4 August 2009

BSE Sensex: 15831

INDIA RESEARCH

AIA Engineering

Rs236

OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs22.2bn; US$465m

Analyst: Bhoomika Nair (91-22-6638 3337; bhoomika@idfcsski.com)

Result: Q1FY10

Comment: Ahead of estimates led by higher other income; Mining volumes start to pick up

Last report: 25 June 2009 (Price Rs230; Recommendation: Outperformer)

Key consolidated valuations

Year to March (Rs mn)	Sales	yoy chg (%)	Net Profit	EPS (Rs)	yoy chg (%)	PER (x)
2007	5,230	28.5	944	10.0	70.3	23.5
2008	6,912	32.1	1,333	14.2	41.2	16.6
2009P	10,233	48.0	1,715	18.2	28.2	13.0
2010E	10,247	0.1	1,786	18.9	4.1	12.4
2011E	12,279	19.8	2,143	22.7	20.0	10.4

KEY HIGHLIGHTS

- AIA reported profit after minority interest at Rs406mn (+2.1% yoy) ahead of our estimates of Rs382mn due to higher than estimated other income during the quarter.
- Revenues for 1QFY10 grew by 13.4% yoy to Rs2.27bn led by higher realizations (+8% yoy). The realization improvement on a yoy basis appears sharp led by a low base effect of FY09. On a qoq basis (4Q09) the realizations have dropped by 10% due to the lower raw material prices which were passed on to the clients. However, the realization drop is not in line with the drop in ferro chrome prices (key raw material for AIA) as the same has been set off against a better revenue mix towards higher value added products.
- The sales volumes were at 22,300MT, a growth of 5.2%. The volumes have been primarily driven by a strong growth in the mining sector (4000MT in 1QFY10, which was negligible last year). On the other hand, the cement volumes (8000MT) have been lower due to the lower construction activity in the international markets.
- Consequently, while the cement sector remains the core earnings driver with contribution of 56% of revenues, its contribution has fallen from 65% of revenues in FY09. On the other hand, the pick up in mining volumes has led to the contribution from mining volumes being 33% against 5-6% in FY09.
- The domestic market contributed 47% of AIA's revenues, while the proportion of international revenues fell marginally to 53% during the quarter against 56% of FY09 revenues.

Trend in operating parameters

	1QFY09	2QFY09	3QFY09	4QFY09	FY09P	1QFY10
Production Volumes (MT)	23,987	29,550	29,280	21,300	103,500	22,619
Sales volumes (MT)	21,200	26,900	23,900	23,300	95,354	22,300
Realisations	94,292	106,347	114,191	113,476	107,315	101,645
% yoy growth						
Production Volumes	35.4	31.0	24.3	(12.5)	17.4	(5.7)
Sales volumes	13.2	30.3	2.0	2.6	11.5	5.2
Realisations	28.9	35.9	41.7	26.6	32.8	7.8

- Operating margins fell by 200bps yoy to 24.8% (albeit higher than our estimates of 24.2%) due to a high base effect. Moreover, AIA has provided forex losses of Rs125mn in other expenses in the quarter.
- Other income increased by 18.5% yoy to Rs87mn due to higher income on surplus cash of Rs3.63bn.
- Consequently, the lower operating margins muted the profit after tax and minorities at 2.1% yoy (vis-à-vis the 13% revenue growth) to Rs406mn.

❑ Order backlog at Rs3.5bn – initiates inroads into the mining sector

While, AIA's order backlog has fallen by 14% yoy to Rs3.5bn (pass through of lower raw material prices as also lower cement orders in international markets), the order backlog has risen on a qoq basis from Rs3.36bn led by pick up in the mining sector (Rs250mn).

The volumes from the cement sector are likely to grow in the domestic market led by production growth. On the other hand, AIA is likely to offset the lower volumes in international segment by market share gains in various markets. Accordingly, AIA has started focusing on China, which constitutes a large cement market.

AIA has been focusing on the mining sector, particularly for iron ore mining, over the past 6-9 months by getting qualified by various international mining companies such as CVRD, Rio Tinto, Minnesota Mines, etc. Post, the slowdown in the iron ore sector, AIA had diversified its focus within the mining sector from only iron ore mining to other mining areas such as gold, copper, zinc, platinum, etc. The focus has led to higher volumes and orders in 1QFY10, which we believe will pick up towards the end of 2QFY10.

❑ Maintain Outperformer

We have not changed our FY10 earnings estimates. 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 12.4x FY10E earnings is 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 Rs270/share.

Consolidated quarterly results

(Rs mn)	1Q09	2Q09	3Q09	4Q09	FY09P	1Q10	FY10E	Remarks
Net Sales	**1,999**	**2,861**	**2,729**	**2,644**	**10,233**	**2,267**	**10,247**	8% yoy increase in realisations led by value added products & rupee depreciation
Operating Costs	1,464	2,191	2,033	2,078	7,766	1,703	7,753	Forex losses of Rs125mn impact margins
EBITDA	**535**	**669**	**697**	**566**	**2,467**	**564**	**2,495**	
EBITDA Margin (%)	26.8	23.4	25.5	21.4	24.1	24.9	24.3	
Other Income	74	25	29	91	218	87	330	Cash of Rs3.6bn on hand at FY09 end
Depreciation	44	57	44	57	203	58	245	Capex of Rs500mn in FY09
Interest	5	4	5	8	20	9	24	Marginal debt of Rs70mn
PBT	**560**	**633**	**677**	**593**	**2,462**	**584**	**2,555**	
Tax	161	181	205	193	740	176	767	Tax rate increased due to higher sales from non EOU \ plants
Tax rate (%)	28.8	28.6	30.2	32.6	30.1	30.1	30.0	
Profit After Tax	**399**	**452**	**472**	**400**	**1,722**	**408**	**1,789**	
Less Minority interet	1	8	2	(3)	7	1	3	Amalgamation of its subsidiaries led to lower minority income
PAT post minorities	**398**	**444**	**470**	**403**	**1,715**	**407**	**1,786**	
Extra-ordinary items	0	0	0	22	22	22	22	Write back of depreciation due to amalgamation of its subsidiaries
Reported PAT	**398**	**444**	**470**	**425**	**1,737**	**429**	**1,808**	
% growth yoy								
Revenues	**45.8**	**77.0**	**44.5**	**29.9**	**48.0**	**13.4**	**0.1**	
Expenses	**96.6**	**85.0**	**32.9**	**17.8**	**50.6**	**5.3**	**1.1**	
EBITDA	96.6	85.0	32.9	17.8	50.6	5.3	1.1	
Other Income	50.5	(59.1)	(59.2)	(33.3)	(31.0)	18.5	50.9	
Depreciation	105.2	75.7	20.1	27.3	49.4	31.1	20.7	
Interest	3.2	(3.8)	21.6	69.8	22.0	104.0	17.8	
PBT	**89.7**	**64.2**	**22.1**	**4.4**	**36.6**	**4.2**	**3.8**	
PAT	82.0	64.4	16.5	(9.8)	28.3	2.3	3.9	
PAT post minorities	**83.8**	**62.9**	**16.7**	**(8.5)**	**28.7**	**2.2**	**4.1**	
Outstanding shares (m)	94.0	94.0	94.3	94.3	94.3	94.3	94.3	
EPS	4.2	4.7	5.0	4.3	18.2	4.3	18.9	
PER (x)	13.9	12.5	11.8	13.8	13.0	13.7	12.4	

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Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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