3 August 2010 | 8 pages

Punj Lloyd (PUJL.BO)

Equity

Sell: 1QFY11 Results – Execution Delays Erode Profitability

- **Disappointing 1QFY11** — Punj Lloyd reported 1QFY11 PAT loss of Rs306mn, significantly below CIRA estimate of Rs439mn profit. PAT loss was driven by sharp decline in revenues. 1QFY11 revenue at Rs16.1bn declined 46% YoY and was 36% below CIRA estimate of Rs25bn. Losses would have been higher but for Rs1.28bn (Rs201mn in 1QFY10) other operating income in the quarter.
- **Continuing execution delays eroded profitability** — ~38% of order backlog comes from slow moving Libya orders. Continuing execution delays and operating leverage led to EBITDA margins falling to 0.4% in 1QFY11 from 9.7% in 1QFY10.
- **Auditor qualifications** — Auditor qualification on profit of Rs1.19bn on sale of investment has been removed in the quarter, but other auditor qualifications on Rs2.43bn of project claims and Rs655mn of liquidated damages related to the ONGC project continue.
- **Project status update** — Ensus bio ethanol project is operating at 98% utilization though 1QFY11 saw reversal of GBP2.5mn on settlement with a subcontractor. Work has started on civil projects in Libya, and the company expects to book revenue from 2QFY11. ONGC Heera project has been completed, and all 4 offshore rigs are fully operational now.
- **Maintain Sell** — Punj Lloyd continues to face execution delays, cost overruns in projects and auditor qualifications. 38% orders backlog consists of delayed Libyan orders where execution is slow.

Sell/Medium Risk	3M
Price (03 Aug 10)	Rs128.00
Target price	Rs115.00
Expected share price return	-10.2%
Expected dividend yield	0.1%
Expected total return	**-10.0%**
Market Cap	Rs42,504M
	US$919M

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2009A	1,962	6.30	-38.9	20.3	1.6	7.5	0.3
2010A	-4,155	-12.22	na	-10.5	1.4	-15.0	0.1
2011E	2,166	6.37	152.1	20.1	1.3	6.8	0.1
2012E	3,428	10.08	58.3	12.7	1.2	10.0	0.3
2013E	4,768	14.02	39.1	9.1	1.0	12.4	0.3

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	20.3	-10.5	20.1	12.7	9.1
EV/EBITDA adjusted (x)	7.7	56.4	9.8	7.9	6.7
P/BV (x)	1.6	1.4	1.3	1.2	1.0
Dividend yield (%)	0.3	0.1	0.1	0.3	0.3
Per Share Data (Rs)					
EPS adjusted	6.30	-12.22	6.37	10.08	14.02
EPS reported	-7.23	-3.19	6.37	10.08	14.02
BVPS	81.86	92.45	98.79	108.65	122.54
DPS	0.40	0.15	0.15	0.40	0.40
Profit & Loss (RsM)					
Net sales	119,120	104,356	105,719	128,243	152,175
Operating expenses	-113,491	-105,348	-100,333	-120,730	-142,190
EBIT	**5,629**	**-991**	**5,387**	**7,513**	**9,985**
Net interest expense	-2,208	-3,190	-3,573	-3,896	-4,453
Non-operating/exceptionals	-3,538	4,334	1,263	1,263	1,263
Pre-tax profit	**-116**	**153**	**3,077**	**4,881**	**6,795**
Tax	-2,199	-1,220	-895	-1,436	-2,010
Extraord./Min.Int./Pref.div.	62	-17	-17	-17	-17
Reported net income	**-2,253**	**-1,084**	**2,166**	**3,428**	**4,768**
Adjusted earnings	1,962	-4,155	2,166	3,428	4,768
Adjusted EBITDA	7,400	1,279	7,929	10,259	12,935
Growth Rates (%)					
Sales	53.6	-12.4	1.3	21.3	18.7
EBIT adjusted	13.8	-117.6	643.4	39.5	32.9
EBITDA adjusted	15.4	-82.7	519.9	29.4	26.1
EPS adjusted	-38.9	-294.0	152.1	58.3	39.1
Cash Flow (RsM)					
Operating cash flow	**-9,805**	**-15,402**	**5,299**	**-3,346**	**-1,743**
Depreciation/amortization	1,771	2,270	2,542	2,746	2,950
Net working capital	-9,828	-16,605	575	-9,537	-9,479
Investing cash flow	**-8,417**	**-2,485**	**-5,000**	**-4,000**	**-3,582**
Capital expenditure	-7,265	-4,518	-4,000	-3,000	-2,582
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**19,186**	**15,899**	**-58**	**7,445**	**5,345**
Borrowings	19,520	8,962	0	7,600	5,500
Dividends paid	-142	-58	-58	-155	-155
Change in cash	**964**	**-1,988**	**241**	**99**	**19**
Balance Sheet (RsM)					
Total assets	**111,292**	**121,941**	**127,706**	**146,462**	**164,353**
Cash & cash equivalent	8,122	6,100	6,308	6,373	6,359
Accounts receivable	26,686	32,505	32,930	39,546	46,457
Net fixed assets	19,768	22,025	23,493	23,757	23,398
Total liabilities	**86,027**	**90,840**	**94,514**	**110,014**	**123,309**
Accounts payable	28,836	22,736	23,033	27,940	33,154
Total Debt	35,592	44,554	44,554	52,154	57,654
Shareholders' funds	**25,265**	**31,101**	**33,192**	**36,448**	**41,044**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	6.2	1.2	7.5	8.0	8.5
ROE adjusted	7.5	-15.0	6.8	10.0	12.4
ROIC adjusted	8.3	-3.8	6.5	8.2	9.5
Net debt to equity	108.7	123.6	115.2	125.6	125.0
Total debt to capital	58.5	58.9	57.3	58.9	58.4

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Powered by: dataCentral

Figure 1. Punj Lloyd – Consolidated Results

In Rsmn	1QFY10R	1QFY11A	1QFY11E	Comments
Order Backlog	278,890	255,560		- Company won orders worth Rs32.84bn in 1QFY11
Net Sales	**29,527**	**16,058**	**25,000**	- Delay in execution in Libya led to sharp decline in revenues
Growth & YoY	**11.5%**	**-45.6%**	**-15.3%**	
Consumption of Raw materials	(8,960)	(4,387)	(7,805)	
as a % of sales	30.3%	27.3%		
Contractor Charges	(9,346)	(4,617)	(8,141)	
as a % of sales	31.7%	28.8%		
Staff Costs	(3,239)	(2,876)	(2,821)	
as a % of sales	11.0%	17.9%		
Other expenditure	(5,127)	(4,117)	(4,434)	
as a % of sales	17.4%	25.6%		
Total Expenditure	(26,670)	(15,998)	(23,200)	
as a % of sales	90.3%	99.6%		
EBITDA	**2,857**	**60**	**1,800**	- EBITDA margin declined due to operating leverage working against the company
EBITDA Margin	**9.7%**	**0.4%**	**7.2%**	
Depreciation	(541)	(640)	(680)	
EBIT	2,316	(580)	1,120	
EBIT Margin	7.8%	-3.6%	4.5%	
Interest	(707)	(810)	(748)	
Other Income	63	41	250	
Other operating income	**201**	**1,281**		**- Sharp jump in other operating income**
PBT	1,872	(69)	622	
Tax	(622)	(235)	(205)	
Tax Rate %	33%	-343%	33%	
Share of Profit of Associates	(19)	21	(19)	
Share of loss transferred to Minority	41	(23)	41	
Recurring PAT	**1,272**	**(306)**	**439**	- Revenue decline resulted in loss at PAT level despite higher other income
Growth % YoY	**30.3%**		**-65.5%**	

Source: Citi Investment Research and Analysis, Company

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 Sell/Medium Risk (3M) given the following risks – (1) Losses in Simon Carves could continue for a couple more quarters; (2) two more pending orders in Simon Carves; (3) 35% of the Rs278bn orders backlog consists of delayed Libyan orders (4) Rs25bn Sabah Sarawak pipeline and two out of five Assam roads are delayed; (5) Recent top and middle management departures; (6) balance-sheet deterioration, apparent from the increase in net debt to equity and working capital intensity; and (7) Rs2.5bn of FCCBs, with a conversion price of Rs272.6 due in late FY11E, are deep out of the money.

Valuation

Our target price for Punj Lloyd of Rs115 is based on a target P/E multiple of 14x Sep2011E. Our target multiple is more or less in line with other mid-cap construction peers (like HCC at 12x, IVRCL at 13.5x and Nagarjuna at 15x) and is set at ~ 39% discount to L&T given L&T's superior skill sets, backlog and execution track record.

Risks

We have a Medium Risk rating on Punj Lloyd shares, as opposed to the Speculative Risk flag suggested by our quantitative risk rating system, which tracks 260-day historical share price volatility. We believe Medium Risk is more appropriate given: 1) Though grey areas remain in terms of accounting of orders, the company has written off a significant portion of the same in its profit & loss statement in the past few years; 3) Our Medium Risk rating is consistent with the risk flag applied to other mid-cap construction peers.

The key upside risks include: 1) Favorable settlement with ONGC; 2) Positive change in macro-economic variables; and 3) Better-than-expected order inflows and sales execution.

The key downside risks to our target price include: 1) Integration risks relating to Simon Carves; 2) Revenue volatility due to project-driven nature of business; 3) Exports being 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, which could be a key challenge.

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Appendix A-1

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Punj Lloyd (PUJL.BO)

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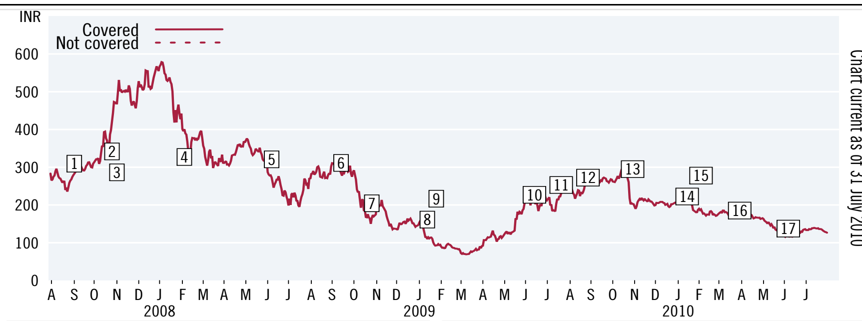
Fundamental Research
Analyst: Venkatesh Balasubramaniam



	Date	Rating	Target Price	Closing Price
1	3-Sep-07	1L	*353.00	282.70
2	25-Oct-07	1L	*464.00	420.95
3	1-Nov-07	1L	*593.00	468.85
4	5-Feb-08	1L	*493.00	400.70
5	6-Jun-08	*1M	*366.00	272.85
6	12-Sep-08	1M	*395.00	284.45

	Date	Rating	Target Price	Closing Price
7	27-Oct-08	1M	*218.00	165.35
8	13-Jan-09	*2H	*142.00	109.80
9	25-Jan-09	*3H	*85.00	92.30
10	12-Jun-09	*3M	*217.00	212.50
11	21-Jul-09	*1M	*263.00	231.15
12	27-Aug-09	1M	*311.00	264.00

	Date	Rating	Target Price	Closing Price
13	29-Oct-09	*2M	*228.00	202.90
14	14-Jan-10	*3M	*197.00	222.45
15	3-Feb-10	3M	*191.00	188.55
16	30-Mar-10	3M	*179.00	175.45
17	6-Jun-10	3M	*115.00	118.65

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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