

Initiating Coverage Avantel Ltd.

May 22, 2023





Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Telecom Equipment & Accessories	Rs. 496.60	Buy in the Rs. 492-502 band & add more on dips to Rs. 442-450 band	Rs. 551	Rs. 591	2-3 quarters

HDFC Scrip Code	AVALTD
BSE Code	532406
NSE Code	N/A
Bloomberg	AVTS IN
CMP May 19, 2023	496.6
Equity Capital (Rs Cr)	16.2
Face Value (Rs)	10.0
Equity Share O/S (Cr)	1.62
Market Cap (Rs Cr)	805.4
Book Value (Rs)	69.0
Avg. 52 Wk Volumes	31,883
52 Week High	510.0
52 Week Low	236.9

Share holding Pattern % (March, 2023)	
Promoters	40.1
Institutions	0.0
Non Institutions	59.9
Total	100.0



* Refer at the end for explanation on Risk Ratings

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Our Take:

Avantel Limited. (Avantel) is technology driven company in India; the company is engaged in the design, development and manufacturing of electronic, communication, satellite communication products/services, software products & services development and research & development activities. The company has developed Mobile Satellite Services based products and UHF Systems and continues to offer solutions for various applications and is looking for growth in this segment by offering integrated solutions for Airborne, Underwater platforms and special operations.

An established track record of over two decades in the electronics and telecom equipment business has enabled it to offer a unique combination of embedded systems and related software used in the defence sector, as well as Radio Frequency (RF systems) used in the civilian telecom segment. Avantel designed and developed various first of its kind, customized wireless/Satcom products and solutions to meet the special requirements of Indian Defense Services & allied institutions. Avantel's unique value proposition is in integration of wireless, embedded firmware and software technologies to create innovative solutions.

The company's performance is strongly backed by the in-house R&D facilities. The company's growth plans include the set-up of a new corporate office and a new manufacturing unit by FY24 which could help further strengthen the market position of the company. The company has been contributing to self-reliance in the strategic segment for close to three decades and has been offering fully indigenous solutions through its well spread product offerings. The push given by government in terms of increased capital overlay and emphasis on domestic sourcing would help it to venture into new technologies, roll out new product lines and strengthen the strategic capabilities of India.

The company has an unexecuted order book of ~Rs 240 crore to be executed over the next two years inclusive of a major order worth ~Rs 126 crore, which ensures short to medium term revenue visibility, book to bill ratio stood at 1.6x FY23. Taking into the consideration of efficient and timely order execution and strong order inflow in near to medium term, we expect that the company could report ~22% and ~15% revenue growth in FY24E and FY25E, respectively.

Valuation & Recommendation:

Avantel is in the niche defence supplies segment for the past three decades and provides customised wireless and satellite communication (SATCOM) solutions and products. The company mainly operates in Aerospace & Defence sector and holds Defence Industrial Licenses issued by government and its customers mainly come from the strategic sector such as space, defence, transport and telecommunications.



The company has established strong relationship with large domestic as well as global defence OEM and service provider companies. The company maintains healthy and long term relationships of over two decades with a reputed clientele that includes Indian Army, Indian Railways, Indian Airforce, Indian Navy, ISRO, DRDO, Goa Shipyard Limited, The Boeing Company, Larsen & Toubro Ltd (L&T), etc. The extensive industry experience of the promoters of around three decades, comfortable financials and long standing relationships with low counter party risk customers including Ministry of Defence (MoD) helps to execute the order in time.

Investors can buy in the Rs 492-502 band and add more on dips to Rs. 442-450 band (16.25x FY25E EPS). Base case fair value of the stock is Rs 551 (20x FY25E EPS) and the bull case fair value of the stock is Rs 591 (21.5x FY25E EPS) over the next two to three quarters. At the CMP of Rs 496.6 the stock trades at 18.1x FY25E EPS.

Financial Summary (Standalone)

Particulars (Rs Cr)	Q4FY23	Q4FY22	YoY-%	Q3FY23	QoQ-%	FY21	FY22	FY23P	FY24E	FY25E
Total Operating Income	52.4	46.7	12.2	38.7	35.4	77.7	104.9	154.3	188.9	216.7
EBITDA	18.9	9.9	91.9	11.9	59.2	22.6	27.8	49.4	56.9	67.6
Depreciation	1.4	1.1	22.5	1.4	0.4	3.0	4.0	5.2	5.9	6.2
Other Income	0.1	0.5	-82.9	0.3	-68.9	0.9	1.4	0.6	0.9	0.9
Interest Cost	1.5	0.4	242.5	1.5	-2.5	1.5	1.5	4.9	4.1	2.7
Tax	5.6	1.9	202.4	1.7	225.1	3.2	4.5	9.9	12.0	15.0
RPAT	10.5	7.0	51.0	7.5	39.6	15.8	19.2	30.0	35.8	44.5
APAT	10.5	7.0	51.0	7.5	39.6	15.8	19.2	30.0	35.8	44.5
Diluted EPS (Rs)	6.5	4.3	51.0	4.7	39.6	9.7	11.8	18.5	22.1	27.5
RoE-%						26.7	25.6	30.7	27.9	27.0
P/E (x)						51.1	42.0	26.8	22.5	18.1
EV/EBITDA (x)						33.8	29.6	16.9	14.5	11.9

(Source: Company, HDFC sec)

Q4FY23 Result Update

- Avantel reported strong performance in Q4FY23, standalone revenue increased to Rs 52.4 crore from Rs 46.7 crore in Q4FY22, supported by robust order execution in the quarter.
- EBITDA grew more than two fold on YoY basis to Rs 18.9 crore, supported by strong revenue growth. EBITDA margin stood at 36.2% in the quarter vs. 21.1% in same quarter previous year.
- Net profit grew by 51% YoY to Rs 10.5 crore in Q4FY23, and net profit margin was at 20.1% vs. 14.9% in Q4FY22.



Recent Triggers

Steady growth in the order book position along with new order accretion and efficient order execution

Avantel has been receiving repeat orders from the existing clientele on the back of its established track record and healthy relationship. As on Sept 2022, the company's unexecuted order book stood at ~Rs 240 crore, to be executed over the next two years inclusive of a major order worth ~Rs 126 crore, which ensures short to medium term revenue visibility. Avantel has received this high value contract from L&T worth ~Rs 126 crore for supply of 6300 loco units for Real Time Train Information Systems to be supplied to Indian Railways, 50% executed in FY23E and 50% will be done in the next financial year. Besides, the company expects Rs 60-70 crore orders during current financial year for execution in the same year.

Avantel is consolidating its position with its current portfolio of Satcom and RF sub systems; it, has indigenously designed the 1KW HF Power Amplifier & Antenna Coupler for Indian Navy & Indian Air Force upcoming requirement 1 KW HF Radios.

The company has been working with Boeing for a long time. In June 2021, Avantel has collaborated with L & T who has bid as Lead system integrator for implementing the RTIS (Realtime TrainInformation System) project of CRIS, Indian Railways. L& T has been declared as the successful bidder. Avantel therefore shall be supplying the IRN (Indian Rail Navigator) and RMT-L (Rail Mount Terminal-Loco) to be installed on 6300 Locos.

In July 2021, Avantel has received an order of US\$19,80,000 from 'Lockheed Martin Corporation' for Satcom Equipment supply. It is the largest listed defense company in US and the U.S. government is its biggest customer. They work in US Aeronautics, Missiles/Fire Control, Rotary/Mission Systems and Space; They manufacture and support advanced combat, missile, rocket, sensors, radar systems, command/control combat simulation/training, advanced cybersecurity and undersea systems for customers that include the U.S. Army, Navy, Air Force, Marine Corps, NASA and dozens of foreign allies. This is huge breakthrough order for Avantel.

On 24 Aug, 2022, Avantel Ltd has received an order for an amount Rs. 11.28 crore from Indian Navy for Supply of Satcom Equipment.

Entry in medical devices market through its subsidiary could help to generate revenue going forward

India is the fastest growing medical devices market amongst the emerging markets and the current market size of the medical devices industry in India is estimated at \$11 bn. The medical devices industry in India is poised for significant growth with the market size expected to reach \$50 bn by 2030, ~21% CAGR over the period. India's medical devices imports stood at US\$ 8.5 bn, and exports contributes US\$2.9 bn in FY22. India's expected export of medical devices could reach ~ US\$10 bn by 2025.

The Indian Government has identified medical devices as a priority sector for the flagship 'Make in India' program and is committed to strengthening the manufacturing ecosystem. The Production Linked Incentive Scheme (PLI) Promoting Domestic Manufacturing of Medical Devices and Production Linked Incentive Scheme for Pharmaceuticals (PLI 2.0) has been introduced to provide an impetus to India's vision of becoming a global manufacturing hub for medical devices, scheme outlay was at Rs 18,420 crore.



Avantel has floated a fully owned subsidiary M/s. Imeds Global Private Limited in September 2021 and established manufacturing facility in Andhra Pradesh Medical Tech Zone (APMTZ), Visakhapatnam. Imeds Global Pvt. Ltd.(IMEDS) is involved in activities such as manufacture of medical, precision and optical instruments, watches and clocks, time of day recording apparatus and apparatus for measuring recording or with synchronous motor. IMEDS has 450 customers with 650K products sold. In the medical segment, Imeds has developed Skin Staplers, Removers and Oxygen Concentrators. Imeds recorded sales of Rs.0.98 lakhs and loss of Rs. 117.3 lakhs in FY22. In FY23, it recorded sales of Rs.18.8 lakhs and EBIT loss of Rs.326 lakhs. Imeds is setting up a plant which will be ready by FY24 end or FY25 start. The total cost of capex for Avantel and Imeds will be Rs.25 cr

Greenfield expansion

Avantel has bought four acres of land in Electronic City in Hyderabad, which is about 10 minutes from the airport at a very reasonable price of one crore per acre approximately. Avantel has plans to build a facility for radar, small satellites, in that particular area, and this facility should be operational by November or December 2023.

Long term Triggers

Established market position in SATCOM, with experienced management and healthy clientele

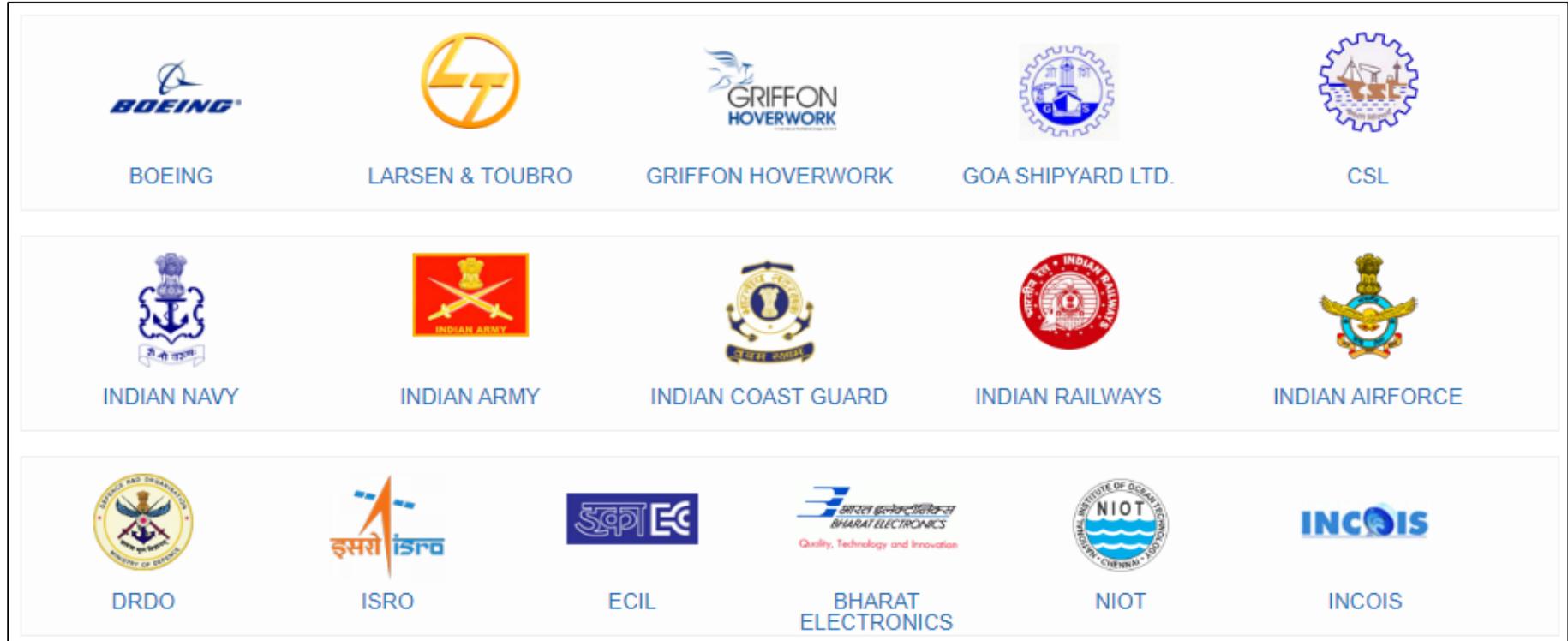
Avantel is operating in the niche defence supplies segment for the past three decades and provides customised wireless and satellite communication (SATCOM) solutions and products. The company provides customized solutions through process oriented design, develop and manufactures RF subsystems, RADAR subsystems, Software depend radios and satellite communication systems, wireless front-end, satellite communication, embedded systems, signal processing devices and provides network management, software development and related customer support services. The company's SATCOM products are proprietary in nature and being the single vendor, it continues to be the major revenue contributor. The company is also involved in development and implementation of network systems for ships, submarines, surface vehicles and aircrafts.

The founder and present Chairman & MD, Dr. A Vidyasagar has an extensive industry experience of over three decades. Other promoters of the family-managed business are also qualified and experienced and a qualified team supports the management.

The company mainly operates in Aerospace & Defence sector and holds Defence Industrial Licenses issued by government and its customers mainly come from the strategic sector such as space, defence, transport and telecommunications. The company maintains healthy and long term relationships of over two decades with a reputed clientele that includes Indian Army, Indian Railways, Indian Airforce, Indian Navy, ISRO, DRDO, Goa Shipyard Limited, The Boeing Company, Larsen & Toubro Limited (L&T), etc.



Cientele



Focused on development of new products with in house R&D

Avantel drives its core business strength from its in house R&D capabilities. Company's research and development is recognised by the department of scientific and industrial research(DISR), ministry of science and technology, GOI. The company spends around 8 to 9 percent of its turnover on research and development expenditure.

Avantel enjoys an excellent track record and building strong relationship with its customers and suppliers. The company also provides customized services and avails customised products. Its employees are highly motivated and technically equipped to meet the organizational goals at all times. The company has over time developed new variants of Mobile satellite services products including Airborne versions and High Power (5 KW) HF systems. In the medical segment, Imeds has developed Skin Staplers, Removers and Oxygen Concentrators. Further, company is developing Software Defined Radios in line with global standards.



Sound financial profile

- Avantel's operating and financial performance has been robust led by negligible debt, healthy cash generating ability and consistent dividend payment to shareholders over the past and the company's production has been performing well over the past. Its financial flexibility is strong, supported by robust liquidity.
- Avantel's revenue rose from Rs 33 crore in FY17 to Rs 154 crore in FY23 - ~29% CAGR over the period. The company recorded the highest turnover since inception by crossing the 150 crore milestone in FY23. We expect that the company could report revenue ~19% CAGR over the FY23 to FY25E and expect EBITDA margin at a range of 30-31.5% band in FY24E and FY25E.
- The company's debt to equity (net) stood at 0.3x in FY23, 90% of debt are short term debt and the company has no further plans to raise any debt going forward. Capital structure is expected to remain comfortable and debt protection metrics could also be healthy going forward.
- The company's debt service coverage ratio (DSCR) also stood comfortable on account of the absence of long-term repayment obligations, DSCR stood at 0.6x in FY23.
- The inventory days has increased from 58 days to 105 days, payable days increased to 7 days, and the receivable days decreased from 126 days to 94 days as on March 31, 2023. With rise in profitability as well as better return ratios in the future, we expect RoE at a range of 27.9% and 27% in FY24E and FY25E, respectively.

Industry Overview

In recent times, the Defence budget has been sensitive to the need for establishing a technological framework to advance growth of a vibrant indigenous defence manufacturing infrastructure. India's Defence budget for FY22-23 is about Rs 4 lakh crore after excluding the component of the Defence pensions and is primarily focused towards the upkeep and modernization of Armed Forces. The capital outlay, which focuses towards the modernization of Armed Forces has been increased by 12.8% with an allocation of Rs 1.52 lakh crore.

The new DAP (Defence Acquisition Procedure) 2020 has given a stronger push to indigenization. The provisions of DAP 2020 will help to expedite the current procurement cases and open new avenues for business. The indigenisation list released recently by the government could further open up many opportunities for diversification / introduction of new product lines. Besides, in the medical segment, there is huge opportunity for indigenous and cost effective medical devices.

What could go wrong?

- Higher delay in execution could lead to increased liquidated damages and lower margins while not enough visibility on order book accretion could lead to softening of multiples.
- Any significant change in policies of the GoI resulting in increased competition in the industry, leading to decrease in the strategic importance of Avantel. Any change in the government policies on defence spending may impact the financial performance of Avantel.



- Any significant deterioration in the capital structure on account of significant debt-funded capex and/or a stretch in the working capital cycle.
- Avantel's business is also a tender based and hence the company remains susceptible to the inherent risk associated with such business and the low scale of operations limits its bidding capacity to some extent. However, the established track record of the company and being the preferred supplier to the reputed clientele for the last many years, helps to get repeat orders.
- The company primarily supplies to defence and defence research organisations, which comes under Ministry of Defence. The company's ~80% of revenue remains exposed to defence and defence based companies in FY22. However, the orders from the railways are expected to diversify the revenue stream going forward.
- The company's operations continue to be working capital intensive due to relatively high inventory and receivable holding periods. The company's conversion cycle has increased to 191 days as on March 31, 2023 mainly on account of the increased inventory holding period.
- Semiconductor Chip shortage, due to less supply and high demand could impact its operation. Delay in timely delivery to its customer due to Semiconductor chip shortage could impact its ongoing projects as well as revenue generation.
- Any delay in cash realization from clients could further increase its receivables days going forward and impact cash flow. A sum of Rs.33.69 cr is included in debtors as on FY22 which is shown as not due. This is from a Govt organization and hence considered good. The standard condition in defence procurement of large size tickets is 25% will be given only after training, installation, and commissioning. Installation and commissioning depends upon the availability of shifts and the readiness of the customer.
- Imeds project could take longer than expected to be commissioned and grow. This could result in continued hit to the consolidated profits.
- Q4 is the best quarter for Avantel due to its dependence on Govt orders.

Company Profile:

Avantel Ltd. (Avantel) incorporated on May 30, 1990, is engaged in the designing, developing and maintaining wireless and satellite communication products, defense electronics, radar systems and the development of network management software applications for its customers predominantly from the aerospace and defense sectors. The company's products include repeaters, filters, power dividers, power amplifiers, directional couplers, and cavity splitters or tappers. The company also offers satellite communication products comprising ship borne terminals, handheld terminals, S-band receivers, UHF transmitters, burst demodulators, network management systems, and solid state power amplifiers, as well as provides vehicle tracking systems. Avantel undertakes R&D activities for development of innovative solutions in the related areas. The company's manufacturing and R&D facilities are situated at Visakhapatnam, Andhra Pradesh.



Financials (Standalone)

Income Statement

(Rs Cr)	FY21	FY22	FY23P	FY24E	FY25E
Net Revenues	77.7	104.9	154.3	188.9	216.7
Growth (%)	49.7	35.1	47.0	22.4	14.7
Operating Expenses	55.1	77.2	104.9	132.0	149.1
EBITDA	22.6	27.8	49.4	56.9	67.6
Growth (%)	46.9	22.8	78.0	15.1	18.9
EBITDA Margin (%)	29.1	26.4	32.0	30.1	31.2
Depreciation	3.0	4.0	5.2	5.9	6.2
EBIT	19.6	23.8	44.2	51.0	61.4
Other Income	0.9	1.4	0.6	0.9	0.9
Interest expenses	1.5	1.5	4.9	4.1	2.7
PBT	18.9	23.6	39.9	47.8	59.5
Tax	3.2	4.5	9.9	12.0	15.0
RPAT	15.8	19.2	30.0	35.8	44.5
APAT	15.8	19.2	30.0	35.8	44.5
Growth (%)	46.4	21.8	56.6	19.1	24.4
EPS	9.7	11.8	18.5	22.1	27.5

Balance Sheet

As at March	FY21	FY22	FY23P	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	4.1	4.1	16.2	16.2	16.2
Reserves	62.2	79.7	95.7	128.2	168.7
Shareholders' Funds	66.2	83.7	111.9	144.4	184.9
Long Term Debt	0.0	2.8	2.4	2.4	2.4
Net Deferred Taxes	0.7	1.0	0.5	0.5	0.5
Long Term Provisions & Others	3.1	0.2	0.6	0.7	0.7
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total Source of Funds	70.1	87.7	115.4	148.0	188.5
APPLICATION OF FUNDS					
Net Block & Goodwill	16.0	24.7	25.5	35.3	41.7
CWIP	0.7	7.0	8.7	8.7	7.7
Other Non-Current Assets	5.2	8.7	13.6	13.2	11.7
Total Non Current Assets	22.0	40.4	47.8	57.1	61.1
Current Investments	0.0	0.0	0.0	0.0	0.0
Inventories	2.5	16.7	44.2	41.4	48.1
Trade Receivables	13.1	36.2	39.7	49.2	57.0
Cash & Equivalents	43.0	0.8	1.0	9.0	20.4
Other Current Assets	6.2	16.1	21.1	23.3	25.6
Total Current Assets	64.8	69.8	106.0	122.9	151.1
Short-Term Borrowings	0.0	12.9	27.9	22.9	14.4
Trade Payables	0.3	0.7	3.0	2.1	3.0
Other Current Liab & Provisions	16.3	8.9	7.5	7.0	6.3
Total Current Liabilities	16.7	22.4	38.4	32.0	23.7
Net Current Assets	48.1	47.3	67.6	90.9	127.4
Total Application of Funds	70.1	87.7	115.4	148.0	188.5

(Source: Company, HDFC sec)



Cash Flow Statement

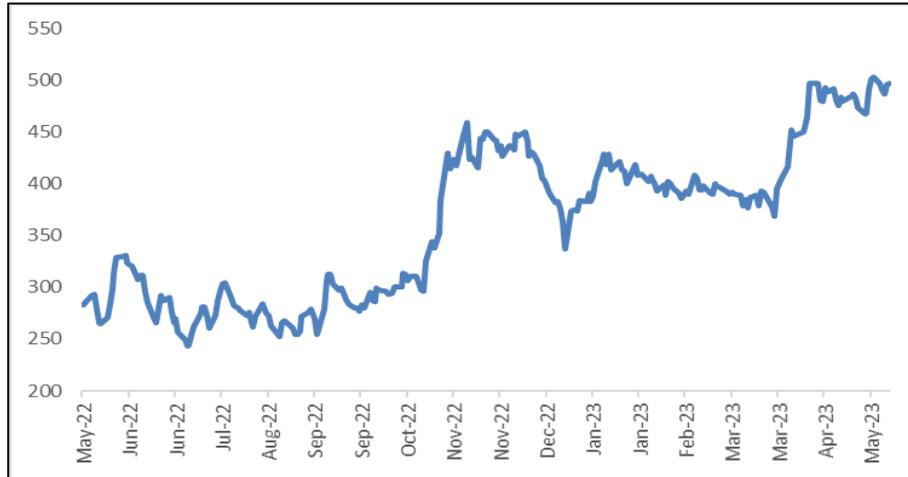
(Rs Cr)	FY21	FY22	FY23P	FY24E	FY25E
Reported PBT	18.5	23.6	39.9	47.8	59.5
Non-operating & EO items	-0.7	0.8	-0.5	-0.9	-0.9
Interest Expenses	1.5	1.5	4.9	4.1	2.7
Depreciation	3.0	4.0	5.2	5.9	6.2
Working Capital Change	25.8	-54.3	-36.5	-10.2	-16.7
Tax Paid	-3.5	-4.0	-8.5	-12.0	-15.0
OPERATING CASH FLOW (a)	44.6	-28.3	4.4	34.6	35.9
Capex	-5.6	-18.9	-7.7	-15.0	-10.0
Free Cash Flow	39.1	-47.2	-3.2	19.6	25.9
Investments	0.0	-5.0	-6.8	-0.2	-0.2
Non-operating income	-36.1	43.6	0.5	0.9	0.9
INVESTING CASH FLOW (b)	-41.7	19.7	-13.9	-14.3	-9.3
Debt Issuance / (Repaid)	-1.2	11.6	14.4	-5.0	-8.5
Interest Expenses	-1.2	-1.2	-4.9	-4.1	-2.7
FCFE	41.4	-57.7	-12.7	28.7	37.1
Share Capital Issuance	0.0	0.0	0.0	0.0	0.0
Dividend	-0.8	-1.6	-1.6	-3.2	-4.1
Other	0.6	0.6	0.0	0.0	0.0
FINANCING CASH FLOW (c)	-2.6	9.5	7.9	-12.3	-15.2
NET CASH FLOW (a+b+c)	0.4	0.8	-1.6	8.0	11.4

Key Ratios

Particulars	FY21	FY22	FY23P	FY24E	FY25E
Profitability Ratio (%)					
EBITDA Margin	29.1	26.4	32.0	30.1	31.2
EBIT Margin	25.2	22.7	28.7	27.0	28.3
APAT Margin	20.3	18.3	19.5	18.9	20.6
RoE	26.7	25.6	30.7	27.9	27.0
RoCE	26.4	24.0	25.1	23.3	24.2
Solvency Ratio (x)					
Net Debt/EBITDA	-1.9	0.5	0.6	0.3	-0.1
Net D/E	-0.6	0.2	0.3	0.1	0.0
PER SHARE DATA (Rs)					
EPS	9.7	11.8	18.5	22.1	27.5
CEPS	11.6	14.3	21.7	25.7	31.3
Dividend	1.0	1.0	1.0	2.0	2.5
BV	40.8	51.6	69.0	89.0	114.0
Turnover Ratios (days)					
Debtor days	62	126	94	95	96
Inventory days	12	58	105	80	81
Creditors days	2	2	7	4	5
VALUATION (x)					
P/E	51.1	42.0	26.8	22.5	18.1
P/BV	12.2	9.6	7.2	5.6	4.4
EV/EBITDA	33.8	29.6	16.9	14.5	11.9
EV / Revenues	9.8	7.8	5.4	4.4	3.7
Dividend Yield (%)	0.2	0.2	0.2	0.4	0.5



One Year Price Chart



(Source: Company, HDFC sec)

HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclical of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.



Disclosure:

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