Welspun Corp (WGSR.BO)

Initiate at Buy: Pipe Demand to Pick Up, a Re-rating in the Offing

- Company Update
- Initiation of Coverage

- **High-quality pipe producer** — We initiate on Welspun Corp (WLCO) with a Buy / High Risk (1H) rating and TP of Rs236 (40% upside). WLCO is strongly levered to an expected pickup in global demand for SAW (submerged arc-welded) pipes used primarily in oil and gas transportation. With high-quality product offerings, accreditations with key customers, and expanding capacities, we believe that WLCO is well-positioned to benefit from strong crude prices and rising global pipe demand.
- **Re-rating on the anvil** — WLCO has de-rated over the last year (38% under-performance) owing to concerns on: (1) overcapacity, (2) a slowdown in demand, (3) the financial health of US customers, and (4) corporate governance issues. However, we believe a re-rating is in the offing, given (1) demand-supply is tight, esp. for high quality pipes, (2) global demand should pick up led by increased E&P activity, esp. in North America and the Middle East, (3) contrary to expectations, US customers have cash and are investing, and (4) WLCO's core business remains strong, notwithstanding corporate governance issues.
- **Export focus a key positive; domestic market over-supplied** — While India could potentially become a key driver of pipe demand, the market currently is oversupplied and margins are low. Hence, WLCO's leverage to higher-margin int'l markets (exports are ~82% of its $1.2bn order book) is a key positive. WLCO has capacities in the US, where demand should remain strong (+150% yoy growth), and the Middle East, where pipeline capex is rising despite political concerns.
- **Compelling valuations** — WLCO trades at ~5.4x Sep-12E P/E vs. historical avg of 8x and the market at 12.7x. We expect this discount to narrow given improving macro and robust growth profile (14% EPS CAGR, 17% ROE), and base our TP on 7.5x P/E. With nearly all capex on expansions complete, we expect it to turn FCF +ve in FY12E.
- **Risks** — (1) Global downturn, (2) Overcapacity, (3) Forex and steel price volatility, (3) Quality and supplier issues, (4) Corporate governance, (5) B/S impact of diversification.

Buy/High Risk	**1H**
Price (28 Jun 11)	Rs169.60
Target price	Rs236.00
Expected share price return	39.2%
Expected dividend yield	1.2%
Expected total return	**40.3%**
Market Cap	Rs34,712M
	US$771M

Price Performance
(RIC: WGSR.BO, BB: WLCO IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2010A	6,104	26.74	133.5	6.3	1.2	27.4	1.2
2011A	6,136	26.83	0.4	6.3	1.0	19.1	1.2
2012E	6,608	28.90	7.7	5.9	0.8	17.3	1.5
2013E	7,779	34.02	17.7	5.0	0.7	17.4	1.8
2014E	9,170	40.10	17.9	4.2	0.6	17.5	1.8

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	6.3	6.3	5.9	5.0	4.2
EV/EBITDA adjusted (x)	3.6	3.7	3.7	2.9	2.2
P/BV (x)	1.2	1.0	0.8	0.7	0.6
Dividend yield (%)	1.2	1.2	1.5	1.8	1.8
Per Share Data (Rs)					
EPS adjusted	26.74	26.83	28.90	34.02	40.10
EPS reported	26.74	26.83	28.90	34.02	40.10
BVPS	141.99	171.85	201.21	235.71	277.01
DPS	2.00	2.00	2.50	3.00	3.00
Profit & Loss (RsM)					
Net sales	73,503	80,236	86,627	98,081	104,282
Operating expenses	-62,377	-69,845	-75,180	-84,928	-89,590
EBIT	**11,126**	**10,391**	**11,447**	**13,153**	**14,692**
Net interest expense	-2,071	-1,471	-1,857	-1,843	-1,356
Non-operating/exceptionals	185	184	200	300	350
Pre-tax profit	**9,240**	**9,104**	**9,790**	**11,610**	**13,687**
Tax	-3,136	-2,871	-3,182	-3,831	-4,517
Extraord./Min.Int./Pref.div.	0	-97	0	0	0
Reported net income	**6,104**	**6,136**	**6,608**	**7,779**	**9,170**
Adjusted earnings	6,104	6,136	6,608	7,779	9,170
Adjusted EBITDA	13,186	12,831	14,358	16,226	17,844
Growth Rates (%)					
Sales	28.1	9.2	8.0	13.2	6.3
EBIT adjusted	126.4	-6.6	10.2	14.9	11.7
EBITDA adjusted	107.7	-2.7	11.9	13.0	10.0
EPS adjusted	133.5	0.4	7.7	17.7	17.9
Cash Flow (RsM)					
Operating cash flow	**4,055**	**3,462**	**6,790**	**8,514**	**10,605**
Depreciation/amortization	2,061	2,440	2,911	3,073	3,151
Net working capital	-4,110	-5,210	-2,729	-2,338	-1,716
Investing cash flow	**-3,115**	**1,742**	**-2,450**	**-1,500**	**-1,500**
Capital expenditure	-3,571	-11,068	-3,950	-1,500	-1,500
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**4,339**	**13,099**	**-3,562**	**-3,186**	**-7,912**
Borrowings	-1,062	12,584	-4,236	-4,000	-9,000
Dividends paid	-478	-479	-599	-718	-718
Change in cash	**5,279**	**18,303**	**778**	**3,828**	**1,194**
Balance Sheet (RsM)					
Total assets	**91,425**	**110,381**	**114,364**	**120,457**	**122,463**
Cash & cash equivalent	17,028	7,532	3,867	7,695	8,889
Accounts receivable	8,077	12,915	14,240	16,123	17,142
Net fixed assets	38,333	51,560	54,001	52,427	50,776
Total liabilities	**62,414**	**73,186**	**71,160**	**70,193**	**63,747**
Accounts payable	9,356	9,672	10,443	11,823	12,571
Total Debt	25,476	38,060	33,823	29,823	20,823
Shareholders' funds	**29,011**	**37,195**	**43,204**	**50,264**	**58,716**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	17.9	16.0	16.6	16.5	17.1
ROE adjusted	27.4	19.1	17.3	17.4	17.5
ROIC adjusted	21.4	15.2	13.6	14.5	15.8
Net debt to equity	29.1	82.1	69.3	44.0	20.3
Total debt to capital	46.8	50.6	43.9	37.2	26.2

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Investment Thesis

Initiate with Buy: Boosted By Strong Pipe Demand

We initiate coverage on Welspun Corp (WLCO) with a Buy / High Risk (1H) rating and a target price of Rs236 (40% upside).

WLCO is a line-pipe manufacturer with manufacturing facilities in both India and abroad. It is significantly leveraged to SAW (submerged arc-welded) pipes, the demand for which is dependent on capex plans of oil firms and investments in overall infrastructure.

Uptrend in E&P capex should boost line-pipe demand

Our positive view on WLCO is based on the thesis that strong crude prices should lead to a revival in the demand for line-pipe (SAW pipes). Higher crude prices generally lead to higher E&P capex and investments in pipeline infrastructure. This is borne out by the fact that a number of projects which were earlier put on hold are now being revived, particularly in the US. In addition, we believe that investments in gas-transportation infrastructure across the globe should also boost pipe demand. This anticipated increase in pipe demand should be a positive for WLCO which already has a strong position in the global markets, and which is expanding its capacities to benefit further from the strong demand that we envisage. While global pipe manufacturing capacities have also risen over a period of time, we believe that WLCO should benefit from the improved demand scenario as well as from its strong competitive positioning.

Higher E&P capex and demand for new pipeline infrastructure are key drivers for pipe demand

WLCO is levered to the international markets as supply in India will likely continue to exceed domestic demand, and international markets will provide it with the opportunity to realize better volumes and margins.

Well positioned to capture export-led growth

Specifically, we believe that WLCO should benefit from: 1) its leverage to the high-margin US market, where it already has a footprint, 2) its expansion in the MENA region (where it has set up a plant), and 3) the fact that it has backward integrated its business to a certain extent.

Leverage to export markets and high-quality product offerings are key competitive advantages

- **Leverage to the high-margin US and Middle-East markets –** WLCO is a premium supplier of pipes and has an established presence in the more lucrative US market. It has the requisite API approvals as well as accreditations in place, which are key entry barriers in the US market. Besides, WLCO has commenced production from its Saudi Arabia mill and has received approvals from Saudi Aramco, a key consumer. These are key positives for WLCO as we believe that demand from international markets would continue to drive demand, especially since the domestic market remains over-supplied.

- **High quality product offering –** WLCO has set up new, hi-tech mills in India, US and Saudi Arabia, which should enable it to service the line-pipe requirements of the most challenging E&P projects. In fact, its new LSAW mill in Anjar (to be commissioned shortly) is one of the few mills in the world with the capability to produce pipe lengths of >18m.

- **Core business remains strong despite corporate governance issues –** WLCO's stock performance has been impacted by corporate governance issues (a SEBI enquiry on the promoters), the timelines on the resolution of which are still unclear. Fundamentally, however, we remain positive on WLCO, as we believe that these issues do not impact the core business.

- **Reasonable return ratios –** We expect WLCO to turn FCF positive in FY12E, led mainly by higher operating cash flow and lower capex requirements (since it has already finished with most of its capex on its new capacities at Anjar and Saudi Arabia). We expect WLCO to generate reasonable ROEs of ~17% going forward.

Target price of Rs236

We base our target price of Rs236 on 7.5x Sep-12E P/E, with our target multiple of 7.5x set at a marginal discount to WLCO's historical average of 8x. With the stock currently trading at 5.4x P/E, we believe it appears attractively positioned given a strong fundamental outlook for the company.

Figure 1. Welspun Corp – A Snapshot

Parameter	Welspun Corp		Comments
Installed capacity*		**% of total**	
-HSAW (Helically Submerged Arc Welded Pipes)	1,300,000	58%	WLCO's product-mix is heavily leveraged to SAW pipes
-LSAW (Helically Submerged Arc Welded Pipes)	700,000	31%	
-ERW (Electrically Resistant Welded Pipes)	250,000	11%	
-DI (Ductile Iron Pipes)	-	-	
-Seamless Pipes	-	-	
Total capacity (pipes)	2,250,000		
Total pipe sales (FY12E)	1,082,000		
Capacity Utilization % (FY12E)	48%		
Backward integration	Y (partially - for HSAW and LSAW pipes)		We expect WLCO to manufacture ~0.6 MMT of steel coils and plates, a part of which is used to manufacture HSAW/LSAW pipes
Key target markets	US, Middle East, India		
Exports as % of total sales	~80%		
Current order-book (US$bn)	1.2		
Current order-book (MT)	~790		
Order-book/sales (FY12E)	0.7		
EPS CAGR (FY11-14E)	14%		
Stock performance vs. Sensex			
-Last 3 months	-10%		
-Last 6 months	10%		
-Last 12 months	-38%		

Source: Citi Investment Research and Analysis *Post expansions in FY12E

Figure 2. WLCO – Key Categories of Pipes Manufactured[1]

Product	End-use	Raw material
HSAW pipe (Helically submerged arc welded pipe)	Low-pressure oil & gas pipelines	Hot-rolled Coil
LSAW pipe (Longitudinal submerged arc welded pipe)	High-pressure oil & gas pipelines	Hot-rolled Plate
ERW pipe (Electric Resistance Welded pipe)	Gas and water pipelines	Hot-rolled Coil

Source: Citi Investment Research and Analysis

[1] Please refer to the Appendix for more details on pipes, manufacturing processes etc

What Has Caused the Stock De-rating?

WLCO has under-performed the Sensex by 38% over the last one year. We believe that the key concerns that led to the stock de-rating are: 1) concerns on over-capacity in pipe manufacturing, 2) a slowdown in projects and pipe demand, and 3) questions on the financial health of North American pipeline companies – the key clients for WLCO. WLCO was also impacted by some corporate governance issues.

We seek to examine the above issues in detail to examine the current fundamentals of the pipe manufacturing business, particularly in the context of WLCO.

Concern I: Manufacturing over-capacity

Our view: Concerns are overdone; demand-supply, especially for high-quality pipes, is reasonably tight.

It has been argued that SAW pipe manufacturing companies are facing an adverse supply-demand scenario. However, current trends indicate that capacity utilization for the export-focused WLCO, especially in an environment of rising demand, should remain robust.

Current demand-supply trends suggest an overall capacity utilization of ~45% for pipe mills

- While exact line-pipe demand and supply are somewhat difficult to forecast given the project nature of pipeline capex and lack of availability of concrete data in various markets, we estimate the global requirement for large-diameter line-pipe (SAW pipe) to be ~15-16 MMT over 2011E. Compared to the estimated installed capacity (post-expansion) of ~35 MMT (for SAW pipes), this implies a utilization of ~45%.

Since peak utilization of a mill is only 55-65%, utilization adjusted for old mills and recent mill closures should be reasonable

- However, this installed capacity itself may be somewhat overstated given that data on mill closures is not very well documented. Also, it should be noted that the peak utilization of a pipe mill is only 55-65%, implying that utilizations, adjusted for closed/under-utilized mills, should be reasonable.

Figure 3. Global Pipe Demand-Supply Scenario (Annual)

	Capex on pipes (US$bn)	Pipe Cost (US$/T)	Pipe demand (MMT)	% of total	Comments
North-America	7.7	1,300	5.9	38%	Still forms the biggest chunk of demand
Middle-east	4.0	1,300	3.1	20%	Demand has remained stable despite political instability
India	1.5	1,300	1.2	8%	Can go up significantly depending on the pace of execution of new projects
Other (Europe, Asia, Latin America)	6.8	1,300	5.3	34%	Chinese demand is fulfilled by local manufacturers; new demand expected from Europe as gas consumption rises
Total	20.0		15.4	100%	
Estd. Installed capacity			35.0		
Implied utilization			**44%**		Overall utilization likely to be higher if adjusted for 1) unreported mill closures, 2) chronically under-utilized older mills

Source: Citi Investment Research and Analysis

As pipe requirements become more advanced, some portion of the current capacity has become unviable and uncompetitive

- Besides, as projects are becoming more complex, we believe that a part of the global capacity has remained chronically underutilized for some time. This is simply because some mills are unable to cater to advanced projects – which generally span tougher terrains and require pipes subscribing to tougher standards. Hence, such capacity should be discounted when looking at aggregate supplies.

Capacity ramp-up for new pipe mills is gradual (can take 3-4 years to reach full capacity)

- In addition, new capacities coming online typically take ~3-4 years to ramp up to peak capacity. Hence, not all the current capacity can operate at peak capacity.

WLCO appears well-placed as it has invested in superior technology

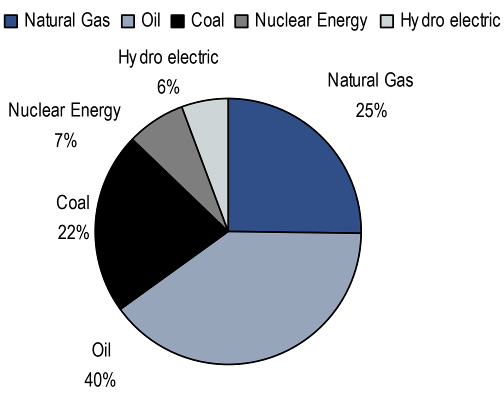
- Also, we believe that WLCO, which has managed to sustain utilizations of 45-55% even during the weaker years of 2009-10, should not be impacted by capacity expansions elsewhere. In fact, as per WLCO, the logic of setting up new capacities (both in India and abroad) lies in the fact that a) Indian producers are more cost competitive, especially since their conversion costs are lower than those of some of the other producers (largely on the back of lower staff costs), and b) investment in plants with superior technology makes it capable of supplying to projects that are relatively more challenging.

Concern II: Slowdown in projects and pipe demand

Our view: As examined in detail in a later section *(Industry Outlook)*, we believe that pipe demand is set to increase led not only by an increase in E&P activity, but also because of an increasing need for oil products and gas to be transported over longer distances.

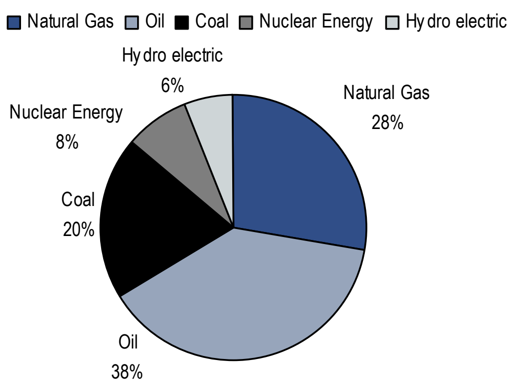
- As seen below, the % of natural gas in the total energy basket of US, the world's largest energy consumer, has been steadily going up over the last few years. Going forward, as gas production and emphasis on greener fuels increase, we believe that the requirement to set up more pipelines to connect supply centers to demand centers is set to rise, not only in the US, but also in the rest of the world.

Figure 4. US – % Energy Consumption by Fuel (2000)



Source: BP Statistical Review 2002

Figure 5. US – % Energy Consumption by Fuel (2009)



Source: BP Statistical Review 2010

Also, global gas supply is set to increase by ~25% over the next 10 years. With production remaining concentrated within a few areas and demand increasing across the globe, we believe that besides pipelines, LNG is likely to emerge as a key gas transport medium. Setting up new LNG terminals is likely to further add to pipeline demand, as regasified LNG would need to be transported from the terminals to major pipeline grids and consumption centers.

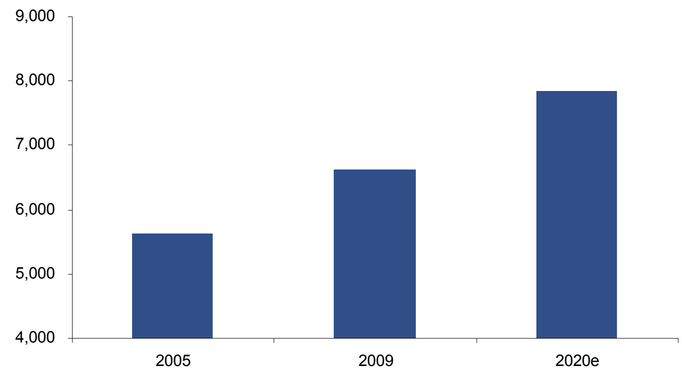
Figure 6. Natural Gas Supply (BCM)

Supply (BCM)	2000	2005	2009	2015E	2020E
North America	760	749	798	831	846
--USA	540	518	585	608	609
--Canada	182	187	161	167	176
--Mexico	38	44	51	56	61
Asia Pacific	274	367	441	513	612
Europe and Eurasia	949	1046	978	1181	1218
Middle East	208	320	407	493	569
Africa	130	176	204	258	303
Latin America	100	139	152	161	184
World	**2421**	**2796**	**2980**	**3437**	**3733**

Source: Citi Investment Research and Analysis, BP stats review, IEA

With the distance between suppliers and consumers increasing, there will be a greater need to build both LNG and pipeline infrastructure

Figure 7. Average Miles Travelled Per Bcm of LNG Increased 18% from 2005-09



Source: Citi Investment Research and Analysis, BP stats review

Higher natural gas consumption is now leading to the setting up of large inter-continental pipelines; this should also boost pipe demand

- This requirement of transporting gas over longer distances has spawned the need for the setting up of large inter-continental pipelines. For instance, several groups of countries are planning to construct transnational pipelines for enabling transportation of large quantities of natural gas over longer distances. While arguably some of these pipelines could see their commissioning schedules being deferred owing to the scale, complexity and political sensitivity of the projects, this trend of transporting gas over long distances by high-capacity pipelines is a positive for line-pipe manufacturers such as WLCO. Even one or two such projects can add significantly to global pipe demand.

Figure 8. Status of Key Transnational Pipelines

Pipeline	Countries connected	Capacity mmscmd	Length km	Capex US$bn	Expected year of commissioning
TAPI	Turkmenistan-Afghanistan-Pakistan-India	90	1700	7.5-10	2014-15
NABUCCO	Turkey-Austria	85	3900	11	2015
ITGI	Turkey-Greece-Italy	27	800	1.8	2015
Trans Adriatic (TAP)	Greece-Italy	27-55	520	2.2	2017
Nord Stream	Russia-Germany	151	1222	10.7	end-2012
South Stream	Russia-Bulgaria	173	900	22.4	end-2015

Source: Citi Investment Research and Analysis, Indianpetro, Reuters

Overall, with crude prices at US$100/bbl+, investments in the E&P space are once again expected to pick up. An increase in such activities requires seamless pipes, oil country tubular goods as well as SAW pipes to transport crude and gas over longer distances.

Concern III: Financial health of North American pipeline companies

Our view: With stable commodity prices and improving businesses, our analysis indicates that North American companies are strongly placed to commit to future capex plans

While macro trends could potentially justify the demand for pipelines and hence pipes, we also analyzed the broad cash flow and capex trends of key North American pipeline companies (as shown in Figure 3, North America is ~40% of global pipe demand). As seen below, the operating cash flow situation of the set of 36 companies analyzed by us is trending up – indicating that these companies are increasingly better placed to commit to future capex. While not all of this capex would be directed towards pipes/pipelines, the overall trend does appear positive.

Figure 9. North American Pipeline Companies – Operating Cash Flow (US$bn)*

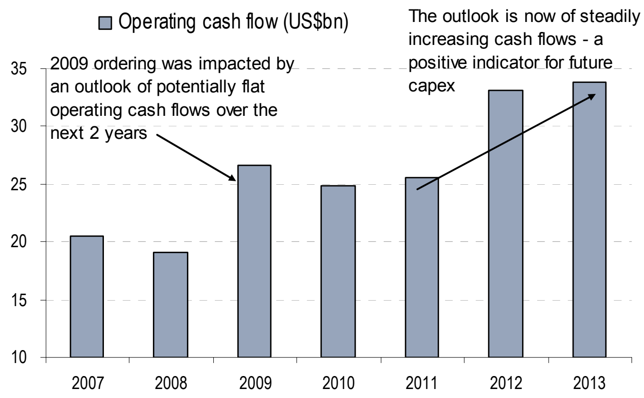
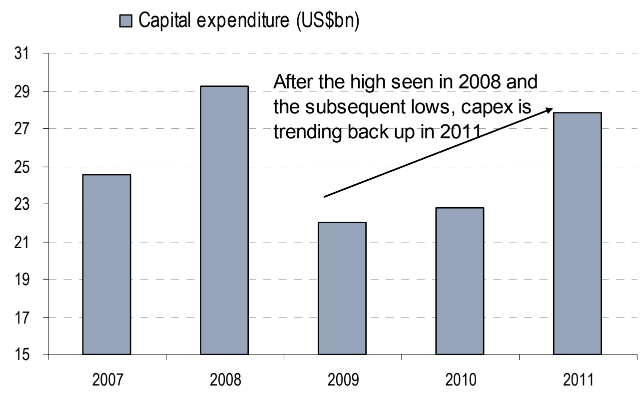


Figure 10. North American Pipeline Companies – Capex Plans (US$bn)*



Source: Citi Investment Research and Analysis *We have analyzed the cash-flows and capex estimates of 36 pipeline companies covered by CIRA

Concern IV: Corporate governance issues

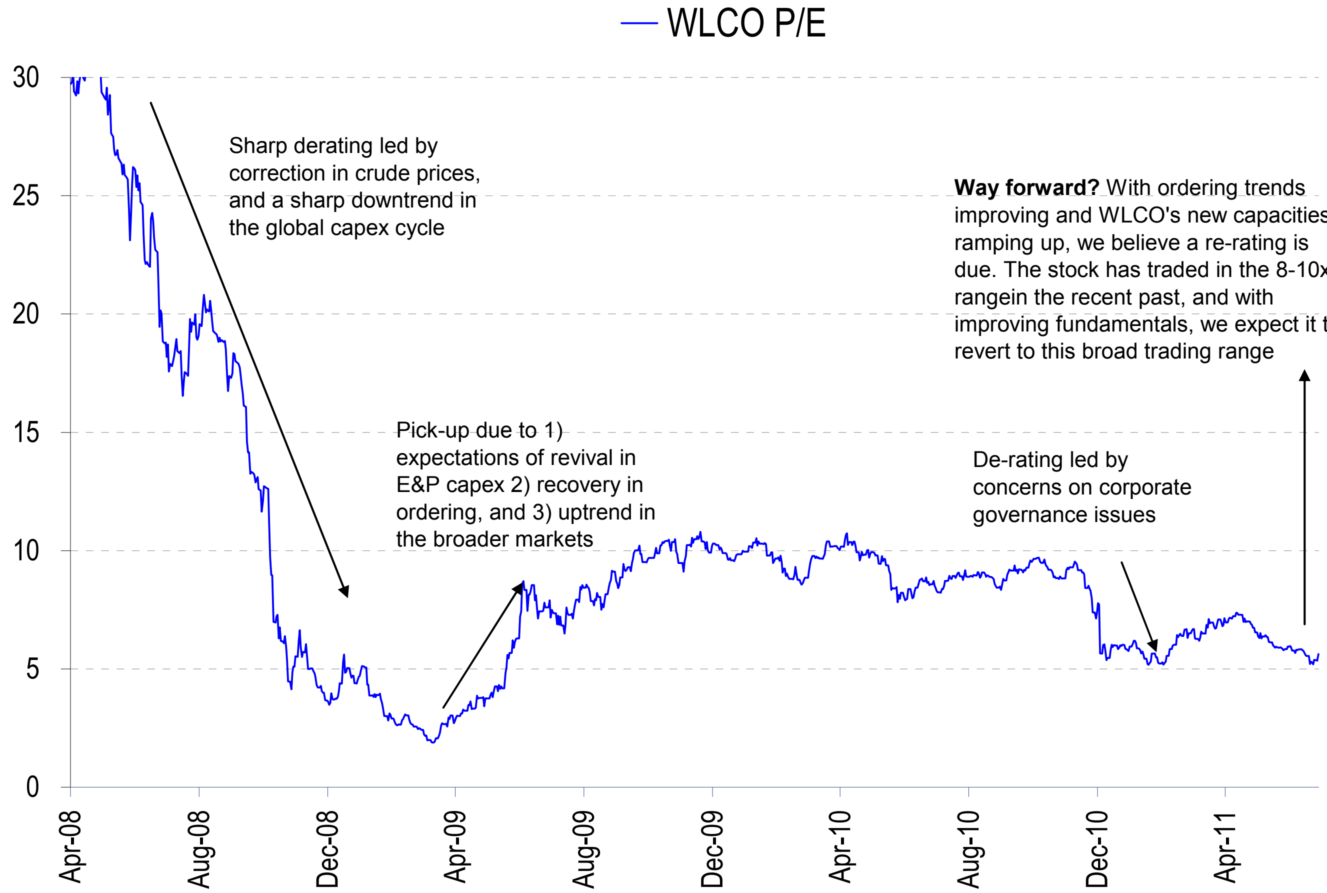
Our view: Corporate governance issues admittedly remain a risk, though they do not impact the core business, which looks fundamentally strong

WLCO's stock performance has been significantly impacted due to corporate governance issues faced by the company. In Dec'10, the SEBI charged WLCO's promoters of rigging the stock price ahead of a QIP in Nov'09. While timelines on the resolution of this are still unclear, we do not think this issue has any major bearing on the regular business of the company.

Re-rating on the Anvil

Given favourable trends in the global E&P space and the increasing importance of natural gas as a fuel, we believe that WLCO is poised for a re-rating, especially since crude prices remain high and capex plans globally suggest a higher line-pipe demand going forward. While the Indian market could continue to be tough given domestic overcapacity and intense competition (impacting margins), we believe that WLCO's significant leverage to export markets means it is well positioned to take advantage of positive industry trends.

Figure 11. WLCO – How Valuations Have Moved in the Last 3 Years



Source: Citi Investment Research and Analysis, Datacentral

Significant long-term correlation to crude prices historically – reversal seen in the recent past

We examined the correlation of the stock-price movement of WLCO with crude prices (Brent), and observed that while this correlation has been fairly strong over the last few years (2001-2011TD) and (2005-2011TD), it is in the period after 2010 that this correlation has broken down substantially. In fact, despite crude prices going up, the stock price has not followed this trend, thereby showing a negative correlation to crude during this period.

As explained above, we believe that concerns on demand and overcapacity have led to a stock de-rating. However, going forward, we expect demand to recover on the back of strong demand from E&P companies as well as gas pipeline operators, which should lead to a reversion of the recent negative correlation towards historical trends.

We expect the negative correlation to crude observed in the period 2010-2011TD to reverse, at least partly, as we expect strong pipe demand going forward

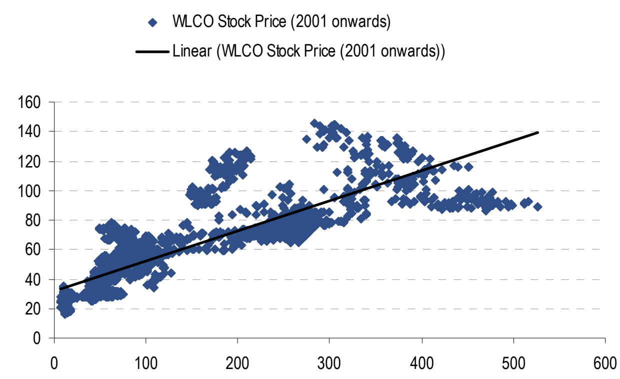
Figure 12. WLCO – Historical Correlation to Crude Prices

WLCO	R^2
WLCO vs. Brent (2001 onwards)	0.84
WLCO vs. Brent (2005 onwards)	0.70
WLCO vs. Brent (2010 onwards)	(0.67)

Source: Citi Investment Research and Analysis

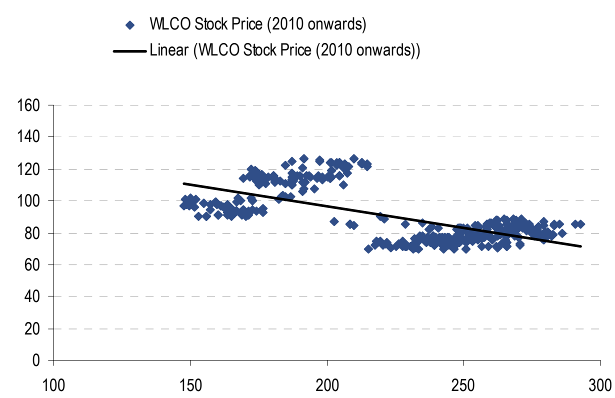
As shown below, the historically strong correlation of WLCO's stock price to crude prices (Figure 13) has broken down in the recent past (Figure 14). With high crude prices and fundamentals for the stock remaining strong, we would expect some reversion to the historical trends.

Figure 13. WLCO – Historical Correlation to Crude Prices (From 2001)



Source: Citi Investment Research and Analysis

Figure 14. WLCO – Recent Correlation to Crude Prices (From 2010)



Source: Citi Investment Research and Analysis

Key Drivers

We examine below the key drivers for WLCO.

Welspun Corp – High quality producer leveraged to US demand

As shown in Figure 1, WLCO's pipe manufacturing business is highly leveraged to SAW pipes – both HSAW and LSAW. HSAW pipes are typically larger diameter pipes and are used in low-pressure oil and gas transportation pipelines. LSAW pipes are lower diameter pipes and are used in higher pressure oil and gas transportation. With most of WLCO's business leveraged to the production of these pipes, we discuss below the key earnings drivers:

- Sustained momentum in global E&P activities leading to an increase in investments in pipeline infrastructure should boost the demand for HSAW and LSAW pipes.

WLCO's new world-class Anjar facility is one of the few mills in the world to be able to produce pipe lengths of >18m and should be a key competitive advantage for WLCO

- WLCO has significant leverage to the high-margin US market, which in our view, is a key competitive advantage and would be a significant contributor to WLCO's earnings and order book. WLCO already has a plant in the US, and is accredited to supply its pipes to most of the big US companies. In fact, while WLCO has set up a new capacity in the US, a number of plants globally are not technologically advanced enough to supply to the US, thereby making WLCO better placed. In fact, once WLCO's new Anjar LSAW capacity commissions, it would be one of the few companies in the world to have the capability to produce pipe lengths of >18m, which should give it a key competitive advantage.

- WLCO has also set up a plant in the Middle-East to cater to the local demand. The plant has already begun production and WLCO has the required approvals from key customer countries such as Saudi Arabia.

- WLCO has also backward integrated its business to an extent and has 1.5 MMT of coil cum plate capacity (we assume 35% capacity utilization in FY12E, of which WLCO is expected to use ~0.15 MMT internally – this could increase once WLCO gets API approval for these coils/plates also). WLCO thus consumes a part of the plate and coil produced internally, and sells the rest in the open market. We believe that slab-plate spreads have bottomed and while it could take some time before they start improving, things should only get better from here.

Order book expansion – key to re-rating

We believe that for WLCO, the ability to win new orders, especially in the context of its new capacity additions, would be key. However, pipe orders are typically short cycle orders – an order won today is typically executed within 6-9 months. While WLCO has sales visibility for the next 6-9 months, we believe that announcements of new order wins on the back of a strong demand outlook should lead to improved utilizations and a stock re-rating.

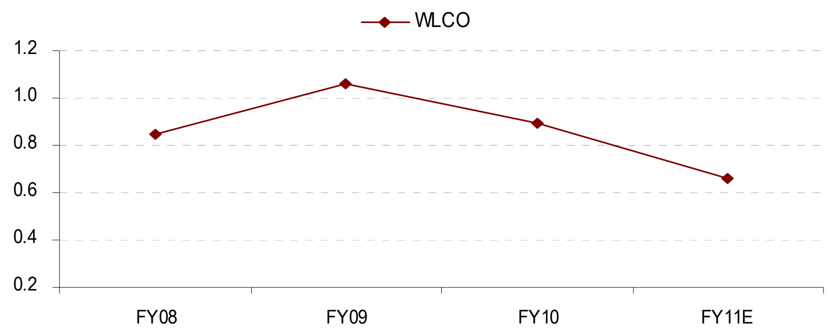
Figure 15. Current Order-Book to Sales Analysis

Rs bn	Order book (Rsbn)	Sales (Rsbn)	Basis	Order book/sales
WLCO	54	69	FY11E Sales	0.8
	54	83	FY12E Sales	0.7

Source: Citi Investment Research and Analysis, Company Reports

We expect strong industry growth to boost WLCO's order-book from current levels

Figure 16. Historical Order-Book To Sales Ratio



Source: Citi Investment Research and Analysis, Company Reports

In the recent past, the peak order book to sales ratio for WLCO of 1.1x was seen in FY09, when the capex cycle was in an uptrend and crude prices rose to record levels. Going forward, we expect WLCO to be able to maintain this ratio. It is unlikely that this ratio would expand significantly; however, we do acknowledge that in view of rising capacities, WLCO would need to win a higher quantum of orders to maintain its order-book/sales ratio. Given the strong outlook for pipe demand, we believe that WLCO should succeed in winning new orders, especially from international companies.

Valuation Methodology

Our valuation methodology for WLCO's pipe manufacturing business is based on traditional P/E multiples. We attribute a 7.5x target P/E multiple, conservatively imputing a slight discount to WLCO's normalized average 5-year historical P/E of 8x. We believe that as ordering picks up, multiples should also expand, at least in-line with the average multiples seen in the past. Our 7.5x target multiple for WLCO equates to a ~40% discount to the current market multiple (12.7x Sep-12E earnings), thus building in a sufficient cushion to account for the cyclical nature of the industry in which the company operates.

Figure 17. Pipe Companies – Valuation Comparables

Company	RIC	Source	Market-cap US$m	Current Price (LC)	P/E FY12E	P/E FY13E	P/B FY12E	P/B FY13E	EPS CAGR FY11-13E
Welspun Corp	**WGSR.BO**	**CIRA**	**762**	**167.7**	**5.8**	**4.9**	**0.9**	**0.8**	**12%**
Indian Peers									
Jindal SAW*	JIND.BO	IBES	920	150.0	4.4	3.2	0.5	0.4	32%
PSL Limited	PSLH.BO	IBES	82	68.9	3.9	3.9	0.3	0.3	31%
Mah Seamless	MHSM.BO	IBES	589	376.0	7.7	6.9	1.0	0.9	5%
Average (Indian peers)					**5.3**	**4.7**	**0.6**	**0.5**	
Global Peers									
Tenaris	TS.N	IBES	25,954	44.0	17.1	13.1	2.3	2.0	33%
Salzgitter AG (Europipe)	SZGG.DE	IBES	4,273	49.8	18.9	9.9	0.7	0.6	202%
Evraz Group	HK1q.L	IBES	13,254	30.3	9.5	7.2	1.9	1.3	65%
SSAB Steel	SSABa.ST	IBES	3,298	88.2	15.5	9.0	0.9	0.9	140%
Tianda Oil Pipe	0839.HK	CIRA	317	2.5	7.7	4.6	0.9	0.8	93%
Shengli Pipe	1080.HK	CIRA	424	1.3	17.0	9.1	1.6	1.4	112%
Chu Kong Pipe	1938.HK	CIRA	430	3.3	10.6	5.8	1.4	1.2	183%
Average (Global peers)					**13.8**	**8.4**	**1.4**	**1.2**	**118%**

Source: Citi Investment Research and Analysis, IBES Note: Using CY11/12E for international companies (31-Dec year ending) *Adjusted for investments

Figure 18. Indian Mid-cap Construction/Capital Goods Companies – Valuation Comparables

Company	RIC	Source	Market-cap US$m	Current Price (LC)	P/E FY12E	P/E FY13E	P/B FY12E	P/B FY13E	EPS CAGR FY11-13E
IVRCL*	IVRC.BO	CIRA	408	68.8	6.4	5.3	0.5	0.5	13%
Nagarjuna Construction*	NCCL.BO	CIRA	446	78.2	6.9	5.3	0.4	0.4	7%
Thermax	THMX.BO	CIRA	1,548	585.0	15.9	14.4	4.1	3.4	13%
Voltas	VOLT.BO	CIRA	1,171	159.4	14.2	12.3	3.2	2.6	10%
Average					**10.8**	**9.3**	**1.7**	**1.4**	**11%**

Source: Citi Investment Research and Analysis *Adjusted for investments

A global peer-set for WLCO is not very well-defined, especially since a large number of pipe manufacturers globally are actually integrated steel companies – with pipe manufacturing comprising a small portion of their overall business.

Welspun Corp – Target price of Rs236

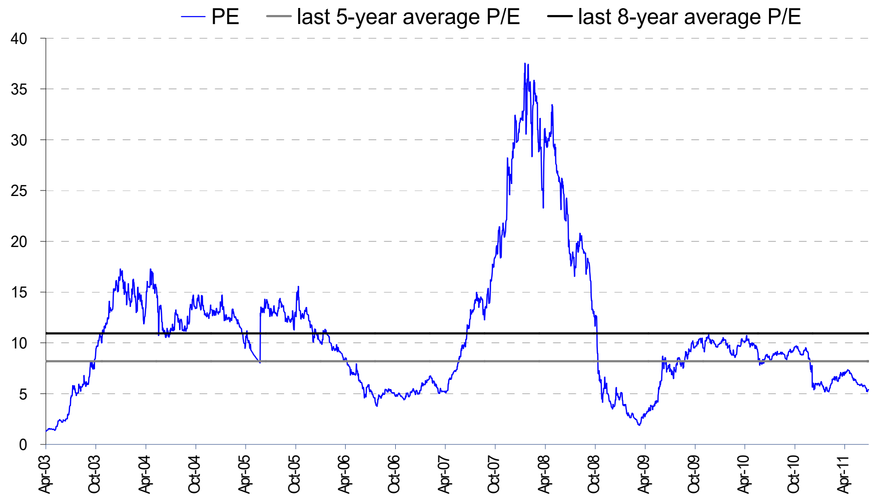
Historically, WLCO has traded at a normalized P/E of 5-10x (excluding the much higher multiples seen in 2007-2008). As discussed above, we apply a 7.5x Sep-12E P/E multiple to arrive at our target-price of Rs236.

Figure 19. WLCO – TP of Rs236

Sep-12E EPS	**31.5**
Target P/E	7.5x
Historical P/E	5-10x
Target Price	236

Source: Citi Investment Research and Analysis

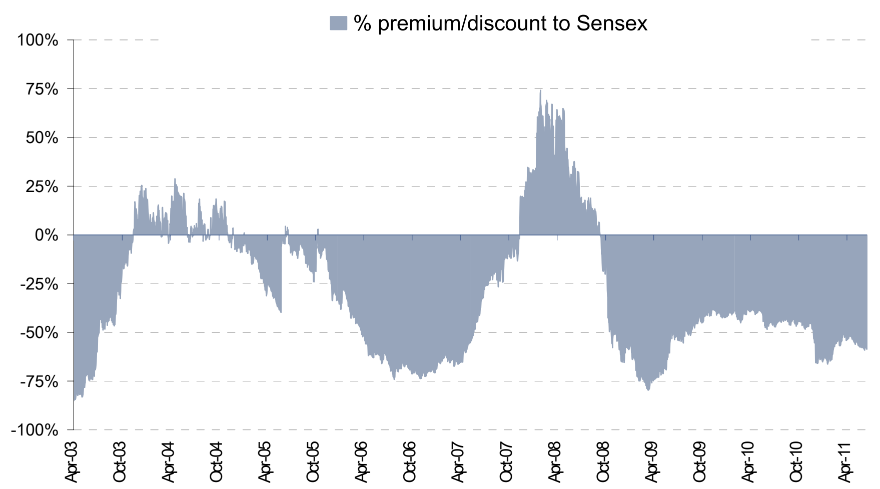
Figure 20. WLCO – Historical P/E



Source: Citi Investment Research and Analysis, Datacentral

As seen below, WLCO has historically traded at a discount to the market most of the time; however there have been times when the stock has traded at a premium to the market. On average WLCO has traded at a 30% discount to the market in the last 8 years. We are not arguing for WLCO to trade at a premium to the market; our target multiple still imputes a ~40% discount to market multiples compared to the average 30% discount at which the stock has traded in the last 8 years.

Figure 21. WLCO P/E vs. Market P/E



Source: Citi Investment Research and Analysis, Datacentral

Industry Outlook

Global demand outlook – fuelled by crude prices and emergence of natural gas

As discussed before, we believe that the key drivers for pipe demand are:

- **An upswing in E&P activities** – A sustained increase in E&P activity bodes well for pipe manufacturers, which cater to the subsea piping and other requirements of drilling projects, as well as provide line pipe to link oil & gas producing hubs to trunk pipelines and then to last mile consumers.

- **Increasing use of natural gas as a fuel –** With increasing supplies and consumption of natural gas and the need to transport it over much longer distances, the requirement of gas pipeline infrastructure is bound to increase, a positive for pipe manufacturers.

Pipe ordering should witness strong pick-up

- As per data released by Simdex, the number of pipeline projects in the pre-construction phase across the globe has already seen an increase in the first 5 months of 2011 – a trend that we expect to sustain. Since pipeline ordering typically lags the trend in crude prices by ~6-9 months, we expect a greater number of pipeline projects to be announced going forward, given the strong crude prices.

Figure 22. Pipeline Projects in the Pre-construction Phase – May'11 vs. Jan'11

	As of May'11				As of Jan'11			
	No. of projects	% of total	Total length (km)	% of total	No. of projects	% of total	Total length (km)	% of total
North America	233	28%	68,817	23%	185	26%	64,578	23%
Latin America	47	6%	33,877	11%	38	5%	28,596	10%
Europe	143	17%	41,021	14%	127	18%	42,208	15%
Africa	54	7%	25,637	8%	50	7%	23,725	8%
Middle East	144	17%	43,505	14%	120	17%	39,346	14%
Asia	137	17%	71,610	24%	126	18%	69,278	24%
Australasia	71	9%	18,551	6%	61	9%	17,764	6%
Total	**829**	**100%**	**303,018**	**100%**	**707**	**100%**	**285,495**	**100%**

Source: Simdex, Citi Investment Research and Analysis

- While the data above shows projects in the pre-construction phase, we discuss below key data points across markets which indicate a strong increase in pipe demand led by increasing investments in pipelines.

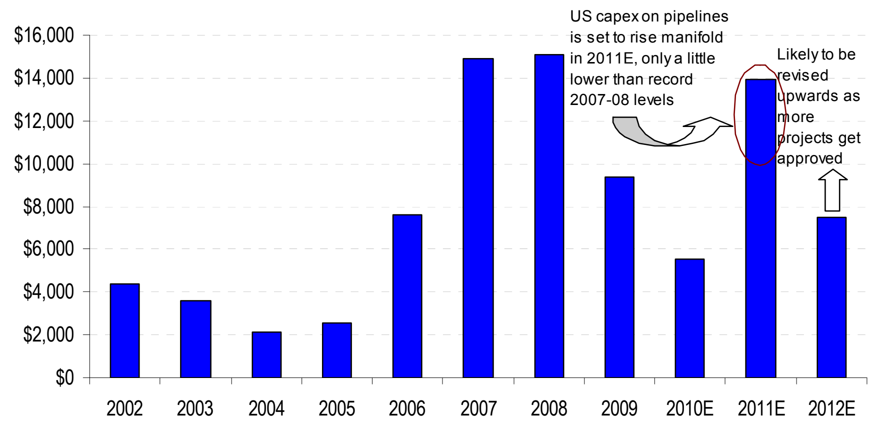
1. US pipeline expansion plans – solid growth over the next two years

- While 2007 and 2008 were record years for pipeline expansions with annual capex exceeding US$14bn, current capex trends show that 2011E capex should be nearly as high as the peaks seen in 2007-08. For 2012E, while the current planned capex seems a little lower at ~US$8bn, we believe this figure should get revised upwards as companies firm up their capex plans and make further investments in boosting their pipeline infrastructure.

- Currently, we believe that the US is seeing demand primarily from new projects. However, the US also has significant replacement demand as a large part of its network was laid out during 1970-1980, which would need to be replaced in the next few years. While it is hard to put a timeline to it, this could eventually boost the prospective demand to even higher levels.

US demand is set to rise substantially in 2011; while current demand is being seen from new projects, replacement demand could be another driver over the next few years. While not all formal plans are available for 2012, we expect investments in 2012 to be much higher than currently suggested by the available data.

Figure 23. North American Pipeline Expansion Investment (US$m)



Source: EIA, CIRA estimates

- We tracked the forthcoming pipeline projects of North American companies, and data shows that the US companies alone have capex plans of ~US$21bn on pipelines over 2011-12 (Figure 25). Assuming line-pipe to be 50-60% of the total pipeline cost, this translates into an opportunity of US$11-13bn for line-pipe suppliers over the next two years. Notably, pipeline capex in the US is expected to be substantially higher than 2010 capex, implying significantly higher demand.

Figure 24. North America – Estd. Line-pipe Requirement

		2002	2003	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E*
Expansion Capital excluding LNG	US$bn	$4.4	$3.6	$2.1	$2.5	$7.6	$14.9	$15.1	$9.4	$5.5	$13.9	$7.5
Capex on pipes	US$bn	$2.4	$2.0	$1.2	$1.4	$4.2	$8.2	$8.3	$5.2	$3.0	$7.7	$4.1
Pipe realization	US$/MT	1,000	1,000	1,000	1,100	1,150	1,350	1,600	1,250	1,300	1,300	1,300
Pipe usage	MMT	2.4	2.0	1.2	1.3	3.6	6.1	5.2	4.1	2.3	5.9	3.2

Source: Citi Investment Research and Analysis *Based on data as of Jan'11, has been revised upwards as per recent data-points

- In the table above, we derive our 2011E and 2012E pipe consumption estimates based on the capex planned by key North American pipeline companies over 2011 and 2012, and assuming that nearly half the capex incurred on the pipeline goes towards the line-pipe cost. Also, the data clearly shows that while 2010 was a lackluster year for pipeline capex, 2011 promises to be much better. We believe this strength should continue into 2012 as well. While the current 2012 data looks somewhat weaker, there could be several companies that might firm up their capex plans later, thereby boosting 2012E capex.

Figure 25. Planned Capex of US Companies on Pipeline Projects (as of Jan'11)

Company	2011 US$m	2012* US$m
Centerpoint	407	120
DCP Midstream Partners	50	-
Duncan Energy Partners	550	-
Enbridge Energy Partners	1,070	580
Enterprise Products Partners	1,362	216
El Paso Pipeline Partners	1,154	230
EQT	94	126
Kinder Morgan Partners	177	-
Magellan Midstream	292	167
National Fuel Gas	73	100
NiSource	250	250
ONEOK Partners LP	754	345
Plains All American	385	-
Questar	157	-
Spectra Energy Partners	1,274	690
Targa Resources	100	250
TransCanada	4,050	3,500
Williams Pipeline	125	125
Others	1,600	800
Total	**13,924**	**7,499**
Total pipeline capex (2011-12)	**21,423**	
Estd. Share of capex on line-pipe	**50-60%**	
Near-term opportunity for line-pipe suppliers	**US$11-13bn**	

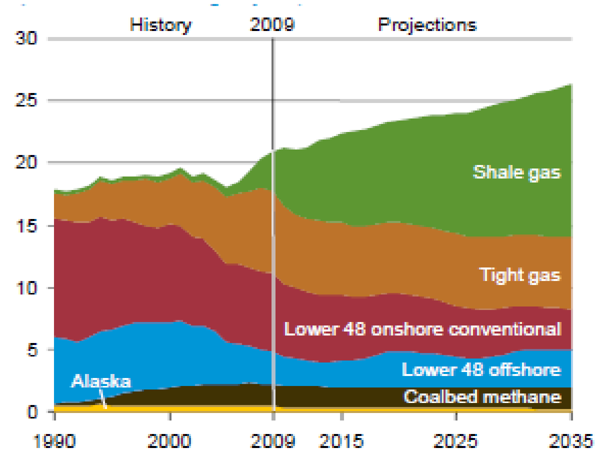
Source: Citi Investment Research and Analysis, Company Reports *Based on data as of Jan'11, has been revised upwards as per recent data-points

Rising shale gas production in the US – to add a new leg to pipeline expansions

Besides, with the production of shale gas in the US on the rise, we anticipate a further increase in line-pipe demand. As shown below, the contribution of shale gas to total gas production from the US is set to increase meaningfully over the next few years, implying significant increases in pipeline capex for tying up of new production centers with the main gas pipeline grid.

Rapid increase in shale gas production in the US to boost pipe demand even more

Figure 26. US Natural Gas Production, 1990-2035 (tcf per year)



Source: EIA

How do these trends benefit WLCO?

The developments in the US should prove to be positive for WLCO, which has already set up a plant in the US and has the requisite approvals in place. In addition, WLCO is also pre-approved with a number of players in the US and also has framework agreements in place with some of them.

We estimate WLCO's FY12E market share to be ~10-11% in the US, with WLCO supplying pipes mainly from the US plant and the remaining from the India plants.

Figure 27. WLCO – Market Share in the US

WLCO FY12E Sales	MMT	1.1
WLCO FY12E Sales (to the US)	MMT	0.6
% sales to the US	%	55%
US FY12E pipe demand	MMT	5.9
WLCO's implied market share	*%*	*11%*
Other key players		Oregon Steel, US Steel

Source: Citi Investment Research and Analysis

Other competitors in the US are mainly integrated steel plants such as US Steel, Oregon Steel, etc., which also produce tubular products. In addition, suppliers from Europe also cater to the US market. However, we believe that WLCO's accreditations and world-class manufacturing facilities should continue to render it competitive in the US market.

2. Middle-East: Pipeline capex bucking the overall trend

Despite political instability, countries such as Saudi Arabia, Oman, etc. continue to see an upswing in E&P activity

- Given its emphasis on infrastructure development, the Middle Eastern market, led by Saudi Arabia, has emerged as a key demand centre for pipes. While the MENA region has been impacted by political tensions and instability, the big demand centers (for line-pipe) such as Saudi Arabia, Oman, Iraq, UAE, have remained relatively insulated from the turmoil.

While capex plans on construction and other sectors have seen a decline, capex planned on pipelines has been steadily increasing

- As per CIRA's MENA Construction Projects Tracker authored by MENA analyst Heidy Rehman and published on 9th May'11, the Middle-East capex on pipelines is estimated at ~US$6.5bn, which has in fact gone up over the last 5-6 months despite political instability. As per our understanding, most of this capex is concentrated in countries such as Saudi Arabia, Iraq, Oman, etc., which have not been impacted by the political tensions in the region. In fact, while capex plans on larger sectors such as construction have seen a decline, capex plans on pipeline projects have remained largely constant. This also indicates that execution is happening at a constant pace with pipeline capex remaining strong at US$6.5bn.

- While the MENA situation continues to evolve, we do not think there is a downside risk to demand from this market. In fact, with Middle-East oil producers benefiting from the spike in crude prices, we believe there would be new pipeline projects coming up – which would further add to the demand potential of the region.

Pipeline capex in the Middle East has bucked the overall trend and has been increasing over the last 3-6 months

Figure 28. MENA Project Capex (US$bn)[2]

	Nov'10	Jan'11	Mar'11	Mar'11	Comments
Total project capex	584.9	528.3	483.5	481.1	Has seen a decline, led by tensions in the MENA region
Construction capex	213.9	179.2	159.4	154.6	Accounts for the largest portion of the total project capex – has also seen a decline
Pipeline capex	6.1	6.3	6.7	6.5	Pipeline capex is a small proportion of total project capex in MENA – however, pipeline capex has in fact gone up over the last 3-6 months

Source: Citi Investment Research and Analysis

- The Middle-East is seeing an increase in pipe manufacturing capacity – especially since Indian manufacturers such as JSAW, WLCO, and PSL are all setting up capacities to capitalize on the healthy demand scenario in the region. As these suppliers will benefit from lower transportation costs by being situated close to the demand centers, we expect demand for their products to remain fairly tight in the region.

WLCO has already commenced operations at its Saudi Arabia plant and should have a first mover advantage in the region

- In addition, major pipe manufacturing capacity in the Middle East has not expanded in a big way due to what was an adverse regulatory environment. This environment has now started to become more favourable to encourage foreign participation, as a result, the Indian manufacturers have already started setting up capacities there. WLCO has already commenced production from its Saudi Arabia plant. As new capacities take ~3 years to be set-up with another 6-12 months required for approvals, we believe that WLCO should benefit from its first mover advantage in the region.

3. India: Seeking to improve low pipeline penetration

The Indian market is currently over-supplied for pipes, and hence most pipe manufacturers are turning abroad to utilize their capacities better. However, we do believe that longer term the Indian market has the potential to become a high-demand market. Hence, we examine below the current industry scenario in India.

India's low pipeline density presents a sizeable potential to increase

As shown below, India lags developed nations like the UK substantially in its current pipeline infrastructure. Interestingly, neighbouring Pakistan is also far ahead of India in its pipeline density.

Figure 29. Comparison of Gas-pipeline Density

S.No.	Country	Pipeline (km)	Pipeline Density (km/sq.km)
1	India	29,000	0.01
2	Pakistan	106,533	0.13
3	UK	275,000	1.13

Source: E&Y, Petrotech

[2] Refer to MENA Construction Projects Trackers published on
1) 16th Nov'10 (https://www.citigroupgeo.com/pdf/SEM08273.pdf),
2) 18th Jan'11 ((https://www.citigroupgeo.com/pdf/SEM07848.pdf),
3) 17th Mar'11 (https://www.citigroupgeo.com/pdf/SEM07464.pdf)
4) 9th May'11 (https://www.citigroupgeo.com/pdf/SEM08616.pdf)

However, we believe that with the ramping up of gas supplies from new fields, emergence of city gas distribution, and the acceptance of natural gas as a cheap and clean fuel, gas pipeline infrastructure in India is set to expand. Moreover, with new refining capacity being set up and rising domestic consumption of fuels, investments in crude and product pipeline infrastructure are also set to go up.

As far as gas infrastructure is concerned, within India itself there exists a large regional disparity. Gujarat, which is the largest gas consumer within India, has a gas pipeline density of 0.395km/million of population. Compared to this, the national average has been estimated at just 0.095, implying that as gas supplies increase and the intensity of gas consumption increases across geographies, it is going to lead to an increase in pipelines in such areas which have been under-supplied till now. Theoretically, if the Indian pipeline density was to move closer to Gujarat's pipeline density, it would entail an additional investment of US$11.6bn on line-pipe alone. While this is certainly more of a long-term demand estimate given several parts of the country are either far from supply sources, or are relatively economically backward, this does show the potential opportunity in the Indian market.

Figure 30. India – Potential Demand for Line-pipe to Increase Overall Pipeline Density

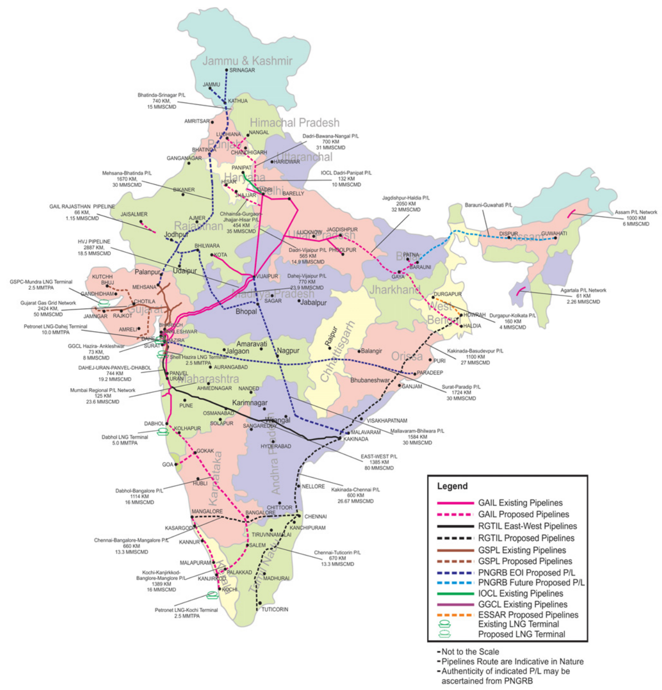
India pipeline density	km/million population	9.5
Gujarat pipeline density	km/million population	39.5
Current pipeline network	km	11,274
Additional pipeline network required (to increase overall pipeline density equal to Gujarat's density)	km	33,119
Additional tonnage of line-pipe required	MT	8,279,776
Additional investment on line-pipe required	**US$bn**	**11.6**

Source: Citi Investment Research and Analysis, Indianpetro

Expansion of pipeline infrastructure

The commencement of KG gas has boosted the transmission volumes of both GAIL and GSPL. In a bid to transport growing KG and other east coast gas volumes over the next few years, GAIL and RGTIL (Reliance Gas Transportation Infrastructure Ltd) are building new pipelines to connect new regions within the country to gas supplies, as shown in the map below. Besides this, GAIL is also augmenting its existing capacities while GSPL has won bids for 3 new cross-country pipelines. We believe pipeline expansion will be boosted by the fact that the Gov't has notified Sec-16 of the PNGRB Act, the Supreme Court has effectively empowered the PNGRB, and the PNGRB has commenced granting licenses to entities for constructing new pipelines.

Figure 31. India's Existing and Proposed Gas Pipelines



Source: PNGRB

GAIL proposes to expand its pipeline capacity from the current ~7,000 km to ~14,000 km over the next 3-4 years. Work on some of these pipelines is already underway (current status of these pipelines is shown below in Figure 32).

Figure 32. GAIL – New Pipeline Capacity Build-up

Project	Approved Cost Rs bn	Additional Capacity mmscmd	Additional Length km	Completion Schedule
DVPL pipelines - Phase II (incl. compressor)	58.4	24-35-78	610	Mainline compressor commissioned at Jabhua and Vijaipur. Standby machine at Jhabua is expected by May'11 and Vijaipur by Dec'11
Vijaipur - Dadri pipelines (incl. compressor))	49.3	20-40-80	499	The commissioning of the compressor at Kailaras and Chainsa is expected by Dec'11
Dadri-Bawana-Nangal pipeline	23.6	31	594	Dadri-Bawana pipeline commissioned. The commissioning of Bawana-Nangal is expected by Dec'11
Chainsa – Jhajjhar – Hissar pipeline	13.2	35	349	Chainsa-Sultanpur and Sultanpur-Neemrana has been commissioned
Dabhol – Bangalore pipeline	49.9	16	1,414	Phase I –Aug'12; Phase II – Dec'12
Kochi – Kanjirkkod – Bangalore – Mangalore pipeline	32.6	16	1,126	Phase I –Aug'12; Phase II – Dec'12
Jagdishpur – Haldia pipeline	76.0	32	2,050	Completion date yet to be finalized
Total	**302.9**	**244**	**6,642**	

Source: GAIL

GSPL currently has a pipeline network of 1,600km, primarily in the state of Gujarat and currently transports ~36 mmscmd of gas. In a bid to expand outside Gujarat, GSPL, in a consortium with IOC, BPCL and HPCL (GSPL: 52% stake), had expressed interest for four cross-country pipelines. The results of three of these are already out with the GSPL-led consortium winning all three bids, while bidding for the fourth pipeline is currently underway. With tendering for materials yet to commence, these pipelines provide a significant opportunity for the Indian line pipe companies.

Figure 33. GSPL – New Pipeline Bids and Wins

Pipeline	Capacity mmscmd	Gas sources	Length (incl spurlines) km	Status
Mallavaram-Bhilwara	>50	1. GSPC (KG Basin)	1595	Won by GSPL-led consortium (GSPL: 52% stake)
Mehsana-Bhatinda	>40	1. LNG (PLNG, Shell, GSPC) 2. Other E&P and CBM blocks along the route	1650	Won by GSPL-led consortium (GSPL: 52% stake)
Bhatinda-Srinagar	15	1. LNG (PLNG, Shell, GSPC) 2. Other E&P and CBM blocks along the route 3. GSPC	447	Won by GSPL-led consortium (GSPL: 52% stake)
Surat-Paradip	30	1. LNG (PLNG, Shell, GSPC) 2. Offshore gas fields in Gujarat	1600	Bidding currently underway

Source: Citi Investment Research and Analysis, PNGRB, GSPL

City gas distribution – another growth avenue for pipeline manufacturers

We expect the auctioning of new cities to pick up pace going forward following the Supreme Court ruling in the PNGRB case. Till date, PNGRB has invited bids for 29 cities in 4 rounds, with results for 11 cities announced. With the settlement of the court case, PNGRB is now empowered to issue licenses to bid winners. This expansion of city gas infrastructure is expected to further boost pipe demand as local gas suppliers would need connectivity with gas transmission companies such as GAIL.

With natural gas set to increasingly become a more important fuel in India, the Indian market provides a significant opportunity to line pipe manufacturers.

Natural gas pipelines alone could provide US$4bn opportunity

If one takes into account only the plans announced by GAIL and GSPL, this alone provides an opportunity of nearly US$4bn. CGD infrastructure, though difficult to quantify, could further add to pipeline demand.

Figure 34. India – Potential line-pipe demand from gas pipelines based on current capex plans

Company	Length Km	Line-pipe requirement MMT/km	Cost US$/MT	Implied investment on line-pipes US$bn
GAIL	5,197	250	1400	1.9
GSPL	4,039	250	1400	1.4
RGTIL	2,628	250	1400	0.9
Total				**4.2**

Source: Citi Investment Research and Analysis, Company Reports

Product pipelines could further add to the pie

With India's refinery capacity increasing (installed capacity is expected to increase from ~188 MMTPA in FY11E to ~242 MMTPA in FY13E), we believe the requirements for crude and product pipelines are set to increase. India's largest OMC (oil marketing company), in particular, has plans to substantially expand its crude and product pipeline infrastructure. Some of the key pipeline projects being undertaken by this company are shown below; we believe these projects in the short-term provide an opportunity of ~US$400m to the Indian suppliers, and can further go up in the future.

Figure 35. India's Largest OMC – Crude Pipeline Capex Plans

	Total project capex (US$m)	Capex on pipes (US$m)	Pipe requirement (MMT)	Completion date
Paradip-Ranchi Pipeline	399	199	0.2	Nov'12
Viramgam to Kandla Branch Pipeline	78	39	0.0	Dec'11
De-bottlenecking of Salaya-Mathura crude pipeline	352	176	0.1	Aug'13
Total	**828**	**414**	**0.3**	

Source: Citi Investment Research and Analysis, Company Reports

India's Competitive Landscape for SAW pipes

- Besides WLCO, the key SAW pipe manufacturers include Jindal SAW, PSL, and Man Industries. The 4 biggest manufacturers have installed capacities of ~5 MMTPA within India.
- Domestic Indian industry typically sees intense competition – large consumers such as GAIL have their orders heavily bid for, resulting in low margins for producers.

Figure 36. Peer Capacities and Plant Locations

000 Tons	SAW pipes	Plant Locations
Jindal SAW	1,500	Mundra, Bellary, Kosi
PSL	1,175	Chennai, Kandla, Vizag, Ahmedabad, Jaipur, UAE
Man Industries	1,000	Anjar, Pitampur

Source: Citi Investment Research and Analysis

Indian market remains over-supplied with top-4 manufacturers alone capable of satisfying the domestic demand

Figure 37. Installed SAW Capacity By 4 Biggest Manufacturers vs. Demand

	KTPA
Jindal SAW	1,500
Welspun Corp	1,250
PSL	1,175
Man Industries	1,000
Total installed SAW capacity	**4,925**
Peak utilization assumed	**65%**
Peak output	**3,200**
Estimated peak Indian demand	**3,000**

Source: Company Reports and CIRA Estimates Note: Includes capacities located in India only

Pipe Manufacturing Industry – Key Characteristics

- While the exact quantum of global pipe manufacturing capacities is difficult to gauge given the existence of several small players and lack of information on new plant openings/closures, we believe that only a small proportion (<5%) of the total annual steel production of ~1200-1300 MMTPA is used up for manufacturing of pipes.

WLCO is a reasonably large player in the SAW pipe business, accounting for ~5-6% of global capacity

- At current installed SAW pipe capacity of 1.9 MMT for WLCO, we believe it would account for ~5-6% of the global installed pipe manufacturing capacity. However, in the absence of concrete data, the exact market share and the geographical break-up of the same is a little hard to determine. In addition, it should be borne in mind that the absolute capacity figure (in tonnage terms) for pipe companies is theoretical, and peak utilizations are typically capped at ~65%. This is because even though capacities are rated in tonnage terms, tonnage could be impacted if small diameter but intricate pipes are manufactured, which despite reduced tonnage do not imply lower utilizations. Since a pipe mill manufactures pipes of various dimensions during a year, it produces different tonnage for the same periods of utilization, which typically get capped at 65%. A mill which produces a greater quantity of lower diameter pipes can theoretically work at full capacity, yet produce lower tonnage.

- The return analysis of a new pipe mill indicates that at a utilization of 55% (peak utilization could go up to 65%), such a mill could result in ROCE of ~13%. However, a new mill would typically take 3-4 years to ramp-up its utilization to peak levels.

Figure 38. New Pipe Mill – Return Analysis

	Units		Comments
Capital Employed	US$/T	500	Typical capex for setting up an average-sized SAW pipe mill is US$400-600/T
EBITDA	US$/T	122	Indian companies expect to make average EBITDA of US$225/T on SAW pipes. We assume a capacity utilization of 55% - peak utilizations could go up to 65%
Depreciation	US$/T	25	Depreciation rate of 5%
EBIT	US$/T	97	
ROCE (pre-tax)	%	19%	
ROCE (post-tax)	%	13%	Assuming corporate tax-rate of 33.3%
Payback (Capex/EBITDA)		4.1	At a utilization of 55%

Source: Citi Investment Research and Analysis

- On the supply side, there are few companies globally which produce only pipes. A large number of pipe mills globally are actually a part of integrated steel mills, and hence are just small arms of large steel companies. We believe that the Indian pipe manufacturers are better placed in this respect as they are focused only on pipes, and are better positioned to understand their target markets.

Accreditations – Key Entry Barriers in Foreign Markets

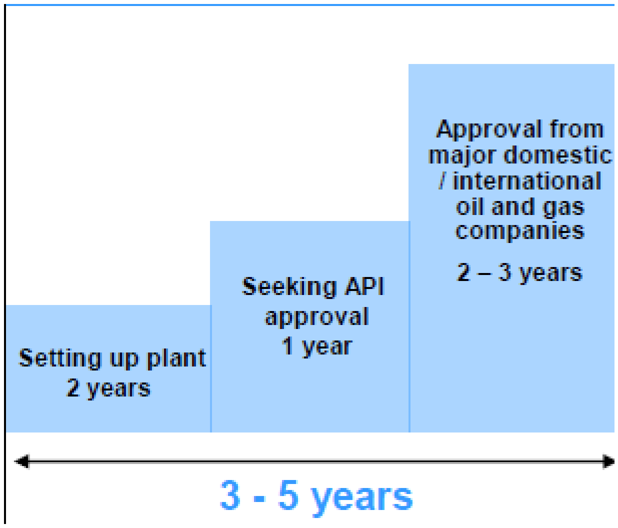
The US and Canada are key markets for WLCO, and contribute significantly to WLCO's revenues and order-book. However, it should be noted that these markets have certain characteristics which differentiate them from other markets (such as India):

WLCO is already an API-approved supplier in the US and is accredited with key North-American pipeline companies; accreditations are key entry barriers in quality sensitive markets such as North America

- **API approval and Accreditations –** Each pipe manufacturer supplying to the US has to be approved by the API (American Petroleum Institute), a process which could take upto a year. Besides, each pipeline company has strict internal processes to keep pipeline quality in check, one of them being supplier accreditations. Suppliers for a company go through a rigorous process to start supplying pipes to the company and to bid for any future projects. These act as key entry barriers for new players. It should be noted that Welspun is already accredited with key pipeline companies such as Kinder Morgan, Transcanada, etc. In addition, it also has framework agreements with some companies, under which a company could simply place its orders with Welspun, without going through a full-fledged tender process.

- **Emphasis on quality –** Projects in the North American market demand adherence to stringent quality norms. Besides, projects there are generally more complex and difficult to execute given difficult terrain and low temperatures. However, successful execution helps the supplier to gain a further toehold in the market, as well as helps it in getting considered by new companies.

Figure 39. Typical Timeline For a New Company to Begin Sale of Pipes to US Companies



Source: Company Reports

Business Overview

- **Manufacture of pipes –** WLCO is primarily a line-pipe producer. It uses the submerged arc welding process[3] to manufacture the following types of pipes:
  - HSAW pipes (Helically Submerged Arc Welded pipes)
  - LSAW pipes (Longitudinally Submerged Arc Welded pipes)
  - ERW pipes (Electric Resistance Welded pipes)
- **Manufacture of plates and coils –** In an attempt to backward integrate its business, WLCO manufactures steel plates and shall soon begin the production of steel coils. Besides other uses, these act as raw material for pipes and hence could either be used internally or sold to external customers.

Figure 40 below shows the products manufactured by Welspun, and their applications.

Figure 40. WLCO – Product range

Product	End-use	Raw material
HSAW pipe (Helically submerged arc welded pipe)	low-pressure oil & gas pipelines	Hot-rolled Coil
LSAW pipe (Longitudinal submerged arc welded pipe)	high-pressure oil & gas pipelines	Hot-rolled Plate
ERW pipe (Electric Resistance Welded pipe)	gas and water pipelines	Hot-rolled Coil
Hot-rolled Plate	LSAW pipe, shipbuilding, industrial components	Steel slab
Hot-rolled Coil	HSAW pipe, construction and transport	Steel plate

Source: Citi Investment Research and Analysis

- **Oil & Gas exploration –** WLCO has a subsidiary called Welspun Natural Resources which has formed a JV with Adani Enterprises called Adani Welspun Exploration Ltd. (AWEL). Welspun Natural Resources holds 35% of this JV with the rest being held by Adani. The JV has majority participating interests in two exploration blocks in India awarded under the NELP-VI bid round; one in Gujarat and another in the Assam. AWEL also won two offshore blocks in NELP VII and recently awarded a contract for the seismic survey of its Mumbai Offshore block to a Schlumberger group company.
- **Renewable Energy –** The company is exploring the possibility of diversifying into solar energy projects through its subsidiary Welspun Urja India Ltd.
- **EPC projects –** WLCO's infrastructure-focused subsidiary, Welspun Infratech, holds 1) a 61% stake in MSK Infrastructure, which is a small-sized EPC player, and 2) a 21% effective stake in Leighton Contractors India, which is a bigger player in the Indian construction space. WLCO has invested Rs4.3bn towards both these entities and we do not expect any additional funding requirements for the same.

  Leveraging on MSK, the company expects to bid for small to medium scale infrastructure projects and intends to diversify in this space. As per the company, MSK currently has an order book of Rs3.5-4bn, which is likely to grow further in the future as MSK would do some sub-contracting work for Leighton Contractors India. Leighton Contractors India is an Indian player focused on construction projects in the oil & gas, civil work, as well as transportation sectors. Its current order book is ~Rs40bn, executable over the next 3 years.

  We currently build in sales of Rs3bn in both FY12E and FY13E from the EPC business, and would wait for more details of order-wins and execution capabilities of MSK as well as Leighton before taking a more constructive view of this diversification into the EPC business.

[3] Refer to the "Appendix" for details on various pipes and manufacturing processes

Capacities and Expansion Plans – Increasing Leverage To Foreign Markets

WLCO has a current pipe capacity of 1.9 MMTPA, with 1.15 MMT located in Gujarat (Western India), and the remaining capacity located at Mandeya (South India), US (Little Rock, Arkansas) and Saudi Arabia. In addition, WLCO is setting up a new 0.35 MMT LSAW plant at Anjar, which has commenced trial production and should begin commercial production shortly.

Figure 41. WLCO – Current Product Capacities (MT)

Product category	Capacity	Location	Year of commissioning
HSAW	50,000	Dahej	FY97
	350,000	Anjar	FY06
	150,000	Anjar	FY08
	350,000	Arkansas, US	FY09
	100,000	Mandeya	FY11
	300,000	Saudi Arabia	FY11
LSAW	350,000	Dahej	FY99
ERW	250,000	Anjar	FY05
Total Pipe Capacity	**1,900,000**		
Plate/Coil	1,500,000	Anjar	FY09

Source: Company Reports

Figure 42. WLCO – Future Capacity Expansion (MT)

Product category	Capacity	Location	Year of commissioning
LSAW	350,000	Anjar	end-1QFY12
Total capacity addition	**350,000**		

Source: Company Reports

Figure 43. WLCO – Plants in India

Source: Company Reports Note: The company recently also commissioned a plant at Mandeya in Karnataka and in Saudi Arabia

Figure 44. WLCO – Plant in Arkansas, USA

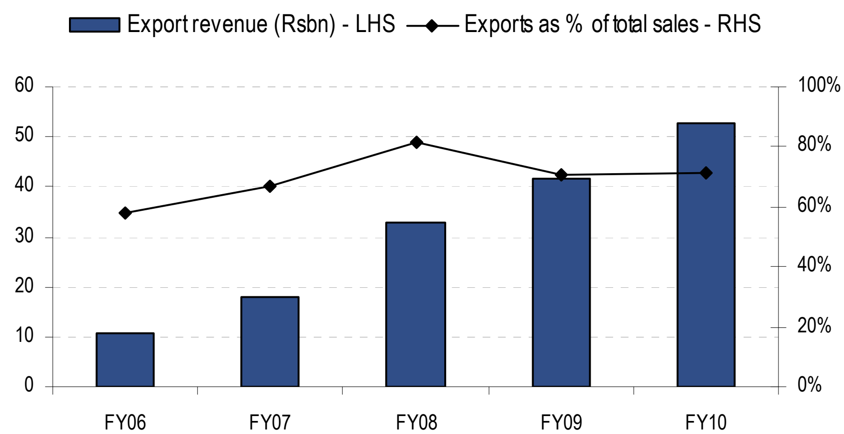
Source: Company Reports

Financials

Leveraging on a global footprint

WLCO has a sizeable client base abroad with exports contributing ~70% of its FY09/10 revenues. With Welspun expanding its capacities overseas (its plant in US is already operational while its Saudi Arabia facility commenced production in 4QFY11), we expect WLCO to continue to have a significant dependence on foreign markets.

Figure 45. WLCO – Contribution of Exports to Total Revenues



Source: Company Reports, Citi Investment Research and Analysis

~82% of its current order-book is geared towards international markets, thus emphasizing WLCO's positioning as an export-oriented player. ~40-50% of WLCO's current orders are from North America.

The company's current order book stands at US$1.2bn. In tonnage terms, this is equivalent to 726,000 MT of pipes, and 40,000 MT of external plate orders.

Figure 46. WLCO – Current Clients

Client	Location
Transacanada Pipe Line Limited	Canada
Enterprise	USA
Saudi Aramco	Middle-East
GAIL	India
IOC	India

Source: Company Reports

Figure 47. WLCO – Order-book and Sales Coverage (estimated)

Units	Order book	Sales	Basis	Order book/Sales
Rs bn	54	69	FY11E Sales	0.8
Rs bn	54	83	FY12E Sales	0.7

Source: CIRA Estimates

The company is currently covered for nearly 70% of its FY12 operations. WLCO has indicated that with rising oil prices, a number of projects that were postponed earlier are being re-initiated, particularly in the Middle-East. The company is bidding for such projects and expects to win new orders in the next quarter.

We expect that WLCO would need to book nearly US$500m of orders every quarter for it to maintain an order-book visibility of ~6 months. This ties in with the fact that line-pipe orders are typically short cycle in nature (executable within 6-9 months of ordering). New order wins would, however, be required consistently as that would 1) help give visibility on sales, and 2) provide visibility on utilizations of new capacities which should ramp up in FY12E.

Significant exposure to the export markets

In a bid to cater to an expected increase in global pipe demand and to further leverage on its strong relationships with global players, WLCO has set up the following capacities abroad:

- HSAW capacity of 350,000 TPA at Little Rock, Arkansas, USA
- HSAW capacity of 300,000 TPA in Saudi Arabia (economic interest of ~50%)

API approval and accreditations for the US and Saudi mill are key positives

Notably, both these mills are API-approved; hence WLCO should be eligible for all major tenders coming up in these markets. Besides, WLCO is separately accredited with several large E&P and pipeline companies in the US, a significant advantage vs. peers and new entrants. Its Saudi mill has received the approvals from Saudi-Aramco, which is a key positive and should enable it to win orders from this potentially large customer.

In the US, WLCO's key competitors are local manufacturers – however, most of them are integrated steel producers which produce a variety of steel products also. While competition in the US is tough, we remain positive on WLCO's prospects to win new orders as: 1) it is already accredited with a number of US customers, 2) it has a plant in the US and is thus at par with the local players on transportation costs, and 3) WLCO also provides value added services such as bending, double-jointing, etc. making it a one-stop solution for pipe requirements.

Key assumptions

- We assume pipe volume sales to ramp up from 0.9 MMT in FY11 to 1.1 MMT in FY12E and 1.3 MMT by FY14E on the back of capacity expansion, improving utilizations as well as better product demand.
- We expect WLCO to make blended EBITDA margins (for pipes and plates) of ~Rs8800-9100/MT going forward, lower than margins attained in FY11E (which included the execution of a one-off high margin order). This is largely in-line with management's guidance of Rs10,500/MT EBITDA margins on pipes and ~Rs6000/MT margins on plates, resulting in blended margins of Rs8,800/MT. We believe that margins should remain stable at these levels because 1) WLCO has positioned itself as a premium supplier and is more levered to international markets where emphasis on quality is high and margins are stronger and, 2) WLCO also provides value added services such as double-jointing, bending of pipes, etc, which are margin accretive. There could be an upside to our margin estimates if stronger than expected demand leads to a tighter supply-demand scenario, or if plate margins rise from current levels.
- Peak utilizations for pipe making facilities are typically between 55-65%. With new capacities attaining these levels in ~3 years, we estimate the company's utilizations will go up to ~54% in FY13E, as production from new capacities ramps up.

Figure 48. WLCO – Key Assumptions

		FY07	FY08	FY09	FY10	FY11	FY12E	FY13E	FY14E
Pipe sales	000 MT	525	641	692	816	909	1,082	1,221	1,297
Pipe capacity	000 MT	930	1,000	1,500	1,500	1,900	2,250	2,250	2,250
Pipe capacity utilization	*%*	*56%*	*64%*	*46%*	*54%*	*48%*	*48%*	*54%*	*58%*
Plate/Coil Sales	000 MT	-	-	42	309	278	525	600	600
Plate capacity	000 MT	-	-	1,500	1,500	1,500	1,500	1,500	1,500
Plate capacity utilization	*%*	*-*	*-*	*3%*	*21%*	*19%*	*35%*	*40%*	*40%*
Pipe EBITDA margin	Rs/MT	6,255	10,301	11,380	12,050	10,910	9,890	10,020	10,100
Plate EBITDA margin	Rs/MT	-	-	7,000	6,800	6,800	6,500	6,500	7,000
Blended EBITDA margin	Rs/MT	6,255	10,301	11,130	10,609	9,987	8,783	8,776	9,277
Exchange Rate	Rs/US$	44.6	40.3	46.0	47.0	45.6	45.0	45.0	45.0

Source: Citi Investment Research and Analysis, Company Reports

Figure 49. WLCO – Segmental Sales Break-up

Segmental	FY07	FY08	FY09	FY10	FY11	FY12E	FY13E	FY14E
Pipes	100%	95%	86%	72%	81%	74%	74%	75%
Steel coils/plates	0%	0%	6%	21%	16%	17%	18%	17%
Others	0%	5%	8%	7%	4%	9%	8%	8%
Total	100%	100%	100%	100%	100%	100%	100%	100%

Source: Citi Investment Research and Analysis, Company Reports

- Going forward, we expect WLCO's revenue mix to remain largely consistent, with pipe and coil/plate sales contributing >90% of its revenues.
- While WLCO is a consumer of steel products such as coils, plates and slabs, it does not have significant exposure to steel price fluctuations. Whenever WLCO wins an order, it books its steel and associated freight immediately, thus reducing its exposure to steel price volatility. It is, however, exposed to the period between submitting a bid and winning the order; unless steel prices are extremely volatile, we do not think WLCO would be impacted significantly by price / forex fluctuations.
- WLCO has a relatively stable debt position, with its current D/E at around ~0.2x (most investments in the balance sheet are liquid investments and can be treated similar to cash). With most of the capex on the LSAW expansion at Anjar and Saudi Arabia already done, we do not expect any major funding requirements going forward.

Figure 50. WLCO – Income Statement (Rupees in millions)

Rs m	FY09	FY10	FY11	FY12E	FY13E	FY14E
Net sales	**58,783**	**73,503**	**80,236**	**86,627**	**98,081**	**104,282**
Cost of goods sold	48,402	52,529	56,454	61,084	69,457	73,313
Other expenditure	-	-	2,008	-	-	-
SG&A	4,034	7,787	8,944	11,185	12,398	13,126
Total expenditure	52,437	60,316	67,406	72,269	81,855	86,439
EBITDA	6,346	13,186	12,831	14,358	16,226	17,844
EBITDA Margin (%)	*11%*	*18%*	*16%*	*17%*	*17%*	*17%*
Adjusted EBITDA (ex-forex loss/gain)	8,165	11,930	14,838	14,358	16,226	17,844
Adjusted EBITDA margin	*14%*	*16%*	*18%*	*17%*	*17%*	*17%*
Depreciation	1,254	2,061	2,440	2,911	3,073	3,151
Interest	1,735	2,071	1,471	1,857	1,843	1,356
Other Income	179	185	184	200	300	350
PBT	3,536	9,240	9,104	9,790	11,610	13,687
Provision for taxes	1,200	3,136	2,871	3,182	3,831	4,517
Tax rate (%)	34%	34%	32%	33%	33%	33%
PAT	2,336	6,104	6,233	6,608	7,779	9,170
Minority interest	0	0	(97)	-	-	-
Reported Net Income	**2,336**	**6,104**	**6,136**	**6,608**	**7,779**	**9,170**
EPS (diluted for FCCB)	**13**	**27**	**27**	**29**	**34**	**40**
DPS	1.5	2.0	2.0	2.5	3.0	3.0

Source: Citi Investment Research and Analysis, Company Reports

Figure 51. WLCO – Balance Sheet (Rupees in millions)

Rs m	FY09	FY10	FY11	FY12E	FY13E	FY14E
Total assets	**44,623**	**57,915**	**79,664**	**82,644**	**87,237**	**88,496**
Gross Block	34,844	38,810	47,981	56,240	57,740	59,240
Less Depreciation	3,847	5,889	8,328	11,239	14,312	17,464
Net block	30,996	32,921	39,653	45,001	43,427	41,776
CWIP	5,808	5,412	7,309	3,000	3,000	3,000
BOT Projects Expenditure	-	-	4,598	6,000	6,000	6,000
Investments	1,140	1,596	14,405	15,905	15,905	15,905
Cash and bank balances	9,470	17,028	7,532	3,867	7,695	8,889
Net current assets	(3,177)	933	6,143	8,872	11,210	12,926
Forex translation diff a/c	355					
Total liabilities	**44,623**	**57,915**	**79,664**	**82,644**	**87,237**	**88,496**
Shareholders Funds	15,597	29,011	35,171	41,180	48,241	56,693
-Share capital	932	1,022	1,023	1,023	1,023	1,023
-Reserves and surplus	14,664	27,990	34,148	40,157	47,217	55,669
Minority interest	0	0	2,024	2,024	2,024	2,024
Total debt	26,538	25,476	38,060	33,823	29,823	20,823
Net debt/equity*	0.4	0.1	0.2	0.2	0.1	0.0
Deferred tax liability	2,488	3,352	4,344	5,617	7,149	8,956

Source: Citi Investment Research and Analysis, Company Reports *FY11E onwards adjusting for liquid (cash-like) investments also

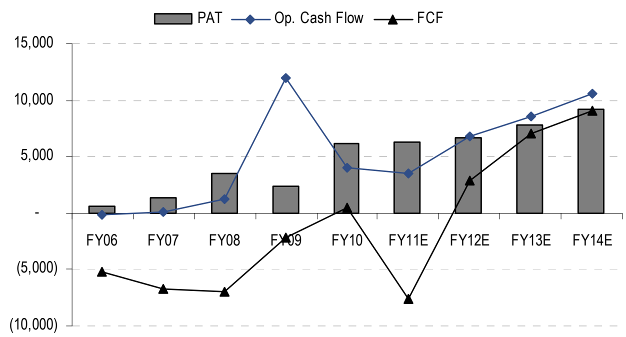
Figure 52. WLCO – Cash Flow Statement (Rupees in millions)

Rs m	FY09	FY10E	FY11E	FY12E	FY13E	FY14E
Net cash income	2,336	6,104	6,233	6,608	7,779	9,170
Deprec., amort.	1,254	2,061	2,440	2,911	3,073	3,151
Net change in WC	8,378	(4,110)	(5,210)	(2,729)	(2,338)	(1,716)
Cash from ops.	**11,968**	**4,055**	**3,462**	**6,790**	**8,514**	**10,605**
Capital expenditure	(14,077)	(3,571)	(11,068)	(3,950)	(1,500)	(1,500)
Change in investments	2,765	(456)	(12,810)	(1,500)	-	-
Cash from investing	**(11,312)**	**(4,026)**	**(23,877)**	**(5,450)**	**(1,500)**	**(1,500)**
Change in borrowings	9,538	(1,062)	12,584	(4,236)	(4,000)	(9,000)
Equity raised	(843)	4,660	2	-	-	-
Dividends paid	(327)	(478)	(479)	(599)	(718)	(718)
Other financing	395	1,220	992	1,273	1,532	1,807
Cash from financing	**8,762**	**4,339**	**13,099**	**(3,562)**	**(3,186)**	**(7,912)**
Net cash flow	**9,417**	**4,368**	**(7,316)**	**(2,222)**	**3,828**	**1,194**

Source: Citi Investment Research and Analysis, Company Reports

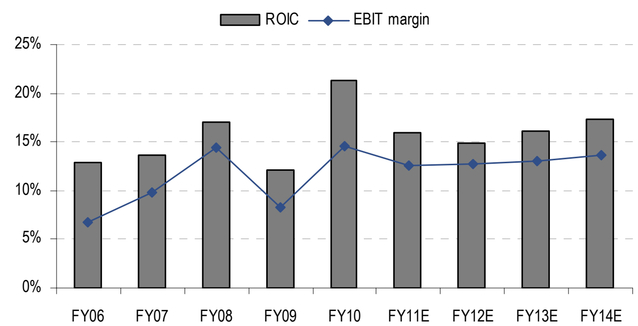
- As shown below in Figure 53, we expect WLCO to turn FCF positive in FY12E, led mainly by higher operating cash flow and lower capex requirements (since it has finished with most of its capex on its Anjar plant and Saudi Arabia facility in FY11E).
- The operating cash flow spike seen in FY09 was due to an abnormal increase in customer acceptances – which has normalized since then. The company in the past has tended to match its current liabilities (creditors, acceptances and trade deposits) with current assets (inventories and debtors) to manage its working capital cycle. Besides, the company times the opening of the letters of credit (from customers) so as to fund its working capital optimally.

Figure 53. WLCO – PAT vs. Operating Cash Flow and Free Cash Flow



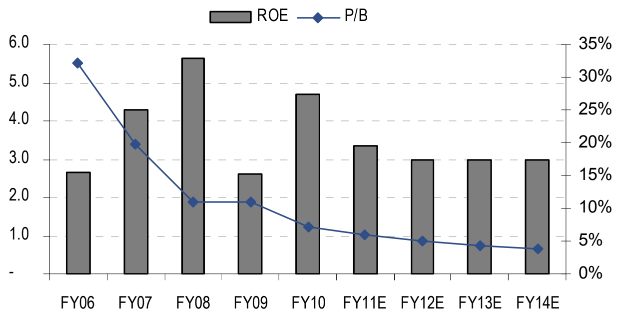
Source: Citi Investment Research and Analysis, Company Reports

Figure 54. WLCO – ROIC vs. EBIT Margin



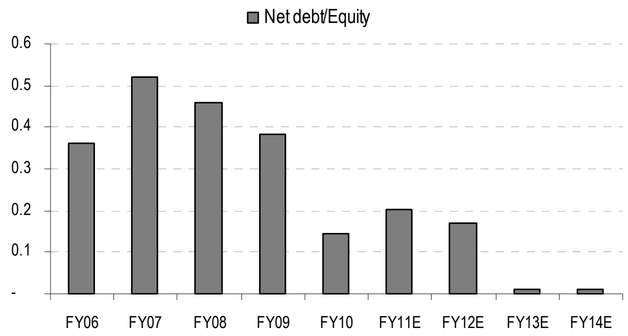
Source: Citi Investment Research and Analysis, Company Reports

Figure 55. WLCO – ROE vs. P/B



Source: Citi Investment Research and Analysis, Company Reports

Figure 56. WLCO – Net debt / equity



Source: Citi Investment Research and Analysis, Company Reports

Key triggers

- **New order wins –** As per WLCO management, the company is seeing the revival of old projects (which were put on hold during the downturn); this has also increased the level of enquiries the company has seen (it recently won US$263m worth of orders). Any new order wins would act as a key trigger for the stock, providing visibility on better utilization of the company's capacities.

- **Sustained high crude prices –** High crude prices going forward would lead to more investments in the oil & gas space and will lead to a sustained increase in demand for pipes.

- **Meaningful increase in contribution from EPC business –** Any significant increase in EPC orders at reasonable margins could be a new growth driver. We, however, have not built in any significant contribution from MSK/Leighton over the next 2 years.

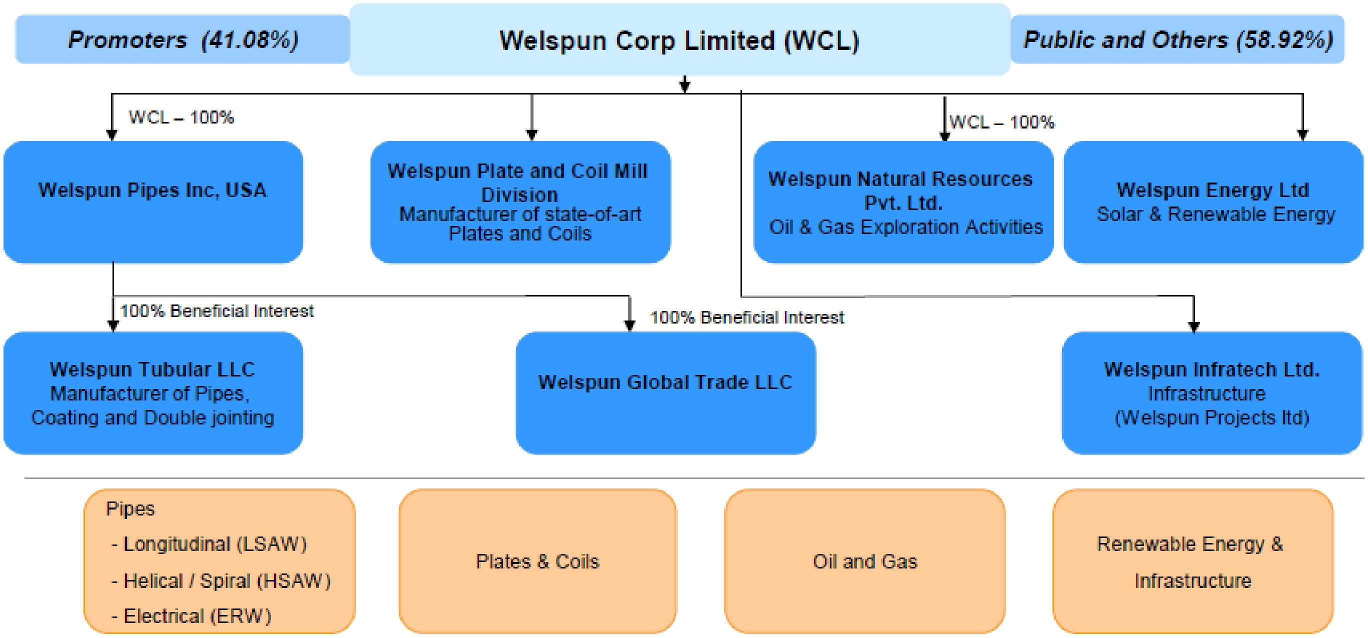
- **Reversal of the US$45m provision taken in FY11 –** WLCO, owing to supply of lower-grade steel from a supplier, faced liabilities amounting to US$45m from Kinder-Morgan, a key US client. To resolve this long-pending stand-off, the company recently (in FY11 accounts) wrote off the entire liability. It is also working with the steel supplier to reimburse it the entire amount in the form of discounts on future steel supply. If this resolution comes through, this could be a key positive as it could lead to lower raw material costs in FY12E and FY13E.

Company Background

Introduction

Welspun Corp (WLCO) is the flagship company of the Welspun group. The group is promoted by the Goenka family and has interests in textiles, steel products, and SAW pipes. WLCO is primarily a pipe manufacturer, and has succeeded in backward-integrating its business to produce steel plates and coils. In addition to its core pipe manufacture business, the company also provides add-on services such as pipe coatings, double-jointing, etc. Besides, the company has also forayed into the infrastructure space, by acquisition of stakes in MSK Projects and Leighton Contractors (India).

Figure 57. Welspun Corp – A Snapshot

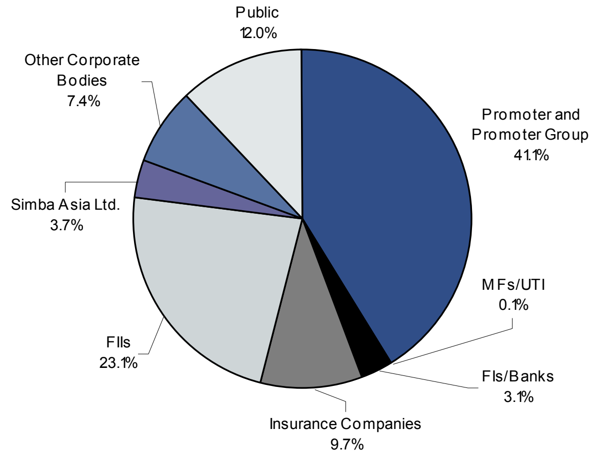


Source: Company Reports

Shareholding Pattern

The promoter group holds ~41% of the company, with FIIs holding ~23%. Nearly 11% is held by corporate bodies, 13% by domestic financial institutions, insurance companies and banks, with the remaining 12% being held by the public.

Figure 58. Shareholding pattern



Source: BSE

Management

Mr. B.K. Goenka is the chairman of the company. He belongs to the promoter family and has been involved with the company's activities for a number of years. Mr. R.R. Mandawewala is the MD of Welspun Corp, and has extensive experience in the SAW pipe business.

Quants View – Contrarian

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Data as of: 17-Jun-11

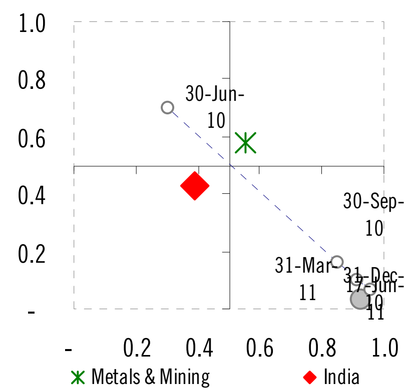
Radar Screen Quadrant Definitions

Glamor *Poor relative value but superior relative momentum*	**Attractive** *Superior relative value and superior relative momentum*
Unattractive *Poor relative value and poor relative momentum*	**Contrarian** *Superior relative value but poor relative momentum*

Welspun currently lies in the extreme corner of the Contrarian quadrant of our Value-Momentum map with relatively weak momentum but strong value scores. It has been a resident there since the past 9 months. Compared to its peers in the Metals & Mining sector, WLCO fares better on the valuation metric but worse on the momentum metric. Similarly, compared to its peers in its home market of India, WLCO fares better on the valuation metric but worse on the momentum metric.

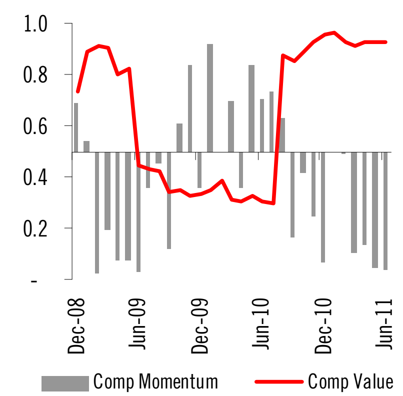
From a macro perspective, WLCO has a high beta to the region so is likely to rise (or fall) faster than the region. It is also likely to benefit from small-cap outperformance, tightening US credit spreads, falling commodity (ex-oil) prices, falling EM yields, and a weaker US Dollar.

Figure 59. Radar Quadrant Chart History



Source: CIRA

Figure 60. Radar Valuation and Momentum Scores



Source: CIRA

Figure 61. Radar Model Inputs

IBES EPS (Actual and Estimates)

FY(-2)	11.51	Implied Trend Growth (%)	20.29
FY(-1)	28.40	Trailing PE (x)	5.37
FY0	28.66	Implied Cost of Debt (%)	5.81
FY1	32.35	Standardised MCap	(0.21)
FY2	37.64		

Note: Standardised MCap calculated as a Z score – (mkt cap - mean)/std dev – capped at 3

Source: Citi Investment Research and Analysis, Worldscope, I/B/E/S

Figure 62. Stock Performance Sensitivity to Key Macro Factors

Region	1.32	Commodity ex Oil	(0.78)
Local Market	1.25	Rising Oil Prices	0.23
Sector	0.05	Rising Asian IR's	(0.10)
Growth Outperforms Value	(0.31)	Rising EM Yields	(0.80)
Small Caps Outperform Large Caps	1.56	Weaker US$ (vs Asia)	3.76
Widening US Credit Spreads	(0.39)	Weaker ¥ (vs US$)	(0.42)

Source: Citi Investment Research and Analysis

Welspun Corp

Company description

Welspun Corp (WLCO) is a line-pipe manufacturer with an installed pipe capacity of 1.9 MMTPA, which is set to expand to 2.25 MMTPA. The company produces three types of pipes: HSAW, LSAW and ERW, which are primarily used in the oil & gas industry. It also expanded its operations by backward-integrating its pipe business with the manufacture of steel coils and plates. WLCO's domestic operations are based out of Anjar and Dahej (in Gujarat) and Mandeya (in Karnataka), while it also has pipe mills in the US and Saudi Arabia. Currently, WLCO has an order-book of US$1.2bn, a significant proportion of which are export orders.

Investment strategy

We have a Buy / High Risk (1H) rating on Welspun shares. After a significant stock under-performance in the past 12 months on sector, we believe a re-rating is due for WLCO, given its high-quality product offerings, accreditations with key customers, and expanding capacities at a time when crude prices are high and global pipe demand is rising. WLCO's leverage to higher-margin international markets (exports are ~82% of its $1.2bn order book) is a key positive. WLCO has capacities in the US, where demand should remain strong (+150% yoy growth), and the Middle East, where pipeline capex is rising despite political concerns. New order wins should be a positive catalyst for the stock, driving capacity utilizations and earnings going forward.

Valuation

Our target price for WLCO of Rs236/share is based on a Sep-12E P/E of 7.5x. We set our target multiple at a slight discount to the 5-year normalized average P/E of 8x, to be conservative given lingering market concerns related to sector and company issues. Our fair-value P/E, which is at the midpoint of a historical one-year forward normalized P/E range of 5x-10x, looks undemanding in light of WLCO's reasonable growth profile (EPS CAGR of 14% over FY11-14E). We believe a P/E methodology is appropriate given that WLCO operates in a cyclical industry.

Risks

We rate WLCO High Risk, as opposed to Medium Risk suggested by our quantitative risk-rating system, given that the resolution of the corporate-governance issue could take time. We see the main downside risks which could prevent the shares from reaching our target price as being:

Decline in crude prices – A sharp decline in crude prices would negatively affect exploration activities, delaying investments in fresh pipe infrastructure.

Economic downturn – Development of new pipeline infrastructure is contingent on sustained economic growth. Slower growth and/or a global downturn would impact new order wins and growth prospects for WLCO.

Execution delays – WLCO has undertaken new projects to expand its capacity; any execution delays would be a negative for the company.

Sourcing of raw material – WLCO is dependent to a large extent on external suppliers for the sourcing of raw materials for its pipe and plate mills. While it manages to lock-in raw material prices once it wins an order, any sharp volatility in steel prices could pose a risk.

Exchange rate fluctuation – Even though there exists a natural hedge between WLCO's revenues and expenses, a sharp currency fluctuation could adversely hit the company.

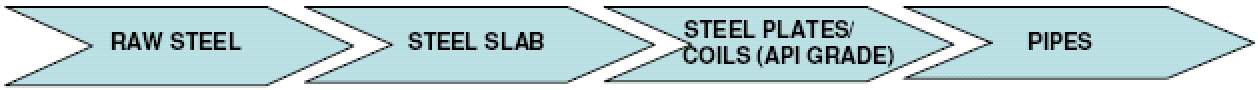
Reputational risk – Most of WLCO's key clients are in quality-conscious markets such as the US and Canada. Any quality issues arising from products supplied by Welspun could hamper its reputation in the global markets.

Appendix

Pipes: Manufacturing Process & Key Definitions

Pipe-making involves the use of plates or hot-rolled coils and its conversion to pipes. There are several methods of pipe manufacture depending on the properties of the end-product.

Figure 63. Pipes – Manufacturing Process



Source: Company Reports

Hot rolled coils

Hot rolled coil refers to a coil of steel rolled on a hot-strip mill. It can be found in the market as coil or sheets and is further processed into finished products by the manufacturer. It is the starting raw material for HSAW pipes.

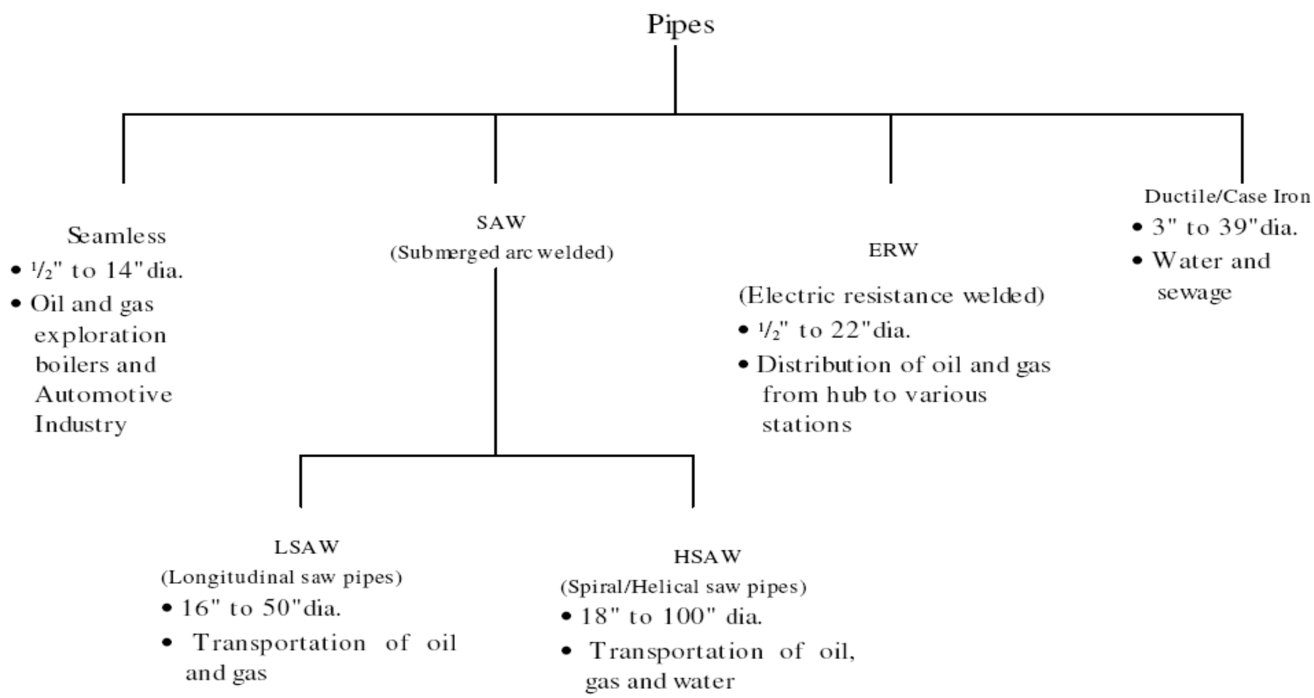
Plates

Plate refers to a flat steel sheet rolled on a Hot Rolling mill. It can be found in the market in the form of sheets which are further processed into finished products by the manufacturer. It is the starting raw material for LSAW pipes.

Pipes

Pipes are tubular products made by either seamless process or by welding. Welding process involves bending a flat plate or a coil and welding it into a tube. Figure 64 gives a brief classification of the kind of pipes used commercially.

Figure 64. Classification of pipes



Source: Company Reports

Where is WLCO placed?

We show below the relative positioning of WLCO with respect to its product mix and raw material requirements.

Figure 65. WLCO – Product Profile

Product	Raw Material	Comments
Pipes		
-HSAW (Helically Submerged Arc Welded Pipes)	Hot-rolled Coil	Makes some coil in-house, and purchases the rest from outside
-LSAW (Helically Submerged Arc Welded Pipes)	Hot-rolled Plate	Makes some plate in-house, and purchases the rest from outside
-ERW (Electrically Resistant Welded Pipes)	Hot-rolled Coil	Purchased from outside
Plate	Steel Slab	Purchased from outside

Source: Citi Investment Research and Analysis

HSAW Pipes

HSAW (also known as spiral) process of manufacturing utilizes hot-rolled coils as the starting material for formation of pipes. Pipes are formed by spirally deforming the HR coil. Continuous welding of seam by submerged arc welding is done after forming. Sizing operations using cold expansion is not carried out due to the presence of well seams all over the pipe body.

LSAW Pipes

The LSAW process of manufacturing utilizes plates as the starting material. Plates are formed into cylinders/cans by roll bending process. Formed shapes are welded from inside/outside by submerged arc welding process. These welded pipes are then expanded to get proper size and relieve stress.

ERW Pipes

Large diameter pipes above 16 inches dia are manufactured either by LSAW or HSAW method and line pipes in sizes smaller than 16 inches are manufactured by ERW (electric resistance welded) process. These are pipes made from strips of hot-rolled steel which are passed through forming rolls and welded.

Seamless Pipes

Seamless pipe is made from a solid round steel billet which is heated and formed until steel is shaped into a hollow tube. Typically, these pipes have a dia of ½” and 14”.

Ductile Iron Pipes

These pipes are made of ductile iron, which is spheroidized graphite cast iron. These pipes are produced by centrifugal casting, where molten ductile iron is poured into a rapidly spinning water-cooled mould. The centrifugal force results in an even spread of iron around the circumference. They are typically coated with zinc/polymer coatings to make them corrosion resistant.

The above write-up has been sourced from: 1) Wikipedia, 2) Interpipe (http://www.interpipe.com/en/products/seamless/), and 3) Company Reports

Notes

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Appendix A-1

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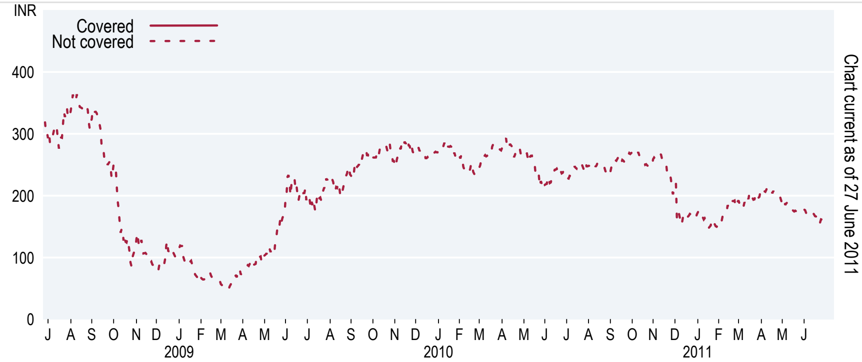
Ratings and Target Price History
Fundamental Research



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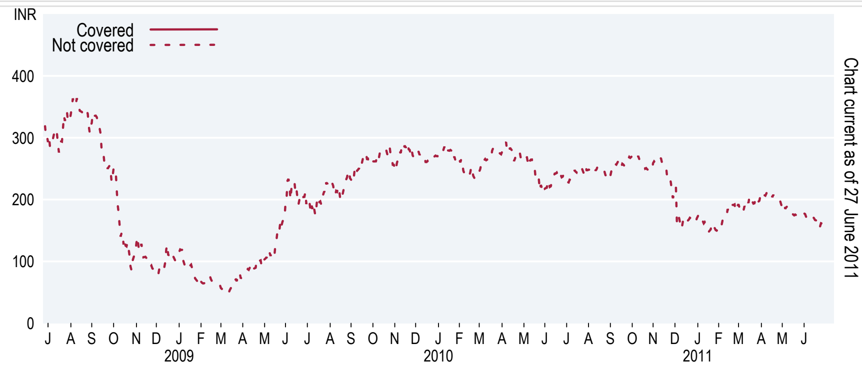
Welspun Corp (WGSR.BO)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)



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