25 April 2016

Update | Sector: Metals

NMDC

BSE SENSEX	S&P CNX
25,679	7,855

Stock Info

Bloomberg	NMDC IN
Equity Shares (m)	3,964.7
52-Week Range (INR)	137/75
1, 6, 12 Rel. Per (%)	-5/6/-17
M.Cap. (INR b)	392.5
M.Cap. (USD b)	5.9
Avg Val (INR m)	236
Free float (%)	20.0

Financials Snapshot (INR b)

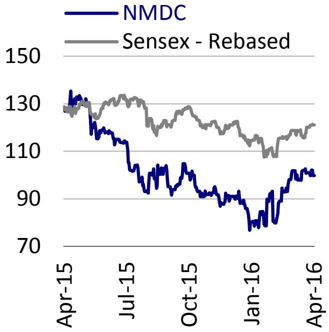
Y/E Mar	2016E	2017E	2018E
Sales	66.8	68.3	67.3
EBITDA	35.5	38.6	36.0
Adj. PAT	33.8	34.3	30.5
Adj. EPS (INR)	8.5	8.6	7.7
EPS Gr(%)	-48.6	1.2	-11.0
BV/Sh. (INR)	79.0	82.9	85.9
RoE (%)	15.7	10.6	9.7
RoCE (%)	15.6	10.6	9.6
P/E (x)	11.5	11.4	12.8
P/BV	1.2	1.2	1.1

Shareholding pattern (%)

As On	Dec-15	Sep-15	Dec-14
Promoter	80.0	80.0	80.0
DII	13.6	13.0	11.2
FII	4.0	3.6	6.2
Others	2.4	3.5	2.6

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR99 TP: INR90 (-9%) Sell

Pricing power improves on surge in global iron ore prices

But domestic supply can be a party pooper; revise TP to INR90

Global iron ore price outlook has improved

Iron ore prices have surged by ~73% from their lows in December 2015, driven by strong Chinese steel market and toning down of iron ore supply growth guidance by BHP, Rio Tinto and Vale. Appreciation of AUD and BRL against USD puts inflationary pressure on the cost structure of iron ore mines in Australia and Brazil that comprise over 90% of seaborne supply.

NMDC's pricing power too has improved

Taking clues from the international market, NMDC has also increased prices in March/April by 17-19% (or INR300/ton). At current global iron ore price (cfr China) of ~USD65/dmt, we believe there is further headroom for NMDC to increase prices. The landed prices of iron ore fines are at 6% discount to imports for a consumer like JSW Dolvi - farthest customer from NMDC's mines at the western coast of India. This implies that NMDC can increase prices by ~INR350/ton as long as iron ore prices remain above USD65/dmt. Although prices in global trade are higher, exports from Chhattisgarh (at 30% export duty) are still unviable. NMDC can sell under the MoU route (concessional export duty of 10%), but the volumes there are not scalable.

Domestic supply can be party pooper

Although NMDC has raised prices, domestic private miners have not been able to increase prices similarly and can put NMDC's realization/volumes at risk. Prices of iron ore in Odisha have remained virtually unchanged despite the huge 73% jump in seaborne trade prices. Overcapacity and lack of export viability (because of 30% export duty on high grade ore) are key reasons behind subdued domestic pricing. There has been a huge jump in iron ore mining capacity after amendment of MMDRA in January 2015. The leases of all merchant mines will expire by March 2020, which has put pressure on them to maximize volumes. Further, Essar Steel has recently secured a lease in auction in Odisha. Jindal Steel has got a favorable decision, allowing it to lift 10-12mt of inventories from Sarda Mines. Demand from Essar and Jindal Steel has declined.

Raising FY17 realization estimate by 23%; target price to INR90

We are increasing our estimate for NMDC's domestic iron ore realization by 23% to INR2,213/wmt for FY17 to reflect latest prices. We are expecting volumes to increase by 7% to 30.9mt in FY17. Resultantly, EBITDA has increased by 38% to INR38.5b. We have raised our target price from INR78/share to INR90/share. Maintain **Sell**.

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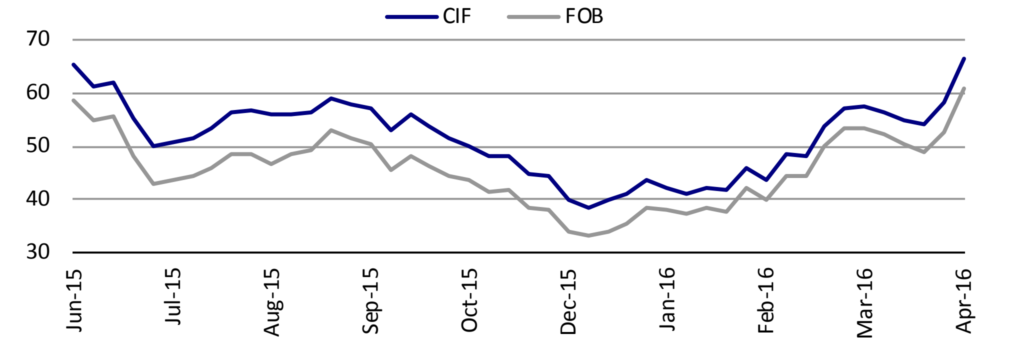
Iron ore price outlook has improved

Iron ore prices have surged by 73% from the lowest point achieved in December 2015 driven by strong Chinese steel market and toning down of iron ore supply growth guidance by BHP, Rio Tinto and Vale. Appreciation of AUD and BRL against USD has inflationary pressure on the cost structure of iron ore mines in Australia and Brazil who comprise of more 90% of seaborne supply.

Iron ore prices have surged 73% from lows of USD38/dmt in dec 2015

Exhibit 1: Iron ore prices for 62% grade (USD/dmt)



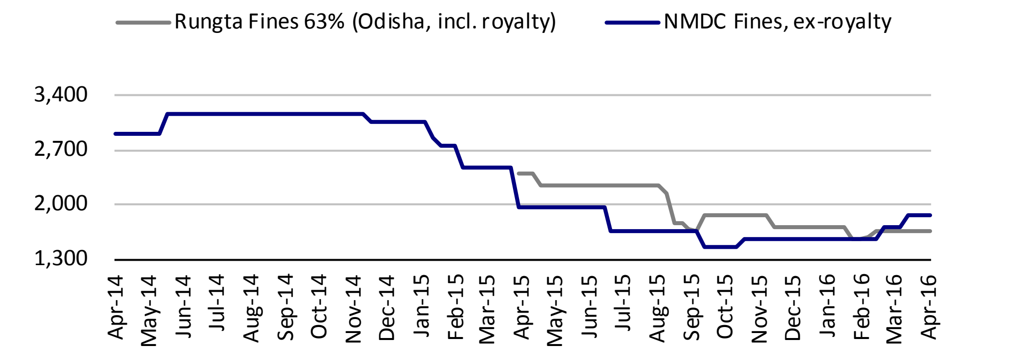
CIF=delivered to Chinese ports; Fob=free on board Indian export ports   Source: Bloomberg, MOSL

NMDC's pricing power too has improved

NMDC too has taken a clue from international market and has increased prices in the month of March and April by a total of 17-19%.

NMDC has increased prices of fines, but Odisha mines have not increased prices

Exhibit 2: Prices of iron ore fines in India



Source: MOSL, Company

According to our calculations, there is more headroom to increase prices. At Iron ore prices of USD65/dmt. The landed prices of iron ore fines are at 6% discount to imports for a consumer like JSW Dolvi - farthest customer from NMDC's mines at west coast of India. This implies that NMDC can increase prices by ~INR350/t as long as iron ore prices remain above USD65/dmt.

NMDC can theoretically increase prices by INR350/t as long as iron ore prices remain above USD65/dmt

Exhibit 3: Iron ore fines: landed cost to Indian steel mills (NMDC v/s. Imports)

	Unit	Dolvi	Essar	RINL
(a) Landed cost from NMDC	USD/wmt	60	48	49
(b) Landed cost of imports	USD/wmt	66	66	66
NMDC premium/(discount) to imported	USD/wmt	-6	-19	-17
(a) calculations for landed cost from NMDC				
Ex-Mine Price	INR/wmt	1,860	1,860	1,860
add: royalty@15%	INR/wmt	363	363	363
add: transportation/port handling	INR/wmt	1,750	950	1,050
Landed cost at plant	INR/wmt	3,973	3,173	3,273
Landed cost at plant	USD/wmt	60	48	49
(b) calculations for landed cost of imports				
Iron ore lumps cfr	USD/dmt	65	65	65
less: moisture (8%)	USD/wmt	5	5	5
add: import duty (2.5%)	USD/wmt	6	6	6
Landed cost at plant	USD/wmt	66	66	66

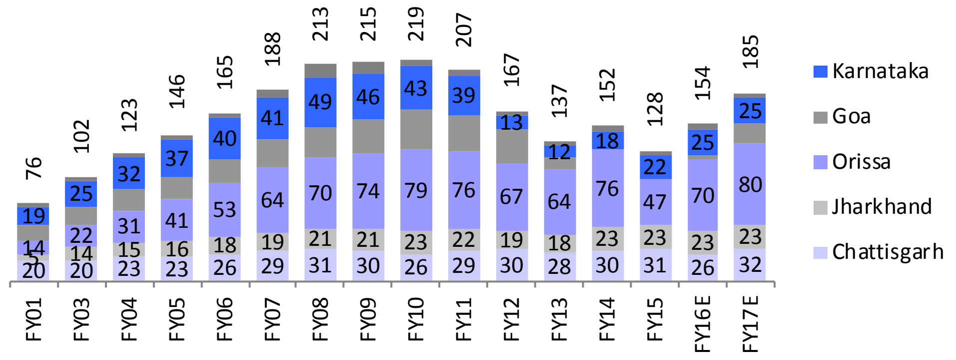
USD/INR exchange rate = 66.4 IODEX65USD/T, CFR China basis Source: MOSL

But, domestic supply is party pooper

It is interesting to note that other private mines are not able to increase prices in similar way. Prices of iron ore in Odisha have remained virtually unchanged despite huge 73% jump in seaborne trades. Overcapacity and lack of exports viability (because of 30% export duty on high grade ore) are key reasons behind subdued domestic pricing scenario. There is huge jump in iron ore mining capacity after amendment of MMDRA in Jan 2015. The leases of all merchant mines will expire by March 2020, which has put pressure on them to maximize volumes. Further, Essar steel has recently secured a lease in auction in Odisha. Jindal steel has got favorable decision allowing it to lift nearly 10-12mt of inventories from Sarda mines. The demand from Essar and Jindal steel has declined.

Domestic supply far outstrips local demands

Exhibit 4: Indian iron ore supply (mt)



Source: MOSL

Exports of high grade ore is still not viable due to high export duty of 30%

Exhibit 5: Margin calculations for iron ore exports from Chhattisgarh mines

		Deductions	Residual realization
CFR price for 62%	USD/dmt		65
moister	8.10%	5.3	60
Sea Freight	USD/wmt	8	52
Export duty	30%	15.5	36
Port charges	USD/wmt	0	36
Rail freight	USD/wmt	24	12
Road handling	USD/wmt	0	12
Royalty	USD/wmt	7.1	5
mining cost	USD/wmt	7.5	-2
EBITDA per ton	USD/wmt		-2

Source: MOSL

Although export of high grade ore is unviable in general, NMDC has started generating some margins on its MoU with Japan and Korea under concessional export duty of 10% under special govt. dispensation. However, this is not scalable.

Margins are returning in MoU with Japan and Korea. But this is not scalable

Exhibit 6: Margin calculations under MoU with Japan and Korea

		Deductions	Residual realization
CFR price for 62%	USD/dmt		65
moister	8.1%	5.3	60
Sea Freight	USD/wmt	8.0	52
Export duty	10%	5.2	47
Port charges	USD/wmt	0.0	47
Rail freight	USD/wmt	24.0	23
Road handling	USD/wmt	0.0	23
Royalty	USD/wmt	9.1	13
mining cost	USD/wmt	7.5	6
EBITDA per ton	USD/wmt		6

Source: MOSL

Global iron ore prices have increased sharply by 73% to ~USD65/dmt, but the sustainability of prices at these levels remains a question mark. At these prices, we expect supply growth to kick-in and put pressure on prices.

We are increasing NMDC's domestic iron ore realization by 23% to INR2,213/wmt for FY17E to reflect latest prices. We are expecting volumes to increase by 7% to 30.9mt inFY17E. Resultantly, EBITDA has increased by 38% to INR38.5b. Target has increased from INR78 to INR90/share.

Exhibit 7: Target price derivation

Y/E March	2014	2015	2016E	2017E	2018E
EBITDA per ton (INR)	2,548	2,549	1,229	1,250	1,096
Volumes (m tons)	30.5	30.5	28.9	30.9	32.9
EBITDA	77,713	77,777	35,459	38,561	36,020
Target EV/EBITDA(x)		4.0	4.0	4.0	4.0
Target EV		311,107	141,835	154,245	144,079
Less: Net Debt			-153,238	-130,540	-122,122
Add: CWIP@50% discount			53,469	71,708	81,213
Equity Value			348,542	356,494	347,414
Target price (INR/share)			**88**	**90**	**88**

Source: MOSL, Company

Financials and Valuations

Income Statement (INR Million)

Y/E Mar	2011	2012	2013	2014	2015	2016E	2017E	2018E
Net Sales	**113,689**	**112,615**	**107,043**	**120,582**	**123,564**	**66,798**	**68,300**	**67,347**
Change (%)	82.2	-0.9	-4.9	12.6	2.5	-45.9	2.2	-1.4
EBITDA	**86,430**	**89,281**	**77,838**	**77,713**	**77,777**	**35,459**	**38,561**	**36,020**
EBITDA Margin (%)	76.0	79.3	72.7	64.4	62.9	53.1	56.5	53.5
Depreciation	1,215	1,328	1,385	1,504	1,622	1,966	2,282	2,519
EBIT	**85,215**	**87,953**	**76,452**	**76,209**	**76,155**	**33,493**	**36,279**	**33,501**
Interest	0	0	0	0	0	0	0	0
Other Income	12,057	20,169	22,389	20,945	23,200	17,865	14,101	11,347
Extraordinary items	0	-513	-4,058	455	0	0	0	0
PBT	**97,272**	**107,610**	**94,783**	**97,609**	**99,354**	**51,357**	**50,380**	**44,847**
Tax	32,280	34,941	31,228	33,391	33,460	17,514	16,122	14,351
Tax Rate (%)	33.2	32.5	32.9	34.2	33.7	34.1	32.0	32.0
Min. Int. & Assoc. Share	0	0	0	0	0	0	0	0
Reported PAT	**64,992**	**72,669**	**63,556**	**64,218**	**65,895**	**33,844**	**34,259**	**30,496**
Adjusted PAT	**64,992**	**73,015**	**66,277**	**63,919**	**65,895**	**33,844**	**34,259**	**30,496**
Change (%)	88.8	12.3	-9.2	-3.6	3.1	-48.6	1.2	-11.0

Balance Sheet (INR Million)

Y/E Mar	2011	2012	2013	2014	2015	2016E	2017E	2018E
Share Capital	3,965	3,965	3,965	3,965	3,965	3,965	3,965	3,965
Reserves	188,181	240,099	271,145	295,918	319,353	309,129	324,832	336,774
Net Worth	**192,145**	**244,064**	**275,110**	**299,883**	**323,317**	**313,093**	**328,797**	**340,739**
Debt	0	0	0	0	0	0	0	0
Deferred Tax	1,029	1,001	1,045	1,073	984	984	984	984
Total Capital Employed	**193,174**	**245,065**	**276,155**	**300,956**	**324,301**	**314,077**	**329,781**	**341,723**
Gross Fixed Assets	22,728	23,882	26,025	28,506	31,969	35,969	39,969	43,969
Less: Acc Depreciation	11,736	11,994	13,379	14,883	16,505	18,471	20,754	23,273
Net Fixed Assets	**10,993**	**11,888**	**12,647**	**13,623**	**15,464**	**17,498**	**19,215**	**20,696**
Capital WIP	6,772	19,147	32,808	57,613	74,973	106,938	143,416	162,426
Investments	1,357	2,478	2,497	2,504	5,619	5,619	5,619	5,619
Current Assets	**191,860**	**232,972**	**260,992**	**241,029**	**248,642**	**205,817**	**183,407**	**174,806**
Inventory	4,154	4,589	6,375	6,812	6,919	3,660	3,742	3,690
Debtors	4,854	7,370	10,822	14,484	17,523	9,150	9,356	9,226
Cash & Bank	172,281	202,646	210,258	186,572	184,431	153,238	130,540	122,122
Loans & Adv, Others	10,571	18,367	33,538	33,161	39,768	39,768	39,768	39,768
Curr Liabs & Provns	**17,807**	**21,420**	**32,788**	**13,814**	**20,397**	**21,794**	**21,877**	**21,824**
Curr. Liabilities	6,145	6,447	11,094	11,092	2,263	3,660	3,742	3,690
Provisions	11,662	14,973	21,694	2,722	18,134	18,134	18,134	18,134
Net Current Assets	**174,053**	**211,552**	**228,204**	**227,216**	**228,245**	**184,023**	**161,531**	**152,981**
Total Assets	**193,174**	**245,065**	**276,155**	**300,956**	**324,301**	**314,077**	**329,781**	**341,723**

E: MOSL Estimates

Financials and Valuations

Ratios

Y/E Mar	2011	2012	2013	2014	2015	2016E	2017E	2018E
Basic (INR)								
EPS	**16.4**	**18.4**	**16.7**	**16.1**	**16.6**	**8.5**	**8.6**	**7.7**
Cash EPS	16.7	18.8	17.1	16.5	17.0	9.0	9.2	8.3
Book Value	48.5	61.6	69.4	75.6	81.5	79.0	82.9	85.9
DPS	2.2	4.5	7.0	8.5	8.6	9.5	4.0	4.0
Payout (incl. Div. Tax.)	15.3	26.3	51.1	61.4	60.2	130.2	54.2	60.8
Valuation(x)								
P/E				6.1	5.9	11.5	11.4	12.8
Cash P/E				6.0	5.8	10.9	10.7	11.8
Price / Book Value				1.3	1.2	1.2	1.2	1.1
EV/Sales				1.7	1.7	3.6	3.8	4.0
EV/EBITDA				2.6	2.6	6.7	6.7	7.5
Dividend Yield (%)				8.6	8.7	9.6	4.1	4.1
EV/ton				2	2	3	3	3
Profitability Ratios (%)								
RoE	29.7	31.6	26.8	22.6	20.8	15.7	10.6	9.7
RoCE	29.5	31.5	26.7	22.6	20.8	15.6	10.6	9.6
RoIC	403.2	346.6	215.3	119.5	88.6	67.5	47.5	46.6
Turnover Ratios (%)								
Asset Turnover (x)	0.6	0.5	0.4	0.4	0.4	0.2	0.2	0.2
Debtors (No. of Days)	16	24	37	44	52	50	50	50
Leverage Ratios (%)								
Net Debt/Equity (x)	-0.9	-0.8	-0.8	-0.6	-0.6	-0.5	-0.4	-0.4

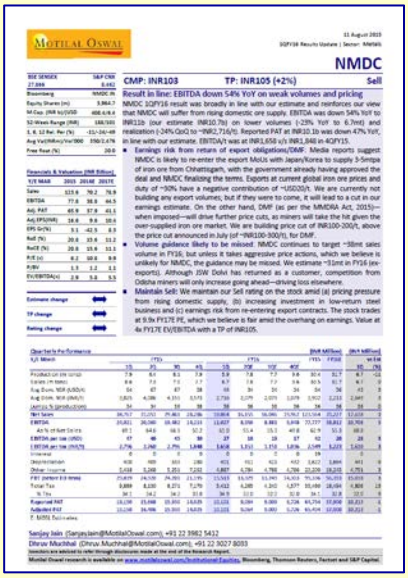
Cash Flow Statement (INR Million)

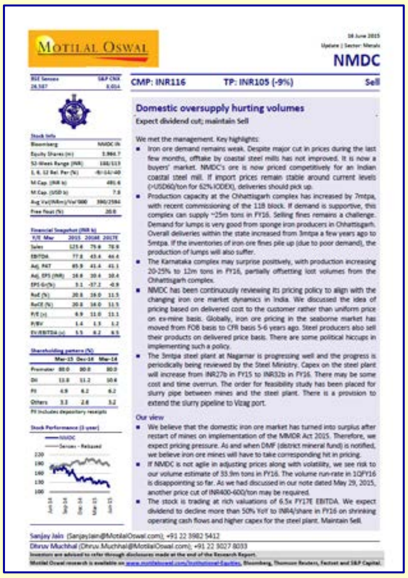
Y/E Mar	2011	2012	2013	2014	2015	2016E	2017E	2018E
Adjusted EBITDA	86,430	89,281	77,838	77,713	77,777	35,459	38,561	36,020
Non cash opr. exp (inc)	12,057	19,656	18,331	21,400	23,200	17,865	14,101	11,347
(Inc)/Dec in Wkg. Cap.	-1,162	-7,134	-9,040	-22,697	-3,170	13,029	-206	131
Tax Paid	-32,280	-34,941	-31,228	-33,391	-33,460	-17,514	-16,122	-14,351
Other operating activities	-4,549	-2,739	5	12	-2,888	0	0	0
CF from Op. Activity	**60,496**	**64,123**	**55,906**	**43,037**	**61,459**	**48,839**	**36,335**	**33,146**
(Inc)/Dec in FA & CWIP	-6,228	-13,529	-15,805	-27,286	-20,823	-35,964	-40,478	-23,010
Free cash flows	**54,268**	**50,595**	**40,102**	**15,751**	**40,636**	**12,874**	**-4,143**	**10,136**
(Pur)/Sale of Invt	-595	-1,121	-19	-7	-3,116	0	0	0
Others	0	0	0	0	0	0	0	0
CF from Inv. Activity	**-6,823**	**-14,650**	**-15,824**	**-27,293**	**-23,939**	**-35,964**	**-40,478**	**-23,010**
Inc/(Dec) in Net Worth	0	0	0	0	0	0	0	0
Inc / (Dec) in Debt	0	0	0	0	0	0	0	0
Interest Paid	0	0	0	0	0	0	0	0
Divd Paid (incl Tax) & Others	-9,942	-19,109	-32,471	-39,429	-39,661	-44,068	-18,555	-18,555
CF from Fin. Activity	**-9,942**	**-19,109**	**-32,471**	**-39,429**	**-39,661**	**-44,068**	**-18,555**	**-18,555**
Inc/(Dec) in Cash	**43,731**	**30,365**	**7,612**	**-23,685**	**-2,141**	**-31,193**	**-22,698**	**-8,419**
Add: Opening Balance	128,549	172,281	202,646	210,258	186,572	184,431	153,238	130,540
Closing Balance	**172,281**	**202,646**	**210,258**	**186,572**	**184,431**	**153,238**	**130,540**	**122,122**

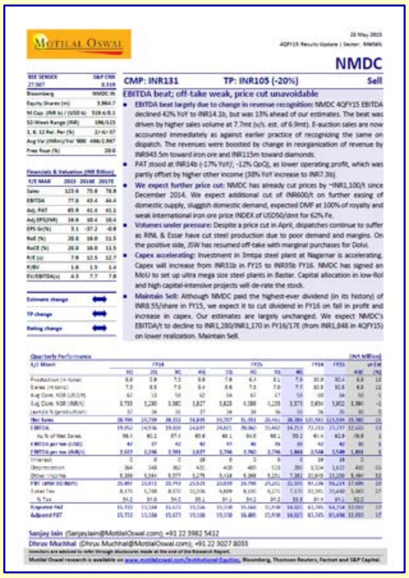
E: MOSL Estimates

NMDC GALLERY

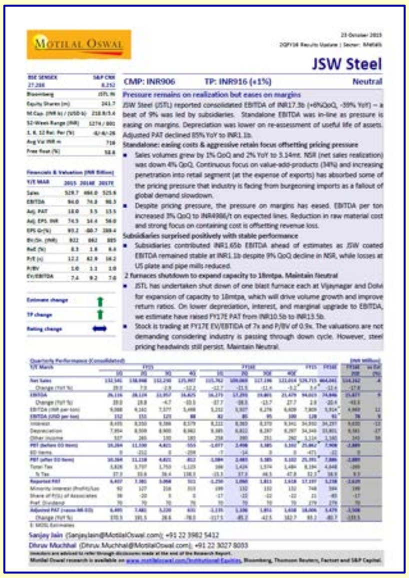
NMDC

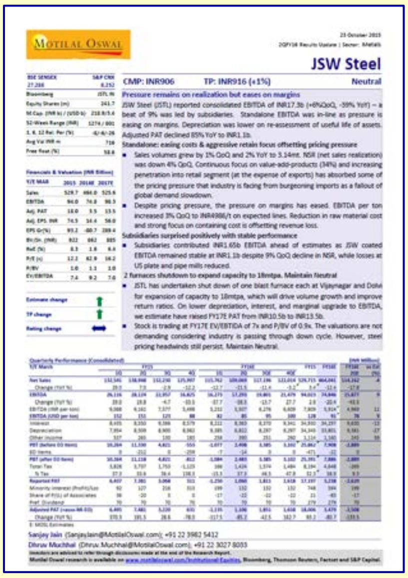

Motilal Oswal
NMDC
CMP: INR103 TP: INR105 (+2%) Sell
Result in line: EBITDA down 54% YoY on weak volumes and pricing


Motilal Oswal
NMDC
CMP: INR116 TP: INR105 (-9%) Sell
Domestic oversupply hurting volumes
Expect dividend cut; maintain Sell


Motilal Oswal
NMDC
CMP: INR131 TP: INR105 (-20%) Sell
EBITDA beat; off-take weak, price cut unavoidable

OTHER COMPANIES


Motilal Oswal
JSW Steel
CMP: INR906 TP: INR916 (+1%) Neutral
Pressure remains on realization but eases on margins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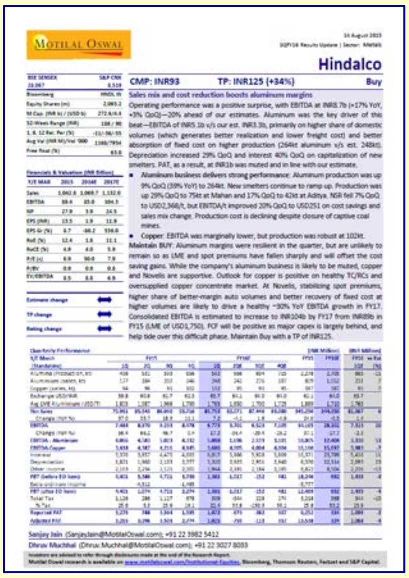
Motilal Oswal
Hindalco
CMP: INR93 TP: INR125 (+34%) Buy
Sales mix and cost reduction boosts aluminum margins

SECTOR UPDATES


Motilal Oswal
Metals
DMF materially lower than the maximum limit
Earnings upgrade for HZ and cut for NMDC


Motilal Oswal
Metals
Steel: Cyclical stress or permanent debt trap?


Motilal Oswal
Metals
Coal auction: High revenue overshadows process flaw

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