

BUY

TP: Rs 2,190 | ▲ 37%

HERO MOTOCORP

Automobiles

31 March 2020

Valuations attractive – upgrade to BUY

At Hero MotoCorp's (HMCL) investor call today, senior management stated that proactive steps have been taken to ensure business continuity. With comfortable liquidity, positive feedback from BS-VI models and the likelihood of pent-up demand, HMCL hopes to bounce back as market conditions normalise. Following a steep 22% correction in the past month, the stock is at cheap valuations of 13x FY21E on our bear case earnings – upgrade from REDUCE to BUY. We have a revised Mar'21 TP of Rs 2,190 (vs Rs 2,360) as we lower FY20-FY22 EPS 5-14%.

Navin Matta | Nishant Chowhan, CFA

research@bobcaps.in

Demand outlook hazy; inventory under control: HMCL refrained from giving out any guidance on the demand outlook given that the duration of the lockdown and economic fallout from Covid-19 are unknown. BS-IV inventory prior to 25 March totalled 150k units and the company has extended discounts of Rs 10k-15k across models to liquidate this inventory through online sales. Current BS-VI inventory stands at ~35 days of sales.

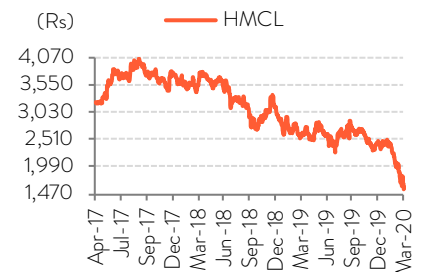
Other key takeaways: (1) Recurring monthly opex is ~Rs 2bn. (2) HMCL currently has ~Rs 40bn in net cash, which should ensure business continuity. (3) Product development projects will progress as planned. (4) Management expects tailwinds from lower crude oil prices and other commodities. (5) HMCL is unlikely to undertake a buyback as the company looks to conserve resources in these uncertain times.

Upgrade to BUY: While we acknowledge BS-VI-led demand challenges and competitive risks in the two-wheeler space, especially for HMCL, we think the recent sharp fall in stock price adequately prices in these concerns. HMCL is trading at 13x FY21E EPS under our bear case earnings scenario (refer Fig 1), which is a ~30% discount to the 10Y average multiple. We upgrade our rating to BUY with a revised TP of Rs 2,190 based on 13x FY22E EPS.

Ticker/Price	HMCL IN/Rs 1,596
Market cap	US\$ 4.2bn
Shares o/s	200mn
3M ADV	US\$ 27.6mn
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	FY20E	FY21E	FY22E
Total revenue (Rs mn)	322,305	336,505	289,315	306,513	344,781
EBITDA (Rs mn)	52,802	49,301	42,005	38,211	45,883
Adj. net profit (Rs mn)	36,974	33,848	30,559	28,107	33,669
Adj. EPS (Rs)	185.1	169.5	153.0	140.7	168.6
Adj. EPS growth (%)	9.5	(8.5)	(9.7)	(8.0)	19.8
Adj. ROAE (%)	31.4	26.3	20.7	17.9	19.8
Adj. P/E (x)	8.6	9.4	10.4	11.3	9.5
EV/EBITDA (x)	5.2	5.3	6.3	7.0	5.8

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – HMCL: SCENARIO ANALYSIS

(Rs mn)	Bear		Base		Bull	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Volume (mn)	5.6	6.1	6.1	6.8	6.5	7.4
YoY (%)	(13.0)	9.3	(5.2)	11.5	1.9	13.0
Net Sales	284,579	314,595	306,513	344,781	326,180	371,446
EBITDA	33,508	40,113	38,211	45,883	42,811	52,167
EBITDA margin (%)	11.8	12.8	12.5	13.3	13.1	14.0
PAT	24,512	29,222	28,107	33,669	31,645	38,571
EPS (Rs)	122.7	146.3	140.7	168.6	158.4	193.1
YoY (%)	(19.8)	19.2	(8.0)	19.8	3.6	21.9

Source: Company, BOBCAPS Research

Valuation methodology

We value HMCL at 13x FY22E EPS which is a ~30% discount to its 10-year average. Our target multiple factors in the modest long-term growth outlook for the domestic 2W industry. While the impact of Covid-19 would vary significantly depending on the duration of the lockdown, our current base case estimates for FY21 build in a 5% YoY drop in volumes for HMCL (H1FY21: -24% YoY, H2FY21: +18% YoY), on the heels of an 18% YoY volume decline in FY20.

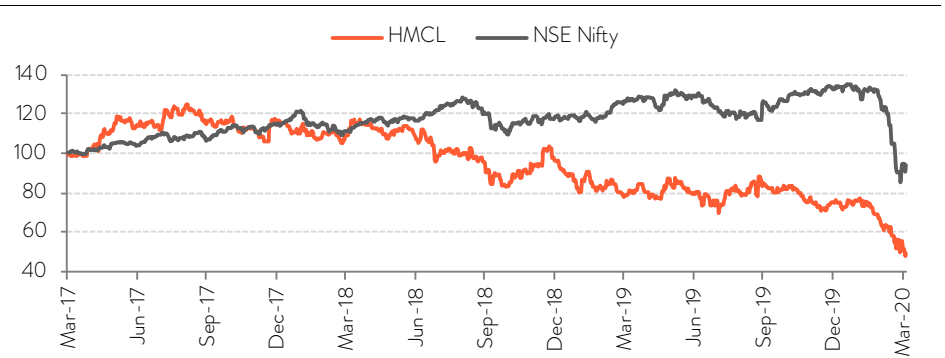
Following a steep 22% correction in the past month, the stock is at cheap valuations of 13x FY21E on our bear-case earnings – we thus upgrade our rating from REDUCE to BUY. We have a revised Mar'21 target price of Rs 2,190 (vs. Rs 2,360 earlier) as we lower FY20-FY22 EPS estimates by 5-14%.

FIG 2 – REVISED ESTIMATES

Change (%)	FY20E	FY21E	FY22E
Volume	(5.3)	(13.8)	(9.1)
Income	(5.2)	(11.4)	(7.2)
EBITDA	(5.7)	(12.4)	(6.3)
EBITDA Margin (bps)	(8)	(13)	11
Profit	(5.5)	(13.2)	(7.2)
EPS (Rs)	(5.6)	(13.5)	(7.2)

Source: Company, BOBCAPS Research

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- An extended lockdown due to Covid-19 will result in a protracted economic and consumption slowdown, especially affecting lower-income households that form a sizeable chunk of 2W buyers.
- Above-expected competition to gain market share could result in further deterioration in industry-level profitability.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	322,305	336,505	289,315	306,513	344,781
EBITDA	52,802	49,301	42,005	38,211	45,883
Depreciation	5,556	6,020	8,387	8,559	9,328
EBIT	47,246	43,281	33,618	29,652	36,555
Net interest income/(expenses)	(63)	(86)	(215)	(215)	(237)
Other income/(expenses)	5,258	6,912	7,342	7,546	7,983
Exceptional items	0	0	7,274	0	0
EBT	52,442	50,107	48,018	36,983	44,301
Income taxes	15,468	16,259	10,186	8,876	10,632
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	36,974	33,848	37,832	28,107	33,669
Adjustments	0	0	(7,274)	0	0
Adjusted net profit	36,974	33,848	30,559	28,107	33,669

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	33,188	33,553	28,946	30,695	34,614
Other current liabilities	9,647	7,160	7,260	7,360	7,460
Provisions	1,747	1,762	1,862	1,962	2,062
Debt funds	0	0	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	399	400	400	400	400
Reserves & surplus	117,289	128,172	147,307	156,718	169,353
Shareholders' fund	117,689	128,571	147,707	157,117	169,753
Total liabilities and equities	162,271	171,047	185,776	197,136	213,890
Cash and cash eq.	66,456	45,333	53,849	52,318	62,377
Accounts receivables	15,202	28,216	25,899	30,695	31,881
Inventories	8,236	10,724	9,141	9,693	10,931
Other current assets	17,556	24,817	29,317	31,917	34,517
Investments	10,209	15,717	16,718	17,718	18,717
Net fixed assets	46,545	46,186	56,217	60,159	60,831
CWIP	3,184	5,419	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(5,117)	(5,365)	(5,365)	(5,365)	(5,365)
Other assets	0	0	0	0	0
Total assets	162,271	171,047	185,776	197,136	213,890

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	42,530	39,869	46,219	36,666	42,997
Interest expenses	63	86	215	215	237
Non-cash adjustments	973	248	0	0	0
Changes in working capital	(27)	(24,871)	(5,007)	(5,999)	(905)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	43,539	15,333	41,427	30,881	42,329
Capital expenditures	(6,679)	(7,895)	(13,000)	(12,500)	(10,000)
Change in investments	(1,551)	(5,508)	(1,000)	(1,000)	(1,000)
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(8,230)	(13,404)	(14,000)	(13,500)	(11,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(63)	(86)	(215)	(215)	(237)
Dividends paid	(22,197)	(20,333)	(18,697)	(18,697)	(21,034)
Other financing cash flows	1,799	(2,634)	0	0	0
Cash flow from financing	(20,460)	(23,052)	(18,912)	(18,912)	(21,270)
Changes in cash and cash eq.	14,848	(21,123)	8,515	(1,530)	10,058
Closing cash and cash eq.	66,456	45,333	53,849	52,318	62,377

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	185.1	169.5	153.0	140.7	168.6
Adjusted EPS	185.1	169.5	153.0	140.7	168.6
Dividend per share	95.0	87.0	80.0	80.0	90.0
Book value per share	589.3	643.7	739.5	786.6	849.8

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	0.8	0.8	0.9	0.9	0.8
EV/EBITDA	5.2	5.3	6.3	7.0	5.8
Adjusted P/E	8.6	9.4	10.4	11.3	9.5
P/BV	2.7	2.5	2.2	2.0	1.9

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	70.5	67.6	78.8	76.0	76.0
Interest burden (PBT/EBIT)	111.0	115.8	142.8	124.7	121.2
EBIT margin (EBIT/Revenue)	14.7	12.9	11.6	9.7	10.6
Asset turnover (Revenue/Avg TA)	211.3	201.9	162.2	160.1	167.8
Leverage (Avg TA/Avg Equity)	139.4	135.4	129.2	125.6	125.7
Adjusted ROAE	31.4	26.3	20.7	17.9	19.8

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	13.1	4.4	(14.0)	5.9	12.5
EBITDA	13.9	(6.6)	(14.8)	(9.0)	20.1
Adjusted EPS	9.5	(8.5)	(9.7)	(8.0)	19.8
Profitability & Return ratios (%)					
EBITDA margin	16.4	14.7	14.5	12.5	13.3
EBIT margin	14.7	12.9	11.6	9.7	10.6
Adjusted profit margin	11.5	10.1	10.6	9.2	9.8
Adjusted ROAE	31.4	26.3	20.7	17.9	19.8
ROCE	42.8	37.5	26.8	22.9	25.4
Working capital days (days)					
Receivables	17	31	33	37	34
Inventory	9	12	12	12	12
Payables	38	36	37	37	37
Ratios (x)					
Gross asset turnover	2.6	2.4	1.8	1.8	1.9
Current ratio	2.4	2.6	3.1	3.1	3.2
Net interest coverage ratio	755.9	503.3	156.4	137.9	154.6
Adjusted debt/equity	(0.6)	(0.4)	(0.4)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

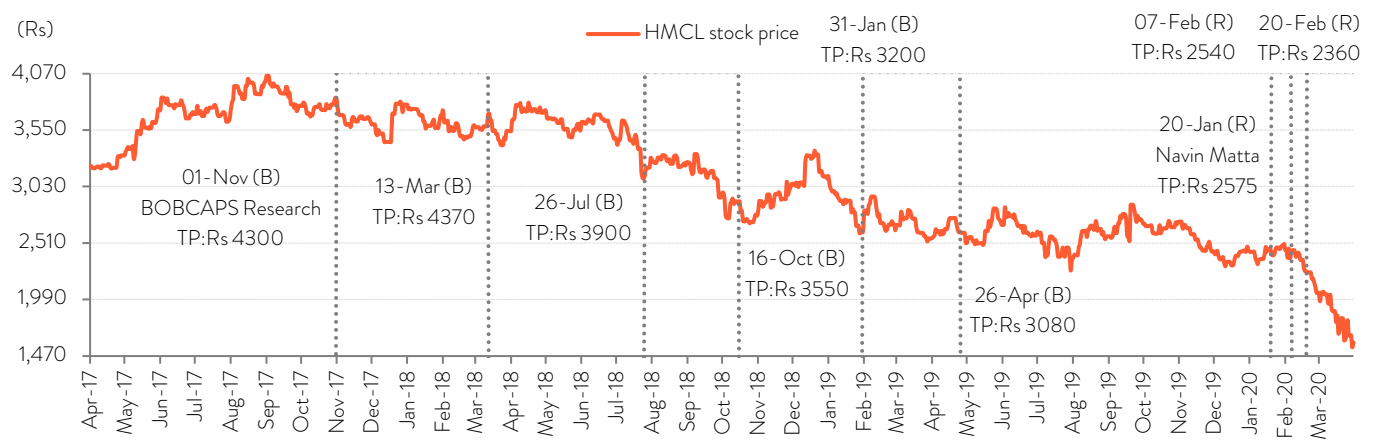
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: HERO MOTOCORP (HMCL IN)



B – Buy, A – Add, R – Reduce, S – Sell

Rating distribution

As of 29 February 2020, out of 85 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 50 have BUY ratings, 17 are rated ADD, 9 are rated REDUCE and 9 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2020. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations

expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.