Amara Raja Batteries Limited

Strong growth prospects

Automobiles	Sharekhan code: AMARAJABAT	Result Update

Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 990**	
Price Target: **Rs. 1,146**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

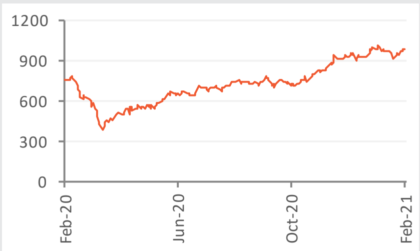
Company details

Market cap:	Rs. 16,910 cr
52-week high/low:	Rs. 1,025 / 350
NSE volume: (No of shares)	9.21 lakh
BSE code:	500008
NSE code:	AMARAJABAT
Free float: (No of shares)	12.3 cr

Shareholding (%)

Promoters	28.1
FII	20.9
DII	14.5
Others	36.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.5	20.0	32.1	27.4
Relative to Sensex	-4.6	1.7	-2.9	1.6

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Amara Raja Batteries (Amara) with a revised PT of Rs. 1,146, owing to a improving batteries demand outlook for automotive and industrial segments (telecom and UPS).
- Q3FY21 revenues broadly in-line with our estimates but misses on EBITDA margin
- Amara well-positioned to gain market share in lead acid battery business by adding clients and widening replacement distribution network. EBITDA margins to remain firm, driven by favourable product mix, led by a higher share of revenues from replacement segment, operating leverage benefits and cost-cutting measures.
- The stock trading below its historical average multiples at P/E multiple of 19.6x and EV/EBITDA multiple of 10.0x its FY2023 estimates.

Amara Raja Batteries Limited (Amara) reported Q3FY21 revenues broadly in-line with our estimates but missed on the EBITDA margin. Net revenue grew by 12 y-o-y at Rs 1,960 crore, led by a strong offtake from OEMs and improving demand in the replacement market. The company witnessed strong demand from exports, and telecom and commercial UPS segments in Q3FY21. The EBITDA margin for the Q3FY21 stood at 15.6%, which was a decline 61 bps y-o-y and 195 bps q-o-q, due to inferior product mix (higher share of OEM revenue) and rise in raw material prices. The EBITDA stood at Rs 306 crore, showing a growth of 7.9 y-o-y and a decline of 10% q-o-q. PAT improved by 17.5% y-o-y to Rs 193 crore, helped by a rise in other income. The company has declared an interim dividend of 500% or Rs 5 per equity share. Our channel checks and discussions with battery dealers suggest strong traction for the replacement demand in the two-wheeler and four-wheeler segments that have been driven by increased mobility on road. We see a strong recovery in automotive battery demand at OEM, as well as replacement. Higher mobility on road has increased battery demand in replacement markets. Amara is expected to be beneficiary of improving business outlook for the automotive and industrial sectors, driven by normalisation of economic activities. The automotive aftermarket segment, which contributes more than 85% of Amara's automotive business, is expected to remain buoyant, aided by pent-up demand and increased preference for personal transport. Capacity expansion for the batteries business of Amara is underway which is, likely to end in FY2021. The company has planned to start a greenfield project to set up lead recycling plant. The details of the proposed plant are awaited. We expect Amara to continue to outpace the organised lead-acid battery industry, led by new client acquisition, product launches and benefits of its extensive distribution network. The company is debt-free and generates strong cash flows, sufficient enough to expand capacity through internal accruals. The company has a strong long-term revenue visibility, given its focus on aftermarket segment. Margins are expected to remain at higher end of historical band of 17-18% driven by operating leverage benefits and cost control measures. We expect Amara's earnings to grow at 18% CAGR, driven by 13% CAGR (FY2021-23) in revenues and 110 bps expansion EBITDA margin. Given strong business growth prospects, we retain our Buy rating on the stock.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 1,146: Amara is witnessing a recovery in automotive and industrial demand. The outlook remains positive with a strong recovery expected from FY2022, driven by the normalisation of economic activities. Operating profit margins would expand on back of operating leverage benefits and cost-control measures. We have retained our earnings estimates, but have increased target P/E multiple, given improved business outlook. The stock is trading below its historical average multiples at P/E multiple of 19.6x and EV/EBITDA multiple of 10.0x its FY2023 estimates. We retain our Buy rating on the stock with a revised PT of Rs. 1,146.

Key risk

A second wave of COVID-19 can lead to a slowdown in economic activities and thus can impact earnings of the company. Also, a steep rise in lead prices, a key raw material, can impact profitability.

Valuation — Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net sales	6,793	6,839	6,907	7,878	8,853
Growth (%)	12.1	0.7	1.0	14.1	12.4
EBIDTA	952	1,099	1,138	1,374	1,557
OPM (%)	14.0	16.1	16.5	17.4	17.6
PAT (Rs cr)	483	661	620	747	862
Growth (%)	2.6	36.7	(6.1)	20.5	15.4
FD EPS (Rs)	28.3	38.7	36.3	43.8	50.5
P/E (x)	35.0	25.6	27.3	22.6	19.6
P/BV (x)	5.1	4.4	4.0	3.5	3.1
EV/EBITDA (x)	17.7	15.1	14.4	11.7	10.0
RoE (%)	14.5	17.4	14.6	15.7	16.1
RoCE (%)	20.5	21.1	18.7	20.1	20.7

Source: Company; Sharekhan estimates

Revenues broadly in-line but EBITDA margins misses our estimates in Q3FY21: Amara Raja Batteries Limited (Amara) reported Q3FY21 revenues broadly in-line with our estimates but misses on EBITDA margin. Net revenue grew by 12 y-o-y at Rs 1,960 crore, led by a strong offtake from OEMs and improving demand in the replacement market. The company witnessed strong demand from exports, and telecom and commercial UPS segments in Q3FY21. The EBITDA margin for the Q3FY21 stood at 15.6%, which was a decline 61 bps y-o-y and 195 bps q-o-q, due to inferior product mix (higher share of OEM revenue) and rise in raw material prices. As a result, the gross margins declined 164 bps y-o-y and 82 bps q-o-q to 33.9% in Q3Fy21. However, the company managed to keep its other costs in control. The other expenditure as a percentage of sales declined 170 bps y-o-y at 12.2% in Q3, offsetting the impact of gross margins reduction to some extent. The EBITDA stood at Rs 306 crore, showing a growth of 7.9 y-o-y and a decline of 10% q-o-q. PAT improved by 17.5% y-o-y to Rs 193 crore, helped by rise in other income. The company has declared an interim dividend of 500% or Rs 5per equity share.

Underline strong automotive demand: Our channel checks and discussions with battery dealers suggest strong traction for the replacement demand in the two-wheeler and four-wheeler segments have been driven by increased mobility on road. Dealers are unable to meet the demand for two-wheeler batteries due to low inventory. In our view, supply issues faced by dealers are due to greater-than-expected demand from OEMs, which are preferred over aftermarket sales and shortage of certain imported components. We see a strong recovery in automotive battery demand at OEM, as well as replacement. Higher mobility on road has increased battery demand in replacement markets. Amara is expected to be the beneficiary of improving business outlook for the automotive and industrial sectors, driven by normalisation of economic activities. The automotive aftermarket segment, which contributes more than 85% of Amara's automotive business, is expected to remain buoyant, aided by pent-up demand and increased preference for personal transport. We expect Amara to continue to outpace the organised lead-acid battery industry, led by new client acquisition, product launches and benefits of its extensive distribution network.

Industrial batteries showing recovery: Industrial battery dealers are also witnessing a recovery in sales, driven by returning demand and attractive offers from the company. The ground checks suggest that the industrial battery demand has recovered to 90% of pre-COVID demand. Dealers have been receiving strong enquiries from inverter battery and the UPS segments. We expect pent-up demand to get converted into actual sales, as the economy gets back to normalcy. Amara is expected to capitalize on this pent demand, given its established relationship with institutional clients and extensive distribution network.

Traction in export markets: Amara is witnessing an upsurge in demand for exports of automotive and industrial batteries in a number of regions. Penetration in the existing market would continue its export growth. The export contributes ~13% of revenues.

Capacity expansion plans: Amara is expanding capacity in the automotive segment which forms about 50% of its revenues. Given the strong demand traction in the automotive segment, Amara is increasing capacity of four wheelers batteries from 12 million units to 14 million units, while in case of two-wheeler segment, Amara is enhancing capacity from 17 million units to about 20 million by the end of FY2021. Amara is gaining market share in both the automotive OEM and replacement space. In the replacement segment, the company is strengthening its distribution network in Western and Eastern India where it has relatively lower presence. In the automotive OEM segment, the company is increasing its share of business and also adding new clients in the two-wheeler segment. We expect Amara to continue outpacing industry growth. The company has invested Rs 200 crore in H1FY2021 and further plans to invest Rs 250 crore for batteries division. The BOD has also approved setting up a greenfield lead acid recycling plant with an estimated capacity of 1 lakh tonnes p.a at a total outlay of Rs 280 crore to be spent over the next 18 months. Further, Amara is also setting up a 50MW solar captive power plant in Chittoor District of Andhra Pradesh at a total outlay of Rs 220 crores to support the sustainability initiatives of the company.

Strong broad-based recovery; expect double-digit growth in FY22: The company is debt-free and generates strong cash flows, sufficient enough to expand capacity through internal accruals. The company has a strong long-term revenue visibility, given its focus on aftermarket segment. Margins are expected to remain at higher end of historical band of 17-18% driven by operating leverage benefits and cost control measures. We expect Amara's earnings to grow at 18% CAGR, driven by 13% CAGR (FY2021-23) in revenues and 110 bps expansion EBITDA margin. We have retained our earnings estimates.

Results Rs cr

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2Y21	QoQ (%)
Net sales	1,960	1,748	12.1	1,936	1.3
Operating profit	306	284	7.9	340	-10.0
OPM (%)	15.6	16.2	(61 bps)	17.6	(195 bps)
Depreciation	79	76	3.4	78	1.1
Interest	3	3	-10.0	2	4.8
Other Income	35	13	175.9	11	212.1
PBT	260	217	19.6	271	-4.1
Tax	67	53	26.0	70	-4.0
Adjusted PAT	193	164	17.5	201	-4.1
EPS	11	10	17.5	12	-4.1

Source: Company

Outlook and Valuation

■ Sector View – Demand picking up in automotive and industrial sector

Business outlook for the automotive and industrial segments is improving with the normalisation of economic activities. Automotive demand is witnessing a strong recovery in two-wheeler and four-wheeler segments, aided by the pent-up demand and increased personal mobility transport. The industrial segment is also witnessing growth, driven by the recovery in telecom and UPS segments. The potential in telecom and UPS industry demand remains buoyant because of increased data usage and digitalisation.

■ Company Outlook – Strong earnings growth

We expect Amara to continue to outpace the organised lead-acid battery industry, led by new client acquisition, new product launches and benefitting from its extensive distribution network. The company has a large distribution network comprising 30000+ Amaron and PowerZone retailers across India. The company is increasing its automotive battery capacity from 29 million units to 34 million units by the end of FY2021 to benefit from the expected rise in demand. With the government opening up the economy, the demand in the automotive replacement segment and UPS is recovering. The OEM business in both the auto and industrial segments is also recovering, which augur well for the company.

■ Valuation – Maintain Buy with a revised PT of Rs. 1,146

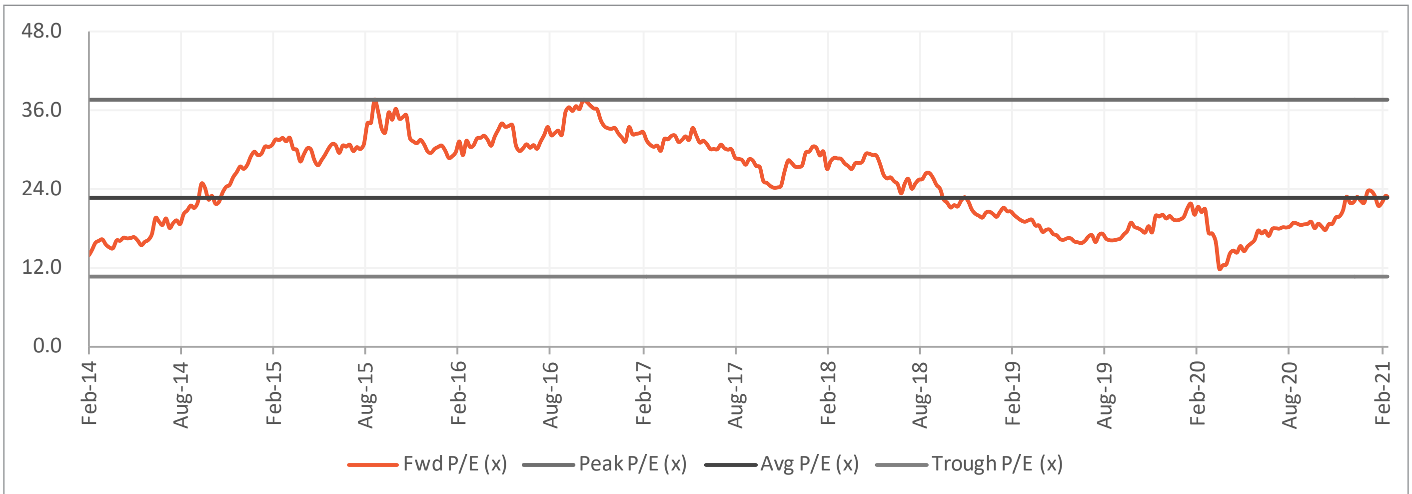
Amara is witnessing a recovery in automotive and industrial demand. The outlook remains positive with strong recovery expected from FY2022, driven by normalisation of economic activities. Operating profit margins would expand on back of operating leverage benefits and cost-control measures. We have retained our earnings estimates, but have increased target P/E multiple, given improved business outlook. The stock is trading below its historical average multiples at P/E multiple of 19.6x and EV/EBITDA multiple of 10.0x its FY2023 estimates. We retain our Buy rating on the stock with a revised PT of Rs. 1,146.

Price Target calculation

Particulars	Rs/ share
FY23E EPS (Rs per share)	50.5
Target P/E Multiple (x)	23
Target Price (Rs per share)	1,146
Current Price	990
Upside (%)	**16%**

Source: Company; Sharekhan Research

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Amara Raja Batteries	27.3	22.6	19.6	14.4	11.7	10.0	18.7	20.1	20.7
Exide Batteries	21.5	18.2	16.1	13.1	11.1	9.7	14.0	15.0	15.3

Source: Company, Sharekhan estimates

About company

Amara is a flagship company of the Amara Raja Group. The company is one of the leading manufacturers of lead acid storage batteries catering to the needs of both industrial as well as the automotive space. In the automotive segment, the company makes batteries for four-wheelers and two-wheelers and caters to the OEM as well as aftermarkets segment. The products for the automotive segment are marketed under the Amaron and Powerzone brands. In the industrial segment, the company is a preferred supplier to major telecom service providers, telecom equipment manufacturers, UPS sector (OEM and Replacement), Indian Railways and to power, oil and gas among others. The company has a commendable share in the telecom and UPS batteries segment. Amara's manufacturing plants are located in Chittor district in Andhra Pradesh and are equipped with state-of-the-art manufacturing plants.

Investment theme

Amara reported Q3FY21 revenues broadly in-line with our estimates but misses on EBITDA margin. We expect Amara be a beneficiary of improving demand for batteries in the automotive as well as industrial segments. With expected normalisation of economic activities, we expect double digit growth from FY22. Amara is expected to continue outpacing organised lead acid battery industry driven by new client additions in automotive OEM as well as new product launches and expanding network reach in automotive aftermarket. The company is enhancing automotive battery capacity from 29 million units to 34 million units by end of FY21. Key segments of telecom and UPS have recovered strongly and have huge growth potential going ahead driven by increasing data usage and increased digitalisation. Margins are expected to remain at higher end of historical band of 17-18% driven by operating leverage benefits and cost control measures. The company is debt-free and generates strong cash flows, sufficient enough to expand capacity through internal accruals. The company has a strong long-term revenue visibility, given its focus on aftermarket segment. We expect Amara's earnings to grow at 18% CAGR, driven by 13% CAGR (FY2021-23) in revenues and 110 bps expansion EBITDA margin. Hence, we retain our Buy ratings.

Key Risks

- The second wave of COVID-19 can lead to slow down in the economic activities and thus can impact earnings of the company.
- A steep rise in lead prices, a key raw material, can impact profitability.

Additional Data

Key management personnel

Ramachandra N Galla	Chairman
Jayadev Galla	Vice - Chairman & Managing Director
Vijayanand S	Chief Executive Officer
Delli Babu Y	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	RNGALLA FAMILY PVT LTD	28.06
2	PANTHER ARBL HOLD LP	24
3	Nalanda India Equity Fund Ltd	7.99
4	ICICI MUTUAL FUND	3.97
5	ICICI Prudential Asset Management	3.76
6	UTI Asset Management Co Ltd	1.72
7	L&T Mutual Fund Trustee Ltd/India	1.63
8	NATIONAL WESTMINSTER BANK	1.35
9	Baron Capital Inc	1.23
10	St James's Place PLC	1.11

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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