

Hindustan Zinc- BUY

CMP Rs1,163, Target Rs1,319

Sector: Metals & Mining

Sensex:	17,231
CMP (Rs):	1,163
Target price (Rs):	1,319
Upside (%):	13.4
52 Week h/l (Rs):	1250 / 303
Market cap (Rscr) :	49,149
6m Avg vol ('000Nos):	264
No of o/s shares (mn):	423
FV (Rs):	10
Bloomberg code:	HZ IB
Reuters code:	HZNC.BO
BSE code:	500188
NSE code:	HINDZINC

Prices as on 23 Dec, 2009

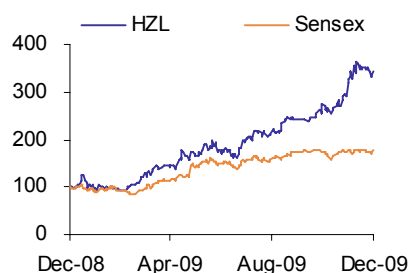
Shareholding pattern

September '09	(%)
Promoters	64.9
Institutions	33.0
Non promoter corp hold	0.8
Public & others	1.3

Performance rel. to sensx

(%)	1m	3m	1yr
HZL	7.3	38.7	165.0
Sterlite	(3.1)	7.0	142.6
Hindalco	14.1	10.7	121.1
NALCO	(0.3)	7.1	35.0

Share price trend



Zinc price at its 21-month high

Zinc price has doubled over the last one year and are currently trading at its 21-month high. The rally in zinc price has been led by a surge in Chinese imports and increasing expectations of a sharp global economic recovery in 2010. The rally in commodity prices has been boosted further by the ample liquidity present globally. China in the first 11 months of 2009 imported 0.7mn tons of zinc, an increase of 142% yoy. ILZSG in its latest release expects zinc demand to increase by 11.9% yoy to 12mn tons in 2010 after a decrease of 5.6% to 10.8mn tons in 2009.

Zinc prices nearing its short term peak

However, we believe that the rally in zinc prices is overdone and is running ahead of fundamentals as the market is overlooking the high idle capacities present globally. The rally in commodity prices in the H2 2009 has led to a series of restarts both in mines as well as smelters. The zinc metal market, which was in a balanced state during the period March-July, turned into a huge surplus over the last three months. We believe zinc prices are nearing their short term peak and expect a correction in Q1 2010. However, considering the continuous signs of economic recovery globally, there may not be any significant fall in zinc prices from here onwards. As a result, we have revised upwards our zinc price estimates by 15% and 10% for FY10E and FY11E, respectively.

Best play on the commodity rally; Maintain BUY

HZL is set to become the world's largest integrated zinc-lead producer by mid-2010. The company is fully integrated with captive mines and power plants, which places it in the lower quartile of the global cost curve. We believe that HZL will be amongst the biggest beneficiaries of the strong commodity prices among the Indian metal companies. We have revised upwards our earnings estimate by 19% and 4.4% in FY10E and FY11E respectively incorporating the revision in commodity price estimate. We expect HZL to report earnings CAGR of 25.8% for FY09-12E and net cash per share to double from Rs236 to Rs460 during the same period. We feel that the stock should trade at par with its international peers on account of the size and the integrated operations of the company. We rollover our price target on FY12E basis and upgrade our target price from Rs960 to Rs1,319, maintaining BUY.

Valuation summary

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Revenues	56,803	77,632	95,813	107,687
yoy growth (%)	(27.9)	36.7	23.4	12.4
Operating profit	27,342	46,645	57,752	65,950
OPM (%)	48.1	60.1	60.3	61.2
Reported PAT	27,276	40,987	48,344	54,361
yoy growth (%)	(38.0)	50.3	17.9	12.4
EPS (Rs)	64.6	97.0	114.4	128.7
P/E (x)	18.0	12.0	10.2	9.0
Price/Book (x)	3.4	2.7	2.2	1.8
EV/EBITDA (x)	14.4	7.9	5.9	4.5
RoE (%)	20.8	25.1	23.6	21.5
RoCE (%)	24.8	30.8	29.0	26.6

Source: Company, India Infoline Research

Zinc demand-supply estimates

('000 tons)	2005	2006	2007	2008	2009E	2010E
Mine Production	10,146	10456	11,129	11,690	11,080	11,970
Metal Production	10,229	10658	11,353	11,655	11,140	12,260
Metal Usage	10,611	10979	11,347	11,438	10,760	12,040
Surplus/deficit	(382)	(321)	6	217	380	220

Source: International zinc and lead study group, India Infoline Research

Revised commodity price estimates

(US\$/ton)	Zinc		Lead	
	New	Old	New	Old
FY10	1,870	1,620	1,920	1,800
FY11	1,950	1,775	2,100	1,900
FY12	2,100	1,775	2,100	1,900

Source: Company, India Infoline Research

Change in HZL's earnings estimate

Change in estimates	FY10E		FY11E	
	New	Old	New	Old
Revenue	77,362	68,793	95,813	86,407
Operating profit	46,645	38,373	57,752	49,129
PAT	40,987	34,423	43,344	41,502

Source: Company, India Infoline Research

HZL's FY11E earnings sensitivity to commodity prices

	Bear Case	Base case	Bull Case
Zinc price estimate (US\$/ton)	1,700	1,950	2,100
Lead price estimate (US\$/ton)	1,900	2,100	2,300
Operating profit (Rs mn)	47,547	57,752	63,319
OPM (%)	56.0	60.3	62.2
PAT (Rs mn)	40,247	48,344	52,761
Change from base case (%)	(16.7)	-	9.1

Source: Company, India Infoline Research

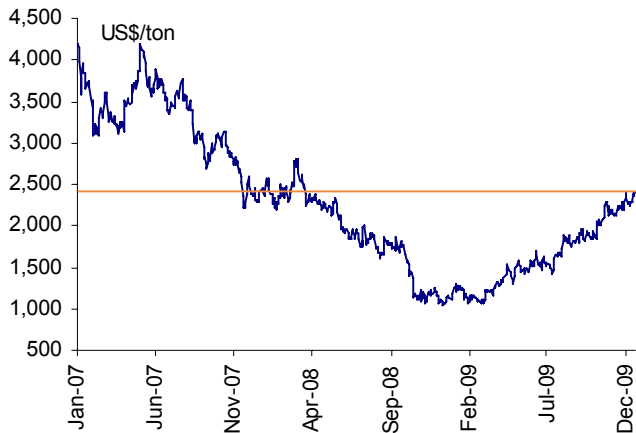
HZL's FY11E earnings sensitivity to currency

	Bull Case	Base case	Bear Case
Rupee estimate (Rs/US\$)	42	45	48
Operating profit (Rs mn)	52,428	57,752	63,077
OPM (%)	58.2	60.3	62.1
PAT (RS mn)	44,119	48,344	52,569
Change from base case (%)	(8.7)	-	8.7

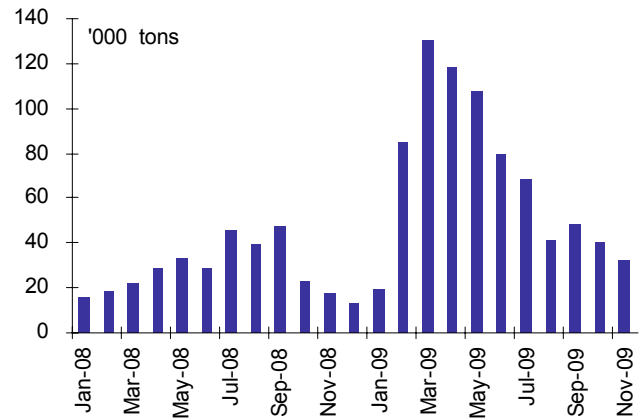
Source: Company, India Infoline Research

Zinc market key indicators

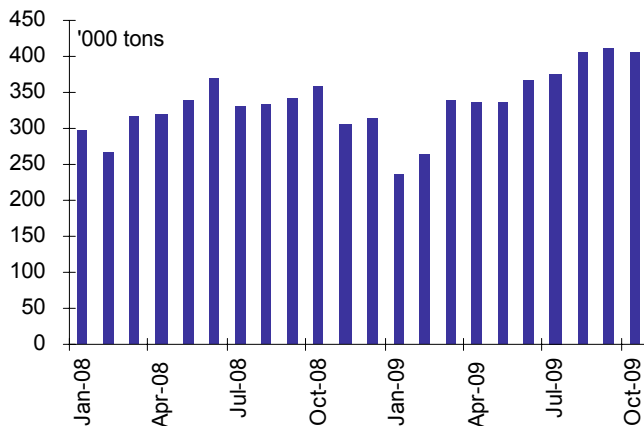
Zinc prices have rallied back to its 21-month high



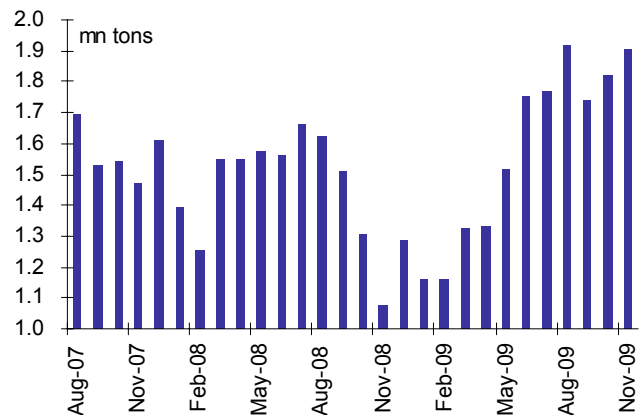
Chinese metal imports have slid as SRB has stopped adding to its reserves....



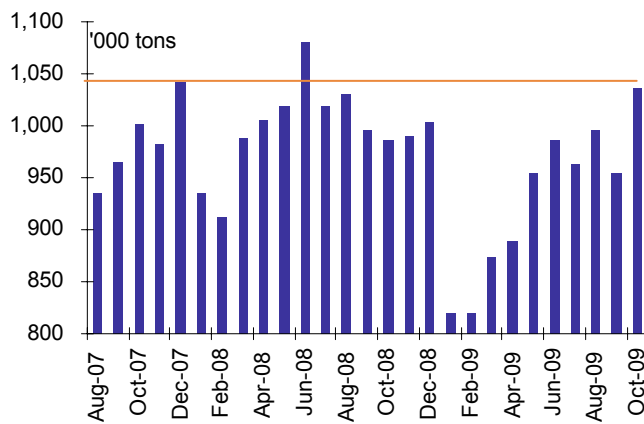
....Chinese domestic zinc production too has jumped to its all time highs



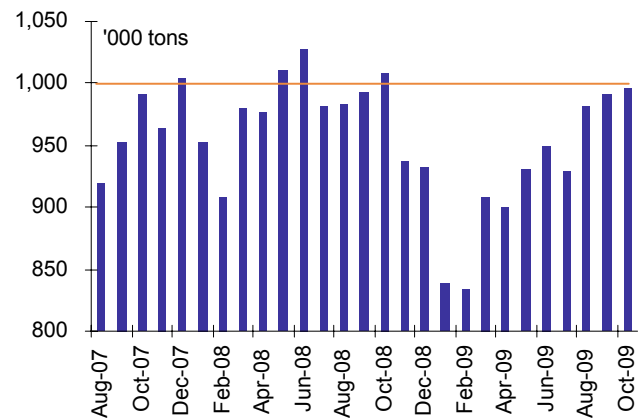
Demand from the galvanizing industry has remained at record high in China



Global mine production has jumped towards its all time high in October

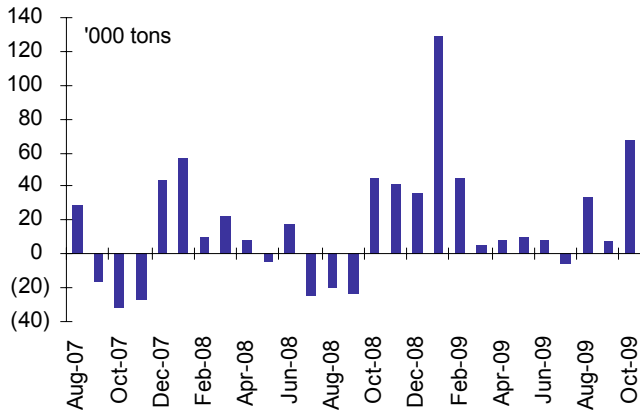


Global metal production too is heading towards its all time high

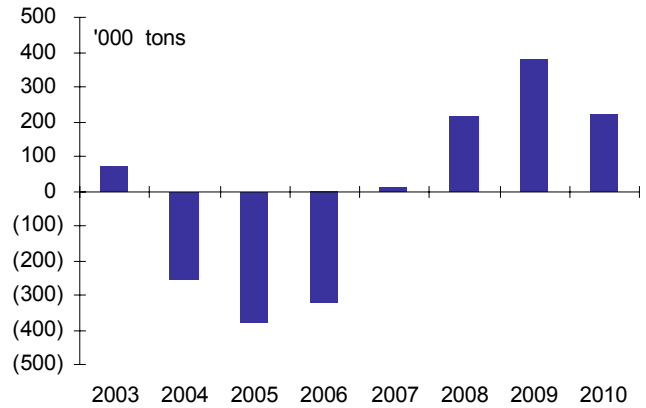


Source: Bloomberg, International Lead and Zinc Study Group (ILZSG)

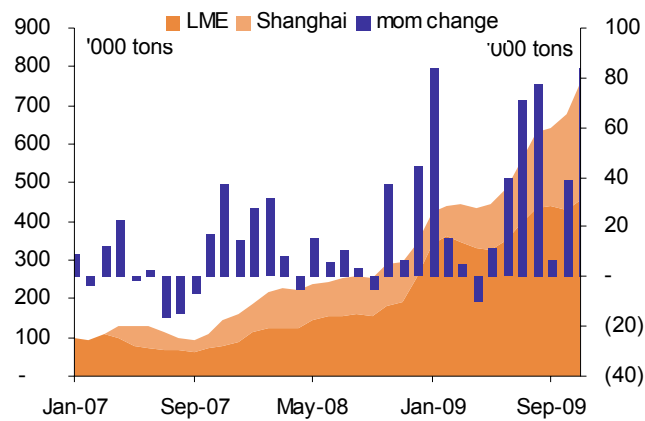
Markets have moved from a balanced state in mid-2009 to a large surplus state over the last three months



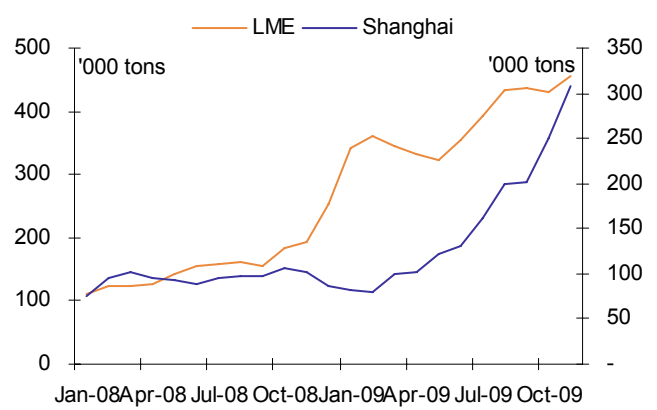
ILZSG expects zinc market to remain in surplus of 0.22mn tons in 2010E



Global inventory levels have jumped in H2 2009



Inventories have shifted from LME to SHFE due to the arbitrage opportunity



Source: Bloomberg, International Lead and Zinc Study Group (ILZSG)

Financials

Income statement

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Revenue	56,803	77,632	95,813	107,687
Operating profit	27,342	46,645	57,752	65,950
Depreciation	(2,853)	(3,340)	(5,045)	(5,532)
Interest expense	(219)	(240)	(240)	(240)
Other income	9,312	8,592	8,463	8,336
Profit before tax	33,583	51,658	60,930	68,513
Taxes	(6,306)	(10,671)	(12,586)	(14,152)
Adj. profit	27,276	40,987	48,344	54,361
Net profit	27,276	40,987	48,344	54,361

Balance sheet

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Equity capital	4,225	4,225	4,225	4,225
Reserves	139,351	178,170	223,430	273,780
Net worth	143,576	182,396	227,655	278,006
Debt	87	-	-	-
Deferred tax liab (net)	5,589	5,589	5,589	5,589
Total liabilities	149,251	187,984	233,243	283,594
Fixed assets	52,133	62,709	82,664	87,132
Investments	69,289	69,289	69,289	69,289
Net working capital	638	1,931	2,217	1,939
Inventories	5,457	7,458	9,204	10,345
Sundry debtors	1,649	2,254	2,782	3,127
Other current assets	3,542	3,972	4,892	5,489
Sundry creditors	(3,722)	(3,495)	(4,314)	(4,848)
Other current liabilities	(6,287)	(8,258)	(10,348)	(12,173)
Cash	27,191	54,055	79,073	125,235
Total assets	149,251	187,984	233,243	283,594

Cash flow statement

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Profit before tax	33,583	51,658	60,930	68,513
Depreciation	2,853	3,340	5,045	5,532
Tax paid	(6,306)	(10,671)	(12,586)	(14,152)
Working capital Δ	3,866	(1,293)	(286)	278
Operating cashflow	33,995	43,034	53,103	60,171
Capital expenditure	(13,360)	(13,916)	(25,000)	(10,000)
Free cash flow	20,635	29,118	28,103	50,171
Equity raised	(205)	206	-	-
Investments	(5,964)	-	-	-
Debt financing/disposal	83	(87)	-	-
Dividends paid	(1,977)	(2,373)	(3,085)	(4,010)
Other items	992	-	-	-
Net Δ in cash	13,564	26,864	25,018	46,161

Key ratios

Y/e 31 Mar	FY09	FY10E	FY11E	FY12E
Growth matrix (%)				
Revenue growth	(27.9)	36.7	23.4	12.4
Op profit growth	(49.2)	70.6	23.8	14.2
EBIT growth	(43.8)	53.5	17.9	12.4
Net profit growth	(38.0)	50.3	17.9	12.4

Profitability ratios (%)

OPM	48.1	60.1	60.3	61.2
EBIT margin	59.5	66.9	63.8	63.8
Net profit margin	48.0	52.8	50.5	50.5
RoCE	24.8	30.8	29.0	26.6
RoNW	20.8	25.1	23.6	21.5
RoA	18.7	22.8	21.6	19.8

Per share ratios

EPS	64.6	97.0	114.4	128.7
DPS	4.0	4.8	6.2	8.1
Cash EPS	71.3	104.9	126.4	141.7
BVPS	339.8	431.7	538.8	658.0

Payout (%)

Dividend payout	7.2	5.8	6.4	7.4
Tax payout	18.8	20.7	20.7	20.7

Liquidity ratios

Debtor days	11	11	11	11
Inventory days	35	35	35	35
Creditor days	24	16	16	16

Du-Pont Analysis

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Tax burden (x)	0.81	0.79	0.79	0.79
Interest burden (x)	0.99	1.00	1.00	1.00
EBIT margin (x)	0.60	0.67	0.64	0.64
Asset turnover (x)	0.39	0.43	0.43	0.39
Financial leverage (x)	1.11	1.10	1.09	1.08
RoE (%)	20.8	25.1	23.6	21.5

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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