

Hero Motocorp Limited

10-Feb-17

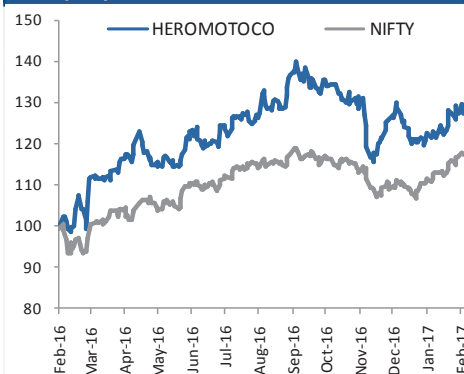
Result Update	
CMP	3264
Target Price	3830
Previous Target Price	3179
Upside	17%
Change from Previous	20%

Market Data	
BSE Code	500182
NSE Symbol	HEROMOTOCO
52wk Range H/L	3740/2440
Mkt Capital (Rs Cr)	65,185
Av. Volume	37142
Nifty	8778

Stock Performance			
	1Month	3Month	1Year
Absolute	6.6	3.8	26.5
Rel.to Nifty	0.7	0.8	6.3

Share Holding Pattern-%			
	3QFY17	2QFY17	1QFY17
Promoter	34.6	34.6	34.6
Public	65.4	65.4	65.4
Others	--	--	--
Total	100.0	100.0	100.0

Company Vs NIFTY



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Results in-line; with stable EBITDA margin

Hero Motocorp posted 3QFY17 results in-line with our expectation. Net revenue de-grew by 12%YoY to Rs. 6365 crore in 3QFY17. Volumes declined by 13%YoY because of demonetization issue during the quarter. Rural areas have witnessed severe hit due to currency crunch which accounts for 60% of the Hero Motocorp volumes. Motorcycle sales were down by 15% in the month of November and December. Realization stood flat because the company took price hike during the quarter. In the month of January, Hero sold 487000 vehicles with a growth of 48% MoM which shows a sharp recovery in the demand. Management expects high single digit growth for the first half and better second half of next financial year in volume terms. LEAP, the cost cutting initiative, has supported the company to post EBITDA margin over 16% despite rising commodity prices.

3QFY17 Results Update

>>Revenue declined by 12% YoY to Rs.6365 crore in 3QFY17 because of 13%YoY decline in volumes.

>>Gross margin improved by 270 bps YoY to 35.1% driven by cost cutting initiative LEAP and lower commodity price benefit.

>>EBITDA margin expanded by 130 bps YoY by lower advertising and promotional expenses.

>>PAT margin improved by 115 bps YoY due to higher other income during the quarter.

Outlook and Valuation

We expect improvement in demand scenario in the domestic market after the demonetization, upcoming marriage season, increasing finance penetration in rural & semi-urban areas and seventh pay commission payout will drive the volumes and implementation of cost cutting initiative LEAP to boost margins further by 100 bps going ahead. It has a healthy dividend payout of 54%, which provides a cushion to the investors to invest in the company for long term. The company is trading at 7 times of FY17 expected book value with a RoE of 36%. We maintain "BUY" rating on this stock with a target price of Rs.3830.

Rs. In crore

Financials	3QFY17	2QFY17	3QFY16	QoQ	YoY
Sales	6365	7796	7224	-18.4%	-11.9%
EBITDA	1080	1369	1131	-21.1%	-4.5%
Net Profit	772	1004	793	-23.1%	-2.7%
EBITDA%	17.0%	17.6%	15.7%		
PAT %	12.1%	12.9%	11.0%		

Investment Arguments

- ◆ **Improving demand scenario after demonetization impact-** 2 wheelers industry have shown strong recovery after the cash crunch issue. Hero itself posted 48%MoM growth in January sales numbers. Certain parts of South and West India have not recovered till yet but we expect domestic market to fully recover by February end.
- ◆ **Increasing finance penetration-** We expect that the increasing penetration of finance in the urban as well as in rural areas aided by favorable interest rates will support the demand going ahead.
- ◆ **Focus on premium segment-** HMCL has increased its R&D expenditure to develop technologically advanced in house products. R&D team will focus on premium products where Hero has minimal presence and this segment has huge growth potential. Hero has only 6% market share in this segment.
- ◆ **Cost cutting initiative to drive margins up-** LEAP, the cost cutting initiative of Hero Motocorp has supported company to post better margins despite rising commodity pressure. Management is targeting approx. 90 bps saving from this program in FY17.
- ◆ **Healthy dividend payout-** Hero Motocorp is a debt free and cash rich company. It has a healthy dividend payout of 54%, which provides cushion to the investors to invest in the company for long term.
- ◆ **Seventh Pay commission to boost demand-** We expect approx.4.7mn government employees will be benefited in this seventh pay commission pay-out. This will improve the living standard and will drive urban and rural demand for two wheelers going forward. We expect as a market leader Hero can be bigger beneficiary after the implementation of 7th pay commission.

Concall Highlights

- ◆ Management expects good single digit growth for first half and better second half for next financial.
- ◆ Capex guidance for FY17: Rs 1200-1500 crore and Rs.1000-1100 crore for FY18.
- ◆ Rs.350-400 crore of capex for Andhra Pradesh plant in FY18.
- ◆ Rs.2000 crore of capex in FY18 for phase-II & III of Halol Plant, If the robust demand comes in.
- ◆ Price hike in January 2017 in the range of Rs.500-1500 covering rising commodity prices and BS-IV compliance.
- ◆ EBITDA margin guidance above 15% in FY17.
- ◆ Target of Rs.255 crore benefit from cost cutting program LEAP in FY17.
- ◆ Other income for FY17 would be higher by 8-9 percent on an average.
- ◆ The tax benefit for plants in Rajasthan and Gujarat will last for 7 years; and the benefit is restricted to the extent of investment
- ◆ Scooters to continue outpace motorcycle growth going forward in FY17. Market share is 14%.
- ◆ Dealer Inventory remained at 6-7 weeks.
- ◆ Effective tax rate for FY17 will be slightly higher than FY16
- ◆ Advertising and Promotion expenses stood 2.4-2.5% of total sales.

Plant Details

Plant Location	Capacity
Haridwar	3060000
Gurgaon	2340000
Dharuhera	2340000
Neemrana	450000
Halol	1800000

- ◆ Gujarat Plant- capacity expansion will include an initial capacity of 1.2 million (mn) units (phase 1: 0.75 mn units by Q3FY17; phase 2: 0.45 mn units by FY17 end) & a final addition of 0.6 mn (phase 3) by FY18 beginning.
- ◆ The Haridwar operations currently contribute towards 38% of HMCL's volumes. Once the excise benefits expire in FY18 end, there will be a 100 bps impact on the EBITDA margins.

Financials Snap Shot

	INCOME STATEMENT					RATIOS			
	FY14	FY15	FY16	FY17		FY14	FY15	FY16	FY17
Net Revenue	25,275	27,538	28,614	28,807	EPS	105	118	155	172
Other Income	444	492	389	531	Book Value	282	328	398	477
Total Revenue	25,720	28,030	29,003	29,338	DPS	76	70	84	93
COGS	18,230	19,715	19,313	19,096	Payout (incl. Div. Tax.)	72%	59%	54%	54%
GPM	28%	28%	33%	34%	Valuation(x)				
Other Expenses	2,576	3,147	3,575	3,442	P/E	22	22	19	20
EBITDA	3,539	3,497	4,382	4,853	Price / Book Value	8	8	7	7
EBITDA Margin (%)	14%	13%	15%	17%	Dividend Yield (%)	3%	3%	3%	3%
Depreciation	1,107	540	447	571	Profitability Ratios				
EBIT	2,432	2,956	3,935	4,282	RoE	37%	36%	39%	36%
Interest	12	12	12	6	RoCE	43%	45%	49%	44%
PBT	2,864	3,437	4,312	4,806	Turnover Ratios				
Tax	758	943	1,262	1,377	Asset Turnover (x)	2	3	2	2
Tax Rate (%)	26%	27%	29%	29%	Debtors (No. of Days)	13	18	16	16
Reported PAT	2,103	2,365	3,094	3,429	Inventory (No. of Days)	13	16	14	14
Dividend Paid	1,519	1,402	1,682	1,864	Creditors (No. of Days)	33	38	36	36
No. of Shares	20	20	20	20	Net Debt/Equity (x)	0.0	0.0	0.0	0.0

	BALANCE SHEET								
	FY14	FY15	FY16	FY17		FY14	FY15	FY16	FY17
Share Capital	40	40	40	40	OP/(Loss) before Tax	2864	3329	4312	4806
Reserves	5,583	6,500	7,913	9,477	Depreciation	1107	540	447	571
Net Worth	5,623	6,540	7,953	9,517	Direct Taxes Paid	(649)	(1000)	(1104)	(1377)
Long term Debt	24	12	146	146	Op before WC	3557	3586	4508	5330
Short term Debt	-	88	84	85	CF from Op. Activity	2963	2250	3796	3981
Deferred Tax	-	-	228	228	Purchase of investment	(9)	1354	26973	(142)
Total Capital Employed	5,647	6,552	8,099	9,663	Capex	(941)	(1156)	(1708)	(1151)
Net Fixed Assets	3,102	3,671	4,689	5,270	CF from Inv. Activity	(1618)	12	(2286)	(1780)
Capital WIP	855	719	653	653	Repayment of Borrowings				
Debtors	921	1,372	1,282	1,291	Interest Paid	(12)	(11)	(11)	(6)
Cash & Bank Balances	120	216	179	510	Divd Paid (incl Tax)	(1403)	(2219)	(1682)	(1864)
Trade payables	2,291	2,855	2,792	2,811	CF from Fin. Activity	(1414)	(2231)	(1561)	(1870)
Total Provisions	1,594	801	884	890	Inc/(Dec) in Cash	(69)	32	(50)	330
Net Current Assets	1,135	1,481	1,999	2,790	Add: Opening Balance	135	66	155	179
Total Assets	10,122	10,654	12,672	14,212	Closing Balance	69	98	104	510