

# Hero MotoCorp

## Performance Highlights

Y/E March (₹ cr)	2QFY17	2QFY16	% chg (yoy)	1QFY17	% chg (qoq)
<b>Net Sales</b>	<b>6,365</b>	<b>7,295</b>	<b>(12.8)</b>	<b>7,796</b>	<b>(18.4)</b>
EBITDA	1,080	1,140	(5.3)	1,369	(21.1)
EBITDA margin (%)	17.0	15.6	(134 bps)	17.6	(59 bps)
<b>Adj PAT</b>	<b>772</b>	<b>796</b>	<b>(3.0)</b>	<b>1,004</b>	<b>(23.1)</b>

Source: Company, Angel Research

**Result indicates demonetisation pain:** Total volumes were at 14.73 lakh vehicles showing a yoy decline of 13%. On sequential basis, volumes declined by 19%. Net realization stood at ₹42,387 per vehicle vs. ₹42,059 in 2QFY17 and ₹42,442 in 3QFY16. The company has maintained the upward trajectory in contribution per vehicle which stood at ₹14,373 per vehicle against ₹13,552 in 3QFY16. EBITDA came in at ₹1080cr vs. 1,140cr in 3QFY16. EBITDA margins improved by ~140bps on yoy basis and declined by ~60bps on qoq basis. Gross margins improved to 35.1% in 3QFY17 vs. 33.5% in 3QFY16. This is mainly due to the 6 month lag in the raw material prices. Net profit declined by 3% yoy from ₹796cr in 3QFY16 to ₹772cr in 3QFY17.

**Outlook and valuation:** The demonetisation has impacted HMCL's volumes sharply with decline in all parameters. Company expects the volumes growth to remain challenging in 4QFY17E and expects high single digit volume growth in FY18E. As automobile industry recovers, HMCL looks to be better positioned due to its higher market share in the motorcycle segment. The company also has rural exposure and as budget sets tone for higher rural spending, HMCL is likely to benefit. Company has lost ~50bps market share in the scooter segment. We forecast 6.8% and 9.5% volume growth in FY18E and FY19E. We also forecast top line and bottom line CAGR of 8.5% and 8.9% over FY17E-FY19E. Company has indicated of ~50-60bps margin expansion in FY18E which is likely to take the operating margins at 17% post which we don't see any lever for expansion. **The stock, at CMP, trades at 17.3x and 15.8x of FY18E and FY19E EPS respectively. We value the stock at 17x of FY19E earnings to arrive at a price target of ₹3,466.**

### Key financials (Standalone)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E	FY2019E
<b>Net Sales</b>	<b>27,351</b>	<b>28,160</b>	<b>28,083</b>	<b>30,096</b>	<b>33,071</b>
% chg	8.9	3.0	(0.3)	7.2	9.9
<b>Net Profit</b>	<b>2,541</b>	<b>3,132</b>	<b>3,432</b>	<b>3,734</b>	<b>4,072</b>
% chg	13.1	31.3	9.6	8.8	9.0
OPM (%)	12.8	15.5	16.7	17.0	17.0
<b>EPS (₹)</b>	<b>119.5</b>	<b>156.9</b>	<b>171.8</b>	<b>187.0</b>	<b>203.9</b>
P/E (x)	27.0	20.6	18.8	17.3	15.8
P/BV (x)	9.8	8.1	6.6	5.5	4.7
RoE (%)	35.3	33.9	30.1	27.9	25.8
RoCE (%)	42.3	44.9	38.8	35.8	33.3
EV/Sales (x)	2.2	2.1	2.1	1.9	1.7
EV/EBITDA (x)	18.5	15.0	13.8	12.2	10.9

Source: Company, Angel Research; Note: CMP as of February 13, 2017

## ACCUMULATE

CMP	₹3,226
Target Price	₹3,466

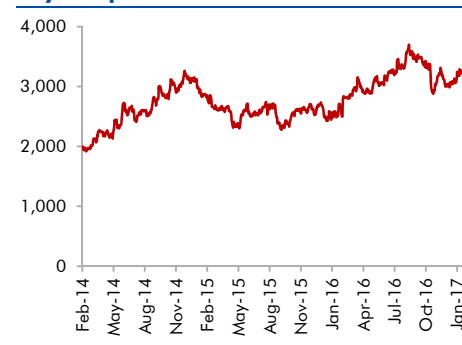
Investment Period	12 Months
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Stock Info	
Sector	Automobile
Market Cap (₹ cr)	64,428
Net Debt (₹ cr)	-103
Beta	0.9
52 Week High / Low	3,739/2,440
Avg. Daily Volume	28,199
Face Value (₹)	2
BSE Sensex	28,352
Nifty	8,805
Reuters Code	HROM.BO
Bloomberg Code	HMCL@IN

Shareholding Pattern (%)	
Promoters	34.6
MF / Banks / Indian FIs	13.4
FII / NRIs / OCBs	42.9
Indian Public / Others	9.1

Abs. (%)	3m	1yr	3yr
Sensex	2.9	19.3	39.3
Hero MotoCorp	3.9	28.2	63.5

### 3-year price chart



Source: Company, Angel Research

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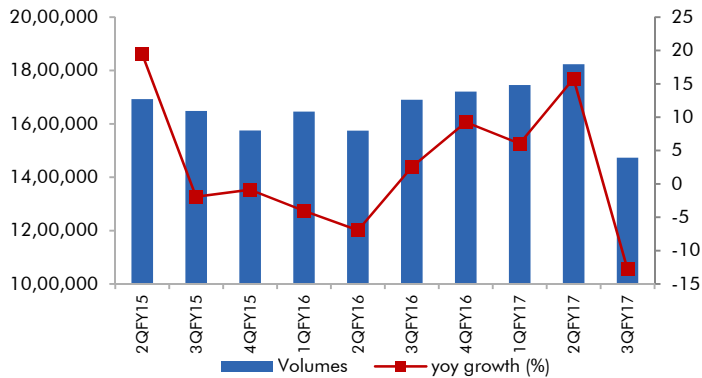
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**Exhibit 1: Quarterly financial performance (Standalone)**

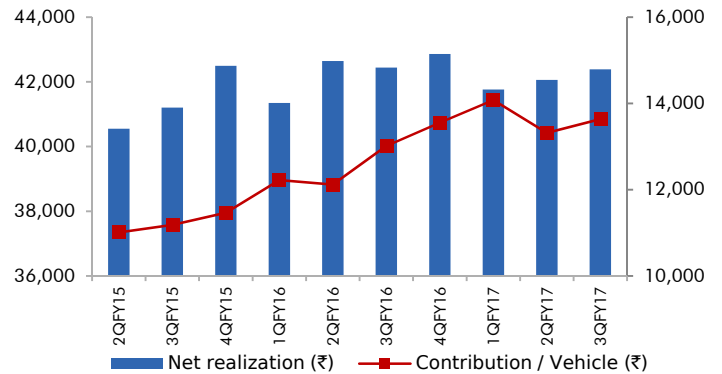
Y/E March (₹ cr)	3QFY17	3QFY16	% chg (yoy)	2QFY17	% chg (qoq)	9MFY17	9MFY16	% chg (yoy)
<b>Total units sold</b>	<b>1,473,548</b>	<b>1,690,354</b>	<b>(12.8)</b>	<b>1,823,498</b>	<b>(19.2)</b>	<b>5,042,435</b>	<b>4,911,082</b>	<b>2.7</b>
<b>Net sales</b>	<b>6,365</b>	<b>7,295</b>	<b>(12.8)</b>	<b>7,796</b>	<b>(18.4)</b>	<b>21,560</b>	<b>21,009</b>	<b>2.6</b>
Consumption of RM	4,128	4,883	(15.5)	5,183	(20.4)	14,277	14,360	(0.6)
(% of Sales)	64.9	66.9		66.5		66.2	68.4	
Staff costs	374	345	8.6	357	4.7	1,068	966	10.6
(% of Sales)	5.9	4.7		4.6		5.0	4.6	
Other expenses	783	927	(15.6)	887	(11.7)	2,537	2,405	5.5
(% of Sales)	12.3	12.7		11.4		11.8	11.4	
<b>Total Expenditure</b>	<b>5,285</b>	<b>6,155</b>	<b>(14.1)</b>	<b>6,427</b>	<b>(17.8)</b>	<b>17,881</b>	<b>17,731</b>	<b>0.8</b>
<b>Operating Profit</b>	<b>1,080</b>	<b>1,140</b>	<b>(5.3)</b>	<b>1,369</b>	<b>(21.1)</b>	<b>3,679</b>	<b>3,278</b>	<b>12.2</b>
OPM	17.0	15.6		17.6		17.1	15.6	
Depreciation	125	114	9.6	119	4.7	359	326	10.2
Other income	132	84	56.7	152	(13.4)	405	300	34.9
Finance cost	2	1	176.4	2	(1.9)	5	3	52.8
<b>PBT (excl. Extr. Items)</b>	<b>1,085</b>	<b>1,110</b>	<b>(2.2)</b>	<b>1,400</b>	<b>(22.5)</b>	<b>3,719</b>	<b>3,249</b>	<b>14.5</b>
<b>Extr. Income/(Expense)</b>	<b>0.00</b>	<b>0.00</b>		<b>0.00</b>		<b>0.00</b>	<b>0.00</b>	
<b>PBT (incl. Extr. Items)</b>	<b>1,085</b>	<b>1,110</b>	<b>(2.2)</b>	<b>1,400</b>	<b>(22.5)</b>	<b>3,719</b>	<b>3,249</b>	<b>14.5</b>
(% of Sales)	17.1	15.2		18.0		17.3	15.5	
Tax	313	314	(0.2)	396	(20.9)	1,060	919	15.3
(% of PBT)	28.9	28.3		28.3		28.5	28.3	
<b>Reported PAT</b>	<b>772</b>	<b>796</b>	<b>(3.0)</b>	<b>1,004</b>	<b>(23.1)</b>	<b>2,659</b>	<b>2,329</b>	<b>14.2</b>
<b>Adj PAT</b>	<b>772</b>	<b>796</b>	<b>(3.0)</b>	<b>1,004</b>	<b>(23.1)</b>	<b>2,659</b>	<b>2,329</b>	<b>14.2</b>
Adj. PATM	12.1	10.9		12.9		12.3	11.1	
<b>Equity capital (cr)</b>	<b>40</b>	<b>40</b>		<b>40</b>		<b>40</b>	<b>40</b>	
<b>Adjusted EPS (₹)</b>	<b>38.7</b>	<b>39.9</b>	<b>(3.0)</b>	<b>50.3</b>	<b>(23.1)</b>	<b>133.2</b>	<b>116.6</b>	<b>14.2</b>

Source: Company, Angel Research

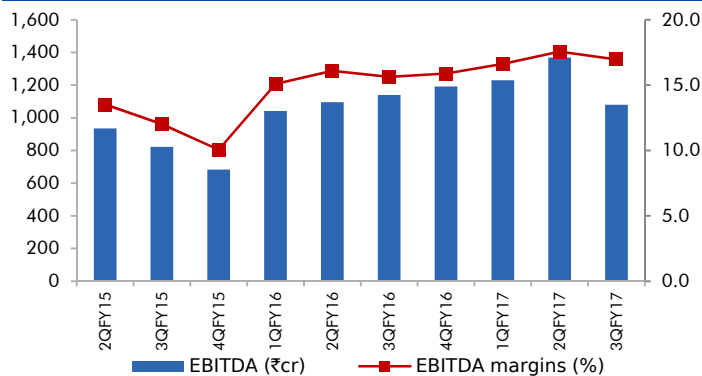
- Total volumes were at 14.73 lakh vehicles showing a yoy decline of 13%. On sequential basis, volumes declined by 19%.
- Net realization stood at ₹42,387 per vehicle vs. ₹42,059 in 2QFY17 and ₹42,442 in 3QFY16.
- The company has maintained the upward trajectory in contribution per vehicle which stood at ₹14,373 per vehicle against ₹13,552 in 3QFY16.
- EBITDA came in at ₹1080cr vs. 1,140cr in 3QFY16.
- EBITDA margins improved by ~140bps on yoy basis and declined by ~60bps on qoq basis. Gross margins improved to 35.1% in 3QFY17 vs. 33.5% in 3QFY16. This is mainly due to the 6 month lag in the raw material prices.
- Net profit declined by 3% yoy from ₹796cr in 3QFY16 to ₹772cr in 3QFY17.

**Exhibit 2: Volume growth at 8 quarter high**


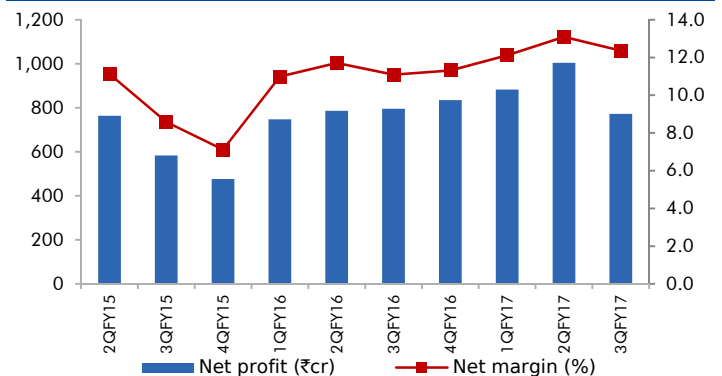
Source: Company, Angel Research

**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

- The company expects soft demand trajectory to continue until the first quarter of next fiscal.
- Feb and March 2017 volumes are expected to be flat however company expects higher single digit growth in FY18
- Company reported higher gross margins (35.1% in Q3FY17 vs. 33.06% in Q3FY16 and 33.5% in Q2FY17). This was due to the increase of material cost lag period from ~3 months to ~6 months.
- The ongoing LEAP program is expected to improve its margins by 80-90bps in FY17E and further 50-60bps in FY18E.
- The Excise benefit at its Haridwar plant will end in FY18E.
- While company gained market share in the motorcycle segment, in scooter segment market remained flat. This will be addressed by new product launches in this category.
- Company has taken 0.5-1% hike in its models to absorb the raw material cost impact.

## Investment arguments

- **Domestic vehicle demand to recover faster than expected:** The automobile demand in India impacted post demonetisation. The demand however is slowly coming back to normalcy as liquidity in the country is improving. From March onwards, there will be no limit on cash withdrawals which will benefit Automobile industry. The lower interest rates, government's focus on rural economy and cut in the entry level tax rates is expected to benefit the automobile sector. Overall we expect the demand scenario to come back to normalcy in 1QFY18E.
- **Hero Motocorp well positioned to gain from demand recovery:** 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 brand in rural area. Push for rural economy and tax rate cuts should benefit HMCL going ahead.
- **Capacity expansion to meet higher demand:** HMCL has total installed capacity of ~8.2 million units. This capacity would further increase by ~0.75mn 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, thus taking the overall capacity to ~10.75 mn units. 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

The demonetisation has impacted HMCL's volumes sharply with decline in all parameters. Company expects the volumes growth to remain challenging in 4QFY17E and expects high single digit volume growth in FY18E. As automobile industry recovers, HMCL looks to be better positioned due to its higher market share in the motorcycle segment. The company also has rural exposure and as budget sets tone for higher rural spending, HMCL is likely to benefit. Company has lost ~50bps market share in the scooter segment. We forecast 6.8% and 9.5% volume growth in FY18E and FY19E. We also forecast top line and bottom line CAGR of 8.5% and 8.9% over FY17E-FY19E. Company has indicated of ~50-60bps margin expansion in FY18E which is likely to take the operating margins at 17% post which we don't see any lever for expansion. **The stock, at CMP, trades at 17.3x and 15.8x of FY18E and FY19E EPS respectively. We value the stock at 17x of FY19E earnings to arrive at a price target of ₹3,466. .**

**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	6,631,198	7,078,838	7,749,013

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)	FY2015	FY2016	FY2017E	FY2018E	FY2019E
<b>Total operating income</b>	<b>27,351</b>	<b>28,160</b>	<b>28,083</b>	<b>30,096</b>	<b>33,071</b>
% chg	8.9	3.0	(0.3)	7.2	9.9
<b>Total Expenditure</b>	<b>24,043</b>	<b>24,152</b>	<b>23,794</b>	<b>25,359</b>	<b>27,884</b>
Cost of Materials	19,754	19,315	18,896	20,244	22,255
Personnel	1,173	1,320	1,418	1,434	1,560
Others Expenses	3,116	3,518	3,481	3,681	4,069
<b>EBITDA</b>	<b>3,307</b>	<b>4,008</b>	<b>4,289</b>	<b>4,736</b>	<b>5,187</b>
% chg	0.1	25.5	7.0	9.4	9.7
(% of Net Sales)	12.1	14.2	15.3	15.7	15.7
Depreciation & Amortisation	540	441	477	551	607
<b>EBIT</b>	<b>2,768</b>	<b>3,567</b>	<b>3,811</b>	<b>4,185</b>	<b>4,580</b>
% chg	21.3	28.9	6.9	9.8	9.4
(% of Net Sales)	10.1	12.7	13.6	13.9	13.8
Interest & other Charges	11	2	6	6	6
Other Income	493	391	527	581	605
(% of PBT)	15.2	9.9	12.2	12.2	11.7
<b>Recurring PBT</b>	<b>3,249</b>	<b>3,956</b>	<b>4,332</b>	<b>4,760</b>	<b>5,178</b>
% chg	19.6	21.7	9.5	9.9	8.8
Prior Period & Extraord. Exp./(Inc.)	-	-	-	-	-
<b>PBT (reported)</b>	<b>3,249</b>	<b>3,956</b>	<b>4,332</b>	<b>4,760</b>	<b>5,178</b>
Tax	943	1,262	1,372	1,499	1,634
(% of PBT)	29.0	31.9	31.7	31.5	31.6
<b>PAT (reported)</b>	<b>2,306</b>	<b>2,694</b>	<b>2,960</b>	<b>3,261</b>	<b>3,544</b>
Add: Share of earnings of asso.	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	-	-
<b>PAT after MI (reported)</b>	<b>2,306</b>	<b>2,694</b>	<b>2,960</b>	<b>3,261</b>	<b>3,544</b>
<b>ADJ. PAT</b>	<b>2,306</b>	<b>2,694</b>	<b>2,960</b>	<b>3,261</b>	<b>3,544</b>
% chg	13.1	31.3	9.6	8.8	9.0
(% of Net Sales)	8.4	9.6	10.5	10.8	10.7
<b>Basic EPS (₹)</b>	<b>119.5</b>	<b>156.9</b>	<b>171.8</b>	<b>187.0</b>	<b>203.9</b>
<b>Fully Diluted EPS (₹)</b>	<b>119.5</b>	<b>156.9</b>	<b>171.8</b>	<b>187.0</b>	<b>203.9</b>
% chg	13.1	31.3	9.6	8.8	9.0

**Balance sheet statement (Standalone)**

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E	FY2019E
<b>SOURCES OF FUNDS</b>					
Equity Share Capital	40	40	40	40	40
Reserves & Surplus	6,501	7,905	9,792	11,659	13,695
<b>Shareholders' Funds</b>	<b>6,541</b>	<b>7,945</b>	<b>9,832</b>	<b>11,699</b>	<b>13,735</b>
Minority Interest	-	-	-	-	-
Total Loans	-	-	-	-	-
Deferred Tax Liability	6	239	239	239	239
Other Liabilities	97	119	119	119	119
<b>Total Liabilities</b>	<b>6,645</b>	<b>8,303</b>	<b>10,191</b>	<b>12,058</b>	<b>14,094</b>
<b>APPLICATION OF FUNDS</b>					
Gross Block	8,114	9,397	10,697	11,797	12,997
Less: Acc. Depreciation	5,201	5,560	6,037	6,589	7,196
<b>Net Block</b>	<b>2,913</b>	<b>3,837</b>	<b>4,660</b>	<b>5,208</b>	<b>5,801</b>
Capital Work-in-Progress	713	605	680	780	780
Investments	3,154	4,266	4,266	4,266	4,266
Current Assets	3,669	3,632	4,739	6,334	8,310
Inventories	815	673	923	825	815
Sundry Debtors	1,390	1,283	1,385	1,402	1,540
Cash	159	131	774	2,212	3,871
Loans & Advances	627	601	646	752	827
Other Assets	677	944	1,011	1,144	1,257
Current liabilities	3,883	4,049	4,166	4,543	5,076
<b>Net Current Assets</b>	<b>(215)</b>	<b>(417)</b>	<b>573</b>	<b>1,791</b>	<b>3,235</b>
<b>Deferred Tax Asset</b>	<b>80</b>	<b>11</b>	<b>11</b>	<b>11</b>	<b>11</b>
Mis. Exp. not written off	-	-	-	-	-
<b>Total Assets</b>	<b>6,645</b>	<b>8,303</b>	<b>10,191</b>	<b>12,058</b>	<b>14,094</b>

Note: Cash includes cash with scheduled banks on dividend current accounts

**Cash flow statement (Standalone)**

Y/E March (₹ cr)	FY2015E	FY2016	FY2017E	FY2018E	FY2019E
Profit before tax	3,329	4,395	4,804	5,233	5,706
Depreciation	540	441	477	551	607
Change in Working Capital	(337)	446	(347)	220	216
Interest / Dividend (Net)	(142)	(173)	6	6	6
Direct taxes paid	(1,000)	(1,103)	(1,372)	(1,499)	(1,634)
Others	(141)	(92)	-	-	-
<b>Cash Flow from Operations</b>	<b>2,250</b>	<b>3,914</b>	<b>3,568</b>	<b>4,511</b>	<b>4,901</b>
(Inc.)/ Dec. in Fixed Assets	0	0	(1,375)	(1,200)	(1,200)
(Inc.)/ Dec. in Investments	12	(2,271)	-	-	-
<b>Cash Flow from Investing</b>	<b>12</b>	<b>(2,271)</b>	<b>(1,375)</b>	<b>(1,200)</b>	<b>(1,200)</b>
Issue of Equity	-	1	-	-	-
Inc./(Dec.) in loans	0	0	0	0	0
Dividend Paid (Incl. Tax)	(1,897)	(1,398)	(1,544)	(1,867)	(2,036)
Interest / Dividend (Net)	(333)	(287)	(6)	(6)	(6)
<b>Cash Flow from Financing</b>	<b>(2,231)</b>	<b>(1,684)</b>	<b>(1,550)</b>	<b>(1,873)</b>	<b>(2,042)</b>
Inc./(Dec.) in Cash	32	(42)	642	1,438	1,659
<b>Opening Cash balances</b>	<b>66</b>	<b>98</b>	<b>131</b>	<b>774</b>	<b>2,212</b>
<b>Closing Cash balances</b>	<b>98</b>	<b>56</b>	<b>774</b>	<b>2,212</b>	<b>3,871</b>



**Key ratios**

Y/E March	FY2015E	FY2016	FY2017E	FY2018E	FY2019E
<b>Valuation Ratio (x)</b>					
P/E (on FDEPS)	27.0	20.6	18.8	17.3	15.8
P/CEPS	20.9	18.0	16.5	15.0	13.8
P/BV	9.8	8.1	6.6	5.5	4.7
Dividend yield (%)	1.9	2.2	2.4	2.9	3.2
EV/Sales	2.2	2.1	2.1	1.9	1.7
EV/EBITDA	18.5	15.0	13.8	12.2	10.9
EV / Total Assets	5.8	4.9	4.1	3.5	2.9
<b>Per Share Data (Rs)</b>					
EPS (Basic)	119.5	156.9	171.8	187.0	203.9
EPS (fully diluted)	119.5	156.9	171.8	187.0	203.9
Cash EPS	154.3	179.0	195.7	214.6	234.3
DPS	60.0	72.0	77.3	93.5	101.9
Book Value	327.6	397.8	492.3	585.8	687.8
<b>Returns (%)</b>					
ROCE	42.3	44.9	38.8	35.8	33.3
Angel ROIC (Pre-tax)	85.7	100.6	79.5	80.2	81.8
ROE	35.3	33.9	30.1	27.9	25.8
<b>Turnover ratios (x)</b>					
Asset Turnover (Gross Block)	3.4	3.0	2.6	2.6	2.5
Inventory / Sales (days)	11	9	12	10	9
Receivables (days)	19	18	17	17	-
Payables (days)	38	38	39	40	41
WC cycle (ex-cash) (days)	(8)	(11)	(10)	(13)	(32)

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### Disclosure of Interest Statement

### 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)