Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

NMDC Limited

Multiple catalysts for re-rating

Metal & Mining	Sharekhan code: NMDC	Company Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco
Reco: **Buy**
CMP: **Rs. 137**
Price Target: **Rs. 165**

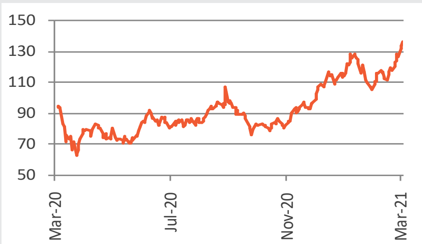
Company details

Market cap:	Rs. 40,032 cr
52-week high/low:	Rs. 137/62
NSE volume: (No of shares)	104.5 lakh
BSE code:	526371
NSE code:	NMDC
Free float: (No of shares)	92.9 cr

Shareholding (%)

Promoters	69.7
FII	4.5
DII	20.4
Others	5.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	17	28	46	45
Relative to Sensex	16	14	12	11

Sharekhan Research, Bloomberg

Summary

- We re-initiate coverage on NMDC with a Buy rating and PT of Rs. 165 as valuation of 3.7x FY23E EV/EBITDA for core business factors in risks associated with higher royalty payout but ignores value unlocking from Nagarnar Steel Plant.
- Multiple triggers for higher iron ore production given re-start of Donimalai mine, expansion for Kumarasamy mines and debottlenecking at Chhattisgarh mines. We expect 30%/7% y-o-y growth in iron ore sales volume to 43mt/46mt in FY22E/FY23E.
- Higher volume and elevated iron ore price (given high international price >$150-160/ton currently and likely iron ore deficit in domestic market until FY23) would cushion NMDC's earnings from potential royalty premium (assumed at 22.5%).
- Strategic sale of Nagarnar Steel plant would result into value unlocking of CWIP of Rs16,500 crore and could add further value (~Rs22-25/share) to the stock as street is ascribing only 50% value to steel plant.

NMDC (NMDC) is in a sweet spot and is expected to benefit from sustained high domestic iron ore prices as a supply deficit in the domestic market is likely to remain until FY2023 (ramp-up of production at the Odisha mines would take time) and sustained elevated international iron ore prices >$110-120/tonne over FY2022E-FY2023E (high demand from China and lower production guidance by Vale). Additionally, NMDC would witness meaningful ramp-up in iron ore production volume over FY2022E-FY2023E led by resumption of production at Donimalai mine (capacity of 7 mtpa) in Karnataka and capacity expansion at Kumarasamy/ Chhattisgarh mines. We thus expect NMDC's iron ore sales volume to grow strongly by 30%/7% y-o-y to 43 mt/46 mt in FY22E/FY23E. Robust pricing environment and volume growth would largely negate the likely negative impact of higher royalty demand (royalty premium of 22.5%) from the Karnataka state government. Potential value unlocking from strategic sale of the 3-mtpa Nagarnar Steel Plant (CWIP of Rs. 16,500 crore or Rs. 54/share), which is not fully factored in into the consensus valuation, could add Rs. 22-25/share to NMDC's valuation. Valuation of 3.7x FY2023E EV/EBITDA (excluding value of CWIP at 0.6x for steel plant) seems attractive as compared to average of 6.3x FY23E EV/EBITDA for global mining companies given NMDC's decent return ratios (RoE/RoCE of 15%). Moreover, we expect NMDC's dividend payout (DPS of Rs. 5-6 historically) could improve considerable post the likely strategic sale of the steel plant given a potential higher cash position and steady EBITDA outlook (Rs. 6,500-7,000 crore) for the core iron ore mining business. Hence, we re-initiate coverage on NMDC with a Buy rating and PT of Rs. 165 (Rs. 133/share for the core iron ore mining business and Rs. 32/share for steel plant valued at 0.6x CWIP of Rs. 16,500 crore).

Our Call

Valuation – Re-initiate coverage on NMDC with Buy rating and PT of Rs. 165: NMDC's valuation of 3.7x FY2023E EV/EBITDA (excluding value of steel plant at 0.6x CWIP) is attractive as it is at a steep discount of 41% to average EV/EBITDA multiple of 6.3x for global mining peers despite decent return ratios (RoE/RoCE of 15%). Value unlocking from demerger and potential strategic sale of the steel plant and resumption of Donimalai are key re-rating catalysts. Additionally, the likely finalisation of royalty (premium assumed at 22.5%) in the coming months would remove the key overhang on the stock and focus would shift back to strong fundamentals of NMDC. Hence, we re-initiate coverage on NMDC with a Buy rating and PT of Rs. 165 (Rs. 133/share for the core iron ore mining business and Rs. 32/share for the steel plant valued at 0.6x CWIP of Rs. 16,500 crore).

Key Risks

A sharp fall in the domestic and international iron ore price, a potential delay in volume pick-up and royalty premium of more than 22.5% for mine lease renewals could impact earning and valuation. Delay in demerger and strategic sale of steel plant beyond FY2022 could impact value unlocking timeline.

Valuation (consolidated) Rs cr

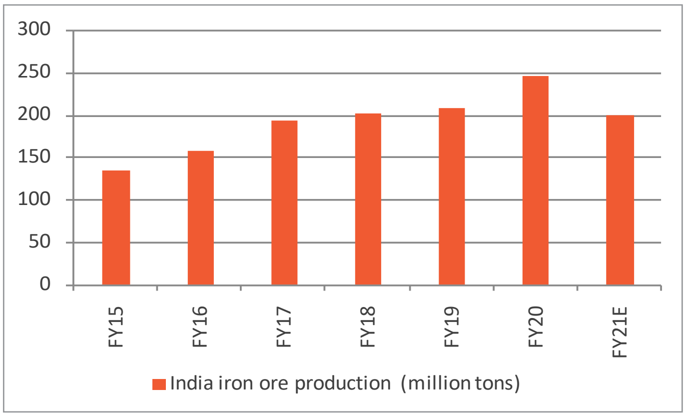
Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	12,153	11,699	14,067	17,217	18,417
OPM (%)	57.0	51.3	64.1	36.6	36.7
Adjusted PAT	4,619	3,671	6,967	4,980	5,386
% YoY growth	26.1	-20.5	89.8	-28.5	8.2
Adjusted EPS (Rs.)	15.1	12.0	22.8	16.3	17.6
P/E (x)	9.1	11.4	6.0	8.4	7.8
P/B (x)	1.6	1.5	1.3	1.2	1.1
EV/EBITDA (x)	5.4	6.7	3.9	5.7	5.2
RoNW (%)	18.3	13.7	23.5	15.0	14.9
RoCE (%)	24.8	19.7	25.7	15.1	15.1

Source: Company; Sharekhan estimates

Tight domestic iron ore supply situation and elevated international prices put NMDC in sweet spot

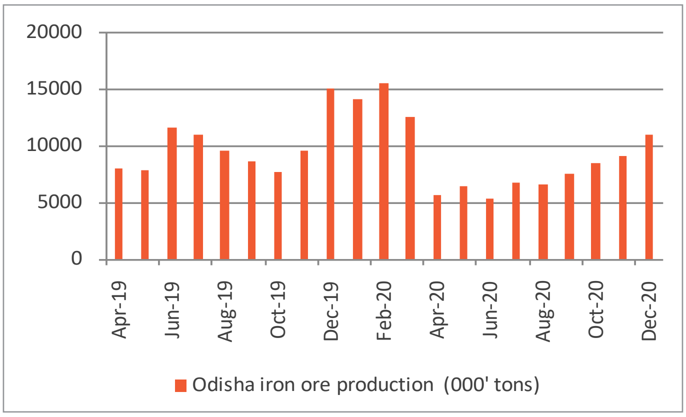
India's iron ore production is expected to fall by ~17-18% in FY2021E due to the COVID-led lockdown in Q1FY2021 and a delayed ramp-up in iron ore production in Odisha (largest iron ore producing state, which has seen ~25% drop in output). Industry experts believe that mines that were put up for auction in Odisha have not reached their earlier production levels and are not expected to do so even in FY2022. The Odisha mines have been acquired at over a 100% premium and are not expected to start production in the near term because of problems in transfer of ownership. Additionally, iron ore exports are also expected to rise further in FY2022 (already up 54% in recent months) given higher international iron ore prices and would reduce domestic availability of iron ore. This is expected to keep domestic iron ore supply into deficit till FY2023 as demand is likely to remain strong driven by rising steel production (iron ore is key raw material in steel-making).

India iron ore production



Source: Indian Bureau of Mines, Industry reports; Sharekhan Research

Odisha Iron ore production declined sharply by 25% y-o-y in 9MFY21



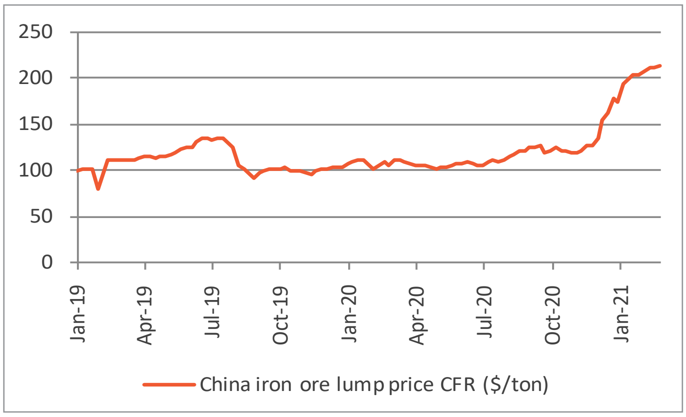
Source: Indian Bureau of Mines, Industry reports; Sharekhan Research

We expect India's iron ore demand to be strong over FY2022-FY2023 led by a double-digit growth in steel production. Our positive stance on steel production/demand stem from multiple factors such as a strong retail demand emanating from a thriving rural economy and green shoots of recovery in white goods and the automobiles sector, especially from tractors, passenger vehicles and two-wheelers. The cumulative domestic steel demand in October-November has already surpassed the pre-COVID-19 levels and demand momentum is expected to sustain given higher infrastructure spending by the government. Globally, a rising focus on a stimulus in China would sustain the recent economic revival and drive steel production higher in the neighbouring country.

NMDC hikes domestic iron ore lumps/fines by 2.3x/2.1x since May 2020 – bodes well for realisation

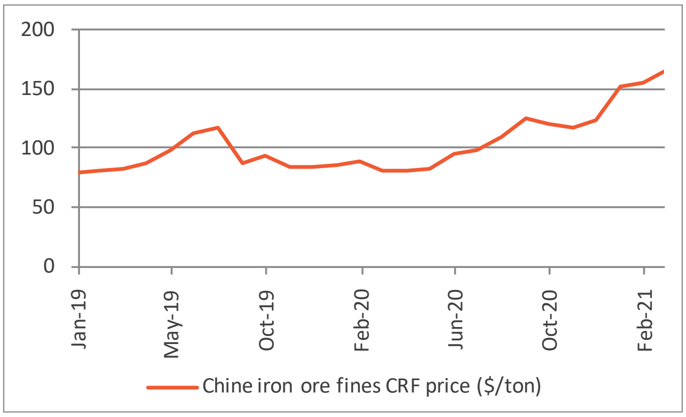
International iron ore price has increased sharply to >$150/ton led by robust iron ore demand from Chinese steelmakers while on the other hand, global players such as Vale lowered production guidance to 315-335 million tonnes for CY2021 (versus the earlier guidance of 375 million tonnes). Higher demand and a lower iron ore production outlook would keep international iron ore price >110-120/tonne over FY2022E-FY2023E. Our optimism for higher domestic iron ore price is also supported by rising Indian iron ore exports (expected to increase to 28% of domestic production in FY2021 versus FY2019/FY2020 level of 8%/15%) as profitability remain strong for exports volume at $65/tonne or Rs4,680/tonne. Hence, we believe that the increased global iron prices and expectation of iron ore deficit in India markets until FY2023 (till Odisha mines production is back to normal levels) would help sustain high domestic iron prices and resultantly higher average selling price for NMDC over FY2022E-FY2023E. Also, NMDC iron ore lump/fines price are at steep discount to 65/63% to international prices which is expected to cushion domestic price from the decline in international prices.

China iron ore lump price CFR



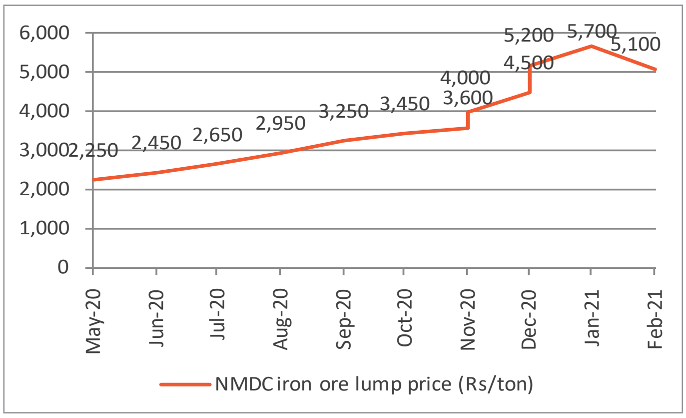
Source: Bloomberg

Chine iron ore fines CRF price



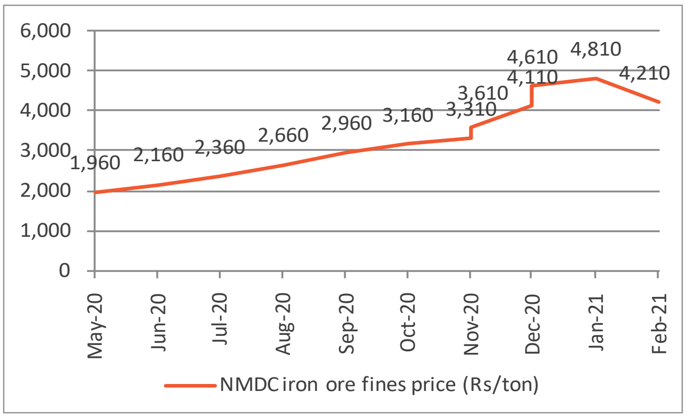
Source: Bloomberg

NMDC iron ore lump price (up 2.3x since May 2020)



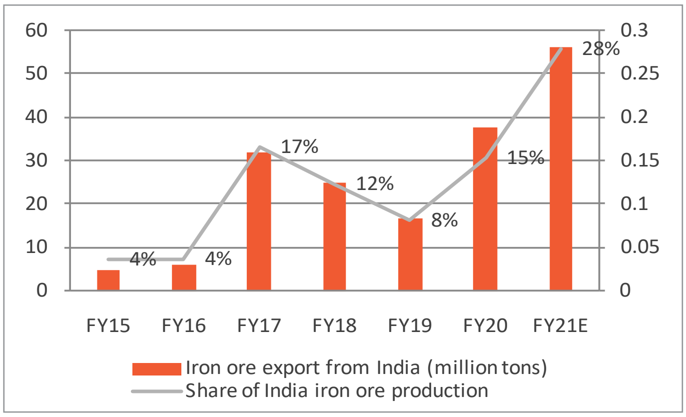
Source: Company

NMDC iron ore fines price (up 2.1x since May 2020)



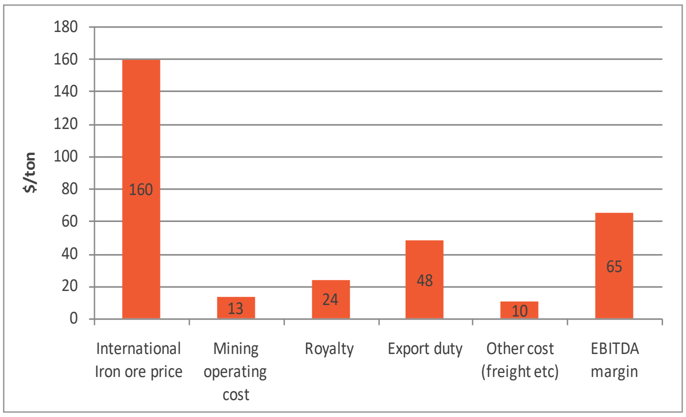
Source: Company

India iron ore exports to rise sharply



Source: Ministry of Mines; Sharekhan Research

Supported by higher international price and better margins



Source: Sharekhan Research

Winners in Odisha block auctions at very high premiums

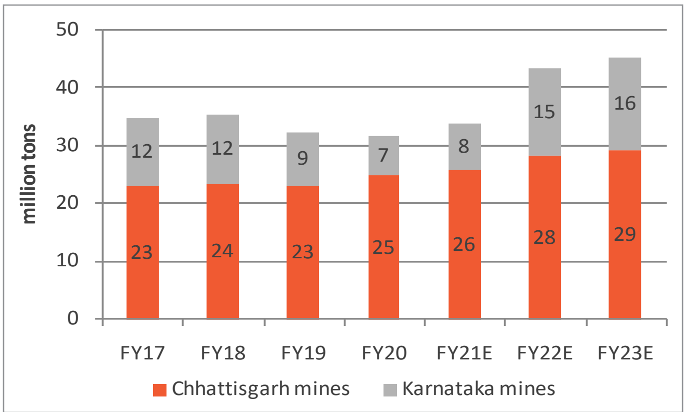
Mine Block	Capacity (mtpa)	Winner	Premium
Narayanpasi	6.00	JSW Steel	99%
Nuagaon	5.62	JSW Steel	95%
Balda Block	15.15	Serajuddin	119%
Thakurani	5.50	ArcelorMittal	108%
Nadidih BICO	5.30	Fomento Resources	141%
Jurudi	2.10	Jagat Janani	126%
Badampahar	1.50	GM Iron and Steel Company Ltd	95%
Gonua	1.20	JSW Steel	132%
Nadidih Feegrade	7.45	Vishal LPG	142%
Jilling- Langalota	6.28	Shyam Metalliks	135%
Teherai	2.50	Tarama Appartment	93%
Jaribahal	0.99	Kashvi International	150%
Gorumahisani	0.75	Ghanshyam Mishra	115%
Tanto, Roida - II	3.50	KN Ram	91%
Siljora-Kalimati	0.14	Debabrata Behera	154%
Mahulsukha	0.04	Patnaik Minerals	93%
Jajang	16.50	JSW Steel	110%
Kolmong	0.04	Yazdani Steel	100%
Total	**80.56**		**116%**

Source: Ministry of mines; Industry sources

NMDC's iron ore output to surge with resumption of production at Donimalai mine; volume ramp-up likely to offset higher royalty demand

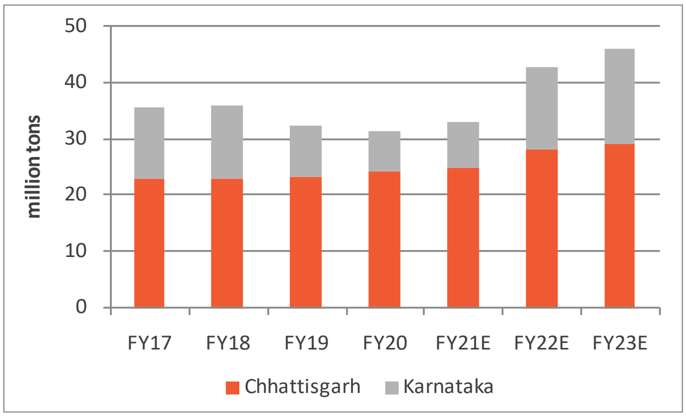
NMDC's iron ore production/sales volume has been in the range of 29-36 million tons over FY2016-FY2020 as benefit of ramp-up from Chhattisgarh mine to 23 million tons was offset by shutdown of Donimalai mines in Karnataka (which has a capacity of 7 mtpa and is non-operational since November 2018). Recently, NMDC has resumed iron ore production from its Donimalai mine in Karnataka as it has completed statutory requirements after it received approval of a lease extension for 20 years from the state government of Karnataka. Moreover, the company is expanding capacity for its Kumarasamy mines in Karnataka to 10 mtpa from 7 mtpa currently and also expanding production in Chhattisgarh by the addition of screening lines and debottlenecking. Hence, we expect NMDC iron ore sales volume to pick-up sharply by 30%/7% y-o-y to 43mt/46mt in FY2022E/FY2023E.

NMDC iron ore production to improve sharply over FY22E-FY23E...



Source: Company; Sharekhan Research

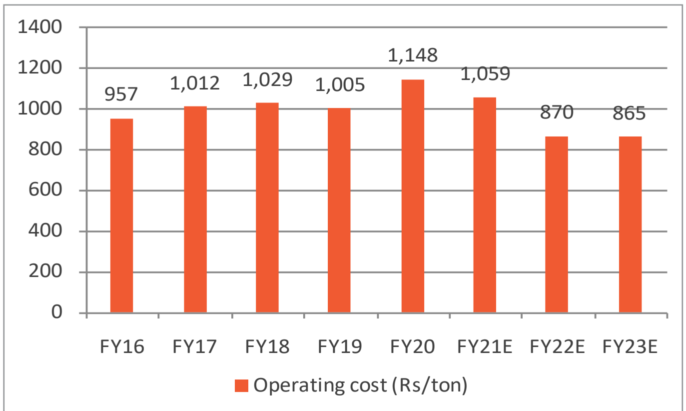
...driving up iron ore sales volumes



Source: Company; Sharekhan Research

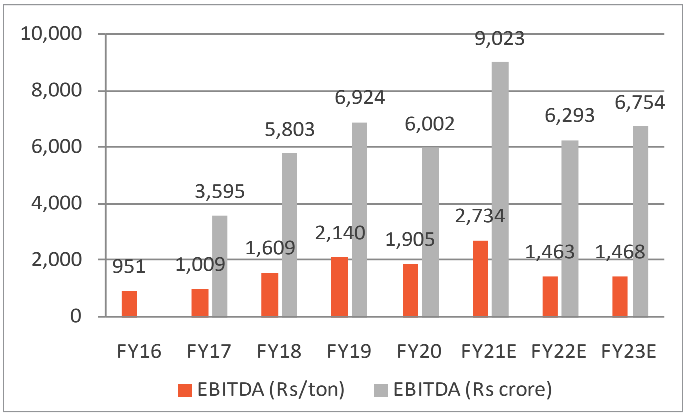
NMDC has witnessed issues with respect to a higher royalty demand from Karnataka state government for renewal of the Donimalai mine. Thus, an additional premium of 22.5% has been suggested for Donimalai (over and above the usual 15% royalty and DMF and NMET charges to customers) until there are new amendments to the law. On a conservative basis, we have assumed 22.5% royalty premium for NMDC's all iron ore mines in Chhattisgarh and Karnataka in case NMDC does not pass on the higher royalty cost to end-customers (although there could be some cost pass-through by NMDC). Thus, we expect EBITDA/tonne to get affected over FY2022E-FY2023E and model the same at $20/tonne (Rs. 1,465/tonne) despite assumption for higher iron ore realisations.

NMDC operating cost (excluding royalty) largely stable



Source: Company; Sharekhan Research

EBITDA/tonne to decline over FY22E-FY23E on higher royalty



Source: Company; Sharekhan Research

Demerger and strategic sale of steel plant to help unlock value; could add Rs. 22-25/share to valuation

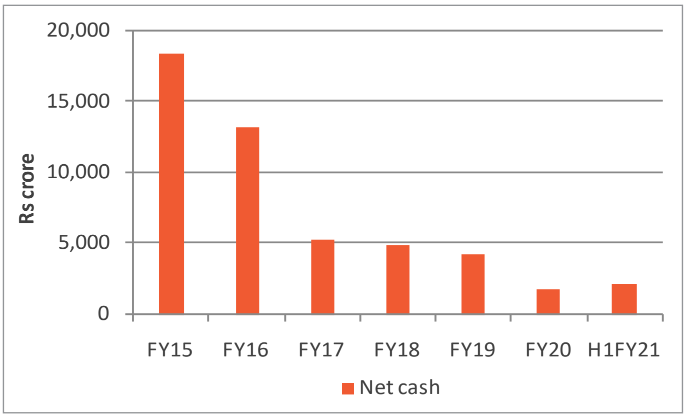
NMDC's board of directors approved the demerger of Nagarnar Steel Plant from NMDC and disinvestment of the same to a strategic buyer. The company has also received the in-principle approval from the Cabinet Committee on Economic Affairs (CCEA) to go ahead with the demerger (expected to get completed by April 2021) and strategic disinvestment (expected by September 2021) of Nagarnar Steel Plant. DIPAM would seek bids from global/domestic steel companies for the sale of NMDC's stake in Nagarnar Steel Plant.

NMDC has guided to complete work on the steel plant by March 2021 at an estimated investment of Rs. 23,140 crore (~Rs. 17,186 crore has already been spent) and CWIP stood at Rs. 16,500 crore as of September 2020. De-merger and consequent sale of the steel plant would help unlock value as a strategic investor could pay premium on CWIP given a ready plant (expected to become operational in next two quarters post completion of capex) and iron ore availability from NMDC. This could add significantly to NMDC's valuation as street is ascribing only a 50% value to the steel plant's CWIP of Rs. 16,500 crore and value unlocking could add Rs. 22-25/share to NMDC's valuation. Apart from the benefit of value unlocking, the steel plant's sale would improve the cash position and resultantly NMDC's dividend payout (historical DPS of Rs5-6/share which implies yield of 4-5%) could also increase in the coming years.

High CWIP of Rs16,500 crore for steel plant

Source: Company; Sharekhan Research

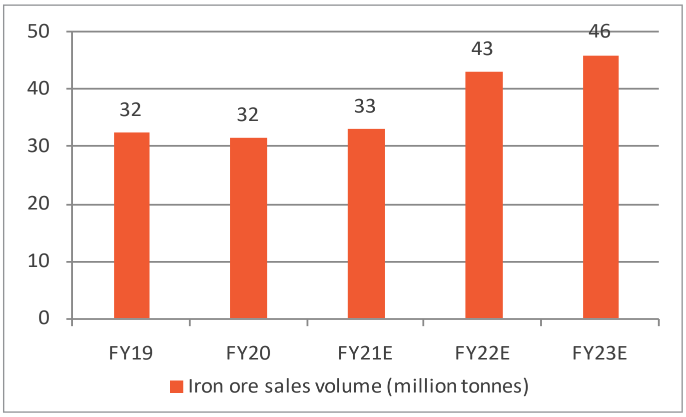
Cash blocked in capex – strategic sale of steel plant to release cash



Source: Company; Sharekhan Research

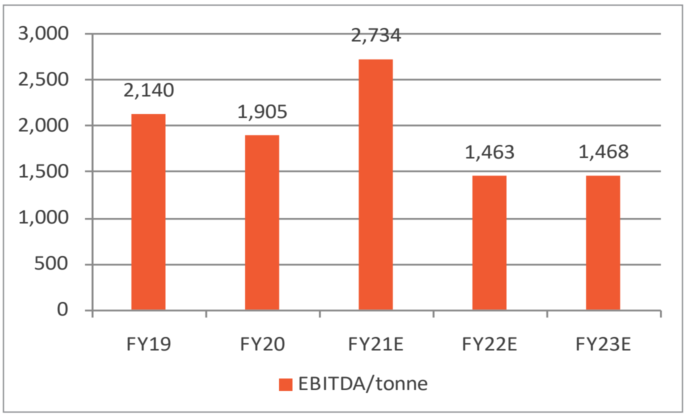
Financials in charts

Iron ore sales volume grow sharply over FY22E-FY23E



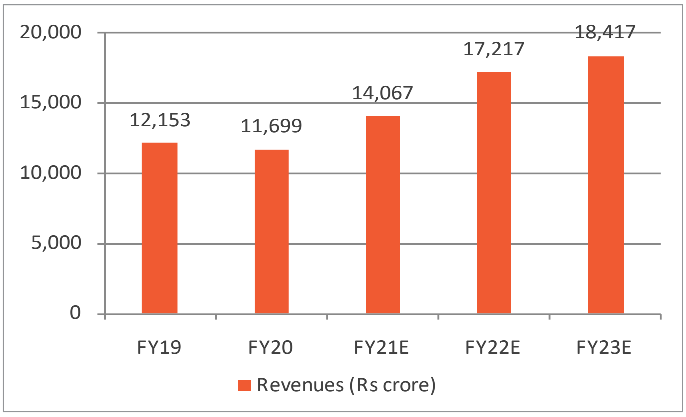
Source: Company, Sharekhan Research

Unit EBITDA margin to decline assuming high royalty



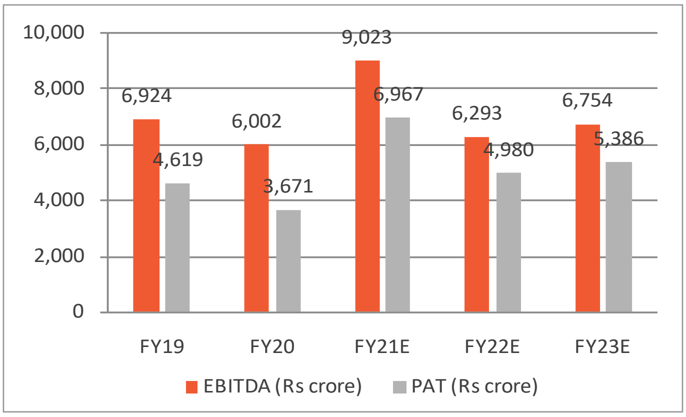
Source: Company, Sharekhan Research

Revenue trend



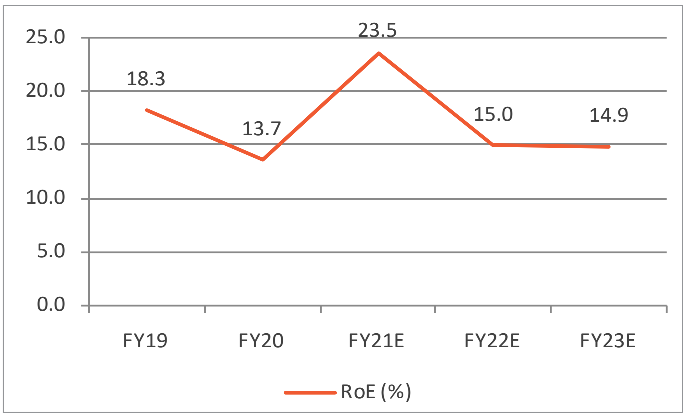
Source: Company, Sharekhan Research

EBITDA/PAT to remain resilient over FY22E-FY23E



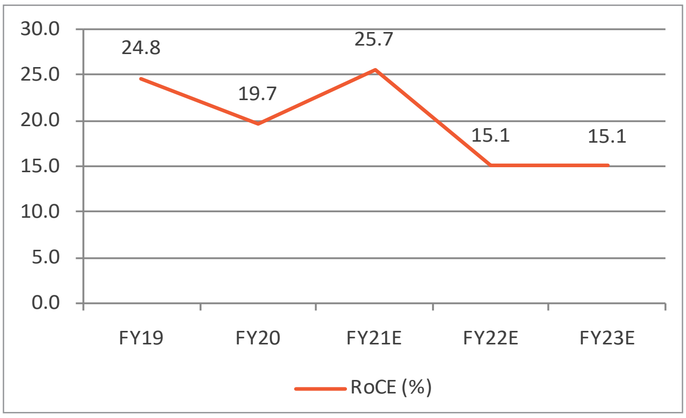
Source: Company, Sharekhan Research

Decent RoE track record



Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Strong iron ore demand led by higher steel production; pricing to remain strong given domestic supply deficit**

We expect India's iron ore demand to be strong over FY2022E-FY2023E led by high growth in the steel production. Our positive stance for steel production/demand stem from multiple factors such as strong retail demand emanating from a thriving rural economy, and green shoots of recovery in white goods and the automobile sector, especially from tractors, passenger vehicles and two-wheelers. Cumulative domestic steel demand in October-November has already surpassed the pre-COVID-19 levels and demand momentum is expected to sustain given higher infrastructure spending by the government. Globally, increased focus on a stimulus in China would sustain the recent economic revival and drive steel production higher in China. We believe that the increased global iron prices (>$150/tonne) and expectation of an iron ore deficit in India until FY2023 (till the Odisha mines' production is back to normal levels) would help sustain high domestic iron prices and resultantly higher average selling price iron ore miners.

■ **Company outlook - Robust volume growth and better realisation to largely offset higher royalty cost**

We see multiple triggers for an improvement in NMDC's iron ore output led by: 1) Resumption of iron ore production at Donimalai mine (7mtpa capacity and was shut down since November 2018), 2) capacity expansion at Kumarasamy mines (in Karnataka) to 10 mtpa from 7 mtpa currently and 3) higher production from Chhattisgarh mines (through addition of screening lines and de-bottlenecking). Hence, we expect NMDC iron ore sales volume to pick-up sharply by 30%/7% y-o-y to 43 mt/46 mt in FY2022E/FY2023E. The increased volume and better realisation would cushion NMDC from potential rise in royalty cost (assumed royalty premium of 22.5% across mines).

■ **Valuation - Re-initiate coverage on NMDC with Buy rating and PT of Rs. 165**

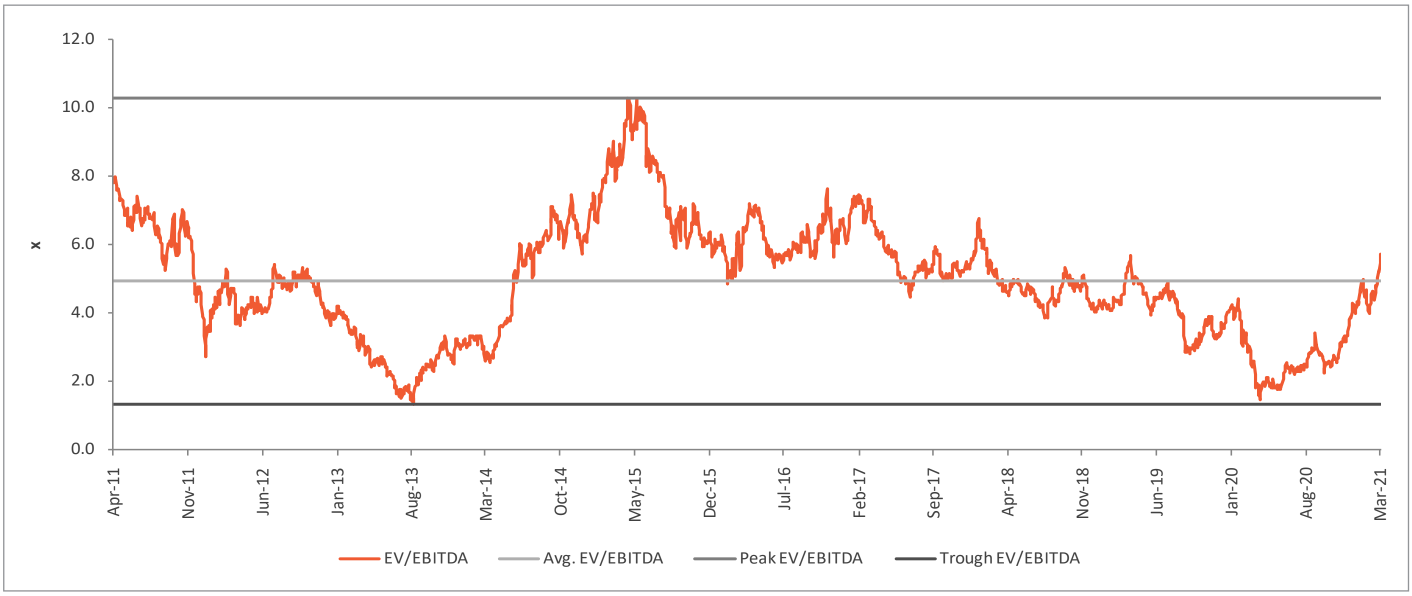
NMDC's valuation of 3.7x FY2023E EV/EBITDA (excluding value of steel plant at 0.6x CWIP) is attractive as it is at a steep discount of 41% to average EV/EBITDA multiple of 6.3x for global mining peers despite decent return ratios (RoE/RoCE of 15%). Value unlocking from demerger and potential strategic sale of the steel plant and resumption of Donimalai are key re-rating catalysts. Additionally, the likely finalisation of royalty (premium assumed at 22.5%) in the coming months would remove the key overhang on the stock and focus would shift back to strong fundamentals of NMDC. Hence, we re-initiate coverage on NMDC with a Buy rating and PT of Rs. 165 (Rs. 133/share for the core iron ore mining business and Rs. 32/share for the steel plant valued at 0.6x CWIP of Rs. 16,500 crore).

NMDC's valuation

Particulars	FY2023E
FY2023E EBITDA (Rs crore)	6,754
EV/EBITDA multiple (x)	5
EV for core business (Rs crore)	33,770
Net Debt (Rs crore)	-6,924
Value of core business (Rs crore)	**40,695**
Value/share of core business (A) - Rs	**133**
Steel Plant CWIP (Rs crore)	16,500
CWIP multiple (x)	0.6
Value of Steel plant (Rs crore)	9,900
Value/share of Steel plant (B) - Rs	**32**
Price Target (A+B) - Rs	**165**

Source: Sharekhan Research

One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			P/BV (x)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
NMDC #	6.0	8.4	7.8	3.9	5.7	5.2	1.3	1.2	1.1
Rio Tinto	9.3	12.5	15.1	5.4	6.7	7.7	2.9	2.8	2.6
BHP	12.3	12.9	14.4	6.8	7.2	7.5	3.2	3.1	3.0
Anglo American plc	8.8	10.7	11.9	4.3	5.0	5.3	1.8	1.6	1.5
Vale	5.3	6.6	8.0	3.4	4.1	4.6	2.1	1.9	1.7

Source: Bloomberg; #Sharekhan estimates

About company

NMDC, a government owned company, is India's largest iron ore producer with more than 35 million tonnes of iron ore from three fully mechanized mines viz., Bailadila Deposit-14/11C, Bailadila Deposit-5, 10/11A (Chhattisgarh State) and Donimalai Iron Ore Mines (Karnataka State). The company is also engaged in the production and sale of diamond, sponge iron and wind power. NMDC is also under final stage to set-up a 3mtpa steel plant with total capital outlay estimated at ~Rs23,140 crore.

Investment theme

We see multiple triggers for improvement in the operational performance of NMDC over next two years with potential sharp ramp-up in iron production given company has resumed production from Donimalai and sustained domestic high iron price led by supply deficit in domestic markets. Potential value unlocking from demerger and strategic sales by its steel plant by September 2021 is key near term catalyst.

Key Risks

- A sharp fall in the domestic and international iron ore price, a potential delay in volume pick-up and royalty premium of more than 22.5% for mine lease renewals could impact earning and valuation.
- Delay in demerger and strategic sale of steel plant beyond could impact value unlocking.

Additional Data

Key management personnel

Sumit Deb	Chairman and Managing Director
Amitava Mukherjee	Director - Finance
P.K. Satpathy	Director - Production

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	13.5
2	Nippon Life India Asset Management	2.4
3	Aditya Birla Sun Life Asset Manage	0.9
4	Vanguard Group Inc/The	0.8
5	Skandinaviska Enskilda Banken AB	0.4
6	Kotak Mahindra Asset Management Company	0.2
7	SBI Funds Management Pvt Ltd	0.2
8	LIC PENSION FUND LTD	0.2
9	WisdomTree Investments Inc	0.2
10	State Street Corp	0.1

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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