

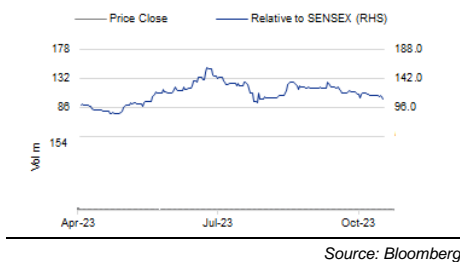
India

ADD (no change)

Consensus ratings*:	Buy 8	Hold 0	Sell 0
Current price:	Rs472		
Target price:	Rs590		
Previous target:	Rs750		
Up/downside:	25.0%		
InCred Research / Consensus:	-8.8%		
Reuters:			
Bloomberg:	AVALON IN		
Market cap:	US\$371m		
	Rs30,932m		
Average daily turnover:	US\$3.7m		
	Rs308.6m		
Current shares o/s:	65.3m		
Free float:	19.7%		
*Source: Bloomberg			

Key changes in this note

- For FY24F-26F, we have cut our revenue, EBITDA and PAT estimates in the range of ~4-8%, ~8-10% and ~9-16%, respectively.
- Reduce target P/E multiple to 35x from 40x.



Price performance	1M	3M	12M
Absolute (%)	(16.1)	(18.8)	0.0
Relative (%)	(14.3)	(18.3)	0.0

Major shareholders	% held
PROMOTERS	51.2
FII	12.5
DII	16.6

Analyst(s)



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Avalon Technologies

Higher growth potential led by US exports

- 2Q revenue was at Rs2bn, down 18% (-15% QoQ), 31% below our estimate and 25% below the consensus estimate.
- Clean energy and industrials segments are likely to be the key growth drivers.
- We retain our ADD rating on the stock with a lower target price of Rs590 (Rs750 earlier), valuing it at 35x Sep 2025F EPS (40x earlier).

Muted revenue performance and compressed margins

Avalon Technologies' 2QFY24 revenue was at Rs2bn, down 18% (-15% QoQ), 31% below our estimate and 25% below the consensus estimate. EBITDA stood at Rs126m, down 59% YoY (-22% QoQ), 61% below our estimate and 41% below the consensus estimate. Raw material costs fell by 19% YoY to Rs1.3bn while total expenses declined by 12% YoY. Despite the drop in costs, the EBITDA margin was under pressure as it fell 621bp YoY to 6.3% from 12.5% in 2QFY23. The margin in the previous quarter was 6.9%. PAT was at Rs73m in 2QFY24, down 54% YoY (+3% QoQ), 61% below our estimate and 45% below the consensus estimate.

Uptick in US market likely to boost the company's growth

Avalon Technologies is primarily export-centric and challenging economic conditions led to a 14% decline in the US market's revenue during 1HFY24. The US market revenue comprised 53% of the company's total revenue. However, domestic market revenue was up 16%. Overall revenue fell by 1% YoY in 1HFY24. Management expects a revenue CAGR of 25-30% over the next three years. However, the margins are likely to remain under pressure in the short term. A gross margin of 33-35% is likely in the long run. The company has taken steps to address the issues related to its US operations by optimizing product allocation from an US plant to its India plant and rationalize costs at the US operations. The company's order book stood at Rs12.4bn as of Sep 2023-end, registering a 13% growth YoY. Management stated that these orders may be executed over 12-14 months.

Reiterate ADD rating on the stock

Avalon Technologies is continuously expanding its technological expertise in manufacturing for diverse industries and integrating its services to serve multiple verticals with high-mix, flexible-volume manufacturing. For FY24F-26F we have cut our revenue estimates in the range of ~4-8%, EBITDA estimates by ~8-10% and PAT estimates by ~9-16% factoring in weak performance in 1HFY24, lower-than-expected growth in the current fiscal and pressure relating to the US exports revenue. However, we believe that with new orders in the pipeline, stable input prices and operating leverage, the company will reduce its debt, which should help improve its profitability and return ratios. **We retain our ADD rating on the stock with a lower target price of Rs590 (Rs750 earlier), valuing it at a multiple of 35x Sep 2025F EPS (40x earlier).** Downside risk: A major downturn in the US economy will massively hit the company's US market revenue.

Financial Summary

	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Revenue (Rsm)	8,407	9,447	10,862	12,965	15,930
Operating EBITDA (Rsm)	975	1,128	1,288	1,481	1,856
Net Profit (Rsm)	675	525	742	961	1,239
Core EPS (Rs)	7.9	8.0	11.4	14.7	19.0
Core EPS Growth	0.0%	1.6%	41.2%	29.6%	29.0%
FD Core P/E (x)	45.72	58.71	41.57	32.09	24.88
DPS (Rs)	0.0	0.0	0.0	0.0	0.0
Dividend Yield	0.00%	0.00%	0.00%	0.00%	0.00%
EV/EBITDA (x)	34.55	26.31	22.76	19.41	15.81
P/FCFE (x)	235.08	(111.66)	(18.70)	40.48	(50.83)
Net Gearing	322.8%	(21.5%)	(25.1%)	(29.7%)	(18.0%)
P/BV (x)	34.77	5.74	5.05	4.36	3.71
ROE	69.6%	16.8%	12.9%	14.6%	16.1%
% Change In Core EPS Estimates					
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

2QFY24 conference-call highlights

- Avalon Technologies reported a muted performance for the quarter owing to low revenue from the US market, which accounts for 53% of the company's total revenue. It is the only Indian electronics manufacturing services or EMS company with manufacturing facilities in the US. 75% of the manufacturing is done in India and the remaining 25% in the US.
- **Guidance:** Management expects a revenue CAGR of 25-30% over the next three years. Margins are likely to remain under pressure in the short term. Management aims to achieve a gross margin of 33-35% in the long run. Working capital days are expected to return to ~120 days, from 150 days currently, over the long run.
- Management stated that the company has taken steps to address the issues relating to the US operations. It will aim to optimize product allocation from an US plant to an India plant and rationalize the costs at the US operations.
- Domestic market revenue was up by 16% YoY and there was a 26% increase in the order book. Management stated that for the Indian business, the EBITDA margin is ~12-13% while the PAT is ~9-10%.
- The company bagged a large contract from one of India's electric vehicle or EV manufacturers for supplying the charging and data transmission systems. Management stated that Avalon Technologies will be involved in an end-to-end box-build solution, with three or four different products going into the EV. The company expects trial runs in 4QFY24F.
- Avalon Technologies' order book stood at Rs12.4bn as of Sep 2023-end, registering a 13% growth YoY. Management stated these orders are likely to be executed over the next 12-14 months. The company has also secured a contract and letter of intent worth an additional Rs7,500m, which is likely to be executed over two-to-four years.
- During the quarter, the company also secured significant customers in the US market across sectors such as industrial video surveillance, grid flexibility in clean energy, automotive heat transfer products and agro technology systems.
- Avalon Technologies has partnered with two significant energy clients - one in the solar inverter and battery systems segment and the other in the hydrogen electrolyzer segment, both of which will commence production in 4QFY24F.
- Two new plants are likely to be commissioned by Jan 2024F, supporting larger box builds, and specialized metal and plastic processing capabilities. Avalon Technologies will continue to focus on providing PCBA/box build solutions. During 1HFY24, 51% of its revenue came from the box build business. Clean energy and industrials sectors continue to be a major focus area of the company. These sectors contributed 17% and 35% to the company's revenue, respectively, during 1HFY24.
- Avalon Technologies has qualified for the transfer of technology by Centre for Development of Advanced Computing (CDAC) for HPC servers as a part of Rudra, India's indigenous server program.
- Management is bullish on sectors like solar, hydrogen and EV, which are likely to drive growth in the EMS space. Moreover, the increase in movement of manufacturing to the US and India bodes well for the company, as a part of the China+1 strategy.
- The company has mostly utilized its IPO proceeds of ~Rs3,000m by way of Rs1,450m for debt repayment, Rs900m for meeting working capital requirement and ~Rs650m for corporate purposes.

Figure 1: Quarterly results snapshot

(Rs m)	2QFY24	2QFY23	YoY (%)	1QFY24	QoQ (%)	InCred Estimates	Diff (%)	Bloomberg	Bloomberg Diff
Net revenue	2,010	2,444	-18%	2,351	-15%	2933	-31%	2694	-25.4%
Raw material costs	1,262	1,561	-19%	1,579	-20%	1961	-36%		
Staff costs	455	426	7%	452	1%	477	-5%		
Other expenditure	166	152	9%	158	5%	171	-3%		
Total expenses	1,884	2,139	-12%	2,189	-14%	2609	-28%		
EBITDA	126	305	-59%	162	-22%	324	-61%	213	-40.8%
Other income	47	29	66%	51	-7%	60	-21%		
Interest	32	70	-54%	56	-42%	70	-54%		
Depreciation	55	46	19%	53	5%	55	0%		
PBT	86	217	-60%	105	-18%	259	-67%		
Tax	13	60	-78%	34	-61%	73	-82%		
Reported PAT	73	157	-54%	71	3%	187	-61%	132	-44.9%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 2: Margin analysis

Margins (%)	2QFY24	2QFY23	YoY (bp)	1QFY24	QoQ (bp)
Raw material costs	62.8%	63.9%	-108	67.2%	-437.2
Staff costs	22.7%	17.4%	524	19.2%	343.2
Other expenses	8.3%	6.2%	206	6.7%	156.4
EBITDA	6.3%	12.5%	-621	6.9%	-62.4
PAT	3.6%	6.4%	-280	3.0%	61.5
Tax rate (%)	15.2%	27.8%	-1,256	32.4%	-1716.7

SOURCE: INCRED RESEARCH, COMPANY REPORTS

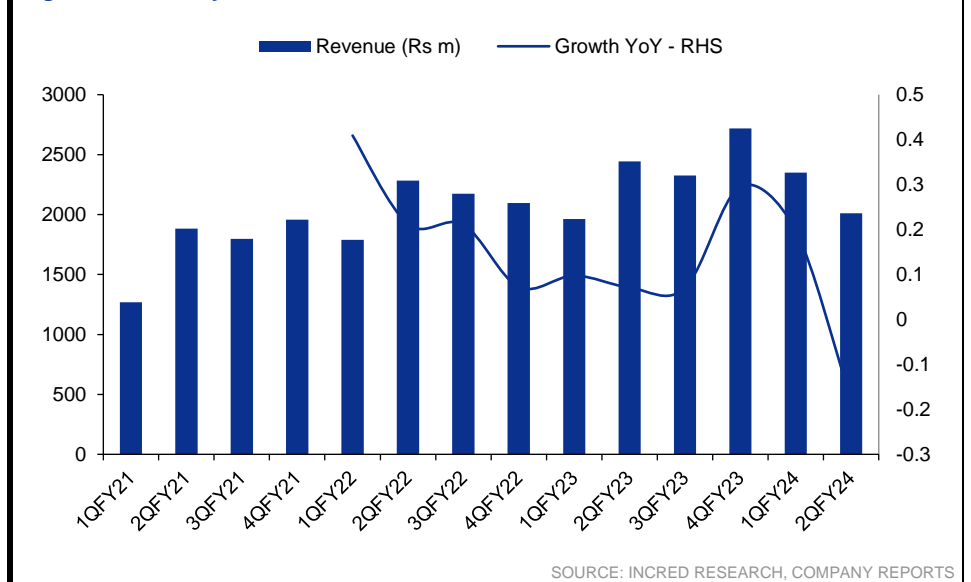
Figure 3: Our revised revenue, EBITDA and PAT estimates

Earnings revision (Rs m)	Old			New			Change (%)		
	FY24F	FY25F	FY26F	FY24F	FY25F	FY26F	FY24F	FY25F	FY26F
Revenue	11,707	14,043	16,643	10,862	12,965	15,930	-7%	-8%	-4%
EBITDA	1,436	1,641	2,028	1,288	1,481	1,856	-10%	-10%	-8%
PAT	884	1,090	1,357	742	961	1,239	-16%	-12%	-9%
EPS (Rs)	13.5	16.7	20.8	11.4	14.7	19.0	-16%	-12%	-9%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

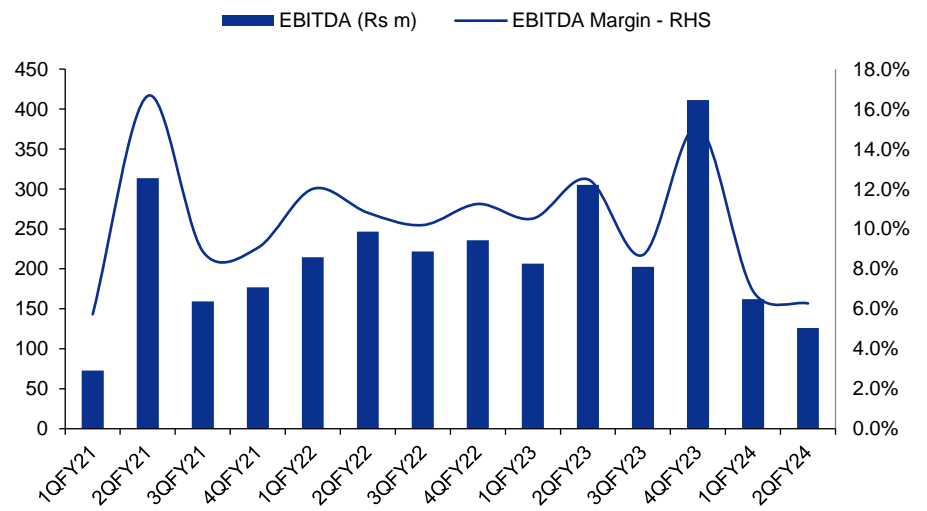
Story in charts

Figure 4: Quarterly revenue trend



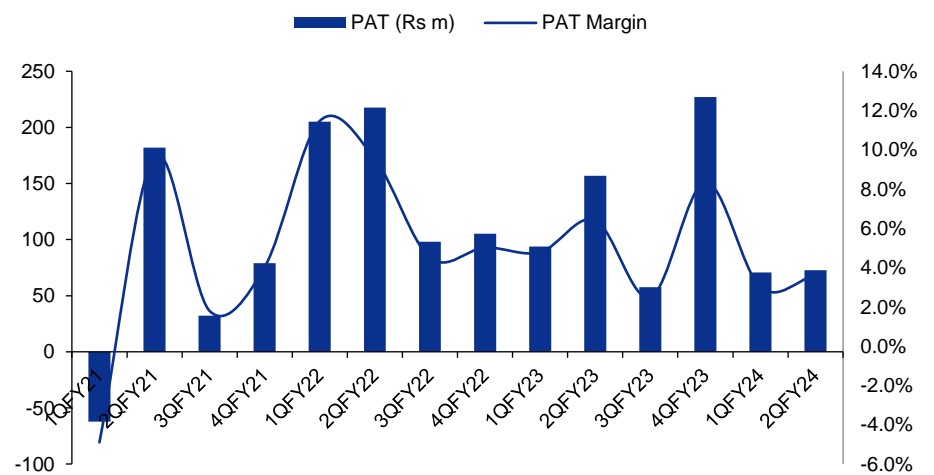
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 5: Quarterly EBITDA trend



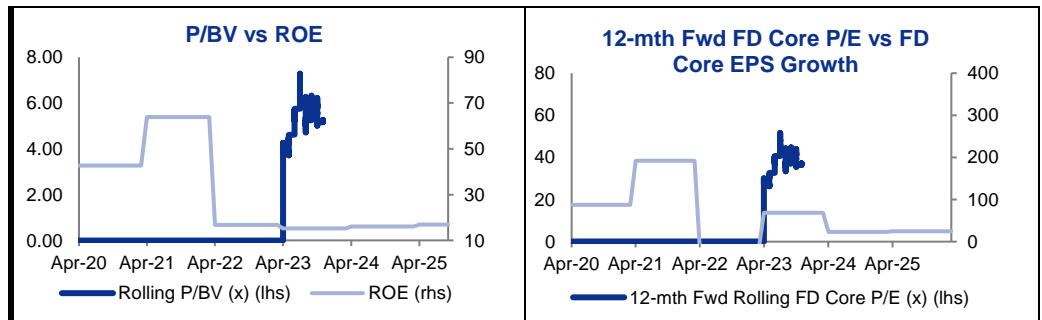
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 6: Quarterly PAT trend



SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS



Profit & Loss

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Net Revenues	8,407	9,447	10,862	12,965	15,930
Gross Profit	2,866	3,380	3,910	4,602	5,576
Operating EBITDA	975	1,128	1,288	1,481	1,856
Depreciation And Amortisation	(180)	(197)	(226)	(260)	(236)
Operating EBIT	795	932	1,062	1,221	1,620
Financial Income/(Expense)	(248)	(348)	(221)	(101)	(89)
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)	109	144	183	206	214
Profit Before Tax (pre-EI)	656	727	1,023	1,326	1,746
Exceptional Items	200				
Pre-tax Profit	856	727	1,023	1,326	1,746
Taxation	(182)	(202)	(281)	(365)	(506)
Exceptional Income - post-tax					
Profit After Tax	675	525	742	961	1,239
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	675	525	742	961	1,239
Recurring Net Profit	517	525	742	961	1,239
Fully Diluted Recurring Net Profit	517	525	742	961	1,239

Cash Flow

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
EBITDA	856	727	1,023	1,326	1,746
Cash Flow from Invt. & Assoc.					
Change In Working Capital	(805)	(1,125)	(342)	(360)	(1,922)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	180	197	226	260	236
Other Operating Cashflow	(158)	13			
Net Interest (Paid)/Received	209	244	221	101	89
Tax Paid	(125)	(189)	(281)	(365)	(506)
Cashflow From Operations	157	(133)	848	963	(358)
Capex	(177)	(273)	(400)	(300)	(280)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/Investments					
Other Investing Cashflow	(6)	2	3	3	3
Cash Flow From Investing	(184)	(271)	(397)	(297)	(277)
Debt Raised/(repaid)	158	128	(2,100)	96	28
Proceeds From Issue Of Shares		798			
Shares Repurchased					
Dividends Paid					
Preferred Dividends					
Other Financing Cashflow	(367)	3,616	(72)	(104)	50
Cash Flow From Financing	(208)	4,542	(2,172)	(7)	78
Total Cash Generated	(235)	4,138	(1,721)	658	(557)
Free Cashflow To Equity	131	(276)	(1,649)	762	(607)
Free Cashflow To Firm	(236)	(648)	229	564	(724)

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS...cont'd

Balance Sheet					
(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Cash And Equivalents	78	4,219	2,498	3,156	2,587
Total Debtors	1,774	2,062	2,346	2,774	4,346
Inventories	2,330	3,179	3,554	4,125	5,674
Total Other Current Assets	298	673	751	816	1,213
Total Current Assets	4,479	10,133	9,149	10,872	13,820
Fixed Assets	913	1,062	1,106	1,146	1,178
Total Investments	53	53	53	53	61
Intangible Assets	6	24	5	5	4
Total Other Non-Current Assets	420	527	527	527	342
Total Non-current Assets	1,391	1,667	1,691	1,731	1,584
Short-term Debt	2,199	2,407	707	777	777
Current Portion of Long-Term Debt					
Total Creditors	1,185	1,418	1,593	1,846	2,513
Other Current Liabilities	595	1,521	1,740	2,192	3,121
Total Current Liabilities	3,979	5,345	4,040	4,816	6,411
Total Long-term Debt	742	656	256	282	310
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	188	302	302	302	241
Total Non-current Liabilities	930	958	558	583	551
Total Provisions	97	130	130	130	130
Total Liabilities	5,006	6,433	4,728	5,529	7,091
Shareholders Equity	887	5,370	6,112	7,073	8,313
Minority Interests					
Total Equity	887	5,370	6,112	7,073	8,313

Key Ratios					
	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Revenue Growth	21.8%	12.4%	15.0%	19.4%	22.9%
Operating EBITDA Growth	47.5%	15.7%	14.1%	15.0%	25.4%
Operating EBITDA Margin	11.6%	11.9%	11.9%	11.4%	11.7%
Net Cash Per Share (Rs)	(43.85)	17.71	23.52	32.12	22.97
BVPS (Rs)	13.58	82.25	93.61	108.33	127.31
Gross Interest Cover	3.20	2.68	4.80	12.08	18.22
Effective Tax Rate	21.2%	27.8%	27.5%	27.5%	29.0%
Net Dividend Payout Ratio					
Accounts Receivables Days	77.99	74.10	74.06	72.07	81.57
Inventory Days	124.75	165.72	176.77	167.59	172.71
Accounts Payables Days	81.00	78.29	79.05	75.06	76.83
ROIC (%)	15.0%	15.2%	16.0%	17.1%	17.0%
ROCE (%)	21.6%	15.2%	13.7%	16.1%	18.5%
Return On Average Assets	12.0%	8.9%	8.0%	8.8%	9.3%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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any other material conflict of interest at the time of publication of the research report or at the time of public appearance	NO	NO
received any compensation from the subject company in the past twelve months for investment banking or merchant banking or brokerage services or investment advisory or depository or distribution from the subject company in the last twelve months for products/services other than investment banking or merchant banking or broker- age services or investment advisory or depository or distribution from the subject company in the last twelve months	NO	NO
managed or co-managed public offering of securities for the subject company in the last twelve months	NO	NO
received any compensation or other benefits from the subject company or third party in connection with the research report	NO	NO
served as an officer, director or employee of the subject company	NO	NO
been engaged in market making activity for the subject company	NO	NO

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