

Hindustan Construction

		Rs42	Neutral										
BSE SENSEX	S&P CNX												
19,151	5,743												
Bloomberg	HCCIN												
Equity Shares (m)	606.6												
52-Week Range (Rs)	75/38												
1,6,12 Rel. Perf. (%)	-2/-43/-53												
M.Cap. (Rs b)	25.4												
M.Cap. (US\$ b)	0.6												
		YEAR	NET SALES	PAT	EPS	EPS	P/E	Adj P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS M)	(RS M)	(RS)	GR. (%)	(X)	(X)	(X)	(%)	(%)	SALES	EBITDA
		3/10A	36,442	1,044	1.7	23.8	24.4	8.4	2.3	8.3	9.0	1.6	13.3
		3/11E	41,617	736	1.2	-29.5	34.5	11.9	0.7	4.4	7.6	1.1	8.6
		3/12E	49,306	748	1.2	1.7	34.0	11.6	0.7	4.0	8.0	1.0	8.0
		3/13E	58,833	962	1.6	28.6	26.4	9.1	0.6	4.9	9.1	0.9	7.4

- 3QFY11 earnings below estimates, impacted by higher interest costs:** HCC reported 3QFY11 revenues of Rs10b (up 8.7% YoY), lower than our estimate of Rs11b (up 16.5% YoY). EBITDA was Rs1.3b (up 30% YoY), in line with our estimate of Rs1.3b (up 31% YoY). 3QFY11 EBITDA margins were 12.8%, up 66bp YoY. Reported PAT was Rs79m. After adjusting for a forex loss of Rs61m and prior period tax arrears of Rs28m, PAT was Rs147m (down 33% YoY). This is lower than our estimate of Rs222m (up 2% YoY). The below-estimate PAT was mainly due to increased interest costs which were up 50% YoY at Rs748m against our estimate of Rs675m (up 36%).
- Order backlog Rs185b, L1 orders Rs15b:** The order book was Rs185b (up 18% YoY, down 6% QoQ), with book to bill ratio of 4.7x TTM. The company lowered its order-inflow guidance. It expects to close FY11 with an order-book of Rs200b, instead of Rs240b, as earlier expected. There was no order-intake in 3QFY11. Order-intake for the first three quarters of FY11 was Rs27b, up 47% YoY.
- Management optimistic of resolving Lavasa issue soon:** Lavasa Corporation recently received an order from the Ministry of Environment and Forests (MoEF), detailing environmental damage and violations of environmental norms by the hill city. The company maintained that it followed applicable laws and regulations at various stages of the project's development. The MoEF said it was prepared to consider the project on merit with imposition of various terms and conditions. The Lavasa management is working on resolving issues raised by the MoEF. The next hearing is due on 28 January 2011.
- We cut FY11 earnings estimates by 24%, by 23% for FY12:** HCC's working capital, which was Rs24b at the start of FY11, crossed Rs30b in 3QFY11. Debt on HCC's books rose to Rs35b, from Rs25b at the end of 2QFY11. The company is due to repay FCCB of US\$130m (including principal of US\$100m) in April 2011, which will be funded by additional debt. We cut our FY11 and FY12 earnings estimates by 24% and 23% respectively.
- Valuations and view:** We have revised our price target downwards to Rs49 (earlier Rs59), comprising the core business of Rs22 (7x FY13E EV/EBITDA), Lavasa Rs20 (NPV) and Rs7 from other assets. Maintain **Neutral**.

QUARTERLY PERFORMANCE

Y/E MARCH	(Rs Million)									
	FY10				FY11				FY10	FY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Sales (Excl JV)	8,725	7,825	9,026	10,867	9,924	8,888	10,025	12,781	36,442	41,617
<i>Change (%)</i>	<i>0.8</i>	<i>20.6</i>	<i>10.2</i>	<i>10.9</i>	<i>13.7</i>	<i>13.6</i>	<i>11.1</i>	<i>17.6</i>	<i>10.0</i>	<i>14.2</i>
Gross Sales (incl JV Inc)	9,641	8,622	9,450	10,917	10,082	8,985	10,275	14,691	38,630	44,033
<i>Change (%)</i>	<i>7.7</i>	<i>23.6</i>	<i>7.9</i>	<i>6.0</i>	<i>4.6</i>	<i>4.2</i>	<i>8.7</i>	<i>34.6</i>	<i>10.4</i>	<i>14.0</i>
EBITDA	1,151	881	1,017	1,230	1,258	1,133	1,320	1,601	4,279	5,263
<i>Change (%)</i>	<i>26.3</i>	<i>5.0</i>	<i>-4.1</i>	<i>-22.7</i>	<i>9.3</i>	<i>28.6</i>	<i>29.8</i>	<i>30.2</i>	<i>-2.8</i>	<i>23.0</i>
<i>As of % Sales</i>	<i>13.0</i>	<i>12.5</i>	<i>12.2</i>	<i>11.3</i>	<i>12.5</i>	<i>12.6</i>	<i>12.8</i>	<i>12.5</i>	<i>12.2</i>	<i>12.6</i>
Depreciation	301	315	322	201	347	359	382	409	1,139	1,497
Interest	613	499	496	443	577	671	748	772	2,052	2,769
Other Income	19	28	41	42	31	61	-56	64	130	100
PBT	256	95	240	628	364	165	134	484	1,218	1,098
Tax	74	40	92	198	81	43	55	160	404	362
<i>Effective Tax Rate (%)</i>	<i>28.8</i>	<i>42.0</i>	<i>38.5</i>	<i>31.6</i>	<i>22.3</i>	<i>26.3</i>	<i>40.7</i>	<i>33.0</i>	<i>33.2</i>	<i>33.0</i>
Reported PAT	182	55	147	430	283	121	79	324	814	736
Adj PAT	268	280	218	342	283	121	147	324	1,044	736
<i>Change (%)</i>	<i>37.2</i>	<i>-701.1</i>	<i>32.8</i>	<i>-42.9</i>	<i>5.6</i>	<i>-56.6</i>	<i>-32.6</i>	<i>-5.2</i>	<i>14.5</i>	<i>-29.5</i>

E: MOSL Estimates

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Profits below estimates due to higher rates, liquidity crunch; earnings estimates cut

- HCC reported 3QFY11 revenue of Rs10b (up 8.7% YoY), lower than our estimate of Rs11b (up 16.5% YoY). EBITDA was Rs1.3b (up 30% YoY), in line with our estimate of Rs1.3b (up 31% YoY). EBITDA margins were 12.8% up 66bp YoY. Reported PAT was Rs79m and after adjustment for forex loss of Rs61m and prior period tax arrears of Rs28m, PAT was Rs147m (down 33%). This is lower than our estimate of Rs222m (up 2% YoY). Lower-than-expected PAT was due to higher interest rates, which were up 50% YoY at Rs748m against our estimate of Rs675m (up 36%).
- The order book was Rs185b (v/s Rs197b in September 2010), indicating no intake in 3QFY11. 9mFY11 order intake was Rs27b, up 47% YoY.
- In 3QFY11 NJJV claims worth Rs650m were settled and the balance Rs2b is expected in the next six months.
- We cut our FY11 and FY12 revenue estimates by 2% each and we cut PAT estimates by 24% and 23% respectively due to lower order intake in FY11 and FY12 and a steep rise in interest costs. Our intake assumptions are Rs62b (down 4.2% YoY) for FY11 and Rs81b (up 30% YoY) for FY12.
- HCC's working capital, which was Rs24b at the start of FY11, crossed Rs30b in 3QFY11. Debt on HCC's books rose to Rs35b, up sharply from Rs25b at the end of 2QFY11. The company is due to repay FCCB of US\$130m (including principal of US\$100m) in April 2011, which will be funded by additional debt. A steep rise in debt and rising interest rates will push interest costs by 30% CAGR over FY10-13, giving 53%, 60% and 60% of EBITDA in FY11, FY12 and FY13 respectively.

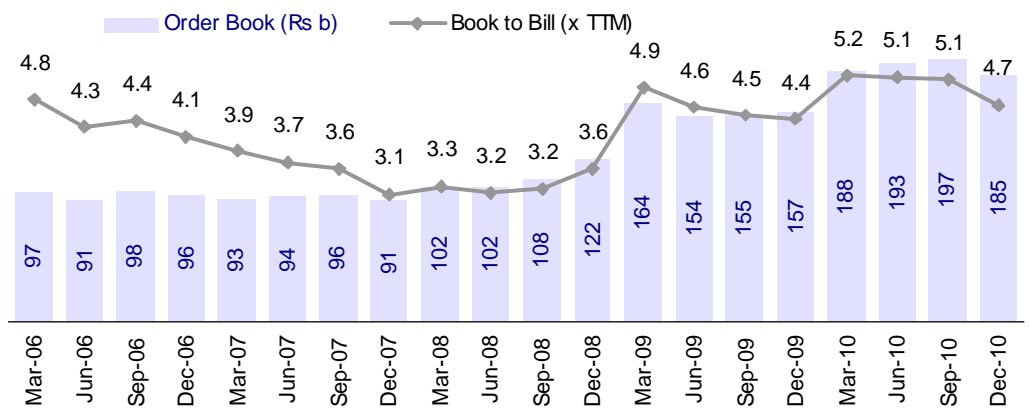
Order backlog Rs185b, L1 orders Rs15b

- HCC derives ~58% of its order book from the state or central government and the rest from the private sector. Order book was Rs185b (up 18% YoY, down 6% QoQ), book-to-bill ratio was 4.7x TTM.
- HCC lowered its order-inflow guidance. It expects to close FY11 with an order-book of Rs200b, instead of Rs240b as earlier expected. Order book was Rs185b (v/s Rs197b in September 2010), indicating no intake in 3QFY11. Order-intake for the first three quarters of FY11 was Rs27b (up 47% YoY). The company had initially guided for order-intake of Rs80b-100b, which has been scaled down to about Rs55b.
- In 3QFY11, HCC had an order cancellation of Rs2.5b, the third big dam on the Bhagirathi River - 600MW Loharinag Pala from NTPC on environmental grounds.

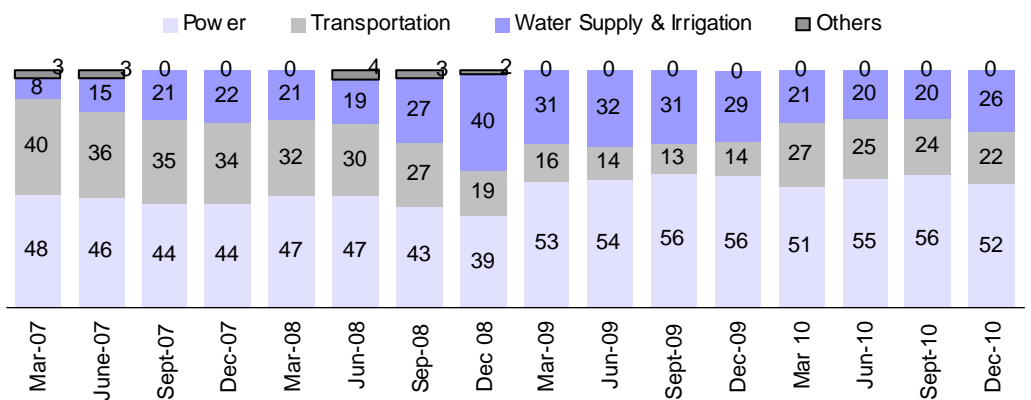
Details of a few projects

- On the Kishanganga hydro-electric project, 5% of execution work is complete, the designing/engineering activity is on schedule and excavation for the river diversion tunnel is complete. About 95% of the balance order work, amounting to Rs29b, is outstanding.
- Construction of permanent work on the NH-34 road package has commenced.
- Excavation is in full swing at the Rajasthan Atomic Power project (7&8), one reactor building and auxiliary building is complete.

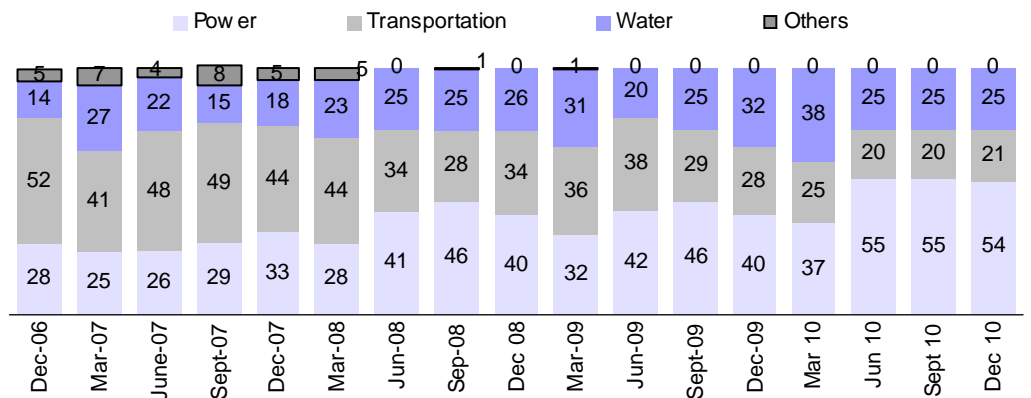
HCC: BTB trend indicates large mix of long-cycle power orders



Order backlog break-up in favor of hydro power projects



Revenue break-up mirrors order backlog mix; hydro mix to hold margins



Source: Company/MOSL

BOT portfolio to have equity commitment of Rs5.4b by the end of FY12

- HCC has BOT road portfolio of six NHAI projects totaling Rs55b. HCC intends to grow the portfolio to Rs200b in 2-3 years. Equity invested so far is Rs5b and the balance will be invested in 9-12 months.

Uncertainty over Lavasa continues; MOEF maintains status quo but management optimistic of resolving issue soon

- Lavasa Corporation recently received the final order from the Ministry of Environment and Forest (MoEF), which detailed environmental damages and violations of environmental norms by the hill city even though Lavassa Corp says it followed laws and regulations applicable at various stages of the project development. The MoEF stated that it was prepared to consider the project on merit, with imposition of various terms and conditions. The conditions also include Lavasa paying a substantial penalty for violating green laws, creating an environment restoration fund and preventing further environmental degradation. The management is working on solving the issues raised by the MoEF. The next hearing is due on 28 January 2010.
- Lavasa's infrastructure development cost is estimated at Rs45b, of which Rs15b has been spent. Town Dasve is on the verge of completion and Mugaon town is in the initial stages of construction. All construction work has been stopped.
- On the books of Lavasa Corp total debt was Rs18b, including convertible bonds of Rs10.5b and long-term debt of Rs9b. Total customer advances were Rs6.5b and equity contribution was Rs3.5b. Of this, a convertible bond of Rs2.5b is due in June 2011.

Karl Steiner AG records profit of 2.9m Swiss francs

- Karl Steiner's 3QFY11 performance has been steady. It reported PAT of 2.9m Swiss francs (against 0.6m Swiss francs in 2QFY11). It is expected to contribute significantly to the group's overall performance.
- Since acquisition, the company has been concentrating on consolidating operations in Switzerland and entering Indian markets as a Total Services Contractor (TCS) in building construction.

Strategic partnerships expected to boost revenue

- In 3QFY11 HCC signed an agreement with Vinci Construction Grand Projects (VCGP), to work on identified power, water, transport and infrastructure projects in India and other countries. The partnership is expected to boost revenue.
- HCC Concessions also signed an agreement with Vinci Concessions SAS to partner it on select public private partnership (PPP) projects. The companies are working together on a mega highway project involving the six-laning of Rs1\$b Kishangarh-Udaipur-Ahmedabad project.

We cut FY11 earnings estimates by 24%, by 23% for FY12

- HCC's working capital, which was Rs24b at the start of FY11 was Rs30b in 3QFY11. Debt on HCC's books rose to Rs35b, up sharply from Rs25b at the end of 2QFY11. The company is due to repay FCCB of US\$130m (including principal of US\$100m) in April 2011, which will be funded by additional debt. A steep rise in debt and rising interest rates will push up interest costs by a 31% CAGR over FY10-13, to give 53%, 60% and 60% EBITDA in FY11, FY12 and FY13 respectively.
- We cut our FY11 and FY12 earnings estimates by 24% and 23% respectively. Our FY12 estimates assume 19% revenue growth, 30% order intake growth and stable EBITDA margin of 12.6%. We believe there is downside risk to our estimates as a revenue slowdown can lead to poor fixed-cost absorption.

FY11 and FY12 earnings cut by 24% and 23% (Rs m)

	Previous estimates		Revised estimates	
	FY11	FY12	FY11	FY12
Revenues	42,476	50,305	41,617	49,306
EBITDA	5,149	6,193	5,137	6,232
EBITDA Margin (%)	12.1	12.3	12.3	12.6
PAT	971	993	736	748
EPS (Rs)	1.6	1.6	1.2	1.2

Interest cost to increase by 36% in FY12 (Rs m)

	Previous estimates		Revised estimates	
	FY11	FY12	FY11	FY12
Debt	37,359	38,006	37,359	41,006
Interest	2,540	3,417	2,769	3,777
Interest/EBITDA (%)	49.3	55.2	53.9	60.6
Interest/Sales (%)	6.0	6.8	6.7	7.7
Interest/Average debt (%)	8.1	9.1	8.9	9.6

Source: MOSL

Valuation and view

- We have revised price target downwards to Rs49 (earlier Rs59), comprising of core business of Rs22 (7x FY13E EV/EBITDA), Lavasa Rs20 (NPV), 247 IT park Rs2 and BOTs, SRA and KSAG Rs5. Maintain a **Neutral** recommendation on the stock.

HCC - equity valuation

	Business Segment	Method (x)	Valuation (Rs m)	Value (Rs/Sh)	Value	Rationale
HCC Standalone	Construction	FY13E EV / EBITDA (x)	6	13,299	22	Par with industry average
Real Estate						
Lavasa	Township	NPV, WACC 17%		12,261	20	Based on 20% discount to NPV of expected cash flows
247 IT Park	Real Estate	NPV, Cap Rate 10%		4,941	2	Based on NPV of expected rentals from office space
Vikhroli SRA		NPV, WACC 15%		898	1	Based on NPV of expected cash flows; consent received for 22 acres
BOT Investments				755	1.2	
Other Investments						
Andhra Road	BOT	Book Value		315	0.5	Book value of Investments as at Mar 10
Badarpur Expressway	BOT	Book Value		439	0.7	Book value of Investments as at Mar 10
KSAG		Book Value		1,500	2	Book value of Investments as at Mar 11
Total				33,654	49	

Source: Company/MOSL

Hindustan Construction: an investment profile

Company description

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

Key investment arguments

- HCC possesses pre-qualifications and proven execution capabilities across sectors and will benefit from large ticket sized orders in the hydro and nuclear powered sectors.
- HCC's focus is on emerging as an integrated infrastructure player with a presence in sectors like roads, power, ports, airports and water transmission space.
- HCC has the youngest fleet of specialized equipment, skilled manpower, in-house fabrication facilities and EPC execution capabilities.

Comparative valuations

		Hind.Const.	NCC	IVRCL
P/E (x)	FY11E	34.5	12.1	15.0
	FY12E	34.0	9.9	11.9
P/BV (x)	FY11E	0.7	9.2	8.4
	FY12E	0.7	7.5	6.6
EV/Sales (x)	FY11E	1.1	11.5	14.7
	FY12E	1.0	12.6	16.4
EV/EBITDA (x)	FY11E	8.6	1.1	0.9
	FY12E	8.0	0.9	0.7

Shareholding Pattern (%)

	Dec-10	Sep-10	Dec-09
Promoter	39.9	39.9	39.9
Domestic Inst	10.7	13.6	15.7
Foreign	24.6	27.0	25.9
Others	24.8	19.5	18.5

Key investment risks

- Focus on key large projects increases project-specific risks. The company has significant investments in its RE/BOT subsidiaries.

Recent developments

- In 3QFY11 there was an overall slowdown in infrastructure activity. Several projects were deferred by the government and private parties due to land clearance and other environmental issues. NHA slowed down awarding contracts and several states stopped awarding activity.
- The Lavasa management is working on overcoming issues raised by the MoEF. The next hearing is due on 28 January 2010.

Valuation and view

- We have revised price target downwards to Rs49 (earlier Rs59), comprising of core business of Rs22 (7x FY13E EV/EBITDA), Lavasa Rs20 (NPV), 247 IT park Rs2 and BOTs, SRA and KSAG Rs5. Maintain a **Neutral** recommendation on the stock.

Sector view

- Increased government commitment towards infrastructure projects is a long-term positive.
- Investments in BOT/real estate projects have adversely impacted the core balance sheet. This will continue to have a negative impact on the core business until the SPVs in real estate and BOT generate cash.

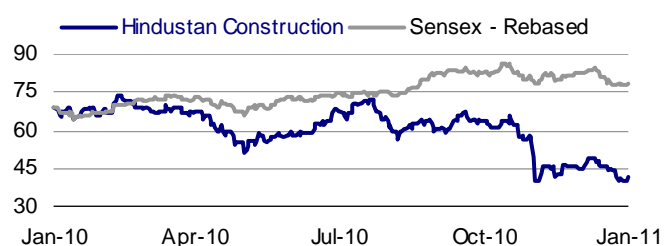
EPS: MOST forecast v/s consensus (Rs)

	Most Forecast	Consensus Forecast	Variation (%)
FY11	1.2	2.0	-40.4
FY12	1.2	2.6	-53.7

Target price and recommendation

Current Price (Rs)	Target Price (Rs)	Upside (%)	Reco.
42	49	16.7	Neutral

Stock performance (1 year)



Financials and Valuation

INCOME STATEMENT						RATIOS					
(Rs Million)											
Y/E MARCH	2009	2010	2011E	2012E	2013E	Y/E MARCH	2009	2010	2011E	2012E	2013E
Net Sales	33,137	36,442	41,617	49,306	58,833	Basic (Rs)					
<i>Change (%)</i>	<i>7.5</i>	<i>10.0</i>	<i>14.2</i>	<i>18.5</i>	<i>19.3</i>	Adjusted EPS	1.4	1.7	1.2	1.2	1.6
EBITDA	4,397	4,429	5,137	6,232	7,437	<i>Growth (%)</i>	<i>19.0</i>	<i>23.8</i>	<i>-29.5</i>	<i>1.7</i>	<i>28.6</i>
<i>% of Net Sales</i>	<i>13.3</i>	<i>12.2</i>	<i>12.3</i>	<i>12.6</i>	<i>12.6</i>	Cash EPS	3.3	3.6	3.7	3.9	4.6
Depreciation	1,152	1,139	1,497	1,602	1,812	Book Value	16.6	25.0	30.6	31.6	32.8
Interest	2,105	2,052	2,769	3,777	4,505	DPS	0.8	0.8	0.2	0.2	0.3
Other Income	588	130	100	120	150	Payout (incl. Div. Tax.)	17.9	34.8	23.4	23.4	23.4
Share of turnover in JV	1	-150	126	145	166	Valuation (x)					
PBT	1,729	1,218	1,098	1,117	1,436	PE (standalone)	19.4	24.4	34.5	34.0	26.4
Tax	392	404	362	369	474	Cash PE	8.2	16.3	5.7	5.4	4.6
<i>Rate (%)</i>	<i>22.7</i>	<i>33.2</i>	<i>33.0</i>	<i>33.0</i>	<i>33.0</i>	EV/EBITDA	8.6	13.3	8.6	8.0	7.4
Reported PAT	1,337	814	736	748	962	EV/Sales	1.1	1.6	1.1	1.0	0.9
EO Income (net of expense)	494	-229	0	0	0	Price/Book Value	1.6	2.3	0.7	0.7	0.6
Adjusted PAT	843	1,044	736	748	962	Dividend Yield (%)	1.9	1.9	0.6	0.6	0.8
<i>Change (%)</i>	<i>19.0</i>	<i>23.8</i>	<i>-29.5</i>	<i>1.7</i>	<i>28.6</i>	Profitability Ratios (%)					
BALANCE SHEET	(Rs Million)					RoE	8.4	8.3	4.4	4.0	4.9
Y/E MARCH	2009	2010	2011E	2012E	2013E	RoCE	12.0	9.0	7.6	8.0	9.1
Share Capital	256	303	607	607	607	Turnover Ratios					
Reserves	9,792	14,869	17,979	18,552	19,289	Debtors (Days)	1	0	0	0	0
Net Worth	10,049	15,172	18,586	19,159	19,896	Inventory (Days)	306	357	385	385	375
Loans	23,218	25,147	37,359	41,006	45,406	Creditors (Days)	159	164	165	165	165
Deferred Tax Liability	1,132	1,426	1,426	1,426	1,426	Asset Turnover (x)	1.0	1.0	0.8	0.8	0.9
Capital Employed	34,398	41,745	57,371	61,591	66,728	Leverage Ratio					
Gross Fixed Assets	16,828	18,142	20,642	22,892	25,892	Debt/Equity (x)	2.3	1.7	2.0	2.1	2.3
Less: Depreciation	5,547	6,645	8,141	9,744	11,556	CASH FLOW STATEMENT	(Rs Million)				
Net Fixed Assets	11,282	11,497	12,500	13,148	14,335	Y/E MARCH	2009	2010	2011E	2012E	2013E
Capital WIP	464	349	523	250	250	PBT before Extraordinary It	1,729	1,218	1,098	1,117	1,436
Investments	3,655	4,087	5,587	5,587	5,587	Add: Depreciation	1,152	1,139	1,497	1,602	1,812
Curr. Assets	34,674	46,243	60,911	68,750	77,765	Interest	2,105	2,052	2,769	3,777	4,505
Inventory	27,766	35,652	43,898	52,008	60,445	Less: Direct Taxes Paid	392	404	362	369	474
Debtors	47	27	30	36	43	(Inc)/Dec in WC	-3,641	-6,471	-8,371	-5,919	-5,105
Cash & Bank Balance	1,539	1,883	6,034	3,961	2,805	CF from Operations	953	-2,466	-3,370	209	2,174
Loans & Advances	5,284	8,633	10,901	12,698	14,425	(Inc)/Dec in FA	-2,692	-1,238	-2,674	-1,977	-3,000
Other Current Assets	38	48	48	48	48	(Pur)/Sale of Investments	-700	-432	-1,500	0	0
Current Liab. & Prov.	15,677	20,430	22,577	26,571	31,636	CF from Investments	-3,392	-1,670	-4,174	-1,977	-3,000
Creditors	10,373	11,868	13,451	15,870	18,963	(Inc)/Dec in Networth	-1,090	4,887	2,424	0	0
Other Liabilities	3,653	6,652	6,930	8,175	9,769	(Inc)/Dec in Debt	4,769	1,929	12,212	3,647	4,400
Provisions	1,651	1,910	2,196	2,525	2,904	Less: Interest Paid	2,105	2,052	2,769	3,777	4,505
Net Current Assets	18,997	25,813	38,334	42,180	46,129	Dividend Paid	240	284	172	175	225
Application of Funds	34,398	41,745	56,944	61,165	66,302	CF from Fin. Activity	1,334	4,481	11,695	-305	-330
<i>E: MOSL Estimates</i>						Incl/Dec of Cash	-1,105	345	4,151	-2,073	-1,156
						Add: Beginning Balance	2,644	1,539	1,883	6,034	3,961
						Closing Balance	1,539	1,883	6,034	3,961	2,805



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Hindustan Construction

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