October 6, 2017

Buy

Exide Industries

Industry: Auto and Auto Components | Industry View: Positive

LKP Since 1948

Company Update

Making a comeback

Goliath in the battery manufacturing space

Exide is the largest manufacturer of lead-acid batteries in India. It is the market leader in the automotive battery industry with market share of >60% in the OEMs and a formidable market share of close to 45% on the replacement side. It is a dominant player in the industrial battery space mainly in the inverters, traction and power domains. With an automotive capacity of 39.9 mn and industrial battery capacity of 3,336 MAh used across Power, Telecom, railways, defence etc Exide stands as a proxy to the automotive and industrial segments within the country. We believe Exide enjoys a competitive advantage over its rivals thanks to its scale, the strength of its brand, its technology tie-ups with global battery producers, and its extensive domestic distribution network.

Drivers remain intact, growth trajectory to set in from FY 18

Exide is well placed for a new start post quite a few subdued years as it has improved its sales and service policy and reduced its price premium as compared to Amara Raja products. Considering this we believe Exide is in for a transformation based on the following drivers - 1). New launches and capacity expansion by the OEMs in line with the increasing automobile demand 2) Growing replacement demand which is less cyclical 3). Increasing focus on capturing market share from the unorganized players in the CV and tractors markets 4). Implementation of GST marginalizing the unorganized players 5).Expansion of product portfolio for emerging requirements such as electric vehicles (batteries for E-Vans and E-buses) and developing advanced solutions like Idle-Stop Start & Enhanced Flooded batteries for hybrid cars and other segments.

Improvement in volumes to result into better operating performance

Exide's recovery of lost market share mainly in the automobile replacement market which is a high margin and less cyclical business may help the company to improve margins and offset the impact of narrowing of price gap between Exide's and Amara Raja's products. Rise in high margin industrial business market share to further add to better margin performance. Better technology, renovation of old plants and implementation of robotics at some of its plants may reduce employee costs though it requires heavy investments which will be funded through internal accruals. Superior return ratios in the 15-16% range, zero debt levels and clean balance sheet remain the assets of the company.

Outlook and Valuation

Exide is all set to forget the past and move ahead with positive developments within and outside the company. Improving client interface, distribution, customer centric approach, launch of new products including for hybrid vehicles and Electric Vehicles, reduction in prices are all heading towards gaining back of market share. Exide's stock price as a result of its competitive weakness earlier has underperformed the auto ancillary industry over the past 6-7 years. As a result of this, the valuations of the stock have never looked stretched. We therefore value the company at 19x times FY19E earnings and Exide Life Insurance valued at ₹41 which entails 2x FY19E Embedded value/share. Maintain BUY with a target price of ₹ 266 per share.

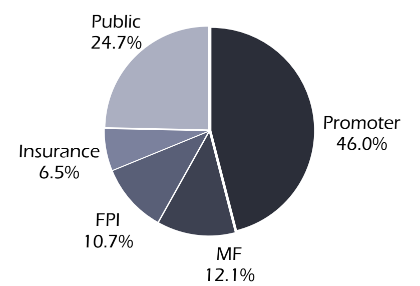
Stock Data

Current Market Price (₹)	205
Target Price (₹)	266
Potential upside (%)	28
FV (₹)	1
Reuters	EXID.BO
Bloomberg	EXID IN
Market Cap (₹ bn)	175
52-Week Range (₹)	250 / 168

What's changed

12 month Price Target (₹)	From 190 to 266
FY2018E EPS (₹)	From 8.5 to 9.8
FY2019E EPS (₹)	From 10.2 to 11.8

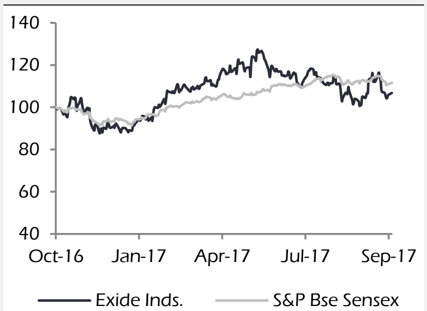
Shareholding Pattern



Fiscal YE

	FY 16	FY 17	FY 18E	FY 19E
Total sales(Rs bn)	68.5	76.2	85.1	97.1
EBITDA margin (%)	15.0%	14.4%	15.0%	15.6%
PAT margins (%)	9.4%	9.4%	9.8%	10.4%
EPS (Rs)	7.5	8.4	9.8	11.8
P/E	27.1	24.2	20.8	17.3
P/BV	3.8	3.5	3.0	2.6
EV/EBITDA	17.6	16.6	14.4	12.2
ROE%	14.2%	14.4%	14.6%	15.3%
ROCE%	18.6%	17.2%	18.9%	20.1%

Relative Price Performance



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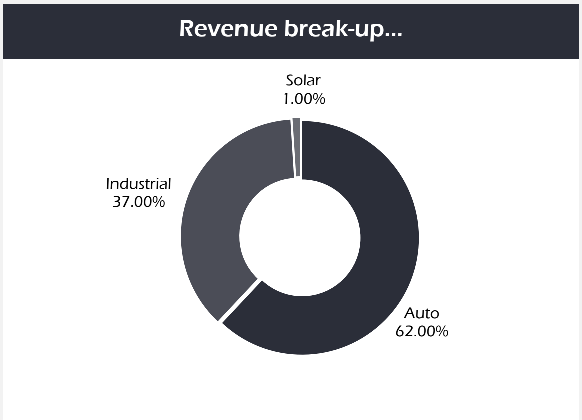
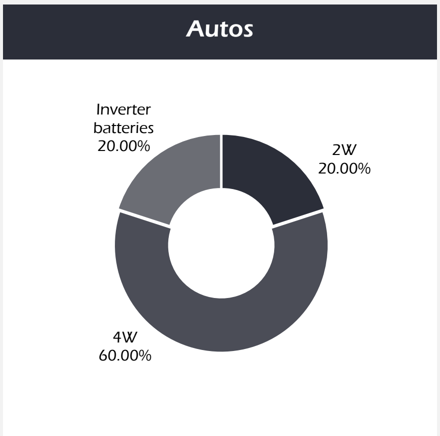
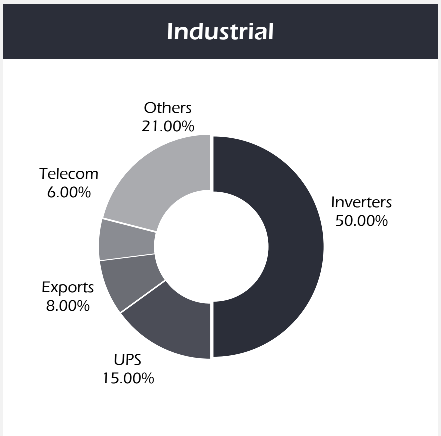
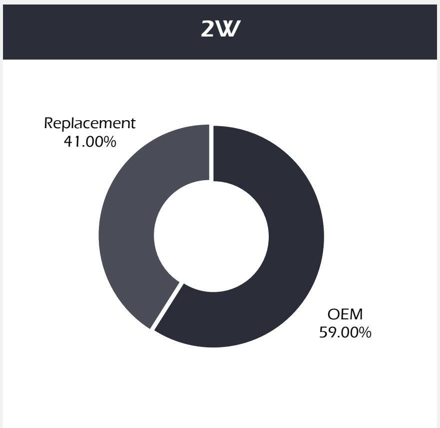
Market leadership position provides the necessary moat

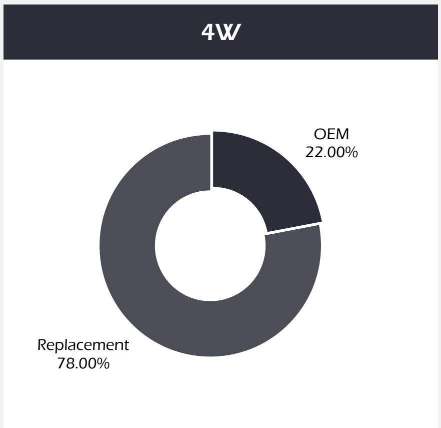
Exide holds a top share in most key battery segments including automobile segments (both OEM and replacement), invertors, railways, traction and power. It is dominant in the automobile OEM segment, for both four wheelers (4W) and two wheelers (2Ws). While in the replacement segment it holds about 45% of the organized replacement market. Exide is the leader in the home inverter segment with a 60% share. The only segments where Exide lags Amara Raja are the UPS segment (it ranks second) and the telecommunications segment (as per management, Exide's share is well behind Amara Raja which holds 60% of this market). We believe Exide has a competitive advantage in the battery industry thanks to its technology tie-ups with global industry majors, its OEM linkages, its strong brand image in India, its scale and its extensive domestic distribution network.





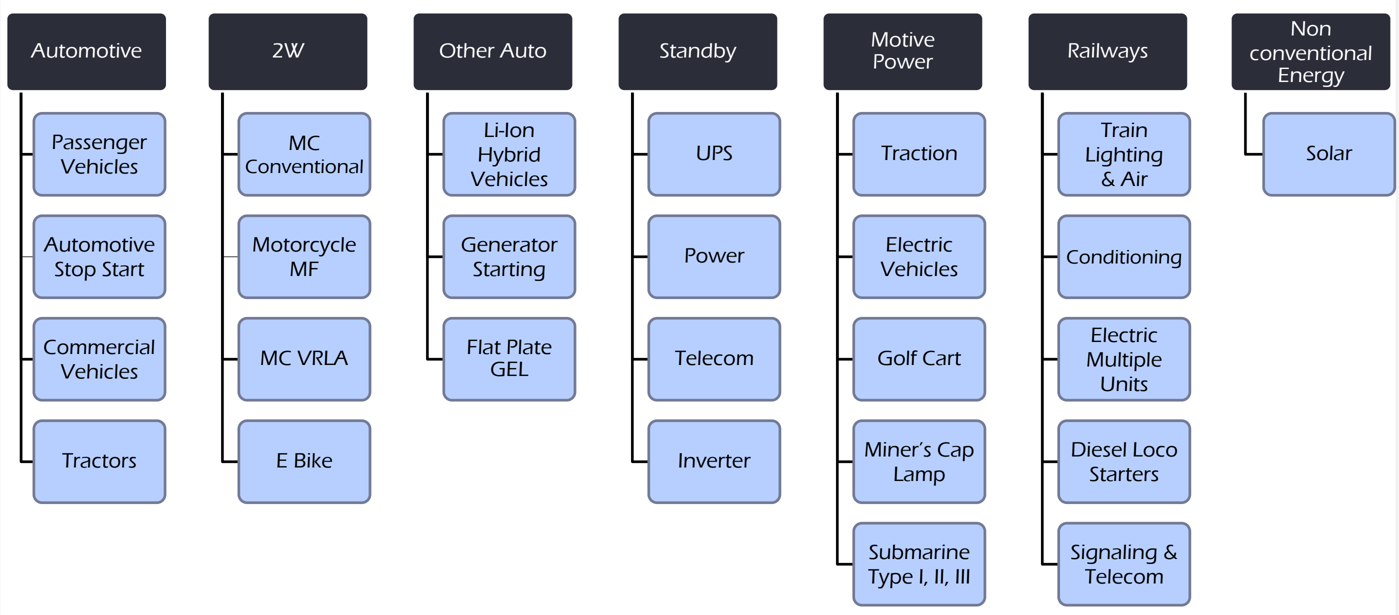






Source: Company, LKP Research

Wide array of products makes the company omnipresent. ..



Technology tie-up enables Exide to take up any new technological initiative seamlessly and with an ease...

Technology Partner	Technology Imported	Valid Till	Absorption	If not fully absorbed
Shin-Kobe Electric Machinery	Automotive and VRLA batteries	31st March, 2020	In Progress*	On-going#
Furukawa batteries co ltd., Japan	VRLA batteries for Motorcycles	31st March, 2020	In Progress*	On-going#
Furukawa batteries co ltd., Japan	Automotive Batteries with C21 Alloy for Taloja and Bawal Plants	30th Nov, 2020	In Progress*	On-going#
Furukawa batteries co ltd., Japan	Automotive Technical Assistance Agreement Taloja and Bawal Plants.	30th Nov, 2020	In Progress*	On-going#
Furukawa batteries co ltd., Japan	Automotive batteries for Idling stop system	31st March, 2020	In Progress*	On-going#
East Penn Manufacturing Co.,USA	Lead acid batteries used for automotive, industrial, motor cycle and other applications	14th Jan, 2020	In Progress	Still under development
Shin-Kobe Electric Machinery Co. Ltd.,Japan	Special Conventional Batteries for Automotive applications	2nd Feb 2023	In Progress	Still underdevelopment
Zhejiang Chaowei Chuangyuan Shiye Co. Ltd. Group, China.	Technical assistance collaboration agreement to manufacture Li-Ion batteries	2nd Jan, 2025	In Progress	Still underdevelopment
Smart Storage Pty Ltd., Australia (Ecoult)	Technology Cooperation and joint marketing of energy storage solution centred around Ultra Battery Technology	31st Dec, 2021	In Progress	Still underdevelopment

Source: Company data
*Agreement is for Technical Assistance for continuous improvements in manufacturing technology of different products
#Technology continues to evolve, so the agreement should be ongoing

Exide has significantly higher scale of operations. It has an annual 4W capacity of 14mn units and 2W capacity of 28 mn units. It has an industrial capacity of 3.3 Bn Ah.p.a and nine plants located in vicinity to the OEMs thus reducing the transportation costs and improving the operating performance. This when compared with its rival amara Raja, we can see a stark difference which makes Exide the best choice for OEMs.

Capacity comparison with Amara Raja...a stark difference...

Segment	Amara	Exide
2W mn units p a	11.0	28.0
4W mn units p a	10.5	14.0
Industrial mn Amp hrs p a	2,200	3,336

Source: Company data

Wide spread, innovative and extensive distribution network to enhance the market share

Exide has the most extensive distribution network in the battery industry in India, both for the automotive and the industrial segments. It is the only company in the sector that follows a dealer-led distribution model in contrast with the distributor-led model employed by Amara Raja and the other battery makers. On the dealers' front, Exide has started to reward its dealers for meeting sales targets.

This has prompted dealers to stock and sell more Exide batteries at the expense of other brands. In its auto segment, Exide has a very wide network of over 35,000 outlets, including about 1,500 Exide Care outlets that the company plans to increase to 2,500 outlets within 12 months. Exide Care outlets are designed to provide a standardized, positive experience for the customer. Exide also has over 19,000 Humsafar partners pan-India, which are multibrand dealers, including garages that source batteries from Exide. In its industrial segment, Exide has over 2,500 exclusive dealers and over 325 sales and marketing executives. It also operates over 30 Exide Power Care shops in India.

Furthermore, Exide has recently introduced its Exide Care App, which is a digital comprehensive battery management ecosystem for the customer right from purchase and warranty, registration to service and emergency help. Through this app, a customer can get a battery delivered to his home from Exide's wide dealer network, enjoy a paperless warranty, receive service alerts and reminders and also have use of on-road free battery emergency assistance. In addition, Exide has set up some customized initiatives to help extend its reach in the auto segment. There are some more innovative initiatives taken by Exide like-

- Kissan dealer network - To build up its brand among tractor owners, Exide has launched Project Kissan. Under this initiative, Exide employees visit villages to provide service for tractor batteries, irrespective of the brand. The company also has a web-based customer relationship management system that allows its tractor customers to register their warranties on line.
- Batmobile - Exide technicians ride around in a service vehicle named Batmobile and respond to customer calls made to a toll-free number that request battery service or replacement.
- CV battery dealer network - As a brand building exercise, Exide has launched Project Highway targeted at truck drivers. This project provides battery service on India's highways.

GST may play a game changer for the organized battery segment

GST aims the economy to benefit through increased tax collection. Under the GST, unorganized companies will no longer be able to keep prices low by evading taxation, which should provide level playing field for organized producers. We have observed that unorganized players are having significant presence in the taxis, 3W, CV and inverter segments, which have great scope for organized players to make a mark once the impact of GST gets intensified. Both Exide and Amara Raja are looking to increase their overall market share by taking share from India's unorganized battery market. Both companies have launched low-priced brands with scaled-down warranty coverage to compete with unorganized makers. Exide's low priced Dynex has been well received by customers and management targets sales of about 1mn Dynex batteries in FY18 end. Exide has also launched a brand specifically for the taxi segment which has traditionally relied heavily on the unorganized brands. We thus expect to see a gradual transition in demand from the unorganized storage battery makers to organized segment players, with small companies either joining with large firms or exiting the business. We see this market consolidation as a significant opportunity to gain market share for Exide in the coming years with the help of GST settling itself. This would also act as entry barriers for new entrants trying to enter this business.

Cutting prices and changing the attitude towards providing services may play a vital role hereon

We are aware that over the past few years, Exide has lost a significant market share to Amara Raja mainly in the replacement and industrial segments. This has been mainly due to management's complacent attitude on the back of it being a market leader and towards dealer/customer needs and requirements. However, having realized this, Exide has revamped its plans and taken some initiatives over the past year or so to get back into the game and they have managed to regain some replacement market share on the auto side. First of all they have reduced the premium it had over Amara Raja from 8-10% to 3-4% now. Secondly, the company has improved their servicing standards. Earlier, if Exide customers could not produce their warranty cards, the warranties were not honored. Now, Exide's warranties are paperless for all its auto battery replacement customers. The clients' details are kept in a centralized database and their records can be accessed immediately allowing the batteries to be serviced without delay. This has helped restore customer confidence in the company. Exide has also launched the Exide Care App, the first such app in the industry, the details of which are mentioned above. Exide has started to reward its dealers for meeting sales targets. This has prompted dealers to stock and sell more Exide batteries at the expense of other brands. In the Industrial segment Exide is targeting growth in the UPS segment. In an effort to gain share, the company has been pricing aggressively and has introduced new products in the telecommunications segment, such as advanced valve regulated lead-acid (VRLA) batteries

Electric vehicles opportunity – The next best and biggest thing

Government is pushing the automobile industry to produce electric vehicles (EVs) with a target to manufacture EVs only by 2030. Because government subsidies, requisite infrastructure and technological expertise are currently lacking, we do not see the electric PVs and CVs picking up in a material way until 2020. Maruti Suzuki, India's largest PV manufacturer plans to introduce its first EV by 2020 and the electric PV and CV segments are likely to start to grow thereafter. However we anticipate seeing electric 2W vehicles, 3W vehicles and buses much sooner. According to the company management, there are already 1mn electric 3Ws on the road in India. Exide has first-mover advantage in the electric 3W segment. Atul Auto and M&M recently launched electric 3W models, and we expect Piaggio and Bajaj Auto to introduce their own electric 3Ws over the next 12 months. So it would appear that this market is set for robust growth going forward benefitting an organized player like Exide. Exide is working to find the best battery solution for the 3W market and to that end it introduced both flat plate and tubular batteries for 3Ws in FY17. In a bid to get the right product in this segment, Exide has recently signed a technology co-operation agreement for the design and manufacture of a 'lithium ion' family of products with Chaowei Group, a large, renowned company of China. Exide intends to source lithium ion batteries for 2Ws and 3Ws from this technical partner and offer it in Indian markets.

Higher the electrification of rural India, higher will be the requirement for inverters

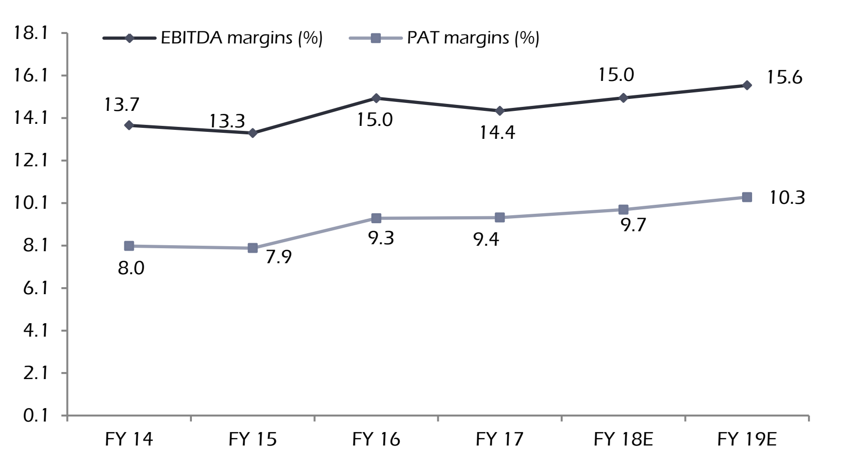
Contrary to the wide belief that higher availability of power will reduce demand for inverters, management believes that demand for inverters increases when grid electricity reaches tier-2 and tier-3 cities and rural households. Once electric power availability rises from about 10 hours per day to 15–18 hours per day, customers demand uninterrupted electric power (i.e., for 24 hours per day) which drives demand for inverters. We thus expect inverter sales to be driven by higher demand from low-tier cities. Power cannot be supplied reliably in many locations due to infrastructure deficiencies. As a result, we see power storage continuing to be a good business opportunity for battery makers along with demand for inverter batteries climbing steadily. We expect leading storage battery manufacturers like Exide to benefit from the increased demand for inverter batteries.The Ministry of New and Renewable Energy is targeting the installation of 10,000 micro-grids and 500 megawatts (MW) of micro and mini-grid power. Batteries are critical components of micro- and mini-grid systems as 100% back-up power in India is required to ensure the steady supply of electricity to rural households during evening hours. We expect the market for batteries for energy storage applications to grow rapidly. In FY17, Exide signed technical collaboration agreements with East Penn Manufacturing (EPM) for developing ultra-batteries (a conventional lead-acid battery with a built-in ultra-capacitor) for stationary industrial applications, and with Ecoult, Australia, EPM's wholly owned Australian subsidiary, for the testing, study and joint marketing of energy storage solutions focused on ultra-battery technology and the indigenization of storage blocks. We expect storage batteries to play a critical role in India's ambitious renewable energy and energy storage programs. It will likely take a few more years for this business to evolve, but it could become the next big growth driver for Exide in 4–5 years thanks in large part to its technical partnerships with EPM and Ecoult.

Margins to be supported by technological upgrades and operating leverage

Since FY16 Exide has been upgrading its manufacturing systems in consultation with its technology partner EPM with the goal of improving the consistency of its product quality. Exide also aims to improve the operating efficiency of its plants, which are quite old as compared to its rivals. These programs are now at different stages of completion at its various plants. In FY17, Exide invested ₹7bn in its Haldia plant introducing punched grid technology (for automotive batteries) with the help of EPM. The Haldia plant accounts for about 25% of Exide's turnover, split equally between auto and industrial products. Battery grids made with punched grid technology are resistant to corrosion and exhibit structural rigidity, which prolong battery life. The punched grid process also consistently produces a quality grid at a relatively low cost thus improving plant efficiency. Exide intends to introduce punched grid technology at all its production facilities. Exide plans to invest an additional ₹7bn to upgrade its other plants in FY18. These upgrades will also include introduction of robotic technology at some sites, which should in turn help it reduce its employee costs. This is a much-needed investment in our view given that Exide has not upgraded its production technology for a long time. We expect the production technology upgrades to improve profitability over our forecast period.

Automobile industry has once again seen a positive surge defying the negativity which had risen from demonetization, BS IV implementation and GST transition. Pent up demand from FY 17, good monsoons and Seventh Pay Commission has led to this demand revival. This will in turn help the battery demand to expand in the coming quarters. In line with this, although the company is cutting its prices, operating leverage coming from higher volumes will help Exide to offset this. Though lead price movement remains a risk, 70% of its lead requirement is procured from local as well as its own smelters at slightly lower rates. Gaining market share with a favorable product mix will help Exide to report a healthy margin performance. We are projecting margins to grow 100 bps over the next two years.

Margin Performance



Source: LKP Research, Company

Exide Life – A good proposition

Exide's wholly owned life insurance subsidiary Exide Life Insurance is doing well, though its growth rate and size is smaller as compared to other listed entities. Exide Life posted Net Profits of ₹1.1bn in FY 17, has ₹110bn AUM and a market consistent embedded value (MCEV) of ₹20.5bn. The CAGR for the insurer's annualized premium equivalent (APE) is 10% for FY15–FY17, with the APE reaching ₹6.6bn last year. Embedded value (EV) was ₹20bn in FY17, up 10% YoY. We forecast a CAGR for Exide Life's EV of around 10% over the two years to FY19. The EV growth of Exide Life at 10% is much lower than the same growth for other listed players in this industry like Max Financial Services and ICICI Prudential Life Insurance, which are growing in the range of 16–18%. These listed entities are currently trading at a consensus P/EV of 2.8–3x FY19E and hence we think a P/EV multiple for Exide Life of 2x is appropriate. This gives us a valuation for Exide's Life Insurance subsidiary of ₹49.6bn which translates to ₹41 per share of Exide (@30% subsidiary discount). Deducting our valuation of Exide Life from Exide's share price leaves the core battery business trading on a PER of 17.6x our FY19 estimates. We believe this is attractive relative to peers.

Outlook and Valuation

Exide is in the process of a significant turnaround of its fortunes thanks to its leadership position in the automotive as well as industrial battery markets. Through its various customer/dealer/distributor friendly initiatives undertaken shortly and reduction in premium it was enjoying over Amara Raja, Exide has already snatched some market share from it in the replacement markets. Various innovative schemes implemented in the rural markets as well as highways will attract tractor and CV space battery demand respectively. Rampant demand in the automobile market, expanding replacement business, omnipresent nature of the company will continue to drive the automobile business. Increasing availability of power and potent requirement for power storage will enable the industrial business to grow at a good pace. GST benefits will help Exide to marginalize the unorganized players in the battery space which are currently consuming a sizeable space. Exide is also getting ready to grab the EV opportunity with the assistance of its various partners and its first mover advantage to get into the 3W batteries. Along with its technology partners the company is getting ready for the next big leap in the EV space where the PV and 2W segments will get transformed into the electric mode. Improvement of operational efficiency and product mix coupled with operating leverage through increasing battery demand will help better margin performance from the ensuing quarters. Given its intrinsic positives like clean debt free balance sheet, superb return ratios and strong earnings profile, we find Exide as one of the auto ancillaries attractive at its current valuations. We value the stock at 19x FY19E core battery business @₹225 + ₹41 deriving from the Insurance business. Maintain **BUY** with a target price of ₹266 per share.

Financials

Income statement

YE Mar (₹.mn)	FY 16	FY 17	FY 18E	FY 19E
Net sales	**68,474**	**76,203**	**85,131**	**97,056**
Raw Material Cost	42,413	47,078	55,103	62,308
Employee Cost	4,670	5,196	6,493	7,594
Other Exp	11,293	13,186	11,067	12,326
EBITDA	**10,259**	**10,965**	**12,768**	**15,128**
EBITDA Margin(%)	15.0%	14.4%	15.0%	15.6%
Other income	577	1120	1100	1100
Depreciation	1,579	2,063	1,623	1,435
EBIT	**9,257**	**10,022**	**12,246**	**14,793**
EBIT Margin(%)	13.5%	13.2%	14.4%	15.2%
Interest	17	43	10	12
PBT	**9,241**	**9,978**	**12,236**	**14,781**
PBT Margin(%)	13.5%	13.1%	14.4%	15.2%
Tax	2,835	2,821	3,915	4,730
Adj PAT	**6,406**	**7,158**	**8,320**	**10,051**
PAT Margins (%)	9.4%	9.4%	9.8%	10.4%

Key Ratios

YE Mar	FY 16	FY 17	FY 18E	FY 19E
Per Share Data (₹)				
Adj. EPS	7.5	8.4	9.8	11.8
CEPS	9.4	10.8	11.7	13.5
BVPS	53.1	58.4	66.9	77.2
DPS	0.7	0.8	1.0	1.2
Growth Ratios(%)				
Total revenues	-0.4%	11.3%	11.7%	14.0%
EBITDA	11.9%	6.9%	16.4%	18.5%
PAT	17.4%	11.7%	16.2%	20.8%
EPS Growth	17.4%	11.7%	16.2%	20.8%
Valuation Ratios (X)				
PE	27.1	24.2	20.8	17.3
P/CEPS	21.7	18.8	17.4	15.1
P/BV	3.8	3.5	3.0	2.6
EV/Sales	2.6	2.4	2.2	1.9
EV/EBITDA	17.6	16.6	14.4	12.2
Operating Ratios (Days)				
Inventory days	60.4	73.2	78.0	80.0
Recievable Days	32.2	29.8	27.0	25.0
Payables day	39.7	36.8	34.0	32.0
Net Debt/Equity (x)	0.15	0.18	0.16	0.15
Profitability Ratios (%)				
ROCE	18.6%	17.2%	18.9%	20.1%
ROE	14.2%	14.4%	14.6%	15.3%
Dividend payout	9.3%	9.5%	10.0%	10.0%
Dividend yield	0.7%	0.8%	1.0%	1.2%

Source: Company, LKP Research

Balance sheet

YE Mar (₹. mn)	FY 16	FY 17	FY 18E	FY 19E
EQUITY AND LIABILITIES				
Shareholder's funds				
Share capital	850	850	850	850
Reserves and surplus	44,264	48,786	56,023	64,788
Total networth	**45,114**	**49,636**	**56,873**	**65,638**
Non current liabilities				
LT borrowings & Provs	405	483	548	613
Deferred tax liabilities	1,270	1,552	1,652	1,752
Current liabilities				
Current liabilities & Provs	10,246	10,702	11,195	11,966
Other current liabilities	2,797	3,023	3,265	3,457
Total equity & liabilities	**61,384**	**67,756**	**76,565**	**87,148**
ASSETS				
Net block	12,424	15,245	18,122	20,187
Capital work in progress	1,858	1,414	2,714	4,014
Intangible assets	191	215	270	300
Non current investments	17,700	17,685	18,685	21,185
Long term loans & Adv	719	1,416	1,416	1,416
Other non current assets	101	18	20	22
Total non curr. assets	**32,993**	**35,992**	**41,226**	**47,123**
Current assets				
Current investments	9,278	9,055	9,755	10,755
Inventories	11,335	15,273	18,192	21,272
Trade receivables	6,039	6,217	6,297	6,648
Cash and cash bank	666	196	861	1,084
Short term loans & Adv	1,055	105	233	266
Other current assets	0	919	0	0
Total current assets	**28,373**	**31,764**	**35,339**	**40,025**
Total Assets	**61,384**	**67,756**	**76,565**	**87,148**

Cash Flow

YE Mar (₹ mn)	FY 16	FY 17	FY 18E	FY 19E
PBT	9,063	9,978	12,236	14,781
Depreciation	1,579	2,063	1,623	1,435
Interest	17	43	10	12
Chng in working capital	5,790	(3,839)	(802)	(1,811)
Tax paid	(2,475)	(2,684)	(2,812)	(3,915)
Other operating activities	(584)	(1,030)	(1,896)	(1,608)
Cash flow from opns (a)	**13,389**	**4,531**	**8,357**	**8,895**
Capital expenditure	(3,952)	(4,161)	(5,855)	(4,830)
Chng in investments	0	0	(1,700)	(3,500)
Purchase/sale of MFs	(7,800)	200	740	838
Other investing activities	293	888	778	1,000
Cash flow from invst (b)	**(11,460)**	**(3,073)**	**(6,037)**	**(6,492)**
Free cash flow (a+b)	**1,929**	**1,459**	**2,320**	**2,403**
Equity raised/(repaid)	176	850	677	577
Inc/dec in borrowings	0	0	0	0
Dividend paid (incl. tax)	(2,346)	(2,422)	(2,443)	(2,646)
Other financing activities	681	(208)	(109)	(111)
Cash flow from fincg (c)	**(1,489)**	**(1,780)**	**(1,875)**	**(2,180)**
Net chng in cash (a+b+c)	**440**	**(322)**	**445**	**223**
Closing cash & cash equiv	**738**	**416**	**861**	**1,084**

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