

Company

5 July 2010 | 10 pages

National Aluminium (NALU.BO)

Still Quite Expensive

 Equity
 Rating change
 Target price change
 Estimate change

- Cutting target price** — We cut our target price from Rs355 to Rs297 on lower LME price forecasts (cut by 6-11%). We continue to value Nalco's core business at 13x Jun11 PE, (average 5-yr core PE), to which we add cash per share of Rs73 (earlier Rs79) and arrive at a TP of Rs297 (from Rs355). At our target price, Nalco would trade at a PE of 14.2x and EV/EBITDA of 6.1x.
- Valuations stretched; Sell maintained** — The stock has run up 9% in the past six months (outperforming Sensex by 8%) probably due to the positive sentiment regarding possible disinvestment by the government. Even though aluminium is our preferred metal, we believe valuations appear overdone at 20.5x Jun11 PE. We move to Sell/Low Risk from Sell/Medium Risk earlier.
- Earnings revised** — We cut earnings estimates by 20% for FY11 and 7% for FY12 incorporating our new LME price forecasts/FX changes. Our new global aluminium forecasts are \$2,090/t (vs. \$2,350/t) for FY11 and \$2,273/t (vs. \$2,416/t) for FY12. The negative impact of taking 6-11% lower LME prices than in previous estimates has been partly offset by our new Rs/US\$ rate forecasts of 44.5 for FY11 (vs. 43.8) and 41.5 (vs. 41) for FY12.
- Aluminium: preferred metal** — We expect limited downside price risk as it already seems to be discounting a significant economic slowdown. Key positives: 1) a modest deficit in 2011 and 2012; 2) at current prices (\$1,900/t) about 30% of production is sub-economic; 3) we expect production cuts in China (high end of cost curve) due to falling margins and government measures; 4) Inventory levels are high but there is good potential for physically backed aluminium ETF.
- Sensitivity to prices** — A 5% change in aluminium prices would impact FY11 and FY12 PAT by 15%. A 5% change in Rs/US\$ rate would impact PAT by 16%.

Sell/Low Risk	3L
<i>from Sell/Medium Risk</i>	
Price (02 Jul 10)	Rs428.55
Target price	Rs297.00
<i>from Rs355.00</i>	
Expected share price return	-30.7%
Expected dividend yield	1.1%
Expected total return	-29.6%
Market Cap	Rs276,119M
	US\$5,927M

Price Performance (RIC: NALU.BO, BB: NACL IN)



Figure 1. Nalco – Statistical Abstract

YE 31 Mar	Net Profit (Rs m)	EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)	ROE (%)	Yield (%)
FY07	23,874	37.1	56%	11.6	6.1	31%	2%
FY08	16,569	25.7	-31%	16.7	8.6	19%	1%
FY09	12,585	19.5	-24%	21.9	10.9	13%	1%
FY10E	8,187	12.7	-35%	33.7	15.6	8%	1%
FY11E	12,645	19.6	54%	21.8	10.2	11%	1%
FY12E	15,974	24.8	26%	17.3	8.1	13%	1%

Source: Company Reports and Citi Investment Research and Analysis estimates. Price as on 2 July 2010.

Pradeep Mahtani

+91-22-6631-9882
 pradeep.mahtani@citi.com

Raashi Chopra, CFA

+91-22-6631-9862
 raashi.chopra@citi.com

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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	16.7	21.9	33.7	21.8	17.3
EV/EBITDA adjusted (x)	8.7	11.0	15.8	10.5	8.4
P/BV (x)	3.1	2.8	2.7	2.4	2.2
Dividend yield (%)	1.4	1.2	0.7	1.1	1.4
Per Share Data (Rs)					
EPS adjusted	25.72	19.53	12.71	19.63	24.79
EPS reported	25.72	19.53	12.71	19.63	24.79
BVPS	137.74	151.63	161.04	175.41	193.18
DPS	6.00	5.00	3.00	4.50	6.00
Profit & Loss (RsM)					
Net sales	49,888	50,945	50,547	56,751	66,718
Operating expenses	-24,953	-31,772	-38,584	-37,743	-42,711
EBIT	24,935	19,173	11,963	19,009	24,007
Net interest expense	-15	-40	-22	-22	-22
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	24,920	19,134	11,941	18,987	23,985
Tax	-8,351	-6,549	-3,754	-6,342	-8,011
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	16,569	12,585	8,187	12,645	15,974
Adjusted earnings	16,569	12,585	8,187	12,645	15,974
Adjusted EBITDA	27,746	21,898	15,151	22,542	27,739
Growth Rates (%)					
Sales	-16.0	2.1	-0.8	12.3	17.6
EBIT adjusted	-31.3	-23.1	-37.6	58.9	26.3
EBITDA adjusted	-29.7	-21.1	-30.8	48.8	23.1
EPS adjusted	-30.6	-24.0	-34.9	54.5	26.3
Cash Flow (RsM)					
Operating cash flow	19,019	19,382	9,445	14,578	17,745
Depreciation/amortization	2,811	2,724	3,188	3,533	3,732
Net working capital	300	3,608	-67	-576	-959
Investing cash flow	-14,291	-14,171	-5,496	-7,576	-7,097
Capital expenditure	-15,441	-12,953	-9,000	-11,000	-11,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-5,279	-3,877	-1,153	-2,284	-3,414
Borrowings	0	0	0	0	0
Dividends paid	-5,277	-3,769	-1,131	-2,262	-3,392
Change in cash	-550	1,335	2,796	4,719	7,233
Balance Sheet (RsM)					
Total assets	110,228	123,244	134,276	147,128	164,116
Cash & cash equivalent	35,165	28,690	31,487	36,205	43,439
Accounts receivable	607	265	290	330	388
Net fixed assets	58,664	68,997	74,809	82,276	89,543
Total liabilities	21,483	25,546	30,513	34,113	39,649
Accounts payable	4,357	4,554	5,911	5,501	6,529
Total Debt	0	0	0	0	0
Shareholders' funds	88,745	97,698	103,763	113,015	124,466
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	55.6	43.0	30.0	39.7	41.6
ROE adjusted	20.0	13.5	8.1	11.7	13.5
ROIC adjusted	30.5	19.8	11.6	16.3	18.7
Net debt to equity	-39.6	-29.4	-30.3	-32.0	-34.9
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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Estimate Revisions

Revisions based on 6-11% cut in LME prices but benefit from revised Rs/\$ rates.

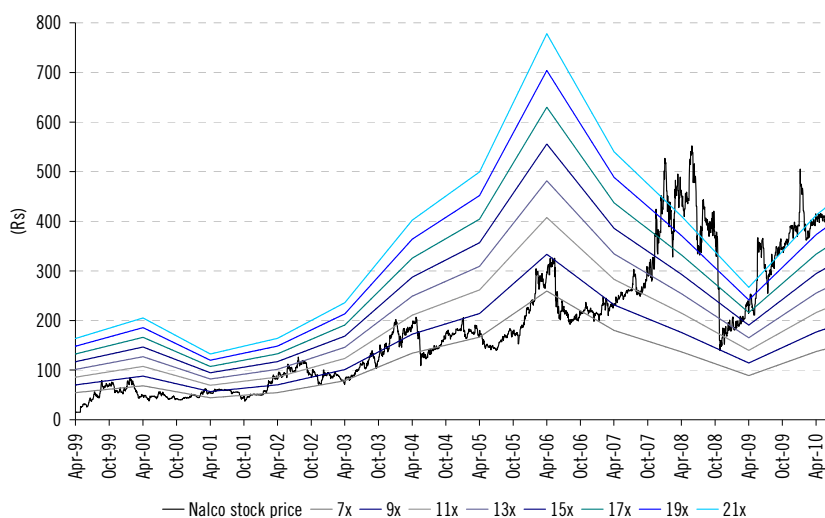
Figure 2. Nalco Estimate Changes – FY11-12E

	FY11E			FY12E		
	Old	New	% chg	Old	New	% chg
Rs/\$ FX rate	43.8	44.5	2%	40.8	41.5	2%
Aluminium price (\$/t)	2,350	2,090	-11%	2,416	2,273	-6%
Alumina price (\$/t)	317	314	-1%	326	330	1%
Net sales (Rs bn)	61.3	56.8	-7%	68.3	66.7	-2%
EBITDA (Rs bn)	27.3	22.5	-18%	29.7	27.7	-6%
Net profit (Rs bn)	15.8	12.6	-20%	17.3	16.0	-7%
EPS (Rs)	24.6	19.6	-20%	26.8	24.8	-7%

Source: Citi Investment Research and Analysis estimates

Nalco has been re-rated to the upper end of its PE trading band on expectations of possible divestment and its relatively low liquidity.

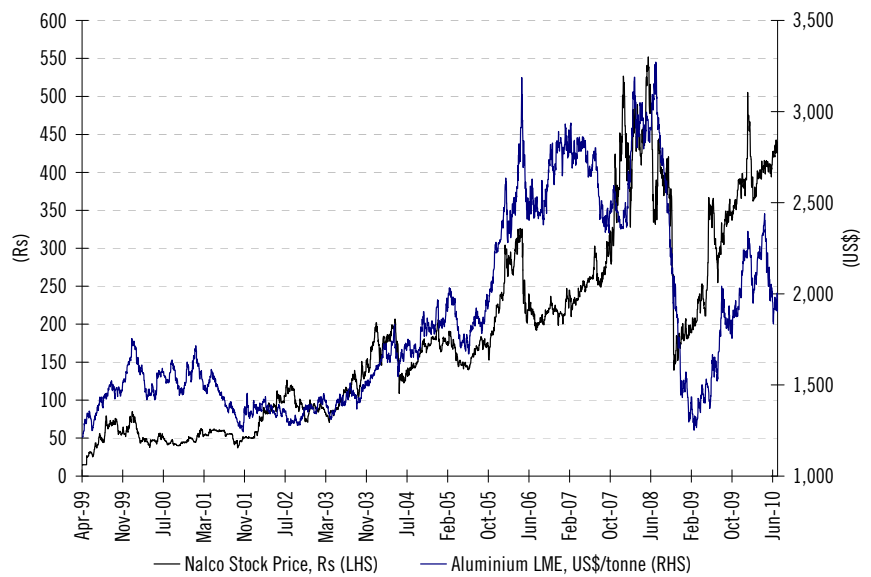
Figure 3. Nalco – Rolling PE Band Chart (1-yr forward)



Source: Datastream, Company Reports and CIRA Estimates

Nalco's stock price has tended to move in tandem with international aluminium prices. However it has remained firm in the past few months despite falling international prices.

Figure 4. Nalco stock price (Rs) vs. Aluminium LME (US\$)



Source: Datastream, Company Reports and CIRA Estimates

Figure 5. Aluminium LME (US\$/t) vs. Nalco Rolling Forward PE



Source: Datastream, Company Reports and CIRA Estimates

Takeaways from India Investor Conference

- **Brownfield expansions** – Nalco's second phase of expansion (capex Rs44bn) will be completed by Jan-11. During this phase, its smelter capacity has been expanded to 460ktpa in Dec-09 (from 345ktpa) and power capacity is expected to reach 1,200MW by July-10 (already enhanced to 1,080MW in Dec-09 from 960MW). Although bauxite capacity has been expanded to 6.3mtpa, it is awaiting completion of the alumina capacity (to be enhanced to 2.1mtpa from 1.58mtpa by Jan-11).
- **Further brownfield expansions** – 1) Alumina: Nalco plans to enhance its alumina capacity to 2.28mt by 2012 and subsequently by another 700kt by 2014. This will be at an investment of Rs18bn. 2) Bauxite: To meet the needs of its enhanced alumina capacity, Nalco feels that it will require 260m tonnes of bauxite until FY40 and taking its existing mines at Panchpatmali and newly allotted mines at Pottangi, it should be able to meet its requirements. 3) Aluminium: It plans to upgrade its smelter in phases by improving the throughput which will add 92,000tpa by 2016 at a capex of Rs15bn. This capex will include additional 120MW of power.
- **Cheaper coal** – In FY10, the proportion of linkage coal fell to ~84% and Nalco was adversely impacted by poor quality coal, expensive imported/e-auction coal. Nalco hopes that linkage coal will rise to 90% in FY11 and help cut power cost.
- **Greenfield expansions in India** – As Nalco will have 1.35mtpa of surplus alumina from FY13, it is looking for ways to enhance its power and metal capacity to use this surplus alumina. In India, it has two options: 1) 500ktpa smelter + 1,250MW of power in Orissa/Chattisgarh at a capex of Rs165bn, 2) 4.2mtpa bauxite + 1.4mtpa refinery+ 500ktpa smelter + 1,250MW of power at Andhra Pradesh at a capex of Rs225bn (likely completion in 3-5 years).
- **International growth plans** – Nalco is also examining opportunities outside India and has made most progress in Indonesia, where it expects to set up a 0.5mtpa smelter (1,250MW in two phases) at estimated capex of \$3.9bn. The company has signed an MOU with the government of South Sumatra, but is also examining an alternate location at East Kalimantan as work has started there on rail, port and coal.
- **Strong balance sheet** – Cash balance is ~Rs41bn. The expansion capex has been funded through internal accruals and Nalco has zero debt. Planned capex is Rs9bn in FY11 and Rs7bn in FY12. Nalco does not expect to raise debt for its medium-term domestic expansion plans.

National Aluminium

Company description

Nalco has smelter capacity of 460,000 tpa based in Orissa in eastern India. It has bauxite deposits to meet more than 50 years' of expanded alumina capacity (2.1m tpa from 1.58m tpa to be completed by 4Q FY11). Good quality bauxite, open cast mines and low bauxite transport costs make Nalco one of the world's lowest-cost alumina producers. It sells surplus alumina in

international markets, and is India's largest alumina exporter. Its thermal power capacity has risen to 1,080 (from 960MW) and will increase to 1,200MW by Jul 2010. The thermal power capacity meets in-house requirements at about a third of grid cost, and any surplus power is sold to the state grid. Low costs for power, alumina and labor make it one of the lowest-cost aluminum producers globally. It plans to raise alumina capacity to 2.3m tpa by FY12 and is awaiting clearances for further expansion of alumina capacity to 3m tpa and aluminium to 575,000 tpa. In addition Nalco has longer-term plans for greenfield capacities in Andhra Pradesh, Orissa, Indonesia and Iran.

Investment strategy

We rate Nalco shares Sell/Low Risk (3L). Our aluminium price forecasts are based on our global price forecasts of US\$2,090/t (FY11E) and US\$2,273/t (FY12E). Aluminium is one of our preferred metals with limited downside price risk as it already seems to be discounting a significant economic slowdown. Key factors in its favour: 1) we expect a modest deficit in 2011 and 2012; 2) at current prices (US\$1,900/t) about 30% of aluminium production is sub-economic; 3) we expect production cuts in China (high end of cost curve) due to falling prices and government measures (capacity closures and higher power tariffs); 4) Inventory levels are high but there is good potential for physically backed aluminium ETF. As Nalco's volumes have already been ramped up in FY10, we expect volume growth of 1% in FY11E and 5% in FY12E. The expansion has been funded through internal accruals and Nalco has zero debt. Its cash balance as of March 2010 was in excess of Rs40bn (>Rs62/share) and Nalco does not expect to raise debt for capex plans for medium-term domestic expansion plans.

Valuation

We use P/E to value Nalco as it is driven largely by commodity price trends, which translate into earnings momentum. Our target price of Rs297 is based on 13x core PE (Rs224), to which we add cash per share of Rs73. Our target multiple of 13x (Sep 2011E) earnings is the average of Nalco's five-year trading range. In the past five years, the stock has largely traded in a P/E range of 11x-17x (core EPS). There have been periods when the 12-month rolling forward P/E multiples have crossed this band, as seen during Jun07- Oct08, and for short periods since the beginning of FY10. A mean PE multiple appears justified based on our high LME price estimates. Based on our target price of Rs297, Nalco's Jun11 EV/EBITDA equates to 6.1x and PE of 14.2x.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, suggests a Low Risk rating for Nalco. Based on its status as an integrated aluminium producer, one of the lowest-cost producers in the world and net cash position, we feel Low Risk is justified. Upside risks that could cause the shares to trade above our target price are: 1) Higher-than-expected aluminium prices; 2) Disinvestment; 3) Rupee depreciation; 4) Higher volumes than we expect.

Appendix A-1

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National Aluminium (NALU.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Pradeep Mahtani

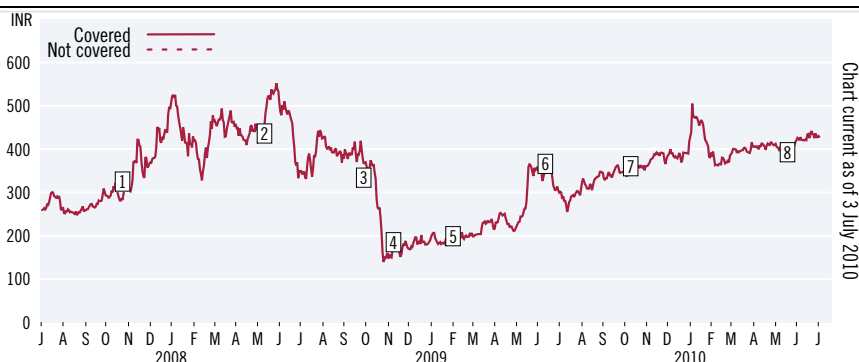


Chart current as of 3 July 2010

	Date	Rating	Target Price	Closing Price		Date	Rating	Target Price	Closing Price		Date	Rating	Target Price	Closing Price
2008	1 24-Oct-07	3M	*231.00	282.60	2009	4 10-Nov-08	1M	*230.00	185.05	2010	7 9-Oct-09	3M	*296.00	344.25
	2 12-May-08	*1M	*546.00	454.05		5 2-Feb-09	*3M	*124.00	189.90		8 19-May-10	3M	*355.00	395.75
	3 29-Sep-08	1M	*466.00	366.20		6 11-Jun-09	3M	*230.00	358.05					

* Indicates change

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