

Capital Goods

AIA Engineering Ltd

*Mining its way forward*

Visit Note

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Date : 4th March 2010

AIA Engineering (AIAE) is the second largest high chrome casting producer in the world after Magotteaux International of Belgium.

- ◆ **Substitution demand for HCMI:** AIAE's HCMI (High Chrome Mill Internals) for the mining industry provides better grinding, higher productivity and relatively less wear of the grinding media as compared to the conventional media.
- ◆ **Entry into new minerals:** Earlier the company was only providing mill internals for iron ore mining. Its recent foray into copper, platinum and gold mining has opened up the market for 1.5mn ton of substitution potential (excluding China).
- ◆ **Potential acquisition – a trigger:** While the Co enjoys a formidable leadership position within the domestic market and a significant share in the overseas segments it has forayed into, what could be a game changer for this player is an acquisition trigger, potentially, of the struggling market leader itself. An acquisition of Magotteaux could propel the AIAE business into a very formidable global enterprise, with immense pricing power and market leadership.
- ◆ **Replacement demand:** AIAE's products have a substantial replacement demand since grinding media and Mill internals tend to wear & tear over a period of time due to its continuous usage. Replacement demand constitutes about 75-80% of the revenues generated by AIAE.
- ◆ **Market share:** AIAE has 90-95% market share in the domestic cement industry and about 25% market share in the overseas cement industry. The company holds about 90% market share in the domestic utility.
- ◆ **Valuations:** At CMP of Rs343, the stock is trading at 18.6x trailing EPS of Rs18.5. We believe that domestic market leadership in the cement space and the substantial substitution opportunity available in the mining space will help the company to register strong CAGR in revenues in the coming years. Considering high OPMs at about 26-28% and a debt free balance sheet, we remain positive on the stock. The richer valuations that the stock has historically traded at are an outcome of the superior earnings visibility and dominant position within the fast-growing Indian economy (virtually with no domestic peers!). We currently have no rating on the stock.

Rating	Not Rated
Target Price	NA
CMP	Rs343
Upside	NA
Nifty	5077

Key Data

Bloomberg Code	AIAE.IN
Reuters Code	AIAE.BO
NSE Code	AIAENG
Current Shares O/S (mn)	94.3
Diluted Shares O/S(mn)	94.3
Mkt Cap (Rsbn/USDmn)	32.7/713.9
52 Wk H / L (Rs)	398/101.1
Daily Vol. (3M NSE Avg.)	184679
Face Value (Rs)	2
Beta	0.91
1USD/INR	45.8

Shareholding Pattern	(%)
Promoters	64.7
FII	13.5
Others	45.8

Price Performance (%)

	1M	6M	1Yr
AIAE	1.5	-1.3	210.7
NIFTY	4.8	-0.6	92.1

Source: Bloomberg ; \* As on 4<sup>th</sup> March 2010

Exhibit 1: Key Financials

Y/E Mar (Rs mn)	Net Revenues	YoY (%)	EBIDTA	YoY (%)	PAT	YoY (%)	EPS (Rs)	BV (Rs)	RoE (%)	RoCE (%)	P/E (x)
FY07	5,230	28.5	1,244	52.6	943.2	80.1	50.2	270.4	19.2	22.9	3.7
FY08	6,912	32.1	1,542	23.9	1,236	31.1	13.2	66.4	20.3	22.5	22.5
FY09	10,233	48.0	2,315	50.1	1,480	19.7	15.7	86.6	19.2	25.9	13.9

Source: Company, Networth Research

## Company Background

AIA Engineering was established in 1978 as Ahmedabad Induction Alloys Pvt. Ltd. In 1992 the company formed a JV AIA Magotteaux Pvt. Ltd., with Magotteaux of Belgium. In 2001 with the AIA's promoters buying the Magotteaux stake, the JV coming to an end and the company was renamed as AIA Engineering Ltd.

AIA Engineering Ltd. specializes in design, development, manufacture, installation and servicing of high chromium wear, corrosion and abrasion resistant mill internals. AIA is the second largest manufacturer of high chrome mill internals, after Magotteaux International of Belgium. The current capacity stands at 165000MTPA.

### Exhibit 2: Key events

1978	Established as Ahmedabad Induction Alloys Pvt. Ltd.
1992	Name changed to AIA Magotteaux Pvt. Ltd after a JV being formed with Magotteaux of Belgium
2000	Name changed to AIA Engineering after the termination of the JV with Magotteaux
2005	Company converted into a public ltd company

*Source: Company, Network Research*

### Key management personnel

Name	Position	Profile
Mr. Bhadresh K Shah	Promoter & MD	An IIT Kanpur Alumnus with more than 28years of experience in manufacturing and design of value added high chrome castings
Mr. Rajendra S Shah	Non Ex Chairman	BE (Mechanical) with experience in administration and finance; Board member of Harsh Engineers Ltd.
Mr. Sanjay Majmudar	Director	Practicing CA; Board member of Parekh Platinum Ltd.

*Source: Company, Network Research*

## Visit highlights

**We met Mr Sanjay Majmudar (Director) to understand the current demand-supply dynamics and have a better understanding of the new initiatives into the copper, gold and platinum mining segment.**

### Substitution demand for HCMI

AIAE's HCMI manufactured for the mining industry provides better grinding, higher productivity and relatively less wear of the grinding media as compared to the conventional media. HCMI costs about 20% more than the conventional media, however leads to a net saving of about 30% due to less wear of media and higher productivity. Moreover there is no capital cost involved in the conversion from the conventional media to the HCMI with only 6-8 months required for the conversion.

### Entry into new minerals

Earlier the company was only providing mill internals for iron ore mining. Its recent foray into copper, platinum and gold mining has opened up the market for 1.5mn ton of substitution potential (excluding China). The company has already started servicing South African groups like Anglo Platinum, Lomin and Nkomati for platinum mining which together have a potential of about 20,000 ton p.a. business for the company. The company expects sales of about 20,000 ton from platinum, 15,000-20,000 ton from iron ore and 8,000-10,000 ton from copper and gold in FY11E.

### Potential acquisition – a trigger

While the Co enjoys a formidable leadership position within the domestic market and a significant share in the overseas segments it has forayed into, what could be a game changer for this player is an acquisition trigger, potentially, of the struggling market leader itself. An acquisition of Maggotteux could propel the AIAE business into a very formidable global enterprise, with immense pricing power and market leadership. Maggotteux has been facing declining revenues and lower margins because of several facilities spread over various locations. AIAE has also been slowly capturing the market share of Maggotteux and the acquisition will help AIAE to become the market leader with global peers gasping to catch up.

### Replacement demand

AIAE's products have a substantial replacement demand since grinding media and Mill internals tend to wear & tear over a period of time due to its continuous usage. Replacement demand constitutes about 75-80% of the revenues generated by AIAE. HCMI products like grinding media need to be replaced every month subject to the cement production volumes, while liners and diaphragms wear over 1-3 years time period. Based on empirical data, the average wear rate of grinding media per ton of cement produced is around 100 gms.

### Market Share

AIAE is the market leader and holds about 95% market share in the domestic cement industry and about 25% market share in the overseas cement industry. In the overall cement market (excluding China) the company has about 35-40% market share. AIAE together with Maggotteux holds about 80% of global (excluding China) market share for HCMI. This near market leadership with long established relationships will help the company to restrict new entry and pressure on margins.

### Margins

AIAE has no domestic competitor and hence it has a significant pricing power, which is evident from the fact that the company has been able to maintain its margins in the range of 23-25%. The company is confident of maintaining OPMs in the range of 22-24%.

The company was earlier seeing realizations of about Rs117/kg. The current realizations have come down to R88/kg. The realizations are expected to settle in the range of Rs80-85/kg.

### **Quarry – new segment**

AIAE is entering into the quarry segment. The products for this segment can be manufactured with the current set up and capacity. The revenues from this segment are expected to be insignificant this fiscal. However, in FY12E the revenues from this segment are expected to be about Rs800-1000mn. The margins are expected to be better in this segment as compared to the current business segment.

### **Valuations**

At CMP of Rs343, the stock is trading at 18.6x trailing EPS of Rs18.5. We believe that domestic market leadership in the cement space and the substantial substitution opportunity available in the mining space will help the company to register strong CAGR in revenues in the coming years. Considering high OPMs at about 26-28% and a debt free balance sheet, we remain positive on the stock. The richer valuations that the stock has historically traded at are an outcome of the superior earnings visibility and dominant position within the fast-growing Indian economy (virtually with no domestic peers!). We currently have no rating on the stock.

## Financial Summary

### Income Statement

	(Rs.mn)			
Y/E March	FY06	FY07	FY08	FY09
<b>Net Sales</b>	<b>4,070</b>	<b>5,230</b>	<b>6,912</b>	<b>10,233</b>
<i>Growth</i>		28.5%	32.1%	48.0%
<b>Expenditure</b>	<b>3,255</b>	<b>3,986</b>	<b>5,370</b>	<b>7,918</b>
Cost of Materials	1,770	1,955	3,230	4,858
Personnel Expenses	226	222	312	411
Manufacturing Expenses	799	1,048	1,109	1,387
Purchase of Traded Goods	24	276	117	242
Administrative & Other Expenses	144	173	185	505
Selling & Distribution Expenses	292	313	416	516
<b>EBDITA</b>	<b>815</b>	<b>1,244</b>	<b>1,542</b>	<b>2,315</b>
<i>Growth</i>		52.6%	23.9%	50.1%
Depreciation	71	83	136	203
<b>EBIT</b>	<b>744</b>	<b>1,162</b>	<b>1,406</b>	<b>2,112</b>
Interest	53	24	17	21
<b>EBT</b>	<b>691</b>	<b>1,137</b>	<b>1,389</b>	<b>2,092</b>
Other Income	104	164	317	115
<b>PBT</b>	<b>795</b>	<b>1,301</b>	<b>1,706</b>	<b>2,206</b>
Tax	252	346	460	750
<b>PAT</b>	<b>543</b>	<b>956</b>	<b>1,246</b>	<b>1,456</b>
<i>Growth</i>		75.9%	30.4%	16.9%
Exceptional Items	-	-	-	(31)
<b>PAT after Exceptional Items</b>	<b>543</b>	<b>956</b>	<b>1,246</b>	<b>1,487</b>
Minority Interest	20	12	9	7
<b>PAT after Profit/(Loss) in Associates</b>	<b>524</b>	<b>943</b>	<b>1,236</b>	<b>1,480</b>
<i>Growth</i>		80.1%	31.1%	19.7%

### Balance Sheet

	(Rs.mn)			
Y/E March	FY06	FY07	FY08	FY09
<b>Net Worth</b>	<b>2,741</b>	<b>4,918</b>	<b>6,100</b>	<b>7,726</b>
Equity Capital	178	188	188	188
Equity Capital Suspense				1
Reserves & Surplus	2,563	4,730	5,912	7,537
<b>Minority Interest</b>	<b>70</b>	<b>82</b>	<b>84</b>	<b>57</b>
<b>Borrowings</b>	<b>485</b>	<b>165</b>	<b>136</b>	<b>442</b>
<b>Deferred Tax Liability</b>	<b>20</b>	<b>19</b>	<b>59</b>	<b>100</b>
<b>Application of Funds:</b>	<b>3,316</b>	<b>5,184</b>	<b>6,379</b>	<b>8,324</b>
Gross Block	940	1,371	2,489	3,127
Depreciation & Amortisation	436	516	648	811
Capital WIP	68	607	309	67
<b>Net Block</b>	<b>571</b>	<b>1,462</b>	<b>2,150</b>	<b>2,383</b>
<b>Investments</b>	<b>967</b>	<b>1,465</b>	<b>947</b>	<b>414</b>
<b>Current Assets</b>	<b>2,890</b>	<b>4,036</b>	<b>5,322</b>	<b>8,532</b>
Inventories	598	983	1,360	1,393
Debtors	1,230	1,422	1,748	1,847
Cash & Bank Balances	185	449	266	2,587
Loans & Advances	877	1,182	1,948	2,670
Interest accrued on Investments			1	35
<b>Current Liabilities &amp; Provisions</b>	<b>1,112</b>	<b>1,779</b>	<b>2,041</b>	<b>3,004</b>
Liabilities	423	698	628	765
Provisions	689	1,081	1,413	2,240
<b>Net Current Assets</b>	<b>1,778</b>	<b>2,256</b>	<b>3,282</b>	<b>5,527</b>

### Ratios

Y/E March	FY06	FY07	FY08	FY09
<b>Per Share Data</b>				
EPS (Rs)	29.5	50.2	13.2	15.7
Dividend Per Share (Rs)	2.6	3.6	0.8	2.5
Dividend Payout Ratio (%)	8.7	7.1	6.2	16.0
Sales per share (Rs)	228.9	278.3	73.5	108.5
Cash per share (Rs)	10.4	23.9	2.8	27.4
BV per Share (Rs)	181.5	270.4	66.4	86.6
EV per Share (Rs)	140.0	225.0	299.9	102.2
<b>Profitability (%)</b>				
OPM	20.0	23.8	22.3	22.6
NPM	12.9	18.0	17.9	14.5
ROI	23.1	22.9	22.5	25.9
ROE	19.1	19.2	20.3	19.2
<b>Turnover</b>				
Days Payable	52	113	47	39
Days Receivable	110	99	92	66
Days Inventory	123	183	154	105
Fixed Asset Turnover (x)	7.1	3.6	3.2	4.3
Inventory Turnover (x)	6.8	5.3	5.1	7.3
<b>Leverage</b>				
D/E (x)	0.2	0.0	0.0	0.1
Interest Coverage (x)	14.1	48.1	83.7	101.9
<b>Valuation</b>				
P/E (x)	4.0	3.7	22.5	13.9
P/BV (x)	0.7	0.7	4.5	2.5
EV/EBITDA (x)	0.2	0.1	0.2	0.1
EV/Sales (x)	0.6	0.6	4.0	1.8
Dividend Yield (%)	2.2	1.9	0.3	1.2

### Cash Flow

	(Rs.mn)			
Y/E March	FY06	FY07	FY08	FY09
<b>Cash &amp; Cash Eq. at Beg. of the yr</b>	<b>123</b>	<b>185</b>	<b>449</b>	<b>266</b>
Net Cash from Oper. Activities	311	741	228	1,921
Net Cash Used in Invest Activities	(1,478)	(1,306)	(287)	271
Net Cash Used in Fin. Activities	1,228	829	(124)	130
Net Inc/(Dec) in Cash & Cash Equ.	61	264	(183)	2,322
<b>Cash &amp; Cash Equ. at End of the yr*</b>	<b>185</b>	<b>449</b>	<b>266</b>	<b>2,587</b>

Source: Company, Network Research

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