

BSE Sensex  
32,273S&P CNX  
10,085

CMP: INR247

TP: INR310 (+25%)

Buy



Mr Satish Pai  
MD  
Hindalco Industries



## Financials Snapshot (INR b)

Y/E Mar	2017	2018E	2019E
Net Sales	1,001.8	1,075	1,148
EBITDA	124.4	136.6	146.7
Net Profit	19.1	44.2	54.6
EPS (INR)	8.6	19.8	24.5
EPS Gr.(%)	-28.5	131.6	23.7
BV/Sh. (INR)	129.9	148.2	171.3
RoE (%)	7.4	14.3	15.4
RoCE (%)	7.3	8.3	9.2
P/E (x)	28.9	12.5	10.1
P/BV (x)	1.9	1.7	1.4
EV/EBITDA(x)	8.2	6.9	5.9

## De-risked businesses delivering strong free cash flows

## Focus on stakeholder value

We hosted Mr Satish Pai, MD and CEO of Hindalco (HNDL), as part of 'CEO Track' at our annual conference. Key takeaways:

- HNDL's business is robust and de-risked. Novelis and copper segments operate on conversion model, with LME being a pass-through. These two businesses account for more than 60% of EBITDA, and provide steady cash flows and support balance sheet. Aluminum smelting is a high margin business; volatility is correlated to metal cycle.
- HNDL is present across the entire value chain of aluminum. There are only few comparable global companies: Norsk Hydro and Hongqiao. Most other players are either only upstream or only downstream producers.
- Superior technology (Pachney) selection for its smelters has helped it achieve stable operations, while competition is struggling to stabilize GAMI pots (Chinese).
- HNDL has access to high quality bauxite, strong logistics, and conveyors for bulk transportation of minerals from mines. It has secured a diversified mix of coal supply in proximity to its captive power plants. This has helped it achieve cost leadership in aluminum production, globally.
- Novelis has global leadership in supplying flat-rolled products to the auto industry. Novelis will continue to look for expansion in the auto space to cater to strong growth in demand. New investments are expected in the US and China. Pricing pressure in can business has eased. Electric vehicles are likely to accelerate light-weighting and drive demand for aluminum.
- HNDL continues to focus on accelerated deleveraging and allocation of capital in downstream, which is less capital intensive. HNDL has already prepaid INR78b debt and plans to prepay another INR30b during FY18.
- There is merit in hedging primary aluminum production, as it helps tide over volatility in LME and provides net gains because forwards curves have always been in contango.

## Our view

We remain bullish on the stock due to (a) strong business fundamentals, (b) free cash flow generation, and (c) the managements' focus on deleveraging, high IRR projects, and attractively-valued inorganic opportunities so as to deliver stakeholder's value. We re-iterate BUY, with a target price of INR310/share (6.5x FY19E).

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

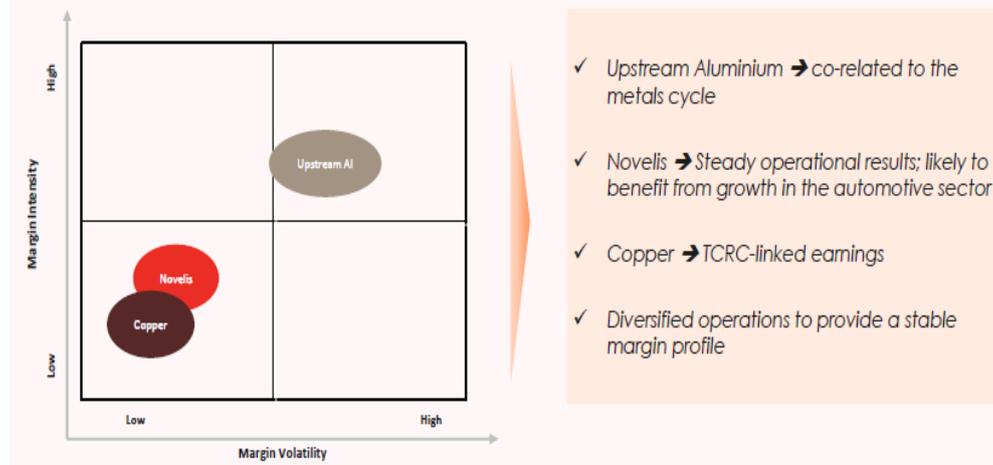
Motilal Oswal research is available on [www.motilaloswal.com/Institutional-Equities](http://www.motilaloswal.com/Institutional-Equities), Bloomberg, Thomson Reuters, Factset and S&P Capital.

**Robust and de-risked business model**

HNDL's business is robust and de-risked. Novelis and copper segments operate on conversion model, with LME being a pass-through. These two businesses account for more than 60% of EBITDA, and provide steady cash flows and support the balance sheet. Upstream, that is, aluminum business is high-margin; volatility is correlated to the metal cycle.

High-margin-high-volatility aluminum business supported by two steady cash flow converter businesses

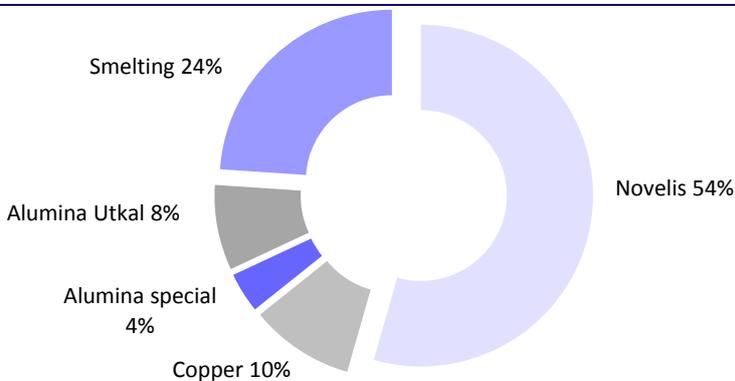
**Exhibit 1: Robust business**



Source: MOSL

More than 60% of EBITDA is independent of LME; our estimates suggest 68% in FY18

**Exhibit 2: EBITDA split**



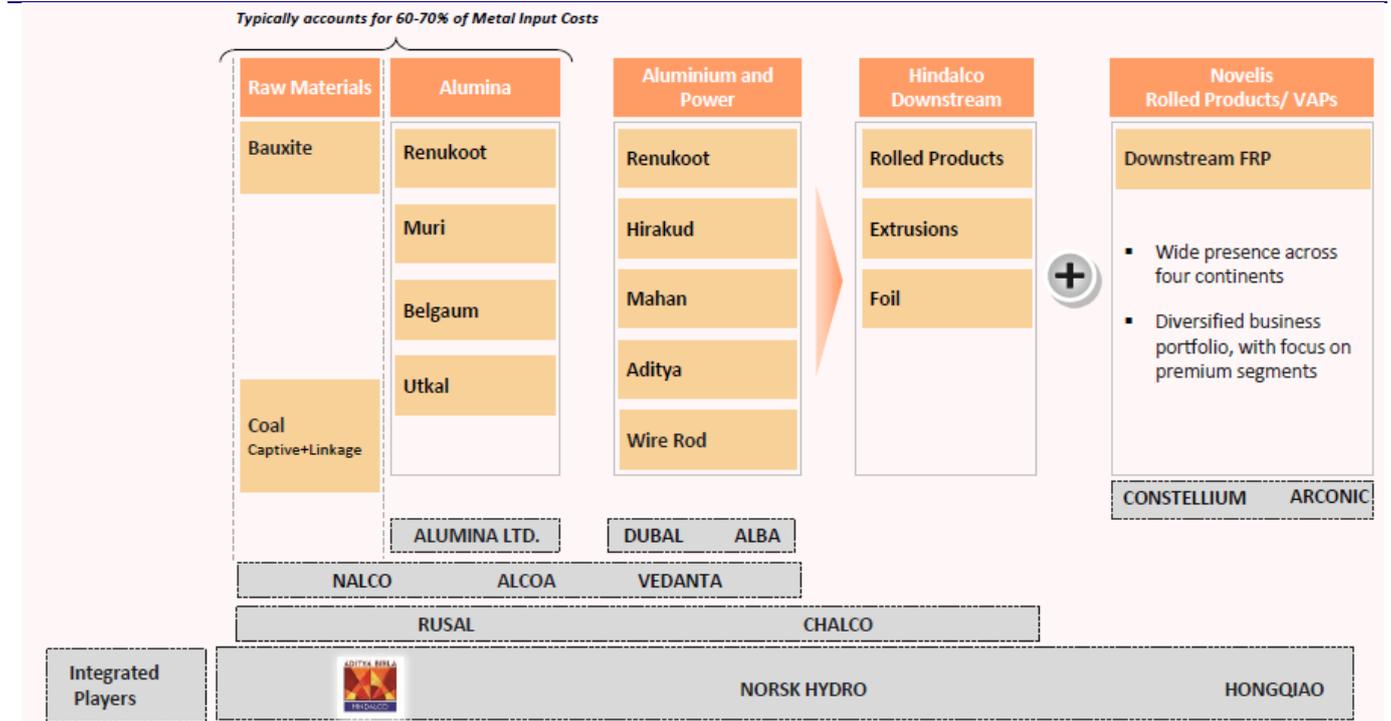
Source: MOSL

**Presence across the aluminum value chain**

HNDL is one of the very few companies in the world present across the value chain. Its operations start from coal and bauxite mining and stretch right up to high-end products like flat rolled products (FRP) used in automobiles. Only Norsk Hydro and Hongqiao are the other two players that have such presence across the value chain.



**Exhibit 3: Presence across the aluminum value chain**



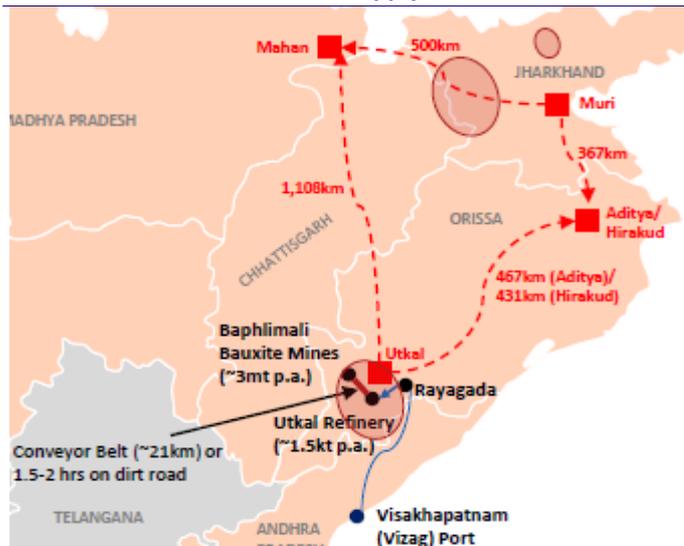
Source: MOSL, Company

**Upstream/aluminum smelting – cost leadership and stable operations**

Access to high quality bauxite

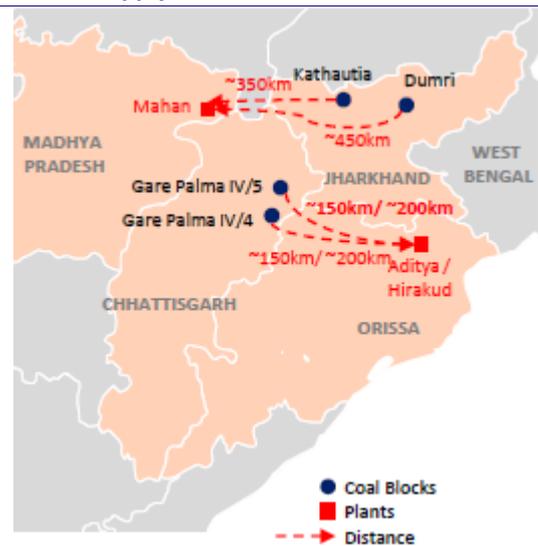
HNDL's upstream smelting business in India has access to 28 bauxite mines located in close proximity to its refineries. Captive bauxite mines have total proved and probable reserves of 246mt.

**Exhibit 4: Bauxite and alumina supply chain**



Source: Company

**Exhibit 5: Coal supply chain**



Source: Company

Utkal alumina refinery has access to good quality bauxite (high in alumina content and low in silica) in Baphimali mine, with ~189mt of proved and probable reserves, and mine life of 42 years. The refinery is located close to the mines. Bauxite is

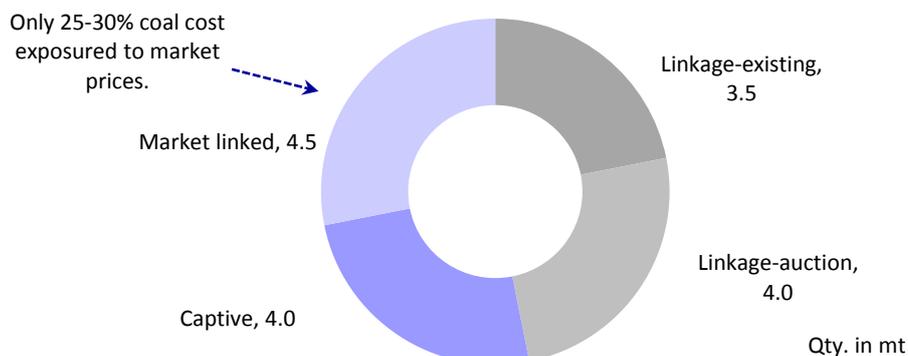
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transported through long-distance conveyor belt. Alumina is transported to Mahan and Aditya smelters through dedicated BTAP wagons.

Hindalco has successfully ensured long-term availability of coal through linkages and captive mines.

- Linkage coal meets over 35% of supply for each smelter.
  - Long-term coal linkage contract with Coal India; typically for five years
  - New Linkage: October-November 2016, and 1QFY18
  - Existing Linkage: 2013/2014
- Bidding/tendering of captive mines meets another 35% of supply for each smelter. HNDL has acquired four coal blocks in 2015:
  - Kathautia, Gare Palma IV/5, Gare Palma IV/4, and Dumri
- Purchase from the market through E-auction and imports meets balance requirements.

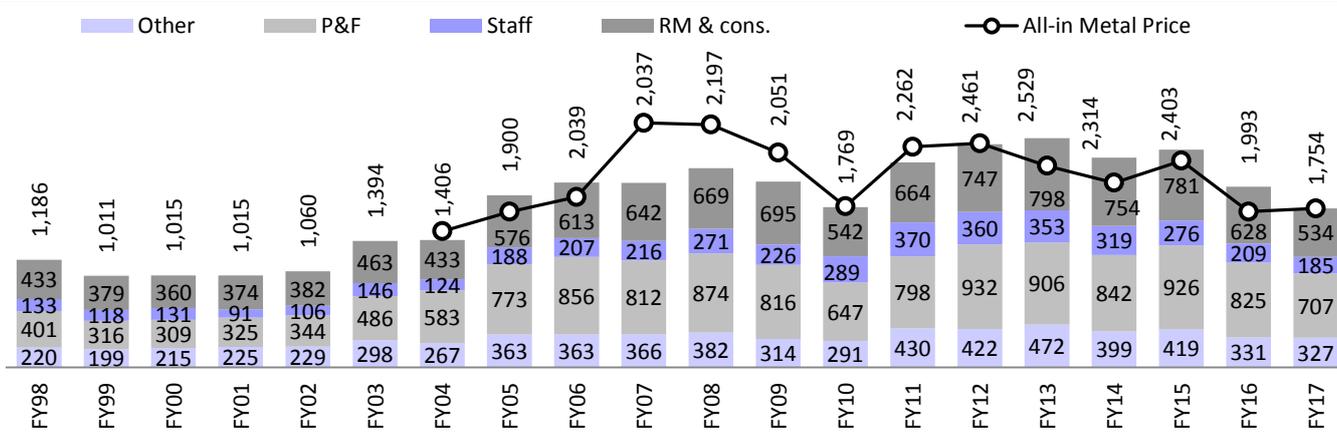
Exhibit 6: Coal sourcing strategy



Source: MOSL, Company

HNDL has benefitted from improvement in domestic supply of coal, start of new bauxite mines at Bhaphimali, installation of conveyors for coal and bauxite in past two years. This has helped in reducing cost of production.

Exhibit 7: Cost of production (USD/t)

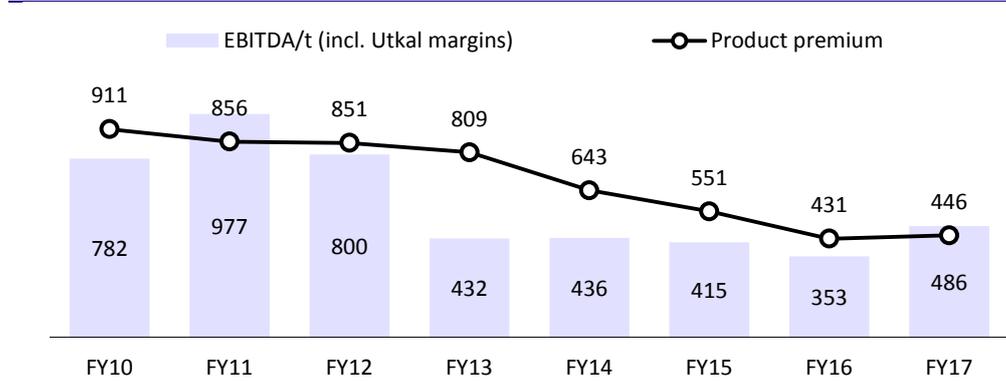


Source: MOSL, Company

It is interesting to note that HNDL's cost of production (CoP) has fallen in line with fall in aluminum prices (Exhibit 7) in past two years.

As HNDL has been able to manage its costs in trying times, the margins have become stable despite falling product premiums.

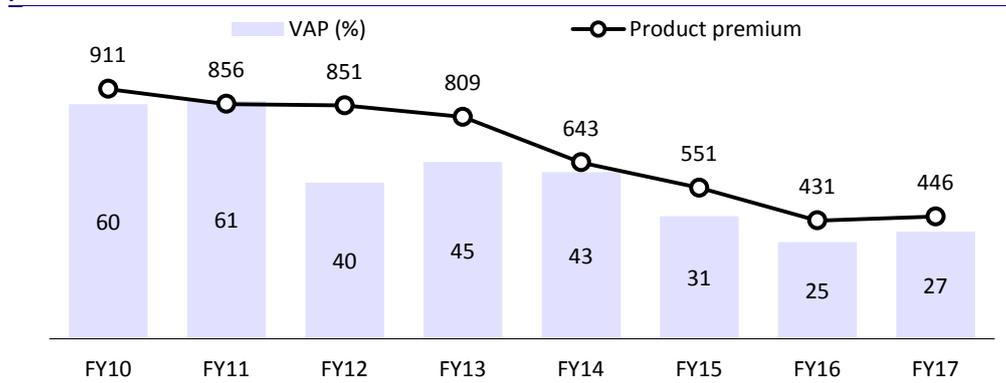
**Exhibit 8: Margins and product premium over all-in-aluminum (USD/t)**



Source: MOSL, Company

The decline in the product premiums is driven by rising domestic over supply and dilution in product mix

**Exhibit 9: Product premium over all-in-aluminum (USD/t) and share of value-added products**



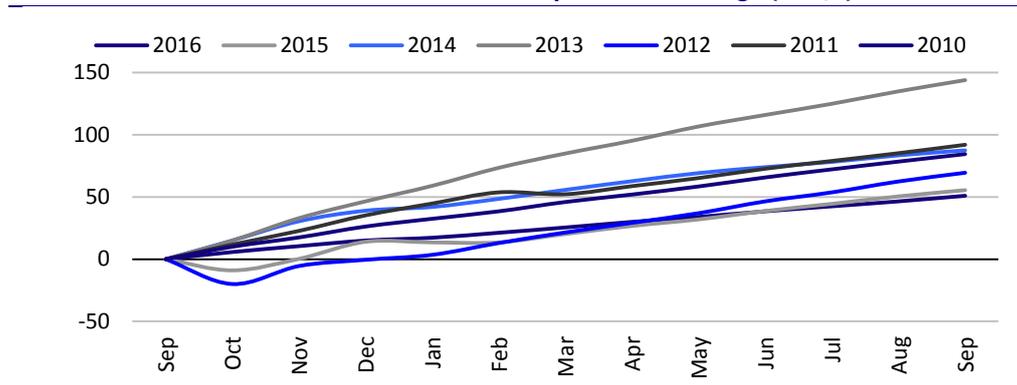
Source: MOSL, Company

**There is merit in hedging aluminum production**

HNDL has been hedging 30-50% of its production to protect its margins against volatility in LME. This exercise has been remunerative for the company because both aluminum and USD/INR rates trade at premium in forward market.



**Exhibit 10: Aluminum forward curves have mostly been in contango (USD/t)**

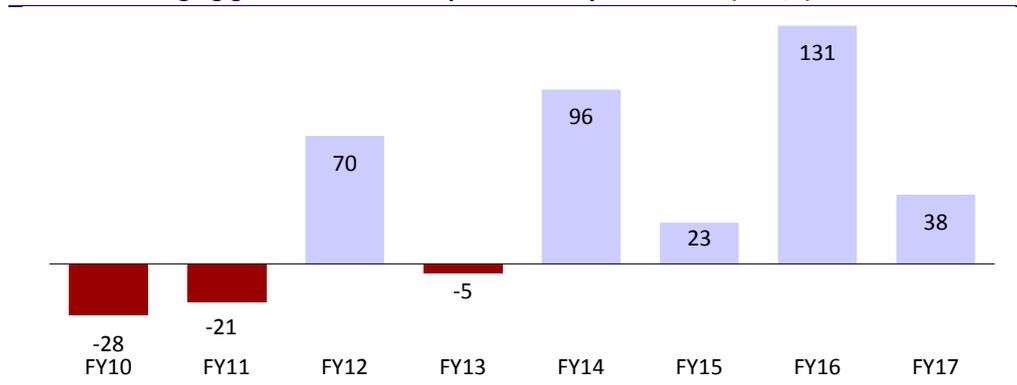


Source: MOSL, Bloomberg

Average hedging gains have outstripped average hedging losses by USD38/t in eight years (Exhibit 10). According to annual report FY17, HNDL has hedged ~980kt aluminum production at average LME of USD1,796/t. However, it has also sold forward USD1.375b at an average rate of INR72.03/USD. If we were to make MTM adjustments, the average realization would equal to USD2,000/t at current USD/INR rate. Therefore, we believe there is merit in hedging.

Average hedging gains have outstripped average hedging losses by USD38/t over eight years

**Exhibit 11: Hedging gains on aluminum products recycled in P&L (USD/t)**



Source: MOSL, Company

**Growth: Focus on downstream and high IRR projects**

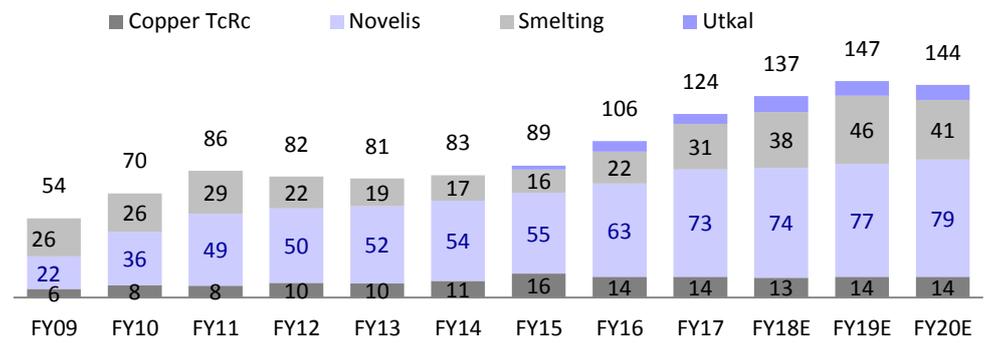
Mr Pai re-iterated his strategy of focusing on accelerated deleveraging, operational excellence, higher value addition, customer centricity, and cash conservation to deliver stakeholder value.

Mr Pai emphasized that incremental capital allocation will be towards high IRR de-bottlenecking at alumina refinery at Utkal and less capital intensive downstream projects. There are huge opportunities for growth in auto segment for Novelis. Electric vehicles will accelerate growth in light-weighting and drive demand for FRP. Mr Pai is very mindful of valuations for any inorganic opportunities.



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Exhibit 12: EBITDA (INR billion)

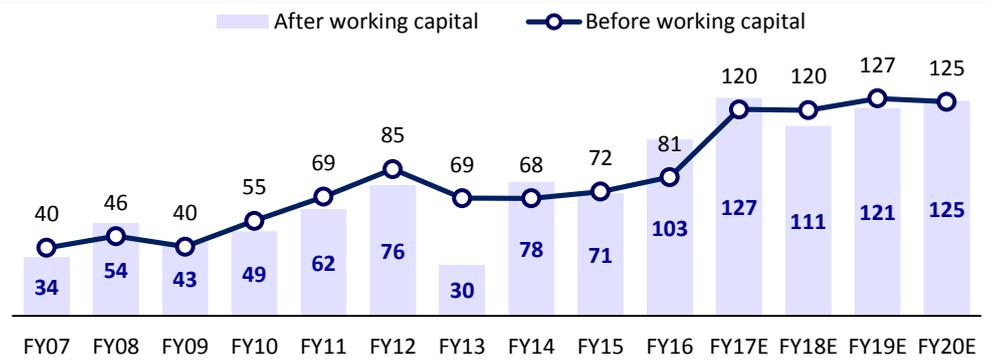


Source: Company, MOSL

Accelerated deleveraging

HINDL has already repaid INR78b debt until August 2017 and plans to repay another INR30b during FY18, as it has strong free cash flows.

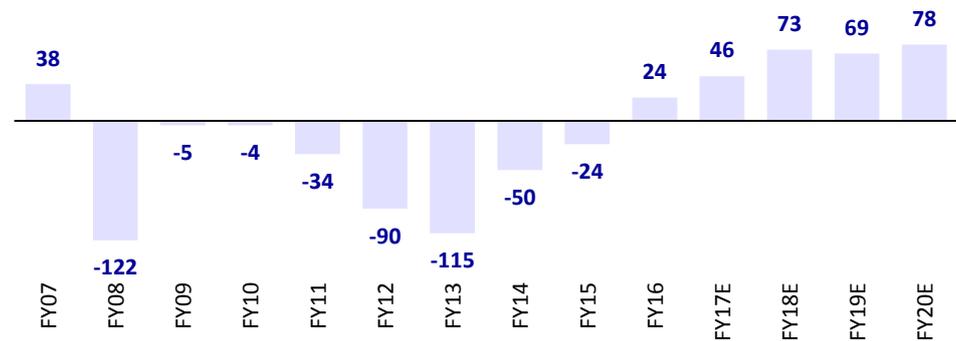
Exhibit 13: Operating cash flow (INR billion)



Source: Company, MOSL

Exhibit 14: Free cash flow (INR billion)

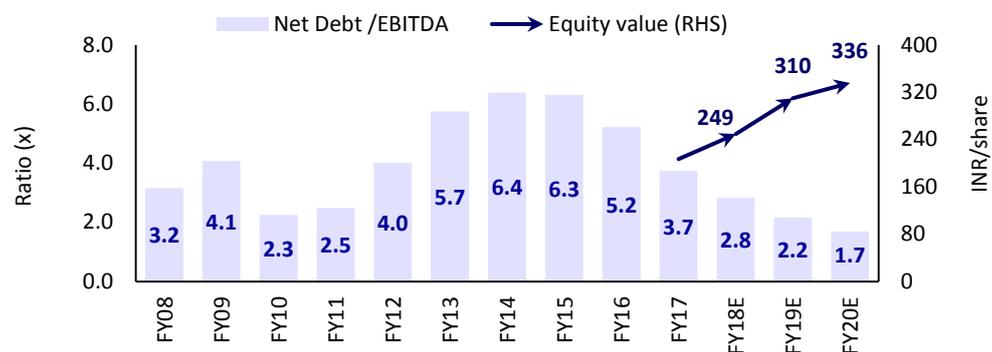
Strong free cash flows are driven by end of capex cycle and asset sweating



Source: Company, MOSL



Exhibit 15: Accelerated deleveraging driving equity value



Source: Company, MOSL

Exhibit 16: Sum-of-the-parts valuations

Y/E March	2016	2017	2018E	2019E	2020E
<b>EBITDA</b>	<b>86,542</b>	<b>124,359</b>	<b>136,646</b>	<b>146,728</b>	<b>144,181</b>
EV/EBITDAx			6.5	6.5	6.5
Target EV			888,198	953,729	937,174
Net Debt	553,792	465,385	387,658	318,472	243,711
EQ = (EV-net Debt)			500,539	635,257	693,463
A. INR/share(EQ)			225	285	311
Investments (quoted)			68,340	68,340	68,340
B. INR/share (invest)			31	31	31
C. discount factor (%)			20	20	20
<b>Equity Value (A+B*(1-C%))</b>			<b>249</b>	<b>310</b>	<b>336</b>
USD/INR		67.1	64.9	65.0	65.0
LME		1,665	1,940	2,025	1,950

Source: MOSL



## Financials and Valuations

### Income Statement

(INR Million)

Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
<b>Net sales</b>	<b>801,928</b>	<b>876,955</b>	<b>1,042,811</b>	<b>1,000,538</b>	<b>1,001,838</b>	<b>1,074,744</b>	<b>1,147,772</b>	<b>1,143,857</b>
Change (%)	-0.8	9.4	18.9	-4.1	1.4	7.3	6.8	-0.3
Total Expenses	721,344	794,092	953,365	894,485	877,479	938,098	1,001,045	999,676
<b>EBITDA</b>	<b>80,584</b>	<b>82,863</b>	<b>89,446</b>	<b>106,053</b>	<b>124,359</b>	<b>136,646</b>	<b>146,728</b>	<b>144,181</b>
% of Net Sales	10.0	9.4	8.6	10.6	12.4	12.7	12.8	12.6
Depn. & Amortization	28,611	35,528	35,906	41,961	44,572	45,200	46,076	47,184
<b>EBIT</b>	<b>51,973</b>	<b>47,335</b>	<b>53,540</b>	<b>64,091</b>	<b>79,786</b>	<b>91,446</b>	<b>100,651</b>	<b>96,997</b>
Net Interest	20,791	27,016	41,784	50,467	57,424	40,935	37,594	35,967
Other income	10,122	10,172	11,047	12,113	11,110	10,867	13,452	17,092
<b>PBT before EO</b>	<b>41,304</b>	<b>30,491</b>	<b>22,803</b>	<b>25,738</b>	<b>33,472</b>	<b>61,378</b>	<b>76,510</b>	<b>78,121</b>
EO income (exp)	-2,216	-3,960	-19,401	-22,083	-76			
<b>PBT after EO</b>	<b>39,088</b>	<b>26,531</b>	<b>3,402</b>	<b>3,654</b>	<b>33,395</b>	<b>61,378</b>	<b>76,510</b>	<b>78,121</b>
Tax	8,857	5,249	2,564	5,148	14,326	17,063	21,619	22,119
Rate (%)	22.7	19.8	75.4	140.9	42.9	27.8	28.3	28.3
<b>Reported PAT</b>	<b>30,231</b>	<b>21,282</b>	<b>838</b>	<b>-1,494</b>	<b>19,069</b>	<b>44,315</b>	<b>54,891</b>	<b>56,003</b>
Minority interests	-196	200	-5,957	-2,378	-174	-107		
Share of asso.	-158	668	1,747	1,749	-251	-251	-251	-251
<b>Adjusted PAT</b>	<b>32,485</b>	<b>25,710</b>	<b>27,943</b>	<b>24,717</b>	<b>19,069</b>	<b>44,171</b>	<b>54,639</b>	<b>55,751</b>
Change (%)	-4.4	-20.9	8.7	-11.5	-22.9	131.6	23.7	2.0

### Cash Flow Statement

(INR Million)

Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
EBITDA	80,584	82,863	89,446	106,053	124,359	136,646	146,728	144,181
XO Exp. (income)	1,410	-4,821	-5,872	-17,472	3,622	401	465	527
tax paid	-13,478	-9,586	-11,280	-7,830	-7,797	-17,384	-20,656	-20,061
Change in WC	-38,740	9,623	-863	21,960	6,691	-9,077	-5,578	508
<b>CF from Op. Activity</b>	<b>29,776</b>	<b>78,079</b>	<b>71,431</b>	<b>102,710</b>	<b>126,875</b>	<b>110,586</b>	<b>120,958</b>	<b>125,154</b>
(Inc)/Dec in FA + CWIP	-118,711	-94,236	-59,776	-39,891	-29,376	-27,804	-27,836	-27,869
<b>Free Cash Flow</b>	<b>-88,936</b>	<b>-16,156</b>	<b>11,655</b>	<b>62,818</b>	<b>97,499</b>	<b>82,782</b>	<b>93,122</b>	<b>97,285</b>
(Pur)/Sale of Inv. & yield	10,729	10,910	15,680	10,658	1,491	10,867	13,452	17,092
Others	-357	1,672	-796	604	7,701	20,433		
<b>CF from Inv. Activity</b>	<b>-108,340</b>	<b>-81,655</b>	<b>-44,892</b>	<b>-28,629</b>	<b>-20,185</b>	<b>3,496</b>	<b>-14,384</b>	<b>-10,777</b>
Equity raised/(repaid)	128	16,305	47	3	33,141			
Debt raised/(repaid)	143,356	48,689	28,323	-19,714	-25,430	-52,511	-55,872	-56,564
Interest	-36,728	-46,919	-50,253	-50,308	-60,754	-40,935	-37,594	-35,967
Dividend (incl. tax)	-3,977	-3,149	-2,488	-2,575	-2,479	-3,648	-3,648	-3,648
<b>CF from Fin. Activity</b>	<b>102,779</b>	<b>14,926</b>	<b>-24,371</b>	<b>-72,594</b>	<b>-55,523</b>	<b>-97,094</b>	<b>-97,114</b>	<b>-96,180</b>
<b>(Inc)/Dec in Cash</b>	<b>24,215</b>	<b>11,351</b>	<b>2,168</b>	<b>1,486</b>	<b>51,167</b>	<b>16,988</b>	<b>9,460</b>	<b>18,197</b>
Add: Opening Balance	81,556	105,771	117,121	119,289	120,962	172,129	189,118	198,578
<b>Closing Balance</b>	<b>105,771</b>	<b>117,121</b>	<b>119,289</b>	<b>120,775</b>	<b>172,129</b>	<b>189,118</b>	<b>198,578</b>	<b>216,775</b>

E: MOSL Estimates

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## Financials and Valuations

## Ratios

Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
<b>Basic (INR)</b>								
EPS	17.0	12.5	13.5	12.0	8.6	19.8	24.5	25.0
Cash EPS	30.7	27.5	17.8	19.6	28.6	40.2	45.3	46.3
BV/Share (adj.)	100.7	114.6	105.4	101.8	129.9	148.2	171.3	195.0
DPS	1.4	1.0	1.0	1.0	1.1	1.4	1.4	1.4
Payout (%)	9.7	9.4	8.6	9.8	15.0	8.3	6.7	6.5
<b>Valuation (x)</b>								
P/E		17.8	16.4	18.6	26.0	11.2	9.1	8.9
Cash P/E		8.1	12.5	11.3	7.8	5.5	4.9	4.8
P/BV		1.9	2.1	2.2	1.7	1.5	1.3	1.1
EV/Sales		1.1	1.0	1.0	1.0	0.8	0.7	0.6
EV/EBITDA		11.9	11.4	9.5	7.7	6.5	5.5	5.1
Dividend Yield (%)		0.4	0.4	0.4	0.5	0.6	0.6	0.6
<b>Return Ratios (%)</b>								
EBITDA Margins (%)	10.0	9.4	8.6	10.6	12.4	12.7	12.8	12.6
Net Profit Margins (%)	4.1	2.9	2.7	2.5	1.9	4.1	4.8	4.9
RoE	18.0	11.6	12.3	11.6	7.4	14.3	15.4	13.7
RoCE (pre-tax)	5.9	4.6	4.9	5.9	7.3	8.3	9.2	8.9
RoC (pre-tax)	10.7	7.6	6.9	7.5	9.1	10.8	12.3	12.1
<b>Working Capital Ratios</b>								
Fixed Asset Turnover (x)	1.7	1.2	1.2	1.0	1.0	1.0	1.1	1.1
Asset Turnover (x)	0.8	0.8	0.9	0.9	0.9	1.0	1.1	1.1
Debtor (Days)	40.7	38.4	32.2	29.0	30.1	30.5	30.6	30.7
Inventory (Days)	65.2	69.5	64.6	61.0	66.6	66.5	66.2	66.2
Payable (Days)	43.8	54.1	54.3	51.5	65.1	64.4	64.5	64.5
<b>Growth (%)</b>								
Sales	-0.8	9.4	18.9	-4.1	1.4	7.3	6.8	-0.3
EBITDA	-1.6	2.8	7.9	18.6	17.3	9.9	7.4	-1.7
PAT	-4.4	-20.9	8.7	-11.5	-22.9	131.6	23.7	2.0
<b>Leverage Ratio (x)</b>								
Current Ratio	1.9	1.7	1.6	1.5	1.6	1.6	1.6	1.7
Interest Cover Ratio	2.5	1.8	1.3	1.3	1.4	2.2	2.7	2.7
Debt/Equity	2.4	2.2	2.6	2.6	1.6	1.2	0.8	0.6

## Cash Flow Statement

(INR Million)

Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
EBITDA	80,584	82,863	89,446	106,053	124,359	136,646	146,728	144,181
XO Exp. (income)	1,410	-4,821	-5,872	-17,472	3,622	401	465	527
tax paid	-13,478	-9,586	-11,280	-7,830	-7,797	-17,384	-20,656	-20,061
Change in WC	-38,740	9,623	-863	21,960	6,691	-9,077	-5,578	508
<b>CF from Op. Activity</b>	<b>29,776</b>	<b>78,079</b>	<b>71,431</b>	<b>102,710</b>	<b>126,875</b>	<b>110,586</b>	<b>120,958</b>	<b>125,154</b>
(Inc)/Dec in FA + CWIP	-118,711	-94,236	-59,776	-39,891	-29,376	-27,804	-27,836	-27,869
<b>Free Cash Flow</b>	<b>-88,936</b>	<b>-16,156</b>	<b>11,655</b>	<b>62,818</b>	<b>97,499</b>	<b>82,782</b>	<b>93,122</b>	<b>97,285</b>
(Pur)/Sale of Inv. & yield	10,729	10,910	15,680	10,658	1,491	10,867	13,452	17,092
Others	-357	1,672	-796	604	7,701	20,433		
<b>CF from Inv. Activity</b>	<b>-108,340</b>	<b>-81,655</b>	<b>-44,892</b>	<b>-28,629</b>	<b>-20,185</b>	<b>3,496</b>	<b>-14,384</b>	<b>-10,777</b>
Equity raised/(repaid)	128	16,305	47	3	33,141			
Debt raised/(repaid)	143,356	48,689	28,323	-19,714	-25,430	-52,511	-55,872	-56,564
Interest	-36,728	-46,919	-50,253	-50,308	-60,754	-40,935	-37,594	-35,967
Dividend (incl. tax)	-3,977	-3,149	-2,488	-2,575	-2,479	-3,648	-3,648	-3,648
<b>CF from Fin. Activity</b>	<b>102,779</b>	<b>14,926</b>	<b>-24,371</b>	<b>-72,594</b>	<b>-55,523</b>	<b>-97,094</b>	<b>-97,114</b>	<b>-96,180</b>
<b>(Inc)/Dec in Cash</b>	<b>24,215</b>	<b>11,351</b>	<b>2,168</b>	<b>1,486</b>	<b>51,167</b>	<b>16,988</b>	<b>9,460</b>	<b>18,197</b>
Add: Opening Balance	81,556	105,771	117,121	119,289	120,962	172,129	189,118	198,578
<b>Closing Balance</b>	<b>105,771</b>	<b>117,121</b>	<b>119,289</b>	<b>120,775</b>	<b>172,129</b>	<b>189,118</b>	<b>198,578</b>	<b>216,775</b>

E: MOSL Estimates

## NOTES



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