

Hero MotoCorp

BUY

INDUSTRY	AUTOS
CMP (as on 10 May 17)	Rs 3,324
Target Price	Rs 3,740
Nifty	9,407
Sensex	30,248
KEY STOCK DATA	
Bloomberg	HMCL IN
No. of Shares (mn)	200
MCap (Rs bn) / (\$ mn)	664 / 10,262
6m avg traded value (Rs mn)	1,348
STOCK PERFORMANCE (%)	
52 Week high / low	Rs 3,740 / 2,844
	3M 6M 12M
Absolute (%)	1.7 5.7 12.4
Relative (%)	(5.1) (4.2) (5.0)
SHAREHOLDING PATTERN (%)	
Promoters	34.64
FIs & Local MFs	15.37
FPIs	42.68
Public & Others	7.31
Source : BSE	

Abhishek Jain
abhishekkumar.jain@hdfcsec.com
+91-22-6171-7320

Sneha Prashant
sneha.prashant@hdfcsec.com
+91-22-6171-7336

Hinging on rural recovery

Hero Motocorp's (HMCL) 4QFY17 EBITDA at Rs 9.57bn (-19.5% YoY) came in below estimates, led by a poor model mix, higher RM cost and discounts offered to clear the BS3 inventory. PAT at Rs 7.2bn (-14% YoY) was affected by a lower operating margin (13.8%, -200bps YoY). The drop in the 4Q margin is a one-time impact, owing to the ban on BS3 vehicles. The situation should improve from 1QFY18, with price hikes in May-17, a pick-up in demand owing to the marriage season and rural recovery.

We believe Hero Motocorp is the best pick, with a likely revival in the rural economy (especially economic revival in UP, the largest market of 2Ws, with a share of 14%), as ~50% of sales are in the rural markets. We believe potential demand drivers of 2W sales would be robust farm output, benefits from the revision of the Pay Commission and government policies to boost farm income. Maintain BUY with a TP of Rs 3,740(18x FY19E EPS)

Financial Summary

(Rs mn)	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)	FY16	FY17E	FY18E	FY19E
Net Sales	69,152	75,052	(7.9)	63,646	8.7	275,651	284,427	284,750	322,871
EBITDA (adj.)	9,576	11,892	(19.5)	10,797	(11.3)	35,220	44,550	46,348	50,402
APAT	7,178	8,333	(13.9)	7,720	(7.0)	23,655	31,602	33,771	36,571
Diluted EPS (Rs)	35.9	41.7	(13.9)	38.7	(7.0)	118.5	158.2	169.1	183.1
P/E (x)						28.3	21.2	19.8	18.3
EV / EBITDA (x)						18.3	14.2	13.4	12.6
RoE (%)						40.5	43.6	39.1	36.9

Source: Company, HDFC sec Inst Research

Highlights of the quarter

- **Strong market share in MC:** HMCL's motorcycle market share in 4Q increased to 55% (+200bps YoY), led by strong volume growth in CD Dawn, Splendor Plus and Acheiver. In the scooter segment, market share was down 218bps YoY at 14.1%. Currently, HMCL's dealer inventory stands at four to five weeks, with the normal level at six weeks.
- **Exports outlook:** Export volumes continue to remain weak (-6% YoY at 51.3k). Headwinds in countries like Nigeria, Republic of Congo, Egypt, Colombia and Nigeria are likely to continue for some time. However, FY18 numbers will reflect growth, owing to a lower base and foray into new geographies
- **Near-term outlook:** Expect a strong volume growth in 1Q, owing to marriage season demand and lower channel inventory. Management indicated that retail sales in May-17 are quite encouraging.

Net revenue fell, owing to a 5% decline in volumes and higher discount (5k-12.5k) offered by the company to dispose off their BS3 inventory. Scooter volumes were impacted more (-36% YoY), as compared to the motorcycle segment (flat YoY)

Net ASP declined (2.2% YoY), lower than our expectations, owing to a better mix (increasing share of motorcycles)

Gross margin contracted 235 bps YoY, owing to higher input cost and a poor model mix.

EBITDA margin witnessed contraction of 200bps YoY to 13.8%, led by a higher discount on BS3 vehicles

Quarterly Financials Snapshot: Standalone

(Rs mn)	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)
Volumes (mn units)	1,621,805	1,721,240	(5.8)	1,473,548	10.1
Net ASP	42,639	43,603	(2.2)	43,192	(1.3)
Net Sales	69,152	75,052	(7.9)	63,646	8.7
Material Expenses	47,361	49,636	(4.6)	41,280	14.7
Employee Expenses	3,281	3,515	(6.7)	3,743	(12.3)
Other Operating Expenses	8,935	10,010	(10.7)	7,826	14.2
EBITDA	9,576	11,892	(19.5)	10,797	(11.3)
Depreciation	1,353	1,147	17.9	1,249	8.4
EBIT	8,223	10,744	(23.5)	9,549	(13.9)
Other Income	1,182	1,168	1.3	1,319	(10.4)
Interest Cost	15	12	21.3	15	(2.6)
PBT	9,390	11,900	(21.1)	10,853	(13.5)
Tax	2,213	3,567	(38.0)	3,133	(29.4)
APAT	7,178	8,333	(13.9)	7,720	(7.0)
Adj EPS	35.9	41.7	(13.9)	38.7	(7.0)

Source: Company, HDFC sec Inst Research

Margin Analysis: Standalone

	4QFY17	4QFY16	YoY (bps)	3QFY17	QoQ (bps)
Material Expenses % Net Sales	68.5	66.1	235	64.9	363
Employee Expenses % Net Sales	4.7	4.7	6	5.9	(114)
Other Operating Expenses % Net Sales	12.9	13.3	(42)	12.3	62
EBITDA Margin (%)	13.8	15.8	(200)	17.0	(312)
Tax Rate (%)	23.6	30.0	(641)	28.9	(530)
APAT Margin (%)	10.4	11.1	(72)	12.1	(175)

Source: Company, HDFC sec Inst Research

We expect volumes to grow at a CAGR of 10% over FY17-19E. We believe government's increased thrust on improving rural income and a better monsoon will drive 2W demand in rural markets

The company has made a price hike of ~Rs 500-2200 on 1 May, partly offsetting the commodity cost increase, and partly for models rolled out with BS IV

Volume Assumptions

(in '000 units)	FY15	FY16	FY17	FY18E	FY19E
Economy	1,110	1,168	1,419	1,561	1,717
% YoY	6.9	5.2	21.5	10.0	10.0
Executive	4,464	4,367	4,239	4,586	4,901
% YoY	5.6	(2.2)	(2.9)	8.2	6.9
Premium	106	69	35	40	43
% YoY	(30.4)	(35.1)	(48.7)	13.1	8.8
Domestic Motorcycles	5,680	5,603	5,694	6,187	6,662
% YoY	4.8	(1.3)	1.6	8.7	7.7
Domestic Scooters	752	819	790	949	1,174
% YoY	7.8	8.9	(3.5)	20.2	23.7
Exports	200	210	180	203	243
% YoY	53.0	5.1	(14.2)	12.4	20.0
Total Volumes	6,632	6,632	6,664	7,339	8,080
% YoY	6.2	0.0	0.5	10.1	10.1

Source: SIAM, HDFC sec Inst Research

Net Realisations

(Rs/vehicle)	FY15	FY16	FY17	FY18E	FY19E
Domestic	40,500	41,659	40,706	42,027	43,489
% YoY	0.8	2.9	(2.3)	3.2	3.5
Exports	36,006	38,526	39,297	40,476	41,690
% YoY	1.1	7.0	2.0	3.0	3.0
Net ASP (incl spares)	41,565	43,122	42,065	43,992	44,929
% YoY	2.7	3.7	(2.5)	4.6	2.1

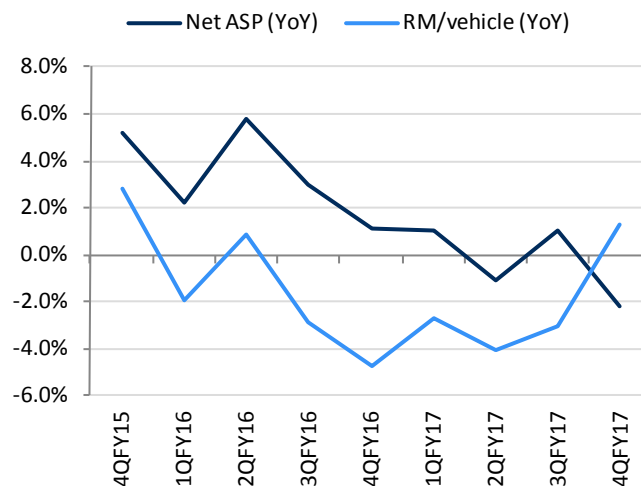
Source: Company, HDFC sec Inst Research

Lower net ASP and higher RM/vehicle costs led to a sharp fall in EBITDA margins. However, 1Q margins will improve, owing to price hike, softness in commodity prices and rupee appreciation

HMCL's scooter market share declined at 12.9% QoQ

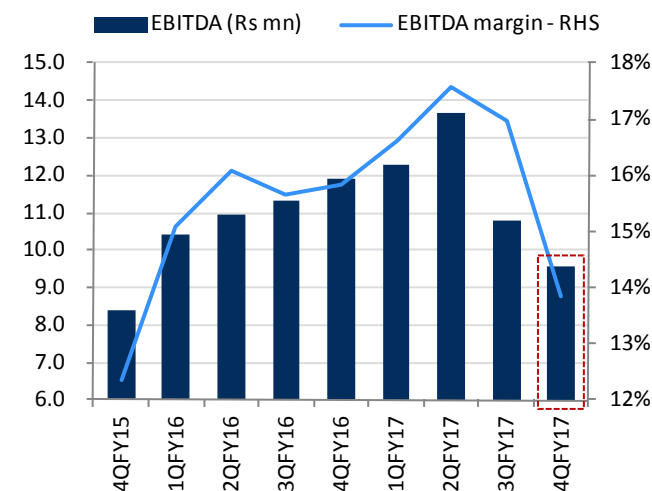
The company is looking to roll out a few new launches in the scooter segment, along with a refreshed version of Duet and Maestro Edge in FY18

GM Contracted Owing To Higher RM prices



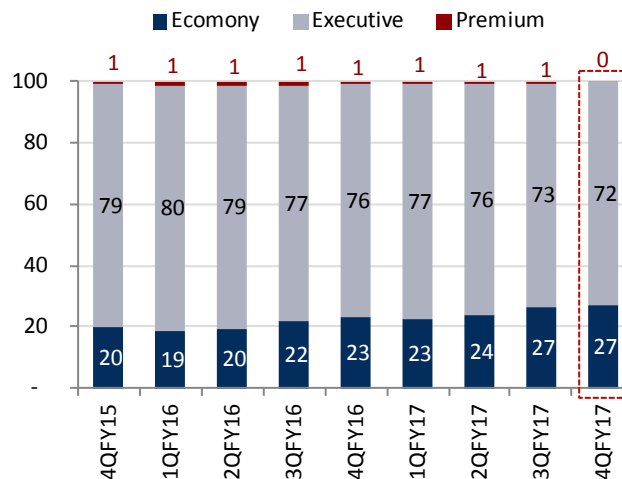
Source: Company, HDFC sec Inst Research

EBITDA Margin Fell Owing To Higher Discount



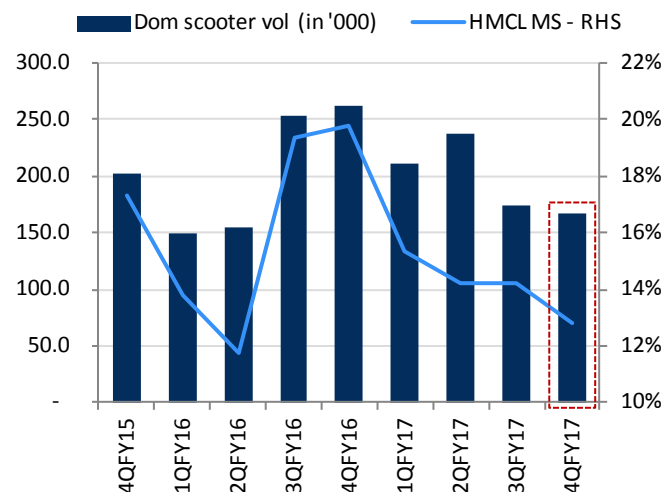
Source: Company, HDFC sec Inst Research

Motorcycles Mix Favours Exec Segment



Source: SIAM, HDFC sec Inst Research

Scooter Market Share Going Down

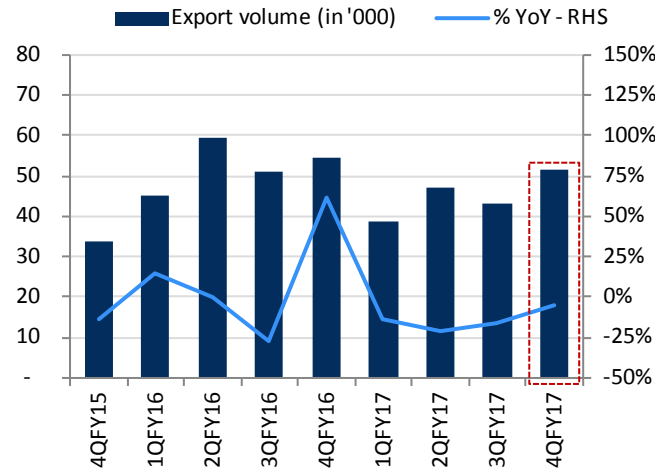


Source: Company, SIAM, HDFC sec Inst Research

HMCL's domestic motorcycle market share gained significantly in 4QFY17

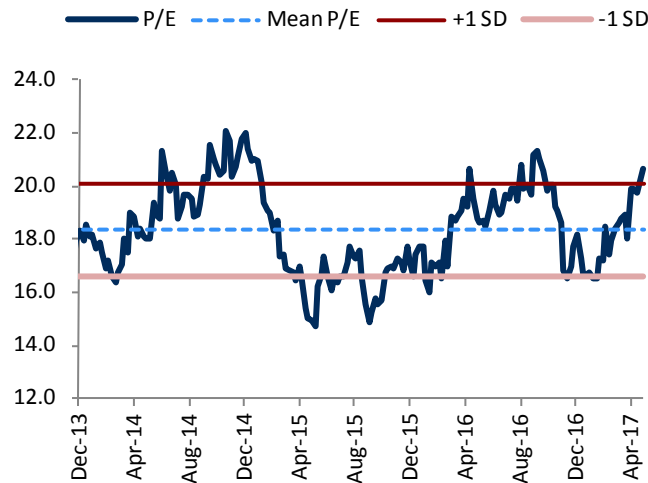
Valuations slightly above the mean level

Exports Affected YoY By Macro Headwinds



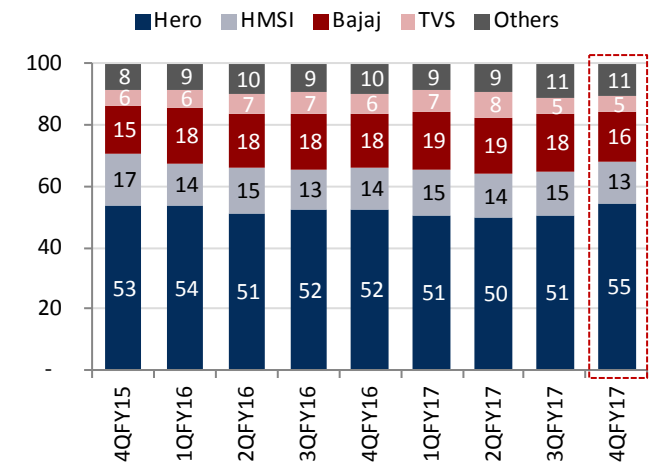
Source: Company, HDFC sec Inst Research

HMCL: One-year Forward P/E Chart



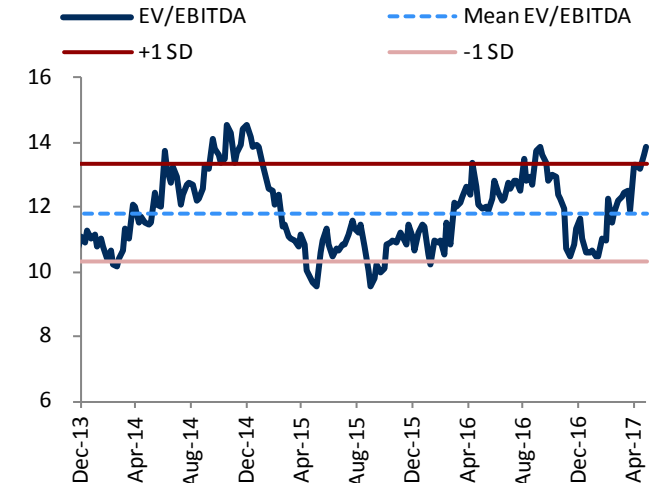
Source: Company, Bloomberg, HDFC sec Inst Research

HMCL's Motorcycle Market Share Improved



Source: SIAM, HDFC sec Inst Research

HMCL: One-year Forward EV/EBITDA Chart



Source: Company, Bloomberg, HDFC sec Inst Research

Peer Valuations

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP	Adj EPS (Rs/sh)			P/E (x)			EV/EBITDA (x)			RoE (%)		
					FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
Maruti Suzuki	2,033	6,731	BUY	7,070	242.9	272.4	353.3	27.7	24.7	19.1	19.5	16.9	12.9	23.2	22.4	26.3
Tata Motors	1,467	432	BUY	516	34.5	49.3	54.2	12.5	8.8	8.0	6.8	4.8	3.7	13.6	16.9	15.9
Bajaj Auto	841	2,905	BUY	3,400	134.8	154.0	172.4	21.5	18.9	16.9	15.8	13.2	11.3	29.9	30.5	29.8
M&M	813	1,376	BUY	1,551	56.6	75.8	86.4	24.3	18.2	15.9	13.6	11.4	9.0	14.4	17.5	17.7
Hero Motocorp	664	3,324	BUY	3,740	169.1	183.1	208.0	19.8	18.3	16.1	13.4	12.6	11.0	39.1	36.9	37.3
Eicher Motors	755	27,869	BUY	31,934	624.3	804.9	1,010.0	44.6	34.6	27.6	32.5	25.7	20.7	39.4	38.9	39.3
Ashok Leyland	243	86	BUY	97	3.7	4.9	6.3	23.3	17.3	13.5	12.6	10.0	8.3	18.1	21.9	24.9
Force Motors	60	4,551	BUY	5,350	131.2	192.9	254.7	34.7	23.6	17.9	21.5	14.0	10.6	11.0	14.4	16.4
SML Isuzu	19	1,352	BUY	1,498	43.4	57.8	74.9	31.2	23.4	18.1	18.4	14.0	10.8	15.5	18.0	19.9
Atul Auto	9	422	BUY	528	17.7	26.2	31.1	23.8	16.1	13.6	13.4	9.4	7.8	23.1	28.5	27.7

Source: Company, HDFC sec Inst Research

Income Statement Standalone

Year ending March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Net Revenues	275,651	284,427	284,750	322,871	363,018
Growth (%)	9.1	3.2	0.1	13.4	12.4
Material Expenses	197,539	193,098	190,118	217,293	245,037
Employee Expenses	11,729	13,159	13,960	15,241	16,613
Other Operating Expenses	31,163	33,620	34,324	39,936	43,690
EBITDA	35,220	44,550	46,348	50,402	57,678
EBITDA Margin (%)	12.8	15.7	16.3	15.6	15.9
EBITDA Growth (%)	(0.5)	26.5	4.0	8.7	14.4
Depreciation	5,400	4,376	4,927	5,090	5,400
EBIT	29,820	40,173	41,421	45,312	52,278
Other Income (Including EO Items)	3,435	4,175	5,163	5,731	6,152
Interest	1,381			-	-
PBT	34,637	44,349	46,584	51,043	58,430
Tax (Incl Deferred)	9,432	12,747	12,813	14,472	16,886
RPAT	25,205	31,602	33,771	36,571	41,544
EO (Loss) / Profit (Net Of Tax)	1,550	-	-	-	-
APAT	23,655	31,602	33,771	36,571	41,544
APAT Growth (%)	12.2	33.6	6.9	8.3	13.6
Adjusted EPS (Rs)	118.5	158.2	169.1	183.1	208.0
EPS Growth (%)	12.2	33.6	6.9	8.3	13.6

Source: Company, HDFC sec Inst Research

Balance Sheet Standalone

Year ending March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
SOURCES OF FUNDS					
Share Capital - Equity	399	399	399	399	399
Reserves	65,014	87,945	100,714	104,930	116,742
Total Shareholders Funds	65,413	88,344	101,113	105,329	117,142
Long Term Debt	-	-	-	-	-
Short Term Debt	-	-	-	-	-
Total Debt	-	-	-	-	-
Net Deferred Taxes	(735)	(51)	824	824	824
Long Term Provisions & Others	7,997	676	753	800	1,000
TOTAL SOURCES OF FUNDS	72,675	88,970	102,690	106,953	118,966
APPLICATION OF FUNDS					
Net Block	29,127	39,014	45,899	53,517	62,117
CWIP	8,937	2,883	2,707	2,000	2,000
Investments	8,638	11,119	13,490	15,490	16,490
LT Loans & Advances	10,034	8,924	6,960	11,301	12,706
Total Non-current Assets	56,735	61,940	69,056	82,307	93,313
Inventories	8,155	6,730	6,563	7,961	8,951
Debtors	13,896	12,828	15,619	14,153	14,919
Other Current Assets	1,200	5,951	5,609	5,709	5,759
Cash & Equivalents	24,496	36,005	46,776	34,558	35,721
Total Current Assets	47,747	61,513	74,567	62,381	65,350
Creditors	28,419	29,163	36,000	31,353	32,625
Other Current Liabilities & Provns	3,388	5,321	4,933	6,383	7,071
Total Current Liabilities	31,807	34,483	40,933	37,735	39,696
Net Current Assets	15,940	27,030	33,634	24,646	25,653
TOTAL APPLICATION OF FUNDS	72,675	88,970	102,690	106,953	118,966

Source: Company, HDFC sec Inst Research

Cash Flow Standalone

(Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Reported PBT	34,637	44,349	46,584	51,043	58,430
Non-operating & EO items	1,550	-	-	-	-
Interest expenses	111	146	273	50	75
Depreciation	5,400	4,376	4,927	5,090	5,400
Working Capital Change	(12,832)	9,019	296	(16,423)	(1,049)
Tax Paid	(9,107)	(12,062)	(12,516)	(14,472)	(16,886)
OPERATING CASH FLOW (a)	19,758	45,828	39,564	25,287	45,970
Capex	(10,991)	(8,266)	(11,731)	(12,000)	(14,000)
Free cash flow (FCF)	8,767	37,562	27,832	13,287	31,970
Investments	9,347	(14,269)	(13,088)	8,000	9,000
Non-operating Income	79	-	-	-	-
INVESTING CASH FLOW (b)	(1,565)	(22,535)	(24,820)	(4,000)	(5,000)
Debt Issuance/(Repaid)	(245)	-	-	-	-
Interest Expenses	(111)	(146)	(273)	(50)	(75)
FCFE	8,412	37,416	27,559	13,237	31,895
Share Capital Issuance	(0)	-	-	-	-
Dividend	(14,319)	(16,588)	(18,956)	(22,199)	(27,727)
FINANCING CASH FLOW (c)	(14,674)	(16,734)	(19,229)	(22,249)	(27,802)
NET CASH FLOW (a+b+c)	3,518	6,559	(4,485)	(962)	13,167
EO Items, Others	(1,550)	-	-	-	-
Closing Cash & Equivalents	24,496	36,005	46,776	34,558	35,721

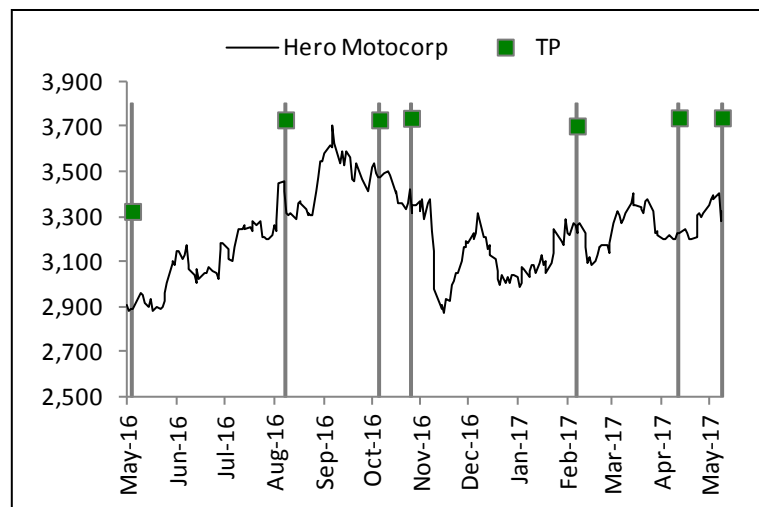
Source: Company, HDFC sec Inst Research

Key Ratios Standalone

	FY15	FY16	FY17E	FY18E	FY19E
PROFITABILITY (%)					
GPM	28.3	32.1	33.2	32.7	32.5
EBITDA Margin	12.8	15.7	16.3	15.6	15.9
APAT Margin	8.6	11.1	11.9	11.3	11.4
RoE	39.0	43.6	39.1	36.9	37.3
RoIC (or Core RoCE)	37.6	41.9	36.2	33.6	36.2
RoCE	40.5	43.6	39.1	36.9	37.3
EFFICIENCY					
Tax Rate (%)	27.2	28.7	27.5	28.4	28.9
Fixed Asset Turnover (x)	3.4	3.0	2.7	2.7	2.7
Inventory (days)	10.8	8.6	8.4	9.0	9.0
Debtors (days)	18.4	16.5	20.0	16.0	15.0
Other Current Assets (days)	1.6	7.6	7.2	6.5	5.8
Payables (days)	37.6	37.4	46.1	35.4	32.8
Other Current Liab & Provns (days)	4.5	6.8	6.3	7.2	7.1
Cash Conversion Cycle (days)	(11.3)	(11.5)	(16.8)	(11.2)	(10.1)
Debt/EBITDA (x)	-	-	-	-	-
Net D/E (x)	(0.4)	(0.4)	(0.5)	(0.3)	(0.3)
Interest Coverage (x)	21.6				
PER SHARE DATA (Rs)					
EPS	118.5	158.2	169.1	183.1	208.0
CEPS	145.5	180.2	193.8	208.6	235.1
Dividend	60.0	70.8	80.9	95.3	118.4
Book Value	327.6	442.4	506.3	527.4	586.6
VALUATION					
P/E (x)	28.3	21.2	19.8	18.3	16.1
P/BV (x)	10.2	7.6	6.6	6.4	5.7
EV/EBITDA (x)	18.3	14.2	13.4	12.6	11.0
EV/Revenues (x)	2.3	2.2	2.2	2.0	1.7
OCF/EV (%)	3.1	7.2	6.4	4.0	7.3
FCF/EV (%)	1.4	5.9	4.5	2.1	5.0
FCFE/Mkt Cap (%)	1.3	5.6	4.1	2.0	4.8
Dividend Yield (%)	1.8	2.1	2.4	2.8	3.5

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
6-May-16	2,894	BUY	3,325
10-Aug-16	3,412	BUY	3,731
8-Oct-16	3,474	BUY	3,731
28-Oct-16	3,314	BUY	3,738
10-Feb-17	3,265	BUY	3,704
13-Apr-17	3,227	BUY	3,740
11-May-17	3,324	BUY	3,740

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH

Disclosure:

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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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