

07 March 2024

India | Equity Research | Company Update

Azad Engineering

Defence

More legs to the rally

Azad Engineering (Azad) has received an order from Baker Hughes for the supply of high-complex and critical components. We believe that this is significant as it: 1) enables Azad to diversify its sector mix; 2) potentially could translate into adjacent revenue streams; and 3) would likely keep earnings growth momentum. In our view, this is the second major order in Q4FY24 after Rolls-Royce for defence engines and signifies that the development efforts made over several years are now getting monetised. We also believe that there is a better possibility of our FY26E EPS of INR 20 being achieved; hence, we raise our P/E multiple to 80x (earlier 70x), valuing the company at INR 1,600 (earlier INR 1,400) on FY26E EPS. Retain 'BUY'.

Second major order in the quarter

Close on the heels of receiving a seven-year order, for the supply for critical engine parts from Rolls-Royce for defence and military applications, Azad has sealed a five-year deal with Baker Hughes for the supply of high-complex and critical components. We view this as an important development given that Azad is diversifying its earnings base beyond its traditional stronghold – energy and power segment. Besides, there is always an opportunity to increase wallet share with Baker Hughes as well as more customers from the O&G industry, where Azad currently has a limited presence.

Upside risk to our FY26E EPS of INR 20/share

Owing to the lack of details at the moment, we have not built in any incremental earnings from the two recent contracts in our estimates. Besides, we understand that management is making efforts to deepen engagement with existing customers by developing new components. In view of the vast market potential and significant cost advantage compared to peers across various geographies, we believe that Azad is at a vantage point. Additionally, the new 95,000m² facility would ensure that management is able to capture and commercialise new opportunities more efficiently. Furthermore, increasing footprint in defence and aerospace and O&G segments is likely to mitigate the product concentration risk to an extent.

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Market Data

| | |
|---------------------|------------|
| Market Cap (INR) | 77bn |
| Market Cap (USD) | 926mn |
| Bloomberg Code | AZAD IN |
| Reuters Code | AZAD.BO |
| 52-week Range (INR) | 1,465 /642 |
| Free Float (%) | 17.0 |
| ADTV-3M (mn) (USD) | 0.0 |

| Price Performance (%) | 3m | 6m | 12m |
|-----------------------|----|----|-----|
| Absolute | - | - | - |
| Relative to Sensex | - | - | - |

Financial Summary

| Y/E March (INR mn) | FY23A | FY24E | FY25E | FY26E |
|--------------------|--------|-------|-------|-------|
| Net Revenue | 2,517 | 3,400 | 4,658 | 6,011 |
| EBITDA | 723 | 1,089 | 1,635 | 2,118 |
| EBITDA Margin (%) | 28.7 | 32.0 | 35.1 | 35.2 |
| Net Profit | 85 | 423 | 915 | 1,181 |
| EPS (INR) | 1.4 | 7.1 | 15.5 | 20.0 |
| EPS % Chg YoY | (71.2) | 398.7 | 116.6 | 29.1 |
| P/E (x) | 905.2 | 181.5 | 83.8 | 64.9 |
| EV/EBITDA (x) | 114.4 | 73.2 | 49.0 | 38.1 |
| RoCE (%) | 10.8 | 11.6 | 13.1 | 13.6 |
| RoE (%) | 6.1 | 13.0 | 17.1 | 15.6 |

Previous Reports

08-02-2024: [Q3FY24 results review](#)

06-02-2024: [Initiating coverage](#)

Outlook: Good times ahead

We believe that Azad's earnings are likely to see an extended period of meaningful growth led by tailwinds from the new contracts. Taking cognizance of higher possibility of our estimates being achieved, we raise our valuation multiple to 80x (earlier 70x), resulting in revised TP of INR 1,600 (earlier INR 1,400). Maintain **BUY**.

Key Risks

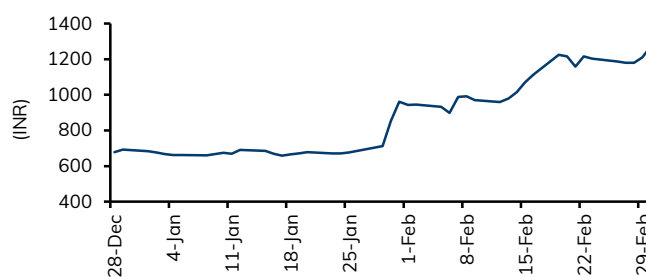
- Delay in approvals from OEMs
- Product concentration around air foils
- Slowdown in aerospace sector might result in lower revenue growth

Exhibit 1: Shareholding pattern

| % | Dec'23 |
|-------------------------|--------|
| Promoters | 65.9 |
| Institutional investors | 10.4 |
| MFs and others | 4.9 |
| Insurance / Bank | 0.8 |
| FII's | 4.7 |
| Others | 23.7 |

Source: Bloomberg

Exhibit 2: Price chart



Source: Bloomberg

Financial Summary

Exhibit 3: Profit & Loss

(INR mn, year ending March)

| | FY23A | FY24E | FY25E | FY26E |
|--|--------------|--------------|--------------|--------------|
| Net Sales | 2,517 | 3,400 | 4,658 | 6,011 |
| Operating Expenses | 1,492 | 1,762 | 2,223 | 2,812 |
| EBITDA | 723 | 1,089 | 1,635 | 2,118 |
| EBITDA Margin (%) | 28.7 | 32.0 | 35.1 | 35.2 |
| Depreciation & Amortization | 166 | 209 | 271 | 345 |
| EBIT | 557 | 880 | 1,365 | 1,773 |
| Interest expenditure | - | - | - | - |
| Other Non-operating Income | 98 | 50 | 53 | 56 |
| Recurring PBT | 132 | 604 | 1,307 | 1,688 |
| Profit / (Loss) from Associates | - | - | - | - |
| Less: Taxes | 47 | 181 | 392 | 506 |
| PAT | 85 | 423 | 915 | 1,181 |
| Less: Minority Interest | - | - | - | - |
| Extraordinaries (Net) | - | - | - | - |
| Net Income (Reported) | 85 | 423 | 915 | 1,181 |
| Net Income (Adjusted) | 85 | 423 | 915 | 1,181 |

Source Company data, I-Sec research

Exhibit 4: Balance sheet

(INR mn, year ending March)

| | FY23A | FY24E | FY25E | FY26E |
|--|--------------|--------------|--------------|---------------|
| Total Current Assets | 2,835 | 4,380 | 5,223 | 5,999 |
| of which cash & cash eqv. | 527 | 1,637 | 1,639 | 1,660 |
| Total Current Liabilities & Provisions | 660 | 684 | 869 | 1,067 |
| Net Current Assets | 2,176 | 3,696 | 4,354 | 4,932 |
| Investments | - | - | - | - |
| Net Fixed Assets | 2,167 | 3,632 | 4,421 | 5,445 |
| ROU Assets | - | - | - | - |
| Capital Work-in-Progress | 380 | - | - | - |
| Total Intangible Assets | - | - | - | - |
| Other assets | 509 | 512 | 512 | 512 |
| Deferred Tax assets | - | - | - | - |
| Total Assets | 5,232 | 7,840 | 9,287 | 10,889 |
| Liabilities | | | | |
| Borrowings | 3,006 | 1,108 | 1,640 | 2,061 |
| Deferred Tax Liability | 161 | 161 | 161 | 161 |
| provisions | 26 | 26 | 26 | 26 |
| other Liabilities | - | - | - | - |
| Equity Share Capital | 17 | 115 | 115 | 115 |
| Reserves & Surplus | 2,023 | 6,430 | 7,345 | 8,527 |
| Total Net Worth | 2,040 | 6,545 | 7,460 | 8,641 |
| Minority Interest | - | - | - | - |
| Total Liabilities | 5,232 | 7,840 | 9,287 | 10,889 |

Source Company data, I-Sec research

Exhibit 5: Cashflow statement

(INR mn, year ending March)

| | FY23A | FY24E | FY25E | FY26E |
|--|--------------|--------------|--------------|--------------|
| Operating Cashflow | (102) | 412 | 586 | 1,054 |
| Working Capital Changes | (810) | (496) | (657) | (557) |
| Capital Commitments | (856) | (1,294) | (1,060) | (1,369) |
| Free Cashflow | (958) | (882) | (473) | (315) |
| Other investing cashflow | (155) | 44 | 53 | 56 |
| Cashflow from Investing Activities | (1,012) | (1,250) | (1,007) | (1,313) |
| Issue of Share Capital | 573 | 4,505 | - | - |
| Interest Cost | (524) | (326) | (110) | (141) |
| Inc (Dec) in Borrowings | 1,214 | (1,898) | 532 | 421 |
| Dividend paid | - | - | - | - |
| Others | - | - | - | - |
| Cash flow from Financing Activities | 1,263 | 2,281 | 422 | 280 |
| Chg. in Cash & Bank balance | 150 | 1,443 | 2 | 21 |
| Closing cash & balance | 194 | 1,637 | 1,639 | 1,660 |

Source Company data, I-Sec research

Exhibit 6: Key ratios

(Year ending March)

| | FY23A | FY24E | FY25E | FY26E |
|-----------------------------|--------|-------|-------|-------|
| Per Share Data (INR) | | | | |
| Reported EPS | 1.4 | 7.1 | 15.5 | 20.0 |
| Adjusted EPS (Diluted) | 1.4 | 7.1 | 15.5 | 20.0 |
| Cash EPS | 4.2 | 10.7 | 20.1 | 25.8 |
| Dividend per share (DPS) | - | - | - | - |
| Book Value per share (BV) | 34.5 | 110.7 | 126.2 | 146.2 |
| Dividend Payout (%) | - | - | - | - |
| Growth (%) | | | | |
| Net Sales | 29.4 | 35.1 | 37.0 | 29.0 |
| EBITDA | 16.1 | 50.7 | 50.2 | 29.5 |
| EPS (INR) | (71.2) | 398.7 | 116.6 | 29.1 |
| Valuation Ratios (x) | | | | |
| P/E | 905.2 | 181.5 | 83.8 | 64.9 |
| P/CEPS | 306.1 | 121.5 | 64.7 | 50.3 |
| P/BV | 37.6 | 11.7 | 10.3 | 8.9 |
| EV / EBITDA | 114.4 | 73.2 | 49.0 | 38.1 |
| Dividend Yield (%) | - | - | - | - |
| Operating Ratios | | | | |
| Gross Profit Margins (%) | 88.0 | 83.9 | 82.8 | 82.0 |
| EBITDA Margins (%) | 28.7 | 32.0 | 35.1 | 35.2 |
| Effective Tax Rate (%) | 35.6 | 30.0 | 30.0 | 30.0 |
| Net Profit Margins (%) | 3.4 | 12.4 | 19.6 | 19.7 |
| Net Debt / Equity (x) | 1.2 | (0.1) | 0.0 | 0.0 |
| Net Debt / EBITDA (x) | 3.4 | (0.5) | 0.0 | 0.2 |
| Fixed Asset Turnover (x) | - | - | - | - |
| Inventory Turnover Days | 166 | 182 | 174 | 163 |
| Receivables Days | 228 | 165 | 171 | 155 |
| Payables Days | 91 | 70 | 71 | 69 |
| Profitability Ratios | | | | |
| RoCE (%) | 10.8 | 11.6 | 13.1 | 13.6 |
| RoE (%) | 6.1 | 13.0 | 17.1 | 15.6 |
| RoIC (%) | 11.8 | 13.7 | 15.9 | 16.5 |

Source Company data, I-Sec research

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