

Sesa Goa

BSE SENSEX	S&P CNX	CMP: INR169	TP: INR204	Buy						
18,625	5,664									
Bloomberg	SESA IN									
Equity Shares (m)	869.1									
52-Week Range (INR)	270/149									
1,6,12 Rel. Perf. (%)	-4/-16/-25									
M.Cap. (INR b)	146.7									
M.Cap. (USD b)	2.7									
Year End	Net Sales (INR m)	PAT (INR m)	EPS (INR)	EPS Gr. (%)	P/E (X)	P/BV (X)	RoE (%)	RoCE (%)	EV/Sales	EV/EBITDA
3/11A	92,051	42,225	48.6	53.6	-	-	40.0	47.3	-	-
3/12A	83,101	27,616	31.8	-34.6	5.3	1.0	19.8	25.7	2.1	2.0
3/13E	41,331	29,498	33.9	6.8	5.0	1.0	19.3	18.7	4.3	5.5
3/14E	63,044	30,009	34.5	1.7	4.9	0.9	19.2	19.4	2.9	4.0

- Sesa Goa's (SESA) adjusted PAT for 2QFY13 grew 72% YoY to INR4b due to consolidation of associate, Cairn India's earnings. Adjusted PAT was 9% below estimate due to abnormally low iron ore volumes, which were impacted by various restrictions imposed by the MoEF, the state government and the Supreme Court. Reported PAT of INR5.22b included forex gain of INR1.9b.
- Core EBITDA was just INR58m, 90% below our estimate due to unabsorbed high fixed costs on low volumes. There was a loss of INR951m against our estimate of INR337m loss before tax.
- Iron ore production was just 0.4m tons and sales were even lower at 0.2m tons. Average realization was USD83/dmt, a little above our expectation of USD80/dmt. The cost of production of iron ore was abnormally high at USD98/dmt due to unabsorbed fixed costs.
- Volumes were higher-than-expected for both the coke (51%) and pig iron (33%) divisions due to start-up of expanded capacity. However, the new furnace has been shut down due to shortage of iron ore. New coke oven batteries, whose environmental permits were temporarily suspended, have got the permits to restart.
- Uncertainties continue to cloud mining operations as well as pig iron and coke making due to various reasons. We have factored iron ore sales volumes of 1.2m tons in 3QFY13, 3.5m tons in 4QFY13 and 15.7m tons in FY14, but the entire or part of the earnings are at risk. In view of regulatory uncertainties over mining business, we have cut the EV/EBITDA multiple for standalone operations of the merged (Sesa Sterlite) entity from 5x to 4x in our SOTP valuation instead of revising earnings. As a result, the SOTP value of Sesa-Sterlite is cut marginally to INR204/share. Maintain **Buy**.

Quarterly Performance (Consolidated)										(INR Million)		
Y/E March	FY12				FY13				FY12	FY13E	FY13	vs Est (%)
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2QE	
Realization (USD/dmt)	102	84	93	102	99	83	62	58	99	74	80	4
Sales Qty ('000 dmt)	4,247	1,540	5,040	5,100	2,900	200	1,176	3,450	15,927	7,726	209	-4
Net Sales	21,089	7,897	26,171	27,944	17,326	2,944	7,076	13,985	83,101	41,331	2,311	27
Change (YoY %)	-12.6	-14.0	16.3	-22.9	-17.8	-62.7	-73.0	-50.0	-9.7	-50.3	-70.7	
EBITDA	11,474	2,600	10,852	11,579	6,762	58	2,058	4,052	36,505	12,930	584	-90
As % of Net Sales	54.4	32.9	41.5	41.4	39.0	2.0	29.1	29.0	43.9	31.3	25.3	
Interest	493	516	730	702	1,178	817	934	934	2,441	3,863	747	9
Depreciation	269	243	263	286	303	334	323	323	1,061	1,283	303	10
Other Income	1,521	504	180	141	151	142	47	12	2,346	351	129	10
PBT (before XO item)	12,232	2,345	10,039	10,732	5,432	-951	848	2,807	35,348	8,136	-337	183
EO	-15	-2,341	-1,779	79	-2,522	1,878	0	0	-4,056	-644	0	
PBT (after XO item)	12,217	4	8,260	10,811	2,910	927	848	2,807	31,292	7,492	-337	-375
Total Tax	3,811	-9	2,564	3,848	922	351	254	842	10,214	2,369	-101	-447
% Tax	31.2	-245.9	31.0	35.6	31.7	37.9	30.0	30.0	32.6	31.6	30.0	
Reported PAT before MI	8,406	13	5,696	6,963	1,988	576	594	1,965	21,078	5,123	-236	-344
Profit from associates	0	0	1,219	4,658	7,652	4,644	5,747	5,689	5,877	23,732	4,672	-1
Adjusted PAT	8,421	2,354	8,695	11,542	11,362	4,053	6,341	7,654	31,012	29,295	4,437	-9
Change (YoY %)	-39.7	-33.0	-18.4	-20.9	34.9	72.2	-27.1	-33.7	-27.2	-5.5	88.5	-18.4

E: MOSL Estimates

Sanjay Jain (SanjayJain@MotilalOswal.com); +9122 39825412

Pavas Pethia (Pavas.Pethia@MotilalOswal.com); +9122 39825413

Core EBITDA just INR58m on abnormally low volumes

- Sesa Goa's 2QFY13 adjusted PAT increased 72% YoY to INR4b due to consolidation of associate, Cairn India's earnings. Adjusted PAT was 9% below our estimate due to abnormally low iron ore volumes, which were impacted by various restrictions imposed by the MoEF, the state government and the Supreme Court. Reported PAT of INR5.22b included forex gain of INR1.9b.
- Core EBITDA was just INR58m, 90% below our estimate due to unabsorbed high fixed costs on low volumes. There was a loss of INR951m against our estimate of INR337m loss before tax.
- Iron ore production was just 0.4m tons. Iron ore operations were impacted by the mining ban in Karnataka, a temporary restriction on iron ore extraction in Goa and transportation restrictions in South Goa during the monsoons.
- Iron ore sales were even lower at 0.2m tons and average realization was USD83/dmt, a little above our expectation of USD80/dmt. The cost of production of iron ore was abnormally high at USD98/dmt due to unabsorbed fixed costs.
- Volumes were higher than expected for both the coke (51% above estimate) and pig iron (33% above estimate) divisions due to start-up of expanded capacity. However, the new furnace has been shut down due to shortage of iron ore. The sinter plant is expected to receive consent to operate very soon. New coke oven

Segmental Financials										(INR Million)		
Y/E March	FY12				FY13				FY12	FY13E	FY13	vs Est
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		2QE	(%)	
Realization												
Iron ore (USD/dmt)	102	84	93	102	99	83	62	58	99	74	80	4
Change (QoQ %)	-13.0	-17.3	10.3	9.2	-2.3	-16.0	-25.7	-6.9	-5.3	-24.6	-19.4	
Coke (INR/ton)	20,755	22,722	20,762	21,496	21,828	20,620	18,360	18,360	21,351	19,604	19,425	6
Pig iron (INR /ton)	28,079	28,703	29,929	29,558	30,558	29,560	29,265	28,972	29,095	29,377	24,503	21
Sales Qty ('000 tons)												
Iron ore (dmt)	4,247	1,540	5,040	5,100	2,900	200	1,176	3,450	15,927	7,726	437	-54
Change (YoY %)	-13.1	-15.6	5.5	-23.3	-31.7	-87.0	-76.7	-32.4	-12.2	-51.5	-71.6	
Coke	67	52	69	70	53	80	80	80	258	293	53	51
Pig iron	58	65	68	60	45	73	120	130	251	368	55	33
Revenue (INR m)												
Iron Ore	19,358	5,943	23,903	25,979	15,683	925	3,933	10,739	75,183	31,280	1,942	-52
Change (YoY %)	-14.7	-16.6	14.4	-26.3	-19.0	-84.4	-83.5	-58.7	-12.5	-58.4	-67.3	
Coke	1,400	1,170	1,430	1,505	1,157	1,650	1,469	1,469	5,505	5,744	1,030	60
Pig iron	1,631	1,866	2,035	1,774	1,369	2,158	3,512	3,766	7,305	10,805	1,343	61
EBIT (INR m)												
Iron ore	10,821	4,712	12,372	11,004	7,334	-164	997	2,965	38,909	11,132	533	-131
Coke	279	-43	-173	97	-506	100	387	387	160	367	31	
Pig iron	125	35	181	113	-143	-151	351	377	454	434	134	
EBIT												
Iron ore (USD/dmt)	57	67	48	43	46	-15	16	16	51	26	22	-167
Change (QoQ %)	-15.9	17.4	-28.0	-10.6	7.9	-131.9	-206.0	1.4	-13.8	-48.1	-27.9	
Coke (INR/ton)	4,135	-837	-2,517	1,389	-9,543	1,245	4,833	4,833	619	1,253	579	
Pig iron (INR /ton)	2,151	540	2,660	1,890	-3,194	-2,064	2,926	2,897	1,809	1,180	2,450	
Costs												
Iron ore (USD/dmt)	45	17	45	59	53	98	46	42	48	48	58	69
Coke (INR/ton)	16,620	23,559	23,279	20,107	31,372	19,375	13,528	13,528	20,731	18,352	18,846	3
Pig iron (INR /ton)	25,928	28,163	27,269	27,668	33,752	31,625	26,338	26,075	27,286	28,197	22,053	43
USD/INR	44.7	45.8	51.0	50.2	54.5	55.5	54.0	54.0	47.9	54.5	55.5	
Iron ore spot (USD/dmt cfr CI)	184	184	148	147	142	116	102	102	161	117	116	

batteries, whose environmental permits were temporarily suspended after abnormal emission during commissioning, have got the permits to restart on 26 October 2012.

Iron ore earnings at risk but Sesa-Sterlite merger dilutes impact; Buy

- Uncertainties continue to cloud mining operations as well as pig iron and coke making due to various reasons. Though we have factored iron ore sales volumes of 1.2m tons in 3QFY13 and 3.5m tons in 4QFY13, the earnings remain at risk. Similarly, we have modeled 15.7m tons of iron ore volumes in FY14, but the entire or part of the earnings is equally at risk. However, the impact on valuations is diluted due to overpowering earnings from Hindustan Zinc and Cairn India in the merged entity.
- In view of regulatory uncertainties over mining business, we have rather cut the EV/EBITDA multiple for standalone operations from 5x to 4x in SOTP valuation instead of revising earnings. As a result, the SOTP value of Sesa-Sterlite is cut marginally to INR204/share. Maintain **Buy**.

Sum-of-the-parts Valuation: SESA-STERLITE

	(INR Billion)													
	Net EBITDA Sales	PAT	Net Debt	Net Worth	Valuations Basis	EV	CWIP		Equity Value	Stake (%)	Attrib. Equity	INR/ share		
	(A)		(G)		(B)	C=(AxB)	(D)	(F) {C-G+D*(1-F)}						
Stand-alone #	356	50	-5	651	406	4.0 x EBITDA	199	187	50	-358	100	-358	-121	
Hindustan Zinc	138	77	71	-269	245	5.0 x EBITDA	387	4		661	64.9	429	145	
Balco	42	4	1	64	22	5.0 x EBITDA	20	95	50	4	51	2	1	
CMT+TSPL+inter seg.	19	5	0	60	-547	5.0 x EBITDA	24	81	20	28	100	28	9	
Zinc International	44	15	10	-58	101	3.5 x EBITDA	51			110	100	110	37	
Cairn India	184	132	104	-181	269	350 =Cairn TP(INR/sh)	98			666	59.0	393	132	
	784	282	181	266	496			466			SOTP	604	204	
Implied TP for Sterlite Inds (at Conv. Ratio of 3:5												122 ;	Implied TP for Sesa (1:1) =	204

Note: - Aluminium prices USD2,100/ton, Zinc & lead prices = USD2,000/ton, Silver = USD27/oz, USD/INR = 53; FY14 estimates
Source: MOSL; # (VAL, copper TcRC, SEL, Sesa); TP = Target Price

Concall highlights: Timeline for restart of iron ore mining uncertain; expect dividend for funding capex

- Iron ore production was impacted due to
 - Transportation ban in South Goa by state government during monsoon.
 - Temporary suspension of mining in Goa by state government after the Shah Commission released the report on its investigation on 11 September.
 - Suspension of environmental clearance from MoEF to all Goa mines till verification of documents on 15 September.
- SESA is currently following a three-pronged strategy - (1) Legal, (2) Compliance, and (3) Engaging with state/central government, to restart mining in Goa. It believes that Goa miners are better placed as compared to Karnataka miners due to the following:
 - Both central and state governments have taken action after the Shah Commission report was released unlike Karnataka where no action was taken.
 - About 25% of Goa's population is dependent upon mining and allied services, which are getting severely impacted.
 - 25-30% of state government revenues come from mining; resultantly, the government now has to resort to austerity measures.

- Additional capacity of pig iron and coke helped ramp up production of met coke and pig iron. Wrong soot firing at new coke plant during start-up led to suspension of operations. However, the suspension has been taken off by the state pollution board on 26 October.
- Pig iron plant has been facing shortage of ore, leading to closure of new blast furnace, while other two old blast furnaces continue to operate at lower capacity.
- Liberia exploration has been encouraging so far and SESA will go ahead with planned capex in Liberia.
- Fixed cost of mining operations in Goa and Karnataka is INR300m. However, pig iron and met coke operations are sufficient to take care of fixed cost.
- **Buffer zone in national wild life area:** The state government has forwarded a CEC recommendation, which talks about a 1-2km buffer zone depending upon wild life area. Wild life areas in Goa are less than 500sq km. SESA believes that 0-1km buffer zone is applicable.
- Currently, SESA has INR40b of borrowings including FCCBs. It expects cash flows from dividend payout by Cairn Energy, which will be sufficient to fund its current capex requirement.
- Expect Supreme Court order on Karnataka mine by 9 November. However, post approval, it will still need to renew its lease, seek fresh MoEF approval for reduced capacity and also the forest approval. Therefore, restarting of Karnataka mine may take more time. Despite Supreme Court approval, category-A mines are yet to start operations due to fresh requirement of above mentioned approvals.
- Currently, SESA has 3.5mt iron ore inventory in Goa. Total processed and not processed ore inventory will be 3.5mt.
- Creditors have been objecting to Sesa-Sterlite merger. Hearing of creditors is over and order is expected by October end.
- Of the forex gains of INR1.9b, INR400m is accounted in pig iron segment and the balance INR1.5b in iron ore segment.

Sesa Goa: an investment profile

Company description

Sesa Goa (SESA) has iron-ore reserves and resources of 374mt in Goa and Karnataka. Goa's ore is medium grade and easy to extract without blasting and crushing. The iron ore from Karnataka is of high grade but found in rocky form, which necessitates blasting and crushing. SESA is India's largest private-sector iron-ore exporter.

Key investment arguments

- Post merger, Sesa-Sterlite's earnings will be less volatile, supported by more stable operations at Hindustan Zinc and Cairn India.
- The cost of mining and transport is significantly lower in Goa (majority of operations) than in Karnataka and Orissa. Further, Indian miners are at an advantage over Brazilian miners due to their proximity to China, the largest customer.

Key investment risks

- Unexpected softening of spot prices of iron ore, led by a slowdown in steel demand will adversely impact earnings.
- Increase regulatory vigil over mining operations in India will hamper volume growth.

Recent developments

- SESA has received an order from Goa State Pollution Control Board on 26 October 2012, revoking its earlier order to stop activity at the second battery of its new metallurgical coke plant in Amona.

Valuation and view

- We value Sesa-Sterlite INR204/share, based on SOTP. Maintain **Buy**.

Sector view

- Average iron ore prices have corrected 18% QoQ in 2QFY13. With demand for raw material in China moderating, the downtrend in iron ore prices is expected to continue. We are modeling average iron ore prices (63.5% CFR China) of USD121/ton in FY13 and USD102/ton in FY14.

Comparative valuations

		Sesa Goa	NMDC	JINDAL STEEL
P/E (x)	FY13E	5.0	9.0	9.7
	FY14E	4.9	7.3	10.0
P/BV (x)	FY13E	1.0	2.4	1.8
	FY14E	0.9	2.0	1.6
EV/Sales (x)	FY13E	4.3	3.9	2.8
	FY14E	2.9	3.0	3.0
EV/EBITDA (x)	FY13E	5.5	5.0	9.0
	FY14E	4.0	3.8	8.4

Shareholding pattern (%)

	Sep-12	Jun-12	Sep-11
Promoter	55.1	55.1	55.1
Domestic Inst	4.2	4.3	5.2
Foreign	27.0	26.4	24.1
Others	13.7	14.1	15.7

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY13	33.9	36.1	-6.2
FY14	34.5	37.5	-8.1

Target Price and Recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
169	204	20.7	Neutral

Stock performance (1 year)



N O T E S

Disclosures

This report is for personal information of the authorized recipient and does not constitute to be any investment, legal or taxation advice to you. This research report does not constitute an offer, invitation or inducement to invest in securities or other investments and Motilal Oswal Securities Limited (hereinafter referred as MOST) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

Unauthorized disclosure, use, dissemination or copying (either whole or partial) of this information, is prohibited. The person accessing this information specifically agrees to exempt MOST or any of its affiliates or employees from, any and all responsibility/liability arising from such misuse and agrees not to hold MOST or any of its affiliates or employees responsible for any such misuse and further agrees to hold MOST or any of its affiliates or employees free and harmless from all losses, costs, damages, expenses that may be suffered by the person accessing this information due to any errors and delays.

The information contained herein is based on publicly available data or other sources believed to be reliable. While we would endeavour to update the information herein on reasonable basis, MOST and/or its affiliates are under no obligation to update the information. Also there may be regulatory, compliance, or other reasons that may prevent MOST and/or its affiliates from doing so. MOST or any of its affiliates or employees shall not be in any way responsible and liable for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

This report is intended for distribution to institutional investors. Recipients who are not institutional investors should seek advice of their independent financial advisor prior to taking any investment decision based on this report or for any necessary explanation of its contents.

MOST and/or its affiliates and/or employees may have interests/positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement

Sesa Goa

- | | |
|---|-----|
| 1. Analyst ownership of the stock | Yes |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

Analyst Certification

The views expressed in this research report accurately reflect the personal views of the analyst(s) about the subject securities or issues, and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations and views expressed by research analyst(s) in this report. The research analysts, strategists, or research associates principally responsible for preparation of MOST research receive compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

Regional Disclosures (outside India)

This report is not directed or intended for distribution to or use by any person or entity resident in a state, country or any jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject MOST & its group companies to registration or licensing requirements within such jurisdictions.

For U.K.

This report is intended for distribution only to persons having professional experience in matters relating to investments as described in Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (referred to as "investment professionals"). This document must not be acted on or relied on by persons who are not investment professionals. Any investment or investment activity to which this document relates is only available to investment professionals and will be engaged in only with such persons.

For U.S.

MOST is not a registered broker-dealer in the United States (U.S.) and, therefore, is not subject to U.S. rules. In reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act") and interpretations thereof by the U.S. Securities and Exchange Commission ("SEC") in order to conduct business with Institutional Investors based in the U.S., Motilal Oswal has entered into a chaperoning agreement with a U.S. registered broker-dealer, Marco Polo Securities Inc. ("Marco Polo"). Any business interaction pursuant to this report will have to be executed within the provisions of this Chaperoning agreement.

This report is intended for distribution only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the Exchange Act and interpretations thereof by SEC (henceforth referred to as "major institutional investors"). This document must not be acted on or relied on by persons who are not major institutional investors. Any investment or investment activity to which this document relates is only available to major institutional investors and will be engaged in only with major institutional investors.

The Research Analysts contributing to the report may not be registered/qualified as research analyst with FINRA. Such research analyst may not be associated persons of the U.S. registered broker-dealer, Marco Polo and therefore, may not be subject to NASD rule 2711 and NYSE Rule 472 restrictions on communication with a subject company, public appearances and trading securities held by a research analyst account.



Motilal Oswal Securities Ltd

Motilal Oswal Tower, Level 9, Sayani Road, Prabhadevi, Mumbai 400 025

Phone: +91 22 3982 5500 E-mail: reports@motilaloswal.com