AIA Engineering Ltd.	
No. of shares (m)	94.32
Mkt cap (Rs crs/$m)	9786/1453
Current price (Rs/$)	1038/15.4
Price target (Rs/$)	917/13.6
52 W H/L (Rs.)	1081/700
Book Value (Rs/$)	240/3.6
Beta	0.2
Daily volume (avg. monthly)	43040
P/BV (FY17e/18e)	3.8/3.3
P/E (FY17e/18e)	23.8/20.9
EPS growth (FY16/17e/18e)	-4.0/0.4/13.9
ROE (FY16/17e/18e)	18.9/16.9/16.8
OPM(FY16/17e/18e)	29.3/28.3/27.5
Net D/E ratio (FY16/17e/18e)	-.4/-.4/-.5
BSE Code	532683
NSE Code	AIAENG
Bloomberg	AIAE IN
Reuters	AIAE.BO

Shareholding pattern	%
Promoters	61.7
MFs / Banks / FIs	5.2
Foreign	28.1
Govt. holding	-
Public & others	5.0
Total	**100.0**

As on June 30, 2016

Recommendation

REDUCE

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Company Brief

AIA Engineering Ltd. manufactures and markets a wide range of high chromium consumable wear parts (mill internals) which are used in the process of crushing/grinding in the cement, mining, thermal power and aggregate industries.

Quarterly Highlights

- With the initiatives now being taken to provide stimulus to the infrastructure industry, India's cement production is expected to increase in the next financial year, albeit not drastically which will fuel the growth of the Indian cement replacement market. While the current focus of the company is overseas mining segment, it also has a major share of the domestic mining demand and shall be able to capture incremental demand as and when the same arises. AIA is perhaps the only company in the world offering complete range of high- chrome consumables to the mining industry, which include grinding media and mining liners.
- The sales volumes in Q4 grew by 5.7% to 53500 mt, the highest reading in the last eight quarters; yet the revenues fell by 210 bps y-o-y. The failure to complement the volume growth with a similar growth in average realization (-6.4% y-o-y), hampered the overall revenue growth in the last quarter.
- FY 2016 sales volumes remained grim primarily attributable to certain strategic and conscious decisions viz. restricting sales to Ukraine; lower volumes in South American market owing to currency uncertainties; and volume reduction owing to closure of one particular iron ore mine in Brazil.
- Encouraged by the overall economic outlook, AIA is expending close to Rs 530 crs ($78.7 m) in ramping up its production facility. This is done keeping in mind the company's incremental sales target of 120000 MT over the next 3 years.
- The stock presently trades at 23.8x FY17e EPS of Rs. 43.54 and 20.9x FY18e EPS of Rs. 49.58. Though the current valuation is not way off from the average reading of last few years, the business is fraught with immense risks. AIA displayed the lowest volume growth (in fact it de-grew) in at least five years. Though operating margins expanded by a massive 230 bps last fiscal, lower chance exists that it would sustain. Notwithstanding its large stock of liquid assets sitting in the books, odds barely favor the conservative. Therefore we maintain our 'reduce' rating on the stock with a revised target of Rs. 917 (previous target: Rs. 770) based on 18.5x FY18e earnings.

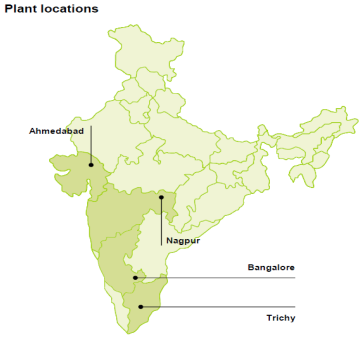
Figures (Rs crs)	FY14	FY15	FY16	FY17e	FY18e
Income from operations	2080.08	2183.64	2098.39	2266.95	2614.07
Other Income	33.41	83.22	59.13	45.84	55.07
EBIDTA (other income included)	507.78	671.65	673.91	686.26	773.94
PAT (after MI and EO)	340.62	426.47	409.24	410.71	467.65
EPS (Rs.)	36.11	45.21	43.39	43.54	49.58
EPS growth (%)	63.3	25.2	-4.0	0.4	13.9

Outlook & Recommendation

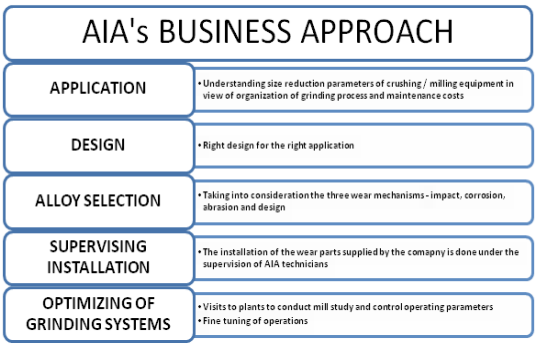
Growth strategy

Mill internals are consumables in grinding mills. Properties like abrasion, corrosion and impact resistance are critical to grinding procedure productivity. New projects and replacement of wear parts are the main drivers of demand. The industry as a whole is moving from cost of parts to total cost of ownership, driving innovation in product development and total solutions. This has led the industry participants to shift their focus from forged grinding media to high chrome cast media. Total solutions include design of parts, metallurgy to meet the specific requirement of material being ground – varies from plant to plant. Mill internals are a small component of the grinding cost but essential for continuous production. Non-availability or product failure can lead to the grinding operations coming to a halt.

Source: AIA, CD Equisearch



Source: AIA



Source: AIA, CD Equisearch

Low penetration of high chrome consumable wear parts in mining and the total mining replacement market estimated at 3 million TPA – Rs 125 bn ($1.86 bn) (2.4 mn TPA last fiscal) with a growth rate of mere 4-5% leads to the opportunity scenario remaining mildly upward over medium to long term horizon. Majority of future growth is anticipated to come from outside India and that too primarily in mining segment.

With nearly 390 million tonnes of cement production capacity, India is the second largest cement producer in the world and accounts for 6.7% of world's cement output. The cement production capacity is estimated to touch 550 million tonnes by FY 20 (Source: IBEF). The supplies of high chrome mill internals to Indian thermal power plants, although flat as of now, are expected to pick up from this fiscal, but the growth rate will be conjoined to the growth rate achieved by thermal power segment in India.

From an imperative positioning viewpoint, a significant contribution in the company's growth is expected to come from the mining industry. AIA Engineering's growth strategy focus on the development of wear parts for crushing and grinding procedure which will improve the process. Cashing in the potential opportunities in wear space in the mining industry as and when they occur is also a priority for the company. This is advocated by the colossal capital expenditure the company is incurring on capacity expansion. Even though AIA has limited presence in China, the company places strategic focus on China together with other emerging markets. Apart from significant cost reduction due to much lower wear rates, high chrome solutions also bring about benefits like superior process efficiencies, diminution in other consumables (other than high chrome consumables), enhanced environmental benefits, etc. which are other key growth drivers. The company endeavors to strengthen total solution capabilities with increased R&D and by establishing strategic partnerships.

Capex Plans

The company's effective capacity reached 260000 MT in FY15 after the successful commissioning of the Moraiya brownfield expansion. The company has planned on adding 180000 MT (greenfield) to make it 440000 MT by commissioning GIDC Kerala greenfield project and augmentation of capacity in Trichy facility. This capex plan which is based in Trichy and GIDC Kerala is to take place in two phases- phase I (commissioned in Q3 FY16) which comprises of around 45% of the total incremental capacity has resulted in a capex of Rs 178 crs ($26.4 m). Phase II necessitate a capex of around Rs. 350 crs ($52 m) out of which Rs. 150 crs ($22.3 m) will be shelled out in FY 17 and the remaining Rs. 200 crs ($29.7 m) in FY18.

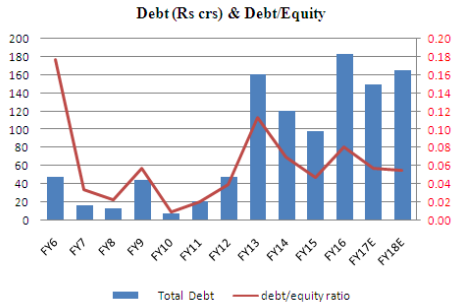
AIA currently has attained the capacity to manufacture 340000 MT of high chromium wear parts on the conclusion of phase I of GIDC Kerala expansion plan. The capacity will completely augment to 440000 MT by March, 2018.

Debt management exercise

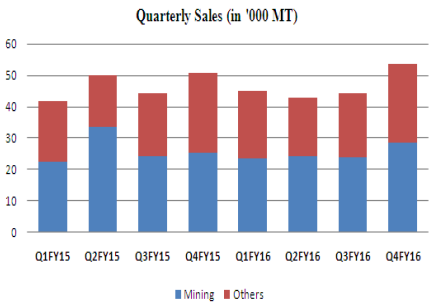
Even though the long term borrowings of the company has decreased from Rs. 55 crs ($8.2 m) in FY15 to almost Rs. 25 crs ($3.8 m) in FY16, the total debt of the company has increased by 86.3%. This surge is primarily led by short term borrowings which jumped from Rs. 9 crs ($1.3 m) in FY15 to almost Rs. 125 crs ($18.6 m) in FY16. The company is following a treasury management exercise wherein it is borrowing, even when there are investments worth Rs. 637 crs ($94.5 m) and a cash balance of Rs 187 crs ($27.7 m) in FY15. In fact the company has made additions to investments in FY16 to a tune of Rs. 254 crs ($37.7 m) culminating to Rs. 891 crs ($132.2 m) in FY16. It is borrowing at about 3% LIBOR plus three quarter of a percent, which is completely hedged. This treasury transaction is enabling them to realize more and resulting in a surplus. The upward trend in short term borrowings is projected to continue while the long term debt will cease to exist in the books post Q3 FY17. Despite this, the debt-equity (gross) would decline in coming years.

Financials and Valuations

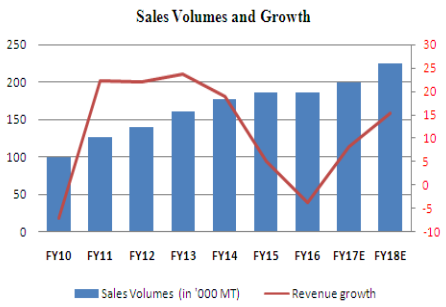
Even though the sales volumes decreased very slightly for AIA in FY16 (-0.5%), the revenues shrunk by almost 4% - stymied by a fall in realization. This is by virtue of the unrest presently characterizing the mining industry and a considerable drop in the commodity prices. The commodity prices have fallen to 2008-2009 levels and the customers have started contemplating closures. AIA is treading forward cautiously and has already reduced presence in countries likes Ukraine, South Africa etc, whose currencies are weakening. The company is witnessing some pressure on pricing on account of these waning currencies. Yet some resurrection was seen last quarter when volumes jumped.



Source: AIA, CD Equisearch

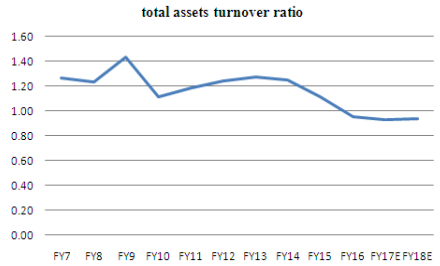


Source: AIA, CD Equisearch

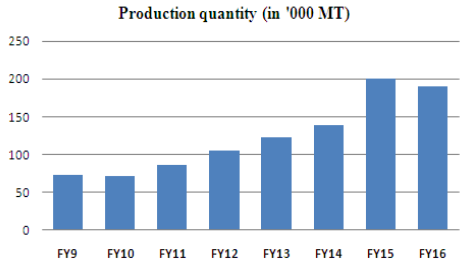


Source: AIA, CD Equisearch

The shrinkage in inventory from Rs 443 crs ($ 65.8 m) in Q2FY16 to Rs 390 crs ($57.9m) in Q4FY16 is mainly on account of sharp jump in volumes in the last quarter. It clocked sales of 53500 MT (29% of annual volumes vs 27% last year) in the last quarter alone. Despite this, cash conversion cycle jumped to 149 days-the highest in a decade. The hike of 16 days (133 days in FY15) can be explained by the sharp increase in debtors- Rs 430 crs ($63.8 m) in FY16 compared to Rs. 394 crs ($58.5 m) in FY15- and a fall in creditors- Rs 98 crs ($14.6 m) in FY16 compared to Rs 119 crs ($17.7 m) in FY15.



Source: AIA, CD Equisearch



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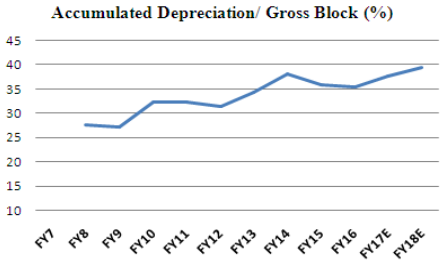
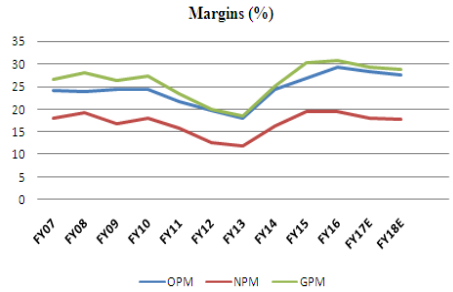
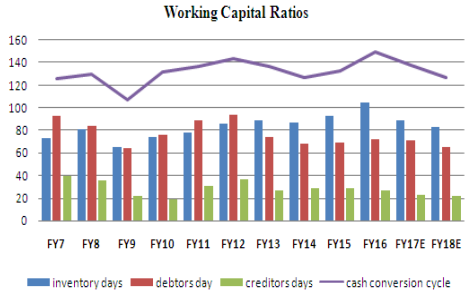


Source: AIA, CD Equisearch

The decrease in some dominant costs also helped the company in maintaining its margins at a tolerable level. The decline in cost of raw materials, power costs (directly proportional to production which fell by 5.4%), transportation costs due to the cost of shipping coming down- patronized the total expenditure to decline by 7% in FY16. The aftermath of these declines proceeded to result in a savings of a commendable Rs. 112 crs ($16.6 m) approx.- the total expenditure, barring interest and depreciation, was almost Rs. 1600 crs ($236.8 m) in FY15 and trimmed down to Rs. 1484 crs ($220.2 m) in FY16. The EBITDA de-grew by 1.9% in FY16- the lowest in the last 6 years.



Source: AIA, CD Equisearch



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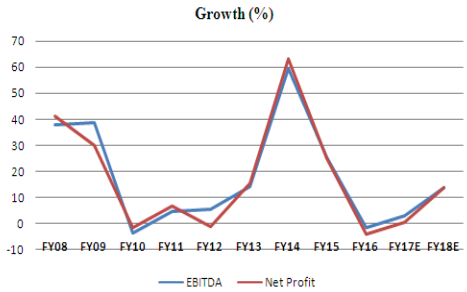
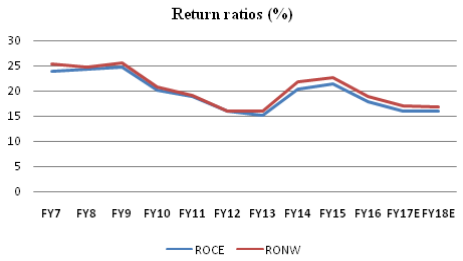


Source: AIA, CD Equisearch

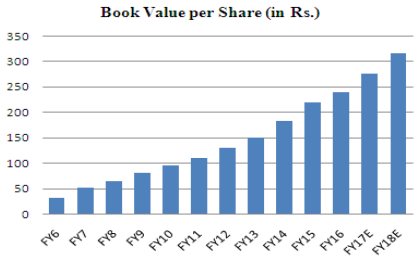
A commemorative dividend paid in FY16 (additional Rs 10 per share together with Rs. 8 per share) escalated the dividend payout ratio to 47%, the highest in a decade; however, the payout ratio is expected to return to normal levels going forward The payout is expected to orbit in the range of 20-25%.

Stymied by strenuous foreign conditions, like shutdown of one of the mines in Brazil, slide in commodity prices or weakening of currencies, AIA's return ratios were agonized somewhat- ROE declined to 18.9% in FY16 from 22.6% in FY15. This declivity is expected to recover as the expansions take place and the company is able to avail of the various opportunities the industry has to offer in the near future.

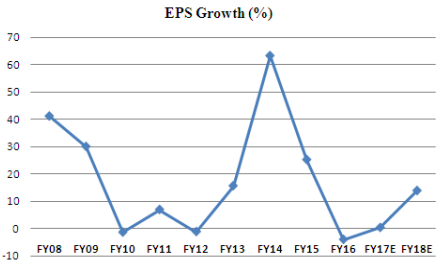
The order book of the company as on FY16 stood at Rs. 534 crs ($79.3 m). Going forward, the company has set an incremental sales target of 120000 MT over the next 3 years i.e. till FY 2019. Sales are likely to pick up pace considering the clout of domestic and foreign customers (eg: Anglo, Rio Tinto, Vale, Arcelor Mittal etc) Reasons underlying the fall in costs will help the company in realizing the additional 120000 MT of sales.



Source: AIA, CD Equisearch



Source: AIA, CD Equisearch



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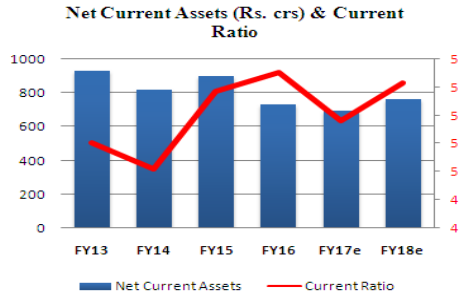
The stock presently trades at 23.8x FY17e EPS of Rs. 43.54 and 20.9x FY18e EPS of Rs. 49.58. Though the current valuation is not way off from the average reading of last few years, the business is fraught with immense risks. AIA displayed the lowest volume growth (in fact it de-grew) in at least five years. Though operating margins expanded by a massive 230 bps last fiscal, lower chance exists that it would sustain. Notwithstanding its large stock of liquid assets sitting in the books, odds barely favor the conservative. Therefore we maintain our previous rating of 'reduce' with a revised target of Rs. 917 (previous target: Rs. 770) based on 18.5x FY18e earnings. (For more details refer to our previous report dated 30th November, 2015)



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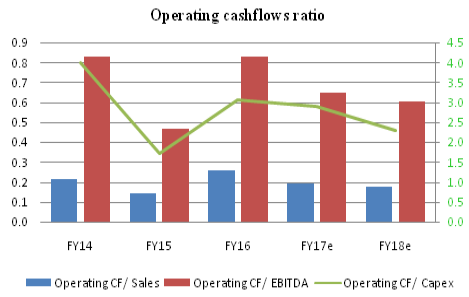

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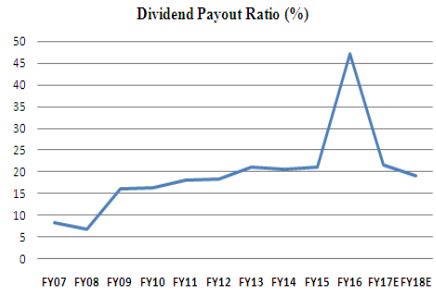

Source: AIA, CD Equisearch

Risks & Concerns

Given its large exports, the company is exposed to foreign exchange rate fluctuation risk. The company closely monitors the currency movements and has a prudent hedging policy to mitigate this risk.

Another major concern is with regard to fluctuation in the raw material prices. However, the company has converted major portion of its contracts from fixed price to fluctuating price regime. Again, the company is closely monitoring raw material price movements and is regularly buying the raw materials during low price cycles so as to iron out the impact of price fluctuations.

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*All $ values expressed in the write-up are translated at current exchange rates.

Financials

Quarterly results- consolidated

Figures in crores

	Q4FY16	Q4FY15	% chg.	FY16	FY15	% chg.
Income From Operations	**591.96**	**604.81**	**-2.1**	**2098.39**	**2183.64**	**-3.9**
Other Income	21.44	17.02	26.0	59.13	83.22	-28.9
Total Income	**613.41**	**621.83**	**-1.4**	**2157.53**	**2266.85**	**-4.8**
Total Expenditure	420.64	447.32	-6.0	1483.62	1595.20	-7.0
EBITDA (other income included)	**192.77**	**174.50**	**10.5**	**673.91**	**671.65**	**0.3**
Interest	2.03	1.65	22.6	8.29	7.56	9.7
Depreciation	18.09	18.04	0.3	66.99	69.75	-4.0
PBT	**172.66**	**154.81**	**11.5**	**598.63**	**594.34**	**0.7**
Tax	38.33	42.53	-9.9	174.50	163.41	6.8
PAT	**134.33**	**112.28**	**19.6**	**424.13**	**430.93**	**-1.6**
Minority Interest	-0.24	-0.40	-40.5	-0.09	-0.01	1374.6
PAT after MI	**134.56**	**112.69**	**19.4**	**424.22**	**430.94**	**-1.6**
EO	0.00	0.00	0.0	14.95	4.47	234.3
Adjusted Net Profit	134.56	112.69	19.4	409.28	426.47	-4.0
EPS(Rs)	**14.27**	**11.95**	**19.4**	**43.39**	**45.21**	**-4.0**

Income Statement- consolidated

Figure in crores

	FY14	FY15	FY16	FY17e	FY18e
Income From Operations	**2080.08**	**2183.64**	**2098.39**	**2266.95**	**2614.07**
Growth (%)	18.8	5.0	-3.9	8.0	15.3
Other Income	33.41	83.22	59.13	45.84	55.07
Total Income	**2113.49**	**2266.85**	**2157.53**	**2312.79**	**2669.15**
Total Expenditure	1605.71	1595.20	1483.62	1626.54	1895.20
EBITDA (other income included)	**507.78**	**671.65**	**673.91**	**686.26**	**773.94**
Interest	9.69	7.56	8.29	10.85	10.24
Depreciation	38.14	69.75	66.99	82.08	95.19
PBT	**459.95**	**594.34**	**598.63**	**593.33**	**668.51**
Tax	134.22	163.41	174.50	172.06	193.87
PAT	**325.73**	**430.93**	**424.13**	**421.26**	**474.65**
Minority Interest	0.75	-0.01	-0.09	-0.10	-0.10
PAT after MI	**324.98**	**430.94**	**424.22**	**421.36**	**474.75**
EO	-15.64	4.47	14.95	10.65	7.10
Adjusted Net Profit	**340.62**	**426.47**	**409.28**	**410.71**	**467.65**
EPS (Rs)	36.11	45.21	43.39	43.54	49.58

Consolidated Balance Sheet

Figure in crores

	FY14	FY15	FY16	FY17e	FY18e
Sources of Funds					
Share Capital	18.86	18.86	18.86	18.86	18.86
Reserves	1719.98	2064.74	2263.48	2594.02	2977.95
Total Shareholders' Funds	**1738.84**	**2083.61**	**2282.34**	**2612.89**	**2996.81**
Minority Interest	7.81	7.73	7.64	7.54	7.44
Long Term Debt	86.72	55.07	25.29	0.00	0.00
Total Liabilities	**1833.37**	**2146.41**	**2315.27**	**2620.43**	**3004.25**
Application of Funds					
Gross Block	614.64	847.53	1027.48	1185.28	1375.28
Less: Accumulated Depreciation	225.99	296.09	356.83	438.91	534.10
Net Block	**388.65**	**551.44**	**670.66**	**746.38**	**841.18**
Capital Work in Progress	99.76	46.48	37.80	30.00	40.00
Investments	529.10	636.96	890.92	1176.02	1393.58
Current Assets, Loans & Advances					
Inventory	350.77	459.64	389.29	406.63	454.85
Trade receivables	431.48	393.75	430.45	453.39	483.60
Cash and Bank	219.76	186.79	124.07	134.39	153.23
Short term loans (inc. other current assets)	191.20	229.20	163.82	172.96	180.01
Total CA	**1193.22**	**1269.38**	**1107.64**	**1167.37**	**1271.69**
Current Liabilities	252.26	230.00	326.13	326.72	359.19
Provisions-Short term	120.85	138.76	50.90	146.05	150.82
Total Current Liabilities	**373.11**	**368.76**	**377.02**	**472.77**	**510.01**
Net Current Assets	**820.11**	**900.62**	**730.61**	**694.60**	**761.68**
Net Deferred Tax Liability	-19.96	-24.65	-32.91	-40.42	-47.92
Net long term assets (net of liabilities)	15.70	35.56	18.19	13.84	15.72
Total Assets	**1833.37**	**2146.41**	**2315.27**	**2620.43**	**3004.25**

Cash Flow Statement

Figure in crores

	FY14	FY15	FY16	FY17e	FY18e
Net Income **(a)**	325.73	430.93	424.13	421.26	474.65
Non cash exp. & others (b)	**69.61**	**47.95**	**17.52**	**46.05**	**49.93**
Depreciation	38.14	69.75	66.99	82.08	95.19
Loss/ (profit) on sale of Fixed Assets	-0.25	-0.09	-0.07	0.00	0.00
Loss on sale of invest. and other income	-29.23	-32.86	-30.08	-43.54	-52.77
Deferred tax	6.75	4.69	8.27	7.50	7.50
Others	54.19	6.47	-27.59	0.00	0.00
(Increase) / decrease in NWC (c)	**45.12**	**-167.09**	**100.59**	**-31.66**	**-65.11**
Trade Receivables	-91.41	37.73	-36.69	-22.94	-30.21
Inventories	52.21	-108.86	70.34	-17.34	-48.22
Trade payables	54.66	-31.92	-18.80	9.08	17.47
Other assets	5.36	-60.06	83.01	-4.79	-8.92
Other liabilities	24.31	-3.97	2.73	4.33	4.77
Operating cash flow (a+b+c)	**440.46**	**311.79**	**542.24**	**435.65**	**459.46**
Change in Fixed Assets	-109.28	-181.23	-177.45	-150.00	-200.00
Change in investments	-326.22	-101.79	-232.94	-270.09	-207.56
Other income	20.45	26.79	9.05	28.54	42.77
Investing cash flow (d)	**-415.05**	**-256.23**	**-401.34**	**-391.56**	**-364.79**
Equity dividend paid	-44.48	-66.54	-288.76	0.00	-90.82
Borrowings	-40.30	-21.99	85.15	-33.78	15.00
Financing cash flow (e)	**-84.78**	**-88.53**	**-203.61**	**-33.78**	**-75.82**
Net change (a+b+c+d+e)	**-59.38**	**-32.97**	**-62.72**	**10.31**	**18.85**

Key Financial Ratios

	FY14	FY15	FY16	FY17e	FY18e
Growth Ratios (%)					
Revenue	18.8	5.0	-3.9	8.0	15.3
EBITDA	59.7	25.6	-1.9	2.8	13.8
Net Profit	63.3	25.2	-4.0	0.4	13.9
EPS	63.3	25.2	-4.0	0.4	13.9
Margins (%)					
Operating Profit Margin	24.3	27.0	29.3	28.3	27.5
Gross Profit Margin	25.0	30.1	30.7	29.1	28.8
Net Profit Margin	16.4	19.5	19.5	18.1	17.9
Return (%)					
ROCE	20.4	21.5	18.0	16.1	16.1
RONW	21.8	22.6	18.9	16.9	16.8
Valuations					
Market Cap/ Sales	2.5	5.4	4.2	4.3	3.7
EV/EBITDA	8.7	16.6	12.3	13.3	11.7
P/E	15.4	27.6	21.6	23.8	20.9
P/BV	3.1	5.7	3.9	3.8	3.3
Other Ratios					
Interest Coverage	50.8	78.8	70.7	54.3	65.3
Debt Equity	0.1	0.0	0.1	0.1	0.1
Net Debt-Equity Ratio	-0.4	-0.3	-0.4	-0.4	-0.5
Current Ratio	4.6	5.2	5.3	5.0	5.2
Turnover Ratios					
Fixed Asset Turnover	5.7	4.9	3.6	3.3	3.4
Total Asset Turnover	1.2	1.1	1.0	0.9	0.9
Inventory Turnover	4.2	3.9	3.5	4.1	4.4
Debtors Turnover	5.4	5.3	5.1	5.1	5.6
Creditor Turnover	12.8	12.7	13.6	15.9	16.6
WC Ratios					
Inventory Days	87.4	92.7	104.5	89.3	83.0
Debtor Days	67.7	69.0	71.7	71.2	65.4
Creditor Days	28.5	28.8	26.8	23.0	22.0
Cash Conversion Cycle	126.6	132.9	149.4	137.5	126.3
Cashflow ratios					
Operating CF/ Sales	0.2	0.1	0.3	0.2	0.2
Operating CF/ EBITDA	0.8	0.5	0.8	0.6	0.6
Operating CF/ Capex	4.0	1.7	3.0	2.9	2.3

Cumulative Financial Data

Figures in crores

	FY07-09	FY10-12	FY13-15	FY16-18
Income from operations	2238	3527	6015	6979
Operating profit	541	760	1408	1975
EBIT	571	751	1385	1844
PBT	559	735	1358	1814
PAT after MI	401	534	976	1288
Dividends	45	94	202	382
OPM (%)	24.2	21.5	23.4	28.3
NPM (%)	18.0	15.2	16.2	18.4
Interest coverage	48.0	47.5	51.5	62.8
ROE (%)	26.1	18.0	19.8	17.0
ROCE (%)	24.3	17.5	19.3	16.4
Fixed asset turnover	5.7	4.2	4.6	3.5
Debtors turnover	4.8	4.2	5.2	5.3
Inventory turnover	5.7	4.2	4.0	3.6
Creditors turnover	14.7	12.2	14.1	13.8
Debtor days	75.3	86.4	69.7	68.8
Inventory days	64.2	87.1	90.4	100.0
Creditors days	24.9	29.8	25.9	26.4
Cash conversion	114.6	143.7	134.2	142.4
Dividend payout ratio (%)	11.0	17.5	20.9	28.9

FY07-09 implies three years ending fiscal 09

Muted volume growth resulting from marked slowdown in global mining activities explains the tepid growth in revenues in FY16-18 – revenues were Rs. 6979 crs ($ 1036 m) vs Rs. 6015 crs ($893 m). Absolute additions would stand at less than Rs. 1000 crs ($143.2 m) in FY16-18 as compared to nearly Rs 2500 crs ($369.3 m) in FY12-15. Yet operating profits rose remarkably all thanks to higher operating margins – 28.3% vs 23.4%.

Both the operating and the net profit margins saw a dip in the FY10-12 period. This can be accredited weak margins in FY11 and FY12. Weak margins also spilled over to the return ratios- ROE plunged to 18% in FY10-12 from 26.1% in FY07-09. Weak commodity prices would rub off on asset turnover ratio. Fixed asset turnover is projected to decline to 3.5 in FY16-18- lowest in analyzed history. After declining in FY13-15 cash conversion would leap frog to 142.4 days in ensuing years.

Financial Summary – US dollar denominated

million $	FY14	FY15	FY16	FY17e	FY18e
Equity capital	3.1	3.0	2.8	2.8	2.8
Shareholders' funds	285.6	329.3	340.7	384.5	441.5
Total debt	20.1	15.8	27.7	22.3	24.5
Net fixed assets (incl. CWIP)	77.5	91.9	103.4	111.9	127.5
Investments	88.0	101.8	134.3	174.6	206.9
Net current assets	136.5	143.9	110.1	103.1	113.1
Total assets	301.3	339.3	345.6	385.6	442.6
Revenues	343.8	357.1	320.6	336.5	388.0
EBITDA	87.6	108.8	99.7	99.6	113.4
EBDT	86.0	107.6	98.5	98.0	111.9
PBT	79.7	96.2	88.2	85.8	97.7
PAT	56.3	69.7	62.5	61.0	69.4
EPS($)	0.60	0.74	0.66	0.65	0.74
Book value ($)	3.03	3.49	3.61	4.08	4.68
Operating cash flow	73.3	49.8	81.7	64.7	68.2
Investing cash flow	-69.1	-40.9	-60.5	-58.1	-54.1
Financing cash flow	-14.1	-14.1	-30.7	-5.0	-11.3

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rates

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