

Company Flash

31 January 2008 | 6 pages

Hindalco Industries (HALC.BO)

Sell: Difficult Time in 3Q FY08

- PAT falls 16% yoy, in line** — Hindalco reported net sales of Rs45.3bn, -3% yoy on lower revenues from both aluminium and copper divisions. Costs for copper came in below estimates largely due to better-than-expected copper smelting margins. Despite a near doubling of other income, PAT fell to Rs5.43bn.
- Aluminium margin decline trend continues** — The aluminium division's margin has fallen for a third straight quarter and reached 33.5%, lower both sequentially and YoY. The division was hit by a 10% decline in international prices and the rupee's appreciation vs. the dollar. On the positive side, sales volumes rose 12% to 121,991 tonnes with a better product mix.
- Copper EBIT falls 41%** — Cathode production went up 7% to 78,333 tonnes. Benefits of earlier contracts led to higher-than-expected TC/RC margins of ~US22c/lb (~US31c/lb in 2QFY08). Recent TC/RC contracts have been at around US11c/lb, and we expect them to remain at these levels in the coming quarters and impact profitability.
- Expansion plans** — Hindalco's aluminium smelter capacity would rise 9% to 504,000tpa when the Hirakud expansion is completed in 4Q FY08. The 340,000tpa Muri alumina plant is being ramped up leading to higher volumes in the coming quarters. The Utkal 1.5m tpa alumina project is expected to be commissioned by March 2010. Other major projects are expected by 2011-12.
- Under pressure** — We expect TC/RC margins to remain under pressure and domestic aluminium realizations to remain range-bound. Maintain Sell (3M).

Sell/Medium Risk	3M
Price (30 Jan 08)	Rs176.10
Target price	Rs146.00
Expected share price return	-17.1%
Expected dividend yield	1.0%
Expected total return	-16.1%
Market Cap	Rs216,098M US\$5,499M

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%	12.2	13.8	12.7	6.7	17%
FY06	16,525	17.7	23%	10.0	16.9	10.4	6.2	17%
FY07	25,643	25.5	44%	6.9	26.7	6.6	3.8	21%
FY08E	22,620	19.8	-22%	8.9	18.5	9.5	4.7	14%
FY09E	18,294	14.4	-27%	12.2	16.0	11.0	6.0	10%
FY10E	12,075	9.2	-36%	19.1	10.2	17.3	9.3	6%

Source: Company Reports, Citi Investment Research estimates *EPS not adjusted for dilution

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

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Quarterly Results

Figure 2. Hindalco Industries — 3Q FY08 Results

(Rs m)	3QFY08	3QFY07	% chg
Net sales	45,317	46,562	-3%
Expenditure	37,311	36,109	3%
EBITDA	8,006	10,453	-23%
% margin	17.7%	22.4%	
Other income	1,143	584	96%
Interest	622	698	-11%
Depreciation	1,460	1,384	5%
PBT	7,067	8,955	-21%
Tax	1,640	2,516	-35%
Tax rate %	23%	28%	
PAT	5,427	6,439	-16%
Divisional Break-up			
Sales (Rs m)			
Aluminium	17,290	17,960	-4%
Copper	28,062	28,621	-2%
EBIT (Rs m)			
Aluminium	5,789	7,555	-23%
Copper	940	1,595	-41%
EBIT margin (%)			
Aluminium	33.5%	42.1%	
Copper	3.3%	5.6%	

Source: Company Reports

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 likely 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 is based on the mid-point (8x) of this trading range. Based on consensus earnings, no substantial improvement is expected 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

Analyst Certification

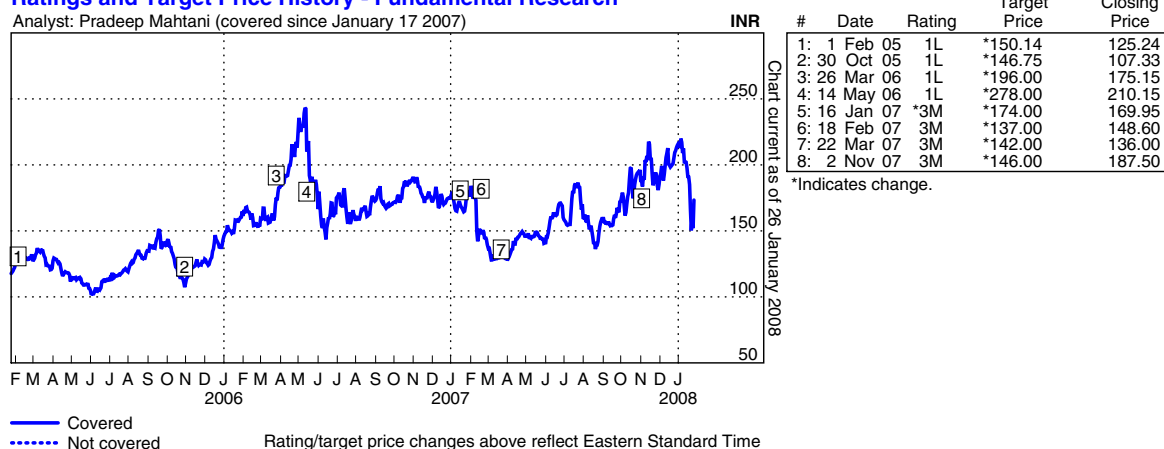
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Ratings and Target Price History - Fundamental Research

Analyst: Pradeep Mahtani (covered since January 17 2007)



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