

Current Reco	: HOLD
Previous Reco	: BUY
CMP	: INR2,087
Target Price	: INR2,236
Potential Upside	: 7%

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**Market data**

Sector	: Automobiles
Market Cap (INRbn)	: 417
Market Cap (USDbn)	: 8
O/S Shares	: 200
Free Float (m)	: 93
52-wk HI/LO (INR)	: 2279/1703
Avg Daily Vol ('000)	: 237
Bloomberg	: HMCL IN

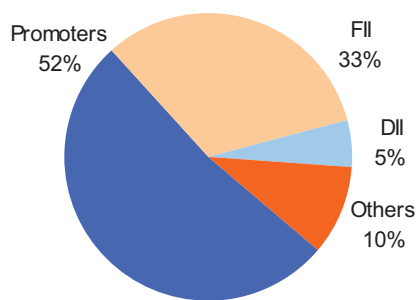
Source: Bloomberg

**Returns (%)**

	<b>1 m</b>	<b>3 m</b>	<b>6 m</b>	<b>12 m</b>
Absolute	4	(5)	10	17
Relative	2	(4)	6	26

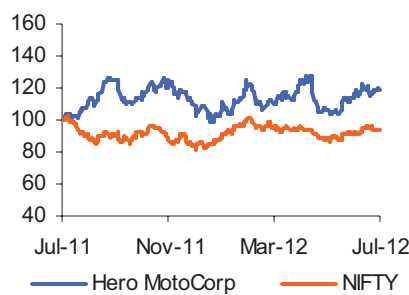
Source: Bloomberg

**Shareholding pattern**



Source: BSE

**Price performance vs Nifty**



Source: Bloomberg

1QFY13 RESULTS REVIEW

# Hero MotoCorp Limited

## Absence of near-term positive catalysts...

**Hero's 1Q results (PAT at INR6.15bn – up 10% YoY; 2% QoQ) missed our estimate by ~4%, primarily on account of lower other income. Adjusted margins at 10.9% (up 36bps YoY; 10bps QoQ) were broadly in-line with our estimate of 11%. Over the next few quarters, volumes are expected to remain subdued while margins too would trend lower due to adverse currency (total imports @14% of sales) and higher marketing spends (transition from Hero Honda to Hero for all models from next quarter). The same would coincide with a higher than normal capex phase as well. For the stock, besides the superior return ratios and eventual margin uptick in FY15, the only support for the bull was the higher dividend, which is unfortunately no more. Downgrade to HOLD!**

**1Q Results – Operationally in-line!**

- PAT at INR6.15bn (up 10% YoY; 2% QoQ) was 4% below our estimate of INR6.4bn (consensus – INR6.3bn) on the back of lower other income.
- Operationally, the results were in-line. The JPY denominated royalty payment to Honda stood at INR2.2bn this quarter as against INR2.05bn in 4Q. Adjusting for the same, EBITDA margins stood at 10.9% (up 36bps YoY; 10bps QoQ) – broadly in-line with our estimate of 11%.

**Margins – Before the eventual uptick (FY15), it will trend lower**

- In the near term, we expect margins to trend lower on the back of A) adverse currency impact from direct (5.5% of sales; USD denominated) and indirect (9.5% of sales; JPY denominated) imports; B) higher brand transition spends (full-fledged transition from Hero Honda to Hero for all models from next quarter) and C) Upcoming foray into export markets (which would dilute margins initially).

**Channel checks validate what we feared**

- We understand from dealers that the brand transition from Hero Honda to Hero hasn't been as smooth as earlier anticipated. In some rural pockets, few dealers mentioned that dropping the Honda badge from the Splendor has impacted conversions by ~5-7% (no impact on the Passion though).

**Absence of near-term positive catalysts... Downgrade to HOLD!**

- We can't ignore the clear cut margin improvement visible in FY15 (~300bps) simply from royalty savings and hence we continue to give a high weightage to the company's DCF value. However, in the absence of any positive catalyst in the near term, we expect the sluggish volume growth/margins to weigh on the stock performance. Hence we downgrade our reco from BUY to HOLD!

**Quarterly financials**

INRm	1QFY13	1QFY12	YoY (%)	4QFY12	QoQ (%)
Net Sales	62,078	56,376	10%	59,625	4%
EBITDA	6,774	5,951	14%	6,449	5%
EBITDA Margin (%)	10.9%	10.6%	36	10.8%	10
Reported PAT	6,155	5,579	10%	6,036	2%
Reported EPS (INR)	30.8	27.9	10%	30.2	2%
Total Volumes (In nos)	1,642,292	1,529,577	7%	1,572,027	4%
Net Realisation (INR)	37,799	36,858	3%	37,929	0%
EBITDA / Vehicle (INR)	4,124	3,890	6%	4,102	1%

Source: Company, Antique

## Financials

INRm	1QFY13	1QFY12	YoY (%)	4QFY12	QoQ (%)
<b>Net Sales</b>	<b>62,078</b>	<b>56,376</b>	<b>10</b>	<b>59,625</b>	<b>4</b>
- Raw Material	46,026	42,448	8	44,183	4
(% of Net Sales)	74	75	(115)	74	4
- Staff Expenditure	2,046	1,645	24	1,923	6
(% of Net Sales)	3	3	38	3	7
- Other Expenditure	7,232	6,333	14	7,071	2
(% of Net Sales)	12	11	42	12	(21)
Total Expenditure	55,304	50,426	10	53,177	4
<b>EBITDA</b>	<b>6,774</b>	<b>5,951</b>	<b>14</b>	<b>6,449</b>	<b>5</b>
<b>EBITDA Margin (%)</b>	<b>10.9</b>	<b>10.6</b>	<b>36</b>	<b>10.8</b>	<b>10</b>
Depreciation	835	628	33	724	15
<b>EBIT</b>	<b>5,939</b>	<b>5,323</b>	<b>12</b>	<b>5,725</b>	<b>4</b>
Interest	29	(32)	(192)	29	0
Other Income	1,439	1,341	7	1,774	(19)
<b>PBT</b>	<b>7,349</b>	<b>6,696</b>	<b>10</b>	<b>7,469</b>	<b>(2)</b>
Tax	1,194	1,117	7	1,433	(17)
<b>Reported PAT</b>	<b>6,155</b>	<b>5,579</b>	<b>10</b>	<b>6,036</b>	<b>2</b>
Reported EPS (INR)	30.8	27.9	10	30.2	2
<b>Total Volumes (In nos)</b>	<b>1,642,292</b>	<b>1,529,577</b>	<b>7</b>	<b>1,572,027</b>	<b>4</b>
<b>Net Realisation (INR)</b>	<b>37,799</b>	<b>36,858</b>	<b>3</b>	<b>37,929</b>	<b>(0)</b>
EBITDA / Vehicle (INR)	4,124	3,890	6	4,102	1

Source: Company, Antique

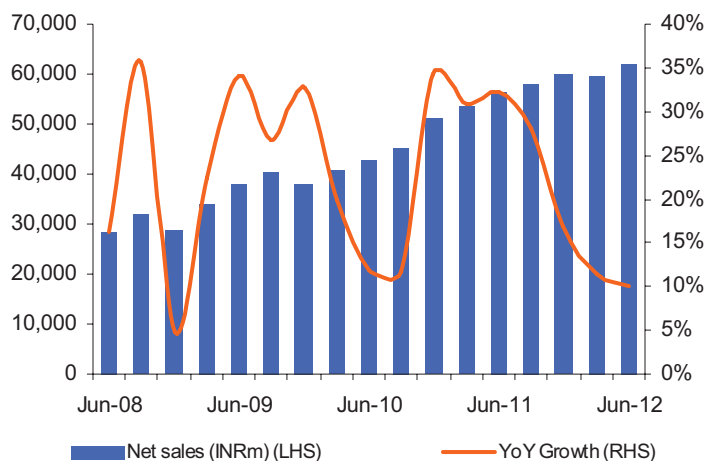
## Highlights during the quarter:

- Revenues were up 10% YoY (4% QoQ) on the back of a 7% YoY growth in volumes (up 5% QoQ) and 3% YoY growth in realisations (flat QoQ). Royalty expense for the quarter stood at ~INR2.2bn (as against INR2.05bn in 4QFY12) due to the JPY depreciation vis-à-vis the INR. After adding back this royalty cost to other expenses (otherwise included in depreciation), adjusted margins stood at 10.9% (up 36bps YoY; 10bps QoQ) as against our estimate of 11%.
- Gross margins were flattish QoQ. We assume that there would have been some relief on last quarter's indirect imports (when currency turned a tad favourable). Hero's forex exposure stands at 14% of sales which is broken up between 9.5% for indirect imports (JPY denominated) and 5.5% for direct imports (USD denominated). The currency impact on the same would be spread over the next two quarters
- PAT (at INR6.15bn - up 10% YoY; 2% QoQ) was 4% below our estimates of INR6.4bn (consensus – INR6.3bn) primarily on account of lower other income (up 7% YoY; down 19% QoQ).

### Key takeaways from the conference call:

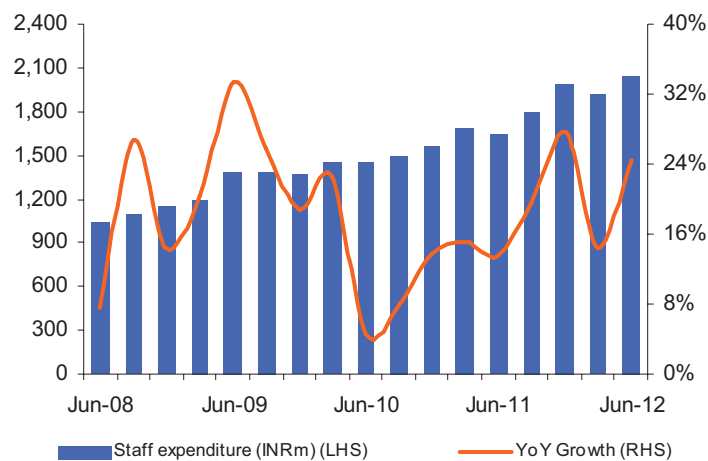
- Dealer inventory which used to be 2-3 weeks is currently at 4 weeks (across the industry).
- Marketing cost has been lower last quarter as the company is saving it for the coming quarter. The company would incur higher marketing costs going ahead as the transition from Hero Honda to Hero, on all remaining models, will commence from the next quarter onwards.
- Sequentially, realizations were flat (despite price hikes) due to the weaker product mix.
- Dividend payout will continue to remain at 40%-50% due to requirement of cash for exports and capex.
- Tax rate will trend lower in FY13 (to ~16%) vis-à-vis 17% in FY12, as the company continues to expand production in Haridwar (currently ~38% of production). Subsequently, post partial expiry of the Haridwar tax benefits, tax rates would increase to around 23-25% in FY14.

#### Revenues up 10% YoY, driven by 7% growth in volumes and 3% growth in realisation



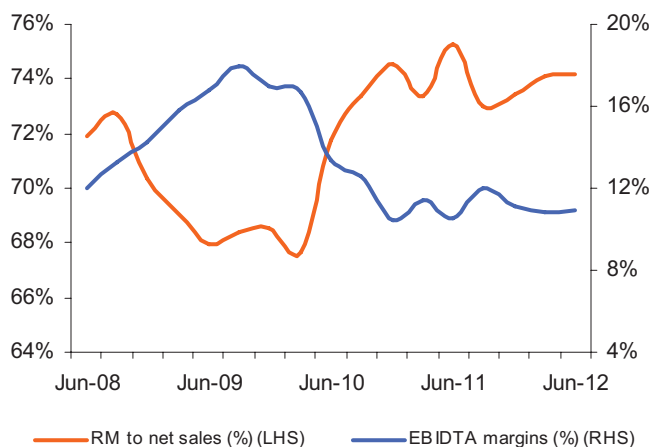
Source: Company, Antique

#### Staff expenditure up 24% YoY; down 6% QoQ



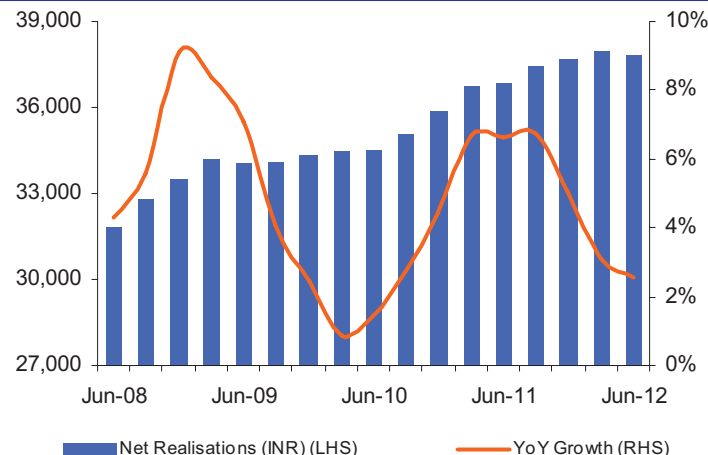
Source: Company, Antique

#### Margins expanded sequentially as there was some relief on last quarter's JPY denominated indirect imports (when currency turned a tad favourable)



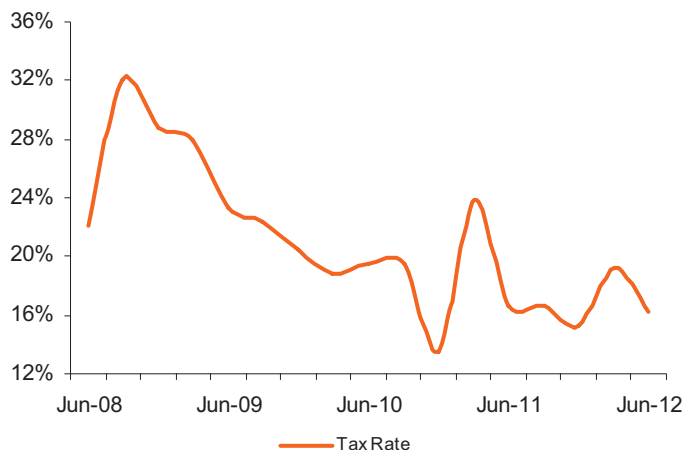
Source: Company, Antique

#### Realisations were flat QoQ (despite price hikes) due to a weaker product mix



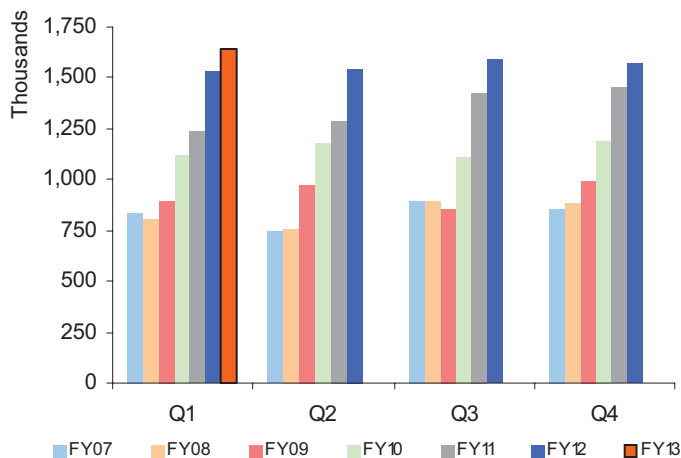
Source: Company, Antique

**Tax rate down 293 bps QoQ (43 bps YoY) due to higher contribution from the Haridwar plant (~38% of production)**



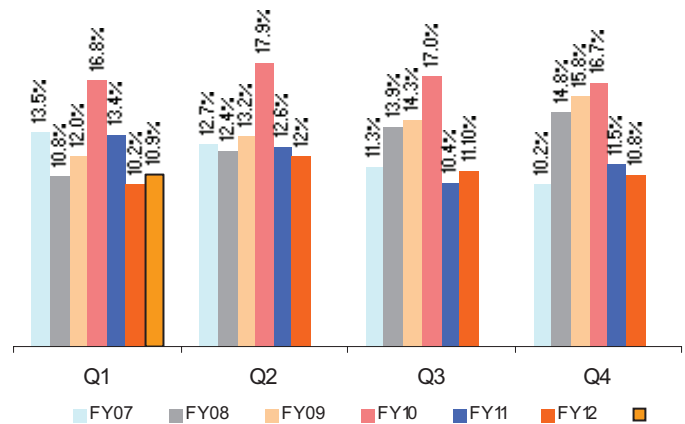
Source: Company, Antique

**Quarterly volumes trend**



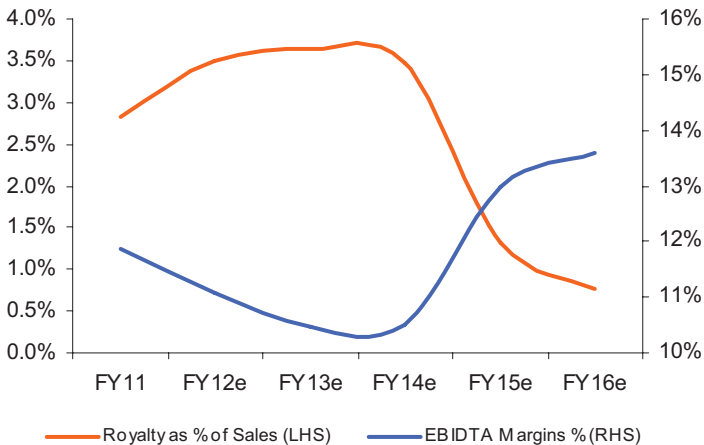
Source: Company, Antique

**EBIDTA margins trend**



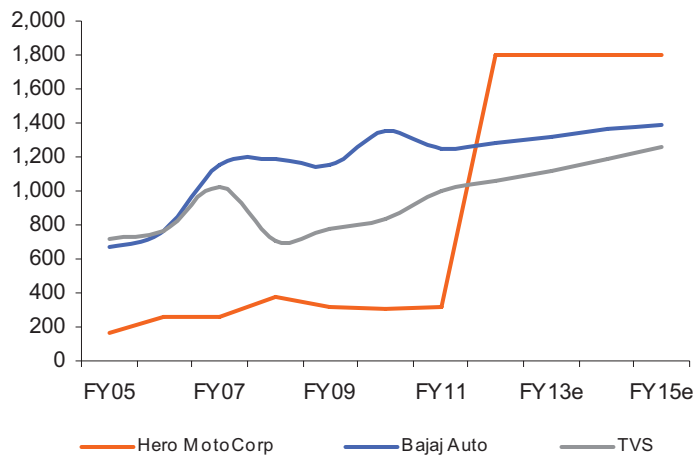
Source: Company, Antique

**Royalty savings will eventually kick-in to aid margin expansion in FY15**



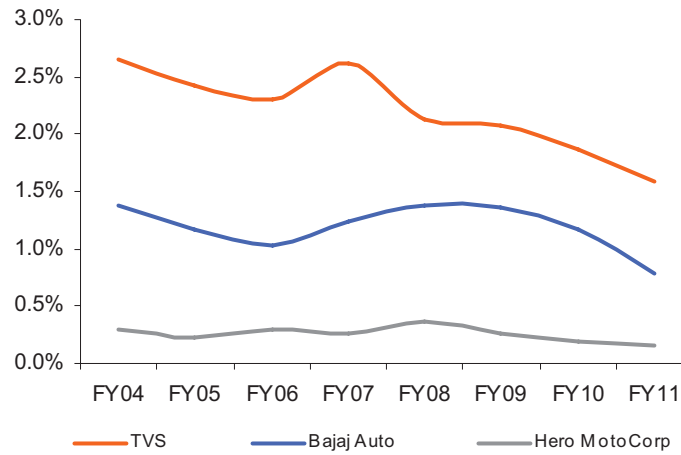
Source: Company, Antique

**R&D Expense (INRm)**



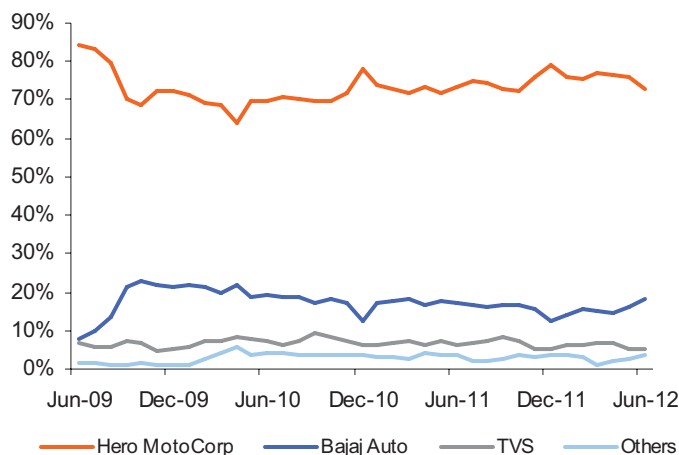
Source: Company, Antique

**R&D as % of net sales**



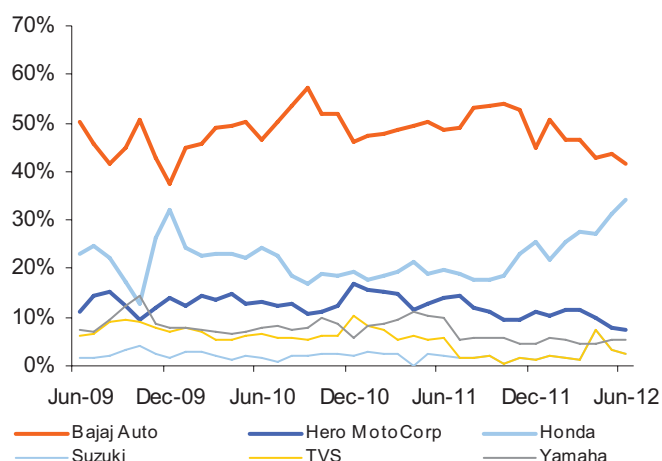
Source: Company, Antique

**75-125cc segment market share**



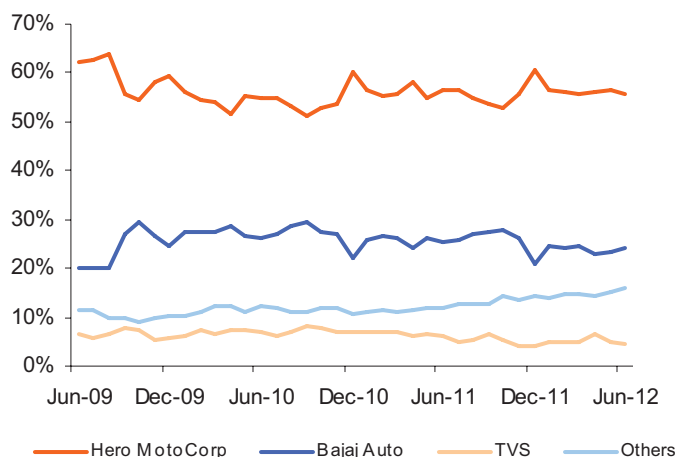
Source: Company, Antique

**125-250cc segment market share**



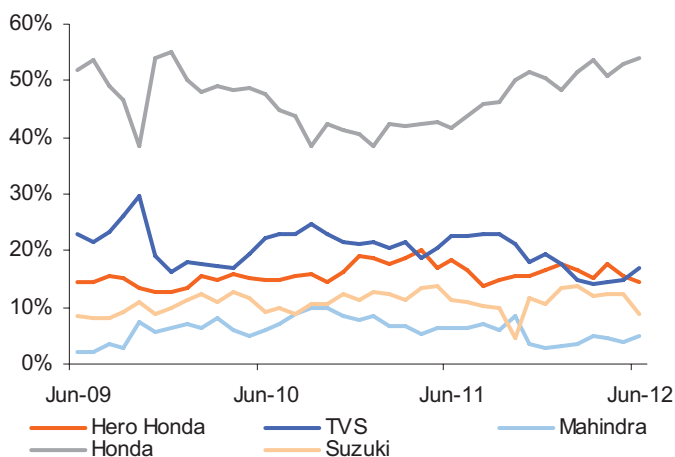
Source: Company, Antique

**Motorcycle market share**



Source: Company, Antique

**Scooter Segment - Market Share**



Source: Company, Antique

**Margins – Before the eventual uptick (FY15), it will trend lower**

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**Channel checks validate what we feared**

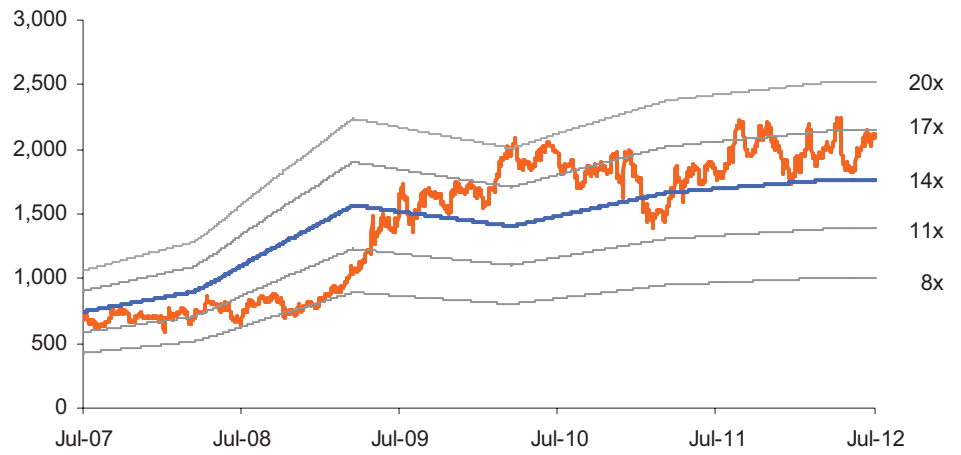
- We understand from dealers that the brand transition from Hero Honda to Hero hasn't been as smooth as earlier anticipated. In some rural pockets, few dealers mentioned that dropping the Honda badge from the Splendor has impacted conversions by ~5-7% (no impact on the Passion though).

**Absence of near-term positive catalysts... Downgrade to HOLD!**

- We can't ignore the clear cut margin improvement visible in FY15 (~300bps) simply from royalty savings and hence we continue to give a high weightage to the company's DCF value. However, in the absence of any positive catalyst in the

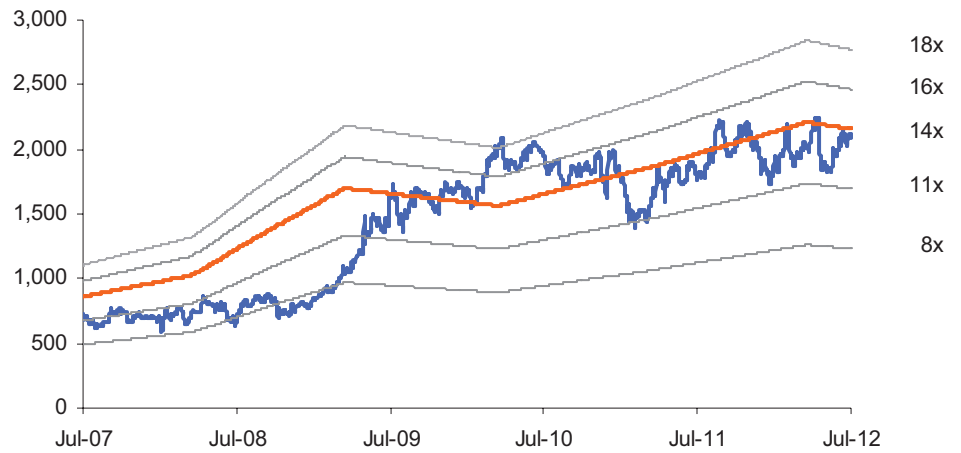
near term, we expect the sluggish volume growth/margins to weigh on the stock performance. Hence we downgrade our reco from BUY to HOLD with a target price of INR2,236.

**Hero MotoCorp - 1-year-forward PE band**



Source: Antique

**Hero MotoCorp - 1-year-forward CASH PE band**



Source: Antique

## Financials

### Profit and loss account (INRm)

Year ended 31 Mar	2010	2011	2012	2013e	2014e
Revenues	157,582	192,450	233,681	261,571	291,116
Expenses	130,962	169,618	207,773	234,205	260,536
<b>EBITDA</b>	<b>26,620</b>	<b>22,833</b>	<b>25,908</b>	<b>27,366</b>	<b>30,580</b>
Depreciation & amortisation	1,915	2,254	2,803	3,353	3,778
<b>EBIT</b>	<b>24,705</b>	<b>20,579</b>	<b>23,105</b>	<b>24,014</b>	<b>26,802</b>
Interest expense	(206)	(19)	213	201	189
Other income	3,406	4,249	5,756	6,446	7,091
Extraordinary Items	-	(798)	-	-	-
<b>Profit before tax</b>	<b>28,317</b>	<b>24,048</b>	<b>28,647</b>	<b>30,259</b>	<b>33,704</b>
Taxes incl deferred taxation	5,999	4,769	4,866	4,988	8,365
<b>Profit after tax</b>	<b>22,318</b>	<b>19,279</b>	<b>23,781</b>	<b>25,271</b>	<b>25,338</b>
<b>Adjusted PAT</b>	<b>22,318</b>	<b>20,077</b>	<b>23,781</b>	<b>25,271</b>	<b>25,338</b>
<b>Recurring EPS (INR)</b>	<b>111.8</b>	<b>100.5</b>	<b>119.1</b>	<b>126.5</b>	<b>126.9</b>

### Balance sheet (INRm)

Year ended 31 Mar	2010	2011	2012	2013e	2014e
Share Capital	399	399	399	399	399
Reserves & Surplus	34,251	29,161	42,499	56,088	68,575
<b>Networth</b>	<b>34,650</b>	<b>29,561</b>	<b>42,898</b>	<b>56,487</b>	<b>68,975</b>
Debt	660	327	-	-	-
<b>Capital Employed</b>	<b>35,311</b>	<b>29,888</b>	<b>42,898</b>	<b>56,487</b>	<b>68,975</b>
Gross Fixed Assets	27,510	29,866	34,866	41,866	49,866
Accumulated Depreciation	10,922	14,582	17,385	20,738	24,516
Capital work in progress	481	1,251	4,251	9,251	14,251
<b>Net Assets</b>	<b>17,069</b>	<b>16,536</b>	<b>21,732</b>	<b>30,380</b>	<b>39,602</b>
Investments	39,257	51,288	39,643	53,518	67,967
<b>Current Assets, Loans &amp; Adv</b>	<b>9,754</b>	<b>14,331</b>	<b>20,235</b>	<b>22,263</b>	<b>23,602</b>
Inventory	4,364	5,249	6,756	8,600	9,571
Debtors	1,084	1,306	2,723	2,867	3,190
Cash & Bank balance	19,072	715	768	2,457	3,418
Loans & advances and others	4,306	7,775	10,756	10,796	10,841
<b>Current Liabilities &amp; Provisions</b>					
Liabilities	38,051	50,637	43,008	45,145	48,030
Provisions	10,264	10,811	10,901	12,614	14,413
<b>Net Current Assets</b>	<b>(19,488)</b>	<b>(46,402)</b>	<b>(32,905)</b>	<b>(33,039)</b>	<b>(35,423)</b>
Deferred expenses	1,528	17,052	4,472	4,472	4,472
Misc. Expenses	-	25,518	18,900	10,100	1,300
<b>Application of Funds</b>	<b>35,311</b>	<b>29,888</b>	<b>42,898</b>	<b>56,487</b>	<b>68,975</b>

### Per share data

Year ended 31 Mar	2010	2011	2012	2013e	2014e
No. of shares (m)	199.7	199.7	199.7	199.7	199.7
BVPS (INR)	173.5	148.0	214.8	282.9	345.4
CEPS (INR)	121.3	111.8	133.1	143.3	145.8
DPS (INR)	80.0	105.0	45.0	50.0	55.0

### Margins (%)

Year ended 31 Mar	2010	2011	2012	2013e	2014e
EBITDA	16.9	11.9	11.1	10.5	10.5
EBIT	15.7	10.7	9.9	9.2	9.2
PAT	14.2	10.4	10.2	9.7	8.7

Source: Company, Antique

### Volumes (In '000s)

Year ended 31 Mar	2010	2011	2012	2013e	2014e
Total Domestic	4,502	5,269	6,069	6,515	7,055
Total Export	98	133	166	207	270
Total Motorcycles	4,386	5,041	5,780	6,207	6,739
Total Scooters	214	361	456	515	585
<b>Total Volumes</b>	<b>4,600</b>	<b>5,402</b>	<b>6,235</b>	<b>6,722</b>	<b>7,325</b>
<b>Growth (%)</b>					
Total Volumes	23.6	17.4	15.4	7.8	9.0

### Cash flow statement (INRm)

Year ended 31 Mar	2010	2011	2012	2013e	2014e
EBIT	24,705	20,579	23,105	24,014	26,802
Depreciation & amortisation	1,915	2,254	2,803	3,353	3,778
Interest expense	(206)	(19)	213	201	189
(Inc)/Dec in working capital	(25,971)	(8,557)	13,444	(1,823)	(3,344)
Tax paid	5,916	(10,756)	17,447	4,988	8,365
<b>CF from operating activities</b>	<b>46,882</b>	<b>42,164</b>	<b>(5,195)</b>	<b>24,000</b>	<b>25,370</b>
Capital expenditure	1,623	3,126	8,000	12,000	13,000
Inc/(Dec) in investments	5,570	12,030	(11,645)	13,875	14,450
Income from investments	3,406	4,249	5,756	6,446	7,091
<b>CF from investing activities</b>	<b>(3,787)</b>	<b>(10,908)</b>	<b>9,400</b>	<b>(19,429)</b>	<b>(20,359)</b>
Inc/(Dec) in debt	(125)	(333)	(327)	-	-
Dividends paid	(25,676)	(24,369)	(10,444)	(11,682)	(12,851)
<b>CF from financing activities</b>	<b>(25,800)</b>	<b>(24,702)</b>	<b>(10,771)</b>	<b>(11,682)</b>	<b>(12,851)</b>
<b>Net cash flow</b>	<b>16,876</b>	<b>(18,357)</b>	<b>53</b>	<b>1,689</b>	<b>961</b>
Opening balance	2,196	19,072	715	768	2,457
<b>Closing balance</b>	<b>19,072</b>	<b>715</b>	<b>768</b>	<b>2,457</b>	<b>3,418</b>

### Growth indicators (%)

Year ended 31 Mar	2010	2011	2012	2013e	2014e
Revenue	27.9	22.1	21.4	11.9	11.3
EBITDA	58.0	(14.2)	13.5	5.6	11.7
PAT	74.1	(10.0)	18.4	6.3	0.3
EPS	74.1	(10.0)	18.4	6.3	0.3

### Valuation (x)

Year ended 31 Mar	2010	2011	2012	2013e	2014e
P/E	18.7	20.8	17.5	16.5	16.4
Cash P/E	17.2	18.7	15.7	14.6	14.3
P/BV	12.0	14.1	9.7	7.4	6.0
EV/EBITDA	13.8	16.4	14.8	13.6	11.7
EV/Sales	2.3	2.0	1.6	1.4	1.2
Dividend Yield (%)	3.8	5.0	2.2	2.4	2.6

### Financial ratios

Year ended 31 Mar	2010	2011	2012	2013e	2014e
RoE	64.4	67.9	55.4	44.7	36.7
RoCE	80.7	83.1	67.3	53.9	49.1
Debt/Equity (x)	0.0	0.0	-	-	-
EBIT/Interest (x)	(119.8)	(1,112.4)	108.5	119.7	141.7

Source: Company Antique