MONTHLY MAG

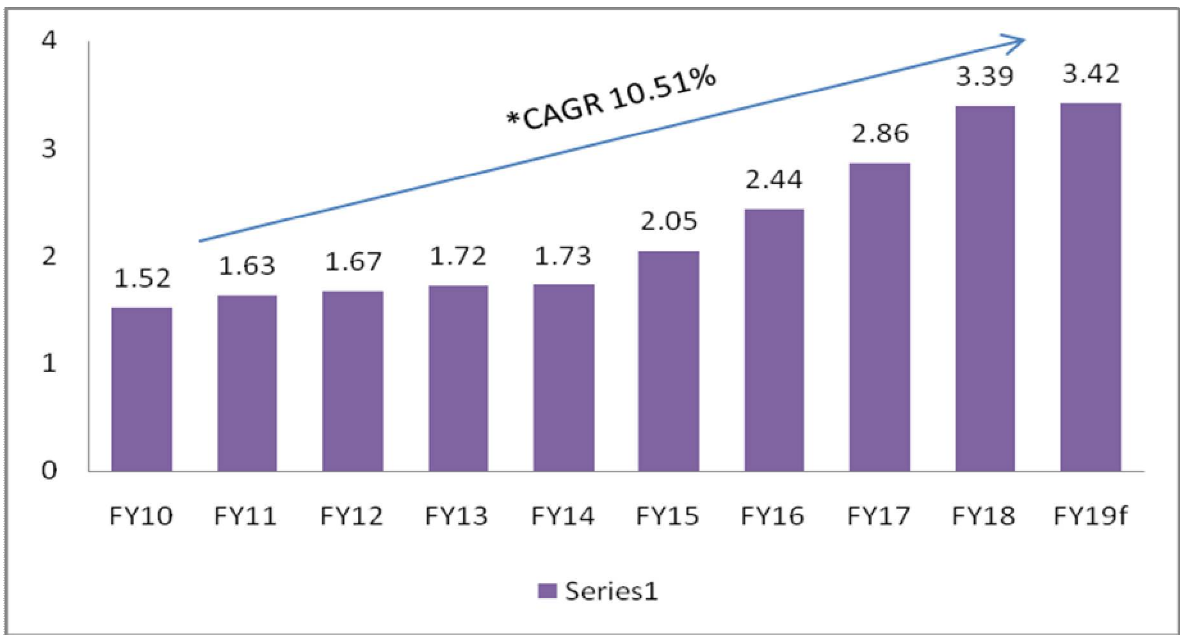
December 2018

- ✓ Sector of the month
- ✓ Picks of the month

Sector of the Month (Metals):

- India metals and mining sector has witnessed strong growth over the past few years. GVA of the mining and quarrying industry has grown at a CAGR of 6.21 per cent between 2011-12 and 2017-18 to reach US$ 58.14 billion in 2017-18.
- The number of operative mines (excluding atomic minerals, petroleum (crude), natural gas (utilized) and minor minerals) in India have increased to an estimated 1,531 in 2017-18 from 1,508 in 2016-17.
- India was the fourth largest producer of aluminium in the world with a share of around 5.33 per cent in global aluminium output.
- The principal user segment in India for aluminium continues to be electrical and electronics sector followed by the automotive and transportation, building, construction, packaging, consumer durables, industrial and other applications including defence
- According to Ministry of Mines, India has the 7th largest bauxite reserves which was around 2,908.85 million tonnes in FY17*.
- Aluminum production increased to 0.65 million tonnes from 0.58 million tonnes at a growth rate of 12.5 per cent between April-July 2018. Over the course of last four years, India's aluminium production capacity has increased to 4.1 MMTPA, driven by investments worth Rs 1.2 lakh crore (US$ 18.54 billion).

Aluminium Production (million tonnes)



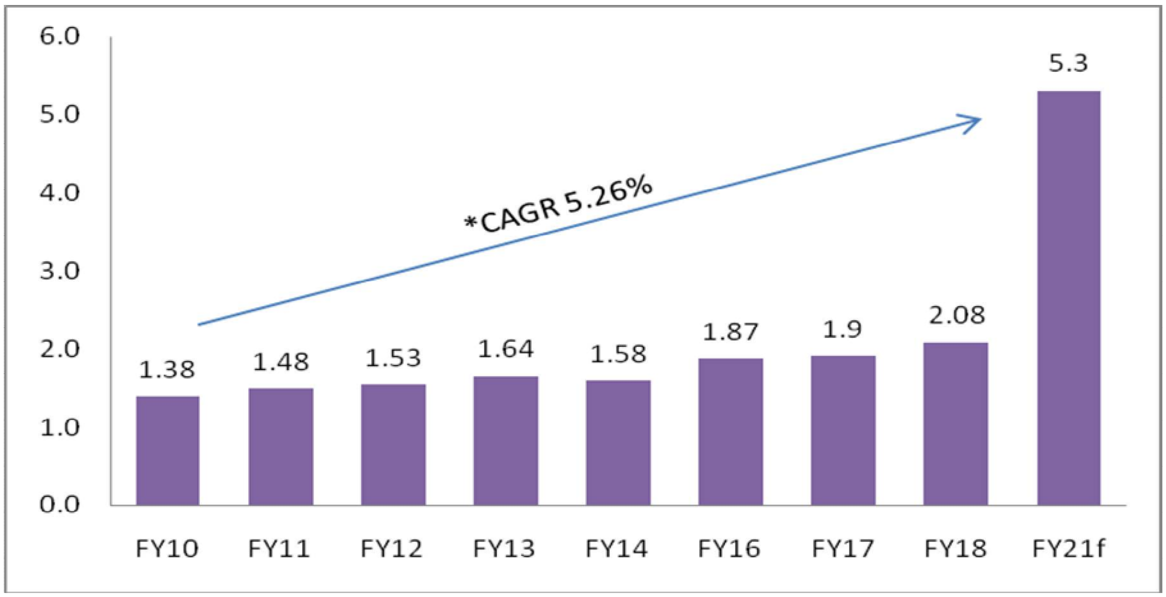
- **Except aluminium, almost all non-ferrous metal prices continued to fall for the second month in a row. No resolution in trade tensions, renewed concerns on emerging economies and a strengthening USD continued to weigh on non-ferrous metal prices.**
- **Aluminium bucked the trend and rose by 2% mom. The earlier price correction and the higher cost of production due to a rise in carbon costs could be the reasons behind this. In addition, the disruption in alumina refinery in Alcoa could be another reason behind stable aluminium prices. Aluminium prices recovered from the level of Rs2061/t in Jul'18.**

Source: Ace equity, CARE, IBEF

GROWING DOMESTIC DEMAND TO SUPPORT ALUMINIUM PRODUCTION

- Demand for aluminium is expected to pick up as the scenario improves for user industries, like power, infrastructure and transportation
- Production of aluminium stood at 3.39 million tonnes during 2017-18 and it is estimated to increase marginally to 3.42 million tonnes in 2018-19.
- Aluminium demand in the country is expected to grow 7 per cent in 2018-19. Aluminium exports from the country grew to 1.66 million tonnes in 2017-18 from 1.22 million tonnes in 2016-17. At the same time, import of aluminium reached 0.36 million tonnes.
- Consumption of aluminium in India grew to 2.08 million tonnes in 2017-18, and is forecasted to reach to 5.30 million tonnes by 2020-21.

Aluminium consumption (million tonnes)



- The demand for metal and metal products is rising in the domestic market with India being a net importer in the metals segment.
- In December 2017, the index of mineral production increased 7.5 per cent month-on-month to 115.5 and the total value of mineral production was estimated at US$ 3.54 billion.
- Mining group under the Index of Industrial Production (IIP) grew 2.3 per cent in 2017-18. Growth of the mining classification increased from -0.4 per cent in February 2018 to 2.8 per cent in March 2018.
- Players in the industry are trying to minimise cost to gain competitive advantage. Players in the industry are focusing on optimising technology to increase process efficiency.
- Alliance with global and domestic players help companies to improve their operational performance through technological improvement and cost optimization.

Source: Ace equity, CARE, IBEF

Zinc market's deficit starts to vanish as mine production growth picks up

The global zinc market is expected to see lower deficit of ~330kt in CY18E which would further reduce sharply to ~80kt as per ILZSG's October-18 forecasts whereas lead is expected to maintain close balance between demand and supply and turn into surplus in CY19. YTDCY18 deficit in zinc/lead has fallen sharply YoY and stood at 17kt/39kt.

On supply side, zinc production has already started at capacities added by New Century Resources (264ktpa) in Australia and Coeur Mining's Silvertip project in Canada. Vedanta's Gamsberg mine in South Africa is expected to start producing soon. Glencore is expected to add supply in CY19 along with expansion of Hindustan Zinc's Sindesar Khurd and Zawar mines. On the demand side, zinc galvanizing activity in China has remained lacklust
re and overall demand from China is expected to remain stable due to rise in property investments and its end use in electronic appliances and automobiles. Modest recovery in demand from US and Europe regions along with new supply is expected to narrow down the zinc deficit to 330kt/78kt in CY18/19 respectively.

Growth Drivers:

- India is witnessing a sustained growth in infrastructure build up. The construction industry has been witness to a strong growth wave powered by large spends on housing, road, ports, water supply, rail transport and airport development.
- Infrastructure projects continue to provide lucrative business opportunities for steel, zinc and aluminium producers.
- It has been estimated that India is going to require US$ 4.5 trillion* of investment by 2040 for infrastructure development
- In Union Budget 2018-19, Government of India has allocated US$ 92.22 billion for infrastructure sector.

- **Construction sector to aid growth:** India's construction industry is expected to grow 6.1 per cent on year-on-year (y-o-y) basis in 2018. Gross Value Added (GVA) of the construction sector grew nearly 8.80 per cent y-o-y to Rs 11.19 trillion (US$ 173.61 billion)* in 2017-18. Iron and steel being a core component of the real estate sector, demand for these metals is set to continue given strong growth expectations for the residential and commercial building industry.

- **Favorable government policies to push for sector growth:** FDI of up to 100 per cent is permitted under the Automatic Route to explore and exploit all non-fuel and non-atomic minerals and process all metals as well as for metallurgy. FDI caps in the mining and exploration of metal and non-metal ores have been increased to 100 per cent under the automatic route. In March 2018, the government allowed 100 per cent FDI in coal mining.

- Profits of companies producing specified metals are given tax concession under the Income Tax Act. Low custom duty on the capital equipment used for minerals. Companies who do mining in backward districts are eligible for complete tax holiday for a period of 5 years from the commencement of production and 30 per cent tax holiday for 5 years thereafter.

Source: Ace equity, CARE, IBEF

Outlook

Demand in the metal sector has weakened globally. Prices are treading downwards and companies are undertaking production cuts as they struggle to cut losses.

India is relatively better off than its global counterparts on the demand and margin front. While demand may have moderated from end-use sectors such as automobiles, capital goods and infrastructure, Indian players continue to remain profitable due to their low cost base.

In this scenario, companies in the sector are looking to optimise production by employing cost-cutting programmes to make their businesses sustainable. The hunt for mining acquisitions abroad has increased as state and central governments have imposed mining restrictions. Input and logistics costs have risen as companies procure raw materials through imports or from distant states. Companies are implementing operational improvement exercises, changing their product mix and increasing their reach to semi-urban or rural areas.

To improve productivity and acquire technical know-how to produce high-end steel, some steel producers have signed strategic alliances with their global counterparts.

Overall, there is an inherent optimism about the India growth story and it is expected that domestic consumption will be the key demand driver in the sector.

Source: Ace equity, CARE, IBEF

Pick of the Month (Hindustan Zinc Ltd.): CMP: 274 Target: 325

Quarter performance: HZL's EBITDA of Rs23.3 bn (-23% yoy, -14% qoq). The sequential earnings decline was due to 6% qoq decline in zinc sales volumes to 160,000 tons, and lower realization of zinc (-13% qoq), lead (-7% qoq) and silver (-4% qoq). Even though HZL's mined metal volumes increased 9% qoq to 232,000 tons (+6% yoy) on ramp-up of underground mines, the refined zinc output declined by 6% qoq to 162,000 tons (-16% yoy) due to lower zinc mined metal availability in the early half of the quarter. This essentially means HZL is carrying higher zinc mined metal inventories from increase production in the latter half of the quarter which will boost 2HFY19 production. Lead production increased 17% qoq to 49,000 tons while silver production increased 25% qoq to 172 tons—increase in silver production was led by higher lead output, increased production from SK mines.

Global zinc demand to rise: According to International Lead and Zinc Study Group (ILZSG), world demand for refined zinc is forecast to increase 0.4% to 13.74 MT in 2018 and then by 1.1% to 13.88 MT in 2019. Zinc mine production is forecast to increase 2% to 13.03 MT in 2018 and further by 6.4% to 13.87 MT in 2019. Refined zinc metal production in 2018 is forecast to increase 1.4% to 13.42 MT while in 2019 it is forecast to increase 3% to 13.81 MT.

Strong margins and superior return ratios: The company has a EBITDA margin 61% and profit margin of 40%. The Company revenue and PAT grew at the growth of 19.8% and 11.54%, respectively. HZL turned debt free in FY18. The company has been maintaining impressive RoE and RoCE of 27.8% and 34.24%, respectively.

Outlook: We recommend HZL for its strong fundamentals together with high free cash flow generation and strong dividend payout track record. HZL is trading at the CMP of Rs. 274, which is trading at a P/E valuation of 12.29x FY19 with the target price of Rs. 325.

NSE / BSE Code	HINDZINC
Sector	Non - Ferrous Metals
Industry	Metal - Non Ferrous
Face value / Book Value (` per share)	2 / 93.7
Dividend yield (%)	2.9
52 H/L (Rs.)	340 / 260
Market Cap. (Rs. Cr)	1,140,836
Shares Outstanding (Cr)	4,225.3
NSE / BSE Code	5,364,807

	18-Sep	18-Jun	18-Mar	18-Dec
Net Sales	4,777.0	5,310.0	6,277.0	5,922.0
EBITDA	2,334.0	2,713.0	3,620.0	3,244.0
PAT	1,815.0	1,918.0	2,505.0	2,230.0
EBITDA %	48.9%	51.1%	57.7%	54.8%
PAT %	77.8%	70.7%	69.2%	68.7%

(In Rs. Cr)	FY14	FY15	FY16	FY17
Net Sales	147,884	154,630	187,980	225,210
Sales Growth	8.5%	4.6%	21.6%	19.8%
EBITDA	71,276	66,520	97,390	122,720
EBITDA Margin	48.2%	43.0%	51.8%	54.5%
PAT	81,780	81,750	83,160	92,760
NPM%	55.3%	52.9%	44.2%	41.2%
Adj. EPS (Rs.`)	19.4	19.4	19.7	22.0

	FY14	FY15	FY16	FY17
P/E (x)	14.0	14.0	13.7	12.3
P/B (x)	2.6	3.1	3.7	3.2
EV/Sales(x)	5.3	5.1	4.2	3.5
EV/EBITDA(x)	11.1	11.8	8.1	6.4
ROCE(x)	23.8%	21.4%	27.3%	34.2%
ROE(x)	20.2%	20.3%	24.4%	27.8%

Source: Ace equity, CARE, IBEF

Pick of the Month (Hindalco Ltd.): CMP: 217 Target: 250

Hindalco Industries, the metals flagship company of the Aditya Birla Group, is an industry leader in aluminium and copper. A metals powerhouse with a consolidated turnover of Rs 600, 128 million ($ 15 billion), Hindalco is the world's largest aluminium rolling company and one of the biggest producers of primary aluminium in Asia. Its copper smelter is the world's largest custom smelter at a single location.

Strong Q2 performance: In Q2FY19, the company reported EBITDA of Rs19.2bn for Hindalco standalone plus Utkal Alumina on higher realization and favorable macroeconomic factors, offset in part by higher input costs. In Q2FY19, revenues of the copper segment were Rs47bn, down 6% yoy, mainly due to lower volumes as a result of a planned maintenance shutdown at one of the smelters in July-18 and also due to lower copper realizations. This was partially offset by higher by-product realizations. In Q2FY19, copper rod production rose 24% yoy 49kt, primarily due to the ramp-up of the new CCR-3 facility. The share of total sales volumes surged to 70% in Q2FY19 from 43% in Q2FY18. The company prepaid long-term loans of Rs15.75bn in Q2FY19.

Better road ahead: Hindalco won back the Krishnashila coal linkage of 3.1mn tons in an auction conducted in Sep'18. Novelis has also secured bank financing for the Aleris acquisition. Novelis started the construction work of an automotive finishing line in Changzhou, China, which when completed, will double its capacity to 200kt from 100kt. Net debt/EBITDA improved to 2.47x from 2.57x in Q1FY19.

Outlook: We believe that Hindalco remains on its guided strategy with deleveraging underway and overall operations getting stronger by each passing period. Hindalco Industries is trading at the CMP of Rs. 217, which is trading at a P/E valuation of 8.1x FY19 with the target price of Rs. 250.

NSE / BSE Code	HINDALCO
Sector	Non - Ferrous Metals
Industry	Metal - Non Ferrous
Face value / Book Value (` per share)	1 / 214.6
Dividend yield (%)	0.5
52 H/L (Rs.)	284 / 193
Market Cap. (Rs. Cr)	487,276
Shares Outstanding (Cr)	2,245.3
NSE / BSE Code	5,522,382

	18-Sep	18-Jun	18-Mar	18-Dec
Net Sales	10,833.0	10,593.2	11,681.1	11,022.8
EBITDA	1,090.7	1,325.3	1,257.6	1,311.7
PAT	308.6	413.5	377.0	375.5
EBITDA %	10.1%	12.5%	10.8%	11.9%
PAT %	28.3%	31.2%	30.0%	28.6%

(In Rs. Cr)	CY14	CY15	CY16	CY17
Net Sales	1,042,811	987,589	1,001,838	1,151,717
Sales Growth	18.9%	-5.3%	1.4%	15.0%
EBITDA	86,294	81,689	123,624	136,872
EBITDA Margin	8.3%	8.3%	12.3%	11.9%
PAT	839	-8,730	19,074	62,080
NPM%	0.1%	-0.9%	1.9%	5.4%
Adj. EPS (Rs.`)	4.1	(1.2)	8.5	27.3

	CY14	CY15	CY16	CY17
P/E (x)	581.1	NA	25.5	7.8
P/B (x)	1.3	1.2	1.1	0.9
EV/Sales(x)	0.5	0.5	0.5	0.4
EV/EBITDA(x)	5.8	6.1	4.0	3.6
ROCE(x)	4.4%	4.4%	8.3%	11.3%
ROE(x)	2.5%	1.4%	4.4%	12.3%

Source: Ace equity, CARE, IBEF

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