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India Research

The Account Shredder:
Hindustan Construction Company Ltd.
(HCNS.BO) (HCC.IN)

Trapped in a vicious circle of low margins-high capex-high working capital requirements…further compounded by a higher tax outlay

+

Interest-bearing advances camouflaged in current liabilities…

+

Free Cash flows, Return Ratios, Revenue trends and more…

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Financial Snapshot (Consolidated)

Key Financials

(YE March. 31) (in mn Rupees)	2003	2004	2005	2006	2007	2008E	2009E
Revenue	7929	11718	15782	20241	23007	31212	36953
Revenue Growth (Y-o-Y)	*57%*	*48%*	*35%*	*28%*	*14%*	*36%*	*18%*
EBITDA	1261	1457	1561	1843	2253	3129	3894
EBITDA Growth (Y-o-Y)	*31%*	*16%*	*7%*	*18%*	*22%*	*39%*	*24%*
EBIT	839	994	1093	1301	1449	1954	2598
EBIT Growth (Y-o-Y)	*24%*	*18%*	*10%*	*19%*	*11%*	*35%*	*33%*
Reported PAT	289	363	731	771	329	943	1308
Reported PAT Growth (Y-o-Y)	*-31%*	*25%*	*102%*	*5%*	*-57%*	*186%*	*39%*
Proforma PAT (Excluding Extraordinary items)	290	362	666	779	500	924	1288
Proforma PAT Growth (Y-o-Y)	*0%*	*25%*	*84%*	*17%*	*-36%*	*85%*	*40%*
Shareholder Equity	1392	1639	3504	8417	8762	9409	10315
No. of diluted shares (mn)	200	200	200	229	274	274	274

Key Operating Ratios

(YE March 31)	2003	2004	2005	2006	2007	2008E	2009E
Proforma EPS (Diluted)	1.4	1.8	3.3	3.4	1.8	3.4	4.7
EPS Growth (Y-o-Y)	*0%*	*25%*	*84%*	*2%*	*-46%*	*85%*	*40%*
Book Value per share (Rs)	7.0	8.2	17.5	36.7	32.0	34.3	37.6
CEPS	3.6	4.1	5.7	5.8	4.8	7.7	9.4
EBITDA Margin (%)	15.9%	12.4%	9.9%	9.1%	9.8%	10.0%	10.5%
EBIT Margin (%)	10.6%	8.5%	6.9%	6.4%	6.3%	6.3%	7.0%
Reported NPM (%)	3.7%	3.1%	4.6%	3.8%	1.4%	3.0%	3.5%
Proforma NPM (%)	3.7%	3.1%	4.2%	3.8%	2.2%	3.0%	3.5%
RoE (%)	22%	23%	25%	13%	6%	10%	13%
RoCE (%)	10%	9%	13%	7.2%	3.0%	6%	7%
Debt/Equity (x)	2.8	2.6	1.2	1.6	2.2	2.2	2.0
Dividend Payout (%)	31.2%	31.1%	21.5%	26.5%	68.3%	25.0%	25.0%

Valuation Metrics

(YE March 31)	2003	2004	2005	2006	2007	2008E	2009E
P/E (x)					73.2	39.6	28.4
P/BV (x)					4.2	3.9	3.5
P/CEPS (x)					28.1	17.4	14.2
EV/EBIDTA (x)					21.1	15.2	12.7
Market Cap. / Sales (x)					1.3	1.0	0.8
EV/ Sales (x)					2.1	1.5	1.3
Dividend Yield (%)					0.5%	0.6%	0.9%

DuPont Ratio

(YE March 31)	2003	2004	2005	2006	2007	2008E	2009E
EBIDTA/Sales	15.9%	12.4%	9.9%	9.1%	9.8%	10.0%	10.5%
Sales/Operating Assets	1.6	2.0	2.6	2.3	1.2	1.1	1.2
EBIDTA/Operating Assets (%)	**26.0%**	**25.2%**	**25.4%**	**21.2%**	**11.9%**	**11.0%**	**12.6%**
Operating Assets/ Net Assets (x)	0.9	0.9	0.8	0.6	0.7	0.9	1.0
Net Earnings/ EBIDTA (%)	23%	25%	43%	42%	22%	30%	33%
Net Assets/ Net Worth (x)	4.0	4.0	2.9	2.5	3.0	3.3	3.1
Return on Equity (%)	**21.6%**	**23.1%**	**25.3%**	**12.9%**	**5.8%**	**10.0%**	**12.8%**

Commonsized P&L Statement							
(YE March 31)	**2003**	**2004**	**2005**	**2006**	**2007**	**2008E**	**2009E**
Total Income	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Operating Expenditure	84.1	87.6	90.1	90.9	90.2	90.0	89.5
EBITDA Margin	**15.9**	**12.4**	**9.9**	**9.1**	**9.8**	**10.0**	**10.5**
Depreciation & Amortisation	5.3	3.9	3.0	2.7	3.5	3.8	3.5
Total Cost	89.4	91.5	93.1	93.6	93.7	93.7	93.0
EBIT Margin	**10.6**	**8.5**	**6.9**	**6.4**	**6.3**	**6.3**	**7.0**
Non Operating Income	0.8	0.2	0.4	0.2	0.9	2.4	1.3
Extraordinaries (Net)	0.0	0.0	0.3	0.1	-1.5	0.0	0.0
Interest Expense	5.6	3.3	2.5	2.0	2.7	3.9	3.0
PBT Margin	**5.8**	**5.3**	**5.1**	**4.7**	**3.0**	**4.8**	**5.4**
PBT Margin (excl. extraordinaries)	**5.8**	**5.3**	**4.8**	**4.6**	**4.5**	**4.8**	**5.4**
Taxes	2.2	2.2	0.5	0.9	1.7	1.7	1.8
Reported PAT Margin	**3.7**	**3.1**	**4.6**	**3.8**	**1.4**	**3.0**	**3.5**
Share of P/L from Associates & Minority Interest (Net)	0.0	0.0	-0.2	0.1	-0.1	-0.1	-0.1
Proforma PAT Margin	**3.7**	**3.1**	**4.2**	**3.8**	**2.2**	**3.0**	**3.5**

Source: Company Reports, FG Estimates

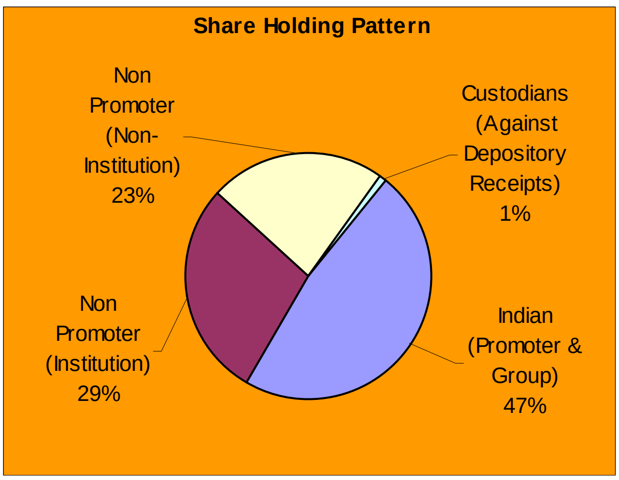
Top Management Team

Designation	**Name**
Chairman & Managing Director	Mr. Ajit Gulabchand
Director	Mr. Ram P Gandhi
Director	Mr. Y H Malegam
Director	Mr. Rajas R Doshi
Director	Mr. D M Popat
Director	Dr. N A Kalyani
Director	Prof. Fred Moavenzadeh
Director	Mr. Nirmal Bhogilal
Director	Mr. Sharad Kulkarni
Director	Mr. R G Vartak
Dy. Managing Director	Mr. K G Tendulkar
Executive Director & President (Construction)	Mr. S K Fotedar

Equity History

Date	**Equity Capital**	**Reason**
31/07/1987	63	As Per Annual Report
30/06/1992	77.7	Debenture Conversion
19/06/1995	155.4	Bonus Issue
30/01/1996	200.4	Debenture Conversion
31/03/2005	229.3	Preferential Issue Of Shares
29/03/2006	256.2	Equity Underlying GDR

Key Statistics



Industry:	**Construction Sector**
52 Week Hi: Lo:	Rs.172 / 82.5
CMP:	Rs.133.4
Avg Daily Vol (20 days):	1.07 mn
Avg Daily Val (20 days):	Rs. 136.71 mn
Performance over 52 weeks:	
HCC:	Up 26.45 %
Nifty:	Up 33.60 %

HCC's Business in Pictures... (FY07)

(All figures are in Rs. Mn except where stated otherwise) All percentages are percent of revenues, unless otherwise stated)

Operations/Value-add

Revenues - Rs.23007 mn (100%)

Export – Few Projects

Markets – India, Gulf countries

Raw Material
Rs. 7482 mn (32.5%) – Main R.M. are Cement & Steel. If the contracts don't have escalation clause, the company has to suffer due to increasing R.M. costs

Power & Fuel – Rs. 1160 mn (5.0%)

Manpower – Rs. 2097 mn (9.1%)

Sub-contracting Exp. – Rs. 8960 mn (38.9%)

Other Expenses – Rs. 1057 (4.6%)

Construction Projects (revenue) -
Transportation – 34%
Water Supply & Irrigation- 25%
Power – 35%
Others – 5%

Below Operating Line

Interest – Rs. 622 mn (2.7%)

Depreciation – Rs. 804 mn (3.5%)

Other Non-Operating Income – Rs. 211 mn (0.9%)

Extraordinary Income – Rs. –341 mn (-1.5%)

Competition

IVRCL Infrastructure, Gammon India, L&T, Nagarjuna Construction

Profit Before Tax
Rs.. 696.90 (3.0%)

Taxes
Rs. 387.10 mn including deferred tax Effective Tax Rate – 10% (due to deduction u/s 80IA, construction cos. get tax deduction for infrastructure construction)

Profit After Tax
Rs. 329.10 mn (1.4 %)

Assets
Rs. 29724 mn
(100%)

Balance Sheet
(FY 07)

Liabilities
Rs. 29724 mn
(100%)

Secured
– Rs. 8298 (27.92%)

Unsecured
- Rs. 11204 (37.69%)

Fixed Assets – Rs. 10232 mn (34.42 %)
Investments – Rs. 172 mn (0.58%)
A/R – Rs. 70.80 mn (0.2%)
Inventory – Rs. 22673 mn (76.28%)
Cash – Rs. 2652 mn (8.92%)
Loans & Advances – Rs. 3356 mn (11.29%)
Misc Exp. & Other C. Assets – Rs. 111.5 mn (0.38%)

Debt – Rs. 19502 mn (65.61%)
A/P – Rs. 8199 (inclusive of Creditors, Def. Tax Liability) (27.59%)
Advance from Clients – Rs.1567 mn (5.27%)
Provisions – Rs. 583 mn (1.96%)
Reserves – Rs. 8505 mn (28.61%)
Equity – Rs. 256 mn (0.86%)

Highlights

Hindustan Construction Company Ltd. (HCC.IN, HCNS.BO) delivered a lukewarm performance, both on the business front as well as the bourses in FY07. The company recorded a topline growth of merely 14% Y-o-Y to Rs.23 bn and a growth of only 11% Y-o-Y in EBIT to Rs.1.11 bn, which was way behind that of its peers, which recorded a growth of over 20%. HCC is currently in the midst of a large-scale capex phase, with huge investments being made in its real estate subsidiary, where most of the projects are of a long gestation and will begin to bear fruits only after FY10.The Bandra-Worli Sea Link issue still remains pending and the company has already incurred 65% of the costs, while the revenues are yet to be booked in the same proportion, thereby adversely impacting its working capital position.

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HCC appears to be caught in a vicious circle of low profitability and high capital requirements – this is bogging it down even as the opportunity pie grows. With the withdrawal of the benefits of Section 80 IA, the companies will now have to cough up more tax, which will hurt their already negative cash flows. There has already been significant equity dilution and the company's interest burden is also pulling down its margins.

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RoCE drops sharply…

The EBITDA margin improved marginally by 70bps to 9.8% in FY07, although the efficiency clearly declined in terms of project execution. The company's fixed asset utilization ratios deteriorated. HCC's working capital management has also not been up to the mark, with its working capital requirements rising to almost 52% of sales in FY07, as compared to 20% in FY06. This was primarily due to the high levels of inventory, which contains a major chunk of uncompleted orders. RoCE has declined from 11.2% in FY06 to 3.2% in FY07.

HCC's working capital management has also not been up to the mark, with its working capital requirements rising to almost 52% of sales in FY07, as compared to 20% in FY06. This was primarily due to the high levels of inventory, which contains a major chunk of uncompleted orders

Revenues & Order book

HCC's revenue growth came in mainly from the Transportation segment (Mainly roads), which contributed around 47% of the total revenues (up 62% Y-o-Y). Due to higher execution of transportation projects, the company was unable to post a very high margin during the year and the growth in the EBITDA margin was restricted to merely 70 bps. ***HCC's order book composition at the end of FY07 remains tilted towards high margin Hydropower projects, which the company bagged in FY07. Around 48% of its order backlog comes from the Hydro and Nuclear power space, which indicates that the company's margins will sustain over the next year.***

Re classification of Contractee Advances…

Over the years, HCC has treated interest bearing contractee advances as unsecured loans and interest free contractee advances as current liabilities. However, this changed in FY07 and both interest bearing and non-bearing contractee advances are now treated as current liabilities. The interest bearing contractee advances stood at Rs.1636.1 mn, up 61% Y-o-Y in FY07, as compared to Rs.1010 mn in FY06. These advances usually carry a higher rate of interest as compared to the average cost of debt for the company. The debt to equity ratio would have increased to 2.41x in FY07, if the contractee advances would have been included in the unsecured loans. Currently, the company's debt to equity ratio stands at 2.23x.

Over the years, HCC has treated interest bearing contractee advances as unsecured loans and interest free contractee advances as current liabilities. However, this changed in FY07 and both interest bearing and non-bearing contractee advances are now treated as current liabilities

Interest burden set to rise…

HCC has total loans of Rs.15.12 bn, excluding ZCCB of Rs.4.37 bn. HCC's fund requirements were partly met by ZCCB and GDS issue, despite this interest expense incurred has increased by 51% Y-o-Y to 622 mn. Thus, in the absence of any interest income (due to high capital requirement), the company will have to cough up high interest expense, which will significantly restrict the PAT growth. The interest paid on contractee advances will further add to the company's interest burden. HCC's interest coverage ratio declined to 3.62x in FY07, as compared to 4.46x in FY06.

Rise in inventory, interest & depreciation pull down RoE…

HCC's sales to operating assets ratio declined from 2.3x in FY06 to 1.2x in FY07, mainly due to an increase in its inventory position, which includes uncompleted contracts, and the value of work done to the extent of ~ Rs.19 bn, comprising of projects such as the Bandra Worli Sea Link, etc., the payments for which have not been completely made or approved by clients. The net earnings to EBITDA declined from 42.3% in FY06 to merely 22.2% in FY07, mainly due to the huge interest and depreciation burden being carried by the company, thereby adding to the pressure on return ratios. RoE has declined from 12.5% in FY06 to 5.8% in FY07.

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All in all, FY07 was a tough year for HCC, in spite of the demand buoyancy and we believe that the company will have to survive a few more similar, if not worse, periods ahead.

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Barometer: What happened to the growth rates, margins, cash flow, returns…

Free Cash Flow Analysis – Lower margin & higher Capex eat into already negative free cash flow

Free Cash flow Analysis

(Year Ended 31st March) (Rs. mn.)	2006	2007	% Y-0-Y Change
EBITA	1,301	1,449	*11.4%*
Less: Adjusted Taxes	238	805	*238.8%*
Plus: Change in deferred tax liabilities/(assets)	-49	176	*NA*
NOPLAT	**1,014**	**820**	***-19.1%***
Add: Depreciation	542	804	*48.2%*
Gross Cashflow	**1,556**	**1,624**	*4.3%*
Less: Increase in Working Capital	4,141	11,624	*180.7%*
Operating Cashflow	**-2,585**	**-10,001**	***NA***
Less: Net Capex	2,287	4,789	*109.4%*
Less: Increase in Net Other Assets	-4	-605	*NA*
FCF From Operation	**-4,868**	**-14,185**	***191.4%***

Source: Company reports, FG Estimates

HCC appears to have become entangled in a vicious circle of low margins-high capex-high working capital requirements, which has been further compounded by a higher tax outlay, resulting in negative cash flows for the company. This scenario is true for most companies in the construction space. The increase in tax outlay resulted in a decline of 19% Y-o-Y in the NOPLAT to Rs.820 mn, while an increase of 180% in the working capital requirement and 109% in the capex led to the free cash available for the company declining to a negative Rs.14185 mn.

HCC appears to have become entangled in a vicious circle of low margins-high capex-high working capital requirements, which has been further compounded by a higher tax outlay, resulting in negative cash flows for the company. This scenario is true for most companies in the construction space

Return on Capital Employed (RoCE) – All round deterioration

RoCE Analysis

(Year Ended 31st March) (IN %)	2006	2007
Expenditure on Contract % of Sales	0.8%	0.5%
Materials Consumed % of Sales	43.1%	32.5%
Sub-contracting Exp. % of Sales	33.1%	38.9%
Power & Fuel as % of Sales	3.3%	5.0%
Personnel Exp % of Sales	6.7%	9.1%
Other Expenses % of Sales	3.8%	4.1%
EBITDA % of Sales	9.1%	9.8%
Depreciation % of Sales	2.7%	3.5%
EBIT % of Sales (A)	**6.4%**	**6.3%**
Net Fixed Assets as % of Sales	22.7%	30.1%
CWIP as % of Sales	3.9%	5.7%
Net Working Capital as % of Sales	20.4%	52.2%
Capital Employed as % of Sales (B)	**46.9%**	**88.0%**
Pre-tax ROCE (A)/(B)	**13.7%**	**7.2%**
Cash Tax Rate as % of EBIT	18.26%	55.55%
Operating RoCE	**11.19%**	**3.18%**

Source: Company reports, FG Estimates

Although the EBITDA margin improved marginally by 70bps to 9.8% in FY07, the company's efficiency clearly declined in terms of project execution. HCC's fixed asset utilization ratios have deteriorated. The growth in net fixed assets was far higher than the growth in the topline, thus impacting the company's turnover ratios. HCC has made huge capital outlays, which resulted in a decline in its asset turnover ratios and an increase of 3.5% in depreciation cost as a percentage of sales, as compared to 2.7% in FY06, leading to a decline of 10 bps Y-o-Y in the EBIT margin.

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The company's working capital management has also not been up to the mark, with its working capital requirements rising to almost 52% of sales, as compared to 20% in FY06. This was primarily due to high levels of inventory, which contains a major chunk of uncompleted orders. HCC had very high capex this year, as many big projects were in the mobilization stage, which also ate up a lot of free cash due to the company's mobilization expenses. As a result, the operating RoCE declined to 3.18% in FY07 as compared to 11.19% in FY06.

HCC had very high capex this year, as many big projects were in the mobilization stage, which also ate up a lot of free cash due to the company's mobilization expenses. As a result, the operating RoCE declined to 3.18% in FY07 as compared to 11.19% in FY06

Revenue & Order book Break-Up

Revenue Break up

Segments	FY06	FY07	% Change
Transport (Rs. Mn)	6679	10813	61.9%
Contribution as % of Total Revenue	33%	47%	
Hydro & Nuclear Power (Rs. Mn)	4048	4601	13.7%
Contribution as % of Total Revenue	20%	20%	
Water (Rs. Mn)	8096	6212	-23.3%
Contribution as % of Total Revenue	40%	27%	
Others (Rs. Mn)	1417	1380	-2.6%
Contribution as % of Total Revenue	7%	6%	
Total	**20,241**	**23,007**	13.7%

Source: Company reports, FG Estimates

HCC's revenue growth came in mainly from the Transportation segment, which contributed around 47% of the total revenues (up 62% Y-o-Y). Revenues from the Water and Irrigation space declined by 23.3% Y-o-Y, thus restricting the overall revenue growth to merely 13%. Due to higher execution of transportation projects, the company was unable to post a very high margin in the year and the growth in the EBITDA margin was restricted to merely 70 bps.

Order book Break up

Segments	FY06	FY07	% Change
Transport (Rs. Mn)	41590	38416	**-7.6%**
Contribution as % of Total Order book	43%	40%	
Hydro & Nuclear Power (Rs. Mn)	36754	46100	**25.4%**
Contribution as % of Total Order book	38%	48%	
Water (Rs. Mn)	14508	8644	**-40.4%**
Contribution as % of Total Order book	15%	9%	
Others (Rs. Mn)	3869	2881	**-25.5%**
Contribution as % of Total Order book	4%	3%	
Total	**96,720**	**96,041**	**-0.7%**

Source: Company reports, FG Estimates

HCC's order book composition at the end of FY07 remains tilted towards high margin Hydra power projects, which the company bagged in FY07. Around 48% of its order backlog comes from the Hydro and Nuclear power space, which indicates that the company's margins will sustain over the next year. HCC's total order backlog remains at almost the same level of Rs. 96 bn. However, the key issue for HCC is that although it has been very good at acquiring orders, there have been some concerns on execution front, thereby pulling down the company's topline growth.

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Eagle Eye: What may otherwise be lost in the fine print…

Re classification of Contractee Advances…

Over the years, HCC has treated interest bearing contractee advances as unsecured loans and interest free contractee advances as current liabilities. However, this changed in FY07 and both interest bearing and non-bearing contractee advances are now treated as current liabilities. The interest bearing contractee advances stood at Rs.1636.1 mn, up 61% Y-o-Y in FY07, as compared to Rs.1010 mn in FY06. These advances usually carry a higher rate of interest as compared to the average cost of debt for the company.

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Advances from Contractees

Advances from Contractees	**FY06**	**FY07**	***% Change***
Interest Bearing advances (Rs. Mn)	1010	1636.1	*62.0%*
Non interest bearing Advances (Rs. Mn)	1410.8	1083.8	*-23.2%*
Total advances from Contractees (Rs. Mn)	2420.8	2719.9	*12.4%*

Source: Company reports, FG Estimates

HCC already has a huge debt burden. To make things worse, the interest-bearing advances camouflaged in the current liabilities are set to impact the company's bottomline in a big way. The company's debt to equity ratio would have increased to 2.41x in FY07 if the contractee advances were included in the unsecured loans. Currently, the company's debt to equity ratio stands at 2.23x.

HCC already has a huge debt burden. To make things worse, the interest-bearing advances camouflaged in the current liabilities are set to impact the company's bottomline in a big way

Interest burden increasing rapidly…

In the absence of any interest income due to HCC's high working capital requirements, the company will have to cough up high interest expenses, which will significantly restrict the PAT growth. However, HCC has benefited immensely through ZCCBs or its huge debt burden would have pulled the company into the red

HCC's interest cost has been very high at Rs.622 mn, after the setting off of the interest income of Rs.248 mn. The company reported a profit before tax of Rs.650.7 mn and has total loans of Rs.15.12 bn, excluding ZCCB of Rs.4.37 bn. Thus, in the absence of any interest income due to HCC's high working capital requirements, the company will have to cough up high interest expenses, which will significantly restrict the PAT growth. However, HCC has benefited immensely through ZCCBs or its huge debt burden would have pulled the company into the red.

The ZCCBs are expected to convert in 2011, with the conversion price being Rs.248.08 per share, which will result in a dilution of 7.01% due to the conversion of ZCCBs. The interest paid on the contractee advances will add further to the company's interest burden. HCC's interest coverage ratio declined to 3.62x in FY07, as compared to 4.46x in FY06. The company's Debt / Equity ratio has increased from 1.6x in FY06 to 2.2x in FY07.

Equity Dilution

Particulars	(Mn Shares)
Current outstanding shares Including GDS	256.25
Maximum number of shares to be issued for FCCB	17.96
Total number of Diluted Shares	274.21
Equity Dilution %	**7.01%**

Source: Company reports, FG Estimates

Bottomline impacted by withdrawal of Sec 80IA benefits

The Union Budget had announced the withdrawal of Sec 80IA benefits (retrospective from the year 2000), which has severely impacted the bottom lines of all companies. HCC had provided for this contingency in its general reserve, which it paid in the year and also paid a tax amount of Rs. 425.2 mn with respect to the prior years.

Low operating ratios, high depreciation and interest burden pulls down RoE…

DuPont Analysis

(Year Ended 31st March)	2006	2007
EBIDTA/Sales (%)	9.1%	9.8%
Sales/Operating Assets (x)	2.3	1.2
EBIDTA/Operating Assets (%)	**21.2%**	**11.9%**
Operating Assets/ Net Assets (x)	0.6	0.7
Net Earnings/ EBIDTA (%)	42.3%	22.2%
Net Assets/ Net Worth (x)	2.5	3.0
Return on Equity (ROE) (%)	**12.9%**	**5.8%**

Source: Company Reports, FG estimates

HCC's operating efficiency has declined significantly, with its sales to operating assets ratio declining from 2.3x in FY06 to 1.2x in FY07, mainly due to an increase in its inventory position. This includes uncompleted contracts and the value of work done to the extent of ~ Rs.19 bn, comprising of projects, such as the Bandra Worli Sea Link, etc., the payments for which have not yet been made or approved by clients.

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The other dampener for the RoE proved to be HCC's huge interest and depreciation burden. The company's net earnings to EBITDA declined from 42.3% in FY06 to merely 22.2% in FY07, even after considering the impact of some income through the funds raised, but not yet used. We expect the RoE to decline further due to pressure from high interest cost and dilution on conversion through ZCCBs, although their conversion is due only after 2011. As a result, we estimate the RoE to decline significantly from 12.9% in FY06 to 5.8% in FY07.

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Working capital cycle zooms up: Inventory days rise…

Working Capital in Cycle (in days)

	2004	**2005**	**2006**	**2007**
Inventory Days	232	176	250	467
Debtors Days	0.6	0.8	1.3	0.4
Creditors Days	106	117	193	144
Net Working Capital cycle	**127**	**60**	**57**	**324**

Source: Company reports, FG Estimates

HCC's performance on the working capital front in the year was dismal, with the inventory days climbing to 467 days, which mainly includes uncompleted contracts, and the value of work done to the extent of ~ Rs. 19 bn, comprising of projects, such as the Bandra Worli Sea Link, etc., for which the payments have not been made or approved by clients. ***This single project has impacted the company's entire balance sheet and will continue to do so in FY08 until the project is completed.***

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HCC's cash conversion cycle increased from 127 days in FY04 to 324 days in FY07. Moreover, in order to meet such a huge order book growth, HCC will require additional capital on a near-permanent basis. The company will also have to improve on its execution and recovery in order to sustain growth in a competitive environment.

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Rise in inventory leads to increase in working capital requirement…

Common Sized Net Working Capital

	2004	2005	2006	2007
Current Assets: (A)	**277%**	**359%**	**152%**	**149%**
Inventories	227%	272%	73%	117%
Receivables	1%	2%	0%	0%
Cash & Bank	20%	43%	66%	14%
Loans & Advances	29%	42%	13%	17%
Others	0.2%	0.0%	0.0%	4.5%
Less: Current Liabilities (B)	**177%**	**259%**	**52%**	**49%**
Creditors	110%	194%	40%	38%
Provisions & Others	67%	65%	12%	11%
Net Working Capital (A) - (B)	**100%**	**100%**	**100%**	**100%**

Source: Company Reports, FG estimates

HCC's inventory increased by 104% in FY07 to Rs. 22.67 bn, as compared to a growth of 14% in revenues. HCC has a significant amount of funds locked up in projects, such as the Bandra Worli Sea Link, for which the payments received have not been commensurate with the expenses incurred by the company, although 65% of its expenses have already been spent. The company has made claims for an increase in the cost of the project, which once approved by the client, will improve its working capital position.

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