

BSE SENSEX 35,312 S&P CNX 10,601



**Stock Info**

Bloomberg	NMDC IN
Equity Shares (m)	3,164
M.Cap.(INRb)/(USDb)	291.9 / 4.1
52-Week Range (INR)	163 / 86
1, 6, 12 Rel. Per (%)	-21/-21/-36
12M Avg Val (INR M)	490
Free float (%)	27.6

**Financials Snapshot (INR b)**

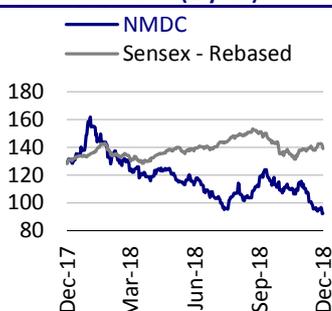
Y/E Mar	2018	2019E	2020E
Net Sales	116.1	106.8	96.2
EBITDA	63.2	61.3	48.8
PAT	41.4	39.2	31.8
EPS (INR)	13.1	12.4	10.0
Gr. (%)	31.5	-5.3	-19.0
BV/Sh (INR)	77.0	81.8	84.7
RoE (%)	17.7	15.6	12.1
RoCE (%)	17.1	14.9	11.5
P/E (x)	7.0	7.4	9.2
P/BV (x)	1.2	1.1	1.1

**Shareholding pattern (%)**

As On	Sep-18	Jun-18	Sep-17
Promoter	72.4	72.4	74.9
DII	19.4	19.1	17.3
FII	3.7	4.0	3.7
Others	4.5	4.5	4.0

FII Includes depository receipts

**Stock Performance (1-year)**



**CMP: INR92 TP: INR110 (+20%) Buy**

**Renewal pre-condition by Karnataka driving stock de-rating**

**Lowering estimates and target price; Maintaining Buy**

Viability of NMDC’s mining operations is threatened by Karnataka’s pre-condition to share of 80% revenue for renewing mining leases of Donimalai, which has capacity of 4mtpa. The outcome of legal and diplomatic settlement may set a precedent for other mines. This was unexpected because public sector enterprises (PSEs) have been getting their leases renewed without sharing of any revenue – e.g. leases of Nalco’s bauxite mines have been recently extended to 2029 and 2032 without any share in revenue; many PSEs have been allotted coal blocks on a nomination basis.

**Demand raised by Karnataka to make mining operations unviable**

We believe that the Karnataka’s government demand for 80% revenue is unreasonable from the company’s perspective because:

- Auction data of captive iron ore mines cannot be used for merchant mines.
- Mining becomes unviable because NMDC’s EBITDA margin is much lower at 50-55%. The margin shrinks sharply at lower prices.
- PSEs are entitled for renewing of leases without sharing of revenue. Other states have been renewing leases without additional share in revenue.

**Chhattisgarh may not ask for share in revenue**

Mining leases of Chhattisgarh are expiring in 2020, but the state may not ask for share in revenue because:

- Chhattisgarh has not been auctioning mines so far, which means there is no comparable data to make a case for demanding share in revenue.
- NMDC operates in Naxal-infested area, where no major private player has been able to mine successfully. If the state government tries to maximize value by auctioning of mines, it will risk production, and thus, the royalties earned.
- NMDC is already investing INR150-200b in a 3mtpa steel plant at Nagarnar to improve industrialization and development in the Baster region. No private steel producer has invested in setting up a steel plant in region despite government allotting them iron ore mines for free.
- Leases of Deposit-13 were renewed for 50 years recently.

**Lowering our earnings estimates**

We are reducing our iron ore sales estimates by 10%/21% to 30.9/32mt for FY19/20 to factor in the loss of volumes (or profit) from the Donimalai mines. EBITDA is reduced by 4/28% to INR62/49b and PAT by 4/30% for FY19/20. The stock trades at EV/EBITDA of 5.2x FY20E and P/E of 9.2x FY20E. We expect the steel plant to start contributing to earnings gradually in FY21.

**Stock is getting de-rated due to uncertainties; Maintain Buy**

The stock is getting de-rated due to uncertainties around longevity of mining profit and delays in commissioning of the steel plant. We, thus, reduce the valuation multiple to 3x FY20E EV/EBITDA (v/s 5x earlier) and book value for cost of steel plant. Consequently, we value the stock at INR110/share. Maintain **Buy**.

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**Investors are advised to refer through important disclosures made at the last page of the Research Report.**

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**Exhibit 1: Key operating metrics**

	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Iron ore production - m tons	25.2	27.8	27.2	30.0	31.0	28.6	34.0	35.6	29.6	32.0
Iron ore sales volume - m tons	26.2	27.3	26.3	30.5	30.5	28.8	35.6	36.1	30.9	32.0
Blended realization - INR/t	4,320	4,125	4,074	3,954	4,049	2,239	2,479	3,220	3,458	3,005
Operating expenses - INR/t	1,036	855	1,112	1,278	1,383	1,025	1,217	1,468	1,474	1,481
Royalty/FDT/Cess	355	375	491	442	573	371	429	615	599	547
Selling	432	53	311	442	383	145	204	177	174	280
Mining	249	427	309	394	427	510	585	675	701	654
EBITDA - INR/t	3,284	3,270	2,963	2,676	2,666	1,214	1,262	1,752	1,985	1,524

Source: MOSL

**Demand raised by Karnataka to make mining operations unviable**

Steel producers have on an average agreed to pay little over 100% of mining revenue for winning iron ore leases in the recent auctions. It is very clear that steel producers are cross subsidizing. Demand is outstripping supply in the state. Imports are filling the gap, which are expensive purely due to higher transportation cost. Steel producers can cross subsidize only some part of raw material cost, not all. In order words, if supply of leases matches or outstrips demand, the bidding price will collapse. Therefore, it is unfair to assume that steel producers will pay similar premium for remaining mines.

Merchant mines or large captive mines are unlikely to get high bids

Paying capacity of merchant mines is far lower because mining is their main source of earnings. Notably, there has been no such auction of leases so far for pure merchant purpose. Therefore, it is not fair on part of Karnataka government to demand 80% revenue based on results of the captive mines auction, especially when the miner makes much lower EBITDA margin of 50-55%. Also, PSEs are entitled for renewing of leases without sharing of revenue, which the Karnataka government is contesting. The outcome of legal and/or diplomatic settlement will set a precedent for another mine in the same state i.e. 7mtpa Kumarswamy leases, which are expiring in 2022.

**Chhattisgarh may not demand share in revenue**

The mining leases of Kirandul and Bachel Complex had expired over 2015-17. However, NMDC is permitted to continue producing until 31<sup>st</sup> March 2020, according to the extension granted to merchant mines under the MMDRA-Act-2015. NMDC has already applied for renewal, while the approval is awaited. Will Chhattisgarh government too demand share in revenue is a key question if NMDC agrees to share revenue with Karnataka? State government will have to evaluate the following before it asks for share in revenue.

Chhattisgarh government will have to evaluate some points before it asks for share in revenue

- Chhattisgarh has not been auctioning mines so far, which means there is no comparable data to make a case for demanding share in revenue.
- NMDC operates in Naxal-infested area, where no major private player has been able to mine successfully. If state government tries to maximize value by auctioning of mines, it will risk production, and thus, royalties earned.
- NMDC is already investing INR150-200b in a 3mtpa steel plant at Nagarnar to improve industrialization and development in the Baster region. No private steel producer has invested in setting up a steel plant in region, despite the government allotting them iron ore mines for free.
- 10mtpa capacity Deposit-13 mining leases have been granted for 50 years.

Therefore, we believe it is less likely that Chhattisgarh government will demand share in revenue for renewing leases.

### Exhibit 2: Mining leases

Mines	Lease area (Ha)	Extraction capacity (mtpa)	Lease Original	Validity extended	Proven reserves (m tons)	Fe %
<b>Merchant mining</b>						
<b>Kirandul Complex, Chhattisgarh</b>						
Deposit 14	322.4	5	2015	2020	132.2	64.7
Deposit 14 NMZ	506.7	7	2015	2020	63.9	65.8
Deposit 11C		0.7	2017	2020	0.7	64.7
<b>Bacheli Complex, Chhattisgarh</b>						
Deposit 5	540.1	10	2015	2020	43.5	65.4
Deposit 10	309.3		2015	2020	142.4	65.9
Deposit 11A	874.9	5	2017	2020	25.6	65.5
Deposit 11B		7			114.3	
<b>Donimalai Complex, Karnataka</b>						
Donimalai	608	4	2018	?	22.1	66.3
Kumarswamy		7	2022	2022	130.9	
<b>Captive, Chhattisgarh</b>						
Deposit 13		10		2067	319.6	65.5
		45.7			995.2	

Source: MOSL, Company

### Lowering our earnings estimates

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### Exhibit 3: Sum of the parts valuation

Y/E March	2016	2017	2018	2019E	2020E	2021E	2022E
<b>Iron ore</b>							
EBITDA per ton (INR)	1,214	1,262	1,752	1,985	1,524	1,494	1,464
Volumes (m tons)	28.8	35.6	36.1	30.9	32.0	33.6	35.3
<b>3mtpa steel with captive ore</b>							
EBITDA per ton (INR)						5,000	10,000
Volumes (m tons)						1.0	3.0
<b>EBITDA</b>	<b>34,998</b>	<b>44,944</b>	<b>63,198</b>	<b>61,293</b>	<b>48,756</b>	<b>55,199</b>	<b>81,642</b>
Target EV/EBITDA(x)					3.0	5.0	5.0
Target EV					146,268	275,993	408,212
Less: Net Debt	-132,666	-52,893	-49,381	-47,733	-37,474	-30,382	-43,096
Add: CWIP	97,229	118,314	125,199	145,199	165,199	80,199	-4,801
Equity Value					348,941	386,574	446,507
<b>Target price (INR/share)</b>					<b>110</b>	<b>122</b>	<b>141</b>

Source: MOSL

## Financials and Valuations

Income Statement							(INR Million)	
Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
<b>Net Sales</b>	<b>107,043</b>	<b>120,582</b>	<b>123,564</b>	<b>64,556</b>	<b>88,294</b>	<b>116,149</b>	<b>106,807</b>	<b>96,153</b>
Change (%)	-4.9	12.6	2.5	-47.8	36.8	31.5	-8.0	-10.0
<b>EBITDA</b>	<b>77,838</b>	<b>81,604</b>	<b>81,369</b>	<b>34,998</b>	<b>44,944</b>	<b>63,198</b>	<b>61,293</b>	<b>48,756</b>
EBITDA Margin (%)	72.7	67.7	65.9	54.2	50.9	54.4	57.4	50.7
Depreciation	1,385	1,504	1,622	2,078	1,962	2,560	2,822	3,299
<b>EBIT</b>	<b>76,452</b>	<b>80,100</b>	<b>79,747</b>	<b>32,920</b>	<b>42,982</b>	<b>60,638</b>	<b>58,471</b>	<b>45,457</b>
Interest	0	0	0	0	0	371	205	0
Other Income	22,389	20,945	23,200	17,744	9,088	5,197	3,728	1,253
Extraordinary items	-4,058	455	0	-1,848	-8,933	-5,309	-1,782	0
<b>PBT</b>	<b>94,783</b>	<b>101,500</b>	<b>102,946</b>	<b>48,816</b>	<b>43,137</b>	<b>60,155</b>	<b>60,213</b>	<b>46,710</b>
Tax	31,228	33,391	33,460	14,769	17,038	22,093	22,121	14,947
Tax Rate (%)	32.9	32.9	32.5	30.3	39.5	36.7	36.7	32.0
Min. Int. & Assoc. Share	0	0	0	0	0	0	0	0
<b>Reported PAT</b>	<b>63,556</b>	<b>68,110</b>	<b>69,487</b>	<b>34,047</b>	<b>26,099</b>	<b>38,062</b>	<b>38,091</b>	<b>31,763</b>
<b>Adjusted PAT</b>	<b>66,277</b>	<b>67,804</b>	<b>69,487</b>	<b>35,335</b>	<b>31,504</b>	<b>41,421</b>	<b>39,218</b>	<b>31,763</b>
Change (%)	-9.2	2.3	2.5	-49.1	-10.8	31.5	-5.3	-19.0

Balance Sheet							(INR Million)	
Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
Share Capital	3,965	3,965	3,965	3,965	3,164	3,164	3,164	3,164
Reserves	271,145	295,918	319,353	297,146	222,026	240,374	255,686	264,669
<b>Net Worth</b>	<b>275,110</b>	<b>299,883</b>	<b>323,317</b>	<b>301,110</b>	<b>225,189</b>	<b>243,538</b>	<b>258,850</b>	<b>267,833</b>
Debt	0	0	0	14,970	0	5,001	5,001	5,001
Deferred Tax	1,045	1,073	984	1,222	6,112	7,141	7,141	7,141
<b>Total Capital Employed</b>	<b>276,155</b>	<b>300,956</b>	<b>324,301</b>	<b>317,302</b>	<b>231,301</b>	<b>255,680</b>	<b>270,992</b>	<b>279,975</b>
Gross Fixed Assets	26,025	28,506	29,446	37,304	39,724	49,473	53,473	57,473
Less: Acc Depreciation	13,379	14,883	16,109	18,234	20,196	22,756	25,579	28,878
<b>Net Fixed Assets</b>	<b>12,647</b>	<b>13,623</b>	<b>13,337</b>	<b>19,070</b>	<b>19,528</b>	<b>26,717</b>	<b>27,895</b>	<b>28,596</b>
Capital WIP	32,361	52,769	77,100	97,229	118,314	125,199	145,199	165,199
Investments	2,497	2,504	5,619	6,954	7,270	7,865	7,865	7,865
<b>Current Assets</b>	<b>261,439</b>	<b>245,874</b>	<b>248,642</b>	<b>210,203</b>	<b>111,909</b>	<b>126,311</b>	<b>124,701</b>	<b>112,400</b>
Inventory	6,375	6,812	6,919	6,370	5,400	5,717	5,852	5,269
Debtors	10,822	14,484	17,523	18,961	10,435	14,727	14,631	13,172
Cash & Bank	210,258	186,572	184,431	147,636	52,893	54,382	52,734	42,475
Loans & Adv, Others	33,985	38,005	39,768	37,237	43,181	51,484	51,484	51,484
<b>Curr Liabs &amp; Provns</b>	<b>32,788</b>	<b>13,814</b>	<b>20,397</b>	<b>16,154</b>	<b>25,719</b>	<b>30,411</b>	<b>34,668</b>	<b>34,084</b>
Curr. Liabilities	11,094	11,092	2,263	3,244	1,988	1,595	5,852	5,269
Provisions	21,694	2,722	18,134	12,909	23,731	28,815	28,815	28,815
<b>Net Current Assets</b>	<b>228,650</b>	<b>232,060</b>	<b>228,245</b>	<b>194,050</b>	<b>86,190</b>	<b>95,900</b>	<b>90,034</b>	<b>78,316</b>
<b>Total Assets</b>	<b>276,155</b>	<b>300,956</b>	<b>324,301</b>	<b>317,302</b>	<b>231,301</b>	<b>255,680</b>	<b>270,992</b>	<b>279,975</b>

## Financials and Valuations

### Ratios

Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
<b>Basic (INR)</b>								
<b>EPS</b>	<b>16.7</b>	<b>17.1</b>	<b>17.5</b>	<b>8.9</b>	<b>10.0</b>	<b>13.1</b>	<b>12.4</b>	<b>10.0</b>
Cash EPS	17.1	17.5	17.9	9.4	10.6	13.9	13.3	11.1
Book Value	69.4	75.6	81.5	75.9	71.2	77.0	81.8	84.7
DPS	7.0	8.5	8.6	11.0	5.2	5.3	6.0	6.0
Payout (incl. Div. Tax.)	51.1	57.9	42.2	172.4	74.9	52.9	59.8	71.7
<b>Valuation(x)</b>								
P/E	5.5	5.4	5.2	10.3	9.2	7.0	7.4	9.2
Cash P/E	5.4	5.3	5.1	9.7	8.7	6.6	6.9	8.3
Price / Book Value	1.3	1.2	1.1	1.2	1.3	1.2	1.1	1.1
EV/Sales	1.4	1.5	1.5	3.6	2.7	2.1	2.3	2.6
EV/EBITDA	2.0	2.2	2.2	6.6	5.3	3.8	4.0	5.2
Dividend Yield (%)	7.6	9.2	9.3	12.0	5.6	5.8	6.5	6.5
EV/ton	2	2	2	3	2	3	3	3
<b>Profitability Ratios (%)</b>								
RoE	25.5	23.6	22.3	11.3	13.5	17.7	15.6	12.1
RoCE	25.4	23.5	22.2	11.0	11.5	17.1	14.9	11.5
RoIC	183.0	119.2	92.6	37.4	44.0	63.4	55.4	47.7
<b>Turnover Ratios (%)</b>								
Asset Turnover (x)	0.4	0.4	0.4	0.2	0.4	0.5	0.4	0.3
Debtors (No. of Days)	37	44	52	50	43	46	50	50
<b>Leverage Ratios (%)</b>								
Net Debt/Equity (x)	-0.8	-0.6	-0.6	-0.4	-0.2	-0.2	-0.2	-0.1

### Cash Flow Statement

(INR Million)

Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
Adjusted EBITDA	77,838	81,604	81,369	34,998	44,944	63,198	61,293	48,756
Non cash opr. exp (inc)	18,331	21,400	23,200	15,896	155	-483	1,742	1,253
(Inc)/Dec in Wkg. Cap.	-5,281	-27,095	-11,975	93	13,117	-8,221	4,218	1,459
Tax Paid	-31,228	-33,391	-30,314	-17,373	-18,942	-23,057	-22,121	-14,947
Other operating activities	5	-3,880	-7,655	-4,455	406	2,774	0	0
<b>CF from Op. Activity</b>	<b>59,665</b>	<b>38,639</b>	<b>54,624</b>	<b>29,159</b>	<b>39,679</b>	<b>34,211</b>	<b>45,132</b>	<b>36,522</b>
(Inc)/Dec in FA & CWIP	-19,563	-22,888	-24,331	-20,242	-23,505	-16,635	-24,000	-24,000
<b>Free cash flows</b>	<b>40,102</b>	<b>15,751</b>	<b>30,293</b>	<b>8,918</b>	<b>16,174</b>	<b>17,577</b>	<b>21,132</b>	<b>12,522</b>
(Pur)/Sale of Invt	-19	-7	-3,116	-1,335	-316	-595	0	0
Others	0	0	0	0	0	0	0	0
<b>CF from Inv. Activity</b>	<b>-19,582</b>	<b>-22,895</b>	<b>-27,447</b>	<b>-21,576</b>	<b>-23,821</b>	<b>-17,229</b>	<b>-24,000</b>	<b>-24,000</b>
Inc/(Dec) in Net Worth	0	0	0	0	-76,078	0	0	0
Inc / (Dec) in Debt	0	0	0	14,970	-14,970	5,001	0	0
Interest Paid	0	0	0	0	0	0	0	0
Divd Paid (incl Tax) & Others	-32,471	-39,429	-29,318	-58,694	-19,553	-20,122	-22,780	-22,780
<b>CF from Fin. Activity</b>	<b>-32,471</b>	<b>-39,429</b>	<b>-29,318</b>	<b>-43,724</b>	<b>-110,601</b>	<b>-15,122</b>	<b>-22,780</b>	<b>-22,780</b>
<b>Inc/(Dec) in Cash</b>	<b>7,612</b>	<b>-23,685</b>	<b>-2,141</b>	<b>-36,141</b>	<b>-94,743</b>	<b>1,860</b>	<b>-1,648</b>	<b>-10,259</b>
Add: Opening Balance	202,646	210,258	186,572	184,431	147,636	52,893	54,382	52,734
<b>Closing Balance</b>	<b>210,258</b>	<b>186,572</b>	<b>184,431</b>	<b>148,290</b>	<b>52,893</b>	<b>54,753</b>	<b>52,734</b>	<b>42,475</b>

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

\*In case the recommendation given by the Research Analyst becomes inconsistent with the investment rating legend, the Research Analyst shall within 28 days of the inconsistency, take appropriate measures to make the recommendation consistent with the investment rating legend.

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