AMARA RAJA

Gotta be a better way

From : 10-03-2014

To : 31-08-2017

Performance : 115%

Recommendation : OPEN

Background & Business

AMRJ is 2nd largest automotive battery manufacturer & largest supplier of industrial storage batteries in India. It is a JV between Galla family and global battery major – Johnson Controls (JCI) with both owning 26% each. The partnership with JCI lends the business with critical technology advantage. It has many firsts to its credit - having introduced VRLA (valve-regulated lead acid) batteries for the 1st time for industrial applications and 2Ws. In the automotive segment too, it was first to introduce batteries with 5-year warranties and zero maintenance fully charged batteries. These initiatives, along with witty advertising, unique franchisee based distribution model and operational efficiency leading to competitive pricing propelled its market share across segments bridging the gap at frenzied pace with market leader – Exide.

Investment Thesis

The Indian lead-acid battery industry is a duopoly with 2 large players – Exide & Amara Raja. ***Over the last few years, Amara Raja has upped its ante and has reported steady market share gains across the automotive and industrial battery segments; mainly at the cost of Exide.*** At the same time, the company has been expanding capacities well in time to support this growth. FY17 however, witnessed sluggishness in demand conditions with growth slowing down in auto after-market (from high teens to low single digits) and the industrial batteries witnessed severe pricing pressures led by Jio's disruptive entry in the telecom sector. To sum it up, ***automotive battery which forms 60% of Amara Raja's revenues is expected to grow at ~18% CaGR, led by steady market share gains in auto after-market and new client additions such as Hero Motocorp in the auto OEM segment.*** The auto after market segment being a duopoly continues to see pricing discipline with both Exide and Amara Raja taking commensurate price increases from time to time. The auto OEM segment also has a raw material pass through clause, which though is effective with one quarter lag. As a result, ***lead price (single largest contributor of raw material costs; which account for the most @65% of sales) increase is a pass through in the automotive battery business and hence we expect EBITDA margins in this segment to be in the range of ~15% of net sales***. The industrial segment (~40% of Amara Raja's revenues) off which telecom accounts for ~65%, has witnessed sharp erosion in EBITDA margins, from high double digits in FY16 to present ~17%. ***The management has guided overall EBITDA margins of Amara Raja in the range of 14-16%. Should the telecom business continue to face pricing pressures, the EBITDA margins could further compress.***

Outlook

We think that the current valuations factor in the overhang of the industrial (telecom) segment. However, from a medium-term perspective, we think that the business continues to have strong merits of brand franchise, industry duopoly leading to pricing power, timely capacity additions to support growth, debt-free balance sheet and healthy free cash flow generation. As a result, we don't see meaningful downside over current levels, unless EBITDA margin stays below the 14% mark for the next couple of quarters. Going ahead, AMRJ is looking at enhancing its capabilities in solar power segment and increasing its presence in the e-rickshaw segment, which is a Rs.15-20bn market. It is also looking to explore the lithium battery space. Though lithium ion is not currently included in its JV with Johnson Controls, it is very likely that AMRJ with its JV partner will explore advancements in this space. In fact should the terms of the JV re-work to include the lithium-ion batteries as well, it will be a meaningful business development. We would be monitoring the growth and EBITDA margin profile very closely and re-look our estimates accordingly.

EQUENTIS

THINKING FUTURE

www.equentiswealth.com