26 August 2009 | 23 pages

Sesa Goa (SESA.BO)

Sell: Cloudy PRC Steel Outlook Casts A Shadow

Equity ☑
Rating change ☑
Target price change ☑
Estimate change ☑

- **Maintain Sell** — The stock has had a stellar run, rising 160% ytd (outperforming the Sensex by 97%) on: 1) a 75% surge in spot iron ore prices vs. April 2009 lows, 2) China momentum, and 3) the well-timed, EPS-accretive Dempo acquisition. Will the party continue? We think not given recent downward trends in spot iron ore and Chinese steel prices. Sesa Goa trades above peak multiples at 9.8x FY11E P/E. We maintain a Sell rating but lower our risk rating to Medium (from High) to reflect its stronger earnings outlook.
- **China matters; Near-term cautious outlook** — Sesa Goa sells 85% of its ore to China, which is key to its performance. We view China as starting to overstock steel and prices are down 10%-15% from the peak. Chinese steel prices are now below our marginal cost of production, putting pressure on near-term iron ore prices.
- **Forecasts raised; Ore pricing based on forward curve** — We raise FY10E-FY11E PAT by 51%-91% to incorporate higher spot and FY11E contract prices, and the Dempo acquisition. CIRA's global commodities analyst expects contract prices to rise 15% in FY11E (vs. -16.5% earlier). We assume a 10% hike in FY11E contracts and a 5% hike in spot given recent trends and the forward swap curve.
- **DCF-based TP of Rs203 (using SOTP)** — Our DCF value for Sesa Goa (standalone) is Rs159/sh and Rs38/sh for Dempo. Sesa Industries at 5x EV/EBITDA adds Rs6/sh. At our TP, the stock would trade at a cash adjusted consolidated Sept-10E PE of 8x. We view the 20%-35% discount to global majors as justified given its dependence on China and high proportion of spot sales.
- **Risks** — 1) Improvement in Chinese steel and iron ore, 2) Higher ocean freight, and 3) Favorable duties. A 1% change in avg. prices could impact FY11E PAT by 2.2%. Higher royalties priced in, but risk of higher export duties/freight remain.

Sell/Medium Risk	**3M**
from Sell/High Risk	
Price (26 Aug 09)	Rs226.60
Target price	Rs203.00
from Rs75.00	
Expected share price return	-10.4%
Expected dividend yield	0.9%
Expected total return	**-9.5%**
Market Cap	Rs185,929M
	US$3,818M

Price Performance (RIC: SESA.BO, BB: SESA IN)

Figure 1. Sesa Goa – Statistical Abstract (Consolidated)

YE 31 Mar	Net Profit (Rsm)	EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)	EBITDA margin (%)	ROE (%)
FY07	6,431	8.2	14%	27.3	16.8	42%	39%
FY08	15,472	19.7	141%	11.3	6.5	59%	52%
FY09	19,934	25.3	29%	8.8	5.2	52%	42%
FY10E	17,266	21.0	-17%	10.6	6.8	42%	25%
FY11E	18,695	22.8	8%	9.8	5.7	37%	22%
FY12E	22,058	26.9	18%	8.3	4.3	37%	22%

Source: Company Reports, Citi Investment Research and Analysis Estimates. Price as on 25 August 2009.
Note – All figures are on a consolidated basis. These figures differ from the Datacentral sheet on page 2 as it shows Sesa Goa standalone numbers (excl. Dempo).

Pradeep Mahtani
+91-22-6631-9882
pradeep.mahtani@citi.com

Raashi Chopra
raashi.chopra@citi.com

See Appendix A-1 for Analyst Certification and important disclosures.

Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	12.0	9.2	12.0	11.4	9.7
EV/EBITDA adjusted (x)	7.6	6.1	7.7	6.6	5.1
P/BV (x)	6.4	3.9	2.9	2.4	1.9
Dividend yield (%)	1.0	1.0	0.9	0.8	0.9
Per Share Data (Rs)					
EPS adjusted	18.95	24.67	18.96	19.95	23.27
EPS reported	18.95	24.67	18.96	19.95	23.27
BVPS	35.45	57.39	78.23	96.13	117.05
DPS	2.25	2.25	2.00	1.75	2.00
Profit & Loss (RsM)					
Net sales	36,022	47,791	44,472	55,819	66,443
Operating expenses	-13,637	-21,450	-25,419	-35,774	-43,071
EBIT	**22,385**	**26,341**	**19,053**	**20,044**	**23,372**
Net interest expense	-15	-34	-35	-35	-35
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**22,369**	**26,307**	**19,018**	**20,009**	**23,337**
Tax	-7,449	-6,882	-3,461	-3,642	-4,247
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**14,920**	**19,425**	**15,557**	**16,368**	**19,090**
Adjusted earnings	14,920	19,425	15,557	16,368	19,090
Adjusted EBITDA	22,810	26,782	19,612	20,708	24,085
Growth Rates (%)					
Sales	79.6	32.7	-6.9	25.5	19.0
EBIT adjusted	148.2	17.7	-27.7	5.2	16.6
EBITDA adjusted	144.4	17.4	-26.8	5.6	16.3
EPS adjusted	146.0	30.2	-23.2	5.2	16.6
Cash Flow (RsM)					
Operating cash flow	**13,063**	**20,777**	**11,132**	**13,086**	**16,096**
Depreciation/amortization	426	441	559	664	714
Net working capital	-1,874	3,148	-2,946	-1,969	-1,384
Investing cash flow	**-11,246**	**-9,399**	**-14,385**	**-11,166**	**-14,416**
Capital expenditure	-576	-1,363	-1,200	-1,200	-1,200
Acquisitions/disposals	-11,132	-9,144	-15,337	-11,982	-15,586
Financing cash flow	**-1,830**	**-11,388**	**3,281**	**-1,920**	**-1,680**
Borrowings	0	19	-19	0	0
Dividends paid	-1,842	-1,382	-2,072	-1,920	-1,680
Change in cash	**-13**	**-10**	**28**	**0**	**0**
Balance Sheet (RsM)					
Total assets	**31,845**	**51,255**	**70,179**	**85,760**	**104,056**
Cash & cash equivalent	132	122	150	150	150
Accounts receivable	4,431	2,567	3,655	4,588	5,461
Net fixed assets	4,139	5,062	5,703	6,240	6,726
Total liabilities	**3,934**	**6,077**	**5,992**	**6,886**	**8,011**
Accounts payable	1,361	2,859	2,791	3,844	4,643
Total Debt	0	19	0	0	0
Shareholders' funds	**27,911**	**45,178**	**64,187**	**78,875**	**96,044**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	63.3	56.0	44.1	37.1	36.2
ROE adjusted	69.4	53.2	28.4	22.9	21.8
ROIC adjusted	164.7	139.6	79.5	72.4	76.9
Net debt to equity	-0.5	-0.2	-0.2	-0.2	-0.2
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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Investment Thesis

China outlook cautious, Sesa Goa valuations have crossed peak levels, maintain Sell.

Sesa Goa has rallied 160% ytd, outperforming the Sensex by 97%, primarily on the back of a surge in spot iron ore prices from the April low of US$63/t (CIF) to cross US$110/t in early August, driven largely by China (strong steel demand, panic buying, logistical issues etc.). China currently accounts for 85% of Sesa Goa's exports. Sesa Goa also gained from the well-timed, EPS-accretive Dempo acquisition. Despite the earning upgrades as detailed below, we do not believe is the time to Buy. Our cautious view is based on concerns relating to the recent downward trend in the iron ore spot market (to US$96/t), and the near-term uncertainty in the Chinese steel market. Sesa Goa is currently trading above peak multiples (FY11E P/E of 9.8x). We maintain our Sell rating but lower our risk rating to Medium (from High) to reflect its stronger earnings outlook.

Steel prices in China now below our assessed marginal cost of production, putting pressure on imported iron ore prices in the near-term.

The near-term outlook is clouded given: (1) Spot iron ore prices have fallen below US$100/t (CIF). The forward curve indicates that prices should fall to US$85/t by March 2010. (2) We think that China is now starting to over-stock on longs and to a lesser extent flats. (3) Steel prices now imply a -5% margin, which will put pressure on imported spot iron ore prices. Prices for rebar have fallen c.15% from August peaks and c.10% for HRC. Seasonality is one explanation, while destocking is a more bearish alternative.

New earnings and target price (from Rs75 to Rs203) incorporate: 1) better outlook for iron ore than previously expected, 2) higher contract prices, and 3) additional value from Dempo.

We upgrade our earnings and target price on Sesa Goa to incorporate: 1) the better-than-expected spot and FY11E contract prices, and 2) the Dempo acquisition. In addition to the higher spot prices, we incorporate higher FY11E contract prices – Alan Heap, CIRA's Global Head of Commodities, recently revised his iron ore forecasts and now expects contract prices will rise 15% in FY11E (vs. a 16.5% decline previously). However, we assume a 10% hike in FY11E contract prices and a 5% hike in spot, based on recent trends in Chinese iron and steel pricing and also the forward swap curve[1].

PAT forecasts raised 51%-91% incorporating higher prices and volumes due to Dempo.

Our FY10E-FY11E consolidated PAT forecasts are raised by 51%-91%. Our new target price of Rs203 (vs. Rs75) is based on SOTP: 1) Rs159 using a DCF for Sesa Goa (standalone), 2) Rs38 using a DCF for Dempo, and 3) Rs6 for Sesa Industries at 5x EV/EBITDA. The 2.7x jump in our target price is mainly being driven by: (1) Higher iron ore price trends, (2) Addition of the Dempo acquisition, (3) Lower WACC for DCF (12.9% vs. 14.8%), and (4) Higher value for Sesa Industries.

Figure 2. Estimate Changes – FY10E-FY11E (Consolidated)

	FY10E			FY11E		
	Old	New	% chg	Old	New	% chg
Iron ore volumes (m tonnes)	**19.1**	**21.9**	**15%**	**23.4**	**27.7**	**18%**
Iron ore avg realization (US$/t)	39	46	17%	38	49	30%
Coke volumes (m tonnes)	**0.21**	**0.24**	**18%**	**0.21**	**0.26**	**21%**
Coke avg realization (US$/t)	372	283	-24%	218	286	31%
Pig iron volumes (m tonnes)	**0.19**	**0.23**	**24%**	**0.19**	**0.25**	**29%**
Pig iron avg realization (Rs/t)	17,000	20,006	18%	16,500	19,301	17%
Rs/US$ rate	48.0	47.0		47.0	45.0	
Net sales (Rs bn)	**43.6**	**53.5**	**23%**	**47.5**	**66.8**	**41%**
EBITDA (Rs bn)	15.9	22.4	40%	14.0	24.4	75%
Net profit (Rs bn)	**11.4[1]**	**17.3**	**51%**	**9.8**	**18.7**	**91%**
EPS (Rs)	14.5	21.0	45%	12.4	22.8	84%

Source: Citi Investment Research and Analysis Estimates. Note - All figures are consolidated. Average realisation is for Sesa Goa (excl Dempo). These figures differ from page 2 as DataCentral has Sesa Goa standalone numbers (excl. Dempo). [1]FY10E standalone PAT was previously Rs12bn (as of 29 January 2009), Rs11.4bn includes attributable loss at Sesa Industries of Rs565m.

[1] For full details please see *'Iron Ore – Structural Erosion, but Cycle Recovery Drives Prices Next Year'*, Alan Heap and Alex Tonks, CIRA report, 17 August 2009 (https://www.citigroupgeo.com/pdf/SGL38458.pdf).

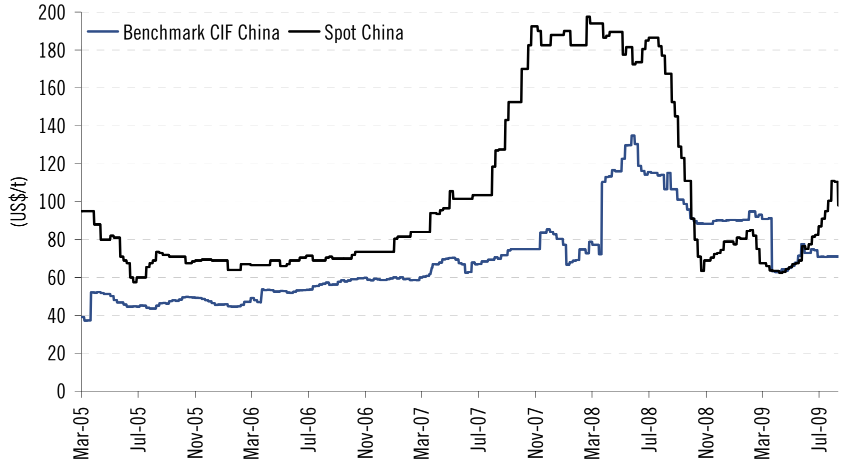
Key Concerns On Sesa Goa

1. Spot prices likely to decline in the near-term

- **Spot iron ore prices have been volatile –** Spot iron ore prices have been volatile in the past few weeks, rebounding from the April lows of US$63/t to levels of US$98/t after having gone beyond US$110/t (CIF). Factors driving the strong surge in spot prices were: (1) Growing demand and rising prices for PRC steel; (2) Constrained volumes due to short-term port congestion; and (3) Panic buying due to concerns on cancellation of iron ore import licenses in China.

Spot prices have been volatile, but US$80/t is around trend. Spot iron ore traded well above contract in the past but they are becoming more closely aligned.

Figure 3. Spot vs. Contract Prices US$/t – Spot Prices Have Begun To Decline



Source: Bloomberg, Citi Investment Research and Analysis

- **Spot prices are weaker –** Spot prices have begun to decline in the past few days and we believe the decline should continue for a while as: (1) Steel prices in China are below their marginal cost of production (based on spot raw material prices), likely to put downward pressure on raw material prices; (2) Chinese end-of-month steel inventories have risen for the first time since February. Stocks of rebar rose 16% MoM to 3.7m tonnes by mid-August, while HRC stocks rose 4.7% MoM at 2.9m tonnes. Overall inventory levels (at traders) have risen 67% YTD and 36% YoY; and (3) Freight rates have been declining.

Sesa Goa's spot sales were in excess of 90% in 1QFY10, we expect the FY10 ratio to be ~80%. Volatility in the spot market creates uncertainty in earnings.

- **Spot sales account for more than 80% of Sesa Goa's sales –** The iron ore industry has mainly been driven by contract sales in past years. This has been a key competitive advantage as volume contracts tend to lock out new entrants. However, given the delay in settling FY10 contract terms for iron ore, more than 60% of iron ore sales volumes globally are being transacted on a spot basis, up from 30%-40% in 2008-2009. In line with the industry trend, Sesa Goa also sold most of its iron ore in 1QFY10 on a spot basis, and we estimate spot sales will be around 80% of FY10 volumes. Volatility in the spot market creates uncertainty in earnings, particularly given the high proportion of spot sales. We estimate this proportion of spot sales will trend downwards to ~70% by FY13 as volumes rise. Sesa Goa's long-term goal is to achieve a contract:spot ratio of 40/60.

Figure 4. Sensitivity of FY11E PAT to change in iron ore prices

	Scenario 1	Base Case	Scenario 2
Spot Price	45.0	47.3	49.5
-% change YoY	0%	5%	10%
Contract Price	53.1	55.6	58.2
-% change YoY	5%	10%	15%
PAT[1]	**16,786**	**18,695**	**20,604**
- % chg from base case	**-10%**		**10%**

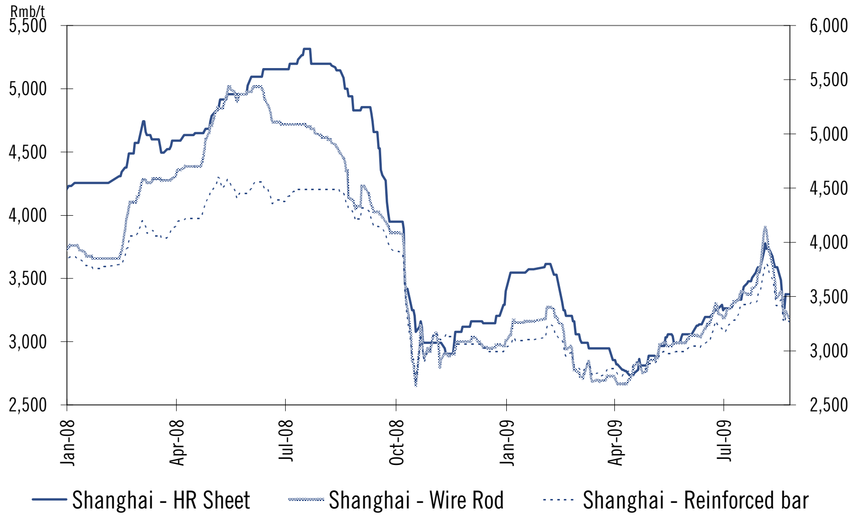
[1]PAT on a consolidated basis

Source: Citi Investment Research and Analysis Estimates

2. Outlook in China[2]

- **Rebar prices down -16.2%, HRC -11.7% since August peak** – This recent fall highlight the risks in the steel story. We define this as if restocking is greater than real demand then this will lead to de-stocking. The big question has been, when? This seems a little too early to us for a sustained downturn.
- **Speculation may be one answer to the current steel prices, seasonality another** – The presence of speculators who may be unfamiliar with dynamics of the steel industry may be driving the steel price temporarily. However, 3Q is a weak season so buyers will be cautious. We have yet to see major mills rein-in prices.
- **Spot prices now below cash cost but steel mills unlikely to shut ahead of 4Q09** – CIRA estimates of the marginal cost of production are shown in Figure 7 at c.-5%. Mills are unlikely to shut down as 4Q is seasonally the strongest quarter, and they will hope peak demand can drive prices higher. We expect utilization rates to remain high.

Figure 5. Shanghai Steel Prices, RMB/t



Source: CUSteel, Citi Investment Research and Analysis

[2] For full details please see '*PRC Steel – Price Dip Highlights Risks, Seasonality and Speculation*', Thomas Wrigglesworth and Catherine Wang, CIRA report, 25 August 2009 (https://www.citigroupgeo.com/pdf/SGL38458.pdf).

- **Chinese steel exports could increase** – 4.75mm HRC prices are at US$470/t excl. VAT, up marginally from last week. However, at these prices we might expect to see China steel exports increase. According to the Metal Bulletin, world export prices are at US$542/t. Increased exports may provide some alleviation from the price drop.

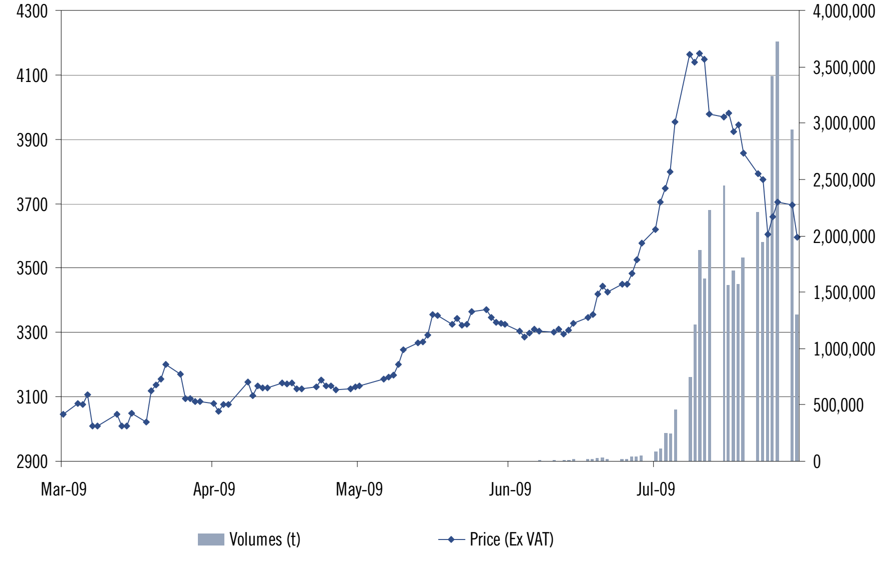
Figure 6. Shanghai Steel Price Movements as at 24-Aug-2009

	Wire rod 6.5 mm	High speed 6.5mm	Rebar 12 mm	Rebar 20mm	Plate 8mm	Plate 20mm	HRC 3 mm	HRC 4.75 mm	CRC 0.5mm	CRC 1.0mm	Galv 0.5mm	Galv 1.0mm	Coloured 0.476mm
25-Aug-2008	4,120	4,179	4,291	4,197	5,812	5,214	4,940	4,231	5,513	5,316	5,983	5,581	7,137
Jan '09	3,051	3,120	3,051	3,026	3,504	3,248	3,547	3,316	4,171	3,889	4,205	3,915	5,385
Max ytd '09	3,906	3,855	3,803	3,880	3,846	3,692	3,778	3,675	4,829	4,829	4,897	4,615	6,368
24-Aug-2009	**3,188**	**3,154**	**3,265**	**3,171**	**3,504**	**3,248**	**3,376**	**3,205**	**4,427**	**4,325**	**4,504**	**4,256**	**6,325**
vs Max	-18.4%	-18.2%	-14.2%	-18.3%	-8.9%	-12.0%	-10.6%	-12.8%	-8.3%	-10.4%	-8.0%	-7.8%	-0.7%
ytd	4.5%	1.1%	7.0%	4.8%	0.0%	0.0%	-4.8%	-3.4%	6.1%	11.2%	7.1%	8.7%	17.5%
YoY	-22.6%	-24.5%	-23.9%	-24.4%	-39.7%	-37.7%	-31.7%	-24.2%	-19.7%	-18.6%	-24.7%	-23.7%	-11.4%

Source: CUSteel, Citi Investment Research and Analysis

- **Focus on futures price** – More and more the market is focusing on the Shanghai Futures Price and this is becoming a driver of share prices too. There would appear to be quality differences between the spot quoted price and the forward price. Spot, at time of writing is RMB3,820/t (incl. VAT) versus a futures price of RMB4,200/t. Nevertheless, it is used as benchmark on the price outlook.

Figure 7. Shanghai Rebar Futures Price (RMB/t) and Volume Trade (t, RHS)



Source: Shanghai Futures Exchange, Citi Investment Research and Analysis

- **Implications for the marginal cost producer**

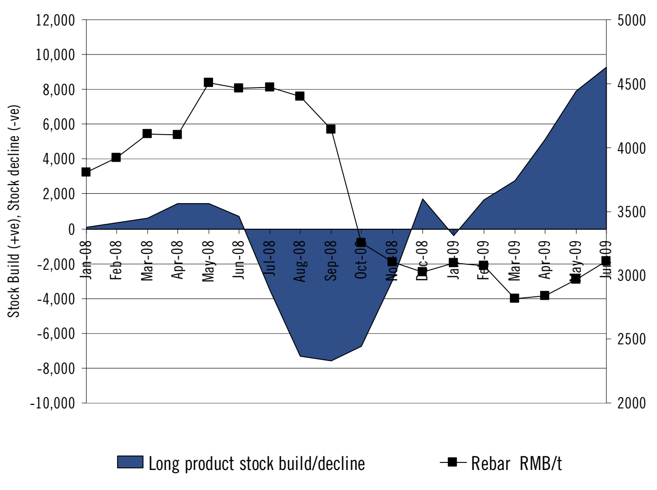
Figure 8. CIRA Marginal Cost Estimate

Process	Description	Cost (US$/)	RMB/t
Pig Iron	Total Iron Ore Costs	127.3	877
	Total Coke Costs	134.4	926
	Other materials and supplies	14.9	103
	Total raw materials costs (FOB)	276.6	1,906
	Transportation costs	54.5	375
	Labour costs	39.4	272
	Power costs	23.5	162
Liquid	Scrap	45.7	315
	Power costs	2.6	18
	Labour costs	3.9	27
	Maintenance costs	11.3	78
HRC	Hot Rolled Coil Conversion Costs (US$/t)	51.1	352
	Total	**508.6**	**3,505**
	Current Spot	**485.5**	**3,316**
	Implied Margin - Spot	**-4.5%**	**-5.4%**

Source: Citi Investment Research and Analysis, CUSteel

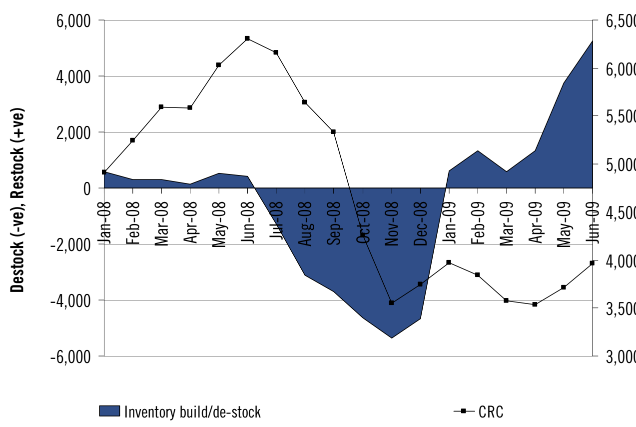
- **Re-stocking vs. De-stocking** – Flat products de-stocked 23mt last year and re-stocked 20mt this year, based on an average level of demand growth at 4% YoY. Long products de-stocked 27mt last year and re-stocked 28.5mt this year, based on an average level of demand growth at 10% YoY. We believe our growth assumption for long products is generous for 2009 and together with the July and now August data the over-stocking will likely be more exaggerated than we illustrate here.

Figure 9. Long Products



Source: Citi Investment Research and Analysis and CEIC

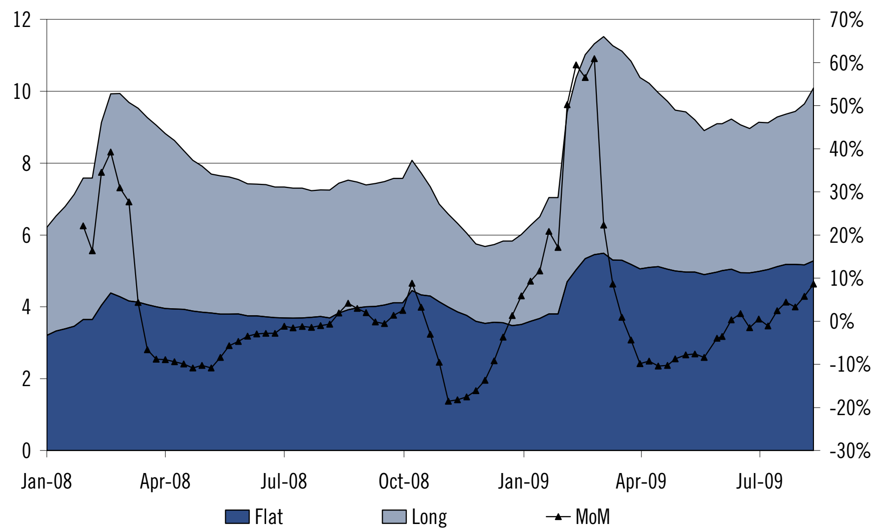
Figure 10. Flat Products



Source: Citi Investment Research and Analysis and CEIC

- **Inventory buildup –** Inventory build through the system is showing itself in the trader inventory. However, this could be just seasonality as 3Q is expected to be a quieter quarter. The chart below is supportive of the more bearish side of the argument.

Figure 11. Trader Inventories, Mt



Source: CUSteel

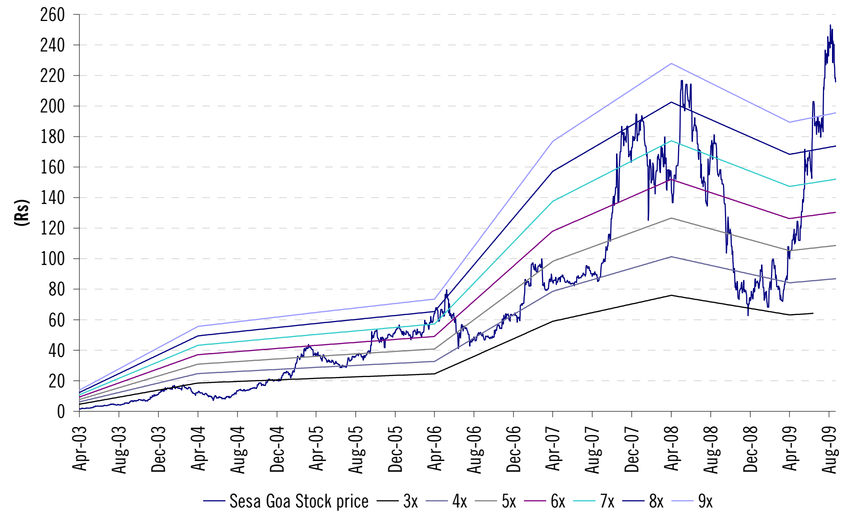
3. Current valuations at peak levels

Figure 12. Sesa Goa Stock Price Movement vs. BSE Sensex (Rebased Jan 2005 = 100)

Source: DataCentral, Citi Investment Research and Analysis

Sesa Goa's stock price has jumped sharply by 160% ytd (outperforming the Sensex by 97%), in-line with the rapid rise in spot iron ore prices on the back of: 1) rising steel prices, 2) constrained volumes, and 3) uncertainty on Chinese import licenses. The stock has been re-rated upwards and is now trading at 10.2x 12-month forward P/E. For the stock to continue to be revalued upwards and to outperform the Sensex, we need to be confident about a rising trend in iron ore prices. We have some concerns about the growth outlook for China, which accounts for ~85% of Sesa Goa's exports. Steel inventories have built up in China and prices have begun to come off, and the outlook in China has become uncertain in view of this.

Figure 13. Sesa Goa – 1-Yr Forward Rolling PE Band Chart



Source: DataStream, Company Reports and Citi Investment Research and Analysis

4. Other concerns

Iron ore royalty has been increased from a flat rate of Rs8-27/t to 10% ad-valorem with effect from 13 August 2009.

- **Changes in iron ore royalties have impacted earnings** – Our earnings would have been higher by 11% for FY11E, but have been adversely impacted by the recent sharp hike in iron ore royalties. The government of India has increased the iron ore royalty from a flat rate of Rs8-27/t to 10% ad-valorem with effect from 13 August 2009. The royalty will be calculated on the sale price of iron ore on the basis of a benchmark price (plus 20%), which will be published state wise by the Indian Bureau of Mines every month. While it is still not clear if this is the FOB price or the 'pit mouth value' (average price excluding freight costs), based on our discussions with industry sources, we have based our royalty calculations on the pit mouth value at 10% of Sesa Goa's average value, as there is no clarity on the average benchmark price in each state at this stage. If the royalty is applicable on FOB rates, our target price for Sesa Goa could fall to Rs182/sh.

- **Higher freight rates on iron ore?** – The Indian Railways have been raising freight rates for iron ore meant for export over the past two years to take advantage of rising global iron ore prices. With contract iron ore prices likely to decline 33% in FY10, the industry was hoping for a reduction in freight rate/surcharge for exported iron ore. However, this expectation may be belied as media reports state that the railways have imposed a surcharge (wef. 6 August 2009) of Rs200/t (~$4/t) on basic railway freight for iron ore meant for exports. A surcharge of Rs200/t would impact FY11E PAT by 7%.

- **Re-introduction of export duties?** – In addition to iron ore royalties (which have recently been enhanced), the industry has also been subjected to export duties from time to time since March 2007. There have been many changes to the duties being charged. The highest level was in June 2008 when the government introduced an ad valorem duty of 15% on all grades of iron ore exported. Currently, there is 0% export duty on fines and 5% on lumps. Media sources indicate that the government is once again considering 10% ad valorem duty on ore exports. A 10% duty could impact Sesa Goa's FY11E PAT by 20%. Currently Sesa Goa is not paying any export duty on its fines, which account for ~85%-90% of sales volumes.

Non-Price Earnings Drivers

1. Dempo acquisition offers synergy benefits and cost savings

We believe Dempo's acquisition is EPS accretive and expect synergy benefits and cost savings.

In June 2009, Sesa Goa acquired the mining assets of Dempo in an all-cash deal valued at Rs17.5bn. Dempo's mines are based in both north and south Goa and the boundary of one of the mines is contiguous to Sesa Goa's mines. Dempo additionally has barges, river loading facilities and transshipping facilities. Dempo's cost per tonne is around US$20/t, and Sesa Goa (whose own cost in Goa is ~20% lower) believes there is scope for cost cutting at Dempo and that likely synergies should benefit overall operations and help reduce overall costs. We believe that the acquisition is EPS accretive.

Figure 14. Dempo – Estimates

Dempo	FY10E	FY11E	FY12E
Iron ore sales (m tonnes)	2.9	4.0	4.6
Average realization (US$/t)	34.6	37.0	38.1
Revenues (Rs m)	4,793	6,664	7,803
EBITDA (Rs m)	1,809	2,939	3,824
EBITDA margin (%)	38%	44%	49%
PAT (Rs m)	1,121	1,862	2,451

Source: Citi Investment Research and Analysis Estimates

2. Good potential for volume growth:

Dempo could account for ~20% of Sesa Goa volumes in future.

Dempo produced 3.94m tonnes of iron ore and sold 4.36m tonnes in FY09. While volumes will remain around 4m tpa in FY10, Sesa Goa is in the process of obtaining approvals, expected in about 18-24 months, following which it hopes to enhance Dempo's production to 10m tonnes. Dempo could account for ~20% of Sesa Goa's volumes in future and contribute to its growth story. Dempo's total reserves and resources are estimated at 70m tonnes with the potential to increase further.

We expect Sesa Goa's total iron ore sales to be 22m tonnes (+45%) and 28m tonnes (+26%) for FY10E and FY11E respectively.

We expect Sesa Goa's volumes to grow at 25% for the next two years (excluding Dempo). Adding on Dempo's volumes, we expect total sales to be 22m tonnes (+45%) and 28m tonnes (+26%) for FY10E and FY11E respectively. Sesa Goa has already achieved 4.7m tonnes of sales (including Dempo) in the first quarter of the current fiscal year (+46% yoy).

Non-Goa mines to drive growth and Sesa Goa is hopeful of reaching 50m tpa of production/sales in four years.

Most of the growth for Sesa Goa is expected to come from Karnataka and Orissa, and the company is hopeful of attaining 50m tonnes of production/sales volumes in the next 3-4 years. Sesa Goa obtained a Prospecting License (PL) in early 2005 from the Jharkhand government and applied for a mining lease in May 2009. The reserves in Jharkhand are estimated to be ~60m tonnes. We have not accounted for these mines in our estimates, and any potential volumes from Jharkhand would provide upside risk to our forecasts. Sesa Goa's reserves and resources were 240m as on 31 March 2009 vs. 202m tonnes at the end of FY2008. In addition, Dempo's reserves and resources are estimated at 70m tonnes.

Valuation

Target price of Rs203 based on SOTP valuing Sesa Goa (standalone) at Rs159, Dempo at Rs38, and Rs6 for Sesa Industries.

Our target price of Rs203 for Sesa Goa is based on a sum-of-the-parts (SOTP) valuation methodology. We value Sesa Goa (standalone) and Dempo using DCF, which gives values of Rs159/share and Rs38/share, respectively. We value Sesa Industries (its pig iron subsidiary) at 5x 12-month forward EV/EBITDA, which adds Rs6/share to our value for Sesa Goa.

2.7x jump in target price, from Rs75 to Rs203, mainly driven by change in view on iron price trends.

The previous target price of Rs75 was also based on SOTP, valuing Sesa Goa (standalone) at Rs73/share using DCF and Sesa Industries at Rs2/share (0.5x Price/Sales). We previously estimated that Sesa Goa's contract prices would decline by 40% in FY10E and by a further 20% in FY11E. The 2.7x increase in target price is on account of: (1) Higher PAT through the forecast period up to FY17E, largely due to the change in price outlook. In FY10E, we now expect a fall of 33% in contract prices, and also higher spot prices (vs. earlier assumptions). In FY11E, we estimate that contract iron ore prices will rise by 10% and will rollover into FY12E; (2) Additional Rs38/share due to the Dempo acquisition in mid-June 2009; (3) Higher value for Sesa Industries (we previously expected a FY10E loss); and (4) Lower WACC (12.9% vs. 14.8%) than earlier assumed.

WACC of 12.9% vs. 14.8% earlier assumed.

We have modeled DCF cash flows out to FY17E based on Sesa Goa's existing proven and probable reserves and resources, and for Dempo we have modeled cash flows out to FY21E based on its reserves and resources. We have not accounted for any terminal value due to lack of sufficient visibility on future iron ore reserves, although we believe there could be upside risk to our DCF valuation based on the company's ongoing exploration effort. Our WACC is 12.9%, calculated based on a beta of 1.2 (relative to Sensex), a risk free rate of 7% and an ERP of 6%, cost of debt of 7.5% (post tax), and a target debt to total capital ratio of 20%. Our earlier target price was calculated using WACC of 14.8% (risk free rate of 9%, ERP 6%, post-tax cost of debt 9%, target debt to equity of 20%).

Figure 15. WACC Estimation

Risk free rate (%)	7%
Equity risk premium (%)	6%
Beta	1.2
Cost of equity	14.2%
Cost of debt (post tax)	7.5%
Target debt to total capital (%)	20%
WACC (%)	12.9%

Source: Citi Investment Research and Analysis Estimates

Figure 16. DCF Valuation (Sesa Goa Standalone – Excluding Dempo)

	FY09	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E
EBITDA	26,782	17,459	18,691	21,716	24,277	26,159	30,952	44,262	55,476
WC Changes	3,148	-2,946	-1,969	-1,384	-1,407	-1,298	-1,703	-2,206	-1,816
Capex	-1,363	-1,200	-1,200	-1,200	-1,200	-1,200	-1,200	-1,200	-1,200
Cash tax	-6,977	-2,955	-3,235	-3,769	-4,220	-4,547	-5,399	-7,783	-9,788
FCFF	21,589	10,359	12,288	15,362	17,451	19,113	22,650	33,074	42,671

WACC	**12.9%**
Firm Value (Rs m)	93,589
Net Debt (Rs m)	-36,923
Market cap (Rs m)	130,512
No. of shares (m)	821
Equity value per share (Rs)	**159**

Source: Company Reports, Citi Investment Research and Analysis Estimates

Figure 17. Valuation Sensitivity

WACC	Target Price (incl. Sesa Industries)
11%	215
12%	209
13%	202
14%	196
15%	191

Source: Citi Investment Research and Analysis Estimates

Figure 18. Sesa Goa Target Price - SOTP

	Stake (%)	Valuation Methodology	Rs/share
Sesa Goa Standalone	100%	DCF	159
Dempo	100%	DCF	38
Sesa Industries	88.25%	5x 12-m fwd EV/EBITDA	6
Target price			**203**

Source: Citi Investment Research and Analysis Estimates

At our Rs203 target price Sesa Goa would trade at an implied 9.3x 12m forward PE and 8x 12m forward cash adj. PE. This is at the top end of its previous trading range. The stock is currently trading at 9.8x FY11E P/E. While this upward re-rating can be partly explained by recent trends, and Sesa Goa's larger size relative to the past, we feel current valuations are high given recent uncertainty on the iron ore and steel outlook in China, and also given the risk of higher taxes in India. Our target multiple is at a discount to the current CY10E P/E multiples for the global majors (BHP Billiton, Rio Tinto, Vale), which range from 12x-15x, which we view is justified given Sesa Goa's dependence on China and its high proportion of spot sales.

Global Comparisons

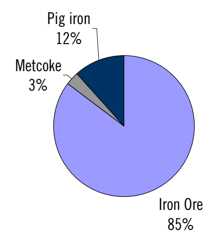
Figure 19. Global Valuation Comparatives – FY11/CY10E

Company	RIC Code	EV/EBITDA (x)	P/E (x)
Rio Tinto Ltd	RIO.AX	5.6	14.2
BHP Billiton Ltd	BHP.AX	7.1	15.4
Vale (Preferred)	VALEp.N	8.0	12.5
Sesa Goa	SESA.BO	5.7	9.8

Source: Citi Investment Research and Analysis Estimates

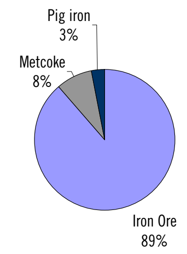
FY09 Revenue and PBIT breakdown for Sesa Goa (Consolidated)

Figure 20. Revenue Breakdown (Consolidated)



Source: Company Reports

Figure 21. PBIT Breakdown (Consolidated)



Source: Company Reports

Iron Ore Supply/Demand – Base Case

IRON ORE SUMMARY SHEET — Last updated: 14-Aug-09

IRON ORE Supply Demand Balance

Mt	2008	2009e	2010e	2011e	2012e	2013e	2014e
Seaborne Imports							
Japan	140	101	111	115	118	119	120
Korea	50	47	51	51	49	41	41
Taiwan	14	13	12	12	12	14	14
China	444	537	568	581	604	606	605
EEC	125	94	110	112	104	105	106
USA	14	11	12	13	11	11	12
Total Seaborne Imports (incl. minor markets)	797	813	894	913	927	927	929
Seaborne Exports							
Australia	309	361	394	430	469	523	520
Brazil	282	271	300	323	399	422	482
India	85	75	70	65	65	65	65
Canada	23	21	15	20	20	20	20
S.Africa	38	41	41	41	41	41	41
other	60	51	51	45	45	45	45
Total Seaborne Exports	797	819	871	923	1,038	1,115	1,172
Surplus/Deficit	-0.1	6.1	-23.2	10.0	110.9	188.2	243.0
Fines Price US$/t (@68% Fe)	75.0	63.5	62.9	65.1	65.1	65.1	65.1

Source: Tex Report; Citi Investment Research

China's Crude Steel Production & Iron Ore Supply

Mt	2008	2009e	2010e	2011e	2012e	2013e	2014e
Crude Steel Production	499	536	577	595	600	600	600
Pig Iron Production	468	509	548	565	568	569	569
China Imports (Mt iron ore @63%)	444	537	568	581	604	606	605
China Imports (Contained iron)	280	338	367	378	381	382	381
Inventory	60	75	60	40	40	40	40
Domestic Production (Contained iron)	197	180	192	198	199	199	199

Source: Tex Report; Citi Investment Research

Pig Iron Production in Major Seaborne Markets

Mt	YTD Prod. Apr-09	Annualized	Prod. Apr-09	% chg ytd	% chg yoy month
Japan	105.0	315.1	4.4	257.8%	-39.0%
Korea	39.2	117.5	2.1	280.5%	-18.7%
Taiwan	12.1	36.4	0.6	265.4%	-31.2%
China	631.4	1894.2	41.6	298.5%	0.9%
Total	**787.8**	**2363.3**	**48.7**	**291.1%**	**-6.2%**

Source: IISI

Asian Iron Ore Imports

Mt	YTD Apr-09	Annualized	Imp. Apr-09	% chg ytd	% chg yoy month
Japan	29.1	87.3	6.5	-36.5%	-43.7%
China	188.5	565.5	57.0	22.8%	33.0%
Total	**217.6**	**696.9**	**63.5**	**6.3%**	**12.7%**

Source: Tex Report

Key points

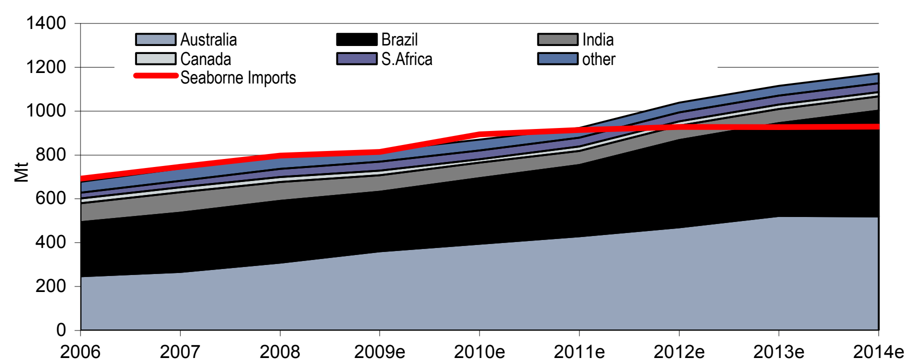
- We expect contract prices to rise 15% in JFY2010/11

-Market in small deficit

-Chinese and other high cost production will be squeezed

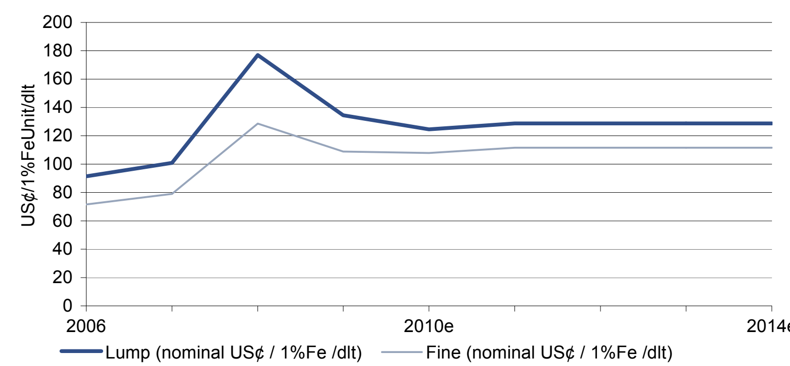
-We expect spot prices to stablise around $US80/t in China

Suppliers to the Seaborne Iron Ore Market



Source: IISI, Citi Investment Research and Analysis Estimates

Price Forecast - Lump & Fines



Source: Citi Investment Research and Analysis Estimates

Sesa Goa

Company description

Sesa Goa, India's largest private sector iron ore company with reserves and resources of ~240m tonnes, was established in 1954. On 23 April 2007, Vedanta Resources plc purchased Mitsui's 51% stake in the company, and it currently owns 53% of Sesa Goa. Its mines based in Goa account for ~65% of volumes, Karnataka for 20% and the balance from Orissa. The majority of its iron ore reserves are in the form of fines. Over 90% of the ore is exported through ports such as Goa, Chennai, Paradip and Haldia. In June 2009, Sesa Goa acquired 100% of V S Dempo & Co (VSD), an iron ore producer based in Goa. VSD owns/has access to 70m tonnes of iron ore in Goa and its mining assets include processing plant, barges, jetties, transhippers and loading facilities in Goa. Sesa Goa is targeting a production/sales volume of 50m tpa of iron ore in the next four years. In addition to iron ore, Sesa Goa manufactures coke, while its 88% subsidiary Sesa Industries produces pig iron. In FY09, iron ore accounted for 85% of Sesa Goa's consolidated net sales, pig iron 12% and met coke 3%. 89% of PBIT in FY09 was from iron ore, 8% from met coke and the rest from pig iron.

Investment strategy

We rate Sesa Goa Sell/Medium Risk (3M). Profits are mainly driven by its iron ore business and the company exports more than 90% of its ore, with China the largest market (85% of sales). Our Sell recommendation is based on a cloudy near-term outlook due to: (1) Spot iron ore prices have fallen below US$100/t (CIF). The forward curve indicates that prices should fall to US$85/t by March 2010. (2) We think China is now starting to over-stock on longs and to a lesser extent flats. (3) Steel prices in China are now below our assessed marginal cost of production, putting pressure on imported iron ore prices in the near-term. Prices for rebar in China have fallen ~15% from August 2009 peaks and for HRC by 10%. Seasonality is one explanation, destocking is a more bearish alternative. CIRA's global commodity analyst expects iron ore contract prices will rise 15% yoy in FY11E. However, we assume a 10% hike in FY11E contract prices and a 5% hike in spot, based on recent trends in Chinese iron and steel pricing and the forward swap curve. Our forecasts incorporate Sesa Goa's aggressive plans and its aim to grow sales volumes by 20%-25% p.a. over the next few years, with a target of production/sales of ~50m tpa in the next four years. The recent Dempo acquisition should help increase FY10E sales volumes by 45% to 22m tonnes.

Valuation

Our target price of Rs203 is SOTP-based using DCF for Sesa Goa and Dempo and EV/EBITDA for Sesa Industries. We model DCF cash flows for Sesa Goa to FY17E and for Dempo to FY21E based on the existing proven and probable reserves for each. We have not accounted for any terminal value due to lack of sufficient visibility on future iron ore reserves, which could lead to upside risk to our DCF value given ongoing exploration efforts. Our iron ore price assumptions are based on global price forecasts adjusted for more recent trends. We estimate Sesa Goa's FY10E average prices could decline by 24% YoY. However, we expect average realizations to rise 2% in FY11E and 3% in FY12E. Our WACC is 12.9%, beta relative to Sensex is 1.2, post tax cost of debt is 7.5% and target debt weight is 20%. Our DCF calculations yield a value of Rs159/sh for Sesa Goa standalone and Rs38/sh for Dempo. To this we add the value of Sesa Industries at Rs6/sh based on 5x Sep10 EV/EBITDA, giving a target price for Sesa Goa of Rs203. The EV/EBITDA multiple for Sesa Industries assumes a discount relative to Sesa Goa (excluding Dempo), which currently trades at 7.2x EV/EBITDA. The implied PE multiple at Sesa Goa's DCF-derived target price is 9.3x, higher than its previous trading range. The implied target PE is at a discount to the CY10E PE multiple for the global majors, which we view is justified given its dependence on China and the high proportion of spot sales.

Risks

We rate Sesa Goa Medium Risk as opposed to the High Risk rating suggested by our quantitative risk-rating system, which tracks 260-day historical share price volatility. Sesa Goa's strong volume growth, low costs (in Goa), EBITDA margins in the range of 36%-44%, potential for cost cutting/synergies from Dempo and net cash position warrant a Medium Risk rating, in our view. Upside risks to our target price include: 1) Higher iron ore prices than we expect; 2) Favourable change in the Chinese iron ore and steel outlook; 3) Depreciation in the rupee versus the US$ vs. the appreciation trend that we expect; 4) Higher ocean freight rates making Indian iron ore more competitive; and 5) Favourable changes in iron ore royalties.

Rio Tinto Ltd (RIO.AX; A$58.94; 1M)

Valuation

Our RIO target price is A$68. Our RIO valuation (NPV) of A$67.50 is based on DCF analysis using a 7.8% real, after-tax, unlevered discount rate. Long-term equilibrium commodity prices and key assumptions are available in our Metals & Mining Strategy reports.

We calculate our one-year target price using a combination of 1) a valuation based on zero premium to NPV, and 2) a multiple-based valuation (a combination 15x PE and 8x EV/EBITDA for FY10), with a 50/50 weighting between each methodology.

Risks

We rate RIO as Medium Risk. Key risks to our projected earnings, cash flows and target price relate to weaker-than-expected commodity prices/economic growth and currency fluctuations. Country risk is a consideration with about 20% of operations by NPV in Africa and South America and Indonesia.

Operating risk in RIO is lower than in smaller metals and mining companies with fewer operations. If the impact on the company from any of these factors proves to be greater than we anticipate, the stock will likely have difficulty achieving our target price.

BHP Billiton Ltd (BHP.AX; A$38.15; 1M)

Valuation

Our target price is A$43.00. Our BHP valuation (NPV) of A$35.00/share is partly based on DCF analysis using a 7.8% real, after tax, unlevered discount rate and a beta of 1.1. Our long-term equilibrium commodity prices and other key assumptions are available in our Metals & Mining Strategy reports. We calculate a 1-year target price using a combination of: 1) a target price based on a 20% premium to NPV; 2) a multiple-based target price (weighted 25%/75% between FY10E and FY11E using a 15x P/E and 8x EV/EBITDA); and 3) a 50% weighting for each method.

Risks

We rate BHP as Medium Risk, referencing a number of quantitative and fundamental screens. Key risks to our projected earnings, cash flows and valuation relate to weaker-than-expected commodity prices/economic growth and currency fluctuations. We see these risk factors to the share price reaching our target price. However, if the impact of these risk factors is less negative than we currently anticipate, then the share price might rise above our target price.

Country risk is a significant consideration with about 40% by NPV of operations in Africa, South America and Asia. Operating risk is lower than in smaller metals and mining companies with fewer operations.

The ongoing global economic slowdown could deteriorate further, providing further downside risk to commodity prices.

BHP is a Medium Risk company utilising an Australian quantitative risk model based on, among other criteria, earnings and dividend stability measured in A$ and ranked against an Australian universe. But, BHP is managed in US$ (e.g., progressive US$ dividends) and there is a natural US$ hedge in its earnings stream which would work to make this more stable in an international context. If a US$ perspective were taken on these issues a lower risk rating could be warranted.

Vale (Preferred) (VALEp.N; US$17.67; 1M)

Valuation

Our target price on the ADR Preferred shares of Vale (NYSE ticker: VALE_p) is US$24 per share. We use a 50:50 weighting of valuation multiples and DCF modeling.

Our target multiples for Vale are 15x EBITDA and 9x PE (15% discount to Ordinary). These multiples are appropriate for CIRA's mid-to-trough commodity price forecasts. Applying these multiples to 2010 earnings results in an average target of US$21/sh.

We explicitly model DCF cash flows out to 2015 and then use a terminal value. Key assumptions include long-run iron ore prices of $60/t and nickel prices of $8/lb. Our WACC is 11% which is calculated based on a beta of 1.0 (relative to Bovespa), a Brazil risk free rate of 8% and a Brazil ERP of 6% (per CIRA LatAm Chartbook), cost of debt of 8%, tax of 30% and a target weight of debt of 30%. We apply a 20% premium which is average for midcycle. The result is US$27/sh.

Risks

We rate Vale Medium Risk. Vale’s earnings are exposed to highly volatile commodity prices, but this is mitigated by the company’s size, investment grade debt and increasing diversification out of iron ore. Key risks that could prevent the shares from reaching our target valuation include: a slowdown in Chinese industrial production, executing on major projects, future oversupply in the iron ore market, future expensive acquisitions and political instability in Brazil.

Appendix A-1

Analyst Certification

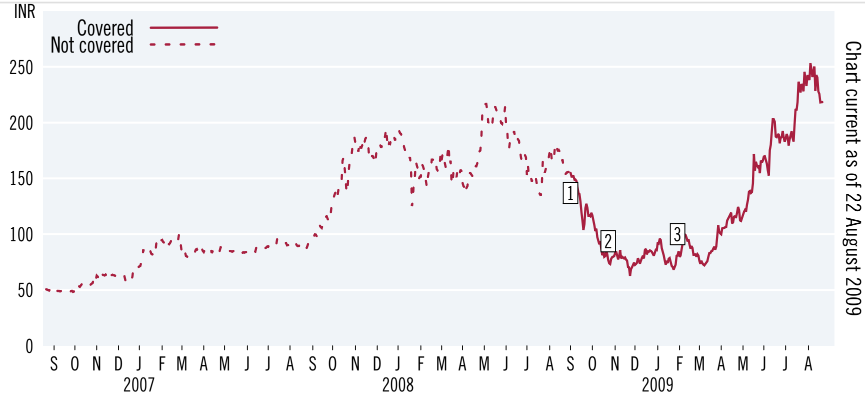
Each research analyst(s) principally responsible for the preparation and content of all or any identified portion of this research report hereby certifies that, with respect to each issuer or security or any identified portion of the report with respect to an issuer or security that the research analyst covers in this research report, all of the views expressed in this research report accurately reflect their personal views about those issuer(s) or securities. Each research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this research report.

IMPORTANT DISCLOSURES

Sesa Goa (SESA.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Pradeep Mahtani
Covered since September 1 2008



Date	Rating	Target Price	Closing Price
1 1-Sep-08	*3H	*145.00	155.00
2 23-Oct-08	3H	*70.00	76.85
3 29-Jan-09	3H	*75.00	81.05

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

BHP Billiton Ltd (BHP.AX)

Ratings and Target Price History
Fundamental Research

Analyst: Clarke Wilkins

Date	Rating	Target Price	Closing Price
1 4-Sep-06	1M	*37.00	27.65
2 25-Jan-07	1M	*35.00	26.09
3 18-Mar-07	1M	*36.00	27.80
4 16-Apr-07	*2M	*33.00	30.39
5 5-Jun-07	*1M	*37.00	32.93
6 22-Jul-07	1M	*42.00	38.40
7 21-Oct-07	*2M	*48.00	47.10
8 2-Dec-08	*1M	*39.30	27.03
9 25-Jan-09	*2M	*31.30	27.45
10 10-Mar-09	2M	*28.90	29.28
11 10-May-09	2M	*36.00	35.31
12 22-Jun-09	*1M	*39.40	35.25
13 7-Jul-09	1M	*40.00	32.25
14 16-Aug-09	1M	*43.00	38.26

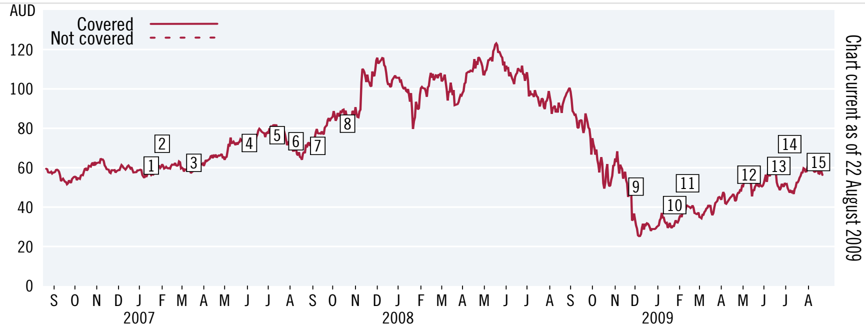
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Rio Tinto Ltd (RIO.AX)

Ratings and Target Price History
Fundamental Research

Analyst: Clarke Wilkins



#	Date	Rating	Target Price	Closing Price
1	17-Jan-07	1M	*74.93	56.24
2	1-Feb-07	1M	*72.56	61.75
3	18-Mar-07	1M	*74.14	58.13
4	5-Jun-07	1M	*81.24	75.84
5	13-Jul-07	*2M	81.24	79.90
6	9-Aug-07	*1M	81.24	69.61
7	9-Sep-07	1M	*83.61	79.66
8	21-Oct-07	*2M	*93.86	86.45
9	2-Dec-08	*1H	*54.42	30.76
10	25-Jan-09	1H	*36.28	30.02
11	12-Feb-09	1H	*51.27	41.01
12	10-May-09	*1M	*63.89	56.47
13	22-Jun-09	1M	*64.00	50.00
14	7-Jul-09	1M	*66.00	47.35
15	16-Aug-09	1M	*68.00	59.99

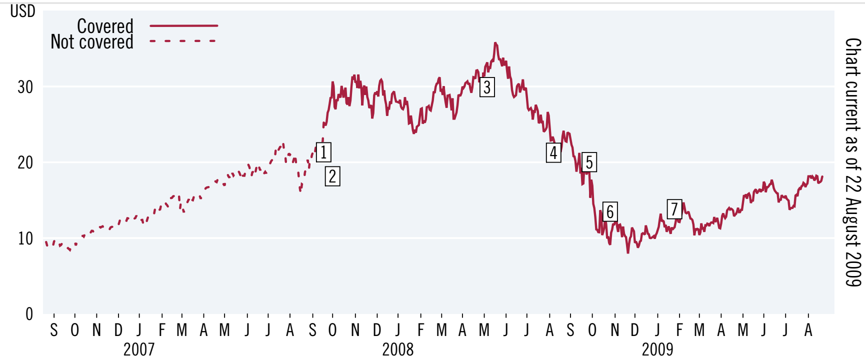
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Vale (Preferred) (VALEp.N)

Ratings and Target Price History
Fundamental Research

Analyst: Alexander Hacking, CFA
Covered since September 19 2007



#	Date	Rating	Target Price	Closing Price
1	18-Sep-07	1M	*29.00	25.24
2	1-Oct-07	1M	*37.00	30.67
3	6-May-08	1M	*41.00	33.19
4	7-Aug-08	1M	*39.00	22.99
5	26-Sep-08	1M	*31.00	18.71
6	26-Oct-08	1M	*26.00	9.35
7	25-Jan-09	1M	*24.00	11.30

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Citigroup Global Markets Inc. or its affiliates beneficially owns 1% or more of any class of common equity securities of BHP Billiton Ltd. This position reflects information available as of the prior business day.

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Citi Investment Research & Analysis Ratings Distribution

Data current as of 30 Jun 2009	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	41%	38%	21%

% of companies in each rating category that are investment banking clients	46%	45%	39%

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CIRA's stock recommendations include a risk rating and an investment rating.
Risk ratings, which take into account both price volatility and fundamental criteria, are: Low (L), Medium (M), High (H), and Speculative (S).
Investment ratings are a function of CIRA's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating.

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