

# AIA ENGINEERING

## Volume drags; strong visibility ahead

India Equity Research | Miscellaneous

AIA Engineering's (AIA) Q3FY18 revenue fell 3% to INR5.7bn (6% below estimates) led by 9% decline in volume (mining volume fell by 10% YoY), while realisation per MT grew 7% YoY on better product mix. Gross margin declined 297bps YoY to 64.0% due to volatility in currency and raw materials. However, it improved 250bps QoQ led by 9% QoQ increase in realisation. EBITDA, at INR1.13bn, slipped 27% (6% below estimates) and EBITDA margin fell 712bps YoY (up 207bps QoQ) to 22.2%. The company reiterated its strategy of customer acquisition through penetrative pricing. While volume guidance for FY18 stands at 220-225k MT (230k MT earlier), management expects incremental 40-50k MT yearly FY19 onwards, led by execution of Barrick Gold order and strong visibility. **Thereby, we expect strong 18% volume CAGR over FY18-20 (70% utilisation in FY20E).** We believe margin recovery will follow (historically seen) with customer stickiness, pricing power and operating leverage, leading to earnings CAGR of 24% over FY18-20E. Maintain 'BUY' with TP of INR1,788 (INR1,588 earlier) at 28.0x as we roll to FY20E EPS.

### Volume slows down; margin pressure

Sales fell 3% YoY led by 9% YoY decline in volume to 51,392 MT as mining volume dropped by 10% YoY, while realisation grew 7%YoY. EBITDA margin fell by 712bps YoY to 22.2% due to higher raw material and power costs and company's conscious strategy of gaining market share through penetrative pricing.

### Key growth drivers over next 12-24 months

Management lowered their FY18 volume guidance marginally to 220-225,000MT from 230,000MT, though they has guided for incremental 40-50k MT/year from FY19, leading to healthy 18% volume CAGR over FY18-20E. This would be led by: i) execution of the Barrick Gold order; and ii) positive response from trials leading to strong visibility. Firming up of commodity prices is an additional driver. With customer stickiness and pricing power, we expect EBIDTA CAGR of 28% over FY18-20.

### Outlook and valuations: Bright; maintain 'BUY'

Led by improving volume visibility in long term contracts, low penetration (10-12%) and strong opportunity in global gold and copper mining and with margin recovery to follow, we maintain 'BUY' with TP of INR1,788 as we rollover to FY20E EPS.

#### Financials

(INR mn)

Year to March	Q3FY18	Q3FY17	% change	Q2FY18	% change	FY17	FY18E	FY19E
Net rev.	5,722	5,901	(3.0)	5,591	2.3	22,460	23,477	28,709
EBITDA	1,269	1,728	(26.6)	1,124	12.9	6,346	5,204	6,889
Adj. profit	1,162	1,203	(3.5)	865	34.3	4,402	3,909	5,023
Adj. Dil EPS (INR)	12.3	12.8		9.2		46.7	41.4	53.3
Diluted P/E (x)						30.7	34.6	26.9
EV/EBITDA (x)						19.6	23.4	17.6
ROAE (%)						17.4	13.7	15.7

#### EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

#### MARKET DATA (R: AIAE.BO, B: AIAE IN)

CMP	: INR 1,434
Target Price	: INR 1,788
52-week range (INR)	: 1,710 / 1,273
Share in issue (mn)	: 94.3
M cap (INR bn/USD mn)	: 135 / 2,105
Avg. Daily Vol. BSE/NSE ('000)	: 61.0

#### SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	61.7	61.7	61.7
MF's, FI's & BKs	7.4	7.4	6.6
FII's	26.0	26.0	26.5
Others	5.0	5.0	5.3
* Promoters pledged shares (% of share in issue)	:		NIL

#### PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(9.9)	(10.3)	(0.4)
3 months	(3.0)	3.6	6.7
12 months	21.2	3.5	(17.7)

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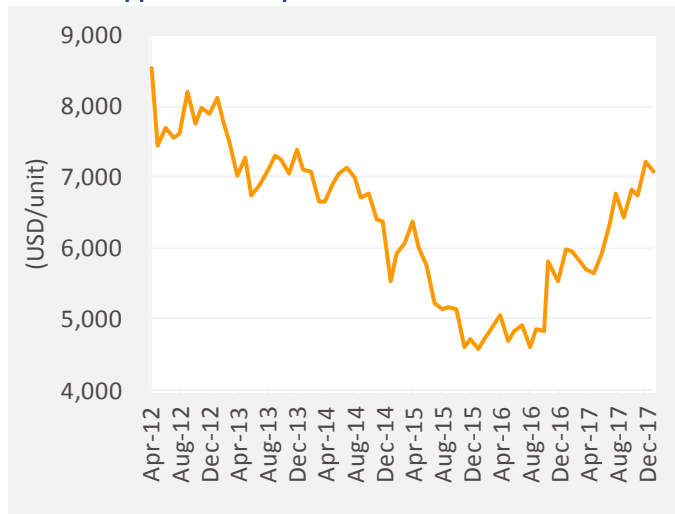
### Q3FY18 conference call: Key highlights

- **Revenue and volume growth:** Revenue fell 3% YoY to INR5.7bn, 6% below estimates, on strong 19.7% YoY growth in Q3FY17. Sales growth in 9mFY18 was 6% YoY. Revenue decline was due to 9% YoY dip in volume from 56,646MT in Q3FY17 to 51,392MT in Q3FY18. For 9mFY18, volume growth was marginal at 3% over 9mFY17 to 1,61,645MT.
  - **Segmental volumes:** While for the current quarter, mining volume fell by 10% YoY to 32,346 MT, it grew by 4% to 100446MT for 9mFY18. Other segments' (cement and utility) volumes declined by 8% YoY but for 9mMFY18 increased by 3%
  - **Volume guidance:** Management has guided for volume of 220,000-225,000MT in FY18 (down from earlier guidance of 50.000 MT). It is confident of incremental volume of 40,000-50,000MT per year as 18,000MT per year order with Barrick Gold gets executed. Further, management expects volume growth to pick up in Q2/Q3 of FY19 and consequent orders from trials that are being done currently. Firming up of commodity prices is an additional driver as financials of its customers become healthy. Replacement in ball mills is doing better than expected.
- **Margins:** Gross margins dropped by 297bps YoY to 64.0%. EBITDA, at INR1.13bn, was down 27% (6% below estimates). EBITDA margin fell sharply by 712bps YoY to 22.2%, on account of gross margin contraction and increase in other expense (driven by higher fuel cost) as a percentage of revenue (37% in Q3FY18 vs. 33% in Q3FY17). For 9mFY18, EBITDA margin contracted by 799bps to 21.7%, leading to EBITDA decline of 22%
- Gross margin contraction YoY was on account of unfavourable raw material prices and currency movement. Steel scrap prices spurred on increasing steel prices. However, increase in raw materials cost will get passed on with a lag of three-four months. Further, gross margin improved by 250bps QoQ, despite key raw material ferrochrome prices increasing 7-8% QoQ led by 9% QoQ improvement in realisation with improved product mix and passing on of raw material prices through price hikes.
- Overall, PAT of INR1.2bn was down 3% YoY because of writing back of excess tax provided in earlier periods. Effective tax rate was lower at 17%.
- **Realisation per MT** increased by 7% to INR108,264 because of better product mix. However, the company reiterated its strategy of focusing on volumes and gaining market share by penetrative pricing. It expects margins to improve over time as volume increases. Management has guided for realisation of INR100,000-105,000 per MT going forward.
- Current order book stands at INR7.2bn (as on January 1, 2018).
- **Capex plans:** Additional capacity of 60K MT will come on stream by June'18. Delayed due to delays in delivery from the vendor. Another 40K MT capacity will come on stream by June'19. Of the INR500cr (convert to mn/bn), company has already spent INR80cr during 9mFY18 and expects to spend another INR50cr in Q4FY18. Capex for FY19 will be INR200cr and the rest in FY20. The company is focused on growing organically and any change in dividend payout will be only after achieving sales of 300,000MT.
- **Anti-dumping duty in Brazil:** In December 2017, Brazil had initiated an anti-dumping investigation on exports of certain grades of grinding media imported into Brazil from India. They have imposed an interim duty that accounts to USD359.16/Mt which is to be paid by the importer. Currently, investigation is going on and the Brazilian government is likely to decide on it by April'18. The company has not experienced any slowdown in volumes from Brazil and does not expect to face any volume pressures from Brazil even going forward.

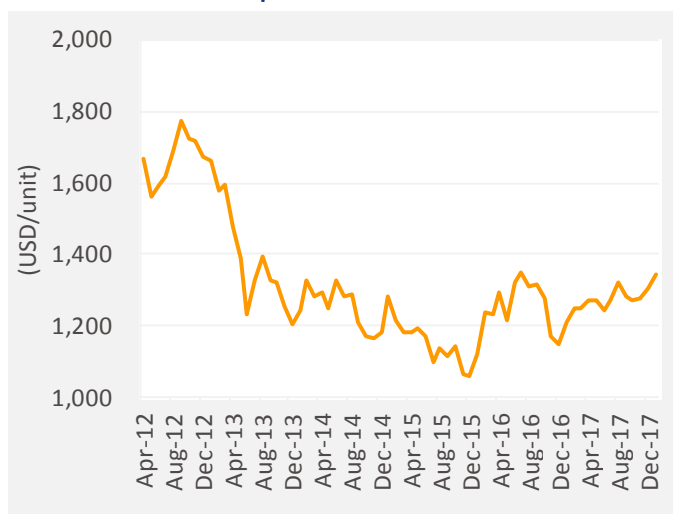
### Improving industry scenario

With improving prices of metals in the recent past, AIA has been targeting metal groups of gold and copper. It is also looking at improvement in traditional iron ore and platinum, leading to stability for miners and acceleration of conversion process from traditional to ferro chrome grinding media, in turn leading to improved growth outlook for AIA.

**Chart 1: Copper - Prices up 36% YoY**

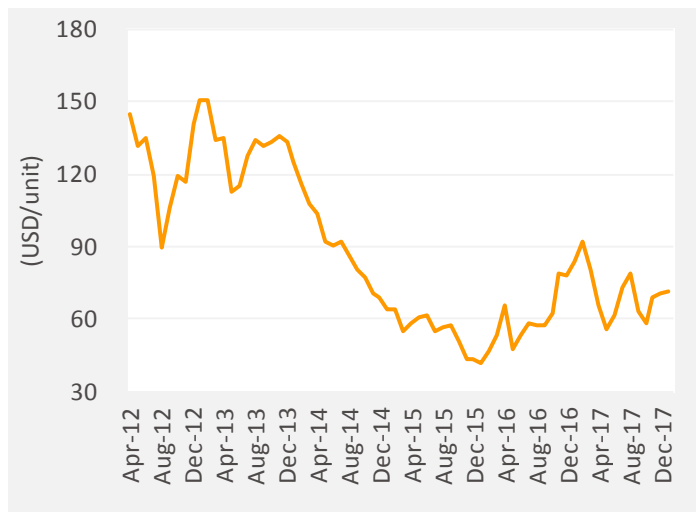


**Chart 2: Gold - Picked up from lows of FY16**

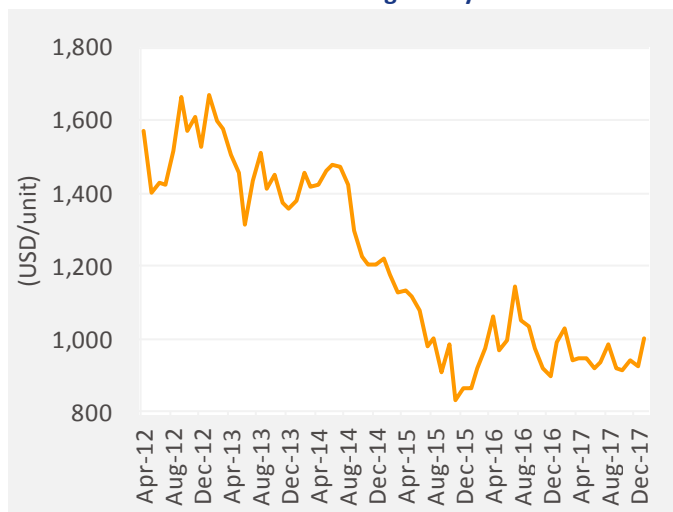


Source: Bloomberg, Edelweiss research

**Chart 3: Iron ore - Prices fallen 10% YoY**



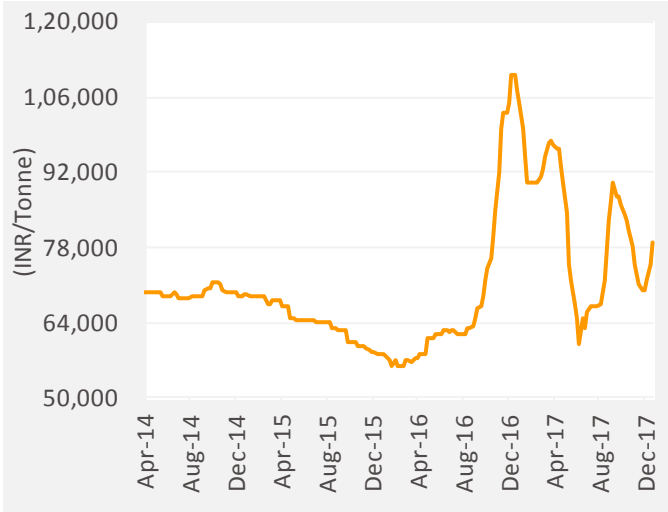
**Chart 4: Platinum - Prices stabilising after years of decline**



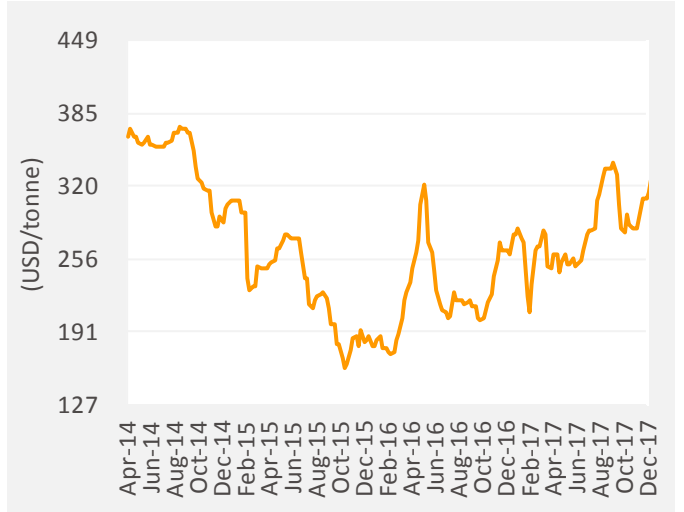
Source: Bloomberg, Edelweiss research

**Volatile raw material prices**

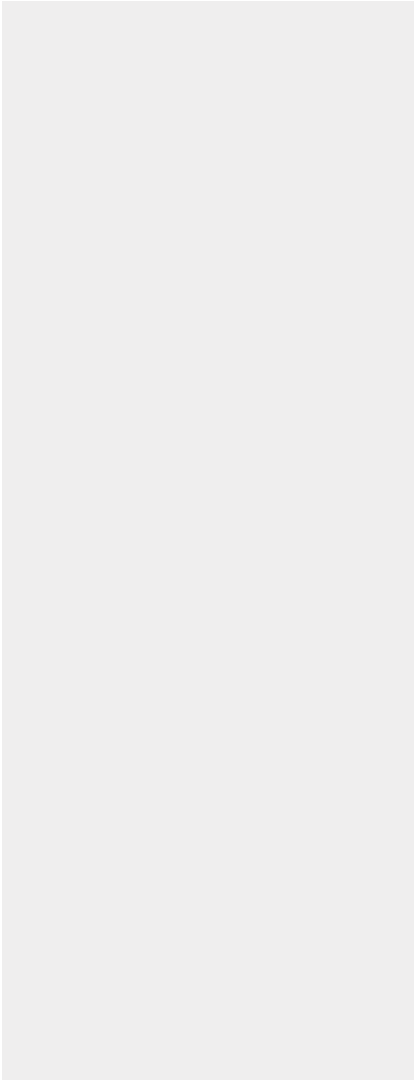
**Chart 5: Ferro chrome – down 18% YoY but up 2% QoQ**



**Chart 6: Scrap steel - Picked up from lows of FY16**



Source: Bloomberg, Edelweiss research



## Financial snapshot

(INR mn)

Year to March	Q3FY18	Q3FY17	% change	Q2FY18	% change	YTD18	FY18E	FY19E
Net revenues	5,722	5,901	(3.0)	5,591	2.3	17,013	23,477	28,709
Raw material	2,061	1,950	5.7	2,154	(4.3)	6,509	8,877	10,815
Employee expenses	288	271	6.3	285	1.2	847	1,136	1,205
Other expenses	2,104	1,951	7.8	2,028	3.7	5,966	8,259	9,801
Total expenditure	4,453	4,172	6.7	4,467	(0.3)	13,322	18,273	21,820
EBITDA	1,269	1,728	(26.6)	1,124	12.9	3,691	5,204	6,889
Depreciation	179	170	5.2	160	12.1	516	759	857
EBIT	1,090	1,558	(30.1)	964	13.0	3,175	4,444	6,032
Other income	321	223	44.1	217	48.1	723	921	1,212
Interest	11	9	27.0	16	(31.1)	41	41	41
Add: Prior period items								
Add: Exceptional items								
Profit before tax	1,400	1,773	(21.0)	1,166	20.1	3,858	5,325	7,203
Provision for taxes	235	568	(58.6)	299	(21.5)	939	1,411	2,175
Minority interest	4	2	138.7	1	164.9	7	4	4
Associate profit share								
Reported net profit	1,162	1,203	(3.5)	865	34.3	2,912	3,909	5,023
Adjusted Profit	1,162	1,203	(3.5)	865	34.3	2,912	3,909	5,023
Diluted shares (mn)	94	94		94		94	94	94
Adjusted Diluted EPS	12.3	12.8	(3.5)	9.2	34.3	30.9	41.4	53.3
Diluted P/E (x)	-	-		-		-	34.6	26.9
EV/EBITDA (x)	-	-		-		-	23.4	17.6
ROAE (%)	-	-		-		-	13.7	15.7
<b>As % of net revenues</b>	-	-		-		-	-	1
Raw material	36.0	33.1		38.5		38.3	37.8	37.7
Employee cost	5.0	4.6		5.1		5.0	4.8	4.2
Other expenditure	36.8	33.1		36.3		35.1	35.2	34.1
EBITDA	22.2	29.3		20.1		21.7	22.2	24.0
Reported net profit	20.3	20.4		15.5		17.1	16.7	17.5
Tax rate	16.8	32.0		25.7		24.3	26.5	30.2

### Company Description

AIA, an ISO 9000 certified company, is a niche player in the value-added, impact abrasion, and corrosion resistant high chrome metallurgy segment with current capacity of 200,000 mtpa. It manufactures products like grinding media, liners, diaphragms, and vertical mill parts (collectively referred to as mill internals) in high chrome metallurgy. These products find application in crushing and grinding operations in cement, thermal power and mining plants, where they are used to crush/grind clinker, coal and mineral ore, respectively. High chrome metallurgy offers lower wear rate than the conventionally used parts of manganese steel, ni-hard iron, hyper steel, and forgings. The company offers complete solutions in grinding to optimise the productivity of grinding mills.

### Investment Theme

We like AIA's business model as the lion's share of mill internals' demand arises from the mining industry, followed by cement. The annual global replacement demand for these two sectors is estimated at ~2.5 mn MT, with demand from the mining sector at ~1.5-2 mn MT. However, 90-95% of the mining demand is currently being serviced by conventional and forged mill internals. With the industry moving from cost of parts to total cost of ownership, there is a huge opportunity for AIA to convert users to high chrome mill internals. Also, while ferro chrome grinding media results in 3-4% net production cost savings, the shift from forged grinding media to ferro chrome does not involve any upfront capital cost.

### Key Risks

#### Venture into global mining

AIA entered into the global mining industry and further increasing its capacity to cater the global mining industry which is mainly served by traditional players. This is an uncharted territory for the company.

#### Fluctuating raw material prices

Even though price escalation clauses have been built into customer contracts, any substantial increase in the raw material prices can adversely affect AIA's performance. In addition, shortage of domestic/imported raw materials may adversely affect its growth prospects.

#### Dependence on end-user industries

AIA is dependent on growth prospects of cement, mining, and power sectors for product sales. Any slowdown in these industries may result in margin contraction or restrict volume growth.

## Financial Statements

### Key Assumptions

Year to March	FY17	FY18E	FY19E	FY20E
<b>Macro</b>				
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.8	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
USD/INR (Avg)	67.1	64.5	65.0	66.0
<b>Company</b>				
Raw Material (% net rev)	32.4	37.8	37.7	37.4
Cement	74,656.4	76,944.1	77,019.6	77,102.7
Utilities	13,341.6	13,741.8	14,154.1	14,578.7
Mining	126,479.0	131,285.2	172,640.0	215,800.1
Total Quantity	214,477	221,971	263,814	307,481
Cement (y-o-y)	3.7	3.1	0.1	0.1
Utilities (y-o-y)	2.0	3.0	3.0	3.0
Mining (y-o-y)	25.6	3.8	31.5	25.0
Average realisation KG	100.9	101.7	105.1	107.2
Capex (INR mn)	(752)	(1,372)	(2,074)	(1,774)
Employee cost (% of rev)	4.8	4.8	4.2	4.1
Power Cost % sales	10.8	11.0	11.0	10.9
Sell. & admin exp % Sale	8.8	8.6	7.7	7.3
Avg. Interest rate (%)	3.4	3.5	3.5	3.5
Depreciation rate (%)	7.0	6.7	6.6	6.5
Dividend payout (%)	9.6	22.5	22.8	30.4
Debtor days	75	75	66	67
Inventory days	232	225	209	213
Payable days	55	52	50	51
Cash conversion cycle	252	247	226	229
Tax rate (%)	30.9	26.5	30.2	31.0

### Income statement

(INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Income from operations	22,460	23,477	28,709	34,043
Direct costs	7,269	8,877	10,815	12,731
Employee costs	1,067	1,136	1,205	1,385
Other Expenses	7,778	8,259	9,801	11,442
Total operating expenses	16,114	18,273	21,820	25,558
EBITDA	6,346	5,204	6,889	8,486
Depreciation	725	759	857	964
EBIT	5,621	4,444	6,032	7,521
Add: Other income	804.42	920.77	1,211.58	1,252.88
Less: Interest Expense	45	41	41	41
Add: Exceptional items	240	-	-	-
Profit Before Tax	6,620	5,325	7,203	8,734
Less: Provision for Tax	2,048	1,411	2,175	2,707
Less: Minority Interest	4	4	4	4
Reported Profit	4,568	3,909	5,023	6,022
Exceptional Items	166	-	-	-
Adjusted Profit	4,402	3,909	5,023	6,022
Shares o/s (mn)	94	94	94	94
Adjusted Basic EPS	46.7	41.4	53.3	63.8
Diluted shares o/s (mn)	94	94	94	94
Adjusted Diluted EPS	46.7	41.4	53.3	63.8
Adjusted Cash EPS	57.7	49.5	62.3	74.1
Dividend per share (DPS)	4.0	8.0	10.4	16.6
Dividend Payout Ratio(%)	0.1	0.2	0.2	0.3

### Common size metrics

Year to March	FY17	FY18E	FY19E	FY20E
Staff costs	4.8	4.8	4.2	4.1
Direct Cost	32.4	37.8	37.7	37.4
EBITDA margins	28.3	22.2	24.0	24.9
Net Profit margins	19.6	16.7	17.5	17.7

### Growth ratios (%)

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	7.0	4.5	22.3	18.6
EBITDA	4.1	(18.0)	32.4	23.2
Adjusted Profit	1.0	(11.2)	28.5	19.9
EPS	1.0	(11.2)	28.5	19.9

Balance sheet		(INR mn)			
As on 31st March	FY17	FY18E	FY19E	FY20E	
Share capital	189	189	189	189	
Reserves & Surplus	26,983	29,793	33,673	37,867	
Shareholders' funds	27,172	29,982	33,862	38,055	
Minority Interest	81	85	90	94	
Short term borrowings	1,155	1,155	1,155	1,155	
Long term borrowings	3	3	3	3	
Total Borrowings	1,158	1,158	1,158	1,158	
Long Term Liabilities	78	78	78	78	
Deferred revenue	712	712	712	712	
<b>Sources of funds</b>	<b>29,201</b>	<b>32,015</b>	<b>35,900</b>	<b>40,098</b>	
Gross Block	9,509	11,223	12,597	14,671	
Capital work in progress	426	426	426	426	
Tangible assets	6,482	7,552	8,769	9,579	
Intangible Assets	218	217	217	217	
Total net fixed assets	7,126	8,194	9,411	10,221	
Cash and Equivalents	12,064	14,584	15,233	16,592	
Inventories	5,341	5,594	6,815	8,022	
Sundry Debtors	4,948	4,695	5,742	6,809	
Loans & Advances	29	29	29	29	
Other Current Assets	2,383	2,425	2,469	2,513	
Current Assets (ex cash)	12,701	12,744	15,054	17,372	
Trade payable	1,207	1,338	1,630	1,918	
Other Current Liab	1,493	1,436	1,436	1,436	
Total Current Liab	2,700	2,773	3,065	3,354	
Net Curr Assets-ex cash	10,001	9,970	11,989	14,018	
<b>Uses of funds</b>	<b>29,201</b>	<b>32,015</b>	<b>35,900</b>	<b>40,098</b>	
BVPS (INR)	288.1	317.9	359.0	403.5	

Free cash flow		(INR mn)			
Year to March	FY17	FY18E	FY19E	FY20E	
Reported Profit	4,568	3,909	5,023	6,022	
Add: Depreciation	725	759	857	964	
Interest (Net of Tax)	30	27	27	27	
Others	(403)	(23)	(23)	(23)	
Less: Changes in WC	2,623	(88)	2,018	2,030	
Operating cash flow	2,296	4,761	3,866	4,961	
Less: Capex	752	1,372	2,074	1,774	
<b>Free Cash Flow</b>	<b>1,544</b>	<b>3,389</b>	<b>1,792</b>	<b>3,187</b>	

Cash flow metrics		FY17	FY18E	FY19E	FY20E
Year to March					
Operating cash flow		2,296	4,761	3,866	4,961
Investing cash flow		(235)	4,854	(1,074)	(774)
Financing cash flow		(824)	(879)	(1,143)	(1,829)
Net cash Flow		1,237	8,736	1,649	2,358
Capex		(752)	(1,372)	(2,074)	(1,774)
Dividend paid		(440)	(879)	(1,143)	(1,829)

Profitability and efficiency ratios		FY17	FY18E	FY19E	FY20E
Year to March					
ROAE (%)		17.4	13.7	15.7	16.7
ROACE (%)		24.1	18.0	21.8	23.6
Inventory Days		232	225	209	213
Debtors Days		75	75	66	67
Payable Days		55	52	50	51
Cash Conversion Cycle		252	247	226	229
Fixed asset turnover (x)		3.3	3.2	3.4	3.6
Gross Debt/EBITDA		0.2	0.2	0.2	0.1
Gross Debt/Equity		-	-	-	-

Operating ratios		FY17	FY18E	FY19E	FY20E
Year to March					
Total Asset Turnover		0.8	0.8	0.8	0.9
Fixed Asset Turnover		3.3	3.2	3.4	3.6
Equity Turnover		0.9	0.8	0.9	0.9

Valuation parameters		FY17	FY18E	FY19E	FY20E
Year to March					
Adj. Diluted EPS (INR)		46.7	41.4	53.3	63.8
Y-o-Y growth (%)		1.0	(11.2)	28.5	19.9
Adjusted Cash EPS (INR)		57.7	49.5	62.3	74.1
Diluted P/E (x)		30.7	34.6	26.9	22.5
P/B (x)		5.0	4.5	4.0	3.6
EV / Sales (x)		5.5	5.2	4.2	3.5
EV / EBITDA (x)		19.6	23.4	17.6	14.1
Dividend Yield (%)		0.3	0.6	0.7	1.2



## Additional Data

### Directors Data

Mr. Rajendra S. Shah	Chairman Independent - Non-Executive	Mr. Bhadresh K. Shah	Managing Director : Executive - Promoter
Mr. Sanjay S. Majmudar	Independent	Dr. S. Srikumar	Non Independent - Non-Executive Director
Mr. Yashwant M. Patel	Whole-time Director	Mr. Rajan Ramkrishna Harivallabhdas	Whole-time Director
Mrs. Khushali S. Solanki	Whole-time Director	Mrs. Bhumika S. Shodhan	Whole-time Director
Mr. Dileep C. Choksi	Whole-time Director		

Auditors - M/s.Talati & Talati

*\*as per last available data*

### Holding – Top10

	Perc. Holding		Perc. Holding
Shah bhadresh k	61.63	Nalanda india equity	9.68
Pinebridge investmen	4.56	Matthews intl capita	3.55
Hdfc asset managemen	2.53	Sbi funds management	1.9
Goldman sach's group	1.86	L&t mutual fund	1.38
Icici prudential ass	1.33	Jwalamukhi inv hldgs	1.28

*\*as per last available data*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

*\*as per last available data*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
29 Mar 2017	Sanjay Shaileshbhai Majmudar	Sell	15120.00
29 Mar 2017	Sharda B. Shah	Sell	23544.00
29 Mar 2017	Balkrishna F. Shah HUF	Buy	23544.00
29 Mar 2017	Ratna Sanjay Majmudar	Buy	15120.00

*\*as per last available data*

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### Coverage group(s) of stocks by primary analyst(s): Miscellaneous

AIA Engineering, Apar Industries Ltd, Aarti Industries, Agro Tech Foods, Balkrishna Industries, CCL Products India, Essel Propack, Orient Refractories, Supreme Industries, Solar Industries, SRF, Vesuvius India, VIP Industries

#### Recent Research

Date	Company	Title	Price (INR)	Recos
06-Feb-18	<b>PI Industries</b>	CSM picks up; outlook positive; <i>Result Update</i>	821	Buy
06-Feb-18	<b>Essel Propack</b>	Europe trips performance; revival awaited; <i>Result Update</i>	268	Buy
05-Feb-18	<b>Aarti Industries</b>	All - round growth imminent; <i>Result Update</i>	1105	Buy

#### Distribution of Ratings / Market Cap

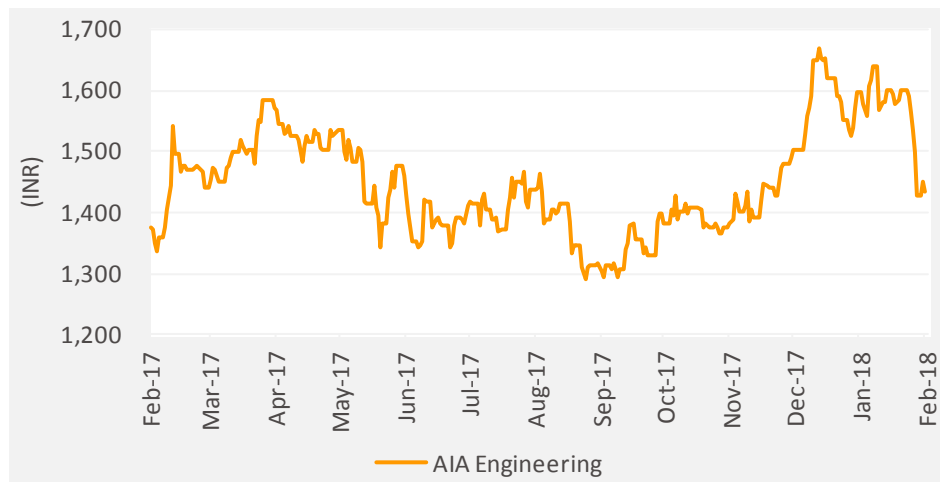
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

#### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

One year price chart



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