



Nalco

STOCK INFO. BLOOMBERG
BSE SENSEX: 14,218 NAEL IN
REUTERS CODE
S&P CNX: 4,167 NALU.BO

25 April 2007

Neutral

Previous Recommendation: Neutral

Rs251

Equity Shares (m)	644.3
52-Week Range	335/185
1,6,12 Rel. Perf. (%)	2/-1/-41
M.Cap. (Rs b)	161.7
M.Cap. (US\$ b)	3.6

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	59,425	23,807	37.0	54.3	6.8	2.0	30.1	37.7	2.1	3.6
3/08E	52,749	18,296	28.4	-23.1	8.8	1.7	19.5	24.7	2.5	4.7
3/09E	53,605	18,294	28.4	0.0	8.8	1.5	16.9	21.3	2.3	4.4

- During 4QFY07, Nalco reported PAT of Rs5.9b in line with our expectations. Net sales grew 1.9% YoY to Rs15.7b whilst fall in revenues of the Alumina segment, owing to lower export prices, were counterbalanced by increased revenues from the Aluminium segment owing to its higher prices. EBITDA declined 9.3% YoY to Rs8.8b and margins declined 690bp YoY to 56.2% due to lower export prices of Alumina and higher provisioning for employee expenses in anticipation of giving higher wages effective 1 January 2007 (currently under negotiation).
- **Aluminium segment revenues up 14% YoY:** Revenue was up 14% YoY to Rs11.2b, driven by 12% YoY higher metal prices on the LME, as volumes remained flat at 90,000 ton. Segmental EBIT margins rose 571bp YoY to 57.9% due to higher metal prices.
- **Alumina segment revenues decline 20%:** Revenue (external sales only, excluding inter-segmental transfer) declined 20% YoY to Rs4.4b despite 41% YoY higher volumes due to decline in average realization of Alumina prices by 43% YoY to US\$333/ton. Segmental EBIT margins declined 2,948bp YoY to 47.2% due to lower average realization on spot as well as yearly contracts, which are now linked to LME prices by 9% v/s 18% in 2006.
- **Valuations:** We are revising our earnings estimates to Rs28.4 (earlier Rs29.1) for FY08 to factor higher employee costs, higher average Aluminium LME prices of US\$2,700 per ton (earlier US\$2,600) and appreciation of the rupee versus the USD. The stock is trading at PE of 8.8x FY08 and EV/EBITDA of 4.7x FY08. We remain **Neutral** on the stock, as the benefit of ongoing capex of Rs41b (to expand capacity by 33%) will accrue in FY10.

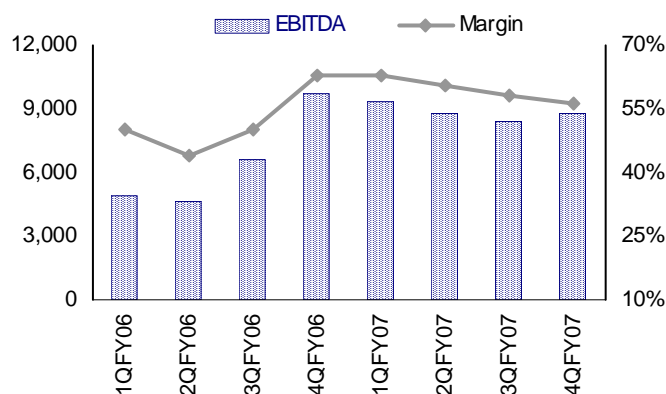
Y/E MARCH	QUARTERLY PERFORMANCE								(RS MILLION)	
	FY06				FY07				FY06	FY07
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Sales	9,787	10,470	13,249	15,380	14,855	14,416	14,486	15,668	48,887	59,425
Change (YoY %)	19.0	7.2	21.5	24.7	51.8	37.7	9.3	19	18.6	21.6
Total Expenditure	4,892	5,881	6,604	5,675	5,512	5,665	6,037	6,870	23,053	24,083
EBITDA	4,896	4,589	6,645	9,705	9,344	8,751	8,449	8,798	25,834	35,341
As % of Net Sales	50.0	43.8	50.2	63.1	62.9	60.7	58.3	56.2	52.8	59.5
Depreciation	983	992	919	894	787	771	744	819	3,787	3,221
Other Income	406	474	545	851	834	1,014	978	1,199	2,276	4,025
PBT (before XO item)	4,319	4,070	6,271	9,663	9,391	8,994	8,684	9,178	24,323	36,246
Total Tax	154	1,240	2,341	3,582	3,168	3,044	2,958	3,270	8,674	12,440
% Tax	35.0	30.5	37.3	37.1	33.7	33.8	34.1	35.6	35.2	34.3
Reported PAT	2,806	2,830	3,930	6,080	6,223	5,950	5,726	5,908	15,945	23,807
Change (YoY %)	28.1	2.7	28.4	44.1	21.8	10.2	45.7	-2.8	28.4	51.1

E: M OSt Esimates

Results in line with our expectation

During 4QFY07, net sales grew 1.9% YoY to Rs15.7b, as fall in revenue of the Alumina segment due to lower export prices were counterbalanced by increased revenue from the Aluminium segment due to 12% YoY higher Aluminium prices on the LME. EBITDA has declined 9.3% YoY to Rs8.8b and margins declined 690bp YoY to 56.2% due to lower Alumina prices and higher provisioning for employee expenses in anticipation of giving higher wages effective 1 January 2007 (currently under negotiation).

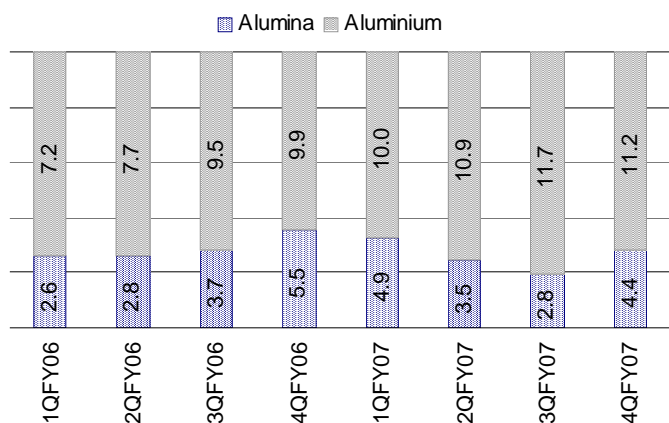
CONTINUED PRESSURE ON EBITDA MARGINS (RS M)



Source: Company/ Motilal Oswal Securities

Other income rose by 41% to Rs1.2b on account of rising surplus cash. Therefore, the decline in PAT was moderate, by 2.8% to Rs5.9b.

SEGMENTAL DISTRIBUTION OF REVENUE



Source: Company/ Motilal Oswal Securities

Segmental revenue growth of Aluminium counterbalances decline in Alumina

Aluminium revenues

Revenues for the Aluminium segment increased by 14% YoY to Rs11.2b primarily on account of 12% YoY higher average LME prices (US\$2,748 per ton). Domestic sales volumes increased from 63,000 tons in 4QFY06 to 72,000 tons in 4QFY07 although total volumes remained constant at 91,000 tons.

Alumina revenues

Revenues for Alumina declined 20% YoY to Rs4.4b despite increase in sales volume by 41% to 302,000 ton to capitalize on improving spot prices in its spot tender during the quarter by liquidating inventories accumulated in 2Q and 3Q. Average realization of Alumina exports declined by 43% YoY to US\$333/ton. There was continued improvement in Alumina prices on spot sales as evident in following table.

SPOT SALE OF ALUMINA DUEING THE QUARTER THOUGH OPEN TENDER

DATE	QTY (TONS)	PRICES (US\$/TON)	REMARKS
3-Jan-07	30,000	237	Alcan (US\$100 per ton under arbitration)
10-Jan-07	30,000	260	Dutch trading company Trafigura
24-Jan-07	30,000	353	Glencore
8-Feb-07	30,000	393	MMTC, Singapore
6-Mar-07	25,000	405	VISA Comtrade, Switzerland
31-Mar-07	10,000	407	VISA Comtrade, Switzerland

Source: Metal Bulletin/ Motilal Oswal Securities

However, Nalco is locked in a one-year contract during 2007 for sale of 540,000 ton of Alumina at an average rate of 9% to the LME Aluminium prices. This will keep average realization on Alumina lower, despite the improving Alumina prices in spot sales. Recently on 25 April 2007, Nalco awarded 30,000 ton tender to Gulf Resources whose bid was the highest at US\$423/ton against the next highest bid of USD362.37/ton by Glencore.

OOQ TREND IN AVG. LME ALUMINIUM PRICES FOR 3 MTH CONTRACTS

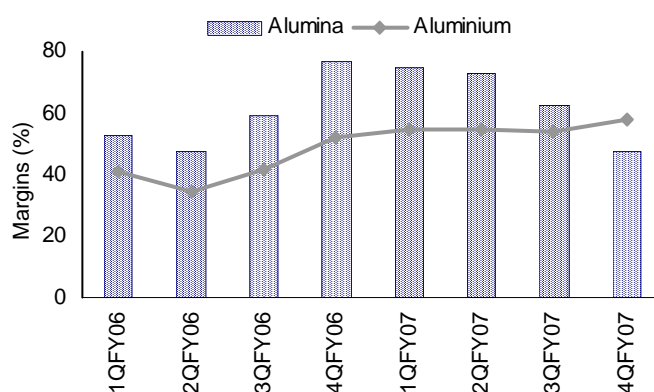
QUARTER	ALUMINIUM			ALUMINA		
	AVG.	QOQ (%)	YOY (%)	AVG.	QOQ (%)	YOY (%)
4QFY07	2,748	1	12	322	34	-47
3QFY07	2,726	8	32	240	-29	-55
2QFY07	2,531	-6	37	340	-42	-21
1QFY07	2,684	10	50	583	-4	34
4QFY06	2,447	18	29	607	15	46
3QFY06	2,071	12	14	530	23	32
2QFY06	1,849	3	8	432	0	29
1QFY06	1,795	-5	6	434	5	-5

Source: LME/ Metal Bulletin/Motilal Oswal Securities

Segmental margins

Aluminium segment's EBIT margins increased 571bp YoY to 57.9% largely on account of higher prices. However, margins of the Alumina segment declined 2,948bp YoY to 47.2% due to lower realization in spot market as well as in the yearly contract mode. Higher 20% YoY provision on account of anticipated increase in wages also had a bearing on margins.

SEGMENTAL MARGINS ON EXTERNAL SALES



Source: Company/ Motilal Oswal Securities

Valuation and view

We are revising our earnings estimates to Rs28.4 (v/s Rs29.1 earlier) for FY08 to factor higher employee costs, higher average Aluminium LME prices of US\$2,700 per ton (earlier US\$2,600) due to continued strength in aluminium prices and appreciation of INR against the USD. The stock is trading at PE of 8.8 xFY08 and EV/EBITDA of 4.7 xFY08. We remain **Neutral** on the stock as the benefit of ongoing capex of Rs41b (to expand capacity by 33%) will accrue later in FY10.

Nalco: an investment profile

Company description

Nalco is a fully integrated producer of Aluminium and Alumina in India. Aluminium contributed 73% and Alumina 27% to FY06 revenues. Its Aluminium smelter, the second largest in India, sources Alumina and power from its captive refinery in Damanjodi and the 960MW captive power plant located in Angul. Coal is sourced from state-owned Coal India for power generation, hence cost of power generated is low. The Alumina refinery, capacity 1.6m tpa, is located in Damanjodi (Orissa) close to captive Bauxite mines at Panchpatmali. Bauxite reserves have superior quality and Bauxite consumes low energy in crushing and digestion process during conversion to Alumina. Thereby, Nalco's cost of production is lowest in world.

Key investment arguments

- The company is undertaking Rs41b capex to increase capacity of its smelter from 345,000 tpa to 460,000 tpa, Alumina refinery from 1.6m tpa to 2.1m tpa and captive power from 960MW to 1,200MW. The project is expected to be completed by December 2008.

Key investment risks

- Unexpected fall in Aluminium prices could adversely impact earnings.

COMPARATIVE VALUATIONS

		NALCO	HZ	SAIL
P/E (x)	FY08E	8.8	5.6	7.2
	FY09E	8.8	5.4	6.4
P/BV (x)	FY08E	1.7	2.2	2.4
	FY09E	1.5	1.6	1.8
EV/Sales (x)	FY08E	2.5	2.9	1.2
	FY09E	2.3	2.8	1.1
EV/EBITDA (x)	FY08E	4.7	3.9	3.6
	FY09E	4.4	3.9	3.3

SHAREHOLDING PATTERN (%)

	MAR.07	DEC.06	MAR.06
Promoter	87.2	87.2	87.2
Domestic Inst	6.9	6.9	5.9
Foreign	2.2	1.9	3.0
Others	3.8	4.1	4.0

Recent developments

- NIL

Valuation and view

- The stock is trading at PE of 8.8x FY08 and EV/EBITDA of 4.7x FY08. We remain Neutral on the stock as the benefit of ongoing capex of Rs41b (to expand capacity by 33%) will accrue only from FY10

Sector view

- Demand for Aluminium products in India is growing 9% p.a. and the momentum is likely to accelerate in forthcoming years. Global demand too is expected to post a growth rate of 5, led strong growth in China.

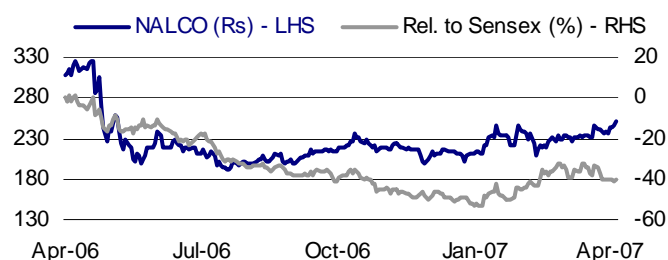
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	28.4	26.0	9.3
FY09	28.4	24.2	17.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
251	-	-	Neutral

STOCK PERFORMANCE (1 YEAR)



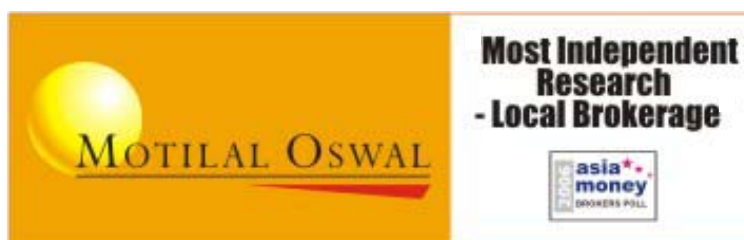
INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Net sales	41,240	48,518	59,425	52,749	53,605	
Change (%)	32.0	17.6	22.5	-112	16	
Total Expenses	19,676	22,969	24,083	24,962	26,123	
EBITDA	21,563	25,550	35,342	27,787	27,483	
% of Net Sales	52.3	52.7	59.5	52.7	51.3	
Depn. & Amortization	4,611	3,772	3,121	3,100	3,000	
EBIT	16,952	21,777	32,221	24,687	24,483	
Net Interest	606					
Other income	2,352	2,222	4,025	3,000	3,200	
PBT before EO	18,698	23,999	36,247	27,687	27,683	
EO income	4	297				
PBT after EO	18,703	24,296	36,247	27,687	27,683	
Tax	6,354	8,674	12,440	9,390	9,389	
Rate (%)	34.0	35.7	34.3	33.9	33.9	
Reported PAT	12,348	15,621	23,807	18,296	18,294	
Adjusted PAT	12,346	15,430	23,807	18,296	18,294	
Change (%)	69.6	25.0	54.3	-23.1	0.0	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Share Capital	6,443	6,443	6,443	6,443	6,444	
Reserves	40,535	52,484	72,614	87,237	101,856	
Net Worth	46,978	58,927	79,057	93,680	108,300	
Deferred Tax Liability	6,525	6,417	6,417	6,417	6,417	
Capital Employed	53,503	65,344	85,474	100,097	114,717	
Gross Block	87,827	89,612	91,612	111,612	130,612	
Less: Accum. Deprn.	46,437	50,167	53,288	56,388	59,388	
Net Fixed Assets	41,390	39,445	38,325	55,225	71,225	
Capital WIP	2,066	2,322	10,322	12,322	2,322	
Investments						
Curr. Assets	18,110	32,979	48,785	43,539	52,430	
Inventory	5,291	5,916	6,512	5,781	6,021	
Account Receivables	928	294	1,628	1,445	1,616	
Cash and Bank Balance	7,552	21,937	35,813	31,481	39,962	
Others	4,340	4,832	4,832	4,832	4,832	
Curr. Liability & Prov	8,064	9,402	11,957	10,988	11,259	
Account Payables	6,163	6,073	8,629	7,659	7,931	
Provisions & Others	1,901	3,328	3,328	3,328	3,328	
Net Curr. Assets	10,047	23,577	36,828	32,551	41,171	
Appl. of Funds	53,503	65,344	85,474	100,097	114,718	

E: M0St Estimates

RATIOS						
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Basic (Rs)						
EPS	19.2	23.9	37.0	28.4	28.4	
Cash EPS	26.3	30.1	418	33.2	33.0	
BV/Share	72.9	91.5	122.7	145.4	168.1	
DPS	4.0	5.0	5.0	5.0	5.0	
Payout (%)	23.8	23.8	15.4	20.1	20.1	
Valuation (x)						
P/E	13.1	10.5	6.8	8.8	8.8	
Cash P/E	9.5	8.3	6.0	7.6	7.6	
P/BV	3.4	2.7	2.0	1.7	1.5	
EV/Sales	3.7	2.9	2.1	2.5	2.3	
EV/EBITDA	7.1	5.5	3.6	4.7	4.4	
Dividend Yield (%)	16	2.0	2.0	2.0	2.0	
Return Ratios (%)						
RoE	26.3	26.2	30.1	19.5	16.9	
RoCE	31.7	33.3	37.7	24.7	21.3	
Working Capital Ratios						
Asset Turnover (x)	0.8	0.7	0.7	0.5	0.5	
Debtor (Days)	8	2	10	10	11	
Leverage Ratio (x)						
Current Ratio	2.2	3.5	4.1	4.0	4.7	
Interest Cover Ratio	28.0	N.A.	N.A.	N.A.	N.A.	

CASHFLOW STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Pre-tax profit	18,703	24,296	36,247	27,687	27,683	
Depreciation	4,561	3,730	3,121	3,100	3,000	
(Inc)/Dec in Wkg. Cap.	-919	-519	625	-55	-140	
Tax paid	-5,788	-8,143	-12,440	-9,390	-9,389	
CF from Op. Activity	16,552	19,364	27,551	21,342	21,154	
(Inc)/Dec in FA +CWIP	-1,069	-2,041	-10,000	-22,000	-9,000	
(Pur)/Sale of Investment:	2,000					
Others						
CF from Inv. Activity	931	-2,041	-10,000	-22,000	-9,000	
Dividend (incl. tax)	-4,371	-2,939	-3,673	-3,673	-3,673	
CF from Fin. Activity	-10,915	-2,939	-3,674	-3,673	-3,673	
(Inc)/Dec in Cash	6,569	14,385	13,876	-4,332	8,480	
Add: opening Balance	984	7,552	21,937	35,813	31,481	
Closing Balance	7,552	21,937	35,813	31,481	39,962	



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2. Group/Directors ownership of the stock
3. Broking relationship with company covered
4. Investment Banking relationship with company covered

Nalco

No
No
No
No

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