

Hero Motocorp

Steady show; maintain "Accumulate"

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Rating	Accumulate
Price	Rs3,816
Target Price	Rs4,302
Implied Upside	12.7%
Sensex	33,600
Nifty	10,441

(Prices as on November 01, 2017)

Trading data

Market Cap. (Rs bn)	762.1
Shares o/s (m)	199.7
3M Avg. Daily value (Rs m)	1523.1

Major shareholders

Promoters	34.64%
Foreign	42.12%
Domestic Inst.	11.60%
Public & Other	11.64%

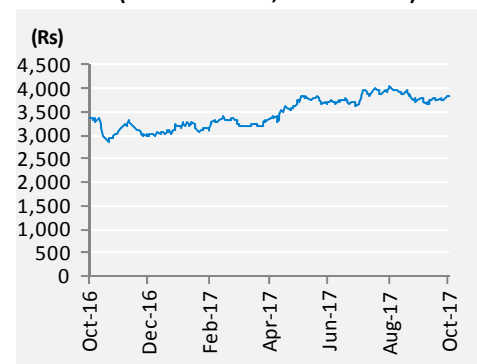
Stock Performance

(%)	1M	6M	12M
Absolute	0.9	15.3	13.2
Relative	(6.5)	3.0	(7.3)

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2019	197.9	203.3	-2.7
2020	232.2	213.0	9.0

Price Perf. (RIC: HROM.BO, BB: HMCL IN)



Source: Bloomberg

While Hero MotoCorp's (HMCL) Q2FY18 performance was marginally below expectations, operating margins at 17.4%, lower 20bps YoY but higher 110bps QoQ, surpassed our expectations of 16.9%. Revenue growth was 7.3% YoY to Rs83.6bn (PL: Rs89.4bn), while EBITDA grew 6.3% YoY to Rs14.6bn (PL: Rs15.1bn). The margin surprise was mainly on account of other expenses as a % of sales being lower 150bps YoY as well as QoQ. With higher depreciation provision and tax rate, along with lower non-operating income, net profit for the company was flat YoY at Rs10.1bn (PL: Rs10.8bn).

Management commentary has indicated that going ahead, with several new launches planned over the next few quarters, particularly in the premium (200cc) motorcycle and scooter (125cc) segments, the company should be able to fill the gap in its product portfolio and garner market share in the premium segment. Improving rural sentiment will also help the company expand its overall motorcycle market share. The management has also indicated that inventory has been maintained at 4-5 weeks, which is lower than the normal level of 5-7 weeks for the company.

The benefits of the rural recovery are likely to be further visible in the current fiscal for HMCL, while improved performance from models like *Glamour* is also expected as supplier constraints get resolved ahead. With sustained recovery in rural demand, entry in the premium segments and increase in overall market share, the medium term outlook for HMCL looks promising. We maintain 'Accumulate' with a price target of Rs4,302 based on 20x Sep'19 EPS. At the current price, the stock is trading at 20.5x FY18E and 19.3x FY19E EPS.

- Total revenue for HMCL in Q2FY18 grew 7.3% YoY to Rs83.6bn (lower than expectations of ~Rs89.4bn). This was on the back of volume growth of 11% YoY whereas realisations for the company dipped 1.7% YoY.

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Key financials (Y/e March)	2017	2018E	2019E	2020E
Revenues (Rs m)	284,731	320,403	344,651	378,683
Growth (%)	0.1	12.5	7.6	9.9
EBITDA (Rs m)	46,329	52,992	56,224	64,520
PAT (Rs m)	33,752	37,110	39,527	46,375
EPS (Rs)	169.0	185.8	197.9	232.2
Growth (%)	6.7	9.9	6.5	17.3
Net DPS (Rs)	85.0	95.0	105.0	115.0

Profitability & Valuation	2017	2018E	2019E	2020E
EBITDA margin (%)	16.3	16.5	16.3	17.0
RoE (%)	35.6	33.7	30.8	31.0
RoCE (%)	35.7	33.7	30.8	31.0
EV / sales (x)	2.7	2.4	2.2	2.0
EV / EBITDA (x)	16.4	14.4	13.5	11.6
PE (x)	22.6	20.5	19.3	16.4
P / BV (x)	7.5	6.4	5.5	4.7
Net dividend yield (%)	2.2	2.5	2.8	3.0

Source: Company Data; PL Research

- EBITDA grew 6.3% YoY to Rs14.6bn (PLe: Rs15.1bn); while EBITDA margin was at 17.4%, lower 20bps YoY, but up 110bps QoQ (above PLe of 16.9%). Gross margins were lower 170bps YoY & 50bps QoQ to ~32%. Staff costs to sales ratio was stable YoY & QoQ, while OE / sales ratio was lower 150bps YoY as well as QoQ.
- Adjusting for the GST impact on Haridwar plant sales (forming 13.5% of total volumes), EBITDA margin stands marginally lower at 17.3% (against reported margins at 17.4%).
- Contribution / vehicle remained stable YoY (up 2.1% QoQ), while EBITDA / vehicle dipped 0.8% YoY (higher 16.8% QoQ).
- With slightly higher tax rate, net profit for the company grew 3.5% YoY to Rs9.14bn (PLe: Rs9.2bn).
- As benefits from the Haridwar plant, which constituted ~36% of sales in FY17 expire in FY18, the possible adverse margin impact can be to the tune of 100bps. However, with the Halol plant ramping up, and with the continuation of the 'Leap' program, the full impact is unlikely to be felt on HMCL's reported performance in FY19e. We have factored in a margin dip of 50bps in FY19 on account of the same.

Conference call highlights:

- The company has seen strong double digit growth in retail sales over the festive period and is expected to have outgrown industry growth during this period.
- The company is maintaining its post festive period inventory at 4-5 weeks.
- With some new launches planned ahead in the coming quarters, the company expects to gain momentum in the Scooter as well as premium motorcycle segment. Also, with supply constraints addressed, it expects *Glamour* volumes to see strong recovery going ahead.
- Other expenses were lower in Q2 due to lower phasing of overheads in the quarter and are expected to be higher in H2FY18 relatively. LEAP cost benefits for the quarter stand at ~Rs300mn.
- The company expects Haridwar plant benefits (~100bps benefit to operating margins) expiring by FY18 end to be partially offset by Halol ramp up.
- Spare parts sales for HMCL in Q2FY18 were flat YoY but higher 15-18% QoQ.
- Hero Fincorp financed ~9% of the total sales for HMCL in Q2FY18.
- The capex guidance given by the company stands at Rs25bn, which includes R&D expenses, part of the Andhra Pradesh greenfield capacity, full capitalisation at the Halol plant and any product development expenses.

Exhibit 1: Q2FY18 Result Overview (Rs m)

Y/e March	Q2FY18	Q2FY17	YoY gr. (%)	Q1FY18	H1FY18	H1FY17	YoY gr. (%)
Net Revenues	83,620	77,963	7.3	79,716	163,336	151,952	7.5
Raw Materials	56,981	51,833	9.9	53,941	110,922	101,487	9.3
<i>% of Net Sales</i>	<i>68.1</i>	<i>66.5</i>		<i>67.7</i>	<i>67.9</i>	<i>66.8</i>	
Personnel	3,837	3,575	7.3	3,737	7,573	6,937	9.2
<i>% of Net Sales</i>	<i>4.6</i>	<i>4.6</i>		<i>4.7</i>	<i>4.6</i>	<i>4.6</i>	
Manufacturing & Other Exp	8,246	8,867	(7.0)	9,079	17,325	17,539	(1.2)
<i>% of Net Sales</i>	<i>9.9</i>	<i>11.4</i>		<i>11.4</i>	<i>10.6</i>	<i>11.5</i>	
Total Expenditure	69,063	64,274	7.5	66,757	135,820	125,962	7.8
EBITDA	14,557	13,689	6.3	12,959	27,516	25,990	5.9
<i>EBITDA Margin (%)</i>	<i>17.4</i>	<i>17.6</i>		<i>16.3</i>	<i>16.8</i>	<i>17.1</i>	
Depreciation	1,360	1,193	14.1	1,330	2,690	2,345	14.7
EBIT	13,197	12,496	5.6	11,630	24,826	23,645	5.0
Interest Expenses	16	16	0.6	16	31	31	3.0
Non-operating income	1,176	1,524	(22.8)	1,317	2,493	2,727	(8.6)
PBT	14,357	14,004	2.5	12,931	27,288	26,342	3.6
Tax-Total	4,252	3,962	7.3	3,790	8,043	7,468	7.7
<i>Tax Rate (%) - Total</i>	<i>29.6</i>	<i>28.3</i>	<i>4.7</i>	<i>29.3</i>	<i>29.5</i>	<i>28.4</i>	<i>4.0</i>
Reported PAT	10,105	10,042	0.6	9,140	19,245	18,873	2.0
Adj. PAT	10,105	10,042	0.6	9,140	19,245	18,873	2.0

Source: Company Data, PL Research

Exhibit 2: Operating Metrics

Y/e March	Q2FY18	Q2FY17	YoY gr. (%)	Q1FY18	H1FY18	H1FY17	YoY gr. (%)
Sales Volume (nos)	2,022,805	1,823,498	10.9	1,853,647	3,876,452	3,568,887	8.6
Net Realisation/Vehicle	42,970	42,755	0.5	43,005	42,135	42,577	(1.0)
Material cost / vehicle	29,207	28,425	2.8	29,100	28,614	28,436	0.6
Gross Profit / vehicle	13,763	14,330	(4.0)	13,905	13,521	14,140	(4.4)
Employee cost /vehicle	1,897	1,960	(3.3)	2,016	1,954	1,944	0.5
Other expenses / vehicle	4,422	4,863	(9.1)	4,898	4,469	4,914	(9.1)
EBITDA/vehicle	7,444	7,507	(0.8)	6,991	7,098	7,282	(2.5)
Net Profit/vehicle	5,243	5,507	(4.8)	4,931	4,965	5,288	(6.1)

Source: Company Data, PL Research



Income Statement (Rs m)

Y/e March	2017	2018E	2019E	2020E
Net Revenue	284,731	320,403	344,651	378,683
Raw Material Expenses	190,118	216,258	235,278	255,758
Gross Profit	94,613	104,145	109,373	122,926
Employee Cost	13,960	15,110	16,249	17,857
Other Expenses	34,324	36,043	36,900	40,549
EBITDA	46,329	52,992	56,224	64,520
Depr. & Amortization	4,927	6,516	6,994	7,682
Net Interest	(684)	(871)	(1,036)	(1,187)
Other Income	5,224	5,844	6,486	7,163
Profit before Tax	46,566	52,268	55,672	63,966
Total Tax	12,813	15,158	16,145	17,591
Profit after Tax	33,752	37,110	39,527	46,375
Ex-Od items / Min. Int.	—	—	—	—
Adj. PAT	33,752	37,110	39,527	46,375
Avg. Shares O/S (m)	199.7	199.7	199.7	199.7
EPS (Rs.)	169.0	185.8	197.9	232.2

Cash Flow Abstract (Rs m)

Y/e March	2017	2018E	2019E	2020E
C/F from Operations	45,822	43,574	46,039	52,924
C/F from Investing	(24,725)	(24,500)	(22,500)	(22,500)
C/F from Financing	(21,044)	(19,024)	(21,012)	(23,000)
Inc. / Dec. in Cash	54	51	2,527	7,424
Opening Cash	1,314	1,367	1,418	3,945
Closing Cash	1,367	1,418	3,945	11,369
FCFF	31,335	26,372	33,495	40,390
FCFE	31,335	26,372	33,495	40,390

Key Financial Metrics

Y/e March	2017	2018E	2019E	2020E
Growth				
Revenue (%)	0.1	12.5	7.6	9.9
EBITDA (%)	3.7	14.4	6.1	14.8
PAT (%)	6.7	9.9	6.5	17.3
EPS (%)	6.7	9.9	6.5	17.3
Profitability				
EBITDA Margin (%)	16.3	16.5	16.3	17.0
PAT Margin (%)	11.9	11.6	11.5	12.2
RoCE (%)	35.7	33.7	30.8	31.0
RoE (%)	35.6	33.7	30.8	31.0
Balance Sheet				
Net Debt : Equity	—	—	—	(0.1)
Net Wrkg Cap. (days)	(30)	(29)	(29)	(29)
Valuation				
PER (x)	22.6	20.5	19.3	16.4
P / B (x)	7.5	6.4	5.5	4.7
EV / EBITDA (x)	16.4	14.4	13.5	11.6
EV / Sales (x)	2.7	2.4	2.2	2.0
Earnings Quality				
Eff. Tax Rate	27.5	29.0	29.0	27.5
Other Inc / PBT	11.2	11.2	11.7	11.2
Eff. Depr. Rate (%)	4.7	5.4	5.2	5.3
FCFE / PAT	92.8	71.1	84.7	87.1

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2017	2018E	2019E	2020E
Shareholder's Funds	101,113	119,251	137,810	161,220
Total Debt	—	—	—	—
Other Liabilities	4,143	4,143	4,143	4,143
Total Liabilities	105,256	123,395	141,953	165,363
Net Fixed Assets	48,606	54,590	60,096	64,914
Goodwill	—	—	—	—
Investments	58,899	70,899	80,899	90,899
Net Current Assets	(2,249)	(2,094)	959	9,551
Cash & Equivalents	1,367	1,418	3,945	11,369
Other Current Assets	38,070	42,464	45,948	51,204
Current Liabilities	41,686	45,976	48,934	53,022
Other Assets	—	—	—	—
Total Assets	105,256	123,395	141,953	165,363

Quarterly Financials (Rs m)

Y/e March	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Net Revenue	63,646	69,152	79,716	83,620
EBITDA	10,797	9,576	12,959	14,557
% of revenue	17.0	13.8	16.3	17.4
Depr. & Amortization	1,249	1,353	1,330	1,360
Net Interest	15	15	16	16
Other Income	1,319	1,182	1,317	1,176
Profit before Tax	10,853	9,390	12,931	14,357
Total Tax	3,133	2,213	3,790	4,252
Profit after Tax	7,720	7,178	9,140	10,105
Adj. PAT	7,720	7,178	9,140	10,105

Key Operating Metrics

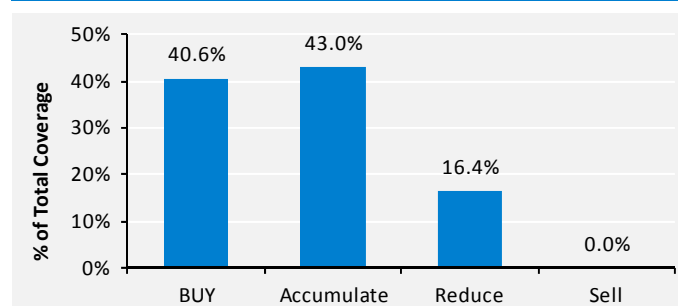
Y/e March	2017	2018E	2019E	2020E
Two-wheeler volume (units)	6,642,204	7,309,117	7,989,097	8,516,870
Realisation per unit (Rs)	42,091	43,068	42,374	43,679
Gross margin per unit (Rs)	14,244	14,249	13,690	14,433
EBITDA per unit (Rs)	6,975	7,250	7,038	7,576
Profit per unit (Rs)	5,081	5,077	4,948	5,445

Source: Company Data, PL Research.

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