

Hindustan Constructions

Q4FY11 Result Review

2 May 2011

Buy

Target Price: Rs41

CMP: Rs35

Upside: 17%

*as on 29 April 2011

EPC Stagnant, Lavasa key trigger

Though HCC's core business of EPC is not performing as expected with lower order intake & tepid execution, its subsidiary Lavasa's clearance by MoEF holds the key for upside triggers. We believe, at the CMP, the EPC business is fairly valued and limited downside risk appears on it, and Lavasa's environment clearance remains key upside trigger. We reduced earnings estimate due to increased interest & depreciation, also marginally changing revenue & operating profits. We believe, HCC's risk-reward is getting better than what it was 3months back at CMP and hence we retain our Buy rating with a new target price of Rs41 (17% upside from the CMP of Rs35). Note that it still remains a high risk stock v/s its construction peers.

- **Order-book:** HCC's order-book is stagnant. New orders in existing business are tough to come by. New segments like Hydrocarbons, industrial, thermal power, etc are expected to have increasing order-book share going forward. Current order-book is at Rs194bn (Incl. L1).
- **Financial Position** – FCCB amount of around Rs6.2bn was paid in early April. This reduces one of investor's major concerns, although interest expense would increase going forward as high cost domestic debt replaces it.
- **Maintain Buy – with downward revision in EPC numbers & higher discount for Lavasa:** We reduce our earnings for EPC business by increasing interest & depreciation expenses, with minor change in revenue & operating profit. We also increase our discount for Lavasa from 25% to 50% now.
- **Lavasa remains a key near-term trigger:** We believe, CMP presents lower downside as of now. Risk-reward improved from what it was 3months back. We maintain Buy with a reduced target of Rs41 (upside 17%). Lavasa remains a key upside trigger for HCC stock price.

Manish Kayal

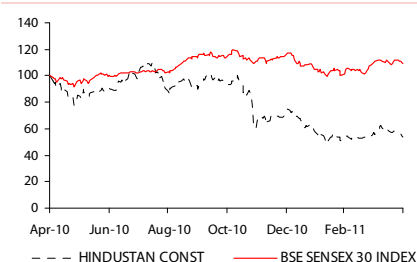
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Key Data

Bloomberg Code	HCC IN
Reuters Code	HCNS.BO
Current Shares O/S (mn)	606.5
Diluted Shares O/S (mn)	606.5
Mkt Cap (Rsbn/USDmn)	21.4/482.7
52 Wk H / L (Rs)	73/31
Daily Vol. (3M NSE Avg.)	5,393,290
Face Value (Rs)	1

USD = Rs44.4

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
HCC Ltd	(5.1)	(42.7)	(46.3)
NIFTY	(2.4)	(6.8)	8.0

Source: Bloomberg, Centrum Research
*as on 29 April 2011

Y/E March (Rsmn) (Standalone)	Q4FY11A	Q4FY10A	YoY%	Q3FY11A	QoQ%	Q4FY11E	Variance %	FY11	FY10	YoY%
Net sales	12,095	9,026	34.0	8,888	36.1	12,612	(4.1)	40,932	36,442	12.3
Consumption of RM	9,171	6,861	33.7	6,524	40.6	9,487	(3.3)	30,857	28,070	9.9
% of sales / bps	75.8	76.0	(19)bps	73.4	242bps	75.2	60bps	75.4	77.0	(164)bps
Employee Costs & SG&A	1,188	992	19.7	1,189	(0.1)	1,516	(21.6)	4,676	3,943	18.6
% of sales / bps	9.8	11.0	(117)bps	13.4	(355)bps	12.0	(219)bps	11.4	10.8	60bps
EBITDA	1,736	1,172	48.1	1,175	47.7	1,609	7.9	5,398	4,429	21.9
EBITDA Margin (%) /bps	14.4	13.0	136	13.2	113	12.8	159	13.2	12.2	103
Dep and Amortisation	440	322	36.6	359	22.6	244	80.5	1,527	1,139	34.0
Interest	903	496	81.8	671	34.6	832	8.5	2,899	2,052	41.3
EBT	393	354	11.2	146	170.0	534	(26.3)	972	1,238	(21.5)
Other income	134	41	NM	61	119.8	44	206.3	170	130	NM
PBT	528	395	33.6	207	155.1	577	(8.7)	1,142	1,368	(16.6)
Exceptional item (reported)	(78)	(18)	NM	(40)	94.8			(30)	205	NM
Provision for tax	228	92	146.9	43	426.9	196	16.1	407	404	0.7
Effective Tax Rate % / bps	34.0	38.5	(4.5)	26.3	772	34.0	0	36.4	33.2	3.3
JV partner's share in profit/Loss	(74)	(155)	NM	(42)	74.6			(25)	(150)	NM
PAT (reported)	226	148	53.2	121	86.3	381	(40.7)	710	814	(12.8)
PAT (adjusted)	148	130	13.8	81	82.0	381	(61.2)	680	1,020	(33.3)
NPM (%) / bps	1.2	1.4	(22)bps	0.9	31bps	3.0	(180)bps	1.7	2.8	(114)bps
EPS (adjusted)	0.24	0.45	(47.5)	0.19	22.0	0.61	(61.2)	1.04	1.30	(19.9)

Source: Company, Centrum Research

Y/E Mar (Rsmn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	EPS (Rs)	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY09	33,137	7.5	4,314	13.0	506	(9.6)	0.9	5.1	10.2	39.0	10.0
FY10	36,442	10.0	4,429	12.2	1,175	132.4	1.9	9.4	8.9	18.8	10.7
FY11E	40,932	12.3	5,398	13.2	652	(44.5)	1.0	4.3	8.6	33.9	10.5
FY12E	46,663	14.0	6,015	12.9	452	(30.7)	0.7	2.9	8.1	48.9	9.9
FY13E	53,964	15.6	6,794	12.6	555	22.8	0.9	3.5	8.7	39.8	9.3

Source: Company, Centrum Research Estimates

Please refer to important disclosures/disclaimers in Appendix A

Q4FY11 Results Review – Revenue In line, PAT 41% lower than expectation

- **Overall Results** – Overall results were disappointing with PAT 41% lower than expectation. The order-intake in existing segments of the company is tough to get as most are in environmentally sensitive segment including Hydro-power, nuclear power, etc. The company plans to get into other segments like hydrocarbons, thermal power, industrials, etc which we believe would reduce operating margins going forward.
- **Order-book:** HCC OB was stagnant at Rs193bn (Incl L1). As no significant orders have come through in its major segment of hydro-power, HCC is planning to explore new regions such as Hydrocarbon, Thermal power EPC, etc.
- **Revenue** at Rs12bn was in line with our estimate of Rs12.6bn & street's 12.5bn. Operating margins were higher at 14.4% v/s our & street's expectations of 12.8%.
- **Profit after tax:** Though operating margins were in line, higher depreciation charges, interest charge, and tax expenses though offset by higher than expected other income, nevertheless brought down actual PAT by around 41% of our expectations.

Exhibit 1: Q4FY11 Order-book & Order-Intake Review

Order - Book Details	Q4FY11A	Q4FY10A	YoY%	Q3FY11A	QoQ%	Q4FY11E	Variance %	Comments
Order-Book	181,270	157,030	15.4	197,350	(8.1)	198,873	(8.9)	Order-intake lower, new segments like Hydrocarbon, nuclear power, etc will take time to see serious share
Power Sector	103,628	87,270	18.7	110,516	(6.2)	110,641	(6.3)	
Nuclear	24,057	6,420	274.7	25,656	(6.2)	25,500	(5.7)	
Hydel	79,572	80,850	(1.6)	84,861	(6.2)	85,142	(6.5)	
Water	37,010	46,300	(20.1)	39,470	(6.2)	38,490	(3.8)	
Transport	44,412	23,460	89.3	47,364	(6.2)	49,741	(10.7)	
Others (EPC, etc)	-	-	NA	-	NA	-	NA	
Order-Intake	8,315	8,020	3.7	11,780.00	(29.4)	26,435	(68.5)	

Source: Company, Centrum Research Estimates

Exhibit 2: Q4FY11 Results Review

Y/E March (Rsmn) (Standalone)	Q4FY11A	Q4FY10A	YoY%	Q3FY11A	QoQ%	Q4FY11E	Variance %	FY11	FY10	YoY%	Comments
Net sales	12,095	9,026	34.0	8,888	36.1	12,612	(4.1)	40,932	36,442	12.3	Inline revenue
Consumption of RM	9,171	6,861	33.7	6,524	40.6	9,487	(3.3)	30,857	28,070	9.9	
% of sales / Change in bps	75.8	76.0	(19)bps	73.4	242bps	75.2	60bps	75.4	77.0		
Employee Costs & SG&A	1,188	992	19.7	1,189	(0.1)	1,516	(21.6)	4,676	3,943	18.6	
% of sales / Change in bps	9.8	11.0	-117bps	13.4	(355)bps	12.0	(219)bps	11.4	10.8		
EBITDA	1,736	1,172	48.1	1,175	47.7	1,609	7.9	5,398	4,429	21.9	Better margins
EBITDA Margin (%) / Change in bps	14.4	13.0	136	13.2	113	12.8	159	13.2	12.2		
Dep and Amortisation	440	322	36.6	359	22.6	244	80.5	1,527	1,139	34.0	Estimate erro made by us and hence the actual came in higher
Interest	903	496	81.8	671	34.6	832	8.5	2,899	2,052	41.3	Higher interest v/s our expectations
EBT	393	354	11.2	146	170.0	534	(26.3)	972	1,238	(21.5)	
Other income	134	41	NM	61	119.8	44	206.3	170	130	NM	Surprised. Actual higher than our estimate
PBT	528	395	33.6	207	155.1	577	(8.7)	1,142	1,368	(16.6)	
Exceptional item (reported)	(78)	(18)	NM	(40)	94.8			(30)	205	NM	
Provision for tax	228	92	146.9	43	426.9	196	16.1	407	404	0.7	Higher as a new law disallows expense related to tax-ree income like dividednds
Effective Tax Rate % / Change in bps	50.2	38.5	11.7	26.3	2393	34.0	1621	36.4	33.2	3.3	
JV partner's share in profit/Loss	(74)	(155)	NM	(42)	74.6			(25)	(150)	NM	
PAT (reported)	226	148	53.2	121	86.3	381	(40.7)	710	814	(12.8)	
PAT (adjusted)	148	130	13.8	81	82.0	381	(61.2)	680	1,020	(33.3)	
NPM (%) / Change in bps	1.2	1.4	-22bps	0.9	31bps	3.0	(180)bps	1.7	2.8	-114bps	
EPS (adjusted)	0.24	0.45	(47.5)	0.19	22.0	0.61	(61.2)	1.04	1.30	(19.9)	

Source: Company, Centrum Research Estimates

Analysts' Meet Takeaways

- **HCC repaid FCCB money due in early April** - The total amount that HCC paid was Rs6.2bn on 1st April '2011. As FCCB's premium (accumulated accrued interest) was charged at a lower rate than the interest the company will pay on domestic debt replacing FCCB this will have the effect of increasing outgo in interest payment by the company going forward.
- **Karl Steiner AG** is expected to contribute a significant share of the consolidated revenue of HCC. The Total Addressable Market (TAM) for the company is CHF9bn in its domestic market of Switzerland. HCC plans to have its presence felt in India as the Indian building market is currently expected to be around Rs700bn (Euro11bn) and few have capabilities that KSAG possesses. The order-book of the company stands at CHF1.4bn Including L1 orders. Order-book of the company almost doubled after HCC took over giving clients the confidence on execution capability of Karl Steiner. Revenue reported for Karl Steiner is CHF565mn, EBIT of CHF9mn and PAT of CHF5.5mn.
- On **Lavasa**, HCC has approached MoEF for the clearance of the first phase of 3,000acres. The decision of MoEF is expected by 11th June this year. The management seemed confident of getting the verdict in the company's favor.

Maintain Buy - EPC Business fairly valued. Discount on Lavasa increased from 25% to 50%; its clearance holds the key

- We have revised our estimates for HCC's EPC business. Though our revenue & operating profit remains almost the same, upward revision in depreciation and interest gives us a net profit number of Rs452mn & Rs485mn for FY12 & FY13 v/s Rs911mn & Rs1bn earlier.
- Though we retain our Buy rating, we believe the trigger for the stock would be the clearance for Lavasa which contributes around 60% of the total fair value. We do not see any major downside from these levels, though it is a high risk play given the fact that the debt levels are high and any negative event that affects debt repayment would be a serious downside.

Exhibit 3: Estimate Change Table

Particulars	Old Est.		New Estimates			
	FY12E	FY13E	FY12E	Var %/bps	FY13E	Var %/bps
Income from Operations	48,106	55,590	46,663	(3.0)	53,964	(2.9)
<i>Growth (in % YoY) / bps</i>	16.1	15.6	14.0	(206)bps	15.6	9
EBITDA (Rsmn)	6,010	6,834	6,015	0.1	6,794	(0.6)
EBITDA Margins (in %)	12.5	12.3	12.9	40	12.6	30
Depreciation	1,496	1,618	1,834	22.6	2,013	24.4
Interest Expenses	3,272	3,640	3,691	12.8	4,141	13.8
Profit Before Tax (Rsmn)	1,380	1,719	696	(49.6)	854	(50.3)
PBT Margin	2.9	3.1	1.5	(138)bps	1.6	(151)bps
Tax Expenses	469	584	243	(48.1)	299	(48.9)
Reported Profit After Tax (Rsmn)	911	1,135	452	(50.4)	555	(51.1)
<i>Net Profit Margin (in %)</i>	1.9	2.0	1.0	(92)bps	1.0	(101)bps
EPS - Diluted	1.5	1.8	0.7	(50.4)	0.9	(51.1)

Source: Company, Centrum Research Estimates

Exhibit 4: HCC Valuation Table

Valuation of HCC	Method	Holding Discount	Book Value (Rsmn)	Stake	Multiple	EPS**	Value / Share
Core Construction Business	P/E	NA		NA	10.0	0.9	8.9
Real Estate Business							
Lavasa	DCF	50%	5,434	65.0%	P/B is 3.7	NA	21.2
247 IT Park (Vikhroli)	DCF	NA	NA	26.0%	N.A.	NA	3.0
Other (Land Bank, etc)	BV						1.9
BOT Projects							2.0
Investment in Karl Steiner	P/BV		1,750		1.5		4.2
Total							41
Current Price							35
Upside / Downside							17%

Source: Company, Centrum Research Estimates

Financials (Standalone)

Exhibit 5: Income Statement

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Revenues	33,137	36,442	40,932	46,663	53,964
Growth in revenue	7.5	10.0	12.3	14.0	15.6
Cost of Raw Material	25,074	28,070	30,857	35,991	41,784
% of Revenue	75.7	77.0	75.4	77.1	77.4
Employee cost	3,749.0	3,943.5	4,676.4	4,656.9	5,385.6
% of Sales	11.3	10.8	11.4	10.0	10.0
EBITDA	4,314	4,429	5,398	6,015	6,794
EBITDA Margin (%)	13.0	12.2	13.2	12.9	12.6
Depreciation	1,152	1,139	1,527	1,834	2,013
PBIT	3,162	3,290	3,871	4,181	4,781
Interest expenses	2,105	2,052	2,899	3,691	4,141
PBIT from operations	1,057	1,238	972	490	640
Other non operating income	588	130	170	206	214
PBT before ext.od items	1,645	1,368	1,142	696	854
Extra-ordinary income/(exp)	(0.6)	149.9	25.0	-	-
PBT	1,645	1,218	1,117	696	854
Provision for tax	392	404	407	243	299
Effective tax rate (%)	23.8	33.2	36.4	35.0	35.0
Minority interest					
PAT	1,253	814	710	452	555
Adjustment for Ext.Od items	(748)	360	(58)	0	0
Adjusted PAT	506	1,175	652	452	555
Growth in PAT (%)	(9.6)	132.4	(44.5)	(30.7)	22.8
PAT margin (%)	1.5%	3.2%	1.6%	1.0%	1.0%

Source: Company, Centrum Research Estimates

Exhibit 6: Balance Sheet

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Share Capital	256	303	607	607	607
Stock Options / Warrants	152	-	-	-	-
Reserves	9,640	14,869	14,615	14,994	15,458
Shareholders' fund	10,049	15,172	15,222	15,600	16,065
Debt	23,218	25,147	34,714	37,514	41,214
Deferred Tax Liability	1,132	1,426	1,665	1,665	1,665
Minority Interest					
Total Capital Employed	34,398	41,745	51,600	54,779	58,943
Gross Block	16,828	18,142	19,901	20,872	22,445
Accumulated dep.	5,547	6,645	8,144	9,978	11,991
Net Block	11,282	11,497	11,757	10,894	10,454
Capital WIP	464	349	342	330	317
Total Fixed Assets	11,746	11,845	12,100	11,224	10,771
Investments	3,655	4,087	5,313	6,613	7,813
Deferred Tax Asset					
Inventories	27,766	35,652	44,990	47,520	53,477
Debtors	47	27	27	35	40
Cash & bank balances	1,539	1,883	1,936	1,287	964
Loans and Advances	5,284	8,633	13,948	17,220	19,742
Other Current Assets	38	48	58	75	86
Total current assets	34,674	46,242	60,960	66,136	74,309
Current lia & provisions	15,677	20,430	26,772	29,195	33,950
Net current assets	18,997	25,813	34,188	36,941	40,359
Misc. Expenditure					
Total Assets	34,398	41,745	51,600	54,779	58,943

Source: Company, Centrum Research Estimates

Exhibit 7: Cash flow Statement

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
CF from operating					
Profit before tax	1,645	1,218	1,117	696	854
Depreciation	1,152	1,139	1,527	1,834	2,013
Interest expenses	2,244	2,262	2,899	3,691	4,141
OP profit before WC change	4,455	4,587	5,543	6,221	7,008
Working capital adjustment	(3,071)	(3,608)	(8,321)	(3,403)	(3,741)
Gross cash from operations	1,384	979	(2,779)	2,817	3,267
Direct taxes paid	(338)	(411)	(407)	(243)	(299)
Cash from operations	1,046	568	(3,185)	2,574	2,968
CF from investing					
Capex	(1,231)	(2,574)	(1,753)	(959)	(1,560)
Investment	(683)	(365)	(1,226)	(1,300)	(1,200)
Others	(1,169)	(1,205)	-	-	-
Cash from investment	(3,083)	(4,144)	(2,979)	(2,259)	(2,760)
CF from financing					
Proceeds from sh cap & prem.	-	4,679	-	-	-
Borrowings/ (Repayments)	4,781	1,939	9,567	2,800	3,700
Interest paid	(2,204)	(2,229)	(2,899)	(3,691)	(4,141)
Dividend paid	(204)	(204)	(116)	(74)	(90)
Others	(1,440)	(264)	(334)	-	-
Cash from financing	932	3,921	6,218	(965)	(532)
Net cash increase/ (dec)	(1,105)	345	53	(650)	(323)

Source: Company, Centrum Research Estimates

Exhibit 8: Key Ratios

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
Margin Ratios (%)					
EBITDA Margin	13.0	12.2	13.2	12.9	12.6
PBIT Margin	9.5	9.0	9.5	9.0	8.9
PBT Margin	5.0	3.3	2.7	1.5	1.6
PAT Margin	1.5	3.2	1.6	1.0	1.0
Growth Ratios (%)					
Revenues	7.5	10.0	12.3	14.0	15.6
EBITDA	17.7	2.7	21.9	11.4	13.0
Net Profit	(9.6)	132.4	(44.5)	(30.7)	22.8
Return Ratios (%)					
ROCE	10.2	8.9	8.6	8.1	8.7
ROIC	6.8	6.0	5.7	5.4	5.8
ROE	5.1	9.4	4.3	2.9	3.5
Turnover Ratios					
Asset turnover ratio (x)	1.0	0.9	0.8	0.9	0.9
Working Capital Turnover (x)	1.7	1.4	1.2	1.3	1.3
Avg collection period (days)	0.5	0.3	0.2	0.3	0.3
Avg payment period (days)	177.6	211.2	267.7	255.2	288.7
Per share (Rs)					
Fully diluted EPS	0.9	1.9	1.0	0.7	0.9
CEPS	3.2	3.8	3.7	3.9	4.3
Book Value	19.6	26.1	26.1	26.8	27.6
Solvency ratios (x)					
Debt/ Equity	2.3	1.7	2.3	2.4	2.6
Interest coverage ratio	1.9	2.2	1.9	1.6	1.6
Valuation parameters (x)					
P/E	39.0	18.8	33.9	48.9	39.8
P/BV	1.8	1.4	1.4	1.3	1.3
EV/ EBITDA	10.0	10.7	10.5	9.9	9.3
EV/ Sales	1.3	1.3	1.4	1.3	1.2
M-Cap/ Sales	0.6	0.6	0.5	0.5	0.4

Source: Company, Centrum Research Estimates

Appendix

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