"Avalon Technologies Limited
Q2 FY25 Earnings Conference Call"

November 07, 2024

MANAGEMENT: **MR. KUNHAMED BICHA – CHAIRMAN AND MANAGING DIRECTOR – AVALON TECHNOLOGIES LIMITED**
MR. BHASKAR SRINIVASAN – PRESIDENT – AVALON TECHNOLOGIES LIMITED
MR. R. M. SUBRAMANIAN – OUTGOING CHIEF FINANCIAL OFFICER – AVALON TECHNOLOGIES LIMITED
MR. SHRIRAM VIJAYARAGHAVAN –GROUP CHIEF OPERATING OFFICER – AVALON TECHNOLOGIES LIMITED
MR. VENKY VENKATESH – GROUP CHIEF SALES OFFICER – AVALON TECHNOLOGIES LIMITED
MR. MICHAEL ROBINSON – CHIEF OPERATING OFFICER, US – AVALON TECHNOLOGIES LIMITED
MR. SURESH VR – INCOMING CHIEF FINANCIAL OFFICER – AVALON TECHNOLOGIES LIMITED

MODERATOR: **MS. BHOOMIKA NAIR– DAM CAPITAL**

Moderator: Ladies and gentlemen, good day and welcome to the Avalon Technologies Ltd Q2 FY25 earnings conference call hosted by DAM Capital Advisors. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star then zero on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Ms. Bhoomika Nair from DAM Capital. Thank you and over to you, ma'am.

Bhoomika Nair: Thanks, Dell. Good afternoon, everyone and a warm welcome to the Q2 FY25 earnings call of Avalon Technologies. To take us through the results today, we have with us from the management, Mr. Kunhamed Bicha, Chairman and Managing Director, Mr. Bhaskar Srinivasan, President, Mr. R. M. Subramanian, Outgoing Chief Financial Officer, Mr. Shriram Vijayaraghavan, Group Chief Operating Officer, Mr. Venky Venkatesh, Group Chief Sales Officer, Mr. Michael Robinson, Chief Operating Officer for US Operations, and Mr. Suresh V. R., Incoming Chief Financial Officer.

Mr. Bicha will give an overview of the business performance and will be followed up by Mr. Suresh's remarks on the financial performance, post which we'll open up the floor for Q&A. As we move forward, it is important to bear in mind that any forward-looking statements made during this call are subject to potential risks and uncertainties, both known and unknown. Now, without any further delay, I'll hand over the floor to Mr. Bicha for his initial remarks, the CMD. Thank you, and over to you, sir.

Kunhamed Bicha: Thank you, Bhoomika. Ladies and gentlemen, on behalf of Avalon Technologies, I extend a very warm welcome to our Q2 FY25 earnings call. I will quickly introduce Avalon Technologies, especially for the ones who are joining us for the first time. Avalon Technologies established itself as a key player in electronics manufacturing services with a global reach.

We take pride in our leadership in high-mix, flexible-volume manufacturing. Serving a diverse range of industrial verticals, especially in mission-critical integrated solutions that require significant engineering expertise. We currently operate across 13 manufacturing facilities in India and the United States. We are also adding a new manufacturing facility in India.

Our three key differentiators are 1. Vertical integration - we offer a complete box-built solution, right from PCB design, new product development to final product manufacturing. 2. Global presence, both in terms of manufacturing presence and customer base. 3. Optimal mix of established industries like industrial, rail, aerospace, medical, communications and emerging industries.

Now turning to our business performance, we are pleased to share that our anticipated growth has begun to take shape, setting the stage for the decadal growth ahead. Our confidence in this year's growth potential continues to be strong. The gradual recovery of our US customers and the momentum we are gaining in India are the key drivers. Aligning with what we discussed in previous calls, key performance in this quarter includes our improved profitability, driving operating leverage, improved networking capital gains, and a growing order book. This provides visibility along with new business reach across industry verticals.

During Q2 FY25, our revenues grew by 36.8% year-over-year. Gross margins improved from 33% in Q1 to 37% in Q2, driven by better product mix. We expect the full year gross margins will continue to be between 33% and 35%, considering the expected revenue growth in the second half. As we had anticipated, the benefits of operating leverage are now visible, with EBITDA margins rising to 11%, and absolute EBITDA growing by 140% year-over-year, our PAT is at INR17.5 crores, reflecting a 140% year-over-year increase, with the PAT margin of 6.3% in Q2.

Regarding net working capital, we had previously targeted to improve by at least 10-15 days by March 2025. We are pleased to report that our networking capital has improved from 161 days in March 2024 to 134 days in September 2024, a reduction of 27 days, primarily due to better inventory management. Our order book grew by 19.4% year-over-year, reaching INR1,485 crores as of September 30, 2024, with an average execution period of 14 months. Additionally, our long-term contracts, which extend beyond 14 months and span an average execution period of 2-3 years, increased by 10.2% year-over-year to INR 1,100 crores.

In our earlier communications, we highlighted the cost optimization measures as we are implementing to address the short-term challenges in our US. manufacturing business. First, by optimizing production allocation and shifting about 45%-50% of existing US production to our India plant. The revenue share from our US manufacturing plant decreased 11% in Q2 FY25, down from 27% in Q1 FY24. We anticipate that US manufacturing production will be around 15% for FY25.

Second, rationalizing costs with our US operation, we have made meaningful progress on this front. As a result, manufacturing at our US plant, which now accounts for 11% of our revenue, reported a net loss of approximately INR4 crores, an improvement from the INR14 crores loss reported in Q1 FY25. Meanwhile, manufacturing at an India plant, which serves both domestic and global customers and represents 89% of our business in Q2 FY25, remains highly profitable with an EBITDA margin of 13.7% and a PAT margin of 8.7% in Q2 FY25.

We had earlier highlighted our three engines of growth, existing US business, new US business, and growing Indian business. The recovery of our existing US customer base, shifting from destocking to restocking at varying rates, underscores the strength of our long-standing customer relationships. Additionally, our recent wins in industrial, clean energy, and auto sectors with leading US companies are advancing from design and prototype phase to commercial and ramp-up production in the coming periods.

In the fast-growing Indian market, our increased focus over the last one to two years has led to key wins in industrial, rail, aero and communications sectors, which we believe will advance to commercial production over the course of the next few quarters. We are encouraged by the traction across all three growth engines which sustains our confidence in guiding to 16% to 20% revenue growth for FY25.

Turning to key deal wins, we continue to see strong traction across multiple sectors in both India and the US. Notably, we secured new businesses in our railway vertical from a global leader and a Box-build contract from a major industrial customer. We are also making strides into aerospace and communications with new orders. Overall, the momentum in new wins and expanding opportunities strengthens our confidence in achieving sustained growth.

On the infrastructure front, we are pleased to report that our new plant in Chennai dedicated to export operations is now complete and has begun production. Additionally, Phase 1 of our brownfield expansion in Chennai, aimed at meeting growing domestic demand is finished, and Phase two is expected to start the second half of FY25 as planned. This puts us in a strong position to handle the increased demand anticipated in the coming period.

With the expected revenue growth in the coming years combined with our established team and infrastructure in place, operating leverage will be a key advantage. Our profit growth is expected to outpace our revenue growth due to the following reasons.

We maintain industry-leading gross margins and we expect to sustain these margins depending on product mix and ramp-up. Most of our costs aside from material expenses are fixed, which drives operating leverage as revenue scales. Our strong focus on improving working capital will allow us to release additional cash, further supporting growth and profitability.

I would like to take a moment to announce a management change. Mr. RM Subramanian, our beloved CFO, is pursuing a new career opportunity outside our company. We thank him for his valuable contributions over the last five-and-a-half years and wish him the very best in his future endeavours.

We are also pleased to welcome Mr. Suresh Veerappan as our group CFO, a Chartered Accountant with an MBA from ISB. He has been with Avalon for about two-and-a-half years and has previously worked with organisations such as Grant Thornton, State Bank of India, Bank of America and The Tattva Group. During his time at Avalon, he has played a key role in leading our business finance and investor relations functions.

In summary, we are seeing strong signs of growth, which we expect to sustain and accelerate through the second half. I would like to thank each of you for being a part of our journey. FY25 will be a pivotal year for us and we look forward to sharing this path with you. We are preparing our organisation for sustained growth in the coming years. Avalon remains committed to building a business focused on long-term profitable growth rather than short-term gains.

With that, I would like to hand over the call to our CFO, Suresh Veerappan, for a detailed overview of our financial performance. Thank you.

Suresh Veerappan: Thank you, KB, and good afternoon, everybody. Thank you for joining the call today. Before we delve into the financial performance, I want to take a moment to thank Mr. R.M. Subramanian for his valuable contributions as CFO. Working alongside him over the last two and a half years has been a great experience. I also extend my gratitude to the Avalon board for their trust in me as I take on this responsibility. I am committed to upholding our high standards and building on the progress we have achieved.

This is an exciting time to step into this role, particularly with the growth momentum we are gaining now. I am eager to contribute to the next phase of our growth journey. Looking ahead, my focus will be on driving efficiency, profitable growth, and optimising capital, and using it to drive shareholder value. I am dedicated to maintaining the financial discipline and transparency our investors expect, and I look forward to maintaining an open dialogue as we move forward together.

Turning to our Q2 FY25 performance. We recorded revenues of INR275 crores, which marks our highest quarterly revenue. This reflects a 37% year-over-year increase from INR201 crores in Q2 FY24, and a 38% sequential growth from INR199 crores in Q1 FY25. This growth is supported by gradual recovery among our US customers and steady momentum with our Indian customers.

Our geographical revenue split for the quarter was 41:59, with India contributing INR113 crores and US, INR163 crores. Our gross profit for Q2 FY25 reached INR101.3 crores, a 36% year-over-year increase from INR74.5 crores in Q2 FY24, with a gross margin of 36.8%., slightly down by 0.21% from 37.1% in the same period last year. We continue to deliver industry-leading gross margins.

EBITDA for Q2 FY25 was INR30.1 crores, a 140% increase from INR12.5 crores in Q2 FY24, resulting in an EBITDA margin of 11%, up 470 basis points from 6.3% in Q2 FY24. PAT rose to INR17.5 crores, a 140% year-over-year increase from INR7.3 crores, with a PAT margin of 6.3%, up 273 basis points from 3.5% in Q2 FY24. The revenue growth has driven operating leverage, with profit growth outpacing revenue growth. For H1 FY25, our revenue stands at INR474.5 crores, with gross profit of INR167.6 crores at a margin of 35.3%, EBITDA of INR34.5 crores at 7.3%, and PAT of INR15.2 crores at 3.1%.

Moving on to the balance sheet, net working capital days improved significantly from 161 days in March 2024 to 134 days in September 2024, a 27-day reduction largely driven by better inventory management. Previously, we had set a target to reduce net working capital days by 10 to 15 days by March 25. Net inventory days improved from 118 in March 2024 to 93 in September 24. Trade receivable days were stable, moving slightly from 79 days in March 2024 to 80 days in September 2024, while trade payable days increased modestly from 36 days to 38 days over the same period.

With a 38% revenue increase from Q1 FY25 to Q2 FY25, receivables rose from INR170 crores on June 30 to INR241 crores on September 30, resulting in negative cash flow from operations of INR minus 17.2 crores in Q2 FY25. However, for H1 FY25, our cash flow from operations remained positive at INR18.7 crores.

As of September 30, our total outstanding debt stands at INR158.8 crores, with cash equivalents and investments at INR188.4 crores, resulting in a net cash position of INR29.6 crores. Our total capex for Q2 FY25 and H1 FY25 was INR12.5 crores and INR21.5 crores, respectively. With a capex-like model, our asset terms are strong at 8.4X.

To summarize, our anticipated growth is beginning to take shape with steady momentum across both our US and Indian customers, reinforcing our confidence in achieving the FY25 revenue growth target of 16% to 20%.

Key highlights this quarter include operating leverage driving improved profitability, reduced networking capital days, and a growing order book. We believe this year marks a pivotal point for our business, setting a strong foundation to capture long-term growth opportunities. Thank you. Over to the moderator for Q&A.

Moderator: Thank you. We will now begin the question-and-answer session. The first question is from the line of Dhananjai Bagrodia from ASK Investment Managers. Please go ahead.

Dhananjai Bagrodia: Congratulations on this fantastic result. Now that we've overcome the issues which were plaguing us earlier, how should one look at maybe now on the balance sheet side? How do we see return ratios now going ahead? What more levers do we have in terms of maybe increasing our ROCE to high double digits? How should we look at that?

Kunhamed Bicha: Historically, ROCEs have been north of 20%. We intend to get there fairly soon.

Suresh Veerappan: Like you rightly pointed out, we have started seeing our growth. With the growth and operating leverage coming into play, we should start seeing our ROCE's going back to our historical level. It should be significantly higher from what we are seeing today.

Dhananjai Bagrodia: But which lever do we see in this scope? Do we see asset terms improving, working capital reducing, or margin increase for the ROCE's to go higher?

Suresh Veerappan: On both the aspects, the asset turn is also going to help. We have started seeing some improvement in working capital days also. And with the margin improvement coming through, we should start seeing those results come into picture.

Dhananjai Bagrodia: So what can we get our working capital to? Because some of the Indian players now have reached 60 to 70 days in working capital. Is that something we could reach?

Kunhamed Bicha: Historically, we have been not at 60 to 70 days, but around 90 days. Our intention is to go towards that direction. It will take some time to get there. But we intend to go there.

Dhananjai Bagrodia: Okay. This could be in our favour that we actually have facilities in America. And if tariffs or something do come along, would we stand to benefit significantly as being a player in America?

Kunhamed Bicha: So the way we look at it is that, of course, we need the US to be a beachhead. We need customers to be comfortable to start making products there, and we can then move them to India. We are seeing a lot of that happen now. Because a lot of our business comes from the US or other countries, but built in India. So, if there are certain businesses which cannot be moved outside the country, we stand to gain from that. And if the new administration decides to do more in the

US, we are happy. The customers ultimately will make the choice at two different price levels, one at a higher cost in the US. So customers have both solutions today. So it's a choice that they can make. And we are the only one positioned to do this in the Indian market today.

Dhananjai Bagrodia: Okay. And lastly, sir, how do we see our capex intensity over the next couple of years?

Kunhamed Bicha: We have historically said that we will do INR40 crores to INR45 crores a year because we operate a satellite model. And for the foreseeable couple of years, we see that remaining so.

Dhananjai Bagrodia: Okay. Fantastic, sir. Thank you.

Moderator: The next question is from the line of Deepak Krishnan from Kotak Institutional Equities. Please go ahead.

Deepak Krishnan: So I just wanted to sort of understand on the clean energy bit. You know, we've seen a sharp recovery. This is where we see a big delta coming through. But, you know, there are murmurs of how much the IRA would be kept in the potential reversal of a lot of policies in the US. Historically, we have indicated that clean energy can be as high as about 35% of the top line.

So just wanted to understand the outlook in terms of how are you seeing this clean energy recovery? How sustainable is it? Is there a big risk from a medium-term perspective that - if these benefits are rolled off - then our green energy customers or our home electrification customers' business is less liable?

And similarly, I think you had already alluded to this with respect to US - I just wanted to understand that if more manufacturing goes there, do we benefit? Because we're still reporting losses at a pretty healthy revenue base. So how do we look at US operations with potential near shoring that is going to happen?

Kunhamed Bicha: Deepak, I'll try to answer. If I missed any question, please let me know. The first part of your question was on the clean energy. So in today's quarterly result, there's not much of clean energy. It is standard. A lot of our clean energy growth is yet to come, and it will come in the later quarters.

And on your second part of the question was that with the IRA and the new administration, what's going to happen? So, we in the clean energy side, we are working on the storage side, which is growing at 60% to 70% percent. It's not solar or anything that way. It is storage, which is growing and which is a requirement. So tomorrow, even if the IRA bit is not there, the customer has a choice. He's paying a lot more to make it in the US. It's an easy switch for him to make in India. That is what we offer today. So he is protected either way. If he needs the benefits of the IRA, it's going to be in the US. If he needs the cost-effective version of this product coming out of India, without the IRA, we can do that also. So that way, we are covered on both sides. The answer to the third part of the question, I don't know if I missed it.

Deepak Krishnan: I just want to understand now if we are near-shoring, what level of revenue growth or numbers do we require for US to break even?

Kunhamed Bicha: So, we're seeing a transition now. So, what we have done is around 45% to 50% of the products - which is produced in the US in the last 6 to 9 months, with customer approvals - have been slowly and surely got transferred to India. You will see a lot of that happen. The only thing we intend to keep there are products which need to be built in the US and the customer can pay a higher cost for doing that. Like how we have a Make in India initiative, certain products, they don't move out of the US.

So the options are open, and the rationalization of costs is still going on, because some of the transfer is complete, some of that is work in progress. But we anticipate a lot of US business hopefully coming in with what's happening now. So, though we are at 11% now on US manufacturing, we think this year we'll do around 15% as US manufacturing.

Deepak Krishnan: Sure, maybe just one follow-up. I just wanted to look at the revenue guidance. Even if I take the higher end of 20%, that implies about a INR280 crores quarter run rate for the second half. And slight dip in gross margins. So, the EBITDA margin will be in the range of 8% to 9% for H2. Are you going to be conservative in terms of revenue guidance, given the strong performance and the anticipated recovery? Is there a possibility that we could do much better than what we are sort of guiding?

Kunhamed Bicha: We're just coming through a tough period, if you remember. This time last year, a little earlier than this, is when we saw the de-stocking happen. It was across the board with 4 or 5 industries. We came out to the market and said, we are seeing this with customers. But we're seeing the opposite effect of that now. Customers have come at various levels back to us. And we shouldn't forget, we have new customers too, which are kicking in and cutting in at different levels.

Deepak Krishnan: Maybe just a follow-up, if you could highlight what level of restocking are we on an overall basis? And when do we get back to 100% or are we already there?

Kunhamed Bicha: Some of it, we are more than 100%. Some of them, we are still coming back. At varying levels, we can't say. But at an overall scale, if you look at it, US growth has been 59%, on a year-on-year basis since the last quarter.

Deepak Krishnan: Sure, sir. Those are my questions. Best of luck for future quarters.

Moderator: The next question is from the line of Meet Jain from Motilal Oswal Financial Services. Please go ahead.

Meet Jain: Congratulations on a very successful set of numbers. First question is regarding the clean energy in the US operation. So, as the earlier participant also highlighted, there will be a sudden backlash on the clean energy projects in the US market. And, as you know, we have our clients into solar panels and everything. So, how much percent of that will be impacted? Have you done rough estimates? What kind of impact it will be apart from any other business?

Kunhamed Bicha: Thank you, Meet. A lot of our growth last quarter is in spite of the clean energy business. And just to let you know, the clean energy business, we are not doing solar panels. We are not doing inverters. We are doing storage or home electrification systems where they store energy. That is growing at 60%-70% year-over-year in the US. So, we are in the growth. And that part is not even relative numbers are not played out yet. It's going to play out in the future.

Meet Jain: Understood. My next question is on our full year guidance. So, we are estimating around 16%-20% kind of growth. And seeing the current trajectory and the recovery. I don't understand the key. What are we seeing? As you also mentioned that there is some restocking happening and there is still restocking pending. But, this quarter being a recovery, can we see a strong growth going ahead and touch a higher number?

Kunhamed Bicha: We are positive about growth. You know, looking at the mid-term, long-term, absolutely. There is no reason why we should doubt it. But, we are just coming out of a period which is a slowdown. So, we will have sustained growth in the next few quarters for sure. Looking forward, we are confident. We are just waiting for the new customers to cut in. Again, they are at different levels today. They should start showing in part of Q4 and some in Q1 which will give us very consistent good growth in 2025.

Meet Jain: Okay. And the last question is on this manufacturing shift to India. As this quarter we indicated, our Indian manufacturing is almost 89%. So, will this increase further in India? Because, when we see our employee cost as a percentage of sales, it has gained almost 5.7%. So what will be the apt level going ahead with this kind of manufacturing?

Suresh Veerappan: So, right now, what we see is the mix in revenue between our India plants and US plants, like you rightly said, this is 89% and 11%. Can you repeat the question, please?

Kunhamed Bicha: So, that will sustain as our top line goes up. You will see that number come down. Like we said, our operating leverage is going to play out. A lot of our costs are fixed in nature.

Meet Jain: So, on this, are we going to further shift our manufacturing? And what will be the ideal ratio? As you mentioned, 15% of manufacturing will be there by end of FY25. Will this be sustainable going ahead? And if yes, what will be the employee expense ratio as a percentage of sales? Because, when we compare this to domestic peers, they are in the range of 8-9%. And currently, after shifting a majority of our manufacturing to India, we are at 17%. So, how much closer we can get to that?

Suresh Veerappan: So, first of all, today what you see is 89-11. I think on a full year basis, we see it to be at around 85-15. That is point one. On the second point, in terms of employee cost, the key aspect to note there is, for us, most of our employee costs are fixed in nature. So, as and when we start seeing the revenue growth to come and happen, the operating leverage effect will start to play. Which is what semblance of what we started seeing in the Q2. We should sustain this operating leverage in the coming quarters. Rather than putting a percentage, I will leave it at that. We should continue to see this operating leverage effect going forward also.

Meet Jain: Can we touch double-digit kind of margins comfortably this year?

Suresh Veerappan: Definitely, our profit growth is going to exceed our revenue growth. There have been quarters where we have touched those higher numbers for sure at EBITDA level. We would want to wait for a quarter or two before putting a number on that.

Meet Jain: Sure. Thanks a lot for all the questions. I will get back in the queue.

Moderator: Thank you. The next question is from the line of Vipraw Srivastava from PhillipCapital. Please go ahead.

Vipraw Srivastava: Yes, just a question on the clean energy business. So, a majority of battery installation in the US happens because of 30% credit on IRA, right? Because government reimburses 30% of the money to customers, which is residential battery storage owners. Now, if there is any tweak in this 30% number, there is a very high likelihood that this demand will come down. So, in that scenario, this best growth we are seeing of 70%, that number will start coming down if the IRA incentives are tweaked. So, in that scenario, how do you plan to cope with it? Do you have any contingency plan? Any thoughts on that?

Kunhamed Bicha: So, let me make this thing clear, I think we are going in a different direction. A lot of our numbers in Q2 include a very small number in this battery storage. Everybody is talking about it. But in these numbers, a very, very small part of it is the storage number. The potential of that growing in next year or later part of this year is huge. But we are not tied to that at all for our numbers.

Moderator: The next question is from the line of Aditya Bhartiya from Investec. Please go ahead.

Aditya Bhartia: So, my question is on the clean energy business itself. Over here, we have gotten quite a few orders which have been included in the order backlog. And we have been anticipating expedited execution on those orders. But somehow there has been a bit of a delay. I just wanted to understand at what stage we are in, what is causing this delay, and by when exactly should we start seeing some of those new customers kicking in?

Kunhamed Bicha: So, like I mentioned before, a lot of our growth is not tied to this only customer. It is part of our growth. And if something large happens there, well and good for all of us. Having said that, the product is completely tested, approved, like the last call I had mentioned. Now we are doing the first few hundred units. And then the ramp will start.

So, that is not counted in a big way in our Q4 and probably start in the Q1 numbers. Does that answer your question, Aditya? So, the growth is not coming from that piece. That is where I am a little worried that everybody thinks it is just that one customer. It is broad-based, whether it is rail, whether it is communication, whether it is industrial. It is growing from multiple industries. And clean energy is one. And the potential for that to grow drastically is there. And with or without IRA, we are positioned well enough to either make it in India or make it in US.

Aditya Bhartia: Understood, sir. Actually, instead of saying that clean energy has been driving growth, I wanted to ask why the ramp-up has been slightly slower than expected from the new customer. But you kind of spelled it out. That maybe if it kicks in, then it can be a big opportunity from FY26 onwards. Some of the other verticals wherein we have seen quite a big jump, like the mobility vertical or medical devices vertical, if you could explain what exactly has transpired. Is it broad-based free-stocking or is there one, two, three large contracts that have contributed to it? Some color on that would be helpful.

Kunhamed Bicha: A lot of the mobility, as you know, we are very well entrenched in the rail segment. We see a lot of activity. We signed a new customer recently. We see a lot of requirements for the Indian railways coming to our customers, whether it's interlocking, whether it's braking, whether it's cables. We're seeing a lot of activity. Some of that is primarily driven by the growth in India, which we are happy to be a significant part of.

And, of course, we are also in the process of testing Kavach system for our customers for interoperability. So that's another piece which may kick in into place during 2025. I wouldn't see that kicking in the next three, four months, but a lot of the testing and operations are going on as we speak.

And our customer has been approved by the Indian railways. So, we are working jointly to get that piece. So that's on the mobility piece, on the rail piece. Then on the air piece, as you know, we have signed 10, 15-year contracts. Some of them will start to get into production late part of this quarter. Some of the contracts will start in a month.

It will be a gradual scale-up in next quarter. So air and rail margin-wise as well as on the location-wise, I think is probably going to be our fastest growing segment in the near term. You had one more part of the question. I probably missed it.

Aditya Bhartia: Medical as well.

Kunhamed Bicha: Medical, a lot of it is our existing customers coming back to full steam, yeah.

Aditya Bhartia: Understood, sir. And so, my last question, like this particular quarter, we have recorded almost 11% EBITDA margins, which historically, if we look at it, are close to the best margins that we've recorded, which used to be somewhere around 11% to 12%. However, the composition has changed wherein we have moved a fair bit of production from the US to India.

Now, when you look ahead, do you think that this change in manufacturing setup can help you generate margins even better than what you have generated historically? Or is our endeavour going to be to kind of sustain these margins and to have a low-double-digit kind of margins going forward as well?

Kunhamed Bicha: So, let's put this in perspective. We know we have the industry-leading gross margins. So, we have seen quarters with higher EBITDA margins, for sure. So if you look at 89% of our business, which is being built in India, so that is, as of last quarter, is running at 13.7% EBITDA margins and 8.7% PAT margins. So, 90% of our business is delivering that today. The 11% is not delivering as much, but that is the bet on the future.

So tomorrow what we get through the US is very relevant and very critical for the India piece growth with the higher margins. We are not chasing business at all costs, we are looking at profitable growth and seeing how we can find businesses which make sense, which are long-term, 5 to 15 years. Usually the products last for 5 to 15 years and we intend to keep it that way. Did I answer your question, Aditya?

Aditya Bhartia: To a large extent, yes, sir. But how should we then think about it? Do you feel that Indian margins that you're recording in India can be sustained? And as we start doing more in the US, those, I mean, from whatever, INR4 crores rupees of loss, that can also be translated into profits and therefore overall console-level margins can be significantly better? Is that how you're kind of thinking about it?

Kunhamed Bicha: Absolutely, Aditya. We believe that happens anytime, but overall it's not bad yet. It's only going to improve going forward.

Aditya Bhartia: Understood, sir. Thank you so much.

Moderator: Thank you. The next question is from the line of Karan from Niveshaay. Please go ahead.

Karan: Thanks for the opportunity. Just had a couple of questions. We have a very healthy order book of around INR 1500 crores. So just wanted to get your outlook, not for this year, but maybe for the next two, three years, if you'd be able to grow at a good 20%, 25% rate with similar margins around 9%, 10%?

Kunhamed Bicha: Yes, I think we will. And our endeavour is always to grow faster, but our order book is fairly strong and we see more getting added to it. And the order book, for the 12 months to 14 months, we have an order book of INR1,485 crores. The long term, which is only between 14 months to 3 years, we've got another INR1,100 crores. We're not counting anything which is over 3 years, and some of our contracts are up to 15 years in the aero world. We're not counting those numbers, so we're trying to be relatively, I would say, conservative in the sense of we look at contracts and orders.

Karan: Okay. And the next question would be like, what would be the capex this year? And also, if you could highlight the current capacity utilization levels?

Kunhamed Bicha: So, I would say our capex, like we said, because our asset turns are fairly high, we always target between 8 and 10 times. So, we anticipate around INR40 crores to INR45 crores each year for the next two years at least. Of course, if there's something substantial, which is out of what we are planning for comes through, that will change, but as of today, we want to maintain the 8 to 10 times asset turns, as well as make ourselves an asset-like model, and spend INR40 crores to INR45 crores per year.

Karan: And the current capacity utilization would be?

Kunhamed Bicha: It would be between 65%, 70%. On a two-shift basis.

Karan: So the performance of the subsidiary was good this quarter. It reported good numbers, so we wanted to understand which sectors drove this performance?

Suresh Veerappan: So it would be more relevant to look at us as a consolidated entity, because that is the numbers which you're presenting from the industry verticals within the presentation as well. In terms of growth, like what KB had mentioned earlier, we are seeing broad-based growth across the verticals. Within India, the growth has been driven by mobility, communication, and industrials. And within US, it has been, again, on the auto side and on the industrials over there.

Karan: Okay, well, thank you so much and all the very best.

Moderator: Thank you. The next question is from the line of Vipraw Srivastava from PhillipCapital. Please go ahead.

Vipraw Srivastava: Yeah, thanks for the follow-up. Just a question on the, obviously, in this quarter, you've done very well on transportation and industrial. So, I mean, how is this growth coming from, I mean, is it from India, or is it from, I mean, US? I mean, some sort of a breakup you can give?

Kunhamed Bicha: Yes see, we, in the last couple of years, our goal is to be 50-50, 50% India and 50% export, okay. Last quarter, it was 60% export and 40% India. And each quarter, it'll vary depending on which customer it is. But our goal is to always have a 50-50. And if we go back three years, we were 80% export and 20% India. So our India side of the business, the size is growing. Did that answer your question, Vipraw?

Vipraw Srivastava: And, so, Indian business mainly grows as a result of which segment?

Kunhamed Bicha: India business is primarily from rail and from air, because rail is the fastest growing. And then, of course, industrials is a big thing. And we are starting to do some defense and things like that.

Vipraw Srivastava: Okay, fair enough. And on industrials, I mean, obviously, in the past, there was an inventory situation in US, and now rate cut cycle has also begun. So, I mean, what is the commentary from your end clients? Is it just restocking, or also has the demand side coming back?

Kunhamed Bicha: Some of it, of course, they were in the destocking phase. They had a one-year inventory rate. Today, they're coming back to a normal rate. Certain customers in that one year, we have got new products. So, the quantum of come back, it's larger. Okay, certain customers, we have new products which are building for them. So, we are also going deeper into the customer. So, it's just not the destocking, restocking. I think that one-year story, which I believe is done, and we're seeing the tail end of it.

Vipraw Srivastava: Right. And then, last question. So, by the end of this year, I mean, roughly, what will be a clean energy mix in the revenue, according to your expectation?

Kunhamed Bicha: So, I believe that we continue the normal thing, and each of the segments are diversified. So we'll be between 20% and 25%, is what we see. So some of it, certain quarters, industrial may do better, certain quarters, mobility may do better. So I think the diversification is there.

Vipraw Srivastava: Right. And the order book mix is in line with the revenue mix, or is it something different?

Suresh Veerappan : That is true. It will be in line with the revenue mix.

Kunhamed Bicha: Pretty close to the revenue mix.

Vipraw Srivastava: Okay, thank you. Thanks a lot.

Moderator: Thank you. The next question is from the line of Pratap Maliwal from Mount Infra Finance. Please go ahead.

Pratap Maliwal: Thanks for taking my question. Nice interacting with the management again. So, I just have a question on the employee cost, as a previous participant was also asking. So, as you said that we have a higher fixed cost base. So, is my understanding correct that this is because we have more permanent employees versus the share of contractual employees that maybe some of our peers may have in greater number? And also that we hire employees with perhaps different skill sets or maybe more qualifications than some of the other EMS players? So is my understanding broadly correct?

Kunhamed Bicha: Close enough, Pratap. See, one of the reasons is because we do some mission-critical stuff, so our level of employees is of the best cadre to deal with that. And number two is that we have a US side also, right? Which is, of course, the cost is higher there. And we do total integration. Box build is 50%-55% of what we do. So that adds to the complications. But I would say otherwise you're fairly right on your statement.

Pratap Maliwal: Okay. And so just one thing I wanted to understand. So, given that we kind of work at a higher gross margin of 33% to 35%, so when I look at our order of expansion potential in India, what can be our addressable market size? Because some of our other peers who might be working at lower margins, they work in the high-volume set, right? Whereas we work on maybe the high-margin, low-to-flexible kind of volume. So what can be our addressable market? Or how can we see our order of expansion kind of happening from here, particularly in India?

Kunhamed Bicha: So, in India, as you know, we are in the rail business. We are in the aero business. These are compared to the consumer-type businesses. Of course, they have larger margins and larger complexity. And saying that, we always look for profitable growth in the sense, you know, businesses which can sustain over, you know, 5, 10 years. And, of course, makes sense for both sides, the customer and for us, to deal with it in the longer term.

So we actually do sometimes walk out of businesses. It's just, if we wanted to have growth at any cost, we would sign up any customer and we could have a much higher growth rate. I mean, we can have a debate on that. But we have taken the path of the longer-term customers with profitable growth. So if you look at us over the last five years, our material margin has always been between 33-35 or a little over.

Pratap Maliwal: Okay. Understood, sir. Thank you for taking my question and congrats on a good set of numbers.

Moderator: Thank you. The next question is from the line of Harsh Mehta from Perpetual Capital Advisors. Please go ahead.

Harsh Mehta: Yes, sir. Congratulations on a very good set of numbers. So, my question was, in the last quarter, 89% of our revenue was from the Indian manufacturing facility, right?

Kunhamed Bicha: That's correct.

Harsh Mehta: So is this sustainable over, say, the next five years or something? Or will it increase in the future?

Kunhamed Bicha: We intend to make it sustainable. And we believe that we've done this over a long period of time, in good times and bad times. So, I believe it will be. And we sign up businesses which cater to that or which we can drive towards that. It's not all businesses giving you these margins. Certain businesses give you much higher margins. Certain businesses give you lower margins. So, it's an average over industries and over products.

Harsh Mehta: Right. And the margins on the Indian manufacturing segment only is 12.7% EBITDA, right?

Suresh Veerappan: 13.7% EBITDA in Q2 and 8.7% PAT.

Harsh Mehta: Okay. Right. Thank you so much, sir. And this is sustainable, right, over the next span of 5, 10 years?

Suresh Veerappan: That is true. Our growth has started to take shape now.

Kunhamed Bicha: Yes, we intend to make it of course. The world's a different place, but that's our endeavour, let's put it that way.

Harsh Mehta: Okay. Thank you so much, sir. That's it.

Moderator: Thank you. The next question is from the line of Vikash Agarwal, who is an individual investor. Please go ahead.

Vikash Agarwal: Yes, I just wanted to clarify. Other operating expenses, in Q2, are they variable or they are also fixed like personnel cost? Because revenue has increased around 36%, but other operating expenses increased by 50%. So what should we assume? Like there is an expense or we assume that the operating expense will follow whatever the percentage we follow as a Q2 FY25.

Suresh Veerappan: So, broadly below our gross margin, approximately 45% to 50% of our expenses are fixed in nature. And there is a fixed component as well as a variable component within the other expenses. It includes the forex gain and loss element as well in that.

Vikash Agarwal: Okay. So we can assume that, like, if we have a gross margin of 36.8%, of that 50% of the cost is fixed in nature and 50% of that remaining in the area, right, below the gross margin.

Suresh Veerappan: Approximately, yes. Between 45% and 50%. That is correct.

Vikash Agarwal: Last year we reported a loss of US operations around INR14 crores. This year it has come down to INR4 crores. So maybe I might have missed it out, but can we expect this loss to recover and get to a break even level, given that we continue with our ramp-up in Indian operations?

And secondly, we are talking about the US opportunities, like if the customers ask us to provide from the US plants, so how are we in a position to ramp up that facility fast? I mean, what would be the lag period?

Kunhamed Bicha: So we are trying to optimize the whole piece to see what needs to be there, what needs to be in India. So, we have done a lot of it. As and when businesses come in the US, there are some good businesses which can come with higher margins, of course, which are a lot more. So that, we will pursue that, because that cannot come to India.

The businesses we do there, either the customer does not want to move to India, or they are not allowed to move to India, because they could be quasi-military defense type of products, or an IRA-based product. So we want to keep the options open, but our goal from the start of the company is always to manufacture in India, which we are doing.

And then the percentage, we have reduced it as a market condition. The cost in the US has gone up. We have reduced it today to 11, and I think ideally it will be around 15% of our sales.

Vikash Agarwal: And, sir, previously in the concall, we mentioned somewhere that we aim to double our revenue in the coming two to three years. So do we stand by that guidance still? Or do we want to increase on it?

Kunhamed Bicha: I believe we intend to do that, and then we should be there.

Vikash Agarwal: Thank you.

Moderator: The next question is from the line of Dhananjai Bagrodia from ASK Investment Managers. Please go ahead.

Dhananjai Bagrodia: Hi. Thank you for giving me a chance again. I just wanted to ask you, this order book gives you visibility for how many years in terms of what is the execution for this order book?

Kunhamed Bicha: If you look at the total of it, it's around INR2,250 crores in the next 3 years. Out of that, INR1,485 crores is for the next 12 to 14 months. Then if you look at a 3-year period, it's around INR2,485 crores. But apart from that, we have orders and contracts. But sometimes the longer-term contracts are five years or in the aero business, sometimes 15 years.

Dhananjai Bagrodia: Okay. So then this INR1,400 crores is basically a confirmation that at least for the next 12 months, that much revenue we will get for sure. And then over and above, if any other order comes, then so be that. Is that a fair assumption?

Kunhamed Bicha: Fair way to look at it.

Dhananjai Bagrodia: So typically contract gets executed over 12 months to 14 months.

Kunhamed Bicha: No. Usually a contract in the industrial world is probably 3 to 5 years. In the railway world, it's a little longer, 5 to 7. In the aero world, it's 15 years. So, these POs are releases for production. And the smaller customers give you a PO for the next six months as well.

Dhananjai Bagrodia: Okay. So at least we have visibility of INR1,200 crores for the next one year.

Kunhamed Bicha: INR1,485 crores

Dhananjai Bagrodia: Let's say, if there was a switch or there's a big reduction in commodity prices now, and we have bought some of our raw materials earlier, will we take that hit right now in the next few quarters?

Kunhamed Bicha: Usually in our business, some of this is passed back to the customer if it fluctuates a lot. So it's not a cost-price model.

Dhananjai Bagrodia: No. See, we hold inventory over 60 days. Sometimes we hold inventory over 90 days. Steel prices have significantly reduced in the last 60 days. So let's say if we have inventory of before, that could impact us in Q3, Q4. How does that work?

Suresh Veerappan: Over the last 4 to 5 years, we were able to maintain our gross margins at a stable level of between 34%-35%. And this is during the period of COVID when the commodity prices were volatile. So I think that should answer your question, hopefully.

Dhananjai Bagrodia: Okay, fine. Fantastic. Thank you so much.

Moderator: Thank you. The next question is from the line of Neel Nadkarni from Dalal & Broca Stock Broking. Please go ahead.

Neel Nadkarni: Yeah, thanks for the opportunity. I just had a couple of questions from my end. First, I wanted to know if you can throw some light on how big is our design employee team? And the other one was that we had also a couple of quarters that we had spoken about the high-performance computing. So any update on that? Also, I think you are tied up to see that. And lastly, how is the seasonality in your business, if you can throw some light on all of these? Thank you.

Kunhamed Bicha: Can you repeat the first part of your question? I missed it.

Neel Nadkarni: Yeah, I want to know how big is our designing team? How many number of employees are there in that?

Kunhamed Bicha: So it's around 130 to 135 employees. We do PCB design and we do it for the larger players in the world. And some of them are not into our manufacturing side. But most of our key customers are on the semiconductor side.

Neel Nadkarni: All right. So just a point on this. So if you look at the peers, is it at the higher end? Are designing employees on the higher end? That's why that can also be one of the reasons why our total employee cost as a percentage of the sales is higher?

Kunhamed Bicha: No, I wouldn't say. It's more on the US-India side. Most of the design engineers are in India. So they are comparatively reasonable in cost.

Neel Nadkarni: Yes, and also on the high-performance computing space. So any development on that and the seasonality in the business?

Kunhamed Bicha: So the work is still in progress. I think we are also working on hopefully some newer programs. So, we are waiting for some releases like in the last call I said. When it all happens, we'll be more than happy to announce it. But we don't want to redo it. But there's a lot of work going on between the two companies.

Neel Nadkarni: And last on the seasonality part, sir. So is there any seasonality in the business?

Kunhamed Bicha: Not much, because we are well diversified. Of course, the seasonality for us came in destocking, restocking. I call it seasonality, but it's a long-term thing. But otherwise, it's fairly, because we're diversified, if some industry slows down, we have other industries that pick up. That has been our usual way to look at our business.

Neel Nadkarni: Sure, sir. Thank you.

Moderator: Thank you. The next question is on the line of Ankush Mahajan from Axis Securities. Please go ahead.

Ankush Mahajan: Sir, I missed an initial remark. Any guidance for the order inflows for this year?

Kunhamed Bicha: I don't want to give that out yet. But to say that we are on the verge of some large contracts coming in. Until it comes in, we don't want to give out the..But we've, our book has grown 19.4% year over year. And we believe that order book is only going to improve.

Ankush Mahajan: Any numbers in terms of margins you put for, guidance for the margins for the full year?

Suresh Veerappan: We do not provide any particular guidance on the margins per se. But we should start seeing the benefits of operating leverage playing out in the coming quarters.

Ankush Mahajan: Thank you, sir. That's all I have.

Moderator: Thank you. As there are no further questions, I would now like to hand the conference over to Ms. Bhoomika Nair for the closing comments.

Bhoomika Nair: I would like to thank everyone, and particularly the management for giving us an opportunity to host the call. Thank you very much, sir, and wish you all the very best. Thank you.

Kunhamed Bicha: Thank you, Bhoomika. We are encouraged by the robust support from our investors. We are committed to reinforcing the trust that our investors have in our company. I sincerely appreciate your steadfast support and confidence in Avalon Technologies. Together we are set for a remarkable journey of profitable growth and success. Thanks to everyone attending the call.

Moderator: Thank you. On behalf of DAM Capital Advisors Limited, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.