

**REDUCE**

TP: Rs 2,300 | ▲ 0%

**HERO MOTOCORP**

Automobiles

10 June 2020

## Optimism priced in – downgrade to REDUCE

**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).**

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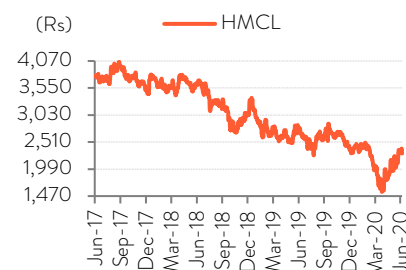
**Subdued Q4FY20:** Q4 revenues declined 24% YoY at Rs 62.4bn. Gross margin contracted 260bps both YoY and QoQ which weighed on EBITDA (Rs 6.6bn, -51% YoY). EBITDA margin at 10.6% was lower than our estimate of 11.7%. HMCL provided dealer support of ~Rs 1.1bn in Q4 and made a provision of Rs 570mn towards 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.

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

**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.

## STOCK PERFORMANCE



Source: NSE

**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).

## 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

**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 – STANDALONE**

Y/E Mar (Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
<b>Net Revenues</b>	<b>62,384</b>	<b>81,652</b>	<b>(23.6)</b>	<b>69,967</b>	<b>(10.8)</b>	<b>288,361</b>	<b>339,308</b>	<b>(15.0)</b>
Raw Materials	43,200	54,385	(20.6)	46,598	(7.3)	196,974	233,177	(15.5)
% of Net Sales	69.2	66.6	-	66.6	-	68.3	68.7	-
Personnel	4,354	4,473	(2.7)	4,697	(7.3)	18,417	17,302	6.4
% of Net Sales	7.0	5.5	-	6.7	-	6.4	5.1	-
Manufacturing & Other Exp	8,231	9,298	(11.5)	8,282	(0.6)	33,390	36,725	(9.1)
% of Net Sales	13.2	11.4	-	11.8	-	11.6	10.8	-
Total Expenditure	55,785	68,156	(18.2)	59,578	(6.4)	248,781	287,205	(13.4)
<b>EBITDA</b>	<b>6,599</b>	<b>13,496</b>	<b>(51.1)</b>	<b>10,390</b>	<b>(36.5)</b>	<b>39,580</b>	<b>52,104</b>	<b>(24.0)</b>
<b>EBITDA Margin (%)</b>	<b>10.6</b>	<b>16.5</b>	<b>-</b>	<b>14.8</b>	<b>-</b>	<b>13.7</b>	<b>15.4</b>	<b>-</b>
Depreciation	1,747	1,502	16.3	2,037	(14.2)	8,180	6,020	35.9
<b>EBIT</b>	<b>4,852</b>	<b>11,994</b>	<b>(59.5)</b>	<b>8,352</b>	<b>(41.9)</b>	<b>31,400</b>	<b>46,083</b>	<b>(31.9)</b>
Interest Expenses	41	22	85.4	59	(31.4)	220	86	156.0
Non-operating income	1,695	1,642	3.2	1,822	(7.0)	7,283	6,913	5.4
Extraordinary Expenses	0	0	NA	0	NA	(7,274)	0	NA
Extraordinary Income	0	0	NA	0	NA	0	0	NA
<b>PBT</b>	<b>6,506</b>	<b>13,614</b>	<b>(52.2)</b>	<b>10,115</b>	<b>(35.7)</b>	<b>45,737</b>	<b>52,910</b>	<b>(13.6)</b>
Tax-Total	299	3,508	(91.5)	1,311	(77.2)	9,404	16,259	(42.2)
Tax Rate (%) - Total	4.6	25.8	(82.2)	13.0	-	20.6	30.7	(33.1)
<b>Reported PAT</b>	<b>6,207</b>	<b>10,106</b>	<b>(38.6)</b>	<b>8,804</b>	<b>(29.5)</b>	<b>36,333</b>	<b>36,651</b>	<b>(0.9)</b>
<b>Adj. PAT</b>	<b>6,207</b>	<b>10,106</b>	<b>(38.6)</b>	<b>8,804</b>	<b>(29.5)</b>	<b>31,241</b>	<b>36,651</b>	<b>(14.8)</b>
<b>PAT Margin</b>	<b>9.9</b>	<b>12.4</b>	<b>-</b>	<b>12.6</b>	<b>-</b>	<b>10.8</b>	<b>10.8</b>	<b>-</b>

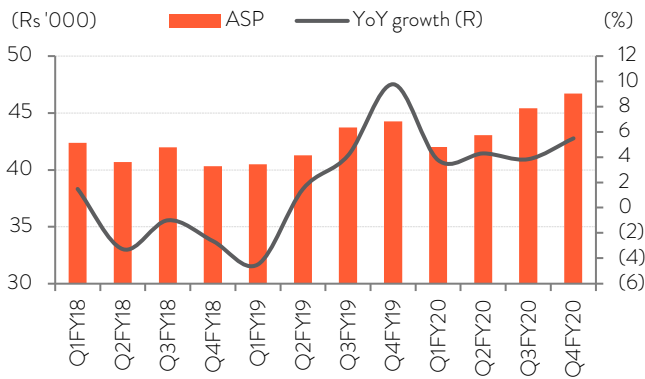
Source: Company, BOBCAPS Research

**FIG 2 – PER UNIT PARAMETERS**

Y/E Mar (Rs)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
<b>Sales Volume (nos)</b>	<b>1,334,511</b>	<b>1,781,276</b>	<b>(25.1)</b>	<b>1,540,868</b>	<b>(13.4)</b>	<b>6,409,719</b>	<b>7,820,861</b>	<b>(18.0)</b>
Net Realisation/Vehicle	46,747	45,839	2.0	45,408	2.9	44,988	43,385	3.7
Material cost/Vehicle	32,371	30,532	6.0	30,241	7.0	30,731	29,815	3.1
Gross Profit/Vehicle	14,376	15,308	(6.1)	15,166	(5.2)	14,258	13,570	5.1
Employee cost/Vehicle	3,263	2,511	29.9	3,048	7.0	2,873	2,212	29.9
Other expenses/Vehicle	6,168	5,220	18.2	5,375	14.8	5,209	4,696	10.9
EBITDA/Vehicle	4,945	7,576	(34.7)	6,743	(26.7)	6,175	6,662	(7.3)
Net Profit/Vehicle	4,651	5,673	(18.0)	5,714	(18.6)	4,874	4,686	4.0

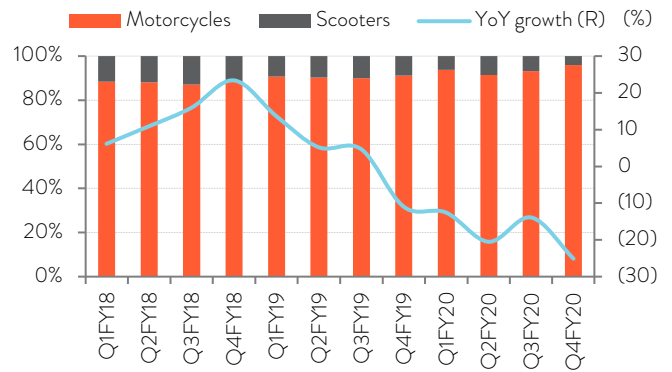
Source: Company, BOBCAPS Research

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



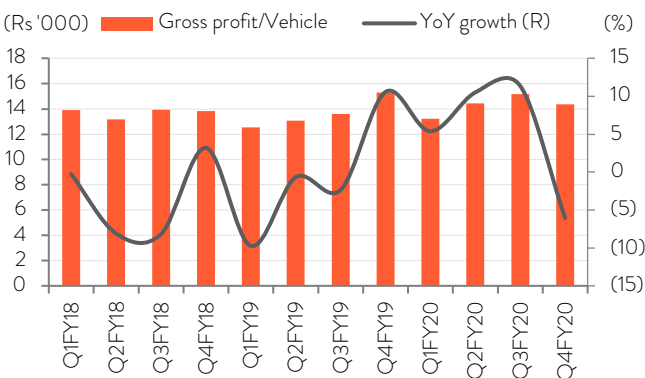
Source: Company, BOBCAPS Research

**FIG 4 – VOLUME GROWTH TREND**



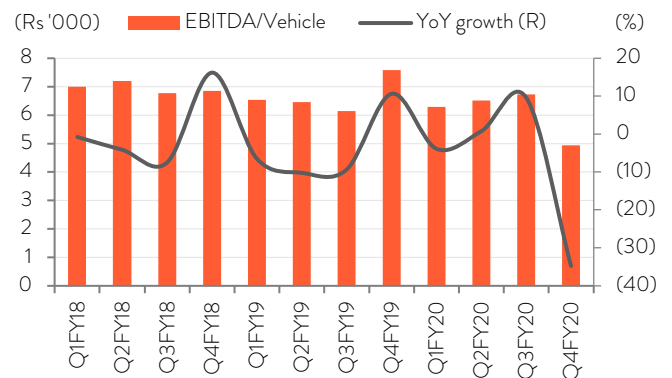
Source: SIAM, ET Autolytics, BOBCAPS Research

**FIG 5 – GROSS PROFIT/VEHICLE**



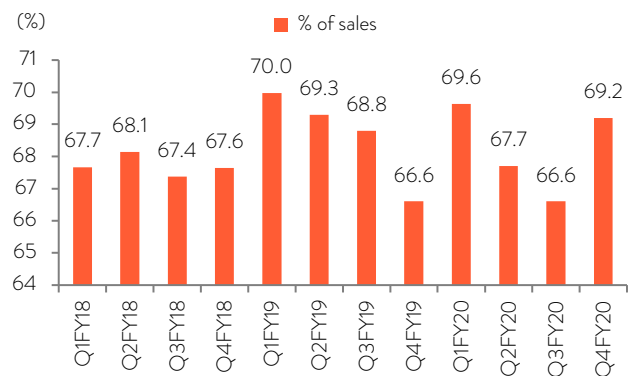
Source: BOBCAPS Research, Company

**FIG 6 – EBITDA/VEHICLE**



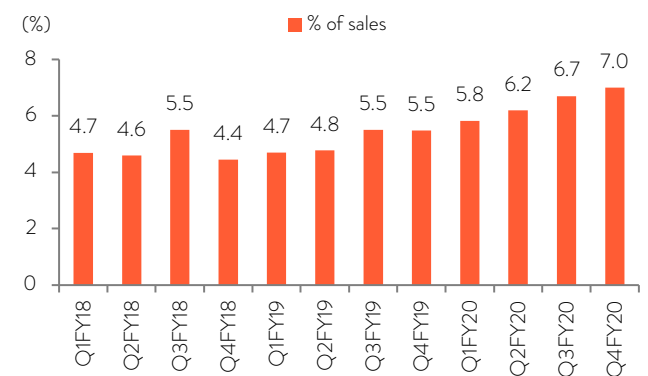
Source: BOBCAPS Research, Company

**FIG 7 – RM COST/SALES TREND**



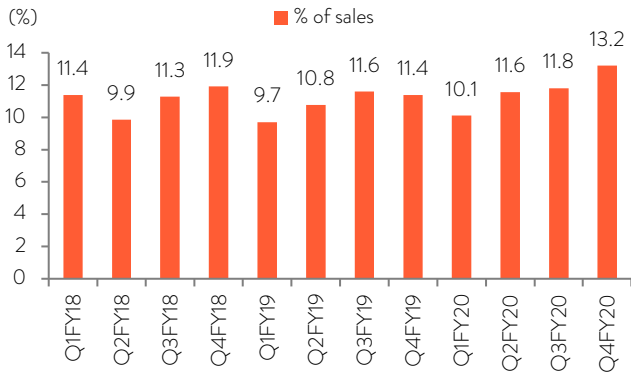
Source: Company, BOBCAPS Research

**FIG 8 – EMPLOYEE COST/SALES TREND**



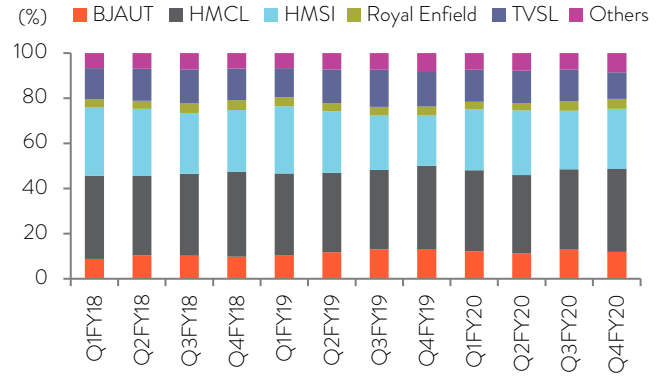
Source: Company, BOBCAPS Research

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



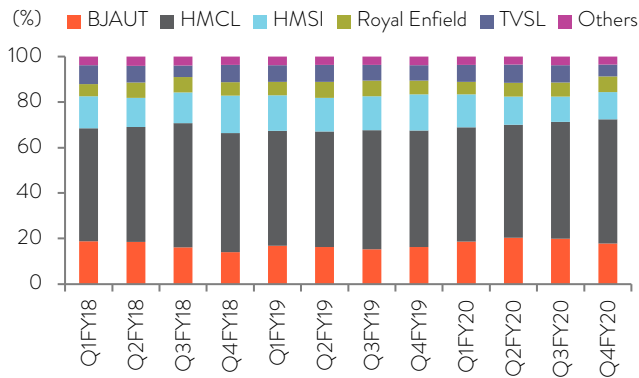
Source: Company, BOBCAPS Research

**FIG 10 – DOMESTIC 2W MARKET SHARE**



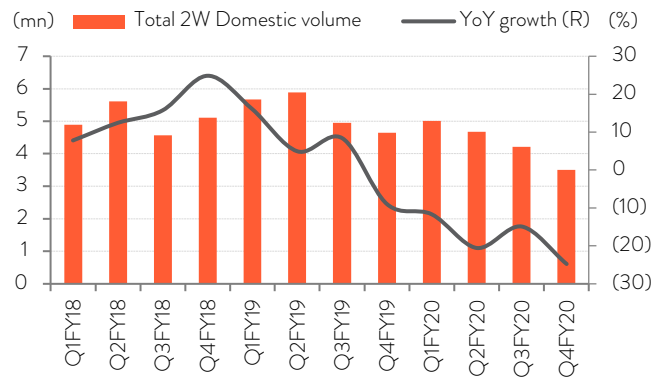
Source: SIAM, ET Autolytics, BOBCAPS Research

**FIG 11 – DOMESTIC MOTORCYCLE MARKET SHARE**



Source: SIAM, ET Autolytics, BOBCAPS Research

**FIG 12 – DOMESTIC 2W INDUSTRY VOLUME TREND**



Source: SIAM, ET Autolytics, BOBCAPS Research

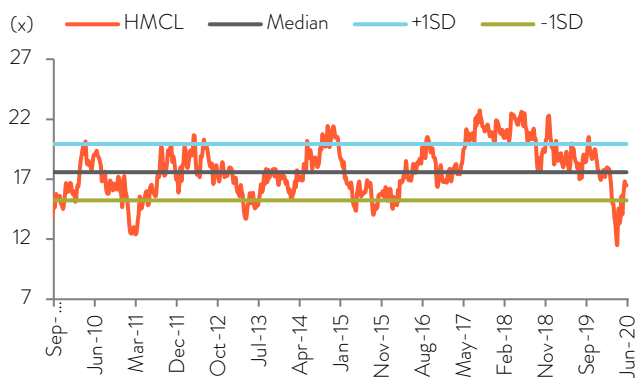
## Earnings call highlights

- In Q4FY20, HMCL provided support to dealers to the tune of ~Rs 1.1bn to clear BS-IV inventory. The company also made a provision of Rs 570mn towards a GST refund pending for the Nimrana plant.
- Dealer inventory was ~550,000 units lower at the end of FY20 compared to the beginning of the year.
- All of HMCL's plants and vendors are currently operational and ~90% of dealerships have reopened too
- BS-VI vehicles comprised 50% of the company's dispatches for the quarter.
- Financing penetration was at 43% for FY20, of which Hero Fincorp commanded 46% share
- HMCL took a price hike in May in order to increase dealer margins and fine-tune cost pass-through for BS-VI vehicles.
- Retail sales have been ahead of production in FY21 YTD and management expects this trend to continue for the short term.
- HMCL has doubled its cost saving target to ~100bps of sales from the LEAP programme for FY21.
- Capex for FY21 is guided at Rs 6bn which is ~Rs 4bn lower than previous guidance. HMCL does not intend to defer spends on long-term product development plans.
- Spare parts revenue for Q4 was at Rs 7.5bn (Rs 28.9bn for FY20).

## Valuation methodology

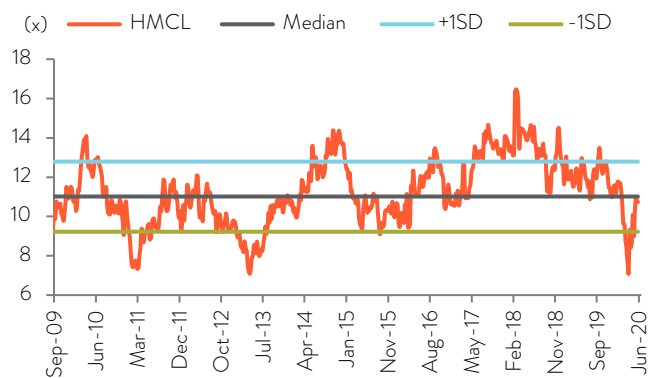
HMCL has witnessed a ~50% rally since 1 April 2020 and currently trades at ~16.8x/13.9x FY21E/FY22E EPS. We see limited upside potential and hence downgrade the stock from BUY to REDUCE. Our Mar'21 target price stands revised to Rs 2,300 (vs. Rs 2,140 earlier) as we now value the stock at 14x FY22E EPS (vs. 13x earlier).

**FIG 13 – P/E MULTIPLE**



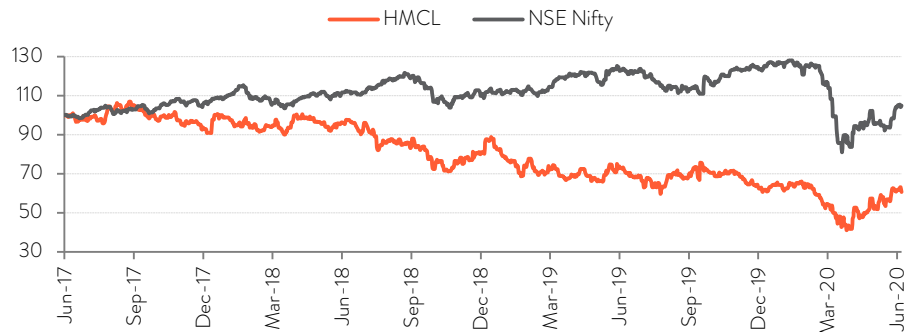
Source: Company, BOBCAPS Research

**FIG 14 – EV/EBITDA MULTIPLE**



Source: Company, BOBCAPS Research

**FIG 15 – 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)	FY18A	FY19A	FY20P	FY21E	FY22E
<b>Total revenue</b>	<b>322,305</b>	<b>336,505</b>	<b>286,033</b>	<b>298,780</b>	<b>336,060</b>
EBITDA	52,802	49,301	39,993	37,084	45,002
Depreciation	5,556	6,020	8,387	8,559	9,328
EBIT	47,246	43,281	31,606	28,525	35,674
Net interest income/(expenses)	(63)	(86)	(215)	(215)	(237)
Other income/(expenses)	5,258	6,912	7,342	7,491	7,873
Exceptional items	0	0	7,274	0	0
EBT	52,442	50,107	46,007	35,802	43,311
Income taxes	15,468	16,259	10,264	8,592	10,395
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>36,974</b>	<b>33,848</b>	<b>35,743</b>	<b>27,209</b>	<b>32,916</b>
Adjustments	0	0	(7,274)	0	0
<b>Adjusted net profit</b>	<b>36,974</b>	<b>33,848</b>	<b>28,469</b>	<b>27,209</b>	<b>32,916</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	33,188	33,553	28,604	29,890	33,706
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	145,218	153,731	165,613
Shareholders' fund	117,689	128,571	145,617	154,130	166,012
<b>Total liabilities and equities</b>	<b>162,271</b>	<b>171,047</b>	<b>183,345</b>	<b>193,343</b>	<b>209,242</b>
Cash and cash eq.	66,456	45,333	51,831	49,585	58,851
Accounts receivables	15,202	28,216	25,593	29,890	31,045
Inventories	8,236	10,724	9,033	9,439	10,644
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
<b>Total assets</b>	<b>162,271</b>	<b>171,047</b>	<b>183,345</b>	<b>193,343</b>	<b>209,242</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	42,530	39,869	44,130	35,768	42,244
Interest expenses	63	86	215	215	237
Non-cash adjustments	973	248	0	0	0
Changes in working capital	(27)	(24,871)	(4,935)	(5,817)	(944)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>43,539</b>	<b>15,333</b>	<b>39,410</b>	<b>30,166</b>	<b>41,536</b>
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
<b>Cash flow from investing</b>	<b>(8,230)</b>	<b>(13,404)</b>	<b>(14,000)</b>	<b>(13,500)</b>	<b>(11,000)</b>
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
<b>Cash flow from financing</b>	<b>(20,460)</b>	<b>(23,052)</b>	<b>(18,912)</b>	<b>(18,912)</b>	<b>(21,270)</b>
<b>Changes in cash and cash eq.</b>	<b>14,848</b>	<b>(21,123)</b>	<b>6,498</b>	<b>(2,246)</b>	<b>9,266</b>
<b>Closing cash and cash eq.</b>	<b>66,456</b>	<b>45,333</b>	<b>51,831</b>	<b>49,585</b>	<b>58,851</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	185.1	169.5	142.5	136.2	164.8
Adjusted EPS	185.1	169.5	142.5	136.2	164.8
Dividend per share	95.0	87.0	80.0	80.0	90.0
Book value per share	589.3	643.7	729.0	771.6	831.1

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	1.3	1.2	1.4	1.4	1.2
EV/EBITDA	7.8	8.1	10.0	11.0	9.0
Adjusted P/E	12.4	13.5	16.1	16.8	13.9
P/BV	3.9	3.6	3.1	3.0	2.8

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	70.5	67.6	77.7	76.0	76.0
Interest burden (PBT/EBIT)	111.0	115.8	145.6	125.5	121.4
EBIT margin (EBIT/Revenue)	14.7	12.9	11.0	9.5	10.6
Asset turnover (Revenue/Avg TA)	211.3	201.9	161.4	158.6	167.0
Leverage (Avg TA/Avg Equity)	139.4	135.4	129.3	125.7	125.8
Adjusted ROAE	31.4	26.3	19.6	17.7	19.8

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



**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	13.1	4.4	(15.0)	4.5	12.5
EBITDA	13.9	(6.6)	(18.9)	(7.3)	21.4
Adjusted EPS	9.5	(8.5)	(15.9)	(4.4)	21.0
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	16.4	14.7	14.0	12.4	13.4
EBIT margin	14.7	12.9	11.0	9.5	10.6
Adjusted profit margin	11.5	10.1	10.0	9.1	9.8
Adjusted ROAE	31.4	26.3	19.6	17.7	19.8
ROCE	42.8	37.5	25.8	22.6	25.4
<b>Working capital days (days)</b>					
Receivables	17	31	33	37	34
Inventory	9	12	12	12	12
Payables	38	36	37	37	37
<b>Ratios (x)</b>					
Gross asset turnover	2.6	2.4	1.8	1.8	1.9
Current ratio	2.4	2.6	3.1	3.1	3.1
Net interest coverage ratio	755.9	503.3	147.0	132.7	150.8
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%

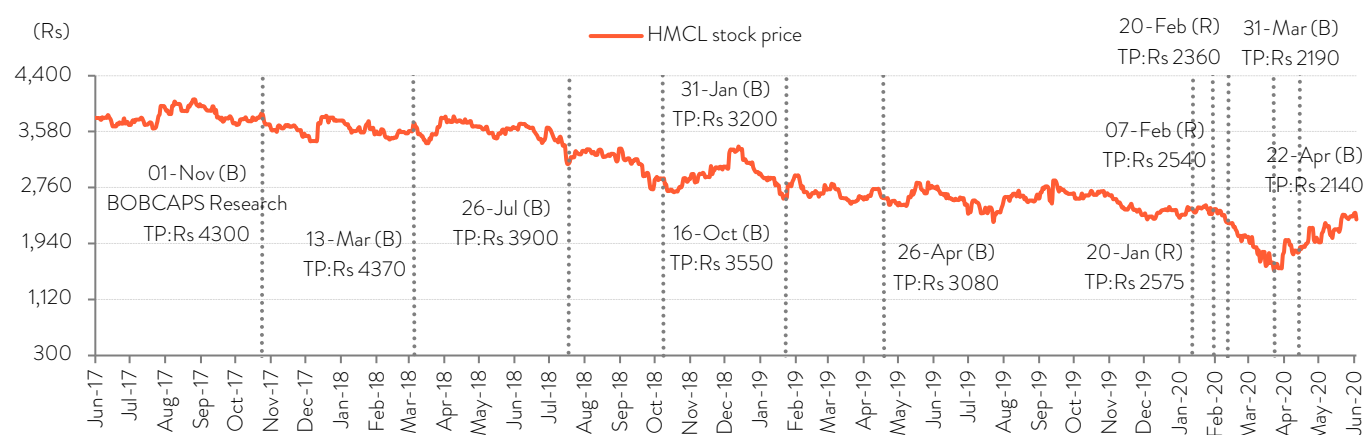
**ADD** – Expected return from >+5% to +15%

**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 31 May 2020, out of 92 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 55 have BUY ratings, 20 have ADD ratings, 9 are rated REDUCE, 7 are rated SELL and 1 is UNDER REVIEW. None of these companies have been investment banking clients in the last 12 months.

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