Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

NMDC Limited

Price hikes and strong volume growth a positive

Metal & Mining	Sharekhan code: NMDC	Company Update

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

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 141**	
Price Target: **Rs. 165**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 41,307 cr
52-week high/low:	Rs. 144/70
NSE volume: (No of shares)	111.2 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	2	14	70	79
Relative to Sensex	5	12	46	15

Sharekhan Research, Bloomberg

Summary

- NMDC has taken cumulative price hike of Rs. 750/Rs. 350 per tonne for iron ore lump/fines over March-April 2021; and current iron ore lump/fines prices are 51%/35% higher versus average price seen in FY2021.
- Strength in domestic iron price to sustain given supply deficit and steep discount (of <60%) to international price. Volume ramp-up to continue as restart of Donimalai mine to drive sales volume growth of 30% y-o-y/7% y-o-y in FY2022E/FY2023E.
- Robust iron ore sales volume (up 19% q-o-q to 11.1mt in Q4FY2021) and higher prices (lump/fines price up by 28%/17% q-o-q in Q4FY2021) re-enforce our confidence for strong earnings performance (expect EBITDA growth of 33% q-o-q in Q4FY2021).
- Valuation of 3.9x its FY2023E EV/EBITDA for the core business is attractive versus average of 5.6x for global mining companies. Potential value unlocking from the steel plant is the key catalyst. We maintain Buy on NMDC with an unchanged PT of Rs.165.

NMDC has resumed iron ore price hikes with cumulative price increase of Rs. 750/Rs. 350 per tonne for iron ore lump/fines over March-April 2021 (post a steep cut of Rs. 600/tonne in February 2021). NMDC's current iron ore lump/fines prices of Rs. 5,850/Rs. 4,560 per tonne is 51%/35% higher as compared to average price of Rs. 3,880/Rs. 3,387 in FY2021E. We expect strength in domestic iron prices to sustain given supply deficit in India (lower output from Odisha), high demand from the steel sector, and steep discount of domestic price to international iron ore prices (domestic iron ore lump/fines price at 67%/62% discount to Chinese iron ore price). Moreover, iron ore demand in India is robust, led by strong demand from the steel sector (higher utilisation rate of ~90%), and the same is reflected in NMDC's Q4FY2021 sales volume growth of 28% y-o-y and 19% q-o-q to 11.1 million tonnes. Robust iron ore sales volume and higher prices (average lump/fines price up by 28%/17% q-o-q in Q4FY2021) re-enforce our confidence with respect to strong earnings performance by NMDC. We expect EBITDA growth of 33% q-o-q in Q4FY2021. We believe that strong volume growth momentum to sustain and expect strong iron ore sales volume growth of 30%/7% y-o-y to 430mt/460mt in FY2022E/FY2023E for NMDC, supported by resumption of Donimalai mine (capacity of 7 mtpa) in Karnataka and capacity expansion at Kumarasamy/Chhattisgarh mines. Robust pricing environment and volume growth bode well for steady EBITDA (expect at Rs. 6,293 crore/Rs. 6,754 crore in FY2022E/FY2023E) despite assuming higher royalty premium of 22.5% for the entire production of NMDC. Valuation of 3.9x its FY2023E EV/EBITDA (excluding value of CWIP at 0.6x for the steel plant) seems attractive, as compared to average of 5.6x its FY2023E EV/EBITDA for global mining companies given decent return ratios (RoE/RoCE of 15%). There is a possibility of further increase in dividend payout (already increased to Rs. 7.8/share for FY2021 versus Rs. 5.3/share for FY2020) as cash position would improve considerably post the likely strategic sale of 3-mtpa Nagarnar Steel Plant (CWIP of Rs. 16,500 crore or Rs. 54/share). Hence, we maintain our Buy rating on NMDC with an unchanged price target (PT) of Rs. 165.

Our Call

Valuation – Maintain Buy rating on NMDC with an unchanged PT of Rs. 165: NMDC's valuation of 3.9x its FY2023E EV/EBITDA (excluding value of the steel plant at 0.6x CWIP) is attractive as it is at a steep discount of 30% to average EV/EBITDA multiple of 5.6x for global mining peers despite earnings visibility and decent return ratios (RoE/RoCE of 15%). Value unlocking from the demerger and potential strategic sales of the steel plant (could add Rs. 22-25/share to NMDC's valuation as the street is ascribing only 50% value to CWIP of Rs. 16,500 crore) and production ramp-up at Donimalai mine are key re-rating catalysts. Hence, we maintain our Buy rating on NMDC with an unchanged PT of Rs. 165.

Key Risks

A sharp fall in the domestic and international iron ore price, potential delay in volume pick-up, and royalty premium of more than 22.5% for mine lease renewals could impact earnings and valuation. Delay in demerger and strategic sale of the 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)	9.3	11.8	6.2	8.7	8.0
P/B (x)	1.7	1.6	1.4	1.2	1.1
EV/EBITDA (x)	5.6	6.9	4.1	5.9	5.4
RoNW (%)	18.3	13.7	23.5	15.0	14.9
RoCE (%)	24.8	19.7	25.7	15.1	15.1

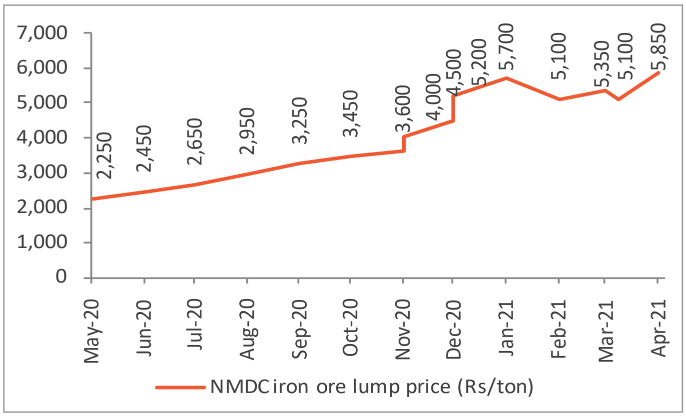
Source: Company; Sharekhan estimates

NMDC hikes domestic iron ore lumps/fines by Rs. 750/Rs. 350 per tonne over March to April 2021 – bodes well for sustained high realisation and profitability

NMDC has taken a cumulative price increase of Rs. 750/Rs. 350 per tonne for iron ore lump/fines over March-April 2021 (post a steep cut of Rs. 600/tonne in February 2021). NMDC's current iron ore lump/fines prices are 51%/35% higher as compared to average price of Rs. 3,880/Rs. 3,387 in FY2021E and are higher by 28%/17% on a sequential basis in Q4FY2021. We expect strength in domestic iron or prices to sustain given supply deficit in India (lower output from Odisha), high demand from the steel sector, and steep discount of domestic price to international iron ore prices. NMDC iron ore lump/fines price is at a steep discount of 67%/62% to international prices, which is expected to cushion domestic price from the decline in international prices.

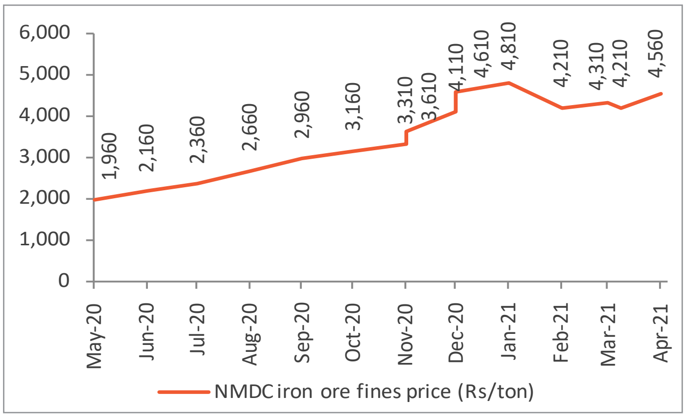
Robust iron ore sales volume (up 19% q-o-q to 11.1mt in Q4FY2021) and higher prices (lump/fines price up by 28%/17% q-o-q in Q4FY2021) are expected to drive strong earnings performance and thus we expect NMDC's EBITDA to growth by 33% q-o-q in Q4FY2021.

NMDC iron ore lump price (up 2.6x since May 2020)



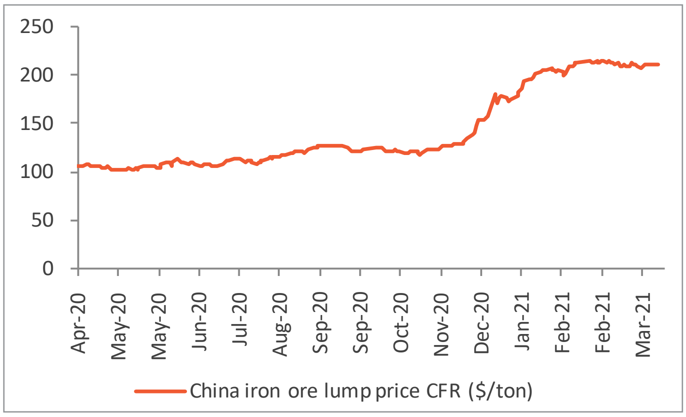
Source: Company

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



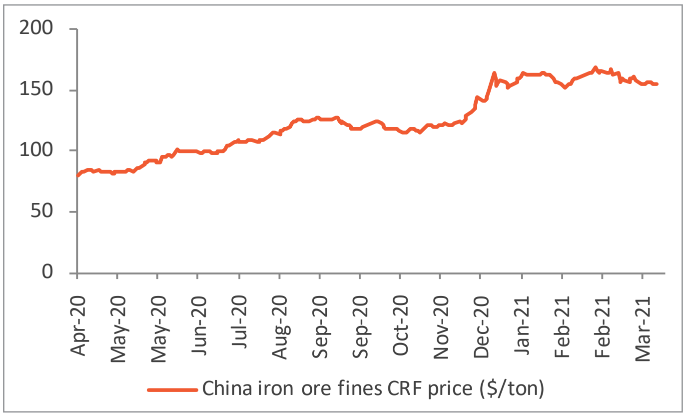
Source: Company

China iron ore lump price CFR remains firm



Source: Bloomberg

China iron ore fines CRF price corrects in March 2021



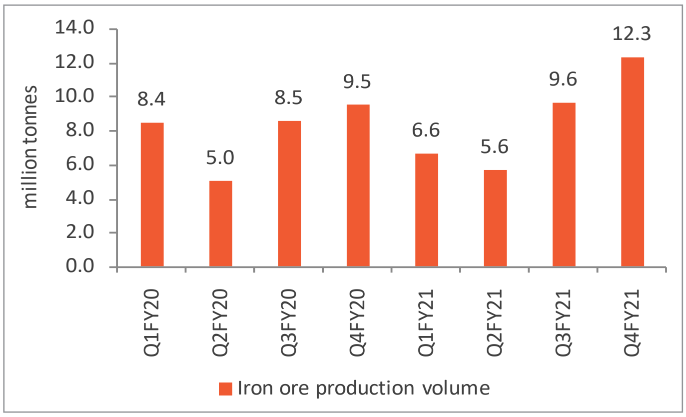
Source: Bloomberg

NMDC's iron ore production/sales volume up 28%/19% q-o-q in Q4FY2021; Multiple volume growth triggers over FY2022E-FY2023E

NMDC posted robust growth of 28%/19% q-o-q in its iron ore production and sales volume respectively to 12.3mt/11.1mt in Q4FY2021 led by strong demand from steel makers. We expect India's iron ore demand to be strong over FY2022-FY2023, led by double-digit growth in steel production. Our positive stance on steel production/demand stems from multiple factors such as strong retail demand emanating from: 1) a thriving rural economy, 2) green shoots of recovery in white goods and the automobiles sector, especially from tractors, passenger vehicles, and two-wheelers, and 3) higher infrastructure spending by the government.

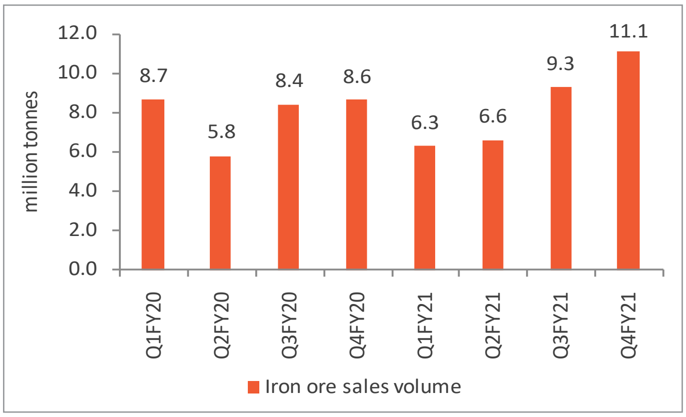
We expect NMDC to be the key beneficiary of higher iron ore demand in India given expectation of supply deficit due to lower output from Odisha iron miners. Hence, we expect NMDC iron ore sales volume to increase sharply by 30%/7% y-o-y to 43mt/46mt in FY2022E/FY2023E. Key drivers of higher volume are: 1) resumption of iron ore production from NMDC's Donimalai mine (capacity of 7mtpa and was shut down for two years) in Karnataka, 2) capacity expansion at its Kumarasamy mines in Karnataka to 10 mtpa from 7 mtpa currently, and 3) higher production in Chhattisgarh by the addition of screening lines and debottlenecking.

Robust 28% q-o-q growth in iron ore production in Q4FY21...



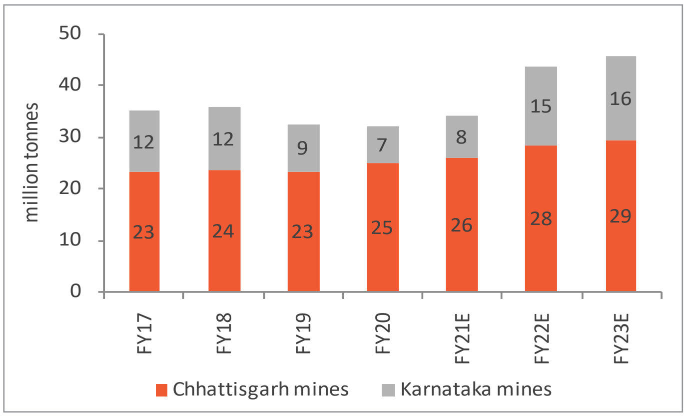
Source: Company, Sharekhan Research

...leading to sharp 19% q-o-q jump in sales volume in Q4FY21



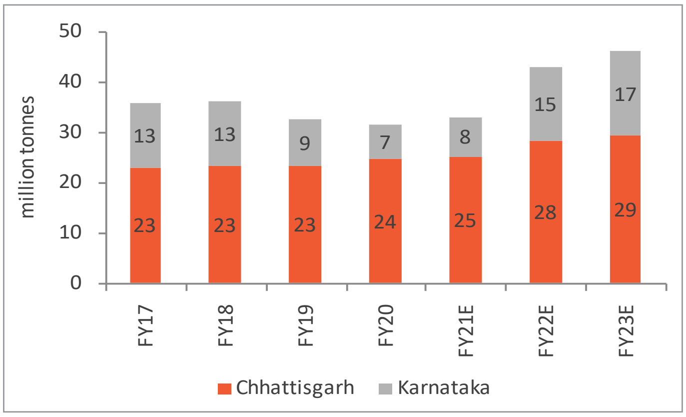
Source: Company, Sharekhan Research

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



Source: Company, Sharekhan Research

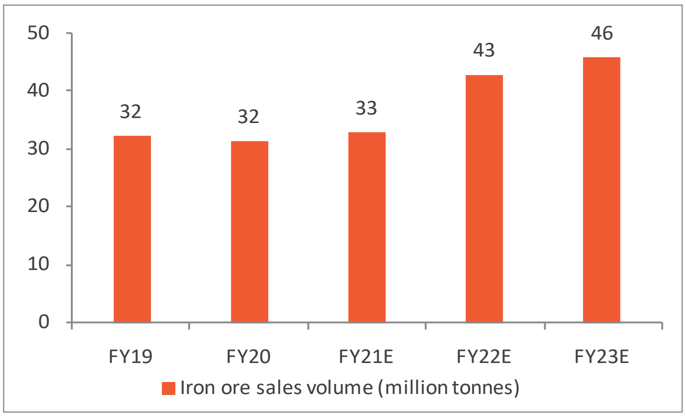
...driving up iron ore sales volumes



Source: Company, Sharekhan Research

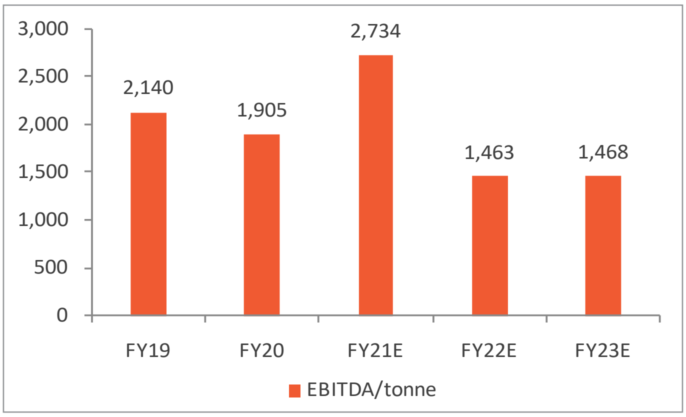
Financials in charts

Iron ore sales volume to grow sharply over FY22E-FY23E



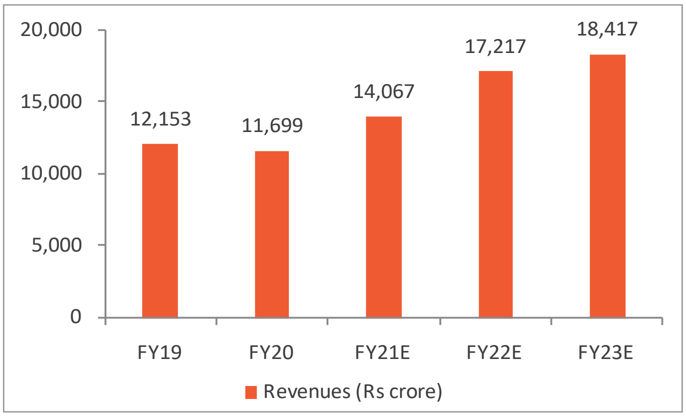
Source: Company, Sharekhan Research

Unit EBITDA margin to decline assuming high royalty



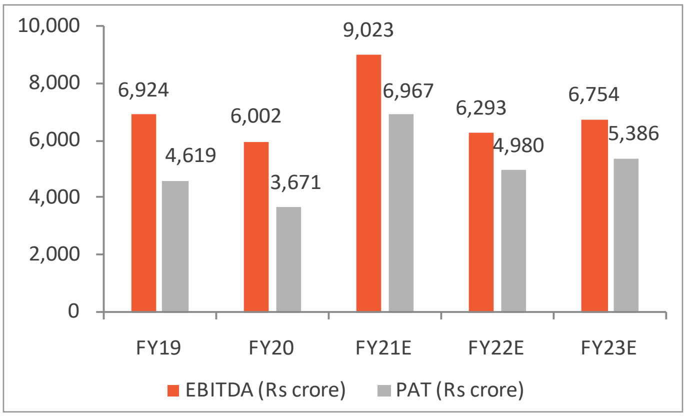
Source: Company, Sharekhan Research

Revenue trend



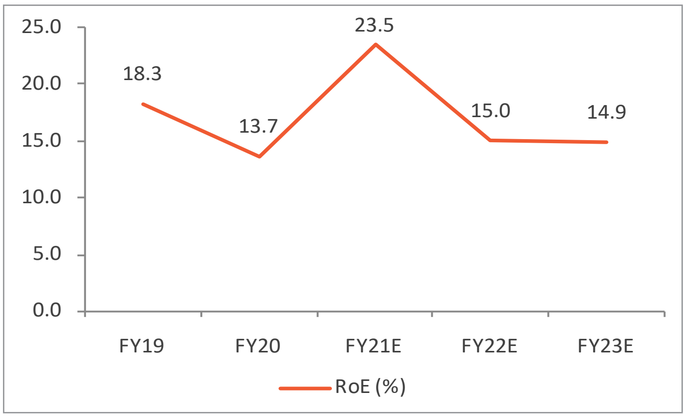
Source: Company, Sharekhan Research

EBITDA/PAT to remain resilient over FY22E-FY23E



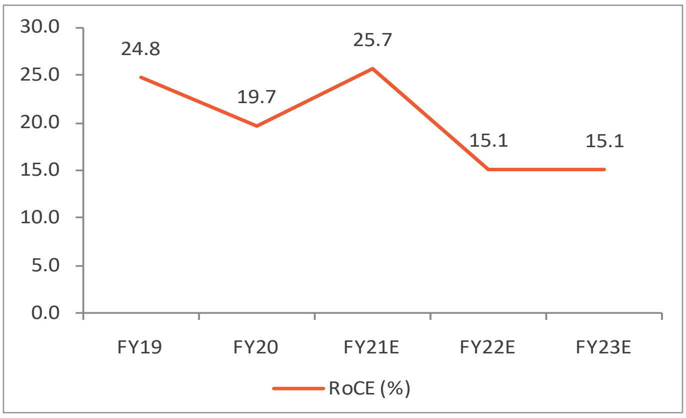
Source: Company, Sharekhan Research

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 steel production. Our positive stance for steel production/demand stems 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 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 increased global iron prices (>$150/tonne) and expectation of iron ore deficit in India until FY2023 (till Odisha mines' production is back to normal levels) would help sustain high domestic iron prices and resultantly higher average selling price to iron ore miners.

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

We see multiple triggers for 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. Increased volume and better realisation would cushion NMDC from potential rise in royalty cost (assumed royalty premium of 22.5% across mines).

■ **Valuation - Maintain Buy rating on NMDC with an unchanged PT Rs. 165**

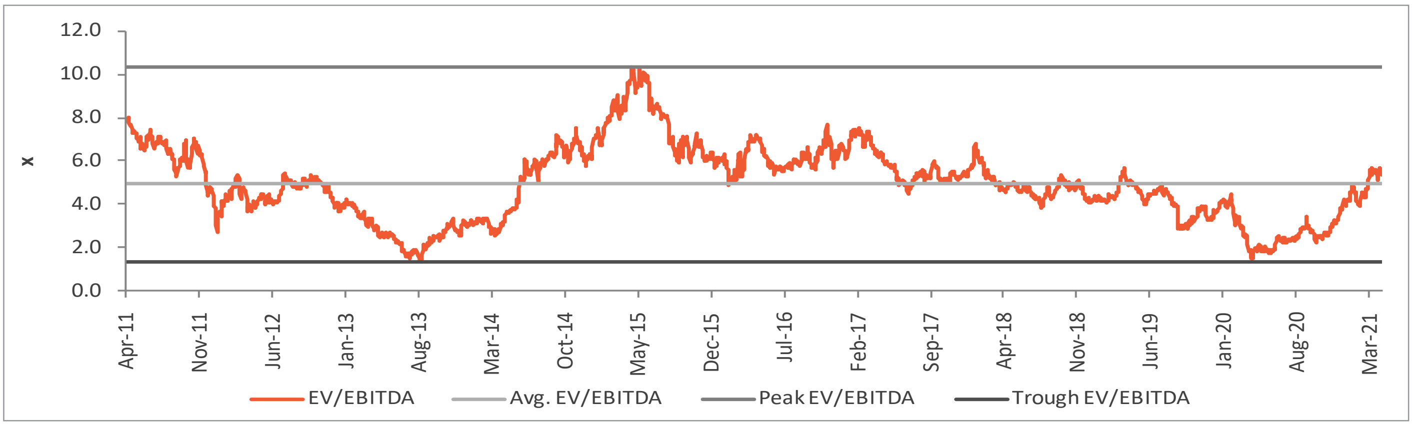
NMDC's valuation of 3.9x its FY2023E EV/EBITDA (excluding value of the steel plant at 0.6x CWIP) is attractive as it is at a steep discount of 30% to average EV/EBITDA multiple of 5.6x for global mining peers despite earnings visibility and decent return ratios (RoE/RoCE of 15%). Value unlocking from the demerger and potential strategic sales of the steel plant (could add Rs. 22-25/share to NMDC's valuation as the street is ascribing only 50% value to CWIP of Rs. 16,500 crore) and production ramp-up at Donimalai mine are key re-rating catalysts. Hence, we maintain our Buy rating on NMDC with an unchanged PT of Rs. 165.

NMDC's valuation

Particulars	FY23E
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)	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)	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#	6.2	8.7	8.0	4.1	5.9	5.4	1.4	1.2	1.1
Rio Tinto	6.9	9.4	12.0	4.1	5.3	6.3	2.3	2.3	2.2
BHP	9.9	10.4	12.0	5.6	6.0	6.6	2.7	2.7	2.6
Anglo American plc	7.5	9.5	10.5	4.1	5.0	5.3	1.6	1.5	1.3
Vale	4.5	5.7	7.4	3.0	3.6	4.2	2.0	1.7	1.6

Source: Bloomberg; #Sharekhan estimates

About company

NMDC, a government-owned company, is India's largest iron ore producer with more than 35 million tonne of iron ore from three fully mechanised 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 diamonds, sponge iron, and wind power. NMDC is also under the final stage to set up a 3mtpa steel plant with total capital outlay estimated at ~Rs. 23,140 crore.

Investment theme

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

Key Risks

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

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; Note: Shareholding as on March 03, 2021

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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