

Results below expectations on lower margins

First Look

HMCL declared 3QFY12 PAT at INR 6.13bn (Nomura and Consensus: INR 6.3bn); below our and consensus estimates. EBITDA margins came in at 15.6%, well below our estimate of 16.4%, on higher RM/sales and a lower than expected decline in other costs. However, higher other income (INR762mn vs our estimate of INR638mn) and lower tax rate (15.3% vs our expectation of 16.7%) has helped net profit to some extent.

Going ahead, we believe that volume growth can come under pressure due to a potential industry slowdown and increased competition from Honda. Therefore, we see downside risks to our EPS estimates. Maintain Neutral.

We expect the stock to react negatively on the results.

We will get back with more details post the conference call scheduled at 11.30 AM IST tomorrow.

Key result highlights

- Net sales came in at INR 60.3bn, in-line with our expectation of INR 60.1bn
- EBITDA came in at INR 9.4bn; below our expectation of INR 9.8bn
- EBITDA margin was 15.6%; below our expectation of 16.4%
- RM/sales came in at 72.9%, higher than our expectation of 72.5%
- Staff cost/sales was 3.3%, as against our expectation of 3.1%
- Other expenditure/sales came in at 8.2%, against our expectation of 8.0%
- Effective tax rate was 15.3%, vs. our expectations of 16.7%
- Other income came in at INR762mn, higher than our estimate of INR638mn

Fig. 1: 3QFY12 results - Actual vs. Expectations

	INR mn			% difference from	
	Actual	Consensus	Nomura	Consensus	Nomura
Net Sales	60,315	60,042	60,085	0.5%	0.4%
Net Profit	6,130	6,300	6,298	-2.7%	-2.7%

Source: Company data, Bloomberg, Nomura research

January 19, 2012

Rating
Remains **Neutral**

Target price
Remains **INR 2237**

Closing price
January 18, 2012 **INR 1861**

Research analysts

India Autos & Auto Parts

Kapil Singh - NFASL
kapil.singh@nomura.com
+91 22 4037 4199

Nishit Jalan - NSFSPL
nishit.jalan@nomura.com
+91 22 4037 4362

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Fig. 2: 3QFY12 results

(INR mn)	3QFY11A	2QFY12A	3QFY12A	Y/Y	Q/Q	3QFY12F
Net Sales	51,616.6	58,293.2	60,314.5	16.9	3.5	60,084.9
Expenses	45,570.0	49,106.1	50,884.6	11.7	3.6	50,242.2
(Inc/Dec in Stock	753.7	-402.3	-586.4			
Raw Materials	37,394.9			0.0	0.0	
Net RM	38,148.6	42,237.4	43,948.0			43,561.5
Staff Cost	1,560.0	1,793.7	1,993.2	27.8	11.1	1,865.4
Other Expenditure	5,861.4	5,075.0	4,943.4	-15.7	-2.6	4,815.3
Operating Profit	6,046.6	9,187.1	9,429.9	56.0	2.6	9,842.6
As % of Net Sales	11.7	15.8	15.6			16.4
Other Income	-458.1	797.5	762.8	-266.5	-4.4	638.0
Interest	-52.2	-44.9	-31.8	-39.1	-29.2	-44.9
Depreciation	559.6	2,784.9	2,986.5	433.7	7.2	2,964.9
PBT	5,081	7,245	7,238	42.4	-0.1	7,561
Tax	790.3	1,208.4	1,107.7	40.2	-8.3	1,262.6
Effective Tax Rate (%)	15.6	16.7	15.3	0.0	0.0	16.7
PAT	4,290.8	6,036.2	6,130.3	42.9	1.6	6,298.0
PAT Margin	8.4	10.2	10.0			10.4
EPS	21.5	30.2	30.7	42.9	1.6	31.5

Source: Company data, Nomura estimates

Fig. 3: Cost ratios

	3QFY11A	2QFY12A	3QFY12A	Y/Y	Q/Q	3QFY12F
staff cost / sales	3.0%	3.1%	3.3%	0.3%	0.2%	3.1%
Other exp / sales	11.4%	8.7%	8.2%	-3.2%	-0.5%	8.0%
RM / Sales	73.9%	72.5%	72.9%	-1.0%	0.4%	72.5%
Gross margins	26.1%	27.5%	27.1%	1.0%	-0.4%	27.5%
OPM	11.7%	15.8%	15.6%	3.9%	-0.1%	16.4%
EBITDA per vehicle (INR)	4,234	5,949	5,933	40.1%	-0.3%	6,193
Realisation/vehicle (INR)	36,145	37,747	37,951	5.0%	0.5%	37,806
RM/vehicle (INR)	26,714	27,350	27,653	3.5%	1.1%	27,409

Source: Company data, Nomura estimates

Appendix A-1

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Mentioned companies

Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Hero MotoCorp	HMCL IN	INR 1861	18-Jan-2012	Neutral	Not rated	

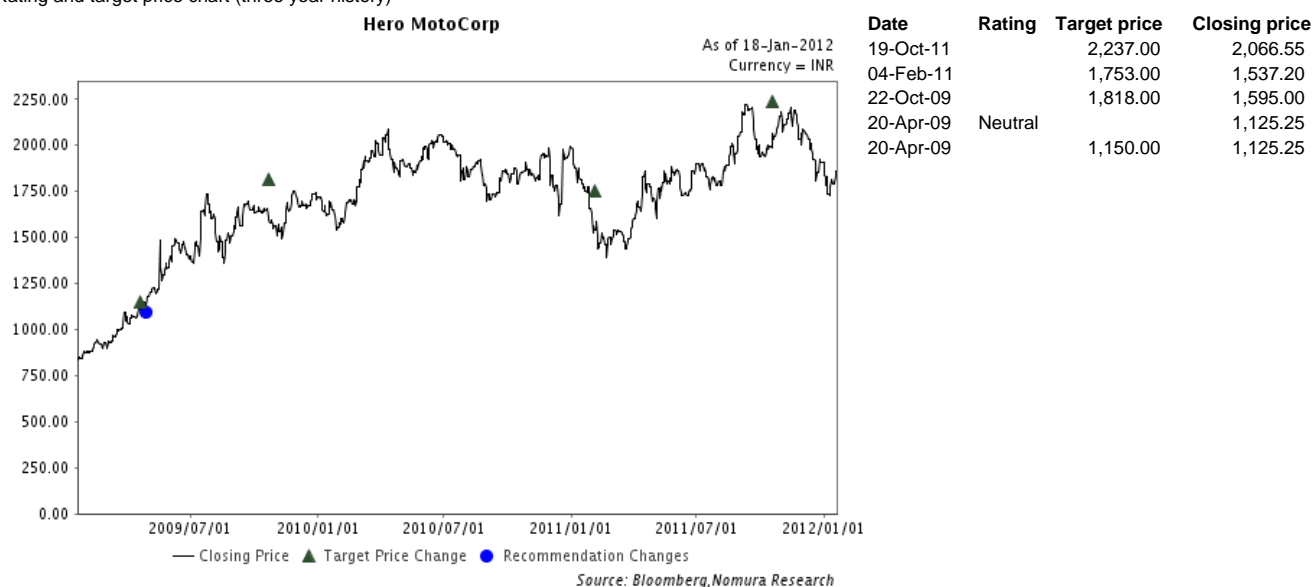
Previous Rating

Issuer name	Previous Rating	Date of change
Hero MotoCorp	Buy	20-Apr-2009

Hero MotoCorp (HMCL IN)

INR 1861 (18-Jan-2012) Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value HMCL based on DCF (methodology unchanged). We have assumed terminal growth of 5% and cost of equity of 13%.

Risks that may impede the achievement of the target price

- Downside
 - HMCL does not have R&D capabilities to design its own motorcycles at present. We believe the company will be able to develop this over the next few years. If the company is unable to set up a successful R&D facility by June 2014, there could be downside risks to our estimates.
 - We have assumed a decline in RM/sales due to decline in commodity prices, in case, commodity prices do not decline, there will be downside risk to our operating margin estimates
 - Macro risks: We have assumed stable macro conditions with GDP growth averaging around 8% over the next few years. In case there is a slowdown leading to lower GDP growth, there will be downside risks to our estimates.
- Upside
 - We have assumed that Hero MotoCorp will take around four to five years to establish itself in new export markets. If the company is able to do so faster there may be upside risks to our estimates.
 - HMCL has booked mark to market losses on license fee payable due to yen appreciation against rupee in 2QFY12. If going ahead, rupee appreciates against yen, then there would be mark to market gains leading to lower outgo on quarterly payments towards license fee; this would pose upside risks to our estimates.

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STOCKS

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

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