

Punj Lloyd Ltd

Pipavav stake sale: Exit from a strategic investment - ALERT

- **Punj Lloyd plans to sell its 19.4% stake in Pipavav Shipyard Limited (PSL) to co-promoter SKIL Infrastructure for Rs6.56B**, as per management. The deal is at a ~21% discount to PSL's Friday market closing price and 1.9x Punj Lloyd's investment (Rs3.5B). The company will book an extraordinary gain of Rs3B in Mar-q, in our view. The stake sale comes in before end of Punj Lloyd's lock-in period, and will be structured as an inter-se transfer between promoters.
- **Sudden exit from a strategic investment?** Punj Lloyd management has all along highlighted the Pipavav investment as strategic for future growth plans in defense and fabrication. Potential benefits highlighted by Punj Lloyd in analyst meets over the last two years: (A) The shipyard was expected to provide access to fabrication facilities such as platforms, rigs, jackets and vessels to exploit opportunities in the offshore market for upstream oil and gas sector companies both in India and abroad. (B) The shipyard was expected to have capabilities to build, repair and maintain naval platforms- management had identified defense as a future growth engine for Punj Lloyd.
- **Prima-facie we do not like the potential stake-sale at cost of future growth opportunities, which management believed in.** As recently as Sep-09, during the IPO of Pipavav Shipyard, Mr. Atul Punj had elaborated on the synergies between Pipavav-Punj Lloyd. Our valuation of Punj Lloyd's stake in Pipavav (Rs7.1B) is similar to stated deal value, the negative impact on SOP is marginal (~Rs1.5/share).
- **Management views on the deal unconvincing.** Management clarified on CNBC that there was no rush to exit Pipavav and the company wanted to focus on its core business. According to company, the partnership on growth opportunities with Pipavav would continue despite Punj Lloyd's exit.
- **The urgency to raise cash through sale of strategic asset** may hint to balance sheet and cash flow pressure on account of: (A) sharper than expected deterioration in working capital. Punj Lloyd has seen a sharp deterioration in its working capital cycle, from 48 days in FY07 to 85 days in FY09, primarily on account of weak execution of longer gestation projects, execution delays and cost-overruns leading to write-offs/ liquidated damages, (B) Operating cash flows have been negative over FY08-10. As on Dec-09, Punj Lloyd's reported net-D/E ratio was 1.24:1, not too-high, but it could increase if working capital requirements continue to rise, (C) company's need for cash (equity funds) to bid for new road/infrastructure projects.

Underweight

PUJL.BO, PUNJ IN

Price: Rs185.30

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Engineering

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Table 1: Sale of Punj Lloyd's stake in Pipavav Shipyard

Shares held by Punj Lloyd (MM)	129.36
Pipavav Shipyard (PSL) shares o/s (MM)	665.80
Punj Lloyd's stake in PSL (%)	19.43
CMP of PSL (Rs.)	63.85
Market value of Punj stake (Rs B)	8.26
Book value of investment in Punj BS (Rs B)	3.5
Expected value from stake sale (Rs B)	6.56
Implied discount to market value (%)	(20.6)
Deal value/BV of investment (x)	1.9

Source: J.P. Morgan estimates, Bloomberg.

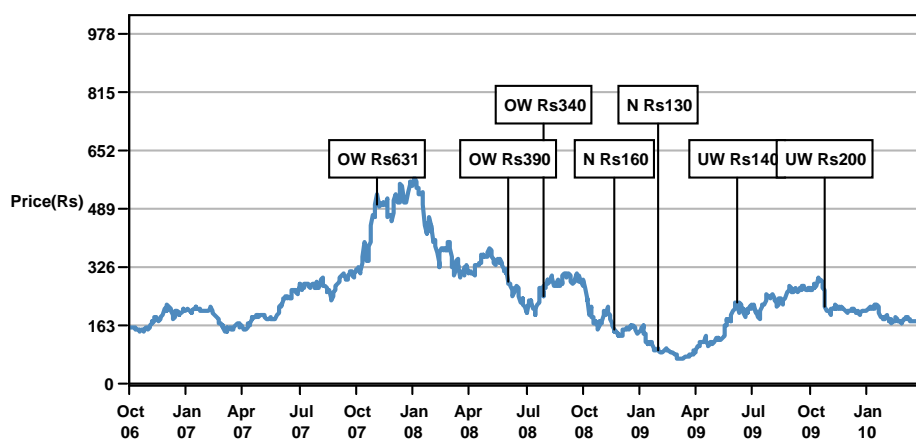
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Punj Lloyd Ltd (PUJL.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
03-Nov-07	OW	498.40	631.00
03-Jun-08	OW	287.05	390.00
30-Jul-08	OW	242.40	340.00
20-Nov-08	N	153.95	160.00
28-Jan-09	N	93.30	130.00
05-Jun-09	UW	226.65	140.00
26-Oct-09	UW	217.40	200.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
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