

Pakistan Technology

AVN PA: Strong backlog order to boost topline

Global IT sector spending is expected to reach US\$4.6tr by CY23 (Source: Gartner), amid rapid digitalization and increasing importance of data analytics & automation. Pakistan's IT exports also witnessed a remarkable growth in last 2-3 years and country's IT exports clocked in at US\$2.6bn in FY22. Similarly, Avanceon Limited (AVN) has witnessed strong topline growth over the years, posting 7-year CAGR of 23% till CY21, where its growth trajectory continued its momentum and in 9MCY22 AVN has posted topline of PKR4.6bn vs. PKR2.8bn in SPLY, up by 28% YoY. With recent acquisition of Emperic AI (previously owned by DH Corp), backlog orders of worth US\$71mn, currency devaluation and economic growth in GCC region amid higher oil prices, AVN is in sweet spot to maintain its growth momentum. Company is aggressively working on new order generation and expects backlog orders of US\$100mn by 2025, with 75% dollarized revenue streams providing company a hedge against currency devaluation.

We continue our liking for AVN and recommend 'BUY' stance with a Dec'23 blended target price of PKR102/sh, providing an upside of 29% from current levels. Our investment thesis is primarily premised on i) 5-year dollarized revenue CAGR of 17%, ii) Integrated business portfolio, iii) Beneficiary of PKR devaluation, iv) Notable partners and high-profile clientele, v) Strong backlog orders and vi) Minimal debt on balance sheet.

Key risks to our valuation thesis includes i) Supply-chain disruptions, ii) Global recession fears and slowing down economies, iii) Lower IT spending, iv) Shortage of skilled human capital, v) changes in regularity regime and vi) Appreciation of PKR against US\$.

IT spending slowing down amid slowdown

As per Gartner, world's IT spending is projected to clock at US\$4.6tr in CY23, up by 5% from US\$4.4tr expected in CY22. It is being witnessed globally that economic slowdown has affected purchasing power of consumers, deferring purchases of IT devices, which is down by 8.4% YoY in CY22. However, overall spending is expected to remain flatter in CY22 amid increased investment in data center systems and shift of spending trend towards cloud, hence 11.3% growth is expected in software segment in CY23. Furthermore, recent boom of E-commerce has increased importance of data and cloud-based management of data. We anticipate that global IT spending will increase once economic turbulence eases off.

Industrial business automation showing no signs of slow-down:

Industrial and process automation has been on the rise from past decade as global businesses started looking into production of goods more efficiently with minimization of operational costs. As per an estimate, total size of industrial automation segment is expected to reach US\$410bn by CY30, witnessing CAGR of 8.5% from levels of US\$197bn in CY21. MEA region has witnessed significant rise in industrial automation in recent times, on the back

Avanceon Limited



BUY

HOLD

SELL

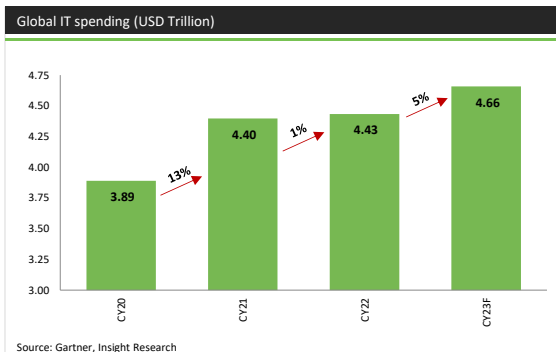
We recommend BUY with Dec'23 blended target price of PKR102/sh, providing 29% Capital Upside

Current Price		79.2
Market cap	PKR b	25.7
Market cap	US\$ m	115
Free Float Market cap	US\$ m	37
30-day Avg. turnover	m Shares	1.8
30-day Avg. turnover	PKR m	155.1
52 week range	PKR/sh	67.2-114.5
Shares Outstanding	m	325
Free float	%	30%

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Financials (PKR mn)	CY21A	CY22E	CY23E
Sales	7,118	10,591	15,547
Cost of sales	4,840	7,448	10,513
Gross Profit	2,278	3,143	5,034
Operating Profit	1,344	1,395	3,111
Profit Before Tax	1,759	2,915	3,141
Profit after Tax	1,600	2,741	2,827
Key Ratios	CY21A	CY22E	CY23E
EPS	4.9	8.4	8.7
DPS	1.0	2.5	2.6
Div. Yield	1%	3%	3%
P/E	15.58	9.39	9.10
P/B	3.16	2.62	2.18
ROE	19%	28%	24%

Source: Company Accounts, Insight Research



Source: Gartner, Insight Research

of their strategy to shift the focus from oil based economy. Recent increase in oil prices has enabled the region to invest more in infrastructure development and process automation. Where most of the demand i.e, ~60% is coming from oil & gas sector followed by power utility & water treatment segments. Thus, AVN's growth prospect cannot be ruled out as more than ~65% of its revenues are derived from MEA region. Furthermore, as per Saudi vision 2030, Qatar national vision 2030 & Dubai industrial strategy 2030, governments have planned to diversify in non-oil sectors while deploying huge investments in renewable power resources and water & waste water projects. Therefore, these verticals would continue to witness strong growth to propel demand for industrial automation. To note, as per Saudi ministry of finance, KSA budget surplus in 9MCY22 stood at US\$40bn, while full year projections manifests real GDP to grow by 8%.

Domestic IT exports has shown promise in last few years

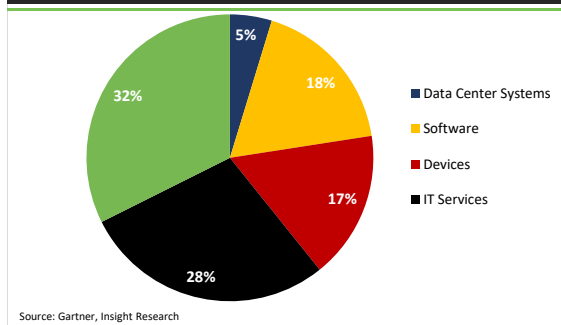
Likewise, with international IT spending local IT exports are also witnessing robust growth over the years. Pakistan's IT exports stood at US\$2.6bn in FY22, up by 24% YoY. Pakistan's IT exports are registering a rapid growth after FY17, posting 5 year CAGR of 23% in FY22, thus, unveils growth potential of Pakistan's IT sector. Domestic IT sector has gained traction in recent times, thanks to PKR devaluation and heightened focus towards IT spending. Local companies enjoy better margins due to dollar linked revenue stream, while a significant portion of the cost is in domestic currency. We believe that favorable policies from Gov't can help Pakistan's IT exports to grow at a rapid pace.

Road Map - US\$100mn by CY25

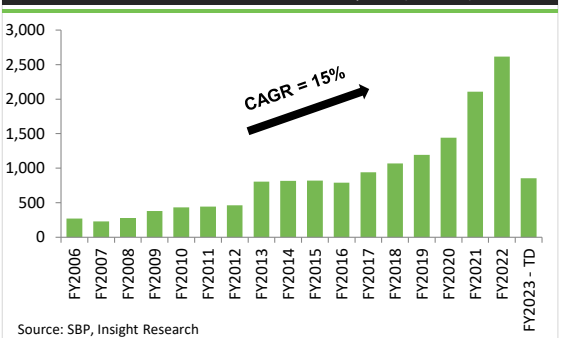
Currently, AVN's ~50% of the total revenue originates from QSA (Qatar & Saudi Arabia) region. Company expects QSA region to grow by 53% by CY25 from current levels of US\$27mn on the back of "Qatar vision 2030" where, local infrastructure and water projects are planned. AVN has also planned to expand in large scale projects by bidding on direct tenders, establishing strategic JVs, registering in local regulatory bodies and training sales work force. In KSA region, AVN has developed strategic partnership with Saudi ZAMCO (Zamil O&M co. ltd) to get benefit of banking facilities. To note, Zamil's close business relations with Saudi ARAMCO and local ministries might help company to set strong foot in the region.

Furthermore, management expects that UAE and African regions are expected to post robust growth from US\$10.5mn in CY22 to US\$40.1mn by CY25, recording CAGR of 55%. The expected growth is anticipated on the back of 23%-25% YoY growth in core automation business in next few years in UAE region which is coupled with a plan to setup JV in Nigeria for oil and gas automation & digitalization and water/waste-water projects in Egypt. Similarly, local business is expected to grow by CAGR of 24% by CY25 amid large scale projects in EPC management, business development, facility management and retail internationalization. To note, company's 5-year dollarized revenue growth stood at ~17%, with expanding presence in GCC region, we expect company's topline growth to remain firm.

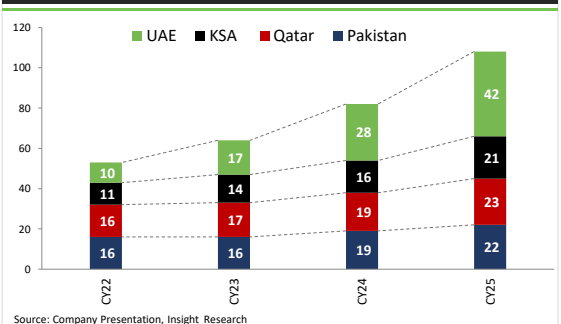
Global IT Spending - Segment Wise



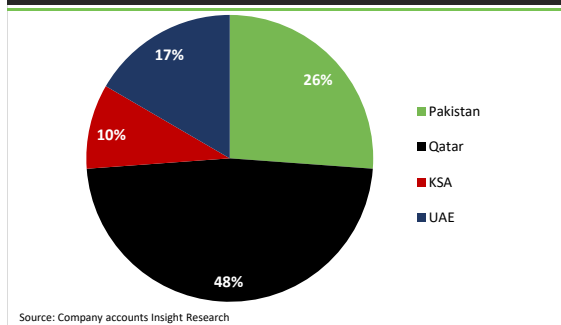
Telecommunication & Information Service Exports (USD mn)



Road to USD100mn orders by 2025



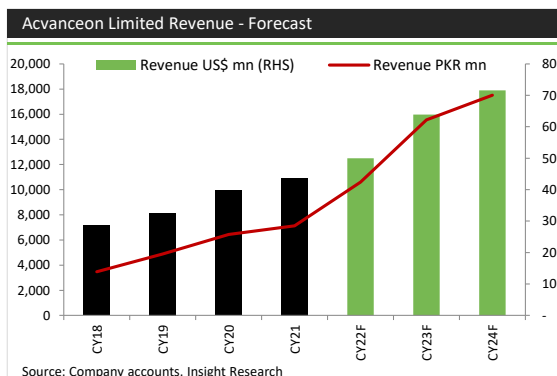
AVN Revenue Contribution - Geographical Segment Wise - CY21



Synergies in Octopus to augment growth

Octopus Digital has posted topline of PKR575mn in 9MCY22, whereas PAT stood at PKR501.5mn (EPS: PKR3.67) which takes net margins to 87%. The robust margins on net basis is attributable to business nature of Octopus that, marginal revenues will not increase marginal costs of the company due to multi-user solutions. Octopus is expected to take its revenues to US\$20.8mn with dollarized net margins of 42% which is based upon its historical revenue streams, customer retention, new markets and planned services.

Furthermore, AVN has recently entered into share swap agreement with DH Corp for acquiring Emperic AI, against stake of Octopus Digital. We opine that such vertical integration will uptick growth potential for company due to combined synergies with an opportunity to add more value in existing portfolio and business development. We believe that Emperic AI being data-oriented business can develop great synergies with Octopus digital’s cloud business and in the next step could be implemented in AVN’s business of industrial automation. Where expertise of Emperic AI in advanced logarithms, analysis, and artificial intelligence could help in product development and optimal effective implementation.



Avanceon (PKR Mn)	CY21	CY22F	CY23F	CY24F
Net sales	7,118	10,591	15,547	17,513
Cost of sales	(4,840)	(7,448)	(10,513)	(11,896)
Gross profit	2,278	3,143	5,034	5,616
Administrative expenses	(933)	(1,748)	(1,923)	(2,115)
Financial charges	(125)	(307)	(119)	(105)
Other income	544	1,839	163	235
Other charges	(5)	(12)	(13)	(14)
Profit before tax	1,759	2,915	3,141	3,618
Taxation	(159)	(174)	(314)	(362)
Profit after tax	1,600	2,741	2,827	3,256
EPS	4.93	8.44	8.71	10.03
GM (%)	32%	30%	32%	32%
NM %	22%	26%	18%	19%

Source: Company accounts, Insight research

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- Discounted cash flow (DCF)
- Relative Valuation (P/E, P/Bv, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

Frequently Used Acronyms

TP	Target Price	DCF	Discounted Cash Flows	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DDM	Dividend Discount Model
SOTP	Sum of the Parts	P/E	Price to Earnings ratio	P/Bv	Price to Book ratio
P/S	Price to Sales	EVA	Economic Valued Added	BVPS	Book Value per Share
EPS	Earnings per Share	DPS	Dividend per Share	DY	Dividend Yield
ROE	Return on Equity	ROA	Return on Assets	CAGR	Compounded Annual Growth Rate

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Insight Securities (Pvt.) Limited

Suite 509, Business and Finance Centre,

I. I. Chundrigar Road , Karachi, Pakistan

+92-21-32462541-44