



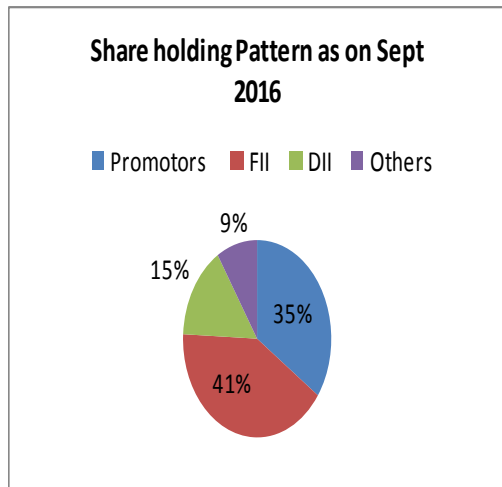
Improvement in Margins

26<sup>th</sup> october, 2016

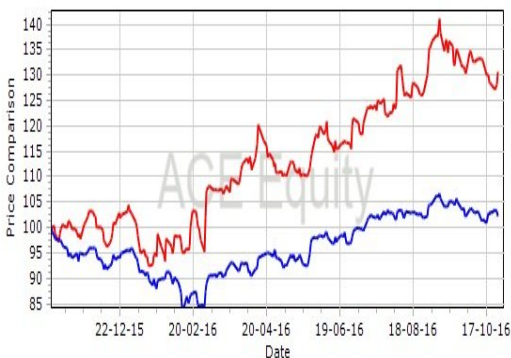
CMP: Rs 3,345  
Target Price: Rs 3,212  
**Recommendation: NEUTRAL**

Stock Info	
BSE Group	A
BSE Code	500182
NSE Symbol	HEROMOTOCO
Bloomberg	HMCL IN
Reuters	HROM.BO
BSE Sensex	27,797
NSE Nifty	8,585

Market Info	
Market Capital	Rs 66,802 cr
Equity Capital	Rs 39.9 cr
Avg Trading Volume	4,11,120
52 Wk High / low	Rs 2,357/3,739
Face Value	Rs 2



Price Vs Sensex Chart



Hero Motocorp Ltd. revenue surged by 14.0% to Rs 7,796 cr from Rs 6,837Cr in the corresponding quarter of previous year, it has achieved highest ever quarterly volumes of 18.23 lakhs units rising by 15.8% on YoY basis and 4.5% on Q-o-Q basis. Hero’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. Glamour consolidates its position as the largest selling 125cc motorcycle in the country during the first half of the fiscal. Company has received positive initial response from customers for Splendor iSmart 110.

Due to lower cost of materials, Operating EBITDA margins increased by 180 bps to 17.6% on YoY basis which is higher than our expectation and EBITDA for the quarter stood at Rs 1,369 cr, margins improved due to reduction in other expenses and robust volume growth in scooters and motorcycles segments during the quarter. Q1 profit surged by 30.1% to Rs.1004 crore on YoY. Due to control on other expenses and higher sales volumes helped Hero Motocorp to post higher profit.

Other highlights

- With the above average monsoon so far and the implementation of the 7<sup>th</sup> pay commission recommendations, we remain optimistic about the remaining months of FY17.
- The growth trajectory has been the 125cc segment where the company now commands well over 50% market share which is contributed by Glamour and Super Splendor.
- Going ahead, Margins are expected to contract due to rise in commodity price.
- Recently launched the all new splendour ismart 110- the first motorcycle to have been completely designed and developed by in-house R&D team at jaipur, and the initial response from customers have been positive.

> **Outlook for next two years:** We remain cautiously optimistic on HMCL’s domestic business outlook over next 2 years, due to expected revival of domestic economy. We have modelled for 6.3% volume growth and 3% price realisation growth in FY17E and 15% volume growth and 3% price realization for FY18E.

> **Financial, Estimates :** We estimate Hero Moto’s Revenue growth of 10.4% in FY17E and 19.3% in FY18E, expect EBITDA margins close to 16.9% for FY17E and FY18E, expect PAT growth of 17.6% in FY17E and 20% in FY18E.

> **Valuation:** The stock at Rs 3,345 trades at 15x our estimated FY18 EPS of Rs 222 per share. We assign a price target of Rs 3,212 at 14.5x FY18 EPS, and have “NEUTRAL” rating on the stock.

Y/E March, (in Rs crore)	FY14	FY15	FY16	FY17E	FY18E
Net Sales	25,125	27,351	28,160	31,086	37,090
yoy%	6.5%	8.9%	3.0%	10.4%	19.3%
Operating EBITDA	3,540	3,542	4,447	5,253	6,268
Operating EBITDA %	14.0%	12.8%	15.5%	16.6%	16.6%
PAT	2,109	2,386	3,132	3,684	4,424
yoy%	-0.4%	13.1%	31.3%	17.6%	20.1%
EPS	105.6	119.5	156.9	184.5	221.5
P/E (x)	21.5	22.1	18.8	18.6	15.5

Quarterly P&L in Rs cr	Q2FY17	Q2FY16	yoy%	Q1FY17	qqq%
Volumes (in numbers)	18,23,498	15,74,861	15.8%	17,45,389	4.5%
Net Realization per unit	42,059	42,830	-1.8%	41,765	0.7%
Net Sales	7,670	6,745	13.7%	7,290	5.2%
Other Operating Income	127	92		109	
Income from Operations	7,796	6,837	14.0%	7,399	5.4%
Materials Consumed	5,183	4,666	11.1%	4,965	4.4%
Employees Cost	357	310		336	
Other Expenditure	887	778		867	
Total Expenditure	6,427	5,754	11.7%	6,169	4.2%
Operating EBITDA	1,369	1,083	26.3%	1,230	11.3%
margin	17.6%	15.8%		16.6%	
Core EBITDA	1,242	991	25.3%	1,121	10.8%
margin	16.2%	14.7%		15.4%	
Depreciation and Amortization	119	109	9.4%	115	3.5%
Operating EBIT before Other Income & Excp Items	1,250	974	28.2%	1,115	12.1%
Other Income	152	103		120	
Interest	1.55	0.54		1.50	
PBT before Exceptional Items	1,400	1,076	30.1%	1,234	13.5%
Exceptional item	0	0		0	
PBT	1,400	1,076	30.1%	1,234	13.5%
Tax Expense	396	304		351	
Effective Tax Rate	28.3%	28.3%		28.4%	
Net Profit after Tax	1,004	772	30.1%	883	13.7%
EPS	50.3	38.7		44.2	

Source: Company data, Arihant Research

## Profit and Loss Account, Year Ending March

Particulars, in Rs crore	FY14	FY15	FY16	FY17E	FY18E
<b>Net Sales</b>	<b>25,125</b>	<b>27,351</b>	<b>28,160</b>	<b>31,086</b>	<b>37,090</b>
YoY%	6.5	8.9	3.0	10.4	19.3
Other Operating Income	151	235	439	622	742
<b>Income from Operations</b>	<b>25,275</b>	<b>27,585</b>	<b>28,599</b>	<b>31,707</b>	<b>37,832</b>
Materials Consumed	18,230	19,754	19,315	20,983	25,036
Total Expenditure	21,735	24,043	24,152	26,454	31,564
<b>Operating EBITDA</b>	<b>3,540</b>	<b>3,542</b>	<b>4,447</b>	<b>5,253</b>	<b>6,268</b>
Operating EBITDA margin %	14.1	13.0	15.8	16.9	16.9
Depreciation	1,107	540	441	528	601
Operating EBIT	2,433	3,002	4,006	4,726	5,668
Other Income	446	492.7	391	435	519
Interest	12	11.1	2	9	-
Exceptional Item	-	(155)	-	-	-
<b>PBT</b>	<b>2,867</b>	<b>3,329</b>	<b>4,395</b>	<b>5,152</b>	<b>6,187</b>
Tax Expense	758	943	1,262	1,468	1,763
<b>Reported Net Profit</b>	<b>2,109</b>	<b>2,386</b>	<b>3,132</b>	<b>3,684</b>	<b>4,424</b>
YoY%	(0.4)	13.1	31.3	17.6	20.1
Effective Tax Rate	26.4	28.3	28.7	28.5	28.5
<b>Reported EPS</b>	<b>106</b>	<b>119</b>	<b>157</b>	<b>184</b>	<b>222</b>

## Cash Flow Statement, Year Ending March

Particulars, in Rs crore	FY14	FY15	FY16	FY17E	FY18E
<b>Operating Activities</b>					
<b>PBT</b>	<b>2,867</b>	<b>3,329</b>	<b>4,395</b>	<b>5,152</b>	<b>6,187</b>
Add Depr + non op exp	1,107	540	441	528	601
Others	79	288	(176)	81	(351)
Total	4,054	4,157	4,660	5,761	6,437
Cash Taxes	649	1,000	1,262	1,468	1,763
Changes in Working Cap	(441)	(907)	(515)	(373)	(397)
<b>Cash Flow from Operations</b>	<b>2,963</b>	<b>2,250</b>	<b>2,883</b>	<b>3,920</b>	<b>4,277</b>
<b>Investing Activities</b>					
Change in investments	2,225	1,738	2,007	2,796	2,991
Capex	608	1,750	817	801	862
<b>Cash Flow from Investing</b>	<b>(1,617.0)</b>	<b>12.1</b>	<b>(1,190.0)</b>	<b>(1,994.7)</b>	<b>(2,129.6)</b>
<b>Financing Activities</b>					
<b>Dividends + Taxes paid</b>	<b>1,403</b>	<b>2,219</b>	<b>1,728</b>	<b>1,896</b>	<b>2,109</b>
Change in Non Curr Liab	11.8	11.1	2.2	8.6	-
<b>Cash Flow from Financing</b>	<b>(1,414.9)</b>	<b>(2,231)</b>	<b>(1,730)</b>	<b>(1,905)</b>	<b>(2,109)</b>
Opening Cash	135	66	98	60	81
Changes during year	(69)	32	(38)	20	38
Adj due to amalgamation/unpaid div	51.1	61.3	71.0	80.5	80.5
<b>Closing Cash</b>	<b>118</b>	<b>159</b>	<b>131</b>	<b>161</b>	<b>199</b>

## Balance Sheet, Year Ending March

Particulars, in Rs crore	FY14	FY15	FY16	FY17E	FY18E
<b>Liabilities + Equity</b>					
(a) Share capital	40	40	40	40	40
(b) Reserves and surplus	5,560	6,501	7,905	9,693	12,008
<b>Shareholders' funds</b>	<b>5,600</b>	<b>6,541</b>	<b>7,945</b>	<b>9,732</b>	<b>12,047</b>
Non-current liab & Prov	74	97	347	147	176
Current liabilities	4,423	3,883	4,049	5,099	6,276
<b>Total - Equity and liabilities</b>	<b>10,097</b>	<b>10,522</b>	<b>12,341</b>	<b>14,979</b>	<b>18,500</b>
<b>Assets</b>					
Non-current assets					
Fixed assets	3,097	3,625	4,442	5,536	6,690
Long Term Inv	813	864	1,019	1,142	1,370
Loans + Adv + Others	631	751	944	913	1,439
Non-current assets	4,541	5,240	6,406	7,591	9,499
Current assets					
Cash	118	159	131	161	199
Other Current Assets	5,438	5,123	5,804	7,227	8,801
Sub-total - Current assets	5,556	5,282	5,935	7,388	9,001
<b>Total - Assets</b>	<b>10,097</b>	<b>10,522</b>	<b>12,341</b>	<b>14,979</b>	<b>18,500</b>

## Ratio Analysis

	FY14	FY15	FY16	FY17 E	FY18E
<b>Profitability</b>					
<b>Operating EBITDA%</b>	<b>14.1</b>	<b>13.0</b>	<b>15.8</b>	<b>16.9</b>	<b>16.9</b>
Core EBITDA%	13.5	12.1	14.2	14.9	14.9
PAT%	8.4	8.7	11.1	11.9	11.9
<b>ROAE%</b>	<b>39.8</b>	<b>39.3</b>	<b>43.2</b>	<b>41.7</b>	<b>40.6</b>
<b>Du Pont ROAE breakup</b>					
PAT / Sales	8.3	8.6	11.0	11.6	11.7
Sales / Avg Total Assets	2.6	2.7	2.5	2.3	2.3
Avg Total Assets / Avg Eqty	1.9	1.7	1.6	1.5	1.5
<b>ROE</b>	<b>39.8</b>	<b>39.3</b>	<b>43.2</b>	<b>41.7</b>	<b>40.6</b>
<b>Other Ratios</b>					
<b>Current Ratio</b>	<b>1.3</b>	<b>1.4</b>	<b>1.5</b>	<b>1.4</b>	<b>1.4</b>
Long Term Debt / Equity	0.01	0.01	0.04	0.02	0.01
<b>EPS</b>	<b>105.6</b>	<b>119.5</b>	<b>156.9</b>	<b>184.5</b>	<b>221.5</b>
DPS	65.0	60.0	72.0	80.0	88.0
<b>Dividend Payout ratio</b>	<b>61.5</b>	<b>50.2</b>	<b>45.9</b>	<b>43.4</b>	<b>39.7</b>
<b>P/E</b>	<b>22</b>	<b>22</b>	<b>18.8</b>	<b>18.65</b>	<b>15.5</b>
BVPS	280.4	327.6	397.9	487.4	603.3
P/BV	8.1	8.1	7.4	7.1	5.7

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**Stock Rating**

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

**Research Analyst Registration No.**

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