

April 20, 2010

Sesa Goa (SESGOA)

Rs 457

Rating matrix

Rating	:	Buy
Target	:	Rs 524
Target Period	:	12-15 months
Potential Upside	:	14%

Annual performance

(Rs Crore)	FY09	FY10E	FY11E	FY12E
Net Sales	4959.1	5858.3	10362.7	11127.5
EBITDA	2538.8	3144.8	6165.5	6329.0
EBITDA margin (%)	51.2	53.7	59.5	56.9
Net Profit	1994.9	2639.0	4966.8	5150.3
EPS (Rs)	25.3	31.6	55.8	57.9

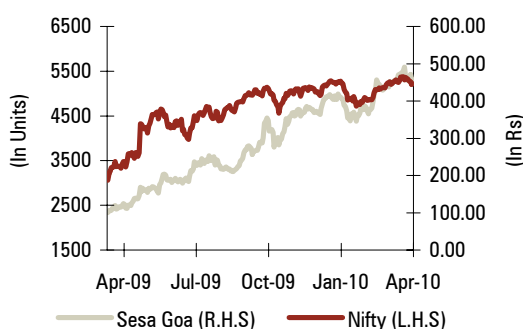
Valuation summary

	FY09	FY10E	FY11E	FY12E
PE (x)	18.1	14.4	8.2	7.9
Target PE (x)	20.7	16.6	9.4	9.0
EV/EBITDA (x)	12.5	10.4	4.8	4.1
P/BV (x)	7.6	4.7	2.7	2.1
RoNW (%)	42.2	32.6	33.3	26.1
RoCE (%)	51.9	30.1	40.5	31.4

Stock data

Market Capitalisation	Rs 40628.2 Crore
Debt (FY10)	Rs 2039.2 Crore
Cash (FY10)	Rs 6952 Crore
EV	Rs 35715.4 Crore
52 week H/L	107/495
Equity capital	Rs 83.1 Crore
Face value	Rs 1
MF Holding (%)	3.4
FII Holding (%)	26.6

Price movement (Stock vs. Nifty)



Analyst's name

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WHAT'S CHANGED...

PRICE TARGET	Changed from Rs 437 to Rs 524
EPS (FY11E)	Changed from Rs 53.2 to Rs 55.8
EPS (FY12E)	Changed from Rs 62.3 to Rs 57.9
RATING.....	Changed from Add to Buy

Turning into a cash machine...

Sesa Goa reported better-than-expected numbers for Q4FY10 with net sales at Rs 2418.9 crore, registering an increase of 67.6% YoY, due to robust sales volume of ~7.4 million tonne (MT), up 48% YoY. The sales volume increased ~36% YoY to 20.5 MT in FY10 with contribution from Dempo to the tune of 3.6 MT. Blended realisations improved ~22% QoQ to ~US\$67/tonne in Q4FY10 due to continuous increase in iron ore spot prices in China. We are revising our blended realisations assumptions for FY11E and FY12E upwards to US\$91/tonne and US\$83.8/tonne, respectively, to factor in increased spot prices. We expect strong cash flow generation, going ahead, with smart volume growth and cash costs remaining below US\$30/tonne.

Strong surge in spot prices, contracts expected at new highs

Iron ore spot prices have surged smartly in the international market and Sesa's profitability is expected to zoom in FY11E on the back of volume push and low cost model (total production cost of US\$27-30/tonne). Benchmark contracts are expected at well above 2008 peaks and are still under negotiation with indications that Japanese buyers have settled contracts at ~90% YoY premium for Q1FY11.

Volume push to be maintained

The company has reiterated its YoY volume growth guidance of 20-25% and also indicated that it has not been affected by the ban on imports of below 60% Fe grade iron ore by Chinese traders.

Valuation

We expect the company to achieve volume growth of 18% and 21% in FY11E and FY12E, respectively, and an EPS CAGR of 35.2% over FY10-12E. We believe that low clarity on benchmark contract pricing and higher volatility in spot prices would increase the risk of earnings volatility for the company. To account for the same, we are assigning a multiple of 5x FY12E EV/EBITDA (~20% discount to global average of 6.2), down from our earlier multiple of 6x. We are revising our target price to Rs 524 and rate the stock as **BUY**.

Exhibit 1: Performance Highlights

(Rs Crore)	Q4FY10	Q4FY10E	Q4FY09	Q3FY10	QoQ (Chg %)	YoY (Chg %)
Net Sales	2418.9	2366.2	1443.5	1889.2	28.0	67.6
EBITDA	1503.0	1241.3	753.5	1036.0	45.1	99.5
EBITDA Margin (%)	62.1	52.5	52.2	54.8	+730 bps	+990 bps
Depreciation	16.6	25.0	15.0	22.5	-25.9	10.7
Interest	22.7	25.5	0.7	25.1	-9.6	2960.8
Reported PAT	1212.9	970.8	547.6	827.5	46.6	121.5
EPS (Rs)	14.6	11.7	7.0	10.1	44.7	109.8

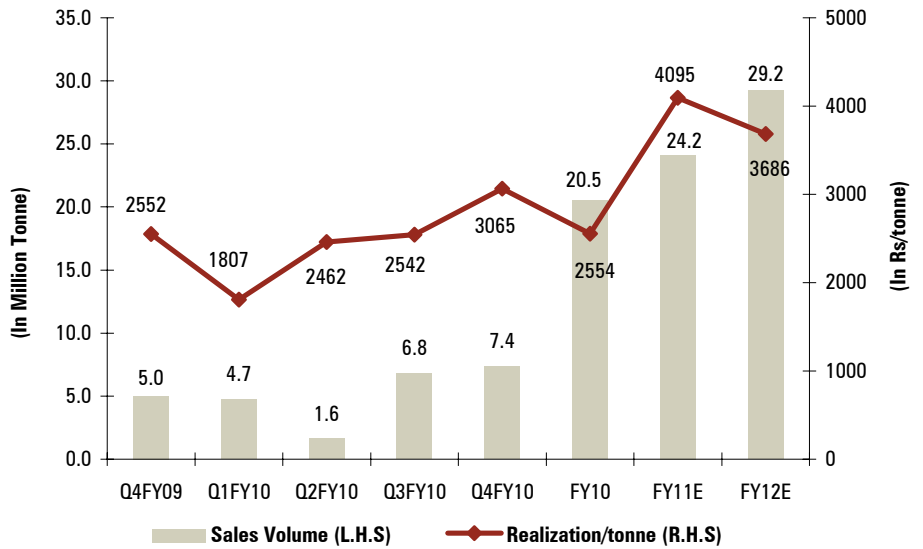
Source: Company, ICICIdirect.com Research

Result Analysis

The company reported excellent numbers for Q4FY10 due to higher sales volume and robust realisations. Sesa Goa reported its highest ever sales volume of ~7.4 MT during Q4FY10 and reaped the benefits of high spot prices of iron ore in the international market and reduced transportation and other expenses due to higher volumes from Goa. The blended realisation for the quarter surged ~22% QoQ to ~US\$67/tonne.

Exhibit 2: Sales volume & realisation

The company has reported a total sales volume of ~7.4 MT, up 48% YoY with contribution from Dempo to the tune of 1.8 MT. Realisations went up 20.1% YoY and ~20% QoQ to be at Rs 3065/tonne

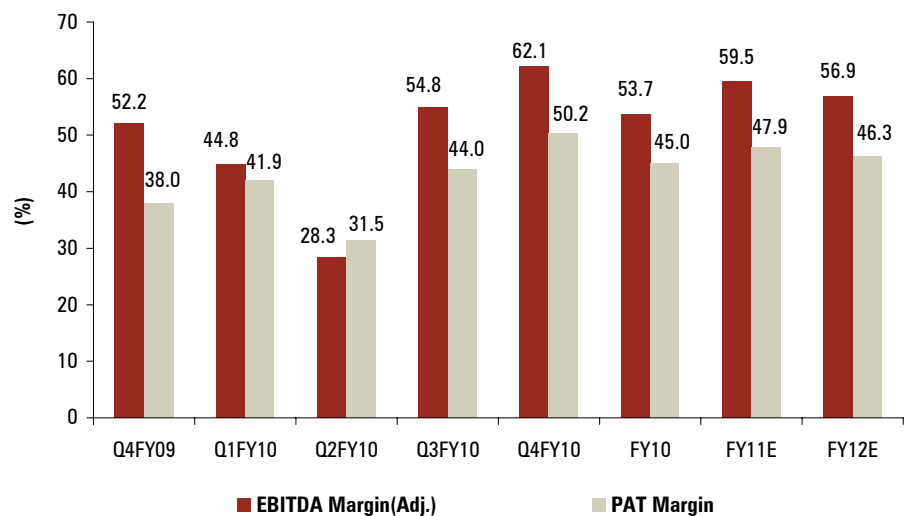


Source: Company, ICICIdirect.com Research

The company realised a sharp increase in the EBITDA and PAT margin due to higher sales volume and increasing iron ore prices. The margin came at the highest point in Q4FY10 when compared with the last six quarters. We expect the EBITDA margin to stay robust at 59.5% and 56.9% in FY11E and FY12E, respectively.

EBITDA margin expanded to ~62.1% due to a 48% YoY increase in sales volume, 22% QoQ increase in blended realisation and reduction in transportation costs. Total expenses as a percentage of net sales dropped to ~38% in Q4FY10 from ~48% in Q4FY09, showing an improvement of ~1000 bps YoY

Exhibit 3: Margins



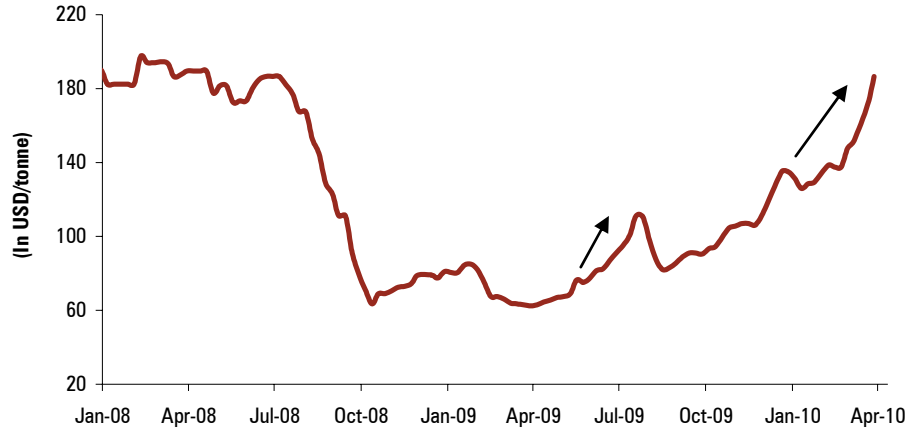
Source: Company, ICICIdirect.com Research

Iron ore price trend

Iron ore prices have moved up at an unbelievable pace in the last few months on the back of strong demand in China. Prices have sustained at higher levels and negotiations on contracts have not yielded any market setting trend for iron ore prices till now. We expect increased volatility in prices to continue before the contract price negotiation gets completed and expect iron ore prices to peak out in the next three to six months.

The price of 63.5% Fe grade imported iron ore in China has spiked sharply from its October levels of US\$90/tonne. It is currently hovering around US\$180/tonne on a CFR basis, registering an increase of ~US\$40 during the last one month

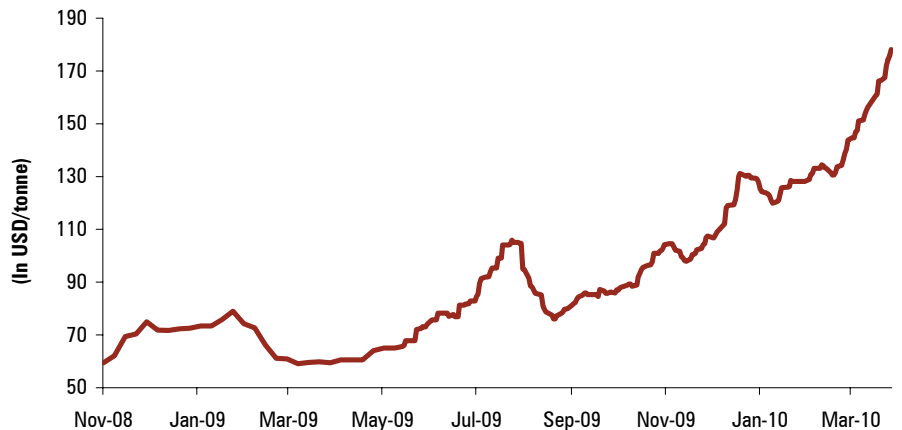
Exhibit 4: China iron ore import - 63.5% Fe Grade (CFR)



Source: Bloomberg, ICICIdirect.com Research

The price of 62% Fe grade imported iron ore in China has gone up sharply from its October levels of ~US\$87/tonne. It has reached US\$170/tonne in the recent few weeks, up ~35% MoM

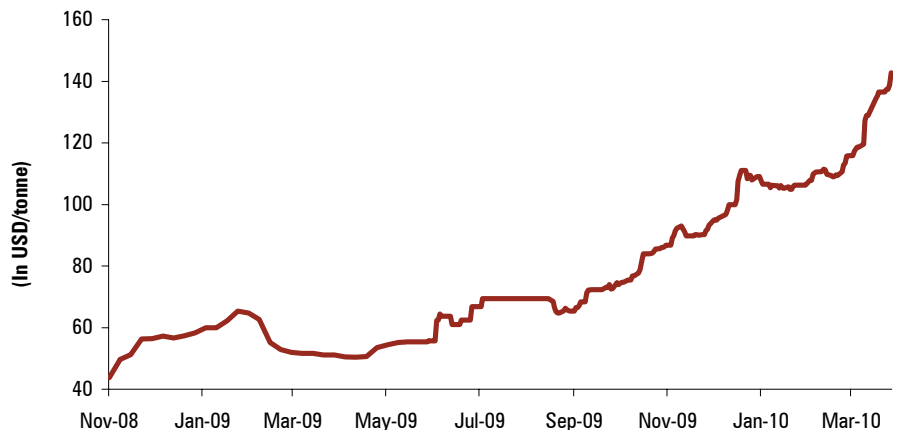
Exhibit 5: China iron ore import - 62% Fe Grade (CFR)



Source: Bloomberg, ICICIdirect.com Research

The price of 58% Fe grade imported iron ore in China has moved above US\$140/tonne due to sustained demand from China for lower grade ore

Exhibit 6: China iron ore import - 58% Fe Grade (CFR)



Source: Bloomberg, ICICIdirect.com Research

China steel dynamics

Iron ore demand in China has remained strong due to the record breaking performance of its steel industry. China recorded its highest ever crude steel production of ~55 MT and pig iron production of ~52 MT in March, 2010, up 20-26% YoY. The record production in the steel industry has kept the iron ore inventory under control in China at ~67 MT.

The crude steel production in China has jumped to ~55 MT in March, 2010, up ~9% MoM and ~21% YoY

The pig iron production has also increased at a fast clip reaching its all-time monthly high of ~52 MT in March 2010

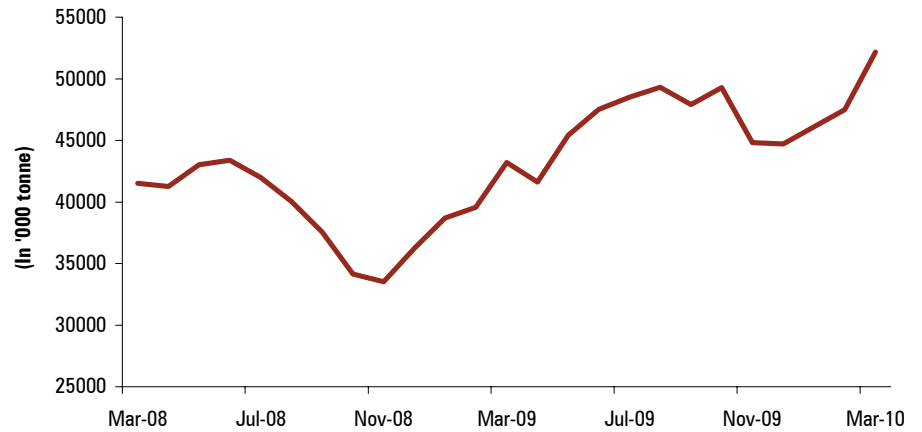
The robust production growth in pig iron and crude steel has kept the iron ore inventory in China under control

Exhibit 7: China crude steel production – breaking records



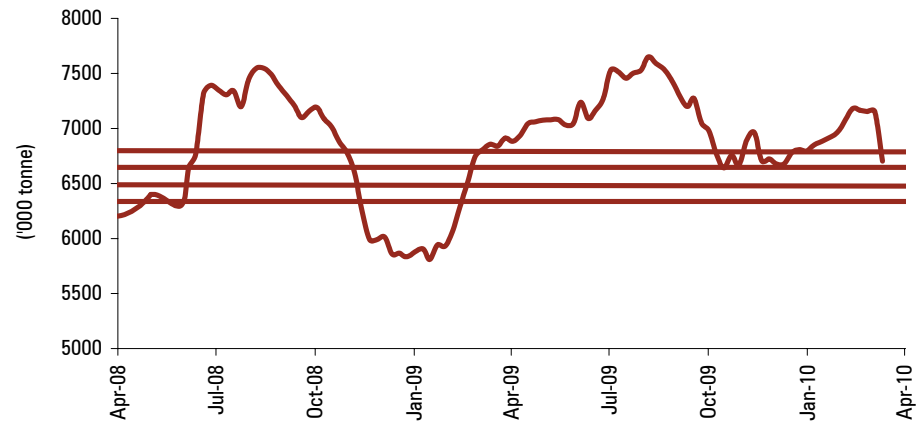
Source: Bloomberg, ICICIdirect.com Research

Exhibit 8: China pig iron production – setting new highs



Source: Bloomberg, ICICIdirect.com Research

Exhibit 9: China iron ore inventory – no sharp rise seen



Source: Bloomberg, ICICIdirect.com Research

Conference Call Highlights

- Sales of iron ore in the full year FY10 from Goa were affected by prolonged monsoons & the cyclone situation and from Orissa due to a delay in permit grants, etc. This resulted in below 20% YoY growth in sales volume excluding Dempo operations. The company expects a YoY volume growth of 20-25% in FY11E
- Guidance for achieving 50 MT of total iron ore sales (including Dempo sales) in the next three years maintained subject to grant of mining permits in Orissa for 10 MT
- The company expects to increase volumes in the range of ~20% (~5 MT) every year and look for attractive assets around the globe in order to achieve its long-term target of sales volume of 50 MT
- The long-term contract sales volume for the company stood at ~20% of overall sales volume during FY10 and is expected to increase as contracts with Chinese buyers are gradually increasing
- Price of iron ore in the spot markets is expected to remain firm on the back of very strong demand in China due to robust steel production and also an up-tick in steel prices in China recently. However, there could be short-term volatility on either side
- Contract pricing of iron ore globally may see a change from this year as BHP Billiton has shown less interest in traditional yearly contracts and is more interested in quarterly spot linked contracts. There has been no confirmed news on finalisation of iron ore contracts on either yearly or quarterly basis
- The news of ban on imports of iron ore below 60% Fe grade by traders in China has not affected Sesa in any way till now. Though the inflow of enquiries from traders has reduced to some extent volumes have not been affected. The company has indicated that approximately 25% of the total iron ore below 60% Fe grade is sold through the trader's route by the company.

Outlook & earnings revision

With Chinese iron ore demand holding up at a robust level on the back of strong steel production, we expect Sesa Goa to continue delivering a strong financial performance, going forward. We expect sales volume of 24.2 MT in FY11E and 29.2 MT in FY12E, factoring a YoY growth of 18% and 21%, respectively. The company has guided towards volume growth in the range of 20-25%. We expect the company to possibly surprise on the upside in our volume estimates with the possibility of a quick ramp-up in capacity at existing mines and inorganic asset acquisition through its rich balance sheet. We are revising our average realisations upwards to Rs 4095/tonne in FY11E and expect realisations of Rs 3685/tonne in FY12E. We are revising our EPS estimates for FY11E upwards by 4.9%. We believe that iron ore prices would peak out by H2FY11 and FY12E realisations would be lower than FY11E. We are revising our FY12E EPS lower by 7.1%.

Exhibit 10: Key assumptions

Iron-Ore	FY11E		FY12E	
	Current	Previous	Current	Previous
Sales Volume (MT)	24.2	24.2	29.2	27.8
Realisation/tonne (Rs)	4095.0	3903.8	3685.5	4098.9

Source: Company, ICICIdirect.com Research

Exhibit 11: Revised financials

(Rs Crore)	FY11E			FY12E		
	Current	Previous	% Chg	Current	Previous	% Chg
Net Sales	10362.7	10167.4	1.9	11127.5	12250.6	-9.2
EBITDA	6165.5	5644.3	9.2	6329.0	6640.6	-4.7
EBITDA Margin (%)	59.5	55.5	+400 bps	56.9	54.2	+270 bps
EBITDA/tonne (Rs)	2553.0	2333.7	9.4	2164.7	2384.9	-9.2
PAT	4966.8	4469.9	11.1	5150.3	5229.8	-1.5
EPS (Rs)	55.8	53.2	4.9	57.9	62.3	-7.1

Source: Company, ICICIdirect.com Research

Valuations

We expect the company to continue growing with expected EPS CAGR of 35.2% over FY10-12E on the back of strong volume growth and robust realisations. We believe that low clarity on benchmark contract pricing and higher volatility in spot prices would increase the risk of earnings volatility for the company. To account for the same, we are assigning a multiple of 5x FY12E EV/EBITDA (~20% discount to global average of 6.2), down from our earlier multiple of 6x to arrive at a revised target price of Rs 524. We rate the stock as **BUY**.

Exhibit 12: Global peer valuation

	EV/EBITDA		P/BV		P/E	
	2010/FY11	2011/FY12	2010/FY11	2011/FY12	2010/FY11	2011/FY12
Vale	8.9	7.7	2.8	2.4	14.3	10.1
Fortescue	15.7	6.4	12.3	5.6	35.3	9.6
BHP Billiton	8.6	5.9	4.5	3.5	16.7	11.1
Rio Tinto	6.8	5.9	2.0	1.6	9.4	7.9
Kumba Iron Ore	6.0	4.9	0.5	7.1	11.0	9.1
Average	9.2	6.2	4.4	4.0	17.3	9.6
Sesa Goa	4.8	4.1	2.7	2.1	8.2	7.9
% discount to global average	47.4%	34.1%	38.3%	49.1%	52.8%	17.5%

Source: Bloomberg, ICICIdirect.com Research

ICICIdirect.com coverage universe (Metals & Mining)

					Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Adhunik Metaliks										
Idirect Code	ADHMET	CMP (Rs)	125.0	FY09	1270.3	5.1	24.4	10.9	13.3	9.1
		Target (Rs)	149.0	FY10E	1457.9	10.9	11.5	6.9	16.9	14.0
MCap (Rs Cr)	1493.3	Upside (%)	19.2	FY11E	1746.1	16.6	7.5	5.6	20.9	17.5
				FY12E	1849.2	17.9	8.3	5.2	18.8	16.7
JSW Steel										
Idirect Code	JINVIJ	CMP (Rs)	1,228.5	FY09	16081.5	14.7	83.6	11.2	3.5	9.3
		Target (Rs)	800.0	FY10E	18617.3	77.2	15.9	9.2	16.3	11.4
MCap (Rs Cr)	19087.5	Upside (%)	-34.9	FY11E	22841.6	102.8	12.0	6.9	18.4	14.1
Usha Martin										
Idirect Code	USHBEL	CMP (Rs)	98.2	FY09	2949.8	6.6	14.9	7.5	14.6	13.9
		Target (Rs)	105.0	FY10E	2722.2	7.4	13.2	7.0	15.2	13.0
MCap (Rs Cr)	2136.4	Upside (%)	6.9	FY11E	3793.3	11.6	8.5	5.2	19.5	17.7
Visa Steel										
Idirect Code	VISST	CMP (Rs)	42.1	FY09	1035.0	-6.1	NA	NA	NA	NA
		Target (Rs)	52.0	FY10E	1072.0	4.4	9.5	7.6	14.8	14.2
MCap (Rs Cr)	478.5	Upside (%)	23.5	FY11E	1443.8	8.5	5.0	5.7	22.1	12.8
				FY12E	1966.9	15.4	3.4	4.2	28.7	17.1
Tata Steel - Cons										
Idirect Code	TISCO	CMP (Rs)	671.0	FY09	145686.3	67.8	9.9	5.0	17.0	15.0
		Target (Rs)	450.0	FY10E	103553.3	-35.7	-18.8	13.8	-12.1	3.4
MCap (Rs Cr)	59493.1	Upside (%)	-32.9	FY11E	123265.8	47.7	14.1	7.3	13.8	11.0
				FY12E	130357.3	58.1	11.6	6.4	14.9	12.1
SAIL										
Idirect Code	SAIL	CMP (Rs)	220.0	FY09	43639.7	14.9	14.7	6.9	32.7	37.4
		Target (Rs)	235.0	FY10E	40638.3	16.0	13.7	8.8	22.1	21.0
MCap (Rs Cr)	90848.1	Upside (%)	6.8	FY11E	49225.3	18.2	12.1	8.2	20.0	17.0
				FY12E	58787.2	21.5	10.2	6.3	19.5	17.2
Sesa Goa										
Idirect Code	SESGOA	CMP (Rs)	456.7	FY09	4959.1	25.3	18.1	12.5	42.2	51.9
		Target (Rs)	524.0	FY10E	5858.3	31.6	14.4	10.4	32.6	30.1
MCap (Rs Cr)	37943.0	Upside (%)	14.7	FY11E	10362.7	55.8	8.2	4.8	33.3	40.5
				FY12E	11127.5	57.9	7.9	4.1	26.1	31.4
Hindustan Zinc										
Idirect Code	HINZIN	CMP (Rs)	1,225.1	FY09	5680.3	64.6	19.0	14.7	20.8	19.8
		Target (Rs)	1,355.0	FY10E	7786.8	93.7	13.1	8.8	24.5	26.7
MCap (Rs Cr)	51762.0	Upside (%)	10.6	FY11E	9300.8	111.5	11.0	6.6	23.3	25.8
				FY12E	11568.8	144.0	8.5	4.3	24.0	27.2
Sterlite Industries										
Idirect Code	STEIND	CMP (Rs)	812.5	FY09	21144.2	50.0	16.3	8.5	14.8	16.4
		Target (Rs)	918.0	FY10E	24334.6	40.4	20.1	7.6	11.0	13.9
MCap (Rs Cr)	68282.5	Upside (%)	13.0	FY11E	28267.7	56.1	14.5	5.3	12.3	14.6
				FY12E	40039.3	99.0	8.2	2.8	18.7	19.5
GPIL										
Idirect Code	GODPOW	CMP (Rs)	272.0	FY09	1092.0	22.8	11.9	7.8	14.6	13.6
		Target (Rs)	254.0	FY10E	799.3	17.9	15.2	8.2	10.2	10.6
MCap (Rs Cr)	708.1	Upside (%)	-6.6	FY11E	967.1	36.9	7.4	4.6	18.4	17.6
				FY12E	1010.2	42.5	6.4	3.7	17.9	17.3

Source: Company, ICICIdirect.com Research

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Strong Buy: 20% or more;
 Buy: Between 10% and 20%;
 Add: Up to 10%;
 Reduce: Up to -10%
 Sell: -10% or more;

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