

## The underground jewel, upgrade to Buy

We upgrade Hindustan Zinc (HZL) to Buy (vs Hold earlier) as we like HZL for strong zinc market fundamentals, its plans to expand output to 1.2 mtpa through transition to underground mining through shafts being on track for FY20E and likely cost economies. We believe that recent correction in zinc prices have little to do with fundamental factors and have been driven by global trade friction which in turn is likely to be short lived. The resultant stock price correction has led to valuations returning to comfort zone thereby making risk-reward fair which was not the case earlier.

- **Volumes subdued as open cast mining gets phased out completely:** MIC production was down ~9% YoY at 212kt led by closure of open cast mining. Led by lower output from Rampura Agucha, overall grades slipped to 7.64% (vs 8.74% in Q4) and led to fall in zinc metal sales to 170kt, down 10% YoY. Higher contribution of SK mine led to robust silver/lead volumes (up 28%/23% YoY).
- **EBITDA below expectations led by higher employee costs:** EBITDA stood at Rs27.1bn (vs estimated Rs29.5bn) and was down 25% QoQ led by lower volumes, lower realisations and higher costs on account of higher commodity prices and new wage settlement. Arrears towards wage settlement stood at Rs1.2bn and adjusted for the same EBITDA stood at Rs28.3bn. Zinc metal CoP stood at US\$1043/t (up 7% YoY) but guidance on CoP was retained at US\$950-975 range for FY19E.
- **Outlook – Volume growth for FY20 remains on track; zinc pricing fundamentals are strong:** HZL indicated that its expansion plans to 1.2mtpa remain on track and volume growth would be strong in FY20E post commissioning of shafts in Q3FY19E while FY19E could see muted volume growth as underground mining would make up for volumes lost from opencast mining. Management sounded optimistic on zinc prices notwithstanding the recent weakness and pointed out to strong demand-supply fundamentals for a quick recovery in LME prices. Lower MIC output globally led by mine closures & resultant concentrate shortage, low Tc/Rc and low inventories were key indicators for a healthy pricing outlook which are expected to overshadow the concerns around trade tensions and stronger dollar index. We reduce our volume estimates marginally for FY19E while retaining our LME price assumptions. Our EBITDA estimates are revised downwards marginally led by higher cost assumptions in line with increasing commodity prices and higher wage costs.
- **Valuation and risks – Upgrade to buy:** We continue to like HZL for its strong fundamentals with structurally positive pricing scenario for zinc and lead globally due to mining supply cuts and the metal deficit. Attractive dividend payouts and high free cash flow generation further buttress our positive stance on the stock. We value the stock at FY20E EV/EBITDA multiple of 7.5x and upgrade to Buy with a TP of Rs310. Key downside risks to our call are slower ramp-up in volumes and lower LME.

Y/E Mar (Rs mn)	Q1FY19	Q1FY18	YoY(%)	Q4FY19	QoQ(%)	Q4FY18E	Var(%)
<b>Net sales</b>	<b>53,100</b>	<b>45,760</b>	<b>16.0</b>	<b>62,770</b>	<b>(15.4)</b>	<b>53,551</b>	<b>(0.8)</b>
Royalty	6,310	5,490	14.9	8,290	(23.9)	6,407	(1.5)
Employee costs	2,320	1,740	33.3	1,820	27.5	1,879	23.5
<b>EBITDA</b>	<b>27,130</b>	<b>23,840</b>	<b>13.8</b>	<b>36,200</b>	<b>(25.1)</b>	<b>29,462</b>	<b>(7.9)</b>
<b>EBITDA margin (%)</b>	<b>51.1</b>	<b>52.1</b>		<b>57.7</b>		<b>55.0</b>	
Depreciation	3,870	3,600	7.5	4,590	(15.7)	3,800	1.8
Other income	2,990	5,300	(43.6)	4,860	(38.5)	4,000	(25.3)
<b>PBT</b>	<b>26,100</b>	<b>24,170</b>	<b>8.0</b>	<b>35,510</b>	<b>(26.5)</b>	<b>29,462</b>	<b>(11.4)</b>
Tax	6,920	5,410	27.9	10,460	(33.8)	8,249	(16.1)
-effective tax rate	26.5	22.4		29.5		28.0	
<b>PAT</b>	<b>19,180</b>	<b>18,760</b>	<b>2.2</b>	<b>25,050</b>	<b>(23.4)</b>	<b>21,213</b>	<b>(9.6)</b>

Source: Company, Centrum Research

Y/E Mar (Rs bn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj. PAT	YoY (%)	Adj. EPS (Rs)	RoE (%)	RoCE (%)	PE (x)	EV/EBITDA (x)
FY16	142.3	(3.8)	66.5	46.8	81.5	(0.0)	19.3	20.2	19.2	8.1	4.6
FY17	172.9	21.5	97.4	56.3	83.2	2.1	19.7	24.3	20.8	12.0	8.5
FY18	220.8	27.7	122.7	55.6	95.2	14.4	22.5	28.1	23.1	11.9	8.4
FY19E	231.6	4.9	130.5	56.4	96.4	1.3	22.8	24.3	22.8	11.8	6.8
FY20E	245.8	6.2	134.7	54.8	98.4	2.1	23.3	21.4	20.2	11.6	6.2

Source: Company, Centrum Research Estimates

In the interest of timeliness, this document is not edited

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Target Price	Rs310	Key Data	
CMP*	Rs267.7	Bloomberg Code	HZ IN
Upside	15.8%	Curr Shares O/S (mn)	4,225.3
Previous Target	Rs320	Diluted Shares O/S(mn)	4,225.3
Previous Rating	Hold	Mkt Cap (Rsbn/USDbn)	1131.1/16.4
<b>Price Performance (%)*</b>		52 Wk H / L (Rs)	340.2/261
		5 Year H / L (Rs)	340.2/74.1
HZ IN	(7.4) (9.8) (4.6)	Daily Vol. (3M NSE Avg.)	1987933
NIFTY	2.4 0.0 11.8		

\*as on 23 July 2018; Source: Bloomberg, Centrum Research

### Shareholding pattern (%)\*

	Jun-18	Mar-18	Dec-17	Sep-17
Promoter	64.9	64.9	64.9	64.9
FII's	2.0	2.3	2.2	2.2
Dom. Inst.	2.0	1.5	1.7	1.7
Public & Others	31.1	31.3	31.3	31.2

Source: BSE, \*as on 23 July 2018

### Operational metrics

(tonne)	Q1FY19	Q1FY18	Q4FY18	YoY %	QoQ%
<b>Production</b>					
Mined Metal (MIC)	2,12,000	2,33,000	2,55,000	(9.0)	(16.9)
Zinc	1,72,000	1,94,000	2,06,000	(11.3)	(16.5)
Lead	42,000	35,000	50,000	20.0	(16.0)
Silver	138	115	170	20.0	(18.8)
<b>Sales Volume</b>					
Zinc	1,70,000	1,90,000	2,10,000	(10.5)	(19.0)
Lead	42,000	34,000	50,000	23.5	(16.0)
Silver	141	110	167	28.2	(15.6)
<b>Realizations</b>					
Zinc LME (US\$/t)	3,112	2,596	3,421	19.9	(9.0)
Lead LME (US\$/t)	2,388	2,161	2,523	10.5	(5.4)
Silver (Rs/kg)	38,794	36,455	38,144	6.4	1.7

Source: Company, Centrum Research

### Earnings Revision

Particulars (Rs bn)	FY19E			FY20E		
	New	Old	Chg (%)	New	Old	Chg (%)
Sales	231.6	234.7	(1.3)	245.8	245.8	-
EBITDA	130.5	134.9	(3.2)	134.7	136.8	(1.6)
EBITDA Margin (%)	56.4	57.5		54.8	55.7	
PAT	96.4	99.5	(3.2)	98.4	99.9	(1.5)

Source: Centrum Research Estimates

### Centrum vs. Bloomberg Consensus\*

Particulars (Rs bn)	FY19E			FY20E		
	Centrum	BBG	Chg (%)	Centrum	BBG	Chg (%)
Sales	231.6	247.0	(6.2)	245.8	268.2	(8.3)
EBITDA	130.5	143.3	(8.9)	134.7	155.4	(13.3)
PAT-adj.	96.4	109.3	(11.8)	98.4	118.5	(16.9)

Bloomberg Consensus				Centrum Target Price (Rs)	Variance (%)
BUY	SELL	HOLD	Target Price (Rs)		
14	4	12	333	310	(7.0)

\*as on 23 July 2018; Source: Bloomberg, Centrum Research

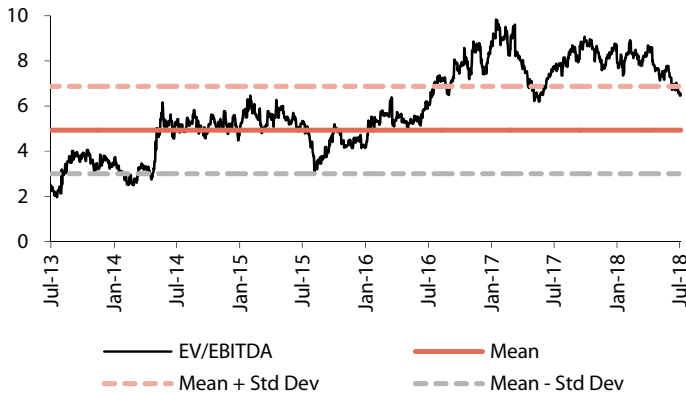
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### Exhibit 1: Sensitivity Analysis (FY19E)

1% negative change	% Chg in EBITDA	% Chg in EPS
Volume - total	(1.9)	(1.5)
Silver	(0.3)	(0.3)
LME Zinc	(1.4)	(1.2)
LME Lead	(0.2)	(0.2)
USD-INR (appreciation)	(1.5)	(1.3)

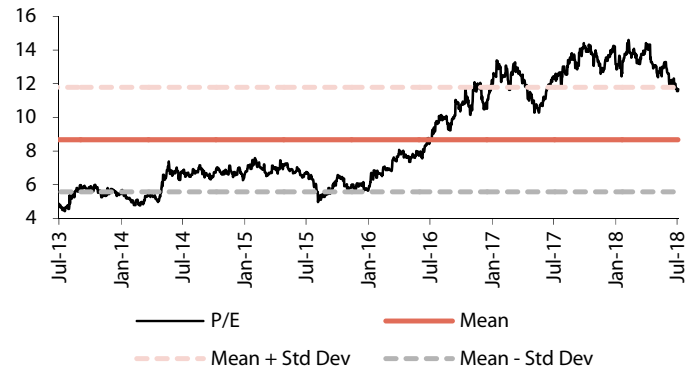
Source: Company, Centrum Research Estimates

### Exhibit 2: 1 year EV/EBITDA chart



Source: Bloomberg, Company, Centrum Research Estimates

### Exhibit 3: 1 year forward P/E chart



Source: Bloomberg, Company, Centrum Research Estimates

### Exhibit 4: Comparative Valuations

Company	Mkt Cap (USD mn)	CAGR FY18-FY20E (%)			EBITDA Margin (%)			PE (x)			EV/EBITDA (x)			RoE (%)			Div Yield (%)		
		Rev.	EBITDA	PAT	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
Hindustan Zinc*	16,433	5.5	4.7	1.7	55.6	56.4	54.8	11.9	11.8	11.6	8.4	6.8	6.2	28.1	24.3	21.4	2.7	2.5	2.6
Boliden AB	7,869	3.7	0.7	(0.8)	27.5	27.4	25.9	10.6	9.9	10.3	5.6	5.1	5.3	21.3	20.1	17.1	3.1	5.6	5.3
Glencore PLC	58,467	6.4	24.2	9.1	5.8	8.0	7.9	8.2	6.3	8.2	6.9	4.1	4.9	12.3	13.7	12.5	5.9	6.7	5.7
Umicore SA	14,664	14.5	32.9	44.2	4.2	5.5	5.6	18.6	34.8	28.6	18.1	18.2	15.2	11.8	15.3	14.9	1.9	1.4	1.7
Nyrstar NV	570	6.2	8.3	8.9	9.5	7.5	9.9	12.2	(27.6)	9.2	5.0	5.7	4.0	7.7	(2.1)	8.2	0.0	0.0	0.0
OZ Minerals Ltd	2,253	2.5	(12.8)	(11.5)	63.6	47.4	46.0	10.6	14.6	16.4	2.7	5.1	4.7	9.5	6.9	6.6	2.4	2.1	1.7

Source: Bloomberg, Centrum Research Estimates, \*For Hindustan Zinc FY17 is reported numbers

### Exhibit 5: EV/EBITDA based valuation

(Rs mn)	Mar'20E
EBITDA	1,34,653
Justified EV/EBITDA (x)	7.5
EV	10,09,898
Add: Net Cash	3,06,291
Fair Value Mkt Cap	13,16,189
No. of Shares (mn)	4,225
<b>Fair value/share (Rs)</b>	<b>310</b>

Source: Company, Centrum Research Estimates

## Quarterly financials, operating metrics and key performance indicators

### Exhibit 6: Quarterly Financials

Particulars (Rs mn)	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19
<b>Total Revenue</b>	<b>35,257</b>	<b>49,799</b>	<b>62,550</b>	<b>45,760</b>	<b>53,090</b>	<b>59,220</b>	<b>62,770</b>	<b>53,100</b>
Mining Royalty	4,429	7,166	8,460	5,490	5,670	7,020	8,290	6,310
Employee Expenses	1,810	1,783	1,900	1,740	2,250	1,950	1,820	2,320
Other Expenses	8,252	17,082	14,760	14,690	14,930	17,810	16,460	17,340
<b>Operating Profit (Core EBITDA)</b>	<b>20,767</b>	<b>23,768</b>	<b>37,430</b>	<b>23,840</b>	<b>30,240</b>	<b>32,440</b>	<b>36,200</b>	<b>27,130</b>
Depreciation	4,317	4,589	5,320	3,600	3,940	3,730	4,590	3,870
<b>EBIT</b>	<b>16,450</b>	<b>19,179</b>	<b>32,110</b>	<b>20,240</b>	<b>26,300</b>	<b>28,710</b>	<b>31,610</b>	<b>23,260</b>
Interest	712	451	140	1370	840	170	450	150
Other Revenue/Income	7,702	5,882	4,860	5,300	4,870	2,810	4,860	2,990
Other Exceptional Items	0	0	0	0	-2910	0	510	0
<b>Profit Before Tax</b>	<b>23,440</b>	<b>24,610</b>	<b>36,830</b>	<b>24,170</b>	<b>33,240</b>	<b>31,350</b>	<b>35,510</b>	<b>26,100</b>
Tax	4,421	5,477	6,259	5,410	7,790	8,370	10,460	6,920
Tax rate (%)	18.9	22.3	17.0	22.4	23.4	26.7	29.5	26.5
<b>Profit After Tax</b>	<b>19,019</b>	<b>19,133</b>	<b>30,571</b>	<b>18,760</b>	<b>25,450</b>	<b>22,980</b>	<b>25,050</b>	<b>19,180</b>
<b>Growth (%)</b>								
Net Sales	(12.6)	45.2	99.7	80.8	50.6	18.9	0.4	16.0
EBITDA	(4.0)	60.8	184.7	110.8	45.6	36.5	(3.3)	13.8
Adj. PAT	(16.8)	4.0	42.3	80.9	33.8	20.1	(18.1)	2.2
<b>Margin (%)</b>								
EBITDA	58.9	47.7	59.8	52.1	57.0	54.8	57.7	51.1
EBIT	46.7	38.5	51.3	44.2	49.5	48.5	50.4	43.8
PAT	53.9	38.4	48.9	41.0	47.9	38.8	39.9	36.1
<b>Key Drivers</b>								
MIC Production-Zinc & Lead (kt)	192	276	312	233	219	240	255	212
Zinc metal sales volumes (t)	1,49,000	2,11,000	2,17,000	1,90,000	1,93,000	2,00,000	2,10,000	1,70,000
Lead metal sales volumes (t)	32,000	36,000	47,000	34,000	40,000	45,000	50,000	42,000
Zinc LME (US\$/t)	2,255	2,518	2,770	2,596	2,963	3,236	3,421	3,112
Lead LME (US\$/t)	1,873	2,150	2,269	2,161	2,334	2,492	2,523	2,388
USD/INR (average)	67.0	67.5	67.1	64.5	64.3	64.7	64.3	67.0

Source: Company, Centrum Research

### Exhibit 7: Key Performance Indicators

Sales Volumes (kt)	FY16	FY17	FY18	FY19E	FY20E
MIC	888	907	947	970	1100
YoY% growth	0.1	2.1	4.4	2.4	13.4
Zinc - Metal	759	697	793	791	867
YoY % growth	3.3	(8.2)	13.8	-0.2	9.6
Lead - Metal	145	138	169	178	193
YoY % growth	12.4	(4.8)	22.5	5.1	8.7
Silver (tonne)	426	448	555	650	750
YoY % growth	30.1	5.3	23.9	17.1	15.4
Sulphuric acid	1,331	1,276	1,313	1,386	245
<b>Realizations (US\$/t)</b>					
Zinc - LME	1,829	2,350	3,057	3,100	3,000
Lead - LME	1,768	2,000	2,379	2,400	2,300
Silver (Rs/Kg)	32,597	38,789	38,090	40,000	40,000
<b>Premium over LME (US\$/t)</b>					
Zinc	214	302	141	200	200
Lead	218	254	214	200	200

Source: Company, Centrum Research Estimates

## Financials

### Exhibit 8: Income Statement

Y/E March (Rs bn)	FY16	FY17	FY18	FY19E	FY20E
<b>Revenues</b>	<b>142.3</b>	<b>172.9</b>	<b>220.8</b>	<b>231.6</b>	<b>245.8</b>
Royalty	16.3	22.7	26.5	27.2	29.0
% of revenues	11.5	13.1	12.0	11.8	11.8
Employee cost	7.7	7.2	7.8	8.4	9.1
% of revenues	5.4	4.2	3.5	3.6	3.7
Other expenses	51.7	45.6	63.9	65.5	73.2
% of revenues	36.3	26.4	28.9	28.3	29.8
<b>EBITDA</b>	<b>66.5</b>	<b>97.4</b>	<b>122.7</b>	<b>130.5</b>	<b>134.7</b>
EBITDA margin (%)	46.8	56.3	55.6	56.4	54.8
Depreciation & Amortisation	7.4	18.1	14.8	16.7	18.5
<b>EBIT</b>	<b>59.1</b>	<b>79.3</b>	<b>107.9</b>	<b>113.8</b>	<b>116.2</b>
Interest expenses	0.2	2.0	2.8	-	-
<b>PBT from operations</b>	<b>58.9</b>	<b>77.3</b>	<b>105.1</b>	<b>113.8</b>	<b>116.2</b>
Other income	27.6	24.7	17.5	20.0	24.4
Exceptional items	0.3	-	(2.4)	-	-
<b>PBT</b>	<b>86.2</b>	<b>102.0</b>	<b>125.0</b>	<b>133.8</b>	<b>140.6</b>
Taxes	4.5	18.8	32.2	37.5	42.2
Effective tax rate (%)	5.2	18.5	25.8	28.0	30.0
<b>Reported PAT</b>	<b>81.8</b>	<b>83.2</b>	<b>92.8</b>	<b>96.4</b>	<b>98.4</b>
<b>Adjusted PAT</b>	<b>81.5</b>	<b>83.2</b>	<b>95.2</b>	<b>96.4</b>	<b>98.4</b>

Source: Company, Centrum Research Estimates

### Exhibit 9: Key Ratios

Y/E March	FY16	FY17	FY18P	FY19E	FY20E
<b>Growth Ratio (%)</b>					
Revenue	(3.8)	21.5	27.7	4.9	6.2
EBITDA	(10.7)	46.4	26.0	6.3	3.2
Adjusted PAT	(0.0)	2.1	14.4	1.3	2.1
<b>Margin Ratios (%)</b>					
EBITDA	46.8	56.3	55.6	56.4	54.8
PBT from operations	41.4	44.7	47.6	49.2	47.2
Adjusted PAT	57.3	48.1	43.1	41.6	40.0
<b>Return Ratios (%)</b>					
ROE	20.2	24.3	28.1	24.3	21.4
ROCE	19.2	20.8	23.1	22.8	20.2
ROIC	56.6	60.6	45.0	41.9	39.4
<b>Turnover Ratios (days)</b>					
Gross block turnover ratio (x)	0.9	1.0	1.2	1.1	1.1
Debtors	6	3	10	10	10
Inventory	27	41	30	30	30
Creditors	20	25	15	15	15
Cash conversion cycle	13	18	25	25	25
<b>Solvency Ratio (x)</b>					
Net debt-equity	(0.9)	(0.5)	(0.6)	(0.6)	(0.6)
Debt-equity	0.0	0.3	0.0	0.0	0.0
Interest coverage ratio	0.0	0.0	0.0	0.0	0.0
Gross debt/EBITDA	0.0	0.8	0.0	0.0	0.0
Current Ratio	2.4	2.4	5.5	6.5	7.3
<b>Per share Ratios (Rs)</b>					
Adjusted EPS	19.3	19.7	22.5	22.8	23.3
BVPS	88.5	73.8	86.5	101.3	116.4
CEPS	21.1	24.0	25.5	26.8	27.7
DPS	27.8	29.4	7.9	6.8	7.0
Dividend payout %	143.7	149.4	36.0	30.0	30.0
<b>Valuation (x)*</b>					
P/E (adjusted)	8.1	12.0	11.9	11.8	11.6
P/BV	1.8	3.2	3.1	2.7	2.3
EV/EBITDA	4.6	8.5	8.4	6.8	6.2
Dividend yield %	17.8	12.5	2.7	2.5	2.6
5 Yr Avg AOCF/EV yield %	17.3	7.4	6.4	8.3	9.6

Source: Company, Centrum Research Estimates

### Exhibit 10: Balance Sheet

Y/E March (Rs bn)	FY16	FY17	FY18P	FY19E	FY20E
Equity Share Capital	8.5	8.5	8.5	8.5	8.5
Reserves & surplus	365.4	303.2	356.9	419.4	483.3
Shareholders' fund	373.9	311.7	365.4	427.9	491.7
Total Debt	-	79.1	-	-	-
Def tax liab. (net)	25.7	25.7	25.7	25.7	25.7
<b>Total Liabilities</b>	<b>399.6</b>	<b>416.5</b>	<b>391.1</b>	<b>453.6</b>	<b>518.5</b>
Gross Block	157.4	176.3	197.0	219.8	242.6
Less: Acc. Depreciation	58.0	76.1	90.9	107.6	126.1
Net Block	99.4	100.2	106.1	112.2	116.5
Capital WIP	23.6	25.4	27.4	29.6	31.8
Net Fixed Assets	123.0	125.5	133.5	141.8	148.3
Investments	351.8	237.8	157.8	182.8	207.8
Inventories	10.6	19.4	18.2	19.0	20.2
Sundry debtors	2.4	1.4	6.1	6.3	6.7
Cash	0.5	12.6	43.4	69.8	98.5
Loans & Advances	62.9	56.4	72.6	76.1	80.8
Other assets	1.1	2.4	3.0	3.2	3.4
Total Current Asset	77.6	92.1	143.2	174.5	209.6
Trade payables	7.8	12.1	9.1	9.5	10.1
Other current Liab.	143.9	15.2	19.3	20.2	21.3
Provisions	1.1	11.8	15.1	15.9	16.8
Net Current Assets	(75.3)	53.1	99.8	129.0	161.3
<b>Total Assets</b>	<b>399.6</b>	<b>416.5</b>	<b>391.1</b>	<b>453.6</b>	<b>518.5</b>

Source: Company, Centrum Research Estimates

### Exhibit 11: Cash Flow

Y/E March (Rs bn)	FY16	FY17	FY18P	FY19E	FY20E
Operating profit bef WC	66.3	97.4	125.1	130.5	134.7
Changes in working capital	1,691.2	574.9	(1,588.6)	(279.5)	(371.1)
<b>Cash flow from operations</b>	<b>65.0</b>	<b>84.3</b>	<b>77.0</b>	<b>90.2</b>	<b>88.8</b>
Adj. OCF (OCF - Interest)	64.8	82.3	74.2	90.2	88.8
Net Capex	16.1	20.6	22.8	25.0	25.0
Adj. FCF	48.7	61.7	51.4	65.2	63.8
<b>Cash flow from investments</b>	<b>(32.8)</b>	<b>118.1</b>	<b>74.8</b>	<b>(30.0)</b>	<b>(25.6)</b>
<b>Cash flow from financing</b>	<b>(32.2)</b>	<b>(190.3)</b>	<b>(121.0)</b>	<b>(33.8)</b>	<b>(34.5)</b>
<b>Net change in cash</b>	<b>0.0</b>	<b>12.1</b>	<b>30.8</b>	<b>26.4</b>	<b>28.6</b>

Source: Company, Centrum Research Estimates

## Appendix A

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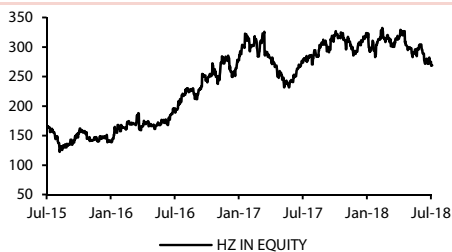
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### Hindustan Zinc price chart



Source: Bloomberg, Centrum Research

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		Hindustan Zinc
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