31 May 2010

BSE Sensex: 16945

IDFC INSTITUTIONAL SECURITIES

India Research

Rs404

AIA Engineering

OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs38.1bn; US$820m

Analyst: Bhoomika Nair (91-22-6622 2561; bhoomika.nair@idfc.com)

Result: Q4FY10

Comment: Sharply below estimates led by lower than estimated revenues; FY11E earnings downgraded by 6%

Last report: 1 February 2010 (Price Rs348; Recommendation: Outperformer)

Key consolidated financials

Year ended	Revenues (Rs m)	% growth, yoy	Adj. PAT (Rs m)	EPS (Rs)	% growth, yoy	PE (x)
2007	5,230	28.5	946	10.1	70.8	40.1
2008	6,912	32.1	1,335	14.2	41.1	28.4
2009	10,233	48.0	1,715	18.2	28.0	22.2
2010P	9,497	(7.2)	1,707	18.1	(0.4)	22.3
2011E	11,967	26.0	2,045	21.7	19.8	18.6
2012E	14,217	18.8	2,509	26.6	22.7	15.2

Key highlights

- AIA reported profit after minority interest at Rs390mn (-2.3% yoy) sharply below our estimates of Rs463mn due to higher than estimated margins during the quarter.
- Revenues for 4QFY10 fell by 5.4% yoy to Rs2.5bn led by fall in realizations (-21% yoy). The realizations fell due to the lower raw material prices which were passed on to the clients. Moreover, higher volumes from the mining segment (typically has lower realizations), further impacted realizations during the quarter.
- The sales volumes were at 28,000MT (+20% yoy). The volumes have grown at a strong pace as the mining sector has started to ramp up, as it contributed 4200MT in the quarter from international markets. For FY10, mining volumes were 20,000MT against ~8000MT in FY09. Further, cement volumes have stabilized in international markets, driving overall sales volumes.
- The cement sector remains the core earnings driver with contribution of 67% to total revenues, the pick up in mining volumes has led to the contribution from mining volumes being 20% in FY10 against 5-6% in FY09, while the balance is from the utilities segment.
- Operating margins fell by 210bps yoy to 23.1% (below our estimates of 24.5%). AIA's margins are typically in the 23-25%, which vary each quarter based on the product mix sold during the quarter. However, margins fell on back of sharp increase in raw material prices, which AIA typically passes on with a lag of a quarter. Further, as it is recently entered the mining sector, the price increases are being done gradually. In addition, the rupee fluctuation vis-à-vis various currencies have led to forex losses in the quarter. In 4QFY10, the forex losses on account of derivative losses are Rs40mn apart from the translation losses.
- Other income fell by 11% yoy to Rs81mn led by interest income of surplus cash of Rs3.5bn and benefits on sale of DEPB license.
- Overall, FY10 revenues fell by 7% yoy to Rs9.5bn (8% volumes growth and 14% drop in realisations), while margins fell by 70bps to 23.4%. Consequently, EBITDA fell by 9.7% yoy to Rs2.23bn, while PAT was flat at Rs1.71bn.

Trend in operating parameters

	1QFY09	2QFY09	3QFY09	4QFY09	FY09	1QFY10	2QFY10	3QFY10	4QFY10	FY10P
Production Volumes (MT)	23,987	29,550	29,280	21,300	103,500	22,619	22,004	28,405	28,472	101,500
Sales volumes (MT)	21,200	26,900	23,900	23,300	95,354	22,300	23,118	29,513	28,000	102,931
Realizations	94,292	106,347	114,191	113,476	107,315	101,645	94,430	86,271	89,328	92,266
% yoy growth										
Production Volumes	35.4	31.0	24.3	(12.5)	17.4	(5.7)	(25.5)	(3.0)	33.7	(2.0)
Sales volumes	13.2	30.3	2.0	2.6	11.5	5.2	(14.1)	23.5	20.2	8.0
Realizations	28.9	35.9	41.7	26.6	32.8	7.8	(11.2)	(24.5)	(21.3)	(14.0)

❑ Management gives guidance of 130,000 -140,000tons for FY11E – uptick in mining volumes

The management has guided for FY11E volumes at 130,000-140,000 tons for FY11E, translating into a 25-35% yoy growth in volumes. Of these volumes, mining would double from 20,000 tons in FY10, to 40,000 tons in FY11E. Apart from supplying to copper and platinum mines, AIA has also begun supplying to iron ore mines, with its first order being from CVRD. Accordingly, AIA's order backlog is at Rs3.5bn. To meet the growth in its volumes AIA is de-bottlenecking its existing manufacturing facilities to increase its capacity from 165,000tons to 200,000 tons, which is likely to be completed by July 2010 at a cost of Rs350-400mn. Further, AIA is planning to set up another greenfield capacity of 100,000tons for which it is likely to acquire land in FY11E at a cost of Rs300-400mn, resulting in total capex plans of Rs750mn for FY11E. The greenfield facility is likely to cost Rs1.75bn in totality, which is likely to be commissioned by end FY12E.

❑ Maintain Outperformer

We have downgraded our FY11E and FY12E estimates by 6% each on back of lower than estimated margins in the quarter, which we believe are likely to continue as AIA gradually passes on the increase in raw material costs to its clients. Overall, we believe AIA, the world's 2nd largest high chrome mill internals player has a strong value proposition in form of a solution based revenues rather than traditional forged equipment based products. This enables AIA to offer its clients reliability in throughput as well as lower operating costs. Consequently, we believe AIA will be able to grow its volumes in cement, mining and power utilities across the domestic and international markets. Moreover, AIA has added capacity (doubling capacity over FY07-10) to meet the strong demand and to garner higher market share. Consequently, we believe the valuations at 18.6x FY11E and 15.2x FY12E earnings are quite attractive considering the oligopolistic nature of the industry and the non – cyclical nature of revenues (80% of revenues are replacement driven). We re-iterate our Outperformer call on the stock with a price target of Rs452/share.

Consolidated quarterly results

(Rs mn)	1Q09	2Q09	3Q09	4Q09	FY09	1Q10	2Q10	3Q10	4Q10	FY10P
Net Sales	**1,999**	**2,861**	**2,729**	**2,644**	**10,233**	**2,267**	**2,183**	**2,546**	**2,501**	**9,497**
Operating Costs	1,464	2,191	2,033	2,078	7,766	1,703	1,667	1,881	2,018	7,270
EBITDA	**535**	**669**	**697**	**566**	**2,467**	**564**	**516**	**665**	**483**	**2,227**
EBITDA Margin (%)	*26.8*	*23.4*	*25.5*	*21.4*	*24.1*	*24.9*	*23.6*	*26.1*	*19.3*	*23.4*
Other Income	74	25	29	91	218	87	117	98	81	384
Depreciation	44	57	44	57	203	58	56	57	57	227
Interest	5	4	5	8	21	9	1	2	2	14
PBT	**560**	**633**	**677**	**593**	**2,462**	**584**	**576**	**704**	**506**	**2,370**
Tax	161	181	205	193	741	176	156	213	115	659
Tax rate (%)	*28.8*	*28.6*	*30.2*	*32.6*	*30.1*	*30.1*	*27.1*	*30.2*	*22.7*	*27.8*
Profit after tax	399	452	472	400	1,722	408	420	492	391	1,711
Less Minority interest	1	8	2	(3)	7	1	0	1	1	4
PAT post minorities	**398**	**444**	**470**	**403**	**1,715**	**407**	**420**	**491**	**390**	**1,707**
Extra-ordinary items	-	-	-	22	22	-	-	-	-	-
Reported PAT	**398**	**444**	**470**	**425**	**1,736**	**407**	**420**	**491**	**390**	**1,707**
% growth yoy										
Revenues	**45.8**	**77.0**	**44.5**	**29.9**	**48.0**	**13.4**	**(23.7)**	**(6.7)**	**(5.4)**	**(7.2)**
EBITDA	**96.6**	**85.0**	**32.9**	**17.8**	**50.4**	**5.3**	**(23.0)**	**(4.6)**	**(14.7)**	**(9.7)**
Other Income	50.5	(59.1)	(59.2)	(33.3)	(31.0)	18.5	377.8	241.2	(11.2)	75.8
Depreciation	105.2	75.7	20.1	27.3	49.1	31.1	(3.2)	29.7	(0.6)	12.0
Interest	3.2	(3.8)	21.6	69.8	23.3	104.0	(71.4)	(66.2)	(75.9)	(32.9)
PBT	89.7	64.2	22.1	4.4	36.5	4.2	(9.0)	4.1	(14.7)	(3.8)
PAT	**82.0**	**64.4**	**16.5**	**(9.8)**	**28.1**	**2.3**	**(7.0)**	**4.2**	**(2.3)**	**(0.6)**
PAT post minorities	**83.8**	**62.9**	**16.7**	**(8.5)**	**28.5**	**2.2**	**(5.5)**	**4.3**	**(3.3)**	**(0.4)**
Eq. shares (m)	94.0	94.0	94.3	94.3	94.3	94.3	94.3	94.3	94.3	94.3
EPS	4.2	4.7	5.0	4.3	18.2	4.3	4.5	5.2	4.1	18.1
PER (x)	23.8	21.3	20.2	23.6	22.2	23.4	22.7	19.4	24.4	22.3

Analyst	Sector/Industry/Coverage	E-mail	Tel. +91-22-6622 2600
Pathik Gandotra	Head of Research; Financials, Strategy	pathik.gandotra@idfc.com	91-22-662 22525
Shirish Rane	Construction, Power, Cement	shirish.rane@idfc.com	91-22-662 22575
Nikhil Vora	FMCG, Media, Mid Caps, Education, Exchanges	nikhil.vora@idfc.com	91-22-662 22567
Ramnath S	Automobiles, Auto ancillaries, Real Estate, Oil & Gas	ramnath.s@idfc.com	91-22-662 22570
Nitin Agarwal	Pharmaceuticals	nitin.agarwal@idfc.com	91-22-662 22568
Chirag Shah	Metals & Mining,Telecom, Pipes, Textiles	chirag.shah@idfc.com	91-22-662 22564
Bhoomika Nair	Logistics, Engineering	bhoomika.nair@idfc.com	91-22-662 22561
Hitesh Shah, CFA	IT Services	hitesh.shah@idfc.com	91-22-662 22565
Bhushan Gajaria	Retailing, FMCG, Media, Mid Caps	bhushan.gajaria@idfc.com	91-22-662 22562
Salil Desai	Construction, Power, Cement	salil.desai@idfc.com	91-22-662 22573
Ashish Shah	Construction, Power, Cement	ashish.shah@idfc.com	91-22-662 22560
Probal Sen	Oil & Gas	probal.sen@idfc.com	91-22-662 22569
Chinmaya Garg	Financials	chinmaya.garg@idfc.com	91-22-662 22563
Aniket Mhatre	Automobiles, Auto ancillaries	aniket.mhatre@idfc.com	91-22-662 22559
Abhishek Gupta	Telecom	abhishek.gupta@idfc.com	91-22-662 22661
Ritesh Shah	Pharmaceuticals, IT Services	ritesh.shah@idfc.com	91-22-662 22571
Saumil Mehta	Metals, Pipes	saumil.mehta@idfc.com	91-22-662 22578
Vineet Chandak	Real Estate	vineet.chandak@idfc.com	91-22-662 22579
Kavita Kejriwal	Strategy, Financials	kavita.kejriwal@idfc.com	91-22-662 22558
Swati Nangalia	Mid Caps, Media, Exchanges	swati.nangalia@idfc.com	91-22-662 22576
Sameer Bhise	Strategy, Financials	sameer.bhise@idfc.com	91-22-662 22574
Nikhil Salvi	Construction, Power, Cement	nikhil.salvi@idfc.com	91-22-662 22566
Shweta Dewan	Mid Caps, Education, FMCG	shweta.dewan@idfc.com	91-22-662 22577
Dharmendra Sahu	Database Analyst	dharmendra.sahu@idfc.com	91-22-662 22580
Rupesh Sonawale	Database Analyst	rupesh.sonawale@idfc.com	91-22-662 22572
Dharmesh R Bhatt, CMT	Technical Analyst	dharmesh.bhatt@idfc.com	91-22-662 22534

Equity Sales/Dealing	Designation	E-mail	Tel. +91-22-6622 2500
Naishadh Paleja	MD, CEO	naishadh.paleja@idfc.com	91-22-6622 2522
Paresh Shah	MD, Dealing	paresh.shah@idfc.com	91-22-6622 2508
Vishal Purohit	MD, Sales	vishal.purohit@idfc.com	91-22-6622 2533
Nikhil Gholani	MD, Sales	nikhil.gholani@idfc.com	91-22-6622 2529
Sanjay Panicker	Director, Sales	sanjay.panicker@idfc.com	91-22-6622 2530
V Navin Roy	Director, Sales	navin.roy@idfc.com	91-22-6622 2528
Nirbhay Singh	SVP, Sales	nirbhay.singh@idfc.com	91-22-6622 2595
Suchit Sehgal	AVP, Sales	suchit.sehgal@idfc.com	91-22-6622 2532
Pawan Sharma	MD, Derivatives	pawan.sharma@idfc.com	91-22-6622 2539
Jignesh Shah	AVP, Derivatives	jignesh.shah@idfc.com	91-22-6622 2536
Sunil Pandit	Director, Sales trading	suniil.pandit@idfc.com	91-22-6622 2524
Mukesh Chaturvedi	SVP, Sales trading	mukesh.chaturvedi@idfc.com	91-22-6622 2512
Viren Sompura	VP, Sales trading	viren.sompura@idfc.com	91-22-6622 2527
Rajashekhar Hiremath	VP, Sales trading	rajashekhar.hiremath@idfc.com	91-22-6622 2516

Explanation of Ratings:

1. Outperformer: More than 5% to Index
2. Neutral: Within 0-5% to Index
3. Underperformer: Less than 5% to Index

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