



## Hindustan Construction

STOCK INFO.	BLOOMBERG
BSE SENSEX: 15,235	HCC IN
	REUTERS CODE
S&P CNX: 4,445	HCNS.BO

27 July 2007

Buy

Previous Recommendation: Buy

Rs131

		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
Equity Shares (m)	274.3	3/07A	23,576	595	2.1	-35.3	61.4	3.7	6.1	6.6	2.0	21.8
52-Week Range	172/83	3/08E	32,642	1,066	3.9	82.4	33.6	2.5	9.1	10.9	1.4	12.9
1,6,12 Rel. Perf. (%)	13/-14/-4	3/09E	44,425	2,027	7.4	90.2	17.7	2.2	13.3	14.1	1.1	9.4
M.Cap. (Rs b)	35.9											
M.Cap. (US\$ b)	0.9											

- 1QFY08 performance better than expectations:** During 1QFY08, HCC reported revenues of Rs7.3b (up 25.8% YoY), EBIDTA of Rs791 (up 71.5% YoY), and net profit of Rs350m (up 39.2% YoY). Extra-ordinaries during 1QFY08 include foreign exchange gain on outstanding FCCBs of Rs317.6m. Adjusted Net profit stands at Rs150m, down 25.6% YoY. While reported revenue was in line with our estimates of Rs7.5b, EBIDTA margins at 10.8% were higher than our estimates of 8%.
- Robust order backlog, increased share of power sector:** Order book during June 2007 stood at Rs93.8b (vs Rs91.4b during June 2006). HCC has submitted tenders for projects worth Rs50.4b, of which it is L1 in projects (roads, tunnel and bridge segments) worth Rs21.6b. The company is pre-qualified to bid for projects worth Rs132.1b.
- Update on Real Estate development:** a) Full scale launch of Lavasa on October 22, 2007 i.e. Dussera, b) Construction of Corporate park at Vikhroli started, Possession by March 2009, c) acquired 150 acres of the contracted 1500 acres (on outskirts of Mumbai, Nashik and Pune) for township development.
- Valuations and view:** We now expect HCC to report net profit of Rs1.1m during FY08 (up 82.4% YoY, upgrade of 2.9%) and Rs2b in FY09 (up 90.2% YoY, upgrade of 11.9%) given reduced losses on Bandra Worli Sealink project. Based on SOTP, we arrive at price target of Rs171. We value core construction business at Rs111/sh (15FY09E), Lavasa at Rs39/sh (5,000 acres at Rs3.5/acre vs past transactions of Rs4-4.5m/acre), Vikhroli Corporate park Rs7/sh (NPV), Slum Rehab projects at Rs6/sh (NPV) and other Land Banks at Rs9/sh (book value of investments expected till Mar 08). At CMP, HCC quotes at reported PER of 61.4x FY07, 33.6x FY08 and 17.7x FY09. Adjusted for value of real estate (Rs60/sh), stock quotes at 33.2x FY07, 18.2x FY08 and 9.6x FY09. Maintain **Buy**.

Q/Y/E MARCH	FY07				FY08E				(Rs Million)	
	1Q	2Q	3Q	4QE	1Q	2QE	3QE	4QE	FY07	FY08E
<b>Gross Sales</b>	5,806	4,257	5,407	8,476	7,306	5,661	8,110	11,565	23,945	32,642
Change (%)	25.9	40.9	18.6	10.3	25.8	33.0	50.0	36.5	20.5	36.3
<b>EBITDA</b>	461	395	664	877	791	544	915	1,339	2,396	3,588
Change (%)	12.8	53.3	36.6	29.9	71.5	37.6	37.9	52.7	31.0	49.7
As of % Sales (Adj)	7.9	9.3	11.1	9.1	10.8	9.6	10.4	10.5	9.3	10.4
Depreciation	161	186	206	244	228	250	260	268	797	1,006
Interest	74	158	175	212	322	270	210	193	620	995
Other Income	62	10	2	125	315	1	1	5	199	321
Extraordinary Items	0	0	0	0	0	0	0	0	0	0
<b>PBT</b>	288	61	284	546	556	25	446	882	1,179	1,909
Tax	36	19	65	266	206	8	151	264	386	630
Effective Tax Rate (%)	12.6	31.5	22.8	48.7	37.1	33.9	33.9	30.0	32.8	33.0
<b>Reported PAT</b>	251	42	220	280	350	16	295	618	793	1,279
<b>Adj PAT</b>	201	42	144	160	150	16	295	618	547	1,066
Change (%)	-11.2	45.3	-36.5	-62.4	-25.6	-60.8	105.3	286.2	-33.1	94.9

E: MOST Estimates

### 1QFY08 performance better than expectations

During 1QFY08, HCC reported revenues of Rs7.3b (up 25.6% YoY), EBIDTA of Rs791 (up 71.5% YoY), and net profit of Rs350m (up 39.2% YoY). The reported numbers however include foreign exchange gain on outstanding FCCBs of Rs317.6m. Adjusted for this, the net profit stands at Rs150m, down 25.6% YoY. While reported revenue was in line with our estimates of Rs7.5b, EBIDTA margins at 10.8% were higher than our estimates of 8%. The company has booked losses of Rs200m on Bandra Worli sea link project during 1QFY08 (EBIDTA margin impact of 274bps).

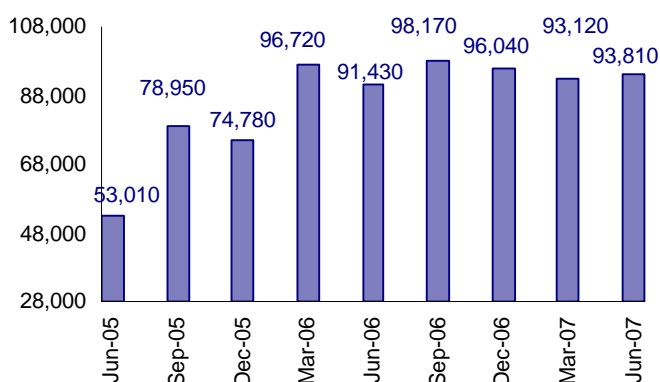
### Interest cost has been higher than estimates

Interest cost (net of interest income) increased to Rs322m during 1QFY08, vs Rs74m in 1QFY07, and Rs212m during 4QFY07. Cash on books declined to Rs1.8b as at June 2007 vs Rs2b as at Mar-07, while debt increased to Rs15.5b vs Rs11.1b as at Mar-07. The company also has not taken mobilization advances from customers (eligibility ~Rs7.5b) which carry interest rates of 10-5-11.0%. During FY08, cash flow should improve as majority of the projects under mobilization would enter construction phase, resulting in receipts from customers against invoice raised.

### Robust order backlog, increased share of power sector

Order book during June 2007 stood at Rs93.8b (vs Rs91.4b during June 2006). HCC has submitted tenders for projects worth Rs50.4b, of which it is L1 in projects (roads, tunnel and bridge segments) worth Rs21.6b. The company is pre-qualified to bid for projects worth Rs132.1b.

TREND IN QUARTERLY ORDER BACKLOG (RS M)



Source: Company

Composition of HCC's order backlog has shifted towards hydro power segment, where margins are significantly better, when compared with roads and irrigation segments. As at June 2007, share of power sector in order backlog has increased to 46% (vs 38% as at Mar 06 and 14% as at Mar 2005).

In terms of revenue mix, power sector accounted for 21% of revenues during 1QFY08, vs 37% during FY05 and 20% during FY06 and FY07. Thus, going forward, we believe that there exists a string possibility for EBIDTA margin expansion as share of hydro power to revenue mix improves.

ORDER BOOK COMPOSITION (%)

	FY04	FY05	FY06	FY07	1QFY08
Hydro & Nuclear Power	23	14	38	48	46
Transportation	38	38	43	40	36
Water Supply & Irrigation	25	37	15	8	15
Others	14	12	4	3	3

Source: Company

REVENUE COMPOSITION (%)

	FY04	FY05	FY06	FY07	1QFY08
Hydro & Nuclear Power	48	37	20	20	21
Transportation	36	36	33	47	54
Water Supply & Irrigation	26	27	40	27	21
Others	N.A.	N.A.	7	6	4

Source: Company

### Bandra Worli Sealink project: provision largely cover expected losses

During 1QFY08, HCC incurred loss of Rs200m on the project, as compared to Rs190m in 4QFY07 and Rs220m in 3QFY07. During FY07, loss stood at Rs710m, an EBIDTA margin impact of 300bps. This is because while expenses were accounted in totality, revenues are booked based on original cost of the project. Till date, the company has booked cumulative revenues of Rs2.5b on this project, and incurred cost of Rs4.8b, thus incurring cumulative under-recovery of Rs2.3b (loss in P/L account).

The management has however indicated that these provisions largely cover the expected losses on the project, and thus the expected losses going forward will not be substantial. Further, HCC has now taken a stance that the

project work would be slowed, pending receipt of payments from the state government. Thus, the project commissioning has been delayed to June / Sept 08 (4 lane), as against the earlier deadline of Mar 08. Thus, from 2QFY08, we expect reduced provisioning on Bandra Worli Sealink project, which could result in improvements in reported EBIDTA margins.

#### BANDRA-WORLI SEALINK: REVISED COST (RS M)

Original Project Cost	3,920
Escalations, based on Index and Variations to original work scope	3,400
Revised project cost	7,320

Source: Company

Since FY03, HCC has reported cumulative revenues of Rs75b, and the cumulative losses booked on Bandra-Worli Sealink project is Rs2.3b. This entails an EBITDA margin impact of 306bp over the project life till date. An early notification on the revised project cost will enable the company to curtail losses going forward, and also recover a part of the cumulative under recoveries of Rs2.3b.

### BOT projects

HCC is in the process of achieving financial closure for the annuity road project of 30kms stretch, costing Rs2.7b in Andhra Pradesh. Concession period is 20 years (including construction period of 2 years). Semi annual annuity receipt is Rs238.5m, and expected ROE is 15%. The company has recently achieved financial closure of the project with DER of 18:82.

Apart from annuity projects in road sector, HCC is also bidding for BOT projects in power sector, and has targeted US\$50m as investments in this space. The company is already looking at hydro power projects in Uttar Pradesh, Uttaranchal, etc.

### Considerable Progress on Real Estate front

Realty development is emerging as a key business vertical for HCC, and the company is seeking opportunities in township development through HCC Real Estate, 100% subsidiary. The company has appointed Mr Nicholas Bashkiroff (who has headed development of US\$8b real estate project in Qatar) as CEO of real estate business.

The company has a total developable area of 186m sq ft, of which HCC's share stands at 126m sq ft. HCC Real Estate (100% subsidiary of HCC) is also looking at various options for fund raising to finance the real estate initiatives. As at June 2007, HCC has already invested Rs1b as equity in HCC Real Estate (100% subsidiary) and expected investment in FY08 is Rs1.5b.

✍ **Update on Lavasa:** HCC plans to launch 300 units comprising bungalows and apartments, at Rs2000/sq ft+ at Lavasa on 22 October 2007 (Dussera). These sales are expected to result in realizations of Rs1b. Of the 12500 acres, the company has already acquired 9,000 acres for which titles have been registered in favour of the company. HCC has recently signed a contract with GDST (an education trust in Europe managing 27 institutes, including Oxford University) to set up an educational university at Lavasa. Lavasa has spent Rs6b till date, of which HCC's equity contribution (60% stake) is Rs700m. Total cost till FY09 is Rs9b, of which Rs5.5b would be financed through debt, Rs2b as equity and Rs1.5b through land sale. Post this, the project is expected to achieve self financing mode. Also, HCC is planning to induct investors for speciality segments (eg hospitality, etc), Infrastructure (eg power, water, sewage, etc) and also for a strategic investor in Lavasa Corp, which would reduce the funding requirement on HCC's books.

✍ **Development of Vikhroli land (Corporate Park):** Construction work on Vikhroli IT park has already commenced (developable area of 1.95m sq.ft) and it plans to offer offices for fit out by Dec 08 and occupation by Mar 09. The revenue booking from the project would start from 4QFY09.

✍ **Other real estate projects:** For Slum Rehabilitation projects in Vikhroli East (15 acres) and Powai (10 acres), the company is in the process of entering into agreements with the slum dwellers. Land acquisition for development of integrated townships in Thane (200 acres), Pune (300 acres) and Nashik (1000 acres) are in progress and HCC has already acquired ~150 acres, at cost of Rs500m. Till Mar 07, HCC has invested Rs2b in HCC Real Estate (100% subsidiary).

## HCC'S REAL ESTATE PORTFOLIO

PROJECT	ACRES	M.SQ.FT.
Lavasa	12,500	150
Vikhroli West (IT Park)	11	2
Res. Project in Mumbai (SRS)	10	1
Vikhroli East	15	1
Township in MMR (Mumbai Metropolitan region)	200	6
SEZ/Township in Nashik	1,000	20
Township in Pune	300	6
<b>Total</b>	<b>14,036</b>	<b>186</b>

Source: Company

### Valuations and view

Based on the reduced losses on Bandra Worli Sealink project and higher interest cost, we expect HCC to report

net profit of Rs1.1m during FY08 (up 82.4% YoY, upgrade of 2.9%) and Rs2.0b in FY09 (up 90.2% YoY, upgrade of 11.9%). Based on SOTP, we arrive at price target of Rs171. We value core construction business at Rs111/sh (15FY09E), Lavasa at Rs39/sh (5000 acres at Rs3.5/acre vs past transactions of Rs4.0-4.5m/acre), Vikhroli Corporate park Rs7/sh (NPV), Slum Rehab projects at Rs6/sh (NPV) and other Land Banks at Rs9/sh (book value of investments expected till Mar 08). At CMP of Rs131/sh, HCC quotes at reported PER of 61.4x FY07, 33.6x FY08 and 17.7x FY09. Adjusted for value of real estate (Rs60/sh), stock quotes at 33.2x FY07, 18.2x FY08 and 9.6x FY09. Maintain **Buy**.

## HCC SUM OF PARTS (RS/SH)

	BUSINESS SEG.	METHOD	VALUATION MULTIPLE	VALUE (RS M)	VALUE (RS/SH)	RATIONALE
HCC Standalone	Construction	FY09E PER (x)	15	30,409	111	At par with industry average
<b>Real Estate</b>						
Lavasa	Township	Land Value (Rs m/acre)	3.5	10,582	39	Out of 12,500 acres of land, 5,000 acres will be developed. Past transactions by Lavasa was at Rs4.0-4.5m/acre (land sale)
Vikhroli Land (11 acres)	Real Estate	NPV, Cost of Equity:15%		1,855	7	Based on NPV of expected rentals from office space
Vikhroli Land (Slum Rehabilitation - 15 acres)	Real Estate	NPV, Cost of Equity:15%		855	3	Based on NPV of expected cash flows
Powai Land (Slum Rehabilitation - 10 acres)	Real Estate	NPV, Cost of Equity:15%		695	3	Based on NPV of expected cash flows
Other Land Banks	Real Estate	Book Value		2,500	9	Book value of Investments as at March 2008
<b>Total</b>				<b>46,896</b>	<b>171</b>	

We do not factor in the land development profit at Lavasa

Source: Motilal Oswal Securities

## Hindustan Construction: an investment profile

### Background

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 & 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 EPC executor.

### Key investment arguments

- ☞ Possesses pre-qualifications and proven execution capabilities across sectors; will benefit from large ticket sized orders in hydro and nuclear sectors
- ☞ Has the youngest fleet of specialized equipments, skilled manpower, in-house fabrication facility and EPC execution capabilities
- ☞ Lavasa project could be value accretive, and 10% increase in FSI can enhance shareholder returns by 100%.

### Key investment risks

- ☞ Focus on key large projects increases the project specific risks
- ☞ Retention of experienced manpower is a challenge.

### Recent developments

- ☞ Lavasa launch by Dussera (22<sup>nd</sup> October, 2007)

### Valuations and view

- ☞ At CMP of Rs131/sh, HCC quotes at reported PER of 61.4x FY07, 33.6x FY08 and 17.7x FY09. Adjusted for value of real estate (Rs60/sh), stock quotes at 33.2x FY07, 18.2x FY08 and 9.6x FY09.

### Sector view

- ☞ Increased government commitment towards infrastructure projects has led to several large projects taking off the ground
- ☞ We notice a trend of margin expansion, driven by changing composition of order book and higher margins at bidding stage.

#### COMPARATIVE VALUATIONS

		HIND.CON.	NCC	GAMMON
P/E (x)	FY08E	33.6	20.8	34.3
	FY09E	17.7	15.2	23.7
P/BV (x)	FY08E	2.5	1.7	3.2
	FY09E	2.2	1.4	2.9
RoE (%)	FY08E	9.1	17.1	9.4
	FY09E	13.3	20.2	12.1

#### SHAREHOLDING PATTERN (%)

	JUN-07	MAR-07	JUN-06
Promoter	47.0	47.0	46.9
Domestic Inst	13.3	11.7	12.1
Foreign	16.4	16.7	22.0
Others	23.3	24.6	19.0

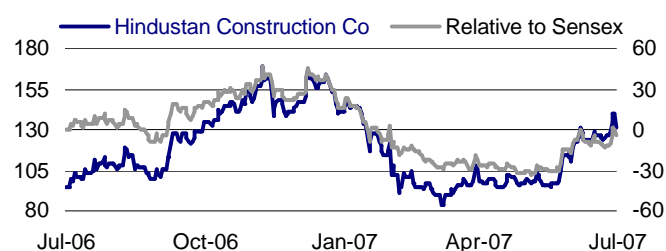
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	3.9	4.0	-3.1
FY09	7.4	6.0	22.9

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
131	171	30.5	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
<b>Net Sales</b>	<b>14,873</b>	<b>19,870</b>	<b>23,576</b>	<b>32,642</b>	<b>44,425</b>
Change (%)	40.6	33.6	18.7	38.5	36.1
Construction Exps.	11,814	16,011	18,370	24,935	33,936
Staff Cost	954	1,314	2,087	2,744	3,550
Office and Site Establish. Exps	546	716	967	1,420	1,538
<b>EBITDA</b>	<b>1,559</b>	<b>1,829</b>	<b>2,153</b>	<b>3,543</b>	<b>5,402</b>
% of Net Sales	10.5	9.2	9.1	10.9	12.2
Depreciation	453	524	797	1,006	1,188
Interest	395	414	620	995	1,272
Other Income	56	461	199	321	6
Share of turnover in JV	-17	31	244	45	80
<b>PBT</b>	<b>750</b>	<b>1,383</b>	<b>1,179</b>	<b>1,909</b>	<b>3,027</b>
Tax	10	135	386	630	999
Rate (%)	13	9.7	32.8	33.0	33.0
<b>Reported PAT</b>	<b>740</b>	<b>1,248</b>	<b>793</b>	<b>1,279</b>	<b>2,028</b>
Extra-ordinary Income (net of e)	82	404	247	318	1
<b>Adjusted PAT</b>	<b>658</b>	<b>844</b>	<b>595</b>	<b>1,066</b>	<b>2,027</b>
Change (%)	84.3	28.3	-29.4	79.0	90.2

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Share Capital	229	256	256	274	274
Reserves	3,300	8,642	8,785	14,212	15,778
<b>Net Worth</b>	<b>3,530</b>	<b>8,898</b>	<b>9,041</b>	<b>14,486</b>	<b>16,052</b>
Loans	4,257	11,959	15,511	11,484	16,296
Deferred Tax Liability	725	677	855	855	855
<b>Capital Employed</b>	<b>8,511</b>	<b>21,535</b>	<b>25,407</b>	<b>26,826</b>	<b>33,203</b>
Gross Fixed Assets	6,208	7,728	11,012	13,775	16,275
Less: Depreciation	2,305	2,807	3,550	4,556	5,744
<b>Net Fixed Assets</b>	<b>3,903</b>	<b>4,921</b>	<b>7,462</b>	<b>9,219</b>	<b>10,531</b>
Capital WIP	478	1,074	1,513	750	750
Investments	1,899	1,265	2,286	5,162	7,162
<b>Curr. Assets</b>	<b>7,721</b>	<b>22,387</b>	<b>23,062</b>	<b>23,514</b>	<b>31,004</b>
Inventory	5,833	10,307	17,386	16,992	23,125
Debtors	31	28	5	7	10
Cash & Bank Balance	875	10,060	2,084	1,591	1,208
Loans & Advances	982	1,991	3,476	4,813	6,550
Other Current Assets	0	1	111	111	111
<b>Current Liab. &amp; Prov.</b>	<b>5,489</b>	<b>8,112</b>	<b>8,916</b>	<b>11,819</b>	<b>16,244</b>
Creditors	4,039	5,910	6,796	9,222	12,552
Other Liabilities	1,167	1,830	1,643	2,000	2,500
Provisions	283	372	477	596	1,193
<b>Net Current Assets</b>	<b>2,232</b>	<b>14,275</b>	<b>14,146</b>	<b>11,695</b>	<b>14,760</b>
<b>Application of Funds</b>	<b>8,511</b>	<b>21,535</b>	<b>25,407</b>	<b>26,826</b>	<b>33,203</b>

E: MOSt Estimates

RATIOS					
Y/E MARCH	2005	2006	2007	2008E	2009E
<b>Basic (Rs)</b>					
<b>Adjusted EPS</b>	<b>2.9</b>	<b>3.3</b>	<b>2.1</b>	<b>3.9</b>	<b>7.4</b>
Growth (%)	610	14.7	-35.3	82.4	90.2
Cash EPS	4.8	5.3	5.2	7.6	11.7
Book Value	15.4	34.7	35.3	52.8	58.5
DPS	0.6	0.7	0.7	0.9	1.5
Payout (incl. Div. Tax.)	212	16.4	28.4	22.8	22.8
<b>Valuation (x)</b>					
P/E (standalone)		39.7	61.4	33.6	17.7
Cash P/E		24.5	25.0	17.3	11.2
EV/EBITDA		19.4	21.8	12.9	9.4
EV/Sales		1.8	2.0	1.4	1.1
Price/Book Value		3.8	3.7	2.5	2.2
Dividend Yield (%)		0.5	0.6	0.7	1.1
<b>Profitability Ratios (%)</b>					
RoE	25.5	13.6	6.1	9.1	13.3
RoCE	15.4	11.8	6.6	10.9	14.1
<b>Turnover Ratios</b>					
Debtors (Days)	1	1	0	0	0
Inventory (Days)	143	189	269	190	190
Creditors. (Days)	125	135	135	135	135
Asset Turnover (x)	2.0	1.3	1.0	1.2	1.5
<b>Leverage Ratio</b>					
Debt/Equity (x)	1.2	1.3	1.7	0.8	1.0

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
<b>PBT before Extraordinary Items</b>	<b>750</b>	<b>1,383</b>	<b>1,179</b>	<b>1,909</b>	<b>3,027</b>
Add : Depreciation	453	524	797	1,006	1,188
Interest	395	414	620	995	1,272
Less : Direct Taxes Paid	10	135	386	630	999
(Inc)/Dec in WC	639	-2,858	-7,847	1,958	-3,448
<b>CF from Operations</b>	<b>2,226</b>	<b>-672</b>	<b>-5,638</b>	<b>5,238</b>	<b>1,040</b>
(Inc)/Dec in FA	-1,139	-2,139	-3,776	-2,000	-2,500
(Pur)/Sale of Investments	-1,413	634	-1,022	-2,876	-2,000
<b>CF from Investments</b>	<b>-2,552</b>	<b>-1,504</b>	<b>-4,798</b>	<b>-4,876</b>	<b>-4,500</b>
(Inc)/Dec in Networth	1,284	4,278	-247	4,458	0
(Inc)/Dec in Debt	61	7,702	3,551	-4,026	4,812
Less : Interest Paid	395	414	620	995	1,272
Dividend Paid	157	205	225	292	462
<b>CF from Fin. Activity</b>	<b>794</b>	<b>11,362</b>	<b>2,460</b>	<b>-855</b>	<b>3,077</b>
<b>Inc/Dec of Cash</b>	<b>468</b>	<b>9,186</b>	<b>-7,976</b>	<b>-493</b>	<b>-383</b>
Add: Beginning Balance	407	875	10,060	2,084	1,591
<b>Closing Balance</b>	<b>875</b>	<b>10,060</b>	<b>2,084</b>	<b>1,591</b>	<b>1,208</b>

E: MOSt Estimates

**N O T E S**



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