# Leading the Tech Wave

ARIF HABIB LIMITED

REP-300

Aug 06, 2020

## Technology

## Avanceon Limited

***We initiate coverage on Avanceon Limited (AVN) with a Jun'21 Target Price of PKR 95.1/share, an upside of 72% from current levels. Our investment thesis is premised on i) A healthy and consistent earnings growth trajectory, ii) A diversified business portfolio as compared to its peers, iii) Attractive valuations in relation to domestic as well as international peers, and iv) Distinguished, high-profile clientele diversified across international territories as well as different sectors. AVN currently trades at a CY21F P/E of 5.7x and P/B of 1.5x.***

### Undeterred Earnings Growth Trajectory

AVN has displayed a concrete earnings growth trajectory over the last few years led by impeccable business ethics and diversified operations. Core income of the company has continued to grow at a healthy 5-Yr CAGR of 20%. Depreciation of the PKR against the USD has helped the company earn healthy exchange gains continuously while a nominal debt/equity ratio has shielded the company from exorbitant financial charges during the aggressive monetary tightening era. An impressive working capital cycle has contributed towards ensuring a strong liquidity position of the company. Diversified operations spread across various territories, build-up of heavy backlog orders, and a strong balance sheet is likely to help the company continue its growth story where we forecast earnings to grow at a 5-Yr CAGR of 30%.

### Diversification at its Best

AVN business operations are well diversified. AVN revenues are sourced from various segments such as its Core business (Application Based Solutions, Systems and Products), Engineering business, Specialized Solutions (Energy Management Systems, High End Solutions), After-Market Support and Overseas businesses (core business, specialized business and engineering services) spread across various territories. Moreover the company is very well diversified across international territories as well which we will discuss later. In addition to this, the company's clientele is varied across different sectors and not concentrated amongst a few.

### Exceptional Clientele

The client base of AVN adds significant brand value and good will to the company. Distinguished and highly well reputed companies and brands such as Saudi Aramco, Unilever, Nestle, P&G, Dubai Metro, Astra Zaneca, Merck, OGDC, PPL, Mari Petroleum, Engro Fertilizers, and Lotte Chemicals, to name a few. Moreover, AVN business is well diversified across various sectors as well such as Oil & Gas, FMCG, Chemicals and Pharmaceuticals.

**Exhibit: 01** Valuation Snapshot

| | | CY19A | CY20E | CY21F | CY22F |
|---|---|---|---|---|---|
| EPS* | PKR | 4.3 | 7.8 | 9.7 | 11.9 |
| DPS | PKR | - | - | 3.0 | 3.5 |
| P/E | x | 8.7 | 7.1 | 5.7 | 4.7 |
| P/B | x | 1.6 | 1.9 | 1.5 | 1.3 |
| RoE | % | 23.0 | 30.7 | 29.8 | 29.9 |

Source (s): Company Financials, AHL Research, * @ 211.79mn shares

*Closing Prices are as of 05-Aug-2020*

| | AVN PA |
|---|---|
| **Recommendation** | **BUY** |
| Target Price (Jun'21) | 95.1 |
| Current Price | 55.3 |
| Upside (% ) | 72.0 |
| Shares (mn) | 212 |
| Market Cap. (PKR mn) | 11,712 |
| Market Cap. (USD mn) | 70 |

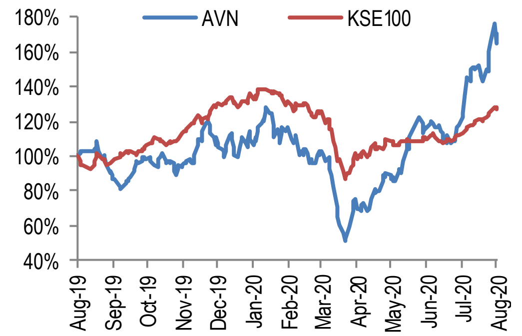
**Major Shareholders**

- Bakhtiar Hameed Wain

**Price Performance**

| | 3M | 6M | 12M |
|---|---|---|---|
| Return (% ) | 97.8 | 55.3 | 68.3 |
| Avg. Volume (000) | 2,961 | 2,729 | 2,595 |
| High Price - PKR | 57.2 | 57.2 | 57.2 |
| Low Price - PKR | 27.7 | 16.8 | 16.8 |

**Relative Performance**




Source: Bloomberg


**Analyst:**

**Faizan Kamran**

D:+92 21 3246 2589

UAN: +92 21 111 245 111, Ext: 248

F:+92 21 3242 0742

E: faizan.kamran@arifhabibltd.com

## Valuation

Our DCF-based Jun'21 target price for the company works out to PKR 95.1/share, which translates into an upside potential of 72% from last closing of PKR 55.3/share. Our valuation parameters include 5-yr adjusted beta of 1.20, risk free rate of 9.0% and a risk premium of 6.0%, which gives a cost of equity of 16.2%. Hence, we have a 'BUY' call on the scrip. Currently the stock is trading at CY21 and CY22 P/E of 5.7x and 4.7x, respectively, while trading at a CY21 and CY22 P/B of 1.5x and 1.3x respectively.

**Exhibit: 02** Valuation Criteria

| | |
|---|---|
| Risk Free Rate | 9.0% |
| Beta | 1.20 |
| Risk Premium | 6.0% |
| Cost of Equity | 16.2% |

Source (s): AHL Research

**Exhibit 03** Valuation Snapshot

| | Dec-20 | Dec-21 | Dec-22 | Dec-23 | Dec-24 | Dec-25 |
|---|---|---|---|---|---|---|
| **Free Cash Flow to the Firm** | | | | | | |
| Profit after tax | 1,651 | 2,060 | 2,517 | 3,114 | 3,378 | 3,510 |
| Add: Depreciation | 28 | 31 | 35 | 38 | 42 | 46 |
| Add: Interest expense (net of taxes) | 77 | 35 | 26 | 3 | 1 | - |
| Capital Expenditure | (61) | (58) | (60) | (63) | (64) | (65) |
| ▲ in Working Capital | (1,095) | (461) | (536) | (613) | (549) | (668) |
| **Free Cash Flow to Frim** | **600** | **1,607** | **1,981** | **2,479** | **2,808** | **2,822** |
| **Discounted Factor** | **1.07** | **0.93** | **0.80** | **0.69** | **0.59** | **0.51** |
| **Discounted Cash Flows** | **644** | **1,492** | **1,585** | **1,703** | **1,659** | **1,435** |
| | | | | | **Terminal Value** | **24,059** |

| | |
|---|---|
| PV of Future Cash Flows | 8,518 |
| PV of Terminal Value | 12,229 |
| Surplus Cash | 105 |
| Debt | 714 |
| Equity Value | 20,138 |
| **Per Share Value** | **95.09** |

Source (s): AHL Research

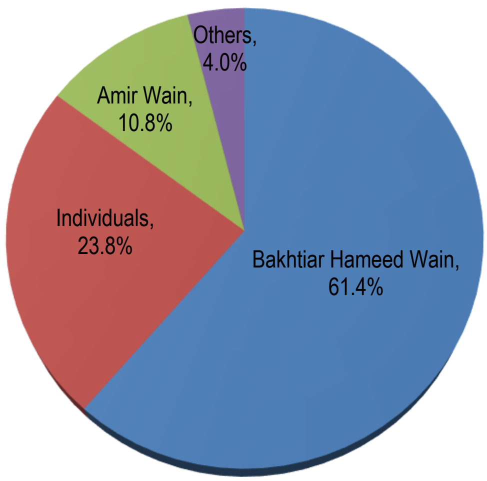
## Shareholding Pattern

**Exhibit. 04** Shareholding Pattern (As of Dec'19)

| | No of Shares | % Holding |
|---|---|---|
| Mr. Bakhtiar Hameed Wain | 118,183,174 | 61.4% |
| Individuals | 45,879,756 | 23.8% |
| Mr. Amir Wain | 20,809,852 | 10.8% |
| Others | 7,663,588 | 4.0% |
| **Total** | **192,536,370** | **100.0%** |

Source (s): Company Financials, AHL Research

**Figure: 01** Shareholding Pattern (as of Dec'19)




Source (s): Company Financials, AHL Research

## Journey of Avanceon Limited

**1984**
- Establishment of Advance Automation Associates Inc. in Exton, Pennsylvania, USA

**2003**
- First successful implementation of EMS project
- Establishment and acquisition of Innovative Automation & Engineering Pvt Ltd.
- Incorporation of Engro Innovative Inc, USA, an investment company for strategic acquisitions in US Market

**2004**
- Entrance into Middle East by Establishment of wholly owned subsidiary in UAE

**2007**
- Recognition as the System Integrator of the Year by Control Engineering Magazine
- Acquisition of Advanced Automation Associates, USA by Engro Innovative Inc. USA

**2008**
- After Market Solutions launched
- Naming & branding as a global company called “Avanceon”
- Conversion into Public Limited Company

**2010**
- First EMS project implemented in USA

**2011**
- Launched in-house training including development and certification of engineers
- Rolling out Carbon Credit Program

**2012**
- The Global Restructuring Agreement with Engro Corporation

**2013**
- Launching of Highway-50 Plan
- Launching of Avanceon Employee Stock Option Scheme 1st Issue

**2014**
- Initial Public Offering (IPO) of Avanceon along with listing at PSX
- Joint Venture with ATCO, KSA

**2015**
- Won NFEH’s CSR award 2015
- Launching of Avanceon ESOP II
- SE Alliance Partner Excellence Award, Middle East

**2016**
- Issuance of Avanceon ESOS-2nd Issue after successful launching of ESOS-1st Issue in 2013

**2017**
- Incorporation of subsidiary Avanceon Automation and Control LLC in Qatar
- Launch of IAAS Business and BMS

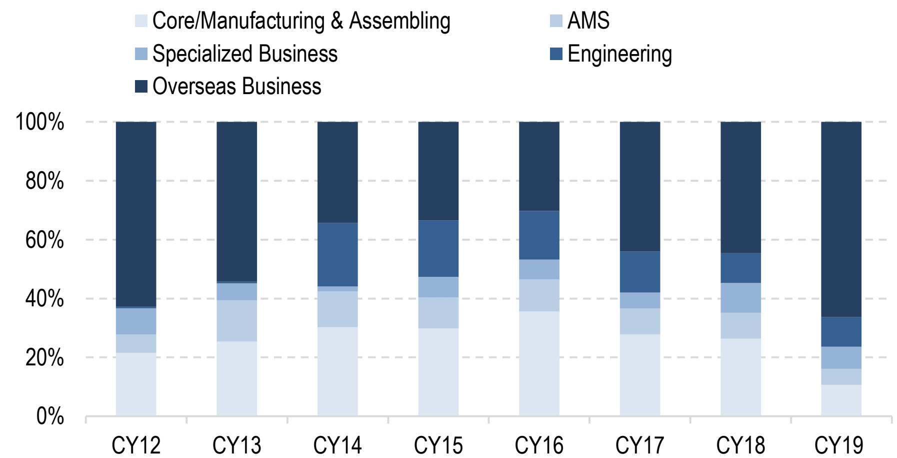
**2018**
- Maturity of ESOS (1st Issue)

**2019**
- Incorporation of subsidiary Octopus Digital
- Sale and Transfer of AMS from Avanceon Limited to Octopus Digital
- Avanceon Ltd Partners with PE Energy in Nigeria

## Diversified Revenue Stream

The company has been focused on the automation business since 1984 and has since then diversified itself into various services, and established itself as a technological powerhouse. Serving a distinguished and highly reputable clientele, AVN is a solution provider for automation, energy management, engineering, maintenance and even tech upgradation services. AVN business model is well-diversified and revenues are not concentrated on a restricted set of business segments. We discuss below the various segments of the business from which it derives its revenues:

**Figure: 02** Diversified Revenue Stream




Source (s): Company Financials, AHL Research

### Core Business

The core services of the company primarily include automation solutions which deal with client needs such as handling multiple products and regulatory requirements. For instance, Oil & Gas clients are assisted in implementation of Supervisory, Control and Data Acquisition (SCADA) while Cement clients are helped in curtailing energy costs. Core business also includes Process Control services (consultancy for automation of processes) which are comprised of Batch Engineering, Distributed Control System, and System Integration. The core segment is divided into:

i) **Application based solutions:** AVN is the sole distributor of Honeywell and Rockwell Automation in Pakistan and sells power products, patented systems, Variable Speed Drives, Variable Frequency Drives and softwares.

ii) **Systems:** This includes embedded solutions of Original Equipment Manufacturers (OEM) equipment coupled with engineering services.

iii) **Products:** The company sells products supplied by Weg, Samson, Endress+Hauser, SEL and other specialized products of OEMs.

### Specialized Solutions

Specialized Solutions includes Energy Management Systems and High End Solutions.

i) Energy Management Systems: This focuses on optimizing energy consumption of plants enabling higher efficiency and cost savings.
ii) High End Solutions: This consists of Advance Process Control, Plant Information Management Systems and Manufacturing Execution Systems.

### After Marketing Support (AMS)

In this business the company provides technical services and service level agreements. In Jul'19 the AMS engineering and technical services were merged into Octopus digital in order to form a full portfolio services company that provides maintenance and technical support to its customers.

### Engineering

The company also provides in-house engineering services that include installation, commissioning, post-implementation support and maintenance of systems, and development of engineering control mechanisms.

### Manufacturing and Assembly

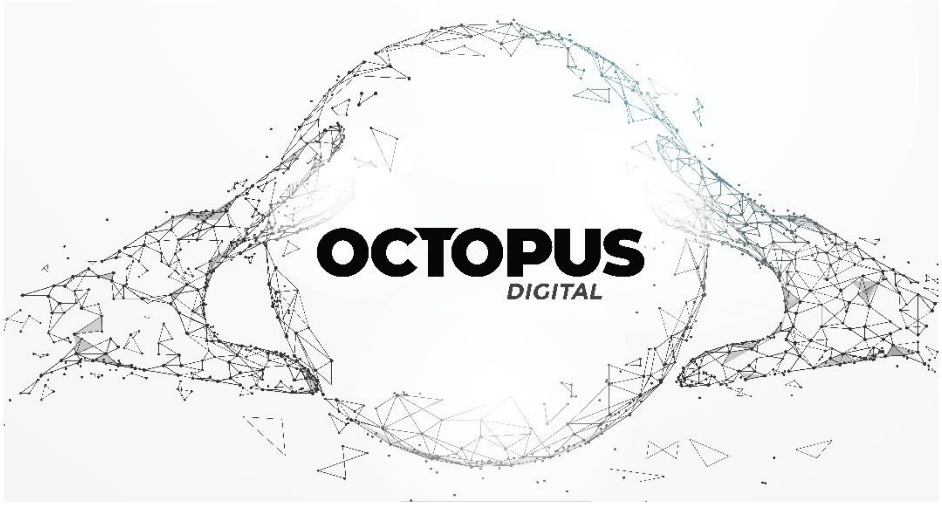
This consists of two solutions for manufacturers: i) Manufacturing Execution Systems, ii) Plant Information Management Systems, iii) Real-time process optimization, iv) Control technologies and v) Custom Software Development. These are used in upstream and downstream oil and gas companies, chemicals, petrochemicals, pharmaceuticals, paper, pulp, printing, cement, power and metals.

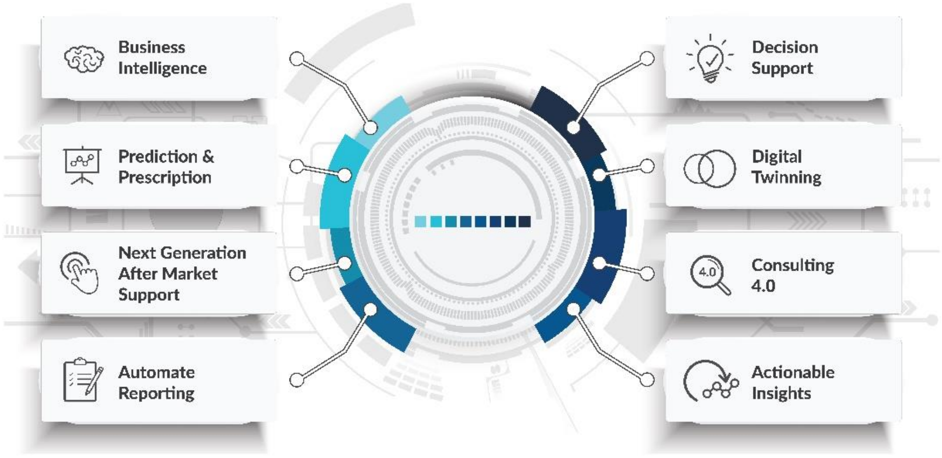
### Overseas Business

This includes distribution and provision of services to Middle Eastern countries such as Saudi Arabia, UAE, Qatar, and Nigeria in addition to other European Union countries. They include the company's core business, specialized business, and engineering services.

## Octopus Digital

Octopus Digital is a 100% wholly owned subsidiary of AVN, which focuses on digitalization solutions for various businesses, apart from providing tech upgradation, and database maintenance services. In CY19 the AMS (After Market Support) Engineering & Technical Services business of the company has been merged into Octopus Digital. As per management, the project's contribution margin will reach around 90%. The company expects revenues from Octopus to contribute ~30% to total domestic revenues by CY21. Under this project, Topware Digitalization Service Suits, which is an analytical software, was created which will cut down traditional project time from 6-8 months to 6-8 days. Further it will be a cloud based platform which will not require Oracle or SQL server. It will have machine learning feature, enabling it to predict and prescribe. The company claims that Topware will be a game changer and it will be used from banks to hospitals, shoemakers to retailers and insurance companies to tech companies.



## Partnerships with Renowned Names add Major Brand Value to the Company

AVN has been Microsoft's Gold partners for numerous years. Partnering with a global leader in the IT sector adds major brand value to the company. AVN uses Microsoft's platforms to deploy the IP's it develops and recently the two companies have decided to co-brand the IP's AVN develops while Microsoft will utilize its markets for those IP's. Moreover, Octopus has also partnered with Microsoft. The goal of this project is to offer digitalization of physical assets on plant floors physical resources through data driven end-to-end services, advance analytics, prediction, exploration and optimization of production process.

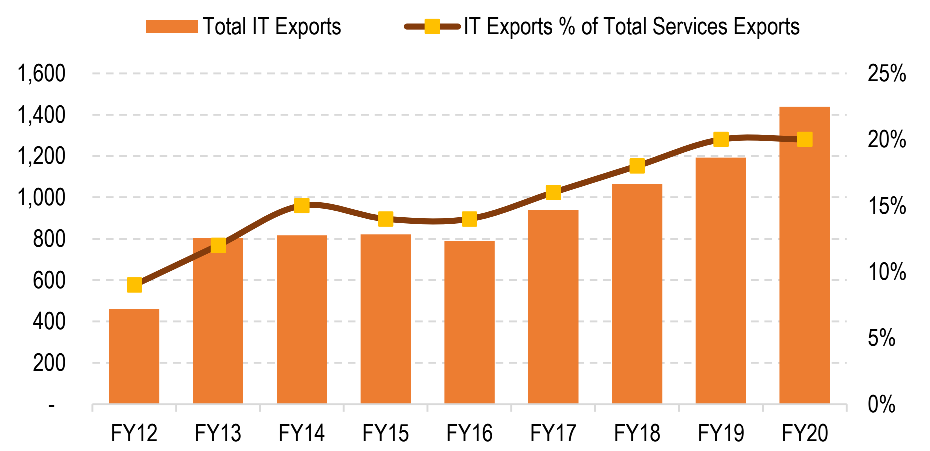
Moreover, the company has a partnership with Rockwell Automation, Schneider Electric, Siemens, WEG, Belden, NDC, Schaffner, PE Energy, Aveva, Endress+Hauser, Dover Fueling Solution, SEL, Microsoft and Samson.

## IT Sector: Continuously Supporting Exports

The IT sector has traditionally been a pillar of support to the export of services for the country. Over the last few years, exports of services have seen a constant improvement in contribution from the export of Telecommunications, Computer and information services. Provisional data as per SBP for 11MFY20 reveals exports of services under this category at USD 1.3bn – contributing 5% to total exports (4% SPLY) and 26% to total exports of services (20% SPLY) during the said period. The IT exports during the period have registered an impressive 19% YoY jump while total exports of services and total exports have contracted 9% and 7%, respectively. Crunching the numbers further reveals that exports of services have consistently seen a higher proportion from the IT sector. FY12-FY16 saw the IT sector contribute an average of 13% to total exports of services, with 9% contribution being witnessed in FY12 and 14% in FY16. Last 3-Yr average of the same has accelerated to 18%. Total exports of IT have outpaced total exports of services, growing at a 5-Yr CAGR of 8% against 2% during FY15-FY19.

The IT sector appeared to be immune from the economic shock posed by the global pandemic. Numbers for exports of IT services have in fact continued to remain encouraging. Exports for 3QFY20 clocked in at USD 375mn, up by an impressive 27% YoY and 2% QoQ. Exports of computer services led by software consultancy services as well as exports of computer software continued to remain upbeat.

**Figure: 03** IT Exports Provide Support to Services' Exports (USD mn)

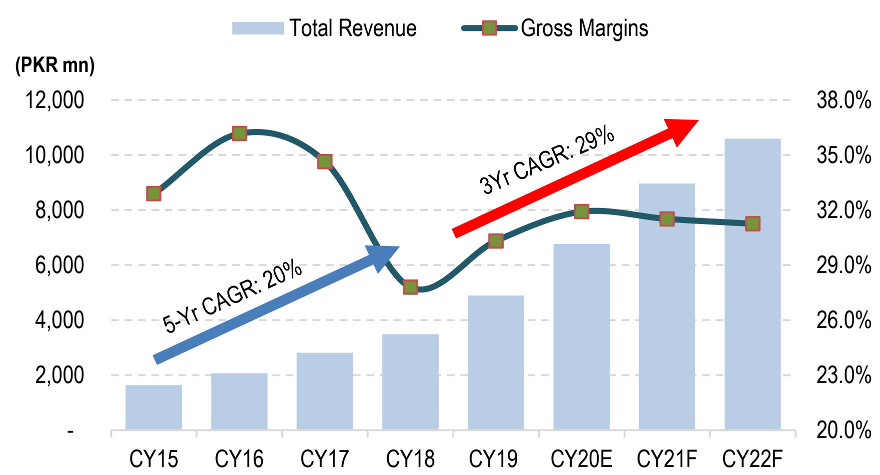



Source (s): SBP, AHL Research

## Core Business to Continue Being the Backbone

Crunching sales numbers reveals that the company has been inherently focused upon consolidating its business overseas. As at 2019, overseas revenues grew at a staggering 5-Yr CAGR of 34% (average contribution: 44%) while the Specialized Business category saw revenues accelerate at a 5-Yr CAGR of 58% (average contribution: 7%) during the same period. Core business contributed an average of 26% over the last 5-years. Engineering business which contributed just 1% in CY12 and CY13 has picked up, contributing 10% as at CY19 while the specialized business contributes 7%. That said, the management is confident that the Core business will drive the earnings momentum of the company going forward. The group's retail clientele is the crown of the business. Shell and Total are major clients of the company. We expect retail clients to contribute 35-40% to the domestic revenues going forward.

**Figure: 04** Phenomenal Growth in Topline

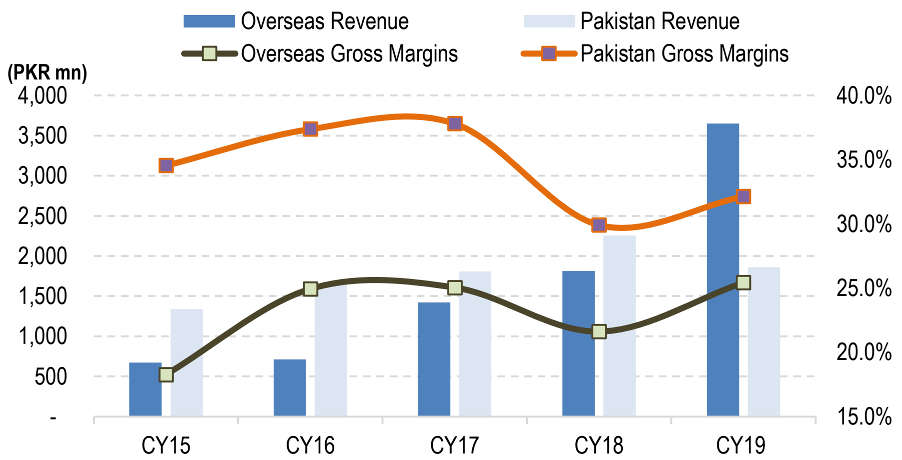



Source (s): Company Financials, AHL Research

## Consolidating Footprint Overseas…

Since CY12 until CY18, core business of AVN contributed an average of 28% to total revenues while export revenues contributed an average of 43% during the same period. However, CY19 saw a drastic change in the revenue constituents of the company. Core/Manufacturing & Assembly accounted for just 11% of revenues while export revenues contributed 66% to total revenues in CY19. Primarily this came on the back of a 193% jump in revenues from KSA, which contributed 40% to total revenues in CY19 against just 19% in CY18. Overseas revenues contributed 66% in CY19 to the total pie but is expected to dip going forward as Octopus contribution and Core business contribution picks up, as per management guidance. We have assumed overseas revenue contribution at average of 55% over the investment horizon. The company was awarded a record USD 69bn worth of contracts in FY19 owing to National Development Plans across the region such as Saudi Vision 2030, Qatar National Vision 2030, Expo 2020 in UAE and Fifa World Cup 2022 in Qatar.

**Figure: 05** Exemplary Growth in Overseas Revenues



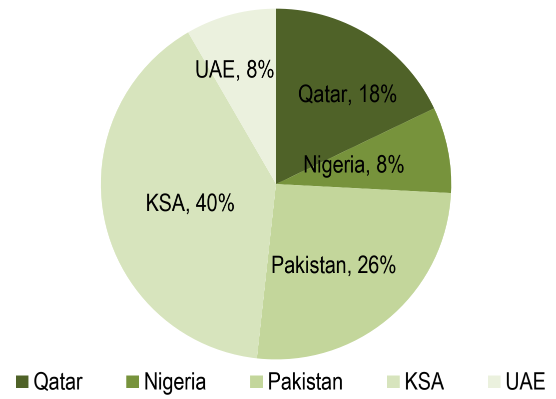

Source (s): Company Financials, AHL Research

### …While Expanding into New Territories

Meanwhile the company continued expanding its footprint in global markets, with Nigeria being the latest addition to its markets. Partnering with an automation and system integration company – PE Energy Limited, AVN will be looking to tap the markets of the largest oil and gas producer in Africa. Revenues from Nigeria during CY19 clocked in at PKR 388mn, contributing 8% to total revenues. The company aims to continue expanding overseas and progress is underway towards expanding into another country in Asia. Moreover, the company is continuously innovating new technologies and keep its overseas business growth trajectory strong. Several upcoming projects are expected in the Middle East through which AVN will venture into new markets and sectors.

We continue to assign a high weightage to the company's consolidated revenues from the overseas businesses. In recent year, overseas business of the group progressively contributed to the group's revenues as the company expanded its footprint in the Middle East. In 2012 and 2013 overseas businesses had contributed 63% and 54% to total revenues respectively but had receded to an average of 33% during CY14-CY16, as the company's focus on its Engineering business had picked up. However, 2017 onwards once again contribution from the overseas businesses had picked up significantly as the Core/Manufacturing & Assembly and Engineering business once again took a back seat. In 2019 AVN expanded its presence into the African territory. Whereas total overseas revenue contribution was primarily on account of a massive jump from KSA revenues.

**Figure. 06** **Country-wise Revenue Break-up in CY19**

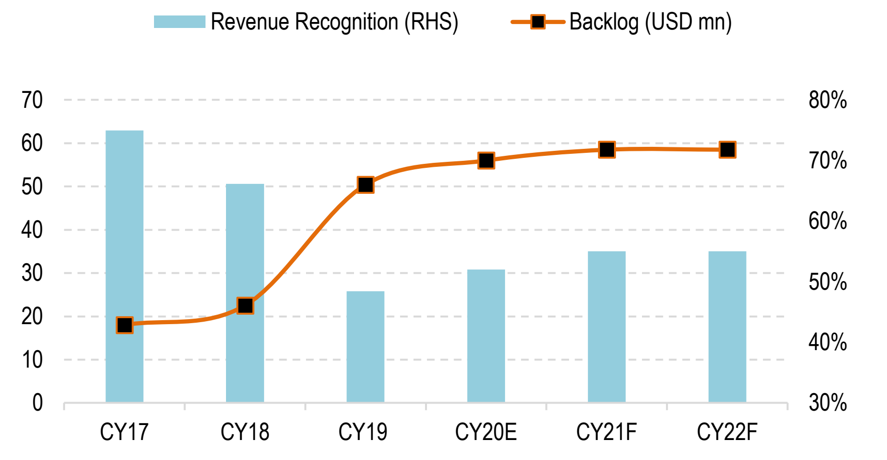



Source (s): Company Financials, AHL Research

## Build-up of Backlog Orders to Cushion Revenue Stream

As mentioned earlier, overseas revenues should contribute on average more than half of total revenues of the group. With the mentioned contracts overseas in the pipeline and numerous contracts that the management is confident about achieving going forward, we view revenues from the overseas business to remain stable over the next few years. COVID-19 impact on the business should be negligible and backlog orders are expected to continue building. Total revenue recognition as a proportion of backlog orders averages out at 102% since CY13. Just twice since CY13 has the company achieved a revenue recognition of less than 100% as a proportion of backlog orders (89% in CY15 and 58% in CY19). Overseas revenue recognition has averaged at 54% over the last 5 years. We have assumed an average overseas revenue recognition of the same over our investment horizon while we have assumed backlog orders at an average of USD 67mn.

**Figure. 07** Backlog Orders and Revenue Recognition Trends



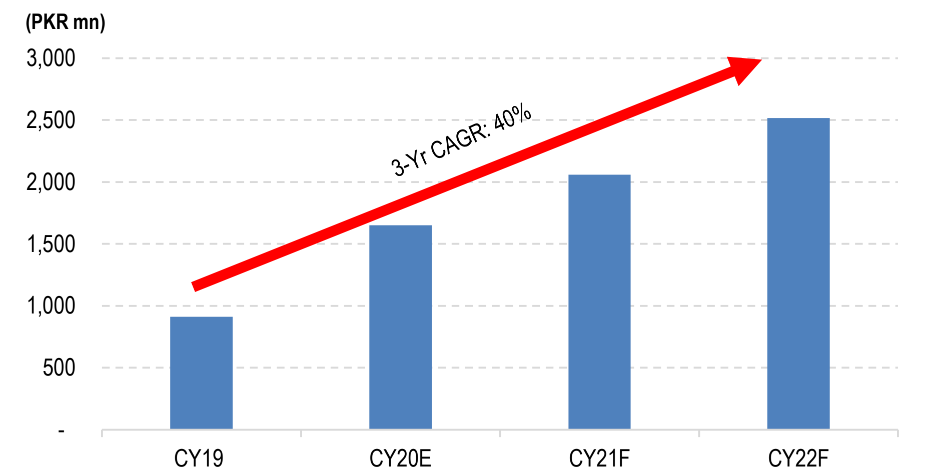

Source (s): Company Financials, AHL Research

## Earnings Growth to Continue Impressive Momentum

Healthy earnings trajectory outlook of the company is one of the key forces that are likely to propel the stock. Overseas business of the company is expected to continue its solid growth trajectory. If we compare the growth of the Pakistan business with the overseas businesses, we see that local revenues have grown at a 5-Yr CAGR of 3% while overseas revenues have grown at a phenomenal 5-Yr CAGR of 34%. The company is very confident of maintaining its growth story overseas. The management is certain that COVID-19 impact will not be major on the group's business. The management is of the view that the diversified clientele and exposure across sectors is likely to shield the company's revenues. Apart from Oil & Gas, AVN's exposure in the Middle East extends to Utilities & Industries, Transportation and Chemicals as well. Moreover, strict implementation of SOP's has ensured that there have been no delays yet and none are expected on any of the company's deliverables. Exchange gains are likely to continue for the company. Around 30% of its trade receivables are from the overseas business.

We further highlight the diversified segments of the company's revenue stream as a major shield to earnings trajectory. Peers such as SYS are predominantly a software house that focus primarily on automation, digitization services, and consulting services. Their revenue is heavily dependent on software implementation (80% of revenues in CY19). NETSOL's business is primarily concentrated in asset finance and leasing business. Their revenue is majorly sourced from implementation of software, maintenance, services and customization fees.

**Figure. 08** Earnings Growth




Source (s): Company Financials, AHL Research

## Liquidity Position to Improve; Dividend Stream Expected to Start Again

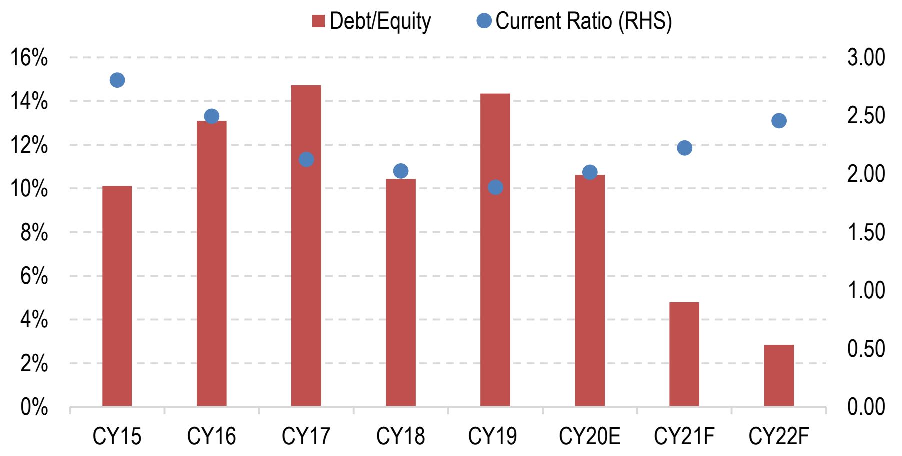
The company has historically boasted an impressive liquidity position – at present, a current ratio of 2.0x while last 5-Yr average stands at 2.3x. The company incurred contract assets of PKR 3.6bn and contract liabilities of PKR 1.1bn in CY19. We expect contract assets (relating to unbilled revenue earned from ongoing projects) and liabilities (earnings in excess of billings) to dwindle down ~20% each year. Current ratio of the company is forecasted to average at 2.4x over the next 5 years.

During 1QCY20 the current ratio increased from 1.89x as at CY19 to 2.0x, attributable to receivables of the company increasing 21% QoQ while creditors contracted 15% QoQ. The management is of the view that the first quarter is usually slow with revenue recognition and the momentum typically picks up in the third and fourth quarter. As per the management, typically the Oil & Gas sector poses liquidity issues to the company as receivables days are usually high from this sector.

The company has boasted an impressive debt/equity profile as well. Last 5-Yr average debt/equity stands at 13% and going forward we assume debt/equity at an average of 6% over the next three years. Any long term financing is unlikely going forward.

A concrete liquidity position of the company should help it resume its dividend payments. We expect dividend payout to initiate in CY21 when contract assets start to come down and liquidity further improves. We expect a DPS of PKR 3.00 in CY21 and PKR 3.50 in CY22, translating to a dividend yield of 5% and 6%, respectively.

**Figure. 09** Liquidity Position to Recover




Source (s): Company Financials, AHL Research

## Attractive Valuations

We view CY20 EPS to clock in at PKR 7.80 and CY21 EPS at PKR 9.73. The stock currently trades at a highly attractive CY21F and CY22F P/E multiple of 5.7x and 4.7x respectively compared to last 5-Yr average of 10.9x. The stock is attractively valued in comparison to the regional stocks as well. Technology stocks in the region are trading at a forward P/E of 28x. Meanwhile the stock trades at an attractive value relative to its domestic peers such as SYS and NETSOL which trade at a LTM P/E of 13.7x and 15.3x, respectively while AVN trades at a LTM P/E of 10.2x.

We further highlight AVN's impressive growth in recent years vis-à-vis its peers: a 3-Yr revenue CAGR of 33% against 26% for SYS and 19% for NETSOL. Current Debt/Equity also stands favorably in relation to its peers: 14% against 16% for SYS and 21% for NETSOL.

**Exhibit: 05** Regional Peers Comparison

| Companies | Mkt Cap (USD mn) | P/E (x) | P/B (x) | P/Sales | EV to EBITDA (x) | Net Margins (%) | DY (%) | D/E (x) | ROA (%) | ROE (%) |
|---|---|---|---|---|---|---|---|---|---|---|
| Avanceon Ltd (Trailing) | 70 | 10.2 | 2.4 | 2.3 | 9.2 | 39.8 | 0.0 | 0.2 | 14.2 | 25.1 |
| Avanceon Ltd (Forward) | 70 | 5.7 | 1.5 | 1.3 | 4.6 | 23.0 | 5.4 | 0.0 | 17.1 | 29.8 |
| **Regional Peers** | | | | | | | | | | |
| Mphasis Ltd | 2,871 | 18.1 | 3.7 | 2.4 | 6.9 | 13.2 | 2.3 | 0.2 | 14.7 | 21.4 |
| Mindtree Ltd | 2,535 | 25.2 | 5.5 | 2.4 | 14.4 | 9.6 | 1.4 | 0.2 | 14.7 | 22.0 |
| NIIT Technologies Ltd | 1,615 | 27.5 | 6.0 | 1.7 | 15.1 | 10.6 | 0.4 | 0.0 | 14.7 | 21.7 |
| KPIT Technologies Ltd | 263 | 13.1 | 1.9 | 0.9 | 5.9 | 6.5 | na | 0.2 | 8.9 | 14.6 |
| Cyient Ltd | 510 | 11.1 | 1.5 | 0.9 | 4.5 | 7.7 | 2.1 | 0.3 | 8.5 | 13.4 |
| Streamax Technology Co Ltd | 1,551 | 42.0 | 7.8 | 5.2 | 38.0 | 12.5 | 0.1 | 0.1 | 13.4 | 21.5 |
| Zhejiang Tiancheng Controls Co Ltd | 410 | na | 5.6 | 2.1 | 33.7 | na | 0.4 | 2.3 | na | na |
| Shanghai Beite Technology Co Ltd | 342 | na | 1.5 | 1.9 | 181.5 | na | 0.7 | 0.6 | na | na |
| Nanning Baling Technology Co Ltd | 218 | na | 1.0 | 2.1 | 91.1 | na | 0.0 | 0.3 | na | na |
| Shenzhen Roadrover Technology Co Ltd | 408 | na | 10.5 | 3.7 | 56.0 | 2.2 | 0.1 | 1.2 | 1.0 | 2.6 |
| Chengdu Haoneng Technology Co Ltd | 766 | 43.1 | 3.3 | 5.9 | 9.2 | 13.8 | 3.5 | 0.2 | 5.0 | 7.7 |
| Huada Automotive Technology Corp Ltd | 805 | 36.9 | 2.1 | 1.5 | 13.6 | 4.0 | 2.4 | 0.1 | 3.3 | 5.7 |
| Intron Technology Holdings Ltd | 318 | 18.5 | 1.8 | 1.0 | 10.4 | 5.1 | 1.8 | 0.4 | 5.6 | 10.0 |
| PCS Machine Group Holding PCL | 220 | 69.3 | 1.4 | 1.3 | 8.5 | 1.9 | 4.4 | 0.1 | 1.6 | 1.9 |
| **Avanceon Ltd (Trailing)** | | **10.2** | **2.4** | **2.3** | **9.2** | **39.8** | **-** | **0.2** | **14.2** | **25.1** |
| **Avanceon Ltd (Forward)** | | **5.7** | **1.5** | **1.3** | **4.6** | **23.0** | **5.4** | **0.0** | **17.1** | **29.8** |
| **Regional Peer Weighted Average** | | **27.8** | **4.7** | **2.7** | **22.2** | **10.1** | **1.5** | **0.3** | **11.8** | **17.8** |
| **Premium / (Discount) (Trailing)** | | **-63%** | **-49%** | **-16%** | **-59%** | **-75%** | **nm** | **-30%** | **-17%** | **-29%** |
| **Premium / (Discount) (Forward)** | | **-80%** | **-67%** | **-51%** | **-79%** | **-56%** | **-73%** | **nm** | **-31%** | **-40%** |

Source (s): Bloomberg, AHL Research

**Exhibit: 06** Relative Valuation

| Model | Weight | AVN | Regional Average | Target Price | 30% Discount to Regional Avg. | Target Price | 40% Discount to Regional Avg. | Target Price |
|---|---|---|---|---|---|---|---|---|
| PER | 50% | 7.09 | 27.81 | 216.79 | 19.46 | 151.76 | 16.68 | 130.08 |
| P/BV | 25% | 1.87 | 4.66 | 137.61 | 3.26 | 96.33 | 2.80 | 82.57 |
| Price/Sales | 25% | 1.73 | 2.69 | 85.75 | 1.88 | 60.03 | 1.61 | 51.45 |
| **Weighted Average Target Price** | | | | **164.24** | | **114.97** | | **98.54** |

Source: Bloomberg, AHL Research

**Exhibit: 07** Domestic Peers Comparison

| Companies | Mkt Cap (PKR mn) | P/E (x) | P/B (x) | 3-Yr Revenue CAGR | D/E (x) | EV to EBITDA (x) |
|---|---|---|---|---|---|---|
| AVN | 11,712 | 10.2 | 2.4 | 33.4% | 0.2 | 9.2 |
| SYS | 24,404 | 13.7 | 4.0 | 25.9% | 0.1 | 13.2 |
| NETSOL | 5,539 | 15.3 | 0.8 | 18.7% | 0.2 | 5.0 |
| **Average** | | **13.0** | **2.4** | **26.0%** | **0.2** | **9.1** |

Source (s): Company Financials, AHL Research

## Key Risks

- Slower than average revenue recognition on backlog orders going forward will adversely impact revenue stream.
- Any further build-up of contract assets may stress liquidity of the company.
- Major economic downturn in the Middle East region can negatively affect the company's business significantly.

## Financial Highlights

### Avanceon Limited (AVN)

| PKR mn | CY19A | CY20E | CY21E | CY22E |
|---|---|---|---|---|
| **Income Statement Items** | | | | |
| Net Sales | 4,896 | 6,761 | 8,962 | 10,589 |
| Cost of Sales | 3,412 | 4,604 | 6,138 | 7,280 |
| Gross Profit | 1,484 | 2,157 | 2,824 | 3,309 |
| EBIT | 1,087 | 1,870 | 2,277 | 2,757 |
| EBITDA | 1,066 | 1,905 | 2,317 | 2,801 |
| Financial Charges | 124 | 83 | 38 | 28 |
| Profit Before Tax | 963 | 1,786 | 2,239 | 2,729 |
| Profit After Tax | 912 | 1,651 | 2,060 | 2,517 |
| **Balance Sheet Items** | | | | |
| Paid-up Capital | 1,925 | 2,118 | 2,118 | 2,118 |
| Total Equity | 4,507 | 6,251 | 7,575 | 9,251 |
| Current Liabilities | 3,701 | 4,913 | 5,121 | 5,428 |
| Non-Current Liabilities | 149 | 135 | 121 | 108 |
| Current Assets | 6,979 | 9,887 | 11,379 | 13,323 |
| Non-Current Assets | 1,378 | 1,412 | 1,439 | 1,465 |
| Total Assets | 8,357 | 11,299 | 12,818 | 14,787 |

| | | | | | |
|---|---|---|---|---|---|
| **Current Price** | | 55.3 | **Upside** | | 71.9% |
| **Target Price** | | 95.1 | **Recommendation** | | BUY |
| | **Unit** | **CY19A** | **CY20E** | **CY21E** | **CY22E** |
| **Per Share** | | | | | |
| Earnings* | PKR | 4.3 | 7.8 | 9.7 | 11.9 |
| Dividend | PKR | - | - | 3.0 | 3.5 |
| Book Value | PKR | 23.4 | 29.5 | 35.8 | 43.7 |
| **Valuation** | | | | | |
| P/E | x | 8.7 | 7.1 | 5.7 | 4.7 |
| Dividend Yield | % | - | - | 5.4 | 6.3 |
| P/B (x) | x | 1.6 | 1.9 | 1.5 | 1.3 |
| EV/EBITDA | x | 7.1 | 6.0 | 4.6 | 3.4 |
| Return on Equity | % | 23.0 | 30.7 | 29.8 | 29.9 |
| Return on Assets | % | 12.7 | 16.8 | 17.1 | 18.2 |
| **Turnover & Activity** | | | | | |
| Asset Turnover | x | 0.7 | 0.7 | 0.7 | 0.8 |
| Current Ratio | x | 1.9 | 2.0 | 2.2 | 2.5 |
| **Margins** | | | | | |
| Gross Margin | % | 30.3 | 31.9 | 31.5 | 31.2 |
| EBITDA Margin | % | 21.8 | 28.2 | 25.8 | 26.4 |
| Net Profit Margin | % | 18.6 | 24.4 | 23.0 | 23.8 |

Source: Company Financials, AHL Research, * @ 211.79mn shares

# Disclaimer

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**Equity Research Ratings**

Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as June 2021 for Target Price. In addition, return excludes all type of taxes. For more details kindly refer the following table;

| Rating | Description |
|---|---|
| BUY | Upside* of subject security(ies) is more than +10% from last closing of market price(s) |
| HOLD | Upside* of subject security(ies) is between -10% and +10% from last closing of market price(s) |
| SELL | Upside* of subject security(ies) is less than -10% from last closing of market price(s) |

* Upside for Power Generation Companies (Ex. KEL) is upside plus dividend yield.

**Equity Valuation Methodology**

AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- **Discounted Cash Flow (DCF)**
- **Dividend Discounted Model (DDM)**
- **Sum of the Parts (SoTP)**
- **Justified Price to Book (JPTB)**
- **Reserve Base Valuation (RBV)**

**Risks**

The following risks may potentially impact our valuations of subject security (ies);

- **Market risk**
- **Interest Rate Risk**
- **Exchange Rate (Currency) Risk**

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**Disclosure required under Research Analyst Regulations, 2015:**

In order to avoid any conflict of interest, we hereby disclosed that;

- Analyst has shareholding in AVN.