

STOCK DATA

Market Cap	Rs100bn.
Book Value per share	Rs280
Eq Shares O/S (F.V. Rs.10)	423mn
Median Vol (12 mths)	105,000 (BSE+NSE)
52 Week High/Low	Rs931 /264
Bloomberg Code	HZ@IN
Reuters Code	HZNC.BO

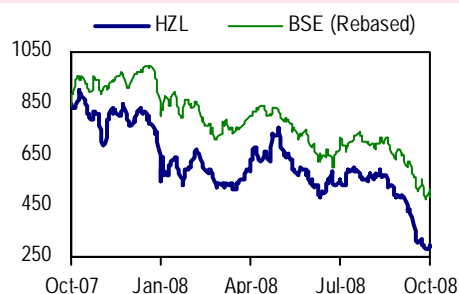
SHAREHOLDING PATTERN (%)

Qtr. Ended	Mar-08	Jun-08	Sep-08
Promoters	64.9	64.9	64.9
Govt of India	29.5	29.5	29.5
MFs/FIs	1.2	1.4	1.4
FIIIs	2.4	2.3	2.2
PCBs	0.4	0.3	0.5
Indian Public	1.6	1.6	1.5

STOCK PERFORMANCE (%)

	1M	3M	12M
Absolute	(51.4)	(55.1)	(71.3)
Relative	(23.6)	(23.7)	(38.9)

STOCK PRICE PERFORMANCE



KEY HIGHLIGHTS

Hindustan Zinc Ltd's (HZL) results in Q2FY09 were a pleasant surprise considering the fall witnessed in LME Zinc prices. The net sales declined only 12% despite a ~45% YoY fall in Zinc prices. Increase in volumes and rupee depreciation helped sustain revenues.

Operating profit declined 34% YoY, as lower LME Zinc prices coupled with higher energy cost (imported coal) had its impact. Hence, OPM shrank 1,780 bps to 53.6%.

● Volumes continue to improve

On the production front, HZL ramped up volumes at the Rampura Agucha mine, with mined metal production witnessing an increase of 17% YoY to 167k mt. Also, despite the 50 day shutdown of one of the smelters translating in a production loss of ~15k mt, refined Zinc production rose 30% to 123k.

● OPM slides further

Zinc prices fell sharply in Q2FY09 and averaged ~USD1750/mt against ~USD3250/mt in Q2FY08. This, along with higher coal cost (feeder for its power plant) led to a 1,780bps fall in OPM to 53.6%. The operating profit fell by >34% YoY to Rs9.4bn. However, lower tax rate and higher other income led to a moderate (-20%) fall in net profits at Rs 9.6bn.

● Expansion plans

HZL announced its plan to set up a new 210k mt smelter at Rajpura Dariba and add another 100k Lead smelter to take its total Zinc and Lead smelting capacity beyond 1mn mt mark. The total capex envisaged for this project is ~Rs36bn, which would be primarily funded through the internal accruals. HZL has a free cash reserve of ~Rs92bn.

VALUATIONS AND RECOMMENDATION

At the CMP of Rs240, the stock is trading at a P/E of 4.2x and EV/EBDIT of 0.4x discounting its FY10 estimates, considering Zinc prices at a very conservative USD 1200/mt levels. With no debt in its books, a cash surplus of ~Rs92bn and an OPM of over 50%, we believe it is one of the most strong company fundamentally, even in these adverse times. Hence, we maintain our 'BUY' recommendation with a revised 12-month price target of Rs 400.

KEY FINANCIALS (STANDALONE)

Rs mn	Quarter Ended			Yr Ended (March)				
	Mar-08	Jun-08	Sep-08	2006	2007	2008	2009E	2010E
Net Sales	22,660	16,436	17,438	38,903	85,602	78,778	59,815	55,773
YoY Gr (%)	12.1	(16.6)	(12.1)	77.7	120.0	(8.0)	(24.1)	(6.8)
Op. Profits	14,810	9,777	9,354	22,994	64,070	53,784	31,265	26,802
Op. Marg.(%)	65.4	59.5	53.6	59.1	74.8	68.3	52.3	48.1
Net Profits	12,780	8,478	9,595	14,725	44,419	43,961	28,620	24,100
Eq Capital	4,225	4,225	4,225	4,225	4,225	4,225	4,225	4,225

KEY RATIOS

	Yr Ended (March)				
	2006	2007	2008	2009E	2010E
Dil. EPS (Rs)	34.8	105.1	104.0	67.7	57.0
ROCE (%)	70.4	113.1	62.8	26.6	18.9
RONW (%)	53.5	80.3	45.1	21.9	15.9
P/E(x)	6.9	2.3	2.3	3.5	4.2
EV/Sales (x)	2.3	0.7	0.3	0.2	0.3
EV/EBIDT(x)	3.7	0.9	0.4	0.3	0.4

PERFORMANCE OVERVIEW

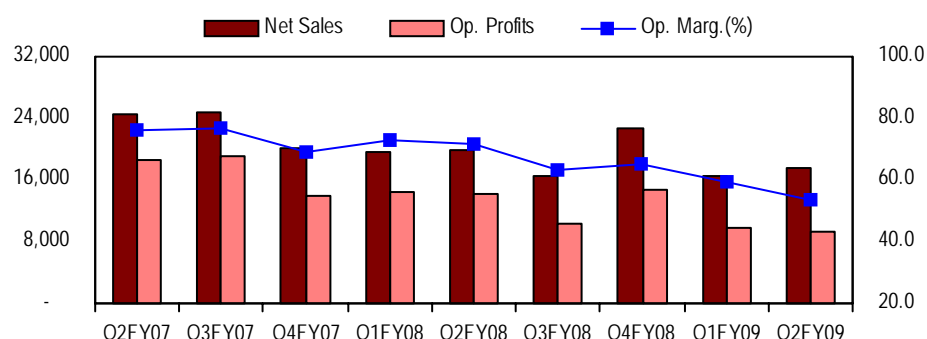
HZL's Q2FY09 results were better than expectations as the erosion of profits was mitigated by increase in volumes, depreciation of rupee and lower tax provisioning. The net sales stood at Rs17.4bn, a fall of only 12% despite a 45% plunge in LME Zinc prices.

Ramp up of mines pushing revenues

The company continued to ramp up production from its Rampura Agucha mine. Consequently, the mined metal production rose from 143k mt to 167k mt, a rise of 17% YoY. The refined Zinc production increased by ~30% YoY to 123k mt mainly because of additional volumes flowing in from 170k mtpa new smelter which was commissioned in H2FY08. However, the ~15k mt of refined Zinc production was lost due to shut down of one of the smelters for ~50 days during the quarter. Therefore the company had excess Zinc concentrate (~76k mt) which was sold in the open market.

Metal Production grew due to ramp up of mines ...

Chart I : HZL's Quarterly Performance



Declining Zinc prices eroded margins...

The falling Zinc prices had a direct impact on the profitability of the company as its manufacturing cost are more or less fixed except imported coal which feeds its power plants. The prices of coal surged from ~USD100/mt to ~USD180/mt in the international market, leading to increase in smelting cost. All these factors led to a 1,780bps erosion in OPM to 53.6% and a 34% fall in operating profit at Rs9.4bn.

However, the company witnessed only a 20% YoY fall in net profits because the tax provision was required to be provided at only 12% compared to 23% in Q2FY08. This was because the company converted one 210k mt Zinc smelter into a 100% EOU, which brought the tax rate down.

Expansion Plans

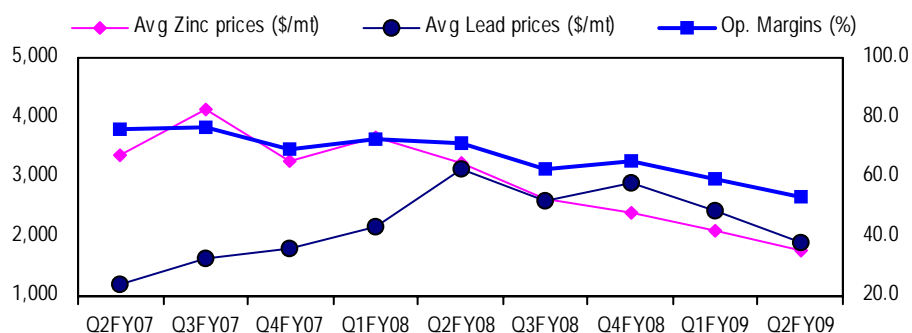
HZL completed all its ongoing expansion plans in FY08 (170k mt smelter, 88k mt de-bottlenecking and expansion of Rampura Agucha Mine to 5mn mt/annum). All these facilities are ramping up and would be running at full capacity in the 2nd half of FY09. HZL has announced a new project to increase zinc and lead smelting capacity by 210k mt and 100k mt respectively. Also, with a view to remain self sufficient on the energy front, the company will set up a 160MW captive power plant. The zinc and lead smelters along with the power plants will be commissioned by mid-CY10.

To further support the enhanced capacities, the *Rampura Agucha* mine capacity will be raised from 5mn tpa to 6mn tpa while that of *Sindesar Khurd* mine will also be increased to 1.5mn tpa from the current levels of ~0.3mn tpa. *Kayar* mine will also be opened with a capacity of ~0.3 mn tpa. The *Rampura Agucha* mine expansion will be completed by mid-CY10 while expansion for the other mines will be completed by H1CY12.

The total investment including cost of smelters, expansion of power facilities, mine development and other infrastructure activities, is ~Rs36bn and will be completely funded through internal accruals.

Proposed expansion to raise total smelting capacity to 1,065k tpa...

Chart II : Zinc & Lead Prices Vs OPM



Source: LME, PINC Research

OUTLOOK

Despite steep fall in zinc prices, HZL managed to post decent results. Though the company also faced problems in its smelting operations (one smelter shut for 50 days), the smelters are now fully operational and are expected to ramp up production over the next 2 quarters to reach rated capacity. In the meantime, it can sell excess concentrate it produces. Moreover, HZL continues to operate with OPM above 50% despite a 60-70% correction in Zinc prices from the peak. This demonstrates strong operational efficiencies of HZL.

We believe that the current level of Zinc prices (<USD1200/mt) can sustain for a short while because of increase in Zinc inventory at LME but it cannot sustain for a long period as at these levels ~20% of the global capacity becomes unviable to operate. Therefore we expect the Zinc prices to average atleast ~USD1400/mt in FY09 and ~1200USD in FY10 assuming a Re/dollar rate at Rs45/USD. On these assumptions we estimate that HZL's OPM would be around 53% in FY09 and ~48% in FY10. But since cost of production of Zinc for the company is almost fixed any change in Zinc prices would change its profitability proportionally as demonstrated by the table below.

Zinc Prices below global marginal cost of production...

FY10 Estimates - Sensitivity to change in Zinc prices					
Zinc prices (USD/mt)	600	800	1,000	1,200	1,400
Sales	38,572	44,306	50,039	55,773	61,506
PAT	11,631	15,787	19,944	24,100	28,256
OPM	29.6	37.3	43.3	48.1	51.9
EPS	27.5	37.4	47.2	57.0	66.9
EV/EBDITA	2.7	2.0	1.5	1.1	0.9
P/E	10.7	7.9	6.2	5.2	4.4

In view of the steep fall in Zinc prices we have revised our estimates downwards and we now expect HZL to post revenues of ~ Rs60bn and Rs56bn assuming Zinc prices of ~USD1400/mt and USD1200/mt in FY09 and FY10 respectively. The net profit is now estimated at Rs29bn and Rs24bn, translating into an EPS of Rs68 and Rs57 in FY09 & FY10 respectively. Moreover the company is sitting on a cash reserves of Rs92bn on its balance sheet which translates into a per share value of more than Rs200.

VALUATIONS AND RECOMMENDATION

At the CMP of Rs276, HZL is trading at a P/E of 4.2x & EV/EBIDT of 0.4x, discounting its FY10 estimates. Considering that it has no debt in its books, a cash surplus of ~Rs92bn and an OPM of over 50% even in the adverse conditions, we believe it is one of the most fundamentally strong companies. So assigning a PE multiple of 3x to its FY10E EPS of Rs 57 and a cash per share of ~RS220 we estimate its fair value at ~Rs400/share, which means a potential 40-50% upside from the CMP. Hence, we maintain our 'BUY' recommendation but revise our 12-month price target to Rs400.

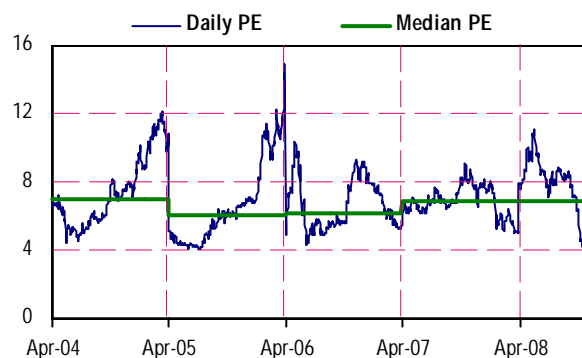
Company description

Hindustan Zinc Ltd. is the largest Zinc producer in India with capacity of 411k tpa. Earlier a govt. held company, HZL was acquired by Anil Agarwal led Sterlite Industries (India) Ltd. in Mar'02, when the govt. decided to disinvest. It has been growing at a rapid pace since then and is now striving to reach 1 mn tpa Zinc capacity by FY10.

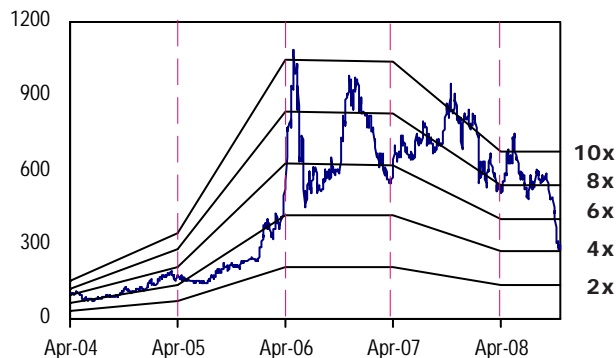
Financial Results for the quarter & half year ended 30 September 2008 (Standalone)

Particulars (Rs mn)	Quarter Ended			Half Year Ended			Year Ended
	30/09/08	30/09/07	Gr %	30/09/08	30/09/07	Gr %	31/03/08
Net Sales	17,438	19,843	(12.1)	33,874	39,543	(14.3)	78,778
Total Expenditure	8,084	5,659	42.8	14,744	10,996	34.1	24,979
(Inc)/Dec in stock	106	38		(211)	(429)		591
Mining & manufacturing exp	5,162	2,849	82.5	9,509	5,766	74.2	12,917
Mining Royalty	1,018	1,407	(27.6)	2,039	2,898	(29.6)	5,111
Staff Cost	865	633	36.7	1,713	1,285	33.3	3,082
Admin, selling & other exp	933	733	27.3	1,694	1,476	14.8	3,278
Operating Profit	9,354	14,184	(34.0)	19,131	28,547	(33.0)	53,799
Other Income	2,273	1,886	20.5	4,367	4,847	(9.9)	8,516
PBDIT	11,628	16,069	(27.6)	23,498	33,394	(29.6)	62,316
Interest	71	57	24.5	140	130	8.0	242
Depreciation & amortisation	704	485	45.0	1,390	936	48.6	2,220
PBT	10,853	15,527	(30.1)	21,968	32,329	(32.0)	59,853
Provision for tax	1,035	3,354	(69.1)	3,502	7,767	(54.9)	14,670
Provision for deferred tax	223	240	(7.3)	394	763	(48.4)	1,220
Net Profits	9,595	11,933	(19.6)	18,073	23,799	(24.1)	43,960
Equity Share Capital	4,225	4,225		4,225	4,225		4,225
Reserves & Surplus (excl rev res)	-	-		-	-		114,257
EPS for the period (Rs)	22.7	28.2	(19.6)	42.8	56.3	(24.1)	104.0
Book Value (Rs)	-	-		-	-		280.4
OPM (%)	53.6	71.5		56.5	72.2		68.3
NPM (%)	55.0	60.1		53.4	60.2		55.8
Expenditure as % of Net Sales							
Mining & manfg. exp (incl stock adj)	30.2	14.5		27.4	13.5		17.1
Mining Royalty	5.8	7.1		6.0	7.3		6.5
Staff Cost	5.0	3.2		5.1	3.2		3.9
Admin, selling & other exp	5.3	3.7		5.0	3.7		4.2
Volumes ('000 MT)							
Zinc							
Mined Metal Production	167	143	16.6	167	143	16.6	551
Refined Metal Production	123	94	30.2	122	94	29.6	426
Zinc Sales volumes	123	94	30.2	122	94	29.6	426
Concentrates Sales	76	85	(10.6)	76	85	(10.6)	72
LME prices (\$/mt)	1,773	3,238	(45.2)	-	-		-

Median PE v/s Daily PE



PE Band



Income Statement	2005	2006	2007	2008	2009E	2010E
Revenues	21,897	38,903	85,602	78,778	59,815	55,773
<i>Growth (%)</i>	-	77.7	120.0	(8.0)	(24.1)	(6.8)
Total Expenditure	13,130	15,908	21,533	24,994	28,551	28,971
Operating Profit	8,767	22,994	64,070	53,784	31,265	26,802
<i>Growth (%)</i>	-	162.3	178.6	(16.1)	(41.9)	(14.3)
Interest & dividend income	1,494	1,158	2,313	8,516	7,082	7,082
EBIDT	10,261	24,152	66,382	62,300	38,347	33,884
(-) Interest	18	474	284	242	-	-
(-) Depreciation	890	1,383	1,561	2,205	3,014	4,131
PBT & extraordinary items	9,353	22,296	64,537	59,853	35,333	29,753
(-) Tax provision	2,716	7,571	20,119	15,893	6,713	5,653
Net Profits	6,637	14,725	44,419	43,961	28,620	24,100
<i>Growth (%)</i>	-	121.9	201.7	(1.0)	(34.9)	(15.8)
Fully diluted Eq. sh. O/s (mn no)	423	423	423	423	423	423
Book Value (Rs)	49.2	81.2	180.5	280.4	336.9	382.7
Basic EPS (Rs)	15.7	34.8	105.1	104.0	67.7	57.0
Diluted EPS (Rs)	15.7	34.8	105.1	104.0	67.7	57.0

Balance Sheet	2005	2006	2007	2008	2009E	2010E
<i>Equity Share Capital</i>	4,225	4,225	4,225	4,225	4,225	4,225
<i>Reserves & Surplus</i>	16,552	30,073	72,045	114,257	138,123	157,470
Net worth	20,777	34,298	76,271	118,482	142,348	161,695
Total Debt	5,713	5,580	4	4	4	4
Deferred Tax liability	1,081	2,414	3,006	4,597	5,097	5,597
Capital Employed	27,572	42,292	79,281	123,083	147,449	167,296
Fixed Assets	18,441	19,181	28,706	41,626	53,058	75,177
Net current assets	2,251	7,062	6,542	18,132	21,067	18,794
Investments	6,879	16,049	44,033	63,325	73,325	73,325
Total Assets	27,572	42,292	79,281	123,083	147,449	167,296

Cash Flow Statement	2005	2006	2007	2008	2009E	2010E
PBT & extraordinary items	9,326	22,296	64,537	59,853	35,333	29,753
Depreciation	890	1,383	1,561	2,223	3,014	4,131
Interest & dividend inc.	(1,494)	(1,158)	(2,313)	(7,911)	(7,082)	(7,082)
Interest paid	18	474	284	242	-	-
Tax paid	(2,291)	(6,238)	(19,524)	(15,288)	(6,213)	(5,153)
(Inc/Dec in working capital	180	(4,293)	690	2,960	477	137
Cash from operations	6,629	12,463	45,236	42,080	25,529	21,785
Net capital expenditure	(10,035)	(1,927)	(10,870)	(15,131)	(14,446)	(26,250)
Net investments	(686)	(9,170)	(27,984)	(14,067)	(10,000)	-
Interest recd	1,494	1,158	2,313	2,262	7,082	7,082
Cash from investing activities	(9,227)	(9,939)	(36,542)	(26,936)	(17,363)	(19,168)
Change in debt	(365)	(133)	(5,576)	-	-	-
Dividend paid	(845)	(1,204)	(2,377)	(2,472)	(4,753)	(4,753)
Interest paid	(18)	(474)	(284)	(241)	(0)	(0)
Cash from financing activities	(1,227)	(1,811)	(8,237)	(2,713)	(4,754)	(4,754)
Inc/Dec. in cash	(3,825)	713	457	12,431	3,412	(2,136)

Key Ratios	2005	2006	2007	2008	2009E	2010E
OPM (%)	40.0	59.1	74.8	68.3	52.3	48.1
ROACE (%)	40.7	70.4	113.1	62.8	26.6	18.9
ROANW (%)	31.9	53.5	80.3	45.1	21.9	15.9
Sales/Total Assets (x)	0.8	0.9	1.1	0.6	0.4	0.3
Debt:Equity (x)	0.3	0.2	0.0	0.0	0.0	0.0
Current Ratio (x)	1.4	2.2	1.8	3.0	3.8	3.6
Debtors (days)	43.5	44.6	26.6	23.2	23.2	23.2
Inventory (days)	92.9	82.3	74.8	74.3	75.0	75.0
Net working capital (days)	95.7	89.0	68.3	56.5	57.2	57.2
EV/Sales (x)	4.5	2.3	0.7	0.3	0.2	0.3
EV/EBIDT (x)	9.7	3.7	0.9	0.4	0.3	0.4
P/E (x)	15.2	6.9	2.3	2.3	3.5	4.2
P/BV (x)	4.9	2.9	1.3	0.9	0.7	0.6

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