PINC RESEARCH

PSL LTD.

Q3 FY 2008 update BUY

Sector Pipes I CMP Rs 425 I Target Rs 550

STOCK DATA

Market Cap	Rs15.8bn.
Book Value per share	Rs99
Eq Shares O/S (F.V. Rs.10)	42mn.
Median Vol (12 mths)	26,000 (BSE+NSE)
52 Week High/Low	Rs 588/191
Bloomberg Code	PSLL.IN
Reuters Code	PSLH.BO

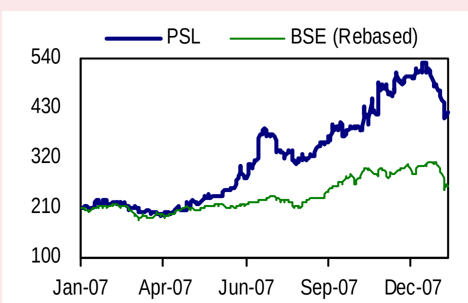
SHAREHOLDING PATTERN (%)

Qtr. Ended	Jun-07	Sep-07	Dec-07
Promoters	60.4	60.2	48.9
MFs/FIs	1.4	2.6	9.9
FIIs	22.7	21.6	23.6
PCBs	8.7	8.7	12.0
Indian Public	6.8	6.9	5.6

STOCK PERFORMANCE (%)

	1M	3M	12M
Absolute	(19.0)	9.1	84.6
Relative	(6.6)	18.9	51.2

STOCK PRICE PERFORMANCE



KEY HIGHLIGHTS

PSL Ltd. (PSL) reported a 32% YoY growth in revenues to ~Rs6.6bn in Q2FY08. This was mainly on account of 73% YoY growth in pipe despatches to 132k mt. Production of pipes rose 43% YoY to 117k mt in the quarter.

- **Margins affected by higher HR Coil and manpower costs**

Marginally higher costs for procuring HR Coil (HRC) led to a jump in raw material costs (as a % of net sales) by 350bps. Staff costs also rose 80bps YoY. Operating margins (OPM) contracted by 260bps to 7.9%. An excise duty refund of ~Rs100mn and scrap sales of ~Rs75mn helped PSL mitigate the fall in margins and higher incidence of interest. Net profits of the company surged 45% YoY to Rs302mn.

- **Order book of Rs22bn**

PSL's current order book stands at Rs22bn, to be executed over the next 10 months. 80% of the order book consists of orders for supply of pipes while the remainder is for coating assignments.

- **Capacity expansion**

The company's Sharjah based HSAW mill of 75k mtpa has already commenced production of water-grade pipes and is in the process of seeking API accreditation. PSL is also in the process of setting up 300k mtpa of HSAW capacity in Mississippi, USA, which is scheduled for commissioning by Sep'08.

VALUATION AND RECOMMENDATION

Given its low levels of CUF and a sustainable demand for pipes over the next 36-48 months, any upswing in order booking and execution could lead to a jump in revenues and simultaneously generate operating leverage for the company. Its large capacities and wide geographical reach make it a strong player, poised to capitalise on the upswing in the oil & gas and infrastructure sectors, in India, the M.East and the US. Hence, we maintain our 'BUY' recommendation with a price target of Rs550 on a 12 month investment horizon.

KEY FINANCIALS (STANDALONE)

Rs mn	Quarter Ended			Yr Ended (March)				
	Jun-07	Sep-07	Dec-07	2005	2006	2007	2008E	2009E
Net Sales	4,101	4,965	6,591	13,962	14,332	14,282	20,751	27,212
YoY Gr. (%)	*9.5*	*60.9*	*32.1*	*248.5*	*2.7*	*(0.4)*	*45.3*	*31.1*
Op Profits	406	499	519	840	1,317	1,485	2,231	3,360
Op. Marg.(%)	*9.9*	*10.1*	*7.9*	*6.0*	*9.2*	*10.4*	*10.8*	*12.3*
Net Profits	171	191	302	320	492	622	1,147	1,822
Eq Capital	341	421	426	289	320	341	432	432

KEY RATIOS

	Yr Ended (March)				
	2005	2006	2007	2008E	2009E
Dil. EPS (Rs)	7.4	11.4	14.4	26.5	42.1
ROCE (%)	19.0	13.3	13.9	19.0	23.8
RONW (%)	38.2	22.9	20.8	23.0	24.8
P/E (x)	38.4	27.6	23.3	16.0	10.1
EV/ Sales (x)	1.2	1.3	1.4	1.2	0.9
EV/EBDIT (x)	17.1	12.9	11.5	9.3	6.4

PERFORMANCE OVERVIEW

Higher despatches drive YoY revenue growth…

PSL's revenue growth in Q3FY08 stemmed from higher despatches, which stood at 132k mt (+43% YoY). Production for the quarter stood at 117k mt (+73% YoY) resulting in a capacity utilisation factor (CUF) of 40%. This was an improvement of 8% points YoY.

Raw material costs were higher on a YoY basis primarily on account of reclassification of items of expenditure from the head 'Other Expenditure' to 'Raw Materials.' There was also a marginal increase in input costs on account of an increase in HRC (+5% YoY). Material costs were higher by 350bps YoY (as a % of sales) at Rs4.5bn. Salary hikes resulted in the payroll costs rising by 80bps YoY (as a % of sales) to Rs183mn. Reclassification of expenditure heads also resulted in other expenditure (as a % of net sales) declining by 260 bps YoY to Rs565mn. This decline was also due to lower outgo on SG&A expenses and lower freight expenditure. However, this couldn't offset the impact of higher material and personnel costs and hence, OPM contracted 260 bps YoY to 7.9% in the quarter. The dip in OPM resulted in PSL's operating profit growing at a slower pace than its revenues. Op. profit stood at Rs519mn (+8% YoY).

The company received a refund of Rs100mn on account of refund of excise duty paid on sale of pipes from its Kutch facility. PSL also registered Rs75mn as proceeds from sale of scrap in the quarter. As a result, other income vaulted 2x YoY to Rs183mn in Q3FY08. All capital charges rose on a YoY basis. Interest costs jumped 21% YoY to Rs163mn, on account of the hardening of interest rates and an increase in working capital borrowing. Depreciation also rose 12% to Rs130mn on account of routine capex at its facilities.

The jump in receipts of other operating income helped mitigate the fall in margins and higher capital charges. As a result, net profits stood at Rs302mn in Q3FY08. (+45% YoY).

In the quarter, PSL's equity capital base expanded by Rs5mn (QoQ) to Rs426mn. This was on account of allotment of shares to FCCB holders.

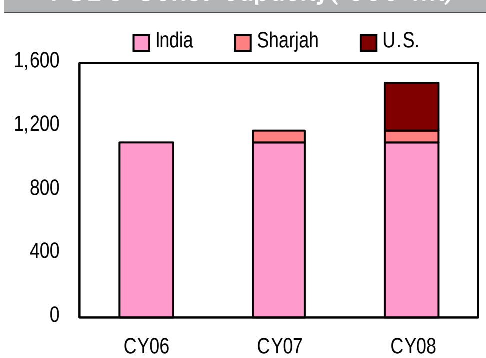
In 9MFY08, PSL's revenues surged 33% to Rs16bn, on back of higher despatches of 255k mt of pipes (+43%). Production stood at 278k mt (+41%), with CUF at 32%. OPM declined marginally by 100bps to 9.1%. Hence, operating profits stood at Rs1.4bn in 9MFY08 (+20%). Other income doubled to Rs300mn in the period, on account receipt of Rs200mn of excise duty refund and Rs80mn from sale of scrap. Interest outflow rose 27% to Rs418mn on account of higher interest rates and enhanced working capital borrowings, while depreciation rose 19% to Rs390mn on account of addition to the gross block, in the form of the Kakinada and Dubai facilities. PAT in 9MFY08 stood at Rs664mn (+35%)

Sharjah Facility

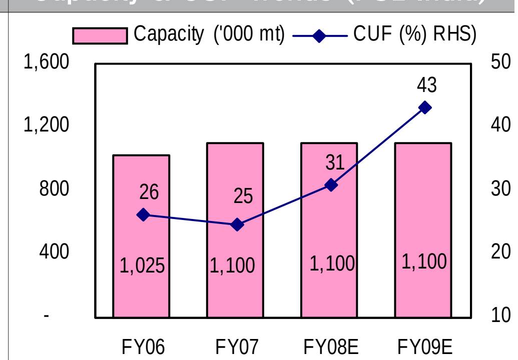
Sharjah facility to target the M.Eastern & N. African oil & gas market…

PSL commissioned its 75k tpa HSAW plant along with coating facilities at Sharjah in May'07. The company is looking to tap demand from the lucrative M.East oil & gas market for pipes and coating operations. PSL hopes to commence merchant coating operations at this facility within the next few months and is currently executing a small order for water-grade pipes. The Sharjah plant has also applied for API certification and the same is expected to fructify by Q4FY08, post which, the company would be eligible to supply to oil & gas sector. PSL is targeting 30% CUF at this facility in FY09 and plans to ramp up the same to ~40% by FY10.

PSL's Cons. capacity('000 mt)



Capacity & CUF Trends (PSL India)



Source: PINC Research

Greenfield US Facility

In Apr'07, PSL announced setting up of a 300k tpa greenfield facility to manufacture HSAW pipes in Mississippi, U.S., at a cost of ~USD100mn. This venture will be 78:22 JV between PSL and A&L, a US pipeline construction company, with an equity component of USD25mn (with PSL's contribution ~USD19.5mn) and the remaining USD78mn being routed through long term zero-coupon debt in the form of municipal bonds.

Of the USD100mn capex on the Mississippi facility, land acquisition and construction costs are expected to amount to ~USD25mn. The primary pipe manufacturing plant, to be supplied by PSL's engineering division in India, will cost USD35mn, while ancillary equipment for the facility is expected to cost ~USD15mn. The JV will maintain the remaining USD25mn as working capital requirement for operations.

US facility targeted at buoyant N.American markets...

PSL is set to commission the facility in Sep'08 and is targeting its API certification by the end of FY09. Through this facility, PSL intends to service the lucrative US market where annual demand for pipes (through replacement demand & new projects) is estimated at ~ 1.5mn mt.

Fund Raising and Equity Dilution

In order to fund its US foray, the company had a QIP issue of ~Rs 435mn (2mn shares @ Rs 207/sh) in Q4FY07. As a result, PSL's equity base expanded 7% to Rs341mn.

PSL had also issued zero-coupon FCCBs worth USD40mn in Sep'05 (convertible before Sep'10 @ Rs234.54/share). However, the reset clause for the same was invoked and the FCCBs are now convertible at Rs188/sh. We have factored in full dilution of the FCCBs in FY08E at the new price of Rs 188/sh, which will result in equity expanding to Rs432mn (+3% from current levels of Rs421mn).

Order Book

Order book of Rs22bn, to be executed over the next 10 months...

PSL's order book currently stands at Rs22bn, which is executable over the next 9-10 months. Of this, ~80% are for the supply of pipes, while the remainder are coating orders. 25% of the order book for pipes is bound for international markets while 75% will be supplied to domestic pipeline projects. 80% of pipes are bound for oil & gas sector (margins of ~11%), with 20% of the order book being accounted for by the water segment (margins of ~9%).

Industry Scenario

Oil & Gas: At present, the rapid pace of economic growth in the country is fuelling the need for energy which is boosting demand for hydrocarbons viz. oil & gas.

In order to cater to this demand, companies like Reliance Ind, GAIL, GSPL etc have outlined capex of Rs400bn on ~10k kms of cross country gas pipelines; to evacuate gas from gas blocks/ LNG Terminals to centres of consumption. Additionally, oil& gas majors like ONGC, Cairn Energy and others have also planned cross country pipelines to transport crude and other petroleum products, thus sustaining the current momentum of capex in the oil & gas sector.

Long term visibility of demand provides robust outlook for pipe manufacturers...

On the international front, demand for large-dia pipeline networks is also being generated in the M.East & West Asia, particularly on account of low level of monetization of the gas reserves in the region. This, in conjunction with demand emanating from North America on account of replacement of existing ageing pipeline networks and new projects, is expected to translate into a requirement of ~25 mn mt of large pipes over the next 5 years. (Source: Simdex)

Planned Pipeline Projects

Region	Projects (Nos)	Length (kms)	Tonnage (mn mt)	Ad. Market (mn mt)	Mkt Size p.a. (Rs mn)
Asia	103	84,446	21.1	10.6	88,668
N. America	166	54,557	13.6	3.4	28,642
L. America	47	29,792	7.4	-	-
Europe	85	42,579	10.6	-	-
M. East	86	33,172	8.3	8.3	69,661
Africa	26	11,820	3.0	3.0	24,822
Australasia	14	5,220	1.3	-	-
Total	**527**	**261,586**	**65.4**	**25.2**	**211,794**

Source: Simdex, Industry estimates

While demand from the oil and gas sector would be the primary driver of revenues and margins for line pipe companies in the foreseeable future, the social infrastructure sector also holds promise of providing sustained long term demand for large-dia pipes. Given the government's thrust on rural development through improvements in access to drinking water and sanitation while simultaneously shoring up urban water supply and sewerage networks, the nascent demand from this sector is expected to pick up significantly in the years to come.

OUTLOOK

Till recently, PSL was largely focussed on the nascent domestic market for oil & gas and social infrastructure i.e. water transportation and sewage. Exports have historically constituted only 25% of the company's revenues. However, the slow flow of orders on the domestic front resulted in the company operating at low levels of CUF (22-25%), which was reflected in the OPM.

Going forward, we expect PSL to increasingly tap the export markets to ramp up CUF from current levels of ~30%. The proximity of most of its facilities to ports will be a key positive for the company since it would facilitate shorter turnaround time between import of HRC and export of pipes. Higher exports in conjunction with heightened supplies in the domestic market should result in improvement in CUF to ~31% in FY08. We expect this metric to rise to ~40% (on a stand-alone capacity of 1.1mn tpa) in FY09E.

Enhanced order book & improving CUF to drive revenues & profitability...

We have consciously not factored in any contribution from the Sharjah & US facilities since we are awaiting API certification of the former and clarity on the commissioning and API certification of the US facility.

In FY08, we estimate PSL's revenues at Rs21bn (+45%), on back of increased exports, robust domestic demand, steady income from coating operations and sale of the pipe mill to its US JV. We expect margins to stabilise at 10.8%. We estimate the company to clock net profits of ~Rs1.1bn (+85%).

As per our FY09E earnings, the company should earn Rs27bn in revenues (+31%) on back of higher order booking and capacity utilisation and net profits of Rs1.8bn (+59%) as the benefits of operating leverage percolate to the bottom-line.

VALUATIONS

Peer Comparison: Large Dia Line Pipe Cos

	FY08E			FY09E		
	EPS	EV/EBITDA	P/E	EPS	EV/EBITDA	P/E
Welspun Guj SR Ltd.	17.5	14.8	27.4	30.8	7.7	15.6
Man Industries Ltd.	13.1	5.8	9.4	16.9	4.4	7.3
Jindal Saw Ltd.#	59.1	8.4	13.7	64.9	7.7	12.5
PSL Ltd.	26.5	9.3	16.0	42.1	6.4	10.1

Source: Bloomberg estimates, PINC estimates
 # Jindal Saw estimates are for year ending Dec'07 (annualised) & Dec'08 resp.

We maintain our 'BUY' recommendation with a one year price target of Rs550...

At the CMP of Rs425, PSL is currently trading at a P/E of 10.1x & EV/EBIDTA of 6.4x, discounting its FY09E diluted numbers, which is at a significant discount to similar sized peers. Given its large, multi-locational capacity, operating leverage that can be generated from higher CUF and the discount it is trading at in comparison to its peers, we maintain our 'BUY' recommendation, with a price target of Rs550 on a one-year investment perspective.

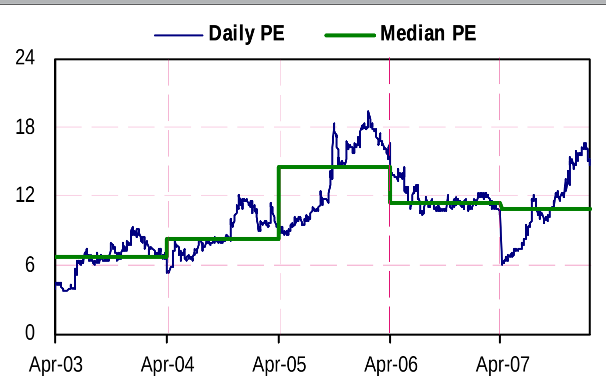
Company description

PSL Ltd is a leading Indian manufacturer of large-diameter pipes, which find application in oil & gas transportation as well as water & sewage projects. The company has one of the largest manufacturing capacities of Helically Submerged Arc Welded (H-SAW) pipes and is tapping the M.Eastern & US markets with new greenfield facilities.

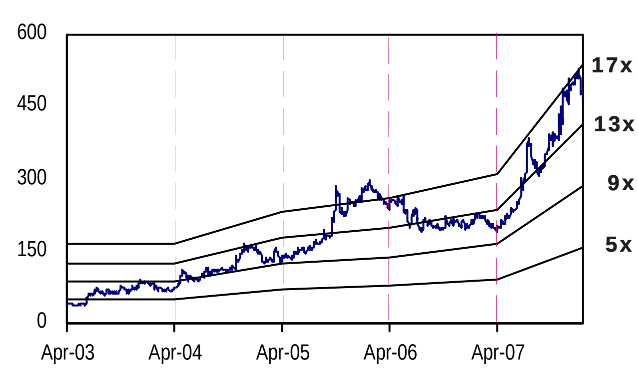
Financial Results for the quarter & nine months ended 31 December 2007 (Standalone)

Particulars (Rs Mn)	Quarter Ended			Nine Months Ended			Year Ended
	31/12/07	31/12/06	Gr %	31/12/07	31/12/06	Gr %	31/03/07
Net Sales	**6,591**	**4,988**	**32.1**	**15,656**	**11,819**	**32.5**	**14,282**
Total Expenditure	**6,072**	**4,509**	34.6	**14,232**	**10,628**	33.9	**12,796**
(Inc.) / Dec. Stock-in-trade	143	(706)		(2,041)	(515)		(773)
Materials	4,455	4,011	39.1	13,224	8,229	45.0	10,556
Staff Cost	183	99	84.8	407	285	42.8	449
Other expenditure	1,291	1,104	16.9	2,641	2,630	0.4	2,565
Operating profit	**519**	**479**	**8.3**	**1,425**	**1,191**	**19.6**	**1,485**
Other Income	189	60		300	148		251
PBIDT	**708**	**539**	**31.2**	**1,725**	**1,339**	**28.8**	**1,736**
Interest	163	134	21.0	418	329	27.3	435
Depreciation	130	117	11.8	390	328	18.9	439
PBT & extra-ord items	**415**	**289**	**43.7**	**916**	**682**	**34.3**	**862**
Provision for tax	113	81		251	190		240
Net Profits	**302**	**208**	**45.1**	**664**	**492**	**35.1**	**622**
Equity Capital (F.V. Rs. 10)	426	320		426	320		341
Reserves (excl. rev. res.)	-	-		-	-		3,362
EPS for the period (Rs)	**7.1**	**6.5**		**15.6**	**15.4**		**18.3**
Book Value (Rs.)	-	-		-	-		98.6
OPM (%)	**7.9**	**9.6**		**9.1**	**10.1**		**10.4**
NPM (%)	4.6	4.2		4.2	4.2		4.4
Exp. (% of Net Sl.)							
Raw materials (incl. stock adj.)	69.8	66.3		71.4	65.3		68.5
Staff costs	2.8	2.0		2.6	2.4		3.1
Other expenses	19.6	22.1		16.9	22.2		18.0
Production (MT)	117,484	82,441	42.5	278,016	197,040	41.1	160,532
Sales (MT)	131,768	76,269	72.8	255,056	178,202	43.1	123,288
CUF (%)	40	30		32	24		15

Median PE v/s Daily PE



PE Band



Year Ended March (Figures in Rs mn)

Income Statement	2005	2006	2007	2008E	2009E
Revenues	**13,962**	**14,332**	**14,282**	**20,751**	**27,212**
Growth (%)	*248.5*	*2.7*	*(0.4)*	*45.3*	*31.1*
Total Expenditure	**13,123**	**13,016**	**12,796**	**18,520**	**23,852**
Operating Profit	**840**	**1,317**	**1,485**	**2,231**	**3,360**
Interest & dividend income	158	176	251	400	420
EBIDT	**998**	**1,493**	**1,736**	**2,631**	**3,780**
(-) Interest	324	485	435	549	498
(-) Depreciation	234	339	439	443	462
PBT & extraordinary items	**440**	**669**	**862**	**1,639**	**2,820**
(-) Tax provision	120	177	240	492	998
Net Profits	**320**	**492**	**622**	**1,147**	**1,822**
Growth (%)	*0.0*	*53.7*	*26.4*	*84.5*	*58.8*
Fully diluted Eq. sh. O/s (mn no)	43.2	43.2	43.2	43.2	43.2
Book Value (Rs)	58	82	99	153	188
Basic EPS (Rs)	11.1	15.4	18.3	26.5	42.1
Diluted EPS (Rs)	**7.4**	**11.4**	**14.4**	**26.5**	**42.1**

Balance Sheet	2005	2006	2007	2008E	2009E
Equity Share Capital	289	320	341	432	432
Reserves & Surplus	1,387	2,305	3,021	6,178	7,678
Net worth	**1,676**	**2,625**	**3,362**	**6,611**	**8,110**
Total Debt	6,490	6,810	6,698	7,402	6,150
Deferred Tax liability	34	32	7	7	7
Capital Employed	**8,201**	**9,467**	**10,066**	**14,020**	**14,267**
Fixed Assets	2,752	3,528	4,617	4,820	4,820
Net current assets	5,335	5,825	4,895	8,200	8,447
Investments	114	114	554	1,000	1,000
Total Assets	**8,201**	**9,467**	**10,067**	**14,020**	**14,267**

Year Ended March (Figures in Rs mn)

Cash Flow Statement	2005	2006	2007	2008E	2009E
PBT & Extraord. items	**440**	**669**	**862**	**1,639**	**2,820**
Depreciation	234	339	439	443	462
Interest & dividend inc.	(193)	(39)	(21)	(400)	(420)
Interest paid	324	484	435	549	498
Tax paid	(148)	(100)	(144)	(492)	(998)
(Inc/Dec in working capital	(2,249)	(1,264)	663	(3,150)	(1,031)
Cash from operations	**(1,591)**	**88**	**2,235**	**(1,411)**	**1,331**
Net capital expenditure	(1,176)	(1,106)	(1,528)	(646)	(462)
Net investments	(56)	-	(440)	(446)	-
Interest recd	21	32	163	400	420
Cash from investing activities	**(1,210)**	**(1,074)**	**(1,805)**	**(691)**	**(42)**
Issue of eq. shares	-	30	21	92	-
Share premium	-	668	414	2,332	-
Change in debt	4,443	320	(113)	704	(1,252)
Dividend paid	(164)	(149)	(185)	(322)	(322)
Interest paid	(324)	(485)	(577)	(549)	(498)
Cash from financing activities	**3,955**	**383**	**(440)**	**2,257**	**(2,072)**
Inc/Dec. in cash	**1,153**	**(603)**	**(11)**	**154**	**(783)**

Key Ratios	2005	2006	2007	2008E	2009E
EBIDTA (%)	7.1	10.4	12.2	12.7	13.9
ROACE (%)	19.0	13.3	13.9	19.0	23.8
ROANW (%)	38.2	22.9	20.8	23.0	24.8
Sales/Total Assets (x)	1.7	1.5	1.4	1.5	1.9
Debt:Equity (x)	3.9	2.6	2.0	1.1	0.8
Current Ratio (x)	2.1	2.0	1.9	2.4	2.1
Interest Cover (x)	2.4	2.4	3.0	4.0	6.7
Debtors (days)	80	105	55	58	57
Inventory (days)	126	144	175	161	160
Net working capital (days)	138	146	123	142	112
EV/Sales (x)	1.2	1.3	1.4	1.2	0.9
EV/EBIDT (x)	17.1	12.9	11.5	9.3	6.4
P/E (x)	38.4	27.6	23.3	16.0	10.1
P/BV (x)	7.3	5.5	4.5	2.8	2.3

Equity Desk

R. Baskar Babu - Head - Equity Broking
baskarb@pinc.co.in *91-22-66186465*

Gealgeo V. Alankara - Head - Institutional Sales
alankara@pinc.co.in *91-22-66186466*

Sachin Kasera - Co-Head - Domestic Equities
sachink@pinc.co.in *91-22-66186464*

Sailav Kaji - Head - Derivatives & Strategist
sailavk@pinc.co.in *91-22-66186344*

Research

Sameer Ranade - Capital Goods / Utilities
sameerr@pinc.co.in *91-22-66186381*

Sujit Jain - Real Estate / Construction
sujitj@pinc.co.in *91-22-66186379*

Amol Rao - Hospitality / Pipes / Packaging
amolr@pinc.co.in *91-22-66186378*

Nirav Shah - Sugar / Textiles
niravs@pinc.co.in *91-22-66186383*

Rishabh Bagaria - Auto / Auto Ancilliary
rishabhb@pinc.co.in *91-22-66186391*

Ruchir Desai - Technology
ruchird@pinc.co.in *91-22-66186372*

Syed Sagheer - Logistics / Light Engineering
syeds@pinc.co.in *91-22-66186390*

Chandana Jha - Banking / Financial Services
chandanaj@pinc.co.in *91-22-66186398*

Rahhul Aggarwal - Metals
rahhula@pinc.co.in *91-22-66186388*

Dipti Solanki - Media
diptis@pinc.co.in *91-22-66186392*

Faisal Memon - Associate - Metals
faisalm@pinc.co.in *91-22-66186389*

Ashish Dangi - Associate - Lifestyle / Retail Products
ashishd@pinc.co.in *91-22-66186481*

Ashwani Agarwalla - Associate- Agro Products /Fertilizers
ashwania@pinc.co.in *91-22-66186482*

Abhishek Gangwani -Associate - Electronics / Hardware
abhishekg@pinc.co.in *91-22-66186385*

Naveen Trivedi - Associate - Speciality Chemicals
naveent@pinc.co.in *91-22-66186384*

Abhinav Bhandari - Associate - Real Estate / Construction
abhinavb@pinc.co.in *91-22-66186371*

Anand Rajgarhia - Associate - Shipping / Logistics
anandr@pinc.co.in *91-22-66186377*

Sales:

Anil Chaurasia
91-22-66186462

Alok Doshi
91-22-66186375

Sapna Mehta
91-22-66186391

Sundeep Bhat
91-22-66186641

Dealing:

Chandrakant Ware/Rajesh Khanna/Shivkumar R/Ashok Savla
idealing1@bloomberg.net *91-22-66186326*

Raju Bhavsar / Manoj Parmar / H Prajapati / Pratiksha
idealing1@bloomberg.net *91-22-66186323*

Directors

Gaurang Gandhi
gaurangg@pinc.co.in *91-22-66186400*

Hemang Gandhi
hemangg@pinc.co.in 91-22-66186400

Ketan Gandhi
ketang@pinc.co.in *91-22-66186400*

Rakesh Bhatia - Head Compliance
rakeshb@pinc.co.in *91-22-66186400*

bright thinking

Infinity.com

Financial Securities Ltd

SMALL WORLD, INFINITE OPPORTUNITIES

Member : Bombay Stock Exchange & National Stock Exchange of India Ltd. : Sebi Reg No: INB 010989331. Clearing No : 211
1216, Maker Chambers V, Nariman Point, Mumbai - 400 021; Tel.: 91-22-66186633/6400 Fax : 91-22-22049195