

October 24, 2009

GEPL Investment Research | Results Update | Construction |

## HINDUSTAN CONSTRUCTION COMPANY (HCC)

"H1 FY 10 underperformance to drag overall FY 10 profitability"

CMP: Rs. 132

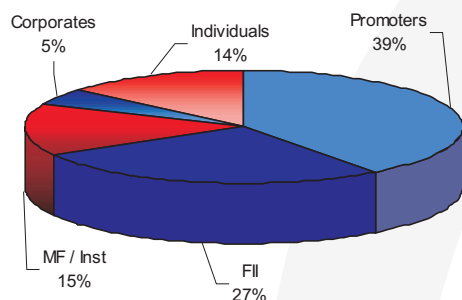
Target Price: Rs.116

Neutral

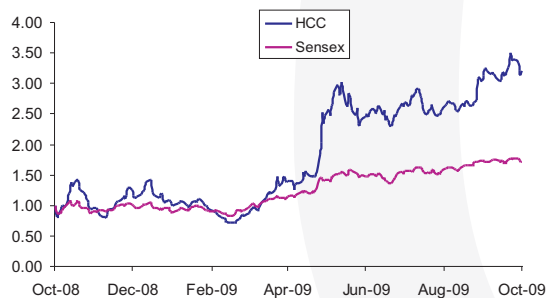
### COMPANY SNAPSHOT (October 23, 2009)

|                |                   |
|----------------|-------------------|
| Market Price   | Sensex            |
| Rs. 132        | 16811             |
| 52 Wk H / L    | Bloomberg Code    |
| Rs. 146 / 29   | HCC IN            |
| Mkt Cap ( mn ) | Shares O/S ( mn ) |
| Rs. 40029      | 303.25            |
| BSE CODE       | NSE CODE          |
| 500185         | HCC               |

### Shareholding Pattern



### Price Performance Chart



### Company Profile

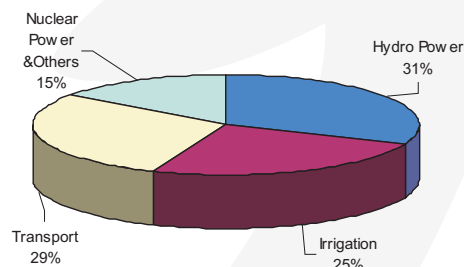
Hindustan Construction Company Limited (HCC) is into engineering construction, both in India and the rest of the world. Seth Walchand Hirachand founded the company and it was incorporated in January 27th of the year 1926. HCC has been entrusted with the construction of high value projects across segments like transportation, power, marine projects, oil and gas pipeline constructions, irrigation and water supply, utilities and urban infrastructure. In Power Generation, HCC have constructed Hydroelectric, Nuclear, Thermal Gas and Diesel based Power Projects. In the field of Water Supply and Irrigation, also constructed major dams, barrages, aqueducts and tunnels. In Transportation, the company concentrates road and rail bridges, expressways & roads and marine construction.

HCC came out with its Q2 FY10 results and conducted post results Analyst Meet on Friday, 23<sup>rd</sup> October 2009.

### Q2 F Y10 Results

HCC came out with its quarterly results ended 30<sup>th</sup> September 2009 with a net rise in income from core operation of 20.3% to Rs. 7.8 bn as against Rs. 6.4 bn in Q2 FY09. Adjusted EBITDA was up by 28% y-o-y to Rs. 1073.7 mn as against Rs. 838.5 mn in Q2 FY09 and registered margin expansion of 80 basis points to 13.7% as against 12.9% in Q2 FY09. The expansion in margins was on account of higher contribution of hydropower in the overall revenue mix at 31%. However the company has booked loss of RS. 192.9 mn on sale of assets under other expenditure which dragged its overall profitability. The interest outgo was almost flat at Rs. 499.1 mn as against Rs. 492 mn in Q2 FY09; however it fell by 18.6% when compared to Q1 FY10 interest outgo of Rs. 613 mn. The company has used majority of QIP proceeds (Rs. 4.8 bn) to pay off its long term debt which led to fall in overall interest outgo. The interest outgo for H2 FY10 is likely to stabilize at the current levels. The company's net profit stood at Rs. 55.1 mn, primarily showing due to one time loss of Rs. 192.9 mn, a decline of 72% on y-o-y basis from Rs. 199.4 mn in Q2 FY 09.

### Chart 1: Revenue Mix Q2 F Y10



Source: Company Data, GEPL Investment Research

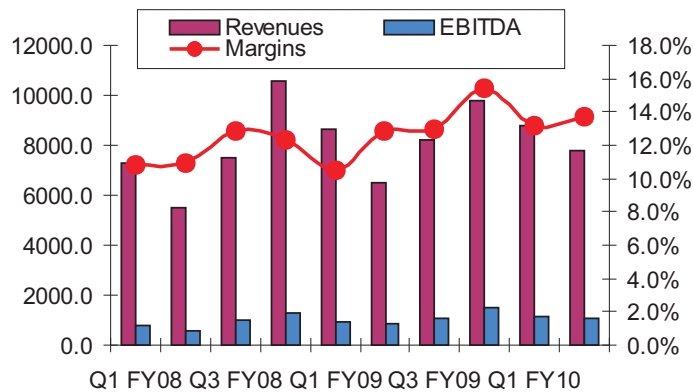
### H1 FY 10 underperformance to drag overall FY 10 profitability

HCC bottom-line during H1 FY10 was affected due to couple of reasons. Firstly during Q1 FY10 company incurred an expenditure of Rs. 52.9 mn towards Bandra-Worli Sea link inauguration and donated Rs. 50 mn to political parties. This has made it to report a profit of Rs. 181.9 mn during Q1 FY10 as against Rs. 308.4 mn in Q1 FY09. During Q2 FY10 it reported a loss of Rs. 192.9 mn on sale of assets, which led the company to report profit of Rs.55.1 mn as against Rs. 199.4 mn in Q2 FY09. This has resulted into H1 FY10 profits of Rs. 237.1 mn, a decline of 53% from Rs. 507.9 mn in H1 FY09. **We are therefore revising our estimates for H2 FY10 and decreasing our EPS estimate by 13% and incorporating a higher equity base, we arrive at FY10 EPS estimate of Rs. 3.9. However we maintain our FY11 estimates, as we feel the pace of construction activity in FY 11 would be much stronger than FY 10.**

## Operational margins provide comfort

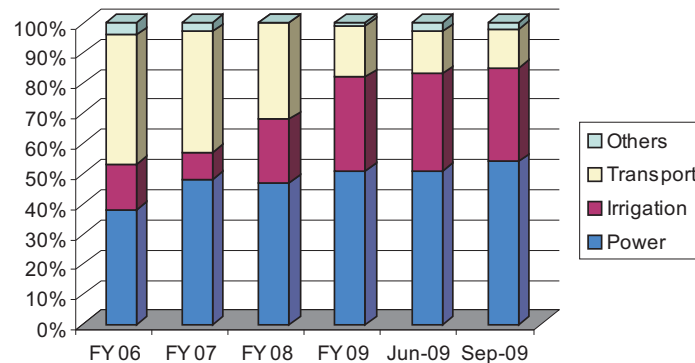
HCC continues to maintain its operational margins at comfortable levels and reported operational margins of 13.7% as against 12.9% in Q2 FY09. The expansion in margins was led by increased contribution from hydropower segment which yields better margins. However these margins are adjusted and do not include the loss of Rs. 192.9 mn on account of sale of asset. Margins during H1 FY10 remained at 12.3% as against 11.5% in H1 FY09. The current order book mix which is in favour of hydro power (a high margins business) provides reasonable comfort that HCC can maintain its operational margins at the current level.

### Chart 2: Operating Margins



Source: Company Data, GEPL Investment Research

### Chart 3: Order book mix

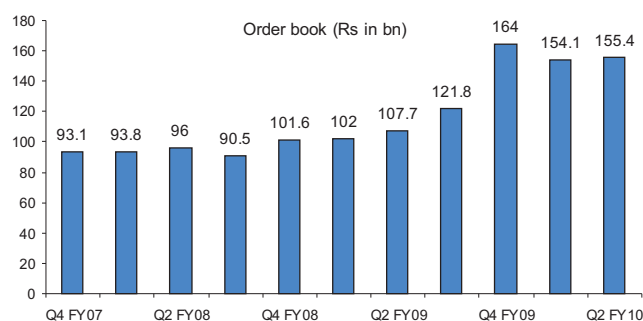


Source: Company Data, GEPL Investment Research

## Order intake muted during H1 FY 10

HCC as on 30<sup>th</sup> September 2009 has an order backlog of Rs. 155.4 bn which is up by 44% y-o-y. The order inflow was muted during H1 FY10 due to the elections and floods in Andhra Pradesh; however the company has L1 status on the orders worth Rs. 9.63 bn. The company is hopeful that this L1 status would be awarded during H2 FY10. HCC has also disclosed that it has submitted bids for the projects worth of Rs. 90 bn and is pre-qualified for projects worth of Rs. 150 bn. The order book to bill ratio of more than 4x provides a visibility of revenues going forward.

### Chart 4: Order book position



## Execution of Irrigation projects likely to witness slowdown during FY 10

HCC has irrigation projects worth of Rs. 50 bn as part of its order book out of which around Rs. 38 bn is from Andhra Pradesh government which constitutes 24% of the overall order book. The recent floods and unfortunate tragedy (demise of Chief Minister) impacting political stability in Andhra Pradesh is a cause of concern. The management expects execution of these projects to pick from

## Focus on infrastructure projects

HCC has identified Nuclear, Transport and Aluminum industry as the growth sectors and is working towards increasing its exposure in these areas. It has formed partnership with AMEC to offer Consulting and EPC services for the establishment of nuclear power plants in India. This is in lieu of government of India's plan to add 40000 MW of nuclear power in the medium term plan with an expected capital outlay of Rs. 1500 bn over the next 10 years. The company has also conveyed that it is bidding aggressively for the upcoming road projects. However the company is of the view that the financial closure for most of these projects would be achieved towards the end of FY10 and therefore one should expect the revenues only towards FY11. The company is also planning to make a strategic entry into aluminum industry, where the planned investment over the next decade is pegged at USD 50 bn.

## Lavasa - Surpasses HCC's profitability

Lavasa had started booking revenues and profit since FY09 and during the quarter it reported net income of Rs. 932 mn and net profit of Rs. 1028.5 mn. EBT margins for the quarter stood at 44.6%.

**Table 1: Lavasa Q2 FY 10 Results**

|             | FY09  | Q1 FY10 | Q2 FY10 |
|-------------|-------|---------|---------|
| Revenues    | 2120  | 932.7   | 1028.5  |
| Expenditure | 770   | 532.7   | 569.8   |
| EBT         | 1350  | 400     | 458.7   |
| EBT Margins | 63.7% | 42.9%   | 44.6%   |
| Tax         | 120   | 136     | 154.1   |
| PAT         | 1230  | 264     | 304.6   |

Source: Company Data, GEPL Investment Research

## Valuations

HCC has an order backlog of Rs. 155.4 bn coupled with L1 status of Rs. 9.63 bn, which we feel would drive the future revenues. The current slowdown in the execution of irrigation projects would drag FY10 performance; however we are confident of FY11 performance and therefore maintain our estimates for FY11. We also believe the success of Lavasa Township would be positively impacting HCC valuations going forward. **We therefore have a "Neutral" recommendation on the stock with a target price of Rs.115.**

**Table 2: Valuation Matrix**

| Method                     | Old            |                 | New        |                 |            |
|----------------------------|----------------|-----------------|------------|-----------------|------------|
|                            | Multiple       | Value per Share | Multiple   | Value per Share |            |
| Core Construction Business | PE             | 10              | 75         | 12              | 76         |
| BOT Projects               | P/Bv           | 1               | 7          | 1               | 7          |
| Realty (247 IT Park)       | DCF            |                 | 8          |                 | 8          |
| Lavasa Corporation         | Capitalisation |                 | 25         |                 | 25         |
| <b>Total</b>               |                |                 | <b>115</b> |                 | <b>116</b> |

**Table 2: Q2 F Y 10 Results**

|                                 | Q2 FY10       | Q2 FY09       | % Change      | H1 FY10        | H1 FY09        | % Change      |
|---------------------------------|---------------|---------------|---------------|----------------|----------------|---------------|
| <b>Total</b>                    | <b>7810.9</b> | <b>6491.6</b> | <b>20.3%</b>  | <b>16571.0</b> | <b>15146.6</b> | <b>9.4%</b>   |
| <b>Expenditure</b>              |               |               |               |                |                |               |
| Materials consumed              | 2158.9        | 2630.4        | -17.9%        | 5038.9         | 5549.0         | -9.2%         |
| % of net sales                  | 27.6%         | 40.5%         |               | 30.4%          | 36.6%          |               |
| Employee Cost                   | 976.8         | 1069.6        | -8.7%         | 1953.2         | 1940.9         | 0.6%          |
| % of net sales                  | 12.5%         | 16.5%         |               | 11.8%          | 12.8%          |               |
| Construction Expenses           | 3311.0        | 1645.0        | 101.3%        | 6637.0         | 5344.8         | 24.2%         |
| % of net sales                  | 42.4%         | 25.3%         |               | 40.1%          | 35.3%          |               |
| Other Expenditure               | 483.4         | 309.9         | 56.0%         | 910.5          | 564.2          | 61.4%         |
| <b>Total</b>                    | <b>6930.1</b> | <b>5654.8</b> | <b>22.6%</b>  | <b>14539.6</b> | <b>13398.8</b> | <b>8.5%</b>   |
| EBITDA                          | 1073.7        | 838.5         | 28.1%         | 2031.4         | 1747.8         | 16.2%         |
| EBITDA Margins                  | 13.7%         | 12.9%         |               | 12.3%          | 11.5%          |               |
| Interest                        | 499.1         | 492.0         | 1.5%          | 1112.1         | 882.5          | 26.0%         |
| <b>PBDT ( Op )</b>              | <b>574.6</b>  | <b>346.5</b>  | <b>65.8%</b>  | <b>919.3</b>   | <b>865.2</b>   | <b>6.2%</b>   |
| Depreciation                    | 314.9         | 296.3         | 6.3%          | 615.7          | 548.9          | 12.2%         |
| <b>PBT ( Op )</b>               | <b>259.7</b>  | <b>50.2</b>   | <b>417.3%</b> | <b>303.6</b>   | <b>316.3</b>   | <b>-4.0%</b>  |
| % of net income                 | 3.3%          | 0.8%          |               | 1.8%           | 2.1%           |               |
| Other Income                    | 28.2          | 268.3         | -89.5%        | 47.1           | 392.6          | -88.0%        |
| <b>PBT</b>                      | <b>287.9</b>  | <b>318.5</b>  | <b>-9.6%</b>  | <b>350.7</b>   | <b>708.9</b>   | <b>-50.5%</b> |
| % of net income                 | 3.7%          | 4.9%          |               | 2.1%           | 4.7%           |               |
| <b>Exceptional Item</b>         | <b>-192.9</b> | <b>-1.733</b> |               | <b>0</b>       | <b>0</b>       |               |
| Profit from Ordinary Activities |               |               |               |                |                |               |
| before tax                      | 95.0          | 316.7         | -70.0%        | 350.7          | 708.9          | -50.5%        |
| % of net income                 | 1.2%          | 4.9%          |               | 2.1%           | 4.7%           | -537.3%       |
| <b>Tax</b>                      | <b>39.9</b>   | <b>117.3</b>  | <b>-66.0%</b> | <b>113.6</b>   | <b>201</b>     | <b>-43.5%</b> |
| Tax rate                        | 13.9%         | 36.8%         |               | 32.4%          | 28.4%          |               |
| <b>PAT</b>                      | <b>55.1</b>   | <b>199.4</b>  | <b>-72.3%</b> | <b>237.1</b>   | <b>507.9</b>   | <b>-53.3%</b> |
| % of net income                 | 0.7%          | 3.1%          |               | 1.4%           | 3.4%           |               |
| <b>EPS</b>                      | <b>0.18</b>   | <b>0.78</b>   | <b>-76.9%</b> | <b>0.85</b>    | <b>1.98</b>    | <b>-57.1%</b> |

Source: Company Data, GEPL Investment Research

**Table 3: Estimates**

|                | FY09    | FY10E   | FY11E   |
|----------------|---------|---------|---------|
| Income         | 33137.6 | 41045.2 | 50739.7 |
| EBITDA         | 4314.5  | 5211.3  | 6726.0  |
| EBITDA Margins | 13.0%   | 12.7%   | 13.3%   |
| PAT            | 1253.5  | 1177.8  | 1916.8  |
| EPS            | 4.9     | 3.9     | 6.3     |

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