

National Aluminium Company Ltd

High fuel costs lead to lower-than-expected earnings

National Aluminium Company (NALCO)'s Q3FY11 PAT, at Rs 2.6bn, was 10% lower than our estimate, largely on account of higher coal/fuel costs. Q3FY11 revenues/EBITDA/PAT grew 3%/32%/65% YoY mainly driven by (1) higher alumina (+34% YoY) and aluminium (+18% YoY) realisations, (2) lower cost of production on account of cost control measures undertaken by the company and (3) improved operational efficiency arising from higher capacity utilisation. In our view, valuations (10.3x FY13E EBITDA) remain expensive and do not justify the risks associated with the stock. We thus maintain our SELL rating on NALCO with a target price of Rs 275.

Higher metal prices propel aluminium earnings: A sharp 18% increase in realisations to US\$ 2,390 (US\$ 2,017 in Q3FY10) pushed up the aluminium segment EBIT to Rs 3.5bn from Rs 0.6bn a year ago, even as volumes remained flat. Moreover, lower input costs and better operational efficiencies led to a sharp increase in EBIT margins. We believe that higher capacity utilisation along with increasing metal prices will result in greater contribution from the metal segment.

Alumina margins decline on lower production, higher fuel costs: Alumina segment EBIT declined 11% YoY largely due to lower alumina sales and higher coal/fuel costs, despite realisations for Q3FY11 increasing 34% YoY. We believe this would largely be on account of a decline in sales volumes. Besides, adverse foreign exchange movement also impacted earnings.

Power segment incurs a loss: Higher coal costs led to an EBIT loss of Rs 1.3bn from the power segment, compared to an EBIT-level profit of Rs 0.7bn in Q3FY10. According to the management, rise in coal costs increased the cost of producing power, resulting in EBIT-level losses.

Coal/employee costs could be a major concern: We believe that rising coal costs may hurt NALCO as its power costs could rise sharply. Though the company has been allotted the Utkal-E coal block with reserves of 70mt, mining is likely to commence only in 2012-13, resulting in higher dependence on imported coal. High employee costs also continue to be a cause of concern.

Valuations stretched; maintain SELL with a target price of Rs 275: We value NALCO at 6x FY13E EBITDA and estimate it to have net cash of Rs 67bn (Rs 105/sh) in FY13E. The stock is currently trading at 10.3x FY12E EBITDA and 20x FY12E earnings, which is expensive in our view. We also believe that the company lacks positive triggers while it is completely exposed to fluctuations in prices of alumina and aluminium. We therefore maintain our SELL rating on NALCO with a target price of Rs 275.

Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	51,745	61,854	70,524	73,979
Growth (%)	(0.82)	19.54	14.02	4.90
Adj net income	7,886	11,398	12,889	12,750
Growth (%)	(37.10)	44.53	13.09	(1.08)
FDEPS (Rs)	12.6	17.7	20.0	19.8
Growth (%)	(36.00)	39.99	13.09	(1.08)

Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	21.0	27.9	27.2	24.7
EBIT margin	14.8	21.7	21.3	18.6
Adj PAT margin	15.7	18.4	18.3	17.2
ROE	8.1	10.6	11.1	10.2
ROIC	16.3	20.2	20.9	19.2
ROCE	12.6	7.6	9.8	10.3

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 393	Rs 275	SELL	MEDIUM

BSE	NSE	BLOOMBERG
532234	NATIONALUM	NACL IN

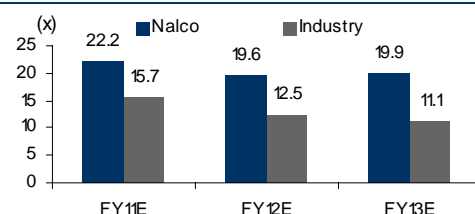
Company data

Market cap (Rs mn / US\$ mn)	253,246/ 5,517
Outstanding equity shares (mn)	644
Free float (%)	8.8
Dividend yield (%)	1.27
52-week high/low (Rs)	448/ 331
2-month average daily volume	58,182

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Nalco	393	(0.0)	(3.1)	(6.9)
BSE Metals	16,116	(8.4)	(3.4)	4.6
Sensex	18,328	(10.6)	(8.5)	2.6

P/E comparison



Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	31.1	22.2	19.6	19.9
P/E @ Target	23.7	17.0	15.0	15.2
EV/EBITDA @ CMP	19.5	11.9	10.3	10.2





Result highlights

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimate	% Variance
Revenue	14,250	16,002	(10.9)
EBITDA	3,896	4,321	(9.8)
Adj net income	2,560	2,841	(9.9)
FDEPS (Rs)	4.0	4.4	(9.9)

Source: RCML Research

Fig 2 - Quarterly performance

(Rs mn)	Q3FY11	Q3FY10	% Chg YoY	Q2FY10	% Chg QoQ
Net revenues	14,250	13,865	2.8	14,548	(2.0)
Other operating income	181	311	(41.9)	244	(25.8)
Total income	14,431	14,176	1.8	14,792	(2.4)
Change in inventory	(877)	497	(276.4)	576	(252.1)
Raw material consumption	2,075	2,089	(0.7)	1,671	24.2
Power and Fuel	4,436	4,401	0.8	4,964	(10.6)
Staff costs	2,310	2,067	11.7	2,027	13.9
Other expenses	2,591	2,161	19.9	2,076	24.8
Total expenditure	10,536	11,215	(6.1)	11,314	(6.9)
EBITDA	3,896	2,961	31.6	3,477	12.0
Depreciation	1,030	789	30.5	952	8.2
EBIT	2,866	2,171	32.0	2,526	13.5
Other Income	894	617	44.8	854	4.7
Interest expense	1	1	(42.9)	0	700.0
Extra-ordinary items	-	-	-	-	-
PBT	3,759	2,787	34.8	3,379	11.2
Tax	1,199	1,236	(3.0)	1,139	5.3
PAT	2,560	1,552	64.9	2,240	14.2

Source: Company, RCML Research

Fig 3 - NALCO: Key operating matrix

Ratios (%)	Q3FY11	Q3FY10	% chg YoY	Q2FY11	% Chg QoQ
EBITDA margin	27.3	21.4		23.9	
Net profit margin	18.0	11.2		15.4	
Effective tax rate (%)	31.9	44.3		33.7	
EPS (Rs)	4.0	2.4		3.5	
Raw material to sales (%)	14.6	15.1		11.5	
Employee cost to sales (%)	16.2	14.9		13.9	

Key operating matrix

Production (tons)					
Alumina production (tons)	398,700	398,300	0.1	354,400	12.5
Aluminium metal production (tons)	111,792	111,206	0.5	109,545	2.1
Power (units)	1,654	1,606	3.0	1,569	5.4

Source: Company, RCML Research



Fig 4 - Segmental performance

Segmental performance	Q3FY11	Q3FY10	% chg YoY	Q2FY11	% Chg QoQ
Segmental Revenue					
Chemicals	4,907	5,087	(3.5)	5,868	(16.4)
Aluminium	11,590	11,414	1.5	11,226	3.2
Electricity	2,499	3,496	(28.5)	6,630	(62.3)
Total	18,996	19,996	(5.0)	23,724	(19.9)
Segmental PBIT					
Chemicals	1,133	1,275	(11.2)	1,365	(17.0)
Aluminium	3,477	622	459.4	(1,455)	(339.0)
Electricity	(1,267)	697	(281.8)	3,076	(141.2)
Segmental PBIT (%)					
Chemicals	23.1	25.1	(7.9)	23.3	(0.7)
Aluminium	30.0	5.4	450.9	(13.0)	(331.5)
Electricity	(50.7)	19.9	(354.4)	46.4	(209.3)
Capital employed					
Chemicals	15,180	13,810	9.9	14,896	1.9
Aluminium	29,829	30,651	(2.7)	27,940	6.8
Electricity	13,272	4,182	217.4	13,172	0.8
Unallocated common assets	60,160	59,910	0.4	59,687	0.8
Total	118,441	108,551	9.1	115,695	2.4

Source: Company, RCML Research

A sharp 18% increase in realisations push up aluminium segment EBIT to Rs 3.5bn; in contrast, the alumina segment EBIT declines 11% YoY on lower alumina sales and higher coal/fuel costs



Financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	51,745	61,854	70,524	73,979
Growth (%)	(0.8)	19.5	14.0	4.9
EBITDA	10,868	17,228	19,148	18,280
Growth (%)	(39.2)	58.5	11.1	(4.5)
Depreciation & amortisation	(3,194)	(3,816)	(4,136)	(4,489)
EBIT	7,674	13,412	15,013	13,790
Growth (%)	(49.3)	74.8	11.9	(8.1)
Interest	(23)	(40)	(40)	(40)
Other income	3,741	3,656	4,284	5,297
EBT	11,688	17,028	19,256	19,047
Income taxes	(3,153)	(4,849)	(5,390)	(5,279)
Effective tax rate (%)	(27.0)	(28.5)	(28.0)	(27.7)
Extraordinary items	-	-	-	-
Min into / inc from associates	-	-	-	-
Reported net income	8,142	11,398	12,889	12,750
Adjustments	256	-	-	-
Adjusted net income	7,886	11,398	12,889	12,750
Growth (%)	(37.1)	44.5	13.1	(1.1)
Shares outstanding (mn)	644.3	644.3	644.3	644.3
FDEPS (Rs) (adj)	12.6	17.7	20.0	19.8
Growth (%)	(36.0)	40.0	13.1	(1.1)
DPS (Rs)	2.5	5.0	5.0	5.0

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	14,743	20,843	23,392	23,537
Non-cash adjustments	(2,831)	(8,464)	(9,634)	(10,536)
Changes in working capital	(195)	883	(394)	825
Cash flow from operations	11,717	13,263	13,363	13,826
Capital expenditure	(6,776)	(10,000)	(5,000)	(4,055)
Change in investments	-	-	-	-
Other investing cash flow	845	3,656	4,284	5,297
Cash flow from investing	(5,931)	(6,344)	(716)	1,242
Issue of equity	-	-	-	-
Issue/repay debt	-	-	-	-
Dividends paid	(3,015)	(754)	(3,769)	(3,769)
Other financing cash flow	(23)	(40)	(40)	(40)
Change in cash & cash eq	2,747	6,124	8,838	11,259
Closing cash & cash eq	31,524	37,648	46,486	57,745

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	31,524	37,648	46,486	57,745
Accounts receivable	1,818	456	532	580
Inventories	9,449	10,437	11,841	12,725
Other current assets	9,306	9,988	11,640	12,708
Investments	9,868	9,868	9,868	9,868
Gross fixed assets	110,180	125,180	135,180	146,235
Net fixed assets	48,363	59,547	65,412	71,978
CWIP	22,434	17,434	12,434	5,434
Intangible assets	-	-	-	-
Deferred tax assets, net	(6,606)	(7,387)	(8,363)	(9,382)
Other assets	-	-	-	-
Total assets	132,761	145,379	158,212	171,037
Accounts payable	953	2,309	2,634	2,900
Other current liabilities	17,547	17,101	19,201	21,415
Provisions	3,700	6,997	7,309	7,653
Debt funds	-	-	-	-
Other liabilities	6,606	7,387	8,363	9,382
Equity capital	6,443	6,443	6,443	6,443
Reserves & surplus	97,513	105,142	114,262	123,243
Shareholder's funds	103,956	111,585	120,705	129,686
Total liabilities	132,761	145,379	158,212	171,037
BVPS (Rs)	161.3	173.2	187.3	201.3

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	21.0	27.9	27.2	24.7
EBIT margin	14.8	21.7	21.3	18.6
Net profit margin	15.7	18.4	18.3	17.2
ROE	8.1	10.6	11.1	10.2
ROCE	12.6	7.6	9.8	10.3
Working Capital & Liquidity ratios				
Receivables (days)	13	3	3	3
Inventory (days)	92	89	90	87
Payables (days)	47	100	100	100
Current ratio (x)	2.35	2.22	2.42	2.62
Quick ratio (x)	1.50	1.44	1.61	1.82
Turnover & Leverage ratios (x)				
Gross asset turnover	0.5	0.5	0.5	0.5
Total asset turnover	0.7	0.8	0.9	1.0
Interest coverage ratio	336.6	335.3	375.3	344.8
Adjusted debt/equity	-	-	-	-
Valuation ratios (x)				
EV/Sales	4.1	3.3	2.8	2.5
EV/EBITDA	19.5	11.9	10.3	10.2
P/E	31.1	22.2	19.6	19.9
P/BV	2.4	2.3	2.1	2.0



Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	13,865	16,288	12,917	14,548	14,250
YoY growth (%)	36.5	49.6	40.2	27.3	2.8
QoQ growth (%)	21.29	17.47	(20.69)	12.62	(2.04)
EBITDA (Rs mn)	2,961	4,816	3,938	3,477	3,896
EBITDA margin (%)	21.4	29.6	30.5	23.9	27.3
Adj net income (Rs mn)	1,552	3,436	2,841	2,240	2,560
YoY growth (%)	(29)	314	125	40	65
QoQ growth (%)	(2.70)	121.39	(17.32)	(21.13)	14.24

DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	65.9	69.7	66.9	66.9	66.9
Interest burden (PBT/EBIT)	127.6	152.3	127.0	128.3	138.1
EBIT margin (EBIT/Revenues)	29.0	14.8	21.7	21.3	18.6
Asset turnover (Revenues/Avg TA)	42.3	39.0	42.5	44.6	43.3
Leverage (Avg TA/Avg equitiy)	126.1	127.0	129.0	130.7	131.5
Return on equity	13.0	7.8	10.1	10.6	9.8

Company profile

National Aluminium Company Limited is an India-based company that operates in three segments i.e. Chemicals, Aluminium and Power. Its products include bauxite, alumina, aluminium, cast metal and power.

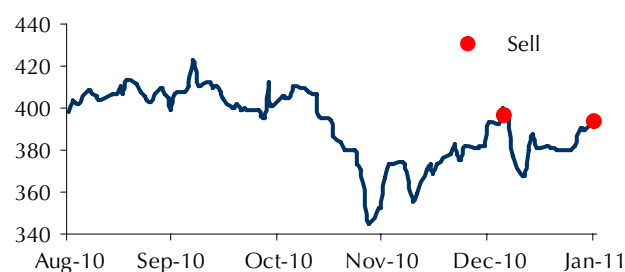
Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	87.15	87.15	87.15
FII's	4.38	4.26	4.31
Banks & FIIs	5.38	5.38	5.36
Public	3.09	3.21	3.18

Recommendation history

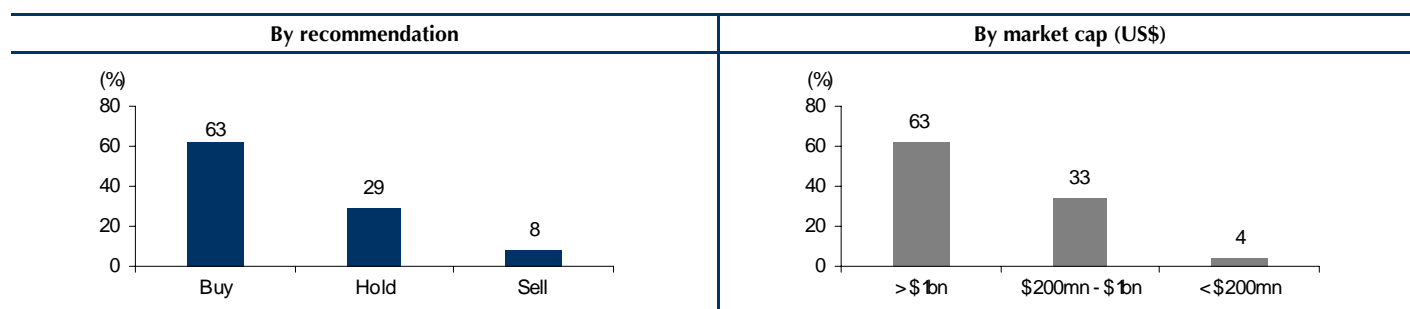
Date	Event	Reco price	Tgt price	Reco
6-Jan-11	Initiating Coverage	396	275	Sell
1-Feb-11	Results Review	393	275	Sell

Stock performance





Coverage Profile



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.

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