Stock Note

HBL Power Systems Ltd

September 01, 2023

RETAILRESEARCH

HBL Power Systems Ltd

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Electrical Equipment	Rs. 268.15	Buy in the band of Rs 265 - 270 and add on dips in the band of Rs 230 - 235	Rs. 295	Rs. 322	2 - 3 quarters

HDFC Scrip Code	HBLPOWEQNR
BSE Code	517271
NSE Code	HBLPOWER
Bloomberg	HBPS:IN
CMP Aug 31, 2023	268.15
Equity Capital (Rs cr)	27.7
Face Value (Rs)	1
Equity Share O/S (cr)	27.7
Market Cap (Rs cr)	7427.8
Book Value (Rs)	34.3
Avg. 52 Wk Volumes	4866752
52 Week High	294.90
52 Week Low	78.55

Share holding Pattern % (June, 2023)	
Promoters	59.1
Institutions	2.8
Non Institutions	38.1
Total	100.0

* Refer at the end for explanation on Risk Ratings

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Our Take:

HBL Power Systems Ltd (HBL) specializes in the design, development and manufacture of batteries and electronic solutions for challenging applications. The company focuses on creating solutions that address key user sectors such as telecom, UPS, railways, power, oil and gas, and defense. It has developed most of these products indigenously. The company has its headquarters at Hyderabad and five manufacturing facilities located in Telangana and Andhra Pradesh.

The battery vertical is the major revenue contributor for the company at ~74%, followed by defense at ~13% and the electronics segment at ~10%. Although batteries continue to remain the major revenue contributor for HBL, the company is gradually working to reduce its dependence on telecom batteries and increasing its focus towards defense and railways. The company has signed big contracts for "KAVACH" (Train Collision Avoidance System) with the Indian Railways. It also expects growth from its train monitoring systems (TMS), electro optics products, grenades, electronic fuzes for defense applications and electric drive trains.

The company is creating a presence in niche categories where competition is limited and the business earns a good return on investment. We believe that the new verticals will report a robust growth over the coming years owing to recent product approvals, order flows, and export opportunities. The order book position as of June 2023 has improved and stood at Rs. 1,607 cr vs Rs. 594 crore in June 2022 providing medium-term revenue visibility.

Valuation & Recommendation:

The company has an established presence in the batteries segment, which continues to grow moderately every year. Since the batteries are replaced every few years, demand is expected to remain stable. Electronic signaling and safety is a priority investment for the railways and is a growing segment for the company. Defense indigenization will also help the company's products, which have been developed in-house. The electronics segment of the company is a high margin business and will scale up rapidly, contributing to ~35% - 40% of revenue by FY25-26. We expect Revenue/EBITDA/PAT to grow at a CAGR of 24%/55%/57% over FY23-FY25E.

We think the base case fair value of the company is Rs. 295 (33.5x FY25E EPS) and the bull case fair value of the company is Rs. 322 (36.5x FY25E EPS) over the next two – three quarters. Investors can buy the stock in the band of Rs. 265 – Rs. 270 (30.5x FY25E EPS) and add more on dips in Rs. 230 – 235 band (26.5x FY25E EPS).

Financial Summary (Consolidated):

Particulars (Rs cr)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)	FY21	FY22	FY23	FY24E	FY25E
Operating Income	467	320	46.2	403	16.1	912	1,236	1,369	1,738	2,121
EBITDA	78	35	123.4	45	74.1	62	139	151	262	363
APAT	52	20	157.0	35	48.6	17	85	99	174	244
EPS (Rs)	1.9	0.7	157.0	1.3	48.6	0.6	3.1	3.6	6.3	8.8
RoE-%						2.2	10.4	10.9	16.9	20.1
P/E (x)						426.5	87.0	75.4	42.6	30.4
EV/EBITDA (x)						119.9	53.2	48.7	28.3	20.2

(Source: Company, HDFC sec)

Q1FY24 Result Review:

Revenue for the quarter grew 46.2% YoY to Rs. 467 Cr vs Rs. 320 Cr in Q1FY23. Revenue from Industrial batteries stood at Rs. 325 Cr (+51% YoY), defence and aviation batteries stood at Rs. 32 Cr (-54% YoY) and from Electronics stood at Rs. 80 Cr (+199% YoY). Contribution from each segment stood at 69%, 7% and 17% respectively. EBITDA for the quarter stood at Rs. 78 Cr vs Rs. 35 Cr; EBITDA margin expanded by 576 bps from 10.9% in Q1FY23 to 16.7% in Q1FY24. PAT came in at Rs. 52 Cr vs Rs. 20 Cr in the corresponding quarter last year.

Key Developments and Triggers:

Bagged contracts for "KAVACH"

HBL as the lead member of a consortium with Siemens, signed the first contract under Mission Raftar project, with Eastern Railway for deployment of KAVACH (TCAS — Train Collision Avoidance System) over 260 kms of track and 120 locomotives, from Howrah to Pradhankhanta in Sep'22. The contract price is Rs. 286.69 cr of which HBL's work share is Rs. 205.88 cr; the contract is scheduled to be completed in 700 days.

Integral Coach Factory (ICF) is manufacturing the Vande Bharat trainsets, designed to run at 160 kmph. HBL also received a purchase order from ICF for the supply of 46 sets of Kavach, to be installed at the time of manufacture of the trainsets, at a total price of Rs 31.66 crores. Deliveries began in Nov'22 and were scheduled to be completed by Jul'23.

HBL, as the lead member of a consortium with Shivakriti International, was declared as the lowest bidder in two other tenders in West Central Railway and Western Railway, on the Delhi-Mumbai route. The tender in West Central Railway is for deployment of Kavach over 549 kms of track and 87 locomotives, for a bid price of Rs 353.84 cr. The tender in Western Railway is for deployment of Kavach over 96 kms of track, for a bid price of Rs 81.67 cr.

HBL has also entered into a contract with Ashoka Buildcon Ltd (ABL) for supply of the Kavach part of an EPC contract won by ABL in Sep'22. The ABL contract with East Central Railway, is for Rs. 220 cr (incl 18% GST) for deploying Kavach and OFC network over 417 km and 60 locomotives, between Pradhankhunta in Jharkhand and Deen Dayal Upadhyay station in Uttar Pradesh. The ABL contract with HBL is for Rs. 135 Cr (incl 18% GST) for delivery and commissioning of all equipment involved in KAVACH to be completed in 18 months.

The management has indicated that the government is planning to cover ~30,000+ kms of railway tracks with KAVACH by FY26. With only 3 OEMs (HBL Power, Kernex Micro and Medha Servo drives) approved by the RDSO, this opens up a huge addressable market for HBL.

Electronics for Rail and Defense to aid growth

Apart from KAVACH, the company also has a train management system (TMS), where a huge display panel shows the status of all trains in the territory of that system. Demand for TMS is expected to slow gradually and the market size is around Rs. 200 Cr. Depending on the size and traffic, each railway zone would need at least one TMS and the typical price per system is about Rs. 40 – 50 Cr.

The company has also produced grenades with electronic fuzes under the 'development cum production partner' contract with ARDE/DRDO, which have been approved by the Ministry of Home Affairs (MHA) for use by the paramilitary forces. Sales to MHA are expected to begin in the current FY. Approval from the Army is also expected to be received in FY24.

HBL is also developing technology for motors and controllers for EV Trucks in India. The company plans to convert old diesel trucks into electric drive using electric drive trains. Sales may begin in FY25 after the company completes the testing.

The company has also developed electronic fuzes for guns and other ammunition. ECIL and BEL have been supplying electronic fuzes for artillery but they import 80% of the content. HBL has developed the technology indigenously and has tested on arm guns. The market is huge and the competition limited, with bulk sales expected by end of FY24.

Investment in Tonbo Imaging to enhance presence in defence electronics management

Tonbo Imaging is an Indian company that indigenously designs and manufactures electro-optics and imaging systems for surveillance, reconnaissance and targeting. The ability to see better at night and over longer ranges to engage targets effectively is a much needed and sought-after technology. Tonbo has supplied advanced electro-optics systems in over 25 countries. It is also a supplier to the Indian Ministries of Defence and Home Affairs.

Electro-optics and imaging subsystems are “the eyes” and “the brain” of surveillance platforms and weapon systems. Tonbo’s technology combines fundamental innovations in the image acquisition process along with powerful computer vision algorithms to support superior imaging and scene interpretation for a wide range of applications.

HBL has entered into an agreement to invest up to Rs.150 cr in Tonbo Imaging India Pvt Ltd, a leading electro-optic solutions provider for defence applications, in the form of CCPS. HBL will also make a nominal investment in Tonbo Singapore. This investment is subject to the execution of agreements, spread over 3 tranches, linked to fulfilment of customary conditions precedents as well as closing conditions. Depending on the various parameters applicable to the valuation conditions, on final conversion, HBL will own 35.96% at floor valuation and 34.46% at cap valuation. HBL’s comprehensive manufacturing infrastructure for electronics, mechanical systems, assembly and testing will help Tonbo to deliver products to match the rapid growth in its order book.

Through this initiative, HBL is likely to leverage the intellectual property strategy and development capabilities that Tonbo brings to the realm of defence electronics.

Established battery business

The company has an established business of designing, developing and manufacturing industrial batteries and defense batteries. Demand for such batteries is expected to continue to grow moderately.

<u>Telecom Tower Batteries</u>

Most telecom batteries today are Valve Regulated Lead Acid. This is a B2B procurement by private telecom operators; and tender based by BSNL. Currently there are only three firms in the telecom market in India, versus six firms about 10 years ago. Amara Raja has the highest share, followed by Exide and then by HBL. ARBL and Exide both expanded capacity but the demand had declined. This excess capacity depressed prices and the margins are still low. However, the management expects that with the addition of 5G towers and return to normalcy on replacement schedules of batteries for older towers, demand will increase with effect from FY24.

<u>Rail and Metro Coaches/Loco Batteries</u>

Every rail/ metro coach needs a battery. These are made as Lead Acid or Nickel Cadmium Alkaline Batteries. HBL has been a recognised supplier in India and in export markets of both types. HBL is the second largest producer of Industrial Nickel Cadmium Batteries, globally. Siemens – Germany has selected HBL as the OEM supplier for their new generation of coaches, called RRX. Siemens – America has bought HBL batteries for coaches they sold to Canada.

<u>DC Power Back up Systems</u>

Pure Lead Tin batteries are Lead batteries designed to deliver higher power for shorter durations. They are being used for stationary engine starting (Cummins resells HBL made batteries under its brand). These are also used for Tanks, Army trucks operating at -30°C temperature etc. These batteries are now also being preferred for Data Centers. HBL is the only producer in India and the second in the world, based on in-house development of technology. HBL also caters to export markets.

<u>Other Batteries</u>

HBL is also one of the two battery suppliers for torpedo propulsion to the Indian Navy. Most missile batteries used in India are designed, developed and manufactured by HBL. It also exports missile batteries to Israel and UAE. It is one of the five suppliers globally of aircraft batteries. Almost all batteries used by the Indian air force are supplied by HBL. All submarine propulsion batteries in India are "Tubular plate flooded lead acid". HBL and Exide supply the same types of batteries. Tenders decide who gets the business. The average life of a submarine battery is four years; and indicative cost about Rs. 15 crores. The market in India is small, but expected to grow. HBL also has export opportunities because there are less than ten companies globally, making such batteries. HBL has been awarded a contract by NSTL / DRDO to develop prototype modules for Li-Ion batteries for Submarine application.

Risks and Concerns:

Elongated operating cycle

The company operates in a working capital intensive industry, which is characterized by a stretched operating cycle. The company has to maintain its inventory for longer and takes a long time to collect is receivables. The company, however, has been funding the inventories from its internal cash flows and reliance on bank borrowings has been low.

Hazardous nature of lead-recycling operations

Lead, which is a highly toxic and polluting material, is the primary raw material for manufacturing batteries. Hence, handling lead requires adherence to pollution control norms. Changes in environmental policies may also lead to additional costs for the company.

Volatility in prices of raw materials

The company faces risk of cost price escalation as the prices of raw material are market driven and are volatile in nature, affecting the margins of the company. Certain raw material are also imported, exposing the company to foreign exchange fluctuating risks too.

Slow adoption of KAVACH

There could be delays in adopting the KAVACH system, which could slow the growth trajectory of the company. HBL could also get lesser share of the government's order book of KAVACH roll out. However, this is unlikely, as the recent train accident would mean accelerated deployment of the system.

Competition in the battery segment

The battery segment could face increased competition from the incumbents. Excess capacity could lead to price competition and lower margins for all players in the segment. The company has faced this issue in the telecom segment in the past.

Investment in Associate Entity

HBL has entered into an agreement with Tonbo Imaging, committing to invest Rs. 150 Cr in multiple tranches. This amounts to ~15% of the current networth of HBL. Returns from investment in Tonbo imaging are uncertain in terms of timelines and the quantum of benefit that will be derived.

Low entry barriers

The power electronics and integrated power supply (IPS) business require very low initial capital investment. Therefore, it attracts entrepreneurial engineers to start as small-scale industries. In IPS, HBL sees increased competition, which will depress sales and profits. The company is planning to demerge these businesses into a separate company and invite entrepreneurs as co-owners.

About the company:

Dr A. J. Prasad promoted HBL in 1986. Dr Prasad has, over a period, built substantial experience in the line of business in which the company operates and has undertaken extensive research in battery and related segments. He has been associated with the industry for around three decades. The Company has five manufacturing facilities located in Telangana and Andhra Pradesh to manufacture batteries, electronics and engineered products based on in-house developed technologies. In addition to catering to niche sectors namely telecom, UPS, solar, defence and railways in India, HBL's products are marketed across the globe spanning 80+ countries. HBL has a global presence in America, Europe and Middle East through its subsidiaries HBL America Inc. and HBL Germany GMBH.

Vertically integrated facilities:

Location	State	Product Line
VIZIANAGARAM	Andhra Pradesh	2V/12V-AGM VRLA and Tubular Gel
VISAKHAPATNAM (SEZ)	Andhra Pradesh	Ni-Cd batteries
THUMKUNTA	Telangana	Electronics
SHAMIRPET	Telangana	Ni-Cd & Specialty batteries and power electronics
NANDIGAON	Telangana	PLT, Lithium-Ion and Submarine Batteries
YAPRAL (DEVELOPMENT CENTRE)	Telangana	Product development initiatives

(Source: Company, HDFC sec)

Financials (Consolidated)

Income Statement

(Rs Cr)	FY21	FY22	FY23	FY24E	FY25E
Net Revenues	**912**	**1236**	**1369**	**1738**	**2121**
Growth (%)	***-16.5***	***35.5***	***10.7***	***27.0***	***22.0***
Operating Expenses	850	1097	1217	1476	1758
EBITDA	**62**	**139**	**151**	**262**	**363**
Growth (%)	***-23.0***	***124.2***	***9.0***	***73.3***	***38.2***
EBITDA Margin (%)	***6.8***	***11.2***	***11.1***	***15.1***	***17.1***
Depreciation	39	35	35	42	46
Other Income	10	25	18	21	21
EBIT	**33**	**129**	**134**	**241**	**338**
Interest expenses	15	7	7	10	13
PBT	**22**	**113**	**128**	**231**	**325**
Tax	6	29	31	59	83
PAT	**16**	**85**	**97**	**173**	**242**
Share of Asso./Minority Int.	1	1	2	2	2
Adj. PAT	**17**	**85**	**99**	**174**	**244**
Growth (%)	***-24.4***	***390.0***	***15.5***	***76.8***	***40.1***
EPS	0.6	3.1	3.6	6.3	8.8

Balance Sheet

As at March (Rs Cr)	FY21	FY22	FY23	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	28	28	28	28	28
Reserves	754	838	924	1079	1298
Shareholders' Funds	**782**	**866**	**951**	**1106**	**1326**
Minority Interest	0	0	0	0	-1
Total Debt	69	63	86	136	126
Net Deferred Taxes	12	10	10	10	10
Other Non-curr. Liab.	0	0	0	0	0
Total Sources of Funds	**864**	**939**	**1048**	**1252**	**1461**
APPLICATION OF FUNDS					
Net Block & Goodwill	308	303	320	399	388
CWIP	14	43	50	10	5
Investments	7	8	9	60	112
Other Non-Curr. Assets	47	31	43	54	66
Total Non Current Assets	**376**	**384**	**422**	**523**	**571**
Inventories	290	307	336	438	529
Debtors	254	293	312	400	476
Cash & Equivalents	68	105	146	104	145
Other Current Assets	48	44	78	95	110
Total Current Assets	**660**	**748**	**872**	**1037**	**1261**
Creditors	67	88	98	125	152
Other Current Liab & Provisions	105	106	148	184	218
Total Current Liabilities	**173**	**194**	**247**	**308**	**370**
Net Current Assets	488	554	626	729	890
Total Application of Funds	**864**	**939**	**1048**	**1252**	**1461**

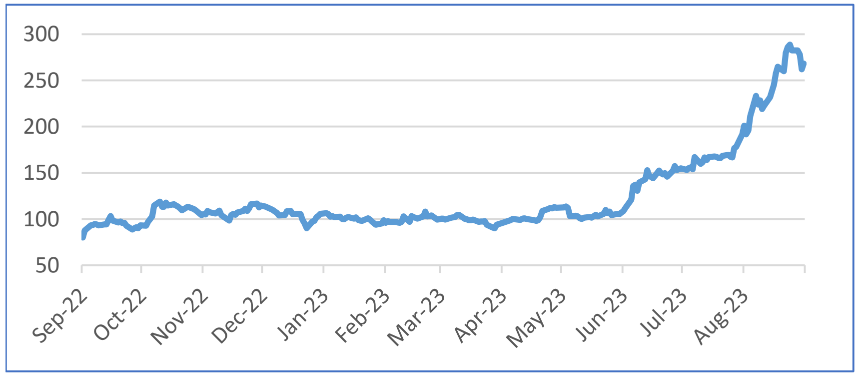
(Source: Company, HDFC sec)

HBL Power Systems Ltd

Cash Flow Statement

(Rs Cr)	FY21	FY22	FY23	FY24E	FY25E
Reported PBT	22	113	128	231	325
Non-operating & EO items	7	-1	5	-12	-12
Interest Expenses	6	2	4	10	13
Depreciation	39	35	35	42	46
Working Capital Change	48	-60	-14	-145	-120
Tax Paid	-1	-27	-37	-59	-83
OPERATING CASH FLOW (a)	**121**	**62**	**122**	**68**	**169**
Capex	-35	-21	-54	-80	-30
Free Cash Flow	86	41	68	-12	139
Investments	-1	-1	-1	-50	-50
Non-operating income	4	5	6	0	0
INVESTING CASH FLOW (b)	**-32**	**-17**	**-50**	**-130**	**-80**
Debt Issuance / (Repaid)	-94	-11	25	50	-10
Interest Expenses	-6	-2	-4	-10	-13
FCFE	-12	33	93	-22	66
Share Capital Issuance	0	0	0	0	0
Dividend	-3	-10	-11	-19	-25
Others	0	0	0	0	0
FINANCING CASH FLOW (c)	**-104**	**-22**	**10**	**21**	**-48**
NET CASH FLOW (a+b+c)	**-15**	**23**	**82**	**-42**	**41**

One Year Price Chart:



(Source: Company, HDFC sec)

Key Ratios

Particulars	FY21	FY22	FY23	FY24E	FY25E
Profitability Ratios (%)					
EBITDA Margin	6.8	11.2	11.1	15.1	17.1
EBIT Margin	3.6	10.4	9.8	13.9	15.9
APAT Margin	1.9	6.9	7.2	10.0	11.5
RoE	2.2	10.4	10.9	16.9	20.1
RoCE	3.7	14.5	13.6	21.2	25.1
Solvency Ratio (x)					
Net Debt/EBITDA	0.0	NA	NA	0.1	NA
Net D/E	0.0	0.0	NA	0.0	0.0
PER SHARE DATA (Rs)					
EPS	0.6	3.1	3.6	6.3	8.8
CEPS	2.0	4.3	4.8	7.8	10.5
BV	28.2	31.2	34.3	39.9	47.8
Dividend	0.4	0.4	0.5	0.7	0.9
Turnover Ratios (days)					
Debtor days	111.8	80.7	80.6	74.8	75.4
Inventory days	118.9	88.1	85.8	81.3	83.2
Creditors days	29.1	22.9	24.8	23.4	23.8
VALUATION					
P/E (x)	426.5	87.0	75.4	42.6	30.4
P/BV (x)	9.5	8.6	7.8	6.7	5.6
EV/EBITDA (x)	119.9	53.2	48.7	28.3	20.2
EV / Revenues (x)	8.2	6.0	5.4	4.3	3.4
Dividend Yield (%)	0.1	0.2	0.2	0.3	0.3
Dividend Payout (%)	56.5	13.2	12.6	11.1	10.2

(Source: Company, HDFC sec)

HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

I,**Nirmam Mehta (ACA),** author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. SEBI conducted the inspection and based on their observations have issued advise/warning. The said observations have been complied with. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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Any holding in stock – **No**

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