

AIA Engineering

Rs236
OUTPERFORMER

RESULT NOTE

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

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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 interest | 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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