DIFFUSION ENGINEERS LIMITED

September 25, 2024

Innovative superconditioning solutions

SMC Ranking

★★☆☆☆ (2/5)

Issue Highlights

Industry	**Consumer Durables**
Fresh Issue (Shares)	9,405,000
Net Offer to the Public	**9,405,000**
Issue Size (Rs. Cr.)	149-158
Price Band (Rs.)	159-168
Employee Discount	Rs.8 per share
Offer Date	26-Sep-24
Close Date	30-Sep-24
Face Value	10
Lot Size	88 Shares

Issue Composition

	In shares
Total Issue for Sale	9,405,000
QIB	4,702,500
NIB	1,410,750
Retail	3,291,750

Shareholding Pattern (%)

Particulars	Pre-issue	Post -issue
Promoters & promoters group	93.10%	69.70%
QIB	6.90%	17.73%
NIB		3.77%
Retail	0.00%	8.80%
Total	**100.00%**	**100.00%**

*calculated on the upper price band

Objects of the Issue

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.

Book Running Lead Manager

- Unistone Capital Private Limited

Name of the registrar

- Bigshare Services Private Limited

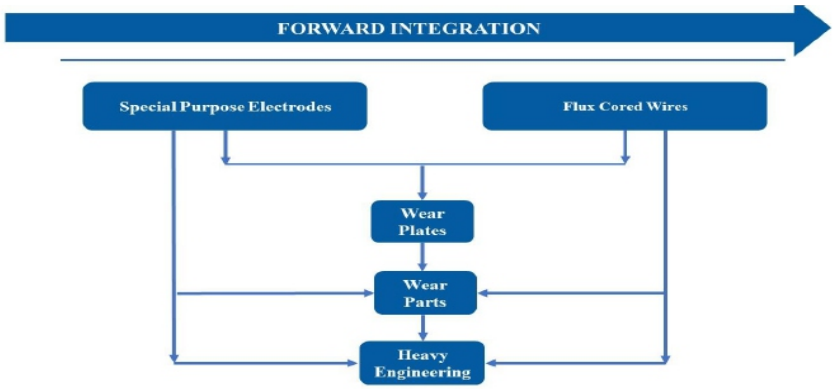
About the company

Founded in 1982, Diffusion Engineers Limited is active in the manufacture of welding consumables, wear plates and parts, and heavy machinery for core industries. The company offers specialized repair and reconditioning services for heavy machinery and equipment. The company also trades in wear protection powders and welding and cutting machines. At its production facilities, the company offers the Super Conditioning process, a surface treatment for machine components that increases wear resistance, eliminates stresses, and improves reparability, ultimately extending service life and reducing production costs. Diffusion Engineers Limited has four manufacturing units, of which Units I, II, and III are located at Nagpur Industrial Area, Hingna, Nagpur, Maharashtra, and Unit IV at Khapri (Uma), Nagpur, Maharashtra is responsible for the processing and manufacturing of the products. The manufacturing operations are spread across the various units as follows:

- Unit I: Welding electrodes for special purposes;
- 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 the financial year 2024), wear plates, and heavy engineering.

Strength

Synergistic business models focused on forward integration: Diffusion Engineers Ltd. has strategically expanded its operations from manufacturing welding electrodes to producing flux-cored wires, wear plates, wear parts, and now heavy engineering machinery, demonstrating its growing expertise in the industry. Over time, the company has not only provided high-quality welding consumables but also offered comprehensive welding services to core industries. This integrated approach ensures that clients receive a seamless solution for their welding and anti-wear requirements, contributing to the longevity and optimal performance of their heavy equipment. The combined revenue from welding electrodes, wear plates, wear parts, and heavy engineering business constituted 90.92%, 92.85%, and 92.78% of the company's total revenue for the fiscal years 2024, 2023, and 2022, respectively. Notably, the company's special-purpose electrodes and flux-cored wire are both consumed internally and sold to customers, domestically and internationally, leading to economies of scale and minimal waste. This forward integration strategy enhances production efficiency, provides a competitive advantage, reduces product costs, and ensures a reliable supply of raw materials, minimizing the company's reliance on third parties.



Serving industry major players directly as well as through OEMs: Diffusion Engineers serves a diverse customer base, including both original equipment manufacturers (OEMs) that cater to major players in the cement, steel, and power sectors, as well as direct customers. This intricate network places the company in a strategic position as a key supplier within the OEM ecosystem of some of the major players in core industries. The following table shows the breakdown of its business between OEM customers and direct customers on a standalone basis:

Particulars	Fiscal 2024	Fiscal 2023	Fiscal 2022
Number of OEM customers	31	27	21
Revenue generated from OEM customers (₹ in million)	731.50	715.53	653.91
% contribution in our revenue from OEM customers	27.75%	29.32%	33.40%
Number of direct customers	472	473	423
Revenue generated from direct customers	1,857.75	1,725.21	1,303.67
% contribution in our revenue from direct customers	72.25%	70.68%	66.60%

Long-standing relationships with customers across industries: Over four decades of operation, Diffusion Engineers has cultivated strong, enduring relationships with numerous Indian and global customers across various industries. The company's diverse customer base has grown steadily, serving 503, 500, and 444 customers in the fiscal years 2024, 2023, and 2022, respectively. Diffusion Engineers believes its unwavering commitment to quality, customized solutions, and timely delivery has been instrumental in fostering long-term relationships, retaining existing customers, and attracting new ones.

Strategically located manufacturing facilities: Strategically located in Nagpur, Maharashtra, Diffusion Engineers benefits from its central position within India. This prime location offers significant advantages for business operations, including easy access to industries nationwide, streamlined logistics for procurement and delivery, and efficient service to diverse segments. The company's manufacturing units, centrally positioned, enable it to reach both urban and remote areas, minimizing transit times and enhancing operational efficiency. This strategic location also contributes to cost-effective logistics, as reduced transportation distances optimize overall costs.

Strategy

Strategic expansion by venturing into nickel, cobalt and iron-based powder manufacturing for enhanced welding consumables portfolio: Diffusion Engineers plans to expand its welding consumables portfolio by venturing into the manufacturing of nickel, cobalt, and iron-based powders. This strategic move aims to address the increasing demand for these powders within its existing customer base and the broader industry. Currently, the company sources thermal spray powders from LSN Diffusion Ltd., a UK-based associate company. Leveraging its extensive trading experience, market knowledge, and understanding of customer demand, pricing, and supply chain dynamics, Diffusion Engineers is confident in its ability to successfully transition into manufacturing. To facilitate this endeavor, the company intends to enter into a technical collaboration agreement with LSN to acquire the necessary manufacturing technology. This strategic expansion not only strengthens existing customer relationships but also opens doors to new customers in untapped markets.

Expanding its geographical reach: Diffusion Engineers has subsidiaries in Singapore, Turkey, and the Philippines, which contribute significantly to its growth. Additionally, the company has joint ventures or associates in the United Kingdom and Malaysia. Over the past three fiscal years, Diffusion Engineers Ltd. has exported its products to Singapore, Uganda, Kenya, Nepal, Malaysia, the Philippines, the United Arab Emirates, Oman, Sri Lanka, Vietnam, Bangladesh, Tanzania, the United Kingdom, Germany, Kuwait, the United States, Indonesia, Russia, Senegal, Switzerland, Lebanon, Bulgaria, Croatia, Zambia, and Nigeria. The following table shows the regional breakdown of its exports on a standalone basis:

Region	Fiscals					
	2024		2023		2022	
	Amount (₹ in millions)	% of total revenue from operations	Amount (₹ in millions)	% of total revenue from operations	Amount (₹ in millions)	% of total revenue from operations
Africa	45.84	1.78	87.52	3.62	54.17	2.79
APAC	104.11	4.05	109.50	4.53	59.60	3.07
Asia	13.19	0.51	25.51	1.06	27.30	1.41
Europe	60.41	2.35	22.47	0.93	4.87	0.25
Middle east	39.90	1.55	28.68	1.19	15.80	0.81
USA	0.04	0.00	20.66	0.85	-	-
Total	**263.49**	**10.25**	**294.34**	**12.18**	**161.74**	**8.33**

Diffusion Engineers aims to expand its customer base and market share in both its existing and new geographies. The company plans to focus its efforts on select regions, such as Turkey, to establish a stronger presence. To achieve this, Diffusion Engineers Ltd. has incorporated a subsidiary, Diffusion Eurasia Mühendislik Sanayi Ve Ticaret Anonim Şirketi, in Turkey.

Strategic Leasing and Maintenance Business Model for Heavy Equipment: India's heavy engineering capital goods industry is estimated to be worth 3.1-3.2 trillion rupees as of fiscal 2024, with projected annual growth of 7.5-8.5% from fiscal 2023 to 2027, reaching 3.8-3.9 trillion rupees. Recognizing the significant financial burden of purchasing heavy equipment for sectors like cement, steel, and power, Diffusion Engineers Ltd. developed a business model focused on alleviating these costs through comprehensive leasing and maintenance solutions. This approach aims to optimize operational efficiency, provide financial flexibility, and enable strategic resource allocation. The company's leasing program allows customers to access heavy equipment without the need for large upfront payments. Pre-determined leasing and maintenance fees offer customers a predictable and manageable financial burden, facilitating budgeting and planning. In fiscal 2024, 2023, and 2022, the revenue generated from leasing and maintenance services amounted to 21.00 million rupees, 20.82 million rupees, and 17.32 million rupees, respectively, representing 0.82%, 0.85%, and 0.82% of its operating revenue.

Diversifying its Anti Wear Solutions and Heavy Engineering Equipment business into new Industries: In response to the universal need for wear and tear solutions in heavy machinery across various industries, Diffusion Engineers is strategically expanding its business beyond its current focus on cement, steel, and power sectors. The company aims to tap into sectors such as defense and mining, both of which heavily rely on heavy equipment. The defense sector presents a unique challenge with its diverse range of heavy machinery, each requiring specialized wear solutions. Meanwhile, the mining industry, known for its abrasive conditions, aligns perfectly with Diffusion Engineers' expertise, providing an ideal opportunity for market expansion. According to a CRISIL report, defense production in India reached 1,269 billion rupees in fiscal 2024, growing at a compound annual growth rate of 8.0% from fiscal 2017 to 2024. By fostering a culture of innovation, Diffusion Engineers seeks to provide customized solutions that address the evolving demands of heavy engineering equipment across different industries. This includes staying at the forefront of technological advancements and tailoring its offerings to meet specific sector requirements.

Risk factor

- The Company is increasingly dependent on a domestic market for its sales and any a downturn in it could dent its market share.
- The company had negative cash flows during certain fiscal years in relation to its operating, investing and financing activities.
- The company operates out of 4 manufacturing facilities, all of which are located in Nagpur, Maharashtra. Any localized social unrest, natural disaster, service outage, or other natural disaster in and around Nagpur, Maharashtra, as well as any disruption in production at, or shutdown of all of its manufacturing units, could harm its business and financial situation.

Peer comparison

As per RHP, there are no listed companies in India that engage in a business similar to that of the company.

Valuation

Considering the P/E valuation, on the upper end of the price band of Rs.168, the stock is priced at pre issue P/E of 15.28x on FY24 EPS of Rs.10.99. Post issue, the stock is priced at a P/E of 20.41x on its EPS of Rs.8.23. Looking at the P/B ratio at Rs.168 pre issue, book value of Rs. 68.17 of P/Bvx 2.46x. Post issue, book value of Rs. 93.26 of P/Bvx 1.80x.

Considering the P/E valuation, on the Lower end of the price band of Rs.159, the stock is priced at pre issue P/E of 14.46x on FY24 EPS of Rs.10.99. Post issue, the stock is priced at a P/E of 19.32x on its EPS of Rs.8.23. Looking at the P/B ratio at Rs.159 pre issue, book value of Rs. 68.17 of P/Bvx 2.33x. Post issue, book value of Rs. 93.26 of P/Bvx 1.70x.

Industry Outlook

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 construction of roads, bridges, ports and airports. The wear plates market in India is estimated at around Rs 22 billion in fiscal 2024 and is expected to grow at a CAGR of 8-9% to ~Rs 28 billion in fiscal 2027. Wear plates are essential part of the industries such as power plants, steel mills, quarrying, cement etc., as these plates protect key components of these industry. As India continues to undergo rapid industrialization, each of these industries would grow and require wear plates to protect their equipment and machinery. India's heavy engineering capital goods industry is estimated to be Rs 3,100-3,200 billion as of fiscal 2024, and is projected to clock a CAGR of 7.5-8.5% over fiscals 2023-27 to reach Rs 3,800-3,900 billion. Heavy electrical engineering, earthmoving, construction and mining machinery, and process plant equipment are the largest segments of the industry. Amongst the players considered for the industry between fiscal 2021-2024, the company recorded third highest CAGR of 21% for operating income, second highest CAGR of 38% for profit after tax and third highest CAGR of 33% for EBITDA.

Outlook

The company manufactures welding consumables, wear plates, wear parts, and heavy engineering machinery for core industries. It has consistently increased its revenue and profit over the past few years. With the anticipated increase in infrastructure and industrialization spending, the company is well-positioned for future growth. Hence, investors may consider holding it for the medium to long term.

An Indicative timetable in respect of the Issue is set out below:

EVENT	INDICATIVE DATE (On or about)
BID/ISSUE OPENS ON	26-September-24
BID/ISSUE CLOSES ON	30-September-24
Finalisation of Basis of Allotment with the Designated Stock Exchange	01-October-24
Initiation of refunds (if any, for Anchor Investors)/unblocking of funds from ASBA Account	03-October-24
Credit of Equity Shares to Demat Accounts of Allottees	03-October-24
Commencement of trading of the Equity Shares on the Stock Exchanges	04-October-24

Annexure

Consolidated Financials

Profit & Loss

Rs. in Cr.

Particulars	Period ended 31-Mar-24 (12 Months)	Period ended 31-Mar-23 (12 Months)	Period ended 31-Mar-22 (12 Months)
Revenue from operations	278.14	254.88	204.59
Total expenditure	239.28	227.00	182.10
Operating Profit	**38.87**	**27.88**	**22.49**
OPM%	13.97	10.94	10.99
Other Income	7.42	3.80	4.16
Total Net Income	**46.28**	**31.67**	**26.65**
Interest	1.76	2.30	1.38
PBDT	**44.53**	**29.38**	**25.26**
Depreciation	4.55	3.84	4.16
Profit/(loss) before Exceptional Items and Tax	**39.98**	**25.54**	**21.10**
Exceptional Items	0.26	0.00	0.00
Profit before Tax and share of profit/ (loss) of associates and joint ventures	**39.72**	**25.54**	**21.10**
Share of profit / (loss) of associates and joint ventures	1.36	3.12	0.88
Profit before tax	**41.08**	**28.66**	**21.98**
Tax	10.28	6.52	4.93
PAT	**30.80**	**22.14**	**17.05**

Balance sheet is on next page

Balance Sheet

Rs. in Cr.

Particulars	As on 31-Mar-24	As on 31-Mar-23	As on 31-Mar-22
Non-current assets			
Property, plant and equipment	90.57	63.28	60.11
Capital work-in-progress	1.11	1.83	0.00
Intangible assets	0.43	0.26	0.17
Financial Assets			
Investments	29.20	19.50	18.88
Other financial assets	6.21	6.40	5.87
Total non-current assets	**127.51**	**91.26**	**85.03**
Current asset			
Inventories	53.21	51.71	44.37
Financial Assets			
Trade receivables	66.65	70.14	50.35
Cash and cash equivalents	7.81	4.53	3.06
Other bank balances	0.00	0.00	0.51
Loans & advances	15.55	5.01	2.78
Others financial assets	1.16	3.33	0.91
Other current assets	3.71	4.38	2.54
Total current assets	**148.08**	**139.08**	**104.52**
Total Assets	**275.59**	**230.34**	**189.55**
Non-current liabilities			
Financial liabilities			
Borrowings	0.00	1.67	2.80
Other financial liabilities	1.00	0.84	0.65
Deferred tax liabilities (net)	5.24	3.76	3.36
Total Non-current liabilities	**6.24**	**6.26**	**6.81**
Current liabilities			
Financial Liabilities			
Borrowings	34.44	46.42	21.80
Trades Payable - MSME	11.16	3.13	0.13
Trades Payable - MESE	19.76	21.61	30.72
Other financial liabilities	2.22	0.78	1.37
Provisions	0.93	0.57	0.27
Other current liabilities	9.82	9.40	7.60
Total Financial liabilities	**78.32**	**81.91**	**61.90**
Total	**84.57**	**88.18**	**68.71**
Net worth represented by:			
Equity Share Capital	28.02	3.74	3.74
Other equity	162.68	138.26	116.91
Non-controlling interests	0.31	0.17	0.19
Net Worth	**191.02**	**142.17**	**120.84**

RANKING METHODOLOGY

WEAK	★
NEUTRAL	★★
FAIR	★★★
GOOD	★★★★
EXCELLENT	★★★★★

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