

Company Focus

3 November 2007 | 9 pages

Hindalco Industries (HALC.BO)

 Target price change
 Estimate change

Sell: Margin Pressures Ahead, Earnings Revised

- 2QFY08 PAT rises 8%, earnings revised** — Hindalco's PAT at Rs6.4bn came in above expectations on lower tax and better than anticipated copper TC/RCS. EBITDA fell by 7% yoy due to pressure on realizations. We revise PAT estimates for FY08E-09E by 1% to -3% on changes in LME prices, exchange rates and TC/RC margins, FY07 Annual Report details and 1HFY08 trends.
- Aluminium realizations impacted** — Even though aluminium EBIT came in higher than expected in 2Q on higher premiums for value added products and higher production volumes (+8% yoy), prices were lower both on a yoy and qoq basis due to pressures from an appreciating rupee. Going forward we expect aluminium LME prices to remain range bound. This will likely be compounded by the rising rupee, keeping margins under pressure.
- Copper TC/RCS to weaken in 2H** — Although copper TC/RCS fell 15% yoy, they were higher than expected (at ~US31c/lb) as Hindalco continued to enjoy benefits of its earlier contracts. TC/RCS are expected to be under pressure in the coming quarters, leading to a decline in copper division profitability.
- Sell maintained, target price adjusted** — With weaker aluminium realizations given an appreciating rupee, lower copper TC/RC margins, and rising input costs, we expect a 14% fall in cons FY09E EPS. However, we marginally adjust our TP from Rs142 to Rs146 on: 1) our target multiple raised from 7x to 8x (mid-point of recent trading range), which gives Rs128, to which we add value of IDEA holding; 2) upward re-rating of metal stocks; 3) rollover to FY09E EPS.

Sell/Medium Risk		3M
Price (02 Nov 07)		Rs187.50
Target price		Rs146.00
	from Rs142.00	
Expected share price return		-22.1%
Expected dividend yield		1.0%
Expected total return		-21.2%
Market Cap		Rs230,087M
		US\$5,865M

Price Performance (RIC: HALC.BO, BB: HNDL IN)



Figure 1. Hindalco Industries – Statistical Abstract

YE 31 Mar	Net Profit (Rs m)	EPS (Rs)	EPS growth (%)	P/E (x)	EPS cons (Rs)	P/E cons (x)	EV/EBITDA (x)	ROE (%)
FY05	13,385	14.4	59%	13.0	13.8	13.5	7.1	17%
FY06	16,525	17.7	23%	10.6	16.9	11.1	6.5	17%
FY07	25,643	25.5	44%	7.3	26.7	7.0	4.1	21%
FY08E	22,620	19.8	-22%	9.4	18.5	10.1	5.0	14%
FY09E	18,294	14.4	-27%	13.0	16.0	11.7	6.4	10%
FY10E	12,075	9.2	-36%	20.3	10.2	18.4	9.8	6%

Source: Company Reports, Citi Investment Research. Price as on Nov 2.

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	10.8	8.5	10.8	13.4	20.3
EV/EBITDA adjusted (x)	8.3	5.2	5.2	5.3	7.1
P/BV (x)	1.9	1.6	1.4	1.3	1.2
Dividend yield (%)	1.2	0.9	1.0	1.0	0.8
Per Share Data (Rs)					
EPS adjusted	17.30	22.12	17.31	14.00	9.24
EPS reported	17.30	22.12	17.31	14.00	9.24
BVPS	97.46	119.03	133.95	145.67	153.15
DPS	2.20	1.70	1.80	1.80	1.50
Profit & Loss (RsM)					
Net sales	113,965	183,130	195,466	203,570	191,149
Operating expenses	-90,686	-145,660	-162,257	-175,476	-170,977
EBIT	23,278	37,470	33,209	28,094	20,172
Net interest expense	-2,252	-2,424	-2,847	-3,203	-3,743
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	21,027	35,046	30,362	24,890	16,428
Tax	-4,501	-9,403	-7,742	-6,596	-4,354
Extraord./Min.Int./Pref.div.	30	0	0	0	0
Reported net income	16,556	25,643	22,620	18,294	12,075
Adjusted earnings	16,556	25,643	22,620	18,294	12,075
Adjusted EBITDA	28,490	43,851	39,314	34,616	26,796
Growth Rates (%)					
Sales	19.7	60.7	6.7	4.1	-6.1
EBIT adjusted	11.7	61.0	-11.4	-15.4	-28.2
EBITDA adjusted	11.9	53.9	-10.3	-12.0	-22.6
EPS adjusted	20.8	27.8	-21.7	-19.1	-34.0
Cash Flow (RsM)					
Operating cash flow	7,083	33,366	20,669	21,474	18,223
Depreciation/amortization	5,211	6,380	6,105	6,522	6,624
Net working capital	-17,434	-1,185	-2,417	-94	3,868
Investing cash flow	-13,250	-56,363	-9,565	-28,304	-45,786
Capital expenditure	-11,554	-14,779	-10,094	-27,102	-40,604
Acquisitions/disposals	-4,109	-93,456	13,990	-7,115	-11,525
Financing cash flow	11,329	20,480	12,041	9,796	12,589
Borrowings	11,034	24,652	-5,000	5,000	19,000
Dividends paid	-2,116	-4,495	0	-2,400	-2,667
Change in cash	5,163	-2,518	23,144	2,966	-14,974
Balance Sheet (RsM)					
Total assets	188,958	249,400	288,056	322,891	349,154
Cash & cash equivalent	9,173	6,655	29,799	32,766	17,792
Accounts receivable	12,484	15,045	17,463	18,170	17,067
Net fixed assets	76,157	84,831	88,820	109,400	143,380
Total liabilities	92,895	125,219	123,768	132,576	149,057
Accounts payable	19,745	22,867	26,681	30,261	29,362
Total Debt	49,034	73,686	68,686	73,686	92,686
Shareholders' funds	96,063	124,180	164,288	190,315	200,097
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	25.0	23.9	20.1	17.0	14.0
ROE adjusted	19.2	23.3	15.7	10.3	6.2
ROIC adjusted	17.8	23.0	19.6	15.0	9.4
Net debt to equity	41.5	54.0	23.7	21.5	37.4
Total debt to capital	33.8	37.2	29.5	27.9	31.7

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Quarterly Results

Figure 2. Hindalco Industries – 2Q FY08 Results

(Rs m)	2QFY08	2QFY07	% chg
Net sales	49,597	46,342	7%
Expenditure	40,380	36,478	11%
EBITDA	9,217	9,864	-7%
% margin	18.6%	21.3%	
Other income	1098	1108	-1%
Interest	632	515	23%
Depreciation	1,446	2,080	-30%
PBT	8,237	8,377	-2%
Tax	1,809	2,401	-25%
Tax rate %	22%	29%	
PAT reported	6,428	5,976	8%
Divisional breakdown			
Sales (Rs m)			
Aluminium	17,851	18,520	-4%
Copper	31,783	27,824	14%
EBIT (Rs m)			
Aluminium	6,620	6,710	-1%
Copper	1,260	1,230	2%
EBIT margin (%)			
Aluminium	37.1%	36.2%	
Copper	4.0%	4.4%	

Source: Company reports

Estimate Revisions

Figure 3. Hindalco Industries – Estimate Changes, FY08E-09E

	FY08E			FY09E		
	Old	New	% chg	Old	New	% chg
Average Aluminium LME (US\$/t)	2,480	2,605	5%	2,425	2,590	7%
Copper TcRc (USc/lb)	15.0	23.3	55%	15.0	16.0	7%
Rs/US\$ rate	43.2	40.2	-7%	42.0	38.0	-10%
Net sales (Rs bn)	199.6	195.5	-2%	188.6	203.6	8%
EBITDA (Rs bn)	35.9	39.3	9%	36.0	34.6	-4%
Net profit (Rs bn)	20.0	22.6	13%	19.8	18.3	-8%
EPS (Rs)	17.6	19.8	13%	15.6	14.4	-8%
Consolidated profit (Rs bn)	20.8	21.1	1%	20.8	20.2	-3%
Consolidated EPS (Rs)	18.3	18.5	1%	16.4	16.0	-3%

Source: Citi Investment Research estimates

Hindalco Industries

Company description

Hindalco is a low-cost integrated aluminum producer (461,000 tpa) with access to captive power and bauxite. It also operates India's largest copper smelter (500,000 tpa, 35-40% market share). The aluminum division accounted for 40% of FY07 sales and 78% of EBIT. In aluminum, Hindalco has a strong domestic market share with a dominant 60-65% share in sheet products. It plans to quadruple its alumina capacity and triple its aluminum capacity in the next 4-5 years. Hindalco owns copper mines in Australia through its 51% subsidiary, Aditya Birla Minerals, which will meet about 15-20% of its requirement when fully ramped up. Hindalco has acquired Novelis, which controls about 19% of the world's aluminium sheet market.

Investment strategy

We rate Hindalco as Sell/Medium Risk (3M). The key reasons for our Sell rating are: 1) Hindalco has paid a high valuation for Novelis whose profits are not expected to improve substantially over the next couple of years. Hence the profits will not be able to compensate for Hindalco's high interest outgo, resulting in an earnings dilution. 2) We expect a YoY downside in FY08-09 earnings for copper and aluminum. In copper, TC/RC margins averaged ~US30c/lb in 1H FY08, largely benefiting from older contracts. But these are already trending down and are expected to average US23c/lb in FY08 and US16c in FY09. For a copper smelter like Hindalco, profits are determined largely by TC/RCs rather than copper prices. For aluminum, we expect international prices to remain range bound at around US\$2,600/tonne in FY08 and FY09, which will result in domestic prices coming under pressure due to the appreciating rupee.

Valuation

Our target price of Rs146 is based on: (1) 8x FY09E earnings (Rs128); and (2) adding the value of Hindalco's investment holding in IDEA and discounting it by 25% (Rs18). We use P/E because stocks such as Hindalco are largely driven by commodity price trends, which translate into earnings momentum. The stock has largely been moving in line with international aluminum prices since October 2002 and has been trading in a P/E band of 7x and 9x over the last four years. Our target multiple of 8x is based on the mid-point of this trading range (up from 7x previously based on recent re-rating of the metal stocks globally). This is at a discount to the 9x PE multiple we are using for National Aluminium. This is because the acquisition of Novelis raises Hindalco's risk profile, increases gearing and reduces consolidated margins. Based on consensus earnings and our own preliminary analysis, we see no substantial improvement in Novelis' earnings in FY08 and FY09. Additionally we do not see any upside trigger to the stock price based on our outlook of falling international prices in aluminum and substantial declines in copper TC/RCs.

Risks

We rate Hindalco Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Possible upside risks to our target price include: 1) commodity prices (aluminum and alumina) surpassing our forecasts; 2) copper TC/RC margins exceeding our forecasts; 3) depreciation in the rupee versus our forecast of an appreciating rupee in FY08 and FY09; and 4) Novelis' operational performance surpassing forecasts.

Appendix A-1

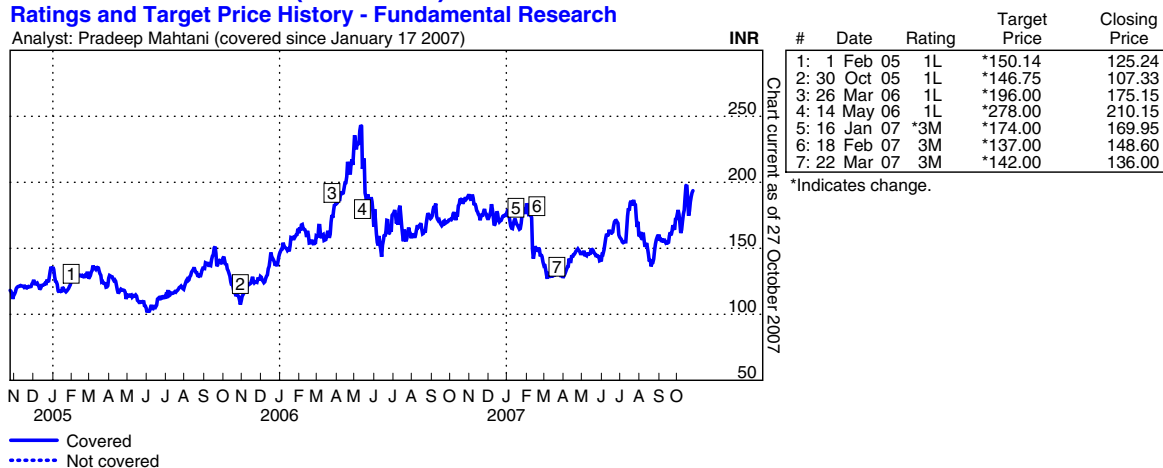
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Analyst: Pradeep Mahtani (covered since January 17 2007)



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