RETAIL EQUITY RESEARCH

Hindustan Zinc Limited (HZL)

Zinc

BSE CODE: 500188 **NSE CODE: HINDZINC**
Bloomberg CODE: HZ:IN **SENSEX: 35,160**

BUY

Rating as per Large Cap 12 month investment period

CMP Rs. 327 **TARGET** Rs. 360 **RETURN 10%**

30th April, 2018

Capacity Addition to drive earnings…

Hindustan Zinc Limited (HZL) is an integrated mining and resources producer of zinc, lead, silver and cadmium. It is a subsidiary of Vedanta Resources PLC.

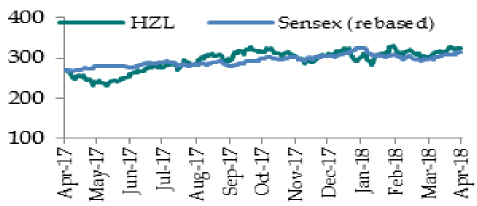
- HZL is well on track to increase metal production capacity to 1.2 mn MTPA by FY20 from 0.9 mn MTPA as of FY17 on the back of two brownfield projects.
- We expect zinc and lead sales volume to grow at a CAGR of 9.0% and 12.3%, respectively over FY17-20E.
- Zinc prices are also expected to remain strong in the near to medium term due to low system inventories and closure of several zinc mines across the world.
- Driven by strong outlook on zinc and HZL's efficient operations, we expect revenue/EBITDA to clock a CAGR of 15.6% /16.3% over FY17-20E.
- We remain positive on HZL given its strong balance sheet, robust fundamentals, lower cost of production, debt free status and healthy div. yield.
- Hence, we initiate coverage on the stock with a BUY rating and a target price of Rs360 and we value the stock at 7.5x FY20E EV/EBITDA.

Company Data	
Market Cap (cr)	Rs. 138,210
Outstanding Shares (cr)	422.5
Free Float	35%
Dividend Yield (%)	2.4
52 week high	Rs. 340
52 week low	Rs. 227
6m average volume (cr)	0.2
Beta	0.8
Face value	Rs. 2

Shareholding (%)	Q2 FY18	Q3 FY18	Q4 FY18
Promoters	64.9	64.9	64.9
FII's	2.2	2.2	2.3
MFs/Insti	1.7	1.7	1.5
Public	31.2	31.3	31.3
Others	-	-	-
Total	100.0	100.0	100.0

Price Performance	3 Month	6 Month	1 Year
Absolute Return	5.2%	2.9%	21.7%
Absolute Sensex	-2.4%	5.7%	17.5%
Relative Return*	7.6%	-2.8%	4.1%

*over or under performance to benchmark index



Y.E Mar (Rs cr)	FY18E	FY19E	FY20E
Sales	21,443	24,493	26,304
Growth (%)	*25.8%*	*14.2%*	*7.4%*
EBITDA	11,966	14,035	15,336
Margins %	55.8	57.3	58.3
Adj. PAT	8,811	10,635	11,395
Growth (%)	*5.9%*	*20.7%*	*7.1%*
Adj. EPS	20.9	25.2	27.0
Growth (%)	*5.9%*	*20.7%*	*7.1%*
P/E	15.6	12.9	12.1
P/B	3.9	3.3	2.9
EV/EBITDA	11.4	9.7	8.8
ROE (%)	26.6	27.7	25.8
D/E	0.0	0.0	0.0

Low inventory and supply disruptions augur well for zinc prices

Zinc inventory declined by 320KT during Jan-Nov 2017. According to the International Lead and Zinc Study Group (ILZSG), world demand for refined zinc metal is forecasted to increase by 2.5% YoY to 14.28 mn tonnes while production is expected to increase by 6% YoY to 13.78 mn tonnes in CY18. Hence, the market is expected to remain in deficit with the extent of the shortage forecasted at 223kt even in CY18. Overall, sustained deficit and decline in inventory levels will worsen the supply situation and keep LME prices firm in the coming months. We build-in LME zinc prices of US$3,186/ton for FY19E and US$3,059/ton for FY20E.

Volume expansion to 1.5 mn MTPA on track

Following continued deficit and limited supply in the zinc market, HZL is ramping up its metal production capacity to 1.2 mn MTPA mined metal (MM) production by FY20E from 0.9 mn MTPA as of FY17. Further, the company is on track to achieve 1.5 mn metric tonnes per annum (MTPA) MM production capacity in the medium term driven by SK and Zawar mines. Ore production capacity at SK mines is expected to increase to 8 mn MT from 4 mn MT, while production at Zawar mines is also expected to double to 4 mn MT. Besides, the company is also planning to increase the silver capacity to 650 MT over the medium term with higher production from Sindesar Khurd mine and enhanced recoveries from the fumer project with peak production of 750-800 MT. Hence, we expect zinc/lead/silver sales volume to grow at a CAGR of 9.0%/12.3%/13.9%, over FY17-20E.

One of the lowest cost of production (CoP)

HZL has one of the largest zinc-lead smelting operations in the world with a capacity of over 1 mn MT. The combination of mining and smelting offers advantages in terms of cost optimisation while close proximity of mines and smelters provides logistical advantage. Further, high grade captive mines and captive power plants also help in reducing CoP. As a result, HZL is amongst the lowest cost producers for zinc globally. This has resulted into healthy EBITDA margin of ~50%+ over the last four years (except FY16). The company expects production costs to further decline to US$850/ton from US$950-975/ton led by (1) lower coal costs due to increased sourcing from Coal India. (cost differential being 30-35% as compared to imported coal), (2) USD20-30/ton savings led by ore hauling from production shafts and (3) operating leverage.

Strong Balance Sheet

Given strong operating performance, the company has built substantial cash reserves over the years, As on Q3FY17, the company's cash and cash equivalents stood at Rs19,176cr (Rs45 per share) invested in high quality debt instruments. The company is debt free. Going forward, we expect it to continue to generate strong FCF (Rs21,282 over FY17-20E). Further, we expect RoE and RoCE to stay robust at 25.8% and 35.4% in FY20E, respectively.

Outlook and Valuation

Driven by strong outlook on zinc and HZL's quality operations, we expect the top line and EBITDA to clock a CAGR of 15.6% and 16.3%, respectively over FY17-20E. Further, we like HZL given its strong balance sheet, robust fundamentals, lower cost of production, debt free status and healthy dividend yield. Hence, we initiate coverage on the stock with a BUY rating and a target price of Rs360 where we value the stock at 7.5x FY20E EV/EBITDA.

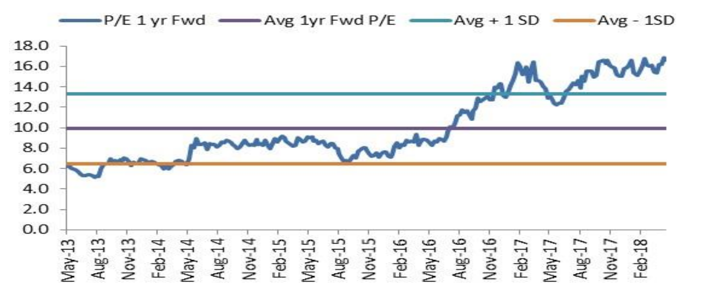
Valuations

The closure of several zinc mines across the world bodes well for zinc prices in the medium term and widens opportunities for strong players in the industry. Although, we expect strong near-term zinc prices due to tight inventories, some correction in FY20 is expected due to new supplies coming in. Therefore, we build-in LME zinc prices of US$3,186/ton for FY19E and US$3,059/ton for FY20E. We like HZL given its strong balance sheet, robust fundamentals, lower cost of production, integrated business model, debt free status and healthy dividend yield. Further, we expect the company to continue to generate strong FCF going forward (Rs21,282 over FY17-20E). We project the top line and EBITDA to clock a CAGR of 15.6% and 16.3%, respectively over FY17-20E. Hence, we initiate coverage on the stock with a BUY rating and a target price of Rs360 where we value the stock at its three year mean of 7.5x FY20E EV/EBITDA.

1 Year forward EV/EBITDA band

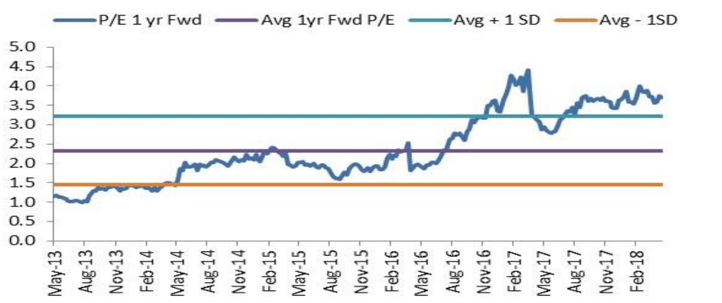
Source: Bloomberg, Geojit Research

1 Year forward P/E band



Source: Bloomberg, Geojit Research

1 Year forward P/BV band



Source: Bloomberg, Geojit Research

Notably, HZL stock price has been highly correlated with LME zinc and lead prices in past 5 years. Besides, in past 3 years, correlation of HZL stock price with zinc and lead price has picked up in line with ramp up at other mines. We expect this to further rise as SK and Zawar mines ramp up production resulting in further benefit from steady zinc and lead prices.

Increasing correlation of HZL's stock price with LME zinc and lead prices in past 3 years

	Zinc	Lead
Last 10 Years	0.84	0.44
Last 5 Years	0.90	0.64
Last 3 Years	0.94	0.95

Source: indexmundi, BSE, Geojit Research

We expect broadly steady zinc and lead prices over FY18-20E which bodes well for HZL given the fact that it is increasing its metal production capacity to 1.2 mn MTPA by FY20 from 0.9 mn MTPA as of FY17 mainly on the back of two brownfield projects.

Increasing correlation between HZL's stock and Zinc LME

Source: indexmundi, BSE, Geojit Research

Increasing correlation between HZL's stock and Lead LME

Source: Bloomberg, Geojit Research

Industry Overview

Zinc

Zinc is currently the fourth most widely consumed metal in the world after iron, aluminum and copper. It has strong anti-corrosive properties and bonds well with other metals. According to the International Zinc Association (IZA), 60% of zinc is used for galvanizing to protect steel from corrosion thus prolonging the service life of steel products significantly. Approximately 15% goes into the production of zinc base alloys, mainly to die casting industry. About 14% goes into the production of brass and bronze and with other metals to form materials that are used in automobiles, electrical components and household fixtures. Around 8% goes into the production of compounds including zinc oxide and zinc sulfate. The remainder is zinc alloys, mainly rolled, utilized in semi-manufactured applications including coinage and architectural applications.

These first-use suppliers then convert zinc into in a broad range of products. By far the largest application area is construction, with 45% of all first-use zinc products used in this area. The transportation sector consumes 25% of global zinc supply and consumer goods (including electrical and electronic appliances) accounts for 23%. The remaining 7% is used for the manufacture of industrial machinery.

Consumption expected to surpass production despite likely ramp up

Over the next two years, new mine supply is expected from Australia, India and South Africa. In Australia, supply would largely be driven by Dugald River expansion (170k tpa) and New Century tailing production (270k tpa). Vedanta's Gamsberg mine and part production at Glencore's 500k tpa mines should also begin productions in H2CY18. Despite such incremental supply, according to the International Lead and Zinc Study Group (ILZSG), world demand for refined zinc metal is forecasted to increase by 2.5% YoY to 14.28 mn tonnes while production is forecasted to increase by 6% YoY to 13.78 mn tonnes in CY18. We therefore expect zinc prices to remain firm, going ahead.

Low inventory augurs well for zinc prices

As per ILZSG, zinc inventory declined by 320KT during Jan-Nov 2017. Eleven consecutive months of deficit and declining inventory augurs well for Zinc. Following continued deficit, inventory level at LME dropped to 180KT, lowest level since January 2009. Again, in CY18, the market is expected to remain in deficit with the extent of the shortage forecasted at 223kt. Sustained deficit and decline in inventory levels will worsen the supply situation and keep LME prices firm in the coming months.

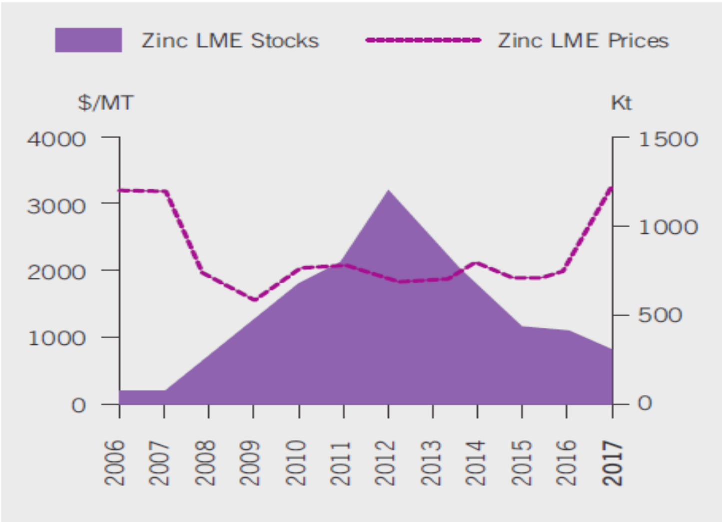
Indian Zinc Market Outlook

The Indian zinc demand is based on growth of the domestic steel market as 70% of Indian zinc goes into galvanizing. The Indian Government's efforts to combat a slew of cheap imports continued this year as well with Minimum Import Price (MIP) being imposed on certain products, in addition to safeguard duty and anti-dumping duty on some steel products. Supported by these efforts, India's steel imports plummeted by 36.6% YoY to 7.4 mn tonnes in FY17. Exports, on the other hand, registered a substantial increase of 102% YoY to 8.2 mn tonnes in FY17. Other Government initiatives like the smart cities, high speed rail network, construction of highways and modernization of railways will also boost the infrastructure industry which uses zinc for sustainable and long-lasting structures. This will pave the way for India to lead the zinc consumption growth globally. Overall, the demand is expected to grow at 4-5% YoY over the next few years in India.

Historical Price Trend in Zinc

Starting in CY16, zinc entered bull market that has seen prices more than double over the past two years. Notably, Zinc remained one of the best performers on the LME in CY17 with 26% YoY appreciation.

Trend in Zinc LME Prices



Source: Wood Mackenzie, Zinc Long Term Outlook Q1CY17, Company, Geojit Research

Lead

Lead acid batteries are the mainstay of storage technologies for renewable energy sources, such as solar cell and wind turbines and are used to power cars, trucks, buses, motorbikes, electric vehicles and hybrid vehicles. Besides, lead is still widely used for pigments, ammunition, cable sheathing, weights for lifting, weight belts for diving, lead crystal glass, radiation protection and in some solders. It is often used to store corrosive liquids.

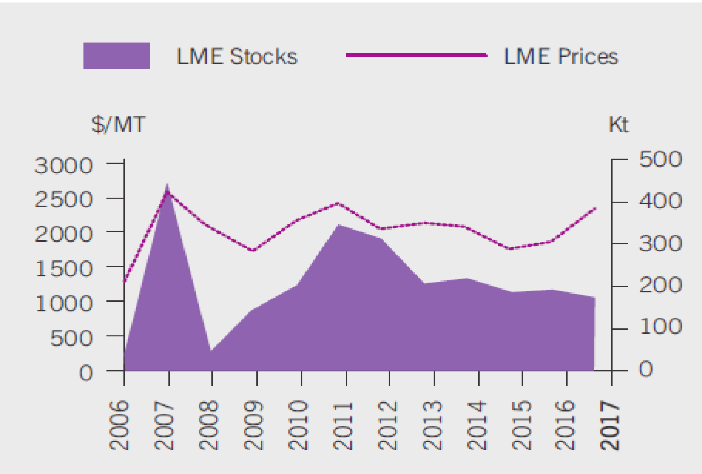
Continued deficit to support prices

The key trend in the lead market in CY17 was a mismatch in supply and demand wherein the demand generally outpaced the supply throughout the year.

On the supply side, the ongoing environmental crackdown in China to solve its pervasive pollution problem led to disruption in supply chain leading to lower output of Chinese lead. As a result, China became a net importer of lead from a net exporter. On the demand side, robust car sales in China as well as solid industrial production data from China, Europe and North America popped up lead prices. As a result, lead remained one of the best performers on the LME in CY17 with a 28% YoY appreciation.

Going forward, mismatch in supply and demand will continue to support higher lead prices. According to the International Lead and Zinc Study Group, demand for refined lead is forecast to reach 11.82 mn tonnes in CY18 while supply (lead mine production) will reach only 5.11 mn tonnes. As a result, the group expects the base metal to reach a deficit of 45,000 tonnes next year. Hence, we expect lead prices to remain firm, going ahead.

Trend in Lead LME Prices



Source: Wood Mackenzie, Zinc Long Term Outlook Q1CY17, Company, Geojit Research

Silver

While silver has broad market fundamentals, industrial demand makes up more than half of the overall market, with most of the other demand coming from jewellery, bullion coins and exchange traded funds. Major industrial uses of silver include photography, solar energy and medical.

Silver prices to remain steady

Silver mine supply declined 0.7% YoY in CY16 and is expected to trend lower in the foreseeable future after it peaked in CY15. This decline has majorly come from Russia, Australia and Mexico which outpaced the marginal increase in production in China and Peru. The declining total supply is therefore expected to be a key driver of annual deficit in the silver market going forward. Global demand also registered a marginal de-growth owing to decline in physical bar and coin demand. Jewellery segment also showed weak demand in Non-Asian markets due to a looming stock overhang. Electronics applications and other industrial application segment demand also declined with respect to their respective levels in CY15.

Going forward, in terms of supply, the silver market is expected to remain in a fundamental surplus for the third year in a row in CY18, with an excess of about 70 mn ounces, according to Precious Metals Investment Focus 2017/2018. However, the only silver lining for silver metal is its increasing demand in solar segment which is also expected to drive demand in years to come, especially in emerging economies. Notably, India aims at having 175 GW of renewable capacity installed by CY22 which means an additional 100 GW of solar power. China has also announced new solar installation targets that suggest its total solar capacity will treble by the end of CY20 to as much as 230GW from 77GW at the end of CY16.

Trend in Silver Prices

Source: silverprice.org, Geojit Research

Investment Rationale

Best in class portfolio of operational mines

HZL's strategy to maintain a portfolio of mines with predominantly long life and low cost of operations enables viability across various stages of demand supply cycle. Besides, forward integration with smelting and refining leads to value addition.

Rampura Agucha Mine

Rampura Agucha mine is one of the largest zinc mines worldwide. It has an ore production capacity of 6.15 mn MT per annum, with best-in-class zinc-lead reserves grade of 15.8%. It produced 528,459 MT of mined metal in the year FY17. Reserve and resource of Rampura Agucha Mine as on FY17 stood at 100 mn MT.

Rampura Agucha Mine

Reserve	: 49.7 Million MT
Resource	: 50.3 Million MT
Reserve Grade Zn	: 13.9%
Reserve Grade Pb	: 1.9%
One Production Capacity	: 6.15 MTPA

Source: Company, Geojit Research

Rajpura Dariba Mine

Rajpura Dariba Mine has annual ore production capacity of 0.90 mn MT and achieved a mined metal production level of 37,882 MT in FY17. As part of the ongoing expansion programme, ore production capacity at Rajpura Dariba will be increased to 1.20 million MT per annum by FY20.

Rajpura Dariba Mine

Reserve	: 9.0 Million MT
Resource	: 50.3 Million MT
Reserve Grade Zn	: 6.3%
Reserve Grade Pb	: 1.5%
One Production Capacity	: 0.9 MTPA

Source: Company, Geojit Research

Sindesar Khurd Mine

Sindesar Khurd has annual ore production capacity of 4.5 mn MT and achieved a mined metal production level of 177,147 MT in FY17. It is a highly mechanised world-class underground mine with state-of-the-art infrastructure facilities. It has a reserve and resource base of 122.8 mn MT with zinc-lead reserve grade of 7.1% as on FY17.

Sindesar Khurd Mine

Reserve	: 35.6 Million MT
Resource	: 87.2 Million MT
Reserve Grade Zn	: 4.2%
Reserve Grade Pb	: 2.9%
One Production Capacity	: 4.5 MTPA

Source: Company, Geojit Research

Zawar Mining Complex

Zawar Mines have annual ore production capacity of 1.20 mn MT and achieved a mined metal production level 68,753 MT in FY17. Its total reserve and resource are 95.2 mn MT as on FY17 with zinc-lead reserve grade of 5.1%.

Zawar Mining Complex

Reserve	: 9.5 Million MT
Resource	: 85.7 Million MT
Reserve Grade Zn	: 3.3%
Reserve Grade Pb	: 1.8%
One Production Capacity	: 4.0 MTPA
Captive Power Plant	: 80 MW

Source: Company, Geojit Research

Kayad Mine

A new underground mine near Ajmer, Rajasthan was opened up at Kayad in Q3FY14. Kayad mine is a small but high-grade deposit. It has an ore production capacity of 1 mn MT and produced 93,939 MT of mined metal in FY17. The ore from Kayad mine is treated at Rampura Agucha Mine's mills. Its total reserve and resource are 7.1 mn MT as on FY17 with zinc-lead reserve grade of 8.9%.

Kayad Mine

Reserve	: 5.4 Million MT
Resource	: 1.7 Million MT
Reserve Grade Zn	: 7.8%
Reserve Grade Pb	: 1.1%
One Production Capacity	: 1.0 MTPA

Source: Company, Geojit Research

Proximity of mines and world class smelters complements each other

HZL has one of the largest zinc-lead smelting operations in the world with a capacity of over 1 mn MT. It is also India's largest manufacturer of sulphuric acid, a by-product of smelting operations. The combination of mining and smelting offers advantages in terms of optimisation of cost while close proximity of mines and smelters provides logistical advantage. The company has portfolio of world class smelters at three locations viz. Chanderiya, Dariba and Debari.

Chanderiya Lead-Zinc Smelter

Chanderiya Lead-Zinc Smelter is the one of the largest zinc-lead smelting complexes in the world. Its current metal production capacity is 610,000 tonnes per annum (525,000 tonnes per annum of zinc and 85,000 tonnes per annum of lead). Chanderiya produced 435,666 MT of zinc and 51,759 MT of lead in FY17. The main products are special high grade (SHG) zinc, continuous galvanizing grade (CGG) zinc, prime western (PW) zinc and pure lead.

Chanderiya Lead-Zinc Smelter

Pyro-metallurigical Lead Zinc Smelter	: 105,000 tpa Zinc : 85,000 tpa Lead
Hydro-metallurigical Zinc Smelter	: 420,000 tpa
Captive Power Plant	: 234 MW

Source: Company, Geojit Research

Zinc Smelter Debari

Zinc Smelter Debari is a Hydrometallurgical zinc smelter situated at Debari in Rajasthan, India. The primary product of Debari is High Grade (HG) zinc and it also recovers cadmium as by-product. The smelter has zinc production capacity of 88,000 MT per annum. It produced 46,442 MT of zinc in FY17.

Zinc Smelter Debari

Hydrometallurgical Zinc Smelter	: 88,000 tpa

Source: Company, Geojit Research

Dariba Smelting Complex

The Dariba hydrometallurgical zinc smelter has a capacity of 220,000 MT of zinc and 100,000 MT of lead. It produced 189,882 MT of zinc and 92,535 MT of lead in FY17. The complex is uniquely self-sufficient - there are lead-zinc mines in the vicinity at Sindesar Khurd and Rajpura Dariba.

Dariba Smelting Complex

Hydrometallurgical Zinc Smelter	: 220,000 tpa
Lead Smelter	: 100,000 tpa
Captive Power Plant	: 160 MW

Source: Company, Geojit Research

Captive power plants help in minimizing cost

In order to ensure reliable and low-cost power for uninterrupted operations, HZL has installed captive power plants to cater to the power requirement of its smelters and mines. The company has thermal captive power plants at Chanderiya, Dariba and Zawar, with power generation capacity of 474 MW. In addition, it also has 35.6 MW of diesel generation capacity and 35.4 MW of power generation capacity from waste heat recovered from roasters. HZL has also successfully commissioned 273.5 MW wind power plants in the States of Gujarat, Karnataka, Maharashtra, Rajasthan and Tamil Nadu.

Smelting and Power Summary

Zinc Smelting	: 833,000 tpa
Lead Smelting	: 185,000 tpa
Silver Smelting	: 518 tpa
Captive Power	: 474 MW
Wind Power	: 274 MW
Solar Power	: 16.2 MW
WHRB Power	: 35.4 MW

Source: Company, Geojit Research

Adequate resources lead to long term visibility

HZL has strong focus on enhancing reserves and resources (R&R). Exploration activities are intensifying further, encouraged by the findings so far. The company is further strengthening its exploration team. Exploratory drilling is likely to increase from 70km in FY17 to 200km in FY19. R&R has increased from 146 mn MT in FY04 to 404 mn MT in FY17 and the plan is to increase it to 550 mn MT. Strong focus on enhancing resources has ensured mine life of more than 30 years at any time despite 10-fold increase in production in the last 12-13 years.

R&R Summary

	Tonnage	Grade		
	million MT	**Zn (%)**	**Pb (%)**	**(Ag) (g/t)**
Reserve	109.1	8.9	2.1	93
Resource	295.3	5.9	2.2	74

Source: Company, Geojit Research

Volume expansion to 1.5 mn MTPA on track

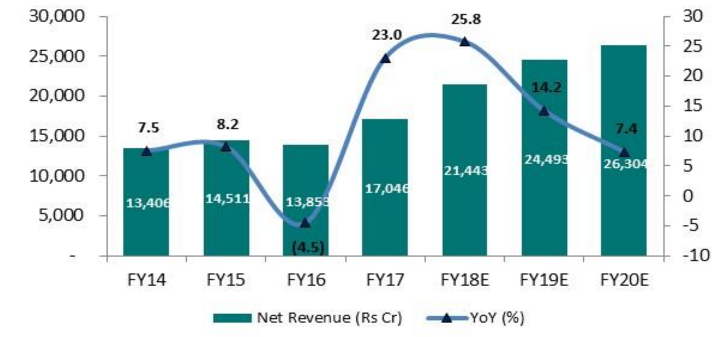
HZL is on track to achieve 1.5 mn Metric tonnes per annum (MTPA) MM production capacity in the medium term, while 1.2 mn MTPA of mined metal (MM) production by FY20E is firmly in sight. Though FY18 would be the last year of production from Rampura Agucha (RA) open-cast mine, production ramp-up at underground mines have been impressive with 85% contribution in 9MFY18. Notably, the SK mine reached 4.5 mn MT production in Q3FY18. The RA underground mine shaft is expected to start ore production from Q3FY19, enabling HZ to reach 1.2 mn MTPA mined metal production in FY20. The SK mine is also in the process of taking regulatory approvals to increase ore mining capacity to 6 mn MT. Growth beyond 1.2 mn MTPA would be primarily driven by SK and Zawar mines. Ore production capacity at SK mines is expected to increase to 8 mn MT from 4 mn MT, while production at Zawar mines is also expected to double to 4 mn MT. Besides, the company is also planning to increase the silver capacity to 650 MT over the medium term with higher production from Sindesar Khurd mine and enhanced recoveries from the fumer project with peak production of 750-800 MT.

Financial Analysis

Revenue to grow at a healthy CAGR of 16% over FY17-20E

The company reported a CAGR of 8% in revenue over the last four years. We expect the company to clock a healthy CAGR of 16% in revenue over FY17-20E led by higher mined and refined production coupled with steady zinc and lead realizations. We expect zinc/lead/silver sales volume to grow at a CAGR of 9.0%/12.3%/13.9% over FY17-20E.

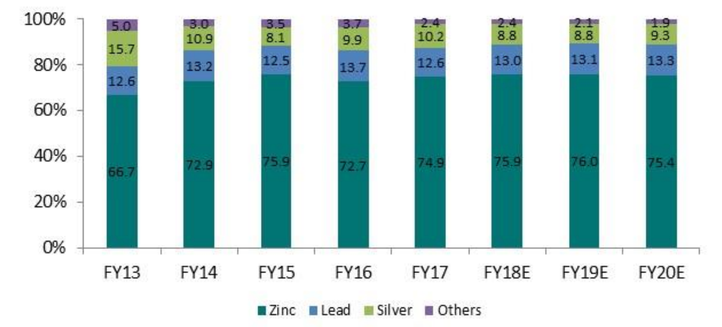
Net revenue to grow at 16% CAGR over FY17-20E



Source: Company, Geojit Research

Being India's largest and world's second largest zinc miner, the company derives almost 75% of its total revenues from zinc. We expect the proportion of current business mix to remain broadly steady over FY17-20E.

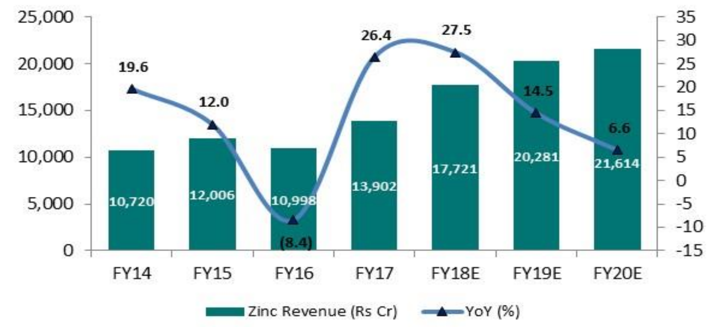
Trend in Revenue Mix



Source: Company, Geojit Research

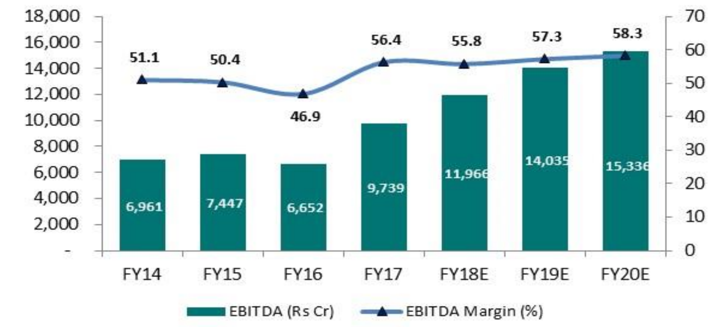
We expect zinc and lead revenues to grow at a CAGR of 16% and 18% over FY17-20E, respectively primarily driven by increase in mined metal production, and hence refined metal production. Firming up of LME prices with a widening deficit situation is also expected to boost revenues. We expect silver revenues to grow at a CAGR of 15% over FY17-20E driven by higher production volumes.

Trend in Zinc Revenue



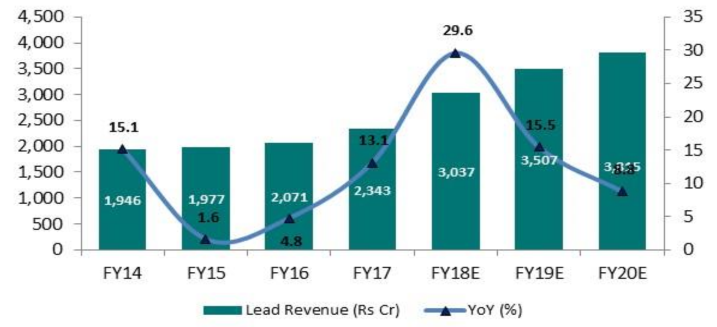
Source: Company, Geojit Research

EBITDA margin to improve to 58.3% by FY20E



Source: Company, Geojit Research

Trend in Lead Revenue

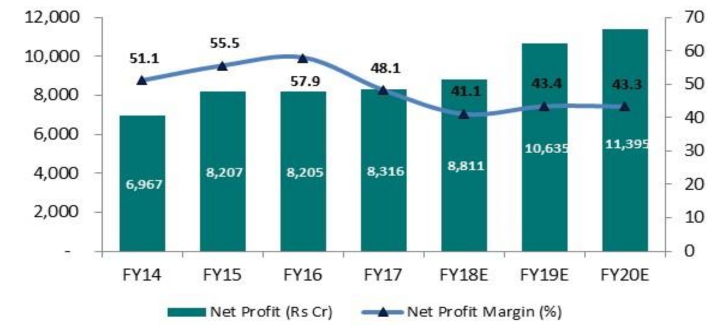


Source: Company, Geojit Research

Healthy operating performance to drive net profit

Despite healthy operating performance, net profit grew at a CAGR of 5% over FY13-17 mainly due to lower other income and higher tax outgo. While, other income increased at a slower CAGR of 5% over FY13-17, tax rate increased to 19% in FY17 from 12% in FY13. Going ahead, we expect net profit to grow at a CAGR of 11% over FY17-20E supported by healthy operating performance but dragged by increasing tax rate as tax holiday enjoyed by some of its facilities will come to an end.

Net profit to grow at a CAGR of 11% over FY17-20E



Source: Company, Geojit Research

Focus on cost reduction

The company expects production costs to further decline to US$850/ton from US$950-975/ton led by (1) lower coal costs due to increased sourcing from Coal India. (cost differential being 30-35% as compared to imported coal), (2) USD20-30/ton savings led by ore hauling from production shafts and (3) operating leverage led by higher mined metal volumes given a large fixed cost base in mining—this can save close to USD40/ton. Besides, management also highlighted other instances of savings such as purchase of clinker instead of cement (utilizing internal slag to make cement). It will lead to reduction in overall cost as cement is used for back filling in underground mines.

EBITDA margin to improve further

The company reported a healthy EBITDA margin of ~50%+ over the last four years (except FY16). Going forward, we expect EBITDA margin to improve to 58.3% in FY20E from 56.4% in FY17 owing to decline in costs coupled with firm zinc and lead prices.

Strong Balance Sheet

Given strong operating performance, the company has built substantial cash reserves over the years, As on Q3FY17, the company's cash and cash equivalents stood at Rs19,176cr (Rs45 per share) invested in high quality debt instruments. The company is debt free. Going forward, we expect it to continue to generate strong FCF (Rs21,282 over FY17-20E). Further, we expect RoE and RoCE to stay robust at 25.8% and 35.4% in FY20E, respectively.

Hindustan Zinc Limited: Business overview

Hindustan Zinc Limited (HZL) (erstwhile Metal Corporation of India) was incorporated in 1966 as a public-sector undertaking (PSU). In April 2002, Vedanta acquired 46% stake in the company through a divestment program undertaken by the GOI (26% from the GOI and the remaining portion from an open offer). Post this, the group acquired an additional 18.9% in the company in 2003 taking the holding to 64.9%. Currently Government of India (GOI) holds 29.5% stake in the company as of Q3FY18.

HZL the India's largest and world's second-largest zinc miner. It caters to ~80% of zinc demand in India. It the only company in the country with three mines rated as 'Five Star' by Indian Bureau of Mines. The company has also the world's second largest operating zinc mine – Rampura Agucha Mine. It is also one of the lowest cost zinc producers in the world.

HZL's business comprises of mining and smelting of zinc and lead along with captive power generation. It is the only integrated zinc manufacturer in India, with zinc smelting capacity of 823 ktpa and lead smelting capacity of 185 ktpa. The company's fully-integrated zinc operations include three lead-zinc mines, two zinc smelters, a lead smelter, and one lead-zinc smelter in Rajasthan. HZL's mines supply most of its concentrate requirements. In addition, the company also recover silver and cadmium as by products.

HZL also own 474 MW of coal based thermal captive power plants in Rajasthan to support its metallurgical operations. In addition, the company's power generation includes 274 MW of wind energy, 16 MW of solar power and 35.4 MW from waste heat generation.

Key risks:

- **Development of New Mines:** We have incorporated a gradual rise in zinc prices owing to the deficit situation. However, if the new mines commence operations earlier than anticipated, it will enhance the supply thereby putting downward pressure on prices and impacting our revenue forecasts.

- **Inability to achieve estimated production:** HZL is increasing its ore capacities and aims to achieve a mined metal production of 1.2 Mn MT by FY20E. Inability to meet the estimated production and ramp up of its smelter capacity for the same, could impact its profitability and cash generating abilities.

- **Slowdown in domestic economy:** Domestic sales form ~80% of HZL's revenues. The realizations are also relatively higher than that of export markets. Hence, a slower than anticipated recovery in domestic economy will hit the demand for zinc, lead and silver, HZL's primary products.

- **Inability to generate higher yield on investments:** HZL currently generates substantial investment income from its investments parked in mutual funds, bonds and other high-quality debt instruments. A lower than anticipated yield on investments will impact our profit estimates.

Standalone Financials

Profit & Loss Account

Y.E March (Rs cr)	FY16A	FY17A	FY18E	FY19E	FY20E
Sales	**13,853**	**17,046**	**21,443**	**24,493**	**26,304**
% change	*-4.5%*	*23.0%*	*25.8%*	*14.2%*	*7.4%*
EBITDA	**6,652**	**9,739**	**11,966**	**14,035**	**15,336**
% change	*-10.7%*	*46.4%*	*22.9%*	*17.3%*	*9.3%*
Depreciation	745	1,811	1,768	1,899	2,030
EBIT	**5,907**	**7,928**	**10,197**	**12,136**	**13,306**
Interest	17	202	250	-	-
Other Income	2,763	2,474	1,778	2,032	2,309
PBT	**8,653**	**10,200**	**11,726**	**14,168**	**15,616**
% change	*-9.9%*	*17.9%*	*15.0%*	*20.8%*	*10.2%*
Tax	448	1,884	2,915	3,534	4,221
Tax Rate (%)	*5.2%*	*18.5%*	*24.9%*	*24.9%*	*27.0%*
Reported PAT	**8,175**	**8,316**	**9,102**	**10,635**	**11,395**
Adj*	(30)	-	291	-	-
Adj PAT	**8,205**	**8,316**	**8,811**	**10,635**	**11,395**
% change	*0.0%*	*1.4%*	*5.9%*	*20.7%*	*7.1%*
No. of shares (cr)	422.5	422.5	422.5	422.5	422.5
Adj EPS (Rs)	**19.4**	**19.7**	**20.9**	**25.2**	**27.0**
% change	*0.0%*	*1.4%*	*5.9%*	*20.7%*	*7.1%*
DPS (Rs)	27.8	29.4	8.0	10.0	10.5

Balance Sheet

Y.E March (Rs cr)	FY16A	FY17A	FY18E	FY19E	FY20E
Cash	53	8,380	1,043	1,745	3,174
Accounts Receivable	107	136	171	195	210
Inventories	1,058	1,936	2,421	2,662	2,758
Other Cur. Assets	474	414	435	456	479
Investments	35,221	23,783	23,783	28,783	33,783
Gross Fixed Assets	16,524	17,904	20,275	21,775	23,275
Net Fixed Assets	10,385	9,993	10,596	10,197	9,667
CWIP	2,428	3,071	3,000	3,000	3,000
Intangible Assets	-	-	-	-	-
Def. Tax (Net)	2,498	2,748	312	624	936
Other Assets	971	1,334	1,334	1,334	1,334
Total Assets	**53,195**	**51,795**	**43,095**	**48,997**	**55,342**
Current Liabilities	15,127	12,322	6,775	7,112	7,386
Provisions	-	-	-	-	-
Debt Funds	-	7,908	-	-	-
Other Liabilities	683	760	760	760	760
Equity Capital	845	845	845	845	845
Reserves and Surplus	36,540	29,960	34,715	40,280	46,351
Shareholder's Fund	37,385	30,805	35,560	41,125	47,196
Minority Interest	-	-	-	-	-
Total Liabilities	**53,195**	**51,795**	**43,095**	**48,997**	**55,342**
BVPS (Rs)	**88.5**	**72.9**	**84.2**	**97.3**	**111.7**

Cash flow

Y.E March (Rs cr)	FY16A	FY17A	FY18E	FY19E	FY20E
Pre-tax profit	**8,623**	**10,200**	**11,726**	**14,168**	**15,616**
Depreciation	745	1,811	1,768	1,899	2,030
Changes in W.C	1,632	198	(3,652)	(262)	(171)
Others	(2,727)	(2,294)	(1,528)	(2,032)	(2,309)
Tax paid	(1,822)	(2,338)	(2,915)	(3,534)	(4,221)
C.F.O	**6,451**	**7,577**	**5,398**	**10,240**	**10,944**
Capital exp.	(1,550)	(2,008)	(2,300)	(1,500)	(1,500)
Change in inv.	(5,692)	13,665	-	(5,000)	(5,000)
Other invest.CF	4,006	(7,841)	1,778	2,032	2,309
C.F - investing	**(3,236)**	**3,816**	**(522)**	**(4,468)**	**(4,191)**
Issue of equity	-	-	-	-	-
Issue/repay debt	-	7,900	(7,908)	-	-
Dividends paid	(3,204)	(18,972)	(4,056)	(5,070)	(5,324)
Other finance.CF	(10)	(183)	(250)	-	-
C.F - Financing	**(3,214)**	**(11,255)**	**(12,214)**	**(5,070)**	**(5,324)**
Chg. in cash	1	138	(7,337)	702	1,430
Closing cash	53	8,380	1,043	1,745	3,174

Ratios

Y.E March	FY16A	FY17A	FY18E	FY19E	FY20E
Profitab. & Return					
EBITDA margin (%)	46.9	56.4	55.8	57.3	58.3
EBIT margin (%)	41.7	45.9	47.6	49.5	50.6
Net profit mgn.(%)	57.9	48.1	41.1	43.4	43.3
ROE (%)	20.0	24.4	26.6	27.7	25.8
ROCE (%)	21.1	27.3	32.2	37.0	35.4
W.C & Liquidity					
Receivables (days)	2.6	2.7	2.7	2.7	2.7
Inventory (days)	73.4	153.0	152.1	151.4	149.5
Payables (days)	45.1	58.4	58.4	58.4	58.5
Current ratio (x)	0.1	0.9	0.6	0.7	0.9
Quick ratio (x)	0.0	0.7	0.2	0.3	0.5
Turnover &Levg.					
Gross asset T.O (x)	0.9	1.0	1.1	1.2	1.2
Total asset T.O (x)	0.3	0.3	0.5	0.5	0.5
Adj. debt/equity (x)	0.0	0.3	0.0	0.0	0.0
Valuation ratios					
EV/Net Sales (x)	9.9	8.0	6.4	5.5	5.1
EV/EBITDA (x)	20.7	14.1	11.4	9.7	8.8
P/E (x)	16.7	16.5	15.6	12.9	12.1
P/BV (x)	3.7	4.5	3.9	3.3	2.9

Recommendation Summary (last 3 years)

Source: BSE, Geojit Research

Dates	Rating	Target
30-Apr-2018	BUY	360

*Initiating Coverage

Investment Rating Criteria

Large Cap Stocks;			Mid Cap and Small Cap;		
Buy	-	**Upside is 10% or more.**	**Buy**	-	**Upside is 15% or more.**
Hold	-	**Upside or downside is less than 10%.**	**Accumulate**	-	**Upside between 10% - 15%.**
Reduce	-	**Downside is 10% or more.**	**Hold**	-	**Absolute returns between 0% - 10%.**
Neutral	-	**Not Applicable**	**Reduce/Sell**	-	**Absolute returns less than 0%.**
			Neutral	-	**Not Applicable**

To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.
The recommendations are based on 12 month horizon, unless otherwise specified. The investment ratings are on absolute positive/negative return basis. It is possible that due to volatile price fluctuation in the near to medium term, there could be a temporary mismatch to rating.
For reasons of valuations/return/lack of clarity/event we may revisit rating at appropriate time. Please note that the stock always carries the risk of being upgraded to BUY or downgraded to a HOLD, REDUCE or SELL.
Neutral - The analyst has no investment opinion on the stock under review.

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KAUSHAL KANUBHAI PATEL

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