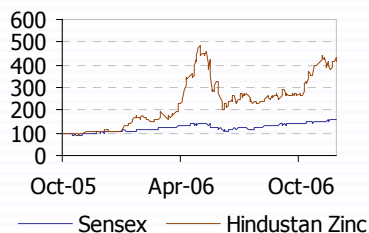


**Stock Data**

No. of shares	: 423mn
Market cap	: Rs.392bn
52 week high/low	: Rs.1,119 / Rs.234
Avg. daily vol. (6mth)	: 1.3mn shares
Bloomberg code	: HZ IN
Reuters code	: HZNC.BO

**Shareholding (%) Mar-06 QoQ chg**

Promoters	: 64.9	0.0
FIIIs	: 1.1	0.4
MFs / UTI	: 1.6	(0.2)
Banks / FIs	: 0.4	(0.1)
Others	: 32.0	(0.1)

**Relative Performance**

Source: ENAM Research, Bloomberg

**Financial summary**

Y/E Mar	Sales (Rs.mn)	PAT (Rs. mn)	Cons. EPS* (Rs.)	EPS (Rs.)	Change YoY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/EBITDA (x)	DPS (Rs.)
2005	22,021	6,036	-	14.3	0	11.9	33.7	36.8	7.7	2.0
2006	38,770	14,383	-	34.0	138	15.4	52.2	67.6	9.0	2.9
2007E	98,880	53,734	102.0	127.2	274	7.3	90.0	126.1	4.4	6.8
2008E	86,821	47,266	86.0	111.9	(12)	8.3	44.4	65.7	4.6	11.4

Source: \*Consensus broker estimates, Company, ENAM estimates.

# Zinc sector/ China visit update

**Rs.927****HZL: Relative to Sector: Neutral**

Target Price: Rs.1,150  
Potential Upside: 24%

**HZL: Set to capitalize on strong Zinc outlook**

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# Summary

- **Strong Chinese Zinc demand to sustain on secular growth and rising usage**
  - Growth estimated to remain buoyant at 10% in 2007. Our visit to China reaffirms our belief that the momentum is likely to continue till 2010
- **Chinese supply constrained by fragmentation and poor grade resource, deficit likely to continue**
- **World Zinc industry to witness higher prices in the medium term, owing to continuing net imports into China, and tight global supply conditions**
- **We revise our Zinc price estimates upwards for FY07 to USD 3,672 per tonne (USD 3,123 earlier) and FY08 prices at USD 3,340 per tonne (USD 2,624 earlier)**
- **Hindustan Zinc Ltd. (HZL), with its high grade mining resources and cost competitive operations, is well placed to capitalize on the firm Zinc pricing outlook**
  - Indian Zinc demand is expected to grow at 10-12% p.a. over the next 3 years, driven by transportation, consumer durables and construction sectors
  - We revise our FY07 EPS estimates upward to Rs 127.2 (Rs 104.2 earlier) and FY08 earnings to Rs 111.9 (Rs.83.4 earlier)
- **Maintain sector Neutral with a price target of Rs.1,150**
  - At CMP (Rs 927), the stock trades at 7.3x FY07E earnings and 4.4x FY07E EV/ EBITDA
  - At current valuations, Sterlite (holds 65% of HZL) provides higher target upside in the non-ferrous sector



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# **China: Zinc outlook**

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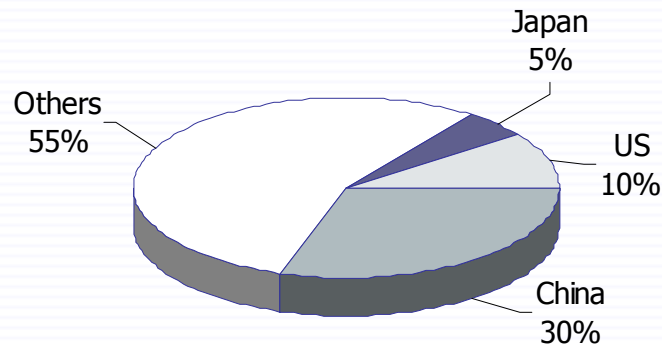
# Chinese Zinc sector: Snapshot

## China Zinc output & consumption

(tonnes)	2001	2002	2003	2004	2005	2006E	2007E
Zinc output	2,080,000	2,150,000	2,310,000	2,710,000	2,770,000	3,030,000	3,520,000
Growth YoY (%)	-	3.4	7.4	17.3	2.2	9.4	16.2
Zinc consumption	1,620,000	2,010,000	2,350,000	2,820,000	3,100,000	3,360,000	3,720,000
Growth YoY (%)	-	24.1	16.9	20.0	9.9	8.4	10.7
<b>Surplus/(Deficit)</b>	<b>460,000</b>	<b>140,000</b>	<b>(40,000)</b>	<b>(110,000)</b>	<b>(330,000)</b>	<b>(330,000)</b>	<b>(200,000)</b>

Source: CNIA, Antaike, ENAM Research

## Global Zinc usage 2007E: 11.38m tonnes

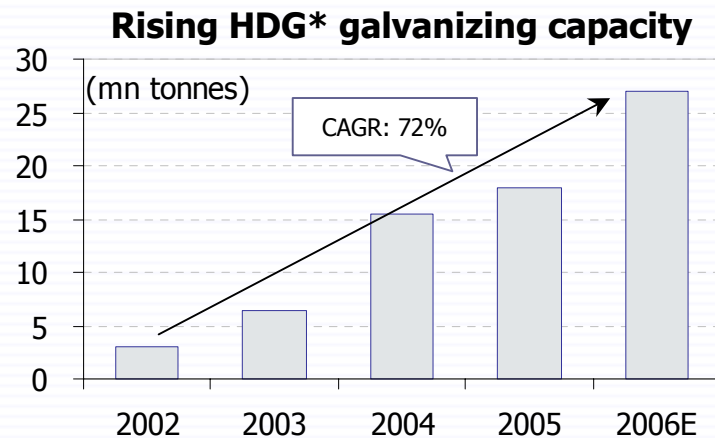
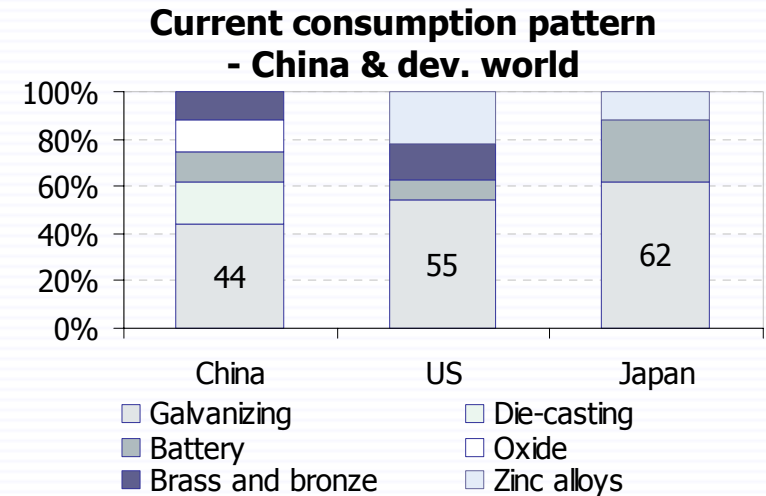


Source: ILZSG, ENAM Research

**China, the largest Zinc producer accounting for 30% of global Zinc demand, has turned into a net importer from 2003 onwards**

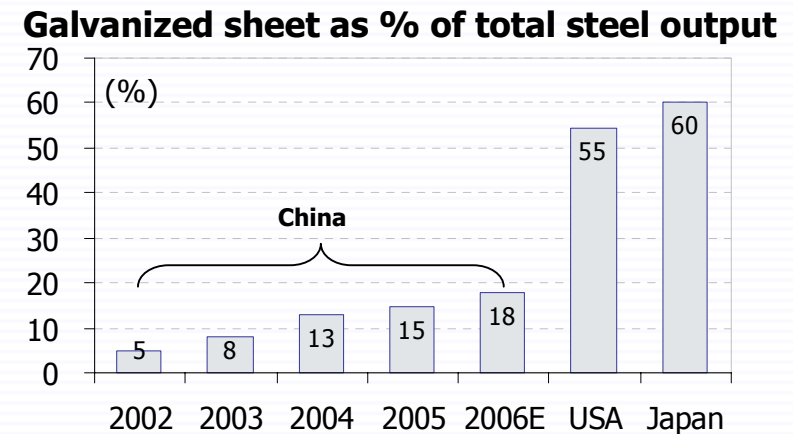
# China: Zinc demand drivers

- Galvanizing constitutes ~44% of total zinc consumption in China
- Galvanized sheet as % of total steel output in China has been steadily rising, still behind developed world



\* HDG: Hot dipped galvanizing

Source: CNIA, Antaike, ENAM Research

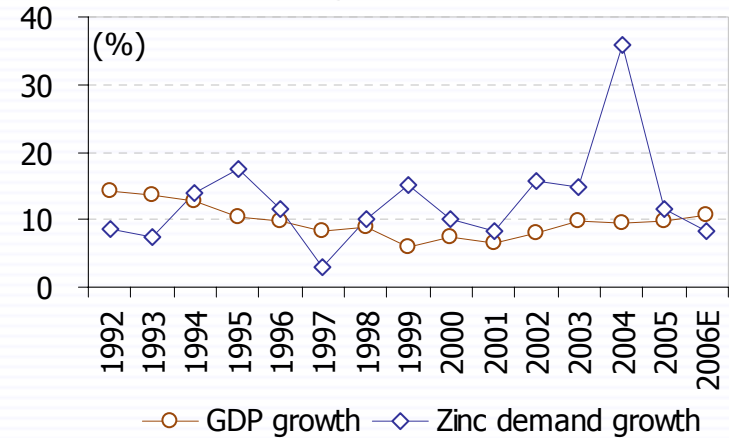


**Galvanized sheet in China accounts for only ~ 20% of total steel output vis-a-vis 55-60% in developed countries**

# China: Zinc demand outlook

- **Zinc consumption to move in line with economic growth**
- **Infrastructure, building construction and durables have been major growth drivers during the last few years**
  - Threat of substitution by aluminium low despite large price difference because of :
    - ▶ Low Zinc requirement, 4% of Zinc is required for galvanizing one tonne of steel
    - ▶ Higher corrosion resistance and better aesthetic appeal
- **GDP growth for 2007 is estimated at 10.2%, and is forecast ~ 8% till 2010**

**China: GDP growth Vs zinc demand growth**



Source: Bloomberg, Antaike, Enam research

**Zinc consumption estimated to touch ~ 4.8 mn tonnes in 2010 (from ~3.4 mn tonnes in 2006) based on historical consumption intensity**

# Supply situation

## FACTORS

## REMARKS

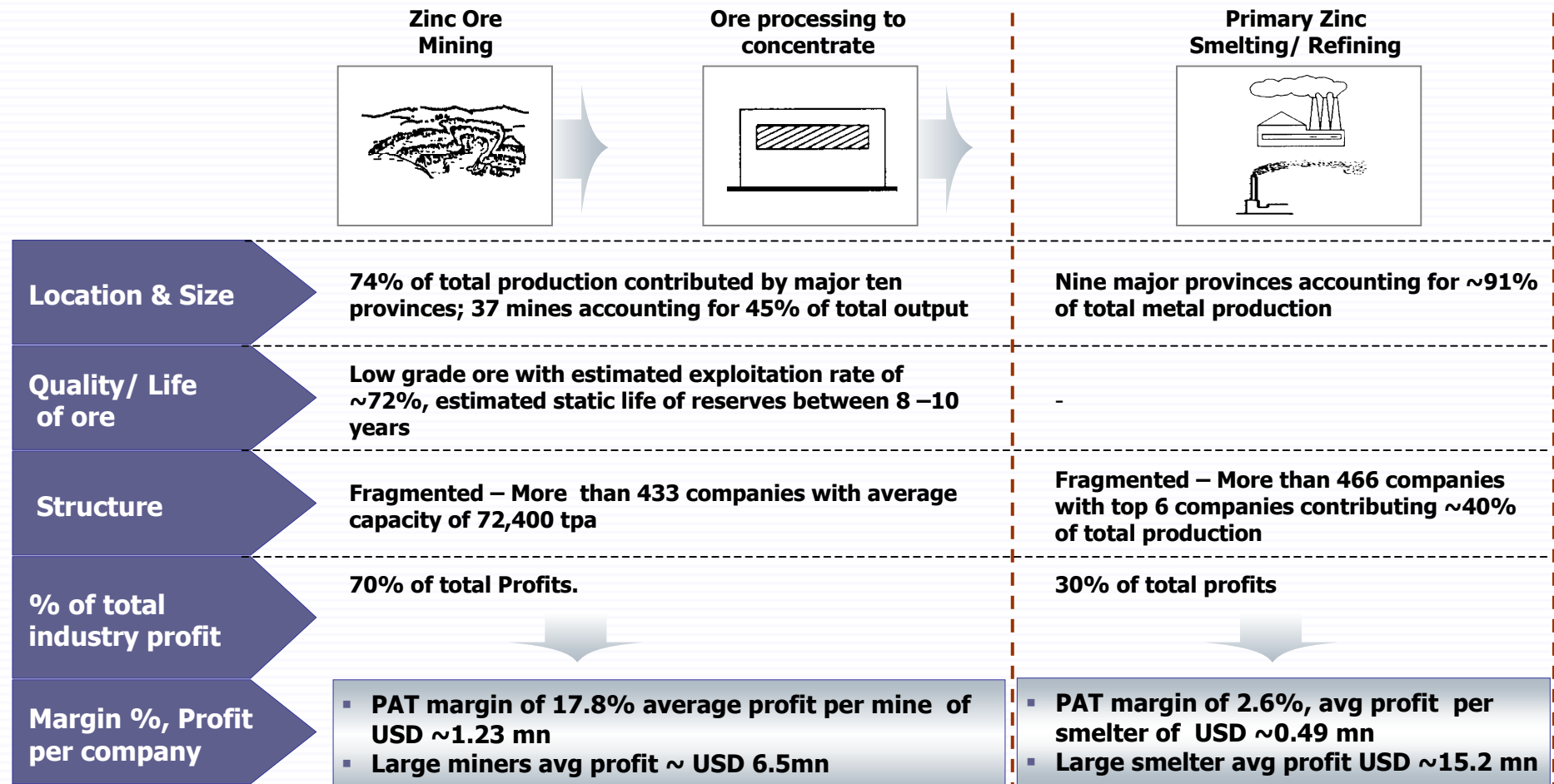
- ➔ **National priorities for self sufficiency**
- ➔ **Resources for production**
  - Zinc concentrate
- ➔ **Structure of Supply**
- ➔ **Recycling of the metal**
- ➔ **Cost of capital/ Economic Return**
- ➔ **Environment protection**

- ➔ **High**
- ➔ **Concentrate availability adequate for short term, tight in long term**
  - Exploration of commercialization of Zinc oxide ore in addition to the current Zinc ore
- ➔ **Fragmented with higher smelter capacity than domestic concentrate**
- ➔ **Not widely prevalent as of now, but focus is increasing**
- ➔ **Current prices above economic/ fair returns inducing supply**
- ➔ **Increased focus on clean environment , could affect smaller mines & smelters not meeting standards**



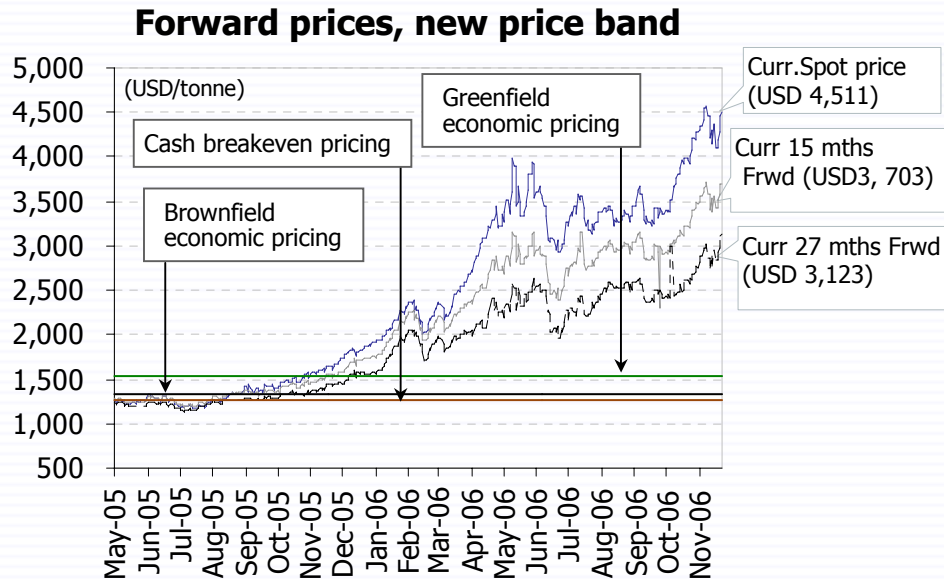
# Structure and profitability

## The value chain



**Scalability of mines limited by ore availability and financial constraints**

# Zinc: Upward shift in price band



## China : Current expansion – Integrated Zinc

	<b>Greenfield</b>	<b>Brownfield</b>
Capital Cost (USD/ton)	1,270	762
Operating Cost (USD/ton)	1,207	1,207
(USD/Tonne)	<b>Greenfield</b>	<b>Brownfield</b>
	20% RoCE	0% RoCE
EBIT	254	-
Depreciation @5%	64	64
EBITDA (add the above two)	318	130
Cost of production	1,207	1,207
Zinc price	1,524	1,270
	12% RoCE	
		91
		38
		130
		1,207
		1,336

Source: Bloomberg, LME, ENAM Research

**Zinc spot & forward prices have been trading far above their economic pricing range in the past year**



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# **Zinc – Global Outlook**

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# World: Demand supply situation

## World refined Zinc metal balance

000 tonnes	2002	2003	2004	2005	2006E	2007E
<b>Mine Production*</b>	<b>8,904</b>	<b>9,579</b>	<b>9,664</b>	<b>9,971</b>	<b>10,181</b>	<b>10,924</b>
(% change)	(0.3)	7.6	0.9	3.2	2.1	7.3
<b>Metal Production</b>	<b>9,720</b>	<b>9,868</b>	<b>10,158</b>	<b>10,268</b>	<b>10,710</b>	<b>11,235</b>
(% change)	5.3	1.5	2.9	1.1	4.3	4.9
<b>Metal Usage</b>	<b>9,386</b>	<b>9,845</b>	<b>10,457</b>	<b>10,677</b>	<b>11,094</b>	<b>11,382</b>
(% change)	5.2	4.9	6.2	2.1	3.9	2.6
<b>Surplus/deficit</b>	<b>334</b>	<b>23</b>	<b>(299)</b>	<b>(409)</b>	<b>(384)</b>	<b>(148)</b>
<b>Average Price (USD/tonne)</b>	<b>779</b>	<b>828</b>	<b>1,048</b>	<b>1,382</b>	<b>3,149**</b>	-
(% change)	-	6.3	26.6	31.9	127.8	-

Source: ILZSG, \*:zinc content derived figure, \*\* average calendar ytd Nov 23, 2006

## Zinc price outlook

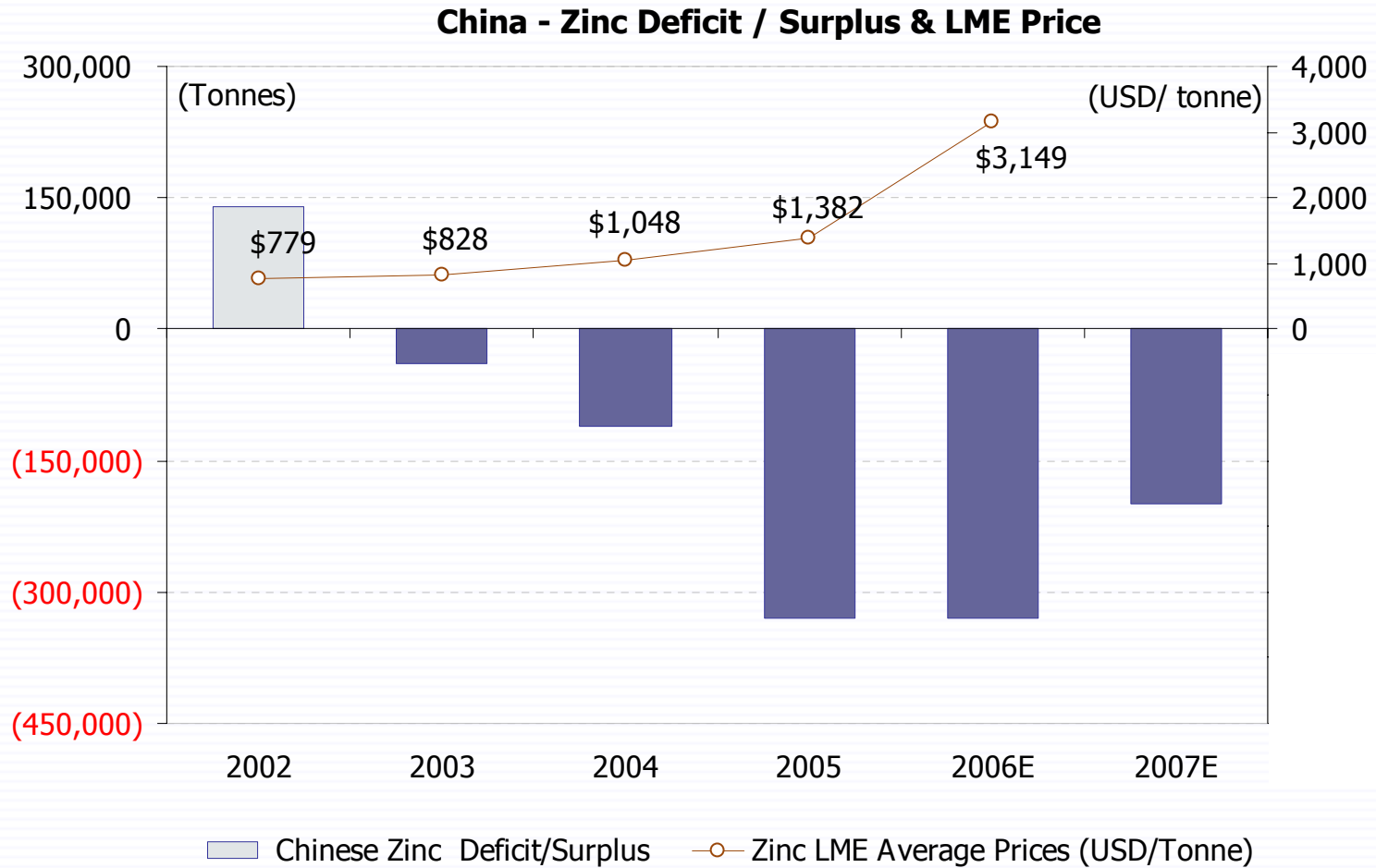
USD/Tonne	FY07E	FY08E
<b>Average (1<sup>st</sup> April06 to 23<sup>th</sup> Nov 06)</b>		
- Forward 15 mths	2,941	-
- Forward 27 mths	-	2,445
- Spot	3,495	-
<b>Forecast (Average USD/Tonnes)</b>	<b>3,672</b>	<b>3,340</b>

Source: LME, ENAM research

Refer Appendix (Slide – 25) for output constraints faced by big miners  
Refer Appendix (Slide – 27) for major additions to world zinc capacity

**Demand exceeding refined output would lead to a deficit, which in turn will exhaust global inventory**

# Firm zinc prices to sustain



*Source: CNIA, Antaike, LME, ENAM research*

**Strong demand from China coupled with tight concentrate supplies in the short term would keep Zinc in deficit/ balance sustaining high prices**



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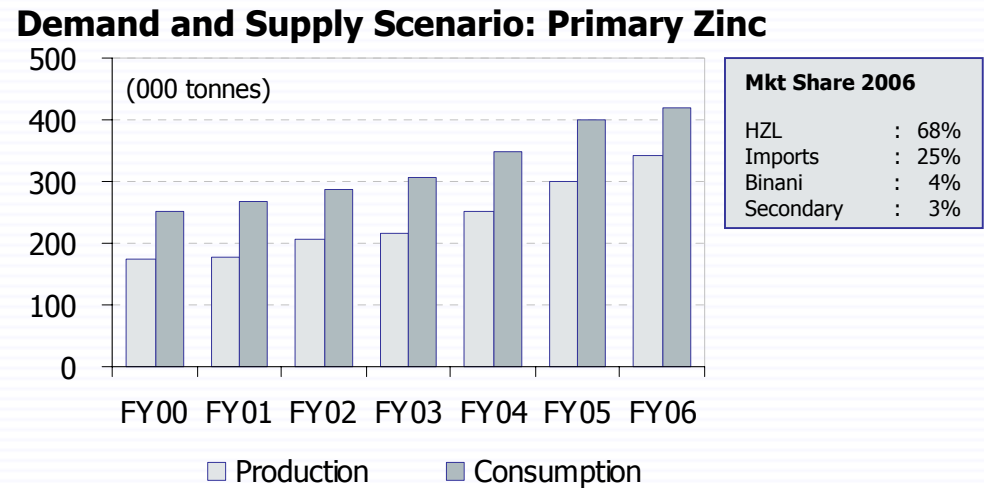
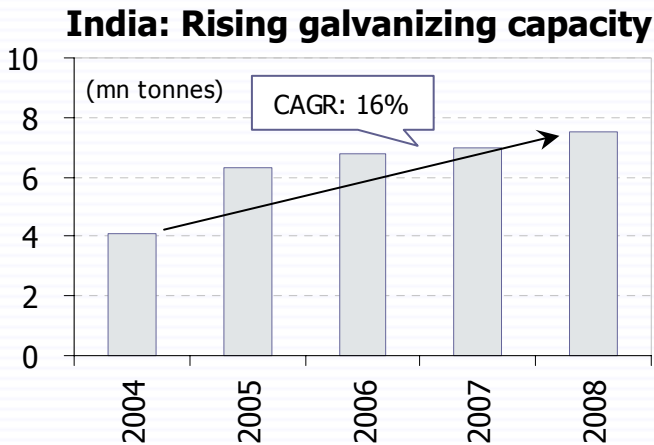
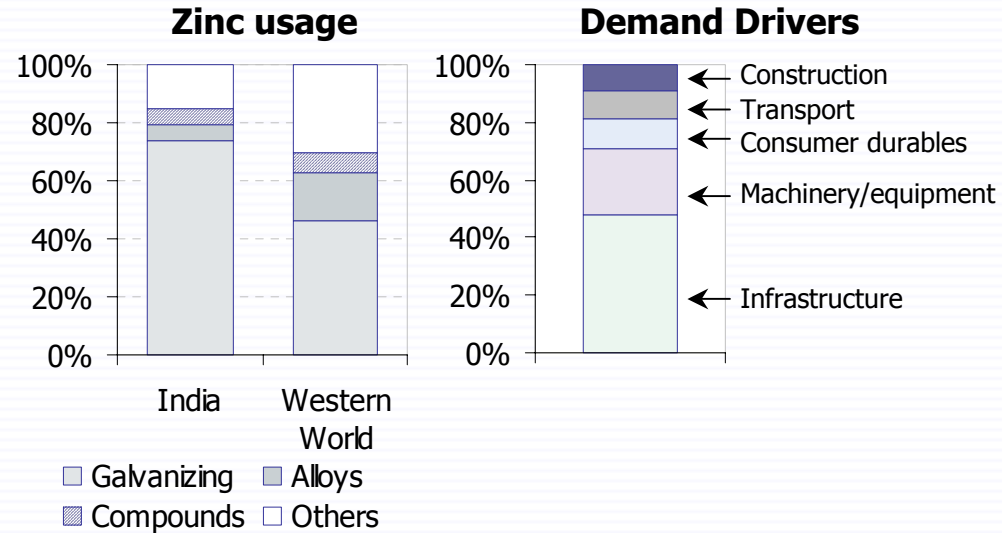
# **HZL**

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Best placed to capitalize on growing Indian demand

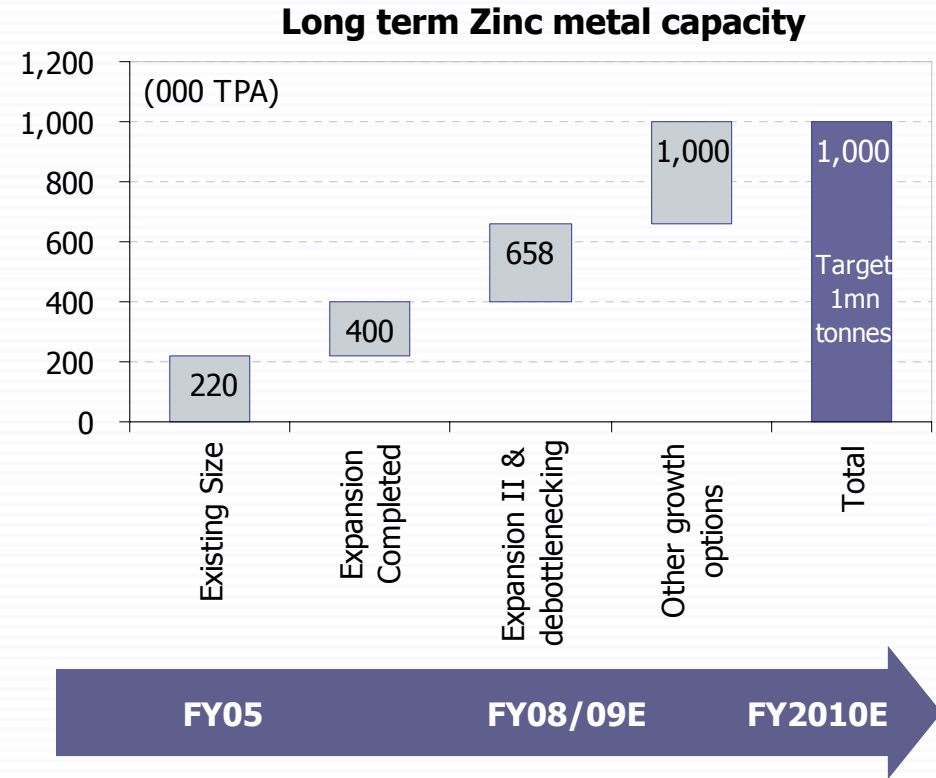
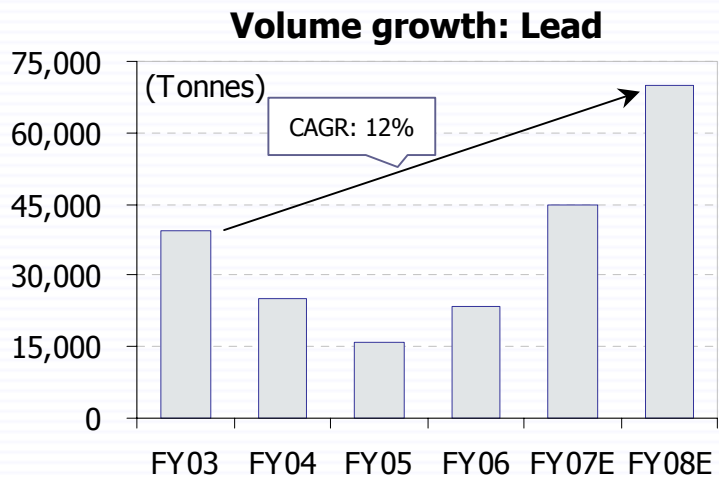
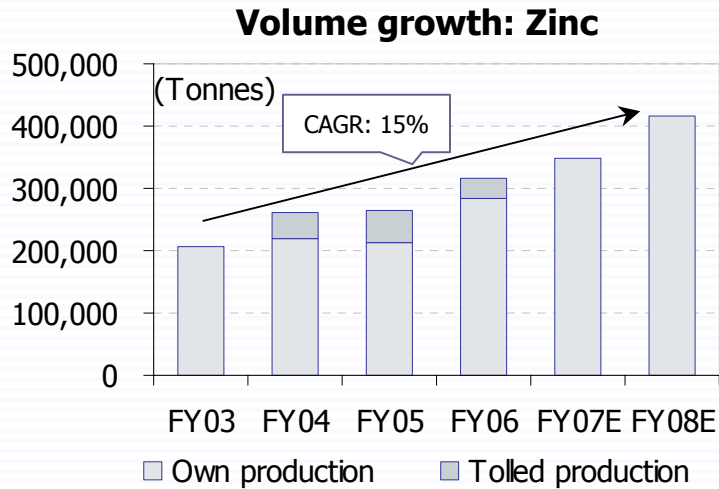
# Indian Zinc market: Growing rapidly

- Demand expected to grow at 10-12% p.a. over the next 3 years. Transportation, consumer durables and construction are the major demand drivers
- HZL's market share for FY06 was 68%, out of total demand of ~420Kt. With expanded capacity, it is expected to fill the import gap
- Steel galvanizing, accounting for 75% of the market, is set to witness strong growth
- Import duty already at 7.5% - close to Asian tariff levels



Source: Company, ENAM Research

# HZL: Strong volume growth & firm pricing



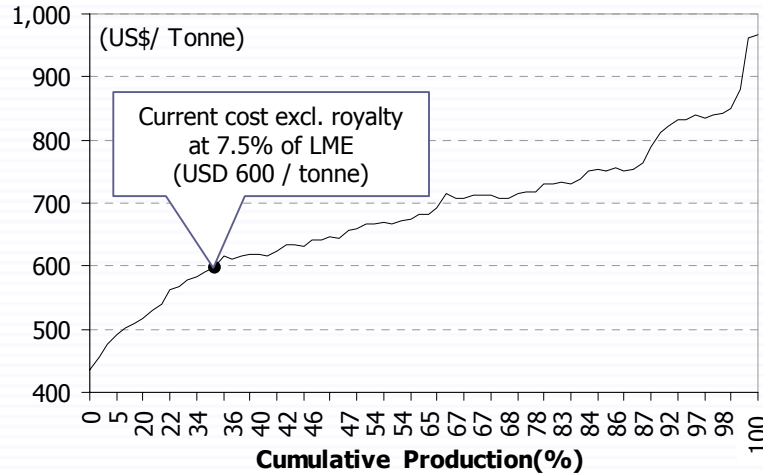
Source: Company, ENAM Research

**Benefits of economies of scale on higher volumes**



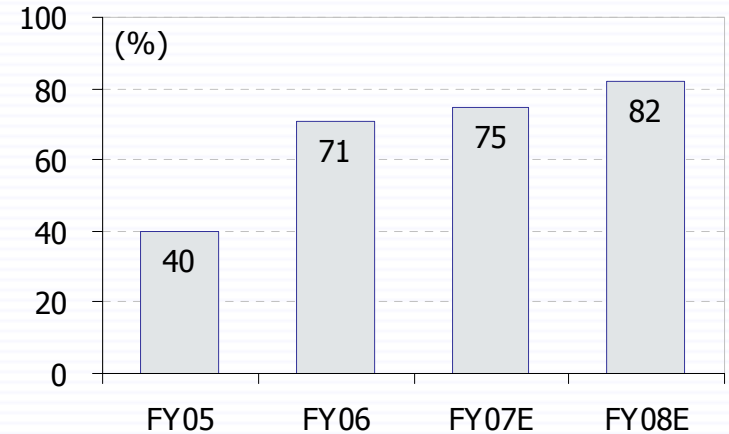
# Captive power to lower costs

**Operating cost to decline**



Refer Appendix (Slide – 26) for details on HZL’s Rampura Agucha mine  
 Refer Appendix (Slide – 28) for HZL volume & price assumptions

**Proportion of cheaper captive power to increase**



**Note: Power costs are ~ 25% of processing costs**

Source: Breakwater, Noranda, ENAM Research, Company

**Integration, captive power and economies of scale leading to cost competitiveness**



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# **Financials & Valuations**

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# Company Financials

## Income statement

Y/E March (Rs. mn)	2005	2006	2007E	2008E
<b>Net sales</b>	<b>22,021</b>	<b>38,770</b>	<b>98,880</b>	<b>86,821</b>
Other operating income	376	316	284	256
Total income	22,397	39,085	99,164	87,077
Cost of goods sold	12,078	14,128	18,877	17,659
Contribution (%)	47	64	81	80
Advt/Sales/Distrn O/H	1,151	1,648	1,811	2,000
<b>Operating Profit</b>	<b>9,168</b>	<b>23,310</b>	<b>78,476</b>	<b>67,418</b>
Other income	465	501	1,982	4,969
<b>PBIDT</b>	<b>9,633</b>	<b>23,811</b>	<b>80,459</b>	<b>72,387</b>
Depreciation	864	1,383	1,624	2,466
Interest	18	474	391	-
<b>Pre-tax profit</b>	<b>8,752</b>	<b>21,954</b>	<b>78,444</b>	<b>69,920</b>
Tax provision	2,716	7,571	24,710	22,654
<b>Adjusted PAT</b>	<b>6,036</b>	<b>14,383</b>	<b>53,734</b>	<b>47,266</b>
E/o income / (Exp.)	509	342	-	-
<b>Reported PAT</b>	<b>6,545</b>	<b>14,725</b>	<b>53,734</b>	<b>47,266</b>

Source: Company, ENAM Research

## Key ratios

Y/E March (%)	2005	2006	2007E	2008E
<b>Sales growth</b>	<b>19.6</b>	<b>76.1</b>	<b>155.0</b>	<b>(12.2)</b>
<b>OPM</b>	<b>41.6</b>	<b>60.1</b>	<b>79.4</b>	<b>77.7</b>
Oper. profit growth	13.7	154.3	236.7	(14.1)
COGS / Net sales	53.9	36.1	19.0	20.3
Overheads/Net sales	5.1	4.2	1.8	2.3
Depreciation / G. block	3.6	4.6	5.0	4.7
Effective interest rate	0.3	8.4	7.0	0.0
Net wkg.cap / Net sales	0.1	0.1	0.1	0.2
Net sales / Gr block (x)	1.1	1.4	3.2	2.0
Incremental RoCE	10.6	270.8	307.8	(178.6)
<b>RoCE</b>	<b>36.8</b>	<b>67.6</b>	<b>126.1</b>	<b>65.7</b>
Debt / equity (x)	0.3	0.2	0.0	0.0
Effective tax rate	31.0	34.5	31.5	32.4
<b>RoE</b>	<b>33.7</b>	<b>52.2</b>	<b>90.0</b>	<b>44.4</b>
Payout ratio (Div/NP)	12.9	8.2	5.4	10.2
<b>EPS (Rs.)</b>	<b>14.3</b>	<b>34.0</b>	<b>127.2</b>	<b>111.9</b>
EPS Growth	0.4	138.3	273.6	(12.0)
CEPS (Rs.)	16.3	37.3	131.0	117.7
<b>DPS (Rs.)</b>	<b>2.0</b>	<b>2.9</b>	<b>6.8</b>	<b>11.4</b>

Source: Company, ENAM Research

# Company Financials

## Balance sheet

Y/E March (Rs. mn)	2005	2006	2007E	2008E
<b>Total assets</b>	<b>27,572</b>	<b>42,292</b>	<b>87,556</b>	<b>130,005</b>
Gross block	23,988	29,900	32,478	52,478
Net fixed assets	13,879	18,603	19,557	37,091
CWIP	4,563	578	7,500	500
Wkg. cap. (excl cash)	2,031	6,322	16,292	12,422
Cash / Bank balance*	7,100	16,789	44,206	79,992
<b>Capital employed</b>	<b>27,572</b>	<b>42,292</b>	<b>87,556</b>	<b>130,005</b>
Equity capital	4,225	4,225	4,225	4,225
Reserves	16,552	30,073	80,917	123,366
Borrowings	5,713	5,580	-	-
Others	1,081	2,414	2,414	2,414

Source: Company, ENAM Research

Note : \* Cash / Bank balance includes liquid investments

## Cash flow

Y/E March (Rs.mn)	2005	2006	2007E	2008E
<b>Sources</b>	<b>6,632</b>	<b>16,103</b>	<b>46,888</b>	<b>44,916</b>
Cash profit	7,324	17,098	55,358	49,732
(-) Dividends	845	1,205	2,890	4,817
Retained earnings	6,480	15,894	52,468	44,916
Issue of equity	-	(0)	-	-
Borrowings	(365)	(133)	(5,580)	-
Others	517	342	-	-
<b>Applications</b>	<b>6,632</b>	<b>16,103</b>	<b>46,888</b>	<b>44,916</b>
Capital expenditure	10,386	2,122	9,500	13,000
Net current assets	(494)	4,291	9,970	(3,870)
Change in cash	(3,261)	9,689	27,417	35,786

Source: Company, ENAM Research



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# **Sensitivity & Risks to call**

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# FY08E Sensitivity

## EPS (Rs)

		USD/INR (Rate)			
		47.1	44.1	41.1	38.1
Zinc price (\$/ton)	1,740	56	52	47	42
	2,540	89	82	75	68
	3,340	121	<b>112</b>	103	94
	4,140	153	142	131	120
	4,940	185	172	159	146
	5,740	217	202	187	172

## P/E (x)

		USD/INR (Rate)			
		47.1	44.1	41.1	38.1
Zinc price (\$/ton)	1,740	16	18	20	22
	2,540	10	11	12	14
	3,340	8	<b>8</b>	9	10
	4,140	6	7	7	8
	4,940	5	5	6	6
	5,740	4	5	5	5

## EBITDA (Rs mn)

		USD/INR (Rate)			
		47.1	44.1	41.1	38.1
Zinc price (\$/ton)	1,740	32,742	29,727	26,713	23,698
	2,540	52,869	48,573	44,276	39,979
	3,340	72,997	<b>67,418</b>	61,839	56,261
	4,140	93,124	86,263	79,403	72,542
	4,940	113,251	105,109	96,966	88,824
	5,740	133,379	123,954	114,529	105,105

## EV/EBITDA (x)

		USD/INR (Rate)			
		47.1	44.1	41.1	38.1
Zinc price (\$/ton)	1,740	10	10	12	13
	2,540	6	6	7	8
	3,340	4	<b>5</b>	5	6
	4,140	3	4	4	4
	4,940	3	3	3	4
	5,740	2	3	3	3

Source: Company, ENAM Research

# Risks to Call

## Risks

- ➔ **Global recession/ Chinese slowdown impacting incremental demand, causing prices to fall**

## Mitigation

- ➔ **Cost competitive producer with captive mine and power**



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# Appendix

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# # 1 Big miners: Facing output constraints

## World's top-ten Zinc mines

Mine	Countries	Metal Prod.(kt)	Contained Zinc (Mnt) *	Rsv/Rsrce life (Yrs)	Remarks
Red Dog	Canada	565	19.7	38.0	<i>Stagnating</i>
McArthur River	Australia	160	15.5	87.0	<i>Mine life extension subject to environment approval</i>
Mount Isa	Australia	245	14.0	51.0	<i>Current Development would support ~ 11-15 yrs</i>
Century	Australia	509	9.4	17.0	<i>Operation impacted by higher over burden/ Stripping ratios</i>
<b>Rampura-Ag</b>	<b>India</b>	<b>377</b>	<b>6.4</b>	<b>15.0</b>	-
Antamina	Peru	180	4.9	19.0	<i>Declining Output</i>
Tara	Ireland	232	2.8	11.0	<i>Old Mine</i>
Skorpion	Nambia	171	2.1	11.0	<i>Good Mine</i>
Brunswick	Canada	265	1.9	7.0	<i>Stagnant</i>
Lisheen	Ireland	178	1.6	8.0	<i>Good Mine</i>
<b>Total</b>		<b>2,882</b>	<b>78.3</b>	-	

Source: Teckcominco,  
Rsv/Rsrce: Reserve/Resource; \* million tonnes

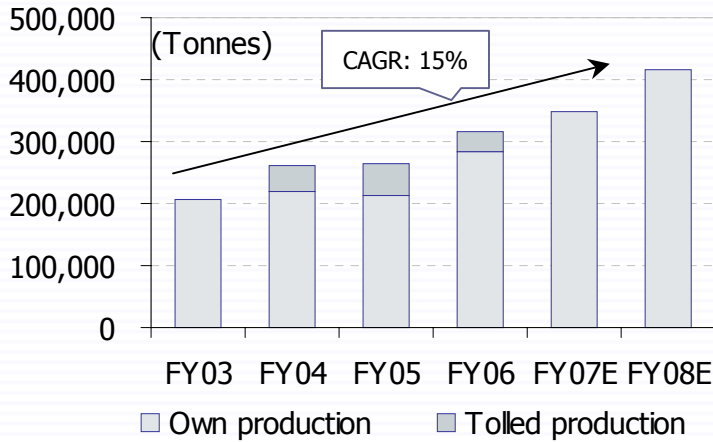
# #2 Major additions to world Zinc capacity

	Location	Country	Company	Cap. (000' tonnes)
<b>Projects 2007</b>				
San Cristobal	San Cristobal	Bolivia	Apex silver mines Corp	180
Dairi	Northern Sumatra	Indonesia	Herald Resources, PT Aneka Tambang	220
Perkoa	Perkoa	Burkina Faso	Metrox (Aim Resources)	60
Langlois	Lebel sur Quevillon, Quebec	Canada	Breakwater Resources	54
Lennard Shelf (Re start)	Kimberly, Western Australia	Australia	Teck Cominco	180
<b>Projects 2008</b>				
Mehdiabad	Yazd, Central Iran	Iran	Union Capital, Itok, IMIDRO, IMPASCO	160
Duddar	Duddar, Baluchistan	Pakistan	MCC Resources, Pakistan Mineral Dev. Co.	100
Tulsequah Chief	British Columbia	Canada	Redfern Resources	50
Prairie Creek	Nahanni River, North Western Territories	Canada	Canadian Zinc Group	50

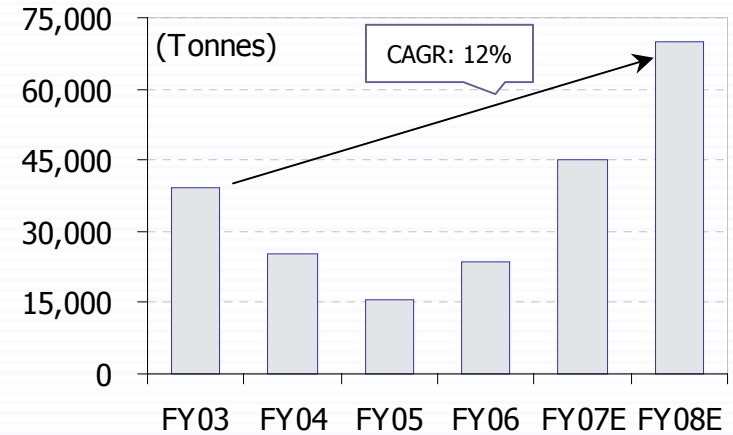
Source: Industry, ENAM Research

# #3 HZL Volume & Price assumptions

**Volume growth: Zinc**



**Volume growth: Lead**



Assumptions (Rs.mn)	2003	2004	2005	2006	2007E	2008E
<b>Zinc</b>						
Volume (Tonne)	207,066	261,226	265,924	317,558	350,000	417,000
Price(\$/Tonne)	806	901	1,107	1,614	3,672	3,340
<b>Lead</b>						
Volume (Tonne)	34,923	25,489	14,622	24,000	45,000	70,000
Price (\$/Tonne)	444	614	921	1,041	1,173	1,200

Source: Company, ENAM Research

# #4 HZL's Rampura Agucha mine

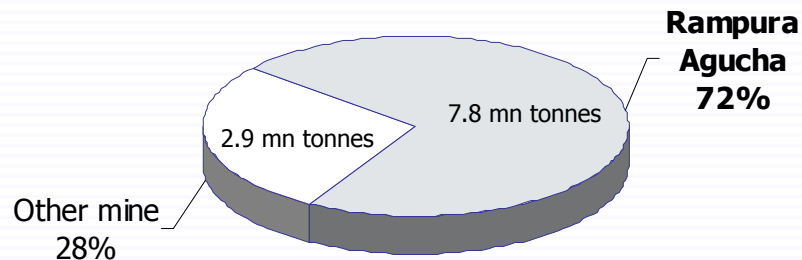
- Long life (15 years)
- High grade ore
- Growing output

## World's leading Zinc mines

Mine	Location	Contained Zinc (mn. tonnes)	Reserve/ Resource Life (Years)
Red Dog	Canada	19.7	38
McArthur River	Australia	15.5	87
Mount Isa	Australia	14.0	51
Century	Australia	9.4	17
<b>Rampura-Agucha</b>	<b>India(Rajasthan)</b>	<b>7.8</b>	<b>15</b>
Antamina	Peru	4.9	19
Tara	Ireland	2.8	11
Skorpion	Nambia	2.1	11
Brunswick	Canada	1.9	7

Source: Teckcominco, Major miners are stagnating

## HZL: Contained Zinc



## Zinc & Lead resource and reserves summary

Reserves & Resources	Mnt	Zinc (%)	Lead (%)
Proved and probable reserves	68.6	11.2	2.0
Measured & indicated resource	54.8	8.8	2.1
Inferred resource	54.2	7.3	2.3

Source: Company, ENAM Research

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1. Analyst ownership of the stock	No
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