

### US Challenges & Domestic Opportunities....

Avalon's Q3FY24 performance was weak due to a macro issues in the US. Management has cut its FY24 guidance in light of the delayed recovery in the US markets. 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 H1 FY25 along with new business in the pipelines.

- INR revenue came in at INR 2,143 Mn, -7.9% YoY / +6.6% QoQ.
- EBITDA stood at INR 165 Mn, -18.1% YoY / +31.3% QoQ.
- EBITDA margins: 7.7%, vs 8.7% / 6.3% in Q3FY23 / Q2FY24 respectively
- PAT came in at INR 66 Mn, +14.7% YoY / -9.6% QoQ.
- PAT margins: 3.0%, vs 2.5% / 3.5% in Q3FY23 / Q2FY24 respectively
- EPS at INR 1.0 in Q2FY24 vs 1.0/ 1.1 in Q3FY23 / Q2FY24 respectively

### Geography-wise

- India contributed 47% of revenue in Q3FY24 vs 47% of revenue in Q2FY24.
- US contributed to 53% of revenue in Q3FY24 vs 53% of revenue in Q2FY24.
- India manufacturing contributed to 77% in Q3FY24 vs 75% in Q2FY24
- US manufacturing contributed to 23% in Q3FY24 vs 25% in Q2FY24

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Net sales	8,407	9,447	8,691	11,733	15,253
EBIDTA	975	1,128	646	1,300	1,864
Margins	11.6	11.9	7.4	11.1	12.2
PAT (adj)	632	525	298	822	1,242
Growth (%)	192.3	-22.2	-43.3	176.1	51.0
EPS	79.16	9.06	4.54	12.53	18.93
P/E (x)	-	55	109	40	26
P/B (x)	-	5	6	5	4
EV/EBITDA (x)	-	28	49	25	17
RoE (%)	55	10	5	13	16
ROCE (%)	24	13	8	17	21
RoIC (%)	19	18	8	14	18
Gross Fixed Asset Turn	8	8	6	7	8

Source: Dalal and Broacha



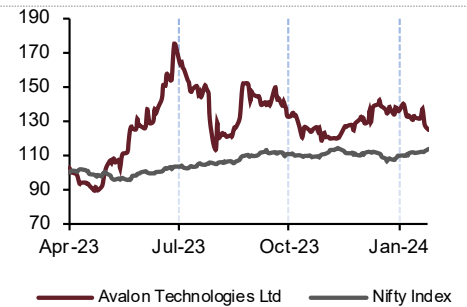
Rating	TP (Rs)	Up/Dn (%)
<b>BUY</b>	<b>662</b>	<b>33</b>

### Market data

Current price	Rs	497
Market Cap (Rs.Bn)	(Rs Bn)	33
Market Cap (US\$ Mn)	(US\$ Mn)	393
Face Value	Rs	2
52 Weeks High/Low	Rs	732.1 / 347.3
Average Daily Volume	('000)	408
BSE Code		543896
Bloomberg		AVALON .IN

Source: Bloomberg

### One Year Performance



Source: Bloomberg

% Shareholding	Dec-23	Sep-23
Promoters	50.97	51.69
Public	49.03	48.91
<b>Total</b>	<b>100</b>	<b>100</b>

Source: Bloomberg

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## Concall Highlights

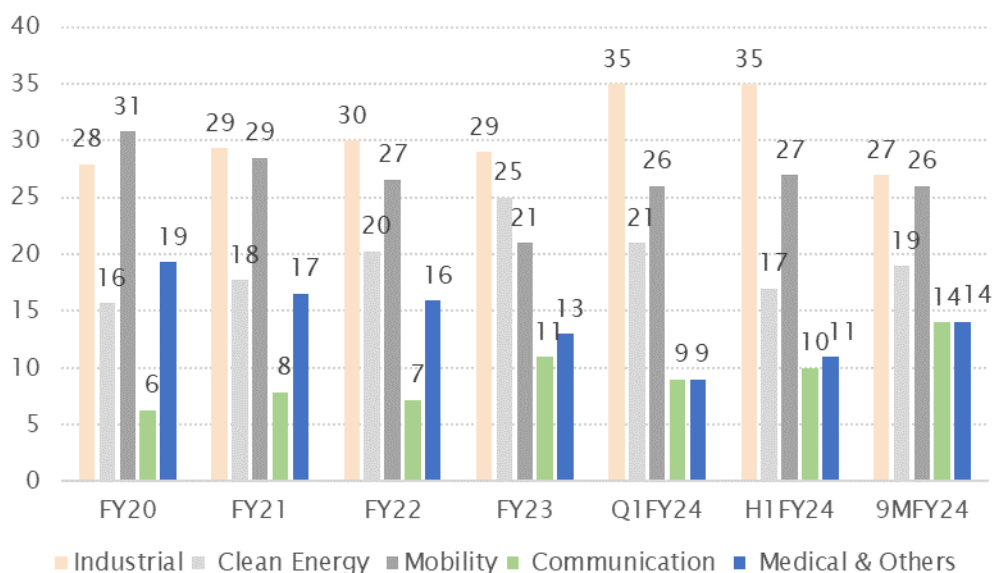
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- **The order book stands at INR 1275 cr, +7.1% YoY/+2.5% QoQ (executable over the next 12 to 14 months). An additional INR 843 cr contracts and LOIs are also in place, with execution expected over the next 2 to 3 years.**
- **Gross margins stood at 37%, (+219 bps YoY).** Management is leveraging various strategies to improve their margins, including optimizing production allocation, strategically relocating some production activities from the US plant to the India plant, cost rationalization in US operations.
- The commissioning of two new manufacturing plants at MEPZ, Chennai, one plant is anticipated to commence operations in Q1FY25. These plants will support larger box-builds, specialized metal processes, and the expansion of plastics capabilities. **The management aims for an 85%-15% manufacturing mix, with 85% production in India and the remaining 15%, primarily final assembly, to be conducted in the US (currently at 77%-23% in Q3FY24).**
- The temporary increase in inventory days in Q3FY24 was attributed to onboarding new customers and initiating the production process for them. **The management anticipates an improvement in the working capital cycle by 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.**
- At the end of Q3FY24, Avalon had 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. Avalon has surplus cash of INR 103 crores in short-term investments, of which 50 crores are earmarked for debt repayments in US subsidiaries (Sienna). **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 9-month 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 12% increase in revenue in Q3FY24. Indian manufacturing operations, contributing 77% of their business, achieved robust operating margins of 14% and PAT margins of 8.9 % in Q3FY24. However, macro issues in the US led to losses of 22 cr in their US operations over 9 months.
- 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.
- 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.

**Vertical-wise updates:**

- Clean Energy (19% of topline in 9MFY24).** Commercial production for US clean energy customers is scheduled to commence from late H1FY25, with a ramp-up in production expected to start from early H2FY25. The US manufacturing presence remains important, enabling Avalon to expand its footprint in the country. This facilitates customer onboarding and leverages the Inflation Reduction Act, a \$390 billion initiative promoting the adoption of clean energy in the US. On the electric vehicle (EV) side in India, Avalon has multiple products on the same vehicle in the electronics segment. These components are designed for various products, with volume production expected to kick in during the first half of next year.
- Mobility/ Transportation (26% of topline in 9MFY24).** In the Aerospace sector, Avalon successfully delivered the first wiper blade assembly sample and is set to begin commercial production in H2FY25. A key focus area is Rail, particularly in rail signaling and braking. Avalon has a robust presence in the rail industry, spanning a decade, and a main customer has received approval for Kavach, jointly developing a product for this initiative. Additionally, Avalon's certain customer has secured a significant portion of the Van de Bharat business. The Rail segment is anticipated to witness substantial growth, projected at 20-30%, driven by these strategic developments.
- Communications (14% of topline in H1FY24).** Avalon Technologies is set to transition into the production of High-Performance Computing (HPC) servers for the Centre for Development of Advanced Computing (C-DAC), a key player in India's indigenous manufacturing of HPC systems. This collaboration aims to contribute to the 'Make in India' initiative and enhance the country's capabilities in the field of HPC. Avalon has been a strategic design and manufacturing partner for C-DAC since 2021, providing expertise in various areas. While specific requirements for CDAC are yet to be determined, the approval for three players suggests significant market potential. Avalon's extensive experience of 2.5 to 3 years with CDAC positions it well in this strategic initiative.

**Rev Mix Industry wise %**



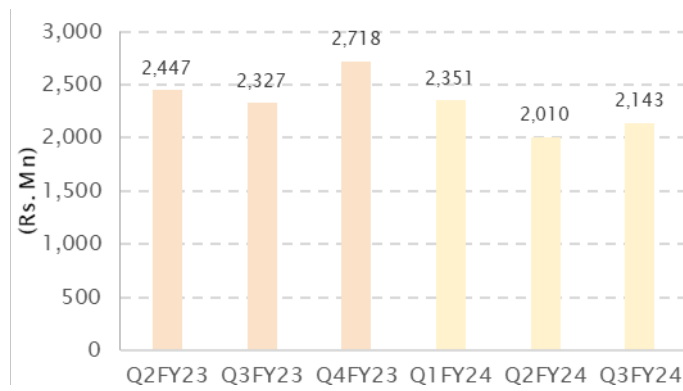
Source: Company, D&B Research

**FY24e Outlook**

- The US market's recovery has been prolonged, leading the management to revise their FY24 guidance to a degrowth of 8-10%. Initially forecasting revenue growth of 15%-25%, anticipating being at the lower end of the guidance with a negative bias for FY24.
- Expects 7% to 8% EBITDA margins for FY24.

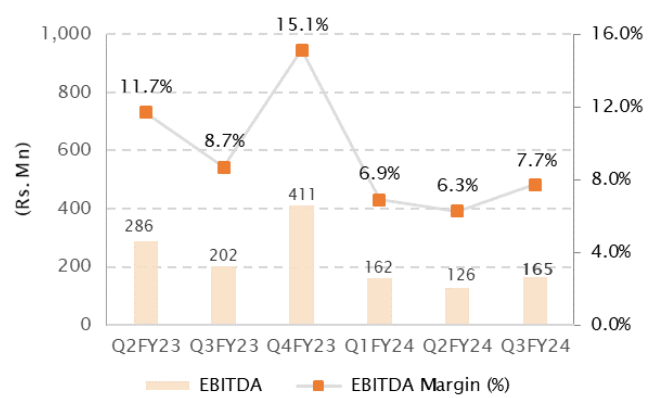
- Working Capital to improve by 10-15 days over the next 6 to 12 months.

## Net Sales Trajectory



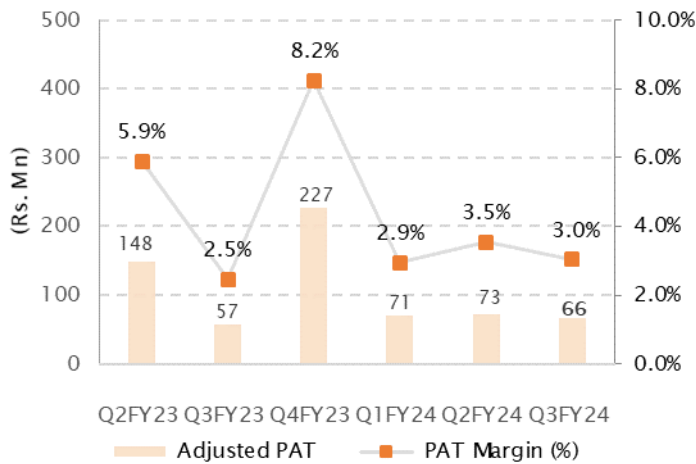
Source: Company, D&B Research

## EBITDA & EBITDA Margin Trajectory



Source: Company, D&B Research

## Adj. PAT (Exc. Exceptional) Trajectory



Source: Company, D&B Research

## Quarterly Deviation Sheet

(Rs.Mn)	Q3FY24	Q3FY23	YoY Growth (%)	Q2FY24	QoQ Growth (%)
<b>Revenue from Operations</b>	<b>2,143</b>	<b>2,327</b>	<b>-7.9%</b>	<b>2,010</b>	<b>6.6%</b>
Other Income	22	12	75.4%	47	-54.6%
COGS	1,350	1,517	-11.0%	1,262	7.0%
Employee Benefits Expense	457	411	11.2%	455	0.3%
Other Expenses	171	197	-13.4%	166	2.5%
Total Expenses	1,977	2,125	-6.9%	1,884	5.0%
<b>EBITDA (Excluding Other Income)</b>	<b>165</b>	<b>202</b>	<b>-18.1%</b>	<b>126</b>	<b>31.3%</b>
Depreciation and Amortisation Expenses	60	50	19.1%	55	8.8%
<b>EBIT / PBIT</b>	<b>127</b>	<b>164</b>	<b>-22.5%</b>	<b>118</b>	<b>7.3%</b>
Finance Costs	36	86	-57.6%	32	11.9%
<b>EBT/ PBT</b>	<b>91</b>	<b>78</b>	<b>15.9%</b>	<b>86</b>	<b>5.6%</b>
Tax Expense	25	21	19.3%	13	90.6%
<b>Net Profit after Tax</b>	<b>66</b>	<b>57</b>	<b>14.7%</b>	<b>73</b>	<b>-9.6%</b>
Adj Earning Per Share	1.0	1.0	1.3%	1.1	-9.9%
No of Shares Diluted (mn)	65.6	58.0		65.5	
<b>Margins Analysis (%)</b>			<b>bps</b>		<b>bps</b>
Gross Margins	37.0%	34.8%	219	37.2%	-21
EBITDA Margins (Excl Other Income)	7.7%	8.7%	-96	6.3%	145
PAT Margins	3.0%	2.5%	59	3.5%	-50
Effective Tax Rate %	27.5%	26.7%	77	15.2%	1225
<b>Cost Analysis (%)</b>			<b>bps</b>		<b>bps</b>
COGS as a % to sales	63.0%	65.2%	-219	62.8%	21
EE Cost as a % to sales	21.3%	17.7%	366	22.7%	-135
Other exps as a % to sales	8.0%	8.5%	-51	8.3%	-31

Source: Company, D&amp;B Research

## Valuation &amp; Outlook

**Avalon is currently trading at 109.3x / 39.6x / 26.2x FY24e / FY25e / FY26e EPS.**

We believe despite facing near-term macro challenges, Avalon, as an export-oriented business, was impacted by issues in the US. However, the company's long-term growth drivers remain robust, driven by demand in clean energy, aerospace, railways, and industrial sectors. The management has revised the FY24 topline guidance to a degrowth of 8-10%, considering near-term weaknesses in the US and providing an EBITDA margin guidance of 7-8%.

To enhance margins, Avalon is implementing various initiatives, including optimizing production allocation, strategically relocating some production activities from the US to India, rationalizing costs in US operations, and leveraging operating efficiencies. The company aims to focus more on the domestic business, expecting a 50-50 split between Indian and US markets, with 85% of manufacturing taking place in India and 15% in the US.

With a strong order pipeline and major orders expected in FY25, Avalon anticipates favorable performance in the medium to long term, supported by solid long-term fundamentals.

Taking the current results and management commentary into consideration, **we have cut our PAT numbers for FY24e/FY25e by (60%/31%) respectively. We maintain our BUY rating on the stock, assigning a target multiple of 35x FY26e to arrive at a target of INR 662 (34% upside).**

Financials

P&L (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E	Cashflow (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	8,407	9,447	8,691	11,733	15,253	PBT	856	727	411	1,134	1,713
Operating Expenses	-5,541	-5,947	-5,519	-7,451	-9,686	Depreciation	180	197	230	231	237
Employee Cost	-1,314	-1,714	-1,851	-2,128	-2,660	Net Chg in WC	-760	-1,273	376	-1,064	-690
Other Expenses	-577	-659	-676	-854	-1,043	Taxes	-125	-189	-113	-312	-471
<b>Operating Profit</b>	<b>975</b>	<b>1,128</b>	<b>646</b>	<b>1,300</b>	<b>1,864</b>	Others	6	405	93	124	105
Depreciation	-180	-197	-230	-231	-237	<b>CFO</b>	<b>157</b>	<b>-133</b>	<b>997</b>	<b>114</b>	<b>895</b>
<b>PBIT</b>	<b>795</b>	<b>931</b>	<b>416</b>	<b>1,069</b>	<b>1,626</b>	Capex	-177	-273	-350	-450	-330
Other income	109	144	144	144	144	Net Investments made	-6	2	-1,138	-46	-47
Interest	-248	-348	-149	-78	-56	<b>CFI</b>	<b>-184</b>	<b>-271</b>	<b>-1,488</b>	<b>-496</b>	<b>-377</b>
PBT	656	727	411	1,134	1,713	Change in Share capital	-68	4,815	3,200	-	-
Profit before tax (post exceptional)	856	727	411	1,134	1,713	Change in Debts	86	48	-2,000	-350	-200
Provision for tax	-182	-202	-113	-312	-471	Div. & Div Tax	-38	-37	-	-	-
<b>Reported PAT</b>	<b>675</b>	<b>525</b>	<b>298</b>	<b>822</b>	<b>1,242</b>	Others	-189	-280	-3,259	-18	40
MI	-43	-	-	-	-	<b>CTF</b>	<b>-209</b>	<b>4,545</b>	<b>-2,059</b>	<b>-368</b>	<b>-160</b>
<b>Owners PAT</b>	<b>632</b>	<b>525</b>	<b>298</b>	<b>822</b>	<b>1,242</b>	<b>Total Cash Generated</b>	<b>-236</b>	<b>4,141</b>	<b>-2,551</b>	<b>-749</b>	<b>357</b>
<b>Adjusted Profit (excl Exceptionals)</b>	<b>485</b>	<b>525</b>	<b>298</b>	<b>822</b>	<b>1,242</b>	<b>Cash Opening Balance</b>	<b>335</b>	<b>101</b>	<b>4,222</b>	<b>1,671</b>	<b>922</b>
						<b>Cash Closing Balance</b>	<b>99</b>	<b>4,243</b>	<b>1,671</b>	<b>922</b>	<b>1,280</b>

Balance Sheet (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E	Ratios	FY22	FY23	FY24E	FY25E	FY26E
Equity capital	16	116	131	131	131	OPM	11.6	11.9	7.4	11.1	12.2
Reserves	872	5,254	5,536	6,358	7,601	NPM	5.7	5.5	3.4	6.9	8.1
<b>Net worth</b>	<b>888</b>	<b>5,370</b>	<b>5,667</b>	<b>6,490</b>	<b>7,732</b>	Tax rate	-21.2	-27.8	-27.5	-27.5	-27.5
<b>Non Current Liabilities</b>	<b>1,016</b>	<b>1,072</b>	<b>878</b>	<b>734</b>	<b>640</b>	<b>Growth Ratios (%)</b>					
<b>Current Liabilities</b>	<b>3,990</b>	<b>5,361</b>	<b>3,420</b>	<b>3,774</b>	<b>4,408</b>	Net Sales	21.8	12.4	-8.0	35.0	30.0
<b>TOTAL LIABILITIES</b>	<b>5,894</b>	<b>11,803</b>	<b>9,964</b>	<b>10,997</b>	<b>12,780</b>	Operating Profit	47.5	15.6	-42.7	101.3	43.3
<b>Non Current Assets</b>	<b>1,391</b>	<b>1,667</b>	<b>2,840</b>	<b>3,050</b>	<b>3,099</b>	PBIT	57.8	17.1	-55.3	156.9	52.1
Fixed Assets	918	1,086	1,053	1,120	1,059	PAT	192.3	-22.2	-43.3	176.1	51.0
Right of Use Assets	244	342	401	489	541	<b>Per Share (Rs.)</b>					
Financial Assets	53	53	1,194	1,243	1,293	Net Earnings (EPS)	79.16	9.06	4.54	12.53	18.93
Deferred Tax Asset	159	130	134	138	142	Cash Earnings (CPS)	101.70	12.45	8.04	16.05	22.54
Other Non Current Assets	18	55	58	61	64	Dividend	-	-	-	-	-
<b>Current Assets</b>	<b>4,503</b>	<b>10,137</b>	<b>7,124</b>	<b>7,947</b>	<b>9,680</b>	Book Value	111.19	92.66	86.34	98.87	117.80
Inventories	2,330	3,179	2,873	3,776	4,379	Free Cash Flow	-7.90	-10.97	8.50	-7.73	6.05
Trade Receivables	1,774	2,062	1,905	2,572	3,343	<b>Valuation Ratios</b>					
Cash and Bank Balances	101	4,222	1,671	922	1,280	P/E(x)	-	55	109.3	39.6	26.2
Other Financial Assets	13	38	40	42	44	P/B(x)	-	5	6	5	4
Other Current Assets	284	635	635	635	635	EV/EBIDTA(x)	-	28	49	25	17
<b>TOTAL ASSETS</b>	<b>5,894</b>	<b>11,803</b>	<b>9,964</b>	<b>10,997</b>	<b>12,780</b>	Div. Yield(%)	-	-	-	-	-
						FCF Yield(%)	-1.59	-2.21	1.71	-1.56	1.22
						<b>Return Ratios (%)</b>					
						ROE	55%	10%	5%	13%	16%
						ROCE	24%	13%	8%	17%	21%
						RoIC	19%	18%	8%	14%	18%

	FY22	FY23	FY24E	FY25E	FY26E		FY22	FY23	FY24E	FY25E	FY26E
ROA	8.2	4.4	3.0	7.5	9.7	Equity	16	116	131	131	131
Current Assets	4,401	5,914	5,453	7,025	8,401	Face Value	2	2	2	2	2
Net Debt	2,839	-1,160	-609	-210	-767	CMP	496	496	496	496	496
Gross Fixed Asset Turn	8	8	6	7	8	Mcap	-	32,385	32,555	32,555	32,555
Net Fixed Asset Turn	9	10	10	12	17	Debt	2,941	3,063	1,063	713	513
						Cash	120	4,277	1,729	983	1,343
						EV	2,821	31,170	31,889	32,285	31,725

Source: Company, Dalal & Broacha Research

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