

NMDC

Date
23/04/11

Sensex
19602.23

Nifty
5884.7

Sector
Mining

CMP
Rs.280

Face Value
Rs.1/share

Equity Capital
Rs.396.47

52 Week H/L in Rs.
304.90-227.00

Market cap Rs. Cr.
110833.19

Share Holding

	Shares	% holding
Promoters	3568418180	90.000
Fin.Inst.	319177040	8.050
FII	22777954	0.570
Pvt.Corp.	11822471	0.300
NRI's	600340	0.015
Others	527773	0.013
Dir/Emp	84309	0.002
Public	25268782	0.640
Totals	3964716000	100

Summary

NMDC is India's largest producer of high grade iron ore with an average content of 66% iron. 99% of its overall revenue is generated from its iron ore business. The company sells 80% of its iron ore in the domestic market through long term contracts, which get re priced every quarter. As a result of this, it is relatively less impacted by the increase in custom duty from 5% to 20%. Valuations at current levels look expensive as the stock is trading at a P/E of 18.4x and 14.5x on FY11E and FY12E EPS respectively. We recommend a **Sell**.

Introduction of the Company

Incorporated in 1958 as a Government of India fully owned public enterprise, NMDC is India's single largest iron ore producer, presently producing about 30 million tonnes of iron ore from 3 mines in states of Chattisgarh and Karnataka. The Company plans to increase its production capability to around 50 million tonnes per year by 2014-15 through increased exploration of its existing mines and development of new mines. The iron ore deposits in Chattisgarh and Karnataka regions are high grade with an average content of 66% iron. Other than iron ore operations, Company has exploration activities in wide range of minerals including copper, rock phosphate, lime stone, dolomite, gypsum, bentonite, magnesite, diamond, tin, tungsten, graphite, beach sands, etc.

Industry Structure - Global

The Chinese dominance in Global steel

A large economy with world-class infrastructure and the advantage of cheap labour is driving economic growth, further fuelling mega investments in China. The rapid growth in fixed asset investment in China catalyzed an unprecedented addition to steel capacities in the country. As a result, China dominates the global steel industry, accounting for more than a third of the global steel capacity.

China's Steel Data (CY 2009)

Million Tonne	Capacity	Production	Consumption	Export
Global	1802	1223	1121	319
China	716.1	567.8	542.4	24.6
% share	40%	46.40%	48.30%	7.70%

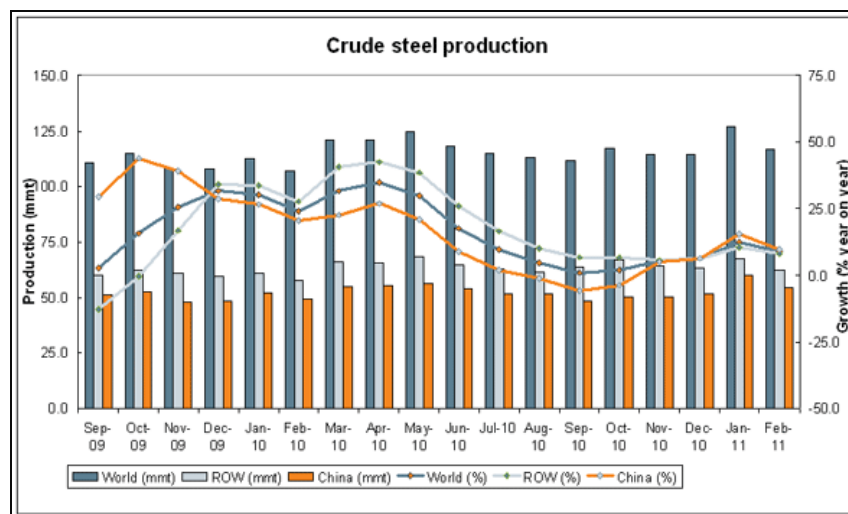
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China’s net addition to its installed capacity was 39 MTPA taking its cumulative installed capacity to an estimated 716 MTPA, when more than 30% of world steel capacity remained non operational across the globe in CY 2009. Chinese steel manufacturers produced 568 million tonnes of steel in 2009, an increase of 14% from the 500 million tonnes in 2008. Domestic steel consumption grew 25% from 435 million tonnes in 2008 to 542 million tonnes in 2009 due to sustained demand from the infrastructure, automotive and housing sectors. The increased domestic consumption led to a huge decline in export from 45 mt to 24.6 mt in 2009. China accounted for more than 48% of the global steel demand in CY 2009.

With its increased consumption of steel, its iron ore dependency has also increased. As cost of producing iron ore is high for marginal producers in China, they are dependent on iron ore imports. With 628 million tonnes, China imported 41% more iron ore in 2009 compared to 2008.

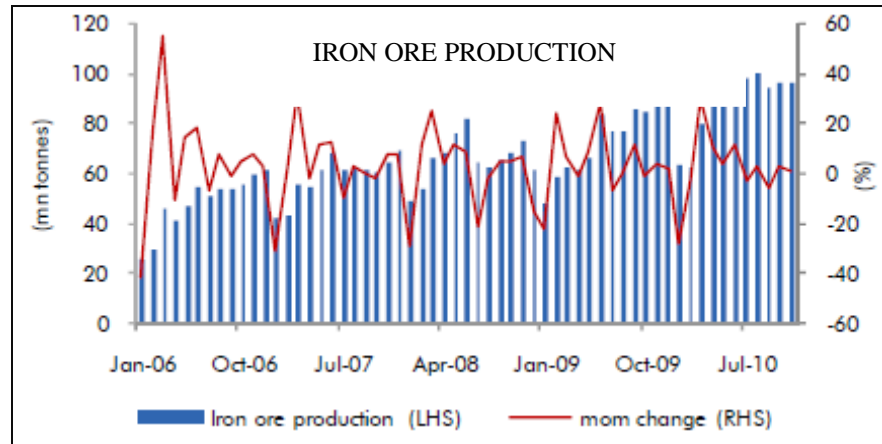
Current scenario

China’s crude steel production for February 2011 was 54.3 mt, up 9.7% compared to February 2010.



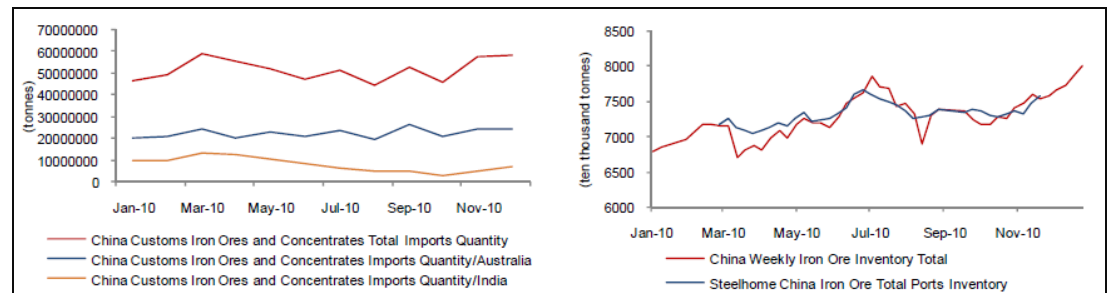
The Australian Bureau of Agricultural and Resource Economics and Sciences expect Chinese crude steel production to increase by 7.5% YOY to 674 mn. tonnes in CY2011.

However, growth in production of iron ore has remained flat during the past quarter.



Although demand for imported iron ore surged on a QOQ basis, iron ore inventories also recorded a 4.5 year high at 80 million tonnes and may bring down the prices of iron ore for short term. For the first time in five years, contract prices of iron ore, the key raw material for making steel has softened, as Japanese Steel mills that account for about 13% of global iron ore consumption, have cut down their requirements following production cutbacks due to turmoil created by tsunami. As a result, the spot price of iron ore is expected to trade around \$155/tonne in the March-June quarter. But spot prices may rebound back in the following quarters, given the prospect of a massive rehabilitation in Japan as well as demand from China. Currently iron ore is trading at \$ 165/tonne, it's lowest since late November.

Chinese iron ore inventory levels



Though Chinese iron ore production is growing, the average grade is falling every year. Moreover, the cost of producing high grade iron ore is high for marginal producers in China. Therefore, they are dependent on imports. Supply from India is expected to come down in 2011 due to rise in export duty of Iron ore to 20% from current rate of 5% thus the tightening of Global supply Further, given the prospect of a massive rehabilitation in Japan could increase demand for steel and hence iron ore. Taking into consideration the above factors we expect the iron ore prices to rebound in the later quarters and remain firm from thereon.

Domestic Outlook

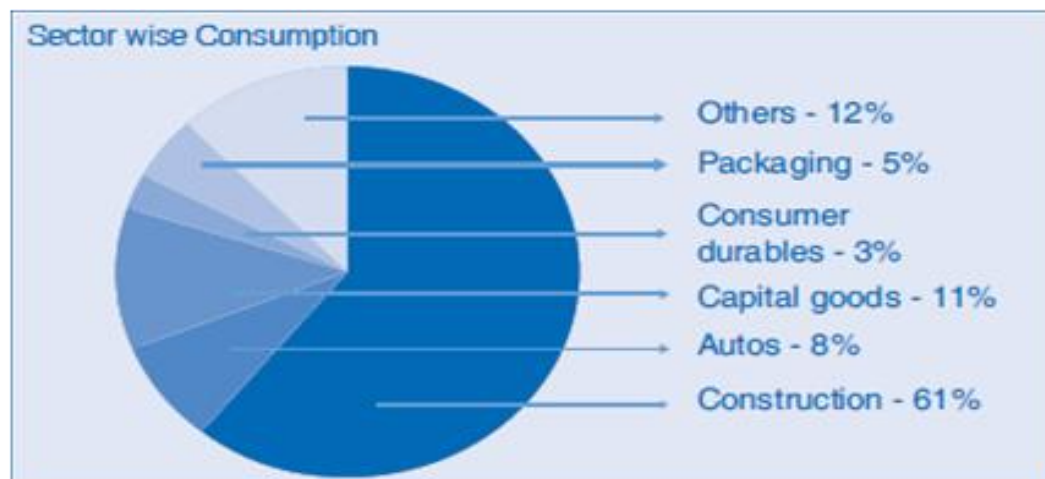
National steel policy in India has set a production goal of 110 million tonnes of steel by the year 2019-20. This requires a compounded annual growth rate of 7.3%. This would require an availability of 190 million tonnes of iron ore for domestic consumption. Therefore, iron ore industry is required to grow at a CAGR of 3.4%.

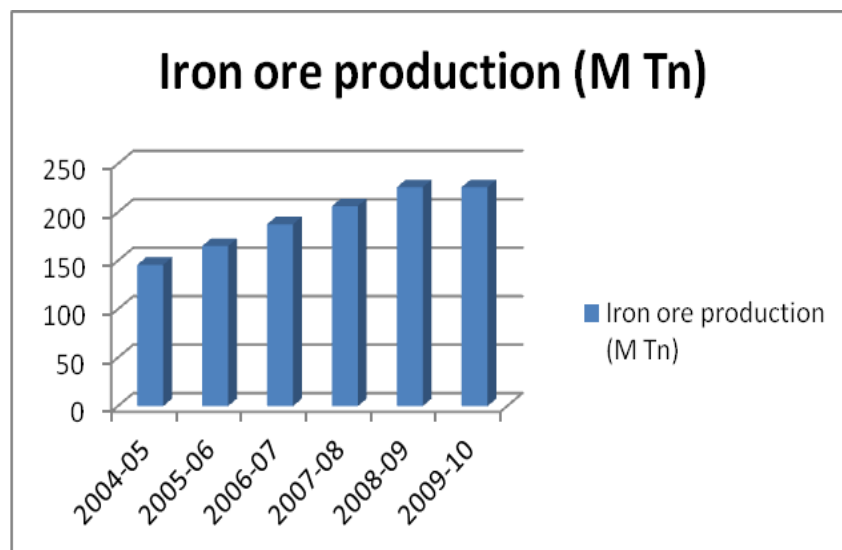
India's Steel Data (FY 2009-2010)

Particulars	2006-07	2007-08	2008-09	2009-2010
Production	52.5	55.2	57.2	59.5
Growth		5.14%	3.62%	4.02%
Imports	4.9	6.9	5.8	7.2
Growth		40.8%	-15.9%	24.13%
Consumption	46.7	51.5	52.3	56.3
Growth		10.2%	1.55%	7.64%
Exports	5.2	5	4.4	3.2
Growth		-3.84%	-12%	-27.27%

The growth in steel demand has outpaced the growth in production during the given period. Whereas the CAGR for production during the given period is 6.5%, CAGR for consumption is 9.1%. The main growth drivers were construction and infrastructure sectors with a share of 61% during the year 2009-10. Over the last five years, India's iron ore production grew at a compounded annual rate of 7.6% to reach 226 million tonnes in 2009-10

Year 2009-10





India's 12th five year plan envisions an investment of 1 trillion dollar in infrastructure. Therefore, steel industry being the backbone to infrastructure will hugely benefit from this investment, thus directly helping the demand of iron ore which is the main raw material for steel.

Products

Iron ore

NMDC has its mining and processing facilities located in Chattisgarh and Karnataka. As of fiscal year 2009-10, the Company produced 23.8 million tonnes of iron ore which contributed to 99.78% of total sales. The Company has access to significant reserves of high grade iron ore, predominantly greater than 64% Fe (iron) content. NMDC estimates its iron ore deposits to be around 1.26 billion metric tonnes. As of fiscal year 2009, 92% of the Company's iron ore sales volumes are made based upon long term sales contracts with its customers. The remaining 8% iron ore sales volume is sold in the spot market.

Diamonds

Company operates a diamond mine in Panna, Madhya Pradesh which is one of the largest diamond mines in Asia with a production capacity of 84000 carats per year. It contributed 0.11% in company's total sales as of Fiscal year 2009-10.

Company Analysis

Quarterly Performance

Rs. in Cr.	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Sales	1587.58	1983.33	2517.99	2459.98	2621.22
Total Expenditure	509.32	604.13	466.88	608.22	598.95
EBITDA	1078.26	1379.2	2051.11	1840.44	2015.89
EBITDA margin(%)	67.92%	69.54%	81.46%	74.82%	76.91%
Depreciation	21.52	25.36	23.72	29.83	29.39
Interest			0	0	0
Other Income	211.51	245.56	221.83	245.87	294.72
EBT	1268.25	1599.4	2249.22	2056.48	2281.22
Tax	431.18	533.81	745.18	677.95	763.19
PAT	837.07	1065.59	1504.04	1378.53	1518.03
PAT margin(%)	52.73%	53.73%	59.73%	56.04%	57.91%

- The net sales increased by 65.2% YOY to Rs.2622 cr. during Q3 FY2011. It was mainly on account of 73% YOY increase in its average sales realization i.e. from \$55/tonne In Q3 FY2010 to \$95/tonne in Q3 FY2011.
- NMDC has increased its export prices of lumps and fines by 94-99% and its domestic price of lumps by 45-54% and fines by 76% in Q1FY2011 compared to Q1FY2010.
- Company's EBITDA margin increased by 900 bps on account of higher sales realization.
- Expenditures grew at a CAGR of 17%, the sales outpaced the expenditure growth at a CAGR of 65%.
- A 36% rise in depreciation to Rs.29.39 cr. in Q3 FY2011 was more than offset by sales realization as profit after tax grew by 81% to Rs.1518.03 cr. and the margin increased by 518 bps.
- The Company reduced the contract price of iron ore by 5% in Q3FY11, which resulted in the lowering of average realization by 7% to \$94.4/tonne as 92% of the revenue is based on contract prices.

Budget impact

The Union Budget 2011-12 has proposed raising the export duty on iron ore to ad valorem 20% on lumps and fines. Currently, lumps are taxed at 15%, while fines are taxed at 5% on ad valorem basis. This will result in the EBITDA margin of NMDC to fall only by 50 bps in spite of the hike as the Company is expected to increase its sales by 20% to 30 million tonnes in FY12E. Moreover, the hike in export duty would be more than offset by the quarterly hikes in the contract prices, thus increasing the average realization.

Growth plans

NMDC is expecting its Chattisgarh steel plant to be operational by 2014. This is the first steel venture of the Company with 3 million tonnes per annum capacity, and is being constructed at a cost of Rs.15500 cr. NMDC had inked a pact with Russia's leading steel maker OJSC Severstal in December 2010 to jointly set up a steel plant with an initial capacity of 2 million tonnes per annum, expandable to 5 million tons per annum later, at an estimated cost of Rs 25,000 cr. The Company is also in talks with Tata Steel to ink an equal joint venture for setting up a 2 million tonnes per annum steel plant at Bastar in Chhattisgarh

Outlook

- NMDC is expected to produce around 30 million tonnes of iron ore in FY12E.
- It may stop exporting iron ore to China at spot price after the increase in export duty to 20%. This export accounts for 8% of net sales. We expect the Company to direct this portion for domestic demand where the realization is \$35-\$40 per tonne lesser than Chinese market. The Company's domestic realization that would account for 8% of net sales for the four quarters of FY12 is represented below in tabular form:

FY12E	China spot price (\$/tonne)	Sales realization in India(\$/tonne)
Q1	160	120
Q2	160	120
Q3	180	140
Q4	180	140

- 92% of the sales are contract based, out of which 13% is exported to Japan and rest 78% is sold in domestic market. We expect the contract prices to increase by 3% during Q1 and Q2 and 5% during Q3 and Q4 due to strong domestic demand and Japan's rehabilitation program.

- We expect the average expense per tonne to increase by approximately \$3 /tonne in FY12E with the hike in export duty to 20%.
- On the basis of above facts, the expected projection of numbers for the four quarters in FY12 is represented below:

	Realization (\$/tonne)	Expenses (\$/tonne)	EBITDA (\$/tonne)
Q1	97.07	20.20	76.86
Q2	100.02	25.82	74.20
Q3	106.60	27.72	78.87
Q4	111.20	31.40	79.79

- Therefore under these assumptions our expected EPS for FY12 comes out to be Rs.19.35.

Valuations

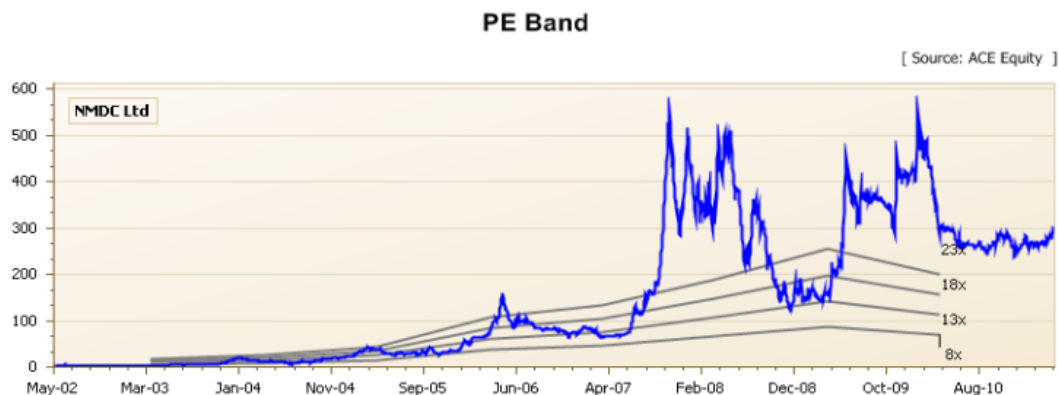
Rs. in Cr.	FY10	FY11(E)	FY12(E)
Sales	6239.09	10653.4	13697
EBITDA	4422.23	8055.09	10289.4
EBITDA margin	70.88%	75.61%	75.12%
PAT	3447.26	6028.49	7674.6
PAT margin (%)	55.25%	56.59%	56.03%
no. of outstanding shares	396.47	396.47	396.47
EPS	8.7	15.2	19.35
Price	280	280	280
P/E(x)	32.2	18.4	14.5
EV/EBITDA(x)	22.2	11.6	8.6

Comparative Valuation

Company	P/E (TTM)*	P/sales (TTM)*	P/book (MRQ)**	EV/tonne (Of iron ore)	EBITDA margin (%)	EV/EBITDA (TTM)
NMDC	20.28	11.55	6.47	17.14	75.77	13.10
Sesa Goa	10.11	4.67	3.35	22.65	52.72	8.60
Rio Tinto	10.07	2.49	2.42	26.36	34.13	6.35
BHP Billiton	16.68	4.49	5.01	24.66	41.22	9.23
Vale	9.37	3.29	2.44	13.66	49.10	6.52

* Trailing twelve month

**Most recent quarter



As can be seen from the above table (comparative valuation), NMDC is trading at a substantial premium to its domestic and global peers in terms of PE x and EV/EBITDA x.

- We understand that the Company is at a premium compared to Sesa Goa due to its less risky business economics as only 20% of its sales are vulnerable to export duty exploits of the Government compared to 90% in Sesa Goa. Moreover the Company has a reserve of 1266 million tonnes of iron ore compared to only 270 million tonnes in case of Sesa Goa.
- But if we compare the Company with its global peers, the premium is not justifiable. These global peers namely BHP Billiton, Vale and Rio Tinto account for 70% of the sea borne iron ore supply. In 2010, the iron ore production for BHP Billiton, Rio Tinto and Vale were 220 mtpa, 184 mtpa and 311 mtpa respectively compared to NMDC's 24 mtpa. BHP Billiton, Rio Tinto and Vale have iron ore reserves to the tune of 3.429 bnt, 3.236 bnt, and 14.96 bnt respectively compared to NMDC's 1.26bnt. The businesses of the global peers apart from iron ore are well diversified in other commodities which help them in de-risking.
- NMDC's move to utilize its cash in setting up integrated steel plants instead of investing in its core business of iron ore/ mining is likely to affect its consolidated EBITDA margins. Though the Company has assured that the cash would also be utilized in buying captive mines for steel, which would not affect the operating margins from the current mines.

As can be seen from the PE band chart, NMDC being in the commodity sector has shown a cyclical trend over the last 10 years, even if we negate the financial crisis that happened in 2008-09. NMDC currently trades at significant premium to its historical average of 13x-15x which we feel is not justifiable.

Recommendation

NMDC being the largest producer of iron ore in India is well poised to participate in the growth story of India when the country is expected to spend \$1 trillion in infrastructure alone. Being the key supplier to major steel companies like SAIL, JSW Steel, Essar Steel, Ispat Industries etc., NMDC is ought to grow northwards with the growth in steel industry which is the backbone of infrastructure. Its forward integrating activities i.e. setting up steel plants will help NMDC to position itself among the major steel makers. On consolidated basis, its revenue is expected to be Rs.13697 cr. by FY12E. Higher demand of steel in India and Rehabilitation program in Japan will be the key growth driver. However, the current valuations at P/E of 18.4x and 14.5x for FY11E and FY12E look expensive. So we recommend a **SELL**.

FINANCIAL PROJECTIONS

Rs. in Crore	FY10	FY11 E	FY12E	BALANCE SHEET	FY10	FY11 E	FY12 E
Net sales	6239.09	10653.44	13697.00	Paid Up Capital	396.47	396.47	396.47
Growth(%)		70.75%	28.57%	Reseves & Surplus	13875.96	18564.75	24443.49
Total				Total shareholders equity	14272.43	18961.22	24839.96
Expenditure	1816.86	2598.35	3407.60	Loan funds		0	0
EBITDA	4422.23	8055.09	10289.4	Deferred tax liability	84.88	93.36	101.77
Growth(%)		82.15%	27.74%	Total	14357.31	19054.58	24941.73
Depreciation	76.62	115.07	153.15	Net fixed assets	787.15	874.91	970.97
Interest	0	0	0	Capital work in progress	556.09	695.11	868.89
Tax	1760.06	3015.81	3953.58	Investments	76.14	79.94	83.94
PAT	3447.26	6028.49	7674.60	Net current assets	12915.95	17383.61	22997.42
Growth(%)		74.88%	27.31%	Miscellaneous Expenses not written off	21.98	21	20.5
EPS	8.69	15.20	19.35	Total	14357.31	19054.58	24941.73
Cash/share	32.38	43.04	56.8				
Key Ratios	FY10	FY11 E	FY12E	working capital ratio	FY10	FY11 E	FY12 E
EBITDA margin(%)	70.88%	75.61%	75.12%	Debtor days	25.0	24.0	25.0
PAT Margin(%)	55.25%	56.59%	56.03%	Creditors days	30.4	24.1	25.3
ROE(%)	24.15%	31.79%	30.90%	Inventory days	17.5	16.0	16.5
ROCE(%)	30.98%	47.70%	46.81%	Working Capital cycle	12.03	15.9	16.2
EV/EBITDA(x)	22.2	11.6	8.6				

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