ENAM Securities
India Research

CMP: Rs 138
Target Price: Rs 161
Potential Upside: 17%
Absolute Rating: BUY

Exide Industries

Relative to sector: Neutral

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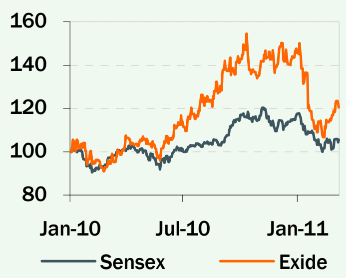
Relative Performance



Source: Bloomberg, ENAM Research

Stock data

No. of shares	: 850 mn
Market cap	: Rs 117.2 bn
52 week high/low	: Rs 180/ Rs 108
Avg. daily vol. (6mth)	: 1.8 mn shares
Bloomberg code	: EXID IB
Reuters code	: EXID.BO

Shareholding (%)		Dec-10	QoQ chg
Promoters	:	46.0	0.0
FIIs	:	15.5	0.0
MFs / UTI	:	5.7	0.0
Banks / FIs	:	10.7	(0.2)
Others	:	22.1	0.1

BUSINESS RECOVERY UNDERWAY

We recently met with the mgmt of Exide Industries to assess the situation post the disappointing Q3 results and changes therein.

Auto Business: Capacity addition to reduce stress

The stress on the auto business (65% of revenues) has been accentuated by the lack of capacities for the replacement market. With ~1 mn increase in capacity (4Ws) in Dec-10 and another 1 mn of capacity expected in Apr-11, we expect the product mix to turn favorable. Additionally, Exide has effected a 5% price hike in Feb-11 to absorb the higher lead costs. We believe the improved product mix along with the price increase should ease margin pressures on the automotive business.

Industrial business remains sluggish on excess capacities

The industrial vertical (~35% of revenues) has been impacted due to: a) excessive capacities in institutional UPS business (~32% of sales); b) slower growth in home UPS segment (~32% of sales) at 5% YoY vs. >25% in H1FY11, due to lesser power cuts in North India; and c) aggressive pricing in the telecom segment (10% of revenues). We understand that the pricing witnessed in Q3 (in telecom) is higher by 10-15% currently and growth in the home UPS business is also recovering. We believe given the surplus capacities across players, profitability for the industrial vertical is likely to remain subdued in the coming quarters.

Profitability set to recover. Maintain BUY rating

We believe that the Q3 performance was a trough in profitability and the business environment has improved. We expect the industrial business to remain a drag on profits, while in auto business we expect a swift recovery. As a result, we expect margins to improve to ~21% in FY12 from 15% in Q3FY11 (already factored into our estimates). Our earnings and TP remains unchanged. Our TP of Rs 161 is based on 16x FY12E standalone earnings of Rs 8.9 + Rs 16/share as value of insurance + Rs 3/share as value of captive smelters.

Financial summary – Standalone

Y/E Mar	Sales (Rs mn)	EBITDA (Rs mn)	Adj. PAT (Rs mn)	EPS (Rs)	Change YoY (%)	Core P/E (x)	RoE (%)	RoCE (%)	EV/EBITDA (x)
2009	33,930	5,448	2,819	3.5	12	-	25	33	-
2010	37,940	8,894	5,370	6.3	79	-	31	42	-
2011E	44,318	8,848	6,048	7.1	13	16.7	24	34	14.5
2012E	52,292	10,862	7,583	8.9	25	13.4	24	35	11.6

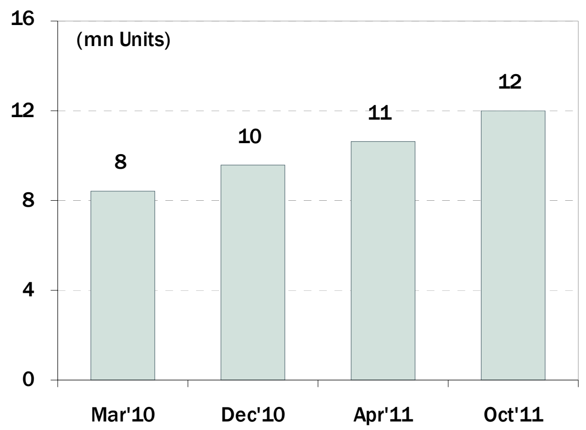
Source: Company, ENAM estimates. **Note: VOI of Rs 19 for insurance biz & smelters adjusted in calculation of core P/E.**

Automotive segment: Capacity expansion to ease woes

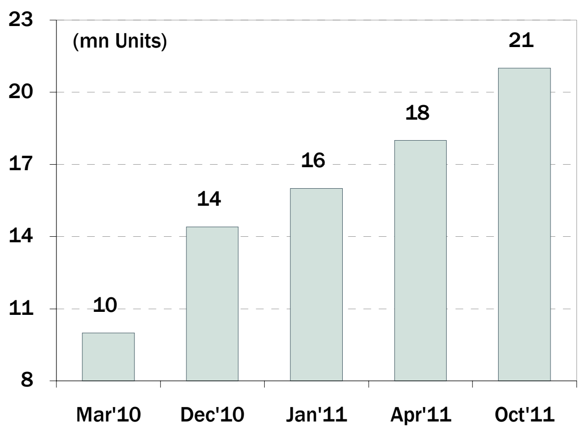
The profitability of the automotive segment (65% of revenues) has been suffering due to lack of supplies into the replacement market on account of strong OEM growth. Additionally, minor delay in capacities (due to delay in machinery installation) has worsened woes for Exide.

With subsequent capacity additions in Dec-10, Apr-11 and Oct-11, we believe that the concerns on account of product mix will recede. Exide is expanding capacities in 4Ws by 45% to 12 mn from 8.4 mn and in 2Ws by 120% to 22 mn from 10 mn. **We thus expect the replacement to OEM mix to improve from the Q3 levels of 117:100 (for 4Ws) to >150:100 (in-line with historical avg). Additionally, Exide has effected a ~5% price increase (in Feb-11) in the replacement market to absorb the higher costs of lead. As a result of the improving mix and the price increase, we expect profitability of the auto segment to recover.**

Capacity expansion: Four wheelers

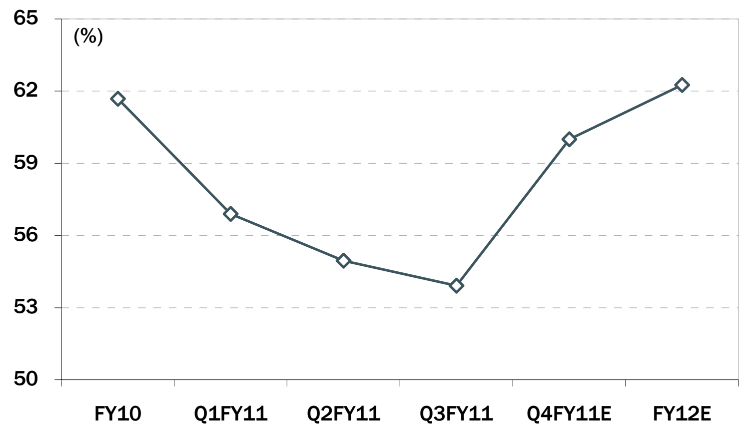


Two-wheelers



Source: Company, ENAM Research

Auto: Share of Replacement market sales



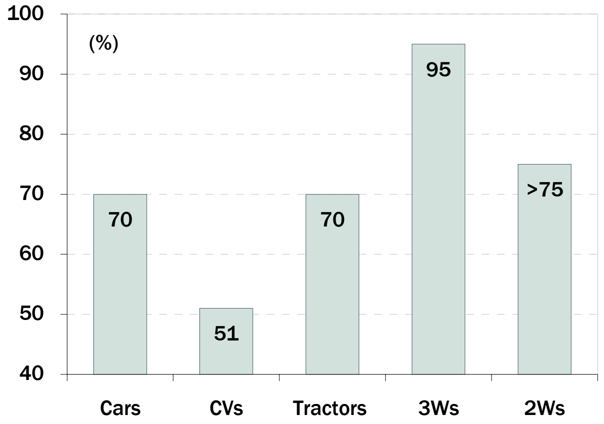
Source: Company, ENAM Research

Two wheelers: An emerging replacement market

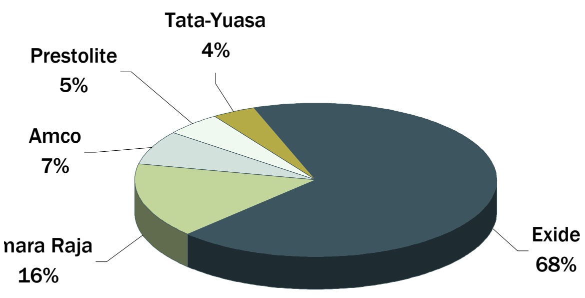
Historically, two-wheelers have had low replacement market as batteries are used only for lighting/ indicator purposes. However, with the growing popularity of self-start vehicles within OEMs, eventual demand in the replacement market (2-2.5 yr replacement cycle) is also likely to happen. Currently the replacement: OEM mix for 2Ws batteries (for industry) is <0.5:1, representing a large opportunity for all players.

As a result, Exide is expanding capacities by 120% to 22 mn by Oct-11 from the 10 mn units p.a. in FY10 Additionally, we understand that the self-start vehicles require VRLA batteries (also being put up by other players like Amara Raja) which have a higher realization (>25%) and thus higher profitability. We expect the share of 2Ws to increase in the coming quarters.

Share of Exide within OEM categories (FY10)



Replacement mkt share (Organized players)

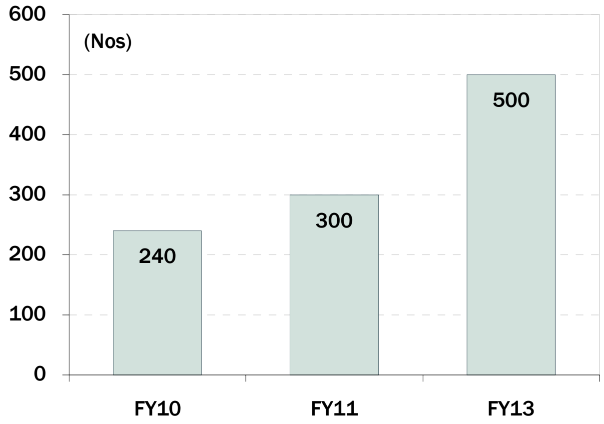


Source: Company, ENAM Research

Distribution focus to increase as additional capacities become available

Exide's ambitious distribution plan to double primary dealers from 240 currently to 500 by FY13E had been put on a slow-track over the last few qtrs due to the lower available supplies for the replacement market. We understand that with new capacities coming on stream, this is likely to be gain impetus. **An increased distribution presence is likely to help Exide gain market share from the unorganized sector (~45% market share).**

Primary distributor expansion



Authorized distributors and dealer network

As of August 2010	(Nos)
Authorized Dealers	13,850
Outlets	41,500
Humsafar Partners	23,000
Depot-cum-Service Stations	204
Exide Power Centre shops	32

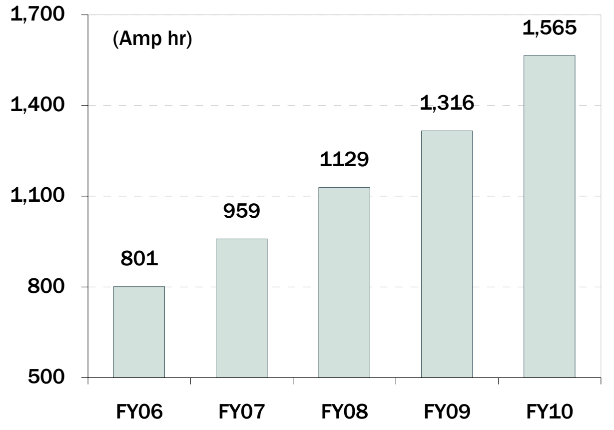
Source: Company, ENAM Research

Industrial business: Recovery plagued by overcapacity

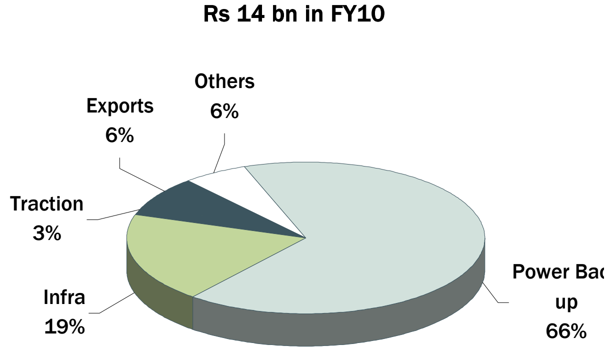
Profitability within Exide's industrial business (35% of revenues) has been suffering due to: a) overcapacities in the institutional UPS business (32% of sales); b) slower growth at 5% (vs. >25% in H1FY11) in the home UPS seg (34% of sales); c) aggressive pricing within the telecom segment (10% of sales). We understand that the institutional UPS segment and the telecom segment are operating at ~50% industry wide capacity utilization, thus lowering margins considerably. <u>While there is a gradual recovery in pricing, we don't expect a sharp turnaround in the coming quarters.</u>

In home UPS segment (32% of industrial sales), we understand that the growth rates have been lowered due to increased availability of power in North India in Q3FY11. While Exide is witnessing a seasonal recovery in Q4FY11 (expected to continue in Q1FY12 as well), over a longer term, India's reducing power deficit could eventually restrict the growth of this segment.

Industrial batteries (Amp hr): 4 yr CAGR of 18%



Share of revenues (FY10)

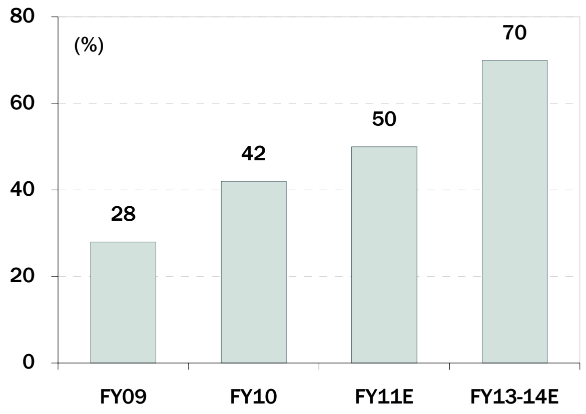


Source: Company, ENAM Research

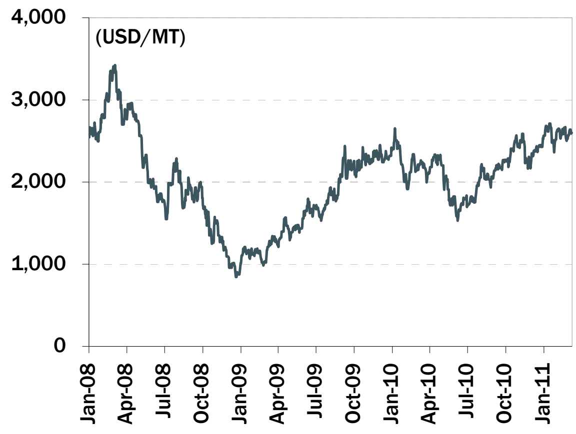
Captive lead sourcing to ease the volatility in lead prices

Exide currently sources ~55% of lead requirements from its captive smelters (vs. 45% in H1FY11). The co. has expanded capacities by 16% to 115,000 MTPA (from 96,000 MTPA) through de-bottlenecking and addition of battery breaking equipments at both locations. **Exide's mgmt has maintained that it would source ~70% of its requirement from the captive sources by FY13, thereby reducing the volatility in lead prices.**

Captive lead usage likely to increase



LME lead prices

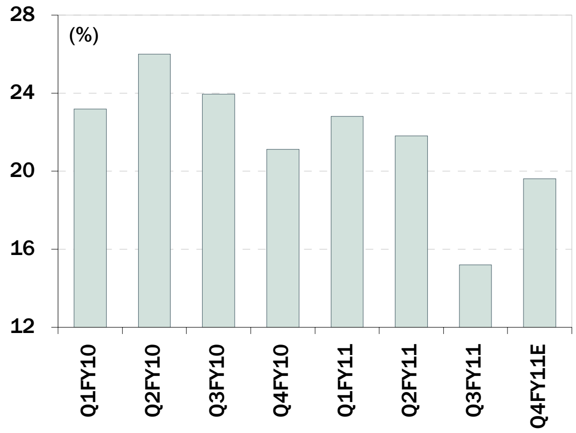


Source: Company, Bloomberg, ENAM Research

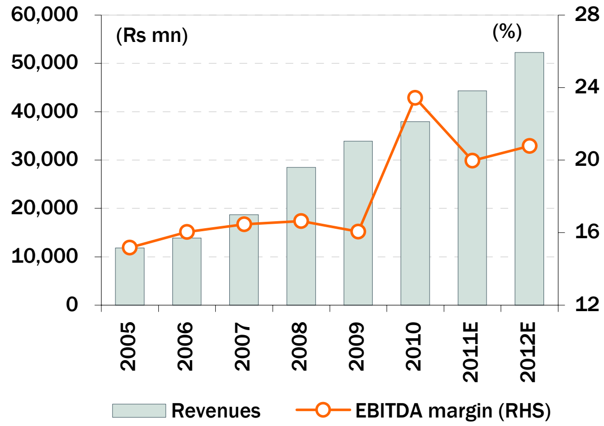
Profitability set to recover in Q4FY11 and Q1FY12

We expect Exide's profitability to recover in Q4FY11 and Q1FY12 as a result of the receding headwinds. While we believe that the mgmt's guidance of a >20% EBITDA margin is possible, continued weakness in the industrial segment remains an area of concern.

Exide: EBITDA margins to recover



Revenue and margin trend



Source: Company, ENAM Research

Maintain estimates and BUY rating. Target Price of Rs 161

We maintain our adj EPS estimates at Rs 7.1 for FY11E and Rs 8.9 for FY12E with a target price of Rs 161 (SOTP below) and a **BUY rating** on the stock.

SOTP valuation

SOTP	(Rs)
a) Core Business	
FY12E EPS	8.9
Multiple (x)	16
Value/ share	**143**
b) ING Vysya Life Insurance	
New business value/ share	20
Embedded Value /share	11
Value of total business / share	31
Value for Exide @ 50%	16
c) Value of smelters (10x PAT)	3
SOTP value (a+b+c)	**161**

Source: ENAM Research