EQUITY RESEARCH — **September 22, 2009**

RESULTS REVIEW

Share Data

Market Cap	Rs. 234.4 bn
Price	Rs. 363.80
BSE Sensex	16,886.43
Reuters	NALU.BO
Bloomberg	NACL IN
Avg. Volume (52 Week)	0.1 mn
52-Week High/Low	Rs. 425/108.35
Shares Outstanding	644.3 mn

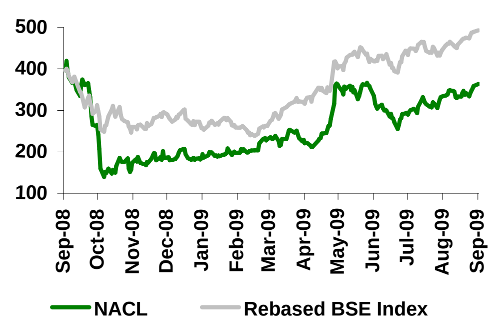
Valuation Ratios

Year to 31 March	2010E	2011E
EPS (Rs.)	12.9	18.5
+/- (%)	(34.6)%	43.0%
PER (x)	28.2x	19.7x
EV/ Sales (x)	4.3x	3.4x
EV/ EBITDA (x)	16.6x	10.9x

Shareholding Pattern (%)

Promoters	87
FIIs	4
Institutions	5
Public & Others	4

Relative Performance



National Aluminium Company Ltd — Sell

Not out of the deep end yet

In Q1'10, National Aluminium Company Limited's (NALCO's) net sales declined by 37.2% yoy to Rs. 9.2 bn and EBITDA fell by 79.1% yoy to Rs. 1.5 bn, mainly on account of a decline in average sale realisations. The average sales realisation for Aluminum (Al) in Q1'10 was USD 1,508 per tonne, as compared to USD 3,040 per tonne in Q1'09, lower by ~50% yoy. The LME Al prices has recovered sharply from last year's lows; however, considering the Al inventory that has piled up at LME and the excess capacity (on account of production cuts across the world), we expect Al prices to remain under pressure in the near-to-medium term.

Resumption of idle capacity to put pressure on Al prices: The LME Al prices have rallied sharply since February 2009, driven by the Chinese State Reserve Bureau's (SRB's) restocking and by an expected recovery in the economy. However, we believe that this rally in the LME Al prices is going to be short-lived, especially with LME inventory piling up (LME inventory has soared to ~4.6 mn tonne, ~12% of last year's production), coupled with the increase in supply (as China has restarted 1.28 million tonnes of idle capacity) will lead to a global-demand supply imbalance and should restrict a further rise in the Al prices. Accordingly, we believe that the LME Al prices will remain under pressure, and expect them to be around USD 1,800 per tonne in FY10, as compared to the current price of USD 1,920 per tonne.

Increased capacities, recovery in domestic demand to boost volume growth: NALCO has increased its Alumina and Al production capacities by 0.5 mn tonne to 2.1 mn tonnes, and by 0.1 mn tonnes to 0.46 mn tonnes, respectively. With the commissioning of new capacities, coupled with the recovery in demand in the Electrical and Power Equipment segment (which

Key Figures

Quarterly Data	Q1'09	Q4'09	Q1'10	YoY%	QoQ%
(Figures in Rs. mn, except per share data)					
Net Sales	14,675	10,885	9,216	(37.2)%	(15.3)%
EBITDA	7,368	584	1,537	(79.1)%	163.3%
Adjusted Net Profit	5,253	829	1,265	(75.9)%	52.5%
Margins(%)					
EBITDA	50.2%	5.4%	16.7%		
NPM	35.8%	7.6%	13.7%		
Per Share Data (Rs.)					
Adjusted EPS	8.2	1.3	2.0	(75.9)%	52.5%

contributes ~70% of Nalco's revenue), the Automobile and Construction segments should result in the volume growth to the company. Consequently, we expect the Al sales volume to increase to 0.37 mn tonne and 0.43 mn tonnes in FY10 and FY11, respectively, as against 0.34 mn tonne in FY09.

Decline in price realisation to drag the Company's margins: With the steep fall in LME prices, the average sales realisation of the Company is expected to decline by ~18% yoy in FY10. This decline in sales realisation will drag the EBITDA margins of the Company. However, the fall will be moderated by the decline in power and fuel costs, which is a result of the dip in coal prices. Accordingly, we expect the Company's EBITDA margin to decline by ~7pts to ~26% in FY10.

Valuation

At the current market price (CMP) of Rs. 363.8, the stock is trading at a forward P/E 28.2x and 19.7x for FY10 and FY11, respectively.

Based on DCF valuation, we have arrived at a target price of Rs. 279 (assuming a 14.8% WACC and a 5% terminal growth rate). Since our target price provides a downside potential of 23% from the CMP, we have maintained our Sell rating for the stock.

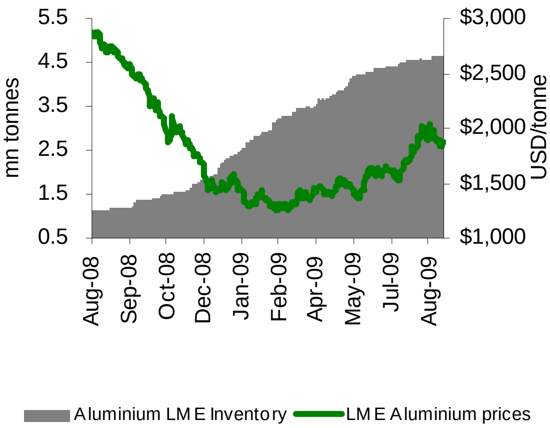
As the DCF valuation is sensitive to the changes in WACC and terminal growth rate, we have performed a sensitivity analysis of the same.

		WACC (in %)				
		13.8	**14.3**	**14.8**	**15.3**	**15.8**
Terminal growth (in %)	**3.0**	276	264	253	244	235
	4.0	290	277	265	254	244
	5.0	309	293	279	266	255
	6.0	331	313	296	281	268
	7.0	361	338	318	300	285

Result Highlights & Outlook

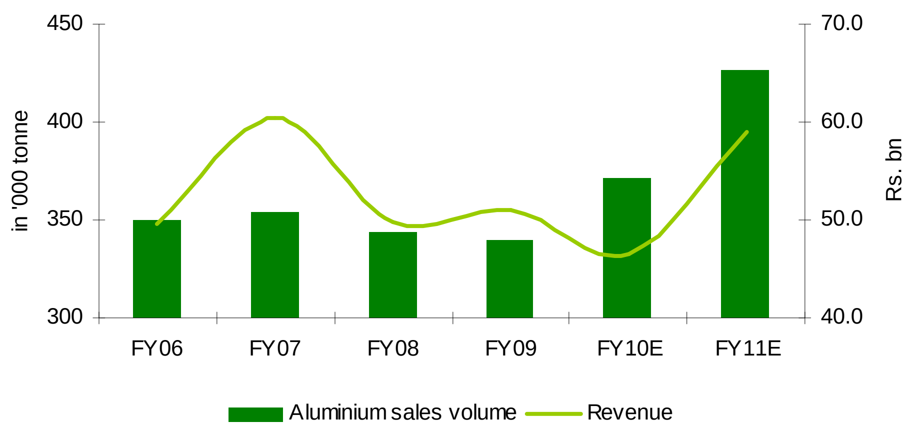
In Q1'10, NALCO reported a weaker set of numbers. Net sales declined by 37.2% yoy to Rs. 9.2 bn, mainly on account of the sharp fall in the average sales realisation of the Company. During the quarter, the Al sales volumes increased by 11.1% yoy to 93,104 tonnes, however, a decline in the average sales realisation for Al to USD 1,508 per tonne, as against USD 3,040 per tonne in Q1'09, lower by ~50% yoy, led to a steep decline in revenue.

Rising Inventory- cause of concern



With the recovery in the key sectors such as Power, Automobile, and Infrastructure, the demand for Al is expected to pick up in the latter half of the year. Additionally, the stabilisation of new installed capacities should result in sales volume growth for the Company. Accordingly, we expect the Company's Alumina and Al sales volumes to increase by ~3% and ~10%, respectively, in FY10.

On the realisation front, average Al prices are expected to decline by ~18% in FY10 to around USD 1,800 per tonne, mainly on account of excess capacities and higher LME inventory. We believe that, for FY10, the decline in average sales realisation will overshadow the benefit resulting from the increase in sales volumes. Accordingly, we expect the top line of the Company to decline by ~9% in FY10.

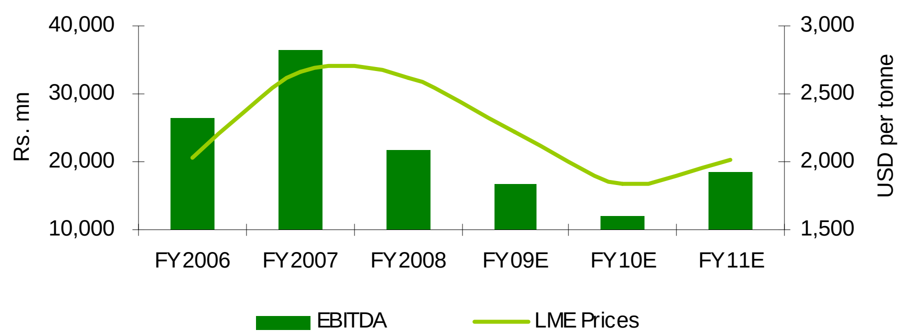


Margins to remain under pressure

In Q1'10, EBITDA sunk 79.1% yoy to Rs. 1.5 bn and the EBITDA margin declined by a massive 33.5pts to 16.7%, mainly due to lower sales realisation, increased staff costs (10.1% yoy) and higher other expenses (15.8% yoy). During the quarter, the cost of production for Alumina and Al increased to 9,379 per tonne and 81,601 per tonne, respectively, as compared to 9,140 per tonne and 74,000 per tonne, respectively, in Q1’09.

Going forward, we expect the Company’s EBITDA margin to decline by ~7pts in FY10, mainly on account of the expected decline in the average sales realisation. In FY09, the Company has faced significant pressures on its EBITDA margins due to rising coal prices. As coking coal is a key input material, the substantial increase in the coal prices had resulted in a 30% yoy and 39% yoy increase in the raw material and power and fuel costs, respectively.

EBITDA following the realisation trend



The coal prices have now eased considerably and we expect power and fuel costs to also fall in FY10, primarily due to lower coal prices. However, we believe that the expected decline in lower realisations will overshadow the benefit resulting from the lower input prices. Thus, we expect the Company’s EBITDA margin to be ~26% in FY10, compared with 32.9% in FY09.

Key Figures

Year to March	FY07	FY08	FY09	FY10E	FY11E	CAGR (%)
(Figures in Rs. mn, except per share data)						(FY09-11E)
Net Sales	59,402	49,888	51,081	46,592	58,902	7.4%
EBITDA	36,332	21,882	16,812	12,197	18,487	4.9%
Adjusted Net Profit	23,926	16,484	12,723	8,316	11,895	(3.3)%
Margins(%)						
EBITDA	61.2%	43.9%	32.9%	26.2%	31.4%	
NPM	40.3%	33.0%	24.9%	17.8%	20.2%	
Per Share Data (Rs.)						
Adjusted EPS	37.1	25.6	19.7	12.9	18.5	(3.3)%
PER (x)	6.3x	14.2x	10.8x	28.2x	19.7x	

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