AXIS SECURITIES

Sector Update
3rd April, 2024

Focus on Non Ferrous Pack
Non-Ferrous Metals

Non-Ferrous Metals Back in Focus

Non Ferrous metals are in focus with an expectation of a US interest rate cut in Jun'24. Recent news on Aluminium production concerns at Yunnan and Copper smelter production cuts in China has provided support to the prices of these nonferrous metals. The CME Fed watch tool now has a 62% probability of a 25 bps rate cut on the 12th Jun'24 Fed meeting. Fed rate cut will be supportive of dollar-denominated base metals.

On the other hand, China's demand uncertainty continues to linger as its property sector continues to remain sluggish. However, its impact is felt more on the steel and its raw materials (iron ore and coking coal) prices. China's steel demand remains slower than expected. China's 3MMA YoY growth in 'floor space started' fell to -9.9% in Dec'23. However, continued policy support has led to the easing of this fall, as the floor space started has slowly recovered from -45% YoY in Aug'22 to -9.9% in Dec'23. As per the China Iron and Steel Association (CISA), the total steel inventory of key enterprises in mid-Mar'24 stood at 19.5 MT, up by 9.7kt as compared to early Mar'24. HRC prices in China have corrected by 8% since Jan'24 to $535/t. Iron ore inventory at Chinese ports stood elevated at 142 MT as of 29th Mar'24. Iron ore prices traded below $100/t on the 1st of Apr'24, at a 10-month low level due to lower steel demand and increased supply from Australia. Coking coal prices have also eased from the peak of $367/t in Oct'23 to spot at $245/t offering some respite to steel spot spreads. Against this backdrop, **we prefer non-ferrous names as they have more fundamental tailwinds than ferrous space.**

Aluminum Prices Find Support

LME Aluminum prices are up 8% from the lows of $2,132/t on 26th Feb'24 to the current level of $2,295/t. An increase in Aluminum prices along with the easing of coal prices supports Aluminum smelters.

Apart from the tailwind of the Fed rate cuts in future, Aluminum prices have found support due to the concerns over the slow recovery of production in China's Yunnan province due to dry weather conditions restricting hydropower supply.

Slow demand from China's property sector remains the headwind for commodities in general.

Copper prices

Spot LME Copper prices are up by 9% from the recent low of $8,065/t on 11th Feb'24 to the current level of $8,767/t.

The tight supply of concentrate along with overcapacity at China's smelting capability and failure to cut refined copper production has pushed the copper treatment charges (Tc) to the lowest since 2013 at $9.4/t in Mar'24.

The collapse of the spot treatment charge has led to the major copper smelters proposing joint output cuts ranging between 5-10% supporting the copper prices.

We foresee more tailwinds for Non-Ferrous space than Ferrous

- **Hindalco:** We see multiple levers to increase Novelis' EBITDA/t above $525/t in the medium term. Upstream Aluminum business is expected to benefit from higher LME Aluminum prices and lower thermal coal prices. Custom copper smelter has TcRc contracts in place for CY24 which protects it from the recent fall in the spot TcRc. We have a **BUY** rating on Hindalco with a TP of Rs 660. Update on the Novelis IPO proceeds and update on capex of Bay Minette project will be the key factor to monitor and remains a key risk.
- **NALCO:** NALCO is consistently operating at its peak refining and smelting capacity, and the recent softness in thermal coal prices has led to lower Power costs. The company will also be ramping up its captive coal blocks. Capex overrun towards the 5th stream of the Alumina refinery remains the key risk for the core business. NALCO also has ventured into Lithium exploration with its JV Khanij Bidesh India Limited (KABIL) entering an agreement with Argentina's CAMYEN SE for the exploration and mining of 5 Lithium brine blocks in Argentina, at an initial cost of Rs 200 Cr.
- **Vedanta (NOT RATED):** We see Vedanta as a potential valuation re-rating candidate. Vedanta has restructured its parent VRL debt through liability management and increased the average maturity from 1 to 3 years, leading to a balanced risk structure. Vedanta has a target to deleverage its parent VRL debt by $3 Bn by FY27 without raising debt at VEDL. FY25 will be a transformational year for the company, with debt peaking out and Aluminum and Zinc international expansion nearing completion along with probable value unlocking from demerger.
- **Hindustan Copper (NOT RATED):** Hindustan copper is the pure play copper price proxy play. However, the valuation is stretched at 13.7x its book value.

Non-Ferrous Stocks

Hindalco	**TP: 660 Rating: BUY**
NALCO	**TP: 160 Rating: BUY (We will revise our TP post Q4FY24 Results)**
Vedanta	**Not Rated**
Hindustan Copper	**Not Rated**

Source: Ace Equity

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Non-Ferrous Stocks Has Room For Upside Potential

Exhibit 1: Hindalco 12MF EV/EBITDA – valuation has still some room for upside

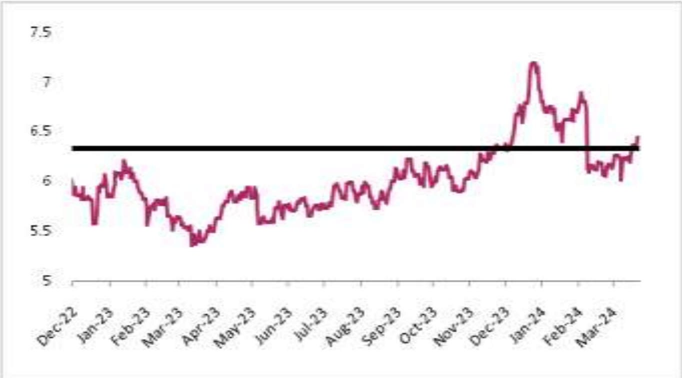
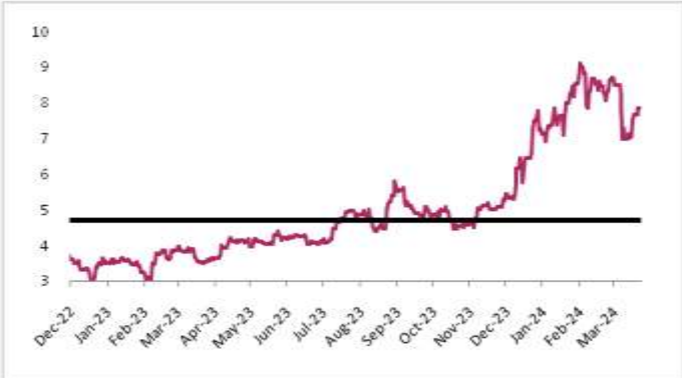


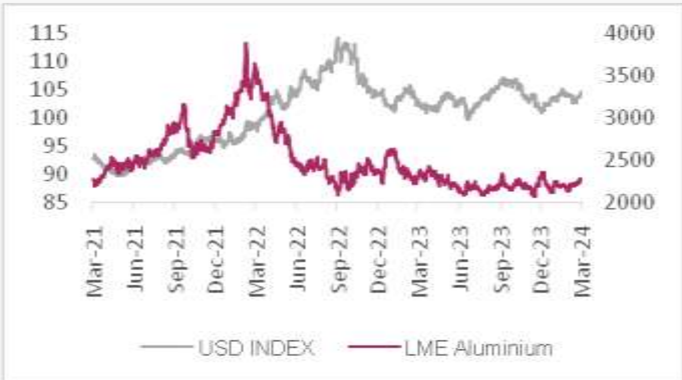
Exhibit 2: Nalco 12MF EV/EBITDA – valuations have re-rated – Lithium optionality and captive coal mine ramp up to support valuation.



Source: LSEG Workspace

Exhibit 3: Vedanta 12MF EV/EBITDA – Deleveraging progress along with ramp-up of the Aluminum segment could lead to rerating potential

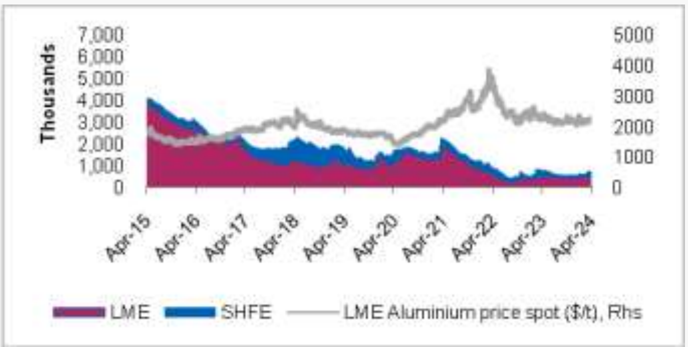
Exhibit 4: USD Index vs LME Aluminium



Source: LSEG Workspace

Exhibit 5: LME Aluminum prices have rallied recently

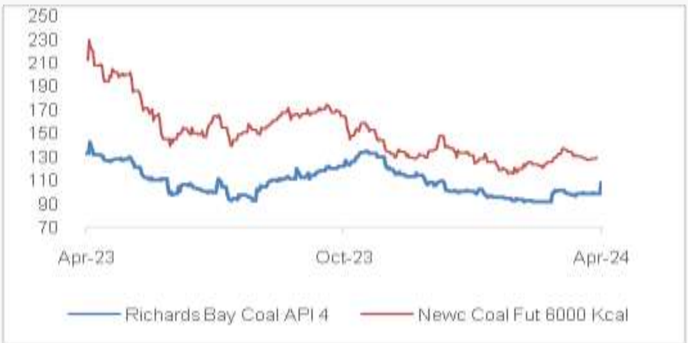
Exhibit 6: Aluminum Inventory remains under control



Source: LSEG Workspace

Exhibit 7: LME Copper prices rallied recently led by China smelter cut pledge

Exhibit 8: Thermal coal prices are soft – Advantage to Aluminum smelters



Source: LSEG Workspace

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