Hindalco Industries Ltd.

Estimate Change **SELL**

Equity | India | Non-Ferrous-Aluminum & Light Metals
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Higher aluminum price does not matter

Merrill Lynch

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Estimates upgraded sharply, but peak is behind us

Following upward revision to our global Aluminum price forecasts, we have raised our EPS estimates: FY08E – by 32% to Rs14.9; FY09E – by 74% to Rs9.9. Despite the sharp upgrade, we reiterate our view that earnings will peak in 4Q FY07. In FY08 pre Novelis, we expect EPS to fall 36% versus our earlier expectation of 49% decline. We expect Novelis to be a further drag on the EPS.

Aluminum price forecasts raised but best is behind

Our global commodities team has raised Al price forecasts by 11% and 14% for FY08 and FY09 respectively. Our new forecast for FY08 is US$2232/t, which is 20% lower than spot. We continue to believe aluminum prices have peaked and as a result we forecast Hindalco's average realization to fall 17.5% in FY08. With single digit volume growth, a large part of the price fall flows to the bottomline.

Chinese alumina and aluminum production still rising

Currently aluminum is benefiting from supply disruptions, copper substitution and also heightened speculative investments. But we are wary of China's rising bauxite imports (+347% in 2006; +64% in Jan 07 over Dec 06) and the flow-on effect into stronger Chinese alumina & aluminum production in 2007. We forecast aluminum to move from a deficit of 549kt in CY06 to a surplus of 335kt in CY07.

Novelis to overshadow aluminum upgrades; Sell

The stock has come off sharply in the past month and indeed valuation looks reasonable at 9xFY08. However, the more important issue now in our view is the Novelis acquisition, which pending a counter bid, should be completed by end-April. We remain negative on the acquisition as we do not see the rationale of moving into a non-integrated low margin downstream business. We expect the deal to be EPS dilutive and we expect gearing to rise sharply. We reiterate Sell.

Estimates (Mar)

(Rs)	2005A	2006A	2007E	2008E	2009E
Net Income (Adjusted - mn)	12,262	15,772	26,879	17,326	11,514
EPS	13.22	16.32	23.17	14.94	9.93
EPS Change (YoY)	22.8%	23.5%	42.0%	-35.5%	-33.5%
Dividend / Share	2.01	2.24	3.33	2.36	1.67
Free Cash Flow / Share	10.69	(8.05)	(1.04)	6.09	(49.02)
GDR EPS (US$)	0.303	0.366	0.524	0.338	0.224
GDR Dividend / Share (US$)	0.046	0.050	0.075	0.053	0.038

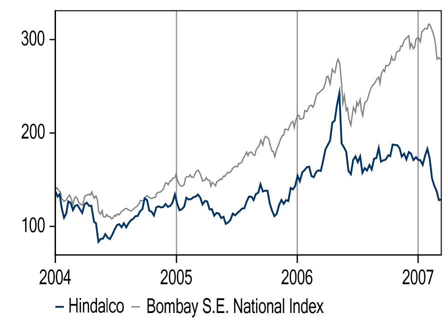
Valuation (Mar)

	2005A	2006A	2007E	2008E	2009E
P/E	9.82x	7.96x	5.60x	8.69x	13.08x
Dividend Yield	1.55%	1.73%	2.56%	1.82%	1.28%
EV / EBITDA*	7.12x	6.08x	3.64x	4.88x	5.98x
Free Cash Flow Yield*	6.59%	-5.16%	-0.798%	4.69%	-37.75%

* For full definitions of *iQmethod* SM measures, see page 9.

Stock Data

Price (Common / GDR)	Rs129.85 / US$3.40
Investment Opinion	C-3-7 / C-3-7
Volatility Risk	HIGH / HIGH
52-Week Range	Rs125.25-Rs251.40
Market Value (mn)	US$3,405
Shares Outstanding (mn)	1,160.0 / 1,160.0
Average Daily Volume	1,847,840
ML Symbol / Exchange	HNDFF / BSE
ML Symbol / Exchange	HNDNF / OTU
Bloomberg / Reuters	HNDL IN / HALC.BO
ROE (2007E)	25.0%
Net Dbt to Eqty (Mar-2006A)	34.7%
Est. 5-Yr EPS / DPS Growth	0% / 0%
Free Float	74.0%



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Refer to important disclosures on page 10 to 11. Analyst Certification on page 8.

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iQprofile SM Hindalco Industries Ltd.

Key Income Statement Data (Mar)

(Rs Millions)	2005A	2006A	2007E	2008E	2009E
Sales	101,053	120,362	191,690	170,536	143,125
Gross Profit	24,306	28,449	47,574	35,485	28,935
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	17,981	20,490	39,116	26,295	19,050
Net Interest & Other Income	620	(208)	(1,062)	(663)	(2,379)
Associates	0	0	0	0	0
Pretax Income	18,600	20,281	38,054	25,632	16,671
Tax (expense) / Benefit	(6,228)	(4,403)	(10,655)	(7,177)	(4,668)
Net Income (Adjusted)	12,262	15,772	26,879	17,326	11,514
Average Fully Diluted Shares Outstanding	928	966	1,160	1,160	1,160

Key Cash Flow Statement Data

Net Income (Reported)	12,262	15,772	26,879	17,326	11,514
Depreciation & Amortization	6,325	7,959	8,458	9,190	9,885
Change in Working Capital	(3,865)	(13,007)	(12,400)	9,927	6,500
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	7,769	1,438	2,759	(752)	(804)
Cash Flow from Operations	22,491	12,163	25,695	35,691	27,095
Capital Expenditure	(12,569)	(19,940)	(26,898)	(28,632)	(83,953)
(Acquisition) / Disposal of Investments	627	1,781	(2,435)	(3,750)	(4,200)
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(11,942)	(18,159)	(29,333)	(32,382)	(88,153)
Shares Issue / (Repurchase)	3	58	58	116	0
Cost of Dividends Paid	(1,732)	(2,113)	(2,486)	(4,407)	(3,122)
Cash Flow from Financing	2,843	16,682	4,576	1,363	18,994
Free Cash Flow	9,922	(7,777)	(1,202)	7,059	(56,858)
Net Debt	23,162	32,790	34,285	28,922	81,527
Change in Net Debt	(1,322)	2,796	557	(10,035)	64,180

Key Balance Sheet Data

Property, Plant & Equipment	86,854	98,834	117,274	136,716	210,784
Other Non-Current Assets	29,559	31,632	34,067	37,817	11,529
Trade Receivables	NA	NA	NA	NA	NA
Cash & Equivalents	26,634	30,489	30,489	30,489	0
Other Current Assets	22,887	48,293	78,144	71,464	79,799
Total Assets	165,933	209,248	259,974	276,486	302,112
Long-Term Debt	49,796	63,278	64,774	59,411	81,527
Other Non-Current Liabilities	11,342	12,281	13,042	13,555	13,889
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	27,911	39,111	51,383	46,279	39,662
Total Liabilities	89,050	114,670	129,199	119,245	135,078
Total Equity	76,884	94,577	130,775	157,241	167,034
Total Equity & Liabilities	165,933	209,247	259,974	276,486	302,112

iQmethod SM - Bus Performance*

Return On Capital Employed	9.3%	10.4%	14.9%	8.6%	5.6%
Return On Equity	16.8%	18.6%	25.0%	12.9%	7.6%
Operating Margin	17.8%	17.0%	20.4%	15.4%	13.3%
EBITDA Margin	24.1%	23.6%	24.8%	20.8%	20.2%

iQmethod SM - Quality of Earnings*

Cash Realization Ratio	1.8x	0.8x	1.0x	2.1x	2.4x
Asset Replacement Ratio	2.0x	2.5x	3.2x	3.1x	8.5x
Tax Rate (Reported)	33.5%	21.7%	28.0%	28.0%	28.0%
Net Debt-to-Equity Ratio	30.1%	34.7%	26.2%	18.4%	48.8%
Interest Cover	8.3x	6.8x	12.4x	9.1x	6.3x

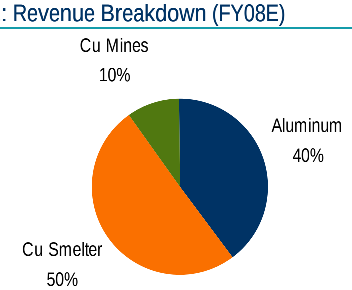
Key Metrics

* For full definitions of *iQmethod* SM measures, see page 9.

Company Description

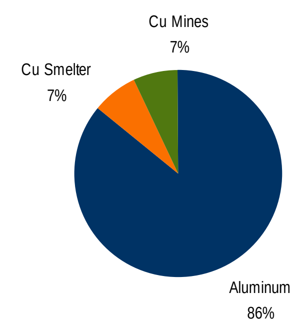
Hindalco is India's largest producer of aluminum and copper. It has an integrated capacity of 425,000 tons of aluminum that accounts for 37% of capacity in India. In copper, Hindalco operates a 500,000-ton smelter, which accounts for 60% of domestic capacity. It also owns two copper mines (capacity 110,000 tons) in Australia. Hindalco ranks as one of the lowest-cost producers of aluminum globally.

Chart 1: Revenue Breakdown (FY08E)



Source: Hindalco, Merrill Lynch Estimates

Chart 2: EBIT Breakdown (FY08E)



Source: Hindalco, Merrill Lynch Estimates

Stock Data

Shares / GDR	1.00
Price to Book Value	1.2x

Aluminum Price Forecast Increased

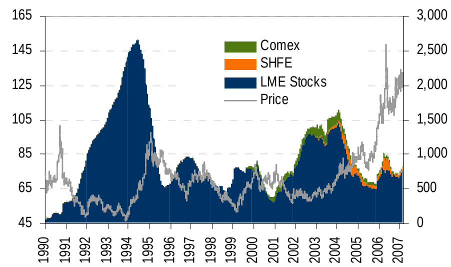
Our global commodities team has recently increased its aluminum price forecast by 11% in FY08 and 14% in FY09. Our new aluminum price forecast for FY08 is US$2232/t which still remains 20% below spot. Table 1 gives details of our price forecast changes.

Table 1: Aluminum Price Assumptions / Changes

US$/ton	FY07E	FY08E	FY09E	FY10E	FY12E/LT*
New Forecast	2,682	2,232	1,984	1,879	1,944
Previous Forecast	2,405	2,012	1,736	1,797	1,944
% Change	11.5%	10.9%	14.3%	4.6%	0.0%

Source: Merrill Lynch Estimates

Chart 3: Aluminum Price & Inventories



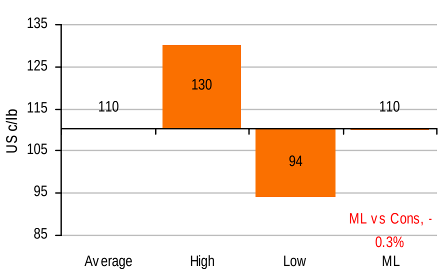
Source: LME, Comex, SHFE, Bloomberg

Extracted from Merrill Lynch 'Commodity Price Review' dated March 14, 2007 authored by Global Co-ordinator, Vicky Binns.

Aluminum Key Issues

- **Supply disruptions** - So far in 2007, supply side disruptions have taken centre stage. Bauxite exports from Guinea (which supplies over 10% of the world market), remain at risk for the immediate future, providing good support for aluminum prices.
- **Strong demand** - Demand has been better than expected; with apparent consumption of aluminum in China up 25% in 2006 (vs. ML est. 20%) and +40% in Jan 07 YoY – this does sound suspiciously like inventory building.
- **Copper substitution** - We suspect aluminum has been a major beneficiary of the weakness in copper demand, with substitution of aluminum for copper occurring in many of copper's main end-use markets. This strength has offset disappointing North American aluminum demand, +15% in Feb YoY in new orders in mill products. This is the lowest February since 2001.
- **Fund activity** - Despite the reported large stocks of aluminum held off warrant by investors (some reports >600kt), aluminum exchange inventories (LME, Comex, Shanghai) continue to climb with +19% in last 3 months and +6% in the last month alone.
- **We expect supply to rise** - We still remain wary of the increasing Chinese bauxite imports (+347% in 2006; +64% in Jan 07 over Dec 06!) and the flow on effect into stronger Chinese alumina and aluminum production in 2007. With plenty of power availability (capacity utilization of IPP's in mid-50's%), there are many aluminum smelters being built and we believe China will continue to be a net exporter of aluminum (most tax effective as a semi-fab product). Overall we expect global demand supply to deteriorate – from deficit of 549kt in CY06 to a surplus of 335kt in CY07.
- **Alumina price likely to fall** - We believe the alumina spot price bounce from ~U$200-220/t in late November 06, to the most recent Nalco spot Tender of U$403/t is un-sustainable. The alumina market is well supplied, and we forecast Chinese alumina production to be ~20mt in 2007 (up from 13.7mt in 2006), and China could be in balance in alumina in 2009. We would expect the alumina price to head back to a more sustainable U$300/t in the near future.

Chart 4: Al 2007 Forecasts: ML vs. Consensus



Source: Industry Sources, Access Economics, Merrill Lynch estimates

Table 2: Alumina Supply/Demand Balance

000 tonnes	2006	2007E	2008E	2009E	2010E
Alumina Production					
China	13,743	19,766	23,812	26,769	27,177
% chg	60%	44%	20%	12%	2%
Rest of world	60,490	63,490	68,971	69,887	73,262
World Production	74,233	83,256	92,783	96,656	100,439
Chemical Alumina Consumption	6,300	6,500	6,815	7,120	7,121
Met Alumina Available	67,933	76,756	85,968	89,536	93,318
Met Alumina Consumption	65,867	72,202	77,211	81,913	86,845
Alumina Surplus	2,067	4,554	8,757	7,623	6,474

Source: Brook Hunt, Antaike, Merrill Lynch Equity Research

Table 3: Aluminum Supply/Demand Balance

000 tonnes	2006E	2007E	2008E	2009E	2010E
Refined Production					
China	9,435	11,351	12,697	13,716	14,822
% chg	21%	20%	12%	8%	8%
Rest of world	24,562	25,902	27,135	28,540	29,976
Total Supply	33,997	37,253	39,832	42,256	44,798
Refined Consumption					
China	8,595	10,228	11,762	13,291	14,886
% chg	23%	19%	15%	13%	12%
Rest of world	25,951	26,690	27,475	28,264	29,104
Total Demand	34,546	36,918	39,237	41,555	43,990
SUPPLY less DEMAND	-549	335	594	701	808

Source: Brook Hunt, WBMS, Merrill Lynch Research estimates

Copper Key Issues

Hindalco is both a custom copper smelter and copper miner. So far the smelting business has been bigger and hence tracking copper TCRC has been more important. But contract TCRC have fallen sharply in CY07 given the absence of price participation. As a result we expect Hindalco's smelting profit to decline sharply in FY08. The copper mine business on the other hand has over the last few years has been impacted by production problems. We expect this trend to change in FY08 and expect copper mine EBIT to be higher than smelting EBIT. We present below our global team's views on Copper.

- **Oversupplied market in 2007:** Our Supply / Demand analysis shows a surplus of copper in 2007 of 466kt. This compares to Brook Hunt forecasts of surplus +326kt and Teck Cominco's forecast at +312kt.

- **Forecast increasing surpluses for 2008-2010:** We believe that the copper supply response is already here. We forecast a growing surplus in 2008 despite continuing strong demand growth (3.7% after +4% in 2007). These surpluses should drive inventories up from distressed levels of 1.4 wks in mid 2006, to 2.9 weeks by the end of 2007 and 4.4 wks in 2008.

- **Chinese restocking but at lower prices.** Chinese consumption may rebound after a poor 2006 (including SRB de-stocking). We question how aggressively the Chinese will re-stock copper inventories at copper prices >$6600/t, however as we forecast an average U$4712/t in FY08, we assume a strong 13% rebound in Chinese copper demand in 2007.

Table 4: Copper S/D Balance Summary

	2006E	2007E	2008E	2009E
Supply	17,255	18,490	19,299	20,304
Demand	17,336	18,024	18,687	19,484
Balance	-82	466	613	820
Brook Hunt	*-80*	*326*	*538*	*n/a*
Total Inventories*	1.7	2.9	4.4	6.2

Source: Brook Hunt, Merrill Lynch Research estimates. * weeks of world consumption

Hindalco EPS estimates revised up

We have raised our EPS estimates: FY08E – by 32% to Rs14.9; FY09E – by 74% to Rs9.9. We are also raising our estimate for FY07E to Rs23.1/sh from Rs22.1/sh to reflect higher than forecast Mar Q aluminum prices.

…we still expect earnings decline in FY08E and FY09E

However, our opinion on earnings peaking in FY07 remains intact and we now look for earnings to decline 36% in FY08E (vs. 49% earlier) and 34% in FY09E (vs. 50% earlier).

Aluminum – 86% of EBIT in FY08E

Post 3 phenomenal years of EBIT growth till FY07E, we forecast Aluminum EBIT to decline 32% and 25% respectively in FY08E and FY09E. This is led by our expectation of falling aluminum prices and very little volume growth. We expect Hindalco's aluminum realization to fall 20% and 11% in next 2 years.

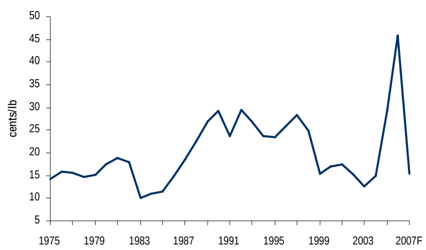
Hindalco's aluminum division is predominantly a price leverage story with unexciting volume growth. Though it is expanding capacities, these are long gestation greenfield projects with volume growth from new capacity expected earliest in FY10. Volume growth in alumina is more front ended – we estimate volume growth of 33% in FY08E but this will likely be negated by decline in realizations. We are forecasting 36% decline in average alumina realizations in FY08. Table 5 gives key assumptions underlying our aluminum forecasts.

Table 5: Aluminum - Key Assumptions

	FY 05A	FY 06A	FY 07E	FY 08E	FY 09E
Aluminum					
Al LME (US$ / ton)	1,791	2,030	2,682	2,232	1,984
Import Duty	15%	9.8%	7.1%	5.0%	5.0%
Rupee Exchange Rate	44.9	44.3	45.2	44.2	44.2
Domestic price - Rs / ton	89,625	98,256	131,033	105,156	93,877
% chg	8.8%	9.6%	33.4%	-19.7%	-10.7%
Al Metal Sales Volume (tons)	420,862	426,027	441,463	475,638	512,200
% chg	29.0%	1.2%	3.6%	7.7%	7.7%
Alumina					
Price - Rs / ton	17,643	20,603	20,660	13,260	13,260
% chg	41.0%	16.8%	0.3%	-35.8%	0.0%
Alumina Sales volume (tons)	322,828	388,646	364,596	484,638	526,438
% chg	-15.0%	20.4%	-6.2%	32.9%	8.6%
Total Turnover (Rs m)	51,685	58,922	76,700	67,938	65,413
% chg	45.0%	14.0%	30.2%	-11.4%	-3.7%
- Aluminum	45,990	50,915	69,167	61,512	58,432
- Alumina	5,696	8,007	7,532	6,426	6,981
EBIT (Rs m)	15,957	21,281	32,930	22,358	16,835
% chg	54%	33%	55%	-32%	-25%

Source: Hindalco, Merrill Lynch Estimates

Chart 5: Long Term Contract TCRC Trend



Source: Source: Brook Hunt

Chart 6: Spot TCRC Trend

Source: Source: Brook Hunt

Copper Smelter – 7% of EBIT in FY08E

Hindalco's copper smelter has had production issues and recent sharp reduction in spot TCRCs has also led to voluntary production closure at one of its smelters. As a result our production estimate for FY07 is ~20% lower than our forecast at the beginning of the year. In FY08E we are forecasting production at 380,750tons, growth of 29%. Overall utilization levels will improve from ~60% in FY07 to 75% in FY08, taking into account biannual maintenance at one of its smelters.

However, benefits from volume growth will be negated by sharp fall in TCRC fees. Poor copper smelter fundamentals and absence of price participation in 2007 contracts have led to a sharp decline in contract TCRC (see Chart 5). We estimate TCRC fee earned by Hindalco will fall from 29.5c/lb in FY07E to 18c/lb in FY08E. We expect copper smelter EBIT to decline sharply by 68% in FY08.

Table 6: Copper Smelter - Key Assumptions

	FY 06A	FY07E	FY08E	FY09E
Production Volume (tonnes)	223,363	294,940	380,750	416,500
% chg	2.9%	32.0%	29.1%	9.4%
TCRC - Blended (c / lb)	18.1	29.5	18.0	18.0
Import duty	9.8%	7.1%	5.0%	5.0%
Duty Differential (%)	9.8%	5.1%	3.0%	3.0%
EBIT (Rs m)	193	5,892	1,887	2,114
% chg	-92%	2954%	-68%	12%

Source: Hindalco, Merrill Lynch Estimates

Copper Mines – 7% of EBIT in FY08E

Slow ramp up at Nifty mines in FY07 and production problems at the Gordon mine have led to lower than expected production and higher operating costs at Hindalco's copper mines. Management now expects production to reach full capacity in the current quarter; we are forecasting a 47% in copper production in FY08E. As a result, we also estimate a decline in operating costs next year, leading to EBIT growth in excess of 100% in FY08E. Production stabilization issues at mines remains a key risk to our estimates.

Table 7: Copper Mines - Key Assumptions

	FY06	FY 07E	FY08E	FY09E
LME Cu (effective) - US$ / t	3,360	5,132	4,712	3,362
Production Volume (tons)	46,240	59,326	87,000	75,000
% chg	6%	28%	47%	-14%
- Copper Concentrate	29,000	42,729	82,000	75,000
- Copper Cathodes	17240	16597	5000	0
EBIT (Rs m)	-824	1727	3485	1535
% chg	-7%	310%	102%	-56%

Source: Hindalco, Merrill Lynch Estimates

Trading at fair value; acquisition concerns will continue to drag

At current price of Rs128/sh Hindalco is trading at 8.6x, close to its last 8 years average PE of ~8.1x. The stock has corrected more than 25% after the company announced its $6bn acquisition of Novelis last month. On a stand alone basis stock valuations look attractive and it is available at more than 30% discount to its replacement value.

However, we expect the picture to deteriorate materially should the Novelis acquisition go through. Pending a counter bid, we expect the deal to be completed by end April 2007. We reiterate our negative view on this acquisition. We do not see the rationale of moving into a non-integrated low margin downstream business. We expect the deal to be EPS dilutive and we expect gearing to rise sharply. Hence we maintain our Sell rating.

Analyst Certification

I, Vandana Luthra, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Special Disclosures

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iQmethod SM Measures Definitions

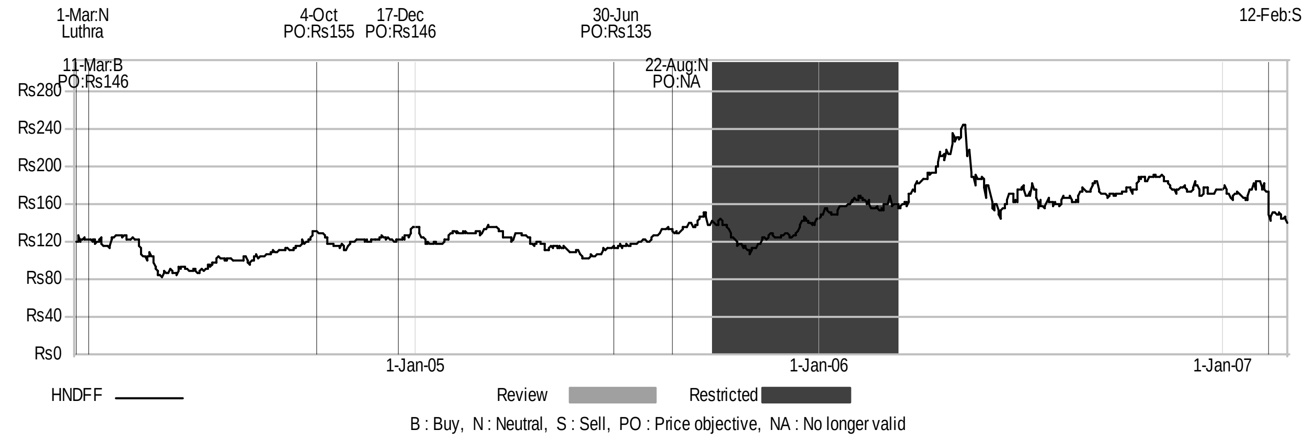
Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

iQmethod SM is the set of Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of *iQmethod* are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

iQdatabase ® is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by Merrill Lynch.

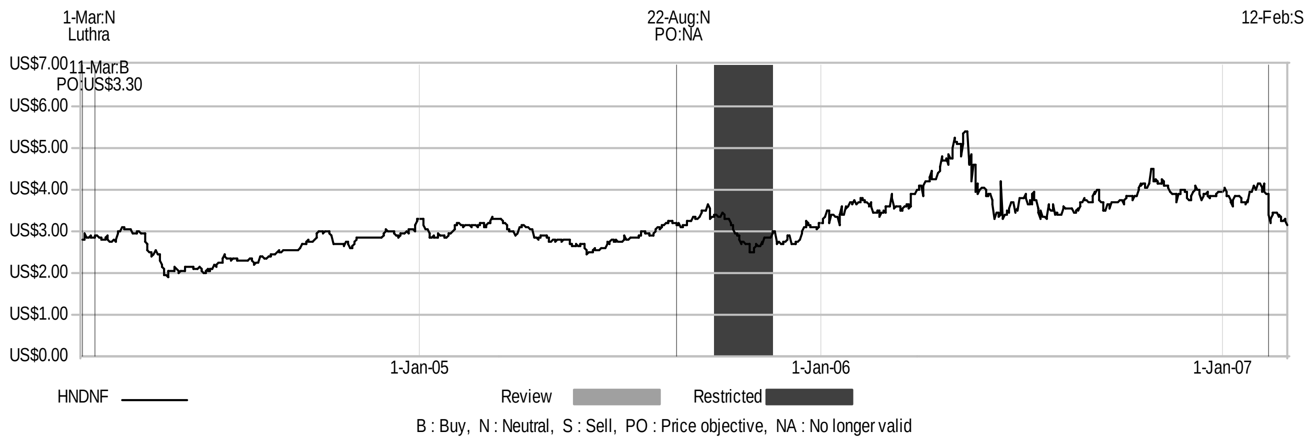
Important Disclosures

HNDFF Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of February 28, 2007 or such later date as indicated.

HNDNF Price Chart



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Investment Rating Distribution: Non-Ferrous Metals/Mining & Minerals Group (as of 31 Dec 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	28	31.11%	Buy	11	39.29%
Neutral	53	58.89%	Neutral	18	33.96%
Sell	9	10.00%	Sell	1	11.11%

Investment Rating Distribution: Global Group (as of 31 Dec 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1306	42.74%	Buy	406	31.09%
Neutral	1509	49.38%	Neutral	446	29.56%
Sell	241	7.89%	Sell	53	21.99%

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