IPO NOTE

DIFFUSION

Innovative Superconditioning Solutions

DIFFUSION ENGINEERS LIMITED

DATE: 25.09.2024

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Canara Bank Securities Ltd
A Wholly Owned Subsidiary Of Canara Bank

- Established on November 5, 1982, Diffusion Engineers is engaged in the business of manufacturing welding consumables; wear plates wear parts and heavy engineering machinery for core industries.
- With over four decades of experience, the Company is dedicated to providing specialized repairs and reconditioning services for heavy machinery and equipment.
- Additionally, they are also involved in trading anti-wear powders and welding and cutting machinery.
- They provide a super conditioning process at their manufacturing facilities, a surface treatment solution for machine components that enhances wear resistance, eliminates stress and improves their repairability ultimately extending their lifespan and reducing production costs.
- They have developed a synergistic system of forward integration whereby they manufacture special -purpose electrodes and flux-cored wires which are utilized for manufacturing wear resistance plates (commonly known as wear plates).
- They presently operate from four manufacturing units, out of which Unit I, II and III are located in Nagpur Industrial Area, Hingna, Nagpur – 440 016, Maharashtra and Unit IV is located in Khapri (Uma), Nagpur, Maharashtra for processing and manufacturing of their products.
- Their manufacturing operations are distributed across different units as under: -
    - Unit I: special purpose welding electrodes;
    - Unit II: flux cored wires, wear plates and wear parts through fabrication and machining;
    - Unit III: coatings for abrasion and corrosion resistance;
    - Unit IV: flux cored wires (since Fiscal 2024), wear plates and heavy engineering machinery.
- As of February 29, 2024, the company had a team of over 130 qualified engineers.

Issue Details

Price Band (in ₹ per share)	159.00-168.00
Issue size (in ₹ Crore)	149.54-158.00
Fresh Issue (in ₹ Crore)	149.54-158.00
OFS (in ₹ Crore)	NA
Issue open date	26.09.2024
Issue close date	30.09.2024
Tentative date of Allotment	01.10.2024
Tentative date of Listing	04.10.2024
Total number of shares (lakhs)	94.05
No. of shares for QIBs (50%) (lakhs)	46.79
No. of shares for NII (15%) (lakhs)	14.04
No. of shares for S-HNI (33%)(lakhs)	4.68
No. of shares for B-HNI (66%)(lakhs)	9.36
No. of shares for retail investors (35%) (lakhs)	32.75
No of shares for Employee Reservation (lakhs)	0.50
Minimum order quantity	88
Face value (in ₹)	10.00
Amount for retail investors (1 lot) (in ₹)	13992-14784
Maximum no. of shares for Retail investors at Lower Band	1232 (14 lots)
Maximum no. of shares for Retail investors at Upper Band	1144 (13 lots)
Maximum amount for retail investors at lower band - upper band (in ₹)	195888-192192
Minimum no. of shares for sHNI (2 Lakhs) at upper band	1232 (14 lots)
Maximum no. of shares for sHNI (10 Lakhs) at upper band	5896 (67 lots)
Minimum number of shares for bHNI at upper band	5984 (68 lots)
Exchanges to be listed on	BSE & NSE

Promoters

- PRASHANT GARG
- DR. NITIN GARG
- CHITRA GARG

Objects of the Offer

The Company proposes to utilize the Net Proceeds from the Issue towards funding the following objects:

- Funding capital expenditure requirements towards the expansion of existing manufacturing facility at Khasra No. 36, 38/1, 38/2, 38/3, Khapri (Uma), Nagpur- 441 501, Maharashtra, India (Proposed Expansion);
- Setting up of a new manufacturing facility located at Plot Nos. 33-B/1/1/ & 33-B/1/1/Part, MIDC, Hingna, Sonegaon District, Nagpur-440 016, Maharashtra (Proposed Facility);
- Funding working capital requirements of the Company; and
- General Corporate Purposes.

BRIEF FINANCIALS

PARTICULARS (Rs. Cr)*	FY24	FY23	FY22
Share Capital^	28.02	3.73	3.73
Net Worth	190.70	141.99	120.64
Total Income	285.56	258.67	208.74
EBITDA	47.38	34.79	27.52
EBITDA Margin (%)	17.04	13.65	13.45
Profit/(Loss) After Tax	30.80	22.14	17.04
EPS (in Rs.)	10.94	7.91	6.08
Net Asset Value (in Rs.)	68.06	50.67	43.06
Total Borrowing	34.43	48.09	24.59
P/E#	15.36	NA	NA
P/B#	2.47	NA	NA

**Restated consolidated financials; #Calculated at upper price band; ^October 11th- Preferential Share Allotment & November 29th- 2024 - Bonus Issue in the ratio of 6:1.*

Profit & Loss Statement

Particulars (In Crores)	FY2022	FY2023	FY2024
Revenue			
Revenue from operations	204.59	254.88	278.14
Other income	4.16	3.80	7.42
Total revenue	208.75	258.67	285.56
YoY Growth (%)	-	23.92%	10.40%
Employee benefit expenses	26.90	30.76	36.06
Employee Expenses-% of Revenue	12.9%	11.9%	12.6%
Cost of raw material and components consumed	116.63	137.63	129.23
Cost of Material-% of Revenue	56%	53%	45%
Manufacturing expenses	26.45	32.86	38.82
Manufacturing cost-% of Revenue	13%	13%	14%
Purchases of stock-in-trade	8.21	12.81	18.56
Changes in In Inventories of finished goods, Work in-Progress and Stock-in-Trade	-7.77	-2.83	-0.95
Other expenses	11.69	15.76	17.57
EBIDTA	**27.52**	**34.80**	**47.39**
EBIDTA Margin (%)	13.45%	13.65%	17.04%
Depreciation and amortisation expense	4.16	3.84	4.55
EBIT	23.36	30.96	42.84
EBIT Margin (%)	11.42%	12.15%	15.40%
Finance cost	1.38	2.30	1.76
Profit before tax	21.98	28.66	41.08
Tax expenses			
Current tax	4.90	5.93	8.79
(Excess)/short provision of tax relating of previous years	-	0.18	-
Deffered tax	0.03	0.40	1.49
Total tax expenses	4.93	6.52	10.28
Profit for the year	17.05	22.15	30.80
PAT Margin (%)	8.33%	8.69%	11.07%
Earnings per share			
EPS (BASIC)	6.08	7.91	10.94

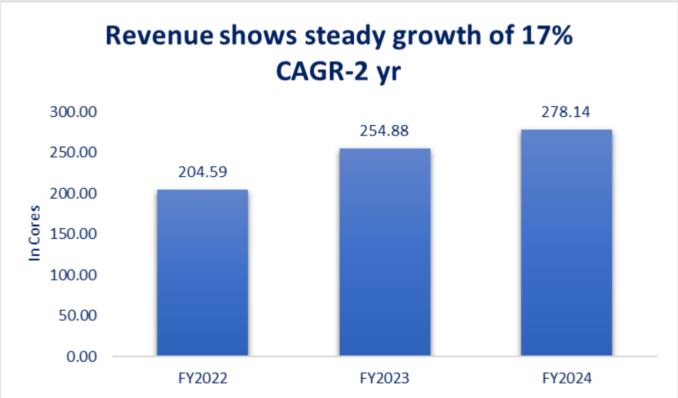
Cashflow Statement

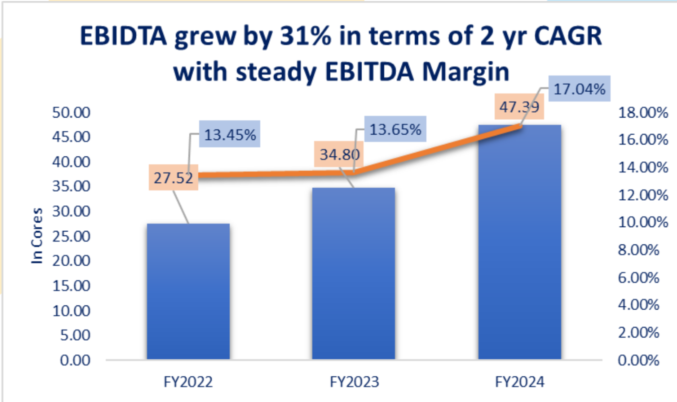
Particulars (In Crores)	FY2022	FY2023	FY2024
Cash generated from operating activities	15.37	0.99	49.38
Income tax paid (net of refunds)	-4.32	-5.73	-10.28
Net cash generated from operating activities	11.05	-4.74	39.10
Net cash used in investing activities	-15.20	-13.37	-38.56
Net cash used in financing activities	2.53	19.58	2.75
Net increase/ (decrease) in cash and cash equivalents	-1.62	1.47	3.28
Cash and cash equivalent as at 1 April	4.68	3.06	4.53
Cash and cash equivalent at the end of the year	**3.06**	**4.53**	**7.81**

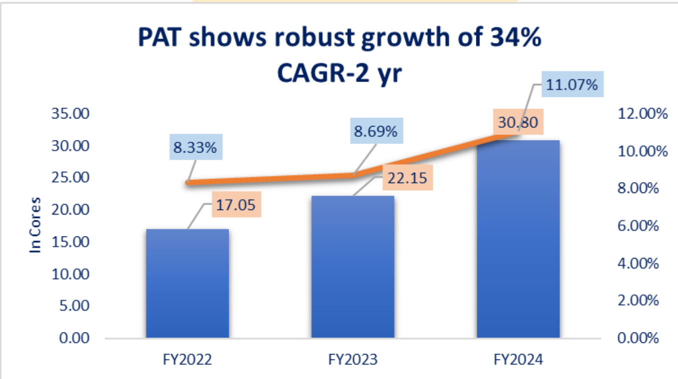
Balance Sheet

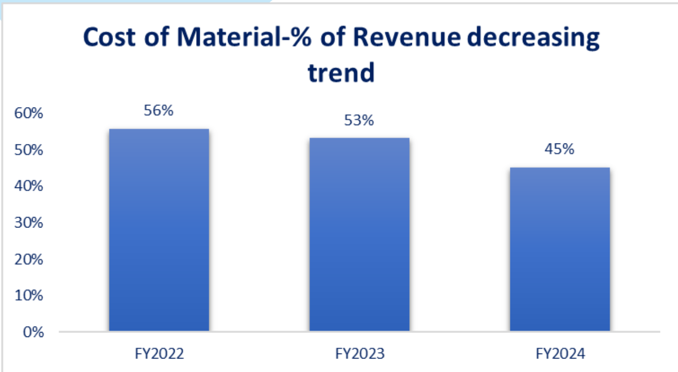
Particulars (In Crores)	FY2022	FY2023	FY2024
Assets			
Non-current assets			
Property, plant and equipment	60.11	63.28	90.57
Capital work in progress	-	1.83	1.11
Intangible assets	0.17	0.26	0.43
Financial assets			
Investments	18.88	19.50	29.20
Other financial assets	5.87	6.40	6.21
Total non- current assets	**85.03**	**91.26**	**127.51**
Current assets			
Inventories	44.37	51.71	53.21
Financial assets			
Trade receivables	50.35	70.14	66.65
Cash and cash equivalents	3.06	4.53	7.81
Other bank balances	0.51	0.00	-
Loans and advances	2.78	5.01	15.55
Other financial assets	0.91	3.33	1.16
Other current assets	2.54	4.38	3.71
Total Current Assets	**104.52**	**139.08**	**148.08**
Total assets	**189.55**	**230.34**	**275.59**
Equity and liabilities			
Equity			
Equity share capital	3.74	3.74	28.02
Other equity	116.91	138.26	162.68
Non-controlling interests	0.19	0.17	0.31
Total equity	**120.84**	**142.17**	**191.02**
Liabilities			
Non-Current liabilities			
Financial liabilities			
Borrowings	2.80	1.67	-
Other financial liabilities	0.65	0.84	1.00
Provision	-	-	-
Deffered tax liabilities (net)	3.36	3.76	5.24
Total Non-Current liabilities	**6.81**	**6.26**	**6.24**
Current liabilities			
Financial liabilities			
Borrowings	21.80	46.42	34.44
Trade payables			
Total outstanding dues of micro and small enterprises	0.13	3.13	11.16
Total outstanding dues of creditors other than micro and small enterprises	30.72	21.61	19.76
Other financial liabilities	1.37	0.78	2.22
Provision	0.27	0.57	0.93
Other current liabilities	7.61	9.40	9.82
Total Current liabilities	**61.90**	**81.91**	**78.33**
Total liabilities	**68.71**	**88.18**	**84.57**
Total equity and liabilities	**189.55**	**230.34**	**275.59**

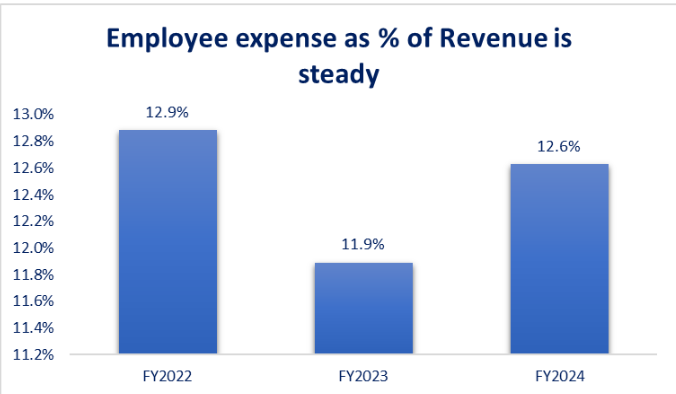
PERFORMANCE

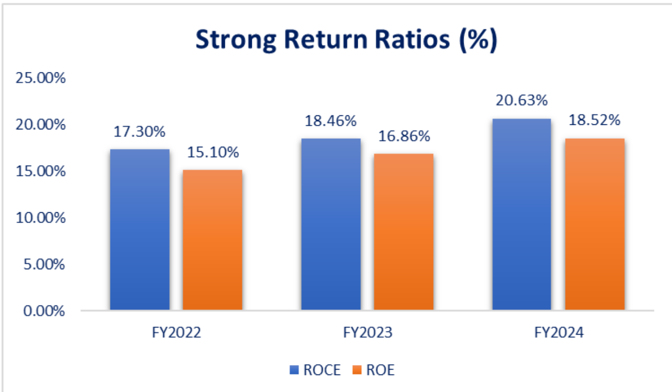












INDUSTRY REVIEW

Market size of the welding consumables industry in India;

- Welding consumables market in India is estimated at around Rs 51 billion in fiscal 2024, with fiscal 2027 projections around Rs 64-66 billion.
- Due to the rise in demand for improved infrastructure, a lot of investment is happening in infrastructure development, such as constructing roads, bridges, ports and airports.
- This investment in infrastructure is one of the key growth drivers for the welding consumables sector, because welding is indispensable in the construction industry, as it provides strong and reliable joining solutions for structural components.
- Also, the expansion of industries such as heavy engineering, energy, oil & gas, shipbuilding, railways, power, transportation, and automotive, promotes the growth of the welding consumables sector due to the construction and maintenance of plants in these industries.
- As India aims to become a global manufacturing hub, growth in the manufacturing sector will lead to a rise in the welding consumables sector.
- Government initiatives such as the National Infrastructure Pipeline, in which about Rs 111 lakh crore is to be invested in infrastructure during fiscals 2020 to 2025 in sectors such as heavy engineering, roads, urban infra, and railways, along with industrial reforms, such as 'Make in India' and 'Atmanirbhar Bharat', will support growth in the welding consumables sector.

Key drivers and trends in the global wear plates industry;

- As mineral resources play a key role in the world economy, the mining sector globally is expected to witness high investments in the sector.
- With these investments in the mining sector, a portion would be in upgrading and maintaining the mining equipment.
- As wear plates protect mining equipment against abrasion, these plates would play a key role in the mining industry and thus would attract high consumption in this sector.
- As the global economy grows, various economies in the world will invest heavily in infrastructure development, due to rising urbanization and increasing industrialization.
- With the investment in the construction industry, protecting construction machinery and equipment against abrasion would be vital.
- Since wear plates play a key role in extending the life of construction machinery and equipment, these plates would see a constant demand from the construction sector.
- In the wear plates market, key innovations, such as laser cladding, plasma transferred arc and advanced casting methods, are promoting wear plates with increased durability.
- Similarly, other advancements in technology in the wear plates sector would attract new customers in these sectors looking for high-performance wear plates with customized options.
- Similarly, adopting new composite materials, such as wear-resistant composite materials over traditional wear plates would offer new opportunities for this market, as these composite materials offer advantages, such as being lightweight, increased customizability and lower maintenance requirements.

Domestic heavy engineering capital goods industry estimated at Rs 3,100-3,200 billion as of fiscal 2024;

- India's engineering sector is divided into two segments: heavy and light engineering.
- This classification is based on the nature of the product and the technology used for processing.
- Heavy engineering includes manufacturing and assembly of industrial machinery and plant equipment for various end-use sectors.
- Equipment is designed and manufactured to suit end-use applications for industries such as fertilizer, textile, chemical, refinery, petrochemical, and oil and gas, as well as for the thermal and nuclear power sectors.
- On the other hand, light engineering includes sub-sectors, manufacturing everything from basic to sophisticated equipment.
- Light engineering products (components, parts, and small equipment) find application in automobiles, industrial machinery, power, oil and gas, fertilizers, steel, refineries, petrochemicals, cement, and railways sectors; and serve as inputs for the heavy engineering capital goods sectors.

COMPETITIVE STRENGTHS OF THE COMPANY

Synergistic business models focused on forward integration

- In 1993, they started manufacturing welding electrodes, gradually expanding their offerings to include flux cored wire in the year 1997.
- Subsequently, they also started manufacturing wear plates and wear parts using flux cored wire.
- These wear plates are further being utilized for the manufacturing of wear parts and heavy engineering equipment.
- They have embarked on a forward integration journey, transitioning from a manufacturer of welding electrodes to producing flux-cored wires, wear plates, and wear parts, and now to heavy engineering, broadening their scope and expertise in the industry.
- Over the years, they have expanded their capabilities to offer not only quality welding consumables but also comprehensive welding services for core industries.
- Their commitment to manufacturing and welding services ensures that their clients receive a comprehensive and streamlined approach to meet their welding and anti-wear needs, ultimately contributing to the longevity and optimal performance of their heavy equipment.
- Their revenues from welding electrodes, wear plates, wear parts and heavy engineering business on a standalone basis contribute in aggregate 90.92%, 92.85% and 92.78%for the fiscals 2024, 2023 and 2022.
- Further, the manufactured special-purpose electrodes and flux cored wire are consumed in-house as well as sold to their customers (domestic and international) ensuring economies of scale and minimal wastage.

Serving industry major players directly as well as through OEMs

- They serve a diverse clientele, which includes both OEMs who service major players in the cement, steel, and power sectors, as well as direct customers.
- These OEMs, in turn, service major players in their respective industries.
- This intricate network positions them as a vital link in the OEM ecosystem of some of the major players in core industries.
- In addition to their relationships with OEM customers, they also directly engage with the end customers in these core sectors.
- This direct interaction with established customers in the cement, steel, and power industries underscores their capability to serve and meet the distinctive needs of major players in these industries.

Consistent financial performance

- Over the years, their Company on a standalone basis has grown from a single-product to a multiproduct manufacturing company.
- They have demonstrated consistent growth in terms of revenues and profitability. Their revenue from operations has grown from ₹878.37 million in Fiscal 2013 to ₹2,571.26 million in Fiscal 2024, registering a CAGR of 10.26% in the last 11 years.
- Their PAT has grown from ₹73.22 million in Fiscal 2013 to ₹ 233.95 million in Fiscal 2024, registering a CAGR of 11.14% in the last 11 years.
- Further, amongst the players considered for the industry between fiscal 2021-2024, their Company recorded the third highest CAGR of 21% for operating income, second highest CAGR of 38% for profit after tax and the third highest CAGR of 33% for EBITDA. (Source: CRISIL Report).
- They strive to maintain a sound financial position with an emphasis on having a strong balance sheet. Their balance sheet and cash flows enable them to fund their strategic initiatives, pursue opportunities for growth and better manage unanticipated cash flow variations.

Experienced promoters and strong management team

- Prashant Garg, Promoter and Managing Director of their Company and a second-generation entrepreneur has been associated with their Company since 2003.
- He has a rich experience of nearly two decades in the industry they operate.
- Their Company has grown rapidly over the last few years primarily due to the vision, commitment and dynamism demonstrated by their promoter and he continues to be the driving force for their Company.
- In addition to their Promoters, their key management and senior management team includes qualified, experienced and skilled professionals who possess requisite experience across various divisions of their business.
- They believe the stability of their management team and the industry experience brought on by their Promoters enable them to continually take advantage of future market opportunities.
- Their senior management team is well qualified to leverage their market position with their collective experience and knowledge in their industry, to execute their business strategies and drive their future growth.

RISK FACTORS

Their Company is increasingly dependent on a domestic market for its sales and any downturn in it could dent their market share.

- They have historically derived the majority of their revenues from sales in the domestic market.
- The company is majorly dependent on domestic sales for their product sales while their products are also sold in Asia, APEC, Africa, Middle East, Europe and US regions.
- Thus, the sales of the Company are widely 39 dispersed throughout the domestic and any failure to maintain such dispersion may impact sales, revenues, and consequently, the financial performance of the Company.
- Further, any failure to expand its geographical presence in the international market will lead to a loss of opportunity to earn higher revenue thereby affecting the growth and profit in the Company.
- Loss of all or a substantial portion of sales to any of their customers from these countries for any reason (including, due to any materially adverse social, political or economic development, civil disruptions, or changes in the policies of the state government or state or local governments in these countries, occurrence of COVID19 infection and strict curbs), could further hurt their business, results of operations, financial condition, cash flows and future business prospects Export destination countries may also enter into free trade agreements or regional trade agreements with countries other than India.

Their Company had negative cash flows during certain fiscal years of their operating, investing and financing activities. Sustained negative cash flows in the future would adversely affect their results of operations and financial condition.

- They have in the three preceding Fiscal Years, and may in future, experience negative cash flows from operating, investing and financing activities.
- The cash flow of a company is a key indicator to show the extent of cash generated from operations to meet its capital expenditure, pay dividends, repay loans and make new investments without raising finance from external resources.
- If they are not able to generate sufficient cash flow, it may adversely affect their business and financial operations.
- They cannot assure you that their net cash flows will be positive in the future.
- Negative cash flows over extended periods, or significant negative cash flows in the short term, could materially impact their ability to operate their business and implement their growth plans.
- As a result, their cash flows, business, prospects, results of operations and financial condition may be materially and adversely affected.

They operate from four Manufacturing Facilities all of which are located in Nagpur, Maharashtra and therefore, any localized social unrest, natural disaster breakdown of services or any other natural disaster in and around, Nagpur, Maharashtra or any disruption in production at, or shutdown of, all their manufacturing units could have material adverse effect on their business and financial condition.

- They operate from four manufacturing facilities all of which are located in Nagpur, Maharashtra.
- They manufacture coated welding electrodes at Unit I; manufacture flux-cored wires, wear plates through fabrication and mild steel scrap (by-product) at Unit II; manufacture anti-wear consumables at Unit III; and manufacture wear plates, flux-cored wires and heavy engineering for core industries, fabrication, and machining at Unit IV.
- Any significant malfunction or breakdown of their machinery may entail significant repair and maintenance costs and cause delays in their operations.
- Although they have not experienced any strikes or labour unrest in the past three years, they cannot assure you that they will not experience disruptions in work in the future due to disputes or other problems with their workforce.
- Any labor unrest directed against them could directly or indirectly prevent or hinder their normal operating activities, and, if not resolved promptly, could lead to disruptions in their operations, which in turn could adversely affect their business, results of operations, financial condition and cash flows.

PEER COMPARISON

Name of the company	Revenue from Operations (in Cr.)	Face Value (Rs per share)	EPS (in Rs)	NAV (Per share Rs)	RoNW (%)	RoCE (%)	P/E*	P/B*
Diffusion Engineers Ltd.	278.14	10.00	10.94	68.06	18.52	20.63	15.36	2.47
Ador Welding Limited	883.83	10.00	46.46	266.49	18.43	24.07	29.03	5.06
AIA Engineering Limited	4853.76	2.00	120.40	705.86	18.41	22.80	36.68	6.26

**P/E & P/B ratio based on closing market price as of September 11th, 2024, at the upper price and of IPO, financial details consolidated audited results as of FY24.*

OUR VIEWS

- Diffusion Engineers Ltd. (DEL), established in 1982, operates in the manufacturing of welding consumables, wear plates, wear parts, and heavy engineering machinery, primarily catering to core industries such as cement, steel, power, and mining. The company also trades in anti-wear powders and welding and cutting machinery, positioning itself as a key player in this industry.
- Over four decades, DEL has built a reputation for offering specialized repairs and reconditioning services for heavy machinery and equipment.
- The company manufactures special-purpose electrodes and flux-cored wires that are then used in the production of wear-resistant plates. These plates are essential for protecting key components of industrial equipment, making them crucial for industries such as power plants, steel mills, and cement factories.
- One of DEL's strategic strengths is its forward integration. This integrated model enhances efficiency, reduces production costs, and strengthens the company's supply chain.
- The Indian market for welding consumables is expected to grow from ₹51 billion in FY24 to around ₹64-66 billion by FY27, while the wear plates market is projected to expand at a CAGR of 8-9% during the same period.
- Given India's rapid industrialization, the demand for wear plates and other industrial equipment is likely to surge. The heavy engineering capital goods industry is also on a growth trajectory, further benefiting DEL's product offerings.
- There is a slowdown in revenue growth (%) adhering to the fact that they maxed out their present capacities and future capacity expansion should widen their growth margins from here on, which is expected to take effect by Q3FY25.
- It has consistently invested in R&D to differentiate its products from competitors, particularly in the welding consumables segment. The company operates a DSIR-approved R&D facility that focuses on refining processes and testing materials to meet client-specific needs.
- DEL’s strategic focus on expanding its geographical presence is also noteworthy. With subsidiaries in Singapore, Malaysia, and Turkey, the company is targeting new regions while continuing to build long-term relationships with its domestic and international customers.
- Its asset-light leasing model allows clients to access heavy machinery without substantial upfront investment, which aligns well with industries looking for cost-effective solutions.
- DEL is also benefiting from the ongoing global capital expenditure cycle, and it plans to double its manufacturing capacity by the third quarter of the next fiscal year. This expansion will likely support its efforts to further penetrate the mining sector while maintaining its stronghold in cement and steel industries.
- Financially, DEL has shown solid growth. Amongst the players considered for the industry between fiscal 2021-2024, with the company recording the third-highest CAGR of 21% in operating income, 38% CAGR in profit after tax between FY21 and FY24 and 3rd highest CAGR of 33% in EBITDA.
- The company reported PAT margins of 8.17% (FY22), 8.56% (FY23), 10.79% (FY24), and RoCE margins of 17.30%, 18.46%, 20.63% for the referred periods, respectively
- On the valuation front, DEL appears attractively priced with a P/E ratio of 15.36x, significantly lower than the industry average of 32.86x.

Therefore, we recommend **SUBSCRIBE** to this issue for long term gains.

Sources: Company website and red herring prospectus

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