

AIA ENGINEERING LTD.

Assaulting global markets...

Q2 FY 2007 update

SUMMARY

- AIA Engineering Ltd (AIA) reported a superlative growth in revenues by 38% on a YoY consolidated basis to Rs 1.3 bn. This was due to a buoyant demand for mill internals across sectors like cement, mining and power utilities.
- The growth was on back of both, volume and realisations growth. Volumes grew by ~20% QoQ to 17,100 MT and realisations improved marginally to Rs 71.4/kg.
- OPM expanded by 830 bps to 25.2%, due to lower raw material expenses and fixed costs spread over the entire capacity. Consequently, operating profits doubled to Rs 331 mn.
- Lower interest expenses due to repayment of debt and stable depreciation led to a 113% increase in PBT to Rs 325 mn.
- Lower taxation (25% vs 30.7%) contributed to ~130% increase in net profits to Rs 241 mn.
- AIA announced an additional capex for a capacity expansion to the tune of 100k MT over and above its ongoing expansion of 104k MT. This would be done post the existing expansion in a single phase. The company is also considering integrating backward by acquiring a ferro chrome manufacturer to ensure quality and availability of key inputs.
- *In light of the new initiatives taken by AIA and a sterling H1FY07 performance we have factored in a margin expansion in FY07E and revised our estimates upwards for FY08E. Consequently, at a CMP of 1,153, the stock is trading at a P/E of 17.4x, discounting its FY08E EPS of Rs 66. It trades at an EV/Sales of 2.5x and EV/EBITDA of 10.9x, discounting its FY08E numbers. Though AIA is a market leader in its segment, there has been a huge run up in its price limiting further upside. Thus, we downgrade the stock to "HOLD" till we achieve better clarity on the demand scenario post FY09 in light of its plans to further expand capacity.*

COMPANY DETAILS

Auditors	M/s Talati & Talati
Bankers	SBI, ABN AMRO Bank
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Plant Locations	Ahmedabad
Website	www.aiaengineering.com

SCRIP DETAILS

Market Capitalisation	Rs. 21 bn.
Book Value per share	Rs. 159
Equity Shares O/S (F.V. Rs 10)	17.8 mn.
Median Volumes (12 mths)	73,925 (BSE+NSE)
52 Week High/Low	Rs. 1224 / 391
BSE Scrip Code	532683
NSE Scrip Code	AIAENG
Bloomberg Code	-
Reuters Code	AIAE.BO

SHAREHOLDING PATTERN (%)

Qtr. Ended	Mar-06	Jun-06	Sep-06
Promoters	73.7	69.0	69.0
Foreign Collaborators	-	4.7	4.7
MFs/FI's/Insu Co	13.1	16.9	16.6
FII's/NRIs/OCBs	8.1	2.8	2.2
PCBs	1.4	2.2	3.1
Others	3.7	4.4	4.4

KEY FINANCIALS (CONSOLIDATED)

Rs Mn	Quarter Ended			Year Ended (March)		
	Mar-06*	Jun-06	Sep-06	2006	2007E	2008E
Net Sales	970	1,158	1,311	4,070	5,240	8,280
YoY Gr. (%)	-	89.6	38.2	38.5	28.8	58.0
Op. Profits	197	284	331	814	1,179	1,838
OP. Marg. (%)	20.3	24.5	25.2	20.0	22.5	22.2
Net Profits	136	221	241	523	762	1,181
Eq. Capital	131	178	178	178	178	178

KEY RATIOS

Year Ended (March)	EPS (Rs.)	ROCE (%)	RONW (%)	P/E (x)	EV/Sales (x)	EV/EBDIT (x)
2006	29.4	42.4	28.2	39.3	5.1	22.7
2007E	42.8	34.6	21.2	26.9	3.8	16.0
2008E	66.3	40.2	25.1	17.4	2.5	10.9

*Standalone

Nov 09, 2006

Sensex :13138

Nifty : 3796

CMP : Rs 1153

Recomm : HOLD

AIA's results for Q2FY07 exceeded expectations.

Revenues grew by 38% to Rs 1.3 bn on the back of robust volume and realisation growth. AIA did volumes of 17k MT this quarter as against 59k in FY06 and 14k MT in Q1FY07.

Realisations were stable at Rs 71.4/kg and were higher by 4% vis-a-vis those of Rs 68.7/kg in FY06.

H1FY07 volumes improved by ~5% to ~34k MT. AIA is currently operating at near full capacity (65k MT) utilisation.

Exports constituted 46% of the total sales at ~Rs 600 mn, a 43% YoY rise. Exports in H1FY07 stood at Rs 1.1 bn and comprised largely sales to global cement sector.

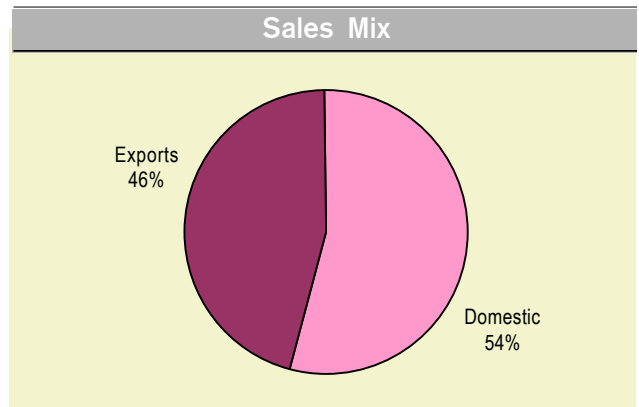
OPM expanded by 830 bps to 25.2% on account of reduction in raw material costs from 58% of sales in Q2FY06 to 44.7% in Q2FY07. This was due to economies of scale, which facilitated absorption of fixed costs. Consequently op. profits doubled to Rs 331 mn.

Lower interest expenses due to repayment of debt, stable depreciation and lower taxation led net profits to grow by ~132% to Rs 241 mn.

AIA has an order book of Rs 3.2 bn, which consists of 60% export orders. The cement sector accounts for 70% of the order book with utilities accounting for a large part of the rest. In volume terms, it consists of 40k MT of mill internals. The mining sector has a very small share of the order book.

Operations

Of the total planned expansion of 104k MT, Phase-I of 52k MT will start commercial production by Jun'07. Trial production of 'head molding' section

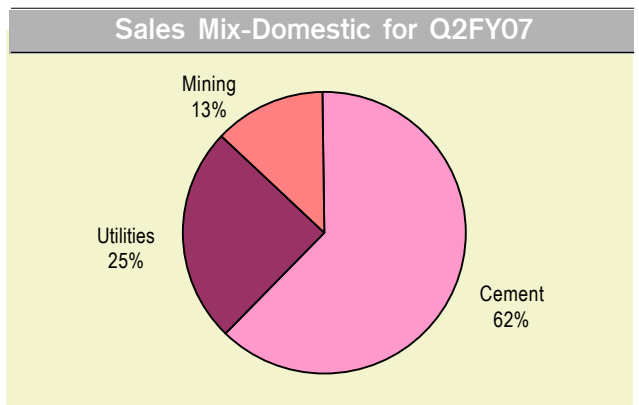
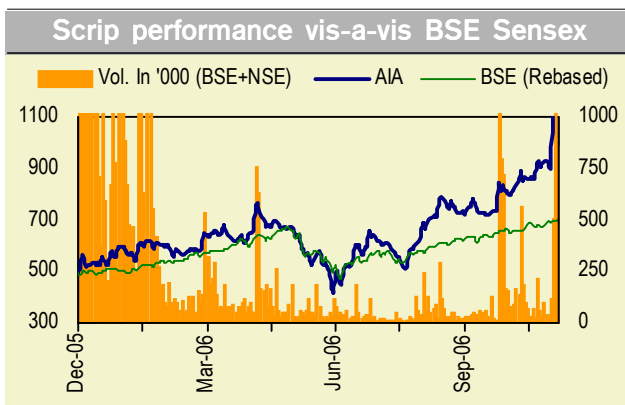


commenced on 28th Oct'06 and the entire capacity's trial production will commence from Dec'06.

Completion of Phase-II of the planned expansion (52k MT) has been preponed by 2 months to Oct'07. This new capacity will cater largely to the export market. Phase-I should see an equal share of cement and mining sectors in sales while Phase-II would comprise of 65% mining with the rest for cement. Thus, the total 104k MT capacity would cater 60% to mining and 40% to cement.

Apart from this planned expansion, AIA is planning a further expansion of 100k MT in a single phase to tap the huge opportunities in mining abroad. It will commence work on the expansion from Q4FY07 and is expected to be onstream by Q4FY08.

To ensure availability and quality of key input material, AIA intends to integrate backwards and acquire a ferro chrome manufacturing facility either in India or abroad by acquiring a unit with a capacity of ~40-50k MT at a capex of ~Rs 300 mn. This would ensure a



steady supply of key RM with right quality though savings in sourcing costs will not be significant. Ferro chrome comprises 20-25% of total RM cost. In volume terms, requirement of ferro chrome/scrap, which is the main RM is 15k MT at present and will rise to 35k MT post expansion of 104k MT.

AIA's plans to set up a 30 MW power plant have currently been put on hold due to delays in getting approvals and is now focusing on the expansion.

Capex

AIA has incurred Rs 380 mn till Sept'06 on Phase-I of the capacity expansion. The total capex outlay for Phase-I is Rs 900 mn and Rs 300 mn for Phase-II. The new initiatives will have a capital outlay of Rs 1.5 bn of which, Rs 1.2 bn will be utilised for capacity expansion.

The investment outlay will be funded entirely by the IPO proceeds (Rs 1.5 bn) and internal accruals. As of Sep'06, AIA had ~Rs 300 mn cash excluding remaining IPO funds of Rs 700 mn. Net debt at consolidated level stood at Rs 250 mn of which, Rs 190 mn was working capital requirements.

The outlook for AIA is buoyant due to the growing domestic demand from cement and power utilities as well as robust export demand from cement sector. Further, there is a latent demand from the global mining sector, that is expected to flow over the next few years.

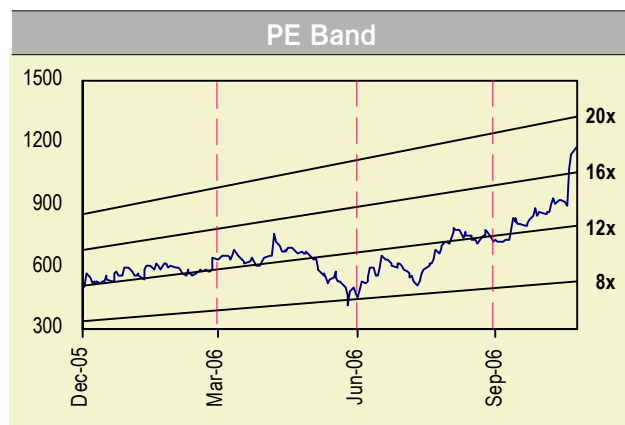
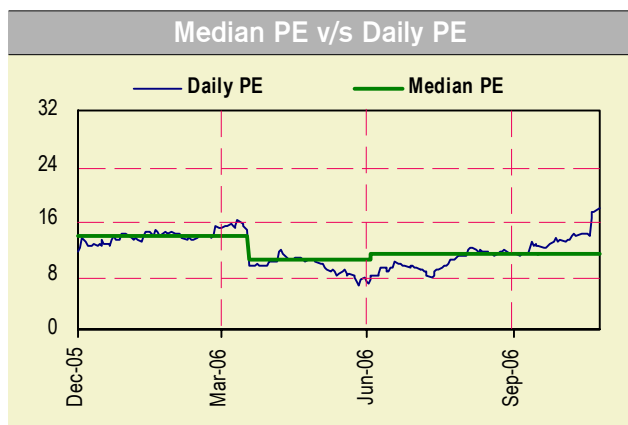
Op. margins should be sustained at current levels of ~23% given better control over its overheads and benefits of economies of scale.

In light of the recent initiatives taken by the company in augmenting capacity to capitalise on the robust demand from end users, we have revised our operating margins upwards for FY07E by 200 bps to 22.5% (a YoY improvement of 250 bps) while retaining our earlier revenue estimate of Rs 5.2 bn. Operating profits should consequently rise by ~45% to Rs 1.2 bn. Net profits should increase by 46% to Rs 762 mn in FY07.

We have revised upwards our estimates for FY08E. Thus, we expect net sales to grow by 58% to Rs 8.3 bn and OPM to decline slightly by 30 bps to 22.2%. Consequently, op. profits should rise by 56% to Rs 1.8 bn. Net profits should increase by 55% to Rs 1.2 bn.

The OPM decline in FY08 is due to factoring in for increased competition in later half of FY08 with possibility of China entering the fray.

At the CMP of 1,153, the stock is trading at a P/E of 17.4x FY08E EPS of Rs 66. It trades at an EV/Sales of 2.5x and EV/EBITDA of 10.9x discounting its FY08E numbers. Though AIA is a market leader in mill internals/grinding media and has assured demand from its end users for its products, valuations have largely factored in the expected growth from the expansions. However, backward integration by acquisition of a ferro chrome unit and incremental capacity can further boost margins which would leave some value on the table and thus, we downgrade the stock to 'HOLD'.



Consolidated results for the quarter and half year ended Sep'30, 2006

Particulars (Rs mn)	Quarter Ended			Half Year Ended			Yr Ended
	30/09/06	30/09/05	Gr %	30/09/06	30/09/05	Gr %	31/03/06
Net Sales	1,311	948	38.2	2,468	1,559	58.4	4,070
Expenditure	980	788	24.4	1,854	1,295	43.2	3,255
Raw Materials	586	550	6.5	1102	898	22.7	1795
Wages and Salaries	62	43	45.0	121	66	82.5	226
Other expenditure	332	195	70.2	632	331	90.9	1235
Operating profit	331	160	106.7	614	264	133.0	814
Other Income	19	12	60.1	64	38	68.3	104
PBDIT	350	172	103.4	678	302	124.8	918
Interest	7	11		15	18		53
Depreciation	18	8		36	12		71
PBT	325	153	112.6	628	272	131.2	795
Tax inc. deferred tax	81	47		161	87		252
Net Profit	244	106	130.2	466	184	153.2	542
Minority Interest	3	2		4			20
Net profit post minority	241	104	131.7	462	184	151.1	523
Equity Capital	178	131		178	131		178
Reserves (excl. rev. res.)	-	-		-	-		2,652
EPS for the period (Rs)	13.6	8.0		26.0	14.1		29.4
Book Value (Rs)	-	-		-	-		159.0
OPM (%)	25.2	16.9		24.9	16.9		20.0
NPM(%)	18.6	11.2		18.9	11.8		13.3
Expend. (% of net sales)							
Raw Materials	44.7	58.0		44.6	57.6		44.1
Wages and Salaries	4.8	4.5		4.9	4.2		5.6
Other expenditure	25.3	20.6		25.6	21.2		30.3

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