

Hindustan Construction Company

 BSE code: 500185
 NSE code: HCC

CMP: Rs 129
Target: Rs 249 ↓

BUY

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Company data

Particulars	
Market cap (Rs bn / US\$ mn)	33.1/826.6
Outstanding equity shares (mn)	256.3
52-week high/low (Rs)	278.9/92.1
1-month average daily volume	697,365

Financial snapshot

Particulars	FY07	FY08	FY09E
Sales (Rs mn)	23,576.2	30,827.6	38,479.0
Growth (%)	18.7	30.8	24.8
Adj net inc (Rs mn)	615.8	710.3	1063.6
Growth (%)	(20.2)	15.3	49.7
FDEPS (Rs)	2.4	2.8	3.8
Growth (%)	(20.2)	15.3	36.4
P/E (x)	53.7	46.5	34.1
ROE (%)	6.9	7.4	7.7

Risk-return profile



Shareholding pattern

(%)	Mar-08	Dec-07
Promoters	47.1	47.0
FIIIs	11.9	13.5
Banks & FIs	17.5	17.4
Public	23.5	22.1

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
HCC	129	(2.3)	(27.5)	(40.1)
Sensex	17,378	11.1	(1.5)	(12.4)

Company website www.hccindia.com

Healthy order booking lends impetus to growth

Hindustan Construction Company (HCC) has registered above-expected growth in net sales for the fourth quarter at 28% YoY to Rs 10.6bn, taking growth for the full fiscal to 31% at Rs 30.8bn. The revenue growth was underpinned by healthy order execution across all its business segments in general and power in particular, which grew at 82% YoY for FY08. The revenue share of power has risen to 28% in FY08 from 20% in FY07. HCC's current order backlog stands at Rs 95.6bn, which is 3.1x FY08 sales.

The EBITDA margin has improved significantly to 11.9% for FY08 (12.4% for the quarter) as compared to 9.1% last year due to the rising contribution from the power and water/irrigation segments, coupled with lower provisioning towards the Bandra-Worli sealink project. Higher interest expenses due to investments in realty ventures and increased working capital requirements caused net profit to dip 2.7% YoY during the quarter to Rs 357.4mn, while rising 15% for the fiscal to Rs 710mn.

HCC's Lavasa township project has done pre-sales of Rs 4.9bn for FY08, with construction of villas and apartments under phase I in progress. Considering the prevailing uncertainty in the realty market, we have raised HCC's holding company discount from 15% to 30% for the Lavasa project, leading to a downward revision of our target price for the company. We are also reducing our net profit estimates for FY09 and FY10 by 23% and 21% respectively on account of increased depreciation and interest expenses, lowering our core business valuation. Consequently, our target price stands revised downwards to Rs 249 from Rs 333.

Actual vs estimated performance

(Rs mn)	Actual	Estimated	% Variance
Net sales	10,550.2	9,353.6	12.8
EBITDA	1,309.9	893.9	46.5
Adj net income	357.4	255.3	40.0
FDEPS (Rs)	1.8	1.0	40.0

Source: Company, Religare Research

Quarterly results

(Rs mn)	Q4FY08	Q4FY07	% Chg YoY	FY08	FY07	% Chg YoY
Net sales	10,550.2	8,277.1	27.5	30,827.6	23,576.2	30.8
Expenditure	9,240.3	7,554.8	22.3	27,161.5	21,423.6	26.9
EBITDA	1,309.9	722.3	81.4	3,666.1	2,152.6	70.3
EBITDA (%)	12.4	8.5	390bps	11.9	9.1	276bps
Depreciation	274.8	243.6	12.8	961.9	796.6	20.8
Interest	452.3	212.3	113.0	1,524.1	619.7	145.9
Other income	-	125.2	-	9.7	21.8	(55.5)
PBT	582.8	391.6	48.8	1,189.8	758.1	56.9
Tax	219.8	178.6	23.1	472.3	386.1	22.3
Reported PAT	264.0	792.5	(66.7)	1,087.7	367.6	195.6
Adjustments	(93.4)	(425.2)	-	(377.4)	248.2	-
Adj. PAT	357.4	367.3	(2.7)	710.3	615.8	15.3
EPS (Rs)	1.8	1.4	(2.7)	2.7	2.4	15.3

Source: Company

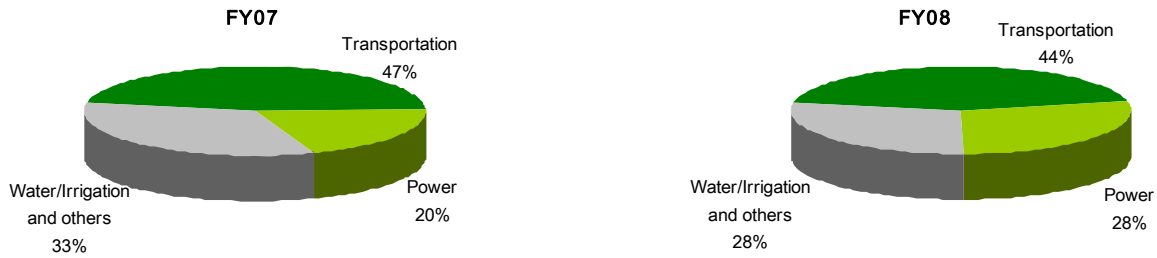
Result highlights

Strong order booking across segments drives revenues past Rs 30bn mark

Strong quarterly net sales growth of 28% YoY

HCC has posted a healthy sales growth of 28% YoY in Q4FY08 to Rs 10.6bn, ahead of our estimate of Rs 9.4bn due to higher order booking in the power and water segments. Net sales for the full fiscal increased 31% YoY to Rs 30.8bn, with transportation dominating the mix at 44%. Strong order booking in all the three segments of transportation, power and water/irrigation has enabled HCC to cross the Rs 30bn revenue mark for FY08.

Turnover composition

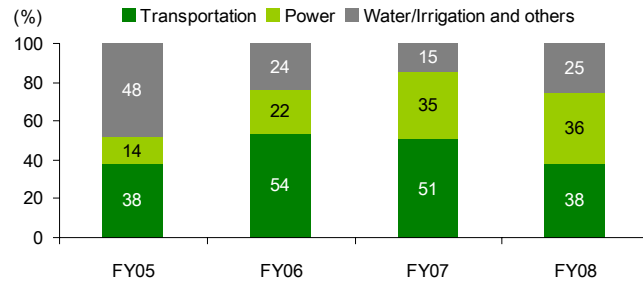


Source: Company, Religare Research

Healthy 30% YoY growth in order backlog to Rs 95.6bn for FY08

The company's order backlog stands at Rs 95.6bn (excluding the Rs 19.4bn Sawalkote project), which is 3.1x FY08 sales. The share of transportation has decreased from over 50% in the last couple of years to 38% in FY08. The rising share of power and water/irrigation would help sustain the EBITDA margin in the rising input cost scenario. HCC is currently executing 36 projects and is the lowest (L1) bidder for three projects worth Rs 37.8bn. In addition, the company has submitted four tenders worth Rs 25.7bn for which bids are yet to open.

Order book composition



Source: Company, Religare Research

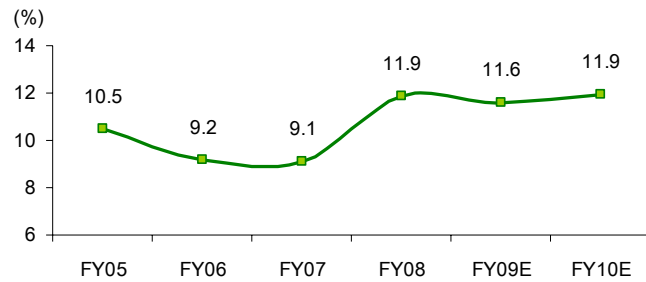
Increased hydro power and water project orders propel 390bps YoY growth in margins

EBITDA margin up 390bps YoY to 12.4% for the quarter

Increased order booking in the hydro power and water/irrigation segments has led to an expansion of 390bps YoY in the EBITDA margin to 12.4%. The margin for the fiscal has increased 276bps to 11.9%. Lower provisioning towards losses on the Bandra-Worli sealink project (Rs 200mn in FY08 as against Rs 710mn booked in FY07) has helped ease pressure on margins.

The company has also been able to sustain its EBITDA margins in the rising input cost scenario due to the cost escalation clause incorporated in all its projects. While 30–35% of the contracts allow for a full pass-along of costs, the pricing of the balance projects is linked to indices like WPI. Hence, going forward, any increase in costs beyond the rise in index can affect margins negatively.

EBITDA margin trend

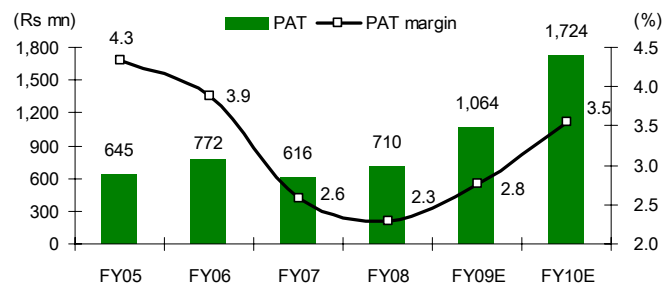


Source: Company, Religare Research

Net profit dips 2.7% YoY to Rs 357mn for Q4FY08

Net profit dipped by 2.7% YoY during the quarter to Rs 357.4mn due to higher tax provisioning. The net profit for the full fiscal grew by 15% to Rs 710mn. Despite the strong operating margins, increased interest expenses (146% rise in FY08 to Rs 1.5bn) and depreciation (21% YoY rise to Rs 962mn) have lowered the net profit margin to 2.3% from 2.6% in the previous year. The rise in working capital requirements and investments in real estate ventures have kept interest costs high and would continue to do so for the next couple of years.

PAT and PAT margins



Source: Company, Religare Research

Pre-sales of Rs 4.9bn on Lavasa, far ahead of targeted sales of Rs 1bn

Investments of Rs 9bn in Lavasa township over next two years

HCC has surpassed its FY08 pre-sales target of Rs 1bn for Lavasa by a distance to record Rs 4.9bn in pre-sales, at an average rate of Rs 3,150/sq ft of villa area and Rs 100/sq ft of land area. The management has stated that most of the infrastructure for phase I, covering 1,700 acres, is ready and the construction of villas and apartments is in full swing. The first phase is expected to be completed in 2010, while phase II will be launched in October 2009.

HCC will invest Rs 20bn on the Lavasa project till 2010, which the company expects to be funded by sales revenue of Rs 8bn and a mix of debt and equity. It will invest Rs 4.5bn each in FY08 and FY09 with ~Rs 2bn being the equity portion. We expect the company to visit the capital market over the next two years for these funds. HCC expects a minimum of Rs 10bn in revenue per annum from the project.

Vikhroli IT park project progressing as per schedule

The 1.9mn sq ft Vikhroli IT park is progressing as per schedule, with the office space to be ready by December 2008 and occupation to commence from March 2009. Project revenues will start accruing from Q1FY09. We have valued the project by capitalising revenues at 10% which gives us an equity value of Rs 3.4bn.

No further losses on Bandra-Worli sealink; project to end by June 2009

Bandra-Worli project to draw to a close by June 2009

The 4-lane southbound stretch of the Bandra-Worli sealink project in Mumbai is expected to be completed by January 2009, while the northbound section is to be completed by June 2009. The company has already booked cumulative losses of Rs 4bn on the sealink project to date, with Rs 200mn booked during FY08. HCC will receive a settlement of Rs 1.6bn as compensation for project delays from the MSRDC. The management has stated that there will be no further losses on the project.

Decision on Sawalkote project due in May 2008

The final court hearing on the 1,200MW Sawalkote hydro project worth Rs 43.1bn (HCC's share is Rs 19.4bn) has been postponed from February to May 2008. A positive outcome for HCC would create a healthier order book position by Q1FY09.

Valuation

PAT estimates revised downwards

We have reduced our net profit estimates for FY09 and FY10 by 23% and 21% respectively, to incorporate higher depreciation and interest expenses.

Revised estimates

(Rs mn)	FY09E			FY10E		
	Earlier	Revised	% Chg	Earlier	Revised	% Chg
Net sales	38,479.0	38,479.0	0.0	48,593.5	48,593.5	0.0
Adj net income	1,375.0	1,063.6	(22.6)	2,188.2	1,723.8	(21.2)
FDEPS (Rs)	4.9	3.8	(22.6)	7.8	6.1	(21.2)

Source: Religare Research

Revaluation of Lavasa to factor in uncertainty in realty prices; maintain Buy

Target price revised downward to Rs 249; maintain Buy

We have valued HCC using the sum-of-the-parts (SOTP) method, which aggregates the valuation of its core business, Lavasa project, BOT road contracts and slum rehabilitation projects. Considering the prevailing uncertainty in the realty market, we have raised HCC's holding company discount for Lavasa and other real estate projects from 15% to 30%, which reduces our per share value for Lavasa from Rs 198 to Rs 142.

Our reduction in estimates for FY09 and FY10 has impacted our core business valuation. This reduces our equity value for the core business to Rs 22.7bn and gives us a DCF-based per share value of Rs 81 from Rs 105 previously. Consequently, our SOTP target price stands revised downwards to Rs 249 from Rs 333. We maintain our Buy recommendation on the stock.

Valuation summary

Particulars	Value for HCC (Rs mn)	Value per share (Rs)	% to total	Comments
Total standalone value	22,680	81	32	Based on DCF, inversely at 7.1x EV/EBITDA and 13x P/E on FY10E
Lavasa	50,423	142	57	DCF, discounted at 30%
Vikhroli West (IT Park)	3,436	9	4	DCF, capitalized at 10%
Vikhroli East (Slum rehab)	2,861	8	3	DCF, discounted at 30%
Powai (Slum rehab)	2,275	6	3	DCF, discounted at 30%
BOT road project (AP)	974	3	1	DCF, inversely at 1.8x P/BV and ROE of 19.4%
Total value		249	100	

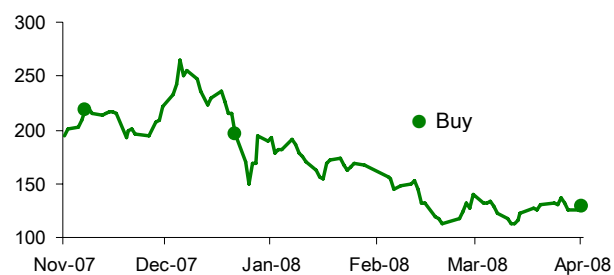
Source: Religare Research

Recommendation history

Date	Event	Reco price	Tgt price	Reco
04-Dec-07	Initiating coverage	209	333	BUY
21-Jan-08	Result update	196	333	BUY
30-Apr-08	Result update	129	249	BUY

Source: Religare Research

Stock performance



Source: Religare Research

Financials

Profit and Loss statement

(Rs mn)	FY07	FY08	FY09E	FY10E
Revenues	23,576.2	30,827.6	38,479.0	48,593.5
Growth (%)	18.7	30.8	24.8	26.3
EBITDA	2,152.6	3,666.1	4,463.6	5,782.6
Growth (%)	17.7	70.3	21.8	29.6
Depreciation	796.6	961.9	1,150.0	1,350.0
EBIT	1,356.0	2,704.2	3,313.6	4,432.6
Growth (%)	4.0	99.4	22.5	33.8
Interest	619.7	1,524.1	1,723.9	1,890.5
Other income	21.8	9.7	20.0	50.0
EBT	758.1	1,189.8	1,609.6	2,592.1
Income taxes	386.1	472.3	546.0	868.4
Effective tax rate (%)	50.9	39.7	33.9	33.5
Adjusted net income	615.8	710.3	1,063.6	1,723.8
Growth (%)	(20.2)	15.3	49.7	62.1
Extra-ordinary items	0.0	377.4	0.0	0.0
Reported net income	367.6	1,087.7	1,063.6	1,723.8
Growth (%)	-70.5	195.9	-2.2	62.1
Shares outstanding (mn)	256.3	256.3	281.4	281.4
Basic EPS (Rs) (adj)	2.4	2.8	4.2	6.7
FDEPS (Rs) (adj)	2.4	2.8	3.8	6.1
DPS (Rs)	0.7	0.8	0.9	1.0

Source: Company, Religare Research

Cash flow statement

(Rs mn)	FY07	FY08E	FY09E	FY10E
Net income	367.6	1,087.7	1,063.6	1,723.8
Depreciation	796.6	961.9	1,150.0	1,350.0
Other adjustments, net	25.1	306.6	1,423.8	103.7
Changes in working capital	(7,847.6)	(2,885.6)	(2,700.1)	(3,998.3)
Cash flow from operations	(6,658.3)	(529.4)	937.3	(820.8)
Capital expenditure	(3,623.0)	(2,000.0)	(2,000.0)	(2,000.0)
Change in investments	(1,021.7)	(500.0)	(500.0)	(500.0)
Other investing inc/(exp)	0.0	0.0	0.0	0.0
Cash flow from investing	(4,644.7)	(2,500.0)	(2,500.0)	(2,500.0)
Free cash flow	(11,303.0)	(3,029.4)	(1,562.7)	(3,320.8)
Issue of equity	0.0	0.0	4,382.6	0.0
Issue/repay debt	3,551.6	2,750.0	124.9	4,000.0
Dividends paid	(224.9)	(233.7)	(288.8)	(320.8)
Other financing cash flow	0.0	0.0	0.0	0.0
Cash flow from financing	3,326.7	2,516.3	4,218.7	3,679.2
Change in cash & cash eq	10,060.0	2,083.7	1,570.5	4,226.6
Opening cash & cash eq	(7,976.3)	(513.2)	2,656.1	358.4
Closing cash & cash eq	2,083.7	1,570.5	4,226.6	4,584.9

Source: Company, Religare Research

Balance sheet

(Rs mn)	FY07	FY08E	FY09E	FY10E
Cash and cash eq	2,083.7	1,570.5	4,226.6	4,584.9
Accounts receivable	5.4	8.6	10.7	13.5
Inventories	17,386.1	21,989.1	26,721.5	33,070.6
Others current assets	3,476.1	4,742.7	5,878.7	7,424.0
Current assets	22,951.3	28,310.9	36,837.5	45,093.0
Long-term investments	2,286.4	2,786.4	3,286.4	3,786.4
Net fixed assets	7,362.4	8,913.2	9,763.2	10,413.2
CWIP	1,512.7	1,000.0	1,000.0	1,000.0
Intangible assets	99.2	99.2	99.2	99.2
Other assets	111	172	214	270
Total assets	34,322.9	41,282.2	51,200.1	60,661.7
Accounts payable	8,439.0	11,382.6	14,429.6	18,222.6
Others	477.1	582.3	747.0	909.1
Current liabilities	8,916.1	11,964.9	15,176.6	19,131.6
Debt funds	15,510.6	18,260.6	18,385.5	22,385.5
Other liabilities	855.4	1,010.1	1,074.5	1,178.1
Equity capital	256.3	256.3	281.4	281.4
Reserves	8,784.5	9,790.3	16,282.1	17,685.0
Shareholder's funds	9,040.8	10,046.6	16,563.5	17,966.5
Total liabilities	34,322.9	41,282.2	51,200.1	60,661.7
BVPS (Rs)	35.3	39.2	58.9	63.8

Source: Company, Religare Research

Financial ratios

	FY07	FY08E	FY09E	FY10E
EBITDA margin (%)	9.1	11.9	11.6	11.9
EBIT margin (%)	5.8	8.8	8.6	9.1
Net profit margin (%)	2.6	2.3	2.8	3.5
FDEPS growth (%)	-20.2	15.3	36.4	62.1
Receivables (days)	0.1	0.1	0.1	0.1
Inventory (days)	261.4	255.0	250.0	245.0
Payables (days)	52.3	55.0	55.0	55.0
Current ratio (x)	2.6	2.4	2.4	0.7
Quick ratio (x)	0.6	0.5	0.7	0.6
Interest coverage ratio (x)	2.2	1.8	1.9	2.3
Debt / equity (x)	0.6	0.6	0.9	0.8
ROE (%)	6.9	7.4	7.7	10.0
ROA (%)	3.9	5.9	6.0	6.5
ROCE (%)	5.4	8.5	8.8	9.6
EV/Sales (x)	2.0	1.7	1.4	1.2
EV/EBITDA (x)	22.6	14.0	12.3	10.1
P/E (x)	53.7	46.5	34.1	21.1
P/BV (x)	3.7	3.3	2.2	2.0

Source: Company, Religare Research

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Recommendation parameters

Large-caps*	> 10%	< - 5%	Returns	Absolute
	BUY	SELL		
Mid-caps**	> 25%	< 10%		

*Market cap over US\$ 1bn **Market cap less than US\$ 1bn

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