

# Sesa Goa

27 January 2012

Reuters: SESA.BO; Bloomberg: SESA IN

## Strong performance, but mining uncertainty persists

Sesa Goa's (SGL) 3QFY12 EBITDA was 31%/23% above our/consensus estimates, respectively, due to higher-than-expected realisation and iron ore volume. PAT was up 14%/7% versus our/consensus estimates, respectively, a lower deviation versus EBITDA, due to higher interest costs and forex loss. We have slightly tweaked our iron ore volume estimates by 2%/(1%) for FY12/FY13, while our realisation estimates have been increased by 14%/13%, respectively, in the same period due to higher proportion of Goa iron ore and stabilisation of iron ore prices. The above factors led to a 11%/10% increase in FY12/FY13 EBITDA, while PAT estimates have been revised upwards by 3%/8%, respectively, for the same period. However, following uncertainty regarding Karnataka and Goa mining operations and likely cyclical downturn in iron ore prices, we retain our Sell rating on the stock with a revised TP of Rs164 (up 12% from earlier TP of Rs146), which is 18% below the CMP.

**Stable volume, but mining uncertainty persists:** SGL posted a 5% YoY growth in iron ore volume at 5.04mt, comprising 4.40mt and 0.64mt from Goa and Karnataka mines, respectively. However, it is left with only 0.10-0.15mt of ore inventory in Karnataka and as a result sales would grind to a halt in case resumption of mining operations is not allowed. Moreover, the Shah Committee is likely to submit its report on Goa iron ore mining post state elections i.e. after February 2012 and it may also propose an interim ban on all mining activities until illegal mines are seized. In our financials, we do not assume any mining ban in Goa and expect mining operations in Karnataka to resume by 2QFY13.

**Blended realisation up driven by change in sales mix, weak rupee:** SGL witnessed a 24% QoQ spurt in realisation at Rs4,743/tonne (US\$93/tonne) due to higher proportion of Goa iron ore sales and 11% rupee fall. Goa ore accounted for 87% of total volume during the quarter versus 54% in 2QFY12.

**Valuation:** SGL is trading at P/E and EV/EBITDA multiples of 5.9x and 6.4x FY13E. We retain our Sell rating on it with a revised TP of Rs164. Core business value increased from Rs53 to Rs66, while the value of Cairn India investment increased from Rs93/share to Rs98/share following a rise in Cairn share price.

## SELL

**Sector:** Metal & Mining

**CMP:** Rs200

**Target Price:** Rs164

**Downside:** 18%

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### Key Data

Current Shares O/S (mn)	8,69.1
Mkt Cap (Rsbn/US\$bn)	174.4/3.5
52 Wk H / L (Rs)	336/148
Daily Vol. (3M NSE Avg.)	3,130,046

### Price Performance (%)

	1 M	6 M	1 Yr
Sesa Goa	24.1	(28.6)	(38.4)
Nifty Index	9.4	(9.2)	(9.3)

Source: Bloomberg

Y/E March (Rsmn)	3QFY11	2QFY12	3QFY12	% Chg (YoY)	% Chg (QoQ)	9MFY11	9MFY12	% Chg (YoY)
<b>Net sales</b>	<b>22,501</b>	<b>7,897</b>	<b>26,171</b>	<b>16.3</b>	<b>231.4</b>	<b>55,815</b>	<b>55,157</b>	<b>(1.2)</b>
Raw material & employee costs	3,899	2,345	6,990	79.3	198.0	7,645	11,548	51.0
% of sales	17.3	29.7	26.7			13.7	20.9	
Export duty	1,167	872	4,485	284.2	414.2	2,970	8,811	196.6
% of sales	5.2	11.0	17.1			5.3	16.0	
Other operating expenses	5,129	2,080	3,844	(25.1)	84.8	14,353	9,873	(31.2)
% of sales	22.8	26.3	14.7			25.7	17.9	
<b>Operating profit</b>	<b>12,306</b>	<b>2,600</b>	<b>10,852</b>	<b>(11.8)</b>	<b>317.4</b>	<b>30,846</b>	<b>24,925</b>	<b>(19.2)</b>
<b>OPM (%)</b>	<b>54.7</b>	<b>32.9</b>	<b>41.5</b>	<b>(13.22)</b>	<b>8.54</b>	<b>55.3</b>	<b>45.2</b>	<b>(10.07)</b>
Depreciation	208	243	263	26.9	8.4	593	776	30.7
Interest costs	134	516	730	445.0	41.4	411	1,739	322.7
Other income	1,268	504	180	(85.8)	(64.3)	3,881	2,205	(43.2)
Forex loss /(gain)	(24)	2,341	1,779	(7,576.1)	(24.0)	523	4,135	691.5
<b>PBT</b>	<b>13,255</b>	<b>4</b>	<b>8,260</b>	<b>(37.7)</b>	<b>223,129.7</b>	<b>33,200</b>	<b>20,480</b>	<b>(38.3)</b>
Provision for tax	2,573	(9)	2,564	(0.3)	(28,271.4)	5,593	6,366	13.8
-effective tax rate	19.4	(245.9)	31.0			16.8	31.1	
<b>PAT before MI</b>	<b>10,683</b>	<b>13</b>	<b>5,696</b>	<b>(46.7)</b>	<b>44,399.2</b>	<b>27,607</b>	<b>14,115</b>	<b>(48.9)</b>
Minority interest	30	0	(1,219)			89	(1,219)	
<b>PAT after MI</b>	<b>10,653</b>	<b>13</b>	<b>6,915</b>	<b>(35.1)</b>	<b>53,925.0</b>	<b>27,518</b>	<b>15,334</b>	<b>(44.3)</b>
<b>NPM (%)</b>	<b>44.9</b>	<b>0.2</b>	<b>21.6</b>			<b>46.2</b>	<b>24.6</b>	
<b>EPS (Rs)</b>	<b>12.4</b>	<b>0.0</b>	<b>8.0</b>	<b>(35.8)</b>	<b>53,925.0</b>	<b>32.0</b>	<b>17.6</b>	<b>(44.9)</b>

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 1: Financial summary

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
Revenue	58,583	92,051	84,473	89,181	89,049
YoY (%)	18.1	57.1	(8.2)	5.6	(0.1)
EBITDA	31,448	52,030	35,571	30,581	23,335
EBITDA margin (%)	53.7	56.5	42.1	34.3	26.2
PAT	26,291	42,135	24,146	33,619	30,740
EPS (Rs)	31.6	48.5	27.8	38.7	35.4
YoY (%)	25.3	53.2	(42.7)	39.2	(8.6)
RoE (%)	33.2	32.9	16.3	18.9	15.0
RoCE (%)	27.1	31.1	15.3	17.2	14.3
P/E (x)	6.3	4.1	7.2	5.2	5.7
EV/ EBITDA (x)	3.7	1.7	5.9	6.4	8.0

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 2: Our estimates versus actuals

Description	3QFY11	2QFY12	3QFY12	YoY(%)	QoQ(%)	3QFY12E	Devi(%)	3QFY12 BBE	Devi(%)
<b>Volume</b>									
Iron ore (dmt)	4.78	1.55	5.04	5.4	225.6	4.20	20.0		
Pig iron (tonne)	63,146	64,611	68,020	7.7	5.3	65,000	4.6		
<b>Realisation (Rs/tonne)</b>									
Iron ore	4,370	3,839	4,743	8.5	23.5	3,939	20.4		
Pig iron	25,303	28,876	29,921	18.2	3.6	29,580	1.2		
<b>Segmental revenue (Rsmn)</b>									
Iron ore	20,891	5,943	23,903	14.4	302.2	16,544	44.5		
Pig iron	1,219	1,170	1,430	17.3	22.2	1,467	(2.5)		
Met coke	1,598	1,866	2,035	27.4	9.1	1,923	5.9		
<b>Gross revenue</b>	<b>23,707</b>	<b>8,979</b>	<b>27,369</b>	<b>15.4</b>	<b>204.8</b>	<b>19,934</b>	<b>37.3</b>		
Less: inter-segment	1,188	1,075	1,186	(0.2)	10.3	1,577	(24.8)		
<b>Net revenue</b>	<b>22,519</b>	<b>7,904</b>	<b>26,183</b>	<b>16.3</b>	<b>231.3</b>	<b>18,357</b>	<b>42.6</b>		
<b>Segmental EBIT (Rsmn)</b>									
Iron ore	11,549	2,371	10,593	(8.3)	346.7	8,008	32.3		
Pig iron	222	(43)	(173)	(178.2)	302.3	(10)	1,694.4		
Met coke	346	35	181	(47.7)	415.4	77	134.4		
<b>Total</b>	<b>12,116</b>	<b>2,363</b>	<b>10,600</b>	<b>(12.5)</b>	<b>348.6</b>	<b>8,075</b>	<b>31.3</b>		
<b>Consol. Financials (Rsmn)</b>									
Net Sales	22,501	7,897	26,171	16.3	231.4	18,357	42.6	19,647	33.2
EBITDA	12,306	2,600	10,852	(11.8)	317.4	8,297	30.8	8,843	22.7
PAT	10,653	13	6,915	(35.1)	53,925.0	6,043	14.4	6,442	7.3

Source: Company, Nirmal Bang Institutional Equities Research

## Change in earnings estimates

### Volume update

We have revised our FY12/FY13 iron ore volume estimates by 2%/(1%), respectively, after the management's comments about the current situation. We have revised our metallurgical coke and pig iron assumptions downwards by 8% and 7%, respectively, for FY12 as the company has deferred the commissioning of new metallurgical coke and pig iron plants to the end of 4QFY12. We maintain our FY13 estimates on the same. We have estimated FY14 iron ore volume at 19.3mt, which implies a 10% growth driven largely by higher Karnataka sales.

### Realisation update

We have increased our FY12 and FY13 iron ore realisation assumptions by 14% and 13%, respectively, after factoring in 3QFY12 numbers. We have marginally tweaked our estimates for metallurgical coke and pig iron also. Our FY14 iron ore realisation estimate is 10% lower compared to FY13.

## Cairn India update

Brent crude oil is trading above US\$100/barrel since a long time and this has led to strong earnings for Cairn India. This has resulted in 1% and 5% upgrade in Cairn India consensus PAT estimates for FY12 and FY13, respectively, from the beginning of January 2012. We continue to maintain our dividend assumptions of Rs5/share and Rs10/share in respect of Cairn India investment for FY12 and FY13, respectively. For FY14, we expect Cairn India to pay a dividend of Rs15/share.

## Exhibit 3: Change in our estimates

Description (Rsmn)	Earlier assumption			New assumption			Change (%)		
	FY12E	FY13E	FY14E	FY12E	FY13E	FY14E	FY12E	FY13E	FY14E
<b>Volume</b>									
Iron ore (dmt)	16.3	17.9	NA	16.6	17.6	19.3	1.8	(1.4)	-
Met coke (tonne)	271,000	463,000	NA	250,000	463,000	512,000	(7.7)	-	-
Pig iron (tonne)	279,128	533,125	NA	258,710	533,125	598,750	(7.3)	-	-
<b>Realisation (US\$/tonne)</b>									
Iron ore	83.9	71.7	NA	95.7	80.3	72.2	14.0	12.1	-
Met coke	444.4	400.0	NA	448.6	400.9	385.0	0.9	0.2	-
Pig iron	598.5	560.0	NA	600.2	561.5	540.0	0.3	0.3	-
USD/INR	48.4	54.0	NA	48.4	54.5	54.5	-	0.9	-
<b>Realisation (Rs/tonne)</b>									
Iron ore	4,059	3,870	NA	4,629	4,378	3,936	14.0	13.1	-
Met coke	21,500	21,600	NA	21,702	21,851	20,983	0.9	1.2	-
Pig iron	28,954	30,240	NA	29,036	30,604	29,430	0.3	1.2	-
<b>Consol. financials (Rsmn)</b>									
Net sales	74,047	82,324	NA	84,473	89,181	89,049	14.1	8.3	-
EBITDA	32,175	27,697	NA	35,571	30,581	23,335	10.6	10.4	-
PAT after MI	23,524	31,262	NA	24,146	33,619	30,740	2.6	7.5	-

Source: Company, Nirmal Bang Institutional Equities Research

## Conference call highlights

- Sesa Goa indicated that logistic constraints in Goa continue and transportation firms are asking for an increase in freight rates. However, the entire mining industry in Goa has termed this demand as irrational.
- The company is only left with 100,000-150,000 tonne of iron ore inventory in Karnataka. We have assumed zero volume during 1QFY13, while our FY13 and FY14 assumptions stand at 3.6mt and 5.3mt, respectively, as we assume partial relief in respect of Karnataka mining ban in 2QFY13. This is lower than the company's target of 6.0mt.
- Sesa Goa's management has indicated that the company is keeping its mine in Karnataka in a ready-to-mine condition. This should enable operations to resume as soon as the mining ban is lifted.
- The average grade of Goa iron ore improved 0.4-0.5% QoQ as compared to 1% QoQ deterioration in 2QFY12, primarily due to the composition of the mines. One particular set of mines' production continues to remain impacted due to logistic constraints. Sesa Goa expects a marginal improvement in average ore grade during 4QFY12 as well.
- Royalty payment during 3QFY12 stood at Rs250/tonne compared to Rs325/tonne in 1QFY12. The decline in royalty payment was primarily attributed to higher proportion of Goa's iron ore production. Royalty paid during 1QFY12 was Rs230/tonne.
- MTM (mark-to-market) loss of Rs1,779mn relates to FCCBs and foreign borrowings to the tune of US\$400mn.
- Sesa Goa currently has net debt of Rs40bn and the company expects this to be its peak debt level.

## Financials (Consolidated)

### Exhibit 4: Income statement

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
<b>Revenue</b>	<b>58,583</b>	<b>92,051</b>	<b>84,473</b>	<b>89,181</b>	<b>89,049</b>
YoY growth (%)	18.1	57.1	(8.2)	5.6	(0.1)
Raw material cost	27,135	40,021	48,902	58,599	65,714
% of sales	46.3	43.5	57.9	65.7	73.8
<b>EBITDA</b>	<b>31,448</b>	<b>52,030</b>	<b>35,571</b>	<b>30,581</b>	<b>23,335</b>
EBITDA margin (%)	53.7	56.5	42.1	34.3	26.2
Depreciation	745	964	1,047	1,473	1,548
<b>EBIT</b>	<b>30,703</b>	<b>51,066</b>	<b>34,524</b>	<b>29,109</b>	<b>21,788</b>
Interest expenses	517	553	2,411	3,599	2,799
Other income	4,260	5,571	2,265	2,610	4,747
Exceptional loss/(gain)	0	488	4,135	0	0
<b>PBT</b>	<b>34,446</b>	<b>55,597</b>	<b>30,243</b>	<b>28,120</b>	<b>23,735</b>
Provision for tax	8,056	13,372	9,032	8,253	8,068
Effective tax rate (%)	23.4	24.1	29.9	29.4	34.0
<b>PAT before MI</b>	<b>26,390</b>	<b>42,225</b>	<b>21,211</b>	<b>19,867</b>	<b>15,668</b>
MI and profit of assoc.	99	89	(2,934)	(13,752)	(15,072)
<b>PAT after MI &amp; assoc. profit</b>	<b>26,291</b>	<b>42,135</b>	<b>24,146</b>	<b>33,619</b>	<b>30,740</b>
YoY growth (%)	32.2	60.3	(42.7)	39.2	(8.6)
PAT margin (%)	44.9	45.8	28.6	37.7	34.5

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 6: Balance Sheet

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
Share capital	831	869	869	869	869
Reserves and surplus	78,346	127,235	147,314	176,865	203,538
Shareholders' fund	79,177	128,104	148,183	177,734	204,407
Short term loan	96	100	100	100	100
Long term loan	19,510	9,895	40,001	32,001	24,001
Loan fund	19,606	9,995	40,101	32,101	24,101
Minority interest	433	0	0	0	0
Deferred tax liability	750	682	754	820	885
<b>Total capital employed</b>	<b>99,966</b>	<b>138,781</b>	<b>189,038</b>	<b>210,655</b>	<b>229,393</b>
Gross block	12,765	15,903	17,903	32,153	37,153
Less: Acc depreciation	5,729	6,480	7,527	8,999	10,547
Net block	7,036	9,423	10,376	23,154	26,606
Capital WIP	787	7,287	15,537	7,287	8,287
Net fixed assets	7,823	16,709	25,913	30,440	34,892
Goodwill	14,734	14,734	14,734	14,734	14,734
Investments	45,649	87,998	133,534	147,285	162,358
Cash and bank	23,918	8,970	5,710	11,562	11,597
Inventories	5,009	7,438	10,564	14,054	15,358
Debtors	3,381	6,830	6,037	6,873	6,306
Other CA and loans & adv	11,851	13,358	3,405	3,876	3,556
Total CA and loans & adv	44,160	36,596	25,716	36,365	36,816
Creditors	7,252	11,692	6,993	12,071	13,170
Other current liabilities	1,034	1,255	1,080	1,280	1,420
Provisions	4,114	4,310	2,784	4,818	4,818
Net current assets	31,760	19,340	14,858	18,196	17,409
<b>Total assets</b>	<b>99,966</b>	<b>138,781</b>	<b>189,038</b>	<b>210,655</b>	<b>229,393</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 5: Cash flow

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
EBIT	30,703	51,066	34,524	29,109	21,788
(Inc.)/Dec in working capital	1,791	(3,037)	(7,252)	480	822
<b>Cash flow from operations</b>	<b>32,495</b>	<b>48,029</b>	<b>27,272</b>	<b>29,589</b>	<b>22,609</b>
Other income	4,260	5,571	2,265	2,610	4,747
Depreciation	745	964	1,047	1,473	1,548
Interest paid (-)	517	553	2,411	3,599	2,799
Tax paid (-)	7,644	13,678	8,960	8,187	8,003
Dividends paid (-)	2,064	3,281	5,592	2,034	4,067
<b>Net cash from operations</b>	<b>27,274</b>	<b>37,052</b>	<b>13,621</b>	<b>19,852</b>	<b>14,034</b>
Capital expenditure (-)	18,628	9,887	10,250	6,000	6,000
<b>Net cash after capex</b>	<b>8,647</b>	<b>27,165</b>	<b>3,371</b>	<b>13,852</b>	<b>8,034</b>
Inc./(Dec.) in short-term debt	77	4	0	0	0
Inc./(dec.) in long-term debt	19,510	(9,615)	30,106	(8,000)	(8,000)
(Inc.)/Dec. in investments	(14,397)	(42,350)	(42,601)	0	0
Equity issue/(Buyback)	5,372	0	0	0	0
<b>Cash from Financial Activities</b>	<b>10,562</b>	<b>(51,961)</b>	<b>(12,495)</b>	<b>(8,000)</b>	<b>(8,000)</b>
Others	2,884	9,847	5,864	0	0
Opening cash	1,825	23,918	8,970	5,710	11,562
Closing cash	23,918	8,970	5,710	11,562	11,597
Change in cash	22,093	(14,948)	(3,260)	5,852	34

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 7: Key Ratios

Y/E March	FY10	FY11	FY12E	FY13E	FY14E
<b>Per share (Rs)</b>					
EPS	31.6	48.5	27.8	38.7	35.4
Book value	95.3	147.4	170.5	204.5	235.2
<b>Valuation</b>					
P/E	6.3	4.1	7.2	5.2	5.7
P/BV	2.1	1.4	1.2	1.0	0.9
EV/EBITDA	3.7	1.7	5.9	6.4	8.0
EV/Sales	2.0	0.9	2.5	2.2	2.1
M-cap/Sales	2.8	1.9	2.1	1.9	2.0
<b>Return Ratio (%)</b>					
ROCE	27.1	31.1	15.3	17.2	14.3
ROE	33.2	32.9	16.3	18.9	15.0
<b>Margin Ratio (%)</b>					
EBITDA margin	53.7	56.5	42.1	34.3	26.2
PBIT margin	59.7	61.5	43.6	35.6	29.8
PBT margin	54.8	57.0	34.9	30.6	25.3
PAT margin	41.8	43.2	27.8	36.6	32.8
<b>Turnover Ratio</b>					
Asset turnover ratio (x)	4.6	5.8	4.7	2.8	2.4
Avg collection period (days)	21.1	27.1	26.1	28.1	25.8
Avg payment period (days)	117.9	141.5	91.6	126.6	113.4
<b>Solvency Ratio</b>					
Debt-equity	0.2	0.1	0.3	0.2	0.1
Interest coverage ratio	60.8	94.1	14.8	8.5	8.3

Source: Company, Nirmal Bang Institutional Equities Research

## Ratings track

Date	Rating	CMP (Rs)	Target price (Rs)
24 June 2011	Sell	265	247
1 July 2011	Sell	282	248
22 July 2011	Sell	278	237
22 August 2011	Sell	223	214
29 August 2011	Hold	204	207
25 October 2011	Sell	205	173
3 January 2012	Sell	157	146
27 January 2012	Sell	200	164

## Disclaimer

### Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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