Indiabulls

HINDALCO INDUSTRIES LTD
RESEARCH

EQUITY RESEARCH **July 07, 2008**

RESULTS REVIEW

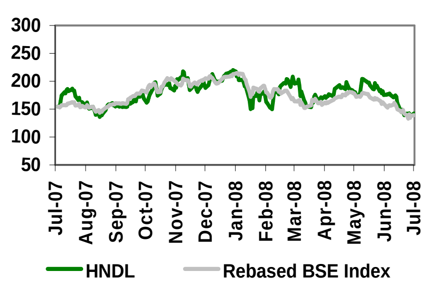
Share Data	
Market Cap	Rs. 174.6 bn
Price	Rs. 142.30
BSE Sensex	13,525.99
Reuters	HALC.BO
Bloomberg	HNDL IN
Avg. Volume (52 Week)	1.1 mn
52-Week High/Low	Rs. 223.3/132.5
Shares Outstanding	1,227.1 mn

Valuation Ratios (Consolidated)

Year to 31 March	2009E	2010E
EPS (Rs.)	16.7	22.1
+/- (%)	(8.9)%	32.4%
PER (x)	8.5x	6.4x
EV/ Sales (x)	0.4x	0.3x
EV/ EBITDA (x)	3.6x	3.4x

Shareholding Pattern (%)	
Promoters	31
FIIs	13
Institutions	15
Public & Others	40

Relative Performance



Hindalco Industries Ltd — Hold

High aluminium prices: a boon

For FY08, Hindalco's standalone net sales rose 4.8% yoy to Rs. 192 bn, supported by higher volumes in both copper and aluminium segments. EBITDA, on the other hand, declined 15.3% yoy to Rs. 34 bn mainly due to the higher cost of raw materials consumed.

In FY09, the Company's aluminium segment is expected to witness a healthy growth led by higher aluminium prices and capacity expansions. While we expect aluminium prices to average around USD 2,748 per ton in FY09 (above the FY08 average of USD 2,624 per ton) due to a healthy global demand, Hindalco's effort to increase the capacities at the Muri and Hirakud plants should boost volumes. In addition, copper prices are also expected to remain above the FY08 levels of USD 7,587 per ton due to a strong global demand and supply constraints. However, copper Tc/Rc rates are expected to fall by 20-30% in FY09 due to the continuing shortage of copper concentrate, which will pressurize the segment's margins. Hindalco's high interest expense, resulting from Novelis's acquisition, will further put pressure on the margins. Though the management plans to repay the loan by undertaking a rights issue, the equity dilution would lead to a lower EPS. Further, Novelis is expected to remain in the red due to its price ceiling contracts, which are scheduled to expire only in 2010. Therefore, while rising metal prices will boost the top line, higher interest expense and lower Tc/Rc rates will be a drag on the bottom line.

At the current market price (CMP) of Rs. 142.3, the stock is trading at a forward EV/EBITDA of 3.6x and 3.4x for FY09E and FY10E, respectively. At these valuations, we believe that the stock is fairly valued, and hence upgrade our rating to Hold.

Key Figures (Standalone)

Quarterly Data	Q4'07	Q3'08	Q4'08	YoY%	QoQ%	FY07	FY08	YoY%
(Figures in Rs. mn, except per share data)								
Net Sales	47,489	45,317	50,102	5.5%	10.6%	183,130	192,010	4.8%
EBITDA	10,499	8,006	7,967	(24.1)%	(0.5)%	40,150	34,011	(15.3)%
Adjusted Net Profit	7,213	5,427	5,363	(25.6)%	(1.2)%	25,682	23,202	(9.7)%
Margins(%)								
EBITDA	22.1%	17.7%	15.9%			21.9%	17.7%	
NPM	15.2%	12.0%	10.7%			14.0%	12.1%	
Per Share Data (Rs.)								
Adjusted EPS	5.8	4.4	4.3	(24.8)%	(1.6)%	26.0	19.9	(23.7)%

Result Highlights

Hindalco's net sales increased 4.8% yoy to Rs. 192 bn for FY08, partly due to the amalgamation of Indian Aluminium Company with Hindalco, further supported by higher sales volumes in the aluminium and copper segments. However, the increase in revenues was restricted by lower aluminium realisations on account of a decline in average LME aluminium prices and a sharp appreciation in the rupee during the year.

Sharp decline in Tc/Rc rates led to a fall in EBITDA margin

EBITDA decreased 15.3% yoy to Rs. 34 bn, and EBITDA margin was lower by 421 bps to 17.7% due to a 379 bps increase in the cost of raw materials consumed to 62.1% as a percentage of revenues.

Adj. net profit declined 9.7% yoy to Rs. 23.2 bn in spite of a lower depreciation charge and tax expense.

Segmental analysis

Copper (standalone): Sales increased 9.9% yoy to Rs. 120 bn, supported by a 26.5% jump in the sales volume of CC rods and higher realisations on by-products such as sulphuric acid. The segment's EBIT declined 2.7% yoy to Rs. 5 bn, and EBIT margin slipped 54 bps to 4.2%, impacted by a sharp decline in Tc/Rc rates (down 42% yoy).

Aluminium (standalone): Sales edged down 2.7% yoy to Rs. 71.5 bn due to a sharp fall in realisations on account of a stronger rupee and lower average LME aluminium prices. The fall in revenues was restricted, however, by a 9.2% yoy increase in the sales volume of the primary metal and a 5.8% yoy increase in the sales volume of rolled products. EBIT from the segment fell 17.3% yoy to Rs. 24.2 bn, and EBIT margin declined sharply by 597 bps yoy to 33.9% on account of lower realisations.

Novelis's FY08 Results

Net sales for FY08 improved 10.7% yoy to USD 11.2 bn, supported by a moderate 1.2% yoy increase in total shipments. The percentage of price ceiling contracts declined to 10% of the total shipments. Therefore, Novelis was unable to pass through only USD 230 mn worth of purchase costs in

FY08, compared with USD 460 mn in FY07. As a result, it reported a net loss of only USD 69 mn in FY08 vis-à-vis USD 265 mn in FY07. However, the improvement in the bottom line was restricted by a 69.5% increase in the depreciation expense to USD 395 mn, on account of a change in the fair value of assets and liabilities after the acquisition by Hindalco.

Key Events

Hindalco announces 185% dividend

Hindalco recommended a 185% dividend for FY07, aggregating Rs. 2,269 mn. The Company would incur a corporate dividend tax of Rs. 386 mn on the announced dividend, taking the total payout to Rs. 2,655 mn.

BOD approves the rights issue

In order to repay its existing bridge loan (raised to fund the Novelis acquisition), Hindalco's board of directors has approved the issue of equity shares in the ratio of 1:3 to its existing shareholders on a rights basis, for an amount not exceeding Rs. 50 bn.

Brown Field Project Update

- **Hirakud:** The second phase of expansion of the smelting capacity from the current 100 ktpa to 143 ktpa is expected to be completed by Q2'09. Further, the full utilization of the 100 MW power generation capacity, commissioned during Q4'08, is expected to be achieved by May.

Key risks

The following factors can pose a threat to our rating:

- Unexpected fluctuations in alumina and aluminium prices
- Early commissioning of the green field projects
- Higher Tc/Rc rates
- Unexpected change in Novelis's financial performance

Outlook

Despite a challenging year, Hindalco managed to post a 4.8% increase in net sales, led by higher sales volumes across both the segments. In FY09, we expect the Company's aluminium segment to post a significant improvement in performance, led by higher realisations and increasing volumes. We remain bullish on aluminium prices as the recent power shortages in China have led to fears of supply shortages, thus pushing prices above USD 3,000 per ton. Though aluminium prices will ease off from the current levels of USD 3,085 per ton once the situation normalises, they are expected to be much higher than their FY08 levels on the back of a strong global demand. In addition, declining exports from China (the world's largest producer), and rising energy costs (a major cost in aluminium production) will continue to put upward pressure on the price of the metal. Thus, we expect aluminium prices to average around USD 2,748 per ton in FY09 and USD 2,800 per ton in FY10 (4.7% and 6.7% above FY08 levels). Further, the aluminium segmen0t will get a boost from the increasing capacities at the Hirakud and Muri plants. However, despite the expected increase in prices of copper and by-products (such as sulphuric acid), the copper segment is expected to remain under pressure due to falling Tc/Rc rates. After plummeting 42% during the year, Tc/Rc rates are expected to fall further by 20-30% in FY09, as the concentrate market is expected to remain in deficit.

Global primary aluminium demand expected to grow by 9% and 8.1% in CY08 and CY09, respectively

Hindalco's bottom line is expected to remain under pressure from the huge interest expense on account of debt raised to fund the Novelis acquisition. In addition, we expect Novelis to continue posting losses in FY09 and FY10 due to its price ceiling contracts and a high depreciation charge. On the other hand, Hindalco is targeting to reduce its interest burden by repaying Rs. 120 bn of loans. It plans to raise Rs. 50 bn through a rights issue and also plans to use its free treasury reserves of about Rs. 43 bn to repay these loans. Though Hindalco's interest costs will reduce significantly after repaying the loan, the heavy equity dilution would result in a lower EPS.

Novelis to remain a drag on the bottom line

Over the past few weeks, Hindalco's stock has taken a severe beating. At the current market price (CMP) of Rs. 142.3, the stock is trading at a forward EV/EBITDA of 3.6x and 3.4x for FY09E and FY10E, respectively. At these valuations, we believe that the stock is fairly valued, and hence upgrade our rating to Hold.

Key Figures (Consolidated)

Year to March	FY06	FY07	FY08	FY09E	FY10E	CAGR (%)
(Figures in Rs. mn, except per share data)						(FY08-10E)
Net Sales	121,197	193,161	600,128	687,597	702,552	8.2%
EBITDA	28,536	44,305	66,351	67,041	70,255	2.9%
Adjusted Net Profit	15,743	26,875	18,392	22,716	30,072	27.9%
Margins(%)						
EBITDA	23.5%	22.9%	11.1%	9.7%	10.0%	
NPM	13.0%	13.9%	3.1%	3.3%	4.3%	
Per Share Data (Rs.)						
Adjusted EPS	16.0	26.7	18.3	16.7	22.1	9.8%
PER (x)	11.4	4.9	7.8	8.5	6.4	

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