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Company update

Metals

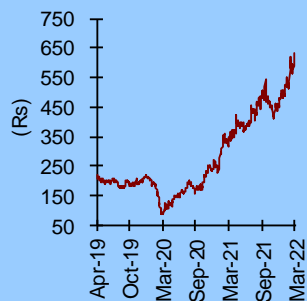
Target price: Rs700

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Institutional investors	34.6	34.6	34.6
MFs and others	45.6	46.1	47.2
FIs and Banks	11.9	11.9	12.0
Insurance Cos.	0.2	0.0	0.1
FII	8.5	8.7	9.1
FII	25.0	25.5	26.0
Others	19.8	19.3	18.2

Source: NSE

Price chart



Hindalco Industries

BUY
Maintain

Embarking on prudent growth capital allocation and with an eye on sustainability

Rs600

Hindalco highlighted potential spend of US\$4.58bn in Novelis and US\$3.43bn in India operations over FY23-27E. Management expects ~US\$2bn of FCF post sustaining capex and has created a roadmap to allocate 75% of the same toward growth projects. 15% will be allocated toward deleveraging and 8-10% toward shareholder returns. In Novelis, incremental capex of US\$3.5-3.8bn will take capacity up by 1.3mtpa. We would have ideally liked to see an upping of the EBITDA/te guidance as well. In the absence of the same, the return potential for incremental investment appears to be a notch below what has been achieved in the previous Novelis expansions (FY11 + FY19). Management followed through on its previous prompt of looking at brownfield smelter expansion (0.185mtpa) in India at a capital cost of US\$3,750/te – the project is still at the appraisal stage; with renewable power sourcing. Management continues to stay focussed on improving the downstream mix as domestic aluminium capacity reaches 1.5mtpa. We maintain BUY.

- **US\$4.58bn of capex in Novelis to take up volume by 1.3mtpa (to 5.8mtpa).** This also entails additional scrap recycling capacity of 1mtpa. Novelis is planning a fully integrated rolling and recycling plant in the US of 0.6mtpa (Can + Auto) for a total capex of US\$2.5bn. The expected commissioning is by FY26E. While capex intensity is high because of first hot mill to be commissioned in the US in over two decades, there was no commensurate upping of the EBITDA guidance. While management continues to see an 11% CAGR in global auto FRP demand, its optimism on can demand appeared a notch higher. Not only were multiple references of US\$4.5bn of investment (in US) undertaken by can customers, the presentation also highlights a growing demand supply gap for the next 7-8 years in North America for beverage cans (from 300kte in CY22 to more than 500kte in CY30) – and management was categorical that the extent of supply shortfall is not that extreme for autos at present. Novelis has also announced 0.4mtpa of rolling and recycling capacity for can in Brazil at a capex of US\$0.8-1bn (completion expected in FY27).
- **Cost and supply chain impact of US\$70-75mn.** While market conditions are favourable, Novelis management highlighted i) inflation and ii) supply chain disruption. While there was energy inflation in the past quarters, management was able to manage the same with recycling benefits. In the current quarter, because of sharp escalation in energy costs, there has been an impact of US\$40mn (additional). Supply chain disruption, ability to source material in time has been a headwind lead to additional impact of US\$30-35mn in the current quarter. Because of a sharp increase in metal prices, there will be an EBITDA tailwind (65% of scrap sourcing), but there was no guidance for the same in the meet.

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Market Cap	Rs1348bn/US\$17.7bn	Year to March	FY21	FY22E	FY23E	FY24E
Reuters/Bloomberg	HALC.BO/HNDL IN	Revenue (Rs mn)	1,319,850	1,927,349	2,059,697	1,897,199
Shares Outstanding (mn)	2,247.2	Net Income (Rs mn)	56,740	127,305	164,341	136,475
52-week Range (Rs)	547/278	EPS (Rs)	25.5	57.2	73.9	61.4
Free Float (%)	65.4	% Chg YoY	38.2	124.4	29.1	(17.0)
FII (%)	26.0	P/E (x)	23.5	10.5	8.1	9.8
Daily Volume (US\$/'000)	70,154	CEPS (Rs)	55.3	87.2	106.6	94.8
Absolute Return 3m (%)	33.4	EV/E (x)	10.4	6.7	5.6	6.1
Absolute Return 12m (%)	83.8	Dividend Yield (%)	0.5	1.8	2.2	2.2
Sensex Return 3m (%)	1.7	RoCE (%)	8.9	15.9	17.8	15.2
Sensex Return 12m (%)	18.2	RoE (%)	9.1	17.6	19.4	14.1

- ▶ **Smelter brownfield expansion with renewable energy under appraisal in India; focus on downstream continues.** If Hindalco can manage 1mtpa greenfield alumina capacity at US\$800mn, it will be at lower intensity than what was finally achieved with Utkal ~7-8 years back. The brownfield cost is also significantly lower at US\$3,700/te (still not competitive with US\$2,000-2,500/te of Chinese capex costs seen in the last round of expansion in NW China). Hindalco has also announced ~US\$459mn of capex for increasing captive coal production from Chakla and Meenakshi mine to 14-16mtpa. Biggest downstream expansion comes in the form of 170kte casting and cold rolling expansion at the Aditya plant with planned capex of US\$400mn. Given the current mix of capital projects, we foresee a gradual improvement in return ratios for the domestic operations.

Chart 1: Novelis Transformational Investments Phase I (FY11-18)

Novelis invested over US\$2bn strategic growth capex in a transformational investment period between FY11-16

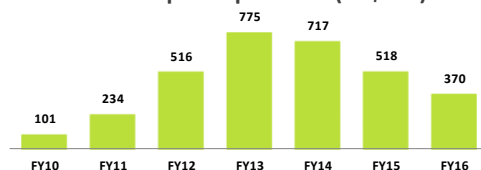
Expanded Cold Rolling and Recycling capacity in Pinda, Brazil

Expanded Hot & Cold Rolling and Recycling capacity in Ulsan & Yeongju, South Korea

Built world's largest aluminum recycling center in Nacterstedt, Germany

Became world leader in Automotive Aluminum FRP, adding 500ktpa of new finishing capacity in the US, Germany and China

Total Capital Expenditure (US\$ mn)



Delivering successful results | FY14 vis-à-vis FY20

Adj. EBITDA

US\$867mn \$1.5bn

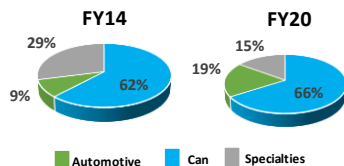
Shipments

2,896kte 3,273kte

Recycled Content

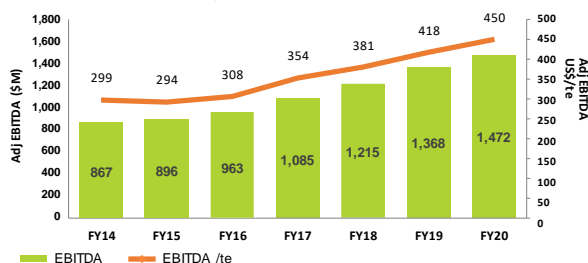
46% 59%

Expanded Automotive Portfolio



Figures are legacy Novelis as reported

Adj. EBITDA Evolution



Source: Company data, I-Sec research

Table 1: Novelis Transformational Investments Phase II (FY19-22)

Recently Completed Organic Projects	Region	Capacity (kte)	Project Cost (US\$)	Status
Automotive Finishing Lines, Kentucky	US	200	\$315mn	In Production
Automotive Finishing Lines, Changzhou	China	100	\$180mn	In Production
Rolling, Casting & Recycling, Pinda	Brazil	100	\$160mn	In Production
TOTAL Completed CapEx FY19-22			\$655mn	

Source: Company data, I-Sec research

Table 2: Novelis Investment Opportunities (FY23-27)

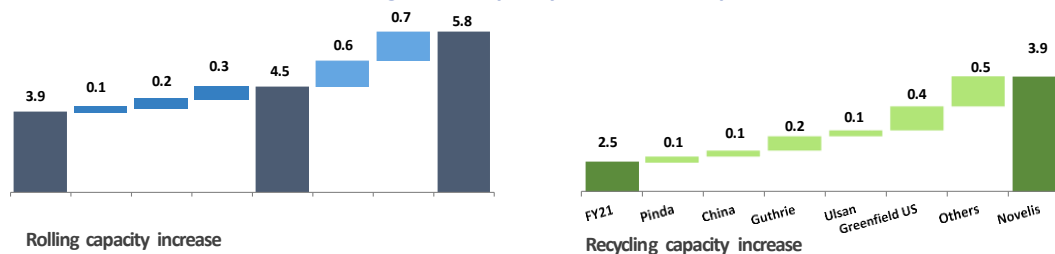
Identified Projects	Location	Primary Product Markets Supported	Capacity (kte)	Cost (US\$)	Expected completion
North America				\$3.0bn	
Hot mill debottlenecking & automotive upgrades	Oswego, US	Specialties, Auto	124	\$130mn	FY24
Recycling expansion & upgrades	Greensboro, US	Can	30	\$30mn	FY23
State-of-the art Automotive Recycling & Casting Centre	Guthrie, US	Auto	240	\$365mn	FY26
Under Appraisal: Fully Integrated Greenfield Rolling & Recycling Mill	US	Can, Auto	600	\$2.5bn	FY26
Asia				\$0.4bn	
Integrated cold mill and closed loop recycling	Zhenjiang, China	Auto	200	\$375mn	FY26
Recycling and Casting Centre at UAL	UAL, S. Korea	All	100	\$50mn	FY26
Under Appraisal: Brownfield rolling capacity	S. Korea	Can	50	\$20-30mn	Est. FY24
Europe				\$0.3-0.4bn	
Under Appraisal: Brownfield rolling capacity	Germany	Can	200	\$200-\$300mn	Est. FY26
Under Appraisal: Brownfield recycling capacity	Germany	Automotive	150	\$100-\$150mn	Est. FY27
South America				\$0.8-0.9bn	
Rolling Debottlenecking	Pinda, Brazil	Can	70	\$50mn	FY24
Under Appraisal: Brownfield rolling & Recycling capacity	Brazil	Can	450	\$800mn-\$1.0bn	Est. FY27
TOTAL				\$4.5-4.8bn	

Source: Company data, I-Sec research

Chart 2: Projected Capacity Evolution in Novelis



Directional Long-Term Capacity Evolution (mtpa)



Source: Company data, I-Sec research

Table 3: Recent Acquisitions in VAP in Indian Business

Inorganic Projects	Products	Capacity	EV	Status
Ryker CCR	Copper CCR	225Kt	\$46 Mn	Completed
SAPA Extrusions	Aluminium Extrusions	15Kt	\$33 Mn	Completed
TOTAL		340 Kt	\$79 Mn	

Source: Company data, I-Sec research

Table 4: Segment-wise Allocation of Growth Capex (FY23-27) in Indian Aluminium Business

Identified Projects	Plant/Region	Capacity (kte)	Estimated Cost (US\$)	Expected Year of Completion
Aluminium – Upstream				
Alumina Expansion (via Debottlenecking)	Utkal	350	\$40mn	FY24
Under Appraisal: Alumina Expansion (Greenfield)	Odisha	1000	\$850mn	FY26
Brownfield Smelter Expansion (via Debottlenecking)	Aditya/Maharan	50	\$135mn	FY24
Under Appraisal: Brownfield Smelter Expansion (with 3rd Party renewable power)	Aditya/Maharan	180	\$685mn	FY26
Aluminium – Downstream				
Extrusions	Silvassa	34	\$97mn	FY25
FRP –Casting & Cold Rolling	Hirakud	170	\$400mn	FY25
Coated AC Fins (under PLI)	Taloja	26	\$50mn	FY25
Under Appraisal: Can Recycling	Aditya	100	\$67mn	FY27
Under Appraisal: Battery Foil Mill	Aditya	24	\$105mn	FY26
Total Spends			\$2.43bn	

Source: Company data, I-Sec research

Table 5: Segment-wise Allocation of Growth Capex (FY23-27) in other Indian Operations

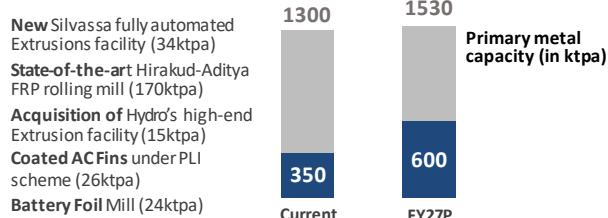
Identified Projects	Plant/ Region	Capacity (kte)	Estimated Cost (US\$)	Expected Year of Completion
Copper Business			\$286mn	
Under Appraisal : Recycling + E-Waste	TBD	100	\$220mn	FY25
Inner Grove Tubes (PLI Scheme) & Alloy Rods	Dahej	25	\$66mn	FY25
Speciality Alumina			\$194mn	
Precipitate Hydrate & White Hydrate	Belagavi	60	\$45mn	FY25
Synthetic Aggregates (Fused & Tabular Alumina)	Aditya/TBD	90	\$55mn	FY25
Under Appraisal : Other Specialty Alumina Products and Brownfield Expansions	Belagavi/TBD	165	\$94mn	FY27
Energy			\$459mn	
Chakla Coal Mine (For Mahan & Renukoot)	Odisha	4-4.5mtpa	\$186mn	FY25
Meenakshi Coal Mine (For Aditya & Hirakud)	Odisha	10-12 mtpa	\$273mn	FY27
India Business Total Spends			\$3.37bn	

Source: Company data, I-Sec research

Chart 3: Projected Capacity Evolution in India

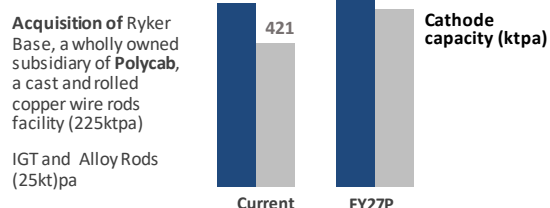
Aluminium VAP (ktpa)

VAP Projects



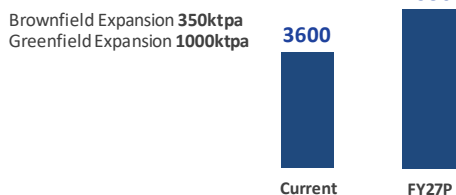
Copper VAP (ktpa)

VAP Projects



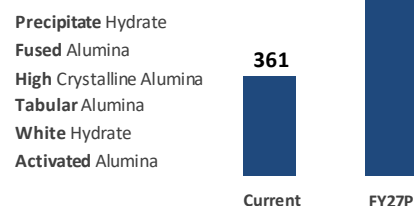
Alumina Capacity* (ktpa)

Expansion Projects



Speciality Alumina VAP#(ktpa)

VAP Projects



*includes capacity for third party sales

#VAP includes speciality hydrates/alumina and other variants of special alumina for non metallurgical applications

Source: Company data, I-Sec research

ESG: On environmental part, by CY50, Hindalco has targeted i) net carbon neutrality, ii) zero waste to landfills, iii) water positive in mining locations and iv) no net loss on bio diversity. In Novelis, the company has targeted ~30% reduction in carbon footprint by 2026 (CO₂e emissions from ~19.8MMT in FY16 to ~13.9MMT in FY26) while in case of primary aluminium + downstream operations it plans to reduce CO₂e emission intensity by ~25% tCO₂e/te to reach at ~18.1 te CO₂/te in FY26 from ~24.1 te CO₂/te in FY16. To reduce carbon emissions, Hindalco has already established 100MW of renewable capacity which will increase to 200MW w/o storage + 100 MW with storage by 2025. The company has also taken other initiatives on pilot/trail basis which includes Fuel Switching, Carbon Capture Storage & Utilisation, Green Hydrogen and Biomass for Dahej to reduce carbon footprints.

Key conference call takeaways

- **Synergies from Aleris:** Synergies from Aleris have been better than initially estimated. Estimated synergies were \$150mn as against actual synergies of ~\$220mn.
- **Demand headwinds and tailwinds:** Tailwinds include the healthy demand outlook due to increased focus on recyclable products and supply constraints from China, while headwinds include higher energy cost due to geopolitical crisis, semiconductor shortage impacting the overall auto segment, supply chain disruptions and other operational issues related to movement of goods. ~\$40mn impact could be seen due to higher energy cost and ~\$25mn-\$30mn impact could be seen due to supply chain disruptions in Q4FY22.
- **Energy hedging:** Significant portion of energy requirement (~75%) is hedged for FY22. And for FY23, the company is waiting for right time to enter into hedging arrangements.
- The carbon emission in case of Novelis includes scope 3. Coal mining is scope 2 in India as the power is captive. For Hindalco India operations, majority of carbon emissions (~90%) are scope 1 and scope 2. The global players are largely divided into three categories i) Players with hydro power like Norsk etc. have CO2 emission of ~4-6te/te of aluminium, ii) Players with Natural Gas like Dubai etc have CO2 emission of ~8-10te/te of aluminium and iii) players with coal based energy sources like most players in India and China have CO2 emissions ~17-18te/te of aluminium. The company will gradually increase the share of renewable energy including hydro power which will eventually bring down the carbon emissions. Also, the company has increased its annual maintenance capex guidance to Rs15bn from earlier Rs10-Rs12bn; this includes the capex incurred by the company to reduce carbon emissions.

Valuation methodology and key risks

We maintain **BUY** with a target price of Rs700/share at 1.5x FY24E book value. We have factored in higher capex as guided for FY23/24E. Novelis is improving consolidated RoE. Earnings though are benefitting from cyclicality.

Key risks

Key upside risks are aluminium prices, higher-than-expected spreads at Novelis and faster-than-expected deleveraging of the consolidated entity. Key downside risks are lower aluminium prices, lower profitability at Aleris and Novelis, and reduction in scrap LME spreads impacting Novelis EBITDA/te.

Financial summary (consolidated)

Table 6: Profit & loss statement
(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Operating Income (Sales)	1,319,850	1,927,349	2,059,697	1,897,199
Operating Expenses	1,144,490	1,604,449	1,699,100	1,583,426
EBITDA	175,360	290,767	337,427	302,578
<i>% margins</i>	<i>13.3</i>	<i>15.1</i>	<i>16.4</i>	<i>15.9</i>
Depreciation & Amortization	66,280	66,510	72,830	74,330
Gross Interest	37,380	38,150	32,000	30,000
Other Income	12,220	10,000	10,000	10,000
Recurring PBT	83,920	196,107	242,597	208,248
Add: Extra ordinaries	-	-	-	-
Less: Taxes	27,230	68,851	78,306	71,823
Less: Minority Interest	(50)	(50)	(50)	(50)
Net Income (Reported)	34,830	135,305	164,341	136,475
Recurring Net Income	56,740	127,305	164,341	136,475

Source: Company data, I-Sec research

Table 7: Balance sheet
(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Assets				
Total Current Assets	620,950	802,622	759,118	742,300
<i>of which cash & cash eqv.</i>	<i>88,090</i>	<i>175,285</i>	<i>55,585</i>	<i>80,427</i>
Total Current Liabilities & Provisions	497,076	549,865	575,856	546,765
Net Current Assets	123,874	252,757	183,262	195,535
Investments	171,540	171,540	171,540	171,540
<i>Strategic/Group</i>	<i>670</i>	<i>670</i>	<i>670</i>	<i>670</i>
<i>Other Marketable</i>	<i>170,870</i>	<i>170,870</i>	<i>170,870</i>	<i>170,870</i>
Net Fixed Assets	871,330	870,070	926,615	974,535
<i>Capital Work-in-Progress</i>	<i>102,020</i>	<i>17,090</i>	<i>57,090</i>	<i>97,090</i>
Goodwill	233,170	233,170	233,170	233,170
Total Assets	1,399,914	1,552,812	1,539,862	1,600,055
Liabilities				
Borrowings	689,550	722,821	574,289	526,767
Deferred Tax Liability	44,930	44,930	44,930	44,930
Minority Interest	100	50	-	(50)
Equity Share Capital	2,224	2,224	2,224	2,224
<i>Face Value per share (Rs)</i>	<i>1</i>	<i>1</i>	<i>1</i>	<i>1</i>
Reserves & Surplus	663,110	774,787	910,418	1,018,184
Net Worth	665,334	777,011	912,642	1,020,408
Total Liabilities	1,399,914	1,552,812	1,539,862	1,600,055

Source: Company data, I-Sec research

* Ex Aleris

Table 8: Cashflow statement
(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Operating Cashflow	109,020	158,540	227,171	200,805
Working Capital Changes	16,750	(41,688)	(50,204)	12,569
Capital Commitments	(169,650)	(65,250)	(129,375)	(122,250)
Free Cashflow	(43,880)	51,602	47,592	91,124
Cashflow from Investing Activities	(64,990)	10,000	10,000	10,000
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	(11,960)	33,271	(148,531)	(47,522)
Dividend paid	(6,660)	(23,678)	(28,760)	(28,760)
Extraordinary Items	-	-	-	-
Chg. in Cash & Bank balances	(127,490)	71,195	(119,699)	24,842

Source: Company data, I-Sec research

Table 9: Key ratios
(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (Rs)				
EPS(Basic Recurring)	25.5	57.2	73.9	61.4
Diluted Recurring EPS	25.5	57.2	73.9	61.4
Recurring Cash EPS	55.3	87.2	106.6	94.8
Dividend per share (DPS)	3.0	10.6	12.9	12.9
Book Value per share (BV)	299.2	349.4	410.4	458.8
Growth Ratios (%)				
Operating Income	11.7	46.0	6.9	(7.9)
EBITDA	21.7	65.8	16.0	(10.3)
Recurring Net Income	38.2	124.5	29.1	(17.0)
Diluted Recurring EPS	38.2	124.4	29.1	(17.0)
Diluted Recurring CEPS	33.1	57.5	22.4	(11.1)
Valuation Ratios (x)				
P/E	23.5	10.5	8.1	9.8
P/CEPS	10.8	6.9	5.6	6.3
P/BV	2.0	1.7	1.5	1.3
EV / EBITDA	10.4	6.7	5.6	6.1
EV / Operating Income	1.4	1.0	0.9	1.0
EV / Operating FCF	16.7	12.2	8.3	9.2
Operating Ratios (%)				
Raw Material/Sales	58.2	58.2	58.2	58.2
SG&A/Sales	14.0	2.3	2.3	2.3
Other Income / PBT	14.6	5.1	4.1	4.8
Effective Tax Rate	32.4	35.1	32.3	34.5
NWC / Total Assets	2.6	5.0	8.3	7.2
Inventory Turnover (days)	103.0	93.9	97.7	103.9
Receivables (days)	31.1	27.9	33.9	41.0
Payables (days)	137.3	119.1	120.9	129.4
D/E Ratio (x)	1.10	0.99	0.68	0.56
Profitability Ratios (%)				
Net Income Margins	4.3	6.6	7.9	7.2
RoCE	8.9	15.9	17.8	15.2
RoNW	9.1	17.6	19.4	14.1
Dividend Payout Ratio	11.7	18.6	17.5	21.1
Dividend Yield	0.5	1.8	2.2	2.2
EBITDA Margins	13.3	15.1	16.4	15.9

Source: Company data, I-Sec research

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BUY: >15% return; ADD: 5% to 15% return; HOLD: Negative 5% to Positive 5% return; REDUCE: Negative 5% to Negative 15% return; SELL: < negative 15% return

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