

Company In-Depth

19 February 2007 | 8 pages

National Aluminum (NALU.BO)

Changing Forecasts: Commodity Price Revisions, Duty Cut

 Rating change
 Target price change
 Estimate change

- Changing forecasts** — Following the recent duty cuts and the upward revision to our near-term global price forecasts, we have adjusted our EPS estimates for FY07E by +5%, FY09E by -4% and FY08E is unchanged. Target price unchanged at 8x FY08E EPS – at the top end of the 6-year P/E band of 6-8x.
- Global commodity team raises near-term forecasts** — Our global commodity analyst, Alan Heap, has raised 1HCY07 price forecasts by 9-10% for alumina and aluminium. This is on the back of strong Chinese demand, and a large speculative long position (expected to last until April).
- Import duty cut for aluminium** — The impact of the increase in our near-term international prices has been offset by the recent reduction in import duty rates, especially for FY09E. Import duty on aluminium was reduced from 7.5% to 5%. Producers responded with a price cut of about 2% taking prices to about Rs135,500/t. The current landed price is higher at Rs139,000/t.
- Spike in spot alumina helps FY07E** — Our FY07 forecasts incorporate the results for 9MFY07. We have also accounted for the jump in spot alumina prices from US\$200/t to around US\$350/t due to the general strike and subsequent martial law declared in Guinea, the world's second-largest bauxite producer, which will likely help support spot alumina prices in the near term.
- Reiterate Sell** — Based on our global outlook of falling international prices for alumina and aluminium, we expect a yoy fall in margins and earnings in FY08 and expect Nalco to underperform. Sell/Medium Risk with Rs206 target price.

Sell/Medium Risk	3M
Price (15 Feb 07)	Rs244.85
Target price	Rs206.00
Expected share price return	-15.9%
Expected dividend yield	2.5%
Expected total return	-13.4%
Market Cap	Rs157,759M
	US\$3,592M

Price Performance (RIC: NALU.BO, BB: NACL 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%	12.8	6.3	33%	2%
FY06A	15,622	24.3	24%	10.3	4.9	33%	2%
FY07E	23,676	36.7	54%	6.7	3.0	40%	2%
FY08E	16,581	25.7	-30%	9.5	4.3	21%	2%
FY09E	14,986	23.3	-10%	10.5	4.9	17%	2%

Source: Company Reports, Citigroup Investment Research estimates. Prices as on Feb15.

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	12.8	10.1	6.7	9.5	10.5
EV/EBITDA adjusted (x)	6.6	5.2	3.4	4.4	5.0
P/BV (x)	3.4	2.7	2.0	1.7	1.6
Dividend yield (%)	1.6	2.0	2.5	2.5	2.5
Per Share Data (Rs)					
EPS adjusted	19.17	24.25	36.75	25.73	23.26
EPS reported	19.17	24.25	36.75	25.73	23.26
BVPS	72.91	91.46	121.36	140.26	156.68
DPS	4.00	5.00	6.00	6.00	6.00
Profit & Loss (RsM)					
Net sales	41,041	48,519	59,509	48,482	47,532
Operating expenses	-21,737	-24,519	-23,636	-23,734	-25,812
EBIT	19,305	24,000	35,873	24,747	21,719
Net interest expense	-606	0	0	0	0
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	18,698	24,000	35,873	24,747	21,719
Tax	-6,354	-8,674	-12,197	-8,167	-6,733
Extraord./Min.Int./Pref.div.	4	297	0	0	0
Reported net income	12,348	15,622	23,676	16,581	14,986
Adjusted earnings	12,348	15,622	23,676	16,581	14,986
Adjusted EBITDA	23,915	27,772	38,937	27,845	25,513
Growth Rates (%)					
Sales	31.4	18.2	22.7	-18.5	-2.0
EBIT adjusted	69.6	24.3	49.5	-31.0	-12.2
EBITDA adjusted	51.6	16.1	40.2	-28.5	-8.4
EPS adjusted	67.5	26.5	51.6	-30.0	-9.6
Cash Flow (RsM)					
Operating cash flow	17,236	19,654	23,258	16,245	15,377
Depreciation/amortization	4,611	3,772	3,064	3,098	3,793
Net working capital	-345	-378	-134	-201	-302
Investing cash flow	944	-2,331	-2,689	-12,815	-17,532
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	18,365	-977	-6,562
Balance Sheet (RsM)					
Total assets	61,567	74,746	95,529	107,879	118,450
Cash & cash equivalent	7,552	21,937	40,303	39,325	32,764
Accounts receivable	928	294	359	296	291
Net fixed assets	43,456	41,767	43,881	56,783	73,405
Total liabilities	14,588	15,819	17,333	17,509	17,501
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	78,196	90,370	100,949
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	58.3	57.2	65.4	57.4	53.7
ROE adjusted	29.2	29.5	34.5	19.7	15.7
ROIC adjusted	26.5	32.6	49.8	30.0	21.3
Net debt to equity	-16.1	-37.2	-51.5	-43.5	-32.5
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)	2,598	2,680	3%	2,287	2,315	1%	2,260	2,260	0%
Alumina as % of aluminium	15.5%	15.5%	0%	9.0%	10.5%	17%	11%	11.0%	0%
Import duty (%)	7.5%	7.1%	-6%	7.5%	5.0%	-33%	7.5%	5.0%	-33%
Net sales (Rs bn)	58.7	59.5	1%	51.2	48.5	-5%	52.2	47.5	-9%
EBITDA (Rs bn)	37.9	38.9	3%	28.6	27.8	-3%	28.0	25.5	-9%
Net profit (Rs bn)	22.6	23.7	5%	16.5	16.6	0%	15.6	15.0	-4%
EPS (Rs)	35.0	36.7	5%	25.7	25.7	0%	24.3	23.3	-4%

Source: Citigroup Investment Research estimates

National Aluminum

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 to average US\$245/t in FY08 and FY09, impacting divisional profitability versus FY07E. For aluminum, we expect average prices to decline 14% 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 Rs206. 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 Rs206, Nalco's EV/EBITDA works out to 3.4x, slightly lower than the mid-point of its medium-term trading range.

Risk

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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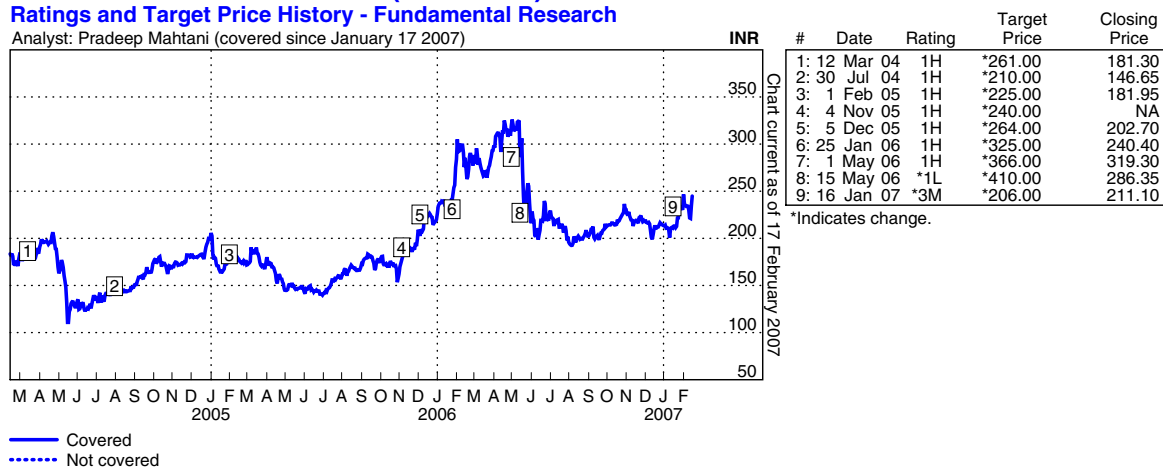
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Analyst: Pradeep Mahtani (covered since January 17 2007)



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