



Company Overview

Incorporated in 1982, Diffusion Engineers Ltd. is engaged in the manufacturing of welding consumables, wear plates, wear parts, and heavy engineering machinery for core industries. The company specializes in the repair and reconditioning of heavy machinery and equipment and also trades in anti-wear powders as well as welding and cutting machinery. Through a forward integration strategy, the company manufactures special-purpose electrodes and flux-cored wires, which are used in the production of wear-resistant plates. These plates are crucial components in the manufacturing of large industrial equipment used in key sectors such as cement, steel, power, mining, engineering, oil & gas, and sugar industries. This forward integration allows the company to enhance production efficiency, gain a competitive edge, reduce product costs, improve supply chain management, and minimize dependency on third-party suppliers. Initially, after its incorporation, Diffusion Engineers traded in welding electrodes for super-conditioning. Over time, the company expanded its operations to four manufacturing units: Units I, II, and III located in Hingna, Nagpur, while Unit IV is situated in Khapri (Uma), Nagpur. Each unit specializes in producing different products. Diffusion Engineers Ltd. holds accreditation from the National Accreditation Board for Testing and Calibration Laboratories (ISO/IEC 17025:2017) for General Requirements for the Competence of Testing & Calibration Laboratories. Additionally, they conduct multiple stringent quality checks and hold Environment Management System (EMS) certification from TÜV SÜD South Asia Private Limited, Quality Management System (QMS) - ISO 9001:2015, Occupational Health and Safety Management Systems - ISO 45001:2018, and Environment Management System - ISO 14001:2015. Approximately 91% of the company's revenue is derived from the domestic market, with the remaining 9% coming from exports to various countries. Its overseas presence includes subsidiaries in Singapore, Turkey, and the Philippines, as well as joint ventures and associates in the United Kingdom and Malaysia.

Objects of the issue

The company proposes to utilize the net proceeds from the issue towards funding of the following objects:

- ⇒ Funding capital expenditure requirements towards expansion of its existing manufacturing facility at Khapri (Uma), Nagpur ("Proposed Expansion");
- ⇒ Setting up of a new manufacturing facility at Hingna, Nagpur ("Proposed Facility");
- ⇒ Funding working capital requirements of the company; and
- ⇒ General corporate purposes.

Investment Rationale

Forward integration-driven synergistic model expands business scope

In 1993, Diffusion Engineers started manufacturing welding electrodes and gradually expanded into producing flux-cored wires in 1997. Over time, they diversified into manufacturing wear plates and wear parts using flux-cored wires which were further used for manufacturing heavy engineering equipment. This transition from manufacturing of basic components to producing specialized components reflects forward integration and has allowed it to broaden its scope in the industry. Over the years, the company expanded into providing welding services for core industries and is committed to meet customer needs for welding and anti-wear solutions, enhancing the longevity and performance of heavy equipment. The primary revenue drivers are the welding electrodes, wear plates, wear parts, and heavy engineering products, contributing around 90-93% of the company's revenues in the last three fiscal years (FY22-FY24). Additionally, the manufactured special purpose electrodes and flux cored wire are consumed in-house as well as sold to domestic as well as international customers, ensuring economies of scale and minimal wastage. Forward integration has provided multiple benefits such as increased production efficiency, cost reductions, control over supply of raw materials, and decreased reliance on third parties.

Direct and long-standing industry relationships reduce business risks

Diffusion Engineers, with over four decades in business, have established long-standing relationships with both Indian and global customers. They cater to a diverse clientele including OEMs that service major players in the cement, steel, and power sectors, as well as direct customers. These OEMs, in turn, supply major companies within their respective industries, positioning Diffusion Engi-

Issue Details

Offer Period	26 th Sep 2024 - 30 th Sep 2024
Price Band	Rs. 159 to Rs. 168
Bid Lot	88
Listing	BSE & NSE
Issue Size (no. of shares in mn)	9.4
Issue Size (Rs. in bn)	1.6
Face Value (Rs.)	10

Issue Structure

QIB	50%
NIB	15%
Retail	35%

BRLM Unistone Capital Pvt. Ltd.

Registrar Bigshare Services Pvt. Ltd.

Particulars Pre Issue Post Issue

Promoters and promoter group	93	70
Public	7	30
Total	100	100

(Assuming issue subscribed at higher band)

Research Team - 022-61596138

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neers as a critical link in the OEM ecosystem of key industry players. Additionally, the company engages directly with core customers in the cement, steel, and power sectors, highlighting its capability to serve and meet the unique needs of these major players. The company believes that its focus on quality, customized solutions for customers, and timely delivery of products has enabled the company to establish and maintain long-term relationships, retain existing clients, and attract new ones. In FY24, customers with relationships exceeding five years contributed a significant 68.6% of total revenue, demonstrating the company's ability to retain key clients and maintain steady income. The remaining revenue comes from new clients which reflects the company's adaptability and growth potential.

Valuation

Diffusion Engineers operates in the manufacturing of welding consumables, wear plates, wear parts, and heavy engineering machinery for core industries. They also provide specialized and customized repair and reconditioning services for heavy machinery and equipment. Additionally, the company is involved in trading of anti-wear powders, as well as welding and cutting machinery. They follow a synergistic business model, focusing on forward integration by manufacturing both basic and specialized products, which gives them a competitive edge and broadens its scope in the industry. With a diverse customer base of OEMs and direct customers both domestically and internationally, Diffusion Engineers demonstrates its ability to meet specific needs of major players in sectors like cement, steel, and power. The company's long-standing relationships with customers generate a significant portion of its revenue, ensuring steady income growth. As India continues to experience rapid industrialization and increasing demand for improved infrastructure, the welding consumables market is estimated at around Rs. 51 billion in FY24, with projections of Rs. 64-66 billion by FY27. To meet this growing demand, the company is strategically planning to expand its manufacturing activities. Diffusion Engineers ranks among the top three industry players in terms of CAGR for operating income, profitability, and EBITDA between FY21 and FY24. The company demonstrated substantial revenue growth from FY22 to FY24, with a CAGR of 16.6%. The company's profit after tax (PAT) also rose significantly, from Rs. 170.5 million in FY22 to Rs. 308.0 million in FY24. **The current issue is priced at a P/E ratio of 11.7x on the upper price band based on FY24 earnings, which is relatively lower compared to its peers. Therefore, we recommend a SUBSCRIBE rating for this issue with a medium to long-term investment perspective.**

Key Risks

- ⇒ The company faces significant risks due to its reliance on several industries, including cement and power, which are vulnerable to economic downturns. Its increasing dependence on the domestic market and a small number of key customers, 20.81% of revenue from the top five and 29.43% from the top ten, heightens the risk of revenue loss if existing arrangements fail.
- ⇒ The company faces significant risks related to obtaining necessary approvals, licenses, and permits, which could delay its capital expenditure plans. Additionally, the orders for the required machinery are still pending. These delays or cost overruns in setting up the Proposed Facilities may adversely impact its financial condition, operations, and growth prospects, putting overall project execution at risk.
- ⇒ The company faces significant risks due to past non-compliance with the Companies Act, including incorrect filings and untraceable corporate records. These issues may result in penalties and adversely affect its reputation and financial condition. Additionally, ongoing regulatory scrutiny and the potential for future compliance failures pose risks to the company's operations and growth prospects.

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Income Statement (Rs. in millions)

Particulars	FY22	FY23	FY24
Revenue			
Revenue from Operations	2,046	2,549	2,781
Total Revenue	2,046	2,549	2,781
Expenses			
Cost of materials consumed	1,166	1,376	1,292
Purchase of stock-in-trade	82	128	186
Changes in inventories of finished goods and work in progress	-78	-28	-10
Manufacturing expenses	265	329	388
Employee benefit expenses	269	308	361
Other expenses	117	158	176
Total Operating Expenses	1,821	2,270	2,393
EBITDA	225	279	389
Depreciation and Amortization expenses	42	38	45
Other income	42	38	74
EBIT	225	278	417
Finance costs	14	23	18
Exceptional Item	-	-	3
Share of Profit (Loss) of associate	9	31	14
PBT	220	287	411
Current tax	49	59	88
Deferred Tax charge/ (credit)	0	4	15
Short / (Excess) provision of earlier years	-	2	-
Total tax	49	65	103
PAT	170	221	308
Diluted EPS	6.1	7.9	10.9

Source: RHP, BP Equities Research

Cash Flow Statement (Rs. in millions)

Particulars	FY22	FY23	FY24
Cash Flow from operating activities	111	(47)	391
Cash flow from investing activities	(152)	(134)	(386)
Cash flow from financing activities	25	196	27
Net increase/(decrease) in cash and cash equivalents	(16)	15	33
Cash and cash equivalents at the beginning of the period	47	31	45
Cash and cash equivalents at the end of the period	31	45	78

Source: RHP, BP Equities Research

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Balance Sheet (Rs. in millions)

Particulars	FY22	FY23	FY24
ASSETS			
Non-current assets			
Property, plant and equipment	601	633	906
Capital work-in-progress	-	18	11
Intangible assets	2	3	4
Financial assets			
Investments	189	195	292
Other financial assets	59	64	62
Total Non-Current Asset	850	913	1,275
Current assets			
Inventories	444	517	532
Financial Assets			
Trade receivables	503	701	666
Cash and cash equivalents	31	45	78
Other bank balances	5	0	-
Loans and advances	28	50	155
Other financial assets	9	33	12
Other current assets	25	44	37
Total Current Asset	1,045	1,391	1,481
Total Assets	1,895	2,303	2,756
EQUITY AND LIABILITIES			
Equity			
Equity share capital	37	37	280
Other equity	1,169	1,383	1,627
Equity attributable to owners of the Company	1,206	1,420	1,907
Non-controlling interest	2	2	3
Total Equity	1,208	1,422	1,910
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings	28	17	-
Other financial liabilities	7	8	10
Deferred tax liabilities	34	38	52
Total Non-Current Liabilities	68	63	62
Current Liabilities			
Financial liabilities			
Borrowings	218	464	344
Trade payables	309	247	309
Other financial liabilities	14	8	22
Provisions	3	6	9
Other current liabilities	76	94	98
Total Current Liabilities	619	819	783
Total Equity and Liabilities	1,895	2,303	2,756

Source: RHP, BP Equities Research

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

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