Punj Lloyd – ADD

PUNJ IN	Rs185	Construction	13 July 2009	Company Update

Positive surprise in order wins drives earning upgrade

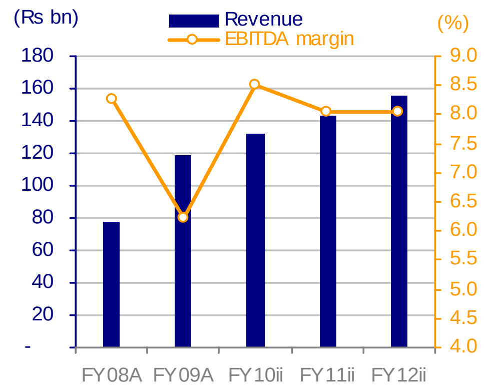
Order inflow momentum at Punj Lloyd has gathered pace with the company announcing orders worth Rs99bn—49% of the end-FY09 order book—in the last three months. The upgrade to our FY10 and FY11 revenue estimates, at 8% and 13% respectively, are lower than those suggested by headline order inflow numbers, because the execution cycle of the new contracts is longer. The consequent increases in our FY10 and FY11 earnings estimates stand at 13% and 12%; they would have been higher, but for our assumption of low margins in recent order wins. Commencement of operations at Pipavav Shipyard would provide the much-needed fabrication capability for an offshore platform and process plant contracts, increasing competitiveness in bids for ONGC and Middle East orders. We upgrade the stock to ADD.

Order intake momentum accelerates: Over the last three months, Punj Lloyd has announced orders worth Rs99bn, mainly driven by Rs77.8bn order inflows from Libya. The Libyan orders mainly comprise longer-gestation urban utilities and real-estate construction. Hence, the upgrade to our FY10 and FY11 revenue estimates, at 8% and 13% respectively, are lower than those suggested by headline order inflow. Post the recent wins, Libya would account for more than a third of Punj's order book. Increasing political stability should allay worries about geographical concentration.

We upgrade earnings estimates: We increase our FY10 and FY11 earnings estimates by 13% and 12% respectively. The increase in our earnings estimate for FY11 would have higher, but for a 50bps cut in our EBITDA margin estimate for the year. The recent Libyan orders, especially the Rs59bn real estate construction contract won by SEC, would offer significantly lower margins than those earned by Punj in the hydrocarbon contracts.

Commercial operations at Pipavav Shipyard to boost capability in hydrocarbon contracts: Pipavav Shipyard's 660m x 65m dry dock, among the largest of its kind in India, should be fully operational by 2HFY10. Lack of domestic fabrication capability was one of the key reasons for Punj's below-par performance in ONGC's Heera offshore platform contract. Pipavav Shipyard, in JV with Punj Lloyd, has bid for ONGC's US$370m B-22 offshore platform contract. The shipyard recently won a US$114m contract from ONGC for supplying 12 offshore vessels.

New orders improve revenue visibility



Source: IIFL Research, *FY09 margins adjusted

Financial Summary

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenues (Rs m)	77,529	119,120	132,012	143,777	155,080
EBITDA Margins (%)	8.3	6.2	8.5	8.0	8.0
Pre-Exceptional PAT (Rs m)	3,210	-2,407	4,813	4,906	5,359
Reported PAT (Rs m)	3,581	-2,253	4,813	4,906	5,359
EPS (Rs)	10.6	-7.9	15.9	16.2	17.7
Growth (%)	63.0	N/A	N/A	1.9	9.2
PER (x)	**17.5**	**N/A**	**11.7**	**11.4**	**10.5**
ROE (%)	16.0	-9.2	17.7	15.4	14.5
Debt/Equity (x)	0.3	1.1	1.0	0.7	0.7
EV/EBITDA (x)	**10.2**	**11.3**	**7.6**	**7.1**	**6.7**
Price/Book (x)	2.0	2.3	1.9	1.6	1.4

Price as at close of business on 10 July 2009

12-mth Target price (Rs) 211 (14%)

Market cap (US$ m)	**1,145**
52Wk High/Low (Rs)	324/66
Diluted o/s shares (m)	304
Daily volume (US$ m)	39.2
Dividend yield FY08ii (%)	0.2
Free float (%)	58.5

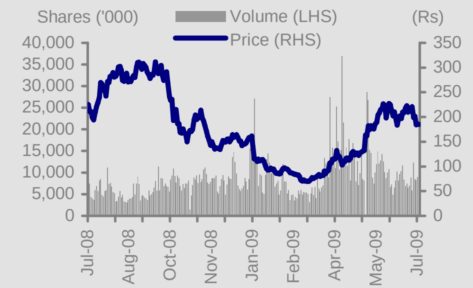
Shareholding pattern (%)

Promoters	41.5
FIIs	18.2
Domestic MFs/Insurance cos	12.5
Others	27.9

Price performance (%)

	1M	3M	1Y
Punj	-18.5	61.8	-18.1
Rel. to Sensex	-5.8	36.8	-15.1
L&T	-16.7	63.0	7.1
Nagarjuna	-9.5	75.6	-13.9
IVRCL Infra	-15.2	114.9	-1.9

Stock movement



Gopal Ritolia
gopal.ritolia@iiflcap.com
(91 22) 4646 4651

Anupam Gupta
anupam.gupta@iiflcap.com
(91 22) 4646 4641

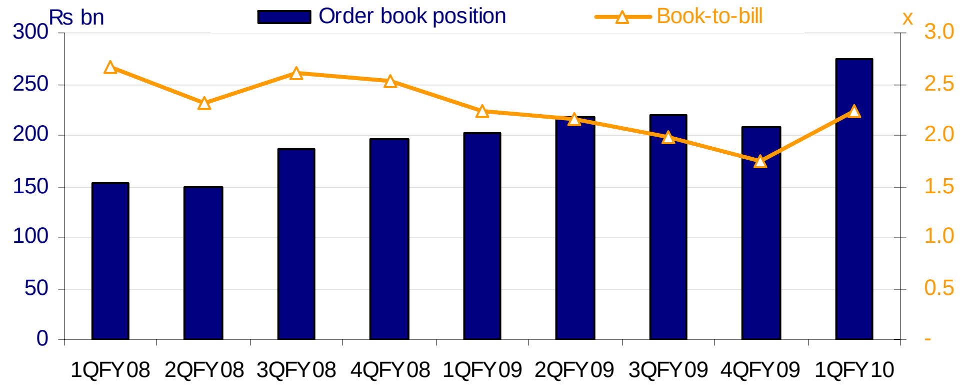
Order intake momentum accelerates: Over the last three months, Punj Lloyd has announced orders worth Rs99bn, which is 49% of the end-FY09 order book. We estimate the current order book at Rs272bn, which represents a 31% increase over end-FY09 order book. This would translate into a healthy order coverage ratio of 2.2x as at end-1QFY10.

Figure 1: FY10 order inflows

Country	Project	Size (Rs m)
Projects won by Punj Lloyd		
India	Eight stations for Bangalore metro	3,080
Libya	EPC for utilities at Zawara, Ragdaleen and Al Jamail Towns	18,732
Saudi Arabia	Port tank farm at Jubail Export refinery project in Saudi Arabia (Dayim Punj)	5,929
Projects won by Sembawang E&C (SEC)		
Singapore	Two MRT stations	12,631
Libya	Three real-estate hospitality, resort building contracts	59,040
Total		**99,412**

Source: Company, IIFL Research

Figure 2: Large order wins improves order coverage ratio



Source: Company, IIFL Research

Libya and not Middle East is the key driver of order intake: The surge in order intake is mainly driven by Rs77.8bn order wins from Libya. Post the recent wins, Libya accounts for more than one-third of Punj's order book—a significant concentration for a company with as wide a geographical footprint. Punj won its first contract in Libya in 2006—a Rs13.3bn gas pipeline contracts from Sirte Oil Company. The company ventured into the country when other E&C players were wary of entering Libya owing to the political risk. Punj's experience in executing the pipeline contract was not very different from that in other geographies. Increasing political stability in Libya should ally concerns about geographical concentration.

Figure 3: Recent large wins in Libya, which now accounts for 34% of order book

Order	Size (Rs m)
EPC along with infra - water, sewage, storm water and others	6,300
Execution of utilities in Souk Al Juma	7,867
EPCof utilities at Zawara, Ragdaleen and Al Jamail Towns	18,732
Three real-estate hospitality, resort building contracts	59,040
Total order book from Libya	**91,939**
Estimated current order book (excluding 1QFY10 revenues)	**274,197**
% of total order book	**33.5%**

Source: Company, IIFL Research

Positive surprise in order inflows drive upward revision in revenues: We increase our FY10 and FY11 revenue estimates at 8% and 13% respectively. The revenue upgrade is lower than that suggested by headline order inflow numbers. The Libyan orders mainly comprise longer-gestation urban utilities and real-estate construction projects. The other orders from MRTS project in Singapore and tank farm project for Saudi Arabia are also long-cycle projects. The weighted average execution timeline for the Rs99bn order inflow in FY10 is 43 months, against an average execution cycle of 30 months for Punj's FY09 order book.

Figure 4: Long gestation wins drive increase in average age of order book

	Order book (Rs m)	Average age (months)
FY09 order book	208,030	30
FY10 order inflow	99,412	43
1QFY10 order book	274,198	35

Source: IIFL Research

We upgrade earnings estimates by 12%-13%: We increase FY10 and FY11 earnings estimates by 13% and 12% respectively. The increase in our FY11 earnings estimates would have higher, but for a

50bps cut in our FY11 EBITDA margin estimates. We believe that the recent Libyan orders, especially the Rs59bn real estate construction contract won by SEC, would offer significantly lower margins than those earned by Punj in the hydrocarbon contracts.

Figure 5: Long-gestation wins drive increase in average age of order book

	Revised estimates			Change		
	Revenue (Rs m)	EBITDA margin (%)	EPS (Rs)	Revenue	EBITDA margin (pp)	EPS
FY10ii	132,012	8.5	15.9	7.7%	0.02	13.5%
FY11ii	143,777	8.0	16.2	13.2%	-0.45	12.3%

Source: IIFL Research

Commercial operations at Pipavav Shipyard to boost capability in hydrocarbon contracts: Pipavav Shipyard's 660mx65m dry dock, among the largest of its kind in India, should be fully operational by 2HFY10. This would be the second offshore yard in India after L&T, with capability to roll out single structures in the 5,000-tonne weight range. Lack of domestic fabrication capability was one of the key reasons for Punj's below-par performance in ONGC's Heera offshore platform contract. Pipavav Shipyard, in JV with Punj Lloyd, has bid for ONGC's US$370m B-22 offshore platform contract. Pipavav Shipyard is keen that the B-22 contract marks its entry into ONGC's offshore EPC business. The shipyard recently won a US$114m contract from ONGC for supplying 12 offshore vessels. Punj Lloyd may also have put in a competitive bid for the process platform package of the US$1.5bn Mumbai High North redevelopment project. However, given the large size of the contract, Punj might not been very keen in following up on it, for fear of spreading itself too thin.

Figure 6: Punj is in contention to win a couple of ONGC contracts in FY10

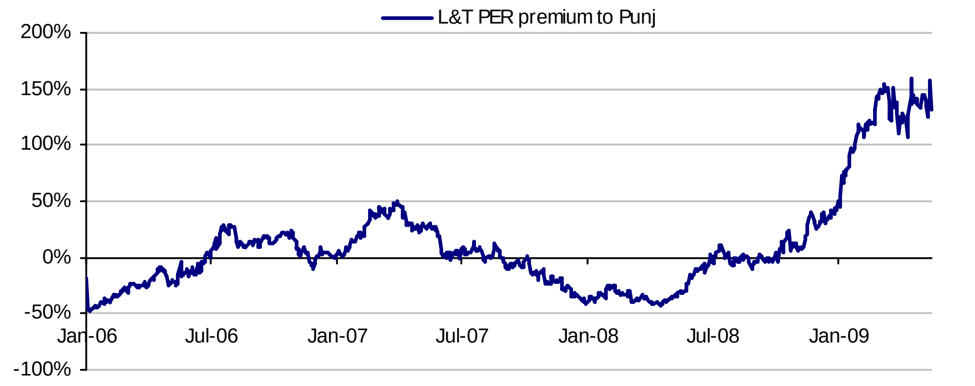
Project	Bid close date	Cost (US$m)	Other bidders	Probability of win
Mumbai high north	July-August	1000	L&T, Hyundai, Samsung, NPCC	Aggressive bids by Hyundai, NPCC; Punj might face technical issues
B22	End August	377	NPCC, Punj-Pipavav, Afcons	Aggressive bidding by L&T; AFCONS might be spread thin; Pipavav is keen
B193	3Q-4QFY10	650		ONGC likely to split projects in three parts: process platforms, pipelines and compressors. ONGC is calling for third round of tendering instead of asking L&T and Punj to submit fresh prices
Group B and C of renewal of Assam fields	3Q-4QFY10	1000		Punj had won the contracts by bidding for $1.15bn but ONGC wanted it reduced to US$857mn.

Source: IIFL Research

We upgrade stock to ADD from REDUCE: Positive surprise in order inflows has improved revenue visibility. Order wins from areas of traditional strength in the hydrocarbon sector would provide positive momentum to the stock. Punj looks well-placed to win a couple of ONGC orders to be finalised during FY10.

Given a series of negative surprises in its short listed history, Punj would need to execute steadily over the medium term for a sustained re-rating. The uneven execution is reflected in high discount to L&T.

Figure 7: Discount to L&T has widened over last six months



Source: IIFL Research

The stock is currently trading at 10.6x FY10ii EPS—a 56% discount to E&C major L&T. The discount has widened in the recent past, following large write-downs in the SABIC contract during 2HFY09. Even adjusting for SABIC losses, margins contracted sharply in FY09, owing to recognition of potential losses / cost over-runs in other contracts like the ONGC offshore platform contract. We expect margins to return to FY08 levels as potential losses have been provided for in FY09 and legacy order book inherited from SEC acquisition is now almost exhausted.

Our SOTP value of Rs211 per share is derived from Rs194 from the core construction business valued at 12x FY11ii EPS and Rs17 from value of investments in Pipavav Shipyard and Medicity project.

Figure 8: Sum-of-parts valuation

	Rs m	Rs ps
FY11ii PAT	4,906	
PER (x)	12.0	
Company equity value	**58,876**	**194**
Pipavav stake value at book value	3,493	12
Other investments at 80% of book value	1,572	5
Total Equity value	**63,941**	**211**

Source: IIFL Research

Financial summary

Revenue growth dependent on continued traction in order inflows

Income statement summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenue	77,529	119,120	132,012	143,777	155,080
EBITDA	6,407	3,093	11,230	11,547	12,454
EBIT	**4,942**	**1,322**	**9,305**	**9,527**	**10,184**
Interest expense	1,292	2,208	2,960	3,000	3,000
Exceptional items	371	154	0	0	0
Others items	811	745	645	600	600
Profit before tax	**4,832**	**13**	**6,990**	**7,127**	**7,784**
Tax expense	1,235	2,260	2,178	2,220	2,425
Extraordinary items	16	6	0	0	0
Net Profit	**3,581**	**-2,253**	**4,813**	**4,906**	**5,359**

Cashflow summary (Rs m)

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Operating profit	4,832	13	6,990	7,127	7,784
Depreciation & Amortization	1,465	1,771	1,925	2,020	2,270
Tax paid	-1,235	-2,260	-2,178	-2,220	-2,425
Working capital change	-10,907	-11,818	-5,924	574	-5,715
Operating Cash-flow	-5,845	-12,294	813	7,500	1,915
Capital expenditure	-4,161	-6,099	-2,700	-4,000	-3,000
Free cash flow	**-10,005**	**-18,393**	**-1,887**	**3,500**	**-1,085**
Equity raised	11,464	-192	0	0	0
Investments	-3,759	0	0	0	0
Debt financing/disposal	-920	19,188	0	0	0
Dividends paid	-135	-106	-106	-106	-106
Other items	227	723	0	0	0
Net change in Cash & cash equivalents	**-3,129**	**1,220**	**-1,993**	**3,394**	**-1,191**

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Cash & cash equivalents	6,898	8,118	6,125	9,519	8,328
Sundry debtors	20,901	33,274	31,828	39,076	37,402
Trade Inventories	20,592	36,847	31,871	42,971	37,755
Other current assets	7,429	13,649	9,678	15,583	11,537
Fixed assets	**16,169**	**20,498**	**21,273**	**23,253**	**23,983**
Other assets	5,715	5,715	5,715	5,715	5,715
Total assets	**77,704**	**118,100**	**106,490**	**136,117**	**124,719**
Sundry creditors	31,479	53,374	37,045	61,432	44,787
Other current liabilities	1,391	2,526	2,538	2,977	2,971
Long-term debt/Convertibles	16,072	35,260	35,260	35,260	35,260
Other long-term liabilities	1,108	1,837	1,837	1,837	1,837
Minorities/other Equity	222	284	284	284	284
Networth	**27,433**	**24,820**	**29,526**	**34,327**	**39,580**
Total liabilities & equity	**77,704**	**118,100**	**106,490**	**136,117**	**124,719**

Ratio Analysis

Large infrastructure project awards would translate into lower margins

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Sales growth (%)	51.2	53.6	10.8	8.9	7.9
Core EBITDA growth (%)	71.2	-51.7	263.1	2.8	7.9
Core EBIT growth (%)	84.3	-73.3	603.9	2.4	6.9
Core EBITDA margin (%)	8.3	2.6	8.5	8.0	8.0
Core EBIT margin (%)	6.4	1.1	7.0	6.6	6.6
Net profit margin (%)	4.1	-2.0	3.6	3.4	3.5
Dividend payout ratio (%)	2.3	1.4	1.1	2.1	2.1
Tax rate (%)	25.6	NA	31.2	31.2	31.2
Net Debt/Equity (%)	33.4	109.4	98.7	75.0	68.0
Return on Equity (%)	16.0	-9.2	17.7	15.4	14.5
Return on Assets (%)	4.7	-2.5	4.3	4.0	4.1

Source: Company data, IIFL Research

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.
