

Hindustan Constructions

Q2FY11 Result Review

1 November 2010

Buy

Target Price: Rs88

CMP: Rs61*

Upside: 44%

*as on 29 October 2010

Slightly below expectation

HCC's revenue for Q2FY11 were slightly below ours and streets expectation at Rs8.9bn (14% YoY, street at Rs9.5bn - off by 7%). EBITDA was inline v/s our estimate at Rs1.2bn (31% YoY) and off by 7% over streets Rs1.3bn. PAT was off 64% from street's expectation on higher depreciation and interest expense. Though Q2 revenue grew only by 14%, the company expects to close the year with 20%-25% growth. Order-book at Rs210 (Incl L1 of Rs15bn). HCC market share in Hydro & Nuclear power civil work awards was 100% during Q2FY11. We maintain HCC's estimates and continue to believe in HCC's EPC business (core EPC business trading at FY12 P/E of ~6X). Maintain Buy with a target price of Rs88 (upside of 44%).

- **Working capital reduction measures** were specifically discussed which we believe will bring relief in FY12 (note that incremental WC investment has been more than 100% of incremental revenue in FY09 & FY10).
- **Robust order-book:** HCC's OB at Rs210bn is 5X TTM. It bagged orders worth Rs12bn in 2Q (L1 Rs15.4bn). Government orders contributed <75% of the total OB. HCC, in our view, is much ahead in terms of order-booking compared to peers.
- **Financial position strong** – HCC currently has a cash balance of Rs4.8bn which it says would be used to repay FCCBs of USD96.6mn due this year.
- **Triggers:** Besides working capital optimization measures, Lavasa's IPO in 2HFY11 and the listing of HCC Infra (100% sub) are short/medium term triggers.

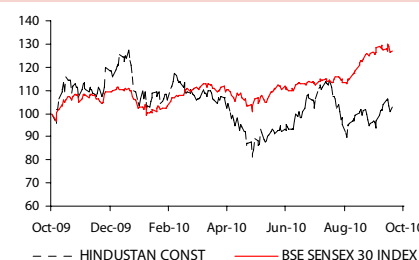
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Key Data

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)	37.1/833.2
52 Wk H / L (Rs)	81/50
Daily Vol. (3M NSE Avg.)	3,088,344
Face Value (Rs)	1
USD = Rs44.5	

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
HCC	0.5	(7.0)	(2.9)
NIFTY	(0.6)	15.8	27.9

Source: Bloomberg, Centrum Research
*as on 29 October 2010

Y/E March (Rsmn) (Standalone)	Q2FY11A	Q2FY10A	YoY (%)	Q1FY11A	QoQ (%)	Q2FY11E	Variance (%)
Net sales	8,888	7,825	13.6	9,924	(10.4)	9,797	(9.3)
Consumption of RM	6,524	5,953	9.6	7,602	(14.2)	7,485	(12.8)
% of sales	73.4	76.1	(268.0)	76.6	(320.0)	76.4	(300.0)
Employee costs & SG&A	1,189	977	21.7	1,094	8.7	1,100	8.1
% of sales	13.4	12.5	90.0	11	235.0	11.2	215.0
EBITDA	1,175	895	31.3	1,228	(4.3)	1,212	(3.1)
EBITDA Margin (%/bps)	13.2	11.4	179.0	12.4	84.0	12.4	84.0
Dep and amortisation	359	315	13.9	347	3.4	258	38.8
Interest	671	499	34.4	577	16.2	582	15.2
EBT	146	81	80.6	304	(52.1)	372	(60.8)
Other income	61	28	116.5	31	98.1	36	68.0
PBT	207	109	89.9	335	(38.2)	408	(49.4)
Exceptional item (reported)	(40)	162		20			
Provision for tax	43	40	8.4	81	(46.6)	139	(68.8)
Effective Tax Rate(%/bps)	26.3	36.6	(1,037.0)	24.2	206.0	34	(772.0)
JV partner's share in profit/Loss	(42)	(14)		29	(243.1)	0	
PAT (reported)	121	55	120.1	283	(57.1)	270	(55.0)
PAT (adjusted)	81	217	(62.5)	303	(73.1)	270	(69.8)
NPM (%/bps)	0.9	2.8	(186.0)	3.1	(214.0)	2.8	(184.0)
EPS (adjusted)	0.19	0.17	14.1	0.45	(57.1)	0.43	(55.0)

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	67.4	13.3
FY10	36,442	10.0	4,429	12.2	1,175	132.4	1.9	9.4	8.9	32.5	14.3
FY11E	45,159	23.9	5,589	12.4	1,486	26.5	2.4	9.4	10.0	25.7	12.1
FY12E	59,036	30.7	7,483	12.7	2,212	48.9	3.5	12.8	12.0	17.3	9.5
FY13E	75,667	28.2	9,591	12.7	3,068	38.7	4.9	15.7	13.8	12.4	7.7

Source: Company, Centrum Research Estimates

Please refer to important disclosures/disclaimers in Appendix A

Analyst Meet Takeaways

- **To reduce working capital** – In our initiation, we factored in the reduction in working capital for the next 2 years. At its Q2FY11 analyst meet, HCC specifically discussed working capital stuck in various projects and vowed to take measures to free it. It expects Rs7.5bn to flow in to the books in the next 6-12months.

Exhibit 1: Measures to reduce working capital investment

Project	Claim description	Status
Bandra-Worli Sealink	Compensation for delays	Submitted to MSRDC
Ennore Port	Arbitration award and bill payments	Under negotiation for settlement
NJJV - Naphtha Jhakri	Extention of time and all other claims	Amicable settlement reached. Under approval
NHAI - West Bengal Road Pkg II	EOT cost and other claims	Court upheld arbitration award in favour
NHAI - Allahabad Bypass	Arbitration awards	Arbitration award in favour
AP - Godavari Lift Irrigation Scheme - Phase I	Reimbursement of VAT	
AP - Godavari Lift Irrigation Scheme - Phase II	Tapaspally Tank	Under government consideration
	Ghanpur tank and epoxy coating of pipes	

Source: Company

- **Ramping up of new projects gives confidence on FY12 revenue visibility** - HCC detailed projects which were to be delivered in the next 6-9months and those about to be ramped up. We believe, though the revenue in the quarter was lower than expectation, 2HFY11 & FY12 will be much better and pose little risk to our numbers.

Exhibit 2: Projects reaching completion & Projects ramping-up

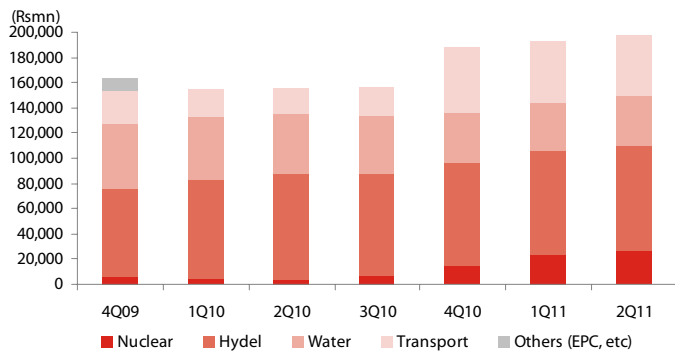
Projects reaching completion	Qtr End	Projects ramping-up	Value (Rsmn)
Chamera HEP	Q3 FY11	Hindalco Packages	7,060
Chutak HEP	Q3 FY11	Hindalco Packages RAPP - 7 & 8	8,880
Badarpur Elevated Highway	Q3 FY11	Mumbai Metro - VAG Corridor	1,450
Chennai Bypass	Q3 FY11	DGNP Dry Dock	6,080
Lucknow Road Packages	Q4 FY11	Padur Rock Cavern	3,750
Vizag Rock Cavern	Q4 FY11	Sainj HEP	4,310
Nimoo Bazgo HEP	Q1 FY12	NH-34 Road Packages	28,600
Uri HEP	Q1 FY12	Kishanganga HEP	27,250

Source: Company, Centrum Research Estimates

HCC's order-book details

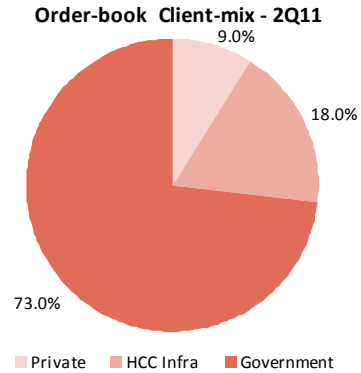
- Order-book intake is increasing from the private sector. We remind investors that HCC's private sector client base is limited and in less competitive segments. Also, its client base comprises India's large conglomerates (GMR Infra, Hindalco, etc). The company cites better terms, quicker cash flows, faster resolution and increasing opportunity as the reason for getting aggressive in private sector orders.
- Order-inflow during the quarter stood at Rs12bn with L1 status in orders worth Rs15.4bn (Including L1, OB stands at Rs210bn). It expects transportation order-intake to improve in 3Q as 2Q was dull.
- In one particular instance, GMR chose HCC for Alakananda Hydro-Electric-Power (HEP) primarily on its capabilities, despite the competition being cheaper by 10%-15%.

Exhibit 3: Order-book trend



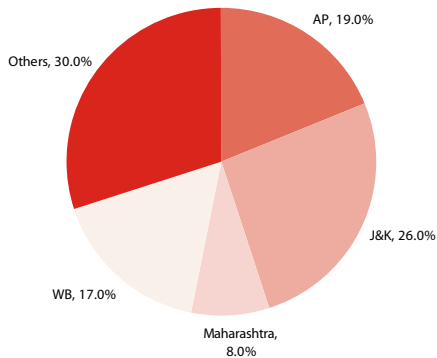
Source: Company, Centrum Research Estimates

Exhibit 4: Order-book Client Mix



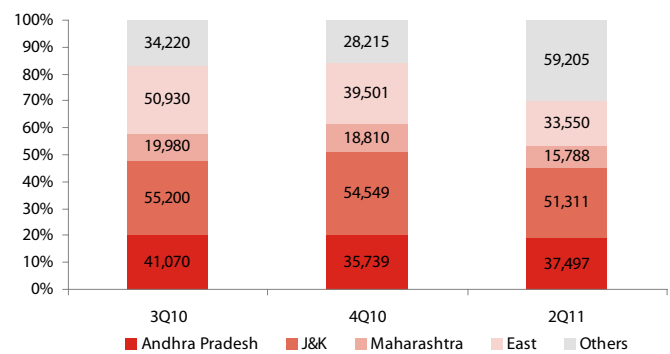
Source: Company, Centrum Research Estimates

Exhibit 5: 1HFY11 Order-Intake Geo-mix



Source: Company, Centrum Research Estimates

Exhibit 6: Geo-mix reasonable & spreading pan-India



Source: Company, Centrum Research Estimates

HCC real estate division update

- HCC is planning to launch Phase II of “247 Park” (Vikhroli). Total area is 2mn sq.ft (saleable area 0.9mn sq.ft). Approvals from 70% of the agencies have been received and construction is to start by Jan’11.
- SRA project in Vikhroli (East) – Approvals are at an advanced stage for 14 acres of land (Phase I). Rehabilitation area would be 1.3mn sq.ft whereas saleable area would be 1.5mn sq.ft.
- Dholera – HCC is in discussion with Gujarat government. Project design has been completed by the agency, but the site is to be finalized by the next “Vibrant Gujarat” event. The company expects investment to be minimal at Rs1bn for initial 2 years.

Update on Karl Steiner

- Background – HCC acquired Swiss based Karl Steiner (KSAG) for CHF35mn (Rs1.6bn) for a 66% stake. KSAG is a contracting company and as a total services contractor provides comprehensive services in the real estate industry in Europe.
- In the quarter, KSAG delivered revenue of CHF 171mn (Rs7.7bn) with an EBITDA of CHF1mn (Rs45mn) and PAT of CHF0.6mn (Rs27mn). Since acquisition (5th May’10), KSAG has delivered a revenue of CHF263mn, EBITDA of (CHF3.4mn) and PAT of (CHF2.8mn). (1CHF=Rs45 as on 31th Oct’10).
- Current order-book of KSAG stands at CHF789mn (Rs35bn). It bagged two orders during the quarter worth CHF200mn (Rs9bn).
- HCC is planning to bring KSAG’s expertise in executing projects including high-rise buildings, complex structures, etc (non-Infra segment) to India where very few players like L&T, Shapporji Pallonji, etc. are capable

Update on HCC Infrastructure

- Delhi-Faridabad elevated expressway is expected to be operational by Nov'10.
- Financial closure has been executed for its Rs30bn road project in West Bengal. Interest rates of 10.5% fixed during the construction period.
- It plans to add 1 to 2 road projects worth Rs30bn-Rs40bn annually in JV with large international players like Vinci (France) and Orascom (Russia). Current portfolio includes 6 road projects worth Rs55bn. For existing projects, HCC has put in Rs2.5bn during the year and further investment of Rs2.5bn in remaining part of FY11 will be required.
- On stake sale for future equity funding – It said stake sale would be in SPVs (not at holding company HCC Infrastructure) and would not be more than 10%.

Other discussions

- Interest cost during the quarter was Rs670mn v/s 499mn last year. HCC reasons the new “base rate” system for rise, since company was heavily dependent on Commercial Paper (CP) market for its working capital. HCC was able to get money at interest rates of 5% whereas the new base system increased cost by around 3percentage points (amount from CP market stands at Rs5bn). Apart from CP money, HCC has been taking advances from clients at higher than bank charges (advance increased from Rs6bn to Rs10bn currently). Going forward, HCC wants to maintain interest cost in the range of 5%-6% of revenue (Q2FY11 was around 7% as revenue was muted)
- On the share of losses from JV, HCC said it was due to conservative accounting policies (Accounting Standard 7) wherein claims submitted are processed/received in future but provided now in books. This quarter's amount pertains to project done for DMRC's Airport express line (in JV with Alpine Mayreder – Austria and Samsung Corporation).
- It has a cash balance of Rs4.8bn along with undrawn cash credit limits of Rs6bn which will be enough to fund FCCB repayment of USD96.6mn due this year.

Financials (Standalone)

Exhibit 7: Income Statement

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Revenues	33,137	36,442	45,159	59,036	75,667
<i>Growth in revenue</i>	7.5	10.0	23.9	30.7	28.2
Cost of Raw Material	25,074	28,070	34,522	45,044	57,734
<i>% of Revenue</i>	75.7	77.0	76.4	76.3	76.3
Employee cost	3,749.0	3,943.5	5,048.9	6,508.2	8,341.7
<i>% of Sales</i>	11.3	10.8	11.2	11.0	11.0
EBITDA	4,314	4,429	5,589	7,483	9,591
<i>EBITDA Margin (%)</i>	13.0	12.2	12.4	12.7	12.7
Depreciation	1,152	1,139	1,276	1,668	2,138
PBIT	3,162	3,290	4,313	5,815	7,453
Interest expenses	2,105	2,052	2,369	2,639	3,009
PBIT from operations	1,057	1,238	1,944	3,176	4,445
Other non operating income	588	130	154	176	203
PBT before ext.od items	1,645	1,368	2,097	3,352	4,647
Extra-ordinary income/ (exp)	(0.6)	149.9	(29.4)	-	-
PBT	1,645	1,218	2,127	3,352	4,647
Provision for tax	392	404	680	1,139	1,580
<i>Effective tax rate (%)</i>	23.8	33.2	32.0	34.0	34.0
<i>Minority interest</i>	-	-	-	-	-
PAT	1,253	814	1,447	2,212	3,068
Adjustment for Ext.Od items	(748)	360	39	-	(0)
Adjusted PAT	506	1,175	1,486	2,212	3,068
<i>Growth in PAT (%)</i>	(9.6)	132.4	26.5	48.9	38.7
<i>PAT margin (%)</i>	1.5	3.2	3.3	3.7	4.1

Source: Company, Centrum Research Estimates

Exhibit 8: Balance Sheet

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Share Capital	256	303	303	303	303
Stock Options / Warrants	152	-	-	-	-
Reserves	9,640	14,869	16,079	17,931	20,499
Shareholders' fund	10,049	15,172	16,383	18,235	20,803
Debt	23,218	25,147	29,547	32,947	35,847
Deferred Tax Liability	1,132	1,426	1,426	1,426	1,426
Minority Interest	-	-	-	-	-
Total Capital Employed	34,398	41,745	47,356	52,608	58,076
Gross Block	16,828	18,142	20,042	22,132	24,431
Accumulated dep.	5,547	6,645	7,921	9,589	11,727
Net Block	11,282	11,497	12,121	12,543	12,704
Capital WIP	464	349	367	380	385
Total Fixed Assets	11,746	11,845	12,488	12,923	13,089
Investments	3,655	4,087	6,387	7,087	7,687
Deferred Tax Asset					
Inventories	27,766	35,652	42,770	47,628	53,530
Debtors	47	27	33	43	55
Cash & bank balances	1,539	1,883	920	1,018	1,518
Loans and Advances	5,284	8,633	11,104	14,555	18,073
Other Current Assets	38	48	72	93	119
Total current assets	34,674	46,242	54,899	63,338	73,296
Current lia & provisions	15,677	20,430	26,418	30,739	35,996
Net current assets	18,997	25,813	28,481	32,598	37,300
Misc. Expenditure	-	-	-	-	-
Total Assets	34,398	41,745	47,356	52,608	58,076

Source: Company, Centrum Research Estimates

Exhibit 9: Cash flow

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
CF from operating					
Profit before tax	1,645	1,218	2,127	3,352	4,647
Depreciation	1,152	1,139	1,276	1,668	2,138
Interest expenses	2,244	2,262	2,369	2,639	3,009
OP profit before WC change	4,455	4,587	5,772	7,659	9,794
Working capital adjustment	(3,071)	(3,608)	(3,631)	(4,019)	(4,202)
Gross cash from operations	1,384	979	2,140	3,639	5,592
Direct taxes paid	(338)	(411)	(680)	(1,139)	(1,580)
Cash from operations	1,046	568	1,460	2,500	4,013
CF from investing					
Capex	(1,231)	(2,574)	(1,919)	(2,103)	(2,304)
Investment	(683)	(365)	(2,300)	(700)	(600)
Others	(1,169)	(1,205)	-	-	-
Cash from investment	(3,083)	(4,144)	(4,219)	(2,803)	(2,904)
CF from financing					
Proceeds from sh cap & prem.	-	4,679	-	-	-
Borrowings/ (Repayments)	4,781	1,939	4,400	3,400	2,900
Interest paid	(2,204)	(2,229)	(2,369)	(2,639)	(3,009)
Dividend paid	(204)	(204)	(236)	(360)	(500)
Others	(1,440)	(264)	-	-	-
Cash from financing	932	3,921	1,796	400	(608)
Net cash increase/ (dec)	(1,105)	345	(963)	98	500

Source: Company, Centrum Research Estimates

Exhibit 10: Key Ratios

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
Margin Ratios (%)					
EBITDA Margin	13.0	12.2	12.4	12.7	12.7
PBIT Margin	9.5	9.0	9.5	9.8	9.8
PBT Margin	5.0	3.3	4.7	5.7	6.1
PAT Margin	1.5	3.2	3.3	3.7	4.1
Growth Ratios (%)					
Revenues	7.5	10.0	23.9	30.7	28.2
EBITDA	17.7	2.7	26.2	33.9	28.2
Net Profit	(9.6)	132.4	26.5	48.9	38.7
Return Ratios (%)					
ROCE	10.2	8.9	10.0	12.0	13.8
ROIC	6.8	6.0	6.7	8.0	9.2
ROE	5.1	9.4	9.4	12.8	15.7
Turnover Ratios					
Asset turnover ratio (x)	1.0	0.9	1.0	1.1	1.3
Working Capital Turnover (x)	1.7	1.4	1.6	1.8	2.0
Avg collection period (days)	0.5	0.3	0.3	0.3	0.3
Avg payment period (days)	177.6	211.2	220.9	197.3	206.3
Per share (Rs)					
Fully diluted EPS	0.9	1.9	2.4	3.5	4.9
CEPS	3.2	3.8	4.6	6.4	8.6
Book Value	19.6	26.1	28.1	31.3	35.7
Solvency ratios (x)					
Debt/ Equity	2.3	1.7	1.8	1.8	1.7
Interest coverage ratio	1.9	2.2	2.4	2.8	3.2
Valuation parameters (x)					
P/E	67.4	32.5	25.7	17.3	12.4
P/BV	3.1	2.3	2.2	1.9	1.7
EV/ EBITDA	13.3	14.3	12.1	9.5	7.7
EV/ Sales	1.7	1.7	1.5	1.2	1.0
M-Cap/ Sales	1.0	1.0	0.8	0.6	0.5

Source: Company, Centrum Research Estimates

Appendix A

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