Indbank Merchant Banking Services Ltd (A Subsidiary of Indian Bank)

Hindustan Zinc Ltd.

EQUITY REPORT

June 6, 2014

BSE Code:	500188	NSE Code:	HINDZINC	Reuters	HZNC.NS	Bloomberg Code:	HZ:IN

Hindustan Zinc Ltd. (HZL) has amongst the lowest cost of zinc production globally. Its Rampura Agucha mine is amongst the world's largest and best quality zinc mines. Overall, HZL's integrated operations, access to high quality captive concentrate, and low-cost structure are its strengths. The company's mine metal capacity is set to increase from 1mtpa currently to 1.2mtpa over the next 2-3 years. Silver is high value by-product with FY14 annual production of close to 300t. The Company has zinc-lead mines at Rampura Agucha, Sindesar Khurd, Rajpura Dariba, Zawar and Kayad; primary smelter operations at Chanderiya, Dariba and Debari, all in the state of Rajasthan; and finished product facilities in the state of Uttarakhand. The company has cash and cash equivalents of ₹255 bn on its balance sheet with virtually zero debt. Hindustan Zinc is a subsidiary of the BSE, NSE and NYSE listed Sesa Sterlite Limited, a part of London listed FTSE 100 diversified metals and mining major, Vedanta Resources plc.

Investor's Rationale

- During FY14, there was a gross addition of 26.1 MMT (million metric tons) to reserves and resources, prior to a depletion of 9.3 MMT in FY13. Total reserves and resources as of March 31, 2014 were 365.1 MMT, containing 35.2 MMT of zinc-lead metal and 28,804 tons of silver. Overall mine life continues to be over 25 years and gives a long term visibility in earnings through existing mines. Besides, HZL is focusing on the development of existing mines so as to increase production instead of acquiring new mines, which is a long and tedious process and requires huge capex. HZL's huge reserve base provides long term earnings visibility.

- Expansion plan is on track to fill demand supply gap and to earn higher realizations. According to "ILZSG International Lead and Zinc Study Group", the demand of Zinc is likely to outpace supply by about 117,000 tons and thereby likely to put upward pressure on zinc prices. HZL being a lost cost producer of metals coupled with the company's efforts to ramp up capacity will likely to boost profitability through higher realizations. While on the expansion front, Kayad and the Rampura Agucha underground mine projects commenced commercial production during the year and are now ramping up well and are likely to boost mined metal and thereby profitability.

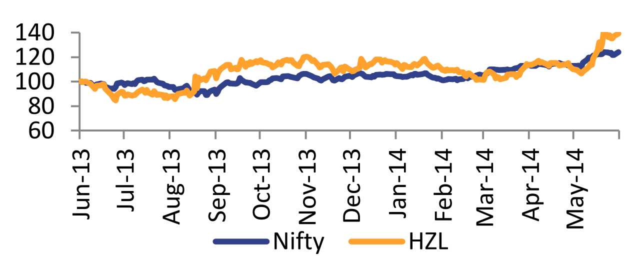
- HZL's reported a mixed performance in FY'14 with the standalone revenue grew by 7% YoY to ₹136,360 mn mainly driven by higher zinc sales volume and premium supported by rupee depreciation but is partially offset by lower metal prices in the global market. As a result, the company managed to report a growth of 7% in EBITDA to ₹69,615 mn in FY14. Average realization of zinc grew by around 17% to ₹126,511 per MT in FY14 on account of rupee depreciation and higher metal prices. While average realization of lead grew by around 16% to ₹165,057 during FY14. However, the net profit was flat at `69,046 mn in FY14.

Market Data	
Rating	**BUY**
CMP (₹)	173.0
Target (₹)	**203**
Potential Upside	~17%
Duration	Long Term
Face Value (₹)	2.0
52 week H/L (₹)	**175.5/94.0**
Adj. all time High (₹)	**175.5**
Decline from 52WH (%)	**1.4**
Rise from 52WL (%)	**84.0**
Beta	1.1
Mkt. Cap (₹bn)	731.0
Enterprise Value (₹bn)	700.7

Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
Revenue (₹bn)	127.0	136.4	142.9	154.3
EBITDA (₹bn)	64.8	69.6	72.9	77.9
Net Profit (₹bn)	69.0	69.0	72.6	77.4
Adj EPS (₹)	16.3	16.3	17.2	18.3
P/E (x)	10.6	10.7	10.1	9.4
P/BV (x)	2.3	2.0	1.7	1.5
EV/EBITDA (x)	10.2	10.1	9.6	8.9
ROCE (%)	23.4	20.6	18.9	17.8
ROE (%)	21.4	18.3	16.9	15.8

One year Price Chart



Shareholding Pattern	Mar'14	Dec'13	Diff.
Promoters	64.9	64.9	0.0
FII	2.1	2.0	0.1
DII	31.3	31.4	(0.1)
Others	1.7	1.7	0.0

HZL has a world-class resource base with total reserves & resources of 365.1 MMT and average zinc-lead reserve grade of 12.0%.

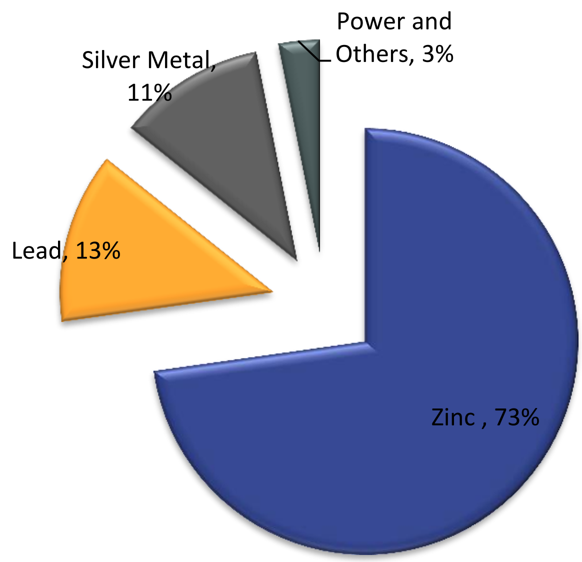
Hindustan Zinc - World's largest integrated zinc producer with total reserves & resources of 365.1 MMT

HZL is a Vedanta Group company engaged in zinc, lead and silver business. HZL is the world's largest integrated producer of zinc and is among the leading global lead and silver producers. HZL is also among the lowest cost metals producers (miners) in the world and are well placed to serve the growing demand of Asian countries. HZL is a subsidiary of the NYSE listed - Sterlite Industries (India) Limited (NYSE: SLT). HZL core business comprises of mining and smelting of zinc and lead along with captive power generation. HZL manufacturers three qualities of zinc - special high grade zinc, which is used in construction, infrastructure, household appliances etc.; high grade zinc and prime western zinc.

The company manufactures 99.99% pure lead used in lead acid battery, ceramic glazes, electrodes, etc. It also manufactures silver used in photographic material, conductor and jewelry, etc. The mineral major produces cadmium, whose purity ranges from 99.95-99.99%. It is used in Ni-Cd batteries, stabilizers, coating and alloys. HZL also manufactures sulphuric acid used in fertilizers, dyes, textiles, sugar refining, etc. They have four mines and four smelting operations. Their mines are situated at Rampura Agucha (largest zinc producing mine in the world), Sindesar Khurd, Rajpura Dariba and Zawar in the State of Rajasthan; while the smelters are located at Chanderiya, Debari and Dariba in the State of Rajasthan and Vizag in the State of Andhra Pradesh.

HZL has a world-class resource base with total reserves & resources of 365.1 MMT and average zinc-lead reserve grade of 12.0%. The company has a track record of consistently growing its reserves & resource base since 2003 and currently has a mine life of over 25 years. The company is self-sufficient in power with an installed base of 474 MW coal-based captive power plants. Additionally, it has the green power capacity of 309 MW including 274 MW of wind power and 35 MW of waste heat power.

Segment wise revenue (FY14)



HZL's Q4FY14 revenue declined due to lower metal production but partially offset by product premium in the spot market

Rampura Agucha mine's mined expected to decline further in FY1. However, growth in other mines is expected to more than make up for this shortfall.

HZL's reported a 6.8% YoY decline in its net revenue to ₹36,426.8 mn in Q4FY14 as against ₹39,086.5 mn in Q4FY13. The decline in revenue was due to lower mined metal output but was partially offset by higher custom smelting and an increase in product premiums at spot market. Mined metal output during the quarter declined 23.1% YoY due to slower ramp-up of underground mining at Rampura Agucha and changes in mining sequence. Though zinc metal production was flat on a yearly basis, integrated metal production declined by 1.2% YoY in Q4FY14. The decline in integrated metal production was higher in lead at 10% YoY during Q4FY14. Silver production declined by over 25.2% YoY to 68,000 tons in Q4FY14 as against 91,000 tons during Q3FY13. However, the impact of decline in the production of silver was negated by an increase in product premiums at spot market. Product premiums continued to move northwards during the quarter due to the supply tightness in the global market.

Financial performance snapshot (₹in mn)

in ₹mn	Q4FY'14	Q4FY'13	YoY (%)	FY'14	FY'13	YoY (%)
Net Revenue	**36,426.8**	**39,086.5**	**(6.8)**	**136,360.4**	**126,998.4**	**7.4**
EBITDA	**3,355.8**	**2,682.8**	**25.1**	**69,615.2**	**64,816.4**	**7.4**
EBITDA Margin (%)	*48.2*	*54.1*	*(595.1)bps*	*51.1*	*51.0*	*1.5bps*
Other Income	5,886.6	4,118.2	42.9	18,993.9	20,321.5	**(6.5)**
Depreciation	2,041.1	1,218.8	67.5	7,845.9	6,470.4	**21.3**
Interest	202.5	108.3	**87.0**	1,518.3	1,743.5	**(12.9)**
PBT	**21,195.2**	**23,950.8**	**(11.5)**	**80,313.8**	**78,376.5**	**93.3**
Exceptional item	-	-	-	616.7	175.3	**251.8**
PBT (In. Exceptional)	**21,195.2**	**23,950.8**	**(11.5)**	**79,697.1**	**9,206.4**	**765.7**
Tax	2,383.2	2,117.4	12.6	10,650.9	1,311.1	712.4
PAT	**18,812.0**	**21,658.1**	**(13.1)**	**69,046.2**	**68,994.8**	**0.1**
PAT Margin %	*51.6*	*55.4*	*(376.7)bps*	*50.6*	*54.3*	*(369.0)bps*
EPS (₹)	4.5	5.1	(13.1)	16.3	16.3	0.1

Profitability declined due to higher cost of production

Cost is expected to remain stable going ahead due to economies of scale despite pressure from higher fuel prices and general inflation.

HZL reported 13.1% decline in its net profit to ₹18,812.0 mn in Q4FY14 as against ₹21,658.1 mn in Q4FY13 due to lower mined metal output, jump in power costs and an increase in diesel costs. Mining costs or the cost of production were higher due to some mine development costs. Cost of production increased by 23.5% YoY in rupee term and 8.0% higher in USD term to ₹55,467/ton in Q4FY14 against ₹44,900/ton in Q4 FY13. However the increase in cost of production was partially offset by higher product premiums for metal sales.

HZL guided for marginal YoY growth in refined zinc, lead and silver in FY15, in line with the growth for mine metal production.

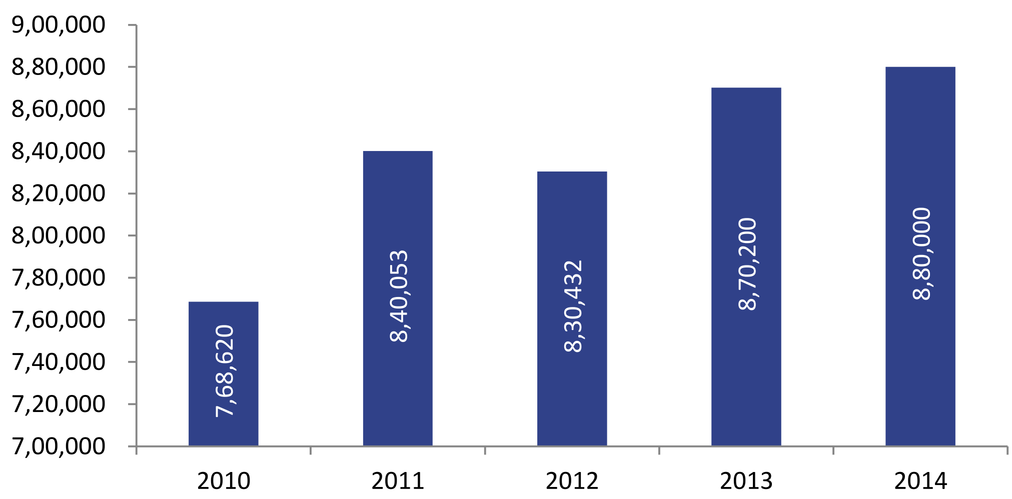
Higher volume and rupee depreciation led to improved revenue in FY14

The standalone revenue grew by 7% YoY to ₹136,360 mn in FY14 mainly driven by higher zinc sales volume and premium supported by rupee depreciation but is partially offset by lower metal prices in the global market. As a result, the company managed to report a growth of 7% in EBITDA to ₹69,615 mn in FY14. Average realization of zinc grew by around 17% to ₹126,511 per MT in FY14 on account of rupee depreciation and higher metal prices. While average realization of lead grew by around 16% to ₹165,057 during FY14. However, the net profit was flat at ₹69,046 mn in FY14.

With the disappointment in mined metal production in FY14 at 880,000 tons, the company expects only marginal growth in FY15 to ~910,000-92,0000 tonnes.

During FY14, company's total mined metal production was 880,000 tonnes as against 870,200 tonnes in FY13, a marginal growth of 1.1% YoY. Integrated production of refined metal during the year was the highest ever due to operational efficiencies and higher availability of company's owned smelters. Full year integrated production of zinc, lead and silver were higher by 13%, 10% and 4% respectively. The zinc metal cost of production before royalty during the year was ₹51,054 (USD 844) per metric tonne (MT), 12% higher in rupee terms and 1% higher in USD terms from the previous year. The increase was driven by rupee depreciation of 11% in FY14. Significantly higher mine development & diesel cost also hamper profitability during FY14. The cost for Q4FY14 was ₹55,467 (USD 899) per MT, 24% higher in rupee terms and 8% higher in USD terms from the corresponding period of the previous year. The increase was due to 14% rupee depreciation, lower mined metal production and higher mine development.

HZL mined metals trend (in MT)



HZL guided for marginal YoY growth in refined zinc, lead and silver in FY15, in line with the growth for mine metal production.

Margin remained flat despite higher realisations

During FY14, EBITDA margins were at 51.1%, which was relatively flat on a yearly basis due to lower mining output and higher mine development costs related to underground mining while, continuation of strong premiums on zinc & lead (~USD250/tonne) and better LME realizations mitigated the negative impact of lower volumes and higher CoP (cost of production). Mine development costs were higher by ~50% YoY in FY14 and are expected to increase further due to a further increase in the area to be covered for development going ahead.

Global zinc demand likely to overshoot supply leading to higher prices and realizations

We continue to like HZL for its strong fundamentals with structurally positive pricing scenario for zinc & lead globally due to mining supply cuts and attractive valuations with favorable risk-reward.

According to industry body "ILZSG (International zinc & lead study group)" world usage of refined zinc metal will increase by around 4.5% to 13.58 MMT in CY14 as against 4.9% in CY13. While, usage in China- which currently accounts for 44% (CY13) of total world zinc demand, is likely to rise by 5.8% in CY14. While, demand for zinc metal is likely to increase by 3% in Europe and 1.7% in the United States during CY14.

For the last four years, zinc supply remained relatively stable due to global economic slowdown. Now it is widely expected that Chinese production of refined zinc metal likely to grow by 7.3% in CY14 and this is the main factor behind an anticipated overall increase in global production of 4.4% to 13.46 MMT. While it is still lower than expected zinc demand. Accordingly, global demand for refined zinc metal is likely to exceed supply in 2014. It is anticipated that the size of the deficit will be around 117,000 tonnes. HZL being a lost cost producer of metals coupled with the company's efforts to ramp up capacity will likely to boost profitability through higher realizations.

Global supply constraints likely to increase lead prices and thereby company realization

ILZSG expects that the world market for refined lead metal will remain in modest deficit in CY14 with the extent of the shortage estimated at 49,000 tonnes.

According to industry body "ILZSG", global demand for refined lead metal is likely to increase by 4.4% in CY14 to 11.73 MMT. This will be driven mainly by growth in China where usage is forecast to increase by 7.4% in CY14. In 2013, China accounted for 45.2% of total global lead usage. On the supply side, it is widely expected that global lead mine production is likely to increase by 5.2% in CY14 to 5.66 MMT primarily as a consequence of higher output in Australia and China. While, the world production of refined lead metal is forecasted to rise by 4.3% in CY14 to 11.68 MMT taking modest supply deficit of around 49,000 tonnes.

According to the demand supply rule, this supply deficit is likely to increase lead prices (lead is a globally traded commodity and its price is determined by demand-supply gap in the global market) and thereby would to led to increase in the realizations and profitability of the company.

Long term strategic plan to boost volume and profitability

Company's plan to increase metal production aims to fill the demand- supply gap and to earn higher realizations to boost profitability.

Based on long term evaluation of assets and in consultation with mining experts, HZL announced the next phase of its growth plan with an annual capex of around ₹15,000 mn a year over next six years, which comprises of developing a 3.75 MMTPA underground mine at Rampura Agucha and expanding Sindesar Khurd mine from 2.0 MMTPA to 3.75 MMTPA, Zawar mines from 1.2 MMTPA to 5.0 MMTPA, Rajpura Dariba mine to 1.2 MMTPA and Kayad mine to 1.0 MMTPA.

It will also involve opening up of a small new mine at Bamnia Kalan in Rajpura Dariba belt. The projects are due to be completed in six years i.e.in FY 18-19 though the benefit of growth projects will start flowing in from the third year itself.

The company's plans to incur capex of around ₹15,000 mn would likely to boost volumes with no or little leverage as HZL is a cash rich company with zero debt on its books.

HZL has added gross reserves and resources of 26.1mt against depletion of 9.3mt to reach total reserves and resources of 365.1mt, indicating mine life of over 25 years.

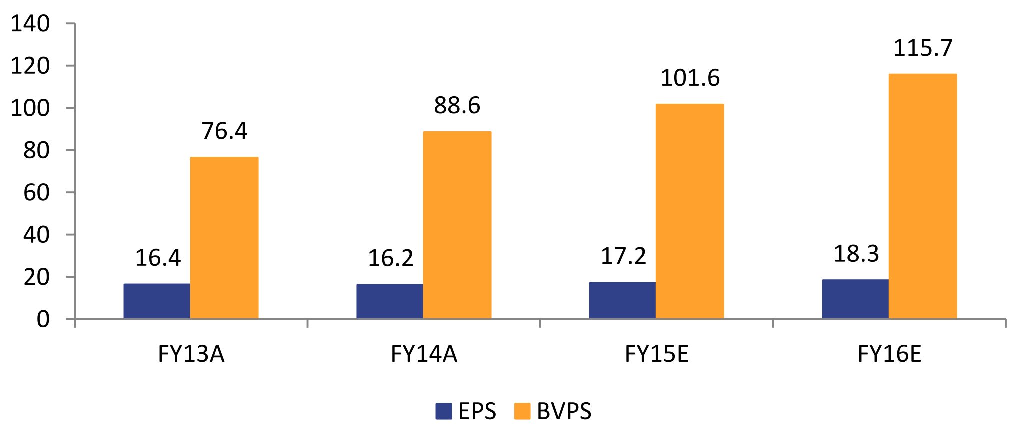
Concall highlights (FY14)

- HZL guided for marginal YoY growth in refined zinc, lead and silver in FY15, in line with the growth for mine metal production. In FY14, integrated, refined zinc, lead and silver production were 743,000 tonnes (up 13%YoY), 11,000 tonnes (up 10%YoY), 301 tonnes (up 4%YoY), respectively.
- With the disappointment in mined metal production in FY14 at 880,000 tonnes, the company expects only marginal growth in FY15 to ~910,000-920,000 tonnes due to slower and more challenging mine development. Though H1FY15 mined metal production is expected to drop YoY, H2FY15 is expected to more than cover up for the loss. However, HZL expects stronger growth in FY16 so as to touch volumes of 1,000,000 tonnes.
- For FY14, Rampura Agucha mine's mined metal production dropped to 710,000 tonnes in FY14 from 743,000 tonnes in FY13 due to the company's focus on underground mine development. This is expected to further decline in FY15. However, growth in other mines is expected to more than make up for this shortfall.

Key risk

- Metal price is determined by the supply and demand in the global markets and the same is denominated in USD, hence any unfavorable movement in currency also impact the company's profitability.
- Labor unrest is also the major threat for the company as the company's business is labor intensive in nature.
- HZL's share price is sensitive to zinc and lead prices at LME as around 86% of revenue coming from Zinc and lead alone. Any unfavorable movement in zinc LME prices will adversely impact the company's earnings.

Expected rise in metal prices to aid growth



Balance Sheet (Standalone)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Equity Capital	8,450.6	8,450.6	8,450.6	8,450.6
Reserve and surplus	314,306.8	365,725.5	420,755.8	480,551.2
Total debt	3.9	0.0	0.0	0.0
Deferred tax liabilities	12,798.6	16,581.1	16,581.1	16,581.1
Long term provisions	8,248.7	10,157.8	10,680.0	11,500.0
Current liabilities	10,563.2	15,288.0	16,050.0	17,320.0
Other long term liabilities	282.3	563.7	563.7	563.7
Total Equity & Liability	**354,654.1**	**416,766.7**	**473,081.2**	**534,966.6**
Fixed Assets	95,655.9	106,881.9	121,881.9	136,881.9
Non-current Investments	27.0	28.1	28.1	28.1
Current assets	237,596.4	280,463.1	320,307.9	364,107.0
Long term loans & advances	18,982.9	29,393.6	30,863.3	33,949.6
Other assets	2,391.9	0.0	0.0	0.0
Total Assets	**354,654.1**	**416,766.7**	**473,081.2**	**534,966.6**

Profit & Loss Account (Standalone)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Total Income	**126,998.4**	**136,360.4**	**142,881.2**	**154,322.5**
Operating Expense	62,182.0	66,745.2	70,014.3	76,424.2
EBITDA	**64,816.4**	**69,615.2**	**72,866.9**	**77,898.3**
Depreciation	6,470.4	7,845.9	8,238.2	8,650.0
Interest	291.0	449.4	462.0	499.6
Other income	20,321.5	18,993.9	19,662.0	20,645.1
Profit Before Tax	**78,376.5**	**80,313.8**	**83,828.7**	**89,393.8**
Tax	9,206.4	10,650.9	11,200.0	12,000.0
Exceptional item	175.3	616.7	0.0	0.0
Net Profit	**68,994.8**	**69,046.2**	**72,628.7**	**77,393.8**

Key Ratios (Standalone)

Y/E	FY13A	FY14A	FY15E	FY16E
EBITDA Margin (%)	51.0	51.1	51.0	50.5
EBIT Margin (%)	61.9	59.2	59.0	58.3
NPM (%)	54.3	50.6	50.8	50.2
ROCE (%)	23.4	20.6	18.9	17.8
ROE (%)	21.4	18.3	16.9	15.8
EPS (₹)	16.3	16.3	17.2	18.3
P/E (x)	10.6	10.7	10.1	9.4
BVPS (₹)	400.9	501	615.4	724.3
P/BVPS (x)	2.3	2.0	1.7	1.5
EV/Operating Income (x)	7.8	7.9	7.5	7.0
EV/EBITDA (x)	10.2	10.1	9.6	8.9

Valuation and view

Zinc and lead are preferred base metal because of its favorable demand outlook and constraints in supply growth due to shortage of large scale low cost mines in the world. According to IZLSG, about 1.2 mtpa of capacity will be closed by 2016 and global supply of zinc and lead will lag behind demand in 2014. The global metal deficit will widen. The prices are likely to be in uptrend due to shortage of supply. HZL, being one of the lowest cost producers of zinc and lead metals is likely to get the benefit of higher metal prices in terms of higher realizations as around 86% of the revenue coming from zinc and lead. Also, the company’s plan to ramp up capacity with a view to take advantage of supply constraints, bolster the revenue outlook.

At a current market price (CMP) of ₹173.0, the stock trades at 9.6x FY15E and of 8.9x FY16E, EV/EBITDA. We recommend ‘BUY’ with a target price of ₹203.0, which implies potential upside of ~17% to the CMP from long term (1 year) perspective.

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