

2QFY09 results – ahead of estimates

 22nd October 2008

Not Rated

Price	Target Price
Rs288	NA

Sensex – 10,683

Price Performance

(%)	1M	3M	6M	12M
Absolute	(41)	(46)	(51)	(66)
Rel. to Sensex	(22)	(30)	(22)	(44)

Source: Bloomberg

Stock Details

Sector	Metals & Mining
Reuters	HZNC.BO
Bloomberg	HZ@IN
Equity Capital (Rs mn)	4225
Face Value (Rs)	10
Number of shares o/s (mn)	423
52 Week H/L (Rs)	931/264
Market Cap (Rs bn/USDmn)	122/2,485
Daily Avg Vol (No of shares)	118495
Daily Avg Turnover (US\$ mn)	1.2

Shareholding Pattern (%)

	30/9/08	30/6/08	31/3/08
Promoters	64.9	64.9	64.9
FII/NRI	2.2	2.4	2.4
Institutions	1.4	1.4	1.2
Private Corp.	0.5	0.3	0.4
Public	31.0	31.0	31.1

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The 2QFY09 results of Hindustan Zinc Ltd (HZL) were above our estimates. Net sales stood at Rs17.4bn (yoy down 12.1%, qoq up 6.1%), EBITDA stood at Rs9.4bn (yoy down 34.1%, qoq down 4.3%) and PAT stood at Rs9.6bn (yoy down 16.5%, qoq up 13.1%). HZL reported EPS of Rs22.67. Zinc volume grew by 29.3% on yoy basis to 121,556t. During the quarter, the company has reported effective tax rate (ETR) of 12% (yoy down 1,229bps, qoq down 1,214bps). The reduction in ETR was primarily due to various tax saving initiatives undertaken by the company including conversion of one of the zinc smelter at Chanderiya into 100% EOU in May 2008. In 2QFY09, HZL reported zinc and lead concentrate sales of 97,000DMT. The capacity expansion projects to increase the zinc-lead smelting capacities to 1.065mtpa with matching mining and captive power generation capacities are progressing as per schedule. As on 30th Sep '08, HZL has cash balance of Rs92bn. At the CMP of Rs288, the stock is trading at 4.5x FY09E EPS of Rs64.23 and at 4.2x FY10E EPS of Rs67.93

Key takeaways from the concall

- The company has guided for FY09 zinc production in excess of 600,000t despite 50days planned shutdown of 170,000t Chanderiya hydro smelter.
- In 2QFY09, HZL reported ETR of 12% (yoy down 1,229bps, qoq down 1,214bps). The reduction in ETR was primarily due to various tax saving initiatives undertaken by the company including conversion of one of the zinc smelter at Chanderiya into 100% EOU in May 2008. HZL has guided for full year FY09E ETR of 18%-19%.
- HZL currently has cash balance of Rs92bn, which translates to Rs217/share.
- Although the company has coal linkage with Coal India Limited for its captive thermal power plants, HZL is still dependent on imported coal to run its power plants.
- In 2QFY09, the company has produced 24t of silver. The current price of silver is Rs17,580/kg. At this rate, the value of the silver is around Rs421.9mn (USD8.6mn).
- HZL produces 1.6t of sulphuric acid per tonne of zinc produced. In 2QFY09, average sulphuric acid prices stood at USD379/t (yoy up 351.2%, qoq up 13.6%)

Other points

- During the quarter, HZL has reported refined zinc volume growth of 29.3% on yoy basis to 121,556t. However, the refined zinc production volume declined by 5% on sequential basis due to 50 days planned maintenance shutdown of one of its smelter at Chanderiya, which has resulted in production loss of around 14,000t of refined zinc.
- For 2QFY09, HZL's cost of production was to the tune of USD473/t, excluding royalty and net of by-product revenue, which the company plans to reduce further through various cost saving measures over a period of time. We believe, opening of captive coal mine - Madanpur (S) coal block could be one of the biggest costs saving mechanism. The company has guided that the coal mine is likely to operational by early CY10.
- In 2QFY09, HZL reported zinc and lead concentrate sales of 97,000DMT (qoq up 823%). As per the management, there will not be any sales of concentrate, going forward. With the ramping up of increased smelting capacities, all the concentrate produced is expected to be converted into refined metal.

Emkay's views

The zinc prices during the quarter are down by 40% on yoy basis. Current zinc price at USD1,180/t has declined by 29% since 30th Sep '08.

Nearly 20% of the global zinc capacity has a cash cost in excess of USD1,700/t. In case prices continue at the current level, these smelters are likely to announce shut down. Any reduction in output from these smelters or shut down is likely to reduce surplus. As per industry expectations, zinc is likely to be in surplus to the tune of 215,000t. With energy prices shooting through the roof in China, South Africa and other nations, probability of smelter shut down especially in China remains high.

The company is well on its path to achieve 1mtpa production capacity in zinc and lead combined. The combined facility will become the biggest integrated zinc and lead facility in the world and will have one of the lowest cost of production. It is likely to achieve this capacity in CY10. The Vedanta group has so far delivered on all its announced projects ahead of schedule and below costs. We do not have reasons for believing otherwise this time also.

The company is likely to show consistent volume growth during FY09 and FY10. In FY08, HZL sold 425kt of metal, the company has already guided for 600kt+ in FY09, which is a 41% growth.

Contribution of byproducts expected to be significantly high especially for silver and sulphuric acid. The byproduct realization in 1QFY09 alone was to the tune of Rs2.5bn.

We do not have a rating on the stock, but believe that the negatives are fully priced in the stock and the possibility of the stock coming off from the current levels is unlikely.

Volume (t)

	2QFY08	3QFY08	4QFY08	1QFY09	2QFY09	% yoy	% qoq
Production volume							
Mined Metal Production (t)							
Zinc	143,000	135,891	137,846	138,278	166,998	16.8%	20.8%
Lead	18,225	19,037	21,020	19,584	21,048	15.5%	7.5%
Refined Metal production (t)							
Zinc	94,000	104,093	135,491	127,889	121,556	29.3%	-5.0%
Lead	13,081	14,526	16,989	17,298	12,530	-4.2%	-27.6%
Zinc and lead concentrate sales (DMT)	95,000	72,115	75,455	10,507	97,000	2.1%	823.2%
Zinc Price at LME (USD/t)	3,235	2,649	2,434	2,123	1,953	-39.6%	-8.0%
Lead price at LME (USD/t)	3,143	3,242	2,888	2,307	1,912	-39.2%	-17.1%

Source: Company

Quarterly Results summary

	2QFY08	3QFY08	4QFY08	1QFY09	2QFY09	% yoy	% qoq
Net Sales	19,840	16,580	22,660	16,437	17,438	-12.1%	6.1%
Expenditure							
Manufacturing & Mining Exp	2,840	3,250	3,910	4,347	5,162	81.8%	18.8%
Change in stock	40	130	890	-317	106	164.3%	-133.4%
Net Manufacturing & Mining Exp	2,880	3,380	4,800	4,030	5,268	82.9%	30.7%
Mining Royalty	1,410	1,060	1,150	1,021	1,018	-27.8%	-0.3%
Gross profit	15,550	12,140	16,710	11,386	11,152	-28.3%	-2.0%
Gross margin	78.4%	73.2%	73.7%	69.3%	64.0%	-144bps	-532bps
Employee Cost	630	930	870	847	865	37.3%	2.1%
Other selling & administrative Exp	730	770	1030	761	933	27.8%	22.6%
Total operating exp	1,360	1,700	1,900	1,609	1,798	32.2%	11.8%
EBITDA	14,190	10,440	14,810	9,777	9,354	-34.1%	-4.3%
Ebitda margin	71.5%	63.0%	65.4%	59.5%	53.6%	-1788bps	-584bps
Depreciation & amortization	490	540	740	686	704	43.7%	2.6%
EBIT	13,700	9,900	14,070	9,091	8,650	-36.9%	-4.8%
EBIT margin	69.1%	59.7%	62.1%	55.3%	49.6%	-1945bps	-570bps
Interest	60	60	50	69	71	18.7%	3.8%
Other income	1,440	1,110	3,260	2,094	2,273	57.9%	8.6%
PBT	15,080	10,950	17,280	11,116	10,853	-28.0%	-2.4%
Provision for tax	3,600	3,100	4,500	2,638	1,257	-65.1%	-52.3%
ETR (%)	24%	28%	26%	24%	12%	-1229bps	-1214bps
Current tax	3,360	3,010	3,890	2,467	1,035	-69.2%	-58.0%
Deferred tax liability	240	90	610	171	223	-7.3%	30.1%
PAT	11,480	7,850	12,780	8,478	9,595	-16.4%	13.2%
Net margin	57.9%	47.3%	56.4%	51.6%	55.0%	-284bps	344bps
less: Extraordinary Items adj for Tax	-	-733	-3,517	-	-		
Adjusted PAT	11,480	7,117	9,263	8,478	9,590	-16.5%	13.1%
Adjusted net margin	57.86%	42.93%	40.88%	51.58%	54.99%	-287bps	341bps
Equity capital	4,230	4,230	4,230	4,230	4,230	0.0%	0.0%
Reported EPS	27.14	18.56	30.21	20.04	22.68	-16.4%	13.2%
Adjusted EPS	27.14	16.83	21.90	20.04	22.67	-16.5%	13.1%

All fig. in Rs mn except percentage and per share data

Common size ratios

	2QFY08	3QFY08	4QFY08	1QFY09	2QFY09	% yoy	% qoq
Net Sales	100%	100%	100%	100%	100%	-	-
Manufacturing & Mining Exp	14%	20%	17%	26%	30%	1529bps	316bps
Change in stock	0%	1%	4%	-2%	1%	40bps	253bps
Net Manufacturing & Mining Exp	15%	20%	21%	25%	30%	1569bps	569bps
Employee Cost	3%	6%	4%	5%	5%	179bps	-19bps
Mining Royalty	7%	6%	5%	6%	6%	-127bps	-37bps
Other expenses	4%	5%	5%	5%	5%	167bps	72bps
EBITDA	72%	63%	65%	59%	54%	-1788bps	-584bps
Depreciation	2%	3%	3%	4%	4%	157bps	-14bps
Interest expense	0%	0%	0%	0%	0%	11bps	-1bps
Other income	7%	7%	14%	13%	13%	578bps	30bps
PAT	58%	47%	56%	52%	55%	-284bps	344bps

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