Business Standard

Fri, 18 Aug-17; Business Standard - Mumbai; Size : 414 sq.cm.; Circulation:-; Page : 13

Bright outlook for Hind Zinc on rising prices

10-year high zinc prices drive profitability at a time coal costs are up

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New Delhi, 17 August

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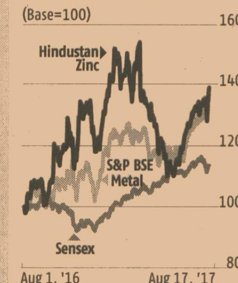

Data compiled by BS Research Bureau

IMPROVING PROFITABILITY

	FY17	FY18E
Net revenues (₹ crore)	18,798	21,950
% change year-on-year	32.1	16.8
Ebitda (₹ crore)	9,738	11,887
Ebitda margins (%)	51.8	54.2
Net profit (₹ crore)	8,316	9,713
% change year-on-year	1.8	16.8
EPS (₹)	19.7	23.0

Ebitda: Earnings before interest, tax, depreciation and amortisation
E: Estimates Source: Edelweiss Research

Hindustan Zinc's stock is up 10 per cent in less than a week because of rising zinc prices. With the price of the metal scaling its highest level in 10 years, there is more upside for Hindustan Zinc.

Zinc prices on the London Metal Exchange (LME) touched $3,009 per tonne on Wednesday, the highest in a decade. This is a strong rebound after a correction from the $2,860-level in March to $2,424 a tonne in mid-June.

Analysts had earlier ascribed this weakness to muted Chinese data, even as they maintained their positive view looking at lower supplies. Chinese zinc concentrate production has declined four per cent year-on-year (y-o-y) during the first half of 2017. While demand for zinc in China, too, has dipped, the pace has been slower at 1.5 per cent in the same period.

Analysts at Axis Capital had said lower zinc concentrate production and falling inventories were supporting the price of the metal. They expect LME zinc to sustain in the range of $2,700-3,000 per tonne for the rest of FY18, against an average of $2,600 per tonne during the first quarter of FY18. Thus, they maintained their LME zinc price forecast of $2,700 per tonne and $2,900 per tonne for FY18 and FY19, respectively.

Analysts at Reliance Securities, too, remained positive on zinc prices led by supply deficit due to the closure of global mining and smelting capacities. Echoing similar views, analysts at Motilal Oswal Securities said the supply of zinc was getting tighter due to strong demand and a lag in supply response and hence pricing outlook had turned bullish. They raised their LME zinc price assumption by $400 to $3,200 per tonne for the second half of FY18.

Given that zinc had averaged at $2,366 per tonne in FY17, the significantly higher price estimates for FY18 bode well for Hindustan Zinc. Analysts' estimates for Hindustan Zinc's refined zinc production stand at 795,000 tonnes in FY18 against 696,000 tonnes in FY17, an increase of 14 per cent. Following the June quarter (Q1) results, the company maintained its guidance of producing 1.2 million tonnes (mt) of mined metal by FY20 and reiterated that smelter de-bottlenecking and the Fumer project (for additional silver, lead and zinc recovery) is progressing.

Rising realisations as well as volumes also bode well for the company. While being a low-cost producer of zinc stands to its advantage, per tonne costs have increased to $973 (versus a past run-rate of $800) led by higher coal prices and could shave off some gains. However, a much faster increase in realisations should be more than enough to take care of the cost increase and lead to better profit margins.

After the Q1 results, analysts at HDFC Securities had said, "We remain constructive, except for valuations (9.2 times of FY18 and 7.7 times of FY19 estimated Ebitda, or earnings before interest, tax, depreciation and amortisation, thereby assigning neutral ratings."

Motilal Oswal Securities and Reliance Securities, too, have set their target prices at ₹301. While this is close to the current levels, an improving outlook could also see the target prices being upped.