RESULTS REVIEW

Share Data

Market Cap	Rs. 127.7 bn
Price	Rs. 198.15
BSE Sensex	8,822.06
Reuters	NALU.BO
Bloomberg	NACL IN
Avg. Volume (52 Week)	0.2 mn
52-Week High/Low	Rs. 565.9/108.35
Shares Outstanding	644.3 mn

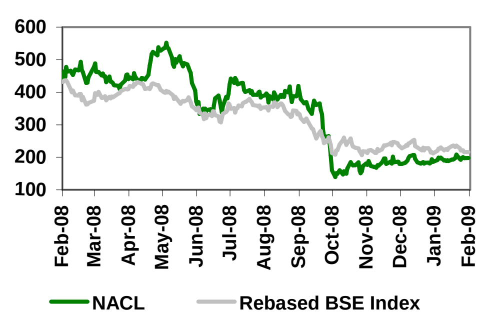
Valuation Ratios

Year to 31 March	2009E	2010E
EPS (Rs.)	16.5	10.2
+/- (%)	(35.4)%	(38.2)%
PER (x)	12.0x	19.4x
EV/ Sales (x)	2.1x	2.6x
EV/ EBITDA (x)	6.7x	10.4x

Shareholding Pattern (%)

Promoters	87
FIIs	4
Institutions	5
Public & Others	4

Relative Performance



National Aluminium Company Ltd — Sell

Falling LME prices threaten profitability

National Aluminium Company Limited (NALCO) reported a weak set of numbers in Q3'09, mainly on account of lower sales due to declining demand. Net sales fell 6.6% yoy to Rs.10.4 bn because of a 14.9% yoy decline in the aluminium sales volume to ~75,000 tonnes. EBITDA plunged 39.7% yoy mainly on account of higher input costs. We do not expect aluminium prices to bounce back in the upcoming quarters, given the rising inventory levels on the LME and the falling demand. Factoring in the Company's weak performance and the downbeat aluminium outlook, we have downgraded our rating from Hold to Sell. We expect NALCO to under-perform in the near-to-medium term due to the following reasons.

***Aluminium prices to remain under pressure*:** We believe that aluminium prices will be in the range of USD 1,400–1,600 per tonne in FY10. LME aluminium prices have declined ~60% since July 2008, and we do not foresee any price recovery in the near term as the automobile, infrastructure, and packaging industries (which drive more than two-thirds of the global aluminium demand) are witnessing a recession. In addition, inventory levels at the LME have reached 3 million tonnes, mainly on account of lower demand. Thus, amidst the weak global demand and rising inventory levels, aluminium prices on the LME are expected to remain subdued in FY10.

Margins to contract: We expect the Company's operating cost to decline by 18–20% in FY10, primarily due to falling power & fuel costs. However, we believe that the expected lower realisations will overshadow the benefit resulting from reduced operating costs. Thus, we expect NALCO's EBITDA margin to be ~32% in FY09 and ~25% in FY10, compared with 43.9% in FY08.

Key Figures

Quarterly Data	Q3'08	Q2'09	Q3'09	YoY%	QoQ%	9M'08	9M'09	YoY%
(Figures in Rs. mn, except per share data)								
Net Sales	11,093	15,715	10,359	(6.6)%	(34.1)%	36,311	40,750	12.2%
EBITDA	4,401	6,759	2,655	(39.7)%	(60.7)%	16,733	16,782	0.3%
Adjusted Net Profit	3,294	4,445	2,194	(33.4)%	(50.6)%	12,158	11,892	(2.2)%
Margins(%)								
EBITDA	39.7%	43.0%	25.6%			46.1%	41.2%	
NPM	29.7%	28.3%	21.2%			33.5%	29.2%	
Per Share Data (Rs.)								
Adjusted EPS	5.1	6.9	3.4	(33.4)%	(50.6)%	18.9	18.5	(2.2)%

Sales volume to decline: We expect the Company's aluminium and alumina sales volumes for FY09 to decline by 10–12% and 8–10%, respectively, due to the deepening economic slowdown and rising inventory levels on the LME. Currently, NALCO's average realisation (USD 1,750 per tonne) is marginally above its average cost of aluminium production (USD 1,500–1,600 per tonne). Though we have not assumed a production cut, any unanticipated fall in realisations will worsen the current situation and strengthen our Sell rating on the stock.

Valuation

At the current market price (CMP) of Rs. 198.15, NALCO's stock is trading at a forward P/E of 12x and 19.4x for FY09 and FY10 earnings, respectively. Based on DCF valuation, we have arrived at a target price of Rs. 149 (assuming a 16.8% WACC and a 5% terminal growth rate). Since our target price provides a downside potential of 25% from the CMP, we have downgraded our rating from Hold to Sell.

As our valuation is sensitive to the assumed aluminium sales realisation for NALCO, we have performed a sensitivity analysis for the same.

FY10 Aluminium Prices (USD/tonne)	FY11 Aluminium Prices (USD/tonne)					
	1,800	1,900	2,000	2,100	2,200	2,300
1,450	141	143	145	146	148	150
1,550	143	144	146	148	150	151
1,650	144	146	148	149	151	153
1,750	146	148	149	151	153	154
1,850	147	149	151	153	154	156
1,950	149	151	152	154	156	158
2,050	150	152	154	156	157	159

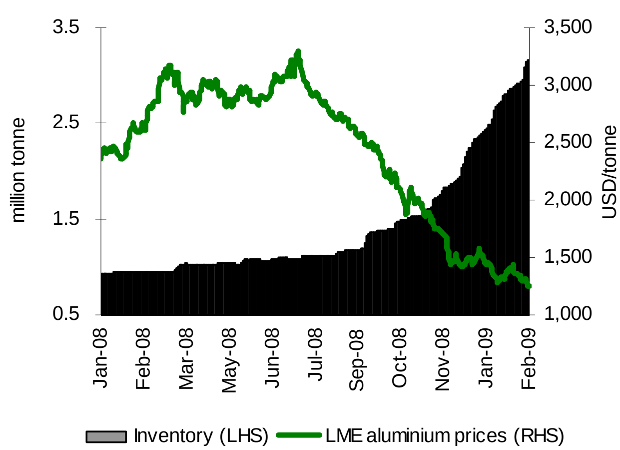
Result Highlights & Outlook

Lower realisations to drag the top line

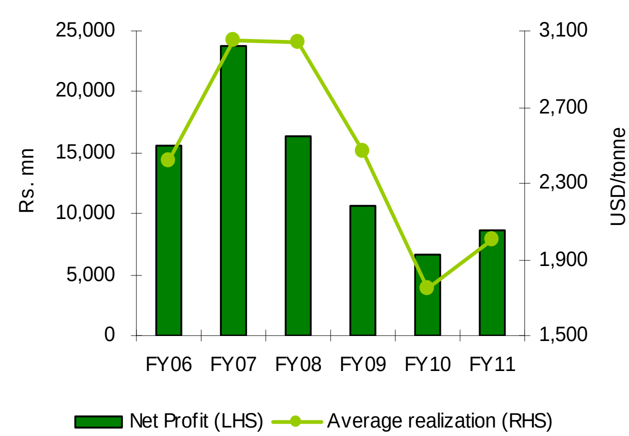
NALCO reported a weaker set of numbers in Q3'09. Net sales declined by 6.6% yoy to Rs. 10.4 bn, primarily due to declining demand. During the quarter, the Company's alumina and aluminium sales volumes declined by 11.6% yoy to ~179,000 tonnes and by 14.9% yoy to ~75,000 tonnes, respectively, because of the global economic slowdown.

We expect the Company's top line to decline by 9–10% in FY09 and by 22–25% in FY10 due to the expected lower sales volume and falling realisations. The automobile, construction, and packaging industries, which account for more than two-thirds of the global demand for aluminium, are facing a recession, resulting in demand destruction for aluminium suppliers. Thus, we expect NALCO's alumina and aluminium sales volumes to decline by 10–12% and 8–10%, respectively, in FY09. On the realisations front, aluminium prices should continue to feel the pressure due to weakening demand and rising inventory levels on the LME. Thus, we expect NALCO's average sales realisation to decline by 18–20% to USD 2,400–2,500 per tonne in FY09.

Rising inventory—cause for concern



Net profit—following the realisations trend



Margins to contract

In Q3'09, EBITDA sank 39.7% yoy to Rs. 2.7 bn and the EBITDA margin declined 14 pts to 25.6%, mainly on account of higher power & fuel costs and employee expenses. Power & fuel costs increased 45.3% yoy due to a sharp increase in coal prices, while employee expenses increased 44.4% primarily due to provisioning on account of the wage hikes as recommended by the Sixth Pay Commission.

We expect NALCO's EBITDA margin to decline ~12 pts in FY09 and by another ~7 pts in FY10 on the back of the declining sales realisation. Though power & fuel costs are expected to fall 25–30% in FY10, mainly on account of lower coal prices, we believe that the expected lower realisations and declining demand will overshadow the lower cost benefit. Thus, we expect the Company's EBITDA margin to be ~32% in FY09 and ~25% in FY10, compared with 43.9% in FY08.

All told, given the bleak aluminium outlook and our analysis of the Company's performance, we have downgraded our stock rating from Hold to Sell.

Key Risks

The following factors can pose a threat to our rating:

- Any increase in the import duty for aluminium
- A faster-than-expected recovery of the global economy

Key Figures

Year to March	FY06	FY07	FY08	FY09E	FY10E	CAGR (%)
(Figures in Rs. mn, except per share data)						(FY08-10E)
Net Sales	49,537	60,432	49,888	45,198	37,027	(13.8)%
EBITDA	26,509	36,332	21,882	14,184	9,201	(35.2)%
Adjusted Net Profit	15,776	23,926	16,484	10,652	6,580	(36.8)%
Margins(%)						
EBITDA	53.5%	60.1%	43.9%	31.4%	24.8%	
NPM	31.8%	39.6%	33.0%	23.6%	17.8%	
Per Share Data (Rs.)						
Adjusted EPS	24.5	37.1	25.6	16.5	10.2	(36.8)%
PER (x)	12.0x	6.3x	17.7x	12.0x	19.4x	

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