

Analyst Meet Update

HERO MOTOCORP LTD (HMC)

Stock Details

Market cap (Rs mn)	:	649172
52-wk Hi/Lo (Rs)	:	4200 / 3034
Face Value (Rs)	:	2
3M Avg. daily vol (Nos)	:	449,541
Shares o/s (mn)	:	200

Source: Bloomberg
Financial Summary

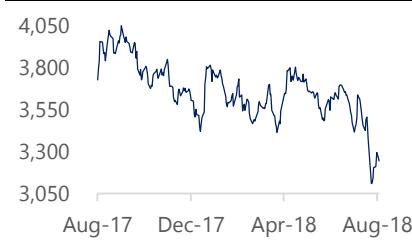
Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenues	322,305	353,940	393,201
Growth (%)	13.1	9.8	11.1
EBITDA	52,802	54,265	60,621
EBITDA margin (%)	16.4	15.3	15.4
Adj. Net profit	36,973	36,627	40,801
Adj. EPS (Rs)	185.1	183.4	204.3
Adj. EPS Growth (%)	9.5	(0.9)	11.4
Book value (Rs/share)	589.3	658.3	730.2
Dividend per share (Rs)	95.0	110.0	120.0
ROE (%)	33.8	29.4	29.4
ROCE (%)	46.0	41.6	41.8
P/E (x)	17.6	17.7	15.9
EV/EBITDA (x)	11.2	10.9	9.6
P/BV (x)	5.5	4.9	4.5

Source: Company, Kotak Securities - PCG
Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	34.6	34.6	34.6
FII	39.6	42.3	42.1
DII	14.4	11.5	11.6
Others	11.4	11.5	11.6

Source: Company
Price Performance (%)

(%)	1M	3M	6M
Hero MotoCorp	(5.7)	(11.1)	(10.3)
Nifty	6.2	6.4	5.6

Source: Bloomberg
Price chart (Rs)

Source: Bloomberg
PRICE Rs.3251
TARGET Rs.3473
ACCUMULATE

We attended the analyst meet of Hero MotoCorp. Management discussed their upcoming new products and touched upon broader aspects of the two wheeler industry.

Key Highlights

HMC is making yet another attempt to improve its presence in the scooter segment by launching two products (of existing brands) in the 125cc category. Management highlighted that the 125cc scooter segment is a fast growing segment with 60% volume growth as buyers move up the value chain. HMC do not have presence in the 125cc scooter segment which accounts for 20% of the overall scooter volumes. Company has also renewed its focus back on the premium motorcycle segment. HMC will be targeting this segment with Xtreme 200R. On exports, the company highlighted that the scale-up is taking more time as expected initially. However, the company is working towards its ambition of expanding its presence in the export market.

Outlook and Valuation

We expect healthy volume growth for the company in FY19-FY20. Pickup in rural demand, (HMC is large player in rural areas) has led to improved demand for motorcycle. Expected good monsoon and government measures to improve farm income will likely keep rural demand healthy in the near to medium term. Further, we expect new products to add to the growth for the company. While there are certain near term headwinds to the margins, we expect the margins to improve over the medium term. We retain ACCUMULATE rating on the stock with unchanged price target of Rs3,473.

Looking to gain market share in the scooter segment

Company's market share in the domestic scooter segment declined from a peak of 19.2% in FY14 to 10.4% in 1QFY19. HMC's attempt in the past few years towards gaining market share did not yield positive result. HMC is making yet another attempt to improve its presence in the scooter segment by launching two products (of existing brands) in the 125cc category. Management highlighted that the 125cc scooter segment is a fast growing segment with 60% volume growth as buyers move up the value chain. The 125cc category now accounts for 20% of the scooter segment. Company highlighted that 125cc category in the scooter segment took less time to reach the 20% share as compared with the 125cc category in the motorcycle segment. Further, the management also stated that unlike in the 110cc scooter segment, where one product has significant market share; the 125cc category customers are willing to experiment with different products/brands. For HMC, 125cc scooter segment is a white space and its entry in this segment will increase the scooter target market by another 20% (will inch close to 100% of scooter's target market). Given new segment, we expect limited cannibalization with the 110cc segment and expect new products to generate incremental sales volume for the company.

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Re-entry into the premium motorcycle segment

HMC is a small player (1% market share) in the domestic premium motorcycle segment. While the company had 12% market share in the premium segment in FY12, the presence has been very weak since FY16. Company has now renewed its focus back on the premium motorcycle segment. HMC will be targeting this segment with Xtreme 200R. HMC is looking to disrupt the current market dynamics by positioning Xtreme 200R as higher CC product with ABS technology at a slight premium price.

Exports – working towards increasing presence

On exports, the company highlighted that the scale-up is taking more time as expected initially. However, the company is working towards its ambition of expanding its presence in the export market. HMC has plants in Bangladesh (120,000 units annual capacity) and Columbia (80,000 units annual capacity). In Bangladesh, HMC has a market share of 30% (market leader for two consecutive months). For the African market, the company is modifying its products to suit regions requirement.

Other highlights of the analyst meet

Company shared that as per a study, the top five two wheeler buying factors are mileage, strength/durability, brand, styling/design and ownership cost.

In the domestic motorcycle industry, entry segment accounts for 26% of the volumes, deluxe segment is 51% of the volume and balance 23% comes from the premium segment. HMC has 58% market share in the entry level motorcycle segment, 71% market share in the deluxe segment and 1% market share in the premium segment.

Two wheeler penetration in India is ~30-40%. In the urban areas (accounts for 60% industry volumes) penetration levels is ~40-45% and in the rural areas (accounts for 40% industry volumes) penetration levels stands at ~20-25%.

HMC is working on the electric vehicle segment through its Centre of Innovation and Technology (CIT) and its investment in Ather Energy. HMC is developing its own product in the electric vehicle segment; however the management did not share the launch timeline. Ather Energy has launched its product in Bangalore and has received good response in the pre-order. Going ahead, Ather Energy will extend its offerings to few more cities.

In the two wheeler segment, first time buyer's accounts for 51% of industry volume, replacement segment is 27% of industry volumes and 22% volumes comes from multiple two-wheeler owners. Two wheeler replacement cycle is down from ~7 years in 2001 to 4.5-5 years now.

In the domestic two wheeler industry, 36% of two wheelers sold are financed. Financed vehicle sales are higher in the urban areas as compared to rural areas (~20-25% sales in rural areas are financed). Management expects that higher access to finance options and lower cost of finance can give boost to demand.

On the aggressive strategy adopted by competition in the entry level motorcycle segment, the management says that currently the company is not looking to respond to the competition pricing action.

Outlook and Valuation

HMC reported low sales volume growth between FY12-FY17. However, in FY18 the volume grew by 14%. We expect healthy volume growth for the company in FY19-FY20. Pickup in rural demand, (HMC is large player in rural areas) has led to improved demand for motorcycle. Expected good monsoon and government measures to improve farm income will likely keep rural demand healthy in the near to medium term. Further, we expect new products too to add to the growth for the company. While there are certain near term headwinds to the margins, we expect the margins to improve over the medium term. We retain ACCUMULATE rating on the stock with unchanged price target of Rs3,473. We have valued the stock at a PE of 17x on FY20E earnings.

Risk

Price war in the two wheeler segment remains key risk to volume and margin assumption.

Company background

HMC is the largest two wheeler player in India. In 2001, the company became the largest two-wheeler manufacturing company in India and globally in terms of unit volume sales in a calendar year. HMC is the market leader in the domestic motorcycle segment with 50% market share (overall two wheeler domestic market share is ~37%). In FY17, the company surpassed 70 million units in cumulative sales since its inception. HMC's extensive sales and service network, comprising of authorised dealerships, service & parts outlets, and dealer-appointed outlets, spans over 6,000 customer touch points across the country. Company's manufacturing plants are located at Gurugram, Dharuhera, Haridwar, Neemrana and Vadodara.

Financials: Stanalone

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Revenues	285,005	322,305	353,940	393,201
% change YoY	(0.3)	13.1	9.8	11.1
EBITDA	46,348	52,802	54,265	60,621
% change YoY	4.2	13.9	2.8	11.7
Depreciation	4,927	5,556	6,050	6,570
EBIT	41,421	47,246	48,215	54,051
% change YoY	3.4	14.1	2.1	12.1
Net interest	61	63	70	70
Other Income	5,224	5,258	5,718	6,020
Exceptional income/(loss)	0	0	0	0
Profit before tax	46,585	52,441	53,863	60,001
% change YoY	6.0	12.6	2.7	11.4
Tax	12,813	15,468	17,236	19,200
as % of PBT	27.5	29.5	32.0	32.0
Profit after tax	33,771	36,973	36,627	40,801
Adjusted PAT	33,771	36,973	36,627	40,801
% change YoY	7.8	9.5	-0.9	11.4
Shares outstanding (m)	200	200	200	200
Adjusted EPS (Rs)	169.1	185.1	183.4	204.3
DPS (Rs)	85.0	95.0	110.0	120.0

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Cash and cash equivalents	46,776	57,325	59,131	68,575
Accounts receivable	15,619	15,202	17,455	19,391
Inventories	6,563	8,236	9,269	10,270
Loans and Adv & Others	15,889	17,556	19,280	21,160
Current assets	84,846	98,318	105,135	119,397
LT investments	13,490	19,341	21,341	23,341
Net fixed assets	48,606	49,729	59,496	62,926
Total assets	146,943	167,388	185,972	205,663
Payables	32,473	33,188	36,849	40,936
Other liabilities	8,071	9,647	10,612	11,673
Current Liabilities	40,543	42,835	47,460	52,609
Provisions	1,143	1,747	1,922	2,114
Deferred Tax Liability	4,143	5,117	5,117	5,117
Debt	0	0	0	0
Equity	399	399	399	399
Reserves	100,714	117,289	131,073	145,424
Total liabilities	146,943	167,388	185,972	205,663
BVPS (Rs)	506	589	658	730

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
EBIT	41,421	47,246	48,215	54,051
Depreciation	4,927	5,556	6,050	6,570
Change in working capital	3,343	(540)	374	1,150
Chg in other net current asset	1,821	514	(585)	(627)
Operating cash flow	51,512	52,775	54,054	61,144
Interest	(61)	(63)	(70)	(70)
Tax	(10,895)	(14,495)	(17,236)	(19,200)
Other Income	5,224	5,258	5,718	6,020
EO income	-	-	-	-
Others	(55)	64	-	-
CF from operations	45,726	43,540	42,466	47,894
Capex	(11,636)	(6,679)	(15,816)	(10,000)
(Inc)/dec in investments	(13,088)	(16,354)	(4,089)	(12,000)
CF from investments	(24,725)	(23,032)	(19,905)	(22,000)
Proceeds from issue of equities	0	0	-	-
Proceeds from share premium	23	52	-	-
Dividends	(20,970)	(20,512)	(22,843)	(26,450)
CF from financing	(20,947)	(20,461)	(22,843)	(26,450)
Opening cash	1,314	1,367	1,413	1,131
Closing cash	1,367	1,413	1,131	575

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Margins				
EBITDA margin (%)	16.3	16.4	15.3	15.4
EBIT margin (%)	14.5	14.7	13.6	13.7
Adj. net profit margin (%)	11.8	11.5	10.3	10.4
Working capital days				
Inventory (days)	9	8	9	9
Receivable (days)	18	17	18	18
Payable (days)	38	37	38	38
Ratios				
Debt/equity ratio (x)	0.0	0.0	0.0	0.0
ROE (%)	35.7	33.8	29.4	29.4
ROCE (%)	47.6	46.0	41.6	41.8
Valuations				
EV/ Sales	2.1	1.8	1.7	1.5
EV/EBITDA	13.0	11.2	10.9	9.6
Price to earnings (P/E)	19.2	17.6	17.7	15.9
Price to book value (P/B)	6.4	5.5	4.9	4.5

Source: Company, Kotak Securities – Private Client Research

RATING SCALE

Definitions of ratings

BUY	- We expect the stock to deliver more than 12% returns over the next 12 months
ACCUMULATE	- We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	- We expect the stock to deliver 0% - 5% returns over the next 12 months
SELL	- We expect the stock to deliver negative returns over the next 12 months
NR	- Not Rated. Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
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NA	- Not Available or Not Applicable. The information is not available for display or is not applicable
NM	- Not Meaningful. The information is not meaningful and is therefore excluded.
NOTE	- Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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