AMBIT
Acumen at work

National Aluminium Co.

SELL

CHANGE IN STANCE | NACL IN EQUITY | July 15, 2014

Lack of triggers

We turn SELLers on Nalco after the recent stock price rally, as the stock is already factoring in a gradual increase in aluminium prices (as depicted by the forward curve). However, due to global overcapacity, aluminium prices face significant downside risks. Also, if the UK court allows the LME to implement warehousing reforms, aluminium prices could weaken. However, even if current aluminium prices sustain, we expect Nalco's RoEs to remain muted (~6-8% over FY15-17) and EPS growth to stagnate beyond FY16, given the limited visibility on future projects. Hence, the stock appears fully valued at an FY16 P/E of 12.6x and P/B of 1.0x.

Competitive position: WEAK   Changes to this position: STABLE

Aluminium: Price increase beyond fundamental improvements

Over the past three months, aluminium price + premiums have increased by ~9-16% across regions. Although, after many years, CY14 aluminium consumption could exceed production, the deficit (~0.9mt) is unlikely to have a material impact given global inventory of ~10mt. Moreover, we see downside risks to aluminium prices/ premiums if the UK court rules in favour of the LME allowing warehousing reforms resulting in inventory liquidation. However, for FY15/FY16, we have conservatively built in aluminium price of US$1,867/1,977 (in line with the forward curve) and premium of US$420/450 (similar to current levels).

Poor visibility on future projects

Poor visibility on key projects: **(a)** an alumina refinery in Gujarat in a JV with GMDC; **(b)** Utkal E coal block, and **(c)** nuclear power project in a JV with NPCIL. Each of these projects is in the initial stages and no material investment/timelines have been committed yet. Hence, we neither factor in capex nor the benefits from these projects into our estimates and valuation.

Upward revision to estimates driven by higher realisations

We raise our FY15/FY16 revenue estimates by 1%, as higher aluminium realisations are largely offset by lower alumina realisations. We raise our EBITDA estimates for FY15 by 9% and FY16 by 7%, due to higher aluminium realisations and stable power and fuel costs (as lower dependence on imported coal would be partially offset by rise in CIL's coal prices).

Valuations stretched; downgrade to SELL

We revise our DCF-based target price to ₹53 (from ₹43) due to: (b) revision to our EBITDA estimates; (c) roll forward of TP to September 2014; and (c) no investment assumed towards the NPCIL JV. Our TP implies an FY16 P/E of 12.6x (8-year average of 13.7x) and FY16 P/B of 1.0x (eight-year average of 1.7x). We believe the discount is justified given that Nalco's EBITDA margins have declined to 14% in FY14 (from 35% in FY09) and RoE has declined to 5.8% in FY14 (13.5% in FY09). On a P/B basis, Nalco trades at a premium to peers such as Hindalco, Rusal and Norsk Hydro. **Key risk:** higher aluminium prices/margins and progress on captive coal block.

Key financials

Year to March	FY12	FY13	FY14E	FY15E	FY16E
Net revenues (₹ mn)	66,116	69,165	67,809	73,307	78,685
EBITDA (₹ bn)	11,449	9,069	9,341	13,748	14,816
EBITDA margin (%)	17.6%	13.3%	14.0%	19.1%	19.2%
EPS (₹)	3.4	2.3	2.7	3.8	4.2
RoE (%)	7.6%	5.0%	5.8%	7.8%	8.3%
P/E (x)	15.7	23.0	19.7	14.1	12.6
P/B (x)	1.2	1.1	1.1	1.1	1.0

Source: Company, Ambit Capital research

Metals & Mining

Recommendation	SELL
Mcap (bn):	₹136/US$2.3
3M ADV (mn):	₹343/US$5.7
CMP:	₹53
TP (12 mths):	₹53
Downside (%):	0%

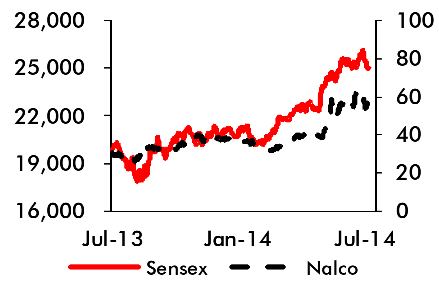
Flags

Accounting:	GREEN
Predictability:	RED
Earnings Momentum:	GREEN

Catalysts

- Fall in aluminium prices / premiums
- Rise in coal costs due to price hikes by Coal India
- Misutilisation of cash in projects such as nuclear power

Performance (%)



Source: Bloomberg, Ambit Capital research

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Aluminium: Price increase beyond fundamental improvements

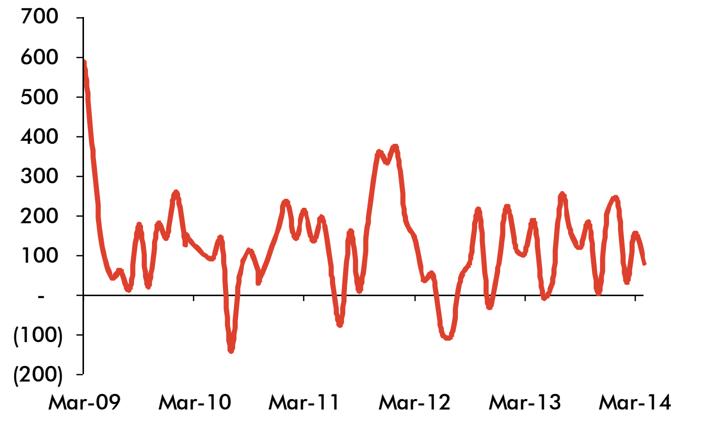
Supply-demand balance likely to improve but still a long way to go

The three key reasons for muted aluminium prices in recent years are: (1) excess production; (2) high aluminium inventories; and (3) low capacity utilisation/overcapacity. Aluminium production outpaced demand (see Exhibit 1 below), as production in CY13 exceeded consumption by 1.6mt vs 0.83mt in CY12.

From January to April 2014, global aluminium production exceeded consumption by 190kt. Aluminium makers expect world demand to grow at 6-7% in CY14. Further, on the back of ongoing production cuts, aluminium makers expect CY14 to be the first year since 2004 when consumption is likely to be higher than production. However, we highlight that Alcoa estimates an aluminium production deficit of merely 930kt in CY14 vs existing inventory (LME + non LME) of more than 10mt; we do not expect the deficit of CY14, if any, to have any material impact on the fundamentals of aluminium.

Further, the demand growth estimate of 6-7% (by Alcoa and Rusal) for CY14 is based on the assumption that Chinese demand grows by 10%. Note that China constitutes ~47% of global aluminium production and consumption. With our house-view on a slowdown in the Chinese economy, actual demand growth could disappoint.

Exhibit 1: World production in excess of demand for the past few years (kt per month)



Source: Bloomberg, Ambit Capital research

Exhibit 2: Aluminium market likely to be in a deficit in CY14E (kt)

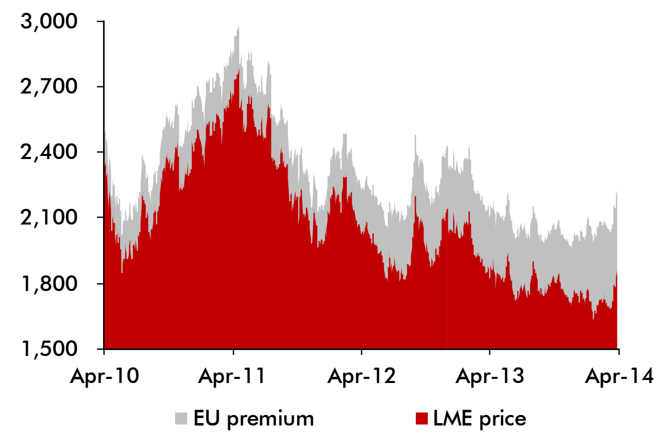
	China	Rest of the world	World
2013 Production	24,650	26,000	50,650
2014 Production to be added	1,704	465	2,169
2014 capacity to be curtailed	(799)	(155)	(954)
Total supply (2014)	**25,555**	**26,310**	**51,865**
Demand (2014)	(25,450)	(27,345)	(52,795)
Net balance (2014)	**105**	**(1,035)**	**(930)**

Source: Alcoa, Ambit Capital research

Aluminium prices + premiums increased 9-16% in the last three months

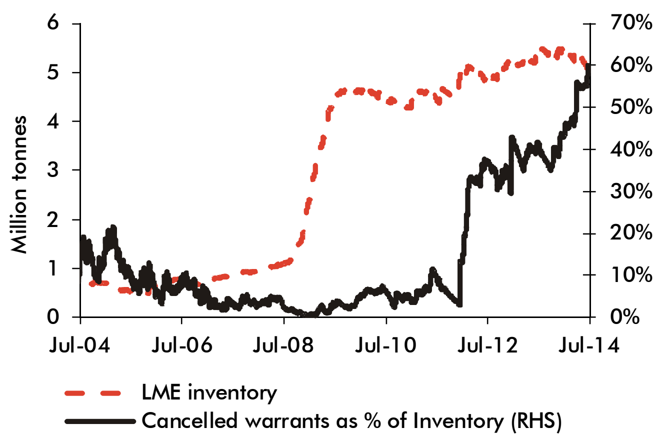
- **Aluminium prices inch higher:** Over the past three months, aluminium price + premiums have increased by ~9-16% across regions. Spot LME aluminium stands at US$1,913/t vs US$1,744/t (up 10% in three months). Similarly, physical premiums stand at US$400-430/tonne vs US$255-402/tonne.
- **Aluminium inventory remains high:** LME aluminium inventory remains high at 5mt (10% of annual consumption) and we also expect a similar quantum of inventory to be available at warehouses outside the LME. Further, cancelled warrants as a percentage of inventory remain high at 59%, which if liquidated poses a risk to aluminium prices.

Exhibit 3: LME price + EU premium (US$/tonne) up 9% since 27 March 2014



Source: Bloomberg, Ambit Capital research

Exhibit 4: Cancelled warrants as a percentage of inventory have also risen significantly



Source: Bloomberg, Ambit Capital research

LME appeal; downside risk to prices remains

On 7 November 2013, the LME had decided to reduce queues at all warehouses where the wait time was greater than 50 days. The rule named 'Linked Load-In Load-Out' was to be applied from 1 April 2014 which would ensure that these warehouses load out more than they load in. Shorter warehouse queues could have resulted in lower physical premiums and thereby lower realisations for aluminium producers.

However, fearing the consequences, Rusal (one of the world's largest aluminium producers) filed a case against the LME's proposed rules, alleging that the consultation suggested only one solution of reducing queues and did not consider any other option. On 27 March 2014, the court opined in favour of Rusal and stated that the consultation should have made reference to the option of banning or capping rent in queues. Thereafter, the LME appealed against the said ruling and the hearing is expected to begin from July 29, 2014.

The downside risks to aluminium prices/premiums remain, as: (a) the court could give a judgement in favour of LME allowing warehousing reforms to be implemented; (b) aluminium premiums could normalise from the all-time highs of ~US$400/t, closer to the recent levels of US$250/t; and (c) optimism from expectations that the aluminium market could go in a deficit in CY14 appear to be overdone, as the deficit of ~0.9mt is marginal as compared to the existing global aluminium inventory of ~10mt.

Aluminium price assumptions and sensitivity

We build in an average aluminium price of US$1,867 for FY15 and US$1,977 for FY16, implying 5.5% CAGR over FY14-16. Further, we build in aluminium premiums of US$420/t for FY15 and US$450/t for FY16. Every US$50/t increase/decrease in LME prices results in an increase/decrease of 6.8% on FY15 EBITDA and 6.5% on PAT.

Poor visibility on future projects

GMDC JV for alumina refinery yet to take off

Nalco plans to set up a 1mt alumina refinery in Gujarat, for which raw material would be sourced from bauxite deposits in the Kutch district of Gujarat. Initially, Nalco planned to set up the plant by itself. However, given that the bauxite reserves are owned by GMDC, Nalco has proposed that project should be implemented in the form of a JV between Nalco and GMDC. However, the equity share between Nalco and GMDC is yet to be finalised. It was initially proposed that GMDC would have a 26% stake in the venture; however, now Nalco has suggested that GMDC must take a higher stake (49%).

The project involves a capex of ₹60bn and construction of the alumina refinery is likely to take ~3 years. Nalco has guided to a capex of ₹5bn in FY15 towards the Gujrat refinery project. Assuming an EBIT of ~₹5,000/t (slightly higher than Nalco's existing refinery), the project is likely to generate an annual EBIT of ₹5bn (~8-10% RoCE pre-tax).

Utkal E faces delay in clearances

Nalco was allocated the Utkal E coal block in 2004. However, there has been little progress over the years and the project still awaits environmental and forest clearances. The total land required for the project is 1,400 acres, out of which ~500 acres is forest land and the rest is a mix of private and government land. Given that the clearances are still awaited, we do not expect savings in coal costs over the next two years.

NPCIL JV takes a back seat

Nalco had entered into a JV with the Nuclear Power Corporation of India (NPCIL) for a 26% equity stake to set up two nuclear power units at Kakrapar, Gujarat (unit 3 and unit 4) of 700MW each. These units are already under construction and are likely to be commercialised in FY16. The 26% equity stake purchase involved an investment of ~₹9bn by Nalco. Further, Nalco planned to increase its stake from 26% to 49% and thereby its investment in nuclear power from ₹9bn to ₹17bn. The history of nuclear power in India suggests that the plants usually have a long gestation period with low PLFs for many years even after commencement of generation. Our earlier estimates factored in an investment of ₹9bn in the NPCIL JV in FY14 and we did not ascribe any value to this investment.

Amendments, to allow investment by government companies in nuclear power plants, to the Atomic Energy Act 1962 are still awaited. Given that the same has been delayed for the past two years, Nalco has not been able to invest the allocated amount of ₹9bn since then. Our discussions with the management suggest NPCIL has already made significant progress in the construction of the plants, but Nalco is unlikely to be able to get a 26% equity stake in the project. **Hence, we do not allocate ₹9bn for investment in nuclear power anymore and thus increase our cash balance by ₹9bn (~₹3/share).**

Revisions to our estimates

Realisations: Although we largely retain our average LME aluminium forecasts for FY15-16, we revise our aluminium realisation estimates to factor in higher physical premiums. For FY15 and FY16, we raise our aluminium realisation estimates by 5% and 7% to factor in the recent rise in physical aluminium premiums from an average of US$250/t in FY14 to US$400/t currently.

On the other hand, we cut our FY15-16 alumina price estimates by 8-9%, as alumina prices as a percentage of aluminium prices have declined from 19.2% in 4QFY14 to 17.6% in 1QFY15 (vs 18.3% for FY14). We revise our FY15 alumina realisation estimate to US$327/t from US$341/t earlier. Similarly, we revise our FY16 alumina realisation estimate to US$346/t from US$359/t earlier.

Volumes: We retain our aluminium volume estimates of 320kt for FY15 and 328kt for FY16. We highlight that Nalco is currently running its smelter at a capacity utilisation of only 70%, as running the smelter above 70% utilisation would require purchase of coal at market prices, which makes it unviable at current aluminium realisations. The balance 30% capacity would be viable only if aluminium prices rise to ~US$2,100-2,200/t. Given the global overcapacity and high inventory, we do not expect aluminium prices to increase to ~US$2,100-2,200/t over the next 1-2 years.

We revise our alumina sales estimate upwards by 4% for FY15, as we factor in an alumina production of 2.1mt for FY15-16 vs 2.04mt earlier.

Revenues and margins: We raise our FY15 and FY16 revenue estimates by 1%, as higher aluminium realisations are largely offset by lower alumina realisations. Higher aluminium realisations coupled with our expectation of lower power and fuel costs due to lower dependence on imported and e-auction coal makes us raise our EBITDA estimates for FY15 by 9% and FY16 by 7%. As a result, we revise our margin estimate to 19% from 18% earlier.

PAT: We revise our PAT estimates upwards by 22% for FY15 and 26% for FY16 due to: (a) higher other income and (b) higher cash balance (as we do not expect Nalco to invest in the JV with NPCIL (~₹9bn for 26% stake estimated earlier).

Target price: We revise our target price to ₹53 from ₹43 earlier due to: (a) no investment assumed towards the NPCIL JV (as it appears unlikely); (b) upward revision to our EBITDA estimates; and (c) roll forward of TP to September 2014.

Exhibit 5: Changes to our estimates

	New estimates		Old estimates		% Change	
	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
Drivers						
USD-INR	60.0	60.0	60.0	60.0	-	-
Average LME Aluminium (US$/t)	1,867	1,977	1,877	1,977	(1)	-
Chemical sales (kt)	1,428	1,411	1,368	1,411	4	-
Aluminium sales (kt)	320	328	320	328	-	-
Chemical Realisation (₹/t)	19,625	20,785	21,484	22,634	(9)	(8)
Aluminium Realisation (₹/t)	137,130	145,590	130,350	136,350	5	7
Estimates						
Target Price	53		43		24	
Revenues (₹ mn)	73,307	78,685	72,502	78,264	1	1
EBITDA (₹ mn)	13,748	14,816	12,654	13,831	9	7
EBITDA margin (%)	19.1%	19.2%	17.8%	18.0%	132	118
PBT (₹ mn)	14,446	16,214	11,814	12,864	22	26
PAT (₹ mn)	9,679	10,863	7,916	8,619	22	26
EPS (₹)	3.76	4.22	3.07	3.34	22	26

Source: Ambit Capital research

Key assumptions and estimates

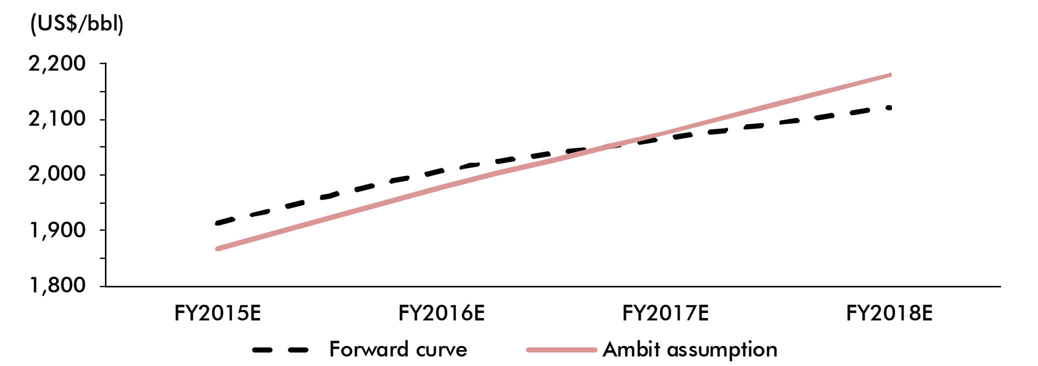
Exhibit 6: Key assumptions and estimates

Y/E Mar	FY12	FY13	FY14E	FY15E	FY16E	Comment
Pricing drivers						
USD-INR	47.9	54.4	60.4	60.0	60.0	We build in average aluminium prices of US$1,867 for FY15 and US$1,977 for FY16, implying 5.5% CAGR over FY14-16.
Average LME Alumina US$/t	356	328	324	329	348	
Average LME Aluminium US$/t	2,318	1,976	1,775	1,867	1,977	
Alumina/ Aluminium ratio (%)	15.4	16.6	18.3	17.6	17.6	We assume exchange rate of ₹60/USD for FY15 and FY16.
Operational parameters						
Chemical sales (kt)	817	984	1,343	1,428	1,411	Based on our muted outlook for aluminium prices, we expect Nalco to run the aluminium smelter at ~70% utilisation in FY15-16, similar to FY14.
Aluminium sales (kt)	417	403	320	320	328	
Chemical Realisation (₹/t)	18,690	17,735	18,520	19,625	20,785	
Aluminium Realisation (₹/t)	119,214	125,525	129,472	137,130	145,590	We expect alumina as well as realisation/t to increase by 6% CAGR over FY14-16.
Financials (₹ mn)						
Net Revenues	66,116	69,165	67,809	73,307	78,685	
Operating expenditure excl. D&A	54,667	60,096	58,467	59,559	63,870	We expect revenues to grow at 7.7% CAGR driven by ~6% realisation CAGR and 1-2% growth in alumina as well as aluminium volumes.
EBITDA (incl. operating income)	11,449	9,069	9,341	13,748	14,816	
EBITDA margin (%)	17.6%	13.3%	14.0%	19.1%	19.2%	
Depreciation	4,666	5,054	5,247	5,188	5,240	EBITDA margins likely to recover from 14% in FY14 to 19% in FY15-16 due to realisation growth of 6% and normalisation of power supplies from Coal India. Nalco has been facing issues in coal supply from Coal India. With Coal India's production likely to report healthy growth of 5% over FY14-17, we expect power supplies to normalise.
Other non-op income	5,422	5,111	5,577	5,886	6,638	
EBIT	12,205	9,125	9,671	14,446	16,214	
Interest expense	9	75	0	0	0	
Adjusted PBT	12,197	9,050	9,671	14,446	16,214	
Tax	3,483	3,123	2,755	4,767	5,351	EBITDA growth to result in PAT growth of 25% over FY14-16.
Tax rate (%)	29.1%	34.5%	30.0%	33.0%	33.0%	
Adjusted net profit	8,714	5,927	6,916	9,679	10,863	
Balance Sheet and Cash flow						
Net Debt (Debt (-) cash and listed invts)	(49,216)	(48,334)	(52,923)	(58,815)	(67,193)	
Gross fixed assets	136,586	141,750	146,296	151,296	156,296	Our estimates currently factor in only maintenance capex of ~₹5bn p.a. Due to lack of clarity on timelines for Nalco's potential projects: (a) Investment in nuclear power project as a JV with NPCIL; (b) alumina refinery in JV with GMDC; and (c) development of the Utkal E coal block.
CFO/ EBITDA %	77%	97%	129%	104%	116%	
CFO	8,867	8,762	12,058	14,290	17,191	
CFI	(823)	(13,116)	(2,096)	(5,000)	(5,000)	
CFF	(4,313)	(2,285)	(4,523)	(3,397)	(3,813)	
Net change in C&CE	3,731	(6,640)	5,439	5,893	8,378	

Source: Company, Ambit Capital research

Our average aluminium price assumption of US$1,867 for FY15 and US$1,977 for FY16 is broadly in line with the aluminium forward curve.

Exhibit 7: Our aluminium price estimate is similar to forward curve (US$/t)



Source: Bloomberg, Ambit Capital research

Ambit vs consensus

Our FY15 and FY16 revenue estimates are 1% and 3% above consensus, as we revise our aluminium realisations to reflect higher-than-expected aluminium premiums. Our EBITDA estimates for FY15-FY16 are 20% and 17% above consensus respectively due to: (a) higher aluminium realisations and (b) our expectation of lower power and fuel costs due to lower dependence on imported coal. Post the recent rally in aluminium prices and premiums, we expect consensus estimates to be revised upwards.

Exhibit 8: Ambit vs consensus

₹ mn	Ambit	Consensus	% deviation
Net Revenues			
FY15E	73,307	72,665	1%
FY16E	78,685	76,749	3%
EBITDA			
FY15E	13,748	11,456	20%
FY16E	14,816	12,647	17%
PAT			
FY15E	9,679	7,660	26%
FY16E	10,863	8,299	31%

Source: Ambit Capital research

Exhibit 9: Explanation for our flags on the cover page

Field	Score	Comments
Accounting	**GREEN**	In our forensic accounting model (see our November 2013 forensic thematic for details), Nalco has a relatively high score (of 11.3 vs the metals sector average of 8.7). The key parameters on which Nalco has weak scores are: (a) contingent liabilities to net worth; (b) audit fees as a percentage of auditors' remuneration; (c) non-operating expenses as a percentage of total revenues; and (d) volatility in margins.
Predictability	**RED**	Earnings remain highly leveraged to a: (a) change in aluminium prices / premiums and (b) availability of coal supplies from Coal India. Every US$50/t increase/decrease in LME prices results in an increase/decrease of 6.8% on FY15 EBITDA and 6.5% on PAT.
Earnings momentum	**GREEN**	Over the past six months, EBITDA and EPS estimates have been upgraded by 5-9% for FY15 and FY16 due to stabilisation of power and rise in aluminium premiums.

Source: Bloomberg, Ambit Capital research

Valuations expensive; turn SELLers

We revise our DCF-based target price to ₹53 from ₹43 earlier, mainly due to: (a) no investment assumed towards the NPCIL JV (as it appears unlikely); (b) upward revision to our EBITDA estimates; and (c) roll forward of TP to September 2014. However, given the sharp rally in the stock price over the past six months (50%), we do not see material upside from the current stock price, and hence, we downgrade our stance from BUY to SELL. Our target price implies a valuation FY16 P/E of 12.6x (vs the historical average of 13.8x) and FY16 P/B of 1x (vs historical average of 1.7x). We believe the discount to historical multiples is justified given that: (a) Nalco's EBITDA margins have been significantly impaired (EBITDA margins declined from 35% in FY09 to 14% in FY14) and (b) RoE has declined from 13.5% in FY09 to 5.8% in FY14.

Absolute valuation

We value Nalco using a DCF methodology and discount free cash flows to the firm at a WACC of 15%. Our valuation is based on explicit forecasts until FY25, and we arrive at the residual value by applying a terminal growth rate of 4%. For FY16, we build in LME aluminium prices of US$1,977/t (vs US$1,911/t) currently and aluminium sales volume of 330kt. Thereafter, we build in aluminium realisation growth of 5% p.a. and volume growth of 3% p.a., resulting in a gradual improvement in Nalco's capacity utilisation to 93% by FY25 vs 70% currently.

Further, our earlier estimates factored in Nalco's investment into the nuclear power plant (~₹9bn) for a JV with NPCIL. However, as this project has likely taken a back seat, we do not factor in any investment by Nalco into nuclear power. This alone elevates our cash balance at the end of FY16 by ₹9bn.

We revise our DCF-based target price to ₹53 from ₹43 earlier, mainly due to: (a) no investment assumed towards the NPCIL JV (as it appears unlikely); (b) upward revision to our EBITDA estimates; and (c) roll forward of TP to September 2014. We derive comfort from the fact that 50% of our valuation is derived from the present value of the next three years' cash flows and cash balance.

Exhibit 10: DCF valuation

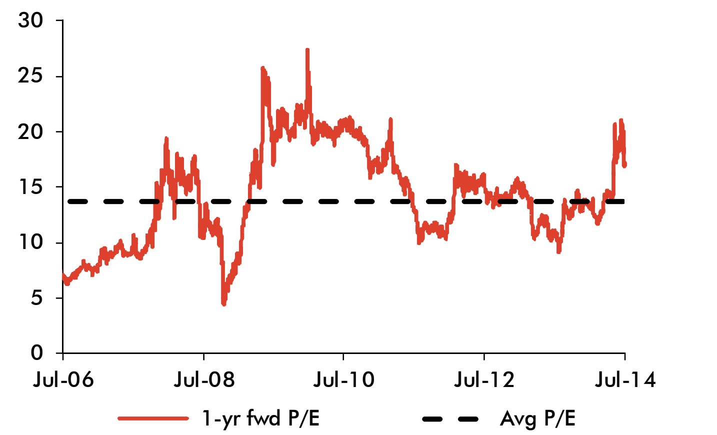
Particulars	**₹ mn**
PV of FCFF (FY16E-25E)	44,219
PV of Terminal value	29,874
Implied Enterprise value	**74,093**
Less: Net debt/(cash) (average FY15-16E)	(61,756)
Implied equity value	**135,849**
Shares in issue	2,577
Value per share (₹/share) (Sep 2014)	**53**

Source: Ambit capital research

Cross-cycle valuation

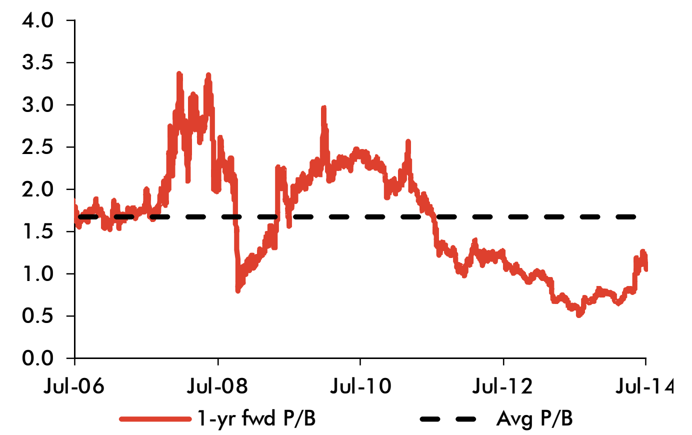
On one-year forward P/B, the stock is trading at an expensive 1.1x, despite our expectations of RoEs remaining muted (~8%) over the next 2-3 years. On a P/E basis (at consensus estimates), the stock is trading at 17.2x, 25% above its historical average of 13.8x. However, based on our estimates, the stock is trading at an FY16 P/E of 12.6x and we expect consensus earnings estimates to be revised upwards to factor in the recent run up in aluminium prices. We believe Nalco must trade at a discount to historical multiples, as: (a) Nalco's EBITDA margins have been significantly impaired (EBITDA margins declined from 35% in FY09 to 14% in FY14) and (b) RoE has declined from 13.5% in FY09 to 5.8% in FY14.

Exhibit 11: Historical one-year forward P/E - at a premium



Source: Ambit Capital research

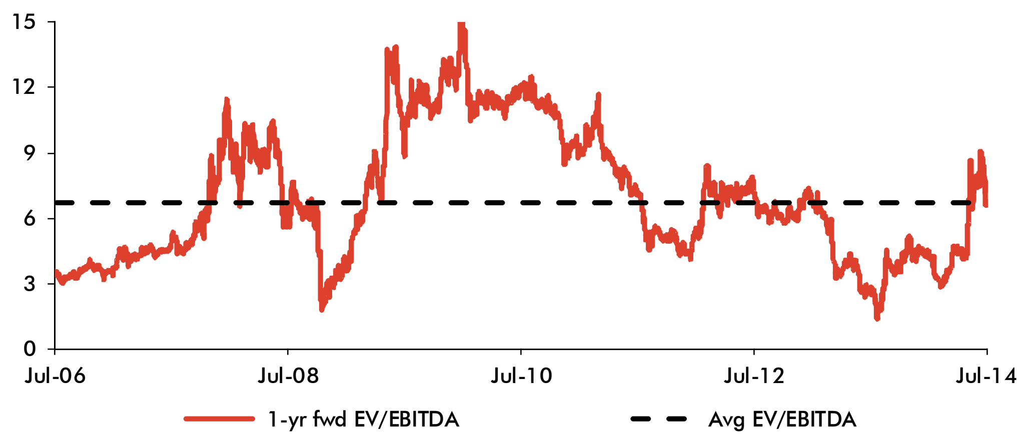
Exhibit 12: Historical one-year forward P/B – discount justified given decline in RoE profile



Source: Ambit Capital research

As shown in the exhibit below, the stock is currently trading at 6.8x one-year forward EV/EBITDA, in line with its 8 year average of 6.8x. However, based on our estimates, the stock is trading at an FY16 EV/EBITDA of 5.6x and we expect consensus earnings estimates to be revised upwards to factor in the recent run up in aluminium prices.

Exhibit 13: Historical one-year forward EV/EBITDA – in line with average



Source: Ambit Capital research

Relative valuation

Valuations of global aluminium players have been marred due to weak aluminium prices globally. As a result, RoE profile of these companies has declined to ~3-8%. On a P/B basis, Nalco appears to be trading in line with global major companies such as Rusal, Chalco and Norsk Hydro but at a discount to Alcoa. Hindalco's P/B of 0.8x (at a discount to Nalco) is justified, given its rising investment in the aluminium business, with significant uncertainties on the availability of captive coal and its high net debt profile.

Exhibit 14: Relative valuation of global aluminium companies

Companies	Crncy	Mcap	EV/EBITDA (x)		P/E (x)		P/B (x)		EBITDA CAGR % (FY14-16)	RoE (%)	
		US$ mn	FY15	FY16	FY15	FY16	FY15	FY16		FY15	FY16
Hindalco	INR	5,954	8.6	7.3	12.9	10.6	0.9	0.8	23	6.8	7.7
Nalco	INR	2,259	6.4	6.4	16.1	16.1	1.1	1.1	6	6.6	6.6
United Co RUSAL*	HKD	7,136	16.2	13.6	15.7	8.0	1.0	0.9	36	8.2	11.7
CHALCO*	HKD	6,354	22.6	15.1	NA	NA	0.8	0.8	21	-9.7	-3.7
Norsk Hydro*	NOK	11,781	9.6	7.6	34.3	20.2	1.0	1.0	25	3.2	5.3
Alcoa*	USD	18,751	9.8	8.2	27.3	20.3	1.6	1.5	17	4.7	7.3

*Source: Bloomberg, Company, Ambit Capital research; Note: * indicates December-ending companies (CY14=FY15)*

Key risks to our stance

- **Further increase in aluminium prices:** If aluminium prices rebound above our estimates of US$1,867/t average for FY15 and US$1,977/t average for FY16, there could be upside risks to our estimates. Every US$50/t increase in LME prices (2%) results in an increase of 6.8% on FY15 EBITDA and 6.5% on PAT.
- **INR depreciation:** Domestic aluminium realisations are linked to the LME aluminium prices and physical premiums, which are denominated in USD, whereas costs are in INR. Hence, INR depreciation and the resultant improvement in realisations would directly flow through to earnings. We currently assume an exchange rate of ₹60/USD for our estimates. A 1% INR depreciation results in an increase of 2.5% on FY15 EBITDA and 2.4% on PAT.
- **Progress on captive coal block:** Given Nalco has not received any clearances (environment/forest) and land acquisition is yet to be completed, we do not expect any material benefit from the captive coal block over the next 2-3 years. Faster than expected progress could help reduce coal cost, boosting its margins.

Income statement

Y/E Mar (₹ mn)	FY12	FY13	FY14E	FY15E	FY16E
Net sales	**65,069**	**68,095**	**66,488**	**71,907**	**77,085**
Other operating income	1,047	1,070	1,321	1,400	1,600
Net sales inc other operating income	**66,116**	**69,165**	**67,809**	**73,307**	**78,685**
Material costs inc chge in stocks	10,279	11,036	11,217	11,185	11,902
Power & Fuel	21,967	24,323	20,177	19,710	20,791
Employees' Remuneration & Benefits	10,345	11,539	12,453	13,944	15,761
Other Manufacturing Expenses inc repairs	6,945	5,037	4,113	4,240	4,477
Administrative & Other Expenses	3,600	7,253	9,759	9,700	10,108
Freight, Selling and Distribution Expenses	1,531	909	749	780	831
Operating expenditure exc D&A	**54,667**	**60,096**	**58,467**	**59,559**	**63,870**
EBITDA inc Other operating income	**11,449**	**9,069**	**9,341**	**13,748**	**14,816**
EBITDA Margin (%)	17.6%	13.3%	14.0%	19.1%	19.2%
Depreciation	4,666	5,054	5,247	5,188	5,240
Operating profit	**6,784**	**4,014**	**4,094**	**8,560**	**9,576**
Operating Margin (%)	10.4%	5.9%	6.2%	11.9%	12.4%
Other non-op income	5,422	5,111	5,577	5,886	6,638
EBIT	**12,205**	**9,125**	**9,671**	**14,446**	**16,214**
Interest and Financing Charges	9	75	-	-	-
Adjusted PBT	**12,197**	**9,050**	**9,671**	**14,446**	**16,214**
Add/(Less) : Prior Period Adjustments (Net)	(219)	-	(494)	-	-
Reported PBT	**11,978**	**9,050**	**9,177**	**14,446**	**16,214**
Tax	**3,483**	**3,123**	**2,755**	**4,767**	**5,351**
Effective tax rate (%)	29.1%	34.5%	30.0%	33.0%	33.0%
Adjusted Net profit to shareholders	**8,714**	**5,927**	**6,916**	**9,679**	**10,863**
Reported Net profit to shareholders	**8,495**	**5,927**	**6,423**	**9,679**	**10,863**

Source: Company, Ambit Capital research

Balance Sheet

Y/E Mar (₹ mn)	FY12	FY13	FY14E	FY15E	FY16E
Equity Capital	12,886	12,886	12,886	12,886	12,886
Reserves & surplus	104,265	106,438	108,338	114,620	121,670
Net worth	**117,151**	**119,325**	**121,225**	**127,506**	**134,556**
Deferred Tax Liability (Net)	8,491	9,031	9,101	9,101	9,101
Capital employed	**128,439**	**131,150**	**133,058**	**139,339**	**146,390**
Net Fixed Assets (inc CWIP)	72,968	76,308	75,607	75,419	75,179
Investments	7,543	14,901	12,450	12,450	12,450
Cash and Bank Balances	41,684	35,044	40,483	46,375	54,753
Inventories	12,127	13,806	11,737	12,693	13,607
Sundry Debtors	1,381	1,430	2,436	2,634	1,690
Loans and Advances	5,153	5,250	4,814	4,814	4,814
Other Current Assets	2,346	1,938	2,353	2,353	2,353
Liabilities	26,319	30,493	30,955	31,533	32,590
Provisions	450	1,627	1,473	1,473	1,473
Net current assets	**35,922**	**25,349**	**29,395**	**35,864**	**43,154**
Total Assets	**128,439**	**131,150**	**133,058**	**139,339**	**146,389**

Source: Company, Ambit Capital research

Cash flow statement

Y/E Mar (₹ mn)	FY12	FY13	FY14E	FY15E	FY16E
Net Profit before tax and Extraordinary Income	**11,978**	**9,050**	**9,177**	**14,446**	**16,214**
Depreciation	4,666	5,054	5,247	5,188	5,240
Interest income	(5,422)	(5,111)	(5,577)	-	-
Others	(792)	(591)	-	-	-
CFO pre WC changes	**10,452**	**8,728**	**8,847**	**19,634**	**21,454**
Working capital changes	(3,966)	(726)	318	(577)	1,088
Payment of Direct Taxes	(3,041)	(4,351)	(2,685)	(4,767)	(5,351)
Cash from operating activities	**3,445**	**3,651**	**6,480**	**14,290**	**17,191**
Purchase of Fixed Assets	(1,808)	(6,489)	(4,546)	(5,000)	(5,000)
Dividend income from Mutual fund	985	731	-	-	-
Add: Other Income	5,422	5,111	5,577	-	-
Purchase of investments	-	(7,358)	2,450	-	-
Cash from investing activities	**4,599**	**(8,006)**	**3,481**	**(5,000)**	**(5,000)**
Dividends including dividend tax paid	(4,156)	(2,211)	(4,523)	(3,397)	(3,813)
Cash from financing activities	**(4,313)**	**(2,285)**	**(4,523)**	**(3,397)**	**(3,813)**
Change in cash	**3,731**	**(6,640)**	**5,439**	**5,893**	**8,378**
Opening Cash	37,952	41,684	35,044	40,483	46,375
Closing cash	**41,684**	**35,044**	**40,483**	**46,375**	**54,753**

Source: Company, Ambit Capital research

Valuation parameters and ratio analysis

Y/E Mar	FY12	FY13	FY14E	FY15E	FY16E
EBITDA margin (%)	17.6%	13.3%	14.0%	19.1%	19.2%
Adjusted Net profit Margin (%)	13.4%	8.7%	10.4%	13.5%	14.1%
Return on Equity (%)	7.6%	5.0%	5.8%	7.8%	8.3%
Return on Capital employed (adj for CWIP) (%)	7.9%	4.3%	4.9%	9.8%	11.2%
Gross Debt/ Equity (x)	-	-	-	-	-
Net Debt (Cash)/ Equity (x)	(0.4)	(0.4)	(0.4)	(0.5)	(0.5)
Adjusted EPS Fully Diluted	3.4	2.3	2.7	3.8	4.2
Net Dividend Per Share	1.0	1.2	1.5	1.1	1.3
Book Value Per Share	45.5	46.3	47.0	49.5	52.2
P/E on adjusted basis (x)	15.7	23.0	19.7	14.1	12.6
P/B (x)	1.2	1.1	1.1	1.1	1.0
EV/ EBITDA (x)	7.3	9.2	9.0	6.1	5.6
Dividend yield (%)	1.9%	2.4%	2.8%	2.1%	2.4%

Source: Company, Ambit Capital research

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