Sharekhan by BNP PARIBAS

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Amber Enterprises

Mixed Q3, scalability in component sales is the key

Capital Goods	Sharekhan code: AMBER

Reco/View: Buy ↔	CMP: Rs. 2,023	Price Target: Rs. 2,360 ↓

↑ 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 29.63
Updated Dec 08, 2022

Medium Risk

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

Source: Morningstar

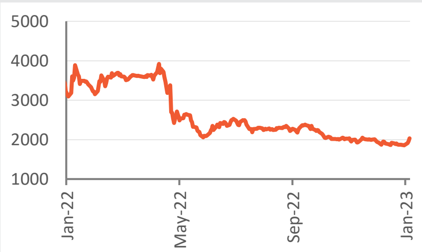
Company details

Market cap:	Rs. 6,816 cr
52-week high/low:	Rs. 4,026 / 2,040
NSE volume: (No of shares)	1.1 lakh
BSE code:	540902
NSE code:	AMBER
Free float: (No of shares)	2.0 cr

Shareholding (%)

Promoters	40.3
FII	26.9
DII	8.8
Others	24.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.9	-3.7	-17.8	-37.0
Relative to Sensex	7.0	-5.6	-26.6	-43.0

Sharekhan Research, Bloomberg

Summary

- Amber Enterprises' (Amber's) Q3FY2023 performance was mixed as component sales were robust but profitability was impacted due to high interest and depreciation.
- Structural changes in the manufacturing landscape of RAC would tilt the company's revenue towards components rather than finished goods. The company is confident of maintaining 26-28% market share in manufacturing industry of RACs.
- Long-term growth would be driven by demand for RAC components, mobility, motor and electronics as well as traction in exports. Company guided for 30% growth in EBITDA in FY24E but refrained from giving margin guidance
- We maintain a Buy rating with a revised PT of Rs. 2,360. We believe, profitability should improve following ramp up in capacity utilization and once non-RAC components achieve scalability.

Amber Enterprises' (Amber)'s Q3FY2023 performance was above our expectations on the revenue front. However, OPM and net profit missed estimates by a wide margin. Sales grew by 38% y-o-y to Rs 1,348 crore. The sales were driven by the components division, which is growing at a faster pace, and the growth is fuelled by a strong order book, new customer addition and expansion in newer geographies like Sri City and Chennai. Operating profit grew by 6.6% y-o-y to Rs 79 crore while operating margin remained under pressure and came lower at 5.8% (down 173 bps y-o-y) due to higher raw material cost owing to unfavourable product mix and operating expenses. PAT decreased by 56% y-o-y to Rs 14 crore due to poor operating performance, higher interest rates and depreciation as the company is carrying out capacity expansion in its manufacturing plants. However, sequentially the performance has improved as the company has reported a net profit vs loss of Rs 3 crore in Q2FY23.

Key positives

- Healthy demand for RAC components supported revenue growth for the quarter.
- Mobility, electronics and motor divisions reported strong revenue growth.
- Capacity expansion in Chennai, Pune, Sri city and Pant Nagar is on track.

Key negatives

- Share of RAC - finished goods is declining in the total revenue, which led to margin compression.
- Sub-assemblies have a lower margin as compared to other components.
- OPM fell y-o-y by 173 bps.
- Sharp increase in interest cost and depreciation weighed on profitability.

Management Commentary

- In the past few quarters, the contribution of finished goods RAC to total revenue has substantially come down. In the long term, the company expects RAC and non-RAC (components, sub-assembly and other divisions) to be 40:60.
- For RAC business, Q3 was a muted quarter wherein October/November witnessed a slowdown and the demand has started picking up from mid-December.
- Amber refrained from giving EBITDA margin guidance for the coming years. However, it indicated that it could post 30% y-o-y growth in absolute EBITDA for FY24E onwards.
- The company is expanding for heat exchangers, and compressor parts for refrigerators and Capex would be Rs 650 crore for FY23. For FY24, Amber plans to incur capex of Rs 200-250 crore.
- The company has gross debt of Rs 1,350 crore and net debt of Rs 900 crore. The company expects net debt to come down to Rs 450-500 crore by FY23.

Revision in estimates – We have tweaked our estimates downwards for FY2023-FY2025E to factor in margin pressure and low profitability in the near term.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 2,360: Despite the structural change in the RAC industry wherein brands are resorting to in-house manufacturing of finished goods, Amber is well-placed to capture incremental demand accruing from components ecosystem development. However, we reckon that decreasing share of RAC finished goods may alter the margin profile of the company for a brief period till non-RAC components gain scalability. The management remains optimistic about growth in components (including mobility, electronics, and non-RAC components), new customer additions as well as exports in the next 3-4 years. Further, under penetration of RAC, rising temperatures in India, changing lifestyle patterns and increasing contribution from Tier II,III,IV cities would drive the RAC industry growth and benefit Amber, indirectly driving demand for its components. The stock has corrected sharply from its peak levels due to changes in its business structure and low profitability. Therefore, at current price levels, risk-reward looks favourable. We maintain Buy with a revised price target (PT) of Rs. 2,360, valuing the stock on September FY2024E EPS.

Key Risks

1) Increase in the revenue share of RAC components vs finished goods may impact margin. 2) Increase in the share of exports to total revenue exposes the company to currency risk.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	4,206	6,201	7,892	9,534
OPM (%)	6.5	5.7	5.8	6.0
PAT	109	114	171	252
Growth (%)	33.3	4.8	50.0	47.3
EPS (Rs.)	32.3	33.8	50.8	74.8
P/E (x)	62.6	59.7	39.8	27.0
EV/EBITDA (x)	43.1	34.3	26.7	21.5
RoCE (%)	7.9	8.4	10.0	12.2
RoE (%)	6.5	6.4	8.8	11.7

Source: Company; Sharekhan estimates

Robust sales growth but lower profitability

Amber Enterprises' (Amber)'s Q3FY2023 performance was above our expectations on the revenue front. However, OPM and net profit missed estimates by a wide margin. Sales grew by 38% y-o-y to Rs 1,348 crore. The sales were driven by the components division, which is growing at a faster pace, and the growth is fuelled by a strong order book, new customer addition and expansion in newer geographies like Sri City and Chennai. Operating profit grew by 6.6% y-o-y to Rs 79 crore while operating margin remained under pressure and came lower at 5.8% (down 173 bps y-o-y) due to higher raw material cost owing to unfavourable product mix and operating expenses. PAT decreased by 56% y-o-y to Rs 14 crore due to poor operating performance, higher interest rates and depreciation as the company is carrying out capacity expansion in its manufacturing plants. However, sequentially the performance has improved as the company has reported a net profit vs loss of Rs 3 crore in Q2FY23.

RAC components and other business divisions would drive growth

The management expects RAC demand to pick up in Q4FY23, given the onset of the summer season. The company would also be present in South India, with its Sri City unit getting operational in FY2023. Amber has carried out multiple acquisitions in the recent past, which have strengthened its product offerings in electronics, motor and mobility. The share of components in total revenue is likely to increase as compared to finished goods as most of its customers are now manufacturing a finished product in-house. Amber is also focusing on augmenting exports for various components and expects strong traction in FY2024 as well. This shall help the company combat the seasonal nature of domestic RAC and component sales.

Q3FY2023 investor update and conference call highlights

- **Change in the manufacturing landscape would bring change in revenue mix:** In the past few quarters, the contribution of RAC- finished goods to total revenue has substantially come down. The majority of the RAC brands have resorted to in-house manufacturing of finished goods and are doing different levels of backward integration. This has led to declining in finished product demand from these brands. On the other hand, a requirement for components has increased and brands prefer component manufacturers like Amber having a PAN India presence. Hence, the company has scaled up its component capacities in its plant in Chennai, Pune, Sri city and Pant Nagar. However, the company is confident of maintaining 26-28% market share in the manufacturing footprint of RACs. In the long term, the company expects RAC and non-RAC (components, sub-assembly, and other divisions) share in total revenue to be 40:60.

- **Performance of RAC components division:** The RAC component sales have increased to Rs 1,137 crore vs Rs 545 crore in Q3FY23. For 9MFY23, revenues grew by 78% y-o-y to Rs 2,822 crore. The growth was led by a strong order book, new customer additions and expansion in its Chennai, Pune and Pant Nagar plants. For RAC business, Q3 was a muted quarter wherein October/November witnessed a slowdown and the demand has started picking up from mid-December. The company expects good numbers in Q4FY23 owing to summer season-led demand beginning from mid-February.

- **Electronics division update:** The electronics division including its subsidiaries- ILJIN and Ever Electronics, reported revenue of Rs 710 cr (+91% y-o-y) during 9MFY23. The company has entered into hearables & wearables, and other communication equipments. OPM for 9MFY23 was at 4.2% vs 3.2% in 9MFY22. The company is in advanced discussions with new customers in the telecom sector and has expanded the manufacturing footprint of the electronic division with the new facility in South India. This division is expected to grow by more than 50% y-o-y in FY2024.

- **Mobility division update:** This division includes its subsidiary - Sidwal and its revenue for 9MFY23 stood at Rs 310 crore (+50% y-o-y). The government's thrust on modernisation of railways is providing positive traction for this division. Apart from railways, all other segments of the mobility division, such as metros, defence, precision air conditioning for telecom, are on strong footing. The order book for the segment stands at Rs. 700 crore.

- **Motor division update:** Motor division revenue during 9MFY23 stood at Rs 202 crore (+30% y-o-y). OPM for 9MFY23 stood at 12.8% vs 10.2% in 9MFY22. The company received BLDC motor approvals from a few customers. Exports approval from the customers is in process and the company expects to receive large orders in FY24. The strong order book with new product addition and geographical expansion should lead to more than 30% growth for FY23, while the exports from this division should grow by 30-40% in FY24.
- **Capex guidance:** The company is expanding its four new facilities for components, heat exchangers, compressor parts for refrigerators; etc and capex would be Rs 625- 650 crore for FY23. For FY24, the company plans to incur capex of Rs 200-250 crore.
- **Capacity utilization:** The capacity utilization of new plants would be 25% and next year is expected to be ~50% . Currently, the motor division has a utilization of 50% and room AC is at 25-30% and some old plants are at 75-80% utilization levels.
- **EBITDA guidance:** The company refrained from giving EBITDA margin guidance for the coming years. However, it indicated that it could post 30% y-o-y growth in absolute EBITDA for FY24E onwards.
- **Debt status:** The company has gross debt of Rs 1,350 crore and net debt of Rs 900 crore. The company expects net debt to come down to Rs 450-500 crore by FY23 end as it expects inventory to be depleted in Q4FY23 given the onset of summer. Its cash flow from operations was Rs 150 crore, including other income.
- **Increase in finance cost and depreciation:** The increase in finance cost and depreciation is largely due to capex incurred in the past and an increase in interest rates.
- **Margins are low in Sub-assemblies:** Sub-assemblies have many components that pass through and therefore, margins are lower than the standard margin of 8-10% in components.
- **Industry inventory levels:** Following the implementation of BEE norms, all brands have taken price hikes in the range of Rs 1,200- 1,300 per unit. The industry was optimistic for Q3 which turned out to be a muted quarter and therefore, inventory levels are currently higher for some of the brands.
- **Asset turnover:** As far as peak revenue is concerned, the company indicated that it can achieve 5x gross block turnover.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Sales	**1,348**	**974**	**38.4**	**750**	**79.7**
Operating Profit	**79**	**74**	**6.6**	**37**	**114.1**
Depreciation	36	27	34.1	32	14.2
Interest	29	12	134.8	24	18.7
Other Income	9	9	3.7	12	-26.6
PBT	**22.2**	**42.8**	**-48.2**	**-7.3**	**NM**
Tax	7.1	9.9	-27.9	-5.0	NM
Reported PAT	15.1	32.9	-54.2	-2.3	NM
Minority Interest	-0.9	-0.8	12.8	-0.7	NM
Adjusted PAT	**14.2**	**32.1**	**-55.9**	**-3.0**	**NM**
Adjusted EPS (Rs.)	**4.2**	**9.5**	**-55.9**	**-0.9**	**NM**
Margins			**BPS**		**BPS**
OPM (%)	5.8	7.6	*-173*	4.9	*94*
NPM (%)	1.1	3.4	*-226*	-0.3	*142*
Tax Rate (%)	32.1	23.1	*901*	-	*NM*

Source: Company; Sharekhan Research

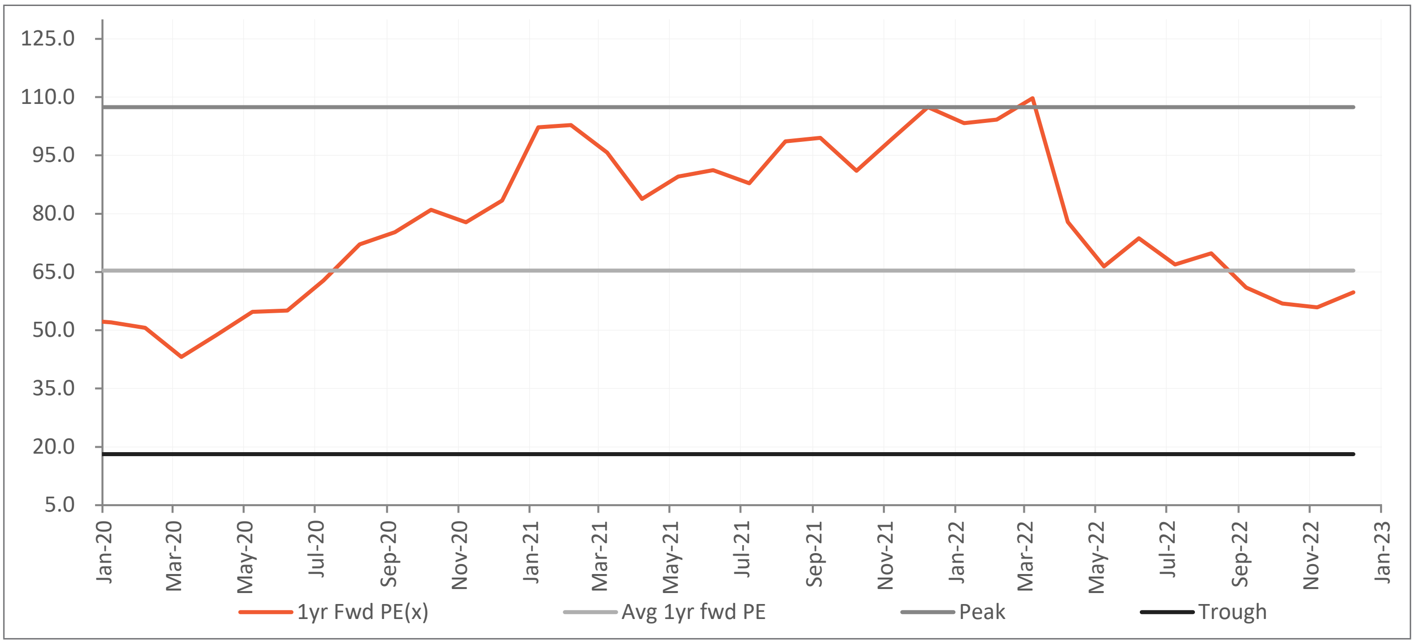
Outlook and Valuation

■ **Sector View – Demand outlook encouraging, healthy growth prospects:** The air-conditioner industry is well poised for growth, given a strong pent up demand post-two-year lull. Further, increasing disposable incomes, upgrade in lifestyles, and rising temperatures are the structural growth drivers. Moreover, owing to a shift in manufacturing base outside China and the government's incentives to enhance manufacturing through the Make in India initiative, there are enormous opportunities for well-integrated players such as Amber Enterprises. An enhanced capacity and wider product offerings, and customer penetration are likely to drive the company's performance in addition to a healthy demand outlook for the electronics outsourcing industry.

■ **Company Outlook – Long runway for growth:** Amber is well-placed to capture incremental demand accruing from the indigenisation of both fully built-up units and components ecosystem development through reduced imports. It will also be a key beneficiary of recently-announced PLI schemes for AC and components. The company is expanding capacity through two greenfield projects, one in Supa, Pune and the other in Chennai. Management remains optimistic about export prospects for fully built-up units and components that can potentially emerge over the next 3-4 years. Overall, the outlook remains optimistic, with the management confident of capturing opportunities with better volumes offtake despite short-term challenges, such as supply chain issues and a spike in raw-material prices.

■ **Valuation – Retain Buy with a revised PT of Rs. 2,360:** Amber is well-placed to capture incremental demand accruing from the indigenisation of both fully built-up units and components ecosystem development. Demand is primarily being led by PLI schemes and the need to reduce dependency on imports of AC components to tackle supply chain constraints and become self-sufficient. The management remains optimistic about growth in components (including mobility, electronics, and non-RAC components) as well as exports in the next 3-4 years. Further, under penetration of RAC, rising temperatures in India, changing lifestyle patterns and increasing contribution from Tier II,III,IV cities would drive the RAC industry growth and benefit Amber. Overall, we believe the company's strong long-term prospects as an all-around player in the AC space will be driven by expanding its customer base and widening product supplies aided by recent acquisitions. The stock has corrected sharply in the recent past and we believe near-term margin pressure is largely factored in. Hence, we maintain a Buy with a revised price target (PT) of Rs. 2,360, valuing the stock on September FY2024E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Incorporated in 1990, Amber has emerged as a market leader in the Indian Room AC OEM/ODM industry. The company's comprehensive product portfolio includes room AC (Indoor and Outdoor units and window ACs) and reliable critical components, which have a long approval cycle. The company is one of the largest manufacturers and suppliers of critical components such as heat exchangers, PCBs, motors, sheet metal, case liner etc., of RAC and other consumer durables such as refrigerators and washing machines. Amber has emerged as a market leader in the Indian RAC OEM/ODM industry with more than 70% market share and 26.5% market share in the overall RAC market in FY2022. The company has 15 manufacturing facilities located close to customers, enabling faster turnaround. It also has high degree of backward integration coupled with strong R&D capabilities, resulting in a high proportion of ODM. The company has been serving most customers for over five years and has a marquee customer base, as eight out of top 10 RAC brands are its clients.

Investment theme

Amber Enterprises has a market leadership position in the OEM/ODM segment for branded room ACs. Moreover, the opportunity size seems to be increasing as OEM players are now more focused on innovation and marketing side of the business and relying on outsourcing for manufacturing of their products. We believe that enormous growth opportunities would come across going forward owing to global players shifting their manufacturing base outside China and the Government of India to enhance manufacturing through the Make in India initiative by providing incentives. Further, Amber remains a strong beneficiary from recently announced PLI schemes for AC and components. A healthy demand outlook for the electronic outsourcing industry and enhanced capacity, increased product offerings, and customer penetration are likely to drive the company's performance.

Key Risks

- Lower demand offtake due to economic slowdown might impact revenue growth momentum and raw-material price volatility and forex rate fluctuation can impact profitability.
- Lack of diversified revenue base in terms of product categories and high revenue concentration with few customers pose a threat to revenue.

Additional Data

Key management personnel

Jasbir Singh	Executive Chairperson and CEO
Daljit Singh	Executive Managing Director
Sudhir Goyal	Chief Financial Officer
Konica Yadav	Company Secretary and Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Ascent Investment Holdings	9.76
2	Kotak Mahindra Asset Management Co Ltd	4.99
3	Goldman Sachs Group Inc	3.47
4	ICICI Prudential Life Insurance Co Ltd	3.23
5	Vanguard Group Inc	2.13
6	Goldman Sachs Fund	1.38
7	L&T Mutual Fund Trustee Ltd	1.25
8	Newport Asia Institutional	1.18
9	Fundrock Management Co Sa	1.1
10	Fidelity International Ltd.	0.83

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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