

# Avalon Technologies

Estimate change	↓
TP change	↓
Rating change	↔

**CMP: INR487**

**TP: INR680 (+40%)**

**Buy**

## US business continues to drag earnings

Bloomberg	AVALON IN
Equity Shares (m)	65
M.Cap.(INRb)/(USD\$)	31.9 / 0.4
52-Week Range (INR)	732 / 347
1, 6, 12 Rel. Per (%)	-11/30/-
12M Avg Val (INR M)	289

### Financials & Valuations (INR b)

Y/E Mar	FY24E	FY25E	FY26E
Sales	10.7	13.6	17.0
EBITDA	1.2	1.7	2.2
Adj. PAT	0.7	1.1	1.5
EBITDA Margin (%)	11.1	12.5	12.9
Cons. Adj. EPS (INR)	10.6	16.9	22.9
EPS Gr. (%)	17.3	58.8	35.6
BV/Sh. (INR)	93.1	110.0	132.8

### Ratios

Net D:E	(0.2)	(0.2)	(0.2)
RoE (%)	12.1	16.6	18.8
RoCE (%)	10.5	15.8	18.5

### Valuations

P/E (x)	45.8	28.9	21.3
EV/EBITDA (x)	25.9	17.9	13.6

### Shareholding pattern (%)

As on	Sep-23	Jun-23
Promoter	51.1	51.2
DII	16.3	16.6
FII	9.2	12.5
Others	23.4	19.7

Note: FII includes depository receipts

- Avalon's revenue declined 18% YoY in 2QFY24 (up 1% YoY in 1HFY24.) Total revenue was dragged down by a 14% YoY decline in US business revenue in 1HFY24 (53% revenue share in 1H). The India business registered healthy growth of 16% in 1HFY24.
- However, the order book increased to ~INR12.4b as of Sep'23 vs. ~INR11b in Jun'23, aided by strong inflows in the clean energy and industrials (~60% order book mix) segments. As a result, 2HFY24 is expected to be strong.
- Considering the 2Q performance and a slowdown in the US business resulting in adverse operating leverage, we reduce our EPS estimates for FY24/FY25/FY26 by 9%/8%/6%. We retain our BUY rating on the stock with a TP of INR680 (30x FY26E EPS).

### Lower margins due to adverse operating leverage

- 2Q consolidated revenue declined 18% YoY/15% QoQ to INR2b and EBITDA declined 56% YoY/22% QoQ to INR126m, due to a decline in the US business. EBITDA margins contracted 540bp YoY (-60bp QoQ) to 6.3% on the back of adverse operating leverage. Gross margins expanded 170bp YoY/440bp QoQ to 37.2%. Adjusted PAT declined by 51% YoY (up 3% QoQ) to INR73m.
- For 1HFY24, revenue/EBITDA/Adj. PAT declined 1%/40%/40% YoY to INR4.4b/INR288m/INR143m. The India market's revenue increased by 16% YoY in 1H, but challenging conditions in the US market led to a 14% YoY decline in US business revenue. As a result, overall revenue declined 1% YoY.
- Net working capital days increased to 151 from 144 in Mar'23, owing to higher inventory days (up by 6 days) and lower payable days (down 25 days).

### Highlights from the management commentary

- Guidance:** The company has maintained its long-term revenue growth guidance of 25-30%; however, it targets the lower end of the FY24 revenue growth guidance band at 15-20%. Avalon expects to achieve FY24 margins similar to FY23 margins.
- US Strategy:** The company targets to reduce the impact of the US business slowdown by rationalizing costs in the US operations; and moving existing US customer orders to India for manufacturing.
- Order inflow:** Avalon has secured one large order from an innovative Indian EV manufacturer for its charging and data transmission systems. The company was also successfully qualified for the transfer of technology by the Centre for Development of Advanced Computing (CDAC) for High Performance Computing Solution (HPC) servers as part of Rudra, India's indigenous server program.

**Valuation and view**

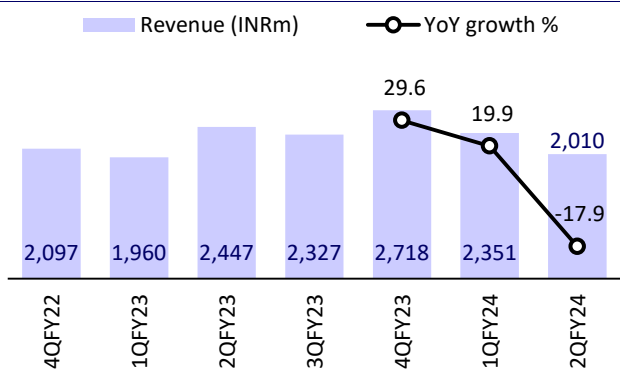
- We believe there are two key growth drivers for Avalon: 1) an increase in the mix of box build through new orders or increasing the wallet share from existing customers; and 2) order flows from high-growth/high-margin industries such as Clean Energy and Aerospace. However, the ongoing slowdown in the US business will have a short-term impact on Avalon's revenue and profitability.
- We estimate Avalon to deliver a CAGR of 22%/25%/42% in revenue/EBITDA/Adj. PAT over FY23-26 on the back of strong order inflows.
- Considering the 2QFY24 performance and a slowdown in the US business resulting in adverse operating leverage, we reduce our earnings estimates for FY24/FY25/FY26 by 9%/8%/6%. We retain our BUY rating on the stock with a TP of INR680 (30x FY26E EPS).

**Consolidated - Quarterly Earning Model**

Y/E March	FY23				FY24				(INRm)	
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE	FY23	FY24E
<b>Gross Sales</b>	<b>1,960</b>	<b>2,447</b>	<b>2,327</b>	<b>2,718</b>	<b>2,351</b>	<b>2,010</b>	<b>2,909</b>	<b>3,452</b>	<b>9,447</b>	<b>10,721</b>
YoY Change (%)	NA	NA	NA	NA	19.9	-17.9	25.0	27.0	350.4	13.5
Total Expenditure	1,765	2,161	2,125	2,307	2,189	1,884	2,524	2,938	8,319	9,535
<b>EBITDA</b>	<b>195</b>	<b>286</b>	<b>202</b>	<b>411</b>	<b>162</b>	<b>126</b>	<b>384</b>	<b>514</b>	<b>1,128</b>	<b>1,187</b>
Margins (%)	10.0	11.7	8.7	15.1	6.9	6.3	13.2	14.9	11.9	11.1
Depreciation	46	49	50	52	53	55	62	73	197	243
Interest	71	100	86	95	56	32	37	40	348	165
Other Income	66	64	12	38	51	47	13	54	144	165
<b>PBT</b>	<b>145</b>	<b>201</b>	<b>78</b>	<b>302</b>	<b>105</b>	<b>86</b>	<b>298</b>	<b>455</b>	<b>727</b>	<b>944</b>
Tax	52	53	21	75	34	13	80	123	202	250
Rate (%)	35.8	26.6	26.7	24.7	32.4	15.2	27.0	27.0	27.8	26.5
<b>Reported PAT</b>	<b>93</b>	<b>148</b>	<b>57</b>	<b>227</b>	<b>71</b>	<b>73</b>	<b>218</b>	<b>332</b>	<b>525</b>	<b>694</b>
<b>Adj PAT</b>	<b>93</b>	<b>148</b>	<b>57</b>	<b>227</b>	<b>71</b>	<b>73</b>	<b>218</b>	<b>332</b>	<b>525</b>	<b>694</b>
YoY Change (%)	NA	NA	NA	NA	-23.9	-50.7	280.1	46.4	NA	32.1
Margins (%)	4.7	6.0	2.5	8.4	3.0	3.6	7.5	9.6	5.6	6.5

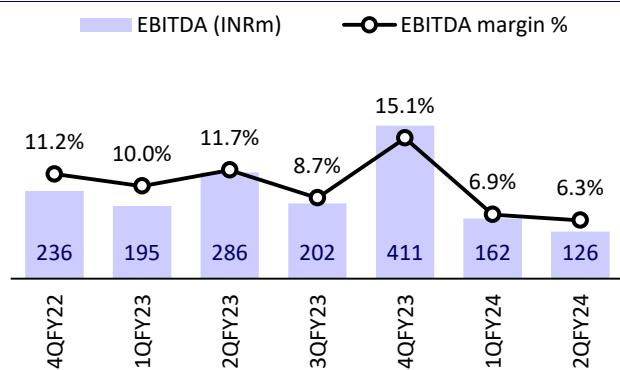
Key exhibits

Exhibit 1: Consolidated revenue trend



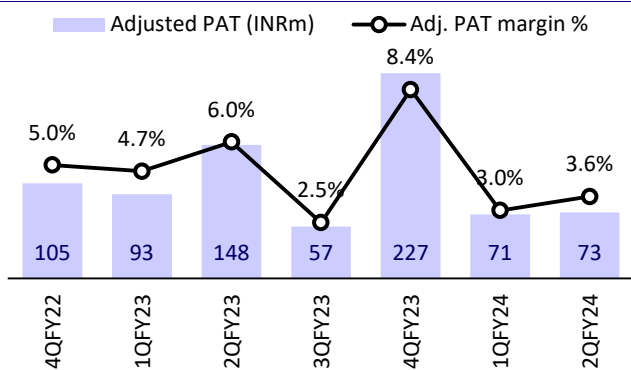
Source: Company, MOFSL

Exhibit 2: Consolidated EBITDA trend



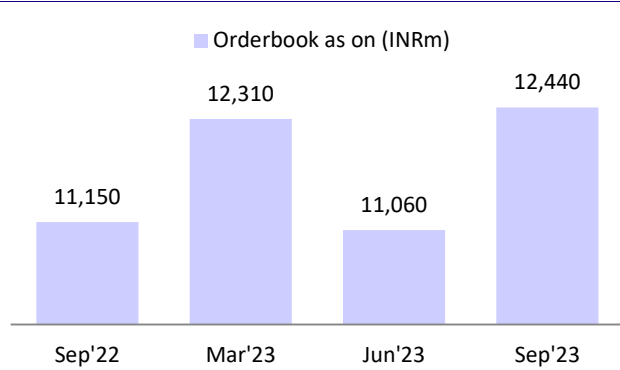
Source: Company, MOFSL

Exhibit 3: Consolidated Adj. PAT trend



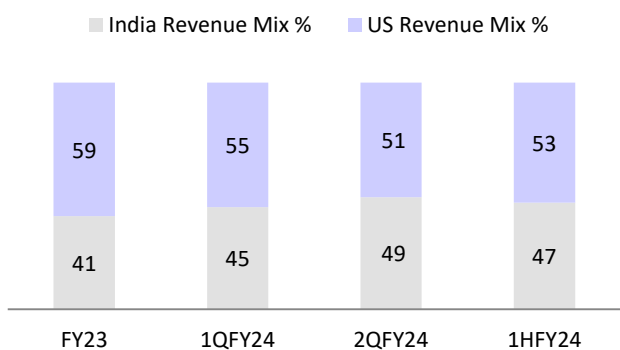
Source: Company, MOFSL

Exhibit 4: Order book trend



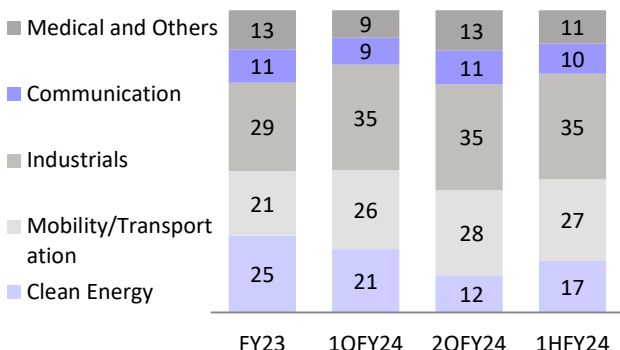
Source: Company, MOFSL

Exhibit 5: Region mix



Source: Company, MOFSL

Exhibit 6: End-user industry mix



Source: Company, MOFSL



## Highlights from the management commentary

### Guidance

- The company has maintained its long-term revenue growth guidance of 25-30%.
- The management is targeting the lower end of the revenue growth guidance band of 15-20% for FY24 and targets to achieve FY24 margins similar to FY23.
- Gross margins are expected to be in range 33-35% in the long run.
- The management targets to reduce net working capital days by 10 to 15 in the medium term by reducing inventory days and increasing payable days. In the long term, it targets to bring down NWC to 120 days.
- Avalon has realized the potential of India's EMS market over the last 6-12 month, so it has now started to focus on the India market. Avalon earlier focused on exports, with almost 75% of its revenue coming from the US. It now targets a balanced revenue mix of 50% each from the US and India.

### US business

- Indian market revenue increased by 16% in 1H, but challenging conditions in the US business led to a 14% decline in US market revenue, resulting in a 1% overall revenue decrease.
- In 1HFY24, the US business registered a loss of INR150m, while the India business posted PAT of INR293m.
- US market revenue constitutes 53% of total revenue in 1HFY24.
- The management has been working on reducing the impact of the US slowdown by: 1) rationalizing cost (both FC and VC) in the US operations; and 2) allocating US order to India plants i.e. move existing US customer orders to India for manufacturing. The company will keep only Clean energy manufacturing in the US (to enjoy BIL benefits). About 50% of its customers have agreed and the company is in discussions with the rest.

### Order book

- In 1HFY24, Avalon's India order book expanded by 26% to INR12.4b (up 11.6% YoY). This order book is executable in the next 12 to 14 months.
- The Clean Energy and Industrials segments contributed to 60% of the closing order book.
- Avalon secured a large contract with one of India's innovative EV manufacturers for its charging and data transmission systems.
  - This will be a part of Avalon's Clean Energy business.
  - The company will start initial production in 4QFY24 and has already secured the order for the next 12 months. These are box build orders.
- Avalon has also won a significant number of customers in the US across sectors such as, industrial video surveillance, grid flexibility in clean energy, automotive heat transfer products & agro technology systems.
- The company successfully qualified for the transfer of technology by CDAC for HPC servers as part of Rudra, India's indigenous server program.
  - Avalon has been a long standing partner for CDAC and has also worked for Rudra 1.
  - For Rudra 2, It is only going to be three vendors for CDAC, which are Avalon, Kaynes and VVDN.
  - This can be a ~INR5b potential business for Avalon.

- Main growth drivers for Avalon in India are Clean Energy and Industrials.
- The company is also into railways and has done substantial work. It hopes to be a strong part in the Indian railways growth story too. Opportunities in Railways are in Breaking, signaling, Kavachh and Vande Bharat.

### Others

- Box build mix for 1HFY24 increased to 51% vs. 47% in FY23.
- Two new plants to be commissioned by Jan'24, supporting larger box builds, specialized metal & plastic processing capabilities.
- The company on-boarded three seasoned professional in this quarter, apart from Mr. Shriram Vijayaraghavan, who joined as new Group Chief Operating Officer.
- Revenue mix- 75% of the production is done in India and 25% in the US
- Gross debt as on Sep'23 was ~INR1b.
- Cash position as on Sep'23 INR1.26b cash (INR530m earmarked for investment)

### Valuation and View

- We expect the company's growth to be driven by two factors: 1) an increase in the mix of box build (through new orders or increasing wallet share from existing customers); and 2) order flows from high-growth/high-margin industries such as Clean Energy and Aerospace. However, the ongoing slowdown in the US business will have a short-term impact on Avalon's revenue and profitability.
- We estimate Avalon to deliver revenue/EBITDA/Adj. PAT CAGR of 22%/25%/42% over FY23-26 on back of strong order inflows.
- Factoring in the 2QFY24 performance, we have reduced our earnings estimates for FY24/FY25/FY26 by 9%/8%/6% on the back slowdown in the US business resulting in adverse operating leverage. We retain our BUY rating on the stock with a TP of INR680 (30x FY26E EPS).

### Exhibit 7: Changes to our estimates

Earnings change (INR m)	Old			New			Change		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	11,387	14,461	17,643	10,721	13,616	17,020	-6%	-6%	-4%
EBITDA	1,401	1,837	2,329	1,187	1,702	2,196	-15%	-7%	-6%
Adj. PAT	766	1,199	1,591	694	1,102	1,494	-9%	-8%	-6%

## Financials and valuations

Consolidated - Income Statement							(INRm)
Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
<b>Total Income from Operations</b>	<b>6,419</b>	<b>6,905</b>	<b>8,407</b>	<b>9,447</b>	<b>10,721</b>	<b>13,616</b>	<b>17,020</b>
Change (%)	NA	7.6	21.8	12.4	13.5	27.0	25.0
RM Cost	4,128	4,574	5,552	6,067	6,899	8,810	10,978
Employees Cost	1,162	1,192	1,314	1,605	1,874	2,219	2,774
Other Expenses	484	478	566	647	761	885	1,072
<b>Total Expenditure</b>	<b>5,774</b>	<b>6,243</b>	<b>7,432</b>	<b>8,319</b>	<b>9,535</b>	<b>11,914</b>	<b>14,825</b>
% of Sales	90.0	90.4	88.4	88.1	88.9	87.5	87.1
<b>EBITDA</b>	<b>645</b>	<b>662</b>	<b>975</b>	<b>1,128</b>	<b>1,187</b>	<b>1,702</b>	<b>2,196</b>
Margin (%)	10.0	9.6	11.6	11.9	11.1	12.5	12.9
Depreciation	155	158	172	197	243	281	328
<b>EBIT</b>	<b>490</b>	<b>504</b>	<b>803</b>	<b>931</b>	<b>944</b>	<b>1,421</b>	<b>1,868</b>
Int. and Finance Charges	450	270	248	348	165	78	29
Other Income	113	54	309	144	165	177	221
<b>PBT bef. EO Exp.</b>	<b>153</b>	<b>288</b>	<b>864</b>	<b>727</b>	<b>944</b>	<b>1,520</b>	<b>2,060</b>
EO Items	0	0	0	0	0	0	0
<b>PBT after EO Exp.</b>	<b>153</b>	<b>288</b>	<b>864</b>	<b>727</b>	<b>944</b>	<b>1,520</b>	<b>2,060</b>
Total Tax	30	58	183	202	250	418	567
Tax Rate (%)	19.4	19.9	21.1	27.8	26.5	27.5	27.5
Minority Interest	8	16	50	0	0	0	0
<b>Reported PAT</b>	<b>115</b>	<b>215</b>	<b>632</b>	<b>525</b>	<b>694</b>	<b>1,102</b>	<b>1,494</b>
<b>Adjusted PAT</b>	<b>115</b>	<b>215</b>	<b>632</b>	<b>525</b>	<b>694</b>	<b>1,102</b>	<b>1,494</b>
Change (%)	NA	86.1	193.9	-16.9	32.1	58.8	35.6
Margin (%)	1.8	3.1	7.5	5.6	6.5	8.1	8.8

Consolidated - Balance Sheet							(INRm)
Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	15	16	16	116	131	131	131
Preference Capital	356	388	388	0	0	0	0
Total Reserves	450	584	856	5,254	5,948	7,050	8,544
<b>Net Worth</b>	<b>822</b>	<b>988</b>	<b>1,260</b>	<b>5,370</b>	<b>6,079</b>	<b>7,180</b>	<b>8,674</b>
Minority Interest	-431	-317	0	0	0	0	0
Total Loans	2,388	2,775	2,789	3,063	963	463	63
Deferred Tax Liabilities	-263	0	0	0	0	0	0
<b>Capital Employed</b>	<b>2,515</b>	<b>3,445</b>	<b>4,049</b>	<b>8,433</b>	<b>7,041</b>	<b>7,643</b>	<b>8,737</b>
Gross Block	1,126	1,335	1,512	1,861	2,159	2,548	2,961
Less: Accum. Deprn.	139	295	390	586	829	1,110	1,437
<b>Net Fixed Assets</b>	<b>987</b>	<b>1,041</b>	<b>1,123</b>	<b>1,275</b>	<b>1,330</b>	<b>1,438</b>	<b>1,524</b>
Goodwill on Consolidation	0	0	0	0	0	0	0
Capital WIP	27	0	20	153	206	266	253
<b>Total Investments</b>	<b>24</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Current Investments	0	0	0	0	0	0	0
<b>Curr. Assets, Loans&amp;Adv.</b>	<b>3,197</b>	<b>4,084</b>	<b>4,738</b>	<b>10,375</b>	<b>7,824</b>	<b>8,757</b>	<b>10,305</b>
Inventory	1,553	1,458	2,330	3,179	2,741	3,138	3,760
Account Receivables	1,138	1,819	1,774	2,062	2,203	2,798	3,497
Cash and Bank Balance	266	335	101	4,219	2,023	1,868	2,027
Loans and Advances	241	472	532	915	858	953	1,021
<b>Curr. Liability &amp; Prov.</b>	<b>1,719</b>	<b>1,680</b>	<b>1,831</b>	<b>3,370</b>	<b>2,318</b>	<b>2,818</b>	<b>3,345</b>
Account Payables	1,369	1,289	1,242	1,418	1,418	1,810	2,256
Other Current Liabilities	216	253	449	1,823	750	817	851
Provisions	134	138	141	130	150	191	238
<b>Net Current Assets</b>	<b>1,478</b>	<b>2,404</b>	<b>2,906</b>	<b>7,005</b>	<b>5,506</b>	<b>5,939</b>	<b>6,960</b>
Misc Expenditure	0	0	0	0	0	0	0
<b>Appl. of Funds</b>	<b>2,516</b>	<b>3,445</b>	<b>4,049</b>	<b>8,433</b>	<b>7,041</b>	<b>7,643</b>	<b>8,737</b>

## Financials and valuations

### Ratios

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
<b>Basic (INR)</b>							
<b>EPS</b>	<b>2.0</b>	<b>3.7</b>	<b>10.9</b>	<b>9.1</b>	<b>10.6</b>	<b>16.9</b>	<b>22.9</b>
Cash EPS	4.7	6.4	13.9	12.5	14.3	21.2	27.9
BV/Share	14.2	17.0	21.7	92.7	93.1	110.0	132.8
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Valuation (x)</b>							
P/E	244.3	131.3	44.7	53.8	45.8	28.9	21.3
Cash P/E	104.3	75.8	35.1	39.1	33.9	23.0	17.5
P/BV	34.4	28.6	22.4	5.3	5.2	4.4	3.7
EV/Sales	4.7	4.4	3.7	2.9	2.9	2.2	1.8
EV/EBITDA	46.4	45.9	31.7	24.0	25.9	17.9	13.6
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	8.4	-2.4	-0.4	-7.0	-1.7	3.8	5.6
<b>Return Ratios (%)</b>							
RoE	14.1	23.8	56.2	15.8	12.1	16.6	18.8
RoCE	15.1	12.8	22.5	12.4	10.5	15.8	18.5
RoIC	21.4	17.7	20.2	17.7	15.6	20.0	22.6
<b>Working Capital Ratios</b>							
Fixed Asset Turnover (x)	5.7	5.6	5.9	5.6	5.3	5.8	6.2
Asset Turnover (x)	1.5	1.3	1.4	0.8	1.1	1.3	1.4
Inventory (Days)	98	120	125	166	145	130	125
Debtor (Days)	65	78	78	74	75	75	75
Creditor (Days)	87	106	83	80	75	75	75
<b>Leverage Ratio (x)</b>							
Current Ratio	1.9	2.4	2.6	3.1	3.4	3.1	3.1
Interest Cover Ratio	1.1	1.9	3.2	2.7	5.7	18.1	64.7
Net Debt/Equity	2.6	2.5	2.1	-0.2	-0.2	-0.2	-0.2

### Consolidated - Cash Flow Statement

(INRm)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
OP/(Loss) before Tax	153	288	856	727	944	1,520	2,060
Depreciation	155	158	180	197	243	281	328
Interest & Finance Charges	434	222	209	244	0	-99	-192
Direct Taxes Paid	-47	-35	-125	-189	-250	-418	-567
(Inc)/Dec in WC	-121	-561	-805	-1,125	-698	-588	-862
<b>CF from Operations</b>	<b>574</b>	<b>72</b>	<b>315</b>	<b>-147</b>	<b>239</b>	<b>697</b>	<b>767</b>
Others	83	-17	-158	13	0	0	0
<b>CF from Operating incl EO</b>	<b>657</b>	<b>55</b>	<b>157</b>	<b>-133</b>	<b>239</b>	<b>697</b>	<b>767</b>
(Inc)/Dec in FA	-170	-192	-177	-273	-350	-450	-400
<b>Free Cash Flow</b>	<b>487</b>	<b>-137</b>	<b>-21</b>	<b>-406</b>	<b>-111</b>	<b>247</b>	<b>367</b>
(Pur)/Sale of Investments	-24	29	0	0	0	0	0
Others	2	-104	-6	2	165	177	221
<b>CF from Investments</b>	<b>-192</b>	<b>-267</b>	<b>-184</b>	<b>-271</b>	<b>-185</b>	<b>-273</b>	<b>-179</b>
Issue of Shares	0	73	0	798	15	0	0
Inc/(Dec) in Debt	-296	461	158	128	-2,100	-500	-400
Interest Paid	-426	-217	-189	-283	-165	-78	-29
Dividend Paid	-4	-37	-38	-37	0	0	0
Others	302	22	-138	3,915	0	0	0
<b>CF from Fin. Activity</b>	<b>-424</b>	<b>301</b>	<b>-207</b>	<b>4,522</b>	<b>-2,251</b>	<b>-578</b>	<b>-429</b>
<b>Inc/Dec of Cash</b>	<b>42</b>	<b>89</b>	<b>-234</b>	<b>4,118</b>	<b>-2,196</b>	<b>-155</b>	<b>159</b>
Opening Balance	204	246	335	101	4,219	2,023	1,868
Other cash & cash equivalent	20	0	0	0	0	0	0
<b>Closing Balance</b>	<b>266</b>	<b>335</b>	<b>101</b>	<b>4,219</b>	<b>2,023</b>	<b>1,868</b>	<b>2,027</b>

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NOTES



Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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