Hindustan Construction Co

HCC IN

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India
Industrials/Construction

Initiation
9 September 2008

SO WHAT? THE BNP PARIBAS ANGLE — INDUSTRY OUTLOOK: ↑

- Our FY09 EBITDA margin estimate of 10.9% is 70bp below Street estimates due to anticipated raw-material cost pressures.
- Unlike the Street, we include the Badarpur elevated-road project in our valuation.

Net Profit 09.......INR1.31b

Diff from consensus....4.8%
Consensus (mean) INR1.25b
Consensus (momentum) .... ↓

Target Price.....INR132.00

Diff from consensus....5.6%
Consensus (median)... INR125.00
Consensus (momentum) .... ↓

Current Price.......INR99.20
Upside/(Downside)............33.1%

BUY

Recs in the Market

Positive....................................11
Neutral.......................................3
Negative 4
Consensus (momentum) .... ↓

Sources: Thomson One Analytics; Bloomberg; BNP Paribas estimates

We initiate coverage of Hindustan Construction (HCC) with a BUY rating and TP of INR132. We estimate 26.5% growth in 2009 construction revenue; there is major upside to our 49% order-growth estimate in 2009 due to its bid pipeline. Catalysts: real-estate milestones, positive results from stalled projects. High leverage, sea-link loss priced in.

Opportunity knocks: Initiate with BUY

New-order growth estimate of 49.1% is conservative

We initiate coverage of Hindustan Construction (HCC) with a BUY rating and target price of INR132, implying 33.1% upside. We estimate a 26.5% CAGR for standalone revenue based on a new-order CAGR of 32.5% in FY08-11. A conservative 10% bid success rate for submitted tenders of INR111.7b would result in an 18.7% increase in our new-order estimate. The roads sector represents a huge opportunity.

Up to 71.5% of order book shielded from cost pressures

Our conservative 10.9% EBITDA margin estimate for FY09 represents a 100bp decline y-y; this is primarily due to the 28.5% order book, which is susceptible to raw-material price increases. We expect the EBITDA margin to rebound to 11.9% by FY11.

Lavasa: Not a pie in the sky

Lavasa is a 12,500-acre project on the Mumbai-Pune route. Axis Bank, a private domestic bank, acquired a 2.5% stake in the project for INR2.5b, valuing it at INR100b (contribution of INR235 per HCC share). Comparatively, Lavasa's INR38 contribution to our TP is conservative. So far, Lavasa sales have been unaffected by the real-estate slowdown.

Catalysts

- Reimbursement of INR1.6b for Bandra-Worli sea link losses.
- Resolution of INR19.4b Sawalkote hydropower project in HCC's favour.
- Any further sale of a stake in the Lavasa project at a higher valuation.
- Refinancing, as debt-equity of 2.9x is a key concern.

Valuation – BUY, with TP of INR132

We value HCC's stock at INR132 on a sum-of-the-parts (SoTP) basis. The construction business contributes INR71 based on a 15x P/E multiple based on our standalone FY09 EPS estimate of INR4.74 and is supported by our DCF and EV/EBITDA valuation. Lavasa (HCC holding of 65%) contributes INR38 to our TP. We value road build-operate-transfer (BOT) projects and the Vikhroli IT Park at INR14 and INR9, respectively, using DCF analysis.

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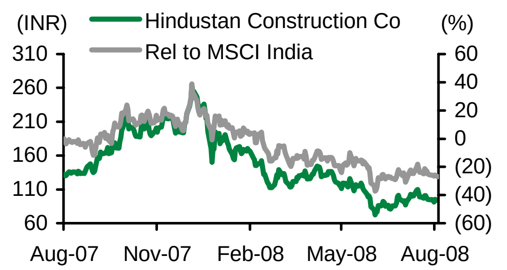
Earnings Estimates And Valuation Ratios

YE Mar (INR m)	2008	2009E	2010E	2011E
Revenue	30,828	39,560	49,657	62,313
Reported net profit	1,088	1,311	1,844	2,922
Recurring net profit	1,077	1,311	1,844	2,922
Recurring EPS (INR)	3.90	4.74	6.67	10.58
Rec EPS growth (%)	35.8	21.7	40.7	58.5
Recurring P/E (x)	25.5	20.9	14.9	9.4
Dividend yield (%)	0.8	0.8	0.8	0.8
EV/EBITDA (x)	9.9	8.6	6.6	4.9
Price/book (x)	2.5	2.3	2.0	1.7
ROE (%)	11.3	12.4	15.5	20.8
Net debt/equity (%)	157.4	144.1	120.1	88.2

Sources: Hindustan Construction Co; BNP Paribas estimates

Share Price Daily vs MSCI



Next results/event	October 2008
Market cap (USD m)	558
12m avg daily turnover (USD m)	11.9
Free float (%)	44
Major shareholder	Promoters (46%)
12m high/low (INR)	265.15/72.30
ADR (USD)	Nil
Avg daily turnover (USD m)	Nil
Discount/premium (%)	Nil
Disc/premium vs 52-wk avg (%)	Nil

Source: Datastream

Please see the important notice on the inside back cover.

BNP PARIBAS
CORPORATE & INVESTMENT BANKING

Contents

Please see India Research Team list on page 24.

BUSINESS OVERVIEW

More than 8 decades' experience and counting

Hindustan Construction (HCC), established in 1926, is a construction company specialising in hydroelectric (hydel) and nuclear power projects. The company has several firsts to its name; it executed the first metro-rail project in the country in Kolkata and constructed the six-lane Mumbai-Pune Expressway. HCC has been involved in six out of 11 operational nuclear power plants in the country; HCC is involved in the largest nuclear power plant under development at Kudankulam (2x1000MW). It is one of the large players in the water and irrigation segment. The company has forayed into the transportation assets management space with two road build-operate-transfer (BOT) projects. The Vikhroli Information Technology (IT) Park marks HCC's entry into the real estate development segment. With Lavasa, another first-of-its-kind project spread over 12,500 acres, it aims to establish a planned township that will serve as an educational, recreational, tourist and residential centre. The company expects a student population of over 10,000 in Lavasa. The town will have multiple hotels, recreation facilities and a hospital-cum-wellness centre.

NEW ORDER, ORDER BOOK MIX AUGUR WELL

Estimate 49% new-order growth in FY09

We estimate 49.1% y-y growth in new orders in FY09 after flat growth in FY08. We believe there is further upside to our estimate due to the INR111.7b bid pipeline. The order-book project mix allows pass-through of 71.5% of price increases. We are estimating a 100bp decline in EBITDA margin in FY09 due to the unprotected portion of the order book.

FY09 order-growth estimate is conservative

Potential upside to new-order growth

The company claims to have submitted bids for tenders worth INR111.7b. Any additional order win offers significant upside to our estimates. We have not included any upside from these bids primarily because 2009 is an election year; new project announcements may be put on hold until the new government takes office. More than 90% of HCC's orders are from state and central government agencies.

A 10% bid success rate in submitted tenders of INR111.7b would increase our new-order estimate by 18.7%

HCC lowest bidder (L1 status) for INR49.2b worth of orders

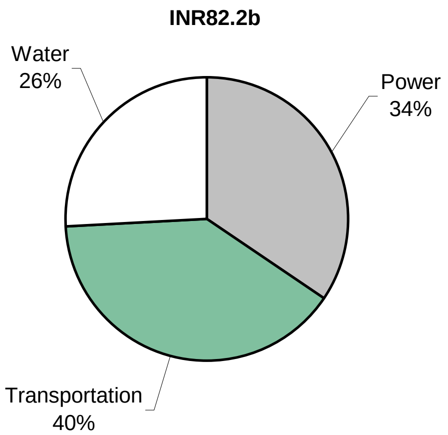
Our tracking of new order announcements in addition to the L1 orders gives us confidence in our INR58.6b estimate for new order inflow in FY09. Typically, the announcement of award of order to the L1 bidder is a formality. Our tracking of new orders indicates that INR22.3b of our new order estimate has already been awarded.

Exhibit 1: New-Order Update

Period	Project	Awarder	Segment	Value (INR m)	Status
1QFY09	Phase IV of Teesta hydel project (4x125MW)	Lanco Infratech	Power (hydel)	3,030	Awarded
	Undisclosed projects	na	na	6,299	Awarded
	Total			9,329	
2QFY09	Badarpur elevated road BOT (construction portion)	NHAI	Transportation	3,400	Awarded
	Pranahita-Chevella lift irrigation (package III)	Irrig & CAD Dept (AP)	Water	3,260	Awarded
	Devadula lift irrigation (phase III)	Irrig & CAD Dept (AP)	Water	6,293	Awarded
	Kishenganga hydel project (330MW)	NHPC	Power (hydel)	30,000	L1 status
	Other undisclosed projects	Na	na	6,286	L1 status
	Total			49,240	

Sources: Hindustan Construction Co; BNP Paribas

Exhibit 2: Order Book As Of 31 March 2008



Order book INR82.2b (excluding INR19.4b Sawalkote Hydel Project)
Source: BNP Paribas estimates

71.5% orders fully shielded from cost increases

HCC's order book is 71.5% protected from the increases in steel costs. Management has indicated that bitumen and cement cost increases will not have a material impact on margins. We are estimating a 100bp decline in EBITDA margin in FY09 due to the cost pressures on the unprotected portion of the order book.

Exhibit 3: Steel Price Increase Impact

	Steel required (million tonnes)	Incr. in exp (INR m)	Protected (INR m)	% protection (%)
Type of escalation clause				
Star rated	12,420	200	200	100.0
Indices based	103,739	1,290	930	72.1
Fixed price	5,035	90	—	—
Total	121,194	1,580	1,130	71.5

Sources: Hindustan Construction Co; BNP Paribas

We expect margin pressure will ease by FY10-11 as measures to curb inflation take effect and estimate a rebound in EBITDA margin to 11.9% levels.

No further losses expected from BWSL…

No further margin pressure due to legacy loss-incurring BWSL project

The lower margin in FY07-08 was due to the loss at Bandra Worli Sea Link (BWSL) project. The company has booked cumulative loss of INR2.5b from BWSL. The project was modified to accommodate the demands of the local fishermen. The southbound portion is due for completion in January 2009 and the northbound by June 2009, and we do not expect any further losses (1QFY09 was the first quarter which did not have any losses due to BWSL).

BWSL is an eight-lane elevated sea-link (first of its kind in India) connecting Worli (in Southern Mumbai) to Bandra (a western suburb). It was initially awarded in 2004 at a project cost of approximately INR4.5b (USD120m). The BWSL project was executed on a cash-contract basis (tolls will be collected by MSRDC).

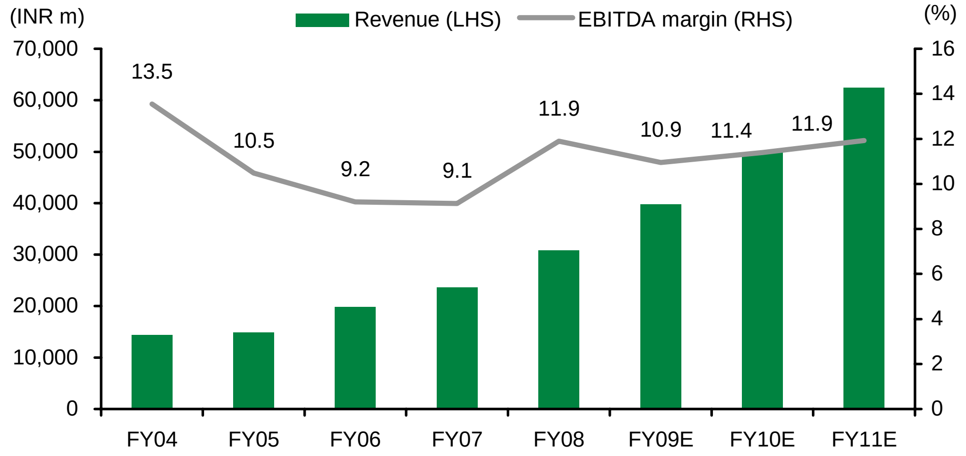
…and expect compensation from MSRDC for losses incurred

Expect a one-time gain from compensation for incurred losses on the BWSL project

The Maharashtra State Road Development Corp (MSRDC), which had commissioned the BWSL project, has sanctioned INR1.6b toward compensation for the increase in costs due to modified scope of the project. Our checks with the MSRDC confirmed that the first tranche of INR650m should be paid out in FY09. The company has indicated that it plans further claims for the losses incurred due to the BWSL project. We have not included any upside from this one-time compensation in our estimates.

Order-book mix encouraging, hydel projects dominate

Exhibit 4: Revenue And EBITDA Margin



Source: BNP Paribas estimates

HCC intends to bid only for projects greater than INR5.0b in size. The high complexity of these projects results in higher margins for the contractor. As a result, we are estimating a bounce back in EBITDA margins to FY08 levels of 11.9% by FY11.

HCC has executed projects across the length and breadth of the country and is an experienced player across its operating segments. Power, transportation and water (HCC's major operating segments) are priority sectors for infrastructure development in the country and will be among the last to face delays.

EBITDA sensitivity

Our sensitivity analysis indicates that a 50bp change in the core EBITDA margin results in a 10.1% corresponding change in our standalone EPS estimate.

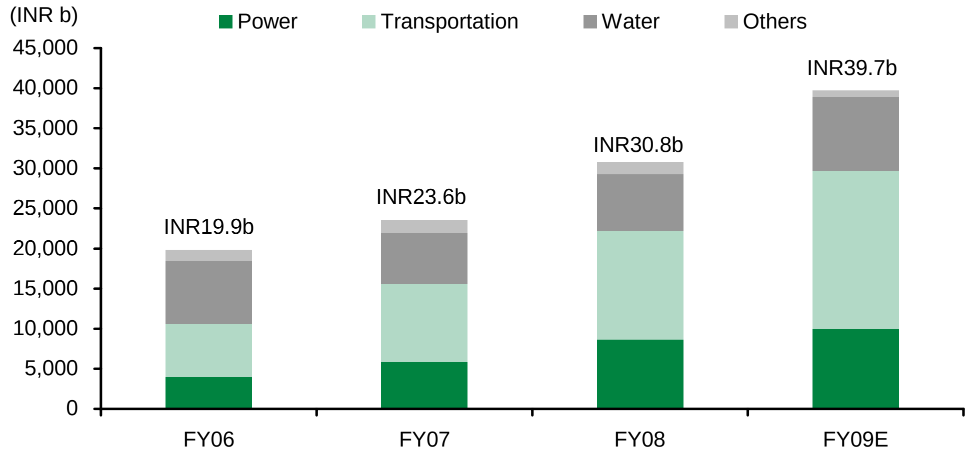
A 50bp change in EBITDA margin results in a 10% change in standalone EPS

Exhibit 5: EBITDA Margin Sensitivity

		Revenue				
		18.3%	**23.3%**	**28.3%**	**33.3%**	**38.3%**
EBITDA	**9.9%**	3.04	3.41	3.79	4.16	4.53
	10.4%	3.48	3.87	4.26	4.65	5.05
	10.9%	3.93	4.34	4.74	5.15	5.56
	11.4%	4.37	4.80	5.22	5.65	6.08
	11.9%	4.81	5.26	5.70	6.15	6.60

Source: BNP Paribas estimates

Exhibit 6: Segment Revenue



Source: BNP Paribas estimates

Power segment is the largest contributor to order book

The present power order book constitutes primarily of hydel projects. HCC is one of the largest players in the hydroelectric (hydel) power segment; the company claims to have contributed to more than 30% of India's installed hydropower capacity. Competition is restricted to four other companies (please refer to Appendix 1 on page16 for a detailed discussion on sector). This segment has the highest EBITDA margin (18-20%). HCC is focused on increasing its exposure to the hydel space.

Power orders in current order book are primarily hydel power projects; HCC claims to have contributed to more than 30% of India's installed hydropower capacity

Exhibit 7: Hydel Power – Competitors

J P Hydro
Larsen & Toubro (L&T)
Gammon India
Patel Engineering

Source: BNP Paribas

HCC is a leading player in the nuclear power segment and has been involved in six out of 11 nuclear power plants in the country. It is now executing part of the 2 x 1,000MW Kudankulam nuclear power plant (the largest in the country) near Chennai in south India. Though the nuclear deal is in a very early stage, HCC will be a key beneficiary if the deal goes through. We are not including any upside from nuclear power in our estimates at this stage due to lack of visibility (please refer to Appendix 1 on page16 for a detailed discussion).

Transportation – new forays into BOT projects augurs well

The roads and bridges sector has the second highest allocation of INR3,118b (USD74.2b) under the country's 11th Five Year Plan (please refer to Appendix 1 on page16 for a detailed discussion on the sector). HCC's entry into the asset management space is a natural progression for this transportation major. The company has several firsts to its name including the Mumbai–Pune Expressway (first six-lane highway in the country) and the Kolkata Metro Rail Project. HCC recently secured the INR5.5b (USD130.9m) Badarpur Toll BOT project in a competitive bidding process. This is in addition to the Nirmal BOT (INR2.8b) project in its order book. (Please refer to p.11 for details about the BOT projects.) HCC has been late in entering the BOT segment compared to peers, but this venture will provide a platform to bid for future projects. EBITDA margin in this segment is in the 9.5-10.5% range; this sector is very competitive and there are several large players (please refer to Appendix 1 on page 16 for a detailed discussion on the transportation sector).

Transportation is the highest revenue contributor; with the Badarpur project, transportation should maintain its position as the highest contributor to revenue

Water and irrigation

With seven dams and 17 barrages – constructions across the mouths of rivers to prevent the entry of seawater – under its belt, HCC is among the leaders in the water and irrigation segment. Orders in the current order book include a water pipeline order of INR3.3b for the Andhra Pradesh government and another pipeline order in Mumbai for INR3.12b. The water and irrigation sectors have been allocated INR4.22t (USD100b) in the 11th Plan (see Appendix 1 on page16 for a detailed discussion). EBITDA margin in the sector is in the 10-12% range. The market is fragmented and regional players dominate in their home states. HCC has executed projects in this segment across the country (see Appendix 1 on page 16 for a detailed discussion on the water and irrigation segment).

LAVASA

Starting to gain traction

Lavasa is a 12,500-acre project situated on the Mumbai-Pune route. HCC plans to make Lavasa an educational, recreational and residential centre. Phase I of the project is in full swing – the company has exceeded the targets set for the launch in 1QFY09. Axis Bank has picked up a 2.5% stake in the project for INR2.5b (press release on 26 June) with an implied valuation of INR100.0b, or INR235 per share, for HCC's 65% holding compared with our value of INR38. We are conservatively valuing this project to factor in execution and demand risks.

Key takeaways

- HCC has invested INR1.8b to acquire approximately 11,000 acres of land for Lavasa through its real estate subsidiary, Hindustan Real Estate (HREL).
- Equity investments in coming projects will be in the form of land. Lavasa will have minority stake in the projects to the extent of land provided, while the remaining investment will be made by the equity partner for the project.
- Infrastructure investments are front loaded; approximately 56% of the total infrastructure investment (approximately INR3.6b of planned INR4.6b already invested) would be made during Phase I.

Master plan – Phase I (2008-12) status update

Tourism, hospitality and leisure

The Accor Group is setting up three hotels under their Novotel, Pullman and Mercure brands. Another hotel owned by Lavasa is part of the plan. Agreements for each of these have been inked. Construction on each of these hotels has started.

Execution on track, construction started for most Phase I projects

Novotel – resort

- Spread over 200,000 sqft with 209 rooms
- Lavasa has 24% stake (investment in the form of land, no cash outflow), 74% is with a private investor
- Construction has started, operational by December 2009

Pullman – hotel

- A 250-room five-star hotel
- Will have a convention centre with 1,500 seats
- Construction has begun
- Negotiations are continuing to get an investor on board

Mercure – budget hotel

- A 133-room budget hotel
- Private investor will hold 74% stake, Lavasa 24%
- Construction has begun
- Agreement not complete

ITC-managed hotel

- A 60-room hotel
- To be managed by ITC (which owns one of India's largest hotel chains) for a 20-year period
- Lavasa will hold 100% stake in the project
- Construction should be completed by October

Education

Lavasa plans to have a 10,000-strong student population. The company is in various stages of reaching an agreement with Oxford's Said business school, Lausanne Hospitality Consulting, Girls' Day School Trust (GDST), Symbiosis and Christ Church College. Events to watch out for in the near term:

- Lausanne Hospitality Consulting – awaiting completion of construction
- GDST – International Baccalaureate (IB) school's construction in progress
- Symbiosis – acquired 60 acres of land, to commence construction in October
- Christ College – acquired 20 acres of land, to commence construction in October 2008

Residential – no slowdown in demand for Lavasa projects

Demand for residential properties at Lavasa unaffected by downturn in the realty market

All 289 apartments in the first phase have already been sold in the first three days of the launch. This gives us reason to believe that the novelty of the concept is not significantly affected by the real estate slowdown across the country. The company has sold 314 villas during the launch compared to a target of 175. However, we will closely monitor the next offering to gauge the impact, if any, of the slowdown in the sector on the demand for residential properties at Lavasa.

Health and wellness – tie-up with Apollo Hospitals

Apollo Hospitals, one of the largest hospital chains in India, is setting up a 40-bed hospital in Lavasa. Construction on this project has started and expected date of completion is January. Currently, Lavasa hold 62.5% stake in the project but management has indicated that Apollo will increase its stake in the project.

BOT PROJECTS

Badarpur project sets the stage for future wins

HCC has been a late entrant in the BOT game but has recently secured the INR5.5b Badarpur elevated toll road project (second BOT project after Nirmal BOT).The company has indicated that it will continue to bid for BOT projects as and when they are announced. Venturing into road BOT projects is a natural progression for a company that has built more than 173 bridges and more than 1,000km of highways on a cash-contract basis. The company has 38 bridges to its credit in Iraq alone.

Exhibit 8: Road BOT Projects – Details

Transportation Projects	Badarpur Elevated Road BOT	Nirmal Road BOT
Type	Toll	Annuity
Length (kms)	4.4	31
Projects size (INR m)	5,500	2,400
Semi annual payment (INRm)	na	23.8
Debt (INR m)	640	40
Equity (INR m)	2,560	200
D/E	4:1	4:1
Concession period	18 years operation + 2 years construction	18 years operation + 2 years construction
Expected Date of completion of construction	September 2010	September 2008
Status	Awaiting financial closure	On track, operational by October 2008

Sources: Hindustan Construction Co; BNP Paribas estimates

Badarpur BOT – elevated toll road

Badarpur BOT will serve as a platform to bid for larger projects

This road BOT project has been secured through a competitive bidding process. The project is a six-lane elevated road connecting New Delhi with Faridabad (in the neighbouring state of Uttar Pradesh). HCC has executed various road projects with high complexity levels.

Nirmal BOT – annuity project

The Nirmal BOT was the first BOT project secured by HCC. Though a small project, this created a platform for the company to bid for larger projects.

BWSL extension

The MSRDC intends to extend this sea-link in two phases: the first phase will extend to Haji Ali (central Mumbai) and the second link will extend up to Nariman Point (the commercial hub of Mumbai). Both these projects will be awarded on a BOT basis. Reliance Infrastructure and Larsen & Toubro have evinced interest in these projects. HCC will be a favourite for both these extensions based on its experience and expertise of executing the first sea link. Additionally, equipment utilised for BWSL may be reused for the extension projects.

REAL ESTATE

Vikhroli IT Park on track

Hindustan Real Estate (HREL) is the real-estate subsidiary of HCC. The Vikhroli Information Technology (IT) Park is being executed by HREL. Additionally, HREL will redevelop a parcel of land in Vikhroli (a Mumbai suburb). Plans for a special economic zone (SEZ) near Nashik (in Maharashtra) and an integrated township in a Mumbai suburb are in a nascent stage. We have included only the Vikhroli IT Park in our estimates due to lack of visibility for the other projects.

Vikhroli IT Park – cash cow

Approximately 23% of 247 Park already booked; management expects better pricing toward the end of completion

The Vikhroli IT Park, nicknamed 247 Park, has 1.2m sqft of area that can be leased. HREL has signed letters of intent (LOIs) with Future Group and Orange for leasing commercial and real estate space of 275,000 sqft at INR90/sqft per month. Scheduled completion of the project is in March.

Slum rehab – could add INR19 to TP, not in estimates

HCC owns a 14.5 acre parcel of land in Vikhroli East (a suburb of Mumbai) that has been declared a slum under the Slum Rehabilitation Act (SRA) of 1973. The company has received the consent of more than 70% of slum dwellers (minimum required for the project) to be classified under the SRA. An additional 26 acres of adjoining slum land is part of the project; the company has signed a memorandum of understanding (MOU) for 15 acres. This is a commercial project and the company expects to develop and sell units (as opposed to a lease).

The project cost is INR10.0b and will require INR3.0b of debt. The remainder will be funded through internal accruals and advances received from pre-sales.

HREL should begin rehabilitation by FY10. We are not including this project in our estimates primarily because execution of slum rehabilitation projects is difficult and prone to delays.

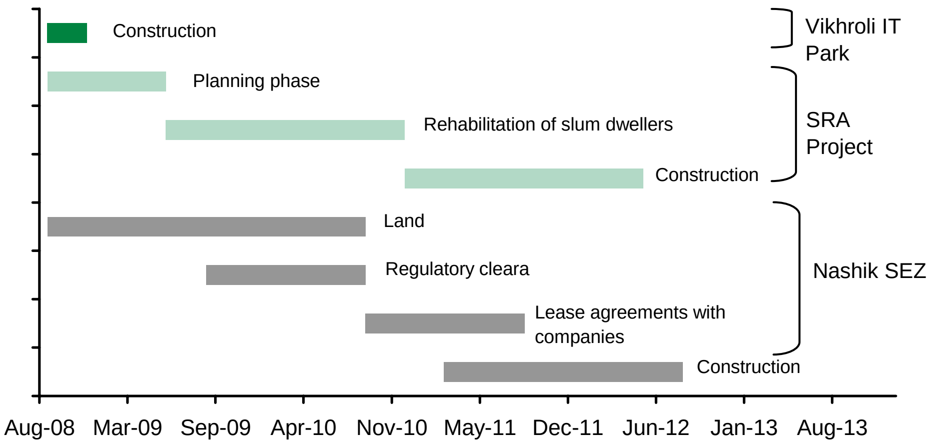
Planned projects

The company has three other real estate projects in the pipeline:

- Nasik SEZ – land acquisition in progress
- Integrated township development at Thane (a Mumbai suburb) – yet to commence land acquisition
- Charosa Wineries Limited – in the planning stages of the project

We have not included any upside from these projects in our estimates because they are in very early stages of development.

Exhibit 9: Real Estate Projects – Approximate Timelines



Source: BNP Paribas estimates

CATALYSTS

Catalysts

Payout from MSRDC for BWSL losses

The final announcement of the MSRDC compensating HCC for losses incurred on the BWSL project should provide a one-time boost to the top line.

Several macro and company-specific catalysts for the stock

Sawalkote hydel project – mired in litigation

This INR19.4b project in the northern states of Jammu and Kashmir has been languishing in the High Court pending a decision. The project was awarded to HCC but has been put on hold by the government authorities. A decision in HCC's favour will have a positive impact. Assuming a conservative 16% EBITDA margin, this project could add INR690m to EBITDA annually over the 4.5-year life of the project

Debt refinancing

The debt-equity ratio is 2.9x as of FY08 with a blended interest rate of 13.2%. Debt refinancing to bring down the blended rate will be a catalyst for the stock. Our sensitivity analysis indicates that a 50bp reduction in the variable interest cost results in a 3.2% change in our FY09 standalone EPS estimate.

Lavasa – timely progress has upside potential

The launch of the project has been successful with the sale of 314 villas and 289 apartments. Quarterly sales update will be indicative of the demand momentum in a slowing realty market. Any private equity infusion could act as a catalyst.

Real estate – land acquisition a key milestone

Slum rehabilitation projects are fraught with execution risks. Additionally, the planned SEZ and integrated township projects are also in the land acquisition phase. Completion of land acquisition is a prerequisite for us to include these projects in our estimates.

Lowering of benchmark interest rates

The Reserve Bank of India (RBI), the central bank, has repeatedly raised key benchmark rates in the last few months in an effort to control high inflation. As a result, borrowing costs have increased. Softening of the inflationary environment leading to a reduction of the benchmark rates would be a positive for HCC.

VALUATION

Valuation

Our SoTP valuation for HCC results in a target price of INR132. The standalone construction business contributes INR71 to our TP. Lavasa contributes INR38 to our TP. Our DCF analysis results in a value of INR14 for the road BOT projects and INR9 for the Vikhroli IT Park. Our TP does not include any contribution from the real estate projects in very early stages of development.

Our SoTP-based TP of INR132 represents upside potential of 33.1% from current levels

Standalone construction business – INR71

Our INR71 valuation for the standalone business is based on 15.0x our FY09 standalone EPS estimate of INR4.74.The P/E multiple is at a 10% discount to the peer average of 16.6x; this is supported by our DCF and EV/EBITDA valuations. The implied P/E multiples based on DCF and EV/EBITDA are 17.4x and 16.8x.

Lavasa – INR38

Our Lavasa contribution of INR38 is conservative compared with the implied valuation of INR235 from the Axis Bank deal

We estimate a contribution of INR38 from the 65% stake held by HCC in the Lavasa project. The price addition by Lavasa is the arithmetic mean of the values arrived at by three different valuation methods. Book value of investments results in INR10 contribution per share. Our DCF model spread over a 13-year period until FY2021 (actual planned duration of project) results in a price contribution of INR39. Additionally, if the company successfully sells all the planned construction in a five-year period (by FY2013), we arrive at a contribution of INR67. Our estimate is conservative compared to the implied valuation from the Axis Bank deal. Axis Bank has paid INR2.5b for a 2.5% stake in the project, which values the project at INR235 per share. Any further private equity infusions would make us incrementally positive.

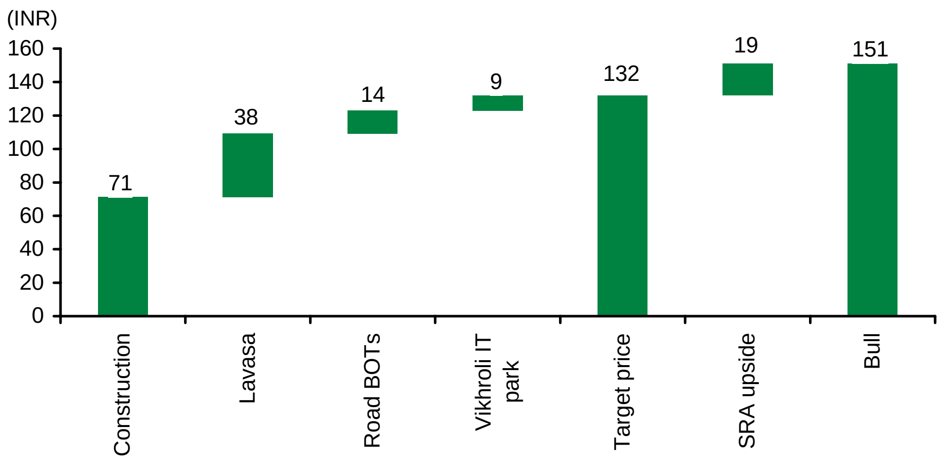
Vikhroli IT Park – INR9

We are valuing the Vikhroli IT Park at INR9. We are assuming cost of equity of 16% and cost of debt of 12.5% for a WACC of 14.6% for our DCF model up to FY2023. We are assuming a terminal growth rate of 3% for free cash flows beyond this period.

Road BOT projects – INR14

Our DCF valuation for the two road BOT projects results in an addition of INR14 to our TP. We are assuming 16% cost of equity and cost of debt of 10.5% for Nirmal BOT and 12.5% for the Badarpur elevated road. Any other BOT project wins would be incrementally accretive to our TP.

Exhibit 10: Target Price Breakdown



Source: BNP Paribas estimates

APPENDIX 1

The big picture: Investments to continue

Power

The power segment has received the highest allocation of INR6.17t (USD154b) among all sectors under the 11th Plan; this represents a 111% increase over the 10th Plan allocation. Approximately half the population of India is without electricity or without a consistent supply of any form of power and thus justifies the need for the high monetary allocation for this sector. The 11th Plan (2008-12) aims to provide electric connections to the entire population.

Hydropower

Hydropower represents a USD122b-147b opportunity over the next 10-12 years

The total identified hydropower capacity in the country is 148.7GW, of which 32.4GW is operational and another 13.6GW is under construction. Approximately 102.7GW of capacity is yet to be developed. This represents an opportunity of INR5.13tb-6.16t (USD122b-147b) assuming a cost of development of approximately INR50m-60m per MW. There is increasing consensus about moving toward hydropower as a viable alternative to thermal energy due to the availability and rising cost of coal and gas. Approximately 2,185MW of hydropower capacity was commissioned in 2007 (current installed hydropower capacity is 36,159MW). We expect the momentum in this sector to continue over the near term. HCC is one of the largest players in this sector (competition is limited to four other players), having executed more than 30% of total existing hydropower capacity in the country.

Thermal

Thermal power accounts for 64.6% of the total installed power generation capacity in the country. Approximately 9,000MW of thermal capacity was added in the first nine months of FY08 (current installed capacity of 93,115MW). Approximately INR40m-50m of investment is required per MW of thermal capacity addition. The 11th five-year plan target is the addition of 50,124MW of thermal power capacity. HCC has constructed several thermal power plants but has not ventured into the operation and management of power assets.

Nuclear

Positive developments in the nuclear deal with the US will be a plus for HCC

Nuclear power represents a latent opportunity for HCC. The company has been involved in 6 of 11 nuclear power plants in the country. The Working Group on Power has set a target of 3,160MW of nuclear power capacity addition during the 11th Plan (current installed capacity of 4,120MW). The Indian government is in the process of signing a nuclear deal with the United States that will provide a fillip to the nuclear power industry in the country. However, timelines are still hazy; 2009 is an election year which could delay progress of the deal. HCC is well-positioned to take advantage of new activity in this segment.

Water and irrigation

Water supply and sanitation

The proper utilisation of available groundwater and annual rainfall will go a long way in reducing the acute water shortages faced by the country; however, the unequal distribution of water resources and untimely rainfall are major hindrances. Additionally, underdeveloped water conservation methods and inefficient storage practices lead to severe shortfall. The water supply and sanitation outlay of INR1.99t (USD49.8b) represents an increase of 207% over the 10th plan outlay. The Planning Commission estimates that this outlay will be sufficient to ensure potable water and sanitation facilities to the entire population over the stipulated 2008-12 period. Government spending will constitute 97.3% of the total outlay.

Irrigation

Approximately 65-70% of India's population is dependent on agriculture, though it contributes only about 20-22% of the GDP. The expenditure on irrigation is necessary and justified due to poor distribution, conservation and storage systems for water resources. The 11th plan outlay for the irrigation sector is INR2.23t (USD56b) for the 2008-12 period representing an increase of 100% over the planned outlay in the 10th plan. The entire irrigation outlay will be spent by the central and state governments with no private participation. However, the construction of these projects is typically outsourced to private players.

Transportation

The roads segment will be lucrative for bigger players; our checks reveal that government officials prefer larger players to ensure timely completion and quality of big ticket projects

Roads and highways have received the second highest allocation of INR3.12t (USD74b) among infrastructure subsectors in the 11th plan. Road projects are now typically being tendered on a BOT basis under the public-private partnership (PPP) model. We recently attended a conference on road development that witnessed participation by key industry and government officials (refer to our note "The 'Road' Ahead" dated 27 August 2008). Several issues concerning the sector were raised and resolved. We expect project awards will continue without glitches. We expect a near-term opportunity of INR1.50t (USD36b) from Phases III and V of the NHDP. Additionally, the other phases (IV, VI, VII and smaller programs) represent a mid- to long-term (2009-12) opportunity of INR800b (USD19b).The state highway programme envisages an additional investment of INR1.27t (USD30b) over the 2008-12 period. The rural road programs will include investment of INR365b (USD9b) over the same period. Government officials reiterated that government funding should not be a constraint; they identified that additional tax collected from the sale of high-speed diesel (HSD) and petrol as sources of financing. Officials also indicated that states can avail 20% of capital costs as viability gap funding and an additional 20% as debt from India Infrastructure Financing (IIFC).

APPENDIX 2

Devil's advocate: Risks to our investment case

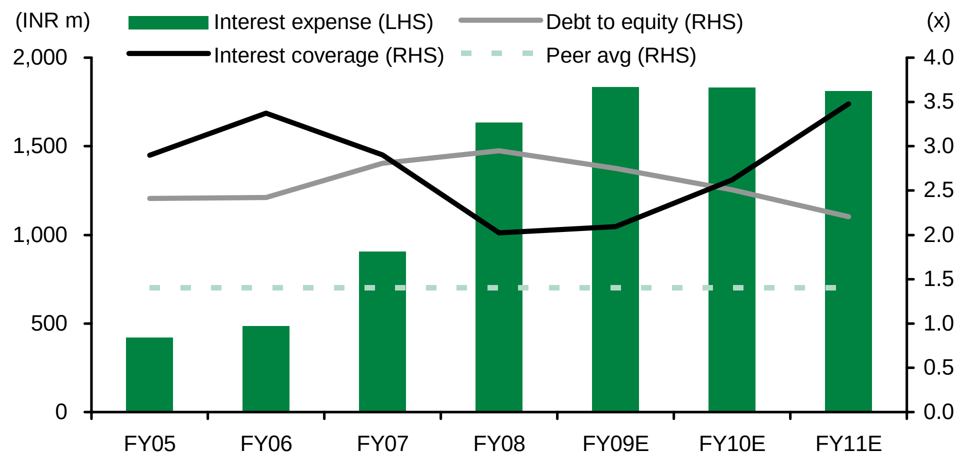
High leverage makes it difficult to raise additional debt

The high debt level could make it difficult for the company to raise additional funds in the prevailing high interest-rate scenario

HCC has a debt-to-equity ratio of 2.9x, significantly higher than the peer group average of 1.4x. The company will find it difficult to raise additional debt in the prevailing high interest-rate environment. Our analysis indicates that if the company uses the BWSL reimbursement of INR1.60b to repay its debt, it can bring down debt to equity to 2.1 by FY11. We believe that the interest coverage ratio has bottomed out and we are estimating an increase to 3.5x by FY11.

Exhibit 2.1: Leverage Concerns: Interest Expense And Interest Coverage Ratio

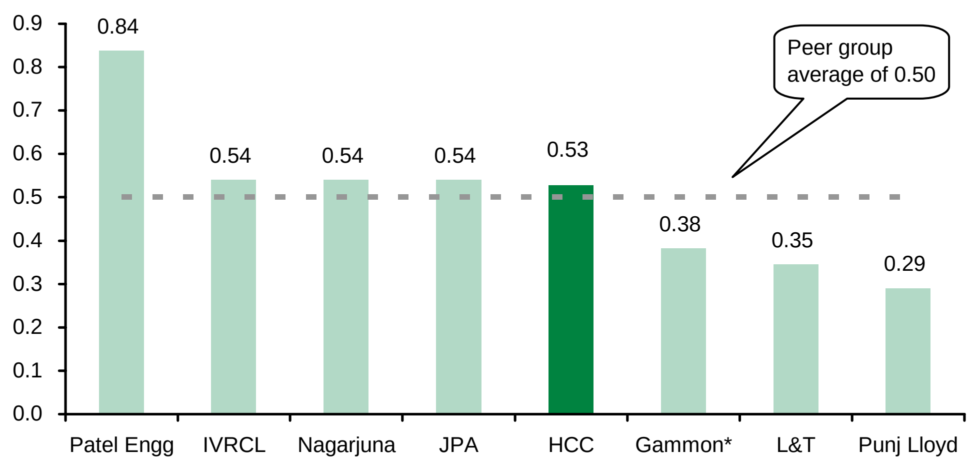
Interest coverage should improve as new projects begin to pay off



Source: BNP Paribas estimates

Exhibit 2.2: Working Capital To Sales – Essentially In Line With Peers

Working capital-to-sales ratio is essentially in line with peer group average



* FY07 ratios
Source: BNP Paribas estimate

Lavasa – demand may be at risk

The ambitious project has not faced any delays until now. However, the downturn in the real estate market may spill over to this project as well. A slowdown in sales in the prevailing high interest rate environment and downturn in the realty segment could adversely affect the project.

Political risk – general elections in 2009

More than 90% projects executed by the company are government projects. The coming elections could result in a slowdown in project announcements. But we believe this will be a temporary phenomenon. Project announcements should resume once the new government takes office.

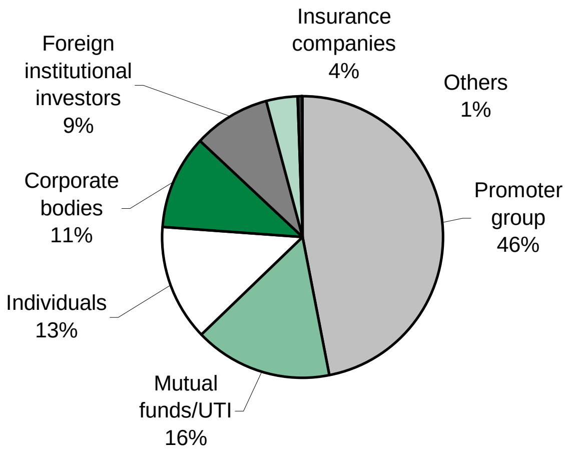
Raw-material cost increases could pressure margins

An increase in raw-material prices (primarily cement and steel) could exert pressure on margins as 28.5% of the order book is susceptible to price increases. The company has indicated that new projects have escalation clauses that better protect the company from cost increases.

APPENDIX 3

Shareholding

Exhibit 3.1: Shareholding As Of 30 June 2008



Sources: Hindustan Construction Co; BNP Paribas

APPENDIX 4

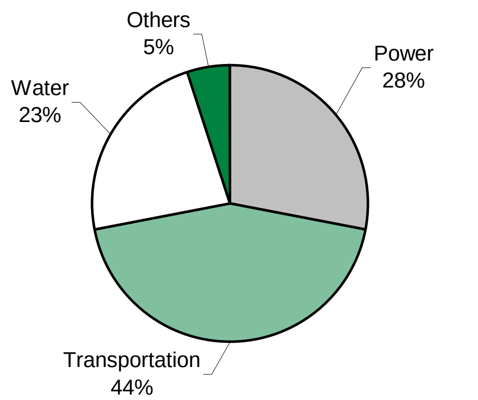
Key company information

Exhibit 4.1: Industry Data

Industry structure :	Competitive
Customers :	Central and state governments; Public sector entities
Competitors :	Larsen & Toubro, Nagarjuna Construction Co, Gammon India
Suppliers :	na
Markets :	India
Distributors :	na
Regulation :	Medium

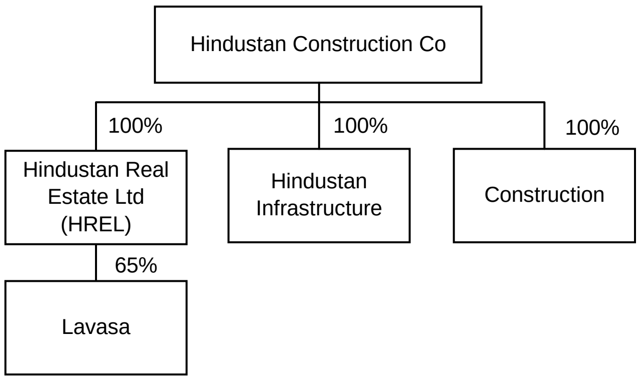
Source: Hindustan Construction Co

Exhibit 4.2: Sales Breakdown – FY08



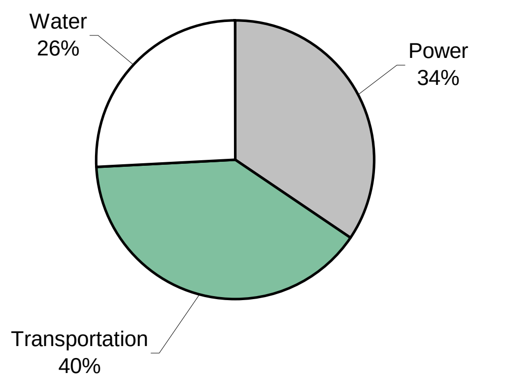
Sources: Hindustan Construction Co; BNP Paribas

Exhibit 4.3: Ownership Structure



Sources: Hindustan Construction Co; BNP Paribas

Exhibit 4.4: Order Book Breakdown – FY08



Sources: Hindustan Construction Co; BNP Paribas

Exhibit 4.5: Company Background

Hindustan Construction (HCC), established in 1926, primarily undertakes big-ticket infrastructure projects. HCC has many firsts to its name – the Mumbai-Pune Expressway, the Kolkata metro rail project and the Bandra Worli sea link to name a few. It has a presence across the power, transportation and water-and-irrigation sectors. The company has recently secured road projects on a build-operate-transfer (BOT) basis, a natural progression for an experienced player in the roads segment. In keeping with its pioneering history, HCC has launched the Lavasa project, a new township set amid hills and positioned as an educational, recreational, residential and tourist centre.

Source: Hindustan Construction Co

FINANCIAL STATEMENTS

Hindustan Construction Co

Profit and Loss (INR m) Year Ending March	2007A	2008A	2009E	2010E	2011E
Revenue	23,576	30,828	39,560	49,657	62,313
Cost of sales ex depreciation	(19,337)	(24,189)	(31,314)	(39,021)	(48,498)
Gross profit ex depreciation	4,239	6,638	8,246	10,636	13,814
Other operating income	-	-	-	-	-
Operating costs	(2,087)	(2,972)	(3,915)	(4,975)	(6,382)
Operating EBITDA	**2,153**	**3,666**	**4,331**	**5,661**	**7,432**
Depreciation	(797)	(962)	(1,163)	(1,686)	(1,836)
Goodwill amortisation	-	-	-	-	-
Operating EBIT	**1,356**	**2,704**	**3,168**	**3,976**	**5,597**
Net financing costs	(620)	(1,524)	(1,695)	(1,750)	(1,800)
Associates	244	(7)	-	-	-
Recurring non operating income	199	387	484	605	665
Non recurring items	-	-	-	-	-
Profit before tax	**1,179**	**1,560**	**1,957**	**2,830**	**4,462**
Tax	(386)	(472)	(646)	(986)	(1,540)
Profit after tax	**793**	**1,088**	**1,311**	**1,844**	**2,922**
Minority interests	-	-	-	-	-
Preferred dividends	-	-	-	-	-
Other items	-	-	-	-	-
Reported net profit	**793**	**1,088**	**1,311**	**1,844**	**2,922**
Non recurring items & goodwill (net)	-	**(11)**	-	-	-
Recurring net profit	**793**	**1,077**	**1,311**	**1,844**	**2,922**
Per share (INR)					
Recurring EPS *	2.87	3.90	4.74	6.67	10.58
Reported EPS	3.08	4.24	5.11	7.19	11.39
DPS	0.75	0.80	0.80	0.80	0.80
Growth					
Revenue (%)	18.7	30.8	28.3	25.5	25.5
Operating EBITDA (%)	17.8	70.3	18.1	30.7	31.3
Operating EBIT (%)	4.1	99.4	17.2	25.5	40.8
Recurring EPS (%)	(19.5)	35.8	21.7	40.7	58.5
Reported EPS (%)	(13.5)	37.5	20.5	40.7	58.5
Operating performance					
Gross margin inc depreciation (%)	14.6	18.4	17.9	18.0	19.2
Operating EBITDA margin (%)	9.1	11.9	10.9	11.4	11.9
Operating EBIT margin (%)	5.8	8.8	8.0	8.0	9.0
Net margin (%)	3.4	3.5	3.3	3.7	4.7
Effective tax rate (%)	32.8	30.3	33.0	34.9	34.5
Dividend payout on recurring profit (%)	26.1	20.5	16.9	12.0	7.6
Interest cover (x)	2.9	2.0	2.2	2.6	3.5
Inventory days	261.4	292.9	276.5	263.5	247.8
Debtor days	0.3	0.3	0.5	0.4	0.4
Creditor days	152.7	140.4	142.8	149.4	147.2
Operating ROIC (%)	8.7	12.0	12.8	15.4	20.9
Operating ROIC - WACC (%)	(6.0)	(2.7)	(1.9)	0.7	6.3
ROIC (%)	10.3	12.2	13.2	15.9	21.1
ROIC - WACC (%)	(4.4)	(2.4)	(1.5)	1.3	6.4
ROE (%)	8.8	11.3	12.4	15.5	20.8
ROA (%)	4.4	7.0	7.0	7.5	8.8

** Pre exceptional, pre-goodwill and fully diluted*

Sources: Hindustan Construction Co; BNP Paribas estimates

We estimate a revenue CAGR of INR26.5% in FY08-11

We estimate a 100bp decline in the EBITDA margin in FY09; margins should rebound by FY11

Cash Flow (INR m) Year Ending March	2007A	2008A	2009E	2010E	2011E
Recurring net profit	793	1,077	1,311	1,844	2,922
Depreciation	797	962	1,163	1,686	1,836
Associates & minorities	-	-	-	-	-
Other non-cash items	-	-	-	-	-
Recurring cash flow	**1,589**	**2,039**	**2,474**	**3,530**	**4,758**
Change in working capital	(7,749)	(1,580)	(440)	(1,048)	(1,324)
Capex - maintenance	-	-	-	-	-
Capex - new investment	(3,837)	(2,448)	(2,000)	(1,500)	(1,500)
Free cash flow to equity	**(9,997)**	**(1,990)**	**34**	**981**	**1,934**
Net acquisitions & disposals	-	-	-	-	-
Dividends paid	(179)	(191)	(240)	(240)	(240)
Non recurring cash flows	(1,152)	(575)	-	-	-
Net cash flow	**(11,327)**	**(2,755)**	**(206)**	**741**	**1,694**
Equity finance	0	152	-	-	-
Debt finance	3,623	3,200	(43)	(214)	(167)
Movement in cash	**(7,704)**	**596**	**(249)**	**527**	**1,527**
Per share (INR)					
Recurring cash flow per share	6.18	7.95	9.64	13.76	18.55
FCF to equity per share	(38.89)	(7.76)	0.13	3.82	7.54

Significant capex planned in FY09-11

Balance Sheet (INR m) Year Ending March	2007A	2008A	2009E	2010E	2011E
Working capital assets	20,979	24,457	29,047	33,395	38,592
Working capital liabilities	(8,916)	(10,640)	(14,790)	(18,089)	(21,962)
Net working capital	**12,062**	**13,817**	**14,257**	**15,306**	**16,629**
Tangible fixed assets	8,974	10,206	11,043	10,858	10,522
Operating invested capital	**21,037**	**24,023**	**25,300**	**26,163**	**27,151**
Goodwill	-	-	-	-	-
Other intangible assets	-	-	-	-	-
Investments	2,286	2,955	2,955	2,955	2,955
Other assets	-	-	-	-	-
Invested capital	**23,323**	**26,979**	**28,256**	**29,119**	**30,107**
Cash & equivalents	(2,084)	(2,644)	(2,394)	(2,921)	(4,449)
Short term debt	-	-	-	-	-
Long term debt *	15,511	18,449	18,406	18,192	18,025
Net debt	**13,427**	**15,805**	**16,011**	**15,271**	**13,577**
Deferred tax	855	1,133	1,133	1,133	1,133
Other liabilities	-	-	-	-	-
Total equity	9,041	10,041	11,111	12,715	15,397
Minority interests	-	-	-	-	-
Invested capital	**23,323**	**26,979**	**28,256**	**29,119**	**30,107**

** Includes convertibles and preferred stock which is being treated as debt*

Per share (INR)					
Book value per share	35.17	39.14	43.31	49.57	60.02
Tangible book value per share	35.17	39.14	43.31	49.57	60.02
Financial strength					
Net debt/equity (%)	148.5	157.4	144.1	120.1	88.2
Net debt/total assets (%)	39.1	39.3	35.2	30.5	24.0
Current ratio (x)	2.6	2.5	2.1	2.0	2.0
CF interest cover (x)	(8.9)	1.3	2.2	2.4	2.9

Interest coverage should improve as investments in projects begin to pay off

Valuation	2007A	2008A	2009E	2010E	2011E
Recurring P/E (x) *	34.6	25.5	20.9	14.9	9.4
Recurring P/E @ target price (x) *	46.0	33.9	27.8	19.8	12.5
Reported P/E (x)	32.2	23.4	19.4	13.8	8.7
Dividend yield (%)	0.8	0.8	0.8	0.8	0.8
P/CF (x)	16.0	12.5	10.3	7.2	5.3
P/FCF (x)	neg	neg	754.6	25.9	13.2
Price/book (x)	2.8	2.5	2.3	2.0	1.7
Price/tangible book (x)	2.8	2.5	2.3	2.0	1.7
EV/EBITDA (x) **	12.1	9.9	8.6	6.6	4.9
EV/EBITDA @ target price (x) **	15.2	12.0	10.3	7.9	6.0
EV/invested capital (x)	1.7	1.5	1.5	1.4	1.3

** Pre exceptional, pre-goodwill and fully diluted*
*** EBITDA includes associate income and recurring non-operating income*

Sources: Hindustan Construction Co; BNP Paribas estimates

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Unless otherwise specified, these recommendations are set with a 12-month horizon. Thus, it is possible that future price volatility may cause a temporary mismatch between upside/downside for a stock based on market price and the formal recommendation.

*In most cases, the target price will equal the analyst's assessment of the current fair value of the stock. However, if the analyst doesn't think the market will reassess the stock over the specified time horizon due to a lack of events or catalysts, then the target price may differ from fair value. In most cases, therefore, our recommendation is an assessment of the mismatch between current market price and our assessment of current fair value.

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