

COMPANY

UPDATE

Hero MotoCorp Limited

Earnings beat priced in...

REDUCE

Analyst

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Nifty: 5,139; Sensex: 17,085

CMP	Rs2,067
Target Price	Rs1,926
Potential Upside/Downside	(7)%

Key Stock Data

Sector	Auto
Bloomberg / Reuters	HMCL IN / HROM.BO
Shares o/s (mn)	199.7
Market cap. (Rs mn)	412,734
Market cap. (US\$ mn)	8,393
3-m daily average vol.	55,006

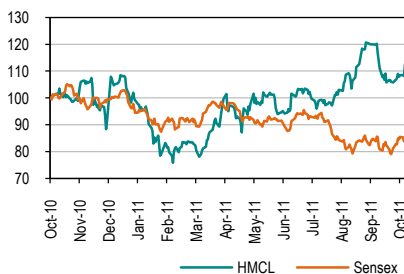
Price Performance

52-week high/low	Rs2,232/1,378
	-1m -3m -12m
Absolute (%)	(6) 15 13
Rel to Sensex (%)	(8) 24 27

Shareholding Pattern (%)

Promoters	52.2
FII's/NRI's/OCBs/GDR	34.9
MFs/Banks/FIs	4.2
Non Promoter Corporate	1.6
Public & Others	7.1

Relative to Sensex



Source: Capitaline

During the post results conference call, HMCL management sounded sanguine on the volume growth momentum and its ability to maintain and improve on Q2FY12 profitability. **We are upgrading our FY12/13 estimates upwards by 9%/8% to Rs118/Rs138, led by upward revision in margin estimates by 80bps/80bps to 12.2%/12.4%**, largely to factor in better than expected margin performance in Q2FY12 and expectations of sustainability of the same.

Table: Revised assumption table

(Units)

	FY12E			FY13E		
	Revised	Old	Change (%)	Revised	Old	Change (%)
Total volumes	62,48,957	63,17,143	(1.1)	71,28,329	72,06,215	(1.1)
Growth (%)	15.7	16.9	(1.3)	14.1	14.1	(0.0)
Motorcycles	57,97,116	58,49,984	(0.9)	66,08,712	66,68,982	(0.9)
Growth (%)	15.0	16.0	(1.0)	14.0	14.0	-
Scooters	4,51,841	4,67,159	(3.3)	5,19,617	5,37,233	(3.3)
Growth (%)	25.0	30.0	(5.0)	15.0	15.0	-
Realisation	34,227	34,250	(0.1)	35,253	35,276	(0.1)
Growth (%)	3.0	3.0	0.0	3.0	3.0	0.0
EBITDA margin (%)	12.2	11.4	0.8	12.4	11.6	0.8

Source: IDBI Capital Research

Nonetheless, we would keep a close watch with regards to (i) Any significant additional investment in brand building, (ii) foray into export markets and the related investment on brand building and distribution setup.

On our revised valuation, HMCL trades at 17.5x/15x FY12/13E, which is at ~10% premium to BJAUT valuation. **We have revised upwards HMCL's valuation multiple to 14x FY13E (vs. 13x earlier) to factor in smooth transition post split (dealer interactions suggest no impact of split on the brand) and largely immune product portfolio.** We also note that during uncertain times, HMCL has performed well on volume front, which has been evident from its volume growth of 20% during H1FY12 (peers like BJAUT and TVSL have growth by 15-16%). **Our revised price target stands at Rs1,926. Reiterate REDUCE.**

Though, in the short term, considering headwinds in the form of higher fuel prices and interest rates, we feel that HMCL is marginally better placed than BJAUT due to its higher rural exposure and largely executive segment portfolio (we infer that impact of rising fuel prices and higher interest rates is minimal in rural areas where large part of sales are on cash). This has been vindicated during our recent dealer visits, wherein we gather that downtrading (preference for cheap/lower segment vehicles) is visible over the past 2-3 months, which we believe will not impact HMCL, considering its product profile (largely *Splendor* and *Passion*). Nonetheless, over the medium term, we continue to believe that BJAUT provides better risk reward, led by more profitable product mix and greater clarity on product pipeline.

Table: Financial snapshot

(Rs mn)

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	P/E (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY10	158,220	27,319	17.3	22,318	111.8	18.5	14.4	61.4	65.8
FY11	193,564	25,840	13.3	21,900	109.7	18.8	16.5	68.2	56.3
FY12E	229,326	28,070	12.2	23,579	118.1	17.5	14.7	81.1	54.0
FY13E	268,344	33,289	12.4	27,478	137.6	15.0	12.0	91.3	61.5

Source: Company; IDBI Capital Research

Key highlights of conference call

- QoQ reduction of 220bps in RMC/sales at 72.5% was largely on account of price hike of Rs600 taken on June 24, 2011 – the full impact of which came in Q2 – and softness in commodity prices.
- Fixed component of royalty outgo (amortized royalty) was at Rs2.1 bn (vs. normal outgo of Rs1.8 bn) on account of INR depreciation vs. Japanese Yen. Excluding the same, normalized depreciation stood at Rs700 mn.
- Large part of ~Rs1 bn branding expenditure has been accounted for in Q2FY12 and balance will come in Q3FY12.
- Employee cost was up QoQ to Rs1.8 bn vs. Rs1.6 bn on account of wage settlement effective from August 2011.
- Management indicated that demand environment continues to be healthy, despite multiple headwinds in the form of rising interest rates, inflation and higher fuel prices. It stated that HMCL continues to stay away from discounting.
- Inventory levels remain at reasonable levels.
- Management maintained its FY12 volume guidance at 6 mn plus vehicles and expects industry to grow at 15%.
- It expects margin to improve further in Q3/Q4 led by marginal softening/stabilising of commodity costs. Management indicated that they have witnessed softening/stabilizing of commodity prices across nickel, copper, rubber, aluminium among others.
- HMCL's current capacity is 6.4 mn units, with 2.4 mn at Haridwar, 2 mn at Dharuhera and 2 mn at Gurgaon. Management stated that current capacity can be stretched to 7 mn units by March 2012 through debottlenecking at Dharuhera and Gurgaon plants and capacity ramp up at Haridwar plant (to scale up production to 9.5k units/day from 8k units/day at present). It plans to take scooter capacity to 50k units/month from 40k/month at present.
- It is looking for a new plant with capacity of 750k units, which is likely to come up by Q4FY13 (announcement on the same likely to be soon).
- The company is progressing gradually on its exports strategy and is targeting Latin America, Africa and South East Asia. It plans to sell 1 mn units over next 5-6 years, contributing ~10% to overall volumes.
- It has price revision clause with a quarterly lag for ~65% of its raw materials.
- It clarified that decision making has become easier post the Honda split. The company also clarified that there is no cap on the no. of models that can come from Honda stable till June 2014 and expects more new products to come in FY13 (in addition to the recently launched bike *Impulse* and soon to be launched scooter *Maestro*).
- HMCL has kept its Yen position open as it expects Yen to depreciate going forward as royalty is payable over 11 more quarters till June 2014. However, it mentioned that it will start hedging if Yen reaches 80 to USD vs. ~77 at present. In addition, it does not expect INR to go beyond 50 to USD.
- The company has spent Rs1.3 bn capex in H1FY12 and would be spending Rs6 bn in FY12.
- It expects to clock >500k units in Oct-11.
- Rural sales share has gone up to 45% from 35% in FY09.
- Management stated that tax rate would remain at ~17% levels for FY12.
- The company indicated that scouting for alternative sources of vendors is a continuous exercise and no significant breakthrough has been achieved as yet.
- Its sales and services touch points have gone up to 4,500 at present from 2,200 five years back and it plans to take that up to 5,000 by Mar-12.
- The company has very negligible import content (direct + indirect).
- Cash on books stood at Rs39 bn as on September 2011.

Financial summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY10	FY11	FY12E	FY13E
Net sales	158,220	193,564	229,326	268,344
Growth (%)	28.4	22.3	18.5	17.0
Operating expenses	(130,900)	(167,723)	(201,256)	(235,055)
EBITDA	27,319	25,840	28,070	33,289
Growth (%)	58.0	-5.4	8.6	18.6
Depreciation	(1,915)	(2,201)	(2,709)	(3,183)
EBIT	25,405	23,639	25,361	30,106
Interest paid	(21)	(158)	(158)	(158)
Other income	2,933	3,187	3,205	3,158
Pre-tax profit	28,317	25,870	28,408	33,106
Tax	(5,999)	(4,769)	(4,829)	(5,628)
Effective tax rate (%)	21.2	18.4	17.0	17.0
Net profit	22,318	21,101	23,579	27,478
Adjusted net profit	22,318	21,900	23,579	27,478
Growth (%)	74.1	(1.9)	7.7	16.5
Shares o/s (mn nos)	200	200	200	200

Balance Sheet

(Rs mn)

Year-end: March	FY10	FY11	FY12E	FY13E
Net fixed assets	17,068	42,053	38,976	33,926
Investments	39,259	51,289	51,289	51,289
Other non-curr assets	79	60	60	60
Current assets	28,644	13,842	24,285	37,710
Inventories	4,364	5,249	6,220	7,279
Sundry Debtors	1,084	1,306	1,547	1,811
Cash and Bank	19,072	715	14,409	26,512
Loans and advances	4,124	6,571	2,108	2,108
Total assets	85,049	107,243	114,609	122,984
Shareholders' funds	34,650	29,561	28,609	31,556
Share capital	399	399	399	399
Reserves & surplus	34,251	29,161	28,209	31,157
Total Debt	660	14,912	14,912	14,912
Secured loans	-	14,585	14,585	14,585
Unsecured loans	660	327	327	327
Other liabilities	2,267	17,439	18,379	19,319
Curr Liab & prov	48,550	60,664	68,027	72,576
Current liabilities	48,132	60,244	67,621	72,109
Provisions	418	420	406	467
Total liabilities	50,399	77,682	86,000	91,428
Total equity & liabilities	85,049	107,243	114,609	122,984
Book Value (Rs)	174	148	143	158

Source: Company; IDBI Capital Research

Cash Flow Statement

(Rs mn)

Year-end: March	FY10	FY11	FY12E	FY13E
Pre-tax profit	28,317	25,870	28,408	33,106
Depreciation	1,496	3,660	2,709	3,183
Tax paid	(5,622)	(5,295)	(2,686)	(4,688)
Chg in working capital	4,975	11,030	9,264	3,165
Other operating activities	-	-	-	-
Cash flow from operations (a)	29,166	35,265	37,695	34,766
Capital expenditure	(1,623)	(30,468)	368	1,868
Chg in investments	(5,570)	(12,030)	-	-
Other investing activities	1	-	-	-
Cash flow from investing (b)	(7,192)	(42,498)	368	1,868
Equity raised/(repaid)	-	-	-	-
Debt raised/(repaid)	(125)	14,251	-	-
Dividend (incl. tax)	(4,973)	(25,376)	(24,369)	(24,531)
Chg in minorities	-	-	-	-
Other financing activities	-	-	-	-
Cash flow from financing (c)	(5,097)	(11,124)	(24,369)	(24,531)
Net chg in cash (a+b+c)	16,877	(18,357)	13,694	12,103

Financial Ratios

Year-end: March	FY10	FY11	FY12E	FY13E
Adj EPS (Rs)	111.8	109.7	118.1	137.6
Adj EPS growth (%)	74.1	(1.9)	7.7	16.5
EBITDA margin (%)	17.3	13.3	12.2	12.4
Pre-tax margin (%)	17.9	13.4	12.4	12.3
RoE (%)	61.4	68.2	81.1	91.3
RoCE (%)	65.8	56.3	54.0	61.5
Turnover & Leverage ratios (x)				
Asset turnover	2.2	2.0	2.1	2.3
Leverage factor	2.0	3.0	3.8	3.9
Net margin (%)	14.1	11.3	10.3	10.2
Net Debt/Equity	(0.5)	0.5	0.0	(0.4)
Working Capital & Liquidity ratios				
Inventory days	10	10	10	10
Receivable days	3	2	2	2
Payable days	31	31	35	35

Valuations

Year-end: March	FY10	FY11	FY12E	FY13E
PER (x)	18.5	18.8	17.5	15.0
Price/Book value (x)	11.9	14.0	14.4	13.1
PCE (x)	17.0	17.1	15.7	13.5
EV/Net sales (x)	2.5	2.2	1.8	1.5
EV/EBITDA (x)	14.4	16.5	14.7	12.0
Dividend Yield (%)	5.7	5.5	5.5	5.5



Notes

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Key to Ratings

Stocks:

BUY: Absolute return of 15% and above; **ACCUMULATE:** 5% to 15%; **HOLD:** Upto $\pm 5\%$; **REDUCE:** -5% to -15%; **SELL:** -15% and below.

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