

CMP: Rs.1947

Recommendation: BUY

Target Price: Rs.2164

Sector: Automobiles**Key Data**

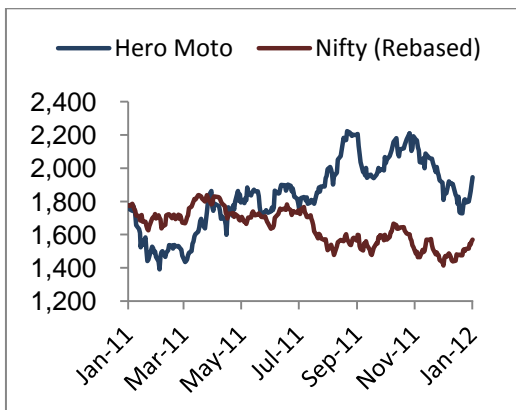
Financial Year End	March
Market Cap (Rs. Cr.)	38,839
Market Cap (USD Bn.)	7.8
52 Week H/L	2250/1376
Avg. 12M volumes (k)	643
Face Value (Rs.)	2
Bloomberg	HMCL IN
Reuters	HROH.BO
NSE	HEROMOTOCO
BSE	500182

Source: BSE, SIHL Research

Shareholding Pattern

	Q3 FY12	Q2 FY12
Promoters	52.2%	52.2%
FII's	33.8%	34.8%
DII's	5.4%	4.2%
Others	8.7%	8.8%

Source: BSE, SIHL Research



Source: Ace Equity, SIHL Research

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Record volume growth in Q3 FY12

Hero MotoCorp (Hero Moto) remained highly unaffected from the slowdown in domestic 2-W industry as it grew by 11.3% YoY; while its peers Bajaj Auto and TVS in Q3 FY12 recorded volume growth of 7.2% and -12% YoY. This has enabled Hero Moto to further consolidate its dominant position and increase its market share by 125 bps to 56.2%. Total revenue in Q3 FY12 was higher 16.9% YoY and 3.5% QoQ to Rs.6,031 Cr. (our est. Rs.6,025 Cr.). Realization in Q3 FY12 was higher merely by 0.4% QoQ to Rs.40,287 due to lower contribution of 125cc - 250cc segment bikes. Contribution of bikes from 125cc – 250cc segment is lower by 156 bps YoY and 137 bps QoQ to 4.9% of total 2-W sales. Going by the robust sales volume in 9M FY12, we estimate Hero Moto will easily over achieve its quarterly rate of 1.5 mn units in Q4 FY12 as Q4 is generally the strongest quarter. Hero Moto might also over achieve our revised estimated FY12 volume target of 6.2 mn units (earlier 6.15 mn units).

Increase in raw material cost impact EBITDA margin

EBITDA margin for Q3 FY12 was lower by 12 bps QoQ to 15.8%. After adjusting for royalty in other expenditure, EBITDA margin in Q3 FY12 was higher 68 bps YoY but lower 38 bps QoQ. Royalty payment accounted in Q3 FY12 was Rs.228 Cr. vs. Rs.210 Cr. in Q2 FY12. As the currency exchange risk is with Hero Moto, the royalty payment was higher in Q3 FY12. Raw material cost as % of total revenue was higher 43 bps QoQ to 73.4%. Hero Moto direct import content is not more than 1-1.5% of raw material cost but indirect imports (imports by Hero Moto vendors) is in the range of 14-15%. Since imports are Dollar or Yen denominated and weak Rupee in Q3 FY12, raw material cost is higher QoQ. Post split with Honda, Hero Moto has no obligation to import component from Honda approved vendors. The management indicated that post the split, there is scope for vendor rationalization. The company may shift away from Honda-approved vendors but not at the cost of quality.

Lower effective tax rate; but could increase from FY14

Effective tax rate in Q3 FY12 was lower by 138 bps QoQ to 15.3%. Lower tax rate was on account of higher contribution from Haridwar plant as it enjoys tax benefits. The tax benefits from Haridwar plant is set to expire in FY14. We see Hero Moto effective tax rate rising to 27% in FY14 from 17% in FY12, which will be another dampener on earnings growth.

No threat from Honda Motors despite capacity expansion to 4 mn by FY14

After exiting from its Indian joint venture Hero Honda, Honda Motors (Honda Motorcycle Scooter India) has announced an aggressive expansion plan for India which includes an additional investment of Rs.1,000 Cr. in FY13. Honda Motors has two manufacturing plant in Haryana and Rajasthan and is coming up with third plant in Karnataka. Honda Motors will double its capacity from its existing 2.2 mn to 4 mn by FY13. With 50% of capacity dedicated to Motorcycles (2 mn units), out of which 45% of capacity is dedicated to sub-125 cc segment which is around 0.9 mn units. Hero Moto sub-125 cc capacity by the end of FY13 would be around 6.3 mn units. We estimate that Honda Motors is no threat to Hero Moto in terms of capacity (Exhibit 2 for detailed analysis).

At the Auto Expo 2012, Honda Motors unveiled its 110cc bike "Dream Yuga", which competes with Hero Moto in sub-125 cc segment. We are not upbeat about Honda Motors new product as it did not come across as a 'WOW' product. We estimate more executive launches from Honda Motors by the end of FY13 and believe competition to further intensify and escalate by end of FY14 rather than in FY13.

2-W business is more brand-based. Products like Dream Yuga and Suzuki's new motorcycle are like 'me too' products. By the time competition intensifies, Hero Moto will be ready with its export strategy. So, in the long run, Hero Moto's position is unlikely to remain affected.

Valuation & Outlook

Going by the robust sales volumes in 9M FY12, we estimate Hero Moto to easily over achieve 6.2 mn units in FY12. Hero Moto has also expanded its capacity at its plants to 7 mn units per year from 6.2 mn units currently. The capacity at its Haridwar plant will go up to 9,500 units/day from 8,000 units/day. It has raised scooter production capacity to 50,000 from 35,000, backed by strong 30% year-to-date growth in sales. We have revised our FY12 and FY13 sales volume target to 6.2 mn and 7 mn respectively from 6.15 mn and 6.8 mn respectively. We have downgraded our EBITDA margin for FY12 and FY13 to 15.5% and 15.9% (earlier 16.0% and 16.1% in FY12 and FY13); as we estimate raw material cost to be higher (in line with Q3 FY12) due to adverse forex fluctuation as 15-17% of raw materials is imports. We have downgraded our FY12E EPS to Rs.122.2 from Rs.125.9 earlier. We have also factored in effective tax rate of 27.0% from FY14 as tax benefit of Haridwar plant is set to expire in FY14.

We do not anticipate major threat from Honda Motors in Sub-125 cc segment despite increase in capacity for Honda Motors. We estimate more executive launches from Honda Motors by the end of FY13 and believe competition to intensify and escalate by end of FY14 rather than in FY13. By the time competition intensifies, Hero Moto will be ready with its export strategy.

The stock is trading at PE of 15.9x FY12E EPS of Rs.122.2 and 13.2x FY13E EPS of Rs.147.4.

We downgrade our target price to Rs.2,164 (earlier Rs.2,257) on DCF basis and reiterate BUY, with an investment horizon of 12 months and upside potential of 11.1%.

Assumption & Valuation**DCF based Valuation**

Rs. Cr.	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E	Terminal Value
Free Cash Flow	2,825	3,014	1,775	2,282	1,520	1,936	2,378	2,708	63,074
NPV of Cash Flow	2,754	2,653	1,410	1,637	984	1,132	1,255	1,290	-
NPV of Enterprise Value									43,166

Source: SIHL Research

Terminal Growth Rate	4%
Beta	0.57
Risk Free Rate	8%
Market Premium	5%
Post Tax Cost of Debt	6.60%
Cost of Equity	10.85%
WACC	10.77%
Debt	1%
Equity	99%

Total Enterprise Value (Rs. Cr.)	43,166
Net Debt (Rs. Cr.)	(39)
No of Shares (Cr.)	19.97
Value per Share	2,164

Exhibit 1: Trend in Volume Growth

Product Mix	Q3 FY12	Q3 FY11	YoY	Q2 FY12	QoQ
75cc-125cc Motorcycle	1,397,116	1,240,822	12.6%	1,340,145	4.3%
% of Total	87.9%	86.9%	102 bps	86.8%	113 bps
125cc-250cc Motorcycle	77,699	92,119	-15.7%	96,614	-19.6%
% of Total	4.9%	6.5%	(156) bps	6.3%	(137) bps
Total Motorcycle	1,474,815	1,332,941	10.6%	1,436,759	2.6%
Scooters	114,461	95,089	20.4%	107,556	6.4%
% of Total	7.2%	6.7%	54 bps	7.0%	24 bps
Total 2 Wheelers	1,589,276	1,428,030	11.3%	1,544,315	2.9%
Of which Exports	46,064	38,479	19.7%	39,845	15.6%
% of Total	2.9%	2.7%	20 bps	2.6%	32 bps

Source: Company Data, SIHL Research

Exhibit 2: Hero Moto and Honda Motors Capacity Analysis

Capacity	FY12E	FY13E
Hero Moto	7,000,000	7,500,000
Motorcycle Capacity	6,510,000	7,012,500
% of Total Capacity	93.0%	93.5%
Domestic Market Capacity	6,366,780	6,802,125
% of Total Motorcycle	97.8%	97.0%
Sub 125 cc Capacity	5,991,140	6,257,955
% of Domestic Market	94.1%	92.0%
Scooter Capacity	490,000	487,500
% of Total Motorcycle	7.0%	6.5%
Honda Motors	2,800,000	4,000,000
Motorcycle Capacity	1,176,000	2,000,000
% of Total Capacity	42.0%	50.0%
Domestic Market Capacity	1,046,640	1,800,000
% of Total Motorcycle	89.0%	90.0%
Sub 125 cc Capacity	210,375	900,000
% of Domestic Market	20.1%	50.0%
Scooter Capacity	1,624,000	2,000,000
% of Total Motorcycle	58.0%	50.0%

Source: SIHL Research

- ☞ Hero Moto and Honda Motors 2-W capacity at the end of FY12 would be 7 mn units and 2.8 mn units respectively and 7.5 mn units and 4 mn units at end of FY13
- ☞ We estimate out of total capacity for Hero Moto, 93.5% would be dedicated to MCY (motorcycle) which would be around 7 mn units of total capacity. Out of 7 mn units MCY, 6.8 mn units capacity would be for domestic market as we do not estimate rapid surge in exports for Hero Moto as in the case of Bajaj Auto. Out of 6.8 mn units of domestic MCY capacity for Hero Moto, if on a conservative basis, we assume only 92%* of it would be allocated for sub 125cc, even then capacity for sub 125 cc would be 6.3 mn units.
- ☞ For Honda Motors, 50%** of the capacity is dedicated for MCY which would be around 2 mn units of total capacity. Out of 2 mn units MCY, 1.8 mn units capacity would be for domestic market. So out 1.8 mn units even if we assume 50% of capacity for sub 125cc segment (We have estimated aggressive sub-125 cc capacities considering current capacity is around 20.1%) then also **capacity for sub-125 cc is only 0.9 mn units way below Hero Moto capacity of 6.3 mn units.**

*We estimate 92% of domestic MCY capacity to be allocated to sub -125cc segment as current capacity is 94.1% as we estimate Hero Moto wants to enter high margin 125 cc+ segment. ** Honda Motors has given guidance of 50% of capacity dedicated to MCY and remaining 50% to Scooters.

Exhibit 3: Quarterly Income Statement

Particulars, (Rs. Cr.)	Q3 FY12	Q3 FY11	YoY	Q2 FY12	QoQ
Gross Revenue	6,403	5,479	16.9%	6,198	3.3%
Excise Duty	419	361	16.2%	413	1.4%
Net Sales	5,984	5,118	16.9%	5,784	3.4%
Other Operating Income	48	43	10.2%	45	6.4%
Total Revenue	6,031	5,162	16.9%	5,829	3.5%
Total Expenditure	5,088	4,585	11.0%	4,911	3.6%
EBITDA	943	577	63.5%	919	2.6%
<i>EBITDA Margins%</i>	15.6%	11.2%	446 bps	15.8%	(13) bps
Depreciation	299	56	433.7%	278	7.2%
EBIT	644	521	23.8%	640	0.6%
<i>EBIT Margins%</i>	10.7%	10.1%	60 bps	11.0%	(30) bps
Other Income	76	62	23.0%	80	-4.4%
Interest	(3)	(5)		(4)	
Exceptional Items	-	(80)		-	
PBT	724	508	42.5%	724	-0.1%
<i>PBT Margins%</i>	12.0%	9.8%	216 bps	12.4%	(43) bps
Tax	111	79	40.2%	121	-8.3%
<i>Effective Tax Rate</i>	15.3%	15.6%	(25) bps	16.7%	(138) bps
PAT	613	429	42.9%	604	1.6%
<i>Pat Margins%</i>	10.2%	8.3%	185 bps	10.4%	(19) bps
EPS, Rs.	30.70	21.48	42.9%	30.23	1.6%

Source: Ace Equity, SIHL Research

Exhibit 4: Standalone Annual Income Statement

Particulars, Rs. Cr.	FY09	FY10	FY11	FY12E	FY13E
Gross Sales	13,543	16,781	20,662	24,881	28,442
Less: Excise Duty	1,224	1,022	1,417	1,585	1,625
Net Sales	12,319	15,758	19,245	23,296	26,817
Other Operating Income	63	102	156	200	200
Total Revenue	12,382	15,861	19,401	23,496	27,017
Total Expenditure	10,633	13,094	16,784	19,852	22,730
EBITDA	1,750	2,767	2,617	3,644	4,287
<i>EBITDA Margins%</i>	14.1%	17.4%	13.5%	15.5%	15.9%
Depreciation	181	191	402	993	1,022
EBIT	1,569	2,575	2,215	2,652	3,265
<i>EBIT Margins%</i>	12.7%	16.2%	11.4%	11.3%	12.1%
Other Income	181	245	270	300	300
Interest	(32)	(12)		12	18
Exceptional Items	-	-	(80)	-	-
PBT	1,781	2,832	2,405	2,940	3,547
<i>PBT Margins%</i>	14.4%	17.9%	12.4%	12.5%	13.1%
Tax	500	600	477	500	603
<i>Effective Tax rate</i>	28.1%	21.2%	19.8%	17.0%	17.0%
PAT	1,282	2,232	1,928	2,440	2,944
<i>PAT Margins</i>	10.4%	14.1%	9.9%	10.8%	11.0%
EPS	64.2	111.8	96.5	122.2	147.4

Source: Ace Equity, SIHL Research

Exhibit 5: Standalone Annual Balance Sheet

Particulars, Rs. Cr.	FY09	FY10	FY11	FY12E	FY13E
Sources of Funds					
Shareholder's Fund	3,801	3,465	2,956	4,462	6,354
Share Capital	40	40	40	40	40
Reserves & Surplus	3,761	3,425	2,916	4,422	6,315
Loans Funds	78	66	33	70	108
Deferred Payment Credits	-	-	1,458	750	42
Total Liabilities	3,879	3,531	4,447	5,282	6,505
Application of Funds					
Fixed Assets	1,694	1,707	4,205	3,813	3,091
Gross Block	2,516	2,751	5,538	6,138	6,438
Less: Depreciation & Write Down	943	1,092	1,458	2,451	3,473
Net Block	1,574	1,659	4,080	3,688	2,966
Capital WIP	121	48	125	125	125
Investment	3,369	3,926	5,129	5,129	5,129
Current Assets, Loans & Advances	1,013	2,883	1,505	3,069	5,930
Inventories	327	436	525	634	729
Sundry Debtors	150	108	131	164	189
Cash and Bank Balances	220	1,907	72	1,307	3,904
Other Current Assets	6	25	49	70	81
Loans & Advances	311	406	729	893	1,027
Current Liabilities and Provision	2,053	4,831	6,145	6,482	7,397
Liabilities	1,526	3,805	5,064	5,401	6,316
Provision	527	1,026	1,081	1,081	1,081
Net Current Assets	(1,039)	(1,949)	(4,640)	(3,412)	(1,467)
Deferred Tax Assets/Liabilities	(144)	(153)	(247)	(247)	(247)
Total Assets	3,879	3,531	4,447	5,282	6,505

Source: Ace Equity, SIHL Research

Exhibit 6: Standalone Annual Cash Flow

Particulars, Rs. Cr.	FY09	FY10	FY11	FY12E	FY13E
Cash Flow from Operations	1,359	2,687	3,131	2,732	3,910
PAT	1,282	2,232	1,928	2,440	2,944
Depreciation	181	191	402	993	1,022
Non Cash Adjustment	(316)	(1,834)	-	(708)	(708)
Change in WC	213	2,098	801	8	652
Cash Flow from Investing	(861)	(528)	(300)	(600)	(300)
Capital Expenditure	(315)	(212)	(300)	(600)	(300)
Change in Investment	(669)	(363)	-	-	-
Other Investment Items	123	47	-	-	-
Cash Flow from Financing	(500)	(2,109)	(2,486)	(897)	(1,014)
Issue of Equity	-	-	-	-	-
Issue/Repay of Debt	(54)	(12)	(33)	38	38
Dividend Paid	(379)	(1,996)	(2,097)	(799)	(899)
Dividend Tax	(64)	(98)	(356)	(136)	(153)
Other Financing Cash Flow	(3)	(3)	-	-	-
Net Cash	(2)	50	345	1,235	2,596
Opening Balance	15	13	63	72	1,307
Closing Balance	13	63	72	1,307	3,904

Source: Ace Equity, SIHL Research



Exhibit 7: Key Ratios

Particulars	FY10	FY11	FY12E	FY13E
BV, Rs.	173.5	148.0	223.4	318.2
EPS, Rs.	111.8	96.5	122.2	147.4
P/BV, x	11.2	13.1	8.7	6.1
P/E, x	17.42	20.16	15.93	13.20
ROE	64.4%	65.2%	54.7%	46.3%
ROCE	72.9%	74.1%	58.5%	50.5%
EBITDA Margins	17.4%	13.5%	15.5%	15.9%
EV/EBITDA, x	13.4	12.1	10.3	8.2

Source: Company Data, SIHL Research

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