



Hindalco

STOCK INFO. BLOOMBERG
BSE SENSEX: 14,283 HNDL IN
REUTERS CODE
S&P CNX: 4,148 HALC.BO

27 January 2007

Buy

Previous Recommendation: Buy

Rs175

Equity Shares (m)	1,159.3
52-Week Range	251/139
1,6,12 Rel. Perf. (%)	-4/-26/-36
M.Cap. (Rs b)	203.2
M.Cap. (US\$ b)	4.6

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/06A	120,362	15,777	13.6	1.4	12.9	2.2	16.9	12.0	2.1	9.0
3/07E	194,210	26,635	23.0	68.8	7.6	1.7	21.9	18.5	1.2	5.3
3/08E	200,607	27,004	23.3	1.4	7.5	1.3	17.3	16.1	1.1	5.0

- Hindalco 3QFY07 results are in line with our estimates. PAT grew 90% to Rs6.4b (v/s our estimate of Rs6.2b). Revenues for aluminium segment increased by 15% YoY to Rs17.9b, largely on account of 31% higher average LME prices (US\$2,723 per ton). Part of LME gains were offset by lower import duty of 7.5% (v/s 10%) and stronger Indian currency against US\$ (44.9 v/s 45.4). Share of value added products improved 800bp YoY to 67%. Revenue for the copper segment increased by 119% YoY driven by 47% higher volumes and 65% higher LME prices.
- EBITDA increased 79% YoY to Rs10.5b and margins improved 210bp YoY to 22.4% due to better treatment and refining (tc/rc) margins and higher aluminium prices.
- Aluminium segment EBIT margins improved 740bp YoY to 42.1% largely on account of higher prices and improvement in product mix. Margins improved sequentially as well by 580bp.
- Copper segment EBIT margins improved 1,200bp YoY to 5.6%. The company had borne backwardation losses due to Cu-3 unexpected breakdown last year. Falling tc/rc trend had bearing on QoQ performance. Realized EBIT fell from US28.3c/lb in 2QFY07 to US21.3c/lb in 3QFY07.
- We expect volume growth of 7.8% in the aluminium segment due to start of phase 1 of Hirakud smelter expansion and 20% in copper segment coupled with operating efficiencies to offset falling tc/rc margins. Muri expansion of alumina refinery would add to earnings after its planned start up in June 2007. We are revising our consolidated EPS estimate for FY07 to Rs23 (v/s 22.4) to factor in stronger aluminum prices and for FY08 downward to Rs23.3 (v/s25) to factor in decline in customs duty from 7.5% to 5%. After adjusting Rs17.8 (value of investments), the stock is trading at 6.8x FY08E earnings. We maintain **Buy**.

QUARTERLY PERFORMANCE

(RS MILLION)

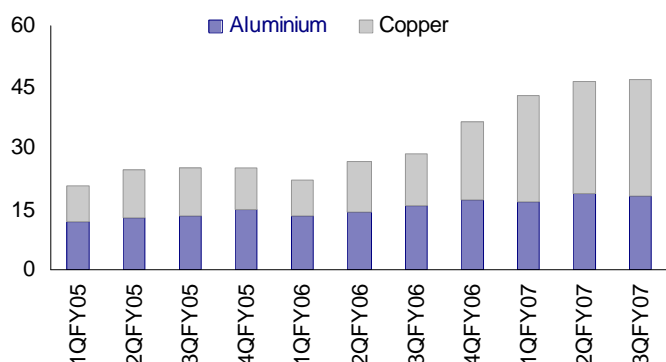
Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	22,078	26,608	28,737	36,574	42,737	46,342	46,562	42,151	113,964	177,792
Change (YoY %)	7.1	8.3	15.4	45.4	93.6	74.2	62.0	15.2	19.7	56.0
Total Expenditure	16,034	21,729	22,907	27,276	33,403	36,478	36,109	31,725	87,914	137,715
EBITDA	6,044	4,879	5,830	9,298	9,334	9,864	10,453	10,426	26,050	40,077
Change (YoY %)	31.1	-9.7	-9.8	47.9	54.4	102.2	79.3	12.1	14.4	53.8
As % of Net Sales	27.4	18.3	20.3	25.4	21.8	21.3	22.4	24.7	22.9	22.5
Interest	461	539	628	624	634	515	698	700	2,252	2,547
Depreciation	1,169	1,285	1,314	1,443	1,341	1,353	1,384	1,522	5,211	5,600
Other Income	336	927	433	743	776	1,108	584	600	2,439	3,068
PBT (before EO item)	4,750	3,982	4,321	7,974	8,135	9,104	8,955	8,804	21,027	34,998
Extra-ordinary Income	-	-	30.0	-	-	-727.0	-	-	30.2	-727.0
PBT (after EO item)	4,750	3,982	4,351	7,974	8,135	8,377	8,955	8,804	21,057	34,271
Total Tax	1,015	851	930	1,705	2,120	2,401	2,516	2,474	4,501	9,511
% Tax	21.4	21.4	21.4	21.4	26.1	28.7	28.1	28.1	21.4	27.8
Reported PAT	3,735	3,131	3,421	6,269	6,015	5,976	6,439	6,330	16,555	24,760
Adjusted PAT	3,735	3,131	3,397	6,269	6,015	6,495	6,439	6,330	16,532	25,286
Change (YoY %)	58.5	5.1	-5.9	37.4	61.1	107.4	89.5	1.0	23.8	53.0

E: MOST Estimates: Stalone numbers

Strong metal prices and copper volumes drive revenue

Net revenues have gone up 62% YoY to Rs46.6b, driven by strong metal prices and volume growth in copper segment.

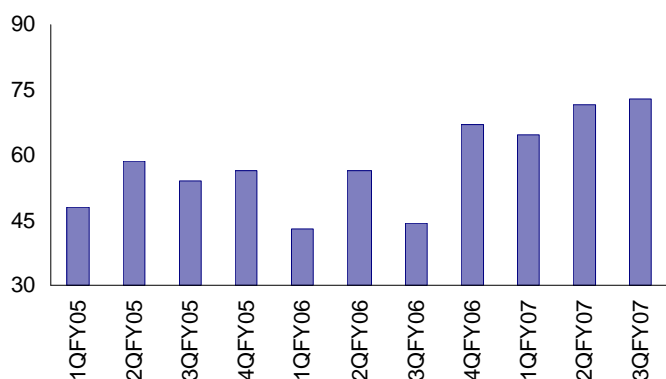
SEGMENTAL DISTRIBUTION OF REVENUE (RS B)



Source: Company/ Motilal Oswal Securities

Revenues for aluminium segment increased by 15% YoY to Rs17.9b, largely on account of 31% higher average LME prices (US\$2,723 per ton). A part of the LME gains were offset by lower import duty of 7.5% (v/s 10%) and stronger Indian currency against US\$ (44.9 v/s 45.4). Share of value added products improved 800bp YoY to 67%. Rolled product output strengthened due to better performance from the rolling plants as also the acquisition of the rolling mill at Mouda (in Maharashtra). Extrusion output showed significant improvement due to rated capacity utilization of the extrusions press operating at Renukoot (in Uttar Pradesh) since April 2006.

PRODUCTION OF COPPER CATHODE ('000 TON)



Source: Company/ Motilal Oswal Securities

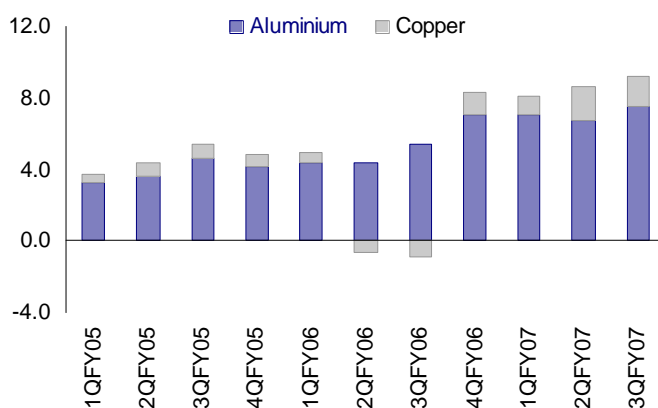
Copper segment revenues increased by 119% YoY to Rs18b due to 47% higher sales volumes and 65% higher LME prices. Production of copper cathode rose by 65% YoY and 2% QoQ to 730,000 tons. Copper smelter Cu-3 performed very well and achieved rated capacity in the month of November 2006. Smallest smelter Cu-2 (Ausmelt – 70k tpa) has been shut down temporarily due to its high cost of production and falling tc/rc rates. This will bring down average conversion costs.

Strong aluminium prices and significantly better performance of copper division boosted EBITDA and margins

EBITDA increased 79% YoY to Rs10.5b and margins improved 210bp YoY to 22.4% due to better tc/rc margins and higher aluminium prices.

Aluminium segment EBIT margins improved 740bp YoY to 42.1% largely on account of higher prices and improvement in product mix. Margins improved sequentially as well by 580bp.

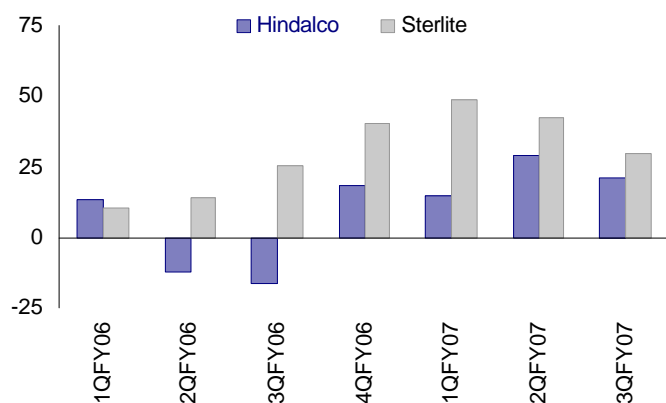
SEGMENTAL EARNINGS (RS B)



Source: Company/ Motilal Oswal Securities

Copper segment EBIT margins improved 1,200bp YoY to 5.6%. The company had borne backwardation losses due to Cu-3 unexpected breakdown last year. Falling tc/rc trend had bearing on QoQ performance. Realized EBIT fell from US28.3c/lb in 2QFY07 to US21.3c/lb in 3QFY07.

COPPER DIVISION PERFORMANCE INCHING CLOSER TO THE WORLD'S BEST SMELTER (STERLITE) REALIZED EBIT (US\$LB)



Source: Company/ Motilal Oswal Securities

Progress of brownfield projects

35KTPA aluminium capacity added at Hirakud. Another 43KTPA by March 2008

The commissioning of Phase 1 of the expanded smelting capacity from 65KTPA to 100KTPA at Hirakud has been completed. All of the 150 pots have been energized. Phase 2 of the project which will raise smelting capacity to 143KTPA, is on track and is scheduled to go on stream in the first half of next year.

340KTPA (+22% of existing capacity) additional alumina capacity by June 2007

The brownfield expansion of the Alumina refinery from 110 KTPA to 450 KTPA is at an advanced state of completion. It is expected to be commissioned in the first quarter of the next fiscal.

Belgaum alumina expansion on hold

For the expansion of the alumina refining capacity at Belgaum, Karnataka from 350,000 TPA to 650,000 TPA, the leases for bauxite mining are yet to be secured. Until such time the expansion plan will be on hold.

Progress of greenfield projects

Work is progressing on Uktal 1.5MTPA alumina refinery (completion - May 2009)

Work on this 1,500KTPA alumina project is on track. The pile foundation for the precipitation area is progressing. The

layout of the non-plant buildings has been finalized. Detailed engineering for mines has commenced. The second phase of the rehabilitation settlement process is underway. This project is being carried out under a joint venture with Alcan.

SEZ status for Aditya Alumina - 1.5MTPA Alumina & 325KTPA smelter (Target completion 2010)

For this greenfield integrated 1.5m TPA alumina, and 325KTPA of aluminium project, land acquisition is expected to be completed by June 2007. In principle approval has been obtained for SEZ status for the smelter.

SEZ status for Bargawan (MP) – 325KTPA aluminium and 250MW CPP

This project envisages setting up of a 325KTPA smelter and a 250MW captive power plant (CPP) supported by a captive coal mine. The proposed location in Bargawan is in the Sidhi District of Madhya Pradesh. The topographical survey for the smelter has been completed. In principle approval has been obtained for SEZ status for the smelter and power plant. The coal mine will be in a joint venture with Essar Power for which the mine plan is under finalization.

Lathehar (Jharkhand) – 325KTPA aluminium and 750MW CPP

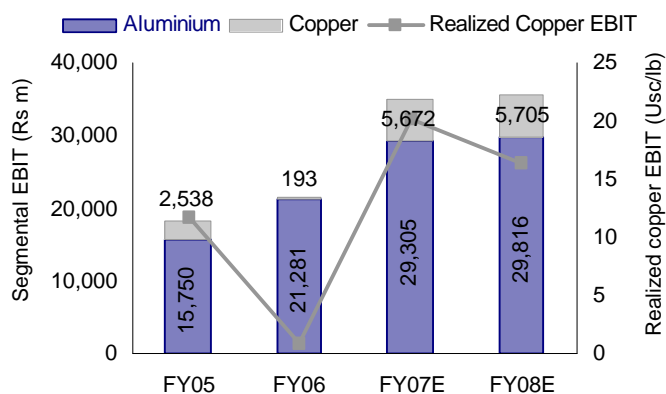
For this project entailing the setting up of a 325KTPA aluminium smelter with 750MW captive power plant, supported by a 5MTPA captive coal mine in Jharkhand, an MoU was signed in March 2005 with the government of Jharkhand. The allotment of the coal block is awaited. An application for requisite land, water and necessary infrastructure support has been submitted to the Jharkhand state authorities.

Outlook

Expansion of Hirakud smelter from 65,000 tpa to 100,000 tpa has been completed and all the 150 pots have been energized. This would result in 7.8% higher aluminium volumes in FY08E. Expansion of alumina refinery at Muri, Jharkhand from 110,000 tpa to 450,000 tpa in June 2007 would add to earnings thereafter in FY08. Improving performance of the largest smelter Cu-3 (250,000 tpa i.e.

50% of total capacity) and temporary shutting of most inefficient and smallest Cu-2 (70,000 tpa) would bring down average operating costs and drive copper volume growth of 20% to 340,000 tons (we remain conservative on volume though there is potential of higher volumes), though tc/rc margins on long term contracts have fallen from US\$90/9 cents to US\$60/6 cents with elimination of price participation. This normally would result in a decline in earnings. However, **we believe that the share of BRIC contracts and improving productivities coupled with strong volume growth would protect copper earnings from falling.**

VOLUME GROWTH TO COMPENSATE FOR FALL IN TCRC



Source: Company/ Motilal Oswal Securities

The mining operations in Australia which meets nearly 20% of its copper concentrate requirement have turned profitable. Aditya Birla Mineral Pty., listed in Australia has posted net profit Aus\$20m in the first half. We believe subsidiaries of Hindalco instead of being a drag so far would contribute Rs1.44 to FY08E EPS of the consolidated entity.

Valuation and view

We are revising our consolidated EPS estimate for FY07 to Rs23 (v/s 22.4) to factor in stronger aluminum prices and for FY08, downward to Rs23.3 (v/s 25) to factor in decline in customs duty from 7.5% to 5%. After adjusting Rs17.8 (value of investments) in the current share price, the stock is trading at 6.8x FY08E earnings. We maintain **Buy.**

VALUATION OF INVESTMENTS

	(RS M)	(RS/SHARE)
Quoted Investments	17,946	15.5
Aditya Birla Nuvo	9,430 *	
Grasim	6,581 *	
NALCO	1,935 *	
Others	7,817	6.7
Total Value of Investment	-	22.2
Discount for Locked Value	20%	4.4
Valuation of Investment Portfolio	-	17.8

* At the market price on 25.1.07 Source: Motilal Oswal Securities

Hindalco: an investment profile

Company description

Hindalco is the largest Aluminium producer in India with market share of 45% and is the only player which converts 67% of metal production into value-added products including high-end products like aluminium foils and packaging material. Copper smelting capacity of 500,000 tpa is the largest in Asia. Hindalco has laid out an aggressive growth plan for tripling its aluminium production capacity in next four years through number of brownfield and greenfield expansions in India and would be funded through recent rights issue, internal accrual and debt.

Key investment arguments

- Aggressive growth plan to triple its aluminium capacity in four years through a number of brownfield and greenfield projects. New smelting capacities are coming close to energy sources and alumina would be set up close to bauxite mines thereby lowest cost of production on increment capacity.
- Copper smelter operating efficiency will improve and lower conversion cost along with strong volume growth.

Key investment risks

- Unexpected fall in aluminium prices would adversely impact earnings.

COMPARATIVE VALUATIONS

		HINDALCO	NALCO	STERLITE
P/E (x)	FY07E	7.6	6.4	6.2
	FY08E	7.5	8.8	6.7
P/BV (x)	FY07E	1.7	1.9	2.1
	FY08E	1.3	1.6	1.4
EV/Sales (x)	FY07E	1.2	2.0	1.2
	FY08E	1.1	2.3	1.1
EV/EBITDA (x)	FY07E	5.3	3.3	3.1
	FY08E	5.0	4.6	3.0

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	26.8	26.8	26.0
Domestic Inst	16.2	17.9	15.7
Foreign	33.5	33.3	40.0
Others	23.5	22.0	18.3

Recent developments

- Entering into 70% JV with ALMEC USA. Inc., for manufacturing of high strength aluminium alloys for applications in aerospace, sporting goods and surface transport.

Valuation and view

- On adjusting Rs17.8 (value of investments) in the current share price, the stock is trading at 6.8x FY08E earnings. We maintain **Buy**.

Sector view

- Demand for aluminium products in India is growing at 9% p.a. and the momentum is likely to further accelerate in forthcoming years. Global demand too is expected to post growth rate of 5%-led by strong growth in China. Copper tc/rc appears to have bottomed out as high cost smelters have started closing.

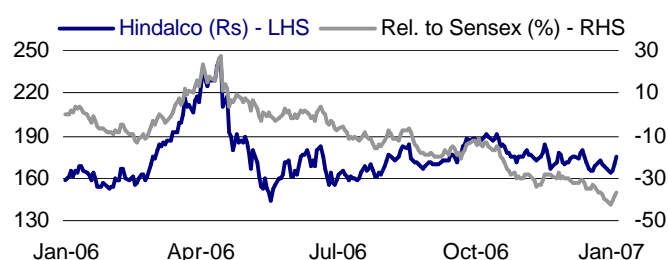
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	23.0	22.9	0.6
FY08	23.3	20.1	16.1

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
175	205	17.1	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Net sales	85,241	101,053	120,362	194,210	200,607	
Change (%)	32.3	18.5	19.1	61.4	3.3	
Total Expenses	66,153	76,748	91,913	148,927	154,249	
EBITDA	19,089	24,306	28,449	45,283	46,358	
% of Net Sales	22.4	24.1	23.6	23.3	23.1	
Depn. & Amortization	5,140	6,325	7,959	8,350	8,550	
EBIT	13,949	17,981	20,490	36,933	37,808	
Net Interest	2,186	2,159	3,014	3,297	3,625	
Other income	3,102	2,779	2,805	3,468	3,600	
PBT before EO	14,865	18,600	20,281	37,104	37,783	
EO income	-19	585	24	-727		
PBT after EO	14,846	19,186	20,305	36,377	37,783	
Current tax	3,234	5,419	3,424	9,711	10,101	
Deferred tax	1,638	809	980			
Tax	4,871	6,228	4,403	9,711	10,101	
Rate (%)	32.8	32.5	21.7	26.7	26.7	
Reported PAT	9,975	12,958	15,902	26,666	27,681	
Minority interests	40	110	106	564	677	
Adjusted PAT	9,948	12,452	15,777	26,635	27,004	
Change (%)	28.9	25.2	26.7	68.8	14	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Share Capital	925	928	986	1,044	1,159	
Reserves	67,654	75,098	92,296	120,758	155,360	
Net Worth	68,579	76,026	93,282	121,802	156,519	
Minority Interest		858	1,295	1,859	2,536	
Total Loans	25,646	49,796	63,278	63,278	63,278	
Deferred Tax Liability	9,951	11,342	12,281	12,281	12,281	
Capital Employed	104,176	138,023	170,137	199,221	234,614	
Gross Block	66,585	109,532	134,433	154,433	179,433	
Less: Accum. Deprn.	19,183	39,065	46,002	54,352	62,902	
Net Fixed Assets	47,402	70,467	88,431	100,081	116,531	
Capital WIP	4,677	16,387	10,403	10,403	10,403	
Investments	33,772	29,559	31,632	31,632	31,632	
Curr. Assets	29,084	49,521	78,781	108,007	133,353	
Inventory	11,913	26,970	44,975	48,223	56,135	
Account Receivables	5,611	8,404	13,057	17,649	20,259	
Cash and Bank Balance	2,314	4,730	10,423	24,649	36,787	
Others	9,245	9,416	10,326	17,485	20,172	
Curr. Liability & Prov.	10,758	27,911	39,111	50,903	57,304	
Account Payables	7,677	18,812	28,861	39,987	46,127	
Provisions & Others	3,081	9,099	10,250	10,916	11,177	
Net Current Assets	18,326	21,610	39,671	57,104	76,048	
Appl. of Funds	104,176	138,023	170,137	199,221	234,615	

E: Most Estimates

RATIOS						
Y/E MARCH	2004	2005	2006	2007E	2008E	
Basic (Rs)						
EPS	10.7	13.4	13.6	23.0	23.3	
Cash EPS	16.3	20.8	20.6	30.2	31.3	
BV/Share	73.9	81.9	80.5	105.1	135.0	
DPS	16	2.0	19	2.4	2.6	
Payout (%)	17.3	17.0	15.7	11.8	12.6	
Valuation (x)						
P/E		13.1	12.9	7.6	7.5	
Cash P/E		8.4	8.5	5.8	5.6	
P/BV		2.1	2.2	1.7	1.3	
EV/Sales		2.1	2.1	1.2	1.1	
EV/EBITDA		8.5	9.0	5.3	5.0	
Dividend Yield (%)		1.1	1.1	1.4	1.5	
Return Ratios (%)						
RoE	14.5	16.4	16.9	21.9	17.3	
RoCE	13.4	13.0	12.0	18.5	16.1	
Working Capital Ratios						
Asset Turnover (x)	0.8	0.7	0.7	1.0	0.9	
Debtor (Days)	24	30.4	39.6	33.2	36.9	
Inventory (Days)	14	26.7	37.4	24.8	28.0	
Working Capital Turnover (x)	19	16.7	24.3	16.7	19.6	
Leverage Ratio (x)						
Current Ratio	2.7	1.8	2.0	2.1	2.3	
Interest Cover Ratio	6.4	8.3	6.8	11.2	10.4	
Debt/Equity	0.4	0.7	0.7	0.5	0.4	

CASHFLOW STATEMENT		(RS MILLION)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Pre-tax Profit	14,846	19,186	20,305	36,377	37,783	
Depreciation	5,140	6,325	7,959	8,350	8,550	
(Inc)/Dec in Wkg. Cap.	5,961	-868	-12,367	-3,208	-6,806	
Tax Paid	-3,234	-5,419	-3,424	-9,711	-10,101	
CF from Op. Activity	22,714	19,224	12,474	31,808	29,425	
(Inc)/Dec in FA + CWIP	-6,558	-54,657	-18,917	-20,000	-25,000	
(Pur)/Sale of Investments	-13,059	4,213	-2,074			
CF from Inv. Activity	-19,617	-50,444	-20,991	-20,000	-25,000	
Equity raised/(repaid)	0	3	58	58	116	
Chg in minorities		858	437	564	677	
Debt raised/(repaid)	1,696	24,150	13,482			
Dividend (incl. tax)	-1,721	-2,120	-2,473	-3,139	-3,400	
Other financing activities	-3,789	10,745	2,705	4,935	10,320	
CF from Fin. Activity	-3,814	33,637	14,210	2,418	7,713	
(Inc)/Dec in Cash	-718	2,417	5,693	14,226	12,138	
Add: opening Balance	3,031	2,314	4,730	10,423	24,649	
Closing Balance	2,314	4,730	10,423	24,649	36,787	

N O T E S



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Disclosure of Interest Statement	Hindalco
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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