

HDFC Scrip Code	Industry	CMP	Recommended Action	Averaging Band	Sequential Targets	Time Horizon
AIAENGEQNR	Metallurgy	Rs 710.6	Buy at CMP and add on dips	Rs 585 – Rs 629	Rs 802 & Rs 889	2-3 quarters

In our Stock Note on AIA dated 9th December 2014 we had recommended investors to buy the stock at CMP (Rs.439.65) and add on dips to Rs 389-Rs 407 (11-11.5x FY15E EPS) for a target price of Rs 496 (14x FY15E EPS) in the next 2-3 qtrs. It achieved our target on 15th January 2014. Post its Q4FY14 results we present an update on the stock.

Company Background

AIA is the second largest high chrome casting producer in the world. It manufactures grinding media, liners, diaphragms which are collectively known as mill internals. These are used in crushing and grinding operations in cement, power, utility and mining industries.

Blockbuster performance in Q4FY14, Net Profit up 87.6% on higher volumes, improved realizations and higher margins

At a consolidated level, in Q4FY14 Net Sales of the company was up 29.7% y-o-y and 11.5% q-o-q to Rs 565.7 cr driven by higher volumes and improved realizations. Tonnage sale for FY14 is 177000 (48800 tonnes for Q4FY14) with cement sector accounting for 68000 tonnes and mining sector 96000 tonnes. For current fiscal the company's volume growth is driven largely by mining sector. Management expects a volume sale of 200000-210000 tonnes in FY15. Unit realization for Q4FY14 and FY14 stood at Rs 115/kg and Rs 110/kg respectively compared to Rs 105/ kg and Rs 104/kg in respective corresponding previous period.

Operating margins have gone up from 20.1% in Q4FY13 to 28.7% in Q4FY14. This is amongst the highest margins which the company has recorded in past many quarters. The robust margin in Q4FY14 is on account of gradual conversion of entry level pricing to more sustainable level especially in mining. More over the power cost is also lower as the company increasingly sourced from power exchange through power traders. There was no major forex gain or loss in Q4FY14 compared to Rs 15 cr of forex loss in corresponding previous period. Employee costs have come down from 5.1% in Q4FY13 and 5.7% in Q3FY14 as a percentage cost to sales to 2.8% in Q4FY14. Other expenses too have come down from nearly 40% of net sales in previous quarters to 28.3% in Q4FY14. In FY14, the company has done a production of about 178000 tonnes out of effective capacity of 200000 tonnes. Of the revenue for FY14 about 75% of the revenue came from overseas and balance is accounted by domestic.

Company reported other income of Rs 11.9 cr in Q4FY14 compared to Rs 5.7 cr in corresponding quarter last and Rs 12.8 cr in Q3FY14. EBITDA margins have improved 900 bps from 21.1% to 30.1% y-o-y. Interest costs have remained nominal at Rs 2.4 cr compared to Rs 1.6 cr in Q4FY14 and Rs 0.5 cr in Q3FY14. Depreciation costs have gone up 23.1% y-o-y and 16.3% q-o-q to Rs 10.8 cr post capex undertaken. PBT was up 87.8% y-o-y and 32.9% q-o-q to Rs 163.9 cr. Tax rate at 26.9% remained at the same level as on Q4FY13. Net profit of the company has jumped 87.6% y-o-y and 80.5% q-o-q to Rs 119.6 cr.

Expansion plans on track

To cater to the increasing demand, AIA has undertaken an aggressive capex plan doubling its capacity from 200,000TPA to 440,000TPA by FY16 in three phases. With this expansion plans, AIA will become world's largest HCMI producer. Phase one of brownfield expansion of 60,000TPA is already completed and commenced production for which the company incurred Rs 120 cr in FY14. The Greenfield expansion of 180,000 tonnes will commence in two phases one by March'15 and other by Oct'15. It should be completed and go on stream by Dec 2015. The cost of green field project will be about Rs 600 cr and of which about Rs 350-400 cr will be spent in FY15. Majority of these capex would be funded via internal accruals and a small part will be funded via debt.

Magotteaux litigation settled

Security Deposit of US\$ 7228544.64 was placed in the District Court of Nashville, Tennessee USA for the execution of judgement awarded in Patent Matter. During the year out of the above, Company has paid US\$60.0 Lacs to Magotteaux International (MI), Belgium towards the Settlement of US Patent case as per the Settlement agreement entered by the Company with the MI and the balance has been received by the Company. AIA had accounted for Rs 31.1cr as exceptional expenses in Q3FY14.

Concerns:

Delay in capacity expansion: AIA is currently undergoing a massive capacity expansion plan to increase its capacity by 120% current capacity. It will be done in three phases. Any delay in commencement of any of these phases or any cost overrun in putting up these capacities may impact its revenue and profit growth.

Volatility in currency poses at the biggest risk: 75% of revenue is from exports, which is subject to risks associated with fluctuations in currency. With increasing penetration in the global mining industry, we expect the proportion of exports to increase further. Though the company actively addresses this issue by regular hedging, forex fluctuations pose as the biggest risks to the company's financial performance.

Fluctuation in raw material prices: Steel scrap constitutes ~75% of raw material cost and the rest is by ferro chrome. Generally the company is able to pass on any RM cost increases to its customers; however any delay or inability to pass on any future increase in RM prices may impact the margins.

Delay in converting mining clients: HCMI constitutes only 15-20% of total mill internal demand in mining Industry. HCMI is gaining market share by rapidly replacing the traditional forged media. However any delay or slowdown in gaining market share may impact the growth estimates and in turn impact our earnings estimates.

Change of technology: Vertical mill compared to traditional horizontal mill poses as a threat due to its advantages related to lower power consumption, a lower wear-and-tear rate of grinding media, and smaller space requirements. However, the current penetration of vertical mill is negligible and it will take time to gain substantial market share. AIA is also present in the vertical mill manufacturing. Therefore, it can cater to demand for vertical mill internals.

Outlook & Valuation

At global level, AIA is the 2nd largest player in its segment after its Belgian rival Magotteaux. However, capacity expansion would make AIA much ahead of its competitors. AIA has significant global presence in around 90 countries under its wholly owned sub-sidiary 'VEGA' and over 75% of its revenue comes from overseas market. Globally, only few players are operating high chromium grinding technology and in that space, AIA and Magotteaux together account for over 80% of the market share, while rest of the share is controlled by Chinese players. With the improvement in macroeconomic conditions across the globe and rising investments in core areas, AIA could be amongst the first to take advantage of the turnaround. Lower per unit realization than Mogatteaux on the back of cost advantage and economies of scale are two strengths that help AIAE.

AIA managed to report positive y-o-y growth in past several quarters and that it achieved in a sluggish environment, where cement, mining and thermal power companies are witnessing underutilization of installed capacities is noteworthy. In FY14 it reported average y-o-y growth of ~20%. AIA has a strong net debt-free balance sheet, with net cash and equivalents of Rs 659 cr in FY14. The strong cash flows help AIA to continuously fund its capex from internal accruals. The company has been on the conservative side of dividend payouts at below 20% ploughing back profits for its expansion program.

Company is currently operating at OPM and net margin of 28.7% and 20.3% respectively (Q4FY14). Management believes 22-23% operating margins are sustainable. Profitability has improved in past few quarters due to significant control over operating expenses. Low debt burden and strong cash flows has provided moderate flexibility to the company for expansion. Improvement in margins aided key metrics. Cash & Investments constitutes 34% of total assets.

We have revised our FY15 estimates upwards to reflect growth post further expansion and opportunities in the mining sector. Revival in local mining and cement sector once manufacturing goes back on track would also one of the drivers for revenue growth. At the current market price, the stock trades at ~16x FY15(E) EPS of Rs.43.4. Historically, the stock has traded in the range of 23-19x its PE. The current valuation looks quite attractive given strong revenue and earnings growth, debt free balance sheet, robust cash flows and market leadership. The key thing to track will be mining volumes and corresponding margins. As visibility on this business line improves, the stock has the potential to trade at higher multiples. Mining volumes have already showing initial signs of pick up over last few quarters. With huge conversion opportunity in the mining segment and AIA's success in penetrating the mining segment, we expect AIA to post better top-line in the coming years.

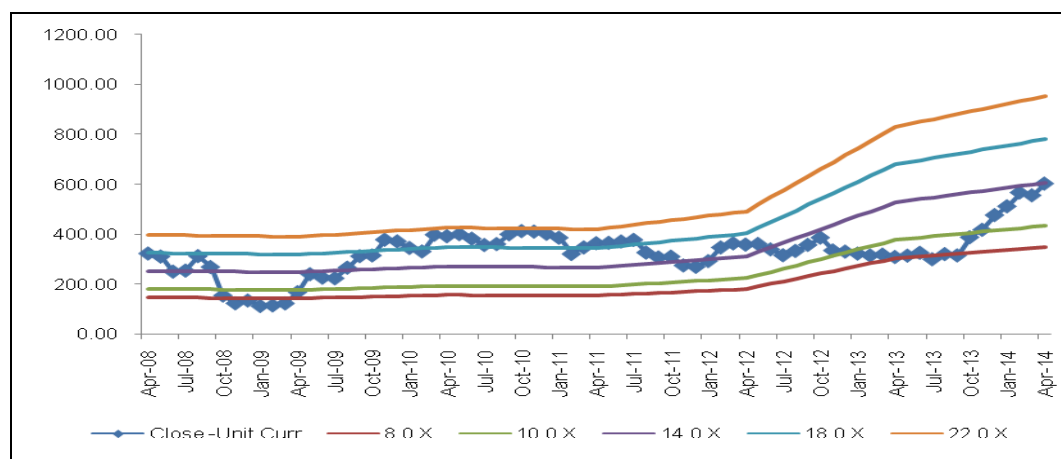
Based on better margin led by product mix improvement within mining, higher realization, expansion in capacity and mining sector opportunities, we feel investors could look to buy the stock at CMP and add on dips to Rs 585 -629 (13.5x-14.5x FY15E EPS) for sequential targets of Rs 802 & Rs 889 (18.5x & 20.5 FY15E EPS) in the next 2-3 quarters.

Particulars (Consolidated)	FY10	FY11	FY12	FY13	FY14 E	FY14 A	FY15 E	FY15 RE
Total Operating Income	966.8	1160.7	1416.7	1751.3	2014.5	2080.1	2412.0	2453.2
Operating Profit	246.0	249.2	273.3	310.2	454.5	502.1	538.8	582.1
OPM%	25.4%	21.5%	19.3%	17.7%	22.6%	24.1%	22.3%	23.7%
Other Income	15.2	24.7	13.3	21.3	21.3	33.4	21.3	33.4
Reported PAT	170.7	183.4	180.5	210.8	285.5	325.0	333.7	409.6
Adjusted PAT	170.7	183.4	180.5	210.8	285.5	356.1	333.7	409.6
PATM%	17.4%	15.5%	12.6%	11.9%	14.0%	16.8%	13.7%	16.5%
EPS	18.1	19.4	19.1	22.4	30.3	37.8	35.4	43.4
PE (x)	39.3	36.6	37.2	31.8	23.4	18.8	20.0	16.4

OE : Original Estimates; RE : Revised Estimates

Source: Company, HDFC sec Estimates

Forward PE Chart



Financials -Consolidated:

Particulars (Rs cr)	Q4FY14	Q4FY13	% chg	Q3FY14	% chg	FY14	FY13	% chg
Net Sales	565.71	436.1	29.7%	507.38	11.5%	2016.8	1688.2	19.5%
Other Op income	10.94	21.37	-48.8%	18.85	-42.0%	63.31	63.08	0.4%
Total Operating Income	576.7	457.5	26.1%	526.2	9.6%	2080.1	1751.3	18.8%
Total Expenditure	411.4	365.5	12.6%	406.0	1.3%	1577.9	1441.1	9.5%
Chg in Stock	38.68	-4.77	-910.9%	-21.46	-280.2%	69.59	-31.63	-320.0%
Raw material	196.86	170.97	15.1%	191.23	2.9%	726.81	685.93	6.0%
Employees cost	15.67	22.26	-29.6%	28.88	-45.7%	88.84	80.89	9.8%
Other expenditure	160.2	177.1	-9.5%	207.3	-22.7%	692.7	705.9	-1.9%
Operating Profit	165.2	92.0	79.7%	120.3	37.4%	502.1	310.2	61.9%
Other income	11.9	5.7	109.3%	12.8	-7.0%	33.4	21.3	56.7%
EBIDTA	177.1	97.7	81.4%	133.1	33.1%	535.6	331.6	61.5%
Interest	2.4	1.6	51.9%	0.5	433.3%	6.4	5.5	15.6%
PBDT	174.7	96.1	81.9%	132.6	31.8%	529.2	326.1	62.3%
Depreciation	10.8	8.8	23.1%	9.3	16.3%	38.1	34.5	10.6%
PBT	163.9	87.3	87.8%	123.3	32.9%	491.1	291.6	68.4%
Tax	44.1	23.5	88.2%	25.8	71.0%	134.2	80.0	67.9%
Minority Interest	0.2	0.1	150.0%	0.2	25.0%	0.8	0.8	-6.3%
Reported PAT	119.6	63.8	87.6%	66.2	80.5%	325.0	210.8	68.9%
Extraordinary items	0.0	0.0	NC	31.1	NC	-31.1	0.0	NC
Adjusted PAT	119.6	63.8	87.6%	97.4	22.8%	356.1	210.8	68.9%
EPS	12.7	6.8	87.6%	7.0	80.5%	37.8	22.4	68.9%
Equity	18.9	18.9		18.9	0.0%	18.9	18.9	
Face Value	2	2		2	0.0%	2	2	
OPM %	28.7%	20.1%		22.9%		24.1%	17.7%	
EBIDTA %	30.1%	21.1%		24.7%		25.3%	18.7%	
NPM %	20.3%	13.8%		12.3%		15.4%	11.9%	
Tax %	26.9%	26.9%		20.9%		27.3%	27.4%	

(Source: Company, HDFC sec)

Profit & Loss (Rs in cr)	FY11	FY12	FY13	FY14 (A)	FY15 (E)
Sales	1136.2	1352.5	1688.2	2016.8	2383.5
Other Operating Income	24.42	64.14	63.1	63.3	69.6
Total Operating Income	1160.7	1416.7	1751.3	2080.1	2453.2
Input Cost	377.0	542.4	654.3	796.4	929.6
Purchases	109.0	0	0	0	0
Staff Cost	52.3	64.9	81	89	107
Other Expenses	373.3	536.1	705.9	692.7	834.2
Operating profit	249.2	273.3	310.2	502.1	582.1

Other Income	24.7	13.3	21.3	33.4	33.4
EBIDTA(inc other income)	273.9	286.6	331.6	535.6	615.5
PBDIT	273.9	286.6	331.6	535.6	615.5
Depreciation	25.4	29.4	34.5	38.1	54.5
PBIT	248.5	257.1	297.1	497.4	561.0
Interest	2.0	4.4	5.5	6.4	6.4
Exceptional Items	0.0	0.0	0.0	-31.1	0.0
PBT & Extraordinary	246.5	252.7	291.6	459.9	554.6
Current Tax	60.5	69.6	78.8	132.6	144.2
Deferred Tax	2.5	1.9	1.2	1.7	0.0
Minority Int	0.2	0.8	0.8	0.8	0.8
Reported Net Profits	183.4	180.5	210.8	325.0	409.6
Adjusted Net Profit	183.4	180.5	210.8	356.1	409.6
Cash Profits	211	212	246	396	464
Dividend per share (Rs.)	3	3	4	6	8
EPS (Rs.)	19.4	19.1	22.4	37.8	43.4
CEPS (Rs.)	22	22	26	42	49
Operating Margin	21.5%	19.3%	17.7%	24.1%	23.7%
PATM	15.5%	12.6%	11.9%	16.8%	16.5%
EBIDTA(%)	23.1%	20.0%	18.7%	25.3%	24.8%

Balance Sheet	FY11	FY12	FY13	FY14	FY15E
Share Capital	18.9	18.9	18.9	18.9	18.9
Reserves & Surplus	1033.3	1216.7	1398.9	1720.0	2041.4
Shareholder' Funds	1052.1	1235.5	1417.8	1738.8	2060.2
Minority Interest	6.5	4.4	8.08	7.81	9.7
Long term borrowings	8.2	7.1	106.3	86.7	70.0
Deferred tax liabilities	15.2	15.8	13.2	20.0	22.0
Long term provisions	3.0	4.3	5.9	6.5	6.5
Non current liabilities	26.4	27.2	125.4	113.1	98.5
Short term borrowings	10.6	38.6	52.4	3.3	3.3
Trade payables	130.2	98.6	112.6	132.9	146.2
Other current liabilities	22.6	35.6	53.2	116.1	133.5
Short term provisions	44.4	50.3	75.0	120.9	126.9
Current liabilities	207.7	223.2	293.3	373.1	409.9
Total	1292.7	1490.2	1844.7	2232.9	2578.2
Assets					
Fixed assets	297.5	360.0	394.5	467.4	665.0

Goodwill on consolidation	0.0	14.1	14.3	21.0	31.0
Non current investments	0.0	0.0	7.4	0	0
Long term loans and advances	9.3	18.0	16.5	21.2	23.3
Other non current assets	4.9	6.2	3.73	0.98	0.98
Non current assets	311.7	398.3	436.3	510.6	720.3
Current investments	150.1	140.3	186.7	529.1	529.1
Inventories	236.7	301.1	403.0	350.8	417.4
Trade receivables	354.4	371.7	340.1	431.5	474.6
Cash	152.7	149.6	279.1	219.8	235.4
Short term loans & advances	87.1	125.8	198.6	190.9	200.4
Other current assets	0.1	3.4	0.81	0.32	1
Current assets	981.0	1091.9	1408.3	1722.3	1858.0
Total Assets	1292.7	1490.3	1844.7	2232.9	2578.2

Particulars	FY11	FY12	FY13	FY14	FY15 (E)
Capital Employed	1086.2	1297.0	1589.8	1848.8	2155.4
Net Worth	1052.1	1235.5	1417.8	1738.8	2060.2
RoCE	26.9%	21.6%	20.6%	28.9%	28.0%
RoNW	20.4%	15.8%	15.9%	22.6%	21.6%
Book Value (Rs.)	112	131	150	184	218
Debt/Equity Ratio	0.02	0.04	0.11	0.05	0.04
Dividend Payout	15%	16%	18%	16%	18%

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