

US Challenges & Domestic Opportunities....

Avalon's Q2FY24 performance was weak due to a macro issues in the US. Management has guided to be at the lower end of their guidance but 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 2,010 Mn, -17.9% YoY / -14.5% QoQ.
- EBITDA stood at INR 126 Mn, -55.9% YoY / -22.2% QoQ.
- EBITDA margins: 6.3%, vs 11.7% / 6.9% in Q2FY23 / Q1FY24 respectively
- PAT came in at INR 73 Mn, -50.7% YoY / +3% QoQ.
- PAT margins: 3.5%, vs 5.9% / 2.9% in Q2FY23 / Q1FY24 respectively
- EPS at INR 1.1 in Q2FY24 vs 1.1/ 2.6 in Q2FY23 / Q1FY24 respectively

Geography-wise

- India contributed 47% of revenue in Q2FY24 vs 45% of revenue in Q1FY24.
- US contributed to 53% of revenue in Q2FY24 vs 55% of revenue in Q1FY24.
- India manufacturing contributed to 75% in Q2FY24 vs 72% in FY23
- US manufacturing contributed to 25% in Q2FY24 vs 28% in FY23

Y/E Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Net sales	6,905	8,407	9,447	10,864	13,852
EBIDTA	661	975	1,128	1,172	1,780
Margins	9.6	11.6	11.9	10.8	12.8
PAT (adj)	215	632	525	740	1,186
Growth (%)	86.7	192.3	-22.2	41.0	60.2
EPS	26.92	79.16	9.06	11.34	18.16
P/E (x)	17.8	6.1	53.0	42.3	26.4
P/B (x)	6.4	4.3	5.2	5.1	4.3
EV/EBITDA (x)	3.9	2.9	26.7	26.5	17.4
RoE (%)	35.9	54.6	9.8	12.1	16.3
ROCE (%)	15.7	23.6	12.7	15.7	21.7
RoIC (%)	13.9	19.1	18.4	13.9	17.7
Gross Fixed Asset Turn	7	8	8	8	8

Source: Dalal and Broacha



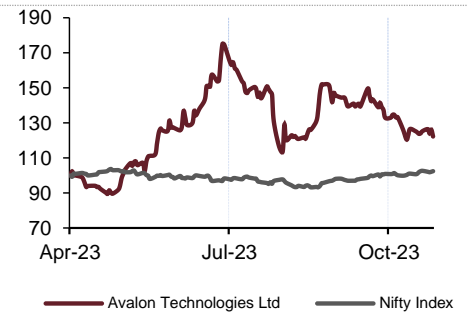
Rating	TP (Rs)	Up/Dn (%)
BUY	636	33

Market data

Current price	Rs	480
Market Cap (Rs.Bn)	(Rs Bn)	31
Market Cap (US\$ Mn)	(US\$ Mn)	377
Face Value	Rs	2
52 Weeks High/Low	Rs	732.1 / 347.3
Average Daily Volume	('000)	154
BSE Code		543896
Bloomberg		AVALON .IN

Source: Bloomberg

One Year Performance



Source: Bloomberg

% Shareholding	Sep-23	Jun-23
Promoters	51.69	51.24
Public	48.91	48.76
Total	100	100

Source: Bloomberg

Neel Nadkarni
(022) 67141412
neel.nadkarni@dalal-broacha.com

Concall Highlights

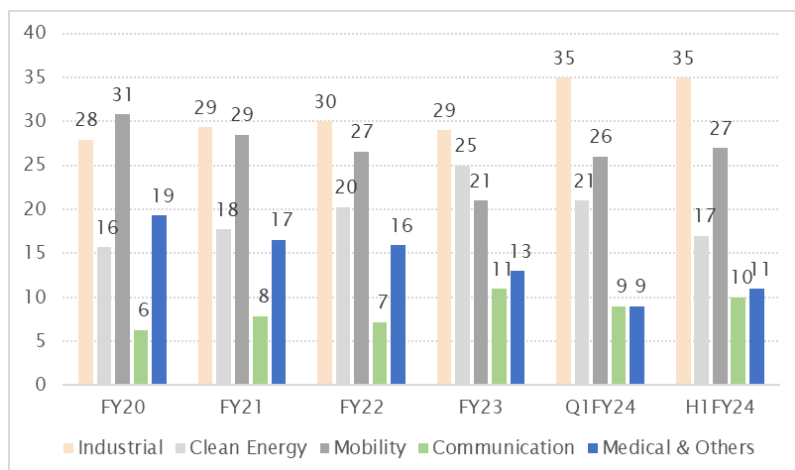
- **The order book stands at INR 1244 cr, +11.6% YoY/+12.5% QoQ (executable over the next 12 to 14 months). An additional INR 750 cr contracts and LOIs are also in place, with execution expected over the next 2 to 4 years.** The Indian order book has expanded by 26%, and management anticipates sustained growth in the longer term. Clean Energy & Industrial segments are set to contribute over 60% to the current order book.
- **Gross margins stood at 37.2%, (+303bps QoQ/ +173 bps YoY).** The improvement in gross margins is attributed to certain service businesses, and the company aims to maintain margins in the range of 33-35% in the long run. Management has guided to keep PAT margins stable from FY23, leveraging various strategies, including optimizing production allocation, strategically relocating some production activities from the US plant to the India plant, cost rationalization in US operations, and benefiting from operating leverages along with the ramp-up of US customers.
- The commissioning of two new manufacturing plants at MEPZ, Chennai, is anticipated by January 2024. These plants will support larger box-builds, specialized metal processes, and the expansion of plastics capabilities. **The management aims for an 80%-20% manufacturing mix, with 80% production in India and the remaining 20%, primarily final assembly, to be conducted in the US (currently at 75%-25% in Q2FY24).**
- The management observes initial signs of a reduction in working capital demand as supply chain inflation normalizes. The upward trend in inventory over the past year has stabilized. **The management anticipates a working capital cycle improvement of 10 to 15 days in the next 6 to 12 months compared to FY23. In the long run, the management aims to achieve pre-COVID working capital days.**
- As of October 31st, Avalon holds INR 125 crore in cash, including both cash bank balance and investments. Out of this, INR 50 crore will be utilized for investment in the company's US subsidiary (Sienna), and the remaining INR 75 crore will be retained as surplus for reserves and growth capital. **Avalon is maintaining existing working capital lines totaling INR 185 crore, providing flexibility to aggressively bid for and execute substantial orders in the pipeline and explore potential inorganic growth opportunities.**
- The first-half results were influenced by challenging economic conditions in the US, mitigated by robust domestic demand and acquisitions of marquee global customers. The Indian growth story is promising, marked by a 16% increase in revenue and a 26% expansion in the order book in H1. Indian manufacturing operations, contributing 75% of their business, achieved a robust 8.7% PAT during H1. However, macro issues in the US led to losses in their US operations.
- Indian revenue grew by 16% while US market revenue declined by 14% in H1.
- Avalon is taking proactive steps in response to the short-term challenges in the US markets.
 - a. Optimizing product operations in the US and shifting manufacturing from the US plant to the India plant.
 - b. Rationalizing costs in Avalon's US operations: Avalon has already achieved half their targeted improvements with remaining changes expected to be completed in the next 3 to 6 months.
- The US manufacturing presence enables Avalon to expand its footprint in the country, facilitating customer onboarding and leveraging the Inflation Reduction Act, a \$390 billion initiative promoting the adoption of clean energy in the US.
- Avalon secured significant wins in the US, spanning various sectors, including industrial video surveillance, clean energy grid flexibility systems, automotive heat transfer products, medical equipment, and residential ventilation solutions.

- Avalon is realigning its business strategy to adapt to the current macro situation, with a focus on increasing its presence in the Indian market. The company aims to achieve a 50-50 revenue ratio between the US and Indian markets while maintaining a strong presence in the highly profitable US market.
- Avalon has repaid INR 200 cr of Debt in the Indian entity and as of today at the group level Avalon is left with INR 100 cr debt in the US entity Sienna. Presently their Indian entity is almost debt free.
- The India manufacturing business achieved an EBITDA margin of 12-13%, with PAT margins at 9-10%. Avalon attained a profit of about INR 15 crores in the quarter. However, the US manufacturing sector experienced a decline in sales, coupled with higher fixed costs, resulting in a consolidated profit impact of INR 7.28 crores in Q2FY24. Cumulatively, the net loss from the US business was approximately INR 15 crores in H1FY24.
- Avalon has successfully acquired 7 new customers, with one in the rail segment and two in the industrial segment. Despite the economic slowdown, Avalon remains confident about the future. The company has also invested in three new regions for sales and business development while optimizing costs in other regions. Typically, new customers take 4 to 6 months to ramp up in all segments except for Air and Rail, which may take slightly longer and are expected to contribute significantly starting from the late part of Q4 and ramp up in FY25.

Vertical-wise updates:

- **Clean Energy (17% of topline in H1FY24).** Avalon has secured contracts with two significant clean energy clients—one in the US solar and inverter battery systems, and the other in the hydrogen electrolyzer domain. Both partnerships are on the verge of production, set to commence in Q4FY24. The company has also clinched a substantial contract from an innovative EV manufacturer in India for the manufacturing of chargers and data transmission systems. With end-to-end solutions for various electronics parts in a vehicle, Avalon plans to start the initial production runs in Q4, having secured orders for the next 12 months. Shipments for one of their clean energy customers, Ohmium, are expected to commence in the later part of Q3 and Q4, with further units in the following year. Another major clean energy customer in the EV space is targeted to be finalized and commence production in the later part of FY24, representing a higher volume product. Avalon anticipates that 35% of their business in the next 3 to 4 years will come from clean energy, primarily from the US through their Hybrid Model.
- **Mobility/ Transportation (27% of topline in H1FY24).** The Aerospace Wiperblade Assembly project in India is expected to commence product delivery in Q2FY25, with around 200 units in the first set scheduled for the early part of next year. Additionally, Avalon's aerospace cable projects have received approval for production into the next year. Having ventured into metals, plastics, and cables, particularly in the cabin and some engine parts for aerospace, Avalon is witnessing substantial projects from existing customers in the Rail industry in India. The company has also signed a new global major in the rail segment. As the growth in the rail segment continues, Avalon is poised to benefit significantly. Some of Avalon's customers are exploring new Kavach systems and investing in metros and Vande Bharat, which could potentially grow 3 to 4 times the current business, subject to government releases.
- **Communications (10% of topline in H1FY24).** Avalon has achieved successful qualification for the Transfer of Technology by CDAC for High-Performance Computing (HPC) servers under Rudra, India's indigenous server program. As a longstanding collaborator with CDAC, Avalon has actively contributed to the PCB design and engineering of the Rudra 2 liquid-cooled server platform, which is currently in development at CDAC. The management sees this as a significant opportunity, estimating it to be worth INR 500 billion over the next 3 to 4 years. Presently, only three vendors have received approval from CDAC for this initiative.

Rev Mix Industry wise %

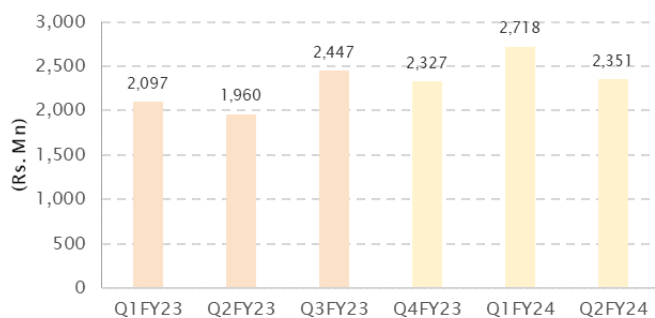


Source: Company, D&B Research

FY24e Outlook

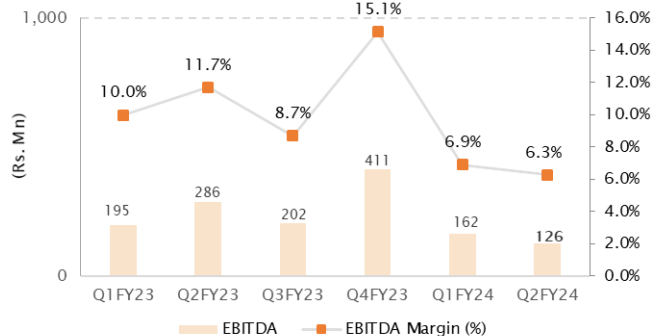
- Management had earlier guided for 15%-25% revenue growth for FY24 as it stands meeting the full year revenue guidance depends on the resurgence of US markets. **The management has indicated that they expect to be at the lower end of the guidance with a negative bias for FY24. The Management remains confident of achieving 25-30% revenue CAGR over the next 3 years.**
- The FY24 bottom-line margins are expected to remain stable over FY23.
- Working Capital to improve by 10-15 days over the next 6 to 12 months.

Net Sales Trajectory



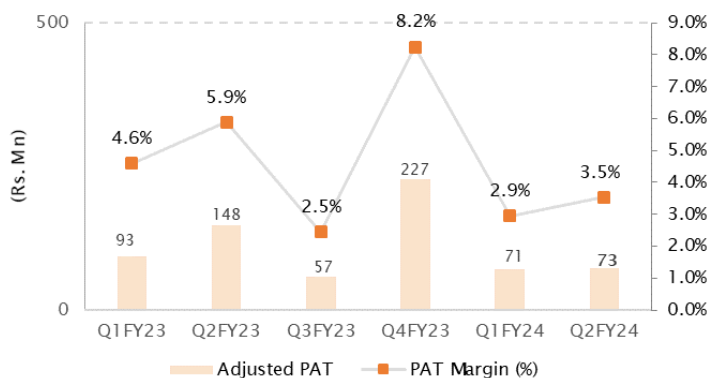
Source: Company, D&B Research

EBITDA & EBITDA Margin Trajectory



Source: Company, D&B Research

Adj. PAT (Exc. Exceptional) Trajectory



Source: Company, D&B Research

Quarterly Deviation Sheet

(Rs.Mn)	Q2FY24A	Q2FY23	YoY Growth (%)	Q1FY24	QoQ Growth (%)
Revenue from Operations	2,010	2,447	-17.9%	2,351	-14.5%
Other Income	47	64	-26.0%	51	-7.3%
COGS	1,262	1,579	-20.1%	1,547	-18.4%
Employee Benefits Expense	455	435	4.7%	482	-5.6%
Other Expenses	166	147	13.0%	159	4.5%
Total Expenses	1,884	2,161	-12.8%	2,189	-13.9%
EBITDA (Excluding Other Income)	126	286	-55.9%	162	-22.2%
Depreciation and Amortisation Expenses	55	49	13.2%	53	4.6%
EBIT / PBIT	118	301	-60.7%	161	-26.3%
Finance Costs	32	100	-67.6%	56	-42.0%
EBT/ PBT	86	201	-57.3%	105	-17.9%
Tax Expense	13	53	-75.5%	34	-61.4%
Net Profit after Tax	73	148	-50.7%	71	3.0%
Adj Earning Per Share	1.1	2.6	-57.9%	1.1	2.7%
No of Shares Diluted (mn)	65.5	58.0		55.9	
Margins Analysis (%)			bps		bps
Gross Margins	37.2%	35.5%	173	34.2%	303
EBITDA Margins (Excl Other Income)	6.3%	11.7%	-541	6.9%	-62
PAT Margins	3.5%	5.9%	-235	2.9%	59
Effective Tax Rate %	15.2%	26.6%	-1134	32.4%	-1716
Cost Analysis (%)			bps		bps
COGS as a % to sales	62.8%	64.5%	-173	65.8%	-303
EE Cost as a % to sales	22.7%	17.8%	488	20.5%	214
Other exps as a % to sales	8.3%	6.0%	226	6.8%	151

Source: Company, D&B Research

Valuation & Outlook

Avalon is currently trading at 42.3x / 26.4x FY24e / FY25e EPS.

We believe that despite the near-term macro issues in the US faced by Avalon, the long-term growth levers remain intact with demand coming in from Clean energy, aerospace, railways & Industrial. Management has indicated that it will achieve the lower end of its guidance of 15-25% 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.

Avalon intends to only keep the Clean energy manufacturing in the US to take advantage of the Inflation Reduction Act and shift the rest of the customers to Indian manufacturing from US

Taking the current results and management commentary into consideration, **we have cut our PAT numbers for FY24e/FY25e by (8.8%/6.4%) respectively. We maintain our BUY rating on the stock, assigning a target multiple of 35x FY25e to arrive at a target of INR 636 (33% upside).**

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	10,864	13,852	PBT	288	856	727	1,007	1,636
Operating Expenses	-4,560	-5,541	-5,947	-6,953	-8,796	Depreciation	157	180	197	203	231
Employee Cost	-1,192	-1,314	-1,714	-1,954	-2,305	Net Chg in WC	-555	-760	-1,273	-424	-905
Other Expenses	-491	-577	-659	-785	-971	Taxes	-35	-125	-189	-267	-450
Operating Profit	661	975	1,128	1,172	1,780	Others	200	6	405	50	102
Depreciation	-157	-180	-197	-203	-231	CFO	55	157	-133	568	614
PBIT	504	795	931	970	1,549	Capex	-192	-177	-273	-350	-450
Other income	54	109	144	144	144	Net Investments made	-99	-6	2	-1,138	-46
Interest	-270	-248	-348	-106	-56	Others	29	-	-	-	-
PBT	288	656	727	1,007	1,636	CFI	-263	-184	-271	-1,488	-496
Profit before tax (post exceptional)	288	856	727	1,007	1,636	Change in Share capital	73	-68	4,815	3,200	-
Provision for tax	-57	-182	-202	-267	-450	Change in Debts	440	86	48	-2,100	-450
Reported PAT	231	675	525	740	1,186	Div. & Div Tax	-37	-38	-37	-	-
MI	-16	-43	-	-	-	Others	-201	-189	-280	-3,217	4
Owners PAT	215	632	525	740	1,186	CFF	275	-209	4,545	-2,117	-446
Adjusted Profit (excl Exceptionals)	215	485	525	740	1,186	Total Cash Generated	67	-236	4,141	-3,037	-327
						Cash Opening Balance	266	335	101	4,222	1,185
						Cash Closing Balance	333	99	4,243	1,185	858

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	10.8	12.8
Reserves	583	872	5,254	5,978	7,164	NPM	3.1	5.7	5.5	6.7	8.5
Net worth	599	888	5,370	6,109	7,295	Tax rate	-19.9	-21.2	-27.8	-26.5	-27.5
MI	-317	-	-	-	-	Growth Ratios (%)					
Non Current Liabilites	1,051	1,016	1,072	828	634	Net Sales	7.6	21.8	12.4	15.0	27.5
Current Liabilites	3,792	3,990	5,361	3,696	3,933	Operating Profit	2.6	47.5	15.6	3.9	51.8
TOTAL LIABILITIES	5,125	5,894	11,803	10,633	11,862	PBIT	2.9	57.8	17.1	4.1	59.7
Non Current Assets	1,329	1,391	1,667	2,867	3,077	PAT	86.7	192.3	-22.2	41.0	60.2
Fixed Assets	841	918	1,086	1,080	1,147	Per Share (Rs.)					
Right of Use Assets	200	244	342	401	489	Net Earnings (EPS)	26.92	79.16	9.06	11.34	18.16
Financial Assets	43	53	53	1,194	1,243	Cash Earnings (CPS)	46.64	101.70	12.45	14.44	21.70
Deferred Tax Asset	232	159	130	134	138	Book Value	75.07	111.19	92.66	93.56	111.73
Other Non Current Assets	12	18	55	58	61	Free Cash Flow	-25.25	-7.90	-10.97	2.16	-0.02
Current Assets	3,796	4,503	10,137	7,766	8,785	Valuation Ratios					
Inventories	1,458	2,330	3,179	3,524	4,290	P/E(x)	18	6	53	42.3	26.4
Trade Receivables	1,819	1,774	2,062	2,381	2,960	P/B(x)	6	4	5	5	4
Cash and Bank Balances	335	101	4,222	1,185	858	EV/EBIDTA(x)	4	3	27	26	17
Other Financial Assets	14	13	38	40	42	FCF Yield(%)	-5.26	-1.65	-2.29	0.45	-0.00
Other Current Assets	170	284	635	635	635	Return Ratios (%)					
TOTAL ASSETS	5,125	5,894	11,803	10,633	11,862	ROE	36%	55%	10%	12%	16%
						ROCE	16%	24%	13%	16%	22%
						RoIC	14%	19%	18%	14%	18%

Source: Company, Dalal & Broacha Research

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Address: - 508, Maker Chambers V, 221 Nariman Point, Mumbai 400 021.

Tel: 91-22- 2282 2992 | : equity.research@dalal-broacha.com