



**AMARA RAJA**  
Gotta be a better way



Zero  
Maintenance

Higher  
cranking power

60 months  
Warranty



**Amara Raja Batteries Ltd (NSE Code: AMARAJABAT) – Alpha/Alpha  
+ stock recommendation for May'12**

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Dear Members,

Everyone wishes to own a 2-wheeler or a 4-wheeler and every 2/4 wheeler needs a battery. Further, every battery has on an average a life span of 3 years and thus one need to change battery in his/her automobile every 3-4 years.

Similarly, it goes for UPS and their batteries. Thus, manufacturing batteries seems like a good and recurring business and what is most important about batteries industry is its duopoly structure. So why not look at one of the major company that deals in Automotive and industrial batteries.

**Amara Raja Batteries (NSE Code – AMARAJABAT)**, in case the name sets you thinking about this new brand in the segment of batteries apart from the well known Exide and Amaron, it would be interesting to mention here that Amara Raja is the company behind the well known AMARON and QUANTA brand in the segment of automotive and industrial batteries respectively.

Yes, Amara Raja Batteries (ARBL) is the second largest battery maker in India after Exide, and is already challenging Exide's un-disputed leadership in the automobiles battery segment, while commands a leadership position in the Industrial battery segment.

**Before we discuss the finer details, here's a brief snapshot:**

- Market capitalization – Rs 2,550 cr.
- Debt free except for Interest free sales tax deferment loan
- Cash and cash equivalents – Rs 230 cr.
- Average cash flows from operations (post tax) for the last 5 years – Rs 141 cr.
- Average Net profit for the last 5 years – Rs 142 cr.
- Long standing dividend history, with the company adopting 15% annual dividend payout policy

## Investment Snapshot (As on 31<sup>st</sup> May'12)

**Recommendation** – Buy

**Portfolio Allocation Strategy** –

1. Start with ~2% portfolio allocation in the range of 295-305.
2. Increase allocation to 4% in the range of 260-275

**Profit Booking** – Refer Alpha/Alpha + weekly

**Current Market Price** – Rs 300.65

**BSE Code** – 500008; **NSE Code** – AMARAJABAT

**Bloomberg Code** – AMRJ: IN

**Market capitalization** – Rs 2,550 cr.

**Total Equity shares** – 8.54 cr.

**Face Value** – Rs 2.00

**52 Weeks High/Low** – Rs 324/ Rs 179

**Promoter's holding** – 52.06%

## **Amara Raja Batteries Ltd – An Introduction**

Amara Raja Batteries (ARBL), a JV between Galla family and Johnson Controls, U.S., is India's second largest manufacturer in the organized VRLA (valve regulated lead acid) batteries market, finding applications in the automotive and industrial (telecom, UPS, railways, Solar power, etc) segments.

ARBL was set-up in 1985. The company began commercial production in 1992 and got its first bulk order of 200 sets of batteries from the Department of Telecom (DoT) around 1993, followed by a commercial order in 1995. ARBL was the first company in India to launch batteries based on VRLA (Valve regulated lead acid) technology and back in early 1990s DoT was its biggest client.

Realizing the need to diversify and not be dependent on the industrial segment alone for the business, in Dec'97 the company entered into a Joint Venture Agreement with US based **Johnson Controls Inc (JCI)**, the world's largest manufacturer of automotive batteries, to manufacture automotive batteries in India with an advanced technology. Thus, in 2000 ARBL entered the segment of Automotive batteries with the launch of **AMARON** batteries based on **Zero maintenance technology** for the first time in India, the key differentiator in an otherwise cluttered automotive battery market.

Since the company started business by focusing on the industrial segment, it commands a market leadership in Telecom and UPS battery business with 45% and 32% market share respectively.

In the Automotive battery business, Exide commands the leadership position by a wide margin, however it is important to note here that ARBL started with the automotive battery division in 2000-01, while Exide's been in the business since 1950s. In the light of the same, we like the fact that on the back of improved technology and a differentiated distribution strategy, ARBL has been able to garner a market share of 25% in OEM and 30% in after market segment in just 12 years in the organized four-wheeler battery business.

Until 2007-08, the company was not providing batteries in the two-wheeler automotive battery segment; however, since the launch of Amaron Pro Bike Ride brand in the two-wheeler segment in May'08, the company has been able to garner a market share of 25% in the organized replacement battery market, despite the fact that they still don't have any presence in the two-wheeler OEM segment.

We believe, the company's philosophy of pre-empting customer needs and its constant endeavor to redefine products, technology with its JV partner and on its own has helped it earn sizable market share within such a short span of time.

Further, for companies such as ARBL, distribution network plays a vital role in aftermarket automotive batteries sales and Amara Raja has been successful in creating a dominant network (240 franchised distributors, about 18,000 retailers, 800 exclusive retail partners in the PowerZone format spread across semi-urban and rural locations and around 2,000 service hubs) in the automobile battery segment in India and thus carve out a brand equity as strong as market leader Exide Industries (EIL).

### **Johnson Controls Inc.**

Before we proceed with other details on ARBL, it's important to know more about Johnson Controls Inc., being a Joint venture partner with 26% stake in ARBL.

Johnson Controls is the global leader in lead-acid automotive batteries and advanced batteries for Start-Stop, hybrid and electric vehicles.

Company's 50 manufacturing, recycling and distribution centers supply **more than one third** of the world's lead-acid batteries to major automakers and aftermarket retailers. Johnson was also the first company in the world to produce lithium-ion batteries for mass-production hybrid vehicles.

The company has over 162,000 employees worldwide and for FY 2011 it recorded more than \$40.8 billion in sales. The company is currently placed at No. 267 on Global Fortune 500 list.

Amara Raja's association with Johnson Controls has brought in significant competitive advantages to the company in terms of:

- Advanced technology in comparison to peers in all the spheres of lead acid batteries.
- Lead sourcing capabilities
- Ability to launch new products based on advanced technologies such as lithium-ion

## Business Units

ARBL has two strategic business units (SBUs):

1. The Industrial batteries division and
2. The Automotive batteries division

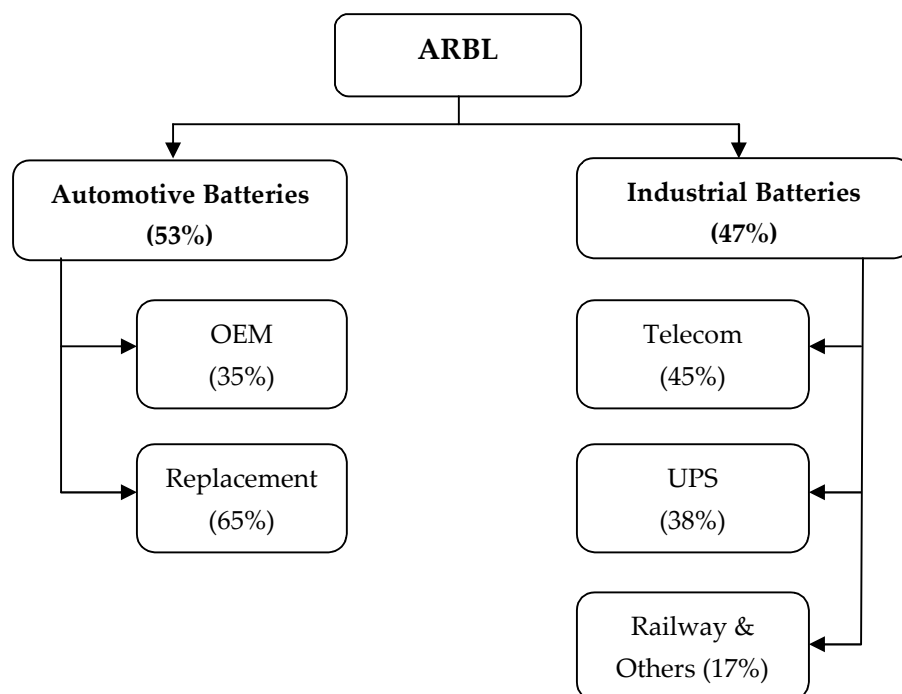
Prior to 2001-02, the company didn't have any presence in the automotive space and was thus susceptible to the vagaries of the demand in the industrial sector, primarily telecom. Realizing the potential of automotive batteries space and the need to diversify in order to achieve stability, ARBL roped in JCI for the manufacturing of automotive batteries.

The automotive batteries business unit commenced operations in 2001 with technology from JCI.

Since the commencement of automotive batteries unit, ARBL has achieved stability and consistency in growth as automotive space is relatively more stable with buoyant aftermarket demand.

Within 11 years, the revenue mix between the two units has changed from 100:0 to approximately 47:53 at the end of FY 11. In case the demand from the telecom space remains subdued (discussed later) for an extended period, it is very likely that the automotive battery division may make up for a greater proportion of the revenue mix in the years ahead.

At the moment the approximate revenue contribution from each division is as follows:



As can be observed above, ARBL has fairly diversified revenue streams and not over-dependent on any one particular sector. The same is very important because both automotive and telecom in particular have had their share of ups and downs and thus over-reliance on any one sector can lead to volatility in the earnings of ARBL, as was the case till early 2000 when the company was solely dependent on industrial batteries division.

### **Automotive batteries division:**

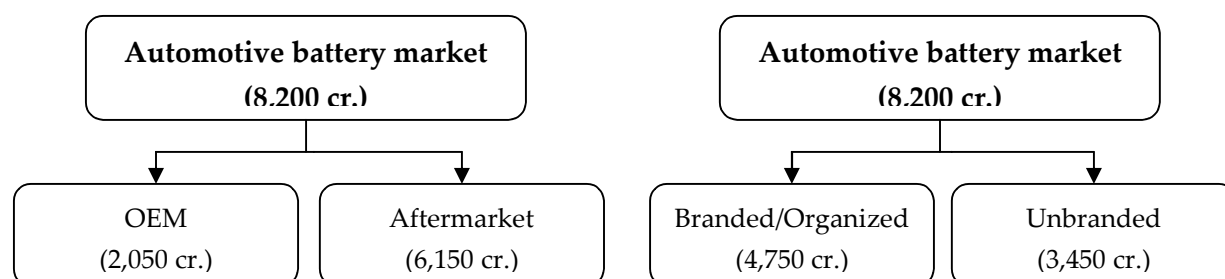
**Brand Equity:** We believe, the automotive battery industry commands high degree of branding power on account of being duopoly in nature with top two players' viz. Exide and Amara Raja controlling ~90% of the organized market. Amongst all the components in the automobile, battery probably commands the highest degree of branding power and its either AMARON or Exide that is preferred by both OEMs and after market customers.

**Competitive Advantages for ARBL:** Advanced technology and the wide distribution network are the two major competitive advantages that have helped ARBL thwart competition and make in-roads in an industry that was solely dominated by Exide.



Further, now that the company has established itself as a well-known brand, it itself acts as a sustainable moat and creates a vicious circle for the company to outgrow competition.

**Sector details and market share:** At Mar'11, the size of the Indian lead acid automotive storage battery was estimated at 8,200 crores. It can further be classified into OEM & Aftermarket, and Branded and Unbranded.



Demand for automotive batteries is divided among different segments, with cars and utility vehicles constituting the largest share of 36%, followed by commercial vehicles at about 28%, 2-wheelers at about 21% and tractors at 15%.

At the OEM level, Exide and AMARON are the only two preferred brands and at the moment there's no scope for unorganized players. In the 4W OEM segment, ARBL commands 25% market share, while its strong association with OEMs and wide distribution network has reportedly helped the company penetrate replacement market segment where it holds 30% market share in the 4W organized segment and overall 18%.

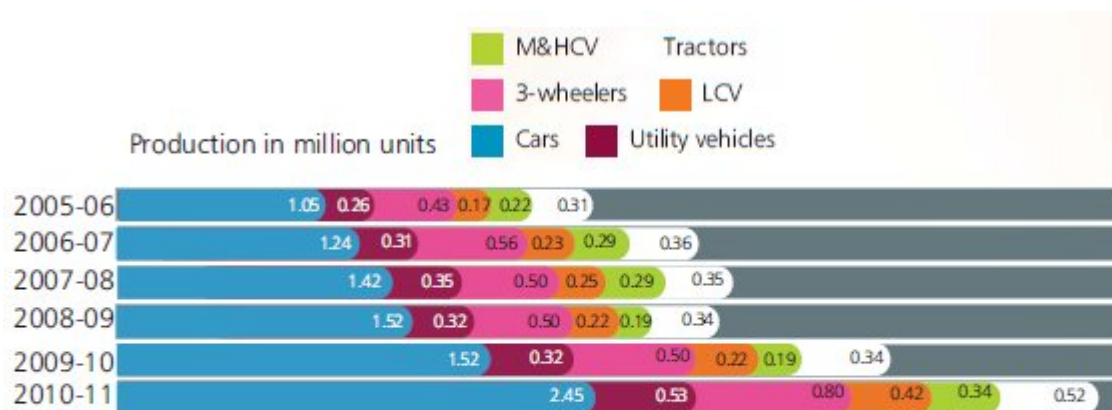
Sales to OEMs are from organized segment, while the unbranded/unorganized players, who sell low-cost products for two-wheelers, commercial vehicles and tractors still account for ~50% of the total sales in the aftermarket.

However, there lies a good opportunity for ARBL (as primarily focused on replacement market) as the share of unorganized manufacturers has been in a downtrend in recent years owing to product unreliability, rising disposable incomes, increasing quality consciousness, environmental restrictions, and technology advancements in the automotive industry.

**Automobile sector growth:** Automotive batteries sales growth is directly proportional to the growth in new vehicle roll-out each year. Roll-out of new vehicles in any year contributes directly to the OEM sales in the first year, while it also adds to the replacement demand over a recurring cycle of 3 years.

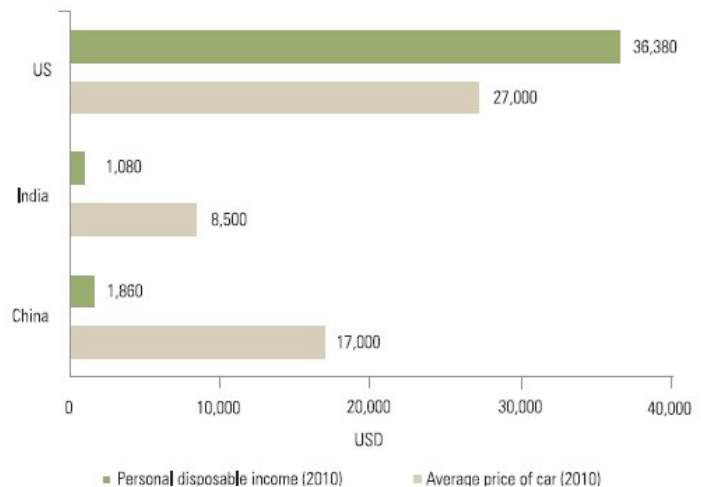
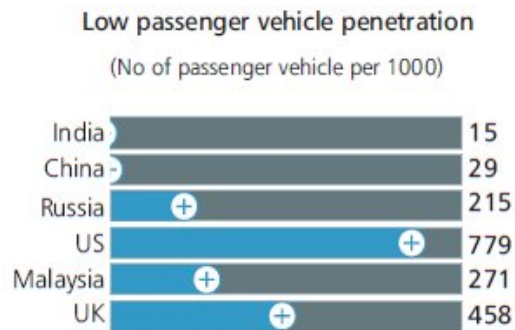
The OEM business is driven by fresh vehicle (4-wheelers and 2-wheelers) demand in any particular year. Aftermarket sales are influenced by the number of vehicles in use, average battery life, average vehicle age and population growth. On an average, a 4-wheeler battery life expectancy is about three years, while 2-wheeler battery life expectancy is around two years.

The automobile (2W + 4W) sector saw a 9% volume CAGR over five years (2005-06 to 2009-10), while 4-wheeler OEM sales grew about 13% CAGR between 2005-06 and 2009-10.



CAGR for the last five years (2005-06 to 2010-11): Car – 18.6%, UV 15.2%, 3W – 13%, LCV – 18.9%, M&HCV – 9.4% and Tractor – 10.8%

Though OEM sales have slowed down since the last 1 year on account of various micro and macro economic factors, in the longer run the twin factors of increasing affordability and low penetration are expected to help sustain double digit growth for the next 5 years in India’s automobile demand.



Source: KPMG Research, EIU

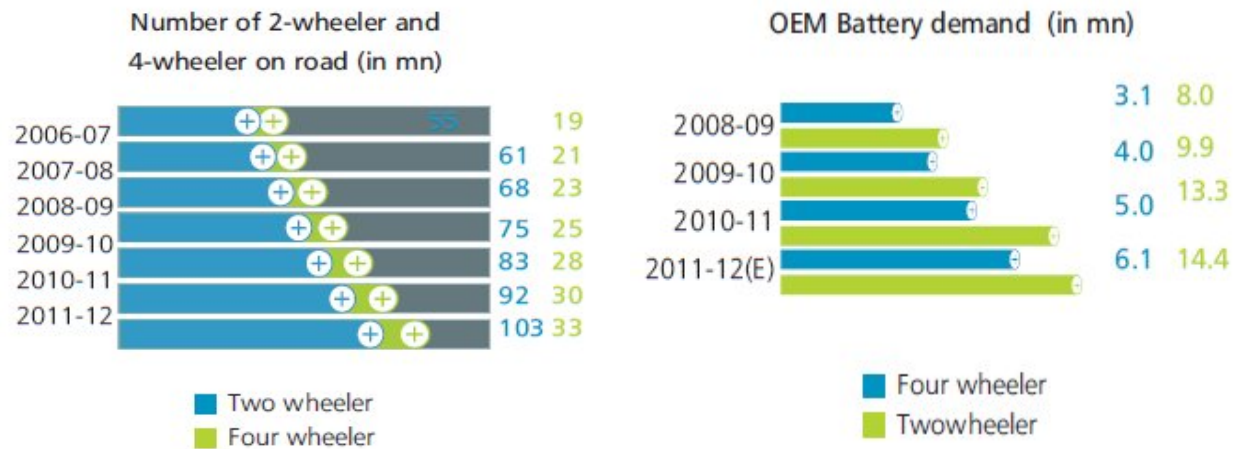
Yes affordability has improved several folds on account of various below mentioned reasons and is one of the key reasons driving automobile demand in India.

- Rising prosperity
- Favorable demographics with a predicted increase in working-age population
- Easier access to finance
- Growing competition with continuously improving price-value proposition for customers

The average salary of middle income group has increased substantially over the years while the advancement in technology has enabled the companies provide an improved product at a cost marginally higher than what they used to quote several years back and thus buying 2-4 wheelers is within the reach of larger share of population in India.

Strong replacement market is another positive for battery manufacturers. Consider this, at the end of FY 03, there were 6.7 crore registered vehicles in India while the number of registered vehicles are expected to have crossed a mark of 13.5 crore at the end of FY 12.

Since the average life span of battery ranges from 2-4 years and since the battery replacement decision cannot be deferred, companies like Amara Raja are expected to benefit immensely from the ever increasing number of registered vehicles on the Indian roads.



Further, it is important to note here that replacement market has much better margins in comparison to sales to OEMs and is relatively insulated from interest rate cycles.

As per the recent report by ICICI, they estimate overall automotive battery demand to increase at a CAGR of ~16.4% over FY11-14E and touch ~63 million units.

The OEM demand is expected to be ~26 million units while the replacement demand has been estimated at ~37 million units by FY14. They expect domestic auto sales to remain structurally robust and witness ~13.5% CAGR during FY11-14E.

Replacement demand	CAGR (14E-11)						
(mn units)	FY09	FY10	FY11	FY12E	FY13E	FY14E	
Passenger vehicles	2	3	3	4	5	6	19.2%
Commercial vehicles	1	1	1	1	1	2	16.4%
Three wheelers	1	1	1	1	1	2	16.9%
Two wheelers	12	15	17	20	21	28	18.8%
Total*	15	20	22	26	29	37	18.7%
<b>OEM demand</b>							
(mn units)							
Passenger vehicles	2	2	3	3	4	4	13.0%
Commercial vehicles	0	1	1	1	1	1	19.0%
Three wheelers	0	1	1	1	1	1	14.3%
Two wheelers	8	11	13	16	18	19	13.3%
Total	11	14	18	21	24	26	13.5%
Overall auto demand	26	34	40	47	53	63	16.4%

**Pricing power:** Being a renowned brand in a sector dominated by only two players controlling 90% market share, lends pricing power to the company.

Therefore, in the automotive battery space, Amara Raja is able to pass on the rise in input costs, primarily lead, in the replacement market. With OEMs, it has a “**lead pass through agreement**”. These contracts are linked to LME prices, such that a rise in cost of production due to lead is passed on to OEMs with a lag of 3 months.

**Capacity expansion:** In order to stay ahead of demand and gain access to larger market share in both OEM and replacement market, the company has been judiciously expanding its capacity.

During FY 12, in the automotive battery space the company enhanced its 4-wheeler and 2-wheeler battery capacities to 5.60 million units per annum (4.2 million units p.a. at the end of FY 11) and 4.80 million units per annum (3.6 million units p.a. at the end of FY 11) respectively.

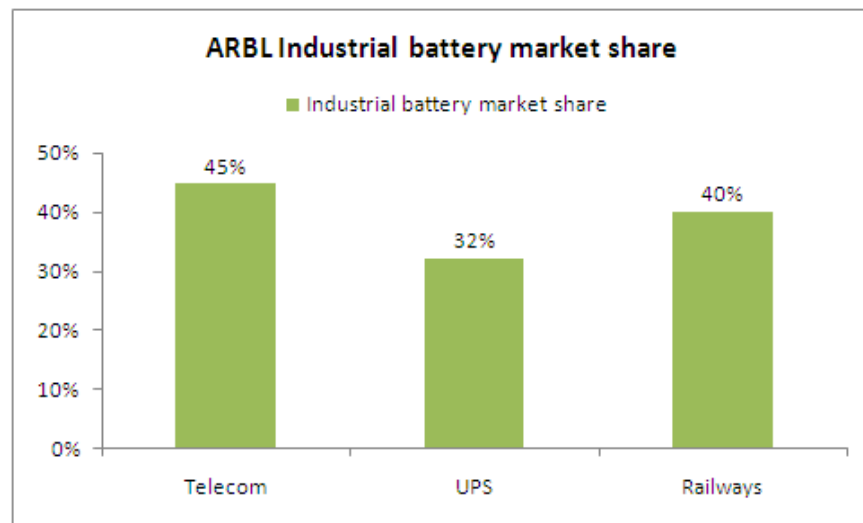
For FY 13, the management has already guided for enhancing the capacity of 4-wheeler batteries to 6.0 million units per annum.

### Industrial batteries division:

ARBL started with industrial battery business in 1991-92 and was the first company to introduce VRLA battery technology in India.

Basically, the company could seal its place in the India market on account of its vastly improved product line and still continues to dominate the market.

The company caters to the requirements of telecom, UPS back-up systems, railways, solar power and power utility sectors. In the telecom sector, the batteries support switches and transmission (wire line and wireless) networks; the Indian Railways use batteries in coach air-conditioning; the batteries also support the transmission and distribution networks of power stations. The UPS batteries support IT and ITES operations as part of UPS systems that regulate power supply to critical equipment during voltage fluctuations.



In the telecom space, its key customers include Indus towers, Bharti Airtel, GTL, VIOM networks, Tower vision, etc. Further, Bharti Airtel has chosen to partner with ARBL as its preferred vendor for Africa network expansion programs.

Though sales to Indian Railways constitute a small portion of the overall industrial batteries business, ARBLs products are used in more than 40% of II and III tier air-

conditioned coaches; they also support train lighting, and signaling and telecom (S&T) power supply solutions (*Source: Company*)

In the medium VRLA segment for commercial UPS applications (BIFS sector, Government sector, IT/ITES, etc) the company enjoys long-term supplier relationship with national OEMs such as Emerson, Numeric, Delta, DB Power, Tritronics and Uniline.

**Telecom battery business:** Though ARBL continues to be the preferred vendor to all the major telecom infrastructure and service providers, the last 2 years have been tough on the telecom battery division with significant pressure on pricing during the last 2 quarters of FY 11.

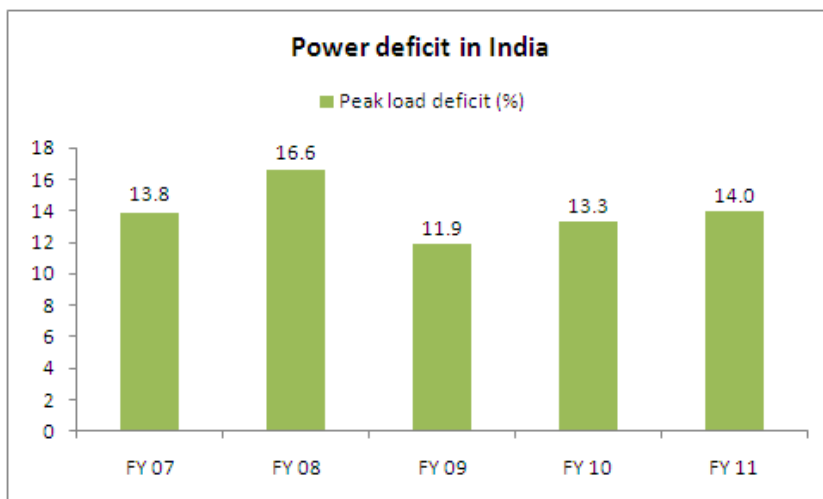
Since then the prices in the telecom battery space have bottomed out and the customers are now negotiating directly with the preferred vendors as against the previously followed norm of reverse auction mechanism, where the lowest bidder used to get the orders. Here again ARBL is being preferred on account of its technologically advanced product line.

As far as growth in the telecom battery space is concerned, the management is hopeful of maintaining low double-digit volume growth against expected industry growth of 6-8% on account of its preferred vendor status with most of the service providers and tower companies, network expansion in Africa (comparatively much higher market share in Africa) and impending replacement demand.

However, to account for any unforeseen slowdown, the company has been working on ways to make Large VRLA capacity more flexible so that it can cater to segments other than telecom and thus maximize capacity utilization.

**UPS battery business:** Despite slowdown in telecom battery business, ARBL has been able to sustain ~15-20% volume growth in industrial battery division on account of robust demand for UPS batteries.

Plagued by the perennial problem of power deficit, power backup market in India is growing at an annual rate of 15-20% varying within the four different segments namely generators, UPS, inverters and batteries.



Extensive computerization of banking and government departments, robust growth of IT/ITES sector in India, rapidly expanding ATM network and persistent power shortage is expected to help sustain 15% annualized growth for UPS batteries during the next five years.

In UPS battery business, ARBL has been able to build a brand out of its "QUANTA" batteries and thus leads Medium VRLA (for commercial UPS applications) product segment with ~32% market share. The demand for company's batteries has been very robust and therefore ARBL has been consistently achieving 90-95% capacity utilization on expanding capacity base.

As per the management, more than 30% of the current market requirement is still met by imports from China and South East Asian countries; however their share is rapidly declining on account of inferior quality and lack of after sales service.

Thus, besides a gradual expansion in market size, declining share of unorganized players lends forward a huge opportunity for companies such as ARBL to consistently grow at 18-20% and outpace industry growth rate.



## Brand building

	Advertizing cost (cr.)	Commission on Sales (cr.)	Sales Expenses (cr.)	Total Sales & Advertizing Expense (cr.)	Net Revenue (cr.)	Adv. & Sales cost as % of revenue
FY 01	0.16	1.03	1.98	3.17	125.93	2.52%
FY 02	0.03	0.77	2.66	3.46	151.85	2.28%
FY 03	0.91	0.83	3.09	4.83	160.73	3.01%
FY 04	9.98	0.83	4.37	15.18	163.64	9.28%
FY 05	7.11	0.78	3.53	11.42	219.98	5.19%
FY 06	10.04	0.96	4.40	15.40	363.25	4.24%
FY 07	10.04	1.42	8.24	19.7	596.38	3.30%
FY 08	18.50	2.00	12.40	32.9	1085.33	3.03%
FY 09	17.83	2.35	19.84	40.02	1315.18	3.04%
FY 10	13.55	3.66	18.31	35.52	1466.63	2.42%
FY 11	10.29	2.65	20.07	33.01	1763.38	1.87%

As can be observed above, till 2003 the company wasn't spending much on brand building and advertisements, given the fact that it was primarily into B2B operations.

However, as the share of automotive battery business gained traction, the company increased its expense on advertizing 10 fold from 0.91 crore to 10 crores.

ARBL derives 65% of its automotive batteries sales from replacement market and in the replacement market the demand for batteries is to a certain extent driven by brand building and thereby advertizing.

ARBL didn't build its brand on the basis of advertizing alone, however it played a significant role in creating space for AMARON in the minds of customers. The other important factors being:

**Setting up wide distribution network** – A wide distribution network creates easy accessibility and serviceability of the product.

**Vendor association with all the major OEMs** – Any automobile is factory fitted with a battery and thus when a customer replaces a battery after 2-3 years; the performance of the original battery plays a key role in decision making.

An important point to be noticed from the above illustration is that ARBL spent around 50% more on advertizing and sales in FY 11 that it did in FY 07. However, during the same period the turnover of the company has improved by 200% with increasing contribution from automobile battery business.

Well this is how it is with good brands; beyond a certain point they create a positive feedback look without company having to do much on enhancing the brand equity.

### Performance Snapshot

Particulars (In cr.)	2012	2011	2010	2009	2008	2007	2006
Net Sales	2371.03	1763.38	1466.63	1315.18	1085.33	596.38	363.25
Operating Profit	357.66	259.7	289.48	169.25	179.17	83.15	47.6
Operating Profit Margin (%)	15.08%	14.73%	19.74%	12.87%	16.51%	13.94%	13.10%
Interest	4.05	2.39	7.92	20.1	14.43	4.73	2.83
Depreciation	46.47	41.71	42.94	34.56	24.45	17	14.7
Profit Before Tax	318.64	220.38	254.61	122.65	145.93	71.19	37.32
Tax	103.58	72.28	87.58	42.17	51.57	24.15	13.48
Profit After Tax	215.06	148.09	167.03	80.48	94.36	47.04	23.84
Profit After Tax Margin (%)	9.07%	8.40%	11.38%	6.12%	8.69%	7.89%	6.56%
Cash from Opt.	NA	85.51	214.25	236.36	-17.09	-36.56	26.64
Return on Equity	29.27%	24.89%	35.19%	21.79%	32.72%	21.14%	12.48%

As can be observed from the above illustration, the company's performance has been very good over the years and consistently delivered return on equity in excess of 20% without employing excessive leverage. Ignoring the small base of FY 06, the company has still been able to grow at 23% on annualized basis during the last 4 years and it is important to note here that during the same period both automotive and telecom industry witnessed extreme lows and highs.

Besides, the company achieved the above performance on the back of consistent yet effective capacity expansion, while de-leveraging its balance sheet. Even during FY 12, the company enhanced its 4-wheeler and 2-wheeler battery capacities to 5.60 million units per

annum (4.2 million units p.a. at the end of FY 11) and 4.80 million units per annum (3.6 million units p.a. at the end of FY 11) respectively. For FY 13, the management has indicated enhancing the capacity of 4-wheeler batteries to 6.0 million units per annum.

Despite the above expansion, as at 31st Mar'12, the company continues to be debt free with cash and cash equivalents in excess of Rs 230 crores.

As far as accounting policy of the company is concerned, for FY 2009 the company recorded drop in profits owing to Rs. 32.2 crore provisioning towards cash and notional forex loss on account of sudden depreciation in rupee. It is important to note here that instead of resorting to lenient provisioning allowed under AS 11, the company adopted a conservative approach of charging the entire forex loss in the same year.

Regarding margins, the management expects to sustain operating margins in the range of 15-16%, barring any unforeseen slump in demand. The company recorded ~20% operating margin in FY 10, however in that year company benefitted from extremely low average price for lead, one of the key raw materials, as a fallout of global economic crisis in 2008-09.

### Operating efficiency

	Net Sales (cr.)	Avg. Capital Employed (cr.)	Avg. Working Capital (cr.)	Capital Turnover	Sales to Working Capital	Debt Equity ratio	* Debt Equity ratio
FY 06	363.25	222.97	105.01	1.63	3.46	0.20	0.09
FY 07	596.38	313.14	165.74	1.90	3.60	0.58	0.44
FY 08	1085.33	516.92	307.15	2.10	3.53	0.95	0.81
FY 09	1315.18	670.45	368.62	1.96	3.57	0.70	0.56
FY 10	1466.63	663.24	326.85	2.21	4.49	0.17	0.05
FY 11	1763.38	689.95	352.35	2.56	5.00	0.15	0.04
FY 12	2371.03	824.22	449.04	2.88	5.28	0.10	0.01

\* - On excluding interest free sales tax deferment loan

As can be noticed from the above table, the good point about ARBL's performance has been an overall improvement in operating and capital allocation efficiency.

With every passing year the company has been generating more revenue for every single rupee employed in the business.

Similarly, there's been a concerted effort by the management to optimize working capital requirement of the company as they adopted a policy of 'Cash and Carry' system of sales in the automotive aftermarket. The impact is already evident with a gradual improvement in Sales to working capital ratio from 3.46 in FY 06 to 5.28 in FY 12.

Further, since the company has been generating good cash flows from operations, they have been able to repay all the debts while still carry out requisite expansion every year.

### Capacity and Sales expansion

ARBL's management, led by Mr. Jayadev Galla, business prowess has resulted in significant capacity and sales expansion in both industrial and automotive batteries segment over the years.

Particulars	2011	2010	2009	2008	2007	2006	2005
Installed Capacity (in no.)	10070000	9300000	8800000	5850000	4300000	2900000	1775000
Avg. Installed Capacity (in no.)	9505873	8162000	6535000	4900000	3400000	2600000	NA
Production (in no.)	8188533	6424560	5070387	4194960	3116954	2129491	1230974
Sales (in no.)	8077061	6475396	5029394	4121017	3083573	2117664	1222943
Gross Sales (in cr.)	2076.48	1691.08	1583.95	1349.98	745.10	445.82	268.54

The management's focus on establishing itself as a premium and technologically advanced brand is reaping returns as there's been an increasing trend of shift from unbranded to branded products and ARBL has been successful in capturing a larger share of the unorganized market, while still holding its premium pricing and thereby margins.

Since unorganized segment still constitutes a large share of automotive aftermarket and UPS batteries segment, we believe the above trend will continue for next many foreseeable years.

### Management and Shareholding Pattern

	Mar'12	Dec'11	Sep'11	Jun'11	Mar'11
<b>Promoter and Promoter Group</b>	<b>52.06%</b>	<b>52.06%</b>	<b>52.06%</b>	<b>52.06%</b>	<b>52.06%</b>
India	20.54%	20.54%	20.54%	20.54%	20.54%
Foreign	31.52%	31.52%	31.52%	31.52%	31.52%
<b>Public</b>	<b>47.94%</b>	<b>47.94%</b>	<b>47.94%</b>	<b>47.94%</b>	<b>47.94%</b>
Institutions	25.87%	25.93%	26.01%	25.59%	24.36%
FII	6.22%	6.32%	4.28%	3.45%	2.44%
DII	19.65%	19.61%	21.73%	22.14%	21.92%
Non-Institutions	22.07%	22.01%	21.93%	22.35%	23.58%
Bodies Corporate	2.70%	2.95%	2.83%	2.61%	2.88%
Custodians					
<b>Total</b>	<b>85,406,250</b>	<b>85,406,250</b>	<b>85,406,250</b>	<b>85,406,250</b>	<b>85,406,250</b>

Out of a total Promoter's stake of 52%, both Galla family and Johnson Controls hold 26% each.

Johnson Controls has been one of the most important factors behind ARBL's resounding success during the last 10 years as it has helped the company launch technologically advanced products in the automobiles battery market.

We believe Johnson's 26% stake in the company is significant from various view points:

- First, 26% is a significant stake and thus aligns their interest with the interests of the company.
- Access to advanced technology
- Better Corporate Governance standards – In the past JCI has been named as one of the world's most ethical company, while it was also ranked #1 in Corporate Responsibility Magazine's "100 Best Corporate Citizens" list.

## Dividend Policy

The company has been consistently paying dividends. Further, since 2010 the company has adopted a policy of distributing up to 15% of the profit after tax (PAT) to shareholders. We believe 15% payout is very reasonable as the company has been able to maintain a healthy mix of debt and equity and consistently delivered return on equity in excess of 20%.

## Valuations

		Rs. In Lakhs	
Particulars	As at	As at	
	31.03.2012	31.03.2011	
	Audited	Audited	
<b>A EQUITY AND LIABILITIES</b>			
<b>1 Shareholder's funds</b>			
a. Share capital	1,708.12	1,708.12	
b. Reserves and surplus	80,638.77	62,884.59	
<b>Sub Total - Shareholders' funds</b>	<b>82,346.89</b>	<b>64,592.71</b>	
<b>2 Non-current liabilities</b>			
a. Long-term borrowings	7,847.17	7,010.17	
b. Deferred tax liabilities (net)	2,196.07	2,049.33	
c. Long-term provisions	1,461.73	1,041.66	
<b>Sub Total - Non-current liabilities</b>	<b>11,504.97</b>	<b>10,101.16</b>	
<b>3 Current liabilities</b>			
a. Short-term borrowings	560.42	2,001.04	
b. Trade payables	8,885.02	10,537.91	
c. Other current liabilities	11,245.63	9,679.26	
d. Short-term provisions	20,608.79	14,679.89	
<b>Sub Total - Current liabilities</b>	<b>41,299.86</b>	<b>36,898.10</b>	
<b>TOTAL - EQUITY AND LIABILITIES</b>	<b>135,151.72</b>	<b>111,591.97</b>	
<b>B ASSETS</b>			
<b>1 Non-current assets</b>			
a. Fixed assets	38,609.48	35,262.81	
b. Non-current investments	1,607.56	1,607.56	
c. Long-term loans and advances	961.14	1,259.69	
d. Other non-current assets	11.13	23.70	
<b>Sub Total - Non current assets</b>	<b>41,189.31</b>	<b>38,153.76</b>	
<b>2 Current assets</b>			
a. Inventories	26,661.69	28,469.67	
b. Trade receivables	31,968.33	30,566.24	
c. Cash and cash equivalents	22,921.99	4,511.84	
d. Short - term loans and advances	12,094.39	9,659.51	
e. Other current assets	316.01	230.95	
<b>Sub Total - Current assets</b>	<b>93,962.41</b>	<b>73,438.21</b>	
<b>TOTAL - ASSETS</b>	<b>135,151.72</b>	<b>111,591.97</b>	

ARBL has 8.54 crore shares outstanding. At the current stock price of Rs 300 per share, the stock is quoting at a market cap of Rs 2550 crores, i.e. 12 times trailing twelve months' earnings of Rs 215 crores.

The company is debt free (78 crore outstanding interest-free sales tax deferment loan is a financial incentive by the state of Andhra Pradesh for setting up industry in a backward area. The sales tax collected by the Company in a particular year needs to be paid to the government after 14 years) with cash holdings in excess of Rs 230 crores.

We believe that current valuations are attractive and do not capture expected future growth in earnings.

Amaron, Power Zone and Quanta are all major brands in the automotive and industrial battery segments. Further, on the back of advanced technology and the differentiated distribution strategy the company has been able to convert the industry from Exide's monopoly to ARBL and Exide's duopoly in just 10 years, which speaks volumes of the management's execution ability.

In the long run, the growth outlook for the battery segment is very bright and ARBL has been consistently expanding its capacity and its distribution network in order to sustain the growth momentum.

### **Key investment highlights**

The Indian battery industry commands a certain branding power on account of being duopoly in nature with top players' viz. Exide and Amara Raja controlling ~90% of the organized market. As we see it, amongst all the components in the automobile, battery probably commands the highest degree of branding power.

Further, companies like Amara Raja and Exide are able to pass on the rise in input costs, primarily lead, in the replacement market. With OEMs, they have a "lead pass through agreements". These contracts are linked to LME prices, such that a rise in cost of production due to lead is passed on to OEMs, though with a certain degree of lag.

Strong replacement market is another positive for battery manufacturers. At the end of FY 03, there were 6.7 crore registered vehicles in India while the number of registered vehicles are expected to have crossed a mark of 13.5 crore at the end of FY 12. Since the average life span of battery ranges from 2-4 years and since the battery replacement decision cannot be

deferred, companies like Amara Raja are expected to benefit immensely from the ever increasing number of registered vehicles on the Indian roads.

Even though automobile industry witnessed muted growth in FY 12, over the longer term the industry is expected to maintain the growth rate of ~13-15%. Besides, in the automotive battery business, the unorganized segment still accounts for ~45% market share, however it's steadily declining in favor of organized segment and thus there lies a good opportunity for ARBL.

Similarly in the industrial batteries division, UPS battery segment is expected to grow at 14-15% on annualized basis and there's a fairly large unorganized segment.

What is best about ARBL is its constant search for better technology and these days' customers are willing to shell extra money in the name of advanced technology

### **Risks & Concerns**

For FY 11, ARBL derived ~20% of its revenue from Telecom sector. Off-late ARBL's been witnessing pricing pressure on telecom batteries as the telecom industry is facing a lot of headwinds and the companies are resorting to cost cutting measures such as sharing of towers, thus bringing down the expansion of telecom infrastructure. However, company has still been able to manage low double digit volume growth on account of good order flow from Airtel's expansion in Africa and since the company enjoys the "Preferred supplier status".

Lead accounts for ~85% of the total raw material cost of the company and the prices of lead have been very volatile in the past. Though ARBL enjoys "lead pass through agreements" with OEMs, there's a certain degree of delay before the company is able to pass on the hike to the customers and thus in a year with a sharp increase in prices of lead, the margins of the company can come under pressure.

Lastly, Mr. Jayadev Galla, the Managing Director of ARBL evinced interest in joining politics and this is a much bigger area of concern.



## Katalyst Wealth – Alpha Portfolio



Katalyst Wealth Alpha Portfolio service is focused on helping individual investors/institutions beat market returns by a wide margin without taking large risks through in-depth research, analysis and follow up on the stock.

For more information on Amara Raja Batteries Ltd, discuss with **Ekansh Mittal**

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