

Company Overview

Incorporated in 1983, Azad Engineering Ltd. is one of the key manufacturers of highly engineered, complex, and mission and life-critical components. The company supplies products to global original equipment manufacturers (OEMs) in the energy, aerospace, defense, and oil and gas industries. The company's expertise is in the manufacturing of complex and highly engineered precision forged and machined components that are mission and life-critical. Hence, some of its products have a "zero parts per million" defects requirement. Azad's customers include General Electric, Honeywell International Inc., Mitsubishi Heavy Industries, Ltd., Siemens Energy, Eaton Aerospace, and MAN Energy Solutions SE. Their products include 3D rotating airfoil/ blade portions of turbine engines and other critical components for (a) gas, nuclear, and thermal turbines used in industrial applications or energy generation, and (b) defense and civil aircraft and spaceships. The demand for such precision forged and machined components is driven by requirements relating to energy turbines (industrial, gas, nuclear, and coal), and aircraft (commercial and military), amongst others. Azad has four advanced manufacturing facilities in Hyderabad, India, capable of producing high-precision forged and machined components with a total manufacturing area of approximately 20,000 square meters. Further, it has two manufacturing facilities in the pipeline at (a) Tuniki Bollaram village in Siddipet district, Telangana, and (b) Mangampet village, Sangareddy district, Telangana, with a total manufacturing area of 94,898.8 square meters and 74,866.8 square meters, respectively.

Objects of the issue

The net proceeds from the fresh issue will be used towards the following purposes:

- ⇒ Funding capital expenditure of the company;
- ⇒ Repayment/prepayment, in part or full, of certain of its borrowings availed by the company; and
- ⇒ General corporate purposes.

Investment Rationale

Preferred name in the manufacturing of highly engineered, complex, and mission and life-critical high-precision components for global OEMs

Azad Engineering is one of the key manufacturers of highly engineered, complex, and mission and life-critical components and supplies to global OEMs primarily engaged in highly regulated industries, including energy, aerospace and defense, and oil and gas industries. Despite growing competition from China, Europe, the USA, and Japan, Azad is a preferred name in the manufacturing of highly engineered, complex, and mission and life-critical high-precision components for global OEMs. Despite the significant expenses associated with qualifying manufacturing partners, it has demonstrated efficiency pursuant to machining time reduction, which it believes to be a competitive strength against manufacturers from China, Europe, the USA, and Japan. Further, the company has been successful in obtaining stringent and highly sought qualifications for products from global customers in a lesser time period than the industry standard. Further, the attractiveness of China has reduced due to the growing geopolitical tensions and also rising labour costs. The energy, aerospace and defence and oil and gas industries have significant entry barriers due to a lengthy qualification process for components driven by the criticality of their usage. Thus, it ensures repeat orders and customer stickiness for the company.

Advance manufacturing facilities with a diverse range of products and solutions

Azad has four manufacturing facilities in Hyderabad, India which are spread across approximately 20,000 square meters and have a combined annual installed capacity of 642,310 hours per annum, annual actual production of 578,316 hours per annum, and capacity utilization of 90% per annum. Leveraging on its advance machines and technologies, the company is a prominent player in the industries in which it operates, with intricate engineering capabilities and the production of high-quality components that meet the stringent demand of modern applications. Azad constantly strives to introduce innovation in its manufacturing processes, expand in-house capabilities to undertake forging and special processes, and improve efficiencies to reduce costs to lower lead times to manufacture a product. Consequently, this helps in increasing the company's revenues, margins, and profitability. Additionally, their manufacturing facilities are equipped with sophisticated equipment and machinery including robotics equipment that enables them to produce high-quality products and helps minimize the number of employees required to operate them, thereby reducing costs.

Issue Details

Offer Period	20 th Dec, 2023 - 22 nd Dec, 2023
Price Band	Rs. 499 to Rs. 524
Bid Lot	28
Listing	BSE & NSE
Issue Size (no. of shares in mn)	14.1
Issue Size (Rs. in bn)	7.4
Face Value (Rs.)	2

Issue Structure

QIB	50%
NIB	15%
Retail	35%

BRLM	Axis Capital Ltd., ICICI Securities Ltd., SBI Capital Markers, Anand Rathi Securities Ltd.
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Registrar	KFin Technologies Ltd.
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Particulars	Pre Issue %	Post Issue %
Promoter	78.61%	65.90%
Public - Others	21.39%	34.10%
Total	100.00	100.00

(Assuming issue subscribed at higher band)

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Azad Engineering Ltd.

Valuation and Outlook

Among the addressable markets for the company, there is a high variation in the expected CAGR between gas, nuclear, and coal turbines with the highest CAGR expected for components of nuclear turbines (+8% CAGR by 2027) followed by gas turbines (+1% CAGR by 2027). The market for aerospace and defense components is the largest at Rs. 99,000 crores in 2022 and is also expected to have the highest CAGR of +9% by 2027. The overall addressable market across energy turbine, aerospace, and defense components for the company is expected to grow at +7% CAGR from Rs. 1,28,000 crores in 2022 to Rs. 1,81,000 crores in 2027. Additionally, there is an addressable market for oilfield drilling components which is expected to grow at +4% CAGR by 2027. The energy turbine, aerospace & defense industries have a significant entry barrier due to a lengthy qualification process for the components driven by the criticality of their usage. Some of these components are life-critical and mission-critical and hence, have zero parts per million defect requirements. Superior manufacturing demands a unique blend of expertise, innovation, quality, and advanced safety controls in the industry which cannot be obtained by only installing CNC machines. Azad Engineering Ltd. increased its revenue from Rs. 124 crores in FY20 to Rs. 262 crores in FY23 (CAGR of 28.4% between FY20-23), with an EBITDA margin of 31.4% in FY23. The company is one of the fastest growing manufacturers (in terms of revenue growth for the period between FY20-23) with one of the highest EBITDA margins among key players for machined components for the key industries serviced by the company. As a strategic and growth partner to customers across highly regulated industries, the company enjoys long-term relationships along with high customer stickiness and a high percentage of repeat business. This allows them to have long-term contracts, a stable customer base, and strong visibility on long-term revenue. **The company is one of the fastest-growing manufacturers (in terms of revenue growth for the period between FY20-23) with one of the highest EBITDA margins among key players for machined components for the key industries serviced by the company. With Azad Engineering being in the niche industry and promising growth seen in the industry, we give a “Subscribe” rating to the issue. On the upper price band, the issue is valued at a P/E of 48.3x based on FY24 annualized earnings which we feel is fairly valued in comparison to its peers.**

Key Risks

- ⇒ Azad Engineering's business is dependent on the sale of its products to key customers. The loss of any of the key customers or loss of revenue from sales to the customers could have a material adverse effect on its business, results of operations, financial condition, cash flows, and prospects.
- ⇒ The company depends on third-party suppliers for raw materials, plant, machinery, and components, which are on a purchase-order basis. Such suppliers may not perform, or be able to perform their obligations on time, or at all. Any delay, shortage, interruption, reduction in the supply of or volatility in the prices of raw materials, plant, machinery, and components may have a material adverse effect on its business and prospects.
- ⇒ The company is required to comply with certain restrictive covenants under its financing agreements. Any non-compliance may lead to, amongst others, suspension of further drawdowns, which may adversely affect its business, results of operations, financial condition, cash flows, and prospects.



Azad Engineering Ltd.

Income Statement (Rs. in millions)

Particulars	FY21	FY22	FY23	H1FY24
Income				
Revenue from operations	1,227	1,945	2,517	1,587
Other income	23	48	98	108
Total Income	1,250	1,993	2,615	1,695
Expenses				
Cost of materials consumed	222	376	495	290
Changes in inventories of finished goods, work-in-progress	(84)	(168)	(194)	(91)
Employee benefits expense	326	463	593	338
Finance costs	54	136	524	219
Depreciation expense	89	133	166	98
Other expenses	482	652	900	526
Total expenses	1,088	1,591	2,484	1,379
Profit before tax for the period / year	162	401	132	316
Tax expenses:				
Current tax	41	87	26	55
Tax pertaining to earlier years	0	0	2	0
Deferred tax	6	20	19	-8
Total tax expense	47	107	47	47
Profit for the period/year	115	295	85	269
Other comprehensive income/(loss)				
A) Items that will not be reclassified to profit and loss				
Re-measurement gains/(losses) on defined benefit plans	(1)	(5)	3	(3)
Income tax relating to these items	0	1	(1)	0
Other comprehensive income/(loss)	0	-3	2	(3)
Total comprehensive income	115	291	87	266
Basic EPS	2.53	6.49	1.79	5.43
Diluted EPS	2.53	6.49	1.79	5.43

Source: RHP, BP Equities Research

Cash Flow Statement (Rs. in millions)

Particulars	FY21	FY22	FY23	H1FY24
Cash Flow from operating activities	48	209	(102)	(86)
Cash flow from investing activities	(347)	(1,142)	(1,012)	139
Cash flow from financing activities	236	959	1,263	(46)
Net increase/(decrease) in cash and cash equivalents	(63)	27	150	8
Cash and cash equivalents at the beginning of the period	81	18	44	194
Cash and cash equivalents at the end of the period	18	44	194	202

Source: RHP, BP Equities Research



Azad Engineering Ltd.

Balance Sheet (Rs. in millions)

Particulars	FY21	FY22	FY23	H1FY24
ASSETS				
Non-current assets				
Property, plant and equipment	1,211	1,444	2,167	2,149
Right of use assets	0	0	0	29
Capital work-in-progress	0	237	380	445
Financial assets				
Other financial assets	34	31	34	21
Other non-current assets	56	655	476	545
Total Non-Current Assets	1,301	2,366	3,056	3,189
Current Assets				
Inventories	343	574	861	1,057
Financial Assets				
Trade receivables	526	746	1,187	1,334
Cash and cash equivalents	18	44	194	202
Bank balances other than cash and cash equivalents	154	132	333	145
Other financial assets	12	0	1	31
Other current assets	207	180	261	410
Total Current Assets	1,260	1,677	2,836	3,178
Total Assets	2,560	4,043	5,892	6,366
EQUITY AND LIABILITIES				
Equity				
Equity Share Capital	15	15	17	99
Other Equity	894	1,185	2,023	2,206
Total Equity	909	1,200	2,040	2,305
Liabilities				
Non-current Liabilities				
Financial Liabilities				
Borrowings	415	1,226	2,209	2,137
Lease liabilities	0	0	0	20
Provisions	14	23	26	32
Deferred tax liabilities (net)	98	116	136	128
Total Non-Current Liabilities	526	1,364	2,370	2,318
Current Liabilities				
Financial Liabilities				
Borrowings	463	746	797	1,112
Lease liabilities	0	0	0	3
Trade Payables				
total outstanding dues of MSMEs	26	33	25	25
total outstanding dues of creditors other than MSMEs	347	393	450	394
Other financial liabilities	76	158	123	141
Provisions	7	11	22	29
Other current liabilities	168	54	39	33
Current tax liabilities (net)	39	84	25	6
Total Current Liabilities	1,125	1,479	1,482	1,743
Total Liabilities	1,652	2,843	3,852	4,061
Total Equity and Liabilities	2,560	4,043	5,892	6,366

Source: RHP, BP Equities Research

**Disclaimer Appendix****Analyst (s) holding in the Stock : Nil****Analyst (s) Certification:**

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