

Mid Cap
 Construction & Engineering
 Equity – India

Overweight (V)

Target price (INR)	122.00
Share price (INR)	98.50
Potential total return (%)	25.2

Performance	1M	3M	12M
Absolute (%)	5.3	-30.2	-44.7
Relative ^A (%)	-0.6	-28.4	-52.9

Index^A BOMBAY SE IDX

RIC HCNS.BO
 Bloomberg HCC IN

Market cap (USDm) 614
 Market cap (INRm) 25,230

Enterprise value (INRm) 32696
 Free float (%) 100

Note: (V) = volatile (please see disclosure appendix)

Hindustan Construction

FY07 full year result

- ▶ **HCC FY07 result was disappointing with top line growth of 20% and PAT decline of 4.4%**
- ▶ **The delay in execution, higher interest and tax rate have impacted the overall profit growth**
- ▶ **Reducing FY08e and FY09e, profit by 11% and 7% to incorporate higher interest rate, staff cost and depreciation. Reducing our price target to INR122 from INR134. Maintain Overweight(V)**

Delay in execution impacted the Full year growth

FY07 result summary

HCC declared their full year number with sales growth of 19% to INR23.6bn (vs HSBC estimate of INR24.3bn). The PBT was up 20% yoy, however, higher tax rate (additional INR220mn due to removal of 80IA benefit) has resulted in decline in a profit to INR793mn (vs HSBC estimates of INR857mn). The lower sales growth has been due to the excessive snowfall and rain at some of its project sites resulting in project execution delay. The net profit growth was impacted by higher staff cost (up 59%), higher interest (50%), and depreciation cost (up 52%, capex of INR3.8bn).

Changing estimates

We have changed our FY08e and FY09e estimates to incorporate lower sales growth, higher interest rate and rising depreciation. We have reduced our FY08e and FY09e profit by 11% and 7% to INR1.18bn and INR1.56bn respectively. We have reduced our FY08e sales by 4% to INR30.7bn, while increasing the sales of FY09e marginally. We now estimate HCC to report EPS of INR4.6 and INR6.1 for FY08e and FY09e. We have also introduced FY10e estimates for the company.

Valuation and target price

We continue to value the core construction business at 15x FY08e and based on our new estimates, we value the core construction business at INR69 per share (vs INR81 previously). We maintain our real estate business valuation, which add another INR53 per share. We haven't included HCC other real estate projects in Mumbai, Nashik and Pune in the valuation primarily because these projects are in the very initial stage. Based on this we arrive at a target price of INR122 (vs INR134 per share previously). Key risks: Delay in execution, rising interest rate and staff cost, delay in the real estate project.

30 April 2007

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Issuing office: Mumbai

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Financials & valuation

Financial statements

Year to	03/2007a	03/2008e	03/2009e	03/2010e
Profit & loss summary (INRm)				
Revenue	23,576	30,694	37,499	44,106
EBITDA	2,153	2,935	3,734	4,499
Depreciation & amortisation	-797	-900	-1,109	-1,157
Operating profit/EBIT	1,356	2,034	2,625	3,342
Net interest	-620	-722	-768	-1,033
PBT	1,179	1,761	2,329	2,784
HSBC PBT	1,179	1,761	2,329	2,784
Taxation	-386	-581	-768	-919
Net profit	793	1,180	1,560	1,865
HSBC net profit	793	1,180	1,560	1,865

Cash flow summary (INRm)

Cash flow from operations	-569	894	2,261	3,020
Capex	-3,630	-1,500	-1,000	-600
Cash flow from investment	-7,130	-2,000	-1,500	-1,100
Dividends	-219	-364	-364	-364
Change in net debt	8,342	1,470	-397	-1,559
FCF equity	-4,642	-1,054	790	1,946

Balance sheet summary (INRm)

Intangible fixed assets	0	0	0	0
Tangible fixed assets	8,828	9,428	9,319	8,763
Current assets	19,483	20,106	22,714	25,013
Cash & others	3,718	747	644	703
Total assets	33,075	34,798	37,798	40,040
Operating liabilities	8,372	10,780	13,084	15,322
Gross debt	14,978	13,478	12,978	11,478
Net debt	11,260	12,731	12,334	10,775
Shareholders funds	9,048	9,863	11,059	12,563
Invested capital	16,221	18,006	18,306	17,750

Ratio, growth and per share analysis

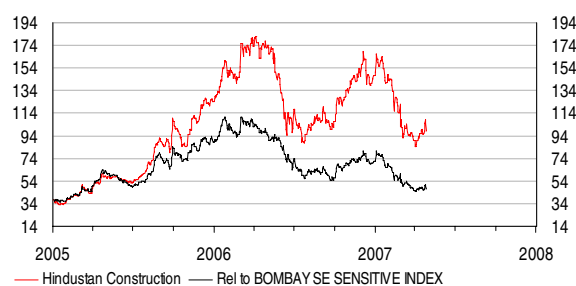
Year to	03/2007a	03/2008e	03/2009e	03/2010e
Y-o-y % change				
Revenue	18.7	30.2	22.2	17.6
EBITDA	17.7	36.3	27.2	20.5
Operating profit	4.0	50.0	29.0	27.3
PBT	-15.9	49.3	32.3	19.5
HSBC EPS	-4.4	48.8	32.3	19.5
Ratios (%)				
Revenue/IC (x)	1.7	1.8	2.1	2.4
ROIC	6.6	8.0	9.7	12.4
ROE	8.8	12.5	14.9	15.8
ROA	3.8	4.9	5.7	6.6
EBITDA margin	9.1	9.6	10.0	10.2
Operating profit margin	5.8	6.6	7.0	7.6
EBITDA/net interest (x)	3.5	4.1	4.9	4.4
Net debt/equity	124.5	129.1	111.5	85.8
Net debt/EBITDA (x)	5.2	4.3	3.3	2.4
CF from operations/net debt		7.0	18.3	28.0
Per share data (INR)				
EPS reported (fully diluted)	3.09	4.60	6.09	7.28
HSBC EPS (fully diluted)	3.09	4.60	6.09	7.28
DPS	0.75	1.25	1.25	1.25
NAV	35.31	38.49	43.16	49.02

Valuation data

Year to	03/2007a	03/2008e	03/2009e	03/2010e
EV/sales	1.3	1.1	0.8	0.7
EV/EBITDA	14.7	11.1	8.5	6.6
EV/IC	2.0	1.8	1.7	1.7
PE*	31.8	21.4	16.2	13.5
P/NAV	2.8	2.6	2.3	2.0
FCF yield (%)	-22.7	-5.3	4.1	10.3
Dividend yield (%)	0.8	1.3	1.3	1.3

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 27 Apr 2007

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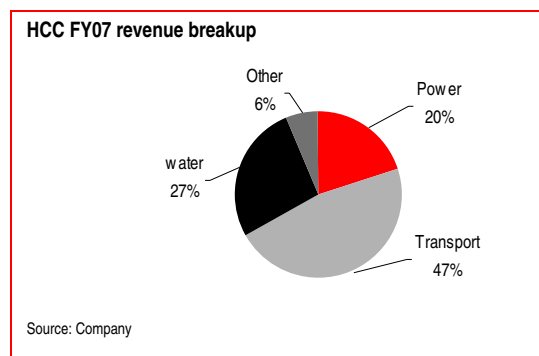
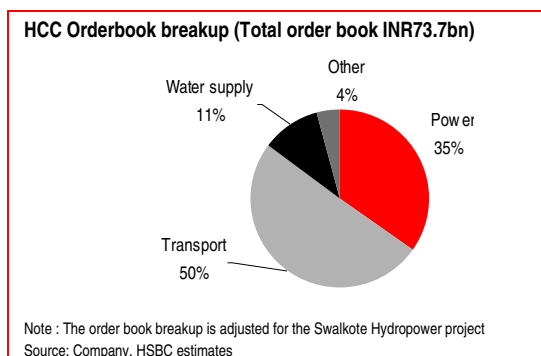
FY07 result

Execution delay impacted the full year

HCC declared their full year results with sales growth of 19% to INR23.6bn (vs HSBC estimates of INR24.3bn). The lower sales growth has been due to the excessive snowfall impacting HCC's Uri and Chamera Hydel power projects. Also, the excessive rain fall in Andhra Pradesh impacted the execution of the Godavari irrigation project in the 3QFY07. The PBT margin was impacted due to higher staff cost (up 59%) and higher interest (50%) and depreciation cost (up 52%, capex of INR3.8bn). The PBT was up 20% yoy. Also, the higher tax rate due to the removal of 80IA benefit (INR220mn) has resulted in a decline in profit to INR793mn (vs HSBC estimates of INR857mn). The company has provided for INR710mn for the Bandra Worli sealink project for FY07.

Orderbook and order inflow

The current order book for the company is INR73.7bn, c3xFY07 revenue (after excluding the INR19.4bn Swalkote Hydropower project). Power (48% of order book) and the transport sector form the major part of the order book in FY07. The order inflow in the last year has been INR21.5bn. However, we expect that this will improve this year with the company already the lowest bidder (L1) in 5 projects valued at INR19.3bn.



Real estate business under development phase

Lavasa Project

The major portion of the land acquisition (9,000 acres acquired and 1,500 acres acquired by the Government) for the Lavasa project has been completed. The company is expected to launch the first phase of Lavasa by October 2007. HCC is expected to spend another INR3bn in the development of the Lavasa projects, part of which would be funded through debt (cINR2bn). It has already spent INR6bn for the project. HCC has signed an agreement with Starwood Hotels & Resorts International (owner of Sheraton and Le Meridien brand) to manage two hotel properties, a 250 room luxury hotel with a 150,000 square feet of convention centre and another 250 resort rooms, at Lavasa. It has also agreed with Accor hotel to build two hotels with a total capacity of 400 rooms.

Another project

HCC has started the construction of mn square feet Vikhroli (West) Corporate Park, which is expected to be completed by December 2008. Regarding HCC's other real estate projects, the land acquisition as well as the process for getting required approval are in progress. The company has already acquired

c100 acres of land for the township project and has paid INR500mn. We have included only the Vikhroli West Corporate Park in our valuation. We would wait for further clarity on the other projects to value these projects.

Land Details of HCC Real Estate Projects

Project	Land (acres)	Development (mn sft)
Lavasa	12500	150
Vikhroli (West) Mumbai IT/Corporate Park	11	1.7
Residential project in Powai, Mumbai	10	1
Residential project in Vikhroli (East), Mumbai	15	1
Township in Mumbai Metropolitan Region*	200	6
SEZ/Township in Nashik*	1000	20
Township in Pune*	300	6
Total	14036	186

Source: Company, * Land under acquisition

Changing Estimates

We have changed our FY08e and FY09e estimates to incorporate lower sales growth (4% in FY08e), higher interest rate and rising depreciation. We have reduced our FY08e and FY09e profit by 11% and 7% to INR1.18bn and INR1.56bn respectively. We have reduced our FY08e sales by 4% to INR30.6bn, while increasing the sales of FY09e marginally. We expect that the investment made during the last year in terms of resource mobilisation and initial cost incurred at various project sites will help HCC report revenue growth as well as higher profit growth in FY08e and FY09e. We now estimate HCC will report EPS of INR4.6 and INR6.1 for FY08e and FY09e. We have introduced FY10e estimates for the company.

Estimate change table

	Sales			EBIDTA			PAT		
	New	Old	% change	New	Old	% change	New	Old	% change
FY08e	30694	32023	-4%	2935	3052	-4%	1180	1324	-11%
FY09e	37499	36932	2%	3734	3601	4%	1560	1685	-7%

Source: HSBC estimates

Valuation

We have valued HCC using a sum-of-the-parts method, with the core construction business valued using a multiple valuation method. We have valued the real estate business using the current market value of land bank and estimated profit from the project.

Sum of the part Valuation

Particulars	Basis	Value per share
Core construction business	15x FY08e multiple	69
Lavasa Project	Land value less development cost	45.0
Vikhroli Projects		14.2
Total Value		122
Upside from current level		23.9%
Dividend yield		1.3%
Total potential return		25.2%

Source: HSBC estimates

Risk

Key challenges to the business include execution and arbitration risk. The real estate venture adds to the risks. Other challenges include the possibility of a potential rise in raw material prices and scarcity of skilled human capital.

Disclosure appendix

Analyst certification

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Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

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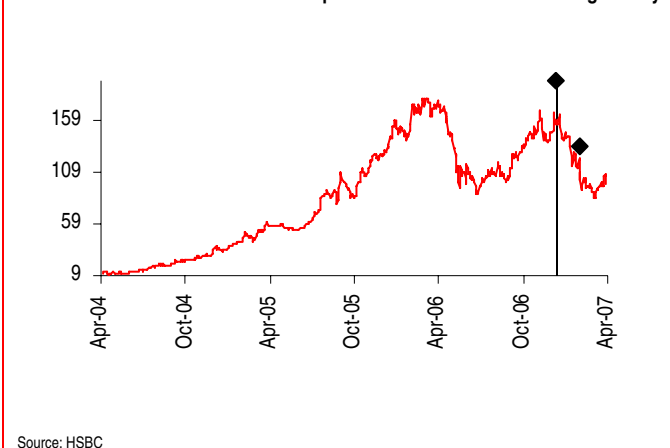
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As of 30 April 2007, the distribution of all ratings published is as follows:

Overweight (Buy)	42%	(16% of these provided with Investment Banking Services)
Neutral (Hold)	37%	(17% of these provided with Investment Banking Services)
Underweight (Sell)	21%	(14% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Hindustan Construction Share Price performance INR Vs HSBC rating history



Recommendation & price target history

From	To	Date
N/A	Overweight	09 January 2007
Target Price	Value	Date
Price 1	198.00	09 January 2007
Price 2	134.00	28 February 2007

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
HINDUSTAN CONSTRUCTION	HCNS.BO	98.50	27-Apr-2007	4

Source: HSBC

- 1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
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