

Company In-Depth

26 April 2007 | 7 pages

National Aluminium (NALU.BO)

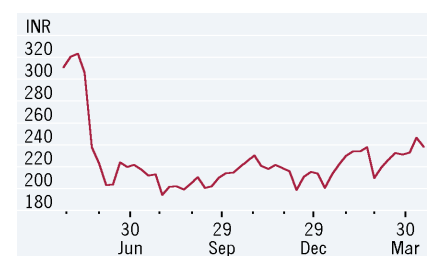
Sell: 4Q Earnings Decline Will Likely Be a Trend

 Rating change
 Target price change
 Estimate change

- 4Q lower yoy, cutting forecasts** — 4QFY07 sales rose just 1.9% yoy, restrained by lower alumina prices. PAT fell 2.4% yoy, 9% better than forecasts, driven by higher aluminium prices and other income. Taking into account our new Rs/US\$ rate forecasts results in a cut to our FY08 forecasts by 4% and FY09 by 7%. We thus lower our target price to Rs232, which is based on 8x FY08E EPS.
- Alumina PBIT falls 67% yoy** — The 4Q results appear to reflect the impact of lower alumina prices, which fell to US\$300/t vs. US\$575/t achieved in 4Q FY06. Divisional PBIT fell 67% yoy and 30% sequentially. The trend in lower PBIT will likely continue in 1HFY08 due to limited volume growth and alumina prices at US\$340-370/t versus 1HFY07 levels of US\$500-570/t.
- Aluminium could face pricing pressure** — Aluminium prices were 16% higher yoy in 4Q to US\$2,800/t due to strong demand from China and the US. We expect aluminium prices to fall from the current level of US\$2,820/t and forecast US\$2,480/t for FY08E and US\$2,425/t for FY09E.
- Forecasts cut due to new INR/US\$ assumptions** — Our economist, Rohini Malkani, recently changed her Rs/US\$ exchange rate forecast to Rs41.75 (from Rs43.2) for FY08 and to Rs40 (from Rs42) for FY09. Adjusting for INR forecast changes and aluminium prices leads to our 4-7% EPS cut for FY08/FY09E.
- Sell/Medium Risk (3M)** — We expect prices of both alumina and aluminium 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.

Sell/Medium Risk	3M
Price (26 Apr 07)	Rs248.20
Target price	Rs232.00
	<i>from Rs241.00</i>
Expected share price return	-6.5%
Expected dividend yield	2.4%
Expected total return	-4.1%
Market Cap	Rs159,918M
	US\$3,935M

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
	(Rs m)	(Rs)	(%)	(x)	(x)	(%)	(%)
31 Mar							
FY05A	12,348	19.2	71%	13.1	6.4	33%	2%
FY06A	15,622	23.8	24%	10.5	5.0	33%	2%
FY07E	23,352	36.2	52%	6.9	3.2	40%	2%
FY08E	18,650	28.9	-20%	8.7	3.9	24%	2%
FY09E	16,348	25.4	-12%	9.9	4.6	18%	2%

Source: Company Reports, Citigroup Investment Research estimates. Prices as of April 25.

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	13.0	10.2	6.8	8.6	9.8
EV/EBITDA adjusted (x)	6.7	5.3	3.5	4.0	4.6
P/BV (x)	3.4	2.7	2.1	1.7	1.5
Dividend yield (%)	1.6	2.0	2.4	2.4	2.4
Per Share Data (Rs)					
EPS adjusted	19.17	24.25	36.24	28.95	25.37
EPS reported	19.17	24.25	36.24	28.95	25.37
BVPS	72.91	91.46	120.86	142.97	161.50
DPS	4.00	5.00	6.00	6.00	6.00
Profit & Loss (RsM)					
Net sales	41,041	48,519	59,034	51,781	49,635
Operating expenses	-21,737	-24,519	-23,652	-23,946	-25,943
EBIT	19,305	24,000	35,381	27,835	23,693
Net interest expense	-606	0	0	0	0
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	18,698	24,000	35,381	27,835	23,693
Tax	-6,354	-8,674	-12,030	-9,186	-7,345
Extraord./Min.Int./Pref.div.	4	297	0	0	0
Reported net income	12,348	15,622	23,352	18,650	16,348
Adjusted earnings	12,348	15,622	23,352	18,650	16,348
Adjusted EBITDA	23,915	27,772	38,445	30,933	27,486
Growth Rates (%)					
Sales	31.4	18.2	21.7	-12.3	-4.1
EBIT adjusted	69.6	24.3	47.4	-21.3	-14.9
EBITDA adjusted	51.6	16.1	38.4	-19.5	-11.1
EPS adjusted	67.5	26.5	49.5	-20.1	-12.3
Cash Flow (RsM)					
Operating cash flow	17,236	19,654	22,954	18,178	16,531
Depreciation/amortization	4,611	3,772	3,064	3,098	3,793
Net working capital	-345	-378	-131	-251	-303
Investing cash flow	944	-2,331	-2,701	-12,761	-17,344
Capital expenditure	-1,070	-2,022	-5,178	-16,000	-20,415
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-11,611	-2,939	-2,204	-4,407	-4,407
Borrowings	-6,544	0	0	0	0
Dividends paid	-4,371	-2,939	-2,204	-4,407	-4,407
Change in cash	6,569	14,385	18,048	1,011	-5,221
Balance Sheet (RsM)					
Total assets	61,567	74,746	95,209	109,597	121,510
Cash & cash equivalent	7,552	21,937	39,985	40,996	35,775
Accounts receivable	928	294	357	315	303
Net fixed assets	43,456	41,767	43,881	56,783	73,405
Total liabilities	14,588	15,819	17,338	17,483	17,455
Accounts payable	2,341	2,674	2,568	2,691	2,800
Total Debt	0	0	0	0	0
Shareholders' funds	46,978	58,927	77,871	92,114	104,055
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	58.3	57.2	65.1	59.7	55.4
ROE adjusted	29.2	29.5	34.1	21.9	16.7
ROIC adjusted	26.5	32.6	49.1	33.8	23.3
Net debt to equity	-16.1	-37.2	-51.3	-44.5	-34.4
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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Figure 2. National Aluminium – Estimate changes for FY08E-09E

	FY08E			FY09E		
	Old	New	% change	Old	New	% change
Rs/US\$ FX rate	43.2	41.8	-3%	42.0	40.0	-5%
Aluminium price (US\$/t)	2,480	2,480	0%	2,425	2,425	0%
Alumina as % of aluminium	12.5%	12.5%	0%	12.5%	12.5%	0%
Import duty (%)	5.0%	5.0%	0%	5.0%	5.0%	0%
Net sales (Rs bn)	52.9	51.8	-2%	51.3	49.6	-3%
EBITDA (Rs bn)	32.1	30.9	-4%	29.3	27.5	-6%
Net profit (Rs bn)	19.4	18.6	-4%	17.6	16.3	-7%
EPS (Rs)	30.1	28.9	-4%	27.3	25.4	-7%

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 (25% of FY07 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 for 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 4Q FY07 due to a strike and martial law in Guinea, the world's second-largest bauxite producer, which has since concluded. 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 to 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 value Nalco at 8x FY08E EPS, the top end of its historical P/E band, which gives us a target price of Rs232. 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

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EV/EBITDA has ranged between 3x and 5x. Over the past two-and-a-half years, the range has been lower at 3-4x. Based on our target price of Rs232, 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.

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Appendix A-1

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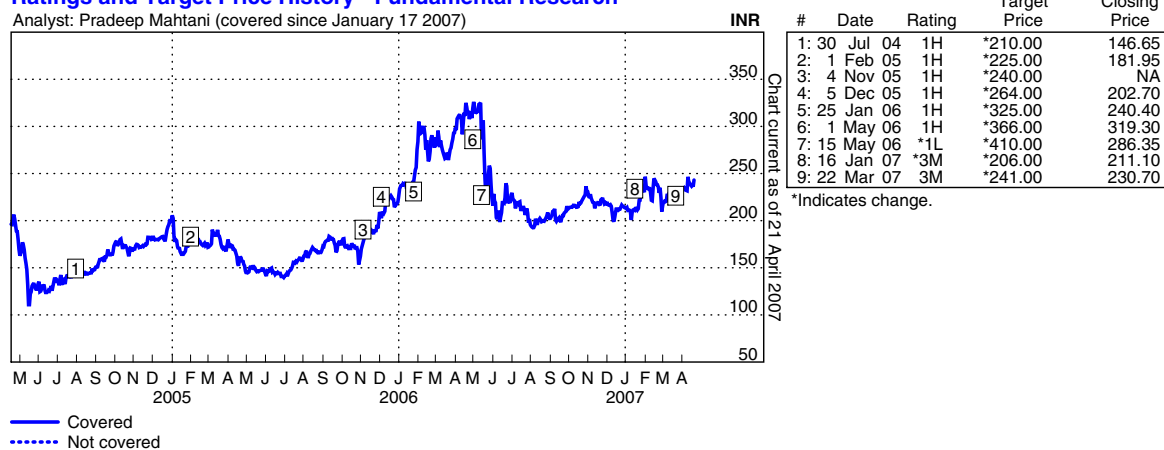
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Analyst: Pradeep Mahtani (covered since January 17 2007)



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