

Nalco

STOCK INFO. BLOOMBERG
BSE Sensex: 18,513 NACL IN
REUTERS CODE
S&P CNX: 5,496 NALU.BO

24 October 2007

Neutral

Previous Recommendation: Neutral

Rs283

Equity Shares (m)	644.3
52-Week Range	335/185
1,6,12 Rel. Perf. (%)	-9/-16/-19
M.Cap. (Rs b)	182.3
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
3/07A	59,402	23,926	37.1	55.1	7.6	2.4	31.1	38.9	2.4	4.1
3/08E	49,367	17,012	26.4	-28.9	10.7	2.1	19.2	20.8	3.1	6.9
3/09E	46,939	16,560	25.7	-2.7	11.0	1.8	16.7	19.0	3.4	6.9

- Nalco reported a PAT of Rs4.4b in 2QFY08. Though PAT declined 26% YoY, it is higher than our estimate. Rising surplus cash & equivalents led to higher than expected other income. This was, however, somewhat offset by higher expenditure – a temporary disruption of coal supply from linkages mandated coal imports.
- Net sales declined 9.3% YoY to Rs13.1b. While volumes were higher, domestic realizations declined due to lower import duty protection (5% v/s 7.5% last year) and export realizations fell due to rupee appreciation (Rs40.5/US\$ v/s Rs46.4/US\$ last year). Alumina exports declined 28% YoY in value terms and aluminum sales fell 3% YoY.
- EBITDA margins declined 1,480bp to 43.5% YoY due to lower realizations. A temporary disruption in coal supplies during the quarter had led to reliance on imports, as a result of which an additional expenditure of Rs397.5m was incurred. Margins on alumina exports declined to 40% (v/s 73% in 2QFY07) while aluminum segment margins declined to 48% (v/s 54% in 2QFY07).
- We expect Nalco's earnings to decline QoQ till 3QFY08, due to lower aluminum prices and lower prices of alumina in CY07 annual contracts. Thereafter, a possible hike in alumina prices in CY08 annual contracts could boost earnings – the terms of the new annual contracts are better. The stock trades at 11x FY09E earnings (price assumptions: aluminum=US\$2,500/ton; alumina=US\$325/ton) and an EV of 6.9x FY09E EBITDA. As on 31 March 2007, the company had cash surplus of Rs57/share. We maintain **Neutral**.

QUARTERLY PERFORMANCE (STANDALONE)

(RS MILLION)

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	14,855	14,416	14,486	15,668	11,652	13,082	12,093	12,541	59,425	49,367
Change (YoY %)	51.8	37.7	9.3	1.9	-21.6	-9.3	-16.5	-20.0	21.6	-16.9
Total Expenditure	5,512	5,665	6,037	6,870	5,488	7,397	6,765	7,151	24,083	26,802
EBITDA	9,344	8,751	8,449	8,798	6,164	5,685	5,327	5,389	35,341	22,565
Change (YoY %)	90.9	90.7	27.2	-9.3	-34.0	-35.0	-36.9	-38.7	36.8	-36.2
As % of Net Sales	62.9	60.7	58.3	56.2	52.9	43.5	44.1	43.0	59.5	45.7
Interest	0	0	0	0	1	6	0	0	0	7
Depreciation	787	771	744	819	692	683	744	798	3,121	2,917
Other Income	834	1,014	978	1,199	1,310	1,644	1,522	1,634	4,025	6,109
PBT (before EO Item)	9,391	8,994	8,684	9,178	6,782	6,639	6,105	6,225	36,246	25,751
Extra-ordinary Exp.									-170	0
PBT (after EO Item)	9,391	8,994	8,684	9,178	6,782	6,639	6,105	6,225	36,076	25,751
Total Tax	3,168	3,044	2,958	3,270	2,315	2,242	2,071	2,111	12,440	8,739
% Tax	33.7	33.8	34.1	35.6	34.1	33.8	33.9	33.9	34.5	33.9
Reported PAT	6,223	5,950	5,726	5,908	4,467	4,397	4,034	4,114	23,636	17,012
Change (YoY %)	121.8	110.2	45.7	-2.8	-28.2	-26.1	-29.5	-30.4	50.8	-28.4

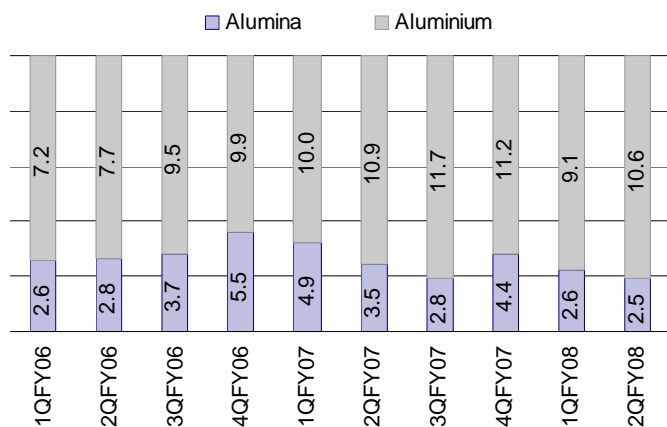
E: MOST Estimates

Falling realizations impacted revenues

Nalco's net sales declined 9.3% YoY to Rs13.1b due to the following:

- Alumina export revenues declined 28% YoY to Rs2.5b (after cancelling inter-segment transfers), with average realizations dropping 44% YoY. Though the dip in US\$-denominated realizations was lower at 36% YoY, a 13% appreciation in the rupee vis-à-vis the dollar accentuated the decline in rupee-denominated realizations.
- Aluminum revenues declined 3% YoY to Rs10.6b, despite volumes being 1% higher at 92.3kton. Average realizations dipped 6% YoY to Rs113,574/ton on account of lower import duty protection (5% v/s 7.5% last year).

NALCO: ALUMINA CONTINUES TO LOSE REVENUE SHARE



Source: Motilal Oswal Securities

NALCO'S SALES VOLUMES AND AVERAGE METAL PRICES

	1QFY07	2QFY07	1QFY08	2QFY08
Alumina ('000 tons)	180	152	204	213
Aluminium ('000 tons)	79	90	76	93
LME avg (US\$/ton) for aluminium	2,652	2,531	2,802	2,610
YoY(%)	53	38	6	3
QoQ(%)	10	-5	2	-7

Source: Company

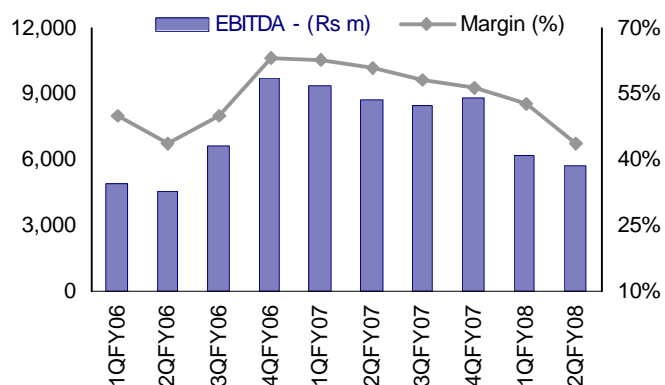
NALCO'S PRODUCTION VOLUMES

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08
Alumina ('000 tons)	358	339	382	396	388	384
YoY(%)	-14	-6	-2	8	13	
QoQ(%)	-11	-5	13	4	-2	-1
Aluminium ('000 tons)	9	92	90	89	87	92
YoY(%)	1	-1	-1	-2	1	
QoQ(%)	-1	3	-2	-1	-2	6
Power (MU)	1,461	1,487	1,483	1,537	1,449	1,341

Source: Company

Disruption of coal supplies led to further pressure on margins EBITDA margins declined 1,480bp to 43.5% YoY due to lower realizations. A temporary disruption in coal supplies during the quarter had led to reliance on imports, as a result of which an additional expenditure of Rs397.5m was incurred.

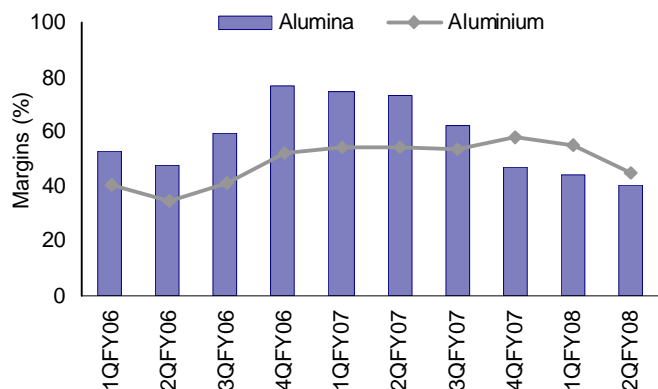
NALCO: EBITDA MARGIN TREND



Source: Motilal Oswal Securities

Margins on alumina exports declined to 40% (v/s 73% in 2QFY07) while aluminum segment margins declined to 48% (v/s 54% in 2QFY07). Margins are expected to remain under pressure due to falling realizations and rising prices of CT pitch and CP coke.

NALCO: SEGMENTAL EBIT MARGIN TREND



Source: Motilal Oswal Securities

Alumina export contracts for CY08 at significantly better terms

Nalco has signed two annual contracts for supply of 300,000 ton alumina during CY08 (33% of surplus alumina production). The prices of alumina have been linked to 12.88% of average aluminum prices at LME, which is significantly better than CY07 annual contracts (~9% of LME metal prices). The company will be signing more such annual contracts in the coming months to cover 50-60% of its surplus alumina sales. This should lift earnings 4QFY08 onwards.

Stock fairly valued; maintain Neutral

We expect Nalco’s earnings to decline QoQ till 3QFY08, due to lower aluminum prices and lower prices of alumina in CY07 annual contracts. Thereafter, a possible hike in alumina prices in CY08 annual contracts could boost earnings – the terms of the new annual contracts are better. Also, Nalco has been allotted coalmines for captive consumption (Utkal E Block) for power generation, which would ensure unfettered supply and insulate it from input price risk.

Nalco is the lowest cost producer of aluminum – its cost of production averaged US\$1,200/ton in FY07. The company is expanding capacity of aluminum and alumina by 33%. The expanded capacity is likely to be commissioned by December 2008 and the benefits would be available in FY10. The stock trades at 11x FY09E earnings (price assumptions: aluminum=US\$2,500/ton; alumina=US\$325/ton) and an EV of 6.9x FY09E EBITDA. As on 31 March 2007, the company had cash surplus of Rs57/share. We ~~maintain~~ **Neutral**.

Nalco: an investment profile

Company description

Nalco is a fully integrated producer of Aluminum and Alumina in India. Aluminum contributed 73% and Alumina 27% to FY07 revenues. Its Aluminum smelter, the second largest in India, sources Alumina and power from its captive refinery in Damanjodi and the 960MW captive power plant located in Angul. Coal is sourced from state-owned Coal India for power generation, hence cost of power generated is low. The Alumina refinery, capacity 1.6m tpa, is located in Damanjodi (Orissa) close to captive Bauxite mines at Panchpatmali. Bauxite reserves have superior quality and Bauxite consumes low energy in crushing and digestion process during conversion to Alumina. Thereby, Nalco's cost of production is lowest in the world.

Key investment arguments

- ✍ The company is undertaking Rs41b capex to increase capacity of its smelter from 345,000 tpa to 460,000 tpa, Alumina refinery from 1.6m tpa to 2.1m tpa and captive power from 960MW to 1,200MW. The project is expected to be completed by December 2008.
- ✍ Company has been allocated a coal block Utkal E which has coal reserves of 75m tons which will insulate the company from input price risk.

COMPARATIVE VALUATIONS

		NALCO	HINDUS. ZINC	SAIL
P/E (x)	FY08E	10.7	8.1	12.8
	FY09E	11.0	8.0	12.0
P/BV (x)	FY08E	2.1	3.0	4.5
	FY09E	1.8	2.3	3.4
EV/Sales (x)	FY08E	3.1	3.4	2.4
	FY09E	3.4	2.8	2.2
EV/EBITDA (x)	FY08E	6.9	4.8	7.3
	FY09E	6.9	4.2	7.0

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	64.9	64.9	64.9
Domestic Inst	1.1	1.1	1.6
Foreign	2.3	2.1	1.3
Others	31.7	31.9	32.1

Key investment risks

- ✍ The earnings of company is fully exposed to metal and Alumina prices.

Recent developments

- ✍ Nalco has proposed to set up 500,000tpa capacity aluminum smelter in South Africa equipped with a captive power plant at an estimated Capex of US\$ 3.8b.

Valuation and view

- ✍ The stock is trading at P/E of 11x FY09E and EV/EBITDA of 6.9x FY09E. Maintain **Neutral**.

Sector view

- ✍ Demand for Aluminum products in India is growing 9% p.a. and the momentum is likely to accelerate in forthcoming years. Global demand too is expected to post a growth rate of 5, led strong growth in China and other emerging countries.

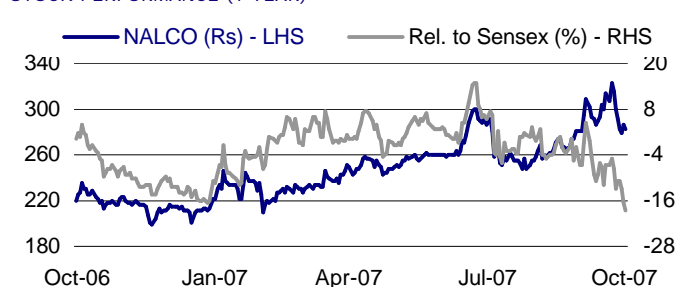
EPS: MOST FORECAST V/S CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	26.4	29.1	-9.2
FY09	25.7	22.9	12.1

TARGET PRICE AND RECOMMENDATION

*CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
283	-	-	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Net sales	41,240	48,518	59,402	49,367	46,939	
Change (%)	32.0	17.6	22.4	-16.9	-4.9	
Total Expenses	19,676	22,969	23,983	26,802	23,854	
EBITDA	21,563	25,550	35,419	22,565	23,085	
% of Net Sales	52.3	52.7	59.6	45.7	49.2	
Depn. & Amortization	4,611	3,772	3,061	2,917	3,000	
EBIT	16,952	21,777	32,358	19,649	20,085	
Net Interest	606			7		
Other income	2,352	2,222	4,017	6,109	5,087	
PBT before EO	18,698	23,999	36,374	25,751	25,173	
EO income	4	297	-170			
PBT after EO	18,703	24,296	36,204	25,751	25,173	
Tax	6,354	8,674	12,390	8,739	8,613	
Rate (%)	34.0	35.7	34.2	33.9	34.2	
Reported PAT	12,348	15,621	23,814	17,012	16,560	
Adjusted PAT	12,346	15,430	23,926	17,012	16,560	
Change (%)	69.6	25.0	55.1	-28.9	-2.7	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Share Capital	6,443	6,443	6,443	6,443	6,443	
Reserves	40,535	52,484	70,509	81,963	92,964	
Net Worth	46,978	58,927	76,952	88,406	99,407	
Deferred Tax Liability	6,525	6,417	6,127	6,127	6,127	
Capital Employed	53,503	65,344	83,080	94,533	105,534	
Gross Block	87,827	89,612	90,341	110,341	139,341	
Less: Accum. Deprn.	46,437	50,167	53,220	56,136	59,136	
Net Fixed Assets	41,390	39,445	37,121	54,204	80,204	
Capital WIP	2,066	2,322	8,404	10,404	404	
Investments						
Curr. Assets	18,110	32,979	49,741	40,031	35,337	
Inventory	5,291	5,916	6,350	5,012	5,273	
Account Receivables	928	294	341	1,253	1,415	
Cash and Bank Balance	7,552	21,937	36,865	27,582	22,465	
Others	4,340	4,832	6,185	6,185	6,185	
Curr. Liability & Prov	8,064	9,402	12,186	10,107	10,410	
Account Payables	6,163	6,073	8,720	6,641	6,944	
Provisions & Others	1,901	3,328	3,466	3,466	3,466	
Net Curr. Assets	10,047	23,577	37,555	29,925	24,927	
Appl. of Funds	53,503	65,344	83,080	94,533	105,535	

E: Most Estimates

RATIOS		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Basic (Rs)						
EPS	19.2	23.9	37.1	26.4	25.7	
Cash EPS	26.3	30.1	41.7	30.9	30.4	
BV/Share	72.9	91.5	119.4	137.2	154.3	
DPS	4.0	5.0	7.5	7.5	7.5	
Payout (%)	23.8	23.8	23.2	32.7	33.6	
Valuation (x)						
P/E		11.8	7.6	10.7	11.0	
Cash P/E		9.4	6.8	9.1	9.3	
P/BV		3.1	2.4	2.1	1.8	
EV/Sales		3.3	2.4	3.1	3.4	
EV/EBITDA		6.3	4.1	6.9	6.9	
Dividend Yield (%)		18	2.7	2.7	2.7	
Return Ratios (%)						
RoE	26.3	26.2	31.1	19.2	16.7	
RoCE	31.7	33.3	38.9	20.8	19.0	
RoIC	25.5	34.1	56.3	23.0	16.0	
Working Capital Ratios						
Asset Turnover (x)	0.8	0.7	0.7	0.5	0.4	
Debtor (Days)	8	2	2	9	11	
Leverage Ratio (x)						
Current Ratio	2.2	3.5	4.1	4.0	3.4	
Interest Cover Ratio	28.0	N.A.	N.A.	N.A.	N.A.	

CASHFLOW STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Pre-tax profit	18,703	24,296	36,204	25,751	25,173	
Depreciation	4,561	3,730	3,053	2,917	3,000	
(Inc)/Dec in Wkg. Cap.	-919	-519	1,190	-1,653	-119	
Tax paid	-5,788	-8,143	-12,599	-8,739	-8,613	
CF from Op. Activity	16,552	19,364	27,617	18,275	19,441	
(Inc)/Dec in FA +CWIP	-1,069	-2,041	-6,811	-22,000	-19,000	
(Pur)/Sale of Investment	2,000					
Others						
CF from Inv. Activity	931	-2,041	-6,811	-22,000	-19,000	
Dividend (incl. tax)	-4,371	-2,939	-5,878	-5,558	-5,558	
CF from Fin. Activity	-10,915	-2,939	-5,878	-5,559	-5,559	
(Inc)/Dec in Cash	6,569	14,385	14,928	-9,284	-5,118	
Add: opening Balance	984	7,552	21,937	36,865	27,582	
Closing Balance	7,552	21,937	36,865	27,581	22,464	



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	Nalco
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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