

Subdued Margins

3rd November 2017

 CMP: Rs 3,709
 Target Price: Rs 3,800
Recommendation: Neutral
Stock Info

| | |
|------------|------------|
| BSE Group | A |
| BSE Code | 500182 |
| NSE Symbol | HEROMOTOCO |
| Bloomberg | HMCL IN |
| Reuters | HROM.BO |
| BSE Sensex | 33,573 |
| NSE Nifty | 10,423 |

Market Info

| | |
|-----------------------|----------------|
| Market Capital | Rs 74,330 cr |
| Equity Capital | Rs 39.9 cr |
| 6M Avg Trading Volume | 3,82,940 |
| 52 Wk High / low | Rs 4,091/2,849 |
| Face Value | Rs 2 |

Share holding pattern as on June 17

| | |
|------------|------|
| Promoters | 34.6 |
| DII's | 11.6 |
| FII's | 42.1 |
| Others | 11.7 |
| Face Value | Rs 2 |

Price Vs Sensex Chart


Hero Motocorp Ltd. revenue increased by 9% to Rs 8,362 cr from Rs 7,670 cr in the corresponding quarter of previous year. During quarter, company has registered sales of 20.22 lakh units, increase of 11% on YoY basis and by 9% on Q-o-Q basis. Hero Motocorp's strong point is the executive segment in the motorcycle market, but this is also the category that is increasingly being cannibalized by scooters, owing to similar price points. Company has continued to maintain leadership in Motorcycle segment.

Operating EBITDA margins decreased by 20 bps to 17.4% on YoY and EBITDA for the quarter stood at Rs 1456 cr, Q2 PAT increased marginally by 0.6% to Rs.1010 cr on YoY basis.

Concall highlights:

- Revenues representation has changed due to GST related adjustments.
- Taxes/Duties such as service tax, NCCD and excise duty have been excluded from revenues and expenses (RM cost, other expenses).
- Haridwar plant duty benefits have been partially accrued in revenues.
- Company has accounted for 58% of the GST incentive in Haridwar plant pertaining to Central Government share of CGST/IGST in accordance with the "Scheme of Budgetary Support under GST" issued by Ministry of Commerce and Industry on October 05, 2017 and await state notification on the balance 42%.

Demand:

- Festive season was strong, with double-digit growth in volumes.
- Urban demand has been strong since Q1FY18, while rural demand picked up in Q2FY18.
- New products such as premium motorcycle and scooters will be launched in H2FY18.
- Glamor model sales were impacted due to supply constraints in H1FY18. It is expected to pick up in H2FY18.
- Hero Fincorp financed 180,000 units in Q2FY18, implying 9% of sales. This number is expected to increase going ahead.
- Spare parts revenue was flat yoy, though higher by 18% qoq.
- The effective tax rate was higher on account of phasing out of investment allowance and reduction in allowable deduction of R&D expenditure.
- Dealer inventory post festive season stands at 4-6 weeks.
- Dealer network stands at over 6,000. Focus has been on refreshing dealer portfolio.
- Expiry of Haridwar plant tax benefits by Mar'18 would impact margins by 100bps. This negative impact would be partially offset by tax benefits from new plants. Cumulative capex for FY18-19 is expected at Rs2500 cr

> **Valuation:** The stock is currently trading at Rs 3,733 at 19.2 x our estimated FY19E EPS of Rs 200 per share. We assign a price target of Rs 3800 at 19x FY19 EPS, and have **"Neutral"** rating on the stock.

| Y/E March, (in Rs crore) | FY17 | FY18E | FY19E |
|--------------------------|--------|--------|--------|
| Net Sales | 28,475 | 31,292 | 34,806 |
| yoy% | 1.1% | 9.9% | 11.2% |
| Operating EBIDTA | 4,635 | 5,007 | 5,708 |
| Operating EBITDA % | 16.3% | 15.7% | 16.1% |
| PAT | 3,377 | 3,514 | 3,995 |
| yoy% | 7.8% | 4.0% | 13.7% |
| EPS | 168 | 176 | 200 |
| P/E (x) | 22.1 | 21.2 | 18.7 |

| Quarterly P&L in Rs cr | Q2FY18 | Q1FY18 | Q2FY17 | YoY% | QoQ% |
|---|-----------|-----------|-----------|------|------|
| Volumes (in numbers) | 20,22,805 | 18,53,647 | 18,23,498 | 11% | 9% |
| Net Realization per unit | 41,339 | 43,005 | 42,059 | -2% | -4% |
| Net Sales | 8,362 | 7,972 | 7,670 | 9% | 5% |
| Other Operating Income | 0 | 0 | 127 | | |
| Income from Operations | 8,362 | 7,972 | 7,796 | 7% | 5% |
| | 0 | | | | |
| Materials Consumed | 5,698 | 5,394 | 5,183 | 10% | 6% |
| Employees Cost | 384 | 374 | 357 | 7% | 3% |
| Other Expenditure | 825 | 908 | 887 | -7% | -9% |
| Total Expenditure | 6,906 | 6,676 | 6,427 | 7% | 3% |
| | | | | | |
| Operating EBITDA | 1,456 | 1,296 | 1,369 | 6% | 12% |
| margin | 17.4% | 16.26% | 17.6% | -1% | 7% |
| Core EBITDA | 1,456 | 1,296 | 1,242 | 17% | 12% |
| margin | 0 | 16.3% | 16.2% | 7% | 7% |
| | | | | | |
| Depreciation and Amortization | 136 | 133 | 119 | 14% | 2% |
| | 0 | | | | |
| Operating EBIT before Other Income & Excp Items | 1,320 | 1,163 | 1,250 | 6% | 13% |
| Other Income | 118 | 132 | 152 | -23% | -11% |
| Interest | 2 | 1.58 | 1.55 | 1% | -1% |
| PBT before Exceptional Items | 1,436 | 1,293 | 1,400 | 3% | 11% |
| Exceptional item | 0 | 0 | 0 | | |
| PBT | 1,436 | 1,293 | 1,400 | 3% | 11% |
| Tax Expense | 425 | 379 | 396 | 7% | 12% |
| Effective Tax Rate | 30% | 29.3% | 28.3% | 5% | 1% |
| Net Profit after Tax | 1,010 | 914 | 1,004 | 0.6% | 11% |
| EPS | 50.6 | 45.8 | 50.3 | 0.6% | 11% |

Profit and Loss Account, Year Ending March

| Particulars, in Rs crore | FY17 | FY18E | FY19E |
|-------------------------------|---------------|---------------|---------------|
| Net Sales | 28,475 | 31,292 | 34,806 |
| YoY% | 1.1 | 9.9 | 11.2 |
| Other Operating Income | - | 626 | 696 |
| Income from Operations | 28,475 | 31,918 | 35,502 |
| Materials Consumed | 19,012 | 21,279 | 23,668 |
| Total Expenditure | 23,840 | 26,911 | 29,794 |
| Operating EBITDA | 4,635 | 5,007 | 5,708 |
| Operating EBITDA margin % | 16.3 | 16.0 | 16.4 |
| Depreciation | 493 | 601 | 683 |
| Operating EBIT | 4,142 | 4,406 | 5,025 |
| Other Income | 522 | 516 | 574 |
| Interest | 6 | 8 | 11 |
| Exceptional Item | - | - | - |
| PBT | 4,658 | 4,914 | 5,588 |
| Tax Expense | 1,281 | 1,401 | 1,593 |
| Reported Net Profit | 3,377 | 3,514 | 3,995 |
| YoY% | 7.8 | 4.0 | 13.7 |
| Effective Tax Rate | 27.5 | 28.5 | 28.5 |
| Reported EPS | 168 | 176 | 200 |

Cash Flow Statement, Year Ending March

| Particulars, in Rs crore | FY17 | FY18E | FY19E |
|------------------------------------|------------------|------------------|------------------|
| Operating Activities | | | |
| PBT | 4,658 | 4,914 | 5,588 |
| Add Depr + non op exp | 493 | 601 | 683 |
| Others | 173 | (351) | (466) |
| Total | 5,325 | 5,164 | 5,806 |
| Cash Taxes | 1,281 | 1,401 | 1,593 |
| Changes in Working Cap | (153) | 574 | 917 |
| Cash Flow from Operations | 4,028 | 4,338 | 5,130 |
| Investing Activities | | | |
| Change in investments | 3,095 | 4,065 | 6,000 |
| Capex | 1,151 | 1,816 | 2,865 |
| Cash Flow from Investing | (1,943.9) | (2,249.1) | (3,135.0) |
| Financing Activities | | | |
| Dividends + Taxes paid | 2,091 | 2,044 | 1,959 |
| Change in Non Curr Liab | 6.1 | 8.1 | 11.3 |
| Cash Flow from Financing | (2,096) | (2,052) | (1,970) |
| Opening Cash | 27 | 15 | 52 |
| Changes during year | (12) | 37 | 25 |
| Adj due to amalgamation/unpaid div | | | |
| Closing Cash | 15 | 52 | 77 |

Balance Sheet, Year Ending March

| Particulars, in Rs crore | FY17 | FY18E | FY19E |
|---------------------------------------|---------------|---------------|---------------|
| Liabilities + Equity | | | |
| (a) Share capital | 40 | 40 | 40 |
| (b) Reserves and surplus | 10,071 | 10,346 | 12,233 |
| Shareholders' funds | 10,111 | 10,386 | 12,273 |
| Non-current liab & Prov | 490 | 137 | 154 |
| Current liabilities | 4,093 | 5,132 | 5,760 |
| Total - Equity and liabilities | 14,694 | 15,655 | 18,186 |
| Assets | | | |
| Non-current assets | | | |
| Fixed assets | 4,581 | 6,690 | 7,290 |
| Long Term Inv | 1,349 | 1,619 | 1,943 |
| Loans + Adv + Others | 1,031 | 1,032 | 2,168 |
| Non-current assets | 6,962 | 9,341 | 11,400 |
| Current assets | | | |
| Cash | 15 | 52 | 77 |
| Other Current Assets | 7,659 | 7,054 | 7,109 |
| Sub-total - Current assets | 7,732 | 6,314 | 6,786 |
| Total - Assets | 14,694 | 15,655 | 18,186 |

Ratio Analysis

| | FY17 | FY18E | FY19E |
|------------------------------------|--------------|--------------|--------------|
| Profitability | | | |
| Operating EBITDA% | 16.3 | 16.0 | 16.4 |
| Core EBITDA% | 16.3 | 14.0 | 14.4 |
| PAT% | 11.9 | 11.2 | 11.5 |
| ROAE% | 37.4 | 34.3 | 35.3 |
| Du Pont ROAE breakup | | | |
| PAT / Sales | 11.9 | 11.0 | 11.3 |
| Sales / Avg Total Assets | 2.1 | 1.9 | 1.7 |
| Avg Total Assets / Avg Eqty | 1.5 | 1.6 | 1.8 |
| ROE | 37.4 | 34.3 | 35.3 |
| Other Ratios | | | |
| Current Ratio | 1.9 | 1.4 | 1.2 |
| Long Term Debt / Equity | 0.05 | 0.01 | 0.01 |
| EPS | 168.4 | 176.0 | 200.1 |
| DPS | 80.0 | 88.0 | 88.0 |
| Dividend Payout ratio | 47.5 | 50.0 | 44.0 |
| P/E | 22.1 | 21.2 | 18.7 |
| BVPS | 506.4 | 520.1 | 614.6 |
| P/BV | 7.3 | 7.1 | 6.0 |

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Stock Rating

| | Absolute Return |
|------------|-----------------|
| Buy | > 20% |
| Accumulate | 12% to 20% |
| Hold | 5% to 12% |
| Neutral | -5% to 5% |
| Reduce | < -5% |

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