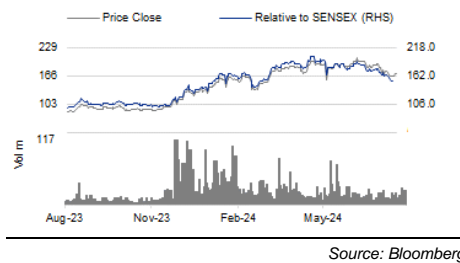


India

**HOLD** (previously ADD)

Consensus ratings*:	Buy 4	Hold 2	Sell 4
Current price:	Rs172		
Target price:	Rs176 ▲		
Previous target:	Rs103		
Up/downside:	2.3%		
InCred Research / Consensus:	-1.0%		
Reuters:			
Bloomberg:	NACL IN		
Market cap:	US\$4,352m		
	Rs316,011m		
Average daily turnover:	US\$52.3m		
	Rs3798.3m		
Current shares o/s:	1,865.0m		
Free float:	48.7%		
*Source: Bloomberg			



<b>Price performance</b>	1M	3M	12M
Absolute (%)	(7.7)	(13.9)	98.2
Relative (%)	(7.9)	(21.2)	60.0

<b>Major shareholders</b>	% held
Promoter & Promoter Group	51.3
SBI PSU	3.6
LIC India	3.5

# National Aluminium Co Ltd

## Cost savings-driven earnings growth

- Cost savings in the form of lower coal prices as well as declining CP coke prices will help Nalco to achieve a 16% EBITDA CAGR over FY24-27F.
- Recent alumina tender fetched 22% of LME price - we see this as an anomaly. We expect aluminium to stay at US\$2,350/t & alumina at 17% of LME price.
- We downgrade the stock's rating to HOLD but raise our target price to Rs176. At our target price, the stock will trade at 6.6x FY26F EV/EBITDA.

### Cost savings-driven earnings growth over the next three years

National Aluminium Company or Nalco is likely to witness cost savings-driven earnings growth in the coming quarters. We expect Indian e-auction coal prices to fall, which will drive savings in power and fuel costs for the company. A decline in CP coke and pitch prices will also lead to lower costs of aluminium production. While volume growth remains a challenge for Nalco, and until new alumina capacity comes online, we don't expect any volume growth. Earnings growth will come from the reduction in costs.

### CP coke and pitch prices to decline in coming quarters

Calcined petroleum coke (CP coke) and pitch are essential raw materials used in the production of aluminium, specifically in the creation of carbon anodes, which are critical components in the aluminium smelting process. CP coke provides the carbon needed for the anode's electrical conductivity and structural integrity, while pitch binds the CP coke particles, providing thermal stability, and serving as a reducing agent during aluminium smelting. On average, in the pre-baked process, anode consumption is 0.45t per 1t of aluminium. The decline in CP coke prices is one of the main reasons for lower input costs.

### Global excess production will weigh on coal prices

The company's aluminium smelter plant is having a captive power plant (CPP) for sustainable power supply. The CPP is a thermal power plant and requires around 6.8mt of coal per annum to meet power generation, as demanded by the smelter plant. For CPP, coal is sourced from the nearby coal mines of Mahanadi Coalfields (MCL). Nalco has a fuel supply agreement with MCL for 4.716mt of coal, and 0.90mt of Bridge Linkage coal Memorandum of Understanding or MoU with MCL. The remaining shortfall quantity is sourced through coal auction (spot/exclusive) route. As global prices fall and Coal India's e-auction prices converge with FSA prices, the power costs will come down significantly( Please see [IN: Coal India - E-auction prices to fall; retain REDUCE \(REDUCE - Maintained\)](#)).

### We downgrade Nalco's rating to HOLD

We value Nalco at 6.6x FY26F EV/EBITDA to arrive at a higher target price of Rs176 (Rs103 earlier). We downgrade its rating to HOLD (from ADD). Upside risk: A sudden spurt in aluminium prices will lead to the stock moving beyond our target price. Downside risk: A supply chain crisis-driven coal price rise can lead to a decline in the stock price.

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### Financial Summary

	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Revenue (Rsm)	142,549	131,492	143,090	142,877	145,607
Operating EBITDA (Rsm)	24,481	28,729	41,773	44,164	44,837
Net Profit (Rsm)	15,445	20,600	27,320	28,933	29,254
Core EPS (Rs)	8.3	9.4	14.6	15.5	15.7
Core EPS Growth	(47.7%)	12.9%	56.6%	5.9%	1.1%
FD Core P/E (x)	20.78	15.58	11.75	11.09	10.97
DPS (Rs)	4.5	4.5	4.5	4.5	4.5
Dividend Yield	2.62%	2.62%	2.62%	2.62%	2.62%
EV/EBITDA (x)	12.20	10.23	6.81	6.17	5.80
P/FCFE (x)	56.26	44.87	18.03	15.85	15.38
Net Gearing	(16.7%)	(18.6%)	(22.2%)	(26.1%)	(29.5%)
P/BV (x)	2.42	2.20	1.95	1.73	1.56
ROE	12.0%	12.5%	17.6%	16.5%	15.0%
% Change In Core EPS Estimates			52.73%		
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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## Cost savings-driven earnings growth

Nalco is likely to witness cost savings-driven earnings growth in the coming quarters. We expect Indian e-auction coal prices to fall, which will drive savings on power and fuel costs for the company. A decline in CP coke and pitch prices will also lead to lower cost of aluminium production. While volume growth remains a challenge for Nalco, until the new alumina capacity comes online, we don't expect any volume growth. Earnings growth will come from the reduction in costs.

### Costs set to decline

Coal costs to come down in the coming future as e-auction prices will fall. At the same time, falling crude oil prices means a fall in coal tar and pitch prices. All these are likely to reduce the cost of production for Nalco in FY25F and FY26F.

### What is CP coke and pitch and why they are used in aluminium smelting? ➤

**Calcined petroleum coke (CP coke)** and **pitch** are essential raw materials used in the production of aluminium, specifically in the creation of carbon anodes, which are critical components in the aluminium smelting process.

#### Calcined petroleum coke (CP coke)

##### What is it?

- CP coke is a high-carbon content material derived from petroleum. It is produced by heating green petroleum coke to remove volatile substances and increase its carbon content.
- **Role in aluminium production:**
  - **Anode production:** CP coke is the primary raw material for producing carbon anodes used in the Hall-Héroult process for aluminium smelting. The anodes are consumed during the electrolysis process, where aluminium is extracted from alumina ( $\text{Al}_2\text{O}_3$ ).
  - **Electrical conductivity:** CP coke provides the necessary electrical conductivity and structural integrity to the anodes, allowing them to efficiently conduct electricity during the smelting process.

#### Pitch

- **What is it?**

Pitch is a thick, sticky, tar-like substance derived from the distillation of coal tar or petroleum. It is primarily composed of complex hydrocarbons.
- **Role in aluminium production:**
  - **Binder for anodes:** Pitch acts as a binder material in the production of carbon anodes. It binds the CP coke particles together, forming a solid and cohesive anode block.
  - **Thermal stability:** Pitch helps improve the thermal stability of the anodes, ensuring they can withstand the high temperatures of the electrolysis process without degrading.
  - **Reducing agent:** During the electrolysis process, pitch also acts as a reducing agent, aiding in the conversion of alumina to aluminium metal.

#### Aluminium smelting process

In the Hall-Héroult process, which is the most common method for aluminium production, carbon anodes made from CP coke and pitch are immersed in a molten bath of cryolite and alumina. An electric current is passed through the anodes, causing the alumina to break down into aluminium and oxygen. The oxygen reacts with the carbon in the anodes, producing carbon dioxide, and the aluminium is deposited at the bottom of the cell, where it is collected and cast into ingots or other forms.

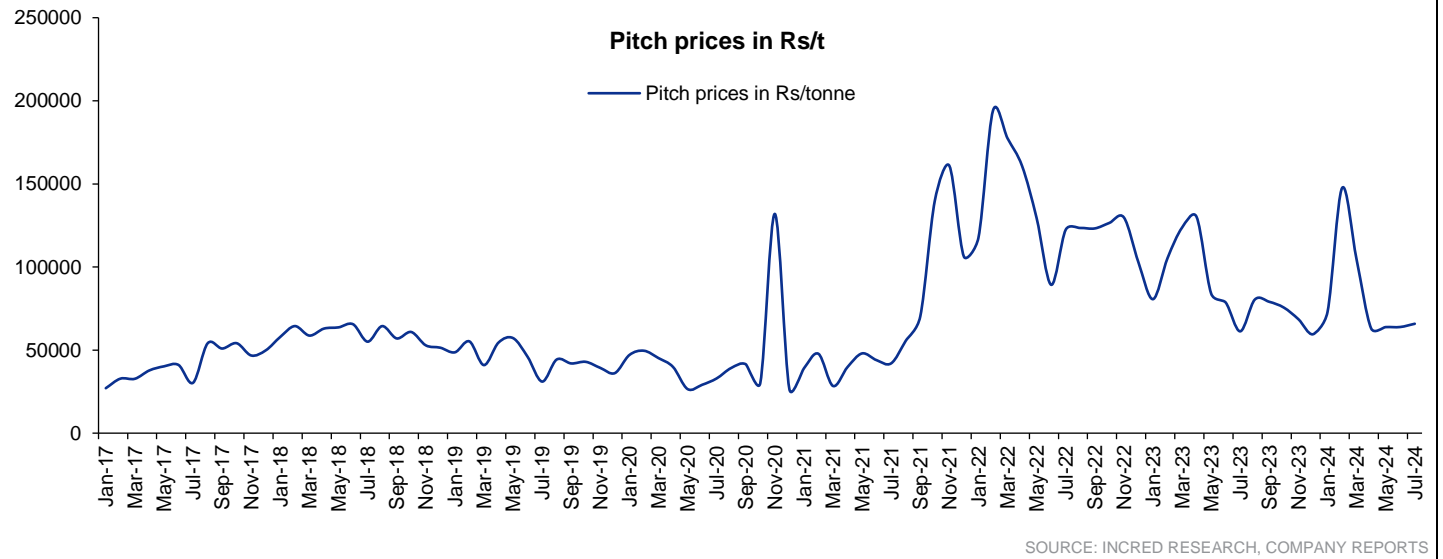
**In a nutshell**

- **CP coke:** Provides the carbon needed for the anode's electrical conductivity and structural integrity.
- **Pitch:** Binds CP coke particles, provides thermal stability, and serves as a reducing agent during aluminium smelting.

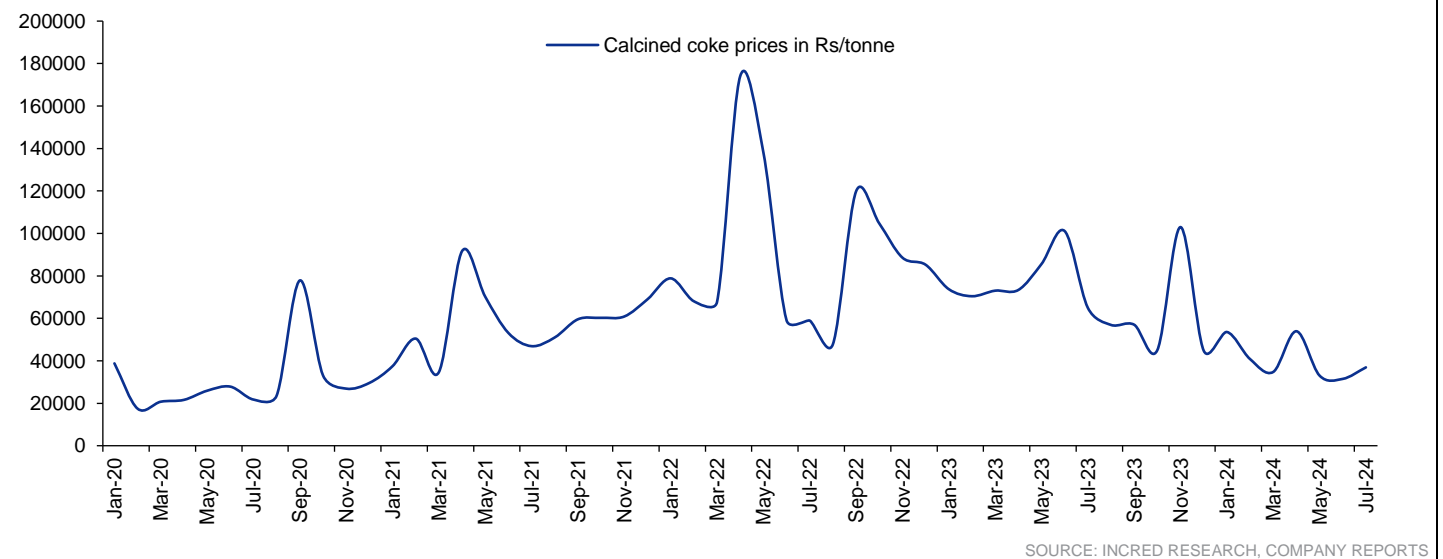
Both these materials are crucial in the efficient and continuous production of aluminium.

**Prices of both CP coke and CP pitch are on the decline ➤**

**Figure 1: Pitch prices are coming down...**

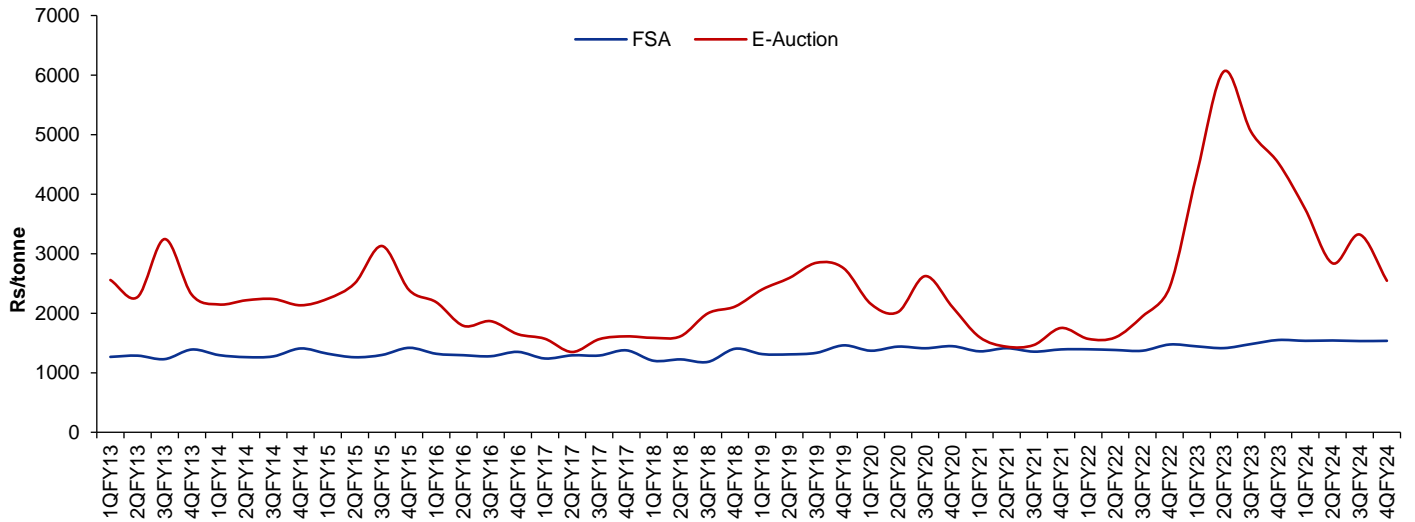


**Figure 2: ...and so is the case with calcined coke prices**



**On the other hand, Indian e-auction coal prices are falling, which is good news for Nalco ➤**

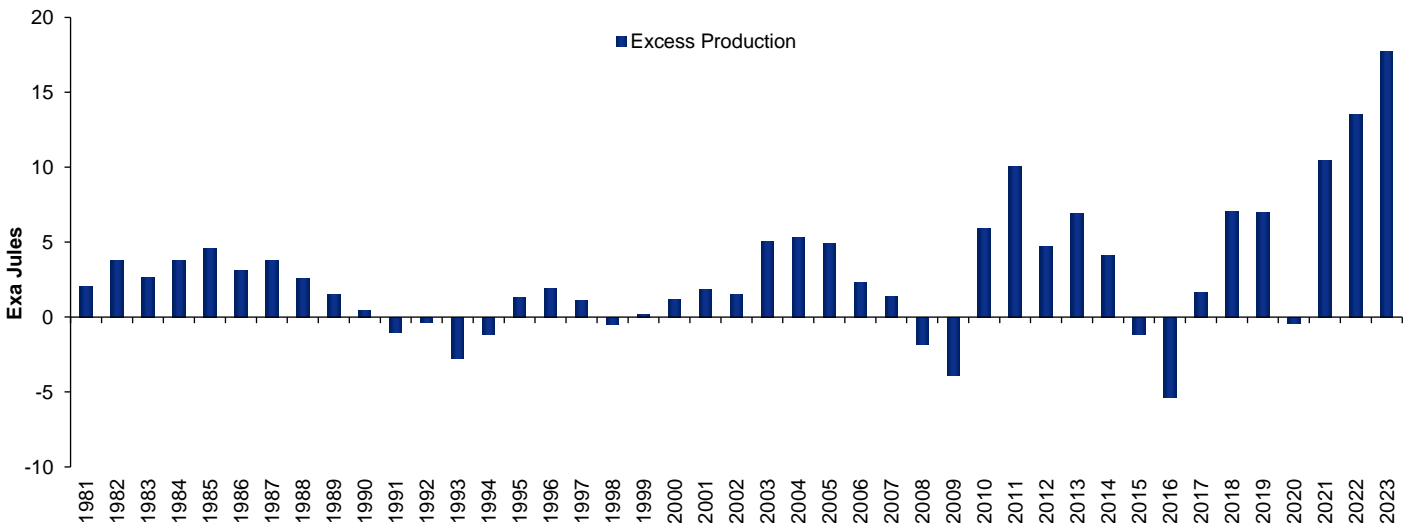
**Figure 3: It's not long before Coal India's e-auction and FSA prices converge, which will further boost Nalco's profits**



SOURCES: INCRED RESEARCH, COMPANY REPORTS

**Global coal prices will be also under stress as demand is dwindling and production is increasing ➤**

**Figure 4: Global excess coal production (excess production = production- consumption) is the highest in the last four decades; it's only a matter of time before RB1 (6,000 Kcal South African coal) prices fall to US\$70-75/t**



SOURCE: INCRED RESEARCH, COMPANY REPORTS

It's only a matter of time before we find that 6,000Kcal coal prices fall in the US\$70-75/t range. The fall in LNG prices will only exacerbate the decline in coal prices.

**Earnings and valuation**

We expect product prices to remain steady in the coming quarters. Increased scrap usage acts as both a floor and a cap on aluminium prices. We expect aluminium volatility to reduce significantly over the next few years. As we all know, lower volatility garners a higher P/E ratio, and hence, we wouldn't be surprised if all aluminium stocks rerate. Please see our earlier report: [IN: Non Ferrous - Aluminium is back to where it belongs](#)

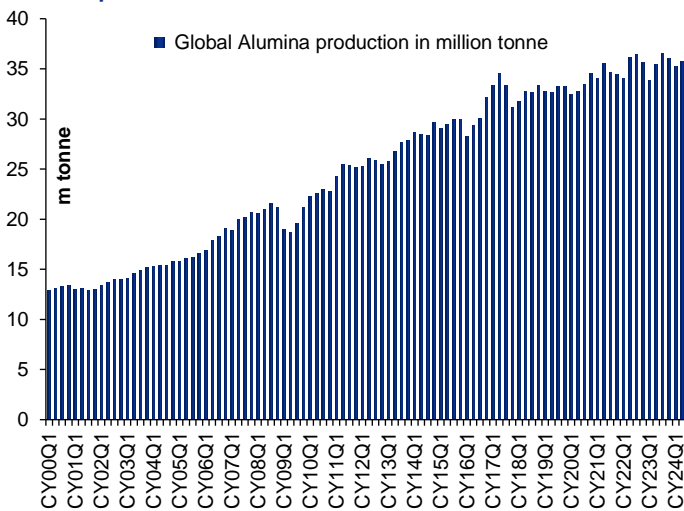
**Volume growth to be negligible ➤**

Nalco is already operating near 100% capacity utilization in aluminium as well as alumina. Hence, unless new capacity comes online (which is still two-to-three years away), earnings growth will be driven by only cost reduction.

**Recent tenders of alumina have been at very high prices, but we believe they are more of an anomaly ➤**

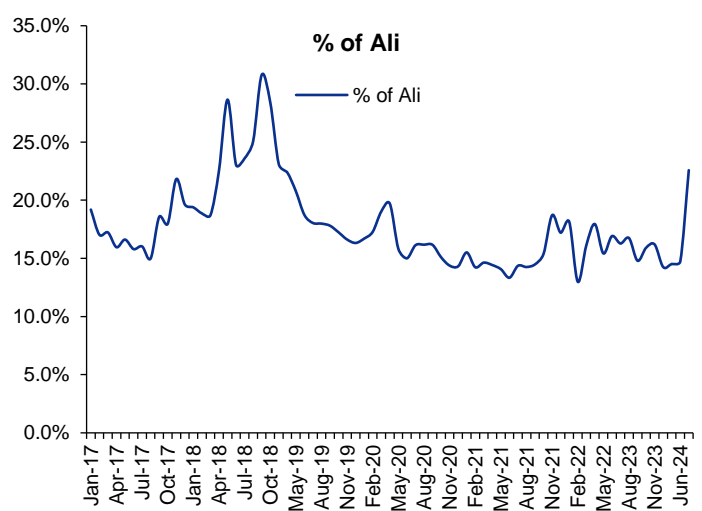
Nalco's Jul 2024 tender for alumina opened at US\$517/t, which is around 22% of LME or London Metal Exchange price. Normally, this percentage remains around 14-17% of LME price. We don't see any significant scarcity of alumina in the global market and hence, this rise is more of an anomaly rather than the norm.

**Figure 5: There hasn't been any significant decline in global alumina production**



SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 6: The high tender price appears more of an anomaly**



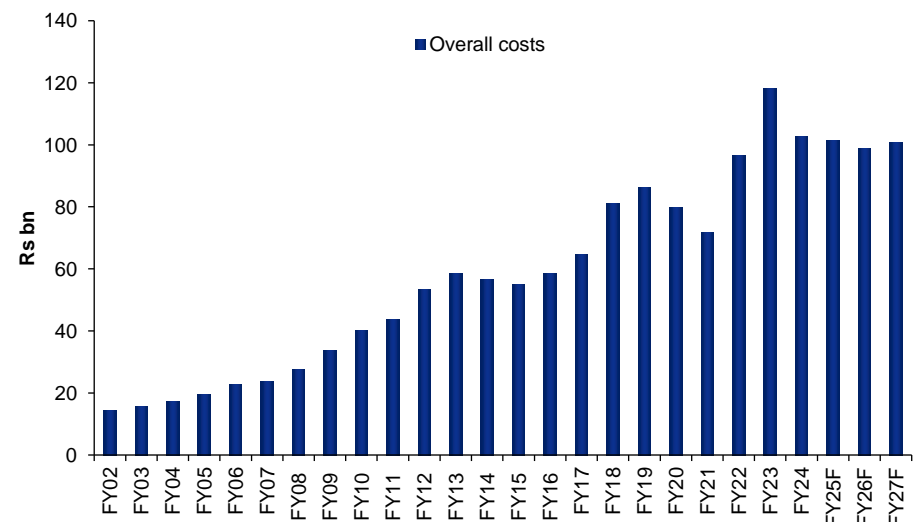
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**We build in US\$2,350/t aluminium price and alumina at 17% of LME price to project earnings ➤**

As alumina is not in shortage, we believe the alumina tender price, as a percentage of LME price, will revert back to 16-17% in the near term. Therefore, we estimate the aluminium price at US\$2,350/t and alumina at US\$ 391/t.

**We build in lower costs of coal, CP pitch and CP coke in our estimates ➤**

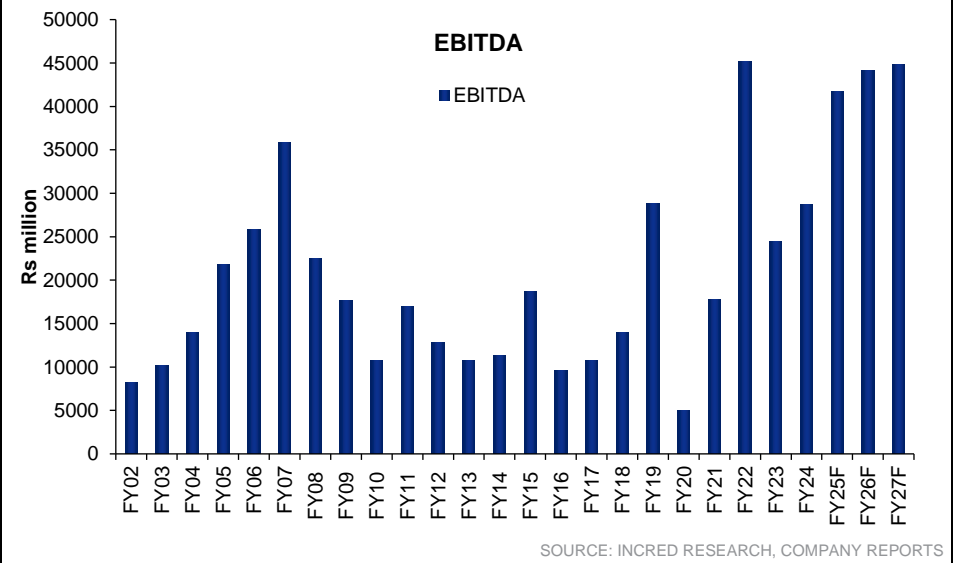
**Figure 7: Overall costs peaked in FY23 and will come down over the years**



SOURCE: INCRED RESEARCH, COMPANY REPORTS

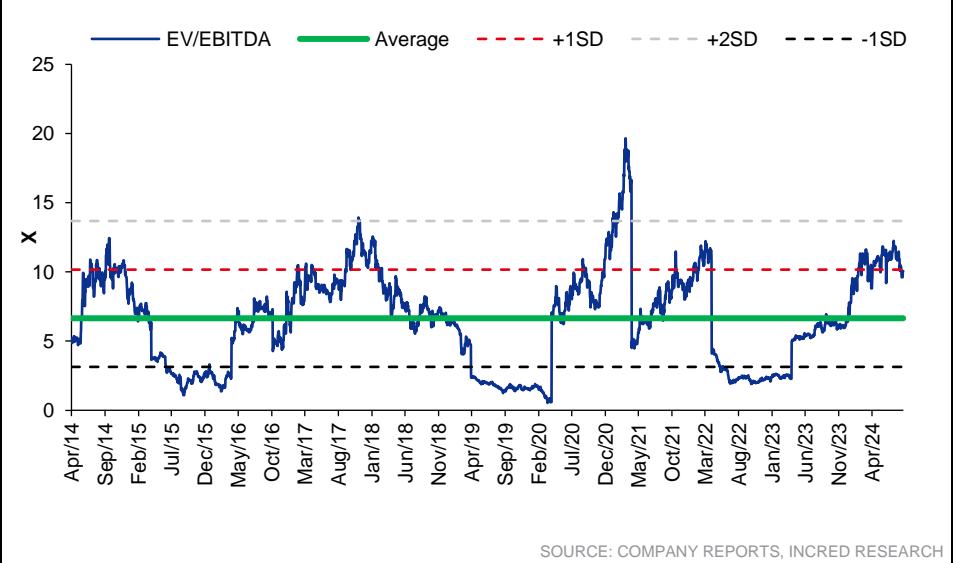
**This will drive EBITDA to post a 16% CAGR over FY24-27F ➤**

**Figure 8: EBITDA is likely to post a 16% CAGR over FY24-27F**



**We value the stock at last 10 years' average EV/EBITDA multiple; downgrade its rating to HOLD ➤**

**Figure 9: Over the last decade, Nalco has traded at an average 6.6x current year EV/EBITDA**



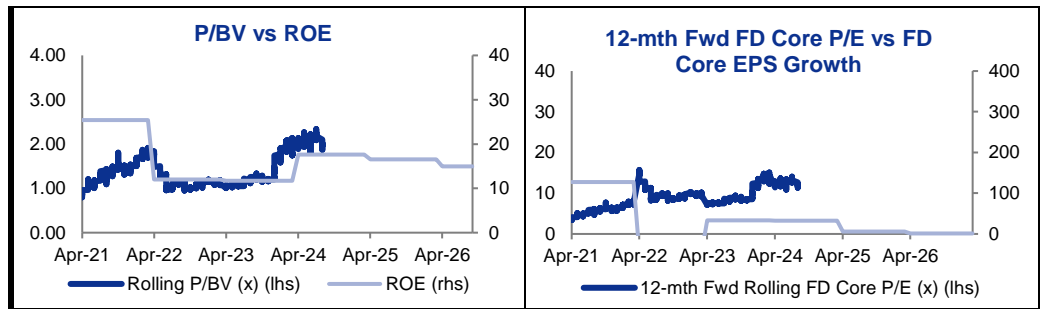
**Figure 10: We value Nalco at 6.6x FY26F EV/ EBITDA to arrive at a higher target price of Rs176; downgrade its rating to HOLD**

**Target Price Methodology**

Item	Unit	Valuation
FY26F EBITDA	Rs m	44,164
FY26F EV/EBITDA (x)	x	6.6
End FY26E EV	Rs m	2,91,482
End FY26F Net Cash	Rs m	36,866
End FY26F Equity Value	Rs m	3,28,348
Target Price	Rs/share	176

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS



Profit & Loss

(Rs mn)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
<b>Total Net Revenues</b>	142,549	131,492	143,090	142,877	145,607
<b>Gross Profit</b>	110,994	105,033	118,381	117,685	119,923
<b>Operating EBITDA</b>	24,481	28,729	41,773	44,164	44,837
Depreciation And Amortisation	(7,158)	(7,497)	(7,871)	(8,265)	(8,678)
<b>Operating EBIT</b>	17,323	21,233	33,902	35,899	36,159
Financial Income/(Expense)	(129)	(172)	(35)	(35)	(35)
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)	2,356	2,507	2,658	2,817	2,986
<b>Profit Before Tax (pre-EI)</b>	19,550	23,568	36,524	38,681	39,110
Exceptional Items		4,268			
<b>Pre-tax Profit</b>	19,550	27,836	36,524	38,681	39,110
Taxation	(4,105)	(7,236)	(9,204)	(9,748)	(9,856)
Exceptional Income - post-tax					
<b>Profit After Tax</b>	15,445	20,600	27,320	28,933	29,254
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
<b>Net Profit</b>	15,445	20,600	27,320	28,933	29,254
Recurring Net Profit	15,445	17,441	27,320	28,933	29,254
<b>Fully Diluted Recurring Net Profit</b>	15,445	17,441	27,320	28,933	29,254

Cash Flow

(Rs mn)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
<b>EBITDA</b>	24,481	28,729	41,773	44,164	44,837
Cash Flow from Invt. & Assoc.					
Change In Working Capital	(8,825)	(84)	(430)	8	(101)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	4,687	7,384			
Other Operating Cashflow	(3,664)	(2,316)	1,319	1,009	587
Net Interest (Paid)/Received	(129)	(172)	(35)	(35)	(35)
Tax Paid	(7,467)	(6,348)	(9,204)	(9,748)	(9,856)
<b>Cashflow From Operations</b>	9,083	27,193	33,423	35,398	35,432
Capex	(13,054)	(15,605)	(17,000)	(17,000)	(17,000)
Disposals Of FAs/subsidiaries	6	185			
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	9,706	(4,584)	1,374	1,843	2,434
<b>Cash Flow From Investing</b>	(3,343)	(20,005)	(15,626)	(15,157)	(14,566)
Debt Raised/(repaid)	(37)	(37)			
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	(9,183)	(7,347)	(8,393)	(8,393)	(8,393)
Preferred Dividends					
Other Financing Cashflow	(15)	(3)	(35)	(35)	(35)
<b>Cash Flow From Financing</b>	(9,235)	(7,387)	(8,428)	(8,428)	(8,428)
Total Cash Generated	(3,495)	(198)	9,369	11,813	12,438
<b>Free Cashflow To Equity</b>	5,704	7,151	17,797	20,241	20,866
<b>Free Cashflow To Firm</b>	5,869	7,361	17,832	20,276	20,901

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**BY THE NUMBERS...cont'd**

<b>Balance Sheet</b>					
<b>(Rs mn)</b>	<b>Mar-23A</b>	<b>Mar-24A</b>	<b>Mar-25F</b>	<b>Mar-26F</b>	<b>Mar-27F</b>
Total Cash And Equivalents	22,631	27,481	36,866	48,680	61,118
Total Debtors	913	1,535	1,670	1,668	1,700
Inventories	18,402	18,297	19,911	19,882	20,261
Total Other Current Assets	11,022	14,002	13,986	13,986	13,986
<b>Total Current Assets</b>	<b>52,968</b>	<b>61,315</b>	<b>72,434</b>	<b>84,215</b>	<b>97,065</b>
Fixed Assets	105,718	119,558	128,687	137,422	145,744
Total Investments	3,253	3,523	3,523	3,523	3,523
Intangible Assets					
Total Other Non-Current Assets	15,449	9,791	9,791	9,791	9,791
<b>Total Non-current Assets</b>	<b>124,419</b>	<b>132,871</b>	<b>142,000</b>	<b>150,735</b>	<b>159,057</b>
Short-term Debt	478	392	392	392	392
Current Portion of Long-Term Debt					
Total Creditors	12,633	14,963	16,282	16,258	16,569
Other Current Liabilities	15,746	16,423	16,423	16,423	16,423
<b>Total Current Liabilities</b>	<b>28,857</b>	<b>31,777</b>	<b>33,097</b>	<b>33,072</b>	<b>33,383</b>
Total Long-term Debt					
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	5,560	6,573	6,573	6,573	6,573
<b>Total Non-current Liabilities</b>	<b>5,560</b>	<b>6,573</b>	<b>6,573</b>	<b>6,573</b>	<b>6,573</b>
Total Provisions	10,586	10,120	10,120	10,120	10,120
<b>Total Liabilities</b>	<b>45,002</b>	<b>48,469</b>	<b>49,789</b>	<b>49,765</b>	<b>50,076</b>
Shareholders Equity	132,385	145,717	164,644	185,185	206,046
Minority Interests					
<b>Total Equity</b>	<b>132,385</b>	<b>145,717</b>	<b>164,644</b>	<b>185,185</b>	<b>206,046</b>

<b>Key Ratios</b>					
	<b>Mar-23A</b>	<b>Mar-24A</b>	<b>Mar-25F</b>	<b>Mar-26F</b>	<b>Mar-27F</b>
Revenue Growth	0.5%	(7.8%)	8.8%	(0.1%)	1.9%
Operating EBITDA Growth	(45.8%)	17.4%	45.4%	5.7%	1.5%
Operating EBITDA Margin	17.2%	21.8%	29.2%	30.9%	30.8%
Net Cash Per Share (Rs)	11.88	14.52	19.56	25.89	32.56
BVPS (Rs)	70.98	78.13	88.28	99.29	110.48
Gross Interest Cover	134.08	123.37	961.91	1,018.58	1,025.95
Effective Tax Rate	21.0%	26.0%	25.2%	25.2%	25.2%
Net Dividend Payout Ratio	54.3%	51.4%	30.7%	29.0%	28.7%
Accounts Receivables Days	2.13	3.40	4.09	4.26	4.22
Inventory Days	201.64	253.14	282.21	288.28	285.24
Accounts Payables Days	157.34	190.35	230.78	235.74	233.25
ROIC (%)	13.5%	12.8%	19.2%	19.0%	18.0%
ROCE (%)	12.5%	14.3%	20.7%	19.5%	17.7%
Return On Average Assets	8.9%	8.9%	13.4%	12.9%	11.9%

SOURCE: INCRED RESEARCH, COMPANY REPORTS



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#### Recommendation Framework

<b>Stock Ratings</b>	Definition:
Add	The stock's total return is expected to exceed 10% over the next 12 months.
Hold	The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
Reduce	The stock's total return is expected to fall below 0% or more over the next 12 months.
<i>The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.</i>	
<b>Sector Ratings</b>	Definition:
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.
<b>Country Ratings</b>	Definition:
Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.