NMDC

CMP Rs376, Not Rated

Sector: Metals & Mining

Sensex:	17,053
CMP (Rs):	376
52 Week h/l (Rs):	572 / 140
Market cap (Rscr) :	148,934
6m Avg vol ('000Nos):	1,316
No of o/s shares (mn):	3,965
FV (Re):	1
Bloomberg code:	NMDC IB
Reuters code:	NMDC.BO
BSE code:	526371
NSE code:	NMDC

Prices as on 09 Mar, 2010

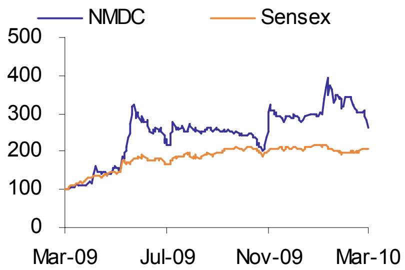
Shareholding pattern

December '09	(%)
Promoters	98.4
Institutions	1.4
Non promoter corp hold	0.1
Public & others	0.2

Performance rel. to sensex

(%)	1m	3m	1yr
NMDC	(29.7)	(10.7)	54.3
Sesa Goa	16.0	16.1	404.6
Tata Steel	8.7	12.9	207.6
SAIL	5.9	16.4	104.8

Share price trend



NMDC, a government-owned (98.4%) Navratna company is the country's largest iron ore producer. NMDC has a large iron ore reserve base of 1,360mn tons and is blessed with high quality iron ore reserves (64-66% iron content). The company plans to increase its annual production from 30mtpa to ~50mtpa by 2015. Average operating costs for the company over the past four years are a mere US$6.3/ton. We believe the robust volume growth in the domestic steel market coupled with strong iron ore realizations globally, will lead to a strong earnings growth for the company. After reporting weaker numbers in FY10E, we expect the company to witness earnings CAGR of 36% over FY10-12. NMDC's strong balance sheet will offer opportunities to grow inorganically. Cash balance of Rs127bn (Rs32/share) at the end of FY09 is expected to double by FY12. At the lower end of the price band, which is Rs300, NMDC will trade at 13.3x FY12 EV/EBIDTA, which is at a significant premium (100%) to its domestic and international peers. We believe that such high valuations even at the lower end of the band are unjustified.

Production target of 50mtpa by FY15E

NMDC accounts for over 15% of iron ore production in India and sells ~87% of its production in the domestic market. NMDC has seen a volume growth of 25-30% compounded annually from FY04 to FY09. The company further plans to increase its annual production from 30mn tons to ~50mn tons by 2015 with the commissioning of four new mines. However, we feel it would be running behind schedule as mining leases on two of these are awaited and there is an ongoing litigation on the third. Commissioning of the fourth mine has been delayed for various reasons to March '11.

One of the lowest cost producers of iron ore

NMDC has always been a low cost miner on account of availability of cheap labor and highly mechanized mines, which means lower wastage. NMDC's operating expense per ton of low stood as low as US$7.6/ton in FY09. Also NMDC's contracts with the domestic players (85% of total sales) are typically on 'Free on rail' or 'Free on truck' basis with transportation arranged by the customer at their own cost. Also, the royalties levied by the government are payable by the domestic customers. As a result, EBIDTA/ton of iron ore is directly proportional to the change in realizations and would not be largely impacted by the rise in operating costs.

Valuation summary

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Revenues	75,640	64,185	101,392	116,104
yoy growth (%)	32.4	(15.1)	58.0	14.5
Operating profit	58,370	48,239	84,516	97,407
OPM (%)	77.2	75.2	83.4	83.9
Reported PAT	43,724	39,201	63,011	72,632
yoy growth (%)	34.5	(10.3)	60.7	15.3
EPS (Rs)	11.0	9.9	15.9	18.3
P/E (x)	34.1	38.0	23.7	20.5
Price/Book (x)	12.8	10.2	7.7	6.0
EV/EBITDA (x)	23.9	28.3	15.7	13.3
RoE (%)	43.9	29.8	37.0	32.7
RoCE (%)	66.5	42.8	55.0	48.6

Source: Company, India Infoline Research

Abundant high quality reserves

NMDC has access to significant reserves of high grade iron ore, predominantly greater than 64% Fe content. The company as on January 2010, has an iron ore reserve base of 1,360mn tons and is blessed with high quality iron ore reserves (64-66% iron content). The company's iron ore reserves are processed in lump, fine ore and slimes. The company's producing mines are open cast and primarily fully mechanized. The company currently operates its iron ore business through three mining complexes: the Kirandul complex, the Bacheli complex and the Donamalai complex.

Iron ore reserves

Deposit name (mn tons)	Fe % for proved reserves	Proved reserves	Probable reserves	Mineral resources	Total
Kirandul Complex					
Deposit 14	64.7%	130.1		19.5	149.7
Deposit 14 NMZ	65.9%	60.6		3.0	63.6
Deposit 11C	64.7%	0.7		9.4	10.1
Bacheli complex					
Deposit 5	65.3%	38.7	182.2		220.8
Deposit 10	66.0%	140.1		56.5	196.6
Deposit 11A	65.4%	25.4		1.4	26.8
Donamalai	66.8%	17.6			17.6
Non-operating mines					
Deposit 4				105.0	105.0
Deposit 11B	66.4%	114.3		6.2	120.6
Kumaraswamy	64.0%	130.4			130.4
Deposit 13	67.2%	319.6			319.6
Total		**977.5**	**182.2**	**201**	**1,360.6**

Source: Company, India Infoline Research

NMDC expects the growth in iron ore volumes from its new four mines. The four mines are at various stages of commissioning:

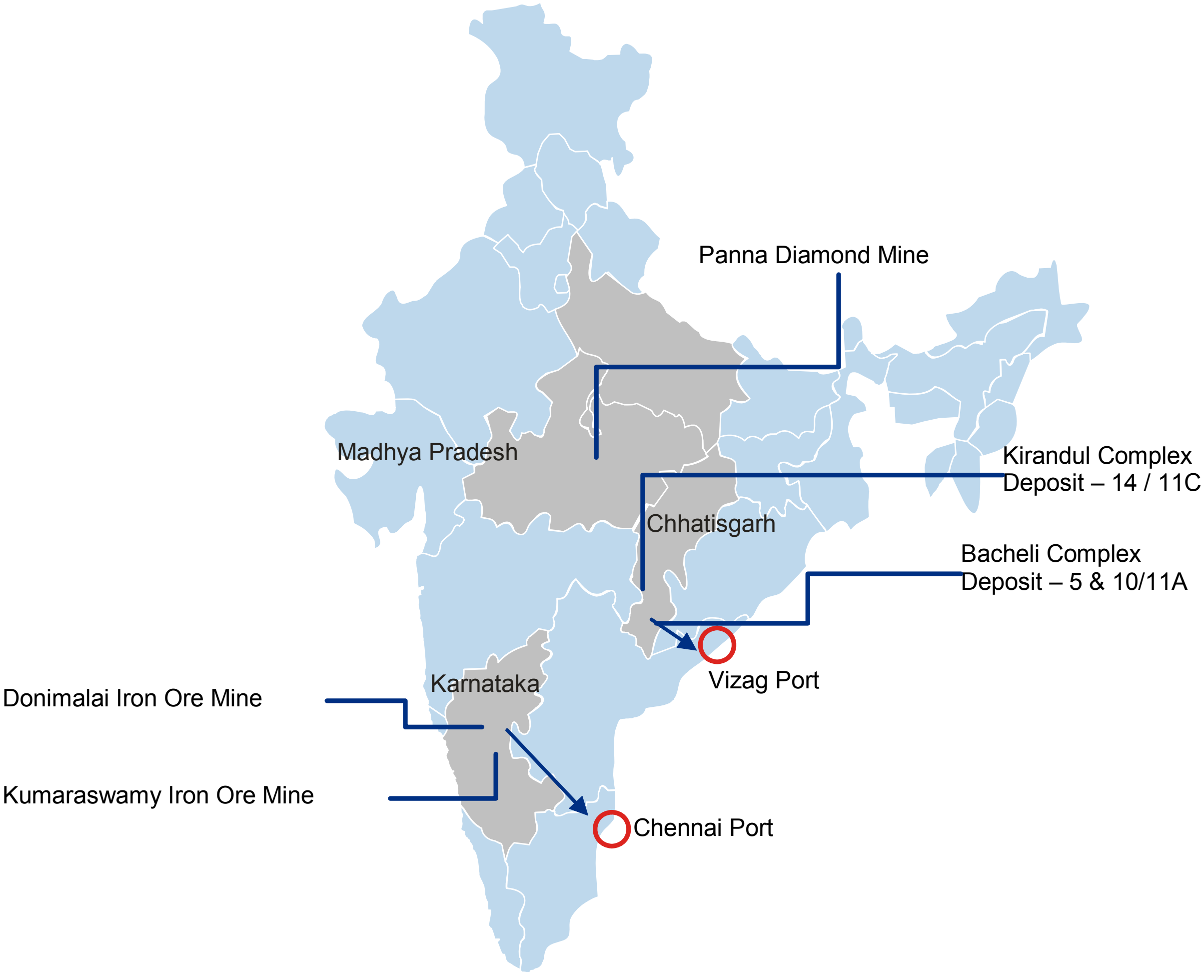
1) **Deposit 4:** Application has been made for mining lease. However, the company has not yet received approval for the mining lease, mining plans, forest clearance or environmental approval.

2) **Deposit 11B:** The mine is currently under construction and is being developed and integrated with infrastructural facilities of the Kirandul complex.

3) **Kunmaraswamy:** A mechanized mine is being developed and integrated with the currently operational Donimalai complex. Of the total 648 hectares, 378 hectares are under dispute.

4) **Deposit 13:** This mine will be developed by the company through the joint venture with Chhattisgarh Mineral Development Corporation Ltd, in which it has a 51% equity interest. The mining lease is yet to be granted and forest clearance and environmental approvals have not been obtained as yet. There are also certain litigations with respect to this deposit.

NMDC's production sites



Source: Company, India Infoline Research

NMDC's iron ore deposits

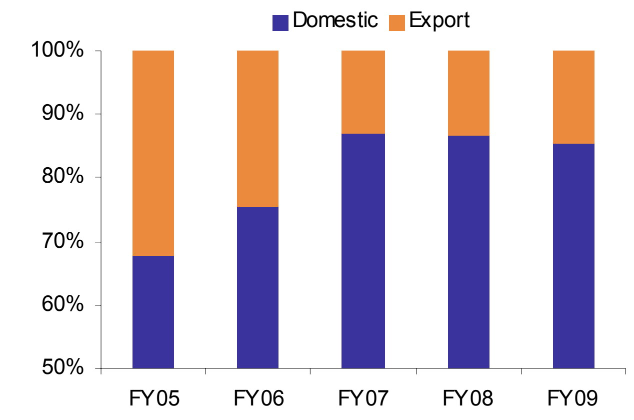
Mine (mn tons)	Date of commissioning	Original reserve est.	Mined till date	Production capacity	Life of Mine Left
Bailadila Deposit 14	1968	254	210.7	5	27
Bailadila Deposit 11/C	1987			7	11
Bailadila Deposit 5	1977	206	166.2	10	24
Bailadila Deposit 10/11A	2002	233	16.9	5	45
Donimalai	1977	112	105.1	4	6
Bailadila Deposit 11B	2010	114		7	
Kumaraswamy	2012	132		3	

Source: Company, India Infoline Research

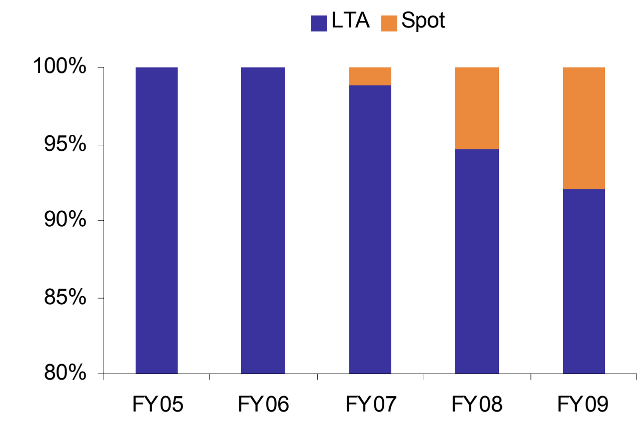
Contract sales account for 92% of total sales

The company sells most of its high grade iron ore production to the Indian domestic steel market, primarily pursuant to long-term sales contracts. For FY09, ~92% of the company's iron ore sales volume was based on long-term sales contracts and the rest was sold in the spot market at negotiated prices. Domestic market accounted for ~85% of total sales and ~15% of the total sales were exports primarily to Japan and South Korea.

Exports contribute ~15% in FY09



Spot sales account for ~8% of total sales

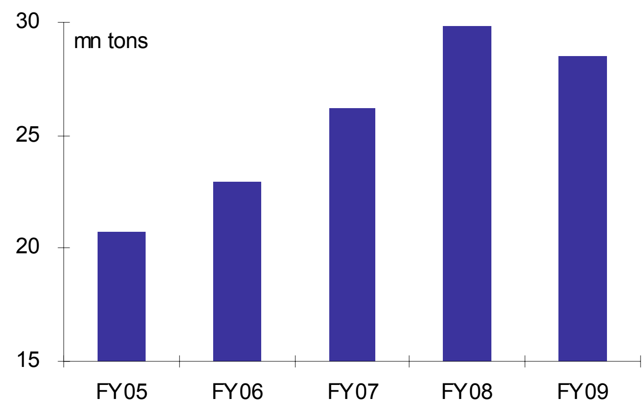


Source: Company, India Infoline Research

The agreements provide for a price adjustment for any increase or decrease in the Fe content of the iron ore delivered to the customer by at least one percent. Such agreements contain a quantity allocation provision, which provides for the range of iron ore to be supplied to the customer. The exact amount to be supplied is negotiated on a yearly basis. The customer no longer benefits from its long term customer status if its yearly lifting is less than 90% of the quantity agreed to be delivered. If the customer loses its long term customer status, the Company can impose on the customer to pay a higher price for the full quantity of iron ore supplied under the agreement. In existing domestic contracts, the price was fixed for the first year and has subsequently been determined based upon a formula taking into consideration the variation of the Japanese benchmark price and the variation in the exchange rate for rupees/dollars on a six months basis.

Export prices were at 71% premium to its domestic peers

Iron ore production declined in FY09



Source: Company, India Infoline Research

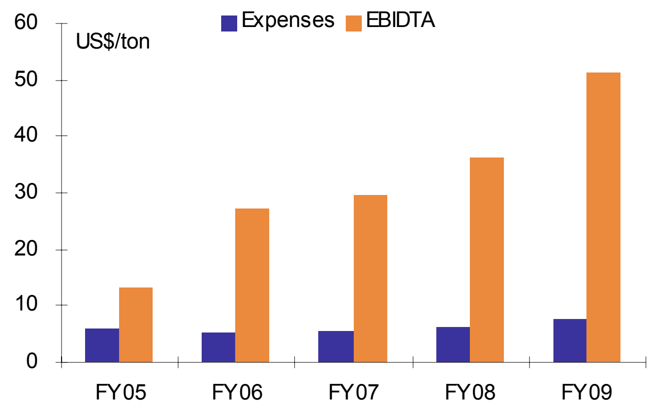
NMDC's realisations in the domestic market has been always at a discount to global peers as sales to domestic customers are priced 'free on rail' or 'free on truck'. As a result, the customer has to pay for the transportation cost and also the royalties levied by the government. For exports, NMDC has to incur the transportation cost to the port and the royalty levied by the government.

Majority of the five year contracts with the domestic players will expire on March '10 and all the export contracts will expire on March '11. NMDC has appointed a consultant to look at various possible pricing mechanisms available to realize higher iron ore price once the benchmark system is changed.

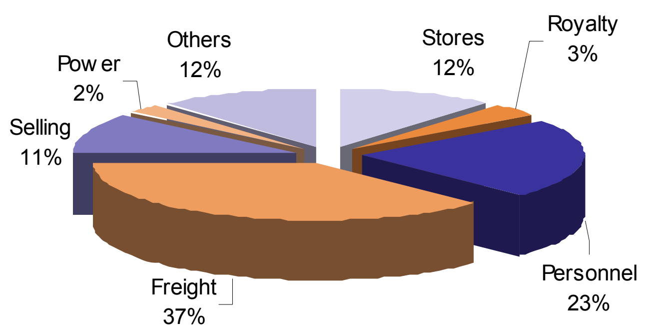
One of the lowest cost producers of iron ore

NMDC has always been a low cost miner by global standards on account of availability of cheap labor and highly mechanized mines, which means lower wastage. NMDC's operating expense per ton of low stood as low as US$7.6/ton in FY09. Also NMDC's contracts with the domestic players (85% of total sales) are typically on 'free on rail' or 'free on truck' basis with transportation arranged by the customer at their own cost. Royalties levied by the government are also payable by the domestic customers. Iron ore is transported by conveyors from the company's screening plant to its loading plant stock pile for loading into railway wagons. As a result, there is very little wastage and the cost of transportation is also quite low. Due to this EBIDTA/ton of iron ore is directly proportional to the change in realizations and would not be impacted by the rise in operating costs.

Expenses in FY09 stood at US$7.6/ton



Freight and personnel costs accounted for ~50% of total costs in FY09



Source: Company, India Infoline Research

Value addition plans a distant future

For value addition, NMDC is in the process of developing a 3mtpa steel plant at Jagdalpur and 2 pellet plants at Donimalai (1.2mtpa) and at Bacheli (2mtpa). Besides, NMDC is also in the process of merger of Sponge Iron India Limited with plan for expansion to produce billets. At Jagdalpur, Chhattisgarh, the company is planning to set up a 3mtpa steel making plant with an investment of Rs168bn. Environmental clearance for the project is already obtained and the company has managed to receive 995 acres till now. The management expects the project to be operational over the next four years. Additionally, NMDC has also formed a JV with the Karnataka government for setting up a 2mtpa plant at Bellary/Hospet area. The company has outlaid a total capex of Rs265bn to be spent over the next five years. It plans to fund the entire capex through internal accruals and also aims at augmenting its iron ore resources inorganically.

9M FY10 performance hindered by terrorist attack

NMDC reported a 28.2% decline in its 9M FY10 net profit to Rs24.1bn from Rs33.5bn in the corresponding period last year, hit by supply disruptions to customers due to suspected Maoist activities and a decline in iron ore realizations. Revenue for the period dipped 24.4% yoy to Rs42.6bn compared to Rs56.3bn in the year-ago on account of a 9.7% yoy decline in sales volume and a 16.5% yoy decline in average realisations. Maoists have sabotaged NMDC's pipelines used to transport iron-ore slurry to customer sites. As a result, production volumes dipped 13.4% yoy to 16.9mn tons during the first nine months of FY10. Operating margin during 9M FY10 declined from 79.6% in 9M FY09 to 71.5% as a result of lower realisations.

Nine months performance

(Rs m)	9M FY10	9M FY09	% yoy
Production (mn tons)	16.9	19.5	(13.4)
Sales (mn tons)	17.2	19.1	(9.7)
Realisation (Rs/ton)	2,468	2,954	(16.5)
Net sales	**42,558**	**56,280**	**(24.4)**
Material costs	(1,284)	(549)	133.9
Personnel costs	(2,708)	(2,780)	(2.6)
Selling expenses	(3,447)	(5,891)	(41.5)
Other overheads	(4,685)	(2,256)	107.7
Operating profit	**30,434**	**44,804**	(32.1)
OPM (%)	***71.5***	***79.6***	***(810) bps***
Depreciation	(513)	(527)	(2.7)
Other income	6,505	6,584	(1.2)
PBT	**36,426**	**50,860**	**(28.4)**
Tax	(12,381)	(17,348)	(28.6)
Effective tax rate (%)	***34.0***	***34.1***	
Adjusted PAT	**24,046**	**33,512**	**(28.2)**
Adj. PAT margin (%)	***56.5***	***59.5***	***(304) bps***
Reported PAT	**24,046**	**33,512**	**(28.2)**
Ann. EPS (Rs)	8.1	11.3	(28.2)

Source: Company, India Infoline Research

Government to offload 8.4% stake in the company

NMDC has filed for a follow-on public offering (FPO) of 0.3bn equity shares of face value Re1 each through an offer for sale by the Government of India. The offer comprises a net offer to the public of 330,500,000 equity shares and a reservation of 1,743,200 equity shares for purchase by eligible employees at a discount of 5% of the floor price. The offer shall constitute 8.38% of the post offer paid-up equity share capital of the company. The government panel has set a price band of Rs300 to Rs350 for the follow-on public offer in NMDC, a discount of 7-20.2% to Tuesday's closing price. Retail investors and staff will get a further 5% discount on the final price.

Issue details

Details	
Issue opens	10-Mar-10
Issue closes	12-Mar-10
Price band (Rs)	Rs300-350
Face value (Re)	1
Issue size (mn nos)	331
Issue size (Rs bn)	99.2-115.6
Issue type	100% Book building
Minimum bid	20
Industry	Mining

Source: Company, India Infoline Research

Share reservation

Categories	(%)
QIB	50
Non institutional	15
Retail	35

Source: Company, India Infoline Research

Issue manager details

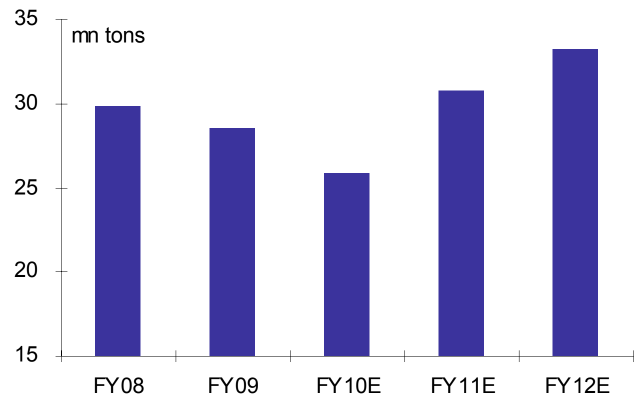
Issue manager	
Lead manager	UBS, Citi, Edelweiss, Kotak, Morgan Stanley, RBS
Registrar	Karvy
Listing	NSE, BSE

Source: Company, India Infoline Research

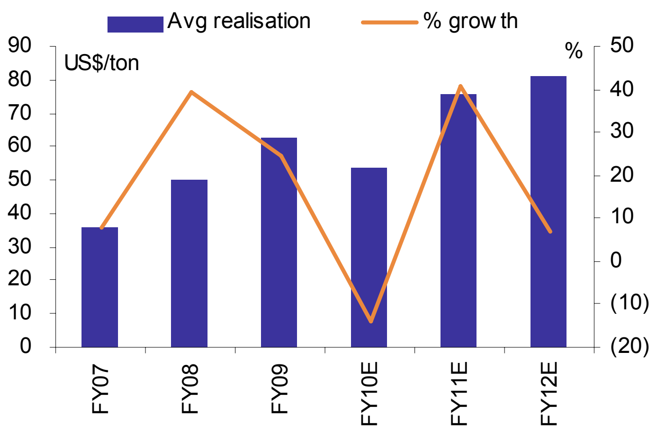
Trading at rich valuations

NMDC will be a major beneficiary of the strong rebound in the demand of iron ore over the next two years. We believe that iron ore prices will remain strong on account of the tight iron ore supply. The jump in sales volume coupled with strong realisations would lead to an earnings CAGR of 18% over FY09-12E. At the lower band of Rs300/share, NMDC will trade at 13.3x FY12 EV/EBIDTA, which is at a huge premium (100%) to its domestic peer Sesa Goa (6.1x FY12EV/EBIDTA) and its international peers (5.8x FY12 EV/EBIDTA). While we believe that NMDC should trade at a premium to its peers considering the high quality iron ore reserves and the low cost operations of the company, the current premium is unjustifiable.

Volume to grow to 33.2mn tons by FY12E

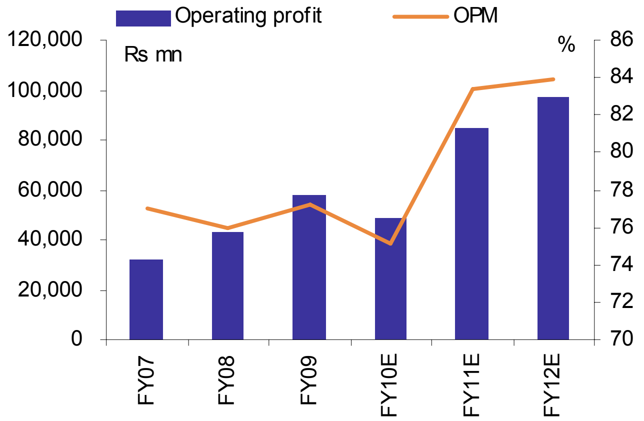


Average realisations to jump 40% yoy in FY11E

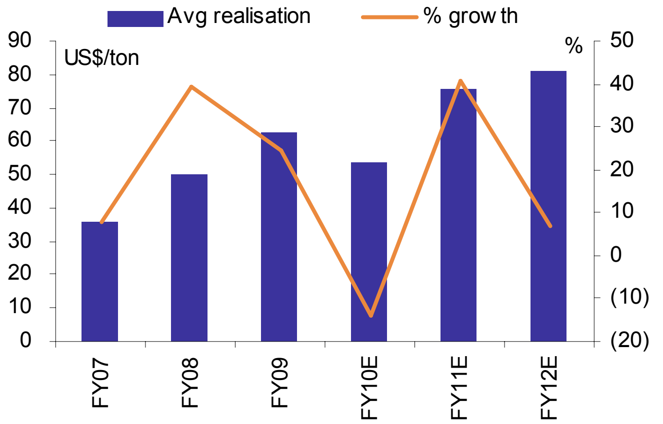


Source: Company, India Infoline Research

OPM to expand to 83.4% in FY11E



PAT to witness an earnings CAGR of 18% over FY09-12E



Source: Company, India Infoline Research

Financials

Income statement

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Revenue	75,640	64,185	101,392	116,104
Operating profit	**58,370**	**48,239**	**84,516**	**97,407**
Depreciation	(736)	(728)	(779)	(857)
Other income	8,848	8,964	10,309	11,855
Profit before tax	**66,482**	**56,475**	**94,046**	**108,405**
Taxes	(22,759)	(17,274)	(31,035)	(35,774)
Net profit	**43,724**	**39,201**	**63,011**	**72,632**

Balance sheet

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Equity capital	3,965	3,965	3,965	3,965
Reserves	112,404	142,415	190,653	246,256
Net worth	**116,369**	**146,379**	**194,617**	**250,220**
Deferred tax liab (net)	581	581	581	581
Total liabilities	**116,950**	**146,960**	**195,198**	**250,801**
Fixed assets	9,949	12,438	17,660	39,803
Investments	708	753	753	753
Net exp written off	222	-	-	-
Net working capital	**9,620**	**6,362**	**11,775**	**13,776**
Inventories	3,009	3,319	4,719	4,864
Sundry debtors	10,165	6,469	10,219	11,702
Other current assets	8,062	6,841	9,726	11,137
Sundry creditors	(4,846)	(4,523)	(7,145)	(8,182)
Other current liabilities	(6,770)	(5,744)	(5,744)	(5,744)
Cash	96,450	127,407	165,011	196,469
Total assets	**116,950**	**146,960**	**195,198**	**250,801**

Cash flow statement

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Profit before tax	66,482	56,475	94,046	108,405
Depreciation	736	728	779	857
Tax paid	(22,759)	(17,274)	(31,035)	(35,774)
Working capital ∆	(6,393)	3,258	(5,413)	(2,002)
Operating cashflow	38,067	43,187	58,377	71,487
Capital expenditure	(3,886)	(3,217)	(6,000)	(23,000)
Free cash flow	**34,181**	**39,970**	**52,377**	**48,487**
Investments	125	(45)	-	-
Dividends paid	(10,251)	(9,191)	(14,773)	(17,029)
Other items	544	222	-	-
Net ∆ in cash	**24,599**	**30,957**	**37,604**	**31,458**

Key ratios

Y/e 31 Mar	FY09	FY10E	FY11E	FY12E
Growth matrix (%)				
Revenue growth	32.4	(15.1)	58.0	14.5
Op profit growth	34.6	(17.4)	75.2	15.3
EBIT growth	34.4	(15.1)	66.5	15.3
Net profit growth	34.5	(10.3)	60.7	15.3
Profitability ratios (%)				
OPM	77.2	75.2	83.4	83.9
EBIT margin	87.9	88.0	92.8	93.4
Net profit margin	57.8	61.1	62.1	62.6
RoCE	66.5	42.8	55.0	48.6
RoNW	43.9	29.8	37.0	32.7
RoA	39.9	27.4	34.5	30.7
Per share ratios				
EPS	11.0	9.9	15.9	18.3
DPS	2.6	2.3	3.7	4.3
Cash EPS	11.2	10.1	16.1	18.5
BVPS	29.4	36.9	49.1	63.1
Payout (%)				
Dividend payout	23.4	23.4	23.4	23.4
Tax payout	34.2	30.6	33.0	33.0
Liquidity ratios				
Debtor days	49	37	37	37
Inventory days	15	19	17	15
Creditor days	23	26	26	26

Du-Pont Analysis

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Tax burden (x)	0.66	0.69	0.67	0.67
Interest burden (x)	1.00	1.00	1.00	1.00
EBIT margin (x)	0.88	0.88	0.93	0.93
Asset turnover (x)	0.69	0.45	0.56	0.49
Fin leverage (x)	1.10	1.09	1.07	1.06
RoE (%)	**43.9**	**29.8**	**37.0**	**32.7**

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

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

Sell – Absolute return below -10%

This report is for the personal information of the authorised recipient and is not for public distribution and should not be reproduced or redistributed without prior permission.

The information provided in the document is from publicly available data and other sources, which we believe, are reliable. Efforts are made to try and ensure accuracy of data however, India Infoline and/or any of its affiliates and/or employees shall not be liable for loss or damage that may arise from use of this document. India Infoline and/or any of its affiliates and/or employees may or may not hold positions in any of the securities mentioned in the document.

The report also includes analysis and views expressed by our research team. The report is purely for information purposes and does not construe to be investment recommendation/advice or an offer or solicitation of an offer to buy/sell any securities. The opinions expressed are our current opinions as of the date appearing in the material and may be subject to change from time to time without notice.

Investors should not solely rely on the information contained in this document and must make investment decisions based on their own investment objectives, risk profile and financial position. The recipients of this material should take their own professional advice before acting on this information.

India Infoline and/or its affiliate companies may deal in the securities mentioned herein as a broker or for any other transaction as a Market Maker, Investment Advisor, etc. to the issuer company or its connected persons.

India Infoline Ltd. One India Bull Center, Jupiter Mill Compound, 841, Senapati Bapat Marg, Nr, Elphinstone Road, Lower Parel (W), Mumbai 400 013.

For Research related queries, write to: Amar Ambani at amar@indiainfoline.com or research@indiainfoline.com
For Sales and Account related information, write to customer care: info@5pmail.com or call on 91-22 4007 1000