

Short term pain but Long term gain....

Avalon's Q1FY24 performance was weak due to a slowdown in the US. Management has lowered its revenue guidance range and expects to maintain its bottomline margin guidance. The performance for the quarter can be characterized by significant growth in domestic business and a slowdown in US customers, which are expected to come back in H2 FY24 along with new business in the pipelines.

- INR revenue came in at INR 2,351 Mn, +19.9% YoY / -13.5% QoQ.
- EBITDA stood at INR 162 Mn, -17% YoY / -60.6% QoQ.
- EBITDA margins: 6.9%, vs 10% / 15.1% in Q1FY23 / Q4FY23 respectively
- PAT came in at INR 71 Mn, -23.9% YoY / -68.9% QoQ.
- PAT margins: 2.9%, vs 4.6% / 8.2% in Q1FY23 / Q4FY23 respectively
- EPS at INR 1.1 in Q1FY24 vs 1.7/ 3.9 in Q1FY23 / Q4FY23 respectively

Geography-wise

- India contributed 45% of revenue in Q1FY24 vs 41% in FY23.
- US contributed to 55% of revenue in Q1FY24 vs 59% in FY23
- India manufacturing contributed to 73% in Q1FY24 vs 72% in FY23
- US manufacturing contributed to 27% in Q1FY24 vs 28% in FY23

Y/E Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Net sales	6,905	8,407	9,447	11,337	14,454
EBIDTA	661	975	1,128	1,293	1,949
Margins	9.6	11.6	11.9	11.4	13.5
PAT (adj)	215	632	525	812	1,267
Growth (%)	86.7	192.3	-22.2	54.6	56.1
EPS	26.92	79.16	9.06	12.43	19.41
P/E (x)	17	6	52	38	24
P/B (x)	6	4	5	3	3
EV/EBITDA (x)	4	3	26	20	13
RoE (%)	36	55	10	9	12
ROCE (%)	16	24	13	12	16
RoIC (%)	14	19	18	18	23
Gross Fixed Asset Turn	7	8	7	8	8

Source: Dalal and Broacha



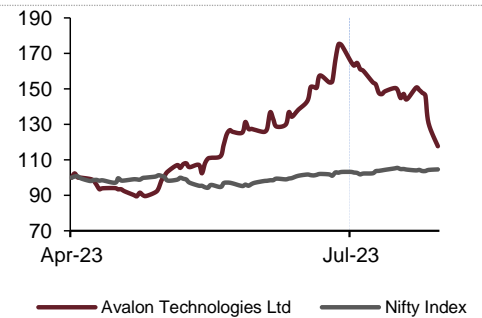
Rating	TP (Rs)	Up/Dn (%)
BUY	679	45

Market data

Current price	Rs	469
Market Cap (Rs.Bn)	(Rs Bn)	31
Market Cap (US\$ Mn)	(US\$ Mn)	369
Face Value	Rs	2
52 Weeks High/Low	Rs	732.1 / 347.3
Average Daily Volume	('000)	1,676
BSE Code		543896
Bloomberg		AVALON.IN

Source: Bloomberg

One Year Performance



Source: Bloomberg

% Shareholding	Jun-23
Promoters	51.00
Public	49.00
Total	100

Source: Bloomberg

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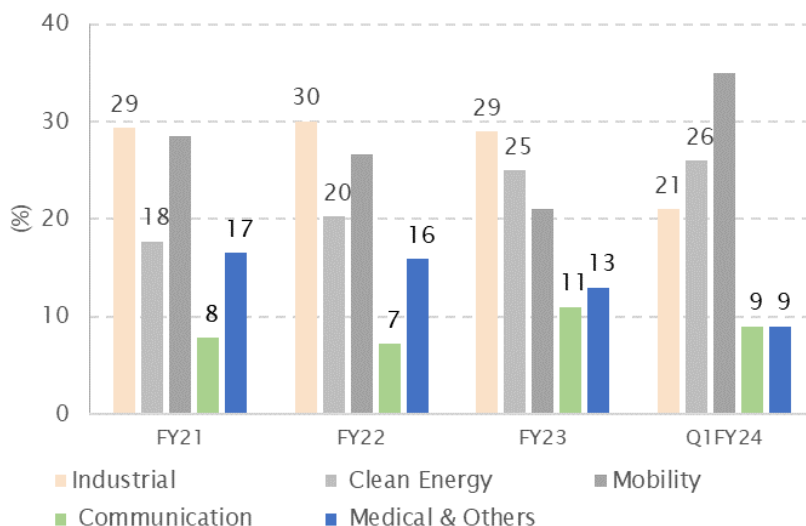
Concall Highlights

- **The order book stood at INR 1106 cr +6.4% YoY/-10.2% QoQ (executable over the next 12 to 14 months) along with an additional INR 600 cr of contracts and LOI which are executable over the next 2 to 4 years.** Additionally, management stated that the rebalancing of inventory from the US customer base is impacting the flow of orders for the short term. While the order book is increasing in the longer term.
- **Gross margins stood at 32.8% (down 343 bps YoY) mainly impacted by the change in the product mix and the geographies as well with one of Avalon's high margin customers in the US having slowed down. Management has guided for a 200 bps improvement in the Gross margins and PAT margins to be in the range of 7-8% for FY24 due to several levers such as Optimizing production allocation and strategic relocation of some of their production activities from the US plant to India plant, rationalizing costs in US operations, kicking in of operating leverages and the ramp up of US customers.**
- The major growth for the Indian market is coming from industrial, along with clean energy pass through to the US and their largest segment Railway side is gaining a lot of traction. India geography is showing robust growth growing by 50% YOY. **The management expects the Indian markets to continue to grow at +35% on full year basis.**
- The US market is facing challenges in the near term due to mainly a couple of reasons, a Slowdown in the US economy and inventory rebalancing steps taken by customers from a 40-50 week lead time to a 20 week lead time which they were doing pre-covid. Despite the slowdown in the US, they have not lost a customer during the slowdown in the US.
- The expansion of 2 new manufacturing plants at MEPZ, Chennai is progressing well, which will be used for the expansion of big Box-builds, specialized metal processes & expansion of plastics capabilities. **The management aspires to get to an 80%-20% mix (currently 73%-27% in Q1FY24) with 80% manufacturing done in India and the rest 20% mainly the final assembly to be done in the US.**
- The management is witnessing initial indications of a decline in working capital demand as the supply chain inflation is normalizing. The upward trajectory of inventory over the last year has reached a stabilization point. **The management expects the working capital cycle to improve by 10 to 15 days in FY24 over FY23.**
- As of 31st July, they have INR 125 cr+ of cash both from the IPO and internal accruals. Out of which INR 40 cr will be used for investment in their US subsidiary (Sienna). **Avalon is keeping existing working capital lines available amounting to INR 175 cr, which should allow them to aggressively bid for and execute significantly large orders which are in the pipeline and be open for any inorganic growth opportunities.**

Vertical-wise updates:

- Clean Energy (21% of topline in Q1FY24)** Added 3 new clean energy customers which are expected to ramp up in Q4FY24. Along with some of their previous clean energy wins which are expected to transition to volumes in two to three quarters and expansion is expected in FY25. **The shipments for one of their clean energy customers (Ohmium) which were delayed previously, the first 100 sets (INR 50-70 lakh per set) should start flowing out in the later part of Q3 and Q4, while Avalon also has an LOI for 600 units over the next 2 years.** One of Avalon’s largest customers in clean energy is in the EV space, which the management is targeting to finalize and start production in the later part of FY24, this should be a higher volume product. **There is significant growth opportunity in this sector which is growing faster than the rest of the sectors and the management expects 35% of their business in the next 3 to 4 years to come from clean energy mostly from the US through their Hybrid Model.**
- Transportation (26% of topline in Q1FY24)** The company has entered a new segment and has received the first tooling orders for plastic components used in the interiors of commercial aircrafts. This is a big win that Avalon has been working on for a couple of years. **The management indicated that the production should take 8-12 months to start but they expect 3-5 Mn dollars to flow in per year but just on one part.** Avalon has also entered the heat shield market (thermal blanket) inside the aircraft engines segment, the work for which is being transitioned from the US to India, with a PO expected in Q4FY24. The company has been previously involved with the manufacturing of smoke detectors in planes. The Railway sector is growing robustly and the management is expecting their immediate business (braking, interlocking) to grow significantly. **Some of Avalon’s customers are getting into the new Kavach systems and also in the metros which can grow 3 or 4 times what Avalon currently does contingent on the government releases.**

Rev Mix Industry wise %



Source: Company, D&B Research

FY24e Outlook

- Management had earlier guided for 25%-30% revenue growth for FY24 as it stands meeting the full year revenue guidance depends on the resurgence of US markets. **The management has revised the guidance on the conservative end, expecting the near term FY24 growth to be in the range of 15-25%.**
- The FY24 bottom-line margins are expected to remain stable in the range of 7-8%.
- Working Capital to improve by 10-15 days in FY24 from FY23.

Quarterly Deviation Sheet

(Rs.Mn)	Q1FY24A	Q1FY23	YoY Growth (%)	Q4FY23	QoQ Growth (%)
Revenue from Operations	2,351	1,960	19.9%	2,718	-13.5%
Other Income	51	66	-22.9%	38	36.0%
COGS	1,579	1,249	26.4%	1,700	-7.1%
Employee Benefits Expense	452	357	26.5%	427	5.9%
Other Expenses	158	158	-0.2%	180	-12.5%
Total Expenses	2,189	1,765	24.0%	2,307	-5.1%
EBITDA (Excluding Other Income)	162	195	-17.0%	411	-60.6%
Depreciation and Amortisation Expenses	53	46	15.7%	52	1.6%
EBIT / PBIT	161	216	-25.7%	397	-59.5%
Finance Costs	56	71	-21.6%	95	-41.1%
EBT/ PBT	105	145	-27.7%	302	-65.3%
Tax Expense	34	52	-34.6%	75	-54.6%
Net Profit after Tax	71	93	-23.9%	227	-68.9%
Adj Earning Per Share	1.1	1.7	-34.9%	3.9	-72.4%
No of Shares Diluted (mn)	65.3	58.0		55.9	
Margins Analysis (%)			bps		bps
Gross Margins	32.8%	36.3%	-343	37.5%	-463
EBITDA Margins (Excl Other Income)	6.9%	10.0%	-307	15.1%	-823
PAT Margins	2.9%	4.6%	-164	8.2%	-530
Effective Tax Rate %	32.4%	35.8%	-339	24.7%	766
Cost Analysis (%)			bps		bps
COGS as a % to sales	67.2%	63.7%	343	62.5%	463
EE Cost as a % to sales	19.2%	18.2%	99	15.7%	353
Other exps as a % to sales	6.7%	8.1%	-136	6.6%	7

Source: Company, D&B Research

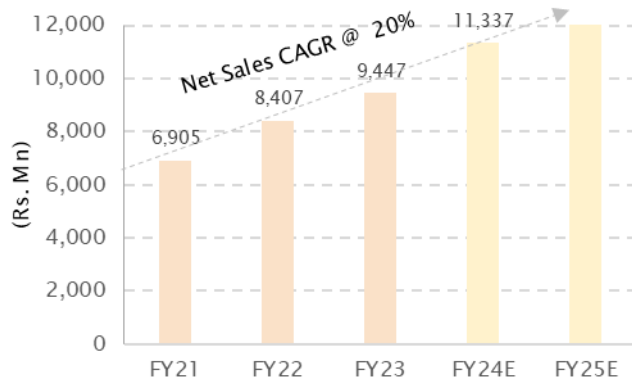
Valuation & Outlook

Avalon is currently trading at 37.8x / 24.2x FY24e / FY25e EPS.

We believe that despite the near term issues faced by Avalon, the long term growth levers for Avalon remain intact with demand coming in from Clean energy, aerospace, railways & Industrial. Management has downgraded its revenue guidance factoring in the near term weakness in the US due to rebalancing of inventory but has maintained their bottom-line margin guidance supported by various levers such as Optimizing production allocation and strategic relocation of some of their production activities from the US plant to India Plant, rationalizing costs in US operations, kicking in of operating leverages and the ramp up of US customers.

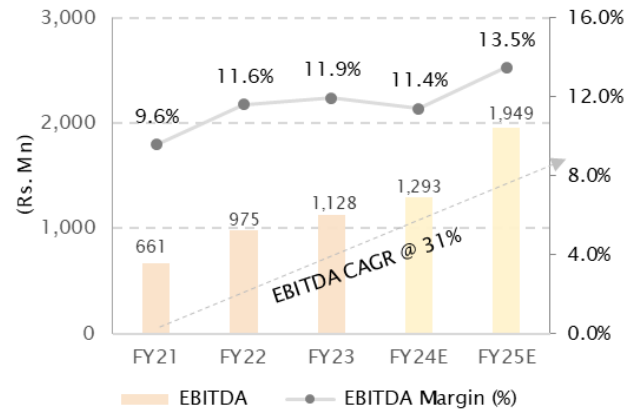
Taking the current results and management commentary into consideration, **we have cut our revenue and PAT numbers for FY24e by (6%/21%) and FY25e by (6%/14%) respectively. We maintain our BUY rating on the stock, assigning a target multiple of 35x FY25e to arrive at a target of INR 679 (45% upside).**

Net Sales Trajectory



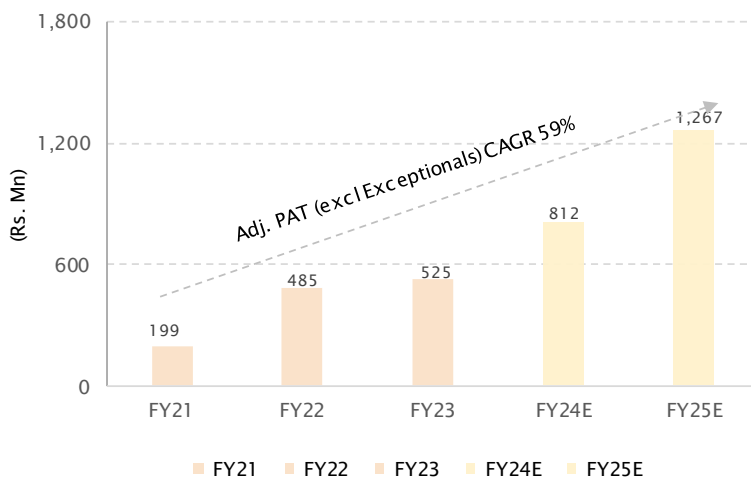
Source: Company, D&B Research

EBITDA & EBITDA Margin Trajectory



Source: Company, D&B Research

Adj. PAT (Exc. Exceptional) Trajectory



Source: Company, D&B Research

Financials

P&L (Rs mn)	FY21	FY22	FY23	FY24E	FY25E	Cashflow (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Net Sales	6,905	8,407	9,447	11,337	14,454	PBT	288	856	727	1,128	1,760
Operating Expenses	-4,560	-5,541	-6,067	-7,369	-9,323	Depreciation	157	180	197	210	234
Employee Cost	-1,192	-1,314	-1,605	-1,927	-2,273	Net Chg in WC	-555	-760	-1,273	-594	-1,040
Other Expenses	-491	-577	-647	-749	-909	Taxes	-35	-125	-189	-316	-493
Operating Profit	661	975	1,128	1,293	1,949	Others	200	6	405	42	144
Depreciation	-157	-180	-197	-210	-234	CFO	55	157	-133	471	606
PBIT	504	795	931	1,082	1,715	Capex	-192	-177	-273	-350	-450
Other income	54	109	144	144	144	Net Investments made	-99	-6	2	-	-
Interest	-270	-248	-348	-98	-98	Others	29	-	-	-	-
PBT	288	656	727	1,128	1,760	CFI	-263	-184	-271	-350	-450
(post exceptional)	288	856	727	1,128	1,760	Change in Share capital	73	-68	4,815	3,200	-
Provision for tax	-57	-182	-202	-316	-493	Change in Debts	440	86	48	-1,973	-
Reported PAT	231	675	525	812	1,267	Others	-201	-189	-280	49	51
MI	-16	-43	-	-	-	CFF	275	-209	4,545	1,276	51
Owners PAT	215	632	525	812	1,267	Total Cash Generated	67	-236	4,141	1,397	206
(excl Exceptionals)	215	485	525	812	1,267	Cash Opening Balance	266	335	101	4,222	5,619
						Cash Closing Balance	333	99	4,243	5,619	5,825

Balance Sheet (Rs mn)	FY21	FY22	FY23	FY24E	FY25E	Ratios	FY21	FY22	FY23	FY24E	FY25E
Equity capital	16	16	116	131	131	OPM	9.6	11.6	11.9	11.4	13.5
Reserves	583	872	5,254	9,250	10,517	NPM	3.1	5.7	5.5	7.1	8.7
Net worth	599	888	5,370	9,381	10,648	Tax rate	-19.9	-21.2	-27.8	-28.0	-28.0
Non Current Liabilites	1,051	1,016	1,072	878	884	Growth Ratios (%)					
Current Liabilites	3,792	3,990	5,361	3,837	4,342	Net Sales	7.6	21.8	12.4	20.0	27.5
TOTAL LIABILITIES	5,125	5,894	11,803	14,096	15,873	Operating Profit	2.6	47.5	15.6	14.6	50.8
Non Current Assets	1,329	1,391	1,667	1,663	1,735	PBIT	2.9	57.8	17.1	16.2	58.4
Fixed Assets	841	918	1,086	1,073	1,136	PAT	86.7	192.3	-22.2	54.6	56.1
Right of Use Assets	200	244	342	342	342	Per Share (Rs.)					
Financial Assets	43	53	53	56	59	Net Earnings (EPS)	26.92	79.16	9.06	12.43	19.41
Deferred Tax Asset	232	159	130	134	138	Cash Earnings (CPS)	46.64	101.70	12.45	15.66	22.99
Other Non Current Assets	12	18	55	58	61	Book Value	75.07	111.19	92.66	143.67	163.08
Current Assets	3,796	4,503	10,137	12,433	14,138	Free Cash Flow	-25.25	-7.90	-13.59	0.70	-0.33
Inventories	1,458	2,330	3,179	3,654	4,547	Valuation Ratios					
Trade Receivables	1,819	1,774	2,062	2,485	3,089	P/E(x)	17	6	52	37.8	24.2
Cash and Bank						P/B(x)	6	4	5	3	3
Balances	335	101	4,222	5,619	5,825	EV/EBIDTA(x)	4	3	26	20	13
Other Financial Assets	14	13	38	40	42	FCF Yield(%)	-5.37	-1.68	-2.89	0.15	-0.07
Other Current Assets	170	284	635	635	635	Return Ratios (%)					
TOTAL ASSETS	5,125	5,894	11,803	14,096	15,873	ROE	36%	55%	10%	9%	12%
						ROCE	16%	24%	13%	12%	16%
						RoIC	14%	19%	18%	18%	23%

Source: Company, Dalal & Broacha Research

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