

## Company In-Depth

22 March 2007 | 7 pages

# National Aluminum (NALU.BO)

## Sell: Changing Forecasts on Revised Commodity Prices

 Rating change   
 Target price change   
 Estimate change 

- Raising forecasts, target price** — Our global commodity forecasts have been revised upwards. Following this we have upgraded Nalco's EPS estimates by 17% for both FY08E and FY09E. Our target price has also been increased by 17% to Rs241 based on 8x FY08E EPS – at the top end of the 6-year P/E band of 6-8x. The new target price offers limited upside, and we maintain Sell/Medium Risk.
- Aluminium prices raised** — Alan Heap, our global commodity analyst, has revised up aluminium prices by 7%; from US\$2,315/t to US\$2,480/t for FY08E and from US\$2,260/t to \$2,480/t in FY09E. This upgrade is supported by a tightening market. Demand is strong in China and holding up relatively well in the US. There is also some short-term speculative support to aluminium prices.
- Spot alumina prices expected to decline** — Supply disruption in Guinea, which supplies 14% of the world's bauxite, was largely responsible for spot alumina prices doubling to around US\$400/t levels. We have incorporated this in our forecasts. However, with recent signs of settlement of the disruptions in Guinea, we expect prices to settle at lower levels.
- Reiterate Sell** — Despite the increase in our target price, we retain our Sell/Medium Risk recommendation. The stock price is being supported by the current firm trends in both alumina and aluminium. However we expect prices of both these to fall from current levels, putting pressure on domestic prices and sentiment on the stock. We expect a yoy fall in margins and earnings for FY08E and FY09E.

<b>Sell/Medium Risk</b>	<b>3M</b>
Price (22 Mar 07)	Rs230.70
Target price	Rs241.00
	<i>from Rs206.00</i>
Expected share price return	4.5%
Expected dividend yield	2.6%
<b>Expected total return</b>	<b>7.1%</b>
Market Cap	Rs148,642M
	US\$3,435M

### Price Performance (RIC: NALU.BO, BB: NAEL IN)



See Appendix A-1 for Analyst Certification and important disclosures.

Figure 1. Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	EV/EBITDA	ROE	Yield
	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
31 Mar							
FY05A	12,348	19.2	71%	12.0	5.9	33%	2%
FY06A	15,622	23.8	24%	9.7	4.6	33%	2%
FY07E	23,352	36.2	52%	6.4	2.8	40%	3%
FY08E	19,417	30.1	-17%	7.7	3.3	25%	3%
FY09E	17,611	27.3	-9%	8.4	3.8	19%	3%

Source: Company Reports, Citigroup Investment Research estimates. Prices as on March 22.

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
<b>Valuation Ratios</b>					
P/E adjusted (x)	12.0	9.5	6.4	7.7	8.4
EV/EBITDA adjusted (x)	6.2	4.9	3.2	3.5	3.9
P/BV (x)	3.2	2.5	1.9	1.6	1.4
Dividend yield (%)	1.7	2.2	2.6	2.6	2.6
<b>Per Share Data (Rs)</b>					
EPS adjusted	19.17	24.25	36.24	30.14	27.33
EPS reported	19.17	24.25	36.24	30.14	27.33
BVPS	72.91	91.46	120.86	144.16	164.65
DPS	4.00	5.00	6.00	6.00	6.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	41,041	48,519	59,034	52,883	51,340
Operating expenses	-21,737	-24,519	-23,652	-23,903	-25,817
<b>EBIT</b>	<b>19,305</b>	<b>24,000</b>	<b>35,381</b>	<b>28,981</b>	<b>25,523</b>
Net interest expense	-606	0	0	0	0
Non-operating/exceptionals	0	0	0	0	0
<b>Pre-tax profit</b>	<b>18,698</b>	<b>24,000</b>	<b>35,381</b>	<b>28,981</b>	<b>25,523</b>
Tax	-6,354	-8,674	-12,030	-9,564	-7,912
Extraord./Min.Int./Pref.div.	4	297	0	0	0
<b>Reported net income</b>	<b>12,348</b>	<b>15,622</b>	<b>23,352</b>	<b>19,417</b>	<b>17,611</b>
Adjusted earnings	12,348	15,622	23,352	19,417	17,611
Adjusted EBITDA	23,915	27,772	38,445	32,079	29,316
<b>Growth Rates (%)</b>					
Sales	31.4	18.2	21.7	-10.4	-2.9
EBIT adjusted	69.6	24.3	47.4	-18.1	-11.9
EBITDA adjusted	51.6	16.1	38.4	-16.6	-8.6
EPS adjusted	67.5	26.5	49.5	-16.8	-9.3
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>17,236</b>	<b>19,654</b>	<b>22,954</b>	<b>18,898</b>	<b>17,662</b>
Depreciation/amortization	4,611	3,772	3,064	3,098	3,793
Net working capital	-345	-378	-131	-258	-306
<b>Investing cash flow</b>	<b>944</b>	<b>-2,331</b>	<b>-2,701</b>	<b>-12,731</b>	<b>-17,235</b>
Capital expenditure	-1,070	-2,022	-5,178	-16,000	-20,415
Acquisitions/disposals	0	0	0	0	0
<b>Financing cash flow</b>	<b>-11,611</b>	<b>-2,939</b>	<b>-2,204</b>	<b>-4,407</b>	<b>-4,407</b>
Borrowings	-6,544	0	0	0	0
Dividends paid	-4,371	-2,939	-2,204	-4,407	-4,407
<b>Change in cash</b>	<b>6,569</b>	<b>14,385</b>	<b>18,048</b>	<b>1,760</b>	<b>-3,980</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>61,567</b>	<b>74,746</b>	<b>95,209</b>	<b>110,353</b>	<b>123,510</b>
Cash & cash equivalent	7,552	21,937	39,985	41,746	37,766
Accounts receivable	928	294	357	321	313
Net fixed assets	43,456	41,767	43,881	56,783	73,405
<b>Total liabilities</b>	<b>14,588</b>	<b>15,819</b>	<b>17,338</b>	<b>17,471</b>	<b>17,425</b>
Accounts payable	2,341	2,674	2,568	2,691	2,800
Total Debt	0	0	0	0	0
<b>Shareholders' funds</b>	<b>46,978</b>	<b>58,927</b>	<b>77,871</b>	<b>92,881</b>	<b>106,085</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	58.3	57.2	65.1	60.7	57.1
ROE adjusted	29.2	29.5	34.1	22.7	17.7
ROIC adjusted	26.5	32.6	49.1	35.2	25.1
Net debt to equity	-16.1	-37.2	-51.3	-44.9	-35.6
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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Figure 2. National Aluminium – Estimate changes FY07-09

	FY07E			FY08E			FY09E		
	Old	New	% change	Old	New	% change	Old	New	% change
Aluminium price (US\$/t)	2,680	2,658	-1%	2,315	2,480	7%	2,260	2,425	7%
Alumina as % of aluminium	15.5%	15.5%	0%	10.5%	12.5%	19%	11%	12.5%	14%
Import duty (%)	7.1%	7.1%	0%	5.0%	5.0%	0%	5.0%	5.0%	0%
Net sales (Rs bn)	59.5	59.0	-1%	48.5	52.9	9%	47.5	51.3	8%
EBITDA (Rs bn)	38.9	38.4	-1%	27.8	32.1	15%	25.5	29.3	15%
Net profit (Rs bn)	23.7	23.4	-1%	16.6	19.4	17%	15.0	17.6	18%
EPS (Rs)	36.7	36.2	-1%	25.7	30.1	17%	23.3	27.3	18%

Source: Citigroup Investment Research estimates

## National Aluminium

### Company description

Nalco has a smelter capacity of 345,000 tpa in eastern India. It has enough deposits of bauxite to meet more than 50 years' requirements of its expanded alumina capacity (2.1m tpa from 1.58m tpa by end-2008). Good quality bauxite, open cast mines and low bauxite transport costs make Nalco one of the lowest-cost producers of alumina in the world. The company sells its surplus alumina (27% of FY06 sales) in the international markets, and is India's largest alumina exporter. In the power-intensive business of producing aluminum, Nalco's 960MW thermal power capacity meets all of its in-house requirements at 33% of the grid cost, and some surplus power is sold to the state grid. Low costs for power, alumina and labor make Nalco one of the lowest-cost aluminum producers in the world.

### Investment thesis

We rate Nalco as Sell/Medium Risk (3M). The key reason for our Sell rating is the YoY price declines we expect in FY08 for alumina and aluminum. Alumina prices were strong in FY06 and 1H FY07. However, oversupply of alumina led to prices crashing by December 2006. Prices have recovered in recent weeks due to a strike and martial law in Guinea, the world's second-largest bauxite producer. This will help support alumina prices in the near term. We expect prices of around US\$300/t in FY08 and FY09, impacting divisional profitability versus FY07E. For aluminum, we expect average prices to decline 7% yoy in FY08 and remain around that level in FY09. Nalco's share price has generally moved in line with international aluminum prices, and based on the trends we forecast, we expect the stock to trade in a narrow band over the next year. Nalco is already operating at full capacity, and there is limited scope for volume growth until FY10.

### Valuation

We use P/E to value Nalco because it is driven largely by commodity price trends, which translate into earnings momentum. In the past six years, the stock has traded in a P/E range of 6-8x. During this period it has decisively crossed 8x only three times. We have valued Nalco at 8x, the top end of its historical P/E band, which gives us a target price of Rs241. This also appears justified based

on its position among the lowest-cost producers of alumina and in the lowest cost quartile for aluminum globally. Over the past six years Nalco's EV/EBITDA has ranged between 3x and 5x. Over the last two-and-a-half years, the range has been lower at 3-4x. Based on our target price of Rs241, Nalco's EV/EBITDA works out to 3.5x, at the mid-point of its medium-term trading range.

### **Risks**

We rate Nalco as Medium Risk according to our quantitative risk-rating system, which tracks 260-day historical share price volatility. The rating reflects greater uncertainty with respect to the aluminum price outlook and the increased volatility in international prices of alumina and aluminum. Possible upside risks to our target price include: (1) aluminum and alumina prices surpassing our forecasts; (2) depreciation in the rupee versus the US\$ rather than our forecast of an appreciating rupee in FY08 and FY09; and (3) a revival in the plan to privatize PSUs such as Nalco.

## Appendix A-1

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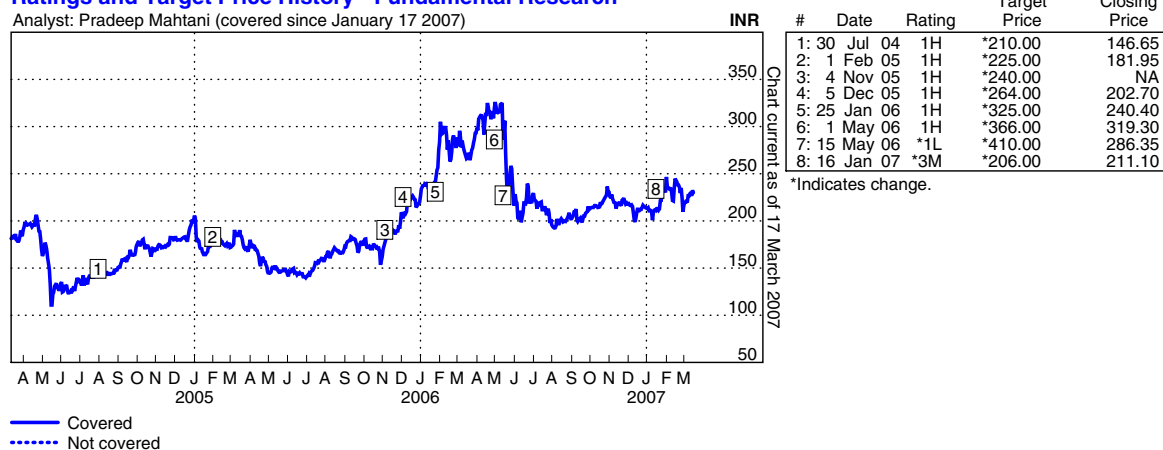
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Analyst: Pradeep Mahtani (covered since January 17 2007)



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