



Sesa Goa

STOCK INFO. BLOOMBERG
BSE Sensex: 14,565 SESA IN
REUTERS CODE
S&P CNX: 4,360 SESA.BO

29 August 2008

Sell

Rs158

Previous Recommendation: Buy

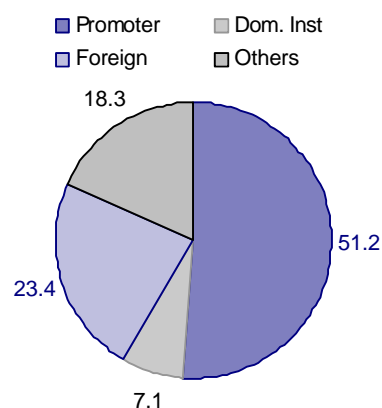
Equity Shares (m) 787.2
52-Week Range 220/90
1,6,12 Rel. Perf. (%) -8/20/67
M.Cap. (Rs b) 124.6
M.Cap. (US\$ b) 3.0

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	20,496	6,418	8.2	12.3	19.4	7.7	39.9	54.5	5.7	12.1
3/08A	35,797	15,416	19.6	140.2	8.1	4.2	52.4	74.2	2.9	4.6
3/09E	63,625	20,812	26.4	35.0	6.0	2.7	45.0	61.1	1.5	3.3
3/10E	64,527	18,390	23.4	-11.6	6.8	2.1	30.3	39.1	1.3	3.4

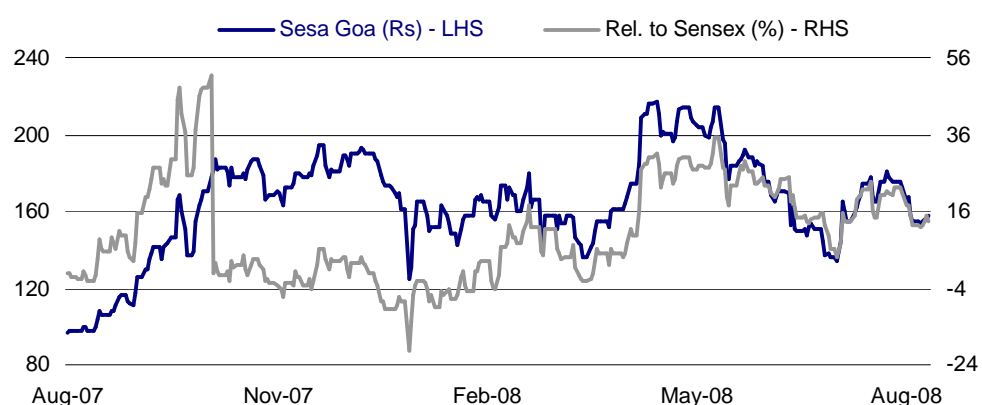
Consolidated

- Rising iron ore supplies:** Iron ore production growth of top 3 merchant miners has accelerated by 10% in 1HCY08 (14% for BHP, 14.5% for Rio, 6.7% for Vale), and 26% for China. New Australian miner FMG will add significantly to supplies.
- Moderating consumption:** Chinese pig iron production, the sole driver of iron ore demand, has moderated to 8.8% in 1HCY08 (v/s 15% in 1HCY07) due to closing of inefficient blast furnaces, shortage of coking coal, and rising raw material prices. This has resulted in softening of demand and piling up of inventories on Chinese ports.
- Fall in demand for low grade Indian ore:** Rising supplies from Australia and Brazil and high coke prices have weakened the Chinese demand for low grade Indian iron ore because it has high alumina and other impurities, which need more met coke for reduction in blast furnace. Falling sea freights have reduced the freight differential from Brazil and India to China, thereby further weakening the demand for low grade Indian ore.
- Spot prices down 30% in six months:** Spot prices for 63% Fe Indian iron ore have fallen from peak of US\$205/ton cfr in January 2008 to US\$145/ton cfr in July 2008, which are likely to weaken further post monsoon when supplies from west coast of India resume.
- Iron ore prices to weaken further; downgrade Sesa to Sell:** We cut our FY09E EPS by 6% to Rs26.4 and FY10E EPS by 24% to Rs23.4 factoring in weaker iron ore prices. The earnings are now expected to decline 12% (earlier a growth of 9.3%) in FY10, which will result in derating of the stock. We arrive at 1-year price target of Rs117 (26% downside) based on 5x FY10E earnings and downgrade the stock to **Sell**.

SHAREHOLDING PATTERN JUNE 2008 -%



STOCK PERFORMANCE (1 YEAR)



Rising iron ore supplies; consumption declining

Iron ore production by top 3 merchant miners has increased significantly. BHP and Rio have increased production by 14% and 14.5% respectively in 1HCY08, while Vale's production has increased 10-11% in 1QCY08. Production disruptions in 2QCY08 due to heavy rains dragged the 1HCY08 growth to 6.7% for Vale, which is likely to pick up in 2HCY08. China's production of iron ore too has grown sharply by 26% in 1HCY08.

IRON ORE: RISING PRODUCTION; MODERATING CONSUMPTION

COMPANY	CY05	CY06	CY07	1HCY08	REMARKS
Iron ore production - robust growth					
China (m tons)	397	574	698	391	
YoY (%)	36.9	44.7	21.7	25.8	Growth rebounds
Vale (m tons)	255	276	300	153	
YoY (%)	10.5	8.2	8.7	6.7	1Q growth (10.8%)
Rio (m tons)	148	152	179	91	
YoY (%)	15.5	2.6	17.4	14.5	High growth
BHP (m tons)	114	114	125	58	
YoY (%)	15.0	0.0	9.1	14.0	Growth pick up
Pig iron production - growth is moderating					
World (m tons)	779	867	940	488	
YoY (%)	9.5	11.4	8.4	5.8	
China (m tons)	327	405	466	245	
YoY (%)	28.4	23.9	15.0	8.8	Sharp decline
RoW (m tons)	451	462	474	243	
YoY (%)	-1.0	2.3	2.5	3.0	

Source: Motilal Oswal Securities

In addition, new miner FMG will increase the production from nil in CY07 to 22m tons in CY08 and 55m tons in 2009. It is already producing 2m tons per month. Other junior miners like MMX, Mineracao, and CSN will also add significant production in 2HCY08 and CY09.

Pig iron production continues to moderate due to shortage of coking coal. In 1HCY08, global production of pig iron increased only 5.8% YoY to 488m tons, whereas Chinese production grew 8.8%. **If Chinese pig iron production - the main driver of iron ore seaborne trade - continues to moderate and iron ore supply grows at twice the pace, we expect iron ore price to correct significantly.**

IRON ORE SUPPLY TO INCREASE SIGNIFICANTLY

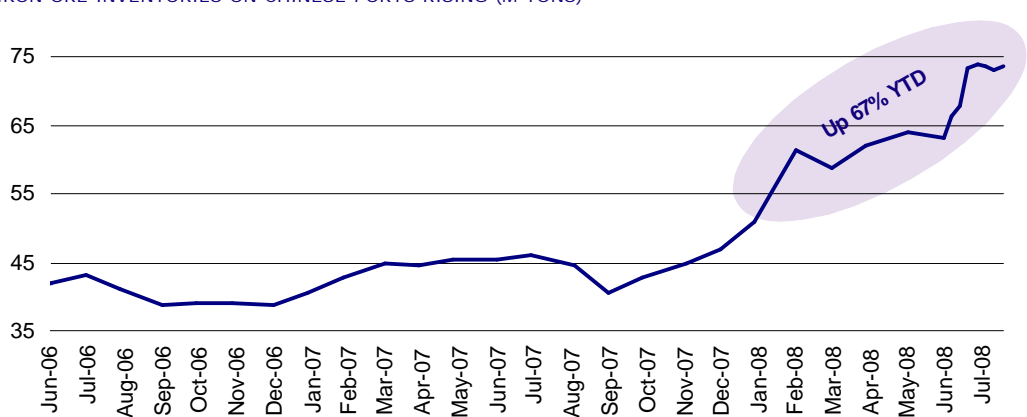
	2004	2005	2006	2007	2008	2009E	2010E
Existing players							
Vale	231	255	276	300	325	355	390
Rio Tinto	128	148	152	179	217	220	231
BHP-Billiton	99	114	114	125	145	147	170
India	121	140	165	165	182	200	220
Kumba	30	32	33	34	35	40	45
CSN	14	15	16	21	30	44	55
(A) Total of Existing Players	624	704	756	823	933	1,005	1,110
Change (m tons)	80	81	51	67	110	73	105
Change (%)	15	13	7	9	13	8	10
New Players							
FMG				0	22	55	65
MMX				3	6	11	12
MHAG				1	1	1	10
Mineracao J Mendes				6	10	15	20
Ferrous Resources				0	3	14	24
(B) Total of New Players				10	42	96	131
Change (m tons)				10	32	54	35
Total (A+B)	624	704	756	832	975	1,101	1,241
Change (m tons)	80	81	51	77	142	126	140
Change (%)	15	13	7	10	17	13	13

Source: Motilal Oswal Securities

Inventories on Chinese ports have piled up

Moderating pig iron production growth, restriction on movement of material around Beijing during Olympics, and rise in import shipments have resulted in piling up of inventories on Chinese ports.

IRON ORE INVENTORIES ON CHINESE PORTS RISING (M TONS)



Source: Bloomberg

Demand for Indian low grade ore waning...

We spoke to iron ore miners in Goa to assess the business sentiment. We understand that the demand for low grade ore is waning. Chinese buyers now prefer high grade ore due to improved supply from Australia and Brazil. Low grade ore consumes more coke in blast furnace. Additionally, Indian iron ore has impurities of high alumina, which need longer processing, thereby higher consumption of coke.

In India, the supply from western coast falls during monsoons. Hence, miners are expecting spot prices to pick up in September when demand from China picks up (as their production declines in winter) and supply from Indian ports improves post monsoon. However, we don't see them so confident this year in view of new supplies, especially from FMG. Also, the recently imposed export duty of 15% has reduced the profitability of Indian exporters with continued rhetoric to increase the export duty further.

...due to zooming high grade supplies from Australia

Iron ore shipments from Australia have risen 61% YoY and 46% YoY in June 2008 and July 2008 respectively. FMG shipped 4m tons of iron ore since commencement in May 2008 to July 2008 and plans to ship 22m tons in CY08 and 55m tons in CY09. Shipments from BHP and Rio too are growing. We understand BHP-Billiton has started selling more of iron ore in spot market to benefit from better realization.

CHINA'S IRON ORE IMPORTS: AUSTRALIA GAINING MARKET SHARE

MONTH	TOTAL	FROM INDIA			FROM BRAZIL			FROM AUSTRALIA			FROM SOUTH AFRICA		CHINA PRODUCTION	
	IMPORTS (M TONS)	(M TONS)	YOY (%)	SH. (%)	(M TONS)	YOY (%)	SH. (%)	(M TONS)	YOY (%)	SH. (%)	(M TONS)	YOY (%)	(M TONS)	YOY (%)
31-Jul-08	39.6	6.2	0	16	8.6	-14	22	18.1	46	46	0.8	-35	81.6	20
30-Jun-08	37.8	7.9	17	21	7.9	13	21	15.5	61	41	1.6	116	75.5	25
31-May-08	38.9	10.7	65	27	9.6	40	25	13.4	25	34	1.0	-4	68.2	26
30-Apr-08	42.8	12.6	48	29	8.8	11	21	14.6	17	34	1.8	75	66.1	19
31-Mar-08	35.7	8.8	-10	25	7.8	-14	22	13.1	8	37	1.3	28	53.2	26
29-Feb-08	38.2	8.6	20	22	8.6	51	23	14.8	30	39	1.3	37	48.0	16
31-Jan-08	36.8	8.3	20	23	7.8	2	21	13.7	-9	37	1.3	-9	68.5	12
31-Dec-07	34.2	8.4	21	25	6.9	5	20	13.5	22	40	0.7	-44	64.1	8
30-Nov-07	35.5	5.7	1	16	11.7	60	33	12.2	3	34	1.0	15	59.8	8
31-Oct-07	29.8	4.3	15	15	7.2	29	24	11.3	22	38	1.0	-17	61.5	16
30-Sep-07	33.2	4.7	-5	14	9.6	28	29	13.6	18	41	1.1	79	62.0	15
31-Aug-07	29.3	4.6	-30	16	8.3	7	28	11.3	-17	38	0.9	-41	60.6	21
31-Jul-07	33.6	6.2	-1	19	10.0	82	30	12.4	38	37	1.2	66	67.8	24

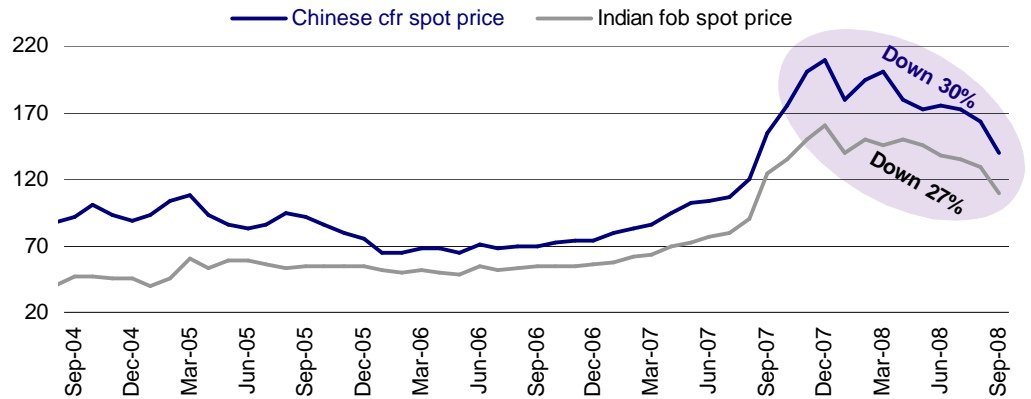
Source: Bloomberg

Spot iron ore prices falling towards long term prices

Spot iron ore prices peaked in January 2008 and since then have trended lower. The magnitude of correction has been modest in comparison to run up in prices in the preceding six months. We understand that spot prices of iron ore of 63% Fe have fallen from peak US\$205/ton cfr in January 2008 to US\$145/ton cfr in July 2008. This has resulted in fall of fob Indian prices for same grade from US\$165/ton to US\$120/ton. We expect further fall in spot prices once shipments increase from west coast of India post monsoon.

Sesa has high exposure to spot prices (65% by volumes)

DECLINE IN IRON ORE SPOT PRICES



Source: Motilal Oswal Securities

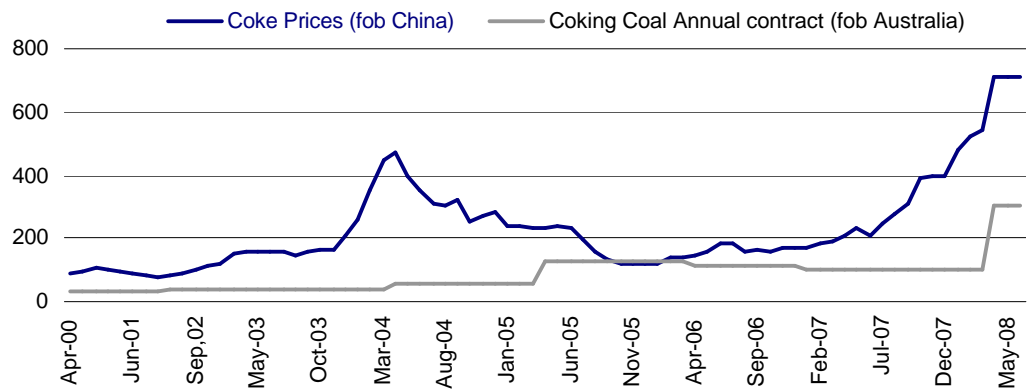
64% of Sesa's iron ore is low grade

Discount for low grade to rise sharply due to high coke prices

Coke prices continue to move up on the back of increase in export duty from 25% to 40% by China on 20 August 2008 and moderating coke production in China. We believe Chinese mills will continue to prefer high grade ore till coke prices remain high, which will further weaken the demand for low grade ore.

Post monsoon, supply of low grade ore will substantially increase from India, while the demand is getting weaker. Hence, we expect discounts for low grade to rise sharply.

COKE AND COAL PRICES (US\$/TON)

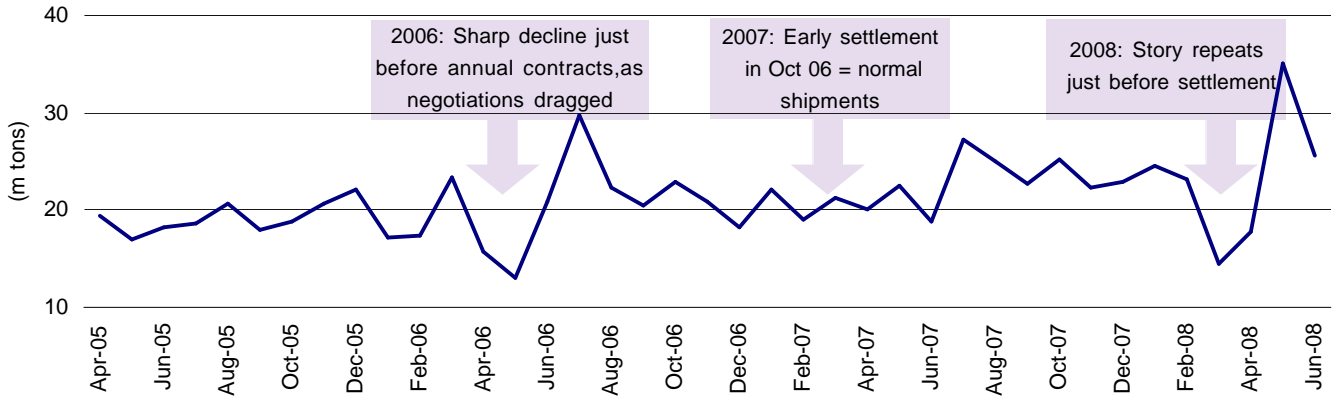


Source: Company/Motilal Oswal Securities

Pricing power of miners to weaken

Vale, Rio, and BHP together account for 80% of seaborne iron ore trade. There have been instances when iron ore miners have resorted to cutting shipments to make buyers agree to price hikes. Iron ore supply has appeared tighter than the actual situation. With the entry of fourth significant iron ore miner (FMG) and weakening demand, we believe iron ore miners will lose pricing power going forward.

IRON ORE EXPORTS FROM BRAZIL

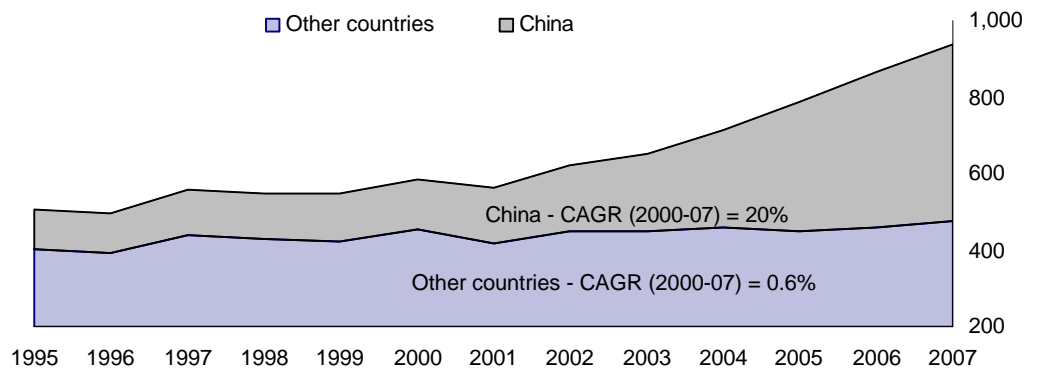


Source: Bloomberg/Motilal Oswal Securities

Chinese pig iron production: Sole driver of iron ore demand

Chinese producers depend on blast furnace route for steel making due to low generation of steel scrap, while availability of coking coal and iron ore is superior from domestic mines. Production of pig iron has grown at CAGR of 20% in China during 2000-07, while the same has been just 0.6% in rest of the world. This has driven China’s imports of iron ore at CAGR of 29% during the same period and has been the sole driver of international iron ore prices.

PIG IRON PRODUCTION IN CHINA AND REST OF THE WORLD

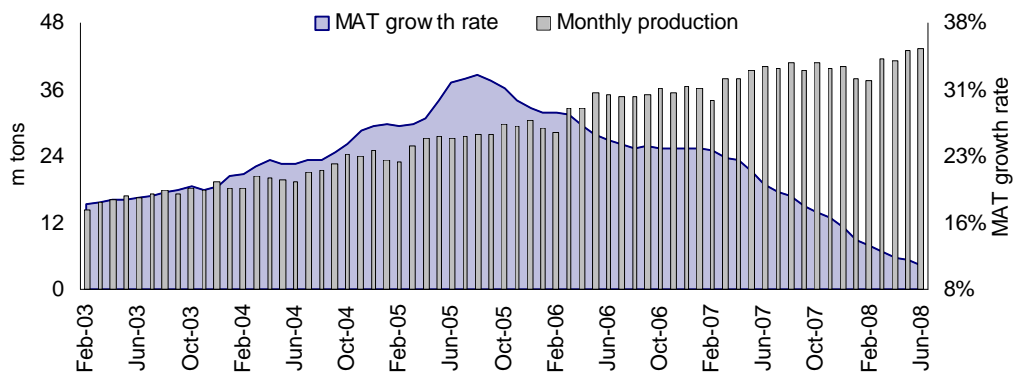


Source: IISI

Moderating Chinese pig iron production...

Pig iron production has been moderating due to shortage of coking coal, high raw material prices, and conscious efforts by Chinese government to close inefficient small furnaces and slow down investments in the steel sector.

CHINESE MONTHLY PIG IRON PRODUCTION



Note: MAT =Moving Annual Total of crude steel production

Source: IISI

...is unlikely to rebound

The shortage of coking coal is expected to continue in China, as coal mines there are focusing on production of thermal coal to meet the rising power deficit (presently, China has power deficit of 16GW). Coking coal supplies are already tight in the international market. China has increased export duty on coking coal from 5% to 10%. Coke production growth has fallen to 7% in July 2008 from 11.2% in January 2008.

CHINESE PRODUCTION OF PIG IRON AND ITS RAW MATERIALS (M TONS)

MONTH	IMPORTS		PRODUCTION							
	IRON ORE (M TONS)	YOY (%)	IRON ORE	YOY (%)	STEEL	YOY (%)	PIG IRON	YOY (%)	COKE	YOY (%)
Jul-08	35.7	0.2	81.6	20.3	44.9	8.8	42.0	5.8	30.1	7.0
Jun-08	38.2	32.9	75.5	24.8	46.9	11.5	43.4	8.4	31.2	8.0
May-08	36.8	2.7	68.2	25.5	46.0	10.5	43.0	8.8	29.9	9.2
Apr-08	34.2	19.4	66.1	18.8	44.7	10.2	41.3	9.0	29.6	11.9
Mar-08	35.5	24.2	53.2	26.1	44.9	11.5	41.5	9.1	29.0	11.5
Feb-08	29.8	35.5	48.0	15.8	38.9	7.0	37.5	10.3	25.7	12.3
Jan-08	33.2	18.1	68.5	12.5	40.6	6.4	38.1	5.7	26.7	11.2
Dec-07	29.3	-10.7	64.1	8.2	41.3	8.5	40.0	9.2	29.6	8.1
Nov-07	33.6	35.9	59.8	7.8	39.7	4.6	39.9	12.3	28.8	12.7
Oct-07	26.9	-6.4	61.5	15.8	42.9	13.9	40.8	13.0	28.5	14.6
Sep-07	27.6	12.4	62.0	15.4	42.7	18.1	39.5	13.0	28.9	19.0
Aug-07	33.4	22.4	60.6	20.5	41.6	13.3	40.8	17.3	28.0	14.4
Jul-07	35.6	20.7	67.8	24.5	41.3	14.3	39.7	14.3	28.1	17.6
Jun-07	28.7	16.3	60.5	31.2	42.1	15.0	40.0	14.2	28.9	20.5
May-07	35.8	34.9	54.3	34.1	41.6	15.8	39.5	11.9	27.4	17.1
Apr-07	28.6	7.0	55.6	22.1	40.6	20.3	37.8	16.6	26.5	21.9
Mar-07	28.6	4.7	42.2	43.2	40.3	22.4	38.1	17.0	26.0	22.5
Feb-07	22.0	-1.4	41.4	64.6	36.3	23.3	34.0	20.1	22.9	25.2
Jan-07	28.1	22.3	60.9	39.9	38.1	26.4	36.0	24.6	24.0	28.5
Dec-06	32.8	42.1	59.3	50.3	38.1	18.9	36.6	20.8	27.4	21.0
Nov-06	24.7	14.6	55.5	45.0	38.0	24.5	35.5	21.7	25.5	25.3
Oct-06	28.7	30.7	53.1	54.6	37.7	19.0	36.2	21.7	24.9	22.5
Sep-06	24.6	12.9	53.7	43.4	36.2	19.1	35.0	24.7	24.3	29.2
Aug-06	27.3	12.4	50.3	52.7	36.7	20.5	34.8	23.8	24.4	31.3
Jul-06	29.5	21.2	54.4	55.0	36.1	23.4	34.7	25.6	23.9	30.0

Pick up in iron ore production

Coke and pig iron production decelerated

Source: Bloomberg

Despite record high coke prices in the international market, the margins of Chinese coke converters are under pressure due to sharper rise in coking coal prices and increase in export duty. Coke ovens in Shanxi are planning to cut coke production to push local coke prices.

Volume growth will be function of spot prices

Weak spot prices may discourage volume growth

Sesa Goa is ramping up iron ore production at a CAGR of 26% to 25m tons by FY11. Despite limited reserves of less than 200m tons, the new promoter has adopted aggressive strategy of ramping up production, which has been motivated by high prices of iron ore in the spot market. The company has consciously moved away from the strategy of selling through long term contracts to spot market. The share of spot sales has increased from 30% before acquisition to 60-65% during FY09, as incremental production is being sold in spot market.

If iron ore prices continue to weaken in the spot market, Sesa may not pursue aggressive production growth, as the company has limited reserves.

Cutting assumptions in our model

We believe spot iron ore prices will merge with contract prices during FY09. Therefore, we are changing our assumption of iron ore price realization on spot sales from US\$95/ton to US\$80/ton, which is in line with 85% price hike for FY09 (though Sesa has yet to settle its annual contract). We are also changing our assumption of US\$/INR exchange rate from Rs40 to Rs43. However, we stick to our assumption of 25% volume growth in FY09.

In FY10, we expect iron ore prices on contracts to roll over and spot prices to soften further by US\$10/ton. Also, we are revising our volume growth assumption downwards to 10% from 25%.

CHANGE IN ASSUMPTIONS

	FY09		FY10	
	OLD	NEW	OLD	NEW
Iron ore production (m tons)	15.5	15.5	19.4	17.0
Prices of iron ore				
Spot(US\$/ton)	95	80	90	70
Contract (US\$/ton)	81	81	85	81
Currency (US\$/INR)	40	43	40	43

Source: Motilal Oswal Securities

FY10E EPS cut by 24%; downgrade to Sell

We cut our FY09E EPS by 6% to Rs26.4 and FY10E EPS by 24% to Rs23.4 factoring in weaker iron ore prices. The earnings are now expected to decline 12% (earlier a growth of 9.3%) during FY10, which will result in derating of the stock. We arrive at 1-year price target of Rs117 (26% downside) based on 5x FY10E earnings and downgrade the stock to **Sell**.

FY10 ESTIMATES: REVISION (RS M)

	OLD	NEW	REVISION (%)
Sales	79,186	64,527	-18.5
EBITDA	33,245	24,656	-25.8
PAT	24,145	18,390	-23.8
EPS (Rs)	30.7	23.4	-23.8

FY10 ESTIMATES: COMPARISON WITH CONSENSUS (RS M)

	MOSL	CONSENSUS	VARIATION (%)
Sales	64,527	72,849	-12.9
EBITDA	24,656	34,631	-40.5
PAT	18,390	25,135	-36.7
EPS (Rs)	23.4	32.3	-38.0

Source: Motilal Oswal Securities/Bloomberg

INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2006	2007	2008	2009E	2010E	
Net sales	18,443	20,496	35,797	63,625	64,527	
Change (%)	20.2	11.1	74.6	77.7	14	
Total Expenses	9,775	10,868	12,764	34,236	39,872	
EBITDA	8,668	9,629	23,033	29,390	24,656	
% of Net Sales	47.0	47.0	64.3	46.2	38.2	
Depn. & Amortization	296	393	500	522	546	
EBIT	8,373	9,236	22,533	28,867	24,110	
Net Interest	42	30	28	21	21	
Other income	251	407	744	2,342	3,478	
PBT before EO	8,582	9,614	23,250	31,188	27,567	
EO income						
PBT after EO	8,582	9,614	23,250	31,188	27,567	
Tax	2,833	3,147	7,760	10,332	9,146	
Rate (%)	33.0	32.7	33.4	33.1	33.2	
Reported PAT	5,748	6,467	15,490	20,856	18,421	
Preference dividend						
Adjusted PAT	5,712	6,418	15,416	20,812	18,390	
Change (%)	20.7	2.3	140.2	35.0	-11.6	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2006	2007	2008	2009E	2010E	
Share Capital	394	394	394	787	787	
Reserves	11,081	15,697	29,041	45,489	59,871	
Net Worth	11,475	16,091	29,435	46,276	60,658	
Minority Interest	144	193	266	311	342	
Total Loans	98					
Deferred Tax Liability	604	649	664	664	664	
Capital Employed	12,321	16,933	30,365	47,251	61,664	
Gross Block	5,807	7,219	7,696	9,295	10,895	
Less: Accum. Deprn.	2,350	2,622	2,936	3,464	4,010	
Net Fixed Assets	3,457	4,597	4,760	5,831	6,885	
Capital WIP	615	202	215	215	215	
Investments	0	195	925	925	925	
Curr. Assets	11,243	14,555	28,228	46,282	59,691	
Inventory	3,321	2,985	3,118	8,858	8,982	
Account Receivables	2,474	2,708	4,725	8,133	8,245	
Cash and Bank Balance	5,115	8,471	19,796	28,701	41,875	
Others	333	391	590	590	590	
Curr. Liability & Prov.	2,994	2,617	3,763	6,002	6,051	
Account Payables	1,398	1,114	1,688	3,945	3,995	
Provisions & Others	1,596	1,503	2,076	2,057	2,057	
Net Current Assets	8,249	11,938	24,465	40,280	53,640	
Appl. of Funds	12,321	16,933	30,365	47,251	61,664	

E: MOST Estimates

RATIOS						
Y/E MARCH	2006	2007	2008	2009E	2010E	
Basic (Rs)						
EPS	7.3	8.2	19.6	26.4	23.4	
Cash EPS	7.7	8.7	20.3	27.2	24.1	
BV/Share	14.6	20.4	37.4	58.8	77.1	
DPS	2.0	2.0	2.3	4.5	4.5	
Payout (%)	314	28.4	13.4	19.9	22.5	
Valuation (x)						
P/E		19.4	8.1	6.0	6.8	
Cash P/E		18.2	7.8	5.8	6.6	
P/BV		7.7	4.2	2.7	2.1	
EV/Sales		5.7	2.9	15	13	
EV/EBITDA		12.1	4.6	3.3	3.4	
Dividend Yield (%)		13	14	2.8	2.8	
EV/ton		10,684	8,459	6,192	4,856	
Return Ratios (%)						
EBITDA Margins (%)	47.0	47.0	64.3	46.2	38.2	
Net Profit Margins (%)	31.0	31.3	43.1	32.7	28.5	
RoE	49.8	39.9	52.4	45.0	30.3	
RoCE	68.0	54.5	74.2	61.1	39.1	
RoIC	85.1	77.0	159.2	110.9	86.4	

Working Capital Ratios						
Fixed Asset Turnover (x)	3.2	2.8	4.7	6.8	5.9	
Asset Turnover (x)	15	12	12	13	10	
Debtor (Days)	49.0	48.2	48.2	46.7	46.6	
Inventory (Days)	18.0	14.6	8.7	13.9	13.9	
Leverage Ratio (x)						
Current Ratio	3.8	5.6	7.5	7.7	9.9	

CASHFLOW STATEMENT		(RS MILLION)				
Y/E MARCH	2006	2007	2008	2009E	2010E	
Pre-tax profit	8,582	9,614	23,250	31,188	27,567	
Depreciation	296	393	500	522	546	
(Inc)/Dec in Wkg. Cap.	-1,266	-334	-1,202	-6,910	-185	
Tax paid	-2,829	-3,091	-7,745	-10,188	-9,009	
Other operating activities	-113	-157	-569	-452	-31	
CF from Op. Activity	4,669	6,424	14,233	14,211	18,887	
(Inc)/Dec in FA + CWIP	-872	-999	-490	-1,599	-1,600	
(Pur)/Sale of Investments	0	-195	-730			
CF from Inv. Activity	-872	-1,194	-1,219	-1,599	-1,600	
Chg in minorities	30	48	74	45	32	
Debt raised/(repaid)	-134	-98				
Dividend (incl. tax)	-1,795	-1,825	-2,072	-4,145	-4,145	
CF from Fin. Activity	-1,899	-1,874	-1,999	-3,706	-4,113	
(Inc)/Dec in Cash	1,898	3,356	11,015	8,906	13,174	
Add: Opening Balance	3,217	5,115	8,471	19,796	28,701	
Closing Balance	5,115	8,471	19,796	28,701	41,875	

N O T E S



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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Disclosure of Interest Statement

Sesa Goa

1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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