

Steel - Pipes

PSL Ltd

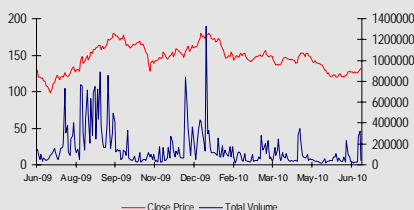
Buy

CMP **Rs. 132**Target Price **Rs. 158**

Key Data

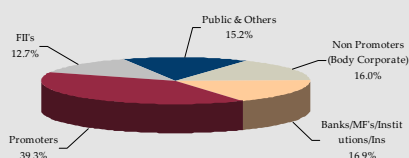
| | |
|-------------------------------|-----------|
| Face Value (in Rs) | 10.00 |
| Market Cap (Rs in mn) | 7062 |
| Total O/s Shares in (in mn) | 53.5 |
| Free Float | 60.75% |
| 52 Week High / Low | 188/98 |
| Avg. Monthly Volume (BSE) | 77241 |
| Avg. Monthly Volume (NSE) | 109971 |
| BSE Code | 526801 |
| NSE Code | PSL |
| Bloomberg Code | PSLL IN |
| Beta | 1.16 |
| Date of Incorporation | Aug. 1987 |
| Last Dividend Declared | 40% |
| Six month return | -22.2% |
| Indices | BSE-500 |
| FCCB's outstanding (in Rs mn) | N.A |
| Warrants outstanding | N.A. |

One Year Price Chart



Source: Capitaline

Share Holding Pattern (31.03.2010)



Source: Company, KJMC Research

Hiral Kotak

Research Analyst

Phone-022 4094 5500 Ext. 205

Email - hiral.kotak@kjmc.com

PSL limited is the largest player in HSAW pipe in India with a capacity of 1.8mtpa. The domestic demand for pipes from Gail, Reliance, GSPL etc is expected to be ~ 2 mtpa over next two years and PSL expects the larger share of the proposed pipeline network. Demand for HSAW pipes would be robust with increase in E&P activities, city gas distribution and replacement demand from US. Going forward, we expect PSL to register CAGR of 3.9% and 17.1% in net sales and net profit respectively during FY10-FY12E.

Investment Trigger Highlights

Huge pipe demand from domestic and overseas market: There is a significant requirements of pipes from India and overseas market led by demand from 1) Setting up of national gas grid 2) City gas distribution 3) USD 78bn replacement demand opportunity from US and Europe 4) To reduce crude imports more emphasis on NELP programme 5) Huge Government spending on water pipeline projects 6) Investment by private players like Reliance, Cairn, GSPL in setting up Oil & Gas pipeline infrastructure.

Largest in HSAW pipes and present across multiple locations: PSL is the largest HSAW pipe manufacturers in India having a capacity of 1.8 mtpa. PSL Limited has 13 pipe mills located across various strategic locations namely Chennai, Kandla, Vizag, Jaipur and Ahmedabad. PSL has also established its presence internationally by setting up 0.3mtpa plant in USA and 0.075 mtpa in UAE to cater international demand reduce transportation cost and increase margins.

Relocation of plants helps in competitive bidding: PSL has the flexibility to relocate HSAW conventional pipe mills near the customer's end which reduces the transportation cost and enable it to bid competitively. PSL has 13 mills at various strategic locations across India and abroad of which 11 mills are located in India. PSL with its relocation facility is well equipped to cater to the burgeoning pipe demand from the various projects being implemented by Gail, Reliance, GSPL, Cairn etc.

Major domestic pipeline projects in south-east India in next 2-3 years: In India most of the gas pipeline infrastructure is concentrated in west and north while the south and east have largely been untouched. The south India will start getting natural gas from KG basin from 2012. Major domestic players Reliance, Gail etc are going to lay pipeline network in untouched south and east India. Over next 2-3 years the demand opportunity for pipe from southern India would be ~ 2 mn tonnes. PSL with its 525000 mtpa capacities available in the south and east India can expect a large share of the proposed pipeline network.

Order book of Rs 20 billion and strong execution track record: PSL has a healthy order book of Rs 20 bn to be executed over a period of 9-12 months period. 70% of the order book consists of domestic orders. Healthy order inflows from domestic users like GAIL give higher visibility to its topline & bottom line growth. Gail has plans to add further 5000km pipelines in next 3 years translating into pipe demand of ~1mn tones.

Consolidated Financial Snapshot

Rs in mn

| Particulars | FY08 | FY09 | FY10E | FY11E | FY12E |
|--------------------|---------|---------|---------|---------|---------|
| Total Income | 22931.1 | 36489.1 | 39935.6 | 38622.2 | 43126.3 |
| Growth (%) | 40.5 | 58.3 | 10.7 | -3.3 | 11.8 |
| EBITDA | 2370.8 | 3100.5 | 3551.0 | 3981.0 | 4488.1 |
| EBITDA margins (%) | 10.3 | 8.5 | 8.9 | 10.3 | 10.4 |
| Net Profit | 844.0 | 948.4 | 1226.7 | 1241.7 | 1681.0 |
| EPS | 19.8 | 22.3 | 23.0 | 23.3 | 31.5 |
| P/E | 6.6 | 5.9 | 5.7 | 5.7 | 4.2 |
| P/BV | 1.0 | 0.8 | 0.7 | 0.7 | 0.6 |
| EV/EBITDA | 5.2 | 5.3 | 6.2 | 5.2 | 4.2 |
| ROE (%) | 14.8 | 13.7 | 13.1 | 11.9 | 14.0 |

Source: Company, KJMC Research

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General data sources

Company, Capitaline, Public domain, Bloomberg.

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Investment Highlights

Huge pipe demand from domestic and overseas market: There is a significant requirements of pipes from India and overseas market led by demand from 1) Setting up of national gas grid entailing an investment of Rs 210 bn 2) City gas distribution from present 10 cities available the coverage expected to increase to 100 cities in next 5 years entailing an investment of Rs 250-300 billions 3) USD 78bn replacement demand opportunity from US and Europe 4) To reduce crude imports more emphasis on NELP programme 5) Huge Government spending on irrigation water pipeline projects 6) Investment by private players like Reliance, Cairn, GSPL in setting up Oil & Gas pipeline infrastructure

Largest in HSAW pipes and present across multiple locations: PSL is the largest HSAW pipe manufacturers in India having a capacity of 1.8 mtpa. PSL which manufactures only HSAW pipes have a competitive advantage over LSAW pipes due to easy availability of HR coil domestically and large diameter pipes above 56 inches can be manufactured. PSL Limited has 13 pipe mills located across various strategic locations namely Chennai, Kandla, Vizag, Jaipur and Ahmedabad. PSL has also established its presence internationally by setting up 0.3mtpa plant in USA and 0.075 mtpa UAE to cater huge international demand reduce transportation cost and increase margins.

Current details of location wise HSAW pipe mills and their capacity is as under:

| Location | Pipe / Coating mill | Capacity (mtpa) |
|--------------------------------------|----------------------------------|-----------------|
| Chennai | 1 HSAW pipe mill - Conventional | 150000 |
| Kandla | 4 HSAW pipe mills - Conventional | 300000 |
| | 1 HSAW pipe mill - Two Stage | 350000 |
| Vizag | 1 HSAW pipe mill - Conventional | 75000 |
| | 1 HSAW pipe mill - Two Stage | 300000 |
| Ahmedabad | 1 HSAW pipe mill - Conventional | 75000 |
| Jaipur | 2 HSAW pipe mill - Conventional | 150000 |
| Sharjah, UAE | 1 HSAW pipe mill - Conventional | 75000 |
| Mississippi, USA | 1 HSAW pipe mill - Conventional | 300000 |
| Total HSAW Pipe Mill Capacity | | 1775000 |

Source: Company

Relocation of plants helps in competitive bidding: PSL has the flexibility to relocate HSAW conventional pipe mills near the customer's end which reduces the transportation cost and enable it to bid competitively. PSL has 13 mills at various strategic locations across India and abroad of which 11 mills are located in India. PSL geographical dispersion of its pipe mills at various strategic locations enable it's to relocate the conventional pipe mill to cater a particular project. We believe PSL with its relocation facility is well equipped to cater to the burgeoning pipe demand from the various projects being implemented by Gail, Reliance, GSPL, Cairn etc

Major domestic pipeline projects in south-east India in next 2-3 years: In India most of the gas pipeline infrastructure concentrated in west and north while the south and east have largely been untouched. The south India will start getting natural gas from KG basin from 2012. Major domestic players Reliance, Gail etc are going to lay pipeline network in untouched south and east India. Over next 2-3 years the demand opportunity for pipe from southern India would be ~ 2 mn tonnes. PSL with its 525000 mtpa capacities available in the south and east India can expect a large share of the proposed pipeline network to be built.

Details about various domestic pipeline projects in south-east India

| Pipeline | Company Name | Length (km) | -Metric ton |
|----------------------------|--------------|-------------|-------------|
| Dabhol - Bangalore | Gail | 1480 | 220000 |
| Kochi - Bangalore | Gail | 840 | 180000 |
| Jagdishpur - Haldia | Gail | 1690 | 400000 |
| Kakinada - Chennai | Reliance | 600 | 200000 |
| Kakinada - Haldia | Reliance | 670 | 200000 |
| Chennai - Bangalore | Reliance | 660 | 200000 |
| Mallavaram - Bhilwara | GSPL | 1585 | 400000 |
| Mehsana-Bhatinda- Srinagar | GSPL | 2410 | 400000 |

Source: Gail ppt, GSPL, KJMC Research

Order book of Rs 20bn and enhanced capacities to capture future growth opportunities: PSL has a healthy order book of Rs 20bn of which Rs 14bn orders are from domestic market. PSL has a strong presence in the domestic market and with the healthy order inflows from domestic users like GAIL give higher visibility to its top & bottom line growth. Gail has plans to add further 5000km pipeline in next 3 years which translate into pipe demand of ~ 1mn tonnes. India's largest gas company, GAIL, which operates about 7,200 km of pipelines, recently announced plans to put up an additional 1,000 km by the end of this calendar year and a total of 5,000 km by 2013. The company has outlined investments of \$6-7 billion (Rs 28,000-33,000 crore) in the next five years.

The Indian pipe industry is among the top three manufacturing hubs after Japan and Europe. However, the penetration level of pipelines in oil and gas transportation is low at 32% in India. The low penetration levels represent the huge scope of growth for the pipe industry. Even on the international fronts while the demand for Pipelines is continuously on rise mainly due to surging of crude oil prices. The replacement demand from USA and European countries, having a vast pipeline infrastructure, will be huge. Hence ample opportunities are available both on national as well as international front for PSL.

The Company Background

PSL Limited, large manufacturers of high grade large-diameter spiral (helical) submerged arc welded pipes, or HSAW pipes with a current capacity to produce up to 1,775,000 metric tonnes of spiral arc welded pipes per year. HSAW pipes are used in the transmission of oil, gas and water.

Mr. Ashok Punj is the Managing Director of the Company. He has a Bachelors degree and a Masters degree in engineering from the Illinois Institute of Technology located in Chicago, Illinois. Mr. Punj has over 36 years experience in setting up industrial enterprises in diverse fields and managing them successfully.

PSL manufactures HSAW pipes at 13 HSAW pipe mills, 11 pipe mills are located in five locations geographically spread throughout India and one in the United Arab Emirates owned by our subsidiary PSL FZE and one in the state of Mississippi, USA owned by our subsidiary PSL North America LLC.

PSL also provide pipe coating services which include pipe corrosion protection. In addition, PSL also provide various other types of ancillary products and services related to the pipe industry such as induction pipe bending, sacrificial anodes, reinforcement bar (rebar) coating and turnkey HSAW plant and machinery manufacturing.

However, HSAW pipe manufacturing and pipe coatings are our two main business segments

PSL Products

HSAW

HSAW pipes are typically used for the transmission of oil, gas and water. PSL produce large-diameter (18 inches up to 120 inches) HSAW pipes of varying thickness between 5 mm to 25 mm. All pipe mills are certified to conform to, amongst others, the American Petroleum Institute Standards (Spec 5L) for line pipes which makes PSL eligible to manufacture pipes for transportation of oil and gas. Other uses of HSAW pipes include structural pipes for buildings.

Pipe Coating

Steel pipes if exposed to atmosphere corrode. To prevent the steel pipes from corroding and increasing the life of the pipe, anti corrosive coating is applied on the steel pipes. There are different types of coatings such as 3 Layer Polyethylene / Fusion bonded epoxy coating, Coal Tar Enamel Coating, Concrete Weight Coating, Internal Coating, Internal Cement Mortar Lining etc. The coated pipes find its application in transportation of Oil, Gas and water. Pipe coating services are provided for both onshore and offshore pipe projects. Offshore pipe coating is a niche market. The majority of onshore coating work is provided in connection with the pipe manufacturing projects.

Industry Overview

Pipelines are the preferred mode of transportation for liquids and gases globally. Various developments in the oil & gas exploration and procurement sector are providing an increasing need to create logistics infrastructure to market oil and gas. The result is the increasing demand for pipes. Though capex cost in pipelines is higher as compared to road and rail, the logistics costs in the case of pipes works out to be much lower, which results in higher benefits for companies that prefer to opt for pipelines to transport its products.

In addition to transportation of oil and natural gas, pipelines find their application in various other industries and applications, including water, oil and gas related products, sewage transportation and in mechanical, structural, chemical, automobile and general engineering industries.

Steel pipes are the preferred mode of transportation of high pressure oil, gas and water. Pipes manufactured from steel are further classified on the basis of their manufacturing process into following categories:

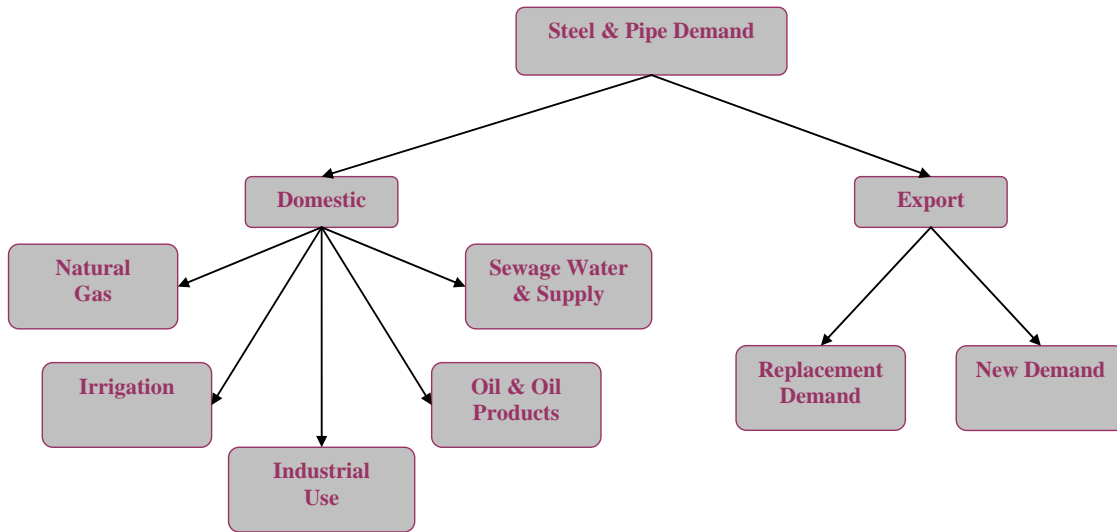
- Spiral/helical SAW (HSAW) pipes;
- Longitudinal SAW (LSAW) pipes;
- Seamless pipes; and
- Electric resistant welded (ERW) pipes

Pipe manufacturing is a capital intensive industry and for executing larger projects any new player needs to establish substantial capacity. There are stringent pre-qualification criteria for most large projects in the oil and gas sector and only established players with a track record of executing projects can qualify.

| | Spiral/Helical Saw pipes (HSAW) | Longitudinal Saw Pipes (LSAW) | Seamless | Electric Resistance Welded (ERW) |
|--------------------------------------|---|--|--|---|
| Raw Material used and Process | Made by spirally welding HR coils | Made by Longitudinally submerged arc welding of steel plates. | Made by piercing steel billets | Made from hot rolled steel coils using electrical resistance welding process. |
| Application | Oil & gas transportation, water transportation and sewage disposal | Oil & gas transportation | Petroleum exploration, general engineering, boilers and automotive. | Oil and gas / water distribution |
| Size | 18" to 120" diameter | 16" to 56" diameter | 0.5" to 14" diameter | 0.5" to 22" diameter |
| Principal Indian Producers | PSL Ltd., Jindal Saw Ltd., Welspun Corp. Ltd., Man Industries Ltd, Ratnamani Metals & Tubes Ltd | Jindal Saw Ltd., Welspun Corp. Ltd., Man Industries Ltd., Ratnamani Metals & Tubes Ltd | Maharashtra Seamless Ltd. and Jindal Saw Ltd, Ratnamani Metals & Tubes Ltd | Welspun Corp. Ltd. and Maharashtra Seamless Ltd. |
| Key Differentiator | 1. Uses lighter equipment which can be relocated to project site. 2. Can go upto any diameter up to 120" 3. Offshore use limited due to limitation of wall thickness beyond 25mm. 4. Find application in trunk lines | 1. Uses heavy machinery and hence not relocatable. 2. Limited diameter due to plate width. 3. Suited for offshore pipeline due to higher wall thickness capability. 4. Find application in trunklines | 1. Find application in branch lines | 1. Limitation on size, thickness and grade. |

Source: Company, KJMC Research

Demand for steel Pipes



Demand for pipes in India

Demand for steel pipe products depends on oil, gas and water infrastructure projects being executed in India. The extent to which such projects are executed in turn is dependent on a number of factors, including the Indian economy, Indian Government policy and the global and domestic oil and gas industry.

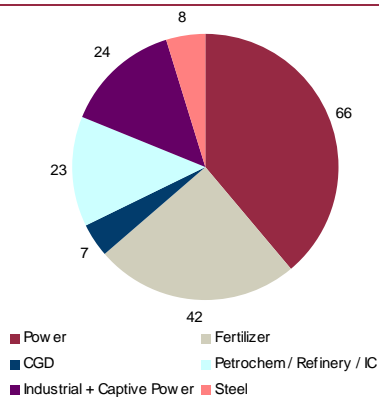
Gas transmission pipeline capacity set to more than double in next five years

India with its large geographical area has very low pipe penetration levels at 32% compared to global average of 79% in oil and gas transport. India current gas transmission pipeline length is estimated at ~10500 km and has a capacity of ~270 mmscmd. India will add over 7,450 km of gas pipeline network over the next 2-3 years to ramp up its supply lines to keep pace with the growing demand from the country.

Sector wise Gas Supply Projections

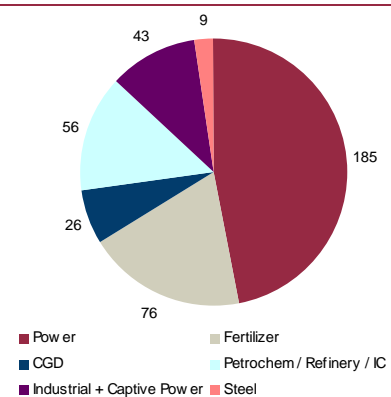
At present, gas occupies about 10% of the total energy basket of the country, much less than the world average of 24%. The scenario is fast changing, largely because of the increase in the availability of natural gas and the efforts being made towards expanding the natural gas infrastructure. Discoveries by Reliance Industries in the Krishna Godavari basin have almost doubled the availability of gas from domestic sources. India's natural gas demand is expected to nearly double to 320 million standard cubic meters per day by 2015, global consultancy firm McKinsey.

Natural Gas Consumption (170 MMSCMD) – FY10



Source: Industry

Natural Gas Consumption (395 MMSCMD) – FY20E



Source: ICRA's estimate

Demand for Petroleum Products in India (mmt)

| Year | Petroleum Products |
|------|--------------------|
| FY10 | 127.8 |
| FY11 | 136.6 |
| FY12 | 141.8 |
| FY17 | 179.3 |

Source: Working group report of XI th plan, KJMC Research

Gail pipeline project over next 2-3 years

| Future Projects | Length (km) |
|---------------------------------|-------------|
| Dabhol - Mangalore | 1389 |
| Kochi-Mangalore-Bangalore | 1114 |
| Jagdishpur-Haldia | 2050 |
| Projects under execution | |
| Dadri-Bawana-Nangal | 621 |
| Chainsa- Jhajjar-Hissar | 443 |
| Dahej-Vijaipur-grep upgradation | 1108 |
| Total GAIL pipeline | 6725 |

Source: Gail ppt, KJMC Research

GSPL proposed pipelines

| | length (km) |
|----------------------------------|-------------|
| Mehsana - Bhatinda | 1670 |
| Bhatinda - Jammu - Srinagar | 740 |
| Surat - Paradip | 1680 |
| Mallavaram - Vijaypur - Bhilwara | 1585 |

Source: GSPL, KJMC Research

Thrust on National Gas grid and NELP programme

The Government of India in its efforts to reduce crude imports has formulated the New Exploration Licensing Policy (NELP) programme for exploration and production of oil & gas. The GoI has awarded 256 blocks till date and the number is set to increase to 330 by 2010. The government thrust on creation of National Grid entailing an investment of Rs 210 bn will also result in demand for line pipes.

City Gas Distribution

City gas pipe is currently available in 10 cities and the coverage is expected to grow to 40 cities in the next five years, entailing an investment of Rs. 250-300 bn.

Water transport

Demand is also likely to come from the increasing expenditure on urban infrastructure and water transport projects. According to Crisil, over the next three-four years, Rs 2,65,000 crore will be invested on urban infrastructure, a three-fold increase compared to the Rs 85,300 crore invested in the past four years. In order to improve the sanitation levels, the government launched the reform-linked Jawaharlal Nehru National Urban Renewal Mission (JNNURM) along with Urban Infrastructure Development Scheme for Small and Medium Towns (UIDSSMT) in December 2005. The total outlay for the Urban Infrastructure and Governance component of JNNURM is Rs 315 billion for the mission period i.e. 2005-2012.

International markets

The outlook for pipe companies in the international markets has also improved on the back of recovery in crude oil prices, leading to higher E&P expenditure. According to the global research agency Simdex, 714 pipeline projects of 3,24,301 km are to be implemented over the next five years. The demand is estimated to be coming largely from North America, Asia and the Gulf countries.

International pipeline project

| Region | Projects | Total Length (kms) | Quantity (MMT) | Business Potential (US\$ Bn) |
|---------------|------------|--------------------|----------------|------------------------------|
| North America | 193 | 67225 | 14 | 16 |
| Latin America | 44 | 32561 | 7 | 8 |
| Europe | 102 | 43232 | 9 | 11 |
| Africa | 57 | 22594 | 5 | 5 |
| Middle East | 115 | 50067 | 10 | 12 |
| Asia | 156 | 92085 | 18 | 22 |
| Australia | 47 | 16537 | 3 | 4 |
| Total | 714 | 324301 | 66 | 78 |

Source: Simdex, US, March 2010 update

Replacement Demand

Apart from the demand from new projects, there is another opportunity emerging in the form of replacement demand for line pipes which is expected to be much bigger than demand from new projects. The average life of a pipe used for transportation of oil and gas is approximately 25 to 30 years. More than one million miles of gas pipelines out of the 1.5 million miles in the US were laid prior to 1975. These pipelines which have outlived their economic life have a pressing need for replacement to ensure smooth flow of operations. Demand from replacement market has not yet started flowing in but when it does, it may provide an additional opportunity for Indian SAW pipe manufacturers as the US companies alone will not be in a position to satisfy this additional demand.

Key Risk & Concerns

Downturn in E&P activities: Demand for steel pipe comes from mainly comes from oil and gas industry. Any downturn in the crude oil prices will affect E&P activities and inturn result in decline in demand for pipes.

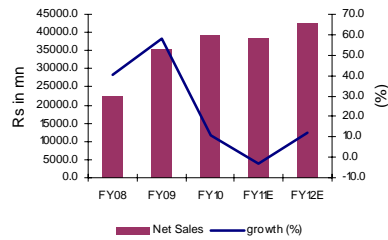
Raw material price volatility: Raw material accounts for ~70% of the revenues. The company is exposed to the raw material price volatility between the time it is bidding for a project and time it places the order for raw material. Any volatility in the prices of HR coils may have impact on the margins and profitability of the company.

Volatility in rupee dollar may adversely impact: PSL imports HR coil and majority of its sales come from the domestic markets. As a result any adverse movement in the rupee dollar will have an impact on the profitability.

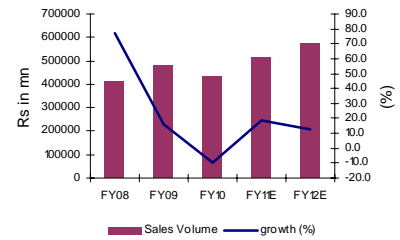
Financial Analysis

Net sales to grow by CAGR of 3.9% during FY10-FY12E: The consolidated net sales of the company grew by 10.7% in FY10 mainly led by increase contribution from US subsidiary. For FY10 US subsidiary sales volumes were 108000 mt and standalone sales volume were 323000 mt down 32.3% y-o-y and overall consolidated volume were down by 10% to 431000 mt. Going forward we expect sales volume growth of 18.9% and 12.2% in FY11E and FY12E respectively led by pick up in domestic volumes and contribution from US subsidiary. The management has given consolidated volume guidance of 500000-550000 for FY11E. We expect the net sales to decline by 3.3% in FY11E on account of decline in realizations.

Net Sales and Growth



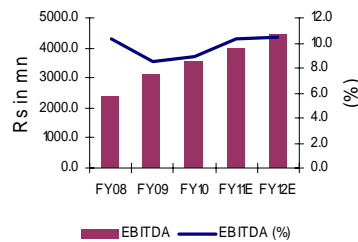
Sales Volume and Growth



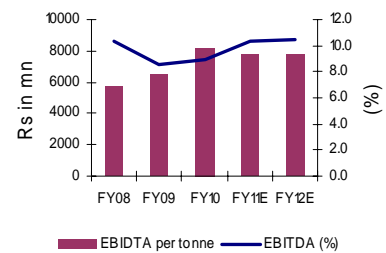
Source: Company, KJMC Research

PAT to grow by CAGR of 15.8% during FY10E-FY12E: The consolidated net profit of the company grew by 29.3% in FY10 led by contribution from US subsidiary and EBITDA increased by 14.5%. For FY11E and FY12E we expect the company to clock EBITDA per tonne of Rs 7766 and Rs 7800 respectively. For the FY11E and FY12E we expect the net profit to grow by 1.2% and 35.4% respectively.

EBITDA and Margin



EBITDA (per tonne) and Margin



Source: Company, KJMC Research

Quarterly Financial Summary

(in Rs mn)

| Particulars | Q4 FY10 | Q4 FY09 | y-o-y(%) | Q3 FY10 | q-o-q(%) |
|------------------------|---------|---------|----------|---------|----------|
| Net Sales | 8333.4 | 12165.7 | -31.5 | 7117.6 | 17.1 |
| Other Operating Income | 169.6 | | | 91.0 | 86.4 |
| Total Income | 8503.0 | 12165.7 | -30.1 | 7208.6 | 18.0 |
| Total Expenditure | 7803.4 | 11541.4 | -32.4 | 6409.8 | 21.7 |
| EBITDA | 699.6 | 624.3 | 12.1 | 798.8 | -12.4 |
| EBITDA margins(%) | 8.2 | 5.1 | 310bps | 11.1 | -290bps |
| Depreciation | 121.5 | 138.7 | -12.4 | 180.8 | -32.8 |
| EBIT | 578.1 | 485.6 | 19.0 | 618.0 | -6.5 |
| Interest | 355.8 | 296.6 | 20.0 | 318.0 | 11.9 |
| PBT | 222.3 | 189.0 | 17.6 | 300.0 | -25.9 |
| Tax | -15.7 | 53.0 | -129.6 | 96.3 | -116.3 |
| PAT | 238.0 | 136.0 | 75.0 | 203.7 | 16.8 |
| PAT margins (%) | 2.8 | 1.1 | 170bps | 2.8 | |
| Equity Capital | 533.3 | 425.8 | 25.2 | 523.7 | 1.8 |
| EPS | 4.5 | 3.2 | 39.7 | 3.9 | 14.7 |

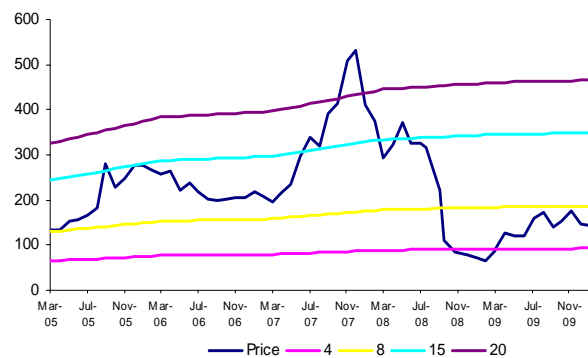
Source: Company, KJMC Research

Peer Comparison

| Companies | EBITDA (%) | | Net Profit (%) | | ROE | | EV/EBITDA | | P/BV | | PE | |
|----------------------------------|------------|-------|----------------|-------|-------|-------|-----------|-------|-------|-------|-------|-------|
| | FY 11 | FY 12 | FY 11 | FY 12 | FY 11 | FY 12 | FY 11 | FY 12 | FY 11 | FY 12 | FY 11 | FY 12 |
| Vallourec (European composite) * | 18.9% | 24.3% | 9.1% | 12.8% | 9.7 | 16.3 | NA | NA | 2.1 | 1.8 | 20.8 | 11.5 |
| Tubos Reunidos (Spain)* | 9.2% | 15.3% | 3.6% | 7.5% | 7.9 | 14.0 | 9.6 | 5.3 | 0.8 | 1.2 | 21.5 | 12.7 |
| Tenaris (US)* | 27.7% | 30.0% | 15.1% | 17.4% | 13.9 | 19.0 | NA | NA | 2.2 | 2.0 | 17.6 | 11.8 |
| TMK (Russia)* | 17.4% | 17.6% | 3.8% | 5.4% | 1.6 | 10.8 | NA | NA | NA | NA | 1.2 | 1.0 |
| Welspun Corp. Ltd.# | 16.3% | 16.5% | 7.4% | 7.9% | 18.2 | 17.7 | 4.2 | 3.5 | 1.6 | 1.3 | 8.6 | 7.4 |
| Jindal Saw | 17.8% | 17.3% | 9.9% | 10.3% | 16.8 | 15.7 | 7.9 | 7.3 | 1.5 | 1.3 | 10.2 | 9.0 |
| Maharashtra Seamless Ltd | 24.4% | 23.8% | 16.2% | 15.8% | 17.9 | 17.4 | 5.2 | 4.4 | 1.5 | 1.3 | 9.5 | 8.3 |
| Ratnamani Metals & Tubes Ltd | 18.0% | 17.1% | 8.9% | 8.7% | 22.4 | 19.8 | 4.0 | 3.6 | 1.3 | 1.1 | 6.4 | 5.7 |
| Man Industries Ltd | 9.7% | 8.5% | 4.0% | 3.6% | 14.7 | 14.9 | 3.3 | 3.0 | 0.8 | 0.7 | 6.2 | 5.1 |
| PSL Ltd. # | 10.3% | 10.4% | 3.3% | 3.9% | 11.9 | 14.0 | 5.2 | 4.2 | 0.7 | 0.6 | 5.7 | 4.2 |

Source: Bloomberg Estimates, # KJMC Research, * Calendar Year

Forward PE Chart



Source: Company, KJMC Research

Outlook & Valuations

With the worst of the financial crisis behind us, we remain optimistic regarding the potential demand for the pipe sector. The E&P projects which were earlier stalled or revoked are being given a new lease of life based on the rise in crude oil prices above USD 70 per barrel. The pipeline network of India for oil & gas transport being lower in India (32% penetration level) it represents a huge scope for growth for the pipe industry.

The government thrust on setting up of national grid, allocation of E&P blocks under NELP programme, water transportation and city gas distribution will result in strong demand for HSAW pipes. In addition to the new projects, the replacement market in North America would be an additional demand driver for Indian pipe manufacturers.

PSL the major domestic player and the largest in HSAW pipe is set to benefit from ~2mn tonnes domestic pipe demand over next 2-3 years from Gail, Reliance and GSPL. At CMP of Rs 132 the stock is available at P/E of 5.7x and 4.2x of its FY11E and FY12E earnings of Rs 23.3 and 31.5 respectively. The stock is trading at an average P/E of 5x from last two years. We have valued the stock by assigning P/E of 5x to FY12E earnings arriving at a target price of Rs 158 translating into potential upside of 20% from CMP.

Financial Summary

| Consolidated Profit & Loss Statement | | | | | | Consolidated Balance Sheet | | | | | |
|--------------------------------------|---------------|---------------|---------------|---------------|---------------|-----------------------------------|----------------|----------------|----------------|----------------|----------------|
| <i>Rs. in mn</i> | | | | | | <i>Rs. in mn</i> | | | | | |
| Particulars | FY08 | FY09 | FY10 | FY11E | FY12E | Particulars | FY08 | FY09 | FY10E | FY11E | FY12E |
| Net Sales | 22482.9 | 35599.3 | 39410.6 | 38122.2 | 42626.3 | SOURCES OF FUNDS : | | | | | |
| Growth (%) | 40.5 | 58.3 | 10.7 | -3.3 | 11.8 | Share Capital | 425.8 | 425.8 | 533.3 | 533.3 | 533.3 |
| Other operating Income | 448.2 | 889.9 | 525.0 | 500.0 | 500.0 | Reserves Total | 5271.0 | 6479.5 | 8842.3 | 9927.9 | 11452.9 |
| Total Income | 22931.1 | 36489.1 | 39935.6 | 38622.2 | 43126.3 | Total Shareholders Funds | 5696.8 | 6905.3 | 9375.6 | 10461.3 | 11986.2 |
| Total Expenditure | 20560.3 | 33388.6 | 36384.6 | 34641.2 | 38638.2 | Minority Interest | 177.8 | 273.0 | 273.0 | 273.0 | 273.0 |
| Raw Material | 15493.2 | 25724.7 | 31502.3 | 28803.0 | 32376.6 | Total Debt | 9316.9 | 11423.0 | 16023.1 | 15023.1 | 12798.6 |
| Employees cost | 623.4 | 706.2 | 691.4 | 729.8 | 805.7 | Deferred Tax Liabilities | 15.6 | -146.9 | -146.9 | -146.9 | -146.9 |
| Other Expenses | 4443.7 | 6957.7 | 4190.9 | 5108.4 | 5455.9 | Total Liabilities | 15207.1 | 18454.5 | 25524.8 | 25610.5 | 24911.0 |
| EBITDA | 2370.8 | 3100.5 | 3551.0 | 3981.0 | 4488.1 | APPLICATION OF FUNDS : | | | | | |
| Depreciation | 539.4 | 687.7 | 816.0 | 1101.3 | 1162.1 | Gross Block | 7827.4 | 12720.2 | 17054.0 | 17954.0 | 18854.0 |
| EBIT | 1831.4 | 2412.8 | 2735.0 | 2879.8 | 3326.0 | Less : Accu Depreciation | 2746.9 | 3477.6 | 4293.6 | 5394.9 | 6557.0 |
| Interest | 578.6 | 1027.5 | 1169.3 | 1112.2 | 954.7 | Net Block | 5080.6 | 9242.6 | 12760.3 | 12559.1 | 12297.0 |
| Other Income | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | Capital Work in Progress | 1310.7 | 3730.7 | 2491.1 | 2491.1 | 2491.1 |
| PBT | 1252.9 | 1385.3 | 1565.7 | 1767.6 | 2371.3 | Investments | 42.6 | 42.6 | 42.6 | 42.6 | 42.6 |
| Tax | 408.9 | 436.9 | 339.0 | 525.9 | 690.3 | Current Assets, Loans & Adv | 16971.3 | 47901.3 | 27557.5 | 26897.4 | 29478.9 |
| Net Profit | 844.0 | 948.4 | 1226.7 | 1241.7 | 1681.0 | Inventories | 7436.4 | 34800.3 | 16196.1 | 15666.7 | 17517.7 |
| | | | | | | Sundry Debtors | 3459.7 | 5429.9 | 3779.1 | 3655.6 | 4087.5 |
| | | | | | | Cash and Bank | 4005.1 | 2132.6 | 1103.8 | 1308.6 | 866.7 |
| | | | | | | Loans and Advances | 2070.1 | 5538.5 | 6478.5 | 6266.7 | 7007.1 |
| | | | | | | Less : Current Liabilities & Prov | 8365.2 | 42462.7 | 17326.8 | 16379.8 | 19398.6 |
| | | | | | | Current Liabilities | 7686.1 | 41781.0 | 16520.1 | 15666.7 | 18685.5 |
| | | | | | | Provisions | 679.2 | 681.7 | 806.7 | 713.1 | 713.1 |
| | | | | | | Net Current Assets | 8606.0 | 5438.5 | 10230.8 | 10517.7 | 10080.3 |
| | | | | | | Misc. Exp not w/o | 167.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| | | | | | | Total Assets | 15207.1 | 18454.5 | 25524.8 | 25610.5 | 24911.0 |

| Consolidated Cash flow Statement | | | | | | Ratios | | | | | |
|----------------------------------|---------------|----------------|----------------|---------------|---------------|--|-------|-------|-------|-------|-------|
| <i>Rs. in mn</i> | | | | | | | | | | | |
| Particulars | FY08 | FY09 | FY10E | FY11E | FY12E | Particulars | FY08 | FY09 | FY10E | FY11E | FY12E |
| Pre-tax Profit | 1252.9 | 1385.3 | 1565.7 | 1767.6 | 2371.3 | Profitability and Return Ratios | | | | | |
| Depreciation & Non Cash | 539.4 | 687.7 | 816.0 | 1101.3 | 1162.1 | EBITDA Margin (%) | 10.3 | 8.5 | 8.9 | 10.3 | 10.4 |
| Interest & Others | 578.6 | 1027.5 | 1169.3 | 1112.2 | 954.7 | Net Profit Margin (%) | 3.8 | 2.7 | 3.1 | 3.3 | 3.9 |
| Changes in Workin Capital | -1023.2 | 1629.9 | -5946.0 | 11.4 | -4.5 | EPS basic | 19.8 | 22.3 | 23.0 | 23.3 | 31.5 |
| Tax Paid | -252.5 | -390.3 | -339.0 | -525.9 | -690.3 | CEPS | 10.2 | 19.2 | 17.3 | 25.7 | 31.4 |
| Operating Cash Flow | 1095.2 | 4340.0 | -2734.0 | 3466.5 | 3793.3 | BVPS | 133.8 | 162.2 | 175.8 | 196.2 | 224.7 |
| Capex | -1799.1 | -7312.9 | -3094.1 | -900.0 | -900.0 | Dividend Yield (%) | 4.0 | 3.0 | 3.0 | 1.9 | 1.9 |
| Free Cash Flow | -703.9 | -2972.9 | -5828.1 | 2566.5 | 2893.3 | ROE | 14.8 | 13.7 | 13.1 | 11.9 | 14.0 |
| Investment | -17.5 | 0.0 | 0.0 | 0.0 | 0.0 | ROACE | 14.4 | 14.3 | 12.4 | 11.3 | 13.2 |
| Equity Capital | 1676.6 | 0.1 | 1493.2 | 0.0 | 0.0 | Operating Efficiency and Other Ratios | | | | | |
| Loans | 2619.1 | 2376.5 | 4600.1 | -1000.0 | -2224.4 | Debtors T/o | 6.5 | 6.6 | 10.4 | 10.4 | 10.4 |
| Dividend | -254.0 | -249.0 | -124.6 | -249.6 | -156.0 | Interest Coverage (x) | 3.2 | 2.3 | 2.3 | 2.6 | 3.5 |
| Others | -578.2 | -1026.9 | -1169.3 | -1112.2 | -954.7 | Asset / Turnover (x) | 1.5 | 1.9 | 1.5 | 1.5 | 1.7 |
| Net Change in Cash | 2742.2 | -1872.2 | -1028.8 | 204.7 | -441.8 | D/E (x) | 1.6 | 1.7 | 1.7 | 1.4 | 1.1 |
| Opening Cash Position | 1263.1 | 4005.1 | 2132.6 | 1103.8 | 1308.6 | Valuation Ratios | | | | | |
| Closing Cash Position | 4005.3 | 2132.9 | 1103.8 | 1308.6 | 866.7 | P/E (x) | 6.6 | 5.9 | 5.7 | 5.7 | 4.2 |
| | | | | | | P/CEPS (x) | 12.9 | 6.9 | 7.6 | 5.1 | 4.2 |
| | | | | | | P/BV (x) | 1.0 | 0.8 | 0.7 | 0.7 | 0.6 |
| | | | | | | Mcap / Sales (x) | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 |
| | | | | | | EV / Sales (x) | 0.5 | 0.5 | 0.6 | 0.5 | 0.4 |
| | | | | | | EV / EBITDA (x) | 5.2 | 5.3 | 6.2 | 5.2 | 4.2 |

Source: Company, KJMC Research

| | | | |
|--------------------------|---------------------------------|------------------------|---------------|
| Mr. Girish Jain | Executive Director | jaingirish@kjmc.com | 2288 5201 (B) |
| Mr. Suresh Parmar | A.V.P. - Institutional Equities | suresh.parmar@kjmc.com | 4094 5551 (D) |
| Mr. Vipul Sharma | A.V.P. - Institutional Sales | vipul.sharma@kjmc.com | 4094 5556 (D) |

Recommendation Parameters

Expected returns in absolute terms over a one-year period

| | | |
|-----------------------|---|--|
| Buy | - | appreciate more than 20% over a 12- month period |
| Accumulate | - | appreciate 10% to 20% over a 12- month period |
| Hold / Neutral | - | appreciate up to 10% over a 12- month period |
| Reduce | - | depreciate up to 10% over a 12- month period |
| Sell | - | depreciate more than 10% over a 12- month period |

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| MCX-Commodity* | : | MCX/TM/CORP/1772 |
| Mutual Fund's AMFI No. | : | ARN - 2386 |

* Under KJMC Commodities Market India Ltd

Atlanta Bldg., 16th Flr., Nariman Point, Mumbai - 400 021. Tel. : 22885201-04/4094 5500 Fax : 22852892 E-mail : eq@kjmc.com