

Hindalco Industries

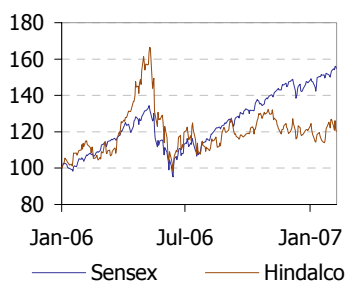
Relative to sector: **Outperformer**

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Relative Performance



Source: Bloomberg, ENAM Research

Stock data

No. of shares	: 1,159mn
Market cap	: Rs 179bn
52 week high/low	: Rs 251 / Rs 139
Avg. daily vol. (6mth)	: 5.0mn shares
Bloomberg code	: HNDL IN
Reuters code	: HALC.BO

Shareholding (%) Dec-06 QoQ chg

Promoters	: 26.8	0.0
FIIs	: 19.1	1.2
MFs / UTI	: 5.0	(1.8)
Banks / FIs	: 11.3	0.1
Others	: 37.9	0.4

Financial Summary

Y/E Mar	Sales (Rs mn)	Adj. PAT (Rs mn)	Consensus EPS* (Rs)	EPS (Rs)	Change YoY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/EBIDTA (x)	DPS (Rs)
2005	92,994	12,985	-	11	46	10.9	33.9	35.7	6.0	1.8
2006	110,808	15,017	-	13	16	14.1	17.4	16.8	8.4	2.1
2007E	188,378	26,816	23.1	23	79	6.7	24.2	21.3	3.8	2.5
2008E	200,208	28,961	20.0	25	8	6.2	20.1	18.7	3.3	2.5

Source: *Consensus broker estimates, Company, ENAM estimates

NOVELIS ACQUISITION — CAPITAL ALLOCATION ISSUE?

Novelis: Hindalco is planning a USD6bn leveraged buyout of Novelis, world leader in downstream aluminium products. While Hindalco, has a revenue of ~USD 1.4bn in aluminium business, EBITDA margin of 43%+ and ROCE 40%+, Novelis is currently loss making due to a one time unprofitable can-pricing contract. As per Hindalco's management Novelis' EBITDA margin can be ~10-12%, with an estimated normalized ROCE of ~10%.

Deal: Novelis' EV of USD 6bn consists of USD2.4bn in debt. The EV/EBITDA multiple is ~8x normalized EBITDA. Regarding funding, Hindalco will contribute only USD 0.5bn with an additional USD 0.3bn contributed by the AV Birla Group. The balance, as per management, would be funded largely using debt with recourse to the cash flows of Novelis. While there could be competing bids, Hindalco is confident of making a successful acquisition.

Analysis: While the acquisition could enlarge Hindalco's revenues on a global scale, the valuation is steep (double Hindalco's current EV/EBITDA multiple) for an inferior business. **This calls into question, Hindalco's capital allocation mind-set.** In an environment where the global trend is to acquire upstream units, this decision, on the surface, doesn't seem to have a strong business case. The only possible reprieve is the fact that the deal effectively has a call option of USD450mn (~10% of its market cap or capital employed) on the possibility that Novelis will turnaround at some point, once the unprofitable can-contract expires.

Reco: We believe the deal does not provide any upside in the short term. However, Hindalco's standalone business remains strong, with strong cash flows and 10% p.a. aluminium volume growth for next two years. **At CMP of Rs 154, it's attractively valued at 6.2x FY08E earnings with minimum transaction exposure to its balance sheet. However, to factor in the questionable capital allocation decision and capped short term upside, we reduce our price target by ~15% to Rs 245, while maintaining sector Outperformer rating on Hindalco.**

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