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Stock Rating
Overweight

Industry View
Attractive

Sesa Goa

Iron Ore Strength to Reverse Recent Underperformance

What's Changed	
Price Target	**Rs1458.60 to Rs1,478.00**
F07E EPS	**From Rs203.30 to Rs189.64**
F08E EPS	**From Rs229.33 to Rs234.66**

Conclusion: Sesa Goa stock has lagged the Sensex by 34% since Jun'06 due to volatile commodity prices and exaggerated fears over India's export ban. We conclude that Sesa's valuations do not reflect its mid-cycle state – we see a strong outlook for ore prices and likely strong earnings trend, reiterating our positive view on what we feel is the only actionable iron ore stock in India. Our new price target shows an upside of 45.5%.

What's New: Reflecting our global metals and mining team's reaffirmation of its strong outlook on iron ore, we are pushing up our iron ore price projections, expecting a 15% YoY increase in contract prices in CY07 and a rollover pricing in CY08. China's appetite will likely remain influential in fuelling this – we estimate that the country will require an additional 47 mt of iron ore in CY07 via imports, even as suppliers struggle to catch up. The likelihood of a trend reversal in iron ore export volumes from India strengthens our expectation of a sustained phase of iron ore market tightness.

Implications: The 19% contract price increase for CY06 supplies should be visible in Sesa's earnings in the coming quarters. The company's iron ore division should gain further from logistics cost reduction, while the upturn in pig iron and coke division should continue with improving costs and realizations. Our projected EBITDA CAGR of 19.6% between F06 and F09 would lead to net cash per share of about Rs682 by F09 end.

Valuations: The largest private iron ore player in India is available at an attractive P/E of 5.4x F07e and 4.3x F08e. At our price target, the stock would trade at 6.3x F08e – fair in our view, as we believe we are at least two years away from a softening of iron ore prices.

Key Ratios and Statistics

Reuters: SESA.BO Bloomberg: SESA IN
India Nonferrous Metals & Mining

Price target	Rs1,478.00
Shr price, close (Oct 4, 2006)	Rs1,015.75
Mkt cap, curr (mn)	Rs39,982
Mkt cap, curr (mn)	US$876
52-Week Range	Rs1,613.75-789.75
Sh out, basic, curr (mn)	39.4

Fiscal Year (Mar)	2006e	2007e	2008e	2009e
ModelWare EPS (Rs)*	140.97	189.64	234.66	248.17
Prior ModelWare EPS (Rs)	148.07	203.30	229.33	-
Rev, net (Rs mn)	18,363	22,401	25,600	26,616
ModelWare net inc (Rs mn)	5,607	7,543	9,334	9,871
P/E	7.2	5.4	4.3	4.1
P/BV	3.3	2.1	1.5	1.2
Div yld (%)	1.5	3.8	4.9	5.2

* = Please see explanation of Morgan Stanley ModelWare later in this note.
e = Morgan Stanley Research estimates

Financial Summary

Profit and Loss Statements

Rs mn (Year-end March)	F2005	F2006	F2007E	F2008E	F2009E
Net Sales	**15,253**	**18,363**	**22,401**	**25,600**	**26,616**
Increase/Decrease in Stock	(172)	(326)	(55)	(58)	(58)
Consumption of Raw Materials	1,591	2,340	3,056	2,849	2,586
Consumption of Stores	982	1,196	1,107	1,239	1,342
Purchase of Iron Ore	1,435	1,604	2,517	2,749	2,857
Personnel	416	519	459	482	506
Administrative & Other Exp	3,457	4,510	3,937	4,390	4,796
Total expenditure	7,708	9,843	11,021	11,650	12,029
EBITDA	**7,544**	**8,519**	**11,380**	**13,949**	**14,587**
Other income	105	242	315	478	666
Interest	75	42	14	12	10
Depreciation	320	295	388	442	465
PBT	7,255	8,424	11,292	13,973	14,778
Tax	2,401	2,784	3,749	4,639	4,906
PAT	**4,853**	**5,640**	**7,543**	**9,334**	**9,871**

Balance Sheets

Rs mn (Year-end March)	F2005	F2006	F2007E	F2008E	F2009E
Sources of Funds					
Share Capital	394	398	398	398	398
Reserves	6,968	11,975	19,098	26,156	33,636
Net worth	**7,362**	**12,373**	**19,496**	**26,554**	**34,033**
Minority interest	85	117	-	-	-
Loans	233	156	111	116	106
Deferred tax liability	600	615	633	657	681
Capital Employed	**8,279**	**13,261**	**20,240**	**27,327**	**34,820**
Application of Funds					
Gross fixed assets	5,326	6,358	7,759	8,308	8,606
Less depreciation	2,121	2,442	2,830	3,272	3,737
Net fixed assets	**3,205**	**3,916**	**4,929**	**5,036**	**4,869**
Capital WIP	212	179	228	179	151
Investments	3,040	3,960	4,413	4,723	4,723
Inventory	2,019	2,290	2,716	2,825	2,658
Sundry Debtors	1,827	2,739	3,183	3,604	3,739
Cash & Bank Balances	177	2,730	7,837	14,547	22,414
Others	238	238	238	238	238
Sundry Creditors	1,069	1,218	1,330	1,414	1,452
Other Liabilities	325	331	365	394	404
Provisions	1,046	1,245	1,612	2,021	2,120
Net Current Assets	1,820	5,203	10,668	17,386	25,075
Misc. Expenditures	2	2	2	2	2
Application of Funds	**8,279**	**13,261**	**20,240**	**27,327**	**34,820**

Cash Flow Statements

Rs mn (Year-end March)	F2005	F2006	F2007E	F2008E	F2009E
Net Profit	4,853	5,640	7,543	9,334	9,871
Depreciation	320	295	388	442	465
(Incr) / Decr in Inventory	(279)	(271)	(427)	(108)	167
(Incr) / Decr in Debtors	(462)	(912)	(444)	(421)	(135)
(Incr) / Decr in Others	492	-	-	-	-
Incr / (Decr) in Creditors	(537)	148	112	84	38
Incr / (Decr) in Other Liabilities	94	6	34	29	10
Incr / (Decr) in Total Provisions	714	199	367	409	99
Capital expenditure	(407)	(974)	(1,450)	(500)	(270)
Other Investing Cash Flow	(3,040)	(920)	(453)	(310)	-
Cash Flow from Investing	(3,447)	(1,893)	(1,903)	(810)	(270)
Incr / (Decr) in Equity (695)	44	1,196	(38)	(51)	
Change in Minority Interest	25	33	-	-	-
Ordinary Dividend Paid	(1,016)	(673)	(1,733)	(2,238)	(2,341)
Change in Borrowings	(685)	(77)	(45)	5	(10)
Changes in Def Tax Liabilties	(61)	15	19	23	25
Change in Misc Expenditure	24	-	-	-	-
Inc / (Dec) in Cash	**(659)**	**2,554**	**5,106**	**6,711**	**7,867**

Ratio Analysis

	F2005	F2006	F2007E	F2008E	F2009E
Modelware EPS	122.48	140.97	189.64	234.66	248.17
Book Value per Share	187.0	311.1	490.1	667.6	855.6
DPS	22.65	14.84	38.77	50.05	52.37
Valuation					
P/E	6.0	6.8	5.4	4.3	4.1
EV/EBITDA	3.8	4.2	2.9	1.9	1.2
EV/Sales	1.9	1.9	1.5	1.0	0.7
Price to Book Value	3.9	3.1	2.1	1.5	1.2
Dividend Yield (%)	3.1	1.6	3.8	4.9	5.2
Profitability Ratios (%)					
EBIDTA Margins	49.5	46.4	50.8	54.5	54.8
Net Profit Margins	31.8	30.7	33.7	36.5	37.1
Average RoE	83.8	57.2	47.2	40.5	32.6
Average RoCE	68.7	52.4	45.0	39.2	31.8
Growth (%)					
Sales	71.7	20.4	17.4	14.3	4.0
Operating Profit	159.3	12.9	27.2	22.6	4.6
Modelware EPS	42.6	15.1	34.5	23.7	5.8
Leverage Ratio					
Debt/Equity (x)	0.03	0.01	0.01	0.00	0.00
Net Debt/Equity (x)	0.01	(0.21)	(0.40)	(0.54)	(0.66)

E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Investment Case

Summary & Conclusions

We are pushing up our F08 earnings estimate for Sesa Goa by 2.3% – in-line with our global metals and mining team's higher iron ore price projections. However, we are trimming our F07 estimate by 6.7% to Rs189.64, reflecting our curtailed iron ore volume growth assumption. We also introduce our F09 estimate for the company. We are nudging up our price target by 1.3% to Rs1,478.

We reiterate our Overweight rating on the stock in view of continued tightness in the iron ore market and a likely rebound in the company's pig iron and coke businesses. Our recommendation should also be viewed against the backdrop of the stock's 34.0% underperformance against the Sensex in the last four months.

Sesa Goa trades at a P/E of 5.4x on our F07 estimate and 4.3x on F08e. At our price target of Rs1,478, the stock would trade at a P/E of 7.8x on F07e and 6.3x on F08e. We estimate that by end-F08, the company will be sitting on cash of Rs485 per share (about 47.7% of the current stock price).

Iron Ore – Among the Best Placed in the Commodity Cycle

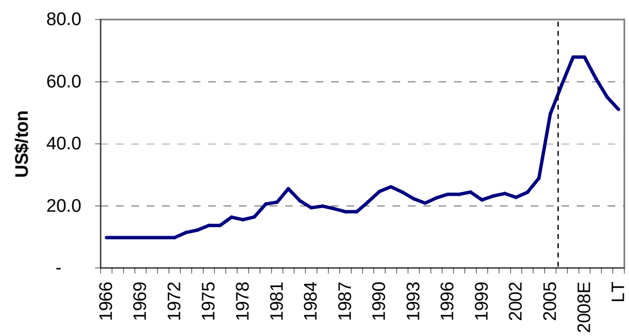
We believe that iron ore exposure can reap rich rewards for investors as the demand/supply imbalance looks set to tighten further in the coming two years. While the iron ore industry has probably suffered more than most from a lack of investment, demand for the mineral continues to grow at a healthy pace. Iron ore tightness is being further compounded by the structural imbalance in steel industry development – more than 35% of steel capacity is in iron-ore deficient China.

Even as the big three players (which control more than 75% of the seaborne iron ore market) are striving hard to expand capacities to satiate Chinese demand, it seems likely that they will be stretched to their limits. We feel that plateauing exports from India (which has about an 11% share of the global seaborne iron ore market) and widening demand from China will tweak up the prices further.

We now project iron ore prices to rise by 15% in CY07 and roll over in CY08. This supports our Overweight thesis on Sesa Goa, which in our view is the only meaningful play in the third-largest iron-ore exporting country. Towards the fourth quarter, as we enter the "mating season" for iron ore suppliers and customers, talks to determine ore prices for CY07 will begin, and we will treat this as a trigger for the stock given our above-consensus stance.

Exhibit 1

Iron Ore Price (US$/ton)



e=Morgan Stanley Research estimates
Source: CRU, Brookhunt, Morgan Stanley Research

Company Description

Sesa Goa is India's largest private sector player in the iron ore sector, contributing about 14% to India's exports. Mitsui of Japan has a 51% stake in the company. It has operations in the three states of Goa, Orissa and Karnataka. The company largely exports its output, with China, Japan and Europe the major destinations. It sells a large part of its output on the basis of long-term contracts. Sesa Goa manufactures coke and produces pig iron too and is active in ship building and repair.

Industry View: Attractive

Enjoying the logistics advantage of being located close to the fast growing Chinese market, long term iron ore players in India look well placed, more so with the tightening iron ore market globally. We expect the latter to be prompted by demand surge in China even as capacity enhancement projects come up with a lag.

MSCI Country: India

Asia Strategist's Recommended Weight: 2.2%
MSCI Asia/Pac All Country Ex Jp Weight: 6.8%

Exhibit 2

What's Changed: Iron Ore Lumps Price (US$/ton)

Period	Iron Ore (Lump)		
	New	Old	Chg
	US$/t	US$/t	%
2006e	59.03	59.03	0%
2007e	67.88	64.93	5%
2008e	67.88	61.68	10%
2009e	61.09	55.51	10%
2010e	54.98	44.68	23%
LT	51.06	44.68	14%

e=Morgan Stanley Research estimates
Source: Morgan Stanley Research

Cost Reduction – A Key to Sesa's Earnings Growth

Sesa Goa is aiming to reduce its operational costs by plugging the logistics and operational loopholes into its system.

- Logistics cost reduction –The company has already purchased two railway rakes for its Karnataka operations (which contribute about 20% of the company's business) and will be purchasing two more for its Orissa operations (about 15% of the total business) in the coming 3-4 months. In all, these purchases will involve an investment of Rs0.5 billion. This initiative will lead to a meaningful reduction in demurrage charges and lead times for exports of iron ore. The company's Orissa operations will also gain from the upcoming railway line between its Barbil mine and the Paradip port. The company expects that its transportation cost in Orissa will come down by half once the line becomes operational by end CY06 as currently the road route is used for transportation of iron ore, which is much costlier than railways.

- Commissioning of stamp charging facility – In its coke division when the compact charging facility becomes operational by F3Q07, the company will start blending semi soft coking coal with hard coking coal, which will imply substantial cost saving (feed cost is about 85% of the coke production cost), given the price differential between the two varieties of coal, and our view that the soft coking coal market is currently looking weaker than the hard coking coal market. We estimate that at current prices, this can result in a cost reduction of Rs4 per share (we assume a blending ratio of 15:85 for soft coking coal: hard coking coal). The company also expects the compact charging process will facilitate productivity improvement to the tune of about 15-20% for the coke plant, implying an incremental production of more than 40,000 tpa. Overall, the compact charging process can contribute about Rs5 per share to the company's EPS in F08, based on our estimates.

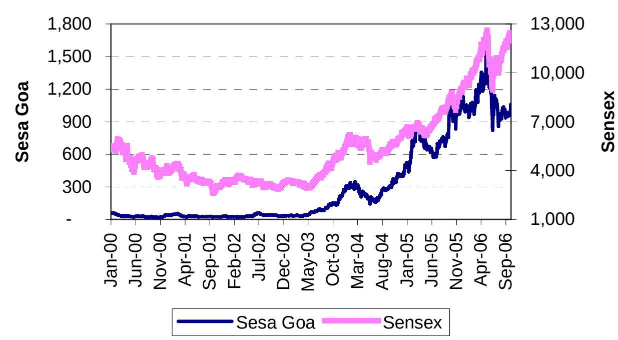
- Commissioning of power plant – The company also stands to gain from the likely commissioning of a 30MW power plant on BOO (Build Own Operate) basis towards the end of F3Q07. This plant will use flue gases from the coke oven and pig iron plants as fuel and we estimate this would lead to a positive impact of about Rs118 million at the operating level on a sustainable basis.

Regulatory Issues Unlikely to Hurt Sesa Goa

As the debate on iron ore continues in India, Sesa Goa, being an important player on the export front, has been under pressure (Exhibit 3).

Exhibit 3

Sesa vs Sensex



Source: Bloomberg, Morgan Stanley Research

However, we feel that the likelihood of an adverse regulatory stricture is reasonably low and accordingly believe that the recent share price dip offers a good buying opportunity.

The reasons why we feel that the company will not feel the heat of regulatory issues are:

- **Ban on iron ore exports from India looks improbable** to us as exports are likely to come down on their own in the coming two years, soothing the fears of various quarters favoring a ban. Further, India doesn't have sufficient pelletisation and sintering capacity to utilize fine iron ore, which comes out when lump iron ore is mined, so fines will continue to be exported.

- **Curb on Goan ore exports even more unlikely** – Even if the central government bans iron ore exports, Goa, where 65% of Sesa's operations are based, is unlikely to come under the ban since Goan ore has extremely low demand in India – being of low quality (ferrous content between 55 to 60%) and having a high proportion of fines.

- **Long term players like Sesa Goa can also tap the domestic market** – In the eventuality of artificial curbs on exports being put in place, we believe that iron ore traders will be squeezed out of the system, thus elevating the position of large, responsible players like Sesa Goa in the Indian iron ore market. Increased demand from steel producers in India will offer companies like Sesa Goa a ready market on its domestic turf. We believe that with domestic prices now following global trends, Sesa Goa would not be a loser in this scenario.

Healthy Volume Growth Likely Over the Medium Term

While the company is keeping tabs on its export growth, we feel that as exports from India start leveling off, the company will be in a position to display good growth in F08 and F09. In our view, this is because the surge in export volumes from India (especially from the traders) has put the limelight even on long-term players like Sesa Goa, who have come under pressure to check their export volumes. As exports from India come down in the coming 3-4 quarters and focus shifts elsewhere from the iron ore exporters, Sesa should be able to ramp up its output.

We also feel that the company's Orissa operation is strategically placed in a region with high demand for DRI grade iron ore and where there aren't too many independent miners. Hence, over the next 2-3 years, we believe the company will be able to increase its domestic sales proportion from the current level of 5% to 8-9%.

Overall, we expect the company to display a CAGR of 5.3% in iron ore sales volume in F07-F09.

Growing Pellets Capacity in India Will Generate Opportunities for the Company

As many steel makers in India are setting up new pelletisation facilities to make use of the iron ore fines being produced in the country, independent miners like Sesa Goa can witness a surge in the domestic demand for their products. We believe that in the coming 2-3 years the company will have more options in terms of its geographical mix.

Exhibit 4
India: Pellet Capacity of Top Players

Pellet Plants	Capacity ('000 Tons)
Kudremukh Iron Ore Co. Ltd.	4,000
Mandovi Pellets Ltd.	1,800
Jindal Vijaynagar Steel Ltd.	4,200
Tisco	800
Chowgule & Co Ltd	550
Essar Steel Ltd.	1,760

Source: Indian Bureau of Mines, Morgan Stanley Research

Exhibit 5
India: Key New Pellet Plants

	Capacity ('000 Tons)	Location
Ispat Industries Ltd	3,000	Visakapatnam
Essar	8,000	Orissa

Source: Company data, Morgan Stanley Research

Chinese Demand Growth to Aid Sesa Goa

Sesa Goa enjoys the geographical advantage of being in close proximity to the large and fast growing market of China. We expect Chinese iron ore imports to grow at a CAGR of 12%-plus between CY06-CY08, which should aid Sesa with the freight advantage that it has. We estimate that freight advantage available to Indian ore exporters vis-à-vis their Brazilian counterparts will continue to be in the range of US$10-20 per ton.

Improving Outlook for Sesa's Coke and Pig Iron Business

Improvements in pig iron prices are leading to margin rebounds for the business and we believe that the uptrend will continue from here. The company's position as a coke producer should improve post the commissioning of the compact charging facility as its coke processing margin will be buttressed substantially.

With the recent US$10-15 decline in coking coal prices and rebound in coke prices, Sesa's coke business should also maintain the upward momentum over the coming quarters. The company has already seen a marked improvement in F1Q07 with EBIT loss coming down to Rs15 million from Rs179 million in F4Q06. We expect Sesa to clock an EBIT CAGR of 59% between F06-F09e for the coke and pig iron business.

Exhibit 6
Sesa Goa: Segment EBIT

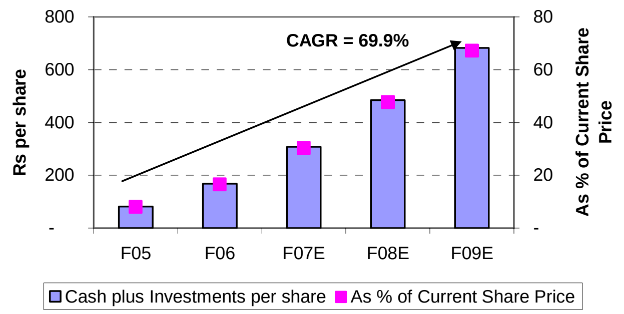
	F04	F05	F06	F07e	F08e	F09e
Iron Ore	1,448	4,686	7,797	9,900	12,283	12,820
Coke	754	2,017	18	379	1,023	1,072
Pig Iron	411	441	425	906	569	740

e=Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Strong Cash Position

As Sesa remains on a high earnings path, it will have sizeable cash pile in the coming 2-3 years. We project that Sesa Goa will be sitting on Rs485 cash per share at the end of F08.

Exhibit 7
Sesa: Cash Plus Investment per Share

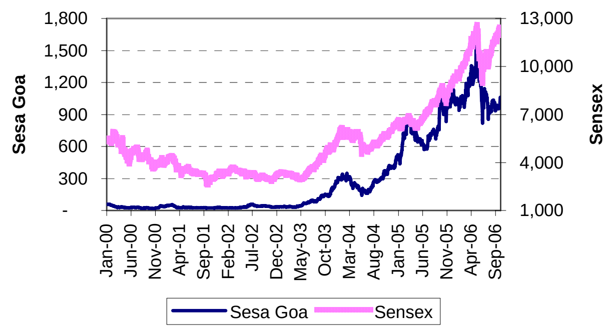


e=Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Valuation and Price Target

In our view, Sesa Goa stock has been under pressure in the last four months due to concerns on regulatory issues and commodity price fluctuations.

Exhibit 8
Sesa vs Sensex



Source: Bloomberg, Morgan Stanley Research

We believe the negative issues have been overdone as the possibility of a ban on exports from India is unlikely and iron ore prices are looking strong on a two-year perspective. As the market gains more clarity on these issues in the coming 2-3 months, we expect the valuations being assigned to the stock to be lifted up.

DCF Valuation

We are raising our DCF-based price target by 1.3% to Rs1,478, taking the iron ore business as one part and the coke and pig iron businesses as the other.

For iron ore, we assume an explicit phase of 13 years based on existing reserves, while for coke plus pig iron, we take an explicit phase of six years and a terminal growth rate of 2%. The WACC for the company is 12.0%.

Exhibit 9
Sesa Goa: DCF Value for Iron Ore Division

Particulars	Rs. Mn
Present value of the explicit phase	45,502
Net present value as on date	47,703
Net debt	(2,188)
Equity Value Rs mn	49,891
Shares (m)	40
Implied DCF value per share (Rs)	1,254

Source: Morgan Stanley Research Estimates

Exhibit 10
Sesa Goa: DCF Value for Coke & Pig Iron Division

Particulars	Rs. Mn
(A) Present value of the explicit phase	4,641
Terminal value	6,469
Terminal growth rate	2%
(B) Present value of the terminal value	3,285
(A+B) Total present value	7,925
Net present value as on date	8,507
Net present value	8,507
Net debt	(386)
Equity Value Rs mn	8,893
Shares (m)	40
Implied DCF value per share (Rs)	224

Source: Morgan Stanley Research Estimates

Based on the sum of the above two businesses, we arrive at a total DCF value of Rs1,478.

Exhibit 11
Sesa Goa: WACC Calculation (%)

Particulars	%
Risk Free Return (Rf)	7.0%
Market Premium (Rm)	6.5%
Assumed Beta	1.03
Cost of Equity (Re)	13.7%
Equity (%)	80.0%
Cost of Debt (Rd)	7.5%
Tax rate	33.1%
After-tax cost of debt (Rd [1-t])	5.0%
Debt (%)	20.0%
WACC	12.0%

Source: Morgan Stanley Research Estimates

The stock trades at a P/E of 5.4x on our F07e EPS and 4.3x F08E. At our price target of Rs1,478, the P/E would be 7.8x and the P/BV 3.0x on our F2007 estimates. We feel that the current stock price does not fully reflect the higher-for-longer iron ore scenario that we believe is going to play out.

Sesa Goa does not have a comparable peer group in India, as it is one of the country's few iron ore mining companies. We present a global comparison table, although there is a considerable difference in the size of Sesa and the group displayed in Exhibit 12.

Exhibit 12

Global Comparables

Company Name	Price 10/4/2006	Market Cap USD Million	P/E 2006E	P/B 2006E	RoE (%) 2006E
BHP Billiton	25.15	111,028	12.6	5.4	58%
Rio Tinto Plc	69.33	70,248	8.5	3.6	53%
Sesa Goa	1,015.75	876	5.4	2.1	47%

Source: Company data, Morgan Stanley Research
E= Morgan Stanley Research Estimates
For Sesa Goa; 2006E refers to March 2007

Risks to Price Target

A big drop in steel production coupled with a spurt in iron ore production in China and faster-than-expected capacity ramp in Australia and Brazil can threaten iron ore prices in the process putting our price target at risk.

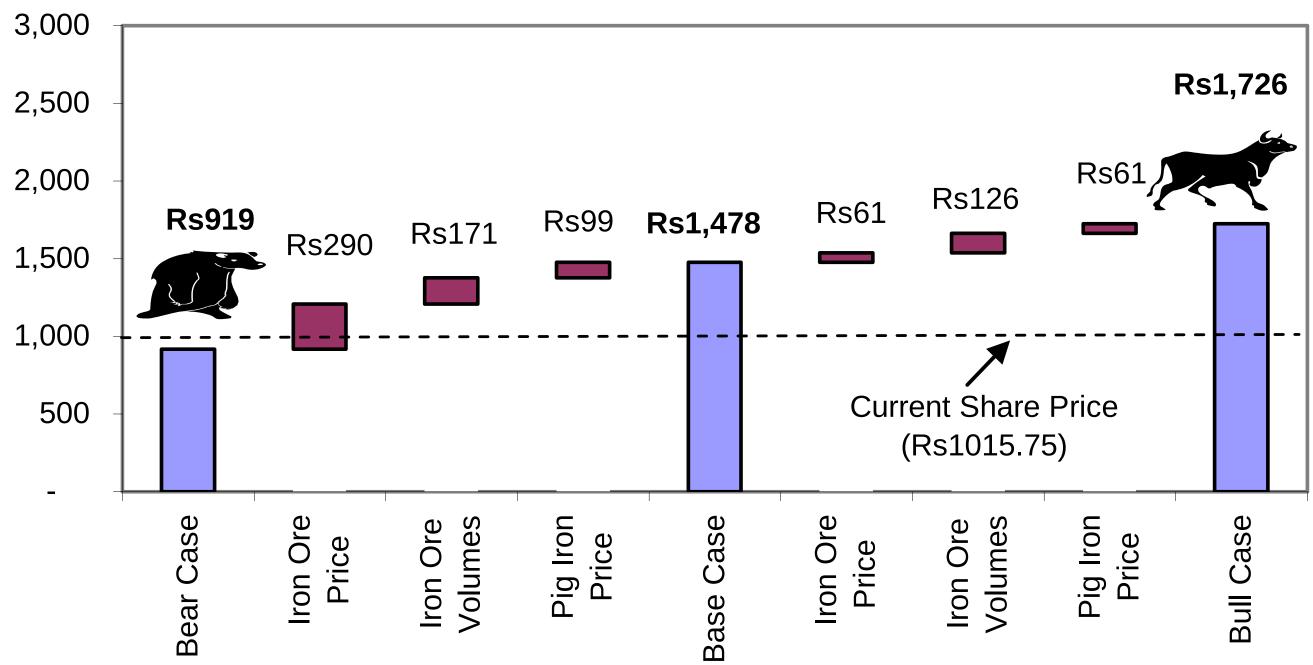
Another risk to our price target over the medium term would be negative news flow regarding the Indian government's stance on iron ore export rules that could spark negative sentiment toward the stock.

Bull-Bear Case Scenario

We base our bull case scenario on our higher iron ore price assumptions (including long-term prices) vs. our base case scenario. Our bull case scenario pegs the long-term iron ore price at US$53.6 per ton compared to our base case assumption of US$51.1 per ton. In addition, there would be status quo with regards to regulatory regime in India and Sesa Goa would be able to commission its Jharkhand mine in F2010 leading to higher long term sales volume. Also, there could be increased demand for Pig Iron domestically, leading to higher realization for Sesa Goa. Based on these, we arrive at our bull case scenario valuation of Rs1,726, indicating an upside potential of 69.9%.

On the other hand, our bear case scenario assumes a lower iron ore price assumption including a long-term iron ore price of US$39.0 per ton. In addition, there could be some negative news on the export front ruling lead to significant drop in Sesa Goa's iron ore sales volume. Additionally, there could be increased supply of Pig Iron globally leading to a significant drop in Pig Iron realization for Sesa. Based on these, we arrive at a bear case valuation of Rs918, indicating a downside potential of 9.6% from current levels.

Exhibit 13
Sesa Goa: Bull- Bear Case Scenario



Source: Morgan Stanley Research Estimates

Scenario Summaries	
Bull Case	(1) Delayed capacity growth globally coupled with increased demand from China leading to higher iron ore prices, with long term iron ore price at US$53.6 per ton vis-à-vis our base case assumption of US$51.1 per ton
Rs1,726	(2) Status quo in regulatory regime and Sesa Goa commissions its Jharkhand mine in F2010, resulting in iron ore sales volume increase to 11.18 mt p.a. compared to our base case of 9.81 mt p.a. post F2010.
	(3) Increased domestic demand for Pig Iron leading to 10% higher realization vis-à-vis our base case
Base Case	(1) Based on two-phase DCF model assuming an explicit phase of 13 years for iron ore, and six years for pig iron & coke business with terminal growth rate of 2% and WACC of 12.0%
Rs1,478	(2) Iron ore lumps prices to increase by 15% in F08 and remain flat in F09. Long term price assumption at US$ 51.1 per ton
Bear Case	(1) Negative ruling on exports front leading to lower iron ore volumes for Sesa with flat growth trends till F09 instead of base case CAGR of about 5.3% for F06-F09E and long term sales volumes of 6.96 mt p.a. vis-à-vis our base case assumption of 9.81 mt p.a. post F2010.
Rs919	(2) Rapid surge in Chinese iron ore production could lead to lower iron ore prices of 8.7% and 13.3% in F08 and F09 respectively versus our base case assumption, with long term iron ore price at US$39 per ton vis-à-vis our base case assumption of US$51.1 per ton
	(3) Increased supply of Pig Iron leading to a 4%-18.6% drop in realization in F07-F09 vis-à-vis our base case with long term price assumption at US$218 per ton vis-à-vis base assumption of US$268 per ton

Exhibit 14

Sesa Goa: Key Assumptions

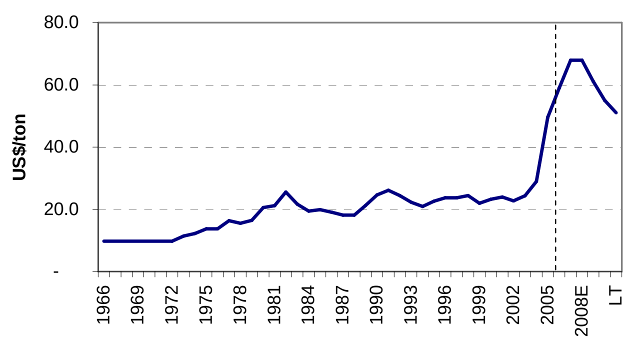
Particulars	Unit	F04	F05	F06A/E	F07E	F08E	F09E
Iron Ore							
Production Volume	'000 Tonnes	4,497	5,046	4,945	5,192	5,608	5,832
Y-o-Y Change	%	23.0	12.2	(2.0)	5.0	8.0	4.0
Purchase Volume	'000 Tonnes	3,909	4,632	4,539	4,766	5,005	5,255
Y-o-Y Change	%	34.1	18.5	(2.0)	5.0	5.0	5.0
Average Realization	Rs. per Ton	642	1,024	1,471	1,702	1,891	1,891
Y-o-Y Change	%	26.9	59.6	43.6	15.7	11.1	-
Pig Iron							
Production Volume	'000 Tonnes	220	248	260	273	287	290
Y-o-Y Change	%	(0.5)	12.7	5.0	5.0	5.0	1.0
Average Realization	Rs. per Ton	11,128	16,635	15,462	15,515	14,894	15,639
Y-o-Y Change	%	47.4	49.5	(7.0)	0.3	(4.0)	5.0
Coke							
Production Volume	'000 Tonnes	271	260	263	276	284	285
Y-o-Y Change	%	2.3	(4.1)	1.0	5.0	3.0	0.5
Average Realization	Rs. per Ton	7,602	14,481	10,024	10,667	11,201	10,641
Y-o-Y Change	%	45.0	90.5	(30.8)	6.4	5.0	(5.0)
Input-Output Ratio							
Iron Ore to Pig Iron	Ratio	1.56	1.53	1.54	1.54	1.54	1.54
Coking Coal to Coke	Ratio	1.24	1.29	1.30	1.30	1.27	1.27
Coking Coal Cost/ton	Rs. per Ton	3,400	4,121	6,882	6,390	5,400	4,500
Y-o-Y Change	%	8.6	21.2	67.0	(7.1)	(15.5)	(16.7)

E=Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Iron Ore in an Elevated Orbit

Iron ore prices have seen three consecutive years of increase by 19%, 71% and 19% YoY, respectively, beginning 2004, primarily buoyed by increased demand for the raw material from China. We believe that underinvestment in capacity expansion in recent past, continued demand from China and curtailed exports from India will ensure that supplies lag demand, keeping iron ore prices strong in the coming 3-4 years. In the medium term we believe that iron ore prices will be raised by 15% in CY07, remain at that level in CY08 before decreasing by 10% in CY09.

Exhibit 15
Iron Ore Prices (US$/ton)



E=Morgan Stanley Research estimates
Source: CRU, Brookhunt, Morgan Stanley Research Estimates

World Iron Ore Deficit Set to Continue
We believe there will be a continued deficit in the iron ore market in the coming 3-4 years, primarily due to three factors:

- Growing demand from China as steel production growth will likely remain strong there.
- Supply growth is falling short as mining projects have started with a lag and are getting hampered due to issues related to shortage of equipment and skilled labor. Project cost escalation will also play an important role in dictating high iron ore prices in coming years, we feel.
- Prospects of leveling off iron ore exports from India (the third largest ore exporter behind Australia and Brazil), which will support the continuation of iron ore as a sellers market in the medium term.

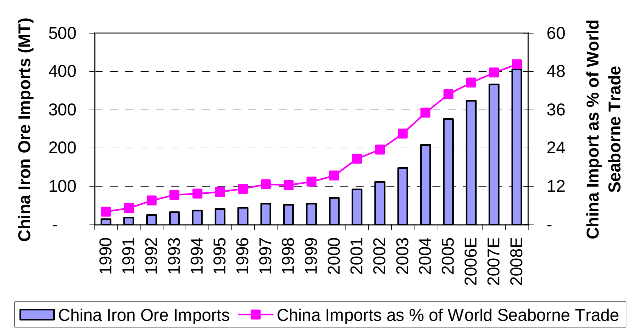
Exhibit 16
Iron Ore Supply / Demand Balance

MT	2005	2006E	2007E	2008E	2009E
Supply					
Brazil	225	256	295	314	334
YoY Change (%)	9.8	13.8	15.2	6.4	6.4
Australia	255	272	296	330	364
YoY Change (%)	20.9	6.7	8.8	11.5	10.3
Others	213	247	250	256	258
YoY Change (%)	17.0	16.0	1.2	2.4	0.8
Total	**692**	**774**	**841**	**900**	**955**
YoY Change (%)	15.7	11.8	8.7	7.0	6.1
Demand					
China	275	338	390	438	490
YoY Change (%)	32.2	22.9	15.4	12.3	11.9
Others	417	445	457	472	472
YoY Change (%)	5.3	6.7	2.7	3.3	-
Total	**693**	**783**	**847**	**910**	**962**
YoY Change (%)	14.7	13.0	8.2	7.4	5.7
Surplus / (Deficit)	**0**	**-9**	**-6**	**-10**	**-6**
Iron Ore Lumps Prices (US$/ton)	49.6	59.0	67.9	67.9	61.1

Source: Tex Reports, IISI, Morgan Stanley Research Estimates

Chinese Ore Demand Continues on its Uphill Journey
Steel production in China has surged by a CAGR of about 26% between 2003 and 2005, exposing the iron ore deficiency in that country. As a result, China's ore imports have magnified at an average rate of 36% in the same period.

Exhibit 17
China Contribution to World Seaborne Iron Ore Trade

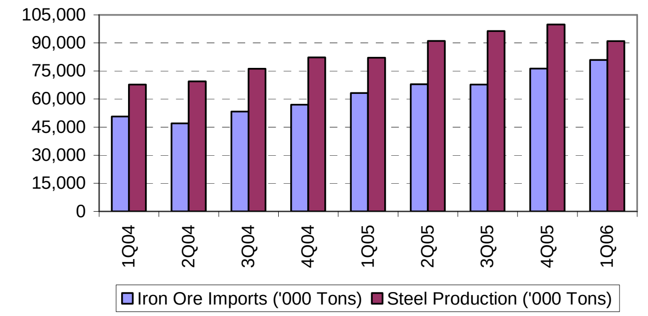


E=Morgan Stanley Research estimates
Source: Tex Reports, Morgan Stanley Research

To give a perspective, Chinese demand growth has contributed to 84.6% of the incremental global demand growth for sea borne iron ore between 2003 and 2005.

Exhibit 18

China: Steel Production vs. Iron Ore Imports



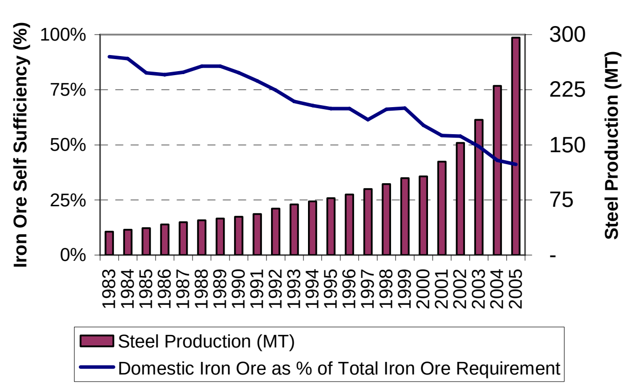
Source: Mysteel, Morgan Stanley Research

In the first eight months of CY06, crude steel production in China has grown 23.7%, driving up iron ore imports at a rate of 24.5% YoY. Even though we feel that steel production growth will retreat to some extent by CY06 year-end, this should still be sufficient to test the iron ore miners' ability to meet demand.

A potential risk to our scenario would be a rapid pick-up in iron ore production in China (in 1H06, it grew by 41.7% YoY).

Exhibit 19

China: Iron Ore Self-sufficiency vs Steel Production

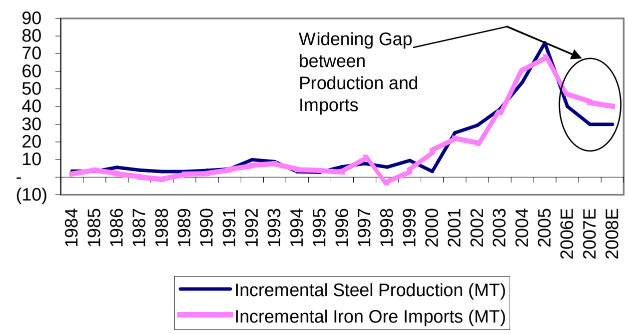


Source: Mysteel, Tex Reports, Morgan Stanley Research

However, given the low quality (and deteriorating) iron ore there, we feel that the need to blend that material with imported ore will continue to keep up the demand for imported ore. In addition, many of the larger players located near the coastal areas of China will likely continue to prefer imported ore due to the latter's high ferrous content and ease of logistics.

Exhibit 20

China: Incremental Steel Production vs. Iron Ore Imports



E=Morgan Stanley Research estimates
Source: Mysteel, Tex Reports, Morgan Stanley Research

As shown in Exhibit 20, incremental iron ore imports by China are not falling to the same levels as incremental steel production in the country, implying increased dependence on imported iron ore. We ascribe this trend to falling grades of ores produced in China.

Unorganized Importers in China May Lose Relevance
As Chinese steel companies gear up for 2007 iron ore negotiations, we expect them to increasingly look for:

- Unified negotiation – Though even for 2006 supplies, the larger companies had put up a unified front at the negotiating table, a plethora of the smaller companies continued to shop in the unorganized, spot market largely from traders supplying Indian ore.

- Reduced volatility in spot prices – We believe that to move in this direction, even the smaller Chinese companies will shift towards the contract market.

The Chinese government is trying to bring down the number of ore importers. There are about 120 importers in China currently – 70 steel makers and 50 traders (vis-a-vis about 500 that existed in early 2005). The authorities are now trying to bring down this number further by raising the threshold limit for qualification as an importer. Many believe that only those steel makers with capacities of more than 2 mtpa (the current threshold is 1 mtpa) will be able to import iron ore. Similarly, only traders who import at least 0.7 mt (the current threhold is 0.3 mt) may be allowed to import.

This, in turn, will mean that Indian traders who have enjoyed a ready market in the last 2-3 years will see lesser takers in the unorganized sector.

We believe this will curb iron ore price fluctuations, reduce the size of the spot market, curtail the market for the short-term Indian traders and reaffirm the status of the Chinese as the prime negotiators for iron ore.

Global Capacity Enhancement – Delayed Initiative to Take Its Toll
The three major players in the iron ore selling business are gearing up to ramp up their production volumes to benefit from the high iron ore price scenario. The three companies have announced a slew of projects, both brown field and green field, to cater to the growing demand for iron ore globally. In the coming four years (CY06-09), these companies plan to add about 154.mt capacity in total.

Exhibit 21
Capacity Additions by Top Miners (MT)

	2004	2005	2006E	2007E	2008E	2009E	2010E
BHP	12.0	14.4	14.1	11.2	8.8	11.6	7.1
Rio	8.7	13.6	26.4	5.5	3.0	13.4	6.0
CVRD	17.5	15.5	41.5	19.0	-5.0	5.0	0.0

E=Morgan Stanley Research estimates
Source: Tex Reports, Morgan Stanley Research Estimates

However, we suspect that since these projects are coming after a long phase of underinvestment in the nineties and the first half of the current decade, it may take a while before supply can outpace demand. Moreover, these capacity enhancement plans will likely face hiccups due to equipment and skilled labor shortages, ensuring that the iron ore market will remain a sellers market for some time.

Project Cost Overruns – Becoming More of a Reality Now
Another aspect that we would watch keenly is the specter of cost overruns in many mining projects. For a project that would have been finalized a year ago and work on which is starting now (and for which the equipment is being ordered now), the cost would have jumped sharply given the surge in metals prices (which constitute a strong proportion of project and mining equipment) and oil prices in the period.

Exhibit 22
Cost Inflation in Metals

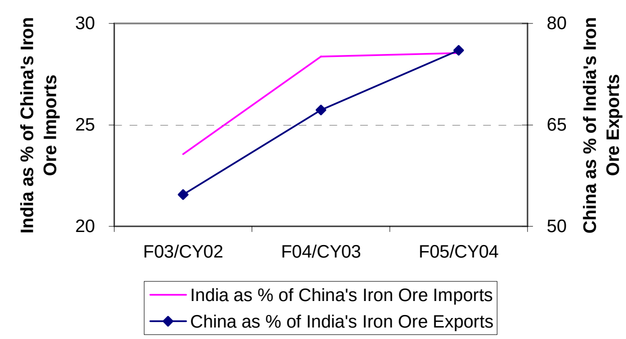
US$/ton	Price in Sep 05	Price in Sep 06	% Change
Copper	3,916	7,568	93.3
Aluminium	1,836	2,553	39.0
Zinc	1,414	3,325	135.2
Nickel	13,525	31,300	131.4
Steel (Far East)	465	470	1.1

Source: Bloomberg, LME, Morgan Stanley Research

Taking into account the higher-than-projected labor cost, the question of returns on many of the marginal projects could become an issue unless the expected iron ore prices are nudged up.

India Remains an Important Cog in the Iron Ore Wheel
In the last three years, iron ore exports from India have played a meaningful role in meeting the demand surge from China.

Exhibit 23
China – India: Iron Ore Inter linkage



Source: MMTC, WSD, Morgan Stanley Research

While a large part of the jump in exports from India has come from the unorganized sector controlled by traders, it has also been marked by the following:

- Exports have largely consisted of fines (almost 90%)
- Stock piles of unutilized, low grade iron ore (often with Fe content as low as 50%) have served as major sources of exports

Indian Ore Exports to Diminish with Changing Dynamics
Amid a spate of plans being announced regarding the setting up of new steel plants in the country, a wide ranging discussion is on to formulate a mining policy that will determine the future course towards trends in the Indian iron ore and steel industries.

In the backdrop of hectic lobbying by both the sides, this has fuelled the belief amongst many that the government can put in place some artificial mechanisms to curb iron ore exports from India.

However, we are of the view that iron ore exports will wane on their own under the weight of surging domestic demand, increasing ability of the Indian steel industry to utilize fines ore, and a feverish pace of mining capacity growth.

On the margins, reduced Indian exports can keep the global ore dynamics tight for a protracted period, we feel.

Robust Domestic Steel Production

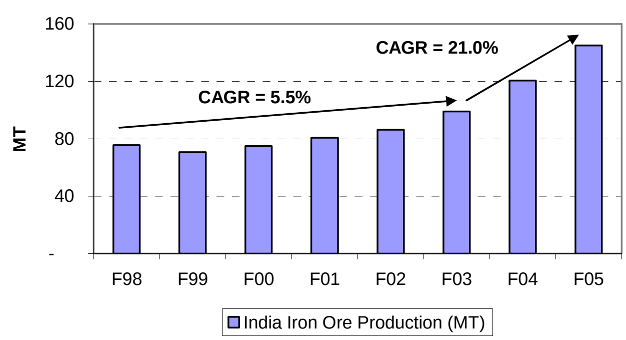
The Indian steel industry is currently in an expansion mode, to match the robust steel demand growth that the country is witnessing currently. Apart from the green field projects (which are in most cases coming up with assurances regarding new iron ore sources), many brown field projects are under various stages of commissioning and this would obviously imply that domestic iron ore consumption will pick up smartly. We project that steel production in India will increase at a CAGR of over 10.1% over the coming three years from about 39.3 MT in FY06 to about 52.4 MT in FY09.

Iron Ore Production Unlikely to Maintain Its Steep Trend

The last three years have witnessed a sudden spurt in iron ore production (Exhibit 24). We believe that in the absence of any significant mining project being kicked off in the coming two years, iron ore production growth in the country will fail to keep pace with demand growth.

Exhibit 24

India: Iron Ore Production (MT)



Source: IBM, MMTC, Morgan Stanley Research

Attempts on to Utilize a Larger Proportion of Fines

Having an abundant availability of lumpy ore Indian steel makers currently does not utilize the fines produced in the country due to the lack of sintering and pelletisation facilities.

Exhibit 25

Key Sintering Plants in India

Sintering Plants	Capacity ('000 Tons)	Production ('000 Tons) 2000-01	2001-02	2002-03	2003-04
Bokaro Steel Plant	6,200	5,090	4,864	5,202	5,227
Bhilai Steel Plant	6,550	4,639	5,050	5,210	5,802
Durgapur Steel_Plant	3,009	2,324	2,486	2,556	2,640
Rourkela Steel Plant	3,067	2,192	2,317	2,396	2,624
Visakhapatnam Steel Plant	5,256	4,463	4,856	NA	5,840
TISCO Steel Plant	2,500	NA	-	NA	NA
Kalinga Steel Plant	800	0.5	-	NA	NA

Source: Indian Bureau of Mines, Morgan Stanley Research

Exhibit 26

Key Pellet Plants in India

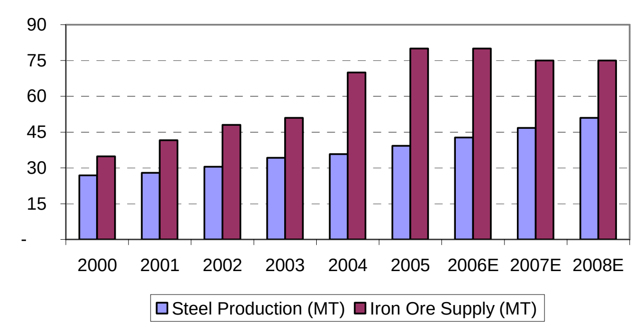
Pellet Plants	Capacity ('000 Tons)	Production ('000 Tons) 2000-01	2001-02	2002-03	2003-04
Kudremukh Iron Ore Co. Ltd.	4,000	2,737	3,215	3,450	3,671
Mandovi Pellets Ltd.	1,800	591	546	151	Nil
Jindal Vijaynagar Steel Ltd.	4,200	379	1,729	2,863	3,254
Tisco	800	NA	NA	NA	NA
Chowgule & Co Ltd	550	-	-	-	-
Essar Steel Ltd.	1,760	1,662	-	-	-

Source: Indian Bureau of Mines, Morgan Stanley Research

As they strive to raise capacities and as the iron ore mines allotment process remains cumbersome, many more steel producers will opt to set up sinter and pellet plants in India.

Exhibit 27

India: Steel Production vs. Iron Ore Supply (Seaborne Exports) (MT)



E=Morgan Stanley Research estimates
Source: Steel Ministry, Mines Ministry, IISI, Morgan Stanley Research

Role of Trading Companies to Recede in Exports from India

Over the last couple of years, traders have made some easy money exporting the low grade iron ore that had been stacked up as inventory at the mines. This inventory is coming down and we therefore do not expect much supply to come from this front beyond CY06.

Besides, as mentioned earlier, with the declining influence of small importers in China, Indian traders who have enjoyed a ready market in the last 2-3 years will see a lesser number of takers in that country.

Capacity Enhancement Plans in India – Longer Term in Nature

India is estimated to have reserves to the tune of 17 billion tons of iron ore (sixth largest reserves base globally) and is among the leading producers as well as exporters of iron ore in the world. A number of new mines are expected to be developed in the country.

However, most of these plans have a timeline of more than four years. In addition, a large proportion of the mines to be developed is for captive consumption for steel companies, and hence would not mean much for the sea borne supplies.

Exhibit 28

India: Development of New Mines

Company	Mine	Remarks
SAIL	Rowghat	Full Benificiation Facilities
SAIL	Chiria	Full Benificiation Facilities
SAIL	Barsua	WHIMS plant to produce WHIMS concentrate
SAIL	Dalli	Benificiated lumps and fines for Bhilai Steel Plant
NMDC	Bailadila	Blue Dust for supply to Essar
NMDC	Bailadila	Deposit No.13 and 4
NMDC	Ramandurg	Process of acquiring mine is currently going on
NMDC	Subbrayanahalli	Process of acquiring mine is currently going on
NMDC	Kumaraswamy	Repalcement for Donimalai mine
NMDC	Bailadila	Deposit 10/11, approved by Government at cost of Rs4.3 bn
Tisco		Orissa 6 MT integrated steel plant
Posco		6 MT integrated steel plant

Source: Mines Ministry, Morgan Stanley Research

Regulatory Landscape

An intense debate is under way in India on the allocation of new iron ore mines, even as the government is trying to formulate a new mining policy with an eye on encouraging investments in the steel and mining sectors. The issue being discussed, broadly, is whether iron ore mining should be left to miners or if it should be taken up as an upstream part of steel making (i.e. captive mines by the steel makers). Indeed, the two groups – steel makers and independent iron ore miners – are submitting diverging views to the government. Effectively the debate has boiled down to whether India should allow iron ore exports to be unhindered.

Against this backdrop, companies like Sesa Goa have felt pressure with concerns regarding the future of independent miners in India.

The government has displayed seriousness on its part by setting up two committees, the Dang Committee and the Hoda Committee, to study the matter.

(a) R.K. Dang Committee – The first committee known as the "R.K. Dang Committee" submitted its recommendation to the government in September 2005. It recommended that conserving natural resources and setting up steel capacities to satisfy the growing steel demand should be of primary importance for the country. Accordingly, captive mines should be allotted to steel companies in order to reduce their dependence on the imports of iron ore and to lower their cost exposure. After fulfilling the requirements of the steel makers, some reputed independent miners should also be given mining leases with a condition that they will sell a major proportion of their output in the domestic market only.

In our view, these recommendations were tilted towards the steel makers' views. The government set up another committee, the "A.Hoda Committee" to study the matter further.

(b) A. Hoda Committee – This committee recently submitted its recommendation to the government. It was feared its recommendation would be in favour of the mining companies. Although the outcome was much softer than expected, the recommendations were this time tilted towards the independent miners' views. The committee concluded that that it would be in the best interest of the country to provide space in the mining sector for both stand-alone mines as well as captive mines. It recommended that the resource position should be reviewed after 10 years and captive mines should be renewed if the companies have complied with the conditions of the lease and the life of the steel plant.

None of the two committees were binding in nature for the government and parleys are on to work out a long-term policy in the best common interest of the stakeholders.

As we mentioned earlier in the note, we believe that the status quo will continue in terms of regulatory controls. Exports from India are likely to come down on their own due to surging domestic demand, constrained supply growth and growing irrelevance of traders in the system. Also, with limited ability to utilize iron ore fines, the country will find it difficult to close the tap on exports, we feel. The government will also have to keep its WTO obligation in mind in case it wants to place a ban on exports, we feel.

However, we also feel that some restraining factors could be introduced – e.g., a reduction in the threshold limit of ferrous content for direct exports (currently, iron ore with ferrous content exceeding 63.5% can be exported only through the state-owned trading agency, MMTC, which acts as a deterrent to some extent as the latter understandably keeps its share of the margins). To discourage the export of high quality iron ore, the government may decide to bring down this threshold by a couple of percentage points. Also, a cap may be set on the export of a particular type of ore from a particular state. However, we feel that these measures will more likely be to discourage non-serious players from export activity.

Morgan Stanley
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ModelWare EPS illustrates the approach. It represents ModelWare EPS as ModelWare net income divided by average fully diluted shares outstanding. ModelWare net income sums net operating profit after tax (NOPAT), net financial income or expense (NFE) and other income or expense. ModelWare adjusts reported net income to improve comparability across companies, sectors and regions. Among these adjustments: We exclude goodwill amortization and items deemed by analysts to be "one-time" events; we capitalize operating leases where their use is significant (e.g., in transportation and retail); and we convert inventory to FIFO accounting when LIFO costing is used. For more information on these adjustments and others, as well as additional background, please see *Morgan Stanley ModelWare (ver. 1.0): A Road Map for Investors*, by Trevor Harris and team, August 2, 2004.

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(as of September 30, 2006)

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Equal-weight/Hold	**915**	**45%**	**305**	**44%**	**33%**
Underweight/Sell	**336**	**17%**	**79**	**11%**	**24%**
Total	**2,034**		**689**		

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More volatile (V) - We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in this report is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

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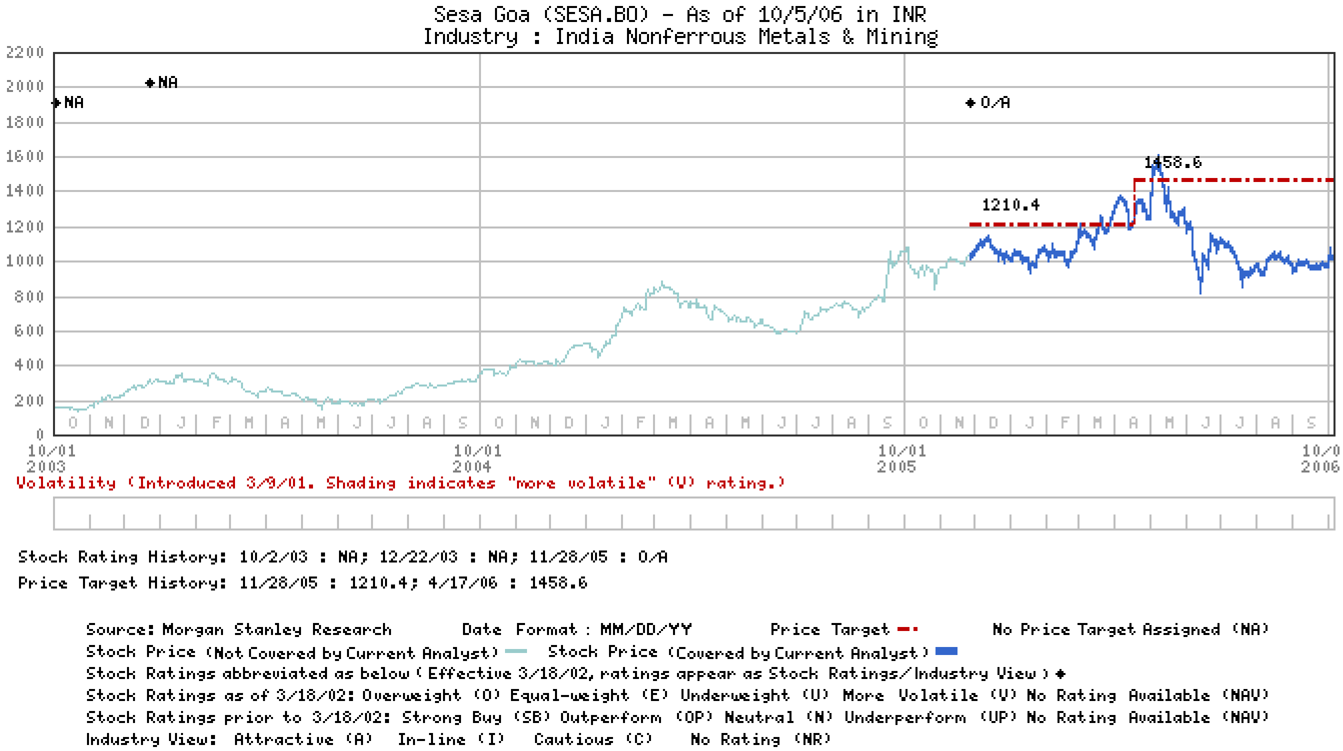
Stock Price, Price Target and Rating History (See Rating Definitions)



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Industry Coverage:India Nonferrous Metals & Mining

Company (Ticker)	Rating (as of)	Price (10/05/2006)
Vipul Prasad		
Hindalco Industries (HALC.BO)	O (03/02/2006)	Rs172.55
National Aluminium (NALU.BO)	E (08/24/2005)	Rs214.00
Sesa Goa (SESA.BO)	O (11/28/2005)	Rs1024.45

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