Nat Resources & Energy
Metals & Mining
Equity – India

Hindalco (HNDL IN)

Neutral (V)

Target price (INR)	130.00
Share price (INR)	110.80
Forecast dividend yield (%)	1.4
Potential return (%)	18.7

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Performance	1M	3M	12M
Absolute (%)	-8.2	-25.2	-40.7
Relative^ (%)	-0.9	-15.9	-33.0

Index^	BOMBAY SE IDX
RIC	HALC.BO
Bloomberg	HNDL IN
Market cap (USDm)	3,805
Market cap (INRm)	212,582
Enterprise value (INRm)	393,695
Free float (%)	100

Note: (V) = volatile (please see disclosure appendix)

24 May 2012

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N(V): Valuations interesting, but little to get excited about

- **Novelis adjusted EBITDA at USD233m marginally below our estimates of USD250m; volumes surprise negatively**
- **NVL business might improve in FY13; but subdued aluminium price expectations prevent us from getting bullish**
- **Roll forward valuations to FY14e; cut TP to INR130 (was INR170) on lower multiples; retain N(V) rating**

Novelis (HNDL's 100%-owned subsidiary) 4Q EBITDA marginally below estimates; volumes surprise negatively

- Shipments for 4Q fell c8% y-o-y with sharpest fall in Asia (down c18% y-o-y) as lower electronics demand hurt volumes
- EBITDA/t increased to USD331/t for 4Q, but stayed below FY12 average of USD371/t
- Expansions are on track with Brazil (c220ktpa) commissioning by end CY12; contracting volumes might not be easy though, in difficult end-markets
- Guidance for EBITDA and FCF before capex in FY13 was flat.

Novelis business might show signs of improvement in FY13

The management did communicate that the underlying business dynamics are improving and that 1QFY13 results should be better than 4QFY12. However, we note that in 2HFY12, volumes have fallen 9% y-y and average EBITDA/t was lower by USD80/t (partly explained by lower volumes) over 1H. We were also surprised that usually considered a stable business (beverage cans) also showed decline in volumes in 2H. In addition, Novelis did miscalculate the extent of electronics demand, following which they had to shift mix, which impacted volumes. With that getting under control and concerns over the external operating environment subsiding, we believe volumes and margins may return to normal in FY13, although we do not build huge EBITDA upside vs FY12.

But, expectations of subdued aluminium prices prevent us from getting bullish

Aluminium prices have corrected 15% since the recent peak in Mar-12 and we believe prices will continue to remain subdued over the coming quarters (for further discussion on this, please refer to section on page 4)

Cut TP to INR130 from INR170; stay N(V) on the stock

Our TP is based on 5.5x EV/EBITDA multiple for standalone business and 6x EV/E multiple for Novelis. HNDL now trades 0.53x FY14e book, but given the low RoCE (c8%) for Novelis business, stability of earnings and growth in FCF is imperative for us to keep valuing that business at 6x EV/E, which is difficult to come by in FY13 at least. We stay N(V) on HNDL.

HSBC

Financials & valuation

Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRm)				
Revenue	720,779	767,737	831,752	877,145
EBITDA	80,017	83,051	89,340	104,175
Depreciation & amortisation	-27,500	-28,532	-33,854	-39,024
Operating profit/EBIT	52,517	54,519	55,486	65,151
Net interest	-18,393	-16,554	-14,899	-13,409
PBT	38,432	44,010	43,126	54,280
HSBC PBT	38,432	44,010	43,126	54,280
Taxation	-9,638	-11,003	-10,781	-13,570
Net profit	24,564	29,201	28,157	36,104
HSBC net profit	24,564	29,201	28,157	36,104
Cash flow summary (INRm)				
Cash flow from operations	62,263	53,806	58,077	70,395
Capex	-77,171	-59,626	-104,969	-114,856
Cash flow from investment	-67,104	-59,626	-104,969	-114,856
Dividends	-3,838	-6,415	-6,415	-6,415
Change in net debt	33,323	12,330	53,306	50,875
FCF equity	-32,217	-11,865	-49,429	-46,999
Balance sheet summary (INRm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	455,361	486,454	557,569	633,401
Current assets	279,848	260,036	264,473	269,595
Cash & others	25,563	1,884	2,261	2,713
Total assets	843,759	855,040	930,592	1,011,546
Operating liabilities	216,840	212,878	208,818	204,148
Gross debt	276,920	265,570	319,253	370,581
Net debt	251,356	263,686	316,992	367,868
Shareholders funds	327,829	350,615	372,357	402,047
Invested capital	492,806	531,728	610,964	696,135

Ratio, growth and per share analysis

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	18.7	6.5	8.3	5.5
EBITDA	8.1	3.8	7.6	16.6
Operating profit	13.7	3.8	1.8	17.4
PBT	-37.8	14.5	-2.0	25.9
HSBC EPS	55.4	18.9	-10.6	28.2
Ratios (%)				
Revenue/IC (x)	1.7	1.5	1.5	1.3
ROIC	9.0	8.0	7.3	7.5
ROE	8.4	8.6	7.8	9.3
ROA	5.5	5.3	4.9	5.2
EBITDA margin	11.1	10.8	10.7	11.9
Operating profit margin	7.3	7.1	6.7	7.4
EBITDA/net interest (x)	4.4	5.0	6.0	7.8
Net debt/equity	71.8	70.0	78.8	84.2
Net debt/EBITDA (x)	3.1	3.2	3.5	3.5
CF from operations/net debt	24.8	20.4	18.3	19.1
Per share data (INR)				
EPS reported (fully diluted)	12.83	15.25	13.64	17.49
HSBC EPS (fully diluted)	12.83	15.25	13.64	17.49
DPS	1.50	1.50	1.50	1.50
Book value	171.23	183.13	194.48	209.99

Key forecast drivers

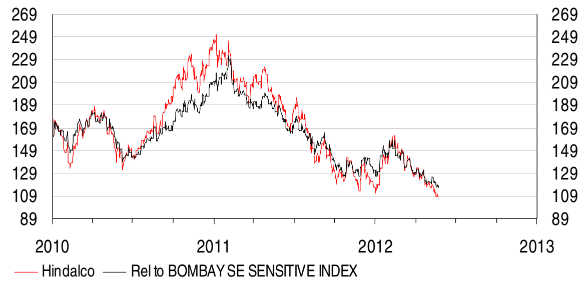
Year to	03/2011a	03/2012e	03/2013e	03/2014e
Alumina production (kt)	1,353	1,425	1,425	2,250
Aluminium production (kt)	538	555	670	810
Copper cathode production (kt)	336	330	330	330
Novelis shipments (kt)	2,969	2,838	2,980	3,129
USD:INR	45.59	48.06	49.38	48.93

Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	0.5	0.5	0.5	0.6
EV/EBITDA	4.7	4.7	5.1	4.9
EV/IC	0.8	0.7	0.7	0.7
PE*	8.6	7.3	8.1	6.3
P/Book value	0.6	0.6	0.6	0.5
FCF yield (%)	-25.5	-9.1	-36.8	-33.9
Dividend yield (%)	1.4	1.4	1.4	1.4

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 24 May 2012

Exhibit 1: Novelis 4Q-12 results ; Adjustments made simpler

	Included in Operating or Recurring (O/R) EBITDA calculation?	4QFY12	3QFY12	4QFY11	Growth (%)		What is it; and why should/ should not be included in EBITDA calculation
(USDm)		**JFM 2012**	**OND 2011**	**JFM 2011**	**qoq**	**yoy**	
Net income as reported		(107)	(12)	50	**nm**	**(314.0)**	
Add: net interest		73	71	79			
Add: income taxes		(3)	(10)	(21)			
Add: D&A		80	79	97			
Add: Non controlling interests		1	1	13			
Standard EBITDA		**44**	**129**	**218**	**(65.9)**	**(79.8)**	**Standard, Unadjusted EBITDA**
Less Adjustments for:							
Unrealized gain or loss on dervs	**YES**	(23)	(63)	(27)			This includes both realized (reported separately in Statement of Operations) as well as unrealized (included as part of COGS/Revenues in Statement of Operations). Should be added/(reduced) for calculating O/R EBITDA
Goodwill impairment	**YES**	-	-	-			Impairment charged through P&L. Although operating, not recurring and therefore needs to be added to find O/R EBITDA
Gain on debt exchange	**YES**	-	-	-			Neither operating, nor recurring. Should be reduced from O/R EBITDA
Proportionate consolidation	**NO**	(15)	(9)	(14)			NVL's stake of gain/loss for the period in JV. It is clearly operating and may/may not be recurring. Should NOT be added back to O/R EBITDA
Restructuring charges	**NO**	(29)	(1)	1			Restructuring now will lead to higher revenues later. Should be treated as operating expense and NOT be added to O/R EBITDA
Other costs		**(13)**	**(8)**	**(13)**			
Metal price lags	***NO***	(19)	8	(3)			Results from timing difference between NVL purchasing ingots and charging them to clients. NVL has risk management program to minimize the lag. BUT, lag is a legitimate loss that is not recoverable. Should NOT be added back/(reduced) to/(from) O/R EBITDA
Forex re-measurement	***YES***	(4)	(2)	9			Results from remeasuring Assets/Lia based on period-end forex rates. Not operating; may/may not be recurring. Should be added back/(reduced) to calculate O/R EBITDA
Purchase accounting	***YES***	(3)	(3)	(3)			PV of future can sheet losses bundled-up and reduced from Net Worth, so that impact on profitability is minimal. Should be added/(reduced) from O/R EBITDA
Can price ceiling	***YES***	-	-	-			Results from fixed-price contracts of NVL; not-recurring from Jan-10. Although operating, not recurring post Jan-10. Should be added back to O/R EBITDA
Others	**NO**	13	(11)	(16)			**Detailed information not available on break-up of these items; therefore not classified as O/R item**
Adjusted EBITDA		**233**	**213**	**280**	**9.4**	**(16.8)**	
Our calculation of EBITDA		**183**	**200**	**248**	**(8.5)**	**(26.2)**	

Source: Company data, HSBC [Note: O/R stands for Operating/ Recurring]

Exhibit 2: Novelis operational performance

	4QFY12	3QFY12	4QFY11	Growth (%)	
	JFM 2012	**OND 2011**	**JFM 2011**	**qoq**	**yoy**
Shipments (kt)	**703**	**648**	**771**	**8.5**	**(8.8)**
NAFTA	254	248	280	2.4	(9.3)
Europe	228	183	240	24.6	(5.0)
Asia	124	117	152	6.0	(18.4)
South America	97	100	99	(3.0)	(2.0)
Revenues (USDm)	**2,608**	**2,462**	**2,960**	**5.9**	**(11.9)**
NAFTA revenues	821	912	1,097	(10.0)	(25.2)
Europe revenues	924	804	1,038	14.9	(11.0)
Asia revenues	398	398	526	-	(24.3)
South America revenues	336	321	338	4.7	(0.6)
Eliminations	129	27	(39)		
Per ton revenues (USD/ton)	**3,710**	**3,799**	**3,839**	**(2.4)**	**(3.4)**
NAFTA (US$/ton)	3,232	3,677	3,918	(12.1)	(17.5)
Europe (US$/ton)	4,053	4,393	4,325	(7.8)	(6.3)
Asia (US$/ton)	3,210	3,402	3,461	(5.6)	(7.2)
South America (US$/ton)	3,464	3,210	3,414	7.9	1.5
EBITDA (USD/ton)	**331**	**329**	**363**	**0.8**	**(8.7)**

Source: Company data, HSBC

HSBC

Little room for aluminium to surprise on upside

Aluminium prices have corrected 15% since the recent peak in Mar-12 and we believe prices will continue to remain subdued over the coming quarters. We had highlighted in our recent note, *If only ally could rally*, that despite the existence of some reasons why aluminium prices could theoretically rally, we see enough evidence that they might actually not.

We noted that these reasons would likely make investors believe that aluminium prices had a theoretical upside

- *(a) conversion spreads (measured as listed price of aluminium less alumina and power costs) are well below their historical highs,*
- *(b) c35% of global capacity is running in losses at current LME prices,*
- *(c) Integrated projects (the likes of HNDL's Mahan) would make only single-digit RoCE at current aluminium prices, and (d) c1,2mt of production cuts announced could get the markets in balance.*

However, we saw two reasons why aluminium prices may not rally back then:

- *(a) Strong Chinese aluminium production growth matches consumption growth,*
- *(b) Ex-China unprofitable capacity forms only 6% of global capacity and*
- *(c) Part of the c1.2mt closures relate to factors other than unprofitable aluminium prices and that restarts would happen.*

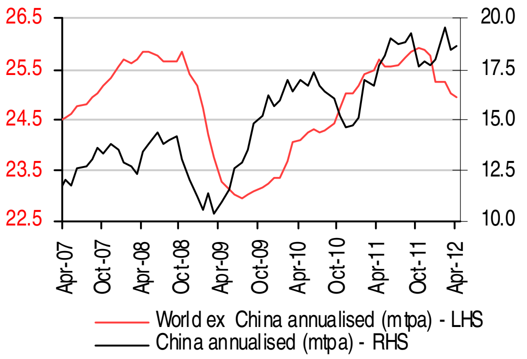
Three developments have happened since, two of which, reinforce our belief in our earlier stated hypothesis.

- Apr-12 aluminium production details released by International Aluminium Institute (IAI) and China Nonferrous Metals Industry Association (CINA) suggest that production actually increased (rather than falling due to adverse aluminium prices) by 131kt annualised in Apr-12. The break-up of production is more interesting where, Chinese annualised production increased 208kt which more than offset an 81kt decline in rest of world (RoW). YTD, the annualised figures for China stands at an 845kt increase over Jan-Dec 2011 against a 519kt decrease in RoW production over the comparable period. Some Chinese smelters are widely assessed as occupying the very top part of the cost curve; the resilience of the country's production might appear surprising. Some publications suggest that the smelter costs are actually a moving target, as higher-cost capacity closes in the east and is replaced by lower-cost capacity in northwest provinces. Secondly, point two below would as well, in part seek to explain the surprise.
- Physical premiums, which provide extra revenue over and above LME price of aluminium, have been rising across the globe despite apparently high LME inventory. Recently, US Midwest market hit all-time-high premiums of 10c/lb (cUSD220/t) and Rio Tinto recently proposed to increase quarterly premiums to record USD200/t (were USD122/t) for Jul-Sept12 shipments. Traditionally, these premiums have reflected interaction of regional demand-supply balance, but now – the equation of physical vs investment buyers for aluminium units is also in question leading to higher premiums despite almost c5mt of inventory in LME warehouses (which seems to be securely tied-up in financing arrangements), and

- Indonesia has proposed to ban bauxite exports. Now, China imported 36mt of bauxite from Indonesia (of 45mt), of which BrookHunt estimates it consumed c26mt by SGA refineries. The ban, if instituted, would then look to impact c30% of Chinese aluminium production capacity. Whereas there is a question whether the ban will, infact get instituted, we note that China has several options like c30 week equivalent imported bauxite stocks (imports hit new all-time record high in Apr at 4.6mt, up 53% y-y) which can be replenished, or there are other sources that can replace the Indonesian bauxite. Either outcome, will however, increase the cost of production for China - which would support Aluminium prices in the long run.

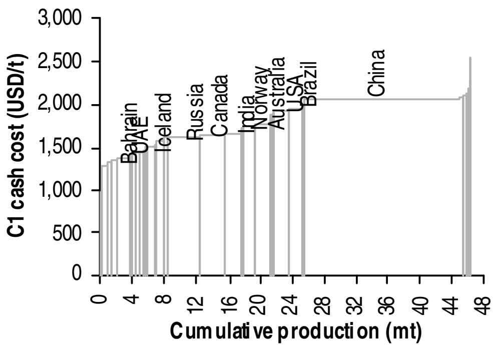
Lastly, with respect to the western production cutbacks, we note that the indication that the 1.06mt production fall since Oct-11 was a result of price-induced production constraint seems a bit deceptive. Around half of that figure reflects involuntary cutbacks, primarily the lock-out of Rio Tinto's Alma plant in Canada and what BHP Billiton has called 'a major unplanned outage' at its 715ktpa Hillside smelter in South Africa. Nevertheless, annualized production in Western Europe dropped to 3.6mt in Apr-12, its lowest since 2009.

Exhibit 3: The decline in RoW production is being more than offset by increase in Chinese production



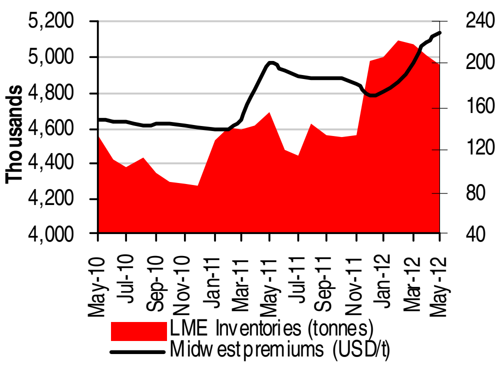
Source: International Aluminium Institute, CEIC

Exhibit 4: Which is surprising given China's position high up in the cost curve



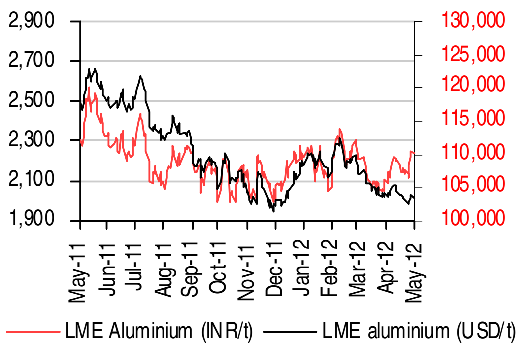
Source: Brook Hunt, HSBC

Exhibit 5: What has benefitted producers to an extent is higher metal premiums, mainly as spot supplies are choked due to material being locked in financing deals



Source: Thomson Financial Datastream, Bloomberg, HSBC

Exhibit 6: For Indian producers, the recent INR depreciation is a positive to an extent as LME in INR terms (RHS below) is still firm



Source: Thomson Financial Datastream, HSBC

HSBC

Change in estimates

Exhibit 7: Our earnings cuts are driven by lower aluminium volumes from Mahan in FY13 and a 3%/1% cut in volumes and 6%/3% cut in EBITDA at Novelis, the impact of which is offset by a 3%/5% weaker INR in FY13/14e respectively.

(INRm)	FY13e New	FY14e New	FY13e Old	FY14e Old	FY13e Change	FY14e Change
Sales	831,752	877,145	838,819	868,992	-1%	1%
EBITDA	89,340	104,175	91,412	104,606	-2%	0%
NPAT (HSBC)	28,157	36,104	30,184	37,082	-7%	-3%

Source: HSBC estimates

Valuations

We value HNDL on a FY14e (earlier FY13e) EV/EBITDA-based SOTP, with multiples of 5.5x (unchanged) for the Indian operations and 6.0x (was 6.5 earlier) for Novelis. We derive a TP of INR130 (was INR170). Our target price implies a potential return of 18.7% (including the expected dividend yield of 1% over the closing price of INR110.8 on 24 May 2012).

Under our research model, for stocks with a volatility indicator, the Neutral band is 10 ppts above and below the hurdle rate for Indian stocks of 11%. Our target price implies a potential return of 19%, within the Neutral band; therefore, we rate HNDL Neutral (V). Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated. Volatile ratings are defined as stocks having historical volatility (defined as the past month's average of the daily 365-day moving average volatilities) of more than 40%.

Exhibit 8: We value HNDL at INR130/share on FY14 EV/EBITDA

	Valuation base	EBITDA (INR bn)	EV/EBITDA (x)	EV (INR bn)	Stake (%)	Attributable EV (INR mn)	Attributable EV (USD mn)	Value (INR/share)
Hindalco standalone	2014	46,123	5.5	253,678	100	253,678	5,637	132
Novelis standalone	2014	56,640	6.0	339,840	100	339,840	7,552	177
ABML	2014			17,118	51	8,730	194	5
Other joint ventures	2014	1,412	5.5	7,764	100	7,764	173	4
Enterprise value		**104,175**		**618,400**		**610,012**	**13,556**	**319**
Less: Net debt	**2014**					**355,417**	**7,898**	**186**
Target valuation						**254,595**	**5,658**	**133**
Valuation (INR/share)								**130**

Source: HSBC estimates

Risks

Higher (lower)-than-estimated aluminium prices pose positive (negative) risks for HNDL's standalone earnings. Profitability of Mahan Aluminium will depend on availability of captive coal and therefore an early resolution to deadlock on the coal block approval could impact stock movement positively although positive impact on earnings would take c15months from the date of approval of the block. High financial leverage creates high earnings sensitivity and is negative in downcycles. Weaker than expected market conditions in key markets could hurt Novelis' profitability. Our EPS estimates are dependent on our INR:USD assumptions given 1) pricing of aluminium/copper in USD terms while expenses are largely in INR terms 2) translation of Novelis' (US based subsidiary) earnings into INR. 1% depreciation (appreciation) of INR, increases (decreases) EPS by 4%. Hence our base case is tied to HSBC's exchange rate view even though spot rates are vastly different.

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Jigar Mistry

Important disclosures

Stock ratings and basis for financial analysis

HSBC believes that investors utilise various disciplines and investment horizons when making investment decisions, which depend largely on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations. Given these differences, HSBC has two principal aims in its equity research: 1) to identify long-term investment opportunities based on particular themes or ideas that may affect the future earnings or cash flows of companies on a 12 month time horizon; and 2) from time to time to identify short-term investment opportunities that are derived from fundamental, quantitative, technical or event-driven techniques on a 0-3 month time horizon and which may differ from our long-term investment rating. HSBC has assigned ratings for its long-term investment opportunities as described below.

This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings and other considerations. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations. Investors should carefully read the definitions of the ratings used in each research report. In addition, because research reports contain more complete information concerning the analysts' views, investors should carefully read the entire research report and should not infer its contents from the rating. In any case, ratings should not be used or relied on in isolation as investment advice.

Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

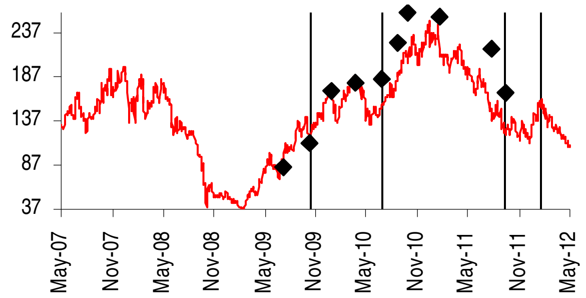
Rating distribution for long-term investment opportunities

As of 24 May 2012, the distribution of all ratings published is as follows:

Overweight (Buy)	49%	(26% of these provided with Investment Banking Services)
Neutral (Hold)	37%	(25% of these provided with Investment Banking Services)
Underweight (Sell)	14%	(16% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Hindalco (HALC.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Underweight (V)	Neutral (V)	04 November 2009
Neutral (V)	Overweight (V)	16 July 2010
Overweight (V)	Overweight	04 October 2011
Overweight	Neutral (V)	08 February 2012
Target Price	**Value**	**Date**
Price 1	85.00	31 July 2009
Price 2	111.00	04 November 2009
Price 3	172.00	21 January 2010
Price 4	180.00	19 April 2010
Price 5	185.00	16 July 2010
Price 6	225.00	13 September 2010
Price 7	260.00	17 October 2010
Price 8	255.00	13 February 2011
Price 9	220.00	15 August 2011
Price 10	170.00	04 October 2011

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
HINDALCO	HALC.BO	107.55	23-May-2012	2,4,7

Source: HSBC

1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
4 As of 30 April 2012 HSBC beneficially owned 1% or more of a class of common equity securities of this company.
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