



“Avalon Technologies Limited Q1FY24 Earnings Conference Call”

August 11, 2023



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MODERATOR: **MR. DHURUV JAIN** — AMBIT CAPITAL.

Moderator: Ladies and gentlemen, good day and welcome to Avalon Technologies Limited Q1FY24 Conference Call hosted by Ambit Capital.

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 this conference call, please signal an operator by pressing “*” then “0” on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Dhruv Jain from Ambit Capital. Thank you and over to you sir.

Dhruv Jain: Thank you. Hello, everyone, welcome to Avalon Technologies Q1FY24 Earnings Calls.

From the management side, today we have with us Mr. Kunhamed Bicha – Chairman and Managing Director, Mr. Bhaskar Srinivasan – President, Mr. R M Subramanian – CFO of the company, Mr. Michael Robinson – the COO for USA business and Mr. Suresh VR – Head of Corporate Planning and Investor Relations.

Thank you and over to you sir for your opening remarks, post which we will then open the floor for Q&A. Thanks.

Kunhamed Bicha: Thank you Dhruv. On behalf of Avalon Technologies, we extend our sincere welcome to all of you for our Q1FY24 Earnings Call.

We deeply appreciate the unwavering support we have garnered since our listing and we are committed to continue running your trust as we move ahead. Given that a comprehensive business overview was presented during our first earnings call, we intend to provide a condensed version for the benefit of those who are new to our discussion today.

Avalon Technologies is one of India’s leading players in electronic manufacturing services with a global delivery footprint. Our journey started in 1997 with two aspiring entrepreneurs with a vision of bringing world class electronics manufacturing to India. We are one of the leaders in high mix flexible volume manufacturing, and are present across multiple industry verticals with a focus on complex integrated solutions with a significant engineering content. We have 12 manufacturing units located in India and United States and are now adding two more manufacturing units in Chennai. Our key differentiators are vertical integration in its true sense enabling us to be a focused box-build player, global presence, both in terms of manufacturing presence and customer base, and three, focusing on winning opportunities not only in mainstream sectors, but also on emerging sunrise sectors like clean energy, and high margin businesses like aerospace.

One of our core differentiators is that we offer vertical integrated solutions. Today, we are a one stop shop offering box-build solution that includes PCB design, new product development, cable assembly, sheet metal, plastics, magnetics, testing and logistics. We do end to end development

from PCB design to manufacturing of the final product. We proudly extend our services to a range of industries including clean energy, industrial, rail, aerospace, electric vehicles, medical and security infrastructure.

Moving to our business performance. Let me begin by acknowledging that our Q1 results have been comparatively subdued, however, in line with our past trends, industry comparisons and our previous communication, our second half is expected to be significantly stronger than our first half. Currently we are observing distinctive growth dynamics between the Indian and US markets in the near term. The Indian market displays remarkable buoyancy and the US market presents immediate short-term challenges. To share a perspective, in Q1, 45% of our business is from India, and 55% is from the US. Notably, our Indian customer segment demonstrated robust growth, achieving a 50% increase in revenue during Q1 FY24 compared to the same period in FY23. As I anticipate, this growth is likely to be around 35% on a full year basis. Conversely, revenue from our US customers remains relatively flat year-on-year in Q1. This trend is a consequence of current hurdles posed by a slowing US economy and inventory rebalancing steps taken by our customers from a 40 to 50-week lead time down to a 20 week lead time, which was there during pre COVID levels.

Throughout our journey, we have encountered intermittent short term decline often followed by periods of renewed market strength. While our US customers revenue grapples with immediate challenges, we also anticipate benefiting once the US market regain its strike. Avalon has always played the role of a partner rather than a vendor, and we continue to stand by our customers to serve our customers through all phases of the business cycles. The fact that we have not lost a customer during the slowdown is testimony to our partnership. We had earlier guided for 25% revenue growth in FY24. As it stands, our Indian customer segment continues to outpace the industry growth. Yet, meeting our full year revenue growth guidance hinges on the US market resurgence. If I were to wear a conservative hat, the near-term revenue growth in FY24 may range between 15% to 25%. While macro conditions remain beyond our control, and we have spoken about the growth perspective, allow me to shift our focus to what we control - Our profitability. Our financial success is not solely tied to delivering high mix products, it is also rooted to a commitment to operational efficiency. Given the near-term challenges in the US, and as we strive to be operationally efficient, we are implementing two measures. One, optimizing production allocations - strategic relocation of some of our production activities from our US plant to our India plant. Two, rationalizing costs of the US operation – we have taken concrete steps in initiating a plan and optimizing our US operations, this process is already underway. The positive outcomes of these measures will become increasingly evident in the forthcoming quarters.

As we address some of our short-term challenges, what truly excites us as the multitude and scale of opportunities that are coming our way. We are witnessing India's emergence as an accepted manufacturing designation, coupled with rapid growth of domestic electronics manufacturing. Let me highlight some of the customer wins and opportunities.

We have made significant inroads in terms of customer breakthroughs, and geographies and new segments. To give some examples, we have added three new clean energy customers, with one of them being in the EV space. The ramp up of the same is expected in late '24, and '25. Furthermore, some of our previous wins are expected to transition into volume production in two to three quarters, with expansion accelerated in FY25.

We entered a new segment, received the first tooling orders for plastic parts for the use in interiors of commercial aircraft. We are also entering production of thermal blankets and heat shields inside the aircraft engines for our aero customers.

We have also entered a new geography for delivering complex PCB design and development in a strategic sense that can open up into revenue growth. It is not always about the near term, the business environment we are experiencing now is challenging outside India, we endeavor to build an organization that can win and deliver on these opportunities that are unfolding over the next decade. Towards that, we are proactively adding seasoned senior management professionals across operations and business development, we are also expanding capacity by adding two new plants in Chennai. With that, I would like to thank all of you for joining the call. I will hand it over to Mr. Subramanian, our CFO for this detailed financial commentary.

R M Subramanian:

Thank you KB and good evening to all. Thanks for joining the call today. I would like to start this conversation with a discussion on the last quarter gone by. In terms of numbers in Q1 FY24, our revenue from operations is INR 235 crores, an increase of 19.9% year-on-year and a decrease of 14% quarter-on-quarter. Coming to gross margin, gross margin is about 77 crores, up by 9% year-on-year and a decrease of 25% on a quarter-on-quarter basis., EBITDA was at 16.2 crore for the last quarter, up 17% year-on-year and a decrease of 61% quarter-on-quarter basis. If you look at EBITDA margin, that stood at 6.9%, a decrease of 307 basis points on a yearly basis and 823 basis points on quarter-on-quarter basis. PAT stood at 7 crores for the last quarter, down 24% year-on-year and 69% on a quarter-on-quarter basis. PAT margin stands at 2.9% for the last quarter.

Coming to IPO funds utilization:

We applied for Rs. 320 crores from IPO as a primary capital and our approved IPO fund utilization consists of debt repayment of 145 crores, working capital of 90 crores and general corporate purposes requirements of 64.4 crores post issue expenses. We have fully utilized all our IPO funds that have been made available to us. A small amount of IPO funds are left and post reconciliation with the BRLMs, the same will be utilized this quarter. Utilizing a mix of IPO and company generated internal accrual funds, we have repaid approximately 200 crores of outstanding debt compared to pre-IPO levels in the Indian entities. As of today, at the group level, by end of this quarter we are left with approximately 100 crore of debt in our US subsidiaries Sienna. Our Indian entities are almost fully debt free now.

Moving on to the balance sheet side:

Working capital days was at 151 days in Q1 FY24, comprising of 108 days of inventory, 67 days of receivable and 24 days of payable. Encouragingly, we are witnessing initial indicators of decline in working capital demand as the supply chain situation gradually normalizes. The once upward trajectory of inventory which was seen in the last one year has reached stabilization points. Balancing the imperative of working capital efficiency alongside supporting the growth objectives presents a complex challenge. We will do our best in terms of managing it and maintain the balance without compromising growth. To add, while we are focused on growth, working capital cycles may fluctuate in line with personal requirements, including strict delivery lines, facing new prototype to customers, et cetera. We continue to focus on reducing our working capital cycle and expect it to decrease by 10 to 15 days by end of FY24 as compared to FY23. As on 31st July, we have about INR 125 crores of cash, both from IPO as well as from internal accruals. Out of this, INR 40 crores is earmarked for investment in our US subsidiary Sienna to pre-pay cost disbursement funds and the balance 85 crores will be surplus meant as a reserve and growth capital. Additionally, we prefer to keep the existing working capital lines in India available, amounting to INR 175 crore. This additional cushion should allow us to aggressively bid for and execute significantly large orders which are in our pipeline, and also be open for any inorganic growth opportunities which present itself.

In summary:

Our Q1 performance was characterized by significant growth in domestic business and slowdown in US geography along with the related fixed cost, which will be seen in the reduction in the margins. But we believe the US customers should come back in H2 and coupled with our new business pipeline, we believe we can reach the guidance of the top line which our CEO gave for this financial year. With respect to the margin, in spite of the headwinds, with saving interest cost and optimization of our manufacturing operations and cost rationalization measures in US which our CEO talked about, we are confident of maintaining our FY24 margin at similar levels to that of FY23. Having talked about the past performance, we will move your attention to the market opportunities in the medium term. Avalon has been in the sector for more than 20 years selling the story of India manufacturing to the world. But we have not seen this level of new business that we see in terms of global customer interest, number of branch visits, customer audits and last but not the least, the support from Government of India is very encouraging.

These are the best times to be in the industry and as much as we are focusing on short term performance, we need to focus on building the organization for the future and exploit the industry tailwinds. We are cognizant of the substantial market opportunity in front of us and the early indications suggest that multinational firms and global firms are desirous of creating alternative supply chains and diversifying their supply chain beyond China. I must highlight, nevertheless, that the EMS Industry is a long-term play predicated on customer relationships and our performance. As a result, this China plus one strategy will evolve over a longer timeframe.

One more aspect that I would like to share is that, we are engaging in organizations that can handle the end-to-end growth momentum. This is in terms of the right talent recruitment both of

senior and mid-levels, processes for production delivery and working capital management. We expect that by implementing these initiatives, we'll be able to take advantage of expanding market opportunities and increase the long-term shareholder value.

With this, I request the moderator to open the floor for Q&A. Thank you.

Moderator: Thank you. We will now begin the question-and-answer session. The first question comes from the line of Rahul Gajare from Haitong Securities. Please go ahead.

Rahul Gajare: I have a couple of questions. You touched on some aspects of the questions that I had on the performance during the quarter. Now, I understand, performance has been impacted by softer US business, which you were expecting. Therefore, H1 was expected to be soft, but incrementally for us to have a better understanding or better projection of financials, when you are guiding for the revenue growth you could actually talk about India business and US business separately and the respective revenue levels so we have better predictability on the revenue side. So, you talked about 35% growth that you are expecting this year for the India business, what is the kind of growth that you are expecting for the US business? That's the first question.

Kunhamed Bicha: Okay, so there are two or three aspects to this. One is we are signing multiple new customers in the US which are going to give us revenue in the later part of the year. That is greenfield coming in. Number two is on some of these larger customers who are rebalancing inventory. After four or five years of continuously building up inventory during the COVID times and then the supply chain issues, things have quietened down now in those two elements. They were at 40-to-50-week lead time who are now coming back to the pre-COVID levels of 20-week lead time. So them coming back itself will get us to normal levels along new customers coming in. And three, some of our clean energy customers who have had delayed starts, they are also supposed to cut in during the later part of this year. Does that answer your question Rahul?

Rahul Gajare: If you could quantify the kind of growth that you would expect?

Kunhamed Bicha: So that's a little bit tricky to answer, because it will depend on when the customers will step back in, but we would see similar growth like last year.

Rahul Gajare: Okay. My second question is on profitability, you did talk about being able to maintain margins of between 12% to 13% in FY24. Looking at the first quarter performance, obviously you would be expecting a bump up in profitability in the second half. Now, my question is, you talked about rationalizing cost of our US operation, could you touch upon how you intend to ultimately cut cost in the US and whether this 12% to 13% margin is something that will be sustainable for a longer period of time?

R M Subramanian: Yes, Subramanian here, so in terms of how we plan to achieve this, we said we want to maintain the profitability at the PAT level and we are confident of achieving the same as FY23 levels. That's point number one. In terms of the various measures we are doing, KB did talk about, starting with product-mix, leading to product optimization in terms of where we manufacture

and that leading to cost optimization at the US level. So that's where, at a very high level, we are going to work on. Considering the sensitivity of the matter, we would not like to get into the individual details of what we are doing, but these are the measures which we have started. It will take some time to cut in, but coupled with the interest cost saving and these measures, we are confident of reaching the profitability levels and the bottom line.

Kunhamed Bicha: So, we won't be explaining that in depth here.

R M Subramanian: Yes. And just to add to it in terms of the way our business is organized, basically about 75% of the manufacturing is done in India, and 25% is done in US, as on date. And if you look at it on an India manufacturing level, we've been able to maintain the profitability in terms of the last year levels for the Indian business. It is the US business where we have been impacted, and the reasons are very clear, it's because of the US economic slowdown and the consequent top line impact with the fixed cost being what it is. Coupled with all of these measures in terms of cost rationalization, we should be able to achieve our guidance. That's how we want to do it in the long term as well. We want to try and keep the US front end, but focus manufacturing in India and try and service customers in the US, which is a high margin business. This will not dilute our focus on India business, which continues to grow at 50% or what KB said, and guidance has also been given in terms of what we will end up with for the future.

Rahul Gajare: Yes, fair enough now. Just to take this point further. Now, the breakup of revenue has been pretty much like it was last time, where industrial was a large piece followed by mobility and then clean energy, which is the area where you actually faced headwinds on profitability side. Something you can talk about that will be helpful.

R M Subramanian: We don't give guidance specifically in terms of segments. We are spread out across all sectors and we are seeing significant growth opportunities and clean energy is growing better than the rest of the sectors. In terms of profitability, we don't track it at an individual segment level.

Moderator: Thank you. The next question comes from the line of Ravi Swaminathan from Spark Capital. Please go ahead.

Ravi Swaminathan: My first question is with respect to the strong traction that we are seeing in the India market, which are the sectors that are driving this growth, if you can throw some light on it?

Kunhamed Bicha: So a lot of it is coming from industrial and some of it is clean energy passing through to the US. We are seeing our largest segment, railways, pick up quite a bit compared to last year.

Ravi Swaminathan: Got it sir. And from a futuristic aspect in terms of the India business, are there any plans to get into the high volume segments like auto, consumer durable, et cetera which can drive India business growth?

Kunhamed Bicha: So when we say clean energy, one of our largest customers is in the EV space. We hope to finalize and start work on that in the later part of this year, and that will be a high volume product.

- Ravi Swaminathan:** Okay. And durable space also? Any thoughts on that, is there plan to foray into those kind of categories?
- Kunhamed Bicha:** Ravi, it's not like we don't like that business, but our mindset needs to change for that. But in saying that, I would say in the future we will relook at it, but for sure not as of now.
- Ravi Swaminathan:** Got it sir. And in terms of working capital, how much scope is there for us to improve going forward, because if you end up reducing that, your return metrics can improve significantly...
- R M Subramanian:** Yes, Subramanian here, I will try and answer this question. If you look at pre-COVID level in terms of inventory, which is where the real numbers have gone up, we were operating about 80 to 90 days levels, today we are significantly higher. So there is a good scope for us to look at it and we believe we can do about 10 to 15 days reduction on that side. The only thing is, we need to keep balancing between the growth opportunities and efficiency. When you have a new customer kicking in, you cannot look at efficiency. But we will continue to manage this balance and work on working capital, once the customer stabilizes we definitely can improve this.
- Moderator:** Thank you. The next question comes from the line of Aadesh from Motilal. Please go ahead.
- Aadesh:** Sir, I just wanted to understand that with this slowdown in US, you mentioned that growth will be similar to what you did in last year. If only the domestic growth sustains, last year we did around 12% to 15% top line growth, is that the number we are looking at?
- Kunhamed Bicha:** No, when I mentioned that, I thought I was asked based about US growth. So that's the answer for the US growth, because we are seeing very flat lines now. We hope to have 12-15%, so that was the answer to the US growth when I was answering.
- Aadesh:** Okay, sir. And sir when we are talking about cost optimization in our US operations, does that imply somewhat of defocusing US, at least for the near term and putting more focus on the domestic front, where actually the growth and predictability is?
- Kunhamed Bicha:** So, as you all are well aware, India is going through phenomenal growth phase compared to all the markets around the world. In the near term, a cost optimization is to make sure that we deliver what we have promised and we'll rethink it six months down the road. But we are not stopping the process of optimizing cost in the US, with both transferring products to India, as well as looking at what we need not do there. In the same sense, we're increasing our business development activities in the US.
- Aadesh:** Got it sir. And sir, I see Q-o-Q there is a slight dip in your order book. Now, obviously there would be some execution also, but has the run rate of order inflows also slowed down for you?
- Kunhamed Bicha:** So there are two pieces to that. How we look at orders is what is executable in the next 12 to 14 months, the rest of it comes either in network intents or contracts, multiyear contracts. So you see our contracts piece actually increase, but on the negative side, coming in from the US

customer base especially, when you're rebalancing inventory, you don't expect new orders to come in for the short term. So, it's a combination of two where the order book is actually increasing in the longer term, but not in the 12 to 14 month term which is very much covered for this year.

Aadesh: Got it sir. So, we should see some moderation in your order book growth as well. And sir, can you throw some more light on this inventory normalization which is happening, in which segment is it happening, in US solar, US wind or US general industrial?

Kunhamed Bicha: It is well diversified. So normally in COVID times when the aero business went to zero, it didn't affect us because something else picked up. But in this scenario, what we are seeing is that the overall optimism in the US has been there for too long and people are seeing monetary tightening there. This is happening across the board, it could be one clean energy, one auto, one healthcare. So it's not just one industry or so. It is an across-the-board phenomenon with customers there and their mentality today. Normally they are the first to react either way, whether you want to increase or decrease they will react first, but unfortunately a lot of our customers are doing it together.

Moderator: Thank you. The next question comes from the line of Renu Baid Pugalia from IIFL Securities. Please go ahead.

Renu Baid Pugalia: Few questions from my side. First, I missed some of the initial comments, I'm not sure if you answered. Can we have some more updates on clean energy? Last year we had a delay in the shipment for Anarca. So where are we this year in terms of the first shipment plus the rest of the volume ramp up? And apart from that, how is the outlook for rest of the other segments? While you did mention that the US is seeing a broad-based slowdown across diversified industries, there the government has been very aggressively giving incentives for some of the clean energy transition. So is it not that some of the clean energy segments would be growing at a much better pace from the startups compared to the rest of the economy or the industry there. That's the first question.

Kunhamed Bicha: Renu, just repeat the first part of the question, it was two or three questions at once.

Renu Baid Pugalia: Okay. First update on how has been the optics for Anarca and the clearances that they were waiting for. When do we expect the shipment picking up for them?

Kunhamed Bicha: So we believe that as of today, the first 100 sets or so with around 50 to 70 lakhs per set should start flowing out in the late part of Q3 and Q4. So from what we know today, that has started and we also have LOI for 600 units for the next two years.

Renu Baid Pugalia: Yes, that's the first part and the second part - In general, outlook on the clean energy on the US?

Kunhamed Bicha: So, absolutely there's a lot of activity in the US and we have signed up two or three more customers, two in US and one locally in the clean energy space. And it is all in the hybrid

manufacturing model where labor intensive part is done in India, and the final assembly and the automated part is done in the US. So that is going strong and one of our other larger customers, we expect there been two delays in start. I know that will be your next question, so the latest info we have is that they would start in Q4 of this year, which is a substantial piece for us.

Renu Baid Pugalia: So, broadly if we take a three year view in your sense, what should be the size of this clean energy business portfolio given large customers which are in pipeline and products are on the way. So conservatively in your view, how could we see the size of the business three years down the line?

Kunhamed Bicha: So, the way we have always committed, 25% of our business in the next three to four years will come from the clean energy business, mostly out of the US geography with most of the manufacturing done in India, and the final assembly done in the US.

Renu Baid Pugalia: Sure. Sir secondly if you look at the railway segment, so clearly government has been going very aggressively with upgradation of the old network, both rolling stock as well as the signaling telecom braking system. So can you share updates in terms of how are you looking at the pipeline from your customers for the domestic market building up and any global export opportunity of manufacturing for some of our Japanese customers, which was under discussion sometime back?

Kunhamed Bicha: Yes, as you will know it's already increased this quarter. And we were, I would say 20% to 30% this quarter already in the railway side. We are expecting a lot more coming in the next two or three quarters, depending on the government releases. But once the releases happen, immediate business which we already do, whether it's braking or whether it is interlocking, is going to see a substantial increase. And some of our customers, Japanese and Indian, are getting into the new Kawach systems. But that's not immediate, that's in the longer term, and also in the metros into gates. Most of this is from Japanese and French customers.

Renu Baid Pugalia: Partially yes. Can we quantify the addressable opportunity size for us over the next couple of years or say some three year, four year perspective, our addressable market, what size are we looking at?

Kunhamed Bicha: So it's very interesting that you ask that, because I asked the same thing to our customers in Japan a couple of weeks back. And they said it's all relative to the government releases. But they said get ready for a substantial increase, which is three or four times what we do, but they are not sure how much is released to them. But in our mindset, we can execute it fairly straightforward once it comes through because we've been doing this for seven or eight years.

Renu Baid Pugalia: Correct. So when it gets ready, does that really mean that while on an average today we are working at 60% utilization levels, we may have to upgrade our capacity for rail segment of the market?

Kunhamed Bicha: It's not that our buildings are getting built or getting finished in the next four or five months. For us the longest lead time is the building and the infrastructure. And we believe if we need enough

capacity in the short term, there's always eight months, nine months lead time to get this thing going from our customer. So there is enough time to get equipment if required, which in the near term we are very much covered with the capacity which exists today.

Renu Baid Pugalia: Sure. And lastly, question is related to IT PLI, while we know you are not directly there into IT products, but you also deal with customers on the communication and networking devices. So, you think the recent government initiative to drive localization and have import duties and restrictions on direct imports can drive substantial growth for you also in this business or this would not be one of the core areas for you?

Kunhamed Bicha: There are some strategic elements we are doing which I cannot discuss on the call, but we are looking at two large entities or government bodies who we will be working with.

Moderator: Thank you. The next question comes from the line of Amar from Alf Accurate Advisors. Please go ahead.

Amar: Sir firstly on the growth guidance which we are talking about, what we are seeing is that India looks strong and when we are guiding for a 25% to 30% growth rate, ideally we are talking about a 24%, 25% growth rate even from the US business?

Kunhamed Bicha: Yes, that was initially, but with the slowdown we have little concerns on that, that's why we have rationalized and said 15% to 25%. So it's not 25% to 30%, as we initially was saying, but we very much hope that customers kick back in as well as the new projects kick off.

Amar: Okay. So we can do 25%?

Kunhamed Bicha: Between 15% to 25%.

Amar: And secondly sir, in terms of the margin guidance which we talked about, 12% to 13%. Like, in this quarter if I see our gross margin, all the pressure of EBITDA is largely from the gross margin. So what should we assume like going forward, is this a change in the product mix which led to this kind of gross margin?

R M Subramanian: Subramanian here, on the gross margin as you rightly said, the key reason is change in the product mix, in terms of the geographies as well and some of our high margin customers tend to be from US and they have slowed down. But as we see an uptick from the US customers moving forward, we should get a claw back, if not to the previous level, definitely 100, 200 bps increase is a possibility. And in terms of overall profitability, taking into account all the measures which we are taking in terms of cost optimization, product rationalization, at the bottom-line of the PAT level, we should be able to reach last year levels about 7% to 8%.

Amar: 7% to 8% at a PAT level?

R M Subramanian: Yes.

- Amar:** Okay. So that means what like 12%, 13% at the EBITDA level right?
- R M Subramanian:** Yes, you can work on the numbers, there'll be saving on interest cost as well. So that's how overall it comes down to that.
- Amar:** Okay. And sir, on one side we are saying that second half is going to be stronger for us, because of the new customer signing which we are doing today. So then why are we becoming cautious on the US, because we already have a large pipeline of US customers which are going to become deliverables in the second half. And that was the story even earlier for us, and we always guided that first half will be muted and second half will be the strongest. And still, we were guiding about 30% kind of a growth rate. So what is changing here, that story remains same?
- Kunhamed Bicha:** Yes, the story remains the same, we may be talking about two different things. Even if it's a US customer, 73% of what we do is done in India and 27% in the US. The goal is to have an 80:20 mix, historically we have said that. 80% of manufacturing is done in India, maybe the front end of 20% will be done in the US. So the rationalization there is to say if it slowed down for US manufacturing, that's the only thing which is getting affected; Nothing to do with the 75% of what we do in India for the US market.
- Moderator:** The next question comes from the line of Neel Nadkarni from Dalal & Broacha. Please go ahead.
- Neel Nadkarni:** So, I just had a couple of questions. So you have mentioned that we have entered with a new segment that is the heat shield and we have received order for plastic components for the commercial aircraft business. So can you just give some color on this, like what is the market size and what is the opportunity size over here?
- Kunhamed Bicha:** So, to start off with, these are parts of the aircraft where you sit in the seat, you touch the plastic on top, so we've got the tooling order, that's a huge win for us, we've been working on that for a couple of years. And it's the start, if you look at it, it will take you 8 to 12 months to get started. But the start itself will be around \$3 to \$5 million a year, but just on one part. And we expect this to expand because we are getting into plastics in the interiors of aircrafts for the first time, we have been doing smoke detectors in planes before this.
- Neel Nadkarni:** And also, you have mentioned that we do a lot of work in the railway side also. So what is your market share for the railway category, in India especially?
- Kunhamed Bicha:** I'm not exactly sure what our customers market share is, but it are a substantial share in what is happening in interlocking. In the braking systems, it's normally two to three vendors and we are one of the larger players and we've been doing this for 7 to 10 years.
- Neel Nadkarni:** And also sir, this time around, I believe our box-build share has gone up, now around 52% versus last year, it was around 47%. Sir, what do we expect box-build to be as part of our total revenue going ahead? And what is the margin profile for this, is it reasonably higher compared to just the plain PCB and plastic?

- Kunhamed Bicha:** Yes, for any product, whether the product normally has cable, PCB, metal, we may start up with new commodity, but our endeavor is to get the whole product. It takes a few years to go there or sometimes it's immediate. So our endeavor always is to increase our box-build capability where it's a total solution provided for the customer. There was a second part of your question, I may have missed it. So, it's a good thing it goes up and it's not a huge difference, two, three points were there if you do a box-build more than just PCB or plastic or so.
- Neel Nadkarni:** Okay. And lastly sir can you give some color on like how is the seasonality across the industry verticals through the year?
- R M Subramanian:** Sorry can you repeat the question please?
- Neel Nadkarni:** Sir, what is the seasonality across industry verticals across the year?
- R M Subramanian:** Generally as we look at our past, the H1 is generally lighter and H2 is stronger, that's the essential seasonality we have seen, otherwise it's spread across both US and Indian geographies, and we're not seeing any specific seasonality's other than the H1, H2.
- Moderator:** Thank you. The next question comes from the line of Navid Virani from Bastion Research. Please go ahead.
- Navid Virani:** First one is on margins sir, so as far as my understanding goes, box-build and the export business has a relatively better margin than the others. So, if I try to correlate the increase in box-build percentage in our revenue and also export being a significant part of our revenue, I am finding it difficult to correlate with the substantial margin hit which would have taken during the quarter. So your comments on that front initially will be very helpful.
- R M Subramanian:** So in terms of the box-build margin, what you say is true only if you look the box-build perspective, but there are also other factors playing in. The key factor which in terms of leading to the margin dip for us this quarter, is the way our business is organized into the India business and US business. So, just to give an understanding, products of the India business are manufactured here. And that, if you look at the margins, the margins are similar to last year and we have been able to deliver on that. It's the US business where the top line has gone down, but the fixed costs remain. That is where a bit of operating leverage in the reverse side has made the margin come down. So at a consolidated level, you're seeing that impact, that's where the hit in the margin comes out. If you look at it on a standalone basis what you said, just for the box-build, what you say is true. But what is playing out for us is this factor because of which you are seeing a dip in the margins.
- Navid Virani:** Yes, that's very helpful. So, secondly we are saying that 75% to 80% of our production is happening here in India, and the rest is happening in the US. But if I look at our employee cost, and just try to compare it with our peers, our employee cost seems to be substantially high. So just want to get your sense on how one should look at employee cost going forward?

- Kunhamed Bicha:** So, you kind of nailed what our issue is today, because a lot of our employee cost is driven by the US cost, though there's lower production out of US. So if you just look at the India costs, it'll be very similar to our peers, I would say a little higher. So because of the US-India model, of course we enjoy better margins, but there's also a cost to it. And that is the rationale this quarter where the business didn't come through. So the costs have shown out. We've not seen a slowdown in the US like this before. So that is the fundamental issue, a lot of the higher cost is because of the US employee cost.
- Navid Virani:** And can you quantify understanding as to how this employee cost will look once the business becomes status quo?
- R M Subramanian:** This is Subramanian, I'll try and answer this question. In terms of the employee side, KB did talk about what happened in Q1, our endeavor is to keep the US front end and the employee cost minimal and our target ratio in terms of 80:20. But mind you, our US market is a high value market for us. So we will continue to focus on that, India market is growing at a much faster pace, and we'll work on that also. In terms of the target market, we will be at 50:50 in the long run. And in terms of employee cost, our endeavor is to keep it minimum so that our profitability margins are maintained.
- Navid Virani:** Okay, that's helpful. And sir lastly, if you can give us the contribution of PCBA, wire harnessing and other segments for FY23, as well as for this quarter it will be of great help.
- R M Subramanian:** Segment wise we don't track it, so that is something which we don't share. We track it at a consolidated level and in terms of segment as a box-build at a revenue level.
- Moderator:** Thank you. The next question comes from the line of Vishal Singh from Makrana Capital. Please go ahead.
- Vishal Singh:** Sir, I just wanted to understand, you mentioned something like the margin difference between a normal PCB and a box-build. Did I hear it correctly, it was 2%, 3%?
- Kunhamed Bicha:** I would say that Vishal.
- Vishal Singh:** Okay, thanks. Secondly, Indian market is growing very fast and I understand that there is a pickup in infra in India, et cetera, there is a lot of CAPEX which is going on. But I want to understand basically, whatever the government is doing in terms of creating an electronic manufacturing ecosystem in India, in terms of import pushing for import substitution, how is that helping your company in terms of growth?
- Kunhamed Bicha:** Personally, I've been a big proponent of import substitution, for years we've been doing that in India; If you look at railway segments, a lot of that came from outside the country before and over the last few years that's been done. But today, it's been very much formalized and each segment is starting to see that, we only welcome that and that will lead to a lot of opportunities where you need to Make in India and that is where a lot of the China transfers will start

happening. And we are starting to see some of that already with some industrial majors we've been working with, where the state governments wanted Made in India products and they are helping us transition from China to India.

Vishal Singh: Okay. So if I understood correctly, you are getting more and more business from the companies who are getting their businesses transferred from China, and within India as well, people are giving more and more business to Indian EMS companies because of the government rule? Is that correct?

Kunhamed Bicha: That is true across the industry, not just for us. There is an opportunity, not only for the Indian market – what used to come from outside will happen in India and that's our belief, and the ecosystem is trending towards that.

Moderator: Thank you. The next question comes from the line of Amar from Alf Accurate Advisors. Please go ahead.

Amar: Sir, as you are talking about this destocking issue in US, how much time will it take for the destocking issue to go away?

Kunhamed Bicha: To be honest we are hoping tomorrow, but that's not the right way to look at it.

Amar: Any understanding from the customer side?

Kunhamed Bicha: This is all fairly new, starting in the last few weeks. So, it could be that some of the customers may come back in a couple of months, some may come back in five or six months; we are hoping that they do come back faster, but different customers have different timeframes. As we get closer, we'll know more. It's very difficult for us to predict because everybody is going through this at the same time, so we are hoping some of it will be resolved shortly.

Moderator: Thank you. This was the last question for today. I now hand the conference over to the management for closing comments.

Kunhamed Bicha: We are very heartened by the strong support of our investors during our journey as a listed company. We would strive to fulfil the faith that investors have placed in our company. I express my sincere gratitude for your unwavering support and confidence in Avalon. Together we are poised for an exceptional journey of profitable growth and success. Thank you so much.

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