RESULT UPDATE

MID CAP

Aditya Birla Nuvo

Maintain Outperformer

Price: Rs 847 | **BSE Index: 16,358** | **30 January 2010**

3QFY10 Result – Sweet spot – Operating performance improves and so do funding constraints

The revenue from value businesses grew by 4% (YoY) and 2% (QoQ) mainly due to increase in revenue from the carbon black (volumes up 53% YoY and (6)% QoQ) and the insulators segment (volumes up 22% YoY and 28% QoQ). The realisations though were down led by a fall in commodity prices. Aditya Birla Nuvo (ABNL) has posted a sharp improvement in the standalone apparel retail business. The operating margins improved considerably by 230 bps QoQ and from (3.1)% YoY to 4.1% mainly due to rent re-negotiation and also by manpower rationalisation, overheads cost reduction even as ABNL expanded the retail space from ~0.7 mn sq ft to ~0.8 mn sq ft in 9MFY10. ABNL has ventured in high end apparel retiling through two separate subsidiaries: 'People' and 'The Collective' in FY08. Investment in infrastructure and brand building had resulted in start up losses in FY09. Both the subsidiaries combined reported net loss of Rs 505 mn but have since improved their performance. BPO faced top line constraints due to lower business from few existing clients. The revenues grew by (13)% YoY to Rs 3,614 mn but managed to post a positive EBIT for the second consecutive quarter led by site rationalisation and partially moving the back office support jobs to India. The profit grew from Rs (378) mn in 3QFY09 to Rs 10 mn in 3QFY10. MINACS balance sheet was strengthened by the infusion of Rs 2.5 bn via zero coupon compulsory convertible debentures and is looking at deals of US$ 550 mn. Birla Sun Life continued with its robust performance with a 14% growth in APE for 9MFY10 and managed to lower its opex ratio by 400 bps. We maintain Outperformer rating on the stock with a target price of Rs 880 based on the structural value of Rs 597 for the life insurance business. If we add the embedded value of Rs 162 (25% discount to the Rs 30.6 bn EV declared by BSLI) then our target price would rise to Rs 1,042.

Share Data

Reuters code	ABRL.BO
Bloomberg code	ABNL IN
Market cap. (US$ mn)	1,887
6M avg. daily turnover (US$ mn)	5.8
Issued shares (mn)	103
Target price (Rs)	880

Performance (%)	1M	3M	12M
Absolute	(5)	2	75
Relative	1	0	(1)

Valuation ratios

Yr to 31 Mar	FY10E	FY11E
EPS (Rs)	18.9	22.6
+/- (%)	30.5	19.9
PER (x)	44.9	37.4
PBV (x)	2.1	1.7
Dividend/Yield (%)	0.4	0.4
EV/Sales (x)	2.6	2.4
EV/EBITDA (x)	15.5	14.8

Major shareholders (%)

Promoters	46
FIIs	17
MFs	3
BFSI's	11
Public & Others	23

Financial highlights (Standalone)

(Rs mn)	3QFY09	3QFY10	YoY (%)	2QFY10	QoQ (%)	9MFY09	9MFY10	YoY (%)	FY09	FY10E	YoY (%)
Net Revenues	11,725	12,228	4.3	11,984	2.0	35,620	33,870	(4.9)	47,862	48,296	0.9
EBITDA	865	2,382	175.5	2,139	11.4	4,212	5,631	33.7	5,537	8,112	46.5
EBITDA Margin (%)	7	19	–	18	–	12	17	–	12	17	45.2
Other Income	30	167	452.0	212	(21.5)	123	443	260.7	653	496	(24.0)
Depreciation	421	439	4.4	449	(2.3)	1,213	1,330	9.6	1,660	1,722	3.7
EBIT	475	2,110	344.7	1,902	11.0	3,122	4,744	52.0	4,529	6,887	52.1
Interest (Net)	728	801	10.1	861	(7.0)	1,714	2,512	46.5	2,906	3,317	14.1
PBT	(253)	1,309	(617.4)	1,041	25.8	1,408	2,232	58.6	1,623	3,570	120.0
Tax	(294)	503	–	448	–	297	856	–	249	1,428	474.2
Reported PAT	41	807	1,862.3	592	36.1	1,111	1,377	24.0	1,374	2,142	55.9
Adjusted PAT	41	807	1,862.3	592	36.1	1,111	1,377	24.0	1,374	2,142	55.9
Adjusted EPS (Rs)	0.4	7.1	–	5.2	–	9.8	12.1	–	12.1	18.9	–

Business overview

Garments

- Madura Garments (21% of standalone sales) posted an 8% volume growth and about 5% growth in realisations (also lead by product mix change) resulting in a revenue growth of 13% (YoY) to Rs 2.6 bn.
- The operating margins improved considerably by 230 bps QoQ and from (3.1)% YoY to 4.1% mainly due to rent re-negotiation and also by manpower rationalisation, overheads cost reduction even as ABNL expanded the retail space from ~0.7 mn sq ft to ~0.8 mn sq ft in 9MFY10.
- They plan to increase the total count of stores to over 700 by March end. This will increase their total land area from approx. 7 lakh sq ft to 8.5 lakh sq ft on YoY basis. They plan to expand mostly in the metros and Tier 1 cities.
- ABNL has ventured in high end apparel retiling through two separate subsidiaries: "People" and "The Collective" in FY08. "People" is a family store offering menswear, women's wear & kids wear and 'The Collective' offers various international apparel and accessory brands under one roof.
- Investment in infrastructure and brand building had resulted in start up losses in FY09. Both the subsidiaries combined reported net loss of Rs 505 mn in 1HFY09. In 4QFY09, both the subsidiaries combined reported loss of Rs 438 mn. The key areas are improving the retail productivity, controlling overheads and rightsizing stores.

Garments retail – Standalone financials

(Rs mn)	3QFY09	2QFY10	3QFY10
Revenue	2,344	2,968	2,656
Growth YoY (%)	5.8	4.8	13.3
Growth QoQ (%)	(17.2)	41.4	(10.5)

Rayon yarn

- VFY posted a flat growth YoY and QoQ in volumes but caustic soda volumes grew on account of capacity expansion.
- The realisations of VFY posted a 7.6% growth YoY and 2% QoQ to Rs 226 per kg led by product mix change towards finer denier yarn. The ECU realisations were under pressure (down 21% YoY and QoQ) due to higher supply in the market.
- Due to higher VFY realisations coupled with lower sulphur and wood pulp prices the margins grew 1,200 bps YoY but pressure on the ECU front led to a 230 bps fall QoQ to 22.3%.

VFY financials

(Rs mn)	3QFY09	2QFY10	3QFY10
Revenue (VFY + ECU)	1,258	1,344	1,294
Growth YoY (%)	4.9	(3.9)	2.8
Growth QoQ (%)	(10.0)	(4.1)	(3.7)
Prop. of standalone Rev of 3QFY10 (%)	10.5	10.9	10.3
EBIT (VFY + ECU)	**130**	**328**	**288**
Growth YoY (%)	(32.6)	75.2	122.0
Growth QoQ (%)	(30.7)	(14.8)	(12.2)
EBIT Margins (%)	10.3	24.4	22.3

Carbon black

- Robust demand in the OEM and replacement market for tyres led to higher volume sales for carbon black. The capacity expansion also contributed to the 53% YoY growth in the carbon black volumes. On a sequential basis, volumes are down 6%.
- The realisations increased 15% QoQ led by higher feedstock prices reflecting the movement in crude oil prices with a time lag of three months.
- Lower cost of CBFS (YoY) led to an improvement in operating margins from (9.1)% in 3QFY09 to 24.5% in the quarter. Sequentially though the feedstock price rise dented margins by 500 bps.
- ABNL is planning a capacity expansion by 85,000 MTPA at Patalganga in second phase and plans to expand in southern India by 85,000 MTPA. This will lead to an overall capacity expansion from 2.3 Lakh MTPA to 4.85 lakh MTPA post the commissioning of 85,000 mtpa at Patalganga.

Carbon black financials

(Rs mn)	3QFY09	2QFY10	3QFY10
Revenue	2,219	2,867	3,104
Growth YoY (%)	(9.5)	(15.2)	39.9
Growth QoQ (%)	(34.3)	16.6	8.3
Prop. of standalone Rev of 3QFY10 (%)	18.5	23.3	24.8
EBIT	**(263)**	**782**	**698**
Growth YoY (%)	(170.4)	235.0	(364.9)
Growth QoQ (%)	(212.9)	212.9	(10.8)
EBIT Margins (%)	(11.9)	27.3	22.5

Insulators

- Domestic volumes grew by a strong 22% QoQ , as ABNL was able to supply the power projects gaining momentum due to the capacity expansion.
- But the realisations remained under pressure due to increased competition from Chinese suppliers.
- The operating margins expanded to 27.7% led by lower energy and raw material costs.

Insulators financials

(Rs mn)	3QFY09	2QFY10	3QFY10
Revenue	1,128	910	1,158
Growth YoY (%)	14.9	(14.1)	2.6
Growth QoQ (%)	6.5	16.0	27.2
Prop. of standalone Rev of 3QFY10 (%)	9.4	7.4	9.3
EBIT	**252**	**172**	**275**
Growth YoY (%)	(20.9)	(39.8)	8.9
Growth QoQ (%)	(11.5)	0.4	59.9
EBIT Margins (%)	22.3	18.9	23.7

Linen and wool textiles

- The revenue from linen fabrics posted a sharp growth in revenue (39% YoY & 46% QoQ) led by robust demand. Roll out of the 'linen Club' stores also contributed to volumes.
- The revenue from woolen fabrics was down 5% QoQ and YoY.
- The operating margins increased led by lower flax fibre prices (used for linen fabric).

Textiles financials

(Rs mn)	3QFY09	2QFY10	3QFY10
Revenue	1,399	1,380	1,554
Growth YoY (%)	(6.7)	(7.5)	11.0
Growth QoQ (%)	(6.3)	5.2	12.6
Prop. of standalone Rev of 3QFY10 (%)	11.7	11.2	12.4
EBIT	**49**	**99**	**138**
Growth YoY (%)	(58.7)	(22.1)	181.7
Growth QoQ (%)	(61.2)	117.0	40.4
EBIT Margins (%)	3.5	7.1	8.9

Life insurance

BSLI financials

(Rs mn)	3QFY09	2QFY10	3QFY10
Revenue	1,399	1,380	1,554
Growth YoY (%)	(6.7)	(7.5)	11.0
Growth QoQ (%)	(6.3)	5.2	12.6
EBIT	**49**	**99**	**138**
Growth YoY (%)	(58.7)	(22.1)	181.7
Growth QoQ (%)	(61.2)	117.0	40.4
EBIT Margins (%)	3.5	7.1	8.9

BPO

- The segment faced top line constraints due to lower business from few existing clients. The revenues grew by (13)% YoY to Rs 3,614 mn but managed to post a positive EBIT for the second consecutive quarter led by site rationalisation and partially moving the back office support jobs to India.
- Site consolidation and cost control efforts has helped Minacs to improve their EBITDA margins by 200 bps (QoQ) and 1,000 bps (YoY) basis and also turn positive at the net profit level during the quarter posting a growth of approx. 100% from Rs (378) mn in 2QFY09 to Rs 10 mn in 3QFY10.
- MINACS balance sheet was strengthened by the infusion of Rs 2.5 bn via zero coupon compulsory convertible debentures.

BPO financials

(Rs mn)	3QFY09	2QFY10	3QFY10
Revenue	4,160	3,870	3,614
Growth YoY (%)	3.2	(14.6)	(13.1)
Growth QoQ (%)	(8.2)	(1.4)	(6.6)
EBIT	**(247)**	**97**	**138**
EBIT Margin (%)	(5.9)	2.5	3.8

Idea

Telecom financials

(Rs mn)	3QFY09	2QFY10	3QFY10
Revenue	7,372	8,019	8,472
Growth YoY (%)	35.8	19.3	14.9
Growth QoQ (%)	9.6	(0.2)	5.6
EBIT	**1,054**	**1,022**	**907**
EBIT Margin (%)	14.3	12.7	10.7

- Idea has shown an increase in the minutes of usage. This increase in due to the reversal or inflow of minutes (or traffic) that idea lost to competitors due to tariff arbitrage existing till last quarter. As Idea captures its lost minutes, usage pattern in future will follow a more rational pattern. In 3Q , subscriber's base grew by 12% (QoQ) while the total minutes of usage grew by 14% to 64 billion minutes.

Outlook and valuation

We expect the dominant position in the men's apparel segment, carbon black, ceramic insulators, and import parity price realisations for urea (at least 100,000 tonne) would result in strong cash generation for ABNL. The robust performance of the value businesses would drive the cash flow generation and hence funding of the growth business to be met without strains.

We increase our FY11 EBITDA estimate by 14% to Rs 8.5 bn led by an increase in volumes for carbon black, insulators and garments and improvement in operating performance of the garments business. We also increase our APE growth assumption to 16% from 10% earlier. These have led to an increase in our target price from Rs 786 to Rs 880 based on SOTP of our FY11 earnings estimates.

We value ABNL on SOTP basis and maintain an Outperformer rating with a target price of Rs 939 based on FY11E post a 20% conglomerate discount. We value the Idea at Rs 391 per share of ABNL (at 53 per share based on the target price of our telecom analyst) and Birla Sun Life Insurance at Rs 597 per share of ABNL.

We value Birla Sun Life Insurance at structural value Rs led by 16% NBAP margins and 16x NBAP multiple assuming a 16% growth in new business and a 15% growth in APE (earlier 10%). If we assume an ad hoc 25% discount to the embedded value of Rs 30.6 bn declared by BSLI on account of opex rations, reserves and mortality assumptions, then our EV would be Rs 23 bn resulting in Rs 162 per share and consequently our target price would rise to Rs 1,042 after ascribing a 20% holding company discount.

Valuations (FY11)

	EBITDA					EV/EBITDA	Value	
(Rs mn)	FY07	FY08	FY09	FY10E	FY11E	(x)	(Rs mn)	(Rs)
1. Carbon Black	1,322	1,526	498	2,745	2,288	5	11,441	101
2. Rayon Business	1,197	1,244	1,230	1,568	1,321	4	5,284	47
3. Branded Garments	814	671	17	535	876	8	7,006	62
4. Textile – Jayshree	674	679	543	617	633	3	1,900	17
5. Insulator	543	1,363	1,227	1,088	1,437	5	7,183	63
6. Fertiliser	1,296	1,023	2,284	1,933	1,933	5	9,663	85
Standalone Enterprise Value	**5,846**	**6,506**	**5,799**	**8,486**	**8,487**	**5**	**42,476**	**374**
Less: Net debt (Avg. Standalone FY10)				0	0		36,969	326
Standalone Equity Value (A)							**5,507**	**49**
7. PSI Data Systems (70.2% stake)	45	57	(7)	27	42	4	169	1
8. Madura – Contract Manufacturing	55	(93)	(638)	(400)	(150)	1	(150)	(1)
9. Minacs Worldwide Ltd Business (88.3% stake)	447	473	350	1,202	1,316	7	8,134	72
Total Enterprise Value (7+8+9)	**547**	**437**	**(295)**	**829**	**1,208**		**8,153**	**72**
Less: Net Debt PSI Data Sys (FY08)							360	3
Less: Net Debt Madura Contract Manufacturing (FY08)							1,650	15
Less: Net Debt Minacs Worldwide Ltd. (FY08)							8,500	75
Equity Value (7+8+9) (Rs mn) (B)							**(2,357)**	**(21)**
10. Other Financial Services (C)	**26**	**33**	**253**	**59**	**88**	**6**	**528**	**5**
Equity Value (B+C) (D)							**(1,829)**	**(16)**
Following Business are valued at Investments (per share)								
11. Idea Cellular (27.02% stake) @ Rs 53 per share							44,394	391
12. Apollo Sindhoori (76% stake) @ Rs 28 per share							1,196	11
13. Birla Sun Life Insurance (NBAP margin 16%, 16x)							67,796	597
14. AMC Business (3% of AUM of Rs 520 bn)							7,800	69
Total Investment Value (Per share Value) (E)							**121,186**	**1,068**
Total Equity Value (A+D+E)							**124,864**	**1,100**
Less: Conglomerate Discount (%)						20	24,973	220
Value of ABNL per share (diluted 113.5 mn shares)							99,891	880
No. of shares of ABNL (mn)								114
Current market price (Rs)								**847**

Income Statement

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10E	FY11E
Net sales	**39,242**	**47,862**	**48,296**	**52,423**
Growth (%)	*14.7*	*22.0*	*0.9*	*8.5*
Operating expenses	(33,322)	(42,325)	(40,184)	(43,966)
Operating profit	5,920	5,537	8,112	8,457
EBITDA	**5,920**	**5,537**	**8,112**	**8,457**
Growth (%)	*5.8*	*(6.5)*	*46.5*	*4.3*
Depreciation	(1,411)	(1,660)	(1,722)	(1,929)
Other income	670	653	496	500
EBIT	**5,179**	**4,529**	**6,887**	**7,028**
Interest paid	(2,045)	(2,906)	(3,317)	(3,078)
Pre-tax profit (before non-recurring)	3,135	1,623	3,570	3,951
Non-recurring items	11	0	0	0
Pre-tax profit (after non-recurring)	3,145	1,623	3,570	3,951
Tax (current + deferred)	(715)	(249)	(1,428)	(1,383)
Net profit (before Minority Interest, Pref. Dividend, etc.)	2,431	1,374	2,142	2,568
Reported PAT	2,431	1,374	2,142	2,568
Adjusted net profit	**2,420**	**1,374**	**2,142**	**2,568**
Growth (%)	*7.0*	*(43.2)*	*55.9*	*19.9*

Balance Sheet

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10E	FY11E
Cash & marketable sec.	972	898	3,145	2,491
Other current assets	20,141	21,674	24,299	26,088
Investments	40,542	57,124	52,881	58,881
Net fixed assets	15,017	16,050	17,135	18,206
Total assets	**76,671**	**95,746**	**97,459**	**105,665**
Current liabilities	7,004	7,735	8,289	8,852
Total debt	27,434	44,992	41,460	39,460
Other non-current liabilities	2,003	1,802	1,802	1,802
Total liabilities	**36,441**	**54,529**	**51,551**	**50,114**
Share capital	950	950	950	950
Reserves & surplus	39,287	40,266	44,484	54,127
Shareholders' funds	**40,237**	**41,216**	**45,434**	**55,077**
Minorities interests	(7)	1	(7)	(7)
Total equity & liab.	**76,671**	**95,746**	**96,978**	**105,184**
Capital employed	**69,668**	**88,011**	**89,170**	**96,813**

Cash Flow Statement

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10E	FY11E
Pre-tax profit	3,145	1,623	3,570	3,951
Depreciation	1,411	1,661	1,722	1,929
Change in working capital	(4,267)	(397)	(2,070)	(1,227)
Total tax paid	(461)	(640)	(1,428)	(1,383)
Cash flow from oper. (a)	**(172)**	**2,246**	**1,794**	**3,270**
Capital expenditure	(3,255)	(2,364)	(2,806)	(3,000)
Change in investments	(2,048)	(16,582)	4,243	(6,000)
Others	(92)	(329)	0	0
Cash flow from inv. (b)	**(5,395)**	**(19,276)**	**1,437**	**(9,000)**
Free cash flow (a+b)	**(5,566)**	**(17,030)**	**3,231**	**(5,730)**
Equity raised/(repaid)	3,414	0	2,500	7,500
Debt raised/(repaid)	(884)	17,558	(3,532)	(2,000)
Dividend (incl. tax)	0	(639)	(424)	(424)
Others	3,781	8	(8)	0
Cash flow from fin. (c)	**6,310**	**16,927**	**(1,465)**	**5,076**
Net chg in cash (a+b+c)	**744**	**(102)**	**1,766**	**(654)**

Key Ratios

Yr end 31 Mar (%)	FY08	FY09	FY10E	FY11E
Adjusted EPS (Rs)	25.5	14.5	18.9	22.6
Growth	5.1	(43.2)	30.5	19.9
Book NAV/share (Rs)	423.4	433.8	400.2	485.2
Dividend/share (Rs)	5.8	4.0	3.3	3.3
Dividend payout ratio	26.4	30.9	19.8	16.5
Tax	22.7	15.3	40.0	35.0
EBITDA margin	15.1	11.6	16.8	16.1
EBIT margin	13.2	9.5	14.3	13.4
RoCE	7.9	5.7	7.8	7.6
Net debt/Equity	65.8	107.0	84.3	67.1

Valuations

Yr end 31 Mar (x)	FY08	FY09	FY10E	FY11E
PER	33.3	58.6	44.9	37.4
PCE	21.0	26.5	24.9	21.4
Price/Book	2.0	2.0	2.1	1.7
Yield (%)	0.7	0.5	0.4	0.4
EV/Net sales	3.2	2.6	2.6	2.4
EV/EBITDA	21.2	22.7	15.5	14.8

Du Pont Analysis – ROE

Yr end 31 Mar (x)	FY08	FY09	FY10E	FY11E
Net margin (%)	6.2	2.9	4.4	4.9
Asset turnover	0.6	0.6	0.5	0.5
Leverage factor	2.0	2.1	2.2	2.0
Return on equity (%)	6.8	3.4	4.9	5.1

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