



Hindustan Construction

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,183	HCC IN
	REUTERS CODE
S&P CNX: 4,090	HCNS.BO

19 January 2007

Buy

Previous Recommendation: Buy

Rs153

		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
Equity Shares (m)	274.3	3/06A	19,870	844	3.3	14.7	46.6	4.4	13.6	11.4	2.1	23.1
52-Week Range	196/83	3/07E	24,260	982	3.8	16.4	40.0	4.0	10.5	8.1	1.9	18.9
1,6,12 Rel. Perf. (%)	3/32/-45	3/08E	35,100	1,769	6.4	68.3	23.8	2.7	13.9	12.3	1.4	12.8
M.Cap. (Rs b)	16.7											
M.Cap. (US\$ b)	0.4											

⚡ **3QFY07: Net profit lower than expectations due to higher interest and tax rates;** During 3QFY07, HCC reported revenues of Rs5.4b (up 17.6% YoY), EBITDA of Rs583m (up 19.9% YoY), and adjusted net profit of Rs155m (down 31.5% YoY). EBITDA margins improved to 10.9% during 3QFY07, better than our expectations of 10.1%. The key reason for lower net profit (Rs155m v/s expectations of Rs297m) have been the higher interest cost at Rs175m (v/s estimated Rs90m) and tax rates of 22.8% (v/s estimated 10%).

⚡ **Revenue growth impacted by rains, positive surprise from EBITDA margins:** Revenue growth during 3QFY07 was impacted due to loss of work on the back of heavy rain in Andhra Pradesh. EBITDA margin expansion to 10.9% during 3QFY07 (v/s 10.7% YoY) came as a positive surprise, despite Rs220m loss on Bandra Worli Sealink Project and non-booking of margins on revenues of Rs1b given margin recognition threshold of 10%. Order book as of Dec.2006 stood at Rs96b with power sector accounting for 47% v/s 38% as at Mar.2006 and 14% as at Mar.2005.

⚡ **Considerable progress on real estate front:** (a) commenced construction of IT park (2m sq ft) at Vikhroli, Mumbai, (b) Contracted 1,786 acres for township development in Maharashtra and (c) slum rehabilitation on 25 acres. The company has a developable area of 189m sq ft (HCC's share stands at 129m sq ft). HCC real estate (100% subsidiary of HCC) is looking at fund raising options to finance the real estate initiatives.

⚡ **Valuations and view:** Based on higher than expected interest expenditure and tax rates, we now expect HCC to report net profit of Rs982m (up 16% YoY) in FY07, Rs1.8b (up 80% YoY) in FY08 and Rs2.4b (up 38% YoY) in FY09 post taking additional losses of Rs1.2b from Bandra Worli Sealink project. Based on SOTP, we arrive at a price target of Rs206/share. At CMP of Rs153/share, HCC trades at PER of 40x FY07E, 23.8x FY08E and 17.3x FY09E. Adjusted for value of real estate (Rs92/share), the stock trades at 15.9x FY07E, 9.5x FY08E and 6.9x FY09E.

Y/E MARCH	QUARTERLY PERFORMANCE								(Rs Million)	
	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Sales	4,610	3,022	4,557	7,681	5,743	4,203	5,361	8,953	19,870	24,260
Change (%)	30.9	12.8	28.4	50.4	24.6	39.1	17.6	16.6	34.0	22.1
EBITDA	409	258	486	675	461	395	583	1,040	1,829	2,478
Change (%)	-4.2	10.7	20.5	40.9	12.8	53.3	19.9	54.0	17.3	35.5
As of % Sales	8.9	8.5	10.7	8.8	8.0	9.4	10.9	11.6	9.2	10.2
Depreciation	118	129	130	147	161	186	206	241	524	794
Interest	83	120	126	85	74	158	175	155	414	563
Other Income	35	29	9	8	62	10	2	30	61	104
Extra-ordinary income	0	400	1	12	0	0	81	0	431	81
PBT	243	437	239	463	288	61	285	674	1,383	1,307
Tax	16	81	12	25	36	19	65	139	135	260
Effective Tax Rate (%)	6.7	18.5	5.2	5.4	12.6	31.5	22.8	20.7	9.7	19.9
Reported PAT	227	357	227	438	251	42	220	534	1,248	1,047
Adj PAT	227	29	226	426	251	42	155	534	817	982
Change (%)	71.5	131.3	106.3	5.9	10.9	45.3	-31.5	25.4	21.4	20.2
E: MOST Estimates										

3QFY07: net profit lower than expectations due to higher interest and tax rates

During 3QFY07, HCC reported revenues of Rs5.4b (up 17.6% YoY), EBITDA of Rs583m (up 19.9% YoY), and adjusted net profit of Rs155m (down 31.5% YoY). EBITDA margins improved to 10.9% during 3QFY07, better than our expectations of 10.1%. The key reason for lower net profit (Rs155m v/s expectations of Rs297m) have been the higher interest cost at Rs175m (v/s estimated Rs90m) and tax rates of 22.8% (v/s estimated 10%).

Revenue growth impacted by rains, positive surprise from EBITDA margins

Revenue growth during 3QFY07 was impacted as the company could not undertake construction activities on projects in Andhra Pradesh (accounting for 10% of order book). This was primarily a result of heavy rains during mid October – mid December 2006. During FY07, the management indicated that they could achieve revenues of Rs25b (up 25% YoY).

Positive surprises have been from EBITDA margin expansion to 10.9% during 3QFY07 (vs 10.7% YoY). The improvement in EBITDA margins during 3QFY07 have been despite (1) losses of Rs220m on Bandra Worli Sealink Project (410bp margin impact) and (2) non booking of margins on revenues of Rs1b (19% of 3QFY07 revenues), as these projects did not cross the margin recognition threshold of 10%. As per Accounting Standard-7, HCC accounts for margins on projects post 10% completion threshold. As share of hydro power to the revenue mix improves, we expect further margin improvement going forward.

Robust order backlog, increased share of power sector

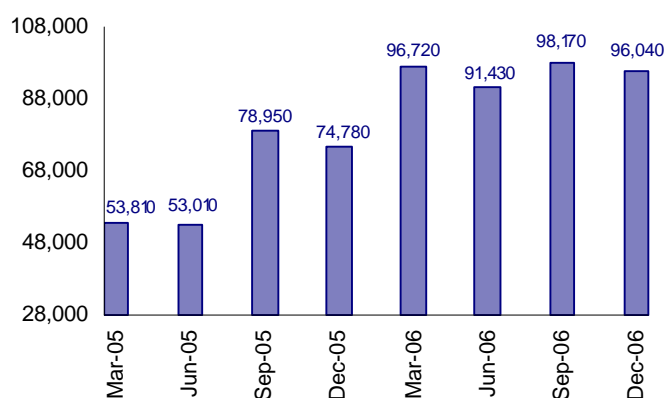
Order book during December 2006 stood at Rs96b, up from Rs75b during December 2005. Power sector (hydro and nuclear) now account for 47% of the order book vs 38% as at March 2006 and 14% as at March 2005. Thus, going forward, we expect a significant margin expansion driven by increased share from hydro power.

ORDER BOOK COMPOSITION (%)

	FY04	FY05	FY06	DEC-06
Power	23	14	38	47
Transportation	38	38	43	39
Water Supply & Irrigation	25	37	15	11
Others	14	12	4	3

Source: Company

TREND IN QUARTERLY ORDER BACKLOG (RS M)



Source: Company/ Motilal Oswal Securities

Interest cost has been higher than estimates

Interest cost (net of interest income) increased to Rs175m during 3QFY07, v/s Rs126m in 3QFY06, as cash on book has declined to Rs3b as at December 2006 v/s Rs10b as at March 2006. HCC has also incurred capex of Rs3b during April – December 2006. Also, the company has not taken mobilization advances from customers (eligibility ~Rs5b) which carry interest rates of 10-5-11%. During FY08, cash flow should improve as majority of the projects under mobilization would enter construction phase, resulting in receipts from customers against invoice raised.

Bandra Worli Sealink project: continues to be drag on margins

During 3QFY07, HCC incurred loss of Rs220m on the project, as compared to Rs150m in 2QFY07 and Rs100-120m during 1QFY07. This has led to an EBITDA margin impact of 410bp for the 3QFY07 and 314bp during April – December 2006. 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 Rs2.2b on this project, and incurred cost of Rs4.3b, thus incurring cumulative under-recovery of Rs2.1b (loss in P/L account). The management expects additional loss of Rs1,300m on the project till the scheduled completion by April 2008. The management also seemed hopeful of recovering part of this amount going forward.

BANDRA-WORLI SEALINK: REVISED COST (RS M)

Original Project Cost	4,300
Escalations, based on Index	1,000
Variations to original work scope	900
Revised project cost	6,300

Source: Company

Since FY03, HCC has reported cumulative revenues of Rs67b, and the cumulative losses booked on Bandra-Worli Sealink project is Rs2.1b. This entails an EBITDA margin impact of 310bp over the project life till date. An early notification on the revised project cost will enable the company to curtail losses going forward, and also recover a part of the cumulative under recoveries of Rs2.1b.

BOT projects

HCC has emerged as L1 in annuity road project of 30kms stretch, costing Rs2.7b in Andhra Pradesh. Concession period is 20 years (including construction period of 2 years). Semi annual annuity receipt is Rs238.5m, and expected RoE is 15%. HCC has also submitted bids for two more road projects on BOT basis. Apart from annuity projects in road sector, HCC is also bidding for BOT projects in power sector, and has targeted US\$50m as investments in this space. The company is already looking at hydro power projects in Uttar Pradesh, Uttaranchal, etc.

Considerable progress on real estate front

Realty development is emerging as a key business vertical for HCC, and the company is seeking opportunities in township development through Hicon Realty Ltd, 100% subsidiary. The management has indicated a target to be amongst the Top 10 real estate developers in the country. The company is also looking into opportunity of entering into construction the real estate project given large scale project size and increasing complexity of the job. The

company has appointed Mr Nicholas Bashkiroff (who has headed development of US\$8b real estate project in Qatar) as CEO of real estate business. The company has a total developable area of 189m sq ft, of which HCC's share stands at 129m sq ft. HCC Real Estate (100% subsidiary of HCC) is also looking at various options for fund raising to finance the real estate initiatives.

✍ **Update on Lavasa:** Total area under development stands at 12,500 acres. Lavasa Corp has already spent Rs4.5b on the project till date, of which HCC's equity contribution (60% stake) is Rs700m. Total cost till FY09 is estimated to be Rs10b and significant part of which would be financed through debt. Post this investment, the project is expected to achieve self sustenance in terms of financing structure, resulting in limited equity contribution. Also, HCC is planning to induct investors at three levels: specialty segments (eg hospitality, etc), Infrastructure (eg power, water, sewage, etc) and strategic investor in Lavasa Corp, which would reduce the funding requirement on HCC's books.

✍ **Development of Vikhroli land (IT Park):** The Company commenced construction of IT park (2m sq ft) at Vikhroli land, Mumbai. The estimated projects cost is estimated at Rs5b which would be financed through debt and bank guarantees. The management indicated that expected rentals from the property are estimated at Rs1b p.a.

✍ **Other land banks:** The company has already contracted for around 1,786 acres (on outskirts of Mumbai, Navi Mumbai, Nashik and Pune) for township development and is also developing slum rehabilitation project on 25 acres, entailing 2m sq ft development.

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
Township in New Mumbai	250	3
SEZ/Township in Nashik	1,000	20
Township in Pune	300	6
Total	14,286	189

Source: Company

Valuations and view

Based on higher than expected net interest expenditure and tax rates, we downgrade FY07 Net profit by 22% to Rs982m. We now expect HCC to report net profit of Rs982m (up 16% YoY) in FY07, Rs1.8b (up 80% YoY) in FY08 and Rs2.4b (up 38% YoY) in FY09. Our earnings estimates factor in additional losses of Rs1.2b from Bandra Worli Sealink project during January 2007 – March 2008.

Based on SOTP, we arrive at a price target of Rs206/share. We value the core construction business at Rs114/share (20x FY09E), Lavasa at Rs41/share (5,000 acres, out of total 12,500 acres at Rs3.5m/acre v/s past transactions of Rs4-4.5m/acre), Vikhroli IT park at Rs28/share (NPV), Slum Rehab projects at Rs13/share (NPV) and other land banks at Rs10/share (expected investments by March 2007). At CMP of Rs153/share, HCC trades at PER of 40x FY07E, 23.8x FY08E and 17.3x FY09E. Adjusted for value of real estate (Rs92/share), the stock trades at 15.9x FY07E, 9.5x FY08E and 6.9x FY09E.

HCC SUM OF PARTS TABLE (RS/SH)

	BUSINESS SEG.	METHOD	VALUATION MULTIPLE	VALUE (RS M)	VALUE (RS/SH)	RATIONALE
HCC Standalone	Construction	FY09E PER (x)	12	29,200	114	At par with industry average
Real Estate						
Lavasa	Township	Land Value (Rs m/acre)	3.5	10,582	41	Out of 12,500 acres of land, 3,500 acres will be developed. Recent transactions by Lavasa was at Rs4-4.5m/acre (land sale)
Vikhroli Land (11 acres)	Real Estate	NPV, Cost of Equity:15%		7,108	28	Based on NPV of expected rentals from office space
Vikhroli Land (Slum Rehabilitation - 15 acres)	Real Estate	NPV, Cost of Equity:15%		1,447	6	Based on NPV of expected cash flows
Powai Land (Slum Rehabilitation - 10 acres)	Real Estate	NPV, Cost of Equity:15%		1,841	7	Based on NPV of expected cash flows
Other Land Banks	Real Estate	Book Value		2,500	10	Expected investments in land banks by March 2007
Total				52,678	206	

We do not factor in the land development profit at Lavasa

Source: Motilal Oswal Securities

Hindustan Construction: an investment profile

Established in 1926 by the Walchand Hirachand group, HCC is one of the oldest and largest construction companies in India with pre-qualification skills and proven execution capabilities across sectors like power, roads, bridges, ports, water irrigation and supply, urban infrastructure and pipelines. HCC specializes in the construction of technologically complex and long-gestation period projects. The company has successfully and gradually transformed from a civil engineering contractor to an integrated EPC executor.

Key investment arguments

- ✍ Possesses pre-qualifications and proven execution capabilities across sectors; will benefit from large ticket sized orders in hydro and nuclear sectors.
- ✍ Has the youngest fleet of specialized equipments, skilled manpower, in-house fabrication facility and EPC execution capabilities.
- ✍ Lavasa project could be value accretive, and 10% increase in FSI can enhance shareholder returns by 100%.

Key investment risks

- ✍ Focus on key large projects increases the project specific risks.
- ✍ Retention of experienced manpower is a challenge.

COMPARATIVE VALUATIONS

		HIND.CON.	NCC	GAMMON
P/E (x)	FY07E	40.0	24.2	28.1
	FY08E	23.8	15.6	18.6
P/BV (x)	FY07E	1.9	2.1	3.2
	FY08E	1.4	1.7	2.8
RoE (%)	FY07E	10.5	18.1	11.5
	FY08E	13.9	24.0	15.2

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	47.0	47.0	52.4
Domestic Inst	12.0	20.5	11.3
Foreign	19.2	12.2	15.2
Others	21.8	20.3	21.1

Recent developments

- ✍ Significant ramp on real estate front, tied up additional 2,500 acre at Lavasa, commencement of work on IT Park at Vikhroli during November 2006 and working on other Slum Rehabilitation projects
- ✍ During 3QFY07 HCC contracted for 1,300 acre of land in Maharashtra, taking total land bank at 14,300 acres.

Valuations and view

- ✍ At CMP of Rs153/share, HCC trades at PER of 40x FY07E, 23.8x FY08E and 17.3x FY09E. Adjusted for value of real estate (Rs92/share), the stock trades at 15.9x FY07E, 9.5x FY08E and 6.9x FY09E.

Sector view

- ✍ Increased government commitment towards infrastructure projects has led to several large projects taking off the ground.
- ✍ We notice a trend of margin expansion, driven by changing composition of order book and higher margins at bidding stage.

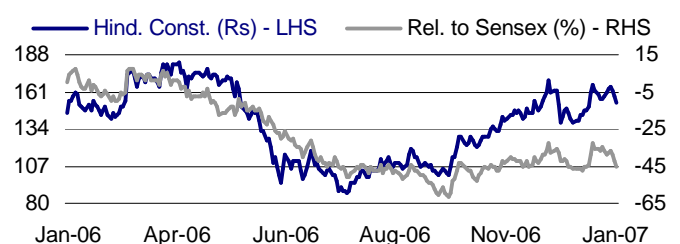
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	3.8	4.4	-13.6
FY08	6.4	6.2	2.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
153	206	34.6	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Net Sales	14,873	19,870	24,260	35,100	44,900	
Change (%)	40.6	33.6	22.1	44.7	27.9	
Construction Exps.	11,814	16,011	19,490	28,110	35,959	
Staff Cost	954	1,314	1,525	2,096	2,549	
Office and Site Establish. Exps	546	716	768	1,154	1,304	
EBITDA	1,559	1,829	2,478	3,739	5,089	
% of Net Sales	10.5	9.2	10.2	10.7	11.3	
Depreciation	453	524	794	897	1,080	
Interest	395	414	563	668	948	
Other Income	56	461	115	64	64	
Share of turnover in JV	-17	31	70	90	90	
PBT	750	1,383	1,307	2,328	3,214	
Tax	10	135	260	560	781	
Rate (%)	13	9.7	19.9	24.0	24.3	
Reported PAT	740	1,248	1,047	1,769	2,433	
Extra-ordinary Income (net of e)	82	404	81	0	0	
Adjusted PAT	658	844	982	1,769	2,433	
Change (%)	84.3	28.3	16.4	80.1	37.6	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Share Capital	229	256	256	274	274	
Reserves	3,300	8,642	9,485	15,349	17,236	
Net Worth	3,530	8,898	9,741	15,624	17,510	
Loans	4,257	12,978	11,652	8,751	10,761	
Deferred Tax Liability	725	677	677	677	677	
Capital Employed	8,511	22,554	22,071	25,052	28,948	
Gross Fixed Assets	6,208	7,728	11,502	13,002	15,002	
Less: Depreciation	2,305	2,807	3,601	4,498	5,578	
Net Fixed Assets	3,903	4,921	7,901	8,504	9,424	
Capital WIP	478	1,074	800	800	800	
Investments	1,899	1,265	4,745	8,245	10,245	
Curr. Assets	7,721	23,067	17,991	20,588	24,658	
Inventory	5,833	10,987	11,964	15,386	19,682	
Debtors	31	28	34	50	63	
Cash & Bank Balance	875	10,060	4,047	2,900	2,032	
Loans & Advances	982	1,991	1,945	2,251	2,880	
Other Current Assets	0	1	1	1	1	
Current Liab. & Prov.	5,489	7,773	9,367	13,085	16,180	
Creditors	4,039	5,910	7,208	10,397	13,300	
Other Liabilities	1,167	1,491	1,600	1,850	2,000	
Provisions	283	372	559	838	880	
Net Current Assets	2,232	15,294	8,624	7,503	8,479	
Application of Funds	8,511	22,554	22,071	25,052	28,948	

E: MOST Estimates

RATIOS		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Basic (Rs)						
Adjusted EPS	2.9	3.3	3.8	6.4	8.9	
Growth (%)	610	14.7	16.4	68.3	37.6	
Cash EPS	4.8	5.3	6.9	9.7	12.8	
Book Value	15.4	34.7	38.0	57.0	63.8	
DPS	0.6	0.7	0.7	1.1	1.8	
Payout (incl. Div. Tax.)	212	16.4	19.5	19.4	22.5	
Valuation (x)						
P/E (standalone)		46.6	40.0	23.8	17.3	
Cash P/E		28.7	22.1	15.8	12.0	
EV/EBITDA		23.1	18.9	12.8	10.0	
EV/Sales		2.1	1.9	1.4	1.1	
Price/Book Value		4.4	4.0	2.7	2.4	
Dividend Yield (%)		0.5	0.5	0.7	1.1	
Profitability Ratios (%)						
RoE	25.5	13.6	10.5	13.9	14.7	
RoCE	15.4	11.4	8.1	12.3	15.1	
Turnover Ratios						
Debtors (Days)	1	1	1	1	1	
Inventory (Days)	143	202	180	160	160	
Creditors. (Days)	125	135	135	135	135	
Asset Turnover (x)	2.0	1.3	1.1	1.5	1.7	
Leverage Ratio						
Debt/Equity (x)	12	15	12	0.6	0.6	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
PBT before Extraordinary Items	750	1,383	1,307	2,328	3,214	
Add : Depreciation	453	524	794	897	1,080	
Interest	395	414	563	668	948	
Less : Direct Taxes Paid	10	135	260	560	781	
(Inc)/Dec in WC	639	-3,877	658	-26	-1,843	
CF from Operations	2,226	-1,691	3,061	3,307	2,618	
(Inc)/Dec in FA	-1,139	-2,139	-3,500	-1,500	-2,000	
(Pur)/Sale of Investments	-1,413	634	-3,481	-3,500	-2,000	
CF from Investments	-2,552	-1,504	-6,981	-5,000	-4,000	
(Inc)/Dec in Networth	1,284	4,278	0	4,458	0	
(Inc)/Dec in Debt	61	8,722	-1,326	-2,901	2,010	
Less : Interest Paid	395	414	563	668	948	
Dividend Paid	157	205	205	344	547	
CF from Fin. Activity	794	12,381	-2,093	545	515	
Inc/Dec of Cash	468	9,186	-6,013	-1,148	-867	
Add: Beginning Balance	407	875	10,060	4,047	2,900	
Closing Balance	875	10,060	4,047	2,900	2,032	

E: MOST Estimates

N O T E S



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Hindustan Construction

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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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