

HERO MOTOCORP LIMITED

Industry
Bloomberg
BSE Code
NSE Code

Automobiles
HMCL IN
500182
HEROMOTOCO

26 July 2018

RATING	BUY
CMP	3112
Price Target	3861
Previous Target	4150
Potential Upside	24%

Stock Info

52wk Range H/L	4200/3037
Mkt Capital (Rs Cr)	62,149
Free float (%)	65%
Avg. Vol 1M (,000)	434
No. of Shares (Crore)	20
Promoters Pledged %	NA

Volume growth outlook remains robust

Key Highlights

- ✓ Hero Motocorp is the largest 2 wheeler manufacturer in India with a market share of 37%. It is also a market leader in the entry segment motorcycles and commands over 55% market share. The management's cost cutting initiatives coupled with operating leverage benefit has expanded its margins by 370 bps to over 16% in last 3 years.
- ✓ The management has given long term sustainable EBITDA margins guidance of 14-15%.
- ✓ Tax benefit on Haridwar plant expired on 31st March 2018. The negative impact on margins due to the expiry of incentives in Haridwar plant will be partly offset by incentives in Rajasthan and Halol plants.
- ✓ Hero Motocorp has invested Rs.130 crores in Ather Energy towards the development of electric scooters. Currently it is the only investor and will invest further in order to increase the stake in the entity.

1Q FY19 Result:

Net sales grew by 11%YoY to Rs.8810 crores. Volume growth has been robust while realisation declined by 3%YoY. Gross margin declined by 230bps YoY to 30% due to shift in product mix towards lower realization bikes and increasing commodity prices. EBITDA margin has been protected over 15.5% despite 230bps YoY decline in gross margins. PAT remained flat YoY to Rs.909 crores.

View and Valuation

Hero Motocorp has been able to protect the EBITDA margin over 15.5% levels despite sharp contraction (230bps YoY) in gross margins. However we remain cautious on the near term margin sustainability due to increasing commodity prices and heavy discounts given by the competitors in the entry segment bikes in order to gain market share. The 125cc scooter segment continued to grow at 20%YoY and margin in this segment is also higher than 110cc scooters. Considering the buoyancy in the 125cc segment, the company will launch one 125cc scooter and one bike in premium segment before the current festive season. Going forward, the growth will be supported by monsoon, MSP, under penetration of 2 wheelers and rural infra spending. Considering higher discounts in the entry level bikes by competitors and higher tax expense due to expiration of Pant Nagar plant benefit we reduce our FY20e EPS estimate by 6%. We value Hero Motocorp at 17.5x FY20e EPS to arrive at target price of Rs.3861 and maintain BUY.

Key Risks to our rating and target

- ◆ Delay in monsoon can drag the rural volumes as 60% sales comes from rural areas
- ◆ Early shift in demand towards premium segment motorcycles

KEY FINANCIAL/VALUATIONS	FY16	FY17	FY18	FY19E	FY20E
Net Sales	28457	28585	32458	35590	39468
EBITDA	4398	4576	5325	5552	6464
EBIT	3954	4074	4750	4951	5785
PAT	3112	3546	3722	3760	4406
EPS (Rs)	156	178	186	188	221
EPS growth (%)	32	14	5	1	17
ROE (%)	35	34	31	28	28
ROCE (%)	44	39	39	36	37
BV	442	517	599	684	784
P/B (X)	7	6	6	5	4
P/E (x)	19	19	19	17	14

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1Q FY 19 Results

Below Estimates

Financials	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	YoY %	QoQ%	FY17	FY18	YoY %
Total Volumes	1849	2023	1709	2002	2105	13.8%	5.2%	6,664	7,583	13.8%
Realization(Rs)	43,104	41,339	42,745	42,787	41,853	-2.9%	-2.2%	42,895	42,805	-0.2%
Net Sales	7,972	8,362	7,305	8,564	8,810	10.5%	2.9%	28,585	32,458	13.6%
Other Income	132	118	110	166	116	-12.1%	-30.1%	522	523	0.2%
COGS	5,394	5,698	4,922	5,793	6,165	14.3%	6.4%	19,091	21,886	14.6%
Gross Margin	32%	32%	33%	32%	30%	-2.3%	-2.3%	33%	33%	-0.6%
Employee Cost	374	384	402	381	413	10.6%	8.5%	1,432	1,584	10.6%
Other Expenses	908	825	824	1,020	854	-5.9%	-16.2%	3,486	3,664	5.1%
EBITDA	1,296	1,456	1,158	1,371	1,377	6.3%	0.5%	4,576	5,325	16.4%
EBITDA Margin	16%	17%	16%	16%	16%	-0.6%	-0.4%	16%	16%	0.4%
Depreciation	133	136	138	148	148	11.4%	-0.1%	502	575	14.5%
EBIT	1,163	1,320	1,020	1,222	1,229	5.7%	0.6%	4,074	4,750	16.6%
Interest	2	2	2	2	2	34%	37.0%	27	31	12.9%
PBT	1,293	1,436	1,128	1,386	1,343	3.8%	-3.1%	4,568	5,242	14.8%
Exceptional	-	-	-	-	-	-	-	(262)	-	-100.0%
Tax	379	425	323	419	434	14.4%	3.4%	1,339	1,570	17.2%
PAT	914	1,010	805	967	909	-0.5%	-6.0%	3,546	3,722	5.0%
PAT Margin	11%	12%	11%	11%	10%	-1.1%	-1.0%	12%	11%	-0.9%

Robust volume growth supported revenue growth; realization declined by 3%YoY

Hero Motocorp has reported 1QFY19 results below our estimates. Net sales grew by 11%YoY to Rs.8810 crores. Volume growth has been robust while realisation declined by 3%YoY. The volume growth was driven by robust sales in rural areas which pushed the sales of entry segment motorcycles. Rural growth has once again outpaced the urban growth by 200bps

230bps YoY decline in gross margins

Gross margin declined by 230bps YoY to 30% due to shift in product mix towards lower realization bikes and increasing commodity prices. The management has taken price hike of 1% in July to somewhat set off commodity pressure. Going ahead we expect due to heavy discounting practice adopted by competition may lead to price cut in order to sustain market share.

EBITDA margin sustained due to lower other expenses and operating leverage benefit

EBITDA margin has been protected over 15.5% despite 230bps YoY decline in gross margins. Lower other expenses and operating leverage benefit arising from higher volumes helped to sustain margins over 15% level.

Higher Tax expenses arrested PAT growth

PAT remained flat YoY to Rs.909 crores. Tax expense was higher during the quarter due to expiration of Pant nagar plant tax benefit and hence, the management expects tax rate to be higher going ahead.

Concall Highlights :

- ✓ The management expects double digit volume growth for industry in FY19.
- ✓ Rural growth has outpaced urban growth by 200bps.
- ✓ The management expects raw material cost to stabilize going ahead.
- ✓ The growth will be supported by monsoon, MSP, under penetration of 2 wheelers and rural infra spending.
- ✓ The company has taken 1% price increase in July and further price hike will happen in september/october.
- ✓ Inventory level stands at 4-6 weeks.
- ✓ 40-50bps benefit from LEAP program.
- ✓ On the scooter side 110cc segment is not growing well and growth is only in the 125cc segment.
- ✓ 125cc scooter segment holds 21% market share of overall industry volumes.
- ✓ Tax rate will be in range of 32% level going ahead.
- ✓ Halol plant will produce 600000 units in FY19 vs 300000 units produced in FY18.
- ✓ Andhra Pradesh plant will commence production from FY20.
- ✓ West Bengal is witnessing decline in volumes due to new registration norms. (5% of total industry volume)

Exhibit: Volume Trend

The volume growth was driven by robust sales in rural areas which pushed the sales of entry segment motorcycles

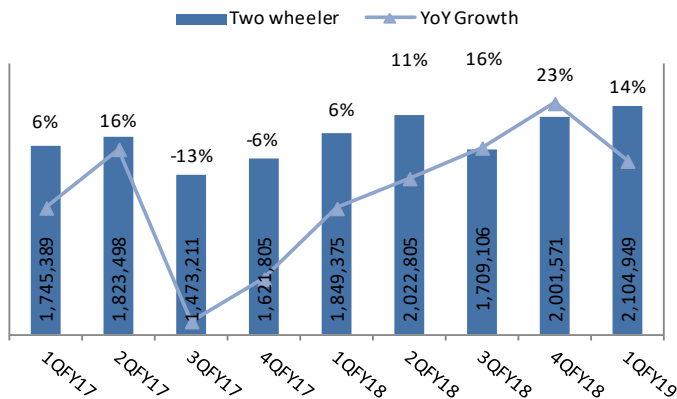


Exhibit: Realisation Trend

Sales of 100cc motorcycles outpaced sales of 125cc vehicles due to some supply issue

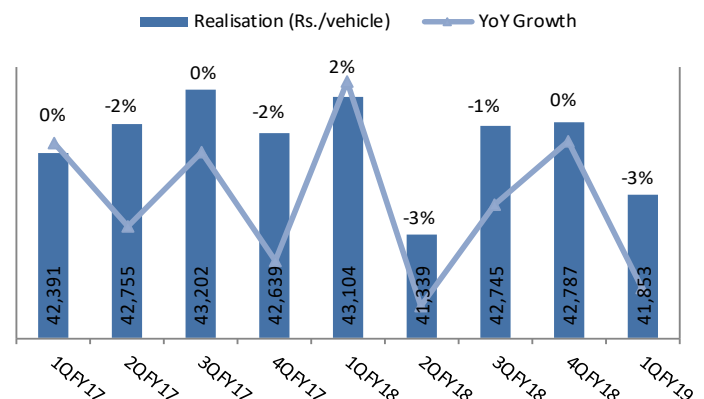


Exhibit: EBITDA (Rs. Crore) and EBITDA Margin trend

EBITDA margin has been protected over 15.5% despite 230bps YoY decline in gross margins

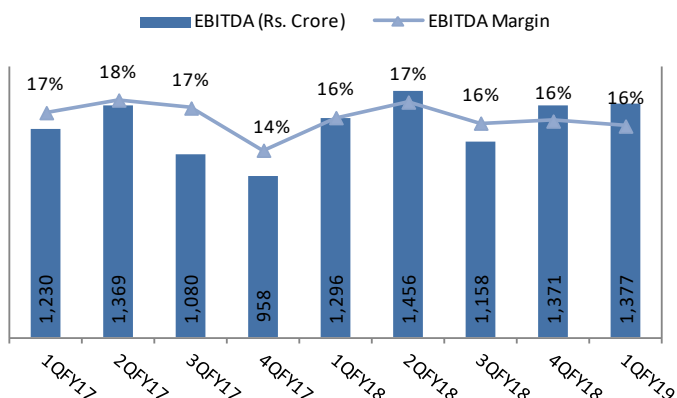


Exhibit: PAT (Rs. Crore) and PAT Margin trend

PAT remained flat as tax expense was higher during the quarter due to expiration of Pant nagar plant tax benefit

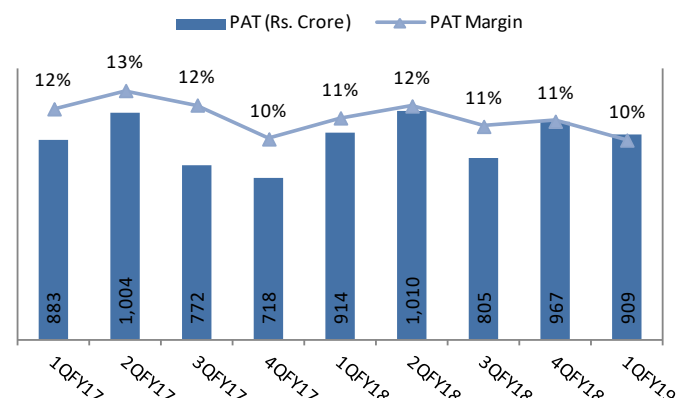


Exhibit: Trend in Segment Mix

Motorcycles sales continue to dominate scooter sales for second consecutive quarter

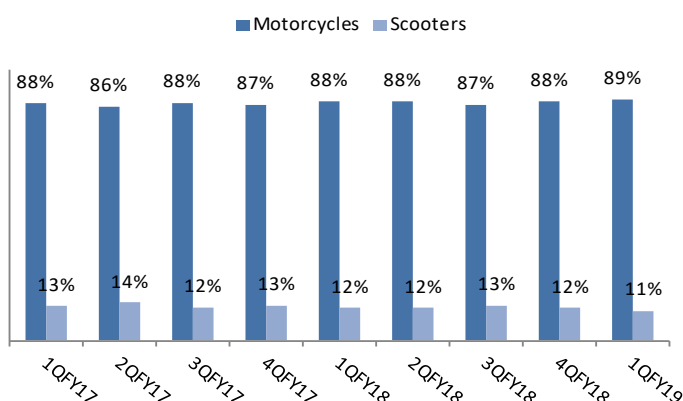
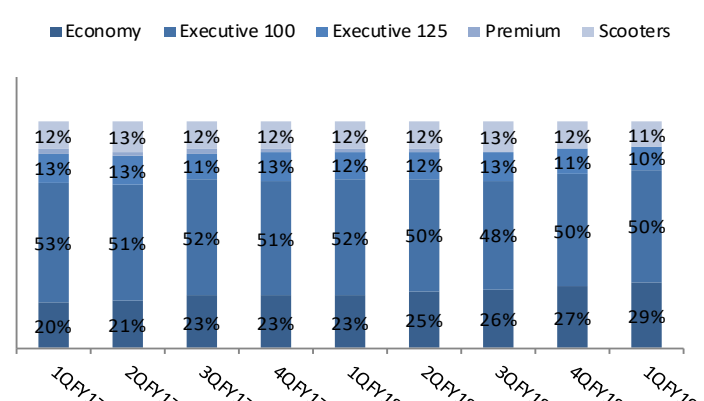


Exhibit: Share of Scooter and 125cc Segment

125 cc scooter sales was robust in the industry, scooter mix declined for the company due to presence in 110cc segment



Financial Details

Balance Sheet

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Share Capital	40	40	40	40	40	40	40	40
Reserves	4,966	5,583	6,500	8,794	10,276	11,932	13,628	15,616
Networth	5,006	5,623	6,540	8,834	10,316	11,971	13,668	15,655
Debt	302	24	100	230	248	225	169	127
Other Non Current Liab	-	-	-	-	-	-	-	-
Total Capital Employed	5,308	5,647	6,640	9,064	10,563	12,196	13,837	15,782
Net Fixed Assets (incl CWIP)	3,133	3,102	3,671	4,437	5,180	5,316	5,954	6,514
Non Current Investments	614	830	821	1,030	1,522	918	2,589	3,469
Other Non Current Assets	36	48	60	848	658	560	560	560
Non Current Assets	4,564	4,563	5,275	6,592	7,741	8,395	9,543	10,983
Inventory	637	670	861	762	709	963	1,056	1,171
Debtors	665	921	1,372	1,282	1,552	1,427	1,565	1,735
Cash & Bank	181	120	216	75	74	131	134	256
Other Current Assets	32	22	60	562	524	212	233	258
Current Assets	5,078	5,558	5,380	6,303	7,571	9,002	9,783	10,778
Creditors	1,873	2,291	2,855	2,675	3,266	3,375	3,701	4,104
Provisions	1,440	1,594	801	98	118	179	197	218
Other Current Liabilities	888	588	309	506	457	765	712	789
Curr Liabilities	4,171	4,424	3,898	3,487	4,137	4,406	4,684	5,172
Net Current Assets	907	1,135	1,481	2,816	3,434	4,596	5,099	5,605
Total Assets	9,642	10,122	10,654	12,896	15,312	17,397	19,326	21,760

Income Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Revenue from Operation	23,768	25,275	27,538	28,457	28,585	32,458	35,590	39,468
Change (%)	1%	6%	9%	3%	0%	14%	10%	11%
Other Income	-	-	-	-	-	-	-	-
EBITDA	3,284	3,539	3,497	4,398	4,576	5,325	5,552	6,464
Change (%)	-9%	8%	-1%	26%	4%	16%	4%	16%
Margin (%)	14%	14%	13%	15%	16%	16%	16%	16%
Depr & Amor.	1,142	1,107	540	443	502	575	601	679
EBIT	2,143	2,432	2,956	3,954	4,074	4,750	4,951	5,785
Int. & other fin. Cost	12	12	12	15	27	31	23	17
Other Income	398	444	492	413	522	523	530	624
EBT	2,529	2,864	3,437	4,353	4,568	5,242	5,458	6,392
Exp Item	-	-	145	-	(262)	-	-	-
Tax	411	758	943	1,275	1,339	1,570	1,755	2,048
Minority Int & P/L share of Ass.	-	(3)	16	34	55	50	57	63
Reported PAT	2,118	2,103	2,365	3,112	3,546	3,722	3,760	4,406
Adjusted PAT	2,118	2,103	2,365	3,112	3,546	3,722	3,760	4,406
Change (%)	-11%	-1%	12%	32%	14%	5%	1%	17%
Margin(%)	9%	8%	9%	11%	12%	11%	11%	11%

Financial Details

Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
ROE	42%	37%	36%	35%	34%	31%	28%	28%
ROCE	40%	43%	45%	44%	39%	39%	36%	37%
Asset Turnover	2.47	2.50	2.58	2.21	1.87	1.87	1.84	1.81
Debtor Days	10	13	18	16	20	16	16	16
Inv Days	10	10	11	10	9	11	11	11
Payable Days	29	33	38	34	42	38	38	38
Int Coverage	180	206	253	271	149	154	214	334
P/E	14.5	21.6	22.3	18.9	18.6	19.4	16.5	14.1
Price / Book Value	6.2	8.1	8.1	6.7	6.4	6.0	4.5	4.0
EV/EBITDA	9.4	12.8	15.0	13.4	14.4	13.6	11.2	9.6
FCF per Share	1,283	2,022	1,094	2,084	2,769	3,193	3,182	4,052
Div Yield	4%	3%	2%	2%	3%	3%	3%	3%

Cash Flow Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
PBT	2,529	2,864	3,329	3,112	3,546	3,722	5,458	6,392
(inc)/Dec in Working Capital	(787)	55	(336)	323	462	197	36	188
Non Cash Op Exp	1,142	1,107	540	443	502	575	601	679
Int Paid (+)	12	12	11	15	27	31	23	17
Tax Paid	(613)	(649)	(1,000)	(1,103)	(1,187)	(1,513)	(1,755)	(2,048)
others	(392)	(427)	(446)	(269)	(130)	(376)	-	-
CF from Op. Activities	1,890	2,963	2,250	3,722	4,007	4,017	4,420	5,291
(inc)/Dec in FA & CWIP	(608)	(941)	(1,156)	(1,638)	(1,238)	(824)	(1,239)	(1,239)
Free Cashflow	1,283	2,022	1,094	2,084	2,769	3,193	3,182	4,052
(Pur)/Sale of Inv	628	(9)	1,354	(645)	(714)	(1,172)	-	-
others	(753)	(519)	69	181	197	228	(2,194)	(1,438)
CF from Inv. Activities	(733)	(1,618)	12	(2,300)	(1,972)	(1,858)	(2,273)	(2,677)
inc/(dec) in NW	-	-	-	-	-	-	-	-
inc/(dec) in Debt	-	-	-	181	28	(33)	(56)	(42)
Int. Paid	(12)	(12)	(11)	(14)	(27)	(31)	(23)	(17)
Div Paid (inc tax)	(1,044)	(1,403)	(2,219)	(1,682)	(2,091)	(2,043)	(2,064)	(2,419)
others	-	1	-	182	30	(30)	(56)	(42)
CF from Fin. Activities	(1,056)	(1,414)	(2,231)	(1,475)	(2,036)	(2,102)	(2,143)	(2,478)
Inc(Dec) in Cash	101	(69)	32	(53)	(1)	57	4	136
Add: Opening Balance	34	135	66	127	75	74	131	134
Closing Balance	135	69	98	75	74	131	134	270

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