Company Focus

1 November 2007 | 17 pages

# Punj Lloyd (PUJL.BO)

Target price change ☑
Estimate change ☑
Results ☑

## Buy: Ready for the Next Quantum Jump; Target Price Rs593

- **Target price Rs593** — We raise our target price to Rs593 to factor in (1) 16-21% upward earnings revision over FY08E-FY10E and (2) target P/E multiple revision to 25x Sep09E from 23x Sep09E on the back of Punj's superior earnings CAGR of 55%, the fastest in our E&C universe.
- **Higher P/E multiples justified** — Our P/E multiple increase is also driven by the fact that Punj Lloyd is perhaps the only Indian mid-cap E&C company that has the necessary skill sets and the desire to leapfrog into the next level, a level that is occupied by L&T with its immensely diversified skill sets.
- **Delivering on the early promise** — The first sign that Punj Lloyd can actually leverage on these skill sets and deliver on its potential came when the company reported 4QFY07 PAT of Rs889mn, which was 59% ahead of CIR estimates. Punj Lloyd has followed this up with impressive 101% YoY and 168% YoY earnings growth in 1QFY08 and 2QFY08 respectively.
- **Valuation gap with L&T should narrow** — L&T's order backlog is 2.7x that of Punj + Semb but (1) its market cap is 7.0x and (2) is 30%+ more expensive than Punj. We expect this valuation and market capitalization gap to narrow as we forecast Punj Lloyd delivers earnings growth at a pace superior to L&T over the next three years.

| **Buy/Low Risk** | **1L** |
|---|---|
| Price (01 Nov 07) | Rs478.00 |
| Target price | Rs593.00 |
| *from Rs464.00* | |
| Expected share price return | 24.1% |
| Expected dividend yield | 0.1% |
| **Expected total return** | **24.1%** |
| Market Cap | Rs139,033M |
| | US$3,547M |

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


**Figure 1. Punj Lloyd Statistical Abstract**

| Year to | Net Profit | FD EPS | EPS Growth | P/E | EV / EBITDA | ROE | Div. Yield | #Adj P/E | #Adj EV/EBITDA |
|---|---|---|---|---|---|---|---|---|---|
| 31-Mar | (Rsmn) | (Rs) | (%) | (x) | (x) | (%) | (%) | (x) | (x) |
| FY05A | 272 | 2.23 | na | 214.0 | 30.9 | 7.8% | 0.0% | 199.3 | 29.0 |
| FY06A | 545 | 1.93 | -13.6% | 247.7 | 68.0 | 6.7% | 0.0% | 230.6 | 63.4 |
| FY07 | 1,973 | 6.98 | 261.7% | 68.5 | 35.2 | 16.4% | 0.1% | 63.8 | 32.9 |
| FY08E | 3,904 | 12.12 | 73.6% | 39.4 | 19.4 | 20.8% | 0.1% | 36.7 | 18.1 |
| FY09E | 6,049 | 18.78 | 54.9% | 25.5 | 13.8 | 21.8% | 0.1% | 23.7 | 13.0 |
| FY10E | 8,375 | 26.00 | 38.5% | 18.4 | 10.5 | 24.1% | 0.1% | 17.1 | 9.8 |

Source: Citi Investment Research estimates. # Adjusted for the value for real estate and other investments

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



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| Fiscal year end 31-Mar | 2006 | 2007 | 2008E | 2009E | 2010E |
|---|---|---|---|---|---|
| **Valuation Ratios** | | | | | |
| P/E adjusted (x) | nm | 68.5 | 39.4 | 25.5 | 18.4 |
| P/E reported (x) | nm | 68.6 | 39.4 | 25.5 | 18.4 |
| P/BV (x) | 11.1 | 9.8 | 5.6 | 4.5 | 3.6 |
| Dividend yield (%) | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 |
| **Per Share Data (Rs)** | | | | | |
| EPS adjusted | 1.93 | 6.98 | 12.12 | 18.78 | 26.00 |
| EPS reported | 1.94 | 6.97 | 12.12 | 18.78 | 26.00 |
| BVPS | 42.95 | 48.95 | 85.03 | 105.42 | 133.80 |
| NAVps ordinary | na | na | na | na | na |
| DPS | 0.20 | 0.25 | 0.30 | 0.35 | 0.35 |
| **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** | **1,306** | **2,691** | **6,346** | **9,396** | **12,998** |
| Non-oper./net int./except. | -475 | -35 | -688 | -758 | -1,038 |
| **Pre-tax profit** | **831** | **2,656** | **5,657** | **8,637** | **11,960** |
| Tax | -291 | -690 | -1,694 | -2,588 | -3,585 |
| Extraord./Min. Int./Pref. Div. | 7 | 3 | -59 | 0 | 0 |
| **Reported net income** | **547** | **1,969** | **3,904** | **6,049** | **8,375** |
| Adjusted earnings | 545 | 1,973 | 3,904 | 6,049 | 8,375 |
| Adjusted EBIT | 1,298 | 2,682 | 6,336 | 9,386 | 12,989 |
| Adjusted EBITDA | 1,902 | 3,743 | 7,690 | 11,033 | 14,928 |
| **Growth Rates (%)** | | | | | |
| NOI | na | na | na | na | na |
| EBIT adjusted | 2.8 | 106.5 | 136.3 | 48.1 | 38.4 |
| EPS adjusted | -13.6 | 261.7 | 73.6 | 54.9 | 38.5 |
| **Cash Flow (RsM)** | | | | | |
| **Operating cash flow** | **-549** | **6,319** | **-2,383** | **2,001** | **2,150** |
| Depreciation/amortization | 604 | 1,062 | 1,354 | 1,647 | 1,939 |
| Net working capital | -1,680 | 3,536 | -7,958 | -5,694 | -8,164 |
| **Investing cash flow** | **-2,705** | **-8,498** | **-8,530** | **-5,500** | **-5,500** |
| Capital expenditure | -2,548 | -7,215 | -4,500 | -4,500 | -4,500 |
| Acquisitions/disposals | 0 | 0 | 0 | 0 | 0 |
| **Financing cash flow** | **3,953** | **11,032** | **8,038** | **1,881** | **3,381** |
| Borrowings | -1,622 | 11,427 | 0 | 2,000 | 3,500 |
| Dividends paid | -60 | -92 | -102 | -119 | -119 |
| **Change in cash** | **699** | **8,853** | **-2,875** | **-1,617** | **32** |
| **Balance Sheet (RsM)** | | | | | |
| **Total assets** | **23,071** | **57,278** | **82,937** | **101,853** | **127,843** |
| Cash & cash equivalent | 1,122 | 10,027 | 7,035 | 5,417 | 5,449 |
| Net fixed assets | 7,108 | 12,019 | 15,175 | 18,038 | 20,609 |
| **Total liabilities** | **11,847** | **44,432** | **58,208** | **71,195** | **88,929** |
| Total Debt | 5,566 | 16,994 | 16,995 | 18,996 | 22,497 |
| **Shareholders' funds** | **11,224** | **12,847** | **24,732** | **30,662** | **38,918** |
| **Profitability/Solvency Ratios** | | | | | |
| EBIT margin adjusted (%) | 7.7 | 5.2 | 7.6 | 8.8 | 9.4 |
| ROE adjusted (%) | 6.7 | 16.4 | 20.8 | 21.8 | 24.1 |
| ROA adjusted (%) | 2.7 | 4.9 | 5.6 | 6.5 | 7.3 |
| Net debt to equity (%) | 39.6 | 54.2 | 40.3 | 44.3 | 43.8 |
| Interest coverage (x) | 2.4 | 4.5 | 5.5 | 7.3 | 8.1 |

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## Increasing target price to Rs593

We raise our target price to Rs593 from Rs464 to factor in (1) 16 -21% upward earnings revision over FY08E-FY10E and (2) target P/E multiple revision to 25x Sep09E from 23x Sep09E on the back of Punj's superior earnings CAGR of 55%, the fastest in our E&C universe.

**Figure 2. Punj Lloyd Sum-of-the-Parts**

| Part | Remark | Rs/share |
|---|---|---|
| Punj + Semb | 25x Sep 09 FD EPS | 560 |
| Real Estate and Other Investments | P/BV of 2.0x | 33 |
| Target Price | | 593 |

Source: Citi Investment Research estimates

Our P/E multiple increase is also driven by the fact that Punj Lloyd is perhaps the only Indian mid-cap engineering & construction (E&C) company that has the necessary skill sets and desire to leapfrog into the next level, a level that is occupied by L&T with its immensely diversified skill sets.

The first sign that Punj Lloyd can actually leverage on these skill sets and deliver on its potential came when the company reported 4QFY07 PAT of Rs889mn, which was 59% ahead of CIR estimates. Punj Lloyd has followed this up with impressive 101% YoY and 168% YoY earnings growth in 1QFY08 and 2QFY08 respectively.

Over the years, Punj Lloyd has taken more risks in terms of bidding in more countries and domains to ramp up its skill sets. In FY07, Punj Lloyd acquired Semb, which helped the company scale up its expertise to upstream oil & gas, airports, jetties, MRT/LRT and tunnelling amongst others, in the infrastructure domain. If one looks at the table on the next page, one can easily comprehend the skill set gap that Punj Lloyd has extended over the other mid-cap peers. Punj Lloyd is now also pre-qualified for larger and more complex project bids.

An indication of Punj Lloyd moving up the value chain is the increase in average project sizes won, which has moved up from US$30mn to US$100mn in FY07 and could further move up to US$200mn in the coming years.

**Figure 3. India Engineering & Construction Skill Set Matrix**

| | L&T | Punj Lloyd | Semb | Punj + Semb | HCC | Gammon | Nagarjuna |
|---|---|---|---|---|---|---|---|
| Pipelines | Yes | Yes | | **Yes** | Yes | Yes | Yes |
| Tankages & Terminals | Yes | Yes | | **Yes** | | | |
| Metals and Mining | Yes | Yes | | | | | Yes |
| Process Plants | Yes | Yes | | **Yes** | | | |
| Roads and Bridges | Yes | Yes | | **Yes** | Yes | Yes | Yes |
| Water/Irrigation/Sewage | Yes | Yes | | **Yes** | Yes | Yes | Yes |
| Transmission & Distribution | Yes | | | | | Yes | Yes |
| Nuclear | Yes | | | | Yes | Yes | |
| Thermal | Yes | Yes | | **Yes** | Yes | Yes | |
| Hydel | Yes | | | | Yes | Yes | |
| Buildings | Yes | Yes | Yes | **Yes** | Yes | Yes | Yes |
| Upstream Oil & Gas | Yes | | Yes | **Yes** | | | |
| Airports | Yes | | Yes | **Yes** | | | |
| Ports/Jetties | Yes | | Yes | **Yes** | | Yes | Yes |
| MRT / LRT | Yes | | Yes | **Yes** | | | |
| SEZs | Yes | | Yes | **Yes** | | | Yes |
| International | Yes | Yes | Yes | **Yes** | | Yes | Yes |
| Ship Building | Yes | Yes | | | | | |
| Electrical Equipment | Yes | | | | | | |

Source: Citigroup Investment Research estimates

**Figure 4. Punj Lloyd Earnings Revision Table**

| | FY08E | FY09E | FY10E |
|---|---|---|---|
| **PLL (ex Semb) Sales** | | | |
| Old | 50,000 | 65,000 | 81,250 |
| New | 55,000 | 74,250 | 100,238 |
| % Chg | 10.0% | 14.2% | 23.4% |
| **Semb Sales** | | | |
| Old | 26,000 | 30,550 | 35,133 |
| New | 28,000 | 32,900 | 38,658 |
| % Chg | 7.7% | 7.7% | 10.0% |
| **PLL (ex Semb) EBITDA Margin %** | | | |
| Old | 12.0% | 12.0% | 12.0% |
| New | 12.2% | 12.2% | 12.0% |
| % Chg | 20bps | 20bps | 0bps |
| **Semb EBITDA Margin %** | | | |
| Old | 3.5% | 5.5% | 7.0% |
| New | 3.5% | 6.0% | 7.5% |
| % Chg | 0bps | 50bps | 50bps |
| **Recurring PAT** | | | |
| Old | 3,358 | 5,153 | 6,910 |
| New | 3,904 | 6,049 | 8,375 |
| % Chg | 16.3% | 17.4% | 21.2% |
| **FD EPS** | | | |
| Old | 10.42 | 16.00 | 21.45 |
| New | 12.12 | 18.78 | 26.00 |
| % Chg | 16.3% | 17.4% | 21.2% |

Source: Citi Investment Research estimates

## Earnings revised upwards

We have revised our FD EPS upwards by 16-21% over FY08E to FY10E on the back of our increased confidence on the management's ability to execute post two robust quarters of 100%+ YoY growth. We have now factored in:

- 10-23% and 8-10% higher sales for Punj and Semb respectively over FY08E-FY10E.
- 20 bps higher EBITDA margins for Punj in FY08E and FY09E; and 50 bps higher EBITDA margins for Semb in FY09E and FY10E

We now expect Punj to grow FD EPS as a CAGR of 55% over FY07-FY10E vis-à-vis our earlier 45% with RoE at the 20-24% levels.

## Strong growth in 1HFY08

- **1QFY08 PAT up 168% YoY** — Punj Lloyd did an encore of its 1QFY08 PAT growth of 101% yoy; only this time better with 2QFY08 PAT of Rs895mn up 168% yoy (46% ahead of CIR estimate of Rs613mn, up 84% yoy) on better-than-expected sales growth and higher EBITDA margins.
- **Strong operating performance** — Sales at Rs18.9bn (up 60% yoy) was ahead of CIR expectations of Rs16.4bn (up 38% yoy) on stronger-than-expected order execution. Further EBITDA margin expansion of 2.9% was ahead of CIR expectations of 2.3%. Despite the fact that margin expansion is largely driven by Punj and Semb EBITDA margins of 1.5% in 2Q is below full-year expectations of 3.5%, we remain positive as we expect significant margin improvement in Semb in 4QFY07 similar to last year.

- **Comfortable order backlog** — Punj + Semb booked five quality large orders totaling Rs20.7bn ending 2QFY08 with an order backlog of Rs148.5bn (up 33% yoy) comprising Rs43.4bn of Semb orders (up 24% yoy) and Rs105bn of Punj orders (up 37% yoy).

**Figure 5. Punj 1HFY08 Results**

| End Mar31 (Rsm) | Punj | Semb | P + S | Punj | Semb | P + S | Punj | Semb | P + S | Punj | Semb | P + S |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1QFY07 | 1QFY07 | 1QFY07 | 1QFY08 | 1QFY08 | 1QFY08 | 2QFY07 | 2QFY07 | 2QFY07 | 2QFY08 | 2QFY08 | 2QFY08 |
| **Order Backlog** | 53,220 | 40,950 | 94,170 | 109,816 | 42,426 | 152,242 | 76,982 | 34,977 | 111,959 | 105,105 | 43,415 | 148,520 |
| **Net Sales** | 4,790 | 3,265 | 8,054 | 8,373 | 5,577 | 13,950 | 5,880 | 5,963 | 11,843 | 11,664 | 7,278 | 18,942 |
| *YoY Growth* | | | | *74.8%* | *70.8%* | *73.2%* | | | | *98.4%* | *22.1%* | *217.7%* |
| **EBITDA** | 487 | 22 | 508 | 1,055 | 159 | 1,214 | 719 | (22) | 697 | 1,554 | 111 | 1,666 |
| **EBITDA Margin** | 10.2% | 0.7% | 6.3% | 12.6% | 2.9% | 8.7% | 12.2% | -0.4% | 5.9% | 13.3% | 1.5% | 8.8% |
| Depreciation | | | (188) | | | (355) | | | (249) | | | (334) |
| **EBIT** | | | 321 | | | 860 | | | 449 | | | 1,332 |
| **EBIT Margin** | | | 4.0% | | | 6.2% | | | 3.8% | | | 7.0% |
| Interest | | | (120) | | | (289) | | | (168) | | | (394) |
| Other Income | 200 | 0 | 200 | 166 | 64 | 230 | 94 | 34 | 128 | 190 | 115 | 305 |
| **PBT** | | | 401 | | | 801 | | | 409 | | | 1,243 |
| Tax | | | (138) | | | (272) | | | (73) | | | (349) |
| Tax Rate % | | | 34% | | | 34% | | | 18% | | | 28% |
| Associates | (0) | 0 | (0) | | | | | | | | | |
| Minority Interest | 1 | 0 | 1 | | | 0 | (2) | 0 | (2) | | | 0 |
| **PAT** | | | 263 | | | 529 | | | 334 | | | 895 |
| *Growth* | | | | | | *101%* | | | | | | *168%* |

Source: Citi Investment Research estimates

# Management conference call takeaways

*We had a chat with Mr. Ravi Keswani (Executive Director, Punj Lloyd) and Mr. Sanjay Goel (CEO, Simon Carves – India) two weeks back to get an update about business. Key takeaways are as below:*

## Execution and management bandwidth

**Our take: As the infrastructure capex in India grows in size and Punj Lloyd starts bagging orders in the hydrocarbons and the petrochemicals space the order sizes are bound to get larger. As a consequence the number of project sites that have to be managed might not increase at the same pace as order inflow/sales.**

- Punj is not growing by increasing number of orders. It is growing by increasing order sizes and there is enough bandwidth to manage projects. Last year Punj was working on 35 orders and this year it is working on 38-39 orders. So number of projects has increased very slowly. One year back average order size was US$35mn, this year average order size is US$135mn and next year average order will be US$200 mn. Vision is to have 11-12 orders of size > US$200 mn each, constituting 60% of order book.

- Punj is being positioned as global company and the company is taking the following step to retain employees: (1) Creating the right culture, (2) Providing world-class infrastructure, (3) Providing higher quality of work, and (4) Providing training.

- Currently there are no problems in execution of projects. Only facing problems in the Assam road projects but these are not that important as they form a very small part of order book.
- Currently involved in bidding for US$4-5bn worth of projects. There is a six-month time gap between start and end of bidding process.
- **Order flow from Dayim-Punj –** Already received order on the tankages side and some more orders should come in the current year on the oil & gas side.

### Ramprastha Group JV and other investments

**Our take: The Ramprastha Group JV could help Sembawang bag a large number of captive building contracts in which it will make margins of ~ 10%. This is similar to mid-cap construction companies bidding for road BOT projects through which they win road cash contracts in which they make 6-8% margins.**

**Access to fabrication facilities with a water front would give Punj Lloyd the requisite execution capabilities for big ticket platform orders from ONGC and the GCC nations and giving L&T serious competition in this space.**

- The Ramprastha Group has ~ 1,500 acres of land in NCR. In the Punj – Ramprastha JV, Ramprastha will contribute land at ~ market rate less 10% and Sembawang will construct at ~ Cost +10% margins. Since JV is 50%-50%, Punj will have the right to 50% of development profit of JV. IRR in JV to be high, which should take care of variability of real estate prices. Currently average market rate of land in NCR is ~ Rs30mn/acre, so total value of land bank with Ramprastha is Rs45bn. But the JV will have to buy the land from Ramprastha group. Since Punj does not have such deep pockets it will try and bring financial investors in the JV and Punj's stake on developmental profits will proportionately go down based on the dilution. Punj made an initial investment of Rs1.8bn to bring in 29 acres of land into the JV for developmental purposes. First real estate development will happen in Vaishali, which is 29 acres of land with total construction of 2.5mn sqft. Sembawang will get a US$125mn construction order for this construction. Total construction area for all land under JV is 70 - 80mn sqft so Sembawang will get a number of orders over a period of time.
- The total market size for offshore platforms is US$20bn in next 5-6 years with ONGC alone investing US$10bn. Punj is technically qualified to win these orders, but does not have access to fabrication facilities. Subcontracting fabrication might also be a problem because fabrication facilities/shipyards globally are running at full capacity and have a waiting time of 3-4 years. Punj Lloyd initially wanted to develop its own shipyard but could not get waterfront land in India despite searching for one year. So the company has invested Rs3.5bn in a shipyard on the west coast. Even if Punj had got the land for developing shipyard, getting approvals would have taken three years.

## Simon Carves India - Captive Engineering Center

**Our take: An India-based captive engineering center would provide: (1) Increased execution capacity to Simon Carves UK using low-cost staff, (2) In-house engineering capability for Punj, (3) Criticality of resources while keeping intellectual property (IP) in house, and (4) Ability to capture the value added at this stage in the group**

- Currently Simon Carves India has 300 employees and will scale upto to 1,000 employees in next 6-8 months. Currently work is largely captive but over time expected to win third-party clients. Since client management is costly in this business, expects to win 4-6 big clients only. Labor arbitrage is £50 pounds/hr v/s less than half of that in India

- Have done value engineering work worth US$10mn in six months at EBITDA margins of 10%. Margins are low currently as (1) During ramp-up phase a number of employees are on bench, (2) Number of Employees are on training. Over time, margins can go up to 18% (in next 2-3 years). Over time, 50% of business will be internal and 50% will be external. Utilization to improve to 80% from 60% today.

- Future strategy will be to 1) Develop packages to resell to new clients, and 2) improve utilizations. In next 6-8 months, will get anchor clients and offer complete back office engineering solutions.

- **Main competitors are:**Foster Wheeler, Jacobs and Anchor Covener. Even the Punj Lloyd Group outsources 30%-40% of engineering work to outsiders.

- **On employees:** Biggest challenge is recruitment. Recruited from Bechtel, Foster Wheeler and Aker Kvaerner. 60% of people are through referrals. Currently hiring 30-40 people every month. 30% employees < 3 years of experience, 50% have between 5 to 12 years of experience and 20% have 15 to 20 years of experience. Work experience of >3 years is required for an employee to be a real contributor. Hired 40 freshers from 14, 2nd and 3rd level engineering colleges such as: 15 people from Dehradun based Petroleum Design Institute, eight from Pune based institute and MLNR Allahabad. A fresher takes six months to become billable. During the first six months training is given through e-learning, on the job and advanced software packages. Expected annual attrition rate is ~ 15%

## No plans of raising more equity soon

- For next 12-18 months Punj Lloyd does not expect to raise any equity. Post the recent QIP, net worth is Rs21bn which will rise to Rs27-30bn as soon as the outstanding FCCBs get converted. The current debt is Rs13bn, so there is ample scope for increasing leverage to meet funding requirements.

**Figure 6. Punj Lloyd + Sembawang Consolidated Abridged Profit & Loss Statement**

| Rsmn | FY05 | FY06 | FY07 | FY08E | FY09E | FY10E | CAGR |
|---|---|---|---|---|---|---|---|
| PLL Sales | 17,900 | 16,846 | 30,131 | 55,000 | 74,250 | 100,238 | 49.3% |
| Sembawang Sales | | | 21,135 | 28,000 | 32,900 | 38,658 | 22.3% |
| **Total Sales** | **17,900** | **16,846** | **51,266** | **83,000** | **107,150** | **138,895** | **39.4%** |
| PLL EBITDA | 2,102 | 1,902 | 3,519 | 6,710 | 9,059 | 12,029 | 50.6% |
| Sembawang EBITDA | | | 224 | 980 | 1,974 | 2,899 | 134.8% |
| **Total EBITDA** | **2,102** | **1,902** | **3,743** | **7,690** | **11,033** | **14,928** | **58.6%** |
| PLL EBITDA Margins % | 11.7% | 11.3% | 11.7% | 12.2% | 12.2% | 12.0% | |
| Sembawang EBITDA Margins % | | | 1.1% | 3.5% | 6.0% | 7.5% | |
| **Total EBITDA Margins %** | **11.7%** | **11.3%** | **7.3%** | **9.3%** | **10.3%** | **10.7%** | |
| Depreciation | 839 | 604 | 1,062 | 1,354 | 1,647 | 1,939 | |
| **EBIT** | **1,262** | **1,298** | **2,681** | **6,336** | **9,386** | **12,989** | **69.2%** |
| Interest | 1,333 | 794 | 825 | 1,388 | 1,508 | 1,838 | |
| Other Income | 439 | 317 | 794 | 700 | 750 | 800 | |
| **PBT** | **368** | **821** | **2,650** | **5,648** | **8,628** | **11,950** | **65.2%** |
| Tax | 102 | 291 | 690 | 1,694 | 2,588 | 3,585 | |
| Tax Rate % | 27.6% | 35.5% | 26.0% | 30.0% | 30.0% | 30.0% | |
| **PAT** | **272** | **545** | **1973** | **3904** | **6049** | **8375** | **61.9%** |
| **FD EPS** | **2.2** | **1.9** | **7.0** | **12.1** | **18.8** | **26.0** | **55.0%** |

Source: Citi Investment Research estimates

**Figure 7. Punj Lloyd + Sembawang Consolidated Balance Sheet**

| Year End Mar31 (Rsmn) | FY2005 | FY2006 | FY2007 | FY2008E | FY2009E | FY2010E |
|---|---|---|---|---|---|---|
| Share capital | 243 | 522 | 523 | 582 | 582 | 582 |
| Reserves and Surplus | 4,850 | 10,693 | 12,266 | 24,150 | 30,080 | 38,337 |
| **Total Networth** | **5,093** | **11,215** | **12,789** | **24,732** | **30,662** | **38,918** |
| | | | | | | |
| Preference share capital | 9 | - | - | - | - | - |
| Minority Interest | 17 | 9 | 59 | - | - | - |
| | | | | | | |
| Secured Loans | 5,998 | 4,921 | 11,232 | 11,232 | 13,232 | 16,732 |
| Unsecured loans | 1,188 | 644 | 338 | 338 | 338 | 338 |
| FCCB | - | - | 5,423 | 5,423 | 5,423 | 5,423 |
| **Loan Funds** | **7,187** | **5,565** | **16,992** | **16,992** | **18,992** | **22,492** |
| | | | | | | |
| DTL | 618 | 606 | 361 | 618 | 618 | 618 |
| **LIABILITIES + NETWORTH** | **12,924** | **17,395** | **30,200** | **42,342** | **50,272** | **62,029** |
| | | | | | | |
| **Tangible Gross Block** | **7,264** | **8,915** | **17,090** | **21,590** | **26,090** | **30,590** |
| Accumulated Depreciation | (2700) | (3193) | (5929) | (7273) | (8910) | (10839) |
| **Net Block** | **4,564** | **5,722** | **11,161** | **14,317** | **17,180** | **19,751** |
| CWIP | 500 | 1,230 | 710 | 710 | 710 | 710 |
| Pre Operative Expense | 80 | 156 | 148 | 148 | 148 | 148 |
| **Net Fixed Assets** | **5,144** | **7,108** | **12,019** | **15,175** | **18,038** | **20,609** |
| | | | | | | |
| **Intangible Gross Block** | **149** | **155** | **1,580** | **1,580** | **1,580** | **1,580** |
| Amortization | (62) | (86) | (269) | (279) | (289) | (299) |
| **Net Intangible Assets** | **87** | **68** | **1,311** | **1,301** | **1,291** | **1,281** |
| | | | | | | |
| Investments | 259 | 416 | 1,698 | 5,728 | 6,728 | 7,728 |
| | | | | | | |
| Inventories | 5,510 | 8,043 | 15,017 | 25,528 | 34,603 | 47,098 |
| Sundry Debtors | 3,364 | 3,944 | 12,234 | 20,797 | 26,848 | 34,803 |
| Cash and bank balances | 432 | 1,122 | 10,027 | 7,035 | 5,417 | 5,449 |
| Other CA | 54 | 192 | 511 | 511 | 511 | 511 |
| Loans and advances | 1,929 | 2,179 | 4,462 | 6,862 | 8,416 | 10,364 |
| **Total CA** | **11,289** | **15,479** | **42,250** | **60,733** | **75,796** | **98,224** |
| | | | | | | |
| CL | 3,708 | 5,387 | 25,430 | 37,745 | 47,820 | 61,056 |
| Provisions | 147 | 288 | 1,647 | 2,850 | 3,761 | 4,758 |
| **Total CL** | **3,855** | **5,676** | **27,077** | **40,595** | **51,581** | **65,814** |
| | | | | | | |
| **Net current assets** | **7,434** | **9,804** | **15,172** | **20,138** | **24,215** | **32,410** |
| | | | | | | |
| **ASSETS** | **12,924** | **17,395** | **30,200** | **42,342** | **50,272** | **62,029** |

Source: Citi Investment Research estimates

**Figure 8. Punj Lloyd + Sembawang Consolidated Cash Flow Statement**

| Year End Mar31 | FY2005 | FY2006 | FY2007 | FY2008E | FY2009E | FY2010E |
|---|---|---|---|---|---|---|
| Recurring PAT | 272 | 545 | 1973 | 3904 | 6049 | 8375 |
| Change in DTL | 7 | (12) | (245) | 257 | 0 | 0 |
| Add: D&A | 839 | 604 | 1062 | 1354 | 1647 | 1939 |
| | | | | | | |
| Chg in Inventories | (2544) | (2533) | (6974) | (10511) | (9075) | (12495) |
| Chg in Debtors | (1148) | (580) | (8290) | (8563) | (6051) | (7954) |
| Chg in Loans & Advances | (374) | (250) | (2283) | (2401) | (1554) | (1948) |
| Chg in other CA | (44) | (138) | (319) | 0 | 0 | 0 |
| Chg in CL | 409 | 1679 | 20043 | 12314 | 10075 | 13236 |
| Chg in Provisions | 103 | 142 | 1358 | 1203 | 911 | 997 |
| Change in Working Capital | (3598) | (1680) | 3536 | (7958) | (5694) | (8164) |
| **Cash Flow from Operations** | **(2480)** | **(544)** | **6325** | **(2442)** | **2001** | **2150** |
| | | | | | | |
| Capex | (398) | (2548) | (7215) | (4500) | (4500) | (4500) |
| Change in Investments/Assets | 2536 | (157) | (1283) | (4030) | (1000) | (1000) |
| **Cash Flow from Investing Activities** | **2138** | **(2705)** | **(8498)** | **(8530)** | **(5500)** | **(5500)** |
| | | | | | | |
| Change in Debt | (2680) | (1622) | 11427 | 0 | 2000 | 3500 |
| Change in Minority Interest | (2) | (7) | 49 | (59) | 0 | 0 |
| Change in Preference Shares | 9 | (9) | 0 | 0 | 0 | 0 |
| Change in Equity | 37 | 279 | 0 | 59 | 0 | 0 |
| Change in Reserves | 2157 | 5355 | (304) | 8081 | 0 | 0 |
| Dividend and Dividend Tax | (21) | (60) | (92) | (102) | (119) | (119) |
| **Cash Flow from Financing Activities** | **(500)** | **3936** | **11081** | **7980** | **1881** | **3381** |
| | | | | | | |
| Extrordinary Items + Tax Adjustments | 734 | 2 | (3) | 0 | 0 | 0 |
| | | | | | | |
| **Increase/(Decrease) in Cash** | **(109)** | **690** | **8905** | **(2992)** | **(1617)** | **32** |
| **Opening Cash and Bank Balance** | **540** | **432** | **1122** | **10027** | **7035** | **5417** |
| **Closing Cash and Bank Balance** | **432** | **1122** | **10027** | **7035** | **5417** | **5449** |

Source: Citi Investment Research

# 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. Its services include laying pipelines, building roads, and the construction of 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 Buy/Low Risk (1L) as: 1) We always believed that Punj could be the only mid-cap Indian construction company to give L&T a run for its money. The first sign that Punj Lloyd could actually deliver on its potential came with a 4QFY07 PAT of Rs889mn that was 59% ahead of our estimates. 2) Punj Lloyd has taken more risks in terms of bidding in more countries and domains to ramp up its skill sets. At the end of FY07 Punj Lloyd had the third-largest order backlog of Rs149bn after BHEL and L&T. 3) In FY07 Punj Lloyd acquired Semb, which has helped it scale up its infrastructure expertise to upstream oil & gas, airports, jetties, MRT/LRT and tunnelling amongst others. Also, Punj Lloyd is now pre-qualified for larger and more complex project bids. 4) Punj Lloyd's move up the value chain is reflected in the average size of the projects it has won increasing from US$30mn to US$100mn in FY07 (which could move up to US$200mn).

### Valuation

We raise our target price to Rs593 from Rs464 to factor in (1) 16-21% upward earnings revision over FY08E-FY10E and (2) target P/E multiple revision to 25x Sep09E from 23x Sep09E on the back of Punj's superior earnings CAGR of 55%, the fastest in our E&C universe.

Our target price of Rs593 is based on a target P/E multiple of 25x Sep09 for Semb + Punj, which is well supported by earnings CAGR of 55% over FY07-10E and RoEs expanding from 20% in FY08E to 24% in FY10E. Our target multiple is at a 20% discount to that of L&T. Despite Punj Lloyd's superior earnings CAGR of 55% over FY07-10E vis-à-vis that of 41% for L&T, we believe Punj Lloyd should trade at a discount to L&T given L&T's superior order backlog, RoEs and execution capabilities. Further, we also value Punj Lloyd investments in a shipyard and a real estate JV at a P/BV of 2.0x

### Risks

We rate Punj Lloyd shares Low Risk, which differs from the Medium Risk rating suggested by our quantitative risk rating system but is in line with other construction companies given the company's 2QFY08 ending order book of Rs149bn implying sales coverage of 3.1x FY07 sales, providing visibility over the next 2-3 years, in our view. The key downside risks that could impede the stock from reaching our target price include: 1) Integration risks relating SembCorp E&C; 2) Revenue volatility due to project-driven nature of business; 3) Exports - 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.

## Larsen & Toubro **(LART.BO - Rs4,426.60; 3L)**

### Valuation

Using a comps-based P/E of 30x Sep09E, we get a core business value of Rs3,483 for L&T's core business. We also believe that the parent numbers do not capture the value inherent in the subsidiaries of L&T. We use a sum-of-the-parts (SOTP) methodology to value the L&T group, resulting in a target price of Rs4,010. We value L&T's subsidiaries at Rs527.

### Risks

We rate L&T shares Low Risk, as opposed to the High Risk suggested by our quantitative risk-rating system, because L&T's order backlog of c.Rs440bn represents two years' sales and provides earnings visibility. Upside risks to our target price: 1) Better-than-expected order inflow; 2) Better-than-expected execution and sales growth; 3) Better-than-expected margin expansion; 3) Listing of subsidiaries at a premium to what our SOTP captures; and 4) Any significant chunky airport, hydrocarbon or UMPP win. Downside risks to our target price include: 1) Attracting and retaining talent; 2) the E&C and electrical equipment businesses are sensitive to economic variables; 3) Competitive pressures, and 4) L&T needs to keep abreast of technology trends to sustain valuations and earnings.

# Appendix A-1

## Analyst Certification

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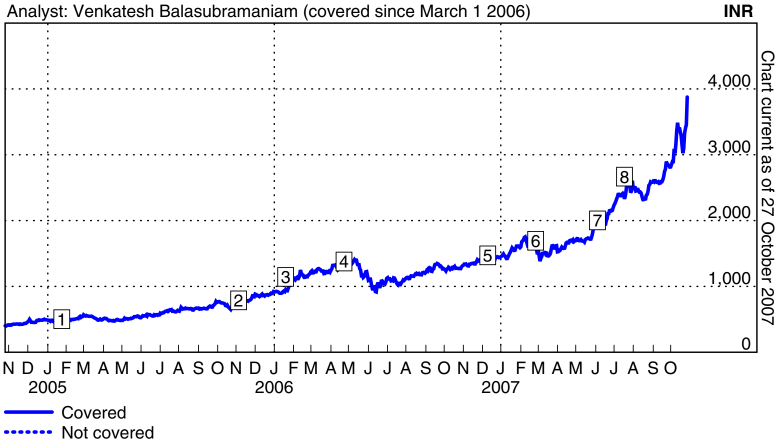
Analyst: Venkatesh Balasubramaniam (covered since March 1 2006)



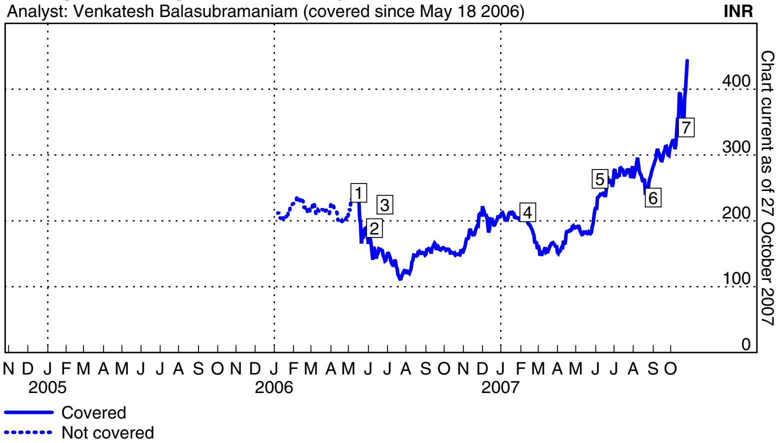

| # | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1: | 25 Jan 05 | 1L | *578.50 | 453.05 |
| 2: | 4 Nov 05 | 1L | *840.00 | NA |
| 3: | 19 Jan 06 | 1L | *1,169.00 | 950.15 |
| 4: | 24 Apr 06 | 1L | *1,579.50 | 1,378.18 |
| 5: | 11 Dec 06 | 1L | 1,579.50 | 1,436.30 |
| 6: | 26 Feb 07 | *2L | *1,733.00 | 1,592.40 |
| 7: | 5 Jun 07 | *1L | *2,360.00 | 1,945.05 |
| 8: | 18 Jul 07 | 1L | *2,765.00 | 2,329.55 |

*Indicates change.

**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: | 28 Jun 06 | 1M | 228.60 | 138.99 |
| 4: | 13 Feb 07 | *3M | *175.40 | 197.13 |
| 5: | 8 Jun 07 | *1L | *305.00 | 239.60 |
| 6: | 3 Sep 07 | 1L | *353.00 | 282.70 |
| 7: | 25 Oct 07 | 1L | *464.00 | 420.95 |

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|---|---|---|---|
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