Company In-Depth

3 September 2007 | 11 pages

Punj Lloyd (PUJL.BO)

Buy: Likely to Leapfrog to the Next Level, Target Raised to Rs353

Rating change ☐
Target price change ☑
Estimate change ☑

- **Target price raised to Rs353** — Raising target price to Rs353 (from Rs305) as we have revised earnings by 14-16% over FY08E-10E on the back of (1) 73% YoY sales and 101% YoY PAT growth in 1QFY08; (2) 22% higher sales growth on faster execution of orders and 50bps higher margins in Punj (ex Semb); (3) Dilution because of the recent equity placement and promoter warrants.

- **Valuation gap with L&T to narrow** — L&T's order backlog is 2.7x that of Punj + Semb but (1) its market is 7.5x and (2) is 32% more expensive than Punj. We expect this valuation and market capitalization gap to narrow as we forecast Punj Lloyd will start delivering earnings growth at a pace superior to L&T over the next 3 years.

- **Starting to deliver on the early promise** — Punj Lloyd is perhaps the only mid cap E&C company that could leapfrog into the next level which is occupied by L&T with its diversified skill sets. The first sign that Punj Lloyd can actually deliver on its potential came when the company reported 4QFY07 PAT of Rs889mn which was 59% ahead of CIR estimates.

- **Painting on a larger canvas** — In FY07 Punj Lloyd acquired Semb which scaled up its expertise to upstream oil & gas, airports, jetties, MRT/LRT and tunnelling. With these extended capabilities Punj is now pre-qualified for larger/more complex projects. Indications of this scale up is already available (Average order is up from US$30mn to US$100mn in FY07 and likely to go up to US$200mn).

Buy/Low Risk	1L
Price (31 Aug 07)	Rs278.85
Target price	Rs353.00
from Rs305.00	
Expected share price return	26.6%
Expected dividend yield	0.1%
Expected total return	**26.7%**
Market Cap	Rs81,106M
	US$1,996M

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

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	545	1.93	-13.6	144.5	6.5	6.7	0.1
2007A	1,973	6.98	261.7	39.9	5.7	16.4	0.1
2008E	3,358	10.42	49.3	26.8	3.4	18.2	0.1
2009E	4,944	15.34	47.2	18.2	2.8	18.6	0.1
2010E	6,648	20.63	34.5	13.5	2.3	20.6	0.1

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	144.5	39.9	26.8	18.2	13.5
P/E reported (x)	143.9	40.0	26.8	18.2	13.5
P/BV (x)	6.5	5.7	3.4	2.8	2.3
Dividend yield (%)	0.1	0.1	0.1	0.1	0.1
Per Share Data (Rs)					
EPS adjusted	1.93	6.98	10.42	15.34	20.63
EPS reported	1.94	6.97	10.42	15.34	20.63
BVPS	42.96	48.95	83.15	99.74	122.19
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**	**5,566**	**7,696**	**10,081**
Non-oper./net int./except.	-475	-35	-688	-638	-588
Pre-tax profit	**831**	**2,656**	**4,877**	**7,058**	**9,493**
Tax	-291	-690	-1,460	-2,115	-2,845
Extraord./Min. Int./Pref. Div.	7	3	-59	0	0
Reported net income	**547**	**1,969**	**3,358**	**4,944**	**6,648**
Adjusted earnings	545	1,973	3,358	4,944	6,648
Adjusted EBIT	1,298	2,682	5,556	7,687	10,071
Adjusted EBITDA	1,902	3,743	6,910	9,333	12,010
Growth Rates (%)					
NOI	na	na	na	na	na
EBIT adjusted	2.8	106.5	107.2	38.4	31.0
EPS adjusted	-13.6	261.7	49.3	47.2	34.5
Cash Flow (RsM)					
Operating cash flow	**-548**	**6,319**	**747**	**4,518**	**6,175**
Depreciation/amortization	604	1,062	1,354	1,647	1,939
Net working capital	-1,680	3,536	-4,281	-2,072	-2,412
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	**3,938**	**11,047**	**8,038**	**-119**	**-119**
Borrowings	-1,637	11,442	0	0	0
Dividends paid	-60	-92	-102	-119	-119
Change in cash	**685**	**8,868**	**256**	**-1,100**	**556**
Balance Sheet (RsM)					
Total assets	**23,056**	**57,278**	**79,247**	**91,867**	**107,566**
Cash & cash equivalent	1,107	10,027	10,166	9,066	9,622
Net fixed assets	7,108	12,019	15,175	18,038	20,609
Total liabilities	**11,833**	**44,432**	**55,064**	**62,860**	**72,031**
Total Debt	5,551	16,994	16,995	16,996	16,997
Shareholders' funds	**11,225**	**12,848**	**24,186**	**29,011**	**35,540**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	7.7	5.2	7.3	8.3	8.9
ROE adjusted (%)	6.7	16.4	18.2	18.6	20.6
ROA adjusted (%)	2.7	4.9	4.9	5.8	6.7
Net debt to equity (%)	39.6	54.2	28.2	27.3	20.8
Interest coverage (x)	2.4	4.5	5.0	6.7	8.7

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Powered by: dataCentral

New Target Price Rs353

- We raise our target price to Rs353 (from 305 earlier) as we have revised earnings by 14-16% over FY08E-10E on the back of (1) 73% YoY sales and 101% YoY PAT growth in 1QFY08; (2) 22% higher sales growth on faster execution of orders and 50bps higher margins in Punj (ex Semb); and (3) Dilution because of the recent equity placements and promoter warrants.

- L&T's order backlog is 2.7x that of Punj + Semb but (1) its market capitalization is 7.5x and (2) is 32% more expensive than Punj. We expect this valuation and market capitalization gap to narrow as we forecast Punj Lloyd to start delivering earnings growth at a pace superior to L&T over the next 3 years.

Figure 1. L&T vs. Punj – A Brief Comparison

Parameter	Larsen & Toubro	Punj Lloyd + Sembawang E&C	Remarks
Mkt Cap (US$mn)	17612	1931	
Mkt Cap Attributable to Non E&C (US$mn)	3056	0	
E&C Mkt Cap (US$mn)	14556	1931	- L&T's E&C market capitalization is 7.5x Punj + Semb
1QFY08 Order Backlog (Rsbn)	416	152	- L&T's order backlog is 2.7x that of Punj + Semb
FY09E E&C P/E Multiple	24.0	18.2	- L&T trades at a 32% premium to Punj +Semb
Earnings CAGR FY07-10E	35%	44%	- Punj (coming off smaller base) should have superior earnings growth
Average RoE FY08E-10E	31%	19.1%	- L&T has superior RoEs
Average EBITDA Margins FY08E - 10E	10.5%	9.9%	
Average EBIT Margins FY08 - 10E	9.7%	8.2%	
Skill Sets			- On paper Punj + Semb should have ~ 70% of L&T's skill sets
Execution History			- L&T has a far superior execution history

Source: Citigroup Investment Research estimates

Earnings revised upwards

We raise our FD EPS by 14-16% over FY08E-10E as:

- We have increased our sales estimate for Punj (ex Semb) by 22% over the next three years on faster execution of the order backlog on the back of robust sales growth of 75% in 1QFY08.

- Further, a robust Punj (ex Semb) order backlog of Rs110bn at the end of 1QFY08 and strong order inflow outlook provides us the confidence to estimate a much stronger sales growth trajectory.

- We have also increased the Punj (ex Semb) EBITDA margins by 50 bps as we believe Punj (ex Semb) 1QFY08 EBITDA margins of 12.6% provides an early indication of a higher margins vis-à-vis our earlier expected 11.5%.

- As a consequence we have increased our Recurring PAT ~ 30% over the next three years. However, we have diluted the FD EPS by 29.6mn shares for the recent equity placements and 10mn shares for the warrants issued to the promoters. As a consequence we now have FD EPS estimates which are higher by 14-16% over FY08E-10E.

Figure 2. Punj Lloyd Earnings Revision Table

	FY08E	FY09E	FY10E
PLL (ex Semb) Sales			
Old	41,000	51,250	64,063
New	50,000	62,500	78,125
% Chg	22.0%	22.0%	22.0%
Semb Sales			
Old	26,000	30,550	35,133
New	26,000	30,550	35,133
% Chg	0.0%	0.0%	0.0%
PLL (ex Semb) EBITDA Margin %			
Old	11.5%	11.5%	11.5%
New	12.0%	12.0%	12.0%
% Chg	500bps	500bps	500bps
Semb EBITDA Margin %			
Old	3.5%	5.5%	7.0%
New	3.5%	5.5%	7.0%
% Chg	0bps	0bps	0bps
Recurring PAT			
Old	2,577	3,750	5,127
New	3,358	4,944	6,648
% Chg	30.3%	31.8%	29.7%
FD EPS			
Old	9.12	13.27	18.15
New	10.42	15.34	20.63
% Chg	14.3%	15.6%	13.7%

Source: Citigroup Investment Research estimates

The Next Big Thing?

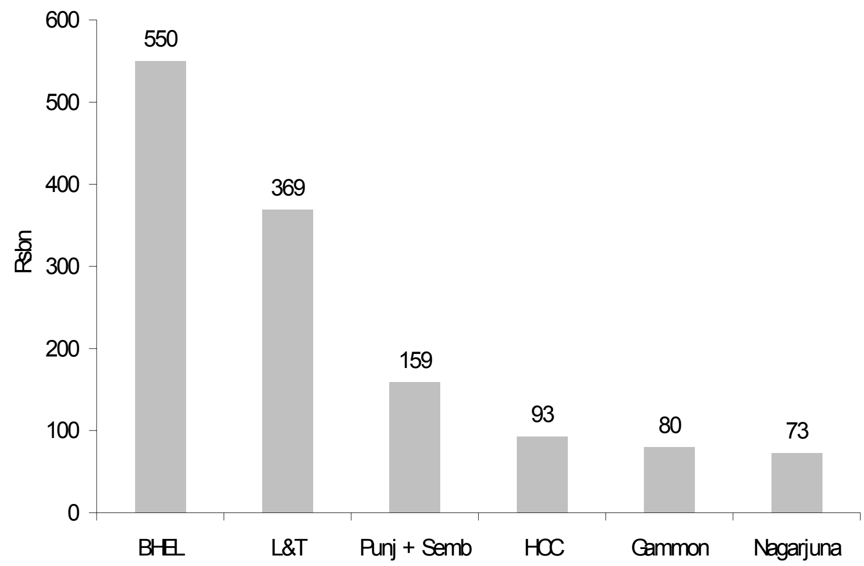
- Punj Lloyd is perhaps the only Indian mid cap engineering & construction (E&C) company that has the necessary skill sets and desire to leapfrog into the next level, a level that is occupied by L&T with its immensely diversified skill sets. The first sign that Punj Lloyd can actually leverage on these 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 an impressive 1QFY08 when earnings grew 101% YoY.

- Over the years 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 has the third largest order backlog of Rs159bn after BHEL and L&T. The gap between Punj and the other mid cap construction companies is not a mere numerical one but also one of skill sets which Punj can leverage further in the coming years.

- 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 FY07 End E&C Order Backlog



Source: Citigroup Investment Research

Figure 4. India Engineering & Construction Skill Set Matrix

	L&T	Punj Lloyd	Semb	Punj + Semb	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: Citigroup 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 the company 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 thesis

We rate Punj Lloyd 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 Rs159bn 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 Rs353 is based on a target P/E multiple of 23x FY09E, which is well supported by earnings CAGR of 44% over FY07-10E and RoEs expanding from 18% in FY08E to 21% in FY10E. Our target multiple is at a discount to that of L&T. Despite Punj Lloyd’s superior earnings CAGR of 44% over FY07-10E vis-à-vis that of 35% 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.

Risks

We rate Punj Lloyd Low Risk which differs from the Medium Risk rating suggested by our quantitative risk rating system but in line with other construction companies given the company’s FY07E ending Order Book of Rs159bn 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:

- Integration risks relating SembCorp E&C
- Revenue volatility due to project-driven nature of business
- Exports – subject to geopolitical risks
- Project implementation risks, bad debts and receivables
- Sensitivity to raw material costs and foreign currency fluctuations
- Employee retention could be a key challenge

Larsen & Toubro (LART.BO - Rs2,582.75; 1L)

Valuation

Using a comps-based P/E of 26x FY09E, we get a core business value of Rs2,326 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 Rs2,765. We value L&T's subsidiaries at Rs439 with L&T Infotech at Rs222 (16x FY09E EPS, in-line with second-tier peers) and L&T IDPL at Rs79 (a 20% premium to private equity valuations, because a number of projects will be commissioned over the next couple of years).

Risks

We rate L&T Low Risk, as opposed to the High Risk suggested by our quantitative risk-rating system, because L&T's order backlog of c.Rs369bn represents two years' sales and provides earnings visibility. 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

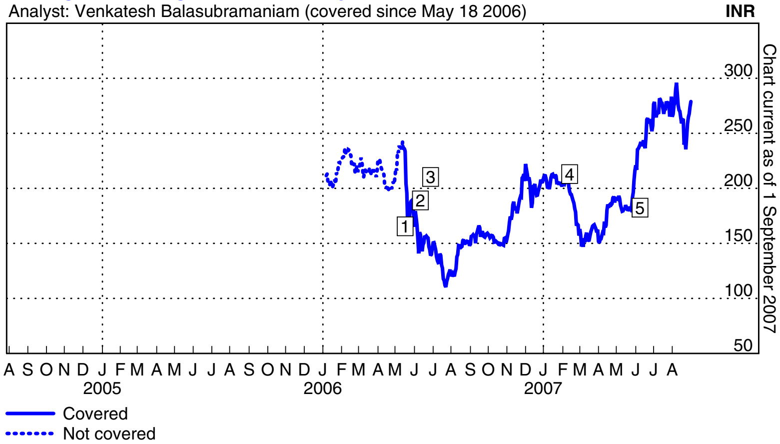
We, Venkatesh Balasubramaniam and Deepal Delivala, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

Punj Lloyd (PUJL.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Venkatesh Balasubramaniam (covered since May 18 2006)



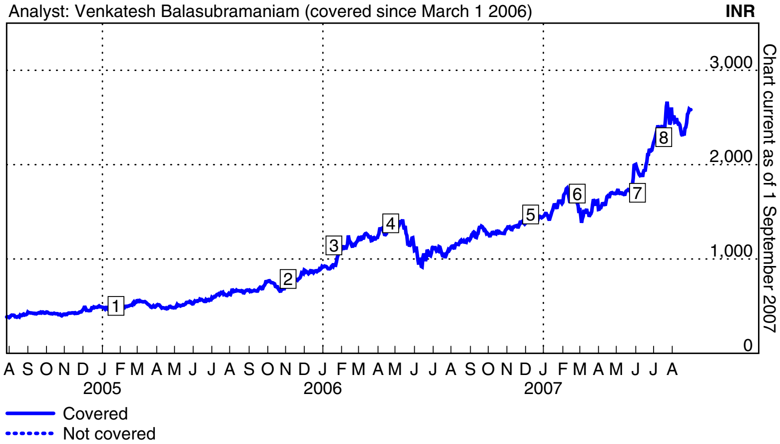
#	Date	Rating	Target Price	Closing Price
1:	17 May 06	3M	212.00	233.76
2:	12 Jun 06	*1M	*228.60	158.08
3:	28 Jun 06	1M	228.60	138.99
4:	13 Feb 07	*3M	*175.40	197.13
5:	8 Jun 07	*1L	*305.00	239.60

*Indicates change.

Larsen & Toubro (LART.BO)

Ratings and Target Price History - Fundamental Research

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.

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Citigroup Investment Research Ratings Distribution

Data current as of 19 July 2007	Buy	Hold	Sell
Citigroup Investment Research Global Fundamental Coverage (3320)	47%	39%	14%
% of companies in each rating category that are investment banking clients	71%	70%	70%
India -- Asia Pacific (144)	64%	11%	25%
% of companies in each rating category that are investment banking clients	89%	94%	83%

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