Company Flash

31 January 2008 | 6 pages

Punj Lloyd (PUJL.BO)

Buy: Disappointing Quarter

- **Recurring PAT below estimates** — After 1HFY08 PAT growth of 138% YoY, Punj Lloyd's 3QFY08 Recurring PAT at Rs613mn up 27% YoY was substantially lower than CIR estimates of Rs1.0bn on the back of losses on legacy projects in Semb E&C to the tune of Rs680mn. Reported PAT was higher at Rs917mn on the back of sale of investments of Rs371mn.

- **Losses on legacy orders** — In 3QFY08 Semb E&C substantially completed certain low-margin legacy orders in which there were cost overruns due to delays and design changes, which led to a booking of losses of Rs680mn. According to the company, it has been conservative and provided for the entire amount of losses on these orders.

- **Recoveries possible - but is there more?** — The company is negotiating to recover the cost overruns and expects to make some recoveries. However, the key question remains, "Are there more such legacy orders in Semb E&C's Rs62bn order backlog, which could have similar huge potential losses?" We hope to get clarification regarding the same in the conference call tomorrow.

- **Tepid order backlog growth** — The Punj + Semb combine ended 3QFY08 with an order backlog of Rs160bn up a tepid 12% YoY. Though the Semb backlog at Rs62bn is up 35% YoY, Punj backlog at Rs98bn, down 13% YoY, is a concern given that the margins are higher on the Punj orders than on the Semb orders.

Buy/Low Risk	**1L**
Price (31 Jan 08)	Rs442.20
Target price	Rs593.00
Expected share price return	34.1%
Expected dividend yield	0.1%
Expected total return	**34.2%**
Market Cap	Rs134,154M US$3,414M

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

Figure 1. 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	197.9	28.8	7.8%	0.0%	183.0	26.9
FY06A	545	1.93	-13.6%	229.0	63.0	6.7%	0.0%	211.8	58.5
FY07	1,973	6.98	261.7%	63.3	32.7	16.4%	0.1%	58.6	30.4
FY08E	3,904	12.12	73.6%	36.5	18.0	20.8%	0.1%	33.7	16.8
FY09E	6,049	18.78	54.9%	23.5	12.9	21.8%	0.1%	21.8	12.0
FY10E	8,375	26.00	38.5%	17.0	9.8	24.1%	0.1%	15.7	9.1

Source: Citi Investment Research estimates

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

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Figure 2. Punj Lloyd Consolidated 3QFY08 Results

	3QFY07	3QFY08E	% Change
Net Sales	**14,333**	**21,170**	**47.7%**
Growth			
Raw Material + Subcontracting %	60.9%	67.8%	
Consumption of Raw materials	(5,123)	(7,614)	
as a % of sales	35.7%	36.0%	
Contractor Charges	(3,610)	(6,747)	
as a % of sales	25.2%	31.9%	
Staff Costs	(1,954)	(2,392)	
as a % of sales	13.6%	11.3%	
Other expenditure	(2,816)	(3,373)	
as a % of sales	19.6%	15.9%	
Total Expenditure	(13,502)	(20,126)	
as a % of sales	94.2%	95.1%	
EBITDA	**831**	**1,045**	**25.7%**
EBITDA Margin	**5.8%**	**4.9%**	
Depreciation	(296)	(365)	
EBIT	**535**	**679**	
EBIT Margin	**3.7%**	**3.2%**	
Interest	(279)	(284)	
Other Income	302	459	
PBT	557	854	
Tax	(80)	(241)	
Tax Rate %	14%	28%	
Share of Profit of Associates	0	0	
Share of loss transferred to Minority	5	0	
Recurring PAT	**483**	**613**	**26.9%**
Extraordinary items	0	371	
Tax Adjustment @ 18%	0	(67)	
Reported PAT	**483**	**917**	**90.0%**

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

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.

Appendix A-1

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Punj Lloyd (PUJL.BO)

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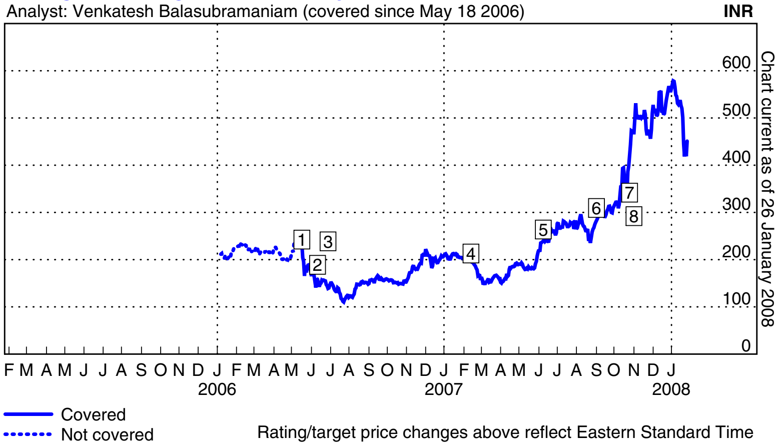
Analyst: Venkatesh Balasubramaniam (covered since May 18 2006)



#	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
8:	1 Nov 07	1L	*593.00	468.85

*Indicates change.

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