

Hero MotoCorp

Performance Highlights

Y/E March (₹ cr)	2QFY17	2QFY16	% chg (yoy)	1QFY17	% chg (qoq)
Net Sales	7,796	6,809	14.5	7,399	5.4
EBITDA	1,369	1,096	24.9	1,230	11.3
EBITDA margin (%)	17.56	16.09	146bp	16.63	93bp
Adj PAT	1,004	786	27.7	883	13.7

Source: Company, Angel Research

Hero Motocorp (HMCL) reported strong 2QFY2017 numbers with 14.7% yoy growth in its gross revenues to ₹8,322cr and 27.7% yoy growth in its net profit to ₹1,004cr in Q2FY17. Net sales increased by 14.5% yoy to ₹7,796cr in this quarter. With the strong recovery in consumer sentiment and revival in the auto industry, HMCL reported 15.8% growth in its total 2W units sold in this quarter.

EBITDA came in at ₹1,369cr vs. ₹1,096cr a year ago. EBITDA margins improved to 17.6% vs. 16.1% in Q2FY16 and 16.7% in Q1FY17. Overall improvement in its margins came due to the 1) lower input costs (4.1% yoy decline in RM cost per unit) 2) 1% QoQ increase in net realizations per unit (₹42,059 per unit in Q2FY17 vs. 41,765 per unit in Q2FY17)

Outlook and valuation: We believe that HMCL volumes are expected to see further growth this year owing to the improved consumer sentiment. HMCL is expected to emerge as a strong beneficiary of the recovery in the rural economy as it has a strong presence in the rural region. Company holds more than 50% market share in the overall 2W industry which will also benefit the company further. Company indicated some cost pressure going ahead as commodity prices have started to move up. However, overall profitability is expected to increase over higher sales volumes. We have estimated double digit volume growth (~10%) in remainder of FY2017E and in FY2018E. We also forecast slightly higher RM costs in our model to accommodate higher input costs. The stock is currently valued at 15.9x of FY2018E EPS. We value stock at 17.0x of its FY2018E EPS considering current momentum of growth and earnings. **We rate HMCL as "Accumulate" with a price target of ₹3,541 implying 7% upside.**

Key financials (Standalone)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net Sales	27,351	28,001	31,021	34,133
% chg	8.9	2.4	10.8	10.0
Net Profit	2,386	3,162	3,824	4,010
% chg	13.1	32.5	20.9	4.9
OPM (%)	12.4	15.9	17.1	16.8
EPS (₹)	119.5	158.3	191.5	200.8
P/E (x)	27.7	20.9	17.1	15.9
P/BV (x)	10.1	8.3	6.6	5.4
RoE (%)	32.9	34.2	33.5	30.0
RoCE (%)	39.9	45.0	43.5	39.8
EV/Sales (x)	2.4	2.4	2.1	1.9
EV/EBITDA (x)	20.9	16.4	13.5	12.2

Source: Company, Angel Research; Note: CMP as of Oct 27, 2015

ACCUMULATE

CMP	₹3,314
Target Price	₹3,541

Investment Period	12 Months
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Stock Info

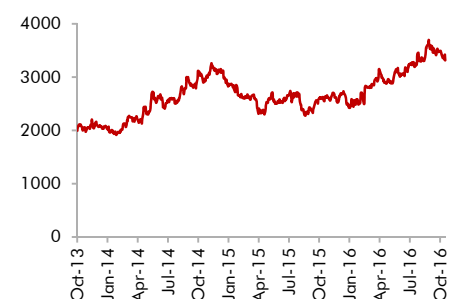
Sector	Automobile
Market Cap (₹ cr)	66,193
Net Debt (₹ cr)	(103)
Beta	0.9
52 Week High / Low	3,739/2,375
Avg. Daily Volume	17,212
Face Value (₹)	2
BSE Sensex	27,916
Nifty	8,615
Reuters Code	HROM.BO
Bloomberg Code	HMCL@IN

Shareholding Pattern (%)

Promoters	34.6
MF / Banks / Indian Fls	12.6
FII / NRIs / OCBs	43.8
Indian Public / Others	9.0

Abs. (%)	3m	1yr	3yr
Sensex	(0.5)	1.7	13.9
Hero MotoCorp	6.8	30.6	71.3

3-year price chart



Source: Company, Angel Research

Amarjeet S Maurya

022-3935 7800 Ext: 6846

Shrikant.akolkar@angelbroking.com

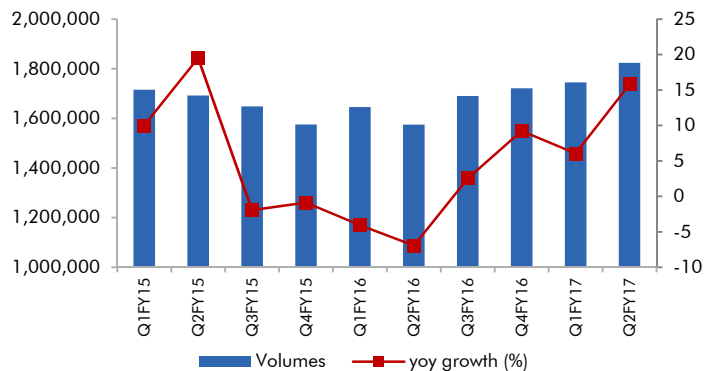
Exhibit 1: Quarterly financial performance (Standalone)

Y/E March (₹ cr)	Q2FY17	Q2FY16	% chg (yoy)	Q1FY17	% chg (qoq)	1HFY17	1HFY16	% chg (yoy)
Total units sold	1,823,498	1,574,861	15.8	1,745,389	4.5	3,568,887	3,220,728	10.8
Net sales	7,796	6,809	14.5	7,399	5.4	15,195	13,714	10.8
Consumption of RM	5,183	4,666	11.1	4,965	4.4	10,149	9,477	7.1
(% of Sales)	66.5	68.5		67.1		66.8	69.1	
Staff costs	357	308	15.9	336	6.3	694	621	11.6
(% of Sales)	4.6	4.5		4.5		4.6	4.5	
Other expenses	887	739	20.0	867	2.2	1,754	1,478	18.6
(% of Sales)	11.4	10.9		11.7		11.5	10.8	
Total Expenditure	6,427	5,714	12.5	6,169	4.2	12,596	11,576	8.8
Operating Profit	1,369	1,096	24.9	1,230	11.3	2,599	2,138	21.6
OPM	17.6	16.1	146.8	16.6	93.3	17.1	15.6	
Depreciation	119	109	9.4	115	3.5	234	212	10.6
Other income	152	112	36.6	120	26.6	273	216	26.3
Finance cost	2	1	26.0	2	3.3	3	2	25.0
PBT (excl. Extr. Items)	1,400	1,097	27.7	1,234	13.5	2,634	2,139	23.1
Extr. Income/(Expense)	-	-	-	-	-	-	-	-
PBT (incl. Extr. Items)	1,400	1,097	27.7	1,234	13.5	2,634	2,139	23.1
(% of Sales)	18.0	16.1		16.7		17.3	15.6	
Tax	396	311	27.5	351	13.0	747	605	23.4
(% of PBT)	28.3	28.3		28.4		28.4	28.3	
Reported PAT	1,004	786	27.7	883	13.7	1,887	1,534	23.1
Adj PAT	1,004	786	27.7	883	13.7	1,887	1,534	23.1
Adj. PATM	12.9	11.5		11.9		12.4	11.2	
Equity capital (cr)	40	40		40		40	40	
Adjusted EPS (₹)	50.3	39.4	27.7	44.2	13.7	94.5	76.8	23.1

Source: Company, Angel Research

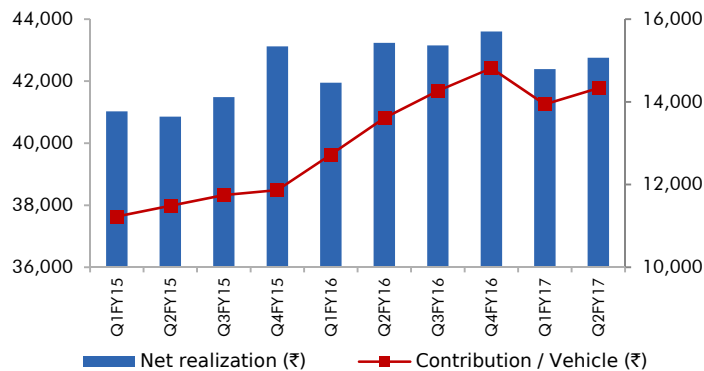
- The 15.8% growth in its quarterly volumes is the highest growth seen in the last 8 quarters.
- Contribution per vehicle after decline in Q1FY17 has shown improvement in this quarter indicating lower discounts in Q2FY17 vs. Q1FY17.
- HMCL continues to maintain leading position in the domestic 2W market and expects better performance of its 150cc segment going ahead due to more launches in this category. In the 100cc market, company has achieved 68% market share.
- Gross margins improved to 33.5% in Q2FY17 vs. 32.9% in Q1FY17. This is mainly due to the subdued commodity prices seen during this quarter.
- This is first time in last 25 quarters HMCL has reported EBITDA margins in excess of 17% and these are the highest margins in the last 27 quarters.
- At ₹1,004cr, its highest ever net profit.
- The company has grown faster than the industry in its scooters segment.
- During the quarter its other income rose by 36.7% to ₹152cr. Company has said that most of its investments are in debt instruments which did well during the quarter.

Exhibit 2: Volume growth at 8 quarter high



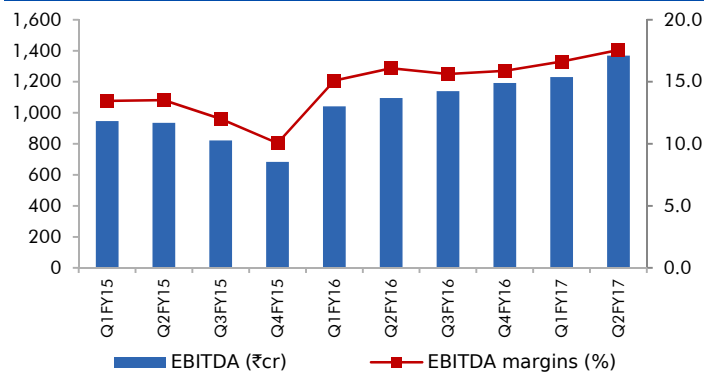
Source: Company, Angel Research

Exhibit 3: Realisations & contribution/vehicle improve



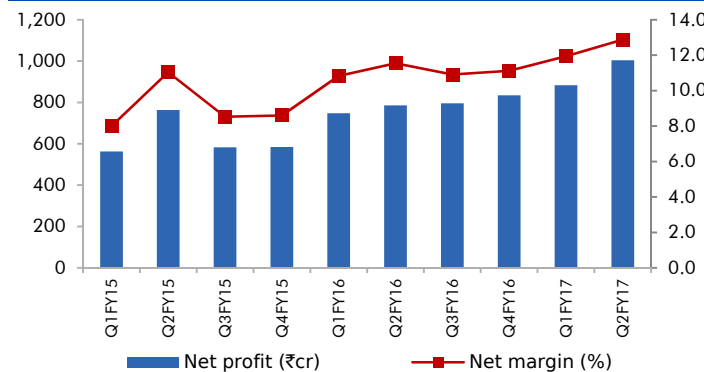
Source: Company, Angel Research

Exhibit 4: Consistent rise in EBITDA margins beat



Source: Company, Angel Research

Exhibit 5: PAT at record high



Source: Company, Angel Research

Conference call – Key highlights

- During the quarter, HMCL has benefitted due to the lower commodity prices and has indicated that steel, rubber and plastic prices have started to move up indicating that raw material costs in Q3 will be higher.
- The company said that urban demand remained strong in Q2FY17 while rural demand has just started to pick-up. It expects strong demand once farmers start to get harvests money.
- HMCL also said that a strong traction is seen in scooters segment and H2FY17 will see higher sales from scooters segment.
- Haridwar plant has a maximum production capacity of ~9,000-9,500 units per day but at the moment it is producing ~6,000 units a day, indicating utilization of ~67%. The new capacity will be commissioned in 3QFY17.
- HMCL will launch emission compliant models from Q4FY17 onwards which will increase costs by ~₹250-300 and it will pass on the additional costs to customers.
- HMCL also holds highest market share than its peers in the 100cc category and Glamour remains the best selling product in the entry level motorcycle segment.

- Company was under represented in 150cc category but with launch of new products in this category sales traction is expected to improve in this category.
- It acquired 25-30% shareholding of Bangalore based technology start-up Ather Energy Private Limited for ₹205cr. The company is in the business of designing and manufacturing of smart electric vehicles and is already working on two models. This investment is expected to boost HMCL's electric vehicle aspirations.

Investment arguments

- **Strong recovery in the domestic vehicle demand:** The automobile demand in India is seeing a strong traction due improvement in the consumer sentiment as well as recovery in the rural economy. The lowering the interest rate is expected to further increase the demand. Overall the demand scenario is expected to remain strong over next few quarters which will result in growth in volumes for the Automobile companies.
- **Hero Motocorp well positioned to gain from improving demand:** Hero Motocorp (HMCL) is a well established brand and commands more than 50% market share in the domestic 2W industry. 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.
- **Capacity expansion to meet higher demand:** HMCL has total installed capacity of ~8.2 million units. This capacity would further increase by ~0.750mn units after commissioning of new capacity at Neemrana plant which is currently under trial product run. Company is also developing a new capacity at Halol in Gujarat (~1.8mn units), which is expected to be operational in FY2017. As a result of its capacity expansion, HMCL remains well positioned to meet future demand. Its Haridwar plant contributes ~35% of the total volumes and is currently running at the capacity utilization of ~67% which gives enough room for volume growth in short term.

Outlook and valuation

We believe that HMCL volumes are expected to see further growth this year owing to the improved consumer sentiment. HMCL is expected to emerge as a strong beneficiary of the recovery in the rural economy as it has a strong presence in the rural region. Company holds more than 50% market share in the overall 2W industry which will also benefit the company further. Company indicated some cost pressure going ahead as commodity prices have started to move up. However, overall profitability is expected to increase over higher sales volumes. We have estimated double digit volume growth (~10%) in remainder of FY2017E and in FY2018E. We also forecast slightly higher RM costs in our model to accommodate higher input costs. The stock is currently valued at 15.9x of FY2018E EPS. We value stock at 17.0x of its FY2018E EPS considering current momentum of growth and earnings. **We rate HMCL as "Accumulate" with a price target of ₹3,541 implying 7% upside.**

Exhibit 6: Key assumptions – Volumes

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E	FY2018E
Total two-wheelers	6,075,583	6,245,960	6,631,826	6,632,322	7,372,660	8,071,888

Source: Company, Angel Research

Company background

Hero MotoCorp (HMCL) is a leading 2W manufacturer globally and the market leader in the domestic motorcycle segment with more than 50% market share. HMCL has four manufacturing facilities in India, located at Gurgaon, Dharuhera, Haridwar and Neemrana. It has also a production facility in Colombia. Together it has a capacity of ~8.2mn units/year as of September 2016. Over 2010-16, HMCL recorded a strong volume CAGR of ~12%, backed by its strong brands (*Passion* and *Splendor*) and a well-entrenched dealership network (~19,000), which has a good presence across rural areas as well.

Profit and loss statement (Standalone)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Total operating income	25,125	27,351	28,001	30,958	34,139
% chg	6.5	8.9	2.4	10.6	10.3
Total Expenditure	21,735	24,198	23,982	26,094	28,771
Cost of Materials	18,230	19,754	19,315	21,047	23,209
Personnel	930	1,173	1,314	1,441	1,611
Others Expenses	2,576	3,271	3,354	3,606	3,950
EBITDA	3,389	3,152	4,018	4,863	5,368
% chg	7.8	(4.3)	31.7	20.0	9.9
(% of Net Sales)	13.5	11.5	14.4	15.7	15.7
Depreciation & Amortisation	1,107	540	441	481	529
EBIT	2,282	2,612	3,577	4,382	4,838
% chg	16.6	14.5	36.9	22.5	10.4
(% of Net Sales)	9.1	9.6	12.8	14.2	14.2
Interest & other Charges	12	11	5	6	6
Other Income	446	493	423	557	515
(% of PBT)	16.4	15.9	10.6	11.3	9.6
Recurring PBT	2,717	3,094	3,995	4,933	5,347
% chg	15.9	13.9	29.1	23.5	8.4
Prior Period & Extraord. Exp./(Inc.)	-	-	-	-	-
PBT (reported)	2,717	3,094	3,995	4,933	5,347
Tax	758	943	1,275	1,555	1,699
(% of PBT)	27.9	30.5	31.9	31.5	31.8
PAT (reported)	1,958	2,151	2,720	3,378	3,648
Add: Share of earnings of asso.	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	-	-
PAT after MI (reported)	1,958	2,151	2,720	3,378	3,648
ADJ. PAT	1,958	2,151	2,720	3,378	3,648
% chg	(0.4)	13.1	32.5	22.3	7.6
(% of Net Sales)	7.8	7.9	9.7	10.9	10.7
Basic EPS (₹)	105.6	119.5	158.3	193.6	208.3
Fully Diluted EPS (₹)	105.6	119.5	158.3	193.6	208.3
% chg	(0.4)	13.1	32.5	22.3	7.6

Balance sheet statement (Standalone)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
SOURCES OF FUNDS					
Equity Share Capital	40	40	40	40	40
Reserves & Surplus	5,560	6,501	7,905	10,031	12,111
Shareholders Funds	5,600	6,541	7,945	10,071	12,151
Minority Interest	-	-	-	-	-
Total Loans	284	-	-	-	-
Deferred Tax Liability	5	6	239	239	239
Other Liabilities	74	97	119	119	119
Total Liabilities	5,963	6,645	8,303	10,430	12,510
APPLICATION OF FUNDS					
Gross Block	6,909	8,114	9,397	10,697	11,597
Less: Acc. Depreciation	4,666	5,201	5,560	6,041	6,571
Net Block	2,243	2,913	3,837	4,656	5,026
Capital Work-in-Progress	854	713	605	680	780
Investments	4,089	3,154	4,266	4,266	4,266
Current Assets	2,805	3,669	3,632	4,736	5,961
Inventories	670	815	673	1,018	1,309
Sundry Debtors	921	1,390	1,283	1,527	1,871
Cash	118	159	131	365	630
Loans & Advances	572	627	601	712	853
Other Assets	525	677	944	1,114	1,297
Current liabilities	4,139	3,883	4,049	3,920	3,535
Net Current Assets	(1,334)	(215)	(417)	816	2,425
Deferred Tax Asset	111	80	11	11	11
Mis. Exp. not written off	-	-	-	-	-
Total Assets	5,963	6,645	8,303	10,430	12,510

Cash flow statement (Standalone)

Y/E March (₹ cr)	FY2014E	FY2015E	FY2016	FY2017E	FY2018E
Profit before tax	2,867	3,329	4,395	5,421	5,859
Depreciation	1,107	540	441	481	529
Change in Working Capital	55	(337)	446	(999)	(1,345)
Interest / Dividend (Net)	(134)	(142)	(173)	6	6
Direct taxes paid	(649)	(1,000)	(1,103)	(1,555)	(1,699)
Others	(282)	(141)	(92)	-	-
Cash Flow from Operations	2,963	2,250	3,914	3,354	3,351
(Inc.)/ Dec. in Fixed Assets	(937)	0	0	(1,375)	(1,000)
(Inc.)/ Dec. in Investments	(680)	12	(2,271)	-	-
Cash Flow from Investing	(1,617)	12	(2,271)	(1,375)	(1,000)
Issue of Equity	-	-	1	-	-
Inc./ (Dec.) in loans	0	0	0	0	0
Dividend Paid (Incl. Tax)	(1,199)	(1,897)	(1,398)	(1,740)	(2,080)
Interest / Dividend (Net)	(216)	(333)	(287)	(6)	(6)
Cash Flow from Financing	(1,415)	(2,231)	(1,684)	(1,746)	(2,086)
Inc./ (Dec.) in Cash	(69)	32	(42)	234	265
Opening Cash balances	135	66	98	131	365
Closing Cash balances	66	98	56	365	630

Key ratios

Y/E March	FY2014E	FY2015E	FY2016	FY2017E	FY2018E
Valuation Ratio (x)					
P/E (on FDEPS)	31.4	27.7	20.9	17.1	15.9
P/CEPS	20.6	22.6	18.4	15.2	14.1
P/BV	11.8	10.1	8.3	6.6	5.4
Dividend yield (%)	2.0	1.8	2.2	2.6	3.1
EV/Sales	2.6	2.4	2.4	2.1	1.9
EV/EBITDA	19.6	20.9	16.4	13.5	12.2
EV / Total Assets	6.6	6.3	5.3	4.6	4.1
Per Share Data (₹)					
EPS (Basic)	105.6	119.5	158.3	193.6	208.3
EPS (fully diluted)	105.6	119.5	158.3	193.6	208.3
Cash EPS	161.1	146.5	180.4	217.7	234.8
DPS	65.1	60.0	72.0	87.1	104.2
Book Value	280.4	327.6	397.8	504.3	608.5
Returns (%)					
ROCE	38.8	39.9	45.0	43.5	39.8
Angel ROIC (Pre-tax)	136.0	80.9	100.8	80.6	66.7
ROE	35.0	32.9	34.2	33.5	30.0
Turnover ratios (x)					
Asset Turnover (Gross Block)	3.6	3.4	3.0	2.9	2.9
Inventory / Sales (days)	10	11	9	12	14
Receivables (days)	13	19	18	20	-
Payables (days)	33	38	38	32	26
WC cycle (ex-cash) (days)	(10)	(8)	(11)	-	(12)

Research Team Tel: 022 - 39357800

E-mail: research@angelbroking.com

Website: www.angelbroking.com

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Hero MotoCorp

1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

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)