

NALCO

Expensive valuation

Company background: The government of India is divesting 10% stake in Nalco via an OFS at ₹40/share (a 9.6% discount to its closing price as on March 14, 2013). Nalco, a Navratna company, is India's third largest aluminium producer. The company has Asia's largest integrated aluminium complex. The company engages into alumina refining (capacity – 2.1mn tonnes), aluminium smelting (capacity - 0.7mn tonnes) and power generation (capacity - 1,200MW). The company has a captive bauxite mine at Panchpatmali with a mining capacity of 6.3mn tonnes p.a. The company also sells excess power. Nalco exports its products to South East Asia, Far East, Indian subcontinent, Gulf, China and the U.S.

Aluminium business continues to make losses: At current aluminium price of US\$2,000-2,100/tonne, we expect Nalco to make losses on its Aluminium business. Moreover, prices of key inputs such as coal, caustic soda, CP coke, aluminium fluoride etc continue to remain high. Hence, we expect Nalco to operate its aluminium smelters at lower utilization levels during FY2013-14.

Coal supply issues to continue: Nalco has been facing coal supply issues, which disrupted its operations in the past few quarters. The company sources its annual coal requirement from Mahanadi Coalfields Ltd., but the supply is not evenly distributed. In our view, any disturbance in coal supply would increase the company's dependence on imported or external coal (which is very expensive compared to linkage coal), thereby negatively affecting its margins.

No clarity on timelines for production from Utkal coal block: Nalco has been allotted Utkal-E coal block which has estimated reserves of 70mn tonnes. Currently, there is no clarity on land acquisition for coal block. Although Nalco expects to commence production from this mine by end of CY2013, our recent experience suggests that it could take a much longer time to acquire land and sign the mining lease with the state government.

Outlook and valuation: Nalco's earnings over the past 6-8 quarters have remained very volatile. Although Nalco has captive bauxite mines, the cost of aluminium production remains very high on account of high power costs. Further, there is lack of clarity over the company's future expansion plans. At the OFS price, Nalco is trading at 7.4x FY2013E and 5.2x FY2014E EV/EBITDA, which is at a significant premium compared to its peers. Hence, **we recommend investors to avoid subscribing to Nalco OFS.**

Key financials (Standalone)

Y/E March (₹ cr)	FY11	FY12	FY13E	FY14E
Net sales	5,959	6,500	6,630	8,357
% chg	17.9	9.1	2.0	26.0
Net profit	1,069	871	548	840
% chg	31.3	(18.5)	(37.1)	53.3
FDEPS (₹)	4.1	3.4	2.1	3.3
OPM (%)	26.7	17.5	11.4	14.5
P/E (x)	9.6	11.8	18.8	12.3
P/BV (x)	0.9	0.9	0.9	0.8
RoE (%)	9.9	7.4	4.6	6.9
RoCE (%)	10.2	5.5	2.0	5.0
EV/Sales (x)	0.9	0.8	0.8	0.8
EV/EBITDA (x)	3.3	4.7	7.4	5.2

Source: Company, Angel Research

AVOID

Issue Open: March 15, 2013

Issue Close: March 15, 2013

Issue Details

Face Value: ₹5

Present Eq. Paid-up Capital: ₹1,288cr

Offer Size: 25.8cr Shares

Post Eq. Paid-up Capital: ₹1,288cr

Issue size (amount): ₹1,031cr

OFS Floor Price: ₹40

Post-issue implied mkt cap: ₹10,308cr

Promoters holding Pre-Issue: 87.2%

Promoters holding Post-Issue: 77.2%

Post Issue Shareholding Pattern

Promoters Group	77.2
MF/Banks/Indian FIs/FILs/Public & Others	22.8

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Company Background

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Issue Details

The Promoter (Government of India), proposes to sell 12,88,61,925 equity shares of the face value of ₹5 each with an option to sell an additional 12,88,61,925 equity shares of the face value of ₹5 each collectively aggregating to approximately 10% of the total paid up equity share capital of the company. Nalco has fixed the OFS floor price at ₹40 per share (at a 9.6% discount to its closing price as on March 14, 2013).

Exhibit 1: Shareholding Pattern

Particulars	Pre-Issue		Post-Issue	
	No. of shares	(%)	No. of shares	(%)
Promoter and promoter group	2,24,60,63,363	87.2	1,98,83,39,512	77.2
Total public holding	33,11,75,149	12.8	58,88,99,000	22.8
Total	2,57,72,38,512	100	2,57,72,38,512	100

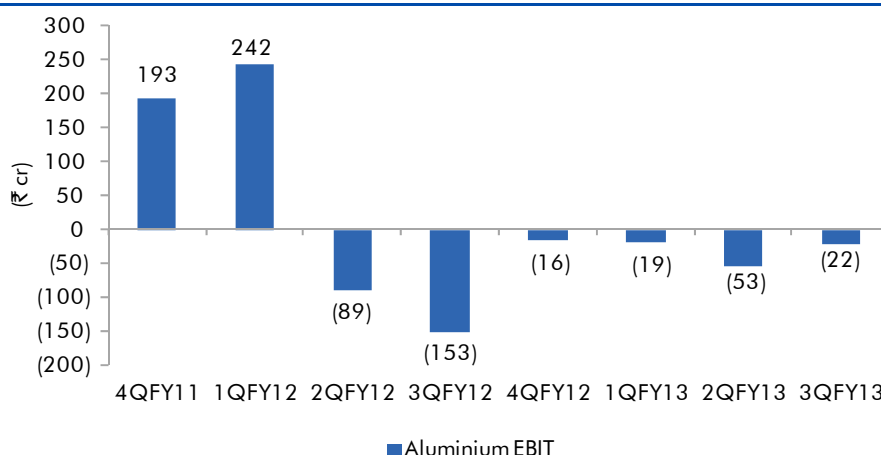
Source: Company, Angel Research

Investment rationale

Aluminium business continues to make losses

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Exhibit 2: Aluminium business continues to make losses



Source: Company, Angel Research

Coal supply issues to continue

Nalco has been facing coal supply issues, which disrupted its operations in the past few quarters. The company sources its annual coal requirement from Mahanadi Coalfields Ltd., but the supply is not evenly distributed. In our view, any disturbance in coal supply would increase the company's dependence on imported or external coal (which is very expensive compared to linkage coal), thereby negatively affecting its margins.

No clarity on timelines for production from Utkal coal block

Nalco has been allotted Utkal-E coal block which has estimated reserves of 70mn tonnes. Currently, there is no clarity on land acquisition for coal block. Although Nalco expects to commence production from this mine by end of CY2013, our recent experience suggests that it could take a much longer time to acquire land and sign the mining lease with the state government.

Limited growth visibility

There is little clarity on Nalco's proposed expansion plans, as they are in various stages of financial closure and significant progress is yet to be made.

Outlook and valuation

Nalco's earnings over the past 6-8 quarters have remained very volatile. Although Nalco has captive bauxite mines, the cost of aluminium production remains very high on account of high power costs. Further, there is lack of clarity over the company's future expansion plans. At the OFS price, Nalco is trading at 7.4x FY2013E and 5.2x FY2014E EV/EBITDA, which is at a significant premium compared to its peers. **Hence, we recommend investors to avoid subscribing to Nalco OFS.**

Profit & loss statement (Standalone)

Y/E March (₹ cr)	FY09	FY10	FY11	FY12	FY13E	FY14E
Net Sales	5,095	5,055	5,959	6,500	6,630	8,357
Other operating income	-	119	98	111	136	149
Total operating income	5,095	5,174	6,057	6,612	6,766	8,506
% chg	2.1	1.6	17.1	9.2	2.3	25.7
Total Expenditure	3,401	4,071	4,464	5,473	6,013	7,298
Net Raw Materials	585	808	704	1,034	1,094	1,254
Other Mfg costs	1,562	2,124	1,765	2,197	3,070	3,802
Personnel	771	813	961	1,035	1,153	1,239
Other	483	326	1,033	1,208	696	1,003
EBITDA	1,694	1,102	1,592	1,139	753	1,208
% chg	(23.7)	(34.9)	44.4	(28.5)	(33.9)	60.4
(% of Net Sales)	33.2	21.8	26.7	17.5	11.4	14.5
Depreciation & Amortisation	272	319	422	467	500	557
EBIT	1,421	783	1,170	673	253	651
% chg	(26.7)	(44.9)	49.5	(42.5)	(62.4)	157.4
(% of Net Sales)	27.9	15.5	19.6	10.3	3.8	7.8
Interest & other Charges	4	2	0	1	6	2
Other Income	496	374	353	542	548	586
Recurring PBT	1,913	1,155	1,524	1,214	794	1,235
% chg	(23.2)	(39.6)	31.9	(20.3)	(34.6)	55.5
Extraordinary Inc/(Expense)	14	-	-	(22)	-	-
PBT (reported)	1,927	1,155	1,524	1,192	794	1,235
Tax	655	341	455	342	246	395
(% of PBT)	34.0	29.5	29.8	28.7	31.0	32.0
PAT (reported)	1,272	814	1,069	850	548	840
PAT after MI (reported)	1,272	814	1,069	850	548	840
ADJ. PAT	1,258	814	1,069	871	548	840
% chg	(24.0)	(35.3)	31.3	(18.5)	(37.1)	53.3
(% of Net Sales)	24.7	16.1	17.9	13.4	8.3	10.1
Basic EPS (₹)	4.9	3.2	4.1	3.4	2.1	3.3
Fully Diluted EPS (₹)	4.9	3.2	4.1	3.4	2.1	3.3
% chg	(24.0)	(35.3)	31.3	(18.5)	(37.1)	53.3

Balance sheet (Standalone)

Y/E March (₹ cr)	FY09	FY10	FY11	FY12	FY13E	FY14E
SOURCES OF FUNDS						
Equity Share Capital	644	644	1,289	1,289	1,289	1,289
Reserves & Surplus	9,126	9,751	9,876	10,426	10,613	11,061
Shareholders Funds	9,770	10,396	11,165	11,715	11,902	12,350
Total Loans	-	-	-	-	-	-
Other long-term liabilities	-	-	270	280	280	280
Deferred Tax Liability	621	661	693	849	849	849
Total Liabilities	10,391	11,056	12,128	12,844	13,030	13,479
APPLICATION OF FUNDS						
Gross Block	9,900	11,018	12,076	13,659	14,709	16,409
Less: Acc. Depreciation	5,868	6,182	6,583	7,046	7,546	8,103
Net Block	4,032	4,836	5,494	6,612	7,162	8,306
Capital Work-in-Progress	2,868	2,243	1,707	684	584	284
Goodwill	-	-	-	-	-	-
Investments	896	987	1,332	754	754	754
Current Assets	4,529	5,210	5,589	6,269	6,006	5,611
Cash	2,869	3,152	3,795	4,168	3,952	3,218
Loans & Advances	616	786	612	750	750	750
Other	1,044	1,272	1,183	1,351	1,303	1,643
Current liabilities	1,933	2,220	2,821	2,677	2,677	2,677
Net Current Assets	2,596	2,990	2,768	3,592	3,329	2,934
Other long-term assets	-	-	827	1,201	1,201	1,201
Mis. Exp. not written off	-	-	-	-	-	-
Total Assets	10,391	11,056	12,128	12,844	13,030	13,479

Cash flow statement (Standalone)

Y/E March (₹ cr)	FY09	FY10	FY11	FY12	FY13E	FY14E
Profit before tax	1,927	1,155	1,524	1,197	794	1,235
Depreciation	273	319	422	467	500	557
Change in Working Capital	361	(20)	288	(397)	47	(339)
Others	60	9	(56)	(77)	-	-
Direct taxes paid	682	292	548	304	246	395
Cash Flow from Operations	1,938	1,172	1,630	886	1,095	1,057
(Inc.)/ Dec. in Fixed Assets	(2,211)	(678)	(833)	(181)	(950)	(1,400)
(Inc.)/ Dec. in Investments	-	-	-	-	-	-
(Inc.)/ Dec. in loans and adv.	-	-	-	-	-	-
Others	13	84	65	-	-	-
Cash Flow from Investing	(2,198)	(593)	(768)	(181)	(950)	(1,400)
Inc./(Dec.) in loans	-	-	-	-	-	-
Dividend	-	-	-	416	361	392
Others	388	303.8	219	15	-	-
Cash Flow from Financing	(388)	(304)	(219)	(430)	(361)	(392)
Inc./(Dec.) in Cash	(647)	275	642	275	(216)	(734)
Opening Cash balances	3,516	2,878	3,152	3,794	4,168	3,952
Closing Cash balances	2,869	3,152	3,794	4,168	3,952	3,218

Key ratios

Y/E March	FY09	FY10	FY11	FY12	FY13E	FY14E
Valuation Ratio (x)						
P/E (on FDEPS)	8.2	12.7	9.6	11.8	18.8	12.3
P/CEPS	6.7	9.1	6.9	7.8	9.8	7.4
P/BV	1.1	1.0	0.9	0.9	0.9	0.8
Dividend yield (%)	3.1	1.6	2.2	2.5	3.0	3.3
EV/Sales	1.3	1.2	0.9	0.8	0.8	0.8
EV/EBITDA	3.9	5.6	3.3	4.7	7.4	5.2
EV/Total Assets	0.6	0.6	0.4	0.4	0.4	0.5
Per Share Data (₹)						
EPS (Basic)	4.9	3.2	4.1	3.4	2.1	3.3
EPS (fully diluted)	4.9	3.2	4.1	3.4	2.1	3.3
Cash EPS	6.0	4.4	5.8	5.1	4.1	5.4
DPS	1.3	0.6	0.9	1.0	1.2	1.3
Book Value	37.9	40.3	43.3	45.5	46.2	47.9
Dupont Analysis						
EBIT margin	27.9	15.5	19.6	10.3	3.8	7.8
Tax retention ratio (%)	66.0	70.5	70.2	71.3	69.0	68.0
Asset turnover (x)	1.4	1.2	1.2	1.1	0.9	1.0
ROIC (Post-tax)	25.8	13.4	17.2	8.1	2.5	5.5
Cost of Debt (Post Tax)	-	-	-	-	-	-
Leverage (x)	-	-	-	-	-	-
Operating ROE	25.8	13.4	17.2	8.1	2.5	5.5
Returns (%)						
ROCE (Pre-tax)	14.3	7.3	10.2	5.5	2.0	5.0
Angel ROIC (Pre-tax)	39.1	18.6	24.1	11.2	3.5	7.9
ROE	13.6	8.1	9.9	7.4	4.6	6.9
Turnover ratios (x)						
Asset Turnover (Gross Block)	0.5	0.5	0.5	0.5	0.5	0.5
Inventory / Sales (days)	55	65	62	64	64	64
Receivables (days)	2	13	7	8	8	8
Payables (days)	717	718	0	0	0	0
WC cycle (ex-cash) (days)	(5)	(27)	22	71	73	64
Solvency ratios (x)						
Net debt to equity	(0.4)	(0.4)	(0.5)	(0.4)	(0.4)	(0.3)
Net debt to EBITDA	(2.2)	(3.8)	(3.2)	(4.3)	(6.2)	(3.3)

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Disclosure of Interest Statement

Nalco

1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

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