Research analysts

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INITIATION

UC RUSAL

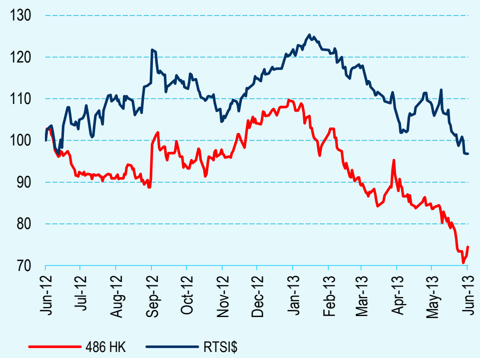
Expensive option

SELL

Ticker	486 HK
Target price, HKD	2.22
Last price of common shares, HKD	3.44
Upside	-35%
Number of common shares, mn	15,191
Market cap, $mn	6,730
Net debt, $mn	10,171
EV, $mn	10,570
Free float	10%
52-week min, HKD	3.26
52-week max, HKD	5.08

Sources: Bloomberg, Otkritie Capital Research

Share price performance



Sources: Bloomberg

UC RUSAL is the ultimate high beta play on a sustainable aluminium price recovery. However, aluminium is unlikely to see a sustainable recovery until at least 2015 in our view. Without growth, a significant valuation discount or dividends, we see little investment case in RUSAL. We initiate with a SELL rating and HK$2.22/share target price, implying 35% potential downside.

Aluminium structurally challenged. In spite of significant curtailments outside China in recent years, the Chinese continue to build more capacity, typically further down the cost curve, while unprofitable smelters are not being closed. Aluminium is not short of demand growth, with a CAGR of c. 5% pa expected in the next few years, but a surplus will remain, in our view, for the foreseeable future. Even when there is a global recovery and interest rates start to rise, the contango in the forward curve will decrease; c. 60% of LME inventories currently locked up in financing trades will come back to market, killing an immediate pricing recovery. It is hard to see a sustained price recovery in the near future.

UC RUSAL remains a high cost option. At 16x 2013 EV/EBITDA with no volume growth (higher cost facilities will shut, offsetting growth from the BEMO greenfield project), RUSAL remains a high cost call on the aluminium price due to high leverage and sub-10% EBITDA margins. When aluminium does see a sustainable recovery, RUSAL's share price could make big gains, but we do not expect this in the near/medium term. We believe government support and dividends from Norilsk will mean debt covenants will not be an issue. However, debt holders will see all of the projected FCF, leaving little for equity holders.

Valuation. We derive a HK$2.22 target price assuming a slow recovery to a $2,400/t real long term aluminium price, a more sustainable level to incentivise longer term investment. Around 100% of RUSAL's market cap is accounted for by its 27.8% stake in Norilsk at present, but there is no reason that this should act as a floor price for the stock given the $6.3bn stake is part collateral for some of the $11bn net debt. Net debt less the Norilsk stake value is currently $4.6bn and RUSAL generates close to zero EBITDA at spot aluminium prices, implying there is little equity value in the core aluminium business.

Catalysts. RUSAL is too illiquid and expensive to short given the lack of real catalysts, but we would avoid the stock on valuation grounds.

Risks. High sensitivity of EBITDA to the aluminium price and the ruble means RUSAL could rally significantly in the event of stimulus or significant capacity rationalisation.

Figure 1. Key metrics ($mn)

	2012	2013E	2014E	2015E
Revenues	10,891	10,271	10,716	11,302
EBITDA	915	656	692	723
EBIT	676	192	195	226
Net income	(337)	(10)	260	315
Net debt	10,829	10,171	9,702	9,642
EPS, $	(0.02)	(0.00)	0.02	0.02
CEPS, $	0.01	0.03	0.05	0.05
BVPS, $	0.72	0.68	0.70	0.72
DPS, $	-	-	-	-

Sources: Bloomberg, Otkritie Capital estimates

Figure 2. Valuation

	2012	2013E	2014E	2015E
P/E	nm	nm	25.9	21.3
EV/EBITDA	10.5	16.1	14.6	13.9
EV/Sales	0.9	1.0	0.9	0.9
P/BV	0.6	0.6	0.6	0.6
EBITDA margin	*8.4%*	*6.4%*	*6.5%*	*6.4%*
Net margin	*(3.1%)*	*(0.1%)*	*2.4%*	*2.8%*
Revenue growth	*-11%*	*-6%*	*4%*	*5%*
EPS growth	*n/m*	*n/m*	*n/m*	*21%*
Div yield	-	-	-	-

Sources: Bloomberg, Otkritie Capital estimates

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Expensive option

Investment summary

RUSAL remains an expensive option on the aluminium price, in our view, due to narrow margins and excessive leverage. We see limited scope for RUSAL to make further cost savings beyond the ongoing capacity rationalisation plan and, as such, the company remains a slave to the aluminium price and ruble. Norilsk dividends appear the only source of funds for de-leveraging at current aluminium prices, and we see risks to these, but again, it is out of RUSAL's hands.

We see little scope for a sustainable rally in the aluminium price in the near or medium terms, and as a result initiate with a SELL rating and target price of HK$2.22. RUSAL's EBITDA, earnings and EV have enormous leverage to the aluminium price, but despite a recent $100/t rally in the aluminium price, RUSAL fell further (this rally was short-lived and aluminium has since fallen back c. $100/t to close to $1,800/t in the last week). It trades at roughly the value of the Norilsk Nickel stake and the underlying equity value of the aluminium business remains over-priced. It is too expensive and illiquid to short, and the fact that it receives state support and flexible debt covenant agreements means that, despite the unsustainable leverage, it is unlikely to be forced into bankruptcy. If it de-rates further and the Norilsk dividends help to reduce leverage, it may become a high beta risk-on aluminium play once more. But at present it remains an over-priced option and this is not the time to buy the stock.

Aluminium – a structural underweight for the foreseeable future

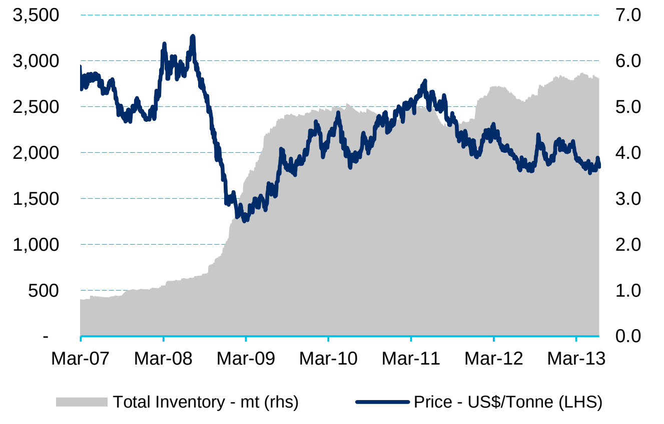
We do not like aluminium fundamentally due to oversupply and high inventory overhang in spite of a relatively strong demand outlook. These themes in aluminium have not changed drastically in the last year and, if anything, demand has deteriorated of late given weak Chinese data.

No shortage of demand…

Aluminium is not short of demand growth as the China growth story moves into a later stage, more focused on auto-production, airlines, etc rather than steel-intensive construction. As a result, a demand CAGR of c. 5-6% pa is possible for the next few years, on our estimates. Alcoa expects demand growth in China (c. 40% of global demand) to be c. 11% YoY in 2013.

Figure 3. Inventories still growing and price remains low

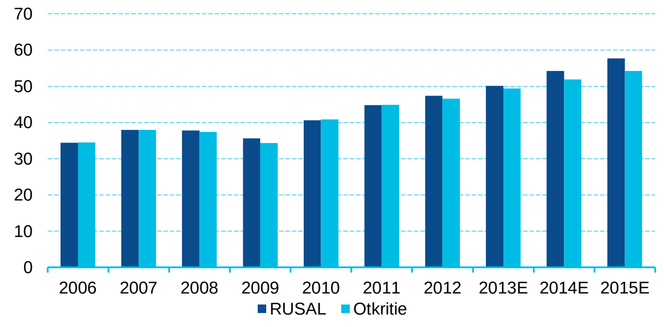
Aluminium price vs inventories (LME and Shanghai)



Sources: Otkritie Capital Research, Bloomberg

Figure 4. Strong demand outlook - we expect a 5% CAGR to 2015

Our expectations vs RUSAL's forecast for aluminium demand.



Sources: Otkritie Capital Research, RUSAL

… but supply growth remains too high

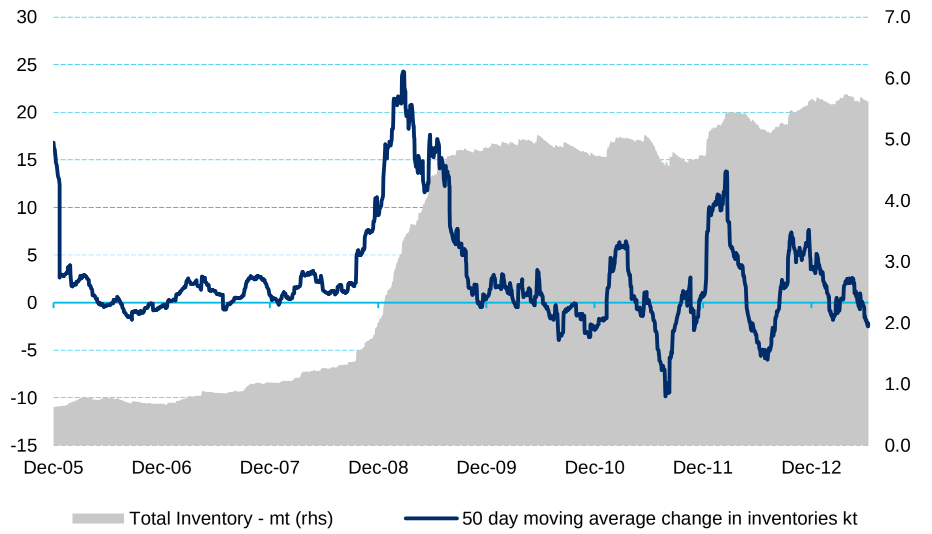
Curtailments in the West have not dramatically altered the surplus in the aluminium market. The Chinese continue to build capacity in line with growth in demand, and we haven't seen the growth in Chinese imports that RUSAL predicted a few years ago.

The cost curve shows close to a third of global production under water at current price levels, including premiums over LME prices that physical volumes change hands at today. Much of this capacity is in China, and they have been slow to curtail production in order to support domestic demand and maintain employment. The top end of the cost curve should be pushed up further by a strengthening RMB and power cost inflation, coupled with higher taxes on Indonesian bauxite exports. However, we expect the aluminium market to remain oversupplied for the foreseeable future given China's reluctance to curtail supply. We note that Chalco recently committed to shutting 380kt of capacity (close to 9% of its production), though this will be reopened when prices pick up, which does little to change the structure of the market.

Inventories remain high

Inventories remain higher in aluminium than for other base metals owing to the ongoing contango in the forward curve, which provides an incentive for traders to buy and store the metal. As long as rates stay low, this contango may continue and inventory will remain locked up. However, when world growth accelerates and rates rise, a significant quantity of inventory is due to come back to the market, which could keep the market in over-supply even longer.

Figure 5. Inventories remain high
Inventories and inventory movements

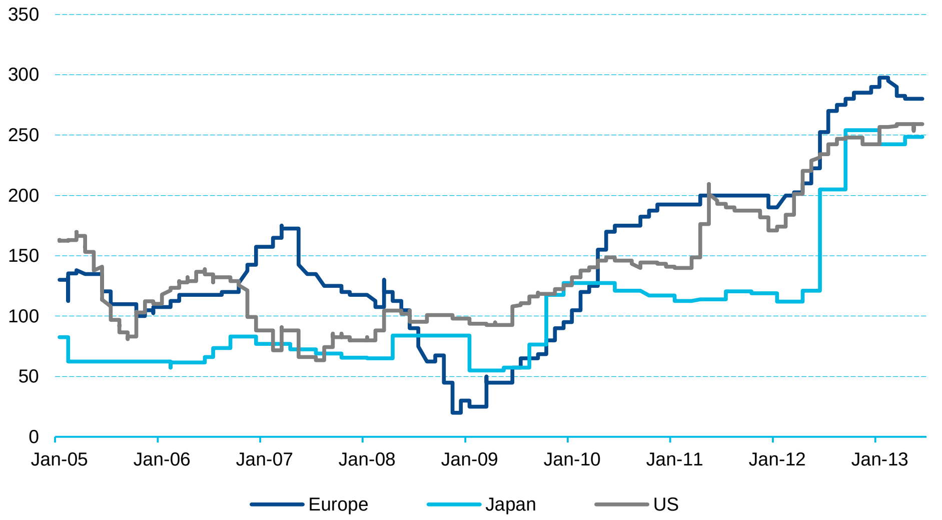


Sources: Otkritie Capital Research, Bloomberg

At least premiums remain strong

About 30% of the cost curve is underwater even when physical premiums above the LME price remain at very high levels in all markets. It is primarily due to these premiums that RUSAL is largely able to break even and service interest payments.

Figure 6. Premiums remain elevated
Physical premiums over LME aluminium prices ($/t)



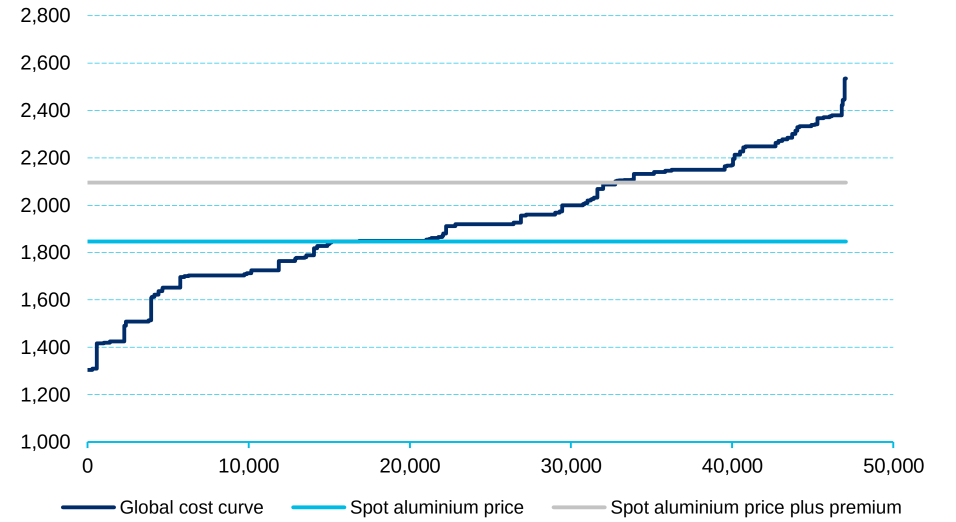
Sources: Otkritie Capital Research, Bloomberg

We assume premium levels will normalise as warehousing rules change and taking material out becomes easier, which will offset some of the LME price increases we expect over time.

Cost support in the long term

In the short term, the cost curve is unlikely to provide much if any support for producers, or allow significant margin expansion, as the curve is relatively flat. As c. 30% of global production is currently loss making on our estimates, it is clear that a higher aluminium price is required for a more sustainable market in the longer term. We believe at least c. $2,400/t is needed to incentivise production outside China. It is hard to imagine the Chinese will continue to produce at a loss indefinitely, but it will take time for them to permanently curtail enough production to balance the market.

Figure 7. Around 30% of global production is underwater at current price levels including premiums
Global cost curve relative to aluminium prices (with and without premiums), $/t



Sources: Otkritie Capital Research, Bloomberg, RUSAL

Given this backdrop, we see little reason to be positive on aluminium in the near future. We do expect a medium- to long-term recovery, so we model the following profile.

Figure 8. Our forecast commodity and FX prices

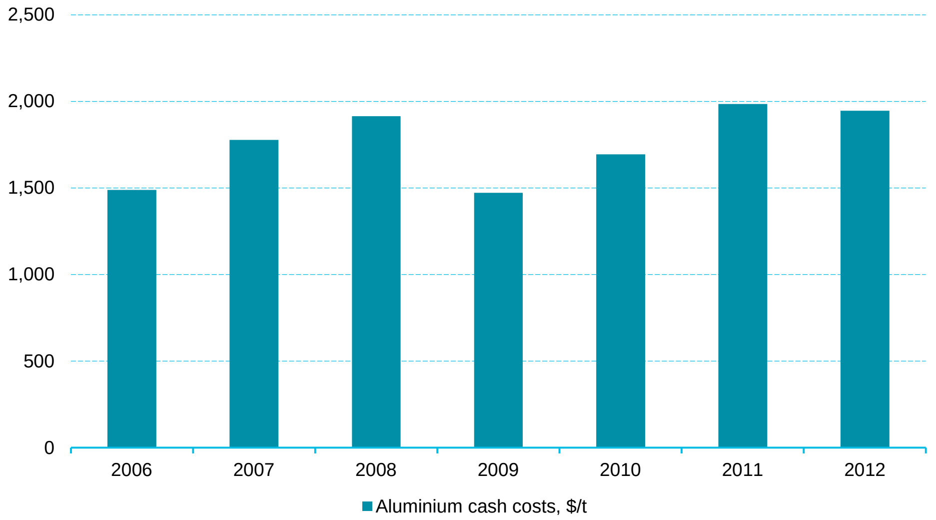
$/t	2013	2014	2015	2016	LT real
Aluminium	1,954	2,100	2,275	2,475	2,400
Alumina	325	319	341	371	408
Bauxite	31.1	31.9	34.1	37.1	40.8
RUB/$	31.2	31.0	31.1	31.5	
Realised aluminium price (with premium)	2,217	2,341	2,468	2,625	

Sources: Otkritie Capital Research

RUSAL is doing the right things

Following the collapse in aluminium prices in 2008/9, RUSAL implemented a massive efficiency drive, cutting cash costs from $1,915/t in 2008 to $1,471/t in 2009. Since then, the company was hit by increased distribution tariffs on its Siberian smelters, as part of the tariff liberalisation programme in order to reduce tariff inflation for retail users. This reversed RUSAL's progress on cost cutting in 2011.

Figure 9. Major cash cost savings were made in 2009 and have since been reversed by tax on power tariffs
Aluminium division cash cost progression annually



Sources: Otkritie Capital Research, RUSAL

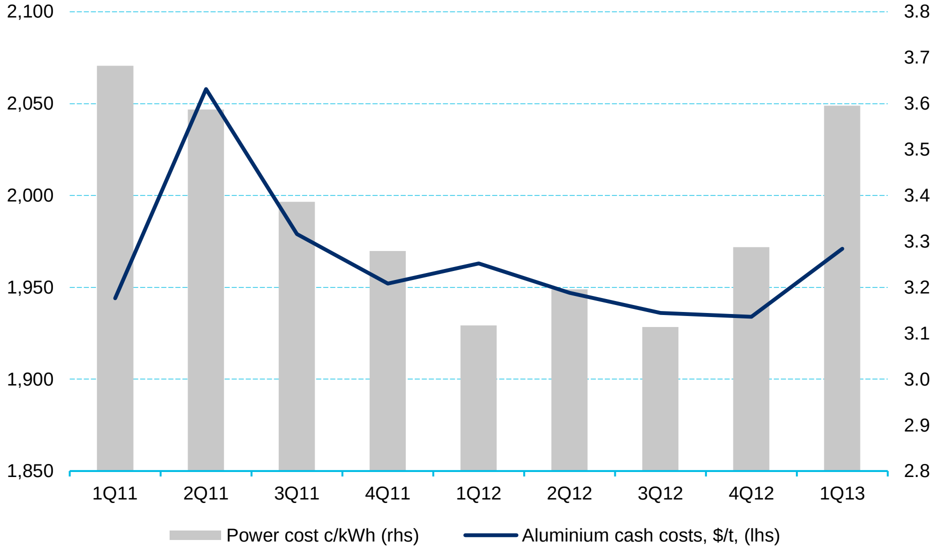
RUSAL has increased its percentage of value added products from 18% in 2009 to 40% in 1Q13 in order to increase premiums over LME pricing. Coupled with strong global premium growth, RUSAL's premiums have risen from $83/t in 1Q10 to $264/t in 1Q13, cushioning the fall in average realisations from lower LME prices.

On the core asset base, RUSAL has said there are no further significant cost savings to be exploited.

In the absence of scope to increase smelting margins, RUSAL has finally resorted to cutting capacity. It has announced plans to cut 300kt of capacity this year largely in European Russia where power costs are higher and we assume costs are close to $2,400/t. Cutting loss-making capacity should raise EBITDA, all things being equal. However, as much as RUSAL would like to close these smelters, job losses would be too great and we believe the social cost to mono-towns would not be tolerated by the government. As a result, they will remain open at lower capacity, so although group average costs will come down, unit costs at these smelters will increase due to inverse economies of scale. There would be scope for efficiencies here, but in reality, it is not a realistic option for RUSAL in our view. They may be able to close one smelter, potentially VAZ if they can lobby the government, but large scale closures are unlikely.

In short, once the capacity rationalisation programme is complete, we see limited scope for RUSAL to cut costs without government assistance in reducing power tariffs.

Figure 10. Cash cost incremental savings have been limited in recent quarters (before 1Q13), driven by lower power costs
Aluminium division cash cost progression vs power costs



Sources: Otkritie Capital Research

Is there scope for power tariff cuts?

RUSAL had some bargaining power at Bogoslovsk (BAZ) where it was able to negotiate a lower tariff due to its position as the main customer for the plant there, but this was only on c. 30kt and we understand BAZ production will fall from 103kt in 2012 to closer to 30-35kt this year. We also believe RUSAL may have received some state assistance in negotiations in order to maintain employment. We doubt there is much scope for RUSAL to significantly reduce tariffs at other high cost European smelters given its decision to rationalise capacity.

Power prices typically rise or fall with the aluminium price, as three smelters have tariffs linked to the aluminium price. As a rule of thumb, tariffs change 10% for a $100/t move in the aluminium price at the affected smelters. However, these typically fall to a floor price at $1,800/t, so further falls in LME prices will not provide further cost savings.

Could a weaker ruble reduce cost inflation?

The ruble is a commodity currency. Arguably, an end to QE and strengthening of the dollar should weaken commodity prices and the ruble. RUSAL and other producers will argue that if we model low commodity price forecasts, we should offset this by a weakening of the currency. We model our in-house forecasts for the RUB/$ rate and CPI, which assumes close to 6% pa inflation and a relatively flat/gradually weakening ruble in the next few years. While the ruble is a commodity currency, it is largely based on oil where the supply side is managed by a cartel and prices could remain high despite the strong dollar or a slowing China. In this case, the ruble can and probably will hold up. The worst case scenario for RUSAL is strong oil and weak aluminium, as the company will not feel the relief on its cost base, which benefits from a weakening ruble as shown in figure 11.

Figure 11. EBITDA is extremely sensitive to currency and commodity prices

Sensitivity of 2014 EBITDA to the aluminium and RUB/$

		Aluminium, $/t				
		-20%	***-10%***	***0%***	***10%***	***20%***
RUB/$	***-20%***	-487%	-385%	-289%	-201%	-113%
	-10%	-323%	-221%	-129%	-39%	53%
	0%	-192%	-94%	0%	93%	186%
	10%	-88%	11%	107%	201%	296%
	20%	-1%	100%	197%	291%	387%

Sources: Otkritie Capital Research

Improving vertical integration

RUSAL is currently c. 70% integrated into bauxite, lower than peers like Alcoa. While it is c. 93% integrated into alumina, its alumina refineries are high cost.

Alumina prices were traditionally linked as a percentage of the aluminium price in long term contracts. RUSAL, Alcoa and Rio Tinto have been pushing the idea of creating a more active spot market in alumina. They believe the fundamentals of aluminium and its feedstock differ. While there is surplus smelting capacity due to loss-making Chinese production, China imports bauxite and alumina, and the low aluminium-linked prices are not high enough to incentivise new production, especially when it is a capex intensive process. This could lead to a supply shortage for alumina in the medium to long term, so we believe alumina pricing will outpace aluminium. As a result, companies that are not integrated through the value chain will suffer. While bauxite is relatively plentiful, it is concentrated in awkward jurisdictions such as Guinea where lack of a clear outlook for taxes and property rights create less appetite for investment.

As RUSAL cuts aluminium production from 4.17mt to c. 3.87mt by the end of 2013, its demand for alumina will fall c. 580kt, increasing self-sufficiency to c. 96%. Lower alumina demand will lower bauxite requirements by nearly 1.2mt following the capacity rationalisation programme.

On top of this, RUSAL has the rights to develop Dian Dian, the world’s largest undeveloped bauxite deposit, having been granted a mining license in December. The company expects to produce 3mt by 2015 in phase one and, given the simplicity of the project, it expects capex to only be c. $200mn. This would increase self-sufficiency in bauxite to c. 90%, with the option to expand further. Though we see limited scope for RUSAL to finance the development from its own overstretched balance sheet, project finance or a JV with Chalco are options. RUSAL and Chalco recently signed a memorandum of understanding (MoU) to cooperate on mutually beneficial projects.

While this would have a limited impact on group financials in the short term, we see this as a strategic positive which will position RUSAL well for the future.

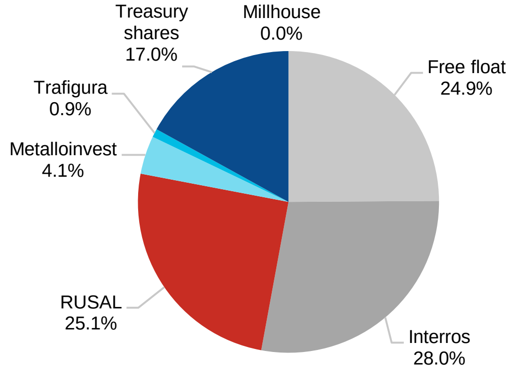
Cash flow breakeven at c. $2,025/t

RUSAL has cash costs of c. $1,970/t. In addition to cash costs, it needs to pay maintenance capex of c. $500-600mn pa, and interest payments of c. $650-700mn pa. This requires a price realisation of $2,280-90/t which equates to an LME price of $2,020-30/t at current levels of premiums, c. $2,190/t under an average 2005-2009 c. $100/t premium. Given spot is now $1,850/t, the aluminium business does not generate enough cash flow to reduce leverage.

Norilsk dividends provide some relief

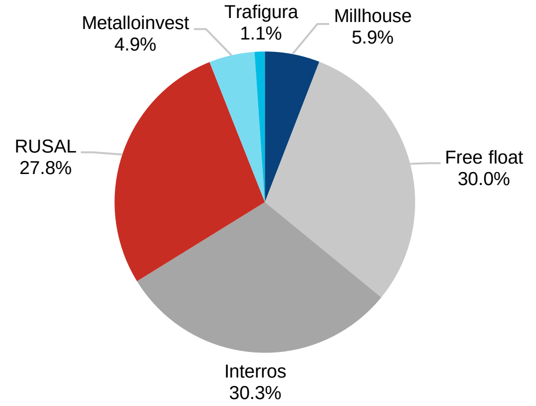
Following the shareholder agreement in December and the treasury stock cancellation, RUSAL has been able to increase its ownership in Norilsk from 25.1% to 27.8%, including the sale of 3.87mn shares to Millhouse at $160/share, raising $620mn in the process. This will be used to pay down some of the Sberbank debt.

Figure 12. Norilsk ownership before
Norilsk ownership structure before the treasury cancelation and Interros and RUSAL's share sale to Millhouse



Sources: Otkritie Capital Research, RUSAL

Figure 13. After
Norilsk ownership structure after the treasury cancelation and Interros and RUSAL's share sale to Millhouse



Sources: Otkritie Capital Research, RUSAL

RUSAL will also receive $567mn in dividends from the 2012 Norilsk dividend, which we expect to be paid in July, so in total, the company should reduce net debt by nearly $1.2bn. Nonetheless, RUSAL remains the most leveraged stock in our universe by some distance at c. 9x net debt/EBITDA (if we add the Norilsk associate income to the core EBITDA). If it were to liquidate the Norilsk stake at market prices, it would reduce debt by $6.3bn, so net debt would be c. 7x 2013E EBITDA, still above normal covenant breach levels.

With aluminium prices below FCF post interest-breakeven levels, the company is unlikely to significantly reduce this debt in the near future. It is therefore relying heavily on Norilsk's dividend flow to de-lever, hence the CEO Mr Deripaska's aggressive push for higher dividends, one of the reasons for the shareholder conflict before the agreement in December.

In our view, the outlook for Norilsk's dividend stream remains uncertain in spite of RUSAL's insistence that Norilsk will pay $3-4bn next year (dependent on the Inter RAO stake sale) and $3bn after that, $1.67-1.95bn for RUSAL in total. As we say in our Norilsk initiation, these dividends are not backed by FCF and could encounter political opposition if they threaten the financial stability of a Russian mining champion. Raising debt to pay dividends just de-rates the equity and may limit the price RUSAL will receive if it eventually sells out.

However, despite the high debt burden, RUSAL's creditors have been unwilling to take a harsher line with the company. Like Mechel, we see RUSAL as being too important to the Siberian economy for the government to allow the company to go bankrupt, as these leverage levels would imply. In addition, the international lenders waived debt covenants at the end of 2012 despite RUSAL being in breach of any sensible limits. While there is always a risk, we see it as small and do not worry about RUSAL's ability to refinance and roll the debt forward with help from the state-backed banks.

We are justifiably below consensus

Our estimates are below consensus, largely due to lower forecast aluminium prices and probably slightly stronger than consensus ruble forecasts. Our revenue estimates are c. 2% behind consensus and our costs 2-5% above (we assume due to a stronger-than-spot ruble forecast). Given the sub-10% EBITDA margins, this means our EBITDA estimates are 38-51% lower. Our net income estimates are even further behind consensus for the same reason.

Figure 14. We are below consensus due to lower aluminium prices
Our estimates vs Factset consensus, $mn

		Revenue			EBITDA			Net Income			Revenue-EBITDA		
		2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
United Co. Rusal	Consensus	10,515	10,922	11,520	1,063	1,314	1,464	826	592	616	9,452	9,608	10,056
	Otkritie	10,271	10,716	11,302	656	692	723	(10)	260	315	9,616	10,024	10,579
	Vs consensus	*-2%*	*-2%*	*-2%*	*-38%*	*-47%*	*-51%*	*-101%*	*-56%*	*-49%*	*2%*	*4%*	*5%*

Sources: Otkritie Capital Research, Factset

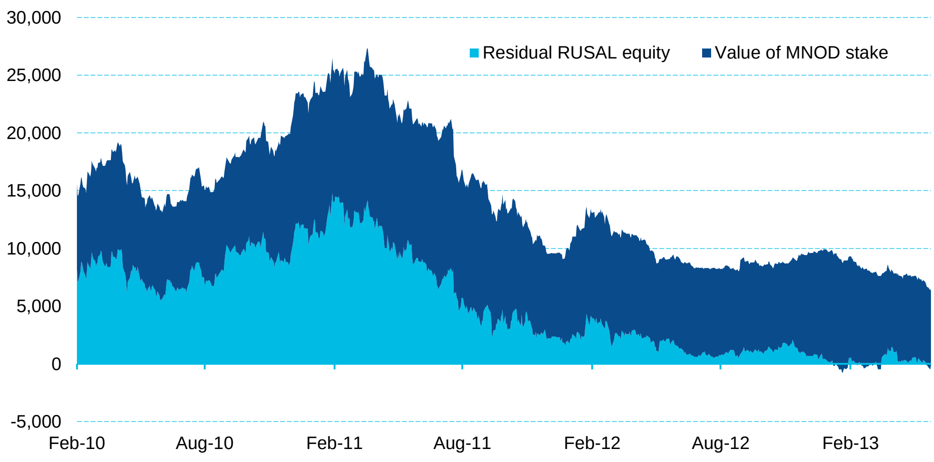
We believe our aluminium prices are realistic for the reasons given above. It is difficult to argue that aluminium should break out on the upside in the near future given the oversupply we see at present. RUSAL generated $246mn EBITDA in 1Q13 at an average LME price of c. $2,000/t. Aluminium averaged c. $1,900/oz in 2Q13 (assuming sales lag production by six weeks), so we expect $127mn in EBITDA to give $373mn in 1H13. To reach the $1,307mn 2013 consensus EBITDA figure, RUSAL needs to generate $690mn in 2H13, requiring c. $2,100/t in the second half (assuming flat costs). The average price in recent weeks has been only $1,800-1,900/t. The weaker ruble should lend some assistance and RUSAL is very sensitive to ruble movements as demonstrated above, but consensus appears too optimistic to us and we feel comfortable being 38% below at the EBITDA level.

Valuation

RUSAL's equity value ex-Norilsk is now insignificant after a big de-rating since 2011.

Figure 15. RUSAL's rump value is now little more than an option at present

RUSAL's market cap split between the value of the Norilsk stake and the residual equity, $mn



Sources: Otkritie Capital Research

Valuing RUSAL on standard metrics is difficult. Given the narrow margins, small changes in aluminium prices or RUB/$ can move FCF generation from positive to negative and make a large percentage difference to EBITDA and FCF. We estimate a 10% change in the LME aluminium price equates to a c. 90%+ change in 2014 EBITDA, with similar sensitivity to the RUB/$ rate. Couple that with the high financial leverage (with debt being a large percentage of the EV), the sensitivity of the equity valuation is extreme. As an example, reducing our price forecasts by 5% makes our DCF negative, and we already assume an increase to a long term $2,400/t aluminium price. We struggle to justify a positive valuation for RUSAL ex-Norilsk without a strong pick-up in aluminium prices in the long term.

The best way to look at RUSAL is as an out of the money option which is worth little now, but with high leverage to aluminium. Having said this, the EV has fallen so much on a spot basis that the DCF of the aluminium business is below the debt value, even with a significant recovery in aluminium prices. As a result, it seems as though the market attributes little value to the equity of the aluminium business and seems to see the value of the Norilsk stake as a floor.

As the Norilsk stake is pledged against the Sberbank debt, we see no logical reason why this should be a floor price. If the stake was liquidated at market value, RUSAL would still have $4.6bn of net debt, and it does not generate FCF until aluminium reaches c. $2,025/t, c. $200/t above the current spot price. The DCF of the aluminium business EV including BEMO is worth $9bn under our base case (less than the $11bn net debt), so there is little equity value for investors in the core (ex-Norilsk) business.

Given our view on aluminium, we see little benefit to owning RUSAL now, but at some point it could be a useful levered play on a sustainable price recovery, provided it reaches a more appropriate valuation. On valuation, we initiate with a SELL rating. We see limited downside in aluminium given how low down the cost curve the LME price is now, though that doesn't mean it couldn't trade down further in the near term. RUSAL is unlikely to be driven into bankruptcy due to benevolent state-backed banks, and shorting the stock is expensive and liquidity poor, leaving the trade heavily exposed to a short squeeze if there was a rally in the aluminium price.

The main negative catalyst we could expect would be news flow ruling out a large dividend at Norilsk next year, but as it is an annual event, this will not be a catalyst in the near term. To summarise our view on RUSAL, it is one to avoid on valuation, but not to short.

Our valuation is based entirely on DCF as shown in figure 16.

Figure 16. DCF
DCF for UC RUSAL, $mn

	2013	2014	2015	2016	2017	2018	2019	2020	TV
EBITDA	656	692	723	1,036	1,487	1,659	1,877	1,950	
Depreciation	(511)	(498)	(498)	(498)	(498)	(498)	(498)	(498)	
EBIT	145	195	226	539	989	1,161	1,379	1,453	
Tax rate	12%	12%	12%	12%	12%	12%	12%	12%	
Tax	(17)	(23)	(27)	(65)	(119)	(139)	(166)	(174)	
Change in WC	(142)	-	-	-	-	-	-	-	
Capex	(450)	(450)	(464)	(475)	(481)	(485)	(487)	(498)	
FCF	46	219	232	497	887	1,034	1,225	1,278	13,792
Discount rate	0.94	0.84	0.75	0.67	0.60	0.53	0.48	0.42	0.42
Discounted FCF	43	184	174	332	530	551	583	543	5,860
Cumulative FCF	8,800	8,756	8,572	8,399	8,067	7,537	6,986	6,403	5,860
Enterprise value	8,800								
Net debt	10,968								
BEMO	181								
MNOD stake	6,330								
Equity value	4,343								
Number of shares	15,191								
Value per share, $	0.29								
Value per share, HK$	**2.22**								
Discount rate	12.0%								
Terminal growth rate	2.5%								

Sources: Otkritie Capital Research

As an aside, we value the Norilsk stake at the current market price. If we were to use our target price for Norilsk ($11/ADR vs the current price of $14.4/share), our valuation for RUSAL would be lower at HK$1.46/share. At our Norilsk target price, the adjusted net debt (net debt less equity stake in Norilsk) would be $6.1bn, over 9x our forecast 2013 EBITDA, clearly an unsustainable level.

RUSAL appears very expensive on EV/EBITDA multiples, so setting our target price on a sector average multiple would imply negative equity value, hence why we prefer to use DCF which takes into account normalised earnings when the aluminium price recovers in the long term.

Below, we show a comps sheet comparing RUSAL to its major aluminium peers and Russian base metals peer Norilsk Nickel. It trades on a 37% premium to peers this year and nearly 100% in 2014/15. This is largely due to our estimates being based on lower aluminium prices than the average consensus expectations used for forecasting RUSAL's peers in this table. The high EBITDA sensitivity means the multiple premium appears much higher. However, even on consensus EBITDA estimates, RUSAL would trade at c. 10x, implying a premium to all peers except Chalco and a premium to RUSAL's three year average of 7.7x (according to Factset consensus). It also trades at a considerable premium to its Russian base metals peer Norilsk, which in our view is over-priced as well.

Figure 17. RUSAL appears very expensive on multiples
RUSAL vs peers, a comparison on multiples

	EV/EBITDA			P/E		
	2013E	2014E	2015E	2013E	2014E	2015E
Aluminium peers						
UC RUSAL	16.1	14.6	13.9	n/a	n/a	n/a
Chalco	34.0	16.9	14.7	n/a	n/a	n/a
Alcoa	6.3	5.2	4.3	20.1	12.5	9.5
Norsk Hydro	7.0	5.7	4.6	27.3	14.4	11.5
Hindalco	6.7	6.0	n/a	6.8	6.2	8.7
Century Aluminum	10.4	6.0	5.6	n/a	15.4	20.4
Kaiser Aluminum	6.2	5.3	6.1	15.2	13.3	11.3
Average	**12.4**	**8.5**	**8.2**	**17.4**	**12.4**	**12.3**
Average ex-RUSAL	**11.8**	**7.5**	**7.1**	**17.4**	**12.4**	**12.3**
RUSAL premium	**37%**	**95%**	**97%**	**n/a**	**n/a**	**n/a**
Norilsk Nickel	6.4	6.8	6.4	10.1	9.9	9.4
Premium to Norilsk	**153%**	**115%**	**116%**	**n/a**	**n/a**	**n/a**

Sources: Otkritie Capital Research for RUSAL and Norilsk, Factset consensus for other peers

What could change our view?

Bullish signals that could change our outlook for RUSAL include:

- Significant closure in Chinese aluminium capacity (enough to balance the market) – unlikely in the near term in spite of a temporary shutdown of 380kt planned by Chalco announced in the last two weeks.
- Stabilisation and a return to growth in the Eurozone (enough to balance the market) – unlikely in the near term
- Chinese stimulus – unlikely now
- Sale of the Norilsk stake at a premium to market value. RUSAL was offered as much as $333/share for its stake in Norilsk in 2011. This would have been sufficient to cancel out the debt, but Deripaska declined in the hope of eventually merging the companies. The stake is now worth half of that and we believe it should be worth less still. Sale of the stake and reduction in the leverage would be a major positive. Very unlikely
- Removal of additional taxes imposed in 2011 on the previously low cost Siberian smelting capacity, which moved RUSAL up the cost curve. Unlikely
- Lower regulated gas tariff inflation and associated cuts to power tariff increases. This is possible, even likely and not in our base case. However, it would not be enough to change the investment case.

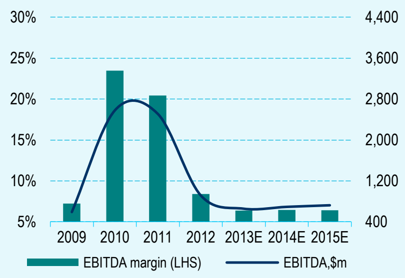
On the negative side, we see the following risks:

- Suspension of Norilsk dividends could increase leverage further at current aluminium prices – possible if not probable
- Further falls in aluminium prices – unlikely
- Falling premiums – likely in the medium term.

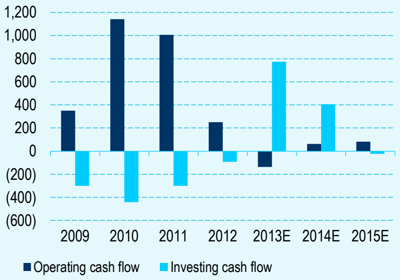
Ultimately, movements in the Norilsk share price appear to have more influence on RUSAL than the value of the core aluminium business. A rally in Norilsk remains a major upside risk for RUSAL. However, given our view on Norilsk, we believe it is more likely to depress the RUSAL share price going forward.

UC RUSAL: Financial forecasts

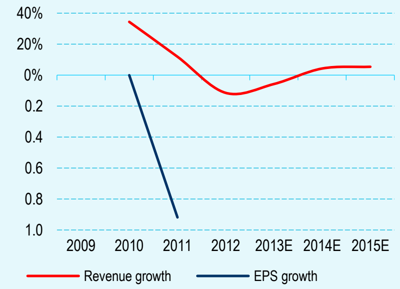
Profitability



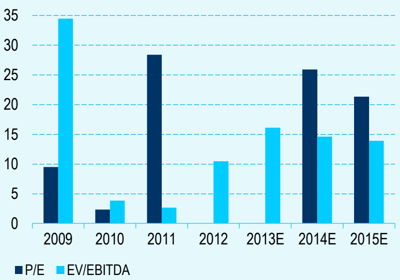
Cash flows, $mn



Momentum



Valuation



$mn unless otherwise stated

	2010	2011	2012	2013E	2014E	2015E
Income statement						
Revenues	10,979	12,291	10,891	10,271	10,716	11,302
Depreciation	498	518	543	511	498	498
EBITDA	2,578	2,510	915	656	692	723
Operating profit (EBIT)	2,129	2,237	676	192	195	226
Net interest expense	1,430	815	895	582	553	559
Non-op. revenue (expenses)	2,410	(324)	524	511	673	706
Pretax profit	3,011	610	(311)	27	314	373
Taxes	144	373	26	36	55	58
Minority interest	-	-	-	-	-	-
Net income	2,867	237	(337)	(10)	260	315
Cash flow statement						
Net change in work. cap.	(717)	(644)	287	(142)	0	0
Provisions and write-offs	94	296	360	61	0	0
Other	-	-	-	-	-	-
Operating cashflow	1,142	1,006	252	(137)	63	83
Capex	(361)	(608)	(486)	(450)	(450)	(464)
Disposals (Acquisitions)	(81)	309	393	1,223	856	440
Investing cashflow	(442)	(299)	(93)	773	406	(24)
Equity	2,236	0	(2)	0	0	0
Debt	(2,318)	(618)	(441)	(601)	(437)	(27)
Financing cashflow	(401)	(795)	(521)	(617)	(437)	(27)
Net change in cash	299	(88)	(362)	28	32	33
Balance sheet						
Cash & equivalents	491	646	505	529	561	593
Current assets	3,978	4,693	4,057	4,011	4,043	4,075
PP&E	5,875	5,746	5,453	5,351	5,303	5,270
Goodwill and other assets	300	185	200	283	283	283
Total assets	26,525	25,345	25,401	24,172	23,994	24,283
Current liabilities	2,968	2,456	2,712	2,507	2,507	7,456
S-T Debt	1,361	629	931	793	793	5,742
L-T Debt	10,602	11,066	10,403	9,907	9,470	4,494
Other L-T liabilities	1,499	1,284	1,363	1,353	1,353	1,353
Shareholders funds	11,456	10,539	10,923	10,405	10,665	10,980
Total liabilities & equity	11,456	10,539	10,923	10,405	10,665	10,980
Net Debt	11,472	11,049	10,829	10,171	9,702	9,642
Margins and profitability						
EBIT margin	19.4%	18.2%	6.2%	1.9%	1.8%	2.0%
EBITDA margin	23.5%	20.4%	8.4%	6.4%	6.5%	6.4%
Net margin	26.1%	1.9%	(3.1%)	(0.1%)	2.4%	2.8%
ROE	25.0%	2.2%	(3.1%)	(0.1%)	2.4%	2.9%
ROA	10.8%	0.9%	(1.3%)	(0.0%)	1.1%	1.3%
ROIC	7.4%	8.0%	2.4%	0.7%	0.7%	1.1%
Momentum						
Revenue growth	34%	12%	-11%	-6%	4%	5%
EBITDA growth	336%	-3%	-64%	-28%	6%	4%
EPS growth	309%	-92%	n/m	n/m	n/m	21%
Liquidity and solvency						
Cash ratio	0.2	0.3	0.2	0.2	0.2	0.1
Current ratio	1.3	1.9	1.5	1.6	1.6	0.5
Interest coverage	1.5	2.7	0.8	0.3	0.4	0.4
Debt/Equity	1.0	1.1	1.0	1.0	1.0	0.9
Debt/Total assets	0.5	0.5	0.4	0.4	0.4	0.4
Net debt / EBITDA	4.4	4.4	11.8	15.5	14.0	13.3
Valuation						
P/E	2.3	28.4	nm	nm	25.9	21.3
P/CE	2.0	8.9	32.7	13.4	8.9	8.3
P/BV	0.6	0.6	0.6	0.6	0.6	0.6
EV/Sales	0.9	0.5	0.9	1.0	0.9	0.9
EV/EBITDA	3.8	2.7	10.5	16.1	14.6	13.9
Dividend yield, (ords)	-	-	-	-	-	-
Dividend yield, (prefs)	-	-	-	-	-	-
Per Share Data						
EPS	0.19	0.02	(0.02)	(0.00)	0.02	0.02
DPS, ords	-	-	-	-	-	-
DPS, prefs	-	-	-	-	-	-
BVPS	0.76	0.69	0.72	0.68	0.70	0.72

Sources: Company data, Otkritie Capital estimates

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