

Hero Motocorp
HMCL IN

Target price: **Rs2,225.00** →
Rs2,225.00

Up/downside: **+24.5%** Share price (4 Jan): **Rs1,786.45**

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell

Growth story intact

Ambrish Mishra
(91) 22 6622 1060
ambrish.mishra@in.daiwacm.com

Navin Matta
(91) 22 6622 8411
navin.matta@in.daiwacm.com

- HMCL has positively surprised the market YTD in FY12, with over 18% sales-volume growth
- We forecast a 14.7% EPS CAGR for FY11-14
- Reiterate Buy (1) rating and target price of Rs2,225

What's new

We met with the management of Hero Motocorp (HMCL) to get an update on the near- to medium-term outlook of the company. We also introduce our FY14 forecasts.

What's the impact

HMCL has positively surprised us and the market so far in FY12 with a sales-volume growth of over 18% YoY. The company gained about 200bps share in the motorcycle volume segment and about 100bps share in the scooter volume segment in the period. According to management, HMCL will focus on maintaining its leadership through new launches (in the motorcycle and scooter segments) and by capitalising on the strong brand pull enjoyed by its products, especially in the rural/semi-urban markets.

During our meeting, the management did not seem too concerned about EBIDTA-margin pressure, as it believes there is a healthy/rational competitive

environment in the industry and that the likelihood of a price war is low. The easing of commodity prices, reasonable sales-volume growth and cost-cutting measures should help the company to maintain its EBIDTA margin at healthy levels of 12-14% (adjusted for royalty payouts) over the medium term.

Although the management seemed a little concerned about demand growth in the near future, it guided for volume growth of about 8-10% for the domestic market in FY13, and believes HMCL will at least be able to match the industry growth. On the R&D front, the company is confident of launching its own products before June 2014, until when HMCL is assured of new products from Honda Motor (7267 JP, ¥2,453, Buy [1]), in line with the agreement signed in December 2010. Going forward, R&D costs should be equivalent to about 1-1.5% of net revenue, according to management.

While have revised our FY12-13 forecasts slightly, and introduce our FY14 forecasts. We forecast an EPS CAGR of 14.7% for FY11-14, backed by a sales-volume CAGR of 11.2%.

What we recommend

The stock currently trades at PERs of 12.7x and 11.8x for FY13E and FY14E, respectively. We reiterate our Buy (1) rating and six-month target price of Rs2,225, based on a target PER of 16x on our FY13E EPS.

Given the economic uncertainty globally in 2012 and that we believe HMCL's earnings will be quite resilient despite this, we factor in a marginal premium to its past three-year average PER of 15x to arrive at our target PER of 16x. The key risks to our investment view are: 1) greater-than-expected pricing

competition, 2) a sharp slowdown in domestic GDP growth, and 3) sharp commodity price inflation.

How we differ

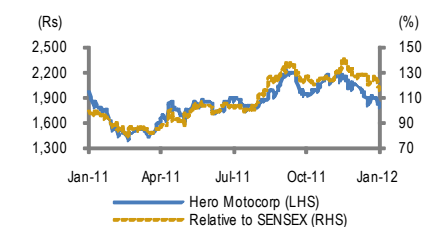
Our EPS forecasts are above those of the Bloomberg consensus by 1.7%, 3.4% and 3.3% for FY12, FY13, and FY14, respectively, which we believe is mainly due to our greater conviction that the company can protect its domestic market share and improve margins through an improved product mix.

Forecast revisions (%)

Year to 31 Mar	12E	13E	14E
Revenue change	0.8	1.5	n.a.
Net-profit change	0.1	1.3	n.a.
EPS change	0.1	1.3	n.a.

Source: Daiwa forecasts

Share price performance



12-month range	1,390.55-2,222.50
Market cap (US\$bn)	6.73
Average daily turnover (US\$m)	23.87
Shares outstanding (m)	200
Major shareholder	Munjal Family (52.2%)

Financial summary (Rs)

Year to 31 Mar	12E	13E	14E
Revenue (m)	227,818	251,267	282,620
Operating profit (m)	23,811	28,431	32,873
Net profit (m)	23,832	28,133	30,301
Core EPS	119	141	152
EPS change (%)	18.7	18.0	7.7
Daiwa vs Cons. EPS (%)	1.7	3.4	3.3
PER (x)	15.0	12.7	11.8
Dividend yield (%)	3.1	3.9	4.5
DPS	55.000	70.000	80.000
PBR (x)	8.8	6.8	5.6
EV/EBITDA (x)	10.8	9.1	7.9
ROE (%)	67.9	60.5	52.0

Source: Bloomberg, Daiwa forecasts

Financial summary
■ Key assumptions

Year to 31 Mar	2007	2008	2009	2010	2011	2012E	2013E	2014E
Sales volume (units)	3,336,756	3,337,142	3,722,000	4,600,130	5,402,444	6,190,381	6,774,914	7,437,015
Average selling price (LC)	32,705	34,022	34,175	34,170	35,863	36,927	37,443	38,084
Sales Volume, chg YoY	11.2%	0.0%	11.5%	23.6%	17.4%	14.6%	9.4%	9.8%
Average Selling Price, chg YoY	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports share in Sales volume, %	2.9%	2.7%	2.2%	2.1%	2.5%	2.8%	3.3%	3.9%
Advt/Publicity Cost as % of Revenues	2.4%	2.1%	2.0%	2.3%	2.0%	2.7%	2.5%	2.5%

■ Profit and loss (Rs m)

Year to 31 Mar	2007	2008	2009	2010	2011	2012E	2013E	2014E
2 wheelers	93,605	97,439	115,702	147,607	180,458	213,396	234,155	262,038
Other revenues	5,395	5,879	7,489	9,975	11,991	14,422	17,112	20,581
Others	0	0	0	0	0	0	0	0
Total revenue	99,000	103,318	123,191	157,582	192,449	227,818	251,267	282,620
Other income	0	0	0	0	0	0	0	0
COGS	(71,787)	(74,025)	(87,420)	(107,364)	(141,111)	(165,624)	(180,913)	(203,486)
SG&A	(5,071)	(5,036)	(5,822)	(7,604)	(8,665)	(11,876)	(12,607)	(14,027)
Other op. expenses	(11,808)	(12,366)	(14,522)	(17,909)	(22,095)	(26,507)	(29,316)	(32,234)
Operating profit	10,333	11,891	15,428	24,705	20,578	23,811	28,431	32,873
Net-interest inc./(exp.)	336	486	537	558	601	701	805	910
Assoc/forex/extraord./others	1,792	1,726	1,849	3,055	2,868	4,216	4,848	5,333
Pre-tax profit	12,462	14,103	17,815	28,317	24,047	28,728	34,085	39,115
Tax	(3,882)	(4,424)	(4,997)	(5,999)	(4,769)	(4,895)	(5,951)	(8,814)
Min. int./pref. div./others	0	0	0	0	0	0	0	0
Net profit (reported)	8,580	9,679	12,818	22,318	19,278	23,832	28,133	30,301
Net profit (adjusted)	8,580	9,679	12,818	22,318	20,076	23,832	28,133	30,301
EPS (reported) (Rs)	42.962	48.467	64.185	112	96.535	119	141	152
EPS (adjusted) (Rs)	42.962	48.467	64.185	112	101	119	141	152
EPS (adjusted fully-diluted) (Rs)	42.962	48.467	64.185	112	101	119	141	152
DPS (Rs)	16.999	18.999	19.999	110	105	55.000	70.000	80.000
EBIT	10,333	11,891	15,428	24,705	20,578	23,811	28,431	32,873
EBITDA	11,731	13,494	17,235	26,620	24,602	33,877	38,951	43,827

■ Cash flow (Rs m)

Year to 31 Mar	2007	2008	2009	2010	2011	2012E	2013E	2014E
Profit before tax	12,462	14,103	17,815	28,317	24,047	28,728	34,085	39,115
Depreciation and amortisation	1,398	1,603	1,807	1,915	4,024	10,066	10,519	10,955
Tax paid	(3,788)	(4,452)	(4,806)	(5,916)	(3,828)	(4,395)	(5,351)	(8,214)
Change in working capital	(3,192)	3,842	1,863	25,847	22,808	(5,490)	1,236	(453)
Other operational CF items	(680)	(486)	(537)	(1,058)	(1,400)	(701)	(805)	(910)
Cash flow from operations	6,199	14,610	16,141	49,106	45,650	28,207	39,684	40,493
Capex	(5,017)	(3,696)	(3,102)	(2,041)	(29,009)	(8,311)	(3,849)	(3,569)
Net (acquisitions)/disposals	880	(5,930)	(8,019)	(5,570)	(12,030)	(3,500)	(6,500)	(10,500)
Other investing CF items	(221)	(970)	(990)	(1,100)	0	0	0	0
Cash flow from investing	(4,358)	(10,596)	(12,111)	(8,711)	(41,039)	(11,811)	(10,349)	(14,069)
Change in debt	0	0	0	0	0	0	0	0
Net share issues/(repurchases)	900	892	1,290	2,250	1,928	0	0	0
Dividends paid	(3,972)	(4,439)	(4,673)	(25,676)	(24,369)	(12,796)	(16,286)	(18,612)
Other financing CF items	(106)	358	17	(444)	19	60	100	120
Cash flow from financing	(3,178)	(3,189)	(3,366)	(23,869)	(22,422)	(12,736)	(16,186)	(18,492)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	(1,336)	825	665	16,525	(17,811)	3,661	13,149	7,931
Free cash flow	1,182	10,913	13,040	47,064	16,641	19,897	35,835	36,923

Source: Company, Daiwa forecasts

Financial summary continued ...
■ Balance sheet (Rs m)

As at 31 Mar	2007	2008	2009	2010	2011	2012E	2013E	2014E
Cash & short-term investment	358	1,311	2,196	19,072	715	5,016	18,870	27,591
Inventory	2,756	3,171	3,268	4,364	5,249	7,490	8,261	9,292
Accounts receivable	3,353	2,974	1,499	1,084	1,306	4,993	5,507	7,743
Other current assets	2,667	1,912	3,172	4,306	7,775	8,374	10,551	11,805
Total current assets	9,133	9,368	10,135	28,826	15,046	25,873	43,189	56,431
Fixed assets	13,555	15,648	16,943	17,069	42,054	40,299	33,629	26,244
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	19,739	25,668	33,688	39,257	51,288	54,788	61,288	71,788
Total assets	42,426	50,684	60,765	85,152	108,387	120,960	138,106	154,462
Short-term debt	0	0	0	0	0	0	0	0
Accounts payable	10,419	13,250	15,259	38,051	50,637	49,121	50,329	52,070
Other current liabilities	4,372	4,998	5,270	10,264	10,811	13,363	16,853	19,179
Total current liabilities	14,792	18,247	20,528	48,314	61,448	62,484	67,182	71,249
Long-term debt	1,652	1,320	785	660	14,912	14,912	14,912	14,912
Other non-current liabilities	1,282	1,254	1,444	1,528	2,468	2,968	3,568	4,168
Total liabilities	17,725	20,821	22,757	50,502	78,827	80,363	85,661	90,329
Share capital	399	399	399	399	399	399	399	399
Reserves/R.E./others	24,301	29,463	37,608	34,251	29,161	40,198	52,046	63,735
Shareholders' equity	24,701	29,862	38,008	34,650	29,561	40,597	52,445	64,134
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	42,426	50,684	60,765	85,152	108,387	120,961	138,107	154,463
EV	358,048	356,763	355,343	338,342	370,950	366,650	352,795	344,074
Net debt/(cash)	1,294	9	(1,411)	(18,412)	14,196	9,896	(3,959)	(12,680)
BVPS (Rs)	124	150	190	174	148	203	263	321

■ Key ratios (%)

Year to 31 Mar	2007	2008	2009	2010	2011	2012E	2013E	2014E
Sales (YoY)	13.6	4.4	19.2	27.9	22.1	18.4	10.3	12.5
EBITDA (YoY)	(14.0)	15.0	27.7	54.5	(7.6)	37.7	15.0	12.5
Operating profit (YoY)	(17.3)	15.1	29.8	60.1	(16.7)	15.7	19.4	15.6
Net profit (YoY)	(11.7)	12.8	32.4	74.1	(10.0)	18.7	18.0	7.7
EPS (YoY)	(11.7)	12.8	32.4	74.1	(10.0)	18.7	18.0	7.7
Gross-profit margin	27.5	28.4	29.0	31.9	26.7	27.3	28.0	28.0
EBITDA margin	11.8	13.1	14.0	16.9	12.8	14.9	15.5	15.5
Operating-profit margin	10.4	11.5	12.5	15.7	10.7	10.5	11.3	11.6
ROAE	38.3	35.5	37.8	61.4	62.5	67.9	60.5	52.0
ROAA	21.1	20.8	23.0	30.6	20.7	20.8	21.7	20.7
ROCE	42.8	41.3	44.1	66.7	51.6	47.6	46.3	44.9
ROIC	30.7	29.2	33.4	73.7	55.0	41.9	47.4	51.0
Net debt to equity	5.2	0.0	net cash	net cash	48.0	24.4	net cash	net cash
Effective tax rate	31.2	31.4	28.0	21.2	19.8	17.0	17.5	22.5
Accounts receivable (days)	9.1	11.2	6.6	3.0	2.3	5.0	7.6	8.6
Payables (days)	39.0	41.8	42.2	61.7	84.1	79.9	72.2	66.1
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	39.6	39.2	31.2	98.4	108.8	46.1	49.7	52.7

Source: Company, Daiwa forecasts

■ Company profile

Hero MotoCorp Limited (erstwhile Hero Honda Motors Limited) is the largest two-wheeler company in the world with domestic motorcycle market share of ~55% in FY11. Its best-selling brands include Splendor and Passion. With a combined capacity of 6.2m units, the company has plants in Dharuhera, Gurgaon and Uttaranchal. Honda Motor Co., JV partner of over 25 years, exited the company in December 2010.

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