“Hindustan Zinc Limited First Quarter Fiscal Year 2019 Earnings Conference Call”

July 23, 2018

MANAGEMENT: MR. SUNIL DUGGAL – CHIEF EXECUTIVE OFFICER, HINDUSTAN ZINC LIMITED
MR. AMITABH GUPTA – CHIEF FINANCIAL OFFICER, HINDUSTAN ZINC LIMITED
MS. PREETI DUBEY – GENERAL MANAGER-INVESTOR RELATIONS, HINDUSTAN ZINC LIMITED

Moderator: Ladies and gentlemen, good day and welcome to Hindustan Zinc First Quarter Fiscal Year 2019 Earnings Conference Call. As a reminder, all participant lines will be in the 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 that this conference is being recorded.

I now hand the conference over to Ms. Preeti Dubey from Investor Relations. Thank you and over to you, ma'am.

Preeti Dubey: Thank you, Aman. Good afternoon and thank you for joining us for Hindustan Zinc's First Quarter Fiscal 2019 Results call.

For our call today, we have with us Mr. Sunil Duggal – CEO and Mr. Amitabh Gupta – CFO. Mr. Duggal will present an update on business performance while Mr. Gupta will present financial performance and after that we will be happy to take your questions. Over to you, Mr. Duggal.

Sunil Duggal: Thank you Preeti and a warm welcome to all of you. We have started Fiscal Year 2019 on a positive note with notable progress in our ongoing mining projects and over 13% growth in underground mine metal production. I am pleased to inform that we have received environment clearance from MOEF for expansion of ore production at Sindesar Khurd mine from 4.5 million tons to 6 million tons per annum and beneficiation capacity from 5 million tons to 6.5 million tons per annum. This is an important year for us as we are filling the production gap from closure of open cast operation which contributed 24% of our mine metal production last year.

We are confident of reaching our guidance and surpassing last year record production of mine metal. And now I will take you through on zinc market. Since mid-June the base metal prices including zinc have declined in a deepening global trade conflict environment and also due to appreciation in US dollars. The trend towards increasing protectionism continues to weigh on base metal prices. This has unnerved market sentiment exaggerating the near-term impact on metal prices. If you look beyond these factors the fundamentals for zinc are robust with stable demand supported by increasing galvanization and tight supply as evident from low stock levels.

Market is expecting about 2% annual growth in annual zinc demand over the next 5 years which is slightly lower than 2.7% annual growth since 1990. The growth in zinc consumption is coming from emerging countries where galvanization levels are quite low. For example, in India only 10% of domestic cars are galvanized while those exported are 70% galvanized and also the level of galvanizations in urban infrastructure is quite low. So, while a potential trade war may impact global economic growth in near term we feel long-term outlook for zinc to remain strong.

Global metal stocks continue to remain close to decade low now. Recently negotiated 15% decrease in benchmark TCs of 2018 and low spot TC that contribute to hover around $25 to $30 signal continue tightness in concentrate market. This is contrary to recent fall in LME zinc prices and over 90% capacity utilization of metals globally. Considering the pipeline of mining projects, we believe there will not be enough supply to meeting increasing consumption and increased inventory levels.

Total inventory level continues to remain at 30 days or so over the next three years. Therefore, we expect Zinc LME prices to bounce back to the level of three months ago. Now I will give you an update on our operating performance. Underground mines ramp up during the quarter with mine metal production up from previous quarter by 7% and 13% from a year ago. Despite some issues in Rampura Agucha underground mine which have now been resolved. Overall mine metal production was 212 KT lower by 17% from last quarter and 9% from last year primarily on account of closure of open cast operations.

Last year 24% of mine metal production came from open cast mine and as the year progresses we are confident of more than filling this gap. Zinc metal production during the quarter was 170 KT in line with availability of Zinc mine metal. Integrated Lead production was 42 KT during the quarter up 20% YOY in line with the availability of Lead mine metal and down 16% sequentially due to maintenance related shutdown which obviously had taken in Quarter 1.

Integrated Silver production was 138 tons up 20% YOY on higher STM production and Silver growth. Sequentially Silver production declined by 19% in line with Lead production. In FY 2019 we will maintain our momentum in underground mine production which will increase progressively every quarter. We maintain our guidance of higher mine metal and refine Zinc Lead versus the level set in FY 2018. And also Silver production to be in the range of 650 tons to 700 tons. Now I will update on the progress of extension projects during the current year.

Capital mine development increased by 18% YOY to over 10 kilometers during the quarter. Rampura Agucha underground mine continues to maintain high development rate during the quarter at 6 kilometers. The ventilation system has now been commissioned. With this mine has been liberated from ventilation issues for the light and it will help in ramping up the ore production. Additionally, we have innovatively designed mid sharp loading which will be completed in the current quarter. This will build the haulage capacity earlier than expected by two quarters and increased productivity to facilitate the quick ramp up. At Sindesar Khurd, the main shaft skip winder was commissioned and production from the shaft is expected to start in Q3 FY19. Civil work and equipment erections of the new 1.5 MTPA mill is progressing well and is expected to commission by Quarter 3 FY19. As part of ongoing digitization of SK mine, we have placed orders with leading global vendors for manpower and equipment tracking.

Traffic management, data analytics through underground WiFi communication network and onboard technology. At Zawar, as a first step, we have decided to build a dry tailing plant which will increase the life of existing tailing parts by additional 25 years. This will avoid need for additional land for storage. The civil construction of the new MTPA mill at Zawar is on track and is expected to be commissioned by Quarter 4 FY19. The equipment supplies for fumer project at Chanderiya have been achieved on site, an erection is expected to be completed in current quarter with commissioning in Quarter 3 FY19.

We have finalized our next phase of our expansion to 1.35 million tons which was announced in April this year. One of the innovative solution we have come up with this to convert the metallurgical Zinc smelter at Chanderiya to start producing Lead sinter. This will enable us to cater to higher proportion of Lead mine metal that we are getting primarily from higher production from SK mines while also helping us to reduce cost of production.

Zinc smelting configuration and basis engineering is under finalization to ensure smelting capacity matches with the ramp up in mining. Now Mr. Gupta will take you through the financials and results.

Amitabh Gupta: Good Afternoon to all. Revenue from operations during the quarter was Rs. 5,310 crores an increase of 16% YOY primarily due to higher Zinc LME price, Rupee depreciation and higher Lead and Silver volumes and partly offset by lower Zinc volumes. Sequentially revenues were lower due to lower metal volumes. The forward sale of Zinc and Lead metal has insignificant impact on revenue this quarter as hedge prices were close to average spot prices. There is no forward sale position on a go forward basis.

The cost of production before royalty or COP for Zinc during the quarter was $1,043 up 7.2% YOY and up 12.7% sequentially.

The YOY increase was primarily on account of lower overall volume due to open-cast closure. About 20% increase in the prices of met coke, coal and diesel and impact of long-term wage settlement. The sequential increase was on account of lower volume, higher power cost, maintenance related shut down costs and impact of wage settlement. The linkage coal allocation continues to be poor due to evacuation issues from Coal India subsidiaries. EBITDA for the quarter was Rs. 2,785 crores up 16% YOY and down 24% QOQ.

We recently concluded five-year long-term settlement with our recognized unions impacting cost of production by $33 per ton for the current quarter and going forward.

EBITDA was also impacted by arrears of Rs. 125 crores related to wage settlement. The resultant net profit for the quarter was Rs. 1,918 crores up 2% YOY and down 23% sequentially in line with EBITDA. Additionally, net profit was impacted by lower investment income on account of Mark-to-Market loss on debt investment due to spike in interest rates. Our gross investments were at Rs. 21,283 crores at the end of the year invested in high quality debt instruments.

In terms of outlook we continue to maintain our guidance of COP before royalty for Zinc to be in the range of $950 to $975 per metric tons in FY19. COP in Q2 will trend down marginally and we expect it see it lower in Q4 when the two shafts start delivering production. With this I would now request Mr. Duggal to kindly sum up today's discussion.

Sunil Duggal: So, we are positive on Zinc prices outlook despite recent abrasion. We expected new supply will not be sufficient to bring inventory back to normal levels. It will take prices to the level of three months ago. Our mining projects are ramping up as per plan. And innovative measures to fast track sharp production via mid shaft loading will ensure higher production rate at Rampura Agucha underground mine. We are expecting another year of record production in FY19 around on track for 1.2 MTPA mine metal capacity. With this I open the floor of Q&A.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session.

The first question is from the line of Sumangal Nevatia from Macquarie. Please go ahead.

Sumangal Nevatia: I have couple of questions. One on the cost side. Your commentary mentioned about commodity cost inflation and wage cost impact. But you have maintained your full year guidance. So, both commodity cost and wage revision was it on expected lines?

Amitabh Gupta: So, the long-term settlement on wage agreement was slightly more than what we had expected. So, there is a going forward impact of $33 per ton however as our volumes start ramping up we expect that the cost would soften and plus in this quarter we did not get any linkage or virtually very limited linkage, so the arrears of the linkage will also start coming in from the next couple of months is our expectation. So, our anticipation is that as the volumes go up our costs will start trending downwards, so we are maintaining our guidance at 952 to 975.

Sunil Duggal: If I can add on the employee cost what has gone up as we have entered into a long-term settlement with the federation or the unions so what is happening is that in the current quarter we have launched a VRS scheme and the response as such is that there could be number which may come up to the extent of offsetting the major portion of the cost and this is the way we may expect our cost to come down going forward.

Amitabh Gupta: Also, in the coming quarters we expect Rampura Agucha performance the underground mine's performance to improve which will help us from a great perspective and hence on the cost perspective.

Sumangal Nevatia: So, this quarter for this $33 impact of wage cost, was there any provision for previous quarter, previous year also accounted in this quarter?

Amitabh Gupta: No, not in the COP.

Sumangal Nevatia: Okay, understood. Just continuing on this, I mean for full year midpoint guidance is 960 so now remaining three quarters ask rate is around 940, so it is almost around $100 cost reduction. Is it possible to break as to how much will come from, I mean what is the assumption in commodity price deflation to contribute towards this and how much will shaft commissioning, etc., will contribute?

Amitabh Gupta: I am afraid I do not have numbers off the cuff, but we can certainly talk offline.

Sunil Duggal: These are the major drivers I would say, that these are the major drivers of the cost as the earnings start from there, the volume goes up, the grade comes higher because of the higher contribution from the Rampura Agucha because if we look at the current quarter, you know the last quarter whatever the loss has come basically it has come primarily from Rampura Agucha and going forward as we have spoken in our commentaries that there are couple of key events which have happened, one or two events which are likely to happen in the next 7 or 10 or 15 days' time.

So, these are two events which will raise the volume from Rampura Agucha and the overall grade jumps up, so three, four things, then VRS, the linkage realization. So, these are four or five factors which will be mainly responsible to push our cost back to the original levels.

Amitabh Gupta: So, to an extent this spike was not unexpected coming after being the first quarter after open cast closure.

Sumangal Nevatia: Just one last question on the modeling perspective. On 1.2 million tons what will be Zinc and Lead breakup given that lead of course the proportion is increasing given the mine mix?

Sunil Duggal: So, it is about 25% of Lead as it is ramping up.

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

Amit Dixit: I have couple of questions. One is that if you can let us know the Zinc grade in Q1 and how does it compare YOY and QOQ and what is your expectation of overall Zinc grade for FY19?

Amitabh Gupta: We do not give individual grades for Zinc or Lead, but our overall grade was 7.64% for the quarter. This was compared to a year ago that was 8.41%, so there is a fall in the grade even sequentially if I look at the prior quarter it was 8.74%. So, from 8.74% to 7.64% there is a 1% fall but again it is on expected lines because this is the quarter immediately after closure of open cast.

Sunil Duggal: So, the overall grade for the year is expected to be around 8%.

Amit Dixit: Okay. Second question is on linkage coal. I mean how much out of our total sourcing how much was through linkage in this quarter and how is this quarter looking like Q2 and how much you are receiving through linkage?

Amitabh Gupta: So, you know, we would this is the auctions that we have in hand we were expecting to go up to about 40% to 42% of linkage and we have got only 7.8% of linkage coal in this quarter. So, the good news is that whatever you do not get it is a deferment and not a cancellation. So, we are hoping that sooner or later all these arrears including for the current quarter will start coming in but that has not started as yet.

So, railways is still struggling with evacuation from some of these coal mines. But we are also looking at some innovative schemes, there is a RCR scheme and some other schemes which are coming up which will hopefully help us in the evacuation. So, sooner or later this will start catching up.

Amit Dixit: Sir, if you can help me out with those schemes, that would be helpful?

Amitabh Gupta: So, currently the railway scheme is in a manner that you have to take it to the Coal India's or their subsidiaries railway siding and from there it can be loaded onto rakes. Now there is new scheme which has come up, which we are looking at participating in and there you can take it to a private siding. Now if that happens, because ultimately the problem with Coal India's subsidiaries is not about production, it is an evacuation problem. So, we are still examining some of these kinds of schemes.

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

Rajesh Lachhani: Sir, as you rightly mentioned that Zinc prices have plunged because of the concerns regarding trade wars and you expect the prices to rebound but given the supplies rising including your supply in the second half Gamsberg project and other projects as well as trade war concerns are not going away anywhere soon. So, what makes you confident and what are the triggers that you think will take the Zinc prices to the levels seen three months ago?

Sunil Duggal: See you partly have also seen the correction from a low of 2,450 to 2,600 plus again. So, some correction has already taken place. I would personally feel that this is an abrasion which has taken place because the fundamental is strong and you were also saying some supply from Gamsberg and all that which will be coming but if you see the overall equation and balance this will give you the sense that overall stocks are not going to go up in the next two, three years' time.

And if you study the Wood Mackenzie and others they are speaking much higher LME even in the current context in the Quarter 4 Wood Mackenzie is even speaking of (+3,700). I am not saying (+3,700) my own estimate is that what the LME was there three months back it will bounce back.

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

Abhishek Poddar: First is regarding the production volumes. You have mentioned in the release that the production for main shaft at RA and SK Mine will start from 3Q FY19. So, when do we start seeing that 1.2 MTPA run rate from third quarter or after that?

Sunil Duggal: No, after it matures because once the shafts will get commissioned so maybe there could be some of the trading issues and maybe some month in the Quarter 4 as the production stabilizes as the events happen, this may get stabilized but as I spoke in my commentary which I suppose all of you must have understood that there is early opportunity we have found in the Rampura which are because necessity is the mother of invention they say because what we did is that it is like the lift in a building wherein you dump the material in the basement and you lift the material to the top floor.

In the current context what we thought that at the existing level where we are working if we connect that level to and if we commission mid-level landing we can load the material and bring the people in the mine through that. So, we have already connected our mine to the shaft and the landing also we have done, where the working people at that area have already started coming in that area. But we are putting up some infrastructure like belts and ware and all that so that we can load the waste from the mine in the shaft and carry the ore through the ramp, so this will meet the condition of hauling the material to the extent of 33% to 35% through the shaft and the remaining material coming through the ramp.

So, this was one of the innovative way we have been able to use the shaft. And this will give us some relief that we will be able to ramp up our Rampura Agucha mine much faster. Although we all know that the Rampura Agucha has been a bigger challenge or a bigger issue than all other mines where we have been able to ramp up as per our plan. But I think some of these things and apart from that we also spoke of the ventilation issue getting liberated. First quarter was very hot and on one side of the mine still the ventilation was not commissioned now, we have liberated the mine in this week itself from the ventilation issue for the life of the mine.

So, this has made the life more comfortable or rather be comfortable along the total strike length and this will help us to ramp up. But as you said after the commissioning of the shaft it can take a little while when the teething issues will get settled when we will start getting the 1.2 million tons run rate.

Abhishek Poddar: Okay. So, maybe early FY20 we should start looking at the number?

Sunil Duggal: Or maybe in Quarter 4 some month.

Abhishek Poddar: Okay and second question was regarding the grade slippage that you mentioned about falling from 7.64, so when you are given that 1.2 MTPA guidance do you expect the grades to improve or the guidance is based upon this kind of a grade only?

Sunil Duggal: No, the grades will be almost at this level between 7.8% to 8% because the contribution from Zawar will go up, the contribution from RD mine will go up, the contribution at SK also although stabilizing at a peak level now but as the Rampura Agucha ramps up some grade improvement will come but I think the overall grade will be 7.8% to 8% only and that is why like you see we were mining around we were to if we would have stayed the earlier grade we would have to do 12 million tons of ore production to meet 1.2 million tons.

But now we have calculated that we will have to do 15 million tons plus ore production to meet the target of 1.2 million tons and that is primarily because of the grade which has gone down over the years because of the contribution from Rampura Agucha as it changes.

Abhishek Poddar: Sir, just a last question on the hedging. Are there any outstanding hedges which are left and what was the hedging loss in the quarter?

Amitabh Gupta: $2 million for the quarter and nil going forward.

Abhishek Poddar: Sir, only $2 million for the quarter?

Amitabh Gupta: Yes.

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

Ritesh Shah: Amitabh sir, any color on royalties being included under GST if you could provide some color over there and how the impact would look like going forward?

Amitabh Gupta: We are not adversely affected. I will need to check why exactly not but we get the credit. So, we are not impacted by that discussion.

Moderator: Thank you. The next question is from the line of Anshuman Atri from Premji Invest. Please go ahead.

Anshuman Atri: Sir, my question is regarding the tailings. Now that we are putting all the fumer so do we expect further usage of tailings or all these will be converted to something which can be used for as a say in the cement industry or something else?

Sunil Duggal: So, this is the first fumer which is going to get commissioned and this will convert the Zerosite into a slack which will substitute the clinker replace the clinker in the cement industry and this is almost equivalent to the granulated slack which is produced by the steel industry and going forward we will have to put up the Fumers and all our hydro smelters so that we become the zero-waste company.

Anshuman Atri: Okay and sir second question is regarding the cost. So, this 960 mid-range in dollar terms and so do you expect given the rupee volatility are you expecting similar conversion rate or it is like in the dollar term it will be constant but in rupee terms?

Sunil Duggal: That is the question I normally ask you. I think that the rupee will bounce back, that is our expectation. It is a matter of time, maybe after the elections, maybe after the trade fears subside and Mr. Trump stops making these statements, I think rupee will start appreciating again.

Anshuman Atri: So, in the rupee terms do you expect cost to reduce?

Sunil Duggal: Hopefully Yes.

Moderator: Thank you. The next question is from the line of Dhaval Doshi from Phillip Capital. Please go ahead.

Dhaval Doshi: Sir, just one clarification. Mr. Gupta you mentioned Rs. 125 crores of arrears included in the employee cost right. This pertains to prior quarters, I am sorry if you can just clarify on this?

Amitabh Gupta: So, the figure of Rs. 125 crores is the arrear which is included in the EBITDA, so there was a onetime hit because remember the long-term settlements are with retrospective effect. So, our five-year LTS starts on July 1 for permanent workmen and even for contract workmen there is a settlement which takes place between the contractors and the contract workmen and we participate and facilitate that discussions.

That also is effective September 1. So, there are two retrospective dates from which these agreements are effective and there are some arrears to be paid. These arrears are not a part of the COP which is why in my talk that I mentioned a figure of Rs. 125 crores as the arrears, which is not built in the COP but is built into the EBITDA as a onetime effect, one time arrear.

Dhaval Doshi: So, while I was just looking at the employee cost Rs. 232 crores is what we have had the absolute cost if I were to remove this Rs. 125 crores pertaining to the arrears?

Amitabh Gupta: No, so that would not be the right way to look at it, because the substantial part of the manpower cost goes into other expenses which is the manufacturing category mostly. So, there are two types of people. There is one permanent workmen and executives their cost goes into manpower which is about 4,500 people. In addition to that 4,500 people there are another 12,000 people who are contractor’s workmen whose salaries are not paid by us and hence they do not come in manpower cost.

Their salaries get factored into the per ton cost as a part of the manufacturing expenses. So, somewhere it is per ton, somewhere it is per meter day, somewhere it is per cubic meter, it gets factored, those 12,000 people are not our workforce, so they do not come in the employee cost. They come in the other expenses where the manufacturing cost mostly reside.

Dhaval Doshi: Can I have the breakup of this Rs. 125 crores how much would be in the employee and how much in the other expenses?

Amitabh Gupta: About a Rs. 100 crores would be in the contract employee, but this is like I said it has gone into other expenses and as we guided so if there is any confusion about the employee benefit expenses, maybe I will mention, that our manpower expenses we expect would be in the region of about Rs. 200 crores going forward just for clarity sake.

Dhaval Doshi: Okay, on a quarterly basis, that is helpful. Sir, second question is more on the ring markets. So, typically what we have seen is a period of April to June in a calendar year is most of the times seen as a weaker period in terms of pricing and post that we tend to see some bounce back coming in terms of ring prices.

What would you attribute this to okay this time around we have seen a significant fall because of other factors which are known, and Mr. Duggal highlighted it at the start of the call. But what part of this fall would you attribute it to seasonality and we could see that coming back? We have seen this in past years as well so?

Amitabh Gupta: I will not be able to comment on this.

Sunil Duggal: I think your conclusion may not be fully valid because some of our famine and feast when we had the open cast, was the open cast was a bit cyclical and it so happened that one or two famine periods may have coincided with April to June period, so you are coming to this conclusion. But this would not be a right conclusion.

Dhaval Doshi: My analysis was simply on the basis of past 15 years of ring prices that is about it?

Sunil Duggal: No, we will not be able to comment anything because we cannot say that this factor is related or not related? It could be cyclic but what is the reason of cycle I am not also able to, maybe it is summer months in many parts. We would not be able to comment.

Moderator: Thank you. The next question is from the line of Sanjay Jain from Motilal Oswal Securities. Please go ahead.

Sanjay Jain: What are the volumes you are looking at in FY19 this current year 2018-19 for zinc, lead and silver?

Sunil Duggal: So, we have given the guidance that the MIC we are looking higher than last year. Again, I would like to say that this is 24% rise in volume from undergone mine will enable me to deliver the volume of last year. So, we have lot of work to do. But in the current year we are expecting the volume greater than last year which was 947 MIC and metal was 960 and as per the production of MIC we will be closely following the metal. On silver because the contribution from SK is going up the lead production is also going up our estimate is that silver should lie between 650 to 700.

Sanjay Jain: I mean you are not going to put number how much more it could be low single digit growth or high single digit growth, any more color on this or you should take just little more than what you did last year?

Sunil Duggal: So, what I am saying is that I would like to repeat for you that we have to grow at 24% to deliver the last year volume. So, in the apple to apple growth would be 24% minimum. So, the silver I said 650 to 700 which is against 558 of last year.

Moderator: Thank you. Ladies and gentlemen, we will take our last question from the line of Amit Dixit from Edelweiss. Please go ahead.

Amit Dixit: It is on depreciation. We saw depreciation going down significantly in this quarter on a QoQ basis while some of it might be attributed to your WDV method of accounting for depreciation. But as we commission new equipment and all the depreciation should go up that is my understanding. So, just wanted to clarify whether it is correct or what kind of quarterly run rate do we expect?

Sunil Duggal: See you are comparing from the sequentially prior quarter, that comparison would not be correct because that was the last quarter of our open cast operations and hence there may be a slightly higher than normal depreciation in Q4 of last year because it was the last quarter of open costs. So, depreciation run rate should be around Rs. 400 crores, Rs. 459 crores last quarter was perhaps an aberration because of open costs.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Ms. Preeti Dubey for closing comments. Thank you and over to you, ma'am.

Preeti Dubey: Thank you everyone. And if you have any further questions, please feel free to contact me. Thank you.

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