

STOCK DATA

Market Capitalisation	Rs32bn
Book Value per share	Rs39
Eq Shares O/S (F.V. Rs.10)	256mn
Median Vol. (12 mths)	2.1mn (BSE+NSE)
52 Week High / Low	Rs265/95
BSE Scrip Code	500185
NSE Scrip Code	HCC
Bloomberg Code	HCC IN
Reuters Code	HCNS.BO

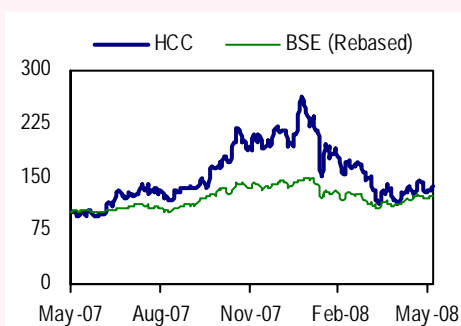
SHAREHOLDING PATTERN (%)

Qtr. Ended	Sep-07	Dec-07	Mar-08
Promoters	47.0	47.0	47.0
MFs/FIs	17.3	17.4	17.4
FII's/NRI's/OCBs	14.0	13.5	11.9
PCBs	8.2	10.1	10.8
Indian Public	13.6	12.2	13.2

STOCK PERFORMANCE (%)

	1M	3M	12M
Absolute	(13.2)	(15.5)	25.0
Relative	(3.2)	(13.3)	14.4

STOCK PRICE PERFORMANCE



Incorporated in 1926, Hindustan Construction Company (HCC) is a construction major with significant presence in power, transportation, marine projects, water supply & irrigation etc. The company has undertaken construction for ~20% of India's installed hydel power capacity and ~57% of installed nuclear power capacities.

It has also forayed in real estate development and boasts of a landbank of ~14k acres. Around 12.5k acres is accounted for by Lavasa, its marquee real estate project, touted as India's first private hill station. It has recently formed a subsidiary which will bid for BOT/BOOT projects in transportation, power and airports verticals.

HCC was awarded the prestigious Bandra-Worli Sea Link (BWSL) project in 2001. The project faced substantial time and cost overruns due to environmental issues causing contraction of margins during FY05-FY07. However, the company has not booked any losses on BWSL since Q1FY08. The management has indicated that no further losses will be booked and expects to complete the project by Jul'09. This has given to a boost to HCC's margins in FY08. Another important development is that MSRDC has recommended recovery of the cost of BWSL through the extension of BWSL to Worli Haji Ali Sea Link.

We expect a healthy pick up in order book over the next couple of years, especially in sectors like irrigation and hydel power. Consequently, HCC should be able to sustain better margins in core construction business. Additionally, its real estate business is expected to add substantial value on the back of Lavasa, which has received a good response during its recent soft launch. We initiate coverage with a 'BUY' recommendation with an one year price target of Rs175.

INVESTMENT RATIONALE

- We expect net sales to grow at 26% CAGR to Rs47.4bn in FY10 on the back of a healthy order book. With no additional losses in BWSL, OPM is expected to remain in the 11.7%-12% range. Better operating performance should see net profit grow at a CAGR of 42% to Rs1.5bn in FY10.
- We have valued HCC using the SOTP method at Rs175/share where the core construction business is valued at 14x FY10E EPS of Rs5.8. At CMP of Rs125, the stock offers a potential upside of 40%.

KEY FINANCIALS					(Rs Mn)	
Yr Ended (March)	Net Sales	YoY Gr (%)	Op Profits	Op Marg (%)	Net Profits	Eq Capital
2006	19,870	33.6	1,829	9.0	1,248	256
2007	23,576	18.7	2,153	9.0	793	256
2008	30,828	30.8	3,666	11.9	1,088	256
2009E	38,539	25.0	4,512	11.7	1,006	256
2010E	47,402	23.0	5,555	11.7	1,519	264

KEY RATIOS						
Yr Ended (March)	EPS (Rs.)	ROCE (%)	RONW (%)	P/E (x)	EV/Sales (x)	EV/EBDIT (x)
2006	3.1	9.8	20.1	38.6	1.7	17.7
2007	2.0	7.3	8.8	60.5	1.9	18.8
2008E	2.7	10.2	11.4	45.7	1.5	13.1
2009E	3.8	11.5	9.6	31.8	1.3	10.9
2010E	5.8	13.1	12.5	21.7	1.1	9.2

HCC (erstwhile Premier Construction Co. Ltd.) was incorporated by Seth Walchand Hirachand in 1926 and became a public limited company in 1939. Post the split of the Walchand Group in 1993, the company came under the control of Mr. Ajit Gulabchand, who is the current CMD.

HCC for decades has been a pure construction player with focus on providing integrated construction services...

HCC is actively engaged in all the major segments of the construction sector. Its strength lies in heavy engineering areas, especially in the power sector (hydel, thermal & nuclear). HCC boasts of a strong team of 2,600 skilled personnel including 1,900 engineers. The company constructed more than 550 technically complex & high value projects and has several 'firsts' to its credit. Some of the landmark projects awarded to HCC are the Tala Hydroelectric Power Project (Bhutan), Kudankulam Nuclear Power Project & Tirupur Water Supply Scheme (Tamil Nadu), NH6 in West Bengal & Bandra Worli Sea Link Project (Mumbai). For a list of key projects executed, please refer to annex.1

Over the years, HCC has tied up with leading construction companies for specific project. These include overseas partners like Skanska (Sweden), Itochu (Japan), Kumagai Gumi (Japan) & Samsung (S.Korea) as well as Indian companies like Kirloskar Brothers, L&T & Sadbhav Engineering Ltd. The same has enabled it to enhance its technical capabilities as well as bid for large volume projects, which demand stringent pre qualification criteria, besides a track record of having implemented projects of large magnitude. For a list of HCC's JVs please refer to annex.2

CORE BUSINESS SEGMENTS

HCC has successfully executed complex infrastructure projects, which have long gestation periods, are capital intensive & require high technical capabilities. Over the years, it has executed several projects spanning diverse segments. The following is a brief overview of its core business segments:

POWER

Hydroelectric Power Projects: HCC has played a key role in the development of the hydro-power sector in India. The company has constructed over 42 dams & barrages as well as 13 power houses, which account for ~20% of India's installed hydro power capacity. Its scope of work includes providing construction services for the entire civil segment involving dams, barrages, tunnels, underground & surface power stations, systems like surge shafts, pressure shafts and penstocks etc.

HCC's foray in the segment commenced with the construction of an underground powerhouse at Maithon, Bihar in 1954. Since then, its contribution to hydropower is 4300MW from 5 surface powerhouses (550MW) and 7 underground powerhouses (3750MW). The total length of tunneling projects executed stands in excess of 135kms.

Thermal Power Projects: HCC has constructed 18 thermal power projects (diesel & coal based) & 3 gas based power projects. It undertakes the complete range of civil works including earthwork, piling, pump house, heavy foundations, main structures, cooling towers, chimneys etc.

Nuclear Power Projects: HCC possesses strong technical know-how in construction of nuclear power projects. It was the first construction company to undertake civil engineering works for PHWR (Pressurized Heavy Water Reactor) type nuclear power projects in India, the first in the series being Units 1 & 2 (235MW each) at Kota, Rajasthan, in 1965. Since then, HCC has constructed 3 more nuclear plants.

Power projects, especially Hydel power projects, have been HCC's mainstay businesses...

Out of the total 4kMW of installed nuclear power capacity in India, HCC has carried out ~ 57% of the construction work. Currently it is constructing reactor buildings for the country's largest nuclear power plant; the 2000MW Kudankulam Nuclear Power plant (Tamil Nadu).

Water supply, irrigation and transportaion occupy an important role in HCC's gameplan going forward...

TRANSPORTATION

HCC also undertakes construction of bridges, roads & expressways and MRTS under this segment. Since its inception, the company has built more than 200 roads & 100 railway bridges in addition to over 1k kms of highway construction (which includes a segment of the renowned Mumbai - Pune Expressway Project in Maharashtra). Further, it has to its credit the MRTS projects for Kolkata & Delhi Metro, executed on an EPC basis.

MARINE

HCC covers a range of activities like construction of jetties, berths, harbors, docks, breakwaters & sea links. The company entered the marine segment by laying the first submarine pipeline in India, 3.5m below the seabed near Mumbai in the early '50s. Since then, it has executed many projects prominent among them being Asia's largest Breakwater Project at Ennore.

WATER SUPPLY & SANITATION

HCC has an extensive experience in executing water supply projects. The company has built over 7 dams & 18 major barrages throughout the country. It has also built 13 aqueducts since '50s & executed over 115 environmental projects ranging from water treatment to sewage treatment plants.

CIVIL CONSTRUCTION

The company executes civil and structural works for various industries in the core sectors viz. cement, steel, petrochemical, fertilizers, automobiles etc. It also undertakes civil construction jobs, mostly for commercial projects. It has constructed a number of plants/buildings across the country, prominent projects being the RBI Building (Nagpur), SAIL's steel plant (Bhilai) & the paper boards factory for ITC (Tamil Nadu) etc.

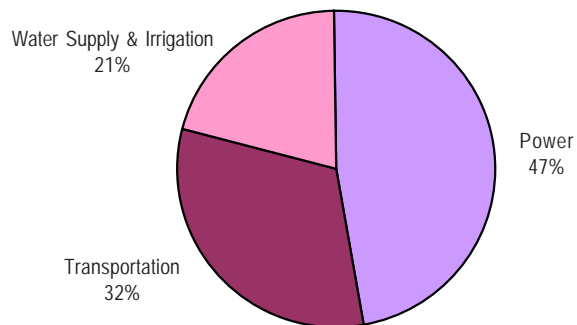
ORDER BOOK ANALYSIS:

HCC's order book as on Mar'08 stood at Rs101.6bn (USD2.5bn). The same stood at Rs90.5bn as on Dec'07. The company has received a fresh order of Rs3.8 bn in Q4FY08. It has also received incremental work in some of its existing orders to the tune of Rs 17.8bn. These include Rs 1.6bn cost escalation granted by MSRDC in the BWSL project and ~Rs3bn incremental work in the Godavari Lift Irrigation Scheme Project (original value of the order Rs18bn).

HCC's current order book is at Rs101.6bn with power projects accounting for a major chunk at 47%...

HCC's strong presence in the power segment is visible as 47% of the FY08 orderbook comes from power projects. Transportation accounts for 32% of the orderbook while water supply and irrigation make up the remainder.

FY08 order book break-up

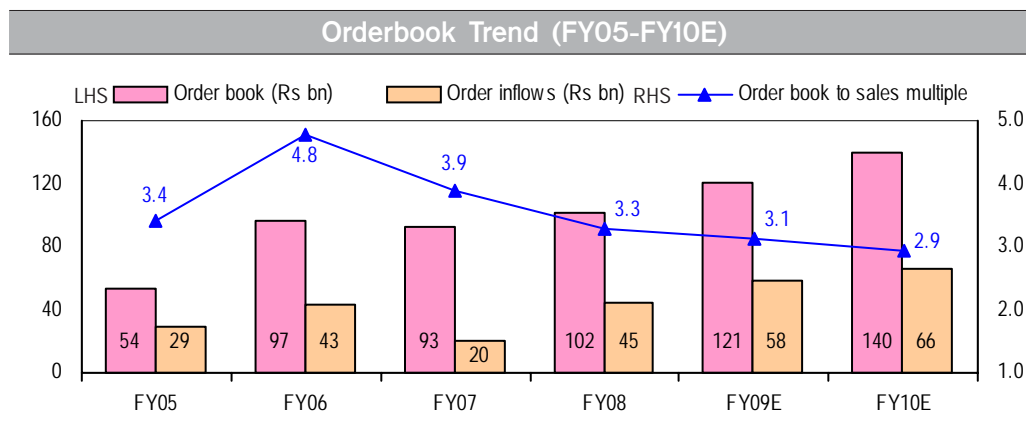


Source: Company

ORDER BOOK TREND:

Orderbook as on FY08 grew at 9.1% YoY while the same has registered a 23% CAGR from FY05-08. This growth was achieved on back of order inflows in the power segment (mainly hydel power projects). HCC is L1 in 3 projects worth Rs37.8bn. It has submitted 4 tenders for orders worth Rs25.7bn. Also ~25 tenders are under submission for orders totaling Rs246.6bn.

The following chart shows the orderbook trend for FY05-10E period:



Source: Company

Decision awaited on the Sawalkote hydropower project (J&K):

HCC's orderbook includes Rs19.4bn Sawalkote hydropower project where the J&K government has suspended the work and invited rebidding. HCC has formed a JV with SPAS, Norway and Ozaltine, Turkey to execute the project. The JV has filed a suit in J&K high court to revoke the suspension of work contracted. HCC's management expects decision on the case in the ensuing quarters. Any adverse decision in this case could affect HCC's financials.

REAL ESTATE BUSINESS:

HCC operates its real estate business through its 100% subsidiary *HCC Real Estate Ltd.* (HREL). The company boasts of a large land bank of ~14k acres spread across Mumbai Metropolitan Region, Pune & Nashik. A brief snapshot of the major ongoing reality projects is given below:

HREL boasts of a landbank of ~14k acres, with project Lavasa contributing ~12.5k acres...

Proposed Real Estate Projects		
Projects	Land Bank (acres)	Dev. Area (mn sq.ft.)
Lavasa	12,500	150.0
Vikhroli West IT Park	11	1.8
Res. Project in Mumbai (SRS)	12	1.4
Vikhroli East (SRS)	41	4.5
Township in MMR	183	1.6
SEZ/Township in Nashik	1,000	21.8
Township in Pune	230	5.0
Total	13,977	186.0

Source: Company

1. Lavasa:

Conceptualized as the first private sector hill station

Located in the western mountain ranges between Mumbai & Pune, Lavasa is part of the 25k acres of land declared as "Hill Station", built around the 20kms long Warasgaon Lake. Its design is based on a model, wherein, the development of the Hill Station begins from a densely populated town center and gets sparser as it goes uphill.

Lavasa, envisaged as the first private sector hill station, sets the tone for HCC's ambitious real estate foray...

While the master plan has been made by HoK, USA; project branding is done by Landor, Hong Kong. Post completion of the project, HCC expects a permanent population of 1.5 lakh and a tourist population of ~2mn pa.

The development is planned across three town centers and is targeted towards the upwardly mobile segment. With most of the infrastructure work being complete, the focus now is on developing residential & commercial space. Lavasa will be developed into an integrated hub involving development of IT parks, convention centres, educational institutes as well as plots, apartments, villas, shopping malls, multiplexes etc.

HCC's economic interest stands at 65%

Lavasa Corp. Ltd. (LCL) is developing Lavasa as an integrated township spread over 12.5k acres. HREL, a 100% subsidiary of HCC holds a 65% stake in LCL. Avantha Group, Venkateshwara Hatcheries and some private real estate developers together hold the remaining equity.

Has seen an interest to the tune of Rs4.9bn so far

A recent soft launch of Lavasa has seen an interest in properties worth Rs4.9bn ...

LCL launched Phase I in Oct'07 and pre-sold around 400 bungalows & apartments in Dasve town center. The bookings made at Rs2,450/sq.ft. for apartments & Rs3,150/sq.ft. for villas enabled LCL to book properties worth Rs4.9bn for FY08.

Phase 1 to be executed by FY11 and the entire project to be executed by 2022

LCL plans to execute the entire project by 2022, divided over three phases. Phase I will comprise of 1684 acres. Construction of the first phase is currently taking place as scheduled. Phase II will be spread over 5,552 acres and phase III will span over 5,264 acres. LCL has acquired 7,559 acres land and another 2,147 acres has been tied up through agreements.

Lavasa site map



Tie ups announced so far:

LCL has entered into MoUs & JVs with renowned entities across the globe for entailing tourism, hospitality & educational development at the location. Some of the current tie-ups include names like University of Oxford, GDST (UK), Apollo Hospitals, Novotel, Grand Mercure Hotel & Spa, Symbiosis etc.

Lavasa Tie Ups So Far	
Tie up	Remark
ITC Fortune	60 room hotel
Accor	Novotel- 150 room hotel in Phase I
Accor	Grand Mercure-250 room hotel in Phase II
Apollo Hospitals	150 bed hospital, 200 acres wellness centre
University of Oxford	will set up a business school
Lausanne hospitality consulting	Hospitality training institute
Girl's Day School Trust	Manages 27 public schools in the UK which also include Oxford School. Will set up an international school.
Symbiosis Institute, Pune	has taken up 60 acres to build an MBA institute
Christ College, Bangalore	will set up a college by 2010

Source: Company

'247 IT park' launched in Mar'08 will soon see HCC delivering its first commercial development ...

2. 247 IT park-Vikhroli (W): The construction on the ~2mn sqft IT park at Vikhroli (W) is in full swing. The same is expected to be completed by Dec'08 & revenues from lease rentals are expected to be booked in Q4FY09. We expect lease rentals to be in the range of Rs55-60/sqft pm.

3. Slum Redevelopment: HREL has decided to re-develop 15 acres of land owned by the company at Vikhroli (E). It has also entered into an agreement with a land owner to redevelop another parcel measuring 25 acres. Both these projects would be executed under Slum Redevelopment Scheme.

4. Other projects: HREL plans to build townships over an aggregate area of ~1.5k acres in MMR, Pune & Nashik, for which land acquisitions are underway.

RESTRUCTURING OF BUSINESSES

HCC has 3 separate SBUs to streamline its various business segments.

1. Core construction business: It will remain housed in HCC. The construction business is further divided into 5 segments viz. Hydel Power, Nuclear Power, Thermal projects, Transportation, Water.
2. Real estate: For Real estate business, the company has formed a 100% subsidiary-HREL.
3. Infrastructure development business: It is now housed in a separate company HCC infrastructure Ltd. (HIL). HIL already has two BOT projects. The details of which are as follows:
 - a. *Pune Paud road project:* This stretch of road leads to Lavasa, from Chandani Chowk, Pune. The total cost of the project is ~Rs300mn (D:E of 6.5:1).
 - b. *Kadta-Armur highway project:* This is a BOT annuity road project connecting Kadta and Armur (Andhra Pradesh) by means of a 30km, 4-lane highway. The project costing Rs2.75bn is being funded in a D/E ratio of 4:1. The project will see semi annual receipts of Rs238mn spread over 36 installments (18 years) starting from FY10.

HCC will increasingly focus on real estate business and infrastructure business alongside the core construction business...

HCC has been a late entrant in the PPP (Public Private Partnership Projects) arena through the BOT/BOOT projects route and currently has only a couple of projects under its belt. However, it has identified roads, airports, power as the major growth drivers where it is pursuing suitable opportunities. In its Q4FY08 analyst meet, HCC has already revealed that it stands L1 in one BOT project. (details for the same are awaited).

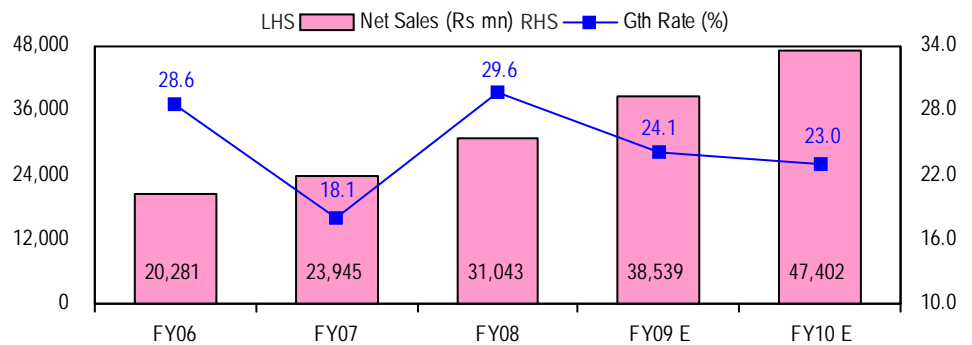
PERFORMANCE OVERVIEW (STANDALONE)

HCC reported revenues of Rs10.6bn in Q4FY08 (+ 28% YoY) excluding share in turnover of JVs. Consumption of materials as % of sales was lower by 190bps to 29.3%. Construction expenses rose 24% to Rs4.9bn and the same were at 47% (as a % of sales) compared to 48% in Q4FY07. Other expenses were stable at Rs355mn. Lower material expenses and construction costs coupled with stable other expenses led to a strong 369 bps margin expansion in Q4FY08 to 12.4%. Additional funding for the Lavasa & BWSL projects resulted in higher interest outflow (Rs452mn). Depreciation expenses rose by 13% to Rs275mn on account of purchase of new construction equipment. Profit before extraord. item grew 44% to Rs348mn due to better operating performance and also lower effective tax rate. However, mark to market losses on FCCBs at Rs84mn adversely impacted net profit , which fell 28% YoY to Rs264mn.

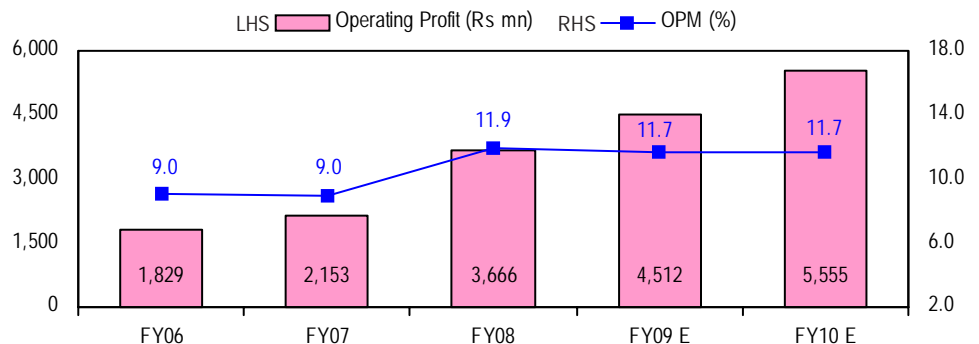
With stemming of losses from BWSL, HCC posted improved OPM and better results for FY08...

For FY08, revenues grew 31% to Rs30.1bn. OPM was higher by 282 bps at 11.8% due to lower construction expenses (as a % of sales) at 43% compared to 46% in FY07. HCC posted no losses on account of the troubled BWSL project post a Rs200mn loss in Q1FY08. This also helped in boosting the margins. Net profit (after adjusting for mark to market FCCB gains of Rs387mn) rose 37% to Rs1.1bn.

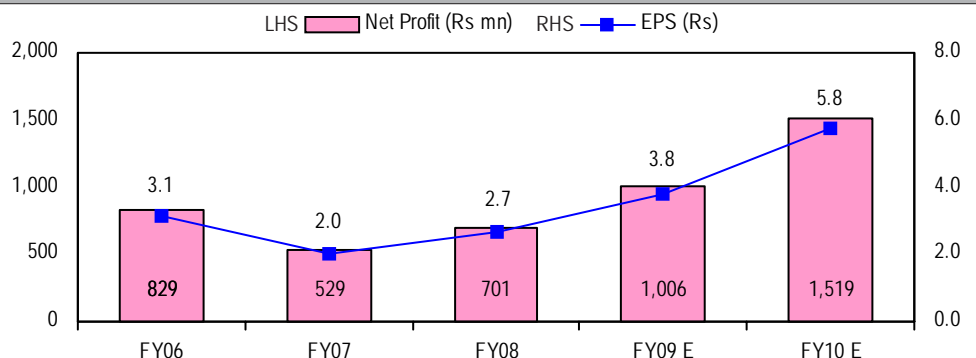
Net Sales & Growth Trend



Operating Profit & OPM Trend



Net Profit & EPS Trend



Subdued order book..

HCC's current order book stands at Rs101.6bn, where the project portfolio varies across hydel, nuclear, transportation & water supply and irrigation segments. However, the growth in its order book (9.1% YoY) is lower in comparison to its peers and it received only 1 fresh order worth Rs3.8bn in Q4FY08. Also, the current order book includes a Rs19.4bn Sawalkote hydel power project order, work on which can commence subject to a favorable judgment in a suit filed in the J&K high court.

..however order inflows are expected to pick up in FY09

We believe most of the L1s (Rs37.8bn) would materialise in FY09 and correspondingly the order book should grow by 19% to Rs 121 bn in FY09. Order inflows are expected to pick up significantly in FY09 by 30% to Rs 58bn (44.7bn in FY08). We estimate the order book to register a CAGR of 14.5% to 139.6 bn in FY07-FY10E period. The growth in order book would largely be riding on a healthy increase in water supply and irrigation segment orders coupled with the rise in power segment order backlog .

Revenue growth expected to be in the range of 26% CAGR

HCC's revenues grew 18% in FY07 and 31% in FY08. As execution of power projects gathers momentum, we believe that HCC will clock ~26% CAGR in sales in the FY07-FY10 period.

Increasing contribution from high margin power segment..

~47% of the current order backlog comprises of orders from the power segment. Typically, power projects yield better margins in the range of 14-15% compared to ~7-9% in transportation and ~12% in water supply & irrigation.

..hence margins expected to improve going forward

With no further losses being booked on account of the Bandra Worli Sealink project and the proportion of power projects in its sales moving up, we estimate HCC's OPM to move from 9% in FY07 to ~11.7% in FY09 and FY10.

Better visibility on BWSL completion and losses arising out of the same

MSRDC (Maharashtra State Road Development Corporation) awarded the project to HCC in 2001. The project involves construction of an 8 lane, 4 km concrete bridge between Bandra Fort and Worli Sea Face. The project had an initial timeline of 30 months with a project cost of Rs4bn. However, the project got delayed due to environmental issues leading to cost and time overruns. The cost escalated by ~Rs3.5bn.

HCC had booked losses to the tune of Rs2.5bn till Q1FY08. BWSL losses has depressed OPM (>10%) during the period FY05-FY07. Work on the project resumed in Q3FY08 after which MSRDC approved an additional compensation of ~Rs1.6bn, against HCC's demand of Rs2.4bn in addition to interest thereon of ~Rs1.5bn. For the remaining amount, HCC has entered into arbitration proceedings. HCC expects the project to be partially operational by Jan'09 and has indicated that no further losses will be booked.

MSRDC (Maharashtra State Road Development Corp.) set to recover cost of the BWSL through the proposed Worli Haji Ali Sea Link (WHSL)

Recently, MSRDC invited bids for a four lane 3.4 km sea link between Worli and Haji Ali with an estimated cost of Rs14bn. The WHSL will be an extension of the BWSL. The successful bidder will have to pay Rs16bn as the cost of BWSL. The contractor would recover this upfront payment through collection of toll, over 30 years. The proposed scheme would thus take care of funding the escalated costs of BWSL. If this were to fructify, HCC's final losses can be much lower than what it has booked so far. Consequently, HCC may write back losses in FY09/FY10 as the project nears completion (partial completion by Jan'09 and full completion by Jul'09). However, we have not factored the same in our estimates.

With an L1 of Rs37.8bn expected to materialise in FY09, HCC's orderbook should witness a healthy growth...

With MSRDC agreeing to pay Rs1.6bn as an additional compensation, HCC expects no further losses in the BWSL project...

Encouraging response for Lavasa, but a challenge as a commercial hub

Launched in Oct'07, Lavasa has seen interest in properties worth Rs4.9bn. Around 400 villas/apartments were on offer ranging from Rs1mn to Rs15mn and the response was encouraging. A second round of offer will be opened for booking in Oct'08. LCL is developing the entire township including infrastructure like approach roads and utilities. We believe that it could emerge as a hill station housing theme parks, hotels, wellness centres and educational institutes.

HCC further wants to establish Lavasa as a commercial hub. While it will definitely attract holiday home investments and be known as a tourist destination, we are sceptical about its acceptance as a commercial hub. However, the fact that it is ~60kms from Pune (~80-minutes drive from Hinjewadi covering a distance of ~50kms) can rule out regular commute from Pune to Lavasa. Also, the project has a long gestation period and can be subject to delays.

VALUATIONS AND RECOMMENDATION

We have valued HCC as per SOTP method which takes into account the potential value of each business stream/project.

Construction business

We expect net sales to grow at 26% CAGR to Rs47.4bn in FY10 on the back of a healthy order book. With HCC booking no more losses on BWSL, the OPM is expected to remain in the 11.7%-12% range. We have been conservative in our OPM expectation due to steep rise in commodities prices. Better operating performance (v/s OPM in FY05-07) should see the net profit grow at a CAGR of 42% to Rs1.5bn in FY10 leading to an EPS of Rs5.8 for FY10E. We value the core construction business at 14x FY10E EPS, contributing a value of Rs81/sh.

Lavasa valuation

As per our DCF calculation, Lavasa has a potential value of Rs68/share. While the company expects to execute the project over next 12-14 years, we have taken a longer execution period of ~20 years. Also we expect 10-15% price correction in the realty market of Pune in FY09, which will weigh down on Lavasa sales in the short term. Lavasa is a very long gestation project. Consequently, we have given a discount of 20% to Lavasa's value and add Rs54/share to over SOTP valuation.

Key assumptions for Lavasa valuation are:

1. We have assumed a sale model for the area available
2. Cost of acquisition of land at Rs0.1mn/acre
3. We have taken a capital value of Rs2700/sqft for sale of residential development. For land/plot sales we have assumed a rate of Rs100/sqft. We expect a price correction in the neighbouring Hinjewadi area over the next 12-18 months. Consequently, we have not escalated the selling prices for both residential development and plots/land till FY10. From FY11 we have escalated capital values at ~5% CAGR.
4. Construction cost at Rs 1200/sqft, escalated at 5% CAGR from FY08 onwards.
5. Infrastructure cost of Rs9.5bn in phase 1
6. Tax rate of 30%
7. Discount rate of 14%

Backed by a healthy order book, we expect a 41% CAGR in HCC's net profits over FY07-FY10E period...

As per DCF calculation we have valued project Lavasa at Rs28bn...

'247 Park'Vikhroli (W) IT Park:

We have valued this 1.7mnsqft IT park assuming

1. lease rentals of Rs60/sqft pm.
2. construction cost of Rs2k/sqft
3. capitalisation rate of 9%

We arrive at a value of Rs5.4bn for '247 Park'. This works out to a per share value of Rs20.6.

SRS in Vikhroli(E) and Powai

Assumptions for 11 acres SRS in Vikhroli and 15 acres SRS in Powai

1. Rehab. cost of Rs1k/sqft
2. Realisation of Rs6.5k/sqft for the saleable component.
3. Discount rate of 15%
4. Execution till FY11

Both the projects put together should yield a value of Rs9.1/sh.

Landbank of 1,400 acres

Apart from realty projects mentioned above, HCC has built a landbank of ~1.4k acres.

Since there is no immediate visibility on the proposed projects on this land, we have valued the same at cost i.e.Rs2bn (as indicated by the management).

Recommendation:

Inspite of being one of the oldest existing construction companies in the country, HCC has been overtaken by companies like Nagarjuna, IVRCL, Gammon etc. on parameters like orderbook, profitability etc. Also, the substantial time/cost overruns in a prestigious project like BWSL has significantly dented its profitability in the recent past.

However, with more clarity emerging on BWSL, we expect HCC's profitability to improve. Also as mentioned before, order flows are expected to pick up in the coming quarters.

HCC's foray in real estate will play a crucial role in shaping its financial performance. This is evident from the fact that Lavasa forms ~31% of our SOTP valuation. Our SOTP valuation puts HCC's value at Rs175/share, where the core construction business is valued at 14x FY10E EPS of Rs5.8.

At CMP of Rs125, the stock offers a potential upside of 40%. We initiate coverage with a 'BUY' recommendation and a price target of Rs175 on an one year time horizon.

HCC offers a potential upside of 40% as per our SOTP valuation at Rs175/sh...

SOTP valuation		
Segment	Valuation Method	Value Rs/sh
HCC standalone	FY10E EPS Rs5.8 x 14PE	80.6
Lavasa	as per DCF valuation	54.1
Vikhroli IT park	at 9% cap rate	20.6
BOT projects	as per 1.2x P/BV method	2.7
SRS in Powai and Vikhroli	as per NAV method	
covering 25 acres	Disc rate 15% and assumed execution till FY11	9.1
1,400 acres Land	At book value Rs2bn	7.6
Total value per share		175
CMP		125.0
Potential upside		39.8%

Source: PINC, company

Concerns

The escalation in the prices of key raw materials like steel and cement could severely impact HCC's margins. The management indicates that majority of the contracts have escalation clauses for key raw materials. Around 40% of the contracts are covered fully for the actual escalation in raw material prices. The remaining contracts have raw material prices linked to certain indices. This could result in a dip in margins in the event of a sharp jump in raw material prices.

While Lavasa will be a landmark project for the company, any slowdown in the property sales could put strain on HCC's balance sheet.

The company has outstanding FCCB of ~USD100mn at a conversion price of Rs248.1/share with conversion option till Feb'11. Since the FCCBs are substantially out of the money (CMP Rs125), non conversion of FCCBs could strain its leverage.

Peer comparison					
Rs mn (Cons.FY10E)	Gammon India	IVRCL	Jaiprakash	Nagarjuna	HCC
Revenues	38,250	64,757	83,762	70,468	47,402
Op. Profit	3,474	6,161	21,967	7,430	5,555
Net Profit	1,682	3,767	10,891	3,820	1,519
OPM%	9.1	9.5	26.2	10.5	11.7
EPS (Rs)	19.4	27.9	8.4	15.9	5.8
P/E	21.2	13.6	23.9	11.4	21.7
CMP (Rs)	411	380	201	182	125

Source: Bloomberg, PINC

INFRASTRUCTURE INVESTMENT OPPORTUNITY:

Following table shows the infrastructure building requirement in the 11th five year plan (FY08-FY12) across segments according to a study by a government committee on infrastructure. As is shown by the table, power, transportation and irrigation segments will see substantial capital outlays, benefiting construction majors like HCC.

Planned Infrastructure Investments (11th five year plan)	
Segment	Amount (Rs bn)
Private investment in roads	340
Express way development	2,200
Railways (Public)	1,800
Railways (Private)	1,200
Civil aviation	400
Ports (Private)	500
Freight corridor	220
Power generation	4,200
JNNURM	600
Housing	1,500
Others	1,600
Total	14,560

Source: 11th Five Year Plan, working group report

The construction sector in India, is in a high growth phase, primarily fuelled by infrastructural and industrial development...

Given below is a brief description of opportunities available in main business segments of HCC.

POWER

India with a power generation capacity of 141GW, produced 699bn kwh in FY08 as compared to 659.5bn kwh in FY07. This represented a growth of 6% over the last year. India ranks 5th in electricity generation capacity in the world. It also possesses a Transmission & Distribution network of 6.8mn circuit kms, the 3rd largest in the world. However, the per capita consumption is lower at 612 units; about one third of China. ~54% of the installed generation capacity is constituted by coal-fired plants, followed by 25% from hydel power, 10% from gas based plants, 3% from nuclear energy and 8% from renewable sources.

Even with a low per capita consumption, there is a large demand-supply gap for power in India. All India average electricity shortfall stands at 10% and peak demand shortfall stand at 14-15%. Some states like Maharashtra alone face a peak shortage of as high as 28% (~4,972MW).

This creates large opportunities in generation for:

- Coal based plants at pithead or coastal locations (imported coal)
- Natural Gas/CNG based turbines at load centres or near gas terminals
- ~100,000 MW untapped hydel power potential as assessed by GoI
- Renovation, modernisation, up-rating and life extension of old thermal and hydro power plants.

There are opportunities in distribution segment through bidding for the privatisation of distribution in 13 states that have unbundled/corporatised their SEBs. Transmission network represents significant opportunities with additional ~60k circuit kms of transmission network expected by 2012. This is expected to bring large orders for construction companies over the next 2-3 years.

All in all, power sector represents an investment opportunity of about USD200bn over a seven year horizon.

Opportunity available in hydel power (HCC's core business segment)

In terms of hydel power potential, India ranks 5th in the world with an estimated potential of ~1,48,700 MW. So far it has developed only 21.1% of the same and another 9.6% is under development. The 11th five year plan envisages a capacity addition of ~16,553MW which forms ~21% of the total planned power capacity addition. Following table shows the statewise/regionwise hydel power potential.

We estimate that HCC could bag significant orders in the forthcoming hydel projects since there is limited competition in this segment from players like Patel Engg, Gammon.

Hydel power: Potential in India						
	Potential (mw)	Developed		Under devpt.		CEA cleared potential (mw)
		(mw)	(%)	(mw)	(%)	
North	53,395	13,002	24.4	7,488	14	10147.5
Haryana	64	62	97.5	0	0	0
Himachal Pradesh	18,820	6,086	32.3	4,435	24	2,811
Jammu & Kashmir	14,146	1,864	13.2	899	6.4	2,297
Punjab	971	1,298	100	0	0	50
Rajasthan	496	430	86.7	0	0	0
Uttaranchal	18,175	2,752	15.1	2,154	12	4,990
Utter Pradesh	723	510	70.6	0	0	0
West	8,928	5,719	64.1	465	5.2	980
Gujarat	619	555	90	0	0	0
Goa	55	0	0	0	0	0
Madhya Pradesh	2,243	2,374	106	465	21	920
Chattisgarh	2,242	137	6	0	0	60
Maharashtra	3,796	2,653	70	0	0	0
South	16,458	9,062	55.1	854	5.2	222
Andhra Pradesh	4,424	2,018	46	404	9	59
Karnataka	6,602	3,448	52	230	3	0
Kerala	3,514	1,839	52	160	5	163
Tamil Nadu	1,918	1,758	92	60	3	0
East	10,949	2,389	21.8	2,751	25.1	3,314
Jharkhand	753	237	32	0	0	0
Bihar	70	45	64	0	0	0
West Bengal	2,841	157	6	292	10	405
Orissa	2,999	1,862	62	150	5	9
Sikkim	4,286	84	2	2,309	54	2,900
North East	58,971	1,203	2	2,684	4.6	2,456
Assam	680	375	55	0	0	0
Arunachal Pradesh	50,328	424	1	2,600	5	600
Manipur	1,784	105	6	0	0	1,566
Meghalaya	2,394	185	8	84	4	0
Nagaland	1,574	99	6	0	0	0
Mizoram	2,196	0	0	0	0	290
Tripura	15	15	100	0	0	0
India	148,701	31,375	21.1	14,242	9.6	17,120

Untapped hydel power potential stands at more than 100k MW in India...

Source: Ministry of Power, Crisinfac

TRANSPORTATION - ROAD SECTOR

The Government of India spends about Rs180bn annually on road development.

India has an extensive road network of 3.3mn kms, second largest in the world. The same carries ~65% of the freight and ~80% of the passenger traffic. The number of vehicles has grown at an average pace of 10.2% p.a. over the last five years.

The National Highway Development Project (NHDP) is at an advanced stage of implementation. Key projects under the NHDP include:

- The Golden Quadrilateral (GQ-5,846kms of 4 lane highways)
- North-South & East-West Corridors (NSEW-7,300kms of 4 lane highways)

Being implemented in 4 phases I,II, IIIA and V, phase I&II are scheduled to be completed by Dec'08. Phase IIIA is scheduled for completion by Dec'09. Phase V envisages 6 laning of certain stretches and ~148kms have already been awarded for 6 laning.

A program for 4-laning of about 14,000kms of National Highways is already underway.

Following table gives a latest update on the progress of NHDP and also shows the opportunity available under NHDP.

NHDP & Other NHAI Projects (Status :30th April , 2008)

	NHDP					Port Connv'ty	Others	Total by NHAI
	GQ	NS - EW Ph. I & II	NHDP Phase III	NHDP Phase V	NHDP Total			
Total Length (Kms)	5,846	7,300	12,109	6,500	31,755	380	962	33,097
Already 4-laned (kms)	5,669	2,208	428	-	8,305	175	516	8,996
Under implementation (kms)	177	4,113	1,647	1,030	6,967	199	426	7,592
Contracts under imlementation (Nos.)	22	146	31	7	206	8	15	229
Balance length for award (kms)	-	821	10,034	5,470	16,325	6	20	16,351

Source: NHAI

WATER SUPPLY & IRRIGATION

As per a CrisInfac estimate, irrigation construction investment is pegged to grow to Rs288bn in the two year period FY08-FY09 from Rs261bn in the previous two year period FY06-FY07. States like Andhra Pradesh, Karnataka, Gujarat, Maharashtra etc. are taking the lead in investments in the irrigation sector. While state governments take the tab for funding the projects, Govt. of India chips in funds through the Accelerated Irrigation Benefit Program (AIBP). Also, Centre provides 35-50% funding under the JNNURM (Jawaharlal Nehru National Urban Renewal Mission) for water supply projects in urban area.

Annexures

Key Completed Projects

Project	Contractee	Value (Rs mn)
Transportation		
Kaliabhomora Bridge, Assam	N.F.Railway, Assam	1,348
Mumbai Pune Expressway Project, Maharashtra	MSRDC Ltd.	3,503
West Bengal Road Project	NHAI	3,457
New Metro Railway Project, Kolkata	Metro Railway	6,360
Delhi Metro Rail Project	Delhi Metro Rail Corporation	9,379
Water Supply & Irrigation		
Farakka Barrage Project, West Bengal	Farakka Barrage Division	5,909
Hathnikund Barrage, Chandigarh	Haryana Irrigation Deptt.	3,042
Iduki Dam, Kerala	Kerala State Electricity Board	3,366
Salal Dam, Himachal Pradesh	National Hydroelectric Power Corp.	4,277
Haldia Dock Complex Project, West Bengal	Calcutta Port Trust	5,226
Power		
Chamera Hydroelectric Project, Himachal Pradesh	National Hydroelectric Power Corp.	2,095
Tala Hydroelectric Project, Bhutan	THPA Gedu, Bhutan	7,300
Nathpa Jhakri Hydroelectric Project, HP	Nathpa Jhakri Power Corporation	5,457
Koyna hydel Project, Maharashtra	Irrigation Deptt., Koyna	6,084

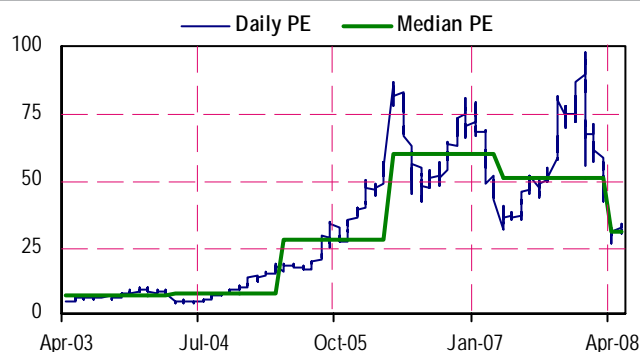
HCC JV Details

Project	Name of JV Partner
Ennore Breakwaters, Tamil Nadu	Van Oord ACZ BV, Netherlands
Godavari Rail Bridge, Andhra Pradesh	M/S Bureau BBR, Switzerland
Nathpa Jhakri Hydro-electric Project, HP	Impregilo SPA, Italy
Naini - Allahabad Bridge, UP	Hyundai Engineering & Construction Co. Ltd., Korea
Delhi Metro Project	Kumagaigumi Co. Limited & Itochu Corp, Japan; Skanska Civil Engineering AB, Sweden
East-West Road Corridor Project, Rajasthan	M/s. Continental Engineering Corporation, Taiwan
Highway projects for NHAI	Alfred McAlpine International, UK, and John Laing International, UK
Purulia Pumped Storage, West Bengal	Larson & Toubro Ltd

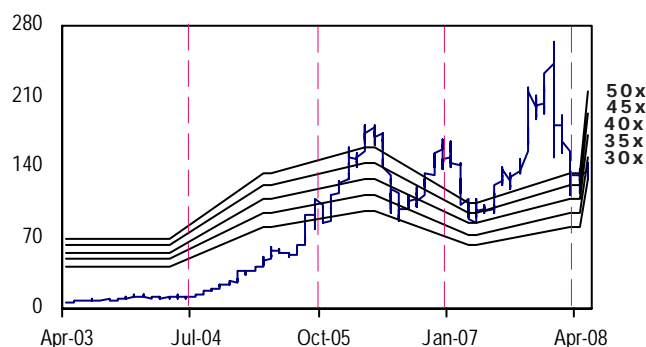
Financial Results for the quarter & year ended Mar'31, 2008 (Standalone)

Particulars (Rs Mn)	Quarter Ended			Year Ended		
	31/03/08	31/03/07	Gr %	31/03/08	31/03/07	Gr %
Net Sales	10,550	8,277	27.5	30,828	23,576	30.8
Sales	10,717	8,476		31,043	23,945	
Less: Share of Turnover in JVs	167	199		216	369	
Total Expenditure	9,240	7,555	22.3	27,162	21,424	26.8
Consumption of Materials	3,087	2,579	19.7	9,711	7,406	31.1
Personnel Expenses	851	614	38.6	2,972	2,087	42.4
Construction Expenses	4,948	4,003	23.6	13,339	10,964	21.7
Other expenses	355	359	(1.2)	1,140	967	17.9
Operating profit	1,310	722	81.4	3,666	2,153	70.3
Other Income	(15)	154	(109.9)	(7)	266	(102.7)
PBDIT	1,295	876	47.7	3,659	2,419	51.3
Interest	452	212	113.0	1,524	620	145.9
Depreciation	275	244	12.8	962	797	20.8
PBT & extra-ordinary items	568	420	35.0	1,173	1,003	17.0
Provision for current tax	220	93	136	472	269	76
Provision for deferred tax	-	78		-	178	
Fringe benefits	-	7		-	26	
PAT before extra-ordinary items	348	242	43.8	701	529	32.4
Translation gains/losses	(84)	125		387	176	
Provision for earlier years	-	(425)		-	(338)	
Add/(Less): Transfer from G.R. 2	-	425		-	425	
Net Profit	264	367	(28.0)	1,088	793	37.2
Equity Capital (F.V. Rs 1)	256	256		256	256	
Reserves (excl. rev. res.)	-	-		9,632	8,785	
EPS for the period (Rs)	1.4	0.9		2.7	2.1	
Book Value (Rs)	-	-		37.6	34.3	
OPM (%)	12.4	8.7		11.9	9.0	
NPM (%)	3.3	2.9		2.3	2.2	
Expenditure (% of Net Sales)						
Consumption of Materials	29.3	31.2		31.3	30.9	
Personnel Expenses	8.1	7.4		9.6	8.7	
Construction Expenses	46.9	48.4		43.0	45.8	
Other expenses	3.4	4.3		3.7	4.0	

Median PE v/s Daily PE



PE Band



Income Statement	2005	2006	2007	2008	2009E	2010E
Revenues	14,873	19,870	23,576	30,828	38,539	47,402
<i>Growth (%)</i>	<i>40.6</i>	<i>33.6</i>	<i>18.7</i>	<i>30.8</i>	<i>25.0</i>	<i>23.0</i>
Total Expenditure	13,315	18,041	21,424	27,162	34,027	41,847
Operating Profit	1,559	1,829	2,153	3,666	4,512	5,555
Interest & dividend income	56	61	23	-	20	20
EBIDT	1,597	1,921	2,419	3,659	4,532	5,575
(-) Interest	395	414	620	1,524	1,919	2,041
(-) Depreciation	453	525	797	962	1,088	1,233
PBT & extraordinary items	750	983	1,003	1,173	1,525	2,301
(-) Tax provision	63	153	473	472	518	782
Add/(Less) extraord. item	53	419	264	387	-	-
Net Profits	740	1,248	793	1,088	1,006	1,519
Fully diluted Eq. sh. O/s (mn no)	229	256	256	256	256	264
Book Value (Rs)	15	35	35	39	42	51
Basic EPS (Rs)	3.0	3.2	2.1	2.7	3.9	5.8
Diluted EPS (Rs)	2.6	3.1	2.0	2.7	3.8	5.8

Balance Sheet	2005	2006	2007	2008	2009E	2010E
<i>Equity Share Capital</i>	229	256	256	256	256	264
<i>Reserves & Surplus</i>	3,300	8,642	8,785	9,632	10,414	11,702
Net worth	3,530	8,898	9,041	10,041	10,822	13,484
Total Debt	4,257	11,959	15,511	18,449	20,199	21,949
Deferred Tax liability	725	677	855	1,133	1,133	1,133
Capital Employed	8,511	21,534	25,407	29,622	32,154	36,566
Fixed Assets	4,380	5,995	8,974	10,206	11,218	12,195
Net current assets	2,232	14,275	14,146	16,461	17,181	20,616
Investments	1,899	1,265	2,286	2,955	3,755	3,755
Total Assets	8,511	21,534	25,407	29,622	32,154	36,566

Cash Flow Statement	2005	2006	2007	2008	2009E	2010E
PBT & Extraord. items	750	983	1,179	1,560	1,525	2,301
Depreciation	453	525	797	962	1,088	1,233
Interest & dividend inc.	(27)	(72)	(227)	(52)	(20)	(20)
Interest paid	420	484	837	1,575	1,919	2,041
Tax paid	(289)	(454)	(388)	(329)	(518)	(782)
Other Adjustments	14	373	(151)	(304)	-	-
(Inc)/Dec in working capital	849	(2,870)	(7,662)	(1,580)	(494)	(2,822)
Cash from operations	2,169	(1,031)	(5,615)	1,832	3,500	1,951
Net capital expenditure	(1,110)	(2,125)	(3,784)	(2,323)	(2,100)	(2,210)
Net investments	(1,413)	862	(1,205)	(710)	(800)	0
Interest recd	31	72	116	153	20	20
Cash from investing activities	(2,491)	(1,191)	(4,873)	(2,880)	(2,880)	(2,190)
Issue of eq. shares	1,270	4,325	-	-	-	8
Change in Loans	42	7,686	3,536	3,200	1,750	1,750
Eq. Dividend paid	(100)	(136)	(179)	(191)	(225)	(231)
Interest paid	(423)	(467)	(846)	(1,553)	(1,919)	(2,041)
Cash from financing activities	790	11,407	2,512	1,456	(394)	(514)
Inc/(Dec) in cash	468	9,186	(7,976)	408	226	(753)

Key Ratios	2005	2006	2007	2008	2009E	2010E
EBIDT (%)	9.9	9.0	9.0	11.9	11.7	11.7
ROACE (%)	18.4	9.8	7.3	10.2	11.5	13.1
ROANW (%)	28.6	20.1	8.8	11.4	9.6	12.5
Sales/Total Assets (x)	185.2	94.2	94.2	104.8	119.9	129.6
Debt:Equity (x)	1.2	1.3	1.7	1.8	1.9	1.6
Current Ratio (x)	1.4	2.8	2.6	2.5	2.4	2.3
Debtors (days)	1	-	-	1	-	-
Inventory (days)	158	206	292	284	245	241
Net working capital (days)	51	253	213	191	160	157
EV/Sales (x)	2.0	1.7	1.9	1.5	1.3	1.1
EV/EBIDT (x)	20.1	17.7	18.8	13.1	10.9	9.2
P/E (x)	41.7	38.6	60.5	45.7	31.8	21.7
P/BV (x)	8.1	3.6	3.5	3.2	3.0	2.4

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