India Equity Research
Mining

July 4, 2011

HOLD

Target price (INR) 275

NMDC

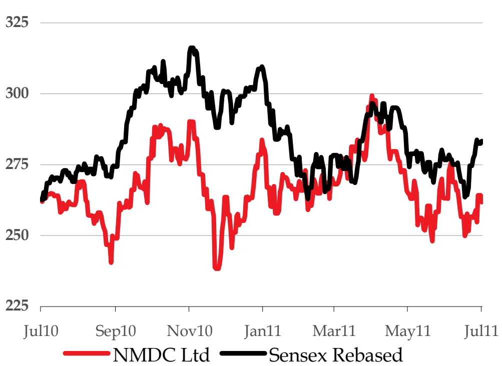
Valuations factor in earnings growth, lower uncertainty

Initiating Coverage

Last Price (INR)	262
Bloomberg code	NMDC IN
Reuters code	NAMI.BO
Avg. Vol. (3m)	266,212
Avg. Val.(3m)(INRmn)	73.4
52-wk H/L (INR)	305 / 227
Sensex	18,814
MCAP (INRtn/USDbn)	1,038/ 23.4

Shareholding (%)	12/10	03/11
Promoters	90.0	90.0
MFs, FIs, Banks	8.5	8.5
FIIs	0.6	0.7
Public	0.6	0.6
Others	0.3	0.3

Stock Chart (Relative to Sensex)



Stock Perfm. (%)	1m	6m	1yr
Absolute	-0.5	-7.0	-0.4
Rel. to Sensex	-2.9	1.2	-8.2

Financials (INRmn)	03/11	03/12f	03/13f
Sales	113,915	115,288	126,482
y-o-y (%)	83	1	10
EBITDA (%)	76	76	76
A.PAT	65,511	68,032	73,894
Sh o/s (diluted)	3,965	3,965	3,965
A.EPS (INR)	16.5	17.2	18.6
y-o-y (%)	53	4	9
D/E (x)	-0.9	-0.8	-0.6
P/E (x)	15.9	15.3	14.1
EV/E (x)	10.0	9.6	8.8
RoCE (%)	39	31	27
RoE (%)	39	31	27

Quarterly Trends	06/10	09/10	12/10	03/11
Sales (INRmn)	25,180	24,600	26,212	37,698
PAT (INRmn)	15,040	13,785	15,180	20,986

Expansion of mining capacity and setting up of a steel plant with pellet capacity are likely to boost NMDC's revenues from FY13f. The higher iron ore production is likely to be evacuated through improved railway and pipeline infrastructure. Being a low-cost iron ore producer with iron content above 64% gives NMDC an edge over its peers. The company is less affected by changes in government policies on exports as a majority of sales are in the domestic market. Net profit is likely to grow at a CAGR of 9.9% during FY12f-FY14f. Valuations discount the earnings growth and stable outlook, restricting any further upside. We initiate coverage with a Hold rating and Jun12 target of INR275.

Capacity addition and value addition to boost revenue from FY13f

NMDC is likely to increase annual production capacity to 48mn tonnes by FY15f as it commissions mining operations in Chhattisgarh and Karnataka. The company has initiated work for setting up a 3mn tonne integrated steel plant and pellet plant. The pellet plant is likely to utilize the waste slimes available at the mine pit head, reducing waste and protecting the environment.

Improved infrastructure, acquisitions to support growth

The company plans to set up an iron ore pipeline between Bailadila and Vizag to improve iron ore evacuation from the mines in Chhattisgarh. Commissioning of a uniflow railway system and resumption of the Essar Steel iron ore pipeline since Nov10 are likely to support iron ore sales in FY12f and FY13f. Acquisition of stake in Australian mining companies is likely to add to growth.

Business strategy, quality and cost provide an edge over peers

NMDC's iron ore reserves with iron content of 64% and above provide it an edge over peers. The company has market share of 12% and sells 92% of ore through long-term sales contracts, providing stability to earnings. With c90% of sales in the domestic market, it is less affected by government policies for iron ore export duty and railway freight. Being a low-cost producer of high-grade ore, NMDC is likely to remain competitive, even during periods of weak prices.

Three-year CAGR of 9.9% in net profit; FY13f EPS of INR18.6

Sales volumes are likely to grow at a CAGR of 14.8% during FY12f-FY14f, led by capacity expansion. We forecast blended iron ore prices to decline by 10% in FY12 on the back of lower domestic prices for iron ore fines. The benefits of the operating leverage are likely to improve EBITDA margins from 76% in FY11f to 76.3% in FY14f. Net profit during FY12f-FY14f is likely to grow at a CAGR of 9.9%. The EPS is likely to increase from INR16.4 in FY11f to INR18.6 in FY13f.

Initiate with a Hold rating and a Jun12 target of INR275

Our Jun12 target of INR275 values NMDC at a premium to its domestic peers, on account of the low production cost, ore quality and earnings growth; the premium valuation restricts further upsides. We value NMDC using the DCF method and at a 10% discount to historical (Apr10-Jun11) EV/EBITDA and P/E valuations. At our target, the stock trades at an EV/EBITDA and P/E of 9.4 and 14.8x its FY12f earnings, respectively. We initiate coverage with Hold.

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Investment Summary

Expansion of mining capacity and setting up of a steel plant with a pellet plant are likely to boost NMDC's revenue from FY13f. The higher iron ore production is likely to be evacuated through improved railway and pipeline infrastructure. Being a low-cost iron ore producer with iron content above 64%, the company has an edge over its peers. NMDC is less affected by changes in government policies on exports as a majority of sales are in the domestic market. Net profit is likely to grow at a CAGR of 9.9% during FY12f-FY14f. The premium valuations discount lower uncertainties and earnings growth, restricting further upsides. We initiate coverage with a Hold rating and a Jun12 target of INR275. Key risks to our estimates are delay in expansion of mining capacity and higher than estimated decline in iron ore prices.

Capacity addition and value addition to boost revenues from FY13f

Authorized annual production capacity to rise from 34mn tonnes in FY11 to 48mn tonnes by FY15f.

NMDC is likely to increase its authorized annual production capacity from 34mn tonnes in FY11 to 48mn tonnes by FY15f as it commissions mining operations at Chhattisgarh and Karnataka. These mines are likely to be commissioned during FY13f-FY14f. The company also plans to foray into value addition by setting up a 3mn tonne integrated steel plant with pellet capacity at Chhattisgarh.

Improved infrastructure, acquisitions to support growth

Iron ore pipeline from Bailadila to Vizag likely to improve iron ore evacuation from mines.

The company plans to set up an iron ore pipeline between Bailadila, Chhattisgarh, and Vizag, Andhra Pradesh, to improve iron ore evacuation from mines. Commissioning of a uniflow railway system and resumption of the Essar Steel iron ore pipeline since Nov10 is likely to support iron ore sales in FY12f and FY13f. Acquisition of stake in Australian mining companies is likely to drive growth as NMDC utilizes its surplus cash resources for expanding its global reach.

Business strategy, quality and cost provide an edge over peers

NMDC currently has a market share of c12%, with reserves having iron content of 64% and above; this gives the company an edge over its peers. NMDC sells c95% of iron ore through long-term sales contracts with c90% of iron ore sales in the domestic market. Being one of the lowest cost producers of high-grade iron ore within the country, the company is likely to remain competitive, even if iron ore prices decline sharply from current levels.

Three-year CAGR of 9.9% in net profit; FY13f EPS of INR18.6

Blended iron ore prices to decline by 10% in FY12f to INR3,883/tonne due to a decline in prices of iron ore fines.

Sales volumes are likely to grow at a CAGR of 14.8% during FY12f-FY14f, driven by an increase in iron ore production in FY13f and beyond. We forecast blended iron ore prices to decline by 10% in FY12 to INR3,883/tonne due to a decline in prices of iron ore fines. The benefits of operating leverage are likely to help EBITDA margins expand from 76% in FY11 to 76.3% in FY14f. Net profit for FY12f-FY14f is likely to grow at a CAGR of 9.9%. We forecast EPS to increase from INR16.4 in FY11 to INR18.6 in FY13.

Initiate with a Hold rating and a Jun12 target of INR275

Our Jun12 target price of INR275 values NMDC at a premium to its domestic peers, on account of the low production cost, iron ore quality and earnings growth. This restricts any further upside in the stock. At our target, the stock trades at an EV/EBITDA and P/E of 9.4 and 14.8x its FY12f earnings, respectively. We initiate coverage with a Hold rating. Key risks to our estimates are a delay in commissioning of capacity at its mines in Chhattisgarh and Karnataka and correction in iron ore prices.

Exhibit 1: Valuation summary

(INRmn)	Net Sales	EBITDA	Net Profit	EPS (INR)	P/E (x)	EV/EBITDA (x)	EV/Sales (x)	P/B(x)
Mar10	62,391	44,188	42,818	10.8	24.3	20.5	14.5	7.3
Mar11	113,915	86,170	65,511	16.5	15.9	10.0	7.6	5.4
Mar12f	115,288	87,346	68,032	17.2	15.3	9.6	7.3	4.2
Mar13f	126,482	95,658	73,894	18.6	14.1	8.8	6.7	3.4
Mar14f	152,246	116,226	87,024	21.9	11.9	7.3	5.6	2.8

Source: Company, Avendus Research

Capacity addition and value addition to boost revenues from FY13f

NMDC is likely to increase its authorized annual production capacity to 48mn tonnes by FY14f as it commissions mining operations at Bailadila-11B in Chhattisgarh and at the Kumaraswamy mines in Karnataka. These mines are likely to be commissioned over FY13f-FY14f. The company also plans to foray into value addition by setting up a 3mn tonne integrated steel plant. This facility is likely to partially utilize iron ore pellets from the 2mn tonne pellet capacity set up near the steel plant and is likely to be operational by FY15f. The pellet plant is likely to utilize slimes, enabling NMDC to reduce waste and protect the environment.

Mining capacity likely to increase to 48mn tonnes by FY14f

Exhibit 2: Annual mining capacity

	State	Capacity in FY11 (mn tonnes)	Capacity in FY14f (mn tonnes)
Kirandul Complex	Chhattisgarh	12	12
Bacheli Complex	Chhattisgarh	15	15
Donimalai Complex*	Karnataka	7	7
Bailadila-11B	Chhattisgarh		7
Kumaraswamy	Karnataka		7
		34	48

Source: Company, Avendus Research

NMDC has an authorized annual extraction capacity of 34mn tonnes as per the Mining Plan approved by the government. The capacity at the Donimalai complex was increased from 4mn tonnes to 7mn tonnes in 2009. The authorized mining capacity is likely to increase to 41mn tonnes with the commissioning of Deposit 11B (7mn tonnes) in Chhattisgarh by Mar12. The Kumaraswamy mine (7mn tonnes), Karnataka, is likely to be commissioned by May13. The Donimalai complex, which had proved reserves of 17.6mn tonnes at end Jan10, and an estimated mine life of 3-4 years, has seen an increase in its reserves to 29mn tonnes at end Mar11 due to exploration activities during the past year. The company is confident of adding further reserves to the Donimalai mine, though with higher overburden removal cost.

Bailadila-11B likely to be operational in FY13f

Construction work for development of Deposit 11B at Bailadila is likely to be completed by Mar12.

Construction work for development of Deposit 11B at Bailadila is likely to be completed by end Mar12. The project is likely to add 7mn tonnes of authorized iron ore production capacity to NMDC's existing capacity of 34mn tonnes. This is likely to boost iron ore production from FY13f. The total project cost is likely to be INR6.1bn and c75% of the project work has been completed at end Mar11. In the past, progress has been affected by Naxalite activities. However, steps have been taken to improve security at the project site and complete the work in time.

Kumaraswamy iron ore project likely to be operational by FY14f

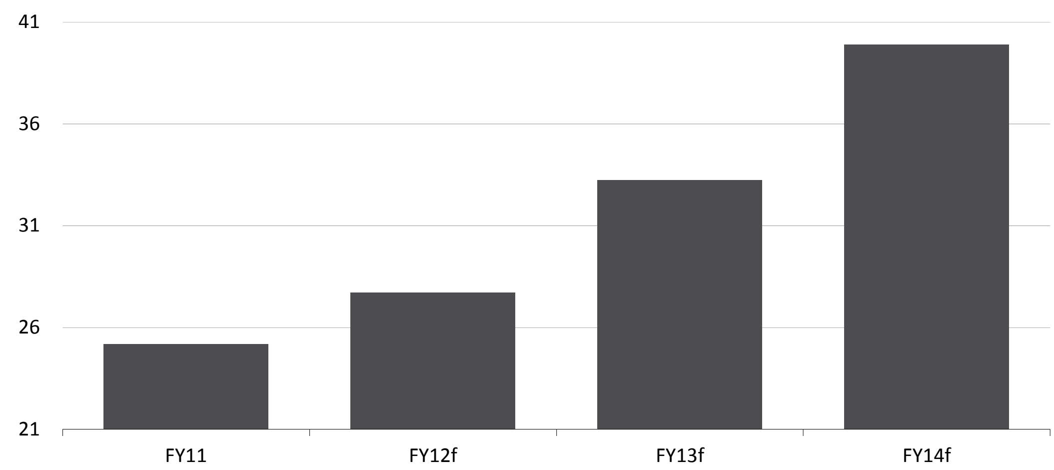
To compensate the depleting reserve of the Donimalai iron ore mine and to augment production capacity, the Kumaraswamy mine is being developed; it has a capacity of 7mn tonnes. The total project cost is likely to be INR9bn. The project has been split up into six packages; work has been awarded for package 1 and 3, which includes setting up of a crushing plant and an electric substation. Setting up of a down hill conveyor (package 2) is the most critical part of the project and is likely to be completed within 24 months from the date of issue of the letter of authorization. The mine is likely to be commissioned by May13.

Iron ore production to grow at a CAGR of 16.6% during FY12f-FY14f

NMDC is likely to report a CAGR of 16.6% in production during FY12f-FY14f as it enhances mining capacity and sets up adequate infrastructure to support the expanded capacity. The key concerns in achieving the production targets are likely to be production disruptions due to Naxal activities and delay in commissioning of the infrastructure project to support the expanded capacity. We forecast iron ore production to increase from 25.2mn tonnes in FY11 to 39.9mn tonnes in FY14.

Iron ore production to increase from 25.2mn tonnes in FY11 to 39.9mn tonnes in FY14f.

Exhibit 3: Iron ore production (mn tonnes)



Source: Avendus Research

Setting up of an integrated steel plant at Chhattisgarh

The 3mn tonne integrated steel plant at Chhattisgarh is likely to be commissioned by FY15f.

NMDC has acquired the required 1,900 acres for setting up a 3mn tonne steel plant at Jagdalpur, Chhattisgarh. The plant is likely to be set up at an investment of INR155bn; the company has started awarding contracts for the project. The first contract for setting up a sintering plant of INR7.6bn was placed in Mar11, while the second contract for setting up a 3mn tonne blast furnace was placed in May11. The plant is likely to be commissioned by FY15f and is to be largely funded through internal accruals. It is likely to be a flat rolled products plant and would procure iron ore from Deposit 4, which is in joint venture with the Chhattisgarh Mineral Development Corporation.

Value addition by setting up a 3.2mn tonne pellet capacity

The company plans to set up two pellet plants with capacity of 2mn tonnes and 1.2mn tonnes at Chhattisgarh and Donimalai, respectively. The Donimalai pellet plant involves capital expenditure of INR5.7bn and is likely to be operational in FY14f. The Chhattisgarh pellet plant is likely to be set up adjacent to the steel plant, with raw material being transported through the slurry pipeline. The project is likely to be commissioned by FY15f. These pellet plants are likely to utilize the iron ore waste slimes available at the mine site and, hence, are unlikely to impact iron ore production and sales from any of the existing mines.

Improved infrastructure, acquisitions to support future growth

The company plans to set up an iron ore pipeline between Bailadila and Vizag along the national and state highways to improve iron ore evacuation from the mines in Chhattisgarh. This pipeline is likely to support the expanded mining capacity at Bailadila. The Essar Steel iron ore pipeline, which was inoperative after a Naxal attack in May09, has been restarted in Nov10 and NMDC managed to generate a sales volume of 1.9mn tonnes in FY11 from the pipeline. Increased rake availability during FY11 has led to higher iron ore sales, despite minor disruptions by Naxalites. Commissioning of a uniflow railway system and resumption of the Essar pipeline are likely to support iron ore sales in FY12f and FY13f. Setting up of a c7mn tonne pipeline and doubling of the railway line between Bailadila and Jagdalpur are likely to support NMDC's incremental iron ore supply in the long run. Acquisition of stake in Australian mining companies is likely to drive growth as the company utilizes its surplus cash for expanding its global reach.

Setting up of railway infrastructure to support incremental volumes

The uniflow railway system at Bacheli is likely to support additional volume of 2.5mn tonnes.

NMDC's 'uniflow' railway line at Bacheli is likely to allow movement of rakes in a round trip, reducing the time taken. This is likely to support additional volumes of 2.5mn tonnes. The company plans to commission the uniflow railway line during FY12f. NMDC also plans to set up an additional railway line along its existing Bailadila-Jagdalpur line, which could supply iron ore to smaller sponge iron units within Chhattisgarh while the existing supply remains unaffected.

NMDC to set up an iron ore pipeline between Bailadila and Vizag

The pipeline is likely to have a capacity for supplying c7mn tonnes of iron ore slurry to domestic customers.

NMDC plans to build a slurry pipeline along the national and state highways between Bailadila and Vizag at a total cost of INR30bn. The pipeline is likely to be set up in two phases. The first phase includes setting up of a 150km pipeline between Bailadila and Jagdalpur over the next 18 months at an investment of INR10bn. The pipeline is likely to have a capacity to supply c7mn tonnes of iron ore slurry to its domestic customers such as Rashtriya Ispat Nigam (RINL) and Essar Steel and its own steel plant in Chhattisgarh. The pipeline is likely to be set up over the next three years, covering a distance of 430km..This is likely to support the expansion of mining capacity at Bailadila from 27mn tonnes to 34mn tonnes by FY13f.

Naxal activities adversely impact iron ore sales and production

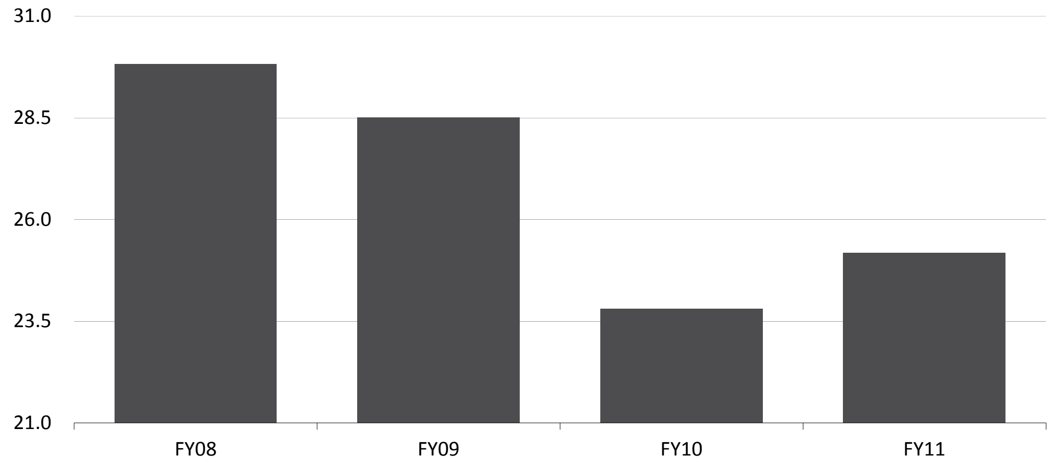
NMDC's production at its Chhattisgarh mining operations has been adversely impacted by Naxal activities. In Dec10, the company reduced its dispatches through railways by c30% to 36,000 tonnes/day due to the damage caused to the railway line and the unavailability of rail rakes during night hours for a period of 3 weeks. Similarly, Naxal attacks on the Chhattisgarh mines in Jul10 adversely impacted mine production. We have not considered any production or sales loss due to Naxal activities.

Rake availability and rising domestic demand to boost production

Commissioning of the Essar Steel pipeline to support incremental sales volume in FY12f.

Production increased by 5.8% in FY11 to 25.2mn tonnes due to an increase in iron ore offtake by domestic consumers and improved rake supply by the Indian Railways. Iron ore production for NMDC declined from 29.8mn tonnes in FY08 to 23.8mn tonnes in FY10 as the slurry pipeline owned and operated by Essar Steel, which can transport 8mn tonnes of iron ore fines, was damaged by Naxalites in May09. This pipeline was repaired and restarted in Nov10, generating a sales volume of 1.9mn tonnes in FY11. We forecast the pipeline to be optimally utilized in FY12f, boosting sales volume to 29.6mn tonnes. Despite NMDC having higher authorized production capacity, it is unable to utilize its resources to the fullest due to infrastructure constraints.

Exhibit 4: Iron ore production (mn tonnes)



Source: Company, Avendus Research

NMDC enters into agreements for stake acquisition in Australia

NMDC has entered into an agreement to acquire up to 50% stake each in Minemakers and Legacy Iron Ore.

NMDC has entered into an agreement with Minemakers, an Australian company, to develop its Wonarah Phosphate deposit in the Northern Territory. The company has agreed to pay most of the development costs. Wonarah is Australia's largest known, undeveloped phosphate deposit. The deal with NMDC is set to bring in the required financial and marketing push to allow the project to be developed to its full potential. The company is likely to buy 50% stake in the mine; the extent of resources and the deal size are as yet unavailable. NMDC and Minemakers are likely to undertake a joint feasibility study for the full development of Wonarah.

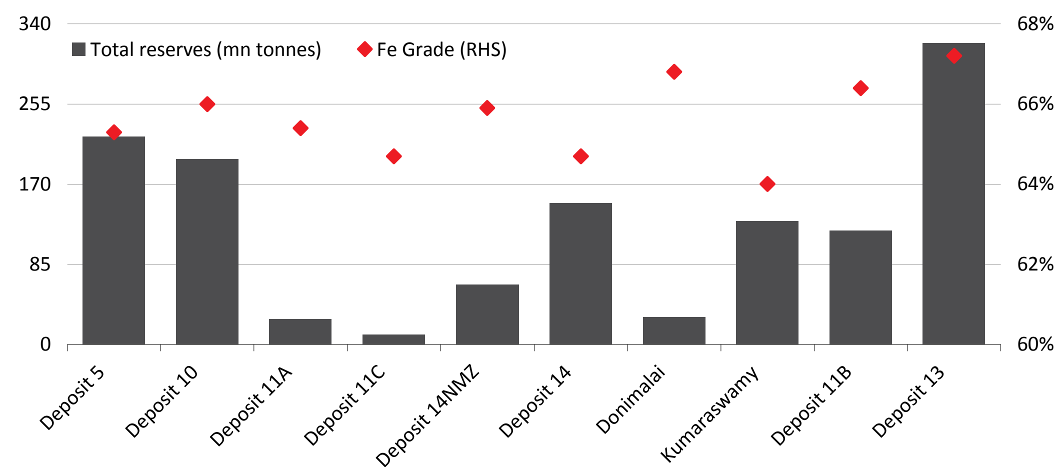
Similarly, NMDC has entered into an agreement with Australia's Legacy Iron Ore to buy up to 50% stake in the company. The deal is estimated to value Legacy Iron Ore at INR1.4bn. The due diligence for the deal is likely to be completed by Aug11. Legacy Iron Ore has two iron ore projects in Australia, with estimated reserves of 130mn tonnes.

Business strategy, quality and cost provide edge over peers

NMDC currently has iron ore reserves with iron content of 64%, which provides an edge over its peers; the company currently has a market share of c12% in the domestic market. NMDC sells c95% of iron ore through long-term sales contracts, with quarterly pricing as per international standards. This provides stability to earnings compared to spot iron ore suppliers who are dependent on Chinese steel demand for pricing. NMDC supplies c90% of its iron ore in the domestic market and, hence, is least affected by government policies for increasing iron ore export duties and railway freight. Being one of the lowest-cost producers of high-grade iron ore within the country, NMDC is likely to remain competitive even in a situation where iron ore prices correct sharply from current levels.

High-grade ore with large reserve base provides a competitive edge

Exhibit 5: Iron ore reserves and grade



Source: Company, Avendus Research

NMDC is one of the largest iron ore producers within the country with a market share of c12%.

NMDC is one of the largest iron ore producers in the country with a market share of c12%. The company has iron ore reserves and resources of 1.26bn tonnes at end Jan10. The reserves are of high quality with iron ore (Fe) content in the range of 64%-67% and lump to fine ratio of 40:60. We have excluded the company's joint venture partner's share in Deposit 4 and Deposit 13 in Chhattisgarh for calculation of iron ore reserves and resources. The company has 54% of reserves and resources in operational mines, 20% in mines that are likely to be operational by FY15f and the balance in mines that are likely to be operational after FY15f.

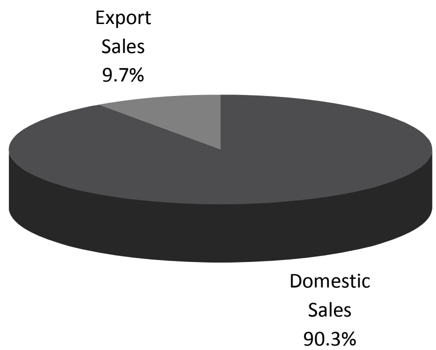
Sales on long-term contracts provides earnings stability

It sells c95% of its iron ore under long-term contracts

NMDC sells c95% of its iron ore under long-term contracts, while the balance is sold in the domestic and export markets on spot basis. This provides higher stability to earnings compared to spot iron ore suppliers dependent on Chinese steel demand for pricing. The company has entered into long-term contracts with large Indian steel producers who do not have captive iron ore mines. RINL, Essar Steel, Ispat Industries (NDEN IN, NR), JSW Steel (JSTL IN, Buy) and Kudremukh Iron Ore are NMDC's largest customers. Other customers include sponge iron manufacturers and small consumers who are allocated iron ore through the State Industrial Promotion Board.

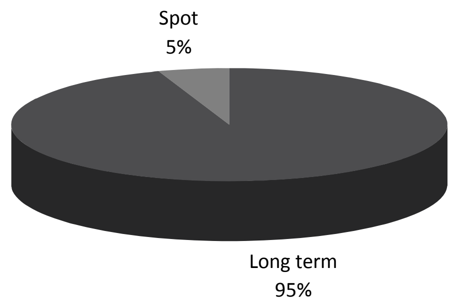
The company also enters into long-term contracts with Japanese and Korean steel mills. NMDC sold c90% of its sales volumes in the domestic market in FY11 while the balance was exported. Exports to China are mainly on spot basis. During 1QFY12, NMDC has been unable to renew its iron ore export contract with Japanese and Korean steel mills due to delay in a cabinet approval, which is required for iron ore exports with iron grade above 64%. In the absence of approval, the company is likely to sell over 95% of its volume in the domestic market, except for minor quantities of iron ore in the spot market to China, if any. We forecast 1.5mn tonnes of iron ore exports during FY12-FY14.

Exhibit 6: Break up of sales for FY11



Source: Company, Avendus Research

Exhibit 7: Break up of sales for FY11



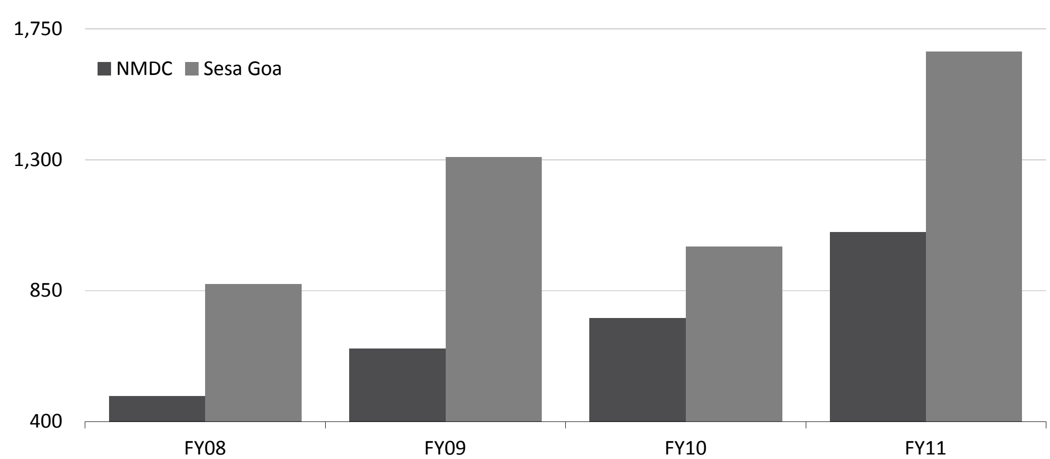
Source: Company, Avendus Research

Positioned at the lower end of the cost curve

NMDC's blended average cost of sales was INR1,056/tonne in FY11.

NMDC has one of the lowest-cost of sales for iron ore produced in India. The blended average cost of sales in FY11 stood at INR1,056/tonne. In comparison, Sesa Goa(SESA IN, Buy), the second largest iron ore miner in India, reported a blended cost of sales of INR1,673/tonne in FY11. EBITDA margins for NMDC in FY11 were 76%, in comparison to SESA's margins of 56.2%. SESA's cost of sales was higher due to the inland cost for transport of iron ore for export and export duties. With such a lean cost structure, NMDC is unlikely to find it difficult to sell its production quantities and is likely to continue remaining competitive even in a situation where iron ore prices correct sharply from current levels.

Exhibit 8: Cost of sales (INR/tonne)



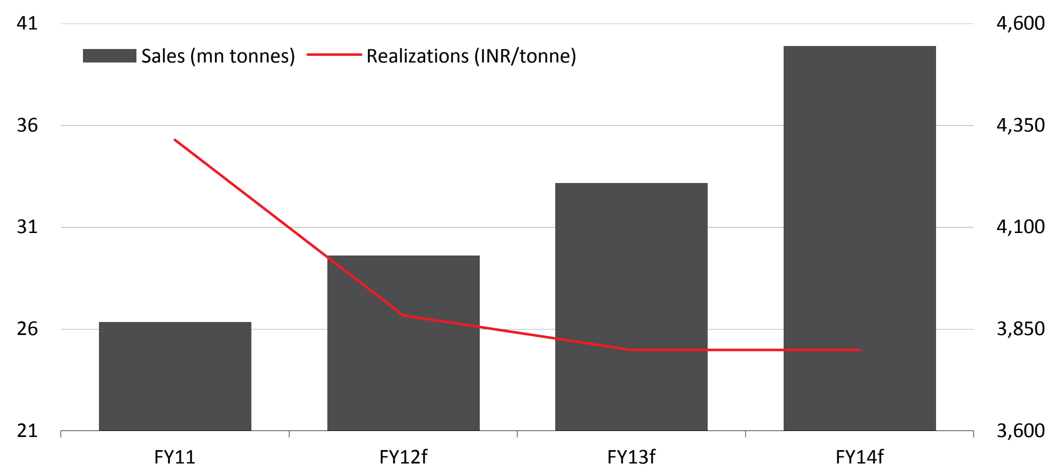
Source: Company, Avendus Research

Three-year CAGR in net profit likely to be 9.9%; FY13f EPS of INR18.6

Sales volume is likely to grow at a CAGR of 14.8% during FY12f-FY14f, largely driven by a 20% increase in iron ore production during FY13f due to commissioning of the iron ore mine in Bailadila. We forecast blended iron ore prices to decline by 10% in FY12 to INR3,883/tonne due to a decline in prices of iron ore fines; prices are likely to remain flat thereafter. EBITDA margins are likely to increase from 76% in FY11 to 76.3% in FY14f due to the benefits of operating leverage, largely driven by higher sales volume. Net profit during FY12f-FY14f is likely to grow at a CAGR of 9.9% due to higher depreciation provisioning on account of commissioning of iron ore mines in Chhattisgarh and Karnataka. We forecast the EPS to increase from INR16.4 in FY11 to INR18.6 in FY13 and INR21.9 in FY14.

CAGR of 10.1% in net sales during FY12f-FY14f

Exhibit 9: Iron ore sales and realizations



Source: Company, Avendus Research

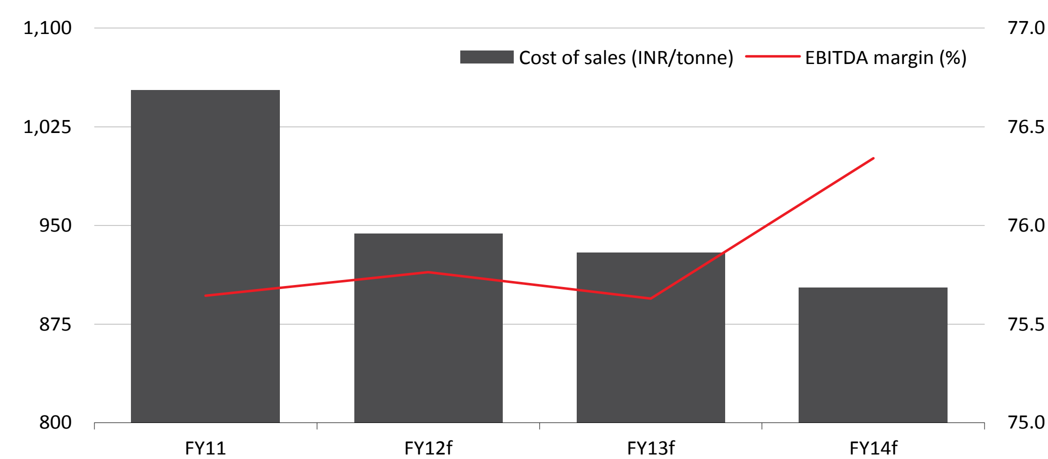
Sales volume is likely to grow at a CAGR of 14.8% during FY12f-FY14f.

Sales volume is likely to grow at a CAGR of 14.8% during FY12f-FY14f, largely driven by a 20% increase in iron ore production during FY13f due to commissioning of an iron ore mine in Bailadila. Iron ore sales are likely to increase from 26.3mn tonnes in FY11 to 29.6mn tonnes in FY12f and 33.2mn tonnes in FY13f. We forecast blended iron ore prices to decline by 10% in FY12 to INR3,883/tonne. Iron ore prices are likely to remain stable during FY13-FY14. We have not assumed any revenue from the 3mn tonne integrated steel operations in Chhattisgarh, which is likely to be commissioned by FY14f.

EBITDA margins likely to remain at c76% over FY12f-FY14f

Exhibit 10: Cost of sales and EBITDA margin

Benefits of operating leverage likely to boost EBITDA margins from 76% in FY11 to 76.3% in FY14f.



Source: Company, Avendus Research

We forecast EBITDA margins to increase from 76% in FY11 to 76.3% in FY14 due to the benefits of operating leverage, largely driven by higher sales volume and lower railway freight cost on account of the decline in exports. EBITDA is likely to increase from INR86.2bn in FY11 to INR116.2bn in FY14f, at a CAGR of 10.5%. Cost of sales is likely to decline from cINR1,053/tonne in FY11 to INR944/tonne in FY12f due to lower freight cost on account of reduced exports.

Net profit likely to grow at a CAGR of 9.9% during FY12f-FY14f

EPS likely to increase from INR17.2 in FY12f to INR18.6 in FY13f and INR21.9 in FY14f.

Net profit for FY12f-FY14f is likely to grow at a CAGR of 9.9%. We forecast net profit to increase from INR65bn in FY11 to INR87.0bn in FY14. Depreciation provisioning during FY12f-FY14f is likely to grow at a CAGR of 20.9%, largely due to commissioning of iron ore mines in Chhattisgarh and Karnataka. Depreciation provisioning for FY13f is likely to increase by 25.7% to INR1.7bn due commissioning of an iron ore mine in Chhattisgarh. We forecast the effective tax rate for the company at 33%. The EPS is likely to increase from INR16.4 in FY11 to INR18.6 in FY13f and INR 21.9 in FY14f.

Initiate with a Hold rating and a Jun12 target of INR275

Our Jun12 target price of INR275 values NMDC at a premium to its domestic peers, on account of the low production cost, iron ore quality and earnings growth. This restricts any further upside in the stock. We value the company on DCF basis and at a 10% discount to its historical (Apr10-Jun11) P/E and EV/EBITDA, as it does not reflect the entire commodity cycle for iron ore. At our target price, the stock trades at an EV/EBITDA and P/E of 9.4 and 14.8x its FY12f earnings, respectively. We initiate coverage on NMDC with a Hold rating. Key risks to our estimates are delay in commissioning of capacity at its mines in Chhattisgarh and Karnataka and correction in iron ore prices.

Exhibit 11: DCF assumptions and summary

Key Parameters	**---------------- Stage-I: 3 years explicit ----------------**					**---------- Stage-II: 12 years -----------**				**----------- Stage-III: 10 years -----------**			
Year	**FY12f**	**FY13f**	**FY14f**	**Over stage I**		**FY15f**	**FY26f**	**Over stage II**		**FY27f**	**FY36f**	**Over stage II**	
Sales Growth (%)	1.2	9.7	20.4	10.2	CAGR	19.5	10.0	14.7	CAGR	9.5	5.0	7.2	CAGR
EBIT margins (%)	88.1	87.2	85.3	86.9	Average	82.4	50.0	66.2	Average	46.2	12.1	29.2	Average
Tax Rate (%)	33.0	33.0	33.0	33.0	Average	33.0	33.0	33.0	Average	33.0	33.0	33.0	Average
Gross Turnover (x)	3.9	3.4	2.3	3.2	Average	2.2	1.3	1.8	Average	1.3	1.3	1.3	Average
WCAP (days sales)	6.4	6.3	8.2	7.0	Average	8.0	6.0	7.0	Average	6.0	6.0	6.0	Average
ROIC (%)	188.8	88.7	57.3	111.6	Average	51.3	45.9	54.8	Average	42.9	15.7	30.9	Average

DCF Value as on Mar10	**(INRmn)**	**% of EV**
Explicit period cash flows	22,016	3
Stage-II cash flows	603,554	73
Stage-III cash flows	158,057	19
Terminal Value	42,342	5
Total EV	**825,969**	**100**
Less: Gross Debt	849	
Add: Investments & Cash	193,315	
Equity Value	**1,018,436**	
No of shares (mn)	3,965	
Value/share (INR) (Jun12)	**266**	

WACC Assumption (%)	
Risk-free rate	8.0
Mkt. Risk Premium	7.0
Beta (x)	1.1
Cost of Equity	15.7
Cost of Debt	10.0
Debt/Total Capital	-
WACC	15.7
Terminal Growth	5.0

Sensitivity Analysis

Terminal growth (%) \ **WACC (%)**	14.7	15.7	16.7
4.0	285	265	248
5.0	286	**266**	249
6.0	288	268	250

Source: Avendus Research

DCF method values NMDC at a fair value of INR266/share

We estimate NMDC's fair value at INR266/share using the three-stage DCF method.

The key assumptions are:

- The first stage uses explicit forecasts during FY12-FY14.
- In the second stage, we have assumed revenue growth to gradually decline to 10% and EBIT margins to decline to 50%.
- In the third stage, we have assumed growth to converge with the terminal growth rate of 5% and EBIT margins to decline to 12.1%.

Valuations factors in earnings growth, better quality of ore

Valuations discount the earnings growth, restricting further upsides.

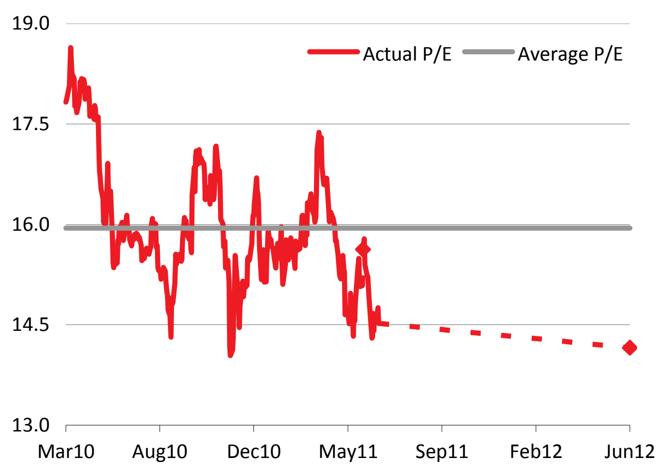
In comparison to the average P/E and EV/EBITDA for global peers, NMDC trades at more than 50% premium, based on FY14f earnings. The valuations discount the low cost of production, the high grade of iron ore reserves with the company and the better earnings growth compared to peers; thus, restricting any further upside. We apply a 10% discount to the historical (Apr10-Jun11) P/E and EV/EBITDA multiple as they do not reflect the entire commodity cycle for iron ore. Applying an EV/EBITDA of 9.2x and P/E of 14.3x to our one-year forward rolling EBITDA and EPS, we arrive at fair values of INR280/share and INR279/share, respectively for the stock.

Exhibit 12: Peer Comparison as on July 1, 2011

	Mcap	----------- P/E -----------			----------- EV/EBITDA -----------			----------- EBITDA (%)-----------		
Company Name	**USDmn**	**2011E**	**2012E**	**2013E**	**2011E**	**2012E**	**2013E**	**2011E**	**2012E**	**2013E**
Cliffs Natural Resources Inc	13,498	6.7	6.3	6.7	4.1	3.6	3.8	46.9	47.7	45.3
Fortescue Metals Group	21,173	12.5	8.7	8.0	8.0	5.6	4.9	54.3	55.3	52.1
Ferrexpo Plc	4,441	7.6	7.2	7.7	5.8	5.6	6.0	50.0	49.7	45.9
Kumba Iron Ore	23,047	8.8	8.2	7.8	4.9	4.6	4.3	68.9	67.0	64.2
Labrador Iron Ore Royalty Co	2,575	11.0	8.8	7.5	13.0	11.0	9.1	106.2	103.8	112.8
Mmx Mineracao E Metalicos Sa	3,315	15.6	18.3	20.2	9.2	6.7	5.2	40.7	43.4	44.6
Northern Iron	637	8.8	3.7	3.2	5.5	2.7	2.4	47.7	64.6	68.7
Eurasian Natural Resources	16,169	6.3	6.0	6.1	4.1	3.8	3.8	49.5	48.9	46.6
Exxaro Resources	9,464	7.9	6.4	6.3	8.6	6.7	6.4	36.9	39.7	38.2
Rio Tinto	145,954	7.4	7.5	7.9	4.7	4.7	4.9	49.6	48.5	46.6
Vale Sa-Pref A	163,603	6.4	6.3	6.4	4.9	4.7	4.9	62.5	65.0	58.0
Om Holdings	497	12.6	6.2	6.1	6.4	4.0	4.3	17.9	24.1	20.6
Mount Gibson Iron	2,133	6.7	3.6	3.5	3.4	2.0	2.0	71.2	71.1	69.3
Atlas Iron	3,299	16.1	9.7	7.8	11.8	6.4	4.7	43.8	52.6	53.1
BHP Billiton	233,991	10.5	8.9	9.2	6.1	5.1	5.2	53.7	56.9	55.4
NMDC *	22,666	15.4	14.2	12.1	9.7	9.0	7.4	75.8	75.6	76.3
Sesa Goa *	5,501	7.7	7.5	5.7	5.7	5.0	3.4	38.1	34.4	37.3
Average		**9.9**	**8.1**	**7.8**	**6.8**	**5.4**	**4.9**			

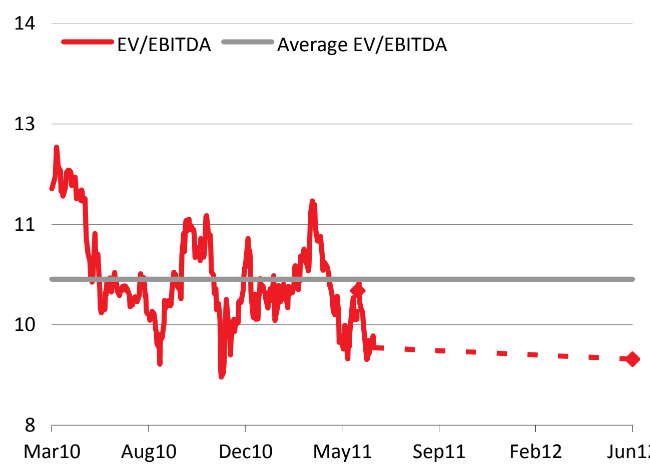
Source: Bloomberg, Avendus Research Note: * year ended Mar

Exhibit 13: One-year forward P/E (x)



Source: Bloomberg, Avendus Research

Exhibit 14: One-year forward EV/EBITDA (x)



Source: Bloomberg, Avendus Research

Our Jun12 target price of INR275 is the average of the fair values based on the DCF, P/E and EV/EBITDA methods. At our target price, the stock trades at an EV/EBITDA of 9.4x and P/E of 14.8x its FY12f earnings, respectively. We initiate coverage on the stock with a Hold rating.

Key risks to our estimates

- Any delay in commissioning of iron ore mines at Chhattisgarh and Karnataka is likely to adversely impact sales volumes, which are forecast to grow at a CAGR of 11.8% during FY11-FY14.
- Naxalite activities could adversely affect the transportation of iron ore from mines to customers, leading to inventory build up at mines.
- A decline in iron ore prices could adversely impact profitability; we have assumed iron ore prices to increase by 5% in FY12f and remain flat thereafter.

Financials and valuations

Income statement (INRmn)

Fiscal year ending	03/10	03/11	03/12f	03/13f	03/14f
Gross sales	62,391	113,915	115,288	126,482	152,246
Less: Excise duty	0	0	0	0	0
Net sales	62,391	113,915	115,288	126,482	152,246
Other operating income	0	0	0	0	0
Total operating income	**62,391**	**113,915**	**115,288**	**126,482**	**152,246**
Total operating expenses	**18,203**	**27,746**	**27,943**	**30,824**	**36,021**
Net materials	2,114	2,081	2,452	2,772	3,363
Other direct costs	4,853	8,434	5,068	5,379	5,763
Personnel	4,195	4,845	5,342	5,890	6,493
SG&A	7,042	12,386	15,081	16,783	20,401
R&D	0	0	0	0	0
EBITDA	**44,188**	**86,170**	**87,346**	**95,658**	**116,226**
Other income	16,963	12,926	15,511	16,286	15,472
Depreciation	732	1,025	1,317	1,655	1,811
EBIT	**60,419**	**98,071**	**101,540**	**110,289**	**129,887**
Interest	0	0	0	0	0
Recurring PBT	60,419	98,071	101,540	110,289	129,887
Net extra ordinary items	0	0	0	0	0
PBT (reported)	60,419	98,071	101,540	110,289	129,887
Total taxes	17,601	32,559	33,508	36,396	42,863
PAT (reported)	42,818	65,511	68,032	73,894	87,024
Add: Share of earnings of associate	0	0	0	0	0
Less: Minority interest	0	0	0	0	0
Prior period items	0	0	0	0	0
Net income (reported)	42,818	65,511	68,032	73,894	87,024
Avendus net income	**42,818**	**65,511**	**68,032**	**73,894**	**87,024**
Dividend + Distribution tax	8,117	15,330	15,919	17,291	20,364
Shares outstanding (mn)	3,965	3,965	3,965	3,965	3,965
Avendus diluted shares (mn)	3,965	3,965	3,965	3,965	3,965
Avendus EPS (INR)	**11**	**17**	**17**	**19**	**22**

Growth ratios (%)

Total operating income	-17.5	82.6	1.2	9.7	20.4
EBITDA	-24.3	95.0	1.4	9.5	21.5
EBIT	-19.6	62.3	3.5	8.6	17.8
Recurring PBT	-19.6	62.3	3.5	8.6	17.8
Avendus net income	-18.3	53.0	3.8	8.6	17.8
Avendus EPS	-18.3	53.0	3.8	8.6	17.8

Operating ratios (%)

EBITDA margin	70.8	75.6	75.8	75.6	76.3
EBIT margin	96.8	86.1	88.1	87.2	85.3
Net profit margin	54.0	51.6	52.0	51.8	51.9
Other income/PBT	28.1	13.2	15.3	14.8	11.9
Effective Tax rate	29.1	33.2	33.0	33.0	33.0

Balance sheet (INRmn)

Fiscal year ending	03/10	03/11f	03/12f	03/13f	03/14f
Equity capital	3,965	3,965	3,965	3,965	3,965
Preference capital	0	0	0	0	0
Reserves and surplus	138,540	188,765	240,913	297,544	364,227
Net worth	**142,505**	**192,730**	**244,877**	**301,508**	**368,192**
Minority interest	0	0	0	0	0
Total debt	0	0	0	0	0
Deferred tax liability	849	849	849	849	849
Total liabilities	**143,353**	**193,579**	**245,726**	**302,357**	**369,040**
Gross block	17,711	23,272	29,389	36,809	66,649
less: Accumulated depreciation	9,840	10,864	12,181	13,836	15,647
Net block	7,872	12,408	17,208	22,973	51,003
CWIP	5,561	6,117	32,420	89,840	134,332
Goodwill	0	0	0	0	0
Investments	761	761	761	761	761
Cash	128,549	172,396	193,315	186,597	179,528
Inventories	2,988	4,681	4,738	5,198	6,257
Debtors	4,270	7,802	7,896	8,663	10,428
Loans and advances	6,829	8,490	8,589	9,277	10,840
less: Current liabilities	7,525	9,922	9,981	10,781	12,222
less: Provisions	5,952	9,156	9,221	10,172	11,887
Net working capital	129,160	174,293	195,337	188,782	182,944
Total assets	**143,353**	**193,579**	**245,726**	**302,357**	**369,040**

Cash flow statement (INRmn)

Fiscal year ending	03/10	03/11f	03/12f	03/13f	03/14f
Net profit	42,818	65,511	68,032	73,894	87,024
Depreciation	732	1,025	1,317	1,655	1,811
Deferred tax	0	0	0	0	0
Working capital changes	9,213	358	-43	508	315
Less: Other income	16,963	12,926	15,511	16,286	15,472
Cash flow from operations	**35,800**	**53,968**	**53,795**	**59,770**	**73,678**
Capital expenditure	-4,098	-6,117	-32,420	-64,840	-74,332
Strategic investments purchased	-46	0	0	0	0
Marketable investments purchased	0	0	0	0	0
Change in other loans and advances	-1,157	-1,645	-82	-672	-1,546
Goodwill paid	0	0	0	0	0
Other income	16,963	12,926	15,511	16,286	15,472
Cash flow from investing	**11,662**	**5,164**	**-16,992**	**-49,225**	**-60,406**
Equity raised	0	0	0	0	0
Change in borrowings	0	0	0	0	0
Dividends paid (incl. tax)	-8,117	-15,330	-15,919	-17,291	-20,364
Others	-8,192	44	35	28	23
Cash flow from financing	**-16,310**	**-15,286**	**-15,884**	**-17,263**	**-20,341**
Net change in cash	**31,153**	**43,847**	**20,919**	**-6,718**	**-7,069**

Key Ratios

Fiscal year ending	03/10	03/11f	03/12f	03/13f	03/14f
Valuation ratios (x)					
P/E (on Avendus EPS)	24.3	15.9	15.3	14.1	11.9
P/E (on basic, reported EPS)	24.3	15.9	15.3	14.1	11.9
P/CEPS	23.9	15.6	15.0	13.7	11.7
P/BV	7.3	5.4	4.2	3.4	2.8
Dividend yield (%)	0.7	1.3	1.3	1.4	1.7
Market cap. / FCF	29.0	19.2	19.3	17.4	14.1
Market cap. / Sales	16.6	9.1	9.0	8.2	6.8
EV/Sales	14.5	7.6	7.3	6.7	5.6
EV/EBITDA	20.5	10.0	9.6	8.8	7.3
EV / FCF	28.6	18.0	39.3	-166.8	-1,301.6
EV / Total Assets	6.3	4.4	3.4	2.8	2.3
Net Cash / Market cap.	12.9	17.3	19.3	18.7	18.2
Per share ratios (INR)					
Avendus EPS	10.8	16.5	17.2	18.6	21.9
EPS (Basic, reported)	10.8	16.5	17.2	18.6	21.9
Cash EPS	11.0	16.8	17.5	19.1	22.4
Book Value	35.9	48.6	61.8	76.0	92.9
Dividend per share	1.7	3.3	3.4	3.7	4.4
ROE Decomposition (%)					
EBIT margin	96.8	86.1	88.1	87.2	85.3
Asset turnover (x)	0.5	0.7	0.5	0.5	0.5
Interest expense ratio	0.0	0.0	0.0	0.0	0.0
Tax retention ratio	70.9	66.8	67.0	67.0	67.0
ROA	32.9	38.9	31.0	27.0	25.9
Total assets / equity (x)	1.0	1.0	1.0	1.0	1.0
ROE	33.1	39.1	31.1	27.0	26.0
Return ratios (%)					
EBIT / Capital Employed	46.5	58.2	46.2	40.2	38.7
ROCE	32.9	38.9	31.0	27.0	25.9
ROIC	328.2	539.0	388.1	321.9	214.6
FCF / IC	243.0	393.7	121.9	-22.1	-1.6
OCF/Sales	57.4	47.4	46.7	47.3	48.4
FCF/Sales	50.8	42.0	18.5	-4.0	-0.4
Turnover ratios (x)					
Gross turnover	3.5	4.9	3.9	3.4	2.3
Net turnover	7.9	9.2	6.7	5.5	3.0
Revenue / IC	4.8	9.4	6.6	5.5	3.8
Inventory / Sales (days)	17.6	12.3	14.9	14.3	13.7
Receivables (days)	42.5	19.3	24.9	23.9	22.9
Payables (days)	324.1	302.8	483.0	464.8	460.0
Working capital cycle (ex-cash) (days)	0.2	-15.2	-15.6	-14.9	-13.3
Solvency ratios (x)					
Gross debt to equity	0.0	0.0	0.0	0.0	0.0
Net debt to equity	-0.9	-0.9	-0.8	-0.6	-0.5
Net debt to EBITDA	0.0	0.0	0.0	0.0	0.0
Interest Coverage (EBIT / Interest)	NA	NA	NA	NA	NA

Analyst Certification

I Jimesh Sanghvi, Chartered Accountant, research analyst and author of this report, hereby certify that all of the views expressed in this document accurately reflect our personal views about the subject company/companies and its or their securities. We further certify that no part of our compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document.

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Disclosure of Interest Statement (as of July 4, 2011)

	Analyst ownership of the stock	Avendus or its associate company's ownership of the stock	Investment Banking mandate with associate companies of Avendus
NMDC	No	No	No
Essar Steel	No	No	No
Minemakers	No	No	No
Legacy Iron ore	No	No	No
Rashtriya Ispat Nigam	No	No	No
Ispat Industries	No	No	No
JSW Steel	No	No	No
Kudremukh iron ore	No	No	No
Sesa Goa	No	No	No
Cliffs Natural Resources Inc	No	No	No
Fortescue Metals Group	No	No	No
Ferrexpo Plc	No	No	No
Kumba Iron Ore	No	No	No
Labrador Iron Ore Royalty Co	No	No	No
Mmx Mineracao E Metalicos Sa	No	No	No
Northern Iron	No	No	No
Eurasian Natural Resources	No	No	No
Exxaro Resources	No	No	No
Rio Tinto	No	No	No
Vale Sa-Pref A	No	No	No
Om Holdings	No	No	No
Mount Gibson Iron	No	No	No
Atlas Iron	No	No	No
BHP Billiton	No	No	No
MOIL	No	No	No

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