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Hindustan Construction

Company Update

BUY

Price	**Rs81**
Target Price	**Rs117**
Investment Period	**12 Months**

Stock Info

Sector	Construction
Market Cap (Rs cr)	2,073
Beta	1.3
52 Week High / Low	279/68
Avg Daily Volume	834046
Face Value (Rs)	1
BSE Sensex	13,102
Nifty	3,985
BSE Code	500185
NSE Code	HCC
Reuters Code	HCNS.BO
Bloomberg Code	HCC IN

Shareholding Pattern (%)	
Promoters	47.0
MF / Banks / Indian FIs	19.5
FII / NRIs / OCBs	9.4
Indian Public / Others	24.1

Abs.	3m	1yr	3yr
Sensex (%)	(9.2)	(22.6)	54.5
HCC (%)	(16.6)	(41.0)	(7.4)

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Broadening 'Land'scape

Recently we met the management of Hindustan Construction (HCC) to get more clarity on its prestigious Real Estate project (Lavasa), opportunities arising from the NSG waiver and its strategy going ahead. Management indicated that they would be focusing on Real Estate and owning of infra assets. In Real Estate, it achieved pre-booking sales of Rs550cr in FY2008. We have valued HCC on SOTP basis. Assigning revised PE of 10x FY2010E EPS (12x earlier) for its core Construction business, we have valued it at Rs59/share. Real Estate, on NAV basis, fetches Rs53/share. The Road BOT segment is valued on DCFE basis at Rs5/share. At Rs81, the stock is attractively trading at 9x FY2009E and 4x FY2010E EPS post adjusting for BOT and Real Estate. ***We maintain a Buy on the stock, with a revised Target Price of Rs117 (Rs140).***

- **Opportune transition from Contractor to Asset owner:** With changing nature of order inflow from cash to ownership basis (BOT mode) in the Road segment, HCC has made an opportune foray into the Road BOT segment. We believe that HCC stands to benefit from the same with huge order inflows expected in the Road segment via this mode over the next six months. HCC expects the Road BOT segment to contribute around Rs2,000cr to its Order book in FY2009.

- **Real Estate contributes 45% of our SOTP Target Price:** For the Lavasa project, HCC has completed the tie-ups with all anchor developers, has sold 300 villas and 290 apartments at Rs3,150/sq.ft. and Rs2,850/sq.ft. respectively, and has also received advance of Rs125cr from its clients. We have conservatively valued Lavasa, on NAV basis, at Rs45/share. For its Vikhroli Corporate Park project, we have pruned valuations by nearly 35% to factor in the lower-than-estimated built-up area, lower realisations and change in captilisation rate. The project now contributes Rs8/share (earlier Rs12) to our SOTP Target Price.

- **Nuclear deal to ensure order inflow:** HCC is a leading player in civil construction of nuclear power plants. The NSG waiver and potential signing of the Indo-US nuclear deal now ensures that India would well attain its target of generating 40GW of nuclear power by 2020. Civil construction at nuclear power plants accounts for 35% of total capex (Rs6cr/MW). However, we expect order inflow to materialise post FY2010E.

Key Financials (Standalone)

Y/E March (Rs cr)	FY2007	FY2008	FY2009E	FY2010E
Net Sales	**2,358**	**3,083**	**3,704**	**4,549**
% chg	*18.7*	*30.8*	*20.1*	*22.8*
Adj. PAT	**54.8**	**70.8**	**68.2**	**155.2**
% chg	*(28.9)*	*29.1*	*(3.7)*	*127.4*
FDEPS (Rs)	**2.1**	**2.8**	**2.6**	**5.9**
EBITDA Margin (%)	9.1	11.9	10.4	11.6
P/E (x)	37.9	29.3	31.3	13.8
RoE (%)	6.1	7.1	6.8	12.2
RoCE (%)	5.3	9.1	8.2	11.3
P/BV (x)	2.3	2.1	2.1	1.7
EV/Sales (x)	1.5	1.4	1.1	0.8
EV/EBITDA (x)	15.9	11.4	10.1	7.1

Source: Company, Angel Research

Investment Argument

Opportune transition from Contractor to Asset owner

HCC has made an opportune move to foray into the Road BOT segment.

Till recently, HCC had kept away from Asset ownership in the Road BOT segment. But, with the change in the nature of orders being awarded in the Road segment from cash basis to ownership basis (read BOT basis), HCC has made an opportune move to foray into the Road BOT segment. The company intends to bid for Road BOT projects by forming alliances. Our talks with management indicate that HCC is in pre-qualification status for 15 projects and expects to secure around 2-3 projects. Accordingly, we expect HCC to witness substantial order inflow in the Road segment over the next six months. The company expects the Road BOT segment to contribution around Rs2,000cr to its Order book by end FY2009.

Currently, the Transportation segment contributes 32% to HCC's total Order book. HCC has a strong track record in the Transportation segment by timely execution of Bridges, Roads and Highways on contract basis. Creditably, HCC has constructed nearly 173 road bridges combined length of which is around 46,000km. HCC's overseas performance is also impressive having constructed over 34 bridges in Iraq alone. Hence, we strongly believe that HCC's transition from contractor to asset ownership business model is indeed an opportune move to encash on its experience and expertise. Further, we believe this opportune transition would be value accretive for HCC in the long run though currently the segment is contributing a mere 7.5% (Rs615cr) to its total Order book. Pertinently, Equity IRR in the Road BOT segment is much higher than the cash contracts, which is intensely competitive. Thus, this move will not only add value to the company in the long run but will also help it counter competition.

Road BOT segment - Assets Portfolio

HCC has a relatively small portfolio of BOT projects with a total project capitalisation of Rs615cr. Nonetheless, within a very short time frame since its foray into asset ownership model HCC was able to bag these orders, which points at its superior positioning v/s peers. HCC has recently bagged a toll based Road BOT for construction of 4.4km of elevated highway at Badarpur on NH2 near Delhi. The order is worth Rs340cr and has a concession period of 20years with 24 months of construction period. However we have not factored in the same in our valuations as the financial closure for the same has not been achieved.

Exhibit 1: Nirmal BOT Project Details	(Rs cr)
Particulars	
Length (km)	30
Concession Period (years)	20
Expected Date of Completion	June 2009
Project Costs	275
Equity Component	76
Debt Component	199
Company's Stake (%)	100
Company's Equity Commitment	76
Company's Debt Commitment	199

Source: Company, Angel Research

√ **Project description:** The project involves design, construction, development, finance, operation and maintenance of 30km of a four lane highway between Kadtal and Armur on NH-7 in Andhra Pradesh. This is first project implemented by HCC for NHAI (National highway authority of India) on BOT basis. The project is semi-annuity based fetching Rs23.8cr. The project has a concession period of 20 years inclusive of the 24 months required to carry out the construction work. HCC holds 100% stake in the project, and debt has been financed at 10.25% rate of interest.

√ **Project status:** Earthwork is complete to the extent of 12.8km and the bituminous work is in progress. The project has achieved completion of 42.5% as on June 30, 2008.

√ **Key takeaways:** We have used a lower discounting rate of 12% for the project as Revenues are fixed and there are no risks related to traffic flow.

Exhibit 2: Profit and Loss Account

Particulars (Rs cr)	FY2009E	FY2010E	FY2011E	FY2012E	...FY2026E	FY2027E
Total Income	11.9	47.6	47.6	47.6	47.6	35.7
Total Expenses	(1.4)	(5.7)	(5.7)	(5.7)	(4.3)	(3.2)
EBIDTA	13.3	53.3	41.9	41.9	43.3	32.5
Dep & Amortisation	(3.8)	(15.3)	(15.3)	(15.3)	(15.3)	(11.5)
Interest	(20.4)	(20.4)	(19.4)	(18.3)	0.0	0.0
PBT	(10.9)	17.6	7.2	8.3	28.0	21.1
Tax	0.0	2.3	0.9	1.1	9.2	7.0
PAT	(10.9)	15.4	6.3	7.2	18.8	14.1
Cash Flow to Equity						
PAT	(10.9)	15.4	6.3	7.2	18.8	14.1
Add: Dep	3.8	15.3	15.3	15.3	15.3	11.5
Less: Capex	(103.1)	0.0	0.0	0.0	0.0	0.0
Cash Flow to Equity & Debt	(110.2)	30.6	21.6	22.5	34.0	25.6
Less: Debt Raised/(Paid)	74.6	0.0	(10.0)	(10.0)	0.0	0.0
Cash Flow to Equity	(35.6)	30.6	11.6	12.5	34.0	25.6
Discounting Rate (%)	12					
NPV of Cash Flows (Rs cr)	120					
Value per share (Rs)	5					

Source: Company,Angel Research; Note: FY2027E Project operational only for 9 months

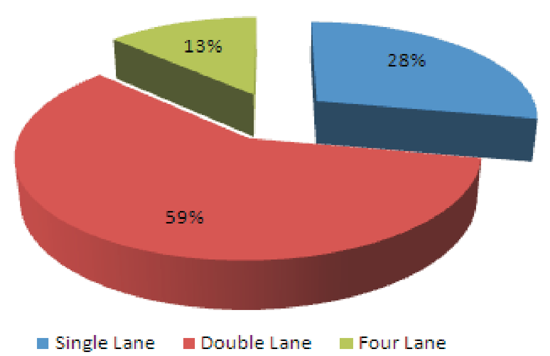
Opportunity in the Road segment

Road network accounts for around 65% of freight and 87% of the passenger traffic

India has the second largest road network in the world spanning across 3.3mn km consisting of National highways, Expressways, State highways, Major district roads and other district roads and villages. The road network accounts for around 65% of freight and 87% of the passenger traffic. Hence, the road network plays an important role in overall transportation of the country.

Highways play a pivotal role in the country's transportation supporting almost 40% of the overall road traffic in the country. Highways, however, constitute a mere 2% of the total length of roads of the country., Highways can be further categorised based on carriageway width.

Exhibit 3: Carriage width classification of Road infrastructure



Source:Dept of Road Transport & Highways, AR 2007-08, Angel Research

With only 13% of total road length four lanned, 59% double lanned and only 28% single lanned, suggests that the laning work remains to be done to strengthen the Highway infrastructure.

More-ever, there has been rapid increase in the proportion of road usage under the passenger category segment, which has its genesis in the changing pattern of vehicle usage in India. In 2004, composition of vehicle population in India highlighted the predominance of two-wheelers, with a share of more than 71% in the total vehicle population followed by cars at 13% and other vehicles at 9% (Source: Working Group report on Road Transport - Eleventh Five-year Plan). The share of buses and trucks at 2% and 5% is much lowered compared to China. With a higher proportion of two-wheelers in India's changing traffic configuration, it has become imperative to bolster investments in the Road infrastructure.

Real Estate contributes 45% of our SOTP Target Price

Lavasa

HCC has completed all the tie-ups with anchor developers including hotels, residential schools and colleges, theme park, hospitals

HCC holds 65% stake in the Lavasa project wherein it is building a private hill station. The project is progressing well. The company has also completed all the tie-ups with anchor developers including hotels, residential schools and colleges, theme park, hospitals, etc. The 60-room ITC Fortune hotel is expected to commence operations by 2HFY2009. Construction work on the 200-room Novotel Accor hotel, a 135- room budget hotel, a Country Club resort and a 3.5km-long nature trail has also started. HCC is also showing considerable progress in sale of residential properties with 300 villas and 290 apartments already sold at Rs3,150/sq.ft. and Rs2,850/sq.ft., respectively. The company has also received advance to the tune of Rs125cr from clients. Volume of residential construction and sales booking in FY2008 suggests that the company's real estate sales would be front-ended. At present, HCC has only 0.54mn sq.ft. of residential space under construction in Lavasa. Construction of a 50-bed hospital in joint venture (JV) with Apollo Hospitals has also started. The hospital is expected to commence operation by FY2010, much before a large and permanent population starts residing in Lavasa.

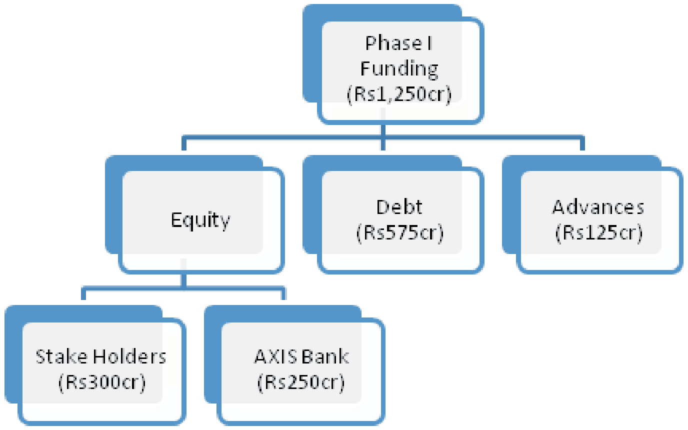
Axis Bank financing fails to peg valuation benchmark; but project financing tied up

Axis Bank has invested Rs250cr in Lavasa via convertible preference shares and convertible debentures. Of Rs250cr, Rs25cr would be convertible preference shares, which would be compulsorily convertible within three years at a valuation of Rs10,000cr implying Rs234/share for HCC. The balance Rs225cr is in the form of debentures with a cash coupon of 6% for three years, but YTM of 14.5% which will be compounded post three years if not converted. Debentures would be convertible only if HCC does an IPO for its Real Estate arm within five years. It will be at a valuation of Rs10,000cr or closer to the IPO price (based on a formula), whichever is lower. In case HCC does not make the IPO, then Axis Bank can redeem the debentures or convert it at a valuation of Rs5,000cr at the end of the five years.

Effectively, the deal does not give a real valuation benchmark considering that conversion of the Rs225cr debentures could happen lower than Rs10,000cr valuation or might not happen at all. However, the deal is positive from the perspective of financing for first phase of the Lavasa project as funds have been tied up at a time when market conditions for raising money are not very conducive.

We believe that with cash advances from pre-sales of Rs125cr and issue of Rs250cr, a significant portion of the funds for further development of Lavasa has been tied up. Notably, this frees up capital for HCC (as it has already invested its share of equity for Phase I) to invest in its core construction and emerging infrastructure development businesses.

Exhibit 4: Lavasa - Phase I funding pattern



Source: Company, Angel Research

Private Equity deal in Lavasa

Rumours of eminent Private Equity (PE) evincing interest in the project have been fairly strong with media reports ascribing valuations ranging between Rs5,000cr-10,000cr for the project

We believe that value creation in Lavasa would be an uphill task. However, rumours of eminent Private Equity (PE) evincing interest in the project have been fairly strong with media reports ascribing valuations ranging between Rs5,000cr-10,000cr for the project. HCC's stake in the project would work out to Rs117-Rs234 per share. At the upper end of the rumoured valuations for Lavasa alone is higher than the market capitalisation of HCC. The rumours have been doing the rounds for quite some time in the markets. Once the deal gets finally announced, it would provide significant upside trigger to the HCC stock.

Exhibit 5: Lavasa Project Details

Development Assumptions	Phase I	Phase II	Phase III	Phase IV	Total
Gross Area (acres)	1,684	4,732	6,084	580	13,080
Area Under Development (acres)	464	2,035	1,899	500	4,898
% of gross area	*28*	*43*	*31*	*86*	*37*
Land Acquired (acres)	1,564	3,607	3,599	-	8,770
Under Acquisition Process (acres)	120	1,125	2,485	580	4,310
% of Land acquired	*8*	*31*	*69*	-	*49*

Source: Company, Angel Research

Exhibit 6: Lavasa Valuation Model

Particulars	Rs cr
Area Under Development (acres)	4,898
Mn sq.ft.	200
Sale Price per sq.ft@Rs2,800	56,000
Cost Per sq.ft@Rs1,500	30,000
PBT	**26,000**
Tax@33%	8,580
PAT	**17,420**
NAV (with COE of 16% and Discounting Period of 10years)	3,949
Debt	900
Net NAV	3,049
Discount to NAV@40%	1,220
Discounted NAV	1,830
HCC's stake@65%	1,189
Value Per share (Rs)	45

Source: Company, Angel Research

Vikhroli IT Park

HCC's 1.2mn sq.ft. IT park in Vikhroli is on schedule and is expected to be ready for fit-outs by December 2008 and occupancy by March 2009. We have pruned valuations of this Project by nearly 35% to factor in lower-than-estimated built-up area, lower realisations and change in captilisation rate. We had estimated total built-up area at 1.95mn sq.ft. However, the development plan indicates that the construction area totals to 1.8mn sq.ft. We have also factored in an increase in the cap rate for lease rentals from 10% to 12% now. As a result, the project contributes Rs8/share to our SOTP Target Price as against the earlier Rs12/share.

- We have assumed that the property would be sold out in FY2020. The capitalisation rate has been assumed at 12%.
- We have assumed a price correction in FY2009 and FY2010 and in FY2011 current price levels (FY2008, Rs90/sq.ft.) would be achieved.
- Post FY2011 we have assumed higher rentals by 5% for every year thereafter to factor in inflation.
- Costs have been assumed at Rs2,200/sq.ft.
- We have assumed occupancy levels of 90% for the rest of the area apart from that leased out to Orange and Future Group (at 2,75,000 sq.ft).

Nuclear deal to ensure order inflow

HCC is one of the leading companies in the civil construction work of Nuclear power plants

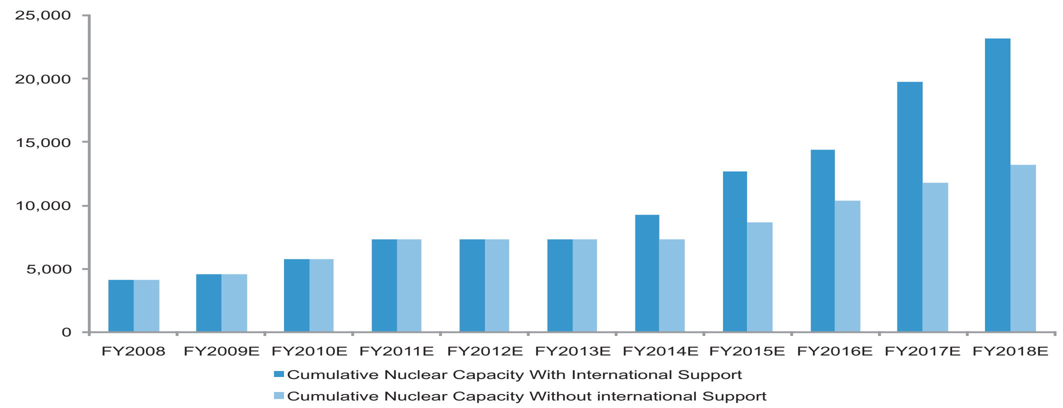
HCC is one of the leading companies in the civil construction work of Nuclear power plants. It has the expertise to construct Nuclear power plants and is the first Indian civil construction company to undertake civil engineering work for pressurised heavy water reactor (PHWR) Nuclear power projects in India. The company specialises in pre-stressed containment structures for reactor buildings. HCC has also developed standardised form work for containment walls, slabs and domes enabling it to do in-time quality work.

HCC has received accolades for excellence in this specialised domain of construction. These accreditations stand testimony to the excellent work that HCC has been carrying out in the Nuclear power plant space. It has been involved in six out of 17 nuclear power plants constructed and running in the country, which entails a marketshare of nearly 35%.

Nuclear Power space - The way ahead

The Eleventh Plan envisages commencement of work for setting up eight indigenous 700MW PHWR (Pressurised heavy water reactor) and an advanced Heavy Water reactor of 300MW by BARC *(Source: Annual Report 2007-08, NPCIL)*. Based on the Eleventh Plan proposals, summary of the cumulative capacity build up is as follows.

Exhibit 7: Trend in Cumulative Projected Nuclear Power Capacity in MW



Source: NPCIL AR 2007-08, Angel Research

India generates 4,120MW of nuclear power and has plans to augment it by around 3,200MW in XIth five year plan

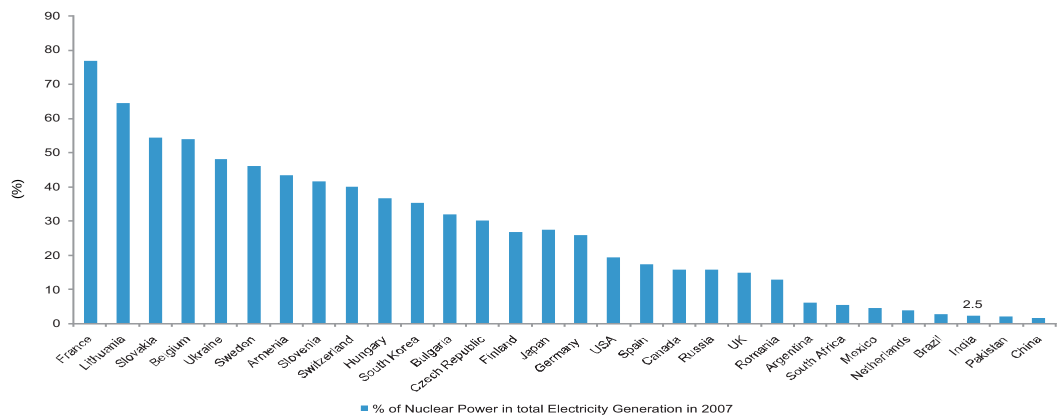
Currently, India generates 4,120MW of nuclear power and has plans to augment it by around 3,200MW in the Eleventh Plan. However, current installed nuclear power capacity stands at a meager 2.5% to India's total installed power capacity. Hence, if capacity additions materialise as planned, it would enhance share of nuclear power to 3.5% at the end of Eleventh Plan. Overall, the civil construction opportunity per MW of nuclear power capacity addition is to the tune of Rs2.1cr.

NSG Waiver - Harbinger of brighter prospects

Of the total installed nuclear power capacity of 4,120MW in India, 96% is based on PHWR technology.

Of the total installed nuclear power capacity of 4,120MW in India, 96% is based on PHWR technology. Globally, the PHWR technology accounts for a mere 6% of the world's nuclear power capacity. This anomaly exists because of non-compatibility issues between the uranium reserves available in India and other superior technology such as PWR, BWR, etc. The cost of pressurised water reactor (PWR) technology is also lower than that of PHWR. Individual unit sizes are also much higher in terms of generating capacity in PWR technology. Hence, power generation in India from nuclear sources stands at a meagre 2.5% of the total generation capacity compared to other countries like France, which have access to superior technology and fuel.

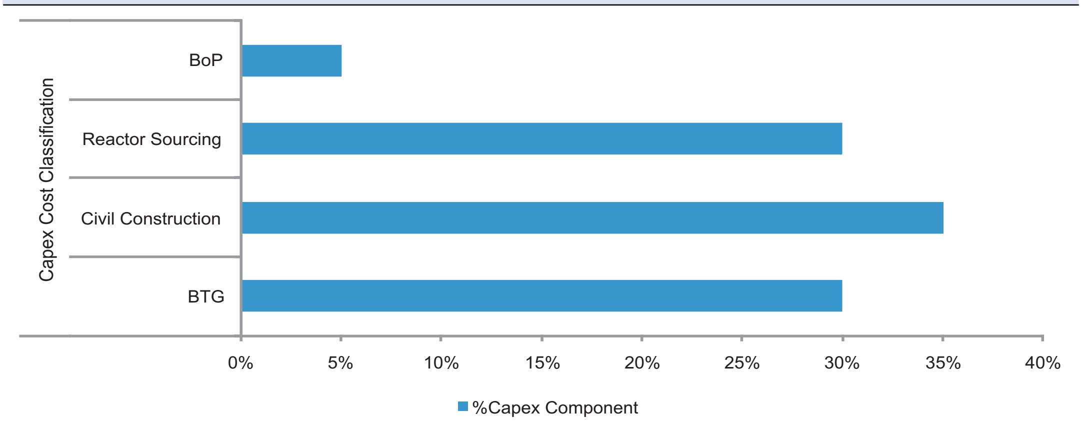
Exhibit 8: Nuclear Power Share in Total Power generation - A Global Comparison



Source: NPCIL AR 2007-08, Angel Research

The Nuclear Supplier Group's (NSG) waiver opens up new vistas for India in the development of Nuclear Power. It will allow India to carry on nuclear trade with nations having advanced nuclear technology/fuel. The NSG waiver and potential signing of the Indo-US nuclear deal would mean that India can now attain its new target of generating 40GW of Nuclear Power by 2020.

Exhibit 9: Capex Classification



Source: Industry, Angel Research

Capex incurred towards setting of a nuclear power plant is around Rs6cr/MW

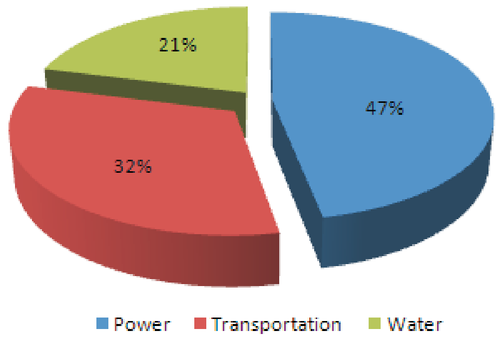
Capex incurred towards setting of a nuclear power plant is around Rs6cr/MW. The optimistic target of 40GW power generation by 2020 entails a capital outlay of Rs2,40,000cr. Pertinently, the civil construction component in a nuclear power plant accounts for nearly 35% of the total capex. However, we expect order inflow for the nuclear civil construction players to materialise post FY2010. HCC commands 35% share in this segment translating into Revenue visibility of Rs29,400cr ie. Rs2,940 per year FY2010 onwards *(till 2020, assuming HCC is able to maintain its market share at 35%).*

The sailing through of the Indo-US deal, HCC's dominant position on account of its technical expertise along with the upcoming opportunity renders strong visibility for order inflows from the nuclear power generation segment. This instills strong confidence in us about HCC's Revenue visibility from nuclear power generation post FY2010.

Robust Order book position

HCC has a strong order book of Rs8,184cr excluding the Rs1,940cr Sawalkote project in J&K. Further, HCC is L1 in orders worth Rs4,924cr. Of the total Order book, 35% constitutes Star Rated contracts, fixed priced contracts account for 10% of the order book while the balance 55% is linked to the WPI. The Power, Transportation and Water Supply sectors are the main contributors to HCC's Order book. Power contributes 47%, Transportation 32% and Water Supply contributes 21% to HCC's total Order book.

Exhibit 10: Order book segmentation



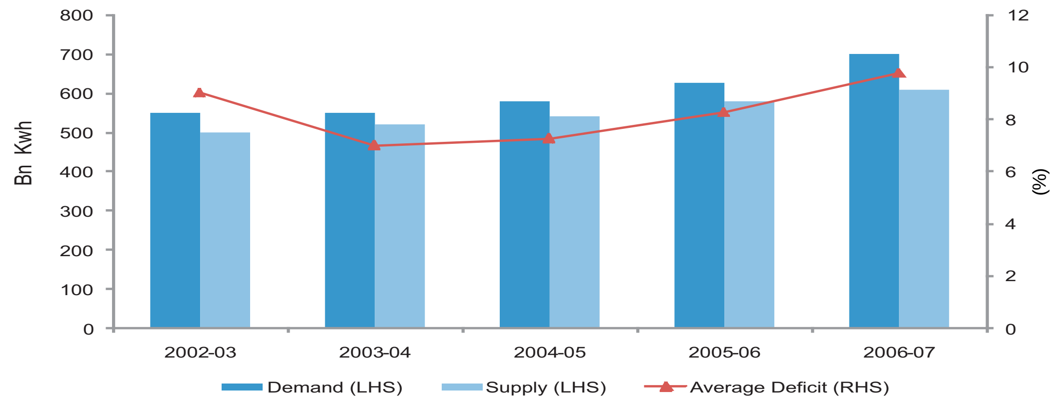
Source: Company, Angel Research

Investments in Hydro Power & Irrigation segments to bolster Revenues

In the Hydro Power segment, HCC specialises in the construction of vital components including construction of dams, head and tail race tunnels and power houses. Execution of a hydro power plant takes 4-5 years depending on the terrain and quantum of work to be done.

Total Capacity addition of 78,577MW is envisaged during the Eleventh Plan against the backdrop of India's growing power demands and average power deficit of around 10%. Power being the back-bone of industrial growth, it is important to invest in the development of power resources. Of the planned capacity addition of 78,577MW, 23% is expected to come from hydro sources, 73.5% from Thermal power plants and the rest would be accounted by Nuclear power generation.

Exhibit 11: Power - Demand Supply mismatch



Source: Cris-Infac, Angel Research

The National Hydro Policy estimates India's hydro power potential at around 148GW

In the current scenario of the total installed capacity of around 143GW, hydro power accounts for 26% which is primarily concentrated in the North and North-Eastern regions of India owing to ample availability of hydel resources. However the share of hydro power has continuously been declining during the last three decades from 44% in 1970 to 26% in 2008. Ideally, the hydro-thermal mix should be in the ratio of 40:60. Hydro developments have been hampered by technical (difficult investigation, inadequacies in tunneling methods), financial (deficiencies in providing long term financing) and managerial (poor contract management) constraints. The National Hydro Policy estimates India's hydro power potential at around 148GW. This is indicative of the vast potential that is waiting to be exploited.

Hydro power stations have the inherent ability to instantaneous start, stop, have load variations, which improves reliability of the power system

Nonetheless, hydro power stations have the inherent ability to instantaneous start, stop, have accommodate load variations, etc., which improves reliability of the power system. Hydro power stations are the best to meet the peak demand. Besides, generation cost is also inflation free and it reduces with time. Hydroelectric projects have a long and useful life extending over 50 years. Overall, the focus has been on developing hydro power in India due to these inherent advantages of hydro power projects. In line with this, of the total power generation capacity of 78,577MW envisaged in the Eleventh Plan, hydro power accounts for 15,585MW or 20% of the total planned capacity.

Following capacity additions during the Eleventh Plan, we estimate contribution of hydro power to total power generation to remain at current levels of 26%. However, this is way off the mark of the desired 40:60 hydro-thermal power mix and emphasizes the need to ramp up hydro power generation.

Excellent execution capabilities coupled with rich experience makes HCC a strong contender to tap this vast potential and bridge the demand-supply mismatch.

Bandra-Worli Sea Link

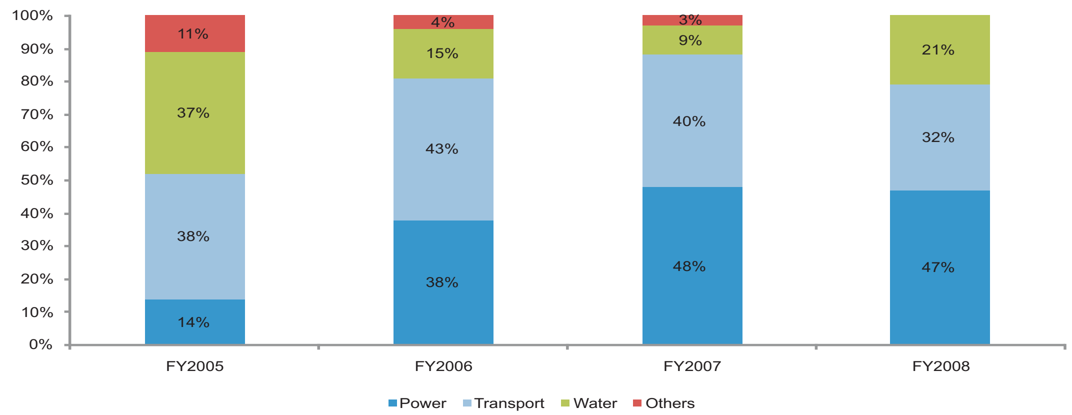
HCC is currently executing the Bandra-Worli Sea Link project. There were differences between client, the Maharashtra State Road Development Corporation (MSRDC) and HCC with respect to the project cost due to design changes and time delays. However, recently, the Maharashtra government approved Rs157cr towards design changes as against HCC's claim of Rs237cr. Even so, HCC proposes to complete the project by January 2009. The company has already provided for losses to the tune of Rs250cr in the project. Management has also indicated that they do not need to provide for further losses. We believe resolution of the matter is a positive development for the company.

Financial Performance

Strong Order book ensures Revenue visibility

HCC's Order book comprises orders bagged from the Power, Transportation and the Water segment in proportion of 47%, 32% and 21%, respectively. Orders in the Hydro Power segment are lumpy in nature. The company expects to see an increase in the order inflow moving on to FY2012. In FY2009, the company does not expect to have major order inflow being an election year.

Exhibit 12: Order book composition trend



Source: Company, Angel Research

HCC has now ventured into the Road BOT segment where substantial orders are expected to be released over the next six months

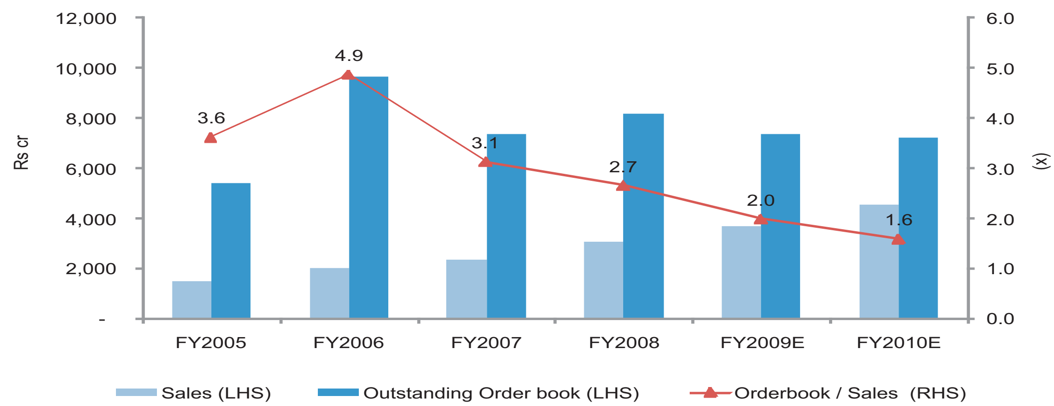
However, HCC has now ventured into the Road BOT segment where substantial orders are expected to be released over the next six months. Our talks with management indicated that the company has already bid for 15 projects and expects to secure 2-3 projects aggregating around Rs2,000cr to its Order book by FY2010. Also, following the NSG waiver and potential signing of the Indo-US nuclear deal, we see activity on the nuclear power front to pick up. However, nuclear power related order inflows would fructify post FY2010. Further, HCC is at L1 stage for orders worth Rs4,924cr, which will help it improve its Order book / Sales ratio going ahead. On the back of healthy order book position of Rs8,184cr we estimate the company to post CAGR of 20% in Revenues over FY2008-10E.

Exhibit 13: Order Intake, Execution Trend

Particulars	FY2005	FY2006	FY2007	FY2008	FY2009E	FY2010E
Opening Order Book	3,980	5,381	9,672	7,372	8,184	7,345
Net Additions	2,888	6,278	58	3,895	2,864	4,419
Execution	1,487	1,987	2,358	3,083	3,704	4,549
Outstanding Order book	5,381	9,672	7,372	8,184	7,345	7,215

Source: Company, Angel Research

Exhibit 14: Sales, Order book Trend

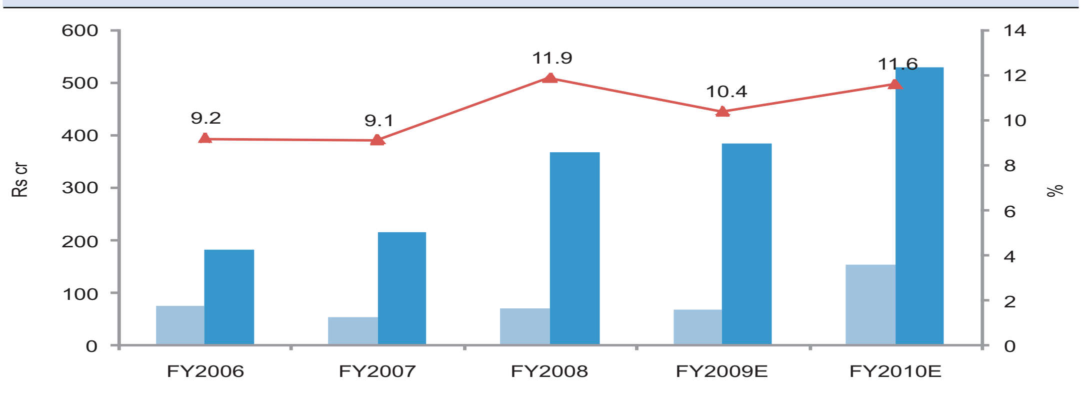


Source: Company, Angel Research

Pressure on Margins

Raw material prices, especially of steel, bitumen and cement, have a high bearing on the EBITDA Margin of infra players. Prices of steel and bitumen have ytd risen by 17% and 34%, respectively. Factoring the rise in commodity prices, we expect HCC to record a decline in EBITDA Margins in FY2009. Moreover, we expect effects of declining commodity prices to get reflected only in FY2010. The infra players have seen their woes compound on the back of spiraling interest costs too which has been on account of monetary tightening by the RBI. Increase in financial expenses has impacted Profitability of the players at the Net level. As a result we expect HCC to grow at mere 20% CAGR on the bottomline front over FY2008-FY2010E

Exhibit 15: Financial Indicators



Source: Company, Angel Research

Concerns

Rise in financing costs to depress Net Margins

Infrastructure is a capital intensive (for fixed and working capital needs) business with high gestation periods. Inherent nature of the business requires regular cash infusion to maintain growth. HCC, with a high debt/equity of 1.8x is highly leveraged with low interest coverage ratio of 1.9x, which we believe could be detrimental in the current high interest rate regime. Also, if HCC's Balance Sheet gets further stretched and there are delays in expected cashflows, it could be a negative for the company. Moreover, a highly leveraged Balance Sheet along with subdued capital markets not only makes it difficult to infuse the much needed capital to further growth but there is the added burden of servicing debt. We believe this could pose a risk to our Earnings estimates. However, HCC is one of the oldest players in the infra space and has been receiving investor support over a period of time, which is evident from the fact that Axis Bank has invested in its Lavasa project. Hence, we believe that HCC will be successful in raising the required sum via equity/debt.

Infrastructure sector fraught with Execution risks

The much hyped Bandra-Worli Sea Link (BWS) project has been delayed endlessly on account of which it has seen cost overruns. BWS is basically a cash contract project undertaken by HCC. The project got delayed to accommodate requests of the local fisherman leading to cost overruns, which impacted HCC's Profitability. This project is an excellent example of unforeseen risks that could derail project execution. Infrastructure projects getting de-railed due to unforeseen circumstances most often than not result in time and cost overruns and in turn impact overall Profitability.

Slowdown in Real Estate

Real Estate is cyclical in nature. Hence, any slowdown in the Real Estate market could hamper project ramp ups and adversely impact HCC's Revenue growth and in turn Cash flows. Real Estate contributes 45% to our Target Price. Hence, any slowdown in this segment could pose downside risk to our estimates. However, we have been conservative in most of our assumptions relating to valuation of Real estate segment.

Outlook and Valuation

In the current scenario of rising inflation and subsequent attempts made by the RBI to curb it by monetary tightening, the Infrastructure sector is plagued by rising interest rates. This is detrimental to the companies in Infrastructure space, which are highly capital intensive. In such times when fears of rising financial costs loom large over infra companies it makes all the more sense to encash on built up experience and expertise and move on to related segments where opportunity beckons. HCC exemplifies this by its recent foray into Road BOT space where a slew of orders are expected to be released over the next six months. This huge quantum of orders to be released in the Road development space re-instates our belief that investment in infrastructure is the need of the hour. We believe that though macro economic conditions, in the short term, may not be all that conducive, HCC's foray into the Road BOT segment would be value accretive in the medium to long term along with its esteemed project in the Real Estate domain - Lavasa.

We have valued HCC on SOTP methodology. We have assigned a revised PE of 10x FY2010E Earnings (12x assigned earlier) for its core Construction business on account of the current market turmoil and expected slowdown in growth and have valued it at Rs59/share. The Real Estate business, on NAV basis, fetches Rs53/share. The Road BOT segment has been valued on DCFE basis at Rs5/share. At Rs81, the stock is attractively trading at 9x FY2009E and 4x FY2010E Earnings post adjusting for BOT and Real Estate. **We maintain a Buy on the stock, with a revised Target Price of Rs117 (Rs140).**

Profit & Loss Statement

Rs crore

Y/E March	FY2007	FY2008	FY2009E	FY2010E
Net Sales	**2,358**	**3,083**	**3,704**	**4,549**
% chg	*18.7*	*30.8*	*20.1*	*22.8*
Total Expenditure	2,142	2,716	3,318	4,022
EBIDTA	**215.2**	**366.7**	**385.2**	**527.7**
(% of Net Sales)	*9.1*	*11.9*	*10.4*	*11.6*
Other Income	10.6	-	25.0	30.0
Depreciation& Amortisation	79.7	96.2	115.2	124.2
Interest	62.0	152.4	211.9	201.9
PBT (Before extra ordinary items)	**93.5**	**118.1**	**83.1**	**231.6**
(% of Net Sales)	*4.0*	*3.8*	*2.2*	*5.1*
Extraordinary Expense/(Inc.)	(24.4)	(38.0)	38.0	-
Tax	38.6	47.2	14.9	76.4
(% of PBT)	*41.3*	*40.0*	*17.9*	*33.0*
PAT	**79.2**	**108.8**	**30.2**	**155.2**
% chg	*(35.6)*	*37.3*	*(72.2)*	*413.2*
(% of Net Sales)	*3.4*	*3.5*	*0.8*	*3.4*
ADJ. PAT	**54.8**	**70.8**	**68.2**	**155.2**
% chg	*(28.9)*	*29.1*	*(3.7)*	*127.4*
(% of Net Sales)	*2.3*	*2.3*	*1.8*	*3.4*

Balance Sheet

Rs crore

Y/E March	FY2007	FY2008	FY2009E	FY2010E
SOURCES OF FUNDS				
Equity Share Capital	25.6	25.6	26.4	26.4
Reserves& Surplus	878.4	978.4	981.2	1247.2
Shareholders Funds	**904.1**	**1004.1**	**1007.5**	**1273.6**
Total Loans	1551.1	1844.9	2181.8	2187.7
Deffered Tax Liability	85.5	113.3	113.3	113.3
Total Liabilities	**2540.7**	**2962.2**	**3302.6**	**3574.6**
APPLICATION OF FUNDS				
Gross Block	1101.2	1409.7	1659.7	1809.7
Less: Acc. Depreciation	355.0	456.6	571.8	696.0
Net Block	**746.2**	**953.1**	**1087.9**	**1113.7**
Capital Work-in-Progress	151.3	67.5	108.8	111.4
Investments	**228.6**	**295.5**	**485.7**	**485.7**
Current Assets	2306.2	2710.1	2897.0	3395.9
Current liabilities	891.6	1064.0	1276.8	1532.1
Net Current Assets	**1414.6**	**1646.1**	**1620.2**	**1863.8**
Mis. Exp. not written off	0.0	0.0	0.0	0.0
Total Assets	**2540.7**	**2962.2**	**3302.6**	**3574.6**

Cash Flow Statement

Rs crore

Y/E March	FY2007	FY2008	FY2009E	FY2010E
Profit before tax	75.3	156.0	45.1	231.6
Depreciation	79.7	96.2	115.2	124.2
Change in Working Capital	369.8	175.5	(124.9)	65.9
Direct taxes paid	20.8	47.2	14.9	76.4
Cash Flow from Operations	**(235.6)**	**29.5**	**270.3**	**213.5**
Inc./ (Dec.) in Fixed Assets	372.2	224.8	291.3	152.6
Free Cash Flow	**(607.8)**	**(195.3)**	**(21.0)**	**60.9**
Inc./ (Dec.) in Investments	102.2	66.9	190.2	0.0
Issue of Equity	(4.2)	0.0	0.8	136.0
Inc./(Dec.) in loans	260.0	293.8	337.0	5.8
Dividend Paid (Incl. Tax)	(22.5)	(24.0)	(26.2)	(27.8)
Others	321.0	(48.4)	1.3	(2.7)
Cash Flow from Financing	**(189.9)**	**251.3**	**120.0**	**116.8**
Inc./(Dec.) in Cash	(797.7)	56.1	99.0	177.7
Opening Cash balances	1006.0	208.3	264.4	363.4
Closing Cash balances	208.3	264.4	363.4	541.2

Key Ratios

Y/E March	FY2007	FY2008	FY2009E	FY2010E
Per Share Data (Rs)				
FDEPS	2.1	2.8	2.6	5.9
Cash EPS	5.2	6.5	7.0	10.6
DPS	0.8	0.8	0.9	0.9
Book Value	35.3	39.2	38.2	48.3
Operating Ratio (%)				
Raw Material / Sales (%)	31.4	31.5	36.0	36.5
Inventory (days)	269.2	253.8	228.1	208.6
Debtors (days)	0.1	0.5	0.4	0.4
Debt / Equity (x)	1.7	1.8	2.2	1.7
Returns (%)				
ROE	6.1	7.1	6.8	12.2
ROCE	5.3	9.1	8.2	11.3
Dividend Payout	35.0	28.9	32.9	15.3
Valuation Ratio (x)				
P/E	37.9	29.3	31.3	13.8
P/E (Cash EPS)	15.4	12.4	11.7	7.6
P/BV	2.3	2.1	2.1	1.7
EV / Sales	1.5	1.4	1.1	0.8
EV / EBITDA	15.9	11.4	10.1	7.1

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