India
Research

HDFC securities
Invest Right

Initiating Coverage

Construction / Infrastructure

Punj Lloyd Ltd.

Punj Lloyd; takeoff from the growth runway

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BUY

CMP	Rs. 933
Target	Rs. 1,365
Stock Return	46.2%
Capital Appreciation	46%
Dividend Yield	0.2%

Nifty	4,107
Sensex	14,253

Key Stock Data	
Reuters Code	PUJL.BO
BLOOMBERG Code	PUNJ IN
No. of Shares (mn)	52.22
Market Cap (Rs bn)	48.72
Market Cap ($ mn)	1103
Avg. 6m Vol. (in mn)	0.20

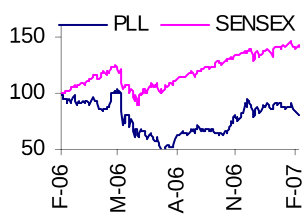
Stock Performance (%)

52 - Week high / low	Rs.1255/544		
	1M	3M	6M
Absolute (%)	-12.0	3.1	22.0
Relative (%)	-12.5	-3.0	-1.7

Shareholding Pattern	(%)
Indian Promoters	55
FIs & Local MFs	10
FIIs	22
Free Float (Others)	13

Source : BSE

Stock Movement



Investment Arguments

Bulging Order book = Visibility => Growth

PLL's [excluding SembCorp (SEC)] order book has grown from Rs.12 bn to Rs.103 bn as of 9MFY07. This was on account of fresh order inflows of Rs. 115 bn between FY06-07. We believe, the rate of order intake remains one of the fastest in the domestic industry. On a consolidated basis, the current order backlog is Rs.143 bn, with a book-to-bill ratio of 8.5x FY06 revenues, and 2.9x FY07E revenues.

Bigger the better

PLL's average order ticket size has improved dramatically. It started out with orders worth US$~30 mn, then moved up to ~US$100mn and now it is above US$200 mn. The ONGC order (Rs. 13 bn) and orders in Africa (Rs. 13 bn) are examples. The company hopes to achieve an average ticket size of US$300 mn soon. With the acquisition of SembCorp, PLL has gained a higher pre-qualification status and also an entry into niche businesses with minimum competition.

2nd largest EPC contractor of the country

L&T is the largest in the field and PLL comes 2nd in the domestic EPC arena. PLL competes with L&T in a majority of verticals viz. pipeline laying, tanks & terminals, process plants, civil infrastructure and now with the setting up of Simon Carves India, PLL hopes to compete with L&T on the engineering technology off-shoring vertical. Thus, niche and high margin verticals are likely to drive growth.

Valuations look exciting

We expect PLL (including SEC) to post a CAGR of 77% in revenues between FY06-09E and 99% in earnings for the same period. At the CMP of Rs.933, the stock trades at a PER of 17x and 11x our FY08E and FY09E EPS estimates of Rs.54 and Rs.84. It also trades at an EV/ EBITDA of 11x and 7x our FY08E and FY09E estimates. We have a 12-month price target of Rs.1365, an upside of 46%. We have arrived at the above target through a 3-stage DCF model. Key assumptions for the same are as follows; Cost of equity,14.5%, post-tax cost of debt, 8% and a WACC of 13.8%. We are positive on the prospects of PLL going forward and initiate coverage with a **'BUY'** rating on the stock.

(Rs. mn)	FY06	FY07E	FY08E	FY09E
Net Sales	16846	49396	71414	94114
% Ch. Y-o-Y	*-6%*	*193%*	*45%*	*32%*
Net Profit	555	1579	2826	4377
% Ch. Y-o-Y	*-45%*	*185%*	*79%*	*55%*
EPS (Rs)	13	30	54	84
YoY Gr. (%)	*-55%*	*137%*	*79%*	*55%*
PER (x)	73	31	17	11
EV/EBITDA (x)	24	16	11	7
Book value (Rs)	215	243	295	377
P/BV (x)	4.3	3.8	3.2	2.5
Debt/Equity (x)	0.49	1.45	1.44	1.30
ROCE	3%	3%	4%	5%
ROE	7%	13%	20%	25%

Source : HDFC Sec. Research

SWOT Analysis

Strengths

- Dominant player in the oil & gas EPC space
- Geographic diversification reduces risk of slowdown in a particular continent. In FY06, 58% of revenues came from South Asia, 22%, 10% and 10% from Asia Pacific, Caspian and Middle East respectively.
- Present in low gestation period projects only, barring the incomplete Assam road project
- Acquisition of SEC gives it better pre-qualification status than domestic peers.
- Simon Carves, UK (100% subsidiary of SEC) gives access to niche projects in the petrochemical space.

Weakness

- On fixed price projects, PLL is exposed to significant construction risks
- High working capital requirement (across the industry phenomenon), could impact profitability in terms of higher interest costs or possible equity dilution.
- Exposed to geo-political risks in foreign countries of operation.

Opportunities

- Off shoring of high end engineering jobs to Simon Carves India, will help improve margins and also serve a niche segment.
- Government's increased impetus on infrastructure development. US$320 bn is the planned expenditure on India's infrastructure over the next 3-5 years.
- Orders from Saudi Arabian JV for King Abdullah Economic City. The total cost of building the city is US$33 bn.
- Medicity, India's first medical SEZ will mark PLL's entry into the SEZ construction business. PLL has currently invested Rs.1350 mn in the project.
- New gas finds across India's eastern coastline will require pipelines and gas terminals for transportation and storage.

Threats

- Reversal of trends in any of the sectors it caters to.
- Acquisition of SEC depressed its margins; covering lost ground could take longer than expected.
- International competition from the likes of Bechtel, Vinci etc. and domestic peers such as L&T.

Peer Comparison

PLL is one of India's largest engineering and construction companies. It comes close to L&T in terms of services offered. It also trades at a discount to L&T, due to the latter's size and niche capabilities.

We believe, it is justified for PLL to trade at a premia in comparison to domestic peers barring L&T, due to the quality of services it offers and its scale of operations. But, it is currently trading at a steep discount, which we believe is unwarranted and expect the valuation gap to narrow in the near future.

Companies		EPS (Rs.)	P/E (x)	BV (Rs.)	P/BV (x)	ROE (%)	EV / EBIDTA (x)	CMP (Rs.)
Punj Lloyd	**FY07E**	**30.2**	**30.9**	**243.0**	**3.8**	**14.4**	**16.1**	**933**
	FY08E	**54.1**	**17.2**	**295.0**	**3.2**	**19.2**	**10.7**	**933**
HCC	FY07E	3.8	32.4	39.0	3.2	10.5	18.0	123
	FY08E	5.8	21.4	42.9	2.9	14.4	14.5	123
L&T	FY07E	52.7	31.7	216.7	7.7	26.5	27.5	1668
	FY08E	67.1	24.8	266.5	6.3	27.3	20.0	1668
IVRCL	FY07E	12.7	28.4	65.2	5.6	20.1	21.0	362
	FY08E	18.5	19.6	81.5	4.4	25.5	15.4	362
Nagarjuna Construction	FY07E	8.6	22.1	52.4	3.6	17.1	15.0	191
	FY08E	12.3	15.5	62.3	3.1	21.2	11.5	191

***Data as of 20/02/2007*

Source : Industry, HDFC Sec. Research

Companies		Book- to-Book Bill (x)	EBITDA (%)	NPM (%)	Fixed Asset T/o	Order Inflow (Rs. Bn)	% Ch. Y-o-Y	Order (Rs. Bn)	%Ch. Y-o-Y
Punj Lloyd	**FY06**	**8.5**	**13.2**	**3.3**	**2.9**	**45**		**52**	
	FY07E	**2.9**	**7.9**	**3.2**	**4.4**	**80**	**78%**	**144**	**177%**
	FY08E		**9.2**	**4.0**	**6.1**	**103**	**29%**	**166**	**15%**
HCC	FY06	4.8	9.2	4.2	1.3	60		100	
	FY07E	3.8	9.4	4.6	1.1	45	-25%	96	-4%
	FY08E		9.5	5.1	1.5	50	11%	135	41%
L&T	FY06	2.2	7.7	6.8	1.7	223		246	
	FY07E	2.0	8.2	6	2.8	229	3%	357	45%
	FY08E		8.6	6.6	3.4	320	40%	460	29%
IVRCL	FY06	4.6	9	6.2	1.7	40		67	
	FY07E	3.0	9.1	6	1.5	40	0%	75	12%
	FY08E		9.4	7	1.4	48	20%	85	13%
Nagarjuna Construction	FY06	3.6	8.9	5.6	1.8	36		55	
	FY07E	2.5	9	5.8	2.0	36	-2%	70	27%
	FY08E		9.3	6.2	2.6	45	26%	92	31%

***FY07E Order inflow and backlog are as of 9MFY07*

Source : Industry, HDFC Sec. Research

With a book-to-bill ratio of 8.5x FY06 and 2.9x FY07E revenues, PLL compares well with the others in the industry, in terms of visibility in revenues over FY07-08E. But, it does not compare well on the margin front, as its operating and net margins are the lowest (on account of SEC acquisition). However, we expect PLL to catch up by FY08E.

As PLL scales up with a higher value order intake capacity, we expect it to achieve a higher asset turnover from 2.9 in FY06 to 6.1x in FY08E. PLL's order inflows are among the fastest growing (CAGR 51%) in the domestic industry. Robust order book and inflows represent visibility and growth in revenues over FY06-09E at CAGR 77%.

Business Description

PLL is one of the largest construction companies in India, providing integrated design, engineering, procurement, construction and project management services for the oil & gas industry and infrastructure sector projects. Some of the major services it provides, are engineering construction for onshore and offshore pipelines, gas gathering systems, oil and gas tanks and terminals, process facilities in the oil and gas industry, including refineries and for power plant projects. In the infrastructure sector, the company has worked on various civil infrastructure projects for highways, flyovers and elevated railroads.

With the acquisition of SEC, PLL now has its presence in the niche petrochemical business, and high-end urban infrastructure services (MRT, Airports, Ports etc).

PLL operates in 5 major geographies i.e. Asia Pacific, the Caspian, Middle East, Africa and South Asia. As of FY06 ~40% of its revenues were generated from projects executed outside India.

Hence, PLL's business can be put into 4 verticals viz.

- Oil & gas pipeline laying
- Process plants
- Tanks & terminals
- Civil/Urban infrastructure

Pipelines

PLL has an extensive track record of laying pipelines for oil majors around the world. This is its core competence. PLL has successfully executed onshore as well as offshore (shallow water) projects. With its technology, it has capabilities to execute orders for laying pipelines of 50" diameter in all terrains and on offshore projects, it can go up to 30 meters deep. As of FY06 PLL has executed about 8000 kms of pipeline projects.

In terms of revenue, this segment contributed 50% (Rs.8.5 bn) and 22% (Rs.7.5 bn) of FY06 and 9MFY07 respectively. It also has the highest margin in comparison to the other verticals. Going forward, we expect pipelines to contribute ~45% of revenues of PLL (excl SEC) in FY08E and ~48% in FY09E.

Domestic Outlook for Pipeline projects

India has a host of crude, product, natural gas and LPG pipelines. Recent gas discoveries, and the proposed LNG terminals are expected to lead to new pipeline infrastructure requirements. Similarly, product pipelines also may see growth, with new refineries being set-up. Above all, trans-national pipelines too throw up opportunities in excess of US $ 5 bn. The Rs.13 bn (US$ 290 mn) order from ONGC for the Heera platform re-development goes to show the robust demand from oil and gas companies. Offshore platform services were L&T's domain, but PLL secured this prestigious order, and cemented our conviction on its capabilities in the segment.

Trans-national Pipelines in the offing

Pipeline	Time line	Project cost	Pipeline in Km
Iran-Pak-India	Talks to begin in June 2007	US$ 4 bn	2000
Myanmar-Bangladesh-India	Talks on since Mar 2004	US$ 1 bn	800
Turkmenistan-Afghanistan-Pakistan	Talks on since 2005	Not known	Not known

Source: HDFC Sec Research

Break down per region-All future pipeline projects

Region	No. Of Projects	% Of Total	Total Length		Avg. Length	
			Kms.	Miles	Kms.	Miles
North America	210	45%	65988	41112	314	196
Latin America	41	9%	31654	19718	772	481
Europe	55	12%	22565	14027	410	255
Africa	21	5%	12036	7482	573	356
Middle East & Asia	119	26%	76074	47111	639	396
Australasia	18	4%	13673	8497	760	472
Total	**464**		**221990**	**137947**	**578**	**359**

Source: Simdex, Data as of Sept 2006

Process Plant Facilities

Oil and gas companies in the course of producing and processing oil, gas and derivative products require process facilities. PLL, has already executed contracts for gas gathering and process facilities, vis-breaker, crude distillation and hydrocracker units, among others. The Supreme Court of India in 2000 passed a judgement, which required all refineries operating in the country to re-furbish their process facilities every 10-15 years and this has augured well for PLL which, along with L&T, is the only company that provides this service in India.

Process plant services generated 3% and 5% of total revenues during FY06 and 9MFY07 for PLL (excl SEC). SEC, through its subsidiary Simon Carves, is also a major player in this segment . For the period ending 9MFY07, it contributed 52% (Rs.8.7 bn) of SEC's revenue of Rs.16.9 bn. We expect this service to ramp up and contribute ~10% of PLL's revenues (excl SEC) in FY08E and FY09E respectively.

In terms of margins, these services do not command the same returns as pipelines, because most of the work relates to procurement, which is a very low margin business (3-4%). The ideal time period for a process facility contract is 15-20 months.

During FY06-07, PLL secured two orders from IOC with a total value of Rs. 11.6 bn. The contracts awarded were on EPC basis for the Hydro-cracker (capacity 1.7 MMTPA) and Hydrogen generation unit (capacity 70,000 TPA). The hydro-cracker turnkey contract will make PLL the first company to execute such a unit on an EPC basis.

Domestic Outlook for Process Plants

The adoption of Euro norms (Euro III & IV)/ British Standard (BS II) , Gas-To-Liquid projects will enhance opportunities in the hydrocarbon midstream and downstream sectors. In the last five years, the downstream sector has witnessed additions in refining capacities and the trend is expected to continue with some new, major capacities also getting off the ground. It is expected that by 2011, the refining capacity of the country would increase from 127.4Mtpa to 212.75 Mtpa, calling in for additional investments in this space which augurs well for PLL

Domestic Refinery Capacity Additions

Capacity in Mtpa	FY05	FY07E	FY09E	FY11E
IOC	54.20	60.20	60.20	69.20
BPCL	17.40	22.50	22.50	31.00
HPCL	13.00	13.00	22.00	25.40
MRPL	9.69	9.69	15.00	15.00
RPL	33.00	33.00	60.00	60.00
Essar Oil	0.00	12.00	12.00	12.00
Tatipaka	0.08	0.15	0.15	0.15
Total	**127.37**	**150.54**	**191.85**	**212.75**

Source: HDFC Sec Research

Tanks & Terminals

The transportation of oil and gas necessitates setting up of huge storage tanks and terminals at the point of production, exploration and refining/processing of derivative products. This vertical completes PLL’s service offerings to the oil and gas sector. As for the transportation of the product (through pipelines), to process facilities, and then storing the final output in floating, fixed-roof storage tanks and cryogenic storage terminals, including LNG storage and re-gasification terminals, PLL is the best in the business in the South Asian market. It has built all the 3 gas terminals in India (Dahej, Dhabol & Hazira) and is in line with global majors, including Bechtel and Vinci, in terms of technology and execution capabilities.

Revenues from this segment were 22% (Rs.3.8 bn) and 8% (Rs.2.8 bn) for FY06 and 9MFY07 respectively. Going forward, we expect tanks and terminals to continue to contribute in the same fashion as in FY06.

PLL was awarded the contract to build a bulk storage terminal at Jurong Island, Singapore. This contract included building 20 tanks as part of the phase III expansion plan on the island. The company has already worked on phase I and phase II of the project by building 30 and 50 tanks in each of the phases respectively. Usually, a project of this size takes 15-20 months to complete and is worth Rs.3 bn.

Domestic Outlook for Tanks & Terminals segment

We believe gas supply will get a major boost from the commencement of RIL's KG D-6 gas production (December 2008), followed by GSPC's find in the KG basin, higher production from Tapti, Panna-Mukta and new sources of supply from proposed and expanded LNG terminals. This increase in domestic production of gas would require additional investments in the pipeline segment. However, it is difficult to assign a number at this stage. The three new proposed LNG terminals, along with expansion possibilities at present terminals, speaks for Punj Lloyd's addressable market potential.

Terminal	Status	Capacity	Date on stream	Companies
Hazira	Completed	2.5 Mtpa (expandable to 10 mtpa)	2004	Shell, Total
Dahej	Completed	5 Mtpa (expandable to 12.5 mtpa)	2004	Petronet LNG
Kochi	Under Construction	2.5 Mtpa (expandable to 5 mtpa)	2009	Petronet LNG
Dabhol	Recently revived	5 Mtpa	2007	Not decided
Mangalore	Proposed	5 Mtpa	2010	ONGC
Ennore	Proposed	5 Mtpa	2010	IOC

Source: HDFC Sec Research

Civil/Urban Infrastructure

India is expected to garner ~US$320 bn worth of investments for improving its existing infrastructure facilities over the next 3-5 years. PLL offers engineering construction services for various infrastructure projects including highways, flyovers, and elevated railroads. It also provides engineering construction services for power plants and is currently working on a 2 x 250 MW thermal power plant at Chhabra, Rajasthan. The company is also working on road projects in Assam and Rajasthan. But, its Assam projects have been delayed due to right-of-way issues, excessive monsoons and terrorism. However, the management indicated that all issues had been sorted out and work was going on at a scorching pace. It expected revenues to start coming in by H2FY08E.

The ideal time frame for road and power projects is 24-30 months and margins for roads are in single digits (6-7%) and for power plants ~10-12%. In FY06, infrastructure projects constituted 19% of PLL's (excl SEC) overall revenues; while during 9MFY07 it was 17%.

SEC's capabilities in executing projects in the urban infrastructure segment, including setting up SEZs, Mass Rapid Transport systems (MRT), Jetties, Airports etc, bodes well for PLL, going forward. Revenues from the infrastructure sector contributed 20% of SEC's 9MFY07 total revenues. During FY06-07, PLL entered into two landmark agreements in the infrastructure space, viz.

a) Construction of India's first medical SEZ Medicity in Gurgaon, where the company has already invested Rs.1.35 bn for a 17% stake. The work is expected to begin in April 2007.

b) A 49:51 JV with a Prince of Saudi Arabia for the US$33 bn King Abdullah Economic City. The entity will handle engineering, procurement, construction, water and sewage sectors, civil infrastructure and industrial projects in the Economic City and in Saudi Arabia as well.

Domestic Outlook on Infrastructure

We remain positive on the prospects of PLL & SEC combine in the infrastructure space, given the huge investments likely to be pumped into the Indian economy for further improvement of domestic infrastructure.

Power: The government has planned huge capacity additions in the 10th and the 11th plans to tide over the power deficit in the country. In fact, it has plans to add around 1,00,000 (MW) by the end of the 11th plan (40000 MW in 10th & 69000 MW in 11th by 2012). But, the government has been lagging behind in achieving the target set for the 10th plan. Consequently, the capacity additions in the 11th plan are expected to be higher, to cover up for the shortfall. The Ministry of Power projects a total investment of Rs 9 trillion in the power sector (Rs 4 trillion in the 10th plan and Rs 5 trillion in the 11th plan).

Roads: Road sector activity in India gathered momentum towards the end of 2004. In 2005, the National Highways Authority of India (NHAI) awarded contracts for stretches totaling 5,000 km, the highest ever made under the National Highway Development Programme (NHDP), since it was launched in 2000. Since the high in 2005, there has been a temporary slowdown in awarding contracts. This is expected to revive in 2007.

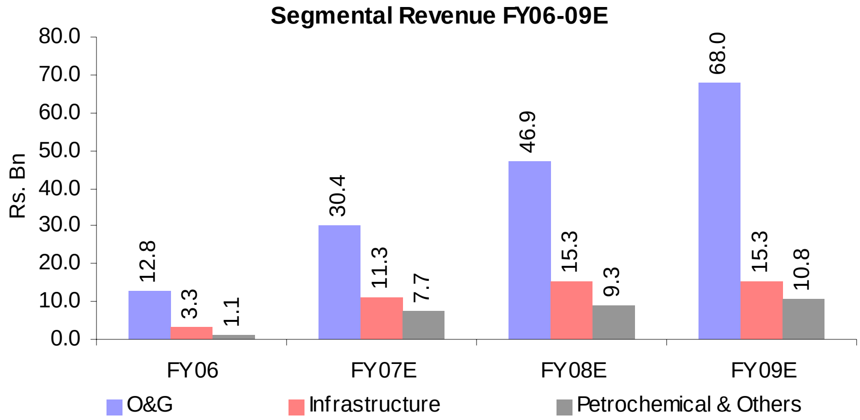
Vision 2021 plan[1]

Scheme	2001-2011		2011-2021	
	Length (Kms)	Amount (Rs billion)	Length (Kms)	Amount (Rs billion)
Expressways	**3,000**	**300**	**7,000**	**700**
National highways	**61,000**	**1,200**	**62,000**	**1,300**
I) Four-laning/six-laning	16,000	640	19,000	760
ii) Two-laning	15,000	188	7,000	88
iii) Strengthening weak pavements	20,000	150	24,000	180
iv) Bypasses, ROBs etc	Lumpsum	73	Lumpsum	93
v) Expansion of NH system	10,000	150	12,000	180
State highways	**78,000**	**750**	**127,000**	**1,250**
I) Four-laning/six-laning	3,000	100	7,000	250
ii) Two-laning	35,000	280	60,000	500
iii) Strengthening weak pavements	30,000	220	40,000	300
iv) Bypasses, ROBs etc	Lumpsum	100	Lumpsum	100
v) Expansion of SH system	10,000	50	20,000	100
Major district roads	**100,000**	**400**	**130,000**	**600**
i) Two-laning	20,000	120	40,000	240
ii) Strengthening weak pavements	30,000	150	40,000	200
iii) Improving riding quality	50,000	50	50,000	50
iv) Bypasses, ROBs etc	Lumpsum	50	Lumpsum	50
v) Expansion of MDR system	Lumpsum	30	Lumpsum	60
Total	**242,000**	**2,650**	**326,000**	**3,850**

[1] At year 2000 price levels

NH: National highways; SH: State highways; MDR: Major district roads; ROB: Rail overbridges

Source: IRC (Road development plan – Vision 2021); Cris Infac



Source: Company, HDFC Sec Research

Order Backlog & Order Intake

In this section, we would like to highlight the phenomenal growth of PLL in terms of its order inflow and backlog. From Rs.12 bn in FY05, PLL's order backlog has grown to Rs.143 bn as of 9MFY07 (includes Rs.39 bn of SEC).

In FY07, the company secured orders at a very fast pace and this trend is likely to continue, given that now it has a higher pre-qualification status with the acquisition of SEC, and its entry into newer business segments including petrochemicals and urban infrastructure. As compared to other domestic peers, the execution cycle of the current order book is shorter at ~24 months.

Average Execution Cycle

Pipelines	12-15 months
Process Plants	15-20 months
Tanks & Terminals	15 months
Infrastructure (Roads, Power Plants)	24-30 months

Source: Company

The order inflow as of 9MFY07 was ~Rs.80 bn as compared to Rs.47 bn in FY06. We expect the current backlog and inflow to generate revenues at a CAGR of 77% over FY06-09E.

Order Inflows Details for contracts over Rs. 2500 Mn during FY06-07

Client	Scope of Work	Start Date	Location	Rs. Mn
Oil & Gas				
Agip Operating company N.V.	Pipeline	Jun-06	Kazakhastan	3,573
Jurang Consultants PTE Ltd	Storage Tanks	Dec-06	Singapore	3,009
IOC Ltd.	Process Plant Hydrogen Unit	Nov-06	Haldia	3,461
IOC Ltd.	Process Plant Hydrocracker Unit	Nov-06	Haldia	9,971
ONGC	Heera redevelopment	Jan-07	Heera Offshore Platform	12,887
Qatar Petroleum	DUPRP	Nov-06	Doha	8,078
Sirte Oil Company	Pipeline from El Khoms to Tripoli	Aug-06	Libya	6,557
Sirte Oil Company	Pipeline from Tripoli to Melita	Aug-06	Libya	6,929
YEMGAS	Process Plants	Aug-06	Yemen	3,218
IOCL	Storage Facilities	Sep-06	Panipat	3,497
Doha International Airport	Process Plant	Mar-06	Doha	3,552
Total Oil & Gas				**64,732**
Roads				
RIDCOR	Improvement and maintenance	Jan-06	Rajasthan	2,624
RIDCOR	Improvement and maintenance	Jul-06	Rajasthan	2,778
Total Roads				**5,403**
Power & Others				
Rajasthan Power	2 x 250 MW Chhabra Thermal Power project	Aug-06	Rajasthan	8,230
Total Power & Others				**8,230**
Grand Total				**78,365**

Source: Company

Key Growth Arguments

Acquisition of SEC – Synergies Unlimited….: In FY06, PLL acquired Singapore based SEC (S$ 1 bn in revenues) for a consideration of S$40 mn. SEC was a wholly owned subsidiary of SembCorp Industries (SCI), a leading utilities and marine group based out of Singapore.

The reasons for acquiring SEC were to:

a) Create synergies between PLL and SEC,

b) Help PLL to grow inorganically and attain a higher pre-qualification status, so that it could compete in the global arena.

c) Enter new verticals of business, such as urban infrastructure (ports, jetties, SEZ's, airports etc) and petrochemicals (through Simon Carves, UK)

Prior to the acquisition, PLL had its presence only in the construction part of EPC contracts, while SEC was a dominant player in engineering and procurement (due to which it had low margins). Construction was outsourced. Hence post-acquisition, it made PLL a complete EPC service provider, and also gave it access to SEC's technology & customer base spread across countries, and its order book.

Another major positive move was the acquisition of Simon Carves, UK (100% subsidiary of SEC). Simon Carves is a niche player in the petrochemical and process plant segment and enjoys minimum competition.

Currently, PLL is undergoing a consolidation phase, due to which, its top line growth is intact, but it has taken a hit on operating margins, due to lower margins of SEC. In the medium to longer-term perspective, we are positive this acquisition will help PLL as the positives outweigh the negatives. The result can already be seen in the ONGC contract (Rs. 13 bn) that PLL secured post-acquisition. However, it will take until FY09E for margins to start recovering and come close to the 11%-12% mark.

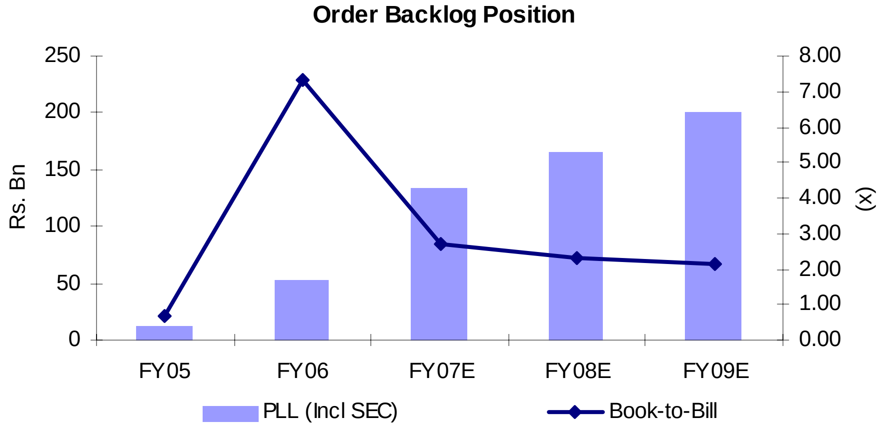
The group business is likely to be restructured as shown below.

PLL	SEC	Simon Carves
Pipelines, Tanks & Terminals (South Asia, Middle East, Caspian, Africa)	**Pipelines** (South East Asia, China, EU)	
Process Plants (South & South East Asia and Caspian)		**Process Plants** (EU, Middle East, China)
Infrastructure (South Asia, Middle East, Caspian)	**Infrastructure** (South East Asia, China, EU)	
		Petro Chemicals (Global operations)

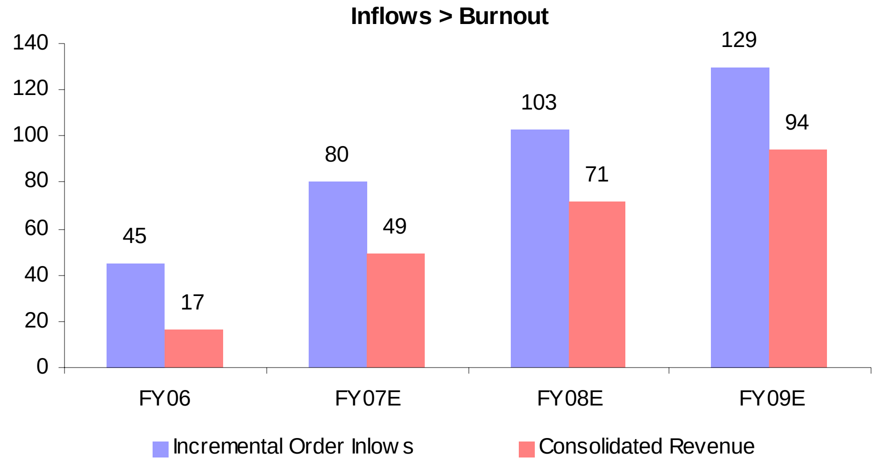
Source : HDFC Sec. Research

Bulging Order Book – Translates into robust revenue growth

PLL's current order book of Rs.143 bn has grown from Rs.12 bn in FY05. This is commendable as it was achieved in just two years. The current order book and order inflow (Rs.80 bn) will translate into a revenue growth of 77% CAGR over FY06-09E from Rs.16 bn to Rs.94 bn.



Source: HDFC Sec Research



Source: HDFC Sec Research

Order book diversified – But skewed towards oil & gas

To de-risk itself in case of a slowdown in any of the verticals or geographies, PLL has made a conscious effort to diversify its order book. However, it is tilted towards the oil and gas sectors and South Asia, because of brisk activity in the domestic as well as international markets.

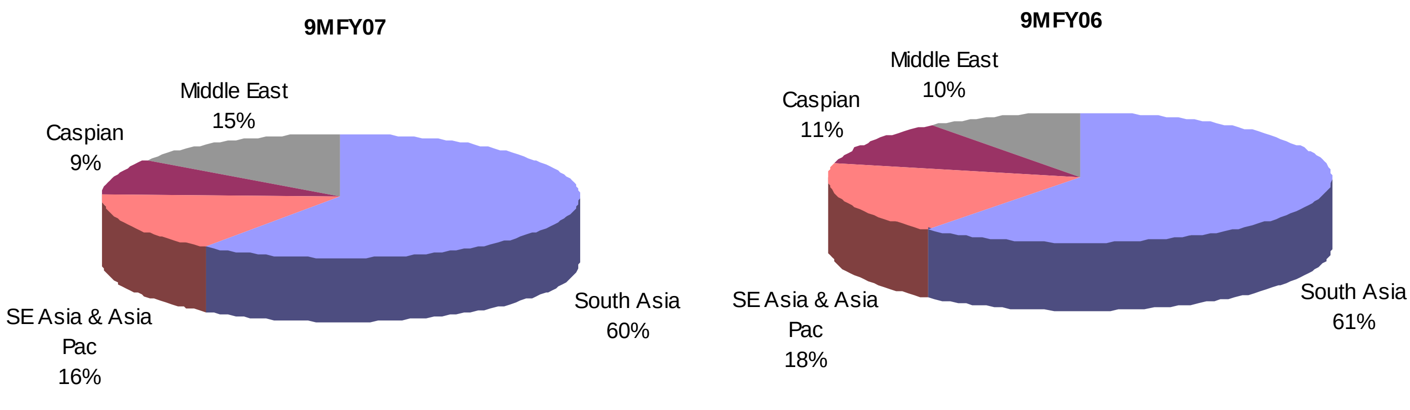
Going forward, the management indicates it will continue to concentrate on oil and gas sectors, but in terms of geography, it could look to newer regions like Africa and Russia. The company entered the African market of Libya for a pipeline contract worth US$290 mn (Rs. 13 bn) only in FY06-07 (after US sanctions were lifted). Hence, we expect oil and gas sectors to contribute to both fresh order inflows and revenues. But in case of regions, we believe PLL will move away from the South and South East Asian markets. Post-acquisition of SEC, we believe newer businesses will be added, including urban infrastructure and petrochemicals. Newer territories could include Europe and China.

PLL Consolidated Order Book as of 9MFY07

(Rs. mn)	South/South East Asia	Middle East & Africa	Rest of World	Total	% Of Total
Petro Chemicals	10263	7379	4502	**22144**	***15%***
Oil & Gas	45641	28686	3384	**77711**	***54%***
Civil Infrastructure & Power	41760	1963	0	**43723**	***30%***
Total	**97664**	**38028**	**7886**	**143578**	***100%***
	68%	***26%***	***5%***	***100%***	

Source : Company

Geographical break-up of Revenue (Excl SEC)



Source : Company

Newer Investment Avenues

- **Saudi Arabia JV (King Abdullah Economic City):** PLL has formed a JV with a Saudi Arabian prince and the venture is called Dayim Lloyd Engineering. PLL holds a 49% stake in the JV and the prince, the balance. The primary investment idea behind this venture is to be a part of the US$ 33 bn King Abdullah Economic City (KAEC) being built in Saudi Arabia. Opportunities in KAEC are immense in terms of onshore and offshore projects for oil and gas sectors, power, petrochemicals, civil infrastructure and industrial projects etc. The prince will be the liaison between PLL and the local authorities, and will help PLL gain a foothold in the Saudi market. We expect orders from KAEC to start flowing in from H2FY08E, and believe investments of this kind will help PLL attain a global face and help the company to enter newer territories.
- **Medicity, Gurgaon:** This is considered India's first medical SEZ. It is a US$250 mn venture, where multiple healthcare groups (Fortis, Escorts etc) across the country and the world, will invest and set up a state of the art medical facility. PLL has invested Rs. 1350 mn in this venture. The opportunities for the company are in design and construction of buildings, internal roads and other infrastructure. Orders from the project are expected to start kicking in from Q1FY08E. This will be PLL's first venture into urban infrastructure and with SEC's technological capabilities, we expect this venture to contribute substantially to its revenue.

Larger contracts- Order of the day

With its focus on high value contracts, PLL is scaling up the value chain and coming close to L&T's proportions. As mentioned earlier, the company is now targeting orders with an average size of US$200 mn and going forward, it will bid for projects of US$300 mn or more. Advantages of large size contracts are, a) margins are higher, b) competition is on a global scale and c) better asset turnover is achieved.

It is evident from the FY07 order inflow statement that PLL is scaling up the value chain. The following are some of the larger contracts won during the year:

Client	Scope of Work	Start Date	Location	Rs. Mn
ONGC	Heera redevelopment	Jan-07	Heera Offshore Platform	12,887
Qatar Petroleum	DUPRP	Nov-06	Doha	8,078
Sirte Oil Company	Pipeline from El Khoms to Tripoli	Aug-06	Libya	6,557
Sirte Oil Company	Pipeline from Tripoli to Melita	Aug-06	Libya	6,929
Rajasthan Power	2 x 250 MW Chhabra Thermal Power project	Aug-06	Rajasthan	8,230
RIDCOR	Improvement and maintenance of State Highways	Jan-06	Rajasthan	2,624
RIDCOR	Improvement and maintenance State Highways	Jul-06	Rajasthan	2,778

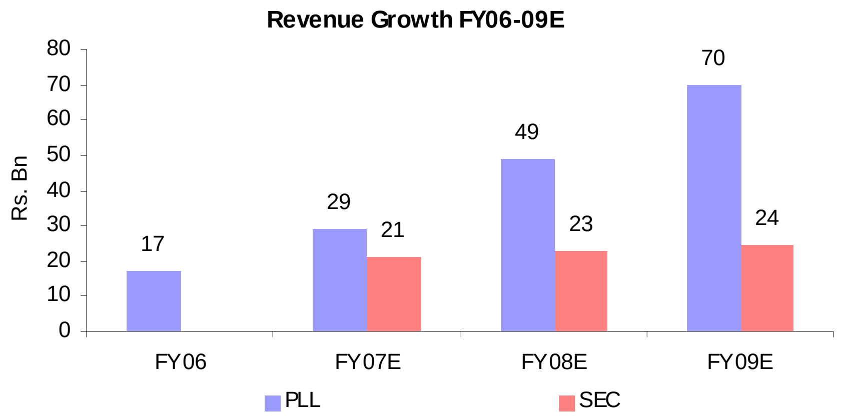
Source: Company

Financial Evaluation

Revenues- Heading Northwards

The current order backlog of PLL as of 9MFY07 is Rs.143 bn (including Rs.39 bn of SEC); the average execution cycle for the same is ~24 months. YTD, the company has witnessed an order inflow of Rs.80bn, as against Rs.47 bn during FY06. This will translate into a revenue growth of 77% CAGR over FY06-09E.

We have taken into account the consolidated numbers of PLL, including SEC. However, we have calculated the operating margins of both the companies independently, as it would give us a true sense of margins that both of them have. On the consolidated front, we expect PLL's revenues to grow at a CAGR of 77% over FY06-09E, from Rs.16 bn to Rs.94 bn. This will primarily be on account of faster execution of orders and the robust scenario prevailing in the oil, gas and infrastructure sectors, domestically and globally. The company has also graduated into the next level of order bidding. It used to initially bid for orders sub-US$100 mn and now it has put in bids for contracts above US$ 200 mn. The Rs. 13 bn (US$290 mn) ONGC order is a case in point.



Source: Company, HDFC Sec Research

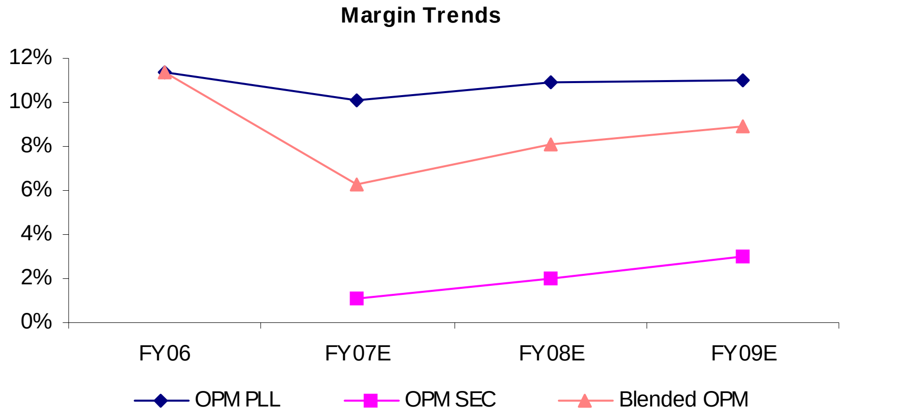
SembCorp Financials (Rs Mn)	FY07E (10 months)	FY08E	FY09E
Revenues	**20721**	**22726**	**24340**
% Growth		***10%***	***7%***
Operating Expenditure	20504	22272	23610
Operating Profit	**217.57**	**454.53**	**730.20**
OPM (%)	*1.1%*	*2.0%*	*3.0%*

Source: HDFC Sec Research

Margins- Stabilizing in FY08E; but needs to cover lost ground & fast

Post acquisition of SEC, PLL witnessed a huge fall in its operating margins. SEC, which was in a sell mode for nearly 3 years is present in highly developed markets. It did not enjoy margins as high as PLL's. In 9MFY07, SEC had an operating margin (OPM) of 1%. SEC's order book of Rs.39 bn still contains orders, which have low margins, and hence we believe SEC will not contribute substantially to the consolidated operating margins until H2FY08E.

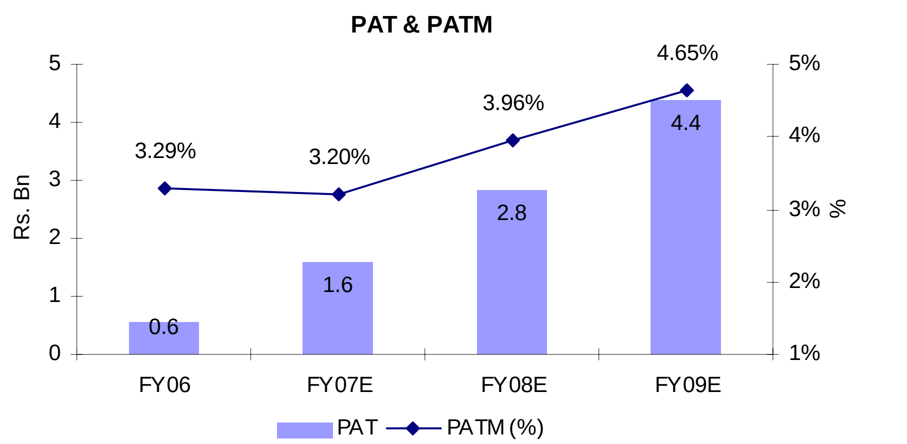
However, the management seems positive on the margins. It intends to include high margin contracts in SEC's backlog from FY08E and revive its OPMs. PLL ex-SEC would see a marginal expansion of 90 bps from 10.1% to 11%. Going forward, we believe, it would take longer than expected for PLL to regain the OPMs it enjoyed prior to FY06. But, we remain positive that some of the lost ground would be covered by a blended margin expansion of 260 bps over FY07-09E from 6.3% to 8.9%, on account of larger deals and niche contracts with higher margins and minimum competition.



Source: HDFC Sec Research

Bottomline

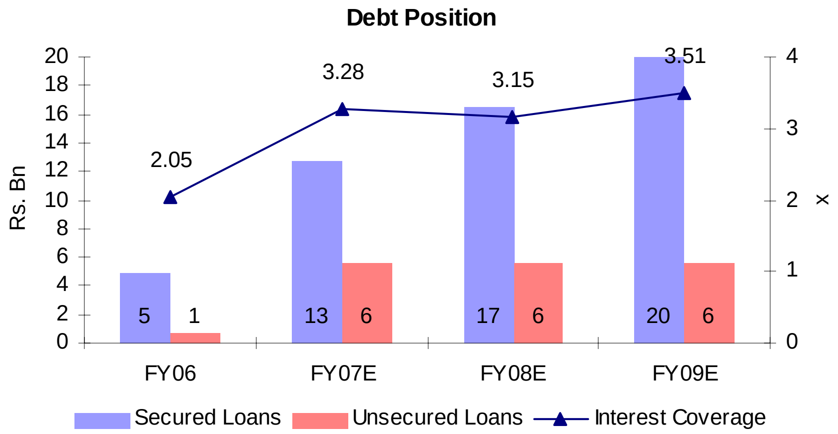
We expect PLL to post a PAT growth of 99% CAGR over FY06-09E. SEC's contribution to bottomline will be negligible, as it has just come into the green during 9MFY07. Net margins are likely to expand by 130 bps between FY07-09E from 3.2% to 4.65%. But they will remain under pressure due to higher interest costs.



Source: HDFC Sec Research

Working Capital Requirements

The industry, where PLL operates, needs huge working capital. As the company operates in diverse locations, expenses, particularly for large orders take some time to recover. The ideal working capital cycle for PLL is 120-130 days. As the company secures orders at a fast pace, we expect it to take term loans to finance its working capital needs. This will increase its debt component and interest cost. With rising interest rates, equity dilution cannot be ruled out.



Source: HDFC Sec Research

Derivation of Fair Price

We have derived our fair price of Rs. 1,365 by the 3-stage DCF model. Our key assumptions for the same are shown below:

At the CMPof Rs. 933, we believe, there will be no further downside, as the pessimism about the outlook on margins and the possible equity dilution have been factored in. Going forward, we believe the quality of contracts secured by PLL , faster execution cycle and the synergistic effect of SEC that will begin to flow in from H2FY08E, will drive PLL's growth trajectory.

DCF Assumptions	(Rs. Mn)
DFCF-Total	18,617
Terminal Value	56,689
Total Entity Value	75,306
Less: Debt	(5,550)
Add: Cash	1,106
Add: Investments	416
Equity value	71,279
No. of Shares	52.2
DCF Value/share	**1365**
Key Assumptions-	
Risk Free Rate	7.5%
Mkt. Premium	5%
Beta	1.4
K_e	14.5%
Post -Tax K_d	8%
WACC	13.8%
Terminal Growth Rate	5%

Off the News Rack

- The company has announced that it plans to reorganize its authorized capital by canceling the provision for 100 mn preference shares and increasing the equity capital by the same amount of shares.
- The company has also announced a stock spilt in the ratio of 1:5. The face value of the stock will be reduced to Rs.2 from Rs.10. Equity capital post-spilt will increase from 52.22mn shares to 261 mn shares.
- The company plans to make a preferential placement of 80,00,000 warrants to the promoters, after necessary approvals from shareholders. This, we believe, is positive as it shows the promoter is not ready to dilute his equity any further and instead is investing in the company.
- A placement of equity share, debentures (unsecured), bonds to domestic, foreign, institutional investors.

Key Concerns

Order Inflow > Burnout; could lead to possible delays in implementation

At the rate at which PLL has secured orders during FY06-07 (Rs. 80 bn), we expect this trend of order inflow to continue going forward. In case of inflow > burnout, we could see some delay/deferment in the timely execution of orders, because the company has too much on its plate. Some other issues that are likely to cause delays in execution are geopolitical (PLL operates in diverse geographies), right-of-way issues (Assam road projects),weather and other natural disasters.

Improvement of margins post SEC acquisition

As mentioned earlier, the acquisition of SEC has depressed PLL's OPMs. SEC operates on a 1% OPM and has just broken even on the bottom line. What needs to be seen is the ability of PLL to synergise the businesses of both the companies and get back to its original margin of ~11-12%.

Availability of skilled labour

All companies in the construction space are facing a skilled manpower crunch and PLL is no exception. Employee costs as a percentage of sales account for 12%. This, we believe is likely to rise further when the company starts hiring engineers for its newly incorporated company Simon Carves, India. Its current employee strength (FY06) is 1800 full time staff and 4000 casual/temporary employees. However, to tackle this problem, PLL plans to tie up with leading engineering colleges and meet their manpower requirements.

Company Profile

Punj Lloyd Limited (PLL) is one of the largest engineering construction companies in India. It offers integrated design, engineering, procurement, construction and project management services to the energy industry and infrastructure sectors. PLL also provides engineering construction services for onshore and offshore pipelines, gas gathering systems, oil and gas tanks and terminals including cryogenic LNG and LPG storage terminals, process facilities in the oil and gas industry including refineries and power plant projects. In the infrastructure sector, Punj Lloyd has worked on various civil infrastructure projects like highways, flyovers, bridges and elevated railroads. In addition, it provides value added engineering services to the energy industry and infrastructure projects, apart from offering comprehensive plant and facility maintenance and management services.

PLL's operations are spread across the Middle East, Caspian, Asia Pacific, Africa and South Asia.

With over 20 years experience in the field, PLL has constructed more than 8,000 km of pipelines and 6 million m^3 of tanks and terminals. It has also executed 11 refinery modernization and quality improvement projects. It has also worked on or is working on 18 highway projects.

PLL's key strengths as one of the largest engineering construction companies in India with a strong international presence, are its significant experience and strong track record, ability to manage operations in diverse industries and economies, long term relationships with world-class clients, strong operational results, an ability to mobilize financial resources, highly qualified and motivated employee base and a proven management team.

Financial Statements

Consolidated Income Statement

(Rs. Mn)

	FY06	FY07E	FY08E	FY09E
Net Revenue PLL	16846	28674	48688	69774
Net Revenue SEC	0	20721	22726	24340
Total Revenues	**16846**	**49396**	**71414**	**94114**
% Growth		*193%*	*45%*	*32%*
Total Operating Expenses	**14937**	**46282**	**65653**	**85709**
Operating Profits	**1909**	**3114**	**5761**	**8405**
PLL (Excl SEC)	1909	2896	5307	7675
SEC	0	218	455	730
Other Income	319	767	805	845
EBITDA	**2229**	**3880**	**6566**	**9251**
Interest	794	922	1755	2326
Depreciation	604	853	1043	1088
PBT	**831**	**2105**	**3768**	**5836**
Taxes	291	526	942	1459
Misc. Exp	15	0	0	0
PAT	**555**	**1579**	**2826**	**4377**
EPS (Rs.)	**12.74**	**30.24**	**54.12**	**83.82**
Blended OPM (%)	*11.3%*	*6.3%*	*8.1%*	*8.9%*
PAT Growth Y-oY (%)		*185%*	*79%*	*55%*
PAT Margin (%)	*3.3%*	*3.2%*	*4.0%*	*4.7%*

Fully Diluted EPS: During H1FY07 the company went in for an FCCB issue of US$125 mn, that are convertible at a price of Rs.1363 per share. In case of full conversion, the equity is likely to dilute by 0.41 mn shares and increase its capital from 52.2 mn shares to 56.28 mn shares. Our fully diluted EPS estimates are

	FY07E	FY08E	FY09E
PAT (Rs. Mn)	1579	2826	4377
Fully Diluted Equity (Mn Shares)	56.28	56.28	56.28
Fully Diluted EPS (Rs.)	**28.06**	**50.22**	**77.77**

Consolidated Balance Sheet

(Rs. Mn)

	FY06	FY07E	FY08E	FY09E
Source of Funds				
Equity Share Capital	522	522	522	522
Reserves	10693	12183	14890	19148
Shareholders Funds	**11215**	**12705**	**15412**	**19670**
Secured Loans	4906	12750	16547	19952
Unsecured Loans	644	5656	5656	5656
Total Debt	**5550**	**18406**	**22203**	**25608**
Deffered Tax Liability	606	606	606	606
Minority Interest	9	9	9	9
Capital Employed	**17380**	**31727**	**38231**	**45894**
Application of Funds				
Gross Block	9070	15300	16800	18300
Depreciation	3280	4133	5176	6264
Net Fixed Assets	**5790**	**11167**	**11624**	**12036**
Capital WIP	1230	-	-	-
Preoperative Expenses	156	156	156	156
Investments	416	1766	1766	1766
Inventories	8043	16317	26727	27420
Sundry Debtors	4024	10150	14674	19338
Cash and Bank	1106	5385	1247	9240
Other Current Assets	111	111	111	111
Loans and Advances	2179	2179	2179	2179
Current Assets	15464	34142	44939	58289
Current Liabilities	5676	15505	20254	26353
Net Current Assets	**9788**	**18638**	**24685**	**31936**
Miscellaneous Expenditure	0	0	0	0
Total Net Assets	**17380**	**31727**	**38231**	**45894**

Consolidated Cash Flow

(Rs. Mn)

	FY06	FY07E	FY08E	FY09E
EBT	**831**	**2105**	**3768**	**5836**
Depreciation	604	853	1043	1088
Interest Paid	627	922	1755	2326
Interest Recd.	-50	-	-	-
Change in WC	-1752	-4571	-10185	742
Direct Taxes Paid	-287	-526	-942	-1459
Others	33	-	-	-
Cash Flow from Operations	**4**	**-1217**	**-4561**	**8533**
Capex Incurred	-2556	-5000	-1500	-1500
Interest & Dividend Received	43	-	-	-
(Inc)/Dec in Investments	-129	-1350	-	-
Others	71	-	-	-
Cash Flow from Investing Activities	**-2572**	**-6350**	**-1500**	**-1500**
Inc/(Dec) in Share Capital	84	-	-	-
Share issue Expenses	-305	-	-	-
Inc/(Dec) in Share Premium	5765	-	-	-
Inc/(Dec) in Debt	-1637	12857	3797	3405
Dividends Paid+Dividend Tax	-18	-89	-119	-119
Interest Paid	-628	-922	-1755	-2326
Cash Flow from Financing Activities	**3260**	**11845**	**1923**	**960**
Net Change in Cash Balance	692	4279	-4138	7993
Exchange Fluctuation Reserve	-18	-	-	-
Opening Cash Balance	432	1106	5385	1247
Closing Cash Balance	**1106**	**5385**	**1247**	**9240**

Ratio Analysis

	FY06	FY07E	FY08E	FY09E
Valuation Ratios(x)				
EPS (Rs.)	13	30	54	84
Fully Diluted (Post FCCB) (Rs.)	12	30	50	78
CEPS (Rs.)	25	47	69	97
P/E	73	31	17	11
P/BV	4.3	3.8	3.2	2.5
EV/Sales	3.2	1.2	1.0	0.7
EV/EBITDA	24	16	11	7
EV/CE	3	2	2	1
Debt:Equity	0.5	1.4	1.4	1.3
Growth Ratios (%)				
Revenue Growth	-6%	193%	45%	32%
EBITDA Growth	-34%	74%	69%	41%
Earnings Growth	-45%	185%	79%	55%
Efficiency Ratios(%)				
Operating Profit Margin	11%	6%	8%	9%
EBITDA Margins	13%	8%	9%	10%
Net Profit Margins	3%	3%	4%	5%
Fixed Assets Turnover	2.9	4.4	6.1	7.8
Interest Coverage	2.0	3.3	3.1	3.5
Profitability Ratios				
ROCE (%)	3%	3%	4%	5%
ROE (%)	7%	13%	20%	25%

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RATING SYSTEM

BUY = Expected to outperform the BSE Sensex by 15% or more over a 12 months' time frame.

MO = Market Outperformer - Expected to outperform the BSE Sensex by 10% or more over a 12 months' time frame.

MP = Market Performer - Expected to be a neutral performer relative to the BSE Sensex over a 12 months' time frame.

MU = Market Underperformer - Expected to underperform the BSE Sensex by 10% or more over a 12 months' time frame.

SELL = Expected to underperform the BSE Sensex by 15% or more over a 12 months' time frame