

Buy

Hero MotoCorp

Industry: Auto and Auto Components | Industry View: Positive

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Since 1948

Result Update

Volumes to remain buoyant on new launches

In line quarter, margins disappoint a bit

Total net revenues in the quarter went up by 17% yoy while dipping by 12.6% qoq as volumes were up 16% yoy, while dipped by 15.4% qoq. Realisations were up by 0.8% yoy and 3.3% qoq. RM costs to sales came in at 67.4% as against 66.1% yoy as the impact of rising RM prices was felt well in this quarter. Margins came in at 15.8% which were slightly lower than expected as competitive intensity along with higher marketing spends were observed during the quarter. However, tight cost control through its LEAP program and phasing out of other expenses including CSR expenditure were some of the positive levers on the margins. Other expenses to sales were high qoq at 11.3% as compared to 9.9% as marketing spends and discounts were high in the festive quarter. Sequentially the margins have dropped by 16 bps. Depreciation came in 11% higher yoy as Halol plant in Gujarat commissioned in Q4 FY17. Tax rate came in at 28.6% as Haridwar plant benefits narrow down, while net profits came in 23% higher yoy at ₹ 8.05 bn.

Volumes to remain buoyant on new launches

Q2 FY18 witnessed the highest ever sale from Hero in a quarter, post which in Q3 FY18, there was a sequential drop. However, scooter business performed well and the mass and executive segments outperformed the industry. Going forward, the company is launching several new products including a 200 cc bike Extreme 200R, a scooter and slurry of refreshes and variants. Additionally, GOI's push on rural (51% of volumes) infrastructure may lead to higher two wheeler growth, as per the management. Hero expects the 2W industry growth momentum to continue and expects to grow higher than the industry rate. Recovery in the rural markets has already started as per the management. Also the Halol plant which started from March will take up the total capacity to 8.9 mn per year which would enable the company to cater to the demand which has already started to move up. Another upcoming plant at AP is supposed to take up this capacity to 10 mn in a couple of years. Scooters growth has been very strong since last two quarters and is expected to be so on new launches. There are some concerns in some pockets in the states of Maharashtra (financing), Karnataka and TN (monsoon), however, northern, eastern and central states are doing very well. We therefore believe that the company is poised for a healthy volume growth in the ensuing years, sorting out capacity issues if any. Hence, we expect Hero's volumes to grow at a higher pace of 10%/9.3%/9.6% for FY18E/19E/20E respectively.

Margins to get impacted by higher RM costs, but better product mix and price hikes may support

Hero's EBITDA margins in the quarter came at 15.8% which were lower than expected as RM prices grew thick and fast. The LEAP cost cutting initiative taken by the company added 40-50 bps to the margins. Also the localization efforts have panned out well. The management has cut down other expenses and CSR related expenses impacting margins. Going forward, the management has given a slightly muted outlook on margins at 14-15% on increasing metal prices, competitive intensity and new vehicle launch costs. Appropriate price hikes and launch of new high margin 200cc product will provide the necessary boost to margins. FY19 will also witness implementation of various emission and safety norms which would require the industry to adjust accordingly, thus incurring costs. Withdrawal of Haridwar plant benefits may get offset by Halol and AP plants coming up. We believe that reduction in other expenses, reduction in discounts and LEAP and other cost cutting initiatives may result into some up move in the margins in the 16% range in FY19E/20E.

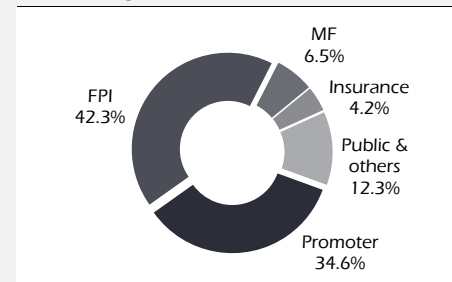
Stock Data

Current Market Price (₹)	3,570
Target Price (₹)	4,097
Potential upside (%)	15
FV (₹)	2
Reuters	HROH.BO
Bloomberg	HMCL IN
Market Cap (₹ bn)	712
52-Week Range (₹)	4,200 / 3,054

What's Changed

12 month Price Target (₹)	From 4,182 to 4,097
FY2018E EPS (₹)	From 203 to 194
FY2019E EPS (₹)	From 233 to 231
FY2020E EPS (₹)	264

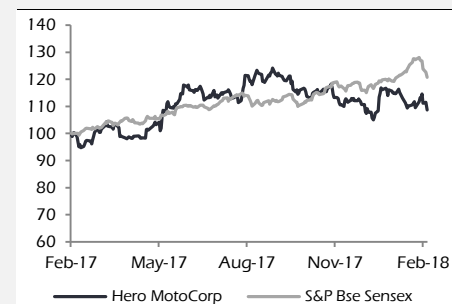
Shareholding Pattern



Fiscal YE

YE Mar	FY17	FY18E	FY19E	FY20E
Revenues (₹ bn)	285	343	389	434
EBITDA (%)	16.3	15.9	16.5	17.0
PAT (%)	11.9	11.3	11.9	12.2
EPS (₹)	169.1	194.1	231.3	264.3
EPS growth (%)	6.9%	14.8%	19.2%	14.3%
P/E (x)	21.1	18.4	15.4	13.5
P/B(x)	2.8	2.4	2.0	1.7
EV/EBITDA (x)	13.9	11.9	10.2	8.9
ROCE (%)	34.2%	34.0%	34.4%	34.5%
ROE (%)	33.4%	32.6%	32.9%	32.0%
Dividend yield (%)	2.0%	2.4%	2.9%	3.3%

Relative Price Performance



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Financial Highlights

All fig in ₹ mn	Q3 FY18	Q2 FY18	% qoq	Q3 FY17	% yoy
Total net sales	73,054.0	83,619.0	-12.6%	62,458.6	17.0%
RM cost	49,220.2	56,980.3	-13.6%	41,280.0	19.2%
Employee cost	4,019.4	3,836.6	4.8%	3,742.7	7.4%
Other expenses	8,235.4	8,245.7	-0.1%	7,826.1	5.2%
EBITDA	11,579.0	14,556.4	-20.5%	9,609.8	20.5%
EBITDA Margins %	15.8	17.4	(160 bps)	15.4	40 bps
Other income	1,100.2	1,176.0	-6.4%	1,319.3	-16.6%
Depreciation	1,382.8	1,360.3	1.7%	1,248.5	10.8%
Interest	15.7	15.6	0.6%	15.2	3.3%
PBT	11,280.7	14,356.5	-21.4%	9,665.4	16.7%
Tax	3,227.0	4,252.2	-24.1%	3,132.5	3.0%
Adjusted PAT	8,053.7	10,104.3	-20.3%	6,532.9	23.3%
APAT margins %	11.0	12.1	(90 bps)	10.5	60 bps
Reported PAT	8,053.7	10,104.3	-20.3%	6,532.9	23.3%
PAT margins %	11.0	12.1	(90 bps)	10.5	60 bps

Outlook and valuation

Volumes witnessed a sound growth in Q3 on festive season. This may continue to see so in the ensuing quarters too. Modelwise, the company is performing well on the scooters side off late. On the 100-125 cc motorcycle segment through Deluxe, Splendor and Glamour, Hero is strengthening its position. Rural pockets along with new launches in the scooters and premium motorcycle segments will provide the volume kicker hereon. On margin front, higher RM prices, higher launch costs, withdrawal of Haridwar tax benefits may impact margins along with setting up of new plants in Gujarat and AP. However, we believe that lower CSR expenses, better product mix via new launches, LEAP cost cutting initiative, lower discounts and higher volumes (leading to operating leverage) may result into margins inching up; slowly and steadily. On the bottomline, setting up of new plants will increase the depreciation expenses but also provide with tax benefits as Halol and AP both are tax haven plants. In line with lower than expected Q3, we have slightly reduced our FY18E/19E estimates, while have introduced FY20E numbers. Rolling over to these numbers, we maintain BUY rating on the stock with a target of ₹4,097.

All figs in ₹	Q3 FY18	Q2 FY18	Q1 FY18	Q4 FY17	Q3 FY17	Q2 FY17	Q1 FY17	Q4 FY16
Volumes (mn)	1.71	2.02	1.85	1.62	1.47	1.82	1.75	1.72
Net Realization	42,744	41,384	43,004	42,639	42,387	42,755	42,391	43,604
Material Cost/Unit	28,799	28,200	29,099	29,203	28,014	28,425	28,449	28,787
Staff Cost/Unit	2,352	1,899	2,016	2,023	2,540	1,960	1,926	2,030
Other Expn/Unit	4,819	4,081	4,898	5,509	5,311	4,863	4,969	5,862
Total Expn/Unit	35,969	34,180	36,013	36,735	35,865	35,248	35,344	36,679
EBITDA/unit	6,775	7,204	6,991	5,904	6,522	7,507	7,048	6,925
Net profit /unit	4,712	5,001	4,931	4,426	4,433	5,507	5,060	4,850

Financials
Income statement

YE Mar (₹.mn)	FY17	FY18E	FY19E	FY20E
Total Revenues	284,750	342,943	389,222	434,348
Raw Material Cost	190,118	231,144	262,725	291,013
Employee Cost	13,960	16,118	18,683	20,849
Other Exp	34,324	41,153	43,593	48,647
EBITDA	46,348	54,528	64,222	73,839
EBITDA Margin(%)	16.3	15.9	16.5	17.0
Other income	5223	5400	5600	5800
Depreciation	4,927	5,264	5,595	6,240
Interest	61	70	80	90
PBT	46,584	54,594	64,146	73,309
PBT Margin(%)	16.4	15.9	16.5	16.9
Exceptional items	0	0	0	0
Tax	12,813	15,832	17,961	20,527
PAT	33,770	38,762	46,185	52,783
PAT Margins (%)	11.9	11.3	11.9	12.2
Adj PAT	33,770	38,762	46,185	52,783
Adj PAT Margin (%)	11.9	11.3	11.9	12.2

Key Ratios

YE Mar	FY17	FY18E	FY19E	FY20E
Per Share Data (Rs)				
Adj. EPS	169.1	194.1	231.3	264.3
CEPS	193.8	220.5	259.3	295.6
BVPS	506.3	595.7	703.8	826.3
DPS	70.0	87.0	102.0	117.0
Growth Ratios (%)				
Total revenues	0.1%	20.4%	13.5%	11.6%
EBITDA	4.0%	17.6%	17.8%	15.0%
PAT	6.9%	14.8%	19.2%	14.3%
EPS Growth	6.9%	14.8%	19.2%	14.3%
Valuation Ratios (x)				
PE	21.1	18.4	15.4	13.5
P/CEPS	18.4	16.2	13.8	12.1
P/BV	2.8	2.4	2.0	1.7
EV/Sales	2.5	2.1	1.8	1.6
EV/EBITDA	13.9	11.9	10.2	8.9
Operating Ratios (Days)				
Inventory days	12.6	14.0	14.0	14.0
Receivable Days	20.0	15.0	15.0	15.0
Payables day	62.3	42.0	42.0	42.0
Net Debt/Equity (x)	0.03	0.02	0.01	(0.00)
Profitability Ratios (%)				
ROCE	34.2%	34.0%	34.4%	34.5%
ROE	33.4%	32.6%	32.9%	32.0%
Dividend yield	2.0%	2.4%	2.9%	3.3%

Source: Company, LKP Research

Balance sheet

YE Mar (₹. mn)	FY17	FY18E	FY19E	FY20E
EQUITY & LIABILITIES				
Equity Share Capital	399	399	399	399
Reserves & Surplus	100,714	118,565	140,140	164,613
Total Networth	101,113	118,964	140,540	165,012
Total debt	4,896	4,946	4,996	5,046
Deferred Tax Liability	0	0	0	0
Current Liab & Prov				
Current liabilities	32,472	41,163	43,188	46,243
Other liabilities & Provisions	8,461	9,261	10,061	10,861
Total Equity and Liabilities	146,940	174,332	198,782	227,160
ASSETS				
Net block	43,107	57,843	66,248	76,008
Capital WIP	2,707	4,207	5,207	6,207
Intangible assets	2,792	2,500	3,000	3,500
Deferred tax assets	0	0	0	0
Long term investments	13,490	15,490	17,490	19,490
Long term loans and advances	3,803	4,503	5,203	5,903
Other non current assets	6,511	5,011	4,011	3,011
Total non-current assets	72,411	89,555	101,160	114,120
Current Assets				
Current investments	45,409	49,409	55,409	61,409
Cash and Bank	1,367	2,303	3,408	5,509
Inventories	6,563	7,599	8,638	11,162
Sundry Debtors	15,619	18,791	22,394	26,180
Loan, Advances & others	5,574	6,674	7,774	8,781
Other current assets	244	444	644	750
Total Assets	146,940	174,332	198,782	227,160

Cash Flow

YE Mar (₹ mn)	FY17	FY18E	FY19E	FY20E
PBT	33,771	38,762	46,185	52,783
Depreciation	4,927	5,264	5,595	6,240
Interest	3,171	0	0	0
Chng in working capital	4,208	3,482	(9,615)	(10,162)
Tax paid	949	1,832	2,961	5,527
Other operating activities	(6,746)	(552)	3,119	564
Cash flow from operations (a)	40,280	48,788	48,245	54,951
Capital expenditure	(11,507)	(21,500)	(15,000)	(17,000)
Chng in investments	(7,174)	(5,708)	(8,500)	(8,500)
Other investing activities	(758)	1,500	1,000	1,000
Cash flow from investing (b)	(19,439)	(25,708)	(22,500)	(24,500)
Free cash flow (a+b)	20,840	23,080	25,745	30,451
Inc/dec in borrowings	0	50	50	50
Dividend paid (incl. tax)	(20,910)	(20,910)	(24,610)	(28,310)
Other financing activities	(61)	(70)	(80)	(90)
Cash flow from financing (c)	(20,956)	(20,930)	(24,640)	(28,350)
Net chng in cash (a+b+c)	(116)	2,150	1,105	2,101
Closing cash & cash equiv	153	2,303	3,408	5,509

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