

Sesa Goa

BSE SENSEX 18,257
S&P CNX 5,479

Bloomberg SESA IN
Reuters SESA.BO
Equity Shares (m) 831.0
52-Week Range 494/209
1,6,12 Rel. Perf. (%) -8/-29/21
M.Cap. (Rs b) 267.6
M.Cap. (US\$ b) 5.7

Rs322

Buy

SESA GOA: Target price cut from Rs460 to Rs376 despite EPS accretive Cairn investment

- We have re-worked our target price for Sesa Goa post the announcement of its intention of acquiring 20% equity of Cairn India (CIL) as part of Vedanta Plc's acquisition of 51-60% stake in Cairn India.

Permanent equity value loss of US\$600-660m due to huge US\$3-3.3b investment in un-related business...

- Sesa will be the vehicle for Vedanta's 20% open offer to minority share holders at Rs355/share of CIL. This will require funds of Rs134.7b (US\$2.9b).
- If Sesa is unable to gain entire 20% equity in open offer, Vedanta Plc will meet the shortfall by supplying CIL's shares at cost i.e. Rs405. This will increase the required funds to a maximum of Rs153.7b (US\$3.3b).
- It is also likely that investors will view the investment as non-core business and start attaching holding company discount, which will result in permanent market cap loss of up to US\$600-660m.

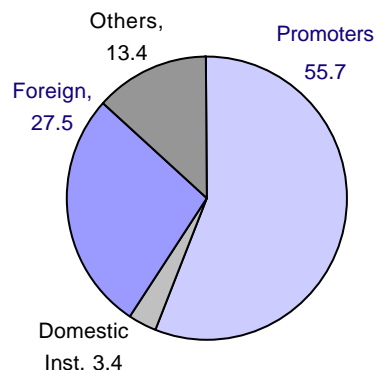
Though, it will be EPS accretive by 16-18% ...

- Since the transaction will be completed by end of FY11, we have analyzed the impact on FY12 earnings.
- Our FY12 PAT estimates for Sesa Goa and CIL are Rs55.9b and Rs83.4b, respectively.
- Since Sesa has gross cash surpluses of US\$2b and strong cash flows (US\$2b in FY11 and FY12), we are assuming that the purchase cost will be funded from internal accruals, which earn post tax yield of 4-5% currently. This amounts to annual interest (post tax) income loss of Rs6.7-7.7b, which will be more than compensated by PAT from associate of Rs16.7b (20% of CIL's PAT). As a result, Consolidated PAT will increase by 16-18% to Rs65-66b (EPS of 78.1-79.2).

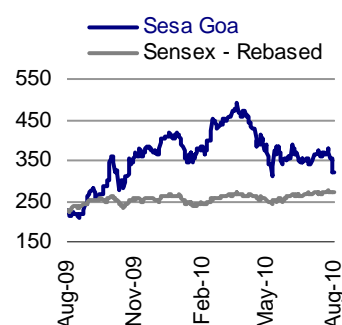
... but de-rating expected

- Though the acquisition is EPS accretive, the stock is likely to be de-rated due to entry into unrelated business and uncertainty over future deployment of cash.
- Deployment of existing cash and next 2 years of cash flows into unrelated business highlights management's pessimism in finding suitable inorganic opportunity in same line of business i.e. iron ore.

SHAREHOLDING PATTERN % (JUN-10)



STOCK PERFORMANCE (1 YEAR)



Financial & valuation summary

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BY	ROE	ROCE	EVI	EVI
END	(RS M)	(RS M)	(RS)	GR. (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/09A	49,591	19,880	25.3	29.0	12.8	5.4	42.2	51.6	4.5	8.8
3/10A	58,583	26,291	31.6	25.3	10.2	3.4	33.8	30.9	3.9	7.2
3/11E	100,073	50,894	61.2	93.6	5.3	2.1	40.5	39.6	1.8	3.1
3/12E	128,733	55,902	67.3	9.8	4.8	1.5	31.3	34.9	1.0	1.8

*Consolidated

Target price cut from Rs460 to SOTP of Rs376

- We are now moving from EV/EBITDA basis of valuation to SOTP valuation wherein core business is valued at Rs270 on DCF, while investment in CIL is at 20% discount to target prices of Rs314 set by our Oil & Gas team factoring crude oil prices of US\$75/bbl.
- **(a) Core business NPV at Rs270**
 - Sesa Goa has total reserves of 353m tons as reported by end of FY10. Assuming production of 55m tons during FY11 and FY12, Sesa will be left with mine reserves of 298m tons, which is expected to be mined over next 10 years.
 - We model long term iron ore prices at US\$100/dmt fob for 63% Fe i.e. at 25% lower than the current spot prices. Present cash on balance sheet and cash flow of next 2 years will be utilized to fund the investment in CIL.
- **(b) Cairn investment valuation at Rs106**
 - At 20% discount to our target price of Rs314 for CIL, the investment is valued at Rs95.3b vs likely cost of Rs135-154b, which translates into equity value of Rs106/share.

Maintain Buy

- Thus, we arrive at SOTP of Rs376 (Rs270 for core business and Rs106 for Cairn) despite EPS accretive transaction. Since the announcement, the stock has already corrected by 10% (market cap correction of ~US\$600m) and now trades at FY12 PE of 4.1x on post acquisition earning estimates.
- We believe iron ore fundamentals are strong. Though there is an upside of only 17% at current stock price, the SOTP is sensitive to iron ore prices and ranges up to Rs578. **Maintain Buy.**

FREE CASH FLOWS

(RS MILLION)

	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Revenue	112,654	120,405	120,405	120,405	120,405	120,405	120,405	120,405	100,226	10,925
Iron ore (Rs m)	103,040	109,480	109,480	109,480	109,480	109,480	109,480	109,480	89,301	
Realization (US\$/ton)	70	70	70	70	70	70	70	70	70	
Qty (m tons)	32	34	34	34	34	34	34	34	28	
EBITDA	56,370	60,055	60,055	60,055	60,055	60,055	60,055	60,055	49,447	2,500
Iron ore (US\$/ton)	37	37	37	37	37	37	37	37	37	
EBIT	55,560	59,262	59,222	59,239	59,198	59,215	59,173	59,191	48,539	1,547
Tax rate (T)	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
EBIT (1-T)	38,892	41,483	41,456	41,467	41,439	41,451	41,421	41,434	33,978	1,083
Add: Depreciation	810	793	833	816	857	840	882	864	908	953
Less: Capex	-1700	-1700	-1000	-1000	-1000	-1000	-1000	-1000	-1000	-1000
Change in W.Cap	-310							807	3572	437
FCFF	37,692	40,577	41,289	41,284	41,296	41,291	41,303	42,105	37,457	1,473

DCF VALUATION (RS M)

WACC (%)	10
Terminal Growth (%)	3
Number of shares (m)	900
Terminal Value	10,152
NPV of cashflows post FY12 (a)	242,841
NPV - Rs per share (a)	270
Value of investment in Cairn (b)	95,289
Value - Rs per share	106
Cairn target price@US\$75/bbl	314
No. of Cairn shares (m)	379
Discount of holding company	20%
Equity Value (a+b)	338,130
Target price (Rs per share)	376

SENSITIVITY OF SOTP TO IRON ORE PRICES

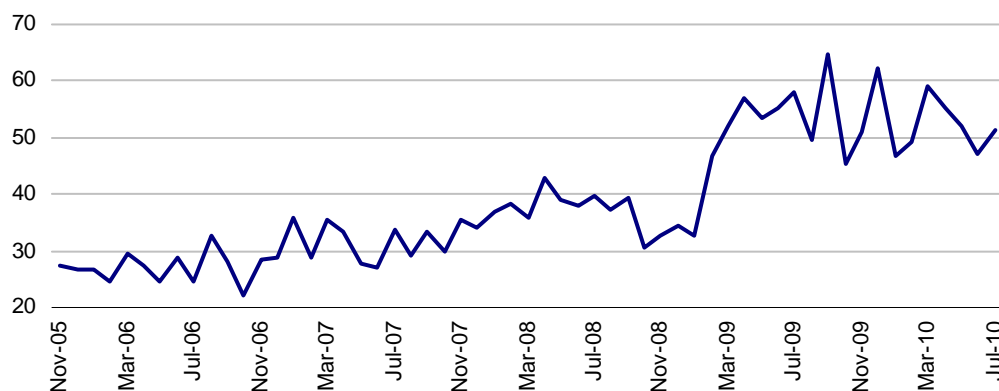
SN	IRON ORE		SESA'S		DCF (RS/SHARE)		
	63% FE		REALIZATION				
	(US\$/D MT FOB)		(US\$/ WMT FOB)		(A)	(B)	NPV TP (A+B)
1	70		43.0		106	114	220
2	80		52.0		106	166	272
3	90		61.0		106	218	324
4	100		70.0		106	270	376
5	120		87.3		106	370	476
6	140		105.0		106	472	578

Most chinese mines become unviable

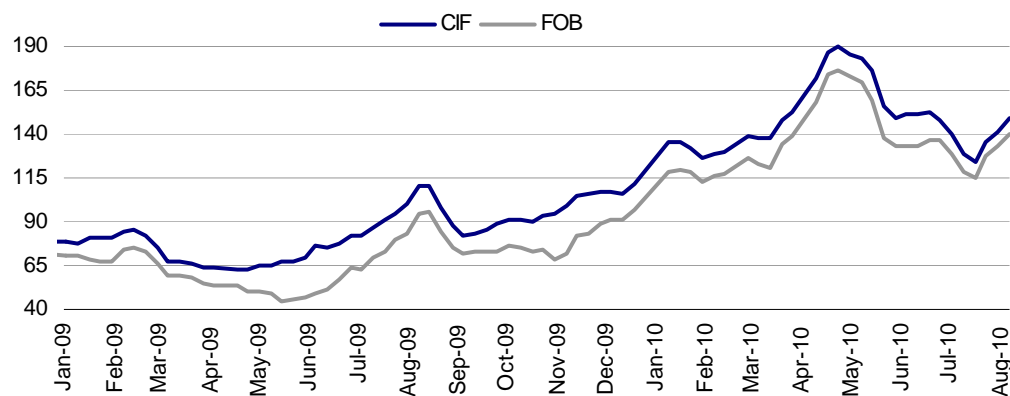
Some Chinese mines become unviable

Annexure

CHINA'S MONTHLY IRON ORE IMPORTS (M TON)



INDIAN IRON ORE 63% FE GRADE PRICES FOR SHIPMENT TO CHINA (US\$/TON)



Source: Bloomberg/MOSL

Financials and Valuation

INCOME STATEMENT (CONSOLIDATED)			(RS MILLION)		
Y/E MARCH	2008	2009	2010	2011E	2012E
Net sales	35,797	49,591	58,583	100,073	128,733
Change (%)	74.6	38.5	18.1	70.8	28.6
Total Expenses	12,764	24,203	27,135	40,804	57,358
EBITDA	23,033	25,388	31,448	59,269	71,374
% of Net Sales	64.3	51.2	53.7	59.2	55.4
Depn. & Amortization	500	517	745	892	1,402
EBIT	22,533	24,871	30,703	58,377	69,972
Net Interest	28	10	517	797	1,028
Other income	744	2,240	4,260	5,525	7,466
PBT before EO	23,250	27,102	34,446	63,106	76,409
EO income				-911	
PBT after EO	23,250	27,102	34,446	62,195	76,409
Tax	7,760	7,153	8,056	12,096	20,476
Rate (%)	33.4	26.4	23.4	19.4	26.8
Reported PAT	15,490	19,949	26,390	50,100	55,933
Minority interests	74	69	99	116	31
Adjusted PAT	15,416	19,880	26,291	50,894	55,902
Change (%)	140.2	29.0	32.2	93.6	9.8

BALANCE SHEET			(RS MILLION)		
Y/E MARCH	2008	2009	2010E	2011E	2012E
Share Capital	394	787	831	831	831
Reserves	29,041	46,369	76,858	124,915	177,724
Net Worth	29,434	47,156	77,689	125,746	178,555
Minority Interest	266	334	405	456	487
Total Loans		19	20,527	20,527	20,527
Deferred Tax Liability	664	664	664	664	664
Capital Employed	30,365	48,174	99,285	147,393	200,233
Gross Block	7,696	8,862	26,662	28,412	30,162
Less: Accum. Deprn.	2,936	3,422	4,351	5,725	7,128
Net Fixed Assets	4,760	5,440	22,311	22,686	23,034
Capital w/IP	215	489	489	489	489
Investments	925	1,475	1,475	1,475	1,475
Curr. Assets	28,228	46,610	81,353	131,865	184,671
Inventory	3,118	2,642	3,980	6,979	7,342
Account Receivables	4,725	2,982	4,396	7,613	8,026
Cash and Bank Balance	19,796	29,955	61,945	106,242	158,271
Others	590	11,032	11,032	11,032	11,032
Curr. Liability & Prov.	3,763	5,840	6,343	9,123	9,437
Account Payables	1,688	3,108	3,611	6,391	6,704
Provisions & Others	2,076	2,732	2,732	2,732	2,732
Net Current Assets	24,465	40,770	75,010	122,743	175,234
Appl. of Funds	30,365	48,174	99,285	147,393	200,233

E: MOSL Estimates

RATIOS					
Y/E MARCH	2008	2009	2010	2011E	2012E
Basic (Rs)					
EPS	19.6	25.3	31.6	61.2	67.3
Cash EPS	20.3	26.0	32.7	61.4	69.0
BV/Share	37.4	59.9	93.5	151.3	214.9
DPS	2.3	2.3	3.3	3.5	3.5
Payout (%)	13.4	10.4	12.0	6.7	6.1
Valuation (x)					
P/E	16.4	12.8	10.2	5.3	4.8
Cash P/E	15.9	12.4	9.9	5.2	4.7
P/BV	8.6	5.4	3.4	2.1	1.5
EV/Sales	6.5	4.5	3.9	1.8	1.0
EV/EBITDA	10.1	8.8	7.2	3.1	1.8
Dividend Yield (%)	0.7	0.7	1.0	1.1	1.1
EV/ton (US\$)	20	19	13	11	8

Return Ratios (%)					
EBITDA Margins (%)	64.3	51.2	53.7	59.2	55.4
Net Profit Margins (%)	43.1	40.1	44.9	50.9	43.4
RoE	52.4	42.2	33.8	40.5	31.3
RoCE	74.2	51.6	30.9	39.6	34.9
RoIC	159.2	112.6	66.5	120.0	128.1

Working Capital Ratios					
Fixed Asset Turnover (x)	4.7	5.6	2.2	3.5	4.3
Asset Turnover (x)	1.2	1.0	0.6	0.7	0.6
Debtor (Days)	48.2	21.9	27.4	27.8	22.8
Inventory (Days)	8.7	5.3	6.8	7.0	5.7
Working Capital Turnover (x)	13.0	21.8	22.3	16.5	13.2
Creditors	38.4	43.0	39.5	33.3	26.8
Leverage Ratio (x)					
Current Ratio	7.5	8.0	12.8	14.5	19.6

CASHFLOW STATEMENT			(RS MILLION)		
Y/E MARCH	2008	2009	2010E	2011E	2012E
Pre-tax profit	23,250	27,102	34,446	62,195	76,409
Depreciation	500	517	745	892	1,402
(Inc)/Dec in w/kg. Cap.	-1,202	-6,146	-2,250	-3,435	-463
Tax paid	-7,745	-7,108	-6,781	-14,580	-15,910
Other operating activities	-569	-624	-2,788	4,327	-4,288
CF from Op. Activity	14,233	13,740	23,372	49,399	57,150
(Inc)/Dec in FA + Cw/IP	-490	-1,440	-17,800	-1,750	-1,750
(Pur)/Sale of Investments	-730	-550			
Others					
CF from Inv. Activity	-1,219	-1,990	-17,800	-1,750	-1,750
Share Capital raised/(repaid)	0	394	8,999		
Chg in minorities	74	68	71	51	31
Debt raised/(repaid)		19	20,508		
Dividend (incl. tax)	-2,072	-2,072	-3,160	-3,403	-3,403
Other financing activities					
CF from Fin. Activity	-1,999	-1,592	26,419	-3,352	-3,372
(Inc)/Dec in Cash	11,015	10,159	31,991	44,297	52,028
Add: Opening Balance	8,471	19,796	29,955	61,945	106,242
Closing Balance	19,796	29,954	61,945	106,242	158,271

N O T E S



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3. Broking relationship with company covered
4. Investment Banking relationship with company covered

Sesa Goa

No
No
No
No

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