

BASE METAL SHINE TO AID THE NON-FERROUS SECTOR

Relevant for: Geography | Topic: Distribution of key natural resources - Land Resources incl. Land conservation in world & India

Aluminium has begun 2022 on a strong note, with prices rising about 7% so far. Soaring energy costs badly hit aluminium output, boosting prices. The base metal had gained as much as 42% in calendar year 2021.

Analysts reckon favourable demand-supply dynamics have improved the prospects of other base metals such as copper, zinc and lead with prices rising 18-32% in 2021 on the London Metal Exchange.

Even so, slowdown in demand from China and the spread of Omicron variant have emerged as concerns in recent months. But higher and sustained prices augur well for earnings prospects of Indian non-ferrous companies. Analysts continue to maintain a positive stance on base metal prices.

Rating agency ICRA Ltd said absolute prices will stay at a comfortable level for the domestic non-ferrous metals industry. "Price buoyancy is expected to continue in CY2022, even as downside price risks, including from the rising spread of Omicron globally, cannot be ruled out, low visible inventories and steady demand may insulate against any sharp price corrections," said ICRA analysts.

Note that the demand-supply situation remains tight for aluminium and other base metals compared with steel. Chinese steel demand is subdued owing to the real estate crisis in that country and its efforts to decarbonize. This would keep pressure on international steel prices and limit gains for Indian steelmakers, too.

For base metals, though, structural changes in China's demand patterns are expected to aid. Analysts at Jefferies India Pvt. Ltd said Chinese demand is shifting from urbanization and industrial development to new economy infrastructure such as renewables. This should drive a shift from steel and coal to copper, aluminium and other "energy transition" metals in 2022. Jefferies is most bullish on copper and aluminium for this year.

As such, better copper realizations would lift revenues of companies with smelters. But TcRc (treatment and refining charges) margins have remained soft and must improve to boost profitability.

For aluminium, it helps that there is no near-term major capacity addition outside China, which will also see restricted supplies as production is controlled to cut carbon emissions. These factors should support aluminium prices, and benefit Hindalco Industries Ltd and National Aluminium Co. Ltd (Nalco), hugely.

Firm global aluminium prices benefit Hindalco, whose domestic operations have reported stronger profitability in the past few quarters. Edelweiss Securities Ltd estimates Hindalco's aluminium business Ebitda per tonne in FY22 at 67,370, up 140% year-on-year. It expects some more improvement in FY23. Further, Novelis contributes more than half to Hindalco's operating profits and has lower earnings risk. Novelis is a converter of metals and, hence, is insulated from aluminium prices' volatility.

Nalco, in turn, may benefit from firm alumina prices. It is among the lowest cost bauxite and alumina producers globally and a major exporter of alumina and aluminium. While Vedanta Ltd's earnings depend on segments such as crude oil, iron-ore, steel and power, the company stands to benefit from the rise in aluminium and zinc prices. The zinc market is also expected to remain in deficit after a few European smelters decided to cut output in October. Favourable demand and firm realization outlook helps Hindustan Zinc Ltd.

Meanwhile, the sharp run up in base metal prices has supported stock performances. Shares of Vedanta, Nalco and Hindalco rose in the range of 91-147% in the past year, suggesting investors are capturing a good portion of the optimism into the price.

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