Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Amara Raja Batteries Ltd

Weak performance continues in Q4; steady growth ahead

Automobiles	Sharekhan code: AMARAJABAT
Reco/View: Buy ↔	CMP: Rs. 529
	Price Target: Rs. 629 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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 23.59

Updated Feb 08, 2021

Medium Risk

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

Source: Morningstar

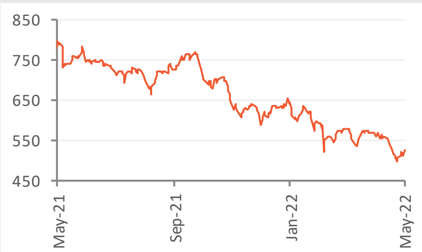
Company details

Market cap:	Rs. 9,036 cr
52-week high/low:	Rs. 804 / 494
NSE volume: (No of shares)	7.3 lakh
BSE code:	500008
NSE code:	AMARAJABAT
Free float: (No of shares)	12.3 cr

Shareholding (%)

Promoters	28.1
FII	18.1
DII	11.4
Others	42.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.3	-8.4	-25.2	-31.5
Relative to Sensex	-1.6	-4.7	-15.2	-41.1

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Amara Raja Batteries Limited (Amara) with a revised PT of Rs.629, owing to stock price correction, a brighter demand outlook for batteries, and comfortable valuations.
- Q4FY22 results were below expectations due to continued contraction in EBITDA margin, led by input cost inflation.
- We expect gradual recovery on EBITDA margins for Amara and thus, have cut earnings estimates by 19%/30% for FY23E/FY24E respectively.
- The stock trades below its historical average at P/E multiple of 12.6x and EV/EBITDA multiple of 5.5x its FY24E estimates.

Amara Raja Batteries' (Amara's) Q4FY22 results were below expectations, led by a sharper drop in EBITDA margin than our expectations. Net revenue, EBITDA and PAT were lower than consensus estimates by 13.1%, 28.2% and 38.8% respectively during Q4. Net revenue increased by 3.7% y-o-y, while declining 7.8% q-o-q at Rs. 2,181 crores in Q4FY22. In Q4, Amara's revenue was impacted by sluggishness in OEM sales due to supply constraints, while the EBITDA margin for the quarter contracted by 190 bps q-o-q to 10.1% versus the expectation of 12.2%, largely hit by increased raw material costs. As a result, EBITDA and PAT declined by 30.5% y-o-y and 48% y-o-y, respectively in Q4FY22. The 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 the 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

- Industrial volume growth was stable across all segments – particularly the UPS business registered higher volume growth.

Key negatives

- OEM offtake got impacted in Q4FY22, led by supply constraints faced by OEMs.
- EBITDA margin for the quarter contracted by 190 bps q-o-q to 10.1% versus expectation of 12.2%, largely hit inflation in raw material costs.

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.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 629: 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 a 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 ~31.5% and underperformed SENSEX by 41.1% in last one year, due to weak OEM offtake, pending case in High Court by AP Pollution Control Board (APPCB) regarding closure orders for its plants in Chitoor district (AP) and trailing behind global competitors in terms of research and development (R&D) investments in lithium-ion technology. Correction in the stock provides a good entry point for investors. The stock is trading below its historical average multiples at P/E multiple of 12.6x and EV/EBITDA multiple of 5.5x its FY24E estimates. We retain our Buy recommendation on the stock with a revised price target (PT) of Rs. 629.

Key Risks

Prolonged supply constraints of OEMs can affect our future projections. 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	FY22	FY23E	FY24E
Net sales	7,150	8,696	9,870	10,857
Growth (%)	4.5	21.6	13.5	10.0
EBIDTA	1,116	1,023	1,273	1,498
OPM (%)	15.6	11.8	12.9	13.8
PAT (Rs cr)	647	511	633	716
Growth (%)	(2.1)	(21.0)	23.9	13.1
FD EPS (Rs)	37.9	29.9	37.1	41.9
P/E (x)	14.0	17.7	14.3	12.6
P/BV (x)	2.1	2.0	1.8	1.7
EV/EBITDA (x)	7.7	8.5	6.7	5.5
RoE (%)	15.2	11.2	12.8	13.3
RoCE (%)	19.6	14.6	16.5	16.8

Source: Company; Sharekhan estimates

Results below expectations in Q4, hit by sharper contraction in EBITDA margin: Amara Raja Batteries' (Amara's) Q4FY22 results were below expectations, led by a sharper drop in EBITDA margin than our expectations. Net revenue, EBITDA and PAT were lower than consensus estimates by 13.1%, 28.2% and 38.8% respectively during Q4. Net revenue increased by 3.7% y-o-y, while declined 7.8% q-o-q at Rs. 2,181 crore in Q4FY22. In Q4, Amara's revenue was impacted by sluggishness in OEM sales due to supply constraints. However, other segments such as replacement market and industrial segments continue to improve and perform well in quarter. EBITDA margin for the quarter contracted by 190 bps q-o-q to 10.1% versus expectation of 12.2%, largely hit by increased raw material costs. Depreciation expense increased by 13.4% y-o-y due to commissioning of the new line in Andhra Pradesh plant. As a result, EBITDA and PAT declined by 30.5% y-o-y and 48% y-o-y to Rs. 220 crore and Rs. 99 crore, respectively, in Q4FY22.

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 the 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 key focus areas: The company is present in more than 35 countries and exports contribute ~12% to total revenue. 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.

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, and micro grids, among others. Technology in this space is emerging rapidly and evolving. The company is all geared up for the electric vehicle space as well. It is coming up with a 100 megawatt-hour lithium-ion battery plant, has already launched an e-rickshaw battery, and has started supplying to original equipment manufacturers. The company has also invested US$5 million in Log 9 Materials, a battery tech start-up in August 2021, as Series A investment round.

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. 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 a capacity of 8-12 GWH.

Results (Standalone) Rs cr

Particulars	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)
Net sales	2,181	2,103	3.7	2,365	(7.8)
Total operating expenses	1,961	1,786	9.8	2,081	(5.8)
EBITDA	220	317	(30.5)	284	(22.6)
Depreciation	99	87	13.4	102	(3.3)
Interest	5	3	68.0	4	22.5
Other Income	16	32	(50.2)	19	(15.7)
PBT	132	259	(48.8)	197	(32.8)
Tax	34	69	(51.0)	52	(35.2)
Adjusted PAT	99	189	(48.0)	145	(31.9)
Adjusted EPS	5.8	11.1	(48.0)	8.5	(31.9)

Source: Company; Sharekhan Research

Key Ratios (Standalone)

Particulars	Q4FY22	Q4FY21	YoY (bps)	Q3FY22	QoQ (bps)
Gross margin (%)	27.9	32.6	(470)	29.7	(190)
EBIDTA margin (%)	10.1	15.1	(500)	12.0	(190)
EBIT margin (%)	5.6	10.9	(540)	7.7	(210)
Net profit margin (%)	4.5	9.0	(450)	6.1	(160)
Effective tax rate (%)	25.6	26.8	(120)	26.6	(100)

Source: Company; Sharekhan Research

Outlook and Valuation

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

The 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.

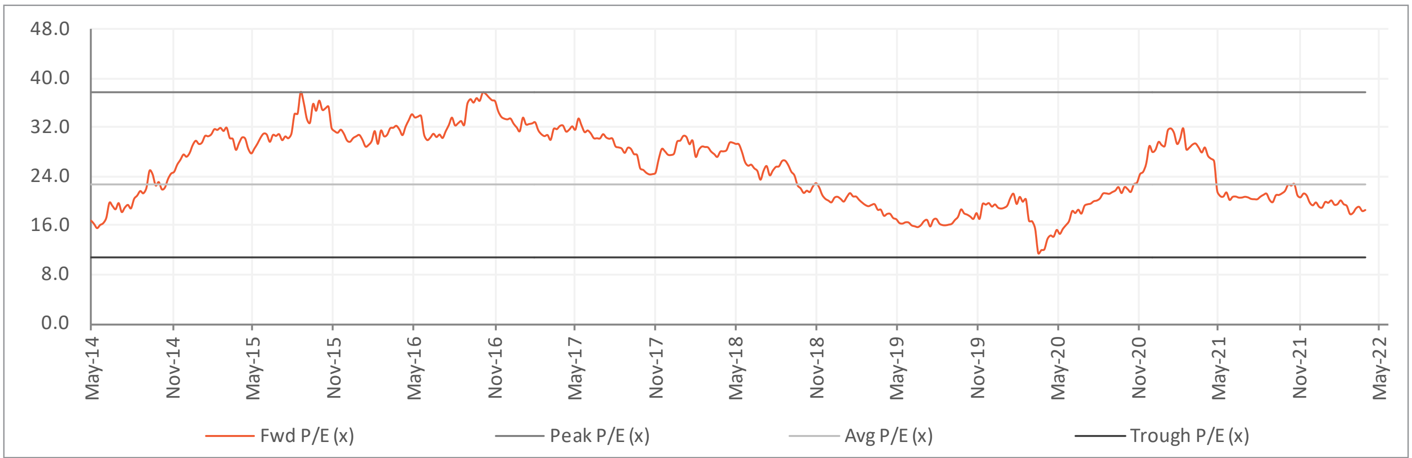
Company Outlook – Steady growth outlook

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.

Valuation – Maintain Buy with a revised PT of Rs. 629

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 ~31.5% and underperformed SENSEX by 41.1% in last one year, due to weak OEM offtake, pending case in High Court by AP Pollution Control Board (APPCB) regarding closure orders for its plants in Chitoor district (AP) and trailing behind global competitors in terms of research and development (R&D) investments in lithium-ion technology. Correction in the stock provides a good entry point for investors. The stock is trading below its historical average multiples at P/E multiple of 12.6x and EV/EBITDA multiple of 5.5x its FY24E estimates. We retain our Buy recommendation on the stock with a revised price target (PT) of Rs. 629.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	Rs/Share	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Amara Raja Batteries	529	14.0	17.7	14.3	7.7	8.5	6.7	19.6	14.6	16.5
Exide Batteries	144	12.4	12.0	10.0	8.4	8.1	6.5	15.2	14.3	15.2

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 segments. 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

- If the Hon'ble Court gives verdict against the company, there could be 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 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

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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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