

Company Focus

24 October 2007 | 7 pages

National Aluminium (NALU.BO)

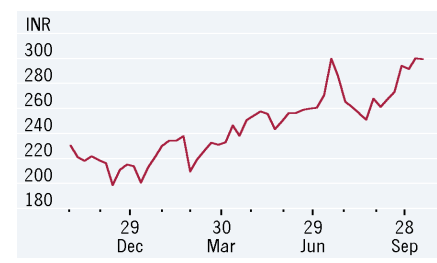
 Target price change
 Estimate change

Sell: 2QFY08 – Trend in Earnings Decline Continues

- 2Q PAT falls 26%, earnings revised** — A sharp drop in alumina PBIT caused a fall in Nalco's PAT to Rs4.4bn, 6% below our est. Costs were impacted by Rs400m due to inadequate coal supply, forcing Nalco to use imported coal and power from external sources. We revise PAT estimates by 1% to -16%, largely based on exchange rate changes and FY07 Annual Report details.
- Alumina PBIT falls 68% yoy** — Lower alumina prices (~US\$300/t vs ~US\$500/t in 2QFY07) was the main reason for the yoy drop in Nalco's PAT for the third quarter in a row. Alumina revenues declined 43% yoy to Rs4.5bn and PBIT margins fell sharply to 40% from 73% last year. Alumina prices are expected to remain subdued over the next few quarters.
- Aluminium: margins decline sequentially** — The division's PBIT margins grew on a yoy basis mainly driven by higher volumes. However on a qoq basis PBIT margins fell 500bps to 34%. The international aluminium price has been declining over the past 2-3 quarters. Given our flat outlook for international prices (~US\$2,600/t) in FY08E-09E, appreciating rupee and lack of volume growth (until FY10E), we see limited upside for the division.
- Maintain Sell, adjusting target price** — Reiterate Sell (3M) based on a dull alumina outlook and likely decline in aluminium realizations. We marginally adjust our target price from Rs232 to Rs231 based on (1) our target multiple being raised from 8x to 9x to the mid-point of 1-yr trading range of 7-11x; (2) upward re-rating of metal stocks globally; and (3) rollover to FY09E EPS.

Sell/Medium Risk	3M
Price (24 Oct 07)	Rs282.60
Target price	Rs231.00
	from Rs232.00
Expected share price return	-18.3%
Expected dividend yield	2.5%
Expected total return	-15.8%
Market Cap	Rs182,082M
	US\$4,600M

Price Performance (RIC: NALU.BO, BB: NACL IN)



Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2006A	15,622	24.25	26.5	11.7	3.1	29.5	1.8
2007A	23,814	36.96	52.4	7.6	2.4	35.1	2.7
2008E	17,923	27.82	-24.7	10.2	2.0	21.5	2.5
2009E	16,585	25.74	-7.5	11.0	1.8	17.4	2.3
2010E	13,470	20.91	-18.8	13.5	1.7	12.7	2.1

Source: Powered by dataCentral

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¹Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	11.7	7.6	10.2	11.0	13.5
EV/EBITDA adjusted (x)	6.1	3.9	5.2	6.0	6.3
P/BV (x)	3.1	2.4	2.0	1.8	1.7
Dividend yield (%)	1.8	2.7	2.5	2.3	2.1
Per Share Data (Rs)					
EPS adjusted	24.25	36.96	27.82	25.74	20.91
EPS reported	23.79	37.05	27.82	25.74	20.91
BVPS	91.46	119.43	139.06	157.20	171.08
DPS	5.00	7.50	7.00	6.50	6.00
Profit & Loss (RsM)					
Net sales	48,519	59,402	51,864	51,313	52,864
Operating expenses	-24,519	-23,138	-24,530	-27,136	-33,229
EBIT	24,000	36,264	27,333	24,177	19,636
Net interest expense	0	0	-12	0	0
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	24,000	36,264	27,321	24,177	19,636
Tax	-8,674	-12,390	-9,398	-7,591	-6,166
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	15,325	23,874	17,923	16,585	13,470
Adjusted earnings	15,622	23,814	17,923	16,585	13,470
Adjusted EBITDA	27,772	39,436	30,339	27,827	25,219
Growth Rates (%)					
Sales	18.2	22.4	-12.7	-1.1	3.0
EBIT adjusted	24.3	51.1	-24.6	-11.5	-18.8
EBITDA adjusted	16.1	42.0	-23.1	-8.3	-9.4
EPS adjusted	26.5	52.4	-24.7	-7.5	-18.8
Cash Flow (RsM)					
Operating cash flow	19,654	27,225	15,759	19,127	17,010
Depreciation/amortization	3,772	3,171	3,006	3,651	5,583
Net working capital	-378	417	-2,506	-1,254	-956
Investing cash flow	-2,331	-6,419	-28,755	-12,946	-938
Capital expenditure	-2,030	-6,815	-31,550	-15,076	-3,500
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-2,939	-5,877	-1,897	-5,277	-4,900
Borrowings	0	0	0	0	0
Dividends paid	-2,939	-5,878	-1,885	-5,277	-4,900
Change in cash	14,385	14,928	-14,893	905	11,171
Balance Sheet (RsM)					
Total assets	74,746	95,266	109,705	122,967	134,029
Cash & cash equivalent	21,937	36,865	21,973	22,877	34,049
Accounts receivable	294	341	315	312	318
Net fixed assets	41,775	45,525	74,069	85,494	83,411
Total liabilities	15,819	18,314	20,107	21,684	23,799
Accounts payable	2,674	3,628	2,703	2,881	3,598
Total Debt	0	0	0	0	0
Shareholders' funds	58,927	76,952	89,598	101,283	110,230
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	57.2	66.4	58.5	54.2	47.7
ROE adjusted	29.5	35.1	21.5	17.4	12.7
ROIC adjusted	32.6	50.1	27.8	19.2	14.6
Net debt to equity	-37.2	-47.9	-24.5	-22.6	-30.9
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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Figure 1. National Aluminium: Quarterly Results

(Rs m)	2Q FY08	2Q FY07	% chg	1Q FY08	1Q FY07	% chg
Net sales	13,082	14,416	-9%	11,652	14,855	-22%
Expenditure	7,397	5,665	31%	5,488	5,512	0%
Op profit	5,685	8,751	-35%	6,164	9,344	-34%
% margin	43.5	60.7		52.9	62.9	
Other income	1,644	1,014	62%	1,310	834	57%
Interest	6	0		1	0	
Depreciation	683	771	-11%	692	787	-12%
PBT	6,639	8,994	-26%	6,782	9,391	-28%
Total Tax	2,242	3,044	-26%	2,315	3,168	-27%
% tax rate	34	34		34	34	
Net profit	4,397	5,950	-26%	4,467	6,223	-28%
Eq sh (m)	644.3	644.3	0%	644.3	644.3	0%
EPS (Rs)	6.82	9.23	-26%	6.93	9.66	-28%
Rs/US\$ rate	40.63	46.41	-12%	41.3	45.44	-9%
Avg LME (US\$/tonne)	2,553	2,482	3%	2,761	2,652	4%
Divisional Breakdown						
Alumina						
Revenues (Rs m)	4,474	7,816	-43%	4,273	9,069	-53%
PBIT (Rs m)	1,808	5,713	-68%	1,900	6,773	-72%
% margins	40	73		44	75	
Aluminium						
Revenues (Rs m)	10,556	10,891	-3%	9,073	9,821	-8%
PBIT (Rs m)	3,615	2,614	38%	3,553	1,636	117%
% margins	34	24		39	17	
Electricity						
Revenues (Rs m)	1,966	1,609	22%	2,100	2,077	1%
PBIT (Rs m)	310	170	83%	661	684	-3%
% margins	16	11		31	33	

Source: Company Reports

Figure 2. National Aluminium - Earnings Revision Summary

	FY08E			FY09E			FY10E		
	Old	New	% change	Old	New	% change	Old	New	% change
Rs/US\$ FX rate	41.8	40.2	-4%	40.0	38.0	-5%	39.0	36.0	-8%
Aluminium (US\$/t)	2,480	2,606	5%	2,425	2,590	7%	2,315	2,315	0%
Net sales (Rs bn)	51.8	51.9	0%	49.6	51.3	3%	56.3	52.9	-6%
EBITDA (Rs bn)	30.9	30.3	-2%	27.5	27.8	1%	28.6	25.2	-12%
Net profit (Rs bn)	18.6	17.9	-4%	16.3	16.6	1%	16.1	13.5	-16%
EPS (Rs)	28.9	27.8	-4%	25.4	25.7	1%	24.9	20.9	-16%

Source: Citi Investment Research Estimates

National Aluminium

Company description

Nalco has a smelter capacity of 345,000 tpa in eastern India. It has enough deposits of bauxite to meet more than 50 years' requirements of its expanded alumina capacity (2.1m tpa from 1.58m tpa by end-2008). Good quality bauxite, open cast mines and low bauxite transport costs make Nalco one of

the lowest-cost producers of alumina in the world. The company sells its surplus alumina (25% of FY07 sales) in the international markets, and is India's largest alumina exporter. In the power-intensive business of producing aluminum, Nalco's 960MW thermal power capacity meets all of its in-house requirements at 33% of the grid cost, and some surplus power is sold to the state grid. Low costs for power, alumina and labor make Nalco one of the lowest-cost aluminum producers in the world.

Investment strategy

We rate Nalco as Sell/Medium Risk (3M). The key reason for our Sell rating is the YoY price declines we expect in FY08 and FY09 for alumina and aluminum. Alumina prices were strong in FY06 and 1H FY07. However, oversupply of alumina led to prices crashing by December 2006. Prices had recovered in 4Q FY07 due to a strike and martial law in Guinea, the world's second-largest bauxite producer, which has since concluded. We expect prices of around US\$300/t in FY08 and FY09, impacting divisional profitability versus FY07. For aluminum, we expect average domestic prices to decline 8% yoy in FY08E and 6% yoy in FY09E. Nalco's share price has generally moved in line with international aluminum prices, and based on the trends we forecast, we expect the stock to trade in a narrow band over the next year. Nalco is already operating at full capacity, and there is limited scope for volume growth until FY10.

Valuation

We use P/E to value Nalco because it is driven largely by commodity price trends, which translate into earnings momentum. In the past six years, the stock has traded in a PE range of 6-8x. During this period it has decisively crossed 8x only three times. In the past one year the PE band has moved up to a range of 7-11x in line with the rerating for metal stocks globally. We value Nalco at 9x FY09E EPS, which gives us a target price of Rs231. This is at the mid point of the trading band of the past one year and reflects the higher multiple at which global and domestic non-ferrous majors are now trading. This also appears justified based on its position among the lowest-cost producers of alumina and in the lowest cost quartile for aluminum globally. Over the past six years Nalco's EV/EBITDA has ranged between 3x and 5x. Over the past one year, the range has been between 3-6x. Based on our target price of Rs231, Nalco's EV/EBITDA works out to 4.5x, at the mid-point of its medium-term trading range.

Risks

We rate Nalco as Medium Risk according to our quantitative risk-rating system, which tracks 260-day historical share price volatility. The rating reflects greater uncertainty with respect to the aluminum price outlook and the increased volatility in international prices of alumina and aluminum. Possible upside risks to our target price include: (1) aluminum and alumina prices surpassing our forecasts; (2) depreciation in the rupee versus the US\$ rather than our forecast of an appreciating rupee in FY08 and FY09; and (3) a revival in the plan to privatize PSUs such as Nalco.

Appendix A-1

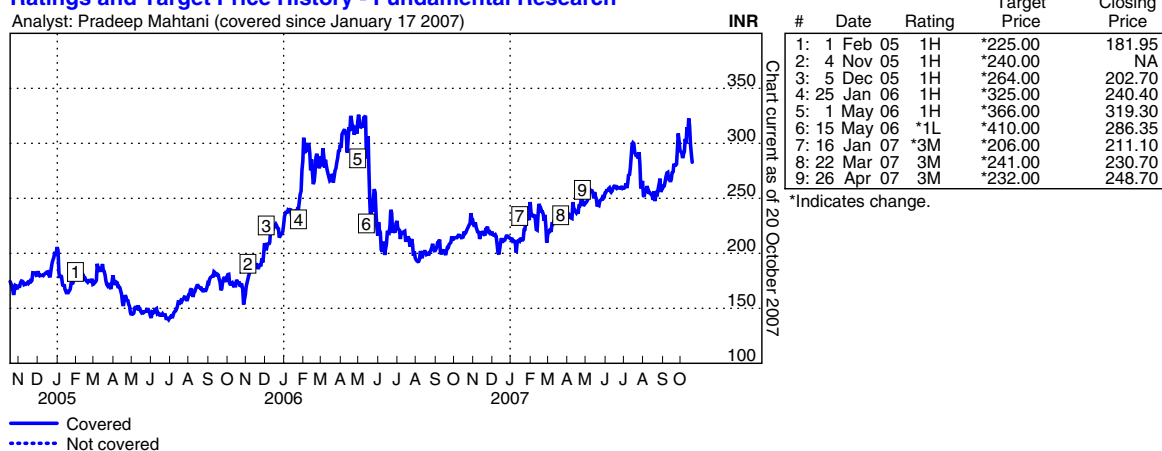
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Analyst: Pradeep Mahtani (covered since January 17 2007)



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