

Hindustan Construction (HINCON)

₹ 21

WHAT'S CHANGED...

PRICE TARGET	Changed from ₹ 27 to ₹ 20
EPS (FY12E)	Changed from ₹ - 0.7 to ₹ - 1.0
EPS (FY13E)	Unchanged
RATING	Unchanged

A quarter full of one offs...

HCC's Q3FY12 operating performance (though ~94% is used to serve debt) was broadly in line with expectations. The one off provisions relating to cost escalations, losses in projects and forex losses led to a sharp expansion in losses in Q3 FY12. Adjusting for these one-offs, HCC's losses were lower than expected on account of lower-than-anticipated interest cost with lower use of CC* limit in the quarter. Going ahead, while, the conditional approval for Lavasa's Phase I development is positive news, the EPC business remains a drag due to stretched working capital, slower execution and delays.

One-offs lead to higher losses...

HCC reported losses of ₹ 130.4 crore vs. our estimates of ₹ 44.6 crore in Q3FY12 due to one-offs relating to cost escalations, losses in projects, forex losses, etc. Adjusting for these one-offs, the losses came at ₹ 24.8 crore, lower than our estimates due to better-than-expected margins (11.7% vs. our estimates of 11.5%) and lower interest cost.

Conditional approval for Lavasa Phase I...

During Q3FY12, ministry of environment & forest (MoEF) accorded conditional approval to Lavasa Corporation for development of phase I at Lavasa involving development of 2000 hectares. This is a positive development for HCC as monthly losses of ₹ 55 crore have stopped and construction has resumed. However, we would like to see further progress at Lavasa in terms of development & debt restructuring.

Operating profits still struggling to serve debts...

Interest expenses at 94.4% of EBITDA mean that almost the entire operating profits are used to service debts. With the stretched working capital, high raw material cost and execution rate yet to pick up, HCC's EPC business remains a major drag. Improvement in working capital would remain key for HCC for any improvement, going ahead.

Valuation

At the CMP, the stock is trading at 1x FY13 P/BV. While conditional resolution of the Lavasa issue is positive news, the EPC business has become a major drag due to slower execution, sharp increase in debt and deteriorating working capital. We have assigned a **HOLD** rating to the stock with a target price of ₹ 20/share.

Exhibit 1: Financial Performance

₹ crore	Q3FY12	Q3FY12E	Q3FY11	Q2FY12	YoY Gr (%)	QoQ Gr (%)
Net sales	946.0	998.3	1008.6	828.6	-6.2	14.2
EBITDA	110.5	111.9	132.0	93.7	-16.3	17.9
EBITDA Margin (%)	11.7	11.2	13.1	11.3	-141.3 bps	36.8 bps
Depreciation	41.2	40.1	38.2	41.4	8.0	-0.4
Interest	104.3	116.4	74.8	107.4	39.4	-2.9
Reported PAT	-130.4	-44.6	7.9	-40.5		
Adjusted PAT	-24.8	-44.6	13.6	-37.7		

Source: Company, ICICIdirect.com Research

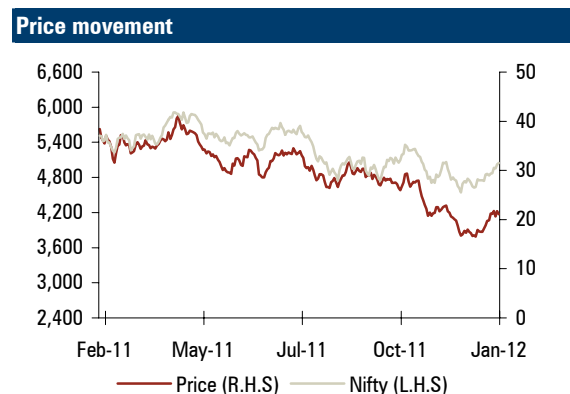
*CC – cash credit

Rating matrix	
Rating	: Hold
Target	: ₹ 20
Target Period	: 12-15 months
Potential Upside	: -5 %

Key Financials				
₹ crore	FY10	FY11	FY12E	FY13E
Net sales	3644.2	4093.2	4067.8	4554.1
EBITDA	462.8	544.3	490.4	578.9
Adj. Net profit	95.2	68.7	-60.0	-25.8

Valuation summary				
	FY10	FY11	FY12E	FY13E
EPS (₹)	1.6	1.1	-1.0	-0.4
PE(x)	15.7	18.0	NA	NA
EV/EBITDA(x)	7.8	8.4	11.1	9.8
P/BV(x)	0.8	0.8	0.9	1.0
RoNW(%)	6.5	4.7	-11.7	-1.9
RoCE(%)	9.5	8.7	6.2	7.1

Stock data	
Market Capitalisation	₹ 1280 crore
Debt (Q2FY12)	₹ 4171 crore
Cash (Q2FY12)	₹ 136 crore
EV	₹ 5315 crore
52 week H/L	44/16
Equity capital	₹ 61 Crore
Face value	₹ 1.0
DII Holding (%)	3.7
FII Holding (%)	24.3



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The interest expenses at ₹ 104.3 crore saw a substantial jump of ~39% YoY on the back of higher debt level and increased interest rates

Another poor quarterly performance

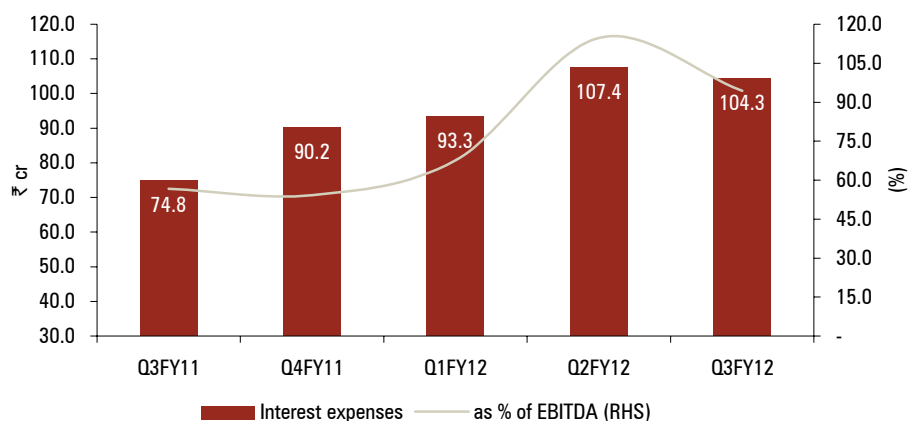
- HCC's Q3FY12 performance was dismal on account of a number of one-offs leading to higher losses than our estimates
- In terms of topline, the company reported ~₹ 946 crore against our estimate of ₹ 998 crore
- The EBITDA margin came at 11.7% vs. 13.1% in Q3FY11, (a tad higher than our estimate of 11.2%) mainly due to rise in raw material price and lower turnover leading to lower absorption of fixed costs
- HCC reported a loss of ₹ 130.4 crore (much lower than our estimates of ₹ 44.6 crore owing to a couple of one-offs, which dampened the bottomline despite better-than-expected margins. Adjusting for the post tax impact of the exceptional items, the adjusted losses stood at -₹ 24.8 crore (vs. our estimate of ₹ 44.6 crore)
- The interest expenses at ₹ 104.3 crore (11% of net sales) went up by ~39% YoY on account of a rise in borrowing and interest rates

Exhibit 2: Q3FY12 – a quarter full of one-offs!!!

	Amount (₹ crore)
Additional cost on account of delays in approval of claims, increase in estimated cost & delays in execution	64.9
Provision for expected future losses in two new projects	52.0
Revision of cost to completion for expected future losses	16.0
Provision against gainst performance bank guarantee wrongfully encashed by client, under arbitration	27.0
Provision against due from subcontractors	6.7
Forex losses	6.8
Less :Profit on sale of residential flats	14.3
Total	159.0

Source: Company, ICICIdirect.com Research

Exhibit 3: Operating profits not sufficient to serve debts...resulting into cash loss



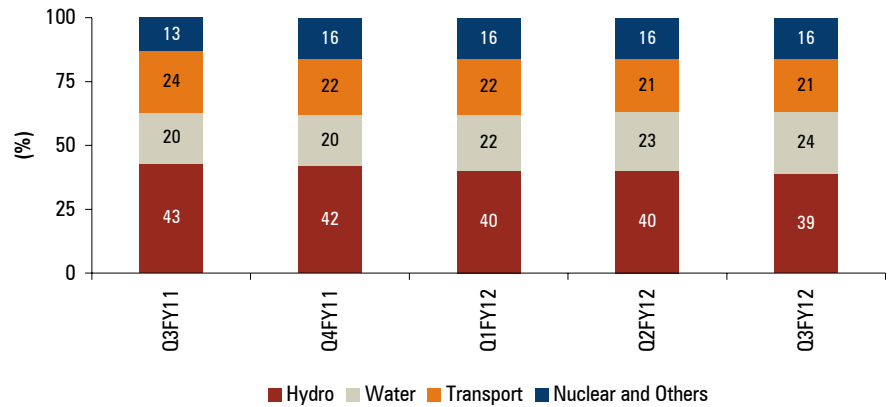
Source: Company, ICICIdirect.com Research

Order inflow of ₹ 2000 crore in 9MFY12

HCC has bagged orders worth ~₹ 2000 crore during 9MFY12 (₹ 1000 crore in H1FY12 and ₹ 1000 crore in Q3FY12) and removed the contentious order of Sawalkot project (₹ 1940 crore) from its order book due to lack of clarity on the same.

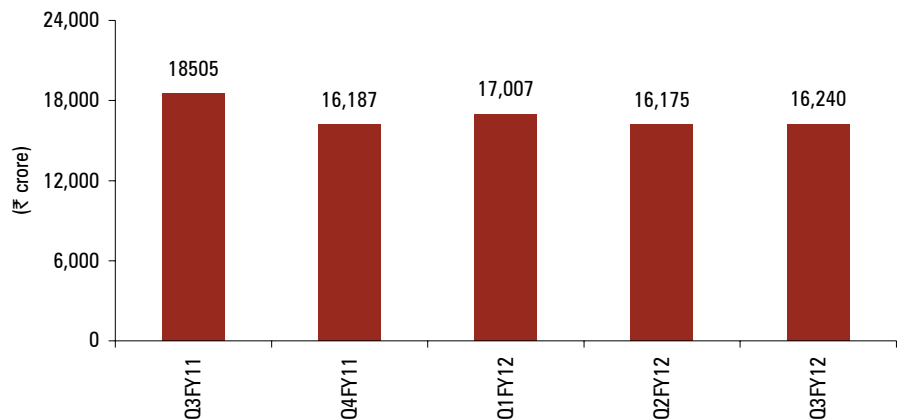
The order book stood at ₹ 16240 crore, implying an order book to bill ratio of 4x on a TTM basis.

Exhibit 4: Segment-wise order book break-up



Source: Company, ICICIdirect.com Research

Exhibit 5: Order book trend



Source: Company, ICICIdirect.com Research

HCC bagged orders worth ~₹ 2000 crore in 9MFY12 and removed the contentious Sawalkot project orders worth ₹ 1940 crore

Conditional clearance granted for Lavasa Phase I during Q3FY12...

After putting it on hold for a year, MoEF accorded conditional approval to Lavasa Corporation for the development of phase I at Lavasa. Phase I development involves development of 2000 hectares (residential – 618.2 hectares), commercial - 33.7 hectares, hotels -72.8 hectares, institutional – 207 hectares, open space – 908 hectares and other activities – 209 hectares). This is a positive development for HCC as the monthly losses of ₹ 55 crore have stopped and construction has resumed. However, we would like to see further progress at Lavasa in terms of development and debt restructuring.

The exhibit below mentions the series of events that have taken place since November, 2010.

Exhibit 6: Lavasa Issue time line

Date	Event
25th November, 2010	MoEF issued show cause notice to Lavasa with status quo ante
30th November, 2010	Lavasa filed a writ petition in high court challenging the order
7th December, 2010	High court directed MoEF to give a hearing to Lavasa and other parties concerned
22nd December, 2010	High court directed MoEF to visit Lavasa after being satisfied with the issues
17th January, 2011	After the visit of officials in first week of January, MoEF passed an order to maintain status quo and submit certain document to consider the plan
25th January, 2011	Meeting between minister, MoEF and Lavasa Chairman. In order to end the controversy, it was decided that Lavasa will make an application for environmental clearance to MoEF
4th March, 2011	EAC recommended permitting Lavasa to continue with construction of 257 structures in 613 hectares
Apr-June 2011	LCL and EAC met over five times where substantive data (over 20,000 pages) in the form of EIA reports, independent analysis - soil, air pollution data, traffic management and predictive natural resources consumption (water) pattern submitted
31st May, 2011	EAC Committee recommended to MoEF to grant clearance to Lavasa project, with certain pre-conditions
15th June, 2011	Additional Solicitor General told the High Court that the minutes of the EAC have been accepted by the ministry with certain conditions and that the final order would be passed within reasonable time and once the conditions set by MoEF, as recommended by the EAC, are met by LCL, MoEF will issue the environmental clearance to Lavasa, enabling Lavasa to proceed with developmental work
27th June, 2011	MoEF issued a letter to Lavasa stating that the five conditions recommended by EAC are pre-conditions and asks Lavasa to submit all necessary documents and details to fulfil the said conditions
5th August, 2011	The Company appeared before the panel and made written submission along with the Board Resolution in respect of the preconditions as stated in MoEF's letter dated 27.6.2011. Thus, the company complied with the preconditions as stated by MoEF
30th August, 2011	The company filed another writ petition in the Hon'ble Bombay High Court seeking directions inter alia that (a) it be declared that the company has been granted / deemed to have been granted environmental clearance for Phase I of the project, in the alternative to prayer (a) above, that the Hon'ble Court be pleased to issue a writ of mandamus or a writ in the nature of mandamus or any other appropriate writ, order or direction commanding the MoEF, to grant environmental clearance to Phase I of the Company's project
23rd September, 2011	High Court gives three weeks time to MoEF to pass "final order". High Court noted the gravity of the matter and stated that if MoEF does not pass order within the above time, the court will be seized of the matter. Further, orders passed by the MoEF not to have any bearing on the prayers of petitioner
13th October, 2011	MoEF passed an order and, thereby, communicated that as the pre-conditions on the credible action by the state govt. on violation of EIA Notification 2006 has not been complied with, MoEF is unable to issue the environment clearance to the first phase of Hill City project (2000 ha) of the company
20th October 2011	The Bombay High Court directed the Government of Maharashtra to take action in accordance with MoEF directives within two weeks. It also directed MoEF to pass a decisive order by November 16, 2011

MoEF granted conditional approval for phase I development of 2000 hectares.

Source: Company Q2FY12 investor presentation, ICICIdirect.com Research

Valuation

We have revised our FY12 earning estimates downwards from ₹ - 0.7/share to ₹ -1/share to incorporate Q3FY12 results and consequently slower than anticipated revenue growth.

At the CMP, the stock is trading at 1x FY13 P/BV. While equity dilution at HCC concession at ₹ 1650 crore valuation and Lavasa's conditional approval for Phase I in Q3FY12 is a positive development, the EPC business has become a major drag indicating losses would continue due to slower execution, sharp increase in debt and deteriorating working capital. We have assigned a **HOLD** rating with a target price of ₹ 20/share.

We have assigned a **HOLD** rating on the stock with a price target of ₹ 20 per share

Exhibit 7: Valuation Metrics

	Sales (₹ crore)	Sales Gr (%)	EPS (Rs)	EPS Gr (%)	P/E (x)	P/BV (x)	RoNW (%)	RoCE (%)
FY10	3644.2	10.0	1.6	-9.5	15.7	0.8	6.5	9.5
FY11	4093.2	12.3	1.1	-27.9	18.0	0.8	4.7	8.7
FY12E	4067.8	-0.6	-1.0	-187.4	NA	0.9	-11.7	6.2
FY13E	4554.1	12.0	-0.4	-57.1	NA	1.0	-1.9	7.1

Source: Company, ICICIdirect.com Research

Exhibit 8: Valuation Table

Entity	Value (₹ crore)	Per share ₹	Comment
Core Construction	3,473.3	57	6x FY13 EV/EBITDA
KSAG acquisition	247.5	4	1x Price/Book
Real Estate	584.2	10	HCC stake have been valued on NAV basis (70% discount to NAV) and recent transaction in Vikhroli IT park
Road BOTs	1,273.7	21	10% discount to Xander deal valuation
Less:Net Debt	4,379.8	72	
Fair Value		20	

Source: Company, ICICIdirect.com Research

Financial summary

Profit and loss statement

(₹ Crore)	FY10	FY11	FY12E	FY13E
Total operating Income	3,644.2	4,093.2	4,067.8	4,554.1
Growth (%)	10.0	12.3	-0.6	12.0
Op. Expenditure	3,181.4	3,548.8	3,577.4	3,975.3
EBITDA	462.8	544.3	490.4	578.9
Growth (%)	5.3	17.6	-9.9	18.0
Depreciation	113.9	152.7	163.9	176.6
EBIT	348.9	391.7	326.6	402.3
Interest	208.8	292.0	414.9	433.2
Other Income	-18.2	12.0	11.0	13.7
Extraordinary Item	0.0	0.0	-166.3	0.0
PBT	121.8	111.7	-243.7	-17.3
Tax	40.4	40.7	-75.2	8.5
Rep. PAT before MI	81.4	71.0	-168.5	-25.8
Minority Interest (MI)	0.0	0.0	0.0	0.0
Rep. PAT after MI	81.4	71.0	-168.5	-25.8
Adjustments	-13.8	2.3	-108.5	0.0
Adj. Net Profit	95.2	68.7	-60.0	-25.8
Growth (%)	7.0	-27.9	-187.4	
EPS (₹)	1.6	1.1	-1.0	-0.4

Source: Company, ICICIdirect.com Research

Cash flow statement

(₹ Crore)	FY10	FY11	FY12E	FY13E
Net Profit before Tax	121.8	111.7	-243.7	-17.3
Other Non Cash Exp	0.0	0.0	0.0	0.0
Depreciation	113.9	152.7	163.9	176.6
Direct Tax Paid	-37.6	-81.9	75.2	-8.5
Other Items	243.8	281.3	419.9	446.9
CF before change in WC	414.0	463.8	405.3	570.4
Inc./Dec. In WC	-379.6	-363.5	-605.9	-48.4
CF from Operations	34.4	100.3	-200.6	522.0
Pur. of Fix Assets	-149.5	-233.6	-170.0	-166.0
Pur. of Inv	-36.5	-122.6	-100.0	-150.0
Others	-229.0	-339.66	0.0	0.0
CF from Investing	-415.0	-695.9	-265.0	-302.3
Inc./Dec. in Debt	193.9	956.7	750.0	240.0
Inc./Dec. in Net Worth	444.1	0.0	0.0	0.0
Others	-222.9	-355.8	-417.8	-438.4
CF from Financing	415.0	600.9	332.2	-198.4
Net Cash Flow	34.5	5.3	-133.4	21.3
Opening Cash	153.9	188.3	193.7	60.3
Closing Cash	188.3	193.7	60.3	81.6

Source: Company, ICICIdirect.com Research

Balance sheet

(₹ Crore)	FY10	FY11	FY12E	FY13E
Liabilities				
Equity Capital	30.3	60.7	60.7	60.7
Reserves & Surplus	1,486.9	1,461.5	1,293.0	1,262.2
Shareholder's Fund	1,517.2	1,522.2	1,353.7	1,322.8
Borrowings	963.0	1,535.3	1,535.3	1,535.3
Unsecured Loans	1,551.7	1,936.1	2,686.1	2,926.1
Deferred Tax Liability	142.6	166.5	166.5	166.5
Source of Funds	4,174.5	5,160.1	5,741.6	5,950.7
Assets				
Gross Block	1,798.1	1,965.2	2,129.2	2,289.2
Less: Acc. Depreciation	655.0	790.1	946.2	1,116.5
Net Block	1,143.2	1,175.1	1,183.1	1,172.7
Capital WIP	34.9	25.7	25.7	25.7
Net Fixed Assets	1,178.0	1,200.8	1,208.8	1,198.4
Intangible Assets	6.5	9.2	10.1	9.9
Investments	408.7	531.3	631.3	781.3
Cash	188.3	193.7	60.3	81.6
Trade Receivables	2.7	2.7	13.5	14.9
Loans & Advances	863.3	1,394.8	1,692.1	1,707.9
Inventory	3,565.2	4,499.1	4,905.3	5,251.8
Total Current Asset	4,624.2	6,096.0	6,678.6	7,064.8
Current Liab. & Prov.	2,043.0	2,677.2	2,787.4	3,103.9
Net Current Asset	2,581.3	3,418.8	3,891.3	3,961.0
P&L Account	0.0	0.0	0.0	0.0
Application of Funds	4,174.5	5,160.1	5,741.6	5,950.7

Source: Company, ICICIdirect.com Research

Key ratios

	FY10	FY11	FY12E	FY13E
Per share data (₹)				
EPS	1.6	1.1	-1.0	-0.4
Cash EPS	3.2	3.7	-0.1	2.5
BV	25.0	25.1	22.3	21.8
DPS	0.4	0.4	0.0	0.1
Cash Per Share	3.1	3.2	1.0	1.3
Operating Ratios (%)				
EBITDA Margin	12.7	13.3	12.1	12.7
PBT / Total Operating income	3.3	2.7	-6.0	-0.4
PAT Margin	2.2	1.7	-4.1	-0.6
Inventory days	318	360	422	407
Debtor days	0	0	1	1
Creditor days	111	108	118	113
Return Ratios (%)				
RoE	6.5	4.7	-11.7	-1.9
RoCE	9.5	8.7	6.2	7.1
RoIC	9.6	8.7	6.1	7.0
Valuation Ratios (x)				
P/E	15.7	18.0	NA	NA
Net Sales/Total Asset	95.7	87.7	74.6	77.9
EV / EBITDA	7.8	8.4	11.1	9.8
EV / Net Sales	1.0	1.1	1.3	1.2
Price to Book Value	0.8	0.8	0.9	1.0
Solvency Ratios				
Debt/EBITDA	5.4	6.4	8.6	7.7
Debt / Equity	1.5	2.2	3.1	3.3
Current Ratio	2.3	2.3	2.4	2.3

Source: Company, ICICIdirect.com Research

ICICIdirect.com coverage universe (Construction)

Simplex Infra				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)	
Idirect Code	SIMCON	CMP	199	FY10	FY10	24.7	8.3	1.1	13.1	12.8
Mcap (₹ crore)	1023	Target	285	FY11	FY11	24.8	8.3	0.9	12.0	11.9
		% Upside	44%	FY12E	FY12E	17.9	11.5	0.9	7.9	11.0
				FY13E	FY13E	22.9	9.0	0.8	9.2	11.5
Unity Infra				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)	
Idirect Code	UNIINF	CMP	40	FY10	1,476.8	11.7	3.4	0.4	17.6	17.6
Mcap (₹ crore)	294	Target	52	FY11	1,701.5	12.7	3.1	0.4	15.5	16.5
		% Upside	31%	FY12E	1,949.9	13.2	3.0	0.3	14.1	16.9
				FY13E	2,217.6	14.7	2.7	0.3	13.8	17.2
IVRCL				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)	
Idirect Code	IVRINF	CMP	44	FY10	5,477.6	7.9	2.8	0.5	11.5	14.3
Mcap (₹ crore)	1168	Target	48	FY11	5,617.4	5.9	3.8	0.5	8.2	11.6
		% Upside	10%	FY12E	5,842.9	4.0	5.6	0.5	5.2	9.4
				FY13E	7,049.8	5.3	4.2	0.5	6.6	10.7
NCC				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)	
Idirect Code	NAGCON	CMP	49	FY10	4,777.8	7.5	1.6	0.6	11.8	12.9
Mcap (₹ crore)	1252	Target	64	FY11	5,073.7	6.4	2.3	0.6	7.1	9.7
		% Upside	31%	FY12E	5,312.0	4.2	3.5	0.6	4.4	8.5
				FY13E	6,098.4	5.3	2.8	0.5	5.4	9.0
Patel Engineering				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)	
Idirect Code	PATEN	CMP	97	FY10	3,190.9	24.2	2.9	0.4	17.8	14.6
Mcap (₹ crore)	675	Target	80	FY11	3,475.9	16.4	4.7	0.4	9.4	10.7
		% Upside	-17%	FY12E	3,615.3	14.7	5.6	0.4	7.2	9.4
				FY13E	3,888.6	13.7	6.0	0.4	6.1	8.8
Hindustan Construction				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)	
Idirect Code	HINCON	CMP	21	FY10	3,644.2	1.6	15.7	0.8	6.5	9.5
Mcap (₹ crore)	1280	Target	20	FY11	4,093.2	1.1	18.0	0.8	4.7	8.7
		% Upside	-5%	FY12E	4,067.8	-1.0	NA	0.9	-11.7	6.2
				FY13E	4,554.1	-0.4	NA	1.0	-1.9	7.1

Source: Company, ICICIdirect.com Research

Exhibit 9: Recommendation History



Source: Reuters, ICICIdirect.com Research

Exhibit 10: Recent Releases

Date	Event	CMP	Target Price	Rating
24-Jan-11	Q3FY11 Result Update	42		UR
2-May-11	Q4FY11 Result Update	35	38	Hold
29-Jul-11	Q1FY12 Result Update	31		UR
24-Oct-11	Q2FY12 Result Update	26	27	Hold

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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Strong Buy: > 15%/20% for large caps / midcaps, respectively, with high conviction;

Buy: > 10%/15% for large caps / midcaps, respectively;

Hold: Up to +/-10%;

Sell: -10% or more;

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