

AIA Engineering Ltd

BUY

CMP Rs1603

Target Rs1948

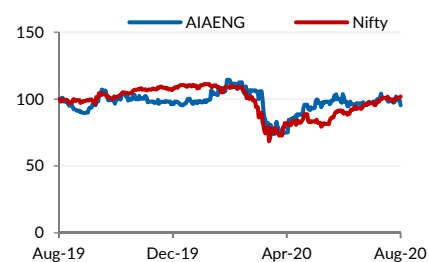
Upside 22%

HIGHLIGHTS	✓ AIA reported promising set of result as Sales/EBITDA/PAT came in 17%/41%/110% ahead of our estimates.
	✓ Net sales were down 21% yoy owing to 47% yoy drop in non-mining volumes & 6% fall in realizations which were function of unfavorable mix & decline in ferrochrome prices.
	✓ Adjusted EBITDA margin (incl. FX gain of Rs380mn) was at 27.8%, up 290bps yoy due to favorable currency movements.
	✓ Net cash position improved by Rs3bn qoq to Rs17.5bn due to improvement in working capital from Rs12bn to Rs9.7bn.
	✓ Mgmt. is aiming for flat volume growth in rest of 9MFY21.
Our View	✓ We increase our FY21 earning estimate by 6% to factor in, i) Increase in volumes by 3% to 247k MT, ii) Realization cut of 2% & iii) Higher other income due to forex gain. We retain FY22 volume estimates at 296k MT assuming i) Increase in annual grinding media volumes by 20-25k MT on a normalized base of FY20, ii) 10k MT contribution from mill lining solutions.
	✓ Though AIAE's client addition has largely skewed towards Gold & Copper segments in last 2-3 years, management continues to remain bullish on prospects of, i) Gold mining due to recent rally, ii) Copper mining due to electronics, smart products & digitalization, should aid in incremental mineral volume demand.
	✓ We believe AIAE is better poised for long term growth with a successful diversification move to address product adjacencies through value added offerings like EEMS product solutions with increased throughput & power saving benefits for customers.
Valuation	✓ We are building in ~70bps margin expansion over FY20-22 led by benefits of INR depreciation (~75% exports), launch of value added mill lining solutions & operating leverage play.
	✓ We remain optimistic on the business prospects with strong adjusted ROE (ex-cash) of 28%, healthy FCF generation, prudent capital allocation & strong balance sheet. Retain 'BUY' with TP of Rs1948 at 28x FY22 EPS.
Risk tcall	✓ Delay in demand recovery & Unfavorable currency movement

Stock data (as on August 11, 2020)

Nifty:	11,323
52 Week h/l (Rs)	1990 / 1102
Market cap (Rs/USD bn)	151 / 2
Outstanding Shares	94
6m Avg t/o (Rs mn):	95
Div yield (%):	1.7
Bloomberg code:	AIAE IN
NSE code:	AIAENG

Stock performance



	1M	3M	1Y
Absolute return	(1.9)	2.1	(2.9)

Shareholding pattern (As of Jun'20 end)

Promoter	58.5%
FII+DII	37.8%
Others	3.4%

Δ in earnings estimates

	FY21e	FY22e
EPS (New)	55.9	69.6
EPS (Old)	52.8	69.6
% change	6%	0%

Exhibit 1: Financial Summary (Consolidated)

Y/e 31 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
Revenues	24,451	30,695	29,809	27,538	33,647
yoy growth (%)	8.9	25.5	(2.9)	(7.6)	22.2
EBITDAM (%)	21.9	21.5	22.8	22.1	23.5
Adjusted PAT	4,434	5,108	5,903	5,271	6,563
yoy growth (%)	(2.9)	15.2	15.6	(10.7)	24.5
EPS (Rs)	47.0	54.2	62.6	55.9	69.6
P/E (x)	34.3	29.7	25.7	28.7	23.0
P/BV (x)	5.0	4.3	4.1	3.7	3.3
EV/EBITDA (x)	26.1	21.2	20.2	21.4	16.3
Net D/E (x)	(0.4)	(0.4)	(0.4)	(0.5)	(0.5)
ROE (%)	15.5	15.7	16.4	13.5	15.1
Core ROIC (%)	19.4	19.6	19.8	16.9	21.6

Source: Company, YES Sec - Research

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CON-CALL HIGHLIGHTS

Business outlook

- ✓ Management has refrained from giving out any guidance for FY21 as situation is still evolving. However, its primary focus will remain on business recovery & normalization.
- ✓ Mining market continues to be AIAE's growth engine. It represents a large opportunity for conversion of conventional forged grinding media to high chrome grinding media.
- ✓ Management is extremely bullish on business prospects from Gold & Copper mining.
- ✓ Annual consumption of grinding media for the mining segment is estimated at 2.5mn tons with less than 20% of the same converted to high chrome, thus offering a sizeable growth opportunity of conversion.
- ✓ In addition, AIAE increasing its wallet share with Mill linings which has ~0.3mn tons global market and represents a growth opportunity. It is focusing on effective penetration through, a) Ability to offer significant reduction in the grinding media cost through use of high chrome media in place of forged media resulting in much lower wear rates, b) Reduction of other costly consumables/reagents in the down process by using high chrome grinding media and thereby also improving recoveries, c) Mill optimization through unique high chrome mill lining solutions resulting into improvement in throughputs and cost reduction.
- ✓ In the Cement segment, the near-term prospects continue to remain flat. However, whenever production will go up, AIAE will be an immediate beneficiary service the additional requirement. Cement customers in India are optimistic about the cement demand picking up and see a lot of demand in the future. Cement companies are seeing traction from infrastructure segment and not so much from real estate projects. Utilities segment was stable as the coal production activities was not impacted that much. Power generation did get impacted as commercial consumption went down and industrial activities were stalled. As thermal is a small part of the business, it won't affect AIAE's top line that much
- ✓ There is a pause on developmental activities and customer acquisition in near term for mill liners till things settle down. As far as new development is concerned, activities like exchange of information and physical experimentation on the customer end have come down on account of lockdown. Mgmt. believes the activities to pick up as soon as international travel restrictions are lifted and the employees are mentally ready to travel as well
- ✓ Mgmt. expects demand in India to ramp up quickly as it is getting enquiries from its various domestic customers
- ✓ Mgmt. also expects all countries to come up with an infrastructure stimulus which would ultimately increase the demand for AIAE's customers products as infra stimulus would boost demand for cement and iron ores
- ✓ No incremental update from Vale customer.

Promising mining volume performance in Q1FY21

- ✓ Total volumes came in at 53,177 MT, down 16% yoy due to weak non-mining segment volumes during the quarter.
- ✓ Mining volumes surprised positively at 41,055 MT, +1% yoy, non-mining segment volumes slipped 47% yoy to 12,122 MT due to sluggish infrastructure & industrial activities in domestic as well as exports markets.
- ✓ AIAE was very alert and expected production & supply disruptions to arise due to which it produced a little more and stocked up its warehouses strategically which allowed dispatches to the customers during Q1FY21 amid lockdown.

- ✓ Inquiries have picked up pace in June'20 as order book as on Q1FY21 improved to Rs7.4bn vs Rs6bn qoq.
- ✓ Brazil & South Africa markets are also opening up gradually like India.
- ✓ COVID-19 impact: Company faced plant closures for a brief period when the country was placed under Government-mandated lockdown. Its plants were started in a staggered manner from mid of April 2020 and, now running at 70% to 80% of Pre-Covid utilization.
- ✓ Gold plants are running at full throttle, copper is largely linked to electronics customers and consumption there hasn't shrunk as well. Iron ore is linked to infrastructure, and AIAE sees reasonable encouraging signals from its customers on that front

Update on Mill lining and grinding media expansion

- ✓ One of the decisions taken by AIAE in terms of covid-19 impact was to revisit the design and implementation schedule for the grinding media expansion. Once
- ✓ For mill lining expansion, the company is on track but there was a disruption for about 8-10 weeks. Equipment is in place and is commissioned. Mgmt. expects the facility to get commissioned by Mar'21.
- ✓ For the mill lining plant, AIAE spent Rs600mn/ Rs300mn in FY20/Q1FY21 and the balance Rs1.6bn should come in remaining 9MFY21.

Other Highlights

- ✓ Capex planned for FY21: Rs2.6bn (Rs330mn spent in Q1FY21)
- ✓ Working capital has come down to Rs9.7bn from Rs12bn in Q4FY20.
- ✓ Net cash balance stood at Rs17.5bn, up by Rs3bn qoq.
- ✓ Wind mill projects is generating IRR of ~20% & annual saving of Rs250-300mn.
- ✓ AIAE had hedged almost 40% of the receipts at a rate between 76-77.
- ✓ It had a foreign exchange gain of Rs380mn for Q1FY21
- ✓ INR realization rate was at 75, up 7.7% yoy.
- ✓ The company did not see a single customer failing to pay or running in an overdue situation. AIAE also made its payments to vendors on time
- ✓ Tax rate for FY21 would be 22%.
- ✓ Govt. likely to come out with an export incentive policy by CY20 end.
- ✓ Anti-dumping duties from various countries like Brazil won't have a significant impact on AIA's business prospects as company is following fair business practices with no undercutting of product prices.
- ✓ From supply standpoint, AIAE has no dependence on China. From a sales standpoint, the company sells premium castings (3,500 MT) to China
- ✓ If covid-19 had not occurred, AIAE had planned sales of close to 290,000 MT for FY21

Exhibit 2: Result table (Consolidated)

(Rs mn)	Q1 FY21	Q1 FY20	% yoy	Q4 FY20	% qoq
Total sales	5,803	7,333	(20.9)	8,569	(32.3)
EBITDA	1,235	1,686	(26.8)	1,847	(33.2)
EBITDAM (%)	21.3	23.0	(172.1)	21.6	(28.2)
Depreciation	(251)	(236)	6.3	(269)	(6.5)
Interest	(14)	(14)	(1.5)	(14)	3.2
Other income	748	386	93.6	292	155.9
PBT	1,717	1,822	(5.8)	1,857	(7.6)
Tax	(424)	(427)	(0.6)	(433)	(2.2)
Minority Interest	(1)	9	(107.6)	(8)	(91.8)
Recurring PAT	1,293	1,404	(7.9)	1,416	(8.7)
Adj. EBITDA	1,615	1,824	(11.4)	1,818	(11.2)
Adj. EBITDA/Kg	30.4	28.7	5.9	22.1	37.2

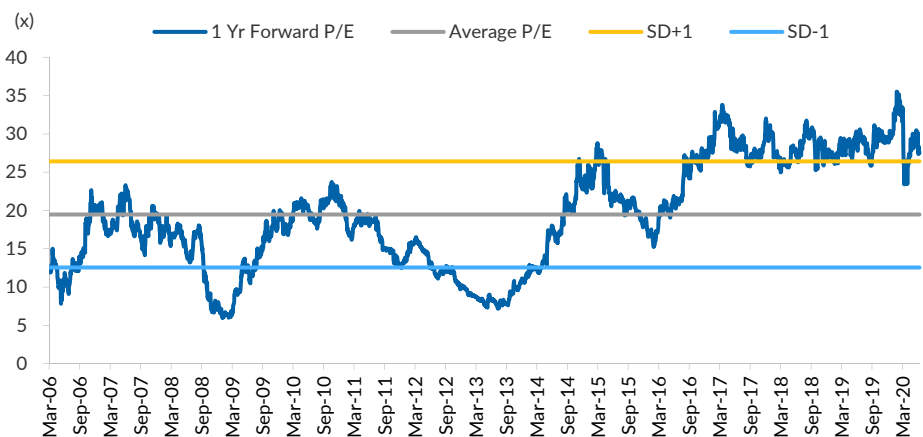
Source: Company, YES Sec – Research

Exhibit 3: Cost analysis (Consolidated)

As a % of net sales	Q1 FY21	Q1 FY20	bps yoy	Q4 FY20	bps qoq
COGS	39.3	39.1	15.9	43.8	(456.4)
Employee cost	5.7	4.4	134.2	4.0	170.3
Other expenses	33.7	33.5	22.0	30.6	314.2
Total costs	78.7	77.0	172.1	78.4	28.2

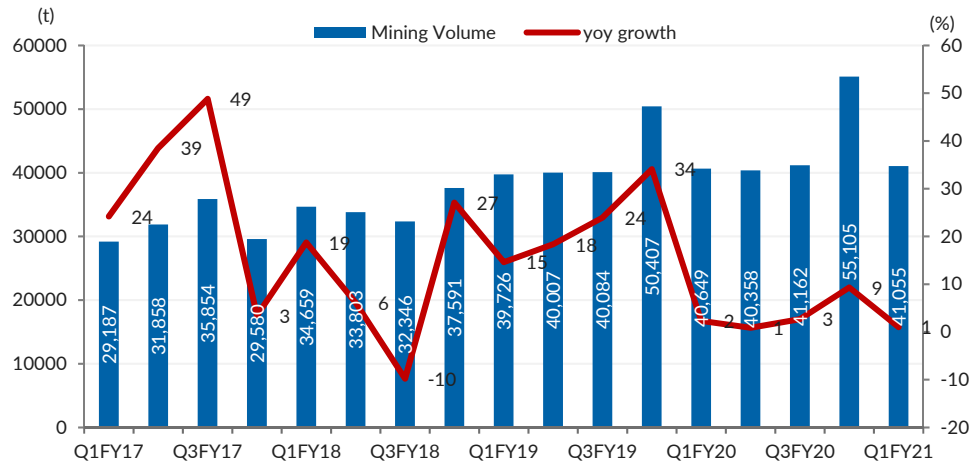
Source: Company, YES Sec – Research

Exhibit 4: AIAE's deserves premium multiple due to strong business MOAT & healthy balance sheet with net cash of Rs17.5bn & Core RoE of 28%



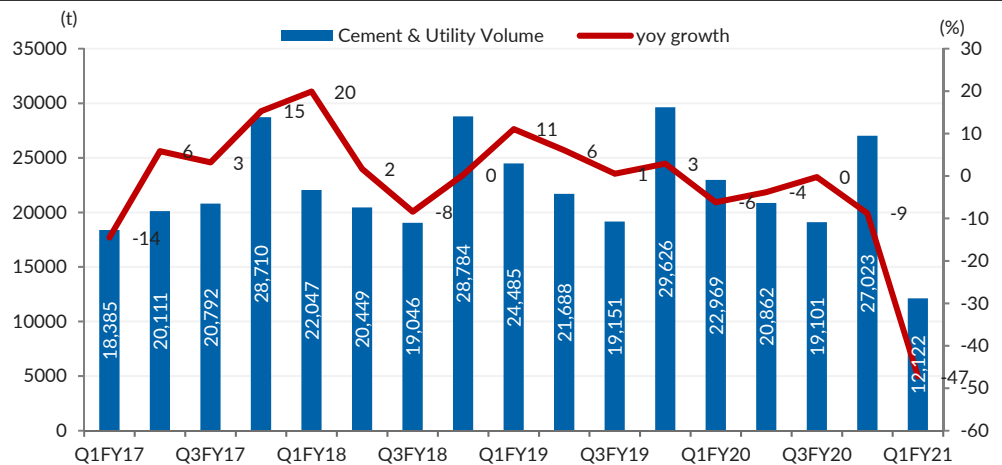
Source: Company, YES Sec – Research

Exhibit 5: Mining segment volume grew 1% yoy in difficult times



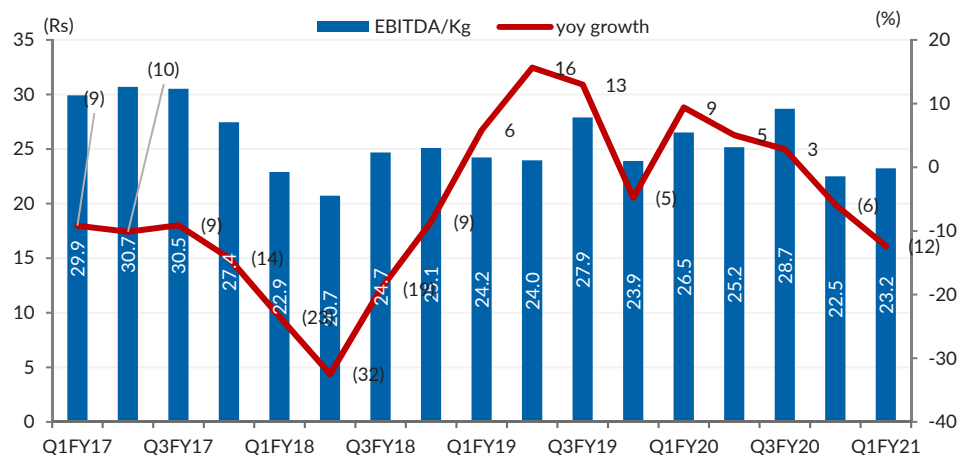
Source: Company, YES Sec – Research

Exhibit 6: Non-mining segment volumes were down 47% yoy due to sluggish infra



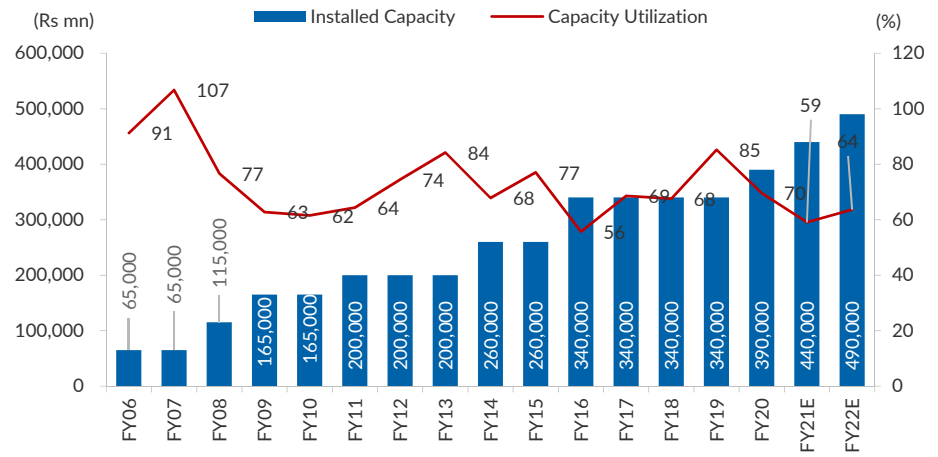
Source: Company, YES Sec – Research

Exhibit 7: EBITDA/Kg declined 12% yoy in Q1FY21



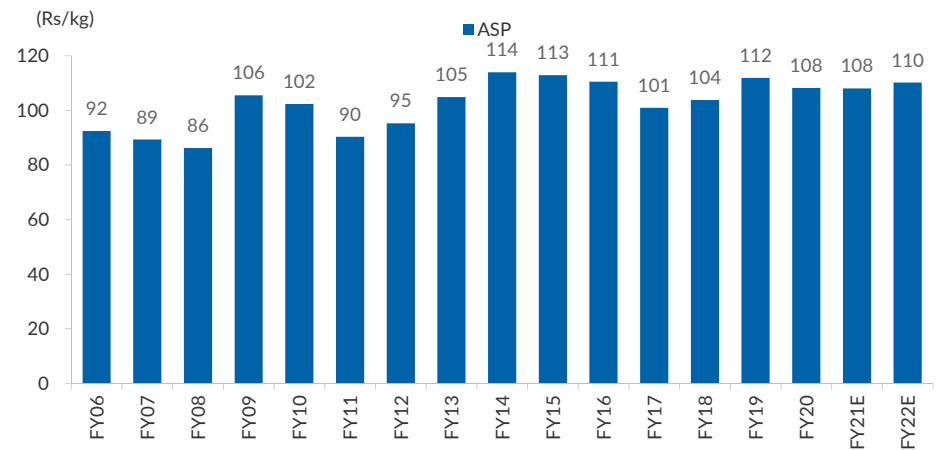
Source: Company, YES Sec – Research

Exhibit 8: Capacity expansion to support volume growth



Source: Company, YES Sec – Research

Exhibit 9: INR depreciation to lead improvement in ASP



Source: Company, YES Sec – Research

FINANCIALS (CONSOLIDATED)

Exhibit 10: Income statement

Y/e 31 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
Total operating revenues	24,451	30,695	29,809	27,538	33,647
Growth (%)	8.9	25.5	(2.9)	(7.6)	22.2
EBITDA	5,357	6,599	6,803	6,093	7,905
EBITDA margin (%)	21.9	21.5	22.8	22.1	23.5
Growth (%)	(15.6)	23.2	3.1	(10.4)	29.7
Depreciation & amortization	656	788	979	1,094	1,294
EBIT	4,701	5,811	5,824	4,999	6,612
EBIT margin (%)	19.2	18.9	19.5	18.2	19.7
Interest	69	75	56	50	48
Other income	1,218	1,209	1,419	1,868	1,850
Profit before tax	5,850	6,944	7,187	6,817	8,414
Tax	1,414	1,830	1,284	1,546	1,851
Associate income	0	0	0	0	0
Minority interest	(3)	(6)	0	0	0
Reported net profit	4,436	5,114	5,903	5,271	6,563
Extraordinary items	206	65	39	75	0
Adjusted net profit	4,227	5,043	5,864	5,196	6,563
Adjusted net margin (%)	17.3	16.4	19.7	18.9	19.5
Diluted EPS (Rs)	47.0	54.2	62.6	55.9	69.6
Growth (%)	(2.9)	15.2	15.6	(10.7)	24.5

Exhibit 11: Balance sheet

Y/e 31 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
SOURCE OF FUNDS					
Share capital	189	189	189	189	189
Reserve & Surplus	29,904	34,948	36,824	40,771	45,745
Total shareholder's funds	30,093	35,137	37,013	40,960	45,933
Minority Interest	89	93	93	93	93
Debt	1,231	1,279	969	753	716
Deferred tax liabilities/(assets)	820	962	890	1,130	1,168
TOTAL	32,234	37,471	38,965	42,936	47,909
APPLICATION OF FUNDS					
Fixed assets	11,660	14,184	15,613	18,388	20,888
Less: Depn. and amort.	4,949	5,737	6,716	7,810	9,103
Net block	6,711	8,447	8,897	10,578	11,784
Capital WIP	968	598	323	300	300
Long term investments	9	9	9	8	8
Other long term assets	927	667	925	746	746
Inventories	5,534	7,859	7,781	6,790	8,296
Debtors	6,002	7,103	6,508	6,036	7,375
Cash & cash equivalents	13,560	13,600	15,725	21,621	22,666
Loans & advances	507	794	432	453	369
Other current assets	1,368	1,251	1,022	(985)	(328)
Total current liabilities	3,351	2,857	2,657	2,610	3,307
Net current assets	23,620	27,750	28,811	31,304	35,071
TOTAL	32,234	37,471	38,965	42,936	47,909

Exhibit 12: Cash flow statement

Y/e 31 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
PBT	5,850	6,944	7,187	6,817	8,414
Depreciation	656	789	979	1,094	1,294
Others	(902)	(1,038)	(1,108)	(75)	0
Tax Paid	(1,609)	(1,805)	(1,493)	(1,546)	(1,851)
Changes in Working Capital	(1,053)	(2,992)	1,229	3,403	(2,722)
Net Cash from Operations	2,942	1,897	6,793	9,693	5,135
Capex	(1,371)	(2,065)	(1,310)	(2,572)	(2,500)
Change in Investment	(718)	185	(2,045)	1	0
Others	126	241	248	0	0
Net Cash from Investing	(1,964)	(1,638)	(3,107)	(2,572)	(2,500)
Change in debt	0	72	(203)	(216)	(38)
Change in Equity	0	0	0	0	0
Others	(1,583)	(73)	(4,085)	(1,009)	(1,552)
Net Cash from Financing	(1,583)	(1)	(4,288)	(1,225)	(1,589)
Net Change in Cash	(604)	258	(602)	5,896	1,045
Free cash flow (FCF)	1,031	314	3,732	7,160	2,672

Exhibit 13: Ratio analysis

Y/e 31 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
PROFITABILITY RATIOS					
EBITDA Margin (%)	21.9	21.5	22.8	22.1	23.5
Adjusted net margin (%)	17.3	16.4	19.7	19.1	19.5
Return on invested capital (%)	19.4	19.6	19.8	16.9	21.6
Return on equity (%)	15.5	15.7	16.4	13.5	15.1
EFFICIENCY RATIOS					
Asset Turnover	3.2	3.4	3.2	2.5	2.8
Debt to equity	0.0	0.0	0.0	0.0	0.0
Net debt to equity	(0.4)	(0.4)	(0.4)	(0.5)	(0.5)
Interest coverage	67.9	77.0	104.2	99.8	137.7
Debtor days	89.6	84.5	79.7	80.0	80.0
Inventory days	82.6	93.5	95.3	90.0	90.0
Payable days	24.4	20.6	16.2	18.0	20.0
PER SHARE DATA					
Diluted EPS (Rs)	47.0	54.2	62.6	55.9	69.6
Book value per share (Rs)	319.1	372.5	392.4	434.3	487.0
DPS (Rs)	8.0	9.0	27.0	11.3	14.3
VALUATION RATIOS					
P/E	34.1	29.6	25.6	28.7	23.0
P/BV	5.0	4.3	4.1	3.7	3.3
EV/EBITDA	25.9	21.0	20.1	21.4	16.3
Dividend Yield (%)	0.5	0.6	1.7	0.7	0.9

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10	Research Analyst or YSL has been engaged in market making activity for the subject company(ies)	No

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