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Incorporated in 1984, Hero MotoCorp Ltd. (HEROMOTOCO) erstwhile Hero Honda Motors Ltd is the world's largest manufacturer of two wheelers and its parts & ancillary services, based in India. The company known for its solidity, sturdiness has 3 manufacturing facilities based at Dharuhera, Gurgaon in Haryana and at Haridwar in Uttarakhand. These plants together are capable of churning out ~3 mn bikes per year. Besides, the firm has a large sales and service network with over 3,000 dealerships and service points across India. HEROMOTOCO with the help of trusted brands aims to add revenues of ~\$10 bn by FY'17.

## Investor's Rationale

After making a flagship entry in Colombia, Sri Lanka, Bangladesh and Nepal, HEROMOTOCO has paved its way to other international market, Latin America via launching its iconic 'Hero brand' to expand its operation. Besides, its pact with reputed Indy Motos Group of Guatemala will further help to unveil its premium 2 Wheeler (2W) namely Hunk, Karizma, Glamour, HF Dawn, Splendor NXG, Super Splendor and Achiever. The furious expansion is aimed at churning 10% of \$10 bn from foreign markets in the next 4-5 years.

HEROMOTOCO is on an expansion spree and is eyeing capacity addition of 7.7 mn units post the completion of construction of its 4<sup>th</sup> manufacturing plant and a new Global Parts Centre (GPC) at Neemrana in Rajasthan with a capex of ₹5.5 bn. It also plans to open its 5<sup>th</sup> plant in Gujarat with capacity expansion of 8.4 mn units by Q2FY'15. Besides, other key plan includes capacity expansion at existing plants and establishment of an integrated R&D Centre at Jaipur. The largest ever investment for the lined up project is likely to cross ₹25 bn.

HEROMOTO has retailed over 11 lakh 2W in April and May 2013, the highest ever retail sales for any non-festival period driven by the good demand momentum, notwithstanding the adverse economic factors.

To boost the sales of its 2W's and to maintain the market share (~58%) HEROMOTOCO, with the help of its financial subsidiary has decided to offer retail financing solutions to customers. With a capex of around 2 bn to extend the dealer outlets to 450 by FY'15 will benefit to more than 25% of company's customers to avail financing options while purchasing a two-wheeler.

## Key risk

Significant expansions being planned by the company and if interest rates increases it will increase the cost of capital and also impact the operations of crucial vendors. Besides, if the depreciation of Indian currency continues, it will significantly shoot up the costs of imported spares, technology royalties, raw materials and capital goods, impacting the company's bottom-line.

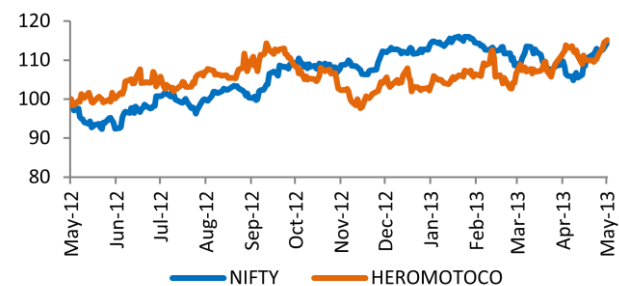
## Market Data

<b>Rating</b>	<b>BUY</b>
<b>CMP (₹)</b>	1,602.3
<b>Target (₹)</b>	<b>1,809</b>
<b>Potential Upside</b>	~18.0%
<b>Duration</b>	Long Term
Face Value (₹)	2
52 week H/L (₹)	2,149.9/1,434.1
Adj. all time High (₹)	15.3
Decline from 52WH (%)	(25.4)
Rise from 52WL (%)	11.7
Beta	0.9
Mkt. Cap (₹ bn)	319.9
Price to Book Value	4.9

## Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Revenue (₹ bn)	235.7	237.6	260.5	291.0
EBITDA (₹ bn)	36.1	32.8	35.9	38.0
Net Profit (₹ bn)	23.7	21.1	23.9	26.2
Adj EPS (₹)	119.1	106.1	120.0	131.4
P/E (x)	13.5	15.1	13.4	12.2
P/BV (x)	7.5	6.4	5.0	4.0
EV/EBITDA (x)	9.1	9.8	8.9	8.4
ROCE (%)	52.0	46.4	45.4	41.7
ROE (%)	55.4	42.3	37.7	33.1

## One year Price Chart



## Shareholding Pattern

	Mar'13	Dec'12	Diff.
<b>Promoters</b>	52.2	52.2	-
<b>FII</b>	30.6	31.9	(1.3)
<b>DII</b>	8.4	7.1	1.3
<b>Others</b>	8.7	8.7	-

With the start of Rajasthan and Gujarat plants, HEROMOTOCO annual production to see a growth of 9 million units from current 7 million units.

Posted foreign sales of 1,61,043 units in FY'13, exports account for about 3% of company's overall sales.

### India's biggest 2W manufacturer

Established in 1984, Hero MotoCorp Ltd. (HEROMOTOCO) erstwhile Hero Honda Motors Ltd is the world's largest 2W manufacturer in terms of production capacity. At present, Hero MotoCorp has an installed annual production capacity of 7 million units across its three plants in Gurgaon, Dharuhera and Haridwar which is likely to rise over 9 million units, once Rajasthan and Gujarat plants are commissioned.

HEROMOTOCO is engaged in manufacturing two wheelers and its parts & ancillary services. The company serving its customer from a decade has 3 manufacturing facilities based at Dharuhera, Gurgaon in Haryana and at Haridwar in Uttarakhand. These plants together are capable of churning out ~3 million bikes per year. Its plants use world class equipment and processes and have become a benchmark in leanness and productivity. Besides, the firm has a large sales and service network with over 3,000 dealerships and service points across India. HEROMOTOCO with the help of trusted brands aims to add revenues of ~\$10 billion and volumes of 10 million 2W's by FY'17.

The Company's growth in the 2W market in India is the result of an intrinsic ability to increase reach in new geographies and growth markets. Hero MotoCorp's extensive sales (₹237.6 bn in FY'13 as against ₹235.7 bn in FY'12) and service network now spans over to 5,000 customer touch points. With foreign sales of 1,61,043 units in FY'13, exports account for about 3% of company's overall sales. Besides, the service network comprise a mix of authorized dealerships, service & spare parts outlets, and dealer-appointed outlets across the country. The expansion will continue with addition of about 500 more touch points in the near term.

### Sales Volume

Sales Volume Break up	Q4FY'13	Q4FY'12	%YoY	Q3FY'13	%QoQ
<b>Domestic</b>					
<125cc	1,275,032	1,330,188	(4.1)	1,317,851	(3.2)
>125cc and<250cc	56,251	82,166	(31.5)	56,533	(0.5)
Scooters	156,884	118,082	32.9	155,738	0.7
<b>Exports</b>					
<125cc	28,162	27,999	0.6	33,083	(14.9)
>125cc and<250cc	4,575	3,891	17.6	5,661	(19.2)
Scooters	6,447	9,701	(33.5)	4,269	51.0

*HEROMOTOCO in its massive expansion drive has searched 30 potential market for its international operations including US, Europe, Latin America and Southeast Asia etc. to accomplish the sales target of 1 million unit by FY'17.*

### **Concerted global splash to earn revenue of \$10 bn by FY'17**

The country's largest two-wheeler maker is all set with its turnkey move of making its entry in international market like US, Europe, Latin America and Southeast Asia during 2013. Along with tapping new geographies it will also design and develop all future products taking into account requirements in global markets. The company has scouted 30 countries to operate its international business and is on course to enter 8-10 new markets in Africa and Latin America by the end of FY'14. The expansion will help the firm to attain a targeted sales of 1 million units from its international business by FY'17.

Heromotoco eyeing the future potential market opportunities ahead is considering the significant market size in Colombia and Bangladesh to establish its manufacturing units that would help the company to expand business in these geographies rapidly. Besides, on gaining requisite volumes, the expansion in African countries such as Kenya and Nigeria are also on the cards.

Recently, Hero had incorporated its first off-shore investment subsidiary in the Netherlands. The foreign arm would take care of the international operations, be it in expanding exports or in making investments in joint venture partnerships and strategic alliances. The company is eyeing 10% of total revenues in coming 2-3 years from the new ventures.

Moreover, if the company felt need to import components from China, it may consider having a subsidiary in Hong Kong too.

*HEROMOTOCO invested ₹5.5 bn and ₹11 bn respectively in ongoing plants in Rajasthan and Gujarat.*

### **Slowdown fails to exert brake on Plant addition**

The 2% drop in domestic sales at 4.42 million units in Q3FY'13 and a mere growth of 1.8% YoY in Q4FY'13 to ₹61.5 bn has failed to lock the HEROMOTOCO'S growth speed. The firm is investing massively in its ongoing projects in Rajasthan and Gujarat to set up plants. Both the facilities are expected to provide employment to over 1,500 individuals. The company commenced construction of its fourth manufacturing plant and a new Global Parts Centre (GPC) at Neemrana in the northern Indian state of Rajasthan with a total consideration of ₹5.5 bn. The GPC will have automated storage and retrieval system, automated packaging and sorting system, on-line tracking of parts through warehouse management system (WMS), lean manufacturing systems and most importantly the Green Building Concept. While, the construction at Gujarat plant is running with an investment of ₹11 bn. The Neemrana and Gujarat plant having capacity of ~750,000 units per annum and 1.2 million units are likely to get operational by FY'14 end.

The management firm believed that once Rajasthan and Gujarat plants are commissioned, HEROMOTOCO's total manufacturing capacity will cross 9 million units a year from the current about 7 million units. Currently, the company manufactures 70 lakh units every year from its three manufacturing plants at Dharuhera and Gurgaon in Haryana, and Haridwar in Uttarakhand. The production from these plants would help to meet the overwhelming demand of the two wheelers in the market.

## Major plans

Unit	Investment (₹bn)	Date Of Commission
4th two-wheeler factory in Rajasthan	5.5	Q1FY'14
Another, the 5th, in Gujarat	11	Q2FY'14
R&D centre at Kukas, Rajasthan	4	Q2FY'14
Capacity expansion at Dharuhera, Gurgaon and Haridwar plants	5	Ongoing
Other investments	1.7	Ongoing
<b>Total</b>	<b>27.2</b>	-

*RBI's expected rate cut will help the company to maintain its sales figure. Since January the central bank has slashed the rate cuts for third time in order to support the economic growth.*

## Bottlenecks

**Prolonged economic slowdown:** "2W industry to witness 4-5% volume growth in FY'13" as underlined by ICRA in its latest report, citing persistent economy slowdown as the major rationale which in turn resulted in lower disposable income, purchasing power and hence the overall demand. The industry in FY'13 witnessed the slowest growth in 4 years, up 2.9% to 13.8 million units (mu). However, the agency forecast that the firm is likely to post better results in the medium term, an uptrend of ~8-9% to 21-22 mu by FY'17 on the back of various structural positives including favourable demographic profile, moderate two wheeler penetration levels etc. HEROMOTOCO to save itself from economy hit has started to make its moves tapping large opportunity available to grow presence in overseas markets, mainly Africa and Latin America.

**RBI's rate cut:** The central bank's rate cut decision plays a major role in adding positives to the 2W industry. However, the current pace of slower economic growth has kept RBI's decision in delimita for a rate cut. If RBI raised the interest rate consumers cut spending and hence impact the demand.

Also, hiked rates increase the cost of capital and also effect the operations of crucial vendors, impacting the overall performance. In order to counter this challenge, the Company is pursuing an aggressive policy of multiple sourcing.

Seperately, the 2W industry has witnessed a growth of 4% YTD (Apr - Feb) 13, on account of uncertain economic situations, coupled with high inflation, firm interest rates and high fuel prices

which has dent the demand for the two wheelers.

**Competition:** Despite country's largest 2W manufacturer, the company has to persistently work on to maintain & gain market share and sales in the domestic market. HEROMOTOCO's rivals Honda is equally running in the race to reach the cusp. Honda is in the process of setting-up its third manufacturing facility in Karnataka and is forecasting that 30% of its business will come from India by 2020. Meanwhile, to uphold its leadership ahead, the company has various launches in store based on extensive market research.

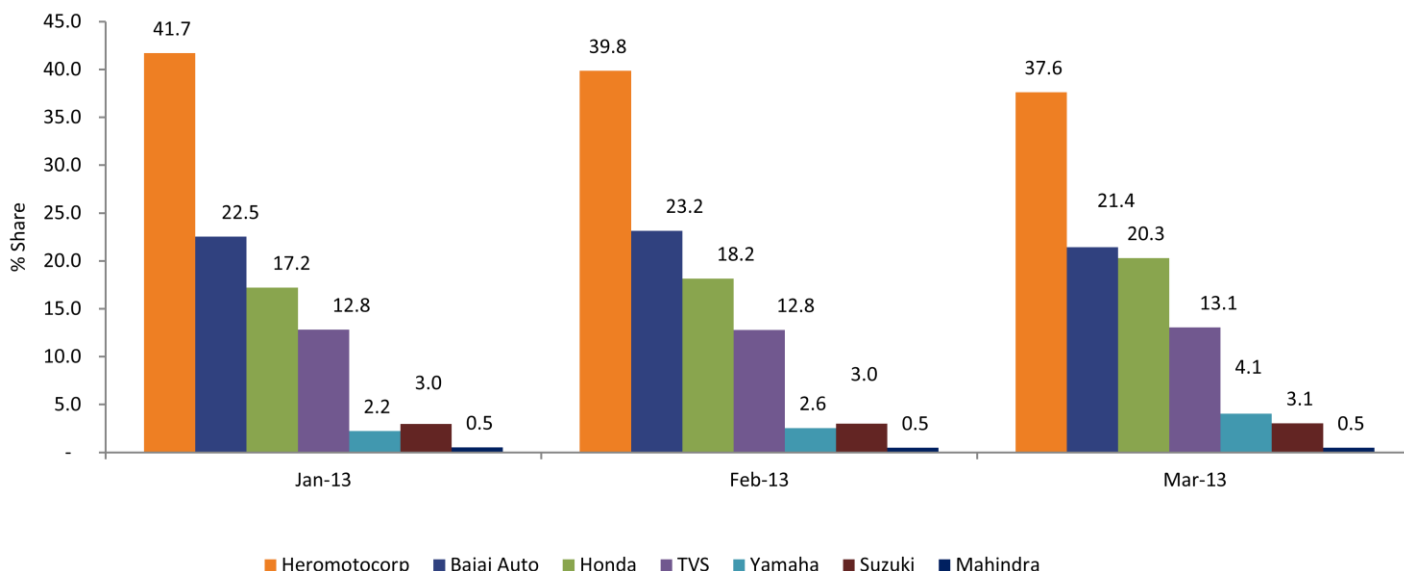
### Revealed new launches to push sales

Despite the ongoing moderate demand environment on passive consumer sentiments led by macro-economic concerns and rising petrol prices and essential parts prices, the firm has left no stones unturned to generate sales milieu. To encounter all these impediments and to further strengthening its steadily growing presence in the scooter segment, the company launched three new models, including variants of existing models successfully during the FY'12 which includes Impulse 150cc, 110cc scooter 'Maestro' and thrilling new Ignitor 125 cc bike. Impulse 150cc is the company's first motorcycle under the 'Hero' brand name and is India's only dual purpose on-road-off road bike. In gearless scooter segment, 110cc 'Maestro' has strengthened its position in the market share and captured Honda's scooter sales.

Considering hike in petrol price and the increase in future demand of scooters, the 2W major has showcased a concept of Hybrid scooter 'Leap' during Auto Expo in Delhi. The series hybrid technology in the new concept will make it one of the most fuel efficient scooters. Leap is a petrol + battery engine with automatic gear and air cooling cylinder. With this novel concept HEROMOTOCO has once again proved its commitment for customers. Looking at the positives, all these super launches will help the company to generate demand and also improve operating margins by 15.3% in FY'14, primarily driven by easing of raw-material cost pressures.

*HERO is concentrating on scooters segment to increase market share and scooter sales by improving its production capacity to 60,000 units every month.*

### 2 Wheelers market share in India



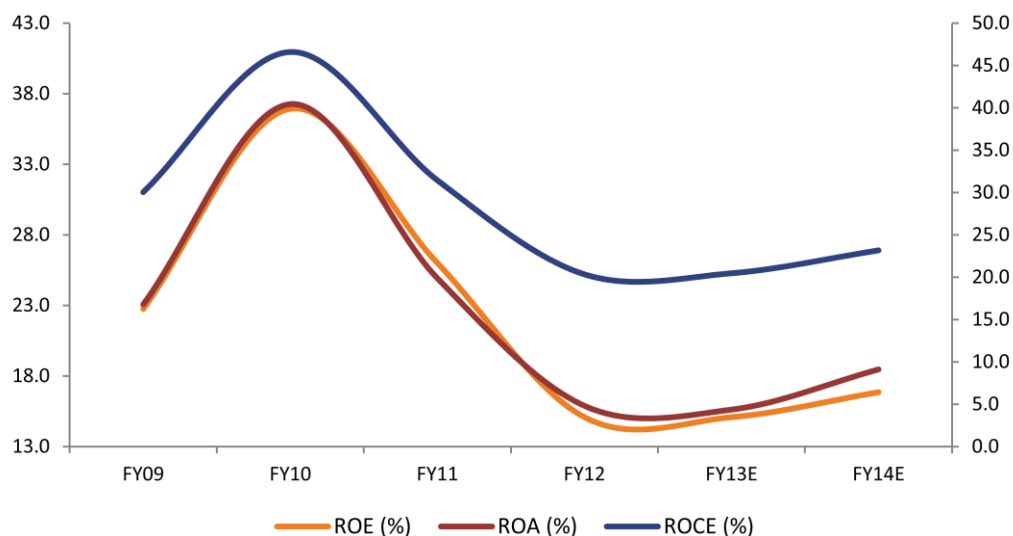
During FY12, HEROMOTOCO retained its position as the World's largest 2W manufacturer Company and continued to lead with the domestic market share of around 45%.

### HEROMOTOCO's Financial

Fuelled by its landmark sales of over 6,075,583 units in FY13 against 6,235,205 units in FY12, HMCL's notched 0.9% YoY growth in sales. FY13 was a challenging year for the company with problems ranging from contracting margins to loss of market share in motorcycle segment (~48% in November 2012), affecting the company's performance while scooter segment gained market share. Thus, sales volume declined while higher realisation and lower raw material cost improved the EBITDA margin and operating margin. Going forward, we expect that other expenses may continue to remain high on the back of new product launches, higher power and transportation expenses.

Further, higher prices of raw materials & components also dragged operating margin (10.69% YoY in FY13 as against 11.39%). Further, EBIT margin was also impacted by higher depreciation during FY12 impacting the PAT margin. Going forward we expect marginal improvement in returns as it has regained market share, in scooter segment which would improve volumes sales, realisation and operating margin.

#### Performance ratios trend



Moreover, in FY'14 we expect better subsequent improvement in returns as HEROMOTOCO has plans to increase its production capacity with some diversification and product mix and increased scooter demand to meet these requirements. Also, on export front, we note that the dispatches have already begun to new territories like Africa and Latin America which will benefit the firm to add to its balance sheet.

**Balance Sheet (Standalone)**

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Share Capital	399	399	399	399
Reserve and surplus	42,499	49,663	63,176	78,963
<b>Net Worth</b>	<b>42,898</b>	<b>50,062</b>	<b>63,576</b>	<b>79,363</b>
Long term debt	10,114	3,022	1,500	500
Long Term Provisions	380	302	354	396
Current liabilities	43,414	41,707	38,187	34,283
Deferred Tax Liabilities	2,083	1,324	1,700	1,700
<b>Total liabilities</b>	<b>98,889</b>	<b>96,417</b>	<b>105,317</b>	<b>116,242</b>
Fixed Assets	38,244	31,331	30,177	30,960
Non-Current Investment	6,740	6,145	6,300	6,500
Loans & Advances(LT)	5,336	7,801	8,565	9,567
Other Non-current Assets	260	364	280	300
Current Assets	48,310	50,776	59,995	68,914
<b>Total assets</b>	<b>98,889</b>	<b>96,417</b>	<b>105,317</b>	<b>116,241</b>

**Key Ratios (Standalone)**

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	15.3	13.8	13.8	13.1
EBIT Margin (%)	12.2	10.7	11.7	11.8
NPM (%)	10.1	8.9	9.2	9.0
ROCE (%)	52.0	46.4	45.4	41.7
ROE (%)	55.4	42.3	37.7	33.1
Adj EPS (₹)	119.1	106.1	120.0	131.4
P/E (x)	13.5	15.1	13.4	12.2
BVPS (₹)	214.8	250.7	318.4	397.4
P/BVPS (x)	7.5	6.4	5.0	4.0
EV/Operating Income (x)	8.3	8.7	8.0	7.6
EV/EBITDA (x)	9.1	9.8	8.9	8.4
EV/EBIT (x)	11.4	12.6	10.5	9.3

**Profit & Loss Account (Standalone)**

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Net Revenue	235,790	237,681	260,526	291,004
Expenses	199,603	204,836	224,550	252,960
EBITDA	36,187	32,845	35,976	38,045
Other Income	3,646	3,984	4,000	4,100
Depreciation	10,973	11,418	9,500	7,928
EBIT	28,860	25,411	30,476	34,217
Interest	213	119	150	150
Profit Before Tax	28,647	25,292	30,326	34,067
Tax	4,866	4,110	6,368	7,835
Net Profit	23,781	21,182	23,958	26,232

**Valuation and view**

HEROMOTOCO is on an expansion spree and is looking towards boosting production capacity and also plan to raise export turnover from key foreign markets. The company has been investing in new capacities after exiting ex-partner Honda and plans to invest nearly ₹27 bn in next couple of years. We expect HEROMOTOCO's revenues to grow at a CAGR of ~10% over FY12-14, aided by robust scooter segment demand which would improve the volume growth, realisation and market share.

At a current market price (CMP) of ₹1,602.3, the stock trades at 13.4x FY14E and of 12.2x FY15E, earnings. We recommend 'BUY' with a target price of ₹1,890, which implies potential upside of 18.0% to the CMP from 1 year perspective.



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