

AIA Engineering

ADD

CMP Rs1,979

Target Rs2,209

Upside 12%

- ✓ **Our View:** We have introduced FY23E volume estimates at 326K assuming i) incremental volumes from mining markets, ii) incremental contribution from mill lining solutions, and iii) ~75 bps margin expansion over FY21-23E led by the benefits of INR depreciation and addition of relatively higher margin mill lining solutions. We believe company deserves a premium multiple due to its cost leadership, product superiority, and strong business MOAT. We remain positive on AIAE's story of multi-year shift from forged media to HCMI led by healthy FCF generation, prudent capital allocation, and strong balance sheet. Post our Q2FY21 result note, the stock has rallied by 15% which leaves us with limited upside in the near term. Hence, we downgrade stock to 'ADD' from 'BUY' rating with a Target price of Rs2209 at 28x FY23E earnings.
- ✓ **Growth prospects intact:** 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 medium to long term 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.
- ✓ **Value added offerings like EEMS product solutions to aid in growth FY22E onwards:** 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 costly consumables in the down process by using high chrome grinding media & thereby improving recoveries, c) Optimization via unique high chrome mill lining solutions resulting into higher throughputs & cost reduction.

Exhibit 1: Financial Summary (Consolidated)

Year ending March	FY19	FY20	FY21E	FY22E	FY23E
Total operating revenues	30,695	29,809	27,596	33,651	37,931
Growth (%)	25.5	(2.9)	(7.4)	21.9	12.7
EBITDA	6,599	6,803	6,356	7,921	9,018
EBITDA margin (%)	21.5	22.8	23.0	23.5	23.8
Growth (%)	23.2	3.1	(6.6)	24.6	13.9
Depreciation & amortization	788	979	1,080	1,280	1,341
EBIT	5,811	5,824	5,276	6,641	7,677
EBIT margin (%)	18.9	19.5	19.1	19.7	20.2
Interest	75	56	51	48	49
Other income	1,209	1,419	1,755	1,820	1,911
Profit before tax	6,944	7,187	6,980	8,413	9,539
Tax	1,830	1,284	1,596	1,851	2,099
Associate income	0	0	0	0	0
Minority interest	(6)	0	0	0	0
Reported net profit	5,114	5,903	5,384	6,562	7,440
Extraordinary items	65	39	37	0	0
Adjusted net profit	5,043	5,864	5,347	6,562	7,440
Adjusted net margin (%)	16.4	19.7	19.4	19.5	19.6
Diluted EPS (Rs)	54.2	62.6	57.1	69.6	78.9
Growth (%)	15.2	15.6	(8.8)	21.9	13.4

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CONCALL HIGHLIGHTS

- ✓ On a 9-month basis, Mining volumes were similar to the previous year as mining operations were largely unaffected during the pandemic, however, cement & other utility volumes were impacted during the first quarter due to lockdown in India, and outside non-business got affected.
- ✓ Structurally and fundamentally there is no change in business direction/initiatives, the company is currently facing restraint due to traveling restriction. In India, Covid is largely under control, however, globally - North America, Europe, Latin America it's very difficult to travel. Predominantly, the development of new conversions is suffering. The management expects by Q4-end with vaccination gaining momentum and travel starting from Q1 FY22E, things should start accelerating.
- ✓ The company is facing headwinds in terms of an extremely sharp increase in Raw material prices (increase in Ferro chrome prices), volatile shipping rates strengthening rupee. However, management expects these are temporary in nature and the better picture would emerge by the end of the quarter. Given increasing raw material prices, the management has not taken a price hike (increase/decrease in RM prices is a function of pass-through).
- ✓ Key drivers for the company are – 1) As compared to forged media, Chrome is known for cost-saving as it leads to a significant drop in wear rates and a significant drop in consumption, 2) DPA (Down Process Time advantage) which technically improves the recovery and reduces the consumption of toxic reagent like Cyanide makes the process more environment friendly, and as a natural fallout Copper and gold have prone to demonstrate these benefits, and 3) Special mill lining solution increases the throughput and efficiency of the grinding circuit.
- ✓ Capex – The company plans to add a wind turbine by March/ April. Besides, the company will incur Rs1.3-1.4bn towards the mill lining plant (payables are due this quarter). Moreover, after Covid hit, the company paused Grinding media expansion and it has been shifted to next FY. Once things stabilize the expansion will be executed. Grinding media capex is Rs2.5bn.
- ✓ The company is in midst of setting up a manufacturing plant of Mill Liners with a capacity of 50,000 MT with an estimated capex of Rs2.5 bn and it is expected to be commissioned by June-2021 (commission was delayed as equipment were imported from Europe OEM which led to delay in installation due to travel restriction). Post its commissioning, management expects the plant to reach an optimum level in the next 4 years.
- ✓ In Brazil, volumes are affected due to import duty (Interim duty was 36% and Final duty is 11.8%) and with customers preferring multiple vendors. However, management remains optimistic about getting some volume from that market. In Canada, there is a likelihood of interim duty between mid of March and April. Annually, 25000 MT volume is exported to Canada. Suppose, if a duty is levied there might be disruption in volume for a quarter or two.
- ✓ The management expects FY21E volumes to be +/-5000 of FY20 volumes.
- ✓ Treasury income was at Rs0.23 bn during the quarter
- ✓ Average USD/INR realization was Rs73 during the quarter
- ✓ The company had a net cash position of Rs18.3 bn, with cash of Rs20.2 bn and debt of Rs1.9 bn

Other key highlights from Q3FY21

- ✓ Revenue increased marginally by 0.7% YoY at Rs6.9 bn (-3% vs our estimates)
- ✓ Mining volumes came in at 43,397 MT, growth of 5.4% YoY and Cement & other utility volumes were at 21,766 MT, a growth of 14%YoY.
- ✓ EBITDA was flat at Rs1.7 bn (+4% vs our estimates) with marginal contraction of EBITDA Margin by 25 bps at 24.7%.

- ✓ PAT increased by 9.3% at Rs1.5bn (+17% vs our estimates) due to higher other income at Rs0.5 bn
- ✓ Order book as of 1st January 2021 was Rs5.60 bn
- ✓ The Present Installed Capacity is 3,90,000 TPA
- ✓ Capex incurred for Nine Months FY21 is Rs 0.88 bn

Exhibit 2: Result table (Consolidated)

Particulars (Rs mn)	Q3FY21	Q3FY20	% yoy	Q2FY21	% qoq
Total sales	6,987	6,941	0.7	7,423	(5.9)
EBITDA	1,723	1,729	(0.3)	1,903	(9.5)
EBITDAM (%)	24.7	24.9	(25)bps	25.6	(98)bps
Depreciation	230	252	(8.6)	233	(1.2)
Interest	10	13	(25.0)	12	(23.7)
Other income	494	460	7.5	248	99.6
PBT	1,977	1,924	2.8	1,905	3.8
Tax	416	360	15.5	433	(4.0)
Adjusted PAT	1,591	1,457	9.3	1,440	10.5
Exceptional item	(37)	104		37	
Reported PAT	1,561	1,564	(0.2)	1,471	6.1
PATM (%)	22.8	21.0	179bps	19.4	338bps
EPS (Rs)	16.5	16.5	(0.4)	15.7	5.3

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