

## Hindustan Zinc

BSE: 500188 | Sector: Metal

21st June 2017

vScore : 60 | Gain% : **20.19%**

**Buy Date:** 21-Jun-2017 | **Buy Price :** Rs. 251.90

**Partial Profit Booked** at: Rs. 296.05 on 31-Aug-2017

**Exit Date:** 08-Sep-2017 | **Exit Price :** Rs. 309.5

### BUSINESS BACKGROUND

Hindustan Zinc Ltd (HZL) is a leading integrated miner and manufacturer of zinc and lead in India with a capacity of 1.0 mn MTpa and a leading producer of silver. HZL is the 2nd-largest company by mined metal and the 4th largest by Zinc/Lead produced globally. It is also amongst the lowest cost producers for zinc globally. Zinc has application in galvanising steel, which is further used in the automobile and consumer goods industry on the other side lead is primarily used in automobile batteries. The company has zinc-lead mines at Rampura Agucha, Sindesar Khurd, Rajpura Dariba, Zawar and Kayad. The company has a huge reserve base which stood at 404.4 MT as of date. It has installed capacity of zinc as 823,000 tonnes, lead as 185,000 tonnes and of silver as 500,000 kg.

The company is self sufficient in power with installed base of 474 MW coal based power plant. Also, it has green power capacity of total 309 MW including wind power (274 MW) and waste heat power (35 MW).

### INVESTMENT HIGHLIGHTS

**Q4FY17 results:** In Q4FY17, HZL's gross sales rose by 98.63% YoY and 36.66% QoQ to Rs 6756.15 cr led by strong zinc, lead and silver prices, higher production and sale of mined metal. EBITDA grew by 185% YoY and 34.66% QoQ to Rs 3748 cr. EBITDA margin expanded by whopping 1744bps to 55.48% YoY. PAT surge by 42.37% YoY and 31.77% QoQ to Rs 3057 cr. PAT margin stood at 45.25% in Q4FY17 vs 62.17% in Q4FY16.(All figures are on standalone basis.)

### Segment Highlights:

The company produces mainly zinc, lead and silver with revenue share of 77%/12.81%/8.40% respectively. Zinc sales volume for the quarter was at ~217000 tonnes (up 37.3% YoY, 2.8% QoQ). Lead sales volumes came in at ~47000 tonnes (up 14.6% YoY, 30.6% QoQ). Silver sales volumes came in at ~135000 kg (up 10.7% YoY, 15.4% QoQ).

### KEY DATA

FACE VALUE	Rs	2
DIVID YIELD %		10.25
52 WK HI/LOW		333.20/160.85
NSE CODE		HINDZINC
MARKET CAP		Rs.114654 Cr

### SHAREHOLDING PATTERN

PROMOTERS	-	64.92%
BANKS, MFs & DIIs	-	1.08%
FIIIs	-	2.64%
Others	-	31.36%

### KEY FUNDAMENTALS

Year Ending	FY17A	FY18E	FY19E
Rev Gr%	21	8	9
Net Profit Gr%	2	2	13
ROE%	27	27	24
ROCE %	27	33	30
EPS (Rs)	19.7	20.1	22.7
P/E (x)	12.5	12.2	10.8

**Improving production and realisations continue to drive growth:**

The company has achieved highest mined metal production in H2FY17 which rose by 41.36% YoY to 58800 MT as compare to H1FY17. The company recorded surge in mined metal production by 2% on yearly basis in FY17 to total 907000 MT. The average zinc and lead per tonne prices at \$2612/\$2159 are higher by 62%/27% on yearly basis, attributing well for HZL's strong performance. Recently zinc and lead prices have softened over geopolitical development. This softness can be compensated by rising production. It is targeting for 1.2 mn MT by FY20 which augurs well with development of new mines on track for completion by FY19.

**Huge reserve base; provides strong earnings visibility :**

HZL is the leading miner & manufacturer of zinc and lead in India. Zinc metal has wide application across sectors. It is primarily used in galvanising steel, which is further used in the automobile & consumer goods industry and also zinc is a main ingredient in cosmetics, rubber and other healthcare products. Meanwhile lead is primarily used in manufacturing automobile batteries. The company has a huge reserve base, which provides strong earnings visibility. In FY17, net addition of 14.5 MT was made to reserve and resource (R&R), adding further to HZL's R&R. Total R&R at March 31, 2017 was 404.4 MT containing 36.09 MT of zinc-lead metal and 1032 million ounce (Moz) of silver. Overall mine life continues to be 25+ years.

**Low cost advantage aids in sustaining superior operating margins :**

HZL's smelting assets are in the lowest quartile on the global cost curve. The low cost advantage can be attributed to its fully integrated nature of operations involving mines, smelter and captive power plants. Furthermore, HZL's smelters are logistically well placed in Rajasthan, near its mines, which results in low transportation and shifting costs. Zinc cost of production remained stable at US\$800 levels despite higher coal/met-coke prices, led by higher volumes. The company enjoys strong operating margins in the range of 55% which is considered healthy in the industry.

**Strong business model and robust balance sheet:**

HZL's integrated business model ensures steady cash flows, which reiterates our positive stance on the company. Among all major base metals, zinc is the best placed backed by healthy fundamentals. HZL is a zero debt company with highest interest coverage ratio of 51.74x. Over FY13-17, HZL has maintain healthy average inventory days to 26 days and also receivable days to 10 days which delivers strong inventory and debtors turnover ratio in the range of 13-15x/30-37x. The company delivers healthy sales to working capital ratio 0.5-0.7x which shows financial strength of the company. It also has healthy cash flow which supports its capex plans of investing Rs 1000 cr in setting up of two more zinc fumer plants over next three years. This plant will be useful in increasing volume of zinc and lead which in turn aids topline and bottomline of the company.

**Industry Tailwinds to drive growth:**

Zn has performed exceptionally well in past 12 months, led by production cuts (Century, Lisheen, Glencore) which drove deficits. The growth in China economy at 6.9% on account of higher government infrastructure spending and a property boom is eventually driving base metal demand. Also cutting of excess steel making capacity in China boosts galvanising production globally which enhances demand for base metal. Due to which some of the capacity is now scaling up (China, Antamina in Peru, Nyrstar US ops). Still the deficit situation witnessed earlier will be

continue but at lower pace of 0.2-0.3 MT. HZL (10% market share globally and sole player in India) is placed well and continues to guide for a strong uptick in volumes (~18% YoY) which will drive earnings.

## Business Outlook and Valuation :

At the moment at current price of **252** the stock is trading at (TTM) P/E of 12.53x. Going ahead we expect revenue growth of 8% for FY18 and 9% FY19. Hence our expectations for revenue for FY18 and FY19 are INR 20302 Cr and INR 22129 Cr respectively.

We expect company to maintain EBITDA margin around 55-57% for next two years. Going ahead we expect PAT margins of 44-46% for next two years. Our PAT expectations for FY18 and FY19 are INR 8474 Cr, INR 9603 Cr respectively. Our EPS expectations for FY18 and FY19 are INR 20.1 and INR 22.7 Cr respectively.

We believe Hindustan Zinc Ltd at PE of 13.78 with ROCE around 24-27% with superior margins is attractively valued. For FY 18 EPS expectations of 20.1, we expect target price of **310/share** with a stop loss at 225.

## FINANCIALS:

For the Year Ended March (INR)	FY16A	FY17A	FY18E	FY19E
Net Sales (Cr)	14226	17518	19022	20849
EBIDTA (Cr)	6641	9556	10650	12000
EBIDTA %	46.68	54.55	55.99	57.56
Profit Before Tax (Cr)	8610	10199	10524	12311
Interest (Cr)	17	202	17	17
Depreciation (Cr)	713	1811	2099	2209
Tax (Cr)	444	1884	1686	2157
Profit After Tax (Cr)	8167	8316	8474	9603
PAT%	57.41	47.47	44.55	46.51
Diluted EPS (INR)	19.3	19.7	20.1	22.7
Shareholder's Funds (Cr)	37385	31716	37889	45180
Borrowings (Cr)	0	0	0	0
Gross Block (Cr)	15741	16118	18040	21689

## Key Risks and Concerns:

- Zinc and lead prices have corrected from \$2800/\$2400 per tonne to \$2600/\$2150 due to geopolitical development and we anticipate a modest recovery in metal prices going forward. Further softening of zinc and lead prices at global markets due to unexpected event can affect value of topline.

- The company recently switched from straight line depreciation calculation method to a written down value method which can put pressure on profit margin of the company.

vScore: Value Score is our proprietary company rating system based on last 5 years of historical data and value investing philosophy at its core. v360 combined with Macroeconomic indicators, projections, fundamental and technical trigger makes it a 360 degree view.

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*Source: Niveza Research Desk*