Sesa Goa Ltd. - Analysis of Consolidated Q1-FY10 Results

August 3, 2009

Price: Rs241 | **52 week High/Low: 247/60** | **MCap: 196bn ($4093mn)**

BSE Sensex: 15670 | **No rating**

Highlights

- Net sales down 29.9% q-o-q due to fall in iron ore realizations by 29.2%
- EBITDA margin slips 740 bps to 44.8% due to rise in staff and freight costs
- PAT down 22.9%, in spite of lower tax rate and higher other income
- Cash is king: appetite for inorganic growth still exists

Highlights of Quarterly results

(RsCr)

Particulars	Q1FY09	Q4FY09	Q1FY10	q-o-q %	y-o-y %
Net Sales	1280.04	1443.54	1011.52	-29.9%	-21.0%
Total Expenditure	474.98	690.04	558.42	-19.1%	17.6%
EBITDA	805.06	753.5	453.1	-39.9%	-43.7%
EBITDA margin (%)	62.9%	52.2%	44.8%	-7.4%	-18.1%
Other income	61.12	56.7	75.15	32.5%	23.0%
Interest	0.04	0.74	2.03	174.3%	4975.0%
PBT	854.54	794.43	511.04	-35.7%	-40.2%
Tax	218.5	246.07	86.94	-64.7%	-60.2%
Tax rate (%)	25.6%	31.0%	17.0%	-45.1%	-33.5%
PAT	633.07	547.64	422.29	-22.9%	-33.3%

Chinese import prices of iron ore seem to have bottomed out...

The gradual recovery in the world economy and the implementation of a stimulus plan in China has led to restocking of major commodities. Restocking has also led to price recovery indicating that the bottom has been formed.

Iron ore import prices from India (63% Fe grade CFR China) for China have sharply increased by 43.3%, from $66.5 / tonne on March 10, 2009 to $96 / tonne currently.

The run up in steel prices has put marginal Chinese players back in business. Chinese crude steel production has reached 49.42mn tonnes in June 2009 (up 6.4% over May). This too has led to revived demand for iron ore, resulting in further run up in iron ore prices.

Outlook

SGL predominantly exports to China (90% of its iron ore production). Over the next 3 years, SGL plans to more than triple its shipments, from 15mn tonnes in FY09. In order to achieve such volume scalability, SGL acquired Dempo Group's iron ore assets in May. Dempo shipped about 4mn tonnes in FY09.

It is further under various stages of obtaining environmental clearances, so as to achieve the target of 50mn tonnes of iron ore sales over next 3 years. It targets 20mn tonnes from the existing operations in Goa, and 10mn tonnes each from Dempo, Orissa and Karnataka.

We expect better realizations and higher EBIT margins for SGL's iron ore division in Q2FY10, as spot market prices have risen and cost of production from the Orissa mine will decline.

Pritesh U. Jani, Analyst (pritesh@keynoteindia.net)
Nitin A. Khandkar, Head - Research (nitin@keynoteindia.net)

Keynote Capitals Institutional Research
(+9122-30266043)

...however, Indian iron ore prices likely to fall

The sharp rise in Indian iron ore prices is attributable to the slowdown in shipments from Australian miner Rio Tinto, which in turn was due to delay in price settlement with China. According to Steel Business Briefing, Rio Tinto is expected to restart iron ore shipments as it cannot halt exports to China ad infinitum. It may start exports to China by September 2009 leading to correction in prices of Indian iron ore.

European markets are in the holiday season and hence steel demand and prices will likely remain subdued. We therefore expect no fresh surge in demand and prices. On the contrary, as iron ore inventory in China has risen above the 3 year average, showing signs of a small bubble, we expect iron ore prices to correct.

Valuation

SGL trades at

- 11.1x FY10E EPS and 8.9FY11E EPS vis-à-vis Rio Tinto (23.4x FY10E and 20.4x FY11E earnings and and BHP Billiton (25.1x FY10E and 18.5x FY11E earnings).
- EV/EBITDA of 7.8x FY10E and 6x FY11E.

Key Statistics

Iron Ore

	Q1FY09	Q4FY09	Q1FY10	q-o-q %	y-o-y %
Sales (tonnes)	3,250,000	5,025,000	4,736,000	-5.8%	45.7%
Sales (RsCr)	1116.97	1282.49	855.72	-33.3%	-23.4%
Blended Realization (Rs/tonne)	3437	2552	1807	-29.2%	-47.4%
EBIT (RsCr)	698.18	717.14	392.57	-45.3%	-43.8%
EBIT margin	62.5%	55.9%	45.9%	-10.0%	-16.6%
EBIT / tonne (Rs)	2148	1427	829	-41.9%	-61.4%

Net sales down 29.9% q-o-q due to fall in iron ore realizations by 29.2%.

As per our expectations (*refer our Q4FY09 results analysis dated April 22, 2009*), SGL's blended realizations for iron ore declined by 29.2% to Rs1807 per tonne, taking net sales down 29.9% to Rs10.11bn. Iron ore volumes declined 5.8% to 4.73mn tonnes.

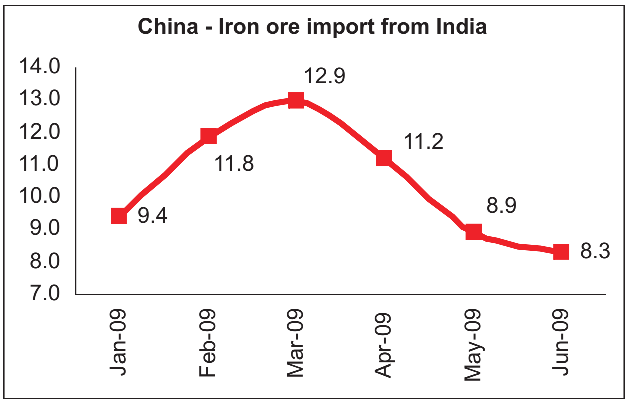
The Goa unit continues to account for a dominant (67%) share of production, while Karnataka and Orissa account for at 25% and 8% respectively, and have the highest cost of production at about $60-65.

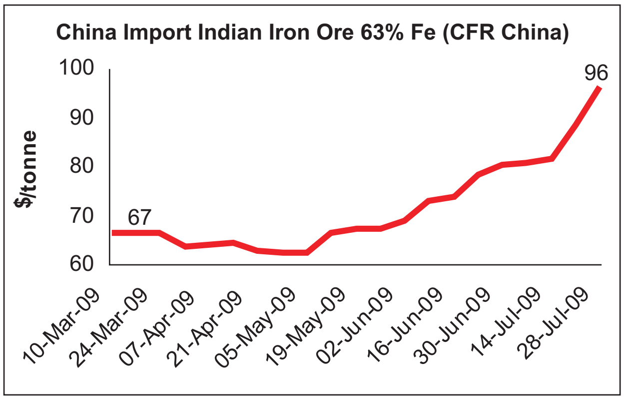
Of the 1.1mn tonnes sold from Dempo in Q1FY10, SGL has consolidated 47000 tonnes for the quarter.

Iron ore, which constituted 84.5% of the product-mix, continues to drive revenue growth and profitability.

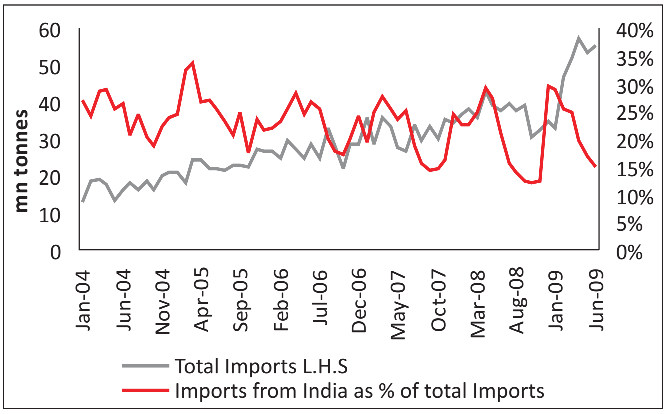
The mix of spot vs. contract sales in Q1FY10 stood at 85:15. The management expects the mix to be 75:25 for full year FY10.

India's iron ore exports to China: prices sharply up on lower volumes





China: Reducing Iron ore imports from India



EBITDA margin slipped 740 bps to 44.8% due to rise in staff and freight costs

EBITDA declined on the fall in blended realizations and shipments of iron ore.

Blended cost per tonne declined to Rs1126 (down 19.2%), primarily on lower other expenditure per tonne. In spite of this, EBIT/tonne for iron ore division slumped to Rs829 down 41.9%.

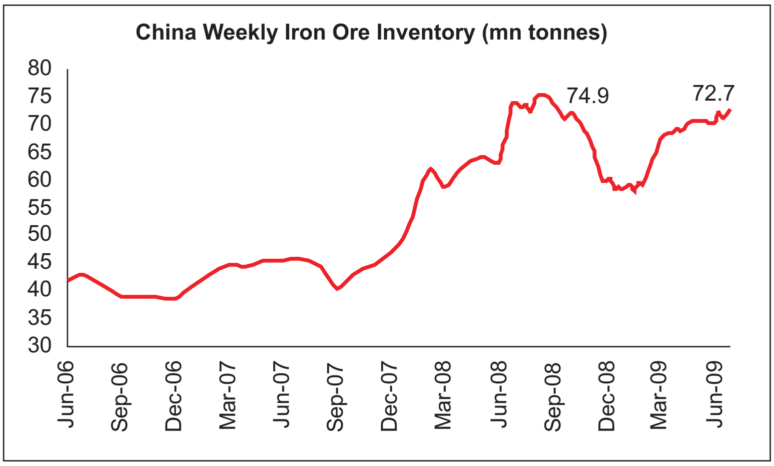
EBITDA fell by 39.9% to Rs453Cr. EBITDA margin slipped to 44.8% a fall of 740 bps due to higher staff costs (up 220 bps as % of sales) and freight costs (up 840 bps as % of sales).

Analysis of Cost per tonne

	Q4FY09 (RsCr)	% cont.	Q1FY10 (RsCr)	% cont.	△ q-o-q	△ % cont. q-o-q
Inland Transportation	400.98	28.8%	450.07	40.0%	12.2%	11.2%
Raw material	222.29	15.9%	197.83	17.6%	-11.0%	1.6%
Other Services	170.77	12.2%	131.08	11.6%	-23.2%	-0.6%
Consump. of Stores	108.56	7.8%	106.55	9.5%	-1.9%	1.7%
Other Expenditure	275.42	19.8%	99.84	8.9%	-63.8%	-10.9%
Staff Cost	49.77	3.6%	78.57	7.0%	57.9%	3.4%
Purchase of Ore	191.68	13.7%	54.35	4.8%	-71.6%	-8.9%
Export Duty	-25.37	-1.8%	7.82	0.7%	-130.8%	2.5%
Total Cost per tonne	**1394.09**	**100.0%**	**1126.11**	**100.0%**	**-19.2%**	**0.0%**

China iron ore inventory levels indicate a small bubble

The average inventory levels held by China since June 30, 2006 is 61.4mn tonnes. The current Chinese iron ore inventory levels (as on July 24, 2009) is 72.7mn tonnes, i.e., about 18.3% higher than the average inventory levels. We believe China would need to consider ways and means of reducing this inventory, leading to a correction in iron ore prices going forward.



Imports by China **(mn tonnes)**

Source	2004	2005	2006	2007	2008	June 2009
Australia	78.16	112.17	126.84	145.65	183.66	121.66
Growth	-	*43.5%*	*13.1%*	*14.8%*	*26.1%*	-
Brazil	46.03	54.74	76.29	98.02	100.65	60.85
Growth	-	*18.9%*	*39.4%*	*28.5%*	*2.7%*	-
India	50.18	68.63	74.75	79.54	91.09	62.54
Growth	-	*36.8%*	*8.9%*	*6.4%*	*14.5%*	-
Total imports by China	208	275	326	384	444	297.33
Chinese imports from:						
Aus, Brazil, India(A.B.I.)	174	236	278	323	375	245
% of total imports for A.B.I.	83.8%	85.6%	85.2%	84.2%	84.5%	82.4%
Share of Imports from India	**24.1%**	**24.9%**	**22.9%**	**20.7%**	**20.5%**	**21.0%**
Share of Imports from Australia	**37.6%**	**40.8%**	**38.9%**	**38.0%**	**41.4%**	**40.9%**

PAT down 22.9% in spite of lower tax rate and higher other income

The performance of pig iron and met coke divisions improved. Met coke in particular reported higher shipments on flattish realizations, helping restrict the fall in PAT. Though realizations were flat, cost control measures led to margin improvement.

In spite of better performance from other businesses and lower tax rate of 17% (down 14 pps) and higher other income of Rs75Cr (up 32.5%), PAT reduced to 422Cr (down by 22.9%), largely to lower EBITDA.

Performance of other businesses

Key Statistics

Pig Iron

Particulars	Q1FY09	Q4FY09	Q1FY10	q-o-q %	y-o-y %
Sales (tonnes)	57,000	71,000	71,000	0.0%	24.6%
Sales (RsCr)	163	133	133	-0.3%	-18.7%
Blended Realization (Rs/tonne)	28,625	18,738	18,675	-0.3%	-34.8%
EBIT (RsCr)	36	7	21	189.0%	-42.1%
EBIT margin	21.9%	5.4%	15.6%	10.2%	-6.3%
EBIT/tonne (Rs)	6,256	1,007	2,910	189.0%	-53.5%

MET Coke

Particulars	Q1FY09	Q4FY09	Q1FY10	q-o-q %	y-o-y %
Sales (tonnes)	63,000	51,000	74,000	45.1%	17.5%
Sales (RsCr)	135.32	71.1	100.76	41.7%	-25.5%
Blended Realization (Rs/tonne)	21,479	13,941	13,616	-2.3%	-36.6%
EBIT (RsCr)	60.35	14.05	25.41	80.9%	-57.9%
EBIT margin	44.6%	19.8%	25.2%	5.5%	-19.4%
EBIT/tonne (Rs)	9,579	2,755	3,434	24.6%	-64.2%

Cash is king: appetite for inorganic growth

SGL, post acquisition of Dempo, carries cash of Rs 2045Cr on its books, making the balance sheet stronger. It is scouting for inorganic growth opportunities in and outside India, primarily for acquiring iron ore assets.

For its steel business, SGL has commenced acquisition of land in Jharkhand. It plans to acquire 1000 acres of land for setting up a 1mn tonne steel plant and will incur capex of Rs100Cr. It applied for the mining license in May 2009 and expects it to be allotted, post completion of the value addition plant in Jharkhand.

Costs break-up (RsCr)

Particulars	Q1FY09	Q4FY09	Q1FY10	q-o-q %	y-o-y %
(inc)/Dec in stock in trade and WIP	-88.23	47.41	18.00	-62.0%	-120.4%
as % of sales	-6.9%	3.3%	1.8%	-1.5%	8.7%
Consumption of Raw materials	47.63	64.29	81.41	26.6%	70.9%
as % of sales	3.7%	4.5%	8.0%	3.6%	4.3%
Staff Cost	28.58	25.01	39.48	57.9%	38.1%
as % of sales	2.2%	1.7%	3.9%	2.2%	1.7%
Consumption of Stores	39.52	54.55	53.54	-1.9%	35.5%
as % of sales	3.1%	3.8%	5.3%	1.5%	2.2%
Contractors for Inland trasns & Other Ser.	0	0	0	-	-
- Inland Transportation	213.57	201.49	226.16	12.2%	5.9%
as % of sales	16.7%	14.0%	22.4%	8.4%	5.7%
- Other Services	76.43	85.81	65.87	-23.2%	-13.8%
as % of sales	6.0%	5.9%	6.5%	0.6%	0.5%
Purchase of Ore	74.53	96.32	27.31	-71.6%	-63.4%
as % of sales	5.8%	6.7%	2.7%	-4.0%	-3.1%
Export Duty	55.97	-12.75	3.93	-130.8%	-93.0%
as % of sales	4.4%	-0.9%	0.4%	1.3%	-4.0%
Other Expenditure	35.43	138.4	50.17	-63.8%	41.6%
as % of sales	2.8%	9.6%	5.0%	-4.6%	2.2%

Valuation

	EPS (Rs.)		P/e (x)		EV/EBITDA (x)	
	FY10	FY11	FY10	FY11	FY10	FY11
SGL	21.66	27.05	11.1	8.9	7.8	6.0
Rio Tinto ^	2.58	2.96	23.4	20.4	13.8	11.9
BHP Billiton *	1.51	2.06	25.1	18.5	11.9	9.1

^ Fiscal ending December

* Fiscal ending June

Yearly P&L Statement Highlights (RsCr)

Particulars	FY08	FY09	%y-o-y
Net Sales	3822.65	4959.1	29.7%
Total Expenditure	1522.13	2420.31	59.0%
EBITDA	2300.52	2538.79	10.4%
EBITDA margin (%)	60.2%	51.2%	-9.0%
Other income	74.41	224.03	201.1%
Interest	0.03	0.99	3200.0%
PBT	2324.94	2710.16	16.6%
Tax	776.01	715.27	-7.8%
Tax rate (%)	33.4%	26.4%	-7.0%
PAT	1541.58	1988.13	29.0%

Keynote Capitals Ltd.

Member

Stock Exchange, Mumbai (INB 230930539)

National Stock Exchange of India Ltd. (INB 010930556)

Over the Counter Exchange of India Ltd. (INB 200930535)

Central Depository Services Ltd. (IN-DP-CDSL-152-2001)

Registered Office

4th Floor, Balmer Lawrie Building,

5, J. N. Heredia Marg,

Ballard Estate, Mumbai 400 001.

Tel Nos. 022-2269 4322 / 24 / 25