

**REDUCE**

TP: Rs 2,700 | ▼ 4%

**HERO MOTOCORP**

Automobiles

14 August 2020

**Optimism priced in – maintain REDUCE**

Hero MotoCorp (HMCL) delivered a Q1FY21 revenue beat but disappointed on earnings due to lower operating efficiencies. Per management, production is gradually returning to normal and HMCL is gearing up to fill the low inventory levels at dealers ahead of the festive season. Supply is currently ahead of demand, but the company has the buffer of inventory filling. We adjust FY21/FY22 earnings by +5%/–5% and maintain REDUCE as valuations look full at 17x FY22E EPS. On rollover to Sep’21, our TP remains at Rs 2,700.

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**Lower operating efficiencies impact Q1:** Q1 revenues at Rs 29.7bn (–63% YoY) came in ahead of our estimate of Rs 26.6bn, purely driven by a 21% YoY jump in ASP (9% est.). Volumes for the quarter were down 69% YoY. Gross margin contraction of 120bps QoQ and lower operating efficiencies (fixed costs of Rs 2bn every month during lockdown) weighed on EBITDA (Rs 1.1bn, –91% YoY). EBITDA margin at 3.6% was far short of our estimate of 12.2%. Per management, adjusting for the lockdown impact EBITDA margin would have been higher at 12%. Adj. PAT declined 88% YoY to Rs 613mn.

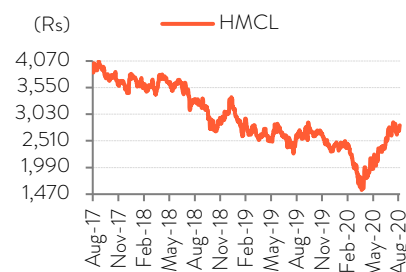
**Ramping up production:** All of HMCL’s plants are now operational and gradually ramping up production. While inventory at dealers has been low and our channel checks suggest that retail demand in July was lower than June, the company intends to continue supply ahead of the upcoming festive season to take advantage of low inventories.

**Maintain REDUCE:** We expect HMCL to clock a CAGR of 9%/9%/9% in revenue/EBITDA/PAT during FY20-FY23. Following the recent stock rally, we believe market optimism is priced in and hence maintain REDUCE. Our Sep’21 TP of Rs 2,700 values the stock at an unchanged 15x one-year forward EPS.

Ticker/Price	HMCL IN/Rs 2,810
Market cap	US\$ 7.5bn
Shares o/s	200mn
3M ADV	US\$ 58.8mn
52wk high/low	Rs 3,023/Rs 1,475
Promoter/FPI/DII	35%/32%/19%

Source: NSE

**STOCK PERFORMANCE**



Source: NSE

**KEY FINANCIALS**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	336,505	288,361	269,538	343,661	378,576
EBITDA (Rs mn)	49,301	39,580	32,862	45,166	50,167
Adj. net profit (Rs mn)	33,849	29,559	23,151	33,657	38,285
Adj. EPS (Rs)	169.5	148.0	115.9	168.5	191.7
Adj. EPS growth (%)	(8.5)	(12.7)	(21.7)	45.4	13.7
Adj. ROAE (%)	26.3	20.9	15.0	19.6	19.7
Adj. P/E (x)	16.6	19.0	24.2	16.7	14.7
EV/EBITDA (x)	11.4	14.1	17.0	12.4	11.1

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 – QUARTERLY PERFORMANCE**

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Volume (nos)	563,426	1,842,920	(69.4)	1,334,503	(57.8)
Avg. Realisation per Vehicle	52,741	43,574	21.0	46,747	12.8
Net Revenues	29,715	80,303	(63.0)	62,384	(52.4)
<b>Total Income (A)</b>	<b>29,715</b>	<b>80,303</b>	<b>(63.0)</b>	<b>62,384</b>	<b>(52.4)</b>
<b>Operating Expenses:</b>					
Raw materials consumed	20,939	55,919	(62.6)	43,200	(51.5)
Employee Expenses	3,824	4,677	(18.2)	4,354	(12.2)
Other Expenses	3,872	8,127	(52.4)	8,231	(53.0)
<b>Total Expenditure (B)</b>	<b>28,635</b>	<b>68,723</b>	<b>(58.3)</b>	<b>55,785</b>	<b>(48.7)</b>
<b>EBITDA (A-B)</b>	<b>1,081</b>	<b>11,580</b>	<b>(90.7)</b>	<b>6,599</b>	<b>(83.6)</b>
Other Income	1,485	2,188	(32.2)	1,695	(12.4)
Depreciation	1,708	2,361	(27.7)	1,747	(2.3)
<b>EBIT</b>	<b>858</b>	<b>11,407</b>	<b>(92.5)</b>	<b>6,547</b>	<b>(86.9)</b>
Finance Costs	63	44	43.2	41	54.2
PBT before excep items	795	11,364	(93.0)	6,506	(87.8)
Exceptional items	-	(7,374)	NA	-	NA
PBT after excep items	795	18,738	(95.8)	6,506	(87.8)
Tax expense	182	6,165	(97.1)	299	(39.2)
<b>Reported PAT</b>	<b>613</b>	<b>12,573</b>	<b>(95.1)</b>	<b>6,207</b>	<b>(90.1)</b>
Adjusted PAT	613	5,199	(88.2)	6,207	(90.1)
Adj EPS (Rs)	3.1	26.0	(88.2)	31.1	(90.1)

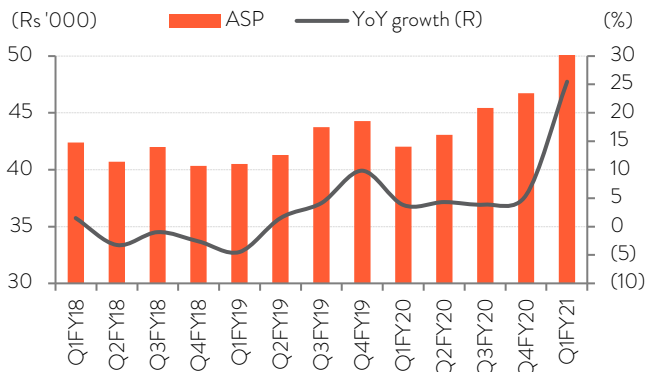
Source: Company, BOBCAPS Research

**FIG 2 – PER UNIT PARAMETERS**

(%)	Q1FY21	Q1FY20	YoY (bps)	Q4FY20	QoQ (bps)
Gross margin	29.5	30.4	(83)	31	(122)
EBITDA margin	3.6	14.4	(1,078)	11	(694)
EBIT margin	2.9	14.2	(1,132)	10	(761)
PBT margin	2.7	14.2	(1,148)	10	(775)
Tax rate	22.9	32.9	(1,003)	5	1,828
Adj PAT margin	2.1	6.5	(441)	10	(789)

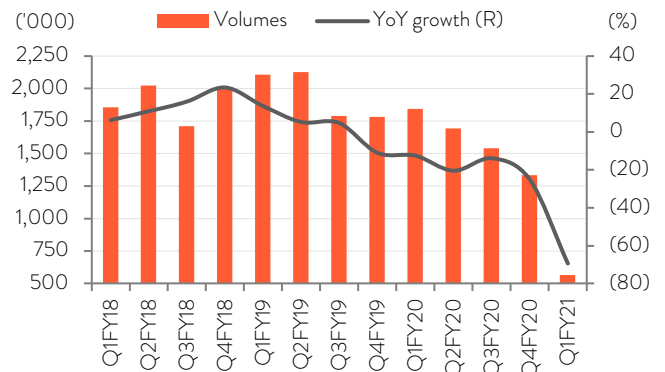
Source: Company, BOBCAPS Research

**FIG 3 – AVERAGE SELLING PRICE (ASP)**



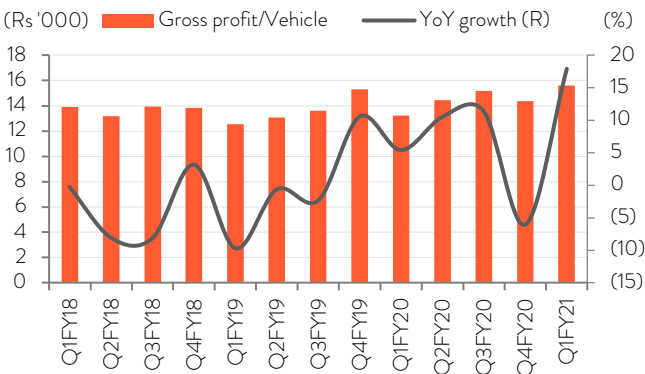
Source: Company, BOBCAPS Research

**FIG 4 – VOLUME GROWTH TREND**



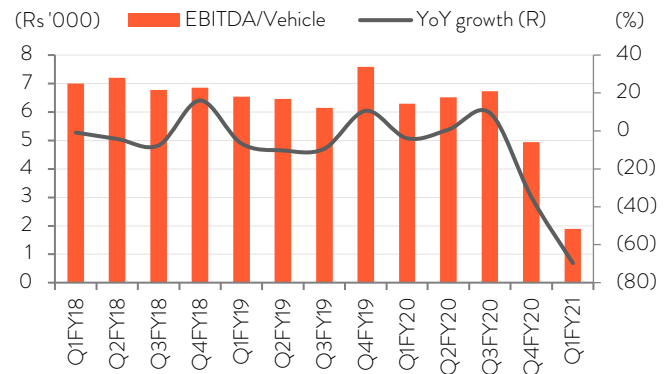
Source: SIAM, BOBCAPS Research

**FIG 5 – GROSS PROFIT/VEHICLE**



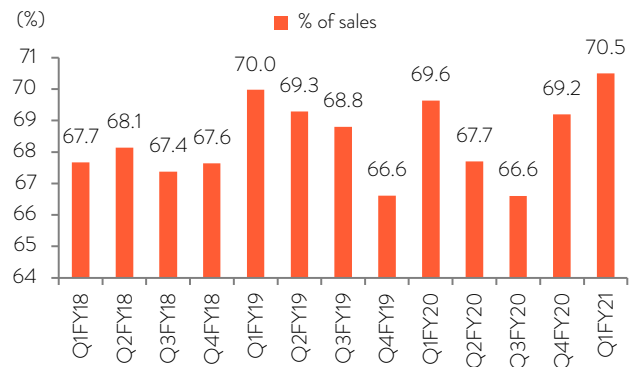
Source: BOBCAPS Research, Company

**FIG 6 – EBITDA/VEHICLE**



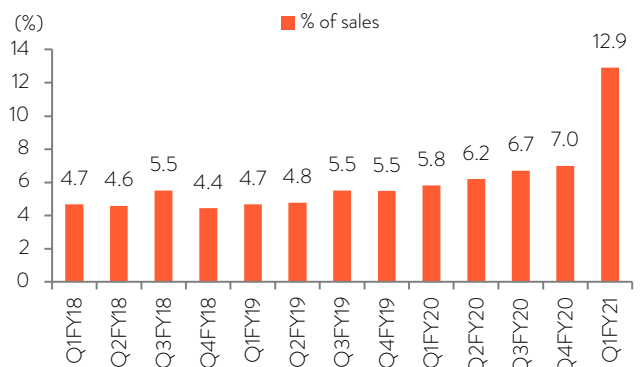
Source: BOBCAPS Research, Company

**FIG 7 – RM COST/SALES TREND**



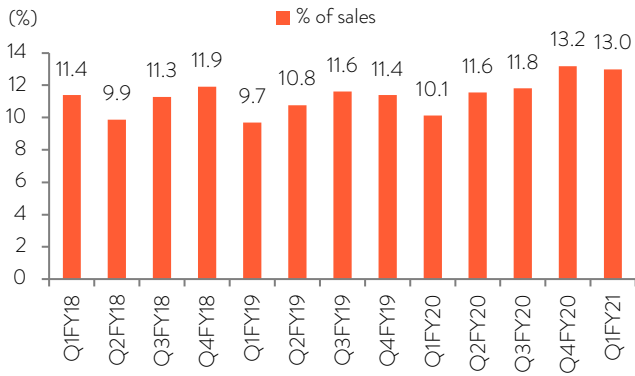
Source: Company, BOBCAPS Research

**FIG 8 – EMPLOYEE COST/SALES TREND**



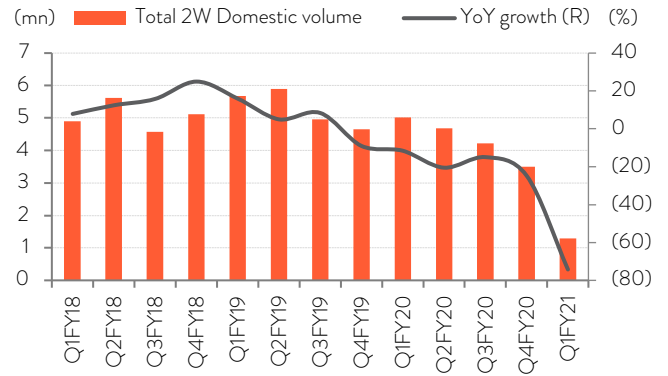
Source: Company, BOBCAPS Research

**FIG 9 – OTHER EXPENSES/SALES TREND**



Source: Company, BOBCAPS Research

**FIG 10 – DOMESTIC 2W INDUSTRY VOLUME TREND**



Source: SIAM, BOBCAPS Research

## Earnings call highlights

- In Q1, HMCL gained ~500bps market share and expects to sustain these gains going ahead.
- Per management, personal mobility needs have surged given social distancing norms and limited public transport facilities, which should benefit the company.
- Erratic lockdowns have led to supply chain issues but production has been ramping up on a sequential basis.
- According to HMCL, there is not much price difference between an e-carburetor (used by its competitors) and a fuel injection system.
- Scooter sales have been weak in recent months due to stricter lockdowns in urban areas. However, post relaxations of these lockdowns, scooter demand should pick up.
- HMCL will roll out its LEAP-II programme aimed at driving cost savings of ~100bps (double the target of LEAP-I).
- Capex planned for FY21 totals Rs 6bn.
- Spare parts revenue for Q1 was at Rs 2.9bn.

## Valuation methodology

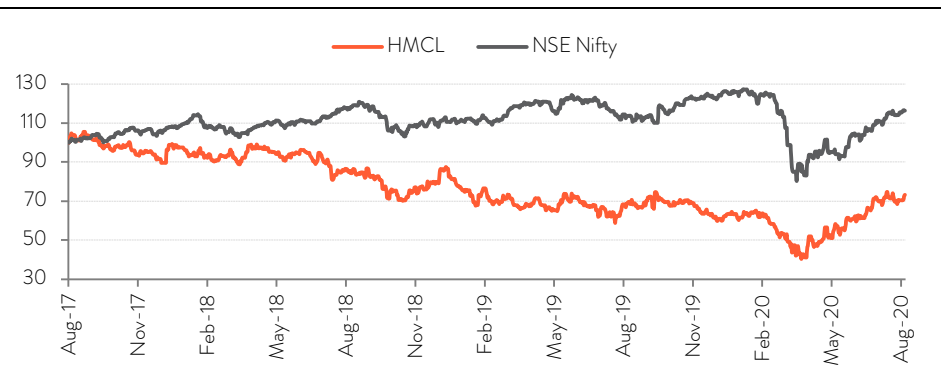
We adjust FY21/FY22 earnings estimates by +5%/–5% to bake in the Q1FY21 performance and now expect HMCL to clock a CAGR of 9%/9%/9% in revenue/EBITDA/PAT during FY20–FY23. On rolling valuations forward, our Sep'21 target price remains at Rs 2,700, set at an unchanged 15x Sep'22E EPS. Following the recent rally, the stock is trading at 24x/17x FY21E/FY22E EPS. We believe market optimism is priced in and maintain REDUCE given limited upsides from current levels.

**FIG 11 – REVISED ESTIMATES**

(%)	FY21E	FY22E
Revenues	6.5	6.5
EBITDA	3.9	(5.1)
EBITDA margin (bps)	(2.4)	(10.9)
Adj. PAT	5.1	(5.4)
EPS	5.1	(5.4)

Source: BOBCAPS Research, Company

**FIG 12 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

- A sharp rise in financing ratio for 2Ws along with favourable credit terms such as extension of loan tenures may reduce the expected negative impact on 2W demand.
- Above-expected pickup in rural demand on the back of good monsoons would disproportionately benefit HMCL given its higher volume mix from these markets – posing an upside risk to our volume estimates.
- Further declines in commodity costs could support margins despite tepid volume growth, though this may be priced away over time due to the elevated competitive intensity.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>336,505</b>	<b>288,361</b>	<b>269,538</b>	<b>343,661</b>	<b>378,576</b>
EBITDA	49,301	39,580	32,862	45,166	50,167
Depreciation	6,020	8,180	9,273	9,923	10,638
EBIT	50,193	39,184	31,170	45,216	51,403
Net interest income/(expenses)	(86)	(220)	(220)	(220)	(220)
Other income/(expenses)	6,913	7,783	7,580	9,973	11,873
Exceptional items	(934)	6,774	0	0	0
EBT	49,173	45,737	30,950	44,996	51,183
Income taxes	16,259	9,404	7,799	11,339	12,898
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>32,915</b>	<b>36,333</b>	<b>23,151</b>	<b>33,657</b>	<b>38,285</b>
Adjustments	934	(6,774)	0	0	0
<b>Adjusted net profit</b>	<b>33,849</b>	<b>29,559</b>	<b>23,151</b>	<b>33,657</b>	<b>38,285</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	34,556	30,305	32,075	43,301	39,751
Other current liabilities	6,158	7,990	4,610	10,428	6,227
Provisions	590	2,689	2,689	2,689	2,689
Debt funds	0	0	0	0	0
Other liabilities	1,172	1,217	1,217	1,217	1,217
Equity capital	400	400	400	400	400
Reserves & surplus	128,172	140,965	154,073	171,755	194,065
Shareholders' fund	128,572	141,364	154,472	172,154	194,464
<b>Total liabilities and equities</b>	<b>171,047</b>	<b>183,565</b>	<b>195,063</b>	<b>229,789</b>	<b>244,347</b>
Cash and cash eq.	1,365	2,419	3,140	1,828	1,986
Accounts receivables	28,216	16,031	24,258	27,493	30,286
Inventories	10,724	10,920	9,703	13,059	13,629
Other current assets	9,181	7,244	7,695	8,066	8,240
Investments	59,686	82,227	86,227	113,227	124,227
Net fixed assets	46,186	61,171	59,898	61,976	61,338
CWIP	5,419	3,413	4,000	4,000	4,500
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(5,365)	(3,928)	(3,928)	(3,928)	(3,928)
Other assets	15,636	4,070	4,070	4,070	4,070
<b>Total assets</b>	<b>171,047</b>	<b>183,565</b>	<b>195,063</b>	<b>229,789</b>	<b>244,347</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	39,869	37,739	32,423	43,580	48,922
Interest expenses	(86)	(220)	(220)	(220)	(220)
Non-cash adjustments	(6,913)	(7,783)	(7,580)	(9,973)	(11,873)
Changes in working capital	(24,871)	25,218	(9,072)	10,084	(11,289)
Other operating cash flows	(4,078)	2,301	0	0	0
<b>Cash flow from operations</b>	<b>3,922</b>	<b>57,254</b>	<b>15,551</b>	<b>43,471</b>	<b>25,540</b>
Capital expenditures	(7,895)	(21,159)	(8,587)	(12,000)	(10,500)
Change in investments	15,566	(22,540)	(4,000)	(27,000)	(11,000)
Other investing cash flows	6,913	7,783	7,580	9,973	11,873
<b>Cash flow from investing</b>	<b>14,583</b>	<b>(35,916)</b>	<b>(5,007)</b>	<b>(29,027)</b>	<b>(9,627)</b>
Equities issued/Others	57	44	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(86)	(220)	(220)	(220)	(220)
Dividends paid	(18,974)	(19,170)	(9,984)	(15,975)	(15,975)
Other financing cash flows	249	(1,437)	0	0	0
<b>Cash flow from financing</b>	<b>(18,754)</b>	<b>(20,783)</b>	<b>(10,204)</b>	<b>(16,195)</b>	<b>(16,195)</b>
<b>Changes in cash and cash eq.</b>	<b>(249)</b>	<b>555</b>	<b>339</b>	<b>(1,752)</b>	<b>(282)</b>
<b>Closing cash and cash eq.</b>	<b>1,365</b>	<b>2,419</b>	<b>3,140</b>	<b>1,828</b>	<b>1,986</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	169.5	148.0	115.9	168.5	191.7
Adjusted EPS	169.5	148.0	115.9	168.5	191.7
Dividend per share	95.0	80.0	50.0	80.0	80.0
Book value per share	643.9	707.9	773.6	862.1	973.8

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	1.7	1.9	2.1	1.6	1.5
EV/EBITDA	11.4	14.1	17.0	12.4	11.1
Adjusted P/E	16.6	19.0	24.2	16.7	14.7
P/BV	4.4	4.0	3.6	3.3	2.9

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	68.8	64.6	74.8	74.8	74.8
Interest burden (PBT/EBIT)	98.0	116.7	99.3	99.5	99.6
EBIT margin (EBIT/Revenue)	14.9	13.6	11.6	13.2	13.6
Asset turnover (Revenue/Avg TA)	270.7	211.8	180.7	208.9	205.2
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	27.5	21.9	15.7	20.6	20.9

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



**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	4.4	(14.3)	(6.5)	27.5	10.2
EBITDA	(6.6)	(19.7)	(17.0)	37.4	11.1
Adjusted EPS	(8.5)	(12.7)	(21.7)	45.4	13.7
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	14.7	13.7	12.2	13.1	13.3
EBIT margin	14.9	13.6	11.6	13.2	13.6
Adjusted profit margin	10.1	10.3	8.6	9.8	10.1
Adjusted ROAE	26.3	20.9	15.0	19.6	19.7
ROCE	27.0	22.9	15.6	20.6	20.8
<b>Working capital days (days)</b>					
Receivables	24	28	27	27	28
Inventory	10	14	14	12	13
Payables	54	60	60	57	57
<b>Ratios (x)</b>					
Gross asset turnover	0.3	0.5	0.5	0.5	0.4
Current ratio	1.2	0.9	1.1	0.9	1.1
Net interest coverage ratio	(583.6)	(177.9)	(141.7)	(205.5)	(233.6)
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

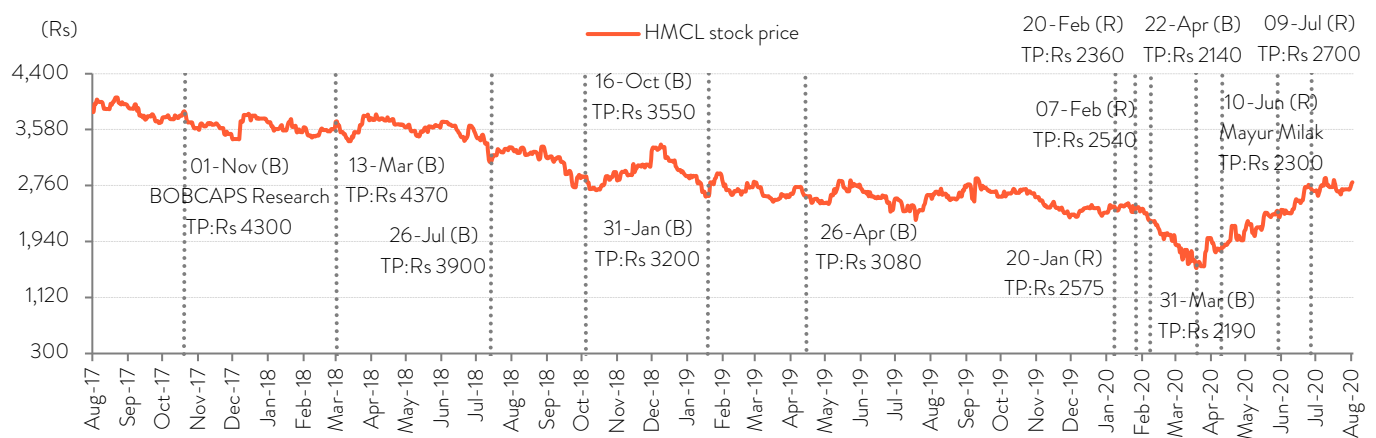
**ADD** – Expected return from >+5% to +15%

**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)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): HERO MOTOCORP (HMCL IN)



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

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