

Hindustan Zinc

BSE SENSEX
17,085

S&P CNX
5,139

CMP: INR121

TP: INR193

Buy

Bloomberg HZ IN
Equity Shares (m) 4,225.3
52-Week Range (INR) 155/109
1,6,12 Rel. Perf. (%) -10/-5/12
M.Cap. (INR b) 512.5
M.Cap. (USD b) 10.4

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GR. (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/10A	80,170	40,414	9.6	48.2	-	-	24.9	29.9	-	-
3/11A	99,121	49,179	11.6	21.7	10.4	2.3	24.2	28.3	3.7	6.6
3/12E	117,400	62,731	14.8	27.6	8.2	1.8	24.7	29.3	2.6	4.5
3/13E	129,520	70,799	16.8	12.9	7.2	1.5	22.5	26.7	1.8	3.1

Consolidated

- Hindustan Zinc's (HZ) 2QFY12 adjusted PAT declined 9% QoQ to INR13.6b, below our estimate of INR15.2b, due to lower zinc metal volumes and the absence of sales of lead concentrate. Mine production was on expected lines.
- Net sales declined 7% QoQ to INR26.4b due to lower zinc metal volumes, absence of concentrate sales and shrinkage in regional price premium over LME.
- Production of refined zinc declined 4% QoQ to 185k tons due to maintenance shutdown of a roaster. However, mine production increased 10% QoQ to 186k tons due to an increased contribution from SK mines.
- HZ commissioned a 100ktpa lead smelter at Dariba, raising zinc and lead metal capacity to 1.064mtpa. HZ expects to commission a 350tpa silver refinery in 3QFY12, which will boost silver volumes. HZ expects to expand silver production capacity to 500tons by early FY13.
- HZ's EBITDA declined 8% QoQ to INR14.6b due to a shortfall in revenue. The net zinc metal cost without royalty declined 3% QoQ to USD847/ton. Royalty as a percentage of sales was higher in 2QFY12 at 8.1% v/s 6.8% in 1QFY12 due to higher production at its Rampura Agucha and SK mines.
- Considering its strong balance sheet and investor demand for higher dividend payout, HZ's board of directors decided to move towards a "percentage of profits" method in distributing dividend. HZ announced interim dividend of 75% (INR1.5/share).
- We are positive on stock due to the strong volume growth of zinc metal and sharper growth in lead and silver production over the next few years. Maintain **Buy**.

Quarterly Performance- HIND ZINC

(INR Million)

Y/E March	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Zn & Pb (000 tons)	179	191	191	210	208	200	222	229	770	859
Change (YoY %)	15.6	25.3	14.0	24.3	16.3	5.1	16.3	9.2	19.8	11.6
Net Sales	19,734	22,010	26,302	32,373	28,471	26,368	31,103	31,458	99,121	117,400
Change (YoY %)	30.5	21.0	16.9	27.2	44.3	19.8	18.3	-2.8	23.6	18.4
Total Expenditure	9,516	10,758	11,229	12,688	12,548	11,720	12,860	13,250	44,165	50,378
EBITDA	10,218	11,253	15,073	19,685	15,923	14,648	18,244	18,208	54,956	67,023
Change (YoY %)	33.1	4.6	8.7	27.1	55.8	30.2	21.0	-7.5	17.7	22.0
As % of Net Sales	51.8	51.1	57.3	60.8	55.9	55.6	58.7	57.9	55.4	57.1
Interest	66	-5	1	133	65	120	0	0	194	185
Depreciation	1,123	1,158	1,195	1,271	1,345	1,455	1,427	1,470	4,747	5,698
Other Income	1,584	1,840	2,071	3,025	3,554	3,868	4,069	4,481	9,792	15,972
PBT (before EO item)	10,614	11,940	15,947	21,306	18,066	16,940	20,886	21,219	59,807	77,112
Extra-ordinary Income	0	-212	0	0	-44	-239	0	0	-212	-283
PBT (after EO item)	10,614	11,728	15,947	21,306	18,022	16,702	20,886	21,219	59,596	76,829
Total Tax	1,705	2,241	3,051	3,594	3,073	3,255	3,968	4,032	10,591	14,328
% Tax	16.1	19.1	19.1	16.9	17.1	19.5	19.0	19.0	17.8	18.6
Reported PAT	8,909	9,487	12,896	17,713	14,949	13,447	16,917	17,188	49,005	62,501
Adjusted PAT	8,909	9,658	12,896	17,713	14,986	13,639	16,917	17,188	49,179	62,731
Change (YoY %)	23.9	3.3	12.3	43.0	68.2	41.2	31.2	-3.0	21.7	27.6
Avg LME Zinc (USD/T)	2,052	2,043	2,330	2,395	2,271	2,280	2,125	2,125	2,205	2,200
Avg LME Lead (USD/T)	1,972	2,065	2,398	2,575	2,531	2,500	2,200	2,200	2,253	2,200
Fixed assets	76,955		81,294			88,249			81,294	80,584
Cash etc (net of debt)	123,528	130,920	149,671	157,200	162,956				149,671	212,314
Net Working Capital	7,593		3,813			12,797			3,813	779

E: MOSL Estimates

Hindustan Zinc's (HZ) 2QFY12 adjusted PAT declined 9% QoQ to INR13.6b, below our estimate of INR15.2b, due to lower zinc metal volumes and the absence of sales of lead concentrate. Mine production was on expected lines.

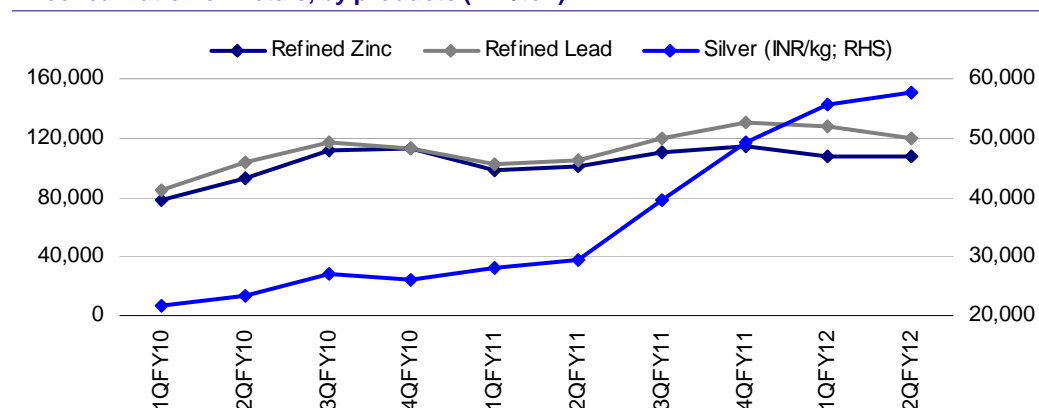
Net sales declined sequentially due to lower zinc volumes, reduced metal premiums; New silver refinery to boost volumes in 2HFY12

- Net sales declined 7% QoQ to INR26.4b due to lower zinc metal volumes, absence of concentrate sales and shrinkage in regional price premium over LME.
- LME zinc prices were sequentially flat at USD2,275/ton and lead prices declined 1.7% QoQ to USD2,488/ton. However regional premiums declined QoQ. Lead premium declined sharply to 6% from 12% in 1QFY12. Silver realizations were up 3.6% QoQ at INR57,746/kg.
- Production of refined zinc declined 4% QoQ to 185k tons due to maintenance shutdown of a roaster. However, mine production increased 10% QoQ to 186k tons due to increased contribution from SK mine. SK mine is set to ramp up production to 2mtpa by the end of FY12.
- Lead production was 15,657 tons and silver production was 42,081 kg (net of internal consumption) in 2QFY12. Silver contributed INR2.4b to net sales.
- HZ commissioned a 100ktpa lead smelter at Dariba, raising zinc and lead metal capacity to 1.064mtpa. It expects to commission a 350tpa silver refinery in 3QFY12, which will boost silver volumes. HZ expects to expand silver production capacity to 500tons by early FY13.

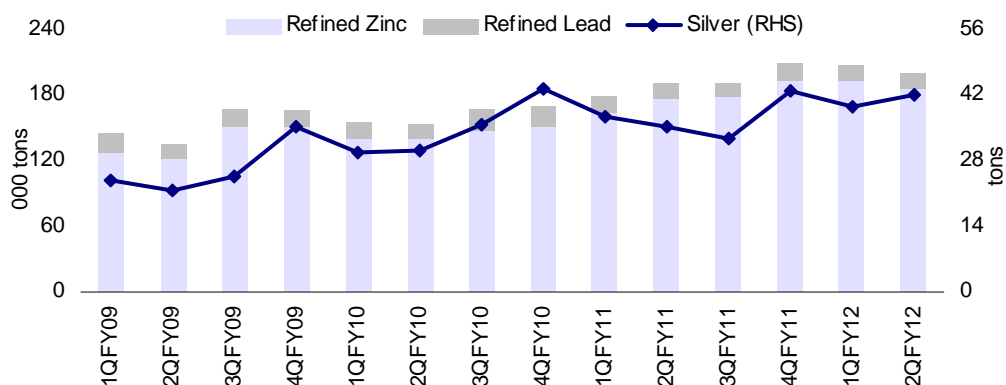
EBITDA declines 8% QoQ; Cost of production (without royalty) USD847/ton

- HZ's 2QFY12 EBITDA declined 8% QoQ to INR14.6b, lower than our estimate of INR15.9b, due to a shortfall in revenue. The net zinc metal cost without royalty (CoP) declined 3% QoQ to USD847/ton. However in rupee terms, CoP was only marginally lower. HZ expects CoP of zinc to remain low in 2HFY12 due to HZ's stringent cost control measures. It expects FY12 CoP to be ~USD850/ton.

Price realization of metals, by products (INR/ton)



Source: Company/MOSL

Maintenance shutdown of roaster affected zinc production in 2QFY12

Source: Company/MOSL

Dividend raised; Strong growth in metal production in 2HFY12; Maintain Buy

- Considering its strong balance sheet and investor demand for higher dividend payout, HZ's board of directors reviewed its dividend payment policy and decided to move towards the "percentage of profits" method. It announced interim dividend of 75% (INR1.5/share).
- Cash and equivalents increased by INR5.7b QoQ to INR163b, of which INR103b was invested in debt mutual funds. HZ is considering options to deploy this cash in its core business, including green-field and inorganic expansion.
- HZ commissioned a 100ktpa lead smelter at Dariba in 2QFY12 and expects it to ramp up lead production in 2HFY12. This will drive lead and silver volumes in FY13.
- HZ is committed to increasing mine metal production. Production at SK mine will ramp up to 2mtpa by the end of FY12. The mining work at its underground Kayar mine has commenced and HZ expects its first ore production by 1QFY14.
- We remain positive on the stock due to the strong volume growth of zinc metal and sharper growth in lead and silver production over the next few years. The stock trades at an EV/EBITDA of 3.1x FY13E and P/E of 7.2x FY13E assuming zinc and lead prices of USD2,200/ton and a rupee-US dollar exchange rate of 45. **Maintain Buy.**

Hindustan Zinc: an investment profile

Company description

Hindustan Zinc (HZ) is a fully integrated zinc producer, with one of the best mining assets in the world. It steadily increased its reserves and production through regular investment in exploration and augmenting smelting capacity. HZ's captive mines of zinc and lead ore are located in Rajasthan, where it has total reserves of 313.2mt, equivalent to 34.7mt of refined zinc and lead MIC (metal in concentrate). Its captive mines and thermal power plants give HZ a significant cost advantage, making it one of the lowest-cost producers of zinc in the world. Sterlite Industries has 64.9% stake in HZ and 29.5% is owned by the government of India.

Key investment arguments

- With HZ's recently commissioned 100ktpa lead smelter at Dariba, it has become the world's largest integrated zinc-lead producer with total smelting capacity of 1.064mtpa. This lead smelter, along with a 350tpa silver refinery (to be commissioned in 3QFY12), will drive lead and silver volumes over FY11-13.
- HZ expects silver production capacity to be 500 tons by early FY13. HZ will be the major beneficiary of the currently strong silver prices.

- HZ's cost of production is among the lowest in the world due to its fully integrated operations and large resource base.

Key investment risks

- An unexpected fall in LME zinc prices will adversely impact earnings.

Recent developments

- HZ's board of directors has recommended interim dividend of 75% (INR1.5/share) for FY12.

Valuation and view

- The stock trades at an EV/EBITDA of 3.1x FY13E and P/E of 7.2x FY13E. Maintain **Buy**.

Sector view

- Zinc is our most preferred base metal because of its favorable demand outlook and constraints in supply growth due to shortage of large scale low cost mines in the world.

Comparative valuations

		Hindustan Zinc	HNDL	NALCO
P/E (x)	FY12E	8.2	7.1	12.2
	FY13E	7.2	6.8	9.4
P/BV (x)	FY12E	1.8	1.3	1.3
	FY13E	1.5	1.1	1.2
EV/Sales (x)	FY12E	2.6	0.6	1.4
	FY13E	1.8	0.6	1.1
EV/EBITDA (x)	FY12E	4.5	5.4	5.3
	FY13E	3.1	5.1	3.4

Shareholding pattern (%)

	Sep-11	Jun-11	Sep-10
Promoter	64.9	64.9	94.5
Domestic Inst	1.8	1.9	1.9
Foreign	1.4	1.5	1.7
Others	32.0	31.7	2.0

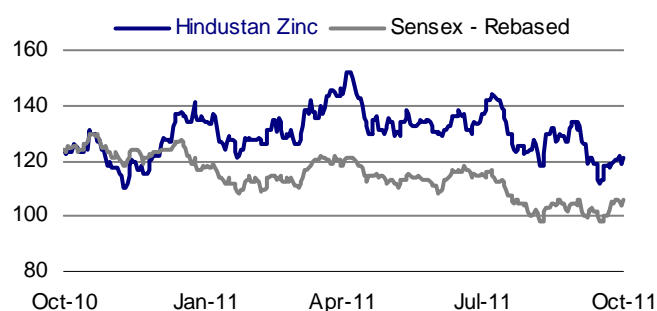
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	14.8	13.8	6.9
FY13	16.8	15.3	9.5

Target Price and Recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
121	193	59.5	Buy

Stock performance (1 year)



Financials and Valuations

Income Statement				(INR Million)	
Y/E March	2009	2010	2011	2012E	2013E
Net Sales	56,803	80,170	99,121	117,400	129,520
Change (%)	-27.9	41.1	23.6	18.4	10.3
Total Expenses	29,461	33,469	44,165	50,378	53,945
EBITDA	27,342	46,701	54,956	67,023	75,576
% of Net Sales	48.1	58.3	55.4	57.1	58.4
Depn. & Amortization	2,853	3,343	4,747	5,698	5,755
EBIT	24,489	43,358	50,209	61,325	69,820
Net Interest	219	439	194	185	0
Other Income	9,312	7,222	9,792	15,972	17,587
PBT before EO	33,582	50,141	59,807	77,112	87,407
EO Income			-212	-283	
PBT after EO	33,582	50,141	59,596	76,829	87,407
Tax	6,306	9,727	10,591	14,328	16,607
Rate (%)	18.8	19.4	17.8	18.6	19.0
Reported PAT	27,276	40,414	49,005	62,501	70,799
Adjusted PAT	27,276	40,414	49,179	62,731	70,799
Change (%)	-38.0	48.2	21.7	27.6	12.9

Balance Sheet				(INR Million)	
Y/E March	2009	2010	2011	2012E	2013E
Share Capital	4,225	4,225	8,451	8,451	8,451
Reserves	139,351	177,014	216,881	273,733	337,611
Net Worth	143,576	181,240	225,332	282,183	346,062
Minority Interest					
Total Loans	87	605	4	4	4
Deferred Tax Liability	5,589	7,112	9,447	11,494	13,866
Capital Employed	149,251	188,957	234,783	293,681	359,932
Gross Block	58,555	82,407	98,023	102,023	106,023
Less: Accum. Deprn.	17,506	20,766	25,481	30,191	34,866
Net Fixed Assets	41,049	61,641	72,542	71,832	71,158
Capital WIP	11,084	11,130	8,752	8,752	8,752
Investments	69,289	109,492	93,346	155,989	222,715
Curr. Assets	37,839	19,953	75,889	74,861	75,758
Inventory	5,457	4,517	7,624	6,433	7,097
Account Receivables	1,649	1,518	2,089	2,252	2,484
Cash and Bank Balance	27,192	9,275	56,329	56,329	56,329
Others	3,542	4,642	9,848	9,848	9,848
Curr. Liability & Provi	10,010	13,258	15,747	17,753	18,450
Account Payables	3,722	4,777	4,748	6,755	7,452
Provisions & Others	6,287	8,481	10,998	10,998	10,998
Net Current Assets	27,830	6,695	60,143	57,108	57,307
Appl. of Funds	149,251	188,957	234,783	293,681	359,932

E: MOSL Estimates

Ratios					
Y/E March	2009	2010	2011	2012E	2013E
Basic (INR)					
EPS	6.5	9.6	11.6	14.8	16.8
Cash EPS	7.1	10.4	12.7	16.1	18.1
BV/Share	34.0	42.9	53.3	66.8	81.9
DPS	0.4	0.6	1.0	1.2	1.4
Payout (%)	7.2	7.3	10.0	9.4	9.8
Valuation (x)					
P/E			10.4	8.2	7.2
Cash P/E			9.5	7.5	6.7
P/BV			2.3	1.8	1.5
EV/Sales			3.7	2.6	1.8
EV/EBITDA			6.6	4.5	3.1
Dividend Yield (%)			0.8	1.0	1.2
Return Ratios (%)					
EBITDA Margins (%)	48.1	58.3	55.4	57.1	58.4
Net Profit Margins (%)	48.0	50.4	49.6	53.4	54.7
RoE	20.8	24.9	24.2	24.7	22.5
RoCE (pre-tax)	24.8	29.9	28.3	29.3	26.7
RoIC (pre-tax)	58.9	86.1	74.2	82.3	96.5
Growth (%)					
Sales	-27.9	41.1	23.6	18.4	10.3
EBITDA	-49.2	70.8	17.7	22.0	12.8
PAT	-38.0	48.2	21.7	27.6	12.9
Leverage Ratio (x)					
Current Ratio	3.8	1.5	4.8	4.2	4.1
Interest Cover Ratio	111.9	98.7	258.8	331	179,027
Cash Flow Statement					
				(INR Million)	
Y/E March	2009	2010	2011	2012E	2013E
Pre-tax profit	33,582	50,141	59,596	76,829	87,407
Depreciation	2,853	3,343	4,747	5,698	5,755
(Inc)/Dec in w/kg. Cap.	3,866	3,219	-6,394	3,034	-199
Tax paid	-5,209	-8,309	-8,255	-12,281	-14,235
Other operating activities	-503	229	-776	-1,299	-1,266
CF from Op. Activity	34,589	48,623	48,918	71,981	77,462
(Inc)/Dec in FA + CwIP	-13,166	-23,897	-13,239	-4,000	-4,000
(Pur)/Sale of Investment	-5,964	-40,203	16,146	-62,643	-66,726
Others					
CF from Inv. Activity	-19,131	-64,100	2,906	-66,643	-70,726
Debt Raised/(Repaid)	83	518	-601		
Dividend (incl. tax)	-1,977	-2,956	-4,911	-5,932	-6,921
Other Finan. Activities			741	594	185
CF from Fin. Activity	-1,894	-2,439	-4,771	-5,338	-6,736
(Inc)/Dec in Cash	13,564	-17,916	47,054	0	0
Add: opening Balance	13,628	27,192	9,275	56,329	56,329
Closing Balance	27,192	9,275	56,329	56,329	56,329

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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
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