

# Avalon Technologies

Estimate change	↑
TP change	↑
Rating change	↔

**CMP: INR708**      **TP: INR920 (+30%)**      **Buy**

## Recovery in the US business drives operating performance

### Earnings above our estimate

- Avalon Technologies (AVALON) reported a strong quarter, with revenue growing 37% YoY in 2QFY25, led by a healthy recovery in US operations (up 57% YoY) and consistent performance in the Indian business (up 16% YoY). Operating profitability improved (up 470bp) led by a shift in ~45-50% of the US manufacturing operations to India and favorable operating leverage.
- With the beginning of restocking by US customers, incremental order flows from new customers, and the growing Indian business, we expect AVALON to deliver a strong 2HFY25 performance coupled with margin expansion (operating leverage play).
- Factoring in the strong 2Q performance and positive growth outlook, we raise our EPS estimates for FY25/FY26 by 36%/10%. **Reiterate BUY with a TP of INR920 (premised on 35x FY27E EPS).**

### Traction within railways drives the domestic business

- Consolidated revenue grew 37% YoY to INR2.75b, driven by growth in both domestic (up 16% YoY due to traction in the mobility segment driven by the Indian railway) and US (up 57% YoY due to recovery in the market and the shift from destocking to restocking) operations.
- Consolidated EBITDA jumped 2.4x YoY to INR301m. Consolidated EBITDA margin expanded 470bp to 11% (+880bp QoQ) despite the contraction of gross margin by 40bp YoY to 36.8%. Operating leverage played its role with employee expense as % of sales decreasing 570bp YoY to ~17% in 2QFY25, while other expenses as a % of sales increased 60bp YoY to ~9% in 2QFY25. The company reported an Adj. PAT of INR175m, up 2.4x YoY.
- The total orderbook stood at 25.85b with short-term order book (executable within 14 months) at INR14.85b (up 19%/2% YoY/QoQ) and longer executable orderbook (from 14 months up to three years) at INR11b (up 10% YoY).
- Gross debt as of Sep'24 stood at INR1.5b vs. INR1.6b as of Mar'24. Net working capital days decreased to 134 from 161 in Mar'24, primarily led by lower receivable days (down 25 days) and higher payable (up 2 days).
- In 1HFY25, Revenue/EBITDA/Adj. PAT increased 9%/20%/6% YoY at INR4.7b/INR345m/152m. For 2HFY25, implied Revenue/EBITDA/Adj. PAT growth is 41%/2.1x/3.3x YoY, led by strong growth across all verticals, coupled with margin expansion.

### Highlights from the management commentary

- **Guidance:** AVALON has maintained its FY25 revenue growth guidance to 16-20% with gross margins ranging from 33% to 35%. It expects healthy growth to continue in 2HFY25. The US manufacturing mix is expected to come down to ~15% by the end of FY25, resulting in cost benefits and margin expansion.

Bloomberg	AVALON IN
Equity Shares (m)	66
M.Cap.(INRb)/(USDb)	46.7 / 0.6
52-Week Range (INR)	708 / 425
1, 6, 12 Rel. Per (%)	32/29/19
12M Avg Val (INR M)	138

### Financials & Valuations (INR b)

Y/E Mar	FY25E	FY26E	FY27E
Sales	10.8	14.6	19.5
EBITDA	1.0	1.7	2.4
Adj. PAT	0.6	1.1	1.7
EBITDA Margin (%)	9.6	11.5	12.5
Cons. Adj. EPS (INR)	9.2	16.6	26.3
EPS Gr. (%)	115.1	80.7	58.6
BV/Sh. (INR)	92.5	109.0	135.3

### Ratios

	(0.1)	(0.1)	(0.1)
Net D:E			
RoE (%)	10.4	16.4	21.5
RoCE (%)	9.7	15.1	20.2

### Valuations

P/E (x)	77.3	42.7	26.9
EV/EBITDA (x)	44.2	27.3	18.9

### Shareholding Pattern (%)

As on	Sep-24	Jun-24	Sep-23
Promoter	50.7	50.9	51.1
DII	23.7	23.2	16.3
FII	3.0	2.6	9.2
Others	22.6	23.4	23.4

Note: FII includes depository receipts

- **Clean Energy:** AVALON is primarily involved in the clean energy storage EMS business in the US, an industry experiencing a robust growth rate of 60-70%. The management is not expecting any major impact with the new US administration's measures to curb clean energy projects (e.g. slashing IRA incentives)
- **Demand Growth:** US customers are restocking and returning to normalcy, and with the US rate cut cycle underway, demand growth is increasing. In India, the company is experiencing growth in the Mobility (Rail and Air), Communication, and Industrial segments.

#### Valuation and view

- With US operations now witnessing a healthy recovery and the Indian business experiencing growth, we expect AVALON's revenue and profitability to experience healthy improvement from 2HFY25 onwards. We also believe the company's long-term revenue trajectory will continue to be strong, backed by: 1) the addition of new customers in the US and Indian markets and 2) order inflows from high-growth/high-margin industries, such as Clean Energy, Mobility, and Industrials.
- We estimate AVALON to post a CAGR of 31%/57%/83% in revenue/EBITDA/adj. PAT over FY24-FY27 on account of strong growth and healthy order inflows.  
**Reiterate BUY with a TP of INR920 (premised on 35x FY27E EPS).**

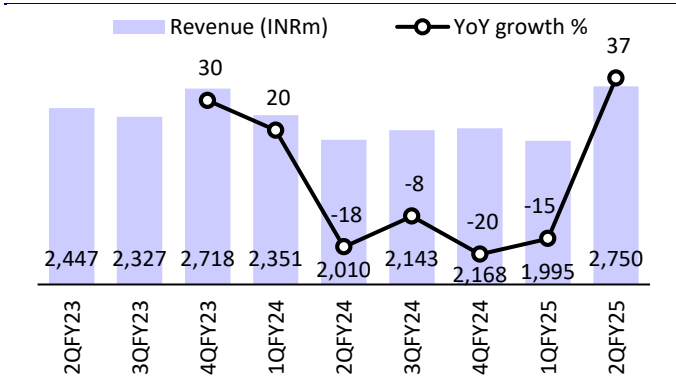
#### Consolidated - Quarterly Earning Model

(INR m)

Y/E March	FY24				FY25E				FY24	FY25E	FY25E	Var. %
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE				
<b>Gross Sales</b>	<b>2,351</b>	<b>2,010</b>	<b>2,143</b>	<b>2,168</b>	<b>1,995</b>	<b>2,750</b>	<b>2,893</b>	<b>3,202</b>	<b>8,672</b>	<b>10,840</b>	<b>2,372</b>	<b>16</b>
YoY Change (%)	19.9	-17.9	-7.9	-20.2	-15.2	36.8	35.0	47.7	-8.2	25.0	18.0	
Total Expenditure	2,189	1,884	1,977	1,996	1,951	2,449	2,566	2,828	8,046	9,794	2,220	
<b>EBITDA</b>	<b>162</b>	<b>126</b>	<b>165</b>	<b>172</b>	<b>44</b>	<b>301</b>	<b>326</b>	<b>375</b>	<b>626</b>	<b>1,046</b>	<b>151</b>	<b>99</b>
Margins (%)	6.9	6.3	7.7	7.9	2.2	11.0	11.3	11.7	7.2	9.6	6.4	
Depreciation	53	55	60	61	66	69	70	73	229	278	68	
Interest	56	32	36	39	42	37	28	25	164	133	35	
Other Income	51	47	22	28	44	39	54	62	148	200	48	
<b>PBT before EO expense</b>	<b>105</b>	<b>86</b>	<b>91</b>	<b>99</b>	<b>-20</b>	<b>234</b>	<b>282</b>	<b>339</b>	<b>381</b>	<b>835</b>	<b>96</b>	
Extra-Ord expense	0	0	0	0	0	0	0	0	0	0	0	
<b>PBT</b>	<b>105</b>	<b>86</b>	<b>91</b>	<b>99</b>	<b>-20</b>	<b>234</b>	<b>282</b>	<b>339</b>	<b>381</b>	<b>835</b>	<b>96</b>	
Tax	34	13	25	29	3	60	78	93	101	233	27	
Rate (%)	32.4	15.2	27.5	29.0	-14.5	25.4	27.5	27.5	26.5	27.9	27.5	
Minority Interest & Profit/Loss of Asso. Cos.	0	0	0	0	0	0	0	0	0	0	0	
<b>Reported PAT</b>	<b>71</b>	<b>73</b>	<b>66</b>	<b>71</b>	<b>-23</b>	<b>175</b>	<b>205</b>	<b>246</b>	<b>280</b>	<b>602</b>	<b>70</b>	
<b>Adj PAT</b>	<b>71</b>	<b>73</b>	<b>66</b>	<b>71</b>	<b>-23</b>	<b>175</b>	<b>205</b>	<b>246</b>	<b>280</b>	<b>602</b>	<b>70</b>	<b>150</b>
YoY Change (%)	-23.9	-50.7	14.7	-68.9	NA	140.1	211.4	247.7	-46.7	115.1	-4.0	
Margins (%)	3.0	3.6	3.1	3.3	-1.2	6.4	7.1	7.7	3.2	5.6	2.9	

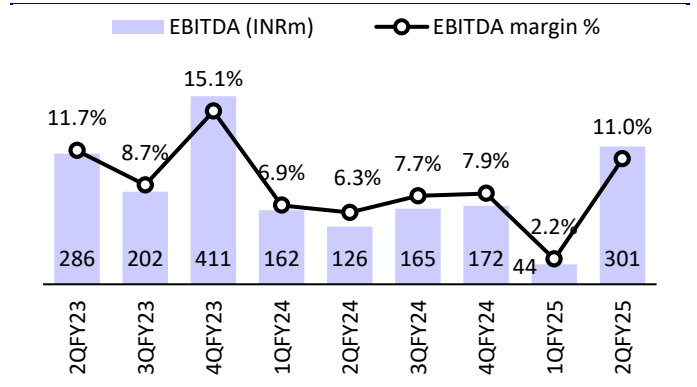
Key exhibits

Exhibit 1: Consolidated revenue trend



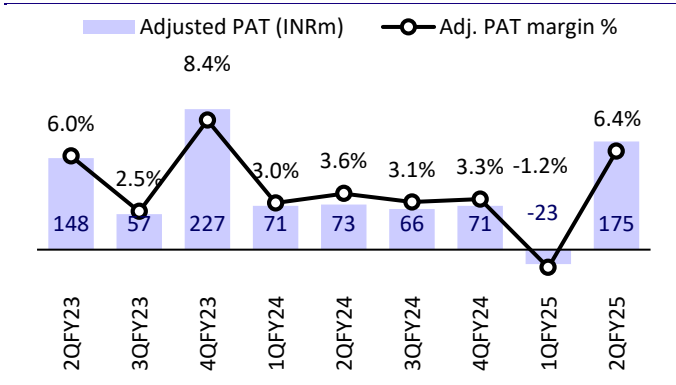
Source: Company, MOFSL

Exhibit 2: Consolidated EBITDA trend



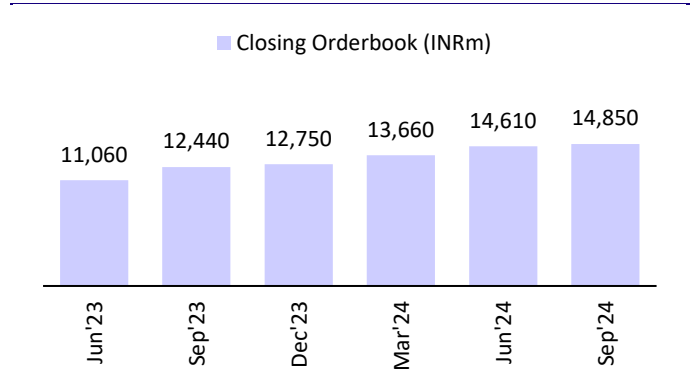
Source: Company, MOFSL

Exhibit 3: Consolidated Adj. PAT trend



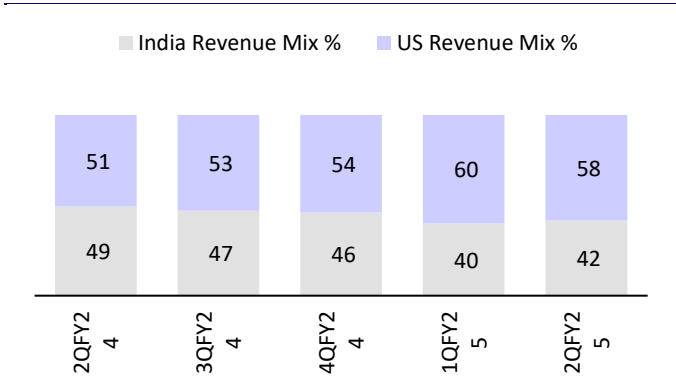
Source: Company, MOFSL

Exhibit 4: Order book trend



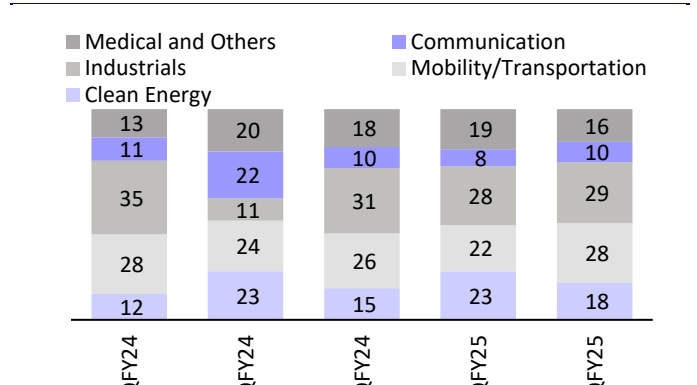
Source: Company, MOFSL

Exhibit 5: Region mix



Source: Company, MOFSL

Exhibit 6: End-user industry mix



Source: Company, MOFSL



## Highlights from the management commentary

### Operating performance

- The company currently operates across 38 manufacturing units in India and the US. Having already shifted approximately 45-50% of its US manufacturing to India, the company plans to reduce its US manufacturing share to around 15% by FY25 while maintaining the current manufacturing mix, with India accounting for 89% of total production.
- Vertical integration and its global presence set the company apart from its competitors.
- Net working capital has improved by 27 days, increasing to 131 days. This is attributed to efficient inventory management, with inventory days decreasing by 25 days and standing at 93 days as of Sep'24
- Revenue in the US business was driven by the recovery of existing customers and the shift from destocking to restocking. Going forward, the continued recovery in the US market is expected to remain a key driver of growth.
- The new plant in Chennai was commissioned during 2QFY25 and is now operational.
- Revenue from India stood at INR1.15b whereas revenue from the US stood at INR1.63b in 2QFY25.
- The Indian manufacturing business posted EBITDA margins of 13.7% and PAT margins of 8.9% in 2QFY25. The company's strategic shift in manufacturing from the US to India is expected to further expand margins going forward.
- The net loss from US manufacturing stood at INR40m in 2QFY25 compared to a loss of INR140m in 1QFY25.

### Guidance

- Going forward, the management expects FY25 gross margins to be in the range of ~33-35%.
- EBITDA margins are expected to start benefiting from operating leverage in 2HFY25.
- Revenue growth is expected to be 16-20% in FY25.
- Profitability growth is expected to outgrow revenue growth.

### Order book

- The order book grew 19% YoY to INR14.85b in 2QFY25.
- Out of the current order book, ~INR11b is for long-term contracts (up 10.2% YoY) that are executable over 14 months to three years.
- The company is on the verge of securing several key contracts, which are expected to significantly contribute to its order inflow.

### Capex

- The company incurred a capex of INR215m in 1HFY25 and INR123m in 2QFY25.
- The company plans to incur a capex of ~INR400-INR450m p.a. for the next two years.
- The utilization level currently stands at ~65-70% on a two-shift basis.

### Others

- The company is focused on the clean energy storage EMS business, which is growing at a rate of 60-70%. It expects no disruption in this growth despite the formation of a new government in the US.

- Going forward, the clean energy segment is expected to account for around 20-25% of the company's portfolio as it aims to maintain a balanced mix across all its business segments.
- There is a significant growth opportunity starting from FY26, driven by new customer orders.
- The company is witnessing growing traction in its mobility division, driven by the Indian Railways. The "Kavach" system is expected to begin making a significant impact starting from the next quarter. Additionally, the company has signed 10-15 year contracts in the aerospace segment, with production set to begin in 3QFY25.
- Existing customers are expected to drive growth in the medical segment going forward.
- In India, the company is experiencing growth across the Mobility (Rail and Air), Communication, and Industrial segments.
- The company has approximately 45-50% of its expenses, before EBITDA and post-gross margins, classified as fixed costs.
- In high-performance computing, the company continues to make progress in its ongoing work and is actively engaged in several additional programs.

#### Valuation and view

- With US operations now witnessing a healthy recovery and the Indian business experiencing growth, we believe AVALON's revenue and profitability will see healthy improvement from 2HFY25 onwards. We also believe the company's long-term revenue trajectory will continue to be strong, backed by: 1) the addition of new customers in the US and Indian markets and 2) order inflows from high-growth/high-margin industries, such as Clean Energy, Mobility, and Industrials.
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**Reiterate BUY with a TP of INR920 (premised on 35x FY27E EPS).**

#### Exhibit 7: Changes to our estimates

Earnings change (INR m)	Old		New		Change	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Revenue	10,462	14,124	10,840	14,634	4%	4%
EBITDA	821	1,554	1,046	1,683	27%	8%
Adj. PAT	443	989	602	1,088	36%	10%

## Financials and valuations

Consolidated - Income Statement								(INRm)
Y/E March	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
<b>Total Income from Operations</b>	<b>6,419</b>	<b>6,905</b>	<b>8,407</b>	<b>9,447</b>	<b>8,672</b>	<b>10,840</b>	<b>14,634</b>	<b>19,463</b>
Change (%)	NA	7.6	21.8	12.4	-8.2	25.0	35.0	33.0
RM Cost	4,128	4,574	5,552	6,067	5,545	7,032	9,292	12,398
Employees Cost	1,162	1,192	1,314	1,605	1,815	1,887	2,561	3,309
Other Expenses	484	478	566	647	685	875	1,098	1,323
<b>Total Expenditure</b>	<b>5,774</b>	<b>6,243</b>	<b>7,432</b>	<b>8,319</b>	<b>8,046</b>	<b>9,794</b>	<b>12,951</b>	<b>17,030</b>
% of Sales	90.0	90.4	88.4	88.1	92.8	90.4	88.5	87.5
<b>EBITDA</b>	<b>645</b>	<b>662</b>	<b>975</b>	<b>1,128</b>	<b>626</b>	<b>1,046</b>	<b>1,683</b>	<b>2,433</b>
Margin (%)	10.0	9.6	11.6	11.9	7.2	9.6	11.5	12.5
Depreciation	155	158	172	197	229	278	319	359
<b>EBIT</b>	<b>490</b>	<b>504</b>	<b>803</b>	<b>931</b>	<b>397</b>	<b>768</b>	<b>1,364</b>	<b>2,074</b>
Int. and Finance Charges	450	270	248	348	164	133	75	59
Other Income	113	54	309	144	148	200	212	292
<b>PBT bef. EO Exp.</b>	<b>153</b>	<b>288</b>	<b>864</b>	<b>727</b>	<b>381</b>	<b>835</b>	<b>1,501</b>	<b>2,307</b>
EO Items	0	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>381</b>	<b>835</b>	<b>1,501</b>	<b>2,307</b>
Total Tax	30	58	183	202	101	233	413	581
Tax Rate (%)	19.4	19.9	21.1	27.8	26.5	27.9	27.5	25.2
Minority Interest	8	16	50	0	0	0	0	0
<b>Reported PAT</b>	<b>115</b>	<b>215</b>	<b>632</b>	<b>525</b>	<b>280</b>	<b>602</b>	<b>1,088</b>	<b>1,726</b>
<b>Adjusted PAT</b>	<b>115</b>	<b>215</b>	<b>632</b>	<b>525</b>	<b>280</b>	<b>602</b>	<b>1,088</b>	<b>1,726</b>
Change (%)	NA	86.1	193.9	-16.9	-46.7	115.1	80.7	58.6
Margin (%)	1.8	3.1	7.5	5.6	3.2	5.6	7.4	8.9

Consolidated - Balance Sheet								(INRm)
Y/E March	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Equity Share Capital	15	16	16	116	131	131	131	131
Preference Capital	356	388	388	0	0	0	0	0
Total Reserves	450	584	856	5,254	5,342	5,944	7,032	8,759
<b>Net Worth</b>	<b>822</b>	<b>988</b>	<b>1,260</b>	<b>5,370</b>	<b>5,473</b>	<b>6,075</b>	<b>7,164</b>	<b>8,890</b>
Minority Interest	-431	-317	0	0	0	0	0	0
Total Loans	2,388	2,775	2,789	3,063	1,642	1,142	742	742
Deferred Tax Liabilities	-263	0	0	0	15	15	15	15
<b>Capital Employed</b>	<b>2,515</b>	<b>3,445</b>	<b>4,049</b>	<b>8,433</b>	<b>7,129</b>	<b>7,232</b>	<b>7,920</b>	<b>9,646</b>
Gross Block	1,126	1,335	1,512	1,861	2,285	2,642	3,033	3,432
Less: Accum. Deprn.	139	295	390	586	815	1,093	1,412	1,770
<b>Net Fixed Assets</b>	<b>987</b>	<b>1,041</b>	<b>1,123</b>	<b>1,275</b>	<b>1,470</b>	<b>1,549</b>	<b>1,622</b>	<b>1,662</b>
Goodwill on Consolidation	0	0	0	0	0	0	0	0
Capital WIP	27	0	20	153	196	239	248	250
<b>Total Investments</b>	<b>24</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>755</b>	<b>755</b>	<b>755</b>	<b>755</b>
Current Investments	0	0	0	0	755	755	755	755
<b>Curr. Assets, Loans&amp;Adv.</b>	<b>3,197</b>	<b>4,084</b>	<b>4,738</b>	<b>10,375</b>	<b>6,886</b>	<b>7,499</b>	<b>8,726</b>	<b>11,357</b>
Inventory	1,553	1,458	2,330	3,179	3,163	3,564	4,201	5,605
Account Receivables	1,138	1,819	1,774	2,062	1,869	2,376	3,007	3,999
Cash and Bank Balance	266	335	101	4,222	1,065	692	494	585
Loans and Advances	241	472	532	912	789	867	1,024	1,168
<b>Curr. Liability &amp; Prov.</b>	<b>1,719</b>	<b>1,680</b>	<b>1,831</b>	<b>3,370</b>	<b>2,178</b>	<b>2,811</b>	<b>3,431</b>	<b>4,377</b>
Account Payables	1,369	1,289	1,242	1,418	974	1,445	1,909	2,548
Other Current Liabilities	216	253	449	1,823	1,048	1,192	1,317	1,557
Provisions	134	138	141	130	156	173	205	272
<b>Net Current Assets</b>	<b>1,478</b>	<b>2,404</b>	<b>2,906</b>	<b>7,005</b>	<b>4,708</b>	<b>4,688</b>	<b>5,295</b>	<b>6,980</b>
Misc Expenditure	0	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>7,129</b>	<b>7,232</b>	<b>7,920</b>	<b>9,646</b>

## Financials and valuations

### Ratios

Y/E March	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
<b>Basic (INR)</b>								
<b>EPS</b>	<b>2.0</b>	<b>3.7</b>	<b>10.9</b>	<b>9.1</b>	<b>4.3</b>	<b>9.2</b>	<b>16.6</b>	<b>26.3</b>
Cash EPS	4.7	6.4	13.9	12.5	7.7	13.4	21.4	31.7
BV/Share	14.2	17.0	21.7	92.7	83.3	92.5	109.0	135.3
DPS	0.0	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	0.0
<b>Valuation (x)</b>								
P/E	355.2	190.9	65.0	78.1	166.2	77.3	42.7	26.9
Cash P/E	151.6	110.2	51.1	56.9	91.4	52.9	33.1	22.3
P/BV	49.9	41.5	32.6	7.6	8.5	7.7	6.5	5.2
EV/Sales	6.7	6.2	5.2	4.2	5.3	4.3	3.1	2.4
EV/EBITDA	66.2	65.2	44.8	35.3	74.1	44.2	27.3	18.9
Dividend Yield (%)	0.0	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	-2.8	0.9	1.0	-2.2
<b>Return Ratios (%)</b>								
RoE	14.1	23.8	56.2	15.8	5.2	10.4	16.4	21.5
RoCE	15.1	12.8	22.5	12.4	5.2	9.7	15.1	20.2
RoIC	21.4	17.7	20.2	17.7	6.4	10.4	16.5	21.4
<b>Working Capital Ratios</b>								
Fixed Asset Turnover (x)	5.7	5.6	5.9	5.6	4.2	4.4	5.2	6.0
Asset Turnover (x)	1.5	1.3	1.4	0.8	0.9	1.1	1.3	1.4
Inventory (Days)	98	120	125	166	209	185	165	165
Debtor (Days)	65	78	78	74	83	80	75	75
Creditor (Days)	87	106	83	80	79	75	75	75
<b>Leverage Ratio (x)</b>								
Current Ratio	1.9	2.4	2.6	3.1	3.2	2.7	2.5	2.6
Interest Cover Ratio	1.1	1.9	3.2	2.7	2.4	5.8	18.1	35.0
Net Debt/Equity	2.6	2.5	2.1	-0.2	0.0	-0.1	-0.1	-0.1

### Consolidated - Cash Flow Statement

(INRm)

Y/E March	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
OP/(Loss) before Tax	153	288	856	727	381	835	1,501	2,307
Depreciation	155	158	180	197	229	278	319	359
Interest & Finance Charges	434	222	209	244	113	-67	-137	-233
Direct Taxes Paid	-47	-35	-125	-189	-164	-233	-413	-581
(Inc)/Dec in WC	-121	-561	-805	-1,125	-414	-354	-804	-1,594
<b>CF from Operations</b>	<b>574</b>	<b>72</b>	<b>315</b>	<b>-147</b>	<b>145</b>	<b>459</b>	<b>466</b>	<b>258</b>
Others	83	-17	-158	13	28	0	0	0
<b>CF from Operating incl EO</b>	<b>657</b>	<b>55</b>	<b>157</b>	<b>-133</b>	<b>173</b>	<b>459</b>	<b>466</b>	<b>258</b>
(Inc)/Dec in FA	-170	-192	-177	-273	-355	-400	-400	-400
<b>Free Cash Flow</b>	<b>487</b>	<b>-137</b>	<b>-21</b>	<b>-406</b>	<b>-182</b>	<b>59</b>	<b>66</b>	<b>-142</b>
(Pur)/Sale of Investments	-24	29	0	0	-1,121	0	0	0
Others	2	-104	-6	2	15	200	212	292
<b>CF from Investments</b>	<b>-192</b>	<b>-267</b>	<b>-184</b>	<b>-271</b>	<b>-1,461</b>	<b>-200</b>	<b>-188</b>	<b>-108</b>
Issue of Shares	0	73	0	798	8	0	0	0
Inc/(Dec) in Debt	-296	461	158	128	-1,580	-500	-400	0
Interest Paid	-426	-217	-189	-283	-88	-133	-75	-59
Dividend Paid	-4	-37	-38	-37	-41	0	0	0
Others	302	22	-138	3,915	-807	0	0	0
<b>CF from Fin. Activity</b>	<b>-424</b>	<b>301</b>	<b>-207</b>	<b>4,522</b>	<b>-2,508</b>	<b>-633</b>	<b>-475</b>	<b>-59</b>
<b>Inc/Dec of Cash</b>	<b>42</b>	<b>89</b>	<b>-234</b>	<b>4,118</b>	<b>-3,796</b>	<b>-374</b>	<b>-197</b>	<b>91</b>
Opening Balance	204	246	335	101	4,219	1,065	692	494
Other cash & cash equivalent	20	0	0	3	643	0	0	0
<b>Closing Balance</b>	<b>266</b>	<b>335</b>	<b>101</b>	<b>4,222</b>	<b>1,065</b>	<b>692</b>	<b>494</b>	<b>585</b>

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NOTES



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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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