Company Flash

28 July 2008 | 8 pages

Hindalco Industries (HALC.BO)

Buy: 1Q FY09 – Buoyed by Strong Global Prices

- **1QFY09 PAT rises 16% yoy** — PAT came inline with our estimates at Rs7bn, driven by a strong performance of the aluminium division. Revenues were almost flat at Rs46.5bn due to a decline in copper volumes. EBITDA margins at 20% were higher than 19% achieved in 1QFY08 and 16% in 4QFY08.
- **Aluminum benefits from higher LME** — Divisional EBIT increased 18% yoy to Rs7.5bn, and EBIT margin rose to 39% in 1QFY09 vs. 36% in 1QFY08 (29% in 4QFY08). The division gained from 6% yoy growth in the average aluminium LME price to US$2,940/t and a 7% yoy increase in the production of aluminium metal to 123,885 tonnes. Domestic alumina realization rose 8% yoy.
- **Copper affected by lower TC/RCs** — Cathode production fell 24% yoy to 60,434 tonnes due to planned shutdown of smelter 1 for a month. Divisional EBIT margin declined from 3.8% in 1QFY08 to 2.7% in 1QFY09 - hit by falling TC/RCs (16.5USc/lb vs 31.2USc/lb last year). Current contracts have been ~7.5USc/lb, and we expect TC/RCs to remain under pressure. A surge in by-product (such as DAP and sulphuric acid) realizations benefited the division.
- **Expansion plans** — The expansion of the Hirakud smelter (which has captive coal) by 43,000tpa to 143,000tpa should scale up by Aug 2008. Hindalco has plans to triple its alumina and aluminium capacities to 4.8mtpa and ~1.6mtpa respectively in stages during 2010 to 2013.
- **Reiterate Buy (1M)** — We expect Hindalco to benefit from a strong aluminum outlook due to power shortages and inadequate good quality bauxite.

Buy/Medium Risk	1M
Price (28 Jul 08)	Rs146.15
Target price	Rs188.00
Expected share price return	28.6%
Expected dividend yield	1.7%
Expected total return	**30.3%**
Market Cap	Rs179,345M
	US$4,254M

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%	10.1	13.8	10.6	5.6	17%
FY06	16,525	17.7	23%	8.3	16.9	8.7	5.2	17%
FY07	25,643	25.5	44%	5.7	26.7	5.5	3.2	21%
FY08E	23,203	20.4	-20%	7.2	16.2	9.0	4.2	14%
FY09E	33,759	22.7	12%	6.4	22.6	6.5	3.4	13%
FY10E	41,015	23.5	4%	6.2	25.5	5.7	3.3	14%

Source: Company Reports, Citi Investment Research estimates. Price as on 28 July 2008. FY08 is still shown as estimate as full Annual Report details are not available yet.

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

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1Q FY09 Results

Figure 2. Hindalco Industries – 1QFY09 Results

(Rs m)	1QFY09	1QFY08	% chg
Net sales	**46,475**	**46,851**	**-1%**
Expenditure	36,985	38,040	-3%
EBITDA	**9,490**	**8,811**	**8%**
% margin	**20.4**	**18.8**	**9%**
Other income	2,147	1,246	72%
Interest	761	563	35%
Depreciation	1,568	1,438	9%
PBT	9,308	8,057	16%
Tax	**2,340**	**2,071**	
Tax rate %	25%	26%	
PAT	**6,968**	**5,986**	**16%**
Divisional Break-up			
Sales (Rs m)			
Aluminium	19,428	17,610	10%
Copper	27,067	29,263	-8%
EBIT (Rs m)			
Aluminium	7,504	6,383	18%
Copper	743	1,123	-34%
EBIT %			
Aluminium	38.6	36.2	
Copper	2.7	3.8	

Source: Company Reports and Citi Investment Research

Hindalco Industries

Company description

Hindalco's acquisition of Novelis has given it a global presence. In India, Hindalco is a low-cost integrated aluminum producer (capacity ~500,000 tpa) with access to captive power and bauxite. It operates India's largest copper smelter (capacity 500,000 tpa, 35-40% market share). The aluminum division accounts for 37% of Hindalco's FY08 standalone net sales and 83% of EBIT. In aluminum, Hindalco has a strong domestic market share with a dominant 60-65% share in sheet products. It plans to triple its alumina and aluminum capacity by 2013. Hindalco owns copper mines in Australia through its 51% subsidiary, Aditya Birla Minerals, which will meet about 10-15% of its ore requirement when fully ramped up. On 16 May 2007, Hindalco acquired Novelis, which is the world's leading aluminium rolled products producer (FY08 sales of 3.15m tonnes), and the leader in the can sheet market with a 37% global market share.

Investment strategy

We rate Hindalco Buy/Medium Risk (1M) based on our strong outlook for global aluminium prices over the next three years. Our global analyst, Alan Heap, expects deficits in 2008-10 on the back of continued robust demand growth (8%/yr) and supply curtailments on the back of high power costs and shortages. We have substantially raised our global aluminium price forecasts to US$3,600/t for FY09 and US$4,500/t in FY10 (from US$2,600-2900/t). However, in the short term, we expect some weakness following a reversal of recent dramatic inflow of investment funds. The strong aluminium outlook more than compensates for our sluggish outlook for copper, where we expect copper TC/RCs to trade in a narrow band of US12-15c/lb during FY09-FY10E. Hindalco's stock price tends to move with international aluminium prices. Given the upward trend in aluminium prices that we have forecasted, we expect Hindalco's share price to appreciate from current levels.

Valuation

Our target price is based on 9x 12-month forward P/E. We use P/E because stocks such as Hindalco are largely driven by commodity price trends, which translate into earnings momentum. The stock has been trading in a P/E band of 7x and 9x over the past four years. It tends to move towards the upper end of the band when international aluminium prices move up. We use a 9x 12-month forward P/E multiple to value the stock, giving a target price of Rs188. The multiple appears justified given the substantial upgrade to our 2008-10E international aluminium price forecasts based on the deficits we expect due to strong demand growth and supply curtailments. Our target multiple continues to be at a discount to Nalco's target P/E multiple of 10x, based on the sluggish outlook for Hindalco's copper division in FY09-10E.

Risks

We rate Hindalco Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Possible downside risks that could impede the stock from reaching our target price are: 1) commodity prices (aluminum and alumina) or copper TC/RCs coming in weaker than our forecasts; 2) appreciation of the rupee versus the US$ more than we forecast; 3) reduction in import duties; 4) lower utilization levels than we expect.

Appendix A-1

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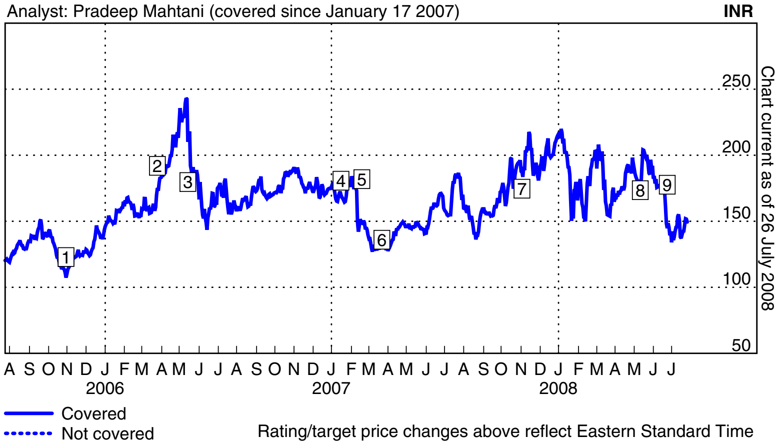
Hindalco Industries (HALC.BO)
Ratings and Target Price History - Fundamental Research
Analyst: Pradeep Mahtani (covered since January 17 2007)



#	Date	Rating	Target Price	Closing Price
1:	30 Oct 05	1L	*146.75	107.33
2:	26 Mar 06	1L	*196.00	175.15
3:	14 May 06	1L	*278.00	210.15
4:	16 Jan 07	*3M	*174.00	169.95
5:	18 Feb 07	3M	*137.00	148.60
6:	22 Mar 07	3M	*142.00	136.00
7:	2 Nov 07	3M	*146.00	187.50
8:	12 May 08	*1M	*240.00	175.00
9:	24 Jun 08	1M	*188.00	144.75

*Indicates change.

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% of companies in each rating category that are investment banking clients	53%	52%	42%

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