

CMP: Rs. 685
BUY
Upside: 15%
Target: Rs. 789

23rd July 2009

Recommendation History

Date	Rating	Rec.Price
12-Mar-09	Outperform	Rs.350
23-Apr-09	Neutral	Rs.500
23-Jul-09	BUY	Rs.685

Key Share Data

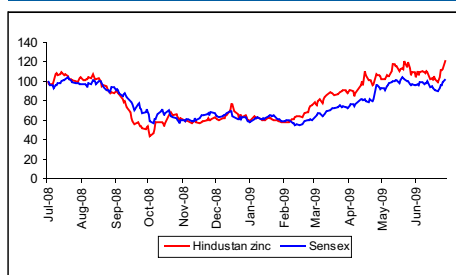
BSE Code	500188
NSE Code	HINDZINC
Bloomberg	HZ IN
Reuters	HZNC.BO
Industry	Metal-Zinc
Sensex	15231
Nifty	4523.7
Equity (Rs.Cr)	422.53
F.V (Rs.)	10
M.Cap (Rs. Cr)	28943
52 Wk H/L	709/215
Avg Daily Volume	104,501

Absolute Returns (%)

	1m	3m	12m
Absolute	20	37	34
Rel. to Sensex	13	0	22

Shareholding Pattern (%): (30th Jun 09)

Promoters	64.9
FII & Institutions	33.0
Public & Others	2.1

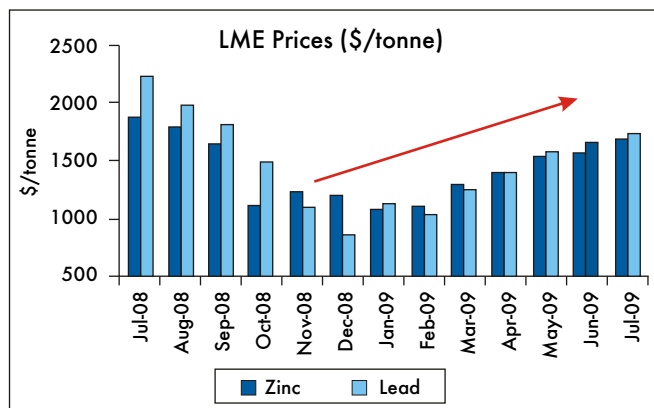
Relative Price Movement


Hindustan Zinc has come out with better than expected results for the quarter ended Q1FY10. Its revenue is down by just 7% YoY and up by 20.9% on QoQ basis to Rs.1526Cr. Its operating profit for the quarter is down by 19.9% YoY to Rs.782Cr, with EBITDA Margin as 51.2%. Its Net Profit is down by 15.1% YoY to Rs.718.8 Crs, with PAT Margin at 47%. The company has managed to deliver such good performance despite of the sharp fall in LME prices. The average LME zinc prices for the quarter has fallen by 30% YoY to \$1476/tonne, while the lead prices have fallen by 35% YoY to \$1506/tonne. The Company's cash balance has increased to Rs.10100Cr amounting to Rs.239/share (35% of Mcap). It has also reported higher production volumes for Q1FY10 of zinc and lead of 162,241 tonnes and 20,601 tonnes respectively (up by 17% YoY and 5% YoY).

In the last three months the LME zinc and lead prices have seen sharp recovery. Zinc has increased by 26% to \$1476/tonne and lead prices have increased by 30% to \$1506/tonne. Keeping in mind the rising LME prices the company has also raised its zinc and lead selling prices week-on-week. It is currently selling zinc at Rs.95800/tonne (\$1995/tonne) and lead at Rs.96800/tonne (\$2016/tonne). Thus considering the sharp run up in the zinc and lead prices coupled with higher premium being demanded by the company we have revised our base case target upwards to Rs.789. Apart from higher zinc and lead prices, we believe another key catalyst for the stock is Government's disinvestment plan. Government currently has a stake of 29.5% in the stock, post this disinvestment, we believe the management would have greater autonomy to scale out larger plans for the company's growth. We therefore upgrade our rating from "NEUTRAL" to "BUY", with a target price of Rs.789, an upside of 15% from the current level.

Revenue down by 7% YoY for Q1FY10- "led by lower realization per tonne"

The company's top-line has dipped by 7% YoY to Rs.1526Cr mainly because of the fall in the LME prices of zinc and Lead on YoY basis.



Source: Bloomberg, AASPL Research

Average LME price realization for Q1FY10 of Zinc and Lead has fallen to \$1476/tonne and \$1506/tonne respectively down from the year ago realization of \$2115/tonne and \$2316/tonne respectively. The realizations are down by 30% YoY and 35% YoY for zinc and lead respectively, thus impacting the sales of the company.

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Realisation(\$/tonne)	Q1FY10	Q1FY09	YoY(%)	Q4FY09	QoQ(%)
Zinc	1476	2115	-30%	1174	26%
Lead	1506	2316	-35%	1160	30%

Source: Company, AASPL Research

As can be observe from the figure and table above, though the LME zinc and lead prices are down on YoY basis, but have increased substantially from their Oct'08 lows. Though we do not expect the prices to improve with this pace going ahead, however the prices are unlikely to revisit the earlier lows again, indicating that the worst is far behind.

In Our DCF Valuation Model, considering the recent spike in the base metal prices and likely bottoming out of metal cycle, we have increased realizations for FY10E of zinc to \$1650/tonne and that of lead to \$1750/tonne.

Production up by 17% YoY during the quarter

In volume terms the company has achieved decent growth in its production volumes for the June quarter. The company's mined metal production of zinc for the quarter has increased by 17% YoY to 162241 tonnes and that of lead has increased by 5% YoY to 20,601 tonnes.

Production	Q1FY10	Q1FY09	YoY(%)	Q4FY09	QoQ(%)
Mined Metal (tonnes)					
Zinc	162241	138278	17%	175438	-8%
Lead	20601	19584	5%	22266	-7%
Saleable Metal (tonnes)					
Zinc	139315	127889	9%	150544	-7%
Lead	15218	17298	-12%	15691	-3%

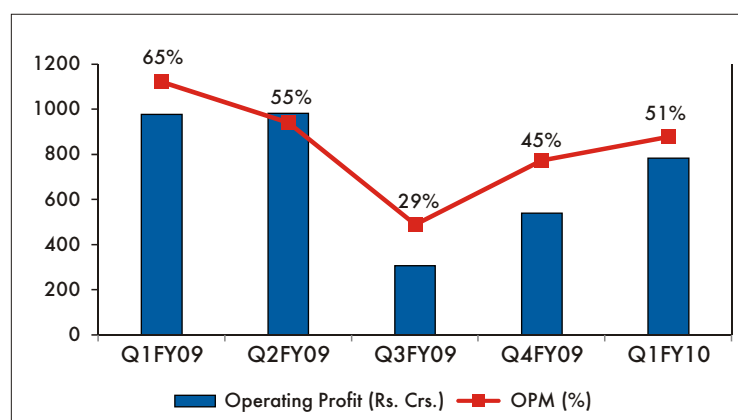
Source: Company, AASPL Research

The refined zinc production in Q1FY10 was lower than the production in Q4FY09, primarily on account of operational factors during the current quarter at the hydro smelters at Chanderiya. Sales during Q1 were augmented by the sale of 73,962 dry metric tonnes of surplus zinc concentrate.

During the quarter, saleable silver production was 29,527 kgs, an increase of 25% compared with the corresponding prior quarter. The increase in production was primarily on account of higher silver content in the mined ore thereby adding to the margins of the company.

Operating profit down by 19.9% YoY to Rs.782 Crs

For the quarter ended June'09 the company has reported lower profit on Operating level due to lower realizations and relatively higher mining cost. Its Mining Cost which accounted for 26% of the revenue in Q1FY10 has now scaled up to 38.8% of the revenue in Q1FY10, resulting into plummeting profit at operating level. As mentioned above sales realization for the quarter for zinc and lead are down on YoY basis by 30% and 35% YoY respectively, this has resulted into lower operating profit. The Operating Profit Margin for the quarter has plunged by 1420 bps YoY to 51.2%, however on a QoQ basis the operating profit has increased by 610 bps as shown in the figure below.



Source: AASPL Research

This rise in Operating profit margin on a QoQ basis despite of a increase in cost of production clearly indicates that the company's margins are now likely to be on the track of expansion. In Q1FY09 when the realizations were at peak the company had a OPM of 65%, which eventually declined to as low as 28% in Q3FY09 due to sharp fall in the realizations. The company due to its lower cost of production of ~\$700/tonne has a potential to post better margins going ahead once the realization increases.

Net Profit down by 15.1% YoY for Q1FY10

The company's Net Profit for the quarter has fallen by 15.1% YoY to Rs.718.8Cr. It has still managed to post a relatively decent PAT Margin of 47.1% for the quarter despite of lower non-operating income. Non-Operating Income for Q1FY10 has decreased by 13.9% YoY and 7.2% QoQ to Rs.180.2 Crs due to relatively lower yields from the debt funds.

Depreciation for the quarter has increased by 9% on a YoY basis to Rs.74.8 Crs due to capex incurred by the company during the quarter, thereby impacting the Net Profit Margin.

Huge Cash reserves to the tune of Rs. 10,100 Crs

The company has huge cash reserves of Rs.10,100 Crs as on 30th June '09, which amounts to Rs.239 cash per share (~35% of Mcap). The company has aggressive Capex plans which could be easily met by this huge cash reserves. The company's expansion plans are well on track till date.

The company plans to ramp up its capacity to 1,064,000 tonnes p.a by this year end, adding in 210,000 tonnes of zinc and 100,000 tonnes of lead to its current capacity. Post this expansion HZL would be the world's largest integrated producer of zinc and lead. The expansion is backed by the huge reserves of 232MT of ore, containing 27.5MT of zinc-lead, providing for a mining life of over 20 years.

ASSUMPTIONS:

We have raised our zinc and lead selling price estimates to match the global commodity price rise. We have increased the zinc price by \$500/tonne in FY10E to \$1650/tonne vs the company's current selling price of \$1995/tonne. Thus anything delivered over and above this would give an upside to our earning estimate.

Old Assumptions	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Zinc realization (\$/tonne)	1150	1150	1200	1300	1500	1700
Zinc sales volume (tonnes)	530000	550000	600000	625000	700000	700000
Lead realization (\$/tonne)	1150	1150	1180	1260	1440	1640
Lead sales volume (tonnes)	60000	65000	75000	80000	85000	95000
USD-INR	48	45	43	43	42	42

New Assumptions	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Zinc realization (\$/tonne)	1650	1815	1997	2156	2329	2399
Zinc sales volume (tonnes)	550000	594000	641520	692842	734412	771133
Lead realization (\$/tonne)	1750	1915	2097	2256	2429	2499
Lead sales volume (tonnes)	70000	75600	81648	88180	95234	102853
USD-INR	48	45	43	43	42	42

Bear Case	Base Case	Bull Case
Target Price		
Rs. 582	Rs. 789	Rs. 838
Assumptions		
<ul style="list-style-type: none"> ➔ Dip in sales Volume to 530,000 tonnes in FY10E and incremental sales volume from there onwards. 	<ul style="list-style-type: none"> ➔ Rise in sales volume to 550,000 tonnes in FY10E and incremental sales volume from there onwards. 	<ul style="list-style-type: none"> ➔ Rise in sales volume to 570,000 tonnes in FY10E and incremental sales volume from there onwards.
<ul style="list-style-type: none"> ➔ Zinc and Lead price at \$1300/tonne and \$1400/tonne respectively in FY10E and gradual increase from there onwards. 	<ul style="list-style-type: none"> ➔ Zinc and lead realization at \$1650/tonne and \$1750/tonne respectively in FY10E and gradual there onwards. 	<ul style="list-style-type: none"> ➔ Zinc and lead price at \$1750/tonne and \$1850/tonne respectively in FY10E and gradual increase from there onwards.
<ul style="list-style-type: none"> ➔ USD-INR exchange rate at Rs.47 FY10E and Rs.42 from FY13E onwards. 	<ul style="list-style-type: none"> ➔ USD-INR exchange rate at Rs.48 in FY10E and Rs.45 in FY11E. 	<ul style="list-style-type: none"> ➔ USD-INR exchange rate at Rs.49 in FY10E and Rs.42 form FY14E onwards.

VALUATIONS

At the current market price of Rs.685 the stock is trading at P/E of 15.1x its FY10E EPS of Rs.45. The company has reported better than expected numbers for the quarter ended June'09 on the back of higher sales realization. Its cash balance has increased to Rs.10,100 Crs amounting to Rs.239/share (35% of Mcap), thereby further strengthening its balance sheet. In the last three months the LME zinc and lead prices have seen a sharp recovery. Zinc has increased by 26% to \$1476/tonne and lead prices have increased by 30% to \$1506/tonne. Keeping in mind the rise in the LME prices, the company has also raised its zinc and lead selling prices week-on-week. It is currently selling zinc at Rs.95800/tonne (\$1995/tonne) and lead at Rs.96800/tonne (\$2016/tonne). Thus considering the sharp run up in the zinc and lead prices coupled with higher premium being demanded by the company we have revised our base case target upwards to Rs.789. Apart from higher zinc and lead prices, we believe another key catalyst for the stock is Government's disinvestment plan. Government currently has a stake of 29.5% in the stock, post this disinvestment we believe the management, would have greater autonomy to exercise better plans for the company's growth in organic or inorganic form. We therefore upgrade our rating from "NEUTRAL" to "BUY" for the stock, with a target price of Rs.789, an upside of 15% from the current level.

FCFF

New Assumptions	FY09	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
Zinc realization (\$/tonne)	1713.5	1650	1815	1997	2156	2329	2399
Zinc sales volume (tonnes)	538000	550000	594000	641520	692842	734412	771133
Lead realization (\$/tonne)	1832.4	1750	1915	2097	2256	2429	2499
Lead sales volume (tonnes)	60000	70000	75600	81648	88180	95234	102853
USD-INR	45.8	48	45	43	43	42	42
(Rs. Crs)							
Revenue	5822.1	5212.6	5769.9	6406.1	7467.6	8409.9	9178.3
EBIT	2590.7	1818.8	2191.9	2551.5	3295.5	3858.4	4303.6
Tax on EBIT	466.3	327.4	394.5	459.3	593.2	694.5	774.6
NOPLAT	2124.3	1491.4	1797.4	2092.2	2702.3	3163.9	3528.9
Depreciation and Amortization	285.3	521.3	577.0	640.6	746.8	841.0	917.8
Operating cash flow	2409.6	2012.7	2374.3	2732.8	3449.1	4004.9	4446.8
Capex	1080.0	2160.0	360.0	200.0	200.0	200.0	120.0
Change in WC	-386.6	406.5	21.8	-33.2	103.5	36.7	58.3
FCFF	1716.2	-553.8	1992.6	2566.1	3145.5	3768.2	4268.4

Sum of PV of Free Cash Flow	9945.8
Present Value of Terminal Value	13312.9
Enterprise Value	23258.7
Implied share price	550.5
Add: Cash per share	239.0
Target Price	789.5

Risk free rate	7.0%
Market Risk Premium	8.0%
Adjusted Beta	1.0
Cost of equity	15.0%
WACC	15.0%

FINANCIALS

QUARTERLY RESULT	Q1FY10	Q1FY09	YoY(%)	Q4FY09	QoQ(%)
(YE March 31)					
Net Sales	1526.6	1643.0	-7.1%	1262.6	20.9%
Mining Exp	592.0	505.1	17.2%	549.9	7.7%
Other expenses	71.7	76.1	-5.8%	70.6	1.6%
Contribution	862.8	1061.8	-18.7%	668.4	29.1%
Personnel	80.6	84.7	-4.9%	87.2	-7.6%
Total expenditure	744.3	666.0	11.8%	707.6	5.2%
Operating Profit	782.3	977.1	-19.9%	581.2	34.6%
OPM (%)	51.2%	65.4%		45.1%	
Non-Operating Income	180.2	209.4	-13.9%	194.2	-7.2%
Interest	3.2	6.9	-53.4%	4.9	-34.2%
Depreciation	74.8	68.6	9.0%	75.0	-0.3%
PBT	884.5	1110.9	-20.4%	695.5	27.2%
Prov. for Tax- Cur	120.2	246.7	-51.3%	91.9	30.9%
Tax/PBT (%)	17.0%	22.2%		17.0%	
Profit after Cur. Tax	764.3	864.3	-11.6%	603.6	26.6%
Prov. for Tax- Def	45.4	17.1	165.7%	52.3	-13.1%
Profit after Tax	718.8	847.2	-15.1%	551.3	30.4%
PAT (%)	47.1%	56.4%		42.8%	
EPS	17.0	20.0	-15.0%	13.0	30.4%

INCOME STATEMENT (Rs. Crs.)	FY08	FY09	FY10E	FY11E
Revenues	7877.8	5822.1	5212.6	5769.9
Net Raw Material	1863.4	1905.6	2038.5	2135.6
Employee Cost	308.2	364.9	573.4	577.0
Other Expenditure	327.8	364.2	260.6	288.5
Total Expenditure	2499.4	2946.1	2872.6	3001.1
Operating Profit	5378.4	2875.9	2340.1	2768.9
<i>EBIDTA (%)</i>	68.3%	49.4%	44.9%	48.0%
Dep. & Amortisations	220.5	285.3	521.3	577.0
EBIT	5157.9	2590.7	1818.8	2191.9
<i>EBIT(%)</i>	65.5%	44.5%	34.9%	38.0%
Interest	24.2	21.9	15.6	17.3
EBT	5133.7	2568.8	1803.2	2174.6
Other Income	228.5	789.4	540.0	562.5
Extraordinary Items	623.1	0.0	0.0	0.0
PBT	5985.3	3358.2	2343.2	2737.1
Tax	1589.3	630.6	422.9	494.0
PAT	4396.0	2727.6	1920.2	2243.0
<i>PAT(%)</i>	55.8%	46.8%	36.8%	38.9%

BALANCE SHEET (Rs. Crs.)	FY08	FY09	FY10E	FY11E
SOURCES OF FUNDS				
Equity Share Capital	422.5	422.5	422.5	422.5
Reserves & Surplus	11425.7	13935.1	15610.2	17608.2
Networth	11848.2	14357.6	16032.8	18030.7
Total debt	0.4	8.7	8.7	0.4
Deferred tax liability	459.7	558.9	240.0	198.0
CAPITAL EMPLOYED	12308.3	14925.1	16281.4	18229.1
APPLICATION OF FUNDS				
Gross Fixed Assets	5181.8	5855.5	8015.5	8375.5
Net Fixed Assets	3697.2	4104.9	5743.7	5526.7
Capital WIP	465.5	1108.4	759.6	730.0
Investments	6332.5	6928.9	6228.9	6828.9
Current Assets	2708.6	3743.1	4249.1	5918.2
Inventories	518.1	545.7	541.7	571.1
Sundry Debtors	443.7	164.9	314.2	347.8
Cash and Bank	1362.8	2719.2	3079.0	4651.5
Loans & Advances	384.1	313.3	314.2	347.8
Current Liabilities	898.5	1001.0	699.8	774.6
Liabilities	774.9	802.8	571.2	632.3
Provisions	123.6	198.1	128.5	142.3
Net Current Assets	1813.2	2783.0	3549.3	5143.6
Misc exp not w/off	0.0	0.0	0.0	0.0
Total Assets	12308.3	14925.1	16281.4	18229.1

CASH FLOW (Rs. Crs.)	FY08	FY09	FY10E	FY11E
Net Income Before Tax	5985.28	3358.24	2343.18	2737.08
Depreciation	220.5	285.3	521.3	577.0
Operating profit before w.cap changes	5608.9	2883.9	2340.1	2768.9
Change in WC	147.8	349.9	-377.7	-35.5
Cash Flow From Operating Activities	4209.7	2712.9	1540.6	2240.7
CAPEX	1515.1	1316.6	2160.0	360.0
Investment	-1406.0	-443.1	700.0	-600.0
Cash Flow from Investing	-2692.9	-3419.3	-920.0	-397.5
Proceeds from borrowings	0.0	8.3	0.0	-8.3
Payment of dividend	247.2	123.6	245.1	245.1
Cash flow from Financing	-271.4	-137.2	-260.7	-270.7
Cash & Cash Equivalent	1365.1	2719.2	3079.0	4651.5

KEY RATIOS	FY08	FY09	FY10E	FY11E
PER SHARE DATA (Rs.)				
EPS	104.0	64.6	45.4	53.1
CEPS	109.3	71.3	57.8	66.7
BV	280.4	339.8	379.4	426.7
DPS	5.0	5.0	5.0	5.0
GROWTH RATIOS (%)				
Net Sales	-8.0%	-26.1%	-10.5%	10.7%
EBITDA	-16.1%	-46.5%	-18.6%	18.3%
PAT	-1.0%	-38.0%	-29.6%	16.8%
VALUATION RATIOS (x)				
PE	6.6	10.6	15.1	12.9
P/CEPS	6.3	9.6	11.9	10.3
P/BV	2.4	2.0	1.8	1.6
EV/Sales	2.7	3.3	3.8	3.0
EV/EBITDA	4.0	6.7	8.4	6.3
Mcap/Sales	3.7	5.0	5.6	5.0
OPERATING RATIOS (DAYS)				
Inventory Turnover	85	86	86	86
Receivable	23	19	22	22
Payables	33	49	40	40
Cash Conversion Cycle	75	55	68	68
Debt: Equity (x)	0.0	0.0	0.0	0.0
PROFITABILITY RATIOS (%)				
ROCE	51.0%	19.0%	11.7%	12.7%
RONW	45.1%	20.8%	12.6%	13.2%
Dividend Payout	5.6%	9.0%	12.8%	10.9%
Dividend Yield	0.7%	0.7%	0.7%	0.7%



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AASPL Investment Ranking

BUY: Expected to outperform the local market by more than 10%
OUTPERFORM: Expected to outperform the local market by 0-10%
UNDERPERFORM: Expected to underperform the local market by more than 0-10%
SELL: Expected to underperform the local market by more than 10%

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Disclosure of Interest Statement	HINDUSTAN ZINC
1. Analyst ownership of the stock	Yes
2. Group/Directors ownership of the stock	Yes
3. Broking relationships with Company covered	No