CENTRUM
Wealth Research

November 21, 2017

Q2FY18 Result Update

AIA Engineering Ltd

Weak quarter, margin pressure to persist **Hold**

AIA Engineering Ltd (AIAE), on a consolidated basis, for Q2FY18 reported weak numbers. Higher raw material prices, currency volatility and pricing strategy to acquire new clients led to margin contraction by 1,001bps YoY to 20.1%. Revenue grew by ~6% to ₹559 crore, on the back of volume growth of 5% to 54,573 tonne. Net profit declined by 23% to ₹87 crore. Net realisations stood at ₹99,489 per tonne (up 0.4% YoY, down 0.2% QoQ), impacted by new client additions and change in product mix. At present AIAE's net cash position stands at ₹1,119 crore.

Management Guidance: The management has revised downwards the sales volume guidance for FY18 to 2,25,000-2,30,000 tonne (vs earlier 2,45,000-2,50,000 tonne). They expect incremental mining volumes of 40,000-50,000 tonne per year from FY19 onwards.

Recommendation: Since our Q1FY18 result update *click here* (18 Aug'17 @ ₹1,410, Rating: Hold), the stock price has not performed (down ~1%), which we believe could be over EBITDA margin contraction. At the CMP, AIAE trades at 31.6x P/E on FY19E basis. AIAE is globally the second largest producer of high chrome mill internals (HCMI). It is looking at adding 1,00,000 tonne capacity by FY19E. AIAE is focusing on ramping up utilization levels and hence has changed its pricing strategy to make in-roads into new markets and on board new customers. This is likely to impact EBITDA margins which could restrict profitability. In addition, the prolonged time taken for new client conversion is likely to impact volume numbers for FY18. We have thus, revised our numbers downwards for FY18 with expected revenue growth of ~6% and PAT decline of 21% (vs earlier revenue growth expectation of 17% and PAT decline of 3%). We maintain our Hold rating and anticipate better capacity utilization from FY19/20 onwards.

Q2FY18 Consolidated Result Summary

Y/E Mar (₹ Cr.)	Q2FY18	Q2FY17	YoY (%)	Q1FY18	QoQ (%)
Revenue	559	529	5.6	570	(1.9)
EBITDA	112	159	(29.5)	130	(13.4)
Margin (%)	*20.1*	*30.1*	*-1,001bps*	*22.8*	*-268bps*
PAT	87	112	(23.0)	88	(2.2)
EPS (₹)	9.17	11.91		9.38	

Source: Company, Centrum Wealth Research, As per the new Indian accounting standard

Near term margin pressure to continue: With an aim to gain market share and attract new customers, AIAE has changed its pricing strategy. In addition, currency volatility and raw material price fluctuation (ferro chrome prices moved from ₹65/kg to ₹100/kg to settle at ₹75/kg currently) further impacted EBITDA margin. Gross margins were down (by 1,084 bps to 61.5%) due to higher raw material prices as there is a lag in passing on of costs by 3-6 months. During the quarter, EBITDA/tonne stood at ₹20,597/tonne (down 33% YoY and 12% QoQ). We expect EBITDA margins to be near 21-22% levels in FY18/19 as compared to 27.6% in FY17.

Better volume growth prospects with client addition: The process of acquiring new customers is time consuming as the customer needs to be convinced in terms of product efficacy (mine specific) which could then result in conversion. The company has secured a long term contract (3 years) from the Barrick Group for a supply of 18,000 tonne per annum (in North and South America). The tangible impact of this order on numbers would be expected from FY19E onwards. Moving forward, AIAE is looking at many such long term volume commitments. We anticipate volume CAGR of ~11% over FY17-19E. AIAE is in the process of adding a capacity of 1,00,000 tonne to take the total capacity to 4,40,000 tonne by FY19. With capacities in place along with client additions, better utilization level could help drive profitability.

Risk factors: 1) Prolonged duration in conversion of clients; 2) Currency risk as 70-75% of revenue is from exports, 3) Volatility in raw material prices (ferro chrome).

Key Data

Current Market Price (₹)	1,399
Target Price (₹)	1,328
Potential downside	-5.1%
Sector Relative to Market	In-line
Stock Relative to Sector	Underperform

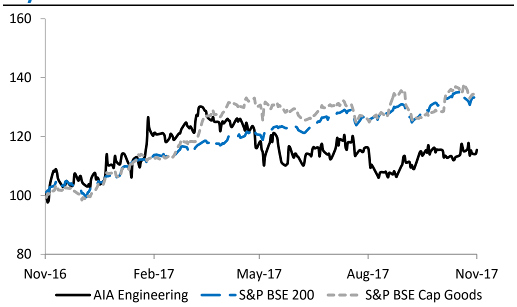
Stock Information

BSE Code	532683
NSE Code	AIAENG
Face Value (₹/Share)	2.0
No. of shares (Cr.)	9.4
Market Cap (₹ Cr.)	13,195
Free float (₹ Cr.)	5,060
52 Week H / L (₹)	1,641 / 1,189
Avg. Daily turnover (12M, ₹ Cr.)	8.3

Shareholding Pattern (%)

	Sept-17	Sept-16
Promoters	61.6	61.6
Mutual Funds	6.9	5.3
FPIs	26.0	28.3
Others including Public	5.5	4.8

1 year Indexed Price Performance



Price Performance (%)

	1M	3M	6M	1YR
AIA Engineering	(0.6)	(1.2)	(1.4)	14.1
S&P BSE 200	2.7	7.5	11.1	34.1
S&P BSE Cap Goods	5.0	7.4	3.8	34.9

Source: Bloomberg, Centrum Wealth Research

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Financial Summary - Consolidated

Y/E Mar (₹ Cr.)	Revenue	YoY (%)	EBITDA	EBITDA (%)	NPAT	YoY (%)	EPS (₹)	P/E (x)	EV/EBITDA (x)	RoE (%)
FY15A	2,184	5.0	585	26.8	431	24.2	45.69	30.6	21.3	22.5
FY16A	2,098	(3.9)	609	29.0	457	6.0	48.44	28.9	20.1	20.7
FY17A	2,226	6.1	615	27.6	443	(3.0)	46.96	29.8	19.7	17.6
FY18E	2,352	5.7	502	21.3	350	(20.9)	37.14	37.7	23.7	12.4
FY19E	2,780	18.2	603	21.7	417	19.2	44.26	31.6	20.0	13.6

Source: Company, Centrum Wealth Research, FY16 and FY17 - as per the new Indian accounting standard

Centrum Wealth Research is also available on Bloomberg: CBWM <GO>, Thomson Reuters, Capital IQ and Factset

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Q2FY18 Concall Highlights

- For Q2FY18 – Production declined by 5% YoY to 56,256 tonne, sales volume grew 5% to 54,573 tonne.
- For H1FY18 – Production down 0.5% to 1,13,000 tonne and sales volume up 11% to 1,10,253 tonne.
- For Q2FY18 segment wise – Mining volume stood at 34,017 tonne (up 7% YoY and down 0.2% QoQ), Non-mining volume stood at 20,556 tonne (up 2% YoY and down 5% QoQ)
- Order book as at 1 Oct'17 ₹656 crore.
- The addressable market to convert forged media to high chrome mill internals is 2.5-3 million tonne. The opportunity provided by this space is immense owing to the low penetration level which current is as 10-12%. Majority of the growth is expected to come from outside India mainly from the mining segment.
- Tax Rate – 30-31% for FY18.
- The company has a current installed capacity of 3,40,000 tonne. It is in the process of adding new capacity at GIDC Kerala, Phase-II in two tranches. It is looking to add 50,000 tonne each in FY18 and FY19 for a total capex of ₹500 crore. Post this, the total installed capacity will increase to 4,40,000 tonne.
- Capex incurred in H1FY18 stood at ₹61 crore and that for FY18 expected to be at ₹185 crore.
- Management guidance – of incremental volumes worth 1,20,000 tonne over 3 years, may fall short and do 90,000-1,00,000 tonne. So FY18 incremental volume of 10,000-15,000 tonne and next 2 years 40,000-50,000.
- FY18 sales volume earlier guidance of 240,000 tonne has been revised to 225,000-230,000 tonne mainly due to entering new markets and on-boarding new customers currently. FY19 onwards, with new mines coming and getting long term contracts - 40,000-50,000 tonne, annual incremental volume growth is expected.

Exhibit 1: Consolidated Quarterly Performance

Y/E Mar (₹ Cr.)*	Q2FY17	Q3FY17	Q4FY17#	Q1FY18	Q2FY18
Revenue	**529**	**590**	**628**	**570**	**559**
YoY Growth %	*8.4*	*19.7*	*6.0*	*19.0*	*5.6*
Raw Materials	147	195	245	229	215
% of sales	*27.7*	*33.1*	*39.0*	*40.2*	*38.5*
Personnel Expenses	27	27	27	27	28
% of sales	*5.0*	*4.6*	*4.3*	*4.8*	*5.1*
Other Expenses	197	195	216	183	203
% of sales	*37.1*	*33.1*	*34.4*	*32.2*	*36.3*
EBIDTA	**159**	**173**	**140**	**130**	**112**
EBIDTA margin %	***30.1***	***29.3***	***22.3***	***22.8***	***20.1***
Depreciation	17	17	21	18	16
Interest	1.0	0.9	1.4	1.4	1.6
Other Income	27	22	25	18	22
Exceptional Gain/(Loss)	-	-	20	-	
PBT	168	177	163	129	117
Provision for tax	56	57	47	40	30
Effective tax rate %	*33.2*	*32.0*	*29.1*	*31.3*	*25.7*
Net Profit	**112**	**120**	**115**	**89**	**87**
Minority Interest	0.09	0.15	0.14	0.21	0.14
Exceptional Item Adj.	-	-	14	-	-
Adj.Net Profit	**112**	**120**	**101**	**88**	**87**
YoY Growth %	*13.2*	*18.5*	*(30.8)*	*(18.8)*	*(23.0)*
PAT margin %	***21.2***	***20.4***	***16.1***	***15.5***	***15.5***

*Source: Company, Centrum Wealth Research, *as per the new Indian accounting standard*
#Note: The company reported an exceptional income of ₹20 crore in Q4FY17 under other operating income, the same has been adjusted for calculation.

Technical View

- AIA Engineering, which had a good rally in the financial year 2016-17, formed an 'Inside Bar' pattern on monthly chart in the month of April 2017 and started moving in sideways direction.
- Currently, the stock is rebounding from its strong support of 38.20% retracement levels of the previous rally from 684 to 1670 on weekly chart.
- The mentioned support also coincides with '89 EMA' on weekly chart.
- Also, the momentum oscillator 'RSI' is placed positively on weekly chart.
- Looking at above technical evidences, it can be constructed that till the time, stock sustains above 1270 on closing basis, an up move towards 1520 – 1540 cannot be ruled out. Thus, traders can accumulate the stock on declines.

Exhibit 2: Technical Chart

Source: Company, Centrum Wealth Research

Financials - Consolidated

Income Statement

Y/E Mar (₹ Cr)	FY15	FY16	FY17	FY18E	FY19E
Revenue	**2,184**	**2,098**	**2,226**	**2,352**	**2,780**
Growth %	*5.0*	*(3.9)*	*6.1*	*5.7*	*18.2*
Raw Materials	762	715	727	912	1,040
% of sales	*34.9*	*34.1*	*32.7*	*38.8*	*37.4*
Personnel Expenses	98	102	107	115	136
% of sales	*4.5*	*4.9*	*4.8*	*4.9*	*4.9*
Other Expenses	739	672	778	823	1,001
% of sales	*33.8*	*32.0*	*34.9*	*35.0*	*36.0*
EBIDTA	**585**	**609**	**615**	**502**	**603**
EBIDTA margin %	***26.8***	***29.0***	***27.6***	***21.3***	***21.7***
Depreciation	70	66	72	78	91
Interest	3.9	4.9	4.5	5.0	5.0
Other Income	83	102	104	89	98
Exceptional Gain/(Loss)	-	-	20	-	-
PBT	594	641	662	508	605
Provision for tax	163	184	205	157	188
Effective tax rate %	*27.5*	*28.7*	*30.9*	*31.0*	*31.0*
Net Profit (Reported)	**431**	**457**	**457**	**350**	**417**
Minority Interest	(0.01)	(0.1)	0.4	-	-
Exceptional Item Adj.	-	-	14	-	-
Adj. Net Profit	**431**	**457**	**443**	**350**	**417**
Growth %	*24.2*	*6.0*	*(3.0)*	*(20.9)*	*19.2*
PAT margin %	***19.7***	***21.8***	***19.9***	***14.9***	***15.0***

Source: Company, Centrum Wealth Research

Balance Sheet

Y/E Mar (₹ Cr)	FY15	FY16	FY17	FY18E	FY19E
Share capital	19	19	19	19	19
Reserves & surplus	2,065	2,304	2,698	2,917	3,181
Shareholder's fund	2,084	2,323	2,717	2,936	3,200
Loan fund	64	151	116	116	116
Deferred Tax Liab	25	50	71	71	71
Minority Interest.	8	8	8	8	8
Total cap. employed	**2,180**	**2,530**	**2,912**	**3,131**	**3,395**
Net fixed assets	598	710	713	835	944
Investments	637	946	960	960	960
Cash and bank	187	126	249	445	317
Inventories	460	389	534	451	624
Debtors	394	431	496	484	609
Loans & adv and OCA	274	182	238	259	306
Total current assets	1,314	1,128	1,518	1,638	1,856
Current lia. and prov.	369	254	278	302	365
Net current assets	945	874	1,240	1,337	1,491
Total assets	**2,180**	**2,530**	**2,912**	**3,131**	**3,395**

Source: Company, Centrum Wealth Research. OCA – Other Current Assets

Cash Flow

Y/E Mar (₹ Cr)	FY15	FY16	FY17	FY18E	FY19E
Net Profit Before Tax	594	641	662	508	605
Depreciation	70	66	72	78	91
Others	(12)	(18)	(79)	(84)	(93)
Change in working capital	(153)	81	(262)	99	(283)
Tax expenses	(193)	(174)	(164)	(157)	(188)
Cash flow from Ops	**306**	**595**	**230**	**443**	**133**
Capex	(182)	(177)	(75)	(200)	(200)
Other investing activities	(74)	(272)	52	89	98
Cash flow from Invest	**(255)**	**(449)**	**(24)**	**(111)**	**(102)**
Borrowings/(Repayments)	(22)	85	(44)	-	-
Dividend paid	(57)	(289)	(44)	(132)	(153)
Interest paid	(4)	(5)	5	(5)	(5)
Others	-	-	0.3	-	-
Cash flow from financing	**(83)**	**(208)**	**(82)**	**(136)**	**(158)**
Net Cash Flow	**(33)**	**(63)**	**124**	**195**	**(128)**

Source: Company, Centrum Wealth Research

Key Ratios

Y/E Mar	FY15	FY16	FY17	FY18E	FY19E
Return ratios (%)					
RoE	22.5	20.7	17.6	12.4	13.6
RoCE	29.6	27.4	23.8	17.0	18.7
RoIC	42.9	39.9	35.8	25.9	27.8
Turnover Ratios (days)					
Inventory	68	74	76	76	71
Debtors	69	72	76	76	72
Creditors	21	19	18	19	19
Fixed asset turnover (x)	3.0	2.2	2.1	2.0	2.0
Solvency Ratio (x)					
Debt-Equity	0.03	0.06	0.04	0.04	0.04
Interest coverage	152.0	132.5	143.9	103.0	122.5
Per share (₹)					
Adj. EPS	45.7	48.4	47.0	37.1	44.3
BVPS	220.9	246.3	288.1	311.3	339.3
CEPS	53.1	55.4	54.6	45.4	53.9
Dividend Ratios					
DPS (₹)	8.0	18.0	8.0	12.0	14.0
Dividend Yield (%)	0.6	1.3	0.6	0.9	1.0
Dividend Payout (%)	21.1	43.3	19.8	37.5	36.8
Valuation (x)					
P/E	30.6	28.9	29.8	37.7	31.6
P/BV	6.3	5.7	4.9	4.5	4.1
EV/EBIDTA	21.3	20.1	19.7	23.7	20.0
EV/Sales	5.7	5.8	5.4	5.1	4.3

Source: Company, Centrum Wealth Research

Note: FY16 and FY17 numbers are in accordance to the new Indian accounting standard and are not comparable to previous years.

Appendix

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9	Whether Research Analysts has served as an officer, director or employee of the subject company	No
10	Whether the Research Analysts has been engaged in market making activity of the subject company.	No

Member (and BSE)

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