Change in ☑ Estimates ☐ Rating ☑ Target

NMDC Ltd

Valuations attractive

NMDC has corrected sharply over the last two months on the back of weak iron ore prices globally, subdued domestic steel demand and Government's plan to divest. NMDC's iron ore realizations are expected to remain resilient to the slide in global iron ore prices as we estimate the domestic iron ore market to remain tight. Volumes are expected to rise in FY14 led by commissioning of the uni-flow system and the Bailadila 11B mine coupled with higher contribution from Karnataka. We **expect earnings CAGR of 6.4% over the period FY12-15 on the back of strong volume growth**.

At the current stock price, the market seems to be building in too much pessimism into the stock. The stock is currently trading at 4x FY14E EV/EBIDTA, which is at a huge discount to its historical one year forward EV/EBIDTA of 12.6. **We value the company at 5x FY14E EV/EBIDTA and arrive at a 9-month price target of Rs182**. Despite the cut in our earnings estimates and target price, we maintain our **BUY recommendation as we see 14.5% upside** to our revised target price from current levels.

We believe global iron ore prices would not stay below the US$100/ton level for a longer period due to high cash costs for Chinese miners and slower than expected volume growth in the seaborne market. A slower ramp up in supplies from Australia and Brazil coupled with very low exports from India would keep the seaborne iron ore market in balance. Slowing demand growth from China would continue to remain an overhang and hence would cap the increase in iron ore prices over the next two years.

Iron ore supply in the domestic market has declined sharply over the last two years due to the various regulatory actions taken by the Government to curb illegal mining. We estimate **domestic iron ore production would decline to FY05 levels to 140mn tons in FY13** on account of the various regulatory checks setup by the Government. On the other hand, demand is expected to remain firm as we **estimate steel capacity addition of ~22mn tons over FY12-14**. A combination of declining iron ore supply and rising iron ore demand would lead to a tight domestic market for iron ore over the next two years.

Financial summary

Y/e 31 Mar (Rs m)	FY12	FY13E	FY14E	FY15E
Revenues	112,619	117,179	119,366	134,272
yoy growth (%)	(0.9)	4.0	1.9	12.5
Operating profit	89,262	91,689	92,002	103,834
OPM (%)	79.3	78.2	77.1	77.3
Reported PAT	73,184	76,781	78,466	88,094
yoy growth (%)	12.6	4.9	2.2	12.3
EPS (Rs)	18.5	19.4	19.8	22.2
P/E (x)	8.6	8.2	8.0	7.2
EV/EBITDA (x)	4.8	4.3	4.0	3.3
Cash per share (Rs)	51.1	59.6	66.1	73.7
RoE (%)	33.6	28.3	24.0	22.8
RoCE (%)	49.3	41.6	35.3	33.6

Source: Company, India Infoline Research

December 12, 2012

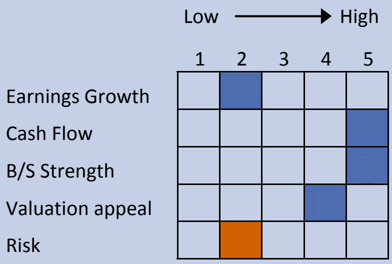
IIFL INDIA PRIVATE CLIENTS

Rating:	BUY
Target (9-12 months):	Rs182
CMP:	Rs159
Upside:	14.5%

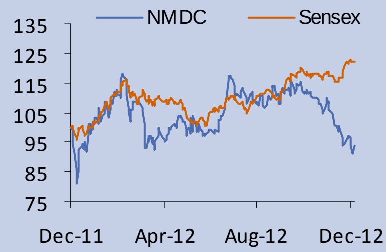
Sector:	Mining
Sector view:	Neutral
Sensex:	19,387
52 Week h/l (Rs):	206 / 136
Market cap (Rscr) :	63,158
6m Avg vol ('000Nos):	471
Bloomberg code:	NMDC IB
BSE code:	526371
NSE code:	NMDC
FV (Re):	1

Prices as on11 Dec, 2012

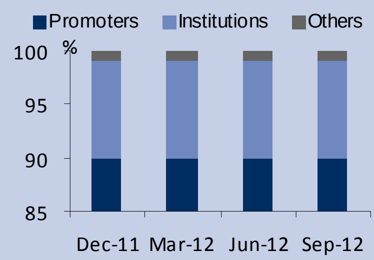
Company rating grid



Share price trend



Share holding pattern



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Nikhil Anand
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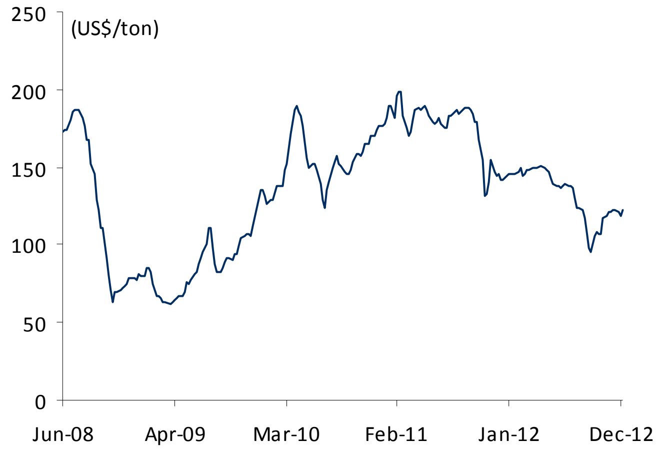
Company Report

Iron ore prices to stay around US$100/ton

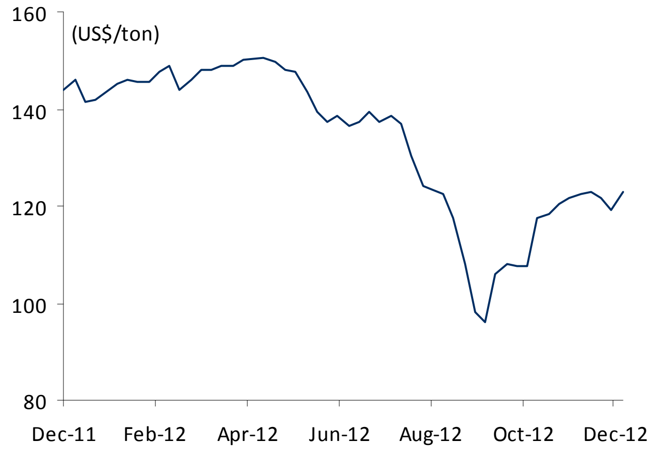
For the first time since 2009, iron ore prices globally slipped below the US$100/ton mark in the month of September. The seaborne spot iron ore price has fallen by around US$45/ton since April '12 and this has been coupled with a dramatic shift down in the forward curve. The sharp decline in iron ore prices was led by rising supplies from Australia and Brazil coupled with Chinese buyers staying away from the markets due to holidays. Iron ore inventories at the port have remained high over the last one year, whereas that of steel mills are low as they remain comfortable to run with low inventories on expectations of further drop in prices. However, with a decline in iron ore prices and end of holidays in China, iron ore prices have managed to bounce back above the US$110/ton levels.

After the end of holidays in China iron ore prices have managed to bounce back above the US$110/ton levels

Spot iron prices slipped below US$100/ton in September for the first time since 2009



… and have bounced back to US$120/ton



Source: Bloomberg, India Infoline Research

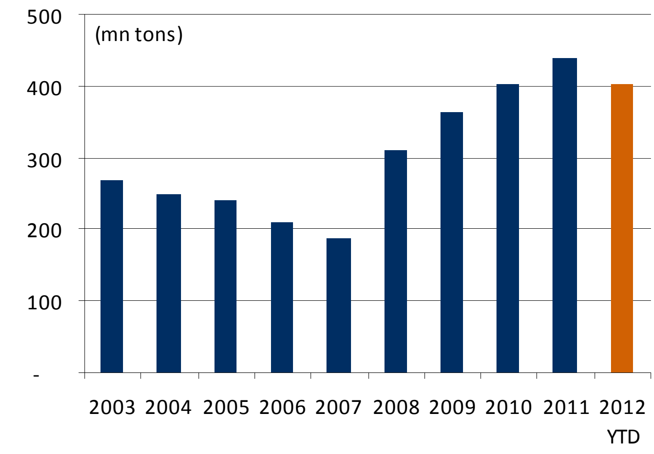
Since 2008, Australian iron-ore exports have grown at a consistent rate of over 10% every year. We expect this rate to continue in 2012 and then accelerate sharply in 2013. Seaborne iron ore supply from Australia has been robust during the year and is expected to increase by ~60mn tons in 2012. For the period January-October 2012, iron ore imports from Australia to China increased by 19.9% yoy to 284mn tons. Australian share of total iron ore imports in China increased to 53.1% in September from an average of 42.9% in 2011. We believe Australia will continue to lead global ore expansion over the next five years despite issues regarding mobilization of manpower and infrastructure.

For the period January- October 2012, iron ore imports from Australia to China increased by 19.9% yoy to 284mn tons

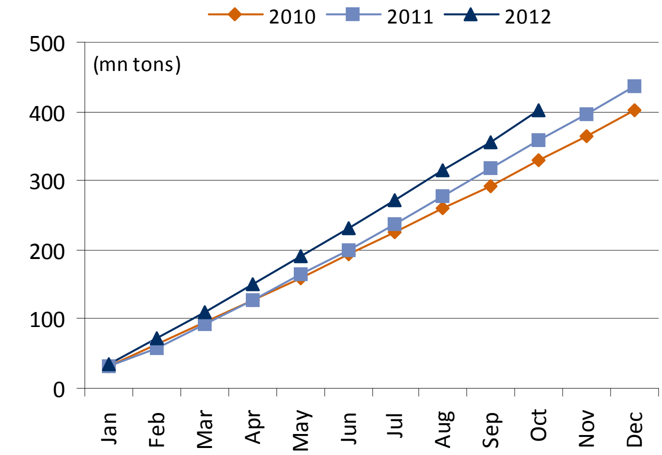
Exports from Brazil to China too have been strong during the year. Exports in ore to China increased 11.7% yoy during the period Jan-Oct '12 as against an increase of 2.8% yoy for the same period for total ore exports from China. Brazil's share of total iron ore imports in China has remained flat in the range of 20-21%. We expect supply from new mines in Brazil to start from 2013, which would further add pressure on prices.

Brazil's share of total iron ore imports in China has remained flat in the range of 20-21%

Iron ore exports from Australia have grown +10% yoy since 2008

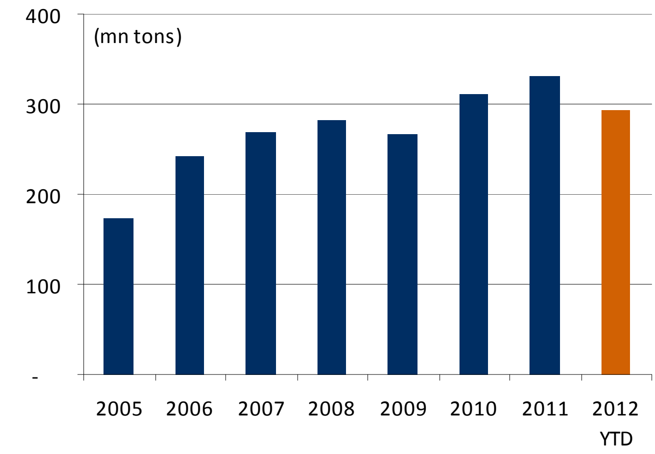


… and for 10M 2012 it has increased by 12.9% yoy

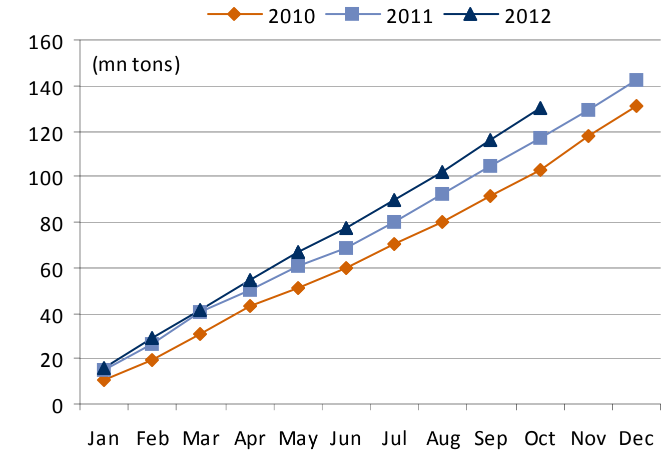


Source: Bloomberg, India Infoline Research

Exports from Brazil too have been stronger post 2009

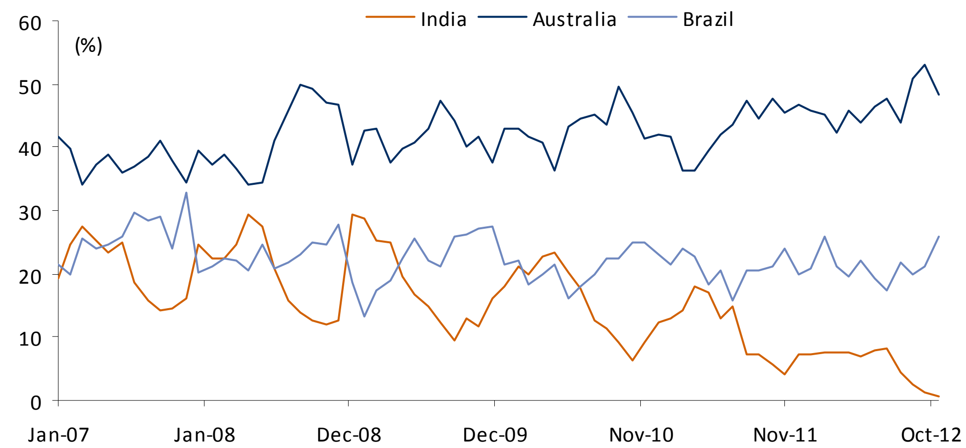


… and for 10M 2012 exports to China have jumped 11.7% yoy



Source: Bloomberg, India Infoline Research

Share of iron ore imports in China jumped to 53.1% from Australia, flat at 21.2% from Brazil and declined sharply to 1.2% from India in September '12

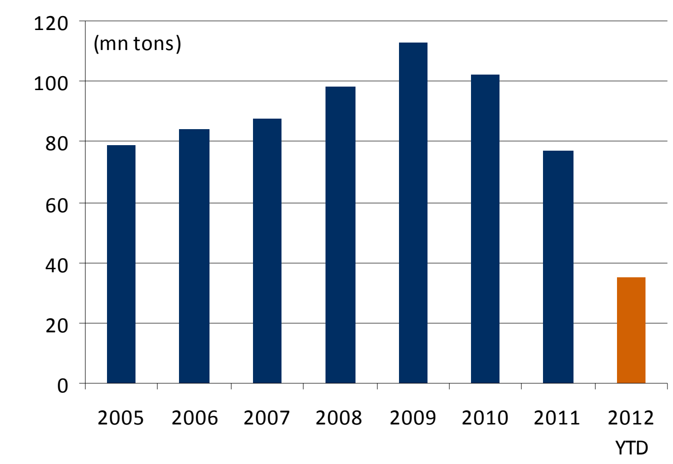


Source: Bloomberg, India Infoline Research

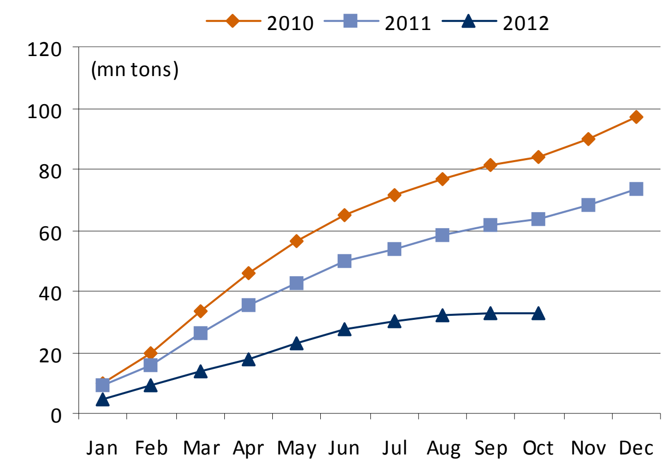
The increase in seaborne iron ore trade has been restricted by a sharp decline in exports of iron ore from India. An increase in iron ore export duty to 30% ad valorem and restrictions on iron ore exports from key iron ore producing states has led to a fall in exports. Iron ore exports in the month of October '12 declined to 0.3mn tons from 2mn tons achieved last year. Total exports to China halved on a yoy basis to 33mn tons in 10M 2012 against 63.7mn tons achieved over the same period last year. Supplies from India are expected to remain low due to mining restriction in Goa, largest iron ore exporting state in India.

Indian exports to China halved on a yoy basis to 33mn tons in 10M 2012 against 63.7mn tons achieved over the same period last year

Iron ore exports from India have halved on a yoy basis



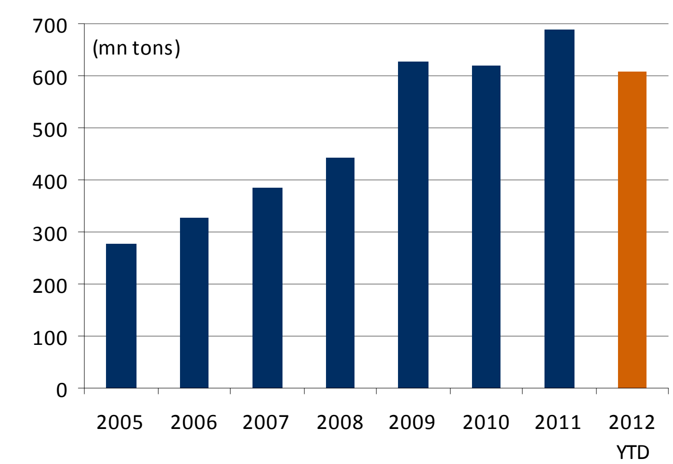
… exports to China dipped as low as 0.2mn tons in October '12



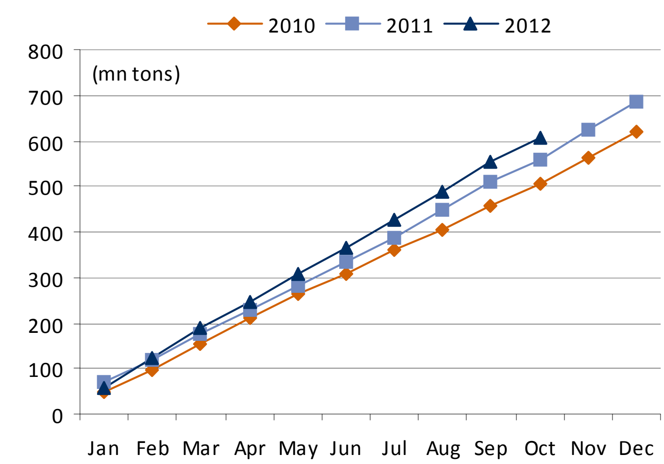
Source: Bloomberg, India Infoline Research

This coupled with steady imports from China has helped iron ore prices bounce back above the US$100/ton level. Chinese steel production has increased 2% yoy during the period Jan-Oct '12 leading to steady demand of iron ore. Total iron ore imports in China over the period Jan-Oct '12 stood at 608mn tons, an increase of 9% yoy. Chinese iron ore production too increased by 2% yoy to 593.8mn tons. With supplies outpacing demand in China, iron ore inventory has gradually built up over the last one year. Chinese iron ore inventory increased by 16% to 8.9mn tons during the period Jan-Oct '12.

Chinese iron ore imports accounts for 2/3rd of total seaborne iron ore trade

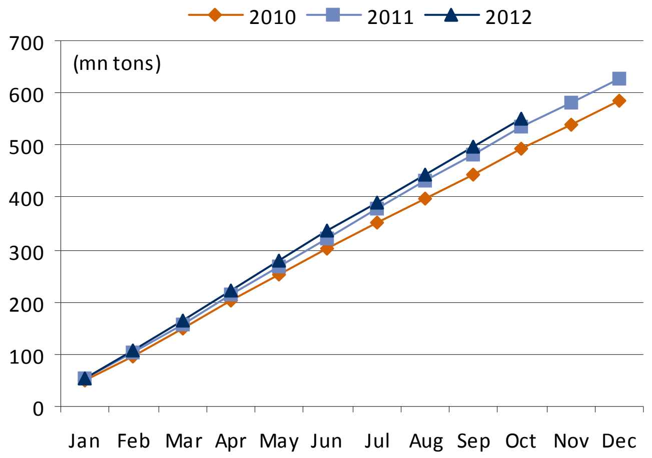


… and for 10M 2012 it has increased by 9% yoy

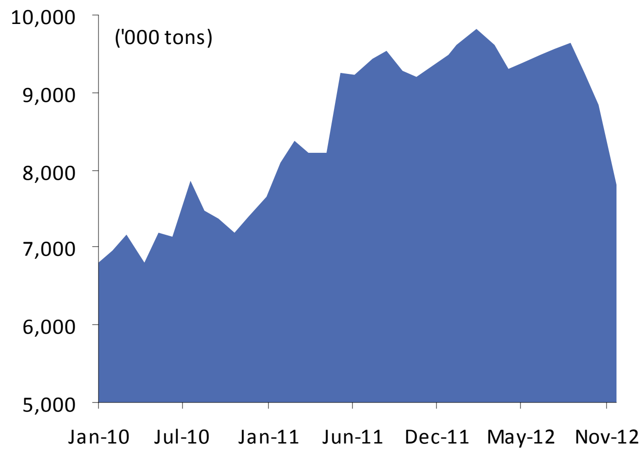


Source: Bloomberg, India Infoline Research

Chinese iron ore production too has been higher despite lower prices



… Supply has outpaced demand in 2012 leading to a built up in inventory levels at port till October '12

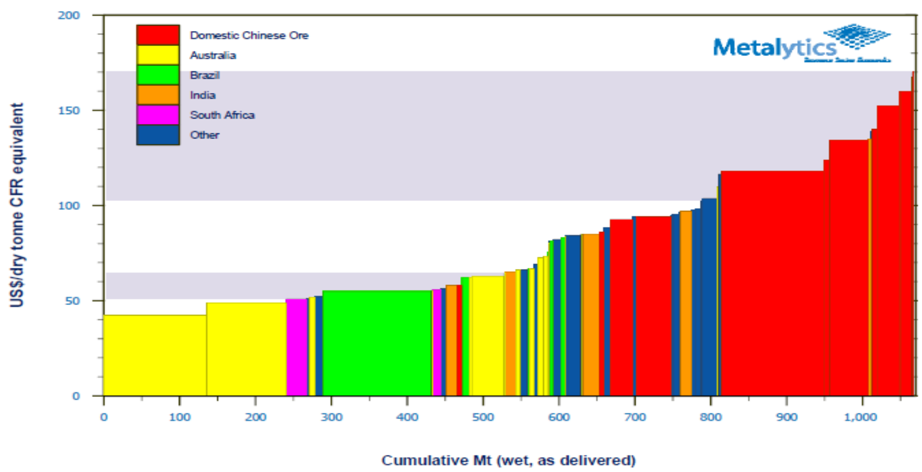


Source: Bloomberg, India Infoline Research

The bounce back in iron ore prices was also supported by the high cost curve of Chinese iron ore producers. Chinese ore has a lower iron content compared with many other countries so producers spend more to extract the mineral compared with global miners. Hence, China's production costs are between US$100-140/ton compared to about US$40-50/ton for Big '3'. Also in future, iron ore cost would be at least US$110 for an average Chinese mine to produce as increasing production would tap lower grades of ore that are more expensive to mine. We believe that iron ore prices cannot sustain below US$100/ton level as majority of Chinese producers would cut production.

China's production costs are between US$100-140/ton compared to about US$40-50/ton for Big '3'

Chinese iron ore costs are above US$110/ton

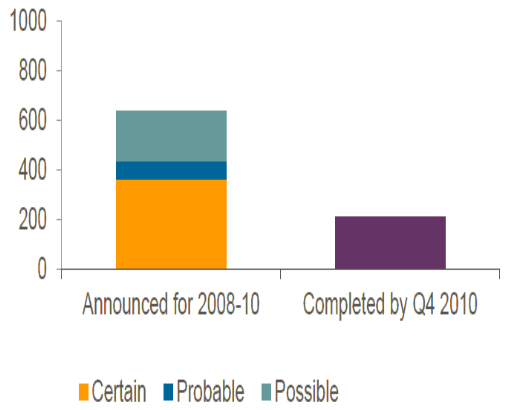


Source: Company, India Infoline Research

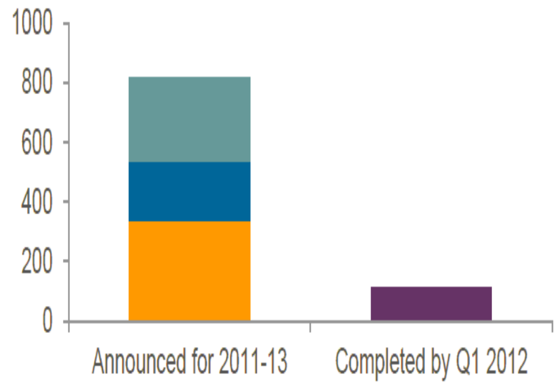
Over the last five years, supply growth from the leading iron ore producing nations has been relatively lower than the targets set earlier. With a boom in iron ore market in the last five years, there has been announcements for various large projects. However, projects have been delayed or forfeited due to difficulty in working in remote areas, protracted approval process, shortage of specialist mining skills, labor issues and reduced sources of project financing. By 2010, only 30% of the projects announced during 2008-2010 were completed. The situation has not changed post 2010, as only 15% of projects announced for 2011-2013 have been completed. We believe that the delay in commissioning of the projects would continue and the growth in supply would be lower than market expectations.

By 2010, only 30% of the projects announced during 2008-2010 were completed

Only ~30% of the projects announced during 2008-2010 have been completed

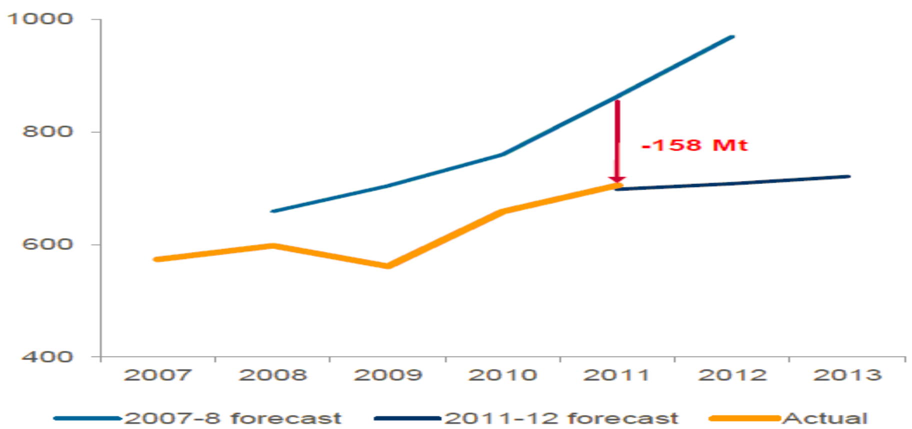


… and that from 2011 has been ~15%



Source: UNCTAD, Rio Tinto

Actual production has been way below forecasts



Source: UNCTAD, Rio Tinto

We believe global iron ore prices would not stay below the US$100/ton level for a longer period due to high cash costs for Chinese miners and slower than expected volume growth in the seaborne market. A slower ramp up in supplies from Australia and Brazil coupled with very low exports from India would keep the seaborne iron ore market balanced. Slowing demand growth from China would continue to remain an overhang and hence would cap the increase in iron ore prices over the next two years. We estimate iron ore prices to average US$120/ton in 2013 and then decline marginally in 2014 as supplies rise.

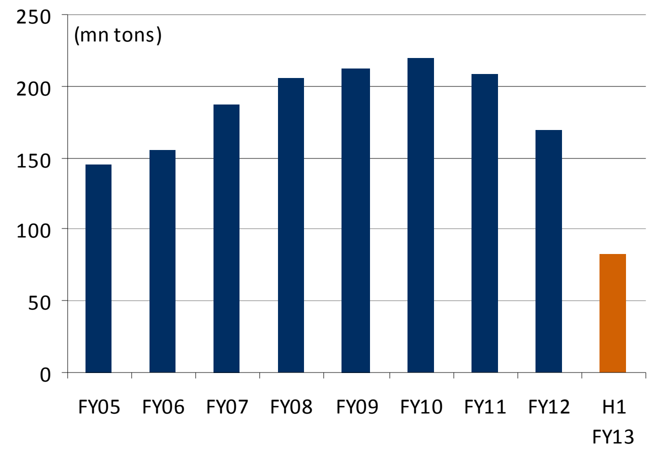
A slower ramp up in supplies from Australia and Brazil coupled with very low exports from India would keep the seaborne iron ore market in balance

Domestic iron ore supplies to remain tight

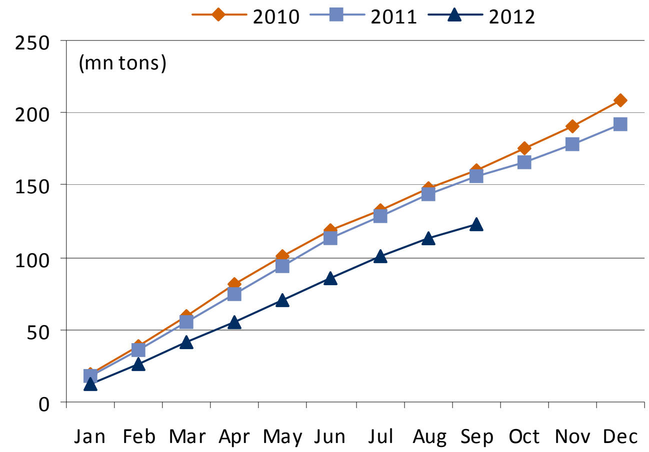
Iron ore supply in the domestic market has been quite tight over the last two years. Iron ore production has declined from 218.6mn tons in FY10 to 208mn tons in FY11 and 169.1mn tons in FY12. The decline in domestic production has been largely due to the various regulatory actions taken by the Central and State Governments to curb illegal mining in the country. Exports from India, which had been on an uptrend till FY10, declined sharply over the last two years. Exports in FY10 stood at 117.4mn tons which declined to 97.7mn tons and 61.8mn tons. In addition to the curbs on production the huge increase in export taxes and transportation costs have also led to sharp decline in exports. Even in H1 FY13, iron ore production has been quite lower at 82.1mn tons, a decrease of 18.2% yoy.

In H1 FY13, iron ore production has been quite lower at 82.1mn tons, a decrease of 18.2% yoy

Iron ore production declined to 169.1mn tons, levels last seen in FY07



… and for H1 FY13 it has declined further by 18.2% yoy

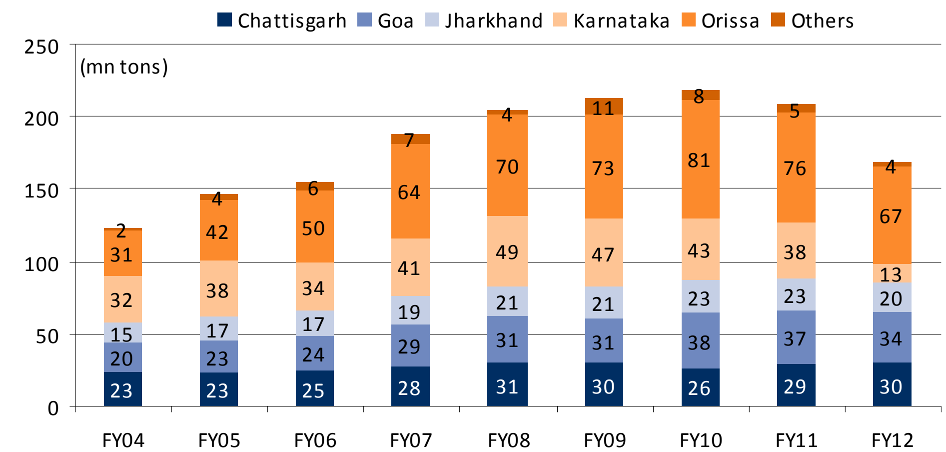


Source: Bloomberg, India Infoline Research

A plunge in output in Karnataka is largely responsible for the decline in iron ore production in India. Karnataka iron ore production in FY12 declined by 25mn tons (down 65% yoy) as mining (except NMDC) has been stopped by the Supreme Court (SC). Besides Karnataka, Orissa production too declined by 10mn tons (down 12% yoy) as more regulatory checks were placed by the Government.

Karnataka iron ore production in FY12 declined by 25mn tons (down 65% yoy)

Indian state-wise iron ore production



Source: Steel Ministry, India Infoline Research

Karnataka: Karnataka was the first state to be impacted by the regulatory restriction put by the Government to curb illegal iron ore mining. The production in the state was impacted since July 2011, as the SC had implemented a mining ban. Except NMDC, no other company was allowed to mine iron ore in the districts of Bellary, Tumkur and Chitradurga. The SC had ordered that no mining operation under any of the mining leases shall take place unless all the statutory sanctions, permissions and approvals are in place. The SC had setup a Central Empowered Committee (CEC) to scrutinize all the mining lease. CEC found that at least 123 mining leases out of the 166 surveyed were involved in illegal mining and divided these companies into 3 categories. Out of these 166 companies, 45 were put under Category A where no illegality was found and the companies could start mining subject to certain conditions. Similarly, 72 companies were labeled category B which had partially broken the rules. Further, the panel recommended cancellation of mining leases of 49 companies under category C.

CEC found that at least 123 mining leases out of the 166 surveyed were involved in illegal mining

The CEC also put a ceiling of 25mn tons for total production of iron ore from Bellary and of 5mn tons from the districts of Chitradurga and Tumkur together. In September '12, the Supreme Court allowed 18 Category-A mines to start production. Out of these 18 mines, 5 of them have pending court cases and are unlikely to begin production in the near term. Moreover, the lone company that started iron ore production in Karnataka in September has shut down its operations due to expiry of its mining lease. Two more Category 'A' miners have started production in the month of October. However, we do not expect supplies from Category 'A' and Category 'B' miners to exceed 5mn tons in FY13 and ~12mn tons in FY14 as mining lease for most of the mines have expired.

The CEC also put a ceiling of 25mn tons for total production of iron ore from Bellary and of 5mn tons from the districts of Chitradurga and Tumkur together.

Orissa: Iron ore mining in Orissa has been plagued by a number of factors such as illegal mining, heavy rainfall, higher railway freight and high export duty leading to a significant decrease in iron ore production from the state. An indefinite strike by truckers hampered iron ore transport in Orissa in August last year. Even as the strike eased off in September, heavy rainfall stopped mining activity for several days and affected transportation of iron ore in the following months. In a bid to curb illegal mining from the state, the State Government banned transportation from three major iron ore railway sidings at Barbil, Bansapani and Jhurudi in Keonjhar district from March to May this year, bringing the movement of iron ore from the state to a standstill. Meanwhile, the Shah Commission visited Orissa to probe illegal mining of iron ore and urged the government to curb its production. A ceiling of 52-55mn tons of iron ore production has been set by the government from the peak of 81mn tons in FY10. As a result of the various disruptions this year, we expect production of iron ore ~40mn tons in FY13. Moreover, we don't expect volumes to revive in the near term as the government has refused to renew the mining lease of companies who do not have captive consumption.

A ceiling of 52-55mn tons of iron ore production has been set by the government from the peak of 81mn tons in FY10

Goa: Majority of Iron ore mined in Goa is exported as the iron content in the ore is of lower grade which is Haematite in nature and transportation cost is quite low. Iron ore mining in the state has stayed above 30mn tons for the last four years. However, over the last few months to curb illegal mining the State Government has implemented various restrictions. Earlier before the monsoons it had stopped transportation of iron ore in South Goa and then later on implemented a complete mining ban. The Shah Commission led to cancellation of all the 93 mining leases in Goa. The panel has recommended capping the iron ore production to FY01 levels or 12.5mn tons. The Supreme Court in the hearing dated 5th October, 2012 ruled that the ban on all mining activities will continue. A Public Interest Litigation (PIL) filed in the Supreme Court by a NGO added that all the mines were functioning without the approval of National Board of Wild Life (NBWL) and that 33 of these mines were within 1.5kms of wildlife sanctuaries. Supreme Court's CEC began its preliminary investigations nearly a month ago and is expected to submit a report shortly. We believe mining to resume in Goa would take the same time as that of Karnataka and hence volumes in FY13 would be quite minuscule.

The Shah panel has recommended capping the iron ore production to FY01 levels or 12.5mn tons

On account of the various regulatory checks setup by the Government we estimate domestic iron ore production would decline to FY05 levels to 140mn tons in FY13. Exports from India which stood at 62mn tons is expected to decline to ~35mn tons in FY13 as the mining ban in Goa would last for few months.

Exports from India which stood at 62mn tons is expected to decline to ~35mn tons in FY13 as the mining ban in Goa would last for few months

Iron ore demand in the domestic market has been rising over the last five years. Demand for flat steel over the period FY09-12 increased by a CAGR of 12.1% against a CAGR of 8% for long products. To match this rising demand many companies have raised their steel making capacity in India. Over the same period, steel making capacity has increased by 40% to 75mn tons. In addition to this, we expect effective capacity in India to increase further by ~22mn tons over FY12-14 as India witnesses new capacities from JSPL, RINL, and SAIL and capacity ramp-up from JSW Steel, Essar Steel and Tata Steel. As a result demand for domestic iron ore is expected to surge over the next five years.

Effective capacity in India to increase further by ~22mn tons over FY12-14E

A combination of declining iron ore supply and rising iron ore demand would lead to a tight domestic market for iron ore over the next two years. We estimate that domestic iron ore prices would remain firm in the near term as import parity prices for fines is higher than the domestic prices. In addition to this, the rising demand for fines in the domestic market on account of the large pellet plants to be commissioned in the next two years would support iron ore prices.

NMDC volumes to surge from H2 FY14

NMDC's mines are located primarily in the states of Chattisgarh and Karnataka with a combined capacity of 39mn tons. In Chattisgarh, NMDC operates two mining complexes, one at Kirandul and the other at Bacheli in the Bailadila complex. In Karnataka, it operates a mine each in Donimalai and Kumaraswamy. NMDC's production volumes over the last two years have been lower than expectations as its operations were impacted by the various Naxal activities.

NMDC's operational iron ore mines

	Capacity (mtpa)	Mining lease expiry
Kirandul complex		
Deposit 14	5	Sep-15
Deposit 14 NMZ	7	Dec-15
Deposit 11C	0.7	Sep-17
Bacheli complex		
Deposit 5	10	Sep-15
Deposit 10/11A	5	Sep-15
Donimalai complex		
Donimalai	4	Nov-28
Kumaraswamy	7	Oct-22

Source: Company, India Infoline Research

NMDC's Bailadila complex (contributing 76% of volume) lies in the state of Chattisgarh, which has been impacted the most. The 267km Essar pipeline was blown up by Naxalites in June 2009 near Chitragonda (Orissa), close to the Chhattisgarh border. It was restarted in Q4 FY11, but the Naxals again damaged it in Q3 FY12 and it has not been repaired since then. The company is also facing transportation issues in Karnataka due to the remote location of the mines. The company has also said that ramping up of production to 12mtpa from Karnataka would be a difficult task. In H1 FY13, the company reported a decline of 6.5% yoy to 12.2mn tons as the slurry pipeline was operational last year.

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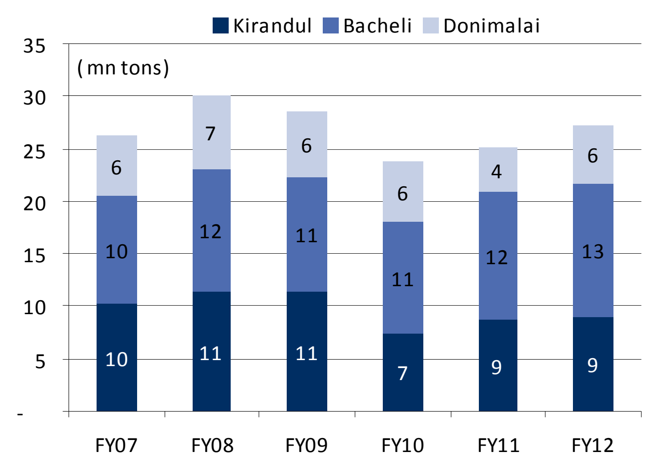
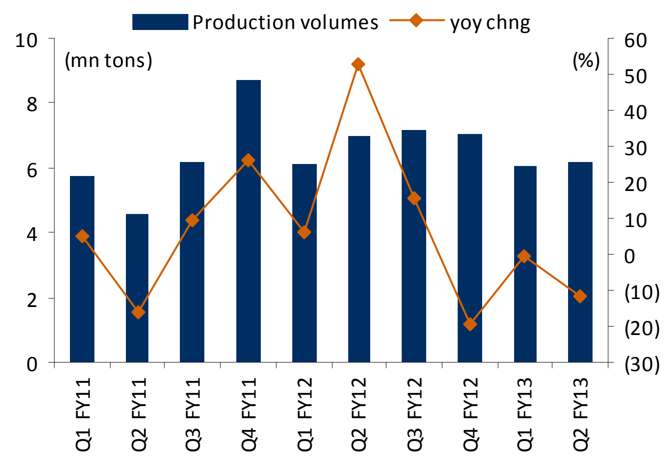
Production growth has been restricted at Kirandul over the last three years



H1 FY13 volumes were lower by 6.5% yoy



Source: Company, India Infoline Research

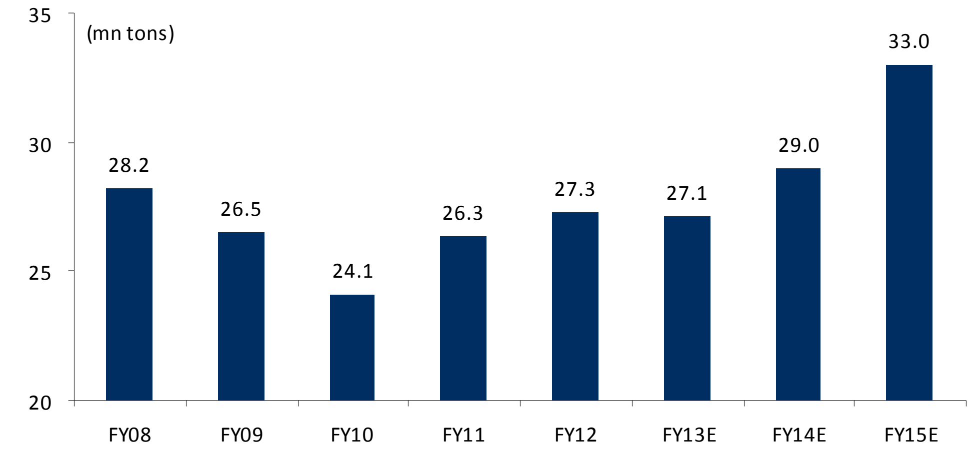
We expect volumes to pick up in the second half of the year led by the commissioning of the uni-flow system and ramp in production from Karnataka. The 3mtpa uni-flow dispatch line from Bailadila to Vizag is expected to be operational in Q3 FY13 and would offset the volumes lost due to closure of slurry pipeline. Volumes from Kumarswamy and Donimalai are expected to increase as the CEC has allowed forward sales of iron ore in Karnataka and better transportation services. As a result, we expect volumes to remain flat on a yoy basis in FY13.

The 3mtpa uni-flow dispatch line from Bailadila to Vizag is expected to be operational in Q3 FY13 and would offset the volumes lost due to closure of slurry pipeline

The company expects volume to jump in FY14E led by the commissioning of the Bailadila 11B mine in FY13. The management expects the mine to be operational by end-FY13. However, we build in some delay in commissioning of the mine and do not expect any contribution from the new mine in FY13. We believe the impact of Bailadila 11B mine would be largely witnessed in H2 FY14E. NMDC is also in the process to mechanise its Kumarswamy mines for a capex of Rs8.9bn. It expects the mine to be fully mechanised by September '13. However, we expect the mechanization process to be delayed as the company had spent minimal capex on the same. We expect volumes to remain subdued in FY13 and FY14 from the Kumarswamy mines.

We expect volumes to increase by 2mn tons in FY14 to 29mn tons in FY14

Iron ore volumes to surge post FY13E



Source: Company, India Infoline Research

We expect volumes to increase by 2mn tons in FY14 to 29mn tons in FY14 led by higher volumes from the uni-flow system, marginal contribution from Kumarswamy and Bailadila 11B mines. With a ramp in production from Bailadila and Kumarswamy production is expected to surge in FY15E. We expect NMDC's volumes to rise by 4mn tons to 33mn tons in FY15E.

With a ramp in production from Bailadila and Kumarswamy production is expected to surge by 4mn tons in FY15E

NMDC's realizations to remain at a premium to global prices

NMDC has over the last two years changed its pricing policy to take advantage of the iron ore demand-supply situation in the domestic market. Earlier, the company used to set its realizations as a discount to global iron ore prices, which was then shifted to export parity prices. However, after a jump in export duty on iron ore and a sharp increase in freight cost for transportation of iron ore meant for exports, the company had to shift its pricing mechanism from export parity to import parity. The tight iron ore market situation in the domestic market also aided the shift in this transition. The company also shifted from annual contracts to quarterly contracts in 2010 (inline with global iron ore players) and then shifted to monthly mechanism in Q3 FY13. Over the last three months the company has shifted to monthly pricing mechanism.

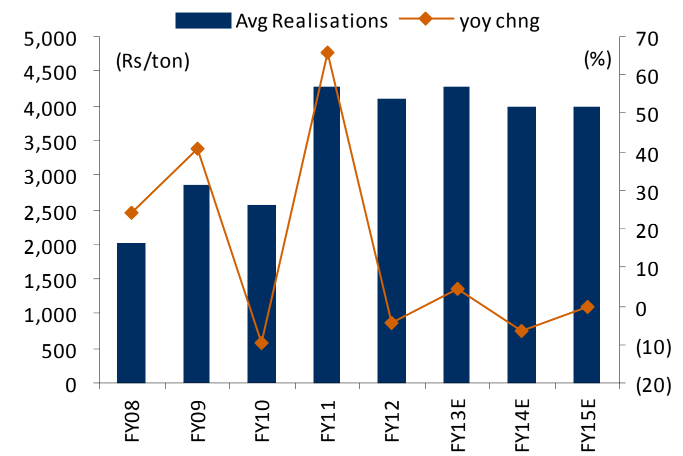
The company also shifted from annual contracts to quarterly contracts in 2010 and then shifted to monthly mechanism in Q3 FY13

NMDC had taken price hikes for both, lumps and fines, in Q1 FY13 and Q2 FY13 in spite of a decline in global iron ore prices. Iron ore prices for lumps and fines were hiked by 10% & 8% in Q1 FY13 and 13% & 8% in Q2 FY13 on the back tight market situation. After the sharp hike in prices in H1 FY13, the company had taken price cuts in October '12 and November '12 before maintaining status quo in December '12. We believe that there would be a marginal decline in iron ore prices in Q4 FY13 as steel prices have been subdued and margins of steel players have been hit. Steel manufacturers in Karnataka have stayed away from buying lumps in the e-auction citing high prices. As a result, we believe iron ore lump prices would decline marginally in Q4 FY13. However, we also expect that prices would be resilient thereon and remain flat in FY14 as domestic supply-demand situation is expected to remain tight. We estimate average FY13 iron ore realizations to be 4.4% higher on a yoy basis and then decline by 6.6% in FY14.

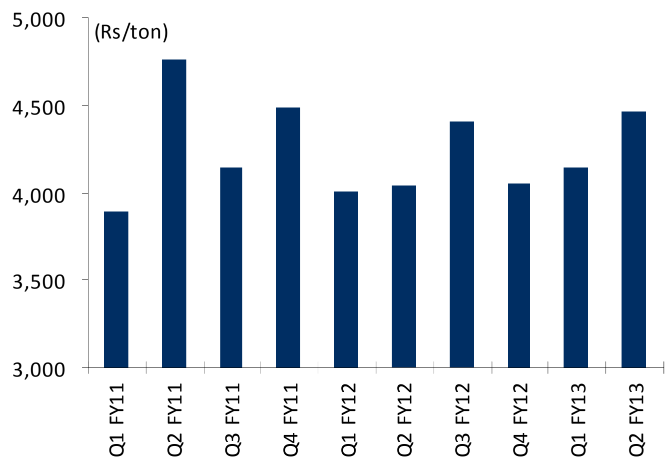
Iron ore prices for lumps and fines were hiked by 10% & 8% in Q1 FY13 and 13% & 8% in Q2 FY13 on the back tight market situation

We estimate average FY13 iron ore realizations to be 4.4% higher on a yoy basis and then decline by 6.6% in FY14

Decline in NMDC's iron ore prices to be quite lower than that of global iron ore prices



NMDC had taken price hikes in H1 FY13

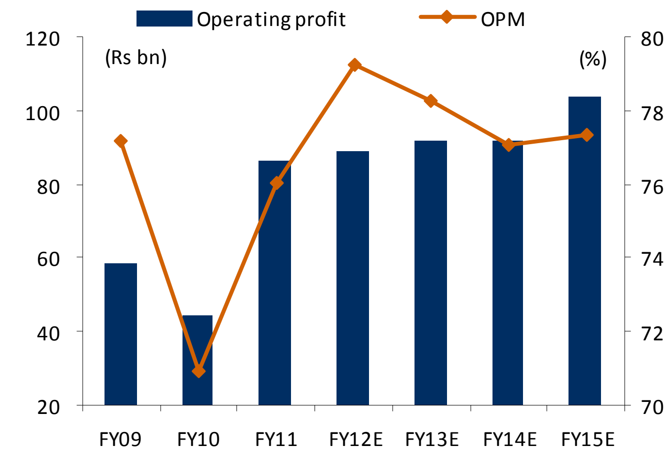


Source: Company, India Infoline Research

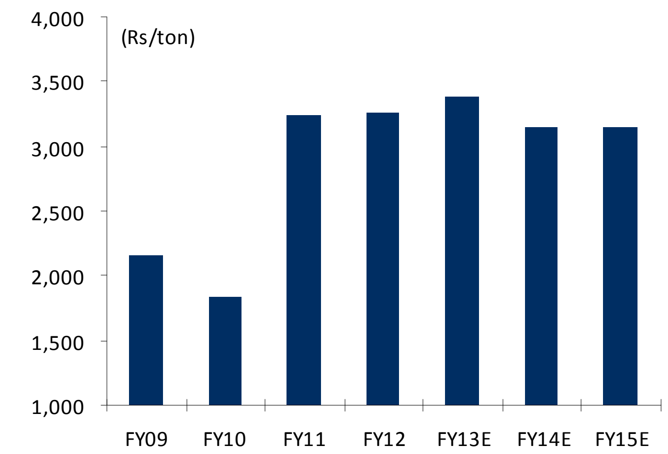
Operating profit to remain flat in FY14E

In FY13, EBIDTA/ton is expected to increase by 3.7% yoy to Rs3,384/ton as the impact of strong realizations would be offset to some extent by a jump in royalty cost per ton, stores cost and high fixed costs. We expect this to shrink to Rs3,151/ton in FY14 led by a decline in iron ore prices. We believe a decline in iron ore prices would lower the royalty costs for the company. This coupled with higher volumes would marginally nullify the impact of a decline in iron ore prices. Operating profit in FY13 is expected to increase by 2.7% yoy to Rs91.6bn as volumes remain flat. In FY14, the impact of a decline in EBIDTA/ton would be offset by higher volumes leading to a flat operating profit growth of 0.3% yoy to Rs92bn. Operating profit is expected to surge in FY15 on the back of strong volume growth and steady iron ore prices.

Operating profit to surge in FY15E

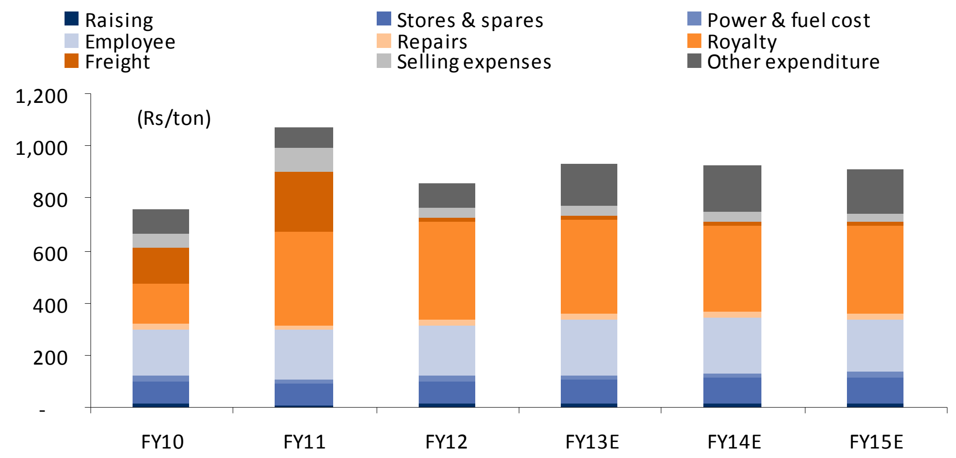


EBIDTA/ton to decline in FY14E led by lower realisations



Source: Company, India Infoline Research

Royalty and employee cost account for 63% of total costs in FY12



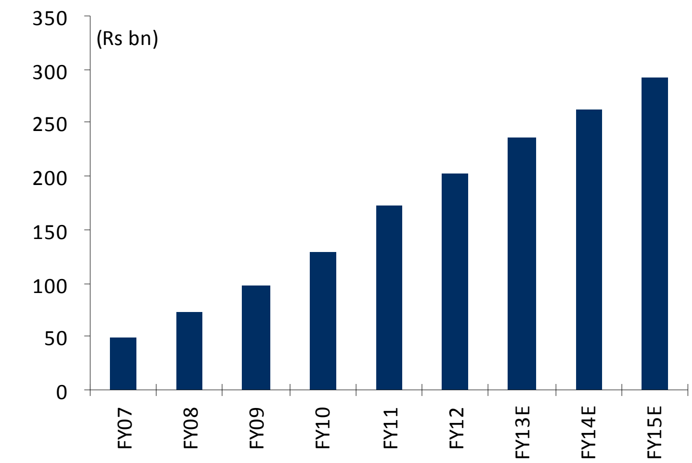
Source: Company, India Infoline Research

Cash per share to jump 44% over FY12-15E

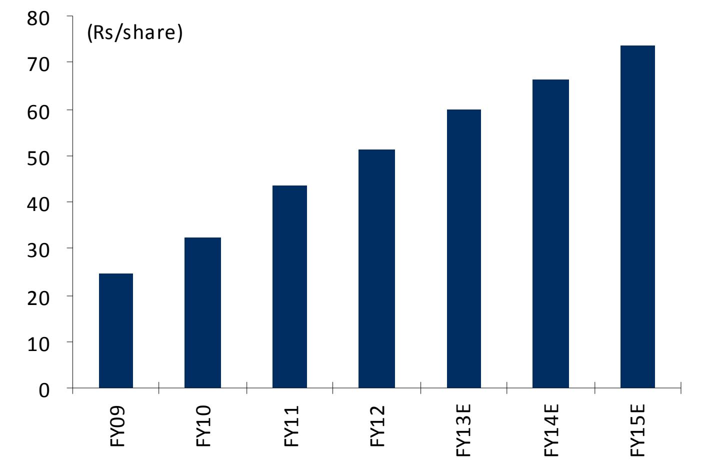
NMDC has been generating steady cash flow over the last three years. With very little capex and no buyouts the cash level for the company has been rising year on year. On account of the buoyancy in prices over the last two years, the company's cash has doubled over FY09-12. Cash at the end of FY12 stood at Rs202bn (1/3rd of current market cap). With abundant cash, NMDC has been scouting for resources globally as domestic capacity expansion has been slower than expected and new mining licenses in the country are hard to come by. Over the next three years, we expect cash levels to increase 44% to Rs292bn, translating into cash per share of Rs73.7.

Cash at the end of FY12 stood at Rs202bn (1/3rd of current market cap)

Cash balance has jumped ~4x over FY07-12 and is expected to increase further by 44% over FY12-15



…we estimate cash per share to increase to Rs73.7 in FY15

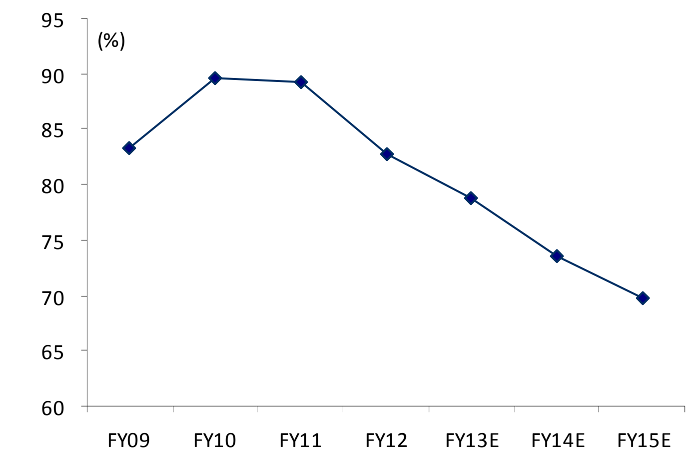


Source: Company, India Infoline Research

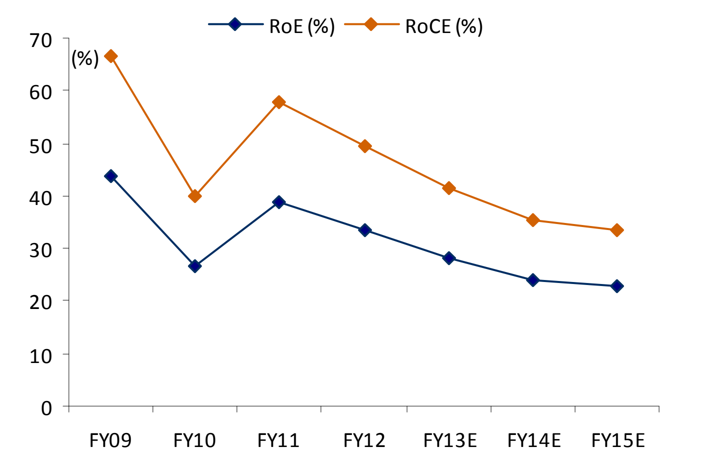
Return ratios to decline due to increase in CWIP

NMDC's return ratios have been declining over the last two years as the share of cash of total capital employed has been rising. Cash as a % of capital employed jumped to 90% in FY10 and has remained above the 80% level since FY07. We see this reducing as the company would deploy some cash for the capex of its steel and pellet plants. Cash as a % of capital employed is expected to decline to 70% in FY15E as CWIP as a share of capital employed is expected to jump from 6% in FY12 to 19% in FY15.

Cash as a % of capital employed is expected to decline to 70% in FY15



Return ratios to decline due to increase in CWIP



Source: Company, India Infoline Research

Recent price correction an opportunity to buy

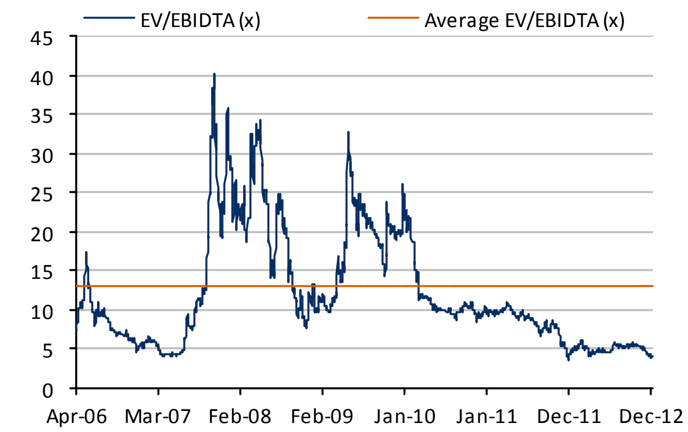
NMDC has corrected sharply over the last two months on the back of declining global iron ore prices, subdued demand from steel manufacturers and the Government's plan to divest 10% stake. We believe this is a buying opportunity as NMDC's iron ore realizations are expected to remain resilient to the slide in global iron ore prices. We expect the domestic iron ore market to remain tight over the next two years. Volumes are expected to increase in FY14 led by commissioning of the uni-flow system, starting operations in Bailadila 11B mine and higher volumes from Kumarswamy in Karnataka. We expect earnings CAGR of 6.4% over the period FY12-15 on the back of strong volume growth.

We expect earnings CAGR of 6.4% over the period FY12-15 on the back of strong volume growth

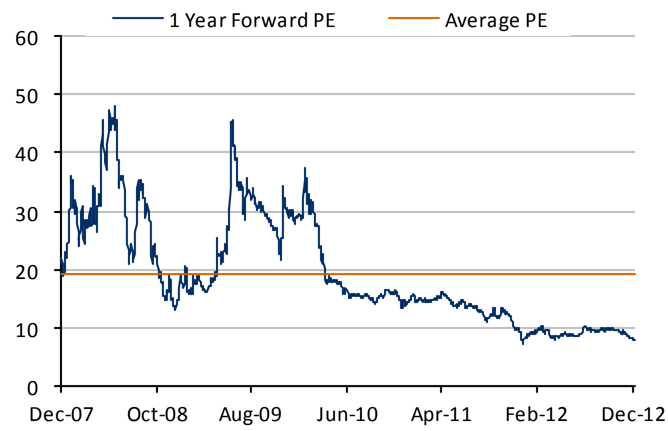
At the current stock price, the market seems to be building in too much pessimism into the stock. The stock is currently trading at 4x FY14E EV/EBIDTA, which is at a huge discount to its historical one year forward EV/EBIDTA of 12.6. We value the company at 5x FY14E EV/EBIDTA and arrive at a 9-month price target of Rs182. Despite the cut in our earnings estimates and target price, we still maintain our BUY recommendation as we see 14.5% upside to our revised target price from current levels.

The stock is currently trading at 3.8x FY14E EV/EBIDTA, which is at a huge discount to its historical one year forward EV/EBIDTA of 12.6.

NMDC is trading at a 50% discount to its 5-year average EV/EBIDTA



Current P/E too is way below its historical average



Source: Company, India Infoline Research

Financials

Income statement

Y/e 31 Mar (Rs mn)	FY12	FY13E	FY14E	FY15E
Revenue	112,619	117,179	119,366	134,272
Operating profit	**89,262**	**91,689**	**92,002**	**103,834**
Depreciation	(1,302)	(1,432)	(1,575)	(1,733)
Other income	20,165	23,190	25,509	28,059
Profit before tax	**108,125**	**113,447**	**115,936**	**130,161**
Taxes	(34,941)	(36,666)	(37,470)	(42,068)
Net profit	**73,184**	**76,781**	**78,466**	**88,094**

Balance sheet

Y/e 31 Mar (Rs mn)	FY12	FY13E	FY14E	FY15E
Equity capital	3,965	3,965	3,965	3,965
Reserves	240,099	294,967	351,039	413,991
Net worth	**244,064**	**298,932**	**355,003**	**417,955**
Deferred tax liab (net)	1,001	1,001	1,001	1,001
Total liabilities	**245,065**	**299,932**	**356,004**	**418,956**
Fixed assets	26,830	47,398	77,823	108,090
Investments	2,478	2,478	2,478	2,478
Net working capital	**13,111**	**13,624**	**13,659**	**16,385**
Inventories	4,589	4,295	3,938	3,986
Sundry debtors	7,370	7,664	7,807	8,782
Other current assets	22,572	23,472	23,910	26,895
Sundry creditors	(9,704)	(10,091)	(10,279)	(11,563)
Other current liabilities	(11,716)	(11,716)	(11,716)	(11,716)
Cash	202,646	236,433	262,045	292,003
Total assets	**245,065**	**299,932**	**356,004**	**418,956**

Cash flow statement

Y/e 31 Mar (Rs mn)	FY12	FY13E	FY14E	FY15E
Profit before tax	108,125	113,447	115,936	130,161
Depreciation	1,302	1,432	1,575	1,733
Tax paid	(34,941)	(36,666)	(37,470)	(42,068)
Working capital Δ	(10,244)	(513)	(35)	(2,726)
Operating cashflow	64,241	77,701	80,006	87,100
Capital expenditure	(11,462)	(22,000)	(32,000)	(32,000)
Free cash flow	**52,780**	**55,701**	**48,006**	**55,100**
Equity raised	(530)	-	-	-
Investments	(1,121)	-	-	-
Dividends paid	(20,736)	(21,913)	(22,394)	(25,142)
Other items	(28)	-	-	-
Net Δ in cash	**30,365**	**33,787**	**25,612**	**29,958**

Key ratios

Y/e 31 Mar	FY12	FY13E	FY14E	FY15E
Growth matrix (%)				
Revenue growth	(0.9)	4.0	1.9	12.5
Op profit growth	3.3	2.7	0.3	12.9
EBIT growth	11.2	4.9	2.2	12.3
Net profit growth	12.6	4.9	2.2	12.3
Profitability ratios (%)				
OPM	79.3	78.2	77.1	77.3
EBIT margin	96.0	96.8	97.1	96.9
Net profit margin	65.0	65.5	65.7	65.6
RoCE	49.3	41.6	35.3	33.6
RoNW	33.6	28.3	24.0	22.8
RoA	30.7	26.1	22.4	21.5
Per share ratios				
EPS	18.5	19.4	19.8	22.2
Dividend per share	5.2	5.5	5.6	6.3
Cash EPS	18.8	19.7	20.2	22.7
Book value per share	61.6	75.4	89.5	105.4
Valuation ratios				
P/E	18.5	19.4	19.8	22.2
P/CEPS	8.5	8.1	7.9	7.0
P/B	2.6	2.1	1.8	1.5
EV/EBIDTA	4.8	4.3	4.0	3.3
Payout (%)				
Dividend payout	28.3	28.5	28.5	28.5
Tax payout	32.3	32.3	32.3	32.3
Liquidity ratios				
Debtor days	24	24	24	24
Inventory days	15	13	12	11
Creditor days	31	31	31	31

Du-Pont Analysis

Y/e 31 Mar	FY12	FY13E	FY14E	FY15E
Tax burden (x)	0.68	0.68	0.68	0.68
Interest burden (x)	1.00	1.00	1.00	1.00
EBIT margin (x)	0.96	0.97	0.97	0.97
Asset turnover (x)	0.47	0.40	0.34	0.33
Financial leverage (x)	1.09	1.08	1.07	1.06
RoE (%)	**33.6**	**28.3**	**24.0**	**22.8**

After receiving two reputed awards for being the 'Best Broker' in 2011, IIFL has now bagged the Best Broking House with Global Presence in 2012.

'Best Equity Broker of the Year' – Bloomberg UTV, 2011

IIFL was awarded the 'Best Equity Broker of the Year' at the recently held Bloomberg UTV Financial Leadership Award, 2011. The award presented by the Hon'ble Finance Minister of India, Shri Pranab Mukherjee. The Bloomberg UTV Financial Leadership Awards acknowledge the extraordinary contribution of India's financial leaders and visionaries from January 2010 to January 2011.

'Best Broker in India' – Finance Asia, 2011

IIFL has been awarded the 'Best Broker in India' by Finance Asia. The award is the result of Finance Asia's annual quest for the best financial services firms across Asia, which culminated in the Country Awards 2011

Other awards

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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