

Weak INR to offset low LME; Lead biz need to catch up

October 19, 2011

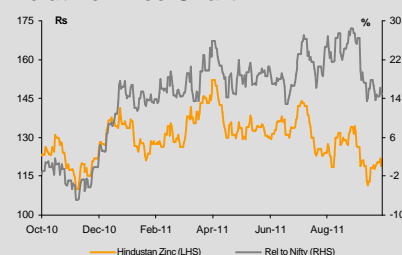
Reco	Previous Reco
Buy	Buy
CMP	Target Price
Rs 121	Rs 159
EPS change FY11E/12E (%)	0.7/ NA
Target Price change (%)	8
Nifty	5,139
Sensex	17,085

Price Performance

(%)	1M	3M	6M	12M
Absolute	(8)	(11)	(16)	(2)
Rel. to Nifty	(9)	(3)	(6)	15

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Metals & Mining
Bloomberg	HZ@IN
Equity Capital (Rs mn)	8451
Face Value(Rs)	2
No of shares o/s (mn)	4225
52 Week H/L	155/109
Market Cap (Rs bn/USD mn)	513/10,436
Daily Avg Volume (No of sh)	1093344
Daily Avg Turnover (US\$m)	2.8

Shareholding Pattern (%)

	Sep-11	Jun-11	Mar-11
Promoters	64.9	64.9	64.9
FII/NRI	1.4	1.5	1.5
Institutions	1.8	1.9	2.0
Private Corp	1.3	1.0	1.0
Public	30.7	30.7	30.7

Source: Capitaline

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- **Revenue at Rs 26.4 bn up 19.8% on YoY basis, but down 7% QoQ due to marginal decline in refined zinc and lead sales, lower LMEs QoQ and no concentrate sales**
- **EBITDA at Rs 14.7 bn was up 30% YoY while down 8% QoQ. EBITDA margin stood at 55.6% up 443 bps YoY basis but down 38 bp QoQ basis. Zinc CoP fell to US\$847/ tonne**
- **APAT at Rs 13.7 bn, broadly in line with revised estimates was up 42% YoY. The shortfall on account of lower lead sales was offset by higher other income Rs 3.9 bn (up 110%)**
- **We refine our FY12E and FY13E assumptions on account of LME, Exchange rate and volumes. Due to global sentiment lowered target to Rs 159 (6x FY13 EV/ EBITDA); Retain Buy**

Lower sales volume with no concentrate sales weighed on topline

Topline for the quarter remained subdued against our expectations on account of lower sales volume in case of lead and no concentrate sales to offset that. Silver sales volume also remained short of our expectations. On a QoQ basis refined zinc sales also was reported 4% lower at 184,161 tonnes. On the positive side, lower LMEs on the other hand were offset by INR depreciation, which kept the realizations healthy and thereby restricted further adverse impact on the topline. We believe, sales volume to ramp up from current levels going forward.

Projects ramp up at Dariba, short of expectations

Ramp up of the 1 lac tpa lead smelter at Dariba, commissioned during June 2011 did not see any significant progress in Q2FY12, as the total lead production was just 17 kt during the quarter. The management expects 40000 tonnes of incremental lead production form it in FY12. On the other hand SK mines capacity is likely to be ramped up to 2 mtpa by end of FY12. We feel the ramping up of Dariba smelter has been slow and may not meet volume expectations in FY12.

Other income boosted by higher cash and interest rate aided bottomline

Cash and cash equivalent of Rs 162.3 bn at the end of September 2011 coupled with higher interest rates helped the company to see 110% YoY (8% QoQ) jump in other income to Rs 3.9 bn, which largely offset impact of higher depreciation and interest on bottomline. The company had declared an interim dividend of 75% i.e. Rs 1.5 per share as a result of profit linked dividend policy. We believe, there would higher cash outflow, however, this would improve return ratios of the company and a better way to utilize its huge cash reserve.

Outlook and Valuations

At the CMP of Rs 121, the stock is trading at 7.7x its FY13E EPS and 3.9x FY13E EV/ EBITDA. Factoring volatile LME, weak INR and contraction in global valuation multiple, we reduce our target EV/ EBITDA multiple to 6x. Applying this on FY13 estimates our fair value for the stock comes at Rs 159/ share, still providing an upside of 31%. Maintain BUY

Financials

(Rs mn)

YE-	Net	EBITDA	EPS	EPS	RoE	EV/				
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA	P/BV
FY10	80,170	46,701	58.3	40,414	9.6	48.2	22.3	12.7	8.4	2.8
FY11	100,393	56,228	56.0	49,217	11.6	21.3	21.7	10.5	6.4	2.3
FY12E	110,709	61,353	55.4	56,221	13.2	14.1	21.0	9.2	5.4	1.9
FY13E	132,199	75,002	56.7	66,905	15.8	19.6	21.0	7.7	3.9	1.6

Source: Company, Emkay Research

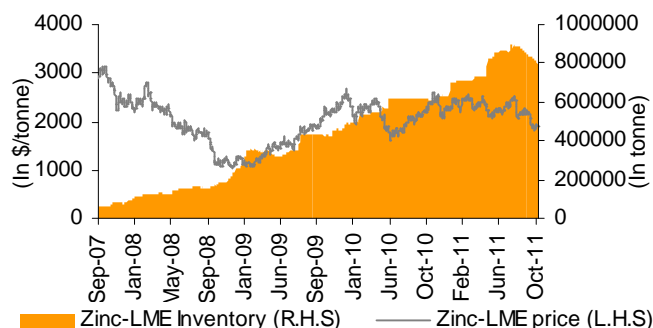
Key Financials – Quarterly

(Rs mn)	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)	YTDFY12	YTDFY11	YoY (%)
Revenue	22,010	26,302	32,373	28,471	26,368	19.8	(7.4)	54,839	41,744	31.4
Expenditure	(10,758)	(11,229)	(12,686)	(12,548)	(11,720)	8.9	(6.6)	(24,268)	(20,274)	19.7
as % of sales	48.9	42.7	39.2	44.1	44.4			44.3	48.6	
Mining & mfg expenses	(8,916)	(9,185)	(10,216)	(10,472)	(9,618)	7.9	(8.2)	(20,090)	(16,168)	24.3
as % of sales	40.5	34.9	31.6	36.8	36.5			36.6	38.7	
Employee Cost	(1,155)	(1,130)	(1,341)	(1,274)	(1,290)	11.7	1.3	(2,565)	(2,637)	(2.8)
as % of sales	5.2	4.3	4.1	4.5	4.9			4.7	6.3	
SGA & Other expenditure	(687)	(914)	(1,128)	(802)	(812)	18.1	1.2	(1,614)	(1,468)	9.9
as % of sales	3.1	3.5	3.5	2.8	3.1			2.9	3.5	
EBITDA	11,253	15,073	19,687	15,923	14,648	30.2	(8.0)	30,571	21,471	42.4
Depreciation	(1,158)	(1,195)	(1,271)	(1,345)	(1,455)	25.6	8.2	(2,801)	(2,281)	22.8
EBIT	10,094	13,877	18,417	14,578	13,193	30.7	(9.5)	27,771	19,189	44.7
Other Income	1,840	2,071	3,024	3,554	3,868	110.2	8.8	7,421	3,425	116.7
Interest	5	(1)	(133)	(65)	(120)	(2,458.8)	85.4	(185)	(60)	206.6
PBT	11,940	15,947	21,308	18,066	16,940	41.9	(6.2)	35,007	22,554	55.2
Total Tax	(2,241)	(3,051)	(3,594)	(3,073)	(3,255)	45.3	5.9	(6,328)	(3,946)	60.4
Adjusted PAT	9,699	12,896	17,715	14,993	13,686	41.1	(8.7)	28,679	18,608	54.1
(Profit)/loss from JV's/Ass/MI	-	-	-	-	-	-	-	-	-	-
Adj.PAT after MI	9,699	12,896	17,715	14,993	13,686	41.1	(8.7)	28,679	18,608	54.1
Extra ordinary items	(212)	-	-	(44)	(239)	-	-	(283)	(212)	-
Reported PAT	9,487	12,896	17,715	14,949	13,447	41.7	(10.0)	28,396	18,396	54.4
Reported EPS	2.2	3.1	4.2	3.5	3.2	44.2	(8.7)	6.8	4.4	55.9

Margins (%)		(bps)	(bps)		(bps)	(bps)		(bps)	(bps)	
EBIDTA	51.1	57.3	60.8	55.9	55.6	443	(38)	55.7	51.4	431
EBIT	45.9	52.8	56.9	51.2	50.0	417	(117)	50.6	46.0	467
EBT	54.2	60.6	65.8	63.5	64.2	1,000	79	63.8	54.0	981
PAT	44.1	49.0	54.7	52.7	51.9	784	(76)	52.3	44.6	772
Effective Tax rate	18.8	19.1	16.9	17.0	19.2	45	220	18.1	17.5	58

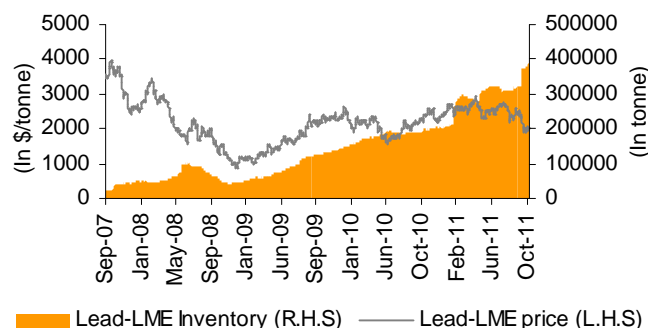
LME prices and inventory trend

Zinc LME has been weak, inventory started falling



Source: Bloomberg, Emkay research

Lead inventory on the rise putting pressure on prices



Key takeaways from conference call:

- Once the 1 lac tpa Dariba smelter ramps up HZL's total capacity would be able to meet about 2/3rd of India's lead requirement. Ramp up to happen in Q4 FY12 with exit around rated capacity
- The Zinc COP (without royalty) of HZL during the qtr was at \$847 per ton viz \$874 per ton in Q1 FY12 mainly due to INR depreciation, it reduced marginally in INR term
- No concentrate sold during qtr. Going forward entire concentrate production likely to meet captive requirement. About 10-15 kt of lead concentrate would have to sourced from outside if lead smelter fully ramps up. HZL however believes the mining capacity too would be increased over 2 years.
- HZL saw current LMEs touching global marginal costs of productions and did not see further corrections in LME on account of some zinc mine closures in the global space. Outlook on lead LME strong
- Moves from "progressive dividend policy" to "profit sharing dividend policy". Can expect about 20% of profits to be shared as dividend going forward, albeit taking external market conditions
- Next phase of expansion projects being closely evaluated – can expect announcement in near future. More Reconnaissance Permits (RPs) & Mining lease (ML) being sought
- HZL taking over Sterlite's Investment in Anglo America's zinc assets not in the "near term radar"

Revising assumptions to factor in LME volatility, INR depreciation

We have revised our assumptions on LME and exchange rates to factor in the recent volatility. Despite lower LME assumption the realizations in INR term is increasing due to higher impact of INR depreciation. On the volume front also we have refined our assumptions mainly for rest of FY12 based on performance so far. We have also factored in higher dividend pay out going forward.

Revision in assumptions

Parameters	FY12E		FY13E	
	Earlier	Revised	Earlier	Revised
Sales volume (tonne)				
Zinc	742,755	758,096	791,100	791,100
Lead	113,388	75,235	144,750	135,100
Silver	275	232	375	375
Realization (Rs/ tonne)				
Zinc	105,750	106,545	110,250	110,450
Lead	117,000	116,706	119,250	119,850
Silver	47,500	52,126	50,000	50,000
LME (US\$/ tonne)				
Zinc	2,200	2,169	2,300	2,200
Lead	2,350	2,288	2,400	2,300
Exchange rate (USD/INR)	45.0	46.5	45.0	47
Dividend/ share (Rs)	1.0	3.0	1.0	3.0

Valuation

We have adjusted for the LME volatility and INR depreciation into our estimates for H2FY12 and full FY13. At the CMP of Rs 121, the stock trades at 7.7x FY13 EPS of Rs 15.8. On EV/ EBITDA basis it discounts FY13 estimates by 3.9x. We believe the company would continue to deliver strong performances, as weak INR would continue to offset lower LME and higher interest rate would have a positive impact on the other income. However, looking at the global sentiment and contraction of valuation multiple we reduce our target EV/ EBITDA multiple to 6x. Applying this on FY13 estimates our fair value for the stock comes at Rs 159/ share, still providing an upside of 31%. Maintain BUY

Deployment of its huge cash reserve in organic/ inorganic growth would warrant a relook at our estimates.

Financials (Consolidated)

Income Statement

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
Net Sales	80,170	100,393	110,709	132,199
<i>Growth (%)</i>	<i>41.1</i>	<i>25.2</i>	<i>10.3</i>	<i>19.4</i>
Expenditure	(33469)	(44165)	(49356)	(57197)
Mining & Mfg. Cost	(25740)	(31351)	(38010)	(40222)
Employee Cost	(4574)	(5108)	(5597)	(7182)
Other Exp	(3156)	(7706)	(5749)	(9793)
EBITDA	46,701	56,228	61,353	75,002
<i>Growth (%)</i>	<i>70.8</i>	<i>20.4</i>	<i>9.1</i>	<i>22.2</i>
EBITDA margin (%)	58.3	56.0	55.4	56.7
Depreciation	-3342.5	-4747.4	-5626.1	-6145.1
EBIT	43,358	51,481	55,727	68,857
EBIT margin (%)	54.1	51.3	50.3	52.1
Other Income	7222	8521	14059	15119
Interest expenses	-439	-194	-332	-344
PBT	50,141	59,807	69,454	83,632
Tax	-9727	-10591	-13233	-16726
<i>Effective tax rate (%)</i>	<i>19.4</i>	<i>17.7</i>	<i>19.1</i>	<i>20.0</i>
Adjusted PAT	40,414	49,217	56,221	66,905
(Profit)/loss from JV's/Ass/MI				
Adjusted PAT after MI	40,414	49,217	56,221	66,905
<i>Growth (%)</i>	<i>48.2</i>	<i>21.8</i>	<i>14.2</i>	<i>19.0</i>
Net Margin (%)	14.1	14.3	15.1	15.1
E/O items	0	-211.6	-282.8	0
Reported PAT	40,414	49,005	55,938	66,905
<i>Growth (%)</i>	<i>48.2</i>	<i>21.3</i>	<i>14.1</i>	<i>19.6</i>

Cash Flow

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
PBT (Ex-Other income)	50,141	51,287	55,395	68,513
Depreciation	-3,343	-4,747	-5,626	-6,145
Interest Provided	-439	-194	-332	-344
Other Non-Cash items	1,492	9,652	25,361	27,753
Chg in working cap	767	-2,116	5,298	-1,131
Tax paid	-7,846	-11,163	-11,910	-15,054
Operating Cashflow	40,772	42,719	68,186	73,592
Capital expenditure	23,897	13,239	20,000	20,000
Free Cash Flow	64,670	55,959	88,186	93,592
Other income	-17,597	-10,732	-20,000	-20,000
Investments	-39,218	18,700	-20,000	-25,000
Investing Cashflow	-56,815	7,968	-40,000	-45,000
Equity Capital Raised	0	0	0	0
Loans Taken / (Repaid)	433	-601	0	0
Interest Paid	439	194	332	344
Others	-1,977	-2,956	-15,163	-15,175
Financing Cashflow	-1,874	-3,633	-14,831	-14,831
Net chg in cash	-17,916	47,054	13,355	13,761
Opening cash position	27,192	9,275	56,329	69,684
Closing cash position	9,275	56,329	69,684	83,445

Balance Sheet

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
Equity share capital	4225	8451	8451	8451
Reserves & surplus	177,014	216,881	257,988	310,063
Net worth	181,240	225,332	266,439	318,514
Minority Interest	0	0	0	0
Secured Loans	0	0	0	0
Unsecured Loans	605	4	4	4
Loan Funds	605	4	4	4
Net deferred tax liability	7112.3	9447	10770.3	12443
Total Liabilities	188,957	234,783	277,213	330,960
Gross Block	82,407	98,023	113,023	128,023
Less: Depreciation	-20,766	-25,481	-31,107	-37,252
Net block	61,641	72,542	81,916	90,771
CWIP	11130	8752	13752	18752
Investment	109,492	93,346	113,346	138,346
Current Assets	19,953	75,889	86,887	102,537
Inventories	4,587	9,948	9,718	10,148
Sundry debtors	1,518	2,089	2,096	2,504
Cash & bank balance	9,275	56,329	69,684	83,445
Loans & advances	4,572	7,523	5,389	6,439
Other current assets	0	0	0	0
Current lia & Prov	13,258	15,747	18,688	19,445
Current liabilities	9,863	10,076	13,017	13,775
Provisions	3,395	5,671	5,671	5,671
Net current assets	6,695	60,143	68,199	83,091
Total Assets	188,957	234,783	277,213	330,960

Key Ratios

Y/E, Mar	FY10	FY11E	FY12E	FY13E
Profitability (%)				
EBITDA Margin	58.3	56.0	55.4	56.7
Net Margin	50.4	48.8	50.5	50.6
ROCE	21.4	20.9	20.2	20.2
ROE	22.3	21.7	21.0	21.0
RoIC	63.0	63.6	66.0	67.2
Per Share Data (Rs)				
EPS	9.6	11.6	13.2	15.8
CEPS	10.4	12.7	14.6	17.3
BVPS	42.9	53.3	63.1	75.4
DPS	0.6	1.0	3.0	3.0
Valuations (x)				
PER	12.7	10.5	9.2	7.7
P/CEPS	11.7	9.5	8.3	7.0
P/BV	2.8	2.3	1.9	1.6
EV/EBITDA	8.4	6.4	5.4	3.9
EV/Sales	4.9	3.6	3.0	2.2
Gearing Ratio (x)				
Net Debt/ Equity	0.00	0.00	0.00	0.00
Net Debt/EBITDA	0.01	0.00	0.00	0.00

Recommendation History: Hindustan Zinc – HZ IN

Date	Reports	Reco	CMP	Target
30/06/2011	Hindustan Zinc Initiating Coverage	Buy	136	173
21/07/2011	Hindustan Zinc Q1FY12 Result Update	Buy	138	173

Recent Research Reports

Date	Reports	Reco	CMP	Target
07/09/2011	Nalco Company Update	NA	66	NA
12/08/2011	Tata Steel Q1FY12 Result Update	Buy	476	670
09/08/2011	Godawari Power Q1FY12 Result Update	Buy	151	210
08/08/2011	Sesa Goa Event Update	Accumulate	241	308

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