Company Focus

SMALL & MID CAP

13 January 2009 | 25 pages

Change in opinion ☑
Rating change ☑
Target price change ☑
Estimate change ☑

Punj Lloyd (PUJL.BO)

Downgrade to Hold: Contract Disputes Drive Balance Sheet Risk

- **The transformation... —** Punj Lloyd is attempting a transformation into a successful global EPC player. Key targets include US$5bn of sales by 2012 (FY09E sales = US$2.5bn) with 2012 order book of ~US$12–15bn (FY09E order backlog US$5.3bn) and operating margins of more than 10%. Recent interactions with L&T suggest Punj Lloyd is a credible threat in hydrocarbons.
- **... becomes tougher in times of macroeconomic stress** — However, it is a fact that transforming a small/mid-size company into a larger company happens during extended periods of robust economic growth. In a slowdown, mid-size companies have a comparatively difficult time accessing capital.
- **Contractual disputes do not help the case** — Punj Lloyd has a history of contractual disputes with clients (IOCL–PIL; GAIL; Petronet; Spie Capag Petrofac; and SABIC). Punj Lloyd's balance sheet has Rs2.75bn of auditor qualifications (Rs2.2bn attributable to SABIC order). SABIC has also en-cashed bank guarantees issued totaling Rs2.1bn (£28.5mn) recently. We write off £53.5mn of SABIC exposure through the P&L as an exceptional item in FY09E.
- **Leveraged to oil & gas** — 66% of the backlog is from oil & gas (a worry in a depressed oil price scenario). 42% of orders are from the private sector.
- **Downgrade to Hold/High Risk (2H) from Buy/Medium Risk (1M)** — We are cutting our target price to Rs142 (from Rs218 earlier) to factor in 1) earnings cut by 8-18% over FY10/FY11E; 2) cut in target multiple to 8x Mar10 from 12x Dec09; and 3) increased balance sheet risk related to the SABIC order.

Hold/High Risk	**2H**
from Buy/Medium Risk	
Price (13 Jan 09)	Rs117.00
Target price	Rs142.00
from Rs218.00	
Expected share price return	21.4%
Expected dividend yield	0.4%
Expected total return	**21.8%**
Market Cap	Rs35,507M
	US$730M

Price Performance (RIC: PUJL.BO, BB: PUNJ IN)

Figure 1. Punj Lloyd – Statistical Abstract

Year to 31-Mar	Net Profit (Rsmn)	FD EPS (Rs)	EPS Growth (%)	P/E (x)	EV / EBITDA (x)	P / Book (x)	ROE (%)	ROCE (%)	Div. Yield (%)
FY05A	272	2.23	na	52.4	10.0	2.8	7.8%	7.2%	0.1%
FY06A	545	1.93	-13.6%	60.6	18.4	2.7	6.7%	5.5%	0.2%
FY07	1,973	6.98	261.7%	16.8	10.0	2.4	16.4%	8.3%	0.3%
FY08E	3,214	10.16	45.6%	11.5	7.0	1.3	16.0%	9.6%	0.3%
FY09E	4,718	14.92	46.8%	7.8	5.7	1.3	17.0%	11.5%	0.4%
FY10E	5,629	17.80	19.3%	6.6	5.1	1.1	18.4%	12.2%	0.5%
FY11E	6,534	20.66	16.1%	5.7	4.7	0.9	17.9%	12.2%	0.6%

Source: Citi Investment Research estimates

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See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	16.8	11.5	7.8	6.6	5.7
P/E reported (x)	16.8	10.5	39.6	6.6	5.7
P/BV (x)	2.4	1.3	1.3	1.1	0.9
Dividend yield (%)	0.3	0.3	0.4	0.5	0.6
Per Share Data (Rs)					
EPS adjusted	6.98	10.16	14.92	17.80	20.66
EPS reported	6.97	11.13	2.95	17.80	20.66
BVPS	48.95	90.40	92.06	109.91	130.62
NAVps ordinary	na	na	na	na	na
DPS	0.30	0.40	0.50	0.60	0.70
Profit & Loss (RsM)					
Net operating income (NOI)	**na**	**na**	**na**	**na**	**na**
G&A expenses	na	na	na	na	na
Other Operating items	na	na	na	na	na
EBIT including associates	**2,691**	**4,931**	**8,328**	**10,465**	**12,002**
Non-oper./net int./except.	-35	-177	-5,284	-2,317	-2,542
Pre-tax profit	**2,656**	**4,754**	**3,043**	**8,148**	**9,460**
Tax	-690	-1,237	-2,116	-2,526	-2,933
Extraord./Min. Int./Pref. Div.	3	1	7	7	7
Reported net income	**1,969**	**3,518**	**934**	**5,629**	**6,534**
Adjusted earnings	1,973	3,214	4,718	5,629	6,534
Adjusted EBIT	2,682	4,948	8,328	10,465	12,002
Adjusted EBITDA	3,743	6,410	10,090	12,455	14,219
Growth Rates (%)					
NOI	na	na	na	na	na
EBIT adjusted	106.5	84.5	68.3	25.7	14.7
EPS adjusted	261.7	45.6	46.8	19.3	16.1
Cash Flow (RsM)					
Operating cash flow	**6,319**	**-5,374**	**-7,353**	**-1,197**	**1,915**
Depreciation/amortization	1,062	1,462	1,762	1,990	2,217
Net working capital	3,536	-10,907	-10,042	-8,809	-6,829
Investing cash flow	**-8,498**	**-8,125**	**-5,000**	**-4,500**	**-4,500**
Capital expenditure	-7,215	-4,366	-4,000	-3,500	-3,500
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**11,032**	**10,205**	**9,597**	**2,787**	**1,751**
Borrowings	11,427	-920	10,028	3,000	2,000
Dividends paid	-92	-142	-178	-213	-249
Change in cash	**8,853**	**-3,294**	**-2,756**	**-2,910**	**-833**
Balance Sheet (RsM)					
Total assets	**57,278**	**77,511**	**101,926**	**119,594**	**134,558**
Cash & cash equivalent	10,027	6,898	4,149	1,246	420
Net fixed assets	12,019	14,590	16,838	18,358	19,651
Total liabilities	**44,430**	**49,856**	**73,769**	**86,021**	**94,699**
Total Debt	16,992	16,072	26,100	29,100	31,100
Shareholders' funds	**12,847**	**27,655**	**28,157**	**33,573**	**39,859**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	5.2	6.4	7.4	7.5	7.6
ROE adjusted (%)	16.4	16.0	17.0	18.4	17.9
ROA adjusted (%)	4.9	4.8	5.3	5.1	5.1
Net debt to equity (%)	54.2	33.2	78.0	83.0	77.0
Interest coverage (x)	4.5	5.0	4.8	4.4	4.6

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Downgrade to Hold/High Risk (2H) from Buy/Medium Risk (1M)

- The Punj Lloyd Group has initiated "Project Hawk" with the help of McKinsey & Company to transform itself into a successful global EPC player. Key targets include US$5bn of sales by 2012 (FY09E sales = US$2.5bn) with 2012 order backlog of ~US$12-15bn (FY09E order backlog US$5.3bn) and operating margins of >10%. Our recent interactions with L&T suggest that Punj Lloyd is a credible threat on the hydrocarbons side of the business.

- However, it is also a fact that transforming a small/mid-size company into a larger company happens during extended periods of robust economic growth. In a slowdown/downturn mid-size companies have a comparatively difficult time accessing capital.

- Punj Lloyd's balance sheet has Rs2.75bn of auditor qualifications with Rs2.2bn contributed by a single order executed for SABIC. Further SABIC has also en-cashed bank guarantees totaling Rs2.1bn (£28.5mn). We write off £53.5mn of SABIC exposure through the P&L as an exceptional item in FY09E.

- Punj Lloyd has had a history of contractual disputes with clients, case in point being: 1) IOCL–PIL; 2) GAIL; 3) Petronet; 4) Spie Capag Petrofac; and 5) SABIC. Management maintains that the nature of business is such that scope and design changes keep happening, and they are actually surprised that such issues do not get reported in other E&C companies. This implies that similar problems cannot be ruled out in the future.

- 58% of Punj Lloyd's order backlog is from government-backed organizations, which compares favourably with L&T's 55% but unfavorably with 85% in the case of BHEL. The single biggest risk is the exposure to commodities (more specifically oil prices), as 66% of Punj Lloyd's order backlog is composed of orders derived from the oil & gas space.

- A Rs10bn (5% of backlog) contract from GVK Power has been delayed, and on the Dighi port project only Rs270mn has been spent so far against the planned Rs1.27bn, as the client has been affected by the credit crunch.

- We downgrade Punj Lloyd to Hold/High Risk (2H) (from Buy/Medium Risk (1M) earlier) and cut our target price to Rs142 (from Rs218 earlier) to factor in (1) earnings cut by 8–18% over FY10/FY11E; (2) cut in our target multiple to 8x March 2010 from 12x December 2009; and (3) increased balance sheet risk related to the SABIC order.

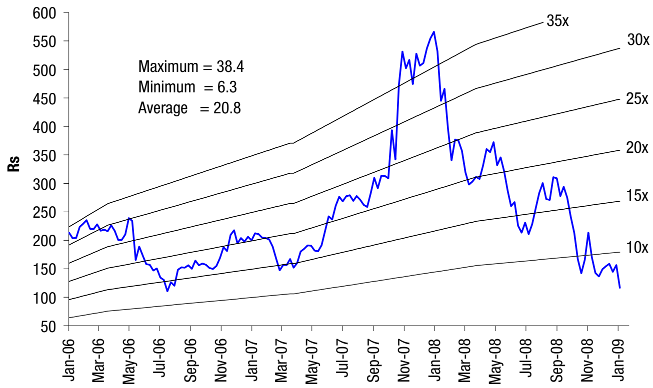
Figure 2. India E&C – Performance Relative to BSE Sensex

	1 Month	3 Months	6 Months	1 Yr	2 Yr	3 Yr
Punj	-22%	-40%	-45%	-78%	-44%	-43%
BSE Sensex	-6%	-13%	-32%	-56%	-35%	-2%
L&T	-11%	-21%	-41%	-66%	-5%	56%
HCC	9%	1%	-44%	-79%	-70%	-64%
Nagarjuna	-21%	6%	-56%	-82%	-75%	-60%
IVRCL	-23%	-23%	-62%	-78%	-70%	-26%
Gammon	32%	-19%	-61%	-88%	-78%	-80%

Source: DataCentral; and Citi Investment Research

- We do not downgrade Punj Lloyd to Sell given the sharp underperformance of the stock and given that the stock now trades at reasonable valuations (P/E of 6.6x FY10E and P/B of 1.1x FY10E and EV/EBITDA of 5.1x FY10E).

Figure 3. Punj Lloyd – 1 Year Forward Rolling P/E Bands



Source: DataCentral; and Citi Investment Research estimates

Figure 4. Punj Lloyd – 1 Year Forward Rolling EV/EBITDA Bands

Source: DataCentral; and Citi Investment Research estimates

Figure 5. India Engineering & Construction – Key Ratios

	L&T	Punj Lloyd	IVRCL	Nagarjuna	Gammon	HCC
Recommendation	**2L**	**2H**	**1H**	**1H**	**3H**	**3H**
EBIT Margins						
FY09E	10.2%	7.4%	8.1%	8.1%	5.7%	8.5%
FY10E	10.0%	7.5%	8.2%	8.2%	5.7%	8.7%
FY11E	9.7%	7.6%	8.4%	8.5%	5.7%	8.4%
Recurring PAT Margins						
FY09E	7.6%	4.2%	3.8%	3.6%	2.2%	2.2%
FY10E	7.1%	4.0%	3.6%	3.5%	2.0%	2.3%
FY11E	6.9%	4.1%	4.1%	4.0%	1.9%	2.4%
RoE						
FY09E	23.0%	17.0%	11.4%	9.7%	5.6%	8.0%
FY10E	21.4%	18.4%	12.6%	10.5%	5.4%	9.3%
FY11E	20.3%	17.9%	14.6%	12.5%	5.2%	10.9%
D/E						
FY09E	0.38	0.93	0.97	0.85	0.51	2.19
FY10E	0.33	0.87	1.00	0.84	0.71	2.22
FY11E	0.30	0.78	0.94	0.68	0.76	2.20
Net Debt/Equity						
FY09E	0.23	0.79	0.91	0.73	0.49	2.10
FY10E	0.26	0.86	0.94	0.68	0.63	2.17
FY11E	0.24	0.80	0.87	0.54	0.69	2.19

Source: Citi Investment Research estimates

Earnings revised downwards

We cut our FY10E/FY11E earnings estimates by 8-18% to factor in:

- Lower order inflows in FY10E leading to a 6% cut in Punj (ex Semb) sales and a 4% cut in Semb sales.
- 20-50 bps cut in Punj EBITDA margins on delays/liquidated damages in the ONGC Heera redevelopment project and possible delays in other orders.

Figure 6. Punj Lloyd – CIR vs. Consensus

	FY09E	FY10E	FY11E
Consensus Estimates	14.40	17.31	20.27
CIR Estimates	14.92	17.80	20.66
Difference	3.5%	2.8%	1.9%

Source: Bloomberg and Citi Investment Research

- 100-104bps cut in Semb EBITDA margins on delays in the Marina Bay Sands project and possible delays in other orders.
- Reduction in FD shares by 10mn as the warrants convertible at Rs254 may not be converted.
- Write-off to the tune of £28.5mn of performance guarantee and £25mn of auditor qualifications as exceptional items in FY09E through the profit and loss statement in line with prudent accounting norms.

We now expect Punj Lloyd to grow EPS at a CAGR of 27% over FY08–11E (from 37% earlier) with average RoEs of 16% (from 18% earlier).

Figure 7. Punj Lloyd – Earnings Revision Table

Year End Mar31	FY09E	FY10E	FY11E	- Remark
PLL (ex Semb) Sales				
Old	80,000	100,000	122,500	- FY11E sales growth cut 6% on slower order inflows in FY10E
New	80,000	100,000	115,000	
% Chg	0.0%	0.0%	-6.1%	
Semb Sales				
Old	32,500	39,000	45,825	- FY11E sales growth cut 4% on slower order inflows in FY10E
New	32,500	39,000	43,875	
% Chg	0.0%	0.0%	-4.3%	
PLL (ex Semb) EBITDA Margin %				
Old	11.8%	11.5%	11.5%	- Cut margins by 20 - 50bps given delays in ONGC order
New	11.8%	11.3%	11.0%	
bps	0	(20)	(50)	
Semb EBITDA Margin %				
Old	2.0%	4.0%	4.6%	- Cut in margins by 100 - 104bps given delay in Marina Bay
New	2.0%	3.0%	3.6%	- Sands orders and some delays in other orders
bps	0	(100)	(104)	
Recurring PAT				
Old	4,789	6,322	8,204	- Recurring PAT cut 1.5% - 20% over FY09E - 11E
New	4,718	5,629	6,534	
% Chg	-1.5%	-11.0%	-20.4%	
Reported PAT				
Old	5,061	6,322	8,204	- £28.5mn of performance guarantee and £25mn of auditor qualifications
New	934	5,629	6,534	- have been written off in line with prudent accounting practices
% Chg	-81.5%	-11.0%	-20.4%	
FD EPS				
Old	14.68	19.38	25.15	- FD shares reduced by 10mn (Promoter warrants may not get converted)
New	14.92	17.80	20.66	- Earnings cut 8 - 18% over FY10E/FY11E
% Chg	1.6%	-8.1%	-17.8%	

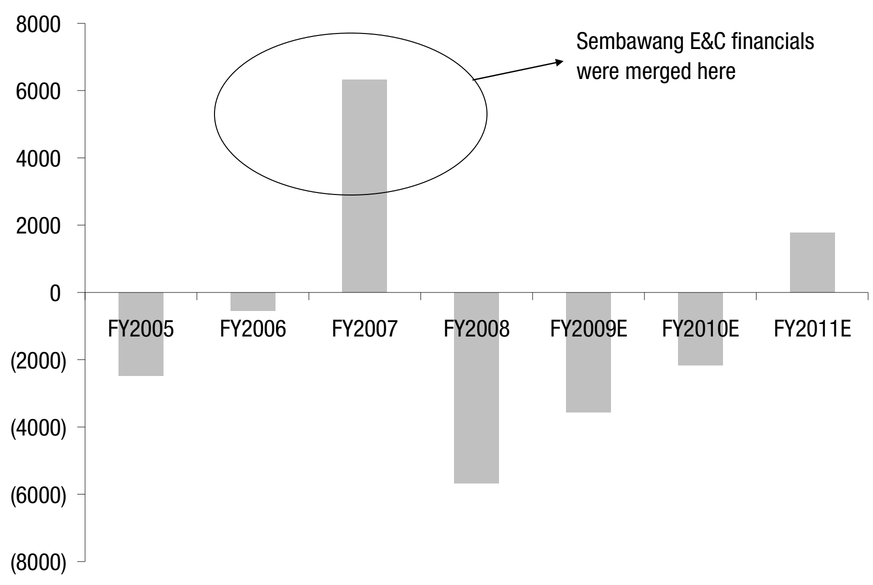
Source: Citi Investment Research estimates

Business Analysis

Punj Lloyd – A credible hydrocarbons competitor to L&T but ...

- The Punj Lloyd Group has initiated "Project Hawk" with the help of McKinsey & Company to transform itself into a successful global EPC player. The key targets include US$5bn of sales by 2012 (FY09E sales = US$2.5bn) with 2012 order backlog of ~ S$12-15bn (FY09E order backlog US$5.3bn) and operating margins of > 10%.
- The group wants to move to high margin segments (refining and upstream) and more complex technology and bigger-sized projects. Further, the company wants to move from pure construction to EPC type projects. Last but not least, the group wants to pick up more negotiated contracts rather than competitively bid projects.
- Our recent interactions with L&T suggest that the company now does consider Punj Lloyd a credible threat on the hydrocarbons side of the business. Further, according to L&T, Punj Lloyd is also getting more reasonable with its bids for recent projects (Evident from the Assam redevelopment project bids where the gap between the two was not too big).
- But it is also a fact that a transformation of a small/mid-size company to a relatively larger company happens in extended periods of robust economic growth. In a slowdown/downturn a mid-size company has a comparatively difficult time, as access to capital becomes that much more difficult.
- Most important, the fact that Punj Lloyd's cash flow from operation (CFO) is negative is worrisome. Generally, companies with negative CFO have a very tough time in an operating environment where there is a capital squeeze – case in point being Suzlon.

Figure 8. Punj Lloyd – Cash Flow From Operations

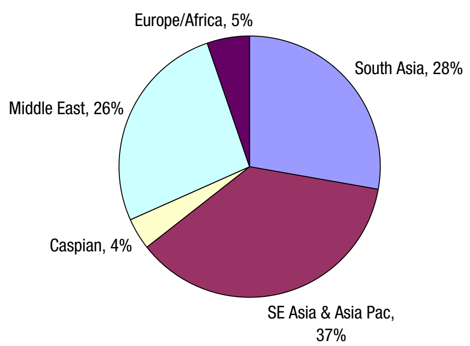


Source: Citi Investment Research estimates

Backlog exposure details – geographical, sectoral and client wise

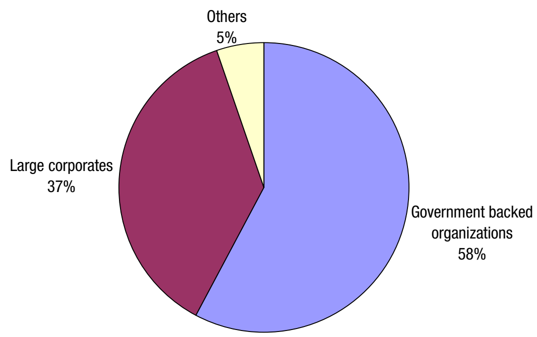
- 58% of Punj Lloyd's order backlog is from government-backed organizations, which compares favourably with L&T's 55% but unfavorably with 85% in the case of BHEL.
- It is a myth that most of Punj Lloyd's orders are from the GCC region. According to the latest order backlog split only 26% of the orders are from the GCC region, and the backlog has good geographical diversity.
- The risk to Punj Lloyd's order backlog is the exposure to commodities and more specifically oil prices, as 66% of Punj Lloyd's order backlog is composed of orders derived from the oil & gas space.

Figure 9. Punj Lloyd – Order Backlog; Geographical Break Up



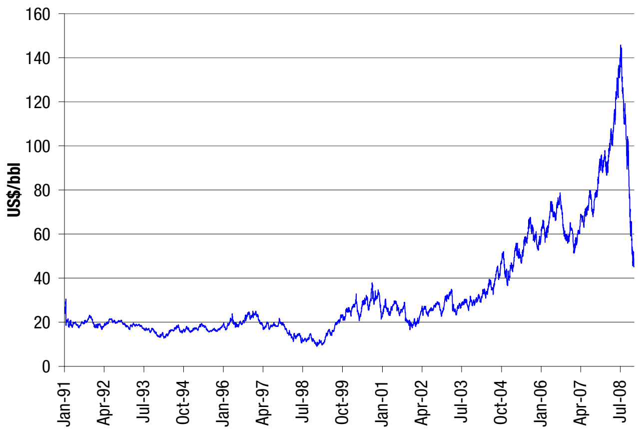
Source: Company and Citi Investment Research estimates

Figure 10. Punj Lloyd – Order Backlog; Client Wise Break Up



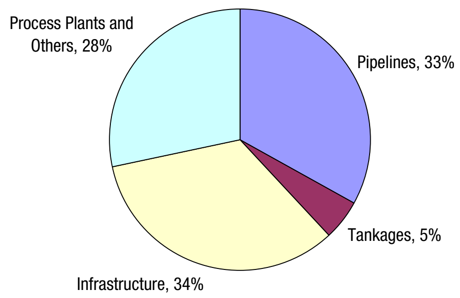
Source: Company and Citi Investment Research estimates

Figure 11. Crude Oil Price - Brent



Source: Bloomberg

Figure 12. Punj Lloyd – Order Backlog; Sectoral Break Up



Source: Company and Citi Investment Research

Punj Lloyd has Rs2.75bn of auditor qualifications and out of this Rs2.2bn is contributed by one single order being executed for SABIC. Further SABIC has also en-cashed bank guarantees issued totalling to Rs2.1bn (£28.5mn)

From a cash flow perspective Punj has taken an additional hit of £28.5mn because of bank guarantees getting enchased.

A likely scenario that could emerge - Punj Lloyd gets back bank guarantees totaling £28.5mn but is unable to recover £25mn of disputed amounts, which might have to be written off.

SABIC order – Going from bad to worse

- Simon Carves contracted with Huntsman Petrochemicals, UK (subsequently acquired by SABIC) in early 2006 to design, build and pre-commission a 400 kte per annum low density polyethylene plant (LDPE) at Wilton, Teeside in UK. This contract was entered into between Simon Carves and SABIC prior to the acquisition of Simon Carves by Punj Lloyd in May 2006. After the completion of the initial front-end engineering design works for the proposed plant, the contract was converted into a lump-sum EPC contract.
- SABIC has recently terminated the contract on the basis that Simon Carves failed to undertake completion of the contractual works with due diligence.
- Simon Carves denies this on the basis that the contract has been significantly completed (~99% according to the Punj Lloyd management) and is on track to be completed within the scheduled completion date.
- SABIC has called the performance and advance payment guarantees in the contract issued by Simon Carves amounting to £28.5mn.
- Simon Carves has commenced adjudication proceedings aimed at seeking restitution through UK courts of the above £28.5mn. Additional costs will also be sought by Simon Carves associated with the cost overruns in the project caused by changes in scope and design requested by SABIC.

Figure 13. SABIC – Order Details

Details	£mn
Initial contract value	140.0
Deadline for completion of contract	Apr-08
Original bank guarantee	13.5
Mar-08	
Expected cost of completion	178.0
Auditor qualification in accounts	38.0
Jun-08	
Interim settlement and client agrees to pay extra	15.0
Bank guarantee given by Punj Lloyd for above amount	15.0
Auditor qualification in accounts after above reduction	23.00
Sep-08	
Estimated cost of completion increases by	2.0
New estimated cost of completion	180.0
Auditor qualification in accounts	25.0
Dec-08	
Project completed 99% according to Punj Lloyd	
SABIC terminates contract	
SABIC en-cashes original bank guarantees totalling to	28.5
Punj Lloyd's Total Exposure	**53.5**
Bank guarantees en-cashed by SABIC	28.5
Disputed amount in contract	25.0

Source: Company and Citi Investment Research

Figure 14. Punj Lloyd – Auditer Qualifications

Client	Project	Executed In	IPO	FY06	FY07	FY08	Jun-08	Sep-08	- Where is this?	Settlement
IOCL - PIL	Sulphur recovery units in the refineries at Mathura and Vadodara on a back to back basis with Petrofac International Limited (PIL) who is the main contractor. IOCL has withheld payment to PIL who has withheld payment to PLL	FY01	223	298	294	10	10		- Sundry Debtors	Settled in January 2008. Company has received Rs284 and has an outstanding amount of Rs10mn
GAIL	Withheld money in the Dahej - Vijaipur pipeline project for liquidated damages and other deductions	FY04								Company hopes to settle this matter in FY09
- LD			423	424	422	416	416	432	- Sundry Debtors	Fighting a case against the liquidated damages
- Deductions			40	40	40	40	40	40	- Sundry Debtors	Under arbitration
- Claims			999	999	999	999	999	999	- Not in sales	Upside if settled
Petronet MHB	Pipeline project	FY05	4	4	4	4	4	4	- Sundry Debtors	Under arbitration
			64	64	64	64	64	64	- Work in Progress	Under arbitration
			517.4	517.4	517.4	517.4	517	517	- Not in sales	Upside if settled
Spie Capag	Invoices raised	FY05	356	378	368	0	0	0	- Sundry Debtors	Settled and company received an amount in excess to what was claimed
SABIC						3053	1948	2,216		Management has settled of Rs1105mn with the client and remaining Rs2216mn settlement expected by Mar2009. In the worst case management does not expect to lose more than Rs500mn on the contract
Total			**1111**	**1208**	**1192**	**3588**	**2483**	**2756**		

Source: Company Annual Reports, IPO Prospectus and Citi Investment Research estimates

Shaded rows have amounts which have either been settled or there is an income upside if settled

Barring L&T, all other engineering & construction companies have significant amounts of contingent liabilities

Figure 15. India Engineering & Construction – March 2008 End Contingent Liabilities

	L&T	Punj Lloyd	IVRCL	Nagarjuna	Gammon	HCC
Contingent Liabilities (CL)	**4,045**	**33,627**	**20,163**	**20,342**	**24,446**	**20,386**
Assets	241,370	44,642	26,813	24,829	13,932	29,622
Gross Sales	295,611	112,500	36,606	34,729	23,449	30,828
Net worth	107,767	27,433	16,031	15,724	9,790	10,041
Order Backlog	526,830	195,960	128,000	89,600	64,300	82,180
CL/Assets	1.7%	75.3%	75.2%	81.9%	175.5%	68.8%
CL/Gross Sales	1.4%	29.9%	55.1%	58.6%	104.2%	66.1%
CL/Net worth	3.8%	122.6%	125.8%	129.4%	249.7%	203.0%
CL/Order Backlog	0.8%	17.2%	15.8%	22.7%	38.0%	24.8%

Source: Companies and Citi Investment Research

Sembwang E&C was awarded the S$400 million (Rs11.2bn) contract in February 2007 by Marina Bay Sands Pte Ltd, Singapore to construct and build the north podium of Marina Bay Sands integrated resort comprising the casino, theatres and retail arcade in Singapore. Work on this project started in Feb 2008 and is to be completed by April 2009.

The project is progressing well and Punj Lloyd is receiving its payments on time.

Problems on the Marina Bay Sands project have been sorted out

- The US$4.2bn Marina Bay Sands integrated resort in Singapore is being executed by Las Vegas Sands (LVS), a US-based casino operator. LVS has run into financial difficulties relating to some of the debt covenants. However over the past couple of months there have been several press reports (*Strait Times* and *Business Times*) suggesting that project execution is likely to continue, albeit with some delay.

- LVS has secured US$3.22bn in capital funding commitments and CEO Sheldon Adelson has reiterated commitment to finish the project, in a meeting with Singapore government officials. However, LVS has indicated that it will not be able to open the entire integrated resort by the end of CY09 as originally planned.

- LVS has invested US$1.81bn in land and construction costs in the Marina Bay project so far, including US$616mn in equity. Current cost to completion is estimated to be US$2.7bn. If LVS is not able to contribute further equity to the project, the Singapore government is likely to step in. Further, several players including CapitaLand and Temasek, may be in a race for picking up stake in the project.

- LVS COO William Weidner has said that LVS is giving priority to the Marina Bay project and one other project in Pennsylvania and consequently has significantly slowed down the pace of development activities at other properties including Cotai Strip at Macau.

Punj Lloyd–PT Sempec Indonesia, a wholly owned subsidiary, secured its single largest offshore platform project - the prestigious US$266mn Heera Redevelopment Project on an EPC basis from ONGC in January 2007. The work is scheduled to be completed within 16 months. The consortium qualified for the project based on the experience of PT Sempec, which has executed offshore platform projects. PT Sempec was acquired by the Group as part of Singapore-based Sembawang E&C, in June 2006.

The project is expected to be completed by March 2009 vis-à-vis the original completion date of May 2008.

The contract provides for additional steel consumption costs but is silent on other aspects. Costs increased due to change in design and increased freight costs from Malaysia due to increased weight.

The project, which was bid earlier expecting EBITDA margins of 11–12%, is now likely to break even.

Further, according to the company, all cost over-runs have been accounted for in the numbers till the September 2008 quarter.

Time over-runs in the Heera redevelopment project

- The Punj Lloyd–PT Sempec consortium contracted by ONGC to handle lump-sum turnkey construction of facilities under the Heera redevelopment project has requested the E&P major to defer the deduction of liquidated damages (LD) from its invoices on account of a severe liquidity crunch that could derail execution of the project (www.indianpetro.com).

- Punj Lloyd–PT Sempec has drawn attention to the global financial turmoil that has severely affected liquidity with banks worldwide in its appeal, noting that in the initial stages of the project, it had secured loans from banks as working capital, and these loans were rescheduled for payment starting October 2008, when it was expected that all the payments would be realized from the project. However, due to various delays in completion of the project, inflows have also been delayed, leaving the consortium in a precarious position.

- While it has been pursuing the bankers to restructure the repayments, the banks have indicated that their hands are tied due to the present global scenario, as a consequence of which they were unable to do such restructuring. They instead informed that they would start deducting the project advances out of the funds received from the project inflows with effect from October 2008 and until March 2009.

- The value of each monthly installment is to the tune of US$6 million. The total value of the contract between ONGC and Punj Lloyd–PT Sempec is $266mn, out of which US$164mn has already been certified by ONGC. Therefore, the consortium is entitled to a further disbursement of $103mn from ONGC till completion of the project.

- However, on account of the delays in the project, ONGC had calculated the contractor's liability toward liquidated damages at US$26.57mn, out of which it has already deducted about half of this amount, which is US$13.42mn. This meant that Punj Lloyd–PT Sempec is left with a further liability of US$13.15mn.

Industry Outlook

More bad news on the E&P spending outlook

Sharp decline of oil price by ~70%+ from the peak and the effects of the credit crunch have sharply reduced E&P spending and corresponding equipment capex. We fear more order cancellations and variation of contract agreements will take place, especially for orders placed in 2008 for delivery in 2011 and beyond where work has not begun.

One cannot rule out order cancellations on the platform, refinery and petrochemicals space in the near future.

- Keppel (KEP) has announced that its US$405mn semi-sub order from Scorpion Offshore will be terminated. In addition, Seadrill has also announced it has made certain amendments to the four jack-ups placed with KEP and Sembcorp Marine (SMM): revising the milestone payment schedule for the first two rigs with KEP and SMM and postponing the remaining milestone payments for the second units at both yards until delivery. KEP's contract with Lewek worth $69m has also been cancelled.

- Separately, Cosco also has announced the cancellation of another two bulk carriers, bringing the total number cancelled to four. Delivery of another two bulk carriers will be postponed (total = nine so far). Cosco had earlier warned that FY08 earnings will be lower than FY07 on *i)* provision for doubtful debts; *ii)* increased operational costs; and *iii)* provisions for payment of penalties due to delivery delays.

Figure 16. Rig Building and Ship Building Order Cancellations and Variations at KEP, SMM and COS

Yard	Customer	Order	Contract Value	Date of Order	Latest Update	Date of Latest Update	Comments
Keppel	Scorpion Offshore	1 DSS 38 Semi-Sub	US$405mn	7-Jul-08	Contract will be terminated. Scorpion is working with KEP in the latter's exploratory discussions with interested third parties to take over the building of the semi-sub, but outcome is "highly uncertain".	9-Jan-09	The semi-sub was originally to be chartered by Scorpion to Petrobras for a period of six years beginning 4Q11. Scorpion indicated that it was unable to secure construction financing. Construction has not begun at the yard and Keppel is entitled to keep the ~10% deposit paid by Scorpion after terminating the contract. Scorpion's liability for the cancellation of its order with KEP and third party equipment providers is not expected to exceed the US$74mn paid by Scorpion to date.
Keppel	Lewek Shipping (subsidiary of Ezra Holdings)	1 Multi-Functional Support Vessel	S$69mn	7-May-08	Ezra and Keppel are currently working towards an amicable mutual termination which is expected to be finalized shortly.	9-Jan-09	Ezra has secured full financing for the MFSV but has decided to scale back capex plans. Construction has not begun and Keppel is entitled to keep the ~5% deposit paid by Ezra.
Keppel	Seadrill	2 Jackup Drilling rigs (Class B design)	US$420mn	6-Jun-08	Seadrill will defer all remaining milestone payments for the second jack-up until delivery and revise the milestone payment schedule for the first jack-up. Seadrill will also issue corporate guarantees for the remaining instalments on the first jack-up, but no corporate guarantees have been provided for payments on the second jack-up.	9-Jan-09	Both jack-ups have not secured underlying charters. Terms are similar to that with SMM's.
SembCorp Marine	Seadrill	2 Baker Pacific Class 375 Jackup Rig	US$430mn	6-Jun-08	Seadrill will defer all remaining milestone payments for the second jack-up until delivery and revise the milestone payment schedule for the first jack-up. Seadrill will also issue corporate guarantees for the remaining instalments on the first jack-up, but no corporate guarantees have been provided for payments on the second jack-up.	9-Jan-09	Both jack-ups have not secured underlying charters. Terms are similar to that with KEP's.
Cosco Corp	Great Eastern Shipping	4 bulk carriers (57,000 dwt each)	est. US$160-180mn	8-Jun-07 and 24-Oct-07	2 bulk carriers will be cancelled. Delivery for two bulk carriers will be postponed: (i) from 15-Feb-10 to 15-Sep-10; and (ii) from 31-Jul-10 to 17-Jan-11.	9-Jan-09	Shipowner has paid compensation to Cosco for the cancellations.
Cosco Corp	Undisclosed (a European and an Asian ship owner)	7 bulk carriers (57,000 dwt each)	Undisclosed	Undisclosed	Delivery schedule will be postponed: 4 vessels from between Feb-10 and Jun-10 to between Feb-11 and Nov-11; another 3 vessels from between Aug-09 and Nov-09 to Jan-12.	30-Dec-08	
Cosco Corp	Undisclosed	5 bulk carriers (57,000 dwt each)	est. US$200mn	11-Jul-07	2 bulk carriers will be cancelled. Cancellations are conditional upon payment by customer of 80% of total contract price of remaining 3 vessels by Dec-08 with last instalment to be paid upon delivery. Delivery for the last bulk carrier will be postponed from Dec-09 to 30-Jun-10.	3-Dec-08	Shipowner has paid compensation to Cosco for the cancellations.

Source: Company Announcements, News Reports and Citi Investment Research

Nothing to write home about the GCC capex outlook

The oil price bust and possible scenarios

- The real problem is the oil price trajectory. Using two scenarios for the average price in 2009 (US$75 and US$50 per barrel), we show that the massive surpluses generated by the GCC could shrink very rapidly. As leading members of OPEC, the price fall will probably be accompanied with production cuts, resulting in a double squeeze.
- If oil prices averaged US$50 pb, only Kuwait would be able to show an external surplus in 2009. This means that the region would have to dig into its overseas wealth to keep the economies moving.

The challenges facing Dubai

- Dubai is the most vulnerable, as it has little oil and has been booming on the oil surpluses from the GCC, Iran and Russia. Dubai's two specific concerns are its real estate sector and how it will refinance the debt it has built up in recent years. Observers have talked about a property crash, debt buy-outs and even default, but we are less foreboding. We see a much needed correction in the property market, and an equally necessary consolidation of Dubai Inc. Global conditions are likely to slow Dubai's economic growth, but not knock it out.

Liquidity crunch severely affecting GCC real estate projects

- Within three months, GCC has gone from a position of excessive credit growth (expanding loans to deposit ratios) and demand-driven inflation to a tight liquidity and concerns over the sustainability of growth. The reversal of foreign exchange positions since April 2008 and the global banking crisis in September has driven this.
- A sustained liquidity crunch obviously impacts all layers of the real estate value chain (developer purchase of land, construction working capital, off-plan buyer finance and end-user mortgage finance).

Falling oil prices imply a lot of projects might not be viable

- Further, E&C investors and management teams often quote similar price thresholds for project profitability. Economic thresholds with "sacred cow" status in the industry include: Middle East Projects at $50-60/bbl oil, deepwater at $60-70/bbl oil, and Canadian Oil Sands at $80-90/bbl oil. We believe lagging construction cost estimates are still rising even through commodity prices are now falling.
- Saudi Aramco plans to sell 25% of its 62.5% stake in the Jubail refinery and petrochemical JV through an IPO (Bloomberg). The project cost was originally estimated at $6 billion, later revised to $10 billion and Aramco has conceded the final price would exceed current estimates.
- Ras Tanura refinery is delayed. Several other Aramco projects have faced delays including the Kursaniyah oilfield and the PetroRabigh refinery and petrochemical project. Aramco and its JV partners could delay financing their refineries at Jubail and Yanbu, currently projected for year-end. (Reuters).

Refineries - First battleground between E&C companies and project sponsors.

- Project sponsors are keenly aware of falling commodities costs such as steel and copper and decreased oil imports to Asian refineries. In an attempt to benefit from lower materials and labor prices, the sponsors have begun stretching bid dates and reworking construction timelines.

- We first noted this trend when companies in Saudi Arabia and the UAE announced they may renegotiate oil contracts and again when Fluor highlighted delays at two US refineries. A more specific example surfaced on 11/6/08 when ConocoPhillips and Saudi Aramco agreed to postpone the bidding process on the Yanbu Export Refinery project. The project will now be re-bid in 2Q09, a delay from 4Q08. While the venture cites uncertainty in the financial markets as the reason for the delay, our read-through interpretation is that the sponsors are following a recent trend of unilaterally wielding increasing negotiating power against potential contractors as the global economy slows down.

Most of the GCC projects are getting delayed

- The Middle East is still slowing down. We recently noted the UAE has delayed its production target of 3.5 million barrels/day until 2018, a delay of 8 years. Additionally, the UAE appears especially affected by current conditions; one energy project finance specialist noted in a 10/27/08 *Pipeline Magazine* article that 150 planned projects across the Gulf countries were delayed, with the majority of them in the UAE.

Domestic macro has also turned bad

Faced with relatively expensive funding and poor availability of bank lending, we maintain our view that growth in capital formation is likely to come in at low single digits vs. the 17% CAGR seen during FY03-FY08. While this capex cycle is far healthier than the one in the 90s, the risk could possibly come in from a further decline in real estate, which comprises ~10.5% of gross capital formation.

- India's infrastructure capex is slowing down, and there is plenty of evidence for the same: (1) Record drop in tipper trucks (used in infrastructure sector) sales by 47.3% in Oct 2008; (2) Slower growth of the electrical industry of 6.6% in 2QFY09 (down from 11.8% in 1QFY09); (3) Projects worth Rs765bn getting shelved in 1HFY09; (4) Fresh investments announcements declining 29% in 1QFY09; (5) GMR curtailing/postponing capex in the Hyderbad/Delhi airports; (6) Slowdown in MMRDA projects to be financed by sale of plots; (7) ADB asking GOI to reduce the size of future UMPPs; (8) Parties interested in Tilaiya UMPP asking PFC to postpone bidding; and (9) Higher interest rates making road BOT projects.

- The "India Infrastructure Super-Cycle" which started in early 2002 is showing signs of stress. The ongoing global credit crisis has reduced the quantum of credit available globally and increased the cost of the same. The very sustenance of any capex cycle is dependent on plentiful availability of cheap credit. The Indian General Elections in FY10E could be another dampener as typically, a new party coming into power takes a year to settle down and a year to restart the projects. Further, ordering typically slows down in the run-up to elections.

RBI and MoF taking steps but ....

- RBI and the Ministry of Finance have been fairly aggressive in managing the liquidity squeeze in the system. But the key call here is not only how fast liquidity will come back into the system but how fast will banks once again start lending aggressively to infrastructure projects.

- Even if lending begins in earnest once again, the cost of domestic debt might not be as cheap as before, which implies that not all public–private partnership (PPP) projects would be taken up as enthusiastically as before. A numbers of lower IRR projects could potentially be cancelled or deferred.

ECBs might not be available in the same quantum

- Most important, with the global credit crisis ECBs might not be available in the same quantum, and one should take note that this source of funding has fueled corporate capex to a large extent over the last 4 years.

Financial Statements

Figure 17. Punj Lloyd – Consolidated Order Backlog Statistics

End Mar31 (Rsmn)	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009E	FY2010E	FY2011E	CAGR 08-11E
Punj Lloyd									
OB b-o-y	19,847	21,982	14,451	42,820	110,399	126,420	156,420	156,420	
Order Inflow	13,211	8,870	44,516	97,710	65,696	110,000	100,000	85,000	
% change yoy		-33%	402%	119%	-33%	67%	-9%	-15%	
Contract Revenues	15,518	17,035	16,147	30,131	49,675	80,000	100,000	115,000	
OB e-o-y	21,982	14,451	42,820	110,399	126,420	156,420	156,420	126,420	0.0%
OB e-o-y/Sales	1.42	0.85	2.65	3.66	2.54	1.96	1.56	1.10	
Sales/OB b-o-y	0.78	0.77	1.12	0.70	0.45	0.63	0.64	0.74	
Sembawang E&C									
OB b-o-y				44,215	49,040	69,540	82,040	93,040	
Order Inflow				25,960	48,355	45,000	50,000	40,000	
% change yoy					86%	-7%	11%	-20%	
Contract Revenues			16,147	21135	27855	32500	39000	43875	
OB e-o-y			44,215	49,040	69,540	82,040	93,040	89,165	8.6%
OB e-o-y/Sales				2.32	2.50	2.52	2.39	2.03	
Sales/OB b-o-y				0.48	0.57	0.47	0.48	0.47	
Total									
OB b-o-y				87,035	159,439	195,960	238,460	249,460	
Order Inflow				123,670	114,050	155,000	150,000	125,000	
% change yoy					-8%	36%	-3%	-17%	
Contract Revenues				51,266	77,529	112,500	139,000	158,875	
OB e-o-y			87,035	159,439	195,960	238,460	249,460	215,585	3.2%
OB e-o-y/Sales				3.11	2.53	2.12	1.79	1.36	
Sales/OB b-o-y				0.59	0.49	0.57	0.58	0.64	

Source: Company and Citi Investment Research estimates

Figure 18. Punj Lloyd – Consolidated Earnings Model

Rsmn	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	CAGR 08–11E
Sales								
PLL	17,900	16,846	30,131	49,675	80,000	100,000	115,000	32.3%
Growth %		*-5.9%*	*78.9%*	*64.9%*	*61.0%*	*25.0%*	*15.0%*	
Sembawang			21,135	27,855	32,500	39,000	43,875	16.4%
Growth %				*31.8%*	*16.7%*	*20.0%*	*12.5%*	
Total	**17,900**	**16,846**	**51,266**	**77,529**	**112,500**	**139,000**	**158,875**	**27.0%**
Growth %		*-5.9%*	*204.3%*	*51.2%*	*45.1%*	*23.6%*	*14.3%*	
EBITDA								
PLL	2,102	1,902	3,519	6,406	9,440	11,300	12,650	25.5%
Sembawang			224	5	650	1,560	1,974	648.9%
Write Offs					0	(405)	(405)	
Total	**2,102**	**1,902**	**3,743**	**6,410**	**10,090**	**12,455**	**14,219**	**30.4%**
EBITDA Margins								
PLL	11.7%	11.3%	11.7%	12.9%	11.8%	11.3%	11.0%	
Sembawang			1.1%	0.0%	2.0%	4.0%	4.5%	
Total	**11.7%**	**11.3%**	**7.3%**	**8.3%**	**9.0%**	**9.0%**	**9.0%**	
Depreciation	839	604	1,062	1,462	1,762	1,990	2,217	14.9%
EBIT	**1,262**	**1,298**	**2,681**	**4,948**	**8,328**	**10,465**	**12,002**	**34.4%**
Interest	1,333	794	825	1,292	2,101	2,817	3,092	
Other Income	439	317	794	811	600	500	550	
PBT	**368**	**821**	**2,650**	**4,467**	**6,827**	**8,148**	**9,460**	**28.4%**
Tax	102	291	690	1,237	2,116	2,526	2,933	
Tax Rate %	27.6%	35.5%	26.0%	27.7%	31.0%	31.0%	31.0%	
Add: share in profits of associates	3	8	10	(17)	0	0	0	
add: share of (profit)/loss transferred to minority	2	7	3	1	7	7	7	
Recurring PAT	**272**	**545**	**1,973**	**3,214**	**4,718**	**5,629**	**6,534**	**26.7%**
Exceptionals	734	2	(3)	304	(3,784)	0	0	
Reported PAT	**1,006**	**547**	**1,969**	**3,518**	**934**	**5,629**	**6,534**	

Source: Company and Citi Investment Research estimates

Figure 19. Punj Lloyd – Consolidated Balance Sheet

Year End Mar31 (Rsmn)	FY2005	FY2006	FY2007	FY2008	FY2009E	FY2010E	FY2011E
Share capital	243	522	523	607	607	607	607
Reserves and Surplus	4,850	10,693	12,266	26,826	27,328	32,744	39,030
Total Networth	**5,093**	**11,215**	**12,789**	**27,433**	**27,935**	**33,351**	**39,637**
Preference share capital	9	-	-	-	-	-	
Minority Interest	17	9	59	222	222	222	222
Secured Loans	5,998	4,921	11,232	13,507	23,536	26,536	28,536
Unsecured loans	1,188	644	338	575	575	575	575
FCCB	-	-	5,423	1,989	1,989	1,989	1,989
Loan Funds	**7,187**	**5,565**	**16,992**	**16,072**	**26,100**	**29,100**	**31,100**
DTL	618	606	361	915	915	915	915
LIABILITIES + NETWORTH	**12,924**	**17,395**	**30,200**	**44,642**	**55,172**	**63,589**	**71,874**
Tangible Gross Block	**7,264**	**8,915**	**17,090**	**18,906**	**22,906**	**26,406**	**29,906**
Accumulated Depreciation	(2700)	(3193)	(5929)	(6441)	(8193)	(10173)	(12380)
Net Block	**4,564**	**5,722**	**11,161**	**12,465**	**14,713**	**16,233**	**17,526**
CWIP	500	1,230	710	2,061	2,061	2,061	2,061
Pre Operative Expense	80	156	148	64	64	64	64
Net Fixed Assets	**5,144**	**7,108**	**12,019**	**14,590**	**16,838**	**18,358**	**19,651**
Intangible Gross Block	**149**	**155**	**1,580**	**1,928**	**1,928**	**1,928**	**1,928**
Amortization	(62)	(86)	(269)	(285)	(295)	(305)	(315)
Net Intangible Assets	**87**	**68**	**1,311**	**1,643**	**1,633**	**1,623**	**1,613**
Investments	259	416	1,698	5,458	6,458	7,458	8,458
Inventories	5,510	8,043	15,017	20,592	31,374	39,734	45,415
Sundry Debtors	3,364	3,944	12,234	20,901	31,846	39,347	44,973
Cash and bank balances	432	1,122	10,027	6,898	4,149	1,246	420
Other CA	54	192	511	814	1,014	1,214	1,414
Loans and advances	1,929	2,179	4,462	6,615	8,615	10,615	12,615
Total CA	**11,289**	**15,479**	**42,250**	**55,820**	**76,998**	**92,155**	**104,837**
CL	3,708	5,387	25,430	31,479	43,668	52,474	58,710
Provisions	147	288	1,647	1,391	3,086	3,531	3,974
Total CL	**3,855**	**5,676**	**27,077**	**32,869**	**46,754**	**56,006**	**62,684**
Net current assets	**7,434**	**9,804**	**15,172**	**22,951**	**30,244**	**36,150**	**42,153**
ASSETS	**12,924**	**17,395**	**30,200**	**44,642**	**55,172**	**63,589**	**71,874**

Source: Company and Citi Investment Research estimates

Figure 20. Punj Lloyd – Consolidated Cash Flow Statement

Year End Mar31	FY2005	FY2006	FY2007	FY2008	FY2009E	FY2010E	FY2011E
Recurring PAT	272	545	1973	3214	4718	5629	6534
Change in DTL	7	(12)	(245)	554	0	0	0
Add: D&A	839	604	1062	1462	1762	1990	2217
Chg in Inventories	(2544)	(2533)	(6974)	(5575)	(10782)	(8359)	(5681)
Chg in Debtors	(1148)	(580)	(8290)	(8667)	(10944)	(7501)	(5626)
Chg in Loans & Advances	(374)	(250)	(2283)	(2153)	(2000)	(2000)	(2000)
Chg in other CA	(44)	(138)	(319)	(303)	(200)	(200)	(200)
Chg in CL	409	1679	20043	6048	12189	8807	6236
Chg in Provisions	103	142	1358	(256)	1696	445	442
Change in Working Capital	*(3598)*	*(1680)*	*3536*	*(10907)*	*(10042)*	*(8809)*	*(6829)*
Cash Flow from Operations	**(2480)**	**(544)**	**6325**	**(5677)**	**(3562)**	**(1190)**	**1922**
Capex	(398)	(2548)	(7215)	(4366)	(4000)	(3500)	(3500)
Change in Investments/Assets	2536	(157)	(1283)	(3759)	(1000)	(1000)	(1000)
Cash Flow from Investing Activities	**2138**	**(2705)**	**(8498)**	**(8125)**	**(5000)**	**(4500)**	**(4500)**
Change in Debt	(2680)	(1622)	11427	(920)	10028	3000	2000
Change in Minority Interest	(2)	(7)	49	164	0	0	0
Change in Preference Shares	9	(9)	0	0	0	0	0
Change in Equity	37	279	0	84	(0)	0	0
Change in Reserves	2157	5355	(304)	11183	(254)	0	0
Dividend and Dividend Tax	(21)	(60)	(92)	(142)	(178)	(213)	(249)
Cash Flow from Financing Activities	**(500)**	**3936**	**11081**	**10369**	**9597**	**2787**	**1751**
Extrordinary Items + Tax Adjustments	734	2	(3)	304	(3784)	0	0
Increase/(Decrease) in Cash	**(109)**	**690**	**8905**	**(3129)**	**(2749)**	**(2903)**	**(826)**
Opening Cash and Bank Balance	**540**	**432**	**1122**	**10027**	**6898**	**4149**	**1246**
Closing Cash and Bank Balance	**432**	**1122**	**10027**	**6898**	**4149**	**1246**	**420**

Source: Company and Citi Investment Research estimates

Punj Lloyd

Company description

Punj Lloyd is an Indian Engineering & Construction (E&C) major catering to the hydrocarbons and civil construction sectors across India, Asia and the Middle East. Services include laying pipelines, building roads, and constructing refineries and tankages, power plants, and other infrastructure facilities. In FY07 Punj Lloyd acquired Semb, which helped it scale up its expertise to upstream oil & gas, airports, jetties, MRT/LRT and tunnelling amongst others, in the infrastructure domain. Enabled by the extended capabilities accruing from this acquisition, Punj Lloyd is now also pre-qualified for larger and more complex project bids.

Investment strategy

We rate Punj Lloyd shares Hold/High Risk (2H)

- Punj Lloyd has initiated "Project Hawk" to transform itself into a successful global EPC player. Our recent interactions with L&T suggest that Punj Lloyd is a credible threat on the hydrocarbons side of the business.

- But is also a fact that a transformation of a small/mid-size company to a relatively larger company happens in extended periods of robust economic growth. In a slowdown/ downturn a mid-size company has a comparatively difficult time as access to capital becomes that much more difficult.

- Punj Lloyd's balance sheet has Rs2.75bn of auditor qualifications and out of this Rs2.2bn is contributed by one single order being executed for SABIC. Further SABIC has also en-cashed bank guarantees issued totalling Rs2.1bn (£28.5mn)

- Punj Lloyd has had a history of contractual disputes with clients, case in point being: 1) IOCL–PIL; 2) GAIL; 3) Petronet; 4) Spie Capag Petrofac; and 5) SABIC. Management maintains that the nature of business is such that scope and design changes keep happening, and they are actually surprised that such issues do not get reported in other E&C companies. This implies that similar problems cannot be ruled out in the future.

- 58% of Punj Lloyd's order backlog is from government-backed organizations which compares favourably with L&T's 55% but unfavorably with 85% in the case of BHEL. The single biggest risk is the exposure to commodities (more specifically oil prices) as 66% of Punj Lloyd's order backlog is composed of orders derived from the oil & gas space.

Valuation

Our target price of Rs142 is based on a target P/E multiple of 8x March 2010 which is well supported by earnings CAGR of 27% over FY08-11E and average RoEs 16%. Our target multiple is set at a 43% discount to that of L&T (at 14x) on L&T's superior order backlog, execution skill sets, RoEs, EBIT margins and PAT margins. Further, the auditor qualifications in Punj Lloyd's financials are a key overhang on the stock.

Risks

We rate Punj Lloyd shares High Risk (previously Medium Risk), in line with our quantitative risk rating for other mid-cap construction companies like IVRCL, Nagarjuna, Gammon and HCC. The key downside risks to our target price include: 1) Integration risks relating to SembCorp E&C; 2) Revenue volatility due to project-driven nature of business; 3) Exports are subject to geopolitical risks; 4) Project implementation risks, bad debts and receivables; 5) Sensitivity to raw material costs and foreign currency fluctuations; and 6) Employee retention could be a key challenge. The key upside risks include: 1) Favorable settlement with SABIC leading to settlement of £53.5mn of outstanding amount 2) Positive change in macro-economic variables 3) Better than expected order inflows and sales execution.

Other Companies Mentioned

Gammon India (GAMM.BO; Rs78.15; 3H)

Hindustan Construction (HCNS.BO; Rs47.65; 3H)

IVRCL Infra & Projects (IVRC.BO; Rs114.70; 1H)

Larsen and Toubro (LART.BO; Rs700.15; 2L)

Nagarjuna Construction (NGCN.BO; Rs55.00; 1H)

Appendix A-1

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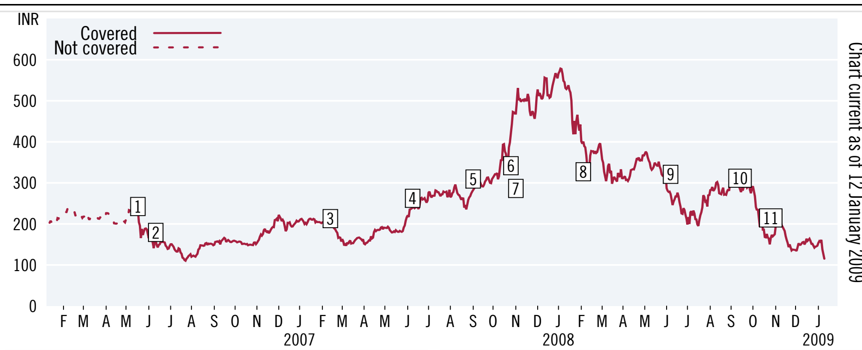
Punj Lloyd (PUJL.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Venkatesh Balasubramaniam
Covered since May 18 2006



	Date	Rating	Target Price	Closing Price
1	17-May-06	*3M	*212.00	233.76
2	12-Jun-06	*1M	*228.60	158.08
3	13-Feb-07	*3M	*175.40	197.13
4	8-Jun-07	*1L	*305.00	239.60
5	3-Sep-07	1L	*353.00	282.70
6	25-Oct-07	1L	*464.00	420.95
7	1-Nov-07	1L	*593.00	468.85
8	5-Feb-08	1L	*493.00	400.70
9	6-Jun-08	*1M	*366.00	272.85
10	12-Sep-08	1M	*395.00	284.45
11	27-Oct-08	1M	*218.00	165.35

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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