21 January 2011
BSE Sensex: 19008

HCC

Rs40
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs24bn; US$536mn

Analyst: Shirish Rane (91-22-6622 2575; shirish.rane@idfc.com)
Salil Desai (91-22-6622 2573; salil.desai@idfc.com)
Ashish Shah (91-22-6622 2560; ashish.shah@idfc.com)
Nikhil Salvi (91-22-6622 2566; nikhil.salvi@idfc.com)

Comment: Sharply lower than estimates due to lower revenues and higher interest costs; earnings downgraded by 30% in FY11E and FY12E

Last report: 29 October 2010 (Rs61; Recommendation: Outperformer)

Key valuation metrics

Year to March (Rs mn)	Sales	yoy chg (%)	Net Profit	EPS (Rs)	yoy chg (%)	PER (x)*
2007	23,820	19.7	616	1.2	(33.5)	1.6
2008	30,820	29.4	724	1.4	17.4	1.4
2009	33,138	7.5	760	1.5	4.9	1.3
2010	36,292	9.5	957	1.6	6.4	1.2
2011E	41,909	15.5	880	1.5	(8.0)	1.3
2012E	51,129	22.0	1,011	1.7	15.0	1.2

** PER adjusted for value of Rs38/share for BOT and real estate projects, including Lavasa*

Highlights of Q3FY11 results

- HCC's Q3FY11 recurring PAT, although increased 15.7%yoy to Rs140mn, was sharply lower than our estimate of Rs276mn, due to slower execution and a sharp jump in interest costs.
- Revenues grew by 12%yoy to Rs10.1bn, and were sharply lower than our estimate of Rs11.4bn due to slower than expected execution during the quarter. Execution was impacted by civil unrest in J&K which led to difficulties in mobilization of hydro projects in J&K as also by sluggish order intake during H1FY11. Further, execution of AP based projects (~Rs33bn in order backlog) continued to remain sluggish during the quarter. Execution however has now picked up in the Kishanganga HEP (order worth ~Rs27bn) and the NH-34 (order worth ~Rs30bn) projects and these projects are likely to significantly contribute to revenues going forward.
- EBITDA margins jumped 180bps yoy to 13.1% (higher than estimated 12.2%) due to lower subcontracting expenses as also due to reversal of provisions worth ~Rs60m in the company's integrated JVs. The JV settled and collected Rs650m worth claims pertaining to the Nathpa Jhakri hydro project during the quarter and hence reversed the provisions created earlier related to these claims.
- Resultant, EBIDTA grew by 29.8%yoy to Rs1.32bn lower vis-à-vis our estimate of Rs1.4bn due to lower than estimated revenues.
- Interest costs jumped 50.7%yoy to Rs748mn (higher than estimated Rs700mn), due to increase in debt levels to ~Rs35bn as on December 31st 2010 from Rs33.8bn as on September 30th 2010. Further there has also been increase of 50-75bp increase in interest rates during the quarter.
- Other income for the quarter at Rs5mn (adjusted for exchange loss Rs61mn), was sharply lower than Rs15mn in Q3FY10 as well as below our estimate of Rs25mn.

- Depreciation charges increased by 18.6%yoy to Rs382mn, above estimates of Rs359mn.
- Effective tax rate for the quarter was 28%, which included provision of Rs25mn related to the previous quarters.
- Order backlog as on December 31st 2010 grew by 20.4%yoy to Rs166bn (excluding the Rs19.4bn Sawalkot hydel plant order which continues to be slow moving). HCC did not book any new orders during the quarter on account of delays in awards on various accounts – projects where HCC is L1 have not yet reached the stage of award, project clearances were delayed and slowdown in decision making in case of both government and private sector projects. There was a cancellation of an order worth Rs2.3bn from NTPC's Lohari-Nagpala hydro project which has been stalled by the government. HCC is currently L1 in orders worth Rs15.3bn.

Trend of geographical break up of order book

Order (%)	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Andhra Pradesh	19	18	19	18
Jammu & Kashmir	29	28	26	27
Others	52	54	55	55

Source: Company

Order backlog and booking trend

In Rsm	3QFY10	4QFY10	FY10	1QFY11	2QFY11	3QFY11
Work order Position	137,630	168,700	168,700	174,060	177,950	165,650
Order booked	18,620	38,850	57,480	15,900	11,780	(2,214)*
Book-to-bill ratio (x)	3.8	4.6	4.6	4.8	4.9	4.6
Work order Position	34.4	16.7	16.7	29.2	30.8	20.4
Order booked	(16.3)	(25.3)	(39.8)	(1519.8)	11.1	(111.9)

** - NIL order flow during the quarter and cancellation of an order worth Rs2.3bn*

Other highlights

MoEF passes final order on Lavasa; case to heard next on 27th January 2011

The Ministry of Environment and Forests (MoEF) had issued a show cause notice to Lavasa Corporation over compliance with environmental norms as defined in Ministry notification. Post the visit to Lavasa by a special committee (as directed by the Bombay High Court in the case filed by Lavasa against the notice), the MoEF has issued its final order. The case in the court is scheduled to be next heard on 27th January 2011. HCC has indicated at a cost escalation of Rs1bn so far in the project due to stay on construction activities at the site.

Kishanganga HEP

Execution activities have picked up in this project with excavation for river diversion tunnel being completed. All components of TBM have been transported to the site and TBM assembly has commenced. Other design and engineering activities are on schedule.

NH-34 Road packages

Equipment and manpower have been mobilized and construction of permanent work has commenced.

BOT projects

- The Badarpur Elevated Expressway has been commissioned in Dec 2010, one month before scheduled start of operations.
- The financial closure of the three road BOT projects in West Bengal has been achieved; the sites have been mobilized, with construction activities commenced.
- HCC has invested Rs5.44bn in its BOT projects till date (Rs2bn in FY11) and aims to invest an additional Rs4bn in FY12.

Karl Steiner AG (KSAG)

During the quarter, KSAG earned revenues of CHF167.8mn, and PAT of CHF2.9mn. For the quarter ended September 30 2010, KSAG had reported a turnover of CHF171mn, EBITDA of CHF1mn and a PAT of CHF0.6mn.

Valuations & View

HCC's Q3FY11 earnings have been sharply below our estimates due to slower execution as well as a sharp increase in working capital levels leading to higher interest costs. While execution has improved in some of the large projects like the Kishanganga HEP in J&K and NH-34 in West Bengal, weak order inflows YTDFY11 are likely to result in lower than estimated revenues in the near term. Further, interest costs too are likely to rise significantly due to higher debt being taken to fund increased working capital needs. Resultant, we have lowered our revenue estimates by 6-7% for FY11 and FY12 leading to an EBIDTA downgrade of 3-4%, after accounting for higher than estimated margin performance during 9MFY11. However, after accounting for higher interest expenses on increased debt levels there has been a downgrade of 30% each in FY11 and FY12 earnings. Our revised earnings estimates are Rs1.5/share for FY11 and Rs1.7/share for FY12.

HCC's stock has corrected 37% over the last three months on uncertainties as regards to the Lavasa project (post MoEF's show cause notice to the project) and concerns on earnings growth due to sluggishness in order intake and order execution as well as rising debt levels. While we expect a visible improvement in order intake over the next six months, execution too has picked up during the current quarter. Further, uncertainties as regards to the Lavasa project too are likely to get addressed with the MoEF willing to let the development activities continue albeit after imposition of penalties. Higher debt levels however continue to remain a concern and unwinding of the receivables/claims worth Rs15-Rs16bn remain key to bring the debt levels down. On the back of our estimate of an 8% decline in earnings in FY11, we expect 15% earnings growth in FY12 led by improved execution and sustained margins. Any reduction in debt levels and a favorable verdict on the Lavasa project are expected to be key triggers for the stock in the medium term. We maintain Outperformer rating on HCC, with a revised 12-month price target of Rs57/share.

Quarterly results

HCC, Rs mn	3QFY10	4QFY10	FY10	1QFY11	2QFY11	3QFY11	FY11E
Net Sales	**9,006**	**10,850**	**36,292**	**9,954**	**8,846**	**10,086**	**41,909**
Raw Material Consumed	2,512	3,049	12,990	2,967	2,560	3,137	13,714
Employee Expenses	992	998	3,944	1,094	1,189	1,205	4,811
Contracting exps	4,037	5,203	13,487	4,208	3,565	3,950	16,185
Other Expenses	447	371	1,464	427	399	474	1,830
Total Expenses	**7,989**	**9,620**	**31,884**	**8,696**	**7,713**	**8,766**	**36,540**
EBITDA	**1,017**	**1,230**	**4,408**	**1,258**	**1,133**	**1,320**	**5,370**
OPM (%)	11.3%	11.3%	12.1%	12.6%	12.8%	13.1%	12.8%
Other Income	15	7	144	60	1	5	87
Interest	496	443	2,052	577	671	748	2,812
Depreciation	322	201	1,139	347	359	382	1,472
PBT	**214**	**593**	**1,361**	**393**	**105**	**195**	**1,173**
Tax	92	198	404	81	25	55	270
Deferred Tax			-	-	-	-	23
Tax Rate (%)	43.2	33.4	29.7	20.6	24.1	28.0	25.0
PAT	**121**	**394**	**957**	**312**	**80**	**140**	**880**
Extra ordinary income	26	35	(143)	(29)	42		-
Extra ordinary expenses			-			61	
Reported Profit After Tax	148	430	814	283	121	79	880
Growth (yoy, %)							
Net Sales	**9.9**	**10.8**	**9.5**	**13.6**	**13.2**	**12.0**	**15.5**
EBITDA	**(4.1)**	**(18.3)**	**2.2**	**9.3**	**5.5**	**29.8**	**21.8**
Other Income	(32.3)	(72.5)	52.0	32.6	(98.3)	(68.7)	(39.1)
Interest	(13.3)	(31.8)	(2.5)	(5.8)	34.4	50.7	37.0
Depreciation	7.6	(33.8)	(1.2)	15.3	13.9	18.6	29.3
PBT	1.5	2.8	18.1	39.5	(68.8)	(8.8)	(13.8)
PAT	**(59.6)**	**9.0**	**25.9**	**49.9**	**(63.3)**	**15.7**	**(8.0)**
Reported PAT	**(36.4)**	**(16.4)**	**(35.1)**	**55.6**	**120.1**	**(46.2)**	**8.1**
EPS							
Outstanding shares	606.50	606.50	606.50	606.50	606.5	606.5	606.5
EPS	0.2	0.7	1.6	0.5	0.1	0.2	1.5
P/E	2.4	0.8	1.2	0.9	3.7	2.1	1.3

Analyst	Sector/Industry/Coverage	E-mail	Tel. +91-22-6622 2600
Pathik Gandotra	Head of Research; Financials, Strategy	pathik.gandotra@idfc.com	91-22-662 22525
Shirish Rane	Construction, Power, Cement	shirish.rane@idfc.com	91-22-662 22575
Nikhil Vora	FMCG, Media, Mid Caps, Education, Exchanges	nikhil.vora@idfc.com	91-22-662 22567
Nitin Agarwal	Pharmaceuticals, Real Estate	nitin.agarwal@idfc.com	91-22-662 22568
Chirag Shah	Metals & Mining,Telecom, Pipes, Textiles	chirag.shah@idfc.com	91-22-662 22564
Bhoomika Nair	Logistics, Engineering	bhoomika.nair@idfc.com	91-22-662 22561
Hitesh Shah, CFA	IT Services	hitesh.shah@idfc.com	91-22-662 22565
Bhushan Gajaria	Automobiles, Auto ancillaries, Retailing	bhushan.gajaria@idfc.com	91-22-662 22562
Salil Desai	Construction, Power, Cement	salil.desai@idfc.com	91-22-662 22573
Ashish Shah	Construction, Power, Cement	ashish.shah@idfc.com	91-22-662 22560
Probal Sen	Oil & Gas	probal.sen@idfc.com	91-22-662 22569
Chinmaya Garg	Financials	chinmaya.garg@idfc.com	91-22-662 22563
Abhishek Gupta	Telecom, Metals & Mining	abhishek.gupta@idfc.com	91-22-662 22661
Ritesh Shah	Pharmaceuticals	ritesh.shah@idfc.com	91-22-662 22571
Saumil Mehta	Metals, Pipes	saumil.mehta@idfc.com	91-22-662 22578
Vineet Chandak	Real Estate	vineet.chandak@idfc.com	91-22-662 22579
Kavita Kejriwal	Strategy, Financials	kavita.kejriwal@idfc.com	91-22-662 22558
Anamika Sharma	IT Services	anamika.sharma@idfc.com	91-22-662 22680
Varun Kejriwal	FMCG, Mid Caps	varun.kejriwal@idfc.com	91-22-662 22685
Swati Nangalia	Media, Education, Exchanges, Midcaps	swati.nangalia@idfc.com	91-22-662 22576
Nikhil Salvi	Construction, Power, Cement	nikhil.salvi@idfc.com	91-22-662 22566
Dharmendra Sahu	Database Analyst	dharmendra.sahu@idfc.com	91-22-662 22580
Rupesh Sonawale	Database Analyst	rupesh.sonawale@idfc.com	91-22-662 22572
Dharmesh R Bhatt, CMT	Technical Analyst	dharmesh.bhatt@idfc.com	91-22-662 22534

Equity Sales/Dealing	Designation	E-mail	Tel. +91-22-6622 2500
Naishadh Paleja	MD, CEO	naishadh.paleja@idfc.com	91-22-6622 2522
Paresh Shah	MD, Dealing	paresh.shah@idfc.com	91-22-6622 2508
Vishal Purohit	MD, Sales	vishal.purohit@idfc.com	91-22-6622 2533
Nikhil Gholani	MD, Sales	nikhil.gholani@idfc.com	91-22-6622 2529
Sanjay Panicker	Director, Sales	sanjay.panicker@idfc.com	91-22-6622 2530
Rajesh Makharia	Director, Sales	rajesh.makharia@idfc.com	91-22-6622 2528
Nirbhay Singh	SVP, Sales	nirbhay.singh@idfc.com	91-22-6622 2595
Suchit Sehgal	AVP, Sales	suchit.sehgal@idfc.com	91-22-6622 2532
Pawan Sharma	MD, Derivatives	pawan.sharma@idfc.com	91-22-6622 2539
Jignesh Shah	AVP, Derivatives	jignesh.shah@idfc.com	91-22-6622 2536
Suniil Pandit	Director, Sales trading	suniil.pandit@idfc.com	91-22-6622 2524
Mukesh Chaturvedi	SVP, Sales trading	mukesh.chaturvedi@idfc.com	91-22-6622 2512
Viren Sompura	SVP, Sales trading	viren.sompura@idfc.com	91-22-6622 2527
Rajashekhar Hiremath	VP, Sales trading	rajashekhar.hiremath@idfc.com	91-22-6622 2516