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FIRST LIGHT

11 June 2020

RESEARCH

[Sector Report] Vehicle Finance NBFCs

Recovery in H2FY22E

Hero MotoCorp | Target: Rs 2,300 | +0% | REDUCE

Optimism priced in – downgrade to REDUCE

SUMMARY

Vehicle Finance NBFCs

Automotive production and sales are expected to plummet to multi-year lows in FY21 as pressures arising from the Covid-19 crisis engulf both demand and supply channels. Tractors and two-wheelers should witness faster recovery (by H2FY21) than PVs and CVs as rural India benefits from a good rabi harvest and likely normal monsoons. We expect vehicle financiers to focus on collections and cost control in FY21, with disbursal growth staying muted in the range of 0-6% CAGR over FY21-FY24. Initiate with BUY on CIFC; ADD on MMFS.

Click here for the full report.

Hero MotoCorp

Hero MotoCorp (HMCL) posted an operationally weak Q4FY20 performance led by poor gross margins and one-off dealer support via discounts. Per management, the company is gradually achieving normalcy in business and clocking higher retail sales MoM, but it is too early to predict demand for FY21. The stock has witnessed a sharp ~50% rally since April. In our view, valuations look full at ~17x FY21E EPS – we downgrade our rating from BUY to REDUCE with a revised Mar'21 TP of Rs 2,300 (vs. Rs 2,140).

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	3,000
Cipla	Buy	690
Eicher Motors	Buy	18,100
GAIL	Buy	140
Petronet LNG	Buy	330

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,950
Greenply Industries	Buy	145
Laurus Labs	Buy	630
Muthoot Finance	Buy	950
Transport Corp	Buy	240

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.83	(5bps)	14bps	(132bps)
India 10Y yield (%)	5.99	(3bps)	2bps	(105bps)
USD/INR	75.62	(0.1)	(0.1)	(8.9)
Brent Crude (US$/bbl)	41.18	0.9	33.0	(33.9)
Dow	27,272	(1.1)	12.1	4.7
Shanghai	2,956	0.6	2.1	1.0
Sensex	33,957	(1.2)	7.3	(15.0)
India FII (US$ mn)	**8Jun**	**MTD**	**CYTD**	**FYTD**
FII-D	(4.6)	(230.3)	(14,285.6)	(4,526.1)
FII-E	139.2	2,737.3	(2,177.2)	4,425.7

Source: Bank of Baroda Economics Research

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NBFC

10 June 2020

Vehicle Finance NBFCs: Recovery in H2FY22E

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Slowdown in PVs and CVs; tractors and 2Ws bright spots: As per CRISIL, India's automobile sector is likely to hit a decadal low in car and truck sales in FY21. Sales of PVs and CVs are expected to sink to FY10 levels, with declines of ~25% and ~27% respectively given the extended lockdown to contain the pandemic. Demand revival in both these segments is expected only in H2FY22. 2Ws and tractors should recover faster in H2FY21 driven by a bumper rabi crop and a normal monsoon forecast. We expect disbursements in auto finance to remain within a tepid CAGR range of 0-6% during FY21-FY24.

Comfort on liquidity, focus on cost control and collections: We believe vehicle finance NBFCs will manage liquidity well in FY21 given regulatory support from RBI and cash levels at 8-10% of the balance sheet (maintained since the FY19 IL&FS crisis). Most players should benefit from a lower repo rate as liabilities come up for repricing. A focus on curbing discretionary and employee expenses will also curb opex, while planned diversion of manpower from sales to collection teams will strengthen the collections architecture.

Recommendations: We initiate coverage on Cholamandalam Investment and Finance (CIFC) with BUY (Mar'21 TP of Rs 200) and Mahindra & Mahindra Financial Services (MMFS) with ADD (Mar'21 TP of Rs 170). CIFC has built a diversified vehicle finance and granular home equity business, wherein we expect stable spreads of 6.2% through FY22 backed by strong pricing power.

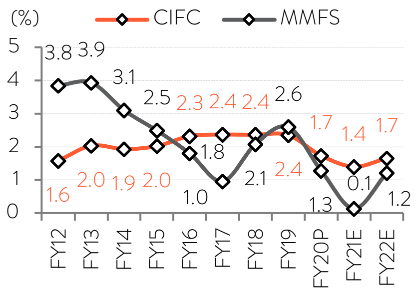
MMFS' pricing power is also likely to remain intact due to its wide distribution reach and multi-OEM client base. With surplus systemic liquidity and strong parentage in M&M, funding costs should decline. We expect covid-19 will weigh more on MMFS on credit costs and profitability than CIFC; normalisation in H2FY22.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
CIFC IN	156	200	BUY
MMFS IN	154	170	ADD

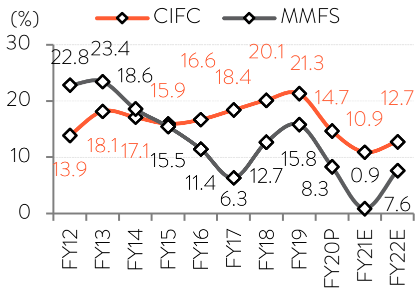
Price & Target in Rupees

CIFC HAS MORE PREDICTABLE ROA THAN MMFS...



Source: Company, BOBCAPS Research

...AND ALSO ROE



Source: Company, BOBCAPS Research

REDUCE
TP: Rs 2,300 | ⮝ 0%

HERO MOTOCORP | Automobiles | 10 June 2020

Optimism priced in – downgrade to REDUCE

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Subdued Q4FY20: Q4 revenues declined 24% YoY at Rs 62.4bn. Gross margin contracted 260bps both YoY and QoQ which weighed on EBITDA (Rs 6.6bn, –51% YoY). EBITDA margin at 10.6% was lower than our estimate of 11.7%. HMCL provided dealer support of ~Rs 1.1bn in Q4 and made a provision of Rs 570mn towards a pending GST refund for its Nimrana plant. Per management, adjusting for the lockdown impact and one-off items, EBITDA margin would have been higher at 13.5%. A lower net tax rate (at ~5%) due to transition to the new tax regime cushioned the fall in adj. PAT at 39% YoY.

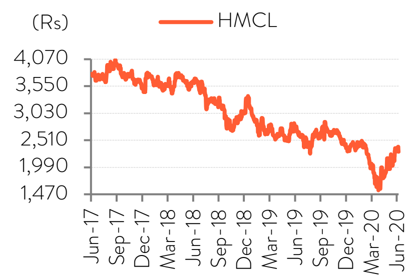
Business activities nearing pre-Covid levels: All of HMCL's plants are now operational and gradually ramping up production. All vendors are also operating and close to 90% of dealers have reopened. Management believes that the prevalence of social distancing norms, pent-up demand and a healthy rural outlook would support volumes, but low customer affordability clouds the demand forecast for FY21.

Cut to REDUCE: After the recent rally in the stock, we believe market optimism is largely priced in. We arrive at a revised Mar'21 TP of Rs 2,300, valuing the stock at 14x FY22E EPS (vs. 13x earlier) and assign a REDUCE rating (vs. BUY earlier).

Ticker/Price	HMCL IN/Rs 2,292
Market cap	US$ 6.1bn
Shares o/s	200mn
3M ADV	US$ 49.3mn
52wk high/low	Rs 3,023/Rs 1,475
Promoter/FPI/DII	35%/36%/18%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	322,305	336,505	286,033	298,780	336,060
EBITDA (Rs mn)	52,802	49,301	39,993	37,084	45,002
Adj. net profit (Rs mn)	36,974	33,848	28,469	27,209	32,916
Adj. EPS (Rs)	185.1	169.5	142.5	136.2	164.8
Adj. EPS growth (%)	9.5	(8.5)	(15.9)	(4.4)	21.0
Adj. ROAE (%)	31.4	26.3	19.6	17.7	19.8
Adj. P/E (x)	12.4	13.5	16.1	16.8	13.9
EV/EBITDA (x)	7.8	8.1	10.0	11.0	9.0

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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