

Hero MotoCorp

Performance Highlights

Y/E March (` cr)	1QFY18	1QFY17	% chg (yoy)	4QFY17	% chg (qoq)
Net Sales	7,972	7,399	7.7	6,915	15.3
EBITDA	1,296	1,230	5.4	958	35.3
EBITDA margin (%)	16.3	16.6	-37 bps	13.8	241 bps
Adj PAT	914	883	3.5	718	27.3

Source: Company, Angel Research

Result meeting consensus estimates: Hero Motocorp's (HMCL) Q1FY18 number to a great extent, meet the consensus estimates. Net sales were at `7,972cr, up 7.7% yoy. EBITDA was at `1,296cr up 5.4% yoy and PAT was at `914cr, up 3.5% yoy. Consensus estimates of revenue, EBITDA and PAT were `8,053cr, `1,280cr and `912cr. HMCL's performance looks better than quarterly performance of Bajaj Auto's with margins maintained and growth in revenue and PAT.

Margins decline: Though Gross margins were maintained above 32%, on yoy basis there was a decline of 56bps. Sequentially gross margins increased by 82bps. The price hike taken by the company in May-2017, helped it to maintain the gross margins above 32%. EBITDA margins were at 16.3% in 1QFY18 vs. 16.6% in 1QFY17 and 13.8% in 4QFY17. The margin declined due to 11% yoy increase in the staff costs.

Realization improves slightly, contribution declines: Net realizations improved 1.4% to `43,005 per vehicle form `42,391 in 1QFY17. Contribution per vehicle however has declined by 0.3% yoy to `13,905 in 1QFY18 vs. `13,942 in 4QFY17 due to the higher RM and Employee costs.

Outlook and valuation: Company expects to aggressively gain market share to consolidate its position. We expect CAGR of ~14%/11% in the sales/PAT over next two years. The company expects ~100bps decline in margins due to the expiry of excise benefits at Haridwar plant. **The stock, at CMP, trades at 18x of FY19E earnings. We value the stock at 20x of FY19E earnings due to slightly better growth outlook. We derive price target of `4,130 with accumulate rating.**

Key financials (Standalone)

Y/E March (` cr)	FY2016	FY2017	FY2018E	FY2019E
Net Sales	28,203	28,170	32,239	36,878
% chg	3.1	(0.1)	14.4	14.4
Net Profit	3,160	3,377	3,682	4,123
% chg	32.5	6.9	9.0	12.0
OPM (%)	15.7	16.3	16.0	15.6
EPS (Rs)	158.2	169.1	184.4	206.5
P/E (x)	23.5	22.0	20.2	18.0
P/BV (x)	8.4	7.4	6.3	5.5
RoE (%)	33.1	30.4	31.3	30.7
RoCE (%)	42.8	37.9	39.4	38.4
EV/Sales (x)	2.5	2.4	2.1	1.8
EV/EBITDA (x)	16.5	15.8	13.0	11.4

Source: Company, Angel Research; Note: CMP as of July 26, 2017

ACCUMULATE

CMP	`3,718
Target Price	`4,130

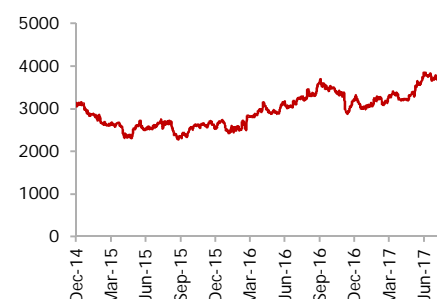
Investment Period	12 Months
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Stock Info	
Sector	Automobile
Market Cap (` cr)	74,242
Net Debt (` cr)	(136)
Beta	1.0
52 Week High / Low	3,880/2,844
Avg. Daily Volume	54,516
Face Value (`)	2
BSE Sensex	32,382
Nifty	10,021
Reuters Code	HROM.BO
Bloomberg Code	HMCL@IN

Shareholding Pattern (%)	
Promoters	34.6
MF / Banks / Indian Fls	11.5
FII / NRIs / OCBs	42.9
Indian Public / Others	10.9

Abs. (%)	3m	1yr	3yr
Sensex	7.0	15.2	24.0
Hero MotoCorp	12.0	15.5	46.3

3-year price chart



Source: Company, Angel Research

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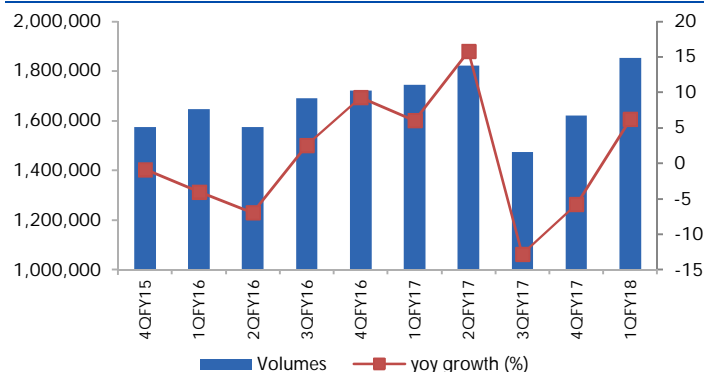
Exhibit 1: Quarterly financial performance (Standalone)

Y/E March (₹ cr)	1QFY18	1QFY17	% chg (yoy)	4QFY17	% chg (qoq)
Total units sold	1,853,647	1,745,389	6.2	1,621,805	14.3
Net sales	7,972	7,399	7.7	6,915	15.3
Consumption of RM	5,394	4,965	8.6	4,736	13.9
(% of Sales)	67.7	67.1		68.5	
Staff costs	374	336	11.1	328	13.9
(% of Sales)	4.7	4.5		4.7	
Other expenses	908	867	4.7	893	1.6
(% of Sales)	11.4	11.7		12.9	
Total Expenditure	6,676	6,169	8.2	5,958	12.1
Operating Profit	1,296	1,230	5.4	958	35.3
OPM	16.3	16.6		13.8	
Depreciation	133	115	15.4	135	(1.7)
Other income	132	120	9.4	118	11.4
Finance cost	2	2	5.3	1	6.8
PBT (excl. Extr. Items)	1,293	1,234	4.8	939	37.7
Extr. Income/(Expense)	0.00	0.00		0.00	
PBT (incl. Extr. Items)	1,293	1,234	4.8	939	37.7
(% of Sales)	16.2	16.7		13.6	
Tax	379	351	8.1	221	71.3
(% of PBT)	29.3	28.4		23.6	
Reported PAT	914	883	3.5	718	27.3
Adj PAT	914	883	3.5	718	27.3
Adj. PATM	11.5	11.9		10.4	
Equity capital (cr)	40	40		40	
Adjusted EPS (₹)	45.8	44.2	3.5	35.9	27.3

Source: Company, Angel Research

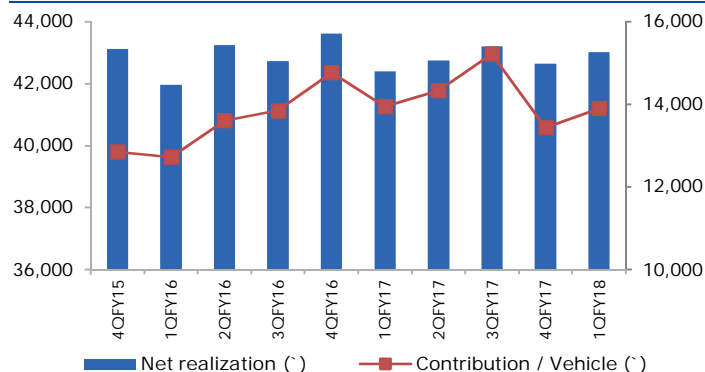
- Total volumes were at 18.54 lakh vehicles, up 6.20 % yoy. On sequential basis, volumes grew by 14.3%.
- Net realization stood at ₹43,005 per vehicle vs. ₹42,391 in 1QFY17 and ₹42,639 in 4QFY17.
- This is second consecutive quarter that company has seen yoy decline in the contribution per vehicle which stood at ₹13,905 per vehicle against ₹13,942 in 1QFY17.
- EBITDA came in at ₹1,296cr vs. 1,230cr in 1QFY17.
- EBITDA margins declined by 37bps on yoy basis and improved by ~241bps on qoq basis. Gross margins declined to 32.3% vs. 32.9% in 1QFY17. This is mainly due to the increase in the raw material prices.
- Net profit increased by 3.5% yoy from ₹883cr to ₹914cr.

Exhibit 2: Volume growth at 6% yoy and 14% qoq



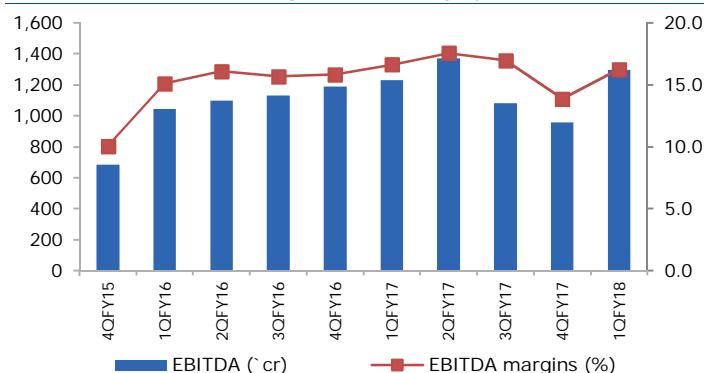
Source: Company, Angel Research

Exhibit 3: Realisations & contribution/vehicle trend



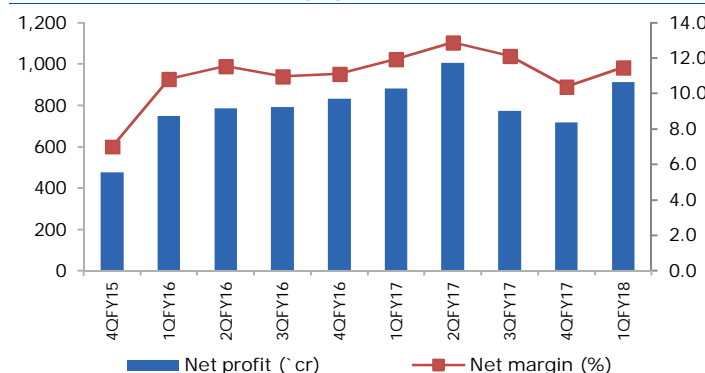
Source: Company, Angel Research

Exhibit 4: EBITDA margins decline yoy



Source: Company, Angel Research

Exhibit 5: PAT up 3.5% yoy



Source: Company, Angel Research

Conference call – Key highlights

- Company expects to outperform the industry growth in FY18. Management expects the industry to grow at higher single digit growth rate in this fiscal.
- Long term margin guidance is at 14-15%. Capex for FY18 and FY19E expected to be ₹2500cr. This will be spend on expansion of existing facility at Gujarat and new facility in Andhra Pradesh. The capex also includes provision for up-gradation of its existing plants.
- Company has indicated that the expiry Excise benefits at Haridwar plant in March-2018 can impact margins by ~100bps; this however would partially get offset by the tax incentives and higher volumes at newly commissioned Halol plant. More clarity on the Haridwar plant is awaited from the govt.
- While urban demand was strong, company expects rural demand to catch up with good monsoon.
- Spare part revenue grew by 5% yoy in the quarter and near term pick up is expected.

- Company took a price hike in May-17 of about 800-1000per unit to pass on the increase in the RM prices however with GST implementation, it also offered discounts on the mass selling models.

Investment arguments

- **Strong recovery in the domestic vehicle demand:** While the industry saw three back to back disruptions in FY17 and early FY18 due to demonetisation, BSIV and GST, the demand for 2W domestic automobile demand is expected to remain strong in FY18E with growth rate in the high single digits. The lower interest rates, government's focus on rural economy and normal monsoon this year is expected to improve the demand for 2Ws.
- **Hero Motocorp well positioned to gain from improving demand:** Hero Motocorp (HMCL) is a well established brand and commands more than 36.9% market share in the domestic 2W market. It has a wide range of brands from entry level to high end motorbikes. It also has strong presence in scooters segment and it is a well recognized in brand in rural area. This is expected to benefit HMCL gong ahead.
- **Several growth drives in place:** After company has commissioned the Vadodara and Bangladesh facilities, its total installed capacity has reached ~9.4 million units. It also has a global spare parts facility at Neemrana. As a result of its capacity expansion, we believe that HMCL remains well positioned to meet future demand and we believe that going ahead company also will derive good degree of operating leverage. While in the domestic market, company remains in top gear to improve its performance. HMCL is expecting to aggressively gain the market share and consolidate its position in the domestic market. Company has lined up about half a dozen new product launches in FY18 and expects them to do well. In the exports too, company is looking to ramp up its business and has entered two large two wheeler markets, Nigeria and Argentina. This takes its exposure to 35 countries.

Outlook and valuation

Company expects to aggressively gain market share to consolidate its position. We expect CAGR of ~14%/11% in the sales/PAT over next two years. The company expects ~100bps decline in margins due to the expiry of excise benefits at Haridwar plant. **The stock, at CMP, trades at 18x of FY19E earnings. We value the stock at 20x of FY19E earnings due to slightly better growth outlook. We derive price target of ₹4,130 with accumulate rating.**

Exhibit 6: Key assumptions – Volumes

Y/E March	FY2014	FY2015	FY2016E	FY2017E	FY2018E	FY2019E
Total two-wheelers	6,245,960	6,631,826	6,632,322	6,664,240	7,438,824	8,407,975

Source: Company, Angel Research

Company background

Hero MotoCorp (HMCL) is a leading 2W manufacturer globally and the market leader in the domestic motorcycle segment. HMCL has five manufacturing facilities located in India, and one each in Columbia and Bangladesh. Together it has a capacity of ~9.4mn units/year as of June-2017. Over 2010-17, HMCL recorded a volume CAGR of ~5%, backed by its strong brands (*Passion* and *Splendor*) and over 6,000 customer touch points including dealership network across rural as well urban areas.

Profit and loss statement (Standalone)

Y/E March (₹ cr)	FY2016	FY2017	FY2018E	FY2019E
Total operating income	28,203	28,170	32,239	36,878
% chg	3.1	(0.1)	14.4	14.4
Total Expenditure	23,988	23,840	27,068	31,119
Cost of Materials	19,310	19,012	21,574	24,796
Personnel	1,316	1,396	1,607	1,836
Others Expenses	3,362	3,432	3,887	4,487
EBITDA	4,216	4,329	5,171	5,759
% chg	25.8	4.0	11.6	11.4
(% of Net Sales)	14.9	15.4	16.0	15.6
Depreciation & Amortisation	438	493	540	602
EBIT	3,778	3,837	4,631	5,157
% chg	36.5	1.6	20.7	11.4
(% of Net Sales)	13.4	13.6	14.4	14.0
Interest & other Charges	5	6	6	6
Other Income	422	522	544	627
(% of PBT)	10.1	12.0	10.5	10.8
Recurring PBT	4,195	4,353	5,169	5,778
% chg	29.1	3.8	18.8	11.8
Prior Period & Extraordinary Expense/(Inc.)	-	-	-	-
PBT (reported)	4,195	4,353	5,169	5,778
Tax	1,275	1,281	1,488	1,655
(% of PBT)	30.4	29.4	28.8	28.6
PAT (reported)	2,921	3,072	3,682	4,123
Add: Share of earnings of associate	-	-	-	-
Less: Minority interest (MI)	-	-	-	-
PAT after MI (reported)	2,921	3,072	3,682	4,123
ADJ. PAT	2,921	3,072	3,682	4,123
% chg	32.5	6.9	9.0	12.0
(% of Net Sales)	10.4	10.9	11.4	11.2
Basic EPS (₹)	158.2	169.1	184.4	206.5
Fully Diluted EPS (₹)	158.2	169.1	184.4	206.5
% chg	32.5	6.9	9.0	12.0

Balance sheet statement (Standalone)

Y/E March (Cr)	FY2016	FY2017	FY2018E	FY2019E
SOURCES OF FUNDS				
Equity Share Capital	40	40	40	40
Reserves & Surplus	8,794	10,071	11,728	13,377
Shareholders' Funds	8,834	10,111	11,768	13,417
Minority Interest	-	-	-	-
Total Loans	-	-	-	-
Deferred Tax Liability	280	477	477	477
Other Liabilities	68	75	75	75
Total Liabilities	9,182	10,663	12,320	13,969
APPLICATION OF FUNDS				
Gross Block	9,126	10,377	11,677	12,877
Less: Acc. Depreciation	5,542	5,982	6,522	7,124
Net Block	3,584	4,396	5,155	5,754
Capital Work-in-Progress	605	465	365	265
Investments	4,581	5,890	5,890	5,890
Current Assets	3,802	3,944	5,654	7,567
Inventories	673	656	883	909
Sundry Debtors	1,283	1,562	1,502	1,718
Cash	131	137	1,238	2,617
Loans & Advances	595	557	806	922
Other Assets	1,120	1,031	1,225	1,401
Current Liabilities	3,448	4,093	4,806	5,569
Net Current Assets	354	(150)	848	1,998
Deferred Tax Asset	58	62	62	62
Mis. Exp. not written off	-	-	-	-
Total Assets	9,182	10,663	12,320	13,969

Cash flow statement (Standalone)

Y/E March (Cr)	FY2016	FY2017	FY2018E	FY2019E
Profit before tax	3,160	3,377	5,169	5,778
Depreciation	438	493	540	602
Change in Working Capital	377	421	104	228
Interest / Dividend (Net)	(170)	(193)	6	6
Direct taxes paid	(1,103)	(1,186)	(1,488)	(1,655)
Others	1,148	1,116	-	-
Cash Flow from Operations	3,849	4,028	4,332	4,959
(Inc.)/ Dec. in Fixed Assets	0	0	(1,200)	(1,100)
(Inc.)/ Dec. in Investments	(2,206)	(1,944)	-	-
Cash Flow from Investing	(2,206)	(1,944)	(1,200)	(1,100)
Issue of Equity	1	1	-	-
Inc./(Dec.) in loans	0	0	0	0
Dividend Paid (Incl. Tax)	(1,398)	(1,737)	(2,025)	(2,474)
Interest / Dividend (Net)	(274)	(343)	(6)	(6)
Cash Flow from Financing	(1,671)	(2,079)	(2,031)	(2,480)
Inc./(Dec.) in Cash	(28)	5	1,101	1,379
Opening Cash balances	159	131	137	1,238
Closing Cash balances	131	137	1,238	2,617

Key ratios

Y/E March	FY2016	FY2017	FY2018E	FY2019E
Valuation Ratio (x)				
P/E (on FDEPS)	23.5	22.0	20.2	18.0
P/CEPS	20.6	19.2	17.6	15.7
P/BV	8.4	7.4	6.3	5.5
Dividend yield (%)	1.9	2.3	2.7	3.3
EV/Sales	2.5	2.4	2.1	1.8
EV/EBITDA	16.5	15.8	13.0	11.4
EV / Total Assets	5.5	4.6	3.9	3.4
Per Share Data (₹)				
EPS (Basic)	158.2	169.1	184.4	206.5
EPS (fully diluted)	158.2	169.1	184.4	206.5
Cash EPS	180.2	193.8	211.4	236.6
DPS	72.0	85.0	101.4	123.9
Book Value	440.4	504.3	587.3	669.9
Returns (%)				
ROCE	42.8	37.9	39.4	38.4
Angel ROIC (Pre-tax)	107.4	106.0	108.3	111.0
ROE	33.1	30.4	31.3	30.7
Turnover ratios (x)				
Asset Turnover (Gross Block)	3.1	2.7	2.8	2.9
Inventory / Sales (days)	9	9	10	9
Receivables (days)	17	20	17	17
Payables (days)	36	45	40	41
WC cycle (ex-cash) (days)	(11)	(16)	(13)	(15)

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Disclosure of Interest Statement	Hero MotoCorp
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹ 1 lakh for Angel, its Group companies and Directors

Ratings (Based on expected returns over 12 months investment period):	Buy (> 15%)	Accumulate (5% to 15%) Reduce (-5% to -15%)	Neutral (-5 to 5%) Sell (< -15%)
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