“Hindustan Zinc Limited Q1 FY2021 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Hindustan Zinc Limited Q1 FY2021 Earnings Conference Call. As a reminder, all participants' lines will be in listen-only mode and 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 this conference is being recorded. I now hand the conference over to Ms. Preeti Dubey from Investor Relations team. Thank you. And over to you, ma'am.

Preeti Dubey: Thank you, Vikram. Good evening, everyone and thank you for joining us for Hindustan Zinc First Quarter Fiscal 2021 Results Call.

I will begin this call today by introducing our new Head of Investor Relations – Ms. Shweta Arora. Shweta has over 12-years of experience in capital markets and joined our group in November 2019. Over to you, Shweta.

Shweta Arora: Thank you and good evening, everyone. I am very excited to be heading Investor Relations Team at Hindustan Zinc and look forward to interacting with you all in the coming few months.

Today, we have with us our CEO-Designate – Mr. Arun Misra and our CFO -- Mr. Swayam Saurabh. Mr. Misra will present an Update on Business Performance, while Swayam will brief you on Financial Performance, after which we will be happy to take your questions.

Before we proceed, we have an announcement to make for which I will hand over the call to Swayam. Over to you, Swayam.

Swayam Saurabh: Good evening, everyone. I am pleased to announce that Mr. Arun Misra will be taking over as CEO of Hindustan Zinc from 1st of August 2020. He has been with us since November last year as Deputy CEO and has been an integral part of our Executive Committee. He has a diverse experience of 31-years and we are excited to have him.

I would also like to thank Mr. Duggal, our outgoing CEO for his immense contribution in the growth of our company and he will continue to guide us as the CEO of Vedanta.

Now I will ask Mr. Misra to take over this call.

Arun Misra: Thank you, Swayam for your kind words. Good evening and a very warm welcome to all of you. I thank our board of directors for giving me the opportunity to lead such an illustrious company. And it will be my endeavor to continue to our growth story and achieve our vision of becoming the largest and most admired zinc, lead and silver company.

I trust that you and your families are safe and maintaining all precautions against spread of COVID-19. While the uncertainty due to the pandemic is still lingering, we have done well in keeping our assets and people safe, and have ramped up our mines and smelters to near normal levels. The needs of our communities remain close to our hearts and we have stepped up our CSR activities during these times, not only to ensure sufficient supply of food, health services, masks and other PPE's, but also continue to provide access to our programs in livelihood, education and childcare.

I am delighted to share that our sustainability efforts over the last several years have paid off and we have been certified as 2.41 times water positive company. What it means is that we are adding 2.41 times more water than we are actually consuming. This is significant as we operate in a water scarce region, where water availability to communities for drinking and agriculture is a key issue. Initiatives like rainwater harvesting, desilting of Udaipur lake, water conservation initiatives like dry tailing and enhanced use of treated sewage water have enabled us to achieve this distinction.

Another good news is that we are now the Sixth Largest Producer of Primary Silver in the World and contribute to over 10% of our domestic demand. We have increased our silver production 4.1x over the last decade to over 600 tons which now constitutes approximately 13% of our total revenue. We have plans to further increase it to over 1,000 tons in the coming years through higher production from existing and new silver rich deposits as well as by enhancing process recovery. This will pave the way for us to become one of the top three silver producers in the world.

Coming to Quarter's Performance

We have continued to deliver good performance despite losing approximately 18-days equivalent of production in April due to lockdown and other workforce related restrictions. Through well planned safe restart and continuous ramp up of operations, while also complying with COVID-19 guidelines, we have achieved 16% higher mined metal production run rate in May and June than the average run rate of last year's Q1 during the same month. We are well aware that risks associated with COVID-19 is yet to fade away, but based on our resilient Q1 performance, we remain confident of delivering strong performance during the year.

Coming to Market Update

After touching multi-year lows in March, zinc prices recovered in May and trended above $2,050 in June, mirroring the rebound in industrial activity, post easing of sanctions and restrictions globally. Majority of the mines where production was suspended on account of COVID-19 related lockdown, resumed operations in May, June and are ramping up, while complying with new protocols. Globally, there are also some mine closures and new project delays on account of an already weak price environment that has been worsened by COVID-19 pandemic. The overall impact of all this is likely to translate into a decline in mine supply by 5% in 2020 as compared to pre-March expectation of a 4% growth.

On the “Demand” side, Chinese consumption which accounts for 40% of global demand, has trended upwards with increasing government spending on zinc intensive infrastructure and real estate, white goods as well as auto sector showing momentum. As a result, Chinese zinc stock have come down despite higher imports and higher output from Chinese smelters. However, demand in rest of the world remains disrupted with secondary outbreaks. So, while we witness demand picking up from the lows recently, it still remains weak and expected to be lower than the last year. As mine supply is expected to be lower and dependent on ramp-up, we expect smelters will cut production due to subdued demand and lower TC which have declined from $300 in March to $170 per DMT (dry metric tons) in spot market. This we believe will provide an upward push to zinc price in the foreseeable future.

In domestic market, our key customers including steel plants, are gradually increasing production and demand is expected to improve towards the end of the current quarter as ‘unlock 4.0’ accelerates. Government’s economic package to reboot the economy will aid downstream demand of zinc as infrastructure activities are anticipated to pick up pace. In lead, we expect replacement demand to gain traction in Q2 though it may take a while for automobile OEM demand to return to normal levels as the segment globally is struggling. Silver demand is steady in domestic market and prices are has steadily rising. Gold to silver price ratio has increased further and the need for safety in these uncertain times will keep silver prices on a secular uptrend.

Now, an update on Operations.

During the quarter, our mined metal production declined by 5% from a year ago to 202 kt due to fewer operation days in the quarter. Our grades remain unchanged at 7.3% from a year ago. Sequentially mined metal production was lower by 19% as per mine plant and a fewer days of production in April. Similar to mine, smelters also saw a gradual ramp up in April and registered 90% utilization in May and June, with production run rate being 11% higher in those two months as compared to similar months in Q1 of last year. Integrated metal production was 202kt, down 8% from a year ago and 9% sequentially in line with the availability of mined metal with zinc at 157kt and lead at 44kt. Saleable silver production was 117 tons, down 26% year-on-year and 30% sequentially, due to delayed stabilization at our Dariba Smelting complex lead smelter and increase in WIP partly offset by improved grades.

Coming to our growth projects, the commissioning of backfill plants at Zawar are expected to be completed in Q2. Fumer plant is ready for commissioning and is waiting for OEM support held up due to visa and travel restrictions. We are conceptualizing our next phase of growth to 1.35 mtpa and finally to 1.5 mtpa. For this a detail life of mine planning and feasibility studies are currently underway in partnership with renowned global experts. I am quite excited about this new phase in our company which will add substantial value to our stakeholders.

Before I hand over to Swayam for an update on financial performance, I would like to present our annual production guidance as promised in the Q4 earnings call.

We expect mined metals and refined metal production for the year to be in the range of 925 to 950 kt each, while saleable silver production is expected to be approximately 650 tons.

Now, our CFO, Swayam Saurabh will provide an Update on Financial Performance. Over to you, sir.

Swayam Saurabh: Thank you, Arun, and welcome everyone again. As outlined by Arun, we continue to strengthen the foundation of our operation to deliver the guided volume growth across our mines and smelters. I am happy to share that our digitization and automation backed cost optimization program launched last year, together with the war rooms which we created towards end of March have started to yield encouraging results. We have been successful in structurally reducing our cost through specific initiatives which were deployed across all our operational units. In addition to this, the tailwind of softer input commodity prices helped us to protect margin in an otherwise uncertain environment. All of this has also laid a strong foundation for us to deliver the promised performance for rest of the year.

Coming to the Financial Performance for the First Quarter, revenue from operations was Rs.3,989 crores, a decrease of 20% from a year ago and 9% sequentially. Our financial performance was impacted by a sharp decline in Zinc LME prices, which fell 29% YoY and 8% sequentially as well as lower LME prices which were down 11% YoY and 9% sequentially as COVID-19 pandemic slowed down economic activity. Metal premiums were lower due to an overall decline of benchmark premiums in international markets as well as mix shift to exports as domestic demand virtually halted down due to lockdown in Q1.

On the positive side, rupee depreciation aided our price realization. Zinc, lead sales volume at 163 kt and 45 kt were in line with production and higher opening inventory. Silver sales of 146 tons were significantly higher than production and marginally better sequentially as we liquidated inventory from previous quarter.

Zinc Cost of production before royalty for the quarter was $1,019/ton and included a $53/ton impact from COVID-19 related donations and another $12/ton as one-time startup cost. Excluding the one-offs, CoP improved 4% sequentially and 11% from a year ago to $954/ton. The reduction in CoP is a combination of structural cost optimization measures in the area of consumption, power management, contracting and overhead optimization as well as softening prices of input commodities like coal, met coke, cement and diesel. These were partly negated by COVID impacted lower volumes and weak acid credit due to temporary mismatch of supply/demand in acid market. Resulting EBITDA for the quarter was Rs.1,599 Crores, lower by 36% from a year ago and 18% sequentially on account of lower LME and one-time cost partly offset by lower operating cost.

Net profit for the quarter was at Rs.1,359 crores, a drop of 23% from a year ago, but a marginal increase of 1% sequentially. The decline in EBITDA was partly offset by higher investment income primarily on account of higher mark-to-market gains due to favorable interest rate movement and lower tax rate due to incoming shift.

Coming to Cost and Capex Guidance for the Year

Our cost base is resetting to a lower level and we therefore expect CoP to remain below $1,000/ton for the fiscal year, which includes higher spend on mine development to support future volume growth. Project Capex for this year is expected to be in the range of $100-$140 million and our focus remains on conserving cash and channeling investment in growth projects with superior paybacks.

With this, I open the floor for questions.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Sumangal Nevatia from Kotak Securities. Please go ahead.

Sumangal Nevatia: First question is on the delays in the expansion plan. So, both the backfill plant at Zawar and Fumer, I think on early May call we guided that both these should start in May and now we are telling 2Q. So just wanted to know what is the reason behind the delay because I am sure a lot of this COVID-related issues are already well known in May?

Arun Misra: Yeah, so you would appreciate that although the COVID-related domestic issues are well known, it was not anticipated that the foreign travel would be restricted to the extent that it has been and specially now the situation with China that has developed the way it is and also, of course, because of COVID only from a couple of countries, international flights were allowed to pick up their own citizens, otherwise for technical people to travel it is still not so easy to happen. So, we are estimating that towards August end perhaps travel would be easier and the foreigners to get visa and then the experts can come in, so, somewhere towards the end of this Q2 we should be able to get the experts to help us in commissioning those facilities.

Sumangal Nevatia: Second half looks like we will be completing all the plant expansion projects and reaching 1.2 mt capacity. So can we expect a steep jump in FY'22 in terms of our volume capability, I mean, just some early color and thoughts on FY'22 how it can look because at least on the capacity or any project commissioning side, we will not have any constraints?

Swayam Saurabh: Indeed we expect most activities related to the current expansion growth project to be completed by Q2. And we also think this would allow us to exit Q4 at a significantly higher run rate, of course, COVID is something we will have to watch out for. This has not gone yet, but it is giving us confidence that we would exit Q4 higher which should give us let's say even better run rate going into FY'22.

Sumangal Nevatia: There are a lot of media reports that we are evaluating a bond issue of a billion dollar or something. So, given that we already have around $2 billion of cash, just wanted to understand the rationale behind this?

Swayam Saurabh: We would not comment on media reports in this forum.

Moderator: Thank you. The next question is from the line of Amit Dixit from Edelweiss. Please go ahead.

Amit Dixit: I have a couple of questions. The first one is on the silver. So, if we look at silver EBIT, we find that for the first time it is greater than zinc, lead EBIT and it has been growing since several quarters, so what is your overall thought process behind this division -- is there a thought process internally to spin it off into a separate hub because clearly this business is not getting the value it should get essentially and given the increasing contribution and you said in your opening remarks that silver production is likely to go up and the kind of EBIT margin it generates, I think the contribution of this particular division is going up? So I just wanted to understand the thought that goes into the future of this particular division.

Arun Misra: It is a very interesting question and the whole management also appreciate the fact that silver constitutes a very significant portion of our revenue and also time now with the scale and the proportion it is having, separate attention is needed. So we have recently appointed a CEO for silver business who would focus exactly on the idea that you are talking about, how to take this segment of the business forward, while still not delinking with the main business of zinc and lead. So, that is the strategy as of now.

Swayam Saurabh: And just to add to that on your question of not getting the right value, we are aware of that and we think that silver as a business should command let us say a significantly higher value than what you see right now. And as Arun explained with more committed and dedicated focus on silver as a vertical, we are looking at ways to enhance and extract this value.

Amit Dixit: The second question is on cost per ton. While you have guided that cost per ton would be lower than $1,000 and in these two quarters Q1 and Q2 we have found that cost per ton has declined and in fact if you adjust it with the one-off cost for COVID-related thing, it is already down to $954 and coal cost is expected to stay low. So, why this guidance of just below $1,000, why not CoP to be nearer to $950, do you expect cost to escalate or something going ahead?

Swayam Saurabh: There are no known reason for cost escalation. It is just that current environment is very dynamic. The second reason cost is guided the way it is guided is the fact that we have mentioned this I think a couple of quarters back that we are focusing on accelerated development which would allow us to generate sufficient let us say higher mineable reserves versus what we have today which would translate in a more volume predictive rates and also let us say a more sustained continuous production levels. So, this is something we are going to be actively investing in. And if the commodity prices and our cost saving initiatives stay the way they are, the cost should be around 950. However, additional development is where we need to focus on to make sure our business remain sustainable for next three to five years and that is where the investments are.

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

Pinakin Parekh: Sir, can you talk more about the acid credits, because historically it has been a material number in terms of revenues and EBITDA and this quarter was particularly weak, so, what is the outlook going forward in terms of prices that you see?

Swayam Saurabh: Acid credit has declined in this quarter, I mean, it has now come to about Rs.1,400/ton of acid which is roughly 40%-45% lower than what we have been realizing till two quarters back. See, acid is a more regional business. Transportation of acid beyond 200-250 Kms makes it unviable. So, a lot of price gets determined by regional demand and supply. And as you know, part of the reason why our price realization came down in Q1 was because of COVID. A lot of our consumers, their factories did not start, while we started to operate, which created small delta between let us say traditional demand and supply. We do expect acid price to improve going forward. The other factor on which prices will depend is sulphur prices which has also crashed coincidentally by 40% over the last six months or so. But we think the acid prices are at bottom level right now. And the only way forward will be prices going up.

Pinakin Parekh: The second question is that I would assume that in the current quarter, you would have exported a much larger share of your volumes than you normally do. So, what was the export percentage and how do you expect this to trend because incrementally domestic sales volume will be more profitable? And the other question is that with the commercial coal blocks coming up for auctioning, does Hindustan Zinc fancy itself entering that segment or would it remain limited to zinc and lead and not participate in the commercial coal block auction?

Swayam Saurabh: Coal block auction, I will let Arun respond, but let me take your first question. Indeed, domestic market was completely under lockdown mode. So, we had to do far more export and export as a percentage which traditionally is about 25%-odd had moved to actually 70% during May and June. But from May to June we are seeing this trend reversing with domestic market opening up we expect towards the end of Q2 the situation should start to get normalized.

Arun Misra: On top of that, in spite of higher exports in the domestic market, our supply was more than what we thought of.

Swayam Saurabh: Market share was maintained.

Arun Misra: And the last part is the coal block. Yes, Hindustan zinc is looking at coal block primarily from the affordability and logistical viability compared to the coal that we use in our power plant. It is under consideration, but I would not be speculating on which mine and how much.

Moderator: Thank you. The next question is from the line of Anupam Gupta from IIFL. Please go ahead.

Anupam Gupta: Just two questions. Firstly, given that exports were much higher in May, June, what is the sort of differential between the prices for exports and domestic? So, the CAPEX number which you indicated \$100-\$140 million, is that only the growth CAPEX or does it include the sustenance CAPEX as well?

Swayam Saurabh: So, to answer your first question, when we sell in domestic we have something called duty factor which gets added back. So approximately, that works out to be \$100-\$120/ton at incremental margin that we generate if we sell domestically. Capex number which has been guided is only growth Capex. Sustaining Capex is on top of that.

Anupam Gupta: So what will be the total CAPEX which will build in for FY'21?

Swayam Saurabh: We are still evaluating sustaining Capex and just like all other corporates focus is on conserving cash. We expect the total Capex at this moment to be in the range of 300 million plus/minus 20-30 million - total capex.

Moderator: Thank you. The next question is from the line of Ritesh Shah from Investec Capital. Please go ahead.

Ritesh Shah: Sir my first question is, how is it that we have deployed 15,500 crores -- is it more towards a short end of the curve or is it towards the long end of the curve, so if at all have to monetize it, sir how do you look at it, so just wanted to understand what sort of deployment is from a maturity perspective?

Swayam Saurabh: All our investments by design are for long-term because our goal is to focus on tax efficient, fixed income or debt investments. Any specific queries around what are the maturity profiles can be obtained offline from our investor relations team.

Ritesh Shah: And sir, when we say long-term, is it like one year plus, that would be say 90% will be a fair, roundabout number?

Swayam Saurabh: You should reach out to our investor relations and they should be able to guide you. It is typically three years plus because you get indexation benefits, but there are different products with different level of tax efficiency and maturity follow.

Ritesh Shah: If a company had to raise debt a certain large quantum, is it something that the board has to sanction the quantum and any regulatory required around this? If it is yes, then what was the last approved or sanctioned quantum that is something which the board did for the requirement of the sort?

Swayam Saurabh: So in past whenever we have raised debt, we have asked for board approval and that is I think all companies are required to follow. And that is where I would leave this question.

Ritesh Shah: We cannot basically disclose the sanction quantum over here?

Swayam Saurabh: We do not disclose this information as a standard information disclosure.

Ritesh Shah: Sir, is there any update on saved leases? I think the government was talking about abolishing Sec.10 (2B) of MMDR Act. This is something which is critical for Hindustan Zinc. Sir, has there been any update over here – positive, negative, work-in progress?

Arun Misra: As of now, on the MMDR Act changes, all our leases on the life of mine it is still protected, there is no risk towards our ownership of the leases that we have.

Ritesh Shah: This also includes saved leases which allocated prior to MMDR that is I am referring to the sunset clause?

Arun Misra: Under various clauses, we still have right over them and for which we are in talks with the government, some cases are on the PIL and some cases government has like in a BK-II project extended the mining lease and some cases we are working with the regional authorities to get our hold on the leases.

Ritesh Shah: My fourth question is for Swayam. Sir, there was an ongoing case regarding payment dispute with a contractor. This was pertaining to the payments in this quarter because of the COVID issue. What is the impact of that on employee cost or is it something which has been deferred and it can come into Q2? This is regarding the four mines which were there and a technomic contractor case, the four main leases actually where we have a common contractor which had actually filed a litigation.

Swayam Saurabh: No, we are not aware of any litigation and we are also not aware of any such large dispute which is material enough let's say to be disclosed or discussed here. There are a few cases we are having discussions and I think they will get resolved. None of them are material.

Ritesh Shah: And lastly, if possible, I think the Supreme Court has been talking about the divestment of government stake in Hindustan Zinc. If at all, the Supreme Court gives a green light, how should a minority investor look at Hindustan Zinc as a listed entity?

Swayam Saurabh: I will not be able to answer this question because we have very little role to play, if at all we get divested. So I would not have answer to this question. This is not the correct forum for this question.

Moderator: Thank you. The next question is from the line of Indrajit Agarwal from CLSA. Please go ahead.

Indrajit Agarwal: Two questions from my side: First on the startup cost that you mentioned about $12/ton. So, how long can you expect this to sustain or do you think as we launch or commission all the projects do the start-up cost will go up on P&L?

Swayam Saurabh: See, the startup cost was a one-time cost since we stopped our operations from 22nd of March and then we restarted towards middle of April. These are one-time cost which we will need to incur where your smelters come to a complete standstill. They are not expected to be repeated in coming quarters.

Indrajit Agarwal:: During the lockdown, were the smelters entirely closed or we did like some hot idling of those smelters?

Arun Misra: Almost 70%-80% of the smelters were closed and only roaster, which is a hot furnace and we are into kind of slow idling it. We could maintain only one or two of them.

Indrajit Agarwal: How are the grades in this quarter?

Swayam Saurabh: So grade are at 7.3%. They declined sequentially which were at 7.9%. But we expect grades to improve going into Q2 and expect them to be in the range of 7.5%-plus for the full year.

Moderator: Thank you. Ladies and gentlemen, we will take the last question due to time constraints. We have the last question from the line of Vivek Ramakrishnan from DSP Mutual Fund. Please go ahead.

Vivek Ramakrishnan: There is also a CRISIL rating which has assigned Rs.8,500 crores fresh NCD line. Sir, could you at least guide us in terms of what are your debt raising plans because I know there were CPs in the last quarter and how much do you propose to raise as long-term debt and what would be the end use?

Swayam Saurabh: As I replied earlier, this is not an appropriate time for us to provide specifics. So, I would request you to drop here and once we are closer to any concrete plan, we would via our investor relations you would be informed.

Moderator: Thank you very much, sir. Ladies and gentlemen, that was the last question. And I would now like to hand the conference over to Ms. Shweta Arora for closing comments. Over to you ma'am.

Shweta Arora: Thank you, everyone for joining the call today. For any follow-up questions or clarifications, please feel free to reach out to investor relations team. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Hindustan Zinc Limited, that concludes today's conference call. Thank you for joining with us and you may now disconnect your lines.