



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	✓	↔	✓

ESG Disclosure Score

NEW

ESG RISK RATING

Updated Oct 08, 2022

30.69

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 36,076 cr
52-week high/low:	Rs. 143/81
NSE volume: (No of shares)	115.3 lakh
BSE code:	526371
NSE code:	NMDC
Free float: (No of shares)	114.9 cr

Shareholding (%)

Promoters	60.8
FII	5.9
DII	21.0
Others	12.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	17.7	42.8	37.9	30.8
Relative to Sensex	-0.5	3.5	9.9	4.4

Sharekhan Research, Bloomberg

NMDC Ltd

Upgrade to Buy on China reopening and firm iron ore prices

Metal & Mining	Sharekhan code: NMDC		
Reco/View: Buy	↑	CMP: Rs. 123	Price Target: Rs. 145
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- We expect reopening of China w.e.f January 8 2023, will lead to improved steel production both in China as well as India, thus improving iron ore volumes. Removal of export duty on iron ore, pellet and steel will lead to further price hikes in the coming quarters. Prices of Chinese fines have rallied 35% since November 1, 2022, and NMDC fines are at 67% discount to Chinese fines versus the long-term average of 40%, which provides a good cushion for further price increases by NMDC.
- The disinvestment of NMDC Steel Limited to a strategic buyer will add value to the company's stakeholders. Since the core mining business is not capital intensive, we expect higher free cash flows and increased dividend pay-out ratio by NMDC in the future.
- With steady margin improvement and 13% volume CAGR over FY2023-FY2025E, we expect Revenue/EBITDA/PAT CAGR of 11%/14%/11% over FY2023-FY2025E. At the CMP, we expect a dividend yield of 8.5% for FY2025E.
- We upgrade our rating to Buy with a revised PT of Rs. 145 to reflect our earnings estimate. At the CMP, the stock trades at 3.8x/3.4x its FY2024E/FY2025E EBITDA.

NMDC is India's largest iron ore producer operating from a total of four iron ore mechanised mines in Chhattisgarh and Karnataka state. Removal of export duty in mid-November 2022 and opening of China in early January 2023 will provide growth momentum over FY2023-FY2025E. We have upgraded our rating to Buy with a revised price target (PT) of Rs. 145.

- China's COVID-19 Unlock:** China in a major shift of its coronavirus response policies announced that COVID-19 management will be downgraded from Class A to B effective from January 8, 2023. The country's focus will now be to only control severe cases and take necessary steps to curb the spread of the virus. China has scrapped quarantine measures for inbound travellers and they will be required to only show a negative RT-PCR test within 48 hours of departure. The opening is in-line with the projections, but the pace of it is well ahead of expectations. The virus has been renamed from COVID-19 pneumonia to COVID-19 infection. These measures taken to boost GDP growth of China will lead to higher production of steel, which will increase demand for iron ore and improve capacity utilisation for NMDC.
- Expect improvement in iron ore prices:** Post the export duty withdrawal on iron ore, pellet, and steel by the government, NMDC has rolled back the Rs. 300 price cut it took on lumps and fines on November 17, 2022. In November 2022, NMDC's iron ore sales increased by 5.6% y-o-y to 3.04 MT and India's crude steel production increased by 5.7% y-o-y to 10.4 MT. Chinese steel production for November 2022 increased by 7.3% y-o-y to 74.5 MT and India's iron ore exports reported a sharp increase of 131% m-o-m to 0.3 MT post the removal of export duty by the government. Domestic flat and long prices have been range-bound in Q3FY2023. At current prices, NMDC fines are at a 67% discount to international iron ore prices versus long-term average of 40%. All these factors show steady steel demand, which would help in the pricing of iron ore and, hence, would be positive for NMDC.
- Demerger of the steel business:** MCA has approved the demerger of the steel business to NMDC Steel Limited vide its order dated October 6, 2022. This will add value to the company's stakeholders by disinvestment of NMDC Steel Limited to a strategic buyer. Since the core mining business is not capital intensive, we expect higher free cash flows and increased dividend pay-out ratio by NMDC in the future.

Our Call

Valuation – Upgrade to Buy with a revised PT of Rs. 145: The recent withdrawal of export duty on steel/iron ore/pellet and reopening of China will lead to higher prices for iron ore and improved volume growth, which will improve the profitability of NMDC. Demerger of the steel business will reduce capital intensity and improve dividend pay-out ratio. At the CMP, we expect dividend yield of 8.5% for FY2025E. We upgrade our rating to Buy with a revised price target (PT) of Rs. 145 at a target multiple of 4.3x its FY2025E EBITDA.

Key Risks

1) Decrease in iron ore prices and demand and imposition of steel/iron ore/pellet export tax are critical downside risks and vice-versa. 2) Increase in Covid cases and extension of China reopening.

Valuation (Consolidated)

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	25,882	18,156	21,842	22,227
OPM (%)	48.6	34.1	33.9	36.1
Adjusted PAT	9,380	4,983	5,767	6,125
% y-o-y growth	49.4	-46.9	15.7	6.2
Adjusted EPS (Rs.)	32.0	17.0	19.7	20.9
P/E (x)	3.8	7.2	6.3	5.9
P/B (x)	1.0	1.0	0.9	0.8
EV/EBITDA (x)	2.4	4.6	3.8	3.4
RoNW (%)	28.9	13.8	14.8	14.6
RoCE (%)	31.9	13.7	15.8	16.1

Source: Company; Sharekhan estimates

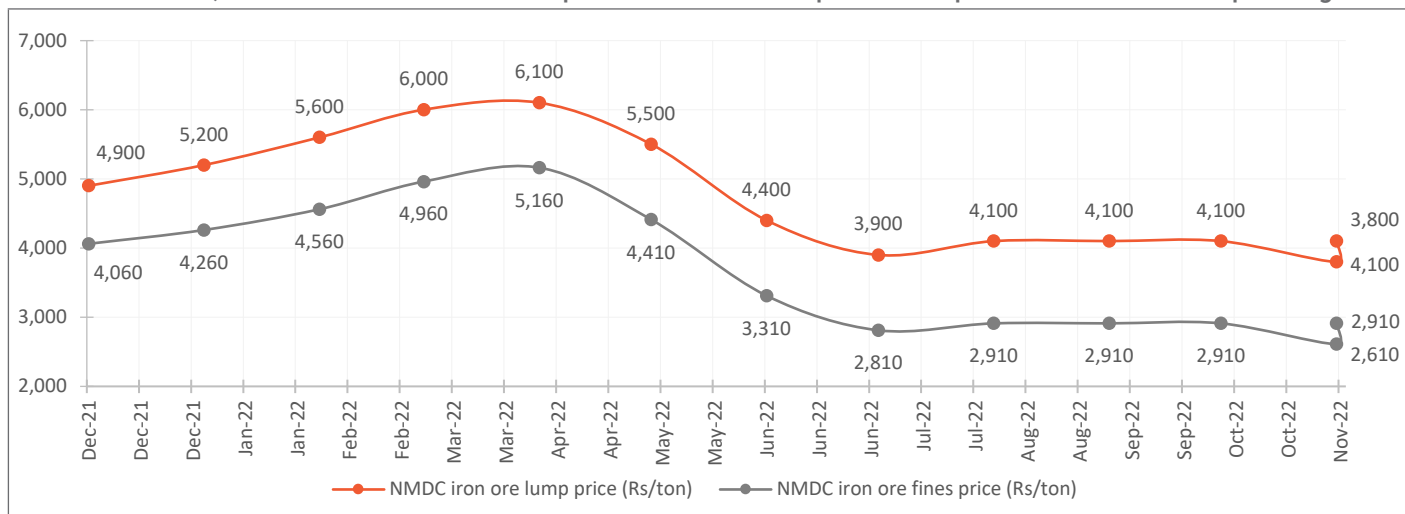
Note: Return ratios are calculated including the steel plant CWIP

Chinese iron ore fine prices have increased by 35% since November 1, 2022



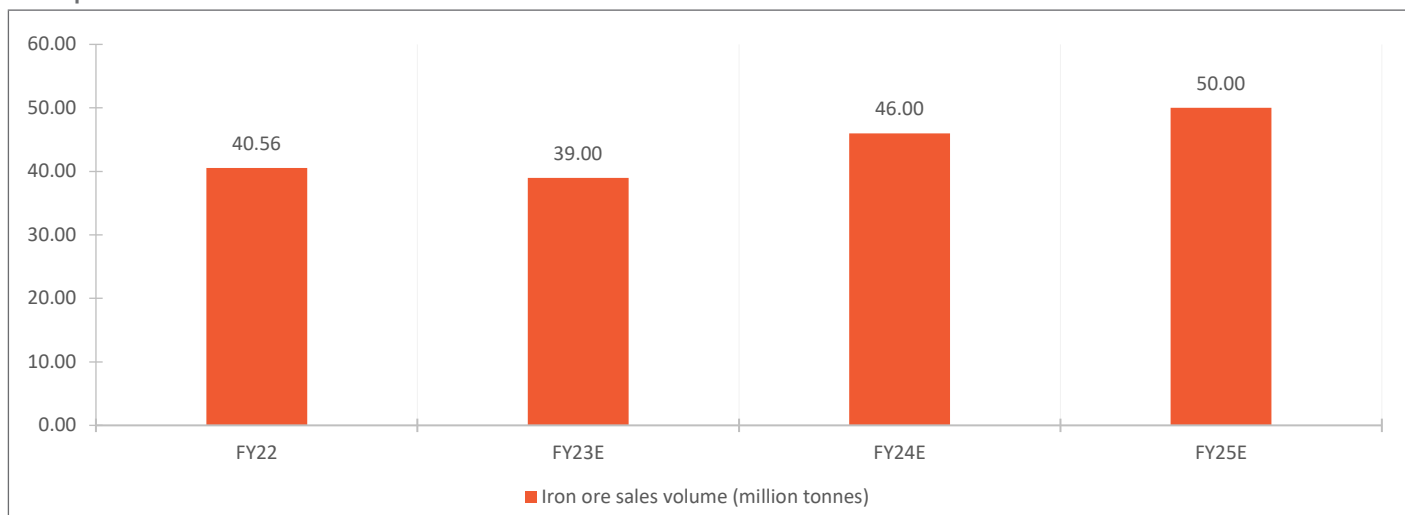
Source: Company, Sharekhan Research

In November 2022, NMDC rolled back the Rs. 300 price cut it took for lumps and fines post the withdrawal of export duty



Source: Company, Sharekhan Research

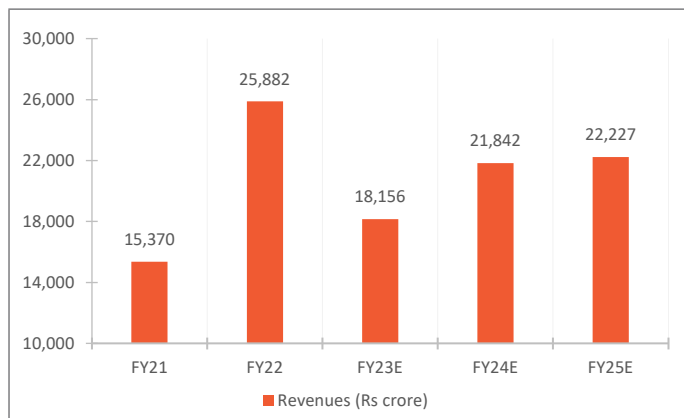
We expect a 13% sales volume CAGR over FY2023-FY2025E



Source: Company, Sharekhan Research

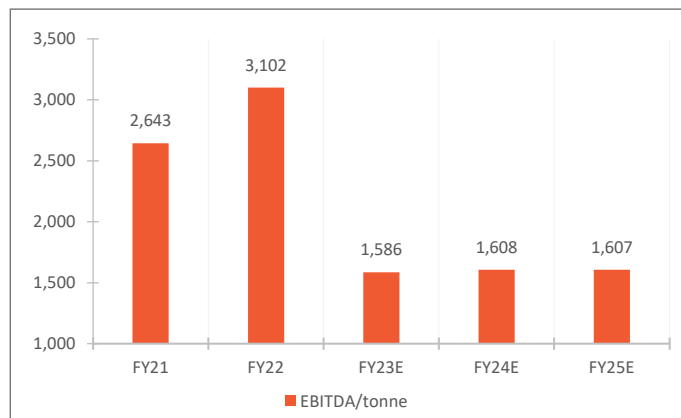
Financials in charts

Revenue likely to post an 11% CAGR over FY2023-FY2025E



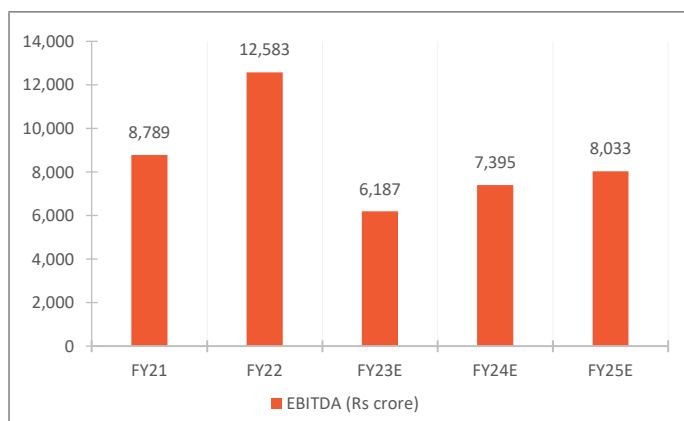
Source: Company, Sharekhan Research

EBITDA/tonne trend



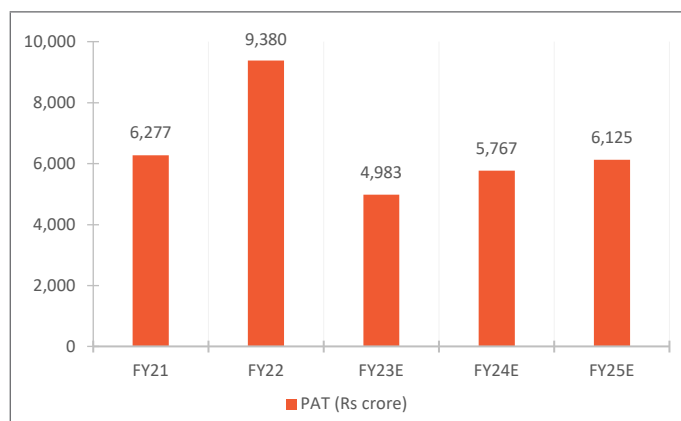
Source: Company, Sharekhan Research

EBITDA likely to post 14% CAGR over FY23-FY25E



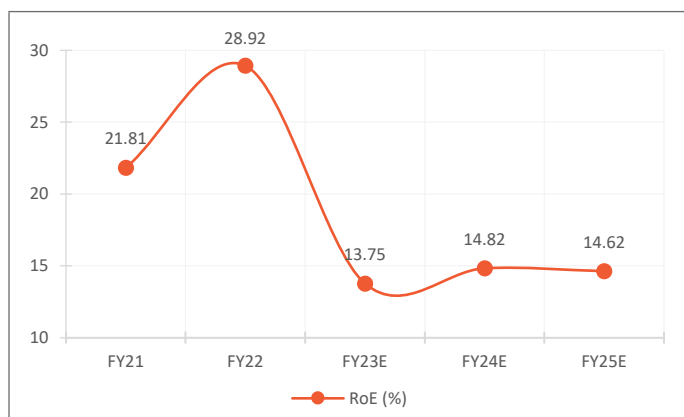
Source: Company, Sharekhan Research

PAT to post an 11% CAGR over FY23-FY25E



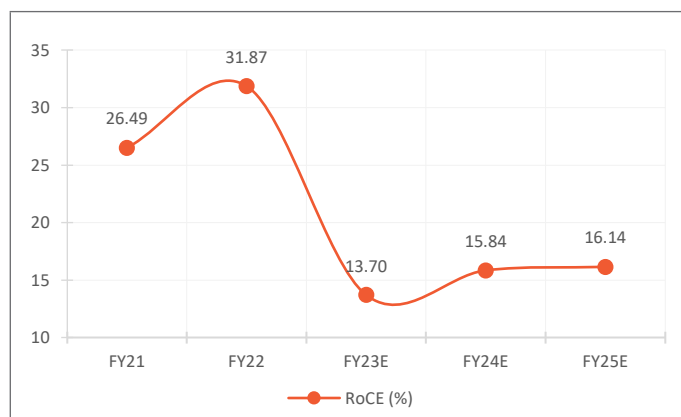
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – China pickup and reversal of export duty to improve sector profitability

We expect domestic steel prices, which were range-bound in Q3FY2022, have bottomed out and will increase as the COVID-19 situation improves in China and sees pickup in activities. FTA signed with Australia provides a further tailwind to domestic steel production as Indian steel producers can now purchase coking coal at zero import duty w.e.f. December 29, 2022. Overall, this will support demand and price levels of iron ore. The reversal of export duty on steel/iron ore/pellets bodes well for the sector as it removes the regulatory burden and will encourage free pricing.

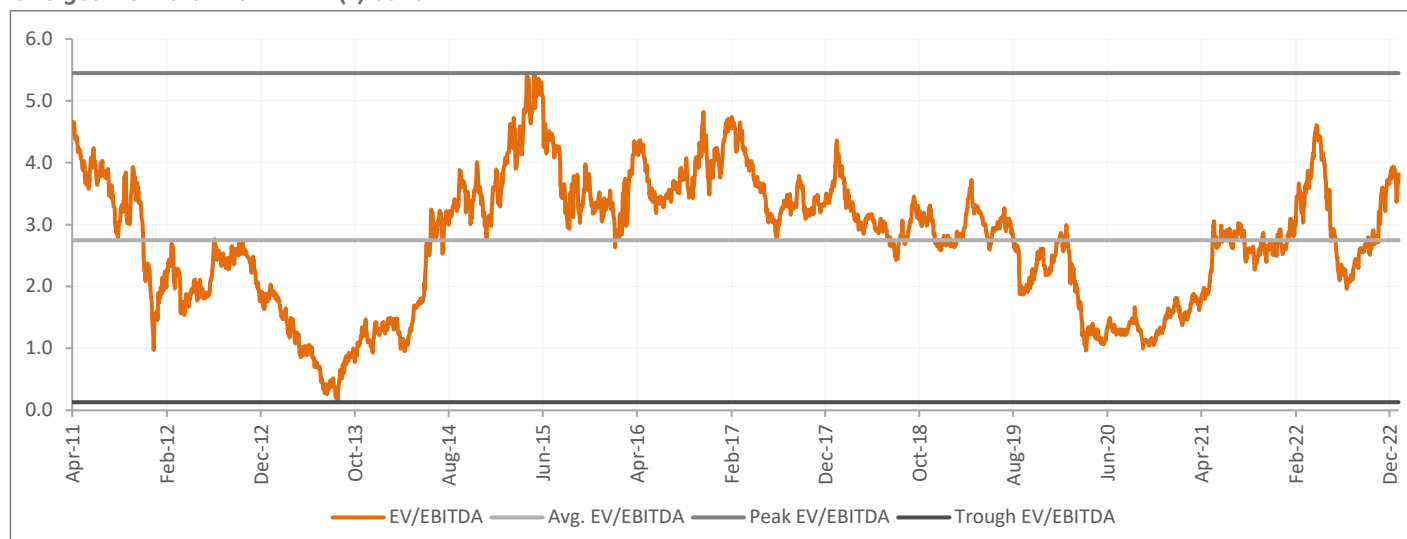
■ Company Outlook – Volume growth and price hikes from current levels will drive growth over FY2023-FY2025E

We expect 13% sales volume CAGR for FY2023-FY2025E driven by China reopening and reversal of export duties. Although iron ore prices have dropped from the highs of FY2022, we believe they have bottomed out and will see improvement in the coming quarters. We expect a Revenue/EBITDA/PAT CAGR of 11%/14%/11% over FY2023-FY2025E

■ Valuation – Upgrade to Buy with a revised PT of Rs. 145

The recent withdrawal of export duty on steel/iron ore/pellet and reopening of China will lead to higher prices for iron ore and improved volume growth, which will improve the profitability of NMDC. Demerger of the steel business will reduce capital intensity and improve dividend pay-out ratio. At the CMP, we expect dividend yield of 8.5% for FY2025E. We upgrade our rating to Buy with a revised PT of Rs. 145 at a target multiple of 4.3x its FY2025E EBITDA.

One-year forward EV/EBITDA (x) band



Source: Company, Sharekhan Research

About company

NMDC, a government-owned company, is India's largest iron ore producer. NMDC is operating four iron ore mechanised mines viz., Bailadila Iron Ore Mines – Kirandul Complex (Dep-14, 14 NMZ, 11B and 11C), Bailadila Iron Ore Mine – Bacheli Complex (Dep-5,10 and 11A) in Chhattisgarh, Donimalai Iron Ore Mine and Kumaraswamy Iron Ore Mine in Karnataka. The company also produces and sells diamonds, sponge iron, and wind power.

Investment theme

We expect domestic iron ore prices to improve, given the recent government decision to withdraw 15%/50%/45% export duty on steel/iron ore/pellets to control inflation. Rise in prices and strong volume growth will improve the valuation for NMDC.

Key Risks

- ♦ Fall in domestic iron ore price and demand could impact the earnings outlook.
- ♦ Imposition of export tax on steel/iron ore/pellets could impact the sector's valuation.
- ♦ Increase in Covid cases and extension of China reopening.

Additional Data

Key management personnel

Sumit Deb	Chairman and Managing Director
Amitava Mukherjee	Director - Finance
Dilip Kumar Mohanty	Director - Production

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	14.16
2	Vanguard Group Inc	1.24
3	PPFAS Asset Management	0.92
4	Aditya Birla Sun Life Asset Management	0.91
5	SBI Funds Management Pvt. Ltd.	0.47
6	ICICI Prudential Asset Management	0.47
7	Blackrock Inc	0.30
8	Nippon Life India Asset Management	0.29
9	Dimensional Fund Advisors	0.28
10	Kotak Mahindra Asset Management	0.27

Source: Bloomberg

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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 deteriorating 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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Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com.

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