Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Amara Raja Batteries Ltd

Charged up for growth

Automobiles	Sharekhan code: AMARAJABAT

Reco/View: Buy	↔	CMP: Rs. 611	Price Target: Rs. 784	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We maintain our Buy rating on Amara Raja Batteries Limited (Amara) with a revised PT of Rs. 784, owing to price correction, a brighter demand outlook for batteries, and comfortable valuations.
- Q2FY2022 results were below expectations due to sharper contraction in EBITDA margin than expectations.
- We have reduced our earnings estimates by 15.7%/8.6% for FY2022E and FY2023E to build in drop in EBITDA margin. Further, we expect Amara's revenue and earnings to report a CAGR of 18.9% and 10.4%, respectively, during FY2021-FY2023E.
- The stock trades below its historical average P/E multiple of 13.2x and EV/EBITDA multiple of 6.7x its FY2023 estimates.

Amara Raja Batteries' (Amara's) Q2FY2022 results were below expectations, led by sharper drop in EBITDA margin than our expectations. Net revenue increased by 17.9% y-o-y and 20% q-o-q to Rs. 2,264 crore in Q2FY2022, driven by recovery in original equipment manufacturer (OEM) and industrial sales. Aftermarket sales were also recovering well. EBITDA margin for the quarter contracted by 140 bps q-o-q to 11.9% versus expectation of 13.6% due to inflation in raw-material prices. The price of lead, which is the key raw material for batteries, rose 7.1% in Q2FY2022. Depreciation expense increased by 26.1% y-o-y due to commissioning of the new line in Andhra Pradesh plant. As a result, EBITDA and PAT declined by 21% y-o-y and 28.5% y-o-y to Rs. 269 crore and Rs. 144 crore, respectively, in Q2FY2022. Management of Amara is taking several strategic initiatives to take advantage of the rapidly emerging new opportunities to accelerate growth in the medium term. Amara laid down the company's vision to remain a dominant battery player in the Indian Ocean Rim and one of the leading global players in batteries through enduring partnerships. The company is open to grow through partnerships, joint ventures, and acquisitions. The company has guided for a 15-17% revenue CAGR in the next five years versus an 8% revenue CAGR during FY2016-FY2021. We remain positive on company's growth prospects, led by recovery in auto and industrial sales with improved aftermarket sales. Thus, we maintain our Buy rating on the stock.

Key positives

- Revenue continues to show recovery in sales, led by growth in all segments, including auto, OEM, and replacement markets sales.
- Industrial volume growth was stable across all segments – particularly the UPS business registered higher volume growth.

Key negatives

- EBITDA margin for the quarter contracted by 140 bps q-o-q to 11.9% versus expectation of 13.6% due to inflation in raw-material prices. The price of lead, which is the key raw material for batteries, rose 7.1% in Q2FY2022.

Management Commentary

- Demand signals are positive across all product segments but increased input material costs are driving margins negatively.
- The company has guided for a 15-17% revenue CAGR in the next five years, through partnerships, joint ventures, and acquisitions.

Revision in estimates – We have cut our earnings estimates by 15.7%/8.6% for FY2022E and FY2023E to build in drop in EBITDA margin. Further, we expect Amara's revenue and earnings are expected to post a CAGR of 18.9% and 10.4%, respectively, during FY2021-FY2023E. We have also introduced FY2024E estimates.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 784: Amara is one of the largest manufacturers of lead acid batteries, commanding a market share of close to 40% in the organised market. Having a strong brand equity and extensive distribution network, we expect Amara to grow strongly in the battery industry, led by higher offtake by the replacement market. The company has laid down its long-term strategic plans for energy and mobility sectors through maximising on its brand recall in the lead acid battery space and investing into new energy product developments. However, the stock has corrected 22.9% and underperformed SENSEX by 36.2%, largely due to pending case in High Court by AP Pollution Control Board (APPCB) regarding closure orders for its plants in Chitoor district (AP), and trailing behind the global competitors in terms of R&D investments in lithium-ion technology. The correction in stock provides a good entry point for investors. The stock is trading below its historical average multiples at a P/E multiple of 13.2x and EV/EBITDA multiple of 6.7x its FY2023 estimates. We retain Buy on the stock with a revised PT of Rs. 784.

Key Risks

Sales of aftermarket and OEMs can be impacted, if COVID cases increases substantially under wave-3. Moreover, if the Hon'ble Court gives verdict against the company, there could uncertainties regarding production of products in its plants in Chitoor district (Andhra Pradesh).

Valuation (Standalone)

Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Net sales	7,150	9,085	10,103	11,012
Growth (%)	4.5	27.1	11.2	9.0
EBIDTA	1,116	1,213	1,452	1,614
OPM (%)	15.6	13.4	14.4	14.7
PAT (Rs cr)	647	631	788	1,016
Growth (%)	(2.1)	(2.5)	24.9	28.9
FD EPS (Rs)	37.9	36.9	46.1	59.5
P/E (x)	16.1	16.5	13.2	10.3
P/BV (x)	2.4	2.2	2.0	1.7
EV/EBITDA (x)	8.9	8.3	6.7	5.8
RoE (%)	15.2	13.5	15.1	17.0
RoCE (%)	19.6	17.4	19.5	21.7

Source: Company; Sharekhan estimates

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		↔	

ESG Disclosure Score

NEW

ESG RISK RATING 27.82

Updated Oct 08, 2021

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

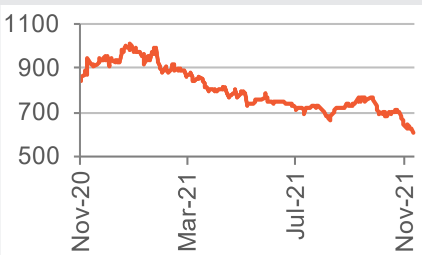
Company details

Market cap:	Rs. 10,437 cr
52-week high/low:	Rs. 1,025 / 607
NSE volume: (No of shares)	10.1 lakh
BSE code:	500008
NSE code:	AMARAJABAT
Free float: (No of shares)	12.3 cr

Shareholding (%)

Promoters	28.1
FII	20.8
DII	14.5
Others	36.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-12.7	-9.6	-22.9	-27.2
Relative to Sensex	-6.1	-12.0	-36.2	-58.5

Sharekhan Research, Bloomberg

Results below expectations, hit by sharper contraction in EBITDA margin: Amara's Q2FY2022 were below expectations, led by sharper drop in EBITDA margin than our expectations. Net revenue increased 17.9% y-o-y and 20% q-o-q to Rs. 2,264 crore in Q2FY2022, driven by recovery in OEM and industrial sales. Aftermarket sales also recovered well. EBITDA margin for the quarter contracted by 140 bps q-o-q to 11.9% versus expectation of 13.6% due to inflation in raw-material prices. The price of lead, which is the key raw material for batteries, rose 7.1% in Q2FY2022. Depreciation expense increased by 26.1% y-o-y due to commissioning of the new line in Andhra Pradesh plant. As a result, EBITDA and PAT declined by 21% y-o-y and 28.5% y-o-y to Rs. 269 crore and Rs. 144 crore, respectively, in Q2FY2022.

Underline strong automotive demand: As per management, demand signals are positive across all product segments but increased input material costs are driving margins negatively. We expect strong traction for replacement demand in the two-wheeler and four-wheeler segments, driven by pent-up demand. We see strong recovery in automotive battery demand at OEM as well as replacement. Higher mobility on roads has increased battery demand in replacement markets to emerge faster than OEM demand. 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 constitutes 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 outpacing the organised lead-acid battery industry, led by new client acquisition, product launches, and benefits of its extensive distribution network.

Energy and Mobility Theme: The company has announced "Energy and Mobility" as its new theme for growth, driven by transformative changes in key operative markets. Amara laid down the company's vision to remain a dominant battery player in the Indian Ocean Rim and one of the leading global players in batteries through enduring partnerships. During the conference call, the company discussed its R&D capabilities and strategies for growth through value maximisation in the lead acid business segment and establishment of a new energy SBU encompassing lithium cell and battery pack, EV chargers, energy storage systems, advanced home energy solutions, and other related products and services. The company is open to grow through partnerships, joint ventures, and acquisitions. The company has guided for a 15-17% revenue CAGR over the next five years versus 8% revenue CAGR during FY2016-FY2021.

Exports remain as key focus areas: The company has presence in more than 35 countries and exports contributes ~12% of total revenue. The export business has reported a 25% CAGR during FY2018-FY2021. With aggressive foraying into the new energy business, the company expects to grow at a faster pace in exports as compared to domestic revenue. The company is open to grow inorganically in export markets as well.

Lead Acid value maximisation: Amara has a positive view on the lead acid batteries business and expects the segment to grow in India, owing to buoyant demand from the automotive, industrial, telecom, and new emerging segments such as data centres. The new strategy, aimed at tapping opportunities in home inverter, motive power and unorganised segments, is expected to further consolidate its existing strengths and market share. It will further invest in advanced process technologies to maintain its technological edge as well as recycling to enhance critical raw-material security.

New Energy business: Amara will establish a new energy SBU encompassing lithium cell and battery packs, EV chargers, energy storage systems, advanced home energy solutions, and other related products and services. The new energy division will build on technological innovations such as lithium and other new age chemistries that enable accelerated transformation in renewable energy, electric mobility, microgrids, etc. Technology in this space is emerging rapidly and evolving. In addition, the Government of India has approved PLI scheme for 'National Programme on Advanced Chemistry Cell (ACC) Battery Storage' with an aim to achieve capacity of 50 Giga Watt Hour (GWH) of ACC and 5 GWH of niche ACC. The government has planned outlay of Rs. 18,100 crore as incentives for ACC storage manufacturers.

Strong balance sheet to aid growth through internal accruals: The company is debt free and generates free cash flow (FCF) of Rs. 300 crore-400 crore every year, sufficient to meet its strategic goals. The company has a strong long-term revenue visibility, given its focus on the aftermarket segment. Margins are expected to remain at the higher end of the historical band of 17-18%, driven by operating leverage benefits and cost-control measures. The company plans to grow in the new energy space through partnership. As of the now, the company has not revealed capex plans in the new energy business but expects to set up ACC plant for capacity of 8-12 GWH. Industry estimates suggest an investment of US$1 billion for setting up a plant with a capacity 10 GWH.

Results (Standalone) Rs cr

Particulars	Q2FY22	Q2FY21	YoY (%)	Q1FY21	QoQ (%)
Net sales	2,264	1,936	17.0	1,886	20.1
Total operating expenses	1,995	1,595	25.1	1,636	22.0
EBITDA	269	340	-21.0	250	7.6
Depreciation	99	78	26.1	96	2.4
Interest	4	2	43.0	3	13.0
Other Income	26	11	134.4	17	59.1
PBT	193	271	-28.7	167	15.7
Tax	49	70	-29.4	43	13.9
Adjusted PAT	144	201	-28.5	124	16.3
Adjusted EPS	8.4	11.8	-28.5	7.3	16.3

Source: Company; Sharekhan Research

Key Ratios (Standalone)

Particulars	Q2FY22	Q2FY21	YoY (bps)	Q1FY21	QoQ (bps)
Gross margin (%)	29.9	34.7	-480	31.1	-120
EBIDTA margin (%)	11.9	17.6	-570	13.2	-140
EBIT margin (%)	7.5	13.5	-600	8.1	-60
Net profit margin (%)	6.4	10.4	-400	6.6	-20
Effective tax rate (%)	25.4	25.6	-20	25.8	-40

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Demand picking up in the automotive and industrial sector

Business outlook for automotive and industrial segments is expected to improve as economic activities get normalised. Automotive demand is expected to witness strong recovery in the two-wheeler and four-wheeler segments, aided by pent-up demand and increased need for personal mobility transport, amid the COVID-19 pandemic. The industrial segment may take a little more time to recover compared to automotive, except the telecom segment.

■ Company outlook – Strong earnings growth

We expect Amara to continue to outpace the organised lead-acid battery industry, led by new client acquisitions, new product launches, and benefitting from its extensive distribution network. The company has a large distribution network comprising 30,000+ Amaron and PowerZone retailers across India. The company is increasing its automotive battery capacity from 29 million units to 34 million units to benefit from the expected rise in demand. The company is debt free and generates strong cash flows, sufficient to expand capacity through internal accruals. The company has a strong long-term revenue visibility, given its focus on the aftermarket segment. we expect Amara's revenue and earnings to report CAGR of 18.9% and 10.4%, respectively, during FY2021-FY2023E.

■ Valuation – Maintain Buy with a revised PT of Rs. 784

Amara is one of the largest manufacturers of lead acid batteries, commanding a market share of close to 40% in the organised market. Having a strong brand equity and extensive distribution network, we expect Amara to grow strongly in the battery industry, led by higher offtake by the replacement market. The company has laid down its long-term strategic plans for energy and mobility sectors through maximising on its brand recall in the lead acid battery space and investing into new energy product developments. However, the stock has corrected 22.9% and underperformed SENSEX by 36.2%, largely due to pending case in High Court by AP Pollution Control Board (APPCB) regarding closure orders for its plants in Chitoor district (AP), and trailing behind the global competitors in terms of R&D investments in lithium-ion technology. The correction in stock provides a good entry point for investors. The stock is trading below its historical average multiples at a P/E multiple of 13.2x and EV/EBITDA multiple of 6.7x its FY2023 estimates. We retain Buy on the stock with a revised PT of Rs. 784.

One-year forward P/E (x) band

Source: Sharekhan Research

Peer Comparison

Particulars	CMP (Rs / Share)	P/E (x)			EV/EBITDA (x)			RoCE (%)		
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Amara Raja Batteries	611	16.1	16.5	13.2	8.9	8.3	6.7	19.6	17.4	19.5
Exide Batteries	164	14.7	12.6	10.9	9.6	8.3	7.0	15.2	15.6	16.3

Source: Company, Sharekhan estimates

About company

Amara is a flagship company of 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 4Ws and 2Ws and caters to the OEM as well as aftermarkets segment. 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 segments 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 is one of the leading battery manufacturers in the duopolistic Indian lead acid battery space. The company is present in the automobile as well as industrial segments. Having a strong brand equity and extensive distribution network, we expect Amara to grow strongly in the battery industry. The company is working on several cost-control measures to improve profitability, such as increasing backward integration, diversifying supplier base, enhancing automation, increasing share of renewable power, and enhancing digital initiatives. Amara is also upgrading its technology and working on import substitution of raw materials to enable cost reduction. We expect the company to outperform the battery industry, driven by new client additions in the OEM space and market share gains in the auto replacement segment, driven by network expansion. Amara is a debt free company with healthy return ratios.

Key Risks

- Sales of aftermarket and OEMs can be impacted if COVID cases increase substantially under wave-3.
- If the Hon'ble Court gives verdict against the company, there could uncertainties regarding production of products in its plants in Chitoor district (Andhra Pradesh).
- 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 6 shareholders

Sr. No.	Holder Name	Holding (%)
1	RNGALLA FAMILY PVT LTD	28.1
2	Clarios Arbl Holding Lp	14.0
3	Nalanda India Equity Fund Limited	9.9
4	Life Insurance Corporation Of India	7.1
5	Kotak Equity Arbitrage Fund	1.4
6	Vanguard Emerging Markets	1.1

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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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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