India

Neutral *(no change)*

Highlighted Companies

NMDC

ADD, TP Rs319, Rs269 close

Iron ore prices are rising & may stay above the above current levels. The uptrend is likely to result in higher FY25F/26F realization at ~Rs5,500-5,750/t. We estimate EPS of Rs22.4/Rs27.2/Rs30.7for FY24F/25F/26F, respectively. We value the stock at 6.5x FY26F EV/EBITDA and introduce a new target price of Rs319(Rs220 earlier).

Summary Valuation Metrics

P/E (x)	Mar24-F	Mar25-F	Mar26-F
NMDC	12.01	9.89	8.76

P/BV (x)	Mar24-F	Mar25-F	Mar26-F
NMDC	2.93	2.43	2.03

Dividend Yield	Mar24-F	Mar25-F	Mar26-F
NMDC	2.5%	3.04%	3.43%

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Metals and Mining

Indian iron ore to be firm for a longer span

- PSUs were always preferred in the MMDR Act, 2015 but even private iron ore mines who got lease in 1996-2014 will have a long-term lower cost structure.
- Integrated private steel makers like Tata Steel will see their iron ore costs rising by at least 2-3x from 2030F (from Rs3,600/t to at least Rs11,000/t of steel).
- NMDC will continue to have a lower cost structure and will reap the benefit of higher prices. Stock can rerate even more. It's our TOP BUY in mining space.

MMDR Act, 2015 – Advantage to miners who got lease in 1996-2014

The MMDR Act, 2015 was a seminal legislation to do away with multiple problems of lease extension and hence, rising procedural illegalities. While it provided a reprieve, it has created an uneven playing field between miners as well as steel companies. Public sector undertakings or PSUs have a clear advantage, even mining companies who got the mining lease just before the promulgation of the MMDR Act, 2015 have their lease period automatically enhanced for 50 years. To cite an example, for all the miners who had got mining leases between 1996 and 2014, their mining lease will expire between 2046 to 2065. The supply dynamics because of higher premiums and upcoming auctions before the end of FY30 indicate that iron ore supply will remain tight in the coming years. All private Iron ore miners will have to surrender even their captive mines and must participate in the auction process. MMDR Act, 2015 has created some unlikely winners as well - these are miners who got their mining leases (without auction) between 1996 to 2014.

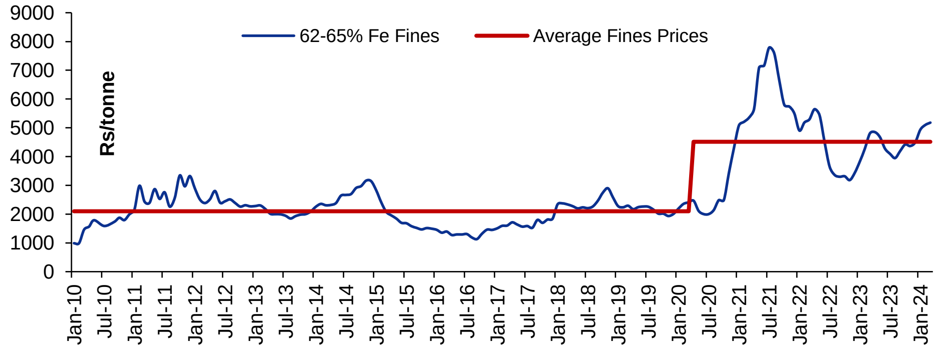
PSU steel companies with captive mines have a long-term advantage

PSU steel companies like SAIL have a natural advantage as all private steel companies like Tata Steel will lose their historical iron ore mines. We estimate that Tata Steel's iron ore cost can increase to at least Rs11,000/t of steel (currently ~ Rs3,600/t). On the other hand, SAIL will retain its mines and continue to enjoy the benefit of low-cost iron ore. Only time will tell whether the rise in Tata Steel's production cost will lead to a general increase in prices. However, as of now, given SAIL's expansion plan, NMDC's new steel capacity, Arcelor Mittal increasing its capacity, and multiple other small steel plants coming into the fray, a systemic steel price rise looks unlikely. Please remember that China is slowly depreciating its yuan, thus bringing more stress to steel makers.

NMDC will rerate as iron ore prices will go up and remain steady

In this scenario, NMDC can rerate and its futile to look at historical trading multiples. More so when iron ore prices are structurally going up in India. Even now, iron ore trades around export parity prices in the country, but in a matter of few quarters we will see it trading at a premium to export parity. Import parity is very unlikely, in our view. After the promulgation of MMDR Act, it's clear that all future mines will be assigned on an auction basis where the average premium has been around 132%. The mining companies are themselves to blame for it as at a 132% premium, mining is simply not viable which creates scarcity and leads to a big opportunity for mining companies who have leases granted between 1996-2004 as well as PSUs like NMDC. These companies have lower costs vs. auction winners. Downside risk: Government ban on exports.

Figure 1: India fines prices have moved upwards structurally since Mar 2020



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Indian iron ore to be firm for a longer span

The supply dynamics because of higher premiums and upcoming auctions before the end of FY30 indicates that iron ore supply will remain tight in the coming years. All private iron ore miners will have to surrender even their captive mines and have to participate in the auction process. MMDR Act, 2015 has created some unlikely winners as well - these are miners who got their mining leases between 1996-2014. As per the MMDR Act, their lease period has been automatically increased to 50 years.

MMDR Act, 2015 has created an uneven field

MMDR Act, 2015 was a seminal act to do away with multiple problems of lease extension and hence, rising procedural illegalities. While it provided a temporary reprieve, it has created an uneven playing field between miners as well as steel companies. The government companies have a clear advantage, even mining companies who got the mining lease just before the promulgation of the MMDR Act, 2015 have their lease period automatically enhanced for 50 years.

MMDR Act, 2015 made seminal changes for India's iron ore mining sector

The salient features of MMDR Amendment Bill, 2015 are as follows:

1. The amendment seeks to bring in utmost transparency by introducing auction mechanism for the grant of mineral concessions. The tenure of mineral leases has been increased from the existing 30 years to 50 years. There is no provision for renewal of leases.
2. The mining industry has been aggrieved due to the second and subsequent renewals remaining pending. In fact, this has led to closure of a large number of mines. The Bill addresses this issue also. ***The Bill provides that mining leases would be deemed to be extended from the date of their last renewal to 31 March 2030 (in the case of captive mines) and till 31 March 2020 (for the merchant miners) or till the completion of the renewal already granted, if any, or a period of fifty years from the date of grant of such lease, whichever is later.***
3. There is a provision to establish District Mineral Foundation in the districts affected by mining-related activities.
4. The Bill proposes to set up a National Mineral Exploration Trust, created out of contributions from the mining lease holders, in order to have a dedicated fund for encouraging exploration in the country. Transfer of mineral concessions granted through auction will be permitted in order to encourage private investors.
5. The amendment removes the need for 'previous approval' from the central government for grant of mineral concessions in case of important minerals like iron ore, bauxite, manganese etc., thereby making the process quicker and simpler. Similarly, state governments will devise a system for filing of a mining plan, obviating the need for prior approval of the mining ministry.
6. The central government will have revision powers in case state governments fail to decide the issues within the prescribed time.
7. In order to address the serious problem of illegal mining, the penal provisions have been made further stringent by prescribing higher penalties up to Rs500,000 per ha and imprisonment up to five years. State governments will now be able to set up special courts for the trial of offences under the Act.

The second clause will lead to windfall gain for some miners- iron ore to start trading at much higher than export parity prices and slightly below import parity prices

1. One of the outcomes (unintended may be) is the windfall gain for miners who had got mining leases after 1996, and thus were not due to lease renewal. By the change of the law their lease got extended.
2. So for all the miners who had got mining leases between 1996 and 2014, mining lease will expire between 2046 to 2065. After the expiry, the mine will go into auction.
3. However, all merchant mining and even captive leases will expire for those who have completed 50 years from the date of grant of mining lease or 2020 (for merchant mining lease) and 2030 (for captive mining lease), whichever is later.
4. This means miners who had got the mining lease between 1996 to 2014 will get a supernormal profitability period for at least 14 years or at the maximum 34 years. Please note that as all leases expire in 2030, the prices of iron ore in the country will rise because of the fact that mining cost will now include the cost of the auction as well.

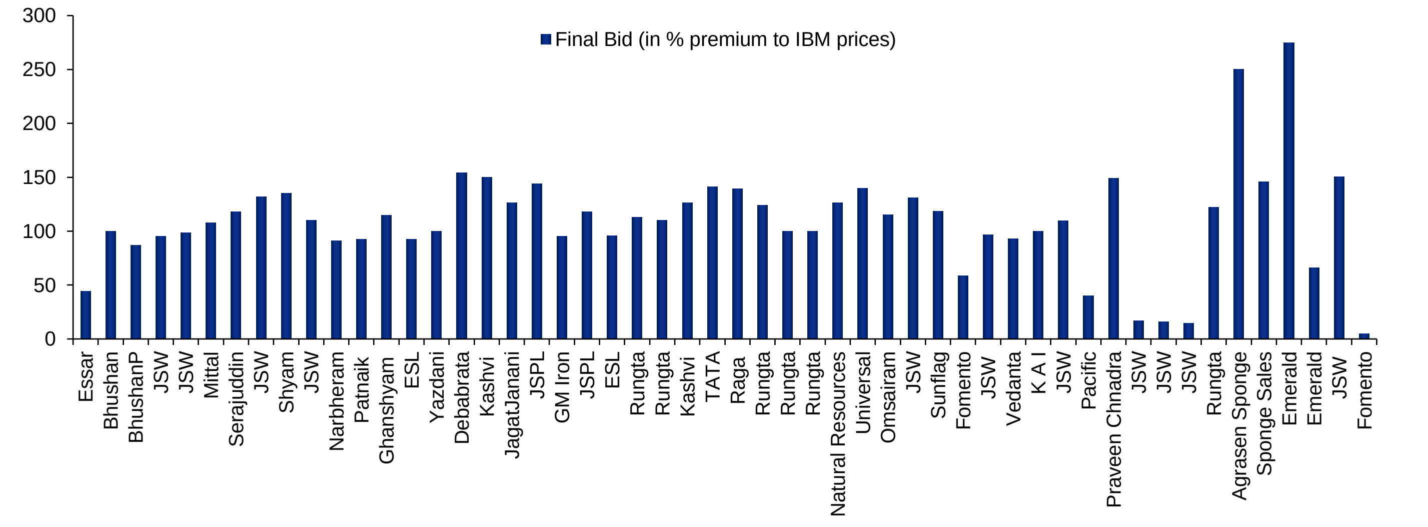
Auction of mines should start by 2028F

Most of the companies' captive iron ore mines (including Tata Steel) have to be auctioned by Mar 2030. This, in turn, means that the auction process will start by 2028. This process normally takes 1-1.5 years.

The past iron ore auction premium has been totally irrational

Past mining auctions have seen irrational bidding by mining companies and even steel companies. Security on iron ore supply has been the primary motive for many steel companies to bid at exorbitant premiums.

Figure 2: The average premium for the explored mines has been at around 110-20% premium to IBM prices; recently JSW got a couple of mines at a 15% premium to IBM prices but they are totally unexplored mines



SOURCE: INCRED RESEARCH, COMPANY REPORTS

We expect 2028 auctions to see even higher premiums

Premiums for the mines which are near to the steel plants can be higher compared to merchant mines. For example, Tata Steel has all the infrastructure made for evacuating iron ore from its mine. Naturally, It will go all out to win the bid. Simultaneously, the mine is so good that people will be ready to pay even a 100% premium to IBM prices to get this mine. As a result, Tata Steel's iron ore cost per tonne of steel can become 3x from the current levels.

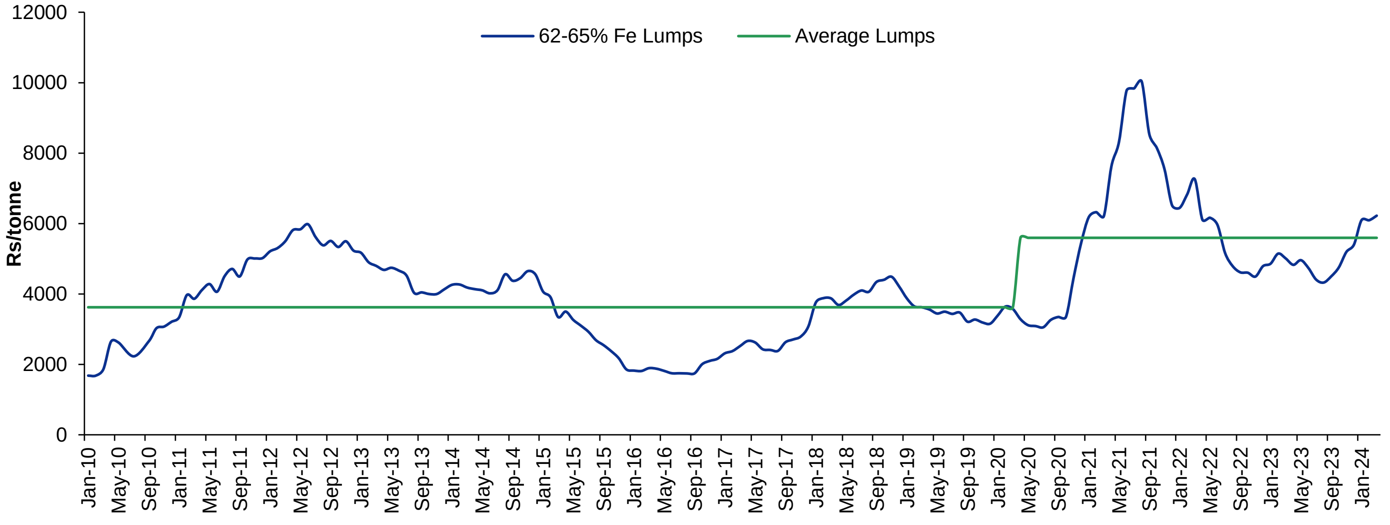
Iron ore prices have changed their trajectory post 2020 and can go higher

Most of the merchant miners in Odisha had to bid at the auction to get the mining licence. This led to a change in the trajectory of iron ore prices in India. Prior to Mar 2020, all India average prices of lumps used to be around Rs3,600/t and fines at Rs2,100/t. Since 2020, the lump average has increased by 50% and fines by 120%. The worst of the mine head inventory scenario is behind us and as new mines ramp up supply, the scenario in Indian market will become better. Having said that, as the cost structure of mining gets inflated, iron ore will become even more costly.

Structurally, iron ore prices will remain high in India

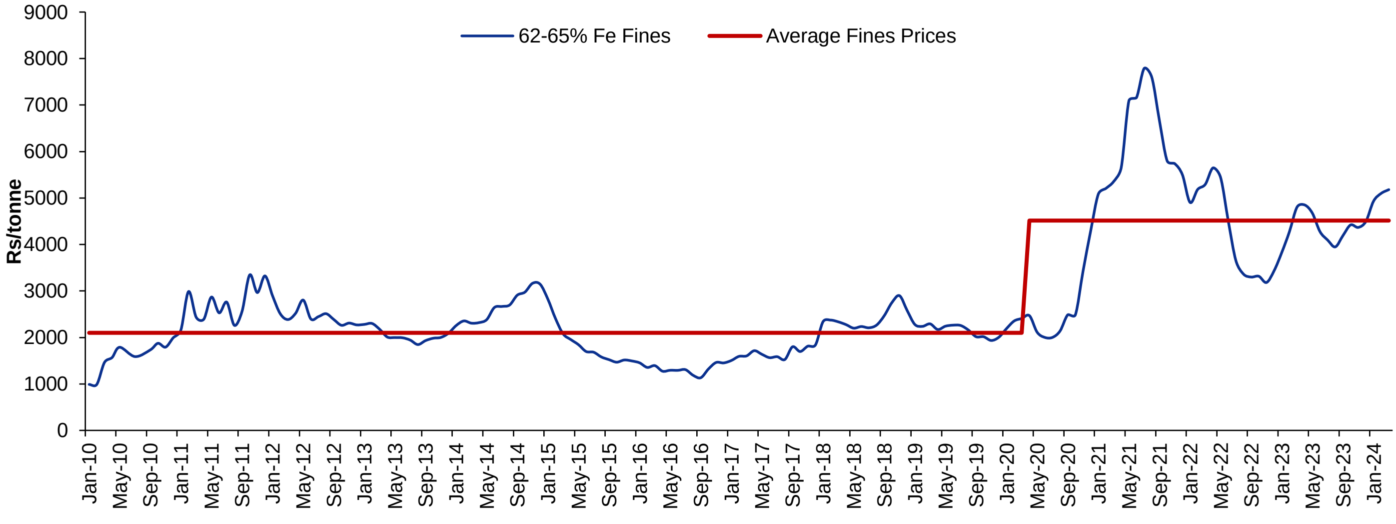
Indian iron ore prices are on the upswing and even as Covid-related supply chain crisis eased, we haven't seen any big fall in iron ore prices. The high premiums paid by merchant miners means that prices can remain higher for a long time.

Figure 3: Since the last decade, Indian lumps used to average around Rs3,600/t but at the auction for merchant miners, the average price increased by 50% to Rs5,600/t



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 4: Similarly, since the last decade, Indian lumps used to average around Rs2,100/t but at the auction for merchant miners, the average price increased by 120% to Rs4,500/t



SOURCE: INCRED RESEARCH, COMPANY REPORTS

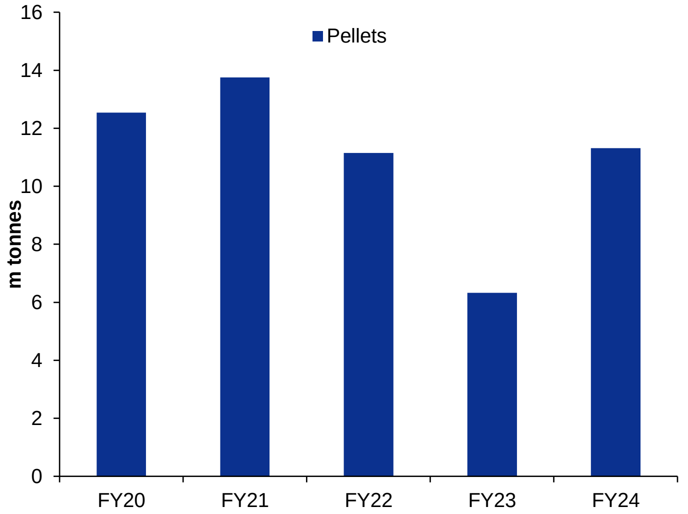
We expect iron ore production to rise as new miners are increasing their production capacity

Iron ore production will rise in the coming months as new miners like Lloyds Metals and Energy (UNRATED) are ramping up their capacities. Lloyds Metals and Energy has got the environmental clearance or EC for 55mt of iron ore mining. The bulk of the iron ore to be mined is of lower grade and hence, it needs new methods of beneficiation.

Indian iron ore and pellet exports have remained unabated for the past few months

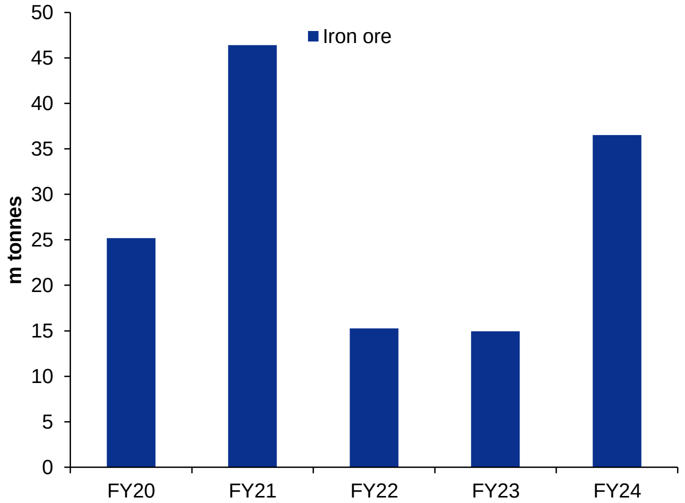
As soon as the export duty on pellets was reduced to 5%, there has been a rise in exports of pellets. At the same time, after the Covid-19 pandemic, all iron ore exports were subjected to 30% export duty but the same has been reversed and now only above 58% grade is subjected to 30% export duty.

Figure 5: Pellet exports have picked up after the export duty was reduced to 5% (from the earlier 30%)



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 6: While export duty on 58%+ fe iron ore has remained at 30%, the reduction in duty on below 58% grade has led to a recovery

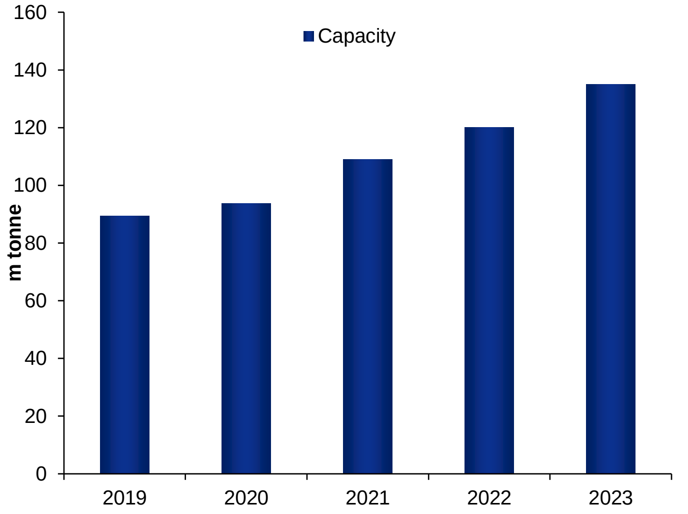


SOURCE: INCRED RESEARCH, COMPANY REPORTS

Indian companies are adding pellet capacity as it has become a necessity to run blast furnaces

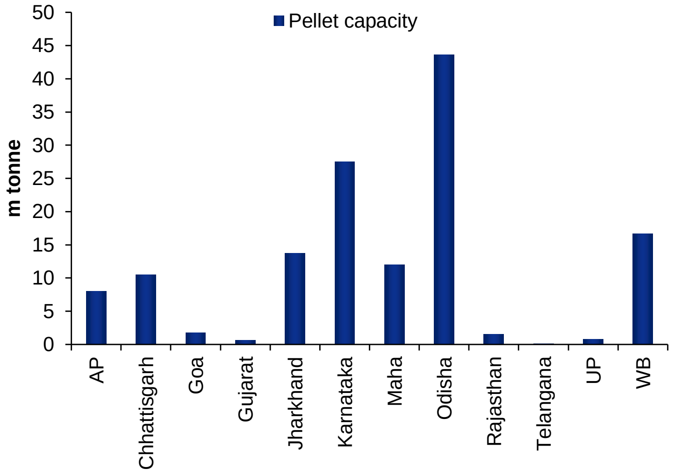
All Indian companies are adding pellet capacity as it has become a necessity to run blast furnaces or even sponge iron plants. The days of high grade (65%+ fe) iron ore lumps are over, which means for even charging a blast furnace we need to have pellets. Therefore, a slew of pellet capacities is being added.

Figure 7: All India pellet capacity has gone up to 136mt



SOURCES: INCRED RESEARCH, COMPANY REPORTS

Figure 8: Odisha (the biggest iron ore mining state in the country) has the highest pellet capacity



SOURCE: INCRED RESEARCH, COMPANY REPORTS

India's metallic balance indicates that demand-supply is finely balanced ➤

Figure 9: While the worst of mine head inventory situation is behind us, it may take 5-6 more years before mine inventory reaches the FY20 level

	All data in mt		FY20	FY21	FY22	FY23	FY24	FY25F	FY26F	FY27F	FY28F	FY29F
A	Indian crude steel production (million tonne)		108.6	102.1	119.9	125.5	140.0	152.6	166.4	181.3	197.6	215.4
B	Indian iron ore production		244.1	204.5	250.3	255.0	279.6	292.6	302.6	317.6	332.6	347.6
	Required Indian iron ore production							271.2	286.7	300.7	320.9	340.0
C	Indian iron ore exports		25.2	46.4	15.3	15.0	36.3	36.0	36.0	36.0	36.0	36.0
D	Pellet exports		12.5	13.7	11.1	6.3	12.0	12.0	12.0	12.0	12.0	12.0
E	Iron ore in pellets	E=D*1.1	13.8	15.1	12.3	7.0	13.2	13.2	13.2	13.2	13.2	13.2
F	Indian mine head inventory		146.7	121.0	110.0	100.0	75.0	96.4	112.3	129.3	141.0	148.6
G	Change in mine head inventory	G	15.9	25.7	11.0	10.0	25.0					
H	Indian scrap imports	H	5.5	4.2	3.6	10.1	10.5	12.5	14.5	16.5	18.5	20.5
I	Scrap imports in terms or iron ore	I=H*1.9	10.4	8.0	6.8	19.1	19.9	23.7	27.5	31.3	35.1	38.9
J	Domestic scrap generation	J	14.5	15.8	22.4	17.9	15.5	17.0	20.0	25.0	28.0	33.0
K	Domestic scrap in terms or iron ore	K=J*1.9	27.6	30.0	42.6	34.1	29.5	32.3	38.0	47.5	53.2	62.7
L	Domestic consumption of iron ore	L=B-C-E-G-I-K	183.0	130.7	184.3	189.9	205.6					
N	Total iron ore equivalent consumption	N=L+K+I	221.0	168.7	233.7	243.1	255.0	278.0	303.0	330.3	360.0	392.4
O	Iron ore equivalent per tonne of steel	O=N/A	2.04	1.65	1.95	1.94	1.82	1.82	1.82	1.82	1.82	1.82

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