

ESDM Industry

20th November 2023

Harnessing the tailwinds in the industry

India's Electronic System Design and Manufacturing (ESDM) industry stands at the cusp of an unprecedented transformation. As the digital landscape continues to evolve, the ESDM industry is poised to lead the charge, emerging as a cornerstone of India's economic strength. With a confluence of favorable factors, ranging from growing domestic demand, global firms shifting their sourcing from China to other countries to visionary government initiatives, it is expected that for the next 5 years, the Indian ESDM industry is expected to grow at ~32%+.

Harnessing the megatrend of outsourcing

The phenomenon of outsourcing is an inevitable and advantageous aspect that greatly contributes to various industries. Given the escalating production of electronics in India, the trend of outsourcing manufacturing components to ESDM companies is poised to become an inescapable reality as OEMs continue to focus on their core activities. Presently, in India, the ESDM sector accounts for ~23% of the total electronics market, in contrast to ~35% globally.

China + 1 strategy

In a strategic move to mitigate the vulnerability of heavily relying on China as their primary source, global firms, particularly based in the US and Europe, have initiated a shift towards procuring electronics and electronic products from alternative destinations, and India is emerging as a prominent player. This shift is driven by the notable disparity in labor costs between China and India. Furthermore, recent initiatives taken by the government designed to incentivize Indian enterprises to set up manufacturing facilities and increase their output capacity have boosted the chances of growth in the Indian ESDM sector, especially in terms of exporting opportunities.

Increasing content of electronics in various products

The surge in electronic content is palpable across various end-user segments. Notably, the automotive industry is poised to witness a strong increase in electronic content per vehicle, primarily attributed to the ongoing shift towards electric vehicles. In addition to this, within the realm of consumer durables, the proliferation of inverter air conditioners and BLDC fans is a key catalyst driving the demand for PCB/PCBA. Furthermore, in the industrial sector, the transition from analogue to smart meters, coupled with the widespread adoption of digital displays in capital goods equipment, is fueling the growth of electronic components.

POSITIVE

Companies Covered

Bloomberg Code	Rating	Current Price	Target Price (FY26)	Upside
AVALON IN	BUY	478	619	29%
CYIENTDL IN	BUY	668	747	12%
KAYNES IN	BUY	2,433	3,013	24%
SYRMA IN	BUY	539	675	25%

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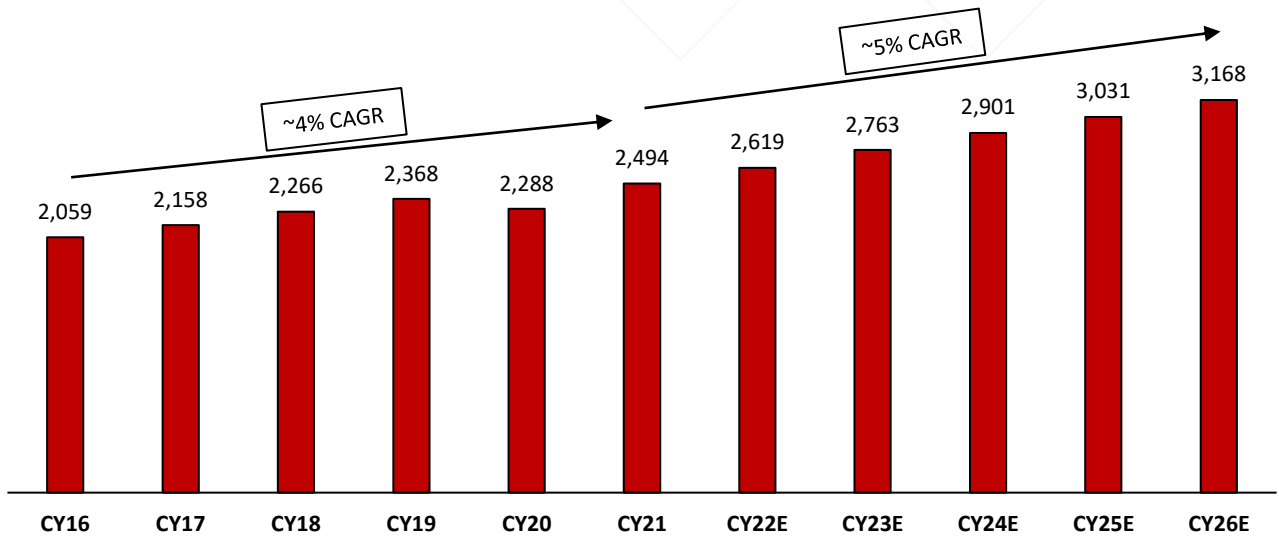
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Global Electronics Market

The global electronics market includes various elements like Electronics Products, Electronics Design, Electronics Components, and Electronics Manufacturing Services (EMS). As of CY21, the global electronics industry was valued at \$2,494 Bn. According to an assessment by Frost & Sullivan, this industry is anticipated to exhibit a 4.9% CAGR, ultimately achieving a potential size of \$3,168 Bn by the CY26. The catalysts for future growth are higher disposable income, higher internet penetration, the proclivity of the younger demographic toward advanced technologies, and the growing prominence of e-commerce platforms.

Global Electronics Industry Market Size (in US Bn)



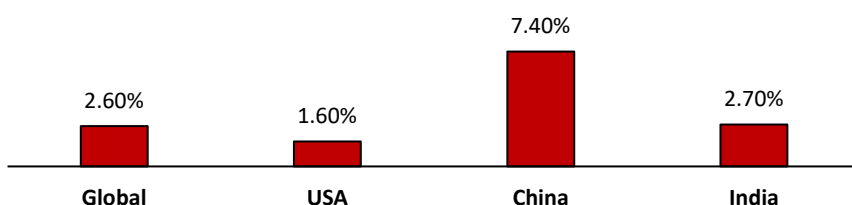
Source: Cyient DLM RHP, Keynote Capitals Ltd.

Electronics manufacturing contribution to GDP for major countries

China is the foremost economy in terms of its electronics manufacturing contribution to the GDP, representing a notable 7.4% as of CY21. However, factors like escalating labor expenses and stringent environmental norms is impacting China's competitive edge in this sector. As a result, a substantial portion of the electronics manufacturing landscape in China appears poised for potential relocation to other countries.

In the United States, the electronics manufacturing industry is important to the national economy, accounting for 1.6% of GDP and 0.7% of jobs as of CY21. Simultaneously, the electronics sector in India contributes ~2.7% to the GDP. With the government's growing emphasis on fostering domestic production of electronic components, the electronics industry is projected to elevate its GDP contribution to an estimated 4.7% by CY26.

Electronics manufacturing contribution to GDP for major countries (CY21)



Source: Avalon Technologies RHP, Keynote Capitals Ltd

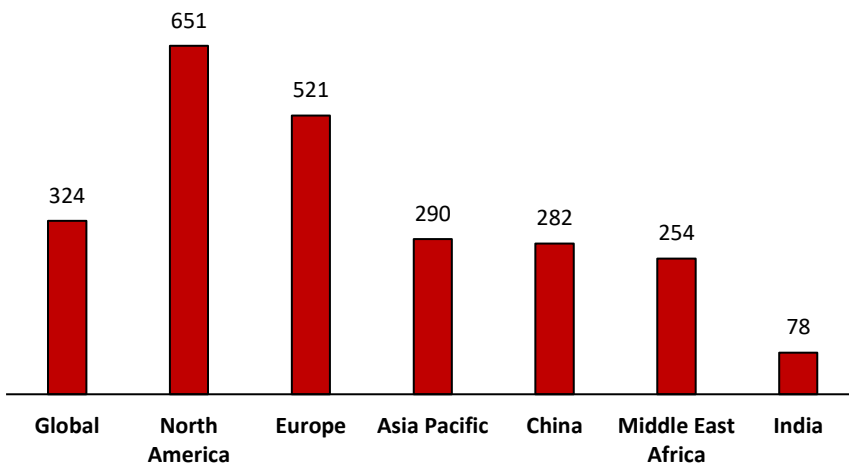
Per Capita Income

The growth of the electronics sector is being propelled by heightened worldwide consumer expenditure. As emerging economies expand, there is a parallel surge in demand for electronics among consumers due to enhanced affordability. Simultaneously, heightened competition is compelling a reduction in the costs associated with electronics manufacturing, thus further lowering the prices of products for individual consumers.

On a global scale, per capita electronic consumption is on the rise, presently standing at \$324 p.a. Notably, the highest per capita consumption is observed in Western regions, with a swift increase witnessed in major economies like North America and Europe. This is primarily attributed to the increasing adoption of wireless connectivity across a multitude of electronic devices.

In contrast, India exhibits a per capita electronics consumption of only \$78 p.a., a quarter of the global average. Nevertheless, domestic electronics consumption in India is rapidly expanding due to urbanization trends and the uptake of electronic products in Tier 2 and Tier 3 cities.

Per Capita Consumption of Electronics in Major Economies as of CY21 (in \$ p.a.)



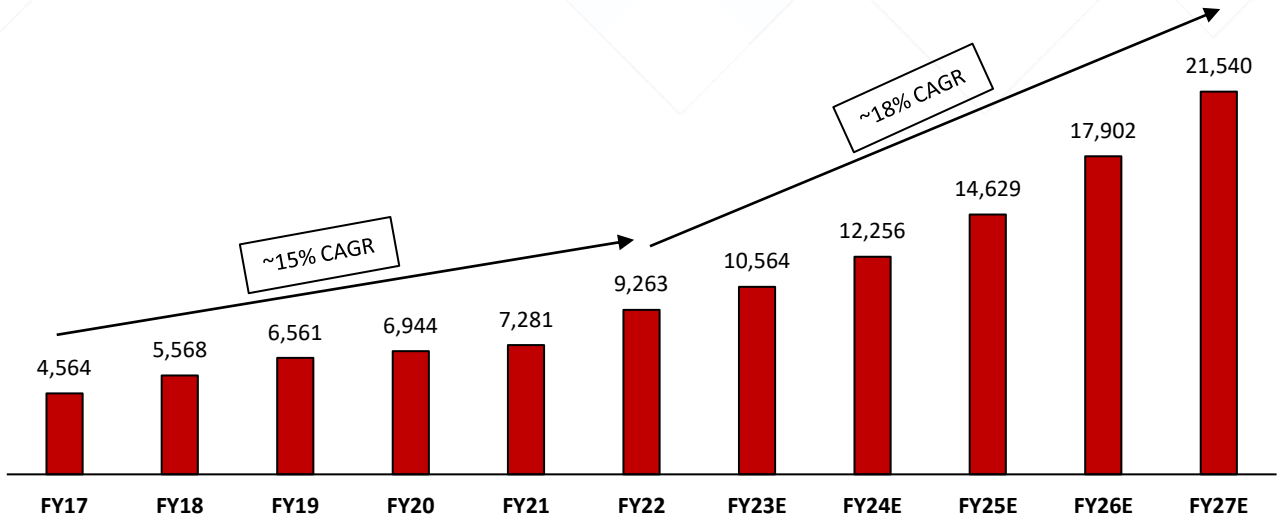
Source: Cyient DLM RHP, Statista, Keynote Capitals Ltd.

ESDM Industry | Indian Electronics Market

Indian Electronics Market

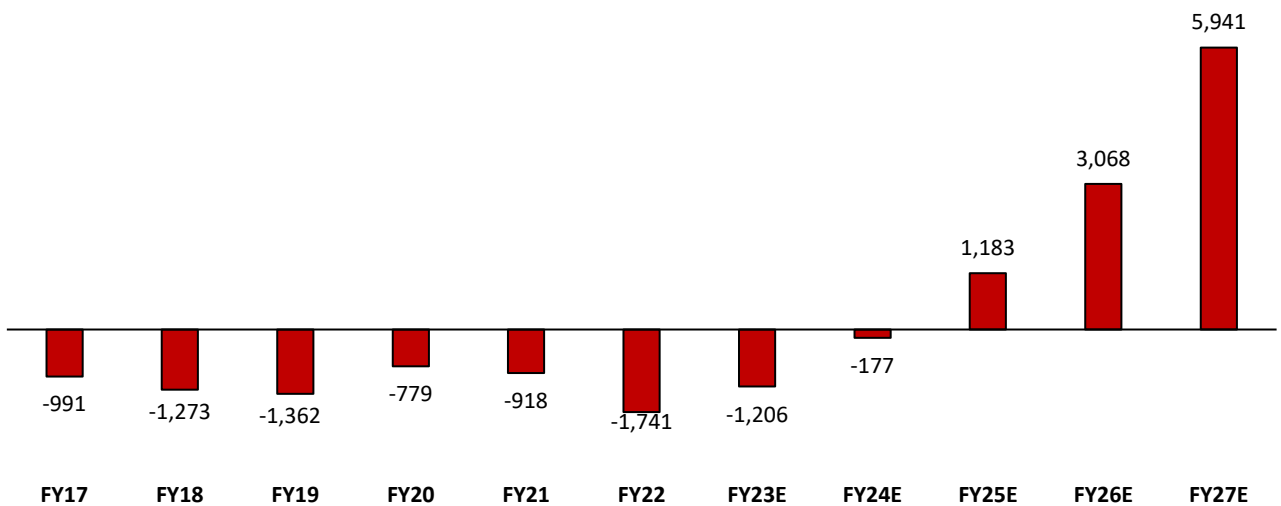
Electronics is one of the fastest-growing industries in the country. The total electronics market (domestic electronics production and imports of finished goods) in India was valued at Rs. 9,263 Bn in FY22, which is expected to grow at a CAGR of 18.4% to reach Rs. 21,540 Bn in FY27E. The industry's landscape is changing significantly, and revised cost structures have shifted the focus of multinational companies towards India.

Indian Electronics Industry Market Size (in Rs. Bn)



Source: Cyient DLM RHP, Keynote Capitals Ltd.

Indian Electronics Industry is expected to become a net exporter (in Rs. Bn)

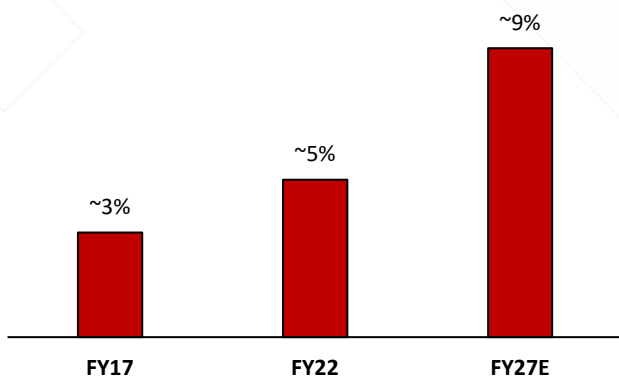


Source: Cyient DLM RHP, Keynote Capitals Ltd.

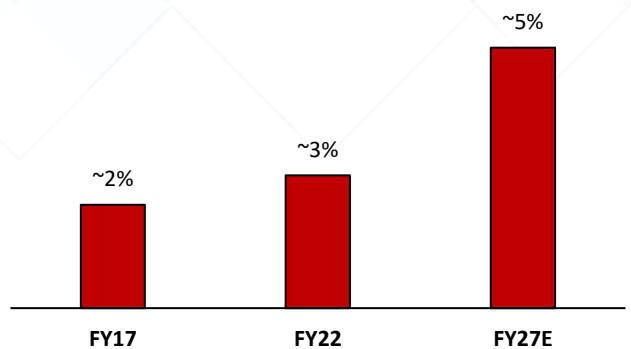
ESDM Industry | Indian Electronics Market

As of FY22, India contributed ~5% to the global electronics market. By FY27, this share is expected to expand to ~9%. This notable surge in India's market presence will shore up due to several factors, including a rise in per capita expenditure, heightened demand for electronic goods, robust growth in electronics exports, and various other contributing elements.

Indian Electronics Market Share (%) in Global Electronics Industry



Indian Electronics manufacturing contribution to GDP (%)

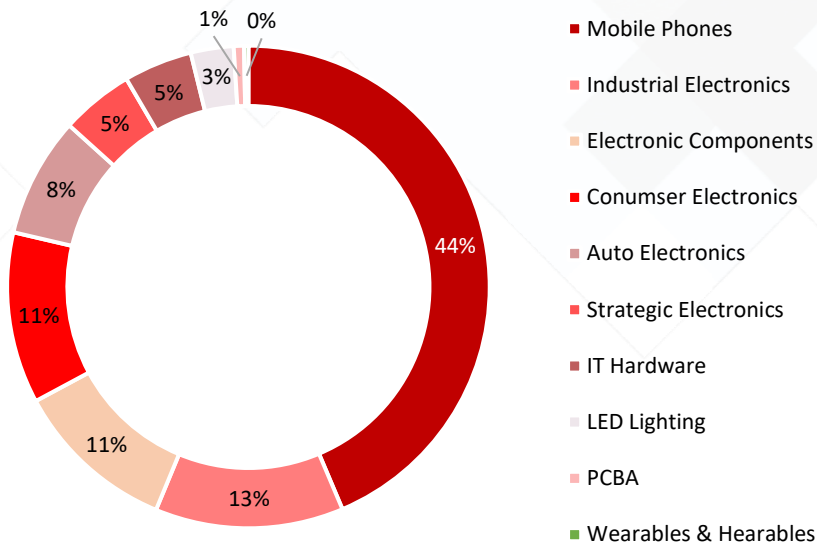


Source: Cyient DLM RHP, Keynote Capitals Ltd.

The government's explicit goal of augmenting manufacturing capabilities within India has been supported by establishing a conducive environment. This encompassing initiative entails measures such as tailored customs duties for specific products, eliminating duties on components, and actively promoting localized component manufacturing. These efforts reflect a commendable endeavor to propel domestic manufacturing. Additionally, the government has taken several steps to make it easier for companies to do business, leading to a rise in foreign companies setting up manufacturing operations in the country. This fostering environment has indeed acted as a catalyst for the Electronic Manufacturing Services (EMS) and Original Design Manufacturer (ODM) market, as electronics brands and Original Equipment Manufacturers (OEMs) persistently strive for collaboration and partnership.

In recent times, there has been a substantial uptick in India's demand for electronic products, which led to advancement in the ESDM segment. Key drivers such as economic labor costs, a proficient workforce, and multiple government initiatives like Product Linked Incentives and the National Policy of Electronics (leading domestic and foreign companies to establish and expand their manufacturing operations in India). India possesses the essential elements needed to become a significant player in the global electronics manufacturing landscape. Evidencing this progress, India currently holds the position of the world's second-largest mobile phone manufacturer.

Production Profile of the Indian Electronics Industry – FY22



Source: MeITY, Keynote Capitals Ltd.

Key Growth Drivers for the Electronics Industry in India

Improvement in demand and supply scenario: The industry is poised to receive momentum due to multiple factors, including a steady growth trajectory for the economy, the implementation of the Digital India program, escalating disposable incomes, evolving lifestyles, the extension of organized retailing into tier 2 and tier 3 cities, availability of electricity, better internet infrastructure, and improved logistics systems. It is on the foundation of these robust fundamentals that numerous international brands, in collaboration with their supply chain counterparts, have made substantial investments in the Country's electronics manufacturing infrastructure in recent times.

China + 1 Strategy: OEMs from US & Europe are contemplating the exploration of an alternative country for supplementary production, as opposed to an outright substitution of China. India stands in a favorable position to reap the advantages of the global OEMs' adoption of the "China + 1" strategy, aimed at diversifying their supply chains.

Localization of the supply chain: Elevated levels of domestic consumption and outsourcing activities are anticipated to exert a compelling influence on domestic electronics manufacturers. This influence is expected to lead them to establish and bolster local component ecosystems and augment their capacity for sourcing components domestically. This strategic move is poised to fortify and streamline the ecosystem.

Emerging Technology: The diminishing lifecycles of electronic products can be attributed to swift technological progress and the introduction of enhanced technology. The advent of cutting-edge technologies like IoT, AI, as well as the integration of robotics and analytics within the industrial and strategic electronics sectors, has collectively propelled the advancement of electronic products, thereby augmenting demand.

WHAT IS ESDM?

ESDM means Electronics System Design and Manufacturing, which includes but is not restricted to, Electronics Hardware Design and Manufacturing (which shall include embedded software) for IT, Telecommunications, Defense, Medical, Industrial, Automotive, Consumer Products and accessories required for the aforesaid products and applications.

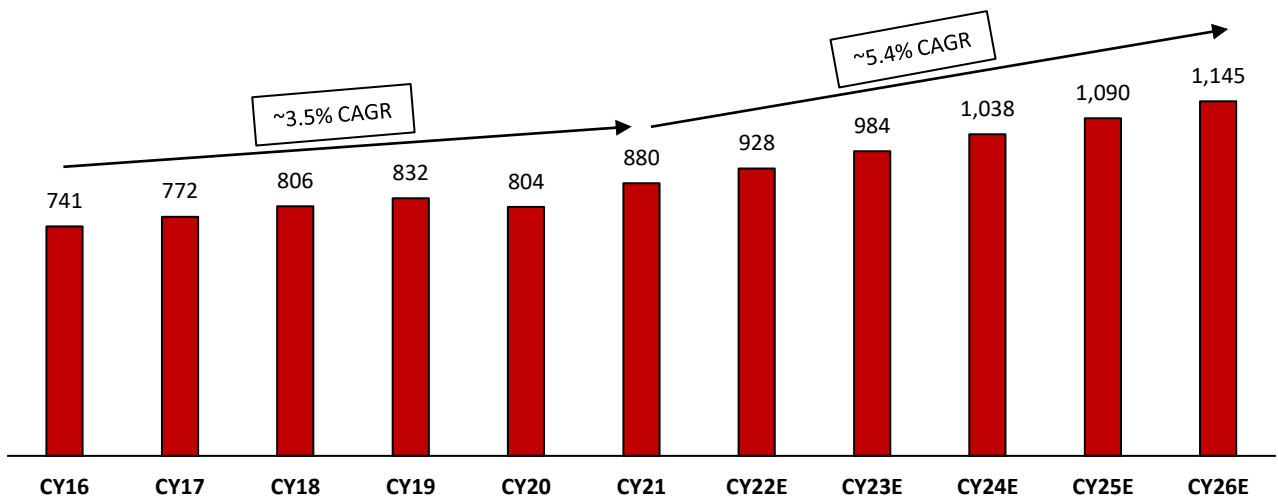
Global ESDM Industry

Historically, the global ESDM market has been under the dominance of firms engaged in the production of electronic goods, primarily through the assembly of components onto Printed Circuit Boards (PCBA) and the construction of complete units for OEMs, with the latter traditionally responsible for design aspects. However, this landscape is undergoing rapid transformation, and OEMs are progressively recognizing the competencies and contributions of ESDM enterprises. Consequently, ESDM companies' participation extends beyond manufacturing, encompassing product design and development, testing, and post-sales services, including repair, re-manufacturing, and holistic product lifecycle management. Noteworthy design-centric undertakings include product conceptualization, chip design, intricate Very Large-Scale Integration (VLSI), circuit board creation, and embedded system development.

Global ESDM accounts for ~35% of the Global Electronics industry. Global ESDM will grow at a CAGR of ~5.4% from CY21 to CY26E, whereas in-house OEMs are expected to grow at a CAGR of ~4.6% in the same period, suggesting that outsourcing of electronics manufacturing is further going to increase.

With clear benefits in terms of production efficiency, reduced overhead, labor costs, and faster new product introductions, OEMs today continue collaborating with ESDMs to develop their products. In addition, OEMs are also increasingly moving product design and development processes to ESDM partners.

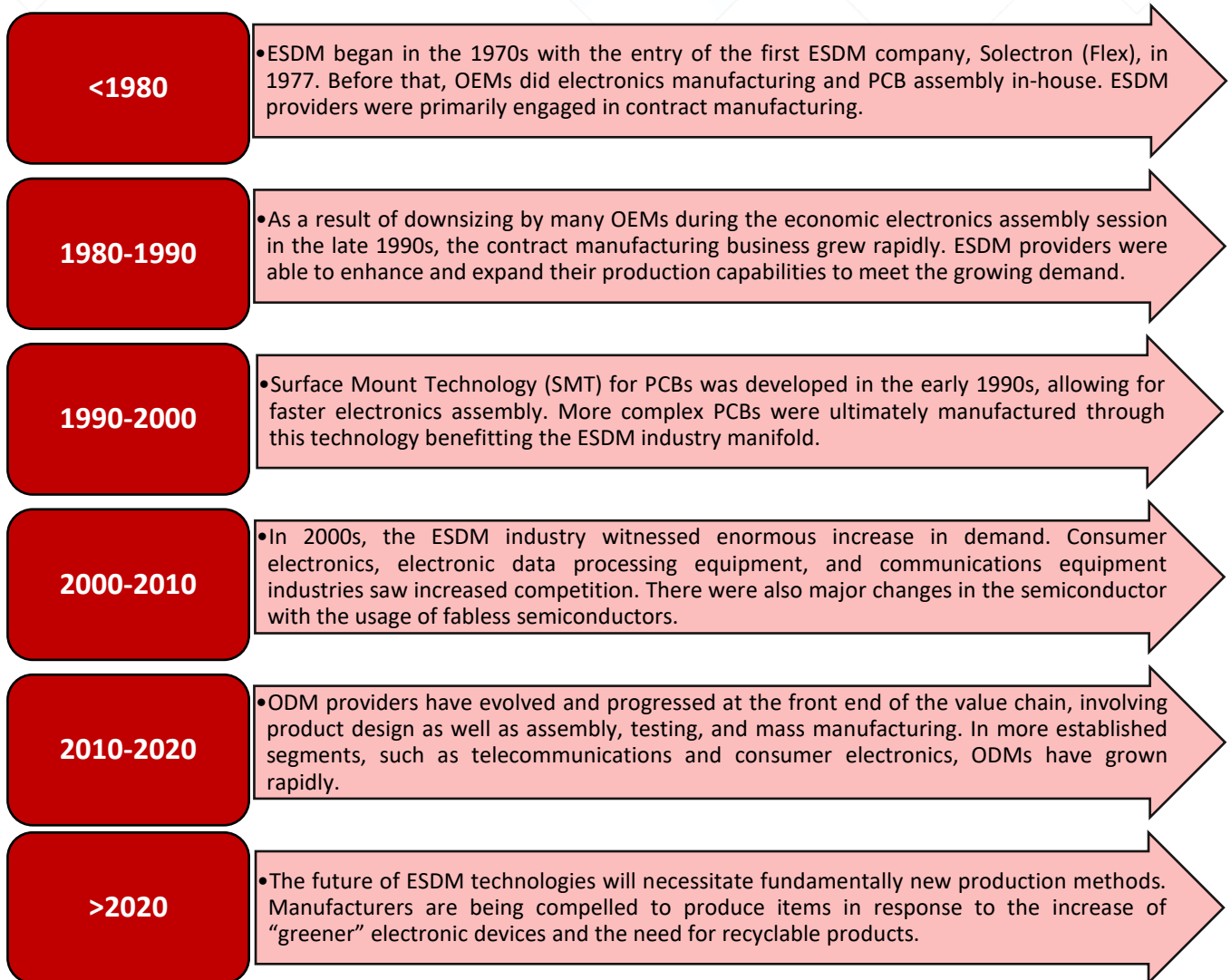
Global ESDM Industry Market Size (in US Bn)



Source: Avalon Technologies RHP, Keynote Capitals Ltd.

History of the Global ESDM Industry

The ESDM market was established over five decades ago to execute manufacturing designs from government, defense, and research institutions. As the years progressed, the ESDM market grew to support demand exceeding the OEMs' manufacturing capacity. By the mid-1990s, OEMs started outsourcing PCB assembly on a large scale. By the end of the 1990s and in the early 2000s, several OEMs sold their assembly plants to major ESDM players. A wave of partnerships followed as the more cash-rich ESDM companies started buying the existing plants and the smaller ESDM companies to consolidate their position in the global market.



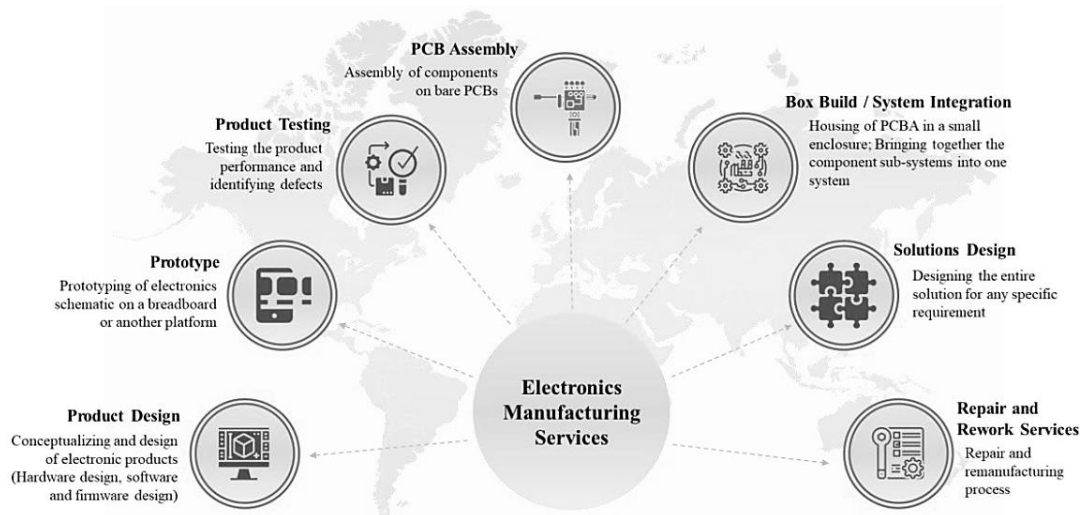
Source: Kaynes Technology RHP, Keynote Capitals Ltd.

ESDM Industry | Global ESDM Industry

Range of Services offered by ESDM Companies

ESDM firms are suitably equipped to offer a comprehensive array of services encompassing electronic components' design, assembly, production, and rigorous testing, primarily catering to OEMs. These ESDM entities are amenable to contractual engagement at various junctures within the manufacturing workflow.

In response to evolving industry trends, OEMs, who traditionally restricted their contract manufacturing partnerships to ESDM companies, have also progressively begun outsourcing design services to them. This broadening spectrum of services has resulted in a heightened reliance of OEMs on ESDM firms. Consequently, this increased dependency serves as a catalyst for expanding wallet share per client and the capacity to increase their pricing power over clients.



Source: Avalon Technology RHP, Keynote Capitals Ltd.

Product Design: Design services encompass a range of activities that transpire after ascertaining the precise requirements of the customer but prior to the commencement of manufacturing or the initiation of assembly. Based on inputs from the OEMs, the ESDM Companies create conceptual designs, which are shared with the OEMs for inputs and approvals.

Prototype: The subsequent phase entails the development of a Proof of Concept (POC) to validate the conceptual design's functionality. Once the principles of design for manufacturability, design for testing, and design for servicing are firmly established, prototypes are fabricated to ensure that the product will effectively fulfill its intended purpose within the context of large-scale production.

Product Testing: Testing is essential across the entire ESDM value chain. ESDM companies that can design test solutions at the PCBA level and at the end-of-line product testing, including functional testers and fixtures, are preferred by the OEMs, enhancing customer loyalty and engagement.

PCB Assembly (PCBA): At the core of the electronics industry lies the Printed Circuit Board (PCB). The manufacturing process is commonly known as PCBA when components are affixed to a PCB. PCBA represents a significant undertaking, typically delegated to ESDM companies through outsourcing.

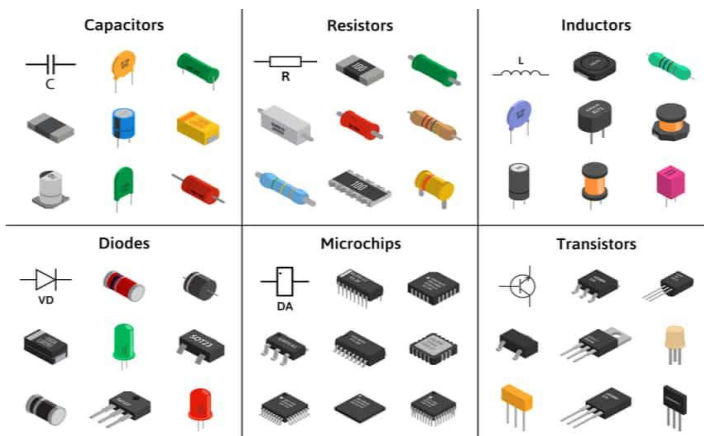
ESDM Industry | Global ESDM Industry

Box Build: In this operational model, an OEM entrusts the entirety of its product manufacturing to an ESDM company. The ESDM company is responsible for fabricating the final product, doing a final round of testing to verify the functionality of the electronics, incorporating the OEM's branding, and subsequently delivering it to the OEM's warehouse for distribution and sales. This model is predominantly employed within high-volume, low-variability (HVLN) product sectors, including mobile devices, computer hardware, and industrial segments. However, it is not limited to HVLN.

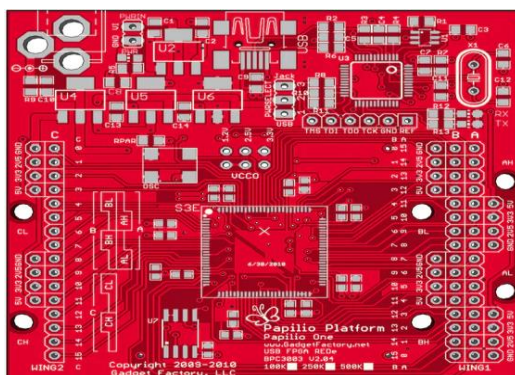
Repair and Rework Services: Aftersales currently generates 7.1 % of the total ESDM market revenue. The demand for repair and remanufacture is not high, as a majority of the electronics products, for instance, mobile phones, tablets, computers, and laptops, do not create a demand for repair or remanufacturing activities. The end-user mindset is fixed on replacement rather than repair; hence, the overall demand for this service is low. Only high-value electronics with warranty will create the necessity for repair and remanufacturing, for instance, telecom or certain products in the aerospace and industrial sectors.

Raw Materials Required by ESDM companies

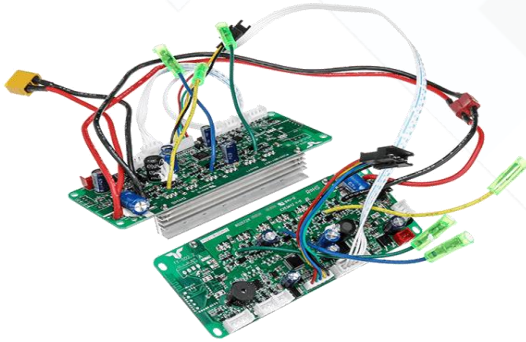
Electronics components: Components such as micro-controllers, capacitors, resistors, inductors, micro-chips and many more.



Bare PCB: A bare board PCB refers to a printed circuit board that is devoid of through-holes or electronic components. Empty, as usual, it is regarded as the skeleton of the conventional PCB before it becomes modified through holes or electronic components. A bare board comprises the PCB substrate, metal coating, vital conductive pathways, and patterns. Due to lower prices and lack of raw material availability, infrastructure, and other factors, ~90% of bare PCBs are imported.



Wire Harness: Wiring harnesses are pre-assembled bundles of wires and connectors used to transmit electrical signals and power within electronic devices or systems. Wiring harnesses are an essential part of the assembly, especially in applications where multiple components must be interconnected. They are crucial in ensuring the final product's functionality, safety, and reliability.



Plastic Parts: Majority of ESDM companies source components from specialized plastic molding firms and serves as an external enclosure upon the completion of the Box-build process.

Avalon Technologies Ltd manufactures plastic parts



PCB Assembly – Product Manufactured by ESDM companies

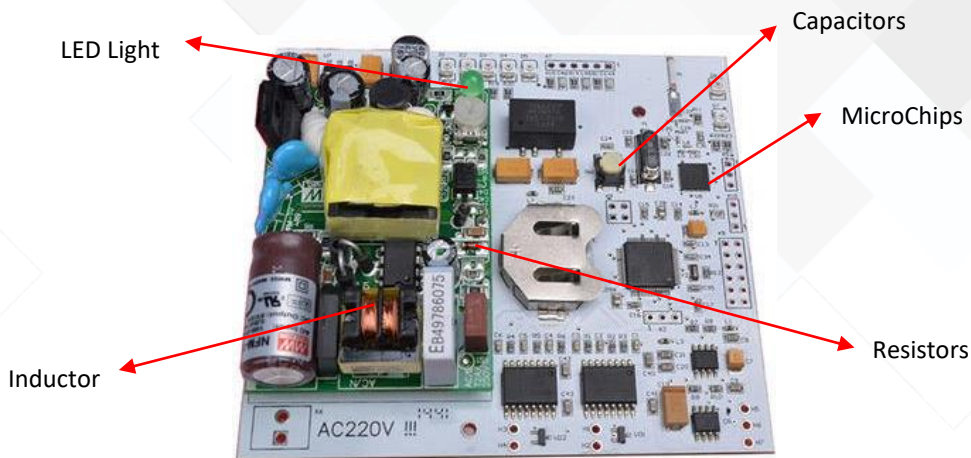
PCB assembly is a process of connecting components onto a PCBs. Components are placed onto the footprints or inserted into the via holes and soldered to complete the electronic circuitry.

There are two main categories of assembly:

- 1) Surface Mount Device Assembly
- 2) Plated Through Hole Assembly

Surface Mount Technology represents a space-efficient alternative to Through Hole Techniques, enabling the creation of smaller, lighter, and faster electronic devices. This methodology facilitates cost reduction, resulting in lower per-unit expenses. Furthermore, it boasts a relatively higher degree of automation, which enhances overall manufacturing capacity. However, it presents challenges in terms of visual inspection and is less resilient to environmental stressors when compared to Through Hole Techniques.

Example of PCBA Board

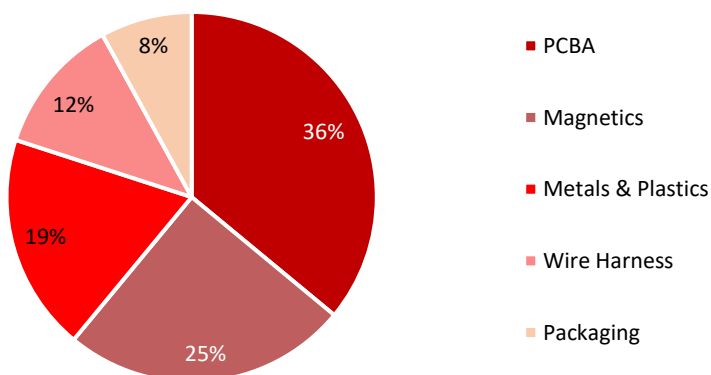


Box Build Systems – Product Manufactured by ESDM companies

In box build system, the OEM delegates the entire product assembly process to a third-party ESDM firm. The ESDM firm assumes responsibility for the complete product assembly and white label it for OEMs, and subsequently delivering the finished product to the OEM's warehouse for resale. They orchestrate the assembly of the final product and conduct requisite testing prior to dispatch. This manufacturing approach finds extensive application in HVLM product categories, such as mobile devices and computer hardware. However, it is not limited to HVLM.

A box build encompasses all assembly tasks related to electromechanical assemblies, excluding the production of the PCBA. The box build process encompasses the integration of PCBAs, cables, wires, harnesses, electromechanical components, and other electronic components tailored to the specific product category. The execution of the box build process is highly project-specific, with complexity levels varying from one project to another. Common activities within the box-build assembly process involve the integration of sub-assemblies, installation of additional components, routing of cables or wire harnesses, and the fabrication of enclosures.

Global ESDM Box Build Market Split (%) – CY21



OEMs Dependency To Further Increase on ESDM Companies

The practice of outsourcing the design and manufacturing of electronic components has been prevalent in the industry for over three decades. This trend is projected to persist, with OEMs increasingly turning to CMs and ODMs for design and manufacturing functions in the long run. Such a shift is poised to contribute to the overall growth of the ESDM sector significantly.

Increasing raw material cost and logistics expenses are negatively impacting the manufacturing costs of OEMs, leading them to focus more on outsourcing. OEMs are looking for more services from ESDM companies rather than just getting done with CM, and they are looking for end-to-end solutions, including design and after-sales services. The ODM companies have versatile capabilities in system designs, plastic moulding, PCBA, software engineering, and more. Instead of investing in R&D, new entrants or Tier-II players collaborate with ODMs to select and develop specific models from existing models to enter the market. This becomes a big reason for the increasing stickiness of clients and the ability of ODM companies to garner more operating margins than CM companies.

Global ESDM Market Segmentation – ODM vs Contract Manufacturing (CM)

ODM Model

Within this framework, ESDM companies conceptualize, design, and engineer products in accordance with specifications provided by OEMs. Subsequently, these ESDM entities oversee component procurement, conduct fabrication and assembly, conduct final product testing, and manage logistics and post-sales service-related activities. The ODM model provides ESDM companies the opportunity to cultivate deeper and enduring business relationships with OEMs. While this business model demands additional investments in research and development, as well as working capital, it yields higher profit margins, along with sustained business and heightened customer retention, when compared to the CM model.

CM Model

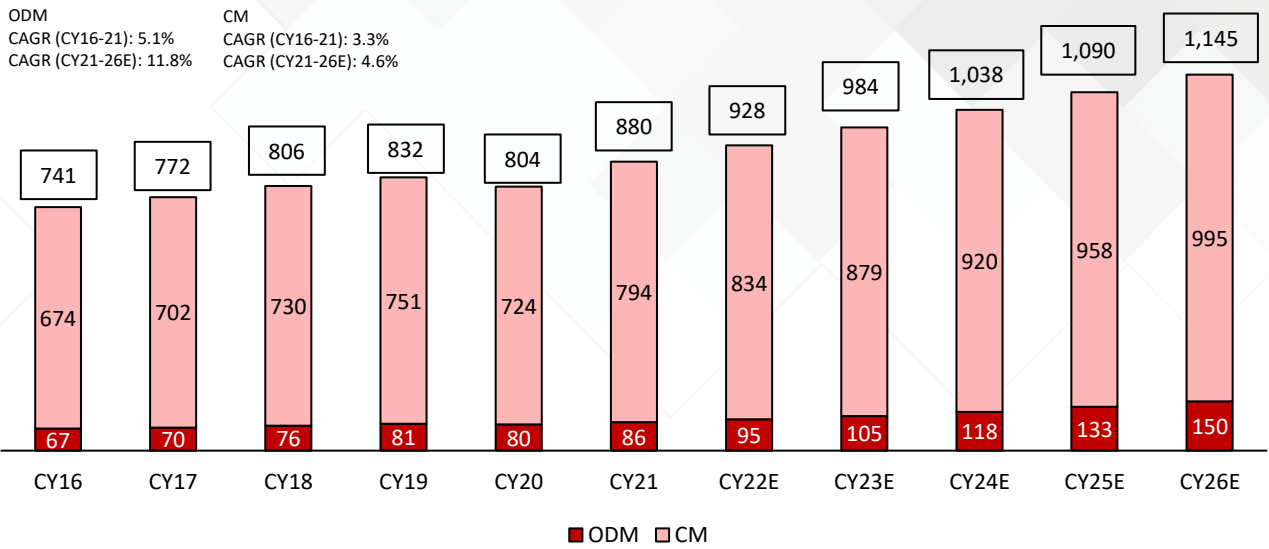
Currently, this prevailing model is widely adopted. In this paradigm, OEMs furnish designs and specifications to ESDM companies. CM entities proceed to procure components, engage in the manufacturing or assembly of said components, and subsequently deliver the finished product back to the OEMs.

CM companies are progressively augmenting their capabilities to provide ODM or Joint Design Manufacturing (JDM) services. Notably, OEMs are increasingly inclined towards engaging on an ODM/JDM basis. This arrangement is mutually advantageous, as ESDM companies stand to gain higher profit margins while OEMs can devote their resources to expansion endeavours.

Contract Manufacturing means just EMS services, which doesn't offer design services.

ESDM Industry | Global ESDM Industry

Global Market Segmentation (in USD Bn)



Source: Avalon Technologies RHP, Keynote Capitals Ltd.

Point of Difference	ODM	CM
IP Rights	Retains IP rights for design	OEMs hold IP rights
Margin	Have more negotiating power [better margin]	Have low negotiating power [low margin]
Client Stickiness	Difficult to switch as ODM own the design rights	Comparatively, easier to shift as CM don't own the rights *
Economies of scale	Low	High (more customers leading to Economies of Scale as technicality is low)
Production Time Taken	High (as customization of product is high)	Low
Cost	High cost due to R&D	Low cost

We posit that there may exist additional factors that contribute to the decision of retaining the same CMs. These factors encompass, but are not limited to, the expediency of delivery, upholding superior quality standards, adeptness in managing substantial production volumes, and various other pertinent considerations.

Source: Syrma SGS RHP, Keynote Capitals Ltd.

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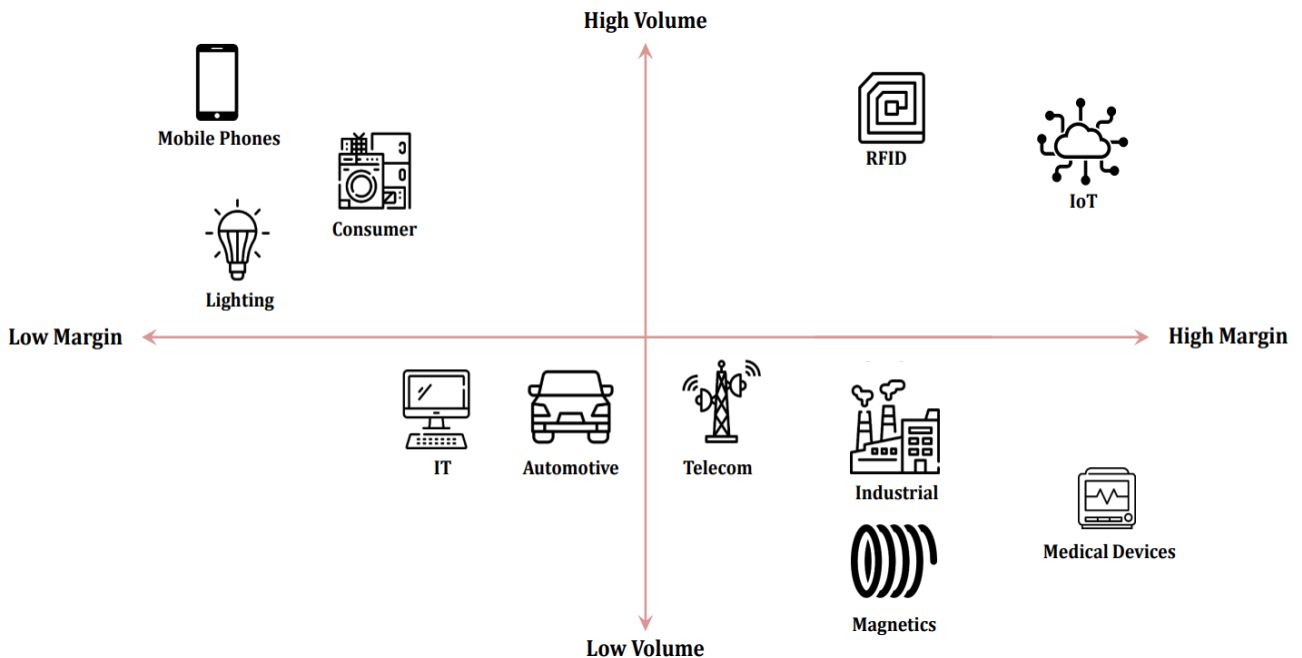
Global ESDM Market Segmentation – End-User Industries

ESDM finds its application across a diverse spectrum of sectors, encompassing Mobile Phones, Consumer Electronics, Automotive, Medical, Industrial, many more. Forecasts indicate that the demand within these sectors is poised to outpace the growth of the overall ESDM industry over the next five years. Specifically, sectors such as Industrial (~6.5% CAGR), Medical (~6.1% CAGR), Automotive, Aerospace & Defence (both ~6% CAGR), Telecom (~5.8% CAGR). Notably, the Mobile Phones sector, although constituting the largest share at ~24% (as of CY21), is expected to expand at a comparatively slower rate, at less than 4% in the same period.

Application mix (in USD Bn)	CY21	CY22E	CY23E	CY24E	CY25E	CY26E	CAGR
Telecom	95	101	106	113	119	126	5.8%
Industrial	80	85	91	97	103	110	6.5%
Automotive	63	67	71	75	80	85	6.0%
Aerospace & Defence	33	35	38	40	42	45	6.0%
Medical	27	29	31	33	35	37	6.1%
Others	581	610	641	673	707	743	5.1%
Total	880	928	978	1,031	1,086	1,145	5.4%

Source: Cyient DLM RHP, Keynote Capitals Ltd.

Volume and Margin Categorization – By End User Industries



Source: Syrma SGS, Keynote Capitals Ltd.

Global ESDM Market Segmentation – by Manufacturing Location

As of CY21, China held a dominant position in the global ESDM industry, commanding a substantial ~46.7% market share. This leadership position is primarily attributed to several key advantages, including cost-efficient operations, a large pool of highly skilled personnel, robust infrastructure, strategic logistical benefits, and close proximity to the world's largest consumer base across diverse industries. However, an emerging trend among global electronics manufacturers involves adopting a "China + 1" strategy, seeking alternative manufacturing destinations for export purposes. This shift presents significant investment prospects for nations such as Vietnam, India, Indonesia and the Philippines.

China + 1 Strategy

- Rising labor cost is impacting operating margins
- Stricter environmental laws leading to higher compliance costs
- US companies seeking alternative manufacturing destinations

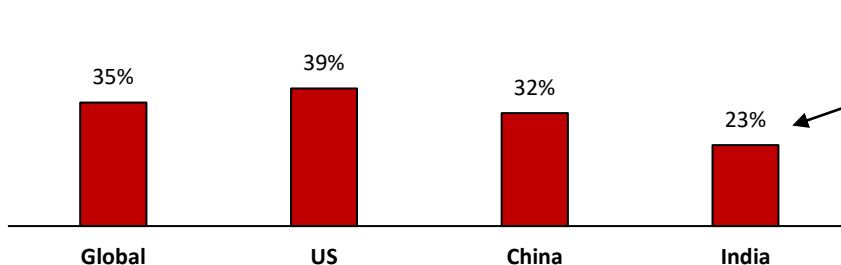
On another front, North America distinguishes itself by embracing cutting-edge technologies and devices. In next five years, the demand for ESDM is expected to surge, driven by heightened consumer demand for electronic devices, a well-established ESDM infrastructure, and evolving government policies that encourage local production. In 2021, the ESDM market in the United States (US) was valued at ~USD 140 Bn. Projections suggest a CAGR of ~6.1%, pushing this market to ~USD 188 Bn by CY26E. The North American electronics manufacturing sector benefits from a skilled labor force, advanced technology capabilities, and pro-business policies. The US, in particular, remains an attractive hub for low- to medium-volume and complex electronics product manufacturing, particularly in sectors such as Medical, Telecom, Information Technology, Automotive, Industrial, and Aerospace & Defense.

Meanwhile, India's ESDM industry, while contributing 2.2% (~USD 19 Bn) to the global ESDM market in CY21, is expecting a remarkable growth. With an impressive CAGR of 32.9%, it is anticipated that India will significantly enhance its global ESDM market share, contributing 7.0% (~USD 80 Bn) by CY26E. The Indian government continues to support initiatives aimed at positioning the country as a prime destination for electronics manufacturing within the region, further stimulating this burgeoning sector's growth.

Geographic mix (in USD Bn)	CY21	CY22E	CY23E	CY24E	CY25E	CY26E	CAGR
China	411	429	447	467	487	508	4.3%
USA	140	148	157	167	177	188	6.1%
Europe	58	60	62	64	66	68	3.1%
South-East Asian Countries	58	61	65	68	72	76	5.4%
India	19	26	34	45	60	80	32.9%
Others	194	200	206	212	219	226	3.1%
Total	880	928	978	1,031	1,086	1,145	5.4%

Source: Cyient DLM RHP, Keynote Capitals Ltd.

Contribution of ESDM to Total Electronics Market (As of CY21)



This indicates that India has significant potential for expansion in the outsourcing of electronics manufacturing

Source: Cyient DLM RHP, Keynote Capitals Ltd.

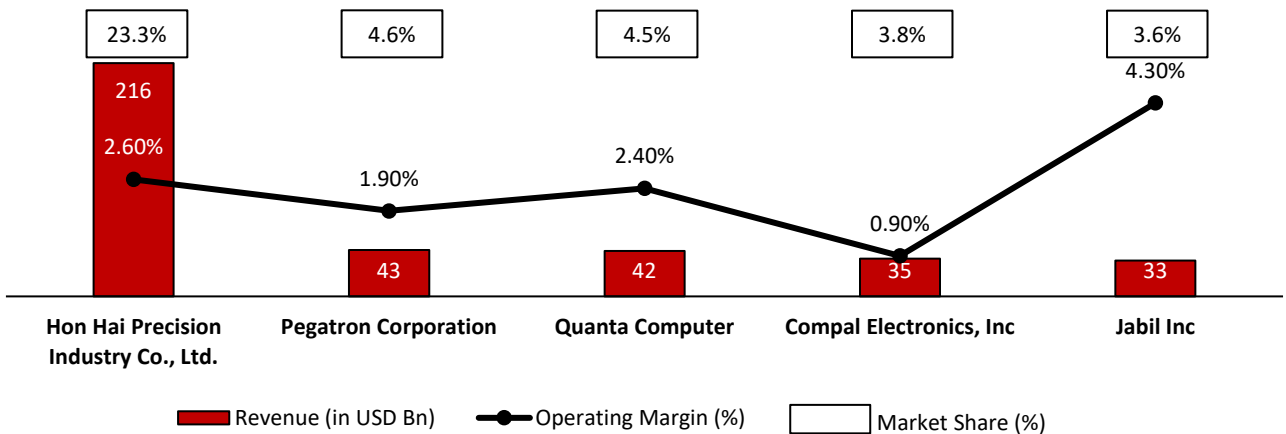
ESDM Industry | Global ESDM Industry

Top 5 Players in Global ESDM Industry

Worldwide, ESDM sector constitutes ~35% of the aggregate electronics industry. The ESDM market has exhibited consistent expansion in recent years, primarily attributable to increasing sales of mobile phones, consumer electronics, and Information Technology (IT) products. The extensive adoption of contractual services by OEMs is a key driver propelling this growth.

The top 5 companies contribute to ~40% of the market. Hon Hai Precision (Foxconn Group company) is the market leader, accounting for ~23% of the market in CY22 and is ~5 times larger than the nearest competitor. Pegatron, Quanta, Compal, and Jabil are some of the leading players in the ESDM market. 4 out of top 5 are Taiwanese companies.

Revenue, Operating Margin(%) and Market Share(%) as of CY22



Source: Companies, Keynote Capitals Ltd.

Name of the Company	End-User industries	Focused Geographies
Hon Hai Precision Industry Co., Ltd.	<ul style="list-style-type: none"> - Consumer Electronics - Cloud & Networking Products - Computing Products - Components & others 	<ul style="list-style-type: none"> - Taiwan - China - Vietnam - India - Brazil & others
Pegatron Corporation	<ul style="list-style-type: none"> - Computing Devices - Consumer Electronics - Communication Devices 	<ul style="list-style-type: none"> - China - Taiwan and Others
Quanta Computer	<ul style="list-style-type: none"> - Communications - Consumer Electronics - Cloud Computing - Networking - Smart Healthcare 	<ul style="list-style-type: none"> - Asia - North America - Latin America - Europe - Southeast Asia
Compal Electronics, Inc	<ul style="list-style-type: none"> - IoT - Healthcare - Laptop Servers - Smart Display - Networking 	<ul style="list-style-type: none"> - Taiwan - Poland - Brazil - USA
Jabil Inc	<ul style="list-style-type: none"> - Appliances - Automotive - Aerospace & Defence - Healthcare - Network & Telecommunications 	<ul style="list-style-type: none"> - USA - China - Singapore - Taiwan and others

Source: Avalon Technologies RHP, Keynote Capitals Ltd.

Indian ESDM Industry

There are more than 12,000 ESDM/EMS companies in India. While a majority of these enterprises primarily provide manufacturing and assembly services, commonly referred to as EMS companies, there are distinct entities that operate within the broader spectrum of services encompassing conceptual product design, component integration, end-product development, and comprehensive solutions, denoted as ESDM companies. EMS companies typically engage in 'Build to Print' operations, encompassing the assembly of either PCBAs or entire finished products. Conversely, ESDM companies leverage their proficiency in conceptual embedded design to augment the value proposition within the electronics manufacturing domain.

Evolution of ESDM Industry in India

The ESDM industry in India is relatively nascent, having been established for nearly three decades. However, its prominence has grown significantly over the past decade, particularly in the last five years. Traditionally, this industry was dominated by Public Sector Undertakings (PSUs), but following the liberalization of the Indian economy, several MNCs and numerous private sector Indian companies have entered the sector. These companies have been catering to the demands of consumer electronics OEMs, and some have even been producing for global markets.

The opportunity in the Indian market is driven by multiple factors, including the anticipated geographical diversification by global OEMs to reduce their reliance on China and the availability of government incentives and schemes, among others. Notably, the period between 2005-07 witnessed significant investments in ESDM operations in India, initiated by the entry of companies like Jabil Circuits and Nokia. This triggered a wave ESDM players started showing keen interest in the Indian market. Since then, the Indian ESDM industry has been on a trajectory of growth. With most global mobile phone manufacturers and their supply chain partners investing in manufacturing facilities, the Indian ESDM industry is poised to realize its full potential in the forthcoming years.

EMS Corridor (since 2017)

- Situated in Chennai, there have been announcements of capital investments by EMS companies totaling ~USD 550 Mn.

Homegrown EMS companies & New investments (2017)

- India is home to over 30 indigenous EMS companies, which have been consistently augmenting their capabilities and capacities. These endeavors have been further bolstered by fresh investments of ~USD 1 billion.

**Expansion and
IPO Route (2017)**

- Several ESDM companies, including Dixon and Amber, have initiated IPOs to enhance their liquidity, facilitating the execution of their expansion strategies. This trend is anticipated to be embraced by other industry participants as well.

**Taiwan
Electronic
Cluster (2018)**

- India has recently pitched USD 350 Mn investment ideas to Taiwan electronic makers.

**EMC in Uttar
Pradesh (2019)**

- First Electronics Manufacturing Clusters (EMC) featuring advanced Smart City infrastructure spans across 210 acres of land in Greater Noida, with a projected investment of USD 18 Bn.

**Make in India &
Notified EMCs
(2020)**

- Companies such as Jabil, Dixon, Flex, Elin, Syrma, and numerous others have committed significant investments towards bolstering their production capacities, aligning with the government's "Make in India" policy endeavors. The government has officially recognized and notified a total of 87 EMCs in this context.

**Investment by
Foxconn (2022)**

- Foxconn has outlined extensive expansion initiatives, with intentions to construct a total of 12 new manufacturing facilities in India, with the targeted completion date set for 2022.

Source: Kaynes Technology RHP, Keynote Capitals Ltd.

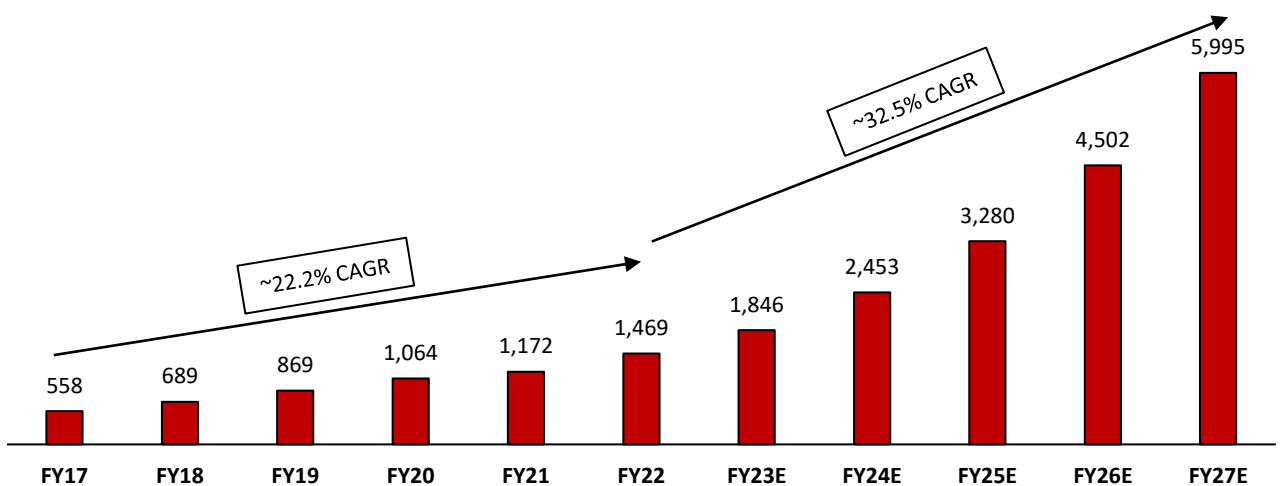
The ESDM sector is poised for substantial growth in the foreseeable future, driven by the ambitious expansion strategies and capacity enhancements undertaken by domestic ESDM entities, capitalizing on favorable policy initiatives. Additionally, India has distinguished itself as a global hub for electronics design, marking a significant achievement. The forthcoming phase of development in the design sector is anticipated to be characterized by the proliferation of indigenous design firms generating proprietary Intellectual Properties (IPs), in contrast to the prior prominence of outsourced captive design service providers. Furthermore, venturing into the design of Integrated Circuits (ICs), Chip Sets, and related components will facilitate the transition towards possessing core design capabilities. This, combined with the anticipated impressive growth in the ESDM market, presents a compelling opportunity for design-centric manufacturing.

ESDM Industry | Indian ESDM Industry

Many OEMs engage in the development, design, and manufacturing of electronic products internally. Currently, OEMs with in-house capabilities account for ~75% of India's total domestic electronics production market, which is estimated at Rs. 7,524 Bn as of FY23E. There is a gradual shift towards relying on ESDM partners. It is expected that by FY27E, ESDM will account for ~31%. ESDM providers are progressively expanding their offerings to include comprehensive design services alongside contract manufacturing. This transition is advantageous for both ESDM providers and OEMs. It enables ESDM providers to secure higher profit margins, while OEMs benefit from the outsourcing of manufacturing and design functions, allowing them to concentrate on other expansion initiatives.

Given the vast, intricate, and highly competitive nature of the electronics industry, OEMs are now inclined towards focusing on marketing and post-sales services, delegating the manufacturing aspect to ESDM partners. An ESDM entity equipped with economies of scale enjoys an advantageous position in adapting to frequent technological shifts, affording enhanced negotiating leverage with suppliers of raw materials.

India ESDM Industry Market Size (in INR Bn)



Source: Cyient DLM RHP, Keynote Capitals Ltd.

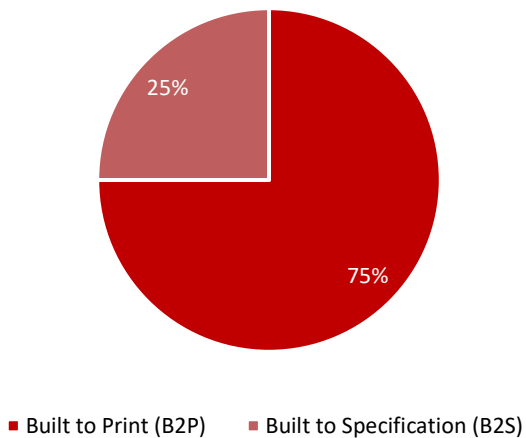
Within the comprehensive ESDM market, ~80% is attributed to CM, with the remaining ~20% allocated to ODM. Indian ESDM entities are progressively transitioning towards ODM models, providing complete turnkey solutions encompassing design, product development, and reverse logistics. Furthermore, heightened competition is compelling ESDM companies to broaden their array of offered products. Within the ODM sector, innovation plays a pivotal role in achieving success. While cost reduction remains a primary motivator for ESDM, augmented design proficiency has also played a significant role in bolstering ODM capabilities.

Indian ESDM Market Segmentation - B2P & B2S

Within the B2P process, a client furnishes the ESDM provider with a comprehensive product specification or drawing meticulously prepared by their internal team. Subsequently, the ESDM manufacturer assumes responsibility for fabricating the product in strict accordance with these provided drawings. The Indian ESDM market predominantly adheres to the B2P process, constituting ~75% of the total ESDM market. In this scenario, the design and specifications are supplied by the clients or OEMs, who retain ownership of the Intellectual Property (IP).

Conversely, the Build-to-Specification (B2S) process entails the creation of products from the ground up, tailored to the client's specific needs, functionalities, or size requirements. ESDM providers assist clients in formulating solutions to meet their precise requisites. Following discussions, the EMS manufacturer aids in the design and development of a product aligned with the specified criteria. In the B2S process, manufacturers guide clients through the entire project lifecycle. However, only a select few entities participate in the B2S process, contributing to ~ 25% of the total ESDM market in India.

Indian ESDM Market Break up (%) FY22



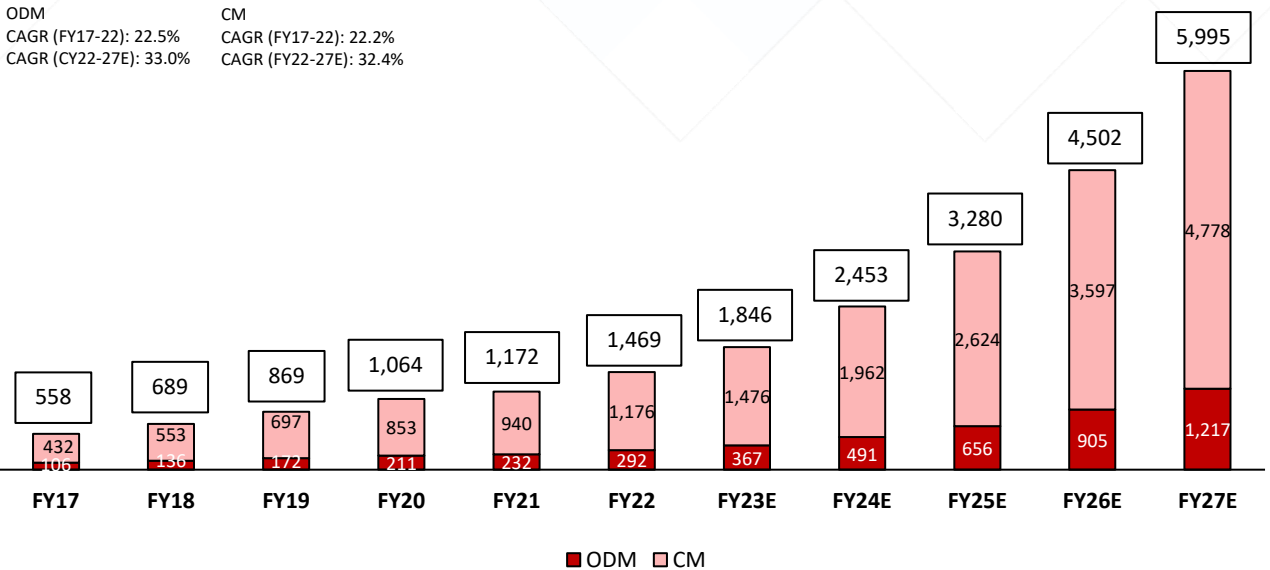
Source: Cyient DLM RHP, Keynote Capitals Ltd.

ESDM Industry | Indian ESDM Industry

Indian ESDM Market Segmentation – ODM vs CM

On the global stage, ODM is exhibiting a growth trajectory that surpasses that of CM. Conversely, within the Indian markets, both categories are demonstrating growth rates that are comparable. This phenomenon signifies an ongoing shift from in-house manufacturing towards outsourcing. As of FY23, the ESDM sector constitutes a modest 25% share of the domestic electronics production landscape.

Indian Market Segmentation (in INR Bn)



Source: Cyient DLM RHP, Keynote Capitals Ltd.

Indian ESDM Market Segmentation – End-User Industries

Various factors drive the growth of India’s ESDM industry. Noteworthy catalysts for this expansion include the escalating availability of economical skilled labor and multiple Indian government’s initiatives. Given the considerable size, complexity, and intense competition within the Indian market, OEMs are allocating more focus towards marketing and post-sales activities, delegating production tasks to CM. ESDM companies are better equipped to adapt to frequent technological shifts swiftly, and their economies of scale grant them enhanced negotiating power with raw material suppliers.

Application mix (in INR Bn)	FY22	FY23E	FY24E	FY25E	FY26E	FY27E	CAGR
Telecom	57	69	83	100	120	145	20.4%
Industrial	58	71	86	105	127	155	21.7%
Automotive	66	86	111	143	185	240	29.4%
Aerospace & Defence	37	51	70	97	134	186	38.3%
Medical	23	32	45	64	89	125	40.3%
Others	1,228	1,635	2,178	2,901	3,863	5,144	33.2%
Total	1,469	1,946	2,578	3,416	4,525	5,995	32.5%

Others includes: Mobile Phones, Consumer Electronics & Appliances, IT hardware, Lighting, Etc

Source: Cyient DLM RHP, Keynote Capitals Ltd.

ESDM Industry | Indian ESDM Industry

In India's ESDM market, mobile phones, consumer electronics, and industrial electronics collectively account for over 75% of the total share. Some EMS providers are gradually transitioning to offer comprehensive design services alongside their contract manufacturing offerings. This transition benefits both ESDM players and OEMs in a mutually advantageous manner.

The substantial financial outlays associated with establishing manufacturing facilities, expanding capacities, conducting research and development, and managing manpower resources significantly influence OEMs to avail themselves of ESDM services. Furthermore, providing post-warranty servicing support by ESDM firms constitutes a valuable asset for OEMs in augmenting their market presence.

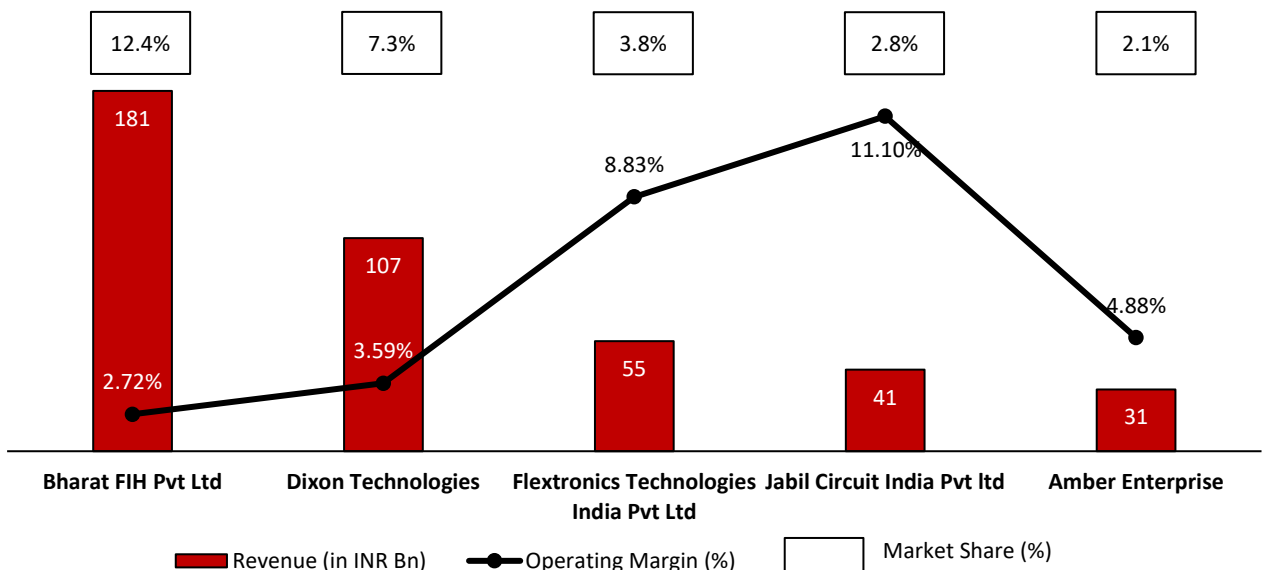
Top 5 Players in India's ESDM Industry

In India, ESDM sector constitutes ~25% (as of FY23) of the aggregate electronics industry. With strong growth of ~32%+ for ESDM industry in India it is expected that it will contribute ~31% of the aggregate electronic market by the end of FY27.

The Indian ESDM/EMS market consists of more than 12,000 companies. However, the top 5 companies contribute to ~28% of the market. Bharat FIH Pvt Ltd (A Foxconn Technology Group Company) is the market leader, accounting for ~12.4% of the market in FY22 and is ~1.7 times larger than the nearest competitor. In India, 3 Out of top 5 companies has an international parent.

*World's Largest Player is ~93 times larger (in terms of revenue [*conversion rate 1 USD = Rs 78]) than India's Largest Player as of FY22. Suggesting Indian Companies have huge room for future growth.*

Revenue, Operating Margin(%) and Market Share(%) as of FY22



Source: Companies, Keynote Capitals Ltd.

ESDM Industry | Indian ESDM Industry

Name of the Company	End-User industries
Bharat FIH Pvt Ltd	<ul style="list-style-type: none"> - Mobile phones - Television - Electric Vehicles - Hearables
Dixon Technologies	<ul style="list-style-type: none"> - Consumer Electronics - Home Appliance - Lighting Solutions - Mobile Phones - Security Surveillance System - Medical Electronics - Reverse Logisitcs
Flextronics Technologies India Pvt Ltd	<ul style="list-style-type: none"> - Mobile phones - Mobile Chargers - Set-up Box - LED Bulbs - Automotive Electronics - Telecommunication equipment
Jabil Circuit India Pvt Ltd	<ul style="list-style-type: none"> - Automotive - Consumer Appliances - Telecommunications - Industrial - Healthcare - Defense & Aerospace - Energy
Amber Enterprise	<ul style="list-style-type: none"> - Consumer Electronics - Home Appliances - Industrial - Automotive

Source: Industry Data, Keynote Capitals

Global Companies Setting Up Manufacturing Base in India

As the cost structure of Chinese electronics contract manufacturing keeps increasing, especially with the changing geopolitical situation, OEMs are becoming more interested in moving electronics production to other countries with similar costs, quality, and openness. Given tariff issues and supply chain disruption, there is an urgency to investigate realistic alternatives to manufacturing in China. However, shifting the entire value chain is not an easy task. Integration of sub-tier vendors for metal fabrication, plastics, and other mechanical components in China reduces product cost, efficiency, and time-to-market. Due to the above factors, OEMs are considering adding another country for increased production rather than replacing China entirely and are looking into production locations like India, Vietnam, Indonesia and the Philippines.

Few Notable Expansion:

1) Pegatron, a major supplier to Apple Inc is shifting a major portion of its operations out of China to country like India. Pegatron is expanding its Tamil Nadu's facility (Capex for Phase II is still unknown). Pegatron entered India in 2021 with Rs. 11 Bn worth of investment to assemble iPhone 13 & 14 in India.

2) Reliance Strategic Business Ventures Ltd (RSBVL), a subsidiary of Reliance Industries Ltd (RIL), entered into a JV with Sanmina Corporation. According to reports, the JV will focus on telecom infrastructure (5G), medical & healthcare systems, industrial & cleantech, defense & aerospace, and also plans to establish a manufacturing technology center of excellence that will serve as incubation for the product development and hardware start-up ecosystem.

3) Jabil Circuits India Pvt Ltd announced it is going to invest Rs. 20 Bn in Pune and plans to venture into smartphones, home appliances, mobile spare parts, and food packaging.

4) Foxconn is gearing up to boost its investment in India over the next three years. They are planning to increase their financial commitment from \$8 Bn to a whopping \$40 Bn. Additionally, they are set to ramp up their workforce from 35,000 to a 200,000 in the next three years.

5) Flex, a U.S.-based manufacturer of electronic components, announced in 2020 that it is considering increasing its investment in India to ~\$ 12 Bn to expand its manufacturing capabilities and boost exports from India.

Government's Policy

The GOI attaches high priority to electronics hardware manufacturing, which is one of the important pillars of both "Make in India" and "Digital India" programme. The intent of the Government is to provide a level playing field for domestic manufacturers, enabling them to compete with imports in the sector by rationalizing tariff structure, simplifying procedures, providing incentives, and upgrading infrastructure.

National Policy on Electronics 2019 (NPE 2019)

NPE 2019 has the vision to position India as a global hub for ESDM by encouraging and driving capabilities in the country for developing core components, including chipsets, and creating an enabling environment for the industry to compete globally.

The aims of NPE 2019 are as follows:

- To increase domestic value addition and combine the potential of both domestic demand and export with the aim of making India a global hub of electronics manufacturing.
- To promote an ecosystem of manufacturing by providing a supporting environment by extending the Phased Manufacturing Programme (PMP) to products other than mobile phones, maintaining a progressive duty regime and incentivizing industry to compensate for disabilities as compared to other manufacturing economies.

In furtherance of the vision of Aatmanirbhar Bharat and positioning India as the global hub for ESDM, a comprehensive program for the development of semiconductors and display manufacturing ecosystem in India has been approved by the Government of India with an outlay of Rs. 760Bn.

Modified Electronics Manufacturing Clusters (EMC 2.0) Scheme

By providing world-class infrastructure, the Government of India is attracting major global electronics manufacturers, along with their supply chains.

The Salient Features of the EMC 2.0 scheme are as follows:

- Financial assistance up to 50% of the project cost subject to a ceiling of Rs. 700 Mn per 100 acres of land.
- 75% of the project cost is subject to a ceiling of Rs. 750 Mn for Common Facility Centres and many more.

Under the scheme, 3 applications for setting up of EMC with a project cost of Rs. 19 Bn, including Central financial assistance of Rs 8.9 Bn have been approved. These EMCs are poised to attract an investment of Rs. 209 Bn.

ESDM Industry | Indian ESDM Industry

Product Linked Incentive Scheme (PLI) for Large Scale Electronics Manufacturing

The PLI scheme has been notified for Large Scale Electronics Manufacturing in India. The scheme aims to attract large investments in the mobile phone manufacturing and specified electronic components, including Assembly, Testing, Marking and Packaging (ATMP) units.

Under the PLI scheme, 4% to 6% incentive will be provided on incremental sales of goods manufactured in India. These incentives will be offered for a period of 5 years subsequent to the base year (FY 2019-20). The applicant companies will be required to meet minimum thresholds of investment and production and meet the eligibility criteria to receive incentives under the scheme with an outlay of ~USD 5.5 Bn.

Scheme for Promotion of Manufacturing of Electronic Components and Semiconductors (SPECS)

The SPECS has been notified with an aim to strengthen the value chain for the manufacturing of electronic products in India. The target segment comprises of the downstream value chain of electronic products, i.e., electronic components, semiconductor/ display fabrication units, ATMP units, specialized sub-assemblies and capital goods for the manufacture of aforesaid goods. The scheme will lead to higher domestic value addition and strengthen the existing ecosystem of ESDM in India.

Under the scheme, financial incentives of 25% will be provided on capital expenditure (on a reimbursement basis) in new units and expansion/modernization/ diversification of existing units. Under the scheme twenty-nine (29) applications have been approved with total proposed investment of Rs. 110 Bn (details updated as of Aug-22).

Semiconductors and Display Fab Ecosystem

Aim of the program is to provide appealing incentive support to companies involved in Silicon Semiconductor Fabs, Display Fabs, Compound Semiconductors/Silicon Photonics/Sensors (including MEMS) Fabs, Semiconductor Packaging (ATMP/OSAT), and Semiconductor Design (CAD). It is a comprehensive incentive program approved by the Government of India for the development of a sustainable semiconductor and display ecosystem in the country with an outlay of Rs. 760 Bn.

Peer Analysis

Particulars	Avalon	Cyient	Kaynes	Syrma
General Details				
Incorporation	1999	1993	1989	2004
Number of Plants	12	2	12	13
Plant Location	- Chennai - Bangalore - Atlanta - Fremont	- Hyderabad - Mysuru	- Himachal Pradesh - Uttarakhand - Haryana - Mysuru - Tamil Nadu	- Himachal Pradesh - Haryana - Uttar Pradesh - Tamil Nadu - Karnataka
Business Mix				
Revenue Mix - Product Wise (FY23)				
PCBA	28%	63%	62%	66%
Box Build	54%	32%	30%	18%
Design	3%		3%	
Wire Harnessing & Cable Assembly	9%	1%		
Metal, Magnetics & RFID	6%			16%
Others		4%	5%	
Revenue Mix - Industry Wise (FY23)				
Clean Energy	25%			
Automotive, Mobility & Transportation	21%		50%	20%
Industrial	29%	25%	27%	31%
Communication	11%		6%	
Medical & others	13%	17%	6%	8%
Aerospace & Defence		58%	11%	
Consumer				32%
IT & Railways				9%
Revenue Mix - Geography Wise (FY23)				
Domestic	41%	31%	85%	69%
Export	59%	69%	15%	31%
Revenue Contribution				
	FY22	FY23	FY23	FY22
Top 5	50%	68%	44%	50%
Top 10	65%	91%	60%	65%
Capacity Expansion Plan /Capex Guidance (Rs. In Mn)	350-400	350-400	Phase I Bare PCB: 4,000 Phase I OSAT: 15,000 (70% to be funded by govt) EMS: 1,600	2,000
Financial Details (FY23) (Rs. In Mn)				
Order book	12,310	24,325	26,482	30,000
Revenue	9,450	8,320	11,261	20,480
Gross Profit	3,414	1,868	3,460	5,079
EBITDA	1,183	872	1,699	1,912
PAT	525	317	950	1,193
Ratios (FY23)				
Gross Margin%	36%	22%	31%	25%
EBITDA Margin%	13%	10%	15%	9%
PAT Margin%	6%	4%	8%	6%
Total Asset Turns (x)	0.8	0.8	0.8	0.8
Financial Leverage (Total Assets to Equity)	2.2	5.6	1.5	1.7
NWC (Days)	145	98	100	90
ROE	9.8%	16.0%	9.9%	7.7%
D/E	0.6	1.6	0.1	0.2
Order Book To Revenue	1.3	2.9	2.4	1.5

Note: ROE of Cyient DLM is high because its IPO came post FY23

Source: Companies, Keynote capitals

ESDM Industry | Industry Opportunities

Opportunities

Localization of Supply Chain: High domestic volumes, consumption and higher outsourcing volumes will influence domestic electronics manufacturers to buy the components locally, thus making the ecosystem stronger and closer-knit. Tier-2 companies (companies supplying products to Tier-1 companies/OEMs) are increasingly focusing on product localization, innovative product design, and R&D. However, the extensive financial costs involved in setting up manufacturing, capacity additions/expansions, R&D, manpower, etc. influence them to leverage ESDM services.

China + 1 Strategy through disability analysis: Presently, the production cost of ESDM in China, with considerations for disability analysis, indicates that, with the exception of manufacturing costs, all other factors are advantageous for China. India is undergoing transformative changes that have the potential to render it a formidable contender in this domain. The nation is enacting a range of policies such as the SPECS, PLI, and NPE 2019, which are poised to enhance preferential conditions for India. Furthermore, a sustained emphasis on augmenting infrastructure is anticipated to lead to a reduction in logistical expenses for enterprises in India. Simultaneously, an upsurge in the accessibility of raw materials is expected to result in reduction of material costs. Noteworthy examples include Micron establishing a semiconductor assembly plant and test facility in India and Kaynes Technology undertaking a backward integration process for the production of Bare PCB. These developments strongly indicate that India possesses the potential to bolster its competitiveness in the global ESDM industry.

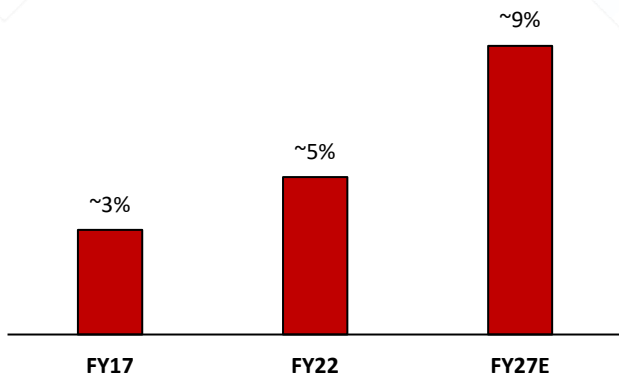
Break-up of components & sub-components in Production cost		High Mix Low Volume (HMLV)		High Volume Low Mix (HVLM)	
Components	Sub-components	China	India	China	India
A. Material and consumables cost	Basic Component costs	74.52	81.06	85.36	90.07
	Inventory costs	1.20	2.44	0.94	1.25
	Total cost of materials	75.71	83.50	86.30	91.32
	% Disability	10.29%		5.82%	
B. Manufacturing cost	Wages (incl. labour costs and productivity)	12.94	7.03	6.41	3.48
	Power	0.74	0.91	0.12	0.16
	Other costs	1.33	2.00	0.88	1.77
	Total cost of manufacturing	15.01	9.94	7.41	5.41
	% Disability	-33.78%		-26.99%	
C. Logistics cost	Total cost of logistics	1.15	2.43	0.13	0.25
	% Disability	110.94%		92.31%	
D. Finance cost	Total cost of finance	2.30	4.13	1.67	3.02
	% Disability	79.57%		80.84%	
Total cost of production (A + B + C + D)		94.18	100.00	95.51	100.00
Absolute disability (Production)		6.18%		4.70%	
Preferential policies	Applicable incentives & EOB measures	2.50	0.50	2.50	0.50
	Total refund	2.50	0.50	2.50	0.50
	% Disability	80.00%		80.00%	
Total Cost		91.68	99.50	93.01	99.50
Absolute disability		8.53%		6.98%	

Source: Bharat FIH, Keynote Capitals Ltd

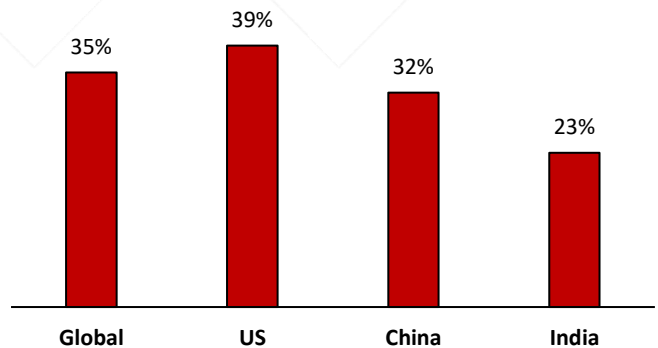
ESDM Industry | Industry Opportunities

Harnessing the megatrend of outsourcing: The phenomenon of outsourcing is an inevitable and advantageous aspect that greatly contributes to various industries. Given the escalating production of electronics in India, the escalating trend of outsourcing manufacturing components to ESDM companies is poised to become an inescapable reality as OEMs will continuously focus on their core activities. Presently, in India, the ESDM sector accounts for 23% (as of FY22) of the total electronics market, in contrast to the global figure of 35%.

Indian Electronics Market Share (%) in Global Electronics Industry



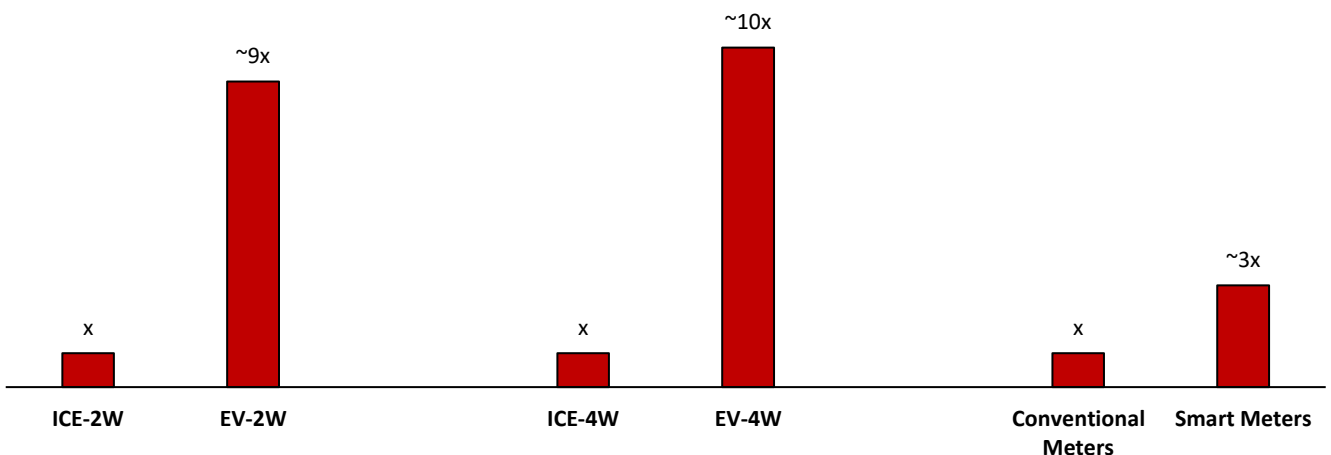
Contribution of ESDM to Total Electronics Market (As of FY22)



Source: Cyient DLM RHP, Keynote Capitals Ltd.

Content of electronics increasing in Products: The surge in electronic content is palpable across various end-user segments, encompassing automobiles, consumer durables, industrial machinery, and telecommunications, among others. Notably, the automotive industry is poised to witness a strong increase in electronic content per vehicle, primarily attributed to the ongoing shift towards electric vehicles. Within the realm of consumer durables, the proliferation of inverter air conditioners and BLDC fans is a key catalyst driving the demand for PCB/PCBA. In the industrial sector, the transition from analog to smart meters, coupled with the widespread adoption of digital displays in capital goods equipment, is fueling the growth of electronic components.

Increase in Electronics Content in Products



Source: Companies, Keynote Capitals Ltd

Threats

Competitive intensity: There are more than 12,000 ESDM/EMS companies in India. Due to its strong growth potential, many companies are entering the industry, which is causing stiff competition in the market, which can lead to profitability pressure and competitive pricing. To create a distinctive edge, companies have to commit substantial resources to R&D to create a differentiation, thereby incurring significant capital expenditure.

Inefficient supply chain: India has a limited component supplier base; a majority of high-value and critical components are imported. Components that are predominantly imported include bare PCBs, and other active components. Moreover, FTAs with ASEAN countries make imports less expensive than domestic production, thereby intensifying the situation. As supply-chain resilience and localization are becoming more significant, India has to take the necessary steps to improve the domestic value chain capability for long-term benefits.

Rich valuation amidst optimistic outlook: Owing to multiple factors mentioned in previous sections, the Indian ESDM industry exhibits the potential to experience a growth of ~33% over the forthcoming years. At present, due to its remarkable growth, Avalon Technologies, Cyient DLM, Kaynes Technology India, and Syrma SGS Technology are trading at 73, 165, 129, and 72, respectively. Nevertheless, even a slight reduction in growth could result in a substantial decline in the valuation of these richly valued stocks.

Company Section

Avalon Technologies Limited

Turnaround in the US business will drive future growth

Avalon Technologies Ltd. (ATL) is one of the prominent Indian ESDM players operating in the “High Mix, Low Volume” segment, catering to customers by manufacturing products with long lifecycles. ATL carries out manufacturing in India and the USA and has a substantial client base overseas. Apart from this, a substantial contribution from “Clean Energy” clients is what differentiates the Company from its peers. As of Q2 FY24, the outstanding order book of ATL stood at ~Rs. 12.4 Bn (excluding LOIs worth Rs. 7.5 Bn). Currently, due to a slowdown in the US economy, the Company is facing difficulties which has impacted margins. We believe that the Company will start showing significant revenue growth along with improved margins as the US business reverts to normalcy.

A higher share of exports and box builds, resulting in industry-leading GPMs

ATL has a history of generating industry-leading gross margins. In FY23, ATL clocked a 36% GPM compared to peers who generated GPMs in the range of 23-31%. This 500-1,300 bps difference in GPMs compared to peers is driven by two factors: a) the higher share of export revenues and b) a higher share of box build. Both exports and box build fetch a higher GPM compared to domestic and non-box build businesses. As of FY23, exports and box build contributed 59% and 47% to ATL’s revenue, respectively.

Moving towards more complex products – Large box builds

Apart from having an industry-leading share of box builds, ATL is also expanding into manufacturing more complex, large-sized box builds. This is going to be a part of the 160,000 sq. ft. expansion that the Company is taking up in Chennai. Out of the total available space, 65,000 sq. ft. will solely be dedicated to manufacturing large box builds. This move will help ATL enter a more complex product category and drive GPMs further as this business gains traction.

Significant contribution from sunrise sectors

Sunrise industries like EV, Solar and Hydrogen contribute significantly to ATL’s revenue. As of FY23, the “Clean Energy” sector contributed 25% to the total revenue of the Company compared to 16% in FY20. Further, ATL also expects production for some of its newly onboarded customers to commence from H2 FY24. Apart from “Clean Energy”, “Aerospace” is another sector that is expected to drive future growth for the Company as both sectors are growing significantly at ~40%.

View and Valuation

The domestic business of the Company is performing in line with its peers, but the Company is currently facing problems with its US business, which is also expected to start normalizing from Q3 FY24 onwards. Given the domestic industry outlook and the US business coming back, we believe that ATL will be able to grow its top line in high teens till FY26, along with an improved PAT margin in the range of 6-7%. Owing to the aforementioned factors, we ascribe a BUY rating on ATL with a target price of Rs. 619, valuing the Company at ~37x FY26E EPS.

BUY

CMP Rs. 478

TARGET Rs. 619 (+29%)

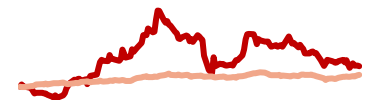
Company Data

Bloomberg Code	AVALON IN
MCAP (Rs. Mn)	31,309
O/S Shares (Mn)	65
52w High/Low	732 / 347
Face Value (in Rs.)	2
Liquidity (3M) (Rs. Mn)	261

Shareholding Pattern %

	Sep 23	Jun 23	Mar 23
Promoters	51.1	51.2	70.8
FIIIs	5.7	8.9	-
DIIIs	19.9	20.2	-
Non-Institutional	23.4	19.7	29.3

Avalon vs Nifty



	Apr, 23	Jun, 23	Sep, 23	Nov, 23
ATL				
NIFTY				

Source: Keynote Capitals Ltd.

Key Financial Data

(Rs. Mn)	FY23	FY24E	FY25E
Revenue	9,447	10,646	12,298
EBITDA	1,128	1,025	1,353
Net Profit	525	542	728
Total Assets	11,673	10,363	11,398
ROCE (%)	14%	10%	13%
ROE (%)	17%	10%	12%

Source: Company, Keynote Capitals Ltd.

ESDM Industry | Avalon Technologies

About Avalon Technologies Ltd

Avalon Technologies Ltd. (ATL) was incorporated in Chennai in the year 1999 as a manufacturing facility mainly to cater to ABV Electronics Inc. In the year 2000, the Company started a plain vanilla PCB design and assembly set-up in India.

Since then, the Company has significantly enhanced its offerings and now operates as a fully integrated ESDM player specialising in high mix, flexible volume manufacturing focussed on complex solutions with high engineering content.

ATL caters to multiple industries like railways, industrials, aerospace, etc., providing customers with mission-critical products with long life cycles.

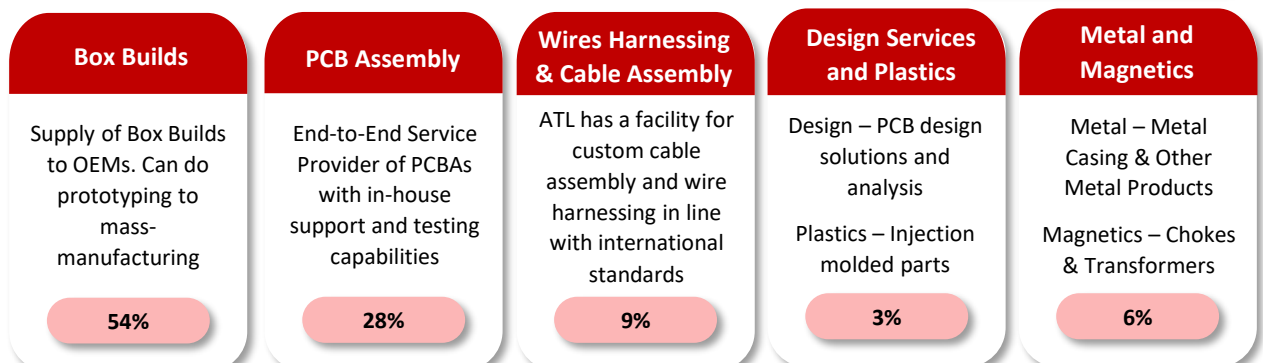
Journey of Avalon Technologies Ltd.

	1999-05	2007-10	2011-23
Milestones	1999 – Incorporated 2003 – Commenced Metals & Plastic Production 2005 – New Facility in Chennai	2007 – Expanded manufacturing in the USA 2009 – Built Design Capabilities 2010 – Entry into Aerospace	2011 – Strategic entry into Railways 2016 – Enhanced Box Build Capabilities 2023 – Fully Integrated ESDM
Geographical Presence	USA	USA, Europe & India	USA, Europe, Japan & India
Industries Served	Power & Communication	Power, Communication, Industrial & Aerospace	Power, Communication, Industrial, Aerospace, Clean Energy, Medical and Others
Capabilities	PCB Assembly	PCB Assembly, Metal, Cable Assembly, and Wire Harness	PCB Assembly, Metal, Cable Assembly, Wire Harness, In-house Design, Magnetics, Plastics, and System Integration
Focus Area	Small Clients and PCB	Large Customers and Diversified Products	Fully Integrated Solutions and in-house Box Build Solutions

Source: Company, Keynote Capitals Ltd.

Product Portfolio of Avalon Technologies Ltd.

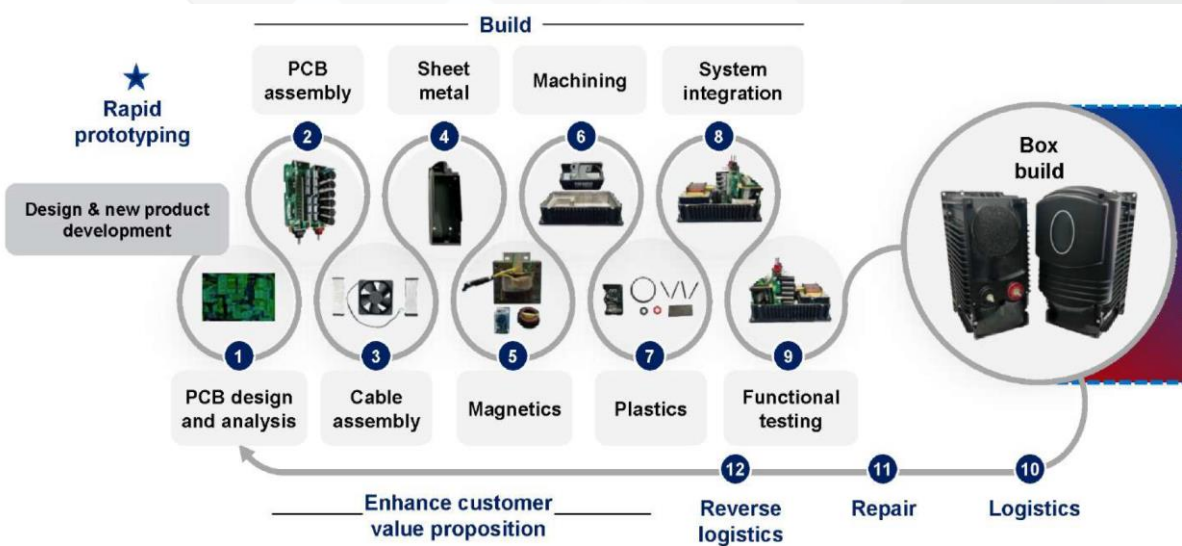
Revenue Contribution FY23



Source: Company, Keynote Capitals Ltd.

ESDM Industry | Avalon Technologies

Ability to offer end-to-end services owing to vertical integration



Source: Company, Keynote Capitals Ltd.

The Company runs a fully integrated operation whereby each operation, right from PCB assembly to making the box build, is performed by ATL in-house. Unlike ATL, peers rely on external support (approved vendors) for functions like cable assembly, sheet metal, plastics, etc.

This is perhaps the reason behind the Company enjoying the highest contribution of box build in its revenue mix.

Substantial share of emerging segments with continued focus



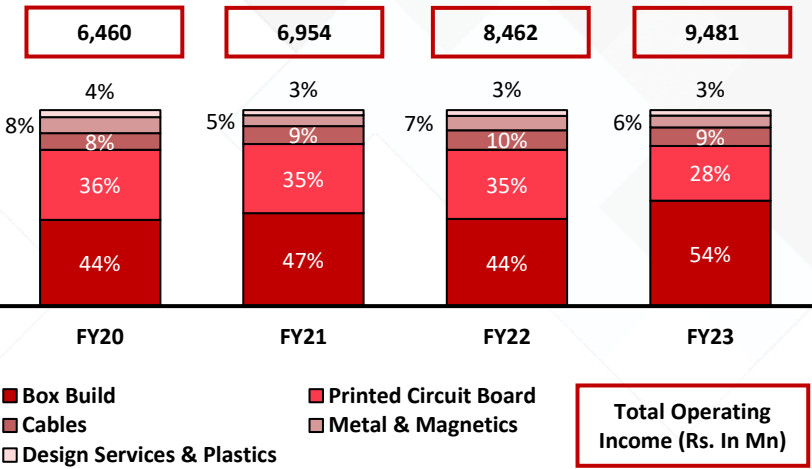
Source: Company, Keynote Capitals Ltd.

Emerging segments like electric vehicles, solar, and hydrogen contribute significantly to ATL's revenue. In FY23, the Clean Energy business contributed 25% to the total revenue.

During H1 FY24, the Company added multiple new customers in this segment, including a large order for charging and data transmission systems from one of India's innovative EV manufacturers. Production ramp-up for these customers is expected to take place from H1 FY24.

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Product Wise Revenue Mix – Significant Contribution from Box Build



The 3 Year Revenue CAGR for ATL is ~14%

Source: Company, Keynote Capitals Ltd.

Industry-wise key clients of Avalon Technologies Ltd.

Industrial Segment - Key Clients



Clean Energy Segment - Key Clients



Mobility Segment - Key Clients



Medical - Key Client



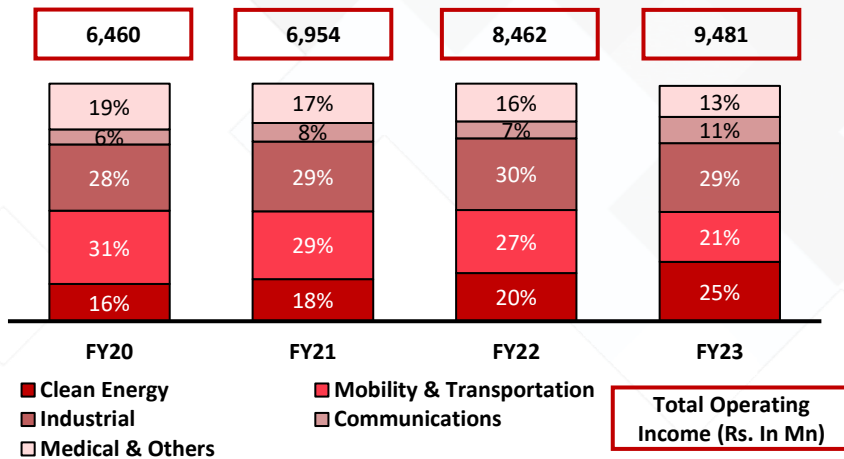
Connectivity - Key Client



Source: Company, Keynote Capitals Ltd.

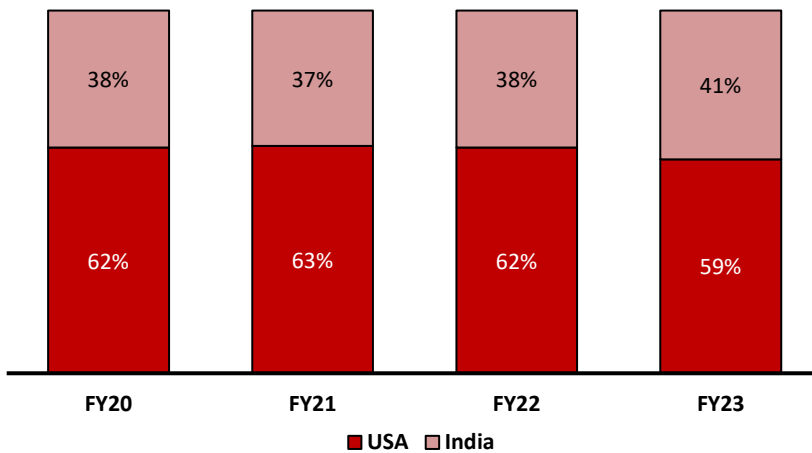
ESDM Industry | Avalon Technologies

Industry Wise Revenue Mix – Significant share of clean energy



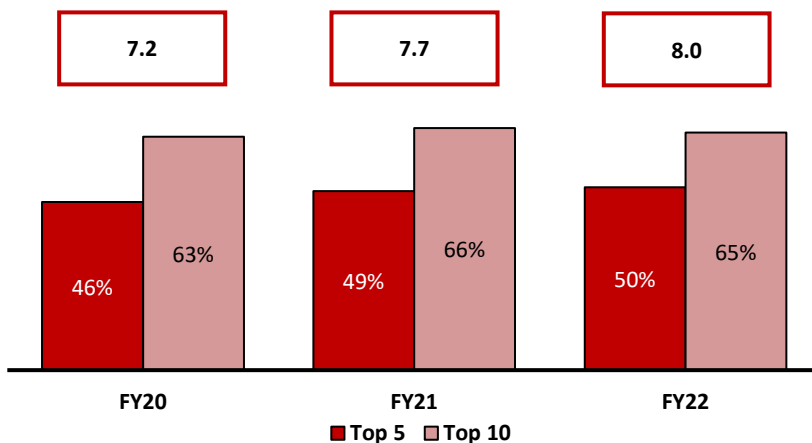
Source: Company, Keynote Capitals Ltd.

Geographical Revenue Mix – Export share higher than Domestic



Source: Company, Keynote Capitals Ltd.

Significant contribution and increasing stickiness of top customers

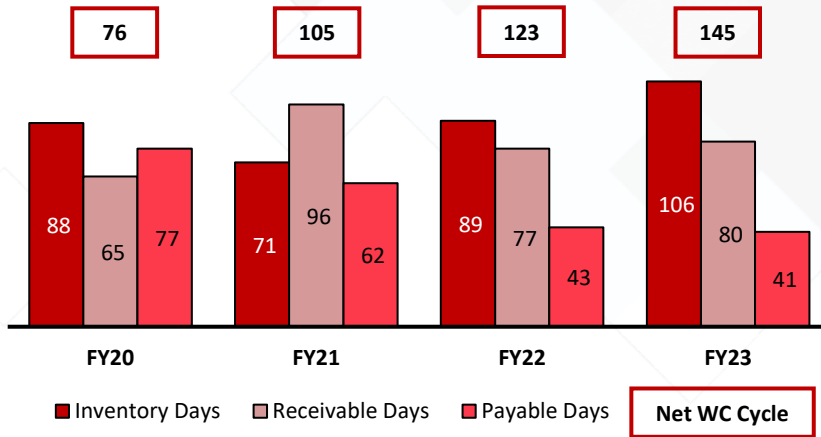


The average length of relationship (in years) with customers contributing >80% to revenue

Source: Company, Keynote Capitals Ltd.

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ATL's Working Capital Cycle (Days)

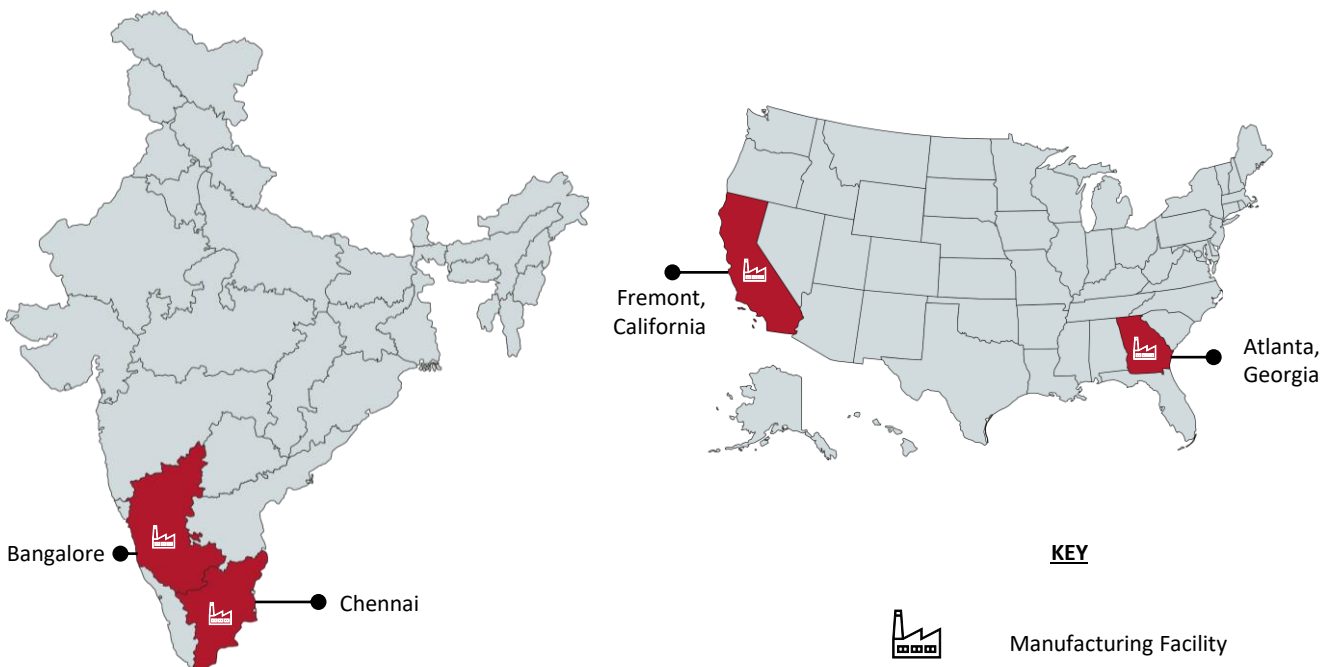


Source: Company, Keynote Capitals Ltd.

The working capital cycle for ATL has been elongated substantially due to a sequential surge in inventory owing to supply chain disruptions and semiconductor shortages. The Company is confident of bringing this cycle down by about 10-15 days by the end of FY24.

Avalon's Manufacturing Prowess

ATL is an integrated, high-mix, low-volume ESDM player catering to clients globally across multiple industries. The Company has established its manufacturing base in India and the USA. In total, ATL has 12 manufacturing facilities in India and a couple of facilities in the USA.



Overall capacity utilization of ATL as of FY23 stands at 60-65%, leaving material room for operating leverage benefits to kick in.

Source: Company, Keynote Capitals Ltd.

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Having a manufacturing base in the USA has dual advantages

ATL is the only ESDM company among its peers with a significant manufacturing presence outside India. As per the management, having a manufacturing base in the USA helps the Company in the following ways.

- i) The Company can tap opportunities in the USA with greater ease by virtue of having manufacturing facilities there. ATL also finds it easier to qualify for large government infrastructure opportunities in the USA as the Company can leverage its manufacturing base there and make its products qualify for the “Made in USA” tag if the project requires or provides incentives for sourcing material only from domestic sources.
- ii) Large overseas customers don’t become comfortable with offshoring production right from day one. The Company, with an established local manufacturing base, can use its overseas facilities to build a relationship of trust initially, and once the trust of the customer is gained, the Company can slowly move to offshoring production of the client to India.

Currently, 75-80% of ATL’s products are made in India, while the rest are manufactured in the USA facilities. The long-term goal is to maintain an 80:20 mix between the production in India and the USA.

Designing only to add strategic value and increase customer stickiness

ATL sees itself as a B2P company that manufactures products using the IP developed and held by its clients. Unlike peers, ATL looks at its design capabilities only as a strategic fit and wants to stick to its core strength of manufacturing. The design capabilities of the Company are only to enable ATL to improve client stickiness.

Capacity expansion plans

The Company has announced a capacity expansion plan at its Chennai plant. The Company is establishing a couple of facilities with a cumulative area of 160,000 sq. ft.

Of this total, 130,000 sq. ft. will be equally divided for making cable assembly, wire harnessing, and manufacturing “Big Box Builds.” These boxes are like a generator or a compressor in size.

Lastly, the balance of 30,000 sq. ft. of space will be utilized to manufacture plastic components and process special metal, which will be a new addition to ATL’s product suite. Both these plants are expected to be commissioned by January 2024.

ESDM Industry | Avalon Technologies

Subsidiaries of ATL

The Company has a total of three subsidiaries, including one material international subsidiary.

Name of Subsidiary (FY23)	Holding %	Revenue (Rs. in Mn.)	Net Profit (Rs. in Mn.)
Avalon Technologies & Services Pvt. Ltd. (ATSPL)	100%	1,956	181
Sienna ECAD Technologies Pvt. Ltd.	100%	207	9
ABV Electronics Inc. (Sienna Corporation)	100%	5,457	51

Source: Company, Keynote Capitals Ltd.

ATSPL – It is a wholly-owned subsidiary that operates in the business of manufacturing, developing, assembling, producing, maintaining, designing, servicing, buying, selling, and dealing in all types of engineering and technology products, all kinds of electronic and electrical products, component assemblies, systems for different applications, accessories, their programs and consultancy in allied fields.

Sienna ECAD – It is a wholly-owned subsidiary that operates in the business of carrying out the business of a design bureau to develop computer-aided designs for the manufacturing of printed circuit boards, integrated circuits, electronic components, devices, equipment and machinery and development of software in all its kind and description.

ABV Electronics Inc. (Sienna Corporation) – This is ATL’s US subsidiary operating in the same business. All the manufacturing that the Company is doing in the USA is done under the name of ABV Electronics Inc.

ATL’s strategy going forward

Optimal Geographical Blend

The Company wants to continue catering to large ESDM markets of India and the USA by continuing to keep a hybrid manufacturing model with greater focus on Indian manufacturing.

Established + Emerging

The Company wants to maintain a blend between customers from well-established industries of today (expand wallet share) and upcoming industries of tomorrow (EV, clean energy, etc.)

Focus on Profitable Growth

The Company wants to focus on profitable growth. The focus is to be in segments with high profitability (Eg: Aerospace) and supply mission-critical products (Eg: Box Builds)

Cost Management

The Company is taking various cost management initiatives, especially with its US manufacturing set-up, which are expected to add to margins of ATL in the long run.

Working Capital Efficiency

ATL is confident of reducing its working capital cycle by 10-15 days. Aims to achieve a working capital cycle of 120 days.

Source: Company, Keynote Capitals Ltd.

ESDM Industry | Avalon Technologies

Recent Developments

The Company has won significant business from customers operating in the aerospace, clean energy and Industrial segment. ATL won business from one of the largest global aerospace conglomerates, including a factory transfer to India.

Apart from this, the Company added multiple new customers in the “Clean Energy” space who are expected to ramp up production from H2 FY24. In H1 FY24, the Company also entered the heat shield and the cable market in the aerospace segment. The Company has innovated its product basket, moving from metals to plastic, and is now manufacturing cables for the aerospace segment.

The Company is currently working on work transitioning from the USA to India. ATL has convinced 50% of its old customers to let the Company shift manufacturing for them to India. This is to rationalise high employee costs in the USA. Going forward, ATL will only manufacture clean energy products in the US.

ATL is seeing strong traction in mobility (railways and aerospace), clean energy space (EV) and industrials. Currently, the industrial and clean energy division contributes 60% to the outstanding order book. The recent projects bagged by the Company are long-term and will set up ATL for growth for the coming five years. ATL is also getting into “KAVACH (Anti-Collision)” for railways.

In terms of geographies, in H1 FY24, the Company entered new geographies and has bolstered its business development team in the US.

Order Book Details*	FY20	FY21	FY22	FY23	Q2 FY24
Order Book (in Rs. Mn)	5,047	6,346	8,579	12,310	12,440
Order Book/Revenue	0.8	0.9	1.0	1.3	1.3
Order Book Growth %	NA	25.7%	35.2%	43.5%	NA

***NOTE**

The Company also has contracts and LOIs worth ~Rs. 7.5 Bn, which are not a part of the order book but are executable in the next 2-4 years. The current order book is executable in the coming 12-14 months.

Source: Company, Keynote Capitals Ltd.

Management Analysis

The Management team of ATL consists of industry veterans who bring immense expertise and rich experience working with the Company.

Name	Designation	Previous Associations	Experience with ATL (Yrs.)
Kunhamed Bicha	Promoter, Chairman & MD	Founder	24
Bhaskar Srinivasan	Promoter, NED	Co-Founder, Sienna Corp	24
RM Subramanian	CFO	Essar Oil, Sembcorp India and Sanmar Group	4
Michael Robinson	COO	Motorola, Vconnect and Robsys Global	14
Shamil Bicha	VP, Business Development	-	21
Kesavan Parthasarathy	VP, Operations	-	23
Arjun Balakrishnan	VP, Corporate Strategy	GE Power and Panasonic India	8

Source: Company, Keynote Capitals Ltd.

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Promoter Holding and Management Compensation

Particulars	FY22	FY23	Sep-23
% Promoter Holding (~)	-	70.7%	51.1%
MD's salary (Rs Mn)	2.4	6.9	-
As a % of PAT (~)	5% *	13%	-

Note: PAT for FY22 was adjusted for exceptional items, which is used for the calculation

Source: Company, Keynote Capitals Ltd.

Top Shareholders of ATL

% Shareholding in the Company (~)	Jun-23	Sep-23
Nippon India AMC	5.8%	5.8%
Anand Kumar	3.7%	3.7%
Sareday Seshu Kumar	2.9%	2.9%
UNIFI Financial Pvt. Ltd.	2.5%	2.5%
Goldman Sachs India Equity Portfolio	2.2%	2.2%
Ashoka India Equity Investment Trust PLC	2.2%	2.2%
India Acorn Fund Ltd.	1.4%	1.4%

Source: Company, Keynote Capitals Ltd.

Opportunities

Strong gross margins owing to skewness towards exports and complex products

ATL has been able to command the strongest gross margins in the industry. The average gross margin that the Company has clocked since FY20 is 35% which is higher by ~400-500 bps compared to listed peers.

Gross Profit Margin	FY20	FY21	FY22	FY23
Avalon Technologies	36%	34%	34%	36%
Kaynes Technology	35%	32%	31%	31%
Syrma SGS Technology	-	-	30%	25%
Cyient DLM	20%	21%	25%	23%

Source: Company, Keynote Capitals Ltd.

The higher gross margin is driven by a higher share of exports and box builds in the Company's revenue mix.

Exports %	FY20	FY21	FY22	FY23
Avalon Technologies	62%	63%	62%	59%
Kaynes Technology	21%	26%	20%	15%
Syrma SGS Technology	-	-	46%	30%
Cyient DLM	-	37%	45%	60%

Source: Company, Keynote Capitals Ltd.

ESDM Industry | Avalon Technologies

Box Build %	FY20	FY21	FY22	FY23
Avalon Technologies	44%	47%	44%	47%
Kaynes Technology	26%	30%	28%	30%
Syrma SGS Technology	-	-	-	18%
Cyient DLM		36%	33%	32%

Source: Company, Keynote Capitals Ltd.

Going forward, the Company has plans to maintain focus on India as well as the USA. Additionally, the Company has also won significant orders from its US customers, especially in the clean energy space.

Currently, the export business for ATL is a bit soft, but based on the business outlook of the Company, maintaining industry-leading gross margins should continue for ATL.

Moving towards more complex box builds can drive margins higher

ATL is entering into making bigger and more complex box builds and has taken up an expansion for the same at its Chennai facility. As per the Company's disclosures, out of the total 160,000 sq. ft. expansion, 65,000 sq. ft. will be dedicated to manufacturing this large generator-sized box build.

Box Builds, by nature, fetches a higher margin for ESDM companies than PCBA. An entry into manufacturing large-sized box builds indicates that the product's complexity will only increase, which should push the margins for ATL higher.

Sunrise sectors contribute significantly to ATL's revenue

ATL generates significant revenue from sunrise sectors like "Clean Energy (includes EV and hydrogen)," In fact, ATL is the only company among its peers that reports the contribution of the "Clean Energy" sector separately.

The clean energy business has grown faster than other businesses for ATL

Clean Energy Mix	FY20	FY21	FY22	FY23
% of Total Revenue	16%	18%	20%	25%

Source: Company, Keynote Capitals Ltd.

The Company has recently added three new customers in the clean energy space, the production for whom is expected to ramp up in late FY24 and early FY25. Additionally, some of the previous wins are also expected to graduate into large-volume production in the coming 2-3 quarters.

In H1 FY24, ATL also entered a new geography for delivering complex PCB design and development. This foray can open significant revenue growth opportunities for the Company in the long run. In the future, ATL wants to strike an optimal balance between established and emerging industries in the long run.

ESDM Industry | Avalon Technologies

Challenges

Elevated employee costs will continue to put pressure on operating margins

ATL is the only listed company among peers with significant overseas operations. Going forward, the Company also has plans to continue with its manufacturing base in the USA because it makes significant business sense to the Company.

The Company's manufacturing operations in the USA will persistently impact its EBITDA margins due to significantly higher employee costs compared to industry standards. This situation hampers ATL's capacity to achieve industry-leading margins, which would have been possible if the Company had solely focused on manufacturing in India.

The Company is putting significant efforts into improving operational efficiency and is taking the following measures:

- Optimizing product allocations by strategically relocating some of its production activities from the US plant to the India plant.
- Rationalizing costs of operation in the US. The Company is taking concrete steps towards initiating a plan and optimizing its operations in the US.

Employee Cost/Rev %	FY20	FY21	FY22	FY23
Avalon Technologies	18.1%	17.3%	15.6%	17.0%
Kaynes Technology	11.5%	10.9%	8.5%	6.8%
Syrma SGS Technology	-	-	5.9%	5.2%
Cyient DLM	9.6%	7.5%	7.2%	7.8%

Source: Company, Keynote Capitals Ltd.

The employee cost of ATL is higher by 8-11% compared to Indian peers, which is more than double what peers are currently spending behind manpower.

Prolonged slowdown in the USA can hamper business growth

The Company is currently facing a business slowdown due to softness in its key market. This is because a) the demand environment in the USA is weak, and b) customers are restoring their businesses to a normalized inventory cycle.

Post COVID, due to the supply chain disruptions, customers switched to an elongated inventory cycle to smoothly satiate the customer demand despite supply chain hiccups. Now, as the supply chain has mostly normalized, customers are restoring to a shorter (normal) inventory cycle resulting in inventory destocking.

This demand softness is creating a negative operating leverage resulting in margins for the US operations getting severely impacted due to the absorption of high employee cost.

Since the US operation forms a significant chunk of the total operations of ATL, it is substantially impacting the overall margins of the Company.

Margins %	FY20	FY21	FY22	FY23	Q2 FY24
EBITDA %	11%	11%	12%	12%	~6%
PAT %	2%	3%	6%	6%	~4%

Source: Company, Keynote Capitals Ltd.

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According to the management, this soft demand scenario is expected to improve gradually from Q3 FY24. In case of unforeseen reasons, if the demand scenario takes much longer to improve than anticipated, it will be a drag on sentiments despite the Indian business of the Company performing in line with its peers and can be a significant source of risk in the short to medium term.

Lack of visibility

In any order book-driven business, the order book is used to get a sense of future revenue visibility. ESDM is also an order book-driven business where one can gauge the future revenue trajectory by looking at the order book.

Currently, the order book of ATL is positioned in such a way that it is giving the least revenue visibility among peers.

Order book/Rev (x)	Q2 FY24
Avalon Technologies *	1.3
Kaynes Technology	2.9
Syrma SGS Technology	1.5
Cyient DLM	2.3

** Ratio for ATL is calculated excluding Contracts & LOIs worth Rs. 7.5 Bn, which are executable over the next 2-4 years.
Source: Company, Keynote Capitals Ltd.*

The above data set indicates that ATL has just one year of revenue visibility, whereas its peers have far more revenue visibility, ranging from 1.5 to 3.0 years. This points towards the fact that the Company will have to put significant efforts into driving its order book, which can give a sense of visibility and comfort.

Financial Statement Analysis

Income Statement

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	8,407	9,447	10,217	12,161	14,511
Growth %	12%	8%	19%	19%	
Raw Material Expenses	5,541	6,067	6,795	8,063	9,505
Employee Expenses	1,314	1,605	1,849	2,067	2,322
Other Expenses	577	647	715	790	943
EBITDA	975	1,128	858	1,240	1,741
Growth %	16%	-24%	45%	40%	
Margin%	12%	12%	8%	10%	12%
Depreciation	180	197	243	288	334
EBIT	795	931	615	952	1,408
Growth %	17%	-34%	55%	48%	
Margin%	9%	10%	6%	8%	10%
Interest Paid	248	348	200	200	200
Other Income & exceptional	309	144	150	120	120
PBT	856	727	565	872	1,328
Tax	182	202	147	227	345
PAT	675	525	418	645	982
Others (Minorities, Associates)	43	0	0	0	0
Net Profit	717	525	418	645	982
Growth %	-27%	-20%	54%	52%	
Shares (Mn)		58.0	58.0	58.0	58.0
EPS	9.06	7.22	11.14	16.95	

Cash Flow

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Pre-tax profit	856	727	565	872	1,328
Adjustments	231	454	293	368	414
Change in Working Capital	-805	-1,125	-173	-516	-667
Total Tax Paid	-125	-189	-147	-227	-345
Cash flow from operating Activities	157	-133	538	498	729
Net Capital Expenditure	-177	-273	-350	-350	-350
Change in investments	0	0	0	0	0
Other investing activities	-6	2	150	120	120
Cash flow from investing activities	-184	-271	-200	-230	-230
Equity raised / (repaid)	-57	4,815	0	0	0
Debt raised / (repaid)	158	128	-2,000	0	0
Dividend (incl. tax)	0	0	0	0	0
Other financing activities	-272	-363	-200	-200	-200
Cash flow from financing activities	-171	4,579	-2,200	-200	-200
Net Change in cash	-198	4,175	-1,862	68	299

Valuation Ratios

	FY22	FY23	FY24E	FY25E	FY26E
Per Share Data					
EPS	11	9	7	11	17
Growth %		-20%	-20%	54%	52%
Book Value Per Share		93	100	111	128

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Cash, Cash equivalents & Bank	101	4,222	2,361	2,429	2,727
Current Investments	0	0	0	0	0
Debtors	1,774	2,062	2,248	2,675	3,192
Inventory	2,330	3,179	3,261	3,709	4,182
Short Term Loans & Advances	220	455	455	455	455
Other Current Assets	78	218	218	218	218
Total Current Assets	4,503	10,137	8,543	9,486	10,775
Net Block & CWIP	1,162	1,428	1,535	1,597	1,613
Long Term Investments	0	0	0	0	0
Other Non-current Assets	71	108	108	108	108
Total Assets	5,736	11,673	10,186	11,191	12,496
Creditors	1,185	1,418	1,513	1,872	2,195
Provision	54	35	35	35	35
Short Term Borrowings	2,199	2,407	1,063	1,063	1,063
Other Current Liabilities	552	1,501	1,501	1,501	1,501
Total Current Liabilities	3,990	5,361	4,112	4,471	4,794
Long Term Debt	742	656	0	0	0
Deferred Tax Liabilities	-159	-130	-130	-130	-130
Other Long Term Liabilities	274	416	416	416	416
Total Non Current Liabilities	858	942	286	286	286
Paid-up Capital	16	116	116	116	116
Reserves & Surplus	872	5,254	5,673	6,318	7,300
Shareholders' Equity	888	5,370	5,789	6,434	7,416
Non Controlling Interest	0	0	0	0	0
Total Equity & Liabilities	5,736	11,673	10,186	11,191	12,496

Return Ratios

Return on Assets (%)	12%	6%	4%	6%	8%
Return on Equity (%)	85%	17%	7%	11%	14%
Return on Capital Employed (%)	27%	14%	8%	12%	15%

Turnover Ratios

Asset Turnover (x)	1.6	1.1	0.9	1.1	1.2
Sales / Gross Block (x)	6.3	6.2	5.5	5.5	5.7
Working Capital / Sales (x)	3%	28%	45%	39%	38%
Receivable Days	78	74	77	74	74
Inventory Days	125	166	173	158	152
Payable Days	70	69	78	73	74
Working Capital Days	133	171	172	159	151

Liquidity Ratios

Current Ratio (x)	1.1	1.9	2.1	2.1	2.2
Interest Coverage Ratio (x)	3.6	3.1	3.8	5.4	7.6
Total Debt to Equity	3.3	0.6	0.2	0.2	0.1
Net Debt to Equity	3.2	-0.2	-0.2	-0.2	-0.2

Valuation

PE (x)		52.8	66.2	42.9	28.2
Earnings Yield (%)		2%	2%	2%	4%
Price to Sales (x)		3.3	3.1	2.6	2.2
Price to Book (x)		5.8	5.4	4.9	4.2
EV/EBITDA (x)		30.3	39.8	27.5	19.6
EV/Sales (x)		3.6	3.3	2.8	2.4

Source: Company, Keynote Capitals Ltd. estimates

View & Valuation

Particulars (Rs. Mn, unless mentioned)	Estimate
Period	FY26E
Revenue	17,311
Net Profit	1,231
Earnings Per Share (Rs.)	~17
PE Multiple (x)	36.5
Expected Price Per Share (Rs.)	619
Upside / (Downside) (%)	29.2%

Source: Company, Keynote Capitals Ltd. estimates

Currently, the domestic business of the Company is already performing in line with its peers, but there is a significant pain in the US business due to a) demand softness and b) customers normalizing their inventory cycle, leading to channel de-stocking.

The management is taking all necessary measures to rationalize costs and minimize the impact of a demand slowdown in the US. Apart from this, the Company is constantly innovating and adding new products and geographies to its existing set.

Owing to the above factors, we expect improved capacity utilization, which will result in operating leverage benefits to ATL. Additionally, debt reduction is expected to aid the bottom line further.

Given the bright domestic industry outlook and the expected rebound of the US business, we believe that ATL is well poised to double its top line by FY26, along with an improved PAT margin in the range of 6-7%. Owing to the aforementioned factors, we ascribe a BUY rating on ATL with a target price of Rs. 619, valuing the Company at ~37x FY26E EPS.

Cyient DLM Limited

Niche player with a strong parentage

Cyient DLM Ltd. (CDLML), a subsidiary of a prominent Engineering R&D (ERD) company Cyient Ltd., is a differentiated ESDM player focused only on regulated industries, unlike peers with a relatively diversified target market. The Company generates ~70% of its revenue from exports, which are made to customers having long-standing relationships with the Company. The Company has two plants located in Mysuru and Hyderabad that are currently operating at ~33% utilization, leaving significant room for revenue growth in the future. This is duly supported by the strong order book of CDLML, which, as of Q2 FY24, stands at ~Rs. 23 Bn, giving a visibility of three years at the revenue scale of FY23. We believe that as the business progresses and the capacities are more optimally utilized, the margin for CDLML will expand, resulting in profits growing faster than revenue until the installed capacities get optimally utilized.

Strong parentage – Cyient Ltd.

The Company is a subsidiary of Cyient Ltd., a prominent ERD company that benefits CDLML in many ways. In the future, the Company is looking to garner more Build-to-Specification (B2S) business wherein it will require more engineering bandwidth, which can be provided by the parent, making it much easier for CDLML to convince a customer compared to it being a standalone entity. Apart from this, the Company will continue to receive financial support (if required) from its cash-rich parent in the future like it has received in the past. We think both businesses have significant synergies which are yet to be fully explored.

Focus on highly regulated businesses with high entry barriers

CDLML caters to customers operating in regulated businesses belonging to the aerospace, defence, medical and industrial sectors. In addition to this, the Company, on an average, enjoys 11+ years of relationship with its key clients. The Company will continue to focus on regulated business as it is helping CDLML create an entry barrier. The Company has attained significant success with this differentiated approach and believes that the same benefits will continue to accrue in the future also.

Sufficient capacities to satiate medium-term growth

The product-wise capacity utilization of the Company for FY23 suggests that CDLML is operating at sub-25 % utilization in PCBA and sub-5 % utilization in cable-harnessing (because of a recent expansion). Box build is the only product where the Company is operating at ~100% utilization and will need CAPEX for future growth in this product category. At an overall level, the Company is only operating at a 33% utilization, leaving the room to expand revenue three-fold. A robust order book well supports this excess capacity.

View and Valuation

Based on the strong revenue visibility, parentage, and underutilization, we believe that CDLML is well poised to see robust business growth. Based on the aforementioned factors, we ascribe a BUY rating on CDLML with a target price of Rs. 747, valuing the Company at ~50x FY26E EPS.

BUY

CMP Rs. 668

TARGET Rs. 747 (+12%)

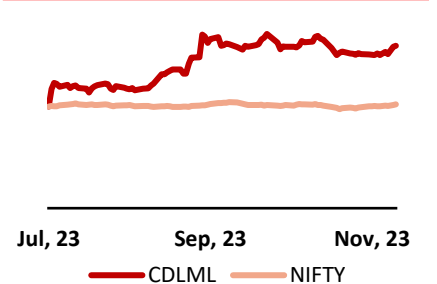
Company Data

Bloomberg Code	CYIENTDL IN
MCAP (Rs. Mn)	53,000
O/S Shares (Mn)	79
52w High/Low	779 / 401
Face Value (in Rs.)	10
Liquidity (3M) (Rs. Mn)	247

Shareholding Pattern %

	Sep 23	Jun 23
Promoters	66.7	66.7
FIIIs	6.2	7.2
DIIIs	12.3	12.0
Non-Institutional	14.8	14.1

Cyient DLM vs Nifty



Source: Keynote Capitals Ltd.

Key Financial Data

(Rs. Mn)	FY23	FY24E	FY25E
Revenue	8,320	10,946	14,011
EBITDA	872	1,095	1,499
Net Profit	317	484	840
Total Assets	10,993	17,231	18,498
ROCE (%)	13%	9%	9%
ROE (%)	23%	8%	8%

Source: Company, Keynote Capitals Ltd.

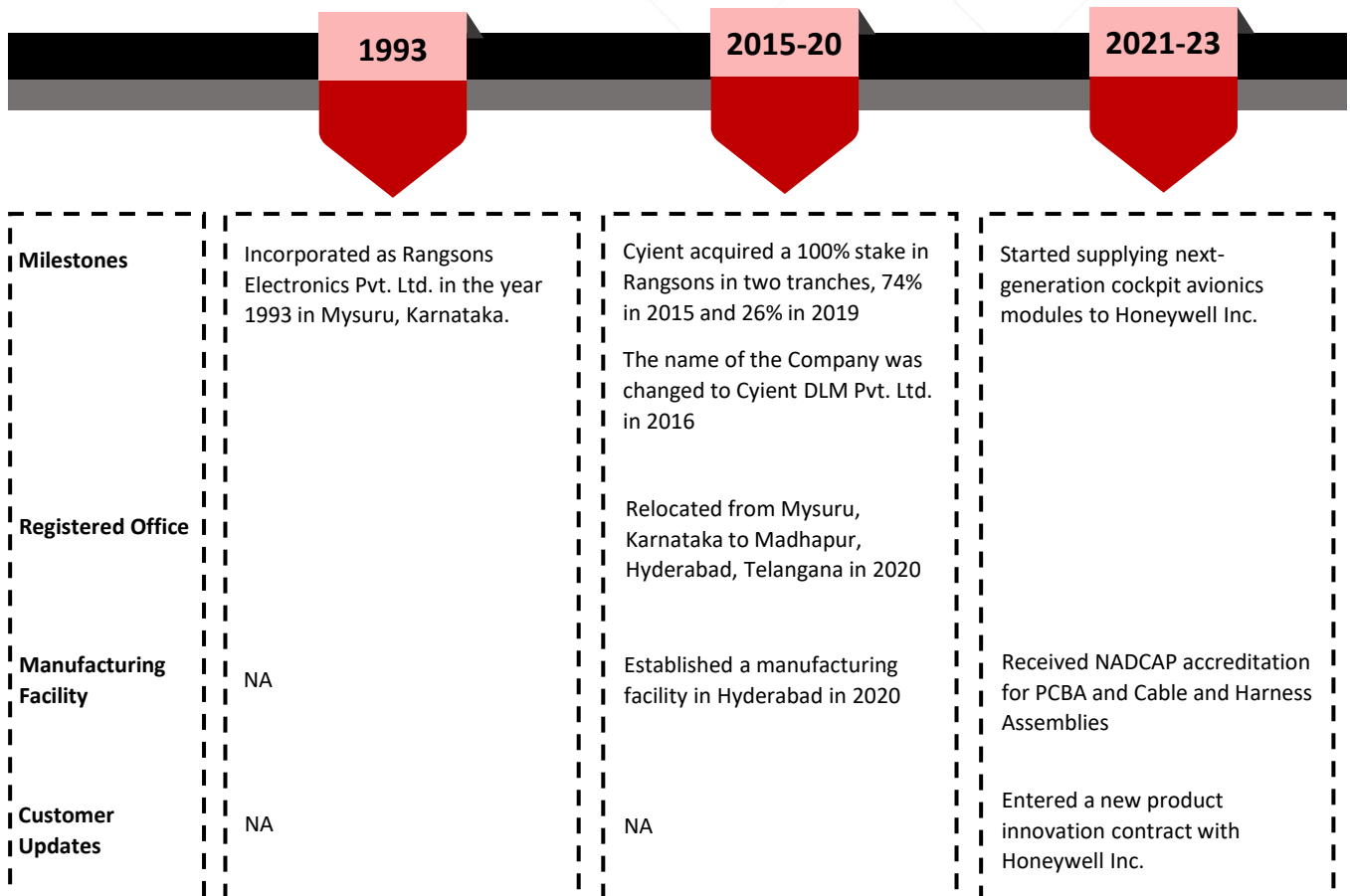
ESDM Industry | Cyient DLM

About Cyient DLM Ltd.

The Company was incorporated as Rangsons Electronics Pvt. Ltd. in 1993 in Mysuru, Karnataka. Later, in 2015, Cyient Ltd acquired a 74% stake, and the name was changed to Cyient DLM in the year 2016. In 2019, Cyient Ltd. also bought the balance 26% stake, making it the sole owner of Cyient DLM Pvt. Ltd.

CDLML is an integrated ESDM player with a focus on the entire life cycle of the product. The Company, with its mission-critical products, caters to clients in the aerospace, defence, medical, and industrial sectors, providing both, B2P and Build-to-Specification services.

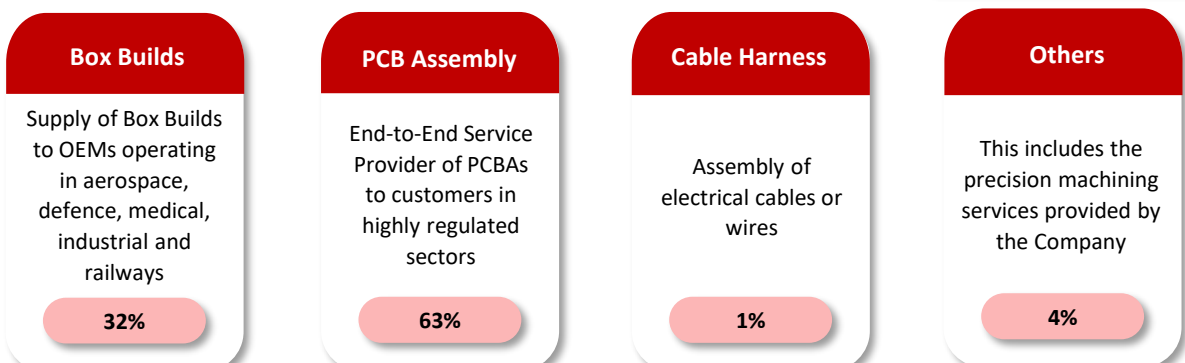
Journey of Cyient DLM Ltd.



Source: Company, Keynote Capitals Ltd.

Product Portfolio of Cyient DLM Ltd.

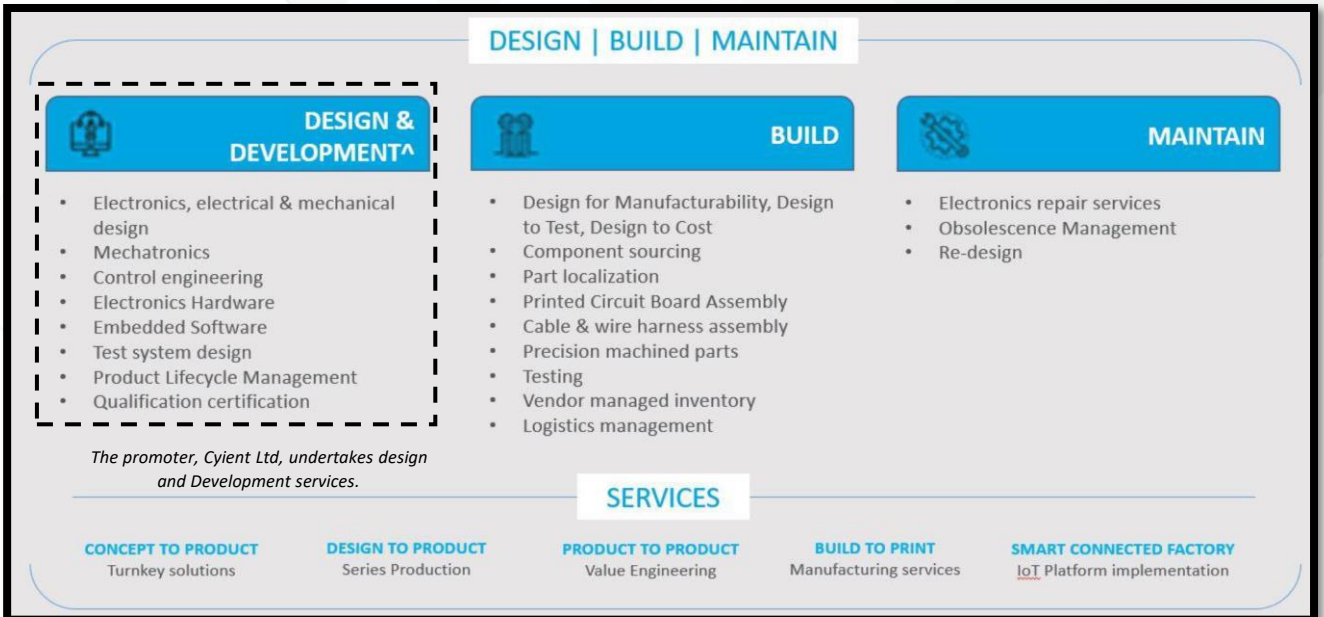
Revenue Contribution FY23



Source: Company, Keynote Capitals Ltd.

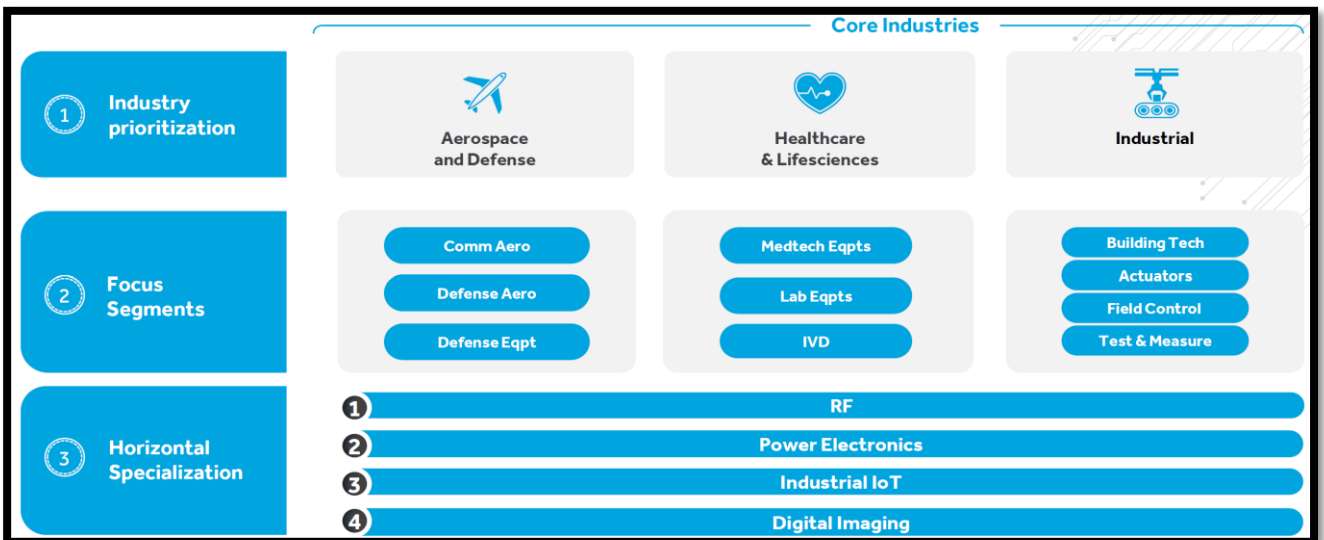
ESDM Industry | Cyient DLM

Offering services end-to-end ESDM services along with IoT platform implementation with the strong support of the promoter, Cyient Ltd.



Source: Company, Keynote Capitals Ltd.

Cyient DLM is focused on regulated sectors with high barriers to entry



Source: Company, Keynote Capitals Ltd.

Over the years, CDLML has created a niche for itself by focusing on highly complex and expensive industries like aerospace, defence, and healthcare. The selection of this niche is helping the Company to keep competition at bay.

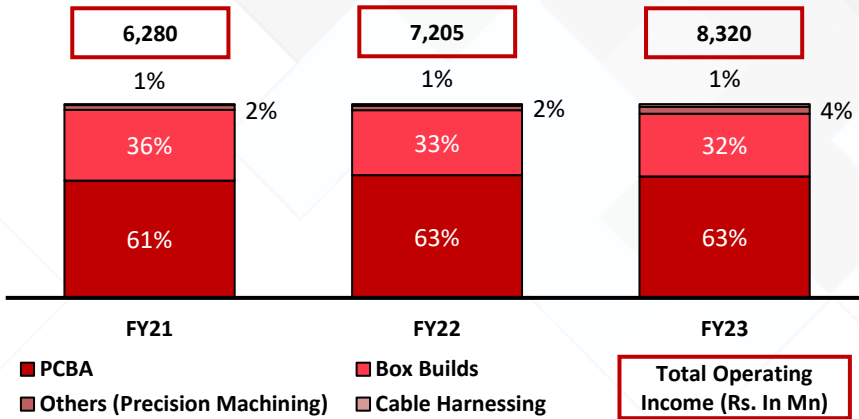
In its initial days, the Company manufactured simple PCBAs used in systems with low complexity. Gradually, as the Company evolved, it has now started providing highly complex mission-critical solutions to its customers.

Owing to this evolution, CDLML has been able to deepen its relationship with its customers, thereby creating significant switching costs and preventing them from switching to other EMS partners.

ABB Inc., Bharat Electronics Ltd., Honeywell Inc., Thales Global Service SAS., and Molbio Diagnostics Pvt. Ltd. are some of the key customers for the Company with whom CDLML has forged long-term relationships ranging from 8-14 years.

ESDM Industry | Cyient DLM

Product Wise Revenue Mix



The 2 Year Revenue CAGR for CDLML is ~15%

Source: Company, Keynote Capitals Ltd.

Industry-wise key clients of Cyient DLM Ltd.

Aerospace & Defence Segment - Key Clients



Medical Segment - Key Clients

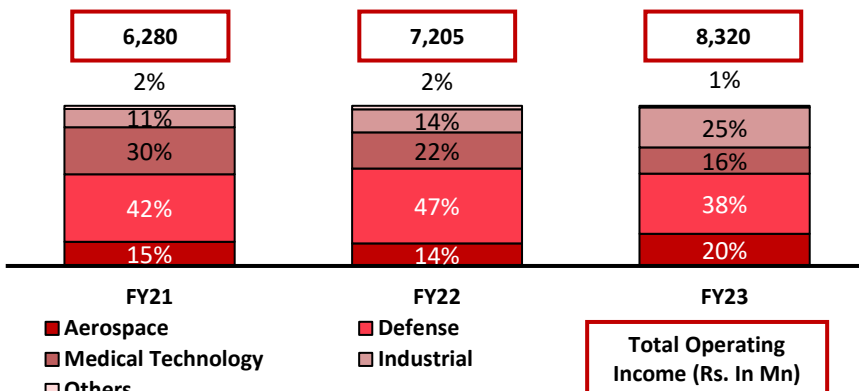


Industrial and Other Segments - Key Clients



Source: Company, Keynote Capitals Ltd.

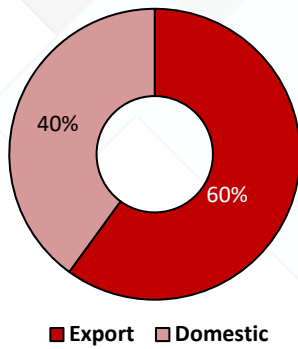
Industry Wise Revenue Mix



Source: Company, Keynote Capitals Ltd.

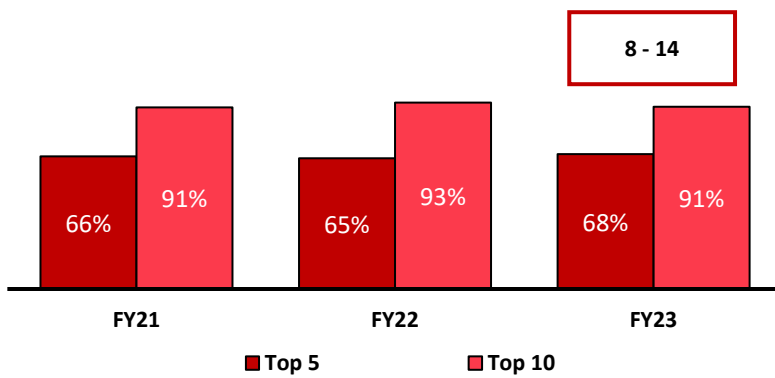
ESDM Industry | Cyient DLM

Geographical Revenue Mix as of FY23



Source: Company, Keynote Capitals Ltd.

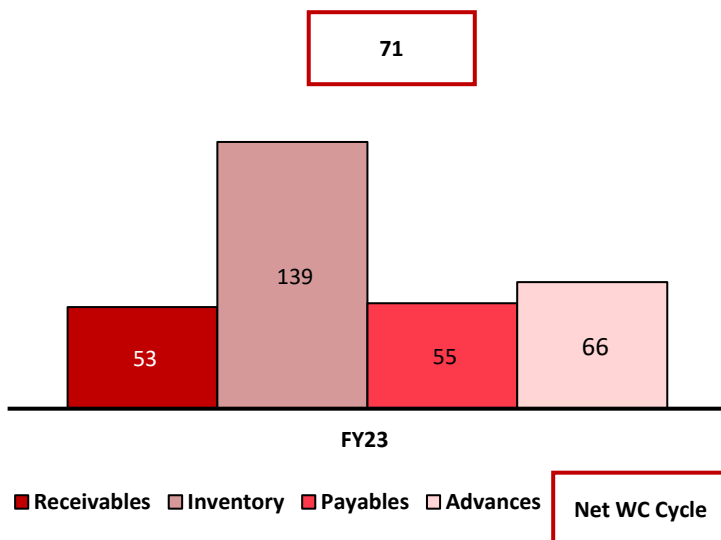
Significant contribution and stickiness of top customers



8 - 14
The average length of relationship (in years) with key customers in each segment

Source: Company, Keynote Capitals Ltd.

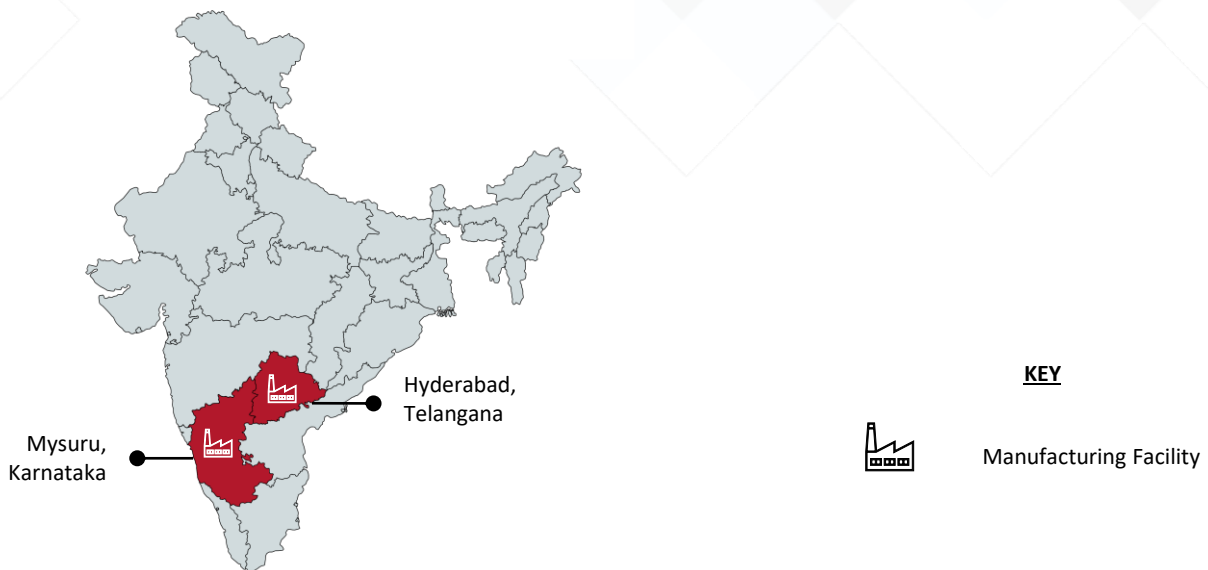
CDLML's Working Capital Cycle (Days)



Source: Company, Keynote Capitals Ltd.

CDLML's Manufacturing Prowess

CDLML is an integrated, high-mix, low-volume ESDM player catering to clients globally across select industries, unlike peers catering to a much wider set of industries. The Company has 3 manufacturing facilities located in South India, catering to clients on a B2P or B2S model. CDLML also leverages the strong design capabilities of its parent, Cyient Ltd., to fulfil the requirements of its clients operating in highly regulated sectors.



CDLML caters to its non-aerospace and non-defence customers from its facility in Hyderabad and its aerospace and defence customers from its facility in Mysuru. Also, high-precision manufacturing is being done at its facility in Bangalore

Source: Company, Keynote Capitals Ltd.

Created a niche by catering to customers belonging to select industries

CDLML has a history of only catering to customers in select industries like aerospace, defence, healthcare and industrial. By following this strategy, the Company has created a niche for itself in the industry, thereby only focusing on regulated sectors and conducting precision manufacturing.

This has resulted in a very high degree of customer concentration, with top 5 and top 10 customers contributing 68% and 91%, respectively to the Company's topline in FY23. CDLML only catered to 35 customers as of FY23.

We believe that such kind of revenue concentration is the result of the Company's above-mentioned strategy. Having said this, the Company doesn't see this as a cause of concern because it is working with some of the largest manufacturing innovators across the globe.

Additionally, the Company also expected the higher share of exports in its business to continue and wants to stay focused on the quality of customers, not the quantity.

Higher focus on Build-to-Specification (B2S) business in the future

Build-to-Specification is a service where the client, instead of hiring an external engineer, works with the Company to get the product developed as well as get the same manufactured.

This will be the focus area of the Company in the future because a) it gives a higher ownership of the product compared to pure B2P, b) increases client stickiness, and c) fetches a higher EBITDA margin compared to B2P.

The biggest advantage that CDLML has is access to the technical know-how of its parent Cyient Ltd., an ERD company. The Company disclosed that it has several programs where it is expected to operate in collaboration with Cyient Ltd.

Currently, the B2S part of the business contributes negligibly (<1%) to the company's overall revenue, but CDLML expects this to become a ~20% revenue contributor in the long term.

Low CAPEX requirements for the short to medium-term

CDLML significantly augmented its cable harness capacity at Mysuru in FY22 and FY23. In FY21, the Company had a capacity of harnessing ~0.7 Mn cables, which stood at ~4.2 Mn in FY23, registering a 6x increase in cable harnessing capacity. Similarly, in box builds, CDLML had a total capacity of manufacturing ~0.26 Mn box builds in FY21 at both plants, which stood at ~0.30 Mn in FY23, registering a 15% expansion. Apart from this, the Company always had sufficient capacity for PCBA, as there has been no significant change in its PCBA capacity since FY21.

Given the above facts, the Company, on an overall basis, is operating at a 33% utilisation, giving it significant room to grow its revenue 3x without incurring material CAPEX, at least in the short to medium term.

The only aberration to the above-mentioned point is the box build capacity utilisation; the total box build capacity utilisation in both plants as of FY23 stood at ~99%. Signifying the need to augment box build capacity soon.

Exploration of adjacencies

There are a few adjacencies and value-added services that the Company can explore to enhance its capabilities and client stickiness. CDLML intends to explore after-market services and select value-added services; the Company plans to focus on strengthening its repair, maintenance and sustenance engineering capabilities. In addition to this, CDLML also plans to enhance value by providing reverse engineering, value engineering and design upgrade services to its clients.

Apart from support and value-added services, the Company also plans to explore offerings across precision and additive manufacturing and is also open to dabbling into Outsourced Semiconductor Assembly and Testing (OSAT) services, thereby looking to expand capabilities across the semiconductor value chain.

ESDM Industry | Cyient DLM

The way forward for Cyient DLM Ltd.

Focus on B2S

The Company wants to sharpen its focus on increasing the B2S revenue contribution. The parent, Cyient Ltd. can play a major role here

Capacity Utilization

The Company is currently operating at very low-capacity utilization. Should be able to improve turns in the future as the business grows

Focus on Regulated Customers

The Company will continue to focus on customers operating in regulated industries thereby, maintaining its niche

Margin Expansion

Currently at the lower end of the spectrum and should inch up owing to better capacity utilization and a higher B2S contribution

Box Build Expansion

The Box Build capacity of the Company requires CAPEX as the same is operating at ~100% utilization. Delay or Inability can hamper growth in the higher margin product

Source: Company, Keynote Capitals Ltd.

Management Analysis

Unlike peers, Cyient DLM Ltd. is a subsidiary of another listed company, Cyient Ltd. and therefore a professionally run organization.

Name	Designation	Previous Associations	Experience with CDLML (Yrs.)
B.V.R Mohan Reddy	Non-Executive Chairman	Founder, Cyient Ltd.	-
Krishna Bodanapu	Non-Executive Chairman	-	-
Rajendra Velagapudi	MD	Simpson & Co, Bajaj Tempo and BEML	7
Anthony Montalbano	CEO	AT&T, Flex, HCL, Aricent and Wipro	1
Ram Dornala	COO	Jabil and Wistron	1

Source: Company, Keynote Capitals Ltd.

Promoter Holding %

Particulars	FY22	FY23	Sep-23
% Promoter Holding (~)	-	92.8%	66.7%

Source: Company, Keynote Capitals Ltd.

Top shareholders of CDLML

% Shareholding in the Company (~)	Jun-23	Sep-23
Amansa Investments Ltd.	5.2%	5.1%
Amansa Holdings Pvt. Ltd.	3.3%	3.3%
ICICI Pru Innovation Fund	-	3.2%
Nippon Life AMC	-	2.7%
Catamaran Ventures LLP	-	1.8%

Source: Company, Keynote Capitals Ltd.

Opportunities

Strong parentage – Support from Cyient Ltd.

Cyient Ltd., one of India's leading ERD companies, is the parent of Cyient DLM Ltd., which holds a ~67% stake in the Company. This strong parentage of Cyient Ltd. has significantly benefitted CDLML and will continue to benefit the Company going forward also.

The Company plans to put more focus on its B2S business because this will help CDLML play a much bigger role in the product lifecycle than being a pure-play B2P manufacturer. Additionally, a higher portion of B2S business will also lead to a higher overall margin for the Company.

In our understanding, as the B2S part of the business grows, the Company will require more access to engineering capabilities, which will be provided by Cyient Ltd., the parent, making it easier for customers to trust and give the engineering business along with manufacturing to CDLML.

Apart from the technical know-how, the Company also gets backing from its parent through funds, bank guarantees, etc., making the Company's operations easier compared to it only being a standalone entity. In the past, the Company obtained a Rs. 10 Bn term loan from the parent for CAPEX in various tranches. This loan was originally repayable from June 2023, which, as per the renewed agreement, will be payable from June 2024. Though the transaction has taken place at arm's length and CDLML is paying 6% interest (lower than 7.5%-9.0% paid to the bank) to the parent, the key takeaway here is that CDLML will receive strong support from its parent in more ways than one which makes it formidable ESDM player.

Focused on regulated businesses with high entry barriers

CDLML has a focus on providing services to customers operating in regulated businesses. This creates a significant entry barrier for competition and a high switching cost for its customers. This becomes clear from the fact that the Company has an 11+ year-long working relationship with its top customers.

ESDM Industry | Cyient DLM

Catering to marquee clients in the following regulated Industries



Aerospace



Defense



Healthcare



Industrial

Going forward, the Company will continue its focus on customers operating in highly regulated sectors and continue to maintain its niche service offering, which differentiates CDLML from its peers.

Sufficient capacities to satiate medium-term growth

The Company is currently operating at a 33% capacity utilization. To give a better perspective, the Company can grow its revenue three-fold without incurring a large CAPEX.

In FY23, CDLML clocked a revenue of Rs. 8.3 Bn, which can easily expand to Rs. 20 Bn+ in the coming years without putting up large capital investments. The capacity utilization numbers, however, suggest that CDLML will have to augment its box-build capacity very soon.

Capacity summary of CDLML for FY23

Product Category	Installed Capacity	Output (FY23)	Utilization %
PCBA (millions of component placements/annum)	949.81	210.79	22.2%
Cable Harnesses (no. of cables/annum)	42,25,360	1,38,692	3.3%
Box Builds (no./annum)	3,02,420	3,02,012	99.9%

Source: Company, Keynote Capitals Ltd.

Challenges

A very high degree of client concentration

The Company, due to its conscious call to cater to clients in a highly regulated industry, is currently working with a much lesser number of clients compared to its peers. As a result of this, the revenue concentration for the Company is much higher than its peers. In FY23, CDLML generated 68% and 91% of its total revenue from its top 5 and 10 customers, respectively.

Number of customers and customer concentration

Company	No. of Customers (FY23)	Contribution of Top 10 %	Contribution of Top 5 %
Avalon Technology	210	-	-
Kaynes Technology	More than 350	60%	44%
Cyient DLM	35	91%	68%

Source: Company, Keynote Capitals Ltd.

Going forward, the Company does not intend to change its business plan and seeks to continue servicing customers in highly regulated industries, which indicates a similar kind of revenue concentration to be maintained.

Any loss of customers or cyclicity in businesses of major customers can pose a significant threat to the business growth of CDLML in the future.

ESDM Industry | Cyient DLM

Fresh senior management team

Most of the members of the senior management team of The Company joined the Company in January 2023.

List of KMPs for CDLML

Name of KMP	Designation	Joined in ? (Year)
Anthony Montalbano	CEO	Jan-2023
Rajendra Velagapudi	MD	Apr-2017
Ram Dornala	COO	Jan-2023
Joseph Crowley	Head, Sales	Jan-2023
Shrinivas Kulkarni	CFO	Jan-2023
Suchitra Royroth	Head, EMS	Nov-1993
Prashant Mokashi	Head, Program Mgmt.	Jan-2016
Jonathan Wong	Head, Supply Chain	Jan-2023

Out of the total, 60%+ KMPs joined the organization in January 2023, just before the IPO of the Company. This indicates that most of the members of the top management team have very limited experience working together as a unit.

ESDM Industry | Cyient DLM

Financial Statement Analysis

Income Statement

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	7,205	8,320	10,946	14,011	17,514
Growth %		15%	32%	28%	25%
Raw Material Expenses	5,440	6,452	8,538	10,929	13,661
Employee Expenses	517	647	876	1,051	1,226
Other Expenses	409	349	438	532	631
EBITDA	840	872	1,095	1,499	1,997
Growth %		4%	25%	37%	33%
Margin%	12%	10%	10%	11%	11%
Depreciation	193	194	210	235	259
EBIT	648	678	884	1,264	1,737
Growth %		5%	30%	43%	37%
Margin%	9%	8%	8%	9%	10%
Interest Paid	220	315	280	180	180
Other Income & exceptional	80	69	50	50	50
PBT	507	432	654	1,134	1,607
Tax	109	114	170	295	418
PAT	398	317	484	840	1,189
Others (Minorities, Associates)	0	0	0	0	0
Net Profit	398	317	484	840	1,189
Growth %		-20%	53%	73%	42%
Shares (Mn)		52.9	79.3	79.3	79.3
EPS		6.00	6.11	10.59	15.00

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Cash, Cash equivalents & Bank	1,218	1,676	6,221	5,357	4,421
Current Investments	0	0	0	0	0
Debtors	1,523	1,617	2,299	3,153	4,203
Inventory	2,696	4,251	5,123	6,284	7,514
Short Term Loans & Advances	414	694	694	694	694
Other Current Assets	68	159	159	159	159
Total Current Assets	5,919	8,397	14,495	15,647	16,991
Net Block & CWIP	1,756	1,623	1,763	1,878	1,969
Long Term Investments	3	895	895	895	895
Other Non-current Assets	52	78	78	78	78
Total Assets	7,730	10,993	17,231	18,498	19,933
Creditors	1,925	2,853	3,199	3,627	3,872
Provision	74	25	25	25	25
Short Term Borrowings	1,936	2,149	1,545	1,545	1,545
Other Current Liabilities	1,257	2,422	2,422	2,422	2,422
Total Current Liabilities	5,192	7,449	7,191	7,619	7,864
Long Term Debt	996	996	0	0	0
Deferred Tax Liabilities	-39	-54	-54	-54	-54
Other Long Term Liabilities	811	624	624	624	624
Total Non Current Liabilities	1,767	1,566	570	570	570
Paid-up Capital	14	529	793	793	793
Reserves & Surplus	757	1,450	8,677	9,516	10,706
Shareholders' Equity	771	1,979	9,470	10,309	11,499
Non Controlling Interest	0	0	0	0	0
Total Equity & Liabilities	7,730	10,993	17,231	18,499	19,933

Cash Flow

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Pre-tax profit	507	432	654	1,134	1,607
Adjustments	478	601	440	365	389
Change in Working Capital	-329	-229	-1,206	-1,587	-2,036
Total Tax Paid	-62	-168	-170	-295	-418
Cash flow from operating Activities	595	635	-282	-383	-457
Net Capital Expenditure	-77	-76	-350	-350	-350
Change in investments	-254	-1,345	0	0	0
Other investing activities	7	3	50	50	50
Cash flow from investing activities	-324	-1,418	-300	-300	-300
Equity raised / (repaid)	0	889	7,001	0	0
Debt raised / (repaid)	591	57	-1,600	0	0
Dividend (incl. tax)	0	0	0	0	0
Other financing activities	-130	-205	-280	-180	-180
Cash flow from financing activities	461	740	5,121	-180	-180
Net Change in cash	731	-43	4,539	-863	-937

Valuation Ratios

	FY22	FY23	FY24E	FY25E	FY26E
Per Share Data					
EPS	16	6	6	11	15
Growth %		-63%	2%	73%	42%
Book Value Per Share		37	119	130	145
Return Ratios					
Return on Assets (%)	6%	3%	3%	5%	6%
Return on Equity (%)	69%	23%	8%	8%	11%
Return on Capital Employed (%)	21%	13%	9%	9%	11%
Turnover Ratios					
Asset Turnover (x)	1.0	0.9	0.8	0.8	0.9
Sales / Gross Block (x)	2.6	2.9	3.6	4.2	4.7
Working Capital / Sales (x)	2%	10%	38%	55%	49%
Receivable Days	96	69	65	71	77
Inventory Days	143	196	200	190	184
Payable Days	106	109	117	103	92
Working Capital Days	132	156	148	158	169
Liquidity Ratios					
Current Ratio (x)	1.1	1.1	2.0	2.1	2.2
Interest Coverage Ratio (x)	3.3	2.4	3.3	7.3	9.9
Total Debt to Equity	3.8	1.6	0.2	0.1	0.1
Net Debt to Equity	2.2	0.7	-0.5	-0.4	-0.3
Valuation					
PE (x)		111.1	109.2	63.0	44.5
Earnings Yield (%)		1%	1%	2%	2%
Price to Sales (x)		6.4	4.8	3.8	3.0
Price to Book (x)		26.7	5.6	5.1	4.6
EV/EBITDA (x)		62.6	49.9	36.4	27.3
EV/Sales (x)		6.6	5.0	3.9	3.1

Source: Company, Keynote Capitals Ltd. estimates

View & Valuation

Particulars (Rs. Mn, unless mentioned)	Estimate
Period	FY26E
Revenue	17,514
Net Profit	1,319
Earnings Per Share (Rs.)	16.6
PE Multiple (x)	~50
Expected Price Per Share (Rs.)	747
Upside / (Downside) (%)	11.8%

Source: Company, Keynote Capitals Ltd. estimates

The current revenue visibility, strong parentage and low capacity utilization indicate that the Company is well poised to witness robust growth in the future. Additionally, CDLML has also shown openness towards acquisition and foraying into adjacencies like OSAT, which can turn out to be interesting optionalities of the future.

Owing to the above factors, we ascribe a BUY rating on CDLML with a target price of Rs. 747, valuing the Company at ~50x FY26E EPS.

Kaynes Technology India Limited

Strong growth outlook with robust expansion plans

Established in 1989 by Mr. Ramesh Khunhikannan, Kaynes Technology India Ltd. (KTIL) provides end-to-end IoT-enabled ESDM services to OEM customers across 26 countries. The Company has 12 manufacturing facilities undertaking "High Mix, Low Volume" production. KTIL also offers ODM services for select products and has dedicated R&D facilities at Mysuru, Bangalore and Ahmedabad. Currently, the Company witnessing robust growth along with industry-leading EBITDA and PAT margins. KTIL is also currently implementing a Rs. 2.6 Bn expansion plan to take the best advantage of the business growth. Apart from strong prospects in the ESDM business, KTIL also has plans to backwards integrate into the manufacturing of "Bare PCBs" and tap into an adjacency by establishing a facility to provide "Outsourced Semiconductor Assembly and Testing" OSAT services.

Backward integration and entry into an adjacency

KTIL is currently establishing facilities for the manufacturing of bare PCBs and to provide OSAT service. Both CAPEX plans are going to be implemented in phases. In the 1st phase, the Company will invest Rs. 4 Bn and Rs. 15 Bn behind bare PCB manufacturing and OSAT, respectively, followed by subsequent phases. This will benefit KTIL in the following ways: a) better control over the supply chain, b) improved growth prospects, c) reduction in working capital requirements and d) better margin.

OSAT is a capital-intensive business, and because KTIL will be an early mover, it will receive substantial government support with government funding of 70% of the total project cost. Apart from this, the Company will conduct this business in technical partnership with a player who has access to the technical know-how of this business.

The 1st phase of the OSAT project will come in Telangana followed by the 2nd one in Karnataka. Groundbreaking at Telangana has already been done.

Robust margin outlook

The Company commands industry-leading margins by virtue of operating in businesses with a higher gross margin while exercising superior control over operating overheads. The operating margin spread between KTIL vs. its peers like ATL, SSTL and CDLML hovers in the range of 300-500 bps. In addition to this, given the way the order book is currently positioned, the Company is confident of being able to maintain PAT margins in the 8-10% range, at least for the coming two years.

View and Valuation

Currently, KTIL is witnessing a robust demand environment and is putting up the requisite CAPEX to satiate the same. The management anticipates to clock a ~Rs. 17,000 Mn topline in FY24E and ~Rs. 25,000 Mn topline in FY25E, along with PAT margins in the range of 8-10%. In addition to the ESDM business, the Company is also foraying into the OSAT and Bare PCB business, which are interesting optionalities that can contribute significantly to KTIL's growth in the medium to long term. Owing to the aforementioned factors, we ascribe a BUY rating on KTIL with a target price of Rs. 3,013, valuing the Company at ~57x FY26E EPS.

BUY

CMP Rs. 2,433

TARGET Rs. 3,013 (+24%)

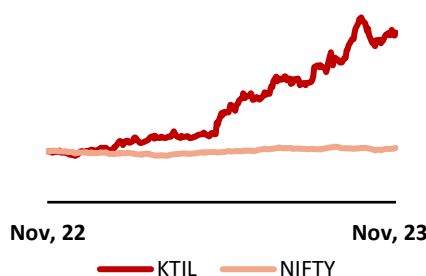
Company Data

Bloomberg Code	KAYNES IN
MCAP (Rs. Mn)	1,41,475
O/S Shares (Mn)	58
52w High/Low	2,954 / 625
Face Value (in Rs.)	10
Liquidity (3M) (Rs. Mn)	443

Shareholding Pattern %

	Sep 23	Jun 23	Mar 23
Promoters	63.6	63.6	63.6
FIIIs	9.9	8.0	8.2
DIIIs	15.6	13.1	13.0
Non-Institutional	10.9	15.3	15.3

Kaynes vs Nifty



Source: Keynote Capitals Ltd.

Key Financial Data

(Rs. Mn)	FY23	FY24E	FY25E
Revenue	11,261	16,684	24,231
EBITDA	1,699	2,619	3,756
Net Profit	950	1,718	2,267
Total Assets	14,460	16,349	21,810
ROCE (%)	15%	16%	19%
ROE (%)	16%	16%	18%

Source: Company, Keynote Capitals Ltd.

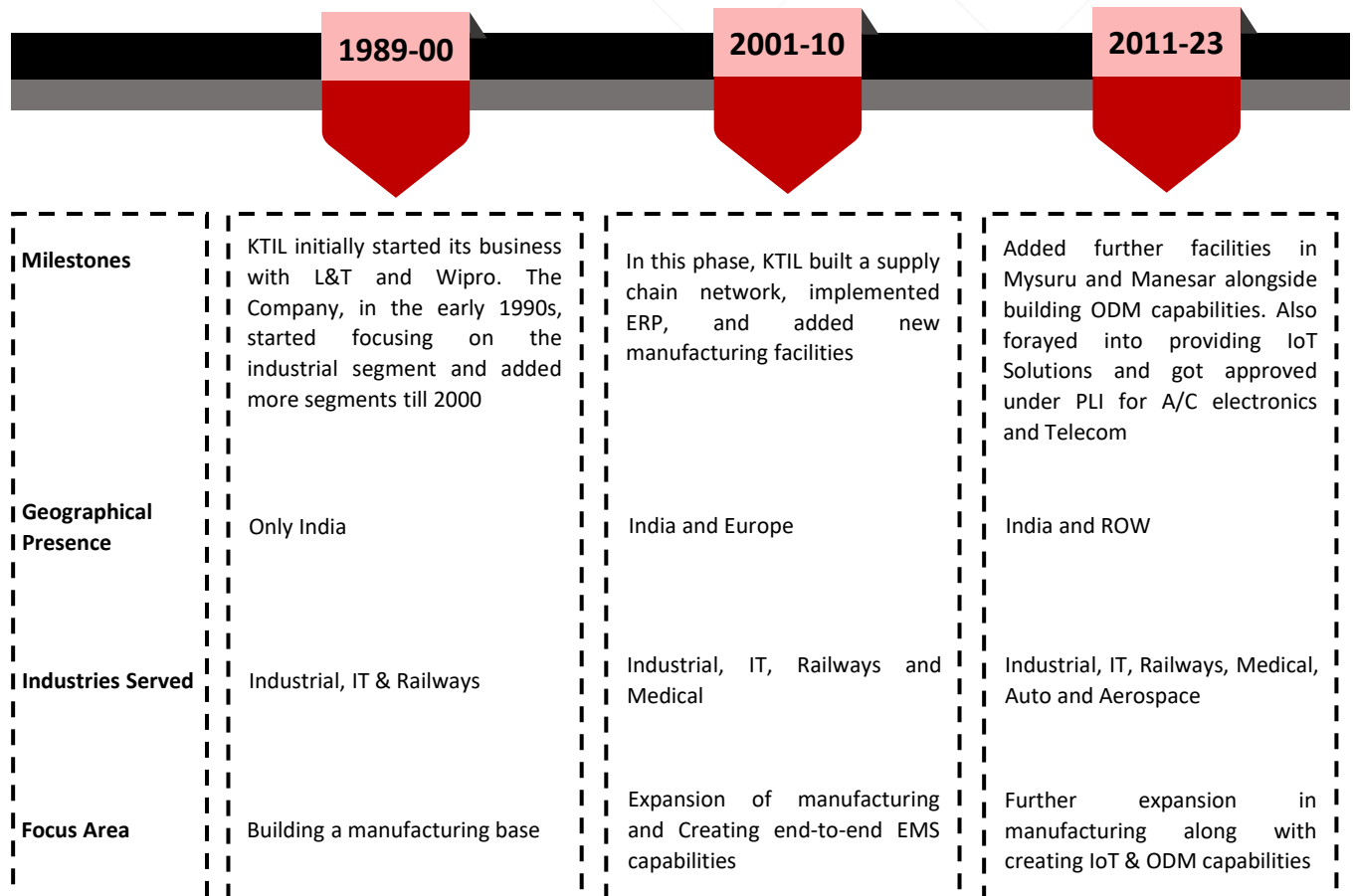
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About Kaynes Technology India Ltd.

The Company was incorporated as a sole proprietorship in 1989 by Mr. Ramesh Khunhikannan, who was later joined by his wife, Mrs. Savitha Ramesh, in 1996. Later, in 2008, the Company changed its form to a private limited by incorporating Kaynes Technology India Pvt. Ltd. (KTIL) in Mysuru, Karnataka.

KTIL is an IoT-enabled integrated ESDM player with capabilities across the value chain, providing services like conceptual design, process engineering, integrated manufacturing, and life-cycle support to major players in automotive, industrial, aerospace, and defense across 26 countries.

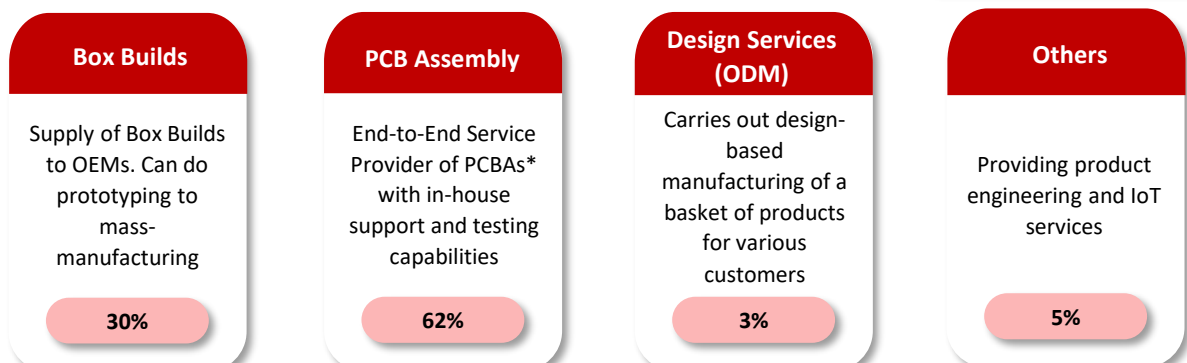
Journey of Kaynes Technology India Ltd.



Source: Company, Keynote Capitals Ltd.

Product Portfolio of Kaynes Technology India Ltd.

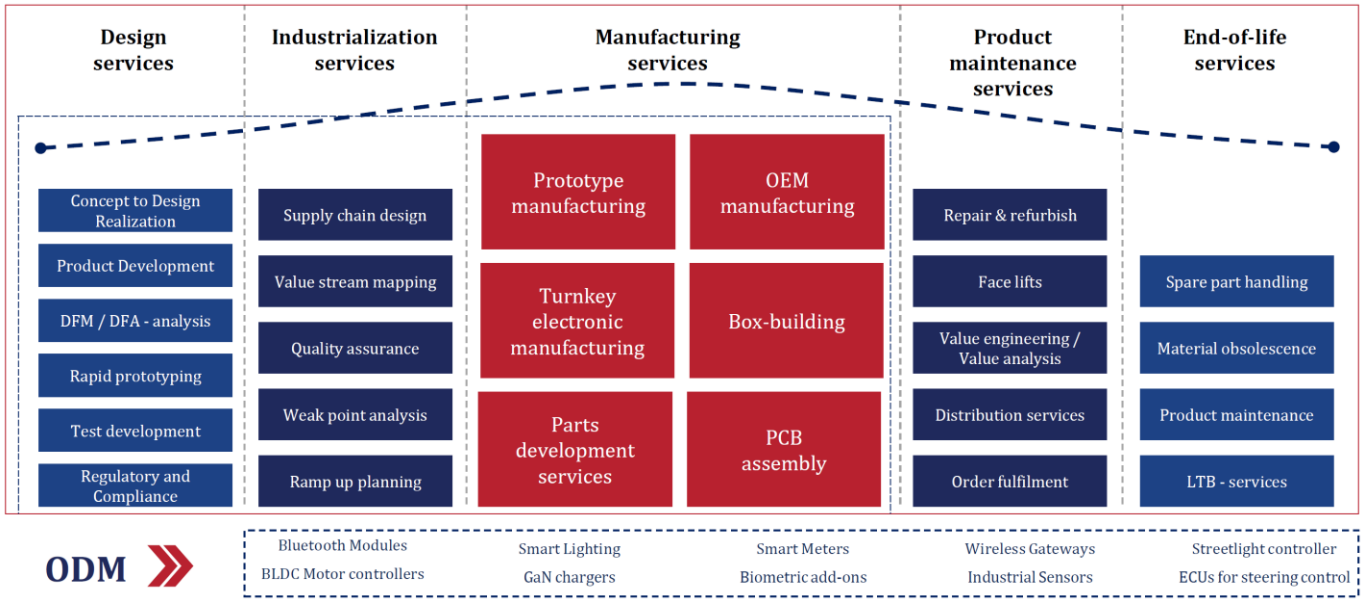
Revenue Contribution FY23



Source: Company, Keynote Capitals Ltd. *PCBA – Printed Circuit Board Assembly

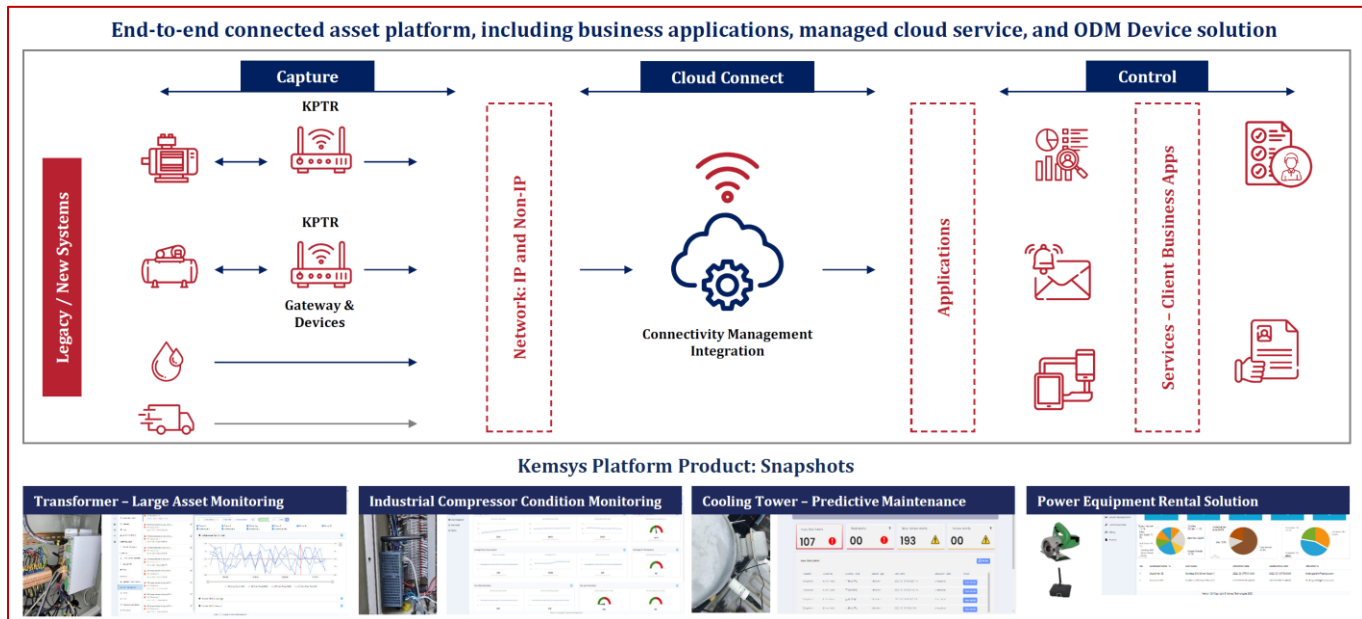
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Offering services across the entire value chain with ODM capabilities in a basket of products



Source: Company, Keynote Capitals Ltd.

Kaynes also provides product engineering, IoT enabled asset monitoring and predictive maintenance solutions



Source: Company, Keynote Capitals Ltd.

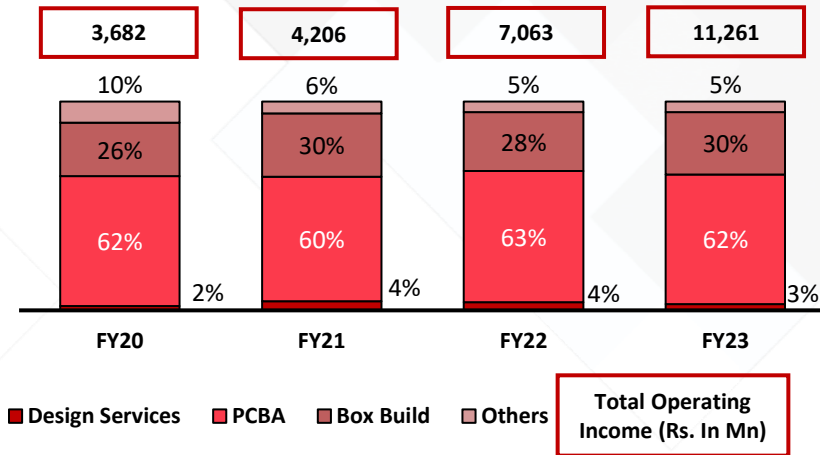
Device Engineering – Turnkey solutions for product companies requiring custom embedded system development. Device engineering involves hardware and mechanical designs involving advanced technologies such as high-end processors, sensors, connectivity, and advanced embedded software and device.

Digital Engineering – One-stop-shop for customers looking for an end-to-end IoT and Cloud enablement solution by providing remote device management IP and cloud platforms to accelerate our customer solution journey.

Quality Engineering – Quality assurance services across the entire connected product lifecycle spectrum, covering quality assurance consulting services, IoT quality assurance implementation services, to end-of-life quality assurance support services.

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Product Wise Revenue Mix (%)



The 3 Year Revenue CAGR for KTIL is ~45%

Source: Company, Keynote Capitals Ltd.

Industry-wise key clients of Kaynes Technology India Ltd.

Railway Segment - Key Clients

SIEMENS

FRAUSCHER
Rail Signalling Systems

HITACHI

Medical Segment - Key Clients

AGAPPE
YOUR BEST PARTNER IN DIAGNOSTICS

BeatO

Aerospace, Defence and Other Segments - Key Clients

TONBO
imaging

CANYON
aeroconnect

Automotive - Key Client

IHL
India Japan Lighting Pvt Ltd

IoT & IT - Key Client

iskraemeco

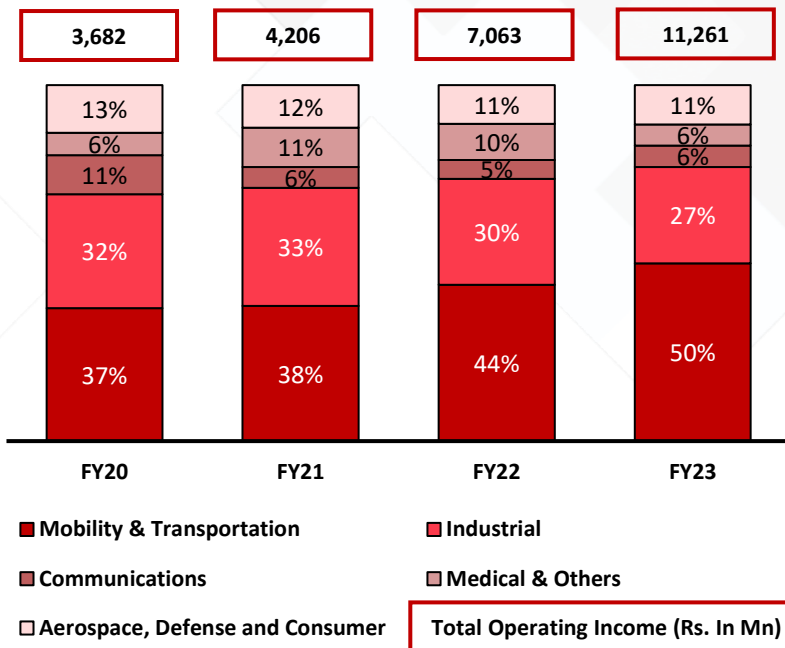
Industrial - Leading global companies manufacturing electronic instruments and electromechanical devices

Consumer – Leading players in BLDC fans and Consumer appliances

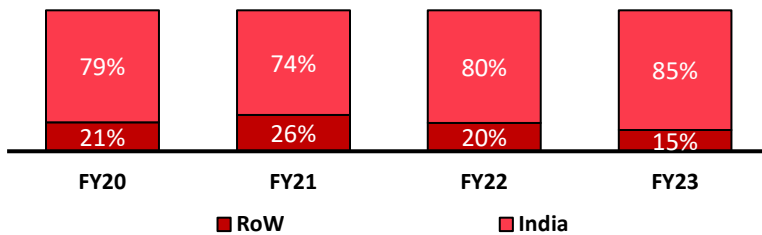
Source: Company, Keynote Capitals Ltd.

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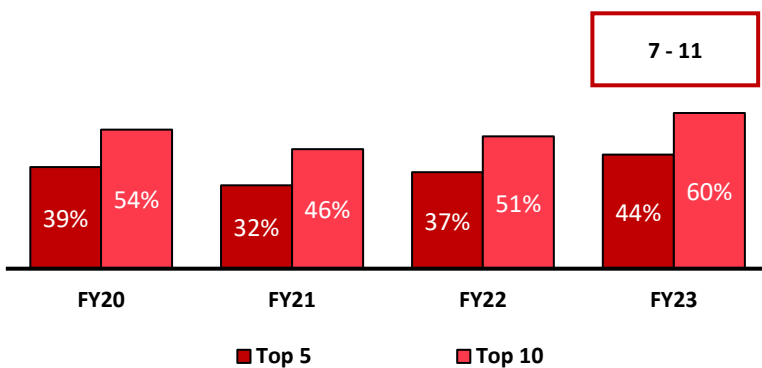
Industry Wise Revenue Mix (%)



Geographical Revenue Mix (%)



Customer Wise Revenue Mix (%)

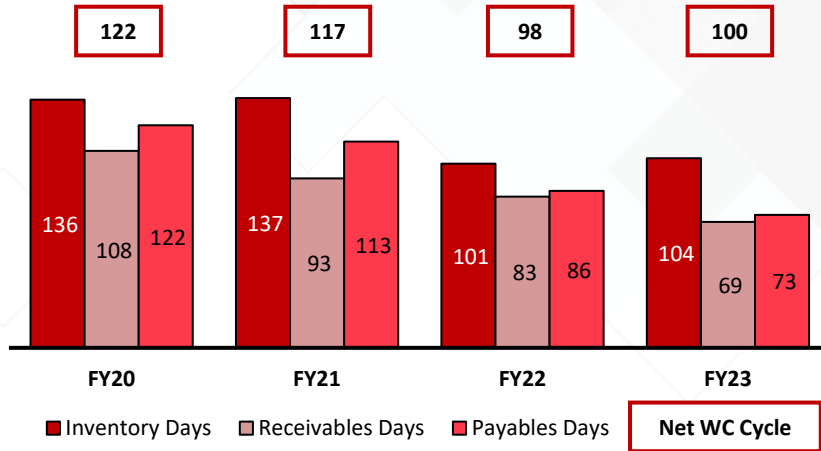


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The average length of relationship (in years) with the top 10 customers in each segment

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KTIL's Working Capital Cycle (Days)

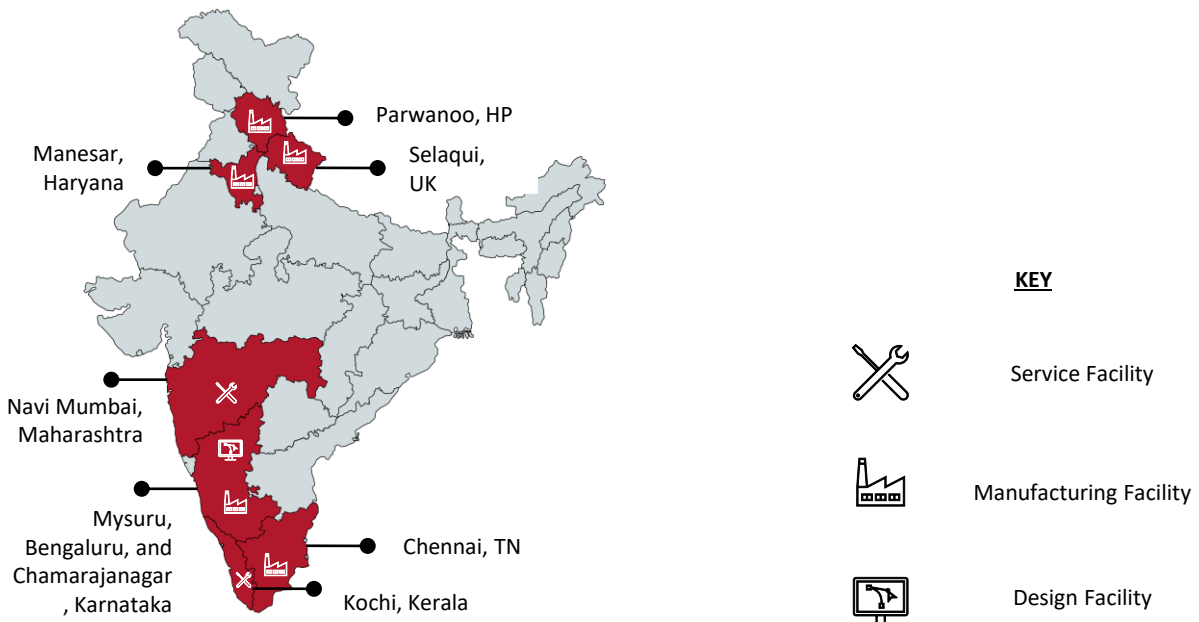


Source: Company, Keynote Capitals Ltd.

Going forward, the Company aims to rationalise its working capital cycle by about 10 days. In efforts to rationalise this, the Company plans to get into a factoring arrangement with 1-2 supply chain finance companies, which will be finalised by the end of FY24.

KTIL's Manufacturing Prowess

KTIL is an integrated, high-mix, low-volume ESDM player catering to clients globally across multiple industries. The entire manufacturing base of the Company is situated in India. KTIL, in total, has 9 manufacturing facilities predominantly located in South India, with three facilities in the North. Additionally, the Company has two service facilities located in Kochi and Navi Mumbai, along with a design centre in Bengaluru.



Given the significant expansion that KTIL is taking up, it will be fair to assume that the Company is currently operating at or closer to peak capacity utilization

Source: Company, Keynote Capitals Ltd.

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Substantial capacity expansion plans

The Company has already undertaken multiple expansion projects, which are expected to come on stream in FY24.

- **Manesar:** KTIL has taken up a 120,000 sq. ft. built-up space, and the operationalisation is under process.
- **Chamarajanagar:** Phase I of the facility is underway. As per the management, this facility is expected to commence production in H2 FY24.
- **Pune:** KTIL has also leased a space to commence manufacturing, which is also expected to be operational by H2 FY24.

Apart from the above-mentioned facilities, KTIL is also upgrading four production facilities, including Mysuru (Unit I & II), Bengaluru, and Chennai. The total money allocated to the above-mentioned expansion plans amounts to Rs. 2.6 Bn. out of which Rs. 1.0 Bn has already been utilised.

After the Manesar, Chamarajanagar and Pune expansions, KTIL can clock Rs. 30 Bn in revenue at peak utilization.

Expansion to manufacture Bare PCB and providing OSAT services

Apart from the above, the Company, with government support, is setting up manufacturing of “Bare PCBs” and foray into the “Outsourced Semiconductor Assembly and Testing (OSAT)” business. KTIL will be working with the state governments of [Telangana](#) and [Karnataka](#) to implement these projects.

Manufacturing Bare PCBs - This is a backward integration initiative that the Company was planning to take independently at a smaller scale previously. The size of this project has now gotten much more significant as the Company signed an MoU with the Karnataka government.

Scope – Manufacturing of low-volume high-end PCBs only.

Funding – The Company had enough money to take care of the previously planned investment, but the funding source remains unclear with the increased size of the project.

OSAT FAB – KTIL also unveiled its plan to set up an Outsourced Semiconductor Assembly and Testing (OSAT FAB) facility in India. This is a CAPEX-intensive project and will be implemented in phases with government support. The 1st Phase of this project will come in Telangana, followed by 2nd Phase in Karnataka.

Scope – Initially, the Company plans to focus on a few packages and products and will work with global chip manufacturers. KTIL’s aim is to be an early entrant, which will help the Company provide more integrated offerings to its customers.

Funding – This is a highly capital-intensive business and will require the Company to raise additional funds to fund this CAPEX despite state and the central government funding ~70% of the project.

Partnership – The OSAT business is also very technology-intensive; therefore, the Company will operate in collaboration with a technology partner.

Manufacturing under the PLI scheme

Under the PLI scheme, the Company is targeting two industry verticals: Telecom and AC electronics. KTIL has an established customer base, business model, and products in both these verticals.

The Company believes that it will be able to do a small portion of production in both verticals in FY24, and as a result, KTIL’s reliance on telecom and white goods will be low during the year.

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This activity will fetch a much lower margin compared to the Company's existing business, and therefore, KTIL will prefer to take projects with significant ODM share. This will help the Company keep margins closer to its desired levels despite catering to the telecom and white goods customers.

Subsidiaries of KTIL

The Company has a total of five subsidiaries, including one international subsidiary. The revenue contribution of subsidiaries is currently insignificant.

Name of Subsidiary	Holding %	Revenue (in Mn.)	Net Profit (in Mn.)
Kemsys Technologies Pvt. Ltd. (KTPL)	100%	91	-13
Kaynes Embedded Systems Pvt. Ltd. (KESPL)	60%	No Revenue	-
Kaynes International Design & Manufacturing Pvt. Ltd (KIDM)	~95%	311	24
Kaynes Technology Europe GMBH (KTE)*	54%	0.02	0
Kaynes Electronics Manufacturing Pvt. Ltd. (KEM)	100%	No Revenue	-

Source: Company, Keynote Capitals Ltd.

* Numbers in foreign currency – CHF

KTPL – IT and engineering services and solution provider to customers in diverse industries. KTPL undertakes data processing, acquisition, and transmission, including development, implementation, customized software development, and other related activities.

KESPL – Deals in embedded computer software technology and allied equipment. Limited relevance as the subsidiary has no revenue.

KIDM – Is engaged in the business of exporting mechanical, electrical, electromechanical, semiconductor, and/or hybrid technology equipment, sub assemblies, components, consumables, designing, developing, manufacturing, and all kinds of software, including analogue and digital signal generation. KIDM operates this business in JV with Mohlenhoff GMBH and Business Guardian, where the stake of the other two parties cannot exceed 33.16%.

KTE – Engaged in consultancy and sales of manufacturing services and related technical services for the electronic manufacturing services industry.

KEM – KEM has no revenue as of now but will be engaged in the business of electronics and electrical, electro-mechanical, electro-pneumatic, semiconductor and/or hybrid technology equipment, subassemblies, components, parts, consumables, etc.

The new facility at Chamarajanagar, Karnataka, will be a part of KEM. Initially, in Phase-I, the Company, in total, will invest Rs. 1.49 Bn behind this facility, which is expected to come live in Q2 FY24.

The way forward for Kaynes Technology India Ltd.

Focus on Full Product

The Company wants to sharpen its focus on providing full box-build services to its customers, resulting in KTIL garnering a higher wallet share and improved margins.

Product Diversification

The Company wants to leverage its in-house manufacturing, design, and R&D capabilities to tap various industry opportunities and expand across verticals.

Focus on Large Customers

The Company wants to expand its geographical footprint by employing more business development representatives and by leveraging its S&M teams in the USA, Japan, and Europe

Expand Manufacturing

The Company wants to continue expanding its manufacturing base in response to increasing demand and to foray into new products

Efficiency Improvement

Enhancing operational efficiency through backward integration with more in-housing. KTIL is also open to looking at in-organic opportunities from time-to-time

Source: Company, Keynote Capitals Ltd.

Going forward, growth in the business is expected to come from the auto segment (both ICE and EVs), IT and railways.

In auto ICE, growth is coming at entry-level products as the segment is witnessing growing functionality. On the EV side, the indigenisation of assemblies is expected to bring growth.

In IT, the Company has already tied up with CDAC for technology and alignment with OEMs to manufacture laptops in India for the rural conceptualisation program. KTIL expects a sizeable contribution from this segment in FY24.

There are significant plans to revamp the existing railway infrastructure in India. KTIL is present in rail and metro signalling and certain onboard equipment. The Company is closely working with the ministry to achieve maximum indigenisation, which should give a significant push to revenue as well.

In addition to this, the Company is also in the process of setting up bare PCB manufacturing and a foray into the OSAT space. These can end up being significant optionalities for the Company in the future.

The current order book gives ~2.5 years of visibility with stable margins

Order Book Details	FY20	FY21	FY22	FY23
Order Book (in Mn)	3,522	6,705	15,166	26,482
Revenue	3,682	4,206	7,063	11,261
Order Book/Revenue	1.0	1.6	2.1	2.4

Source: Company, Keynote Capitals Ltd.

KTIL's order book as of Q2 FY24 stood at Rs. 34,618 Mn, which gives ~3 years of visibility at TTM revenues. Additionally, the current order backlog also gives enough visibility to KTIL to clock a 9-10% PAT margin for the coming two years.

Management Analysis

The Management team of KTIL is a culmination of industry veterans who bring immense expertise and rich experience working with the Company.

Name	Designation	Previous Associations	Experience with KTIL (Yrs.)
Ramesh Kunhikannan	Promoter, MD	Promoter	Since Inception
Savitha Ramesh	Promoter, Chairman & WTD	Promoter	Since Inception
Jairam Sampath	CFO & WTD	Sundaram-Clayton, TVS Electronics and Harita	13
Rajesh Sharma	CEO	Cryo-Save Group, Allergan, Syngene	2
Sajan Anandaraman	Head of Commercial & Corporate Affairs	-	17

Source: Company, Keynote Capitals Ltd.

Promoter Holding and Management Compensation

Particulars	FY22	FY23	Sep-23
% Promoter Holding (~)	-	63.3%	63.6%
MD's salary (Rs Mn)	1.3	3.6	-
As a % of PAT (~)	3.1%	3.8%	-

Source: Company, Keynote Capitals Ltd.

Shareholders holding more than 1% stake in KTIL

% Shareholding in the Company (~)	Jun-23	Sep-23
Axis AMC	1.9%	3.1%
Freny Firoze Irani	3.1%	2.1%
Govt. Pension Fund Global	2.5%	1.9%
Nippon Life AMC	2.4%	1.8%
Motilal Oswal AMC	-	1.7%
Canara Robeco AMC	1.3%	1.3%
Volrado Venture Partners Fund II	1.6%	1.3%
Acacia Banyan Partners	2.0%	-

Source: Company, Keynote Capitals Ltd.

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Opportunities

Backward integration and entry into an adjacency

As stated, KTIL has chosen to integrate backward, manufacturing "Bare PCBs" with a capital outlay of Rs. 4 Bn in Phase I. Additionally, the Company plans to venture into a new area by establishing an "OSAT FAB" facility in India. Both these projects will be executed with the support of the Telangana and the Karnataka government.

The "Bare PCB" manufacturing expansion will be established in two phases. KTIL has a clear plan of not manufacturing commoditized PCBs as it's crowded.

The technology and capital-intensive "OSAT FAB" expansion is expected to take place in three phases, with a massive Rs. 15 Bn capital outlay in Phase I itself. The Company's share in total CAPEX is expected to be ~30%, with the rest of the funding coming jointly from the central and state governments. The management has clarified that the Company will have to resort to external funding (debt/equity/both) to fund the OSAT FAB investment.

The OSAT business will be conducted in technical collaboration with another entity. Additionally, the Company has already signed 3 MoUs and is anticipating to commence its 1st line by the end of FY24. The plan is to add 12 lines eventually with improvement in scale.

KTIL is confident that the pricing will be competitive with countries like China, Taiwan and Malaysia, from where most of the semiconductors are currently sourced.

Both projects will benefit the Company in the following ways,

- a) Better handle on the supply chain – Once both projects come live, KTIL will have better control over its supply chain compared to now, as the Company will be able to better take care of both the quality and time.
- b) Growth – Both projects, especially the OSAT foray, will help KTIL tap more business opportunities and play a meaningful role in the electronic import substitution opportunity. Being an early entrant, the Company is also expected to benefit from supportive government policies.
- c) Reduction in working capital requirements – Since the Company will have better control over its supply chain by virtue of backward integration, there is a reasonable probability of money getting released, which is currently tied to inventory. Hence improving cash conversion.
- d) Margin expansion – Since KTIL will be manufacturing increased amounts of components in-house, the Company will be able to absorb vendor margins and increase margins of its own. Similarly, reduced working capital requirements will reduce the Company's reliance on external funds, reducing interest costs and increasing profit margins for KTIL.

Robust margin outlook

KTIL has had a history of generating the best margins in the Industry. This is because the Company is focused on high gross margin business while having superior control over operational overheads compared to peers.

GP Margins %	FY20	FY21	FY22	FY23
Avalon Technologies	36.0%	33.9%	34.1%	35.9%
Kaynes Technology	34.5%	32.1%	30.7%	30.7%
Syrma SGS Technology	-	-	29.5%	24.8%
Cyient DLM	20.1%	21.2%	24.5%	22.5%

ESDM Industry | Kaynes Technology India

EBITDA Margins %	FY20	FY21	FY22	FY23
Avalon Technologies	10.0%	9.6%	11.6%	12.0%
Kaynes Technology	11.7%	10.0%	13.5%	14.9%
Syrma SGS Technology	-	-	9.5%	9.4%
Cyient DLM	3.1%	7.3%	11.7%	10.6%

PAT Margins %	FY20	FY21	FY22	FY23
Avalon Technologies	1.9%	3.3%	5.7%	5.6%
Kaynes Technology	2.5%	2.3%	5.9%	8.5%
Syrma SGS Technology	-	-	5.6%	6.0%
Cyient DLM	-1.5%	1.9%	5.5%	3.8%

NOTE: PAT margin for Avalon Technologies Ltd. is adjusted for exceptional gain in FY22

From FY20 to FY22, the gross profit margin for KTIL declined by 380 bps, but the EBITDA and PAT margin expanded by 320 bps and 600 bps, respectively.

Management explains KTIL's ability to generate higher margins compared to peers. Excerpts from Q1 FY24 Con Call.

"The contribution of consumer products in our business is minuscule, and most of the business is driven by the industrial type of electronics, and typically we have found over the last several years that we have been operating, the gross margins are higher in these businesses."

"Also, we specialize in a few types of products manufacturing so that we get scale economies in those products, for instance, in automotive, we do, we are one of the largest manufacturers of lighting systems and so on and signaling, etc. So, specialization within vertical and across vertical, different diversified businesses leads to the higher level of margins that you see in us."

Continuous focus on profitability..

*"We actively look at our portfolio for profitability, and there were three factors which we look at before on-boarding any business, **one**, whether the business is long term, **two**, whether the business has got high criticality and technology, and **three**, whether we can in future make reasonable profits in the business. So, that is how we manage our profitability in our business portfolio."*

..will help the Company sustain margins going forward

"EBITDA margins will be about 15%, and you can expect PAT at about 9% to 10% for this year because our gross margins are stable, so because of that, we can confirm that based on the order book, we have already done the math."

"As far as we are concerned, we have planned for the immediate future in the short term. We can consistently do this, and we are able to see a visibility for the next 24 months. Our company's activities are designed in such a way next 24 months; there should not be any up or down."

Challenges

Unexpected delays in expansion

The Company has announced substantial CAPEX plans, which will help the Company clock an Rs. 30 Bn revenue at peak utilization. Any unexpected delays or hiccups in the expansion plans can hamper the growth that KTIL is anticipated to witness. Unexpected expansion delays will deter KTIL from taking advantage of the strong industry tailwind.

Therefore, any unexpected delays or hurdles in expansion can hamper business, profit growth and impact the already rich valuations.

Capacity utilization getting impacted

Given how the business is progressing for KTIL, almost all the existing facilities of the Company are either running at or closer to peak utilization.

Any delay in onboarding new clients, delay in offtake or cancellation of orders from existing clients can lead to overcapacity at the Company's end, which will dent margins and, hence, profit until the status quo is restored. Fructification of any of the above situations will hurt even more after the expanded capacities come on stream.

Hurdles in executing the MoU or in forging the technical partnership regarding OSAT and Bare PCB expansion

KTIL's foray into the Bare PCB manufacturing and OSAT FAB business are expected to be significant growth drivers for the Company in the medium to long term. In this regard, the Company will be working closely with the Telangana and the Karnataka Govt. and is also in talks to get into a technology partnership with another entity for the OSAT business.

Though the business opportunity is significant, currently, the business is at a planning and establishment stage, and there can be hiccups or other unfavourable events before the manufacturing comes to fruition.

Additionally, the Company is in negotiations for a technology tie-up with its partner, which can also get cancelled or take time to finalise in case both parties cannot come to a conclusion of mutual benefit.

Apart from the business establishment challenges, finding tech-savvy manpower with the right skill set is still challenging in India. To mitigate this, the Company has identified skilled workers who will come to India and train employees.

Financial Statement Analysis

Income Statement

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	7,062	11,261	16,684	24,231	32,712
Growth %		59%	48%	45%	35%
Raw Material Expenses	4,894	7,801	11,562	16,841	22,735
Employee Expenses	602	771	1,084	1,575	2,126
Other Expenses	614	991	1,418	2,060	2,781
EBITDA	952	1,699	2,619	3,756	5,070
Growth %		78%	54%	43%	35%
Margin%	13%	15%	16%	16%	16%
Depreciation	132	187	347	562	720
EBIT	820	1,511	2,272	3,193	4,350
Growth %		84%	50%	41%	36%
Margin%	12%	13%	14%	13%	13%
Interest Paid	271	365	100	250	300
Other Income & exceptional	41	114	150	120	120
PBT	590	1,260	2,322	3,063	4,170
Tax	174	308	604	796	1,084
PAT	417	952	1,718	2,267	3,086
Others (Minorities, Associates)	-2	-2	0	0	0
Net Profit	414	950	1,718	2,267	3,086
Growth %		129%	81%	32%	36%
Shares (Mn)		58.1	58.1	58.1	58.1
EPS		16.34	29.56	38.99	53.08

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Cash, Cash equivalents & Bank	216	4,860	1,447	1,260	952
Current Investments	0	0	0	0	0
Debtors	1,977	2,271	3,670	5,573	7,851
Inventory	2,264	4,132	5,781	8,589	11,822
Short Term Loans & Advances	368	789	789	789	789
Other Current Assets	38	529	529	529	529
Total Current Assets	4,864	12,580	12,216	16,740	21,943
Net Block & CWIP	1,178	1,429	3,682	4,619	5,399
Long Term Investments	15	33	33	33	33
Other Non-current Assets	168	418	418	418	418
Total Assets	6,224	14,460	16,349	21,810	27,793
Creditors	1,641	2,229	3,699	5,895	7,790
Provision	166	284	284	284	284
Short Term Borrowings	1,319	1,194	44	794	1,544
Other Current Liabilities	496	718	718	718	718
Total Current Liabilities	3,621	4,424	4,744	7,690	10,336
Long Term Debt	293	150	0	250	500
Deferred Tax Liabilities	68	77	77	77	77
Other Long Term Liabilities	205	205	205	205	205
Total Non Current Liabilities	566	432	282	532	782
Paid-up Capital	465	581	581	581	581
Reserves & Surplus	1,560	9,009	10,727	12,994	16,081
Shareholders' Equity	2,026	9,590	11,309	13,576	16,662
Non Controlling Interest	11	13	13	13	13
Total Equity & Liabilities	6,224	14,460	16,348	21,811	27,793

Cash Flow

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Pre-tax profit	590	1,260	2,322	3,063	4,170
Adjustments	386	452	297	692	900
Change in Working Capital	-743	-1,626	-1,579	-2,515	-3,615
Total Tax Paid	-22	-503	-604	-796	-1,084
Cash flow from operating Activities	211	-416	437	444	371
Net Capital Expenditure	-422	-581	-2,600	-1,500	-1,500
Change in investments	-33	-4,453	0	0	0
Other investing activities	11	98	150	120	120
Cash flow from investing activities	-445	-4,937	-2,450	-1,380	-1,380
Equity raised / (repaid)	0.01	6,600	0	0	0
Debt raised / (repaid)	301	-336	-1,300	1,000	1,000
Dividend (incl. tax)	0	0	0	0	0
Other financing activities	-256	-720	-100	-250	-300
Cash flow from financing activities	45	5,543	-1,400	750	700
Net Change in cash	-189	191	-3,413	-186	-309

Valuation Ratios

	FY22	FY23	FY24E	FY25E	FY26E
Per Share Data					
EPS	9	16	30	39	53
Growth %		82%	81%	32%	36%
Book Value Per Share		165	195	234	287
Return Ratios					
Return on Assets (%)	8%	9%	11%	12%	12%
Return on Equity (%)	24%	16%	16%	18%	20%
Return on Capital Employed (%)	26%	15%	16%	19%	20%
Turnover Ratios					
Asset Turnover (x)	1.4	1.1	1.1	1.3	1.3
Sales / Gross Block (x)	5.0	6.1	5.0	4.5	4.8
Working Capital / Sales (x)	14%	42%	47%	34%	32%
Receivable Days	83	69	65	70	75
Inventory Days	146	150	156	156	164
Payable Days	86	73	82	89	96
Working Capital Days	142	145	140	136	143
Liquidity Ratios					
Current Ratio (x)	1.3	2.8	2.6	2.2	2.1
Interest Coverage Ratio (x)	3.2	4.5	24.2	13.3	14.9
Total Debt to Equity	0.8	0.1	0.0	0.1	0.1
Net Debt to Equity	0.7	-0.4	-0.1	0.0	0.1
Valuation					
PE (x)		152.5	84.3	63.9	47.0
Earnings Yield (%)		1%	1%	2%	2%
Price to Sales (x)		12.9	8.7	6.0	4.4
Price to Book (x)		15.1	12.8	10.7	8.7
EV/EBITDA (x)		86.2	55.9	39.0	28.9
EV/Sales (x)		13.0	8.8	6.0	4.5

Source: Company, Keynote Capitals Ltd. estimates

View & Valuation

Particulars (Rs. Mn, unless mentioned)	Estimate
Period	FY26E
Revenue	35,135
Net Profit	3,364
Earnings Per Share (Rs.)	57.9
PE Multiple (x)	~57
Expected Price Per Share (Rs.)	3,013
Upside / (Downside) (%)	23.8%

Source: Company, Keynote Capitals Ltd. estimates

The Company is investing significantly in ESDM CAPEX (Rs. 2,600 Mn in FY24 and FY25) in anticipation of its existing growth trajectory to continue. KTIL aims to clock a ~Rs. 17,000 Mn topline in FY24E and ~Rs. 25,000 Mn topline in FY25E, along with PAT margins in the range of 8-10%.

Owing to a strong domestic outlook, coupled with the recent progression of the Company, we believe that KTIL will be able to achieve the guidance that it has laid out for FY24E and FY25E. In addition to this, we also anticipate PAT margins to stay close to 9-10%.

Apart from this, KTIL's foray into the OSAT and Bare PCB manufacturing business offers lucrative optionalities, which are expected to add significant value to the Company's business in the medium to long term.

Having mentioned the above, our estimates indicate that the current market price is pricing the future optimism almost perfectly. Therefore, we ascribe a BUY rating on KTIL with a target price of Rs. 3,013, valuing the Company at ~57x FY26E EPS.

Syrma SGS Technology Limited

Strong track record of successful acquisitions

Syrma SGS Technology Ltd. (SSTL) was formed due to Syrma Technology Pvt. Ltd.'s acquisition of SGS Teknics Manufacturing Pvt. Ltd. in the year 2021. Currently, the Company has a well-diversified manufacturing presence with 13 facilities divided across North and South India. A significant growth of SSTL can be attributed to acquisitions done by the Company. A recent example of the same is the acquisition of Johri Digital Healthcare Ltd. (JDHL), a medical devices company, which the Company announced in Q1 FY24. SSTL also has a significant ODM operation, and a higher mix of the consumer segment compared to its peers operating in "High Mix, Low Volume" electronic manufacturing. As a result of this, the GPM% generated by SSTL is 600-1,100 bps lower compared to peers and is anticipated to remain so, given the future business mix.

Strong acquisition track record

SSTL has a history of exercising successful acquisitions and growing the business inorganically without faltering on any of the acquisitions. From 2014-16, SSTL acquired Tovya Automation and carried out the merger of 3G Communication Pvt. Ltd., which allowed the Company to expand its IoT-related product offerings. Later in the year 2020-21, the Company acquired SGS Teknics and Perfect ID, which enabled SSTL to expand its manufacturing and R&D footprint along with opening cross-selling opportunities. Additionally, the acquisition of Perfect ID augmented the manufacturing infrastructure and technical know-how that helped the Company expand its range of products in the RFID segment. The Company plans to continue following this path in the future as well.

Strengthening its foothold in the medical devices space with the acquisition of JDHL

In Q1 FY24, the Company announced the acquisition of a 51% stake in JDHL by spending Rs. 2,295 Mn, marking its full-fledged entry into the large, fragmented, and fast-growing medical device market. SSTL anticipates working synergistically by providing strong manufacturing support to the promoters of JDHL, who are technocrats and want to spend most of their time behind R&D. This acquisition has attached another growth lever to SSTL's business, which will be even more accretive in terms of profits. This is because JDHL is a debt-free business generating ~30% EBITDA margin, which is almost 3 times higher than the Company's current EBITDA margin. The management anticipates the overall EBITDA margin to increase by 100-150 bps post-amalgamation.

Apart from JDHL, SSTL's current healthcare segment is facing challenges. However, a turnaround is expected within the next few quarters, as the company is already observing initial indications of improvement.

View and Valuation

The Company aims to grow faster than the industry using organic as well as inorganic means. We believe that the current efforts will enable SSTL to achieve its above-mentioned objective. Simultaneously, we also believe that the market is currently pricing a fair amount of future positivity and hence ascribe a BUY rating on SSTL with a target price of Rs. 675, valuing the Company at ~45x FY26E EPS.

BUY

CMP Rs. 539

TARGET Rs. 675 (+25%)

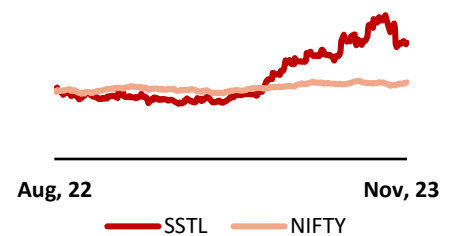
Company Data

Bloomberg Code	SYRMA IN
MCAP (Rs. Mn)	95,239
O/S Shares (Mn)	177
52w High/Low	659 / 248
Face Value (in Rs.)	10
Liquidity (3M) (Rs. Mn)	629

Shareholding Pattern %

	Sep 23	Jun 23	Mar 23
Promoters	47.2	47.3	47.3
FIIIs	10.1	9.3	4.6
DIIIs	9.6	9.2	8.6
Non-Institutional	33.0	34.2	39.5

Syrma SGS vs Nifty



Source: Keynote Capitals Ltd.

Key Financial Data

(Rs. Mn)	FY23	FY24E	FY25E
Revenue	20,484	28,500	40,020
EBITDA	1,838	2,337	3,482
Net Profit	1,180	1,111	1,792
Total Assets	26,640	29,251	34,159
ROCE (%)	12%	8%	11%
ROE (%)	12%	7%	10%

Source: Company, Keynote Capitals Ltd.

ESDM Industry | Syrma SGS Technology

About Syrma SGS Technology Ltd

The Company was incorporated in 2004 in Chennai as “Syrma Technology Pvt. Ltd.” which later, in 2020, acquired SGS Teknics Manufacturing Pvt. Ltd. In the year 2021, a special resolution was passed, and the name of the Company was changed to Syrma SGS Technology Pvt. Ltd.

Syrma SGS Technology Ltd. (SSTL) is a technology-focused end-to-end engineering and design Company providing turnkey solutions and precision manufacturing of PCBAs, RFID tags, magnetics, etc., for diverse end-user industries.

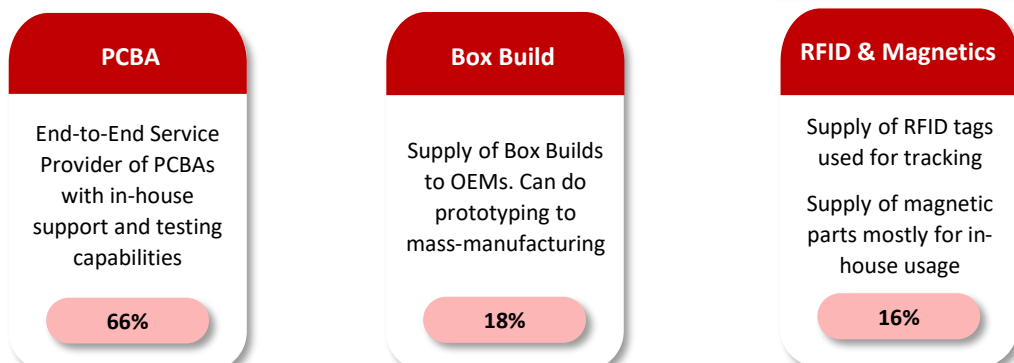
Journey of Syrma SGS Technology Ltd.

	2004-10	2010-20	2020-23
Milestones	<ul style="list-style-type: none"> 2004 – Incorporated 2006 – Manufacturing Unit in Chennai 2010 – New Facility at Bargur 	<ul style="list-style-type: none"> 2014 – SSTL’s first R&D department in India 2016 – Manufacturing of RFID tags 2020 – Entry into EV 	<ul style="list-style-type: none"> 2021 – Acquired 75% stake in Perfect ID 2023 – Acquired 51% stake in Johari Digital Healthcare Ltd.
Acquisition	None	Acquired SGS Teknics Manufacturing Pvt. Ltd.	Acquired stake in Perfect ID and Johari Digital Healthcare Ltd.
Capabilities	ESDM Manufacturing	End-to-end ESDM, Magnetics, and RFID	End-to-end ESDM, Magnetics, and RFID

Source: Company, Keynote Capitals Ltd.

Product Portfolio of Syrma SGS Technology Ltd.

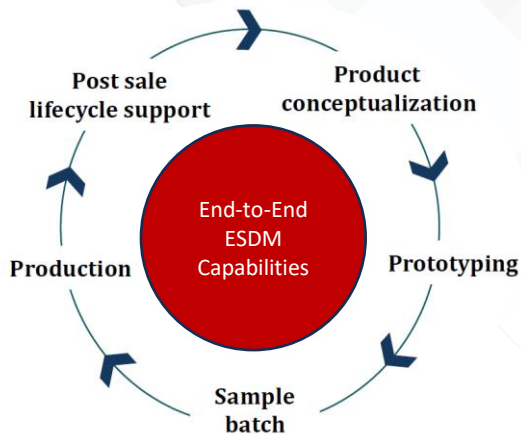
Revenue Contribution FY23



Source: Company, Keynote Capitals Ltd.

ESDM Industry | Syrma SGS Technology

One-stop shop ESDM solution provider

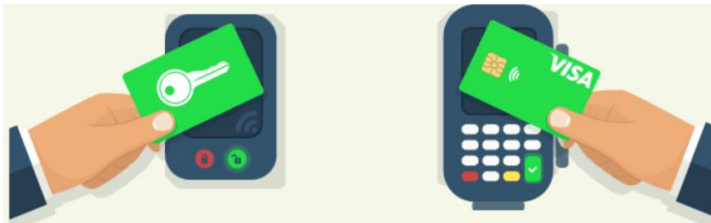


Source: Company, Keynote Capitals Ltd.

The Company operates in high mix flexible volume segments catering to diverse customers across industry verticals. SSTL can provide various services from “Product Conceptualization” to “Post Sales Lifecycle Support.”

The ESDM capabilities of the Company have been built over three decades. The Company also has strong R&D capabilities with three R&D facilities and over a 100 employees. Two R&D facilities are in India, and one is in Germany.

The Radio Frequency Identification (RFID) division



Source: Company, Keynote Capitals Ltd.



This business results from the Company’s acquisition of a USA-based entity, “Perfect ID.” Initially, in October 2021, the Company acquired a 75% stake, and the balance was acquired in March 2023. The total amount for the purchase of Perfect ID summed to ~Rs. 900 Mn.

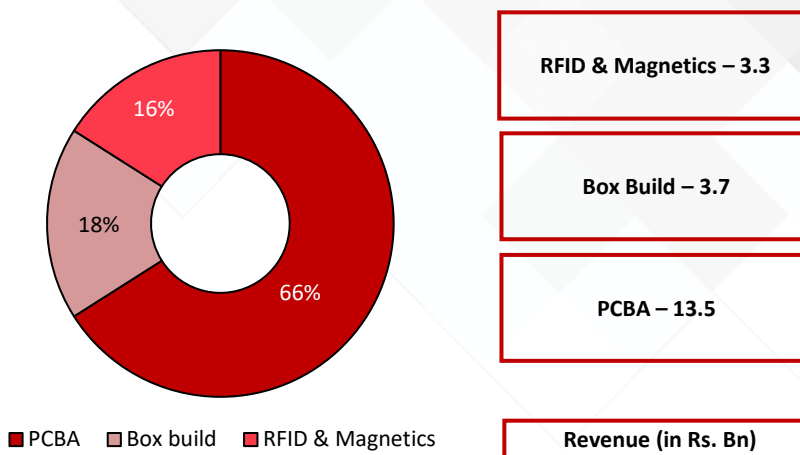
RFID is a form of wireless communication that uses electromagnetic fields to identify and track tags attached to objects automatically. RFID Tags comprise an antenna and a semiconductor chip, and the packaging is done based on the application.

Syrma’s RFID products find application in industries like shipping, healthcare, manufacturing, retail, and fintech. Use cases include pet and livestock tracking, inventory management, asset and equipment tracking, inventory control, cargo and supply chain logistics, vehicle tracking, customer service, and access control in security protocol requirements.

The Company is also working with multiple customers for various opportunities for tags in the future. For example, SSTL is working with a German Home appliances manufacturer, a Netherlands-based Fashion jewellery maker, a large French company for rental apparel, and an American healthcare MNC for medical consumables.

ESDM Industry | Syrma SGS Technology

Product Wise Revenue Mix for FY23



Source: Company, Keynote Capitals Ltd.

Industry-wise key clients of Syrma SGS Technology Ltd.

Industrials Segment - Key Clients



Consumer Segment - Key Clients



Auto & EV Segment - Key Clients



Large OEMs in the IC and EV space

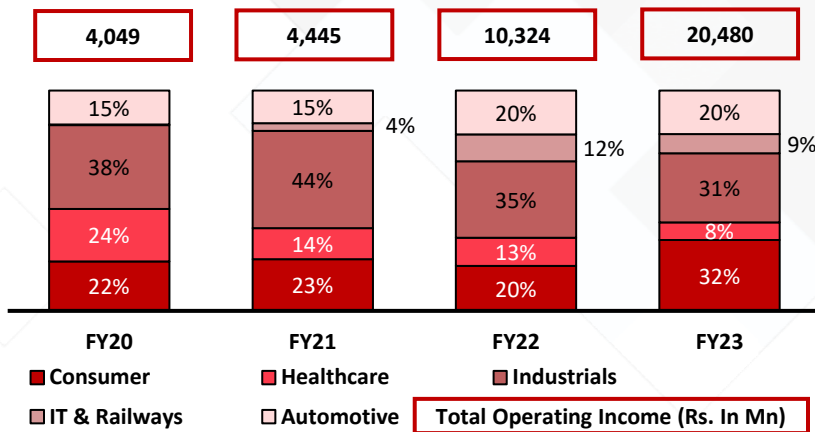
Healthcare, IT & Railway Segment - Key Clients

Leading global healthcare company | Leading laptop manufacturing company |
Leading locomotive companies

Source: Company, Keynote Capitals Ltd.

ESDM Industry | Syrma SGS Technology

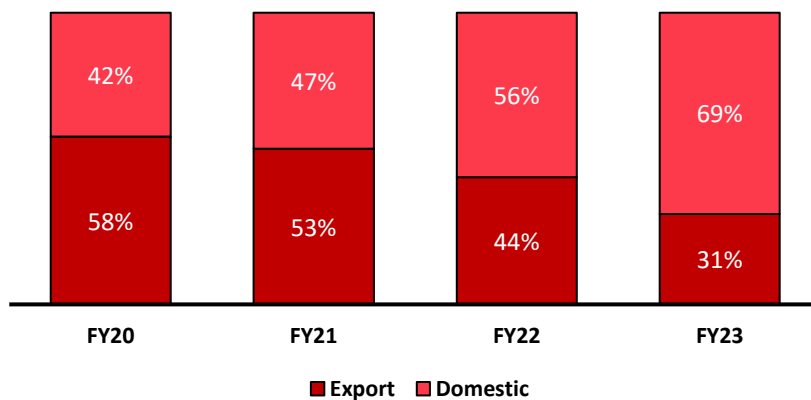
Industry Wise Revenue Mix



The 3 Year Revenue CAGR for SSSL is ~72%

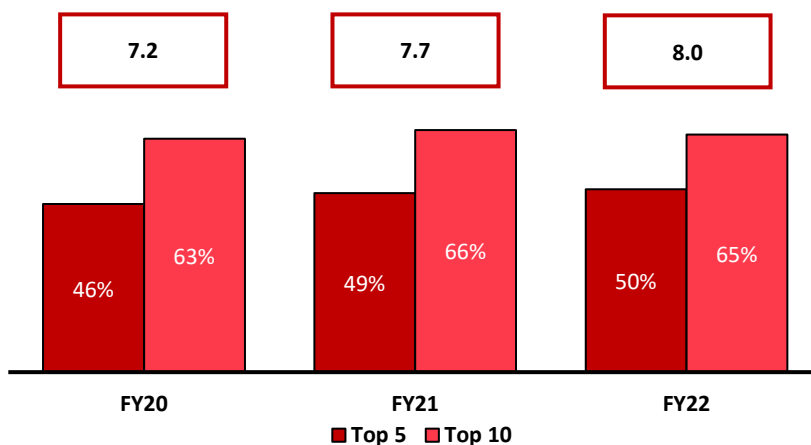
Source: Company, Keynote Capitals Ltd.

Geographical Revenue Mix



Source: Company, Keynote Capitals Ltd.

Significant contribution and increasing stickiness of top customers

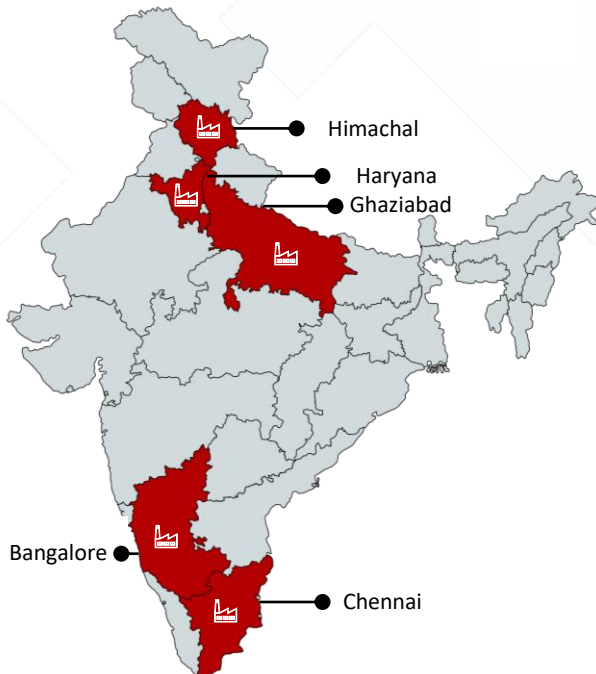


The average length of relationship (in years) with customers contributing >80% to revenue

Source: Company, Keynote Capitals Ltd.

Syrma's Manufacturing Prowess

The manufacturing base of the Company is only in India. In total, SSTL has 13 manufacturing facilities in north and south India, with about 8.4 lakh sq. ft. of manufacturing space and more than 7,500 workers.



KEY



Manufacturing Facility

Source: Company, Keynote Capitals Ltd.

Currently, SSTL has an 8.4 lakh sq. ft. manufacturing area and is in the process of doubling the same

Expansion Plans

SSTL is in the process of doubling its manufacturing capacity. For this purpose, the Company has acquired a 16-acre plot in Krishnagiri and a 6-acre building and plot in Chennai for its domestic business. This will take the Company's total capacity to ~15 lakh sq. ft. Additionally, SSTL has also entered into a long-term lease agreement for its Noida plant, which is currently under the trial production phase. This is an additional 1 lakh sq. ft. space that will solely be dedicated to consumer electronics. This will be a specialised, high-volume, consumer-oriented manufacturing facility. The planned CAPEX for this in FY24-FY25 is between Rs 3.5-4.0 Bn.

Higher focus on design-led manufacturing

SSTL enjoys the highest share of ODM business in its revenue mix among listed peers. In FY23, the Company's ODM share in total revenue stood at 18% vs. single digits for peers.

In the future, the Company wants to drive the ODM share even higher to 20-30% of the total revenue. In line with the above-mentioned objective, SSTL has established a dedicated wholly-owned subsidiary, "Syrma SGS Engineering and Technology Services Ltd." to carry out design activities that generally get diffused as manufacturing gets a higher priority.

This division of SSTL will be headed by Mr Shriram Srinivasan, CEO, who is an industry veteran and will be supported by a senior president with about two decades of experience in the software and engineering services industry. As per the management, the initial customer response is very encouraging, and designing will be a significant vertical going forward in the coming 2-3 years.

ESDM Industry | Syrma SGS Technology

As discussed previously, the ODM business fetches a better margin compared to plain vanilla B2P manufacturing. This division will result in improved margins and customer stickiness.

Efforts to drive the contribution of box build higher

While directionally, it is correct to think that box builds fetch a higher margin to ESDM companies than PCBA. It is also important to acknowledge the fact that the spread between PCBA and box build for each product can differ. For example, the spread is insignificant in the consumer appliances segment.

In FY23, the contribution of box build to SSTL's total revenue stood at 18%, which is primarily supplied to data centres and POSP printers. As the business progresses, the Company wants to increase the share of box builds in its revenue while being mindful that the proportion of box builds goes higher in products where the spread between PCBA and box builds is significant.

Currently, the way the box-build business is structured is such that SSTL has long-term contracts with plastics and sheet metal vendors with whom the Company has been working for more than 15 years. These operations are not done in-house because the current scale doesn't justify establishing a dedicated line for plastics and sheet metal and allocating management bandwidth to the same.

History of Inorganic Expansion

The Company has a successful history of carrying out in-organic expansions. From 2014-16, SSTL acquired Tovya Automation and carried out the merger of 3G Communication Pvt. Ltd., which allowed the Company to expand its IoT-related product offerings and to meet the pre-qualification criteria of certain government orders.

Later in the year 2020-21, the Company acquired a couple of companies back-to-back, including SGS Tekniks and Perfect ID. The acquisition of SGS Tekniks enabled the Company to expand its manufacturing and R&D footprint along with opening cross-selling opportunities for RFID and magnetic products to the customers of SGS Tekniks.

On the other hand, acquiring Perfect ID gave the Company access to better infrastructure and technical know-how for manufacturing more RFID products, thereby expanding its range of product offerings in the RFID segment.

In Q1 FY24, the Company announced another acquisition. SSTL is acquiring a 51% stake in Johari Digital Healthcare Ltd. (JDHL), marking its full-fledged entry into the large, fragmented, and fast-growing medical device market.

Manufacturing under PLI

SSTL also plans to apply under the PLI scheme for telecom and white goods, AC product categories.

Regarding telecom, the Company has already fulfilled the guidelines laid out by the GOI and is eligible for the PLI. The Company expects positive developments to be announced by Q3 FY24.

Regarding AC, the Company has not yet started incurring CAPEX, as a couple of customers are reviewing the products designed by SSTL. Any positive development from the customer's end will result in CAPEX under PLI for AC.

ESDM Industry | Syrma SGS Technology

Acquisition of Johri Digital Healthcare Ltd. (JDHL)

JDHL is the latest acquisition of SSTL, which has enabled the Company to tap a large opportunity in the medical devices space. This is a technology-oriented 40-year-old that has 15-18 US FDA approvals, and its plants and processes are certified by the leading agencies of countries like the USA, Canada, Australia, etc. JDHL was promoted by a technocrat couple in which SSTL acquired a 51% stake.

The reason for onboarding SSTL is two-fold. a) the existing promoters want to spend maximum time in R&D and want to free themselves up from the day-to-day production, and b) SSTL is much bigger than JDHL in terms of reach and scale, which gives JDHL an opportunity to reach to bigger customers, unlike before.

SSTL initially plans to spend Rs. 2,295 mn with an additional commitment to pay Rs. 280 mn if JDHL can fulfil some profitability milestones. In FY23, JDHL clocked a ~1,600 mn turnover with a 30% EBITDA margin. This acquisition will not add more than 5-7% to the overall topline of SSTL but will significantly drive SSTL's EBITDA. The current capacity utilisation of JDHL is 40%, giving it significant room to increase sales at the current installed capacity.

Regarding the management structure, Mr Johri will continue to lead JDHL as a chairman with adequate representation by SSTL on JDHL's board with reserved rights and controls.

Subsidiaries of SSTL

The Company has a total of three operational subsidiaries.

Name of Subsidiary (FY23)	Holding %	Revenue (Rs. in Mn.)	Net Profit (Rs. in Mn.)
SGS Teknics Manufacturing Pvt. Ltd. (STML)	100%	830	51
Perfect ID India Pvt. Ltd. (PIIL)	100%	66	16
Syrma Technology, Inc.	100%	1	-1

Source: Company, Keynote Capitals Ltd.

Subsidiaries that are yet to commence operations – Syrma SGS Technology & Engineering Services Ltd., Syrma SGS Design & Manufacturing Pvt. Ltd., Syrma SGS Electronics Pvt. Ltd.

STML – It is a wholly-owned subsidiary that operates in the business of providing electronic design and manufacturing goods and related services.

PIIL – It is a wholly-owned subsidiary that manufactures fully automated radio frequency identification (RFID) tags and ultra-high frequency radio frequency identification inlays and tags.

Syrma Technology Inc – This is SSTL's US subsidiary providing support services in connection with the Company's business operations.

SGS Solutions GmbH – It is a subsidiary that is 66% owned by SSTL via. STML, which holds a direct stake. This company is engaged in the business of providing design and engineering services.

SSTL's strategy going forward

Strengthening the JDHL Platform

SSTL is viewing JDHL as a platform for medical devices which the Company plans to strengthen going forward, making it a significant entity

Higher share of ODM

ODM remains a large focus area for SSTL as it fetches a higher margin than OEM. The Company's footing in ODM is also quite strong.

Value accretive acquisitions

SSTL has a history of making successful acquisitions and will continue to scout lucrative opportunities going forward as well. JDHL is a recent example.

Strengthening Exports

SSTL has received a breakthrough in the USA and now caters to two geographies, including the EU. The Company expects exports to contribute 1/3rd to its topline in the long-term

Maintaining Double-Digit Margins

SSTL aims to maintain a double-digit (10-11%) EBITDA margin in the future. This can go up by 100-150 bps with the amalgamation of JDHL, as it generates a 30% EBITDA

Source: Company, Keynote Capitals Ltd.

All the future expansions of the Company are aimed at achieving a revenue target of \$1 Bn in the long term

The current order book gives ~1.6 years of visibility with a 23-25% gross margins

Order Book Details	FY22	FY23
Order Book (Rs. mn)	12,000	30,000
Revenue	10,324	20,480
Order Book/Revenue	1.2	1.5

Source: Company, Keynote Capitals Ltd.

SSTL's order book as of Q1 FY24 stood at ~Rs. 35,000 Mn, which gives 1.6 years of visibility at TTM revenues. Additionally, given the current order book mix, the Company believes it can clock gross margins in the 23-25% range.

In terms of end-user industries, the current order book consists of a 25% contribution from autos, 40% from consumers (including ODM), 8-9% from healthcare, 20-22% from industrial and 3-4% from IT.

ESDM Industry | Syrma SGS Technology

Management Analysis

The Management team of SSTL consists of industry veterans who bring immense expertise and rich experience working with the Company.

Name	Designation	Previous Associations	Experience with SSTL (Yrs.)
Sandeep Tandon	Executive Chairman	Founder, Syrma	Since Inception
Jasbir Gujral	MD	Founder, SGS Teknics	Since Acquisition
Krishna Kumar Pant	Head, Domestic Business	Founder, SGS Teknics	Since Acquisition
Ranjit Singh	Head, International Business	Founder, SGS Teknics	Since Acquisition
Bijay Agarwal	CFO	Motorola, Times Internet, Dalmia Bharat	2+
Sreeram Srinivasan	CEO, SETS	Rane Group, Saint Gobain, Shanthi Gears	7+

Source: Company, Keynote Capitals Ltd.

Promoter Holding and Management Compensation

Particulars	FY22	FY23	Sep-23
% Promoter Holding (~)		47.3%	47.2%
MD's salary (Rs Mn)	3.9	4.7	-
As a % of PAT (~)	6.9%	3.8%	-

Note: Promoter holding % includes the holding of Ranjeet Singh Lonial, Sanjiv Narayan, and Krishna Kumar Pant

Source: Company, Keynote Capitals Ltd.

Top Shareholders of Syrma SGS Technology Ltd.

% Shareholding in the Company (~)	Jun-23	Sep-23
Government Pension Fund Global	1.8%	1.8%
TATA AMC	-	1.6%
Franklin AMC	1.7%	1.6%
360 One Special Opportunities Fund	1.0%	1.0%
Kuwait Investment Authority Fund 225	1.4%	-
Malabar Select Fund	1.1%	-

Source: Company, Keynote Capitals Ltd.

Opportunities

Strong acquisition track record

SSTL has successfully taken the inorganic acquisition route to expand its business. Right from the acquisition of Tovya Automation in 2014 to the acquisition of Perfect ID in 2021, the Company has demonstrated a robust track record of navigating the inorganic route of business expansion.

Among peers, SSTL is the only company that has chosen the inorganic expansion path in a substantial way and has also managed to improve the business and its growth prospects with each new acquisition.

A recent example of this ability was demonstrated in SSTL's acquisition of JDHL, which helped the Company get access to a platform to manufacture medical devices, which opened a vast, fast-growing opportunity for the Company. In the future, the Company will continue to scout lucrative acquisition targets and pursue inorganic opportunities.

Strengthening its foothold in the medical devices space with the acquisition of JDHL

In Q1 FY24, the Company announced a promising acquisition of JDHL, which has enabled the company to explore the fragmented but fast-growing medical devices market.

JDHL already has a USFDA/MDSAP-compliant facility in India with 18 USFDA 510(k) clearances on various products. Additionally, JDHL has end-to-end capabilities and can provide design-led manufacturing service and box-build solutions for global customers. Historically, JDHL has seen high customer retention rates and has been able to expand its wallet share.

The Company will initially be spending Rs. 2,295 Mn. (additional Rs. 280 Mn to be paid on achieving certain profitability-based milestones over 2.0-2.5 years) This acquisition is expected to be revenue and margin-accretive right from the first year of consummation.

Rebound in the healthcare business will aid margins

Recently, SSTL encountered challenges within its healthcare business. In Q1 FY23, the healthcare business generated a revenue of Rs. 550 Mn, which declined to Rs. 450 Mn in Q4 FY23 and further dropped to just Rs. 150 Mn in Q1 FY24. This represents a substantial decrease of Rs. 400 Mn and Rs. 300 Mn in healthcare revenue, respectively.

The negative impact of this slowdown intensified further as the Company garners a gross margin of 45%+ in the healthcare business. Therefore, the aggregate impact translated into a significant 67-73% hit on SSTL's gross profit. This is a result of an order getting pushed to Q2 FY24.

Presently, the situation has improved, and the Company is already witnessing signs of recovery. This will result in better profitability in the future. In H1 FY24, the healthcare business of the Company has degrown by 37.5% on a YoY basis along with a material margin impact of 130 bps.

Challenges

Margins are expected to stay lower compared to peers

“See we believe that with the product mix which we have, we should be able to maintain the gross margins at about 23%- 25% along that percent overall. We currently do not see it going up to 30%.” – MD, Syrma SGS, Q1 FY24 Con Call

Based on the management commentary, based on the current order book mix (tilted towards low margin consumer OEM), the Company believes that overall, it will be able to clock gross margins only in the 23-25% range. This is how the gross margins of SSTL stack up compared to peers.

Gross Profit Margin	FY20	FY21	FY22	FY23
Avalon Technologies	36%	34%	34%	36%
Kaynes Technology	35%	32%	31%	31%
Syrma SGS Technology	-	-	30%	25%
Cyient DLM	20%	21%	25%	23%

Source: Company, Keynote Capitals Ltd.

Barring Cyient DLM, the Company is clocking gross margins 600-1,100 bps lower than peers. Additionally, as per the above-cited management commentary, SSTL’s gross margins are expected to stay in the same vicinity going forward.

Possibility of an acquisition going wrong

SSTL has very frequently taken the inorganic route of expansion and has done it very well so far. Apart from this, the Company clearly intends to be on the outlook for lucrative acquisitions.

In general, acquisitions have a very low base rate of playing out successfully, and one can cite numerous examples of acquisitions that looked amazing when announced but turned out to be nightmares even for the best companies belonging to well-known corporate houses.

Since SSTL is going to be continuously scouting for lucrative acquisition targets, there is a possibility that one or a few acquisitions can go south, thereby destroying value for the Company. We believe it will be even more important to look closely at an acquisition that is larger in size.

Financial Statement Analysis

Income Statement

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	10,197	20,484	28,500	40,020	55,789
Growth %		101%	39%	40%	39%
Raw Material Expenses	7,185	15,405	21,945	30,815	42,957
Employee Expenses	548	984	1,368	1,921	2,678
Other Expenses	1,534	2,257	2,850	3,802	5,300
EBITDA	930	1,838	2,337	3,482	4,854
Growth %		98%	27%	49%	39%
Margin%	9%	9%	8%	9%	9%
Depreciation	194	312	569	815	1,030
EBIT	736	1,526	1,768	2,666	3,824
Growth %		107%	16%	51%	43%
Margin%	7%	7%	6%	7%	7%
Interest Paid	86	257	416	416	416
Other Income & exceptional	124	444	150	120	120
PBT	774	1,713	1,501	2,370	3,527
Tax	256	533	390	616	917
PAT	518	1,180	1,111	1,754	2,610
Others (Minorities, Associates)	37	37	38	38	38
Net Profit	555	1,217	1,149	1,792	2,648
Growth %		120%	-6%	56%	48%
Shares (Mn)		176.8	176.8	176.8	176.8
EPS		6.89	6.50	10.13	14.98

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Cash, Cash equivalents & Bank	369	544	648	399	-527
Current Investments	363	780	780	780	780
Debtors	2,722	4,032	5,700	8,004	11,158
Inventory	2,913	5,874	6,584	9,553	13,746
Short Term Loans & Advances	1,061	1,687	1,687	1,687	1,687
Other Current Assets	73	291	291	291	291
Total Current Assets	7,502	13,210	15,691	20,715	27,136
Net Block & CWIP	4,170	5,528	7,458	8,143	8,113
Long Term Investments	47	60	60	59	59
Other Non-current Assets	754	7,842	6,042	5,242	5,242
Total Assets	12,473	26,640	29,251	34,159	40,550
Creditors	2,405	4,881	6,343	9,460	13,202
Provision	565	1,104	1,104	1,104	1,104
Short Term Borrowings	1,874	2,564	2,564	2,564	2,564
Other Current Liabilities	875	997	997	997	997
Total Current Liabilities	5,718	9,546	11,008	14,125	17,867
Long Term Debt	39	870	870	870	870
Deferred Tax Liabilities	123	138	138	138	138
Other Long Term Liabilities	764	658	658	658	658
Total Non Current Liabilities	925	1,665	1,665	1,665	1,665
Paid-up Capital	1,376	1,768	1,768	1,768	1,768
Reserves & Surplus	4,344	13,635	14,746	16,499	19,109
Shareholders' Equity	5,721	15,403	16,513	18,267	20,877
Non Controlling Interest	108	26	64	102	140
Total Equity & Liabilities	12,473	26,640	29,251	34,159	40,550

Cash Flow

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Pre-tax profit	774	1,713	1,501	2,370	3,527
Adjustments	227	207	874	1,150	1,364
Change in Working Capital	-659	-2,299	-914	-2,157	-3,605
Total Tax Paid	-232	-397	-390	-616	-917
Cash flow from operating Activities	110	-777	1,070	747	370
Net Capital Expenditure	-838	-1,182	-2,500	-1,500	-1,000
Change in investments	12	-7,766	1,800	800	0
Other investing activities	-3,111	-196	150	120	120
Cash flow from investing activities	-3,936	-9,145	-550	-580	-880
Equity raised / (repaid)	2,715	8,434	0	0	0
Debt raised / (repaid)	769	1,523	0	0	0
Dividend (incl. tax)	0	0	0	0	0
Other financing activities	103	11	-416	-416	-416
Cash flow from financing activities	3,587	9,967	-416	-416	-416
Net Change in cash	-239	46	104	-249	-926

Valuation Ratios

	FY22	FY23	FY24E	FY25E	FY26E
Per Share Data					
EPS	4	7	6	10	15
Growth %		71%	-6%	56%	48%
Book Value Per Share		87	94	104	119
Return Ratios					
Return on Assets (%)	6%	6%	4%	6%	7%
Return on Equity (%)	14%	12%	7%	10%	13%
Return on Capital Employed (%)	13%	12%	8%	11%	13%
Turnover Ratios					
Asset Turnover (x)	1.2	1.0	1.0	1.3	1.5
Sales / Gross Block (x)	3.7	3.8	3.8	4.2	5.1
Working Capital / Sales (x)	12%	13%	15%	14%	14%
Receivable Days	72	60	62	62	63
Inventory Days	94	104	104	96	99
Payable Days	70	72	90	85	88
Working Capital Days	96	92	76	73	74
Liquidity Ratios					
Current Ratio (x)	1.3	1.4	1.4	1.5	1.5
Interest Coverage Ratio (x)	10.4	7.7	4.6	6.7	9.5
Total Debt to Equity	0.3	0.2	0.2	0.2	0.2
Net Debt to Equity	0.3	0.2	0.2	0.2	0.2
Valuation					
PE (x)		77.8	82.4	52.8	35.8
Earnings Yield (%)		1%	1%	2%	3%
Price to Sales (x)		4.6	3.3	2.4	1.7
Price to Book (x)		6.1	5.7	5.2	4.5
EV/EBITDA (x)		52.4	41.2	27.6	19.8
EV/Sales (x)		4.7	3.4	2.4	1.7

Source: Company, Keynote Capitals Ltd. estimates

View & Valuation

Particulars (Rs. Mn, unless mentioned)	Estimate
Period	FY26E
Revenue	59,850
Net Profit	3,352
Earnings Per Share (Rs.)	~15
PE Multiple (x)	~45
Expected Price Per Share (Rs.)	675
Upside / (Downside) (%)	25.2%

Source: Company, Keynote Capitals Ltd. estimates

The Company envisages growing faster than the industry and has been doing so in the past with the help of organic and inorganic routes. In the future, SSTL plans to stay put on the same strategy whereby it will use organic and inorganic means to grow its business.

The recent steps taken by the Company, like substantial capacity expansions and the acquisition of JDHL, coupled with the robust growth outlook, give us confidence that the Company will be able to achieve its target of growing faster than the industry. With that mentioned, we also believe that the current market price is pricing in a fair amount of future positivity.

Owing to the aforementioned factors, we ascribe a BUY rating on SSTL with a target price of Rs. 675, valuing the Company at ~45x FY26E EPS.

Rating Methodology

Rating	Criteria
BUY	Expected positive return of > 10% over 1-year horizon
NEUTRAL	Expected positive return of > 0% to < 10% over 1-year horizon
REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
NOT RATED (NR)/UNDER REVIEW (UR)/COVERAGE SUSPENDED (CS)	Not covered by Keynote Capitals Ltd/Rating & Fair value under Review/Keynote Capitals Ltd has suspended coverage

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