

October 25, 2012

Precision Castparts (PCP-NYSE-US\$167.18)

Earnings In Line Despite Press Outages; Staying Neutral on Valuation

RATING: Neutral **SECTOR:** Metals
TARGET PRICE: US\$170 **SECTOR RECOMMENDATION:** Market-weight
BASIS OF TARGET: P/E of 15x on our FY'14 EPS estimate of \$11.44.

Maintaining Neutral Rating. We are maintaining our Neutral rating on PCP, due solely to valuation, after the company reported FQ2 EPS (cont ops) of \$2.28 that was essentially in line with our estimate of \$2.27 and slightly below consensus of \$2.35. The company reported \$2.35 in FQ1 and \$2.03 a year ago. Sales were \$1.93b, down 2% sequentially and up 8% from a year ago, though slightly below our estimate of \$2.00b and consensus of \$2.02b. Operating margins were 25.8% overall and above our estimate of 25.2%. Margins were 26.4% a year ago and 26.2% in FQ1.

Segment Summary. Sales in the **Investment Cast Products** segment were \$612MM, below our estimate of \$634MM. (See Variance Table on pg 2.) Growth from a year ago was led by a 17% increase in IGT spares. Operating margins of 34.1% were above our estimate of 32.5%. Operating income of \$209MM was therefore in line with our estimate of \$206MM. The **Forged Products** segment recorded sales of \$761MM, well below our estimate of \$858MM. Operating margins of 20.4% were a bit below our estimate of 20.8%. Lower revenue both sequentially and y/y was due to the planned outage of the 29kt and 50kt presses (previously disclosed). Inefficiencies related to the restart of the presses appear to be the culprit for the revenue miss to our estimates. Sales at the newly renamed **Airframe Products** (formerly Fastener Products) grew 13% sequentially and 34% y/y to \$557MM, beating our estimate of \$515MM. Margins of 29.9% were ahead of our estimate due to strong organic aerospace sales growth and benefits from the acquisitions of Primus and Centra.

Outlook. Management stated that the two end markets with the best performance in the quarter were aerospace and IGT aftermarket sales. It also continues to focus to taking out costs and it shows, particularly in Investment Cast and Airframe Products. The press outages in Forged Products are now complete and should allow for better absorption and performance going forward. On the call the CEO said that missed shipment in the Forged Products segment will not be made up until FQ1'14 as some of the press delays carried over into October. The M&A pipeline is "extremely full" and recent acquisitions in aero-structures have opened new acquisition opportunities.

Tweaking Estimates. We are tweaking our EPS estimates lower near-term based on operational inefficiencies due to the forge outages and Investment Cast sales that missed our estimate. However, we raised our estimates beginning in FY'14 due to a recovery of delayed sales and margin improvement in most segments. Our estimate for the December quarter (FQ3) goes to \$2.46 (from \$2.49) and our FY'13 estimate falls to \$9.73 (from \$9.76). Our FY'14 estimate goes higher to \$11.44 (from \$11.32). PCP should continue to see strong growth in aerospace and oil & gas, as well as benefits from recent acquisitions.

Valuation & Recommendation. We are maintaining our Neutral rating and price target of \$170 given the FQ2 results and modest decrease in our estimates. Our target is based on a P/E multiple of 15x on our FY'14 estimate of \$11.44.

RISK PROFILE: Above Average

RISK CONSIDERATIONS: Outlook for aerospace, industrial gas turbines, and general economy. Ability to maintain market share gains.

Disclosure Code: None

Important disclosures and analyst certifications are in the Disclosure Section.

Valuation Data

FYE Mar	2012A	2013E	2014E
Projected P/E:	19.5x	17.2x	14.6x

Projected

EPS:	Q1	Q2	Q3	Q4	Total
	\$1.97	\$2.03	\$2.12	\$2.31	\$8.43
	\$2.35A	\$2.28A	\$2.46	\$2.64	\$9.73
	\$2.65	\$2.75	\$2.89	\$3.15	\$11.44

Basis of Estimate: Operations Excluding Non-Recurring items

Trading & Operating Data

52-Wk Range:	\$150.53-\$179.47
Dividend Indicated FY1:	\$0.12
Dividend Yield Indicated:	0.1%
Volume 60-Day Avg (Th):	633.59
Avg. Shares O/S- LQ:	146.4
Market Value (\$M):	\$23,504.2
Institutional - % Held:	93.00%
LT Debt /Capital LQtr %:	3.0%
Book Value PS LQtr:	\$61.98
Price/BV:	2.7x
Ret on Equity T4Q:	15.5%
(source: Baseline)	

Company Profile

Precision Castparts Corp. is a worldwide, diversified manufacturer of complex metal components and products mostly for the aerospace, power generation, and general industrial markets. PCC is the market leader in manufacturing large, complex structural investment castings, airfoil castings, and forged components used in jet aircraft engines and industrial gas turbines. PCC also produces critical fasteners for aerospace and other markets.