

BSE SENSEX 16,883
S&P CNX 5,069

CMP: INR57

TP: INR67

Neutral

Bloomberg NACL IN
Equity Shares (m) 2,577.2
52-Week Range (INR) 120/55
1,6,12 Rel. Perf. (%) -8/-29/-25
M.Cap. (INR b) 146.3
M.Cap. (USD b) 3.0

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BY	ROE	ROCE	EV/	EV/
END	(INR M)	(INR M)	(INR)	GR. (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/10A	50,557	8,032	3.1	-36.3	18.2	1.4	7.7	10.6	2.1	10.6
3/11A	60,558	10,693	4.1	33.1	13.7	1.3	9.5	13.3	1.6	5.9
3/12E	68,859	9,991	3.9	-6.6	14.6	1.2	8.4	11.7	1.3	6.8
3/13E	74,658	14,387	5.6	44.0	10.2	1.1	11.0	16.6	1.0	3.7

Consolidated

- NACL's 2QFY12 PAT declined 38% QoQ to INR1.4b, below our estimate of INR2.9b, due to increased operating costs on account of higher coal and fuel oil prices, high cost purchased power and higher raw material prices.
- Aluminum production declined 5% QoQ to 105k tons due to shutdown of CPP, as coal supply from MCL mines was disrupted due to heavy rainfall in the region. According to our calculations, cost of production (CoP) of aluminum increased to USD2,675/ton (including depreciation) and CoP of alumina was USD336/ton.
- EBITDA declined 71% QoQ to INR1.5b due to increased operating costs, led by higher costs of coal, fuel oil and raw material (such as aluminum fluoride, CPC), and high cost purchased power.
- NACL completed refinery expansion during the quarter, which will drive alumina volumes in 2HFY12. It expects to start operations from its Utkal-E block (having reserves of 70m tons) by June 2012, as it has been granted pre-approval for mining lease in August 2011.
- We are cutting our EPS estimate for FY12 by 24% to INR3.9 to model poor 2QFY12 performance. We expect strong volume growth, going forward, but do not factor in the benefits of captive coal in FY13. The stock trades at an EV of 3.7x FY13E EBITDA. Maintain **Neutral**.

Quarterly performance (consolidated)

(INR MILLION)

Y/E MARCH	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Alumina Production ('000 tons)	363	380	398	416	400	390	452	526	1,556	1,768
Aluminium Prod. ('000 tons)	112	110	111	111	111	105	107	109	444	432
Aluminium Sales ('000 tons)	109	109	103	119	109	101	107	109	439	427
Avg LME Aluminium (USD/ton)	2,150	2,110	2,357	2,531	2,618	2,450	2,250	2,250	2,287	2,392
Alumina Exports (USD/ton)	375	316	362	399	428	448	368	370	363	403
Net Sales	13,081	14,792	14,431	18,254	17,625	16,139	16,937	18,157	60,558	68,859
Change (YoY %)	39.9	25.4	1.8	12.3	34.7	9.1	17.4	-0.5	19.8	13.7
EBITDA	3,938	3,477	3,896	4,537	5,298	1,526	3,433	3,048	15,847	13,305
Change (YoY %)	135.2	145.4	31.6	-16.2	34.5	-56.1	-11.9	-32.8	59.7	-16.0
As % of Net Sales	30.1	23.5	27.0	24.9	30.1	9.5	20.3	16.8	26.2	19.3
Interest	0	0	1	0	0	0	0	0	1	0
Depreciation	916	952	1,030	1,319	1,019	1,179	1,203	1,227	4,217	4,629
Other Income	897	854	894	973	1,266	1,321	1,453	1,598	3,617	5,638
PBT (before EO Item)	3,919	3,379	3,759	4,190	5,545	1,667	3,683	3,419	15,247	14,314
Extra-ordinary Income	0	0	0	0	0	0	0	0	0	0
PBT (after EO Item)	3,919	3,379	3,759	4,190	5,545	1,667	3,683	3,419	15,247	14,314
Total Tax	1,079	1,139	1,199	1,138	1,776	274	1,179	1,094	4,554	4,322
% Tax	27.5	33.7	31.9	27.1	32.0	16.4	32.0	32.0	29.9	30.2
Reported PAT	2,841	2,240	2,560	3,053	3,768	1,393	2,505	2,325	10,693	9,991
Minority interest										0
Adjusted PAT	2,841	2,240	2,560	3,053	3,768	1,393	2,505	2,325	10,693	9,991
Change (YoY %)	124.6	40.5	64.9	-22.0	32.7	-37.8	-2.1	-23.8	33.1	-6.6

E: MOSL Estimates

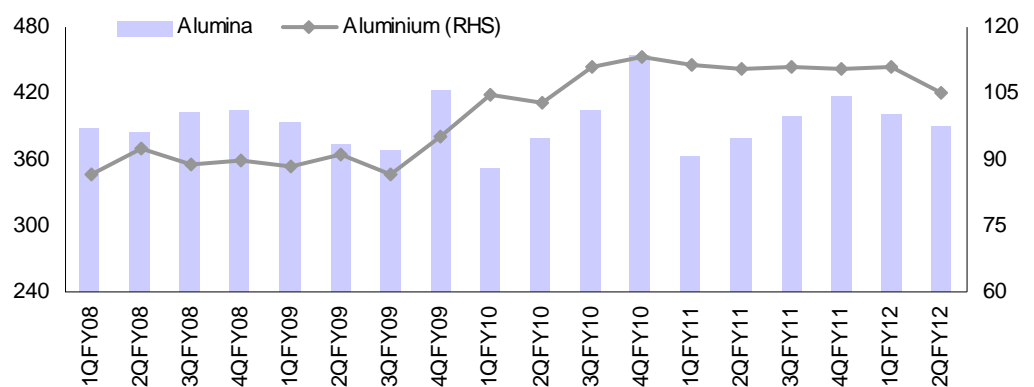
Heavy rainfall impacts coal supply, has cascading effect on NACL's performance

- Net sales declined 8% QoQ to INR16b due to lower metal volumes and lower LME prices. Aluminum sales tonnage declined 8% QoQ to 101k tons, as production was affected due to short supply of coal. NACL produced 390k tons (up 3% YoY; down 2% QoQ) of alumina and 105k tons (down 5% YoY and QoQ) of aluminum during the quarter.
- Aluminum production was impacted by shutdown of CPP, as coal supply from MCL mines was disrupted due to heavy rainfall in the region. NACL received only 7,400 tons of coal per day against its daily requirement of 12,000 tons. It finally had to resort to imported coal, which raised costs. Resultantly, NACL ran 120 pots on low amperage during the quarter. However, coal supply has improved now and NACL expects to improve amperage in the next few weeks.
- Alumina sales declined 20% QoQ to 180k tons. Though NACL has commissioned the second phase expansion during the quarter, incremental production will be received only in 3QFY12.
- Average LME aluminum realization declined 4% QoQ (up 19% YoY) to USD2,656/ton while implied average realization for third party alumina sales was USD448/ton, higher than our estimate of USD396/ton.

EBITDA declines 71% QoQ on increased operating costs

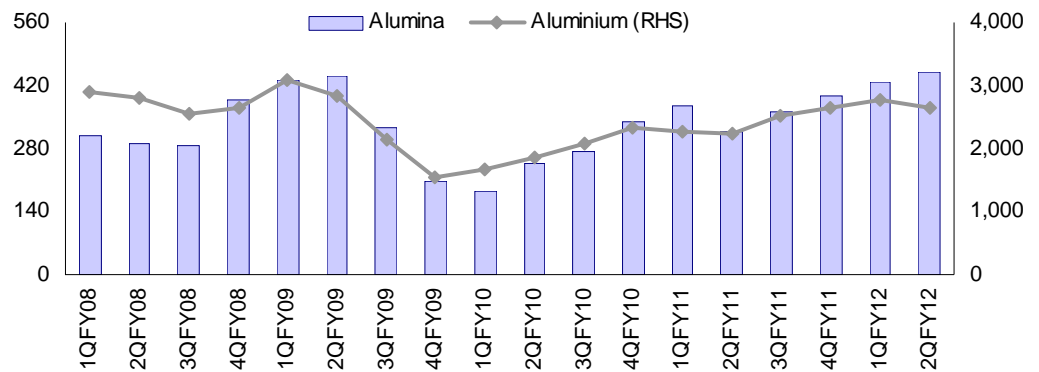
- EBITDA declined 71% QoQ to INR1.5b, below our estimate of INR4.4b. Operating costs were higher led by increase in prices of coal, fuel oil and raw material (such as aluminum fluoride, CPC) and high cost purchased power.
- As availability of linkage coal is reducing in the domestic markets, there has been higher reliance on costlier imported/e-auction coal over the past few quarters. In 2QFY12, linkage coal availability further declined due to heavy rainfall in the region.
- According to our calculations, the cost of production of aluminum shot to USD2,675/ton (including depreciation) and CoP of alumina was USD336/ton.

Production declined due to coal shortage ('000 tons)

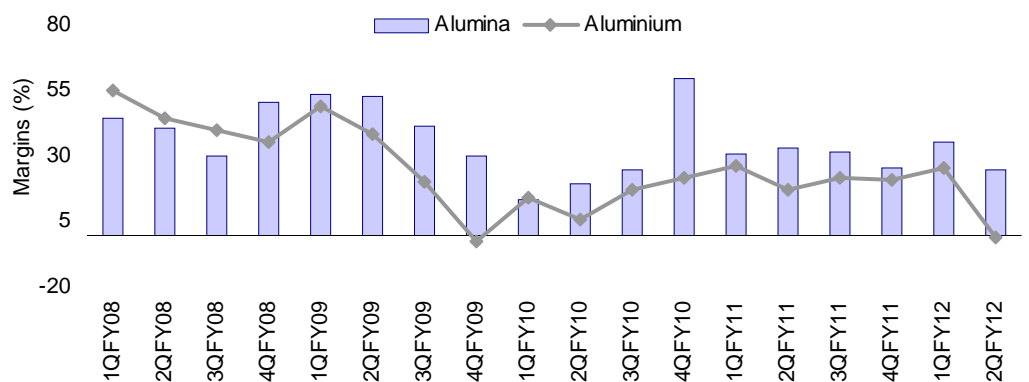


Source: Company

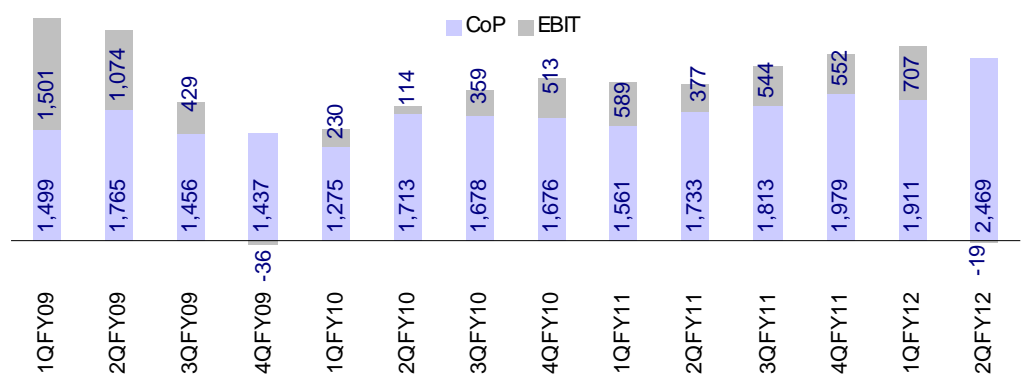
Metal realization down 4% QoQ (USD/ton)



Margins squeezed due to higher RM and coal cost



EBIT loss in aluminum segment after nine quarters (USD/ton)



Source: Company

Cutting FY12 EPS estimate by 24%; maintain Neutral

- NACL completed refinery expansion to 2.1mtpa during the quarter, which will drive alumina volumes in 2HFY12. It expects incremental volumes of ~50k tons in 3QFY12.
- Though benefits of phase-2 expansions will drive earnings growth, higher coal and fuel prices will continue to affect NACL's performance until the captive coal block starts operations. NACL expects to start operations from its Utkal-E block (having reserves of 70m tons) by June 2012, as the mining lease deed is likely to be signed soon. In August 2011, the Ministry of Coal granted its prior approval for mining lease of Utkal-E coal block at Angul, with an estimated reserve of 70m tons in favor of NACL. Mining will be carried out in the allocated area after obtaining permission

from the Forest Department under Forest Conservation Act and meeting other stipulations.

- We are cutting our EPS estimate for FY12 by 24% to INR3.9 to model poor 2QFY12 performance. We expect strong volume growth in both alumina and aluminum, going forward, but do not factor in the benefits of captive coal in FY13. The stock trades at an EV of 3.7x FY13E EBITDA. Maintain **Neutral**.

Nalco: an investment profile

Company description

NACL is a fully integrated producer of aluminum and alumina. Aluminum contributes ~70% and alumina ~30% of revenue. Its aluminum smelter (0.46mtpa) sources alumina and power from its captive refinery in Damanjodi and captive power plant located in Angul. Coal for power generation is sourced from the state-owned Coal India; hence, the cost of power generated is low. The alumina refinery, which has a capacity 2.1mtpa, is located in Damanjodi (Orissa) close to captive bauxite mines at Panchpatmali. The bauxite from these mines is of superior quality and consumes low energy in the crushing and digestion process during conversion to alumina. Therefore, NACL's cost of production is the lowest in the world.

Key investment arguments

- NACL has increased its capacity for aluminum smelting from 345ktpa to 460ktpa, for alumina refining from 1.6mtpa to 2.1mtpa, and for captive power from 960MW to 1,200MW.
- The company has been allotted a coal block, Utkal-E, which has coal reserves of ~70m tons, which will insulate the company from input price risk.

Key investment risks

- Unexpected fall in alumina or aluminum prices may adversely impact profitability.

Comparative valuations

		Nalco	Hindalco	Sterlite
P/E (x)	FY12E	14.6	6.8	6.2
	FY13E	10.2	6.0	6.4
P/BV (x)	FY12E	1.2	1.3	0.8
	FY13E	1.1	1.1	0.7
EV/Sales (x)	FY12E	1.3	0.6	0.8
	FY13E	1.0	0.6	0.6
EV/EBITDA (x)	FY12E	6.8	5.4	3.9
	FY13E	3.7	4.9	3.0

Shareholding Pattern (%)

	Sep-11	Jun-11	Sep-10
Promoter	87.2	87.2	87.2
Domestic Inst	5.2	5.1	5.4
Foreign	4.3	4.5	4.3
Others	3.4	3.2	3.2

Recent developments

- Mr SS Mahapatra has assumed charge as Director (Production) with effect from 1 October 2011 in accordance with the order dated 22 July 2011 from Ministry of Mines, Government of India.

Valuation and view

- The stock trades at 10.2x FY13E EPS and an EV of 3.7x FY13E EBITDA. Maintain **Neutral**.

Sector view

- Base metal prices have corrected amidst an uncertain macroeconomic environment, especially in Europe. Aluminum prices at LME are trading at ~10% lower than the average in the last quarter. At current LME prices, significant global capacity is now believed to be making loss. However, these high cost smelters have yet to cut production. High production costs are expected to support LME. Forward prices continue to trade in contango.

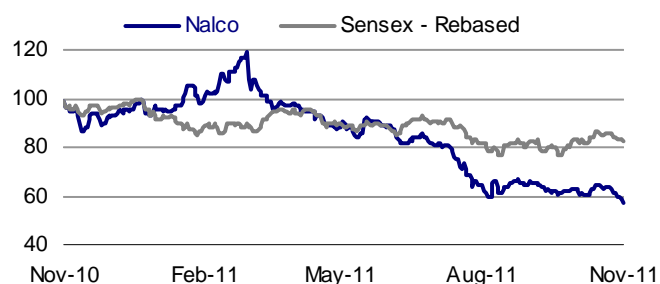
EPS: MOSL forecast v/s Consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY11	3.9	6.0	-34.5
FY12	5.6	5.5	2.8

Target Price and Recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
57	67	17.5	Neutral

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)				
Y/E MARCH	2009	2010	2011	2012E	2013E	
Net Sales	50,945	50,557	60,558	68,859	74,658	
Change (%)	2.1	-0.8	19.8	13.7	8.4	
Total Expenses	34,038	40,635	44,710	55,554	54,304	
EBITDA	16,907	9,922	15,847	13,305	20,354	
% of Net Sales	33.2	19.6	26.2	19.3	27.3	
Depn. & Amortization	2,724	3,194	4,217	4,629	4,710	
EBIT	14,182	6,728	11,630	8,676	15,644	
Net Interest	40	23	1	0	0	
Other income	4,958	4,688	3,617	5,638	6,155	
PBT before EO	19,101	11,392	15,247	14,314	21,799	
EO income	170	156	0	0	0	
PBT after EO	19,272	11,549	15,247	14,314	21,799	
Tax	6,549	3,406	4,554	4,322	7,412	
Rate (%)	34.0	29.5	29.9	30.2	34.0	
Reported PAT	12,723	8,142	10,693	9,991	14,387	
Adjusted PAT	12,610	8,032	10,693	9,991	14,387	
Change (%)	-23.5	-36.3	33.1	-6.6	44.0	

E: MOSL Estimates

Balance Sheet		(INR Million)				
Y/E MARCH	2009	2010	2011	2012E	2013E	
Share Capital	6,443	6,443	12,886	12,886	12,886	
Reserves	91,255	97,513	99,501	106,477	117,849	
Net Worth	97,698	103,956	112,387	119,363	130,735	
Minority Interest						
Total Loans	0	0	0	0	0	
Deferred Tax Liability	6,214	6,606	6,606	6,606	6,606	
Capital Employed	103,912	110,562	118,993	125,969	137,341	
Gross Block	98,998	110,180	117,180	132,180	134,180	
Less: Accum. Deprn.	58,673	61,817	66,034	70,663	75,373	
Net Fixed Assets	40,325	48,363	51,146	61,517	58,807	
Capital WIP	28,671	22,434	22,434	9,434	9,434	
Investments	8,959	9,868	9,868	9,868	9,868	
Curr. Assets	45,288	52,096	60,427	66,918	81,341	
Inventories	8,419	9,449	8,088	10,037	10,227	
Account Receivables	265	1,818	793	1,004	1,023	
Cash and Bank Balance	28,690	31,524	42,240	46,570	60,785	
Others	7,914	9,306	9,306	9,306	9,306	
Curr. Liability & Pro	19,332	22,199	24,881	21,767	22,109	
Account Payables	16,034	18,500	21,181	18,067	18,409	
Provisions & Others	3,298	3,700	3,700	3,700	3,700	
Net Curr. Assets	25,956	29,897	35,546	45,150	59,232	
Appl. of Funds	103,912	110,562	118,993	125,969	137,341	

E: MOSL Estimates

Ratios						
Y/E MARCH	2009	2010	2011	2012E	2013E	
Basic (Rs)						
EPS	4.9	3.1	4.1	3.9	5.6	
Cash EPS	6.0	4.4	5.8	5.7	7.4	
BV/Share	37.9	40.3	43.6	46.3	50.7	
DPS	1.3	0.6	0.8	1.0	1.0	
Payout (%)	29.6	23.1	21.1	30.2	21.0	
Valuation (x)						
P/E			13.7	14.6	10.2	
Cash P/E			9.8	10.0	7.7	
P/BV			1.3	1.2	1.1	
EV/Sales			1.6	1.3	1.0	
EW/EBITDA			5.9	6.8	3.7	
Dividend Yield (%)			1.3	1.8	1.8	
Return Ratios (%)						
RoE	12.9	7.7	9.5	8.4	11.0	
RoCE (pre-tax)	19.3	10.6	13.3	11.7	16.6	
RoIC (pre-tax)	39.0	16.0	25.5	16.6	26.7	
Working Capital Ratios						
Fixed Asset Turnover (x)	0.5	0.5	0.5	0.5	0.6	
Asset Turnover (x)	0.5	0.5	0.5	0.5	0.5	
Debtor (Days)	2	13	5	5	5	
Inventory (Days)	17	19	13	15	14	
Working Capital Turnover	-5	(3)	(11)	(2)	(2)	
Leverage Ratio (x)						
Current Ratio	2.3	2.3	2.4	3.1	3.7	
Debt/Equity	n/a	n/a	n/a	n/a	n/a	

Cashflow Statement		(INR Million)				
Y/E MARCH	2009	2010	2011	2012E	2013E	
Pre-tax profit	19,272	11,549	15,247	14,314	21,799	
Depreciation	2,724	3,194	4,217	4,629	4,710	
(Inc)/Dec in Wkg. Cap.	2,575	-1,108	5,068	-5,274	133	
Tax paid	-6,410	-3,014	-4,554	-4,322	-7,412	
Other operating activities	-1	-50	0	0	0	
CF from Op. Activity	18,160	10,570	19,978	9,346	19,230	
(Inc)/Dec in FA + CwIP	-12,951	-4,944	-7,000	-2,000	-2,000	
(Pur)/Sale of Investment	-7,809	-908	0	0	0	
Others						
CF from Inv. Activity	-20,760	-5,852	-7,000	-2,000	-2,000	
Equity raised/(repaid)	0	0	0	0	0	
Chg in minorities						
Debt raised/(repaid)	0	0	0	0	0	
Dividend (incl. tax)	-3,769	-1,885	-2,262	-3,015	-3,015	
Other financing activities	-105					
CF from Fin. Activit	-3,874	-1,885	-2,262	-3,015	-3,015	
(Inc)/Dec in Cash	-6,474	2,833	10,716	4,331	14,215	
Add: opening Balance	35,165	28,690	31,524	42,240	46,570	
Closing Balance	28,690	31,523	42,240	46,570	60,785	

E: MOSL Estimates

N O T E S

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Nalco

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