

Company

5 July 2010 | 13 pages

Hindustan Zinc (HZNC.BO)

 Equity
 Target price change
 Estimate change

Zinc Surplus until 2012

- Maintain Sell; cutting target price** — We cut our TP to Rs895 (from Rs1,090) on EPS cut of 21-24% for FY11-12E, which incorporates the recent sharp zinc price drop. We continue to value HZL's core business at 5.2x Jun11 P/E (Rs485/share) to which we add cash/share of Rs410. At our TP, HZL would trade at a Jun11E PE of 8.3x and EV/EBITDA of 3.3x. Our order of preference continues to be: aluminium, alumina, zinc.
- Zinc outlook: surplus until 2012** — Zinc prices have fallen by nearly 25% from the April highs, more than any of the other base metals. We have cut our forecasts by 20% in FY11 to \$1,911/t and by 14% in FY12 to \$2,000/t. Rising LME inventories have been an important contributing factor to the price weakness. Although we believe much of this metal has been delivered for financing, it has not been sufficient to support the price. We expect a zinc surplus until 2012.
- Estimate revisions** — We cut PAT by 24% for FY11 and by 21% for FY12 incorporating 1) a 14-20% cut in FY11-12 zinc LME price forecasts, 2) a 15-18% cut in lead LME prices and 3) revised Rs/US\$ rate — 44.5 vs 43.5 in FY11 and 41.5 vs 41 in FY12. Our forecasts do not include the ongoing Anglo American zinc assets acquisition, as we await further acquisition details.
- HZL's positives** — HZL is a fully integrated zinc-lead producer with 34% volume growth in FY11 and 10% in FY12. It is in the lowest-cost quartile globally as 90% of ore is from its low-cost Rampura Agucha mine. This, plus captive power, should help FY11-12 margins range between 66-67%. Mar10 cash was Rs120bn. HZL is in the process of enhancing its zinc-lead capacity by 310ktpa (from 754ktpa). The 210ktpa zinc smelter was completed in Mar10, 3 months ahead of schedule.
- Sensitivity to prices** — A 5% change in zinc-lead prices would impact FY11 and 12 PAT by 7%. A 5% change in Rs/US\$ rate would impact PAT by 8%.

Sell/Medium Risk	3M
Price (02 Jul 10)	Rs940.70
Target price	Rs895.00
	<i>from Rs1,090.00</i>
Expected share price return	-4.9%
Expected dividend yield	0.7%
Expected total return	-4.2%
Market Cap	Rs397,476M
	US\$8,532M

Price Performance (RIC: HZNC.BO, BB: HZ IN)



Figure 1. Hindustan Zinc – Statistical Abstract

YE 31 Mar	Net Profit (Rsm)	EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)	EBITDA margin (%)	ROE (%)
FY07	44,418	105.1	202%	8.9	5.3	78%	58%
FY08	43,961	104.0	-1%	9.0	5.1	79%	37%
FY09	27,276	64.6	-38%	14.6	8.2	65%	19%
FY10E	40,097	94.9	47%	9.9	5.2	68%	22%
FY11E	45,156	106.9	13%	8.8	3.9	66%	20%
FY12E	46,002	108.9	2%	8.6	2.8	67%	17%

Source: Company Reports and Citi Investment Research and Analysis estimates. Price as on 2 July 2010.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	9.0	14.6	9.9	8.8	8.6
EV/EBITDA adjusted (x)	5.4	8.5	5.5	4.3	3.2
P/BV (x)	3.4	2.8	2.2	1.8	1.5
Dividend yield (%)	0.5	0.4	0.6	0.7	0.7
Per Share Data (Rs)					
EPS adjusted	104.04	64.55	94.90	106.87	108.87
EPS reported	104.04	64.55	94.90	106.87	108.87
BVPS	280.41	339.80	428.26	527.53	628.44
DPS	5.00	4.00	5.50	6.50	6.80
Profit & Loss (RsM)					
Net sales	78,778	56,803	78,570	92,487	99,711
Operating expenses	-18,683	-23,002	-28,596	-36,047	-37,246
EBIT	60,095	33,801	49,974	56,440	62,465
Net interest expense	-242	-219	-250	-275	-300
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	59,853	33,582	49,724	56,165	62,165
Tax	-15,893	-6,306	-9,627	-11,008	-16,163
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	43,961	27,276	40,097	45,156	46,002
Adjusted earnings	43,961	27,276	40,097	45,156	46,002
Adjusted EBITDA	62,300	36,654	53,169	60,765	67,226
Growth Rates (%)					
Sales	-8.0	-27.9	38.3	17.7	7.8
EBIT adjusted	-7.3	-43.8	47.8	12.9	10.7
EBITDA adjusted	-6.1	-41.2	45.1	14.3	10.6
EPS adjusted	-1.0	-38.0	47.0	12.6	1.9
Cash Flow (RsM)					
Operating cash flow	40,616	27,127	35,284	43,590	41,216
Depreciation/amortization	2,205	2,853	3,195	4,325	4,760
Net working capital	1,496	3,667	-4,173	-797	-632
Investing cash flow	-6,180	-6,227	-8,924	555	7,720
Capital expenditure	-13,667	-13,743	-15,000	-6,500	-1,500
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-2,713	-1,372	-2,310	-2,994	-3,513
Borrowings	0	83	-83	0	0
Dividends paid	-2,471	-1,236	-1,977	-2,719	-3,213
Change in cash	31,722	19,528	24,050	41,152	45,423
Balance Sheet (RsM)					
Total assets	132,067	159,261	199,487	245,241	288,926
Cash & cash equivalent	76,952	96,480	120,530	161,682	207,105
Accounts receivable	4,437	1,649	4,503	5,312	5,725
Net fixed assets	41,626	52,133	63,938	66,113	62,853
Total liabilities	13,585	15,685	18,533	22,344	23,388
Accounts payable	3,547	3,722	3,361	4,491	4,882
Total Debt	4	87	4	4	4
Shareholders' funds	118,482	143,576	180,954	222,897	265,538
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	79.1	64.5	67.7	65.7	67.4
ROE adjusted	45.1	20.8	24.7	22.4	18.8
ROIC adjusted	106.2	53.8	64.3	62.9	64.0
Net debt to equity	-64.9	-67.1	-66.6	-72.5	-78.0
Total debt to capital	0.0	0.1	0.0	0.0	0.0

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Estimate Revisions

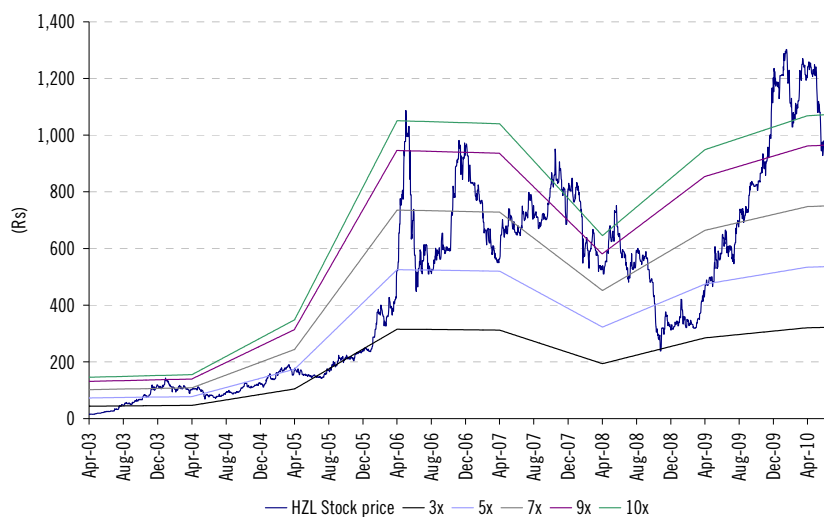
Revisions based on (1) a 14-20% cut in FY11-12 zinc LME price estimates, (2) 11-18% decline in lead LME price forecasts, (3) revised Rs/US\$ rates.

Figure 2. Hindustan Zinc – Estimate changes FY11-12E

	FY11E			FY12E		
	Old	New	% chg	Old	New	% chg
Average Zinc LME (US\$/t)	2,375	1,911	-20%	2,338	2,000	-14%
Average Lead LME (US\$/t)	2,212	1,819	-18%	2,214	1,885	-15%
Rs/US\$ rate	43.5	44.5		41.0	41.5	
Net sales (Rs bn)	110.7	92.5	-16%	115.1	99.7	-13%
EBITDA (Rs bn)	78.5	60.8	-23%	83.4	67.2	-19%
Net profit (Rs bn)	59.5	45.2	-24%	58.0	46.0	-21%
EPS (Rs)	140.7	106.9	-24%	137.2	108.9	-21%

Source: Citi Investment Research and Analysis estimates

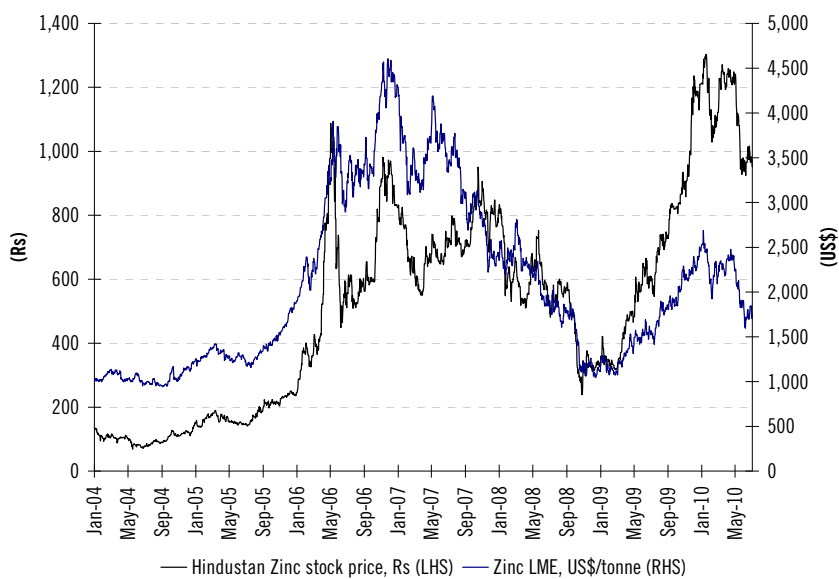
Figure 3. Hindustan Zinc – Rolling PE band chart (1-yr forward)



Source: DataStream, Company Reports and Citi Investment Research and Analysis

HZL's stock price performance is largely driven by trends in zinc prices.

Figure 4. Hindustan Zinc stock price (Rs) vs Zinc LME price (US\$)



Source: Citi Investment Research and Analysis

Acquisition of Anglo Zinc Assets

(Extract from our note of 10 May 2010)

- **Exposure to Africa, Europe** – Vedanta Resources is in the process of acquiring Anglo American's zinc assets (to be routed via Hindustan Zinc) for an EV of \$1.34bn. The assets consist of the Lisheen mine in Ireland (100% owned), the Skorpion mines in Namibia (100%) and 74% in Black Mountain Mining (BMM), which owns the Black Mountain mine and the Gamsberg project in South Africa.
- **Growing the zinc business** – The acquisition would increase the group's zinc/lead production capacity by 37% to 1.46m tpa – 11% of global zinc market – and consolidates Vedanta's position as the world's largest integrated zinc and lead producer. It increases attributable reserves and resources by 76% (206m tonnes) to 478m tonnes. Future growth would come from Gamsberg, with mineral resource of 186mt, planned capacity of 400ktpa and operating life of more than 20 years.
- **Valuations appear fair** – Of the total price, the largest proportion (\$698m) is for the Skorpion mine, which has the lowest COP (\$902/t) of the three assets, \$308m is for the Lisheen mine and \$332m for the 74% stake in BMM. Based on the earnings forecasts by Johann Pretorius for Anglo's zinc business (EBITDA of 55%), CY10 EV/EBITDA is 2.9x, vs. HZL FY11 EV/EBITDA of 3.8x (63% margin) – both based on our previous estimates.
- **Deal likely to be EPS accretive** – Funding for the deal should not be a problem. As of 31 March 2010 the Vedanta group had cash and cash equivalent of US\$7.2bn and HZL had US\$2.6bn. As the profitability of the zinc business would be higher than the interest income earned on HZL's cash on hand, the acquisition should be EPS accretive for HZL. HZL (29.5% owned by the Indian government) will need Board approval for the acquisition.

Anglo American Zinc Assets

Figure 5. Anglo American Zinc

Assets	R & R			Zinc prod (m tonnes)	Lead prod (m tonnes)	Zn R & R Years	Acq cost US\$ m	2010E				2009
	(m tonnes)	Zinc %	Lead %					Rev US\$ m	EBITDA US\$ m	EBITDA margin %	EV/EBITDA (x)	Cash costs US\$/t
Lisheen	8.7	11.9%	1.9%	0.172	0.019	6.0	308	300	176	59%	1.8	1,287
Skorpion	8.3	11.3%		0.150		6.3	698	353	210	59%	3.3	902
Black Mountain*	51.7	1.5%	2.9%	0.031	0.036	25.0	334	179	72	40%	4.6	1,237
Gamsberg*	137.6	6.9%	0.4%	0.400		23.7						
Total	206.3						1,340	832	458	55%	2.9	

Source: Company and Citi Investment Research and Analysis. Note: *Anglo American holds 74% in Black Mountain Mining which owns the Black Mountain mines and Gamsberg project in South Africa. Exxaro Resources holds 24% in Black Mountain Mining and the data in the table above adjusts for the 26% ownership of Exxaro in Black Mountain Mining. Black Mountain cash costs calculated on a zinc equivalent basis.

Other companies mentioned

Anglo American Plc (AAL.L; £23.04; 1M)

Vedanta Resources (VED.L; £21.31; 1M)

Hindustan Zinc

Company description

Hindustan Zinc Ltd (HZL) is India's only integrated zinc producer with an ~80% share of the Indian market. It has open-pit mines for lead-zinc ore at Rampura Agucha and two underground mines - Rajpura Dariba and Zawar. All are in Rajasthan in Northwest India. Two of its three smelters are in Rajasthan - Chanderiya (zinc 735,000 tpa, lead 85,000 tpa), Debari (zinc 88,000 tpa). The third is at Vizag, Andhra Pradesh in south India (zinc 56,000tpa). One of HZL's biggest advantages is the Rampura Agucha mines, which meet 90% of its concentrate requirements. HZL has total captive power capacity of 495MW. Of the expansion plans announced by HZL (210,000tpa zinc and 100,000tpa lead, capex Rs29bn), the zinc capacity (210k tpa) has commenced production in March 2010 – three months ahead of schedule (included above). Once the lead capacity expansion (100,000 tpa) is also completed, it will take HZL's total integrated zinc-lead capacity to 1,064,000tpa with fully integrated mining and captive power generation capacities.

Investment strategy

We rate Hindustan Zinc shares Sell/Medium Risk (3M) with a target price of Rs895. Zinc prices have fallen by nearly 25% from the highs in April 2010, more than any of the other base metals. Rising LME inventories have been an important contributing factor to the price weakness. Although we believe much of this metal has been delivered for financing, it has not been sufficient to support the price. Our forecasts indicate a zinc surplus until 2012. We forecast zinc LME prices to fall 1% yoy in FY11 (to US\$1,911/t) and rise slightly by 5% in FY12 (US\$2,000/t). Lead LME prices are expected to fall 8% in FY11 (to US\$1,819/t) and rise 4% in FY12 (to US\$1,885/t). Based on our forecasts, we expect Hindustan Zinc's EBITDA margins to range between 66-67% in FY11-12. Despite the high margins and expected strong zinc-lead volume growth (34% in FY11 and 10% in FY12), we maintain Sell based on our zinc outlook and likely downside price risk in the near term.

Valuation

We use P/E as our preferred valuation parameter for HZL. We value HZL's core business at 5.2x June11 P/E (5-year trading average) and arrive at a value of Rs485/share. We add cash/share of Rs410 to the PE derived value and arrive at a target price of Rs895. At our TP, HZL would trade at a June 11 PE of 8.3x and EV/EBITDA of 3.3x.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, suggests a Medium Risk rating for Hindustan Zinc shares. We feel this is appropriate based on the company's status as an integrated, low-cost zinc producer, and net cash position. Upside risks that could cause the shares to continue to trade above our target price include: (1) Higher-than-expected zinc and lead prices; (2) Rupee depreciation; (3) Increase in zinc import duty; (4) Higher volumes than we expect.

Anglo American PLC

Valuation

We calculate Anglo American's discounted cash flow target price of ZAR420/£36 based on: 1) A weighted average cost of capital (WACC) of 9.52%; 2) Long-term (2013-23) nominal revenue growth of 5% per annum; 3) Long-term EBITDA margins of 36%; 4) Long-term capex/EBITDA ratio of 41%; 5) Long term ROE of 13%; and 6) a terminal growth rate (after 2023) of 3% (implying an exit P/E multiple of 8x).

Risks

We rate Anglo American as Medium Risk. Its risk rating is derived after considering several factors, including an assessment of the macro-economic environment, industry specific risks, company specific operational risks as well as financial risk.

The biggest risks to our earnings forecasts and valuation relate to commodity prices and currency forecasts.

Industry-specific risks include government actions, such as controls on imports, exports and prices, new forms or rates of taxation and royalties, and increased government regulation. South African miners started paying mining royalties in March 2010, in line with global best practice and market expectations. We do not believe there is a material risk that SA mining assets will be nationalised, despite pressure from various groups.

Higher-than-forecast inflation in the mining sector could lead to near-term margin compression, but should support higher commodity prices in the long term.

Skills, electricity and water shortages in South Africa may affect production and mining inflation more than we anticipate. As around 40% of Anglo's assets are in South Africa, it could erode Anglo's global competitiveness.

Over-estimation of mineral reserves could weaken our investment case. We assume long-term reserve replacement at a fixed capital cost to EBITDA. Failure to discover new reserves or expand existing reserves could therefore impact on Anglo's valuation.

Vedanta Resources Plc

Valuation

Our £33.80 target price is based on a blend of NPV and EV/EBITDA levels. We allocate a 60% weighting to the NPV outcome and a 40% weighting to the EV/EBITDA outcome. We derive an NPV of £26.67 for Vedanta, using a discount rate of 9%, and we apply a 10% premium to that NPV, in line with diversified peers. We apply a 5.0 x EV/EBITDA ratio to VED's EBITDA for the year to March 2011, in line with emerging market mining peers.

Risks

We rate Vedanta as Medium Risk. The risk rating on the stock is derived after consideration of a number of factors. These include an assessment of industry-specific risk, financial risk and management risk. Key risks to our projected earnings, cash flow and target price are focused on the inherent volatility in commodity prices but also relate to product risk as VED wants to increase its Aluminium capacity to 2.5 mtpa by 2013 and specific geographic risk with respect to its Zambian copper assets, which have very high operating costs. The group has an active project pipeline which makes it vulnerable to project-startup delays. Upside risks to our target price include ongoing strength in base metal prices and success in buying out minority stakes.

Appendix A-1

Analyst Certification

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IMPORTANT DISCLOSURES

Hindustan Zinc (HZNC.BO)

Ratings and Target Price History Fundamental Research

Analyst: Pradeep Mahtani
Covered since July 31 2007

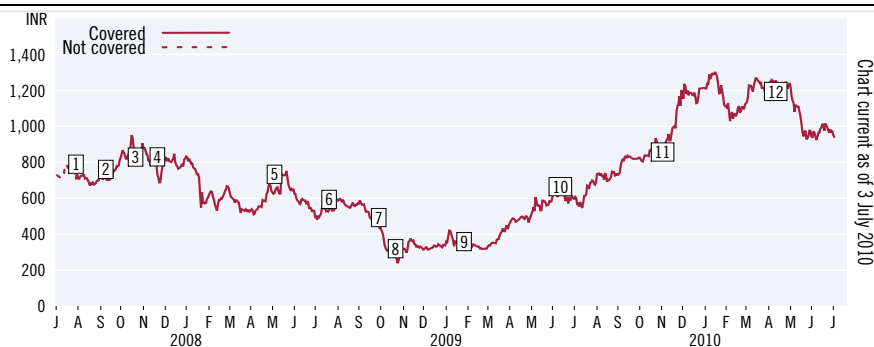


Chart current as of 3 July 2010

	Date	Rating	Target Price	Closing Price
1	30-Jul-07	*1M	*1,155.00	709.10
2	10-Sep-07	1M	*1,194.00	710.80
3	22-Oct-07	1M	*1,128.00	842.40
4	21-Nov-07	1M	*1,007.00	731.25

	Date	Rating	Target Price	Closing Price
5	5-May-08	1M	*845.00	629.75
6	21-Jul-08	*2M	*598.00	534.85
7	29-Sep-08	*3M	*430.00	451.65
8	22-Oct-08	*1M	*388.00	294.25

	Date	Rating	Target Price	Closing Price
9	27-Jan-09	*3M	*304.00	350.40
10	11-Jun-09	3M	*588.00	616.65
11	3-Nov-09	3M	*842.00	857.55
12	11-Apr-10	3M	*1,090.00	1,243.95

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Anglo American PLC (AAL.L)

Ratings and Target Price History Fundamental Research

Analyst: Heath R Jansen
Covered since May 24 2010



Chart current as of 3 July 2010

	Date	Rating	Target Price	Closing Price
1	23-Jul-07	2M	*32.50	32.57
2	3-Aug-07	*1M	32.50	27.59
3	22-Oct-07	*2M	32.50	30.46
4	19-Nov-07	2M	*32.00	28.62
5	23-Jan-08	*1M	32.00	25.49
6	4-Feb-08	1M	*35.00	29.45
7	28-Apr-08	*2M	35.00	33.41
8	16-May-08	*1M	*40.00	35.40

	Date	Rating	Target Price	Closing Price
9	19-Sep-08	1M	*39.00	23.81
10	28-Sep-08	1M	*35.00	19.81
11	27-Oct-08	1M	*20.00	12.06
12	13-Jan-09	*2M	*16.00	14.29
13	25-Jan-09	2M	*12.64	12.70
14	24-Feb-09	2M	*11.00	10.33
15	17-Mar-09	2M	*11.50	11.16
16	10-May-09	2M	*17.00	16.25

	Date	Rating	Target Price	Closing Price
17	10-Sep-09	2M	*22.00	20.40
18	13-Oct-09	2M	*24.00	21.74
19	5-Feb-10	*1M	*30.00	22.74
20	23-Feb-10	1M	*32.00	23.80
21	12-Apr-10	1M	*38.00	29.48
22	3-Jun-10	1M	*36.00	26.05

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Vedanta Resources Plc (VED.L)

Ratings and Target Price History
Fundamental Research

Analyst: Anindya Mohinta
Covered since June 22 2010

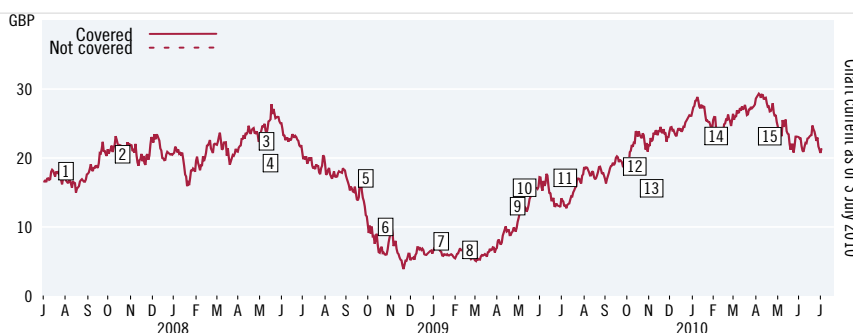


Chart current as of 3 July 2010

	Date	Rating	Target Price	Closing Price
1	2-Aug-07	1H	*23.50	16.73
2	22-Oct-07	*2H	23.50	20.54
3	12-May-08	2H	*27.50	23.50
4	16-May-08	*1H	*30.61	25.61
5	28-Sep-08	1H	*23.00	12.96

	Date	Rating	Target Price	Closing Price
6	27-Oct-08	*1M	*9.40	5.95
7	13-Jan-09	1M	*7.90	6.39
8	23-Feb-09	1M	*7.25	5.55
9	30-Apr-09	1M	*12.30	10.74
10	10-May-09	*3M	*11.00	13.01

	Date	Rating	Target Price	Closing Price
11	7-Jul-09	*2M	*14.60	13.22
12	13-Oct-09	2M	*23.00	22.18
13	5-Nov-09	2M	*23.50	22.42
14	4-Feb-10	2M	*26.85	24.15
15	21-Apr-10	*1M	*33.80	26.74

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2010

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