

JUNE 29, 2011

UPDATE

Coverage view: **Attractive**

Price (Rs): **181**

Target price (Rs): **225**

BSE-30: **18,492**

Positives outweigh negatives; retain ADD. Newspaper reports indicate that the Mahan coal block may be granted forest clearance in July. We believe that this could be a positive development; captive coal block can lower cost of production of aluminium by US\$300-400/ tonne. On the negative side, we find revised commissioning date of Utkal aggressive and believe there could be potential delays and cost escalations. On balance, we believe that Hindalco's valuations are attractive and retain ADD rating with target price of Rs225/ share.

Company data and valuation summary

Hindalco Industries

Stock data

52-week range (Rs) (high,low) 253-140

Market Cap. (Rs bn) 330.8

Shareholding pattern (%)

Promoters 32.1

FIs 40.1

MFs 2.5

Price performance (%)

Absolute (12.5) (16.4) 16.4

Rel. to BSE-30 (12.4) (13.7) 12.1

Forecasts/Valuations	2011	2012E	2013E
EPS (Rs)	12.8	18.2	18.6
EPS growth (%)	(36.0)	42.7	2.1
P/E (X)	13.5	9.5	9.3
Sales (Rs bn)	720.8	848.0	863.4
Net profits (Rs bn)	24.5	34.9	35.6
EBITDA (Rs bn)	80.0	93.5	95.9
EV/EBITDA (X)	7.2	6.7	7.0
ROE (%)	9.7	11.4	10.5
Div. Yield (%)	0.9	0.9	0.9

Positive – likely removal of Mahan coal block from the No-Go zone

Newspaper reports indicate that the Mahan coal block is part of six coal blocks (which were stalled due to being included in a No-Go zone) that may be granted forest clearance. The Mahan coal block with total reserves of 150mn tonnes was jointly allotted to Hindalco (40% share) and the Essar Group (60% share). The Mahan coal block will cater to the captive requirements of the 359ktpa Mahan Aluminium smelter. Grant of stage 1 forest clearance will pave the way for allocation of coal block and will place Mahan Aluminium smelter amongst the lowest cost producers of aluminium. Captive coal block will enable Hindalco to save at least US\$300-400/ tonne over purchase of coal from e-auction or imports. We believe that Hindalco may take 12-15 months to start the coal mine after all regulatory approvals are in place.

Negative – further possible delays in commissioning of Utkal Alumina

Hindalco recently announced delay of 6 months in commissioning of the 1.5mtpa Utkal Alumina refinery; revised date is now end-2012. One of the reasons cited for delay was poor performance by contractors, especially in the area of civil construction. We believe that the even the revised date may be at risk. We understand that work for the refinery continues to face disruptions due to certain local issues which are beyond the control of the company. Any delay in commissioning and local issues may also lead to increase in project cost. Delay in commissioning of Utkal Alumina will force external purchase of alumina to feed the Mahan aluminium smelter in the interim.

Attractive valuations drive ADD rating

Hindalco currently trades at attractive valuations of 5.3X FY2012E and 4.9X FY2013E EBITDA adjusted for capital work-in-progress. Despite delay in commissioning of greenfield projects, Hindalco gets strong valuation support from the steady and growing EBITDA of Novelis. We reiterate our ADD rating on the stock with a fair value of Rs225/share. Our TP of Rs225 is based on (1) 6X multiple to standalone aluminium and copper business, (2) 6.5X EBITDA multiple to Novelis and (3) Rs14 to value of listed investments (after assigning 20% holding co discount). We assign book value to capital invested in new projects.

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Further delays likely in commissioning of Greenfield projects

Details of Hindalco's planned capacity expansions

Project Name	Commissioning date			Project type	Capacity (ktpa)	Capex (Rs bn)
	1 year ago	6 months ago	Revised			
1. Brownfield Expansion Projects						
Hirakud Smelter & Power expansion:						9
155 KTPA to 161 KTPA	Q2FY11	Q4FY11	Completed	Smelter	8	
161 KTPA to 213 KTPA	Q4FY12	Q4FY12	Q4FY12	Smelter	52	
213 KTPA to 360 KTPA				Smelter	147	
Flat rolled products at Hirakud	Q2FY12	Oct-11	End- 2011	FRP		9
Belgaum Special Alumina Project	Not finalised	Not finalised	Not finalised	Alumina refinery	178	
2. Greenfield Projects						
UTKAL Alumina Project	Q2FY12	Early 2012	2012	Alumina refinery	1500	76
Mahan Aluminium Project	Q2FY12	Oct-11	End- 2011	Smelter	359	105
Aditya Aluminium Project	Q3FY12	End 2012	Early 2013	Smelter	359	92
Aditya Refinery Project	Q1FY14	End 2014	End 2014	Alumina refinery	1500	60
Jharkhand Aluminium Project	Q1FY14	Mid 2015	2015	Smelter	359	100
Total						450

Note:

1. UTKAL Alumina project cost has gone up by Rs6 bn owing to additional cost incurred towards contractors.
2. Mahan Aluminium project cost has gone up by Rs13 bn on higher financing cost.
3. Aditya Alumina and Aditya and Jharkhand aluminium project costs does not include any financing costs and may be revised upwards.

Source: Company, Kotak Institutional Equities estimates

Hindalco Industries, key assumptions, March fiscal-year ends, FY2008-2013E (Rs mn)

	2008	2009	2010	2011E	2012E	2013E
Aluminium						
Hindalco						
Aluminium price (US\$/tonne)	2,623	2,234	1,868	2,257	2,400	2,450
Metal sales volume (tonnes)	473,118	521,069	555,066	538,890	571,780	687,750
Blended realization (Rs/tonne)	131,937	127,384	110,516	131,939	138,526	137,549
Cost/tonne (US\$/tonne)	2,141	1,983	1,710	2,208	2,354	2,437
EBITDA/tonne (US\$/tonne)	1,298	937	722	831	798	782
Aluminium EBITDA (Rs mn)	24,711	22,428	19,045	20,415	20,749	23,654
Alumina price (US\$/tonne)	370	278	300	330	372	404
Alumina sales volume (tonnes)	259,627	238,350	241,095	320,720	332,900	186,398
Alumina EBITDA (Rs mn)	3,232	3,237	3,198	3,294	3,320	2,108
Alumina EBITDA (US\$/ tonne)	309	296	279	225	219	257
Novelis						
Average realization (US\$/tonne)	3,570	3,458	3,039	3,415	3,674	3,756
Conversion premium (US\$/tonne)	947	1,224	1,171	1,158	1,274	1,306
Shipments ('000 tonnes)	3,150	2,943	2,854	3,097	3,236	3,382
EBITDA/tonne (US\$/tonne)	169	192	380	302	357	367
EBITDA (US\$ mn)	533	566	1,085	935	1,156	1,242
EBITDA (Rs mn)	21,448	25,997	51,538	42,636	52,597	54,638
Copper						
Price (US\$/tonne)	7,521	5,885	6,112	8,300	8,800	8,360
Copper cathode volumes (tonnes)	180,668	153,236	185,213	188,060	213,652	209,112
Copper rods volumes (tonnes)	138,543	146,323	146,164	145,470	149,834	154,330
EBITDA (Rs mn)	6,693	5,476	8,256	7,720	9,192	8,988

Source: Company, Kotak Institutional Equities estimates

Hindalco (standalone), Profit model, balance sheet and cash flow model, March fiscal year-ends, 2008-2013E (Rs mn)

	2008	2009	2010	2011E	2012E	2013E
Profit model (Rs mn)						
Net sales	192,010	182,197	195,363	238,592	283,082	282,063
EBITDA	34,011	30,359	29,499	31,854	32,275	33,713
Other income	4,929	6,367	2,599	3,168	4,691	5,236
Interest	(2,806)	(3,369)	(2,780)	(2,200)	(900)	(3,139)
Depreciation	(5,878)	(6,453)	(6,672)	(6,875)	(7,472)	(8,133)
Profit before tax	30,256	26,903	22,646	25,947	28,594	27,678
Extraordinaries	5,407	1,508	1,132	—	—	—
Taxes	(7,053)	(6,109)	(4,621)	(4,578)	(6,291)	(6,089)
Reported net income	28,609	22,303	19,156	21,369	22,303	21,589
Adjusted net income	23,203	20,794	18,025	21,369	22,303	21,589
Fully diluted EPS (Rs)	16.8	13.1	10.0	11.2	11.7	11.3
Balance sheet (Rs mn)						
Equity	174,359	237,583	279,110	297,000	316,280	334,845
Deferred tax liability	13,237	14,107	13,664	12,875	12,976	14,665
Total Borrowings	83,286	83,243	63,569	72,715	152,715	222,715
Current liabilities	38,008	26,721	60,134	78,388	79,864	73,105
Total liabilities	308,889	361,653	416,477	460,978	561,835	645,330
Net fixed assets	78,093	78,869	77,348	73,469	68,998	176,091
Capital work in progress	11,198	13,896	37,028	97,014	178,152	155,864
Goodwill	—	—	—	—	—	—
Investments	141,080	191,489	214,808	182,468	182,468	182,468
Cash	1,470	8,437	1,402	2,334	21,836	21,947
Other current assets	77,047	68,962	85,891	105,693	110,381	108,961
Miscellaneous expenditure	1	—	—	—	—	—
Total assets	308,889	361,653	416,477	460,978	561,835	645,330
Free cash flow (Rs mn)						
Operating cash flow excl. working capital	20,273	19,360	18,846	18,333	14,999	10,344
Working capital changes	(5,671)	3,777	(8,090)	(334)	(3,211)	(5,340)
Capital expenditure	(40,240)	(113,736)	(34,353)	(58,709)	(73,954)	(77,108)
Free cash flow	(25,638)	(90,598)	(23,596)	(40,710)	(62,166)	(72,103)
Ratios						
EBITDA margin (%)	17.7	16.7	15.1	13.4	11.4	12.0
EBIT margin (%)	14.7	13.1	11.7	10.5	8.8	9.1
Debt/equity (X)	0.5	0.4	0.2	0.2	0.5	0.7
Net debt/equity (X)	(0.1)	0.1	0.0	0.0	0.2	0.4
Net debt/EBITDA (X)	(0.4)	1.1	0.2	0.4	2.3	4.3
RoAE (%)	15.5	10.1	7.0	7.4	7.3	6.6
RoACE (%)	8.1	5.7	5.0	5.4	4.3	3.7

Source: Company, Kotak Institutional Equities estimates

Hindalco (consolidated), Profit model, balance sheet and cash flow model, March fiscal year-ends, 2008-2013E (Rs mn)

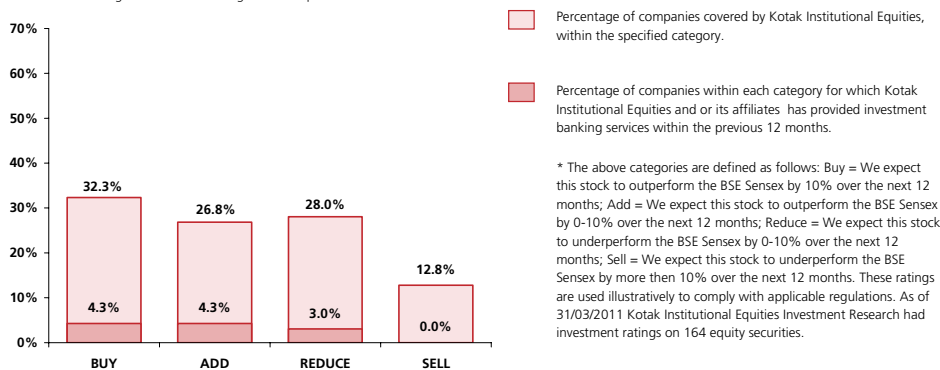
	2008	2009	2010	2011E	2012E	2013E
Profit model (Rs mn)						
Net sales	600,128	656,252	607,221	720,779	847,959	863,359
EBITDA	66,351	53,584	97,458	80,017	93,515	95,919
Other income	6,560	6,878	3,227	4,309	5,428	6,201
Interest	(18,491)	(12,323)	(11,041)	(18,393)	(15,552)	(17,360)
Depreciation	(24,883)	(30,378)	(27,836)	(27,500)	(29,001)	(29,620)
Profit before tax	29,537	17,761	61,808	38,432	54,390	55,140
Extraordinaries	5,481	(22,319)	1,030	100	—	—
Taxes	(11,889)	8,046	(19,319)	(9,739)	(14,779)	(15,210)
Profit after tax	23,130	3,488	43,519	28,793	39,611	39,929
Minority interest	(2,194)	1,718	(4,237)	(3,659)	(4,126)	(3,719)
Share in profit/(loss) of associates	998	(353)	(27)	(571)	(571)	(571)
Reported net income	21,933	4,853	39,255	24,564	34,914	35,639
Adjusted net income	16,452	19,791	38,225	24,463	34,914	35,639
Fully diluted EPS (Rs)	12.9	11.6	20.0	12.8	18.2	18.6
Balance sheet (Rs mn)						
Equity	172,866	158,536	215,446	290,233	322,123	354,739
Deferred tax liability	41,723	27,571	39,382	37,596	37,697	39,386
Total Borrowings	323,524	283,098	239,987	276,920	356,512	424,471
Current liabilities	172,201	162,602	180,166	216,840	224,457	216,044
Minority interest	16,154	12,866	17,372	22,169	26,295	30,014
Total liabilities	726,467	644,672	692,353	843,758	967,084	1,064,654
Net fixed assets	267,820	275,249	290,006	297,374	347,186	441,162
Capital work in progress	24,571	29,495	58,008	122,014	178,152	155,864
Goodwill	79,247	42,908	—	35,973	—	—
Investments	140,077	104,308	112,455	108,549	107,978	107,407
Cash	17,169	21,918	21,954	25,563	65,788	88,933
Other current assets	197,574	170,791	209,930	254,285	267,980	271,289
Miscellaneous expenditure	10	4	—	—	—	—
Total assets	726,467	644,672	692,353	843,758	967,084	1,064,654
Free cash flow (Rs mn)						
Operating cash flow excl. working	27,709	(7,156)	39,333	54,707	63,284	65,038
Working capital changes	7,576	29,309	(5,984)	(7,680)	(6,077)	(11,722)
Capital expenditure	(166,531)	(28,898)	(41,708)	(78,300)	(98,979)	(101,308)
Free cash flow	(131,247)	(6,744)	(8,359)	(31,273)	(41,772)	(47,992)
Ratios						
EBITDA margin (%)	11.1	8.2	16.0	11.1	11.0	11.1
EBIT margin (%)	6.9	3.5	11.5	7.3	7.6	7.7
Debt/equity (X)	1.9	1.8	1.1	1.0	1.1	1.2
Net debt/equity (X)	1.2	1.4	0.7	0.7	0.7	0.8
Net debt/EBITDA (X)	3.2	4.1	1.6	2.4	2.5	2.9
RoAE (%)	10.9	11.9	20.4	9.7	11.4	10.5
RoACE (%)	7.9	5.4	10.4	7.7	7.5	6.6

Source: Company, Kotak Institutional Equities estimates

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Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of March 31, 2011

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