Hindalco Industries Ltd

A mixed quarter for Novelis

Novelis, reported a strong Q3FY11 operating performance with net revenues of US$ 2.6 bn (+21% YoY), shipments of 751 kt (+10% YoY), adjusted EBITDA of US$ 238 mn (+20% YoY) and adjusted pre-tax income of US $85 mn (+23% YoY). EBITDA growth was largely on account of (1) higher shipments, (2) increase in product premium, (3) effective cost management and (4) a better product mix. However, on a sequential basis, adjusted EBITDA declined 18% on higher input costs while net income was lower because of restructuring costs and expenses related to debt refinancing.

In our view, Novelis will continue to report strong operating results aided by demand recovery across all its markets and product segments. Novelis intends to increase rolling capacity through debottlenecking and invest in increasing recycling capacity. We believe this along with rising demand for its products will drive revenue/EBITDA growth over the next 2–3 years. We maintain a HOLD on Hindalco with a target price of Rs 280 and will review our estimates post announcement of the company's Q3 earnings.

One-off costs impact earnings: Novelis reported a net loss of US$ 46 mn for Q3FY11. However, this was on account of: (1) one-time charges of US$ 74 mn on account of debt refinancing and (2) restructuring expenses of US$ 20 mn related to closure of Bridgnorth and Aratu facilities. Adjusted for these expenses, pre-tax income stood at US$ 85 mn, up 23% YoY.

Strong EBITDA performance aided by increase in shipments: Q3FY11 shipments increased 10% YoY to 751kt while shipments of rolled products increased to 715kt for the quarter. This growth was driven by strong can-sheet demand across all geographies. This, along with a rising product premium, pushed up the adjusted EBITDA/ton to US$ 317 as against US$ 291 a year ago.

Capacity expansion at low cost: Novelis stated that it intends to expand its rolling capacity by 2–4% each year. We believe that debottlenecking efforts will result in incremental capacity of 200kt over the next 3–4 years at a low capex spend of US$ 80mn–100mn. It is also expanding its rolling capacity at its Pinda plant in Brazil by 220ktpa, resulting in significant value accretion. Besides, Novelis' management has also stated that it intends to invest in increasing the company's recycling capacity across all its locations. This will ensure continuity in supply of feed for its rolling facilities besides serving as a low-cost alternative for inputs. Moreover, it is exploring opportunities in Asia through investments in Korea and working closely with Hindalco on its green-field rolling capacities.

Strong liquidity position, new capital structure to increase flexibility: Liquidity remained strong at the end of Q3FY11, with total available liquidity at US$ 848mn. This was driven largely by Novelis' recapitalisation efforts. The company raised US$ 4bn of debt in Dec '10 to: (1) refinance its existing debt and (2) repay capital to its parent, Hindalco. According to the management, the new capital structure has increased the maturity profile of its existing debt by 5–7 years and provides increased flexibility to invest in capacity expansion and explore strategic growth opportunities.

Amit Agarwal
(91-22) 6766 3449
amit.ag@religare.in

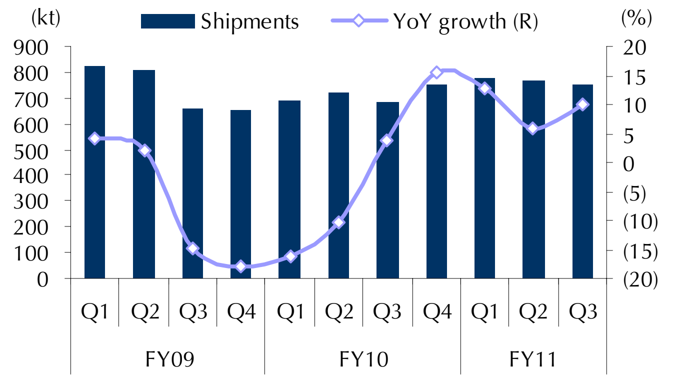
Varun Lohchab
(91-22) 6766 3458
varun.lohchab@religare.in

Fig 1 - Quarterly performance of Novelis

	Q3FY11	Q3FY10	% chg YoY	Q2FY11	% Chg QoQ
Revenues	**2,560**	**2,112**	**21.2**	**2,524**	**1.4**
Cost of goods sold	(2,232)	(1,795)	24.3	(2,188)	2.0
Gross profit	**328**	**317**	**3.5**	**336**	**(2.4)**
Selling, general and administrative expenses	(94)	(92)	2.2	(97)	(3.1)
R&D expenses	(9)	(10)	(10.0)	(9)	-
EBITDA	**225**	**215**	**4.7**	**230**	**(2.2)**
Litigation expenses	-	-		-	
Restructuring expenses	(20)	(1)	1,900.0	(9)	122.2
Reported EBITDA	**205**	**214**	**(4.2)**	**221**	**(7.2)**
Depreciation charges	(100)	(93)	7.5	(104)	(3.8)
EBIT	**105**	**121**	**(13.2)**	**117**	**(10.3)**
Interest Income	4	2	100.0	3	33.3
Interest Expense	(46)	(44)	4.5	(40)	15.0
Extraordinary income (loss)	(44)	40	(210.0)	34	(229.4)
Affiliate income / (loss)	(5)	8	(162.5)	(3)	66.7
Other income (expenses)- net	(16)	2	(900.0)	18	(188.9)
Profit before tax	**(2)**	**129**	**(101.6)**	**129**	**(101.6)**
Income tax	(33)	(48)	(31.3)	(56)	(41.1)
Profit after tax	**(35)**	**81**	**(143.2)**	**73**	**(147.9)**
Minorities	(11)	(13)	(15.4)	(11)	-
Net income	**(46)**	**68**	**(167.6)**	**62**	**(174.2)**
Key operating matrix					
Shipments (kt)	751	683	10.0	767	(2.1)
Avg realisation (US$/ton)	3,409	3,092	10.2	3,291	3.6
Adjusted EBITDA/ton	317	291	8.8	378	(16.2)

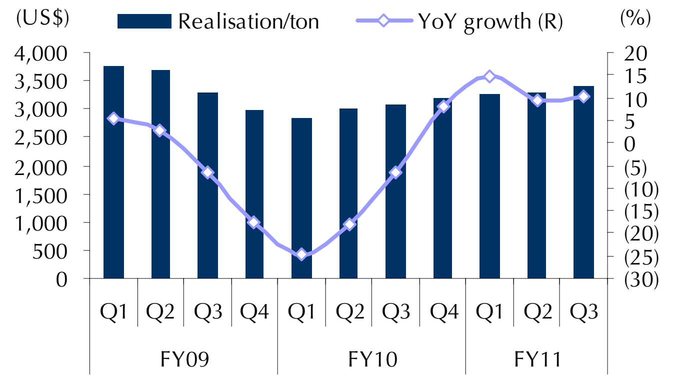
Source: Company, RCML Research

Fig 2 - Trend in Novelis' shipments



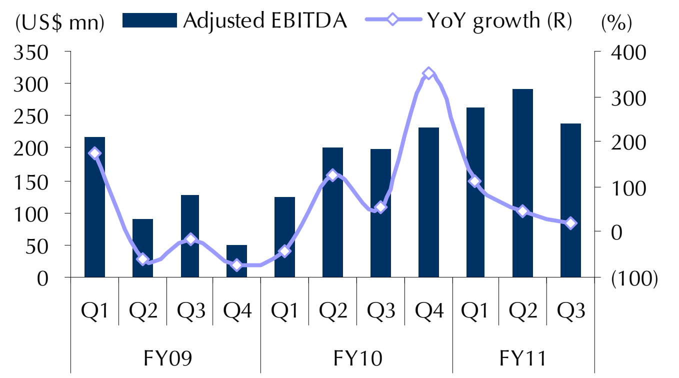
Source: Company, Religare Research

Fig 3 - Realisation has been increasing led by higher premiums



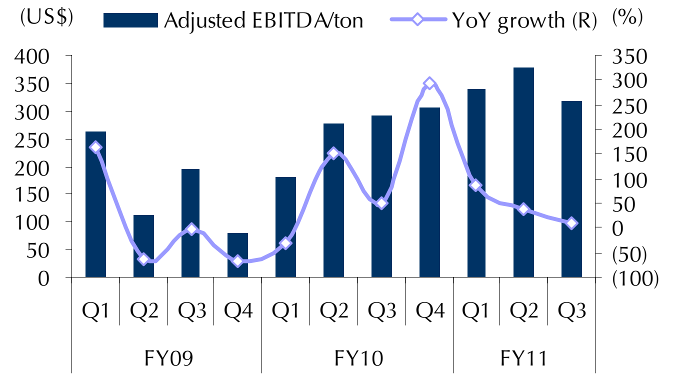
Source: Company, Religare Research

Fig 4 - Adjusted EBITDA trend for Novelis



Source: Company, Religare Research

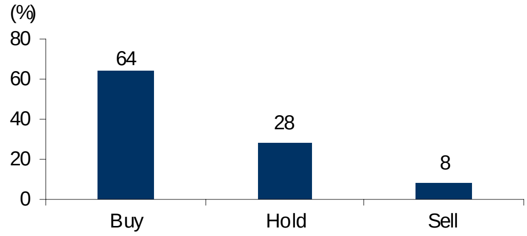
Fig 5 - Adjusted EBITDA/ton trend for Novelis

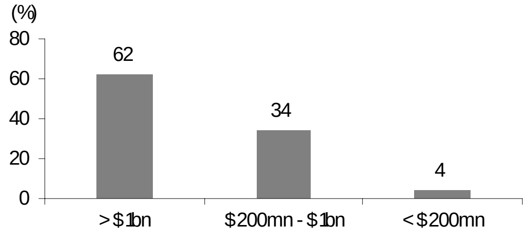


Source: Company, Religare Research

Coverage Profile

By recommendation	By market cap (US$)





Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and –5%
Sell	Less than –5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

Religare Capital Markets Ltd

4th Floor, GYS Infinity, Paranjpe 'B' Scheme, Subhash Road, Vile Parle (E), Mumbai 400 057.

Disclaimer

This document is NOT addressed to or intended for distribution to retail clients (as defined by the FSA).
This document is issued by Religare Capital Markets plc ("RCM") in the UK, which is authorised and regulated by the Financial Services Authority in connection with its UK distribution. RCM is a member of the London Stock Exchange.

This material should not be construed as an offer or recommendation to buy or sell or solicitation of any offer to buy any security or other financial instrument, nor shall it, or the fact of its distribution, form the basis of, or be relied upon in connection with, any contract relating to such action or any other matter. The material in this report is based on information that we consider reliable and accurate at, and share prices are given as at close of business on, the date of this report but we do not warrant or represent (expressly or impliedly) that it is accurate, complete, not misleading or as to its fitness for the purpose intended and it should not be relied upon as such. Any opinion expressed (including estimates and forecasts) is given as of the date of this report and may be subject to change without notice.

RCM, and any of its connected or affiliated companies or their directors or employees, may have a position in any of the securities or may have provided corporate finance advice, other investment services in relation to any of the securities or related investments referred to in this document. Our asset management area, our proprietary trading desks and investing businesses may make investment decisions that are inconsistent with the recommendations or views expressed in this briefing note.

RCM accepts no liability whatsoever for any direct, indirect or consequential loss or damage of any kind arising out of the use of or reliance upon all or any of this material howsoever arising. Investors should make their own investment decisions based upon their own financial objectives and financial resources and it should be noted that investment involves risk, including the risk of capital loss.

This document is confidential and is supplied to you for information purposes only. It may not (directly or indirectly) be reproduced, further distributed to any person or published, in whole or in part, for any purpose whatsoever. Neither this document, nor any copy of it, may be taken or transmitted into the United States, Canada, Australia, Ireland, South Africa or Japan or into any jurisdiction where it would be unlawful to do so. Any failure to comply with this restriction may constitute a violation of relevant local securities laws. If you have received this document in error please telephone Nicholas Malins-Smith on +44 (0) 20 7382 4479.