

BUY

March 29, 2011

Sesa Goa

Sector Outlook: Neutral

Mining

Target price: Rs310

CMP: Rs275*

Upside: 12.7%

* Price as on March 28, 2011

504614	Sensex: 18943
SESAGOA	Nifty: 5687
SESA.BO	52 W-H/L: 495/255
SESA.IN	Face Value-Rs1

Market cap (Rs mn)	236,500
Daily vol. (3M NSE avg.)	774,771
Current share O/S (mn)	860
Diluted shares (mn)	890
Promoters holding (%)	55.7

Niraj Shah

Niraj.shah@fortune.co.in
+91 22 4300 3820

Key financial (Y/E March)

(Rs bn)	FY11E	FY12E	FY13E
Net sales	86.5	102.3	124.2
Growth (%)	47.7	18.3	21.5
EBITDA	48.9	50.7	53.9
EBITDA (%)	56.5	49.6	43.4
PAT	38.2	37.3	40.4
Diluted EPS (Rs)	42.9	41.9	45.4

Source: Company, Fortune Research Estimates

Valuation / Ratios

(x)	FY11E	FY12E	FY13E
P/E	6.4	6.6	6.1
P/B	1.7	1.4	1.1
EV/EBITDA	3.6	5.4	4.4
EV/Sales	2.0	2.7	1.9
RoE (%)	27.0	20.9	18.4
RoCE (%)	22.3	15.7	14.0

Source: Company, Fortune Research Estimates

Attractive valuations despite volume growth uncertainty

We had a discussion with Sesa Goa management on their future outlook and business. Though uncertainty persists on volume growth due to iron ore export ban in Karnataka, we believe that their valuations have become attractive following recent decline in the stock price. We, therefore, upgrade the stock to a **BUY** with a target price of Rs310 from the previous Rs277 on SOTP valuation.

Management confident about volume growth despite uncertainty: The company management is confident of achieving a volume target of about 25 mt in FY12E, but uncertainty prevails. The volume target would be met by 7-8 mt from Karnataka mines and 16-17 mt from Goa mines. The confidence stems from the fact that the Karnataka government has to come out with a law on iron ore exports by March 31, 2011 as per a directive of the Supreme Court. An apex court hearing on the matter is due on April 4. The volume growth will depend on the hearing's outcome. It is unable to ramp up volumes from Goa due to the Ministry of Environment and Forest (MoEF) embargo on issuing any fresh clearance till the introduction of a new mining policy. Besides, other serious logistical problems in Goa are hampering further growth in volumes.

Revising estimates downwards for FY12E: We are revising our earnings estimates downwards by 10.3% for FY12E to Rs41.9 due to downward revision in volumes and prices and a higher interest outgo assuming that Cairn-Vedanta deal goes through for which the company would have to borrow about Rs21 bn.

Upgrade to BUY on SOTP valuation: We are upgrading the stock to **BUY** from **SELL** as valuations have become attractive due to recent decline in the stock price. Besides, current stock price does not include valuation of the probable 20% holding in Cairn India in the event of its acquisition by Vedanta coming through post regulatory approvals. This holding itself would be valued at about Rs53 bn at the Cairn's CMP of Rs350 after factoring in 60% holding company discount. In the event of this deal not happening, the US\$2 bn in cash that would have been utilized for the acquisition would remain in the books bringing down its Enterprise value (EV). At the CMP the stock trades at 6.4x and 6.6x FY11E and FY12E revised earnings estimates of Rs41.9 and Rs45.4 respectively, and on EV/E it trades at 3.6x and 5.4x FY11E and FY12E EBITDA. We are upgrading the stock to a **BUY** at a target price of Rs310 from the previous Rs277 valuing it on SOTP.

Revising estimates downwards for FY12E

We are revising our earnings estimates downwards by 10.3% for FY12E to Rs.41.9 due to downward revision in volumes and price and higher interest outgo, assuming that the Cairn deal comes through for which the company would have to borrow about Rs21 bn.

Exhibit 1: Estimates revision

	Revised estimates	Earlier estimates	% change
	FY12E	FY12E	FY12E
Net sales (Rsmn)	102,329	118,459	(13.6)
EBIDTA (Rs mn)	50,752	54,319	(6.6)
PAT (Rs mn)	37,331	41,573	(10.3)
EPS (Rs)	41.9	46.7	(10.3)

Source: Fortune Research

Exhibit 2: Key assumptions

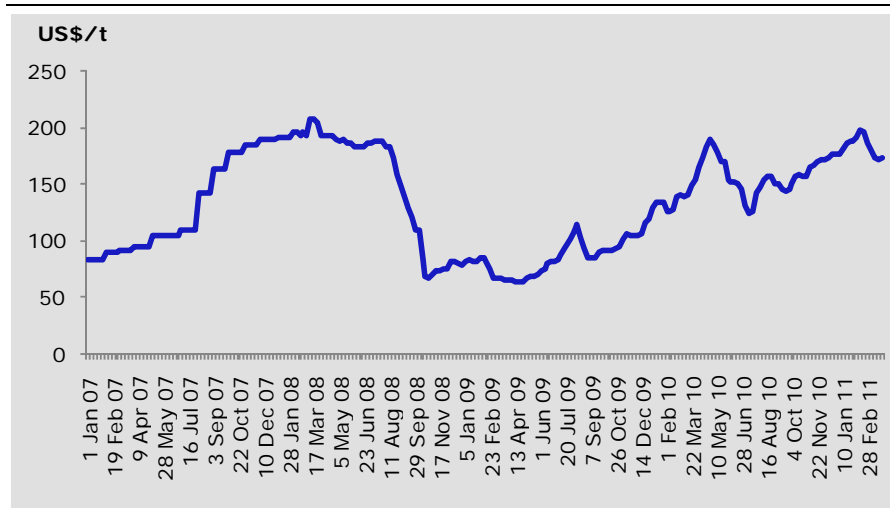
	FY12E	FY13E
Volume (Million tonnes)		
Iron ore	23.0	28.7
Pig iron	0.35	0.56
Met coke	0.35	0.50
Average realization (Rs/T)		
Iron ore	3,800	3,600
Pig iron	21,000	20,000
Met coke	20,000	19,000

Source: Fortune research estimates

Iron ore prices to remain firm over 12-15 months

We believe that iron ore prices would remain firm over the next 12 to 15 months with intermittent seasonal dips. We believe prices for 63% Fe iron ore to remain in the range of US\$120-140/t FOB. We believe that with the closure of some mines in Orissa due to the government action on illegal mining, iron ore production in India would decline by about 20-25 mt in FY12E. Stricter enforcement of environmental and forest regulations is hampering mining activity with the government neither sanctioning new mines nor renewing licenses for existing ones till the passage of the new mining bill. And that may not happen anytime soon.

Besides, there are delays in opening of new mines in Australia by BHP Billiton and Fortescue, which are expected to increase production by about 50 mt in CY2011. On the other hand, China is expected to increase steel production, though at a slower pace of about 4-5%, which would only serve to increase demand for iron ore by about 65 mt for CY2011.

Exhibit 3: Iron ore price for 63% Fe on CFR China port basis

Source: SBB, Fortune Research

Exhibit 4: Sensitivity analysis of Sesa Goa's earnings to iron ore price and export duty movements after normalizing iron ore prices to the company's average Fe grade of 58%.

		FY12E				FY13E			
		Iron ore prices for 63% Fe on FOB basis (US\$/t)				Iron ore prices for 63% Fe on FOB basis(US\$/t)			
Export duty (%)		165	145	125	100	165	145	125	100
	20	52.3	40.3	30	15	63.1	48.4	35.6	16.9
	15	57	43.5	31.6	16.5	69	52.3	37.5	18.8
	10	61	48.3	35.6	19.7	74	58.2	42.5	22.8
	5	65.7	53.8	38.8	22.1	79.9	65.1	46.4	25.7

Source: Fortune Research

Exhibit 5: Valuation

	FY12E		Value			
	EBIDTA	Multiple(x)	EV	Net debt	(Rs mn)	(Rs/share)
Sesa Goa's FY12E EBIDTA	50,752	5	253,759	31,167	222,592	250
Add:						
Value of Cairn India holding at Rs 350/share (60% holding co. discount)					133,000	60
Avg. Market capitalization					355,592	310
Value per share (Rs.)						310

Source: Fortune Research

Exhibit 6: Peer Comparison

	2011					2012				
	P/E	EV/E	P/B	ROE(%)	ROCE(%)	P/E	EV/E	P/B	ROE(%)	ROCE(%)
Sesa Goa*#	6.4	3.6	1.7	27	22.3	6.6	5.4	1.4	20.9	15.7
NMDC#	17.4	11.1	NA	33	NA	13.3	8.5	NA	33	NA
Fortescue Metal Group\$	11.7	7.8	7	74.7	33.2	8.4	5.5	3.9	55.7	30.9
BHP Billiton\$	10.5	7.9	2.1	22.4	18.5	9.7	7.3	1.7	19.9	16.5
Kumba&	8	4.4	7.5	NA	NA	7.5	4	6	NA	NA
Rio Tinto&	8.4	4.6	2.1	29.1	21.7	8.5	4.6	1.8	23.6	19.4
Vale&	6.3	4.8	1.8	31.9	22.6	6.1	4.7	1.5	27.6	20

Source: Bloomberg, *Fortune Research estimates, # Y/E March, \$ Y/E June, & Y/E December

Consolidated financial tables (Y/E March)

(Rs mn)

Income statement	FY09	FY10	FY11E	FY12E	FY13E
Net sales	49,591	58,584	86,518	102,329	124,281
% growth	29.7	18.1	47.7	18.3	21.5
Raw materials	6,769	7,780	7,950	7,950	7,950
% of net sales	13.7	13.3	9.2	7.8	6.4
Employee cost	999	1,691	2,340	2,340	2,340
% of net sales	5.0	8.4	11.7	11.7	11.7
Other expenses	16,435	17,664	27,337	41,287	60,076
% of net sales	33.1	30.2	31.6	40.3	48.3
EBITDA	25,388	31,449	48,890	50,752	53,914
EBITDA margin (%)	51.2	53.7	56.5	49.6	43.4
Depreciation	517	745	888	921	1,014
EBIT	24,871	30,704	48,002	49,831	52,900
Interest exps.	9	517	520	2,500	2,500
EBT	24,862	30,187	47,482	47,331	50,400
Other income	2,240	4,260	3,500	400	600
Extraord. inc./ (Exps).	0	0	0	0	0
PBT	27,102	34,447	50,982	47,731	51,000
Tax-Total	7,153	8,056	12,746	14,319	15,300
Tax rate (%)	26.4	23.4	25.0	30.0	30.0
Profit after tax	19,949	26,392	38,237	33,411	35,700
Minority interest	68	99	80	3,920	4,720
Profit after minority interest	19,881	26,293	38,157	37,331	40,420
PAT margin (%)	40.1	44.9	44.1	36.5	32.5

Source: Company, Fortune Research Estimates

Balance sheet	FY09	FY10	FY11E	FY12E	FY13E
Sources of funds					
Equity capital	787	831	890	890	890
Reserves and surplus	46,370	78,346	140,439	177,770	218,190
Shareholders' funds	47,157	79,177	141,329	178,661	219,080
Minority interest	334	433	334	334	334
Total loan funds	19	19,606	10,206	31,706	31,706
Deferred tax liab	664	750	449	660	660
Total liabilities	48,175	99,966	152,318	211,360	251,780
Appl. of funds					
Gross block	8,863	27,510	29,610	30,710	33,810
Accumulated deprec.	3,422	5,741	6,629	7,550	8,565
Capital WIP	489	787	10,000	10,000	10,000
Net fixed assets	5,930	22,557	32,981	33,160	35,246
Investments	31,252	45,649	15,649	150,336	150,336
Inventories	2,642	5,009	7,111	8,411	10,215
Sundry debtors	2,982	3,381	4,978	7,850	9,534
Cash & bank balances	177	23,918	78,018	538	37,732
Loans and advances	11,032	11,851	20,000	20,000	21,785
Total current asset	16,833	44,160	110,107	36,799	79,266
Current liabilities	3,376	8,286	6,185	8,478	11,567
Provisions	2,464	4,114	235	456	1,501
Total current liab.	5,840	12,400	6,420	8,934	13,068
Net current assets	10,992	31,760	103,687	27,864	66,198
Total assets	48,175	99,966	152,317	211,360	251,780

Source: Company, Fortune Research Estimates

Ratios	FY09	FY10	FY11E	FY12E	FY13E
O/s Shares (mn)	787	831	890	890	890
Per share (Rs)					
Diluted EPS	25.3	31.6	42.9	41.9	45.4
Cash EPS	26.0	32.7	44.0	38.6	41.2
Book value	59.9	95.3	158.8	200.7	246.1
DPS	2.3	3.3	3.3	3.3	3.3
Valuation (x)					
P/E	10.9	8.7	6.4	6.6	6.1
Price/book value	4.6	2.9	1.7	1.4	1.1
EV/sales	4.4	3.8	2.0	2.7	1.9
EV/EBITDA	8.5	7.1	3.6	5.4	4.4
Profit ratios (%)					
RoE	42.2	33.2	27.0	20.9	18.4
RoCE	36.8	23.1	22.3	15.7	14.0

Source: Company, Fortune Research Estimates

Ratios	FY09	FY10	FY11E	FY12E	FY13E
Cash Flow from operations	18,199	23,922	39,045	38,253	41,434
Cash Flow from working capital	3,145	1,791	13,947	1,879	2,185
Net Cash from Operating Activities	21,343	25,713	52,992	40,131	43,619
Net purchase of fixed assets	(1,471)	(1,490)	(2,100)	(1,100)	(3,100)
Net purchase of investments	(8,517)	(52,452)	30,000	(134,687)	0
Net Cash Used in Investing Activities	(9,988)	(53,941)	27,900	(135,787)	(3,100)
Proceeds from equity capital	0	5,372	24,005	0	0
Proceeds from borrowings	(11,390)	21,449	(27,214)	18,175	(3,325)
Net Cash Used in Financing Activities	(11,390)	26,821	(3,209)	18,175	(3,325)
Net Increase/(Decrease) in Cash	(35)	(1,407)	77,683	(77,480)	37,194
Cash at Beginning of the year	210	176	335	78,018	538
Others	0	25,148	0	0	0
Cash at End of the year	176	23,917	78,018	538	37,732

Source: Company, Fortune Research Estimates

Investment ratings (Returns)

Buy (>10%)	Hold (-10 to 10%)	Sell (<-10%)
------------	-------------------	--------------

Disclaimer

This document has been prepared by **Fortune Group**, which includes Fortune Financial Services (India) Ltd, Fortune Equity Brokers (India) Ltd, Fortune Commodities & Derivatives (India) Ltd, Fortune Financial India Insurance Brokers Ltd. & Fortune Credit Capital Ltd. This document is not for public distribution and has been furnished to you solely for your information and any review, re-transmission, circulation or any other use is strictly prohibited. Persons into whose possession this document may come are required to observe these restrictions. This document is subject to changes without prior notice and is intended only for the person or entity to which it is addressed to and may contain confidential information and/or privileged material. We are not soliciting any action based upon this material. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Fortune Group. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. Fortune Group will not treat recipients as customers by virtue of their receiving this report. We have reviewed the report, and in so far as it includes current or historical information, it is believed to be reliable. It should be noted that the information contained herein is from publicly available data or other sources believed to be reliable. Neither Fortune Group, nor any person connected with it, accepts any liability arising from the use of this document. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. Fortune Group and its affiliates, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as advisor or lender / borrower to such company(ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

Address: Lawrence & Mayo, 3rd Floor, D. N. Road, Near Khadi Bhandar, Opp. Citibank, Fort, Mumbai.