

HINDUSTAN ZINC LTD.

Concentrated performance...

Q4 FY 2007 update

COMPANY DETAILS

Auditors	Deloitte Haskins & Sells
Chairman	Mr Agnivesh Agarwal
Regd. office	Yashad Bhawan, Yashadgarh Udaipur - 313004, Rajasthan
Website	www.hzindia.com

SCRIP DETAILS

Market Capitalisation	Rs. 349 bn.
Book Value per share	Rs. 81
Equity Shares O/S (F.V. Rs 10)	423 mn.
Median Volumes (12 mths)	640,000 (BSE)
52 Week High/Low	Rs. 1,119 / 316
BSE Scrip Code	500188
Bloomberg Code	HZ@IN
Reuters Code	HZNC.BO

SHAREHOLDING PATTERN (%)

Qtr. Ended	Sep-06	Dec-06	Mar-07
Promoters	64.9	64.9	64.9
GOI-President of India	29.5	29.5	29.5
MFs/Banks/Fls	1.6	1.2	2.0
FIIs/NRI/OCBs	1.3	2.0	1.2
Pvt. Corp. Bodies	0.7	0.5	0.5
Others	2.0	1.9	1.9

KEY FINANCIALS (STANDALONE)

Rs Mn	Quarter Ended			Year Ended (March)		
	Sep-06	Dec-06	Mar-07	2007	2008E	2009E
Net Sales	16,100	24,410	24,800	85,520	86,077	98,295
YoY Gr (%)	205.5	268.7	171.3	120.6	0.7	14.2
Op Profits	12,440	18,560	19,070	64,070	62,245	70,354
Op. Marg. (%)	77.3	76.0	76.9	74.9	72.3	71.6
Net Profits	8,740	12,980	13,350	44,420	45,713	52,937
Eq Capital	4,225	4,225	4,225	4,230	4,230	4,230

KEY RATIOS

Year Ended (March)	EPS (Rs.)	ROCE (%)	RONW (%)	P/E (x)	EV/Sales (x)	EV/EBIDT (x)
2007	105.0	112.7	80.3	6.6	3.0	3.8
2008E	108.1	68.7	47.2	6.4	2.5	3.1
2009E	125.1	53.5	37.4	5.5	1.6	2.0

SUMMARY

- Hindustan Zinc Ltd. (HZL) posted a 14% YoY increase in net sales to Rs 20 bn in Q4FY07. However, net sales were lower on a QoQ basis by 19% largely due to easing of Zinc prices, which had attained record levels in Q3FY07.
- Total mined metal production of Zinc witnessed a marginal 3% YoY (5% QoQ) decline at ~121k mt.
- However, refined Zinc metal production at 95k mt witnessed a slight increase on both YoY & QoQ basis. Its recently commissioned 170k mt hydrometallurgical smelter at Chanderiya, Rajasthan has now fully stabilised and is operating at full capacity. The 50k tpa *ausmelt* Lead smelter commissioned in Q4FY06 has also stabilised and is producing ~14k mt every quarter.
- Capitalising on global shortage in zinc concentrate supplies, HZL sold ~70k mt of concentrate in Q4FY07 (254k in FY07) equivalent to ~40k of Zinc metal.
- Global Zinc prices after testing record highs in Nov-Dec'06, eased a bit and averaged ~ \$3,300/mt during Q4FY07. Thus, HZL, which witnessed supernormal margins in Q2/Q3FY07, reported a 170 bps YoY and 670 bps QoQ decline in OPM to 69.3%. While higher sales volumes ensured an 11% YoY increase in operating profits to Rs 14 bn, the same was lower by 26% on a QoQ basis.
- Higher depreciation (+18%) was offset by a doubling of other income and decline in interest charges (-33%). This ensured a 17% increase in net profits to Rs 9.4 bn.
- *HZL's results for the quarter were marginally below our expectations as the fall in zinc prices resulted in impairment of margins. However, despite the slide, margins are still at high levels. This, coupled with a continuous ramp up in volumes should enable it to effectively capitalise on the sustained global upsurge in Zinc & Lead prices. Thus, its earning visibility is high and so is the scalability. Hence, we maintain our 'BUY' recommendation with a price target of Rs 900 over a 12 month horizon.*

May 22, 2007

Sensex : 14453

Nifty : 4278

CMP : Rs 825

Recomm : BUY

HZL's performance in Q4FY07 was marginally below our expectation as it witnessed a significant QoQ decline in realisations. Consequently, net sales at Rs 20 bn declined 19% QoQ, but rose by ~14% YoY.

While LME prices have been on a gradual uptrend since Jul'05 (from \$1.2k/mt levels), a sharp correction in non-ferrous metals led to Zinc easing below \$3k/mt by mid-Jun'06. However, they recovered swiftly to post an all-time high of \$4.6k/mt in early Dec'06. In CY07 till date, Zinc prices have been volatile and have been ruling at ~\$3.2k/mt for most of Q1CY07.

This sharp decline in zinc prices impacted realisations & profits of HZL hard and thus, it reported net profits of Rs 9.5 bn for Q4FY07, a QoQ decline of 30%.

HZL's mined metal production of Zinc at 121k mt in Q4FY07, also saw a 3% YoY and 5% QoQ fall. However, the enhanced capacity at the Rampura Agucha mine is operating at near optimum mining and treatment capacity of 3.5 mn mt, (with a yield of ~13% and recovery rate of ~90%).

The new Zinc smelter at Chanderiya (along with the 154 MW power plant) set up at an outlay of ~\$270 mn, is now fully operational and is running at its rated monthly capacity of 14k mt. This ensured a 2% increase in refined metal production both on QoQ and YoY basis.

Since HZL has mining capacity in excess of its smelting capacity, it has been selling Zinc concentrate in the market to capitalise on global shortage in Zinc concentrate. Thus, it was able to sell ~70k mt Zinc concentrate in Q4FY07 and 254k mt in FY07 (with ~52% Zinc content).

Lead production during the quarter did not see much change as stabilisation of recently commissioned 50k tpa *ausmelt* Lead smelter will still take ~2-3 quarters.

Expansion plans update:

HZL's Zinc production capacity currently stands at 400k tpa spread across four smelters-three in Rajasthan (Chanderiya-100k tpa & 170k tpa and Debari-77k tpa) and one in A.P. (Vizag - 53k tpa).

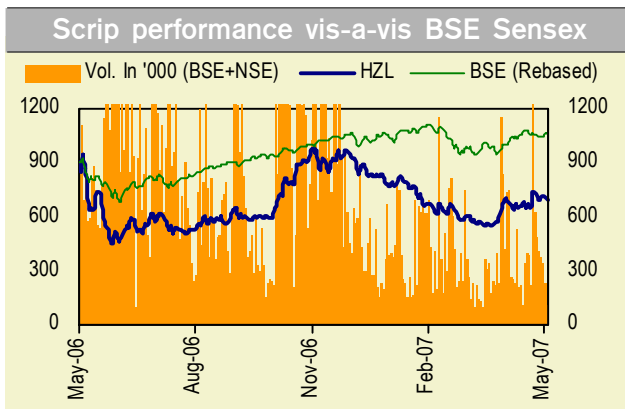
It spent ~\$45 mn in FY06 to expand its Agucha mines at Rampura to 3.75 mn tpa, which now accounts for >80% of it's concentrate production. The mine ranks among top 5 mines globally and is known for its low cost/high grade ore. Apart from these, it has mines at Jhawar (0.6 mn mt) & Rajpura Dariba (1 mn mt), taking its total Zinc-Lead ore mining capacity to 5.35 mn mt. This capacity exceeds the company's current smelter requirements, as the mining expansions have been planned to cater to future smelter needs.

Work on the new Zinc smelter (170k mt) and power plant (77 MW) is in full swing and should go on stream in early CY08, enhancing its Zinc capacity to 570k mt.

HZL also announced de-bottlenecking of Chanderiya and Debari Zinc smelters in Q3FY07 which, upon completion would increase its total Zinc smelting capacity by ~88k mt. It also announced setting up of an 80 MW thermal power plant at Jhawar. These projects are expected to be commissioned in early CY08, at an estimated outlay of ~\$175 mn.

HZL also announced its plan to set up two wind energy farms in Gujarat and Karnataka (total capacity-75 MW), at an outlay of ~\$90 mn.

The current expansions (production as well as mining) coupled with captive power plant are expected to reduce its overall production cost (mainly power and mining cost) by almost \$110-140/mt over the coming year from current levels of ~\$690/mt. However, the same would be negated to a large extent by spurt in royalty on ore (~6.6% of LME) as LME prices have more than doubled in CY06.



World's Top 10 mines			
Mine	Metal Prod. (Kt)	Contained zinc (Mt)	Reserve/Resource Life (Years)
Red Dog	565	19.7	38
McArthur River	160	15.5	87
Mount Isa	245	14.0	51
Century	509	9.4	17
Rampura-Agucha	377	6.4	15
Antamina	180	4.9	19
Tara	232	2.8	11
Skorpion	171	2.1	11
Brunswick	265	1.9	7
Lisheen	178	1.6	8

Source: Teck Cominco Presentation

Demand Supply dynamics:

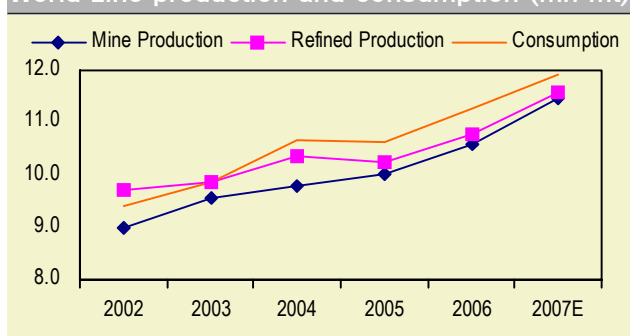
Globally, Zinc consumption has grown at a rapid pace over the last two decades. In CY06, global zinc consumption, fuelled by double-digit growth from China, India & other emerging markets, has grown 6.6% to 11.3 mn mt. Asia alone accounted for ~52% of global Zinc consumption followed by Europe (25%) and America (18%). The consumption is expected to grow at similar pace in CY07 as well.

This led to a huge rally in Zinc prices and which were ~\$2,000/mt at the beginning of CY06, touched an all time high of ~\$4,600/mt in early Dec'06. However, they eased a bit after that. Zinc prices at LME averaged ~\$3,200/mt for Q4FY07 and are currently hovering ~\$3,700/mt.

Demand Drivers:

Globally, Zinc finds maximum usage in galvanising and recent growth in steel & galvanising sectors is a key driver for such upsurge in Zinc demand.

World zinc production and consumption (mn mt)

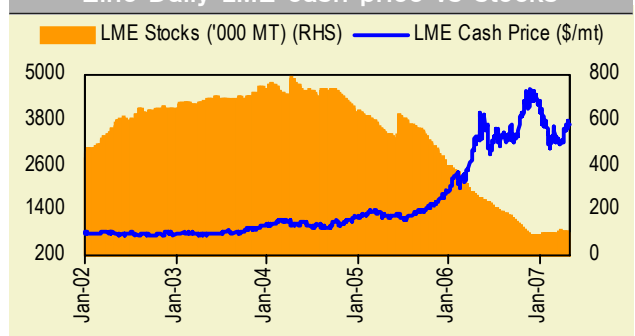


Source: Teck Cominco Presentation

Zinc production saw a 4.9% growth in CY06 with production of ~10.6 mn mt. Out of this Asia contributed ~40% of total world production whereas America contributed ~32% and Oceania & European region contributing ~12% each. China alone contributed ~50% of total Zinc production in Asia.

However, production growth was lower than consumption, thereby expanding the existing demand supply gap for the commodity. Of the global deficit of ~700k mt, Asia accounted for ~200k mt.

Zinc-Daily LME cash price vs stocks



Source: Teck Cominco Presentation

Out of the total zinc production globally, ~47% is consumed by galvanising industry alone. Other major consumers being brass & bronze industry & chemical Industry with share of ~19% & 9% respectively. Zinc alloys also consume ~14% of world production.

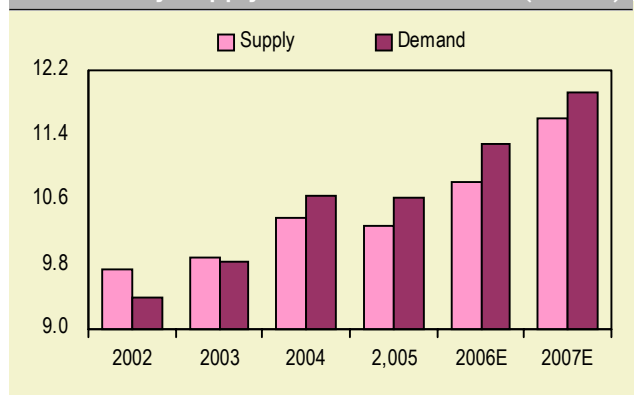
The domestic Zinc demand (pegged at 0.4 mn mt) is growing at a faster rate of 9-10% pa, on back of strong demand from galvanizing, die casting, dry cell batteries and chemical segments.

Zinc- Global concentrate and refined balance

'000 tonnes	2002	2003	2004	2005E	2006E	2007F
Global Concentrate Bal.						
Mine Supply	8,888	9,516	9,729	10,084	10,592	11,606
Concs treated	9,550	9,649	10,176	10,072	10,589	11,606
Surplus/(Deficit)	(662)	(133)	(447)	12	3	0
Global Refined Bal.						
Refined production	9,710	9,874	10,353	10,229	10,726	11,741
DLA Disposals	3	7	32	29	37	6
Total Supply	9,713	9,881	10,385	10,258	10,763	11,747
YoY Gr %	-	1.7	5.1	(1.2)	4.9	9.1
Refined consumption	9,377	9,843	10,646	10,624	11,240	11,836
YoY Gr %	5.2	5.0	8.2	(0.2)	5.8	5.3
Surplus/(Deficit)	336	38	(261)	(366)	(477)	(89)

Source: Teck Cominco Presentation

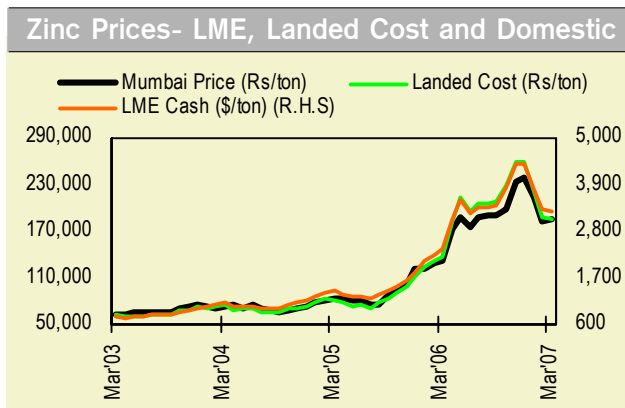
Zinc- Yearly supply & demand scanario(mn mt)



Source: Teck Cominco Presentation

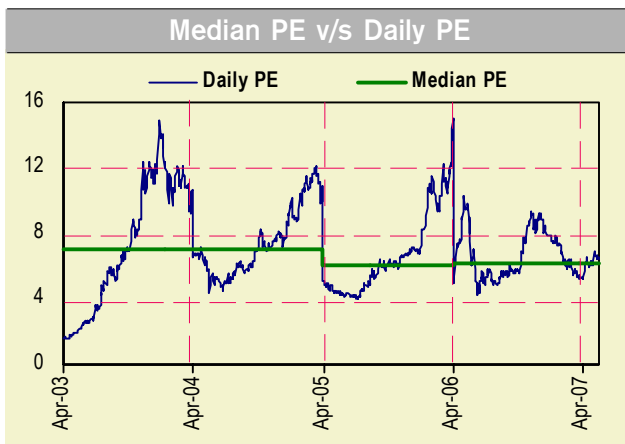
HZL's results were marginally below our expectations as the company reported a significant QoQ decline in net sales to Rs 20 bn because Zinc prices eased off to ~\$3,200/mt levels from more than \$4,000/mt levels for most of Q3FY07.

The company saw a stagnant quarter where on the one hand Zinc prices at LME declined and on the other, production volumes did not see any major improvement as recently commissioned smelter at Chanderiya reach its optimum capacity in previous quarter itself.



Source: Cris Infac

Still, HZL continues to be the biggest beneficiary in the current scenario (tight concentrate market, declining treatment charges, strong demand and buoyant LME prices) vis-a-vis custom smelters. Its captive mines offer a tremendous control over its input costs, enabling it to fully capitalize on the surging LME. Custom smelters tend to be rendered unviable in such a scenario, as it adversely impacts their margins, despite rising LME prices.



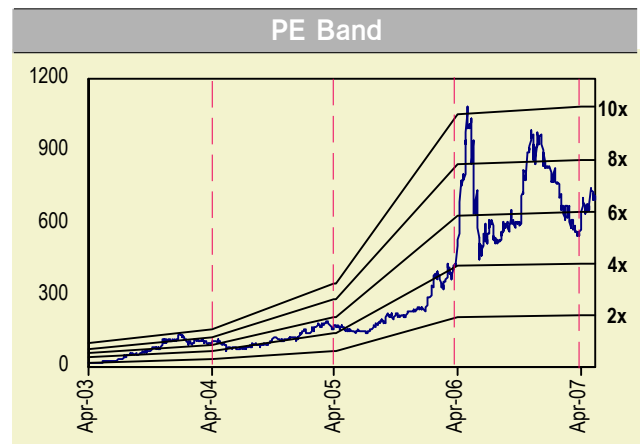
Also, the company continue to reap profits from sale of zinc concentrate as its mining capacity is more than its smelting capacity. It sold ~70k mt of Zinc concentrate in Q4FY07 and ~253k mt in FY07.

HZL's management has a vision to reach a Zinc (current capacity of 400k mt) and Lead (85k mt) capacity of ~0.9-1 mn mt by FY10. With announced expansions, HZL is expected to increase its Zinc production capacity to 570k mt. This would be further enhanced to 658k through de-bottlenecking at Chanderiya and Debari by Q4FY08. It is also planning to de-bottleneck its Lead capacity by 25k mt thereby taking its total Lead capacity to 110k mt.

We believe that HZL could announce a new Zinc smelter project of 200k mt and/or consider inorganic growth in order to achieve its 1 mn mt vision. Its huge cash reserves (estimated >\$1 bn) should effectively facilitate the same.

We have significantly revised our FY08 estimates following recent changes in macro environment and dip in Zinc prices to ~\$3,200/mt, but would defer the same for FY08 earnings until clarity emerges. We now expect revenues of Rs 86 bn and net profits of Rs 45 bn in FY08, translating into an EPS of 108, assuming Zinc volumes of 0.34 mn mt, concentrate volumes of 0.22 mn mt & average Zinc realisation of \$3,600/mt in FY08. As per our sensitivity analysis, every \$100 change in LME prices impacts HZL's EPS by ~5%.

At the CMP of Rs 694, HZL is trading at a P/E of 5.5x and EV/EBIDT of 2x, discounting its FY09 estimates. Considering its integrated operations, scalability potential, strong balance sheet and recent upsurge in Zinc prices, we maintain our 'BUY' recommendation. Following the revision in profits, we have now set a target price of Rs 900 on a 12-month investment perspective.



Financial Results for the quarter & year ended Mar'31, 2007 (Standalone)

Particulars (Rs Mn)	Quarter Ended			Year Ended		
	31/03/07	31/03/06	% chg.	31/03/07	31/03/06	% chg.
Net Sales	20,210	17,740	13.9	85,520	38,770	120.6
Total Expenditure	6,210	5,150	20.6	21,450	15,760	36.1
(Inc)/Dec in stock	420	500		(570)	(430)	
Mining & manufacturing exp	2,710	2,450	6.1	10,320	9,740	4.7
Mining Royalty	1,510	1,000	51.0	6,440	2,740	135.0
Staff Cost	690	520	32.7	2,600	2,060	26.2
Admin, selling & other exp	880	680	29.4	2,660	1,650	61.2
Operating Profit	14,000	12,590	11.2	64,070	23,010	178.4
Other Income	740	370	100.0	2,310	1,160	99.1
PBDIT	14,740	12,960	13.7	66,380	24,170	174.6
Interest	20	30	(33.3)	280	470	(40.4)
Depreciation & amortisation	450	380	18.4	1,560	1,410	10.6
PBT	14,270	12,550	13.7	64,540	22,290	189.5
Provision for tax	4,610	3,660	26.0	19,520	6,240	212.8
Provision for deferred tax	310	870	(64.4)	600	1,330	(54.9)
Net Profits	9,350	8,020	16.6	44,420	14,720	201.8
Equity Share Capital	4,230	4,230		4,230	4,230	
Reserves & Surplus (excl rev res)	-	-		-	-	
EPS for the period (Rs)	22.1	19.0	16.6	105.0	34.8	201.8
Book Value (Rs)	-	-		-	-	
OPM (%)	69.3	71.0	(1.7)	74.9	59.4	
NPM (%)	46.3	45.2		51.9	38.0	
Expenditure as % of Net Sales						
Mining & manufacturing exp (incl stock adj)	15.5	16.6		11.4	24.0	
Mining Royalty	7.5	5.6		7.5	7.1	
Staff Cost	3.4	2.9		3.0	5.3	
Admin, selling & other exp	4.4	3.8		3.1	4.3	
Production Volumes ('000 MT)						
Zinc Data ('000 mt)						
Mined Metal Production ('000 MT)	121	125	(2.9)	505	472	7.0
Refined Metal Production ('000 MT)	95	92	2.8	348	284	22.5
Zinc Sales volumes ('000 MT) (incl. tolling)	95	92	2.8	350	289	21.1
Concentrates Sales ('000 MT)	70	NA	85.5	254	NA	-
LME prices (\$/mt)	3,280	2,237	46.6	3,581	1,614	121.9

Year Ended March (Figures in Rs Mn)

Income Statement	2006	2007	2008E	2009E	Cash Flow Statement	2006	2007E	2008E	2009E
Revenues	38,770	85,520	86,077	98,295	PBT & Extraord. items	22,314	64,540	67,298	79,159
Total Expenditure	15,760	21,450	23,832	27,941	Depreciation	1,381	1,560	1,700	2,497
Operating Profit	23,010	64,070	62,245	70,354	Interest & dividend inc.	(1,158)	(2,310)	(7,038)	(11,564)
Interest & dividend income	1,158	2,310	7,038	11,564	Interest paid	474	280	285	261
EBIDT	24,169	66,380	69,283	81,917	Tax paid	(6,238)	(19,520)	(19,785)	(24,222)
(-) Interest	474	280	285	261	(Inc/Dec in working capital)	(4,291)	(996)	2,103	1,312
(-) Depreciation	1,381	1,560	1,700	2,497	Cash from operations	12,481	43,554	44,562	47,443
PBT & extraordinary items	22,314	64,540	67,298	79,159	Net capital expenditure	(1,927)	(11,422)	(7,288)	(2,000)
(-) Tax provision	7,571	20,120	21,585	26,222	Net investments	(9,170)	(25,086)	(31,211)	(43,450)
Net Profits	14,743	44,420	45,713	52,937	Interest recd	1,158	2,310	7,038	11,564
Fully diluted Eq. sh. O/s (mn no)	422.5	423.0	423.0	423.0	Cash from inv. activities	(9,939)	(34,198)	(31,461)	(33,886)
Book Value (Rs)	81	180	277	391	Issue of eq. shares	-	5	-	-
Basic EPS (Rs)	34.9	105.0	108.1	125.1	Change in debt	(133)	(2,078)	(500)	(250)
Diluted EPS (Rs)	34.9	105.0	108.1	125.1	Dividend paid	(1,222)	(2,379)	(4,759)	(4,759)
					Interest paid	(474)	(280)	(285)	(261)
					Cash from fin. activities	(1,829)	(4,733)	(5,544)	(5,270)
					Inc/Dec. in cash	713	4,623	7,558	8,286
Balance Sheet	2006	2007E	2008E	2009E	Key Ratios	2006	2007E	2008E	2009E
<i>Equity Share Capital</i>	4,225	4,230	4,230	4,230	EBIDTA (%)	59.4	74.9	72.3	71.6
<i>Reserves & Surplus</i>	30,073	72,113	113,067	161,245	ROACE (%)	70.4	112.7	68.7	53.5
Net worth	34,298	76,343	117,297	165,475	ROANW (%)	53.5	80.3	47.2	37.4
Total Debt	5,580	3,502	3,002	2,752	Sales/Total Assets (x)	1.0	1.0	0.8	0.6
Deferred Tax liability	2,414	3,014	4,814	6,814	Debt:Equity (x)	0.2	-	-	-
Capital Employed	42,292	82,859	125,113	175,041	Current Ratio (x)	2.2	1.8	2.0	2.2
Fixed Assets	19,181	29,043	34,631	34,134	Debtors (days)	58.0	54.8	49.7	49.7
Net current assets	7,062	12,681	18,136	25,111	Inventory (days)	32.2	25.6	23.2	23.2
Investments	16,049	41,135	72,346	115,796	Net working capital (days)	59.4	54.1	69.9	84.7
Total Assets	42,292	82,859	125,113	175,041	EV/Sales (x)	7.3	3.0	2.5	1.6
					EV/EBIDT (x)	11.7	3.8	3.1	2.0
					P/E (x)	19.9	6.6	6.4	5.5
					P/BV (x)	8.5	3.8	2.5	1.8

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