

INDIA RESEARCH
Metals & Mining
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Sesa Goa

NEUTRAL

SC lifts iron ore export ban in Karnataka

Rs314

Mkt Cap: Rs270bn; US\$6.1bn

Event: The Supreme Court, in an interim order today, ordered the lifting of the ban of iron ore exports from Karnataka effective 20 April 2011.

Background and other details:

- The Karnataka Government, in July 2010, had banned export of iron ore after a Karnataka 'Lokayukta' report on illegal iron ore mining and transportation from the state. This was later upheld by the Karnataka High Court.
- All the big miners of the region – Sesa Goa, MSPL (flagship company of the Baldota Group) and SB Minerals had moved to the apex court against the high court order citing that, according to the Mines and Minerals Development and Regulation Act provisions, the state has no power to ban iron ore exports.
- In an earlier decision in March 2011, the Supreme Court had allowed miners to export inventory at the ports and asked the state government to put in place new rules to prevent illegal mining before the next hearing on 4 April 2011.
- Sales from Karnataka declined by 26% yoy to 0.7m tonnes in Q3FY11 due to the ban.
- Sesa Goa has been selling part of its produce from Karnataka to domestic steel manufacturers, but had built up an inventory of 2.3m tonnes (60,000 tonnes at ports).
- A draft law for mining in Karnataka has been published in the state gazette inviting suggestions.
- At its last earnings conference call, the management indicated that it expected a favorable outcome and guided for a ramp-up in production run-rate in Karnataka to 10m tonnes by end-FY12.

Our view: We believe this is a huge positive for Sesa Goa as a resolution to the major roadblock in its volume growth story looks closer now. The Karnataka mines have environmental clearance for producing 6m tonnes annually and Sesa Goa plans to apply for an extension of up to 10mt. Assuming resolution of the regulatory impasse by Q1FY12, we had estimated 4m tonnes of sales from Karnataka in FY12. **We may upgrade our FY12 volume estimates of 20.7m tonnes post the Q4FY11 results.** We also highlight that the SC order comes in the backdrop of a strong pricing scenario. At Rs314, the stock trades at 3.7x FY12E EV/EBITDA – close to our current fair valuation of Rs300/share. **Maintain Neutral.**

Chirag Shah

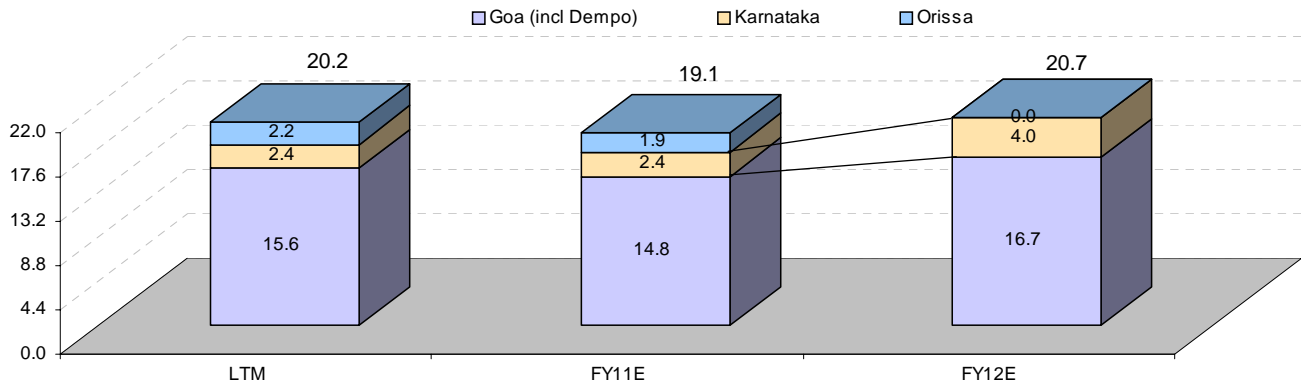
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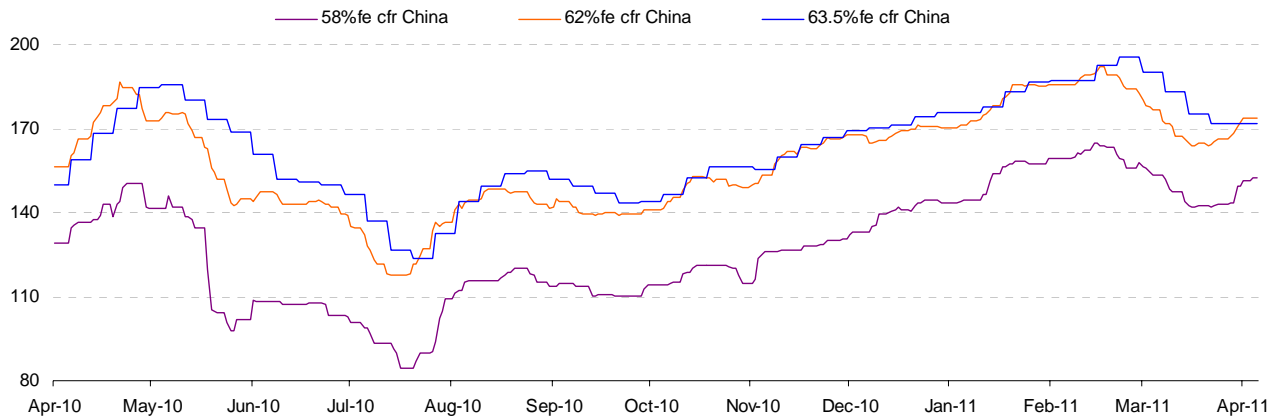
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Exhibit 1: Volume drop in Orissa to be offset by potential ramp-up in Karnataka



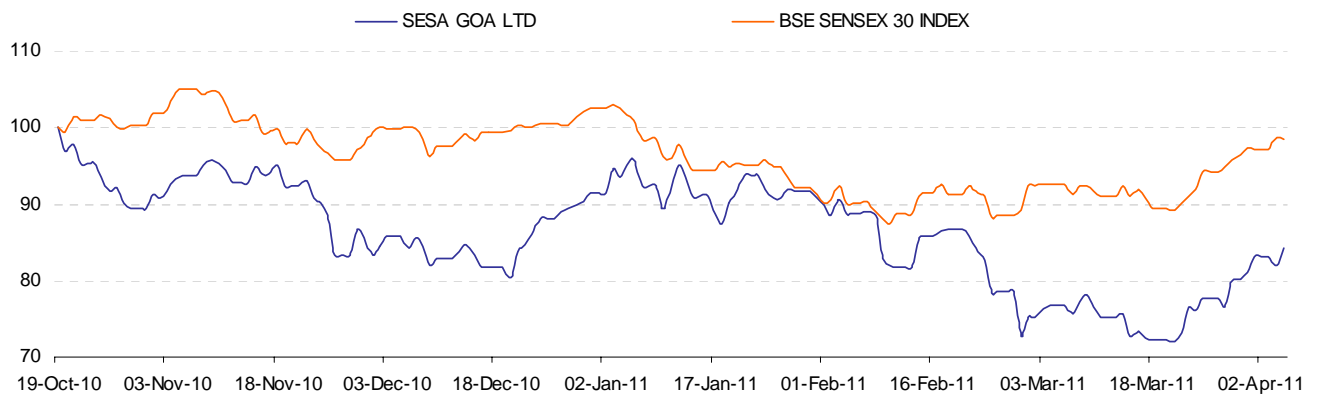
Source: IDFC Securities Research

Exhibit 2: Average benchmark spot prices up 20% qoq



Source: Bloomberg

Exhibit 3: Stock has underperformed the benchmark index by ~14% since we downgraded the stock on 19 Oct 2010



Source: Bloomberg

Sesa Goa Q4FY11 preview: We now estimate iron ore volumes are likely to decline by 14% yoy to 6.3mt (v/s our previous estimate, 7.4mt), in light of the macro headwinds in the industry. But, on the positive side, average spot prices for 58%fe iron ore fines have increased ~20% qoq; therefore, we estimate blended realization this quarter to increase to US\$112/tonne from US\$87 in Q3FY11. Overall, we have lowered our FY11 earnings estimate by ~6% to Rs50.5/share primarily due to lower iron ore volumes.

Exhibit 4: Key financials table

	FY11E			FY12E			FY13E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Key financials									
Revenue (Rs m)	94,786	89,931	(5.1)	93,254	92,968	(0.3)	93,091	92,743	(0.4)
EBITDA (Rs m)	54,259	50,700	(6.6)	46,202	45,314	(1.9)	43,487	42,349	(2.6)
EBITDA margin (%)	57.2	56.4	(87) bp	49.5	48.7	(80) bp	46.7	45.7	(105) bp
Effective tax rate (%)	18.0	18.1	10 bp	33.0	33.0	0 bp	33.0	33.0	0 bp
Net profit (Rs m)	47,919	44,923	(6.3)	46,025	45,563	(1.0)	47,868	47,185	(1.4)
EPS (Rs)	53.9	50.5	(6.3)	51.7	51.2	(0.9)	53.8	53.0	(1.4)
Key assumptions									
Volumes									
Iron ore volume (m t)	20.2	19.1	(5.3)	20.6	20.7	0.3	23.1	23.1	0.1
Pig iron volume (tonnes)	290,646	280,146	(3.6)	367,760	354,110	(3.7)	422,924	407,226	(3.7)
Realizations									
Iron ore (US\$/ t)	96.1	96.0	(0.1)	90.2	90.4	0.2	79.3	79.4	(0.1)
Pig iron (Rs/ t)	24,916	24,804	(0.5)	26,061	25,637	(1.6)	24,758	24,355	(1.6)

Source: IDFC Securities Research

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