

ACTION

Sell

Punj Lloyd (PUJL.BO)

Return Potential: (11%)

Equity Research

Headwinds continue, risk-reward still unfavorable: reiterate Sell

Source of opportunity

We reiterate our Sell rating on Punj on continuing near-term headwinds to growth given 1) minimal contribution to FY12E revenues from Libya orders (16% of order backlog); 2) longer execution-cycle infrastructure orders are roughly 40% of order book, suggesting that an execution uptick is still some time away; and 3) we see risk of further write-offs on the back of incremental Rs12bn auditor qualification on Libya projects in 4QFY11.

Though we increase our FY12-13E EBITDA margin estimates by 60-80 bps, high debt (1.3X net debt/equity for FY12E) and low interest coverage (1X for FY11) mean that the positive impact on net profits is limited.

Catalyst

We see the following negative catalysts for Punj: 1) weak order inflow trend continuing in FY12; 2) further deterioration in execution and receivables cycle; and 3) lower-than-expected FY12 margins. We lower our FY12/13 revenue estimates by 14%/18% as we build in slower-than-expected order inflows as well as execution over this period. This, coupled with high interest expenses, leads to a 71%/35% cut to our FY12/13 EPS estimates. We also introduce our FY14 EPS estimate of Rs 8.62.

Valuation

We revise our valuation methodology to P/B from P/E given limited visibility on earnings growth over the next 12 months. Our new 12-month target price is Rs 57 (from Rs 62), based on 0.63X FY12E BVPS, close to its 5-yr trough P/B. Punj's Indian construction peers trade at FY12E P/B of 1.5X with an average FY12E ROE of 8% vs the 2% ROE that we expect for Punj in FY12E. We reiterate our Sell rating as we see higher relative upside elsewhere in our coverage universe.

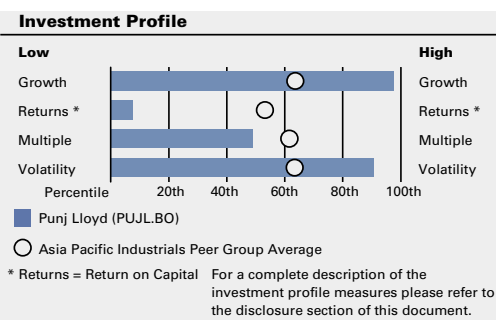
Key risks

Risks to our target price include faster-than-expected improvement in execution and receivables collection; a pickup in order inflow activity from the Middle East; and stronger-than-expected margin improvement in FY12.

INVESTMENT LIST MEMBERSHIP

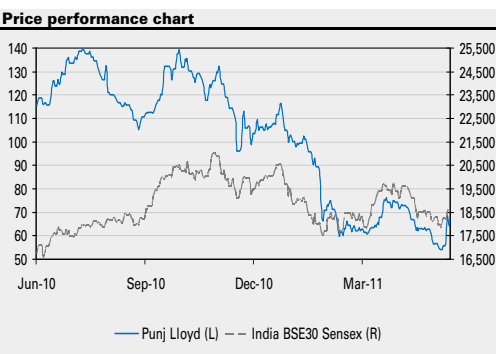
Asia Pacific Sell List

Coverage View: Neutral



Key data	Current
Price (Rs)	64.25
12 month price target (Rs)	57.00
Market cap (Rs mn / US\$ mn)	21,337.4 / 475.8
Foreign ownership (%)	15.0

	3/11	3/12E	3/13E	3/14E
EPS (Rs) New	(1.54)	1.67	5.72	8.62
EPS revision (%)	19.2	(70.5)	(34.8)	--
EPS growth (%)	54.3	208.3	242.7	50.8
EPS (dil) (Rs) New	(1.54)	1.67	5.72	8.62
P/E (X)	NM	38.5	11.2	7.5
P/B (X)	0.7	0.7	0.7	0.6
EV/EBITDA (X)	12.3	7.9	5.9	4.9
Dividend yield (%)	0.3	0.3	0.3	0.4
ROE (%)	(1.7)	1.8	6.1	8.6
CROCI (%)	11.2	12.6	14.0	14.7



Share price performance (%)	3 month	6 month	12 month
Absolute	1.5	(43.2)	(44.4)
Rel. to India BSE30 Sensex	1.2	(38.6)	(49.7)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 6/02/2011 close.

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Punj Lloyd: Summary Financials

Profit model (Rs mn)	3/11	3/12E	3/13E	3/14E	Balance sheet (Rs mn)	3/11	3/12E	3/13E	3/14E
Total revenue	81,662.6	91,629.8	109,413.0	127,776.1	Cash & equivalents	4,043.6	4,228.8	4,705.6	5,721.2
Cost of goods sold	(25,967.8)	(29,232.2)	(34,905.5)	(40,505.0)	Accounts receivable	19,688.5	22,091.6	26,379.0	30,806.3
SG&A	(52,174.9)	(57,860.4)	(68,117.6)	(79,550.0)	Inventory	43,279.7	42,988.5	43,906.3	41,331.7
R&D	--	--	--	--	Other current assets	13,829.1	13,829.1	13,829.1	13,829.1
Other operating profit/(expense)	0.0	0.0	0.0	0.0	Total current assets	80,840.9	83,138.0	88,820.1	91,688.3
EBITDA	6,214.8	7,469.3	9,891.1	11,809.9	Net PP&E	24,879.0	26,375.0	27,773.3	32,648.2
Depreciation & amortization	(2,694.9)	(2,932.2)	(3,501.2)	(4,088.8)	Net intangibles	1,645.4	1,278.8	841.2	841.2
EBIT	3,519.9	4,537.1	6,389.9	7,721.1	Total investments	3,878.5	3,928.5	3,978.5	4,028.5
Interest income	--	384.1	401.7	447.0	Other long-term assets	0.0	0.0	0.0	0.0
Interest expense	(3,568.3)	(4,451.5)	(4,451.5)	(4,451.5)	Total assets	111,243.8	114,720.4	121,413.1	129,206.2
Income/(loss) from uncons. subs.	23.0	50.0	50.0	50.0	Accounts payable	20,136.0	22,593.6	26,978.5	31,506.4
Others	207.5	800.0	800.0	800.0	Short-term debt	13,590.2	13,590.2	13,590.2	13,590.2
Pretax profits	182.1	819.8	2,740.1	4,116.6	Other current liabilities	14,292.6	14,292.6	14,292.6	14,292.6
Income tax	(663.2)	(245.9)	(822.0)	(1,235.0)	Total current liabilities	48,018.8	50,476.4	54,861.3	59,389.2
Minorities	(30.3)	(20.0)	(20.0)	(20.0)	Long-term debt	29,128.8	29,128.8	29,128.8	29,128.8
Net income pre-preferred dividends	(511.4)	553.8	1,898.1	2,861.6	Other long-term liabilities	3,928.8	4,428.8	4,878.8	5,328.8
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	33,057.6	33,557.6	34,007.6	34,457.6
Net income (pre-exceptionals)	(511.4)	553.8	1,898.1	2,861.6	Total liabilities	81,076.3	84,034.0	88,868.9	93,846.8
Post-tax exceptionals	0.0	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	(511.4)	553.8	1,898.1	2,861.6	Total common equity	29,722.1	30,221.1	32,058.9	34,854.1
EPS (basic, pre-except) (Rs)	(1.59)	1.72	5.90	8.90	Minority interest	445.3	465.3	485.3	505.3
EPS (basic, post-except) (Rs)	(1.59)	1.72	5.90	8.90	Total liabilities & equity	111,243.8	114,720.4	121,413.1	129,206.2
EPS (diluted, post-except) (Rs)	(1.54)	1.67	5.72	8.62	BVPS (Rs)	89.50	91.00	96.53	104.95
DPS (Rs)	0.17	0.19	0.21	0.23					
Dividend payout ratio (%)	(10.7)	10.9	3.5	2.6					
Free cash flow yield (%)	9.0	20.8	22.2	24.6					
Growth & margins (%)	3/11	3/12E	3/13E	3/14E	Ratios	3/11	3/12E	3/13E	3/14E
Sales growth	(21.8)	12.2	19.4	16.8	CROCI (%)	11.2	12.6	14.0	14.7
EBITDA growth	70.5	20.2	32.4	19.4	ROE (%)	(1.7)	1.8	6.1	8.6
EBIT growth	156.5	28.9	40.8	20.8	ROA (%)	(0.5)	0.5	1.6	2.3
Net income growth	52.8	208.3	242.7	50.8	ROACE (%)	4.5	5.0	6.8	8.0
EPS growth	52.8	208.3	242.7	50.8	Inventory days	630.9	538.6	454.3	384.0
Gross margin	68.2	68.1	68.1	68.3	Receivables days	92.8	83.2	80.8	81.7
EBITDA margin	7.6	8.2	9.0	9.2	Payable days	296.4	266.8	259.2	263.5
EBIT margin	4.3	5.0	5.8	6.0	Net debt/equity (%)	128.2	125.4	116.8	104.6
					Interest cover - EBIT (X)	1.0	1.1	1.6	1.9
Cash flow statement (Rs mn)	3/11	3/12E	3/13E	3/14E	Valuation	3/11	3/12E	3/13E	3/14E
Net income pre-preferred dividends	(511.4)	553.8	1,898.1	2,861.6	P/E (analyst) (X)	NM	38.5	11.2	7.5
D&A add-back	2,694.9	2,932.2	3,501.2	0.0	P/B (X)	0.7	0.7	0.7	0.6
Minorities interests add-back	(0.7)	(0.7)	(0.7)	(0.7)	EV/EBITDA (X)	12.3	7.9	5.9	4.9
Net (inc)/dec working capital	3,465.2	345.7	(820.3)	2,675.2	EV/GCI (X)	0.9	0.7	0.6	1.3
Other operating cash flow	3,576.3	4,538.1	4,470.5	4,425.2	Dividend yield (%)	0.3	0.3	0.3	0.4
Cash flow from operations	9,224.3	8,369.1	9,048.8	9,961.4					
Capital expenditures	(5,837.4)	(4,061.7)	(4,461.8)	(4,875.0)					
Acquisitions	0.0	0.0	0.0	0.0					
Divestitures	0.0	0.0	0.0	0.0					
Others	0.0	384.1	401.7	447.0					
Cash flow from investments	(5,837.4)	(3,677.5)	(4,060.1)	(4,427.9)					
Dividends paid (common & pref)	(49.9)	(54.9)	(60.3)	(66.4)					
Inc/(dec) in debt	(1,835.5)	0.0	0.0	0.0					
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0					
Other financing cash flows	(3,568.3)	(4,451.5)	(4,451.5)	(4,451.5)					
Cash flow from financing	(5,453.6)	(4,506.4)	(4,511.9)	(4,517.9)					
Total cash flow	(2,066.8)	185.2	476.9	1,015.5					

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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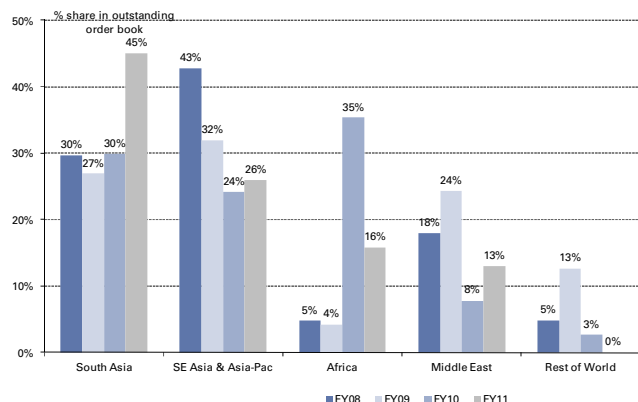
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Exhibit 1: Order book exposure to Africa reduced as part of Libya order book cancelled; however, 16% still exposed to Africa and will not contribute to FY12E revenues in our view

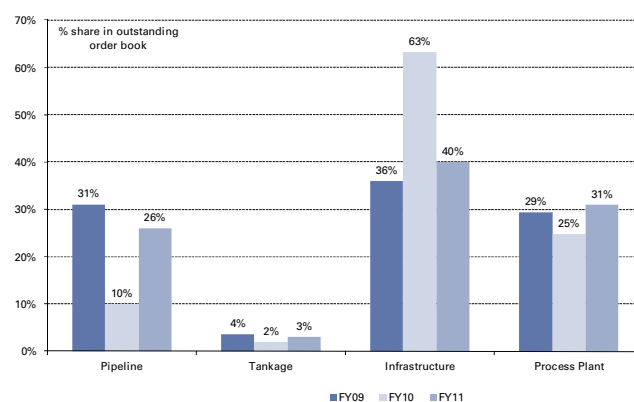
Order book composition by region



Source: Company data, Goldman Sachs Research.

Exhibit 2: Infrastructure orders still constitute majority of order book – the longer execution periods on these projects suggests an uptick in billings and improvement in receivables cycles is still some time away

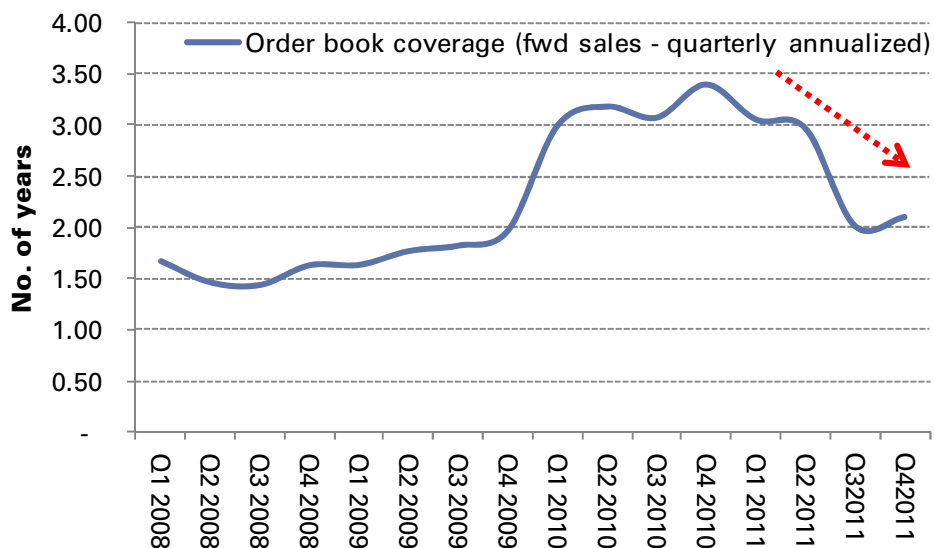
Order book composition by sub-sector



Source: Company data, Goldman Sachs Research.

Exhibit 3: Reduced order book impacts revenue visibility for Punj Lloyd, making not only execution but also order inflow relevant for future growth

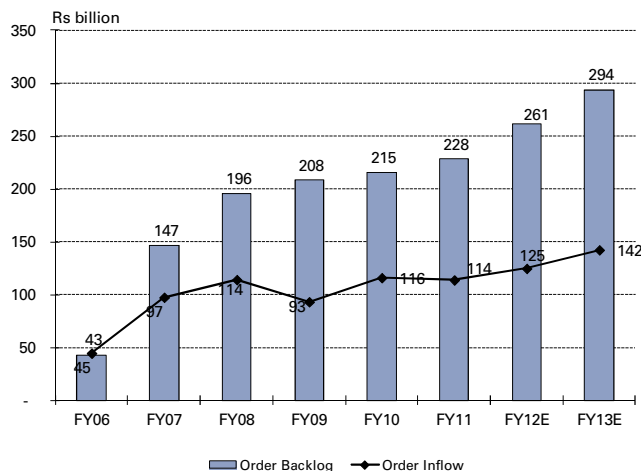
Order inflow coverage trend – quarterly basis



Source: Company data, Goldman Sachs Research.

Exhibit 4: We expect Punj Lloyd's order book to grow at a CAGR of 14% over FY11-13E

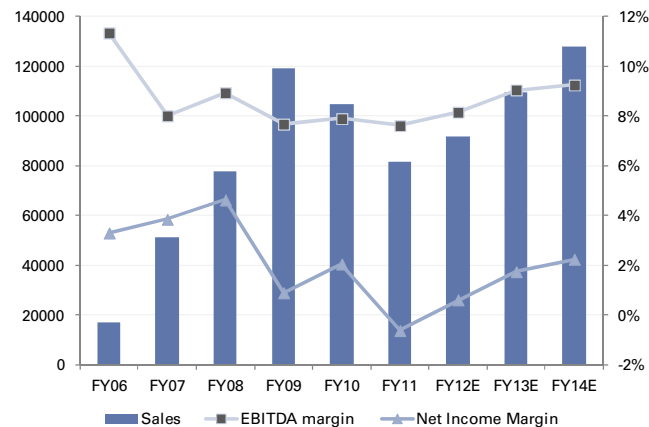
Order book and order inflow growth profile



Source: Company data, Goldman Sachs Research estimates.

Exhibit 5: Though we expect EBITDA margins to improve slightly from the lows of FY11, high interest expenses suggest net profit margin will remain <2% in FY12E-13E

Sales, EBITDA margin and net income margin trend



Source: Company data, Goldman Sachs Research estimates.

Exhibit 6: Though Punj Lloyd valuations are attractive vs its 5-yr median 12m-fwd P/B, we value the stock at 0.63X FY12E P/B given near-term headwinds to growth and reiterate our Sell

12m fwd P/B trend – Punj Lloyd



Source: Datastream, Goldman Sachs Research estimates.

Reg AC

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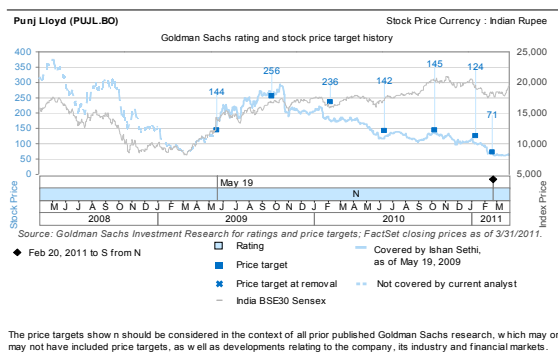
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