Mining / Result Update

India Research

Sesa Goa

DOLAT CAPITAL

CMP: ₹ 200 TP: ₹ 192 Sell

Results inline, regulatory overhang persist

- Sesa Goa profits (pre Cairn income), at ₹ 5.7bn (DCe:₹ 5.73bn), were in line, as lower EBITDA at ₹ 10.7bn (DCe ₹ 11.2bn) was compensated by lower forex loss of ₹1.77bn (Dce ₹ 2.3bn. Adjusted PAT declined 35% YoY to ₹ 6.94bn (Dolat est: ₹ 7.2bn).
- Realisations increased 27.1% QoQ/22.1%YoY to ₹ 4.670/USD91.7 per tonne (DCe: ₹ 4,428/USD87 per tonne) due to higher proportion of sales from Goa. Sales volumes fell 6.5%YoY to 5.03mn tonnes as Sesa discontinued its Orissa operations last year. Iron ore production decreased 22.3% YoY (excluding Orissa) to 3.33mn tonnes due to the ban on mining in Karnataka from August 27, 2012.
- EBITDA declined 11.9%YoY to ₹ 10.73bn (DCe: ₹ 11.23bn) due to forex loss (₹ 200mn) in coking coal operations and lower production in the pig iron plant. EBIT for iron ore rose 37.7% QoQ to ₹ 2,130 per tonne (DCe ₹ 2143)due to higher proportion of high-margin sales (87.5%) from Goa (Low cost operations).
- The coke division's EBIT slipped by 300% QoQ and 178% YoY to a loss of ₹ 178mn (DCe: Profit of ₹ 120mn. The pig iron division's EBIT declined 47%YoY to ₹ 180mn (Dolat est: ₹ 130mn) due to lower production and higher iron ore cost due to e-auction.
- We believe given the current regulatory overhangs regarding the implication of the Shah commission report, weak iron ore pricing environment and the imposition of additional royalty due to MMDR act, Sesa Goa will remain under pressure. We maintain our Sell rating on Sesa Goa with a price target of ₹ 192 (3x FY13 EV/EBITDA, ₹ 105 per share for the holding in Cairn, valuing it at 30% discount to current market price).

High Points

- **Results inline with estimates but below consensus estimate**
- **Better product mix leads to 27.1% QoQ to USD92 per tonne**
- **Regulatory overhang continues**
- **View: We maintain our Sell rating with a target price of ₹ 192**

Scrip Details

Equity	₹ 869mn
Face Value	₹ 1/-
Market Cap	₹ 142bn
	USD 2.9bn
52 week High / Low	₹ 335 / 149
Avg. Volume (no)	3,193,229
BSE Sensex	17,077
NSE Nifty	5158
Bloomberg Code	SESA IN
Reuters Code	SESA.BO

Q3FY12 Result (₹ mn)

Particulars	Q3FY12	Q2FY12	QoQ (%)	Q3FY11	YoY (%)	H1FY12	H2FY11	YoY (%)
Net Sales	**26,043**	**22,373**	**16.4**	**7,841**	**232.1**	**54,832**	**55,382**	**-1.0**
Total Income	26,223	23,641	10.9	8,345	214.2	57,036	59,263	-3.8
Total Expenditure	15,319	10,195	50.3	5,297	189.2	30,232	24,969	21.1
EBIDTA	**10,724**	**12,178**	**-11.9**	**2,544**	**321.5**	**24,600**	**30,413**	**-19.1**
EBITDA margins	*41.2*	*54.4*		*32.4*		*44.9*	*54.9*	
Other income	308	1,395	-77.9	560	64.3	2,530	4,314	-41.4
Interest	730	134	445.0	516	41.4	1,739	411	322.7
PBDT	10,302	13,439	-23.3	2,588	298.1	25,391	34,316	-26.0
Depreciation	263	208	26.9	243	8.4	776	593	30.7
Extraordinary Items	1,779	-24	0.0	2,341	0.0	4,135	523	
PBT	8,260	13,232	-37.6	4		20,480	33,200	-38.3
Tax	2,564	2,573	-0.3	-9		6,366	5,593	13.8
Tax Rate	*31.0*	*19.4*		*-245.9*		*31.1*	*16.8*	
Profit After Tax	5,696	10,659	-46.6	13		14,115	27,607	-48.9
Minority Interest (MI)	-1,219	30		0	0.0	-1,219	87	-1,506.3
Profit After MI	**6,915**	**10,629**	**-34.9**	**13**		**15,334**	**27,520**	**-44.3**
Diluted EPS	8.0	12.3	-35.1	0.0		17.6	31.7	-44.3

Financials

Year	Net Sales	Growth-%	EBITDA	OPM%	Net Profit	Growth-%	EPS (₹)	PER (X)	EV/EBITDA	ROANW-%	ROACE-%
FY11	92,051	57.1	51,516	56.0	41,678	62.4	48.0	3.4	2.8	40.2	46.9
FY12E	81,798	(11.1)	34,821	42.6	27,408	(34.2)	31.5	5.2	4.8	19.6	21.9
FY13E	85,601	4.6	30,236	35.3	35,543	29.7	40.9	4.0	5.0	21.1	14.5
FY14E	85,663	0.1	33,349	38.9	37,707	6.1	43.4	3.8	4.0	18.7	14.5

Figure in ₹ mn

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January 27, 2012

Operating Matrix

Particulars	Q3FY12	Q2FY12	QoQ (%)	Q3FY11	YoY (%)	H1FY12	H2FY11	YoY (%)
Sales Volume (mn tonnes)								
Iron ore sales	5.0	5.4	-6.5	1.6	224.5	10.9	12.3	-11.5
Metallurgical coke (tonnes)	60,000	63,000	-4.8	51,000	17.6	174,000	189,000	-7.9
Pig iron (tonnes)	68,020	63,000	8.0	64,110	6.1	190,130	201,000	-5.4
Goa Sales	4.40	3.74	17.6	0.83	430.1	8.38	8.44	(0.7)
Karnataka Sales	0.64	0.63	1.6	0.71	(9.9)	2.45	1.57	56.1
Production (exclusing Orissa)	3.33	4.29	(22.4)	1.12	197.3	8.84	11.90	(25.7)
Realisations (Rs per tonne)								
Iron ore sales	4,670	3,824	22.1	3,678	27.0	4,436	4,052	9.5
Metallurgical coke (tonnes)	23,835	19,346	23.2	22,945	3.9	22,992	19,549	17.6
Pig iron (tonnes)	29,935	25,360	18.0	29,102	2.9	29,100	24,684	17.9
EBIT (Rs per tonne)								
Iron ore	2,106	2,146	-1.9	1,530	37.7	2,185	2,314	-5.6
Metallurgical coke	-2,890	3,519	-182.1	-845	242.0	359	4,421	-91.9
Pig iron	2,660	5,489	-51.5	547	385.8	1,793	4,960	-63.8
INR	50.9	44.9	13.5	45.8	11.1	47.1	46.1	2.2

Key Highlights:

- Realisations increased 27.1% QoQ/22.1%YoY to ₹ 4.670/USD91.7 per tonne (DCe ₹ 4,428/USD87 per tonne) due to higher proportion of sales from Goa (87.5%vs 53.5%) in Q2FY12. Sesa also improved the grade of iron ore by 0.4% during the quarter as it faced regarding blending of iron ore due to logistical constraints.
- Sales volumes fell 6.5%YoY to 5.03mn tonnes as Sesa discontinued its Orissa operations last year. Sales volumes in Karnataka at 0.71mn tonnes (0.7%YoY,7%QoQ) as Sesa sold iron ore in e-auctions as per Supreme court order. Realizations fell by 21%QoQ to USD31 in Karnataka. Sales volumes in Goa grew by 17.6%YoY to 4.4mn tonne as Sesa sold accumulated inventory in Q2FY12 during the quarter.
- Iron ore production decreased 22.3% YoY (excluding Orissa) to 3.33mn tonnes due to the ban on mining in Karnataka from August 27, 2012 and planned reduction in inventories in Goa.
- EBITDA declined 11.9%YoY to ₹ 10.73bn (DCe: ₹ 11.23bn) due to forex loss (₹ 200mn) in coking coal operations and lower production in the pig iron plant. EBITDA also declined due to increase in domestic sales of iron ore. EBIT for iron ore rose 37.7% QoQ to ₹ 2,130 per tonne due to higher proportion of high-margin sales (87.5%) from Goa (Low cost operations).
- The coke division's EBIT slipped by 300% QoQ and 178% YoY to a loss of ₹ 178mn (DCe: Profit of ₹ 120mn). It was hit by the higher cost of coking coal and forex loss of ₹ 200mn on outstanding buyers' credit for coking coal imports. Coke realizations rose 3.9% QoQ and 23.2% YoY to ₹ 23,835 per tonne, whereas EBIT per tonne stood at a negative ₹ 2890.
- The pig iron division's EBIT declined 47%YoY to ₹ 180mn (Dolat est: ₹ 130mn) due to lower production and higher iron ore cost due to e-auction. Pig iron sales volumes rose 8% YoY/6.1%QoQ to 68,020 tonnes as it liquidated inventories during the quarter. Pig iron production fell 6% YoY to 64,108 tonnes as the capacity remained constrained due to difficulties in availabilities of iron ore. EBIT per tonne of pig iron declined 51%YoY to ₹ 2659 (Dolat est: ₹ 1800 per tonne) due to high cost of iron ore. Sesa will start using sintered ore once its

sinter plant commences production from Q4FY12 and will reduce its dependence on lump ore from Karnataka. Sesa also expects cost reduction of ₹ 3000 per tonne due to usage of sintered ore and increase in usage of its fines from its own mines.

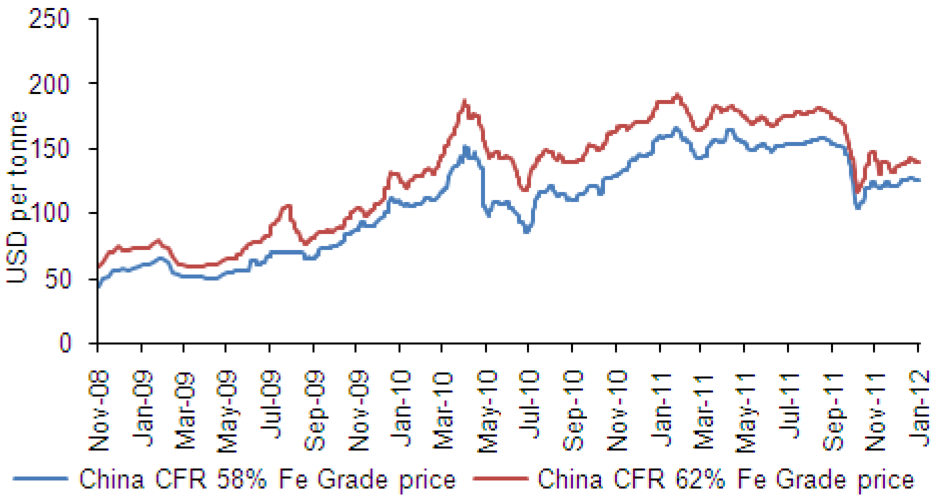
- Sesa had notional mark-to-market loss of ₹ 1.77bn (-24%QoQ, ₹ 2.34bn) due USD 296mn (USD374mnin Q2FY12)mn outstanding forex liabilities (FCCBs of USD 216mn and buyer credit of USD 180mn) following a sharp 9% depreciation in the rupee.
- Interest cost rose 445% YoY/41%QoQ to Rs 733mn (Dolat est: Rs 570mn), whereas other income fell 85% YoY to Rs 308mn as it turned from a net cash to a net debt (Rs44bn) company.
- Adjusted for forex losses, Sesa's PAT declined 35% YoY to ₹ 6.94bn (Dolat est: of ₹ 7.2bn).
- It has turned from a net cash to a company with a net debt of ₹ 39.3bn that includes ₹ 10bn on account of outstanding FCCBs.

Key takeaways from conference call

- Sesa has 0.15mn tonnes of iron ore inventory, which it would sell through e-auctions by CEC. Sesa has recognized the revenue of ₹ 816.2mn (20% withheld of the total proceeds) against sales of iron ore in e auction .The disbursing is expected to be received after the final decision by the Supreme court.
- Sesa has completed the aro-magnetic survey of western cluster and will start the drilling during the quarter. Sesa expects a capex of USD80-120 per tonne of iron ore on mining and ancillary units. We anticipate Sesa to spend about USD1bn.
- Shah commission is busy in Orissa report will be submitted after Mar-12 (Elections in Goa) . After the submission of the report, inter ministerial discussion will take place and remedial actions will be then initiated.
- CEC was expected to submit the report on Karnataka mining by 27th Jan 2012 as it has completed all the surveys and got the various data required from the mines.
- Sesa has opposed the canalization by Govt. for selling the ore and believes its detrimental for the industry. It is perceived by the government as one of the ways to stop the illegal mining.
- Sesa is facing issues in logisitics in Goa due to increase in freight rates by the trucks and hence there is a constraint in its 2-3 mines .This has resulted in slippage of grade for its Goa mines by 0.4%-0.5%.
- Sesa expects the iron ore price to remain firm at USD140-145 (63% Fe China CIF), as it expects to stay it around the marginal cost of production for Chinese guys at USD130-135 per tonne.
- Sesa has announced the interim dividend of ₹ 2 per share.
- Sesa expects that post election in Goa , there will be speedy movement in terms of clearances for its mine expansion.
- Sesa has not provided for the forest development tax of 12.5% and is under litigation in Karnataka high court.
- Sesa expects to complete the expansion of its pig iron capacity to 625,000 tonnes and coke capacity to 560,000 tonne by Q4 FY12 (Delay of 3 months). It is also commissioning a sinter plant and waste heat-based captive power plant that will reduce its cost of pig iron production by Rs3000 per tonne.

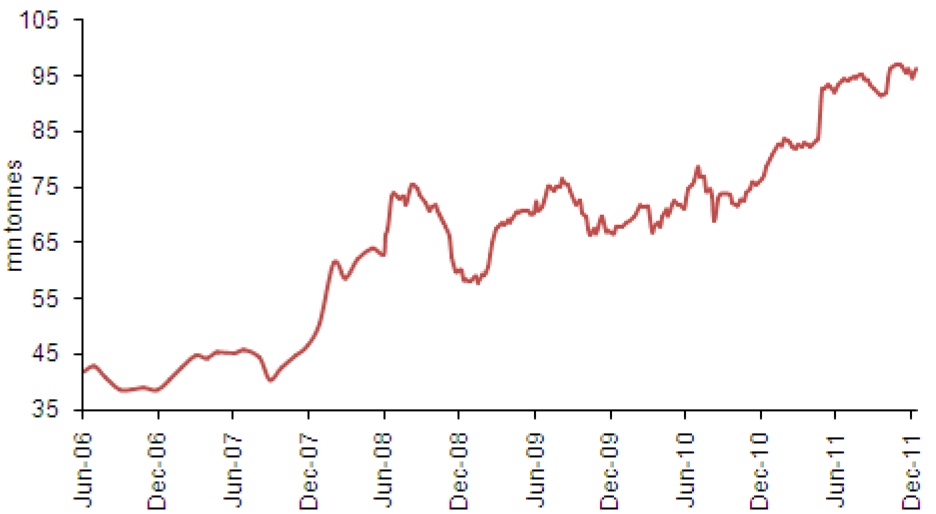
- We have revised our EBITDA upwards by 8% in FY13E as we expect the Karnataka market to remain in balance as we believe there would be restricted supply from iron ore mines.

Iron ore prices have stabilised after fall



Source: Bloomberg, Dolat Research

Inventory of iron ore at Chinese ports



Source: Bloomberg, Dolat Research

- Spot iron ore (62% Fe) prices have stabilized at USD140 CIF China and we expect the prices to stabilize around the current levels. The marginal cost of Chinese players for the comparable grade is at USD130 limiting the downside for iron ore prices. However, over the medium term, we expect the iron ore market to be in balance due to impending supply by FY15.
- We believe that with the current slowdown in demand for steel and hence iron ore in China, spot iron ore prices will remain under pressure. We believe given the current regulatory overhangs regarding the implication of the Shah commission report, weak iron ore pricing environment and the imposition of additional royalty due to MMDR act, Sesa Goa will remain under pressure. We maintain our Sell rating on Sesa Goa with a price target of ₹ 192 (3x FY13 EV/EBITDA, ₹ 105 per share for the holding in Cairn, valuing it at 30% discount to current market price).

INCOME STATEMENT

₹ mn

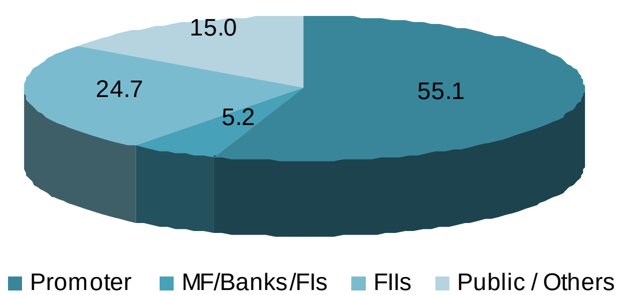
Particulars	Mar10	Mar11	Mar12E	Mar13E
Net Sales	**92,051**	**81,798**	**85,601**	**85,663**
Other income	5,399	2,670	900	1,500
Total Income	97,450	84,468	86,501	87,163
Total Expenditure	40,535	46,977	55,365	52,314
Other expnditure	6,469	46,977	8,899	9,098
EBIDTA (Excl. Other Income)	**51,516**	**34,821**	**30,236**	**33,349**
EBIDTA (Incl. Other Income)	**56,915**	**37,491**	**31,136**	**34,849**
Interest	901	2,295	2,100	2,100
EBDT	**56,014**	**35,196**	**29,036**	**32,749**
Depreciation	964	1,148	2,338	2,494
Profit Before Tax & EO Items	55,050	34,048	26,698	30,255
Extra Ordinary Exps/(Income)	0	2,735	0	0
Profit Before Tax	55,050	31,312	26,698	30,255
Tax	13,372	9,724	8,555	9,549
Net Profit	41,678	21,589	18,143	20,707
Minority Interest	0	(5,819)	(17,400)	(17,000)
Net Profit	**41,678**	**27,408**	**35,543**	**37,707**

BALANCE SHEET

Particulars	Mar10	Mar11	Mar12E	Mar13E
Sources of Funds				
Equity Capital	869	869	869	869
Preference Capital	0	0	0	0
Share Premium	18,694	18,694	18,694	18,694
Other Reserves	108,541	132,390	164,921	199,616
Net Worth	**128,104**	**151,953**	**184,484**	**219,179**
Secured Loans	314	30,314	10,314	10,314
Unsecured Loans	9,680	9,680	9,680	9,680
Loan Funds	**9,995**	**39,995**	**19,995**	**19,995**
Net Deferred Tax Liability	682	682	682	682
Total Capital Employed	**138,781**	**192,630**	**205,161**	**239,856**
Applications of Funds				
Gross Block	30,648	43,761	46,761	49,761
Less: Accumulated Depreciation	6,492	7,640	9,978	12,472
Net Block	**24,156**	**36,121**	**36,783**	**37,289**
Capital Work in Progress	7,287	4,000	5,000	5,000
Investments	98,265	137,716	155,116	172,116
Current Assets, Loans & Advances				
Inventories	7,438	6,723	7,036	7,041
Sundry Debtors	6,830	6,051	6,332	6,337
Cash and Bank Balance	8,970	16,920	11,909	28,500
Loans and Advances	2,949	2,454	2,568	2,570
Other Current Assets	141	141	141	141
sub total	26,329	32,289	27,986	44,589
Less : Current Liabilities & Provisions				
Current Liabilities	12,946	13,607	15,786	15,144
Provisions	4,310	3,888	3,938	3,994
sub total	17,256	17,495	19,724	19,138
Net Current Assets	9,073	14,793	8,262	25,451
Total Assets	**138,781**	**192,630**	**205,161**	**239,856**

E-estimates

Shareholding Pattern as on Dec'11 (%)



CASH FLOW

Particulars	Mar10	Mar11	Mar12E	Mar13E
Profit before tax	55,597	31,312	26,698	30,255
Depreciation & w.o.	964	1,148	2,338	2,494
Net Interest Exp	(4,945)	2,295	2,100	2,100
Direct taxes paid	(13,678)	(9,724)	(8,555)	(9,549)
Chg in Working Capital	(3,037)	2,229	1,520	(597)
Other	433			
(A) CF from Operation	**35,335**	**27,261**	**24,101**	**24,703**
Capex	(9,841)	(9,826)	(4,000)	(3,000)
Free Cash Flow	**25,493**	**17,435**	**20,101**	**21,703**
Inc./ (Dec.) in Investments	(24,765)	(39,451)	(17,400)	(17,000)
Other	4,959			
(B) CF from Invst. Activities	**(29,647)**	**(49,276)**	**(21,400)**	**(20,000)**
Issue of Equity/ Preference	9,979	0	0	0
Inc./(Dec.) in Debt	(9,611)	30,000	(20,000)	0
Interest exp net	(901)	(2,295)	(2,100)	(2,100)
Dividend Paid (Incl. Tax)	(3,559)	(3,559)	(3,559)	(3,559)
Other	(218)			
(C) Cash Flow from Financing	**(4,311)**	**24,146**	**(25,659)**	**(5,659)**
Net Change in Cash	1,377	2,130	(22,957)	(955)
Opening Cash balances	23,918	8,970	16,920	11,909
Closing Cash balances	8,970	16,920	11,909	28,500

E-estimates

IMPORTANT RATIOS

Particulars	Mar10	Mar11	Mar12E	Mar13E
(A) Measures of Performance (%)				
Contribution Margin	**100.5**	**100.0**	**100.0**	**100.0**
EBIDTA Margin (excl. O.I.)	56.0	42.6	35.3	38.9
EBIDTA Margin (incl. O.I.)	58.4	44.4	36.0	40.0
Interest / Sales	1.0	2.8	2.5	2.5
Gross Profit Margin	57.5	41.7	33.6	37.6
Tax/PBT	24.3	31.1	32.0	31.6
Net Profit Margin	42.8	32.4	41.1	43.3
(B) Measures of Financial Status				
Debt / Equity (x)	0.1	0.3	0.1	0.1
Debtors Period (days)	27	27	27	27
Closing stock (days)	29	30	30	30
Inventory Turnover Ratio (x)	12.4	12.2	12.2	12.2
Fixed Assets Turnover (x)	3.0	1.9	1.8	1.7
Working Capital Turnover (x)	10.1	5.5	10.4	3.4
Non Cash Working Capital (₹ Mn)	103	(2,126)	(3,647)	(3,049)
(C) Measures of Investment				
EPS (₹) without cairn	48.0	28.0	20.9	23.8
EPS (₹)	48.0	31.5	40.9	43.4
CEPS (₹)	49.1	32.9	43.6	46.3
DPS (₹)	3.5	3.5	3.5	3.5
Dividend Payout (%)	7.3	11.1	8.6	8.1
Profit Ploughback (%)	92.7	88.9	91.4	91.9
Book Value (₹)	147.4	174.8	212.3	252.2
RoANW (%)	40.2	19.6	21.1	18.7
RoACE (%)	46.9	21.9	14.5	14.5
(D) Valuation Ratios				
CMP (₹)	200	200	200	200
P/E (x)	4.2	6.3	4.9	4.6
Market Cap. (₹ Mn.)	173,820	173,820	173,820	173,820
MCap/ Sales (x)	1.9	2.1	2.0	2.0
EV (₹ Mn.)	174,845	196,895	181,906	165,314
EV/Sales (x)	1.9	2.4	2.1	1.9
EV/EBDITA (x)	3.4	5.7	6.0	5.0
P/BV (x)	1.4	1.1	0.9	0.8
Dividend Yield (%)	1.8	1.8	1.8	1.8

E-estimates

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BUY	Upside above 20%
ACCUMULATE	Upside above 5% and up to 20%
REDUCE	Upside up to 5%
SELL	Negative Returns

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