Punj Lloyd

Apple Green

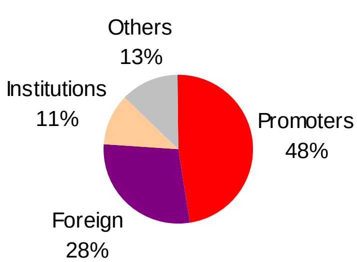
Stepping in the upper league

Buy; CMP: Rs519

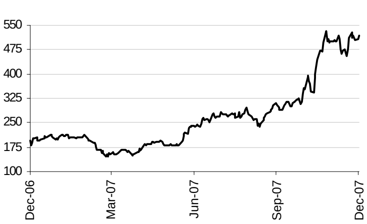
Company details

Price target:	Rs620
Market cap:	Rs15,098 cr
52-week high/low:	Rs598/142
NSE volume: (No of shares)	27.2 lakh
BSE code:	532693
NSE code:	PUNJLLOYD
Sharekhan code:	PUNJLLOYD
Free float: (No of shares)	15.3 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.3	71.3	114.6	167.0
Relative to Sensex	-2.8	31.1	48.1	74.2

Key points

- **Moving up the value chain:** One of the significant achievements for Punj Llyod Ltd (PLL) over the years has been its increasing average order size. PLL started with an average order size of $30 million that has grown to $130-140 million, and the company intends to increase it to $250 million. We believe higher order size would improve the margins of the company and also make it a pre-qualified player for larger and more complex orders.
- **SEC turnaround—a key positive:** PLL acquired Sembawang Engineers & Constructors (SEC) in June 2006. SEC's acquisition has added to the expertise of PLL in the field of oil & gas, airports, jetties, MRT/LRT, and tunneling. SEC has traditionally operated at lower margins, however the new orders are booked at healthy margins. Further, the company expects to execute all the legacy orders of SEC over the next 18-24 months. We expect, this will improve SEC's operating profit margin (OPM) from 3.5% in FY2008E to 7% in FY2010E.
- **Order book—more the merrier:** PLL has had a spectacular flow of orders, with orders growing from Rs3,240 crore at FY2005 end to Rs15,944 crore (including Rs4,900 crore for SEC) by FY2007 end. In H1FY2008 the company bagged orders worth Rs2,070 crore. The company has a healthy order backlog of Rs14,852 crore, which is 2.9x its FY2007 revenues and this we believe imparts strong visibility to the earnings of the company.
- **Acquisitions—help plugging and bridging gaps:** PLL is the second largest engineering, procurement and construction (EPC) company in the country. Acquisition of SEC and Simon Carves has helped PLL plug gaps in its offerings and increase its addressable markets. Post acquisition, PLL has considerably bridged the gap making it more competitive against Larsen and Toubro (L&T), the largest EPC player in the country.

Company background

Punj Lloyd is amongst the largest engineering and construction (E&C) companies in India providing integrated design, EPC and project management services for energy and infrastructure sectors. The Company's acquisition of Sembawang Engineers & Constructors Ltd (Singapore) and Simon Carves (UK) has enabled it to significantly expand its global presence and portfolio of offerings.

Valuation table	FY2006	FY2007	FY2008E	FY2009E	FY2010E
Net profit (Rs crore)	55.4	196.7	327.6	519.4	733.7
Shares in issue (crore)	52.2	52.3	64.2	64.2	64.2
EPS (Rs)	2.1	7.5	10.2	16.2	22.8
% y-o-y change	-	*254.7*	*35.4*	*58.6*	*41.2*
PER (x)	244.5	68.9	50.9	32.1	22.7
P/BV (x)	12.1	10.6	6.9	5.7	4.6
EV/EBIDTA (x)	16.5	40.5	23.3	17.0	13.1
EV/Sales (x)	1.9	4.8	3.2	2.4	1.9
RoCE (%)	7.5	11.4	15.2	19.2	22.0
RoNW (%)	6.8	16.4	17.7	19.5	22.3

Investment argument

Business outlook buoyant

The XIth five-year plan (2007-2012) put emphasis on infrastructure development with focus ranging from power to oil & gas to railways. We believe PLL would be one of the key beneficiaries of this investment in some of the areas like pipelines, power and roads. Its presence not only in India but also across Asia and Middle East makes it a beneficiary of a larger market.

Growth in the pipeline

PLL is one of the leading pipeline contractors in Asia and has a significant presence in Middle East. The company has executed over 8,000 kilometres (km) of pipeline projects in all terrains and has been part of some of the important projects. Domestically, The demand for petroleum products is expected to grow at a compounded annual growth rate (CAGR) of 2.9% resulting in increased expenditure in refinery and pipeline infrastructure. The XIth five-year plan lays out an expenditure of Rs4,230 crore towards crude pipeline, while Rs40,000 crore is laid for gas pipelines and Liquified Natural Gas (LNG) terminals. The five-year plan also talks about transnational pipeline as an option, which will further add to the buoyant demand in the sector. Having rich experience not only in India but also across Asia and Middle East we believe PLL is well placed to benefit from the line-up of expenditure in pipeline infrastructure within the country and abroad.

For the first half of FY2008, the company clocked revenues of Rs824.4 crore, a growth of 79% year on year (yoy). Currently the company has orders worth Rs3,605.9 crore for the pipeline division. According to statistics, close to 2.6 lakh kms of pipeline projects are planned around the world. We believe, this presents a huge growth opportunity for pipeline contractors like PLL.

Future pipeline projects

	Total length	% of total	Number of projects
Middle East & Asia	116639	45	283
North America	58170	22	180
Latin America	35000	13	50
Europe	35400	14	72
Africa	10444	4	28
Australasia	5284	2	12
Total	260937		625

Source: Sindex, Sept 2007 data

Process plants

PLL has rich experience in executing a wide range of projects under the process plant business. It has executed projects including gas gathering and process facilities, hydro cracker units, crude distillation and vis-breaker. Acquisition of SEC and Simon Carves has enhanced PLL's expertise in the process plant business and is helping it to scale its operations.

The Supreme Court of India in the year 2000 passed a judgment, which requires all refineries operating in the country to refurbish their process facilities every 10-15 years. Increased focus on pollution control would further open up more opportunities in process plants. Projects in this area of business usually include equipment erection, fabrication and installation of piping, fabrication of steel structures and electrical instrumentation, painting, insulation and fireproofing services. PLL, is amongst the few players to provide such services in the country and with its expertise in the field and lower competition, we believe PLL to emerge as a key beneficiary from spends on process plants.

In H1FY2008, process plant business reported an impressive Rs329.5 crore of revenues. Revenues from the business grew sharply and contributed 9.86% to the total revenues in HIFY2008 from a mere 2.26% in the corresponding half last year (H1FY2007).

Storage tanks and terminals

With demand for oil and gas increasing, it is necessary to set up storage tanks and terminals at production and exploration points to store and transport oil and gas. PLL is one leading players in south Asia in this space and is the only contractor in the world having experience in mechanical, civil and insulation work for LNG tanks. The company has also been involved in construction of all the three LNG terminals (Dabhol, Hazira, and Dahej) in the country. The XIth five-year plan lays out an expenditure of ~Rs9,220 crore on LNG terminals over the next five years. Refineries in the country are also on an expansion spree and the government has also planned to construct 15 million metric tonne (MMT) of strategic storage in phases. PLL, with its leadership position and experience of having built over 6 million cubic metre of storage space should corner a lion's share in the opportunity presented.

PLL currently has Rs838.1 crore worth of orders in hand for this line of business, which is 5.6% of the total outstanding order book of the company.

Infrastructure—may emerge as strong growth driver

Apart from above-mentioned businesses, PLL is also present in infrastructure business and has executed projects like construction of thermal power plants, highways, elevated railroads, flyovers and bridges. The XIth five-year plan revolves around infrastructure development and we believe companies like PLL will see strong order inflows over the plan period (2007-2012).

Acquisition of SEC has added to PLL's advantage plugging gaps in the service offerings of the company and theirby making it more competitive.

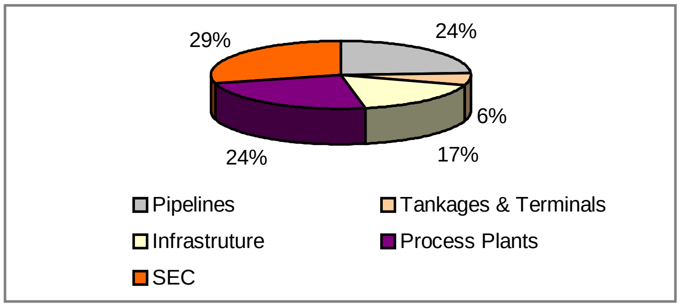
The government has an ambitious plan to add 78,577 megawatt (MW) of power capacity during 2007-2012. This would involve an expenditure of Rs1,031,600 crore in power generation and transmission & distribution (T&D). Another area of focus during the five-year plan is road construction. We expect the government to expedite the process of handing over the road building contracts, going forward. We believe PLL's presence in infrastructure and key areas like power and road construction could well be its growth drivers in the future.

Strong order backlog—moving up the value chain

PLL has a strong order backlog of Rs14,850, which is 2.9x its FY2007 revenues and imparts strong visibility to its earnings, going forward. The company has had a spectacular flow of orders, with orders growing from Rs3,240 crore at FY2005 end to Rs15,944 crore (including Rs4,900 crore for SEC) at FY2007 end. The order book however is fairly skewed towards international markets. The significant point that we would like to highlight here is the average size of orders. The average order size for PLL has gone up from $30 million to $130-140 million and the company intends it to take it to $250 million. We believe higher order size would improve the margins of the company and make it a pre-qualified player for larger and more complex orders.

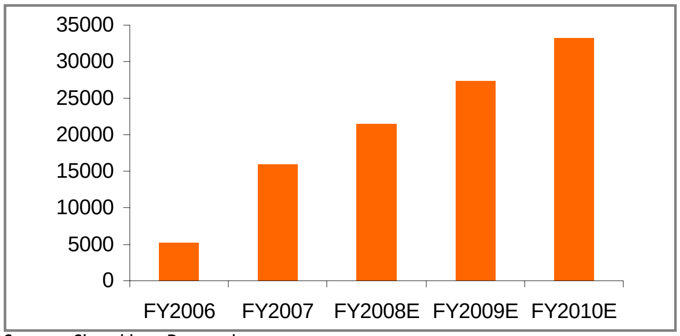
We believe order inflow to remain buoyant for PLL going forward on the back of increased capital expenditure in oil exploration and production (E&P) sector.

Sector-wise breakup of order book



Source: company

Order book growth



Source: Sharekhan Research

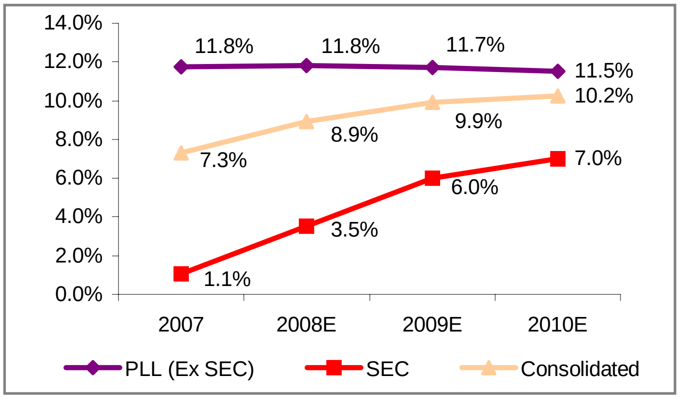
Margins to firm up

Strong revenue growth is expected to firm up operating margins going forward. The company has reported a consolidated earnings before interest, depreciation, tax, and amortisation (EBIDTA) margin of 7.3%. Acquisition of SEC and Simon Carves, which have low OPMs in the range of 1-1.5%, led to a steep decline in the company's margins. At the end of FY2007, SEC has an order backlog of Rs4,900 crore, of which Rs2,600 crore are legacy orders, which are expected to be executed in the next 18-24 months. Post execution of these legacy orders, we expect SEC to achieve an OPM of 7% in FY2010.

	L&T	PLL	SEC	PLL+SEC	HCC	Gammon	Nagarjuna
Pipelines	Yes	Yes		Yes	Yes	Yes	
Tankages & terminals	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						
Electrical equipment	Yes						

Source: Sharekhan Research

Operating margins



Source: Sharekhan Research

Acquisition of SEC and Simon Carves—Plugging gaps to enter upper league

In June 2006, PLL acquired Sembcorp and its subsidiary Simon Carves. The company was then renamed as Sembawang Engineers and Constructions (SEC). SEC is one of the largest engineering and construction company in South East Asia focusing on civil engineering, process engineering and building businesses. With experience in over 35 countries, the company offers complete range of services including master planning, concept designing, detailed engineering designing, development management, construction management and main contracting. We believe the acquisitions have indeed plugged gaps in the service offerings of PLL making it the only company capable of competing L&T, the largest EPC company in the country.

Equity infusion in new business initiatives--to give new revenue stream

Punj Llyod Upstream—providing drilling services

PLL has set up a subsidiary Punj Llyod Upstream Ltd, which would be involved in providing onshore integrated-drilling services. Day rates for oil rigs look robust and we believe PLL to benefit from increasing market for E&P services. The company initially plans to acquire two rigs. Recently, International Finance Corporation (IFC) has picked up a 12% stake in Punj Llyod Upstream for $30 million. As per our estimates this values PLL's 88% stake at Rs869 crore, which works out to Rs27 per share.

Pipavav Shipyard Ltd—PLL holds 25.1% stake

In August 2007, in a strategic move to support growth in offshore business, PLL acquired a 25.1% stake in Pipavav Shipyard Ltd (PSL) for Rs403 crore. PSL will provide PLL access to fabrication facilities for platforms, SBMs, rigs and jackets. With substantial E&P activities undertaken in the country, deploying new platforms and revamping existing offshore platforms is expected to present a significant opportunity. Shipyard industry is expected to grow over 30 % per year in the next few years. The facility is expected to come on stream by Q1FY2009. We believe the investment made by PLL in PSL is a smart move to tap the demand in the E&P sector and also augment its fabrication capability for process plants.

Real estate venture—capitalising rapidly growing market

PLL has signed a memorandum of understanding (MoU) with Ramprastha group for developing multi-storied residential housing schemes through a 50:50 joint venture (JV). The Ramprastha group currently has a land bank of ~800-1,000 acres in and around the National Capital Region (NCR). PLL is expected to initially invest ~Rs187.5 crore in the JV. In the first phase, the JV would be developing a 29-acre housing scheme. The JV would use the expertise of its subsidiary SEC for planning, designing and constructing the residential complex, as SEC has been involved in some of the Singapore's major infrastructure and real estate development. We believe the realty venture would further add to the diversified revenue streams of PLL. Considering the rapidly growing market in the NCR region, PLL looks well placed to capitalise on the demand.

Dayim Punj Lloyd Construction Contracting Co

Dayim Punj Lloyd Construction Contracting Co Ltd is a JV of Dayim Group, headquartered in Kingdom of Saudi Arabia and PLL. PLL holds 49% stake in the company, which offers EPC services for oil & gas, hydrocarbon, petrochemicals and infrastructure sectors. The JV will undertake civil infrastructure and industrial projects.

Key risks

Execution of orders

The most important part for EPC contractors is execution of orders. Any slow down in execution of projects would seriously affect the revenues of the company. Moreover, projects like building roads are awarded by the government and any change in government policy can lead to delays.

SEC integration

PLL has acquired SEC and the biggest challenge now lies in the smooth integration of the two companies. Any delay in execution of legacy orders of SEC could pressurise the margins of the company.

Retention of skilled manpower

The biggest challenge for EPC contractors today is retention of skilled manpower. Engineers are on a short supply in the country and a key challenge for PLL lies in retaining them.

Valuation

We expect PLL's consolidated revenues to grow at a CAGR of 36.9% and 55.1% respectively over FY2007-10E. Order book to sales ratio of 2.9x provides strong visibility to the earnings of the company. We are valuing PLL on the sum-of-the-parts (S-O-T-P) basis. We have valued the core business of PLL at 24x its FY2010E earnings per share (EPS) of Rs22.8. We believe the stock would continue to trade at discount to L&T, the largest player in E&C space owing to L&T's strong order backlog and diverse earnings.

We have valued investments in Pipavav port and real estate venture at 2x price to book. Based on the recent stake sale in the subsidiary, we derive Rs27 per share for value in the subsidiary, Punj Llyod Upstream. We initiate Buy with price target of Rs620, which provides a potential 19.5% upside from current levels.

At the current market price of Rs519, the stock trades at 32.1x and 22.7x its FY2009E and FY2010E EPS of Rs16.7 and Rs22.8 respectively. In terms of enterprise value (EV)/ EBIDTA the stock trades at 17x its FY2009E and 13.1x FY2010E.

Sum-of-the-parts valuations

Particulars	Basis	Value per share
Core business	24x FY10E	548
Shipyard	2x P/BV	25
Real estate business	2x P/BV	20
PLL-Upstream	Based on stake sales	27
Price target		**620**

Peer comparision

Particulars	Punj Llyod	L&T	Gammon	HCC
Net sales (FY2007)	5126.6	17614.2	1864.7	2382.0
Order book(Rs)^	14852.0	44000.0	7500.0	7661.0
Market cap (Rs)	15420.9	124779.2	5185.8	5525.0
OB/Net sales (x)	2.9	2.5	4.0	3.2
M cap/order book (x)	1.0	2.8	0.7	0.7
PER (FY2010E)	22.8	30.0	24.7	30.4

^Orderbook as at the end of H1FY08.
Market cap on current fully issued equity.
Source: Bloomberg, Capitaline, Sharekhan research

Financials (consolidated)

Profit & loss account Rs (crore)

Particulars	FY06	FY07	FY08E	FY09E	FY10E
Net sales	1684.6	5126.6	7971.9	10207.6	13142.8
Total expenditure	1493.7	4752.3	7261.2	9195.0	11796.3
operating profit	190.9	374.3	710.6	1012.6	1346.5
Other Income	31.9	79.4	60.0	63.0	66.2
EBIDTA	222.9	453.7	770.6	1075.6	1412.6
Depreciation	60.4	106.2	132.7	153.7	174.6
PBIT	162.5	347.5	637.9	921.9	1238.0
Interest	79.4	82.5	169.9	179.9	189.9
Profit before tax	83.1	265.0	468.0	742.0	1048.1
Tax	29.2	69.0	140.4	222.6	314.4
Profit after tax	53.9	196.0	327.6	519.4	733.7
Less: Minority interest	1.5	1.2	0.0	0.0	0.0
Reported net profit	55.4	197.3	327.6	519.4	733.7

Balance sheet Rs (crore)

Particulars	FY06	FY07	FY08E	FY09E	FY10E
Sources of funds					
Share capital	52.2	52.3	64.2	64.2	64.2
Reserves total	1069.3	1226.7	2351.1	2860.8	3584.9
Total shareholders funds	1121.5	1278.9	2415.3	2925.1	3649.1
Total debt	556.4	1699.2	1699.2	1799.2	1899.2
Minority Interest	0.9	5.9	5.9	5.9	5.9
Net deferred tax	60.7	36.1	36.1	36.1	36.1
Total liabilities	1739.5	3020.0	4156.4	4766.2	5590.2
Application of funds					
Net block	579.0	1247.2	1464.4	1660.8	1836.2
Capital work in progress	138.6	85.8	100.0	100.0	100.0
Investments	41.6	169.8	569.8	669.8	769.8
Net current assets	980.4	1517.2	2022.1	2335.6	2884.2
Misc expenses not w/o	0.0	0.0	0.0	0.0	0.0
Total assets	1739.5	3020.0	4156.4	4766.2	5590.2

Valuations

Particulars	FY06	FY07	FY08E	FY09E	FY10E
EPS (Rs)	2.1	7.5	10.2	16.2	22.8
PER (x)	244.5	68.9	50.9	32.1	22.7
P/BV (x)	12.1	10.6	6.9	5.7	4.6
EV/EBIDTA (x)	16.5	40.5	23.3	17.0	13.1
EV/Sales (x)	1.9	4.8	3.2	2.4	1.9

Key ratios (%)

Particulars	FY06	FY07	FY08E	FY09E	FY10E
OPM	11.3	7.3	8.9	9.9	10.2
PATM	3.2	3.8	4.1	5.1	5.6
RoCE	7.5	11.4	15.2	19.2	22.0
RoNW	6.8	16.4	17.7	19.5	22.3