

## Company

12 April 2010 | 10 pages

# Hindustan Zinc (HZNC.BO)

 Equity   
 Target price change   
 Estimate change 

## Sell: Further Zinc Price Rally Unlikely

- Maintain Sell; TP hike not enough** — Zinc prices have surged 82% in 12-months to \$2,415/t – key to the 156% HZL stock surge (Sensex +71%). We believe the LME rally is priced in and do not expect much upside from current levels. Recommend Sell. However, we increase TP to Rs1,090 (from Rs842) as we: 1) raise FY11 PAT by 20%, 2) roll forward to Jun11 from Mar11, 3) raise the target PE multiple to 5.2x from 4.7x (on core earnings) and 4) account for higher cash/sh (Rs448 vs Rs379). At our TP, HZL would trade at 7.8x Jun11 PE and 3.4x EV/EBITDA. Our order of preference is: aluminium, alumina, zinc.
- Zinc outlook: flattish** — Our FY11-12 zinc forecasts are \$2,375 (vs \$1,893/t) and \$2,338/t (vs US\$1,928/t). Zinc fundamentals have improved dramatically, due to supply cutbacks and shutdown of zinc-lead smelters due to lead poisoning. However, ample potential supply over the next few years would limit price gains.
- Estimate revisions** — We raise FY11 PAT by 20% but cut FY12 earnings by 2% incorporating 1) a 21-25% hike in FY11-12 zinc LME prices, 2) 11-18% decline in lead LME prices, 3) marginal changes in volumes, 4) higher power (coal) costs, (5) revised Rs/US\$ rate – 43.5 vs 45 in FY11 and 41 vs 44.5 in FY12 and 6) higher tax rates as the tax benefits from its EOU would cease post Mar 11.
- 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 70-73%. Dec 09 cash was Rs107bn. HZL is in the process of enhancing its zinc-lead capacity by 310ktpa (from 754ktpa). The 210ktpa zinc smelter has been completed in Mar10, 3 months ahead of schedule.
- Sensitivity to prices** — A 5% change in zinc-lead LME prices would impact FY11 and 12 PAT by 6%. A 5% change in Rs/US\$ rate would impact PAT by 7%.

<b>Sell/Medium Risk</b>	<b>3M</b>
Price (09 Apr 10)	Rs1,243.95
Target price	Rs1,090.00
	<i>from Rs842.00</i>
Expected share price return	-12.4%
Expected dividend yield	0.4%
<b>Expected total return</b>	<b>-11.9%</b>
Market Cap	Rs525,609M
	US\$11,847M

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

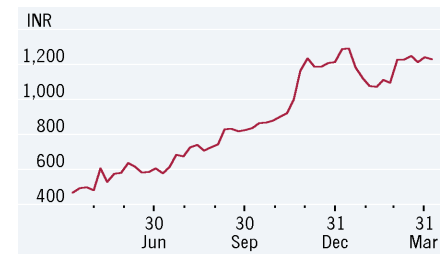


Figure 1. Hindustan Zinc – Statistical Abstract

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%	11.7	7.2	78%	58%
FY08	43,961	104.0	-1%	11.9	7.1	79%	37%
FY09	27,276	64.6	-38%	19.1	11.6	65%	19%
FY10E	40,097	94.9	47%	13.0	7.5	68%	22%
FY11E	59,452	140.7	48%	8.8	4.4	71%	25%
FY12E	57,964	137.2	-3%	9.0	3.5	72%	20%

Source: Company Reports and Citi Investment Research and Analysis. Price as on 8 April 2009.

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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
<b>Valuation Ratios</b>					
P/E adjusted (x)	12.0	19.3	13.1	8.8	9.1
EV/EBITDA adjusted (x)	7.5	12.0	7.9	4.8	3.9
P/BV (x)	4.4	3.7	2.9	2.2	1.8
Dividend yield (%)	0.4	0.3	0.4	0.6	0.6
<b>Per Share Data (Rs)</b>					
EPS adjusted	104.04	64.55	94.90	140.70	137.18
EPS reported	104.04	64.55	94.90	140.70	137.18
BVPS	280.41	339.80	428.26	560.77	689.77
DPS	5.00	4.00	5.50	7.00	7.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	78,778	56,803	78,570	110,732	115,073
Operating expenses	-18,683	-23,002	-28,596	-36,512	-36,444
<b>EBIT</b>	<b>60,095</b>	<b>33,801</b>	<b>49,974</b>	<b>74,220</b>	<b>78,629</b>
Net interest expense	-242	-219	-250	-275	-300
Non-operating/exceptionals	0	0	0	0	0
<b>Pre-tax profit</b>	<b>59,853</b>	<b>33,582</b>	<b>49,724</b>	<b>73,945</b>	<b>78,329</b>
Tax	-15,893	-6,306	-9,627	-14,493	-20,366
Extraord./Min.Int./Pref.div.	0	0	0	0	0
<b>Reported net income</b>	<b>43,961</b>	<b>27,276</b>	<b>40,097</b>	<b>59,452</b>	<b>57,964</b>
Adjusted earnings	43,961	27,276	40,097	59,452	57,964
Adjusted EBITDA	62,300	36,654	53,169	78,545	83,390
<b>Growth Rates (%)</b>					
Sales	-8.0	-27.9	38.3	40.9	3.9
EBIT adjusted	-7.3	-43.8	47.8	48.5	5.9
EBITDA adjusted	-6.1	-41.2	45.1	47.7	6.2
EPS adjusted	-1.0	-38.0	47.0	48.3	-2.5
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>40,616</b>	<b>27,127</b>	<b>35,284</b>	<b>55,977</b>	<b>51,417</b>
Depreciation/amortization	2,205	2,853	3,195	4,325	4,760
Net working capital	1,496	3,667	-4,173	-2,166	-403
<b>Investing cash flow</b>	<b>-6,180</b>	<b>-6,227</b>	<b>-8,924</b>	<b>1,631</b>	<b>9,711</b>
Capital expenditure	-13,667	-13,743	-15,000	-6,500	-1,500
Acquisitions/disposals	0	0	0	0	0
<b>Financing cash flow</b>	<b>-2,713</b>	<b>-1,372</b>	<b>-2,310</b>	<b>-2,994</b>	<b>-3,761</b>
Borrowings	0	83	-83	0	0
Dividends paid	-2,471	-1,236	-1,977	-2,719	-3,461
<b>Change in cash</b>	<b>31,722</b>	<b>19,528</b>	<b>24,050</b>	<b>54,614</b>	<b>57,367</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>132,067</b>	<b>159,261</b>	<b>199,487</b>	<b>260,072</b>	<b>315,472</b>
Cash & cash equivalent	76,952	96,480	120,530	175,144	232,511
Accounts receivable	4,437	1,649	4,503	6,364	6,621
Net fixed assets	41,626	52,133	63,938	66,113	62,853
<b>Total liabilities</b>	<b>13,585</b>	<b>15,685</b>	<b>18,533</b>	<b>23,127</b>	<b>24,024</b>
Accounts payable	3,547	3,722	3,361	4,491	4,882
Total Debt	4	87	4	4	4
<b>Shareholders' funds</b>	<b>118,482</b>	<b>143,576</b>	<b>180,954</b>	<b>236,945</b>	<b>291,449</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	79.1	64.5	67.7	70.9	72.5
ROE adjusted	45.1	20.8	24.7	28.5	21.9
ROIC adjusted	106.2	53.8	64.3	81.9	79.1
Net debt to equity	-64.9	-67.1	-66.6	-73.9	-79.8
Total debt to capital	0.0	0.1	0.0	0.0	0.0

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### Valuation

We value HZL's core earnings (June 2011) at 5.2x, based on its 3-yr trading average (vs 4.7x March 11 earlier). The target multiple we use is in line with HZL's average multiple of 5.2x during the period April 07 to March 09 (FY08 and FY09). This was a phase during which the average zinc price was \$2,300/t, close to our average price estimate for the 12-m period ending June 2011 (US\$2,365/t).

At our TP, HZL would trade at 7.8x Jun11 PE and 3.4x EV/EBITDA.

**Figure 2. Hindustan Zinc – TP calculation**

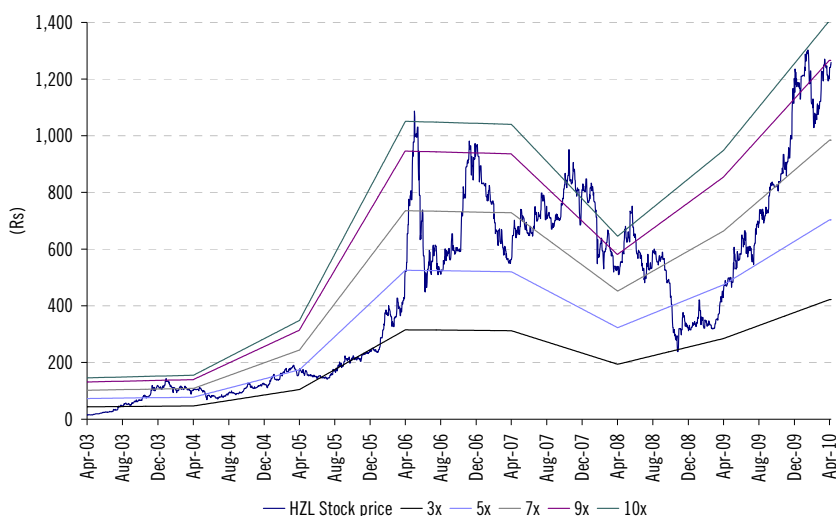
Core EPS of Rs109 valued at 5.2x	641
Cash per share as on 30 June 2010	448
<b>Target price (Rs)</b>	<b>1,090</b>

Source: Citi Investment Research and Analysis

### 1-Year Forward Rolling PE band

The sharp rally in zinc and lead LME prices has led to HZL trading close to its peak PE multiples.

**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: DataStream

### Estimate Revisions

Revisions based on (1) a 21-25% hike in FY11-12 zinc LME prices, (2) 11-18% decline in lead LME prices, (3) marginal change in volumes, (4) higher power (coal) costs, (5) revised Rs/US\$ rate – 43.5 vs 45 in FY11 and 41 vs 44.5 in FY12 and (6) higher tax rates.

Figure 5. Hindustan Zinc – Estimate changes FY10-12E

	FY10E			FY11E			FY12E		
	Old	New	% change	Old	New	% change	Old	New	% change
Average Zinc LME (US\$/t)	1,697	1,934	14%	1,893	2,375	25%	1,928	2,338	21%
Average Lead LME (US\$/t)	2,015	1,982	-2%	2,700	2,212	-18%	2,499	2,214	-11%
Rs/US\$ rate	46.3	46.2		45.0	43.5		44.5	41.0	
Net sales (Rs bn)	67.8	78.6	16%	91.5	110.7	21%	104.4	115.1	10%
EBITDA (Rs bn)	45.3	53.2	17%	64.8	78.5	21%	76.9	83.4	8%
Net profit (Rs bn)	34.6	40.1	16%	49.5	59.5	20%	59.0	58.0	-2%
EPS (Rs)	82.0	94.9	16%	117.1	140.7	20%	139.5	137.2	-2%

Source: Citi Investment Research and Analysis estimates

### Sensitivity of profits to changes in LME and Rs/US\$ rates

Figure 6. Hindustan Zinc's sensitivity to Zinc and Lead LME price – FY11E

Zinc LME (US\$/t)	2,256	2,375*	2,494
Lead LME (US\$/t)	2,102	2,212*	2,323
EBITDA (Rs bn)	73.9	78.5	83.1
EBITDA margin (%)	70%	71%	72%
PAT (Rs bn)	55.8	59.5	63.2
% change from base case		-6%	6%

Source: Citi Investment Research and Analysis estimates. \*Base case

A 5% change in zinc and lead LME prices would impact HZL's FY11 and FY12 PAT by 6%.

**Figure 7. Hindustan Zinc's sensitivity to Zinc and Lead LME price – FY12E**

Zinc LME (US\$/t)	2,221	2,338*	2,454
Lead LME (US\$/t)	2,104	2,214*	2,325
EBITDA (Rs bn)	78.7	83.4	88.1
EBITDA margin (%)	71%	72%	73%
PAT (Rs bn)	54.5	58.0	61.5
% change from base case	-6%		6%

Source: Citi Investment Research and Analysis estimates. \*Base case

A 5% change in Rs/US\$ rate would impact HZL's FY11 and FY12 PAT by 7%.

**Figure 8. Hindustan Zinc's sensitivity to Rs/US\$ rate – FY11E**

Rs/US\$	41.3	43.5*	45.7
EBITDA (Rs bn)	73.5	78.5	83.6
EBITDA margin (%)	70%	71%	72%
PAT (Rs bn)	55.4	59.5	63.5
% change from base case	-7%		7%

Source: Citi Investment Research and Analysis estimates. \*Base case

**Figure 9. Hindustan Zinc's sensitivity to Rs/US\$ rate – FY12E**

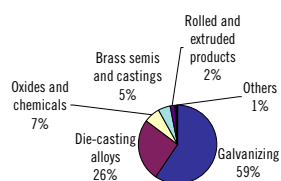
Rs/US\$	39.0	41.0*	43.1
EBITDA (Rs bn)	78.1	83.4	88.7
EBITDA margin (%)	71%	72%	73%
PAT (Rs bn)	54.1	58.0	61.9
% change from base case	-7%		7%

Source: Citi Investment Research and Analysis estimates. \*Base case

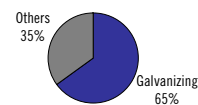
## Zinc consumption break-up

Galvanizing accounts for ~60% of zinc consumption globally and ~60-65% in India.

**Figure 10. Zinc Consumption: World**



**Figure 11. Zinc Consumption: India**



Source: Citi Investment Research and Analysis

Source: Citi Investment Research and Analysis

## 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 525,000 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 335MW. HZL announced expansion plans (210,000tpa zinc and 100,000tpa lead) that would take total integrated zinc-lead capacity to 1,065,000tpa with fully integrated mining and captive power generation capacities, and make it the world's largest integrated zinc-lead producer by mid-2010. Total capex on this will be Rs29bn. The zinc capacity (210ktpa) has commenced production in March 2010 – three months ahead of schedule.

### Investment strategy

We rate Hindustan Zinc shares Sell/Medium Risk (3M) with a target price of Rs1,090. Zinc LME prices have risen 82% over the last year. Zinc fundamentals have improved dramatically, due to supply cutbacks and shutdown of zinc-lead smelters due to lead poisoning. However, there remains ample potential supply over the next few years limiting price gains. Our base case forecasts indicate a small surplus until 2014. We forecast zinc LME prices to rise 23% yoy in FY11 (to US\$2,375/t) and decline marginally in FY12 (US\$2,338/t). Lead LME prices are expected to grow by 12% in FY11 (to US\$2,212/t) and remain flat in FY12 (to US\$2,214/t). Based on our forecasts, we expect Hindustan Zinc's EBITDA margins to range between 70-73% in FY11-12. Despite the expected increase in margins and expected strong zinc-lead volume growth (34% in FY11 and 10% in FY12), we believe that the LME price rally is priced in and do not expect much upside from current levels. Maintain Sell.

### Valuation

We use P/E as our preferred valuation parameter for HZL and roll forward to June11 from March11. We value HZL's core business at 5.2x June11 P/E (3-year trading average vs 4.7x earlier) and arrive at a value of Rs641/share. This multiple is in line with HZL's average multiple (5.2x) over the period April07-March09 (FY08-09) when the average zinc price was ~\$2,300 (12-m period ending June 11 forecast – \$2,365/t). We add cash/share of Rs448 to the PE derived value of Rs641 and arrive at a target price of Rs1,090. At our TP, HZL would trade at a June 11 PE of 7.8x and EV/EBITDA of 3.4x.

### Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, suggests a High Risk rating for Hindustan Zinc shares. However, based on the company's status as an integrated, low-cost zinc producer, and net cash position, we feel a rating of Medium Risk is more appropriate for Hindustan Zinc shares. 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.

# Appendix A-1

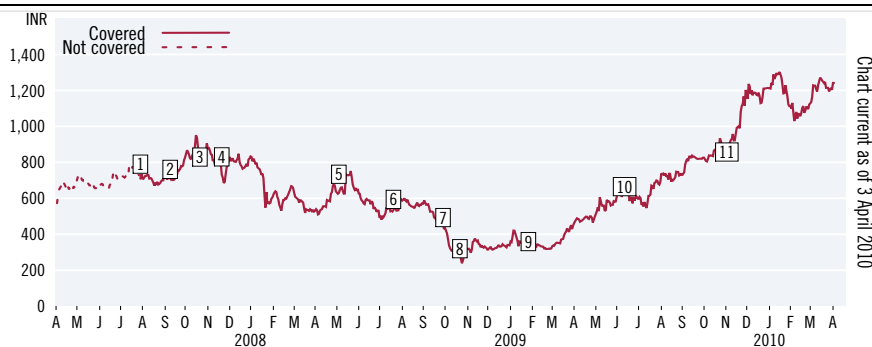
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Analyst: Pradeep Mahtani  
Covered since July 31 2007



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

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Mar 2010

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