented its arguments and in the next hearing, the other party is likely to put forward its arguments. There are two hearing scheduled by mid-February and the company expects a final approval by then. SESA expects the merger to complete by end-Feb.

Overall, mining uncertainties continue in Goa and Karnataka – while the Karnataka situation is close to a resolution (but no clarity on the exact timeline) there is absolutely no clarity on when the mining operation could start in Goa. In our view, it is still too early to start getting positive on the Liberia project. We maintain our Neutral rating on the stock.

Fig. 1: SESA – Detailed Q3FY13 results

INR mn

	Q3FY13	Q3FY12	Q2FY13	YoY	QoQ
Net sales	2,275	26,043	2,885	(91.3)	(21.1)
Other Operating Income	90	128	59		
Total income	2,365	26,171	2,944	(91.0)	(19.7)
Change in stocks	(1,176)	2,179	(1,571)		
RM Cost	2,494	1,795	1,542	38.9	61.7
Staff Cost	560	638	643	(12.2)	(12.8)
Other Expenditure	938	1,334	656	(29.7)	42.9
Total operating costs	3,419	15,218	2,899	(77.5)	17.9
EBITDA	(1,054)	10,953	46		
EBITDA margin (%)	(45)	42	2		
Depreciation	354	263	334	34.3	5.9
Other Income	147	180	142	(18.2)	3.7
Interest	1,020	729	817	40.0	24.8
Exchange gain/loss on FCCB	(250)	(1,779)	1,892		
PBT	(2,530)	8,361	928		
Provision for Tax	(807)	2,664	351		
<i>Tax rate (%)</i>	<i>31.9</i>	<i>31.9</i>	<i>37.8</i>		
PAT	(1,723)	5,697	577		
Net profit	(1,723)	5,697	577		
Share of associates	6,690	1,219	4,644		
Consolidated profit	4,967	6,917	5,221		
EPS (INR)	5.7	8.0	6.0		

Source: Company data, Nomura estimates

Appendix A-1

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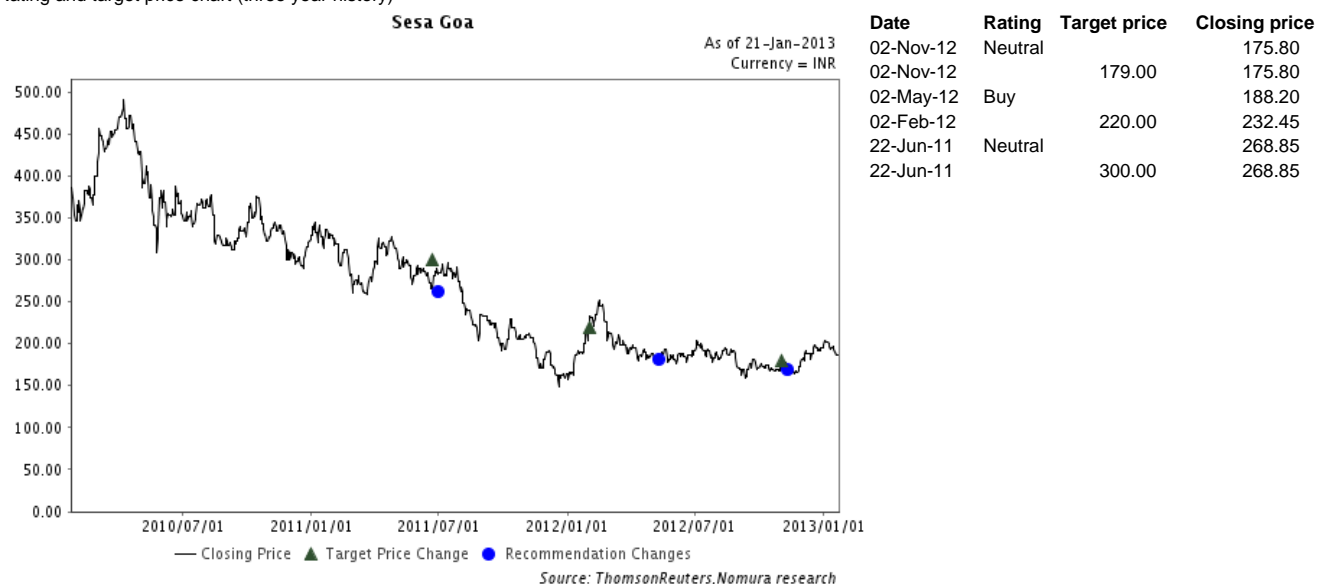
Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Sesa Goa	SESA IN	INR 178	24-Jan-2013	Neutral	Not rated	

Sesa Goa (SESA IN)

INR 178 (24-Jan-2013) Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value SESA on a sum-of-the-parts basis at INR179/share. We have valued Hindustan Zinc at 10x FY14F P/E, Balco at 6x FY14F EV/EBITDA, the copper business at 6x FY14F EV/EBITDA and other businesses using discounted cash flow.

Risks that may impede the achievement of the target price Upside risks include: 1) Government divesting its remaining stake in HZ to Sterlite and HZ being merged with SESA Sterlite 2) allotment of bauxite mine. Downside risks include: 1) iron ore mining ban continuing in Goa 2) a fall in commodity prices

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