

HEROMOTOCO HOLD

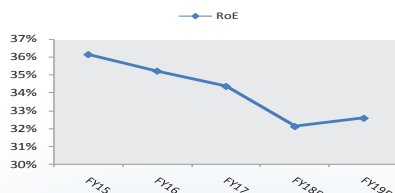
02-Nov-17

INDUSTRY - AUTOMOBILE
BLOOMBERG - HMCL IN
BSE Code - 500182
NSE Code - HEROMOTOCO
NIFTY - 10440

Company Data

CMP	3816
Target Price	4150
Previous Target Price	4150
Upside	9%
52wk Range H/L	4200/2844
Mkt Capital (Rs Cr)	76,213
Av. Volume ('000)	20

RoE to maintain over 32% in FY19

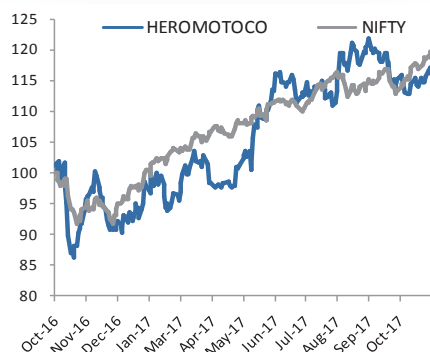


Shareholding patterns %

	2QFY18	1QFY18	4QFY17
Promoters	34.6	34.6	34.6
Public	65.4	65.4	65.4
Total	100.0	100.0	100.0

Stock Performance %

	1Mn	3Mn	1Yr
Absolute	0.3	2.6	13.2
Rel.to Nifty	(5.6)	(0.7)	(7.8)



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Key Highlights of the Report:

- ✓ Hero Motocorp reported 7%YoY growth in the net sales in 2QFY18. Total sales volumes grew handsomely by 11%YoY but realization declined by 3%YoY.
- ✓ EBITDA Margin for the quarter was 17.4%, flat compared to same period last year. However, the margin remained on the higher side because of lower other expenses and operating leverage benefit during the quarter.
- ✓ Hero Motocorp is the market leader in the entry segment motorcycles and commands over 50% market share in that segment.
- ✓ We expect RoE and RoCE of 32.5% and 40% respectively in FY19E.
- ✓ Currently the stock is trading at 18x FY19E EPS. Considering company's current developments and future growth prospects, we recommend Hold with the target price of Rs.4150 (19x FY19E EPS).

Financials/Valu	FY15	FY16	FY17	FY18E	FY19E
Net Sales	27,538	28,457	28,585	31,468	34,866
EBITDA	3,497	4,398	4,576	5,249	5,994
EBIT	2,956	3,954	4,074	4,662	5,331
PAT	2,365	3,112	3,546	3,737	4,284
EPS (Rs)	118	156	178	187	215
EPS growth (%)	12%	32%	14%	5%	15%
ROE (%)	36%	35%	34%	32%	33%
ROCE (%)	45%	44%	39%	39%	40%
BVPS	328	442	517	583	658
P/B (X)	8.1	6.7	6.4	6.6	5.8
P/E (x)	22	19	19	20	18

RECENT DEVELOPMENTS:

- ✓ The company has planned Rs. 2500 crores of capital expenditure to be spent over next two years. This will be towards new product development, phase wise capacity installation & expansion at existing facilities.
- ✓ The company expanded its footprint in the international markets by commencing operations in two significant global markets like Argentina and Nigeria.
- ✓ The company has robust pipe line of new products in Scooter and Premium segment motorcycles (over 200 cc category). These products will be launched in 2HFY18 & FY19.
- ✓ Electric Vehicle Development: Ather Energy Private Limited is a private limited company, focused on developing designing and selling premium electric two wheeler. During the year, Hero Motocorp acquired 30% stake with an investment of Rs.24 crores.

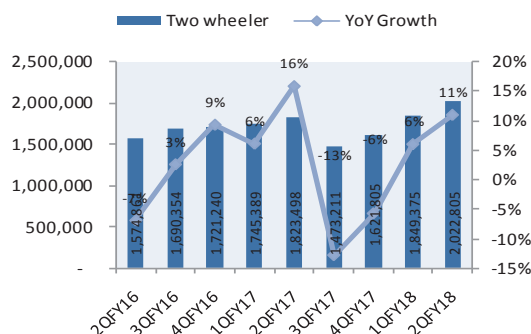
Quarterly Performance

Financials	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	YoY %	QoQ%	FY16	FY17	YoY %
Total Volumes ('000)	1,823	1,473	1,622	1,849	2,023	11%	9%	6,631	6,664	0%
Realization(Rs./ bike)	42,755	43,202	42,639	43,104	41,339	-3%	-4%	42,912	42,895	0%
Net Sales	7,796	6,365	6,915	7,972	8,362	7%	5%	28,457	28,585	0%
Other Income	152	132	118	132	118	-23%	-11%	413	522	26%
COGS	5,183	4,128	4,736	5,394	5,698	10%	6%	19,308	19,091	-1%
Employee Cost	357	374	328	374	384	7%	3%	1,339	1,432	7%
Other Expenses	887	783	893	908	825	-7%	-9%	3,412	3,486	2%
EBITDA	1,369	1,080	958	1,296	1,456	6%	12%	4,398	4,576	4%
Depreciation	119	125	135	133	136	14%	2%	443	502	13%
Interest	2	2	1	2	2	1%	-1%	15	27	87%
PBT	1,400	1,085	939	1,293	1,436	3%	11%	4,353	4,568	5%
Tax	396	313	221	379	425	7%	12%	1,275	1,339	5%
PAT	1,004	772	718	914	1,010	1%	11%	3,112	3,546	14%

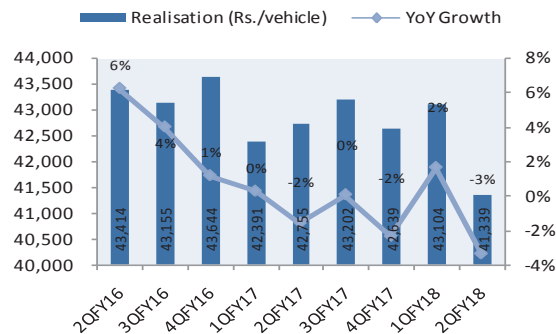
Volume growth of 11% YoY, realisations declined by 3% YoY

- ✓ Hero Motocorp reported 7%YoY growth in the net sales in 2QFY18. Total sales volumes grew handsomely by 11%YoY but realization declined by 3%YoY.
- ✓ 2QFY18 remained the best quarter for the company in terms of sales volume because it has recorded highest ever sales of over 2 million units in a quarter. Robust festive demand coupled with improving rural sentiments on the back of good monsoon and various government initiatives helped company to achieve 11%YoY growth despite the higher base in the corresponding quarter.
- ✓ Realization declined by 3%YoY to Rs.41339. The Company has passed on the benefit of GST to its customers with a reduction in the prices of models across its product portfolio in most of the states w.e.f. July 1, 2017.
- ✓ EBITDA grew by 6% YoY to Rs.1456 crore in 2QFY18 on account of lower other expenses.
- ✓ Profit after tax grew by 1%YoY to Rs.1010 crore during the quarter. The effective tax rate for the quarter is higher on account of phasing out of investment allowance and reduction in allowable deduction of R&D expenditure leading to lower PAT growth versus EBITDA growth.

Volume trend



Realisation trend

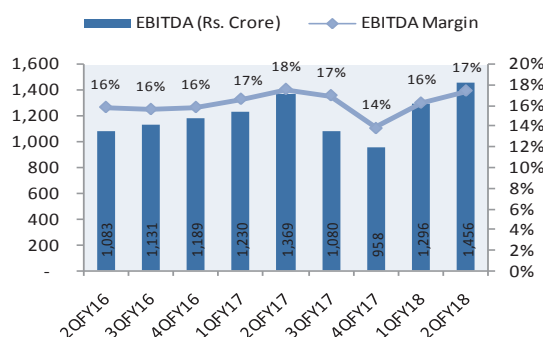


Higher tax expenses led to 80bps decline in PAT margin

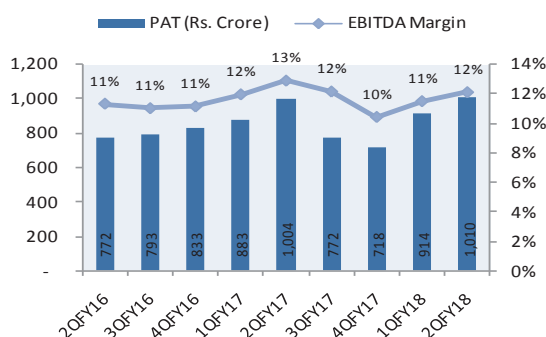
Margin %	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	YoY(+/-)	QoQ(+/-)	FY16	FY17	YoY(+/-)
Gross Margin	34%	35%	32%	32%	32%	(0.02)	0.00	32%	33%	0.01
EBITDA Margin	18%	17%	14%	16%	17%	(0.00)	0.01	15%	16%	0.01
PAT Margin	13%	12%	10%	12%	12%	(0.01)	0.01	11%	12%	0.01

- ✓ Gross Margin contracted by 160 bps YoY to 32% due to carry forward effect of higher commodity prices during the last quarter.
- ✓ EBITDA Margin for the quarter was 17.4%, flat compared to same period last year. Margin remained on the higher side because of lower other expenses and operating leverage benefit during the quarter.
- ✓ Higher tax expenses in 2QFY18 led to 80bps YoY decline in PAT margin.

EBITDA and EBITDA Margin trend



PAT and PAT Margin trend



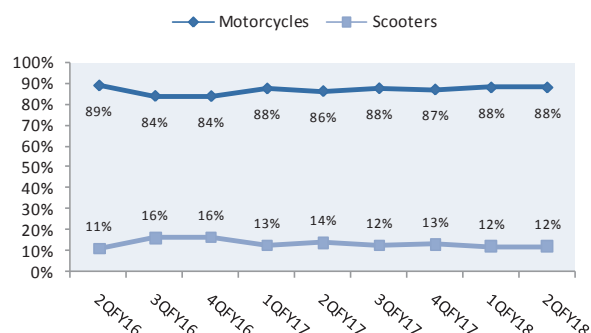
Concall Highlights:

- ✓ High single digit growth for industry in FY18.
- ✓ Double digit growth for Hero in FY18.
- ✓ Operating leverage benefit can boost the margins going forward.
- ✓ There will be cost pressure in 3QFY18.
- ✓ Advertising & Promotion expenses will be 2.3% of sales in FY18.
- ✓ Haridwar plant is currently 35.3% of total production of the company.
- ✓ Scooter segment growth will be higher than industry.
- ✓ Rural market is expected to post good growth in 2HFY18 backed by good monsoon.
- ✓ Capex guidance of Rs.2500 crore to be spent on R&D (new product development) and Andhra plant.
- ✓ Inventory level stood at 4-6 weeks.
- ✓ Management expects benefit from LEAP program to be around 50-60 bps and additional 25-30 bps from other initiatives in FY18.
- ✓ Exports: Management expects positive momentum to continue in major export markets in 2HFY18.
- ✓ Tax rate is 29% for the full year.
- ✓ New product launches in 2HFY18 which includes one premium segment motorcycle, where Hero Motocorp has minimal presence.

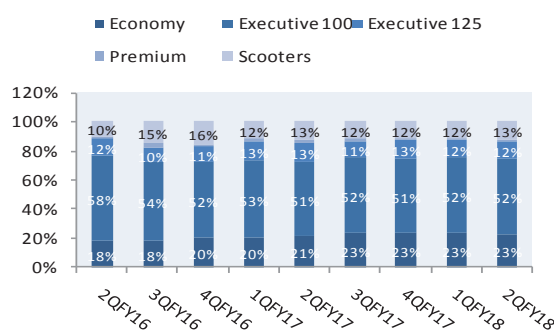
Investment Arguments:

- ✓ **Strong product pipeline in the scooter and premium motorcycle segment-** The company has huge capex plan of Rs.2500 crore over next two years. The launches will be in the fast growing scooter segment and premium segment motorcycles. Hero Motocorp has very minimal presence in the premium segment where peers like Bajaj Auto, TVS Motors and Yamaha has captured more than 80% market share.
- ✓ **Rural Demand to drive growth-** Hero Motocorp has strong penetration in the rural areas with more than 55% exposure in rural segment. Expectation of good monsoon and strong wedding season in the North region will remain the strong key growth drivers in the current fiscal. Though in 2QFY18 the company has recorded highest ever sales with growth of 11%YoY.
- ✓ **Cost cutting initiative to set off higher commodity prices-** LEAP, the cost cutting initiative of Hero Motocorp has supported company to post better margins despite rising commodity pressure. The company received a benefit of 90bps in FY17 and the management expects further 50-60 bps benefit from LEAP program and additional 25-30bps through other initiatives. We expect that this will help the company post EBITDA margin over 16%.
- ✓ **Healthy dividend payout-** Hero Motocorp is a debt free and cash rich company. The company enjoys negative working capital cycle which leads to strong the generation of strong cash flows. It has a healthy dividend payout of 48%, which provides cushion to the investors to invest in the company for long term.

Trend in Segment Mix



Share of Scooters & 125 cc segment increasing gradually



View & Valuation

Hero Motocorp is the market leader in the entry segment motorcycle and commands over 50% market share. The company reported revenue growth of 7.3%YoY to Rs.8362 crore in 2QFY18. EBITDA increased by 6.3%YoY to Rs.1456 crore and PAT for the quarter was Rs.1010 crore. The festive season has turned out well for the company as it has posted 11YoY% volume growth in 2QFY18. We believe that new launches in the premium segment motorcycles, improving rural theme on the back of good monsoon and revival in major export markets may drive healthy volume growth in 2HFY18. Cost cutting initiative LEAP coupled with operating leverage will boost the margins going ahead for the company. Hero Motocorp has a healthy dividend yield of 2.6%, which may provide a cushion to long-term investors with regular cash flows. We expect RoE and RoCE of 32.5% and 40% in FY19E respectively. Currently, the stock is trading at 18x FY19E EPS. Considering company's current developments and future growth prospects, we recommend Hold with the target price of Rs.4150 (19x FY19E EPS).

Financials Snap Shot

Income Statement

Y/E March	FY16	FY17	FY18E	FY19E
Revenue from Operation	28,457	28,585	31,468	34,866
Change (%)	3%	0%	10%	11%
Other Operating Income				
EBITDA	4,398	4,576	5,249	5,994
Change (%)	26%	4%	15%	14%
Margin (%)	15%	16%	17%	17%
Dep & Amortization	443	502	587	663
EBIT	3,954	4,074	4,662	5,331
Interest & other finance cost	15	27	19	17
Other Income	413	522	568	651
EBT	4,353	4,568	5,211	5,964
Exceptional Item	-	(262)	-	-
Tax	1,275	1,339	1,529	1,735
Minority Int & P/L share of Ass.	34	55	55	55
Reported PAT	3,112	3,546	3,737	4,284
Adjusted PAT	3,112	3,546	3,737	4,284
Change (%)	32%	14%	5%	15%
Margin(%)	11%	12%	12%	12%

Balance Sheet

Y/E March	FY16	FY17	FY18E	FY19E
Share Capital	40	40	40	40
Reserves	8,794	10,276	11,593	13,103
Networth	8,834	10,316	11,633	13,143
Debt	230.04	248.0	227.2	208.5
Other Non Current Liab				
Total Capital Employed	9,064	10,563	11,860	13,351
Net Fixed Assets (incl CWIP)	4,437	5,180	5,808	6,360
Non Current Investments	1,030	1,522	2,271	2,786
Other Non Current Assets	848	658	658	658
Non Current Assets	6,592	7,741	8,786	9,853
Inventory	762	709	869	963
Debtors	1,282	1,552	1,565	1,733
Cash & Bank	75	74	85	81
Other Current Assets	562	524	577	639
Current Assets	6,303	7,571	7,887	8,732
Creditors	2,675	3,266	3,272	3,625
Provisions	98	118	130	144
Other Current Liabilities	506	457	503	557
Curr Liabilities	3,487	4,137	4,193	4,606
Net Current Assets	2,816	3,434	3,694	4,127
Total Assets	12,896	15,312	16,673	18,585

Key Ratios

Y/E March	FY16	FY17	FY18E	FY19E
ROE	35%	34%	32%	33%
ROCE	44%	39%	39%	40%
Asset Turnover	2.2	1.9	1.9	1.9
Debtor Days	16.4	19.8	18.1	18.1
Inventory Days	9.8	9.0	10.1	10.1
Payable Days	34.3	41.7	38.0	38.0
Interest Coverage	270.7	149.3	244.9	305.1
P/E	18.9	18.6	20.4	17.8
Price / Book Value	6.7	6.4	6.6	5.8
EV/EBITDA	13.4	14.4	14.5	12.7
FCF per Share	2,084	2,769	3,296	3,844
Dividend Yield	2.4%	2.6%	2.7%	3.1%

Assumptions

Y/E March	FY16	FY17	FY18E	FY19E
Volume ('000)	6,631	6,664	7,498	8,137
Volume Growth	0%	0%	13%	9%
Realization(Rs./vehicle)	42,912	42,895	41,971	42,848
Realization Growth	3%	0%	-2%	2%
Capex(Rs crore)	1,494	1,327	1,225	1,225

Cash Flow Statement

Y/E March	FY16	FY17E	FY18E	FY19E
PBT	3,112	3,546	5,211	5,964
(inc)/Dec in Working Capital	323	462	(164)	94
Non Cash Op Exp	443	502	587	663
Interest Paid (+)	15	27	19	17
Tax Paid	(1,103)	(1,187)	(1,529)	(1,735)
others	(269)	(130)	-	-
CF from Op. Activities	3,722	4,007	4,511	5,059
(inc)/Dec in FA & CWIP	(1,638)	(1,238)	(1,215)	(1,215)
Free Cashflow	2,084	2,769	3,296	3,844
(Pur)/Sale of Investment	(645)	(714)	-	-
others	181	197	(947)	(1,037)
CF from Inv. Activities	(2,300)	(1,972)	(2,162)	(2,252)
inc/(dec) in NW				
inc/(dec) in Debt	181	28	(21)	(19)
Interest Paid	(14)	(27)	(19)	(17)
Dividend Paid (inc tax)	(1,682)	(2,091)	(2,420)	(2,774)
others	182	30	(21)	(19)
CF from Fin. Activities	(1,475)	(2,036)	(2,460)	(2,810)
Inc(Dec) in Cash	(53)	(1)	(111)	(3)
Add: Opening Balance	127	75	74	85
Closing Balance	75	74	85	82