"Hindustan Zinc Ltd Q1 FY19 Results Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Hindustan Zinc Limited Q1 FY'20 Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Preeti Dubey from the Investor Relations team. Thank you, and over to you, ma'am.

Preeti Dubey: Thank you, Rio. Good evening, everyone and thank you for joining us for Hindustan Zinc First Quarter Fiscal 2020 Results Call.

Today, we have with us our CEO -- Mr. Sunil Duggal; and Mr. Swayam Saurabh -- Acting CFO.

Mr. Duggal will begin with an "Update on Business Performance", and then Swayam will present "Financial Performance," after which, we will be happy to take your "Questions." Over to you, Mr. Duggal.

Sunil Duggal: Thank you, Preeti, and warm welcome to all of you. We have started FY'20 on a positive note. I am pleased to inform you that our mining projects are approaching completion and we expect to achieve 1.2 mt mined metal capacity in Q3. The debottlenecking of our smelters to 1.13 mt will be completed in the current quarter and further debottlenecking to 1.2 mt is underway. These will enable us to secure higher production in the second half of this year as well as next year.

I am very excited about the prospects for growth in our silver production. We have delivered 15% CAGR in silver production over the last five years, and our guidance of 750-800 tons of silver this year implies double-digit growth this year too. The upward trajectory will continue as we are targeting over 1,000 tons of silver production in the next two to three years. This will put us among the top three global silver producers. Our higher mining capacity as well as opportunity to mine the silver rich Galena Zone at Rampura Agucha will give us the opportunity beyond 1,000 tons of silver.

Also, the Fumer plant is about to commence operations very soon which will allow us to convert silver in smelter waste and produce additional 35 tons of silver every year. For the long-term growth of our business, we have an aggressive brownfield exploration program across all our mining leases to augment resources to reserves and also add new resources, for which advanced surface and geophysical technologies have been deployed. Our R&R at the end of last year was 403 mt, containing 34.6 mt of metal, which implies mine life of over 25-years. This year we are specifically focusing on upgrading resources at Zawar and Agucha Galena Zone lens and enhancing R&R of Kayar mining lease, new ore body at Bamnia Kalan and new ore body below existing SK deposit.

For digital transformation of our business and to build mines of the future, we have entered into a partnership with leading global players to digitize our SK and Agucha mines through high bandwidth WiFi underground network, real-time tracking of assets, system-driven task scheduling, data analytics for predictive maintenance and cycle time optimization. This will lead to improvement in overall equipment effectiveness by 20% and reduce mining cost by 10%. We expect this system to be in place by the end of current year. We are also setting up a collaboration center to have visibility across the value chain, including mining, milling, smelting and CPP to enable data driven decision-making, operational data analytics and synergies across our operations. This will increase our ore to-metal ratio by around 2%.

I would also like to talk about our dry tailing stack initiative which can potentially change over sustainability profile. Our first dry tailing stack plant is expected to be commissioned in current quarter at Zawar. This plant will remove water from tailing, making it available for reuse and consequently lead to water saving of around 3,000 $\mathbf{m}^3$ per day as well as significantly lower land requirement. This will help improve structural stability and longevity of tailing dams. This technology is being used first time in India, and Zawar plant is one of the few such plants globally. Dry tailing is getting adopted at all our mines to drive our commitment to sustainability.

Now to give you a market update, despite recent price decline, we are quite positive about zinc market fundamentals marked by low global exchange stocks which are at five days of consumption now - a very low level historically.

On the supply side, Chinese zinc production in falling short of market expectations. And the overall global metal supply is constrained due to production issues. There is no major capacity addition of smelters in pipeline and we have seen supply on the mining side growing at a slower pace than expected. The global market therefore continues to be in deficit and we expect it to remain in deficit for at least two years now. It will take much longer for stocks to reach normal levels.

The demand outlook is finely balanced with growth being driven by emerging economies, which are showing good appetite for zinc in infrastructure and housing segment. In this background, we believe the fundamental support from continued low stocks point towards stronger outlook for zinc prices.

For us, India has been the focus with over 80% market share in zinc market. India's zinc consumption is building and construction segment accounting for 58% of zinc consumption continues to show strong growth. Furthermore, we are increasing share of value-added products such as continuous galvanizing grade, electroplating grade, jumbos, die casting alloys. The share of value-added business is targeted to increase from 16% last year to 25% this year to over 50% in the next two years, keeping us in good stead to benefit from the India's story and reap good premium.

Turning to our operating performance now, total ore production for the quarter was up 10% from a year ago with strong growth at Rampura Agucha, Zawar and Rajpura Dariba mines. On a sequential basis, ore production was down 5% primarily due to lower production at Rampura Agucha and Sindesar Khurd caused by temporary geo tech challenges and consequent changes in mine plan. Mined metal production at 203 kt grew slower than ore production on account of lower grades.

Refined lead and silver production continue to show strong gains on YoY basis with double-digit growth. Integrated lead production was up 13% to 48 kt while silver production increased by 15% to 159 kt. Refined zinc production was flat from a year ago. Sequentially, integrated metal production was down 3% on account of lower mined metal and annual maintenance shutdown at smelters, partly offset by WIP conversion.

Now to update you on expansion projects, you will be happy to know that at Sindesar Khurd, ore hoisting has commenced as the shaft has been integrated with the mine. This will help in volume ramp up to 6 mtpa and we expect cost to progressively reduce. Our shaft project at Rampura Agucha is now at an advanced stage and is expected to commission in early third quarter, allowing for incremental volume at lower haulage cost. We are also upgrading the shaft capacity at Rajpura Dariba mine from 0.7 to 1.3 mtpa, which will be completed by the end of current financial year.

The second paste fill plant capacity at SK has been commissioned, which will further aid in ramping up production through quicker filling of voids. We already have sufficient paste fill capacity at Rampura Agucha. The two paste fill plants at Zawar are expected to commission in Q3. Once Zawar paste fill plants are commissioned, we will be using in majority of our tailings for void management in mines, resulting in improved mine stability and increase in life of our tailing dams. This paste filling will allow us to recover the left-out high grade ore from old pillars, improving our volume and grade.

Now an update on our next phase of expansion, we have commenced detail exercise for the next phase of expansion to 1.35 mtpa. This will cover areas like reserves, production, grade, ore-to-metal ratio. Specifically, we are looking at potential of some existing deposits at Bamnia Kalan, SK deep, Zawar, Rampura Agucha Galena Zone, etc., We are engaging a global partner for end-to-end project delivery, including scoping, visibility, project implementation, delivery of targeted outcomes, etc.

Now I request Swayam to provide you an update on the financial performance.

Swayam Saurabh: Thank you, Mr. Duggal. Revenue for the quarter was impacted by lower zinc, lead and silver prices, which have declined in the range of 10-21% from a year ago. This was partly offset by double-digit growth in lead and silver volumes and rupee depreciation by 5%. Consequently, revenue for the quarter was lower by only 6% from a year ago to Rs.4,987 crores.

On the cost side, imported coal prices continue to decline, and we also received higher linkage coal up to 25% of our requirement; however, we produced less power during the quarter due to severe water scarcity caused by less rain last year and delayed pre-monsoon. This led to significantly higher external power purchase which more than offset the benefit from lower coal prices in the quarter. So far in July, there has been sufficient rainfall and we do not foresee any water issues in Q2 or subsequent quarters. Zinc cost of production, excluding royalty increased by 2% YoY to $1,067/ton. On YoY basis our cost was negatively impacted by lower ore grades, higher mine development and higher prices for commodities like cement, partly offset by higher metal volume and lower diesel prices. Sequentially, CoP was higher on account of higher power cost, lower volume and lower grades.

EBITDA for the quarter declined by 11% YoY to Rs.2,480 crores primarily due to lower metal prices as higher volume and lower manpower cost offset increase in power, mine development and other expenses. The sequential 11% decline in EBITDA was driven primarily by lower volume and higher power costs. Net profit for the quarter was at Rs.1,765 crores, down 8% YoY and 12% sequentially in line with lower EBITDA and lower tax rate. Investment income during the quarter was higher on account of higher rate of return from year ago, even as investment corpus was lower.

During the quarter we paid off remaining Rs.2,000 crores of outstanding commercial paper and the ending net cash and equivalents were Rs.18,258 crores. We generated Rs. 1,292 crores in free cash despite lower metal prices and growth investments.

I will now request our CEO to sum up today's discussion.

Sunil Duggal: To sum up, as we get closer to complete 1.2 mtpa project, including debottlenecking of smelters, we expect volumes to improve in the coming months, which together with internal efficiencies, technology and digitization initiatives will help COP to progressively come down. Furthermore, we expect recovery in metal prices driven by robust fundamentals, especially growing demand for infrastructure in emerging economies. This together with higher value-added product portfolio and double-digit growth in silver production, keeps us optimistic about improvement in overall performance in coming quarters.

With this, I open the floor for questions.

Moderator: Sure. Thank you very much. We will now begin with the question-and-answer session. The first question is from the line Amit Dixit from Edelweiss. Please go ahead.

Amit Dixit: I have two questions; the first one is that if we compare the commentary from last quarter, we find that some of the projects such as shaft at Rampura Agucha has been delayed by a quarter, similarly, Fumer has been a little bit delayed. So, just wanted to understand the reasons for the same.

Sunil Duggal: So, first on the shaft, there is no further delay. What we have said is that in the earlier commentary last quarter that the shaft project will get commissioned by the end of Q2. It is just slipping by another five to seven to ten-days and we said that this will get commissioned in the early Q3. Some geo tech issue has come because of which we had to make a separate chamber for two crushers which was one chamber. So, there is not a significant delay I would say in the shaft commissioning. As far as Fumer is concerned, our commissioning activity has already started, 33% trial has already been taken. In Fumer of course will be commissioned in this quarter, but with the teething issues, we are hopeful that the next quarter we will start getting gain out of this.

Amit Dixit: Is there an increase in power cess for captive producers by Rajasthan government?

Sunil Duggal: On power, I would say there is proposed duty increase from Re.0.40 to Re.1 which has been mentioned in the budget. Final notification is about to come, but there is a strong advocacy which is going on with the state government with all the major industries and there is a strong pressure, and the early indication show that there will be pressure to rollback the complete industry duty increase of Re.0.60. But I am quite hopeful that if not full roll back, at least the partial rollback or a major rollback will come.

Amit Dixit: Follow up question to that. In worst case, how will it impact us financially if it is not done?

Sunil Duggal: Worst case means Re.0.60 increase would result into $35/ton cost increase. But I do not think this will happen. There are positives around this also. There are structural initiatives which we are taking -- #1 is that we are reblading our turbines and we have cleared the order with Siemens for the first turbine. This will give us around 6 MW of additional power from one turbine with the same usage of steam and power cost will come down. The potential for all our CPP units is 30 MW. Similarly, there is another structural change which is coming with the global players and benchmarking. We have found the opportunity of another 30 MW from our roaster plants where we can generate the additional steam. Some modification we have already done in part of the roaster which has already started giving us the additional steam which we have started using in the process. But this opportunity is there. We will modify our turbines going forward. So, around 60, 65 MW on the additional power availability will come which can bring a big structural change and a huge cost reduction in the power.

Moderator: Thank you. The next question is from the line Pinakin Parekh from JP Morgan. Please go ahead.

Pinakin Parekh: Sir, the prepared remarks talk about lower grade. Sir, can you talk us through about where the lower grades are and how will it change going forward once the expansions come into play, and how much of the cost increase can be attributed to the lower grades?

Sunil Duggal: So, in the Q1 probably the cost increase was around $15/ton, and the grade fell down by around 0.3% from the previous quarter. You know the grade is a mix of all the mines. So, it all depends on from where we have to use what volume. Basically, we analyze all the mines. The volume at Rampura Agucha has gone up, volume at Zawar has gone up, volume at our RD mine has gone up, volume at our SK mine has gone down. So, the volume which went up at Rampura Agucha which is a very, very happy story if you ask me because at some point of time we were a bit concerned because when we were going open cast to underground in mining below the open pit, this was a big, big concern, but this is a happy situation now. So, in SK mine, we face some geo tech issues and filling of the mine is a priority. You must have noticed that in my top para I said that the second paste fill plant is commissioned. With this mine getting filled in the right sequence and we will start again getting the grades especially from the higher grade area where the silver content is also high which is at a deeper level. So, now the sequence will fall in place and you will see the grades going up quarter-by-quarter.

Pinakin Parekh: The guidance for cost was below $1,000 as of Q4. How should we look at the rest of the year -- will the cost of production fall from what we saw in the first quarter or will it trend at similar levels for the remainder of the year?

Swayam Saurabh: Cost for the quarter was $1,067. Our guidance for the year was approximately $1,000. The first reason why cost is higher is due to lower volumes which as Mr. Duggal just spoke, we progressively see going up over next three quarters. Other than that when shaft comes in we also expect efficiency gain in our haulage. On commodity side, number of gains are not fully reflected yet. So, our coal cost has come down, but we also progressively see coal cost going further down in Q2 and Q3 based on the parcels which we have booked. On top of that, we expect grade to also recover. Putting this all together we are confident that progressively our CoP will come down and we would go back to committed level of $1,000.

Moderator: Thank you. The next question is from the line of Anuj Singla from Bank of America. Please go ahead.

Anuj Singla: Sir, follow-up question on cost. You mentioned that from the 1.2 mt target, which is in Phase-1, we are now proceeding to start work on 1.35 for the Phase-2 target. So, does it imply that the mine development work is going to remain at elevated level for extended period of time and hence some of the cost benefits which we thought could come once the things are stabilized on the $1.2 mt expansion, they will take a bit more time to factor in?

Sunil Duggal: No, actually, we have to understand that there are two types of development -- Revenue and Capital Development. So, revenue development is separate, capital development is separate. Capital development is capitalized. So, once the project finishes, we only do the revenue development. So, like ramp is connected from top to bottom and the footwall levels open up, and then we enter into the ore and mine. The capital development will be applicable for the project activity beyond 1.2mtpa for which we account this into the project cost. So, that will be a separate head between what we do in revenue and in project. So, it will be accounted for in the project activity. So, separate ore body, separate lengths, separate area, the working goes on.

Anuj Singla: If that understanding is correct, that given that in FY21, I am talking about the year after, you have everything going for you, you have the hauling through the shaft, you have the commodity prices obviously the full benefit of that flowing through and you have the lower mine development expenses as well. So, does it imply that there can be a significant reduction in cost of production in FY‘21 or FY‘20?

Sunil Duggal: Absolutely, this will be there. One, I will ask Swayam to pitch in after I give you one comment from my side. We are also looking at the minor metal recovery in a very-very big way because like we done some engineering through which we improve apart from improving our ore to metal ratio. There are opportunities around cadmium, there is opportunity around mercury, there is opportunity around copper, manganese, bismuth. So, all this ancillary industry set up and minor metal extraction, we have benchmarked and some of the orders also we have placed. Current recovery from this is around Rs.35-50 crores. Current year it would go up to Rs. 60-65 crores, but the total opportunity is up to Rs.1,000 crores. So, by bringing all this opportunity on the table and commissioning these projects, if we get the full benefit of Rs.1,000 crores, it will throw our cost down by another $100 or so. So, the opportunity is very big apart from what we have said. But I will ask Swayam to add on from his side.

Swayam Saurabh: Indeed cost would come down. The biggest driver would be volume growth and the grades which are expected to go back to its normal levels. But other than minor metal initiative, which would be quite big and it would come in progressively in 2020, 2021 onwards, we are also looking at fixed cost optimization. And as you know, fixed cost with higher volume would translate into lower cost per ton. Other than that we also had commodity-related hits this year as I talked a few minutes back which would also be better absorbed and together with other efficiencies around IT, automation, digitization, we expect to gain significantly in terms of how our cost will look like let us say in FY'21, '22.

Sunil Duggal: I would add two points on what Swayam has said -- One is you heard me that there are structural initiatives around the power to generate the free power. The commodity prices which was hit badly was cement. What we are trying to do is we have the fly ash available with us. We are putting up a fly ash grinding unit wherein it will be used as a binder. We will purchase the OPC from the cement manufacturers, mix the fly ash, it will cut down our cement cost by 25%. Lot of thinking is going around.

Moderator: Thank you. The next question is from the line of Vishal Chandak from Emkay Global. Please go ahead.

Vishal Chandak: My first question is with respect to your power requirement at 1.35 mt. So, at 1.35 mt, would the existing power be sufficient? Do you plan to have additional capabilities on the captive power front?

Sunil Duggal: So, beyond 1.2 mt, power definitely would be required because we will be exhausting all our resources. But we thought that up to 1.2 mt also, the power was required, but meeting this power requirement from renewable energy, from turbine efficiency improvement, from waste heat recovery. But beyond 1.2 mt there will be definitely some power requirement. But we are a very dynamic company. We will also think of internally what could be the new opportunity going forward.

Vishal Chandak: Secondly, you mentioned in your opening remarks that the average inventory is about five days of consumption today and we are at sub-2,500 levels at LME. What was the last thing when you saw this number and what you believe would be the challenges or responses from the industry to again take it up in terms of pricing?

Sunil Duggal: Last quarter we talked, almost at the same level, maybe four days if I remember correctly. Now, it is five days. There is hardly any difference which has taken place. People are talking, Wood Mackenzie talk that the mining capacities coming up, the gap will get filled up. But you must have also watched for the many-many quarters, how the mining gaps get filled up. The new capacity addition from that is slower than normally expected when the deeper ore bodies around the globe. So, I am quite hopeful that the inventory levels may not improve at least in the coming few quarters. So, my sense is that these prices will improve in the coming quarters. You must have also seen that lead has moved up around $250 in the last 30-days' time. Silver has gone up from $14 to $16.5 today. So, the kind of portfolio we have, we always have the opportunity from one commodity or the other commodity but we are in a very happy situation I would say.

Moderator: Thank you. The next question is from the line of Rajesh Lachani from HSBC. Please go ahead.

Rajesh Lachani: Sir, two questions from my side; #1 is so if you see the production in the first quarter is 21% of our guidances of close to 1 mt. So, are we maintaining our production guidance for mined metal for this year? #2, the reserve and resources this year saw fall. This was the first time in several years that we have seen reserve and resources falling. And what is slightly more concerning is that the reserves have fallen significantly; so they are down 12% from the prior year which means that we have not converted resources into reserves that much by the pace which we are converting previously. So, just want to understand that, is there a one-off this year that we have not been able to convert resources into reserves?

Sunil Duggal: So, I would pick up your first question first. I think you asked that the volume is 20% of the total guidance of the year. So, we are mindful of that that the volume is 20%. We also see that what is going to happen going forward. So, you will see that from now on, the kind of opportunities or the plants we have commissioned, we look at mine-to-mine, we are in a quite happy situation. At the SK mine because of the geo tech issues, we could not lay hand on the higher-grade stopes and the volume. This you will see a huge change with the back filling going on in the mine and you will see better performance. We still maintain our guidance of 1 mt plus metal and the silver guidance of 750 to 800 tons we have given. On your second part, R&R going down, there is no surprise which has happened. The addition from the new drilling has been better this year I would say compared to last year. There is a calculation method. We engage Golder for this, global consultant, who look at our R&R and give us the report, which is JORC compliant, which is Australian guideline. So, Rampura Agucha open cast had certain recovery percentage. So, the method of calculation has changed as we have gone underground and we have taken the actual figures which have been achieved over the last three to four years. But being mindful about this, what we have also done is to improve the ore recovery and improve the valuation, we have changed the mining method. This year we have changed the mining method. You may also see a positive surprise like you have seen the surprise this year. Next year reserves will significantly go up. But it is a calculation method, there is no surprise as such.

Moderator: Thank you. The next question is from the line of Sumangal Nevetia from Kotak Securities. Please go ahead.

Sumangal Nevetia: This year it looks like given the smelter debottlenecking is on track and the mine development will also finish in second half, so can we assume next year at the start of the year itself, we will have both 1.2 mt smelting and mine capacity and volume growth could be 15%, 20% at least?

Sunil Duggal: This is what we hope for. Normally, we have given this growth from underground mines YoY, and this is what we are hopeful.

Swayam Saurabh: You are right.

Sumangal Nevetia: So, given the market is also in deficit, what could be the constraint next year to have any volume growth lower than double-digit and metal production growth?

Sunil Duggal: So, this is what we are hopeful [of double digit increase] as the project has got commissioned and the capacity is built up. Normally, you must have seen that from our underground mines, the CAGR has been very robust. So, we have to prove this point this year and the next year also. And what we have done in the last few years, we continue with the same story this year and next year and now the project activity is getting completed, shaft getting commissioned, paste fill plants are commissioned. So, this gives us the opportunity of mining a higher volume. And I am very hopeful that the same growth what we have envisaged in the last few years should definitely come this year and next year.

Sumangal Nevetia: With respect to the Fumer project, does it take time to ramp up or we can start expecting the 35 tons of additional silver getting added to overall volumes in a quarter or two time?

Sunil Duggal: I do not think it will take much of a time, but at the same time we also have to be mindful that this is the first project of its kind which we have commissioned in our organization. There could be bit of a learning curve, but the kind of initiative we have taken, we have sent our people to those companies where these fumers are operating and spend time there for two to three months, and they have come back after training. With this training in our hand and confidence in our hand, we should be able to commission it and ramp it up quickly. Let us see how it goes. Since this is a first fumer, once the learning will become and the second and the third fumer will become much easier job for us.

Moderator: Thank you The next question is from the line of Abul Fateh from Geecee Holdings. Please go ahead.

Abul Fateh: If I look at your employee cost, it has come down significantly compared to the last year. How should we look at the employee cost going forward? Is there any specific one-off in the cost?

Swayam Saurabh: If you look at sequentially, Rs.182 crores in this quarter has one-off gain of about Rs.20 crores, which is a combination of some incentive provisions which were reversed as well as the bonus provisions which were reversed. That basically should go off from the subsequent quarters.

Abul Fateh: How should we look at the employee cost going forward -- normal growth in employee based on the WPI rate or something like that or around Rs. 200 crores per quarter?

Swayam Saurabh: We should be looking at about Rs. 210-220 crores per quarter.

Sunil Duggal: Normally what we do each year to optimize our cost and whatever the increasing cost comes by way of the annual appraisal cost, we try to optimize it and our endeavor remains that the cost base remains the same every year.

Swayam Saurabh: Our cost grows slower than the top line growth giving us the….

Moderator: Thank you very much. That was the last question in queue. I would now like to hand the conference back to Ms. Preeti Dubey for closing comments.

Preeti Dubey: Thank you, everyone for joining us today. If you have any further questions, please feel free to contact me. Thank you.

Moderator: Thank you very much. On behalf of Hindustan Zinc, that concludes this conference. Thank you for joining us. Ladies and gentlemen, you may now disconnect your lines.