Hindalco Ind Ltd ₹ 127

We Smel(t) Growth ! Buy

Gateway to Prosperity

Jan 11, 2013

Company Background

Hindalco Industries Ltd (Hindalco) is the largest aluminum producer in India and has captive bauxite mines from which it sources ~67% of requirements for its 1.5mtpa alumina refinery. It also has a 0.54 mtpa smelting capacity and is the largest maker of flat rolled aluminum products in India. After turning Novelis around in 2010, Hindalco is focusing on tripling its aluminum production capacity in India in the next three years through brownfield and greenfield projects. Its copper smelting capacity of 500 ktpa is the largest in Asia.

Key Highlights

- Hindalco has a profitable business of aluminum and copper smelting in India. It also owns Novelis' flat rolled products (FRP) business. As the conversion business accounts for ~70% of its cash flows, they are relatively less volatile. Also, it has been able to consistently grow the value of its operating assets.
- Hindalco Industries (HNDL) has the largest lever on CWIP, with CWIP/MCap of 114%. Though its investments in the Mahan and Aditya Aluminum projects have low IRR, its investments in Utkal Alumina and Novelis are value accretive.
- We believe the conversion business of Novelis and copper TcRc provide steady cash flows, resilience and sustainability to Hindalco. The primary aluminum business is at the bottom of the cycle from the perspective of margins.
- The implied valuation of CWIP is at a steep 33% discount, which is far more than warranted. As the capex intensity peaks in 12 months and Utkal Alumina starts generating positive cash flows.
- Hindalco has undertaken USD 6b of capex in India and USD 1.5b of capex at Novelis. Indian projects have suffered execution delays and there have been complications in developing the bauxite and coal mines. Novelis' projects are, however, on schedule and within budget. Currently, Hindalco's CWIP/MCap is 114%, the highest in the Indian Metals sector. Its CWIP/EV is a whopping 46%, well beyond the tolerable limit of 20-30%.
- A bulk of the FY14 domestic capex of Rs 80bn will be for the Aditya Al project (Rs 50bn) expected to commence in FY15. Novelis' capex target for FY14 is US$ 500bn-550bn. Also, it has no major debt repayments till FY16.

Key Financials

Year Ended 31st	Mar 10	Mar 11	Mar 12
Revenue (INR mn)	201,806.7	243,403.9	273,407.7
Rev. growth (%)	5.96	20.61	12.33
EBITDA (INR mn)	33,305.6	35,668.5	37,831.7
Net profit (INR mn)	19,156.3	21,369.2	22,469.3
Shares outstanding (mn)	1,913.5	1,914.9	1,914.5
EPS (INR)	10.0	11.2	11.7
EPS growth (%)	(23.68)	11.47	5.17
P/E (x)	18.1	18.7	11.0
RONW (%)	6.8	7.3	7.1
ROCE (%)	5.3	5.8	5.1

Nishant Chopra
nishantc@indiratrade.com

Info Codes

Reuters	HALC.NS
Bloomberg	HNDL@IN
NSE	HINDALCO
BSE	500440

Market Data

52 Wk Range (₹)	100 / 165
Shares in Issue (mn)	1914.5
Mkt. Cap (₹ bn)	243.85
BSE 2 Wk Avg Vol	740000

Share Holding Pattern (%)

Promoters	32.06
DIIs	14.76
FIIs	26.67
Others	26.51

Investment Theme

Company's new smelting capacities are coming up near energy sources and alumina facilities are near bauxite mines, thus ensuring low cost of production. We expect Novelis to deliver strong earnings growth, given its focus on high margin business, expansions in key markets and continued efforts to improve operating efficiencies across locations. Novelis has already invested $ 345mn till date and the total capital expenditure guidance for FY13 is $ 700mn. The company expects to reach its target of 50% of recycling capacity by FY15. The company has confirmed the stage-1 forest clearance for Mahan coal block, which is a key milestone for the expansion at Mahan smelter. The company has achieved the financial closure of the Aditya Alumina project, signing the loan agreement of INR 99bn with a consortium of banks.

Novel-is the Growth Opportunity !

Financial Statements

Income Statement

(₹ mn)

Year end	Mar 10	Mar 11	% Chg	Mar 12	% Chg
Total Sales + Excise	205729.7	253522.0	23.23	283013.4	11.63
Other Income	6646.8	5135.2	(22.74)	7527.3	46.58
Change in Stocks	7658.7	4036.3	(47.30)	4115.3	1.96
Raw Material Con.	135947.9	159948.2	17.65	181572.2	13.52
Employee Exp.	8700.2	10403.9	19.58	11133.5	7.01
Indirect Taxes	10669.2	15070.3	41.25	17194.2	14.09
Other Exp.	31412.3	41602.6	32.44	46924.4	12.79
Operating Exp.	179070.9	222988.7	24.53	252709.0	13.33
Operating Profit	26658.8	30533.3	14.53	30304.4	(0.75)
Total Interest	2780.0	3630.5	30.59	4979.8	37.17
Gross Profit	30525.6	32038.0	4.95	32851.9	2.54
Net Dep.	6748.3	5982.2	(11.35)	5385.1	(9.98)
Total Taxation	4621.0	4686.6	1.42	4997.5	6.63
Net Profit/Loss	19156.3	21369.2	11.55	22469.3	5.15

4 Years Balance Sheet

(₹ mn)

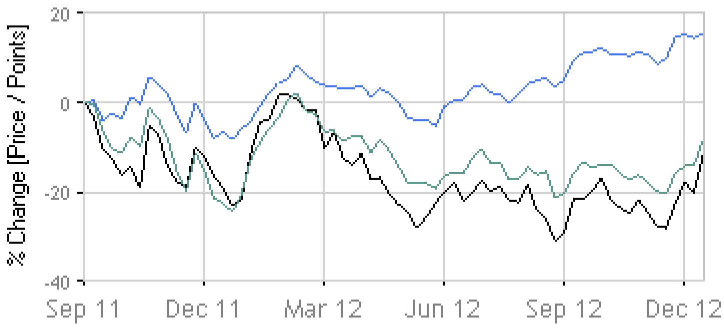
Balance Sheet as on 31st	Mar 09	Mar 10	Mar 11	Mar 12
SOURCES OF FUNDS	**320,830.6**	**342,683.1**	**387,404.3**	**466,063.5**
Equity Share capital	1,700.5	1,913.7	1,914.6	1,914.8
Share Application Money	4.5	4.4	4.4	4.4
Preference Share Capital	4.1	0.0	0.0	0.0
Reserves & Surplus	235,878.6	277,196.0	295,086.4	318,409.9
Long Term Loans	55,851.8	51,530.2	51,495.4	111,166.6
Short Term Loans	27,391.1	12,038.8	38,903.5	34,567.8
USES OF FUNDS	**320,830.6**	**342,683.1**	**387,404.3**	**466,063.5**
Gross Block	131,286.2	135,748.2	145,052.7	146,835.5
Less : Revaluation Reserves	0.0	0.0	0.0	0.0
Less : Accumulated Depreciation	52,416.5	58,400.0	64,849.7	71,219.9
Net Block	78,869.7	77,348.2	75,843.8	71,502.0
Capital Work in Progress	13,896.3	37,027.9	60,304.1	162,569.4
Investments	191,488.4	214,808.3	182,467.5	180,871.0
Current Assets	78,447.0	89,986.1	148,112.4	143,032.3
Less : Current Liabilities	41,870.8	76,487.4	79,323.5	91,911.2
Total Net Current Assets	36,576.2	13,498.7	68,788.9	51,121.1
Misc. Expenses not written	0.0	0.0	0.0	0.0
NOTE				
Bk Val Unquoted Investments	137,813.1	146,019.1	151,049.1	159,554.3
Mkt Val. Quoted Investments	65,031.0	99,351.6	65,894.6	57,627.0
Contingent Liabilities	104,170.7	171,500.5	113,496.3	82,843.3
Dividend (%)	135	135	150	155

Quarterly Income Sheets

(₹ mn)

Quarter Ended	Dec 11	Mar 12	Jun 12	Sep 12
Net Sales	66,469.70	76,470.70	60,279.40	61,635.20
Cost Of Sales	59,320.50	67,822.80	55,648.20	56,482.10
Operating Profit	7,149.20	8,647.90	4,631.20	5,153.10
Recurring Income	900.60	1,605.00	3,014.30	1,323.70
Adjusted PBDIT	8,049.80	10,252.90	7,645.50	6,476.80
Financial Expenses	793.40	800.60	814.70	278.60
Depreciation	1,747.20	1,657.90	1,704.80	1,727.50
Other Write Offs	0.00	0.00	0.00	0.00
Adjusted PBT	5,509.20	7,794.40	5,126.00	4,470.70
Tax Charges	1,002.30	1,394.50	878.30	881.90
Adjusted PAT	4,506.90	6,399.90	4,247.70	3,588.80
Non Recurring Items	0.00	0.00	0.00	0.00
Other Non Cash Adjust	0.00	0.00	0.00	0.00
Net Profit	4,506.90	6,399.90	4,247.70	3,588.80

52 Week Index Relative Percentage Appreciation



Hindalco vs SENSEX vs Metal

Points to Ponder

Hindalco is setting up a 359 ktpa smelter along with 900MW of CPP spread over 3,328 acres at Lapanga in Odisha at a capex of INR132b. The project was originally expected to be completed at a capex of INR82b by October 2011. Until September 2012, INR67b had already been spent. The project is expected to commence production in FY15 and ramp up during FY16. 3mtpa of coal is expected to be available from the Odisha captive mine in JV with Mahanadi Coalfields and Nevyeli Lignite.

Risks Associated

Project delays and cost escalations have de-rated the stock. The implied valuation of CWIP is at heavy discount of 33% and is steeper than a 12% discount according to DCF calculations. Though not entirely trouble-free, the allocation of bauxite and coal mines to Hindalco has largely been non-controversial, barring Mahan. With MoEF clearance, the Mahan coal block too is out of the woods. The greenfield projects may not generate significant cash flows at current LME prices of aluminum and the NPV is a negative INR48b. Utkal Alumina and Mahan are at an advanced stage of completion. If not Mahan, Utkal is most likely to generate positive cash flow right from the beginning and has the potential to expand capacity further at low marginal cost. NPV of the projects is highly sensitive to LME prices and we believe that LME prices of aluminum are at the bottom of the cycle. Its heavy investment in greenfield projects and peaking capex intensity will be a source of significant upside.

Hindalco

In a Nutshell

Hindalco Industries (HNDL) has a profitable business of aluminum and copper smelting in India. It also owns Novelis' flat rolled products (FRP) business. As the conversion business accounts for ~70% of its cash flows, they are relatively less volatile. Also, HNDL has been able to consistently grow the value of its operating assets. However, heavy investments and delays in unfinished projects have resulted in mounting debt on the balance sheet, which in turn, has put pressure on equity value. With the Mahan/Utkal plants to commence in Q1FY14, we estimate ~150kt of added Al production in FY14 with CoP at ~US$2,000/t. Coal stockpiling has begun and stage-2 clearance of the Mahan coal block is likely in 5-6 months with mining set to start in 18 months. Mining of bauxite has started and it will be transported by truck from January till the conveyor belt is ready in 12 months. Hindalco remains focused on capex with planned spend of INR90b on Indian projects (despite low IRR at current LME) and another USD600-700m at Novelis in FY13. Over FY14-15, another INR80b will be spent in India and USD450m at Novelis. Hindalco has a profitable business of aluminum and copper smelting in India. It also owns Novelis' flat rolled products (FRP) business. As the conversion business accounts for ~70% of its cash flows, they are relatively less volatile. Also, Hindalco has been able to consistently grow the value of its operating assets. Hindalco has undertaken USD6b of capex in India and USD1.5b of capex at Novelis. Indian projects have suffered execution delays and there have been complications in developing the bauxite and coal mines.

Indira Group Offices

Registered Office : Singh House, 3rd Floor, 23/25 Ambalal Doshi Marg, Fort, Mumbai 400023
Tel : +91-22-22656812 **Fax :** +91-22-22656985 **Email :** im@indiratrade.com

Administrative Office : Ramavat House, E-15 Saket Nagar, Indore 452018
Tel : +91-731-2566361 **Fax :** +91-731-2562117 **Email :** ii@indiratrade.com

Institutional Dealing Unit : Africa House, 3rd Floor, 5 Topiwala Lane, Lamington Road, Mumbai 400007
Tel : +91-22-30080675 **Fax :** +91-22-23870767 **Email :** ie@indiratrade.com

Rating Interpretation

Buy	: Expected to appreciate 20% or more over 12-months	**Reduce**	: Expected to depreciate up to 10% over 12-months
Accumulate	: Expected to appreciate 10% to 20% over 12-months	**Sell**	: Expected to depreciate 10% or more over 12-months
Trade Buy	: Expected to appreciate more than 10% over 45-days	**Trade Sell**	: Expected to depreciate more than 10% over 45-days