

Metals

Target price Rs1,441

Earnings revision

(%)	FY11E	FY12E
Sales	↑ 1.2	↑ 7.6
EBITDA	↑ 1.9	↑ 12.0
EPS	↑ 1.9	↑ 11.7

Target price revision

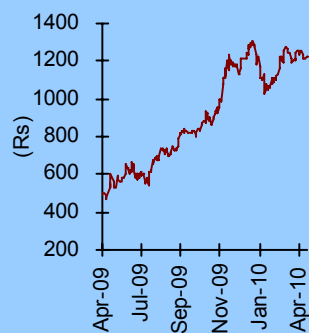
Rs1,441 from Rs1,160

Shareholding pattern

	Sep '09	Dec '09	Mar '10
Promoters	64.9	64.9	64.9
Institutional investors	33.0	33.2	33.2
MFs and UTI	1.3	1.2	1.1
Insurance Cos.	0.4	0.3	0.3
FII	1.6	2.0	2.2
Others	2.1	1.9	1.9

Source: www.nseindia.com

Price chart



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INDIA

Hindustan Zinc

BUY

Upgrade from HOLD

To ride the price bandwagon

Rs1,230

Reason for report: Recommendation change

We upgrade Hindustan Zinc (HZN) to BUY from Hold, with revised target price of Rs1,441/share on the back of 11.7% earnings upgrade for FY12; also, we raise FY12E EV/EBITDA to 5.5x from 4.5x. The zinc cycle is at a critical juncture, with mine shortage issues likely to supersede short-term inventory destocking concerns after '10. We remain confident about improving zinc fundamentals and increase our FY12E zinc price estimate to US\$2,316/te (US\$100/te above consensus). Destocking of Chinese flat products in H2CY10 remains the key risk.

- ▶ **Indicators suggest improving zinc fundamentals; inventory correction likely to be short-lived.** Chinese zinc production is on the rise, while exports are decreasing. Concentrate demand is increasingly being met in-house as ore production is increasing. However, with 500,000te & 600,000te refining capacity likely to come onstream in '10 & '11 respectively, the declining concentrate import scenario would change. Further, cancelled warrants ratio in Shanghai is sharply decreasing, implying lower availability of free zinc in spot. Globally, slabs-to-ore (ex China) are already stretched, indicating that mines are finding it increasingly difficult to support the higher galvanized-steel production in the US & EU. Further, March '10 data shows sharp jump in Chinese slabs-to-ore, implying a tightening market.
- ▶ **Anglo American plc's zinc asset purchase – Management expertise to be critical.** As per media news, HZN is likely to bid for Anglo American plc's (Anglo) zinc assets. We believe that value of these assets can be meaningfully accretive to HZN only if Vedanta succeeds in aggressively ramping-up reserves of Anglo, just as HZN's reserves have doubled since FY04 post its acquisition of majority stake. However, this is a longer-term proposition and the assets are dangerously close to running out (6-7 years of mine life left). Also, prudent tax management would be key. Hence, we believe a pay-back of five years is realistic (given current zinc prices), implying a bid of up to US\$1bn.
- ▶ **Upgrade to BUY.** We believe that by H2CY10, most destocking concerns for zinc will be over. Also, HZN's capacity expansion to 210,000tpa is complete and the company will have ~Rs200bn cash-in-hand by FY12E. We increase our FY12E zinc price estimates US\$100/te, zinc volumes by 5%, and silver volumes by 49% (from 185te to 277te), leading to EPS upgrade of 11.7%. We increase our FY12E EV/EBITDA estimates to 5.5x from 4.5x at present. Upgrade to BUY.

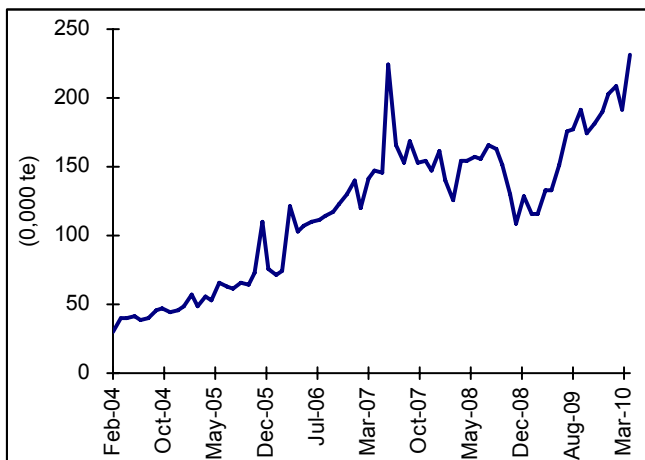
Market Cap	Rs519.6bn/US\$11.6bn
Reuters/Bloomberg	HZNC.BO/HZ IN
Shares Outstanding (mn)	422.5
52-week Range (Rs)	1,303/466
Free Float (%)	35.1
FII (%)	2.2
Daily Volume (US\$'000)	6,620
Absolute Return 3m (%)	10.6
Absolute Return 12m (%)	131.8
Sensex Return 3m (%)	7.0
Sensex Return 12m (%)	44.0

Year to March	FY09	FY10E	FY11E	FY12E
Revenue (Rs mn)	57,760	80,025	94,961	120,910
Net Income (Rs mn)	27,276	40,415	48,991	61,425
EPS (Rs)	61.2	95.6	115.9	145.4
% Chg YoY	(29.3)	56.3	21.2	25.4
P/E (x) (Cash adj)	20.8	11.2	8.4	5.7
CEPS (Rs)	68.0	103.6	125.8	157.8
EV/E (x)	14.9	8.4	6.3	4.3
Dividend Yield (%)	0.3	0.5	0.6	0.6
RoCE (%)	23.8	29.8	28.5	28.7
RoE (%)	19.7	24.9	24.0	23.9

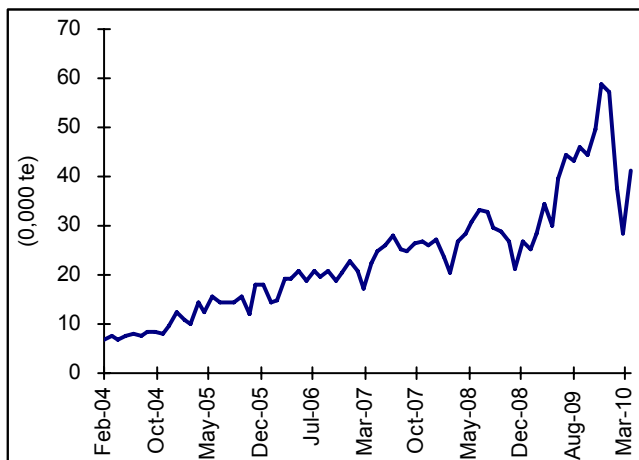
Please refer to important disclosures at the end of this report

Chart 1: Destocking in galvanised products, a risk

China – Galvanised sheet production



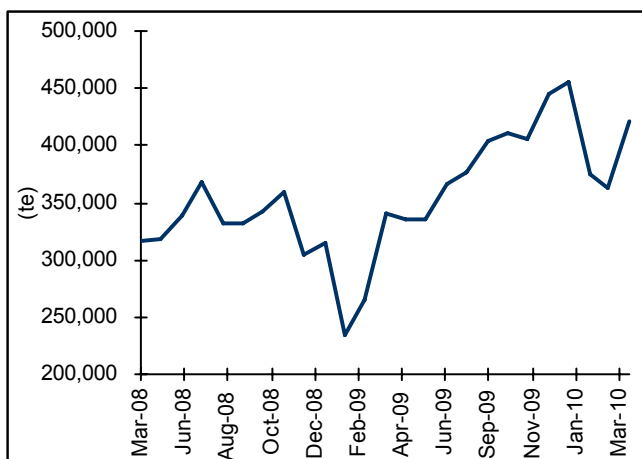
China – Coated sheet production



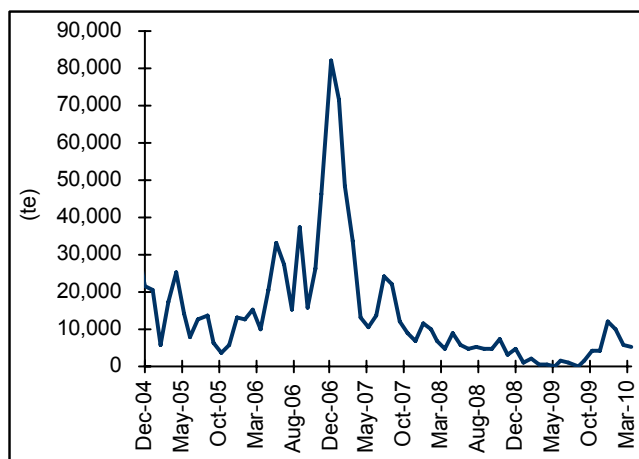
Note: Historically, destocking has not lasted over 3-6 months
 Source: Bloomberg, I-Sec Research

Chart 2: Despite rebound in Chinese zinc production, pick-up in exports only marginal

China – Zinc production



China – Zinc and alloy exports



Source: Bloomberg, Industry, I-Sec Research

Concentrate imports have decreased, implying increase in domestic production. We expect slabs-to-domestic ore to increase as 500,000te of new smelting capacity comes onstream in FY11.

Chart 3: China – Concentrate imports

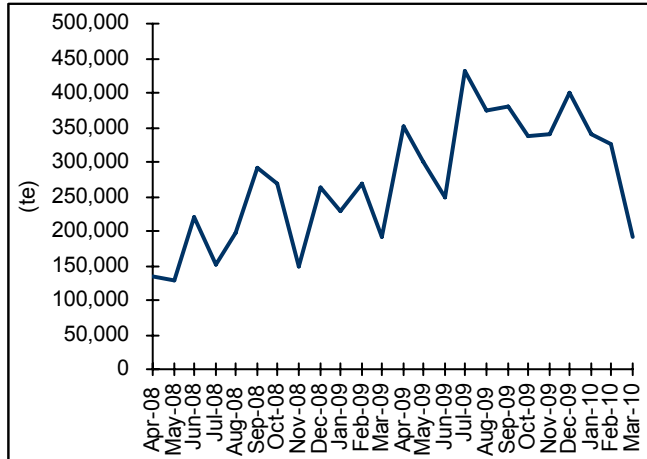
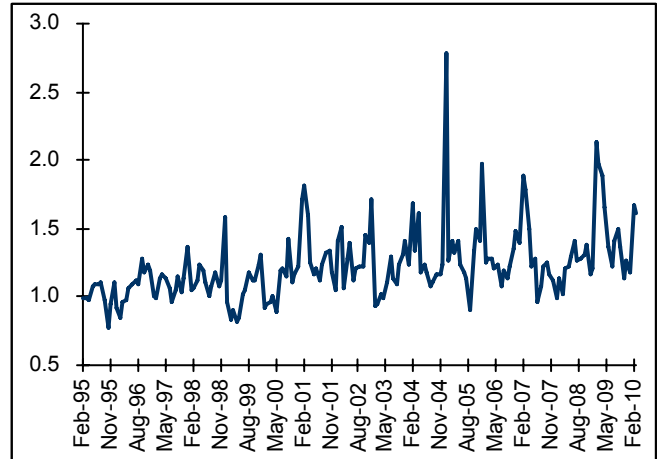


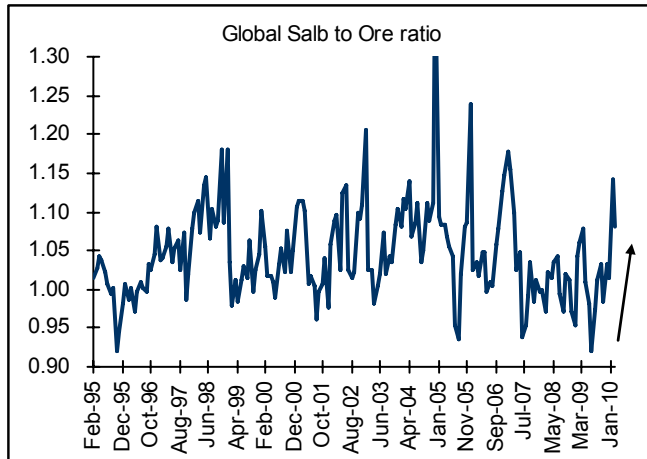
Chart 4: China – Slabs-to-ore increased in March



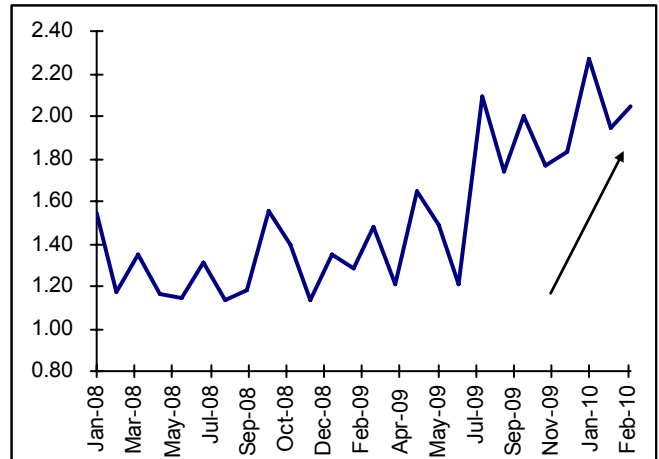
Source: Bloomberg, I-Sec Research

Chart 5: Global mining capacities, ex China, already stretched

Global slabs-to-ore



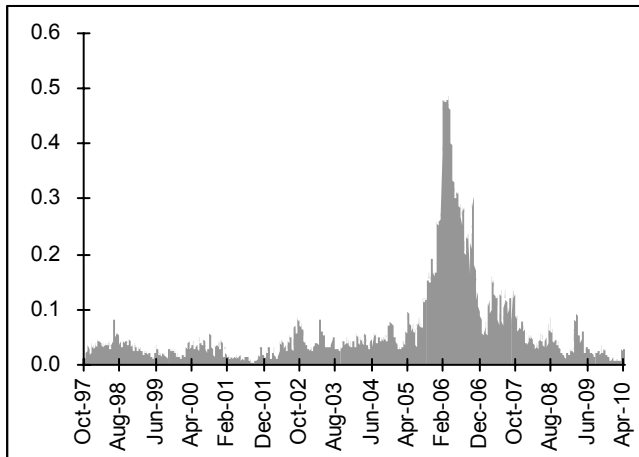
Global slabs-to-ore (ex China)



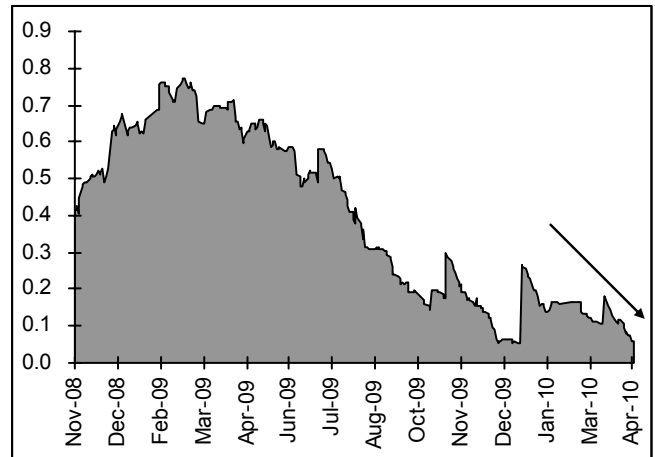
Source: Bloomberg, I-Sec Research

Chart 6: Cancelled warrants – China shows sharp decline; LME increase insignificant

LME – Cancelled warrants

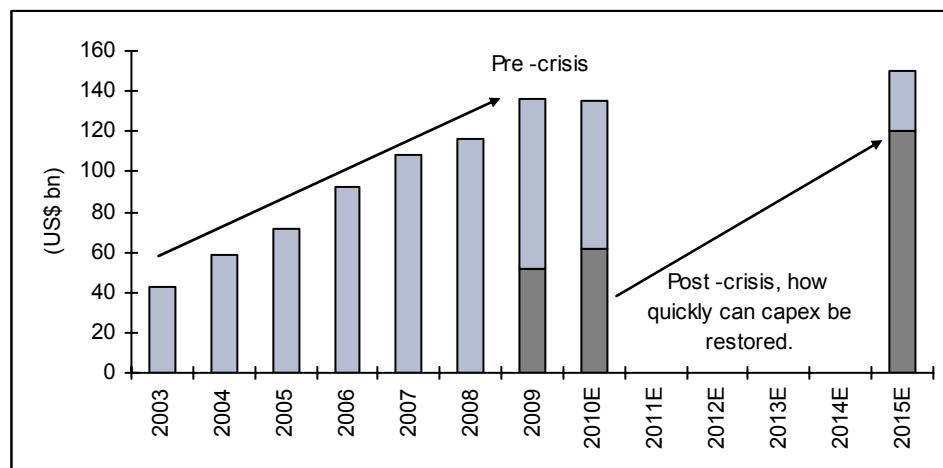


Shanghai Futures Exchange – Cancelled warrants



Source: Bloomberg, I-Sec Research

Chart 7: Capital expenditure estimates for global zinc mining



Source: Nyrstar

Anglo's zinc asset acquisition – Bid payout should not exceed US\$1bn

As per media news, HZL is likely to bid for Anglo American plc's (Anglo) zinc assets (Table 1). We believe that value of these assets can be meaningfully accretive to HZL only if Vedanta succeeds in aggressively ramping-up reserves of Anglo, just as HZL's reserves have doubled since FY04 post its acquisition of majority stake. However, this is a longer-term proposition and the assets are dangerously close to running out (6-7 years of mine life left). Also, prudent tax management would be key. Hence, we believe a pay-back of five years is realistic (given current zinc prices), implying a bid of up to US\$1bn.

Table 1: Details of Anglo's zinc assets

Operation	Location	Anglo's interest (%)	Nature of operations	Status
Skorpion	Namibia	100	Mines + Refinery	Operational
Lisheen	Ireland	100	Mines	Operational
Black Mountain	South Africa	74	Mines	Operational
Gamsberg	South Africa	74	Mines + Refinery	To commence in CY18

Source: Company data

DCF-based valuations (given existing resources)

Our DCF-based valuation yields **US\$660mn** for the Skorpion, Lisheen, Black Mountain and Gamsberg assets (Table 2), with normal corporate tax assumptions for Namibia, Ireland and South Africa. However, post acquisition, if tax rates are managed at CY09 levels, our valuation would increase to **US\$1,018mn**.

Table 2: Current equity value estimates of Anglo's projects

(US\$ mn)

	WACC (%)	Case 1	Case 2
Skorpion	15.0	207	430
Lisheen	12.0	301	395
Black Mountains	13.5	50	91
Gamsberg*		103	103
Total		660	1,018

Note: At zero debt assumption of Skorpion, Lisheen and Black Mountains

*Gamsberg is calculated at corporate tax rate assumption for South Africa

Case 1: At normal tax rate assumptions; Case 2: At managed tax rate assumptions

Source: Company data, I-Sec Research

Fast depleting reserve scenario – Management expertise to come into play

Both Skorpion and Lisheen mines boast of zinc grades similar to HZL's Rampura Agucha mine. However, reserves listed in Anglo's CY09 Annual Report indicate only six years of mining life left in Skorpion & Black Mountain and five years in Lisheen.

Table 3: Reserve and resource details of Anglo’s assets

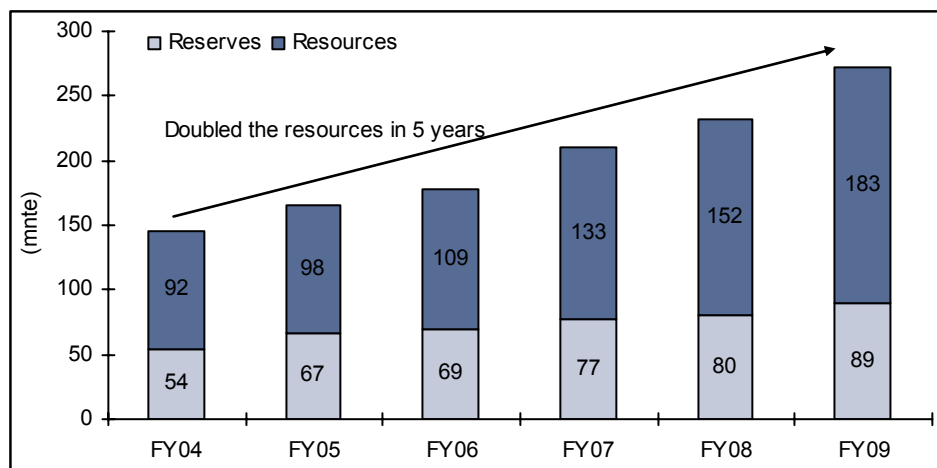
(mnte)

	Skorpion		Lisheen		Black Mountains	
	CY08	CY09	CY08	CY09	CY08	CY09
Proved	4.8	3.8	6.6	5.9	2.9	4.9
Zinc grade (%)	12.94	12.75	11.72	12.02	3.71	3.52
Lead grade (%)			1.91	1.86	3.16	3.68
Copper grade (%)					0.45	0.38
Probable	4.1	4.2	1.6	1.1	5.9	2.8
Zinc grade (%)	10.06	10.06	12.01	9.34	2.89	2.03
Lead grade (%)			1.81	1.87	2.86	2.84
Copper grade (%)					0.37	0.41
Ore Mined	1.39	1.50	1.56	1.53	1.20	1.25
Mine life (yrs)	6.4	5.3	5.3	4.6	7.3	6.2

Source: Company data, I-Sec Research

The depleting mine life is a concern and gives Vedanta a chance to make these assets meaningfully accretive to HZL; this is possible only if Vedanta succeeds in aggressively ramping-up reserves of Anglo, just as HZL’s reserves have doubled since FY04 post its acquisition of majority stake.

Chart 8: Ramp-up in HZL’s reserves by Vedanta



Source: Company data

Operating assumptions for Anglo's zinc assets

Table 4: Skorpion

(te)	CY08	CY09	CY10E	CY11E	CY12E	CY13E	CY14E	CY15E	CY16E
Ore mined (te)	1,390,400	1,495,900	1,300,000	1,300,000	1,300,000	1,300,000	1,300,000	1,300,000	1,300,000
Ore processed (te)	1,333,300	1,426,800	1,248,000	1,248,000	1,248,000	1,248,000	1,248,000	1,248,000	1,248,000
Ore grade processed (%)	11.7	11.5	12.75	12.75	12.75	12.75	12.75	12.75	12.75
Refined zinc production (te)	145,400	150,400	159,120	159,120	159,120	159,120	159,120	159,120	159,120
Realisation (US\$/te)	1,919	1,569	2,366	2,316	2,200	2,200	2,100	2,000	2,001
Revenue	279	236	376	369	350	350	334	318	318
EBITDA	132	100	228	216	193	188	167	146	141

Source: Company Data, I-Sec Research

Table 5: Lisheen

(te)	CY08	CY09	CY10E	CY11E	CY12E	CY13E	CY14E
Ore mined	1,561,900	1,534,500	1,534,500	1,534,500	1,534,500	1,534,500	1,534,500
Ore processed	1,516,900	1,526,200	1,519,155	1,519,155	1,519,155	1,519,155	1,519,155
Ore grade processed (%)							
Zinc	12.10	12.40	12.00	12.00	12.00	12.00	12.00
Lead	1.60	1.80	1.80	1.80	1.80	1.80	1.80
Production							
Zinc concentrate	312,523	321,121	340,745	340,745	340,745	340,745	340,745
Lead concentrate	24,462	29,538	42,069	42,069	42,069	42,069	42,069
Metal paid for, in zinc	142,198	158,056	167,715	167,715	167,715	167,715	167,715
Metal paid for, in lead	15,105	18,240	25,978	25,978	25,978	25,978	25,978
Zinc Tc (US\$/te)	250	180	268	266	260	260	255
Lead Tc (US\$/te)	215	140	228	226	220	220	210
Revenue (US\$ mn)	196	200	327	320	303	301	284
EBITDA (US\$ mn)	40	74	181	170	149	142	120

Source: Company Data, I-Sec Research

Table 6: Black Mountains

(te)	CY08	CY09	CY10E	CY11E	CY12E	CY13E	CY14E	CY15E	CY16E
Copper realisations (US\$/te)	6,959	5,178	7,000	7,000	7,000	7,000	7,000	7,000	7,000
Ore mined	1,199,800	1,249,700	1,249,700	1,249,700	1,249,700	1,249,700	1,249,700	1,249,700	1,249,700
Ore processed	1,204,800	1,293,200	1,249,700	1,249,700	1,249,700	1,249,700	1,249,700	1,249,700	1,249,700
Zinc concentrate	52,150	52,710	65,405	65,405	65,405	65,405	65,405	65,405	65,405
Lead concentrate	72,308	75,538	76,905	76,905	76,905	76,905	76,905	46,154	-
Copper Concentrate	8,333	7,333	12,497	12,497	12,497	12,497	12,497	12,497	12,497
Metal paid for in zinc	23,728	23,983	29,759	29,759	29,759	29,759	29,759	29,759	29,759
Metal paid for in lead	44,650	46,645	47,489	47,489	47,489	47,489	47,489	28,500	-
Metal paid for in copper	2,500	2,200	3,749	3,749	3,749	3,749	3,749	3,749	3,749
Zinc Tc (US\$/te)	250	180	268	266	260	260	255	250	250
Lead Tc (US\$/te)	215	140	228	226	220	220	215	210	210
Zinc revenues (US\$ mn)	32	28	53	52	48	48	46	43	43
Lead revenues (US\$ mn)	66	70	48	48	48	43	38	20	-
Copper revenues (US\$ mn)	17	10	25	25	25	25	25	25	25
Others	-	40	40	40	40	40	40	30	20
Revenues (US\$ mn)	115	148	166	164	161	157	149	119	89
EBITDA (US\$ mn)	37	59	64	60	53	45	35	24	27

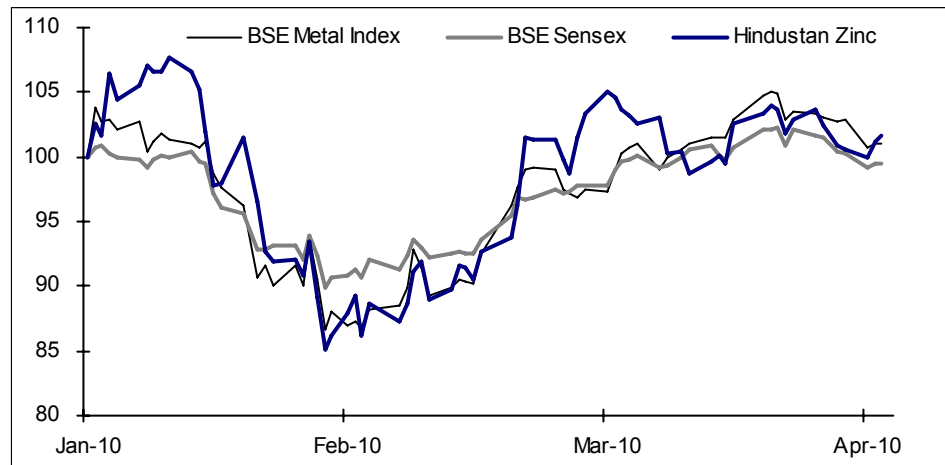
Source: Company Data, I-Sec Research

Table 7: Sensitivity of HZL's valuation to Zinc prices

(Rs/share)	FY12 EV/E (x)			
	3.5	4.5	5.5	6.5
Zinc Price (US\$/te)	1,900	1,110	1,247	1,383
	2,000	1,149	1,293	1,438
	2,100	1,187	1,340	1,493
	2,200	1,225	1,387	1,548
	2,300	1,263	1,433	1,603
	2,400	1,301	1,480	1,658

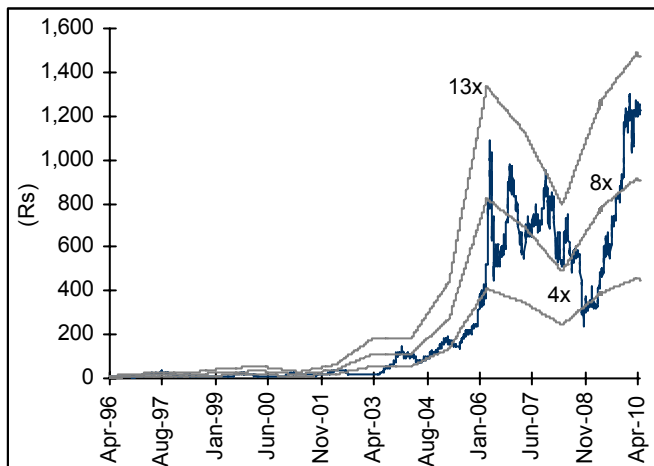
Source: Company Data, I-Sec Research

Chart 9: Relative performance of HZL YTD CY10



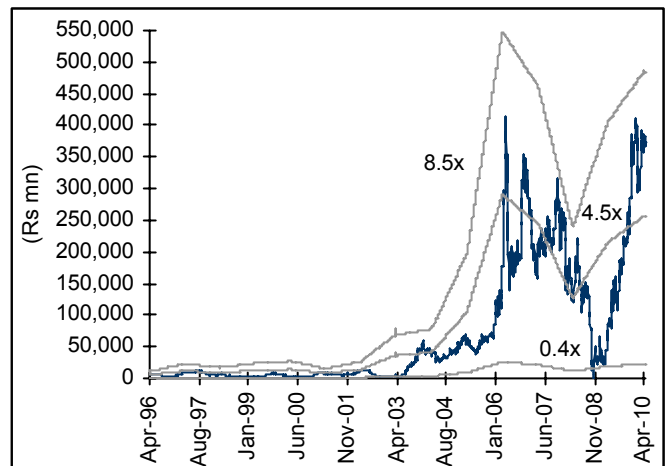
Source: Company data, I-Sec Research

Chart 10: P/E bands



Source: BSE India, I-Sec Research

Chart 11: EV/E bands



Financial Summary

Table 8: Profit and Loss statement

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Operating Income (Sales)	57,760	80,025	94,961	120,910
Operating Expenses	29,461	33,469	36,744	48,506
EBITDA	28,298	47,922	58,217	72,404
<i>% margins</i>	49	60	61	60
Depreciation & Amortisation	2,853	3,343	4,148	5,272
Gross Interest	219	440	440	440
Other Income	6,940	6,003	6,854	9,141
Recurring PBT	32,167	50,142	60,483	75,833
Add: Extraordinaries	1,415	-	-	-
Less: Taxes	6,306	9,727	11,492	14,408
Net Income (Reported)	27,276	40,415	48,991	61,425
Recurring Net Income	25,861	40,415	48,991	61,425

Source: Company data, I-Sec Research

Table 9: Balance sheet

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Assets				
Total Current Assets	37,839	22,524	19,744	30,366
<i>of which cash & cash eqv.</i>	27,192	9,000	3,752	9,605
Total Current Liabilities & Provisions	10,010	18,123	16,984	21,977
Net Current Assets	27,830	4,400	2,760	8,389
Investments				
<i>of which</i>	69,289	110,002	151,390	200,887
<i>Strategic/Group</i>	18	18	18	18
<i>Other Marketable</i>	69,271	109,984	151,372	200,868
Net Fixed Assets	52,133	76,201	82,553	85,481
<i>of which</i>				
<i>Capital Work-in-Progress</i>	11084	21084	11084	3584
Total Assets	149,251	190,602	236,703	294,756
Liabilities				
Borrowings	87	3,558	3,558	3,558
Deferred Tax Liability	5,589	5,589	5,589	5,588
Minority Interest				
Equity Share Capital	4,225	4,225	4,225	4,225
<i>Face Value per share (Rs)</i>	10	10	10	10
Reserves & Surplus*	139,351	177,230	223,331	281,384
Net Worth	143,576	181,456	227,557	285,609
Total Liabilities	149,251	190,602	236,703	294,756

Source: Company data, I-Sec Research

*excluding revaluation reserves

Table 10: Cashflow statement

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Operating Cash flow	23,460	38,309	46,640	58,037
Working Capital Changes	3,121	4,684	(3,963)	(257)
Capital Commitments	(13,793)	(27,410)	(10,500)	(8,200)
Free Cash Flow	13,334	15,583	32,178	49,580
Cash flow from Investing Activities	1,601	(34,710)	(34,535)	(40,355)
Issue of Share Capital	0	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	83	3,471	-	-
Dividend paid	(1,236)	(1,979)	(2,969)	(3,385)
Extraordinary Items	-	-	-	-
Chg. in Cash & Bank balance	13,564	(18,192)	(5,248)	5,853

Source: Company data, I-Sec Research

Table 11: Key ratios

(Year ending March 31)

	FY09	FY10E	FY11E	FY12E
Per Share Data (Rs)				
EPS(Basic Recurring)	61.2	95.6	115.9	145.4
Diluted Recurring EPS	61.2	95.6	115.9	145.4
Recurring Cash EPS	68.0	103.6	125.8	157.8
Dividend per share (DPS)	4.0	6.0	6.8	8.0
Book Value per share (BV)	339.8	429.4	538.6	675.9
Growth Ratios (%)				
Operating Income	(27.4)	38.5	18.7	27.3
EBITDA	(48.2)	69.3	21.5	24.4
Recurring Net Income	(29.3)	56.3	21.2	25.4
Diluted Recurring EPS	(29.3)	56.3	21.2	25.4
Diluted Recurring CEPS	(26.0)	52.4	21.4	25.5
Valuation Ratios (x)				
P/E	20.8	11.2	8.4	5.7
P/CEPS	18.1	11.9	9.8	7.8
P/BV	3.6	2.9	2.3	1.8
EV / EBITDA	14.9	8.4	6.3	4.3
EV / Operating Income	7.3	5.0	3.9	2.6
EV / Operating FCF	15.6	9.4	8.6	5.4
Operating Ratio (%)				
Raw Material/Sales	5.4	10.8	7.9	7.3
SG&A/Sales	0.1	0.2	0.2	0.2
Other Income / PBT	21.6	12.0	11.3	12.1
Effective Tax Rate	18.8	19.4	19.0	19.0
NWC / Total Assets	0.4	(2.4)	(0.4)	(0.4)
Inventory Turnover (days)	46.3	34.4	39.6	39.6
Receivables (days)	5.3	12.5	12.5	12.5
Payables (days)	99.5	170.0	140.0	140.0
D/E Ratio (x)	0.0	0.1	0.0	0.0
Return/Profitability Ratio (%)				
Recurring Net Income Margins	40.0	47.0	48.1	47.2
RoCE	23.8	29.8	28.5	28.7
RoNW	19.7	24.9	24.0	23.9
Dividend Payout Ratio	6.5	6.3	5.9	5.5
Dividend Yield	0.3	0.5	0.6	0.6
EBITDA Margins	49.0	59.9	61.3	59.9

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)

BUY: +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

ANALYST CERTIFICATION

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