

MAY 04, 2010

RESULT

Coverage view: **Attractive**

Price (Rs): **390**

Target price (Rs): **450**

BSE-30: **17,386**

In-line results; raise target price on better margins. MHS reported 4QFY10 revenues and PAT of Rs4.1 bn and Rs751 mn in line with our estimates of Rs4 bn and Rs747 mn. Margins (EBITDA/ton) continued to surprise on the upside (Seamless/ERW 2%/4% above estimates) while volume growth and order intake remained subdued. We raise our target price to Rs450 at 5X Sept 2011E EV/EBITDA and expect MHS' strong margin performance to continue. Maintain BUY.

Company data and valuation summary

Maharashtra Seamless

Stock data

52-week range (Rs) (high,low)	422-162
Market Cap. (Rs bn)	27.5

Shareholding pattern (%)

Promoters	53.6
FIs	11.3
MFs	11.8

Price performance (%)

	1M	3M	12M
Absolute	9.8	5.7	135.7
Rel. to BSE-30	11.8	(1.3)	64.5

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	40.2	43.6	49.8
EPS growth (%)	12.1	8.5	14.2
P/E (X)	9.7	8.9	7.8
Sales (Rs bn)	16.1	18.6	21.7
Net profits (Rs bn)	2.8	3.1	3.5
EBITDA (Rs bn)	4.2	4.6	5.3
EV/EBITDA (X)	5.1	4.5	3.5
ROE (%)	19.3	17.9	17.7
Div. Yield (%)	1.5	2.0	2.6

QUICK NUMBERS

- **4QFY10 PAT growth of 16% yoy to Rs751 mn**
- **Order book declines to Rs4.1 bn**

4QFY10—In-line results with margins beating expectations

MHS reported in-line PAT of Rs751 mn (+16% yoy and +4% qoq), in line with our estimated Rs747 mn. EBITDA margins for both seamless and ERW pipes were better than expected at Rs17,171/ton and Rs6,569/ton, respectively. Revenues at Rs4.1 bn (-26% yoy and +9% qoq) were in line with our estimated Rs4 bn with lower volumes (6.8% lower than KIE) countered by better-than-expected realizations.

Order book declines sequentially, puts margin-expansion led growth at risk

MHS' order book declined to Rs4.1 bn versus Rs5.5 bn at end-3QFY10. EBITDA growth of 14% for FY2010 has been led by margin expansion— FY2010 EBITDA/ton margins have increased 18% and 64% yoy for seamless and ERW pipes, respectively. However, volumes have declined 3% with seamless volumes down 8% but ERW volumes up 10% yoy. There remains a case for order flow to improve over FY2011 led by (1) improved demand due to high oil prices, (2) import tariffs imposed by the US against Chinese seamless pipes and (3) expected annual ONGC order. However, given the volume and order intake trend over FY2010, we would await actual order book addition before factoring in the same in our estimates for FY2011E and FY2012E.

Raise target price to Rs450; maintain BUY

We raise our target price to Rs450 (from Rs400) based on 5X Sept. 2011E EV/EBITDA. We believe that MHS' strong margin performance will continue while volume recovery is possible with improving demand conditions. We value MHS at about the mid-range of its historical trading range of 4-6X one-year forward EBITDA. We are increasing our EPS estimates for FY2011E and FY2012E to Rs43.6 and Rs49.8 from Rs41.1 and Rs46.7, respectively, to factor in higher margins/ton based on FY2010 performance. Current valuations at EV/EBITDA of 4.5X and P/E of 8.9X appear attractive with net cash of Rs90/share on the balance sheet at end-FY2010.

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4QFY10 results—in line with estimates

MHS reported 4QFY10 results in line with our estimates with PAT of Rs751 mn versus our estimated Rs747 mn. Revenues at Rs4.1 bn were also in line with our estimates. EBITDA of Rs1.1 bn was marginally lower than our estimated Rs1.2 bn due to lower volumes while EBITDA/ton was 2.5-4.3% better than our estimates.

- ▶ **Seamless pipes:** EBITDA/ton is 2.5% higher than our estimate at Rs17,171 (expected Rs16,750). Volumes at 52,285 tons were 7% lower than our estimated 56,176.
- ▶ **ERW pipes:** ERW margins, at 6.569/ton, continued their upward trend and were 4.3% higher than our estimate—up 404% yoy and 12% qoq. Volumes, at 29,000 tons, were down 23% yoy though.

4QFY10 results in line with estimates

MHS, interim and annual results, March fiscal year-ends (Rs mn)

	4QFY10	4QFY10E	4QFY09	3QFY10	(% chg.)			Twelve months		
					KIE est.	yoy	qoq	FY2010	FY2009	(%chg)
Net sales	4,053	4,043	5,496	3,726	0.2	(26.3)	8.8	16,112	20,642	(21.9)
Total expenditure	(2,950)	(2,892)	(4,476)	(2,692)	2.0	(34.1)	9.6	(11,909)	(16,964)	(29.8)
Inc/(Dec) in stock	158	124	(1,110)	84	27.3	(114.2)	88.0	34	(434)	
Raw materials	(2,428)	(2,344)	(2,144)	(2,383)	3.6	13.3	1.9	(9,560)	(12,894)	(25.9)
Staff cost	(87)	(99)	(81)	(57)	(12.4)	6.5	53.0	(270)	(239)	13.0
Manufacturing exp	(489)	(378)	(634)	(267)	29.2	(22.9)	83.0	(1,721)	(2,324)	(26.0)
Other expenditure	(105)	(195)	(507)	(69)	(46.1)	(79.3)	51.5	(393)	(1,074)	(63.4)
EBITDA	1,103	1,151	1,020	1,034	(4.2)	8.1	6.7	4,203	3,677	14.3
OPM (%)	27.2	28.5	18.6	27.7				26.1	17.8	46.4
Other income	109	46	12	103	134.8	845.2	NM	321	468	(31.5)
Interest	(7)	(9)	(12)	(7)	(20.0)	(39.0)	-	(33)	(116)	(71.3)
Depreciation	(49)	(49)	(48)	(48)	1.0	3.3	2.3	(190)	(179)	5.9
Pretax profits	1,154.8	1,140	972	1,082	1.3	18.8	6.8	4,301	3,850	11.7
Tax	(404)	(392)	(326)	(360)	3.0	24.1	12.3	(1,465)	(1,244)	17.8
Net income	751	747	646	722	0.4	16.2	4.0	2,836	2,599	9.1
Income tax rate (%)	35.0	34.4	33.5	33.3				34.1	32.3	
Despatch (tons)										
Seamless	52,285	56,176	53,191	52,337	(6.9)	(1.7)	(0.1)	206,109	225,095	(8.4)
ERW	29,000	30,994	37,870	28,439	(6.4)	(23.4)	2.0	111,383	101,666	9.6
EBITDA (Rs/ton)										
Seamless	17,171	16,750	18,140	16,443	2.5	(5.3)	4.4	17,556	14,882	18.0
ERW	6,569	6,300	1,304	5,855	4.3	403.8	12.2	4,810	2,929	64.2

Source: Company, Kotak Institutional Equities estimates

Margins are back on track; volume growth is awaited

MHS' order book visibility deteriorated qoq with outstanding orders at Rs4.1 bn versus Rs5.5 bn at end-3QFY10. There is a case for order flow to improve over FY2011 led by (1) improved demand due to high oil prices, (2) import tariffs imposed by the US against Chinese seamless pipes and (3) expected annual ONGC order. However, given the volume and order intake trend over FY2010, we would await actual order book addition before factoring these into our estimates for FY2011E and FY2012E.

Decline in order book visibility raises concern on volume growth for MHS
MHS order book trend, March fiscal year-ends (Rs mn)

	3QFY09	4QFY09	1QFY10	2QFY10	3QFY10	4QFY10
Seamless	7,050	3,900	2,980	3,200	4,360	3,500
Export	100	80	10	110	1,750	1,560
Domestic	6,950	3,820	2,970	3,090	2,610	1,940
ERW	1,180	1,110	1,030	920	1,140	640
Export	20	60	50	10	150	80
Domestic	1,160	1,050	980	910	990	560
Total order book	8,230	5,010	4,010	4,120	5,500	4,140

Source: Company

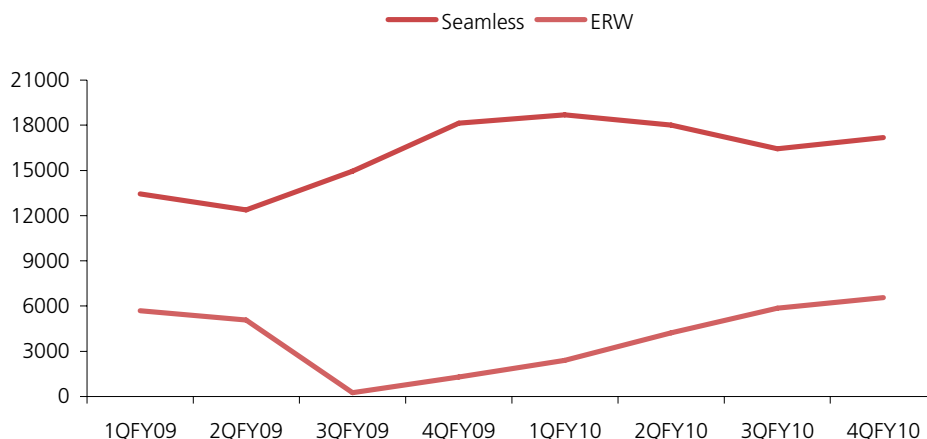
EBITDA margins have recovered but volumes are still subdued

MHS' EBITDA margins have been improving after touching lows in 2QFY09-3QFY09 due to the volatility in commodity prices. Seamless EBITDA margins (Rs/ton) have stabilized since 4QFY09 while ERW EBITDA margins (Rs/ton) have been increasing for five straight quarters and are now at Rs6,569/ton.

However, volumes have remained range bound—seamless volumes are down 2% yoy for 4QFY10 and 8% for FY2010 while ERW volumes are down 23% yoy for 4QFY10 though up 10% for FY2010.

EBITDA margins have recovered post 3QFY09

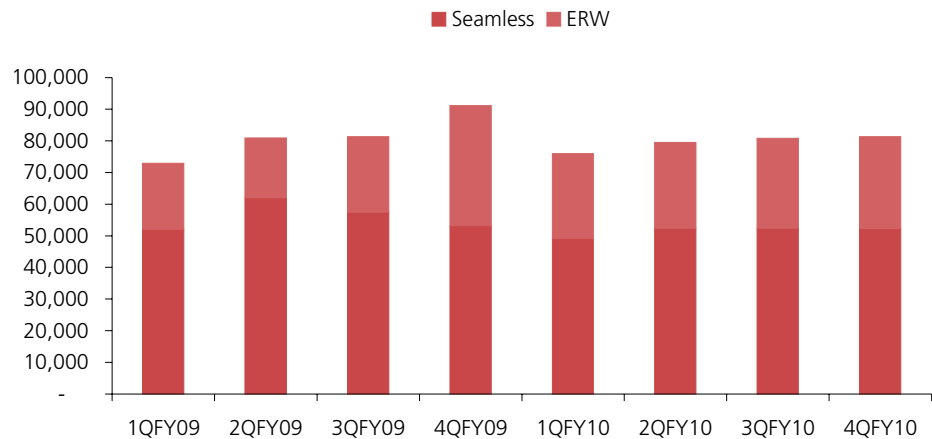
MHS, quarterly EBITDA margins, March fiscal year-ends, (Rs / ton)



Source: Company

Volume trend still sluggish

MHS, quarterly dispatch volumes, March fiscal year-ends, (tons)



Source: Company

Raise estimates to factor in better margins

We increase our EPS estimates for FY2011E and FY2012E to Rs43.6 and Rs49.8 from Rs41.1 and Rs46.7, respectively, to factor in higher margins /ton based on FY2010 performance. We are reducing are volume estimate for seamless pipes to 215,000 and 235,000 for FY2011E and FY2012E, respectively. For ERW pipes, we are keeping constant our FY2011E volume assumption and increasing FY2012E volumes by 4%.

Higher margin assumptions drive increase in EPS estimate

MHS, changes to assumptions, March fiscal year-ends, 2010-12E (Rs mn)

	New estimates		Old estimates		Change (%)	
	2011E	2012E	2011E	2012E	2011E	2012E
Financials						
Net revenues	18,566	21,740	18,315	21,751	1.4	(0.0)
Material cost	10,953	12,887	11,013	13,219	(0.5)	(2.5)
EBITDA	4,626	5,319	4,354	4,996	6.2	6.5
EBITDA (%)	24.9	24.5	23.8	23.0	—	—
PAT	3,078	3,514	2,898	3,297	6.2	6.6
Diluted EPS	43.6	49.8	41.1	46.7	6.2	6.6
Despatch (tons)						
Seamless	215,000	250,000	235,000	290,000	(8.5)	(13.8)
ERW	125,000	130,000	125,000	125,000	—	4.0
Gross realisation (Rs/ton)						
Seamless	64,427	67,004	59,253	60,438	8.7	10.9
ERW	41,608	43,273	39,367	39,367	5.7	9.9
Raw material cost (Rs/ton)						
Billets	29,610	31,263	29,324	30,497	1.0	2.5
HR Coil	31,500	33,259	28,278	29,409	11.4	13.1
EBITDA (Rs/ton)						
Seamless	18,258	18,532	16,850	16,000	8.4	15.8
ERW	5,002	5,077	3,000	3,000	66.7	69.2

Source: Kotak Institutional Equities estimates

Raise target price to Rs450, maintain BUY

We are raising our target price to Rs450 (from Rs400) to factor in a roll forward to September 2011E EBITDA and a 6.2/6.5% increase in EBITDA for FY2011E/12E. Our target price is based on 5X EV/ EBITDA which is near the mid-range of MHS' historical trading range. Current FY2011E valuations at EV/EBITDA of 4.5X and P/E of 8.9X appear attractive with the support of an unlevered balance sheet (net cash of Rs90/share)

We value MHS at Rs450/share

MHS, valuation table (Rs mn)

Sept. 2011E EBITDA	4,972
EV/EBITDA (X)	5.0
EV	24,861
Net debt	(6,828)
Equity value	31,689
No. of shares (mn)	71
Value per share (Rs)	449
Target price (Rs/share)	450

Source: Kotak Institutional Equities estimates

We value MHS at 5X Sept 2011E EBITDA

MHS, one-year forward EV/EBITDA (x)



Source: Bloomberg, Kotak Institutional Equities estimates

Financials

Summary financials

Profit model, balance sheet, cash model for MHS, March fiscal year-ends, 2006-11E (Rs mn)

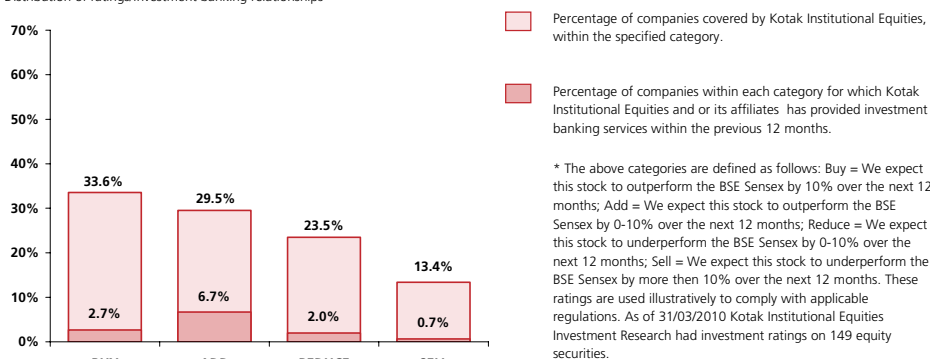
	2007	2008	2009	2010E	2011E	2012E
Profit model						
Net revenues	13,900	15,122	20,641	16,112	18,566	21,740
EBITDA	3,416	3,121	3,677	4,203	4,626	5,319
Other income	314	292	335	321	301	351
Interest (expense)/income	(35)	(38)	(116)	(33)	(15)	(15)
Depreciation	(163)	(174)	(179)	(190)	(256)	(338)
Adjusted pretax profits	3,532	3,202	3,718	4,301	4,656	5,317
Tax	(1,166)	(1,059)	(1,244)	(1,466)	(1,579)	(1,802)
Deferred taxation	(23)	(8)	(8)	1	—	—
Adjusted consolidated net income	2,344	2,135	2,466	2,836	3,078	3,514
Diluted Earnings per share (Rs)	38.4	29.4	35.9	40.2	43.6	49.8
Balance sheet						
Total equity	9,241	10,934	13,100	15,511	18,035	20,846
Deferred taxation liability	411	420	427	427	427	427
Total borrowings	1,082	1,022	824	824	824	824
Current liabilities	797	1,924	1,786	1,531	1,649	1,808
Total liabilities and equity	11,531	14,300	16,137	18,292	20,934	23,905
Cash	3,232	2,549	1,106	2,595	3,548	5,470
Other current assets	4,903	7,483	6,926	5,782	6,975	8,062
Total fixed assets	2,858	3,375	3,906	5,717	6,211	6,173
Investments	538	894	4,199	4,199	4,199	4,199
Total assets	11,531	14,300	16,137	18,292	20,933	23,904
Free cash flow						
Operating cash flow, excl working capital	2,374	1,893	2,582	2,705	3,032	3,501
Working capital changes	(859)	(1,732)	364	889	(1,076)	(928)
Capital expenditure	(213)	(691)	(711)	(2,000)	(750)	(300)
Investments	(325)	(342)	(3,217)	—	—	—
Other income	249	231	151	321	301	351
Free cash flow	1,226	(640)	(830)	1,914	1,507	2,625
Ratios (%)						
EBITDA margin (%)	24.6	20.6	17.8	26.1	24.9	24.5
Debt/equity	11.7	9.3	6.3	5.3	4.6	4.0
Net debt/equity	(23.3)	(14.0)	(2.2)	(11.4)	(15.1)	(22.3)
RoAE	33.0	19.7	20.3	19.3	17.9	17.7
RoACE	23.4	18.1	19.5	18.4	17.1	17.0

Source: Company, Kotak Institutional Equities estimates

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Source: Kotak Institutional Equities

As of March 31, 2010

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