PhillipCapital

Hindustan Construction (HCC IN)

Perseverance pays…

INDIA | Infrastructure | Initiating Coverage

6 February 2017

Perfect turnaround story – another manifestation of our 'EPC Trinity'

HCC is the perfect turnaround story to play in the infrastructure space. After the turnaround in NCC, Ahluwalia Contracts and ITD Cementation, we see HCC's story as another manifestation of our 'EPC Trinity' hypothesis (read here). Over the last four years, the company has been reeling under the pressure of delayed payments by various government bodies (especially NHAI, NHPC) and its 'promiscuous' investments into real estate and BOT projects going bad. However, in the last six months, two events have unfolded, which promise to transform the fortunes of the company.

First, in June 2016, the S4A restructuring exercise was approved, which promises to reduce its debt by half (converting half into equity). Later, in September 2016, a circular issued by NITI AYOG directed all central government bodies to pay developers 75% of the claims that have been awarded in their favour. With these two events, HCC should be able to payback Rs 24bn of debt and convert Rs 8bn into equity – reducing the standalone debt to Rs 20bn at FY17 (Rs 49bn at FY16). This would lead to a significant jump in earnings (53% CAGR over FY16-19 on a reported basis) and rerating of the stock.

We note that the cash payment for arbitrations is absolutely imperative for HCC's turnaround story to play out. In an unlikely event of the company not receiving the expected cash, the 'transformation' will be limited to the S4A restructuring exercise – which will have much longer-drawn-out effects. But with NHAI already having paid two developers, we see little likelihood of the directive not being honoured.

Robust orderbook to drive growth; huge opportunity in key segments

HCC's strong execution track record in the industry ensured that the company continued to win orders, despite its financial stress and CDR status. Its current orderbook of Rs 237bn stands at a staggering 6x book-to-sales – providing high revenue visibility. We also see mammoth opportunity in HCC's key segments. Our bottom-up analysis indicates Rs 4tn investment opportunity in the MRTS segment – Rs 2.3tn of which will be awarded over the next three years. Similarly, NHAI is expected to award Rs 2tn of orders over the next three years, boosted by new pipeline projects of Sagarmala, Bharatmala, and Chardham. At the same time, HCC's core expertise in nuclear and hydro power projects should ensure healthy order inflows from those segments too.

Subsidiaries no more a drag; Lavasa remains a sunk cost

HCC's subsidiaries have demonstrated minor turnarounds of their own, over the last two years. Its Swiss construction arm Stiener AG has reported stable operations, and has a healthy orderbook of CHF 1.32bn (2x book-to-sales). HCC Infrastructure, its BOT holding arm, has divested two road projects over the last 18 months. Two of the three projects in WB are operational and reporting healthy toll growth – the third is delayed due to land acquisition problems. Badarpur flyover is under CDR, and is likely to be taken over by the lenders, with no contingent liability to the parent company.

Lavasa remains a sunk cost, with practically zero interest level in the township as a residential or commercial location. The place only serves as a weekend tourist destination – the popularity of which is also waning. Its bankers are trying to pull off a financial engineering exercise, transferring its debt to an 'infrastructure' subsidiary, which would then be eligible for a 5:25 scheme. Lavasa has Rs 11.5bn of debt with a corporate guarantee or PUT option to be honoured by the parent company. This contingent liability, in the worst case scenario, would amount to a negative value of Rs 10/share.

Topline and earnings CAGR of 16% and 54% over FY16-19; inexpensive valuations

Over FY16-19, HCC should report a robust topline CAGR of 18% (adjusted for claims), stable margin of 12-14%, and earnings CAGR of 53% (adjusted PAT CAGR would be even higher).

Currently HCC is trading at 14x our FY19 earnings – 9.5x adjusting for the value of subsidiaries (Infra and Stiener AG) – a significant discount to all construction peers. We see immense rerating potential being realised as its balance sheet transformation unfolds. We value the company using SoTP methodology – EPC at 15x FY19 P/E (in line with peers), BOT assets at 0.7x BV, and Stiener AG at 2x BV. We do not attribute any value to Lavasa and value outstanding claims (under arbitration) at 0.3x the claim amount. We initiate with a BUY rating with a price target of Rs 71.

Beyond our 12 months price target of Rs 71, we see long term potential in the stock, and forecast Rs 100/share price target by Macrh-2019 – implying 138% upside from current levels, over next two years.

BUY

CMP RS 42

TARGET RS 71 (+70%)

COMPANY DATA

O/S SHARES (MN) :	969
MARKET CAP (RSBN) :	40
MARKET CAP (USDBN) :	0.6
52 - WK HI/LO (RS) :	45 / 17
LIQUIDITY 3M (USDMN) :	2.2
PAR VALUE (RS) :	1

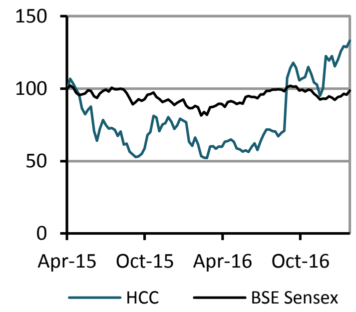
SHARE HOLDING PATTERN, %

	Dec 16	Sep 16	Jun 16
PROMOTERS :	36.1	36.1	36.1
FII / NRI :	13.2	11.8	10.4
FI / MF :	14.1	13.1	13.5
NON PRO :	8.4	10.0	8.1
PUBLIC & OTHERS :	28.3	29.0	31.9

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-1.7	17.2	108.3
REL TO BSE	-7.6	14.2	91.7

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS (Standalone)

Rs mn	FY17E	FY18E	FY19E
Net Sales	36,188	41,616	49,940
EBIDTA	4,343	4,994	5,993
Net Profit	-1,276	2,005	3,013
EPS, Rs	(1.3)	2.0	3.0
PER, x	(33.3)	21.2	14.1
EV/EBIDTA, x	14.3	11.0	9.0
P/BV, x	1.6	1.5	1.3
ROE, %	(5.6)	7.3	10.0
Debt/Equity (x)	0.8	0.5	0.4

Source: PhillipCapital India Research Est.

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A remarkable transformation story

HCC is the perfect turnaround story to play in this cycle – especially with its balance sheet set to undergo remarkable transformation over the next few months. Over the last four years, the company had been reeling under the pressure of delayed payments by various government bodies (especially NHAI, NHPC) and its 'promiscuous' investments into real estate and BOT projects going bad. As a result, this high flier of the last cycle was relegated to being a company under CDR and battling for survival.

However, its perseverance finally paid off in 2016. As per a circular from NITI AYOG in Sep-2016, all central government bodies have been directed to pay the developers 75% of the claims that have been awarded in their favour by an arbitration panel, against a bank guarantee of the same amount. This was the moment of truth for the company – when all its efforts over the last four years were to bear fruit. The cash expected from these claims (Rs 24bn), along with the S4A restructuring exercise approved by shareholders and bankers, should lead to mammoth reduction in standalone debt to Rs 20bn from Rs 49bn in March 2016.

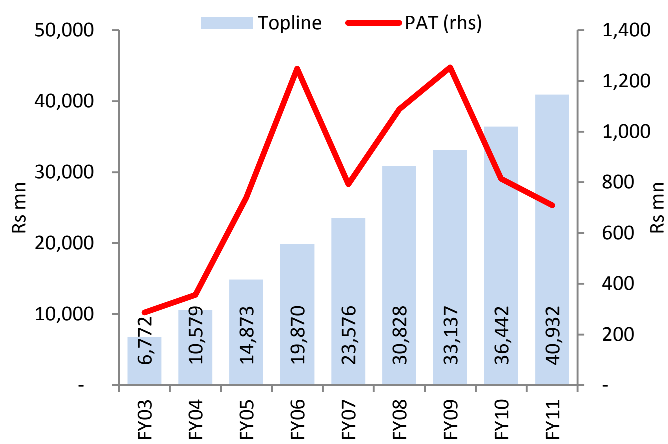
This huge reduction in debt is likely to lead to a significant fall in HCC's interest expense (-64% yoy) and provide a boost to its earnings (+360% yoy). At the same time, strong orderbook of Rs 237bn in Dec-2016 (6x book-to-sales) provides high revenue visibility for the next four years. Hence, we expect robust earnings CAGR of 53% over FY16-19, leading to a complete turnaround in the company's fortunes. After NCC and ITD Cementation, we expect HCC to be the next turnaround story in the infrastructure space.

A brief history of what went wrong

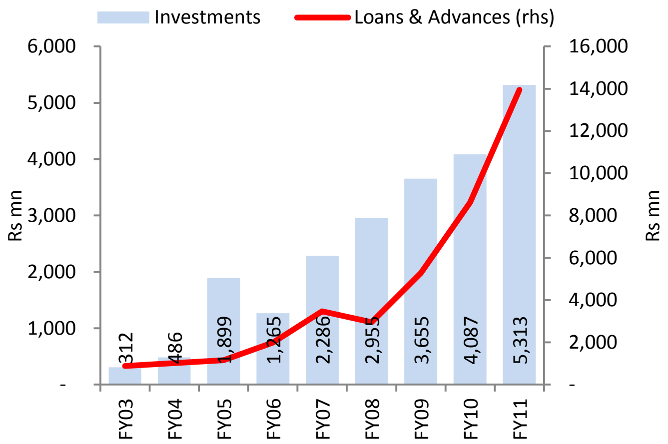
Over FY03-09, HCC's topline CAGR at 37% was robust – leading to its peak profit of Rs 1.25bn in FY09. It always possessed a strong execution track record, having worked on 50% of India's nuclear power projects and having built the iconic Bandra-Worli sealink in Mumbai. It was the star of that cycle – its market cap grew to Rs 40.5bn from Rs 1.1bn over FY03-10.

However, as its EPC business grew, so did its ambition in other (not entirely related) domains. HCC made indiscriminate investments into real estate (Lavasa, and a commercial complex in Mumbai) and also built up a road BOT portfolio of seven projects. The same led to increase in investment and loans to subsidiaries, further leading to rising standalone leverage, and eventually these 'side businesses' started hurting the core EPC business.

Strong growth momentum over FY03-11 ...



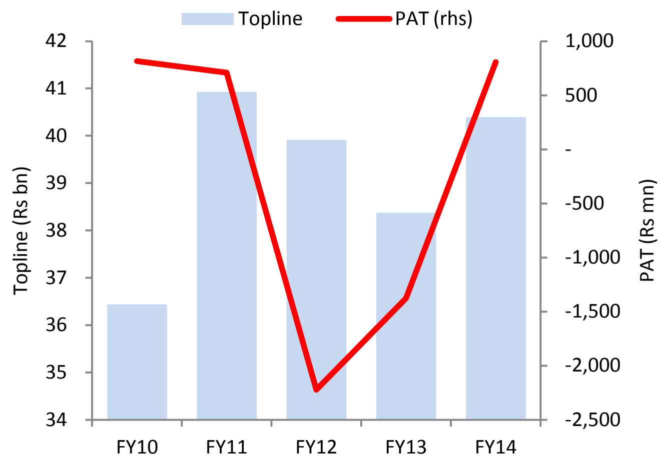
... accompanied by huge rise in investments and L&As



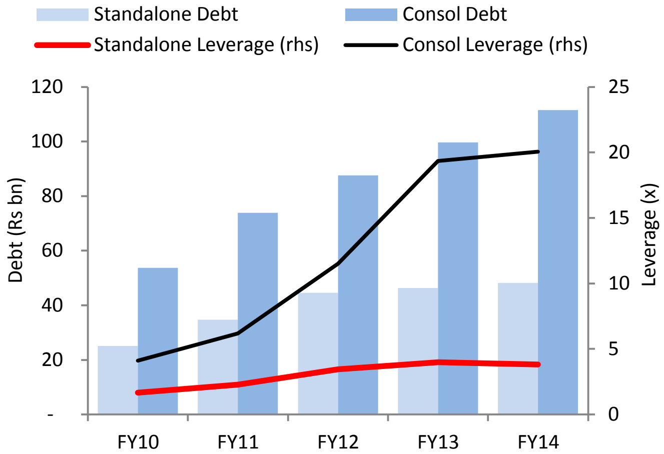
Source: Company, PhillipCapital India Research

As a result, over FY10-14, as the topline growth in the EPC business dried up (due to lack of order inflows and downturn in the sector) HCC reported cumulative losses of Rs 2bn. This led to ballooning of gross standalone debt to Rs 48bn (leverage of 4x) and gross consolidated debt of Rs 111bn (leverage of 20x) in FY14.

With growth drying in FY10-14, profitability collapsed ...



.... and led to a jump in standalone and consol leverage



Source: Company, PhillipCapital India Research

This precarious situation pushed the management to take a bold call – opt for a corporate debt restructuring (CDR) in May 2012. While its entry into CDR meant the company got some breathing space, its financial situation was fast deteriorating. It had to go slow on execution because of limited working capital limits available – this translated into lower profitability. The company tried for an IPO of its real estate subsidiary Lavasa for the second time (first failed attempt was in 2010) but the IPO was withdrawn due to lack of interest. The company was able to scrape through its QIP issue, raising Rs 4bn, but that could only buy it a little more time.

Terms of the Master Restructuring Agreement (MRA) of the CDR, entered on June 29, 2012

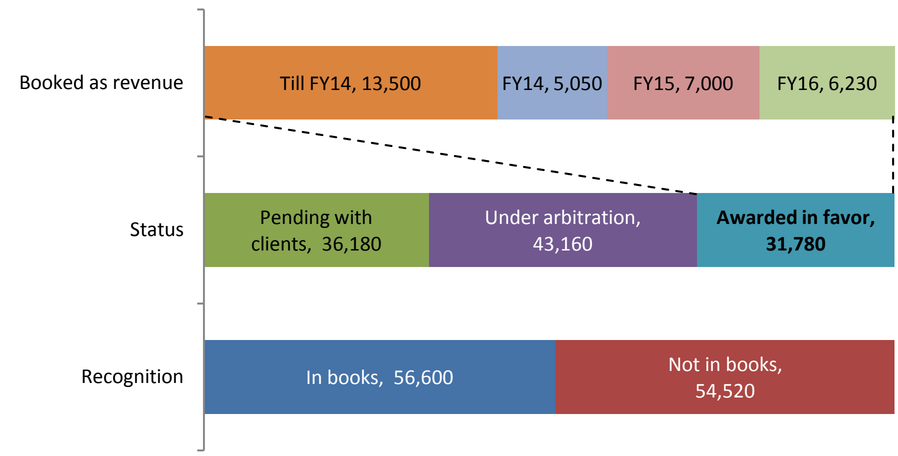
Rate of Interest	To increase from 8% to 15% at the beginning of each Fiscal Year until Fiscal Year 2021 **(on term loans)**
Reset of Rate of Interest	Loan interest rates after every three years Working capital interest on every anniversary of the respective Sanction Letters
Security *first ranking pari passu* on	On all fixed assets (both immovable and movable fixed assets), excluding certain identified properties
second ranking pari passu on	Present and future stocks of raw materials, WIP, finished goods, consumables, cash in hand and book debts
	Trust and Retention Account and any monies lying to the credit of the Trust and Retention Account (and their sub-accounts)
	Long term trade receivables
	Inter-corporate deposits, inter-corporate loans and advances made to subsidiaries and group companies
Restrictive Covenants Approval is required, inter alia to	Declare or pay dividend on any class of its equity or preference share capital
	Issue any debentures, raise any loans, deposits from public, issue equity or preference capital, change its capital structure or create any charge on its assets or give any guarantees, except as specifically permitted under the MRA
	Pay any commission to promoters, directors, managers, or other persons for furnishing guarantees, counter guarantees or indemnities or for undertaking any other liability in connection with any financial assistance or in connection with any other obligation undertaken
	Undertake or permit any merger/demerger, consolidation reorganization, scheme of arrangement or compromise with its creditors or shareholders or effect any scheme of amalgamation or reconstruction
	Create any subsidiary or permit any company to become a direct subsidiary
	Make any investment by way of loans, deposits or share capital in any concern, except as specifically permitted under MRA
Nominee Director	CDR Lenders collectively have the right to appoint one/more nominee directors on the board of directors of the borrowers
Events of Default	Failure to pay principal amounts or interest,
	Default in the performance of any covenant, condition, representation, warranty or other obligation under the CDR docs
	Occurrence of any event that would, in the opinion of the monitoring institutions, impact the ability to pay the relevant amounts required under the terms of the CDR Scheme
Right of Recompense	Better performance compared to the projections provided in the CDR Scheme
	Completion of the CDR Scheme
	Company opting out of the CDR process
	Declaration of a dividend of more than 10%

Source: Company, PhillipCapital India Research

Arbitration claims – the backbone of revival

All along this period, HCC's management claimed that the primary reason for its financial stress was the various government bodies failing to honour their legitimate "claims" of cost and time overruns. The company has, till date, filed claims worth Rs 111bn with various government bodies for projects executed over last 10 years.

HCC has Rs 111bn of claims with various govt bodies, under various stages



Source: Company, PhillipCapital India Research

We note that ***HCC has lost less than 5% of the arbitrations*** *that it has filed – remaining have either been awarded in its favour, or are under process*

HCC formed a dedicated team, to actively look into these specific cases and put forward their case strongly in various arbitration panels. It did achieve success by winning over Rs 36bn of arbitrations over FY13-16, but the government bodies still did not pay up and challenged the decisions of the arbitration panel in higher courts.

Accounting treatment of the claims

The cumulative amount of arbitrations that HCC claims it has with various bodies far exceeds the receivables/inventory on its balance sheet. Hence, there has always been a certain degree of scepticism regarding the 'legitimacy' of its claims. However, it is purely for accounting reasons, which the amount reflected in the balance sheet, is significantly lower than the claims the company has under arbitration.

Accounting treatment of claims

Case	Particular (Rs mn)	Entry # 1	Entry # 2
	Company does execution and raises bill *Expense amount = 90*	BS - Inventory (+90)	BS - Cash (-90)
Regular business proceedings	Client accepts execution amount *Bill amount = 100*	BS - Receivable (+100); Inventory (-90)	PL - Revenue (+100); COGS (+90)
	Client pays the amount due *Claim amount = 100*	BS - Receivable (-100)	BS - Cash (+100)
Arbitration process	Client does not accept amount Company moves to arbitration *Claim amount = 100*	No additional entry	No additional entry
	Two years lapse since raising bills Incremental interest and other charges *Claim amount = 120*	No additional entry	No additional entry
	Company wins arbitration *Claim amount = 120*	BS - Receivable (+120); Inventory (-90)	PL - Revenue (+120); COGS (+90)
	Client pays the arbitration amount *Claim amount = 120*	BS - Receivable (-120)	BS - Cash (+120)

Source: PhillipCapital India Research

Due to incremental interest and other charges, the claim amounts are significantly higher than ones reflected in its balance sheet – particularly because many of these claims have been under arbitration for many years.

The moment of truth

In June 2016, four years after entering CDR, HCC's board agreed to undergo a S4A restructuring exercise under which part of its debt would be converted into equity in favour of lenders – this was its last attempt to make its operations sustainable. The odds were against it, as no company in India's corporate history was known to recover from S4A or a similar restructuring exercise.

Two months later, in Aug 2016, the moment of truth arrived – the Cabinet Committee on Economic Affairs (CCEA) approved the proposal by NITI AYOG, directing central govt bodies to release 75% of arbitrations awarded against them as cash to various developers against bank guarantees, in an escrow account. The resolution was applicable to all central govt bodies including NHAI, NHPC, various port trusts, and other public sector enterprises. HCC had Rs 36bn of arbitrations awarded in its favour over the last four years of which it had only received only Rs 4.5bn.

Key points of the NITI AYOG proposal, accepted by the CCEA

Scenario	Action directed by the CCEA
Arbitration initiated under the pre-amended Arbitration Act	Dept to seek developer's approval to transfer the case to the amended Arbitration Act – which directs the arbitration panel to make an award within twelve months from the date of filing
Dept has challenged the Arbitral award already announced	Dept to release 75% of the award to the developer against bank guarantee without prejudice to the final order of the Court in the matter under challenge
	Payment may be made into a designated Escrow Account
	The amount released will be used in the following order: (1) payment of lenders' dues, (2) completion of the project and (3) completion of other projects of the same Dept
	Any balance remaining in the escrow account may be allowed to be used by the developer with the prior approval of the lead banker and the Dept
In case the subsequent court order requires refund of the money paid by a PSU/ Department	The amount shall be refunded by the developer along with appropriate interest
	The rate of interest to be decided by the dept keeping in view its cost of capital OR the rate of interest provided for in the Contract Agreement OR the rate of interest awarded under the Arbitral Award under challenge.
	If otherwise eligible and subject to contractual provisions, retention money and other amounts withheld may also be released against bank guarantee as per the laid down criteria.

Source: NITIAYOG, PhillipCapital India Research *(Click here for the NITI AYOG circular)*

Overnight, HCC's balance sheet appeared to embark on a radical transformation, with large part of debt expected to be repaid using the cash proceeds from various govt bodies. The company's perseverance in going after the government bodies through arbitrations finally appeared to be paying off.

At the same time, an ICICI-led Joint Lenders' Forum (JLF) approved the S4A restructuring exercise, in which ~50% of HCC's standalone debt was considered to be 'sustainable' – and the remaining was to be converted into equity and OCDs (optionally convertible debentures). In Nov-2016, the scheme received approval from RBI's Overseeing Committee (OC), and in Dec-2016, HCC's board approved it. In early Jan-2017, the scheme was implemented, with 27 lenders subscribing to Rs 8.08bn of equity (@ 34.92 per share) and Rs 14.41bn of OCD (@ 11.5% YTM).

Key features of the S4A restructuring implemented in Jan-17

S.No.	Particular	Rs mn
	HCC Total Funded Debt	**51,070**
A	Sustainable Debt	26,810
B	Unsustainable Debt	24,260
B-1	**Lender to subscribe to equity**	**8,086**
	Per share	Rs 35
	Eventual lenders' stake	22.91%
	Eventual promoter stake (originally 36.07%)	27.81%
B-2	**Optionally convertible Debentures**	**14,415**
	Tenure	10 years
	Coupon rate	0.01%
	YTM	11.50%

Awarded claims, as recognized by NHAI

Project (Rs mn)	Claim	75% of claim
Kolaghat to Kharagpur	43	32
Lucknow-Muzaffarpur	6,292	4,717
Chennai Bypass	2,833	2,124
Allahabad Bypass	1,827	1,370
Others	2,926	2,194
Total	**13,921**	**10,438**

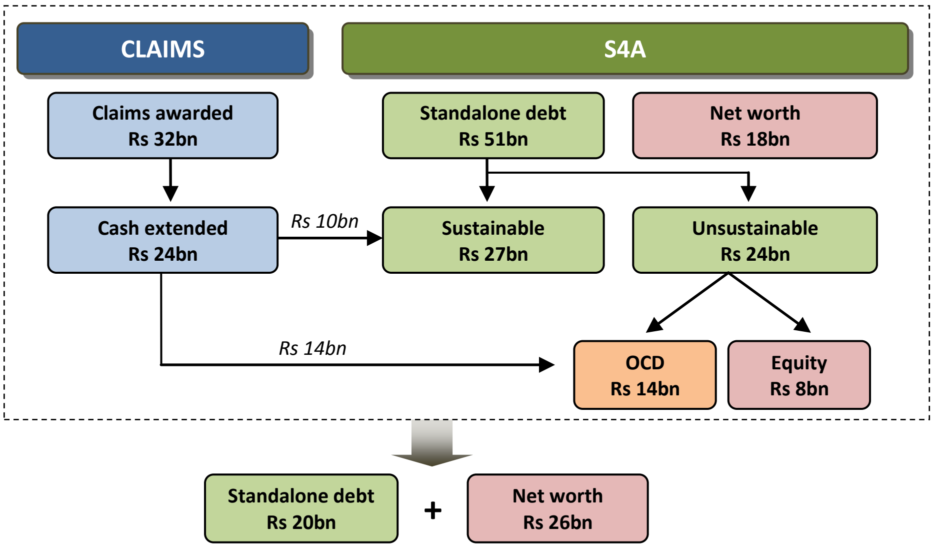
Source: Company, NHAI, PhillipCapital India Research

So, how will the balance-sheet transform now ?

Our recent interaction with NHAI officials leads us to believe that NHAI will disburse the requisite amount of cash within five days of receiving the escrow account details and bank guarantees. We expect the same from other government bodies too. HCC has Rs 36bn of arbitration that has been awarded to it of which Rs 4.5bn cash has already accrued to the company. Hence, it now expects Rs 20-25bn (75% of the remaining Rs 31.5bn) of cash accrual based on the NITI AYOG's initiative.

Assuming Rs 24bn of cash accrual from various govt bodies, HCC will utilise Rs 14bn to pay off the OCD – which would be converted following the S4A exercise. This would leave the company with Rs 10bn of cash from arbitration awards – which the company would use to pay down part of the 'sustainable debt'.

The Balance Sheet transformation – claims and S4A



Source: Company, PhillipCapital India Research

Hence, after the S4A exercise and cash proceeds from various govt bodies (for the current arbitration awards only), HCC's standalone debt will come down to Rs 20bn from Rs 51bn – a whopping reduction of 63%. This is likely to provide a huge fillip to its profitability, though the EPS boost will be partly dampened by the 23% shareholder dilution due to conversion of Rs 8bn of debt into equity.

Transformation in financials over FY16-18

Rs mn	FY16 Adj	FY17E	FY18E
Revenue	34,431	36,188	41,616
EBITDA	5,632	4,343	4,994
Interest Expense	**6,899**	**6,375**	**2,215**
PAT	-1,642	-1,276	2,005
EPS	**-2.11**	**-1.26**	**1.98**
No of shares	779	1,011	1,011
Debt	49,040	20,540	13,540
Equity	18,628	26,614	28,619
Leverage	**2.6**	**0.8**	**0.5**
Receivables	26,687	4,957	1,710
Interest Savings		524	4,160
% Interest Savings		8%	65%
Net PAT impact		366	3,281
% Net PAT impact		22%	257%
Net EPS impact		0.85	3.25
% Net EPS impact		40%	257%

Source: Company, PhillipCapital India Research

So how will the next three years' financials appear?

Its strong 6x book-to-sales orderbook and reduction in interest expense due to deleveraging of its balance sheet will lead to 53% CAGR in earnings over FY16-19. We have based our assumptions on a conservative 15-20% topline growth, which, given its already strong orderbook and huge opportunity in key segments, has an upside risk to it.

Key financials – last three and next three years – diametrically opposite

Rs mn	FY14R	FY15R	FY16R	FY14 Adj	FY15 Adj	FY16 Adj	FY17E	FY18E	FY19E
Revenue	**40,395**	**41,267**	**40,661**	**35,345**	**34,267**	**34,431**	36,188	41,616	49,940
EBITDA	**6,407**	**7,733**	**8,124**	**4,387**	**4,933**	**5,632**	4,343	4,994	5,993
EBITDA Margin	15.9%	18.7%	20.0%	12.4%	14.4%	16.4%	12.0%	12.0%	12.0%
Depreciation	1,446	1,503	1,359	1,446	1,503	1,359	1,372	1,386	1,400
Interest Expense	6,079	6,511	6,899	6,079	6,511	6,899	6,375	2,215	1,695
Other Income	2,028	1,554	1,729	2,028	1,554	1,729	1,500	1,600	1,600
Tax	103	457	481	103	457	481	-629	988	1,484
PAT	**806**	**817**	**850**	**-1,214**	**-1,984**	**-1,642**	**-1,276**	**2,005**	**3,013**
EPS	1.3	1.3	1.1	-2.0	-3.1	-2.1	-1.3	2.0	3.0
Debt	48,170	50,109	49,040	48,170	50,109	49,040	20,540	13,540	12,540
Equity	12,634	13,874	18,628	12,634	13,874	18,628	26,614	28,619	31,633
Leverage	3.8	3.6	2.6	3.8	3.6	2.6	0.8	0.5	0.4
Receivables	16,929	24,169	26,687	16,929	24,169	26,687	4,957	1,710	2,052
Receivable Days	153	214	240	175	257	283	50	15	15

Source: Company, PhillipCapital India Research *(R = Reported; Adj = Adjusted for claims)*

We note that HCC's EPC business has reported losses for last three years, and will report loss in FY17 too – the reported PAT is positive due to booking of claims

Any more claims pending?

Apart from Rs 36bn of arbitrations that it has won, HCC has Rs 43bn of pending claims where it has filed for arbitration, and Rs 36bn of claims where the client approval for proceeding with arbitration is awaited. As per the NITI AYOG directive, all arbitrations are to be moved to under the new Arbitration act, which necessitates resolution within 12 months of arbitration being filed. Hence, we see quick resolution of the Rs 43bn of claims that HCC currently has under arbitration.

Total claims by HCC under various stages of arbitration	Rs mn
Claims awarded in favor	31,780
Claims under arbitration	43,160
Claims awaiting client approval for arbitration	36,180

Source: Company, PhillipCapital India Research

What if none of these claims money comes back?

We see zero likelihood of the central govt bodies not honouring the NITI AYOG directive – especially when NHAI has already disbursed cash payments to IRB Infra and AFCONS, for their claims. However, in the worst case scenario, if the claims amount is not received, HCC's balance sheet transformation will be limited to the S4A restructuring exercise. In such a scenario:

1) Rs 8bn of debt will be converted into equity (@ Rs 35 per share) and Rs 14bn into OCD (@ 0.01% coupon rate, 11.5% YTM).
2) IND-AS accounting standards means the company will have to expense the notional interest (@ 11.5% YTM) on the OCDs, and not the coupon rate (0.01%). So while the interest expense will remain high, the cash outflow with respect to interest expense will be significantly lower.
3) Standalone debt will remain at Rs 26bn, equity at Rs 28bn.

Thus, HCC's transformation story will be much longer drawn out if the cash from arbitration is not received. **We see the receipt of cash from arbitrations awards as absolutely imperative for HCC's transformation. Without this, our investment thesis will not stand**. However, we see zero likelihood of the cash not being received.

What about other subsidiaries and their debt

One of the primary reasons for HCC's financial mess – other than payments stuck with various govt bodies – was its indiscriminate investment into subsidiaries involved in largely unrelated businesses like real estate and BOT projects. HCC has a whopping 70 subsidiaries, which together generated topline/PAT-loss of Rs 47/7bn in FY16 with total debt of Rs 93bn.

HCC – financials of all 70 subsidiaries

	FY15				FY16			
(Rs mn)	**Revenue**	**EBITDA**	**PAT**	**Debt**	**Revenue**	**EBITDA**	**PAT**	**Debt**
Baharampore-Farakka Highways	796	426	(28)	5,180	1,087	313	(312)	5,504
Badarpur-Faridabad Tollway	407	203	156	5,772	407	190	(410)	5,872
Charosa Wineries	38	3	(136)	1,208	32	(28)	(180)	1,227
Dasve Business Hotel	0	(12)	(14)	3	0	(9)	(10)	3
Dasve Convention Center	68	(42)	(103)	54	58	(284)	(382)	54
Dasve Hospitality Institutes	35	(46)	(144)	361	8	(8)	(108)	369
Dhule Palesner Operations & Maintenance	0	(0)	0	140	0	(0)	0	857
Dasve Retail	7	(24)	(25)	6	8	(5)	(34)	165
Euro Hotel SA	0	(2)	(2)	0	0	(4)	(4)	0
Farakka-Raiganj Highways	0	0	0	6,289	0	0	0	7,671
Future City Multiservices SEZ	0	(1)	(1)	0	0	(1)	(1)	0
Green Hills Residences	0	(1)	(1)	213	0	(0)	(0)	213
HCC Aviation	0	(0)	(0)	158	0	(0)	(0)	158
HCC Construction	0	(0)	(0)	0	0	(0)	(0)	0
HCC Mauritius Investment	28	(27)	5	1,481	30	27	22	1,682
HCC Realty	0	(0)	(0)	0	0	(0)	(0)	0
HCC Concessions	74	(86)	(39)	507	96	(112)	(964)	0
HCC Energy	0	0	0	0	0	(1)	(0)	874
HCC Infrastructure	43	(4)	(1,250)	9,946	38	22	(1,651)	13,209
Highbar Technologies	413	28	24	183	337	38	35	217
Highbar Technologies FZ LLC	5	0	0	0	2	1	(0)	0
Hill City Service Apartments	0	(4)	(4)	4	0	(1)	(2)	4
Hill View Parking Services	0	(0)	(0)	0	0	(0)	(0)	0
HCC Mauritius Enterprises	3	(0)	(82)	2,252	4	(1)	(97)	2,315
HCC Operations & Maintenance	254	(2)	2	559	204	12	61	871
HCC Power	0	(0)	(0)	0	0	(0)	(0)	890
HCC Real Estate	2	(213)	(184)	4,307	200	(74)	(40)	4,707
HRL (Thane) Real Estate	0	(125)	(125)	416	0	(0)	(0)	416
HRL Township Developers	0	(0)	(0)	4	0	(0)	(0)	4
Kart Racers	0	(0)	2	1	0	(0)	(0)	1
Lakeview Clubs	19	(30)	(104)	9	15	(57)	(99)	9
Lavasa Corporation	2,622	3,577	(369)	29,301	611	2,135	(2,159)	29,899
Lavasa Bamboocrafts	4	(9)	(10)	0	1	(2)	(3)	0
Maan Township Developers	0	(0)	(0)	249	40	(3)	(3)	216
Mugaon Luxury Hotels	0	(0)	(0)	0	0	(0)	(0)	0
Nashik Township Developers	0	(0)	(0)	17	0	(0)	(0)	17
Nature Lovers Retail	0	(1)	(1)	0	0	(0)	(0)	0
Narmada Bridge Tollway	0	(0)	(25)	231	0	(0)	(28)	271
Osprey Hospitality	0	(0)	(0)	0	0	(0)	(0)	0
Our Home Service Apartments	0	(0)	(0)	0	0	(0)	(0)	0
Panchkutir Developers	0	(0)	(0)	1	0	(0)	(0)	3
Powai Realt Estate	0	(0)	(0)	0	0	(0)	(0)	0
Pune-Paud Toll Road	0	(0)	2	416	0	(5)	(3)	416
Raiganj-Dalkhola Highways	0	0	0	885	0	0	0	923
Reasonable Housing	16	(3)	(3)	1	16	4	(5)	1
Rhapsody Commercial Space	0	(0)	(8)	106	0	(0)	(15)	106
Rosebay Hotels	0	(0)	(0)	0	0	(0)	(0)	0
Steiner AG, Zurich	53,681	556	259	2,637	42,822	258	42	2,414
Sahyadri City Management	79	(93)	(95)	27	100	(36)	(37)	27
Spotless Laundry Services	2	(7)	(51)	142	0	(2)	(44)	142
Steiner India	1,342	(110)	(117)	380	750	(46)	(59)	420

Source: Company, PhillipCapital India Research

HCC subsidiaries financials – all 70 subsidiaries

	FY15				FY16			
(Rs mn)	Revenue	EBITDA	PAT	Debt	Revenue	EBITDA	PAT	Debt
Steiner (Deutschland) GmbH	9	(3)	(3)		0	(19)	(20)	0
SAS Steiner Leman	71	31	(0)	30	57	(15)	(40)	24
Steiner Promotions ET Participations SA	0	(5)	(41)	934	0	(5)	(21)	1,004
SNC Valleiry Route De Bloux	0	(0)	(0)	0	0	(0)	(0)	0
Valley View Entertainment	0	(0)	(0)	0	0	(0)	(0)	0
Verzon Hospitality	10	5	4	0	15	7	5	4
VM & ST AG, Zurich	0	(1)	0	0	0	(1)	(0)	0
Warasgaon Infrastructure Providers	16	(36)	(36)	7	20	(22)	(24)	7
Warasgaon Power Supply	0	(45)	(45)	3,327	0	(37)	(74)	3,287
Western Securities	6	1	1	0	3	(0)	(0)	20
Whistling Thrush Facilities Services	155	4	3	0	100	(1)	(5)	0
Warasgaon Tourism	9	(371)	(374)	8	5	(73)	(76)	8
Warasgaon Valley Hotels	0	(0)	(0)	0	0	(0)	(0)	0
Ecomotel Hotel	128	37	(16)	189	122	25	(16)	122
Full Spectrum Adventure	24	(1)	(39)	99	28	3	(16)	99
Lakeshore Watersports	18	(1)	(5)	0	24	9	7	0
Lavasa Hotel	117	17	(13)	188	107	9	(23)	198
My City Technology	18	(11)	(15)	0	14	(9)	(39)	0
Warasgaon Assets Maintenance	0	(101)	(220)	7,802	0	(49)	(157)	6,647
Total	**60,519**	**3,472**	**(3,269)**	**86,030**	**47,362**	**2,140**	**(6,995)**	**93,568**

Source: Company, PhillipCapital India Research

Of the 70, 14 account for 95% of the total subsidiary topline, 72% of the PAT loss, and 92% of the gross debt. Of these 14, 7 belong to the BOT projects arm, 2 each to Lavasa, Stiener AG and 2 to the Warasgaon arm (infra subsidiary of Lavasa).

HCC – key subsidiaries' financials

	FY15				FY16			
(Rs mn)	Revenue	EBITDA	PAT	Debt	Revenue	EBITDA	PAT	Debt
Baharampore-Farakka Highways	796	426	(28)	5,180	1,087	313	(312)	5,504
Badarpur-Faridabad Tollway	407	203	156	5,772	407	190	(410)	5,872
Farakka-Raiganj Highways	0	0	0	6,289	0	0	0	7,671
Raiganj-Dalkhola Highways	0	0	0	885	0	0	0	923
HCC Mauritius Investment	28	(27)	5	1,481	30	27	22	1,682
HCC Infrastructure (Standalone)	43	(4)	(1,250)	9,946	38	22	(1,651)	13,209
HCC Mauritius Enterprises	3	(0)	(82)	2,252	4	(1)	(97)	2,315
HCC Real Estate (Standalone)	2	(213)	(184)	4,307	200	(74)	(40)	4,707
Lavasa Corporation (Standalone)	2,622	3,577	(369)	29,301	611	2,135	(2,159)	29,899
Steiner AG, Zurich	53,681	556	259	2,637	42,822	258	42	2,414
Steiner Promotions ET Participations SA	0	(5)	(41)	934	0	(5)	(21)	1,004
Warasgaon Power Supply	0	(45)	(45)	3,327	0	(37)	(74)	3,287
Warasgaon Assets Maintenance	0	(101)	(220)	7,802	0	(49)	(157)	6,647
Charosa Wineries	38	3	(136)	1,208	32	(28)	(180)	1,227
Total of Key Subsidiaries	**57,619**	**4,371**	**(1,934)**	**81,319**	**45,231**	**2,751**	**(5,039)**	**86,360**
% contribution by key subsidiaries	*95.2%*	*125.9%*	*59.1%*	*94.5%*	*95.5%*	*128.6%*	*72.0%*	*92.3%*

Source: Company, PhillipCapital India Research

We note that almost 90% (Rs 82bn) of the subsidiaries debt is accounted for, by two division – real estate (HCC Real estate, Lavasa and Warasgaon) and infrastructure (HCC Infra, Mauritius and the three BOT SPVs). With the proposed restructuring of Lavasa *(details ahead in the report)*, and the company looking to divest the BOT business, this entire debt will cease to be a concern for the company, over the next few years.

HCC – standalone and consolidated debt reconciliation

	Total Loans (Rs mn)	HCC Standalone	HCC Real Estate	HCC Mauritius	HCC Infra	Others	Elimination	Total
FY16	Total Debt	**49,040**	40,906	4,988	31,509	1,988	(18,062)	**1,10,291**
FY15	Total Debt	**50,109**	41,450	5,061	34,144	1,572	(13,534)	**1,18,801**

Source: Company, PhillipCapital India Research

HCC Infra – decent portfolio; on the block already

By 2011, HCC had accumulated a sizeable BOT portfolio of 6 BOT projects, with a total investment of Rs 55bn. Over the last two years, it has divested two of its projects in an effort to deleverage its balance sheet. Three of the remaining four projects are operational, and the fourth is stuck due to land acquisition problems faced by NHAI. Currently, HCC Infra and its subsidiaries have a total debt of Rs 33bn – of which Rs 5.8bn belongs to the Badarpur flyover SPV, which is already under SDR.

HCC BOT portfolio

Project	Length (km)	TPC (Rs mn)	Debt (Rs mn)	Equity (Rs mn)	Grant (Rs mn)	CoD	Prd (yrs)
Badarpur flyover	4	5,720	4,004	1,716	-	Jan-11	20
Bahrampur - Farraka	103	11,690	5,504			May-14	25
Farraka - Raiganj	103	17,200	7,671			Oct-16	30
Raiganj – Dalkhola*	50	14,110	6,350			UC	30
Total WB Projects	256	43,000	19,525	13,141	10,335		
Total	**260**	**48,720**	**23,529**	**14,857**	**10,335**		

Historic PE deals in the BOT space

Date	Investor	Company	Amount	Stake	Portfolio size (Rs mn)		Implicit Valuation	
			Rs mn	%	Project Cost	Book value	Rs mn	P/BV
Asset divestment								
Feb-13	SBI Macquarie	GMR - Jadcherla	2,060	74.0	5,155	1,620	2,784	1.72
Sep-13	IDFC PE	GMR - Ullundurpet	2,220	74.0	8,817	3,440	3,000	0.87
Nov-14	**IDFC PE**	**HCC - Nirmal BOT**	**640**	**74.0**	**3,150**	**630**	**640**	**1.02**
Oct-15	Cube Highway	Madhucon - Agra-Jaipur	2,480	74.0	3,680	994	2,480	2.49
Jan-16	Cube Highway	NCC - Meerut - Muzaffarnagar	970	51.0	7,476	2,255	1,902	0.84
Feb-16	IDFC PE	NCC - Bangalore Elevated	1,000	38.0	9,903	4,203	2,632	0.63
Stake Consolidation								
Feb-15	Gammon Infra	Sadbhav - Mumbai Nasik	720	20.0	7,020	1,195	3,600	3.01
Apr-15	**Sadbhav Engg**	**HCC - Dhule Palasner**	**2,040**	**60.0**	**14,200**	**3,550**	**3,400**	**0.96**
Oct-15	Ashoka Buildcon	PNC - Jaora Nayagaon	342	8.5	8,350	2,730	4,023	1.47
Portfolio Buyout								
Aug-15	Brookfield AMC	Gammon Infra	5,630	100.0		7,720	5,630	0.73

Source: PhillipCapital India Research

Badarpur flyover project – already under CDR

The Badarpur flyover, built by HCC for a total cost of Rs 5.7bn, is under CDR. In 2014, the Supreme Court imposed an 'Environmental Compensation Charge' on commercial vehicles entering New Delhi – leading to 40% drop in commercial vehicles traffic – making the project unviable. The project is currently under SDR and the company is evaluating multiple options, including termination of the project.

Twin project in WB – self sustainable

HCC's two projects in WB – part of the three contiguous projects – are already operational, and are reporting healthy toll growth. While Bahrampore-Farakka is reporting average toll collection of Rs 3.9mn/day (sufficient to service debt obligations), Farakka-Raiganj is expected to report jump in toll collection to Rs 7mn/day on 100% CoD (currently Rs 4mn/day).

Xander group – a private equity firm – has 14.5% stake in HCC Infra, having invested Rs 2.4bn in 2011

Raiganj-Dhalkola project – still stuck, even after six years delay

The third project in the set of three contiguous projects in WB has already been delayed by over six years – due to NHAI's inability to acquire land. The land acquisition process is not yet complete, and the project is expected to take another two years, before commencing operations.

We do not see HCC's infra arm leading to any incremental burden on its standalone balance sheet. It has already put the two operational projects in WB on the block – the sale should lead to incremental cashflows into its standalone balance sheet. This would also lead to lowering of consolidated debt, with the SPV debt going out.

Lavasa – sunk cost or salvage value

One of the most hyped investments of HCC has been the proposed township of Lavasa. Situated 65km from Pune (220km from Mumbai), HCC had bought 23,000 acres of land to develop an integrated township – residential and commercial buildings, along with basic infrastructure. However, the environment ministry of Maharashtra, and later MoEF, termed Lavasa's land acquisition as illegal and cancelled the environmental clearance for it in Nov-2010. Thereafter, the company complied with MoEF's requirements and finally got a conditional environmental clearance in Nov-2011.

For all practical purposes, Lavasa is a sunk cost for HCC. The interest level in the township as a residential or commercial location is practically zero. The place only serves as a weekend tourist destination – the popularity of which, too, is waning with time. New residential sales are happening at a snail's pace and not enough to even fund the operating costs of the 'project' – the debt servicing remains a distant target.

Lavasa currently has debt of Rs 38bn – almost all its bankers have declared Lavasa as NPA (payments being due for more than 90 days). Nonetheless, Rs 11.5bn of its debt has some form of recourse to the parent company:

- Rs 8bn of Deep Discounted Convertible Debentures (DDCDs), issued by Lavasa in 2010, carry a PUT option – that can be exercised anytime after 2015.
- Rs 3.5bn of corporate loan with HCC's corporate guarantee – disclosed as contingent liability in HCC's balance sheet.

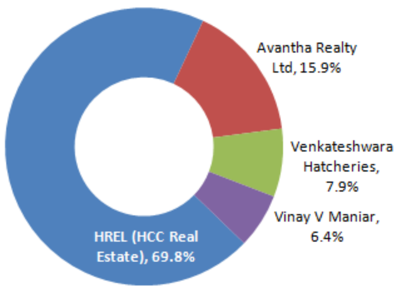
But for these two, the remaining debt on the books of Lavasa does not have any recourse to the parent company. Hence the negative impact of Lavasa to HCC's valuation remains limited to Rs 11.5bn – in the worst case scenario.

Lavasa : A financial web

Lavasa Debt Profile (FY16)	Rs mn
NCDs	660
Terms loans against mortgage	
From Banks	14,135
From Financial Institutions	1,262
ICD from HREL/HCC	2,929
Current maturities of LT debt	
Debentures	4,068
Term Loans from Banks	5,747
Term Loans from Others	1,098
Total Debt	**29,899**

DDCDs Issued in 2010-11	Rs mn
Axis Bank	2,500
ICICI Bank	2,500
Bank of India	1,500
Jammu & Kashmir Bank	1,000
Allahabad Bank	1,000
indusind	500
Andhra Bank	250
united bank	500
Bennet, Coleman & Co Ltd	813
Total	**10,563**

Lavasa Ownership structure



Bank	Payment due > 90 days
Corporation Bank	46
Bank of Baroda	183
Punjab National Bank	692
Oriental Bank of Commerce	13
Karnataka Bank	76
Central Bank of India	315
State Bank of Hyderabad	197
Axis Bank	137
Bank of India	562
IFCI Ltd	366
SSG Investment Holding India	366
Union Bank of India	358
L&T Infrastructure Finance	77
Allahabad Bank	96
IndusInd Bank	48
The Jammu & Kashmir Bank	1,149
Redkite Capital Pvt Ltd	22
ICICI Bank	3,872
Total	**8,578**

Source: Auditors' reports, Company, PhillipCapital India Research

Lavasa financials

Lavasa Corp (Rs mn)	FY15	FY16
Revenue	2,622	611
EBITDA	3,577	2,135
PAT	(369)	(2,159)
Debt	29,301	29,899

Source: Company, PhillipCapital India Research

Lavasa's bankers are trying to pull off a financial restructuring exercise, in their attempt to salvage whatever they can from the project and prevent the account from becoming an NPA (the account is technically already an NPA, with significant interest and debt payment delayed by over 90 days).

The financial restructuring plan for Lavasa, *as per our interaction with bankers,* is to work as follows:

- **An infrastructure subsidiary, Warasgaon Asset Maintenance Ltd (WAML)**, fully owned by Lavasa Corporation, has already been formed. This entity is in charge of infrastructure development and maintenance of Lavasa.
- Lavasa Corp will sell property development rights of Lavasa, to WAML.
- **Existing Lavasa bankers will infuse Rs 40bn into WAML** (in addition to the existing Lavasa Corp debt of Rs 36bn), **along with the promoters of Lavasa (HCC Real estate Ltd) investing Rs 10bn** (alone or with some partner), to revive the project.
- **WAML will then pay Rs 36bn to Lavasa Corp,** for the property development rights, which Lavasa Corp will pay to the same set of lenders, **to payback the entire debt on Lavasa Corp's books**.
- **The Rs 40bn debt in WAML will be restructured under 5:25 scheme,** providing the entity interest/principal moratorium of 2/5 years, and repayment tenure of 20 years, after the moratorium period.
- The IDC corresponding to the moratorium period will be compensated through the Rs 4bn difference between the Rs 40bn debt given to WAML and Rs 36bn debt paid back by Lavasa Corp.
- The promoters will utilise the moratorium period to market Lavasa, and boost property sales, to revive the project.

While this restructuring exercise will definitely provide Lavasa and its bankers some breathing space, its eventual success will depend upon the property sale in Lavasa – of which, we remain highly sceptical. Hence we would not like to ascribe any value to Lavasa for HCC. However, in the worst case scenario, the contingent liability that HCC will have to address stands at Rs 11.5bn – or Rs 10/share.

Stiener AG – a unique turnaround story in itself

HCC acquired Stiener AG (formerly known as Karl Stiener) in March 2010, for CHF 35mn (Rs 1.47bn). It is a Switzerland-based construction company with unique capability in development, planning, and implementation of complex real estate and demanding renovation and restructuring projects.

When HCC acquired the company, it was a loss-making enterprise with a weak orderbook. However, over the last two years, HCC's management has managed to turn around its operations. The company now reports healthy operations (FY16 rev/PAT of CHF 639mn/-1mn) and has an orderbook of CHF 849mn (2x book-to-sales).

Stiener AG financials

	CHF mn			Rs mn		
Steiner AG	**FY14**	**FY15**	**FY16**	**FY14**	**FY15**	**FY16**
Revenue	798	854	639	52,947	56,042	42,560
PAT	8	2	(1)	541	112	(65)
Orderbook	1,180	1,121	1,319	79,560	71,950	90,680
Order inflow	758	796	849	51,070	51,060	58,330

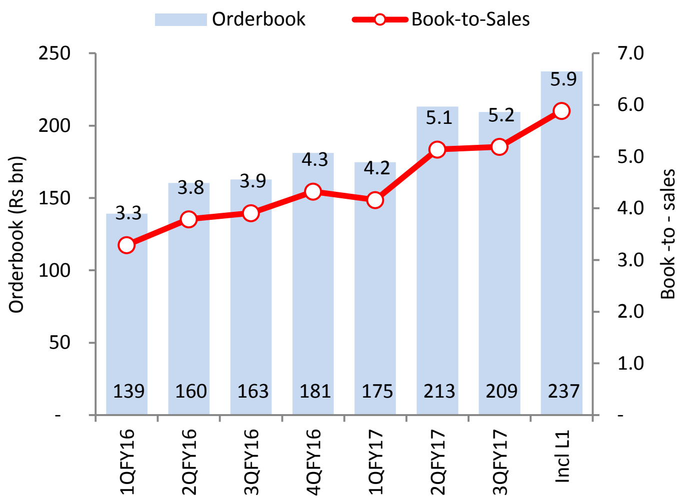
Source: Company, PhillipCapital India Research

While the company does not intend to sell its stake in the entity, it had gauged investor interest in 2014, under pressure from bankers to divest assets to deleverage the balance sheet. The company received immense interest in the subsidiary, with valuations close to CHF 140mn (4x the 2010 acquisition value).

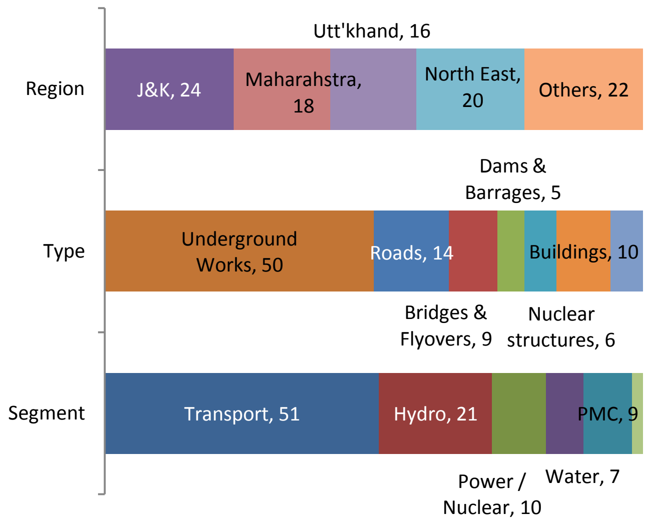
What next? What about future growth prospects?

HCC's strong execution track record in the industry ensured that the company continued to win orders despite its financial stress and CDR status. Its current orderbook of Rs 237bn stands at a staggering 6x book-to-sales – by far the highest in the industry. The orderbook is also fairly diversified across verticals and across the country.

Strong growth in orderbook



Orderbook well spread across segments



Source: Company, Phillip Capital India Research

Key order-wins over the last two years

Name of Project	Client	HCC Share (Rs mn)	Segment
Single line BG Tunnel No.12, Assam	NF Railway	7720	Transportation
Tata Memorial Centre Hospital at Vizag, AP	DAE	1530	Buildings
4-Lanning of Ramban-Banihal sec of NH 1A, J&K	NHAI	17,830	Transportation
C&S Works at BARC Tarapur, Ph I, Maharashtra	BARC	9430	Nuclear
DFMF Plant, Tamil Nadu	IGCAR	430	Nuclear
Kangchup Tamenglong Road, Manipur	PWD, Manipur	8130	Transportation
Tapovan Vishnugad HEP - Bal. works of HRT	NTPC	6340	Hydro
Double Lane Tunnel at Sawalkot, J&K	JKSPDC	1670	Hydro
Nikachhu HEP (118MW), Bhutan	DGPC	4560	Hydro
Total – Orders Won in FY16		**57,640**	
Residential towers at DAE Anushaktinagar	DAE	1590	Buildings
Mumbai Metro Line 3-UGC-02	MMRC	25,230	Transportation
IRCON Tunnel, T-13_2nd Call, J&K	Ircon	17,500	Transportation
High rise buildings at Anupuram, Tamilnadu	DAE	1820	Buildings
Const of parallel safety tunnel of T-12	NFRailway	2050	Transportation
Bistan LIS, MP	NVDA	1,910	Irrigation
Anji Khad railway cable stayed bridge, J&K	Ircon	3,690	Transportation
Total Orders Won in 9MFY17		**53,790**	

Source: Company, Phillip Capital India Research

HCC has reported strong order inflow over last two years – particularly in 1HFY17. That it has achieved this despite various state governments (like UP, Karnataka, Tamil Nadu and AP) barring companies under CDR from bidding, is really commendable. While the current orderbook ensures strong growth for the next 2-3 years, we see immense opportunity in the segments where HCC has strong domain expertise – metros, roads, and nuclear/hydro power projects.

Metros: Rs 4tn opportunity on the anvil

MRTS is slowly becoming the poster-boy of development in every state. Every state government and city municipality in India wants to be able to boast of a metro network. Currently, seven cities in the country have an operational metro network – four of these became operational in the last one year. We see this segment as one of the biggest opportunities in the infrastructure sector over the next three years.

Our bottom-up analysis indicates that currently, seven cities in India have operational and expanding metro networks, built with a total investment of Rs 2tn. Five more cities are expected to join the bandwagon over the next five years, entailing investments worth Rs 1tn. Additionally, metro projects in nine more cities are under the development stage, entailing investments of Rs 1tn. Of this Rs 4tn investment riding on various metro projects, Rs 2.3tn will be awarded over next three years – presenting a mammoth opportunity for players like HCC.

Operational Metro projects

City	Length (Km)	Operational Length (Km)	Project Cost (Rs bn)	Current Status	Future plans
Delhi Metro	349.2	189.9	704	Phases I (65.1km - 2006); Phase II (124.8km - 2011) operational	Phase III by Mar-2018
Kolkata Metro	41.9	27.2	67	North-South Corridor operational	East-West Corridor by Dec-17
Bengaluru Metro	114.4	25.5	409	Reach 1,2, 3 operational	Phase I by Dec-16, Phase II recently approved
Gurgaon Metro	12	5.1	34	Phase I operational in Nov-13	Phase II by 2017
Mumbai Monorail	20.1	8.9	25	Phase I operational in Dec-13	Phase II by June-17
Mumbai Metro	11.4	11.4	24	Phase I operational in June-2014	Multiple phases at various stages
Jaipur Metro	35.8	9.6	135	Phase I operational in June-2015	Phase II planned for 24km
Chennai Metro	143	10	604	Line I operational in June-2015	Line II to be operational by Oct-16
Total	**727.8**	**287.6**	**2,001**		

Under Construction Metro projects

City	Length (Km)	Stations (No)	Project Cost (Rs bn)	Current Status	Future plans
Mumbai Metro	195	158	651	EPC contractors for Phase 2A, 3, 7A awarded	Bids for EPC contracts for Phase 2B, 4 already called
Hyderabad Metro	71.2	66	160	Complete project CoD expected in June-2017	
Nagpur Metro	38.2	36	87	Corridor 1 and 2 Under construction	
Lucknow Metro	35	33	118	Phase 1A CoD by Feb-17; Phase 1B awarded;	Phase 2 activity start in June-17
Ahmedabad Metro	37.9	32	117	Execution/awarding in progress on Corridor 1	Corridor 2 expected CoD 2019
Kochi Metro Metro	25.6	23	52	Expected CoD by June-17	
Total	**402.9**	**348**	**1,185**		

Planned Metro projects

City	Length (Km)	No. of Stations	Project Cost (Rs bn)	Status
Pune Metro	31.5	30	114	DPR approved; foundation stone laid in Dec-16
Kanpur Metro	36.0	29	105	DPR approved; foundation stone laid in Oct-16
Varanasi Metro	26.0	22	75	DPR approved in May-16
Meerut Metro	30.0	22	65	DPR submitted; yet to be approved
Agra Metro	25.0	23	65	DPR submitted; yet to be approved
Ludhiana Metro	28.8	27	87	DPR being prepared
Chandigarh Metro	37.6	30	136	DPR being prepared
Bhopal Metro	85.0	89	80	DPR approved in Dec-16
Indore Metro	107.0	75	120	DPR approved in Dec-16
Vijaywada Metro	26.0	25	68	Bids invited in Nov-16
Vizag Metro	42.5	41	135	DPR approved in Nov-16
Kozhikode Metro	13.3	14	25	DPR approved; foundation stone laid in Feb-16
Trivandrum Metro	21.8	19	42	DPR approved; foundation stone laid in Feb-16
Total	**510.5**	**446**	**1,117**	

Source: PhillipCapital India Research

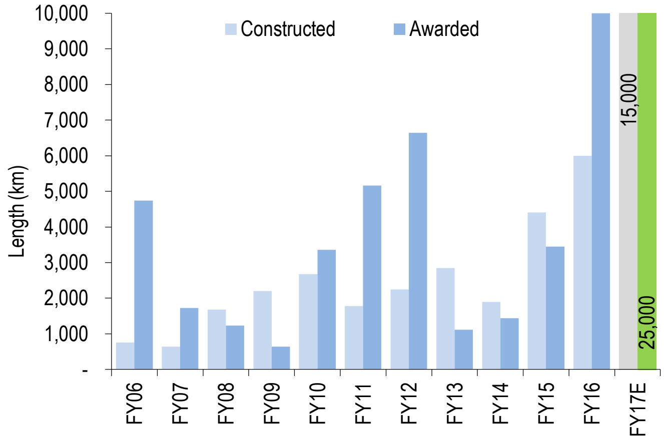
Roads: Huge opportunity from state and national highways

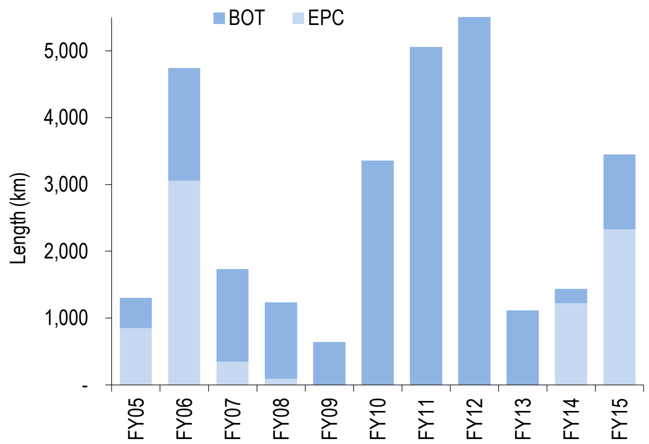
After two forgettable years (FY13 and FY14) NHAI got its act together in FY15. It awarded 3,447 and 10,000km of road projects in FY15 and FY16 (incl MoRTH) – against only 1,100 km and 1,400 km in FY13 and FY14. The dismal performance in FY13/14 was led by problems surrounding land acquisition and environmental clearance – most of which were cleared by the new government over FY15/16.

Buoyed by FY16 performance and strong pipeline, the Ministry of Surface Transport set a highly ambitious target of awarding 25,000km of road projects in FY17 (15,000 NHAI and 10,000 MoRTH). YTD, NHAI and MoRTH have awarded only 4,500km.

Recently, the regulatory body underwent a management transition with Mr YS Malik replacing the ex-chairman Mr S Chandra. We see the management transition in NHAI leading to significant slippages in FY17 order award targets, as the new chairman and team become familiar with the department progress and activities. Typically, January-March sees maximum order award activity from NHAI, but we see momentum slackening this year due to the transition.

NHAI – Strong performance in FY16 after three years of dismal performance





Source: NHAI, PhillipCapital India Research

NHDP current status — December 2016 *(length in km)*

	Total length (km)	Already 4-laned (km)	Under Implementation (km)	To be awarded (km)
Golden Quadrilateral	5,846	5,846	-	-
NS - EW Ph. I & II	7,142	6,513	377	252
NHDP Phase III	12,109	7,269	2,861	1,679
NHDP Phase IV	13,203	3,195	6,169	3,839
NHDP Phase V	6,500	2,502	1,060	2,938
NHDP Phase VI	1,000	-	165	835
NHDP Phase VII	700	22	79	599
NHDP Total	**46,500**	**25,347**	**10,711**	**10,142**
Port Connectivity	402	379	56	-
Others	2,195	1,722	207	-
Total by NHAI	**49,097**	**27,448**	**10,974**	**10,142**

Source: NHAI

New pipeline ready to be rolled out

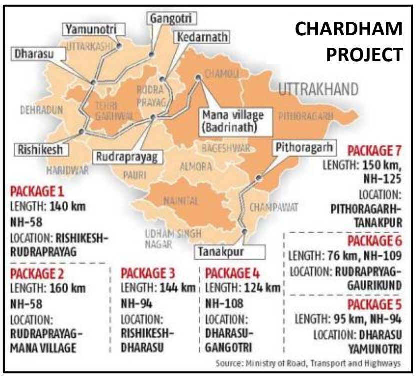
Beyond the 10,000km of projects to be awarded under the current NHDP (which would be exhausted in the next two years), MoRTH has already planned the next phase, which will be awarded starting FY18. Key projects to be awarded are:

1) **Sagarmala**: Projects connecting major ports to the national highways. While part of these projects have already been awarded, Sagarmala phase will address the

cargo evacuation problem at major ports by upgrading the existing road network to 6/8 lanes.

2) **Bharatmala**: Projects improving connectivity in border areas and coastal boundary for the Indian peninsula.
Length: 6000km. Capex - Rs 700bn

3) **CharDham Project**: This phase, in its first part, would connect four religious places of Kedarnath, Badrinath, Gangotri, and Yamunotri in Uttarakhand with 'disaster-proof' two-lane roads. In its second part, the project would encompass enhancing connectivity to other religious places.
Length: 2,500km. Capex - Rs 500bn (Phase I: Length: 900km; Capex: Rs 120bn)



The DPRs for these phases are being finalised and should be submitted to the Ministry of Transport early 2017. The projects from these phases are expected to be included in the NHDP from FY18.

Kick-starting the reform process

Over the last twelve months, NHAI has unveiled a series of reforms, which have significantly resolved the logjam in various projects. Many projects awarded in FY11-14 were stuck or were facing overruns, due to various problems such as land acquisition, environmental clearance, right of way, and the financial state of developers. Some projects, which were operational, were reporting significantly lower traffic than estimated – leading to inability of these projects to service their debt obligations. To address these concerns, NHAI unrolled some critical reforms in the last 12 months:

NHAI – Series of reforms to de-bottleneck the award ad execution

Step	Description	Provided respite to	Proposal extended to
Easier environmental clearance norms	Delinking FC and EC, EC not required for linear brownfield stretches	All projects that were stuck due to clearances	All projects - 24 stuck projects cleared due to this
Premium rescheduling	Back-ending premium payments to align with the cashflows	Developers facing low traffic on operational projects	Extended to 20 projects; 12 more projects eligible
Relaxation of exit clause	100% exit allowed for pre-2009 projects also (earlier only 76% was allowed)	Helps developers to rotate capital	All projects awarded pre 2009
One-time fund infusion	One-time fund infusion by NHAI, to complete the project - NHAI would then recover its investment through first right on toll collections	Projects facing significant cost overruns	Extended to 16 projects - negative response from banks
Extension of concession period	For project that faced delays due to no fault of developers	Projects facing significant time overruns	34 projects with more than 18 month delay have been identified
Hybrid annuity projects	New projects - mix of annuity and toll - 40% project cost to be funded by NHAI	Projects that were not feasible due to low traffic	Tremendous response – 29 HAM projects for 1600km awarded so far
Investment Trust	Trusts with a portfolio of operational BOT projects to float a separately listed entity	Developers stuck with large BOT portfolios - helps them rotate capital	IRB Infrastructure in late stages to list the first InvIT

Source: NHAI

Nuclear/hydro power projects: Strong execution track record

HCC has strong capabilities in construction of power projects – esp nuclear and hydro power projects. It has constructed marquee nuclear and hydro-power projects like Kundakulam and Rajasthan Atomic power plants, and Nimoo Bazgo, Chutak and Kishenganga hydro power plants. The company has constructed:

- 25%+ of India's Installed hydel power capacity
- 50% of India's nuclear power installed capacity
- 18 thermal power projects and three gas-based power projects
- 46 dams and barrages

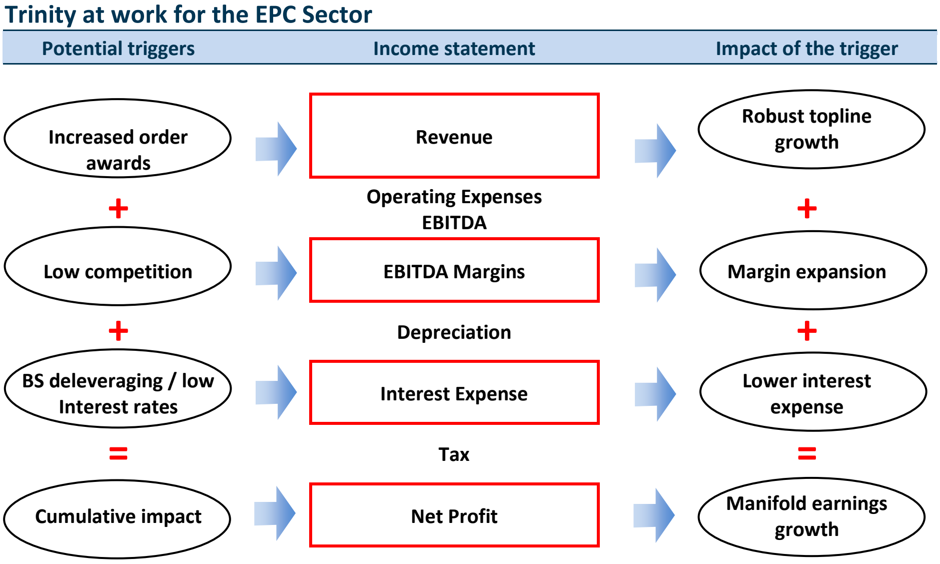
We expect HCC's strong execution track record to help it maintain a consistent orderflow in these segments. With competition relatively low in these segments, margins are also likely to be better.

Another manifestation of the 'EPC Trinity'

We see this turnaround in fortunes of HCC as another manifestation of our 'Trinity of Forces' hypothesis, where we had predicted that the EPC companies will benefit from three forces, acting simultaneously on their P&L, leading to manifold earnings growth (read our detailed report here). The 'trinity' is:

1) Increased order awards
2) Reduced competition
3) Balance sheet deleveraging / low interest rates

Trinity at work for the EPC Sector



Source: PhillipCapital India Research

Over the last three years, we have already seen three companies reporting a turnaround in their fortunes, exactly along the lines of 'EPC Trinity' hypothesis – NCC, ITD Cementation and Ahluwalia Contracts. All these companies actively deleveraged their balance sheets, and benefitted from revival in order award activity and lower competition. The market too rewarded them handsomely, with their market caps growing by 688%, 1566% and 1134% since March-2014.

How our EPC Trinity has worked for NCC, ITDC and ACIL

	NCC				ITD Cementation				ACIL			
Rs mn	**FY14**	**FY15**	**FY16**	**FY17E**	**CY13**	**CY14**	**CY15**	**CY16e**	**FY13**	**FY14**	**FY15**	**FY16**
Revenue	61,173	82,969	83,252	88,468	15,841	17,189	30,709	33,780	13,882	9,603	10,599	12,496
EBITDA	4,049	6,494	7,374	8,183	1,625	911	1,916	2,365	-238	417	1,149	1,608
EBITDA Margins	6.6%	7.8%	8.9%	9.3%	10.3%	5.3%	6.2%	7.0%	-1.7%	4.3%	10.8%	12.9%
Interest Expense	4,660	5,736	5,076	4,232	1,283	1,355	1,377	1,151	334	363	386	352
PAT	405	1,118	2,371	2,785	93	-475	275	664	-762	76	641	844
EPS	1.6	2.0	4.0	5.0	0.8	1.3	-3.8	4.3	-12.1	3.5	9.6	12.6
Debt	24,746	19,951	18,885	16,385	7,695	7,653	6,007	5,507	2,527	2,386	1,731	1,419
Leverage	1.0	0.6	0.6	0.4	1.9	1.3	1.2	1.0	1.2	1.1	0.5	0.3
Share price	22	95	78	80*	14	81	111	168*	23	40	249	266
Market Cap	5,645	53,034	43,138	44,473*	1,565	12,490	17,223	26,067*	1,444	2,511	16,680	17,819
Returns since March-14	**688%**				**1566%**				**1134%**			

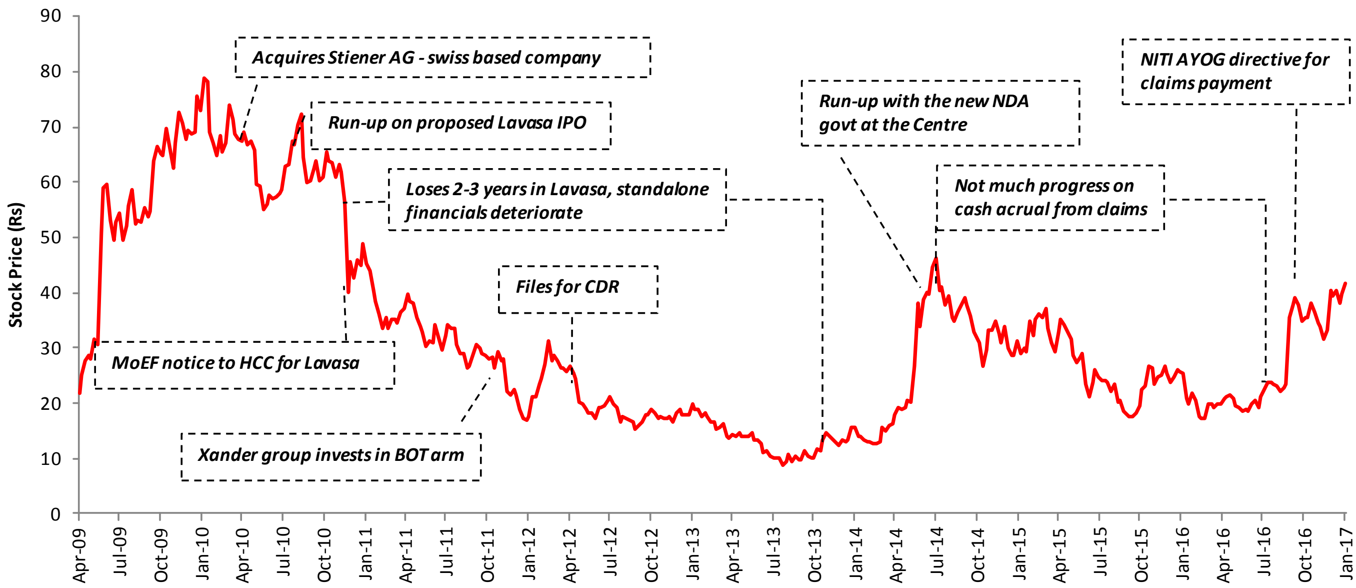
Source: Company, PhillipCapital India Research

Over the next two years, we expect HCC to encore NCC, ACIL and ITD Cementation's performance, driven by the EPC Trinity.

Management evolution – lessons learnt

HCC has had a rough ride over the last ten years. From being the star of the last cycle with a highly popular project of Lavasa, to being a company under acute financial stress, to one with a potential turnaround story – the company and the management has seen it all. It was one of the first companies to opt for Corporate Debt Restructuring (CDR) programme in 2012. It was a tough decision, laden with significant loss of reputation. However, the prudent management chose long term benefits over near term pain, and finally appears to be reaping the benefit of its perseverance and vision.

Swinging fortunes of the company



Source: Bloomberg, PhillipCapital India Research

Over this difficult course, we believe, the management too has evolved to face business challenges in a much better manner. Some of the key takeaways from our management interaction, which inspire high level of confidence, are:

1) **The management is no longer chasing growth.** Despite a strong 6x book-to-sales orderbook, the management intends to grow only by 15-20% every year. It is completely focussing on profitable growth – not repeating its mistakes of 2007-2011 period, where it chased growth, at the expense of balance sheet.
2) **Keeping a close eye on working capital.** The management intends to follow strict discipline in its working capital cycle, and has decided to stop working on projects where the payments are delayed by a specific period (1 month) – ensuring the receivables do not balloon, as they have, now.
3) **Not in a hurry to come out of CDR**. The management is not in a hurry to come out of CDR – which most companies would want to do, to regain their financial and operational freedom. "CDR has only brought more discipline into the system". It believes the checks and balances that a CDR system poses, have ensured the company does not invest indiscriminately in unrelated domains. It intends to apply for coming out of CDR, only when it sees a financial benefit.
4) **No asset ownership hereafter**. The management has decided NOT to bid for any BOT or any asset-ownership project. Even for HAM, they intend to go with a partner. It intends to sell its stake in the three BOT projects in its portfolio, as soon as possible. The focus is to remain on the company's core strength – EPC.

CDR has only brought more discipline into the system

We see the HCC management emerging out stronger and wiser than it was, out of the entire financial crisis. We expect the lessons learnt in this period to help the company regain its past glory in the infrastructure space.

Valuations attractive, despite recent surge

HCC has run up 84% since the day the NITI AYOG circular was floated. Despite the surge, we believe there remains significant upside potential. On our numbers, HCC is currently trading at 14x FY19 P/E – 9.5x adjusting for the value of subsidiaries (Infra and Stiener AG) – at a steep discount to its peers like NJCC, KNRC, and JKIL. We expect significant rerating in HCC driven by its robust topline and earnings growth – a fallout of the huge order award opportunity in the infrastructure space and deleveraging of its balance sheet.

We value HCC using SoTP, valuing:

- EPC business at 15x FY19 P/E (in line with our multiple for peers).
- HCC Infra subsidiary at 0.7x book value.
- Stiener AG at CHF 70mn (0.5x the third party valuation) – implying 2x BV.
- We do not attribute any value to Lavasa – though its contingent liabilities present negative value of Rs 11bn – Rs 10/share.
- We value HCC's other pending claims at 0.3x the amount.

That gives us a price target of Rs 71, implying a significant 70% upside from current levels. We initiate with a BUY rating.

SoTP

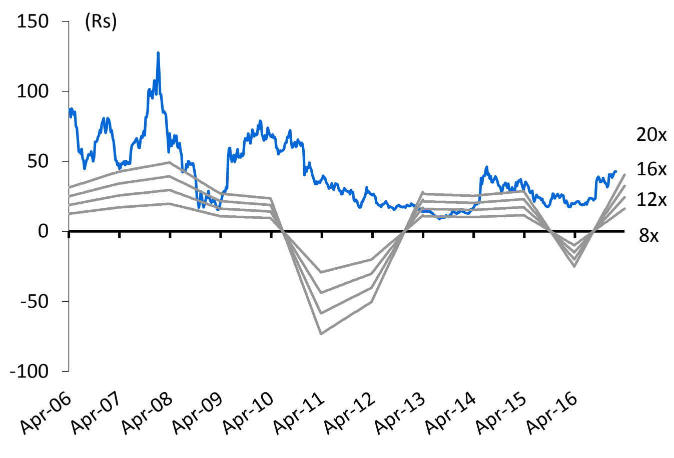
Business division	FY19 EPS Rs	Book Value Rs mn	Multiple	Valuation Rs mn	Per share Rs
EPC	3.0		15.0x	45,202	45
BOT Projects		13,141	0.7x	9,199	9
Stiener AG		2,345	2.0x	4,690	5
Lavasa		10,744	0.0x	-	-
Other pending claims		41,000	0.3x	12,300	12
Total Valuation				**71,390**	**71**

Infrastructure sector – valuation table

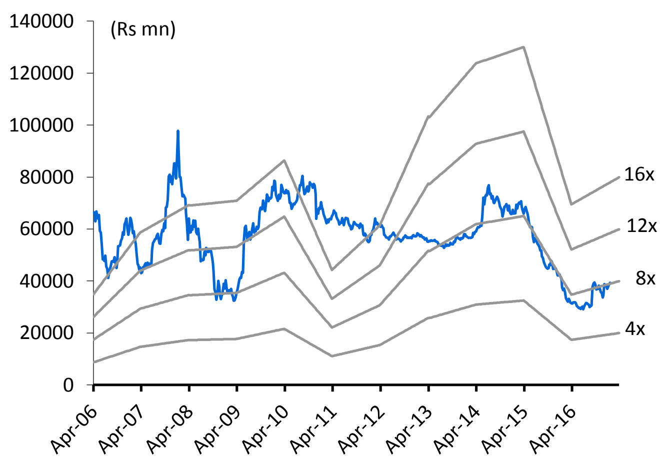
Company	Mkt Cap Rs bn	CMP Rs	Price Target	Upside %	P/E FY18E	P/E FY19E	EV/EBITDA FY18E	EV/EBITDA FY19E	ROE FY18E	ROE FY19E	D/E FY18E	D/E FY19E
NCC	47.3	85	125	47%	12.7	10.2	6.8	6.0	9.3	10.5	0.4	0.4
J Kumar	17.2	228	410	80%	11.0	8.3	6.1	5.1	10.3	12.1	0.4	0.3
KNR	26.2	186	180	-3%	19.2	16.9	12.3	10.0	13.9	13.7	0.2	0.2
ITD Cementation	24.7	159	145	-9%	19.6	16.5	9.0	8.2	18.0	17.6	0.7	0.6
PNC Infra	26.9	105	140	33%	14.6	13.1	8.5	7.1	10.8	10.8	0.1	0.1
Ahluwalia	18.4	275	350	27%	15.0	11.9	8.4	6.9	20.1	20.9	0.1	0.0
HCC	**41.9**	**42**	**71**	**71%**	**20.9**	**13.9**	**10.9**	**8.9**	**7.0**	**9.5**	**0.5**	**0.4**

Source: Bloomberg, PhillipCapital India Research *(*FY18 equivalent to CY17 for ITDC)*

One-year forward P/E band



EV/EBITDA band

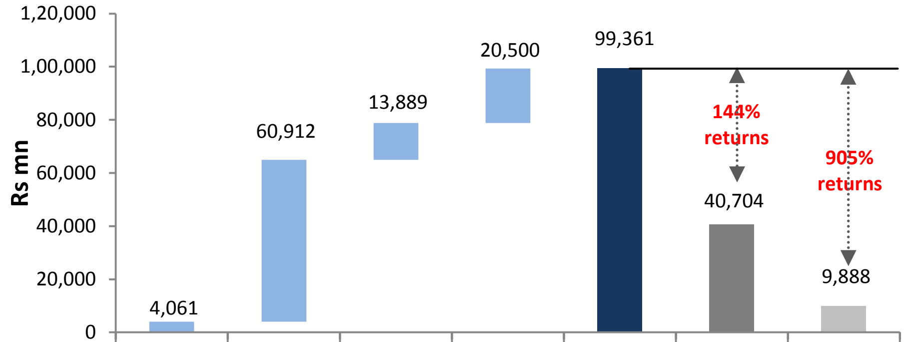


Source: Bloomberg, PhillipCapital India Research

Long term potential – Rs 100/share by March 2019

We believe HCC could transform into a major EPC player, over the next three-five years. Even if half of its claims under arbitrations are awarded in its favour, the cash proceeds from them, would wipe out its entire standalone debt. With a 6x book-to-sales orderbook, debt free balance sheet and strong focus on profitable growth, we could see the company almost doubling its current revenues by 2020, and report profit in excess of Rs 4bn – in turn generating manifold returns for the investors.

How HCC's fortunes can transform over the next three years



	FY20 EPC PAT	FY19 EPC Market cap	BOT and Stiener AG subsidiaries	Claims under arbitration	Total Expected Market Cap	Current market cap	Market cap
Assumption	Current arbitration wins only	15x one year fwd P/E	0.7x BV and 0.5x BV	0.5x BV	FY19E	FY17	FY14

Source: Company, PhillipCapital India Research

Key assumptions

Our key assumptions, for HCC's financials and valuations are:

1) S4A restructuring to lead to extinguishing of Rs 22bn of debt.
2) Rs 32bn of cash accrual (Rs 24bn in FY17; Rs 8bn in FY18) for the arbitrations already won.
3) Our estimates for FY17-19 are for the core EPC business – we have not factored any booking from arbitrations won for any claims.
4) No incremental benefit from other claims – we only value those 'under arbitration' at 0.3x book value – in our SoTP valuation.

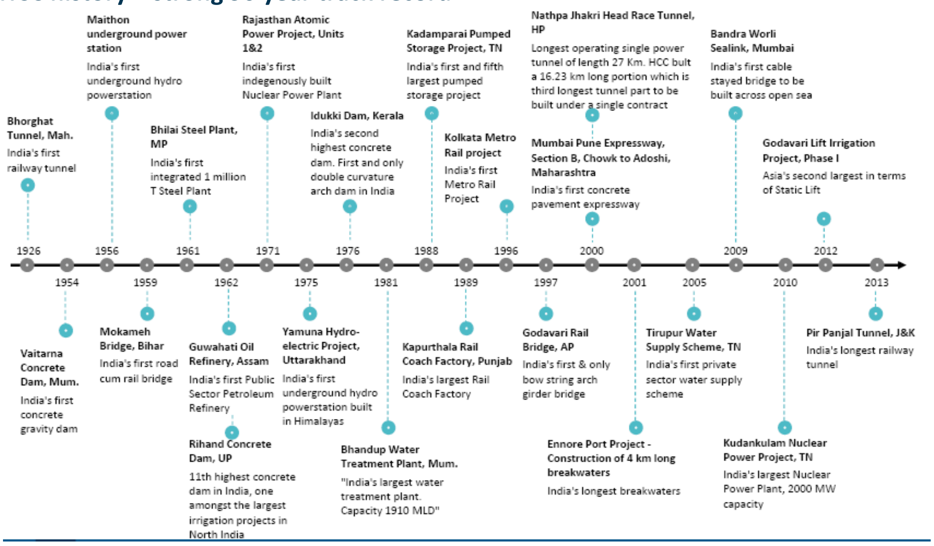
Risks to our investment thesis

Key risks to our investment thesis are:

1) Non compliance or delay by various departments in paying cash for the arbitrations won (However, we see zero likelihood of the same) – the revival might be more long drawn out, in that case.
2) Failure of Lavasa restructuring exercise, followed by lenders exercising their PUT options on DDCD and/or invoking the corporate guarantee on part of the Lavasa's debt – the negative impact will be Rs 11bn – Rs 11/share.
3) Incremental investment by the company in Lavasa (to revive the project) or in unrelated businesses – though we see limited scope of the same, with the company being under CDR, requiring approval for every such decision.
4) Delay in execution of projects in orderbook and/or delay in payments for the same by government bodies – a typical business risk with every EPC company.

Company History and Management Profile

HCC history – strong 90 year track record



Leadership team


Ajit Gulabchand
CMD - HCC
Member of Governor's Steering Board of Infrastructure and Urban Development Community at the WEF, Geneva.
Chairman of the Governing Council of the Construction Skills Development Council of India and President of the Construction Federation of India


Rajgopal Nogja
Group COO & WTD, HCC
Managing Director of Steiner AG
Masters Degree in Construction Management from NICMAR with over 18 years of experience in Infrastructure and Real Estate Sector


Praveen Sood
Group CFO & EVP
A Chartered Accountant with over 32 years of experience in Finance, Accounts, Taxation and Insurance across various sectors


Aditya Jain
Group EVP - HR
Post Graduate in HRM and is a Law Graduate with over 30 years experience across all facets of Human Resources Strategy, Development, Processes and Operations

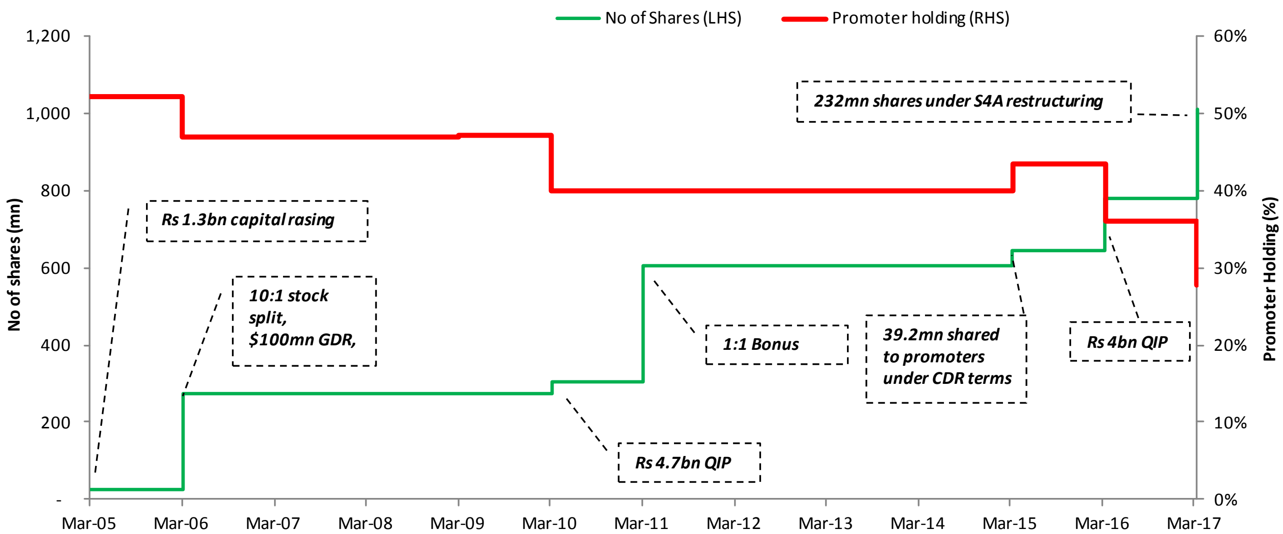

Arjun Dhawan
President & CEO – HCC Infrastructure Limited
MBA from Harvard Business School and worked Managing Director of Arya Capital


Arun Karambelkar
President & CEO – HCC E&C
Masters in Material Management.
30 Years of Diverse Experience


Henry Muhr
CEO – Steiner AG
Masters in Engineering and previously held leading positions in Bouygues Group, France & Germany


Nathan Andrews
President & CEO - Lavasa
Previously Chief Marketing Officer, Kohinoor CTNL Infrastructure Private Ltd.
Experience in Hospitality Industry

Capital history



Source: Company, Bloomberg, PhillipCapital India Research

Financials (Standalone)

(Assuming core EPC business only – no claims for estimates; Historical as reported)

Income Statement

Y/E Mar, Rs mn	FY16	FY17E	FY18E	FY19E
Net sales	**40,661**	**36,188**	**41,616**	**49,940**
Growth, %	-1	-11	15	20
Total income	40,661	36,188	41,616	49,940
Employee expenses	-3,704	-3,981	-4,578	-5,493
Other Operating expenses	-19,316	-18,818	-21,640	-25,969
EBITDA (Core)	**8,124**	**4,343**	**4,994**	**5,993**
Growth, %	5.1	(46.5)	15.0	20.0
Margin, %	20.0	12.0	12.0	12.0
Depreciation	-1,359	-1,372	-1,386	-1,400
EBIT	**6,766**	**2,971**	**3,608**	**4,593**
Growth, %	8.6	(56.1)	21.5	27.3
Margin, %	16.6	8.2	8.7	9.2
Interest paid	-6,899	-6,375	-2,215	-1,695
Other Non-Operating Income	1,729	1,500	1,600	1,600
Pre-tax profit	**1,331**	**-1,905**	**2,993**	**4,498**
Tax provided	-481	629	-988	-1,484
Profit after tax	**850**	**-1,276**	**2,005**	**3,013**
Net Profit	**850**	**-1,276**	**2,005**	**3,013**
Growth, %	36.5	(214.5)	(257.1)	50.3
Net Profit (adjusted)	**1,115**	**(1,276)**	**2,005**	**3,013**
Unadj. shares (m)	779	1,011	1,011	1,011
Wtd avg shares (m)	779	1,011	1,011	1,011

Orderbook

Y/E Mar, Rs bn	FY16	FY17E	FY18E	FY19E
Orderbook	181	230	238	238
Growth YoY (%)	25%	27%	4%	0%
Book-to-Sales (x)	4.5	6.4	5.7	4.8
Order Inflow	77	85	50	50

Balance Sheet

Y/E Mar, Rs mn	FY16	FY17E	FY18E	FY19E
Cash & bank	908	924	1,106	905
Debtors	26,687	4,957	1,710	2,052
Inventory	36,205	39,658	39,906	42,414
Loans & advances	19,965	17,846	18,813	21,891
Total current assets	86,868	66,489	64,638	70,366
Investments	5,924	5,924	5,924	5,924
Gross fixed assets	19,499	19,699	19,899	20,099
Less: Depreciation	-12,808	-14,180	-15,565	-16,965
Add: Capital WIP	17	17	17	17
Net fixed assets	6,708	5,536	4,350	3,150
Total assets	**99,500**	**77,949**	**74,912**	**79,440**
Current liabilities	30,670	29,633	31,591	34,106
Total current liabilities	30,670	29,633	31,591	34,106
Non-current liabilities	50,202	21,701	14,701	13,701
Total liabilities	80,871	51,335	46,293	47,808
Paid-up capital	779	1,011	1,011	1,011
Reserves & surplus	17,849	25,603	27,609	30,622
Shareholders' equity	18,628	26,614	28,619	31,633
Total equity & liabilities	**99,500**	**77,949**	**74,912**	**79,440**

Cash Flow

Y/E Mar, Rs mn	FY16	FY17E	FY18E	FY19E
Pre-tax profit	1,331	-1,905	2,993	4,498
Depreciation	1,359	1,372	1,386	1,400
Chg in working capital	-6,429	19,359	3,990	-3,414
Total tax paid	0	629	-988	-1,484
Cash flow from operating activities	**-3,740**	**19,455**	**7,381**	**999**
Capital expenditure	-156	-200	-200	-200
Chg in investments	1,005	0	0	0
Cash flow from investing activities	**848**	**-200**	**-200**	**-200**
Free cash flow	-2,892	19,255	7,181	799
Equity raised/(repaid)	4,104	9,262	0	0
Debt raised/(repaid)	-1,069	-28,500	-7,000	-1,000
Dividend (incl. tax)	0	0	0	0
Cash flow from financing activities	**2,836**	**-19,239**	**-7,000**	**-1,000**
Net chg in cash	-56	16	181	-201

Valuation Ratios

	FY16	FY17E	FY18E	FY19E
Per Share data				
EPS (INR)	1.4	(1.3)	2.0	3.0
Growth, %	13.1	(188.3)	(257.1)	50.3
Book NAV/share (INR)	23.9	26.3	28.3	31.3
FDEPS (INR)	1.4	(1.3)	2.0	3.0
CEPS (INR)	3.5	0.1	3.4	4.4
CFPS (INR)	(7.0)	17.8	5.7	(0.6)
Return ratios				
Return on assets (%)	5.4	3.1	4.4	5.2
Return on equity (%)	6.9	(5.6)	7.3	10.0
Return on capital employed (%)	7.9	4.7	7.4	9.1
Turnover ratios				
Asset turnover (x)	0.7	0.7	1.1	1.3
Sales/Total assets (x)	0.4	0.4	0.5	0.6
Sales/Net FA (x)	5.6	5.9	8.4	13.3
Working capital/Sales (x)	1.4	1.0	0.8	0.7
Receivable days	240	50	15	15
Inventory days	325	400	350	310
Payable days	327	322	299	270
Working capital days	496	362	280	258
Liquidity ratios				
Current ratio (x)	2.8	2.2	2.0	2.1
Quick ratio (x)	1.7	0.9	0.8	0.8
Interest cover (x)	1.0	0.5	1.6	2.7
Total debt/Equity (x)	2.6	0.8	0.5	0.4
Net debt/Equity (x)	2.6	0.7	0.4	0.4
Valuation				
PER (x)	29.4	(33.3)	21.2	14.1
PEG (x) - y-o-y growth	2.2	0.2	(0.1)	0.3
Price/Book (x)	1.8	1.6	1.5	1.3
EV/Net sales (x)	2.0	1.7	1.3	1.1
EV/EBITDA (x)	10.0	14.3	11.0	9.0
EV/EBIT (x)	12.0	20.9	15.2	11.8

Source: Company, PhillipCapital India Research Estimates

Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

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