AMARA RAJA

Gotta be a better way

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. Along with witty advertising, unique franchisee based distribution model and operational efficiency leading to competitive pricing has propelled the company's market share across segments bridging the gap at frenzied pace with market leader – Exide.

From	: 10-03-2014
To	: 31-05-2018
Performance	: 117%
Recommendation	: OPEN

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. However, in last one year, industry witnessed sluggishness in demand conditions with growth slowing down in auto after-market 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 deliver healthy growth led by steady market share gains in auto after-market and new client additions***. 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 healthy EBITDA margins in this segments.*** The industrial segment (~40% of Amara Raja's revenues) of which telecom accounts for ~65%, has witnessed sharp erosion in EBITDA margins, with margin in the segment very low compared to historical levels, ***however the management expects this to gradually improve 14-16%. The management has guided overall EBITDA margins of Amara Raja in the range of 14-16% and would like to remain on the upper range of this bracket.*** AMRJ is also 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.

Outlook

We are of the opinion that the current valuations have already factored in the overhang of the industrial (telecom) segment. Given this, we believe that in the current scenario, revenue visibility on an absolute basis will be limited, which will in-turn limit its scope to expand margins from current levels. However, from a medium to long 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.

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