


Sesa Goa: To buy 20% stake in Cairn India

CMP: Rs. 321		Target Price: Not rated		Industry: Mining	
Stock Info		BSE Group	A/BSE 200	Shareholding Pattern (30 th June '10)	
Market Capital	Rs.27729 cr	BSE Code	500295	Promoters	69.2%
Free float	Rs.12478 cr	NSE Symbol	SESAGOA	Domestic Institutions	1.3%
Equity Capital	Rs.84 cr	Bloomberg	SESA IN	Foreign Institutions	2.1%
Avg Trading Vol.	2210561(Qtly)	Reuters	SESA.BO	Non Promoters Corp.	6.2%
52 WK High/Low	494/209	BSE Sensex	18051	Public & Others	21.2%
Face Value	Rs. 1	NSE Nifty	5418	Govt. Holdings	-

To buy 20% stake in Cairn India

Vedanta resources in conjunction with Sesa Goa is buying 51-60% stake in Cairn India at an estimated cost of US \$8.5-9.6 bn. As per the details of transaction, Vedanta would be buying 31-40% stake in Cairn India, while Sesa Goa would get to acquire 20% stake through an open offer. Post acquisition, Vedanta Plc along with Sesa Goa will be the majority stake holders in the company. The Acquisition of Cairn India would give Sesa and Vedanta Resources access to world class crude oil resources. The transaction is expected to be completed by Q4FY11.

Transaction Deatils

Vedanta has entered into an agreement with Cairn Energy Plc (Holding Company of Cairn India) to acquire 51% of Cairn India's fully diluted share capital. In addition, Vedanta will pay a non-compete fee to Cairn Energy of Rs 50 per share of Cairn India. The non-compete fee will be paid in consideration for Cairn Energy agreeing not to engage in the business of oil or gas extraction and/or transport or processing in India, Sri Lanka, Pakistan and Bhutan, or any other business which competes with the business of Cairn India and its subsidiaries, for a period of three years.

Sesa Goa would be picking up 20% stake in the Cairn India, to be acquired through a combination of share purchases from Vedanta less the number of Cairn India shares acquired under the Open Offer. The price payable per share in the Open Offer will be Rs 355 a share. In the event of open offer subscribed below 20% of Cairn's equity capital, Sesa Goa would buy balance amount of equity capital from Vedanta Resources at Rs 405 per share to make its desired 20% stake in the Cairn India.

Funding through internal accruals- to strain balance sheet

Sesa Goa would be putting in US \$3bn (Rs 13,500cr) as it's share to buy 20% stake in Cairn India. The deal would be funded completely through internal accruals and some short term borrowings, if required. At present, Sesa has cash and equivalent of Rs9000cr (US \$2bn) including ICDs of Rs 1000 cr with Vedanta Aluminium (VAL). The company can put in Rs 6000cr from internal accruals as closed to Rs 2,000 cr of cash is locked in the form of FCCBs and capex related expenditure. The management is confident of meeting balance funding requirements through future cash flows and forecast cash inflows to the tune of Rs12,000cr by Q4FY11 through its existing iron ore operations; sufficient to meet cost of acquisition. However, we believe, given the current iron ore outlook and present state of iron ore mining issues in domestic market, the company could face cash flow squeeze and may have to resort to debt raising, which in turn will erode the share holder's value.

Acquisition to be EPS accretive

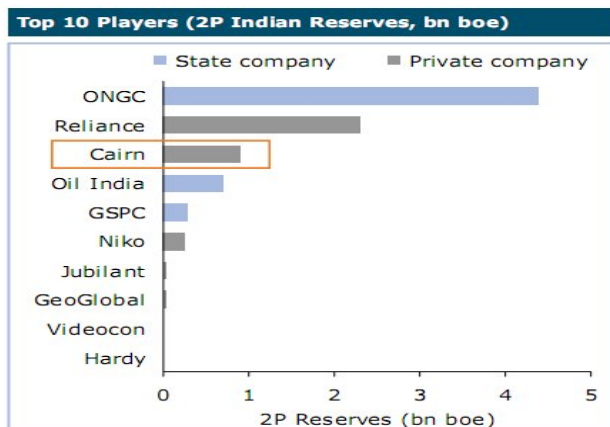
Acquisition of 20% stake Cairn India would be EPS accretive to Sesa Goa and should contribute significantly to the bottom line of company immediately. We believe, even though the share of Sesa Goa in Cairn's profitability is limited to 20%, the incremental profit would be substantially higher than the interest the idled fund would have garnered had the cash been remained in deposit accounts.

Capacity expansion on target...but may face hindrance in inorganic opportunities

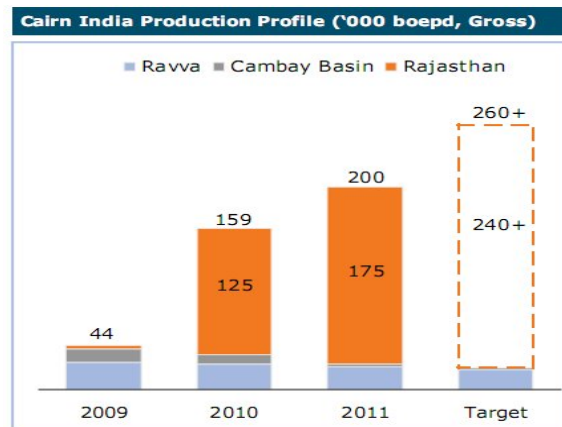
The management has maintained status quo on its future expansion plans and has guided its 50mn tonnes iron ore expansion plan is well on track. However, with surplus cash now being invested in Cairn, any incremental inorganic opportunities that could come in will be at cost and may face funding constraints for inorganic opportunities.

Carin India: Sitting on world class resources

Cairn India's principal asset is located at Barmer, Rajasthan. Cairn's Rajasthan Oil development project (RODP) represents a significant resource base with estimated oil and gas in place in excess of 6.5 bn barrels. The Rajasthan oil find is the biggest in the country over the last two decades, and is expected to account for ~20% of domestic crude production by FY12. Currently Cairn is producing 1,25,000 barrel per day of crude oil and expected to ramp up the production capacity to 2,05,000 barrels per day by FY11, with potential of further ramping it to 2,40,000 barrels per day.



Source: Company, Aриhant Research



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Valuations:

At current market price of Rs 321, the stock is trading at 10.1x its FY10 EPS and 7.1x times FY10 EV/EBITDA. Though stock appears inexpensive at current valuations, however given the current sluggish iron ore pricing outlook in the global markets, China in particular and legal issues pertaining to mining operation in India, are few of the concerns lingering over the stock.

Key Financials

Particulars (Rs. in cr)	FY09	FY10
Net Revenue	4959.1	5803.1
Growth %	29.7	17.0
EBITDA	2538.8	3089.6
PAT	1988.1	2629.1
EPS (Rs)	25.3	31.6
P/E	12.8	10.1
P/BV	5.4	3.4

Key ratio

Particulars	FY09	FY10
EBITDA %	51.2	53.2
ROE (%)	42.2	33.2
ROCE(%)	56.3	35.0
EV/ Sales	5.0	4.2
EV/EBITDA	8.8	7.1
Div. Yield	0.7	1.0
Net Profit (%)	40.1	45.3

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