



Hindustan Zinc

STOCK INFO.	BLOOMBERG
BSE SENSEX: 17,614	HZ IN
	REUTERS CODE
S&P CNX: 5,184	HZNC.BO

22 October 2007

Buy

Previous Recommendation: Buy

Rs842

	YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
	END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	422.5										
52-Week Range	1,021/545										
1,6,12 Rel. Perf. (%)	6/1/-32										
M.Cap. (Rs b)	355.8										
M.Cap. (US\$ b)	8.9										
	3/07A	85,602	44,418	105.1	201.7	8.0	4.7	58.2	78.8	3.6	4.8
	3/08E	80,730	43,962	104.0	-1.0	8.1	3.0	37.5	46.5	3.4	4.8
	3/09E	87,636	44,406	104.8	0.8	8.0	2.3	28.1	35.4	2.8	4.2

- During 2QFY08, Hindustan Zinc reported PAT of Rs11.4b, above our estimate of Rs9.6b, driven by a significant surge in Zinc-concentrate production and sales.
- Net sales declined 18.7% YoY to Rs19.8b due to lower zinc prices (4% YoY) at LME, lower duty protection (import duty of 5% v/s 7.5% last year), appreciation of the rupee against the dollar by 13% (Rs40.5/US\$ v/s Rs46.4/US\$). Sales volumes of refined zinc metal remained flat YoY at 94,000 ton and zinc concentrate declined just 5% YoY to 84,800 ton (as against our estimate of 70,000 ton).
- EBITDA declined 23.5% YoY to Rs14.2b and margins declined 450bp YoY to 71.5% primarily due to lower average realization of zinc; there was no apparent cost pressure.
- Other income was substantially higher than our estimate and comprised of Rs1,150m on account of interest income, Rs220m on account of write-back of entry tax, which was no longer required. Amortization has been higher due to treatment of investment in Wind Power Company as an intangible.
- New zinc smelter of 170,000 ton capacity is expected to get commissioned three months ahead of schedule by December 2007. We are now factoring zinc prices of US\$3,000/ton for 3QFY08 and US\$3,300/ton for 4QFY08 and FY09. The stock is trading at 8.1x FY08E and 8x FY09E EPS, and an EV/EBITDA of 4.8x FY08E and 4.2x FY09E. Hindustan Zinc had cash of Rs104.2/share as on 31 March 2007. We reiterate **Buy**.

QUARTERLY PERFORMANCE										(RS MILLION)	
Y/E MARCH	FY07				FY08				FY07	FY08E	
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			
Net Sales	16,100	24,410	24,800	20,210	19,700	19,840	19,743	21,447	85,602	80,730	
Change (YoY %)	205.5	269.8	171.9	13.9	22.4	-18.7	-20.4	6.1	120.8	-5.7	
Total Expenditure	3,660	5,850	5,730	6,210	5,340	5,650	5,691	6,299	21,528	22,979	
EBITDA	12,440	18,560	19,070	14,000	14,360	14,190	14,052	15,149	64,074	57,751	
Change (YoY %)	465.5	535.6	270.3	11.2	15.4	-23.5	-26.3	8.2	178.4	-9.9	
As % of Net Sales	77.3	76.0	76.9	69.3	72.9	71.5	71.2	70.6	74.9	71.5	
Interest	270	100	-110	20	70	60	80	85	284	295	
Depreciation	370	370	370	450	450	490	450	450	1,566	1,840	
Other Income	470	460	640	740	2,700	1,440	860	905	2,313	5,905	
PBT (before EO item)	12,270	18,550	19,450	14,270	16,540	15,080	14,382	15,519	64,537	61,521	
Extra-ordinary Income									-	-	
PBT (after EO item)	12,270	18,550	19,450	14,270	16,540	15,080	14,382	15,519	64,537	61,521	
Total Tax	3,530	5,570	6,100	4,920	4,690	3,600	4,458	4,811	20,119	17,559	
% Tax	28.8	30.0	31.4	34.5	28.4	23.9	31.0	31.0	31.2	28.5	
Reported PAT	8,740	12,980	13,350	9,350	11,850	11,480	9,924	10,708	44,418	43,962	
Adjusted PAT	8,740	12,980	13,350	9,350	11,850	11,480	9,924	10,708	44,418	43,962	
Change (YoY %)	502.8	562.2	305.8	16.6	35.6	-11.6	-25.7	14.5	201.7	-1.0	

E: MOST Estimates

Topline declines due to lower realization

During 2QFY08, net sales declined 18.7% YoY to Rs19.8b due to lower zinc prices (4% YoY) at LME, lower import duty protection (5% v/s 7.5% last year), appreciation of the rupee against the dollar by 13% (Rs40.5/US\$ v/s Rs46.4/US\$). Sales volumes of refined zinc metal remained flat YoY at 94,000 ton and zinc concentrate declined just 5% YoY to 85,000 ton (v/s our estimate of 70,000 ton) due to higher production despite absence of inventory carried forward from previous quarter. Total zinc-MIC production increased significantly by 15% YoY and 7% QoQ to 143,219 ton.

Lead prices at LME increased 159% YoY to US\$3,094/ton while sales increased 47% YoY to 13,351 ton. Sales volume of lead concentrate declined 66% YoY to 9,941 ton.

PRODUCTION (TONS)

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08
Zinc(MIC)	131,526	124,474	127,699	121,301	134,000	143,219
YoY (%)	16	17	-23	45	2	15
QoQ (%)	57	-5	3	-5	10	7
Zinc (Refined)	82,257	78,444	92,758	95,000	93,000	94,000
YoY (%)	45	18	35	4	13	20
QoQ (%)	-10	-5	18	2	-2	1
Lead (MIC)	17,885	14,604	39,394	17,562	19,442	18,225
Lead (Refined)	10,459	9,479	9,858	14,757	13,651	13,081

Source: Company

SALES (TONS)

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08
Zinc (MIC)	97,000	140,349	113,000	131,773	119,316	138,240
YoY (%)	37	51	6	-14	23	-2
QoQ (%)	-37	45	-19	17	-9	16
Refined Zinc	67,000	93,244	93,000	96,298	93,000	93,608
YoY (%)	2	14	27	-5	39	0
QoQ (%)	-34	39	0	4	-3	1
Zinc conc (MIC)	30,000	47,105	20,000	35,475	26,316	44,632
YoY (%)	500	328	-41	-32	-12	-5
QoQ (%)	-42	57	-58	77	-26	70
Refined Lead	11,000	9,235	12,000	12,536	12,500	13,551
YoY (%)	83	85	200	4	14	47
Lead conc (MIC)	0	29,573	14,000	1,328	4,167	9,941

Source: Company

LME AVERAGE PRICES (US\$/TON)

QUARTER	ZINC			LEAD		
	AVG.	QOQ (%)	YOY	AVG.	QOQ (%)	YOY (%)
2QFY08	3,221	-12	-4	3,094	42	159
1QFY08	3,679	7	14	2,184	25	95
4QFY07	3,441	-17	52	1,751	10	43
3QFY07	4,142	23	152	1,587	33	57
2QFY07	3,359	4	155	1,194	7	37
1QFY07	3,239	43	152	1,119	-9	18
4QFY06	2,267	38	71	1,224	21	31
3QFY06	1,642	25	45	1,011	16	9

Source: LME

Costs remain under control

EBITDA of Rs14.2b was higher than our estimate of Rs13.6b due to higher sales of zinc concentrate (as against our estimate), driven by a significant rise in production while margins declined 450bp YoY to 71.5% due to lower average realization of zinc at LME.

EXPENDITURE (RS M)

	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08
Increase/Dec. in stock	910	(50)	420	(470)	40
Mining & Manufac. Exp.	1,970	2,680	2,710	2,920	2,840
Duties, Taxes & Mining Roy	1,500	1,920	1,510	1,490	1,410
Rem.& other benefits	660	600	690	650	630
Ad,Selling & other exp.	810	580	880	750	730

Source: Company

Projects ahead of schedule

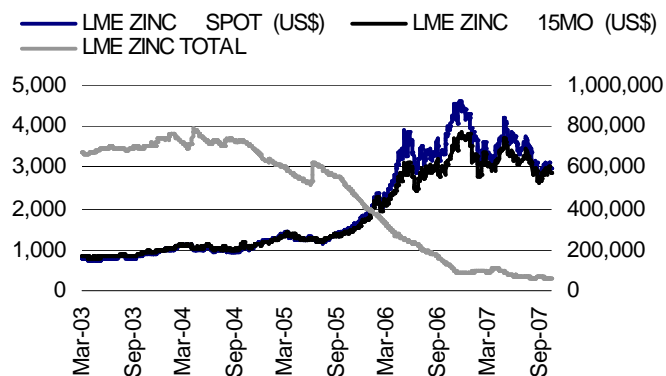
The company's new 170,000 ton zinc smelter is expected to get commissioned three months ahead of schedule by December 2007. Once this happens, the internal consumption of lead is likely to come down and correspondingly sales volumes would increase. The company commissioned wind power capacity of 63.2MW by 30 September 2007 while work on the balance 148.8MW is likely to be completed by March 2008.

Valuations attractive; Buy

We maintain our positive outlook on zinc prices, as demand fundamentals are strong and there are limited projects coming on stream. Also, a number of mines will close down in the next 5-10 years. Prices are likely to remain volatile and high due to extremely low inventory at LME.

We are now factoring zinc prices of US\$3,000/ton for 3QFY08 and US\$3,300/ton for 4QFY08 and FY09. The stock is trading at 8.1x FY08E and 8x FY09E EPS, and an EV/EBITDA of 4.8x FY08E and 4.2x FY09E. Hindustan Zinc had cash of Rs104.2/share as on 31 March 2007. We reiterate **Buy**.

TREND IN ZINC PRICE AND INVENTORY



Source: Bloomberg

Hindustan Zinc: an investment profile

Company description

Hindustan Zinc is a fully integrated zinc producer, with one of the best mining assets in the world. Its mines have total reserves of 118m ton, representing equivalent zinc metal of 11.1m ton and lead metal of 2.5m ton. It is currently mining 500,000tpa of MIC (metal in content), which it plans to ramp up gradually to 1mtpa. Sterlite Industries has 64.92% stake in Hindustan Zinc while 29.54% is owned by the Government of India. Its captive mines and thermal power plants give the company a significant cost advantage, making it one of the lowest cost producers of zinc in the world.

Key investment arguments

- ✎ The company is expanding smelter capacity from 400,000tpa to 660,000tpa by early 2008 through brown-field expansion and de-bottlenecking at capex of ~Rs20b. This would aid strong volume growth.
- ✎ Hindustan Zinc's cost of zinc production is amongst the lowest in the world due to its fully integrated operations and captive source of power. This together with rising metal prices assures high margins.

Key investment risks

- ✎ Unexpected fall in Zinc prices would adversely impact the earnings

COMPARATIVE VALUATIONS

		HINDUSTAN ZINC	NALCO	SAIL
P/E (x)	FY08E	8.1	11.2	12.8
	FY09E	8.0	11.4	12.0
P/BV (x)	FY08E	3.0	2.1	4.5
	FY09E	2.3	1.9	3.4
EV/Sales (x)	FY08E	3.4	3.4	2.4
	FY09E	2.8	3.5	2.2
EV/EBITDA (x)	FY08E	4.8	7.1	7.3
	FY09E	4.2	7.1	7.0

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	64.9	64.9	64.9
Domestic Inst	1.1	1.1	1.6
Foreign	2.3	2.1	1.3
Others	31.7	31.9	32.1

Recent developments

- ✎ The company has been allocated lead, zinc and copper ore mining lease in Rajasthan covering an area of approximately 9,500 square kilometers.

Valuation and view

- ✎ The stock is trading at PE of 8.1x FY08E and 8x FY09E and EV/EBITDA of 4.8x FY08E and 4.2x FY09E.
- ✎ We maintain **Buy**.

Sector view

- ✎ The demand fundamentals for Zinc are strong due to robust economic growth in most of the world, led by developing countries where zinc usage is still low. New 1mtpa of zinc capacity is expected to prop up supply in 2007, though project implementation may spill over in 2008. Inventories at LME too are at an all-time low. We believe that metal prices would remain stable/strong in the next few years.

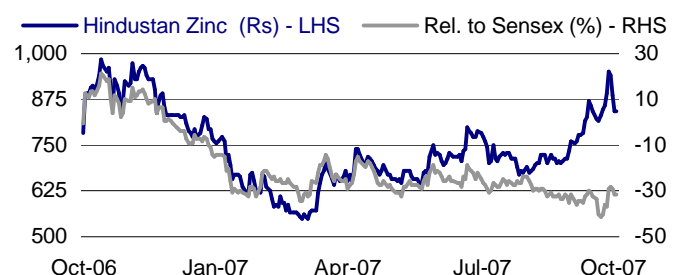
EPS: MOST FORECAST V/S CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	104.0	104.0	-
FY09	104.8	103.9	0.9

TARGET PRICE AND RECOMMENDATION

*CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
842	960	14.0	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Net sales	21,868	38,770	85,602	80,730	87,636	
Change (%)	18.8	77.3	20.8	-5.7	8.6	
Total Expenses	13,195	15,751	21,528	22,979	28,464	
EBITDA	8,673	23,018	64,074	57,751	59,172	
% of Net Sales	39.7	59.4	74.9	71.5	67.5	
Deprn. & Amortization	890	1,407	1,566	1,840	2,065	
EBIT	7,783	21,612	62,508	55,911	57,107	
Net Interest	18	474	284	295	250	
Other income	1,504	1,158	2,313	5,905	7,500	
PBT before EO	9,269	22,296	64,537	61,521	64,357	
EO income						
PBT after EO	9,269	22,296	64,537	61,521	64,357	
Current tax	2,716	7,571	20,119	17,559	19,951	
Deferred tax						
Tax	2,716	7,571	20,119	17,559	19,951	
Rate (%)	29.3	34.0	31.2	28.5	31.0	
Reported PAT	6,553	14,725	44,418	43,962	44,406	
Preference dividend						
Adjusted PAT	6,553	14,725	44,418	43,962	44,406	
Change (%)	19.0	24.7	20.17	-1.0	1.0	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Share Capital	4,225	4,225	4,225	4,225	4,225	
Reserves	16,552	30,072	72,045	113,041	153,978	
Net Worth	20,777	34,298	76,271	117,266	158,203	
Total Loans	5,713	5,580	4	4	4	
Deferred Tax Liability	1,081	2,414	3,006	3,006	3,006	
Capital Employed	27,572	42,292	79,281	120,276	161,213	
Gross Block	23,988	29,900	34,998	51,468	62,468	
Less: Accum. Deprn.	10,109	11,297	12,642	14,482	16,547	
Net Fixed Assets	13,879	18,603	22,356	36,986	45,921	
Capital WIP	4,563	578	6,350	753	753	
Investments	6,879	16,049	44,033	78,169	108,614	
Curr. Assets	7,369	13,094	14,810	13,495	16,057	
Inventory	3,343	3,831	4,993	4,371	5,583	
Account Receivables	2,608	6,899	5,566	4,874	6,224	
Cash and Bank Balance	221	740	1,197	1,197	1,197	
Others	1,196	1,624	3,054	3,054	3,054	
Curr. Liability & Prov.	5,117	6,032	8,268	9,127	10,131	
Account Payables	1,465	1,837	2,065	1,808	2,309	
Provisions & Others	3,652	4,195	6,202	7,319	7,822	
Net Current Assets	2,252	7,062	6,542	4,368	5,926	
Appl. of Funds	27,572	42,292	79,281	120,276	161,213	

E: Most Estimates

RATIOS		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Basic (Rs)						
EPS	15.5	34.8	105.1	104.0	104.8	
Cash EPS	17.6	38.2	108.8	108.4	109.7	
BV/Share	49.2	81.2	180.5	277.5	373.5	
DPS	18	2.5	5.0	6.0	7.0	
Payout (%)	12.9	8.2	5.5	6.7	7.8	
Valuation (x)						
P/E		24.2	8.0	8.1	8.0	
Cash P/E		22.1	7.7	7.8	7.7	
P/BV		10.4	4.7	3.0	2.3	
EV/Sales		9.3	3.6	3.4	2.8	
EV/EBITDA		15.7	4.8	4.8	4.2	
Dividend Yield (%)		0.3	0.6	0.7	0.8	
Return Ratios (%)						
EBITDA Margins (%)	39.7	59.4	74.9	71.5	67.5	
Net Profit Margins (%)	30.0	38.0	51.9	54.5	50.7	
RoE	31.5	42.9	58.2	37.5	28.1	
RoCE	28.2	51.1	78.8	46.5	35.4	
RoIC	34.6	57.3	155.3	99.5	77.8	
Working Capital Ratios						
Asset Turnover (x)	0.8	0.9	1.1	0.7	0.5	
Debtor (Days)	43.5	64.9	23.7	22.0	25.9	
Inventory (Days)	15.3	9.9	5.8	5.4	6.4	
Working Capital Turnover (C)	9.3	16.3	6.2	3.9	5.4	
Leverage Ratio (x)						
Current Ratio	1.4	2.2	1.8	1.5	1.6	
Interest Cover Ratio	433.3	45.6	219.8	189.5	228.4	
Debt/Equity	0.3	0.2	0.0	0.0	0.0	

CASHFLOW STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Pre-tax profit	9,269	22,296	64,537	61,521	64,357	
Depreciation	512	1,187	1,345	1,840	2,065	
(Inc)/Dec in Wkg. Cap.	439	-5,322	1,001	1,057	-2,061	
Tax paid	-2,291	-6,238	-19,526	-17,559	-19,951	
CF from Op. Activity	7,929	11,923	47,357	46,859	44,411	
(Inc)/Dec in FA +CWIP	-10,035	-1,927	-10,870	-10,873	-11,000	
(Pur)/Sale of Investments	-686	-9,170	-27,984	-34,136	-30,445	
CF from Inv. Activity	-10,720	-11,097	-38,854	-45,009	-41,445	
Debt raised/(repaid)	-365	-133	-5,576			
Dividend (incl. tax)	-669	-174	-2,465	-1,850	-2,966	
Other financing activities			-5			
CF from Fin. Activity	-1,034	-307	-8,046	-1,850	-2,966	
(Inc)/Dec in Cash	-3,825	519	457			
Add: opening Balance	4,046	221	740	1,197	1,197	
Closing Balance	221	740	1,197	1,197	1,197	



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Hindustan Zinc

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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