

# Sesa Goa

Bloomberg: SESA IN Equity

Reuters: SESA.BO

Recommendation: HOLD

No Change



## RESULT UPDATE

# Setting More Realistic Targets

## 2QFY11 sees combination of lower realization and higher cost

While net sales was broadly in line with expectation, EBITDA during the quarter was Rs3,034mn, much lower compared with consensus estimates of Rs4,593mn (Bloomberg mean). Adjusted net profit at Rs3,485mn too was below consensus estimates, despite a minimal tax rate of 5%. Ore realisations dropped 19% QoQ to Rs3,380 per tonne from Rs4,157/t, while total operating expenses (excluding depreciation) rose from Rs1,600/t in 1Q to Rs3,046/t in 2Q, led by higher material and transport costs.

## Pig iron business to the rescue ... but only at the topline

The Pig Iron segment, led by better sales volume (84kt), added to the topline - segment revenue showed a 55% YoY and 46% QoQ increase. However, operating profit at Rs341mn was largely in keeping with the level of prior quarters, indicating a drop in margins.

## Volume guidance of 10% in FY11 is more realistic

The management expects volume growth of ~10% this year. In earlier discussions, they had talked about 20-25% volume growth including volume from acquisitions. We believe that 10% is a more realistic guidance and maintain our forecast of 8% volume growth for FY11E (11% for FY12E).

## Long-term growth rate faces hiccups

The outlook on expansion in mining capacity is more muted on account of slower regulatory approvals. Our volume forecast for FY12E (24.6mt) implies full utilization of the current mining capacity (presently 25mt).

## Maintain HOLD recommendation, TP revised to Rs380

We maintain our **HOLD** recommendation on the stock, while rolling forward our TP for September 2011 to Rs380 (earlier Rs370 for March 2011). The TP considers the impact of the Cairn deal as well as the government's profit sharing proposal (at 10% compared with the proposal of 26%).

### Exhibit 1: Key financials

Y/E Mar (Rs mn)	FY08	FY09	FY10	FY11E	FY12E	FY13E
Net sales (Rs mn)	37,659	49,179	57,978	92,372	114,402	126,306
EBITDA (Rs mn)	23,032	27,062	31,486	45,818	58,732	64,737
Adjusted Net profit (Rs mn)	15,416	21,522	25,072	42,033	42,665	47,409
Adjusted EPS FD (Rs)	19.6	27.3	30.8	48.5	48.9	54.3
P/E Adj (x)	18.6	13.4	11.8	7.5	7.5	6.7
EV/EBITDA (x)	11.6	9.5	8.7	5.3	3.5	2.6

Source: Company, Ambit Capital research

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### Recommendation

<b>CMP:</b>	Rs359
<b>Target Price (Sep 2011):</b>	Rs380
<b>Previous TP:</b>	Rs370
<b>Upside (%)</b>	6

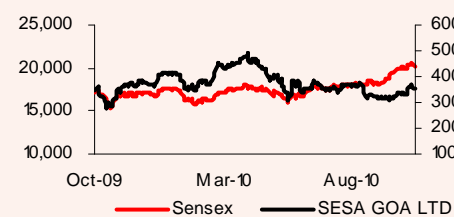
### Stock Information

<b>Mkt cap:</b>	Rs320,153mn/US\$7,259mn
<b>52-wk H/L:</b>	Rs495/266
<b>3M Avg. daily vol. (mn):</b>	6
<b>Beta (x):</b>	1.2
<b>BSE Sensex:</b>	20169
<b>Nifty:</b>	6076

### Stock Performance (%)

	1M	3M	12M	YTD
Absolute	14.6	8.5	4.0	-9.3
Rel. to Sensex	11.3	-3.4	-10.7	-21.5

### Performance (%)



Source: Bloomberg, Ambit Capital research

**Exhibit 2: 2QFY11 results**

Y/E Mar 31 (Rsmn)	2Q FY10	3Q FY10	4Q FY10	1Q FY11	2Q FY11	YoY%	QoQ%
<b>Net Sales</b>	<b>5,341</b>	<b>18,668</b>	<b>24,035</b>	<b>23,940</b>	<b>9,068</b>	<b>70%</b>	<b>-62%</b>
Other operating income	46	224	154	190	115		
<b>Total operating income</b>	<b>5,387</b>	<b>18,892</b>	<b>24,189</b>	<b>24,131</b>	<b>9,183</b>	<b>70%</b>	<b>-62%</b>
Inc (Dec) in stock-in-trade	(1,566)	814	(639)	(1,392)	(1,387)		
Raw materials consumed	881	883	881	855	871		
Iron ore purchased	557	645	1,621	1,471	1,068		
a). Material costs	(129)	2,342	1,863	934	551	-528%	-41%
b). Stores consumed	526	690	686	737	614	17%	-17%
c). Staff & personnel costs	334	515	447	444	466	40%	5%
d). Transport expenses	2,306	3,276	3,649	3,457	2,677	16%	-23%
e). Export duties	47	175	1,215	1,276	527	n.a.	-59%
f). Other prodn & admin exp	777	1,534	1,300	1,776	1,315	69%	-26%
<b>Total Prod &amp; Admin expenses</b>	<b>3,860</b>	<b>8,531</b>	<b>9,159</b>	<b>8,624</b>	<b>6,150</b>	<b>59%</b>	<b>-29%</b>
<b>EBITDA</b>	<b>1,527</b>	<b>10,360</b>	<b>15,030</b>	<b>15,507</b>	<b>3,034</b>	<b>99%</b>	<b>-80%</b>
<b>Margin</b>	<b>28.6%</b>	<b>55.5%</b>	<b>62.5%</b>	<b>64.8%</b>	<b>33.5%</b>		
Depreciation	202	225	166	191	194	-4%	1%
<b>Operating profit</b>	<b>1,325</b>	<b>10,136</b>	<b>14,864</b>	<b>15,315</b>	<b>2,840</b>	<b>114%</b>	<b>-81%</b>
Other income	893	1,325	1,291	1,609	1,004	13%	-38%
Extraordinary income	0	0	0	(911)	364		
<b>EBIT</b>	<b>2,218</b>	<b>11,461</b>	<b>16,154</b>	<b>16,014</b>	<b>4,208</b>	<b>90%</b>	<b>-74%</b>
Interest & other charges	20	251	227	137	140		
<b>Reported PBT</b>	<b>2,198</b>	<b>11,210</b>	<b>15,928</b>	<b>15,877</b>	<b>4,068</b>	<b>85%</b>	<b>-74%</b>
Tax expense	503	2,906	3,777	2,832	189	-62%	-93%
<b>Reported PAT</b>	<b>1,694</b>	<b>8,304</b>	<b>12,151</b>	<b>13,045</b>	<b>3,879</b>	<b>129%</b>	<b>-70%</b>
(-) Minority Interest	30	29	22	27	30		
<b>Reported Net profit to shareholders</b>	<b>1,665</b>	<b>8,275</b>	<b>12,129</b>	<b>13,018</b>	<b>3,849</b>	<b>131%</b>	<b>-70%</b>
<b>Adjusted Net profit to shareholders</b>	<b>1,665</b>	<b>8,275</b>	<b>12,129</b>	<b>13,928</b>	<b>3,485</b>	<b>109%</b>	<b>-75%</b>
<b>Reported EPS (Diluted)</b>	<b>2.1</b>	<b>9.5</b>	<b>14.6</b>	<b>15.2</b>	<b>4.2</b>	<b>106%</b>	<b>-72%</b>

Source: Company, Ambit Capital research

**Exhibit 3: Volume and per tonne figures**

	2Q FY10	3Q FY10	4Q FY10	1Q FY11	2Q FY11	YoY%	QoQ%
Iron ore sales (MT)	1.6	6.8	7.4	5.4	2.0	25%	-63%
Pig iron sales (T)	66,880	71,000	70,000	54,000	84,000	26%	56%
Iron ore realisation (Rs/T)	2,389	2,514	3,024	4,157	3,380	41%	-19%
Net sales/T of iron ore	3,299	2,749	3,259	4,433	4,491	36%	1%
EBITDA/T of iron ore sold	943	1,525	2,038	2,872	1,503	59%	-48%

Source: Company, Ambit Capital research

**Exhibit 4: Consolidated profit & loss**

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E	FY2013E
<b>Net Sales</b>	<b>37,659</b>	<b>49,179</b>	<b>57,978</b>	<b>92,372</b>	<b>113,511</b>	<b>125,346</b>
<b>Total operating costs exc D&amp;A</b>	<b>15,194</b>	<b>22,529</b>	<b>27,097</b>	<b>47,099</b>	<b>56,846</b>	<b>63,455</b>
<b>EBITDA</b>	<b>23,032</b>	<b>27,062</b>	<b>31,486</b>	<b>45,818</b>	<b>57,197</b>	<b>62,455</b>
EBITDA margin %	61.2	55.0	54.3	49.6	50.4	49.8
Depreciation	500	517	745	854	1,065	1,225
<b>Operating profit</b>	<b>22,533</b>	<b>26,545</b>	<b>30,741</b>	<b>44,964</b>	<b>56,131</b>	<b>61,230</b>
FX and exceptional items	0	(1,641)	1,219	0	0	0
Other income	744	2,240	3,041	6,024	7,174	8,403
<b>EBIT</b>	<b>23,277</b>	<b>27,144</b>	<b>35,001</b>	<b>50,988</b>	<b>63,305</b>	<b>69,633</b>
Interest & other charges	28	43	555	824	1,023	1,065
<b>Adjusted PBT</b>	<b>23,249</b>	<b>28,743</b>	<b>33,227</b>	<b>50,164</b>	<b>62,282</b>	<b>68,569</b>
Total exceptional gains (losses)						
<b>Reported PBT</b>	<b>23,249</b>	<b>27,102</b>	<b>34,446</b>	<b>50,164</b>	<b>62,282</b>	<b>68,569</b>
Total taxes	7,760	7,153	8,056	8,026	20,553	22,628
Minority Interest	74	68	99	104	109	115
<b>Adjusted Net profit to shareholders</b>	<b>15,416</b>	<b>21,522</b>	<b>25,072</b>	<b>42,033</b>	<b>41,620</b>	<b>45,826</b>
<b>Reported Net profit to shareholders</b>	<b>15,416</b>	<b>19,881</b>	<b>26,291</b>	<b>42,033</b>	<b>41,620</b>	<b>45,826</b>
Wted no of shares (FD)	787	787	813	888	888	888
<b>Adjusted EPS FD</b>	<b>19.6</b>	<b>27.3</b>	<b>30.8</b>	<b>48.5</b>	<b>47.8</b>	<b>52.5</b>
<b>Reported EPS FD</b>	<b>19.6</b>	<b>25.3</b>	<b>31.6</b>	<b>48.5</b>	<b>47.8</b>	<b>52.5</b>

Source: Company, Ambit Capital research

- The impact of Cairn deal and profit sharing provision are considered in the valuation rather than FY13E financials

**Exhibit 5: Key ratios**

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Total materials cost/Net Sales	12.6%	10.0%	9.2%	11.0%	11.1%	11.4%
Employee cost/ Net Sales	1.8%	2.0%	2.9%	2.0%	1.9%	1.9%
Transport costs/ Net Sales	15.9%	23.3%	20.4%	19.4%	18.9%	19.0%
Royalties & Export duties / Net Sales	4.5%	4.7%	5.3%	10.1%	10.1%	9.8%
Other costs/Net sales	5.5%	5.8%	8.9%	8.4%	8.1%	8.5%
EBITDA margin	61.2%	55.0%	54.3%	49.6%	50.4%	49.8%
Adjusted PBT Margin	61.7%	58.4%	57.3%	54.3%	54.9%	54.7%
Reported PBT Margin	61.7%	55.1%	59.4%	54.3%	54.9%	54.7%
Return on Equity	52.9%	46.0%	31.8%	36.1%	27.1%	23.5%
Return on Capital employed (adj for CWIP)	51.8%	42.2%	24.1%	27.9%	21.8%	19.2%
Gross Debt/ Equity (x)	0.0%	0.0%	24.8%	16.8%	12.7%	10.0%
Net Debt (Cash)/ Equity (x)	-70.4%	-66.6%	-63.1%	-70.9%	-75.7%	-79.2%

Source: Company, Ambit Capital research

**Exhibit 6: Consolidated cash flow statement**

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E	FY2013E
<b>Reported profit before taxes</b>	<b>23,249</b>	<b>27,102</b>	<b>34,446</b>	<b>50,164</b>	<b>62,282</b>	<b>68,569</b>
+ Depreciation expense	500	517	745	854	1,065	1,225
- Interest & dividend recd (net)	(717)	(2,198)	(1,701)	(2,188)	(2,564)	(3,137)
+/- Other adjustments	10	(12)	(1,924)	0	0	0
<b>Cash flows pre working capital changes</b>	<b>23,042</b>	<b>25,409</b>	<b>31,566</b>	<b>48,830</b>	<b>60,784</b>	<b>66,657</b>
Changes in working capital	(1,707)	3,145	1,791	(1,311)	(522)	(941)
Direct Taxes Paid	(7,475)	(7,210)	(7,644)	(8,026)	(20,553)	(22,628)
<b>Net Cash from Operating Activities</b>	<b>13,861</b>	<b>21,343</b>	<b>25,713</b>	<b>39,493</b>	<b>39,709</b>	<b>43,088</b>
Net capex	(674)	(1,471)	(1,490)	(6,000)	(4,000)	(4,000)
Investments	(11,838)	(9,647)	(37,143)	0	0	0
Acquisitions	0	0	(17,132)	0	0	0
Interest & dividend received	480	1,130	1,824	3,012	3,587	4,201
Others	0	0	0	0	0	0
<b>Net Cash from Investing Activities</b>	<b>(12,033)</b>	<b>(9,989)</b>	<b>(53,941)</b>	<b>(2,988)</b>	<b>(413)</b>	<b>201</b>
Proceeds from Issue of Share Capital	0	0	5,372	0	0	0
Borrowings	0	0	23,576	10	10	10
Interest Paid	(0)	(10)	(63)	(824)	(1,023)	(1,065)
Dividend Paid	(1,836)	(1,380)	(2,064)	(2,701)	(4,269)	(4,162)
Others	0	(10,000)	0	0	0	0
<b>Net Cash from Financing Activities</b>	<b>(1,836)</b>	<b>(11,390)</b>	<b>26,821</b>	<b>(3,515)</b>	<b>(5,281)</b>	<b>(5,217)</b>
<b>Net Increase in Cash &amp; Cash Equivalents</b>	<b>(8)</b>	<b>(35)</b>	<b>(1,407)</b>	<b>32,990</b>	<b>34,014</b>	<b>38,073</b>

Source: Company, Ambit Capital research

**Exhibit 7: Consolidated balance sheet**

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Equity Capital	394	787	831	831	831	831
Reserves & surplus	29,041	46,370	78,346	116,111	153,569	194,813
Minority Interest	266	334	433	537	646	761
<b>Networth</b>	<b>29,701</b>	<b>47,491</b>	<b>79,610</b>	<b>117,479</b>	<b>155,046</b>	<b>196,405</b>
Borrowings	0	19	19,606	19,616	19,626	19,636
Deferred Tax Liability	664	664	750	750	750	750
<b>Capital employed</b>	<b>30,365</b>	<b>48,175</b>	<b>99,966</b>	<b>137,845</b>	<b>175,422</b>	<b>216,790</b>
Net Fixed Assets (inc CWIP)	4,975	5,930	22,557	27,703	30,637	33,413
Investments	20,510	31,252	45,649	45,649	45,649	45,649
Cash and Bank Balances	210	177	23,918	56,909	90,923	128,996
<b>Net current assets</b>	<b>4,880</b>	<b>10,992</b>	<b>31,760</b>	<b>64,494</b>	<b>99,136</b>	<b>137,729</b>
<b>Capital employed</b>	<b>30,365</b>	<b>48,175</b>	<b>99,966</b>	<b>137,845</b>	<b>175,422</b>	<b>216,790</b>

Source: Company, Ambit Capital research

**Exhibit 8: Per share figures and valuation ratios (based on CMP)**

Y/E Mar (Rs mn)	FY2008	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Adjusted EPS Fully Diluted	19.6	27.3	30.8	48.5	47.8	52.5
Reported EPS Fully Diluted	19.6	25.3	31.6	48.5	47.8	52.5
Net Dividend Per Share	2.3	2.3	3.2	5.0	4.9	5.3
Book Value Per Share	37.1	59.5	88.7	131.2	173.2	219.6
P/E on adjusted basis (x)	18.6	13.4	11.8	7.5	7.6	7.0
P/E on reported basis (x)	18.6	14.5	11.5	7.5	7.6	7.0
P/B (x)	9.9	6.1	4.1	2.8	2.1	1.7
EV/ EBITDA (x)	11.6	9.5	8.7	5.3	3.6	2.7
Dividend yield (%)	0.6	0.6	0.9	1.4	1.3	1.5

Source: Company, Ambit Capital research

## Explanation of Investment Rating

Investment Rating	Expected return (over 12-month period from date of initial rating)
Buy	> 15%
Hold	5% to 15%
Sell	< 5%

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