

**SESA GOA LTD.**

SELL  
CMP Rs 347  
TP Rs 267

21 Oct 2009

Pawan Burde +91-22-6618 6381  
pawan.burde@pinc.co.in

Faisal Memon +91-22-6618 6389  
faisalm@pinc.co.in

**Sesa Goa's Q2FY10 results were disappointing and came below our estimates on both topline and bottmline due to lower than expected volumes and realisations for iron ore, met coke and pig iron as well as higher than expected coal costs. Change in the royalty structure on Iron ore from fixed rate per tonne to 10% ad valorem has also dragged down the margins.**

**Lower Iron ore prices impact topline:** For Q2FY10, Sesa Goa posted 39% YoY de-growth in consolidated top-line to Rs5,341mn (Rs8,692mn), which came in below our estimates of Rs5,645mn. Topline de-grew mainly on account of a sharp decline in the prices of Iron ore, Met coke and Pig iron on a YoY basis. Notably, realisations fell by 47.8% and 41% YoY for Iron ore and Pig iron, respectively. However, iron ore sales volume growth of 15.6% at 1.62mn tonnes (1.4mn tonnes) supported topline. Iron ore realisation however has moved up 36% on a sequential basis due to recovery in the spot iron ore prices.

**OPM contracts on higher royalty costs:** Sesa Goa reported a sharp 1,990bp decline in EBITDA Margin to 27.7% (47.6%), which was below our estimates. The margins crashed mainly on account of steep fall in the spot iron ore, met coke and pig iron prices. Also increase in the cost due to higher royalty charges and high cost coal inventory dragged down the margins. Notably the royalty rates on iron ore has been changed from fixed per tonne to ad-valorem 10% during the quarter, which has increased the cost to the tune of Rs250mn during the quarter.

**Net Profit almost halved:** The fall in revenues and sharp decline in margins, resulted in the company reporting almost 50% YoY decline in net profit to Rs1,665mn (Rs3,360mn), which came below our estimate of Rs2,019mn for the quarter. Higher than expected interest and depreciation costs also affected the bottomline.

**VALUATIONS AND RECOMMENDATION**

*At the CMP of Rs347, the stock is trading at an EV/EBITDA of 10.6x and 7.6x and a P/E of 14.6x and 11.7x on FY10 and FY11 estimates, which we believe is expensive. Though we upgrade our net profit estimates by 6.3% and 11.4% in FY10 and FY11 respectively, on account of recent run up of almost 64% in the last 3 months due to acquisitions buzz, we downgrade the stock from HOLD to 'SELL', with a target price of Rs267.*

**KEY FINANCIALS (CONSOLIDATED)** Rs mn

	FY07	FY08	FY09	FY10E	FY11E
Net Sales	22,179	38,227	49,591	56,190	73,267
YoY Gr. (%)	20.2	72.4	29.7	13.3	30.4
Op. Profit	9,628	23,032	25,388	23,696	31,199
OPM (%)	43.4	60.3	51.2	42.2	42.6
Adj. Net Profit	6,461	15,416	19,881	19,559	24,288
YoY Gr. (%)	13.1	138.6	29.0	(1.6)	24.2

**KEY RATIOS**

Dil. EPS (Rs)	8.2	19.6	25.3	23.8	29.6
ROCE (%)	59.5	78.3	57.4	28.1	29.6
RoE (%)	44.2	48.1	46.1	33.6	26.9
PER (x)	42.3	17.7	13.7	14.6	11.7
EV/ Net Sales (x)	11.9	6.6	4.9	4.5	3.2
EV/EBDITA (x)	27.5	11.0	9.5	10.6	7.6

**QUARTERLY SNAPSHOT** (Rs mn)

	Quarter Ended		
	Mar-09	Jun-09	Sep-09
Net Sales	14,299	9,986	5,341
YoY Gr. (%)	(15.0)	(20.6)	(38.5)
Op Profits	7,399	4,402	1,481
OPM (%)	51.7	44.8	27.7
Net profits	5,476	4,223	1,665
YoY Gr. (%)	(32.5)	(33.3)	(50.5)

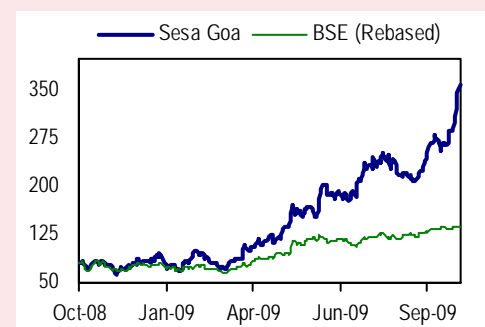
**STOCK DATA**

Market Cap	Rs284.6bn.
Book Value per share	Rs60
Eq Shares O/S (F.V. Rs.1)	820.5mn.
Free Float	42.9%
Avg Traded Value (6 mnths)	Rs2,555mn
52 week High/Low	Rs363/60
Bloomberg Code	SESA IN
Reuters Code	SESA.BO

**PERFORMANCE (%)**

	1M	3M	12M
Absolute	32.7	63.9	349.0
Relative	29.0	46.4	275.3

**RELATIVE PERFORMANCE**



### We upgrade our estimates on recovery in prices

Despite the disappointing quarter, we upgrade our earnings estimates by 6.3% and 11.4% for FY10 and FY11, due to recovery in the spot iron ore prices in the last couple of months. We also upgrade our realisation assumptions for both met coke and pig iron due to recovery in the prices on account of improved industry outlook.

#### Exhibit 1: Change in estimates

Rs mn.	FY10E			FY11E		
	Earlier	Current	% Change	Earlier	Current	% Change
Net Sales	55,911	56,190	0.5	67,863	73,267	8.0
Op profit	23,430	23,696	1.1	27,980	31,199	11.5
Net Profit	18,401	19,559	6.3	21,804	24,288	11.4

Source: PINC Research

#### Exhibit 2: Change in Assumptions

	FY10E			FY11E		
	Earlier	Current	% Change	Earlier	Current	% Change
<b>Iron ore</b>						
Iron ore Volumes (mn tonnes)	18.12	18.43	1.7	21.75	22.48	3.4
Realisaiton (Rs/tonne)	2,219	2,391	7.8	2,334	2,536	8.6
<b>Met Coke</b>						
Met Coke Volumes (mn tonnes)	0.23	0.23	0.8	0.23	0.23	0.8
Realisaiton (Rs/tonne)	13,338	16,975	27.3	13,200	19,200	45.5
<b>Pig Iron</b>						
Pig Iron Volumes (mn tonnes)	0.23	0.24	3.3	0.23	0.24	3.3
Realisaiton (Rs/tonne)	19,400	19,400	0.0	18,000	20,400	13.3

Source: PINC Research

**Exhibit 3: Q2FY10 snapshot**

Rs mn	Sep-09	Sep-08	YoY (%)	Jun-09	QoQ (%)	H1FY10	H1FY09	YoY (%)
<b>Net Sales</b>	<b>5,341</b>	<b>8,692</b>	<b>(38.5)</b>	<b>9,986</b>	<b>(46.5)</b>	<b>15,327</b>	<b>21,266</b>	<b>38.7</b>
Net Raw Material	(685.6)	(445.3)	-	994.1	(169.0)	309	(851)	(375.9)
(% of Net Sales)	(12.8)	(5.1)		10.0		2.0	(4.0)	
Employee Costs	333.7	215.6	54.8	394.8	(15.5)	728.5	501.4	(31.2)
(% of Net Sales)	6.2	2.5		4.0		4.8	2.4	
Freight Cost	2,306	2,804	(17.8)	2,920	(21.0)	5,226	5,704	9.1
(% of Net Sales)	43.2	32.3		29.2		34.1	26.8	
Export Duty	46.6	736.4	(93.7)	39.3	18.6	85.9	1,296.1	1,408.8
(% of Net Sales)	0.9	8.5		0.4		0.6	6.1	
Other expenses	1,859	1,241	49.9	1,236	50.5	3,095	2,651	(14.3)
(% of Net Sales)	34.8	14.3		12.4		20.2	12.5	
<b>Total Expenditure</b>	<b>3,860</b>	<b>4,552</b>	<b>(15.2)</b>	<b>5,584</b>	<b>(30.9)</b>	<b>9,444</b>	<b>9,302</b>	<b>(1.5)</b>
<b>Operating Profits</b>	<b>1,481</b>	<b>4,140</b>	<b>(64.2)</b>	<b>4,402</b>	<b>(66.4)</b>	<b>5,883</b>	<b>11,964</b>	<b>103.4</b>
EBITDA Margins (%)	27.7	47.6		44.1		38.4	56.3	
Interest	19.8	0.1	-	20.3	(2.5)	40.1	0.5	-
Depreciation	202.3	116.6	73.5	151.8	33.3	354.1	232.6	(34.3)
Other Income	938.9	512.8	83.1	880.6	6.6	1,820	1,350	(25.8)
<b>Profit before Tax</b>	<b>2,198</b>	<b>4,536</b>	<b>(51.5)</b>	<b>5,110</b>	<b>(57.0)</b>	<b>7,308</b>	<b>13,081</b>	<b>79.0</b>
(% of Net Sales)	41.1	52.2		51.2		47.7	61.5	
Total Tax	503.4	1,145	(56.0)	869.4	(42.1)	1,373	3,330	142.5
(% of PBT)	22.9	25.2		17.0		18.8	25.5	
<b>Profit after Tax</b>	<b>1,694</b>	<b>3,391</b>	<b>(50.0)</b>	<b>4,241</b>	<b>(60.0)</b>	<b>5,935</b>	<b>9,752</b>	<b>64.3</b>
Minority Interest	29.8	31.8	(6.3)	18.1	64.6	47.9	61.5	28.4
PAT after MI	1,665	3,360	(50.5)	4,223	(60.6)	5,888	9,690	64.6
(% of Net Sales)	31.7	39.0		42.5		38.7	45.9	
<b>FDEPS</b>	<b>2.0</b>	<b>4.3</b>	<b>(52.5)</b>	<b>5.4</b>	<b>(62.1)</b>	<b>7.4</b>	<b>12.3</b>	<b>66.6</b>

Source: Company

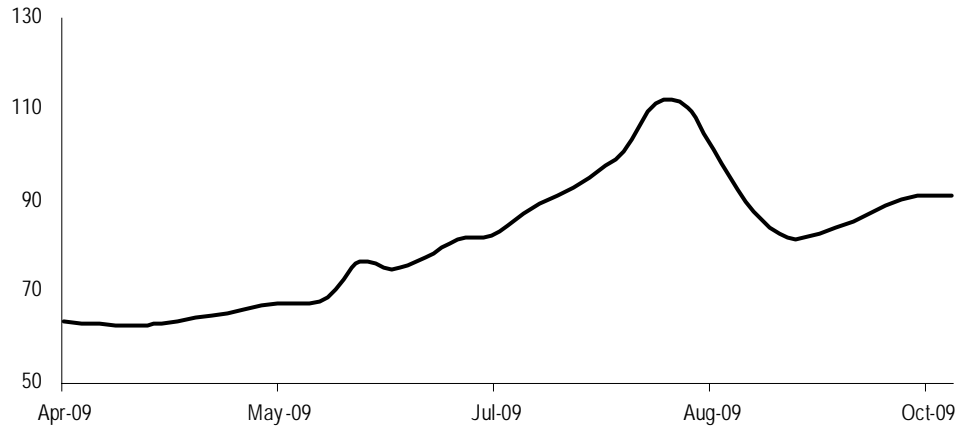
**Exhibit 4: Q2FY10 Segmental performance**

	Q1FY09	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10
<b>Iron ore</b>						
Production (mn tonnes)	4.5	2.5	3.9	4.9	4.7	3.3
Sales volume (mn tonnes)	3.3	1.4	5.4	5.0	4.7	1.6
Revenues (Rs mn)	11,170	6,601	12,484	12,825	8,557	3,986
Realisation (Rs/tonne)	3,437	4,715	2,312	2,552	1,807	2,462
<b>Met Coke</b>						
Production (tonnes)	62,500	66,000	52,800	59,500	65,000	59,000
Sales volume (tonnes)	63,000	61,000	41,000	51,000	71,000	61,000
Revenues (Rs mn)	1,353	1,730	932	711	1,008	758
Realisation (Rs/tonne)	21,479	28,352	22,741	13,941	14,192	12,421
<b>Pig Iron</b>						
Production (tonnes)	50,000	72,000	46,000	57,000	50,000	72,000
Sales volume (tonnes)	56,500	60,500	36,000	71,000	71,000	67,000
Revenues (Rs mn)	1,632	1,952	919	1,330	1,326	1,285
Realisation (Rs/tonne)	28,878	32,263	25,539	18,738	18,675	19,179

Source: Company, PINC Research

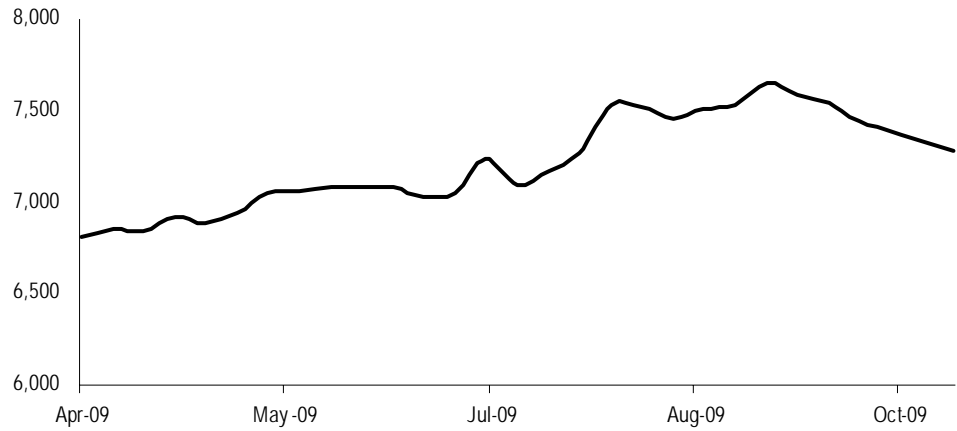
pawan.burde@pinc.co.in

**Exhibit 5: China CFR Iron ore Prices (USD/tonne)**



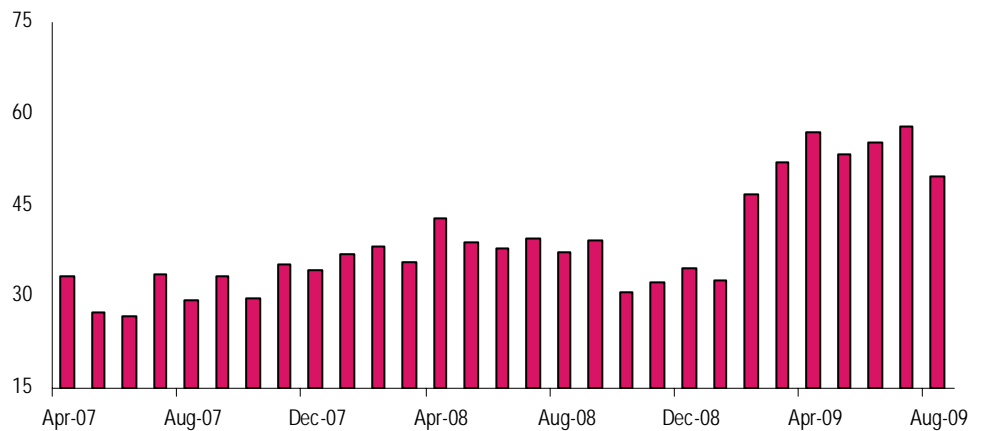
Source: Bloomberg, PINC Research

**Exhibit 6: China weekly iron ore inventory (000' tonnes)**



Source: Bloomberg, PINC Research

**Exhibit 7: Chinese Iron ore import (mn tonnes)**



Source: Bloomberg, PINC Research

Year Ended March (Figures in Rs mn)

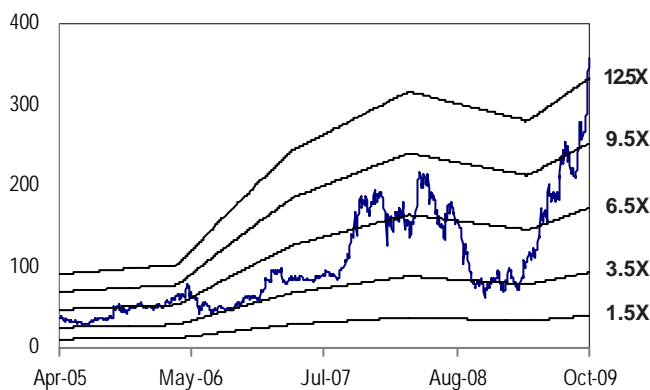
Income Statement	FY07	FY08	FY09	FY10E	FY11E
Net sales	22,179	38,227	49,591	56,190	73,267
Growth (%)	20.2	72.4	29.7	13.3	30.4
Operating Profit	9,628	23,032	25,388	23,696	31,199
Other operating income	-	-	-	-	-
<b>EBITDA</b>	<b>9,628</b>	<b>23,032</b>	<b>25,388</b>	<b>23,696</b>	<b>31,199</b>
Growth (%)	11.6	139.2	10.2	(6.7)	31.7
Depreciation	393	500	517	1,043	1,118
Other Income	451	744	2,240	3,149	3,593
<b>EBIT</b>	<b>9,687</b>	<b>23,277</b>	<b>27,112</b>	<b>25,802</b>	<b>33,674</b>
Interest Paid	30	28	10	640	1,200
<b>PBT (before E/o items)</b>	<b>9,657</b>	<b>23,249</b>	<b>27,102</b>	<b>25,162</b>	<b>32,474</b>
Tax Provision	3,147	7,760	7,153	5,536	8,118
E/o loss/(income)	-	-	-	-	-
<b>Net Profit</b>	<b>6,461</b>	<b>15,416</b>	<b>19,881</b>	<b>19,559</b>	<b>24,288</b>
<b>Adjusted Net Profit</b>	<b>6,461</b>	<b>15,416</b>	<b>19,881</b>	<b>19,559</b>	<b>24,288</b>
Growth (%)	13.1	138.6	29.0	(1.6)	24.2
<b>Diluted EPS (Rs)</b>	<b>8.2</b>	<b>19.6</b>	<b>25.3</b>	<b>23.8</b>	<b>29.6</b>
Diluted EPS Growth (%)	13.1	138.6	29.0	(5.6)	24.2

Cash Flow Statement	FY07	FY08	FY09	FY10E	FY11E
Pre-tax profit	9,657	23,249	27,102	25,162	32,474
Depreciation	393	500	517	1,043	1,118
Total Tax Paid	(3,147)	(7,760)	(7,153)	(5,536)	(8,118)
Chg in working capital	(334)	(1,202)	(6,146)	(2,333)	(1,877)
Other operating activities	-	(13)	(297)	-	-
<b>Cash flow from oper (a)</b>	<b>6,569</b>	<b>14,774</b>	<b>14,023</b>	<b>18,337</b>	<b>23,597</b>
Capital Expenditure	(999)	(490)	(1,442)	(19,500)	(8,000)
Chg in investments	(3,712)	(12,056)	(10,742)	-	-
Other investing activities	-	-	-	-	-
<b>Cash flow from inv.(b)</b>	<b>(4,711)</b>	<b>(12,546)</b>	<b>(12,184)</b>	<b>(19,500)</b>	<b>(8,000)</b>
Free cash flow (a+b)	1,858	2,229	1,840	(1,163)	15,597
Equity raised/(repaid)	-	(0)	219	5,372	-
Debt raised/(repaid)	(98)	-	19	23,981	-
Change in minority interest					
Dividend (incl. Tax)	(1,825)	(2,072)	(2,072)	(2,208)	(2,208)
Other financing activities	(96)	(158)	(38)	439	67
<b>Cash flow from fin (c)</b>	<b>(2,019)</b>	<b>(2,230)</b>	<b>(1,873)</b>	<b>27,584</b>	<b>(2,141)</b>
<b>Net chg in cash (a+b+c)</b>	<b>(161)</b>	<b>(2)</b>	<b>(33)</b>	<b>26,421</b>	<b>13,456</b>

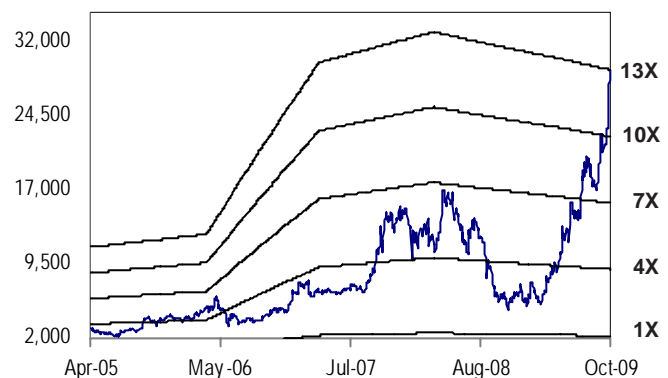
Balance Sheet	FY07	FY08	FY09	FY10E	FY11E
Equity Share Capital	394	394	787	820	820
Reserves & surplus	15,697	29,041	46,370	69,499	91,647
<b>Shareholders' funds</b>	<b>16,091</b>	<b>29,435</b>	<b>47,157</b>	<b>70,320</b>	<b>92,467</b>
Minorities interests	193	266	334	401	469
Total Debt	-	-	19	24,000	24,000
<b>Capital Employed</b>	<b>16,284</b>	<b>29,701</b>	<b>47,510</b>	<b>94,721</b>	<b>116,936</b>
Net fixed assets	4,799	4,975	5,930	24,387	31,269
Cash & Cash Eq.	212	210	177	26,598	40,055
Net Other current assets	3,468	4,670	10,815	13,148	15,025
Investments	8,454	20,510	31,252	31,252	31,252
Net Deferred tax Assets	(649)	(664)	(664)	(664)	(664)
<b>Total Assets</b>	<b>16,284</b>	<b>29,701</b>	<b>47,510</b>	<b>94,721</b>	<b>116,936</b>

Key Ratios	FY07	FY08	FY09	FY10E	FY11E
OPM (%)	43.4	60.3	51.2	42.2	42.6
Net Margin (%)	29.1	40.3	40.1	34.8	33.1
Yield (%)	0.7	0.8	0.8	0.8	0.8
Net debt/Equity (x)	(0.5)	(0.7)	(0.7)	(0.5)	(0.5)
Working Capital Days	100	81	16	30	35
RoCE (%)	59.5	78.3	57.4	28.1	29.6
RoE (%)	44.2	48.1	46.1	33.6	26.9
EV/Net Sales (x)	11.9	6.6	4.9	4.5	3.2
EV/EBITDA (x)	27.5	11.0	9.5	10.6	7.6
PER (x)	42.3	17.7	13.7	14.6	11.7
PCE (x)	39.8	17.2	13.4	13.8	11.2
Price/BV (x)	17.0	9.3	5.8	4.0	3.1

P/E Band



EV/EBITDA



**T E A M****EQUITY DESK**

Gealgeo V. Alankara	Head - Institutional Sales	<i>alankara@pinc.co.in</i>	91-22-6618 6466
Sailav Kaji	Head Derivatives & Strategist	<i>sailavk@pinc.co.in</i>	91-22-6618 6344

**TECHNICAL ANALYST**

Sadanand Raje		<i>sadanand.raje@pinc.co.in</i>	91-22-6618 6366
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**SALES**

Anil Chaurasia		<i>anil.chaurasia@pinc.co.in</i>	91-22-6618 6483
Alok Doshi		<i>adoshi@pinc.co.in</i>	91-22-6618 6484
Sundeep Bhat		<i>sundeepb@pinc.co.in</i>	91-22-6618 6486
Gagan Borana		<i>gagan.borana@pinc.co.in</i>	91-22-6618 6485

**DEALING**

Amar Margaje		<i>amar.margaje@pinc.co.in</i>	91-22-6618 6327
Ashok Savla		<i>ashok.savla@pinc.co.in</i>	91-22-6618 6400
Raju Bhavsar		<i>rajub@pinc.co.in</i>	91-22-6618 6301
Manoj Parmar		<i>manojp@pinc.co.in</i>	91-22-6618 6326
Hasmukh D. Prajapati		<i>hasmukhp@pinc.co.in</i>	91-22-6618 6325
Pratiksha Shah		<i>pratikshas@pinc.co.in</i>	91-22-6618 6329

**DIRECTORS**

Gaurang Gandhi		<i>gaurangg@pinc.co.in</i>	91-22-6618 6400
Hemang Gandhi		<i>hemangg@pinc.co.in</i>	91-22-6618 6400
Ketan Gandhi		<i>ketang@pinc.co.in</i>	91-22-6618 6400

**COMPLIANCE**

Rakesh Bhatia	Head Compliance	<i>rakeshb@pinc.co.in</i>	91-22-6618 6400
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