INITIATING COVERAGE

PRIVATE CLIENT RESEARCH

APRIL 28, 2008

Saurabh Agrawal
agrawal.saurabh@kotak.com
+91 22 6634 1291

Stock details

BSE code	:	500295
NSE code	:	SESAGOA
Market cap (Rs mn)	:	137078
Free float (%)	:	48.8
52-wk Hi/Lo (Rs)	:	3969/ 1630
Avg. daily volume BSE	:	72668
Avg. daily volume NSE	:	226097
Shares o/s (mn)	:	39.36

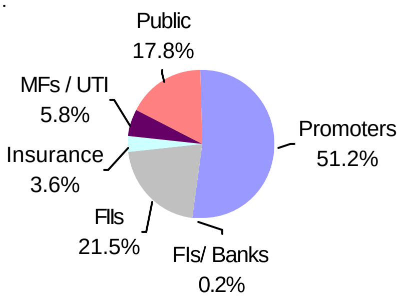
Source: Capitaline, Company

Summary table

(Rs mn)	FY08E	FY09E	FY10E
Sales	35,890	61,810	77,735
Growth (%)	82.3	72.2	25.8
EBITDA	19,530	30,467	41,021
EBITDA margin (%)	53.8	49.0	52.5
Net profit	13,249	20,902	28,340
Net cash (debt)	16,316	27,265	46,382
EPS (Rs)	337	531	720
Growth (%)	118.5	57.8	35.6
BVPS (Rs)	672	1157	1830
RoE (%)	50.1	45.9	39.3
RoAE (%)	63.8	58.1	48.2
EV/Sales (x)	3.4	1.8	1.2
EV/EBITDA (x)	6.2	3.6	2.2
P/E (x)	10.4	6.6	4.9
P/BV (x)	5.2	3.0	1.9

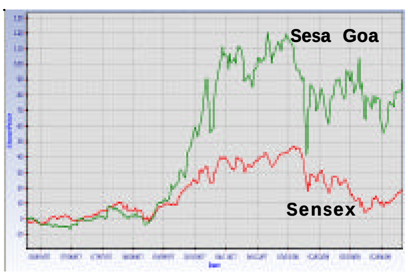
Source: Kotak Securities - Private Client Research

Shareholding pattern



Source: Capitaline

One-year performance (Rel to sensex)



Source: Capitaline

Sesa Goa

PRICE : RS.3500 **RECOMMENDATION : BUY**
TARGET PRICE : RS.5335 **FY09E EV/EBITDA : 3.6X; P/E: 6.6X**

Sesa Goa (orginally Scambi Economici SA Goa) is India's largest private sector exporter of iron ore with mining activities in Goa, Karnataka and Orissa and also owns a prospecting license in Jharkand. Last year, Anil Agarwal led Vedanta Resources Plc, a FTSE 100 listed company, took over the management control and there are already signs of positive striking changes. For the first time, iron ore sales of the company touched an impressive 5 MMT for Q4FY08.

We expect Sesa Goa to sustain high growth rates over FY08-FY10 led by higher volumes, sustained prices and an enterprising management. Higher than expected reserves and increased proportion of spot prices sales can lead to further upsides. Our estimates are after considering the proposed high export duties and proposed higher royalty rates, thus reducing the potential risks associated with policy actions.

Sesa has consistently maintained EBITDA margins in the range of 45-55% in line with other global peers. We see those levels sustaining for the next four years. We estimate an EPS of Rs.531 for FY09E and Rs.720 for FY10E.

We have valued Sesa Goa based on EV/EBITDA multiples, assigning value of 6x EV/EBITDA on FY09E EBITDA for Sesa Goa's standalone operations only. We have also derived the fair value through DCF methodology and also conducted a relative valuation with its global peers. We recommend a BUY on Sesa Goa, with a 9-12 month perspective and a price target of Rs.5355.

Key Investment Rationale

- **Higher volumes -** *We expect Sesa Goa to double the annual iron ore sales to 25 MMT in the next five years while rising 20% to 15 MMT in FY09E from 12.4 MMT in FY08. We foresee a combination of brownfield and greenfield expansions as well as inorganic growth playing out in coming years. We anticipate upward revision of iron ore reserves of Sesa Goa, going forward. We also expect Sesa Goa to be able to negotiate additional mining contract agreements in the coming years. Aggressive brownfield expansion at existing mining facilities is almost certain and the Jharkhand prospecting license is expected to lead to mining of high grade iron ore in next three-four years.*

- **Higher realizations -** *The world's largest iron ore producer, Brazil's Vale, has already secured 65-71% hike for its iron ore fines for FY08-09. However, Australia's BHP and Rio-Tinto (together largest market share) anticipate market conditions to be tighter enough to negotiate higher contract prices. They have still not agreed to the benchmark contract prices. Further, spot prices are trading at a significant premium to even higher settled contact prices. Higher proportion of iron ore sales in spot markets against annual contract prices would boost the average realizations.*

- **Industry fundamentals on track for at least next two years** - *China steel industry led (~ 90% of global iron-ore trade demand growth) global iron-ore sea trade demand is expected to remain robust for coming few years. China has constraints in boosting domestic supply of iron-ore. On an average, the Fe content in China's domestic iron ore is just 28.4% (and falling further sharply), even lower than half of the imported quality.*

  We do not foresee fears of supply surplus for at least two years. However, significant supply shortage would also ease with emergence of Fortescue Metals Group as the fourth largest iron ore player, which begins commercial operations shortly. We expect moderated rise in iron ore prices for the next two years resulting in sustenance of high realizations and profitability.

- **Risks are hedged thereon** - *Constraint of significantly large supply is limited to the next two or three years, post which the number of large projects from all the three top mining giants would start coming on line over late 2010-2013. We expect softening of prices from late FY11 but a steep fall is unlikely due to infrastructure bottlenecks and spiraling costs of the planned new projects by the global iron ore majors. We expect EBITDA margins to fall significantly post FY11. However still then also the absolute EBITDA is likely to remain quite stable, strongly supported by significantly higher volumes.*

- **De-leveraged balance sheet, high cash reserves and strong cash a distinct advantage** - *In the present turbulent, highly leveraged global financial markets, Sesa Goa stands out with not only no long-term debt but also enjoys greater than Rs.15 bn cash equivalents via safer investments in debt (FMP) mutual funds. It is unlikely that even in the medium-term it would be required to raise long-term capital to finance its capex requirements as future free cash flows are expected to be very robust and good enough to meet the aggressive expansion requirements.*

Valuation and Recommendation

We initiate coverage on Sesa Goa with a price target of Rs.5335

- *We are bullish on the company and initiate coverage with a* **BUY** *rating with a 9-12 month target price of Rs.5335/share (offers 52% upside) based on 6x FY09E EV/EBITDA.*

- *Policy risks incorporated in our earnings model - Our valuations incorporate a manifold increase in the new royalty rates (to 10% ad valorem) and export duties (to worse case proposal of Rs.300/t for grade with Fe content below 62% and 15% ad valorem for grade with Fe content of 62% or above), which astonishingly diminish Sesa Goa's operating margins. Even though there has been no official decision on the same, we have incorporated them in our valuation so as to clear the clouds of valuation risks.*

- *We have valued Sesa Goa based on EV/EBITDA multiples. This is in line with widely accepted valuation methodology for commodities companies worldwide. Our target price is based on 6x EV/EBITDA multiple on FY09E EBITDA from Sesa Goa's standalone operations only, at a considerable discount to the global peers. Valuations capture the net cash value of Rs.693/share for FY09E. Corresponding target price P/E multiples works out to 10x FY09E EPS and 7.4x FY10E EPS.*

- *We have done relative valuation of Sesa Goa with its global peers and observe that Sesa Goa is available at significant discount to its global peers. It has higher operating margins than its global peers but still is trading at a significantly lower multiple to its global peers. Fundamentally this discount is unmerited and should be corrected, going forward. However, we have maintained this discount in our valuation, to limit any downside risk to our valuation.*

- *We have also derived the fair value through the DCF methodology. Using DCF, Sesa Goa's standalone operations has fair value of Rs.5264/share, with a WACC of 14.13% and terminal growth of 3% post 2014. The DCF valuation captures the operating life for the next 15 years only. In addition, we value Sesa Goa's stake in Sesa Industries at Rs.71/share based on 88.25% (equivalent to percentage holding) of the net worth of Sesa Industries at end of FY10E.*

Key Concerns

- **Steel plant by Vedanta and transfer pricing** – *There remains a possibility of Vedanta Resources setting up a steel plant of decent scale of 5 MMT/year or so in Orissa. There had been reports of Vedanta examining the option of the same in a JV. If this actually happens, it may be slightly negative as the steel plant is likely to be in some other promoter group company and some form of unfavorable transfer pricing agreement would be expected. However, any greenfield project is at least four to five years away. So, the negative impact in realizations, if any, would be limited.*

- **Any major unanticipated slowdown in Chinese steel demand** — *We believe the steel demand in China is primarily driven by mass urbanization and that is likely to continue at moderate levels even beyond Olympic Games. However, any sharp breakdown in this trend would have negative implications.*

COMPANY BACKGROUND & BUSINESS SEGMENTS

Sesa Goa (initially Scambi Economici SA Goa) is India's largest private sector exporter of iron ore. The company commenced operations way back in 1954. Sesa Goa has mining activities in Goa, Karnataka and Orissa at present. Commercial operations in Jharkhand are likely to commence over the next two or four years. Incorporated by an Italian entrepreneur, for the first 42 years the company was run by Italians. Subsequently, for the next 11 years it was run by the renowned Mitsui Company of Japan. Last year, ownership was taken over by Vedanta Resources Plc, an FTSE 100 company promoted by the dynamic Indian entrepreneur, Anil Agarwal.

Iron ore – The key business

Constitutes > 90% of the sales and > 95% of profits of Sesa Goa on a standalone basis

Existing Iron Ore Mines

	Iron Ore Mines	Mining Type	Capacity (MMTPA)	Grade (Fe content)	Reserves (MMT)	Exporting Ports
Goa	Codli, Sonshi	Captive	7.7	55-58%	80	Mormugao
Karnataka	Chitradurga, Karadikolla (Hospet)	Captive/Contract	2.5	61-62%	50	Mormugao (400 km away), Chennai (600 km away) / Mangalore
Orissa	Thakurani at Barbil	Contract	2	63-64%	80	Paradip (700 km away) Haldia (400 km away)
Jharkand				63-64%	60	

Source: Sesa Goa, Vedanta Resources

Iron Ore Benefication Plants

- *Total 15 MMTPA capacity with Goa (8.8 MT), Karnataka (2.1 MT) and Orissa (4.1 MT)*

Metallurgical Coke - Energy recovery coke making technology

- *Located at Amona, Goa with 322,000 TPA maximum production capacity (as per EC), Sesa Goa has developed its own special plant design that features low capital cost, low operating cost, high energy recovery, high coke quality and virtually zero pollution.*
- *Recently, the technology has been further upgraded with compacted coal charging facility which can incorporate up to 70% of semi soft coking coals and still retain excellent coke characteristics.*
- *Sesa has received a CDM project registration from the United Nations Framework Convention on Climate Change (UNFCC) on this project*

Pig Iron - Foundry Grade

- *The company's plant at Amona (Goa), strategically situated on the bank of the Mandovi River, has two 173 m3 blast furnaces with a combined annual capacity of 292,000 metric tonnes (As per EC). Sesa pig iron plant makes special grades of pig iron to meet customer's requirements for (i) Low Sulphur and low Manganese pig iron and (ii) Nodular grade pig iron.*

Internal support - Logistics & Shipbuilding

- *Sesa Goa fleet consists of 15 barges with a total fleet capacity of ~30,000 DWT and a transshipper vessel, M V Orissa, with holding capacity of about 80,000 DWT and max loading capacity of 30,000 tonnes per day.*
- *Sesa Goa has its own ship building and repair facilities at Sirsaim wherein 62 vessels of all descriptions have been built till date. The range included medium sized vessels, self propelled barges for iron ore, containers, general cargo, dredgers etc.*

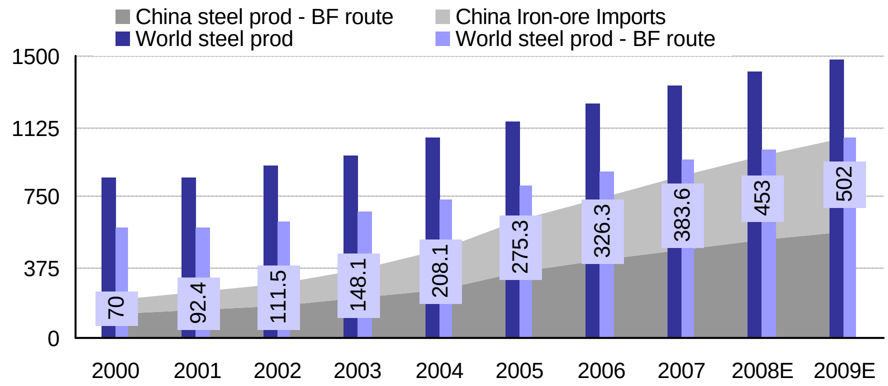
INVESTMENT RATIONALE

Commodity fears - Visible risks may have hidden opportunity; visible opportunities may inherit huge hidden risks. Go beyond noise; go for logical Q&As

- *At times, the fear of commodity cycles has more to do with a lack of understanding and clarity of the matter, either due to paucity of easy data availability or too much complexity, leading to over reliance on the past trend. It has less to do with the actual demand-supply equations extant in reality. Further, the underlying implications of structural changes happening continuously on both the demand and supply front and other critical influential parameters seem to be underestimated, leading to surprises, as are often being witnessed for sometime now.*
- *While downside risks do exist in commodities, it is advisable that investors reassess what valuation multiple (understanding of how one has arrived at the underlying is equally critical on choosing what multiple is justified) is given to various sectors and what it implies. It is advisable to logically examine the valuations. It is likely that the perceived risk associated with valuations would come down with better understanding of the specific industry's macro and micro dynamics.*

Macro factors – Global

Iron-ore thriving on China's consistent incremental demand

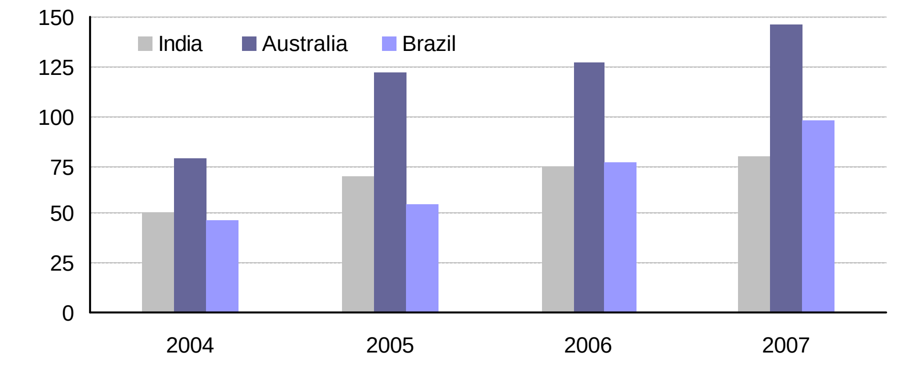


Source: IISI, ABARE, Kotak Securities - Private Client Research

China's domination in global iron ore trade

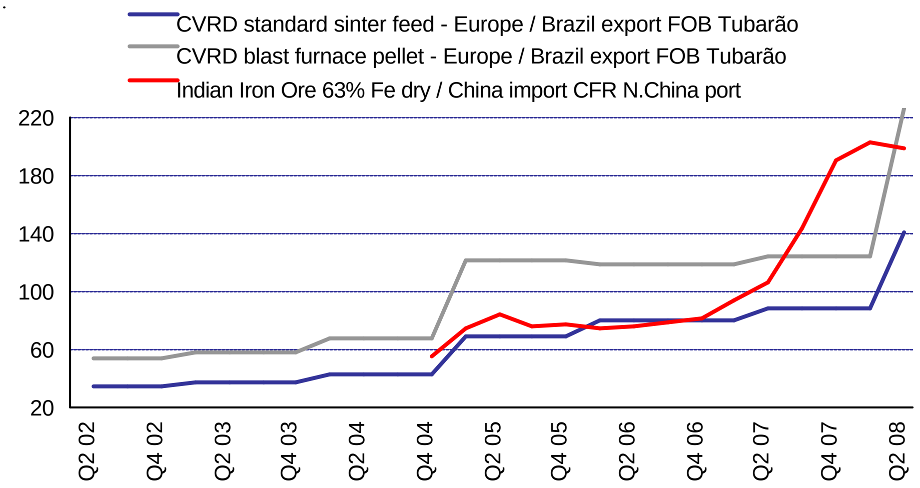
Source: ABARE

Iron-ore exports to China (MMTPA)



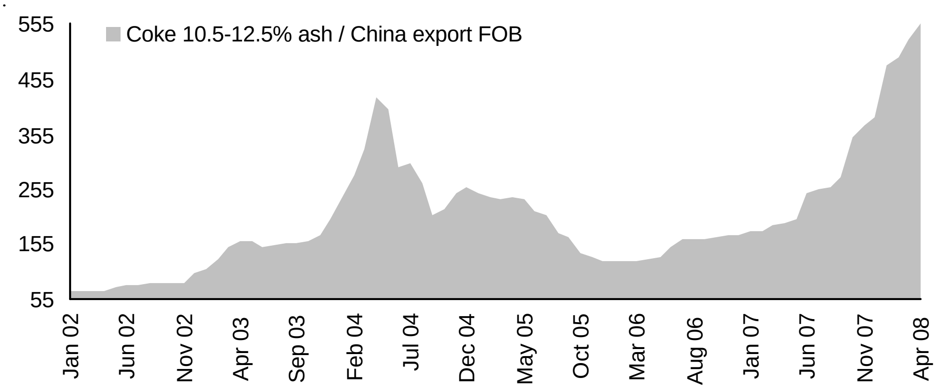
Source: ABARE

Iron Ore Prices - Fines/Pellets; Spot/Contract ($ cent/dmtu)



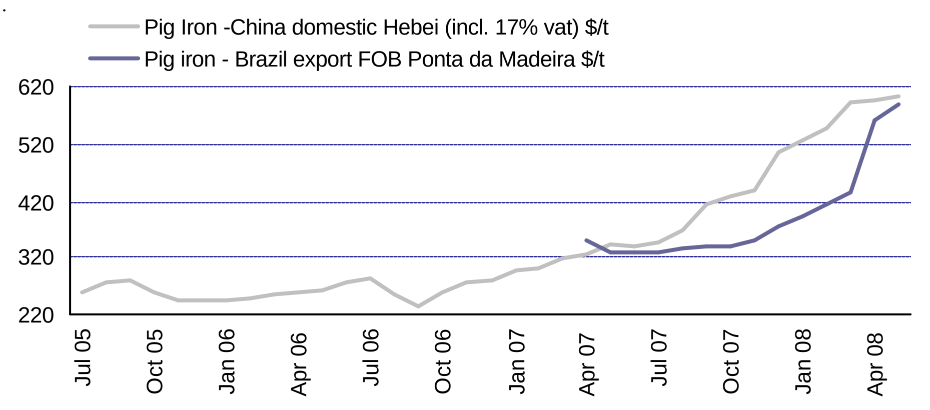
Source: SteelBB

Coke Prices are rising sharply (US$/t)



Source: SteelBB

Pig Iron prices rising sharply



Source: SteelBB

- **BHP, Rio Tinto still to agree to settle contract prices at benchmark price increase settled between CVRD and major steel buyers globally** - *BHP and Rio Tinto have set a deadline of June 30 2008 for the Chinese counterparts to finalize contracts, failing which they have threatened to supply in the spot markets only where traded prices are significantly higher than benchmark contract prices for FY09. BHP and Rio are demanding an increase of 71% and large proportion of the $40/t freight cost saving in shipping from Australia to China vs. Brazil to China. Please note that Brazil's Vale has already secured 65-71% hike for its iron ore fines for FY08-09. Later it secured an 86.67% increase in pellet prices.*

- **China has constraints in boosting domestic supply of iron-ore** - *China mined 707.1 MMT of iron ore in 2007, up 20% YoY compared with a 38% growth rate in 2006. In FY09, the growth rate is expected to slow further to 12% to 792 MT. However, on an average, the Fe content in China's domestic iron ore is just 28.4%, even lower than half of the imported quality. So, given the low and falling grade of domestic raw ore, increased difficulty in deeper exploitation, and constraints from environmental protection, we expect the overexploitation trend to be curbed in China, going forward. China's incremental iron ore demand would be met by iron ore imports, helping sustain the demand-supply tightness currently witnessed in global iron ore trade. It is to be noted that China accounts for almost 90% of the demand growth in international iron-ore trade.*

China Iron Ore DD-SS Model

(In million tonnes)	2000	2001	2002	2003	2004	2005	2006	2007	2008E	2009E
Crude Steel Production	127.3	150.9	182.2	222.4	280.5	355.8	422.7	489.0	538.0	586.0
Pig Iron Production	131.0	147.1	170.7	213.8	256.7	344.7	413.6	469.0	516.5	562.6
Iron Ore Requirement	205.7	230.9	268.0	335.7	403.0	541.2	649.4	736.3	810.9	883.2
Iron-Ore Production	224.0	218.0	231.0	261.0	310.1	420.5	588.2	707.1	792.0	850.0
Concentrate Equivalent								316.0	354.0	380.0
Domestic Ore Grade % Fe								28.4	28.4	28.4
Iron-Ore Imports								383.6	453.0	502.0
Deficit								36.7	3.9	1.2

Source: China Metallurgical Mining Association, SteelBB, ABARE, Kotak Securities - Private Client Research

- **Supply surplus not foreseen for next two years** — *On the supply side of the equation, the constraint of supply is limited to the next two or three years, post which the number of large projects from all three top mining giants start coming on line over 2010-2013. Vale is scaling up from 296 MMTPA to 450 MMTPA by 2013, BHP from 135 MMTPA to 235 MMTPA and Rio Tinto from 180 MMTPA to 350 MMTPA. Till 2010, Fortescue Metals Group (FMG) is expected to emerge as the fourth largest iron ore supplier. It would commence commercial operations from mid-May 2008 from the Pilbara region in Western Australia. The other large iron ore suppliers are Kumba Iron Ore, Cleveland Cliffs and LKAB, who do not have any significant capacity expansions for next three or four years. Incremental supply from India is also likely to be insignificant. Overall, the fears of any supply surplus in iron ore markets are limited for at least the next two years.*

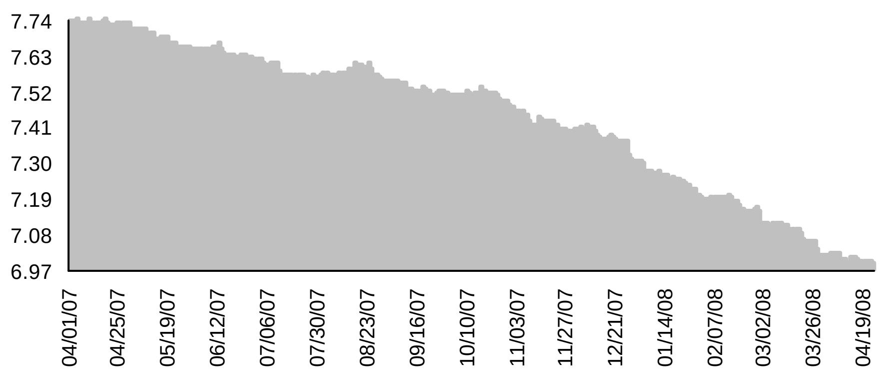
- **Infrastructure bottlenecks, spiraling costs critical** — *Issues on the supply side are beyond lack of ore. The US$/t expansion costs have almost doubled for the ongoing planned capex by large players for augmenting mining capacities, from a similar expansion in the past. This is due to rising costs for new mining equipment, processing plants, labour, energy and rail and port capacities. All this would dramatically raise the cash cost of production of incremental supply, requiring higher prices for maintaining operating margins, which is possible given the very high levels of consolidation in the iron ore industry. Further, the gestation time for covering up the insufficiency of infrastructure has been continuously on the rise.*

Creation of an iron ore index would provide a forward curve across which producers and consumers can settle their contract prices

- **Iron ore index a realistic possibility in coming years** - *Iron ore is the only major commodity, which has been left without an index. There was a precursor to the global traded iron ore index earlier this year when BHP signed a 10-year (starting April 2008) iron-ore supply contract of 10 MMT/year with Baosteel. The prices would not be based on the benchmark prices but would be mutually determined annually, with flexibility to accommodate a different, more market driven approach to pricing. Creation of an index would provide a forward curve across which producers and consumers can settle their contract prices. However, more importantly, it will pave the way for speculative money to enter the paper traded iron ore. It has been observed that prices of all commodities have surged ahead of consumer demand because of the growing popularity of investments in commodity ETFs. A similar behavior is likely for iron ore as well.*

- **Favorable consistent Yuan appreciation vs. US$ is positive** – *China has been recently encouraging the appreciation of its currency Yuan vs. the US dollar. It is positive for sustaining elevated iron ore prices, as it reduces the dollar adjusted iron ore import prices for China's steel companies. It also increases the competitiveness of imported ore vs. China's domestic iron ore production. Further, given that the Indian rupee's appreciation vs. the US dollar has been subdued for the last few months, it is an additional advantage for Indian iron ore exporters like Sesa Goa.*

Chinese Yuan appreciation against US$ is accelerating (Yuan/US$)

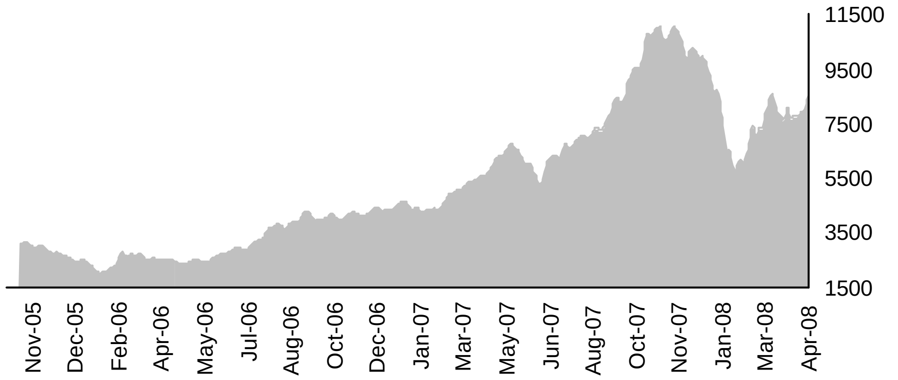


Source: Oanda

India's geographical proximity to China in comparison to its key competitor Brazil, lends significant advantage to Indian companies

- **Freight advantage for Indian iron ore players to sustain in medium term** *- Since last year there has been a considerable increase in freight charges on shipping dry bulk commodities like iron ore, coal etc. We expect the high freight charges to sustain over the next few years as a sustained increase in global trade of iron ore and coal would result in high utilization rates of bulk cargoes and pressure on port infrastructure facilities. India's geographical proximity to China in comparison to its key competitor Brazil, lends significant advantage to Indian companies in the form of lesser freight charges on iron ore import from Indian ports on an fob basis, which, in turn, is reflected in the premium in spot prices of Indian iron ore exports to China.*

Freight Rates inching back to previous highs - Dry Bulk Index



Source: Bloomberg

Macro Factors - India Specific

Indian mining industry - cannot be ignored anymore

- *Indian mining companies could end up paying a total tax of Rs.150 bn in 2007-08, the highest ever in India's history. The figure could be more than the combined tax paid by corporate giants like ITC, HUL, ONGC and Reliance Industries. CIL and NMDC have featured in the national top 10 corporate taxpayers list for the first time. We believe that to come at top on a single but important parameter is just a beginning and the Indian investor community will soon wake up to realize the scale, capability, sustainability and growth potential of the mining industry going forward. Sesa Goa would also benefit from that change in investor perception.*

Positive policy changes

- **National Mineral Policy - India on the verge of a new era in the mining space:** *The Cabinet has recently approved the much delayed National Mineral Policy. It would now be tabled in Parliament for its approval. If approved without major changes, the National Mineral Policy would result in simplifying the system of approvals from various authorities. It would be a shot in the arm for professional miners like Sesa Goa.*

  It would also phase out restrictive clauses in transfer of prospecting licenses and ease its conversion into mining license. The policy would enable Sesa Goa to aggressively pursue local acquisitions and ramp up its mining capacity and reserves, which can lead to higher sales volumes. However, it is to be noted that the minister in charge of mining has been changed since then in the latest Cabinet reshuffle. The mineral rich states have also voiced serious concerns on key regulation changes. Though some delay is possible in clearance from Parliament, approved regulation changes would be of critical importance to the industry.

Negative policy changes

- **Royalty changes taxing on cash flows - to reduce margins but blessing in disguise exists** - *There are proposals to change the royalty rates on iron ore from present fixed nominal rates to an ad-valorem duty of 10% on the realized export fob prices of iron ore. The realized prices would mean deduction of operating costs and duties from export realizations for calculation of the royalty levied. This would result in reduction in EBITDA margins by approximately 6% and net profit margin by approximately 4%.*

  There are a few significant long-term indirect benefits of higher royalty structure. There are provisions in the new royalty structure to earmark a certain percentage of duty collected for infrastructure development in mining areas. This would be positive as these are normally very backward areas and infrastructure development would help in improving mining productivity.

  Also, at present, the mining sector generates limited revenues for state governments. This leads to a very easygoing approach in mine allocations, which usually results in years of delays in commercial start of new mining projects. With the manifold increase in royalties, the negligent approach is expected to go. One can expect some reduction in lead time in arriving at impending decisions to various mining clearances. The impact of and benefit from this can be appreciated appropriately only by entrepreneurs who have to go through the present legislative process for years. The benefits would be visible to investors with a lag of two to three years.

- **Export tax increase not good news** - *The imposition of higher export duties by the Government will further boost their revenues to compensate for revenue loss on excise duties and reduction of countervailing duties on steel products. The impact would be very significant. There would be no advantage of any nature for iron ore players.*

  The strength of a high tax paying company like Sesa Goa, which does not rely on any tax breaks, is that the impact of any negative actions like imposition of higher export duties or increase in royalty rates, etc, on net profits is reduced by a third due to reduction in tax outgo. Further, royalty is generally levied on realized fob prices rather than fob prices. This difference itself results in lowering the impact by almost a third. This accounts for the production and transportation costs. So, the net negative impact of any regulatory action on profitability is actually half of what appears on the face of it.

Investment Positives

Core business

The iron ore business is the key. It contributes to greater than 90% of the sales and 95% of profits of Sesa Goa on a standalone basis.

Iron ore is a lucrative business with long life, low cost, high cash generative assets and has high entry barriers in India

- **Low on costs, high on cash** - *Iron ore is a lucrative business with long life, low cost, high cash generative assets. Sesa has consistently maintained EBITDA margins in the range of 45-55% in line with other global peers. We see the trend sustaining for at least the next three to four years.*

- **High entry barriers** - *The industry has high barriers to entry as it takes several years to obtain and operate mining leases. Of late, there has also been a scarcity of geologists and mining engineers.*

- **Brownfield expansion** - *Given Vedanta's proven mining and project management skills, we see excellent debottlenecking/expansion opportunities at a low cost to significantly increase production of iron ore by exploiting existing prospecting and mining licenses and contract mining.*

- **Greenfield expansion** - *We see long-term organic growth opportunities to increase production and resources by accessing additional prospecting and mining licenses.*

- **Inorganic growth** - *We expect Vedanta to be a leading player in the consolidation of India's highly fragmented iron ore industry. We also foresee the company increasing the contract mining operations in a big way, going forward. The new promoters, the Vedanta group have a very impressive entrepreneurial track record. One can expect visible action on this front in the next few years.*

Vedanta leadership shows sign of positive striking changes

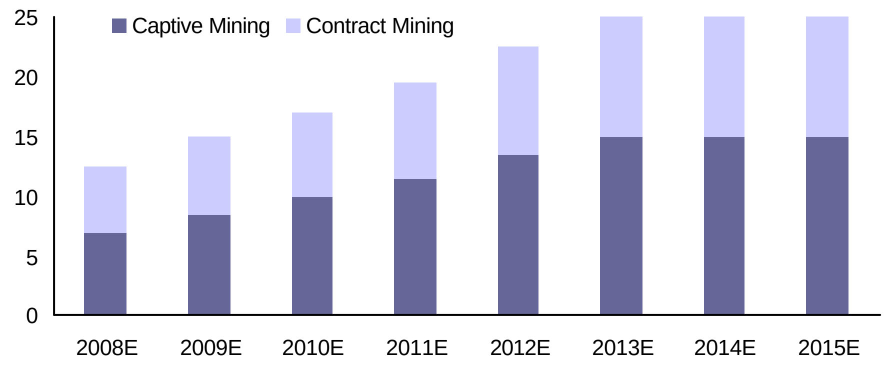
- *One year of operations is still to be completed by new promoters, yet there are few early signs that the functioning of the company would undergo a sea change. For the first time, the quarterly iron ore sales of the company touched 5MMT. We believe, Sesa Goa led by enterprising Vedanta management would embark on a completely new scale and growth trajectory in the coming years.*

Volumes

The Vedanta group has a successful track record of relentlessly scaling up sales volumes across several commodities in its group companies.

- **Impressive volume ramp up plans** - *The Sesa Goa management intends to double the annual iron ore sales volume over the next four years to 25 MMT from 12.4 MMT for the current year. For FY09 it is striving for iron ore sales of 15 MMT. The longer term annual iron ore sales volume being endeavored for is significantly higher. The Vedanta group, the new management has a successful track record of relentlessly scaling up sales volumes across several commodities in its group companies. However, we have opted for a cautious stand and discounted the management's projections for valuation purposes by incorporating higher time lag for enhanced production. Assumptions for valuations are stated in detail later in the report.*

Forecasted Iron Ore Volumes (MMT)

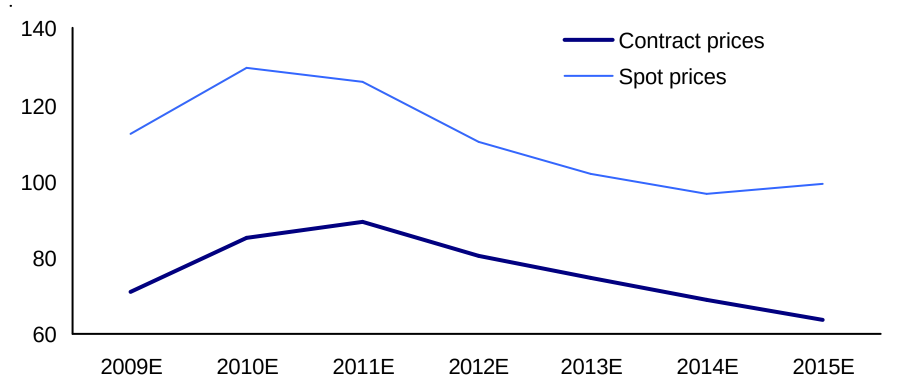


Source: Kotak Securities - Private Client Research

Prices

- **Iron ore spot sales, perking up average realizations** - *Sesa Goa is overhauling the sales mix that was concentrated in long term contracts, in favor of spot sales, as prices in iron ore spot markets have been firmly trading at substantial premium(~2.5 times) to the long-term contract prices, after rising sharply during the last few quarters. The iron ore spot sales proportion has improved from 30% in FY07 to ~50% in FY08E and is expected to rise further to ~60% in FY09E and ~65% in FY10E and assumed constant thereon.*

Forecasted Iron Ore Realizations (US$/t)

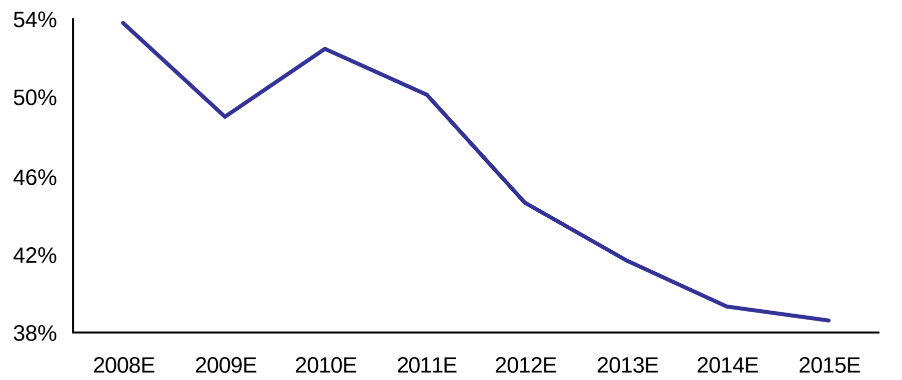


Source: Kotak Securities - Private Client Research

Margins

- *Sesa Goa has historically enjoyed very high EBITDA margins in the range of 45-55% in line with global peers in the industry. We expect the margins to remain at high levels of about 50% for the next four years even after taking into consideration the significant negative impact of higher royalty charges and export duties.*

Valuation incorporates significantly lower EBITDA Margins

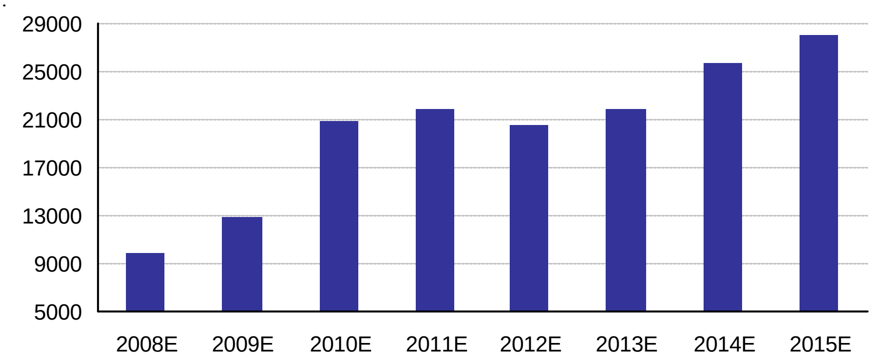


Source: Kotak Securities - Private Client Research

Cash flows

- *Iron ore mining is a very high cash flow generative business and Sesa Goa's annual cash flows are pretty impressive as well.*

Free Cash Flow generation is expected to remain impressive (Rs mn)

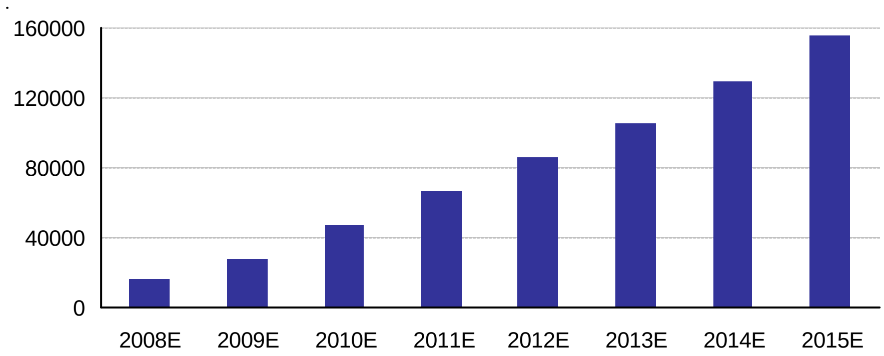


Source: Kotak Securities - Private Client Research

Balance sheet

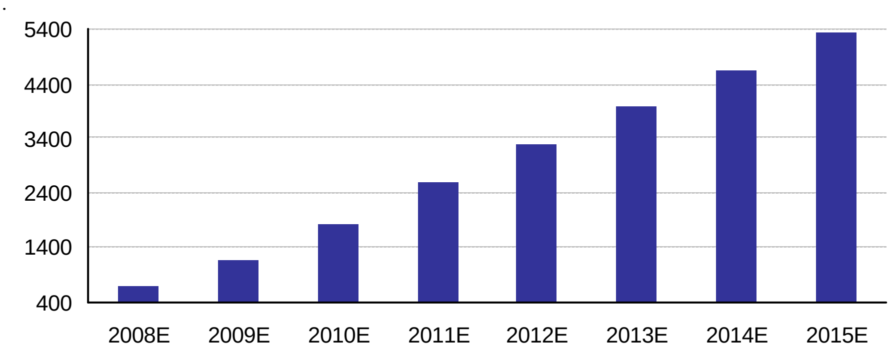
- **Very robust and de-leveraged balance sheet with significant cash reserves** *- a huge bonus: In the present turbulent, highly leveraged global financial markets, Sesa Goa stands out with not only no long-term debt but also enjoys greater than Rs.15 bn cash equivalents via safer investments in debt mutual funds. It is unlikely that even in the medium-term it would be required to raise long-term capital to finance its capex requirements as future free cash flows are expected to be very robust and good enough to meet the aggressive expansion requirements.*

Investments/Cash Equivalents - To further gain strength (Rs mn)



Source: Kotak Securities - Private Client Research

Continous Growth in Net Worth (Rs/share)



Source: Kotak Securities - Private Client Research

FINANCIALS

Profit and Loss (Rs mn)

Year ending Mar	FY08F	FY09F	FY10F	FY11F	FY12F	FY13F	FY14F	FY15F
Net Sales	**35,890**	**61,810**	**77,735**	**88,132**	**90,521**	**96,679**	**93,981**	**95,934**
EBITDA	**19,530**	**30,467**	**41,021**	**44,376**	**40,578**	**40,459**	**37,133**	**37,221**
Other Income	610	1,194	2,003	3,415	4,900	6,282	7,768	9,525
Depreciation	470	635	957	1,442	2,049	2,691	3,244	3,645
Interest	1	-	-	-	-	-	-	-
PBT	**19,670**	**31,027**	**42,067**	**46,349**	**43,428**	**44,051**	**41,658**	**43,102**
Taxes	6,420	10,125	13,726	15,126	14,177	14,385	13,611	14,089
PAT	**13,249**	**20,902**	**28,340**	**31,224**	**29,251**	**29,666**	**28,047**	**29,012**
Shares Outstanding mn	39.36	39.36	39.36	39.36	39.36	39.36	39.36	39.36
EPS (Rs)	**337**	**531**	**720**	**793**	**743**	**754**	**713**	**737**

Source: Kotak Securities - Private Client Research

Balance Sheet (Rs mn)

Year ending Mar	FY08F	FY09F	FY10F	FY11F	FY12F	FY13F	FY14F	FY15F
LIABILITIES								
Equity Share Capital	394	394	394	394	394	394	394	394
Reserves & Surplus	26,077	45,137	71,635	101,017	128,426	156,249	182,454	209,624
Net Worth	**26,471**	**45,530**	**72,029**	**101,410**	**128,819**	**156,643**	**182,847**	**210,018**
Short Term Loans	-	-	-	-	-	-	-	-
Long Term Loans	-	-	-	-	-	-	-	-
Deferred Tax Liabilities	521	521	521	521	521	521	521	521
Total Liabilities	**26,992**	**46,051**	**72,550**	**101,931**	**129,340**	**157,164**	**183,368**	**210,539**
ASSETS								
Gross Block	7,264	10,624	16,321	24,265	33,416	42,339	48,983	53,622
Less Depreciation	2,609	3,244	4,201	5,643	7,692	10,382	13,626	17,271
Net Block	**4,655**	**7,380**	**12,120**	**18,622**	**25,724**	**31,957**	**35,357**	**36,351**
CWIP	**379**	**994**	**1,568**	**2,126**	**2,342**	**2,194**	**1,483**	**1,052**
Investments	**16,591**	**27,540**	**46,657**	**66,753**	**85,471**	**105,594**	**129,375**	**155,530**
of which financial investments	16,171	27,120	46,237	66,333	85,052	105,175	128,956	155,111
Total Current Assets	8,093	13,876	16,077	18,883	20,875	23,005	22,763	23,345
Total Current Liabilities	2,727	3,738	3,871	4,452	5,072	5,585	5,610	5,739
Net Current Assets	**5,367**	**10,138**	**12,206**	**14,431**	**15,803**	**17,419**	**17,153**	**17,606**
Total Assets	**26,992**	**46,051**	**72,550**	**101,931**	**129,340**	**157,164**	**183,368**	**210,539**

Source: Kotak Securities - Private Client Research

Cash Flow Statement (Rs mn)

Year ending Mar	FY08F	FY09F	FY10F	FY11F	FY12F	FY13F	FY14F	FY15F
Net Profits	13,249	20,902	28,340	31,224	29,251	29,666	28,047	29,012
Add Depreciation	470	635	957	1,442	2,049	2,691	3,244	3,645
Decrease in Working Capital	(2,449)	(4,771)	(2,068)	(2,225)	(1,372)	(1,616)	266	(453)
Increase in Deferred Tax	-	-	-	-	-	-	-	-
Cash flow from Operations	**11,271**	**16,766**	**27,230**	**30,440**	**29,928**	**30,740**	**31,557**	**32,204**
Capital Expenditure	(1,516)	(3,975)	(6,271)	(8,502)	(9,367)	(8,775)	(5,933)	(4,207)
Increase in Investments	0	-	-	-	-	-	-	-
Increase in Loans and advances	-	-	-	-	-	-	-	-
Other items	-	-	-	-	-	-	-	-
Cash flow from investing	**(1,516)**	**(3,975)**	**(6,271)**	**(8,502)**	**(9,367)**	**(8,775)**	**(5,933)**	**(4,207)**
Increase in Equity	-	-	-	-	-	-	-	-
Increase in Borrowings	-	-	-	-	-	-	-	-
Dividend Payment	(1,842)	(1,842)	(1,842)	(1,842)	(1,842)	(1,842)	(1,842)	(1,842)
Cash flow from financing	**(1,842)**	**(1,842)**	**(1,842)**	**(1,842)**	**(1,842)**	**(1,842)**	**(1,842)**	**(1,842)**
Total Cash Flow	**7,913**	**10,949**	**19,117**	**20,096**	**18,719**	**20,122**	**23,781**	**26,155**
Opening Cash in Hand	8,403	16,316	27,265	46,382	66,478	85,196	105,319	129,100
Closing Cash in Hand	16,316	27,265	46,382	66,478	85,196	105,319	129,100	155,255
Change in Cash Balance	**7,913**	**10,949**	**19,117**	**20,096**	**18,719**	**20,122**	**23,781**	**26,155**

Source: Kotak Securities - Private Client Research

Key Ratio

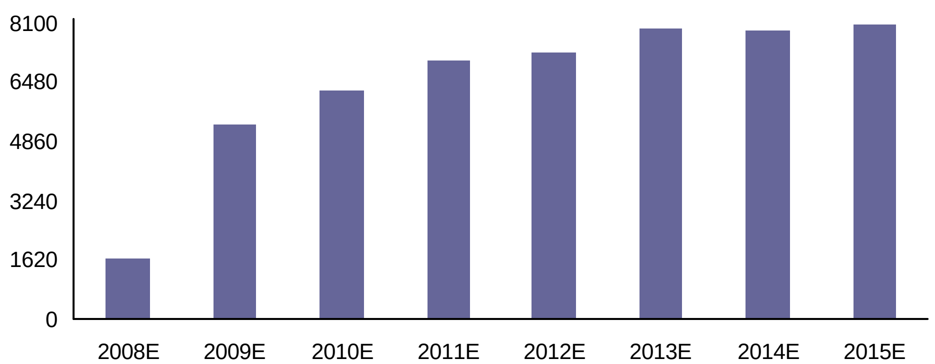
	FY08F	FY09F	FY10F	FY11F	FY12F	FY13F	FY14F	FY15F
EBITDA Margins (%)	53.8	49.0	52.5	50.1	44.6	41.7	39.3	38.6
NPM Margins (%)	36.5	33.6	36.3	35.3	32.2	30.6	29.7	30.1
ROE on yr-end equity (%)	50.1	45.9	39.3	30.8	22.7	18.9	15.3	13.8
ROAE (%)	63.8	58.1	48.2	36.0	25.4	20.8	16.5	14.8
EPS growth (%)	118.5	57.8	35.6	10.2	-6.3	1.4	-5.5	3.4
P/E (x)	10.4	6.6	4.9	4.4	4.7	4.6	4.9	4.7
EV/sales (x)	3.4	1.8	1.2	0.8	0.6	0.3	0.1	-0.2
EV/EBITDA (x)	6.2	3.6	2.2	1.6	1.3	0.8	0.2	-0.5
P/B (x)	5.2	3.0	1.9	1.4	1.1	0.9	0.7	0.7
BVPS (Rs)	672.5	1156.7	1829.9	2576.4	3272.7	3979.5	4645.3	5335.5

Source: Kotak Securities - Private Client Research

ASSUMPTIONS

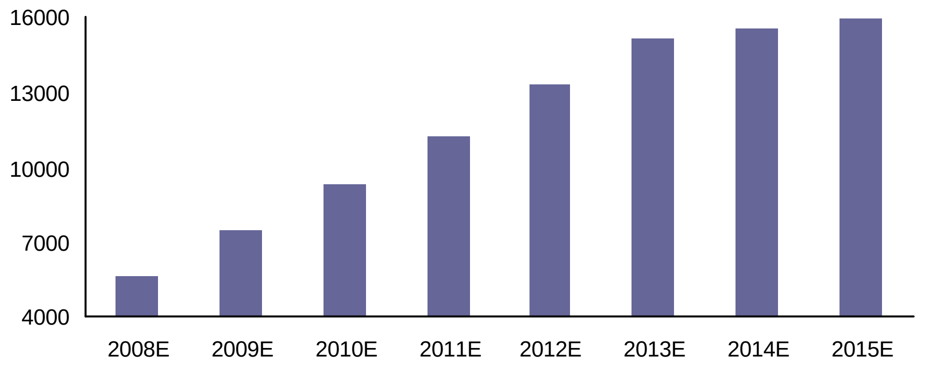
- *The management has given a guidance of iron ore sales of 15 MMT for FY09 and 25 MMT for FY12. Given the impressive production levels of 4.7 MMT and sales of 5 MMT achieved in Q4FY08, the target of 15 MMT for FY09 is highly likely to be achieved (even after accounting for seasonality). As for the 25 MMT target for FY12, we have opted to discount the management guidance by assuming a year's time lag in achieving projected volumes. We have maintained the sales at those levels henceforth. We have noted that the management has an excellent track record on volume ramp up in other group companies. However, we would still prefer to take a cautious approach for the time being.*
- *The Vedanta management envisions a mining life of 20 years on an ongoing basis. This implies the management plans to increase iron ore reserves to near 500 MMT levels in the next five years or so. One has to wait for the modus operandi to achieve the same but we believe it is achievable.*
- *We anticipate upward revision of iron ore reserves of Sesa Goa, going forward. We also expect Sesa Goa to be able to negotiate additional mining contract agreements in the coming years. Aggressive brownfield expansion at existing mining facilities is almost certain and the Jharkhand prospecting license is expected to lead to mining of high grade iron ore in three years. The above assessment helps in raising our confidence levels in the management's ability to achieve the targeted volumes.*
- *We see the incremental supply struggling to meet the incremental iron ore demand, led by China, to continue for the next two years. We see the market softening thereon. However, the improvements in realizations have been assumed to be relatively highly moderate in the coming two years, post which we have taken sustained price corrections. Annual price assumptions have been stated later in the report.*
- *We have taken the proportionate sales in spot markets to rise to 60% in FY09E from the present 50% levels based on management guidance. We have assumed it to rise further to 65% in FY10E and assumed constant thereon.*
- **Proposed policy changes considered - downside protected, in our view.** *We have taken royalty rates at ad-valorem basis to remain constant at 10% of the realized fob export prices. Export duties have been assumed to remain constant at Rs.300/t for grades below 62% Fe and 15% of the fob export prices for iron ore grades above 62% Fe content. Both these are proposed changes and have not yet been enacted but we have taken them into consideration to clear the cloud of risks which it carries. We believe the newly proposed royalty and export duties are pretty high and it looks highly unlikely that there would be any hike in that, going forward. There is a possibility of reduction in export duties in the future but we have been prudent and retained the higher export duties forever.*

Significantly Higher Export Duty going forward (Rs. mn)



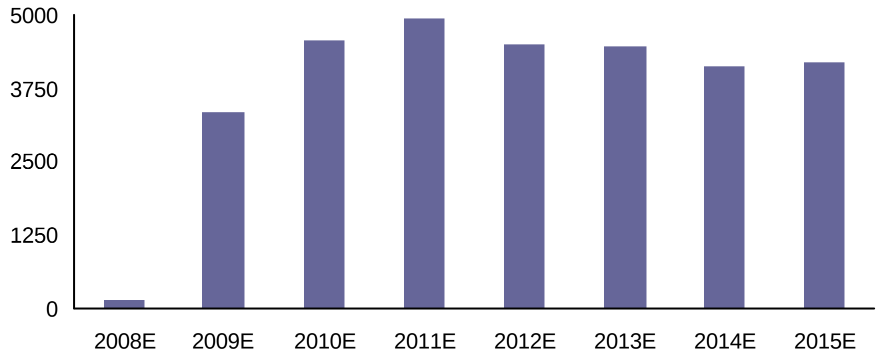
Source: Kotak Securities - Private Client Research

High Freight Costs have been incorporated (Rs mn)



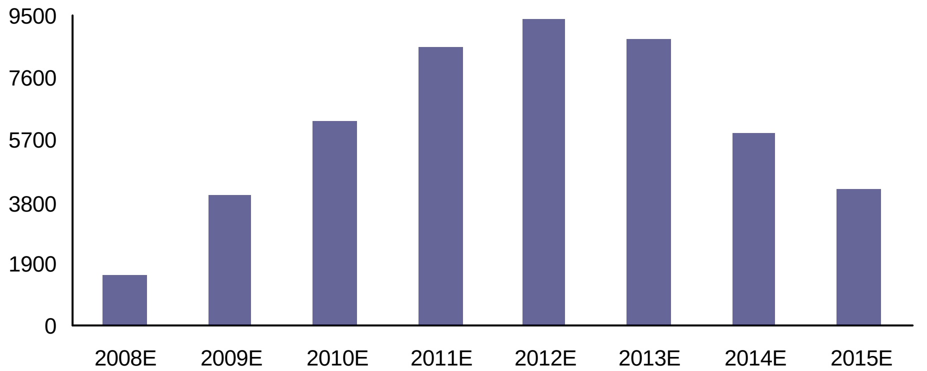
Source: Kotak Securities - Private Client Research

New Royalty Rates to put significant cost pressure (Rs mn)



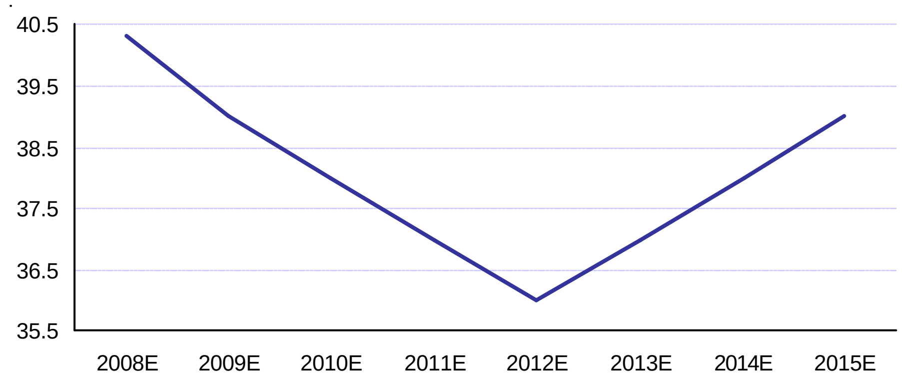
Source: Kotak Securities - Private Client Research

Forecasted Annual Capex by Sesa Goa (Rs mn)



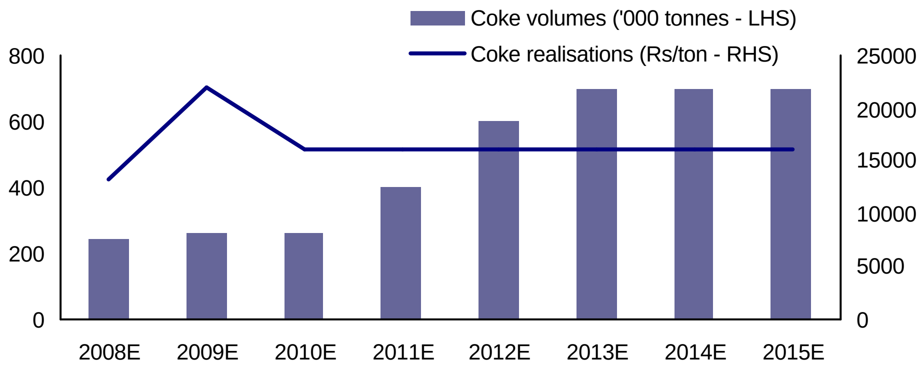
Source: Kotak Securities - Private Client Research

US$ exchange rate assumption (Rs./US$)



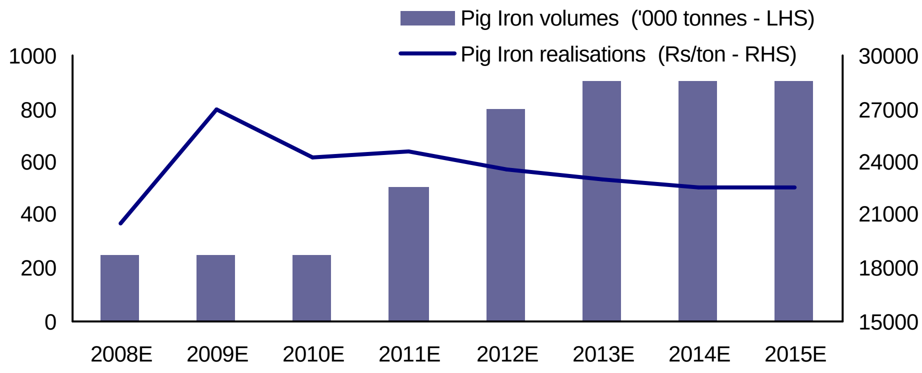
Source: Kotak Securities - Private Client Research

Coke Volumes and Realisations Assumption



Source: Kotak Securities - Private Client Research

Pig Iron Volumes and Realisations Assumption



Source: Kotak Securities - Private Client Research

VALUATION AND RECOMMENDATION

We initiate coverage on Sesa Goa with a **BUY** *recommendation and a target price of Rs.5335/share for an investment horizon of nine to 12 months, which offers an upside of 52% from the current levels.*

EV/EBITDA multiple based target price of Rs. 5335/share

- *Our target price is based on 6x EV/EBITDA multiple on FY09E EBITDA from Sesa Goa's standalone operations only.*
- *The multiple is at discount to the valuations of the global peers, is in line with the historical multiples the company has traded and also justifies the fundamentals of the company.*
- *Sesa Goa is a zero debt company and has substantial investments in debt mutual funds (fixed maturity plans). The value of the same is captured in our valuation.*

Sesa Goa - Standalone (FY09E)

	EBITDA (Rs mn)	Multiple (x)	Valuation (Rs. mn)	Value (Rs./Share)	Basis
Enterprise Value	30467	6	182744	4643	Based on historical traded multiple and discount to global peers
Less: Net Debt of Sesa Goa - Standalone			-27265	-693	Capturing Value of cash and liquid securities
Target Market Capitalization			210008	5335.6	
Target Price				**5335**	

Source: *Kotak Securities - Private Client Research Valuations*

Incorporated considerable valuation hit from proposed amendments (even though not enacted into legislation) in (i) royalty rate (ii) export duty (at the highest proposed rate)

- *We arrive at this conclusion even after incorporating a manifold increase in the new royalty rates (to 10% ad valorem) and export duties (to worse case proposal of Rs.300/t for grade with Fe content below 62% and 15% ad valorem for grade with Fe content of 62% or above), which astonishingly diminish Sesa Goa's operating margins.*
- *Even though the proposals the still doing rounds in government circles, we have included the same to clear the clouds of its risks on the company valuation. We have preferred to have an upside risk to our valuation than a downside risk.*

Other multiples corresponding to our target price – are reasonable

- *Corresponding P/E multiples for the target price are 10x FY09E EPS. On FY10E earnings, the multiples are 7.4x P/E and 4x EV/EBITDA.*

Relative valuation – Sesa Goa available at significant discount to global peers

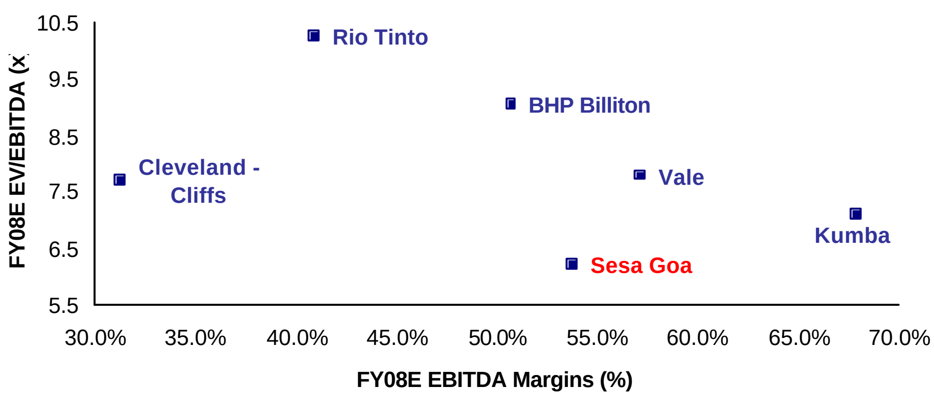
Sesa Goa has higher operating margins than its global peers but still is trading at a significantly lower multiple to its global peers. Fundamentally this discount is not merited and should be corrected going forward. However, we have maintained this discount in our valuation, so as to limit any downside risk to our valuation.

Revative Valuation

	EV/EBITDA (x)			EBITDA Margins (%)		
	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
Sesa Goa***	6.2	3.6	2.2	53.8	49.0	52.4
Simple Average (enlisted Peers)	8.4	7.7	6.7	29.2	55.4	53.9
Cleveland - Cliffs **	7.7	5.3	5.7	31.3	39.5	36.2
Fortescue Metals Group (FMG)*		13.5	6.7	-72.7	66.2	71.0
Kumba Iron Ore**	7.1	5.0	4.8	67.9	69.5	70.4
BHP Billiton*	9.1	6.9	7.2	50.7	57.4	56.1
Rio Tinto**	10.2	8.7	8.8	40.9	46.0	43.6
Vale (former CVRD)**	7.8	6.7	7.2	57.2	53.9	46.1

*Source: Bloomberg, Kotak Securities - Private Client Research; Note: * FY ending June 08E, 09E, 10E; ** FY ending December 08E, 09E, 10E; *** FY ending March 08E, 09E, 10E;*

Sesa Goa - Substantial discount to global peers



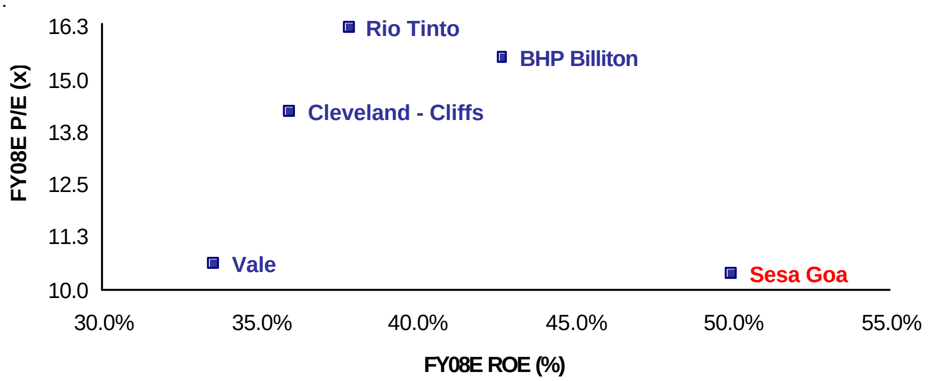
Source: Bloomberg, Kotak Securities - Private Client Research; Note: Please refer to previous table for checking corresponding fiscal year end

Revative Valuation

	P/E (x)			ROE (%)		
	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
Sesa Goa***	10.4	6.6	4.9	50.0	45.9	39.3
Simple Average (enlisted Peers)	13.8	12.2	10.2	32.9	57.1	44.1
Cleveland - Cliffs **	14.2	9.7	9.6	36.0	35.8	29.4
Fortescue Metals Group (FMG)*		22.0	10.2	-108.0	106.1	63.7
Kumba Iron Ore**	12.5	8.4	8.3	155.4	98.4	83.5
BHP Billiton*	15.5	11.9	12.3	42.7	41.0	33.4
Rio Tinto**	16.2	13.4	13.6	37.8	31.8	26.9
Vale (former CVRD)**	10.6	7.9	7.3	33.5	29.7	28.0

*Source: Bloomberg, Kotak Securities - Private Client Research; Note: * FY ending June 08E, 09E, 10E; ** FY ending December 08E, 09E, 10E; *** FY ending March 08E, 09E, 10E;*

Sesa Goa - Substantial discount to global peers



Source: Bloomberg, Kotak Securities - Private Client Research; Note: Please refer to previous table for checking corresponding fiscal year end

DCF valuation - To compliment our base case EV/EBITDA valuation

- *We have also done a DCF valuation of Sesa Goa's standalone. This gives a fair value of Rs.5264/share, with a WACC of 14.13% and terminal growth of 3% post 2014. The DCF valuation captures the operating life for the next 15 years only.*
- *In addition, we value Sesa Goa's stake in Sesa Industries at Rs.71/share based on 88.25% (equivalent to percentage holding) of the net worth of Sesa Industries at end of FY10E. Adding the two corresponds with our target price of Rs.5335/share.*

Free Cash Flow Calculation

Terminal year	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Profits after tax	13,249	20,902	28,340	31,224	29,251	29,666	28,047	29,012
Depreciation	470	635	957	1,442	2,049	2,691	3,244	3,645
Add interest	1	-	-	-	-	-	-	-
Add change in working capital	(2,449)	(4,771)	(2,068)	(2,225)	(1,372)	(1,616)	266	(453)
Capex	(1,516)	(3,975)	(6,271)	(8,502)	(9,367)	(8,775)	(5,933)	(4,207)
Total Cash Flows	9,755	12,791	20,959	21,938	20,561	21,965	25,624	27,997
PV of cash flows	9,755	11,207	16,090	14,756	12,118	11,342	11,593	
Terminal Value								251,502

Source: Kotak Securities - Private Client Research

DCF Valuation

Valuation parameters		Rationale behind assumptions
WACC (%)	14.1	
Terminal Multiple	9.0	Linked to terminal growth rate and WACC
Terminal Year growth (%)	3.0	
PV of FCF FY09E to FY2014E	77,106	
Terminal value	251,502	
PV of terminal value	113,788	
Firm Value	190,894	
Less Net Debt	(16,316)	Not included the investment of 419.2mn in Sesa Ind
NPV	207,210	
Number of equity shares (mn)	39.4	Fully diluted
NPV/Sesa Goa share	**5,264**	Intrinsic value

Source: Kotak Securities - Private Client Research

WACC Calculation

Parameters		Rationale behind assumptions
Risk free rate (%)	8.0	10 year Government bond yield
Market risk Premium (%)	6.0	High premium given current market conditions
Beta of the Stock	1.022	2 year daily returns regressed against Sensex
Cost of equity (%)	14.13	
Gross cost of debt	NA	Target cost of Capital
Tax rate	NA	Marginal Tax
Net cost of Debt	NA	
Target Debt to Capital ratio	0	As free cash flows good enough for capex needs
WACC (%)	**14.13**	

Source: Kotak Securities - Private Client Research

Sensivity Analysis - DCF Valuation

	WACC (%)				
Growth rate	**16.1**	**15.1**	**14.1**	**13.1**	**12.1**
1%	4,178	4,478	4,825	5,230	5,711
2%	4,314	4,643	5,027	5,482	6,029
3%	4,470	4,834	**5,264**	5,783	6,415
4%	4,652	5,061	5,551	6,149	6,898
5%	4,867	5,331	5,899	6,607	7,515

Source: Kotak Securities - Private Client Research

RISKS

- **Steel plant by Vedanta and transfer pricing** - *There remains a possibility of Vedanta Resources setting up a steel plant of decent scale of 5 MMT/year or so in Orissa. There had been reports of Vedanta examining the option of the same in a JV. If this actually happens, it may be slightly negative as the steel plant is likely to be in some other promoter group company and some form of unfavorable transfer pricing agreement might be there. However, any green field project is at least four to five years away. So, the negative impact in realizations, if any, would be limited.*

- **Any major unanticipated slowdown in Chinese steel demand** - *We believe the steel demand in China is primarily driven by mass urbanization and that is likely to continue at moderate levels even beyond Olympic Games. However, any sharp breakdown in this trend would have negative implications.*

- **Further fiscal measures by Indian government** - *For tackling high inflation, supposedly also supported by steel and its key raw materials including iron ore, there has been widespread suggestions of either banning iron ore exports or putting a hefty export duty. While talks of iron ore exports ban have been doing the rounds for years now, our understanding is that it is practically ruled out. However, there exists the decent possibility of higher export duties going on iron ore, going forward. Higher export duties would be negative for the iron ore industry and Sesa Goa. To clear the clouds of risks on the valuation of Sesa Goa, we have already incorporated the negative impact of the worst case scenario of highest export duty proposals doing the round in government circles. So, though there may be knee jerk reactions on stock price when such action is taken, we see that to be a good buying opportunity.*

Research Team

Dipen Shah
IT, Media, Telecom
dipen.shah@kotak.com
+91 22 6634 1376

Sanjeev Zarbade
Capital Goods, Engineering
sanjeev.zarbade@kotak.com
+91 22 6634 1258

Teena Virmani
Construction, Cement, Mid Cap
teena.virmani@kotak.com
+91 22 6634 1237

Awadhesh Garg
Pharmaceuticals, Hotels
awadhesh.garg@kotak.com
+91 22 6634 1406

Apurva Doshi
Logistics, Textiles, Mid Cap
doshi.apurva@kotak.com
+91 22 6634 1366

Saurabh Gurnurkar
IT, Media, Telecom
saurabh.gurnurkar@kotak.com
+91 22 6634 1273

Saurabh Agrawal
Metals, Mining
agrawal.saurabh@kotak.com
+91 22 6634 1291

Saday Sinha
Banking, Economy
saday.sinha@kotak.com
+91 22 6634 1440

Sarika Lohra
NBFCs
sarika.lohra@kotak.com
+91 22 6634 1480

Chetan Shet
FMCG, Power
chetan.shet@kotak.com
+91 22 6634 1382

Siddharth Shah
Telecom
siddharth.s@kotak.com
+91 22 6634 1261

Shrikant Chouhan
Technical analyst
shrikant.chouhan@kotak.com
+91 22 6621 6360

Kaustav Ray
Editor
kaustav.ray@kotak.com
+91 22 6634 1223

K. Kathirvelu
Production
k.kathirvelu@kotak.com
+91 22 6634 1557

Disclaimer

This document is not for public distribution and has been furnished to you solely for your information and must not be reproduced or redistributed to any other person. Persons into whose possession this document may come are required to observe these restrictions.

This material is for the personal information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Kotak Securities Ltd. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients.

We have reviewed the report, and in so far as it includes current or historical information, it is believed to be reliable though its accuracy or completeness cannot be guaranteed. Neither Kotak Securities Limited, nor any person connected with it, accepts any liability arising from the use of this document. The recipients of this material should rely on their own investigations and take their own professional advice. Price and value of the investments referred to in this material may go up or down. Past performance is not a guide for future performance. Certain transactions -including those involving futures, options and other derivatives as well as non-investment grade securities - involve substantial risk and are not suitable for all investors. Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals.

Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance, or other reasons that prevent us from doing so. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

Kotak Securities Limited has two independent equity research groups: Institutional Equities and Private Client Group. This report has been prepared by the Private Client Group . The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, target price of the Institutional Equities Research Group of Kotak Securities Limited.

We and our affiliates, officers, directors, and employees world wide may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions.

The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

Analyst holding in stock: Nil

Registered Office: Kotak Securities Limited, Bakhtawar, 1st floor, 229 Nariman Point, Mumbai 400021 India.