

HINDUSTAN CONSTRUCTION CO.

Arbitration money flow continues

India Equity Research | Infrastructure - Construction



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Hindustan Construction Company's (HCC) Q2FY18 profit came in at INR116mn (estimate: INR342mn loss), facilitated by ~INR1.8bn claims recognition. The company's order book at Q2FY18 end stood at a robust ~INR215bn, ~5.7x TTM revenue. As per CCEA's decision to release 75% of arbitration awards won by contractors, HCC has received ~INR11bn cash till date (INR8.4bn till Q1FY18). Consequently, its debt has declined to ~INR40bn (INR44bn at FY17 end). Trajectory of receipt of balance claims along with execution ramp up will be key catalysts. Maintain 'BUY' with SOTP-based target price of INR55.

Claim recognition continues to bolster profitability

Revenue stood at INR9.7bn (estimate: INR9.2bn), aided by ~INR1.8bn claims recognition. Adjusting for claims, EBITDA margin stood at a healthy ~12.6%. Order backlog, as at Q2FY18 end, stood at ~INR215bn (INR204bn as at FY17 end). Order intake during H1FY18 stood at ~INR30bn.

Arbitration claims money flow continues

HCC currently has ~INR43bn arbitration awards in its favour (additional claims worth ~INR56bn are under arbitration). As at Q2FY18 end, its receivables include INR25bn on account of arbitration awards in its favour. Its clients have agreed to release ~INR19.3bn funds (~INR18.8bn till Q1FY18), of which HCC has already received ~INR11bn cash till date (INR8.4bn till Q1FY18). The company has repaid INR3.5bn debt (INR2.5bn) from these claim proceeds; consequently, debt has reduced to INR40bn (INR41bn). We expect leverage to fall further with the release of additional claims money of INR8bn over the next couple of quarters.

Outlook and valuations: Debt reduction key; maintain 'BUY'

Decline in debt will improve the company's financial health and should drive execution going ahead. The trajectory of receipt of claims money will determine stock performance going ahead. We maintain 'BUY' with SOTP-based target price of INR55—INR27/share from EPC business (valued at 18x FY19E P/E), INR18/share from BOT projects (DCF valuation) and balance from Lavasa.

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

MARKET DATA (R: HCNS.BO, B: HCC IN)

CMP	: INR 39
Target Price	: INR 55
52-week range (INR)	: 48 / 29
Share in issue (mn)	: 1,010.7
M cap (INR bn/USD mn)	: 40 / 617
Avg. Daily Vol. BSE/NSE ('000)	: 7,990.1

SHARE HOLDING PATTERN (%)

	Current	Q1FY18	Q4FY17
Promoters *	27.7	27.8	27.8
MF's, FI's & BKs	34.3	33.3	32.6
FII's	11.1	12.1	10.8
Others	26.9	26.7	28.8
* Promoters pledged shares (% of share in issue)	:	23.74	

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	8.4	22.0	13.6
3 months	8.5	42.8	34.3
12 months	26.8	118.9	92.1

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Financials (Standalone)

(INR mn)

Year to March	Q2FY18	Q2FY17	% change	Q1FY18	% change	FY17	FY18E	FY19E
Revenues	9,708	9,111	6.5	9,307	4.3	41,959	41,794	47,760
EBITDA	1,489	1,951	(23.7)	1,700	(12.4)	7,536	5,883	6,007
Adj. profit	116	220	(47.3)	145	(20.1)	806	(258)	1,566
Dil. EPS (INR)	0.1	0.3	(59.4)	0.1	(20.1)	0.8	(0.3)	1.5
Diluted P/E (x) *						14.8	NA	7.6
EV/EBITDA (x) *						9.6	9.6	5.9
ROAE (%)						3.6	NA	5.7

* for implied construction business

Other highlights

- Toll collection from Baharampore-Farakka BOT project, during Q2FY18 stood at INR3.4mn (INR4.7mn in Q1FY18 and INR3.7mn in Q4FY17). The project SPV received an arbitration award of INR4.5bn in July 2017 for delays on account of NHAI. Tolling was impacted due to heavy rains during the Monsoons season.
- Daily toll collection at the Farakka-Raiganj (Pkg 4) BOT project was INR3.3mn during the quarter (INR5.7mn in Q1FY18 and INR4.7mn in Q4FY17). Toll collection was impacted due to floods in Malda district during the month of August.
- In the Joint Lenders' Forum meeting of the lenders of Lavasa held on September 20, 2017, the lenders have decided to invoke Strategic Debt Restructuring (SDR). The SDR has been invoked in Lavasa Corporation and its wholly owned subsidiaries — Warasgaon Assets Maintenance and Warasgaon Power Supply.

Financial snapshot

(INR mn)

Year to March	Q2FY18	Q2FY17	% change	Q1FY18	% change	YTD18	FY18E	FY19E
Net revenues	9,708	9,111	6.5	9,307	4.3	19,014	41,794	47,760
Direct costs	6,879	5,909	16.4	6,241	10.2	13,120	30,468	36,011
Staff costs	1,103	973	13.3	1,038	6.2	2,141	4,138	4,251
Other expenses	236	277	(14.8)	327	(27.8)	564	1,305	1,491
Total expenditure	8,218	7,160	14.8	7,607	8.0	15,825	35,910	41,753
EBITDA	1,489	1,951	(23.7)	1,700	(12.4)	3,189	5,883	6,007
Depreciation	296	334	(11.4)	288	2.5	584	1,448	1,595
EBIT	1,194	1,618	(26.2)	1,412	(15.4)	2,605	4,435	4,412
Other income	612	598	2.3	605	1.2	1,216	2,283	2,395
Interest	1,631	1,900	(14.2)	1,821	(10.5)	3,452	7,110	4,434
Add: Prior period items								
Add: Exceptional items	-	11	NA	-		-	-	-
Profit before tax	175	327	(46.4)	195	(10.2)	370	(391)	2,373
Provision for taxes	59	96	(38.4)	50	18.7	109	(133)	807
Reported net profit	116	231	(49.7)	145	(20.1)	261	(258)	1,566
Adjusted Profit	116	220	(47.3)	145	(20.1)	261	(258)	1,566
Equity capital	1,011	779		1,011		1,011	1,011	1,011
Diluted shares (mn)	1,011	779		1,011		1,011	1,011	1,011
Adjusted Diluted EPS	0.1	0.3	(59.4)	0.1	(20.1)	0.3	(0.3)	1.5
As % of net revenues								
Direct costs	70.9	64.9		67.1		137.9	72.9	75.4
Other expenses	2.4	3.0		3.5		6.0	3.1	3.1
EBITDA	15.3	21.4		18.3		33.6	14.1	12.6
Reported net profit	1.2	2.5		1.6		2.8	(0.6)	3.3
Tax rate	33.7	29.3		25.5		59.2	34.0	34.0

Company Description

HCC is a leading civil engineering and construction company, engaged primarily in the construction of hydel and power projects, irrigation, water supply, urban infrastructure and transportation projects. It is developing Lavasa, an ambitious project aimed at creating a hill city near Mumbai and Pune. Apart from this, it is also involved in some other real estate development projects. HCC is also making inroads in the asset ownership space with entry into the roads space and has plans to build its BOT portfolio significantly going ahead.

Most of its customers are central government bodies/public sector units like NHAI, NHPC, NPCIL and state governments like Andhra Pradesh, Gujarat, and Maharashtra. It has also worked on hydel power projects in other countries like Bhutan.

Investment Theme

HCC with more than eight decades of experience in the engineering and construction (E&C) space, is amongst the most respected infrastructure majors in India. Its unmatched technical skills are evident in several marquee projects it has executed over the years. With a robust order book, the company is likely to chart a strong growth trajectory going ahead.

With PPP projects gaining currency, HCC has drawn ambitious plans to leverage its E&C strength as far as the asset ownership space is concerned. The company plans to build a sizeable portfolio in the transportation (roads, metro rail, railways and airports) and energy (hydro, nuclear and thermal power) space.

Key Risks

Equity dilution threat

HCC has ventured into real estate and BOT segments, both of which entail upfront investments with returns generally being back-ended. In this context, fund raising in Lavasa has emerged as a key monitorable for the company. Notwithstanding this, there will be demands on the company's balance sheet since the core contracting business also requires funds. Also, working capital management has become a key issue for the company which has stretched its working capital cycle.

Execution risk due to long gestation projects

The company's order book is geared towards hydel projects that are typically long gestation and mostly in difficult terrains. There are inherent risks in execution of such a long duration portfolio.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.9	6.6	6.8	7.4
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.5	67.1	65.0	66.0
Company				
Order intake (INR bn)	79	65	45	65
Y-o-Y growth (%)	81.3	(17.8)	(30.9)	44.8
Book-to-bill ratio (x)	4.3	4.9	4.9	4.7
Order backlog (INR bn)	181	204	207	224
Order backlog growth (%)	25.4	12.5	1.4	8.2
Revenue growth (% yoy)	1	-	-	14
Raw Material (% net rev)	28.4	28.5	22.0	24.0
Power & fuel % net rev.	3.1	3.0	5.2	5.2
Job work (as % of sales)	32.6	38.2	38.7	39.2
Other mfg(as % of sales)	4.3	-	7.0	7.0
Other admin (% net rev)	3.2	2.8	3.1	3.1
Avg. Interest rate (%)	13.8	16.4	13.9	12.5
Depreciation rate (%)	-	-	6.8	6.8
Tax rate (%)	32.5	38.7	34.0	34.0
Inc. in invts (INR mn)	(1,547)	193	-	-
Capex (INR mn)	479	1,956	950	1,500
Debtor days	221	269	240	110
Inventory days	26	25	29	28
Payable days	193	190	198	173
Other creditors days	197	243	280	242
Provisions days	21	19	18	18
Loans & adv (% net rev)	36.4	41.4	44.0	40.0
Incremental debt	1,881	1,366	(14,500)	(19,986)

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	41,909	41,959	41,794	47,760
Direct costs	28,655	29,267	30,468	36,011
Employee costs	3,832	3,968	4,138	4,251
Other Expenses	1,338	1,188	1,305	1,491
Total operating expenses	33,825	34,423	35,910	41,753
EBITDA	8,084	7,536	5,883	6,007
Depreciation	1,525	1,253	1,448	1,595
EBIT	6,559	6,284	4,435	4,412
Add: Other income	2,142	2,622	2,283	2,395
Less: Interest Expense	7,017	7,724	7,110	4,434
Add: Exceptional items	(280)	(212)	-	-
Profit Before Tax	1,404	970	(391)	2,373
Less: Provision for Tax	457	376	(133)	807
Reported Profit	948	594	(258)	1,566
Exceptional Items	(280)	(212)	-	-
Adjusted Profit	1,228	806	(258)	1,566
Shares o /s (mn)	779	1,011	1,011	1,011
Adjusted Basic EPS	1.6	0.8	(0.3)	1.5
Diluted shares o/s (mn)	779	1,011	1,011	1,011
Adjusted Diluted EPS	1.6	0.8	(0.3)	1.5
Adjusted Cash EPS	3.8	2.2	1.0	3.9

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	80.7	82.0	85.9	87.4
EBITDA margins	19.3	18.0	14.1	12.6
Adjusted profit margins	2.9	1.9	(0.6)	3.3

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	1.4	0.1	(0.4)	14.3
EBITDA	3.5	(6.8)	(21.9)	2.1
PBT	10.3	(31.0)	NA	NA
Adjusted Profit	77.4	(34.3)	NA	NA
EPS	47.1	(49.4)	NA	NA

Infrastructure - Construction

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	779	1,011	1,011	1,011	
Reserves & Surplus	17,254	25,889	25,631	27,197	
Shareholders' funds	18,033	26,900	26,642	28,208	
Short term borrowings	24,233	15,644	5,144	3,158	
Long term borrowings	26,117	28,323	24,323	6,323	
Total Borrowings	50,350	43,967	29,467	9,481	
Long Term Liabilities	564	543	408	510	
Def. Tax Liability (net)	65	232	232	232	
Sources of funds	69,011	71,642	56,749	38,431	
Gross Block	19,801	19,657	22,407	23,907	
Net Block	6,870	5,946	7,265	7,191	
Capital work in progress	17	1,872	22	22	
Intangible Assets	15	9	41	21	
Total Fixed Assets	6,902	7,827	7,328	7,234	
Non current investments	6,994	7,186	7,186	7,186	
Cash and Equivalents	1,731	1,973	3,066	3,894	
Inventories	1,735	2,333	2,508	3,017	
Sundry Debtors	26,652	35,156	19,805	8,982	
Loans & Advances	15,251	17,367	18,389	19,104	
Other Current Assets	40,874	40,197	39,972	32,014	
Current Assets (ex cash)	84,511	95,054	80,675	63,117	
Trade payable	14,379	16,164	16,811	17,315	
Other Current Liab	16,748	24,234	24,696	25,685	
Total Current Liab	31,126	40,398	41,507	43,000	
Net Curr Assets-ex cash	53,385	54,656	39,168	20,117	
Uses of funds	69,011	71,642	56,749	38,431	
BVPS (INR)	23.1	26.6	26.4	27.9	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	948	594	(258)	1,566	
Add: Depreciation	1,525	1,253	1,448	1,595	
Interest (Net of Tax)	4,735	4,733	7,110	2,927	
Others	1,166	1,333	(7,242)	(2,120)	
Less: Changes in WC	4,969	1,355	(15,353)	(19,153)	
Operating cash flow	3,404	6,558	16,410	23,121	
Less: Capex	479	1,956	950	1,500	
Free Cash Flow	2,926	4,602	15,460	21,621	

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow		3,404	6,558	16,410	23,121
Investing cash flow		416	(1,947)	(950)	(1,500)
Financing cash flow		(3,887)	(4,368)	(14,500)	(19,986)
Net cash Flow		(67)	243	960	1,635
Capex		(479)	(1,956)	(950)	(1,500)

Profitability and efficiency ratios		FY16	FY17	FY18E	FY19E
Year to March					
ROAE (%)		7.8	3.6	NA	5.7
ROACE (%)		13.1	12.8	10.6	14.5
Inventory Days		26	25	29	28
Debtors Days		221	269	240	110
Payable Days		387	432	477	415
Cash Conversion Cycle		(140)	(137)	(208)	(277)
Current Ratio		2.8	2.4	2.0	1.6
Gross Debt/EBITDA		6.2	5.8	5.0	1.6
Gross Debt/Equity		2.8	1.6	1.1	0.3
Adjusted Debt/Equity		2.8	1.6	1.1	0.3
Net Debt/Equity		2.7	1.6	1.0	0.2
Interest Coverage Ratio		0.9	0.8	0.6	1.0

Operating ratios		FY16	FY17	FY18E	FY19E
Year to March					
Total Asset Turnover		0.6	0.6	0.7	1.0
Fixed Asset Turnover		5.5	6.5	6.3	6.6
Equity Turnover		2.7	1.9	1.6	1.7

Valuation parameters		FY16	FY17	FY18E	FY19E
Year to March					
Adj. Diluted EPS (INR)		1.6	0.8	(0.3)	1.5
Y-o-Y growth (%)		47.1	(49.4)	NA	NA
Adjusted Cash EPS (INR)		3.8	2.2	1.0	3.9
Diluted P/E (x) *		7.5	14.8	NA	7.6
P/B (x)		1.7	1.5	1.5	1.4
EV / Sales (x) *		1.7	1.7	1.4	0.7
EV / EBITDA (x) *		8.6	9.6	9.6	5.9

*for implied construction business

Peer comparison valuation

Name	Market cap (USD mn)	EV / EBITDA (x)		P/B (x)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Hindustan Construction Co.	617	11.3	7.6	1.5	1.4	NA	5.7
Nagarjuna Construction Co	945	10.2	8.5	1.7	1.5	6.8	9.4
Simplex Infrastructures Ltd	404	8.2	6.8	1.6	1.5	5.8	10.3
Median	-	10.2	7.6	1.6	1.5	5.8	9.4
AVERAGE	-	9.9	7.6	1.6	1.5	3.9	8.5

Source: Edelweiss research

Additional Data

Directors Data

Shri Ajit Gulabchand	Chairman & Managing Director	Shri Rajas R. Doshi	Independent Director
Shri Ram P. Gandhi	Independent Director	Shri N. R. Acharyulu	Non Executive Non Independent Director
Shri Sharad M. Kulkarni	Independent Director	Shri Anil C. Singhvi	Independent Director
Ms. Harsha Bangari	Non-Executive Director	Dr. Omkar Goswami	Independent Director
Ms. Shalaka Gulabchand Dhawan	Whole-time Director	Shri Arjun Dhawan	Group CEO & Whole-time Director

Auditors - Walker Chandiok & Co.,LLP Chartered Accountants

**as per latest annual report*

Holding – Top 10

	Perc. Holding		Perc. Holding
HDFC Asset Mgmt Co	6.9	SIWA Holdings	3.57
Industrial Development Bank of India	2.52	Export Import Bank of India	2.40
Punjab National Bank	2.17	Vanguard Group	2.03
Canara Bank	1.94	Reliance Capital Trustee	1.62
Abu Dhabi Investment Authority	1.62	Axis Bank	1.62

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
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No Data Available

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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No Data Available

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Infrastructure - Construction

Ahluwalia Contracts, Ashoka Buildcon, Hindustan Construction Co., J Kumar Infraprojects, KNR Constructions, NBCC, Nagarjuna Construction Co, PNC Infratech, Sadbhav Engineering, Simplex Infrastructures Ltd, Supreme Infrastructure

Recent Research

Date	Company	Title	Price (INR)	Recos
27-Oct-17	Construction	Government's infra push: Potent booster; <i>Sector Update</i>		
16-Oct-17	Construction	Edelweiss Infra Day takeaways: Plethora of opportunities; <i>Sector Update</i>		
09-Oct-17	NBCC	Shifting to higher gear; <i>Visit Note</i>	218	Hold

Distribution of Ratings / Market Cap

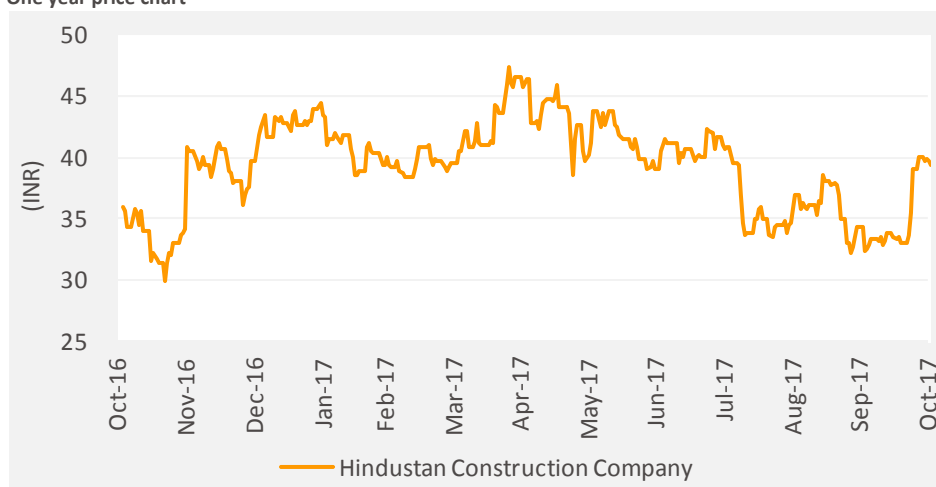
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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