

AUGUST 07, 2009

UPDATE

Coverage view: **Neutral**

Price (Rs): **725**

Target price (Rs): **825**

BSE-30: **15,514**

**Plenty of steam left.** We reiterate our Buy rating on Hindustan Zinc (HZ) on the back of (1) attractive valuations, trading at 4.9X FY2011E EV/EBITDA; (2) pick up in consumption led-demand for zinc can sustain current price levels and can potentially drive earnings upgrades. We currently model zinc prices at US\$1,400/ ton and US\$1,500/ ton for FY2010E and FY2011E, respectively, as against the spot price of US\$1,750/ ton

#### Company data and valuation summary

Hindustan Zinc

Stock data				Forecasts/Valuations			
52-week range (Rs) (high,low)				2009			
Market Cap. (Rs bn)				2010E			
Shareholding pattern (%)				2011E			
Promoters				EPS (Rs)			
FII's				EPS growth (%)			
MF's				P/E (X)			
Price performance (%)				Sales (Rs bn)			
Absolute				Net profits (Rs bn)			
Rel. to BSE-30				EBITDA (Rs bn)			
				EV/EBITDA (X)			
				ROE (%)			
				Div. Yield (%)			

#### QUICK NUMBERS

- **Attractively valued at 4.9X FY2011E EBITDA**
- **Reiterate BUY with TP of Rs825**

#### Reiterate BUY rating as zinc prices, demand could trigger upside

HZ is currently trading at 4.9X FY2011E EBITDA and 9.8X FY2011E EPS. We believe the current stock price offers potential upside as HZ has, historically, traded at much higher multiples. Given the strong cash position (net cash of Rs101 bn as on 30th June, 2009) and potential upside triggers in the form of (1) higher zinc prices and (2) sale of balance government stake to Sterlite, HZ remains attractive. We value HZ's zinc business at Rs516 based on 6X FY2011E EBITDA. We expect HZ to have net cash of Rs308/share in FY2011E. We reiterate our BUY rating with a TP of Rs825/share.

#### Earnings upgrades possible if current zinc price sustains

Our sensitivity analysis for zinc prices suggest that HZ's earnings could increase 8-10% if zinc prices were to be US\$100/ton higher than our current estimates of US\$1,400 / ton for FY2010E and US\$1,500/ ton for FY2011E. Besides, if average zinc prices were to sustain at current levels of US\$1,750/ ton, earnings could be higher by 22-36% for FY2010E and FY2011E. We believe our current assumptions are conservative given long-term averages and factor in the worst for the stock. We believe a pick-up in demand, especially from the steel sector, will likely hold prices steady.

#### Demand appears to be picking up, led by China

We are not too perturbed by the restarting of Chinese smelters after the recent increase in zinc prices. The increase in zinc production is unlikely to pressure prices, in our view, as the increased output will likely be absorbed by a corresponding increase in demand from automobiles (partly led by scrappage incentives announced by various Governments) and consumer goods. Further, economic improvement will likely result in increased demand for steel and consequently, zinc; the increasing number of blast furnaces being restarted is a firm indicator.

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### Capacity expansion on track

Work at 210,000 tpa zinc smelter and the 100,000 tpa lead smelter at Rajpura Dariba is on track and will likely be completed by the targeted mid-2010E (3QFY10E). The expansion will result in total zinc-lead capacity of 1.1 mn tons and will make HZ one of the largest producers of zinc. The low cost of operations, along with higher zinc and lead volumes, will likely result in significant increase in earnings. Besides, work at Rampura Agucha, Sindesar Khurd and Kayar mines is on schedule for progressive commissioning from mid-2010E resulting in significant expansion of mining capacity.

We believe that HZ's increased silver production will significantly add to earnings. HZ is in the process of expanding its silver capacity to 350 tons (11.3 mn ounces) by mid-2012E from current levels of 35-40 tons. We believe that this addition will result in significant earnings expansion.

### US\$100/ ton increase in zinc price from our base case, can result in 8-10% earnings upgrade

Hindustan Zinc, sensitivity analysis, March fiscal year ends, 2010-11E

Pricing assumptions (US\$/ton)	Base case		Price increases by US\$100/ton		Price decreases by US\$100/ton		At current zinc prices	
	FY2010E	FY2011E	FY2010E	FY2011E	FY2010E	FY2011E	FY2010E	FY2011E
Zinc	1,400	1,500	1,500	1,600	1,300	1,400	1,750	1,750
HZ EBITDA margin (%)	45	49	48	51	42	47	53	54
Hindustan Zinc PAT (Rs mn)	24,207	31,301	26,667	34,003	21,748	28,599	32,815	38,056
<b>Hindustan Zinc EPS (Rs)</b>	<b>57.3</b>	<b>74.1</b>	<b>63.1</b>	<b>80.5</b>	<b>51.5</b>	<b>67.7</b>	<b>77.7</b>	<b>90.1</b>
% change			10.2	8.6	(10.2)	(8.6)	35.6	21.6

Source: Kotak Institutional Equities estimates

### Hindustan Zinc, valuation details, FY2011E basis

	EBITDA (Rs bn)	Multiple (X)	Enterprise Value	
			(Rs bn)	(Rs/ share)
FY2011E EBITDA	36	6.0	218	516
Less: Net debt			(130)	(308)
<b>Arrived market capitalization</b>			<b>88</b>	<b>824</b>
<b>Target price (Rs/share)</b>				<b>825</b>

Source: Kotak Institutional Equities estimates

### Hindustan Zinc, Key assumptions, March fiscal year-ends, 2006-2011E (Rs mn)

	2006	2007	2008	2009	2010E	2011E
Mine production (tons)	4,795,124	5,139,915	5,399,513	7,019,367	7,370,335	7,812,555
<b>Zinc ingot production (tons)</b>	<b>317,558</b>	<b>348,567</b>	<b>462,323</b>	<b>651,272</b>	<b>696,600</b>	<b>791,100</b>
Lead ingot production (tons)	23,636	50,187	63,566	83,886	114,400	154,400
<b>Zinc prices (US\$/ton)</b>	<b>1,808</b>	<b>3,580</b>	<b>2,900</b>	<b>1,550</b>	<b>1,400</b>	<b>1,500</b>
<b>Lead prices (US\$/ton)</b>	<b>1,175</b>	<b>1,426</b>	<b>2,700</b>	<b>1,500</b>	<b>1,300</b>	<b>1,300</b>

Source: Company, Kotak Institutional Equities estimates

Hindustan Zinc, Profit model, balance sheet and cash flow model, March fiscal year-ends, 2008-2011E (Rs mn)

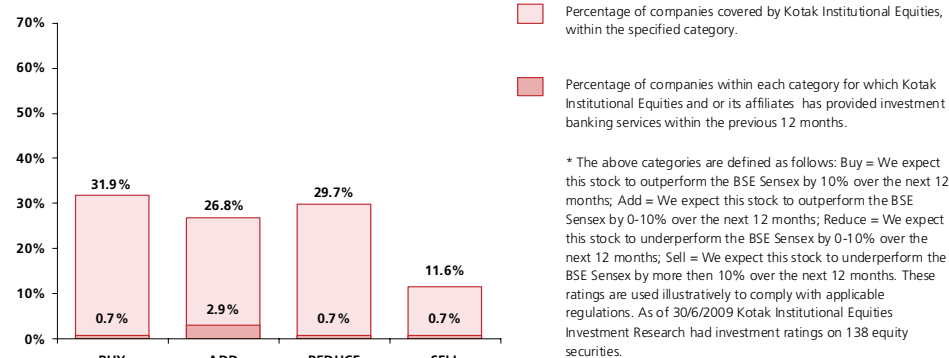
	2008	2009E	2010E	2011E
<b>Profit model (Rs mn)</b>				
Net sales	78,778	58,224	61,370	73,735
<b>EBITDA</b>	<b>53,784</b>	<b>28,759</b>	<b>27,702</b>	<b>36,322</b>
Other income	8,516	7,894	6,399	8,279
Interest	(242)	(219)	(241)	(265)
Depreciation	(2,205)	(2,852)	(3,601)	(5,211)
<b>Profit before tax</b>	<b>59,853</b>	<b>33,581</b>	<b>30,259</b>	<b>39,126</b>
Current tax	(14,673)	(5,207)	(4,734)	(6,244)
Deferred tax	(1,220)	(1,098)	(1,318)	(1,581)
<b>Net profit</b>	<b>43,961</b>	<b>27,276</b>	<b>24,207</b>	<b>31,301</b>
<b>Earnings per share (Rs)</b>	<b>104.0</b>	<b>64.6</b>	<b>57.3</b>	<b>74.1</b>
<b>Balance sheet (Rs mn)</b>				
Equity	118,482	144,067	166,162	195,350
Deferred tax liability	4,597	5,695	7,013	8,594
Total Borrowings	4	4	4	4
Current liabilities	8,984	6,164	6,392	6,865
<b>Total liabilities</b>	<b>132,067</b>	<b>155,930</b>	<b>179,571</b>	<b>210,813</b>
Net fixed assets	41,626	47,749	66,598	68,587
Investments	63,325	93,325	98,325	123,325
Cash	13,628	2,987	3,765	6,819
Other current assets	13,489	11,870	10,884	12,083
Miscellaneous expenditure	-	-	-	-
<b>Total assets</b>	<b>132,067</b>	<b>155,930</b>	<b>179,571</b>	<b>210,813</b>
<b>Free cash flow (Rs mn)</b>				
Operating cash flow excl. working capital	39,120	31,226	29,126	38,093
Working capital changes	2,960	(1,203)	1,214	(725)
Capital expenditure	(15,131)	(8,975)	(22,450)	(7,200)
<b>Free cash flow</b>	<b>26,949</b>	<b>21,049</b>	<b>7,890</b>	<b>30,167</b>
<b>Ratios</b>				
Debt/equity (%)	0.0	0.0	0.0	0.0
Net debt/equity (%)	(0.6)	(0.6)	(0.6)	(0.6)
RoAE (%)	43.4	20.0	15.0	16.6
<b>RoACE (%)</b>	<b>43.6</b>	<b>20.1</b>	<b>15.1</b>	<b>16.7</b>

Source: Company, Kotak Institutional Equities estimates

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Source: Kotak Institutional Equities

As of June 30, 2009

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**ADD.** We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

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