

July 20, 2006

FOR PRIVATE CIRCULATION

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## AIA Engineering Ltd (AIA)

Price: Rs.553  
 Price target: Rs.838

Recommendation: BUY

### Stock details

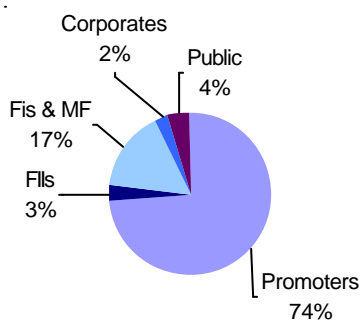
BSE code	: 532683
NSE code	: AIAENG
Market cap (Rs mn)	: 9,830
Free float (%)	: 26.4
52-wk Hi/Lo (Rs)	: 786/391
Avg. daily volume BSE	: 30,156
Avg. daily volume NSE	: 39,486
Shares o/s (mn)	: 17.8

### Summary table (year end Mar)\*

Rs mn	FY05	FY06E	FY07E	FY08E
Sales	2,937	4,070	5,025	8,369
Growth (%)	37.0	38.6	23.5	66.5
EBITDA	389	815	1,078	1,881
EBITDA margin (%)	13.2	20.0	21.4	22.5
Net profit	269	543	725	1,328
Net debt	432	297	62	(228)
EPS (Rs)	20.4	29.5	39.1	72.8
Growth (%)	16.2	96.6	32.6	86.3
DPS (Rs)	-	2.5	2.5	2.5
RoE (%)	31.0	28.4	22.0	31.4
RoCE (%)	33.8	36.1	28.6	40.0
EV/Sales (x)	3.5	2.5	2.0	1.1
EV/EBITDA (x)	26.4	12.4	9.2	5.1
P/E (x)	27.1	18.8	14.2	7.6
P/BV (x)	11.2	3.5	2.8	2.1

Source: Company & Kotak Securities - Private Client Research; \* Consolidated

### Shareholding pattern - June 2006



### One-year performance (Rel to Nifty)



Source: Capitaline

**AIA Engineering Ltd is a niche player in the value-added, impact, abrasion and corrosion resistant high chrome metallurgy segment. The company manufactures high chrome mill internals, which are used as both consumables and for new projects in the cement, mining and thermal power generation industry. The global demand for cement metals, minerals and power is booming due to the strong infrastructure and consumption led demand. The company provides complete packaged solution covering design, development, manufacture, installation and service of mill internals. Due to the strong global demand for the company's products the company is expanding its capacities from 65000 TPA to 165000 TPA, which would lead to significant increase in the revenue and profitability of the company going forward. We initiate coverage on AIA with a BUY recommendation along with a price target of Rs. 838 (52% upside), which is based on the DCF method of valuation.**

### KEY HIGHLIGHTS

- ❑ **Growing Global Market.** The global market for mill internals for the mining and cement industry is estimated at 3 mn TPA and is growing steadily at 4-5% per annum. We feel the demand will continue to grow as the world over new projects are being set up for cement and mining operations.
- ❑ **Expanding focus on global mining and utility segments.** The company has a strong presence in the mill internals for the cement industry commanding more than 90% market share in India and approximately 20% of the global market share excluding China. The company is expanding its focus on the global mining and utility segments, which is much larger than the cement industry in terms of potential consumption of mill internals.
- ❑ **Expansion of capacities.** The company has operated at almost full capacity in the last two years. Currently, the company is in an expansion mode. At present, the company has 65,000 TPA capacities, which is expected to go up by 50,000 TPA to 115,000 TPA by January 2007 and further by 50,000 TPA to 165,000 TPA by January 2008.
- ❑ **Reputed customer base.** The company's products are sold to major cement players like ACC Ltd, Gujarat Ambuja Cement Ltd, UltraTech Ltd, Grasim Industries Ltd, Holcim of Switzerland, Lafarge of France, Cemex of Mexico. In the mining segment their clients include Hindustan Zinc, Bharat Aluminium among others.
- ❑ **Robust Order Book.** As of March 31 2006 the company has a robust order book of Rs. 2.95 bn. Almost 50% of the order book is for exports, which enjoy superior margins than local sales.
- ❑ **Entry barriers to the business.** The average cost of the consumables as a percentage of total cost of production comes to around 1-1.5%. Thus, the users would not like to spend their time and money on small and specialized item which is a consumable in the process of manufacturing. Other major players in the industry are Magotteaux International of Germany, Scaw Metal of South Africa among others.
- ❑ **Attractive valuation.** Based on FY08E estimates, the stock trades at 2.1x book value, 7.6x its earnings and 6.9x its cash earnings. We believe the valuation is attractive considering the strong track record, growth potential in the mining industry, expanding global footprint, superior product quality, major market share and reputed clientele enjoyed by the company in India and abroad.

## HISTORY

Ahmedabad Induction Alloys Pvt Ltd, promoted by Bhadresh K Shah was incorporated in 1978. This company was merged with AIA in 1991. AIA was incorporated on March 11, 1991 as Magotteaux (India) Pvt Ltd. Subsequently, the name of company was changed to AIA Engineering Ltd in May 2000. The word Magotteaux was removed on account of termination of the joint venture (JV) with Magotteaux International S.A., Belgium.

In 1995, the company entered into a technical collaboration with Southwestern Corporation, USA for process improvement in vertical mills.

Mr Shah, Managing Director, is a metallurgical engineer (B. Tech from IIT Kanpur). He started the company as an alloy-casting manufacturer and drove the group towards special steels. He was also a pioneer in getting into technical collaborations abroad.

Jules Spede, Director, is a Civil Engineer from Liege University, Belgium. Mr. Spede is a veteran of the high chrome industry. He was on the board of a global wear part manufacturer at which time he left the company to join the AIAE group. He is based in France and was earlier heading the group's international sales. He subsequently took on the responsibility as a Director of the company and is today involved in strategy of the Group. He heads all discussions for potential collaborations with customers, suppliers and OEMs.

## BUSINESS

The components manufactured by the company include products like grinding media, liners, diaphragms, vertical mill parts like rollers and table liners, blow bars/hammers and dipping tubes among others, manufactured in high chrome metallurgy which are collectively referred to as mill internals.

**Mill internals are used in crushing and grinding operations**

The products find application in the crushing and grinding operation in the mills in cement, utility and mining industries. The use of the above product can translate into substantial savings in terms of continuous and higher output, reduced power consumption and lower maintenance costs.

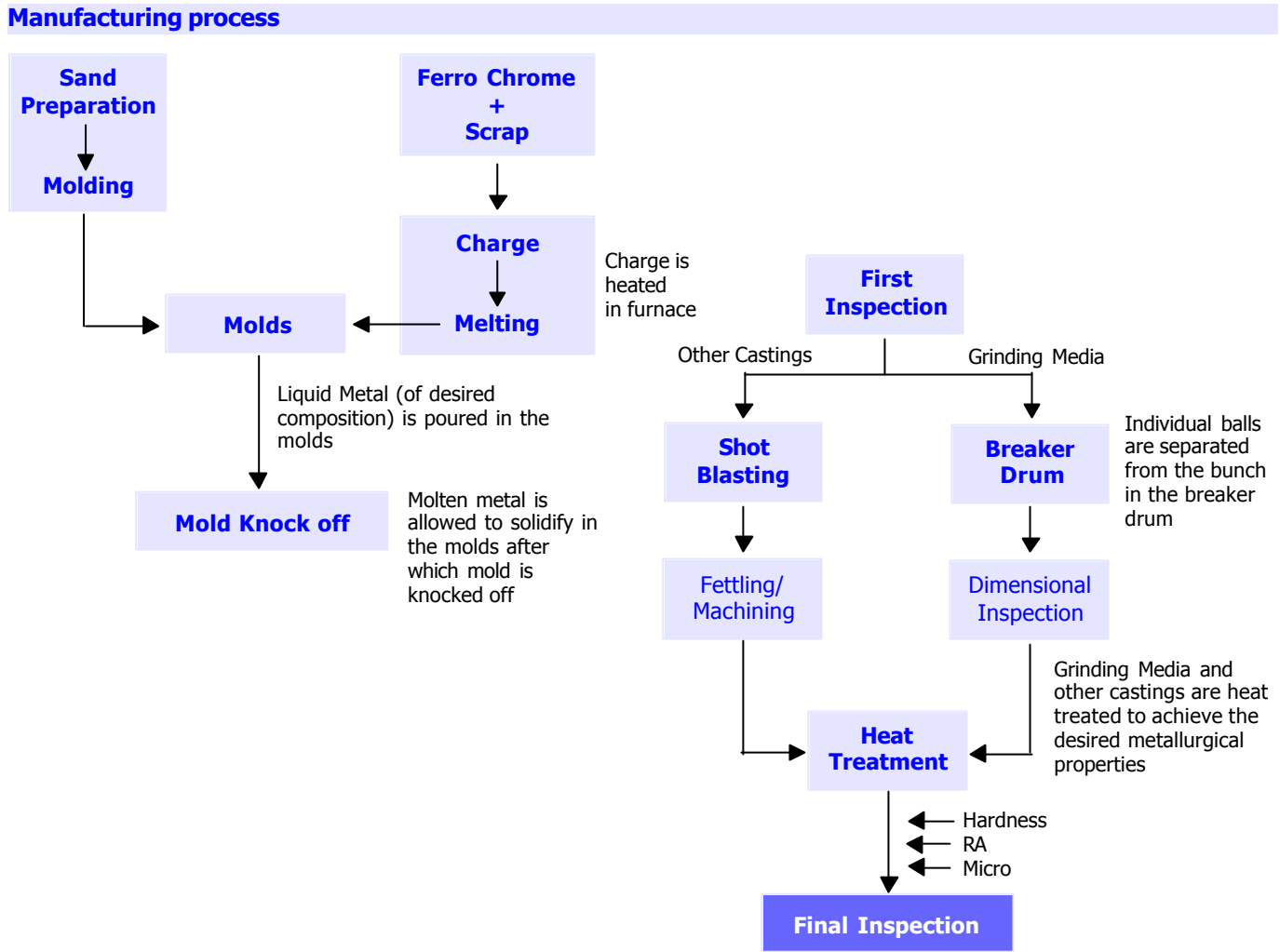
**The grinding process comes to a halt, if the mill internals fails**

In case any of these mill internals fails, the grinding process comes to a halt and eventually the production of that plant comes to a standstill. So, these products are critical for the efficient functioning of the mills. The high chrome mill internals manufactured by the company offer reduced wear rate of the grinding elements and a greater control on the grinding process compared to conventional alternatives like manganese steel, forged steel and nihard iron internals.

**Company provides complete solutions including value added services**

The company offers complete solutions in grinding, to optimize the productivity of the grinding mills. The company also gives advice on the operational parameters of the mills like composition of grinding media, that is, total tonnage, size distribution, metallurgy and design other mill internals depending on the feed material to be ground and the desired fineness of the finished product.

The company also offers services such as installation supervision and mill process optimization for maximum efficiency. The company deploys its own trained staff for the entire process of study, installation and smooth operation of the mill internals.



Source: Company

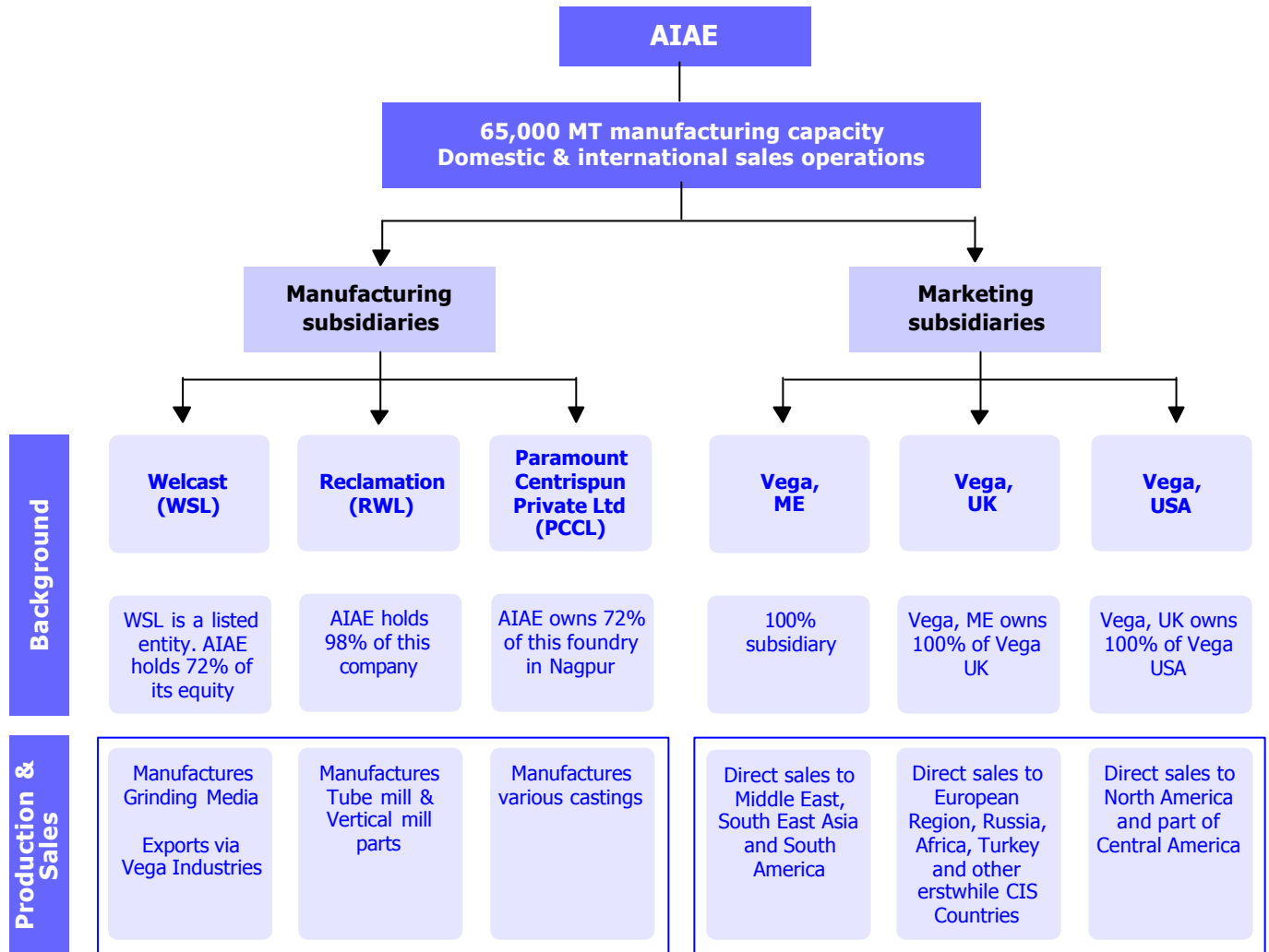
## MANUFACTURING PROCESS

The company first makes the moulds of the desired shapes of the mill internals. Then, ferro chrome and mild steel scrap, the two main raw materials, are heated in a furnace to get a liquid metal. Generally, the company uses 20% ferro chrome and 80% mild steel scrap. The liquid metal so obtained is poured in the moulds and the molten metal is allowed to solidify in the moulds after which the mould is knocked off.

For making grinding media the mould so obtained is passed through a drum wherein the media is fettled. Then it is given heat treatment to achieve the desired combination of properties like wear resistance and toughness.

For other mill internals like liner and vertical mill parts the mould so obtained is cleaned on a shot-blasting machine. Then it is given heat treatment to achieve desired combination of properties. Then, depending on the physical properties and the dimensional accuracy required the castings undergo a different set of operations.

## Organisation structure



Source: Company

## CAPACITY

Currently, the company has 18,000 TPA capacity of its own which is located at GVMM Industrial estate, Odhav, Ahmedabad.

Apart from this, the company holds 72% of Welcast Steels Ltd, which is listed on the Bombay Stock Exchange having a manufacturing capacity of 35000 TPA at Bangalore. Here the company mainly manufactures grinding media, which are exported via its foreign subsidiaries namely Vega Middle East, Vega UK and Vega USA.

The company also holds 72% in Paramount Centrispun Castings Ltd, which has a capacity of 4000 TPA located at Nagpur which manufactures various castings.

### Capacity expansion from 65000 TPA to 165000 TPA

The company also holds 98% in Reclamation Weldings Ltd, which has a capacity of 8000 TPA, which manufactures vertical mill parts for the tube mills. Thus, in all, the company has 65000 TPA of capacity. The company is expanding the capacities to 165000 TPA in two phases. The first phase of 50000 TPA is expected to commence commercial production in January 2007 thereby taking the total capacity to 115000 TPA. The second phase of another 50000 TPA is expected to commence commercial production in January 2008 thereby taking the total capacity to 165000 TPA.

## PRODUCTS: MILL INTERNALS

For Tube Mills, the company manufactures

- a) Head liners
- b) Shell liners
- c) Diaphragms (intermediate with grate plates and back plates, outlet),
- d) Grinding media

For Vertical mills the company manufactures

- a) Grinding rolls
- b) Tyres
- c) Grinding rings
- d) Hollow balls
- e) Bull ring segments
- f) Table, airport assembly,
- g) H.P. classifier

### Function of a mill

**Mill internals are used to smoothen the grinding operation**

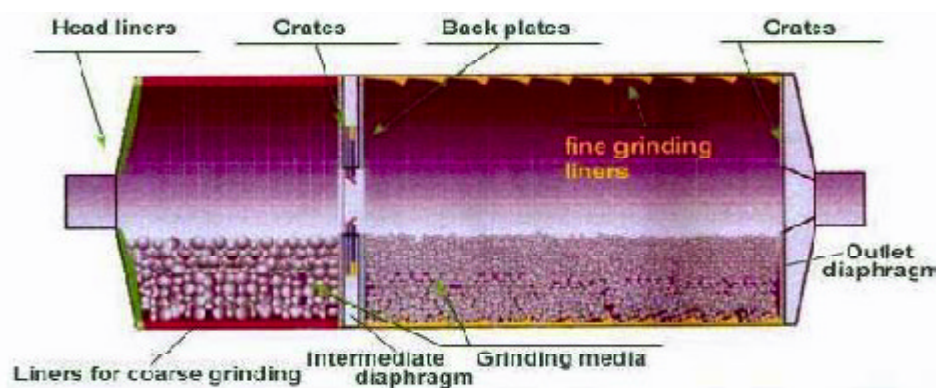
The purpose of the mill is to crush and grind the feed material. The cement plant grinds clinker and lime, while coal is grinded in thermal power plants or mineral ore in mines. The mill internals are used to smoothen the grinding operation, reduce the wearing rate of the machines, to prevent plant stoppage, reduce power consumption by 10-30% and increase mill efficiency leading to consistent end product quality. The specification of the mill internals are chosen based on the input feed that has to be ground and the fineness of the output required.

There are two types of mills:

#### □ Tube mills

In tube mills, when the mill rotates, the grinding media are lifted and they fall with an impact on the feed and thereby grind the feed. The mill is separated into two chambers and the size of the grinding media decreases from the inlet to the outlet as the fineness of the feed increases. An assembly of diaphragms, gates and back plates, which screen the feed and let only a certain size of feed pass into the second chamber, separates the two chambers. The outlet of the shell is fitted with outlet diaphragms and gates.

#### Tube mill



Source: Company

#### □ Vertical Mills

In these mills the grinding takes place when the feed material passes between the rotating table liners and rollers. Over a period, these mill internals also wear out. With increasing wear of these internals, the grinding operation becomes less efficient and the output reduces.

**Grinding media are used in the process of crushing, grinding and extraction**

**□ Grinding Media**

Grinding balls are used to assist in the extraction process for many metals such as gold, copper, lead, zinc, iron, nickel, tin and silver. In addition to metalliferous processing, balls are used for grinding coal in power stations, lime and clinker in the cement industries and base materials in the building products industry. The alloy steel grinding media should be sufficiently hard, abrasion and wear resistant to deformation and not develop cracks on the surface during the operation. The core of these balls should have uniform distribution metallurgy so as to optimally grind the feed material. With repeated operation, the grinding media begins to wear and thus needs to be replaced after a specific number of operations.

**□ Liners**

**Liners are used to protect the shell of the mill**

The grinding media or grinding balls have a very high degree of hardness, which can damage the shell of the mill. Liners are used to protect the shell of the mill. They are also used for aiding and controlling the lifting action of the grinding media. The function of a liner is to impart suitable trajectory to the balls so as to ensure efficient crushing of feed material. The liners are designed in such a way that there is no direct impact of the balls on liners resulting in loss of energy and breakage. Different applications have different requirements and, hence, each liner is designed according to the application. Therefore, there is no unique liner for all the applications.

**□ Diaphragm**

The basic function of a diaphragm is to keep the material level in the first chamber at the optimum level and ensure that it does not go into the second chamber unless required. The material entering the diaphragm chamber through the slotted grates can exit to the second chamber only through the rotating cylindrical lifters. The company also manufactures level control diaphragms, which are used for controlling the level of material in the mill chambers.

**□ Rollers & Table liners**

The company manufactures rollers and table liners for various makes of vertical mills like Atox, Loesche, MPS, Polysius, Raymond and E-Mills. Depending on the application, the rollers are manufactured in mono-block segmented or inserted construction. Similarly, the table liners can be in mono-block or segmented construction.

**□ Dipping tubes**

**Dipping tubes are located in pre-heaters and are designed to improve the efficiency of separation of material and gas**

Dipping tubes or immersion tubes are located in pre-heaters and are designed to improve the efficiency of separation of material and gas. Conventional dipping tubes for lower cyclones are made of stainless steel and in fabricated construction. This construction causes problems during maintenance. The dipping tube in high chromium alloys ensures easy installation and also allows ease in carrying these segments inside pre-heaters. Support castings are welded to steel flange existing inside separators. Other castings hang independently allowing flexibility for expansion as temperature rises. The segments are made of suitable heat resistant alloy to ensure longer life and, thereby, improve the productivity.



## SERVICES

The company offers various services to the clients, which help to improve the process by increasing the productivity with lower cost and consistent end product quality. Some of the services offered are as follows:

### Mill Audit

#### Understanding the complete process of the mill

Here the company engineer understands the complete process of the mill, studies the application parts for the mill internals, determines the mill condition from maintenance and process point of view. The engineer also finds out the bottlenecks, studies the wear profile and finally determines the proposed guarantees for the mill process.

### Designing

Mill audit is followed by stringent design procedures to ensure the right design for the right application by conducting several design reviews, verification and validations. The company uses state-of-the-art equipments to design the mill internals.

### Alloy Selection

#### Company deals with three wear mechanisms - impact, corrosion and abrasion

In alloy selection the company deals with three wear mechanisms - impact, corrosion and abrasion. The following factors influence the alloy selection process:

- Applications and working conditions
- Design of part
- Physical and metallurgical properties
- Manufacturing process
- Chemical composition

### Supervision during installation of wear parts

The installation of the wear parts supplied by the company is done under the careful supervision of experienced engineers of the company so as to ensure optimum efficiency and productivity.

### Optimization of the grinding system

The company's engineers regularly visit the plants to conduct mill studies, which help them in fine-tuning the mills for optimum performance.

### Retrofitting

#### Retrofitting is replacement of the complete set of mill internals to new designs and metallurgy

Whenever the mill internals are due for replacement, there is always the possibility of supplying those internals according to the existing design and metallurgy. The company provides the service of retrofitting, which involves replacement of the complete set of mill internals to new designs and metallurgy thereby offering additional benefits to the customer.

Retrofitting involves a comprehensive range of activities consisting of:

- Study of mills
- Designing of parts
- Decision on metallurgy
- Installation of parts
- Understanding customers' needs
- Decision on ball charge
- Manufacturing of parts
- Fine tuning of mills

### Research & Development

#### R&D forms a critical activity for the development of new alloys

Research and development (R&D) forms a critical activity for the development of new alloys. R&D involves the use of the company's technical services, process engineers and quality control/assurance department. Regular trials are carried out for developing new alloys. These in-house developed alloys are then tested at field to establish its actual performance in comparison to the existing alloys. Based on successful trials the alloys are standardised for production and supply. This process continuously helps to improve the alloys thereby improving the overall efficiency and productivity of the mill.

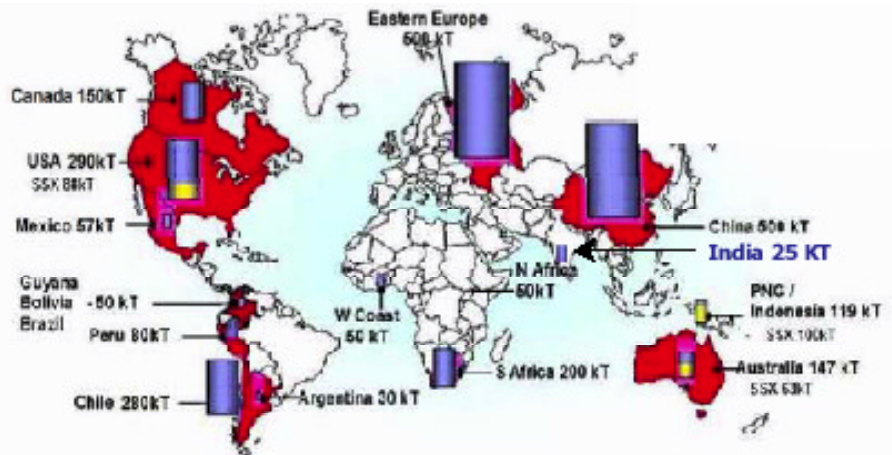
## KEY HIGHLIGHTS

### Growing Global Market

The global market for mill internals for the mining and cement industry is estimated at 3 mn TPA, and is growing steadily at 4-5% per annum. We feel the demand will continue to grow as the world over new projects are being set up for cement and mining operations. Also, the existing plants will need the mill internals as these are consumables and, thus, we anticipate steady growth in the demand for mill internals. According to estimates, the global cement industry is estimated at 2079 mn MT in 2005-06 and is steadily growing at 3.6% p.a. On an average, the wear rate of grinding media per ton of cement production is around 100 grams. Similarly, 300 MT of grinding media is required per 1 mn ton of fresh cement capacity. Based on the projected demand for consumables and new projects the demand for mill internals for the cement industry is estimated at 2,70,000 TPA for the next year.

**Global market for mill internals for the mining and cement industry is estimated at 3 mn TPA**

### Global demand of mill internals by the mining industry



Source: Company

### Expanding focus on global mining and utility segments

The company has a strong presence in the mill internals for the cement industry commanding more than 90% market share in India and approximately 20% of the global market share excluding China. The company is expanding its focus on global mining and utility segments which is much larger than the cement industry in terms of potential consumption of mill internals.

In the mining industry, the mineral ore has to be ground to a specific size before further processing can be done to recover the metals from the mining ores. The average cost of mill internals for the mining sector can go up to 10% of the total cost of production as the grinding media requirement may vary significantly depending on the location and the condition of the mines.

The global size for mining is of 2.5 mn TPA of annual replacement demand as against 270,000 TPA for the cement industry. Currently, only 10-15% of the mill internals in the mining industry are of hi-chrome. So, there is a huge potential to convert the balance into high chrome mill internals, which can lead to substantial savings in terms of better efficiency, reduction in power consumption and consistent production.

Coal is used in thermal power plants in the process of generation of electricity. Coal has to be ground in grinding mills before further processing. Around 67,000 MW of electricity is produced by coal-based thermal power plants. According to the data, the annual replacement demand per MW of electricity generated is around 15 grams per MW hr generation, which is around 7000 MT per year.

**In cement the company commands more than 90% market share in India**

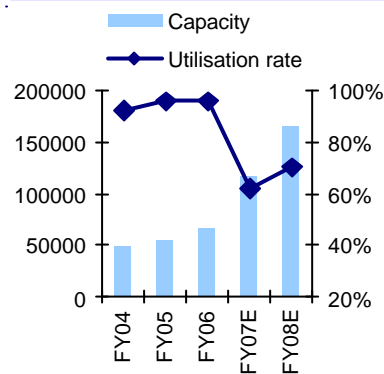
**Global size of mill internals is greater for mining than cement industry**



The government plans to add 100,000 MW of thermal power generation capacity over the next decade, and around 83% thereof are estimated to be coal-based thermal power plants. Thus, about 83,000 MW of coal based power generation capacity is likely to be added in next 10 years, which is the project demand in India. According to the data, for every MW of new thermal power generation capacity, 0.147 MT of wear parts are required, which translates in to the new project demand of around 12,000 MT spread over next ten years. (Source: Ministry of Power)

The expansion into mill internals for the mining and utility industry will reduce the concentration for the company on the cement sector.

### Consolidated capacities TPA



Source: Company, Kotak Securities - Private Client Research

### State-of-the-art equipment to design mill internals

### Expansion of capacities

The company has operated at almost full capacity in the last two years. Currently, the company is in an expansion mode. At present, the company has 65,000 TPA capacities, which is expected to go up by 50,000 TPA to 115,000 TPA by January 2007 and further by 50,000 TPA to 165,000 TPA by January 2008. The new facility is expected to come up at village Changodar, which is about 25 km from Ahmedabad. All the above capacities are on a consolidated basis, which includes its subsidiaries Welcast Steels Ltd, Paramount Centrispun Castings Ltd and Reclamation Weldings Ltd. On the basis of the expanded capacity we expect significant growth in the revenues of the company going forward.

### Technological advantage

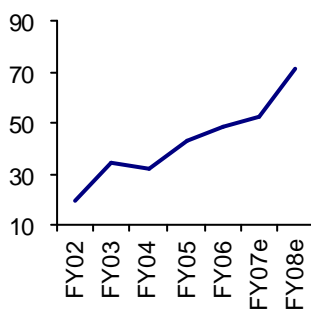
The company has an in-house capability to produce very high quality high chrome mill internals of different sizes to serve the specific needs of customers. The company provides complete packaged solution covering design, development, manufacture, installation and service of mill internals. The company possesses state-of-the-art equipment to design mill internals according to specific requirements of the customers as the grinding media varies from plant to plant and hence it needs individual designing and development according to the specifications of the mill. Currently, the company has a technical collaboration with Southwestern Corporation UK for process improvements relating to vertical mills.

### Focus on exports

The company has significantly increased the exports over the last few years. The exports as a percentage of net sales have increased from 20% in FY02 to 48% in FY06. In FY06, the company exported 28,000 MT valued at Rs. 1.9 bn. Going forward, we expect the company to maintain its focus on exports as they enjoy better margins than local sales. We expect exports to contribute 53% in FY07E and 71% in FY08E of the revenues. The company has global presence in terms of sales and service offices across the world.

For exports, the company sells through three wholly-owned subsidiary companies in the US, UK and Middle East under the brand name Vega. In Australia, the company sells through its branch office and a through a representative office in Philippines. The group also has three warehouses in the US and one in the UK.

### Exports as a % of net sales



Source: Company, Kotak Securities - Private Client Research

### Reputed customers both in India and abroad

### Reputed customer base

The company's products are sold to major cement players in India including ACC Ltd, Gujarat Ambuja Cement Ltd, UltraTech Ltd, Grasim Industries Ltd, etc. In the mining segment, their customers include ferrous and non-ferrous mineral beneficiation plants like Kudremukh Iron Ore Company Ltd., Hy-grade Pellets, Hindustan Zinc, and Bharat Aluminium Company among others. In the utility segment the company supplies to major thermal power plants and OEM.

The company also supplies to global cement manufacturers in major countries located in North and South America, Europe, Middle East, Far East and Africa. The company has supply contracts, with global cement manufacturers like Holcim of Switzerland, Lafarge of France, Cemex of Mexico through wholly owned overseas subsidiaries and commercial relationships with Original Equipment Manufacturers like FL Smidth of Denmark, etc.

**Rs.2.95 bn order book as of  
31 March 2006**

### **Robust Order Book**

As of 31 March 2006 the company has a robust order book of Rs. 2.95 bn. Out of this order book, nearly 30% is for projects and the balance approximately 70% is for replacement. Almost 50% of the order book is for exports. According to the management during the last year, there were lots of orders, which the management had to reject due to lack of capacity. As a prudent policy, the management is willing to take only those orders, which it can fulfill on time. Once the additional capacity becomes operational we feel the order book may grow substantially as the company's products are of superior quality and commands backing from the reputed customers.

**Cost of mill internals is 1-  
1.5% of the total cost of  
production**

### **Entry barriers to the business**

The mill internals are used as consumables in the cement, mining and thermal power generation industry. The average cost of these consumables as a percentage of total cost of production comes to around 1% to 1.5%. Thus, the users would not like to spend their time and money on small and specialized item in the process of manufacturing. A few large companies also tried to manufacture these products but were unsuccessful in producing the same quality products at similar costs. Apart from this, one also needs deep knowledge of the application of these products and also needs to be able to service the customers regularly and consistently. We feel the above barriers would prevent any major player from coming from into this business segment and thus protect the position of market dominance of the company.

**Ferro chrome, mild steel  
scraps are the main raw  
materials**

### **Source of raw materials**

Ferro chrome, mild steel scraps are the main raw materials for the company. The company has agents who source the raw materials for the company, as there are many small players in the country who supply ferro chrome and mild steel scrap. The company does not enjoy fixed contract prices, as the suppliers are small and unorganized players. However, most of the company's sales have escalation clauses so this should not have any major impact on the profitability of the company.

**The company's products are  
used as quality benchmark  
for the other players**

### **Competitors**

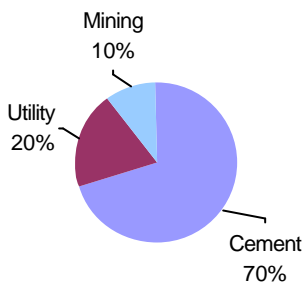
In the past, few large companies in India have tried to manufacture high chrome mill internals but were unsuccessful in producing the same quality products at similar costs. Some of the players in India are L&T and ACC Nihon Ltd, which make vertical mill parts and tube mill liners. Balls & Cylpebs and Blaji Industrial products Ltd make grinding media and maotteaux India Pvt. Ltd. makes vertical mill parts.

Globally the company faces competition from Magotteaux International of Germany, Christian Pfeiffer of Italy, Estanda of Spain, Toyo of Japan, Anhui of China, Aresco of Egypt, Firth Rickson of UK and Scaw Metals of South Africa.

However the company has made a niche for itself in the global market with respect to cement industry where it commands more than 20% market share excluding China. The company's products are well accepted by the global majors and they are also used as quality benchmarks for the other players. Thus we feel that the company would be able to increase its market share going forward once the additional capacity becomes operational.

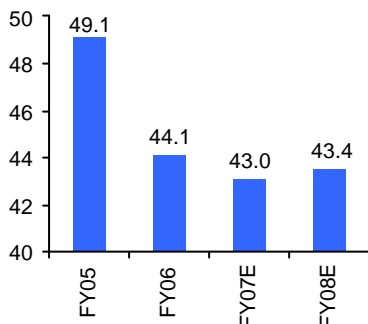
## FINANCIAL ANALYSIS AND OUTLOOK

### FY06 sales breakup



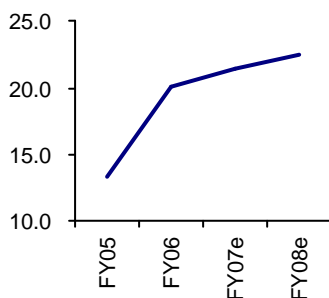
Source: Company, Kotak Securities - Private Client Research

### Raw materials to net sales (%)



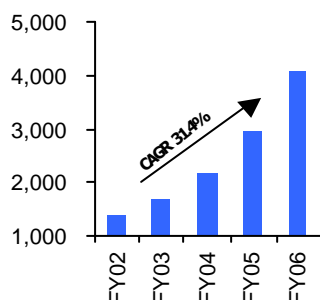
Source: Company, Kotak Securities - Private Client Research

### EBIDTA (%)



Source: Company, Kotak Securities - Private Client Research

### Net sales (Rs mn)



Source: Company, Kotak Securities - Private Client Research

### Equity Dilution: IPO of 4.7 mn shares

In November 2005, the company issued 4.7 mn shares through initial public offering (IPOs) at Rs. 315 per share (including premium of Rs. 305) thereby raising Rs. 1.48 bn. Post-IPO the equity of the company has gone up from Rs. 130.8 mn to Rs. 177.8 mn. The company is using the money it has raised to increase the capacity from 65000 TPA to 165,000 TPA in two phases.

### Possibility of further equity dilution

The capacity expansion will cost the company approximately Rs. 1.2 bn for which the company has already raised Rs 1.48 bn out of the IPO in November 2005. The company has plans to set up a power plant of 30 MW for captive consumption. The cost of setting up the power plant is likely to be Rs. 1.2 bn. Hence, the company might have to further dilute its equity to fund the capex for setting up the 30 MW power plant. In case the power plant is set up it would lead to savings in the power cost and positively impact our earnings estimates. However, as of now we do not have any details of the power plant. Hence, we have not factored in any benefit or any equity dilution in our earnings estimates.

### FY06 financial performance

For FY06, the company reported net sales of Rs. 4.07 bn registering 38.6% YoY growth. Approximately, 70% of the revenue was from the cement industry, 20% from the utility industry and balance 10% form the mining sector. The company reported net profits of Rs. 524 mn, which is a 96.9% YoY growth. On a fully diluted basis, the company reported an EPS of Rs. 29.5 and CEPS of Rs. 33.4 in FY06. At the current market price of Rs.553, the stock is trading at 18.7x its FY06 earnings and 16.5x its FY06 cash earnings.

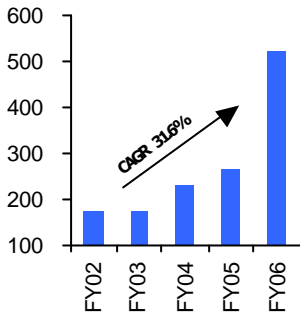
### Improvement in EBIDTA margin

Going forward, we expect the company to report an EBIDTA margin of 21.4% in FY07E and 22.5% in FY08E. We expect the margin to increase in FY07E as the company, with the use of technological know how, is increasing the use of mild steel scrap which is cheaper raw material than ferro-chrome thus leading to reduced raw material to sales ratio from 44.1% in FY06 to the expected level of 43% in FY07E. The average realization for the company has improved from Rs. 50,081 per MT in FY04 to Rs. 59,108 per MT in FY05 and further increased to Rs. 68,594 per MT in FY06.

The margin is expected to further improve in FY08E as the full impact of the commercial production of the expanded capacity by 50000 TPA is expected to be realized in FY08E leading to economies of scale and lower per unit cost of production. The new plant is a state-of-the art plant with latest plant and machines, which will require lower staff strength of around 125 to 200 people as against around 900 people for the existing 65,000 TPA capacity. Thus, the lower overall operational cost is expected to yield better margins for the company going forward. Also the consulting nature of the business and high quality of the products would make the demand relatively price inelastic thereby protecting the margins of the company.

### Impressive revenue and net profit growths

Net sales have grown at a CAGR of 31.4%, from Rs. 1.3 bn in FY02 to Rs. 4.1 bn in FY06. Net profits have grown at a CAGR of 31.6%, from Rs. 175 mn in FY02 to Rs. 524 mn in FY06. We expect the company to maintain the growth momentum in the future also considering the strong new project and replacement led demand for the company's products.

**Net profit (Rs mn)**

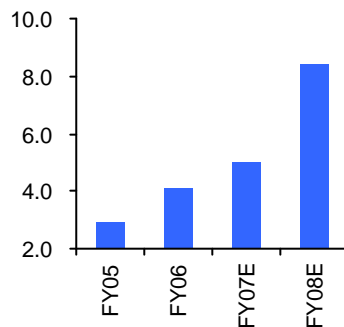
Source: Company, Kotak Securities - Private Client Research

**Attractive valuation**

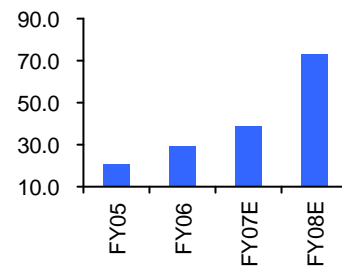
Based on FY08E estimates, the stock trades at 2.1x book value, 7.6x its earnings and 6.9x its cash earnings. We believe the valuation is attractive considering the strong track record, growth potential in the mining industry, expanding global footprint, superior product quality, major market share and reputed clientele enjoyed by the company in India and abroad.

**Projected financials**

- For FY07E, we expect sales to grow by 23.5% to Rs. 5 bn and net profit to be Rs. 695 mn translating into an EPS of Rs. 39.1 and CEPS of Rs. 44.2. The revenues are expected to rise due to 50000 TPA capacity additions in January 2007.
- For FY08E, we expect sales to grow by 66.5% to Rs. 8.4 bn and net profit to be Rs. 1.3 bn, translating into an EPS of Rs. 72.8 and CEPS of Rs. 80.1. The revenues are expected to rise due to full impact of the first expansion and another 50000 TPA expansion commissioning in January 2008.
- For FY07E and FY08E, we expect the book value to be Rs. 196.2 and Rs. 268.1 per share, respectively.
- We expect the RoE to improve from 28.4% in FY06E to 31.4% in FY08E.
- We expect RoCE to improve from 36.1% in FY06E to 40.0% in FY08E.

**Net sales (Rs bn)**

Source: Company, Kotak Securities - Private Client Research

**EPS (Rs)**

Source: Company, Kotak Securities - Private Client Research

## VALUATION AND RECOMMENDATION

- The stock trades at 2.8x for FY07E and 2.1x FY08E to book value.
- The stock discounts FY07E and FY08E earnings at 14.2x and 7.6x, respectively.
- The stock trades at 12.5x FY07E and 6.9x FY08E cash earnings.
- We are positive on the growth prospects of the company and recommend BUY on the stock with a price target of Rs. 838 over a 12-month horizon implying upside potential of 52%.
- We have derived our target price based on two-stage DCF valuation methodology, with a WACC of 14.45% and terminal growth rate of 4%.
- We recommend BUY.

DCF valuation per share (Rs mn)	
Total FCFF from above table	4,174
Terminal value	8,902
Total FCFF	13,076
Less: Net debt	62
Shareholders' value	13,015
<b>12 month fair value per share (Rs)</b>	<b>838</b>

Source: Kotak Securities - Private Client Research

Assumptions	
Beta with sensex	1.13
Risk free rate (%)	7.00
Market Risk Premium (%)	7.00
Cost of Equity (%)	14.9
Cost of Debt (%)	8.00
WACC (%)	14.45
Terminal growth (%)	4.00

Source: Kotak Securities - Private Client Research

Free Cash Flow to Firm						
(Rs mn)	2007	2008	2009	2010	2011	2012
<b>PAT</b>	<b>695</b>	<b>1,294</b>	<b>1,488</b>	<b>1,711</b>	<b>1,968</b>	<b>2,263</b>
Depreciation	90	131	156	176	191	201
Interest (1-Tax)	25	20	18	16	14	12
Capex	(800)	(350)	(156)	(176)	(191)	(201)
Change in NWC	(125)	(930)	(317)	(355)	(399)	(332)
Investments	680	200	-	-	-	-
<b>FCFF</b>	<b>565</b>	<b>364</b>	<b>1,189</b>	<b>1,372</b>	<b>1,583</b>	<b>1,943</b>
Years from now	0.75	1.75	2.75	3.75	4.75	5.75
Discounted Value	511	288	820	827	834	894

Source: Kotak Securities - Private Client Research

Sensitivity analysis					
<b>WACC (%)</b>	<b>13.45</b>	<b>13.95</b>	<b>14.45</b>	<b>14.95</b>	<b>15.45</b>
Value per share (Rs)	932	882	838	797	760
<b>Growth in 2009 - 2012 (%)</b>	<b>10.0</b>	<b>12.5</b>	<b>15.0</b>	<b>17.5</b>	<b>20.0</b>
Value per share (Rs)	779	808	838	867	897
<b>Beta</b>	<b>1.03</b>	<b>1.08</b>	<b>1.13</b>	<b>1.18</b>	<b>1.23</b>
Value per share (Rs)	898	867	838	810	785

Source: Kotak Securities - Private Client Research

### Key Risks

- Delay in setting up of the new capacities would adversely impact our revenue and earnings estimates.
- Lower than expected capacity utilisation could lead to lower revenues and profitability.
- Equity dilution, if any, to fund the new capex, would lead to reduction in value per share.

**Consolidated profit and loss statement (Rs mn)**

Year end March	FY05	FY06E	FY07E	FY08E
<b>Revenues</b>	<b>2,937</b>	<b>4,070</b>	<b>5,025</b>	<b>8,369</b>
% change YoY	37.0	38.6	23.5	66.5
<b>EBITDA</b>	<b>389</b>	<b>815</b>	<b>1,078</b>	<b>1,881</b>
% change YoY	19.3	109.6	32.2	74.5
Other Income	80	104	50	50
Depreciation	33	71	90	131
<b>EBIT</b>	<b>435</b>	<b>848</b>	<b>1,037</b>	<b>1,801</b>
% change YoY	18.6	94.9	22.3	73.6
Net interest	28	53	38	30
<b>Profit before tax</b>	<b>407</b>	<b>795</b>	<b>999</b>	<b>1,771</b>
% change YoY	17.6	95.2	25.6	77.2
Tax	139	252	275	443
As % of EBIT	31.8	29.7	26.5	24.6
Net income	269	543	725	1,328
Minority interest	3	20	30	34
<b>Net Profit</b>	<b>266</b>	<b>524</b>	<b>695</b>	<b>1,294</b>
% change YoY	16.2	96.6	32.6	86.3
Shares outstanding (m)	13.1	17.8	17.8	17.8
<b>EPS (reported) (Rs)</b>	<b>20.4</b>	<b>29.5</b>	<b>39.1</b>	<b>72.8</b>
CEPS (Rs)	22.9	33.4	44.2	80.1
DPS (Rs)	-	2.50	2.50	2.50

**Consolidated balance sheet (Rs mn)**

Year end March	FY05	FY06E	FY07E	FY08E
Cash and cash equivalents	123	153	438	478
Accounts receivable	941	1,240	1,558	2,552
Inventories	420	600	804	1,255
Others	88	820	955	1,046
Current assets	1,571	2,813	3,755	5,331
Misc exp.	(32)	-	-	-
Investments	22	930	250	50
Net fixed assets	291	650	1,360	1,579
<b>Total assets</b>	<b>1,853</b>	<b>4,393</b>	<b>5,365</b>	<b>6,960</b>
Payables	330	410	553	921
Others	70	700	804	1,004
Current liabilities	401	1,110	1,357	1,925
Debt	555	450	500	250
Other liabilities(deferred tax)	21	20	20	20
Equity	131	178	178	178
Reserves	745	2,635	3,310	4,588
<b>Total liabilities</b>	<b>1,853</b>	<b>4,393</b>	<b>5,365</b>	<b>6,960</b>
BVPS (Rs)	49	158	196	268

**Consolidated cash flow statement (Rs mn)**

Year end March	FY06E	FY07E	FY08E
EBIT	848	1,037	1,801
Depreciation	71	90	131
Change in working capital	(400)	(379)	(1,078)
Changes in other net current assets	(103)	(31)	109
Operating cash flow	416	718	962
Interest	(53)	(38)	(30)
Tax	(252)	(275)	(443)
<b>Cash flow from operations</b>	<b>111</b>	<b>405</b>	<b>489</b>
Capex	(468)	(800)	(350)
(Increase)/decrease in investments	(908)	680	200
Dividends	(50)	(50)	(50)
<b>Cash flow from investments</b>	<b>(1,426)</b>	<b>(170)</b>	<b>(200)</b>
Proceeds from equity issue	1,481	-	-
Increase/(decrease) in debt	(105)	50	(250)
Deferred tax credit	(31)	-	-
<b>Cash flow from financing</b>	<b>1,345</b>	<b>50</b>	<b>(250)</b>
Opening cash	123	153	438
Closing cash	153	438	478

**Ratio analysis**

Year end March	FY05	FY06E	FY07E	FY08E
<b>EBITDA margin (%)</b>	<b>13.2</b>	<b>20.0</b>	<b>21.4</b>	<b>22.5</b>
EBIT margin (%)	14.8	20.8	20.6	21.5
Net profit margin (%)	9.1	12.9	13.8	15.5
NPAT growth (%)	16.2	96.6	32.6	86.3
Receivables (days)	100.6	97.8	101.6	89.6
Inventory (days)	51.4	45.7	51.0	44.9
Sales/assets (%)	1,123.0	865.3	500.1	569.6
Interest coverage (x)	15.6	16.1	27.3	60.0
Debt/equity ratio (x)	0.6	0.2	0.1	0.1
RoE (%)	31.0	28.4	22.0	31.4
RoCE (%)	33.8	36.1	28.6	40.0
EV/ Sales (x)	3.5	2.5	2.0	1.1
EV/EBITDA (x)	26.4	12.4	9.2	5.1
<b>Price to earnings (x)</b>	<b>27.1</b>	<b>18.8</b>	<b>14.2</b>	<b>7.6</b>
Price to book value (x)	11.2	3.5	2.8	2.1
Price to Cash Earnings (X)	24.1	16.5	12.5	6.9

Source: Company, Kotak Securities - Private Client Research

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