



Hindustan Construction

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,324	HCC IN
	REUTERS CODE
S&P CNX: 2,828	HCNS.BO

16 January 2009

Buy

Previous Recommendation: Buy

Rs43

Equity Shares (m)	256.3
52-Week Range	222/30
1,6,12 Rel. Perf. (%)	-4/-21/-27
M.Cap. (Rs b)	11.0
M.Cap. (US\$ b)	0.2

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	23,576	564	2.0	-39.9	21.7	1.2	5.7	6.6	1.0	11.4
3/08A	30,828	708	2.8	39.7	15.6	1.1	7.4	11.2	0.9	7.3
3/09E	35,553	846	3.3	19.5	13.0	1.0	8.1	10.8	0.9	7.1
3/10E	44,175	1,102	4.3	30.3	10.0	0.9	9.7	10.8	0.7	6.2

*Fully diluted

HCC's 3QFY09 performance was below estimates, as revenues were impacted given liquidity issues with customers impacting project progress. This also led to increased working capital requirements. Debt as at December 2008 increased to Rs25b, v/s Rs19b YoY and we expect FY09 DER at 1.8x. Order book pipeline remains strong, with HCC being L1 in projects of Rs50b, while order intake till date has been Rs44b. Given the bunching up of orders, we expect increased mobilization and initial expenses during FY10/FY11 impacting EBITDA margins. We expect revenue and earnings CAGR of 20% and 25% during FY08-FY10E. At CMP, the stock trades at 13x FY09E and 10x FY10E earnings.

3QFY09 below estimates: During 3QFY09, HCC reported revenues of Rs8.2b (up 9.3% YoY), EBITDA of Rs1.1b (up 9.5% YoY), and adjusted net profit of Rs190m (down 3.4% YoY). The company has written back tax provision of Rs90m (excess provision in 1HFY09) and incurred forex loss of Rs68m.

Strong order book pipeline: HCC's order book stands at Rs122b (up 35% YoY, 13% QoQ) as at December 2008, book to bill ratio of 3.3x FY09E revenues. HCC is L1 in projects of Rs50.4b as at December 2008, including Kishanganga hydro (Rs30b, expected to be awarded by end January 2009).

Increased debt due to higher working capital, investments: Investments in subsidiaries have increased to Rs3.7b, while the company has provided corporate guarantee of Rs1b to HCC Real Estate. Working capital increased to Rs20b (215 days, ttm) in December 2008 v/s Rs14b (195 days) in March 2008.

Y/E MARCH	FY08				FY09				(Rs Million)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q*	4QE	FY08	FY09E
Sales (Excl JV)	7,290	5,487	7,500	10,550	8,659	6,489	8,194	12,211	30,828	35,553
Change (%)	25.6	28.9	38.7	24.5	18.8	18.3	9.3	15.7	28.7	15.3
EBITDA	791	601	968	1,306	911	837	1,060	1,552	3,666	4,360
Change (%)	71.5	52.3	45.9	48.9	15.2	39.2	9.5	18.9	53.0	18.9
As of % Sales	10.8	11.0	12.9	12.4	10.5	12.9	12.9	12.7	11.9	12.3
Depreciation	228	226	233	275	253	296	299	309	962	1,157
Interest	322	342	408	452	391	492	573	633	1,524	2,089
Other Income	315	106	54	-95	124	268	-46	0	380	347
PBT	556	140	381	483	392	317	143	610	1,560	1,461
Tax	99	23	130	220	84	117	-90	210	472	321
Effective Tax Rate (%)	17.8	16.5	34.2	45.4	21.3	37.0	-62.8	34.4	30.3	22.0
Reported PAT	457	117	251	264	308	199	232	400	1,088	1,140
Adj PAT	142	10	197	359	195	-47	300	400	708	849
Change (%)	-29.3	-75.3	36.9	124.2	37.4	-	52.7	11.4	29.5	19.9

E: MOSL Estimates; *Actual adj profit is Rs190m for 3QFY09, tax write back of 1HFY09 is Rs110m

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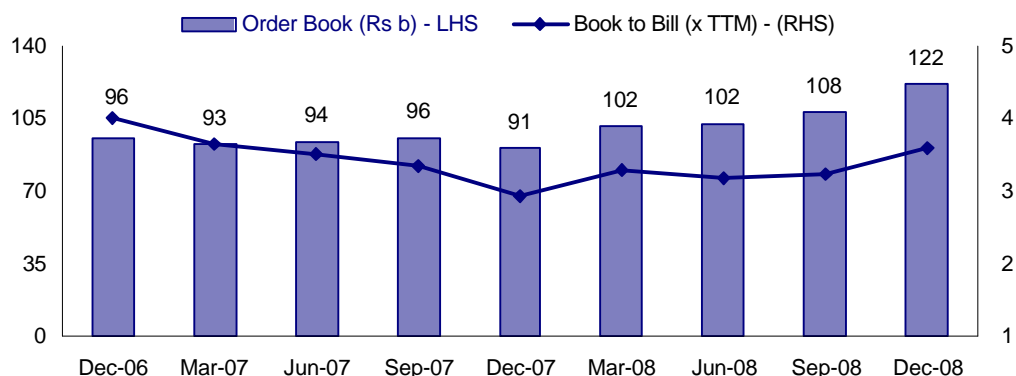
Disappointing operational performance

During 3QFY09, HCC reported revenues of Rs8.2b (up 9.3% YoY), EBITDA of Rs1.1b (up 9.5% YoY), and adjusted net profit of Rs190m (down 3.4% YoY). During 3QFY09, HCC has written back tax provision of Rs90m, being excess provision made during 1HFY09 and incurred forex losses of Rs68m. The results are lower versus our estimates: revenues of Rs9.2b, EBITDA of Rs1.2b and net profit of Rs259m. 3QFY09 revenues were impacted due to liquidity issues with several customers. This impacted project progress. The southbound carriageway for Bandra Worli Sealink will now be completed in March 2009 (v/s January 2009 earlier). HCC has already received ~Rs1b of the accepted claims of Rs2.3b.

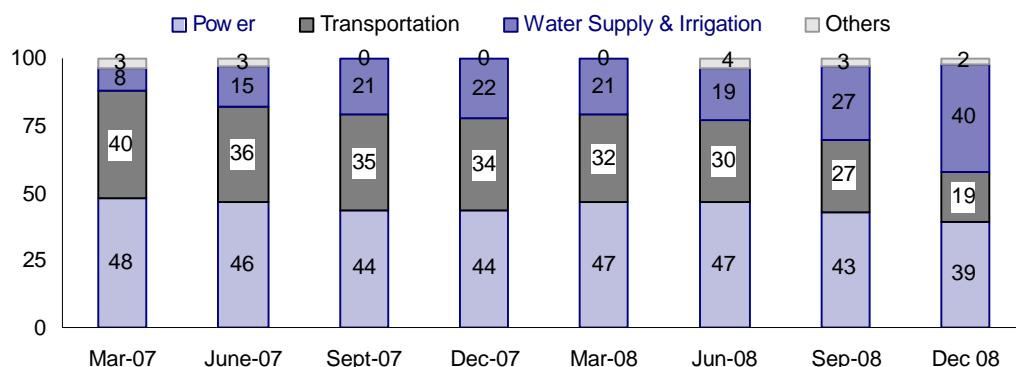
Strong order book pipeline

During 3QFY09, HCC’s order book stands at Rs122b (up 35% YoY, 13% QoQ), book-to-bill ratio of 3.3x FY09E revenues. The current order book includes the Rs19.4b Sawalkote project that awaits high court judgment. Management indicated that the newly elected government in J&K has identified the Sawalkote project as a priority, and thus they expect the project activity to commence. HCC is L1 in projects worth Rs50.4b as at December 2008, including the Kishanganga hydro power project (Rs30b, expected to be awarded by end-January 2009).

ROBUST REVENUE VISIBILITY



INCREASING PROPORTION OF POWER/WATER IN ORDER BOOK (% ORDER BOOK)

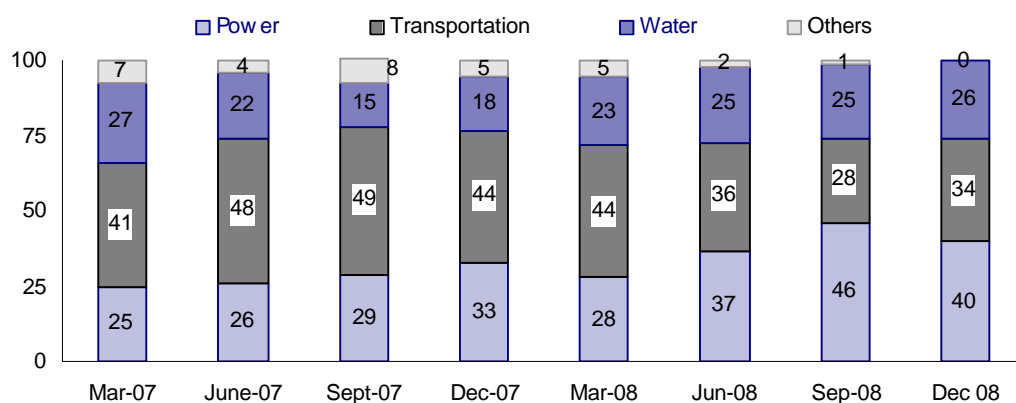


Source: Company

EBITDA margin at 12.9%, driven by increased share of revenues from hydro power / irrigation segments

During 3QFY09, HCC's reported EBITDA margin is at 12.9% versus 13% in 3QFY08. While EBITDA margin is lower than our estimate of 13.3%, HCC could sustain margins at higher levels due to increased proportion of revenues from hydro power at 40% in 3QFY09, up from 33% in 3QFY08. Share of irrigation projects in the order book has increased to 40% in December 2008, from 22% in December 2007; while share of transportation has declined to 19% from 34% in the same period.

REVENUE COMPOSITION: INCREASING CONTRIBUTION FROM HIGH MARGIN SEGMENTS (%)



Source: Company

Investments of Rs3.7b, significant increase in debt given working capital deterioration

Investments in real estate and infrastructure subsidiaries stand at Rs3.7b, up Rs1.2b during 3QFY09. Investment in HCC Real Estate (100% subsidiary) now stands at Rs3b (including Rs2.2b in Lavasa). During April-December 2008, HCC invested Rs1b in HCC Real Estate and Rs700m as equity for the Badarpur road project. Financial closure for the Badarpur project was achieved in December 2008 with estimated cost of Rs5.5b at 12% interest rate with a one-year reset clause. HCC in consortium with Sadbhav Engineering and Jones Laing is also L1 in the Maharashtra Dhule BOT project (97km, cost: Rs7b).

Debt as of December 2008 has increased to Rs25b, up from Rs22b in September 2008 and Rs19b in December 2007. This is largely due to increased working capital to Rs20b (215 days, ttm) in December 2008 v/s Rs14b (195 days) in March 2008.

Real estate plans curtailed

Management indicated that the real estate plans of HCC Real Estate have been curtailed, and currently the focus is on executing a 247 IT park in Vikhroli. During 3QFY09, HCC Real Estate signed a LoI with Future group, Orange and Rohm Hass for leasing 0.3msf of area (~25% of total area) at Rs75-80/sq.ft at 247 IT park. This is lower than the earlier indication of Rs90+/sq ft. Also, HCC has leased 0.3msf at 217 IT park, and thus ~53% of

the area has been leased. The project would be ready for occupation by March 2009. For the SRA project at Vikhroli East (14 acres), the company had achieved the milestone of getting 70% consent from the slum dwellers to apply for the SRA scheme. Also, the company has extended the scope and acquired a further 30 acres of land adjoining the project (a part of the SRA).

HCC'S REAL ESTATE PORTFOLIO

PROJECT	ACRES	MSF	HCC STAKE (%)
Lavasa	12,500	200	65
Vikhroli West (IT Park)	11	1.8	100
Res. Project in Mumbai (SRS)	12	1.4	100
Vikhroli East	41	4.4	100
Township in MMR (Mumbai Metropolitan region)	183	1.6	100
SEZ\Township in Nasik	1,000	21.8	100
Township in Pune	230	5.0	100
Total	13,977	236	

Source: Company

Lavasa to focus on execution, as further sales appears difficult

Lavasa has achieved pre-sales of Rs7b to December 2008 (similar amount as of September 2008) and has received customer advances of Rs1.5b. The project has achieved financial closure, given that the peak investment expectation of Rs18b will be financed through: equity infusion of Rs2.3b, convertible debentures Rs4.5b, debt Rs7.5b and cash flow from existing sales of Rs4.5b (over 2 years). The peak funding requirement for the project has increased to Rs18b from Rs12b earlier, as development plans have been advanced by ~2 years. The company has already spent Rs12b to December 2008 in Lavasa towards infrastructure development. As of now 1,400 villas/apartments have been sold and 350 acres have been leased for commercial purposes. Phase 1 will be fully operational from October 2009; while hotels, service apartments, F&B outlets etc. will start commissioning from 26 January 2009.

Management guidance

Revenue growth of 20-30% with EBITDA margin to be sustained. By end-FY09 order book to reach Rs170b, up from Rs122b in December 2008. Interest costs are expected to remain high. Outstanding debt increased to Rs25b in 3QFY09 from Rs22b in 2QFY09.

Valuation and view

We expect CAGR in revenue, of 20% and in earnings, of 25% during FY08-FY10E. At CMP, the stock trades at 13x FY09E and 10x FY10E earnings. Maintain **Buy** with a target price of Rs51/share based on SOTP.

HCC SUM OF PARTS (RS/SH)

	BUSINESS SEG.	METHOD	VALUATION MULTIPLE	VALUE (RS M)	VALUE (RS/SH)	RATIONALE
HCC Standalone	Construction	FY10E PER (x)	8	8,817	34	At par with industry average
Real Estate						
Lavasa	Township	NPV, WACC 17%		7,794	30	Based on NPV of expected cash flows
247 IT Park	Real Estate	NPV, Cap Rate 14%		1,063	4	Based on NPV of expected rentals from office space; 25% discount to NAV
BOT Investments						
Andhra Road	BOT	Book Value		495	2	Book value of Investments as at March 2009
Badarpur Expressway	BOT	Book Value		700	3	Book value of Investments as at March 2009
Less: FCCB outstanding		Book Value		-5,919	-23	We assume FCCBs will not be converted; Conversion price Rs248, YTM 6.5%
Total				12,951	51	

Source: MOSL

Hindustan Construction: an investment profile

Company description

Established in 1926 by the Walchand Hirachand group, HCC is one of the oldest and largest construction companies in India with pre-qualification skills and proven execution capabilities across sectors like power, roads, bridges, ports, water irrigation and supply, urban infrastructure and pipelines. HCC specializes in the construction of technologically complex and long-gestation period projects. The company has successfully and gradually transformed from a civil engineering contractor to an integrated infrastructure player. Recently it has increased focus on the BOT space and has plans to increase projects in hydropower, transportation, ports and water transmission. HCC has also forayed into real estate with developable area of 186msf under its portfolio of Hill Station (Lavasa), IT park (Vikhroli), SEZ etc. Lavasa is an ambitious project that aims to develop a new hill station near Pune.

Key investment arguments

- ✍ Possesses pre-qualifications and proven execution capabilities across sectors; will benefit from large ticket sized orders in the hydro and nuclear sectors.
- ✍ Focus on emerging as an integrated infrastructure player with presence across sectors such as roads, power, ports, airports and water transmission space.
- ✍ Has the youngest fleet of specialized equipment, skilled manpower, inhouse fabrication facility and EPC execution capability.
- ✍ Lavasa could be value accretive, and 10% increase in FSI can enhance shareholders' returns significantly.

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
43	51	18.6	Buy

SHAREHOLDING PATTERN (%)

	DEC-08	SEP-08	DEC-07
Promoter	47.2	47.2	47.0
Domestic Inst	20.4	19.9	17.4
Foreign	6.7	8.1	14.4
Others	25.7	24.9	21.2

Key investment risks

- ✍ Focus on key large projects increases project-specific risks.
- ✍ Retention of experienced manpower is a challenge.
- ✍ Significant investments in the RE/BOT subsidiaries.

Recent developments

- ✍ The State Cabinet has approved a part of the cost escalation (increased cost from changes in project scope and design) of Rs1.6b v/s claims of Rs2.3b.
- ✍ During phase 1 of bookings (commenced from October 2007), HCC has already booked sales of Rs7b, a total of 1,400 villas/apartments and JVs of 350 acres.

Valuations and view

- ✍ We expect CAGR in revenue of 20% and in earnings of 25% during FY08-FY10E. At CMP, the stock trades at 13x FY09E and 10x FY10E earnings. Maintain **Buy** with target price of Rs51/sh based on SOTP.

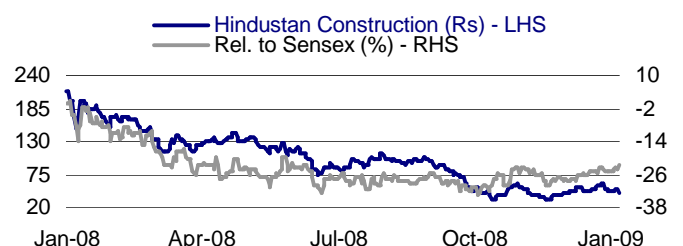
Sector view

- ✍ Increased government commitment towards infrastructure projects in adverse macro environment will help HCC due to its position in the sector.
- ✍ Investments in BOT/real estate projects have adversely impacted the core balance sheet. This will continue to have negative impact on the valuation multiples of the construction companies.

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY09	3.3	4.0	-18.0
FY10	4.3	5.2	-17.1

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2006	2007	2008	2009E	2010E
Net Sales	19,870	23,576	30,828	35,553	44,175
Change (%)	33.6	18.7	30.8	15.3	24.3
Construction Exps.	16,011	18,370	23,049	26,838	33,925
Staff Cost	1,314	2,087	2,972	3,089	3,569
Office and Site Establish. Exps	716	967	1,140	1,269	1,412
EBITDA	1,829	2,153	3,667	4,357	5,269
% of Net Sales	9.2	9.1	11.9	12.3	11.9
Depreciation	524	797	962	1,157	1,332
Interest	414	620	1,524	2,089	2,268
Other Income	461	199	387	347	0
Share of turnover in JV	31	244	-7	2	0
PBT	1,383	1,179	1,561	1,461	1,670
Tax	135	386	472	321	568
Rate (%)	9.7	32.8	30.3	22.0	34.0
Reported PAT	1,248	793	1,088	1,140	1,102
Extra-ordinary Income (net of e)	404	286	380	294	0
Adjusted PAT	844	564	708	846	1,102
Change (%)	28.3	-33.1	25.5	19.5	30.3

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2006	2007	2008	2009E	2010E
Share Capital	256	256	256	256	256
Reserves	8,642	8,785	9,784	10,719	11,588
Net Worth	8,898	9,041	10,041	10,976	11,844
Loans	11,959	15,511	18,449	24,046	23,860
Deferred Tax Liability	677	855	1,133	1,133	1,133
Capital Employed	21,535	25,407	29,622	36,155	36,837
Gross Fixed Assets	7,728	11,012	14,097	16,522	19,022
Less: Depreciation	2,807	3,550	4,566	5,723	7,054
Net Fixed Assets	4,921	7,462	9,531	10,799	11,968
Capital WIP	1,074	1,513	675	750	750
Investments	1,265	2,286	2,955	3,770	4,770
Curr. Assets	22,387	23,062	27,101	31,916	33,678
Inventory	10,307	17,386	21,439	24,351	27,231
Debtors	28	5	45	51	64
Cash & Bank Balance	10,060	2,084	2,644	4,087	2,130
Loans & Advances	1,991	3,476	2,954	3,407	4,233
Other Current Assets	1	111	20	20	20
Current Liab. & Prov.	8,112	8,916	10,640	11,081	14,329
Creditors	5,910	6,796	7,660	8,382	10,596
Other Liabilities	1,830	1,643	2,515	2,000	3,000
Provisions	372	477	466	698	733
Net Current Assets	14,275	14,146	16,461	20,835	19,349
Application of Funds	21,535	25,407	29,622	36,155	36,837

E: MOSL Estimates

RATIOS					
Y/E MARCH	2006	2007	2008	2009E	2010E
Basic (Rs)					
Adjusted EPS	3.3	2.0	2.8	3.3	4.3
Growth (%)	28.3	-39.9	39.7	19.5	30.3
Cash EPS	5.3	5.1	6.5	7.8	9.5
Book Value	34.7	35.3	39.2	42.8	46.2
DPS	0.7	0.7	0.8	0.7	0.8
Payout (incl. Div. Tax.)	16.4	28.4	22.0	17.9	21.2
Valuation (x)					
P/E (standalone)		21.7	15.6	13.0	10.0
Cash P/E		8.5	6.6	5.5	4.5
EV/EBITDA		11.4	7.3	7.1	6.2
EV/Sales		1.0	0.9	0.9	0.7
Price/Book Value		1.2	1.1	1.0	0.9
Dividend Yield (%)		1.7	1.9	1.6	1.9
Profitability Ratios (%)					
RoE	13.6	5.7	7.4	8.1	9.7
RoCE	11.8	6.6	11.2	10.8	10.8
Turnover Ratios					
Debtors (Days)	1	0	1	1	1
Inventory (Days)	189	269	254	250	225
Creditors. (Days)	135	135	121	120	120
Asset Turnover (x)	1.3	1.0	1.1	1.1	1.2
Leverage Ratio					
Debt/Equity (x)	1.3	1.7	1.8	2.2	2.0

CASH FLOW STATEMENT					
Million)					
Y/E MARCH	2006	2007	2008	2009E	2010E
PBT before Extraordinary Items	1,383	1,179	1,561	1,461	1,670
Add : Depreciation	524	797	962	1,157	1,332
Interest	414	620	1,524	2,089	2,268
Less : Direct Taxes Paid	135	386	472	321	568
(Inc)/Dec in WC	-2,858	-7,847	-1,755	-2,931	-470
CF from Operations	-672	-5,638	1,820	1,453	4,231
(Inc)/Dec in FA	-2,139	-3,776	-2,194	-2,500	-2,500
(Pur)/Sale of Investments	634	-1,022	-669	-815	-1,000
CF from Investments	-1,504	-4,798	-2,863	-3,315	-3,500
(Inc)/Dec in Networth	4,278	-247	429	0	0
(Inc)/Dec in Debt	7,702	3,551	2,938	5,597	-186
Less : Interest Paid	414	620	1,524	2,089	2,268
Dividend Paid	205	225	240	205	234
CF from Fin. Activity	11,362	2,460	1,603	3,304	-2,687
Inc/Dec of Cash	9,186	-7,976	560	1,443	-1,956
Add: Beginning Balance	875	10,060	2,084	2,644	4,087
Closing Balance	10,060	2,084	2,644	4,087	2,130



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Hindustan Construction

1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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