

AIA ENGINEERING

Strong operating margins

India Equity Research | Miscellaneous

AIA Engineering reported Q2FY14 top line of INR4.9bn, in line with our estimate, led by 2% YoY growth in overall volumes to 42,000 MT and 11% YoY growth in mining volumes to 23,600MT. However, EBITDA growth of 104% YoY was 20% higher than our expectation with operating margin at 22.9% (up 1030bps YoY, 180bps QoQ) primarily due to better pricing and favorable currency impact. The management has maintained its guidance of 25% plus volume growth in mining and 20% plus EBITDA margin during FY14. With average margins of 22% for H1FY14, better product mix within mining leading to improved pricing alongside better currency realizations, we are revising upward our FY14E and FY15E earnings 16% and 15%, respectively. Maintain 'BUY' with a revised target price of INR480.

Mining segment to drive growth

Mining grew 11% YoY with volumes at 23,600MT, leading to an overall volume growth of 2% YoY at 42,000MT. This implies 10% YoY increase in realization with improved pricing and currency. The management maintained its guidance for 180,000MT-1,90,000MT volume (on current capacity) for full year FY14, predominantly driven by growth in the mining segment.

Improved pricing, better realization boost operating margins

Better product mix within mining coupled with favorable exchange rate boosted EBITDA margin by 1030bps YoY and 180bps QoQ to 22.9%. With improved pricing, lower free trials, better currency realization we are upgrading our margin assumptions by 180bps to 20.6% in FY14 and FY15, respectively.

Outlook and valuations: Mining growth; maintain 'BUY'

With huge conversion opportunity in the mining segment of ~1.5mnMT and AIA's success in penetrating the mining segment, we are confident of the company achieving 25% CAGR in mining volumes over the next few years. Better margin led by product mix improvement within mining, higher realization and favourable currency, we are upgrading the earnings for FY14 and FY15 by 16% and 15% respectively. We value the company at 14x FY15E to arrive at a TP of INR480 (INR418 earlier). We maintain 'BUY' recommendation.

Financials

(INR mn)

Year to March	Q2FY14	Q2FY13	% change	Q1FY14	% change	FY13	FY14E	FY15E
Net rev.	4,918	4,403	11.7	4,854	1.3	17,513	20,504	23,595
EBITDA	1,127	554	103.5	1,026	9.9	3,102	4,224	4,861
Net profit	736	401	83.4	655	12.3	2,108	2,851	3,233
Diluted EPS (INR)	7.8	4.3		6.9		22.4	30.2	34.3
Diluted P/E (x)						18.9	14.1	12.5
EV/EBITDA (x)						11.8	8.5	7.2
ROAE (%)						16.0	18.6	18.1

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Underperformer

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

CMP	: INR 427
Target Price	: INR 480
52-week range (INR)	: 464 / 275
Share in issue (mn)	: 94.3
M cap (INR bn/USD mn)	: 40 / 590
Avg. Daily Vol. BSE/NSE ('000)	: 35.1

SHARE HOLDING PATTERN (%)

	Current	Q1FY14	Q4FY13
Promoters *	61.7	61.7	61.7
MF's, FI's & BKs	6.2	6.4	7.8
FII's	27.0	26.8	25.3
Others	5.1	5.2	5.3
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	6.9	20.3	13.4
3 months	1.8	25.2	23.4
12 months	(9.8)	3.7	13.5

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Q2FY14 concall highlights

- Sales volumes during the quarter were 42,000MT (up 2% YOY and down ~5% QoQ) and mining was at 23,600MT (up 11% YoY and 15% plus QoQ). There was a loss of 1,500MT of production due to plant shut down.
- Management maintained guidance of 95,000MT of volumes in mining for the full year, which indicates a growth rate of 25% plus YoY. Overall management guided for a 1,80,000-1,90,000MT for the full year.
- EBITDA margins improved to 22.93 % (180bps up over Q1 FY14).
- Average realization for the quarter was INR1,12,849KT with weighted average currency realization of INR62. Management estimated to maintain the current realization.
- Company has guided for 20% plus EBITDA margins which will be over 230bps improvement from FY13 margins. The improvement will be due to better product mix within mining, lower free introduction of new products, favourable exchange rate as well as improved realization from mining segment.
- Export incentives stood at INR170mn for the quarter.
- Order book stood at INR4.5-4.6bn.
- Debtor days have remained constant at 72 days. Finished goods and WIP inventory has reduced from INR4.03bn to INR3.54bn.
- Net cash at INR5.2bn has increased by 70% on a YoY basis. Capex of INR600mn is yet to be capitalized for the brownfield expansion at Moraiya. Overall capex to the tune of INR3.6bn over next two years. (INR1.2bn brownfield and INR2.4bn greenfield).
- AIA has taken Rs1bn ECB debt in view of lower interest cost of 3%.
- AIA has chalked out an aggressive expansion plan which will ramp up existing capacity by 50%, of which 60,000MT of brownfield will be commissioned by Q4FY14 and 40,000MT of greenfield by CY14 end.
- Hedging loss during quarter was INR150mn.
- Security deposit of INR392mn has been placed in the District Court of Nashville, Tennessee USA to stay the execution of judgment in ceramic technology patent matter. Management as of now is not having any contribution in sales from this technology.

Financial snapshot

(INR mn)

Year to March	Q2FY14	Q2FY13	% change	Q1FY14	% change	YTD14	FY14E	FY15E
Net revenues	4,918	4,403	11.7	4,854	1.3	9,772	20,504	23,595
Raw material	1,789	1,787	0.1	2,122	(15.7)	3,911	13,686	15,750
Employee expenses	231	199	15.7	212	8.7	443	954	1,097
Other expenses	1,771	1,862	(4.9)	1,494	18.5	3,265	1,640	1,888
Total expenditure	3,790	3,849	(1.5)	3,829	(1.0)	7,619	16,280	18,735
EBITDA	1,127	554	103.5	1,026	9.9	2,153	4,224	4,861
Depreciation	91	86	6.8	89	2.8	180	377	488
Other income	47	47	0.9	53	(12.0)	100	177	177
Interest	19	13	54.3	16	23.7	35	95	95
Profit before tax	1,064	502	111.7	975	9.1	2,038	3,928	4,454
Provision for current tax	326	99	228.4	317	2.7	643	1,070	1,213
Core profit	738	403	83.0	657	12.2	1,395	2,859	3,241
PAT	738	403	83.0	657	12.2	1,395	2,859	3,241
Minority interest	2	2	(6.0)	2	(11.2)	4	8	8
Net profit	736	401	83.4	655	12.3	1,391	2,851	3,233
Tax Rate	30.6	19.7		32.6		63.2	27.2	27.2
Raw material	36.4	40.6		43.7		80.1	66.8	66.8
Employee cost	4.7	4.5		4.4		9.1	4.7	4.7
Other expenditure	36.0	42.3		30.8		66.8	8.0	8.0
EBITDA	22.9	12.6		21.1		44.1	20.6	20.6
Reported net profit	15.0	9.2		13.5		28.5	13.9	13.7
Tax rate	30.6	19.7		32.6		63.2	27.2	27.2

Change in estimates

	FY13E			FY14E			Comments
	New	Old	% change	New	Old	% change	
Net revenue	20,504	19,589	4.7	23,595	22,804	3.5	Led by better growth in mining and better pricing and currency
EBITDA	4,224	3,683	14.7	4,860	4,287	13.4	Improved margin led by better pricing
EBITDA margin	20.6	18.8		20.6	18.8		
Core profit	2,859	2,465	16.0	3,241	2,824	14.8	Led by better operating margin
PAT margin	13.9	12.5		13.7	12.3		
Capex	1,100	1,100	0.0	2,500	2,500	0.0	

Miscellaneous

Quarterly metrics

	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14	Q2FY14
Sales (tonnes)	29,800	37,500	34,500	40,200	40,000	41,300	38,000	41,400	44,000	42,000
<i>change y-o-y (%)</i>	8.8	31.8	14.6	2.0	34.2	10.1	10.1	3.0	10.0	1.7
<i>change q-o-q (%)</i>	(24.4)	25.8	(8.0)	16.5	(0.5)	3.3	(8.0)	8.9	6.3	(4.5)
Realization (INR/tonne)	88,646	90,645	98,519	101,629	106,168	103,098	105,684	105,338	106,753	112,849
<i>change y-o-y (%)</i>	0.2	1.5	1.1	15.4	19.8	13.7	7.3	3.6	0.6	9.5
<i>change q-o-q (%)</i>	0.6	2.3	8.7	3.2	4.5	(2.9)	2.5	(0.3)	1.3	5.7
Raw material cost (INR/tonne)	42,816	50,080	51,870	50,751	45,555	43,272	35,916	40,145	48,233	42,587
EBITDA (INR/tonne)	19,570	16,327	20,429	20,819	20,043	13,416	21,747	22,212	23,315	26,843
<i>change y-o-y (%)</i>	(5.1)	10.5	(2.4)	14.0	6.4	(13.6)	(30.8)	(20.9)	5.9	(1.6)
<i>change q-o-q (%)</i>	(3.8)	17.0	3.6	(2.2)	(10.2)	(5.0)	(17.0)	11.8	20.1	(11.7)
Order book	4,800	4,500	4,790	4,500	4,190	4,360	4,600	4,800	4,280	4,500
<i>change y-o-y (%)</i>	17.1	3.4	16.8	0.7	(12.7)	(3.1)	(4.0)	6.7	2.1	3.2
<i>change q-o-q (%)</i>	7.4	(6.3)	6.4	(6.1)	(6.9)	4.1	5.5	4.3	(10.8)	5.1

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	FY12	FY13E	FY14E	FY15E
Macro				
GDP(Y-o-Y %)	6.5	5.0	4.8	6.0
Inflation (Avg)	8.8	7.4	6.0	6.0
Repo rate (exit rate)	8.5	7.5	7.8	7.0
USD/INR (Avg)	47.9	54.5	62.0	60.0
Company				
Cement	66,000.0	73,500.0	73,600.0	77,370.0
Utilities	12,000.0	14,000.0	14,000.0	16,100.0
Mining	64,000.0	73,500.0	94,815.0	121,363.2
Total Quantity	142,000	161,000	182,415	214,833
Cement (y-o-y)	(5.7)	11.4	13.6	512.2
Utilities (y-o-y)	16.0	16.7	-	15.0
Mining (y-o-y)	42.2	14.8	29.0	28.0
Average realisation KG	95.2	105.0	109.9	107.7
Cost assumptions				
Raw Material Cost as % Net Revenue	56.7	53.8	56.8	56.8
Employee cost as % of sales	4.6	4.6	4.7	4.7
Power Cost % sales	10.5	10.0	10.0	10.0
Selling & admin exp % Sales	8.9	13.8	8.0	8.0
Average Interest rate (%)	12.7	5.3	6.0	6.0
Average Depreciation rate (%)	6.2	6.3	6.6	6.6
Tax rate (%)	28.1	27.2	27.2	27.2
Dividend payout ratio (%)	18.2	20.7	17.0	18.0
Capex (INR mn)	(1,002)	(531)	(1,100)	(2,500)
Debtor days	94	74	67	69
Inventory days	103	115	111	107
Payable days	44	34	32	32
Cash conversion cycle (days)	153	155	146	144

Income statement

(INR mn)

Year to March	FY12	FY13	FY14E	FY15E
Income from operations	14,167	17,513	20,504	23,595
Direct costs	9,522	11,186	13,686	15,750
Employee costs	649	809	954	1,097
Other Expenses	1,263	2,415	1,640	1,888
Total operating expenses	11,434	14,411	16,280	18,735
EBITDA	2,733	3,102	4,224	4,861
Depreciation & Amortization	280	324	377	488
EBIT	2,453	2,778	3,847	4,373
Other income	133	213	177	177
Interest expenses	44	55	95	95
Profit before tax	2,541	2,936	3,928	4,454
Provision for tax	715	800	1,070	1,213
Net profit	1,826	2,137	2,859	3,241
Profit After Tax	1,826	2,137	2,859	3,241
Minority interest	7	8	8	8
Profit after minority interest	1,819	2,129	2,851	3,233
Consolidated profit	1,819	2,129	2,851	3,233
Shares outstanding (mn)	94	94	94	94
Diluted EPS (INR)	19.3	22.6	30.2	34.3
Dividend per share (INR)	3.0	4.0	4.4	5.3
Dividend (%)	15.6	17.7	14.6	15.4

Common size metrics

Year to March	FY12	FY13	FY14E	FY15E
Employee expenses	4.6	4.6	4.7	4.7
Direct Cost	67.2	63.9	66.8	66.8
EBITDA margins	19.3	17.7	20.6	20.6
Net profit margins	12.8	12.2	13.9	13.7

Growth ratios (%)

Year to March	FY12	FY13	FY14E	FY15E
Revenues	20.9	23.6	17.1	15.1
EBITDA	5.2	13.5	36.2	15.1
Net profit	(0.8)	17.0	33.9	13.4
EPS	(0.8)	17.0	33.9	13.4

Balance sheet		(INR mn)			
As on 31st March	FY12	FY13	FY14E	FY15E	
Equity capital	189	189	189	189	
Reserves & surplus	12,166	13,989	16,355	19,006	
Shareholders funds	12,355	14,178	16,544	19,195	
Minority interest (BS)	44	81	89	97	
Short term debt	408	524	524	524	
Long term debt	71	1,063	1,063	1,063	
Borrowings	479	1,588	1,588	1,588	
Deferred revenue	158	132	132	132	
Sources of funds	13,036	15,978	18,352	21,011	
Tangible assets	3,417	3,605	4,323	6,335	
Intangible assets	143	167	167	167	
CWIP (incl. intangible)	181	316	316	316	
Total net fixed assets	3,741	4,088	4,806	6,818	
Current Investments	1,403	1,868	1,872	1,871	
Cash and equivalents	1,496	2,790	3,524	3,048	
Inventories	3,011	4,030	4,307	4,957	
Sundry debtors	3,717	3,401	4,167	4,795	
Loans and advances	180	165	165	165	
Other current assets	1,354	2,032	2,072	2,112	
Total current assets (ex cash)	9,664	11,494	12,582	13,900	
Trade payable	986	1,126	1,292	1,487	
Others current liabilities	880	1,342	1,342	1,342	
Total current liabilities &	1,866	2,468	2,634	2,829	
Net current assets (ex cash)	7,797	9,027	9,948	11,071	
Uses of funds	13,036	15,978	18,352	21,011	
Book value per share (INR)	131.0	150.3	175.4	203.5	

Free cash flow		(INR mn)			
Year to March	FY12	FY13	FY14E	FY15E	
Net profit	1,826	2,137	2,859	3,241	
Depreciation	280	324	377	488	
Deferred tax	-	25	-	-	
Others	(182)	-	-	-	
Gross cash flow	1,924	2,486	3,236	3,729	
Less: Changes in WC	1,503	789	917	1,123	
Operating cash flow	422	1,698	2,319	2,606	
Less: Capex	1,002	531	1,100	2,500	
Free cash flow	(580)	1,166	1,219	106	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted PE (X)		EV/EBITDA (X)		ROAE (%)	
		FY14E	FY15E	FY14E	FY15E	FY14E	FY15E
AIA Engineering	590	14.1	12.5	8.7	7.6	18.6	18.1
Carborundum Universal Ltd	340	14.4	10.6	7.9	6.3	13.2	15.8
Grindwell Norton Ltd	221	9.8	8.2	13.5	11.4	24.0	20.6
Median	-	14.1	10.6	8.7	7.6	18.6	18.1
AVERAGE	-	12.8	10.4	10.0	8.5	18.6	18.2

Source: Edelweiss research

Cash flow metrics					
Year to March	FY12	FY13	FY14E	FY15E	
Operating cash flow	951	1,672	2,319	2,606	
Investing cash flow	(917)	(1,045)	(1,100)	(2,500)	
Financing cash flow	(61)	667	(485)	(582)	
Net cash flow	(27)	1,294	734	(476)	
Capex	(1,002)	(531)	(1,100)	(2,500)	
Dividends paid	(331)	(441)	(485)	(582)	

Profitability & efficiency ratios

Year to March	FY12	FY13	FY14E	FY15E
ROAE (%)	15.9	16.0	18.6	18.1
ROACE (%)	21.8	20.3	23.8	23.4
Debt/EBITDA	0.2	0.5	0.4	0.3
Fixed asset turnover (x)	4.2	4.5	4.6	4.1
Net Debt/Equity	(0.4)	(0.3)	(0.3)	(0.3)

Operating ratios

Year to March	FY12	FY13	FY14E	FY15E
Total asset turnover	1.2	1.2	1.2	1.2
Fixed asset turnover	4.2	4.5	4.6	4.1
Equity turnover	1.2	1.3	1.3	1.3

Valuation parameters

Year to March	FY12	FY13	FY14E	FY15E
Diluted EPS (INR)	19.3	22.6	30.2	34.3
Y-o-Y growth (%)	(0.8)	17.0	33.9	13.4
CEPS (INR)	22.5	26.1	34.2	39.5
Diluted PE (x)	22.2	18.9	14.1	12.5
Price/BV (x)	3.3	2.8	2.4	2.1
EV/Sales (x)	2.5	2.1	1.7	1.5
EV/EBITDA (x)	13.9	12.0	8.7	7.6
Dividend yield (%)	0.7	0.9	1.0	1.2
Market Capitalisation	40,289	40,289	40,289	40,289

Additional Data

Directors Data

Mr. Rajendra S. Shah	Chairman Independent - Non-Executive	Mr. Bhadresh K. Shah	Managing Director : Executive - Promoter
Mr. Vinod Narain	Independent	Mr. Bhupendra A. Shah	Independent
Mr. Sanjay S. Majmudar	Independent	Dr. S. Srikumar	Non Independent - Non-Executive Director
Mr. Yashwant M. Patel	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	16.79
Capital group compan	5.13	Genesis indian inv c	4.09
Hdfc asset managemen	3.53	Matthews internation	3.35
Prudential plc	1.48	Burgundy asset manag	1.21
Birla sun life asset	1.14	Tat aia life insuran	1.06

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
24 May 2013	Hdfc Equity Fund	Sell	1075000	287.99
24 May 2013	Small Cap World Fnd Inc	Buy	500000	288.00
24 May 2013	Europacific Growth Fund	Buy	575000	288.00

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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**as per last available data*

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

AIA Engineering, Balkrishna Industries, Bayer Cropscience, Escorts, Jain Irrigation, PI Industries, Rallis India, Supreme Industries, Solar Industries, United Phosphorus, VIP Industries

Recent Research

Date	Company	Title	Price (INR)	Recos
29-Oct-13	VIP Industries	CSD turnaround, Strong end of season sale; <i>Result Update</i>	58	Buy
29-Oct-13	Balkrishna Industries	Strong margin uptick ; <i>Result Update</i>	277	Buy
25-Oct-13	Exide Industries	Industrial and OEM dip; profitable growth ahead; <i>Result Update</i>	123	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	127	44	8	180
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	112	54	14	

Rating Interpretation

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

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