

April 08, 2013

BSE Code: 526371 NSE Code: NMDC Reuters Code: NMDC.BO Bloomberg Code: NMDC:IN

NMDC was incorporated in 1958 as a Government of India fully owned public enterprise and is under the administrative control of the Ministry of Steel, Government of India. It is India's single largest iron ore producer and exporter, presently producing about 27 million tonnes per annum (MTPA) of iron ore from 3 fully mechanized mines. NMDC had developed many mines like Kiriburu, Meghataburu iron ore mines in Bihar, Khetri Copper deposit in Rajasthan, Kudremukh Iron Ore Mine in Karnataka, Phosphate deposit in Mussorie, some of which were later handed over to other companies in public sector and others became independent companies.

Investor's Rationale

NMDC in its capital expenditure plan has decided to spend a huge amount of approximately ₹300 bn spread over 3-4 years and production capacity expansion to 48 MTPA by FY'15. The company in its forward integration exercise for its operations is looking to establish a 3 MTPA steel plant in Chattisgarh with ₹15,525 crore outlay. Further, it is also eyeing to set up a 1.2 MTPA pellet plant in Karnataka. Increase in pellet capacities is likely to provide impetus to demand for iron ore fines (contributes ~ 65% to NMDC's product mix) and consequently better realizations going forward.

Apart from establishing a 3 MTPA steel plant in Chhattisgarh, the company is planning to commence coal production from its 2 captive mines for captive power purpose for its steel plants by end of 2014. The blocks have resources of 63.6 MTPA and 52.7 MTPA respectively. As per approved mining plan, NMDC is taking all necessary steps. We expect the company to benefit from the captive use of coal for its steel plant which would shield the company against the fluctuating raw material costs and will help to cap its operational expenses.

The company aims to produce over 30 MT iron ore in current fiscal, almost 20% more than in 2011-12 by enhancing production from the existing mines. It has plans to produce 40 MT iron ore by 2014-15. The domestic iron ore demand is firm due to supply side constraints which is expected to contain any further downside to the average ore realisations. Easing of logistic bottlenecks from Bailadila region on commissioning of uniflow loading system would help to grow volumes.

NMDC is a debt free company sitting on a huge cash pile worth ~₹200 bn at the end of FY'12 which reflects on the company's balance sheet strength. Currently the stock is available at an attractive valuation of 2.2x FY14E, EV/EBITDA.

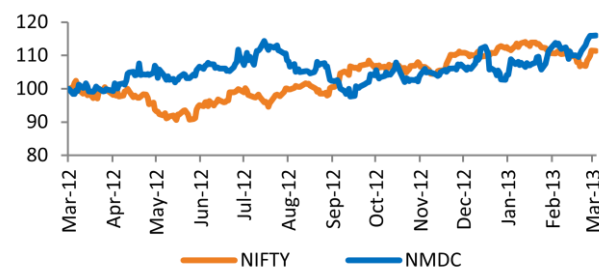
Market Data

Rating	BUY
CMP (₹)	124.8
Target (₹)	150
Potential Upside	~20.0%
Duration	Long Term
52 week H/L (₹)	203.4/123.2
All time High (₹)	572
Decline from 52WH (%)	38.6
Rise from 52WL (%)	1.3
Beta	1.5
Mkt. Cap (₹ bn)	494.4
Enterprise Value (₹ bn)	292.0

Fiscal Year Ended

Y/E	FY11A	FY12A	FY13E	FY14E
Revenue (₹bn)	113.7	112.6	100.7	123.5
Net Profit(₹bn)	86.5	89.3	75.5	93.8
Share Capital (₹bn)	65.0	72.7	64.6	76.8
EPS (₹)	16.4	18.3	16.3	19.4
P/E (x)	7.6	6.8	7.6	6.4
P/BV (x)	2.6	2.0	1.7	1.4
EV/EBITDA (x)	3.7	3.3	3.4	2.2
ROA (%)	46.1	40.6	31.3	31.0
ROE (%)	33.8	30.0	22.5	22.3

One year Price Chart



Shareholding Pattern

Shareholding Pattern	Dec'12	Sep'12	Diff.
Promoters	80.00	90.00	(10.00)
FII	4.40	0.66	3.74
DII	11.88	9.30	2.58
Others	3.72	0.04	3.68

NMDC is India's largest iron ore producer, with a capacity of 32 MTPA. Apart from iron ore business, NMDC has presence in diamond mining and coal business.

NMDC has access to better reserves of high grade iron ore, predominantly greater than 64% Fe content.

NMDC: India's flagship iron ore producer

NMDC is India's largest iron ore producer and produces ~27 MTPA from four mechanized mines namely Bailadila Deposit-14/11C, Bailadila Deposit-5, 10/11A in Chhattisgarh and Donimalai Iron Ore Mines in Karnataka. It also operates the only mechanised diamond mine in the country at Panna in Madhya Pradesh. NMDC has access to better reserves of high grade iron ore, predominantly greater than 64% Fe content. NMDC has also diversified to coal business. It has been allotted 2 coal blocks by the Ministry of Coal in July 2007 - Shahpur East and West blocks, Shahdol, in Madhya Pradesh for commercial and captive use. Also a joint venture (JV) company, International Coal Ventures (P) Limited (ICVL) has been incorporated between NMDC, SAIL, NTPC, Coal India and RINL. The objective of the JV is to primarily acquire coking and thermal coal assets abroad. It has identified coal projects in Australia, New Zealand and Mongolia. NMDC applied for 12 coal blocks (3 for commercial+ 9 for captive use) out of 17 coal blocks notified by Ministry of Coal (MoC) in its notification dated 31.12.2012 for allotment of coal blocks to the government companies under Coal Mines rule.

To expand its global footprints, NMDC has acquired 50% stake in Legacy Iron Ore Ltd (LIOL), a listed Australian Company engaged in exploration of iron ore and other minerals in Australia for a consideration of ₹996.3 mn. The acquisition will aid NMDC in long term mineral security for the domestic industry and utilise LIOL as a platform to source and secure steel making raw material. This is the company's first foray in the international market and shall serve as a reference point in terms of experience to acquire other assets globally.

Government of India has divested 10% stake in NMDC and raised around ₹59 bn on December 13, 2012. The response for offer of 396 mn shares was impressive as it got oversubscribed by 1.7 times. This reflects upon the optimistic investor's view on the company.

Access to high quality iron ore reserves and resources (in MTPA)

Mines	Fe % Grade	Proved Reserves	Probable Reserves	Total Ore Reserves	Total Mineral Resources
Deposit - 5	65.3	38.7	182.2	220.8	
Deposit - 10	66.0	140.1	-	140.1	56.5
Deposit - 11	66.2	140.4	-	140.4	17.0
Deposit - 13	67.2	319.6	-	319.6	
Deposit - 14	64.7	130.1	-	130.1	19.5
Deposit - 14 NMZ	65.9	60.6		60.6	3.0
Deposit - 4	-	-	-	-	105.0
Total Chhattisgarh Mines		829.5	182.2	1,011.7	201.0
Donimalai	66.8	17.6	-	17.6	-
Kumaraswamy	64.0	130.4	-	130.4	-
Total Karnataka Mines		147.9	-	147.9	-
Total Iron Ore		977.4	182.2	1,159.6	201.0

NMDC is lined up with the capacity addition of iron ore to 48 MTPA by FY'15 through brownfield as well as greenfield projects.

Low-cost Producer of Iron Ore

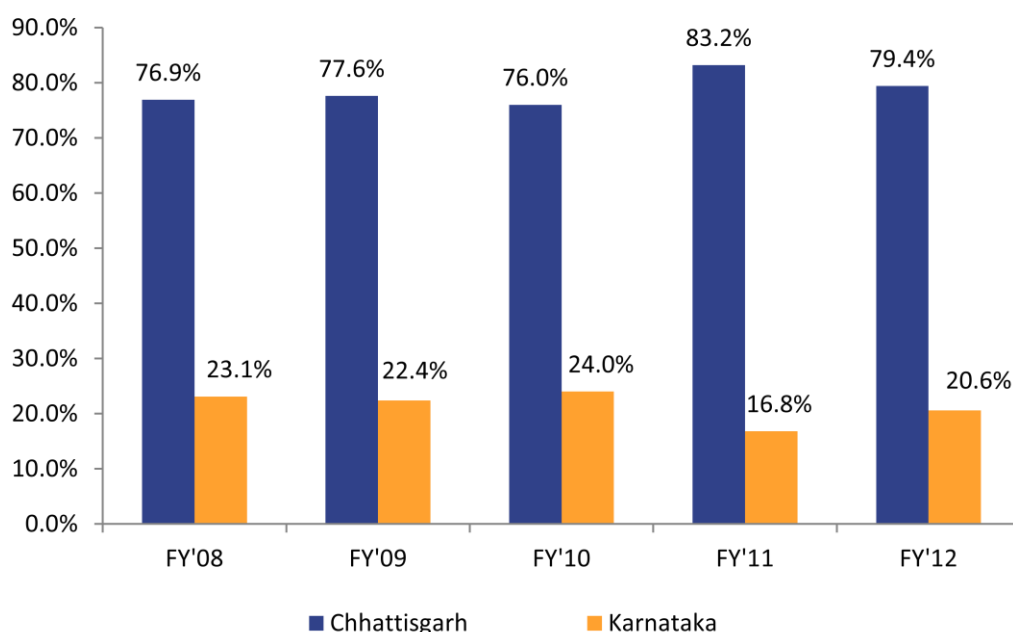
The company's low cost of production is due to highly mechanised mines leading to lower wastage coupled with cost management through cost centre wise monitoring and control practices. This leads to greater operational efficiency and logistics planning. NMDC had produced 27.3 MTPA iron ore in FY'12, up from 25.2 MTPA in FY'11. NMDC is likely to raise its iron ore production capacity to 48 MTPA by FY'15 from current installed capacity of 32 MTPA at its mines in Chhattisgarh and Karnataka. Further, it is also eyeing to start a deposit at Balidala in Chhattisgarh with an annual capacity of 7 mtpa by FY'15.

The proposed capacity expansion would help it feed its upcoming steel-making plant in Chhattisgarh and also partly meet domestic steel makers growing demand. The proximity of expansion projects to existing mines also enables optimal utilization of existing infrastructure which reduces the overall investment cost.

NMDC's mines at Chhattisgarh and Karnataka provide the benefit of accessing the efficient logistics and consequently better control over costs. In FY'12 the EBITDA margins were ~79% as against the sole domestic iron ore peer, Sesa Goa's margins of ~47%. Also, the domestic market comprised 99% of NMDC's total sales while exports contributed meagre 1% in FY'12.

We expect the company to maintain its EBITDA margins at above 75-76% in FY'13E/FY'14E as the iron ore lump prices have seen correction. We expect blended realisations to improve marginally in FY'14 YoY and cost stabilization driven by synergies from existing logistics and infrastructure to provide cushion to the operating margins.

Production trend at key mining locations



Rationalisation of lumps prices by NMDC would help the company to augment its sales volumes in future.

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Higher grade iron ore (Lumps) prices slid in January and also for March dispatches

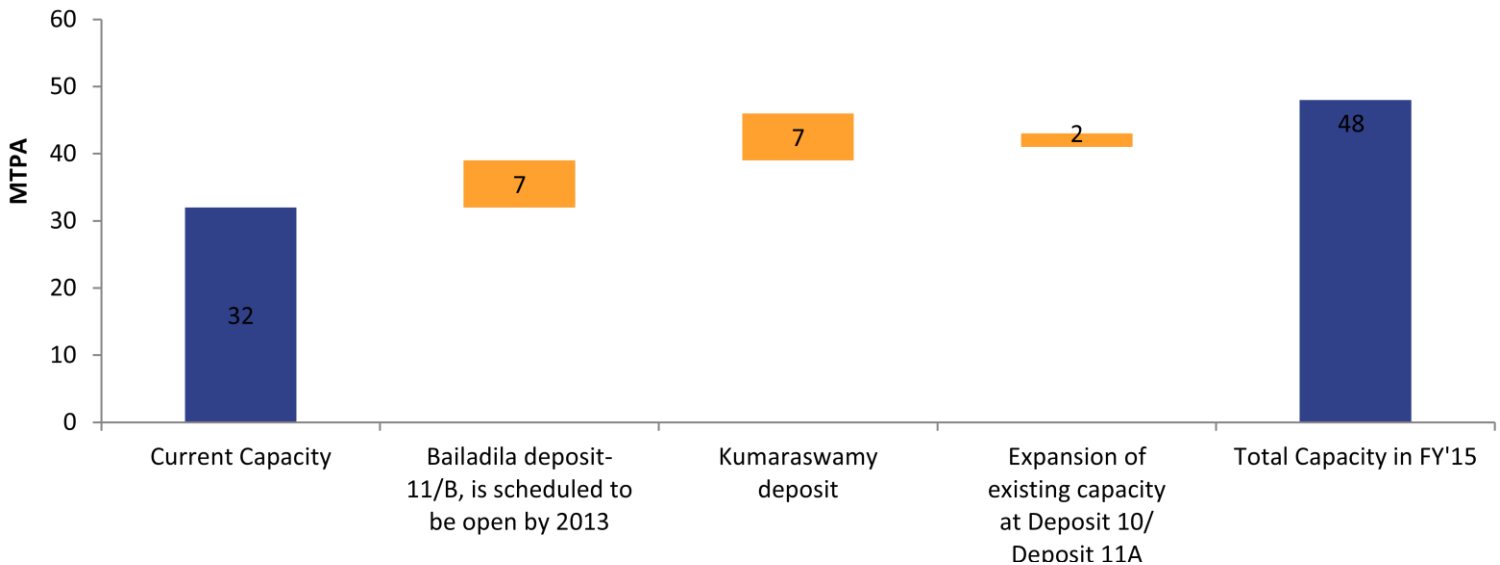
Making a fifth reduction since October 2012 in iron ore lump prices, NMDC has announced a cut in the prices of iron ore lumps by about 7% for April 2013. A month ago, it has slashed 2.5% to ₹4,950 a tonne from ₹5,060, marking a second cut in prices in 2013, while the prices of fines were left unchanged at ₹2,610/tonne. As per the company, the price cut was done to bridge the gap between the demand supply situation. NMDC had earlier cut lump prices by 6% to ₹5,060/tonne in January to ensure parity with the imported iron ore prices. After a continuous price hike in the Q2FY'13, NMDC had decided to revise the prices monthly in order to counter the volatile effect on iron ore prices. In October, it had cut prices 2-11% and in November by 3-11%, while the company had kept the prices unchanged in December 2012. However, the price cuts will be benefitted most to the domestic steel makers, those without captive iron ore mines. Moreover, we expect the price cuts to help in improving the sales volume of the company as a whole.

Capacity expansion plan to augment growth

NMDC proposes to augment its production of iron ore from the present level of about 32 MTPA to 48 MTPA by FY'15 through increased exploration of its existing mines and development of new mines. NMDC is developing two new mines at an indicative cost of around ₹15 bn. The mines to be developed are located in Bailadila sector at Chattisgarh, i.e. Deposit-11B iron ore project and the other in Bellary-Hospet region at Karnataka i.e. Kumaraswamy iron ore mine. The expected commissioning of the Deposit 11B mine by June 2013 and that of Kumaraswamy iron ore mine is likely by November 2013.

The construction of Kumaraswamy iron ore mine with capacity of 7.0 MTPA was taken up with an estimated capital outlay of ₹8.99 bn to compensate the depleting reserve of Donimalai mine and augmenting production capacity. These capacity expansion plans are part of the company's focused strategy to maintain its leadership position in the domestic market. Most of the current expansion programmes will get commissioned by FY'14 and the full benefit will accrue in FY'15.

Focused capacity expansion plans



Volatility in prices, lower off-take and evacuation bottlenecks dragged the turnover by 27.4% in Q3FY'13.

Subdued performance in Q3FY'13

NMDC posted a disappointing performance in Q3FY'13 with turnover fell sharply 27.4% YoY to ₹20.48 bn, primarily due to 17% YoY fall in sales volume to 5.36 MTPA as well as realisations. The company's production of iron ore declined 25% YoY affected by low off-take of iron ore by customers attributed to the logistics problems mainly from Bailadila project due to prolonged monsoon. Iron ore realizations plummeted 13.1% YoY to ~₹3,817/tonne. As a result, the net profit fell ~30% YoY in Q3FY'13 to ₹12.9 bn. EBITDA dropped 38.5% YoY to ~₹13.91 bn. EBITDA/tonne decreased 11% YoY to ~₹2,600 due to fall in average realization. Despite the subdued performance, the company is confident that production will pick up in Q4FY'13 due to recovery in the dispatches of iron ore lumps as the evacuation problem at Bailadila has almost eased out.

The total volumes are also expected to increase as the commissioning of uniflow loading system in Bailadila has reduced the bottlenecks in transportation of iron ore from the region.

Financial Performance

₹ in mn	Q3FY'13	Q3FY'12	YoY (%)	9MFY'13	9MFY'12	YoY (%)
Net Revenue	20,477	28,222	(27.4)	75,000	86,673	(13.5)
EBITDA	13,913	22,608	(38.5)	56,282	69,511	(19.0)
EBITDA Margin (%)	67.9	80.1	-	75.0	80.2	-
Other Income	5,563	5,240	6.2	16,915	14,662	15.4
Depreciation	339	331	2.3	998	971	2.8
PBT	19,137	27,516	(30.5)	72,198	83,202	(13.2)
Tax	6,209	8,928	(30.5)	23,424	26,971	(13.2)
PAT	12,928	18,588	(30.5)	48,774	56,231	(13.3)
PAT Margin %	49.6	55.6	-	53.1	55.5	-
EPS (₹)	3.26	4.69	(30.5)	12.3	14.18	(13.3)

Indian Iron Ore industry scenario

Being a rich source of minerals, India is the world's fourth largest producer of iron ore with iron ore reserves are estimated around 23 bnt and account for 6% of global reserves. Indian Steel industry continues to grow, powered by demand driven by selective Indian economic strengthening, even when rest of the global steel industry is in the middle of a slowdown. As per the report of the Working Group on Steel industry for the 12th Five year plan (2012-17) of Planning Commission of India, India's crude steel capacity is likely to increase to 149 MTPA by FY'17 from 78 MTPA in FY'11, which in turn will help iron ore demand to remain robust.

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However, iron ore exports are badly hit due to global economic slowdown. According to the data compiled by the Federation of Indian Mineral Industries (FIMI), showed total iron ore exports in the first 10 months of FY13 registered a de-growth of ~68% YoY to 16.35 MTPA. FIMI attributed the sharp decline in exports to poor mining activity resulting in lower availability of the mineral and also due to hefty export duty levied by the government in order to discourage exports. A mining ban on iron ore in Goa and only a partial restoration of mining after a similar ban in Karnataka has affected the iron ore exports. Earlier on 2011, the iron ore exports used to be at 100 MTPA before illegal mining and environmental degradation took the centre stage. The export duty on iron ore has been raised tremendously from 5% in FY'10 to 30% in FY'12. The railway freight has also been hiked in various proportions during the period FY'10-FY'12. Currently, it is about four times the domestic freight for iron ore (₹2,600 a tonne). FIMI attributed all the above factors have made the iron ore exports turned unviable.

In a recent report, the Indian Bureau of Mines (IBM) said that "almost all the major iron-ore belts - Orissa, Jharkhand, Chattisgarh, Maharashtra, Goa and Karnataka were exploited for high-grade ore at a cutoff of around 60% iron and many had been exploited for high- and medium-grade ores (62% plus) over the last six decades; but the country has huge potential in low-grade ores in these regions, however exploration efforts have been highly inadequate." Besides, only 10% of the country's landmass has been explored, due to the significant regulatory and bureaucratic hurdles. The industry performance is anticipated to decelerate, with an expected CAGR of 12.5% for the five-year period i.e. FY'11-16, which is expected to drive the industry to a value of US\$255.8 bn by the end of 2016. However, considering the positive developments in the mining sector viz, improving rising domestic demand and favourable regulations such as FDI, Mines and Minerals Development & Regulation (MMDR) bill would help boost growth of the mining sector.

Shift in price mechanism provides NMDC to match up with the international prices

NMDC recently has changed its pricing mechanism from earlier model based on the export parity to a new pricing mechanism which apparently is based on domestic demand supply situation of iron ore. This move provides an opportunity to increase the domestic iron ore prices as the company enjoys pricing power and to bring prices at par with the international benchmark iron ore prices. The company took this measure after the government increased the export duty to 30% from that of 20% earlier coupled with continuous rise in freight costs. In a move towards making the pricing mechanism more transparent, the company has appointed KPMG to come out with a pricing mechanism for the domestic consumers.

With the largest domestic player of iron ore of high grade with 64%+ Fe content coupled with the decline in the domestic iron ore production along with higher demand and global prices, provides the company an upper hand to enjoy the pricing power going forward. Hitherto difference between NMDC's iron ore prices as compared to the international benchmark prices were more than 100%, which has come down to ~50% currently, following the new pricing mechanism adopted by the company.

Change in pricing strategy from international price parity model to monthly pricing model will assist improved realization in tight demand supply scenario.

Balance Sheet (Consolidated)

Y/E (₹million)	FY11A	FY12A	FY13E	FY14E
Share Capital	3,965	3,965	3,965	3,965
Reserve and surplus	188,181	240,099	284,124	340,242
Net Worth	192,145	244,064	288,088	344,206
Long term debt	221	234	234	234
Deferred tax liability	1,029	1,001	1,001	1,001
Long term provisions	149	135	110	135
Current Liabilities	17,437	21,051	19,344	24,232
Capital Employed	210,981	266,484	308,778	369,809
Fixed Assets	16,670	26,830	34,466	45,851
Investment	1,357	2,478	2,478	2,478
Loans & Advances	7,561	15,601	13,958	15,766
Other Non-current Assets	110	66	66	66
Current Assets	185,284	221,510	257,809	305,648
Capital Deployed	210,981	266,484	308,778	369,809

Key Ratios (Consolidated)

Y/E	FY11A	FY12A	FY13E	FY14E
EBITDA Margin (%)	76.0	79.3	74.9	75.9
EBIT Margin (%)	85.6	96.0	96.0	92.9
NPM (%)	51.7	54.7	52.5	52.6
ROCE (%)	50.3	44.1	33.4	33.2
ROE (%)	33.8	30.0	22.5	22.3
EPS (₹)	16.4	18.3	16.3	19.4
P/E (x)	7.6	6.8	7.6	6.4
BVPS(₹)	48.5	61.6	72.7	86.8
P/BVPS (x)	2.6	2.0	1.7	1.4
EV/Operating Income (x)	3.3	2.7	2.6	1.8
EV/EBITDA (x)	3.7	3.3	3.4	2.2
EV/EBIT (x)	4.2	3.5	3.5	2.6

Profit & Loss Account (Consolidated)

Y/E (₹million)	FY11A	FY12A	FY13E	FY14E
Net Sales	113,693	112,619	100,688	123,485
Expenses	27,243	23,357	25,231	29,709
EBITDA	86,450	89,262	75,458	93,777
EBITDA margin (%)	76.0	79.3	74.9	75.9
Other Income	12,031	20,165	22,553	22,553
Depreciation	1,204	1,302	1,345	1,615
EBIT	97,278	108,125	96,666	114,715
Interest	15	15	15	15
Exceptional Items	0	513	0	0
Profit Before Tax	97,263	107,597	96,651	114,701
Tax	32,266	34,942	31,895	37,851
Profit After Tax	64,996	72,656	64,756	76,849
Loss from discontinuing operations	(4)	(2)	0	0
Net Profit	64,992	72,654	64,756	76,849
NPM (%)	51.7	54.7	52.5	52.6

Valuation and view

We expect the volumes to grow ~20% YoY in FY'14 driven by the capacity expansion initiative undertaken by the company. Moreover, easing of logistic bottlenecks at Bailadila mine in Chhattisgarh and steady domestic demand from the domestic steel producers would further augment sales volume. The Supreme Court decision to meet the burgeoning iron ore demand by NMDC in light of the mining ban on the private miners, augurs well for the company. This provides a strategic advantage to the company.

At a current market price of ₹124.8, NMDC is attractively placed at EV/EBITDA of ~3.4x FY13E and 2.2x FY14E. We recommend BUY on the stock with a target price of ₹150 with long term perspective (1 year) based on 3.3x FY14E, EV/EBITDA which provides an upside of ~20%.



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