

INITIATING COVERAGE

Hindustan Zinc Ltd

Hold

Share Data

Market Cap	Rs. 296.93 bn
Price	Rs. 702.75
BSE Sensex	14650.51
Reuters	HZNC.BO
Bloomberg	HZ IN
Avg. Volume (52 Week)	0.52 mn
52-Week High/Low	Rs. 1020.5/488.5
Shares Outstanding	422.53 mn

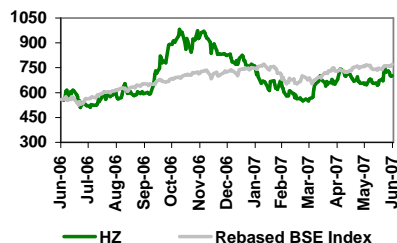
Valuation Ratios

Year to 31 March	2008E	2009E
EPS (Rs.)	105.0	109.0
+/- (%)	(0.1)%	3.9%
PER (x)	6.7x	6.4x
EV/ Sales (x)	2.9x	2.8x
EV/ EBITDA (x)	4.7x	4.5x

Shareholding Pattern (%)

Promoters	65
FII's	2
Institutions	31
Public & Others	3

Relative Performance



Riding the price wave

Hindustan Zinc Ltd (HZL) is India's leading zinc producer. As a vertically integrated miner and smelter it is perfectly positioned to profit from the current scenario of high zinc metal prices, coupled with low TC charges for the treatment of zinc concentrate. The company is investing in further capacity, with a new 170,000 TPA zinc smelter at Chanderiya and an 88,000 TPA de-bottlenecking project due early 2008. These projects will allow HZL to take further advantage of the current price scenario, though zinc prices have already begun to drop off from last year's highs as global supply starts to catch up with demand and the market gradually moves into surplus.

Key Figures

Year to March	FY05	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs mn, except per share data) (FY07-09E)						
Net Sales	22,020	38,900	85,600	86,456	89,914	2.5%
EBITDA	8,890	23,010	64,070	63,811	66,364	1.8%
Net Profit	6,610	14,720	44,419	44,361	46,072	1.8%
Margins(%)						
EBITDA	40.4%	57.4%	72.9%	71.9%	72.0%	
NPM	28.3%	36.7%	50.5%	50.0%	50.0%	
Per Share Data (Rs.)						
Normalised EPS	15.6	34.8	105.1	105.0	109.0	1.8%
PER (x)	44.9x	20.2x	6.7x	6.7x	6.4x	

- Net Sales growth for HZL will not repeat the pattern of FY07, when zinc prices doubled. We expect the average LME cash settlement price in FY08 to be \$3,182 per tonne versus the FY07 figure of \$3,581 per tonne, a fall of 11%, but volume expansion will allow marginal growth. Margins are expected to decline slightly as prices ease off.
- At the current price of Rs. 702.8, the stock is trading at a forward PE of 6.7x FY08E and 6.4x FY09E.
- Based on target EV/EBITDA multiple of 4.4x for FY08E, our 12 month price target of Rs. 774 represents an upside of 10.2% from current levels. We initiate coverage with a Hold.

Investment Rationale

High LME zinc price – tight concentrate scenario: HZL benefits as the only Indian integrated player

Integrated operations

World zinc prices have tripled since 2005, and HZL has profited strongly from this. Furthermore HZL's input costs are protected from the current scenario of a tight concentrate market and declining treatment charges as HZL supplies all its zinc concentrate requirements from its own mines. (The TC treatment rates act as a margin between the price of zinc concentrate and the final metal price after smelting, and in the current tight concentrate market the TC rates have fallen). HZL therefore profits far more from this high zinc price - tight concentrate market scenario than a custom smelter, who can only take the TC treatment margin.

Price levels still historically high versus start-2005, but declining

Zinc prices still strong, but weakening

Though LME prices are still far higher than their levels at the start of 2005, they are weakening as a position of global deficit turns to global surplus due to global supply ramping up to meet demand. The current spot LME zinc spot price is \$3,301 per tonne. This is already lower than the average settlement price for FY07 of \$3,581 per tonne, and is set to decline with the 15 months future price at \$3,063 per tonne. However these levels are much higher than the FY06 average settlement price of \$1,614.

Global Zinc Balance	CY05	CY06	CY07E	CY08E
(kt)				
Mine Supply	10,123	10,355	11,463	12,515
Concs treated by refineries	10,034	10,556	11,424	12,293
CONC. BALANCE	89	(201)	39	222
Refined Zinc Supply	10,258	10,764	11,611	12,429
Refined Zinc Demand	10,614	11,145	11,702	12,287
METAL BALANCE	(356)	(381)	(91)	142

Source: Teck Cominco Presentation

1 mn TPA zinc-lead metal by 2010

Volume expansions

HZL is making progress towards its aim of achieving 1 mn TPA of zinc-lead metal by 2010 with a variety of current projects.

The new 170,000 TPA Chanderiya zinc hydro smelter ramped up to full capacity at the end of FY07 and will be operating at this capacity during the whole of FY08, providing volume growth.

**Capacity expansion plans
ahead of schedule**

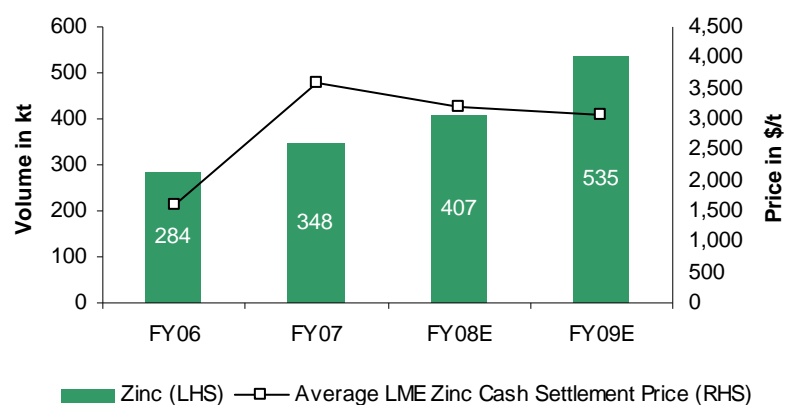
A second 170,000 TPA zinc hydro smelter is currently being built in Chanderiya along with a 77 MW captive power plant. An improvement to the Rampura Agucha concentrator to raise the milling capacity to 5.0 mn TPA is also underway. Progress on this project has been good and it is expected to be commissioned towards the end of 2007, 3 months ahead of the earlier declared schedule. The total cost of the project comes to \$300 mn. It will bring HZL's zinc ingots capacity up from the current 411,000 TPA to 581,000 TPA.

**Increasing existing
capacities by 88,000 TPA**

De-bottlenecking of existing smelters

HZL is also carrying out a de-bottlenecking project at the existing Chanderiya and Debari hydro smelters to increase overall capacity by 88,000 TPA. Together with the building of a new 80MW captive power plant at Zawar, the project comes to a total cost of \$170 mn. These initiatives are scheduled for completion in early 2008, taking HZL's rated zinc ingots capacity to 669,000 TPA and providing further volume led growth in FY09.

Production Summary



\$1 bn in cash reserves***Cash reserves may facilitate future growth***

HZL's cash reserves of \$1 bn would facilitate any future smelter projects and inorganic growth options to get the company to its 2010 target of 1 mn TPA of zinc and lead ingots.

Ausmelt lead smelting plant at full capacity by 2Q07***Lead smelting ramps up***

Although lead prices are set to decline over the coming year, HZL's lead operations will show growth, as the 50,000 TPA Ausmelt smelting plant is expected to reach its rated capacity by the end of 2Q07.

Zinc demand led by the steel galvanising sector***Strong domestic demand***

India's demand for zinc is driven by demand from the steel galvanising market which is growing due to strong demand from the automotive and automotive parts industries. Consumption of refined zinc has accordingly grown at a CAGR of 9% CY03 – CY06, with the galvanising sector accounting for approximately 70% of total consumption. As India's economy continues to boom, and further expansions in construction and infrastructure are pursued, zinc demand will continue to increase.

Majority shareholders look to increase stake***Sterlite's call option***

Sterlite Industries (India) Ltd (Sterlite) currently owns 64.9% of the company's shares, and has a call option to acquire a further 29.5% stake from the Government of India. Sterlite's management has stated that it intends to exercise this option, which became exercisable after April 11, 2007. This is a positive indication and shows the management's confidence in the future growth prospects of the company.

Key Risks***Sensitive to volatility in zinc prices******Volatility in LME zinc prices***

HZL's financial performance is sensitive to LME zinc prices. Lower than estimated prices, in the event of a demand shortfall or oversupply would adversely impact the company's earnings.

Claims of Rs. 3.1 bn by the Rajasthan Department of Mines and Geology

Demands against HZL by Department of Mines and Geology

The Department of Mines and Geology of the State of Rajasthan has issued several show cause notices alleging unlawful occupation and unauthorised mining of minerals other than lead and zinc at HZL's mines in Rajasthan. The claim totals \$76.6 mn (Rs. 3.1 bn). Should this claim become an obligation earnings would be somewhat affected.

Delay in expansion projects

Any unexpected delays in the ongoing expansion projects would reduce the company's forecast earnings as its production output would be lower than currently forecast.

Outlook

Current zinc prices have turned HZL into a strong earnings generating company. Upcoming projects are on schedule to take further advantage of the current price scenario. HZL's, as the only integrated zinc player in India has a strong advantage in servicing local demand. Its strong balance sheet enables it to continue to scale.

Zinc prices to decline gradually

We expect Zinc prices to continue to ease as they have done in recent weeks. This will partially counteract the volume expansions HZL is undertaking, and hurt margins somewhat, despite the cost control measures that HZL is pursuing.

Global balances of zinc concentrate and metal will gradually move into surplus in the next few years, but Asia remains the key driver of global demand, and HZL is in a position to leverage its geographical presence.

Target price represents an upside of 10.2% over the current price – LME price volatile

Capacity expansions are expected to more than compensate for price falls, and lead HZL to a CAGR in net revenues of 2.5% FY07-09E. Net profit is expected to grow at a CAGR of 1.8% over the same period.

Our valuation derives from applying a target EV/EBITDA ratio of 4.4x to our FY08E forecast EBITDA of Rs. 63.8 bn to arrive at target price of Rs. 774. This represents an upside of 10.2% over the current price.

With the current volatility of the LME zinc price we initiate coverage with a Hold rating.

Company Background

India's leading zinc producer

Hindustan Zinc Ltd (HZL) is India's leading zinc producer. It is a vertically integrated zinc and lead mining and smelting company.

A subsidiary of Sterlite

The company is a consolidated subsidiary of Sterlite Industries (India) Ltd (Sterlite). Sterlite currently owns 64.9% of the company's shares, and has a call option to acquire a further 29.5% stake from the Government of India. Sterlite in turn is a part of the Anil Agarwal controlled Vedanta Resources group.

HZL has an installed capacity of 411,000 TPA of zinc ingots, spread over its smelters in Chanderiya (275,000 TPA), Debari (80,000 TPA) and Vizag (56,000 TPA). The company's capacity of lead ingots is 85,000 TPA, all at the Chanderiya location. Additionally the company has a capacity of 687,196 TPA of sulphuric acid and 74 TPA of silver ingots.

HZL operates 3 mines: The Rampura Agucha open cut mine, the Rajpura Dariba underground mine and the Zawar underground mine. Taken together these provide lead-zinc reserves of 68.6 mn tonnes with an average grade of 11.2% zinc and 2% lead.

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