

Sesa Goa

HOLD
Maintained
Rs457

Passé its peak

Reason for report: Earnings revision

Higher-than-expected iron ore price settlement between the Japanese steel makers and the Australian miners will lead to 35% & 28% rise in our FY11E & FY12E iron ore blended realisation for Sesa Goa. This will result in 51% & 43% increase in our FY11E & FY12E earnings estimates. This development is a significant positive for the company. However, as iron ore price cycle approaches its peak and with higher exposure to spot prices (since contracts will be quarterly in nature henceforth), we assign mid-band EV/E valuations of 4x to Sesa's FY12E earnings. We revise our target price to Rs480/share. Maintain HOLD.

- **Iron ore prices hiked 90%; new contracts quarterly in nature.** Forty years of iron ore benchmarking system has been breached as Vale and BHP Billiton have signed quarterly contracts with Japanese steelmakers. Also, similar to '09, the Japanese has acceded to Australian miners' demand at higher-than-consensus expectations, with 90% YoY rise in iron ore prices to US\$120/te (for Q1FY11). The Chinese contracts can be settled at a discount to Japanese contracts (the former is followed by Sesa). Assuming an ~80% price increase for Chinese contracts, we expect Sesa's FY11E blended realisation to be ~US\$85/te.
- **Change in pricing mechanism to increase volatility.** Iron ore contract price has crossed its '08 peak and spot price is approaching its peak in '08. While increased exposure to spot pricing will improve Q1-Q2FY11 profitability, higher price volatility should lead to contraction in Sesa's valuation multiple to account for increased risk.
- **Valuations – Iron-ore price premium largely incorporated.** We raise iron ore price estimate to factor in expected ~80% rise in Chinese contracts post the Japanese settlement. Also, spot iron ore prices in China are at ~US\$140/te levels. With higher spot price exposure, we raise Sesa's FY11E & FY12E blended realisation 35% & 28% to US\$85/te and US\$73/te respectively. We have assumed that iron ore prices will peak in H1FY11 and value Sesa at the average of historical one-year forward EV/E band i.e., 4x. Our revised one-year target price is Rs480 from Rs396. Maintain HOLD.
- **Q4FY10 expectations.** With ~20% YoY volume growth and improved realisation in Q4FY10E, we expect FY10E EPS to be Rs28.6 (9MFY10 EPS Rs16) owing to: i) higher investment income, partly propped by US\$500mn FCCBs and ii) lower inland transportation cost/te for Q4FY10 due to higher contribution from Goa operations (Q3FY10 inland transportation costs also dipped 67% QoQ to Rs322/te).

Market Cap	Rs374.97bn/US\$8.3bn
Reuters/Bloomberg	SESA.BO/SESA IN
Shares Outstanding (mn)	820.5
52-week Range (Rs)	464/97
Free Float (%)	42.5
FII (%)	25.5
Daily Volume (US\$'000)	61,050
Absolute Return 3m (%)	11.3
Absolute Return 12m (%)	359.2
Sensex Return 3m (%)	0.7
Sensex Return 12m (%)	81.2

Year to March	2009	2010E	2011E	2012E
Revenue (Rs mn)	49,591	57,386	99,899	105,497
Net Income (Rs mn)	21,523	25,454	52,909	53,941
EPS (Rs)	27.3	28.6	59.4	60.6
% Chg YoY	42.4	4.6	107.9	2.0
P/E* (x)	19.8	16.4	6.5	5.6
CEPS (Rs)	24.8	29.5	60.7	61.9
EV/E (x)	13.9	11.2	4.5	3.7
Dividend Yield	0.4	0.5	0.5	0.5
RoCE (%)	73.3	45.0	56.3	41.4
RoE (%)	74.4	39.8	52.0	38.9

* Cash adjusted

Metals

Target price Rs480

Earnings revision

	FY11E	FY12E
Sales	↑ 30.2	↑ 24.1
EBITDA	↑ 52.6	↑ 43.8
EPS	↑ 50.9	↑ 43.0

Target price revision

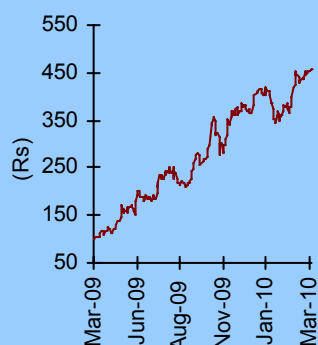
Rs480 from Rs396

Shareholding pattern

	Jun '09	Sep '09	Dec '09
Promoters	53.1	57.1	57.5
Institutional investors	28.7	27.9	29.3
MFs and UTI	2.9	1.6	0.7
Insurance Cos.	3.4	2.1	2.2
FIs	22.3	23.0	25.5
Others	20.1	15.0	13.2

Source: BSE India

Price chart



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Summary financials

Table 1: Profit and Loss statement

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Operating Income (Sales)	49,591	57,386	99,899	105,497
Operating Expenses	22,529	26,845	33,249	38,856
EBITDA	27,062	30,541	66,650	66,641
% margins	55	53	67	63
Depreciation & Amortisation	517	799	1,133	1,207
Gross Interest	43	624	1,192	1,263
Other Income	2,240	3,988	6,215	8,731
Recurring PBT	28,743	33,106	70,540	72,902
Add: Extraordinaries	(1,641)	-	-	-
Less: Taxes	7,153	7,652	17,632	18,961
Net Income (Reported)	19,881	25,454	52,909	53,941
Recurring Net Income	21,523	25,454	52,909	53,941

Source: Company data, I-Sec Research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Assets				
Total Current Assets	16,833	20,332	26,857	28,837
of which cash & cash eqv.	177	172	191	191
Total Current Liabilities & Provisions	5,840	6,888	7,966	8,872
Net Current Assets	10,992	13,445	18,891	19,965
Investments				
of which	31,252	63,942	108,701	158,861
Strategic/Group	-	-	-	-
Other Marketable	31,252	63,942	108,701	158,861
Net Fixed Assets	5,930	24,355	25,579	26,481
of which				
Capital Work-in-Progress	489	375	932	275
Total Assets	48,174	101,742	153,171	205,306
Liabilities				
Borrowings	19	267	1,187	1,781
Deferred Tax Liability	664	664	664	664
Equity Share Capital	787	890	890	890
Face Value per share (Rs)	1	1	1	1
Reserves & Surplus*	46,370	99,920	150,429	201,970
Less: Misc. Exp. n.w.o.	-	-	-	-
Net Worth	47,157	100,810	151,319	202,860
Total Liabilities	48,175	101,741	153,171	205,306

*Excluding revaluation reserves

Source: Company data, I-Sec Research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Operating Cash flow	18,199	22,265	47,827	46,417
Working Capital Changes	3,145	(2,458)	(5,426)	(1,074)
Capital Commitments	(1,471)	(19,212)	(2,357)	(2,108)
Free Cash Flow	19,872	595	40,043	43,235
Cash flow from Investing Activities	(8,517)	(28,702)	(38,544)	(41,428)
Issue of Share Capital	-	30,176	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	19	248	921	594
Dividend paid	(1,380)	(2,160)	(2,400)	(2,400)
Extraordinary Items	-	-	-	-
Chg. in Cash & Bank balance	(33)	(6)	19	0

Source: Company data, I-Sec Research

Table 4: Key ratios

(Year ending March 31)

	FY09	FY10E	FY11E	FY12E
Per Share Data (Rs)				
EPS(Basic Recurring)	27.3	28.6	59.4	60.6
Diluted Recurring EPS	24.2	28.6	59.4	60.6
Recurring Cash EPS	24.8	29.5	60.7	61.9
Dividend per share (DPS)	2.0	2.1	2.3	2.3
Book Value per share (BV)	53.0	113.2	169.9	227.8
Growth Ratios (%)				
Operating Income	30.8	15.7	74.1	5.6
EBITDA	19.1	12.9	118.2	(0.0)
Recurring Net Income	42.4	18.3	107.9	2.0
Diluted Recurring EPS	42.4	18.3	107.9	2.0
Diluted Recurring CEPS	41.2	19.1	105.9	2.0
Valuation Ratios (x)				
P/E	19.8	16.4	6.5	5.6
P/CEPS	20.6	18.3	8.5	8.8
P/BV	8.6	4.0	2.7	2.0
EV / EBITDA	13.9	11.2	4.5	3.7
EV / Operating Income	7.6	6.0	3.0	2.4
EV / Operating FCF	17.6	17.3	7.1	5.5
Operating Ratio (%)				
Raw Material/Sales	5.2	4.5	2.1	2.4
SG&A/Sales	24.5	21.9	16.0	17.5
Other Income / PBT	7.8	12.0	8.8	12.0
Effective Tax Rate	26.4	23.1	25.0	26.0
NWC / Total Assets	22.5	13.0	12.2	9.6
Inventory Turnover (days)	161.8	144.3	166.1	214.3
Receivables (days)	26.9	23.3	24.0	31.4
Payables (days)	155.6	173.1	163.1	158.2
D/E Ratio (x)	0.0	0.0	0.0	0.0
Return/Profitability Ratio (%)				
Recurring Net Income Margins	41.5	41.5	49.9	47.2
RoCE	73.3	45.0	56.3	41.4
RoNW	74.4	39.8	52.0	38.9
Dividend Payout Ratio	7.3	7.3	3.9	3.8
Dividend Yield	0.4	0.5	0.5	0.5
EBITDA Margins	54.6	53.2	66.7	63.2

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)

BUY: +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

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