



Hindustan Construction

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,083	HCC IN
	REUTERS CODE
S&P CNX: 4,146	HCNS.BO

Equity Shares (m)	274.3
52-Week Range	172/82
1,6,12 Rel. Perf. (%)	0/-42/-58
M.Cap. (Rs b)	26.4
M.Cap. (US\$ b)	0.6

11 June 2007

Buy

Previous Recommendation: Buy

Rs96

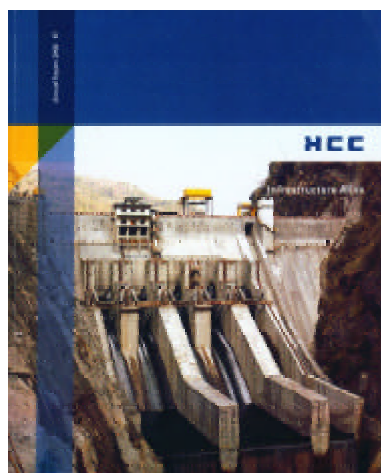
YEAR	NET SALES	PAT*	EPS*	EPS*	P/E*	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	23,576	595	2.1	-35.3	45.2	2.7	6.1	6.6	1.6	17.7
3/08E	34,504	1,036	3.8	77.3	25.5	1.8	8.9	9.4	1.1	10.7
3/09E	46,300	1,811	6.6	74.8	14.6	1.7	12.1	13.3	0.9	8.3

* Pre-exceptionals

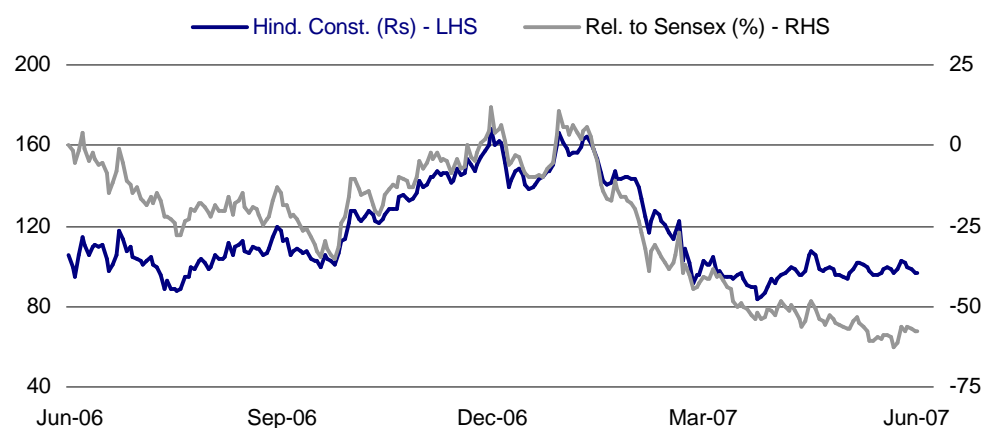
Annual Report FY07: Key takeaways

- FY07 performance:** FY07 performance has been impacted by lower than expected revenues (Rs23.6b, vs expectations of Rs25b), loss of Rs710m on Bandra-Worli Sealink, mismatch in terms of revenues and costs, and projects not crossing margin recognition threshold. As several hydro power projects were awarded during FY06, they required quick mobilization in terms of equipments and manpower, which in turn increased costs (operational, depreciation and interest). Revenues from some of these projects started flowing in from mid FY07, and thus there was a mismatch in cost apportionment.
- Expect robust order intake:** HCC's order book as at Mar 2007 stood at Rs93.1b, vs Rs96.7b during Mar 06. HCC is L1 in projects worth Rs25b (HCC's share Rs19.3b). Further, the company has submitted tenders for nine bids, valued at Rs45.1b. It plans to bid for 24 new projects worth Rs179b in the near future, and has submitted pre-qualification bids for 9 projects of Rs38b. The company also plans to submit pre-qualification bids for 7 projects worth Rs35b in the near future.
- Order book composition towards high margin projects:** As at Mar 2007, share of power sector in order backlog has increased to 48% (vs 38% as at Mar 06 and 14% as at Mar 2005). During FY07, hydro power accounted for 71% of order intake. Hydro power entails comparatively better margins, when compared with roads and irrigation segments.
- Recommend Buy:** We expect HCC to report net profit of Rs1b for FY08 (up 77.3% YoY) and Rs1.8b for FY09 (up 74.8% YoY). Maintain **Buy**.

ANNUAL REPORT FY07



STOCK PERFORMANCE (1 YEAR)



Key takeaways from annual report

1. HCC is L1 in projects worth Rs25b (HCC's share Rs19.3b) and has submitted tenders for 9 bids, valued at Rs45.1b. It plans to bid for 24 new projects worth Rs179b and has submitted pre-qualification bids for 9 projects of Rs38b. Thus, we expect robust order intake during FY08.
2. Hydro projects accounted for 71% of the order intake during FY07. As at Mar 2007, share of power sector in order backlog increased to 48% (vs. 38% as at Mar 06 and 14% as at Mar 2005). These projects entail comparative better margins.
3. The Bandra Worli Sealink project has achieved significant progress and currently piling and bridge sub structure works are being carried out (refer to picture on page 4).
4. Inventory days in FY07 increased to 269 days, vs. FY06 at 189 days, as several large hydro power projects did not cross margin recognition threshold of 10%. Going forward, we expect inventory levels to decline.
5. As HCC bagged several hydro power projects during FY06, they required quick mobilization of equipments and manpower which in turn increased costs (operational, depreciation and interest). Revenues from some of these projects started flowing in from mid FY07, and thus there was a mismatch in terms of revenue and cost recognition. During FY08 and FY09, as these projects start contributing to revenues, we expect a much better cost apportionment.

Expect robust order intake, L1 in projects worth Rs19b

HCC's order book as at March 2007 stood at Rs93.1b, marginally lower than Rs96.7b in March 2006. Excluding the Sawalakote hydro power project, Jammu and Kashmir, HCC's order book stands at Rs73.7b. HCC is L1 in projects worth Rs25b (HCC's share Rs19.3b). Further, the company has submitted tenders for nine bids, valued at Rs45.1b. It plans to bid for 24 new projects worth Rs179b in the near future, and has submitted pre-qualification bids for 9 projects of Rs38b. The company also plans to submit pre-qualification bids for 7 projects worth Rs35b in the near future.

Change in order book composition towards higher margin projects

During FY07, HCC received 5 orders, comprising of 3 hydro power projects and 1 each in canal construction and road (annuity). In terms of value, hydro power accounted for 71% of the order intake during FY07. These projects entail comparatively better margins.

LIST OF NEW PROJECTS SECURED IN FY07 (RS M)

Loharinag Pala Hydro power project (600 MW)	2,465
Nimoo Bazgo Hydro power project (45 MW)	3,839
Chutak Hydro power project (44 MW)	4,105
Kadtal to Armur (part of NHDP phase II) on annuity basis	3,200
Gosikhurd Project Ghodazari Canal	1,100

Source: Company

Thus, the composition of order backlog has shifted towards power segment, where margins are significantly better, when compared with roads and irrigation segments. As at Mar 07, share of power sector in order backlog has increased to 48% (vs 38% as at Mar 06 and 14% as at Mar 05).

In terms of revenue mix, power sector accounted for 20% of revenues during FY07, vs 37% during FY05. Thus, going forward, we believe that there exists a string possibility for EBIDTA margin expansion as share of hydro power to revenue mix improves.

ORDER BOOK COMPOSITION (%)

	FY04	FY05	FY06	FY07
Hydro & Nuclear Power	23	14	38	48
Transportation	38	38	43	40
Water Supply & Irrigation	25	37	15	8
Others	14	12	4	3

Source: Company

REVENUE COMPOSITION (%)

	FY04	FY05	FY06	FY07
Hydro & Nuclear Power	48	37	20	20
Transportation	36	36	33	47
Water Supply & Irrigation	26	27	40	27
Others	na	na	7	6

Source: Company

Enhancing role as project developer

During 1QFY07, HCC bagged project for development of 30km four lane highway between Kadtal and Armur in Andhra Pradesh on annuity basis. Project cost stands at

Rs2.75b, and semi-annual annuity payments stand at Rs238.5m, over 18 year period (20 year concession). The company also intends to bid for BOT projects in power sector, and is already looking at hydro power projects in Uttar Pradesh, Uttaranchal, etc.

Real estate

Realty development is emerging as a key business vertical for HCC, and the company is seeking opportunities in township development through HCC Real estate (hitherto Hicon Realty Ltd), 100% subsidiary. The company has a total developable area of 186m sq ft, of which HCC's share stands at 126m sq ft. HCC Real Estate (100% subsidiary of HCC) is also looking at various options for fund raising to finance the real estate initiatives. During FY07, HCC invested Rs1b as additional equity in HCC Real Estate, and total equity investment as at Mar 07 stands at Rs2.0b. HCC intends to focus on development of large integrated townships, and land acquisition, regulatory approvals and business plans preparation is in progress at 4 locations in Maharashtra.

☞ **Lavasa project (63% stake):** Lavasa Corporation is currently developing a 12,500 acre integrated township in Warasgaon, situated between the cities of Pune and Mumbai. The company has completed the acquisition of 7,559 acres of land and is processing the completion of another 2,147 acres for which the agreement is already in place. Currently, the infrastructure works including access roads, internal roads, promenades, bridges, weirs, hotel, town hall, buildings, bungalows and utilities are in progress.

Lavasa has spent Rs6b till March 07, of which Rs3.5b has been financed through debt, Rs1.5b as equity and Rs1b through land sale. Total cost of Phase 1 stands at Rs9b, post which the project is expected to achieve self financing mode. Of the balance Rs3b, loans sanctioned are at Rs2b and Rs1b will be financed through equity. Also, HCC is planning to induct investors for specialty segments (eg hospitality, etc), Infrastructure (eg power, water, sewage, etc) and also for a strategic investor in Lavasa Corp, which would

reduce the funding requirement on HCC's books. The management indicated that the full scale launch (Phase 1) initially expected by mid FY09, is now expected from Nov 2007.

☞ **Development of Vikhroli land (Corporate Park):** Due to the phase-out of STPI benefits (available to IT companies), the planned IT park at Vikhroli has been converted into corporate park (saleable area 1m sq ft). Developments permission have been obtained and construction has commenced. The estimated project cost stands at Rs5b, which would be financed through debt and bank guarantees.

☞ **Other land banks:** HCC has acquired 100 acres of the contracted 1500 acres (on outskirts of Mumbai, Nashik and Pune) for township development. The expected acquisition cost is Rs3b, and amount spent till Mar 07 is Rs500m. Also, HCC is undertaking slum rehabilitation for 10 acres at Powai and 15 acres at Vikhroli, entailing 2m sq ft of total development area. Preliminary surveys for both the sites have commenced along with the feasibility studies and business plans.

HCC'S REAL ESTATE PORTFOLIO

PROJECT	ACRES	M.SQ.FT.
Lavasa	12,500	150
Vikhroli West (IT Park)	11	2
Res. Project in Mumbai (SRS)	10	1
Vikhroli East	15	1
Township in MMR (Mumbai Metropolitan Region)	200	6
SEZ/Township in Nashik	1,000	20
Township in Pune	300	6
Total	14,036	186

Source: Company

Progress on Bandra Worli Sealink

The piling and bridge sub structure works are being carried out at Bandra Worli Sea Link. During FY07, HCC recorded EBIDTA loss of Rs710m from this project, margin impact of ~300bp. This is because while expenses were accounted in totality, revenues are booked based on original cost of the project. Till date, the company has booked cumulative revenues of Rs2.4b on this project, and incurred cost of Rs4.4b, thus incurring cumulative under-recovery of Rs2.3b (loss in P/L account). The management expects additional loss of Rs1b on the project till the scheduled completion.

SIGNIFICANT PROGRESS ON BANDRA-WORLI SEALINK PROJECT



Source: Company

Financial Performance and Ratio Analysis

During FY07, HCC reported revenues of Rs23.6b (up 18.7% YoY), EBIDTA of Rs2.2b (up 17.7% YoY) and pre-exceptional net profit of Rs546m (down 35.3% YoY). During FY07, the company has provided for tax rates of 32.8%, vs 9.7% during FY07, due to withdrawal of tax benefits under Sec 80 IA. The reported net profit of Rs793m is adjusted for prior period claims in JV of Rs195m and forex gains of Rs90m.

COST ANALYSIS (RS M)

Y/E MARCH	FY03	FY04	FY05	FY06	FY07
Sales (Net of Excise)	6,772	10,579	14,873	19,870	23,576
Construction Expenses	4,604	7,871	11,814	16,011	18,370
% of Net Sales	68.0	74.4	79.4	80.6	77.9
Office and Site Est. Exp.	374	507	546	716	967
% of Net Sales	5.5	4.8	3.7	3.6	4.1
Employee Expenses	610	768	954	1,314	2,087
% of Net Sales	9.0	7.3	6.4	6.6	8.9
EBIDTA	1,183	1,433	1,559	1,829	2,153
EBIDTA Margin (%)	17.5	13.5	10.5	9.2	9.1

Source: Company

- ✎ **Construction expenses** as % of revenues declined to 77.9% in FY07 vs 80.6% in FY06. This is primarily due to the fact that several projects in the hydro power segment are in the initial ramp up and mobilization phase and did not cross the margin recognition threshold.
- ✎ **Staff cost** as a % of revenues increased significantly to 8.9% of sales, vs 6.6% in FY06. This is primarily because several hydro power projects which were awarded during FY06, required quick mobilization in terms of enhancing the on-site manpower which in turn increased costs. Revenues from some of these projects started flowing in from mid FY07, and thus there was a mismatch in terms of revenue and cost recognition. Office and site establishment expenses also increased to 4.1% of revenue in FY07, from 3.6% in FY06, again due to the mismatch in revenue and cost recognition.
- ✎ **EBIDTA margins** remained flat at 9.1% in FY07 (vs 9.2% in FY06). EBIDTA margin for the HCC have been impacted by 1) continued losses on Bandra worli sealink project (EBIDTA margins impact of ~300bps

in FY07), 2) significant share of revenues from roads and irrigation sector, which have comparatively lower margins vs Hydro power and 3) Non booking of revenues (inventory increase of Rs6b) as several hydro power projects did not cross the minimum margin recognition threshold of 10%.

We expect margin improvement during FY08 / FY09 driven by:

- Increasing share of hydro power projects in revenues
- Several large hydro power projects crossing margin recognition threshold.
- Because several hydro power projects were awarded during FY06, they required quick mobilization in terms of enhancing the on-site equipments and manpower which in turn increased costs. Revenues from some of these projects started flowing in from mid FY07, and thus there was a mismatch in terms of revenue and cost recognition (operational, depreciation and interest). During FY08 and FY09, as these projects start contributing to revenues, we expect a much better cost apportionment.
- Bandra-Worli sealink project is expected to be completed by Mar 08 (EBIDTA margin impact of ~300bp during FY07)

BALANCE SHEET ANALYSIS (RS M)

Y/E MARCH	FY03	FY04	FY05	FY06	FY07
Net Worth	1,395	1,639	3,530	8,898	9,041
Borrowings*	3,766	4,195	4,257	11,958	15,511
Gearing (x)	2.7	2.6	1.2	1.3	1.7
Fixed Assets (Gross)	4,891	5,482	6,208	7,728	11,012
Work-In-Progress	356	86	478	1,074	1,513
Cash & Bank Balance	366	407	875	10,060	2,084
Inventory	4,367	5,213	5,833	10,987	17,386
Inventory (Days)	235	180	143	189	269
Creditors	1,603	2,388	4,039	5,910	6,796
Creditors (Days)	127	111	125	135	135
RoE (%)	17.4	23.5	25.5	13.6	6.1
RoCE (%)	31.3	16.4	15.4	11.8	6.6

* Incl. FCCB proceeds of US\$100m (conversion price Rs248/share)

Source: Company

- **Increased gearing:** As at Mar 2007, HCC's gearing stands at 1.7x (vs 1.3x as of FY06). This is excluding

mobilization advances which have been classified as current liabilities. The company has changed its accounting policy for accounting of mobilization advances where in the interest bearing advances which was earlier classified as unsecured loans, and now has been recognized as current liabilities. During FY07, interest bearing mobilization advances stood at Rs1.6b (vs Rs1b in FY06). The management indicated that on the existing projects, the company can avail of further mobilization advances of ~Rs7.5b.

- **Significant increase in Capex:** During FY07, HCC incurred capex of Rs3.7b, up 76% YoY, largely on equipment purchases. As several large hydro power projects were awarded during FY06, they required significant mobilization of equipments at site. For FY08, capital commitment stands at Rs2.4b.

TREND IN INTEREST AND DEPRECIATION COSTS

Y/E MARCH	FY03	FY04	FY05	FY06	FY07
Interest Cost (Rs m)	421	376	395	414	620
As a % to Sales	6.2	3.6	2.7	2.1	2.6
Depreciation (Rs m)	341	438	453	524	797
As a % to Sales	5.0	4.1	3.0	2.6	3.4

Source: Company

- **Cash and bank balance:** Cash and bank balance declined to Rs2.1b in FY07 vs Rs10.1b in FY06. During FY07, the company spent Rs3.4b for capital expenditure and Rs7.8b for meeting working capital requirement.
- **Increase in inventory days:** Inventory days in FY07 increased to 269 days, vs FY06 at 189 days. Inventory largely comprises of a) stores and spares b) work in progress and c) site mobilization expense. Thus, increase in inventory is largely a result of the non booking of revenues on several large hydro power projects, as they did not cross the margin recognition threshold of 10%. Going forward, as these projects cross the margin recognition threshold, we expect inventory levels to decline.
- **Negative cash flow from operations:** During FY07, the cash from operations stood at negative Rs5.6b vs negative Rs1b in FY06. This is largely a result of the increase in inventories by Rs7b during FY07. Going

forward, as projects cross the margin recognition threshold, we expect inventory levels to decline. We expect HCC to report positive cash flow from operations during FY08.

CASH FLOW ANALYSIS (RS M)

Y/E MARCH	FY03	FY04	FY05	FY06	FY07
CF from Operations	652	812	2,169	-1,031	-5,615
CF Used in Investing	1,067	-705	-2,491	-1,191	-4,873
CF from Financing	455	-66	790	11,407	2,512
Net Change in Cash	41	41	468	9,185	-7,976

Source: Company

Recommend Buy

We expect HCC to report net profit of Rs1b for FY08 (up 77.3% YoY) and Rs1.8b for FY09 (up 74.8% YoY). We value the core business of HCC at Rs85/ share (12x FY09E), Lavasa project at Rs35/ share and other real estate projects at Rs18/sh, and arrive at a price target of Rs138 per share. At CMP of Rs96, the stock quotes at reported PER of 45.2x FY07, 25.5x FY08E and 14.6x FY09E. Adjusting for value of real estate, subsidiaries and investments, it quotes at PER of 20.3x FY07, 11.5x FY08E and 6.6x FY09E. **Maintain Buy.**

HCC SUM OF PARTS TABLE (RS/SH)

	BUSINESS SEG.	METHOD	VALUATION MULTIPLE	VALUE (RS M)	VALUE (RS/SH)	RATIONALE
HCC Standalone Real Estate	Construction	FY09E PER (x)	12	21,731	85	At par with industry average
Lavasa	Township	Land Value (Rs m/acre)	3.0	9,071	35	Out of 12,500 acres of land, 5000 acres will be developed. Past transactions by Lavasa was at Rs4.0-4.5m/acre (land sale)
Vikhroli Land (11 acres)	Real Estate	NPV, Cost of Equity:15%		1,966	8	Based on NPV of expected rentals from office space
Vikhroli Land (Slum Rehabilitation - 15 acres)	Real Estate	NPV, Cost of Equity:15%		855	3	Based on NPV of expected cash flows
Powai Land (Slum Rehabilitation - 10 acres)	Real Estate	NPV, Cost of Equity:15%		695	3	Based on NPV of expected cash flows
Other Land Banks	Real Estate	Book Value		1,000	4	Expected investments in land banks by March 2007
Total				35,317	138	

We do not factor in the land development profit at Lavasa

Source: Motilal Oswal Securities

INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Net Sales	14,873	19,870	23,576	34,504	46,300
Change (%)	40.6	33.6	18.7	46.4	34.2
Construction Exps.	11,814	16,011	18,370	26,771	36,062
Staff Cost	954	1,314	2,087	2,901	3,700
Office and Site Establish. Exps	546	716	967	1,420	1,538
EBITDA	1,559	1,829	2,153	3,412	5,000
% of Net Sales	10.5	9.2	9.1	9.9	10.8
Depreciation	453	524	797	1,006	1,188
Interest	395	414	620	908	1,193
Other Income	56	461	199	4	6
Share of turnover in JV	-17	31	244	45	80
PBT	750	1,383	1,179	1,547	2,704
Tax	10	135	386	511	892
Rate (%)	13	9.7	32.8	33.0	33.0
Reported PAT	740	1,248	793	1,037	1,812
Extra-ordinary Income (net of e)	82	404	247	1	1
Adjusted PAT	658	844	595	1,036	1,811
Change (%)	84.3	28.3	-29.4	74.0	74.8

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Share Capital	229	256	256	274	274
Reserves	3,300	8,642	8,785	14,025	15,424
Net Worth	3,530	8,898	9,041	14,299	15,698
Loans	4,257	11,959	15,511	10,484	15,296
Deferred Tax Liability	725	677	855	855	855
Capital Employed	8,511	21,535	25,407	25,639	31,849
Gross Fixed Assets	6,208	7,728	11,012	13,775	16,275
Less: Depreciation	2,305	2,807	3,550	4,556	5,744
Net Fixed Assets	3,903	4,921	7,462	9,219	10,531
Capital WIP	478	1,074	1,513	750	750
Investments	1,899	1,265	2,286	5,162	7,162
Curr. Assets	7,721	22,387	23,062	23,506	31,437
Inventory	5,833	10,307	17,386	17,961	24,101
Debtors	31	28	5	8	11
Cash & Bank Balance	875	10,060	2,084	339	387
Loans & Advances	982	1,991	3,476	5,087	6,827
Other Current Assets	0	1	111	111	111
Current Liab. & Prov.	5,489	8,112	8,916	12,998	18,031
Creditors	4,039	5,910	6,796	9,902	13,338
Other Liabilities	1,167	1,830	1,643	2,500	3,500
Provisions	283	372	477	596	1,193
Net Current Assets	2,232	14,275	14,146	10,508	13,406
Application of Funds	8,511	21,535	25,407	25,639	31,849

E: MOST Estimates

RATIOS					
Y/E MARCH	2005	2006	2007	2008E	2009E
Basic (Rs)					
Adjusted EPS	2.9	3.3	2.1	3.8	6.6
Growth (%)	61.0	14.7	-35.3	77.3	74.8
Cash EPS	4.8	5.3	5.2	7.4	10.9
Book Value	15.4	34.7	35.3	52.1	57.2
DPS	0.6	0.7	0.7	0.8	1.3
Payout (incl. Div. Tax.)	212	16.4	28.4	22.8	22.8
Valuation (x)					
P/E (standalone)		29.3	45.2	25.5	14.6
Cash P/E		18.0	18.4	12.9	8.8
EV/EBITDA		14.5	17.7	10.7	8.3
EV/Sales		1.3	1.6	1.1	0.9
Price/Book Value		2.8	2.7	1.8	1.7
Dividend Yield (%)		0.7	0.8	0.8	1.4
Profitability Ratios (%)					
RoE	25.5	13.6	6.1	8.9	12.1
RoCE	15.4	11.8	6.6	9.4	13.3
Turnover Ratios					
Debtors (Days)	1	1	0	0	0
Inventory (Days)	143	189	269	190	190
Creditors. (Days)	125	135	135	135	135
Asset Turnover (x)	2.0	1.3	1.0	1.4	1.6
Leverage Ratio					
Debt/Equity (x)	12	13	17	0.7	1.0

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
PBT before Extraordinary Items	750	1,383	1,179	1,547	2,704
Add : Depreciation	453	524	797	1,006	1,188
Interest	395	414	620	908	1,193
Less : Direct Taxes Paid	10	135	386	511	892
(Inc)/Dec in WC	639	-2,858	-7,847	1,893	-2,849
CF from Operations	2,226	-672	-5,638	4,843	1,344
(Inc)/Dec in FA	-1,139	-2,139	-3,776	-2,000	-2,500
(Pur)/Sale of Investments	-1,413	634	-1,022	-2,876	-2,000
CF from Investments	-2,552	-1,504	-4,798	-4,876	-4,500
(Inc)/Dec in Networth	1,284	4,278	-247	4,458	0
(Inc)/Dec in Debt	61	7,702	3,551	-5,026	4,812
Less : Interest Paid	395	414	620	908	1,193
Dividend Paid	157	205	225	236	413
CF from Fin. Activity	794	11,362	2,460	-1,713	3,205
Inc/Dec of Cash	468	9,186	-7,976	-1,745	49
Add: Beginning Balance	407	875	10,060	2,084	339
Closing Balance	875	10,060	2,084	339	387



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Disclosure of Interest Statement

Hindustan Construction

1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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