

Exide Industries

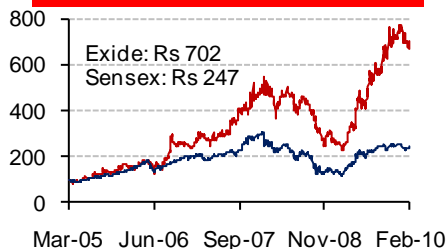
Hold

Target price Rs 138

Market data

Current price	Rs 109 (BSE)
Market cap	Rs 88000 m
Face value	Rs 1.0
FY09 DPS (Rs)	0.6
BSE Code	500086
NSE symbol	EXIDEIND
No. of shares	800.0 m
Free float	51.1%
52 week H/L	Rs 128 /35

Rs 100 invested is now worth



Stock price Performance

	Exide	Index*
6-Mths	24.2%	6.1%
1-yr	202.9%	107.3%
2-yr	23.1%	1.3%

Returns over 1 year are compounded annual averages (CAGR)

* BSE Sensex

Shareholding (Dec-2009)

Category	(%)
Promoters	48.9
Institutions (Banks, MFs, FIs)	19.6
FII's	9.6
Indian public	10.9
Others	11.1
Total	100.0

Report prepared by

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Investment Rationale

- Target price revised:** We last recommended Exide back in August 2009 when the stock was trading at Rs 86 with a target price of Rs 115 from a medium term perspective. Two things have happened since then. One, the company has already met our target price within a time span of few months and secondly, the company's recent quarterly results have forced us to have a relook at our assumptions and subsequently raise our target price. We are of the opinion that Exide's strategy of sourcing some of its lead requirement (lead is the principal raw material of the company and accounts for nearly 60% of its total costs) locally from its recently acquired smelters is likely to bring about a structural change in its operating and net margins. This warrants an upward revision in the company's earnings estimates. The higher earnings translate into higher target price and hence, we recommend investors to HOLD the stock with 2 to 3 year perspective.
- Fully primed up:** Growth in an economy, especially a developing one like India has to be driven by both consumption as well as investment. And there are very few companies who derive their revenues from both. Exide, our stock for this week, is one of the few domestic companies that are favorable positioned to ride the growth wave of both domestic consumption as well as investments. The company plays the consumption story through its exposure to the automotive batteries space where it is a runaway leader, commanding 72% market share in the OEM (original equipment manufacturers) space (all segments put together) and an 80% market share in the branded replacement market.

Although the automotive industry is cyclical in nature, Exide has a cushion in place by way of replacement demand. Auto batteries usually have a life of 2-3 years and this cycle works perfectly for the company as when the OEM demand is in slump, replacement demand takes over and vice versa. Further, with the government putting a few regulations in place with respect to the disposal of lead (lead is a key raw material used in batteries and is environment unfriendly), organised sector players like Exide are gaining market share at the expense of unorganised players and this is also likely to help the company grow its revenues from this segment.

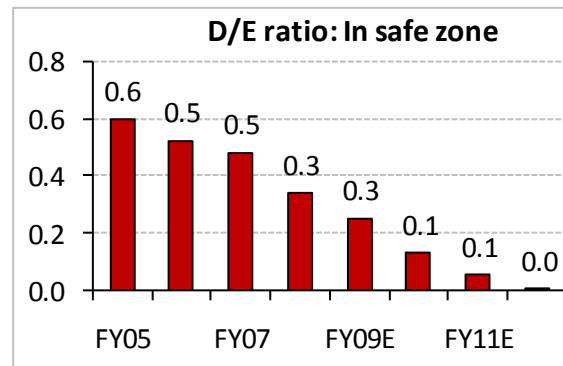
On the investments front, Exide has capitalised on the story by way of exposure to few of the fastest growing segments in the Indian economy currently viz., railways, power and telecom. All these segments are undergoing strong capex cycles with their back up power requirement being met by players like Exide. Furthermore, with strong traction also being observed in the fast moving industrial batteries segment (UPS, Inverters and Traction batteries), we believe the revenues of the company have the potential to grow at our projected average annual rate of 14% between FY09 and FY12.

The same stood at 35% in the preceding three-year period of FY06 to FY09.

- Lead prices starting to behave, finally:** Lead and lead alloys accounted for 50% of the company's revenues in FY09 and 60% of its total costs. Hence, the importance of lead prices to the company's overall profitability cannot be emphasised enough. After wreaking havoc in FY08 and a good part of FY09, lead prices have come off significantly in recent times, thus providing a boost to the company's operating margins. It should be noted that the fall in lead prices was one of the primary reasons behind the company's stellar performance in 1QFY10 where its operating margins expanded by a significant 6.5%. Although prices have started to firm up again, we do not think they would touch the peak of US\$ 2,800 per tonne any time soon (US\$ 1,800 currently) thus boding well for its margins. Further, in order to increase usage of recycled lead, the company has acquired a couple of local smelters recently and this is also likely to lend a helping hand to its margins over the long term. In fact, as per estimates, recycled lead is likely to make up 50% of its total demand for lead as opposed to virtually nothing a couple of years back. These factors put together will likely take up the company's operating margins to 22% in FY10, a good few percentage points higher than FY09. This in turn would provide a boost to its earnings.

- Improved quality of earnings:** Apart from maintaining profitability, Exide has also done well on the capital utilisation front, where a greater focus on cost control and asset sweating, have boosted the return ratios. This has freed up excess cash and has enabled the company to reduce its dependence on the capital markets to fund its needs. Despite the fact that the company has made a couple of acquisitions and has also made a good amount of capex in recent times, the debt to equity ratio has not spiraled out of control and likely to remain so in the medium term.

In fact, as per our projections, the net cash level of the company is only likely to increase, thus improving the quality of earnings. We believe that the company that achieves growth without resorting to excessive debt has a better quality of earnings than the one that uses significant debt to fund growth.



- Insurance foray a positive in the long run:** With a view to park its surplus cash flow, Exide, in July 2005 picked up a 50% stake in ING Vysya Life Insurance Co. for a total consideration of Rs 2.3 bn. Given the tremendous growth potential that exists in the sector and the presence of a partner like ING Vysya, which is well acquainted with the workings of the insurance industry and which has a 26% stake in the entity, we believe that the foray is likely to improve the valuations of the company in the long run. We have valued the company's investments in the insurance venture at Rs 20 per share, arrived on the basis of the new business achieved profits (NBAP) of Rs 15 bn that the company is likely to achieve in FY12.

Investment Concerns

- Threat from cheap imports:** With the worst economic slowdown in recent times gripping the western world, most of the batteries meant for these as also other slowdown hit countries are finding their way into growing economies like India, thus leading to problems for companies like Exide. While we have factored in some impact on the company's sales because of the same, if things turn out worse than expected, it might hurt the growth prospects of the company.
- Technological obsolescence:** As per the company's own admission, lead acid batteries may not be the optimal source of power solutions for major applications in the long term not only due to its inherently polluting nature but also due to shortcomings in physical properties. Against such a backdrop, there is likely to be a shift in the technology and the compounds used for making storage power batteries. If such changes happen fast and Exide is not able to cope up fast enough, it may mean loss of revenues for the company.

Background

Exide is India's largest storage battery company. The company manufactures the widest range of storage batteries in the world from 2.5 Ah to 15,000 Ah capacities, covering the broadest spectrum of applications. Currently, the company has a domestic market share of 45% in industrial, 72% in Auto OEM and 73% in replacement auto. The company being the domestic storage major is also one of the largest power storage solution companies in South-East Asia. It has a technology tie up with Shin Kobe Electric Machinery Co and VRLA batteries and The Furukawa Battery Co.

Industry Prospects

The domestic lead storage battery industry is estimated at around Rs 70 bn and comprises two main segments: Automotive and Industrial batteries. Storage batteries are basically used as a secondary source of power in vehicles and industrial applications. Automotive batteries account for 60% of the total market while industrial batteries contribute the rest. The automobile storage battery industry can be broadly subdivided into two sub-segments: the Original Equipment (OEM) and Retail or Replacement markets.

Unlike the automotive batteries, industrial batteries have a wide range of usage. The industrial batteries market can be broken up into the infrastructure market (railways, telecom and power), submarine batteries and fast-moving industrial batteries (UPS and inverters). Valve Regulated Lead Acid (VRLA) batteries are the most important kind of battery used in the industrial segment. These batteries are completely sealed and maintenance free and are used in remote power and unmanned applications such as telecom installations and in UPS systems. Storage batteries are also used by the Navy for submarines. These batteries are high technology batteries and are even exported from India. While the operating margins are fairly high in the segment, demand is very erratic. With the increasing consumer disposable income and raising technology gap between unbranded and branded products, there would continue to be a steady consumer shift away from the cheaper unbranded batteries.

Note: The company background and the industry outlook have been sourced from the company's recent rights issue document.

Key management personnel

Mr T V Ramanathan, Managing Director & Chief Executive Officer, aged 62 years is a Chartered Accountant and a qualified Company Secretary. His total experience of 39 years includes 15 years overseas of which nearly 5 years was with the World Bank. Before joining his present assignment in 1995, he was with the UB Group and has a wealth of experience in dealing with Financial and Accounting matters.

Mr P K Katakya, B.E. (Electrical), Director-Automotive, aged 59 years, has a wide range of experience in Marketing. His total working experience is 37 years and he has been associated with the battery industry for two decades and as an Engineer has brought to bear his innovative solutions for expanding the reach of the company in automotive batteries after market. He is also a Director of Chloride International Limited, Associated Battery Manufacturers (Ceylon) Limited, Sri Lanka and Tandon Metals Pvt. Ltd..

Risk Analysis

Please see 'Risk Matrix' table on page 5 of this report

Sector: With more and more automobiles plying on Indian roads and with demand for back up power from other segments also remaining robust, we believe the storage battery space will continue to grow at a fast rate over the medium term. As such, we assign a low risk rating to the company on this parameter.

Company standing: With Exide having an industry leading market share in most of the segments that it is present in, we assign a strong rating to the stock on this parameter.

Sales: Exide generated average revenues to the tune of nearly Rs 21.3 bn (US\$ 445 m) each year over the last five years. Further, in the latest fiscal (FY09), the company generated US\$ 706 m in revenues. We thus assign a medium risk rating of 5 to the stock on this parameter.

Operating margin: Operating margin is a measurement of what proportion of a company's revenue is left over after paying for variable costs of production such as raw materials, wages, and sales and marketing costs. A healthy operating margin is required for a company to be able to pay for its fixed costs, such as interest on debt. The higher the margin, the better it is for the company as it indicates its operating efficiency. Exide's average operating margins for the past three years have been 16%,

which we expect to improve to 22% during the next three. As such, we assign a low risk rating of 7 to the stock on this parameter.

Long term EPS growth: Exide has grown its net profits at a CAGR of 41% in the past three years, which we believe was brought about by some strong industry wide tailwinds. Over the next three years however, we expect profit growth to slowdown a bit but still remain an impressive 33%. As such we assign a low risk rating of 9 to the stock on this parameter.

Return on capital invested (ROIC): ROIC is an important tool to assess a company's potential to be a quality investment by determining how well the management is able to allocate capital to its operations for future growth. A ROIC of above 15% is considered decent for companies that are in an expansionary phase. Considering Exide's last three years' average ROIC of almost 30%, we have assigned a low-risk rating of 7 to the stock on this parameter.

Dividend payout: A stable dividend history inspires confidence in the management's intentions of rewarding shareholders. Exide's average payout ratio has been a decent 16% over the past 3 fiscals. Thus, we have assigned a medium-risk rating of 4.

Promoter holding: A larger share of promoter holding indicates the confidence of the people who run it. We believe that a greater than 40% promoter holding indicates safety for retail investors. Promoter shareholding in Exide at the end of December 2009 stood at 49%. As such, we assign a low risk rating of 8 to the stock on this parameter

FII holding: We believe that FII holding of greater than 14% can lead to high volatility in the stock price. The FII holding in Exide at the end of December 2009 stood at 10%. Based on our parameters, the rating assigned is 7.

Liquidity: The average daily trading volumes of Exide's stock over the past 52 weeks stand at nearly 4.1 lakh shares. This level of liquidity level is a matter of comfort, as this might protect the stock from undue volatility in case of exchange of large holdings among market participants/investors. The rating assigned is 9.

Current ratio: Exide's average current ratio during the period FY05 to FY09 has been 1.4 times. This indicates that the company is comfortably placed to pay off its short-term obligations, which gives

comfort to its lenders. We assign a medium-risk rating of 5.

Debt to equity ratio: A highly leveraged business is the first to get hit during times of economic downturn, as companies have to consistently pay interest costs, despite lower profitability. Considering Exide's average debt to equity ratio of 0.4 over the past five fiscals, we have assigned a medium-risk rating of 7 to the stock.

Interest coverage ratio: It is used to determine how comfortably a company is placed in terms of payment of interest on outstanding debt. The interest coverage ratio is calculated by dividing a company's earnings before interest and taxes (EBIT) by its interest expense for a given period. The lower the ratio, the greater are the risks. Exide's average interest coverage ratio has remained 9 over the past three years. With the ratio only likely to further improve from current levels, we assign a low risk rating of 8 to the stock on this parameter.

P/E Ratio: The P/E ratio (price-to-earnings ratio) of a stock is a measure of the price paid for a share relative to the per share income or profit earned by the company. This is one of the important metrics to judge the attractiveness of a stock, and thus gets the highest weightage in our risk matrix. Exide's standalone P/E on trailing twelve month earnings stands at 19 times. As such, we have assigned a high risk rating of 2 to the stock on this parameter.

Considering the above analysis, the total ranking assigned to the company is 78 that, on a weighted basis, stands at 6.2. This makes the stock a medium-risk investment from a long-term perspective.

Valuations

We have used sum of the parts method to arrive at the intrinsic value of the company from a FY12 perspective. We have valued the company's core business using a P/E ratio of 14 times our estimated FY12 earnings. It should be noted that historically, we have valued the company at 12 times price to earnings. However, in view of the company's strong performance in recent years and its efforts at using its capital more efficiently, we have revised the band upwards to 14 times. Thus, the standalone valuation on the company's FY12 EPS works out to be Rs 118 per share. When we further add the valuation of insurance business, which we have worked out as Rs 20 per share on the basis of the projected FY12 NBAP of the insurance company, we get a

composite FY12 target price of Rs 138 per share. On a point-to-point basis, this is 24% higher than the current market price of the company. Alternatively, on an average annual basis, this translates into a gain of 11% per annum and hence, we recommend a 'HOLD' on the stock from a FY12 perspective.

Valuation table

Standalone (Rs m)	FY09	FY10E	FY11E	FY12E
Revenue (Rs m)	33,930	37,728	43,553	50,282
PAT (Rs m)	2,844	4,822	5,710	6,733
EPS (Rs)	3.6	6.0	7.1	8.4
CEPS (Rs)	3.9	5.0	6.2	7.6
Price to earnings (x)	30.9	18.2	15.4	13.1
Price to cash flow (x)	28.0	22.0	17.8	14.5

Risk Matrix

Rating	Weightage* (A)	Rating accorded	
		Rating# (B)	Weighted (A*B)
Sector risk	-	Medium	NA
Company's standing	-	Strong	NA
Performance parameters			
Sales	5.0%	5	0.3
Operating margins	5.0%	7	0.4
Long term EPS growth	10.0%	9	0.9
Return on invested capital	10.0%	7	0.7
Technical parameters			
Dividend payout	5.0%	4	0.2
Promoter holding	10.0%	8	0.8
FII holding	5.0%	7	0.4
Liquidity	10.0%	9	0.9
Safety parameters			
Current ratio	5.0%	5	0.3
Debt to equity ratio	10.0%	7	0.7
Interest coverage ratio	5.0%	8	0.4
P/E ratio	20.0%	2	0.4
Final Rating**		78	6.2

Rating has been assigned on the basis of the company's performance over the past five years and expected performance over the next 3 to 5 years. Rating is on a scale of 1 to 10, with 1 indicating highest risk and 10 indicating lowest risk. * 'Weightage' indicates the relative importance in percentage terms of the parameter. For instance, for an investor, given all the performance metrics, Return on Equity should be the foremost criteria for buying/not buying stocks. ** The final rating has been arrived at by multiplying the rating/points given on each parameter with the respective weightage

Financials at a glance

Standalone (Rs m)	FY09	FY10E	FY11E	FY12E
Sales	33,930	37,728	43,553	50,282
Sales growth (%)	19.3%	11.2%	15.4%	15.4%
Operating profit	5,448	8,300	9,582	11,062
Operating profit margin (%)	16.1%	22.0%	22.0%	22.0%
Net profit	2,844	4,822	5,710	6,733
Net profit margin (%)	8.4%	12.8%	13.1%	13.4%

Balance Sheet

Current assets	7,419	11,656	13,954	17,312
Fixed assets	6,853	7,360	7,515	7,612
Investments	6,682	7,382	9,682	11,982
Total Assets	20,954	26,398	31,151	36,905
Current liabilities	5,278	7,860	9,038	10,399
Net worth	12,504	16,366	20,941	26,335
Loan funds	3,172	2,172	1,172	172
Total liabilities	20,954	26,398	31,151	36,905

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