

24 September 2010 (No. of pages: 10)

Exide Industries (EXID IN)

6-mth rating: **2** → **1**

Target price: Rs139.00 → Rs178.00

Share price: Rs156.30 (23 Sep)

Automobiles & components: India

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Firing on all cylinders

We expect a further re-rating on strong earnings growth

- Exide Industries (Exide) trades currently at a 13.6x PER on our FY12 EPS forecast for its standalone business (excluding our values of its 50% stake in ING Vysya Life Insurance [Not listed] and its two smelters). We believe it is undervalued, given our EPS CAGR of 25% and ROE of 25-30% forecast for FY10-12. In our view, the market is not factoring in the strong EBITDA-margin growth for the smelters that we expect for the next two years.
- We have upgraded our rating to **1 (Buy)** from **2 (Outperform)**, as we believe it will benefit from India's strong automotive demand. We have raised our SOTP-based six-month target price to Rs178 (from Rs139) due to: 1) an estimated value of Rs13/share assigned now to Exide's two smelters, and 2) our target PER now for the standalone business of 16x (previously 13.5x) on our FY12 EPS forecast, to reflect our view of Exide's improving EBITDA-margin profile.

Our positive view reinforced following recent meeting

- Exide expects sales-volume growth for 2H FY11 to exceed that for 1H FY11, with capacity constraints easing. We envisage an EBITDA-margin improvement from 2H FY11 compared with 1Q FY11, on the back of a rising share of replacement batteries in the product mix, Exide's targeted increase in sourcing from its own smelters to 60% by FY12 (from 45% currently) and the 12% decline in lead prices from their peak of March 2010. We forecast the smelters' net profit to more than double in FY10-12, driven by a pick-up in production. Exide's EBITDA margin should be aided by a 5% price increase at its replacement-battery segment in August.

Reuters code EXID.NS

Market data

SENSEX Index		19,861.01
Market cap	(US\$bn)	2.91
EV	(US\$bn: 11E)	2.92
3-mth avg daily T/O	(US\$m)	4.80
Shares outstanding	(m)	850
Free float	(%)	46.0
Major shareholder	Promoter	(46.0%)
Exchange rate	Rs/US\$	45.658

Performance (%)*	1M	3M	6M
Absolute	2.3	19.2	37.2
Relative	(5.6)	7.3	23.4

Source: Daiwa

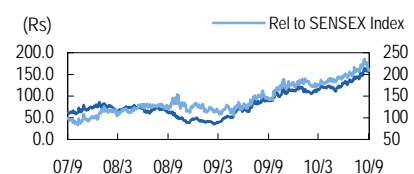
Note: *Relative to SENSEX Index

Investment indicators

		2011E	2012E	2013E
PER	(x)	18.8	15.9	13.9
PCFR	(x)	19.3	15.5	13.6
EV/EBITDA	(x)	11.8	10.0	8.8
PBR	(x)	4.6	3.6	2.9
Dividend yield	(%)	0.4	0.4	0.4
ROE	(%)	27.8	25.6	23.3
ROA	(%)	21.5	20.8	19.4
Net debt equity	(%)	1.6	0.5	0.4

Source: Daiwa forecasts

Price and relative performance



Source: Bloomberg, Daiwa

Income summary

Year to 31 Mar	Revenue		EBITDA		Net profit		EPS		CFPS	DPS
	(Rs m)	(%)	(Rs m)	(%)	(Rs m)	(%)	(Rs)	(%)	(Rs)	(Rs)
2009	33,930	19.3	5,448	16.0	2,844	13.6	3.555	13.6	4.331	0.701
2010	37,940	11.8	8,894	63.3	5,371	88.8	6.318	77.7	6.606	1.061
2011E	47,324	24.7	11,300	27.1	7,070	31.6	8.318	31.6	8.086	0.700
2012E	54,616	15.4	13,317	17.8	8,347	18.1	9.820	18.1	10.078	0.700
2013E	62,582	14.6	15,185	14.0	9,535	14.2	11.218	14.2	11.459	0.700

Source: Company, Daiwa forecasts

IMPORTANT DISCLOSURES, INCLUDING ANY REQUIRED RESEARCH CERTIFICATIONS, ARE PROVIDED ON THE LAST TWO PAGES OF THIS REPORT.

Global Equity Research

The three most important charts in this report...

Exide: SOTP valuation

Asset	FY12E EPS (Rs)	PER (x)	Value/share (Rs)
Standalone business	9.8	16	157
50% stake in ING Vysya Life Insurance			8
100% stake in its two smelters	1.3	10	13
Target price			178

Source: Daiwa forecasts

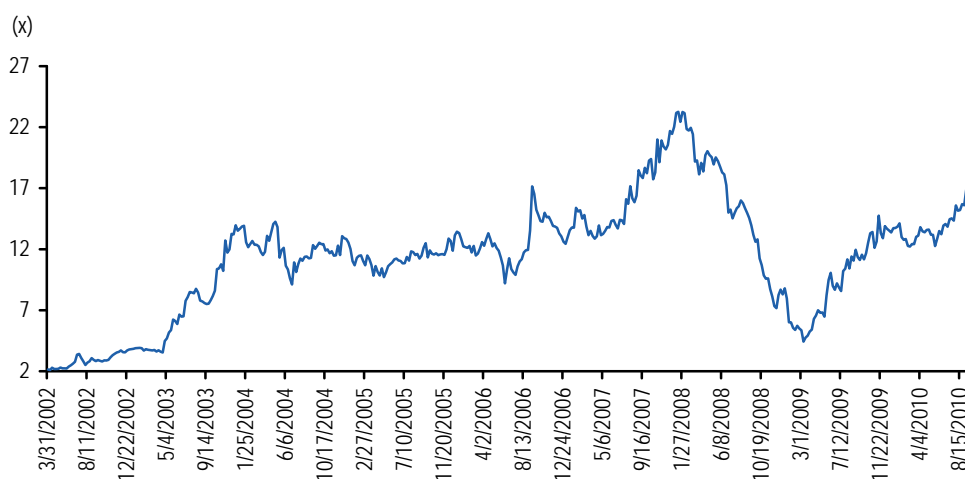
Valuation of Exide's 50% stake in ING Vysya Life Insurance (Rs m)

	FY07	FY08	FY09	FY10	FY11E	FY12E
Individual, single premium income	251	369	225	69		
Individual, non-single premium	4,180	6,583	6,348	6,265		
Group single premium income	23	67	133	89		
Group non-single premium income	221	28	175	2		
APE - new business premium	4,674	7,047	6,882	6,425	7,389	8,497
YoY change (%)		50.8	(2.3)	(6.6)	15.0	15.0
NBAP margin (%)						15
Multiple on new-business premium income, FY12E						14
Valuation (for 50% stake)						8,922
20% holding-company discount						7,138
Fair value/share (Rs)						8

Source: Insurance Regulatory Development Authority, Daiwa forecasts

Note: APE = annual premium equivalent, NBAP = new business achieved profit.

Exide: one-year-forward PERs



Source: Bloomberg, Daiwa forecasts

Company background

Exide Industries (Exide) is India's largest manufacturer of lead acid storage batteries. The company has a 72% market share of the replacement market and 45% market share in the industrial segment currently. In addition, it also has a 50% stake in ING Vyasa Life Insurance Company.

Exide Industries – financial summary

Profit and loss (Rs m)						Balance sheet (Rs m)					
Year to 31 Mar	2009	2010	2011E	2012E	2013E	As at 31 Mar	2009	2010	2011E	2012E	2013E
Auto Segment	20,883	24,809	29,698	34,104	39,220	Cash & short-term investment	337	29	30	30	30
Industrial Segment	13,047	13,131	17,626	20,512	23,362	Inventory	4,385	6,068	6,789	7,788	8,947
Others	0	0	0	0	0	Accounts receivable	2,310	2,546	3,241	3,741	4,286
Total revenue	33,930	37,940	47,324	54,616	62,582	Other current assets	387	476	500	550	600
Other income	0	0	0	0	0	Total current assets	7,419	9,118	10,560	12,109	13,864
COGS	(22,484)	(21,807)	(27,534)	(31,584)	(36,285)	Fixed assets	6,853	7,144	10,269	11,726	13,044
SG&A	(1,725)	(2,145)	(2,515)	(2,895)	(3,326)	Goodwill & intangibles	0	0	0	0	0
Other op. expenses	(4,954)	(5,900)	(6,852)	(7,862)	(8,968)	Other non-current assets	6,682	13,354	15,190	20,338	26,969
EBIT	4,768	8,087	10,424	12,274	14,002	Total assets	20,954	29,616	36,019	44,173	53,877
Net-interest inc./(exp.)	(479)	(103)	(42)	(23)	(14)	Short-term debt	0	0	0	0	0
Assoc/forex/extraord./others	65	121	250	300	350	Accounts payable	3,006	3,912	4,538	5,237	6,001
Pre-tax profit	4,354	8,106	10,632	12,552	14,338	Other current liabilities	1,861	2,017	1,907	1,909	1,909
Tax	(1,510)	(2,735)	(3,562)	(4,205)	(4,803)	Total current liabilities	4,866	5,929	6,445	7,146	7,910
Min. int./pref. div./others	0	0	0	0	0	Long-term debt	3,172	900	500	200	200
Net profit (reported)	2,844	5,371	7,070	8,347	9,535	Other non-current liabilities	412	590	401	402	402
Net profit (adj.)	2,844	5,371	7,070	8,347	9,535	Total liabilities	8,450	7,418	7,346	7,748	8,512
EPS (reported) (Rs)	3.555	6.318	8.318	9.820	11.218	Share capital	800	850	850	850	850
EPS (adj.) (Rs)	3.555	6.318	8.318	9.820	11.218	Reserves/R.E./others	11,704	21,348	27,823	35,575	44,515
DPS (Rs)	0.701	1.061	0.700	0.700	0.700	Shareholders' equity	12,504	22,198	28,673	36,425	45,365
EBIT (adj.)	4,768	8,087	10,424	12,274	14,002	Minority interests	0	0	0	0	0
EBITDA (adj.)	5,448	8,894	11,300	13,317	15,185	Total equity & liabilities	20,954	29,616	36,019	44,173	53,877
						Net debt/(cash)	2,835	871	470	170	170

Cash flow (Rs m)						Key ratios					
Year to 31 Mar	2009	2010	2011E	2012E	2013E	Year to 31 Mar	2009	2010	2011E	2012E	2013E
Profit before tax	4,354	8,106	10,632	12,552	14,338	Sales – YoY %	19.3	11.8	24.7	15.4	14.6
Depreciation and amortisation	679	807	876	1,042	1,182	EBITDA (adj.) – YoY %	16.0	63.3	27.1	17.8	14.0
Tax paid	(1,510)	(2,735)	(3,562)	(4,205)	(4,803)	Net profit (adj.) – YoY %	13.6	88.8	31.6	18.1	14.2
Change in working capital	488	(637)	(926)	(847)	(991)	EPS (adj.) – YoY %	13.6	77.7	31.6	18.1	14.2
Other operational CF items	(546)	75	(147)	24	14	EBITDA margin % (adj.)	16.1	23.4	23.9	24.4	24.3
Cash flow from operations	3,465	5,615	6,873	8,566	9,740	EBIT margin % (adj.)	14.1	21.3	22.0	22.5	22.4
Capex	(1,515)	(1,098)	(4,000)	(2,500)	(2,500)	Net-profit margin % (adj.)	8.4	14.2	14.9	15.3	15.2
Net (acquisitions)/disposal	(1,499)	(6,672)	(1,836)	(5,148)	(6,631)	ROAE (%)	25.0	31.0	27.8	25.6	23.3
Other investing CF items	0	0	0	0	0	ROAA (%)	13.9	21.2	21.5	20.8	19.4
Cash flow from investing	(3,014)	(7,770)	(5,836)	(7,648)	(9,131)	ROCE (%)	32.4	41.7	39.9	37.3	34.1
Change in debt	(326)	(2,272)	(400)	(300)	0	ROIC (%)	21.4	27.9	26.6	24.8	22.7
Net share issues/(repurchases)	0	0	0	0	0	Net debt to equity (%)	22.7	3.9	1.6	0.5	0.4
Dividends paid	(561)	(902)	(595)	(595)	(595)	Effective tax rate (%)	34.7	33.7	33.5	33.5	33.5
Other financing CF items	436	5,278	(42)	(23)	(14)	Accounts receivable (days)	26.4	23.4	22.3	23.3	23.4
Cash flow from financing	(451)	2,105	(1,037)	(918)	(609)	Payables (days)	36.1	33.3	32.6	32.7	32.8
Forex effect/others	320	(308)	1	0	0	Net interest cover (x)	10.0	78.6	248.2	539.5	1,000.2
Change in cash	320	(358)	1	0	0	Net dividend payout (%)	19.7	16.8	8.4	7.1	6.2

Key assumptions						PER bands					
Year to 31 Mar	2009	2010	2011E	2012E	2013E						
Sales revenue growth (YoY %)	19.3%	11.8%	24.7%	15.4%	14.6%						

Source: Company, Daiwa forecasts

Valuation

We have upgraded our rating to Buy and raised our six-month target price to Rs178

We believe Exide offers strong earnings-growth prospects, and our recent meeting with the company has reinforced our positive view. We have upgraded our rating on Exide to **1 (Buy)** from **2 (Outperform)**, as we believe it should be a key beneficiary of strong automotive demand in India currently. We have raised our six-month target price to Rs178 (from Rs139), which is based on our sum-of-the-parts (SOTP) valuation.

Our raised target price is driven by two factors. First, we have increased our target PER assigned to the standalone business to 16x (from 13.5x) to reflect the improvement in its EBITDA-margin profile. We value the standalone business now at Rs157/share. Second, we value Exide's 100% stakes in its two smelters at Rs13/share (not valued previously) given the sharp improvement that we expect in the smelters' profitability. Our value of Exide's 50% stake in ING Vysya is unchanged.

We have revised up our EPS forecasts by 1-2% for FY11-12, with modest upward revisions made to our sales forecasts.

Exide: Daiwa forecasts revisions (Rs m)

	FY11E			FY12E		
	Previous	New	% chg	Previous	New	% chg
Net sales	44,591	47,324	6.1	52,102	54,616	4.8
EBITDA	11,132	11,300	1.5	13,265	13,317	0.4
EBITDA margin (%)	25.0	23.9		25.5	24.4	
Net profit	6,918	7,070	2.2	8,265	8,347	1.0

Source: Company, Daiwa forecasts

Exide: SOTP valuation

Asset	FY12E EPS (Rs)	PER (x)	Value/share (Rs)
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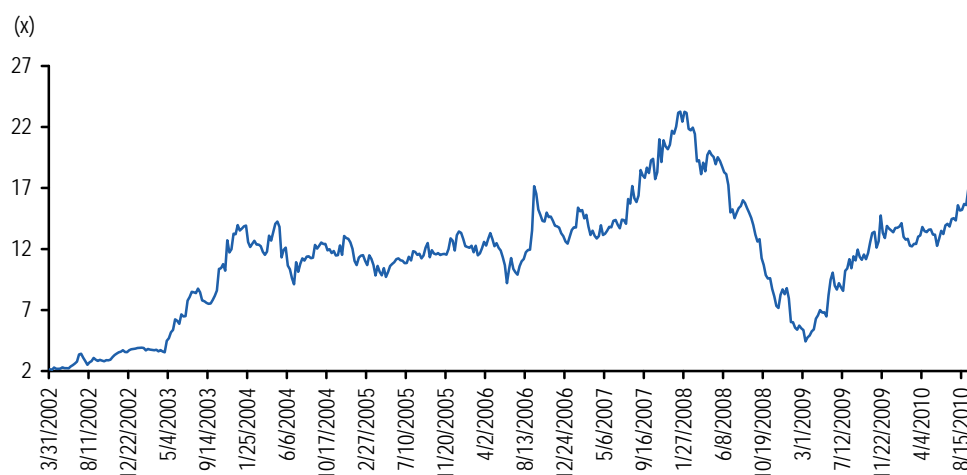
Source: Insurance Regulatory Development Authority, Daiwa forecasts

Note: APE = annual premium equivalent, NBAP = new business achieved profit.

Exide has traded at an average one-year-forward PER of 14x over the past two years, after its smelters (acquired in FY07-08) started to have a positive impact on its earnings. The company's EBITDA margin has improved from 16% for FY09 to 23% for FY10 and we forecast an EBITDA margin of around 24% for the coming years. This change in margin profile has driven a re-rating of the company. Over the past year, its one-year-forward PER has risen from 12x to 15x on our EPS forecasts. Given the strong ROE of 25-30% and EPS CAGR of 25% that we forecast for FY10-12, we believe Exide has the potential to trade at a one-year-

forward PER range of 15-17x. As such, we have raised our target PER for its standalone business in our SOTP valuation to 16x, to reflect the improvement in its EBITDA-margin profile.

Exide: one-year-forward PERs



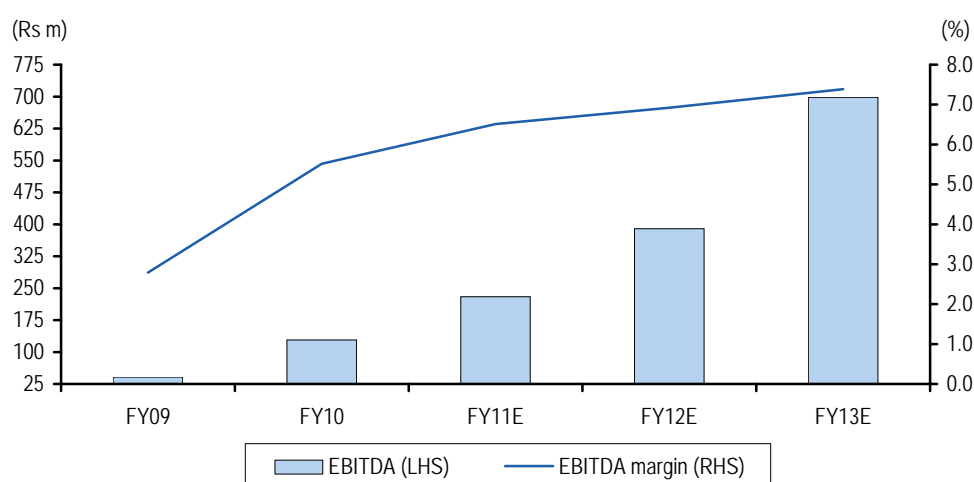
Source: Bloomberg, Daiwa forecasts

We go on to assess the key highlights of our recent meeting with Exide's management.

1. **Sales-volume growth for automotive batteries in 1H FY11 was affected adversely by capacity constraints.** Management indicated that sales-volume growth for the automotive-battery segment was hurt by capacity constraints for 1H FY11. The company has increased its production capacity for four-wheelers by 15% and has set up a new plant to increase capacity for two-wheelers in Ahmednagar. Sales-volume growth for 2H FY11 is likely to be higher compared with 1H FY11, according to management
2. **The automotive segment is driving sales growth.** The company indicated that both its original-equipment-manufacturing (OEM) and replacement-battery segments of its automotive business are recording strong sales-volume growth currently, of more than 20% YoY for the OEM segment and 18% YoY for the replacement-battery segment.
3. **Strong sales growth at the power back-up segment should offset weak sales at the telecom-battery segment.** Sales at the power back-up segment rose by 36% YoY for FY10 and we forecast a 20% sales CAGR for FY10-12, offsetting weakness at the telecom-battery segment (about 10% of total sales for FY10), for which we forecast sales to decline by 10% YoY for FY11. However, we forecast sales for the company's industrial-battery business overall to rise at an 18% CAGR for FY10-12, driven by strong growth for the power back-up, traction and railway activities.
4. **We foresee rising EBITDA margins due to an improvement in the product mix and increase in sourcing from smelters.** We expect an EBITDA-margin improvement for 2H FY11 compared with 1H FY11, due to: 1) a rising share of replacement-automotive batteries in the product mix, 2) an increase in sourcing from Exide's smelters from 40% in 1H FY11 to 45% for 2H FY11, 3) a 5% price increase put through by the company for the aftermarket segment (replacement batteries) in August 2010, and 4) the 12% decline in lead prices since March 2010, which benefits Exide with a lag of one quarter, so raw-material costs as a percentage of sales should be lower for 2Q FY11 compared with 1Q FY11.
5. We expect the company's EBITDA-margin volatility to diminish as sourcing from its own smelters increases and its imported lead requirements decline.

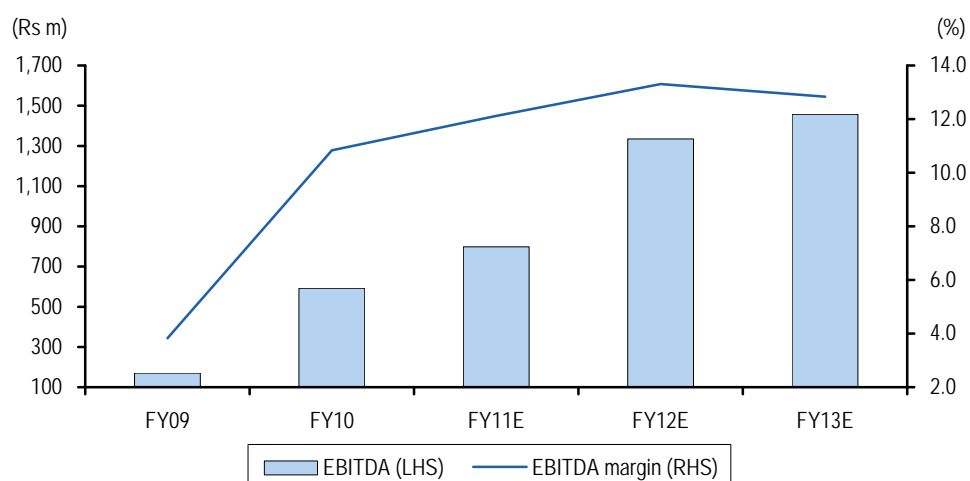
6. The company's capex programme remains at Rs4bn for FY11 and Rs2.5bn for FY12 to increase automotive-battery capacity at all of its plants. In addition, it plans to spend Rs1bn annually over the next two years at its 50%-owned subsidiary, ING Vysya Life Insurance.
7. **We forecast the smelters' net profit to more than double over FY10-12.** Exide's two smelters (Leadage Alloys and Chloride Metals) recorded a net profit of Rs452m for FY10 and we foresee a further improvement, driven by capacity expansion at both smelters. We forecast the two smelters to record a net profit of Rs1.1bn for FY12, adding Rs1.3/share to our consolidated EPS forecast for Exide that year. The company expects to increase the proportion of sourcing from its own smelters from 45% currently to 60% by the end of FY12 and 70% by FY13. However, we believe that it will need to increase capacity by about 67,000 tonnes by FY13 compared with current levels to achieve its 70% sourcing target. Exide acquired recently the remaining 49% stake in Leadage Alloys (a 100%-owned subsidiary now).

EBITDA trend for Chloride Metals (FY09-13E)



Source: Company, Daiwa forecasts

EBITDA trend for Leadage Alloys (FY09-13)



Source: Company, Daiwa forecasts

Risks

We see the downside risks to our rating and target price as a potential sharp rise in lead prices, which could affect Exide's EBITDA margin adversely. Any delay in ramping up the capacity at its own smelters could increase raw-material cost pressure. In addition, a potential decline in replacement automotive sales, a high EBITDA-margin segment for Exide, could lead to a fall in its overall sales.

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