

July 20, 2012

Hindustan Zinc

Performance Highlights

Particulars (₹ cr)	1QFY13	1QFY12	% chg (yoy)	4QFY12	% chg (qoq)
Net sales	2,713	2,821	(3.9)	3,094	(12.3)
EBITDA	1,429	1,592	(10.3)	1,402	1.9
EBITDA margin (%)	52.7	56.4	(378)bp	45.3	733bp
Adjusted PAT	1,581	1,499	5.5	1,280	23.5

Source: Company, Angel Research

Hindustan Zinc's (HZL) 1QFY2013 bottom-line was ahead of our expectations due to higher-than-expected other income and lower-than-expected tax rate. **We maintain our Buy rating on the stock given the current inexpensive valuations.**

Top line decreases by 3.9% yoy: For 1QFY2013, HZL's net sales decreased by 3.9% yoy to ₹2,713cr (below our estimate of ₹2,939cr) mainly on account of a decline in realizations of zinc and lead and also due to lower zinc volumes.

Lower realizations and higher costs dent EBITDA margin: Cost of production of zinc increased by 17.0% yoy to ₹45,759/tonne during the quarter. Hence, HZL's EBITDA margin contracted by 378bp yoy to 52.7% and EBITDA decreased by 10.3% yoy to ₹1,429cr. Other income grew by 61.6% yoy to ₹574cr while tax rate was lower at 13.0% in 1QFY2013 (17.1% in 1QFY2012). Hence, adjusted net profit was higher than our estimate of ₹1,377cr (grew by 5.5% yoy to ₹1,581cr).

Expansion projects remain on track: HZL's underground mine development work at Rampura Agucha mine and greenfield Kayar mine development are on schedule. The commercial production is expected from FY2014.

Outlook and valuation: With cash-rich balance sheet and rising production of zinc, lead and silver over FY2012-14, HZL remains our top pick in the non-ferrous space. Although realizations are expected to decline, increased volumes of lead and silver are expected to drive earnings growth of 15.0% in FY2013. HZL is currently trading at inexpensive valuations of 3.9x and 2.8x FY2013 and FY2014 EV/EBITDA, respectively. Valuing the stock at 4.0x FY2014 EV/EBITDA, **we maintain our Buy rating on HZL with a target price of ₹142.**

Key financials (Standalone)

Y/E March (₹ cr)	FY2011	FY2012E	FY2013E	FY2014E
Total operating income	10,039	11,405	12,446	13,538
% chg	25.2	13.6	9.1	8.8
Net profit	4,922	5,569	6,405	6,969
% chg	21.8	13.2	15.0	8.8
EPS (₹)	11.6	13.1	15.2	16.5
EBITDA margin (%)	55.9	53.2	56.1	56.6
P/E (x)	10.3	9.2	7.9	7.3
P/BV (x)	2.2	1.9	1.6	1.3
RoE (%)	24.1	22.4	21.6	19.7
RoCE (%)	24.2	21.2	20.9	19.4
EV/Sales (x)	3.6	2.9	2.2	1.6
EV/EBITDA (x)	6.4	5.4	3.9	2.8

Source: Company, Angel Research

BUY

CMP	₹120
Target Price	₹142

Investment Period	12 months
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Stock Info

Sector	Base Metals
Market Cap (₹ cr)	50,640
Net debt (₹ cr)	(19,400)
Beta	1.1
52 Week High / Low	150/107
Avg. Daily Volume	104,522
Face Value (₹)	2
BSE Sensex	17,158
Nifty	5,205
Reuters Code	HZNC.BO
Bloomberg Code	HZ@IN

Shareholding Pattern (%)

Promoters	64.9
MF / Banks / Indian Fls	1.9
FII / NRIs / OCBs	1.4
Indian Public / Others	31.8

Abs. (%)	3m	1yr	3yr
Sensex	(2.0)	(6.9)	13.9
HZ	(4.9)	(13.3)	79.5

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Exhibit 1: 1QFY1013 Performance (standalone)

(₹ cr)	1QFY13	1QFY12	yoy %	4QFY12	qoq %	FY12	FY11	yoy %
Net sales	2,713	2,821	(3.9)	3,094	(12.3)	11,255	9,912	13.5
Mining and manufacturing expenses	863	854	1.1	973	(11.4)	3,543	2,759	28.4
% of Net sales	31.8	30.3		31.5		31.5	27.8	
Mining royalty	204	194	5.6	201	1.9	838	803	4.3
% of Net sales	7.5	6.9		6.5		7.4	8.1	
Staff cost	149	127	17.1	134	11.6	535	511	4.7
% of Net sales	5.5	4.5		4.3		4.8	5.2	
Admin, selling and others	966	934	3.4	1,045	(7.5)	421	358	17.4
% of Net sales	35.6	33.1		33.8		3.7	3.6	
Total expenditure	1,319	1,255	5.1	1,385	(4.7)	5,336	4,432	20.4
% of Net sales	48.6	44.5		44.8		47.4	44.7	
Other operating income	35.0	25.7	36.2	40.0	(12.5)	150	127	18.2
EBIDTA	1,429	1,592	(10.3)	1,402	1.9	6,070	5,608	8.2
% of Net sales	52.7	56.4		45.3		53.9	56.6	
Interest	13	6		9	47.9	14	18	
Depreciation	173	135	28.9	159	9.0	611	475	28.6
Other income	574	355	61.6	382	50.4	1,543	866	78.1
Exceptional items	-	4		6		43	21	
Profit before tax	1,817	1,802	0.8	1,610	12.8	6,945	5,960	16.5
% of Net sales	67.0	63.9		52.0		61.7	60.1	
Provision for tax	235	307	(23.4)	336	(30.1)	1,419	1,059	33.9
% of PBT	13.0	17.1		20.9		20.4	17.8	
Profit after tax	1,581	1,495	5.8	1,274	24.2	5,526	4,901	12.8
% of Net sales	58.3	53.0		41.2		49.1	49.4	
Adjusted net profit	1,581	1,499	5.5	1,280	23.5	5,569	4,922	13.2

Source: Company, Angel Research

Exhibit 2: Actual vs. Estimates

(₹ cr)	Actual	Estimates	Variation (%)
Net Sales	2,713	2,939	(7.7)
EBITDA	1,429	1,499	(4.7)
EBITDA margins (%)	52.7	51.0	166bp
Adjusted PAT	1,581	1,377	14.8

Source: Company, Angel Research

Top-line declines 3.9% yoy

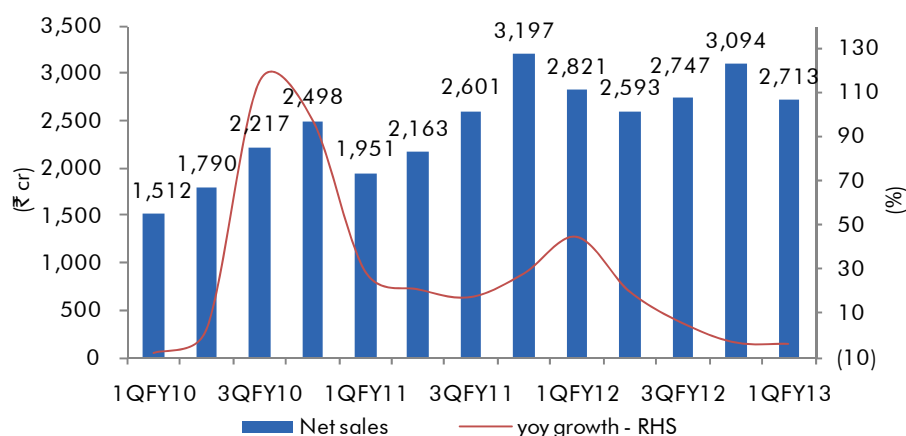
For 1QFY2013, HZL's net sales decreased by 3.9% yoy to ₹2,713cr (below our estimate of ₹2,939cr) mainly on account of a decline in realizations of zinc and lead and also due to lower zinc volumes partially offset by higher lead and silver volumes. Average LME spot zinc prices decreased by 14.3% yoy to US\$1,928/tonne during 1QFY2013. Zinc production volumes declined 16.0% yoy to 161kt due to lower production from Rampura Agucha mines (in line with company's guidance). Nevertheless, lead production volumes grew by 91.0% yoy to 31kt and silver production volumes grew 75.0% yoy to 82kt due to higher production from Sindesur Khurd mine and stabilization of new lead and silver capacities.

Exhibit 3: LME zinc price trend



Source: Bloomberg, Angel Research

Exhibit 4: Net sales decreased by 3.9% yoy

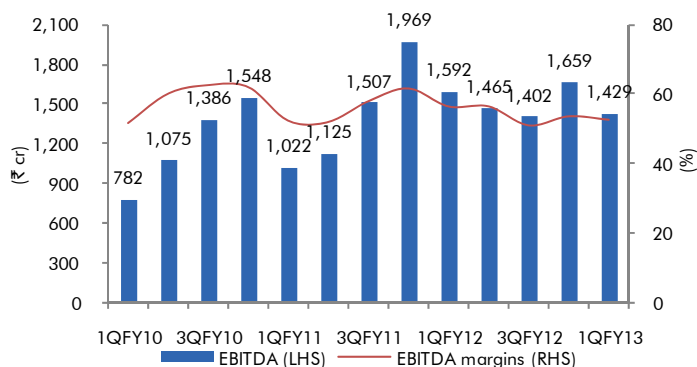


Source: Company, Angel Research

EBITDA margin contracts by 378bp yoy

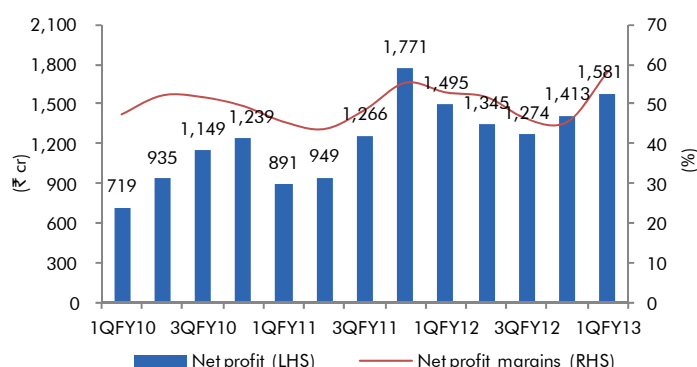
Cost of production of zinc increased by 17.0% yoy to ₹45,759/tonne during the quarter. Hence, HZL's EBITDA margin contracted by 378bp yoy to 52.7% and EBITDA decreased by 10.3% yoy to ₹1,429cr. Other income grew by 61.6% yoy to ₹574cr while tax rate was lower at 13.0% in 1QFY2013 (17.1% in 1QFY2012). Hence, adjusted net profit was higher than our estimate of ₹1,377cr (grew by 5.5% yoy to ₹1,581cr).

Exhibit 5: EBITDA and EBITDA margin trend



Source: Company, Angel Research

Exhibit 6: Net profit and net profit margin trend



Source: Company, Angel Research

Expansion projects

HZL's underground mine development work at Rampura Agucha mine and greenfield Kayar mine development are on schedule with commercial production expected from FY2014. Given the cash-rich balance sheet, HZL is actively exploring greenfield projects through 20 prospecting licenses and four mining lease projects across different states.

Investment arguments

Mining in Kayar could be the next phase of growth

Since the expansion at Sindesar Khurd is complete, HZL has commenced work at its underground Kayar mine, which has 11mn tonnes of high-grade reserves (10-12% zinc content). The company aims to mine 1mn tonnes per year, once it is fully operational. Moreover, given the cash-rich balance sheet, HZL is actively exploring greenfield projects through 20 prospecting licenses and four mining lease projects across different states.

Current zinc prices near marginal cost of production

At current levels of ~US\$1,800/tonne, zinc prices stand near the marginal cost of production for several zinc producers. Hence, we believe probability of a further decline in zinc prices from these levels remains low. Further, over the next 3-5 years, several zinc mines are expected to be exhausted; hence, production is likely to suffer. This should support zinc prices over the medium term in our view.

Outlook and Valuation

With cash-rich balance sheet and rising production of zinc, lead and silver over FY2012-14, HZL remains our top pick in the non-ferrous space. Although realizations are expected to decline, increased volumes of lead and silver are expected to drive earnings growth of 15.0% in FY2013. Moreover, the company is awaiting permission to commence production at its Zawar mines (reserves – 72mn tonnes) from the government. This could be a key catalyst for the stock, although it has not been factored in our estimates currently.

HZL is currently trading at inexpensive valuations of 3.9x and 2.8x FY2013 and FY2014 EV/EBITDA, respectively. Valuing the stock at 4.0x FY2014 EV/EBITDA, we maintain our Buy rating on the stock with a target price of ₹142.

Exhibit 7: Key assumptions

LME prices (US\$/tonne)	FY2013E	FY2014E
Zinc	2,015	2,100
Lead	2,076	2,176
Silver (₹/kg)	48,929	43,647
Sales volume (tonnes)		
Zinc metal	720,780	764,730
Lead metal	129,500	138,750
Silver	340,000	380,000

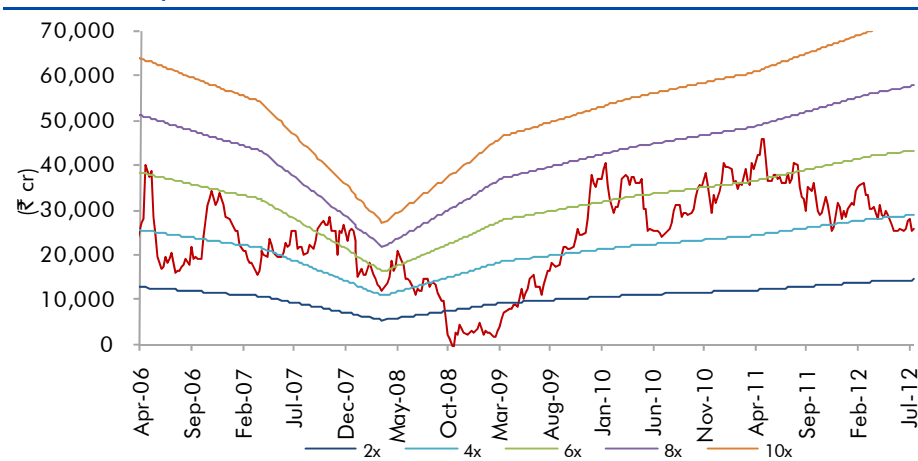
Source: Angel Research

Exhibit 8: EPS – Angel forecast vs. consensus

Year (%)	Angel forecast	Bloomberg consensus	Variation (%)
FY2013E	15.2	14.3	6.0
FY2014E	16.5	15.2	8.5

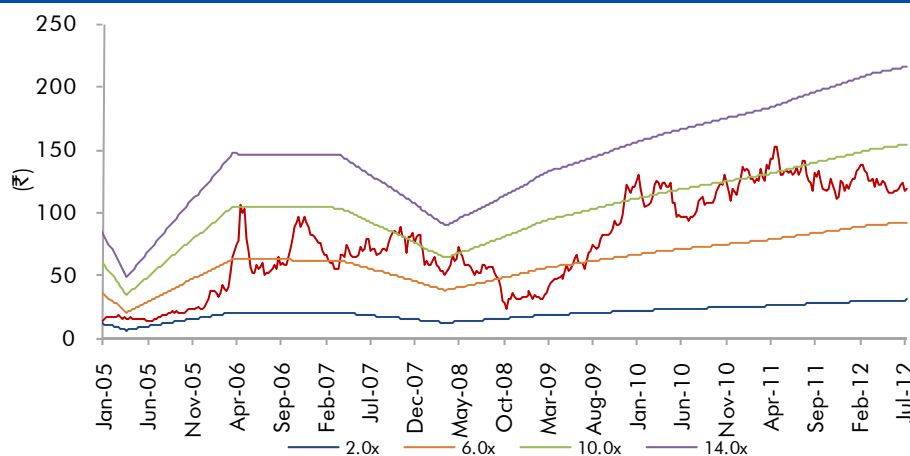
Source: Bloomberg, Angel Research

Exhibit 9: EV/EBITDA band



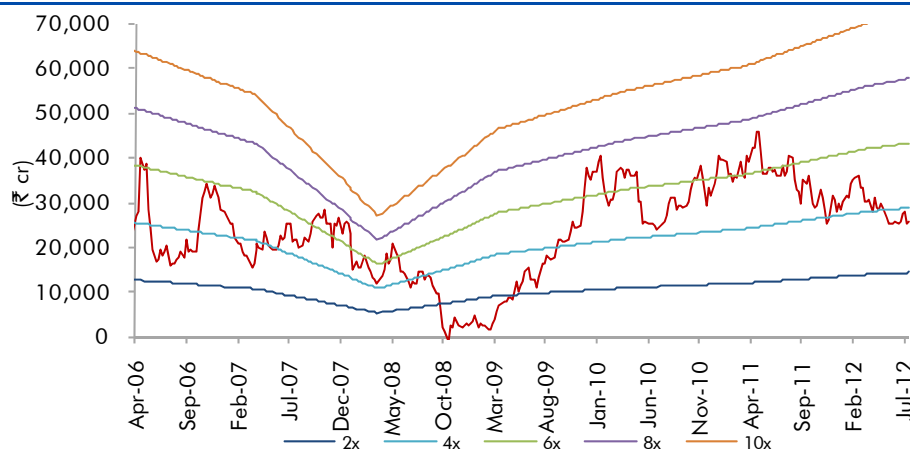
Source: Bloomberg, Angel Research

Exhibit 10: P/E band



Source: Bloomberg, Angel Research

Exhibit 11: P/BV band



Source: Bloomberg, Angel Research

Exhibit 12: Recommendation summary

Company	CMP (₹)	Target Price (₹)	Reco.	Mcap (₹ cr)	Upside (%)	P/E (x)		P/BV (x)		EV/EBITDA (x)		RoE (%)		RoCE (%)	
						FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Hindalco	122	-	Neutral	23,829	-	8.9	6.8	0.7	0.6	5.9	5.3	7.9	9.6	6.6	7.4
Nalco	56	-	Neutral	14,200	(4)	21.9	15.6	1.2	1.1	9.9	7.4	5.5	7.5	3.1	5.7
Sterlite	105	123	Buy	34,183	17	5.9	5.7	0.7	0.6	2.9	2.7	12.3	11.4	12.1	11.0
HZL	120	142	Buy	50,640	18	7.9	7.3	1.6	1.3	3.9	2.8	21.6	19.7	20.9	19.4

Source: Company, Angel Research

Company background

Incorporated in 1966, HZL, a subsidiary of Sterlite Industries, is a vertically integrated company with its mining and smelting operations located mainly in Rajasthan and Andhra Pradesh. HZL's current zinc reserves stand at 34.1mn tonnes with a production capacity of 1.1mn tonnes of zinc p.a., indicating a mine life of 31 years. HZL currently operates two underground mines, namely Sindesar Khurd and Rajpura Dariba, and one open cast mine, Rampura Agucha Mine.

Profit & loss statement(Standalone)

Y/E March (₹ cr)	FY2009	FY2010	FY2011	FY2012	FY2013E	FY2014E
Net sales	5,680	8,017	10,039	11,405	12,446	13,538
Other operating income	-	122	-	-	140	154
Total operating income	5,680	8,139	10,039	11,405	12,586	13,692
% chg	(27.9)	43.3	23.3	13.6	10.4	8.8
Total expenditure	2,946	3,347	4,431	5,336	5,470	5,875
Net raw materials	1,906	1,961	14	312	249	257
Other Mfg. costs	364	613	803	838	902	1,001
Personnel	365	457	511	535	610	650
Other	311	316	3,104	3,651	3,709	3,967
EBITDA	2,734	4,792	5,608	6,069	7,116	7,817
% chg	(49.2)	75.3	17.0	8.2	17.2	9.8
(% of Net sales)	48.1	58.3	55.9	53.2	56.1	56.6
Depreciation	285	334	475	611	709	758
EBIT	2,449	4,458	5,133	5,459	6,407	7,059
% chg	(52.5)	82.0	15.1	6.3	17.4	10.2
(% of Net sales)	43.1	55.6	51.1	47.9	51.5	52.1
Interest & other charges	22	44	18	14	31	14
Other income	931	600	866	1,543	1,630	1,665
(% of PBT)	27.7	12.0	14.5	22.1	20.4	19.1
Share in profit of associates	-	-	-	-	-	-
Recurring PBT	3,358	5,014	5,981	6,988	8,006	8,711
% chg	(43.9)	49.3	19.3	16.8	14.6	8.8
Extraordinary inc/(expense)	-	-	21	43	-	-
PBT (reported)	3,358	5,014	5,960	6,945	8,006	8,711
Tax	631	973	1,059	1,419	1,601	1,742
(% of PBT)	18.8	19.4	17.8	20.4	20.0	20.0
PAT (reported)	2,728	4,041	4,900	5,526	6,405	6,969
ADJ. PAT	2,728	4,041	4,922	5,569	6,405	6,969
% chg	(38.0)	48.2	21.8	13.2	15.0	8.8
(% of Net Sales)	48.0	49.7	49.0	48.8	50.9	50.9
Basic EPS (₹)	6.5	9.6	11.6	13.1	15.2	16.5
Fully Diluted EPS (₹)	6.5	9.6	11.6	13.1	15.2	16.5
% chg	(38.0)	48.2	21.3	12.8	15.9	8.8

Note: Some of the figures from FY2011 onwards are reclassified; hence not comparable with previous year numbers

Balance sheet(Standalone)

Y/E March (₹ cr)	FY2009	FY2010	FY2011	FY2012	FY2013E	FY2014E
SOURCES OF FUNDS						
Equity Share Capital	423	423	845	845	845	845
Reserves& Surplus	13,935	17,701	21,688	26,036	31,453	37,432
Shareholders Funds	14,358	18,124	22,533	26,881	32,298	38,278
Total Loans	9	60	0.4	0.4	0.4	0.4
Deferred Tax Liability	559	711	945	1,109	1,109	1,109
Other long term liabilities	-	-	24	17	17	17
Total Liabilities	14,925	18,896	23,502	28,008	33,424	39,404
APPLICATION OF FUNDS						
Gross Block	5,856	8,241	9,879	11,658	13,858	14,858
Less: Acc. Depreciation	1,751	2,077	2,624	3,145	3,855	4,613
Net Block	4,105	6,164	7,254	8,513	10,003	10,245
Capital Work-in-Progress	1,108	1,113	595	445	145	95
Investments	6,929	10,949	9,335	12,695	12,695	12,695
Long term loans and advances	-	-	617	628	628	628
Other Non current assets	-	-	130	164	164	164
Current Assets	3,784	1,995	7,123	6,979	11,986	17,819
Cash	2,719	928	5,633	5,255	10,302	16,050
Loans & Advances	313	457	286	270	270	270
Other	751	611	1,204	1,454	1,414	1,498
Current liabilities	1,001	1,326	1,551	1,415	2,197	2,241
Net Current Assets	2,783	669	5,572	5,564	9,789	15,577
Total Assets	14,925	18,896	23,502	28,008	33,424	39,404

Note: Some of the figures from FY2011 onwards are reclassified; hence not comparable with previous year numbers

Cash flow statement(Standalone)

Y/E March (₹ cr)	FY2009	FY2010	FY2011	FY2012	FY2013E	FY2014E
Profit before tax	3,358	5,014	5,960	6,945	7,594	8,210
Depreciation	286	335	475	611	716	758
Change in working capital	296	173	(239)	(61)	797	(36)
Less: Other income	(777)	(563)	(835)	(1,501)	-	-
Direct taxes paid	521	785	1,116	1,502	1,595	1,724
Cash flow from operations	2,642	4,173	4,244	4,492	7,513	7,208
(Inc.)/ Dec. in net fixed assets	(1,374)	(2,247)	(1,446)	(1,668)	(1,900)	(950)
(Inc.)/ Dec. in investments	(443)	(3,922)	1,870	(2,455)	-	-
(Inc.)/ Dec. in loans and adv.	71	(96)	28	38	-	-
Other income	(1,602)	2,288	(4,082)	624	-	-
Cash flow from investing	(3,348)	(3,977)	(3,631)	(3,461)	(1,900)	(950)
Inc./ (Dec.) in loans	8	43	(60)	-	-	-
Dividend paid	124	198	296	1,228	989	989
Others	22	33	8	14	-	-
Cash flow from financing	(137)	(187)	(363)	(1,242)	(989)	(989)
Inc./ (Dec.) in cash	(844)	8	250	(210)	4,624	5,269
Opening cash bal.	3,563	2,719	28	277	29	9,879
Closing cash bal.	2,719	928	277	29	9,879	15,148

Note: Some of the figures from FY2011 onwards are reclassified; hence not comparable with previous year numbers

Key ratios (Standalone)

Y/E March	FY2009	FY2010	FY2011	FY2012	FY2013E	FY2014E
Valuation ratio (x)						
P/E (on FDEPS)	18.6	12.5	10.3	9.2	7.9	7.3
P/CEPS	16.8	11.6	9.4	8.2	7.1	6.6
P/BV	3.5	2.8	2.2	1.9	1.6	1.3
Dividend yield (%)	3.3	5.0	0.6	2.0	1.7	1.7
EV/Sales	7.2	4.8	3.6	2.9	2.2	1.6
EV/EBITDA	15.0	8.3	6.4	5.4	3.9	2.8
EV/Total assets	2.7	2.1	1.5	1.2	0.8	0.5
Per share data (₹)						
EPS (Basic)	6.5	9.6	11.6	13.1	15.2	16.5
EPS (fully diluted)	6.5	9.6	11.6	13.1	15.2	16.5
Cash EPS	7.1	10.4	12.8	14.6	16.8	18.3
DPS	4.0	6.0	0.7	2.4	2.0	2.0
Book value	34.0	42.9	53.3	63.6	76.4	90.6
DuPont analysis						
EBIT margin	43.1	55.6	51.1	47.9	51.5	52.1
Tax retention ratio (%)	81.2	80.6	82.2	79.6	80.0	80.0
Asset turnover (x)	1.1	1.3	1.3	1.2	1.3	1.4
RoIC (Post-tax)	40.2	59.3	54.4	46.8	51.8	56.7
Cost of debt (post tax)	-	-	-	-	-	-
Leverage (x)	-	-	-	-	-	-
Operating RoE	40.2	59.3	54.4	46.8	51.8	56.7
Returns (%)						
RoCE (Pre-tax)	18.0	26.4	24.2	21.2	20.9	19.4
Angel RoIC (pre-tax)	58.9	88.5	74.3	62.3	66.0	70.9
RoE	20.8	24.9	24.1	22.4	21.6	19.7
Turnover ratios (x)						
Asset turnover (gross block)	1.0	1.1	1.1	1.1	1.0	0.9
Inventory (days)	35	21	28	26	26	26
Receivables (days)	11	7	8	11	8	8
Payables (days)	46	52	39	40	40	40
WC cycle (days)	30	11	11	17	9	2
Solvency ratios (x)						
Net debt to equity	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)	(0.8)
Net debt to EBITDA	(3.5)	(2.5)	(2.7)	(3.0)	(3.3)	(3.7)
Interest coverage	111.9	101.5	280.8	391.3	205.9	521.4

Note: Some of the figures from FY2011 onwards are reclassified; hence some ratios may not be comparable with previous year ratios

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Note: Please refer to the important 'Stock Holding Disclosure' report on the Angel website (Research Section). Also, please refer to the latest update on respective stocks for the disclosure status in respect of those stocks. Angel Broking Limited and its affiliates may have investment positions in the stocks recommended in this report.

Disclosure of Interest Statement

Hindustan Zinc

1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors.

Ratings (Returns) :	Buy (> 15%) Reduce (-5% to 15%)	Accumulate (5% to 15%) Sell (< -15%)	Neutral (-5 to 5%)
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