

Sesa Goa Ltd (Q1 FY09)

July 24, 2008

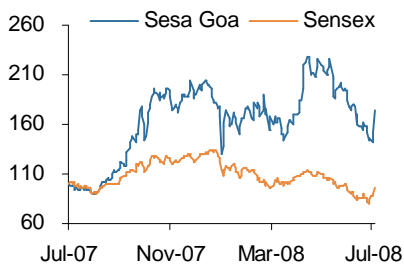
Stock data

Sensex:	14,942
CMP (Rs):	3,302
Target price (Rs):	4,785
Upside (%):	44.9
52 Week h/l (Rs):	4,400/1,686
Market cap (Rs cr)	12,997
6m Avg vol BSE&NSE ('000 nos):	233
No of o/s shares (mn):	39
FV (Rs):	10
Bloomberg code:	SESA IN
Reuters code:	SESA.BO
BSE code:	500295
NSE code	SESAGOA

Shareholding pattern

June 2008	(%)
Promoters	51.2
FII's & institutions	31.0
Non promoter corp hold	5.5
Others	12.3

Share price trend



India Infoline Research Team
research@indiainfoline.com

- Jump in sales volume and realisation boost topline by 147.3% yoy to Rs12.8bn
- Iron ore production jumps 58% yoy to 4.6mn tons, the highest in Q1 in any year
- Coke and pig iron divisions continue to produce strong results, in spite of scheduled maintenance during the quarter
- OPM swells 2,450bps yoy to 62.9% on soaring iron ore realisation
- We recommend a BUY with a target price of Rs4,785

Result table

Period to	06/08	06/07	yoy growth
(Rs mn)	(3)	(3)	(%)
Net sales	12,800	5,177	147.3
Expenditure	(4,750)	(3,191)	48.9
Operating profit	8,051	1,986	305.3
Other income	611	107	473.9
Interest	0	0	300.0
Depreciation	(116)	(107)	8.3
PBT	8,546	1,986	330.4
Tax	(2,185)	(654)	234.1
PAT	6,361	1,332	377.7
Minority interest	(30)	(18)	64.1
Adjusted PAT	6,332	1,314	382.0
OPM (%)	62.9	38.4	
EPS (Rs) (Annualised)	643.4	133.5	382.1
Tax payout	25.6	32.9	
NPM (%)	49.5	25.4	

Source: Company, India Infoline Research

Segmental results

	06/08	06/07	Growth	Sales Contribution	
				06/08	06/07
	(3)	(3)	(%)		
Sales (Rs mn)					
Iron ore	11,170	3,941	183.4	83.3	74.6
Metallurgical coke	1,353	608	122.5	10.1	11.5
Pig iron	1,632	1,142	42.9	12.2	21.6
Total	13,412	5,283	153.9	100.0	100.0
EBIT(Rs mn)				EBIT Contribution	
Iron ore	6,982	1,659	320.8	81.7	83.6
Metallurgical coke	604	(2)	40,333.3	7.1	(0.1)
Pig iron	357	228	56.4	4.2	11.5
Total	8,545	1,985	330.4	100.0	100.0
EBIT Margins (%)			Inc/dec		
Iron ore	62.5	42.1	20.4		
Metallurgical coke	44.6	(0.2)	44.8		
Pig iron	21.9	20.0	1.9		
Total	63.7	37.6	26.1		
ROCE (%)					
Iron ore	360.8	143.3			
Metallurgical coke	114.5	(0.2)			
Pig iron	71.8	55.7			
Total	92.9	43.5			

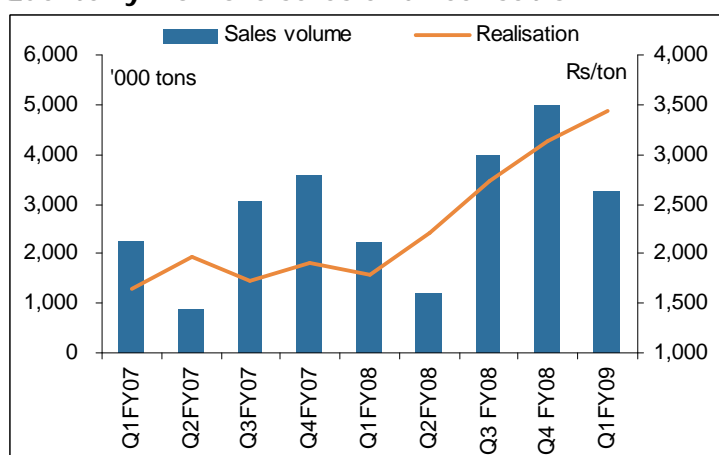
Source: Company, India Infoline Research

Robust iron ore realizations boost Q4 FY08 revenues

Sesa Goa reported strong Q1 FY09 results, with a topline growth of 147.3% yoy to Rs12.8bn. The growth in revenue was mainly driven by a surge in iron ore realisations and iron ore sales volume. The company recorded the highest ever first quarter sales volume at 3.3mn tons, up 47.1% yoy. Growth in sales volume was curtailed by a rise in iron ore inventory levels as iron ore production during the quarter jumped 57% yoy to 4.6mn tons. The increase in inventory level was due to the company stocking its products during the rainy season, a precaution for any production loss. The jump in production during the quarter was a surprise for the markets and was much higher than our expectations.

Iron ore realisations remained strong during the quarter on account of mounting demand for iron ore from Chinese steel producers. Iron ore realisations for the quarter stood at ~Rs3,420 per ton, an increase of 92.7% yoy. On qoq basis, realisations increased by 9.2% due to a jump in spot sales. The ratio of long-term contract sales to spot sales for the quarter was 35:65 from last year's 74:26. The company was able to receive an average of ~US\$90 per ton for its spot sales from US\$52 a ton in the corresponding period last year. For its long-term contracts, the company had sold iron ore with a 65% rise on an interim basis. The average prices received by the company on its long-term contracts were US\$65. The company expects its long-term contract prices to be settled with an increase of ~79-85%.

Quarterly iron ore sales and realisation



Source: Company, India Infoline Research

Sales volume and realisation

	03/08	03/07	Growth
	(3)	(3)	
Iron ore (mn tons)	3.25	2.21	47.1
Coke	63,000	64,000	(1.6)
Pig iron	57,000	68,000	(16.2)
Realisations (Rs/ton)			
Iron ore	3,436	1,783	92.7
Coke	21,500	9,502	126.3
Pig iron	28,620	16,791	70.4

Source: Company, India Infoline Research

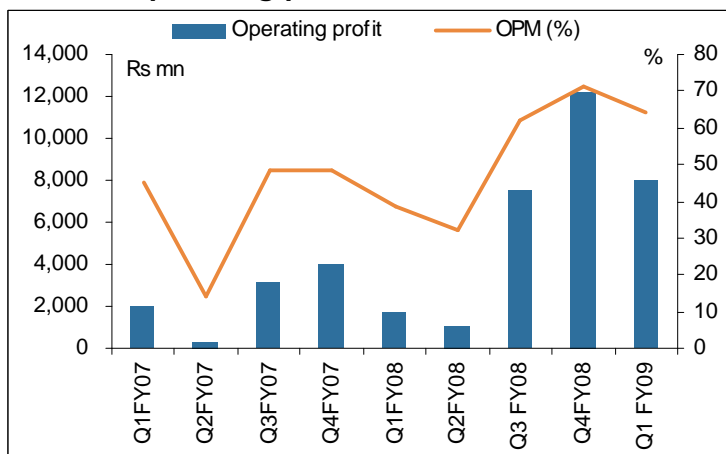
China continued to be the company's highest contributor in sales volumes. Sales to China jumped to 70% of total sales from last year's 52%. Pakistan contributed 9% of total sales, while Japan, Europe and South Korea each contributed ~5% of total sales. Sales in domestic market fell to 6% from last year's 8% of total sales. The company's coke and pig iron divisions continued to produce better results. Revenue from the coke division more than doubled to Rs1.4bn from Rs608mn in the corresponding quarter last year. The jump in coke division revenue was witnessed in spite of a small dip in production volumes. Coke realisations jumped 126.1% yoy in Q1 FY09 to Rs21,500 per ton. Pig iron demand stayed firm in the country, pushing pig iron prices up 70.5%. The company had an annual maintenance program last quarter, reducing pig iron production by 16.2% to 57,000 tons. Revenue from the pig iron division was Rs1.6bn, a rise of 42.9% yoy.

On qoq basis, iron ore realizations rose 15.5% and sales volume grew 25%. The rise in realizations was on account of an increase in spot sales. Revenue for the quarter was further boosted by the rise in sales of metallurgical coke and pig iron division. Coke and pig iron division registered 82.9% and 31.1% yoy growth respectively, boosting Sesa Goa's topline. Thus strong results from all the divisions led to a 40% qoq increase in consolidated revenue Rs17.1bn for the quarter.

OPM swells on soaring iron ore realisations

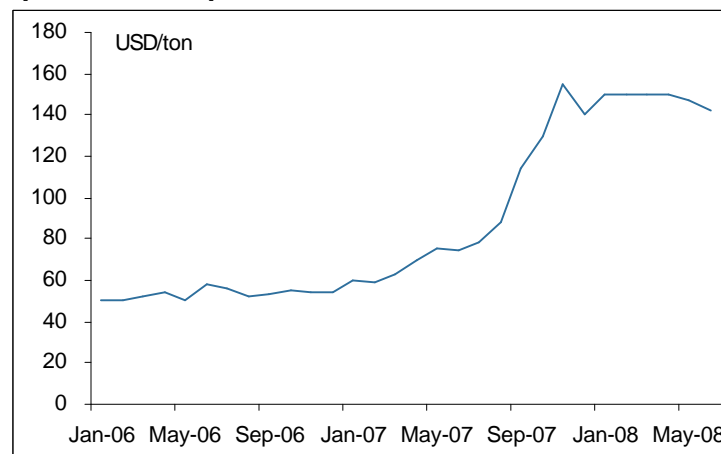
A 47.1% yoy jump in iron ore sales volume and a 92.7% yoy jump in iron ore realisations boosted consolidated operating profits to Rs8.1bn, an increase of 305.3% yoy from last year's Rs1.9bn. This also helped the company to expand its OPM to 62.9% from 38.4% in the corresponding period last year. The iron ore division registered a 320.8% surge in operating profits to Rs6.9bn from Rs1.7bn in the same period last year. But on qoq basis, OPM shrank 850bps on account of a jump in transportation costs. Transportation costs (as % of sales) rose to 22.7% as against 13.0% in Q4 FY08. The rise in transportation costs was due to the increase in railway freight. The company's road transportation cost also increased due to higher fuel prices. Transportation costs jumped by 30% qoq to Rs2.9bn from Rs2.2bn in spite of lower iron ore sales during the quarter. Export duty (as a % of sales) was 4.4%, a rise of 150bps as the new export policy came into effect from June 15. Export tax as a % of sales is expected to rise ~14%, with the new policy taking effect.

Trend in operating profits and OPM



Source: Company, India Infoline Research

Spot iron ore prices



Source: CRU

The metallurgical coke division, which witnessed a turnaround last year saw its operating profit rise to Rs604mn from a loss of Rs2mn in Q1 FY08. Pig iron division also registered a 56.4% yoy jump in operating profit to Rs357mn.

Bottomline soars 377.7% yoy to Rs6.3bn

The jump in iron ore realizations and strong production volumes led to a 377.7% yoy growth in company's profits. The company registered a bottomline of Rs6.3bn during the quarter. On an annualized basis, the profit translates into an EPS of Rs643 per share. At the CMP of Rs3,302, the stock is trading at 5.2x FY09E annualized earnings.

Outlook

Sesa Goa, a Vedanta group company, is India's largest private-sector player in the iron ore segment. Over the last one-year, iron ore spot prices have surged on the back of strong demand from Chinese steelmakers. The trend has caught up with FY09 contract prices too. At the start of the negotiations in April, Brazilian miners had agreed to 65-70% increase in contract prices. Last month, Australian miners went a step forward by negotiating a 95% increase for iron ore lumps. We believe the company should be able to negotiate prices in line with the Australian miners, providing significant upside to our estimates.

The Indian government was reportedly planning to raise royalty rates for iron ore mining. With inflation touching a 13-year high of 12%, we believe the probability of such a scenario is significantly low. However, in our estimates we have factored in a much higher royalty rate of 10% of sales value.

In spite of our conservative assumptions, we expect Sesa Goa to register healthy earnings CAGR of 22.7% during FY08-10E. Based on 4.5x EV/EBITDA on FY10E EBITDA of Rs32.4bn, we recommend a BUY on Sesa Goa with a target price of Rs4,785, implying an upside of 45% from the current levels.

Financial table

Rs mn	FY07	FY08E	FY09E	FY10E
	(12)	(12)	(12)	(12)
Revenues	22,211	38,273	65,080	76,366
yoy growth (%)	20.0	72.3	70.0	17.3
EBITDA	9,660	23,043	28,551	32,390
EBITDA margin (%)	43.5	60.2	43.9	42.4
PAT	6,510	15,516	19,457	23,378
Pre-exceptional PAT	6,510	15,516	19,457	23,378
yoy growth (%)	13.2	138.3	25.4	20.2
EPS (Rs)	165.4	394.2	494.3	593.9
P/E (x)	20.0	8.4	6.7	5.6
P/BV (x)	8.1	4.4	2.8	1.9
EV/EBITDA (x)	13.4	5.3	4.1	3.2
ROE (%)	40.5	52.0	41.4	34.4
ROCE (%)	62.6	79.8	63.2	52.5

Source: Company, India Infoline Research

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