

Hindustan Zinc

Volume growth drives outperformance

Standalone (₹ cr)	2QFY16	2QFY15	yoy (%)	1QFY16	qoq%
Net revenue	3,908	3,749	4.2	3,596	8.7
EBITDA	2,164	1,997	8.4	1,660	30.3
Margin (%)	55.4	53.3	212bp	46.2	920bp
Reported PAT	2,285	2,184	4.7	1,921	19.0

Source: Company, Angel Research

For 2QFY2016, Hindustan Zinc (HZL) reported a 4% increase in revenue at ₹3,908cr (~6% ahead of our estimate of ₹3,693cr). The outperformance was led by better than expected volumes with refined zinc production at 211,000MT, increasing 17% yoy. The EBITDA came in at ₹2,164cr, 16% ahead of our estimate of ₹1,874cr, led by better than expected revenue growth. The EBITDA increased 8% yoy and was up 30% sequentially. The EBITDA margin improved 212bp yoy at 55.4% and was 463bp higher than our expectation. Depreciation and finance expenses were in line with our expectations. The Net profit increased 5% yoy to ₹2,285cr and was 15% ahead of our expectation.

HZL's Management has guided at a ~16% increase in refined metal production volumes in FY2016, led by the strong performance of 2QFY2016. The Management also indicated that the expansion projects remain on track, which should help the company drive volumes.

Outlook and valuation: We expect zinc prices to continue its decline going forward led by global headwinds. We however have increased our volume estimates led by the strong outperformance in 2QFY2016. We raise our FY2016 and FY2017 estimates in view of the better than expected volumes and operating leverage potential. The stock is currently trading at 4x FY2017E EV/EBITDA. We value the stock at 5x FY2017E EV/EBITDA and **arrive at a target price of ₹175**.

We upgrade our recommendation on the stock to Accumulate.

Key financials (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Revenue	12,700	13,636	14,788	14,641	14,026
% chg	11.4	7.4	8.5	(1.0)	(4.2)
Adj. net profit	6,064	6,059	6,448	7,458	6,761
% chg	19.8	(0.1)	6.4	15.7	(9.3)
Adj. EPS (₹)	14.4	14.3	15.3	17.7	16.0
OPM (%)	51.1	50.6	50.2	50.4	50.4
P/E (x)	9.6	9.6	8.1	8.9	9.8
P/BV (x)	2.1	1.8	1.5	1.4	1.2
RoE (%)	23.3	19.8	20.2	16.2	13.2
RoCE (%)	19.8	17.5	16.8	14.3	12.1
EV/Sales (x)	3.5	3.0	2.4	2.2	2.0
EV/EBIDTA	6.9	5.9	4.8	4.3	4.0

Source: Company, Angel Research: Note CMP as of October 23, 2015

ACCUMULATE

CMP	₹158
Target Price	₹175

Investment Period	12 Months
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Stock Info

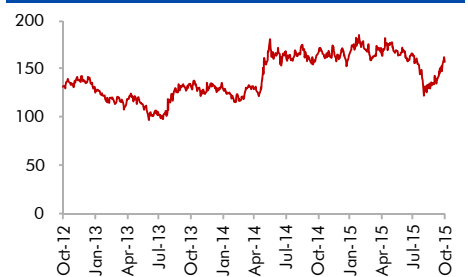
Sector	Metals/Mining
Market Cap (₹ cr)	66,548
Net Cash (₹ cr)	34,568
Beta	0.9
52 Week High / Low	190/117
Avg. Daily Volume	10,21,013
Face Value (₹)	2
BSE Sensex	27,471
Nifty	8,295
Reuters Code	HZNC.BO
Bloomberg Code	HZ IN

Shareholding Pattern (%)

Promoters	64.9
MF / Banks / Indian Fls	31.2
FII / NRIs / OCBs	1.9
Indian Public / Others	2.0

Abs. (%)	3m	1yr	3yr
Sensex	(3.2)	2.3	46.8
HZL	(5.0)	(4.7)	19.6

3-year price chart



Source: Company, Angel Research

Rahul Dholam

Tel: 022- 3935 7800 Ext: 6847

rahul.dholam@angelbroking.com

Exhibit 1: 2QFY2016 performance (Standalone)

(₹ cr)	2QFY16	2QFY15	yoy%	1QFY16	qoq%	FY2015	FY2014	yoy%
Net sales	3,908	3,749	4.2	3,596	8.7	14,788	13,636	8.5
Other operating income	125	53	135.2	34	263.7	-	-	
Revenue	4,033	3,802	6.1	3,630	11.1	14,788	13,636	8.5
Manufacturing exp.	675	602	12.1	499	35.4	5,375	5,134	4.7
% of net sales	17.3	16.1		13.9		36.3	37.6	
Selling & admin exp.	306	303	1.1	629	(51.3)	1,919	1,557	23.2
% of net sales	7.8	8.1		17.5		13.0	11.4	
Other expenditure	888	901	(1.4)	842	5.4	78	45	71.4
% of net sales	22.7	24.0		23.4		0.5	0.3	
Total expenditure	1,869	1,806	3.5	1,970	(5.1)	7,372	6,736	9.4
% of net sales	47.8	48.2		54.8		49.8	49.4	
EBITDA	2,164	1,997	8.4	1,660	30.3	7,417	6,900	7.5
Margin (%)	55.4	53.3	212bp	46.2	920bp	50.2	50.6	477bp
Interest	1	1	(7.6)	2	(24.8)	24	45	(47.7)
Depreciation	175	206	(15.1)	173	1.2	644	785	(17.9)
Other income	869	697	24.7	564	54.1	2,821	1,899	48.5
Profit before tax	2,857	2,486	14.9	2,050	39.4	9,570	7,970	20.1
% of net sales	73.1	66.3		57.0		64.7	58.4	
Tax	572	302		129		1,392	1,065	30.7
% of PBT	20.0	12.2		6.3		14.5	13.4	
Reported net profit	2,285	2,184	4.7	1,921	19.0	8,178	6,905	18.4
Adjusted Net Profit	2,285	2,186	4.5	1,921	19.0	6,448	6,059	6.4

Source: Company, Angel Research

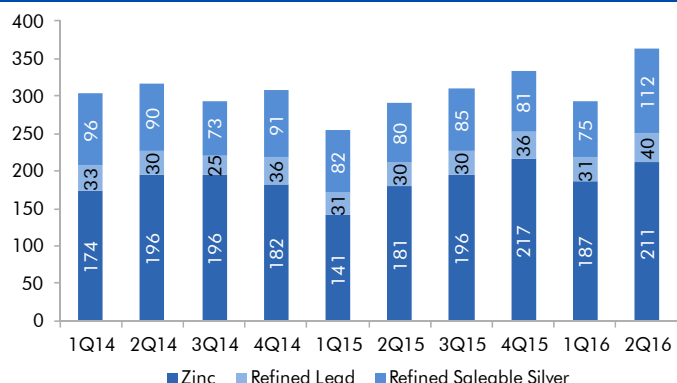
Exhibit 2: 2QFY2016 Actual vs. estimates

(₹ cr)	Actual	Estimates	Variation (%)
Net sales	3,908	3,693	5.8
EBITDA	2,164	1,874	15.5
EBITDA margin (%)	55.4	50.7	463bp

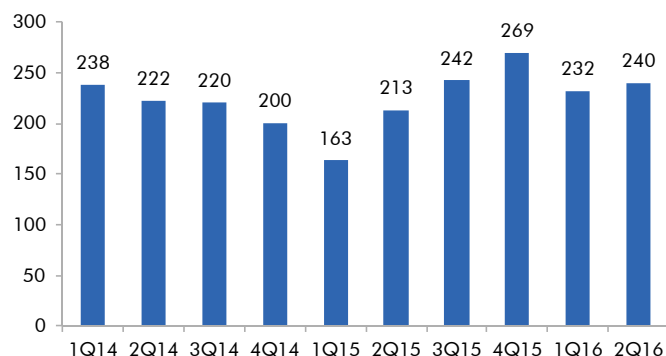
Source: Company, Angel Research

Result highlights
Better than expected volumes drive revenue

HZL reported a 4% increase in revenue at ₹3,908cr, ~6% ahead of estimate of ₹3,693cr. The outperformance was led by better than expected volumes with refined zinc production at 211,000MT, increasing by 17% yoy, during the quarter. Refined lead and silver production also surprised positively. Refined lead production increased 33% yoy to 40,000MT, while refined silver production jumped 40% yoy to 112,000MT. Mined metal production increased 13% yoy to 240,000MT. Global prices have declined ~20-25% for all the three metals over the last year, resulting in lower realizations for HZL. However, volume growth has more than offset the fall in realizations owing to decline in metal prices, thereby resulting in increase in revenue, as against an expectation of a revenue decline.

Exhibit 3: Strong volume growth drives revenue growth


Source: Company, Angel Research

Exhibit 4: Mined metal production (MT)


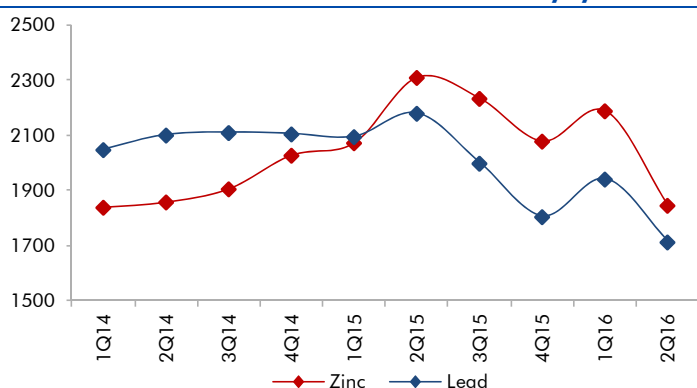
Source: Company, Angel Research

The EBITDA for the quarter, at ₹2,164cr, came in 16% ahead of our expectation of ₹1,874cr, led by higher than expected revenue growth. The EBITDA increased 8% yoy and was up 30% sequentially. The EBITDA margin improved 212bp yoy to 55.4% and was 463bp higher than our expectation. Depreciation and finance expenses came in in line with our expectations. The Net profit increased 5% yoy to ₹2,285cr and was 15% ahead of our expectation.

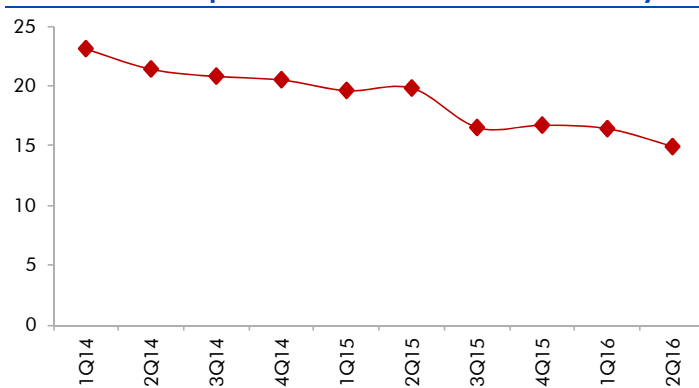
Exhibit 5: EBITDA Margin jumps 212bp yoy

	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16
EBITDA (₹ Cr)	1506	1904	1828	1736	1352	2000	2089	1978	1672	2188
Margin (%)	51%	54%	53%	48%	46%	53%	55%	49%	47%	56%

Source: Company, Angel Research

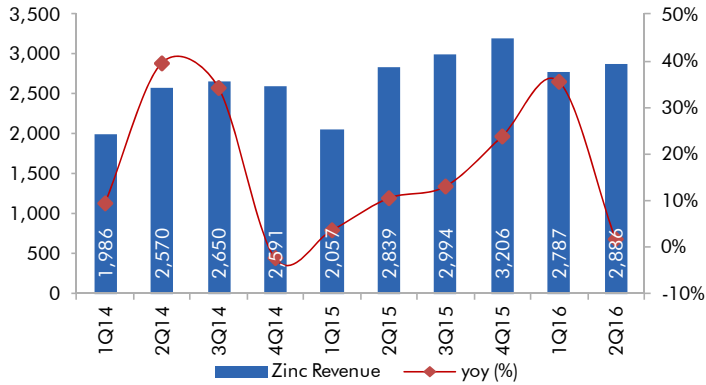
Exhibit 6: Zinc & Lead Prices decline ~20% yoy


Source: Company, Angel Research

Exhibit 7: Silver prices have halved in the last few years


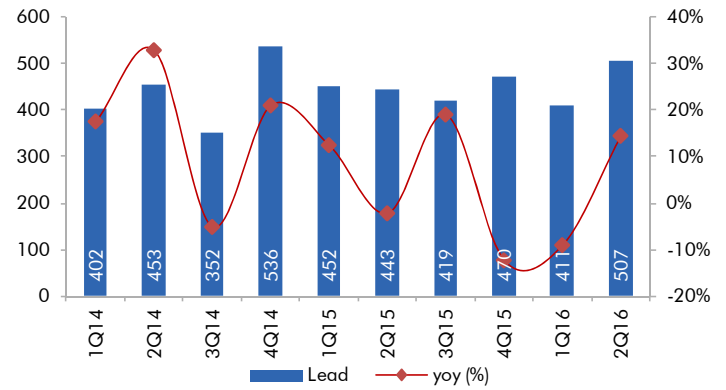
Source: Company, Angel Research

Exhibit 8: Zinc revenue remains flat yoy



Source: Company, Angel Research

Exhibit 9: Lead revenue growth led by strong volumes



Source: Company, Angel Research

Exhibit 10: Silver volumes jump 40% yoy



Source: Company, Angel Research

Exhibit 11: Volume led revenue growth



Source: Company, Angel Research

Investment arguments

Volume growth to remain strong

HZL's Management has guided for a ~16% increase in refined metal production volumes in FY2016, led by the strong performance in 2QFY2016. The Management expects total integrated silver production to be 375,000MT in FY2016. The Management also indicated that the expansion projects remain on track, which should help the company drive volumes. Rampura Agucha open pit deepening project to de-risk the transition to underground mining remains on track. The company has received environment clearance for deepening of pit by another 50meters, to an ultimate depth of 420meters. The pre-stripping work made impressive progress during the quarter and the main shaft sinking is progressing as per the devised plan. At Sindesar Khurd, the company plans to increase ore production capacity by 50% from 2MMT to 3MMT by the year-end. The ramp up of Kayad mine also remains ahead of schedule and the company expects to achieve 1MMT production capacity by the year-end. The Management has kept the capex guidance unchanged at ~\$200-\$225mn, including sustenance capex. We expect the capacity expansions to help the company nearly offset the pressure from falling realizations.

Zinc prices may continue to remain under pressure

We believe with the slowdown in China and in overall steel demand, it will be difficult for zinc prices to firm up over the coming years. Our outlook for zinc prices continues to remain negative and we are not factoring any improvement in prices over FY2015-17, leading to a 1%/4% decline in revenue in FY2016 and FY2017, respectively. Led by the decline in revenue, we expect the EBITDA to decline by ~0.5%/4.2% in FY2016 and FY2017, respectively.

Outlook and valuation

We expect zinc prices to continue its decline going forward led by global headwinds. We have however increased our volume estimates, led by the strong outperformance during 2QFY2016. We raise our FY2016 and FY2017 estimates in view of the better than expected volumes and operating leverage potential. The stock is currently trading at 4x FY2017E EV/EBITDA. We value the stock at 5x FY2017 EV/EBITDA and **arrive at a target price of ₹175. We upgrade our recommendation on the stock to Accumulate.**

Exhibit 12: Valuation

	(₹ cr)
FY2017E Adj. EBITDA	7,070
Multiple (x)	5
Total EV	35,349
Net Cash	38,394
Equity Value	73,744
Target price (₹)	175

Source: Angel Research

Company background

Hindustan Zinc is one of the world's largest integrated producers of zinc and is among the leading global lead and silver producers. With reserves and resources of 375.1mn tonne, the company is one of the lowest cost producers in the world and is well placed to serve the growing demand in Asia. Hindustan Zinc is a subsidiary of the London listed diversified metals and mining major, Vedanta Resources plc.

Profit & Loss Statement (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Net Sales	12,700	13,636	14,788	14,641	14,026
Other operating income	0	0	0	0	0
Total operating income	12,700	13,636	14,788	14,641	14,026
% chg	11.4	7.4	8.5	(1.0)	(4.2)
Total Expenditure	6,209	6,736	7,372	7,257	6,956
Manufacturing Expenses	4,753	5,134	5,375	5,349	5,125
Selling & General Exp.	1,338	1,557	1,919	1,830	1,753
Other Expenses	118	45	78	78	78
EBITDA	6,491	6,900	7,417	7,383	7,070
% chg	7.7	6.3	7.5	(0.5)	(4.2)
(% of Net Sales)	51.1	50.6	50.2	50.4	50.4
Depreciation & Amort.	647	785	644	803	878
EBIT	5,844	6,115	6,773	6,581	6,192
% chg	7.9	4.6	10.7	(2.8)	(5.9)
(% of Net Sales)	46.0	44.8	45.8	44.9	44.2
Interest & other Charges	27	45	24	25	26
Other Income	2,003	1,899	2,821	2,539	2,285
Profit before tax	7,820	7,970	9,570	9,095	8,451
% chg	12.6	1.9	20.1	(5.0)	(7.1)
Tax Expense	921	1,065	1,392	1,637	1,690
(% of PBT)	11.8	13.4	14.5	18.0	20.0
Recurring PAT	6,899	6,905	8,178	7,458	6,761
Adjusted PAT	6,064	6,059	6,448	7,458	6,761
% chg	19.8	(0.1)	6.4	15.7	(9.3)
(% of Net Sales)	47.7	44.4	43.6	50.9	48.2

Balance Sheet (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
SOURCES OF FUNDS					
Equity Share Capital	845	845	845	845	845
Reserves & Surplus	31,431	36,573	42,508	47,980	52,629
Shareholders Funds	32,276	37,418	43,353	48,825	53,474
Total Loans	0	0	0	0	0
Deferred Tax Liability	1,280	1,658	2,519	2,997	3,314
Other Long term liabilities	28	56	132	152	182
Total Liabilities	33,584	39,132	46,004	51,974	56,969
APPLICATION OF FUNDS					
Gross Block	12,281	13,600	14,551	16,051	17,551
Less: Acc. Depreciation	3,797	4,453	5,104	5,907	6,784
Net Block	8,484	9,147	9,446	10,144	10,766
Capital Work-in-Progress	1,082	1,541	2,005	2,105	2,210
Investments	14,540	22,506	27,254	31,342	35,103
Current Assets	9,222	5,543	5,950	6,321	5,957
Cash	6,942	3,031	3,532	3,582	3,292
Inventories	1,111	1,198	1,212	1,464	1,403
Debtor	403	400	659	732	701
Other	766	914	548	543	561
Current liabilities	1,882	2,545	2,988	2,708	2,314
Net Current Assets	7,341	2,998	2,962	3,612	3,642
Other Assets	2,137.5	2,939.4	4,337.3	4,771.1	5,248.2
Total Assets	33,584	39,132	46,004	51,974	56,969

Cash flow statement (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Profit before tax	7,820	7,970	9,570	9,095	8,451
Depreciation	647	785	645	803	878
Change in Working Capital	(984)	(505)	(187)	(600)	(320)
Others	(1,087)	(1,133)	(2,463)	(414)	(447)
Direct taxes paid	(1,611)	(1,645)	(2,033)	(1,159)	(1,373)
Cash Flow from Operations	4,785	5,471	5,531	7,725	7,189
(Inc.)/ Dec. in Fixed Assets	(1,753)	(1,709)	(1,611)	(1,600)	(1,605)
(Inc.)/ Dec. in Investments	(629)	(6,825)	(2,285)	(4,088)	(3,761)
Others	(888)	4,578	89	0	0
Cash Flow from Investing	(3,269)	(3,955)	(3,807)	(5,688)	(5,366)
Issue of Equity	-	-	-	-	-
Inc./(Dec.) in loans	-	-	-	-	-
Dividend Paid (Incl. Tax)	(1,228)	(1,532)	(1,879)	(1,986)	(2,113)
Others	(27)	(45)	(24)	-	-
Cash Flow from Financing	(1,255)	(1,577)	(1,902)	(1,986)	(2,113)
Inc./(Dec.) in Cash	261	(62)	(178)	51	(290)
Opening Cash balances	29	290	228	3,532	3,582
Closing Cash balances	290	228	50	3,582	3,292

Key ratios

Y/E March	FY2013	FY2014	FY2015	FY2016E	FY2017E
Per Share Data (₹)					
Reported EPS	16.3	16.3	19.4	17.7	16.0
Adjusted EPS	14.4	14.3	15.3	17.7	16.0
Cash EPS	17.9	18.2	20.9	19.5	18.1
DPS	3.1	3.5	4.4	4.7	5.0
Book Value	76.4	88.6	102.6	115.6	126.6
Valuation Ratio (x)					
P/E (on FDEPS)	9.6	9.6	8.1	8.9	9.8
P/CEPS	8.8	8.7	7.5	8.1	8.7
P/BV	2.1	1.8	1.5	1.4	1.2
Dividend yield (%)	2.0	2.2	2.8	3.0	3.2
EV/Sales	3.5	3.0	2.4	2.2	2.0
EV/EBITDA	6.9	5.9	4.8	4.3	4.0
EV/Total Assets	1.3	1.0	0.8	0.6	0.5
Returns (%)					
ROCE	19.8	17.5	16.8	14.3	12.1
ROE	23.3	19.8	20.2	16.2	13.2
Turnover ratios (x)					
Asset Turnover (Gross Block)	1.1	1.1	1.1	1.0	0.8
Inventory (days)	27.4	30.9	29.7	33.4	37.3
Receivables (days)	10.6	10.7	13.1	17.3	18.7
Payables (days)	48.3	59.2	68.3	71.0	65.4
WC cycle (ex-cash) (days)	8.7	4.9	(7.4)	(6.7)	5.0
Solvency ratios (x)					
Net debt to equity	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)
Net debt to EBITDA	(3.3)	(3.7)	(4.2)	(4.7)	(5.4)

Research Team Tel: 022 - 39357800

 E-mail: research@angelbroking.com

 Website: www.angelbroking.com

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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 (Based on expected returns over 12 months investment period):	Buy (> 15%)	Accumulate (5% to 15%) Reduce (-5% to -15%)	Neutral (-5 to 5%) Sell (< -15)
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