

# *Energizer*<sup>®</sup>

## Energizer Holdings, Inc.

March 30, 2012  
Volume XXXVIII, Issue III



Searching for Value Since 1975

# Energizer Holdings, Inc.

(NYSE: ENR)

Dow Jones Indus: 13,212.04  
S&P 500: 1,408.47  
Russell 2000: 830.30  
Index Component: S&P MidCap 400

Trigger: No  
Type of Situation: Business Value, Franchise Value

<b>Price:</b>	<b>\$ 74.18</b>
<b>Shares Outstanding (MM):</b>	<b>65.4</b>
<b>Fully Diluted (MM) (% Increase):</b>	<b>65.7 (0.5%)</b>
<b>Average Daily Volume (MM):</b>	<b>0.5</b>
<b>Market Cap (MM):</b>	<b>\$ 4,875.2</b>
<b>Enterprise Value (MM):</b>	<b>\$ 6,876.4</b>
<b>Percentage Closely Held:</b>	<b>~ 2%</b>
<b>52-Week High/Low:</b>	<b>\$ 84.94/62.98</b>
<b>5-Year High/Low:</b>	<b>\$ 118.94/30.96</b>
<b>Trailing Twelve Months Price/Earnings:</b>	<b>13.3x</b>
<b>Price/Stated Book Value:</b>	<b>2.3x</b>
<b>Long-Term Debt (MM):</b>	<b>\$ 2,478.1</b>
<b>Upside to Estimate of Intrinsic Value:</b>	<b>37.1%</b>
<b>Dividend:</b>	
<b>Payout Yield</b>	<b>Nil 0.0%</b>
<b>Net Revenue Per Share:</b>	
<b>LTM:</b>	<b>\$ 69.8</b>
<b>2011:</b>	<b>\$ 66.1</b>
<b>2010:</b>	<b>\$ 60.3</b>
<b>2009:</b>	<b>\$ 63.4</b>
<b>Earnings Per Share:</b>	
<b>LTM:</b>	<b>\$ 5.57</b>
<b>2011:</b>	<b>\$ 5.20</b>
<b>2010:</b>	<b>\$ 5.60</b>
<b>2009:</b>	<b>\$ 5.06</b>

**Fiscal Year Ends:** September 30  
**Company Address:** 533 Maryville University Dr.  
St. Louis, MO 63141  
**Telephone:** (314) 985-2000  
**CEO:** Ward M. Klein

*Clients of Boyar Asset Management, Inc. do not own shares of Energizer Holdings, Inc. common stock  
Analysts employed by Boyar's Intrinsic Value Research LLC do not own shares of Energizer Holdings, Inc. common stock.*



## Overview

Energizer Holdings, Inc. ("ENR," "Energizer," or "the Company") manufactures and markets batteries, portable lighting and personal care products in categories such as wet shave, skin care, feminine care and infant care. The Company's brands include the flagship Energizer battery, Schick, Wilkinson Sword, Edge, Skintimate, Personna, Banana Boat, Hawaiian Tropic, Wet Ones, Playtex and Diaper Genie.

The Company was spun off from pet food manufacturer Ralston-Purina in 2000. In 2003, ENR took the first of several steps to diversify into the personal care business with the acquisition of Schick-Wilkinson Sword, the second largest manufacturer and marketer of men's and women's wet shave products. This was followed in October 2007 by the acquisition of Playtex Products, a leading manufacturer and marketer of well-recognized branded consumer products, which include feminine care, infant care, pre-moistened wipes, sun care, and household gloves. ENR further entrenched its shaving position with the acquisition of the Edge and Skintimate shave preparation brands from S.C. Johnson in June 2009 and American Safety Razor, a leading global manufacturer of private label/value wet shaving razors and blades and industrial and specialty blades in November 2010. These acquisitions helped diversify the Company's sales and profit mix from near

## **Energizer Holdings, Inc.**

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100% batteries and lighting products at the time of the spinoff to around 50% of total sales and profits at the end of fiscal year 2011 (ended September 30<sup>th</sup>).

Energizer commands an approximate 35% market share in the worldwide battery business, second only to Duracell (owned by Procter & Gamble) which has a near 50% market share. The replacement battery business tends to be volatile in both the short term and long term. In the short term, battery companies face unstable raw material costs (such as zinc) and the competitive environment is typically characterized by irrational pricing. In the long term, replacement battery sales are pressured by an ongoing decline in devices powered by replaceable rather than built-in rechargeable batteries. Recent studies have indicated that an increasing number of devices are using built-in rechargeable battery systems, particularly in developed markets. As a result of these challenges, ENR has undertaken cost savings initiatives to manage its battery business for cash flow. On November 1, 2010 ENR announced a multi-year program designed to accelerate investments in both geographic and product growth opportunities, streamline worldwide manufacturing operations and improve the efficiency of its administrative operations. These restructuring actions are expected to cost \$85 million but should yield annual savings of ~\$35 million, of which \$11 million was already achieved in fiscal 2011 (fiscal year ended September 30, 2011). The remaining synergies (~\$25 million) are expected to be achieved in fiscal 2012.

Energizer's Personal Care segment accounts for ~50% of total sales and consists of its wet shave business (both razors and shave preparation), skin care, feminine care and infant care product lines. The biggest contributor of this segment is the wet shave business, which accounted for ~67% of the segment's sales (or 35% of total Company's sales) in fiscal 2011. This was built through the acquisitions of Schick-Wilkinson Sword in 2003, American Razor in 2010, and Edge and Skintimate shave preparation in 2009. Since owning Schick, the Company has revamped the product pipeline in order to better compete with Gillette. Its newest line of products under the Hydro brand was launched in April 2010 and is the first major innovation since 2003. ENR spent heavily on advertising and promotion to encourage strong uptake of the Hydro razor. According to market share trends in the U.S. tracked channels, ENR razor systems have gained substantial share since the introduction of Hydro. ENR's market share in razor systems accelerated significantly to 31.8% from 23.4% since the initial Hydro launch in April 2010. ENR also gained 330 bps of sequential share in blades since the Hydro launch, improving to a 16.3% market share from 13.0%. Schick Hydro currently holds a 13.2% dollar share in razor systems and a 4.5% share in blades. Going forward, we expect Hydro's share momentum in razor systems to translate to greater refill blades share growth, which is important given that refill blades generate much higher margins.

Energizer has consistently been a strong cash flow generator. Over the last 10 years, ENR cumulatively generated ~\$3.2 billion in free cash flow, or ~\$323 million per year on average. Between 2001 and 2007, the Company had been fairly aggressive in repurchasing shares. From 2000 to 2007, ENR repurchased 46.2 million shares for almost \$2 billion and reduced shares outstanding by ~50%. With the acquisitions of Playtex in October 2007 and Edge/Skintimate in June 2009, ENR's priority for free cash flow was redirected towards debt reduction. With those two acquisitions, the Company incurred ~\$1 billion in total debt and the Company's leverage ratio (net debt/EBITDA) increased from 2.0x at the end of fiscal 2007 to 3.5x at the end of 2008. With the Company's leverage ratio declining to just over 2.0x at the end of fiscal 2010, ENR resumed share repurchases in fiscal 2011 by purchasing 3.7 million shares (mostly in the fourth quarter) for \$276 million at an average cost of \$74.59 a share. The Company purchased another 1.9 million shares in the first quarter of fiscal 2012 for ~\$136 million (average cost: \$71.58 per share), leaving ~2.3 million shares remaining on its current authorization.

While Energizer does not currently pay a dividend (a rarity among consumer product companies), we believe instituting a quarterly payout would be viewed favorably by the investment community and allow the Company to attract a wider investment base. Based on current prices, we note that the Company could initiate a dividend with a 2% yield (\$1.48 a share on an annual basis) while keeping its payout ratio less than 25%. At this level, Energizer's payout ratio would be well below the payout ratio of both P&G (3.1% yield) and Clorox (3.4% yield), which boast payout ratios of 46% and 56%, respectively. With a payout ratio of less than 25%, we believe Energizer would still have plenty of room for dividend increases while maintaining liquidity for share repurchases and niche/bolt-on acquisitions.

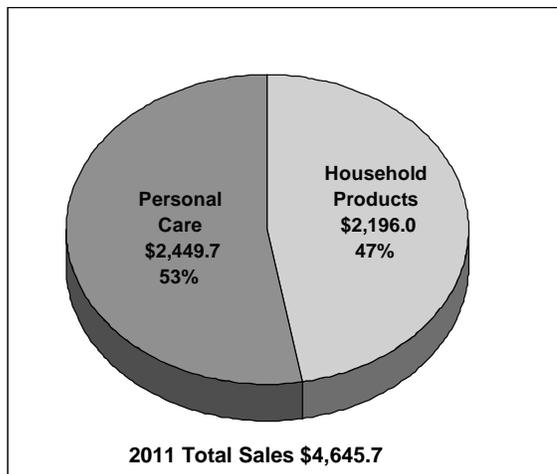
**Energizer Holdings, Inc.**

At current levels, Energizer is trading at ~7.8x LTM EBITDA and 17.4x LTM earnings, which is well below its peers in the consumer products industry such as P&G, Clorox, Colgate-Palmolive, Church & Dwight and Kimberly Clark. We believe the current valuation discount is unwarranted due to Energizer's well-known brands, scale, solid market position, strong balance sheet and ability to generate consistent free cash flow. Approximately 95% of the Company's sales are derived from products that command either a number one or number two market position. Applying discounted (relative to their respective industry peers' trading multiples) multiples to the Household Products and Personal Care segments of 7.0x and 9.0x, respectively to our estimate of 2014E EBITDA for these divisions, our estimate of Energizer's intrinsic is \$102 a share, representing 37% upside from current prices.

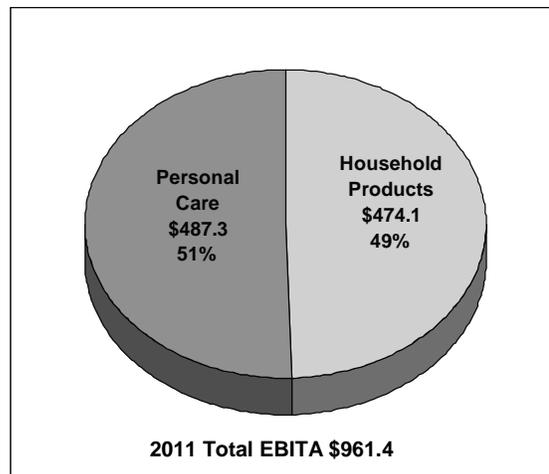
**Company Description**

Energizer Holdings, Inc. manufactures and markets batteries, portable lighting and personal care products such as wet shave, skin care, feminine care and infant care. The Company operates in two business segments: Household Products and Personal Care. The Household Products business consists of the flagship Energizer battery business and lighting products. The Personal Care business includes wet shave products sold under the Schick, Wilkinson Sword, Edge, Skintimate and Personna brand names, Skin Care products sold under the Banana Boat, Hawaiian Tropic, Wet Ones and Playtex brand names, and Feminine Care and Infant Care products sold under the Playtex and Diaper Genie brand names. At year-end 2011, 95% of the Company's sales are generated from product lines that have a number one or number two market share position in their respective markets.

**Sales by Segment (\$MM)**



**EBITA by Segment (\$MM)**



Note: Sales and EBITA are presented before corporate eliminations

**History**

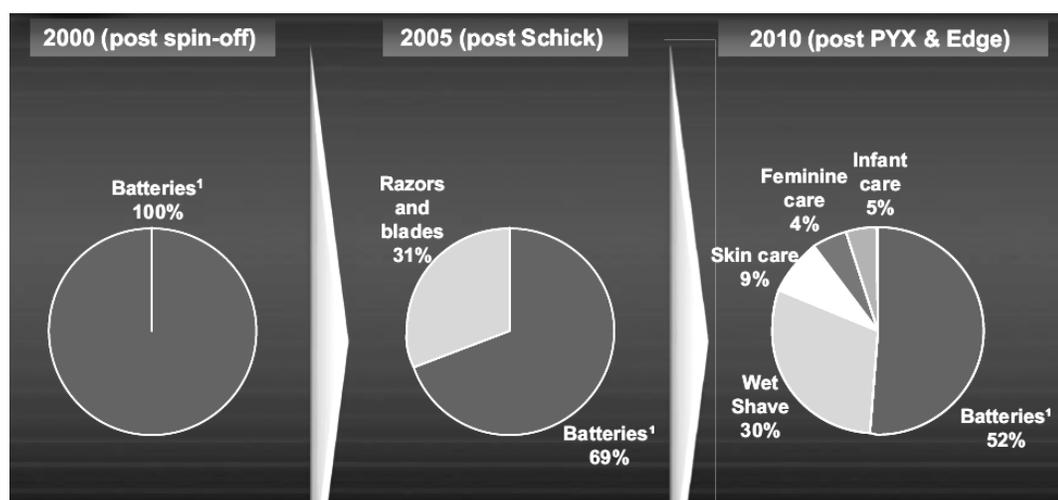
Energizer was originally founded in 1898 as American Electrical Novelty and Manufacturing by Conrad Hubert when he invented the first handheld flashlight. It was subsequently renamed American Ever Ready Company in 1905, became part of National Carbon Company in 1914 and merged with Union Carbide in 1917. Union Carbide enjoyed great success in the consumer battery business driven in part by the growth of portable radios, electronic gadgets and toys. Union Carbide had to fend off a hostile takeover by GAF Industries in the mid-1980s, so it sold Eveready Battery Company for \$1.4 billion to Ralston Purina (a pet food manufacturer) in 1986 in order to raise cash to issue a special dividend for its shareholders. In 2000, Ralston decided to focus on its core operations and spun off the battery business to its shareholders, naming it Energizer Holdings.

On March 28, 2003, ENR took the first of several steps to diversify into the personal care business with the acquisition of the Schick-Wilkinson Sword (Schick) business from Pfizer. Schick is the second largest

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manufacturer and marketer of men's and women's wet shave products in the world. In October 2007, the Company acquired Playtex Products, a leading manufacturer and marketer of well-recognized branded consumer products, which include feminine care, infant care, pre-moistened wipes, sun care, and household gloves. ENR further entrenched its shaving position with the acquisition of the Edge and Skintimate shave preparation brands from S.C. Johnson in June 2009 and American Safety Razor, a leading global manufacturer of private label/value wet shaving razors and blades, and industrial and specialty blades in November 2010.

These acquisitions helped diversify the Company's sales and profit mix from near 100% batteries and lighting products at the time of the spinoff to ~50% of total sales and profit currently.



Source: Company presentation

## Household Products

Energizer's Household Products division manufactures and markets an extensive portfolio of household batteries (which includes Eveready and its namesake Energizer brands), specialty batteries (lithium and watch/hearing aid batteries) and lighting products. In fiscal year 2011, ended September 30<sup>th</sup>, this segment contributed approximately \$2.2 billion in total sales (or ~47% of total sales), split almost evenly between North America and International.

### Household Products Segment (\$MM)

	2007	2008	2009	2010	2011
Alkaline batteries	\$1,461.9	\$1,490.1	\$1,264.3	\$1,327.9	\$1,311.7
Other batteries and lighting products	<u>914.4</u>	<u>984.2</u>	<u>845.2</u>	<u>871.8</u>	<u>884.3</u>
Net Sales	\$2,376.3	\$2,474.3	\$2,109.5	\$2,199.7	\$2,196.0
EBITA	\$472.3	\$489.1	\$398.6	\$451.1	\$410.6
EBITA %	19.9%	19.8%	18.9%	20.5%	18.7%

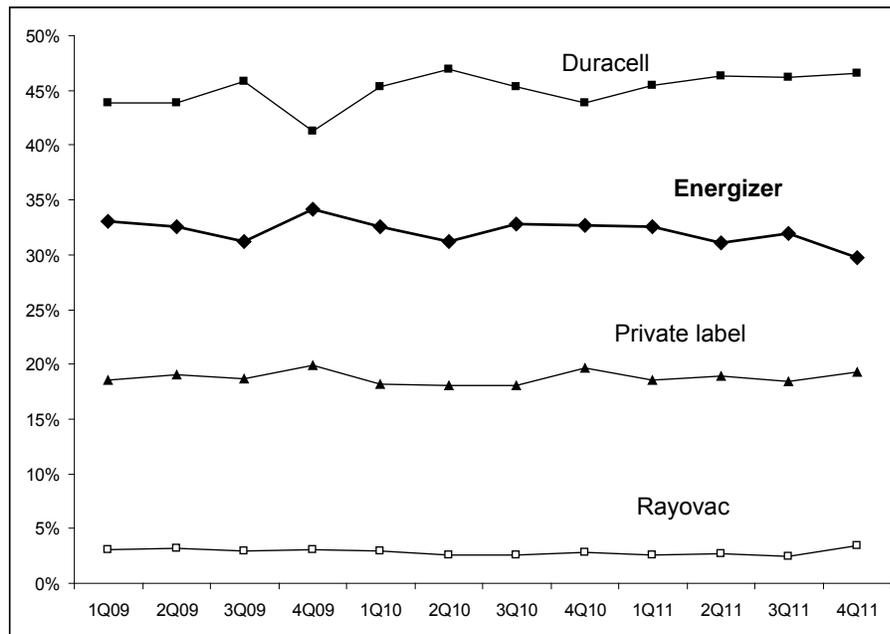
### Battery Market

The global primary battery market (which consists of alkaline, carbon zinc, primary lithium and zinc-air) is approximately \$10 billion to \$12 billion and is dominated by three players: Duracell (owned by Procter & Gamble), Energizer and Rayovac (owned by Spectrum). The size of the U.S. market is about \$4 billion, and

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about 76% of the batteries sold are alkaline, where Duracell is the clear leader with a near 46% market share and ENR is a strong #2 with a 29% market share (as of 4Q 2011). However, Energizer is the market leader in lithium batteries and has a strong competitive position in the zinc carbon (1<sup>st</sup> generation of general purpose battery, has short shelf life) and zinc air (primarily hearing aids) segments. In the alkaline segment, ENR has seen its market share erode during 2011, dropping from 32.7% in 4Q 2010 to under 30%. We attribute some of this share loss to the Company's decision in early 2011 to reduce advertising and media spending, and instead fund future growth initiatives such as lithium and lighting products.

**U.S. Alkaline Market Share Trend**

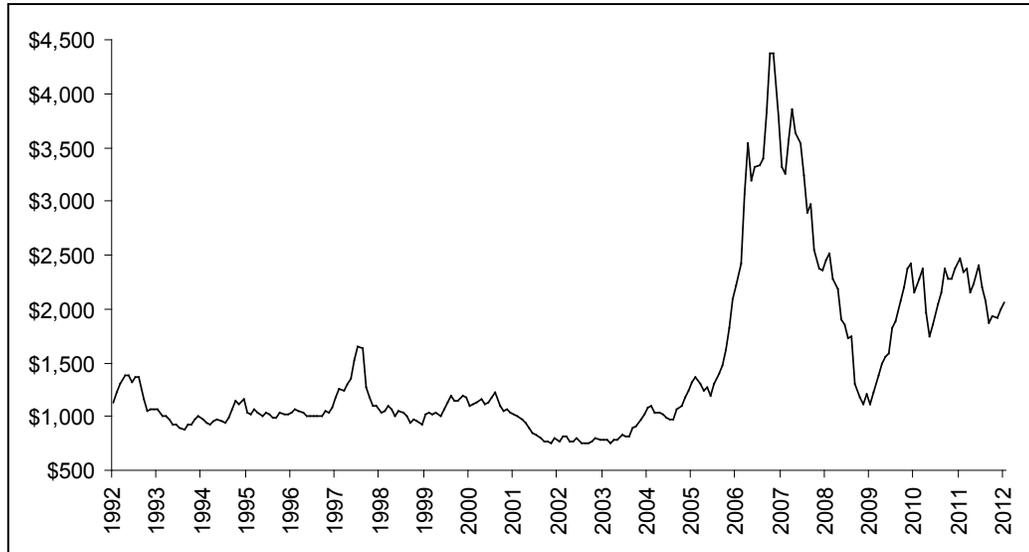


Source: IRI

The competitive landscape of the battery industry outside of the U.S. differs by markets. The European market is about \$5.9 billion but the industry is hyper competitive and private label is the share leader with ~32% market share followed by Duracell and Energizer with a ~28% and ~22% share, respectively. The size of the Latin American market is approximately \$1.5 billion. Duracell dominates in Mexico with a ~45% market share compared to only ~7.5% for ENR. But both Duracell (with ~24% market share) and Energizer (~13% market share) are minor players in Brazil, as this market is primarily carbon zinc, which plays to Rayovac's strength (~40% market share).

The battery business can be extremely volatile due to unstable raw material costs and a competitive environment. Energizer purchases almost 55 million pounds of zinc per year. Zinc prices stood at \$2,057.81 per metric ton in February 2012. This is twice the average price prior to February 2005, prior to a spike to over \$4,300 per metric ton. However, prices have declined 16.8% from the year ago period, providing battery manufacturers some cost reprieve. In addition, ENR has made two rounds of price increases in order to try to recover profitability.

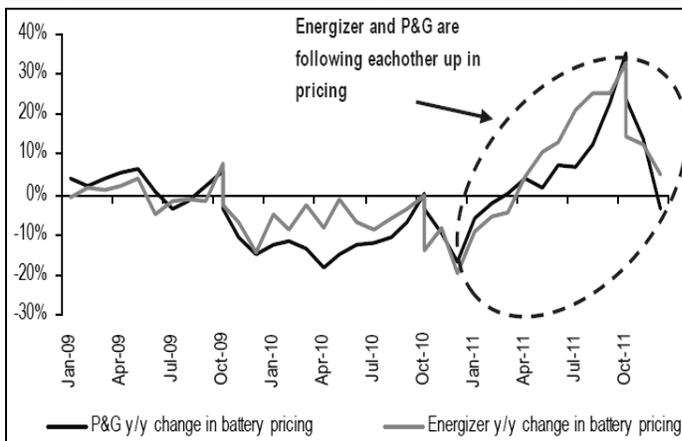
**Monthly Zinc Prices 1992-2012 (\$/Metric ton)**



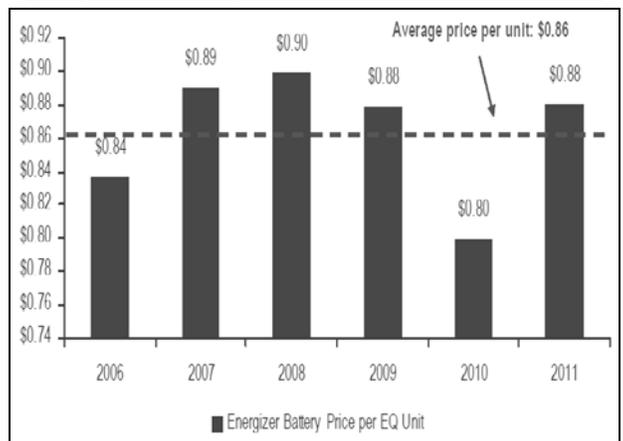
Source: London Metal Exchange

In the past, during times of moderating raw material prices, both Energizer and Duracell tried to use the raw material savings to offer promotions to win shelf space and boost consumer acceptance. These promotions run the gamut from buy one get one free, package upsizing, to bonus packaging, etc. While these promotions tend to help consumers offset higher prices, they hurt the battery companies' operating profit margins. For example, in 2010, Energizer's battery price per unit was \$0.80, down from an average of \$0.86 over the long term. As we mentioned previously, ENR has reduced promotional activities in 2011 to focus on growth initiatives and profitability. Effective March 1, 2011, the Company increased prices by 7% on C, D and 9-volt batteries and eliminated pack up-sizing. Fortunately, Duracell followed with similar price increases. Energizer led another round of 6.7% price increases for alkaline and carbon zinc products effective February 2012, which Duracell once again followed. While Rayovac has not yet increased pricing, we expect them to eventually follow too, as they are primarily a price taker and usually follow the price setters. With battery price per unit near \$0.88 in 2011, we believe that Energizer's pricing has now returned to a more normalized level.

**Energizer and P&G are Exhibiting Rational Pricing Behavior**



**Energizer's Pricing is Back to a More Normal Level**



Source: The Nielsen Company, via UBS Investment Research, February 2012

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Meanwhile, battery market growth is also challenged. In the developed countries, battery sales are pressured by an ongoing decline in devices powered by replaceable rather than built-in rechargeable batteries. Recent studies have indicated that an increasing number of devices are using built-in rechargeable battery systems, particularly in developed markets. This will likely continue to create a negative impact on the demand for primary batteries. In Europe, private label competition is strong and the market is further segmented between premium private label and regular private label. Growth opportunities exist in developing regions, such as Latin America and Asia, which have lower penetration rates of alkaline batteries. These regions should benefit from market growth due to the trade-up to alkaline and growth in consumer electronics. Furthermore, ENR is the leader in premium-priced lithium batteries and flashlights, and continues to add to its product line with new products, such as inductive chargers (the next generation of intelligent chargers that use electromagnetic field to transfer energy to and from the device they are charging).

### ***Restructuring Initiatives***

As a result of the long term secular challenges of the battery business, ENR has undertaken cost savings initiatives to manage this business for cash flow. On November 1, 2010, ENR announced a multi-year program designed to accelerate investments in both geographic and product growth opportunities, streamline worldwide manufacturing operations and improve the efficiency of its administrative operations. Accordingly, the Company closed an alkaline production facility in Switzerland (which had capacity to produce 1 billion alkaline batteries per year) and a carbon zinc product facility in the Philippines. Production capacity in other locations was also reduced. These restructuring actions are expected to cost \$85 million and yield annual savings of ~\$35 million, of which \$11 million was already achieved in fiscal 2011. The remaining (~\$25 million) is expected to be achieved in fiscal 2012.

### **Personal Care**

Energizer's Personal Care segment consists of its wet shave business (both razors and shave preparation), skin care, feminine care and infant care product lines. In fiscal year ended September 30, 2011, this segment contributed approximately \$2.4 billion in total sales (or ~52% of total sales).

#### **Personal Care Segment (\$MM)**

	2007	2008	2009	2010	2011
Wet shave	\$988.8	\$1,085.0	\$1,118.1	\$1,265.1	\$1,637.4
Skin care	0.0	364.1	364.0	383.0	417.6
Feminine Care	0.0	222.6	214.1	198.8	195.1
Infant Care	0.0	185.0	194.1	201.7	198.0
Other personal care products	0.0	0.0	0.0	0.0	1.6
Net Sales	\$988.8	\$1,856.7	\$1,890.3	\$2,048.6	\$2,449.7
EBITA	\$155.5	\$322.5	\$341.1	\$366.6	\$408.4
EBITA %	15.7%	17.4%	18.0%	17.9%	16.7%

The biggest contributor to this segment is the wet shave business, which accounted for ~67% of the segment's sales (or 35% of total Company's sales) in fiscal 2011. This was built through the acquisitions of Schick-Wilkinson Sword in 2003, American Razor in 2010, and Edge and Skintimate shave preparation in 2009.

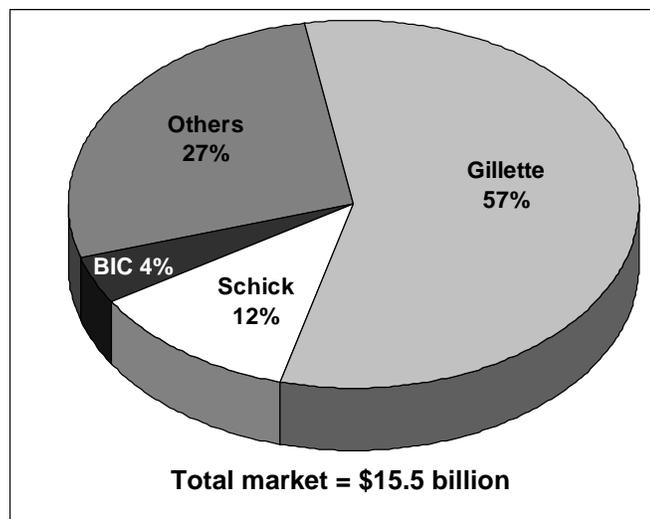
### ***Wet Shaving Market***

The global shaving products market is comprised of wet shave blades and razors, electric shavers, lotions and creams. According to Euromonitor, the global shaving market approximates \$15.5 billion, and is increasing at a 6% annual rate. Gillette (owned by P&G) is the market leader with a 57% share, and Energizer's Schick is a distant #2 with a 12% share. While ENR markets its wet shave products in more than 150 countries worldwide, Schick's primary markets are the U.S., Japan and the larger countries of Western Europe. The Company estimates that its share in these markets is closer to 20%-21%. Growth in developed

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countries is primarily driven by new premium-priced product introductions, demand among men for a better shaving experience led by technological advancements, and growth in razors for women. Meanwhile, growth in developing countries such as Latin America, Asia and Eastern European countries will be strongly influenced by demographic trends and rising living standards. The category is extremely competitive, with numerous companies vying for consumer loyalty and retail shelf space.

**Global Shaving Market Share**



Source: Euromonitor

**Hydro = New Growth Platform**

Subsequent to Energizer’s acquisition of Schick in 2003, the Company has revamped Schick’s pipeline in order to better compete with Gillette. Schick’s newest line of products under the Hydro brand was launched in April 2010 and represents the first major innovation since 2003 when ENR introduced Quattro (a four blade system for men) and Intuition (a three-bladed razor surrounded by a skin conditioning solid which lathers, shaves and provides extra moisture in one step). Both Quattro and Intuition contributed \$520 million in revenue in fiscal 2010. Hydro incorporates new technologies including innovative skin protectors that act to smooth skin between blade tips and an advanced hydrating gel reservoir that lubricates throughout the shaving process. ENR spent heavily on Hydro advertising and promotion to encourage strong uptake of the razor. Since the Hydro rollout in the third quarter fiscal 2010, ENR significantly boosted advertising and promotion spending as a percentage of sales. In fiscal 2011, total advertising and promotion spending increased 100 basis points to 11.9% of sales (before the effect of acquisitions). Almost all of this increase is due to increased investment to support the Hydro launch. As the Company anniversaries the Hydro launch, advertising spending is expected to return to more normalized levels of ~10.5% of sales.

Despite the heavy advertising and promotion investment, which hurt wet shave profitability in fiscal 2011, we view the Hydro innovation favorably. According to market share trends in the U.S. tracked channels, ENR razor systems have gained substantial share since the introduction of Hydro. ENR’s market share in razor systems accelerated significantly to 31.8% from 23.4% since the initial Hydro launch in April 2010, which marked an 840 basis points (bps) sequential market share improvement. ENR also gained 330 bps of sequential share in blades since the Hydro launch, improving to a 16.3% share result from 13.0%. Schick Hydro currently holds a 13.2% dollar share in razor systems and a 4.5% share in blades. Going forward, we expect Hydro’s share momentum in razor systems to translate to greater refill blades share growth, which is important given the much higher margins on refill blades. For perspective, ENR’s prior next-generation innovation cycle (Quattro/Intuition) in wet shave in fiscal year 2003 drove a 40% profit CAGR over a 3½ year period, and we believe that Hydro has the potential to produce similar results. In addition, we believe ENR is

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poised to launch additional wet shave products going forward, including a women's product in the first quarter of fiscal 2012.

### ***ASR Acquisition Boosts Scale***

In November 2010, ENR acquired American Safety Razor (ASR) out of bankruptcy for \$301 million plus the assumption of approximately \$124 million of unfunded pension obligation (or 5.7x LTM EBITDA). ASR is the fourth largest manufacturer of razors and blades (with 6% market share in the U.S. and 2% market share globally); its brands include Personna, Magnum, Matrix and Mystique brands. ASR competes in private label and value priced products which sell at a significant discount to its branded competitors. For example, ASR's M5 Magnum branded refill blades sell for about \$1.50 each, a significant discount compared to Hydro and Gillette's Pro Glide which retail at \$3.00 and \$4.25 per cartridge, respectively. The acquisition of ASR allows Schick to participate across more price points on the retail shelf within the shaving category. Furthermore, even though Schick already competes in 150 countries, ASR strengthens the Company's international presences in countries such as Brazil and Mexico. According to bankruptcy filings, ASR generated approximately \$284 million in sales and \$74 million of EBITDA from its wet shaving business in 2009. However, ironically, in 2010, it lost to Energizer a contract with Wal-Mart, which was approximately \$50 million in sales. Nevertheless, ASR still contributed \$262 million of sales and \$28 million of profit to ENR during fiscal 2011. Further, this acquisition allowed ENR to leverage some of ASR's fixed assets (manufacturing/distribution facilities) for business growth or incremental cost savings and increase its share at the low-end of the market to create an even more stable category pricing architecture.

Just as importantly, ASR's private label offerings strengthen ENR's relationships with retail partners. The Company just became the category manager at a major drug store account due to its private label offering and recently won a separate bid for private label razor business at a 10% premium to its competitor based on higher quality. The Company plans to use the additional capacity acquired with ASR (roughly doubled overall capacity) to manage the category for the benefit of its retail partners and itself. Energizer is likely the only private label player that can make a product with comparable quality to mid/value tier branded systems. Strategically, ASR enables Energizer to capture consumer trade-down and control (to an extent) the degree to which high-end retail private label offerings will compete with existing branded products.

### ***Edge Extends Portfolio***

Energizer filled out and extended its shaving portfolio with the \$275 million acquisition of the Skintimate and Edge brands in 2009, giving it scale in the shave preparation business. The Company's brands of shave preps (Edge, Skintimate, and Hydro) combined to make up a 33% volume share in the last 52 weeks of U.S. data, but Barbasol holds the market leadership in the category with a 17% share on its own. Adding Edge and Skintimate to the Company's portfolio made strategic sense as it strengthens Energizer's shaving prep business and leverage its distribution resources.

### ***Skin Care***

Energizer entered the skin care market through its acquisition of Playtex Products in October 2007. This business accounts for ~9% of total fiscal 2011 sales and includes sun care (under the Banana Boat and Hawaiian Tropic brands), pre-moistened hand wipes (Wet Ones) and household gloves (Playtex Gloves). The majority of skin care sales are derived from sun care products. The U.S. sun care market was about \$1.5 billion in 2011, is projected to grow 3% per year over the next five years, and ENR is the market share leader by volume with a ~32% combined share. When ENR acquired this business, sales were primarily concentrated in North America and about a dozen international countries (~98% of total Playtex sales was derived from North America). Since ENR does business in over 150 countries, it saw an opportunity to leverage its international distribution network to drive sun care sales growth. For example, the market in Western Europe is estimated to total over \$3.0 billion while growing over 5% per year. Both Banana Boat and Hawaiian Tropic have already capitalized on this growth under Energizer's ownership, growing 15% to 20% per year since 2007.

### ***Feminine Care***

In feminine care, *Playtex* is the second largest selling tampon brand overall in the U.S., with a 22% market share. The Company offers plastic applicator tampons under the *Playtex Gentle Glide* and *Playtex Sport* brands, and *Playtex Personal Cleansing Cloths*, a pre-moistened wipe for feminine hygiene. P&G's

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Tampax is the market share leader with ~50% share. Playtex generated almost \$200 million in sales from feminine care products last year. Recently, Playtex has been under pressure from Kimberly Clark, the number 3 player (~16% share), which had revitalized its Kotex line and introduced U by Kotex after years of uninspiring products. We expect Playtex will need to step up innovation and marketing support in order to defend its position against both Kotex and Tampax.

### ***Infant Care***

ENR's infant care business accounted for 4.2% of fiscal 2011 sales, or almost \$200 million, and owns a leading 26% market share in this category. Playtex Baby is a U.S. market leader in feed products, which include a full line of disposable and reusable bottles, children's drinking cups, pacifiers, nursing necessities and meal time products. In addition, ENR owns the #1 diaper disposal pail brand, Diaper Genie, and the Playtex Hip Hammock child carrier. Recent category weakness has been driven by a dip in birthrates as many people have delayed starting a family due to the recession. As the economy recovers, we would expect household formation to normalize and the birthrate to increase again. This should provide the category with a modest tailwind. We would also note that Playtex has a strong track record of introducing innovative products to the category.

### **Is the Company Competitively Advantaged?**

*"Habit leads to customer captivity when frequent purchases of the same brand establish an allegiance that is as difficult to understand as it is to undermine."<sup>1</sup>*

*– Professor Bruce Greenwald, Robert Heilbrunn Professor of Finance and Asset Management at Columbia Business School*

Over the last three years, the Company's return on invested capital (ROIC) has been near 10% (unadjusted for goodwill and other one-time charges and write-offs), down from the mid- to high-teens historically. This calls into question whether Energizer has lost its competitive advantage. However, when we examined the Company's return on tangible capital (ROTC), it ranged between 21%-29% during the same period. We conclude that ENR is competitively advantaged and its advantage stems from its brands, economies of scale, inter-relationships among business units and customer captivity (customer habits). We believe the lower ROIC was due to an over-priced and poorly timed acquisition: we believe ENR paid too rich of a price when it acquired Playtex Products in October 2007. Energizer purchased Playtex for \$1.9 billion, or ~14.5x LTM EBITDA. Energizer levered up significantly to close this deal and it led the Company to bump up over its debt covenant thresholds. The Company had to issue shares (in conjunction with paying for the Edge/Skintimate acquisition) and dilute existing shareholders (by approximately 20%) in 2009 in order to bring debt level back down to a more manageable level. This was a very inopportune time in the capital markets for any company to be issuing its own stock.

Nevertheless, we believe ENR's strong brands and economies of scale provide the Company with competitive advantages. We believe Energizer, Schick and Playtex are strong brands with staying power. They have been built over the last 100 years through continuous marketing to drive consumer recognition and awareness. These brands convey to consumers a sense of quality, innovation, performance and reliability. Many people have developed strong consumer loyalty and allegiance to these brands (how many people put a private label battery in their smoke detector?). As a result, many consumers often purchase them out of habit. This has allowed ENR to charge consumers a premium price, allowing the Company to earn above average returns.

From purchasing to marketing and manufacturing, the Company's scale provides it with a cost advantage, as it can spread its total cost over a larger sales base, resulting in lower per unit cost. This scale is further enhanced through business unit inter-relationships. For example, one of the Company's rationales for purchasing Playtex Products in October 2007 was that it could leverage its international distribution network to help Playtex drive overseas sales. As we mentioned previously, 95% of Playtex sales were derived from North

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<sup>1</sup> Bruce Greenwald and Judd Kahn, *Competition Demystified*, Pg. 32

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America when ENR acquired it. Meanwhile, Energizer's battery and wet shave businesses have distribution points in over 140 countries. ENR's inter-relationships have helped the sun care business grow 15% to 20% per year since being acquired by Energizer in 2007. Finally, ENR enjoys strong retailer support. About 95% of the Company's sales come from products that are either in a number one or number two market position, and also nearly 75% of ENR's product lines overlap with Procter & Gamble's. Retailers look for a strong competitor to counter and keep Procter & Gamble in check.

As a result of these competitive strengths and improving profitability at both business segments, we expect ENR's ROIC to improve from fiscal 2011's low levels. Beginning with Household Products, operating profit should improve due to its restructuring efforts to align capacity with market demand, a more rational pricing environment in the battery market and lower promotional activities. Personal Care profit should also increase as advertising and promotional support for the Hydro launch ramps down. As a result, we expect ROIC to improve from 12.1% at the end of fiscal 2011 to near 15.5% by fiscal 2016.

### **Improving Profitability**

Fiscal 2011 was characterized as a year of investment for Energizer. These investments included increased advertising and promotion support for the Schick Hydro launch, restructuring of the battery operations and the acquisition of American Safety Razors. Altogether, the Company's fiscal 2011 operating profitability margin declined 180 bps to 14.6%. As we mentioned earlier, a good portion of this decline was driven by higher advertising and promotion expense to support the Hydro launch. Fiscal 2011 advertising and promotion expense was 11.9% of sales (excluding ASR) compared to 10.3% in 2009 (which we view as normalized levels).

Beginning in fiscal 2012, we expect improved profitability going forward driven by restructuring benefits, a more rational pricing environment for batteries, and advertising & promotional spending returning to more normalized levels. We expect another \$25 million in cost savings from the Household Products business as the restructuring activities improve productivity and capacity utilization. Further, the battery business should benefit from a more rational pricing environment as ENR has recently initiated two price increases, which was followed by its major competitor, and continues to remain disciplined on promotions. Meanwhile, the Personal Care business should benefit from lower investment spending in advertising and promotion now that Hydro has launched.

Finally, Energizer should benefit from an improving business mix. The Personal Care segment led by wet shave (razor blades) and sun care is faster growing and generates higher margins. Over the next five years, we are projecting the Personal Care segment to grow sales at a 3% CAGR, compared to 1% CAGR for the Household Products business.

	<u>2011</u>	<u>2012E</u>	<u>2013E</u>	<u>2014E</u>	<u>2015E</u>	<u>2016E</u>	<u>CAGR</u> <u>2011-2016</u>
Sales	\$4,645.7	\$4,706.9	\$4,791.7	\$4,878.2	\$4,966.6	\$5,056.8	1.7%
% Growth		1.3%	1.8%	1.8%	1.8%	1.8%	
EBITDA	\$862.1	\$907.1	\$933.6	\$956.8	\$980.7	\$1,003.6	3.1%
Margin	18.6%	19.3%	19.5%	19.6%	19.7%	19.8%	
EPS	\$5.20	\$6.12	\$6.71	\$7.27	\$7.86	\$8.45	10.2%
% Growth		17.7%	9.6%	8.5%	8.0%	7.5%	

### **Balance Sheet and Cash Flow Generation**

The Energizer Bunny keeps going and going generating and generating (cash flow). Over the last 10 years, ENR cumulatively generated ~\$3.2 billion in free cash flow, or ~\$323 million per year on average. Between 2001 and 2007, the Company has been fairly aggressive in share repurchases. From 2000 to 2007,

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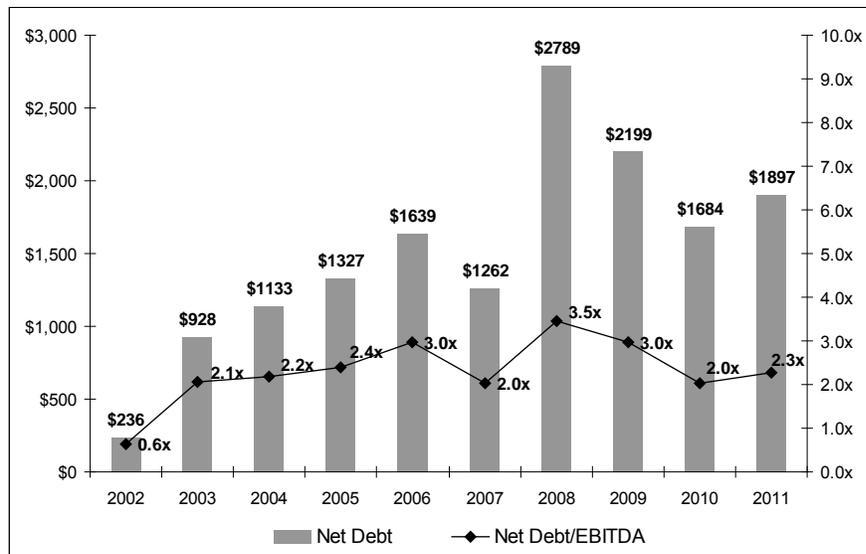
ENR repurchased 46.2 million shares for almost \$2 billion, resulting in an ~50% reduction in shares outstanding. The lower share count helped fuel earnings per share growth. Between 2000 and 2007, operating profit grew at ~7% CAGR, while earnings per share grew ~17% during the same period.

### Strong Free Cash Flow Trend (\$MM)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
FFFO	\$206.1	\$442.1	\$485.7	\$295.9	\$373.0	\$445.3	\$466.5	\$489.2	\$652.4	\$412.5
Capex	(40.7)	(73.0)	(121.4)	(103.0)	(94.9)	(88.6)	(160.0)	(139.7)	(108.7)	(98.0)
FCF	\$165.4	\$369.1	\$364.3	\$192.9	\$278.1	\$356.7	\$306.5	\$349.5	\$543.7	\$314.5

With the acquisitions of Playtex in October 2007 and Edge/Skintimate in June 2009, ENR's priority for free cash flow was redirected towards debt reduction. With those two acquisitions, the Company incurred ~\$1 billion in total debt and the Company's leverage ratio (net debt/EBITDA) increased from 2.0x at the end of fiscal 2007 to 3.5x at the end of fiscal 2008. The Company's leverage declined slightly in fiscal 2009 due to a common stock offering that helped lessen the debt load. With the leverage ratio back near 2.0x by the end of fiscal 2010, ENR resumed share repurchases in fiscal 2011 by purchasing 3.7 million shares (mostly in the fourth quarter) for \$276 million (average cost: \$74.59 per share). The Company purchased another 1.9 million shares in the first quarter of fiscal 2012 for ~\$136 million (average cost: \$71.58 per share), leaving ~2.3 million shares remaining on its current authorization to repurchase shares in the future.

### Balance Sheet Trend (\$MM)



While Energizer does not currently pay a dividend (a rarity among consumer product companies), we believe instituting a quarterly payout would be viewed favorably by the investment community and allow the Company to attract a wider investment base. Based on current prices, we note that the Company could initiate a dividend with a 2% yield (\$1.48 a share on an annual basis) while keeping its payout ratio less than 25%. At this level, Energizer's payout ratio would be well below the payout ratio of both P&G (3.1% yield) and Clorox (3.4% yield), which boast payout ratios of 46% and 56%, respectively. With a payout ratio less than 25%, we believe Energizer would still have plenty of room for future dividend increases while maintaining liquidity for share repurchases and niche/bolt-on acquisitions.

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### Valuation

At current levels, Energizer is trading at ~7.8x LTM EBITDA and 17.4x LTM earnings, which is well below its peers in the consumer products industry such as P&G, Clorox, Colgate-Palmolive, Church & Dwight and Kimberly Clark. This is also at the low end of Energizer's historical trading range of 5.2x to 13.1x LTM EBITDA (with an average multiple of 8.6x) between 2001-2011.

	<u>LTM</u> <u>EBITDA</u>	<u>LTM</u> <u>P/E</u>	<u>Forward</u> <u>P/E</u>
Church and Dwight	12.3	23.2	18.5
Colgate Palmolive	11.9	19.8	15.6
Clorox	10.6	16.8	15.7
<b>Energizer Holdings</b>	<b>7.8</b>	<b>17.4</b>	<b>11.1</b>
Kimberly Clark	8.9	18.5	13.4
<u>Procter &amp; Gamble</u>	<u>11.6</u>	<u>19.8</u>	<u>15.5</u>
Average	10.5	19.2	15.0
<u>Average excl. ENR</u>	<u>11.1</u>	<u>19.6</u>	<u>15.7</u>

We suspect Energizer's below-average valuation range historically reflected the Company's business mix, as ENR still derived ~70% and ~75% of its sales and profit from the volatile, low growth battery business as recently as 2007. However, the Company has diversified its business mix and the battery business now accounts for less than 50% of total sales. Further, with the introduction of Hydro, and the acquisition of Edge shave prep and American Safety Razor, ENR has solidified its position in wet shave—a market that we believe has attractive long-term growth avenues. Furthermore, today approximately 95% of the Company's sales are derived from products that command either a #1 or #2 market position.

We believe the current valuation discount is unwarranted due to Energizer's well-known brands, scale, solid market position, strong balance sheet and ability to generate consistent free cash flow. From a strategic acquirer perspective, Energizer's direct competitor, Gillette, was acquired by P&G at ~19.0x LTM EBITDA in October 2005. Energizer is unlikely to command anything near this takeout multiple given that ENR is a distant second to Gillette in the wet shave market (razor blades are a high margin and recurring business). Applying discounted multiples (relative to their respective industry peers' trading multiples) multiples of 7.0x and 9.0x our estimate of 2014E EBITDA for the Household Products and Personal Care segments, respectively, our estimate of Energizer's intrinsic is \$102 a share, representing 37% upside from current prices. In determining our valuation, we assumed all free cash flow generated over the next two years is used to repay all debt outstanding rather than for share repurchases.

<b>ENR – Estimate of Intrinsic Value</b>	
<b>(\$MM)</b>	
	<u>2014E</u>
Personal Care Sales	\$2,599.6
Personal Care EBITDA	560.8
Multiple	<u>9.0x</u>
Segment Valuation	\$5,047.0
Household Sales	\$2,240.1
Household EBITDA	484.4
Multiple	<u>7.0x</u>
Segment Valuation	\$3,390.9
Corporate Expense	(\$106.8)
Multiple	<u>5.0x</u>
Segment Valuation	(\$533.9)
Total Enterprise Value	\$7,903.9
Less: 2014E Net Debt	(309.3)
Less: Unfunded Pension	<u>(446.5)</u>
Intrinsic Value	\$7,148.2
Shares outstanding	70.3
Intrinsic Value per share	\$101.68
Implied % Upside	37.1%

**Assessing the Primary Risks to Energizer:**

The Company's primary risks include:

- **Volatile Raw Material Prices.** Key raw materials used by ENR include electrolytic manganese dioxide, zinc, silver, nickel, acetylene black, graphite, steel cans, nylon brass wire, separator paper and potassium hydroxide for batteries; steel, zinc, various plastic resins, synthetic rubber resins, soap based lubricants and various packaging materials for wet shave products; and certain naturally derived fibers, resin-based plastics and certain chemicals for the Playtex product lines. Recently, base metal prices (which include zinc) have been volatile due to supply shock from mine closures and inability of supply to keep up with increasing demand. As mentioned previously, ENR purchases ~55 million pounds of zinc annually. The Company employs a 5% layered hedging strategy 16 months forward for zinc and hedges nickel, electrolytic manganese dioxide and steel through supplier agreements three to twelve months out.
- **Customer Concentration.** Like most consumer product companies, Wal-Mart accounts for a significant portion of ENR sales. In fiscal 2011, WMT accounted for almost 20% of ENR's sales. Wal-Mart possesses significant bargaining power over its suppliers. If Wal-Mart decides to drop ENR as a supplier or ask for pricing concessions, this would hurt ENR's sales and profitability. However, Procter & Gamble has bargaining strength relative to Wal-Mart, so it is in Wal-Mart's interest to support a strong number two player to keep P&G in check.
- **Private Label Competition.** In battery, private label owns the leading market share in Europe. In North America, private label is in distant third place in the marketplace. Whether or not the North American battery market will evolve similar to Europe remains to be seen. According to a consumer survey by Sanford Bernstein, the battery category is more prone to private label substitution by consumers. However, those consumers who did trade down were more likely to be dissatisfied with lower priced alternatives given discernable quality differences between high and low end batteries. In the wet shave category,

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private label is less than 5% of the U.S. wet shave market. Energizer purchased American Safety Razor out of bankruptcy and now controls the number one private label brand.

- **Increased Promotional Environment.** So far P&G has been a rational competitor. However, as ENR continues to make inroads in wet shave and take market share away from Gillette, P&G may feel threatened. In response, P&G may either increase advertising and promotion spending in the wet shave market to defend its competitive position or retaliate against ENR by offering promotions in the battery business to undercut ENR's cash flow machine.
- **Technology Obsolescence.** Over the last couple of years studies have indicated that an increasing number of devices are using built-in rechargeable battery systems, particularly in developed markets, and a decline in the number of battery operated devices. The Company believes that the decline in battery operated devices was due to the global recession and that it has not only seen a stabilization of this trend, but also a slight uptick. We will be monitoring whether this trend accelerates. In the meantime, the Company is restructuring the battery operations for manufacturing efficiency and running the business to harvest cash flow.
- **Future Acquisitions.** One of the Company's priorities for free cash flow is acquisitions. While we don't believe the Company would undertake a transformative acquisition, there are opportunities for niche or tuck-in acquisitions, especially in the skin care and infant care categories. Acquisitions, regardless of size, can distract the Company's focus from current operations. Also, the Company may fail to integrate or achieve expected synergies from future acquisitions. ENR has a mixed track record on acquisitions. While the Schick and Edge acquisitions were integrated fairly smoothly, the Playtex acquisition was not—although this may just reflect poor timing due to the ensuing economic downturn.

### **Analyst Certification:**

Asset Analysis Focus certifies that the views expressed in this report accurately reflect the personal views of our analysts about the subject securities and issuers mentioned. We also certify that no part of our analysts' compensation was, is, or will be, directly or indirectly, related to the specific views expressed in this report.



Energizer Holdings, Inc.

**ENERGIZER HOLDINGS, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(in millions - Unaudited)

<b>ASSETS</b>	<b>Dec. 31, 2011</b>	<b>Sept. 30, 2011</b>
Current assets		
Cash and cash equivalents	\$ 476.9	\$ 471.2
Trade receivables, less allowance for doubtful accounts	954.9	893.6
Inventories	640.9	653.4
Other current assets	382.5	374.4
<i>Total current assets</i>	<u>2,455.2</u>	<u>2,392.6</u>
Property, plant and equipment, net	860.8	885.4
Goodwill	1,467.7	1,475.3
Other intangible assets, net	1,870.4	1,878.2
Other assets	30.8	31.9
<b>TOTAL ASSETS</b>	<b>\$ 6,684.9</b>	<b>\$ 6,663.4</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities		
Current maturities of long-term debt	\$ 546.0	\$ 106.0
Notes payable	167.1	56.0
Accounts payable	259.0	289.6
Other current liabilities	642.0	707.7
<i>Total current liabilities</i>	<u>1,614.1</u>	<u>1,159.3</u>
Long-term debt	1,765.0	2,206.5
Other liabilities	1,215.4	1,196.3
<b>TOTAL LIABILITIES</b>	<b>4,594.5</b>	<b>4,562.1</b>
Shareholders' equity		
Common stock	1.1	1.1
Additional paid-in capital	1,589.8	1,593.6
Retained earnings	2,756.5	2,613.0
Treasury stock	(2,052.4)	(1,925.7)
Accumulated other comprehensive loss	(204.6)	(180.7)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>2,090.4</b>	<b>2,101.3</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 6,684.9</b>	<b>\$ 6,663.4</b>

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