Initiating Coverage

MARCH 28, 2019

WELSPUN CORP LTD.

PRICE RS.132 **TARGET RS.161** **BUY**

Stock Details

Market cap (Rs mn)	:	34930
52-wk Hi/Lo (Rs)	:	187 / 87
Face Value (Rs)	:	5
3M Avg. daily vol	:	698,763
Shares o/s (m)	:	265

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY19E	FY20E	FY21E
Revenue	99,068	101,566	103,803
Growth (%)	30.6	2.5	2.2
EBITDA	6,787	8,468	8,754
EBITDA margin (%)	6.9	8.3	8.4
PAT	1,835	3,257	3,664
EPS	6.9	12.3	13.8
EPS Growth (%)	20.0	77.5	12.5
BV (Rs/share)	114	126	139
Dividend/share (Rs)	0.5	0.5	0.5
ROE (%)	6.0	9.7	9.8
ROCE (%)	7.1	10.0	9.9
P/E (x)	19.1	10.7	9.6
EV/EBITDA (x)	5.5	4.2	3.6
P/BV (x)	1.2	1.0	0.9

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Dec-18	Sep-18	Jun-18
Promoters	48.7	48.7	48.3
FII	6.2	5.5	5.9
DII	8.7	8.6	8.3
Others	36.4	37.3	37.6

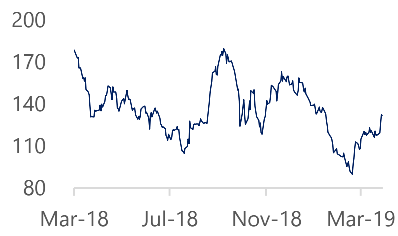
Source: Bloomberg, BSE

Price Performance (%)

(%)	1M	3M	6M
Welspun Corp	21.7	(5.3)	6.0
Nifty	7.2	6.5	5.9

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

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Welspun Corp (WCL) is a leading global manufacturer of large diameter pipes with an installed capacity of 2.4 Mn tonnes. Given its presence in USA, Saudi Arabia and India, we believe that, the company is better placed compared to its peers in terms of tapping the global market opportunity of over US$400 bn. At the end of Feb'19, WCL's order book stood at Rs145 bn, to be executed over the next 15-18 months, thereby providing strong revenue visibility. We expect Welspun Corp to register growth of ~11% CAGR in revenue during the FY18-FY21E period, while PAT is expected to grow at 31% CAGR during the same period, on back of improvement in operating performance and decline in interest outgo. At current valuations, WCL is currently trading at 5.5x/4.2x/3.2x FY19E/FY20E/FY21E EV/EBITDA, which in our view is attractive. We initiate coverage with BUY rating and a target price of Rs.161.

Investment argument

- **Revenue visibility - overseas operations to drive growth:** Welspun Corp order book stands at Rs145 bn (1.66 mn tonnes), to be executed over the next 15-18 months, of which 75% are repeated from its existing customers. The current order book is tilted towards overseas market, which accounts for 73% of the total order book, as at end of Feb'19. Of this, ~23% is from its America manufacturing plant.

- **Higher contribution from US and Stable India business to support operating performance:** The overseas order book not only provides good revenue visibility, but also comes with the stronger margin compared to the domestic market, as number of qualified bidders are less. In addition, increasing demand of spiral pipes in US due to increase in shale gas production and the country's focus on reducing imports of pipes augurs well of local manufacturers. We expect US operations to drive operating performance, while domestic operations likely to remain stable, EBITDA/tonne is expected to remain in the range of Rs7,500-Rs8,000 in FY20E and FY21E vs Rs6,300 in FY18 and Rs6,500 in 9MFY19. EBITDA is expected to increase to Rs8.5 bn and Rs8.8 bn in FY20E and FY21E, respectively from Rs6.8 bn in FY18.

- **Leaner balance sheet to support growth:** WCL undertook restructuring activity in 2013, and demerged its non-pipe business (asset heavy model) to Welspun Enterprises and started focusing on its core (pipe) business. Post the de-merger, WCL has become a pure play on the pipe sector and also has an exposure to the plate segment. With the leaner balance sheet and completion of capex cycle, Free Cash Flow is expected to improve backed by strong operational performance. In addition, the company is also looking to sell its plate mill (37% of capital employed with a negative contribution to EBITDA) which is currently dragging the return ratios. Successful closure of the deal would further reduced the net debt and improved the return ratios.

- **Global opportunity of over US$400bn:** Increasing oil and natural gas consumption has made a significant contribution to the need for increased pipeline construction investment worldwide. The global pipeline demand is likely to generate over US$400 bn opportunity during CY18-22E. North America, Latin America, Africa, Australia and the domestic market would be key volume drivers for global pipe manufacturers.

Outlook

Given its strong manufacturing and execution capabilities, strong order backlog coupled with robust bids in the pipeline, we believe, WCL is better placed compared to its peers, to take advantage of renewed pipe demand globally and in the domestic market. Besides this, its leaner balance sheet has helped the company to sail through the tough times and should be able to withstand the pressure in the domestic market (low margin) as compared to its peers, who had to trim or shut down their operations. Going ahead, since a large part of revenues is expected to come from the US should support margins. Backed by improvement in operating performance and decline in interest outgo (focus is on reducing debt), PAT is expected to grow at 31% CAGR during FY18-21E period. At CMP, the stock is trading at 4.2x/3.6x FY20E/FY21E EV/EBITDA, and is attractive in our view. We initiate coverage on WCL, with a BUY rating and a target price of Rs.161, valuing stock at 4.5x FY21E EV/EBITDA.

Key Risks:

i) Steel price volatility can impact performance; and

ii) Low crude price can defer investments in oil and gas industry

COMPANY BACKGROUND

Welspun Corp (WCL) is a leading global manufacturer of the large diameter pipes with an installed capacity of 2.4MT, offering a one stop solution for all line pipe related requirements with its wide product range of high grade line pipes and meeting stringent specifications. Its manufacturing facilities are located across USA, Saudi Arabia and India and it is a preferred vendor for major oil and gas companies, both overseas and locally. Over the last two decades, the company has demonstrated its strength and capability to execute key projects overseas, including the world's deepest pipeline project in the Gulf of Mexico, LNG pipeline project in Peru and longest pipeline project from Canada to the US.

Key management

Name	Designation
Mr. Balkrishan Goenka	Chairman, Welspun Group
Mr. R.R Mandawewala	Group Managing Director
Mr. Vipul Mathur	M.D and CEO, WCL
Mr. S. Krishnan	Executive Director and CEO, PCMD
Mr. Percy Birdy	CFO

Source: Company

Leader in pipe industry

Leader in pipeline industry with an installed capacity of 2.4 Mn tonnes

WCL has emerged as one of the largest players in the pipe industry with 2.4 Mn tonees installed capacity across the locations, followed by German manufacturer Euro Pipes, having an installed capacity of 2MT and JFE. The installed capacity, is aimed at meeting the increasing demand from both domestic and international market for both oil & gas and water related segments. WCL has consistently crossed 1MT of sales volume for three consecutive years, and we expect it to cross 1MT of sales volume in FY20E and FY21E also. It has been seen in last three years, that company's sales volume is higher than its opening order book.

Multi location line pipe manufacturing

Product ('000 T)	US	Saudi Arabia	India	Total
LSAW	700	700		
HSAW	350	300	700	1,350
ERW	175		200	375
Total	525	300	1,600	2,425

Source: Company, Kotak Securities – Private Client Research

Product Details

Product	Description	Used for	Diameter	Thickness
LSAW	Longitudinal Submerged Arc Welded	Onshore / off-shore oil and gas transmission	16 – 60 inch	6 – 65 mm
HSAW	Helically Submerged Arc Welded	Onshore oil, gas and water transmission	18 – 140 inch	5 – 27 mm
ERW	Electric Welded	Downstream distribution	1 ¼ - 16 inch	2 – 12.7 mm

Source: Company, Kotak Securities – Private Client Research

INVESTMENT ARGUMENT

Global Pipeline Network – opportunities exist both in overseas as well as domestic markets

New projects, replacement demand, developing of terminals to scale shale exports and CGD, augurs well for pipeline manufacturers

North America remains a key market for pipeline construction and line pipe demand, despite the vast network of existing oil and gas pipeline capacity. The total North American pipeline length (large diameter + small diameter) is about 5M km with majority of it comprising natural gas lines. In the US, of the 4.2M km of pipelines, nearly 3.9M km serves natural gas production, while the rest is used to transport crude oil and liquids. Canada's pipeline system comprises of 825k km of transmission, feeder, gathering and distribution lines. Meanwhile, Mexico's is serviced by more than 10k km of pipeline as the country undergoes a major natural gas infrastructure addition.

In total, almost 2.2 million kilometers of transmission linepipe are present worldwide, half of which is in two countries – USA and Russia. Another eight countries (Canada, China, Ukraine, Argentina, UK, Iran, Mexico, and India) take the cumulative total to 70% of the world network by length.

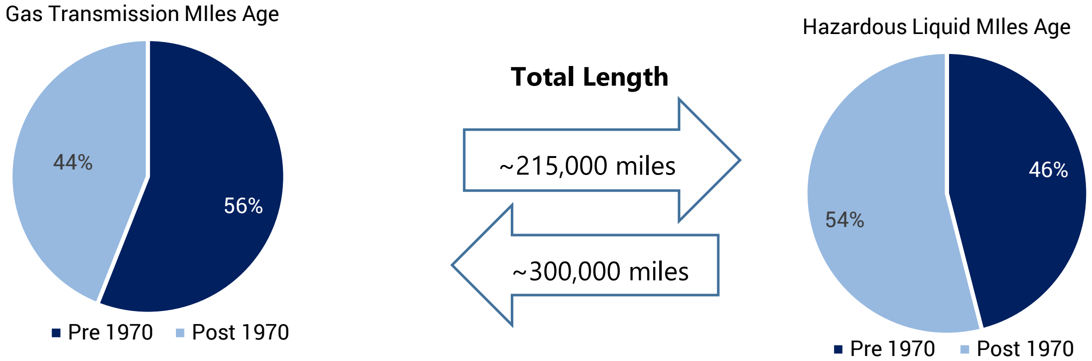
Given the growth in energy demand, the global pipeline demand over the next 4 years is estimated to come from 1,103 projects (as per SIMDEX) resulting in an opportunity for supplies of more than US$ 468 bn across geographies. In addition, with the discovery of shale gas, US is now an exporter of gas, and is developing seven LNG terminals to scale Shale export. There will be a significant surge in pipeline demand, which will connect the producing fields to LNG export terminals. The ticket size can be estimated by the fact that the average distance for connectivity with these terminals could c. 1,000 km/line. We believe that, given the presence of WCL in this key market and its execution capabilities, WCL is well placed to capture the potential demand in the pipeline industry.

The Replacement Demand – An additional upside

Average lifespan of oil and gas transportation pipes ranges between 25-30 years

Replacement of aging infrastructure offers huge potential for the pipe manufacturers. The need to replace old pipelines is particularly high in the US and Russia, where pipeline networks were mostly installed during the 60s and 70s. With the average lifespan of oil and gas transportation pipes ranging between 25 and 30 years, opportunities in the replacement market are huge, particularly for HSAW pipes. In the US spills, breaks and other accidents from all gas, oil and hazardous liquids pipelines have caused a total damage of more than US$ 5.5 bn over the last decade. As per industry, around 56% of gas pipelines and 46% of oil pipelines currently in use have been commissioned prior to 1970; ~12,000 miles of gas pipelines and ~6,700 miles of liquid pipelines are more than 100 years old and With safety norms getting more and more stringent, more pipelines are expected to come up for replacement.

Replacement Market Potential

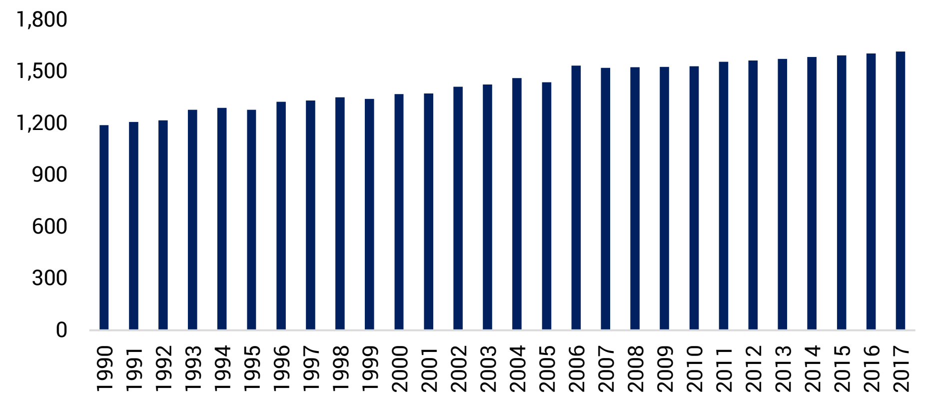


Source: Company, Kotak Securities – Private Client Research

Changes in economic development as well as in energy production have resulted in demand being higher than the capacity of current infrastructure. There are bottlenecks in the transportation of oil and gas from the producing regions to the consuming areas for export. Distribution hubs are short on storage capacity as well. In the US, more than half of the existing pipelines were built before 1970. The potential replacement market is huge with more than 10,000 km of pipelines estimated to be candidates for replacement in the near future.

More than 1 mn miles of pipelines dates back to 1975

Gas pipeline in USA (Mile)



** Excludes service pipe and underground storage. Source: American gas association*

1 mile translates to approximately 550 tons of demand

It is clear from the above exhibit, that over ~1 mn miles of pipelines dates back to 1975 or even earlier, which is why they need to be replaced, as the general life of pipelines are about 25-30 years. Besides, as more and more gas finds become feasible due to new technology in Shale gas drilling, the need of new pipelines will also increase. Since, WCL has a plant in U.S, it stands to gain from the replacement demand.

Nationwide gas grid + Water transfer links to support domestic demand

GAIL is expected to be a key contributor to expansion of pipeline network in domestic market

In addition to the above stated global project for 4 years, we believe that there is huge potential in the domestic market as well for pipe manufactures due to the very low penetration level of about 32% as far as transportation of oil & gas through pipelines is concerned as compared to 78% globally. India is likely to add more to its existing pipeline network over the next couple of years, of which GAIL is likely to contribute a major portion. Though, India has missed its pipeline network target set for 12th five year plan, due to implementation hurdles and unviable tariff. This has resulted in slow-down in pipeline work, leading to a target miss. Given the expansion plan of GAIL and GSPL, we believe demand from domestic market will also remain strong in the coming years.

GAIL pipeline project

Pipeline Projects	Length (Km)
Kochi-Kooanad-Bengaluru/Mangalore	1,056
Vijaipur-Auraiya-Phulpur	672
Jagdishpur- Haldia & Bokaro-Dhamra	2,539
Barauni- Guwahati	727

Source: GAIL FY18 Annual Report

Currently, GAIL owns and operates more than 11500 km of natural gas pipeline and about 2300 Km LPG pipeline across the country. At the same time, working concurrently on multiple pipeline projects, aggregating over 5400 kms. In addition, the company has been additionally entrusted to lay a 750 kms trunk pipeline network from Barauni to Guwahati as an integral link of Jagadishpur-Haldia-Bokaro-Dhamra pipeline project. GAIL has earmarked an aggressive capex plan of Rs239 bn for the pipeline network. Besides this, City Gas Distribution network expansion, augmentation of Jamnagar Loni LPG Pipeline Project and Pipe Line Replacement Projects (KG Basin, Gujarat and Cauvery Basin), also augurs well for the domestic pipe manufacturers. In addition to GAIL, even GSPL has also announced aggressive capex for setting up the pipeline network.

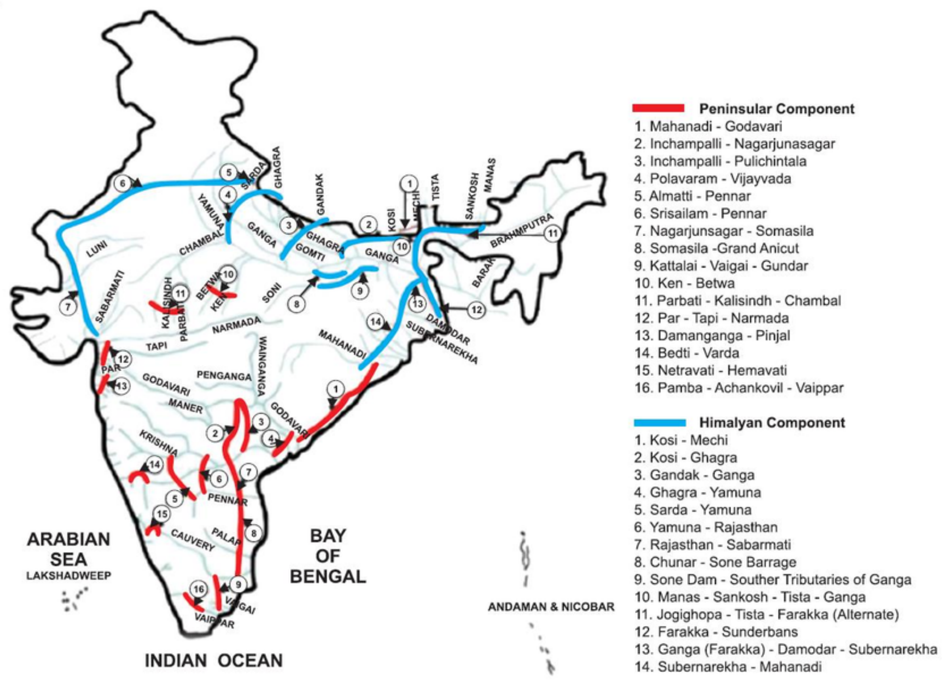
GSPL proposed pipeline

Company	Pipeline Project	Length (Km)
GSPL India Gasnet Limited (GIGL)	Mehsana – Bhatinda	2,052
	Bhatinda - Jammu – Srinagar	725
GSPL India Transco Limited (GITL)	Mallavaram - Bhopal – Bhilwara - Vijaipur	1,881

Source: GSPL FY18 Annual Report

In addition, to the Oil & gas pipelins, Government of India's proposal to link its key rivers under the National River Linking Project (to build 30 river links) offers healthy potential for water-based spiral pipe orders. The company has relocated one of its facilities in Bhopal, targeting the expected water order. In the past, the company had benefited from focusing on Gujarat on such projects and now management expects the benefit to come from the states of Madhya Pradesh, Uttar Pradesh and Rajasthan.

Water Transfer links



Source: Industry, Company, Kotak Securities – Private Client Research

Global footprint lowers risk

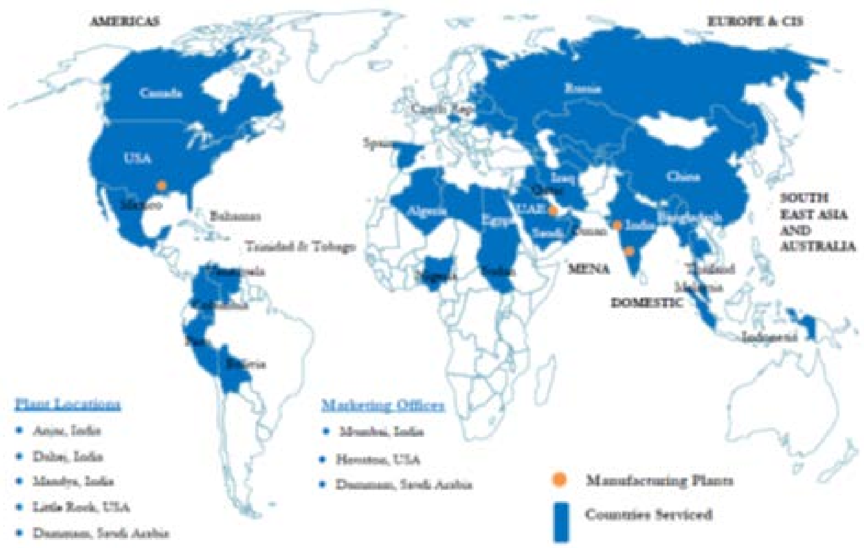
Overseas manufacturing facilities enables the company to win new orders

The current order book is tilted towards overseas market, which accounts for ~73% of the total order book, as at the end of Feb'19. Of this, ~23% is from America. The overseas order book not only provides good revenue visibility, but also comes with the stronger margin compared to the domestic market, as number of qualifying bidders are less. We understand WCL faces competition from few players globally.

Welspun has a 350,000 mtpa helical submerged arc welded (HSAW) facility in the US. The facility can manufacture large (with 24–60" diameter) HSAW pipes along with integrated coating and bending facilities. In addition to the US facility, the company's facility in the Middle-East has enhanced its presence globally. Its global presence and exposure to these markets will be an advantage as, more than 41,000 km of pipeline projects are expected from America and Middle East. In addition, WCL also expects orders from newer regions like Australia and Europe, where it does not have a presence.

We believe overseas operations are likely to remain strong, as oil prices remain stable and orders start flowing in from the US, Middle East, etc.

Global Footprint



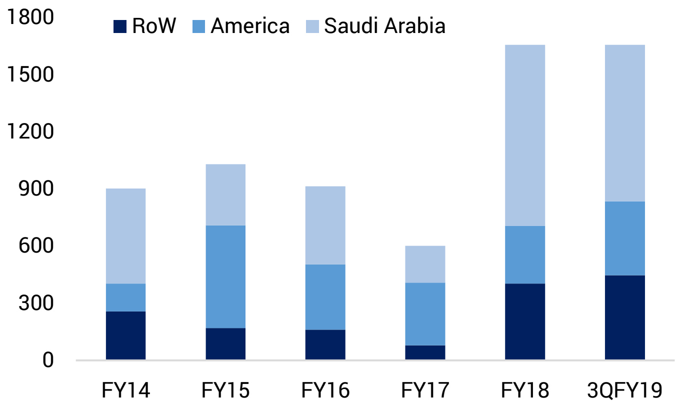
Source: Company

Though, we believe, transportation of crude through steel pipe is cheaper than the road transport and is the best option at the time when crude prices are declining. But, at the same time, there is a possibility of delay in issuing tender or execution of order due to weaker financial condition of an order issuer company, as pipeline capex comes at the end of their capex cycle.

Revenue visibility – backed by global presence

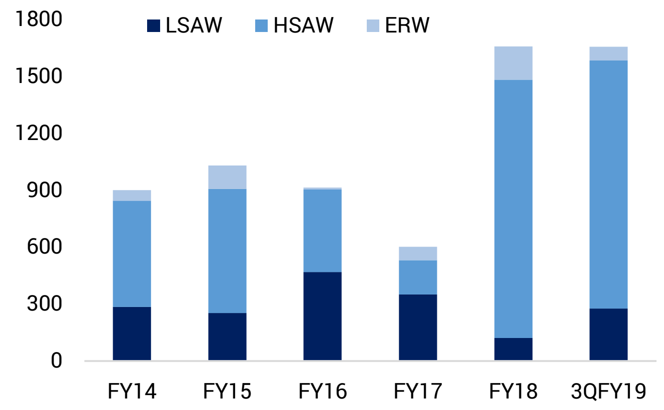
The company's order book stands at Rs145bn (1.66 Mn tonnes), to be executable over the next 15-18 months. FY18 and 9MFY19 revenue was Rs75.9bn and Rs70.36bn, respectively. Given the strong order book, we expect the revenue to increase to Rs101 bn and Rs103bn by end of FY20E and FY21E, respectively.

Order book by Region ('000 T)



Source: Company, Kotak Securities – Private Client Research

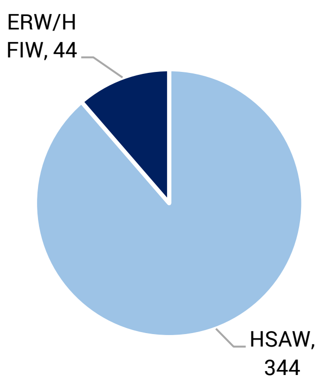
Order book by Type ('000 T)



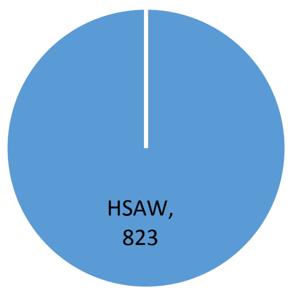
Source: Company, Kotak Securities – Private Client Research

YTD, the company has been a key beneficiary in the U.S. from increased demand of spiral pipes, backed by an increase in shale gas production and curb in imports. This has supported higher volumes and better EBITDA (Welspun Corp has one of the largest manufacturing facility).

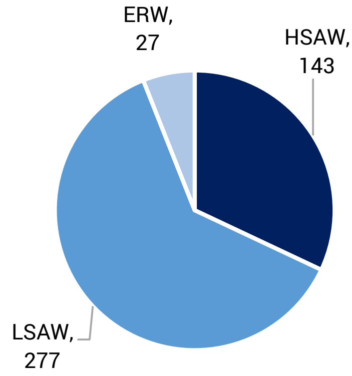
Current - U.S order book ('000 T)



Saudi order book ('000 T)



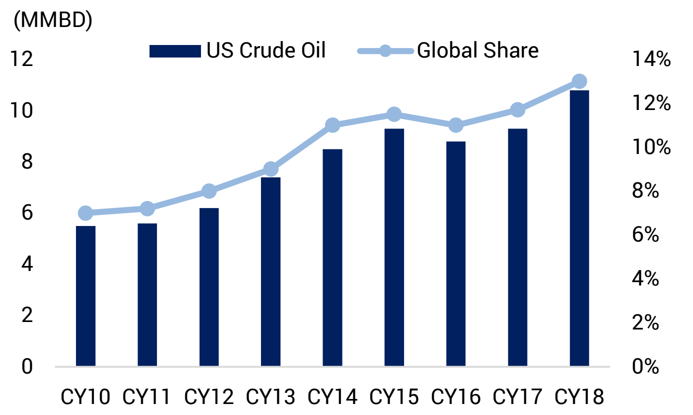
India order book ('000 T)



Source: Company, Kotak Securities – Private Client Research

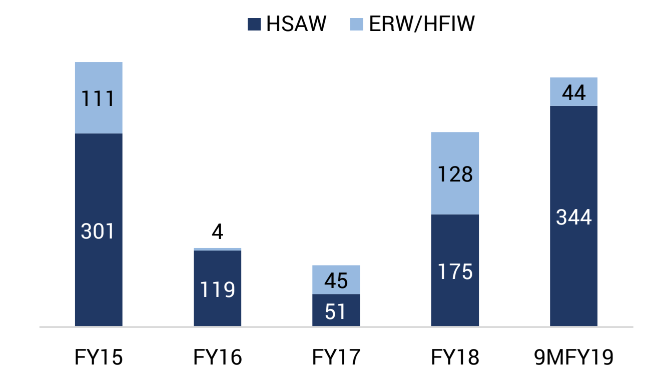
In addition, the company has actively participated in various bids, which are in the pipeline and if converted into order book, it could further enhance the revenue visibility in the coming months. The bid books currently stand ~2.3 Mn tonnes (majority from US). As per management, bid to win ratios stands at ~25%. Besides these, global opportunities of 12,000 KT pipeline are likely to come from the USA, Mexico and Saudi Arabia, where the company has a strong presence and is one of the strongest contenders. High shale oil/gas production is driving demand for pipeline infrastructure (for transporting oil to refining facilities on the Gulf of Mexico and international markets). Demand for gas pipelines are also aided by oil producers to evacuate gas generated. In line with this, majority of leading midstream companies had already planned for additional pipelines

US' share of the global oil production…



Source: EIA, Company, Kotak Securities – Private Client Research

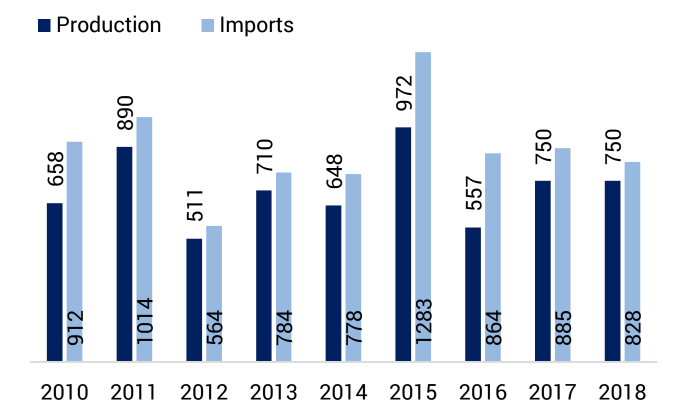
…reflects in Welspuns' order book ('000 T)



Source: EIA, Company, Kotak Securities – Private Client Research

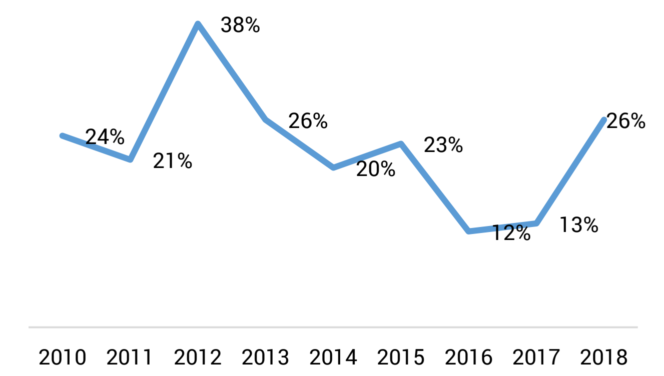
US spiral pipe market has shifted in favor of local players under Trump administration's protectionist regime. Anti-dumping and CVD duties have restricted imports into the country. The benefit of the same has partly come in 2018, and larger impact could be seen in 2019. Lower imports have restricted the competition between 3 players as against 9 prior to the duties. Welspun faces competition from key players such as Jindal Saw, Berg and Stupp, all the key players has revenue visibility for CY19 and discussion is on for CY20. The imposition of duties has also helped Welspun Corp to increase its market share in the US from 13% in 2017 to 26% in 2018. The company is operating its HSAW capacity at 67% utilisation and has enough room to execute increased orders.

US imports trend ('000 T)



Source: Company, Kotak Securities – Private Client Research

Restricting imports helped local manufacturers



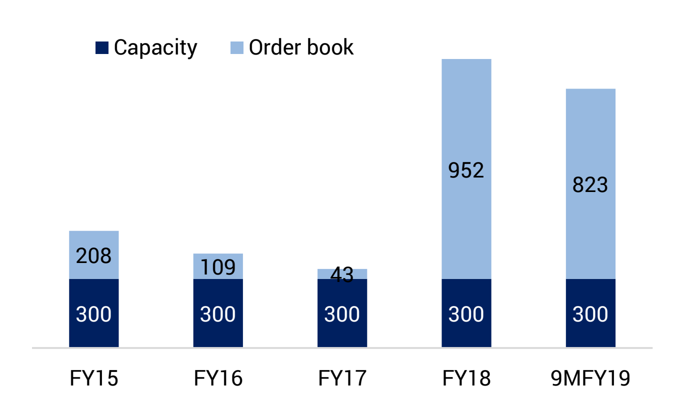
Source: Company, Kotak Securities – Private Client Research

In the global market, Welspun faces strong competition from a German manufacturer EURO pipe, JFE, Nippon Steel, Sumitomo, to name a few. Limited competition gives the company better opportunity to earn higher margin. In the domestic market, given the higher supply, the company faces stiff competition from its local peers and hence, domestic orders come with lower margins. We believe that, the declining crude oil prices make steel pipeline a preferred route for transport, as compared to road. Pipeline industry growth is fuelled by increasing global energy demand and shale gas exploration.

Saudi JV – order book = 3x capacity

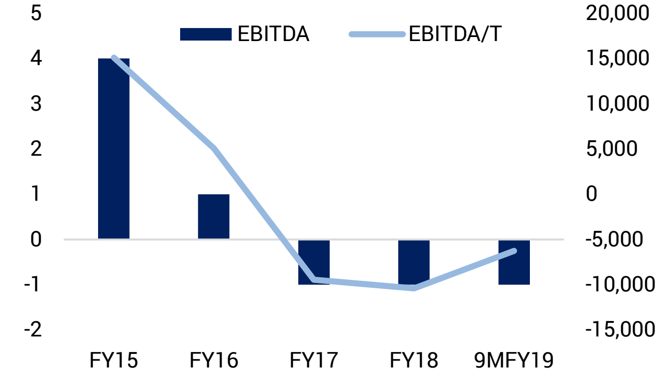
Management indicated that huge business potential exists in Saudi region, as most of the desalination plants are far from demand area. Management sees strong demand in both, Oil & Gas and Water sectors, driven by Saudi Aramco and SWCC respectively. The current order book in Saudi stands at 823KT, which is 3x installed capacity, which provides revenue visibility. Management also indicated that local players get ~10% price preference in addition to the protection.

Saudi JV order book ('000 T)



Source: Company, Kotak Securities – Private Client Research

EBITDA performance to improve in FY20E



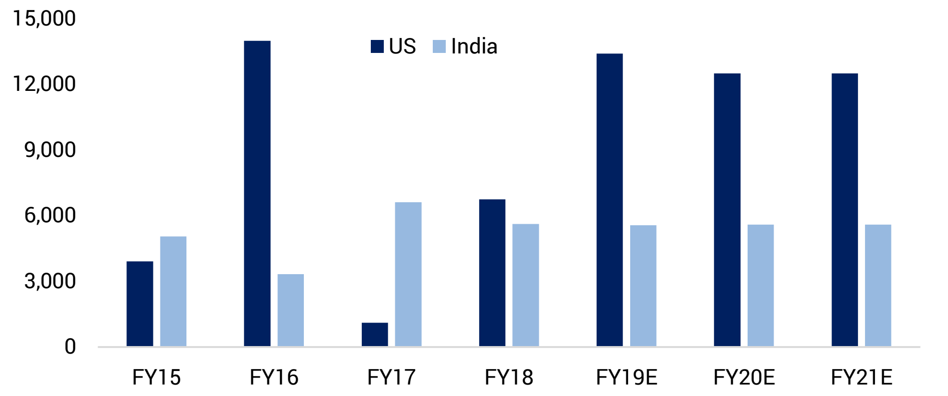
Source: Company, Kotak Securities – Private Client Research

Despite having a strong order book, local preference and protection measures, the JV reported losses at the EBITDA level. The performance was impacted by adverse movement of raw materials, as one of its largest order (392KT from SWCC) was at a fixed price. Management expects, the performance to improve from here on, as a contribution from the new order (higher steel prices) will flow in and lower contribution from the fixed price contract.

EBITDA/T improvement backed by higher contribution from overseas market

Given the higher contribution from US orders and stable domestic operation, we expect EBITDA/tonne to improve from Rs6,306 in FY18 and Rs6,500 in 9MFY19 to Rs7,700 in FY20E & FY21E. This would be better compared to its domestic peers in the welded line pipe industry. As per management, the US operations is likely to report EBITDA/tonne in the range of $180-$200, thanks to its presence in key markets and low competition, as against our expectation of $150-160. India operations likely to remain stable, due to excess capacity in the domestic market. Saudi operation is expected to report $100 as EBITDA/tonne in the coming years. Backed by higher margin order, we expect EBITDA to grow at a CAGR of 8.6% during FY18-FY21E.

US and India EBITDA/tonne Rs)

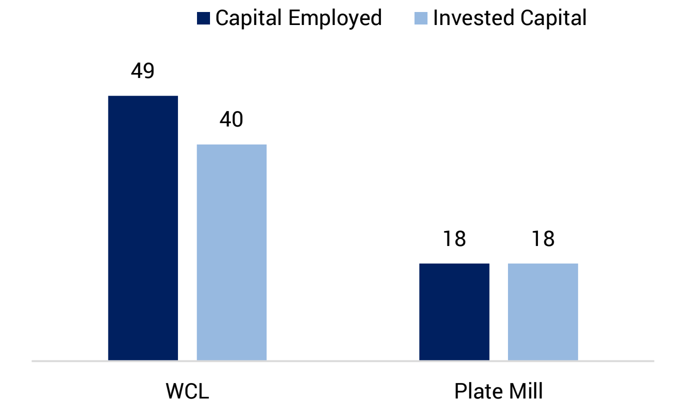


Source: Company, Kotak Securities – Private Client Research

Leaner balance sheet to support growth

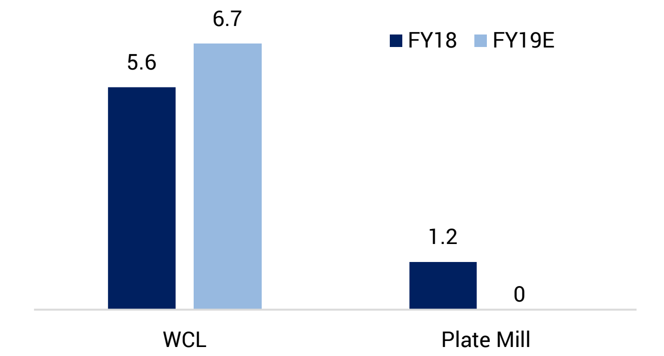
WCL undertook restructuring activity in 2013, and demerged its non-pipe business (asset heavy model) to Welspun Enterprises and started focusing on its pipe business. Post the de-merger, WCL has become a pure play on the pipe sector. It still has an exposure to the plate segment, which is dragging the overall ratios. To focus more on its core business, the company is looking to sell its plate mill (1.5MT) in the near future. If the deal materializes, the proceeds from the same would be used to reduce the net debt further.

Plate mill = 37% of capital employed in 9MFY19 (Rs bn)



Source: Company, Kotak Securities – Private Client Research

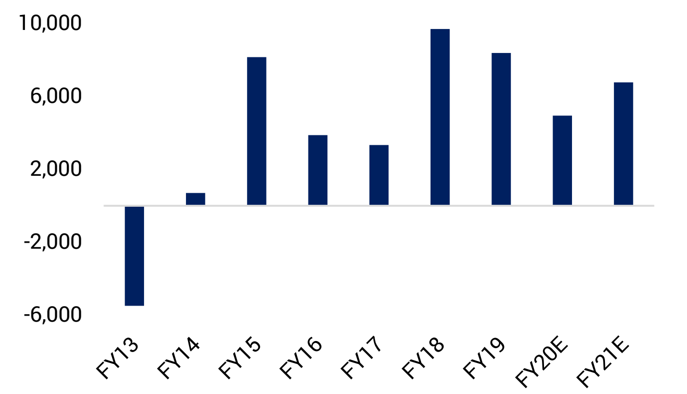
Nil contribution to EBITDA (Rs bn) in FY19E



Source: Company, Kotak Securities – Private Client Research

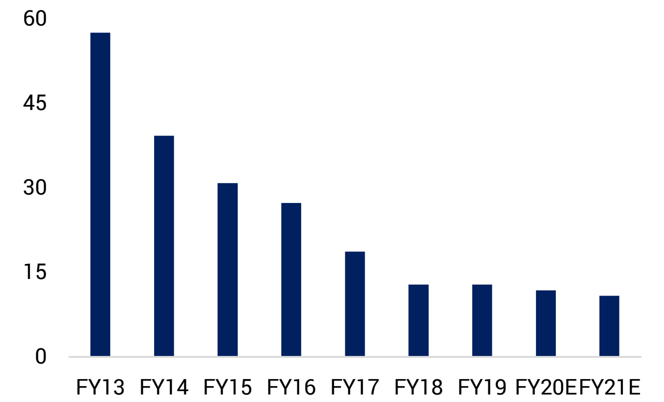
Given strong operating performance and higher FCF (a capex cycle is over), the focus of the company is to further reduce its leverage. The gross debt currently stands at Rs14.62 bn with cash and cash equivalents of Rs11.5bn, resulting in net debt of Rs3.12 bn, at the end of 3QFY19. We expect debt to decline to Rs10.8 bn by end of FY21E.

FCF to remain strong (Rs Mn)



Source: Company, Kotak Securities – Private Client Research

Gross Debt to decline further (Rs bn)



Source: Company, Kotak Securities – Private Client Research

Strong relations across the globe

As a result of growing global presence and business associations of WCL, the following is a list of its prominent business partners across the globe.

Key clients

Source: Company, Kotak Securities – Private Client Research

Besides these, there are many other approved customers that keep WCL's order book full (as 75% of its orders are repeat order from its existing customers). This also acts as an entry barrier for new players in the industry as it requires a minimum of 3–5 years to be accredited by these large oil & gas companies. The company is able to hold its relationship with the above mentioned clientele and gets repeated orders (75%) due to its product quality and execution capabilities.

Execution – a key for WCL

Focus on R&D and pipeline technology, gives WCL an edge over its peers to bag the complex projects. The company has shown its expertise in delivering pipes for critical projects with stringent specifications. The key projects, where the company has shown its execution capabilities include Peru LNG, Stampede Oil Export SCR pipeline, Mexico, Keystone Pipeline to name a few. WCL is one of the preferred vendors to over 50 major oil and gas companies. Given the complexities and stringent norms, very few players qualify for the global tenders. This helps the company to garner better margins in the overseas region.

Expertise in complex projects

Independence Trail 233kms, 24"deep sea gas transmission pipeline in Gulf of Mexico **Complexity**: High collapse resistance	Deepest	Heaviest	**IGAT- IV** 100 kms, 56" high pressure gas transmission pipeline in Persian Gulf **Complexity:** Large diameter high wall thicknes, X70 grade of steel
Peru LNG 118 Kms, 34" gas transmission pipeline **Complexity:** Pipeline in service at very high altitude	Highest	Longest	**Keystone Pipeline** Sole Supplier, Canada to USA Crude oil pipeline (1,700 km, 36") **Complexity:** Very Long distance hydrocarbon pipeline supplied by a single manufacturer
Arabiyah-Hasbah (Wasit Gas Program) 100kms, 36" gas pipeline in Saudi Arabia **Complexity:** Highly sour gas	Offshore	Stringent tolerance level	**Stampede Oil Export SCR* Pipeline** ~32km, 18" oil pipeline in Gulf of Mexico **Complexity:** Only WCL could match specification

**SCR: Steel Catenary Riser; Source: Company*

Global opportunity over US$400 bn

Increasing oil and natural gas consumption have made a significant contribution to the need for increased pipeline construction investment worldwide. The pipeline industry is currently grappling with overcapacity. However, in the coming years, it is expected to witness steady growth backed by pipeline investment. The global pipeline demand is expected to grow at 17% CAGR (excl. China and CIS) to 10.7MT during FY14-FY20E. Overall pipeline demand is likely to generate over US$400 bn opportunity during 2018-2022. North America, Latin America, Africa, Australia and the domestic market would be key volume drivers for global pipe manufacturers. In addition, fall in crude oil prices make steel pipeline a preferred route for transportation as compared to road transport. As per the company, pipeline transport of crude to be ~50% cheaper v/s road transport. We expect markets like North America, the Middle East and India to form a large portion of the global opportunity. In addition, replacement demand in North America would provide further upside, as over 1mn miles of pipelines date back to 1975 or even earlier.

US$468bn of business potential over the next four years

Global Opportunity during 2018-2022

Region	Projects	Total length ('000 km)	Business Potential (US$ Bn)
North America	340	20	89
Latin America	169	16	74
Europe	109	12	43
Africa	82	17	81
Middle East	77	5	29
Asia	55	9	29
Australia	79	22	77

Source: Simdex, Kotak Securities – Private Client Research

Demand driver

Region	Descriptions
North America	■ LNG export terminals in USA - 1st operational; more to come
	■ Focus on LNG export projects – Prince Rupert, Coastal Gas Link
	■ Transnational gas pipeline projects from USA to Mexico
Middle East	■ Iraq-Jordan crude export pipeline (over 1,100 km)
	■ Pipeline development in Kuwait & Oman
	■ Saudi – substituting oil with gas for domestic consumption, emphasis on oil exports, increased demand for water pipelines
	■ Opening up of Iran
Asia Pacific	■ Doubling of gas pipeline infrastructure to 30,000km
	■ ~2.5mn ton water pipeline projects expected in near future
	■ Transnational projects – TAPI, Middle East to India
	■ City gas distribution pipeline projects in multiple cities
	■ Offshore development in Thailand – Myanmar region

Source: Industry data, Company, Kotak Securities – Private Client Research

Energy Demand: The global energy demand is expected to increase from 274mboe/d in 2015 to around 365 mboe/d by the end of 2040 i.e. an increase of 91 mboe/d, or an average annual growth of 1.2%. Almost 95% of the increase will be accounted by developing Countries (including China and India), with an average annual growth of 1.9%. Energy demand in developing countries is projected to increase by almost 86 mboe/d between 2015 and 2040. China is the largest contributor to world demand growth, is expected to by 22 mboe/d during the same period. The OECD demand is expected to remain stagnant, as the market has been already energy efficient and population growth is limited.

Oil demand to grow to the level of 104.5 mb/d and 111.7 mb/d by end of 2023 and 2040, respectively

Oil scenario: For the second consecutive year, long-term oil demand projections have been revised upward. Oil demand at the global level is expected to continue to grow at healthy rates over the medium-term to reach a level of 104.5 mb/d by 2023. In the long-term oil demand is set to increase by 14.5 mb/d to reach 111.7 mb/d in 2040. India is projected to be the country with the fastest demand growth and see the largest additional demand during the stated period. OECD demand is expected to remain muted in the medium term and projected to fall to 38.7 mb/d by the end of 2040. Non-OECD consumption will reach 66.6 Mb/d by 2040 with demand in China is projected to reach 17.4 Mb/d in 2040.

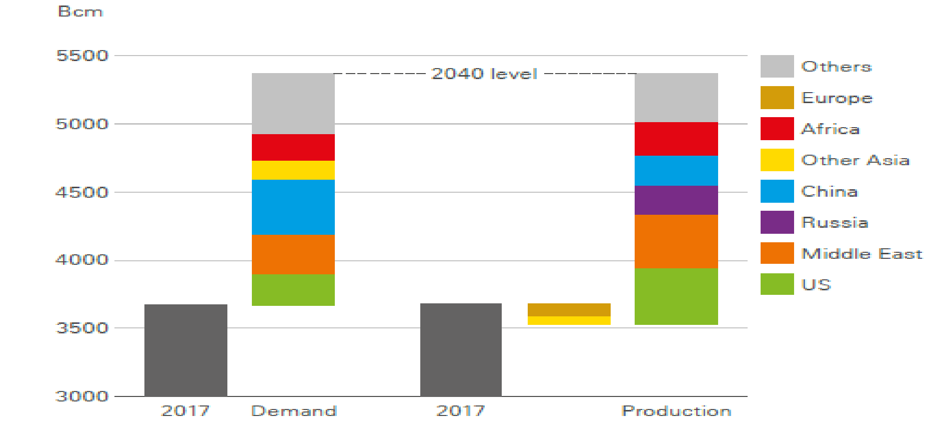
World Oil Demand Outlook, 2017 – 2040 (mb/d)

	2017	2018	2019	2020	2021	2022	2023	2025	2030	2035	2040
OECD America	25	25.3	25.5	25.7	25.8	25.7	25.6	25.2	23.9	22.5	20.9
OECD Europe	14.3	14.4	14.4	14.5	14.4	14.3	14.2	13.9	13.1	12.4	11.6
OECD Asia Oceania	8.1	8.1	8	8	8	7.9	7.8	7.6	7.2	6.7	6.2
OECD	**47.3**	**47.8**	**48**	**48.3**	**48.1**	**47.9**	**47.6**	**46.8**	**44.2**	**41.5**	**38.7**
Latin America	5.7	5.8	5.9	6	6.1	6.2	6.3	6.4	6.8	7.1	7.3
Middle East & Africa	3.8	3.9	4	4.1	4.2	4.3	4.4	4.6	5.1	5.7	6.3
India	4.5	4.7	5	5.2	5.4	5.6	5.9	6.4	7.6	9	10.4
China	12.3	12.7	13.1	13.4	13.7	14	14.3	14.7	15.8	16.6	17.4
Other Asia	8.7	8.9	9.1	9.4	9.6	9.7	9.9	10.3	11.3	12.2	12.9
OPEC	9.3	9.4	9.5	9.8	9.9	10.1	10.3	10.7	11.5	12	12.3
Developing countries	**44.4**	**45.5**	**46.6**	**47.9**	**48.90**	**49.9**	**51**	**53.1**	**58.1**	**62.6**	**66.6**
Russia	3.5	3.5	3.6	3.7	3.7	3.8	3.8	3.9	3.9	3.9	3.9
Other Eurasia	1.9	2	2	2.1	2.1	2.2	2.2	2.2	2.3	2.4	2.5
Eurasia	5.4	5.6	5.7	5.8	5.9	5.9	6	6.1	6.3	6.4	6.4
World	**97.2**	**98.8**	**100.3**	**101.9**	**102.9**	**103.7**	**104.5**	**106**	**108.6**	**110.5**	**111.7**

Source: OPEC, World Oil Outlook 2018

Gas scenario: In 2040, gas is projected to become the second largest energy source and reach an estimated share of 25%, up by more than 3% percentage points from 2015. The expansion of natural gas demand continued in 2017 with a healthy global growth rate of around 3% year-on-year (y-o-y), or 1.8 mboe/d. This is the highest level recorded since 2010. The majority of the increase in gas demand is expected to come from three countries China, Middle East and Europe, which cover almost 85% of the global YoY increase in gas consumption in 2017.

Gas demand and production, 2017-2040



Source: BP Energy Outlook 2019

85% of incremental consumption is expected from Non-OECD regions

Non-OECD regions continue to drive natural gas demand: Global gas demand is expected to increase from 59 mboe/d in 2015 to 91 mboe/d in 2040, which is more than a 50% increase in 25 years. In China, demand is projected to increase by around 6 mboe/d between 2015 and 2040, to reach slightly above 9 mboe/d. In OECD regions, the long-term future of gas demand is mixed. While in OECD America and OECD Europe gas demand still has some potential to increase, gas demand in OECD Asia Oceania is set to stagnate throughout the forecast period.

Non-OECD regions will provide 85% of the additional consumption. China alone represents 30% of this demand, followed by the Middle East with 22%. In contrast, consumption in FSU/non-OECD Europe remains stable.

The global outlook for gas appears to be optimistic over the coming years, as demand is likely to increase by 50% to 169 trillion cubic feet in 2035. New sources of gas, both conventional and unconventional, are expected to bring greater diversity to global supply. Changes in the list of major LNG suppliers will result in the creation of new linkages between regional gas markets, notably between those of North America and the Asia-Pacific, narrowing to a degree the wide regional gas price differentials that exist today.

Natural gas consumption to increase to 185 trillion cubic feet by end of 2040

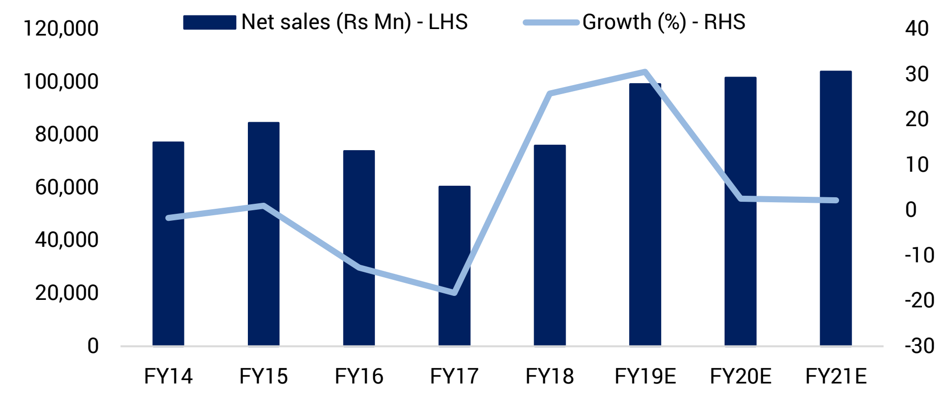
Natural Gas Scenario: The global demand for Natural Gas is projected to rise by 65% from 2010 to 2040, the largest volume in any energy source. Natural gas is the world's fastest growing fossil fuel, with consumption expected to increase from 113.0 trillion cubic feet in 2010 to 185.0 trillion cubic feet in 2040. Natural gas production is projected to grow across regions, so will be the consumption. It is anticipated that, the Natural gas consumption is mostly concentrated in non-OECD countries, where demand increases twice as fast as in OECD countries. Non-OECD producers account for more than 70% of the total growth in world natural gas production from 2010 to 2040.

FINANCIAL ANALYSIS

Revenue to see a CAGR of ~11%

WCL registered a fall of ~7% CAGR in revenue over FY2013-18 owing to fall in revenue from coils and plate segments, as sourcing of plate from a third party was cheaper, compared to its in-house manufacturing cost. We believe that pick-up in orders from the overseas markets is likely to drive the revenue growth from the pipes segment. Overall, backed by good order book and bids in the pipeline we are expecting a revenue CAGR of 11% in FY18-21E.

Order book provides revenue visibility

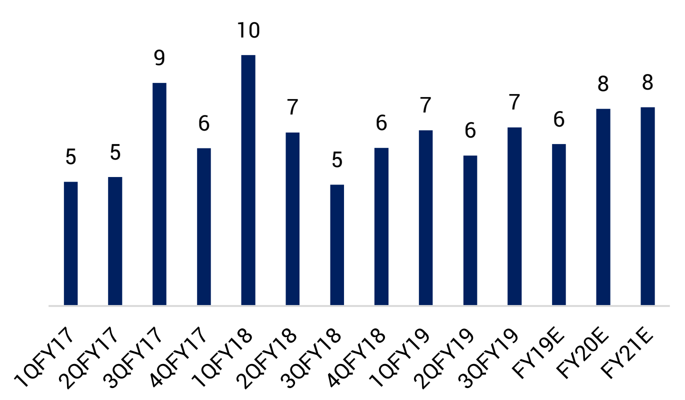


Source: Company, Kotak Securities – Private Client Research

EBITDA/T improvement backed by higher contribution from overseas market

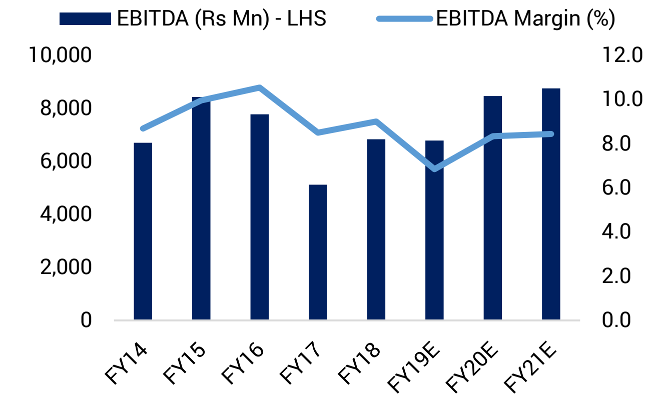
Given the higher contribution from US orders and near completion of low margin order in the Middle East, we expect EBITDA/tonne to improve from Rs6,306 in FY18 and Rs6,500 in 9MFY19 to Rs7,700 in FY20E & FY21E. This would be better compared to its domestic peers in the welded line pipe industry. As per management, the US operations is likely to report EBITDA/tonne in the range of $180-$200. Due to excess capacity in the domestic market and stiff competition, EBITDA/tonne in India is likely to remain stable. Backed by higher margin order, we expect EBITDA to grow at a CAGR of 8.6% during FY18-FY21E. With strong operating performance, coupled with reduction in interest outgo (focus is on reducing debt), PAT is likely to grow at 31% CAGR during the same period.

EBITDA/T to remain range bound (Rs '000/T)



Source: Company, Kotak Securities – Private Client Research

EBITDA Margins to show improvement

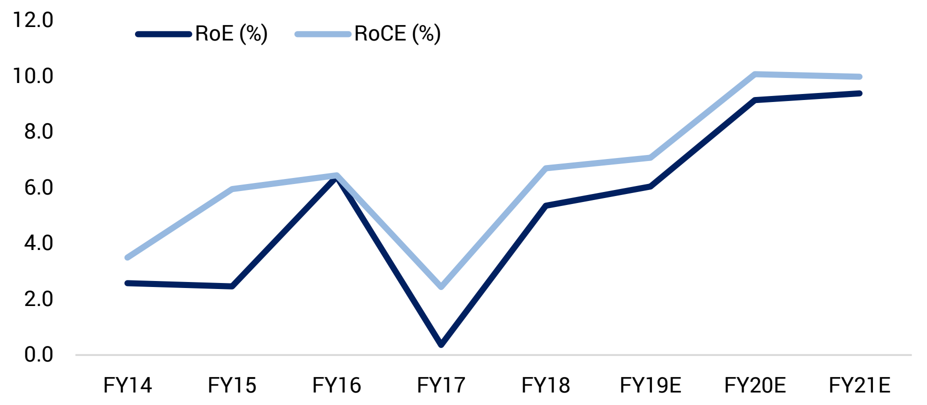


Source: Company, Kotak Securities – Private Client Research

Return ratios to improve

Profitability of the company is likely to improve in the coming few quarters as ~73% of its current order book is from overseas markets where it commands a better margin as the number of qualifying bidders are very less. Accordingly, return ratios are also likely to further boost by lower interest cost. The company was able to survive the low domestic capital expenditure (capex) regime in oil and gas pipeline over the past few years as it focused on overseas opportunities, while some domestic players had to trim or shut down their operations over the same period. The plate mill business (37% of capital employed + negative contribution to EBITDA in 9MFY19) is putting pressure on overall ratios. If the deal materializes, then return ratios will improve substantially from the expected level of 8-10%.

Return Ratios



Source: Company, Kotak Securities – Private Client Research

VALUATION

Given its strong manufacturing and execution capabilities, with strong order backlog coupled with robust bids in the pipeline, we believe that, WCL is better placed compared to its peers, to take advantage of increasing pipe demand globally and in the domestic market. Besides these, its leaner balance sheet has helped it to sail through tough times and should be able to withstand the pressure in the domestic market (low margin) as compared to its peers, who had to trim or shut down their operations. Going ahead, since a large part of revenues are expected to come from US would support margins. Backed by improvement in operating performance and decline in interest outgo (focus is on reducing debt), PAT is expected to grow at 31% CAGR during FY18-21E period. At CMP, the stock is trading at 4.2x/3.6x FY20E/FY21E EV/EBITDA, is attractive in our view. We initiate coverage on WCL, with a BUY rating and a target price of Rs.161, valuing at 4.5x FY21E EV/EBITDA.

EV/EBITDA: Trading at steep discount to its last 7years average

Source: Company, Bloomberg, Kotak Securities – Private Client Research

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end March)	FY18	FY19E	FY20E	FY21E
Net sales	**75,873**	**99,068**	**101,566**	**103,803**
growth (%)	25.7	30.6	2.5	2.2
Operating expenses	69,039	92,281	93,098	95,050
EBITDA	**6,834**	**6,787**	**8,468**	**8,754**
growth (%)	33.4	-0.7	24.8	3.4
Depreciation	3,793	3,457	3,520	3,603
EBIT	**3,041**	**3,330**	**4,948**	**5,151**
Other income	1,312	2,000	845	1,040
Interest paid	1,852	1,862	1,717	1,572
PBT	**2,501**	**3,468**	**4,076**	**4,619**
Exceptional	0	0	0	0
Tax	112	832	1,019	1,155
Effective tax rate (%)	4.5	24.0	25.0	25.0
Net profit	**2,389**	**2,635**	**3,057**	**3,464**
Share of Asso.	(859)	(800)	200	200
Net profit	**1,530**	**1,835**	**3,257**	**3,664**
growth (%)	1,412.4	20.0	77.5	12.5

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY18	FY19E	FY20E	FY21E
Cash & Bank balances	6,279	7,476	8,331	10,659
Other Current assets	33,251	42,933	43,891	47,593
Investments	4,876	4,876	4,876	4,876
Net fixed assets	30,602	29,803	27,065	24,496
Other non-current assets	1,924	1,924	1,924	1,924
Total assets	**76,933**	**87,012**	**86,087**	**89,548**
Current liabilities	31,546	39,944	36,762	37,559
Borrowings	12,847	12,843	11,843	10,843
Other non-current liabilities	3,433	3,433	3,433	3,433
Total liabilities	47,827	56,220	52,039	51,835
Share capital	1,326	1,326	1,326	1,326
Reserves & surplus	27,214	29,050	32,307	35,971
Shareholders' funds	28,540	30,376	33,633	37,297
Minority interest	566	416	416	416
Total equity & liabilities	**76,933**	**87,012**	**86,087**	**89,548**

Source: Company, Kotak Securities – Private Client Research

Cash Flow Statement (Rs mn)

(Year-end March)	FY18	FY19E	FY20E	FY21E
Pre-tax profit	2,501	3,468	4,076	4,619
Depreciation	3,793	3,457	3,520	3,603
Chg in working capital	2,653	(1,284)	(4,140)	(2,905)
Total tax paid	(458)	(832)	(1,019)	(1,155)
Other operating activities	1,682	908	1,917	1,772
Operating CF	**10,172**	**5,717**	**4,354**	**5,934**
Capital expenditure	487	(2,657)	(783)	(1,033)
Chg in investments	1,898	0	0	0
Other investing activities	555	0	0	0
Investing CF	**2,939**	**(2,657)**	**(783)**	**(1,033)**
Equity raised/(repaid)	0	0	0	0
Debt raised/(repaid)	(5,865)	0	(1,000)	(1,000)
Dividend (incl. tax)	0	0	0	0
Other financing activities	(3,261)	(1,862)	(1,717)	(1,572)
Financing CF	**(9,126)**	**(1,862)**	**(2,717)**	**(2,572)**
Net chg in cash & bank bal.	3,985	1,197	855	2,328
Closing cash & bank bal	**6,279**	**7,476**	**8,331**	**10,659**

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end March)	FY18	FY19E	FY20E	FY21E
Profitability and return ratios (%)				
EBITDAM	9.0	6.9	8.3	8.4
EBITM	4.0	3.4	4.9	5.0
NPM	2.0	1.9	3.2	3.5
RoE	5.4	6.0	9.7	9.8
RoCE	6.7	7.1	10.0	9.9
Per share data (Rs)				
O/s shares	265.2	265.2	265.2	265.2
EPS	5.8	6.9	12.3	13.8
FDEPS	5.8	6.9	12.3	13.8
CEPS	20.1	20.0	25.6	27.4
BV	107.6	114.0	125.8	139.1
DPS	0.5	0.5	0.5	0.5
Valuation ratios (x)				
PE	22.9	19.1	10.7	9.6
P/BV	1.2	1.2	1.0	0.9
EV/EBITDA	5.6	5.5	4.2	3.6
EV/Sales	0.5	0.4	0.3	0.3
D/E (x)	0.4	0.4	0.4	0.3

Source: Company, Kotak Securities – Private Client Research

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 15% returns over the next 12 months
ADD	–	We expect the stock to deliver 5% - 15% returns over the next 12 months
REDUCE	–	We expect the stock to deliver -5% - +5% returns over the next 12 months
SELL	–	We expect the stock to deliver < -5% returns over the next 12 months
NR	–	**Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
SUBSCRIBE	–	We advise investor to subscribe to the IPO.
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NA	–	**Not Available or Not Applicable.** The information is not available for display or is not applicable
NM	–	**Not Meaningful.** The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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