

January 27, 2016

Hindustan Zinc

Volume growth drives outperformance

Standalone (₹ cr)	3QFY16	3QFY15	yoy (%)	2QFY16	qoq%
Revenue	3,431	3,853	(11.0)	4,033	(14.9)
EBITDA	1,478	2,089	(29.2)	2,164	(31.7)
Margin (%)	43.1	54.2	(11pp)	53.7	(11pp)
Reported PAT	1,811	2,379	(23.9)	2,285	(20.7)

Source: Company, Angel Research

For 3QFY2016, Hindustan Zinc (HZL) reported a 11% yoy decline in revenue to ₹3,385cr, in line with estimates, led by a 17% decline in zinc revenues as higher volumes and rupee depreciation benefits were offset by lower realizations on account of a decline in LME prices and zinc premiums. Mined metal production declined 13% yoy to 2,40,000MT. EBITDA for the quarter was also in line with expectation at ₹1,478cr, declining 29% yoy, led by lower LME prices and ₹84cr contribution towards the District Mineral Foundation (DMF). While depreciation and finance expenses came in line with our expectations, lower tax rate resulted in the net profit coming in 9% ahead of expectations at ₹1,811cr.

Management has maintained its guidance of a ~16% increase in refined metal production volume for FY2016, despite a weaker mine plan in 4QFY2016. Management also indicated that the expansion projects remain on track, which should help drive volumes.

Outlook and valuation: We expect zinc prices to continue to decline going forward led by global headwinds. We have however retained our volume estimates, led by the healthy growth during the quarter. We reduce our FY2016 and FY2017 estimates in view of the higher than expected fall in realizations and fall in zinc premiums. The stock is currently trading at 4.2x FY2017E EV/EBITDA. We value the stock at 6x FY2017E EV/EBITDA and **arrive at a target price of ₹170. We retain our Accumulate rating on the stock.**

Key financials (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Revenue	12,700	13,636	14,788	14,105	12,977
% chg	11.4	7.4	8.5	(4.6)	(8.0)
Adj. net profit	6,064	6,059	6,448	7,512	6,015
% chg	19.8	(0.1)	6.4	16.5	(19.9)
Adj. EPS (₹)	14.4	14.3	15.3	17.8	14.2
OPM (%)	51.1	50.6	50.2	46.6	44.3
P/E (x)	9.2	9.2	7.8	8.5	10.6
P/BV (x)	2.0	1.7	1.5	1.3	1.2
RoE (%)	23.3	19.8	20.2	16.3	11.8
RoCE (%)	19.8	17.5	16.8	12.7	9.8
EV/Sales (x)	3.3	2.8	2.2	2.1	2.1
EV/EBITDA	6.5	5.5	4.5	4.5	4.6

Source: Company, Angel Research: Note CMP as of January 25, 2016

ACCUMULATE

CMP	₹151
Target Price	₹170

Investment Period	12 Months
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Stock Info	
Sector	Metals/Mining
Market Cap (₹ cr)	63,844
Net Cash (₹ cr)	32,639
Beta	1.0
52 Week High / Low	190/117
Avg. Daily Volume	4,26,554
Face Value (₹)	2
BSE Sensex	24,486
Nifty	7,436
Reuters Code	HZNC.BO
Bloomberg Code	HZ IN

Shareholding Pattern (%)	
Promoters	64.9
MF / Banks / Indian FIs	1.8
FII / NRIs / OCBs	1.7
Indian Public / Govt / Others	31.6

Abs. (%)	3m	1yr	3yr
Sensex	(10.5)	(15.8)	22.3
HZL	(10.4)	(12.0)	10.6

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 3QFY2016 performance (Standalone)

(₹ cr)	3QFY16	3QFY15	yoy%	2QFY16	qoq%	9MFY16	9MFY15	yoy%
Net sales	3,385	3,804	(11.0)	3,908	(13.4)	10,889	10,516	3.6
Other operating income	45	49	(8.1)	125	(63.7)	205	147	39.2
Revenue	3,431	3,853	(11.0)	4,033	(14.9)	11,094	10,663	4.0
Manufacturing exp.	715	478	49.6	675	5.9	1,888	1,744	8.2
% of net sales	21.1	12.6		17.3		17.3	16.6	
Selling & admin exp.	363	370	(1.7)	306	18.6	1,299	871	49.1
% of net sales	10.7	9.7		7.8		11.9	8.3	
Other expenditure	874	917	(4.6)	888	(1.5)	2,604	2,609	(0.2)
% of net sales	25.8	24.1		22.7		23.9	24.8	
Total expenditure	1,952	1,764	10.7	1,869	4.4	5,791	5,224	10.9
% of net sales	57.7	46.4		47.8		53.2	49.7	
EBITDA	1,478	2,089	(29.2)	2,164	(31.7)	5,303	5,438	(2.5)
Margin (%)	43.1	54.2	(11pp)	53.7	(11pp)	47.8	51.0	(791bp)
Interest	5	1	546.8	1	322.3	8	10	(18.2)
Depreciation	172	209	(17.9)	175	(1.9)	520	617	(15.8)
Other income	555	812	(31.7)	869	(36.2)	1,987	2,226	(10.7)
Profit before tax	1,856	2,692	(31.0)	2,857	(35.0)	6,763	7,037	(3.9)
% of net sales	54.8	70.8		73.1		62.1	66.9	
Tax	45	312		572		745	857	(13.0)
% of PBT	2.4	11.6		20.0		11.0	12.2	
Reported net profit	1,811	2,379	(23.9)	2,285	(20.7)	6,017	6,181	(2.6)
Adjusted Net Profit	1,811	2,379	(23.9)	2,285	(20.7)	6,017	6,183	(2.7)

Source: Company, Angel Research

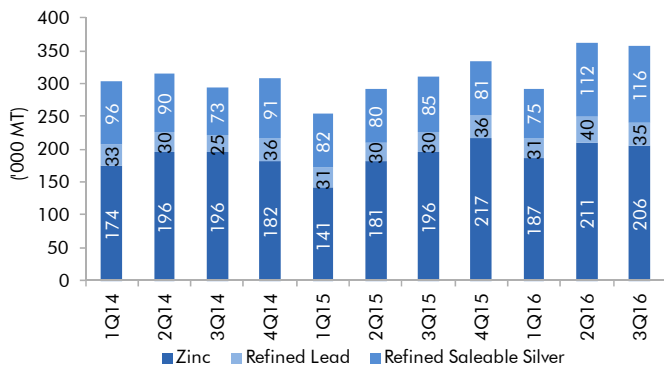
Exhibit 2: 3QFY2016 Actual vs. estimates

(₹ cr)	Actual	Estimates	Variation (%)
Net sales	3,385	3,384	-
EBITDA	1,478	1,471	0.5
EBITDA margin (%)	43.7	43.5	20bp
Net Profit	1,811	1,656	9.4

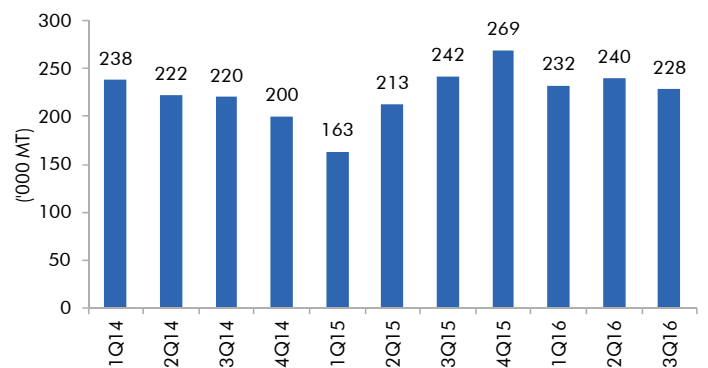
Source: Company, Angel Research

Result highlights
Better than expected volumes drive revenue

HZL reported a 11% yoy decline in revenue for the quarter at ₹3,385cr, in line with estimates, led by a 17% decline in zinc revenues as higher volumes and rupee depreciation benefits were offset by lower realizations on account of a decline in LME prices and zinc premiums. Mined metal production declined 13% yoy to 2,40,000MT led by increased contributions from Sindesar Khurd and Kayad mines, resulting in lower average grades. Volume growth however continued to remain strong with refined zinc production increasing 5% yoy at 2,06,000MT while refined lead and silver production came in ahead of estimates. Refined lead production increased 17% yoy to 35,000MT, while refined silver production jumped 37% yoy to 116,000MT.

Exhibit 3: Strong volume growth drives revenue growth


Source: Company, Angel Research

Exhibit 4: Mined metal production


Source: Company, Angel Research

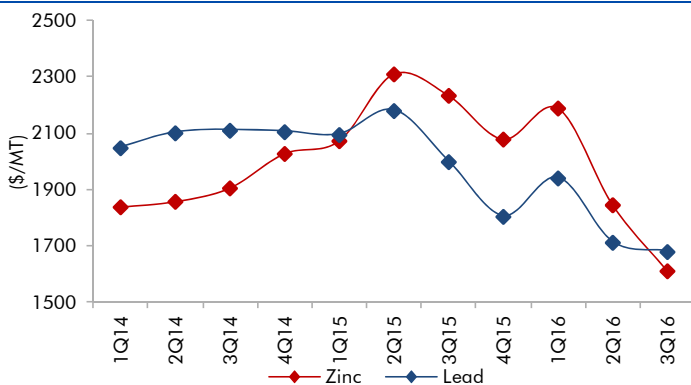
The EBITDA for the quarter was also in line with our expectation at ₹1,478cr, declining 29% yoy, led by lower LME prices and ₹84cr contribution towards the District Mineral Foundation (DMF). Depreciation and finance expenses came in line with our expectation. Tax rate for 9MFY2016 stands at 11% on account of higher proportion of tax efficient investment income and change in methodology of accounting for long-term capital gain, with significant investments now becoming long-term. The lower tax rate resulted in net profit coming in 9% ahead of our expectation at ₹1,811cr.

Exhibit 5: EBITDA Margin jumps 212bp yoy

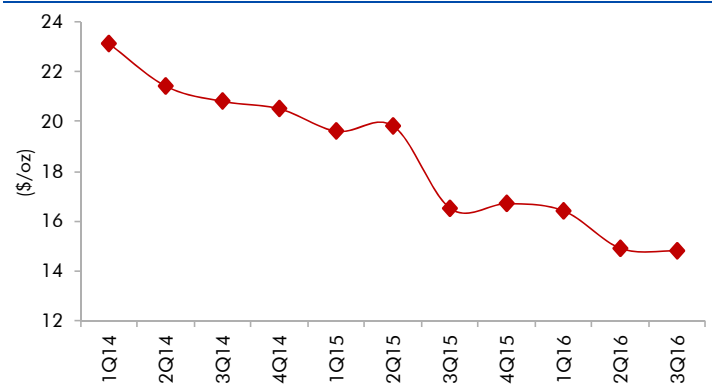
(₹ cr)	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16
EBITDA	1,498	1,822	1,824	1,755	1,352	1,997	2,089	1,978	1,660	2,164	1,478
Margin (%)	50.2	51.2	52.9	48.2	45.0	52.5	54.2	48.0	45.7	53.7	43.1

Source: Company, Angel Research

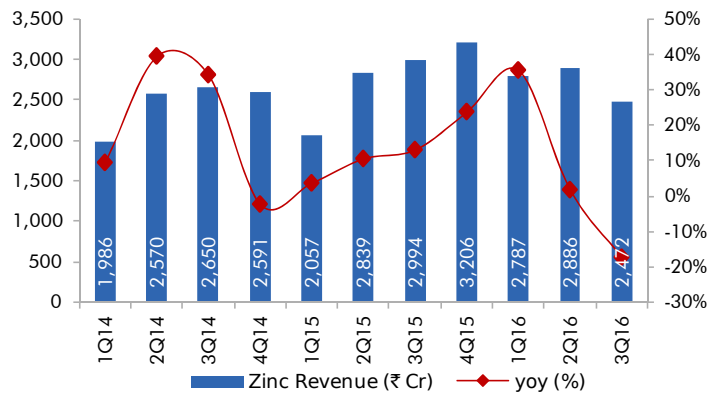
The Management has maintained its guidance for FY2016, despite a weaker mine plan in 4QFY2016. The ongoing expansion projects also remain on track with 16km of mine development during the quarter, 55% higher than the 3QFY2015 and an all time record for the company.

Exhibit 6: Zinc & Lead Prices continue to decline


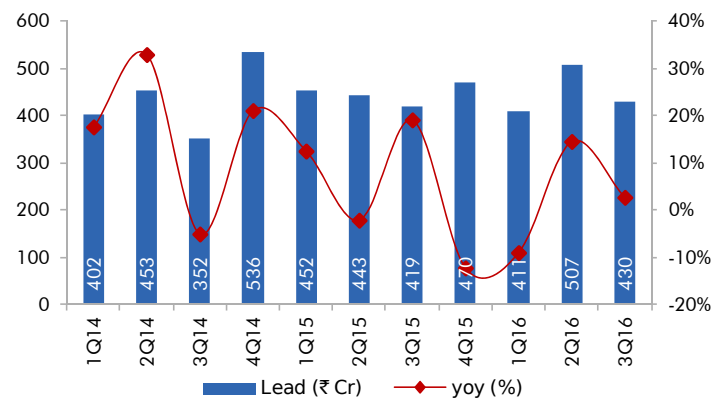
Source: Company, Angel Research

Exhibit 7: Silver prices down 10% yoy


Source: Company, Angel Research

Exhibit 8: Zinc revenue declines 17% yoy


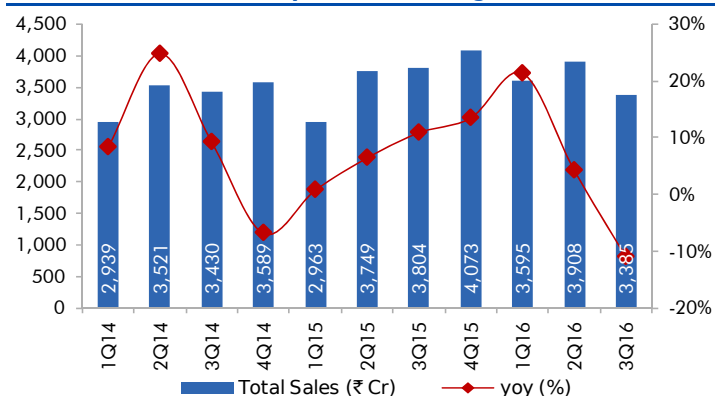
Source: Company, Angel Research

Exhibit 9: Lead revenue remains flat yoy


Source: Company, Angel Research

Exhibit 10: Silver volumes jump 37% yoy


Source: Company, Angel Research

Exhibit 11: Lower zinc premiums drag revenue


Source: Company, Angel Research

Production growth at Sindesar Khurd mine crossed the 3MTPA run rate during the quarter, well ahead of schedule. The mill debottlenecking project has also been completed in-line with the mine production and the company has commenced a new mill project with a capacity of 1.5 MTPA during the quarter and is expected to be commissioned in 4QFY2017. The shaft sinking project continues to be ahead of plan. Despite a slowdown due to much higher rock support and safety precautions at Rampura Agucha, the main shaft sinking project crossed 860 meters during the quarter of the ultimate depth of 950 meters. The ramp-up of Kayad mine also remains on track and is expected to achieve 1 MTPA production capacity run rate by this year-end, making it one of the fastest underground mine ramp-ups. In light of the challenging environment for metals, the company is reviewing the Zawar and Rajpura Dariba Mine expansion projects.

The Management expects zinc demand to grow at a compounded average annual run rate of 2% per annum with the fundamentals of zinc continuing to remain strong on the back of planned mine closures and medium-term supply shortages. However, the weak sentiment and nervousness related to the slowdown in China are dragging prices down contrary to the emerging demand supply imbalances in zinc.

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. The Management had kept the capex guidance unchanged at ~\$200-\$225mn, including sustenance capex. We expect these capacity expansions to help the company 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 5%/8% decline in revenue in FY2016 and FY2017, respectively. Led by the decline in revenue, we expect the EBITDA to decline by ~11-12% in FY2016 and FY2017, respectively.

Outlook and valuation

We expect zinc prices to continue to decline going forward led by global headwinds. We have however retained our volume estimates, led by the healthy growth during the quarter. We reduce our FY2016 and FY2017 estimates in view of the higher than expected fall in realizations and fall in zinc premiums. The stock is currently trading at 4.2x FY2017E EV/EBITDA. We value the stock at 6x FY2017E EV/EBITDA and **arrive at a target price of ₹170. We retain our Accumulate rating on the stock.**

Exhibit 12: Valuation (FY2017E)

	(₹ cr)
Adj. EBITDA	5,750
Multiple (x)	6
Total EV	34,492
Net Cash	37,112
Equity Value	71,604
Target price (₹)	170

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	14,105	12,977
Other operating income	0	0	0	0	0
Total operating income	12,700	13,636	14,788	14,105	12,977
% chg	11.4	7.4	8.5	(4.6)	(8.0)
Total Expenditure	6,209	6,736	7,372	7,538	7,228
Manufacturing Expenses	4,753	5,134	5,375	5,866	5,658
Selling & General Expenses	1,338	1,557	1,919	1,672	1,570
Other Expenses	118	45	78	0	0
EBITDA	6,491	6,900	7,417	6,567	5,749
% chg	7.7	6.3	7.5	(11.5)	(12.5)
(% of Net Sales)	51.1	50.6	50.2	46.6	44.3
Depreciation & Amortisation	647	785	644	691	766
EBIT	5,844	6,115	6,773	5,875	4,982
% chg	7.9	4.6	10.7	(13.2)	(15.2)
(% of Net Sales)	46.0	44.8	45.8	41.7	38.4
Interest & other Charges	27	45	24	13	16
Other Income	2,003	1,899	2,821	2,633	2,370
Profit before tax	7,820	7,970	9,570	8,495	7,336
% chg	12.6	1.9	20.1	(11.2)	(13.6)
Tax Expense	921	1,065	1,392	983	1,320
(% of PBT)	11.8	13.4	14.5	11.6	18.0
Recurring PAT	6,899	6,905	8,178	7,512	6,015
Adjusted PAT	6,064	6,059	6,448	7,512	6,015
% chg	19.8	(0.1)	6.4	16.5	(19.9)
(% of Net Sales)	47.7	44.4	43.6	53.3	46.4

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	48,034	51,937
Shareholders Funds	32,276	37,418	43,353	48,879	52,782
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	52,027	56,278
APPLICATION OF FUNDS					
Gross Block	12,281	13,600	14,551	16,051	17,551
Less: Acc. Depreciation	3,797	4,453	5,104	5,796	6,562
Net Block	8,484	9,147	9,446	10,255	10,989
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	5,948	4,631
Cash	6,942	3,031	3,532	3,197	2,009
Inventories	1,111	1,198	1,212	1,411	1,298
Debtor	403	400	659	705	649
Other	766	914	548	635	675
Current liabilities	1,882	2,545	2,988	2,609	2,141
Net Current Assets	7,341	2,998	2,962	3,338	2,490
Other Assets	2,137.5	2,939.4	4,337.3	4,987.9	5,486.7
Total Assets	33,584	39,132	46,004	52,027	56,278

Cash flow statement (Standalone)

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Profit before tax	7,820	7,970	9,570	8,495	7,336
Depreciation	647	785	645	691	766
Change in Working Capital	(984)	(505)	(187)	(711)	(339)
Others	(1,087)	(1,133)	(2,463)	(631)	(468)
Direct taxes paid	(1,611)	(1,645)	(2,033)	(505)	(1,003)
Cash Flow from Operations	4,785	5,471	5,531	7,340	6,291
(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	-	-
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)	(334)	(1,188)
Opening Cash balances	29	290	228	3,532	3,197
Closing Cash balances	290	228	50	3,197	2,009

Key ratios

Y/E March	FY2013	FY2014	FY2015	FY2016E	FY2017E
Per Share Data (₹)					
Reported EPS	16.3	16.3	19.4	17.8	14.2
Adjusted EPS	14.4	14.3	15.3	17.8	14.2
Cash EPS	17.9	18.2	20.9	19.4	16.1
DPS	3.1	3.5	4.4	4.7	5.0
Book Value	76.4	88.6	102.6	115.7	124.9
Valuation Ratio (x)					
P/E (on FDEPS)	9.2	9.2	7.8	8.5	10.6
P/CEPS	8.5	8.3	7.2	7.8	9.4
P/BV	2.0	1.7	1.5	1.3	1.2
Dividend yield (%)	2.1	2.3	2.9	3.1	3.3
EV/Sales	3.3	2.8	2.2	2.1	2.1
EV/EBITDA	6.5	5.5	4.5	4.5	4.6
EV/Total Assets	1.3	1.0	0.7	0.6	0.5
Returns (%)					
ROCE	19.8	17.5	16.8	12.7	9.8
ROE	23.3	19.8	20.2	16.3	11.8
Turnover ratios (x)					
Asset Turnover (Gross Block)	1.1	1.1	1.1	0.9	0.8
Inventory (days)	27.4	30.9	29.7	33.9	38.1
Receivables (days)	10.6	10.7	13.1	17.6	19.0
Payables (days)	48.3	59.2	68.3	72.4	66.8
WC cycle (ex-cash) (days)	8.7	4.9	(7.4)	(5.5)	8.7

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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)