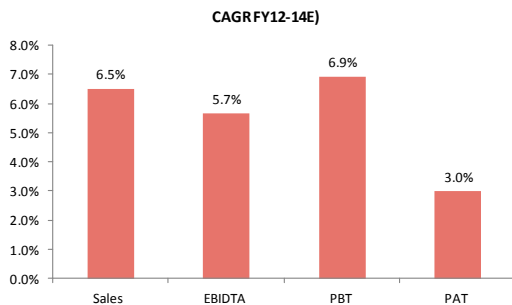


**Automobile  
Sector Outlook - Positive**



Stock Recommendation	Neutral
CMP (₹)	1795
Price Target (₹)	1894
Upside	6
52 Week H / L ₹	2278/1703
BSE 30	18710

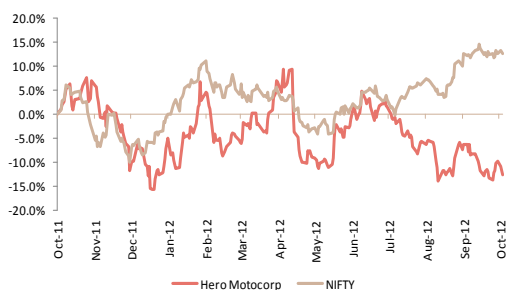
**Key Data**

No. of Shares, Mn.	199.7
Mcap, ₹ Mn	358425.6
Mcap, USD Mn @ ₹53	6516.8
2 W Avg Qty (BSE+NSE) Mn	0.3

**Share holding, Sept'12**

Promoters	52.2
FII	32.3
DII	6.7
Public & Others	8.8

Performance	1 M	3 M	6 M	12 M
Stock Return %	-3.8	-12.2	-16.5	-12.7
Relative Return %	-6.7	-22.0	-24.6	-25.4



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**Reported PAT at ₹4.40bn – against estimates of ₹4.25bn**

HMCL reported Q2FY13 results broadly in line with estimates. Revenue declined by 11% YoY to ₹51.9bn (v/s expectation of ₹50.9bn) due to 13.7% decline in volumes. Although 15% increase in revenue from high margin spare parts segment to ₹c4bn cushioned the fall to some extent in overall revenue. EBIDTA declined by 21.6% to ₹7.19bn (v/s expectation of ₹7.14 bn). EBIDTA margin contracted by 180 bps YoY to 13.9% (against expectation of 14%). PAT declined by 27.0% YoY to ₹4.40 bn (against expectation of ₹4.25 bn). Going forward management expects healthy volume uptick during festive season, however indicated for a 5-6% growth in two wheeler industry in FY13 (against earlier expectation of 10% growth).

**Passion xPro will be available in the market before Diwali**

The competition is expected to rise further as BAL is expected to launch one new motorcycle in 100cc segment in coming months. Further HMCL has also started dispatching its new motorcycle – Passion xPro, which will be available in the market before Diwali. Although we do not expect HMCL to lose its leadership position in near term, we believe that rising competition and high base effect will limit its volume growth (unless it will expand its addressable market and attain success in export market. Currently export contributes 2-3% to the total HMCL volumes). It is to be noted that HMCL has lost 263 bps YoY market share during Sep Ytd FY13 on account of lower dispatch due to higher inventory in the system and intensified competition in the 2 wheeler segment.

**Maintain Neutral rating on the stock with target price of ₹1894**

We continue to remain Neutral on HMCL on account of rising competition in the domestic market, lack of visibility of growth in export volumes (or addressable market) and high base effect for volume growth coupled with higher dependence of profitability on volumes. Although festive season is expected to be healthy for HMCL, visibility for sustainable volume growth is still some time away. We revised our earnings estimates downward by 4.9%/9.6% to ₹116/₹126.3 for FY13E/FY14E. Post revision in our earnings estimates we reduced our target price to ₹1894 (from 2,096). At our target price stock would trade at 16.3x FY13E and 15x FY14E EPS.

Financials	Revenues ₹mn	EBIDTA ₹mn	APAT ₹mn	EPS ₹	P/E x	EV/EBIDTA x	ROAE %
FY11	193979	26125	20077	96.5	18.6	12.5	65
FY12	235790	36188	23781	119.1	15.1	9.3	66
FY13E	236329	35302	23171	116.0	15.5	9.0	47
FY14E	267415	40400	25220	126.3	14.2	7.6	41

Source: Company, Sunidhi Research

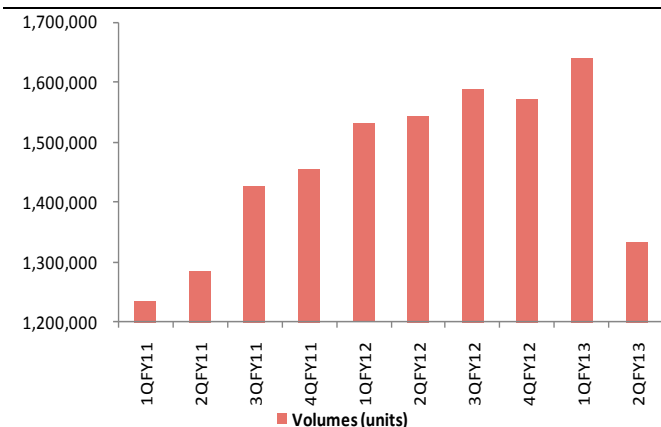


## Quarterly Financials

	Q2FY13	Q2FY12	YoY growth	Q1FY13	QoQ growth	Ytd FY13	Ytd FY12	YoY growth
Net Sales	51875	58262	-11.0%	62473	-17.0%	114347	115079	-0.6%
Expenditure	44683	49091	-9.0%	53104	-15.9%	97787	97627	0.2%
Materials Consumed	37702	42237	-10.7%	46026	-18.1%	83727	84685	-1.1%
% of sales	72.7%	72.5%		73.7%		73.2%	73.6%	
Employee Cost	1922	1794	7.1%	2046	-6.1%	3968	3439	15.4%
% of sales	3.7%	3.1%		3.3%		3.5%	3.0%	
Other Exp	5059	5060	0.0%	5032	0.5%	10092	9503	6.2%
% of sales	9.8%	8.7%		8.1%		8.8%	8.3%	
EBITDA	7192	9171	-21.6%	9369	-23.2%	16561	17452	-5.1%
EBITDA margin (%)	13.9%	15.7%	-11.9%	15.0%	-7.6%	14.5%	15.2%	-4.5%
Depreciation	2895	2785	4.0%	3035	-4.6%	5930	5183	14.4%
EBIT	4297	6386	-32.7%	6334	-32.2%	10631	12269	-13.4%
Other Income	993	888	11.9%	1044	-4.9%	2038	1826	11.6%
Interest expenses	30	29	1.4%	29	0.7%	59	155	-61.9%
PBT	5261	7245	-27.4%	7349	-28.4%	12610	13940	-9.5%
Tax	855	1208	-29.3%	1194	-28.4%	2049	2325	-11.9%
Effective tax rate (%)	16.3%	16.7%	-2.6%	16.3%	0.0%	16.3%	16.7%	-2.6%
Reported PAT	4406	6036	-27.0%	6155	-28.4%	10560	11615	-9.1%
Net Margin (%)	8.5%	10.4%		9.9%		9.2%	10.1%	
EPS	22.1	30.2	-27.0%	30.8	-28.4%	52.9	58.2	-9.1%

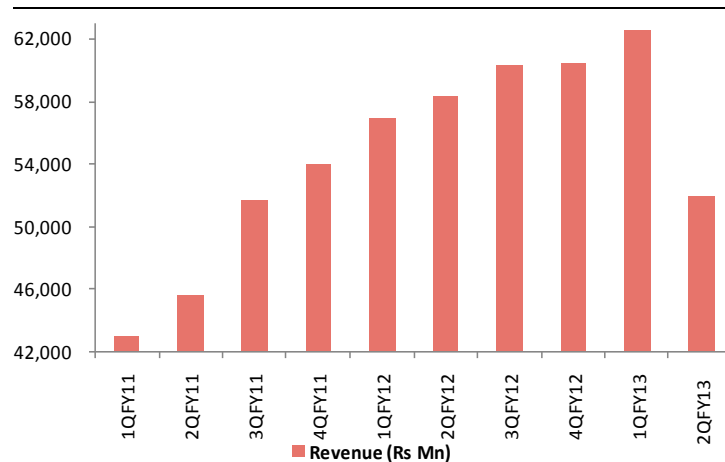
Source: Company, Sunidhi Research

Exhibit 1: Quarterly volume trend



Source: Company, Sunidhi Research

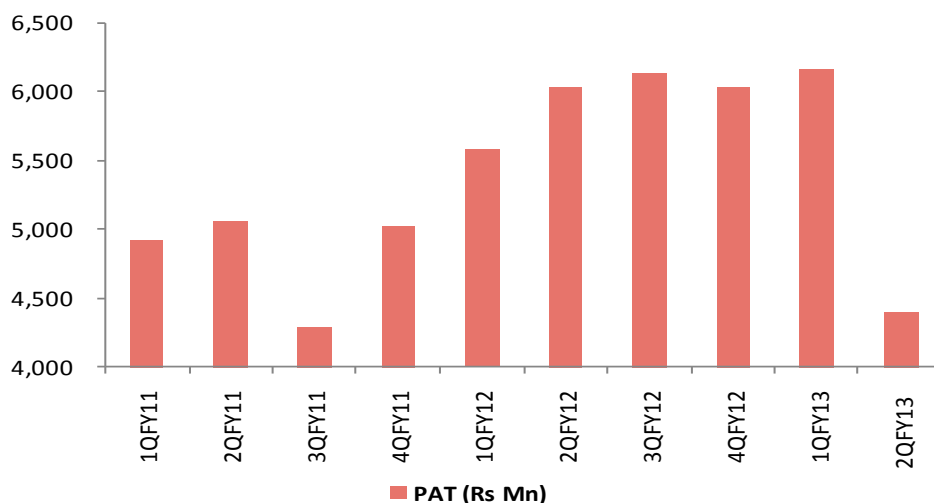
Exhibit 2: Quarterly revenue trend



Source: Company, Sunidhi Research



Exhibit 3: Quarterly PAT trend



Source: Company, Sunidhi Research

### HMCL lost 262 bps mkt share due to rise in competition and high inventory

During the quarter HMCL lost 262 bps YoY market share (to 42.69%) largely due to lower dispatch (led by higher inventory in the system and slow off take at dealer's level) and intensified competition (largely from HMSI). With the launch of Dream Yuga, HMSI has gained significant market share in the domestic two wheeler segment. HMSI's market share stood at 19.03% in Ytd Sep FY13 against 13.19% in Ytd Sep FY12.

### Planning to enter into export market and government slashed DEPB rate

It is to be highlighted that assuming other things constant, HMCL would not be able to generate the profitability from export volumes, which BAL had generated in its earlier years as export benefits has been slashed down. Even though HMCL has been planning to enter into the export market, it will not be able to accrue the benefit of export incentives, given DEPB benefit has been reduced from 9% (till Sep 2011) to 2% (in Oct 2012) .It is to be noted that BAL had availed healthy export incentives in past, which offered 1.5-2.5% point additional EBIDTA margin to BAL.

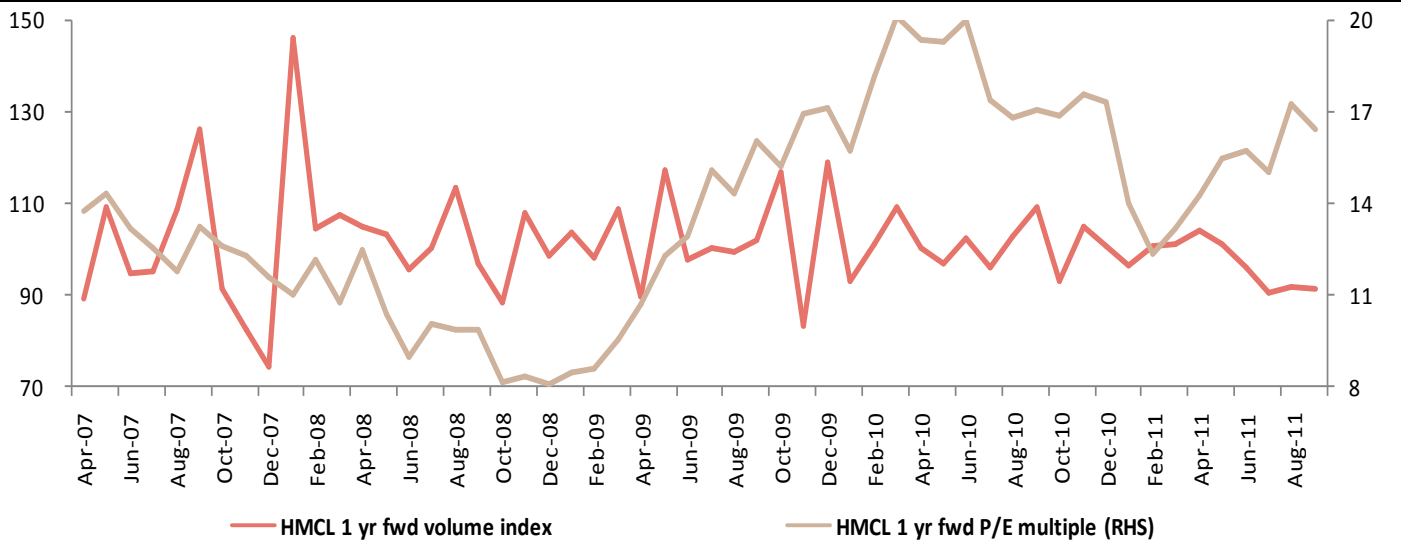
### Stock re rated earlier led by stimulus packages

Given the higher dependency of profitability on volumes, we believe that the significant volume growth is pre-requisite for a sharp revival in earnings and re-rating of the stock. Before Q2FY12, HMCL had registered 4% decline in volumes (in a quarter) in Q3FY09 and it has been coincided by a re-rating of the stock in Q4FY09. The re-rating of the stock in Q4FY09 was led by the stimulus package offered by the government in Dec 08 and Feb 09, which helped HMCL to gain volume growth in subsequent quarters. Further HMCL's stock was traded at a significant premium during Q4FY10 to Q3FY11 coincided by the significant higher dividend payout for FY10 and FY11, given dividend payout ratio (including extraordinary dividend) stood at 98% 108% for FY10/FY11, which subsequently reduced to 37.8% in FY12.



With no indication of any kind of stimulus package to be announced in near future, high base effect, rising competition and dividend payout ratio is expected to be in the range of 40% both for FY13E and FY14E, considerable re rating of the stock appears to be delayed.

HMCL's 1 yr fwd P/E multiple v/s 1 yr fwd volume index



Source: Company, Sunidhi Research

### Concall extracts:

#### Healthy performance during festive season

- The management observes healthy recovery in two wheeler sales during festive season ( Navratri / Dushera period).
- Average sales per day during shradha paksha were 10k units per day.
- Average sales per day during Navratri were 26k units per day.
- The management expects to sell more than 500k units in October ( due to Navratir/ Dushera)

#### Outlook

- Two- wheelers segment is expected to grow by 5-6% in FY13E.
- HMCL aims to grow its volumes in line with the industry
- The management does not want to increase production or capacities without having a visible sign of upsurge in the industry.
- HMCL has started dispatching Passion xPro, which is likely to be available in the market before Diwali.

#### Finance penetration

- Finance penetration in HMCL volumes is 20%.
- HMCL is not offering any discount or freebies to increase two wheeler volumes.

**Increased prices**

- Increased prices by ₹300 across the model due to increase in diesel prices
- No price hike during Q2FY13.
- 6.99% financing scheme in association with HDFC is for festive season only.
- HMCL is not offering any interest subvention

**Inventory in the system**

- Inventory in the system stood at 4 weeks (c600k units)

**Revised earning downward by 4.9%/9.6% for FY13E/FY14E**

Although festive season is expected to be healthy for HMCL, visibility for sustainable volume growth is some time away. We revised our earnings estimates downward by 4.9%/9.6% to ₹116/₹126.3 for FY13E/FY14E. Even in our revised earnings estimates we assume improvement in two wheeler volumes in H2FY13E and FY14E, which are subjected to downward risk if macro factors will not turn positively from here on and monsoon situation will not improve in FY14E (given HMCL generates 46% of its volumes from rural segment).

**Revision in earnings estimates**

	Old		New		% change	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Volumes	6,383,308	7,145,115	6,138,282	6,736,115	-3.8%	-5.7%
Revenue	245,408	283,742	236,329	267,415	-3.7%	-5.8%
EBIDTA	36,729	43,539	35,302	40,400	-3.9%	-7.2%
EBIDTA %	15.0%	15.3%	14.9%	15.1%		
PAT	24,356	27,907	23,171	25,220	-4.9%	-9.6%
EPS	122.0	139.7	116.0	126.3	-4.9%	-9.6%

**Retain Neutral rating with target price of ₹1,894**

We continue to remain Neutral on HMCL on account of rising competition in the domestic market, lack of visibility of growth in export volumes (or addressable market) and high base effect for volume growth coupled with higher dependence of profitability on volume growth.

Given the downward earnings revision (due to sluggishness in domestic two wheeler segment), and high base effect (for volume growth), we do not foresee a significant re-rating of stock in near term. We believe that the improvement in the visibility for export volume growth (or expansion of addressable market opportunity) and commissioning of its new capacity (in Gujarat and Rajasthan) with road map of capacity utilization, will be the trigger for re-rating of the stock.

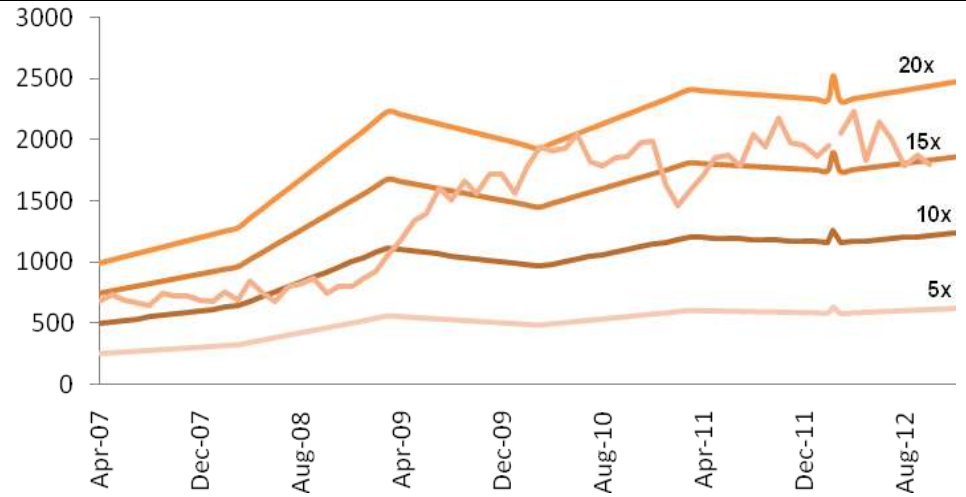
Post revision in our earnings estimates we reduced our target price to ₹1894 (from 2,096). At our target price stock would trade at 16.3x FY13E EPS of ₹116 and 15x FY14E EPS of ₹126.3. We prefer to look stock during correction and at lower valuations.



**Bull- bear case scenario**

FY14E	Volumes	EBIDTA %	EPS	Multiple	Tgt price
Bear case	6,399,310	15.1%	118.6	14	1660
Base case	6,736,115	15.1%	126.3	15	1894
Bull case	7,072,921	15.1%	134.0	16	2144

**HMCL 1 yr forward P/E multiple trend**



Source: Company, Sunidhi Research



## Valuations Summary

Year End-March	FY11	FY12	FY13E	FY14E
<b>Per share (₹)</b>				
EPS	96.5	119.1	116.0	126.3
CEPS	116.7	174.0	175.1	190.6
BVPS	148.0	214.8	276.9	344.5
DPS	105.0	45.0	46.4	50.5
Payout (%)	108.8	37.8	40.0	40.0
<b>Valuation (x)</b>				
P/E	18.6	15.1	15.5	14.2
P/BV	12.1	8.4	6.5	5.2
EV/EBITDA	12.5	9.3	9.0	7.6
Dividend Yield (%)	5.8	2.5	2.6	2.8
<b>Return ratio (%)</b>				
EBIDTA Margin	13.5	15.3	14.9	15.1
PAT Margin	9.9	10.1	9.8	9.4
ROAE	65.2	65.6	47.2	40.6
ROACE	51.4	56.3	45.7	44.3
<b>Leverage Ratios (x)</b>				
Long term D/E	0.5	0.2	0.2	0.1
Net Debt/Equity	0.5	0.2	-0.1	-0.2
Interest Coverage	203.9	205.9	188.1	212.9
Current ratio	1.0	1.1	1.6	1.7
<b>Growth Ratios (%)</b>				
Income growth	23.0	21.6	0.2	13.2
EBITDA growth	-1.9	38.5	-2.4	14.4
PAT growth	-13.6	23.4	-2.6	8.8
<b>Turnover Ratios</b>				
F.A Turnover x	3.5	3.7	3.5	3.0
Inventory Days	9.9	10.5	10.3	10.3
Debtors Days	2.5	4.2	4.0	2.0
Payable days	45.1	41.9	37.6	37.7
<b>Income Statement(₹ mn)</b>				
Year End-March	FY11	FY12E	FY13E	FY14E
Revenues	193979	235790	236329	267415
Op. Expenses	167854	199603	201027	227015
EBITDA	26125	36188	35302	40400
Other Income	2896	3646	4675	5464
Depreciation	4024	10973	11789	12841
EBIT	24998	28860	28188	33024
Interest	152	213	271	271
PBT	24846	28647	27917	32753
Tax	4769	4866	4746	7533
PAT	20077	23781	23171	25220
Minority	-	-	-	-
Prior Period Adj	-	-	-	-
Sh. of Associates	-	-	-	-
Ex. ordinary	-	-	-	-
Adj Pat	20077	23781	23171	25220

Source: Company, Sunidhi Research

## Balance Sheet (₹ mn)

Year End-March	FY11	FY12	FY13E	FY14E
<b>Equity and Liabilities</b>				
Share Capital	399	399	399	399
Reserves and Surplus	29161	42499	54898	68393
<b>Total Shareholders funds</b>	<b>29561</b>	<b>42898</b>	<b>55297</b>	<b>68793</b>
<b>Minority Interest</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Non-Current Liability</b>				
Long Term Borrowings	14710	10114	10114	10114
Deferred Tax Liabilities (Net)	2468	2083	2083	2083
Long Term Liab/ Provisions	<b>357</b>	<b>380</b>	<b>380</b>	<b>380</b>
<b>Current Liabilities</b>				
Short Term Borrowings	-	-	-	-
Trade Payables	20733	22932	20719	23445
Other Current Liabilities	<b>28980</b>	<b>9962</b>	<b>9065</b>	<b>10257</b>
Short Term Provisions	<b>10454</b>	<b>10521</b>	<b>9712</b>	<b>10990</b>
<b>Grand Total</b>	<b>107263</b>	<b>98889</b>	<b>107370</b>	<b>126061</b>
<b>Assets</b>				
<b>Non Current Assets</b>				
<b>Fixed Assets</b>	<b>41302</b>	<b>38244</b>	<b>29955</b>	<b>38614</b>
Deferred Tax Assets	-	-	-	-
Non-Current Investments	4655	6740	6740	6740
Other non current assets	<b>3423</b>	<b>5336</b>	<b>5336</b>	<b>5336</b>
Trade Receivables	164	260	260	260
<b>Current Assets</b>				
Current Investments	<b>46633</b>	<b>32903</b>	<b>35903</b>	<b>38903</b>
Inventories	<b>5249</b>	<b>6756</b>	<b>6638</b>	<b>7515</b>
Trade Receivables	<b>1306</b>	<b>2723</b>	<b>2590</b>	<b>1465</b>
Cash and Cash Equivalents	<b>715</b>	<b>768</b>	<b>14769</b>	<b>21366</b>
Short Term Loans and Advances	<b>3447</b>	<b>4756</b>	<b>4532</b>	<b>5129</b>
Other Current Assets	<b>368</b>	<b>404</b>	<b>647</b>	<b>733</b>
<b>Grand Total</b>	<b>107263</b>	<b>98889</b>	<b>107370</b>	<b>126061</b>
<b>Cash flow Statement</b>				
Year End-March	FY11	FY12E	FY13E	FY14E
PBT	24846	28647	27917	32753
Depreciation	4024	10973	11789	12841
Interest Exp	152	213	271	271
Others	-	-	-	-
<b>CF before W.cap</b>	<b>25506</b>	<b>36331</b>	<b>39977</b>	<b>45864</b>
Inc/dec in W.cap	1847	-6906	-3687	4761
Op CF after W.cap	27354	29424	36289	50626
Less Taxes	4769	4866	4746	7533
Exceptional & Prior Period Adj	-43	-961	-	-
<b>Net CF From Operations</b>	<b>22542</b>	<b>23598</b>	<b>31543</b>	<b>43092</b>
Inc/(dec) in F.A + CWIP	-9963	15047	-3500	-21500
others	-3260	-14119	-3000	-3000
<b>CF from Invst Activities</b>	<b>-13223</b>	<b>928</b>	<b>-6500</b>	<b>-24500</b>
Loan Raised/(repaid)	-	-	-	-
Equity Raised	-	-	-	-
Dividend	-9401	-24369	-10772	-11724
Others	-152	-213	-271	-271
<b>CF from Fin Activities</b>	<b>-9552</b>	<b>-24582</b>	<b>-11043</b>	<b>-11995</b>
<b>Net inc /(dec) in cash</b>	<b>-234</b>	<b>-56</b>	<b>14000</b>	<b>6597</b>
Op. bal of cash	626	715	768	14769
Others	323	109	-	-
<b>Cl. balance of cash</b>	<b>715</b>	<b>768</b>	<b>14769</b>	<b>21366</b>



## Sunidhi's Rating Rationale

The price target for a **large cap stock** represents the value the analyst expects the stock to reach over next 12 months. For a stock to be classified as **Outperform**, the expected return must exceed the local risk free return by at least 5% over the next 12 months. For a stock to be classified as **Underperform**, the stock return must be below the local risk free return by at least 5% over the next 12 months. Stocks between these bands are classified as **Neutral**.

(For Mid & Small cap stocks from 12 months perspective)

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BUY	Absolute Return >20%
ACCUMULATE	Absolute Return Between 10-20%
HOLD	Absolute Return Between 0-10%
REDUCE	Absolute Return 0 To Negative 10%
SELL	Absolute Return > Negative 10%

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Apart from Absolute returns our rating for a stock would also include subjective factors like macro environment, outlook of the industry in which the company is operating, growth expectations from the company vis a vis its peers, scope for P/E re-rating/de-rating for the broader market and the company in specific.

## SUNIDHI SECURITIES & FINANCE LTD

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