

SESA GOA

Looking for restart of mining

India Equity Research | Metals and Mining



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Sesa Goa's (Sesa) Q2FY13 EBITDA at INR1.9bn was ~37% above our estimate led by higher revenue and forex gains. Company is confident of a successful resolution to mining issues in Goa at an early date though we are conservatively building in a delay of one year. The company is also confident of restarting Karnataka mines in near term (our assumption: FY14). Sesa also reiterated timely completion of the Sesa-Sterlite merger. First ore shipment from Liberia, with an initial capacity of 2-3mtpa, is expected in FY14 (but unlikely in our view). We maintain 'HOLD/SP' recommendation/rating and a target price of INR191/share.

EBITDA above estimate led by forex gain, downstream products

Sesa reported an EBITDA of INR1.9bn (including forex gain of INR1.9bn), 37% higher than our adjusted EBITDA estimate (including forex gain of INR1.4bn). This is on account of higher revenues from downstream products and forex gains. However, iron ore sales volume at 0.23 wmt (down 87% YoY) was below our estimate of 0.39wmt. Profit contribution of Cairn India (associate company, 20% stake) at INR4.6bn was lower than our estimate of INR5.2bn. Reported PAT at INR5.2bn is in line with our estimate of INR5.3bn.

Expects mining operations to resume in near term

Sesa expects approval from Supreme Court (SC) wrt its Karnataka mine (2.3mtpa limit), possibly in early November. Regards Goa, the Central Empowered Committee (CEC) appointed by SC is likely to submit its report by end of November. Company is confident of successful resolution to regulatory issues and restart of mining at an early date in Goa.

Outlook and valuations: Negatives priced in; maintain 'HOLD'

Sesa guided that the High Court approval process as part of Sesa-Sterlite merger transaction is expected to be complete shortly and the merger would be consummated by the end of CY12. The Liberia project remains on track. Maintain estimates and 'HOLD/Sector Performer' recommendation/rating with a target price of INR191/share. At CMP, the stock trades at FY14E EV/EBITDA of 3.8x.

Financials (Consolidated)						(INR mn)		
Year to March	Q2FY13	Q2FY12	% change	Q1FY13	% change	FY12	FY13E	FY14E
Net revenue	2,944	7,897	(62.7)	17,326	(83.0)	83,101	24,844	44,575
EBITDA	1,943	2,600	(25.3)	4,439	(56.2)	35,001	2,958	12,108
Net profit	5,220	13	NA	9,640	(45.8)	26,955	16,977	23,938
Diluted EPS (INR)	6.0	0.0	NA	11.1	(45.8)	31.8	19.5	27.5
Diluted P/E (x)						5.3	8.7	6.2
EV/EBITDA (x)						2.0	20.6	3.8
ROAE (%)						17.5	9.2	11.7

EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Underweight

MARKET DATA (R: SESA.BO, B: SESA IN)

CMP	: INR 170
Target Price	: INR 191
52-week range (INR)	: 270 / 145
Share in issue (mn)	: 869.1
M cap (INR bn/USD mn)	: 148/ 2,755
Avg. Daily Vol.BSE/NSE('000)	: 3,316.7

SHARE HOLDING PATTERN (%)

	Current	Q1FY13	Q4FY12
Promoters*	55.1	55.1	55.1
MF's, FI's & BK's	4.2	4.3	4.8
FII's	26.8	26.2	25.0
Others	13.9	14.3	15.1

* Promoters pledged shares : NIL
(% of share in issue)

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Metals and Mining Index
1 month	(7.9)	(0.0)	1.7
3 months	(9.1)	11.2	(1.5)
12 months	(19.1)	12.7	1.8

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Table 1: Iron ore realisations declined 21% QoQ

	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13
Sales volume					
Iron ore (wmt)	1.7	5.5	5.6	3.1	0.2
Pig iron (kt)	65.0	68.0	60.0	45.0	73.0
Realisation (USD/tonne)					
Iron ore	76	85	92	92	72
Pig iron	627	588	595	562	535
PBIT (USD/tonne)					
Iron ore	30	38	34	28	NA
Pig iron	12	52	40	(59)	62

Source: Company, Edelweiss research

Key takeaways from conference call

Confident of early restart of mining in Goa

- The Goa mining companies have made representations to both Central Government and Goa State Governments. Sesa indicated a strong legal ground in its and Goa mining industry's favour for an early restart of mining.
- CEC is expected to visit and meet Goa mining industry next week and its report is likely latest by end of November. Sesa also indicated mounting pressure by labour unions and local trade for an early resolution of the issue.

Karnataka operations – Awaiting SC approval

- Sesa expects that at the next hearing of SC (possibly in early November), Category B mines, including its own Karnataka mine, would be approved for restart. Post this, the company would need to follow the process of MOEF clearances and approval of R&R plan.
- The company's mining lease has technically lapsed but the company having applied for renewal well in advance of the stipulated 1 year period is confident of resolving this issue.

Liberia iron ore project is on track

- Sesa indicated that exploration is on in full swing at Liberia and so is the appointment of specialist consulting firms. The company retained guidance of first shipment for FY14 (we are not considering this in our estimate).
- The company indicated that the current gross debt of INR 40bn is not expected to increase by the end of FY13 in spite of Liberia project capex and cash burn in iron ore business pending restart. This is led by dividend expected from Cairn and profits from downstream business (pig iron, met coke, waste heat power) which would more than offset fixed costs of the iron ore business.

General comments

- Fixed cost in the mining business is INR300mn per month, of which 60% is employee cost
- Sesa indicated that the downstream business (pig iron, met coke, waste heat power) is profitable based on current imported iron ore prices. The company has just restarted its coke ovens after receiving approval from Goa Pollution Control Board.

Financial snapshot

(INR mn)

Year to March	Q2FY13	Q2FY12	% Change	Q1FY13	% Change	FY12	FY13E	FY14E
Net revenues	2,944	7,897	(62.7)	17,326	(83.0)	83,101	24,844	44,575
Increase/decrease in stocks	(1,571)	(852)	NA	(379)	NA	344	-	-
Raw material costs	1,542	1,507	2.3	1,360	13.4	5,720	1,276	5,084
Purchase of ore	22	346	(93.7)	944	(97.7)	3,670	1,043	1,681
Staff costs	643	625	2.9	693	(7.2)	2,684	2,953	3,248
Consumption of stores	656	719	(8.8)	1,009	(34.9)	3,499	1,739	3,120
Inland transportation	102	491	(79.2)	771	(86.7)	3,758	1,320	2,199
Other services	740	652	13.5	959	(22.9)	4,113	1,444	2,407
Export duty	95	872	(89.2)	4,338	(97.8)	16,233	6,717	9,566
Costs/expenses recovered	1	(1)	NA	(73)	NA	-	-	-
Other expenses	(1,229)	938	NA	3,267	NA	8,078	5,395	5,161
Total expenditure	1,001	5,297	(81.1)	12,888	(92.2)	48,100	21,886	32,467
EBITDA	1,943	2,600	(25.3)	4,439	(56.2)	35,001	2,958	12,108
Depreciation	334	243	37.4	303	10.3	1,061	1,470	2,511
Other income	142	504	(71.8)	151	(5.8)	2,346	499	842
Interest	817	2,857	(71.4)	1,178	(30.6)	4,333	3,435	1,319
Profit before tax	934	4	NA	3,108	(70.0)	31,952	(1,448)	9,120
Tax	351	(9)	NA	922	(61.9)	10,214	(478)	3,010
Current taxes	351	(9)	NA	922	(61.9)	-	-	-
Core profit	583	13	NA	2,186	(73.3)	21,739	(970)	6,110
Extraordinary items	7	-	-	198	(96.6)	(661)	-	-
Minority interest								
Share in profit from associates	4,644	-	-	7,652	(39.3)	5,877	17,948	17,828
Net profit	5,220	13	NA	9,640	(45.8)	26,955	16,977	23,938
Net profit	5,227	2,354	NA	9,838	(46.9)	26,294	16,977	23,938
Equity capital	869	869	-	869	-	869	869	869
No. of shares (mn)	869	869	-	869	-	869	869	869
Diluted EPS (INR)	6.0	-	NA	11.1	(45.8)	31.8	19.5	27.5

As % of net revenues

Raw material	(1.0)	8.3	-	5.7	-	7.3	5.1	11.4
Employee cost	21.8	7.9	-	4.0	-	3.2	11.9	7.3
Consumption of stores	22.3	9.1	-	5.8	-	4.2	7.0	7.0
Inland transportation	3.5	6.2	-	4.4	-	4.5	5.3	4.9
Other services	25.1	8.3	-	5.5	-	4.9	5.8	5.4
Purchase of ore	0.7	4.4	-	5.4	-	4.4	4.2	3.8
Export duty	3.2	11.0	-	25.0	-	19.5	27.0	21.5
Other expenses	(41.7)	11.9	-	18.9	-	9.7	21.7	11.6
Costs/expenses recovered			-	(0.4)	-			
EBITDA	66.0	32.9	-	25.6	-	42.1	11.9	27.2
Reported net profit	177.3	0.2	-	55.6	-	32.4	68.3	53.7
Tax rate	37.6	NA	-	29.7	-	32.0	33.0	33.0

Company Description

Sesa Goa is India's largest private sector player in iron ore. In April 2007, Vedanta Resources acquired 51% (controlling stake) in the company from Mitsui & Company, Japan. It has operations in Goa and Karnataka, with an annual capacity of 19 mt (wet), including third-party mining. The company has access to mining resource of 374 mt. It also operates a pig iron plant of 625,000 tpa and a met coke plant of 630,000 tpa. For the pig iron unit, 30% of the iron ore requirement is met captively. The entire coke requirement for pig iron is met captively.

Investment Theme

Sesa Goa's operational cost for the iron ore business is relatively lower due to inherent natural cost advantage of the Indian iron ore mines. Also, its Goa mines are located close to ports, thus, saving the company freight costs. Volumes expected to pick up in FY14 but soft prices and export duty increase to negate benefit.

Key Risks

Higher than estimated volumes

Iron ore prices higher than estimates

Operational costs turn out to be lower than estimates

Financial Statements

Key Assumptions

Year to March		FY10	FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	8.4	6.5	5.8	6.5
	Inflation (Avg)	3.6	9.9	8.8	7.8	6.0
	Repo rate (exit rate)	5.0	6.8	8.5	7.5	6.8
	USD/INR (Avg)	47.4	45.6	47.9	53.5	52.0
Sector -	China IO price (CFR 62)	96.0	156.5	159.8	115.0	120.0
	NMDC's IO fines price (INR/t)	1,733.5	3,208.8	2,933.3	2,862.9	2,862.9
Company -	Iron ore volume (mt) (wmt)	21.6	20.3	17.6	6.2	10.3
	Blended realisation (USD/t)	53.9	92.8	89.1	69.5	66.2
	Blended EBITDA/t (USD/t)	37.6	77.3	43.3	8.4	21.5

Income statement

(INR mn)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Net revenue	58,583	92,051	83,101	24,844	44,575
Materials costs	3,459	3,962	5,720	1,276	5,084
Employee costs	1,691	2,071	2,684	2,953	3,248
Total SG&A expenses	18,456	25,997	32,481	15,664	20,921
Other Expenses	3,492	7,958	7,215	1,994	3,214
EBITDA	31,486	52,063	35,001	2,958	12,108
Depreciation & Amortization	745	964	1,061	1,470	2,511
EBIT	30,741	51,099	33,939	1,488	9,597
Other income	4,260	5,399	2,346	499	842
Interest expenses	555	901	4,333	3,435	1,319
Profit before tax	34,446	55,597	31,952	(1,448)	9,120
Provision for tax	8,043	13,372	10,214	(478)	3,010
Net profit	26,403	42,225	21,739	(970)	6,110
Profit after minority interest	26,304	42,225	26,955	16,977	23,938
Diluted EPS (INR)	31.7	48.6	31.8	19.5	27.5
Dividend per share (INR)	3.2	3.8	4.0	1.0	1.0
Tax rate (%)	23.3	24.1	32.0	33.0	33.0

Common size metrics - as % of net revenues

Year to March	FY10	FY11	FY12	FY13E	FY14E
Operating expenses	46.3	43.4	57.9	88.1	72.8
EBITDA margins	53.7	56.6	42.1	11.9	27.2
Net profit margins	45.1	45.9	26.2	(3.9)	13.7

Growth ratios (%)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Rev. growth (%)	18.1	57.1	(9.7)	(70.1)	79.4
EBITDA	23.9	65.4	(32.8)	(91.5)	309.3
Net profit	32.4	59.9	(50.1)	(104.6)	(729.6)
EPS growth (%)	25.3	53.5	(34.6)	(38.5)	41.0

Balance sheet					
	(INR mn)				
As on 31st March	FY10	FY11	FY12	FY13E	FY14E
Equity capital- Voting shares	831	869	869	869	869
Reserves & surplus	78,346	127,235	150,313	166,273	189,195
Shareholders funds	79,177	128,104	151,182	167,142	190,064
Minority interest (BS)	433	-	-	-	-
Secured loans	444	314	11,190	11,691	11,258
Unsecured loans	19,162	9,680	26,180	26,180	26,180
Borrowings	19,606	9,995	37,369	37,871	37,438
Deferred tax liability	750	682	1,046	1,046	1,046
Sources of funds	99,966	138,781	189,597	206,059	228,547
Gross block	27,510	30,648	40,624	48,996	50,221
Depreciation	5,741	6,492	7,553	9,023	11,534
Net block	21,770	24,156	33,071	39,973	38,687
Capital work in progress	787	7,287	8,372	6,000	12,000
Total fixed assets	22,557	31,443	41,443	45,973	50,687
Investments	45,649	87,998	141,666	146,414	156,057
Inventories	5,009	7,438	8,752	5,469	8,502
Sundry debtors	3,381	6,830	5,494	2,382	4,274
Cash and equivalents	23,918	8,970	977	5,445	9,770
Loans and advances	11,455	13,217	5,679	5,445	9,770
Other current assets	396	141	1	1	1
Total current assets	44,160	36,596	20,903	18,743	32,317
Sundry creditors and others	8,286	12,946	12,047	3,978	6,183
Provisions	4,114	4,310	2,368	1,094	4,331
Total current liabilities & provisions	12,400	17,256	14,414	5,071	10,514
Net current assets	31,760	19,340	6,489	13,671	21,803
Uses of funds	99,966	138,781	189,597	206,059	228,547
Book value per share (INR)	95.3	147.4	174.0	192.3	218.7

Free cash flow					
	(INR mn)				
Year to March	FY10	FY11	FY12	FY13E	FY14E
Net profit	26,304	42,225	26,955	16,977	23,938
Depreciation	745	964	1,061	1,470	2,511
Deferred tax	44	(70)	315	-	-
Others	(1,512)	(10,849)	(6,737)	(23,378)	(25,441)
Gross cash flow	25,580	32,270	21,594	(4,931)	1,008
Less: Changes in WC	(133)	(3,136)	(557)	(2,715)	(3,807)
Operating cash flow	25,713	35,406	22,151	(2,216)	4,815
Less: Capex	17,019	9,841	7,365	6,000	7,225
Free cash flow	8,694	25,565	14,786	(8,216)	(2,410)

Cash flow metrics					
Year to March	FY10	FY11	FY12	FY13E	FY14E
Operating cash flow	25,713	35,406	22,151	(2,216)	4,815
Investing cash flow	(52,338)	(23,034)	(47,244)	(10,748)	(16,868)
Financing cash flow	26,821	(3,738)	17,363	17,432	16,378
Net cash flow	196	8,633	(7,730)	4,468	4,324
Capex	(17,019)	(9,841)	(7,365)	(6,000)	(7,225)
Dividends paid	(2,064)	(3,281)	(5,585)	(1,017)	(1,017)
Share issuance/(buyback)	5,372	-	-	-	-

Profitability & efficiency ratios

Year to March	FY10	FY11	FY12	FY13E	FY14E
ROAE (%)	36.2	35.8	17.5	9.2	11.7
ROACE (%)	86.3	97.2	68.8	2.8	14.5
Inventory day	261	264	304	1,119	377
Debtors days	20	20	27	58	27
Payable days	398	450	469	1,261	274
Cash conversion cycle (days)	(117)	(166)	(138)	(84)	130
Current ratio	3.6	2.1	1.5	3.7	3.1
Debt/EBITDA	0.6	0.2	1.1	12.8	3.1
Debt/Equity	0.2	0.1	0.2	0.2	0.2

Operating ratios

Year to March	FY10	FY11	FY12	FY13E	FY14E
Total asset turnover	0.8	0.8	0.5	0.1	0.2
Fixed asset turnover	4.3	4.0	2.9	0.7	1.1
Equity turnover	0.9	0.9	0.6	0.2	0.2

Valuation parameters

Year to March	FY10	FY11	FY12	FY13E	FY14E
Diluted EPS (INR)	31.7	48.6	31.8	19.5	27.5
Y-o-Y growth (%)	25.3	53.5	(34.6)	(38.5)	41.0
CEPS (INR)	32.6	49.6	33.4	21.2	30.4
Diluted PE (x)	5.4	3.5	5.3	8.7	6.2
Price/BV (x)	1.8	1.2	1.0	0.9	0.8
EV/Sales (x)	1.6	0.7	0.8	2.5	1.0
EV/EBITDA (x)	2.9	1.2	2.0	20.6	3.8
Dividend yield (%)	1.9	2.2	2.4	0.6	0.6
Market cap/Sales (x)	2.4	1.6	1.8	5.9	3.3

Peer comparison valuation

	Price (USD)	Market Cap (USD bn)	PE (x)		EV/EBITDA(x)		ROE(%)	
			2013E	2014E	2013E	2014E	2013E	2014E
Global Companies								
Vale	17.7	96.6	6.2	6.4	4.6	4.3	17.7	16.5
Fortescue	4.2	13.1	10.3	6.3	6.7	4.5	24.8	30.0
Cliffs	36.1	5.1	8.8	7.6	6.3	5.6	9.3	10.9
Atlas Iron Ore	1.6	1.5	15.3	9.8	5.1	3.3	4.8	6.8
Mount Gibson	0.7	0.8	3.5	3.9	0.8	0.5	16.2	12.3
Average			8.8	6.8	4.7	3.6	14.5	15.3
Indian iron ore companies								
Sesa Goa	3.2	2.8	8.7	6.2	20.6	3.8	9.2	11.7
NMDC	3.4	13.5	9.4	8.8	5.2	4.5	27.1	24.0
Average			9.1	7.5	12.9	4.2	18.1	17.8

Source: Edelweiss research

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Bhushan Steel	REDUCE	SU	M	Coal India	BUY	SO	M
Hindalco Industries	BUY	SO	M	Hindustan Zinc	BUY	SP	L
Jindal Steel & Power	BUY	SP	M	JSW Steel	BUY	SO	M
National Aluminium Company	REDUCE	SU	M	Sesa Goa	HOLD	SP	M
Steel Authority of India	HOLD	SU	L	Sterlite Industries (India)	BUY	SO	M
Tata Steel	BUY	SO	M	Usha Martin	HOLD	SU	M

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Metals and Mining

Bhushan Steel, Coal India, Hindalco Industries, Hindustan Zinc, Jindal Steel & Power, JSW Steel, National Aluminium Company, Steel Authority of India, Sesa Goa, Sterlite Industries (India), Tata Steel, Usha Martin

Recent Research

Date	Company	Title	Price (INR)	Recos
26-Oct-12	Vale	Recovery underway; <i>Global Pulse</i>		Not Rated
23-Oct-12	Sterlite Industries	Sound operational performance; <i>Result Update</i>	98	Buy
19-Oct-12	Hindustan Zinc	Volume ramp up ahead ; <i>Result Update</i>	134	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	113	53	19	186
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	14	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

DISCLAIMER

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