

Hero Motocorp

Add

Slowdown impacting volume growth

CMP: Rs2,086

Target Price: Rs2,116

HMCL's results were in line with our estimates. Revenue went up 10% yoy at Rs62.5bn (estimated Rs62.4bn) led by a 7% volume growth and 2% realisation growth. PAT was up 10% yoy, 2% qoq at Rs6.1bn (estimated Rs6.3bn) due to lower raw material and finance costs. The company expects to maintain EBITDA margin of 15% through FY13. Due to rising pressure on the two-wheeler industry, we downgrade volume estimates by 3% and 2%, and earnings estimates by 8% and 4% for FY13 and FY14 respectively. We value HMCL at 16x to arrive at our new target of Rs2,116 (earlier Rs2,304) and maintain our Add rating.

Dominance in entry-level bikes helps growth: Q1 volume grew 7% yoy to 1.64mn and realisation increased 2% (down 1% qoq) to Rs38,042 per vehicle. Dominance in fuel-efficient entry- and executive-bike segments helped it to grow in an otherwise tepid market. Contribution from rural markets is at 45% and exports grew 16% yoy. It had hiked prices in India in May, which helped support realisations.

Raw material cost decline, EBITDA margin steady at 15%: A 104bps fall in raw material cost as a % of net sales and lower advertisement expenditure led to an EBITDA of Rs9.4bn (up 1% qoq, down 5% yoy) and margin of 15%. It expects to maintain this margin level through FY13, though in Q2 (due to planned increase in advertising and marketing expenditure) it may dip to some extent.

PAT up 10% yoy; last year of Haridwar tax exemption: Reported PAT was Rs6.1bn, up 10% yoy (2% qoq) backed by higher volume, steady margin, and lower tax rate. Other income grew 12% yoy to Rs1bn. Tax rate in Q1 was 16.2% and guidance for FY13 is ~16.5%. The rate will rise in FY14 once tax exemptions at its Haridwar plant reduce to 30% from current 100%.

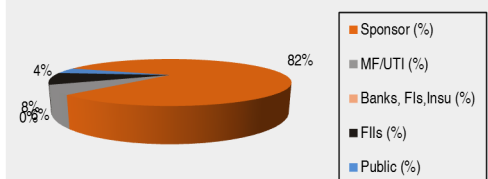
- Corporate development
- Earnings estimate change
- Target price change
- Rating change

KEY DATA

Bloomberg	HMCL IN
Reuters	HROM.BO
52-wk H/L (Rs)	2,279.0/1,702.7
6-m avg trd value	US\$18.7mn
Market cap	Rs416.6bn/US\$7.5bn
Shares o/s	199.7mn
Face value	Rs2

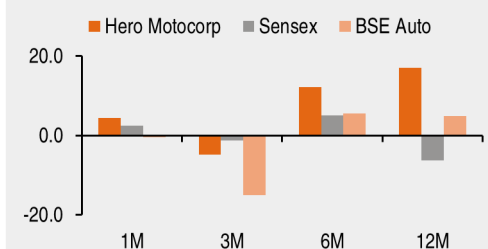
Source: Bloomberg

SHAREHOLDING (%)



Source: Ace equity

RELATIVE PRICE PERFORMANCE



Source: Bloomberg

KEY FINANCIALS	(Rs mn)			
Y/E 31 March	2011	2012E	2013E	2014E
Revenue	194,012	235,790	260,369	300,359
EBITDA	26,148	36,168	40,000	46,788
EBITDA margin (%)	13.5	15.3	15.4	15.6
PAT	20,077	23,783	26,417	32,340
FDEPS (Rs)	100.5	119.1	132.3	161.9
% growth	(9.1)	18.5	11.1	22.4
P/E (x)	20.7	17.5	15.8	12.9
RoCE avg (%)	49.7	48.1	44.0	40.4

Source: Company, BRICS Research

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Exhibit 1: Quarterly performance**(Rs mn)**

Particulars	Q1FY13	Q1FY13	Difference	Q1FY12	yoy %	Q4FY12	qoq %
	Actual	Estimate					
Sales	62,473	62,412	0.1	56,817	10.0	60,349	3.5
EBITDA	9,369	9,887	(5.2)	8,281	13.1	9,253	1.3
EBITDA %	15.0	15.8	(84.6bps)	14.6	42.1bps	15.3	(33.5bps)
Depreciation	3,035	2,924	3.8	2,398	26.6	2,804	8.2
Other income	1,044	954	9.5	938	11.4	1,050	(0.5)
PBT	7,349	7,931	(7.3)	6,696	9.8	7,469	(1.6)
Tax	1,194	1,586	(24.7)	1,117	6.9	1,433	(16.7)
PAT	6,155	6,345	(3.0)	5,579	10.3	6,036	2.0
EPS (Rs)	30.8	31.8	(3.0)	27.9	10.3	30.2	2.0

Source: Company, BRICS Research

Exhibit 2: Physical performance**(units)**

Particulars	Q1FY13	Q1FY12	yoy	Q4FY12	qoq
Volume	1,642,201	1,529,577	7.4	1,572,027	4.5
Realisation (Rs/vehicle)	38,005	37,146	2.3	38,389	(1.0)
Domestic	1,595,625	1,491,162	7.0	1,530,436	4.3
Exports	44,665	38,415	16.3	41,591	7.4

Source: Company, BRICS Research

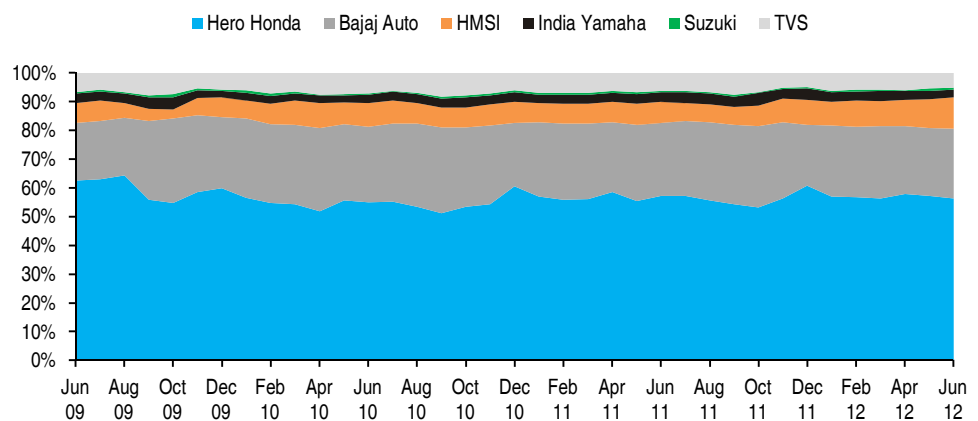
Conference call highlights

- Does not expect the industry to grow above 10% in FY13.
- Inventory levels have increased to 3-4 weeks compared to 2 weeks. The company expects these to come down after the launch of its new sales campaign in Q2.
- Prices were hiked by Rs500-1,000 in May 2012 to offset raw material price increase (lag effect) to cushion its margin.
- Royalty paid in Q1FY13 was Rs2.2bn.
- Rural contribution to sales has held firm at 45% of revenue – the company is of the opinion that the rural market is showing greater resilience than urban.
- Scooter segment growth in Q1 was slow due to capacity constraints. However, with capacity additions for *Maestro* done, it expects to grow at a faster clip in Q2.
- East is proving to be the fastest growing market, followed by south, north and west.
- Plans to start exports to Africa and Latin America are on track. Has identified countries and business partners and completed region-specific product modifications. Expects exports to begin to these regions in CY12 and has set export target of 1mn units in FY17.
- Marketing expenditure as a % of net sales has been maintained at ~2% over the years. This expense fell in Q1, but since it plans to launch fresh versions of its 150cc models in Q2, it will rise.
- Expects commodity prices to soften, but a weak rupee is likely to adversely affect it.

- Announced cash capex of Rs25bn for plants at Neemrana, Rajasthan (at Rs4bn), Gujarat (at Rs11bn) and R&D centre (Rs5bn) to be spread over FY13 and FY14.
- Is open to acquisitions and alliances to build up its R&D expertise. It has entered into technological partnerships with Eric Buell, AVL and also hired expats. As of June 2012, it has grown its R&D engineer headcount to 300.
- Q1 other income (Rs1bn+) was primarily from treasury.

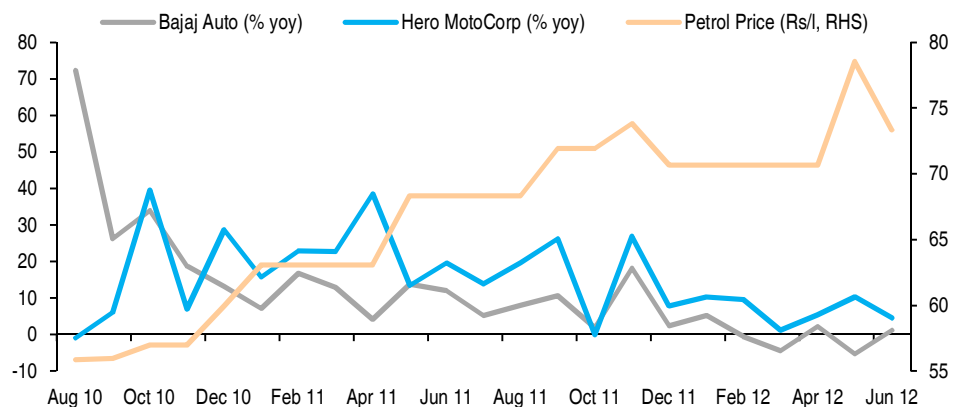
High interest rates and fuel cost impacting domestic sales: Due to high interest rates and fuel costs over the last year, two-wheeler consumers are opting for more fuel-efficient vehicles within the segment. Entry and executive motorcycle fuel efficiency is generally high compared to premium motorcycles. So players like HMCL (which is dominant in entry and executive), is in an advantageous position. Due to a slowdown in the economy, low consumption in the urban markets, and higher cost of ownership, HMCL is gaining market share. We believe that until consumption in urban markets picks up, it will continue to clock higher sales.

Exhibit 3: Hero Motocorp motorcycle market share in FY12 75-125cc (%)



Source: Company, BRICS Research

Exhibit 4: Two wheeler yoy growth vs. petrol price



Source: SIAM, IOC, BRICS Research

Factoring slowdown in the overall industry

Cut volume estimates: Due to rising pressure (due to high cost of ownership) on two wheelers and impact on all players including Hero Motocorp, we cut volume estimates by 3% and 2% for FY13 and FY14 respectively. We estimate 10% and 13% volume growth for FY13 and FY14 respectively. We cut our earnings estimates for FY13 and FY14 by 8% to Rs132 and 4% to Rs162 respectively.

In the current economic environment, HMCL's positioning in entry and executive segment (market share of 75%) puts it ahead of peers. Although two-wheeler industry will continue to face pressures in FY13, we expect Hero Motocorp to outperform the industry as consumers will continue to prefer cheaper and fuel efficient motorcycles.

We believe two-wheeler growth will pickup in FY14 (12%) as penetration level is still low and purchasing power of Indian consumers will continue to rise.

Exhibit 5: Downgrade volume to factor in slowdown

	Old Estimates		New Estimates		% chg	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Total volume	7,037,898	7,896,522	6,861,951	7,770,178	(2.5)	(1.6)
Net Sales	269,012	304,232	260,369	300,359	(3.2)	(1.3)
EBITDA	43,456	48,943	40,010	46,803	(7.9)	(4.4)
EBITDA (%)	16.0	16.0	15.4	15.6	(63.3)	(41.8)
PAT	28,771	33,645	26,417	32,340	(8.2)	(3.9)
EPS (Rs)	144.0	168.0	132.3	161.9	(8.1)	(3.6)

Source: BRICS Research

Valuation: We value Hero MotoCorp at 16x to arrive at our new target of Rs2,116 (earlier Rs2,304). The stock trades at 16x FY13 and 13x FY14. We see its outperformance to the industry attracting a higher multiple and we maintain our Add rating on the stock.

Financial summary

Income statement					Balance sheet				
(Rs mn)					(Rs mn)				
Y/E 31 March	2011	2012E	2013E	2014E	Y/E 31 March	2011	2012E	2013E	2014E
Revenue	194,012	235,790	260,369	300,359	Net fixed assets	42,054	38,244	37,871	48,448
Revenue growth (%)	22.2	21.5	10.4	15.4	Investments	51,288	64,488	77,688	90,888
Operating exp	167,864	199,623	220,369	253,572	Current assets	15,046	20,781	25,419	35,163
EBITDA	26,148	36,168	40,000	46,788	Inventories	5,249	6,961	6,863	7,771
EBITDA margin (%)	13.5	15.3	15.4	15.6	Sundry debtors	1,306	3,602	2,893	3,337
Depreciation	4,024	10,973	12,373	12,423	Cash & bank balance	715	768	5,229	12,018
EBIT	22,124	25,194	27,627	34,365	Loans & advances	7,775	9,450	10,435	12,037
MTM profit / (loss)	—	—	—	—	Other current assets	—	—	—	—
Other income	2,681	3,646	4,194	4,636	Total assets	108,387	123,512	140,978	174,499
Interest paid	(19)	213	(384)	(423)	Net worth	29,561	42,898	60,130	83,284
PBT	24,824	28,627	32,206	39,424	Share capital	399	399	399	399
Tax	4,769	4,866	5,799	7,099	Reserves & surplus	29,161	42,499	59,730	82,884
PAT	20,077	23,783	26,417	32,340	Minority interest	—	—	—	—
Minority interest	—	—	—	—	Total debt	14,912	9,463	2,663	1,679
EO income	—	—	—	—	Secured loans	14,912	9,463	2,663	1,679
APAT	20,077	23,783	26,417	32,340	Unsecured loans	—	—	—	—
PAT growth (%)	(9.1)	18.5	11.1	22.4	Current liabilities & prov	61,448	68,682	75,717	87,068
Shares o/s (mn)	200	200	200	200	Current liabilities	50,637	60,219	66,720	76,771
Fully diluted o/s shrs (mn)	200	200	200	200	Provisions	10,811	8,464	8,997	10,297
FDEPS (Rs) recurring	100.5	119.1	132.3	161.9	Net deferred tax liab	2,468	2,468	2,468	2,468
					Total liabilities	108,387	123,512	140,978	174,499
Cash flow statement					Key ratios				
(Rs mn)									
Y/E 31 March	2011	2012E	2013E	2014E	Y/E 31 March	2011	2012E	2013E	2014E
PBT	24,824	28,627	32,206	39,424	Valuation ratios				
Depreciation	5,724	4,173	5,573	11,438	PE (x)	20.7	17.5	15.8	12.9
Amortisation	—	—	—	—	CEPS (Rs)	120.6	173.9	194.2	224.1
Interest paid	(19)	213	(384)	(423)	PCE (x)	17.3	12.0	10.7	9.3
Tax paid	—	—	—	—	BVPS (Rs)	148	215	301	417
Chg in working capital	8,557	1,553	6,856	8,397	Price/Book (x)	14.1	9.7	6.9	5.0
Int/div in other income	—	—	—	—	EV/EBITDA (x)	16.5	11.8	10.4	8.7
Other operations	—	—	—	—	EV/Revenue (x)	2.2	1.8	1.6	1.4
CF from operations (a)	34,339	29,722	38,462	51,752	Dividend yield (%)	5.3	2.2	1.9	1.9
Capital expenditure	(29,009)	(7,163)	(12,000)	(23,000)	Cash flow yield (%)	1.3	5.4	6.4	6.9
Chg in investments	(12,030)	(13,200)	(13,200)	(13,200)	Performance ratios				
Other investing act	—	—	—	—	Raw material to sales (%)	73.3	73.8	72.4	71.1
Int/div in other income	—	—	—	—	SGA to sales (%)	—	—	—	—
CF from investments (b)	(41,039)	(20,363)	(25,200)	(36,200)	Effective tax rate (%)	19.2	17.0	18.0	18.0
Free cash flow (a+b)	5,330	22,559	26,462	28,752	PAT margin (%)	10.3	10.1	10.1	10.8
Equity raised/(repaid)	—	—	—	—	DPS (Rs)	110.0	45.0	40.0	40.0
Debt raised/(repaid)	(333)	—	—	—	Dividend payout ratio (%)	109	38	30	25
Interest paid	19	(213)	384	423	Return ratios				
Dividend (incl tax)	(25,262)	(10,334)	(9,186)	(9,186)	RoE avg (%)	62.5	65.6	51.3	45.1
Other fin activities	13,920	1,241	—	—	RoCE avg (%)	49.7	48.1	44.0	40.4
CF from financing (c)	(11,657)	(9,306)	(8,802)	(8,763)	Fixed asset turnover (x)	—	—	—	—
Net chg in cash (a+b+c)	(18,357)	53	4,460	6,789	Working capital ratios				
Opening balance	19,072	715	768	5,229	Inventory (days)	13	15	13	13
Closing balance	715	768	5,229	12,018	Payable (days)	95	93	94	93
					Receivable (days)	2	6	4	4
					Working capital (days)	(79)	(73)	(76)	(76)
					Leverage ratios				
					Interest cost (%)	—	—	—	—
					Net debt/equity (x)	0.5	0.2	—	(0.1)
					Interest coverage (x)	(1,195.9)	118.3	(71.9)	(81.2)

BRICS RECOMMENDATION SCALE

BUY:	More than 15% upside
ADD:	Upside up to 15% (between 0% and 15%)
REDUCE:	Downside up to 15% (between 0% and -15%)
SELL:	More than 15% downside

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