Initiating Coverage

AIA Engineering Ltd.

July 21, 2022

RETAILRESEARCH

AIA Engineering Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Engineering	Rs 2406	Buy on dips in Rs 2280-2310 band and add further on dips to Rs 2040-2070 band	Rs 2536	Rs 2697	2 quarters

HDFC Scrip Code	AIAENGEQNR
BSE Code	532683
NSE Code	AIAENG
Bloomberg	AIAE IN
CMP Jul 20, 2022	2405.8
Equity Capital (Rs cr)	18.9
Face Value (Rs)	2
Equity Share O/S (cr)	9.4
Market Cap (Rs cr)	22693
Book Value (Rs)	504.2
Avg. 52 Wk Volumes	69,000
52 Week High (Rs)	2489.0
52 Week Low (Rs)	1475.1

Share holding Pattern % (Jun, 2022)	
Promoters	58.5
Institutions	38.5
Non Institutions	3.0
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
Atul Karwa
atul.karwa@hdfcsec.com

Our Take:

AIA Engineering (AIAE) is in the niche business of manufacturing chrome based mill internals and is the second largest producer in the world after Moggateaux. It is a one-stop shop for grinding mill internals having built strong relationships with major copper and gold mining companies. Gradual shift towards chrome based internals due to its inherent benefits is expected to drive volumes for the company. It has also undertaken brownfield capacity expansion from 390,000 tons to 440,000 tons to meet the increased requirement going forward. Technical collaboration with EEMS would enable the company to cater to the whole mining-grinding market.

Valuation & Recommendation:

We expect AIAE's Revenue/EBITDA/Adj. PAT to grow at 12/14/11% CAGR over FY22-FY24E led by increasing demand for grinding media. AIAE has been able to pass on the entire increase in costs to its customers which has enabled it to protect its margins. We feel investors could buy the stock on dips in Rs 2280-2310 band and add further on dips to Rs 2040-2070 band (28.5x FY24E EPS) for base case fair value of Rs 2536 (31.5x FY24E EPS) and bull case fair value of Rs 2697 (33.5x FY24E EPS) in two quarters.

Financial Summary

Particulars (Rs cr)	Q4FY22	Q4FY21	YoY (%)	Q3FY21	QoQ (%)	FY21	FY22	FY23E	FY24E
Operating Income	1093	860	*27.1*	848	*28.9*	2881	3567	4078	4469
EBITDA	226	169	*33.5*	161	*40.1*	655	721	848	943
APAT	195	134	*45.5*	138	*40.9*	566	620	700	759
Diluted EPS (Rs)	20.6	14.2	*45.5*	14.6	*40.9*	60.0	65.7	74.2	80.5
RoE (%)						14.3	13.8	13.8	13.3
P/E (x)						40.1	36.6	32.4	29.9
EV/EBITDA (x)						31.9	29.3	24.4	21.4

(Source: Company, HDFC sec)

Q4FY22 Result Update

Consolidated revenues grew by 27% YoY to Rs 1093cr. Overall sales volume came in at 72976 tonnes in Q4FY22, down 8.1% YoY. Mining segment volumes declined 10.6% to 44395 tonnes while cement & others segment volumes declined marginally by 3% to 28581 tonnes YoY. Net realisation per tonne increased 38% to Rs 147.9 per kg YoY, owing to product mix and price increases to pass through higher input cost. EBITDA came in at Rs 225cr, up 33.2% YoY. EBITDA margins improved 94 bps YoY to 20.6%, helped by increased in gross margins to 56.7% (vs. 53.1% in Q4FY21) amid higher commodity prices being passed on. AIA reported PAT at Rs 193cr, up 45.3%YoY, aided by higher other income, which grew 66.7% YoY to Rs 38.7cr.

The company lost ~35000-40000 MT of volume in FY22 from Canada and South Africa owing to their new custom duty structure (anti-dumping duty) and supply chain disruption. However, at the same time ~30000 MT volume was gained from new customers. Efforts for new mining customer acquisition and higher wallet share of existing customers is expected to pick up as the travel situation has started to normalise and will allow AIA to gain further volume growth in coming years. The order book of the company was at Rs 502cr as on Q4FY22 (vs. Rs 682cr as on Q3FY22). The company estimates capex of Rs 300cr, which includes mill lining project, grinding media expansion project and hybrid power project of 6.30 MW wind power and 5.67 MW of solar power in addition to general capex in FY23.

Key Triggers

Favourable demand scenario led by copper and gold mining

The overall consumable wear part demand in mining sector is estimated to be between 2.5 and 3 million MT per annum with high chrome segment forming less than 20% of the market with the balance being served by conventional products like forged grinding media. On account of this, there exists a large potential conversion opportunity that can fuel growth for high chrome mill internals. According to Global Info Research study, due to COVID-19 pandemic, the global High Chrome Mill Internals (HCMIs) market size is estimated to be worth US$ 1523.1 million in 2021 and is forecast to a readjusted size of USD 2715.7 million by 2028 with a CAGR of 8.6%. Besides this, there is a strong capex being planned by the key major players in the Copper and Gold mining business which should further help support growth in the market. Key major players in the copper mining space such as Codelco, Anglo American, BHP and Glencore, have healthy capex programs and new capacity additions leading to strong demand for grinding media.

Global demand for copper, an essential component in manufacturing electric vehicles (EVs) and consumer electronics, will outstrip supply by more than six million tonnes by 2030, Rystad Energy projects. A deficit of this magnitude would have wide-reaching ramifications for the energy transition as there is currently no substitute for copper in electrical applications. Significant investment in copper mining is required to avoid the shortfall. This could be a tailwind for companies like AIAE.

Global cement industry to witness strong growth
The global cement market is projected to grow from $340.61 billion in 2022 to $481.73 billion by 2029, at a CAGR of ~5% in 2022-2029. Global cement consumption in 2021 has grown solidly (excluding China) across much of the world. Cement markets in Europe hit by harsh lockdowns in 2020 have staged a strong rebound in 2021 and are expected to see a further demand increase of 4 – 5% in 2022. In the US cement market has enjoyed strong demand throughout 2021, driven by low interest rates and numerous stimulus programmes. Commercial construction is expected to post a solid growth driven by warehousing, urban distribution facilities and data centres. The new US$1.5 trillion infrastructure bill is expected to impact volumes from mid-2023. The oil price recovery has led to a sharp rebound in regional cement demand in Middle East, which is predicted to grow by 3-4% in 2022.

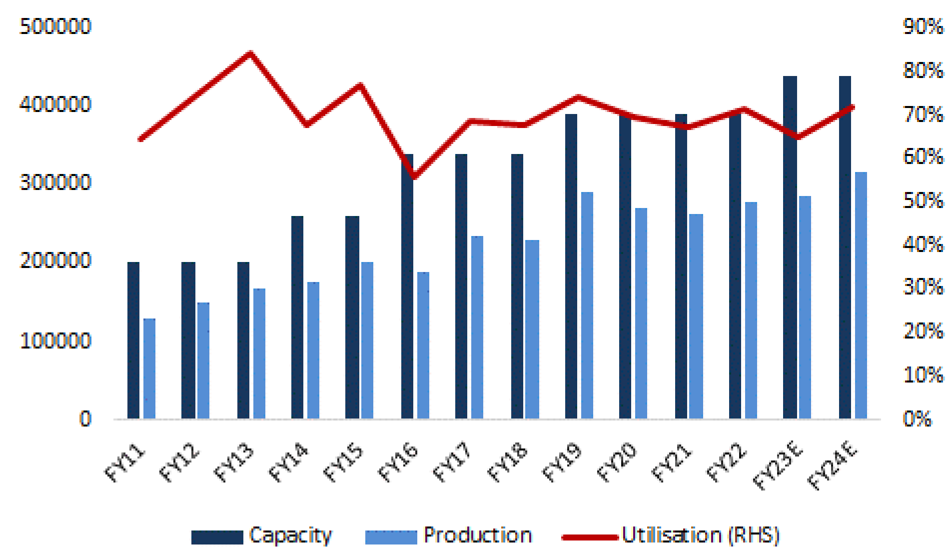
In India, cement demand is expected to grow by 7-8% to around 382 million metric tonnes in the current fiscal, helped by tailwinds of strong demand from rural housing and infrastructure sectors, according to a report by ICRA. The recent budgetary allocation of over Rs 9.2 lakh crore towards agriculture, affordable housing and capital expenditure is expected to augur well for cement demand.

AIAE continues to maintain market share and continues to make investments in new alloys, designs and process improvements which will ensure that it continues to be a preferred supplier to cement companies worldwide.

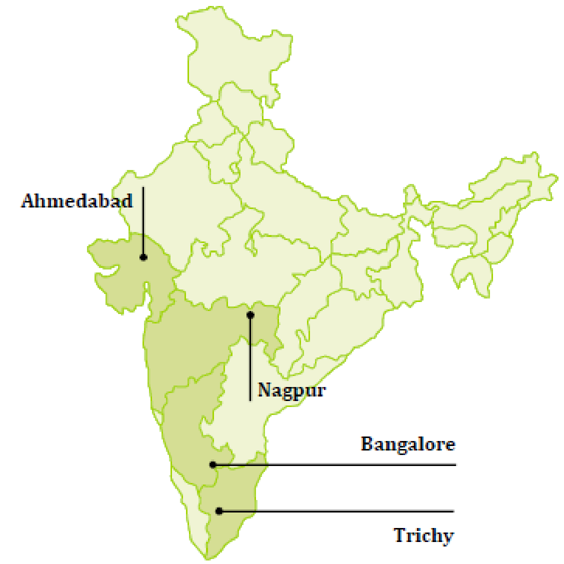
Conversion to chrome castings to benefit company
There has been a gradual shift from forged to high chrome castings in the crushing and grinding processes of cement and mining industries. Chromium mill internals possess certain benefits over forged mill internals. AIAE's chrome products help the end user segments to increase productivity, maintain consistent end product quality, reducing power cost and fewer mill stoppages due to lower wear rate. Metal recovery is higher with ferrochrome due to better oxygen retention. Although the capital cost for chrome internals is higher by ~20% the benefits outweigh the initial capital cost in the longer run. High chrome penetration is less than 15%, hence large conversion opportunity available for growth.

Capacity expansion to support future growth
AIA has been expanding its capacity every few years to meet the need of increasing demand. The company has nearly completed setting up a manufacturing plant of Mill Liners with a capacity of 50,000 Mt and it was expected to be commissioned in June 2022. Further It plans to add 80,000 MT of capacity at an estimated capex of Rs 200cr and commissioning by end of FY2024 taking the total capacity to 520,000 TPA. Power being one of the important cost items, AIA is looking to invest Rs 90cr in wind mills. All the capex is expected to be funded through internal accruals.

Utilisation rate to increase despite of expanded capacities



Plant Locations



(Source: Company, HDFC sec)

Focus on Commodities, Determinants in Product Placement and Pricing:

Gold, Copper, Platinum and Iron Ore mines are under perusal for product placement, particularly Gold and Copper. As HMCI helps in improving productivity of mines, purchase decisions are solely upon mine managers who are responsible for mine productivity making the efforts mine specific and time consuming for product placement. However, over the years, AIA has developed capabilities in addressing multiple determinants like size of high chrome balls, costs, throughput, yield and other geological attributes which are mine specific. AIA management has commented that it has transformed from being a pure cost leader to cost plus value-added supplier in the market. It also commented that supply contracts are locked-in only on volumes and not on prices as these are adjusted on a quarterly or two quarter basis.

Technical collaboration with EE Mill Solutions LLP, USA (EEMS)

AIAE has entered into a technical collaboration with EEMS which has special knowledge of optimising energy efficiency and output of grinding equipment like AG/SAG/Ball Mills in wet & dry grinding industries through re-designing of mill internals i.e. Head & shell liners, grate liners, pulp lifters. Post entering into technical collaboration agreement with EEMS, the company has started market development activity relating to the mining liners based on the technical know-how and inputs obtained from EEMS and the initial results are quite encouraging. The company has also firmed up plans for setting up of a dedicated plant for manufacturing the above products. Till the dedicated plant is set up the above products are being manufactured in the existing plants of the company.

Optimising costs to reduce opex

AIAE is conscious of its operating expenses and trying to reduce them in an effort to improve the company's profitability. To hedge its power costs, the company installed 9 WTGs of 2.1 MW over the last few years through which it was able to meet 17% of its total energy requirement. It is looking to further increase its renewable capacity and is investing Rs 90cr for captive power generation.

Risks & Concerns

Working capital intensive operations

Operations are working capital intensive, marked by large inventory and debtors. AIA has to maintain high inventory and stocking requirement across several geographies. Besides, debtors are moderately high due to extended credit cycles to overseas clients.

Volatility in raw material prices and forex movements

Operating margin remains susceptible to fluctuations in the prices of raw materials (particularly, steel scrap and ferrochrome) and adverse rupee-dollar exchange rate movements, as exports account for 70-75% of sales.

Increasing interest rate

Government's across the world are increasing interest rates to control the inflationary pressure driven by sharp increase in input prices. This could lead to delays in capex plans of companies thereby impacting demand for company's products.

Changes in incentives

Due to changes in export incentives (removal of RoDTEP on grinding media and the reduce rate on non-grinding areas), AIAE had a hit of Rs 60cr for FY22, though due to lower base, there may not be much impact in FY23 onwards.

Improvement in Return ratios

Return ratios could be better if the large cash on books (Rs 506cr and current investment of Rs 1055cr) is put to good use.

Company Background:

Incorporated in 1978, AIA Engineering (AIAE) specialises in the design, development, manufacture, installation and servicing of high chromium wear, corrosion and abrasion resistant grinding media, liners, and diaphragms, collectively known as mill internals used in the cement, mining and thermal power generation industries. AIAE is the second largest hi-chrome casting producer in the world. AIA has one manufacturing plant in India and ten marketing entities overseas and its products are sold in more than 120 countries globally. As of FY22 the company had a manufacturing capacity of 390,000 TPA, which is being expanded to 440,000 TPA in FY23 and further by 80,000 TPA by end of FY24.

AIA's customer base across industries

(Source: Company, HDFC sec)

AIAE provide customers with optimized solutions through technical evaluation of their requirements, thereby providing specifically designed solutions in ideal metallurgy for the application, plus offering process optimization services worldwide.

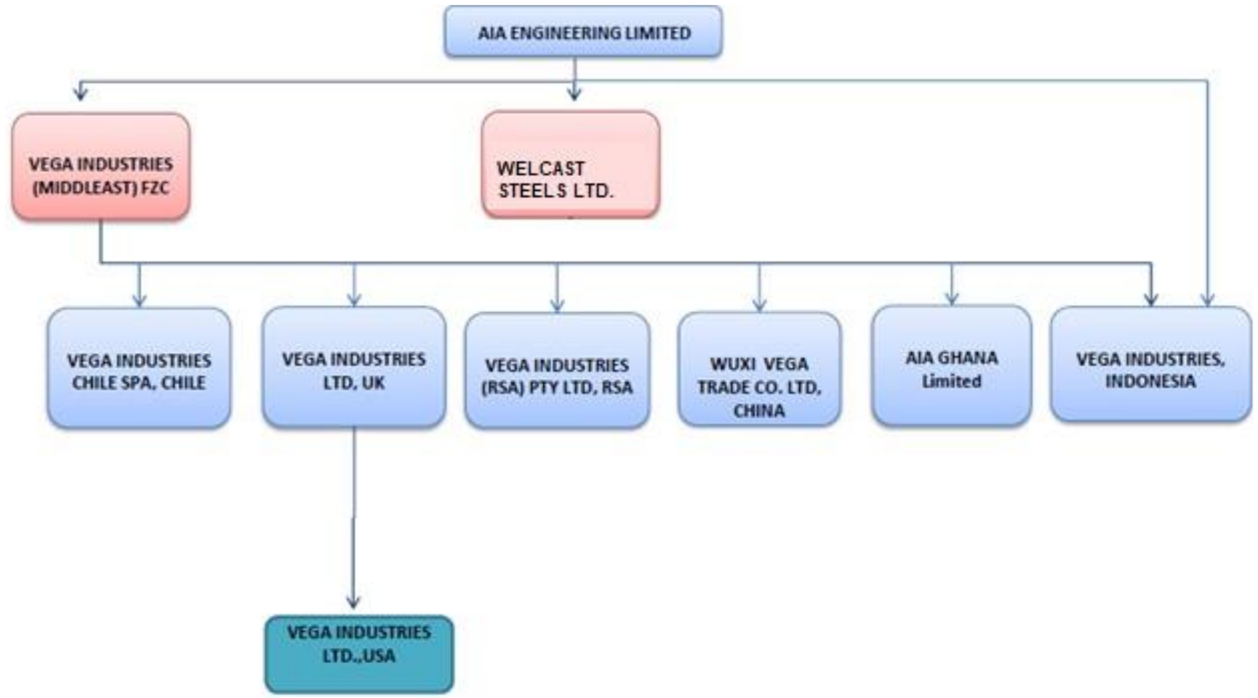
AIAE offers complete grinding solutions

Application	▪ Understanding size reduction parameters of the crushing/milling equipment in view of optimization of grinding process and maintenance costs
Design	▪ Precise design for the perfect application
Alloy Selection	▪ Taking into consideration the three wear mechanisms – Impact, Corrosion & Abrasion, and Design
Supervising Installation	▪ The installation of the wear parts supplied by the company is done under the supervision of AIA technicians
Optimizing of grinding system	▪ Visits to plants to conduct mill studies to Learn and Control operating parameters ▪ Fine tuning of operations

(Source: Company, HDFC sec)

AIAE has a 74.85% subsidiary Welcast Steels Ltd. Engaged in manufacturing High Chrome Grinding Media balls for the Cement and Mining Industry. Founded in 1972, it was acquired by AIA in 2005. The company reported revenues of Rs 86cr in FY22 (FY21: Rs 98cr) and a loss of Rs 0.5cr (Rs 1.8cr)

Corporate Structure



(Source: Company, HDFC sec)

Financials

Income Statement

(Rs cr)	FY20	FY21	FY22	FY23E	FY24E
Net Revenues	**2970**	**2881.5**	**3566.5**	**4077.6**	**4469.5**
Growth (%)	***-3.2%***	***-3.0%***	***23.8%***	***14.3%***	***9.6%***
Operating Expenses	2290	2226	2846	3229	3526
EBITDA	**680**	**655**	**721**	**848**	**943**
Growth (%)	***3.1%***	***-3.7%***	***10.0%***	***17.6%***	***11.2%***
EBITDA Margin (%)	***22.9%***	***22.7%***	***20.2%***	***20.8%***	***21.1%***
Depreciation	98	94	92	104	121
Other Income	142	172	156	163	179
EBIT	**724**	**734**	**785**	**907**	**1001**
Interest expenses	**6**	**4**	**4**	**5**	**5**
PBT	719	730	781	902	996
Tax	128	164	162	203	237
Adj. PAT	**590**	**566**	**620**	**700**	**759**
Growth (%)	***15.6%***	***-4.1%***	***9.5%***	***12.9%***	***8.5%***
EPS	62.6	60.0	65.7	74.2	80.5

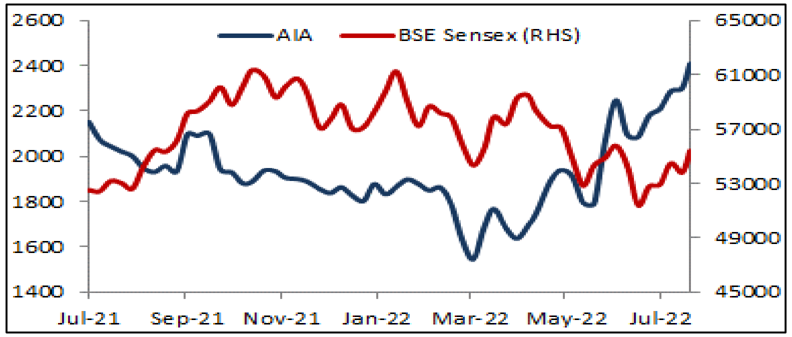
Balance Sheet

As at March (Rs cr)	FY20	FY21	FY22	FY23E	FY24E
SOURCE OF FUNDS					
Share Capital	19	19	19	19	19
Reserves	3682	4225	4736	5341	6006
Shareholders' Funds	**3701**	**4244**	**4755**	**5360**	**6025**
Minority Interest	9	9	8	8	7
Borrowings	97	184	3	0	0
Net Deferred Taxes	67	47	39	39	39
Other Long Term Liab.	11	6	3	9	8
Total Source of Funds	**3885**	**4490**	**4808**	**5416**	**6079**
APPLICATION OF FUNDS					
Net Block & Goodwill	890	811	790	995	1055
CWIP	32	161	210	126	76
Investments	1419	809	1055	1305	1605
Other Non-Curr. Assets	94	69	398	177	249
Total Non-Current Assets	**2435**	**1850**	**2454**	**2604**	**2984**
Inventories	778	755	1226	1341	1408
Trade Receivables	648	638	800	950	1016
Cash & Equivalents	155	1395	506	712	880
Other Current Assets	145	119	140	179	196
Total Current Assets	**1727**	**2908**	**2672**	**3181**	**3500**
Trade Payables	136	166	197	223	245
Other Current Liab & Provisions	140	102	120	140	153
Total Current Liabilities	**277**	**268**	**317**	**363**	**398**
Net Current Assets	**1450**	**2640**	**2355**	**2818**	**3102**
Total Application of Funds	**3885**	**4490**	**4808**	**5416**	**6079**

Cash Flow Statement

(Rs cr)	FY20	FY21	FY22	FY23E	FY24E
PBT	719	730	781	902	996
Non-operating & EO items	-95	-54	-153	226	-73
Interest Expenses	-16	-46	4	5	5
Depreciation	98	94	92	104	121
Working Capital Change	123	60	-601	-257	-116
Tax Paid	-149	-184	-163	-203	-237
OPERATING CASH FLOW (a)	**679**	**598**	**-39**	**778**	**697**
Capex	-131	-123	-125	-220	-130
Free Cash Flow	548	475	-165	558	567
Investments	-204	670	-226	-250	-300
Non-operating income	25	-898	451	0	0
INVESTING CASH FLOW (b)	**-310**	**-351**	**100**	**-470**	**-430**
Debt Issuance / (Repaid)	-419	91	-259	-96	-94
Interest Expenses	-4	-3	-3	-5	-5
FCFE	-54	335	-202	207	168
Share Capital Issuance	0	0	0	0	0
Dividend	-399	0	-76	-94	-94
Others	-9	-9	-10	-5	-5
FINANCING CASH FLOW (c)	**-429**	**67**	**-268**	**-102**	**-100**
NET CASH FLOW (a+b+c)	**-60**	**314**	**-207**	**206**	**168**

Price chart



Key Ratios

	FY20	FY21	FY22	FY23E	FY24E
Profitability Ratios (%)					
EBITDA Margin	22.9	22.7	20.2	20.8	21.1
EBIT Margin	24.4	25.5	22.0	22.2	22.4
APAT Margin	19.9	19.6	17.4	17.2	17.0
RoE	16.4	14.3	13.8	13.8	13.3
RoCE	19.5	17.8	17.1	17.9	17.6
Solvency Ratio (x)					
Net Debt/EBITDA	-0.1	-1.8	-0.7	-0.8	-0.9
Net D/E	0.0	-0.3	-0.1	-0.1	-0.1
PER SHARE DATA (Rs)					
EPS	62.6	60.0	65.7	74.2	80.5
CEPS	73.0	70.0	75.5	85.2	93.3
BV	392.5	450.1	504.2	568.4	638.9
Dividend	27.0	9.0	9.0	10.0	10.0
Turnover Ratios (days)					
Inventory days	96	97	101	115	112
Debtor days	19	19	19	19	19
Creditors days	178	334	241	252	253
VALUATION (x)					
P/E	38.4	40.1	36.6	32.4	29.9
P/BV	6.1	5.3	4.8	4.2	3.8
EV/EBITDA	31.2	31.9	29.3	24.4	21.4
EV/Revenues	7.1	7.3	5.9	5.1	4.5
Dividend Yield (%)	1.1	0.4	0.4	0.4	0.4
Dividend Payout (%)	43.1	15.0	13.7	13.5	12.4

(Source: Company, HDFC sec)

ATUL JAGDISH KARWA

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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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