

**REDUCE**

TP: Rs 2,900 | ▼ 0%

**HERO MOTOCORP**

Automobiles

07 May 2021

**Near-term headwinds; REDUCE**

Hero MotoCorp's (HMCL) Q4FY21 operating performance was marginally ahead of our estimates due to an above-expected gross margin. Revenue grew 40% YoY to Rs 87bn and EBITDA margin stood at 13.9% (12.4% est.). Our FY22/FY23 revenue estimates are on par with consensus, but our EPS forecasts remain ~9% lower on softer gross margin assumptions. We maintain our earnings outlook and Mar'22 TP at Rs 2,900, set at 15x EPS. The stock has corrected ~18% over the last three months and hence we realign to a REDUCE rating from SELL.

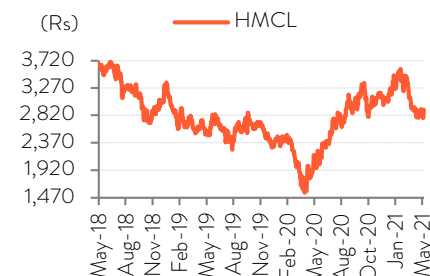
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**Operational beat:** Q4 revenue was in line with our estimate at Rs 86.9bn, up 40% YoY fuelled by strong spares sales and price hikes alongside volume growth of 18% YoY. A steady 29.6% gross margin QoQ (vs. our estimate of a 150bps decline) led to a beat on operating margin (13.9% vs. 12.4% est.). EBITDA increased 84% YoY to Rs 12bn and adj. PAT grew 39% YoY to Rs 8.6bn, 14% ahead of our projection.

Ticker/Price	HMCL IN/Rs 2,913
Market cap	US\$ 7.9bn
Shares o/s	200mn
3M ADV	US\$ 42.2mn
52wk high/low	Rs 3,629/Rs 1,955
Promoter/FPI/DII	35%/32%/19%

Source: NSE

**Near-term margin headwinds:** With inventories above normal, the sustainability of production will hinge on a pickup in retail sales, which looks uncertain due to the rising Covid-19 infections. In addition, we remain cautious on profitability as the sharp inflation in key inputs (~10% QoQ increase in steel and rubber prices during Q4) is estimated to deplete near term gross margin by >150bps (over Q4 levels), even assuming the company takes a 2% hike in vehicle prices.

**STOCK PERFORMANCE**

Source: NSE

**Stock has corrected sharply; REDUCE:** We expect HMCL to clock a revenue/EBITDA/PAT CAGR of 12%/12%/14% during FY21-FY23. Although our revenue numbers are on par with consensus, our earnings forecasts are ~9% lower as we anticipate weaker gross margins. Considering the ~18% stock price correction over the last three months to current valuations of 15x FY23E EPS, we realign our rating from SELL to REDUCE. Our TP of Rs 2,900 is set at 15x FY23E.

**KEY FINANCIALS**

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue (Rs mn)	336,505	288,361	308,006	352,605	388,430
EBITDA (Rs mn)	49,301	39,580	40,191	45,268	50,306
Adj. net profit (Rs mn)	33,849	29,559	29,641	33,981	38,363
Adj. EPS (Rs)	169.5	148.0	148.4	170.2	192.1
Adj. EPS growth (%)	(8.5)	(12.7)	0.3	14.6	12.9
Adj. ROAE (%)	26.3	20.9	19.5	20.0	19.9
Adj. P/E (x)	17.2	19.7	19.6	17.1	15.2
EV/EBITDA (x)	11.8	14.7	14.4	12.8	11.6

Source: Company, BOBCAPS Research | P – Provisional

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	FY21	FY20	YoY (%)
Volume	1,568,313	1,334,503	17.5	1,845,274	(15.0)	5,791,696	6,409,719	(9.6)
Avg. Realisation per Vehicle (Rs)	55,384	46,747	18.5	52,977	4.5	53,181	44,988	18.2
Net Revenues	86,860	62,384	39.2	97,758	(11.1)	308,006	288,361	6.8
<b>Total Income (A)</b>	86,860	62,384	39.2	97,758	(11.1)	308,006	288,361	6.8
<b>Operating Expenses:</b>								
Raw materials consumed	61,173	43,200	41.6	68,912	(11.2)	217,623	196,974	10.5
Employee Expenses	4,884	4,354	12.2	5,167	(5.5)	18,987	18,417	3.1
Other Expenses	8,691	8,231	5.6	9,543	(8.9)	31,203	33,390	(6.5)
<b>Total Expenditure (B)</b>	74,748	55,785	34.0	83,621	(10.6)	267,814	248,781	7.7
<b>EBITDA (A-B)</b>	12,112	6,599	83.5	14,136	(14.3)	40,192	39,580	1.5
Other Income	874	1,695	(48.4)	2,027	(56.9)	5,799	7,783	(25.5)
Depreciation	1,632	1,747	(6.6)	1,698	(3.9)	6,770	8,180	(17.2)
EBIT	11,353	6,547	73.4	14,465	(21.5)	39,221	39,183	0.1
Finance Costs	63	41	54.9	47	35.3	218	220	(0.8)
PBT before excep items	11,290	6,506	73.5	14,418	(21.7)	39,003	38,963	0.1
Exceptional items	-	-	NA	-	NA	-	(6,773)	(100.0)
PBT after excep items	11,290	6,506	73.5	14,418	(21.7)	39,003	45,736	(14.7)
Tax expense	2,642	299	784.0	3,574	(26.1)	9,362	9,404	(0.5)
Reported PAT	8,649	6,207	39.3	10,845	(20.2)	29,641	36,332	(18.4)
<b>Adjusted PAT</b>	8,649	6,207	39.3	10,845	(20.2)	29,641	29,559	0.3
<b>Adj EPS (Rs)</b>	43.3	31.1	39.3	54.3	(20.2)	148	148	0.3

Source: Company, BOBCAPS Research

**FIG 2 – KEY PARAMETERS**

(%)	Q4FY21	Q4FY20	YoY (bps)	Q3FY21	QoQ (bps)	FY21	FY20	YoY (bps)
Gross margin	29.6	30.8	(118)	30	7	29.3	31.7	(235)
EBITDA margin	13.9	10.6	337	14	(52)	13.0	13.7	(68)
EBIT margin	13.1	10.5	258	15	(173)	12.7	13.6	(85)
PBT margin	13.0	10.4	257	15	(175)	12.7	13.5	(85)
Tax rate	23.4	4.6	1,880	25	(139)	24.0	20.6	344
Adj PAT margin	10.0	9.9	1	11	(114)	9.6	10.3	(63)

Source: Company, BOBCAPS Research

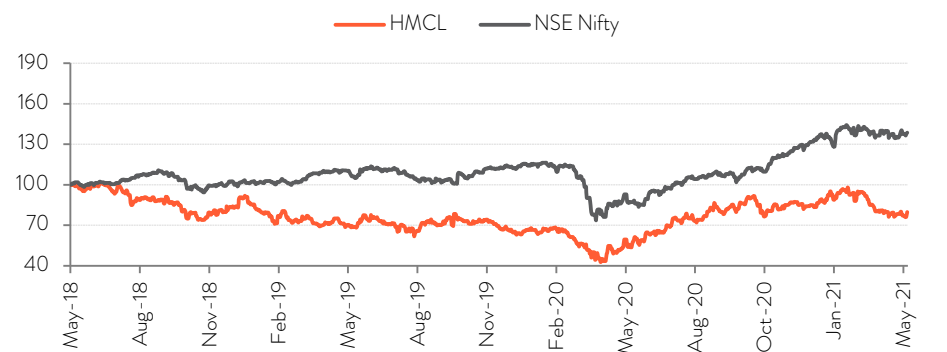
## Earnings call highlights

- HMCL stated that its domestic scooter market share has risen ~270bps to ~10%. Premium category market share stands at 4% as of FY21.
- Demand remains challenging in Q1FY22 due to a resurgent pandemic, but management is confident of a pick-up from H2 as fundamental demand drivers remain in place.
- Headwinds from raw material inflation will continue. RM cost increased 6-7% in FY21. Management anticipates a further 4% rise in FY22 but expects to mitigate the impact via a combination of cost-saving programmes and judicious price hikes.
- The LEAP-II programme drove ~300bps YoY of savings for Q4 and 200bps in FY21.
- Spares business contributed ~Rs 10bn to revenue in Q4FY21 and Rs 31.8bn in FY21. Other operating income was at Rs 2bn in Q4.
- Financing penetration for Q4 was at 48% and Hero Fincorp's share stood at 40%.
- The company has started distribution under the Harley Davidson partnership and appointed ~15 dealers for same. Revenue booking has begun but is nominal at present.
- HMCL has retained its launch timelines for the next 3-5 years.
- Product launch using battery swapping technology from its JV partner GogoRo is expected in CY22.
- FY21 capex totalled Rs 6bn. Plans for FY22 are yet to be finalised given the current volatile situation due to Covid-19.

## Valuation methodology

We expect HMCL to clock a revenue/ EBITDA/PAT CAGR of 12%/12%/14% during FY21-FY23. Although our revenue numbers are on par with consensus, our earnings forecasts remain ~9% lower as we anticipate weaker gross margins. Considering the ~18% stock price correction over the last three months to current valuations of 15x FY23E EPS, we realign our rating from SELL to REDUCE. Our Mar'22 TP remains at Rs 2,900, set at 15x FY23E EPS.

**FIG 3 – 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.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
<b>Total revenue</b>	<b>336,505</b>	<b>288,361</b>	<b>308,006</b>	<b>352,605</b>	<b>388,430</b>
EBITDA	49,301	39,580	40,191	45,268	50,306
Depreciation	6,020	8,180	6,769	7,248	7,836
EBIT	50,193	39,184	39,221	45,650	51,508
Net interest income/(expenses)	(86)	(220)	(218)	(220)	(220)
Other income/(expenses)	6,912	7,783	5,799	7,630	9,037
Exceptional items	(934)	6,774	0	0	0
EBT	49,173	45,737	39,003	45,430	51,288
Income taxes	16,259	9,404	9,362	11,448	12,924
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>29,641</b>	<b>33,981</b>	<b>38,363</b>
Adjustments	934	(6,774)	0	0	0
<b>Adjusted net profit</b>	<b>33,849</b>	<b>29,559</b>	<b>29,641</b>	<b>33,981</b>	<b>38,363</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Accounts payables	34,556	30,305	52,046	47,700	52,547
Other current liabilities	6,158	7,990	8,913	13,767	8,315
Provisions	590	2,689	3,328	3,328	3,328
Debt funds	0	0	0	0	0
Other liabilities	1,172	1,217	1,298	1,298	1,298
Equity capital	400	400	400	400	400
Reserves & surplus	128,172	140,965	151,585	169,592	191,980
Shareholders' fund	128,572	141,364	151,985	169,991	192,379
<b>Total liabilities and equities</b>	<b>171,047</b>	<b>183,565</b>	<b>217,570</b>	<b>236,085</b>	<b>257,868</b>
Cash and cash eq.	1,365	2,419	2,572	1,751	2,188
Accounts receivables	28,216	16,031	24,268	27,856	30,298
Inventories	10,724	10,920	14,696	14,104	15,537
Other current assets	9,181	7,244	6,601	6,767	6,874
Investments	59,686	82,227	104,997	112,997	127,997
Net fixed assets	46,186	61,171	62,471	70,223	72,387
CWIP	5,419	3,413	1,779	2,200	2,400
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(5,365)	(3,928)	(4,041)	(4,041)	(4,041)
Other assets	15,636	4,070	4,229	4,229	4,229
<b>Total assets</b>	<b>171,047</b>	<b>183,565</b>	<b>217,570</b>	<b>236,085</b>	<b>257,868</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Net income + Depreciation	39,869	37,739	36,410	41,230	46,199
Interest expenses	(86)	(220)	(218)	(220)	(220)
Non-cash adjustments	(6,912)	(7,783)	(5,799)	(7,630)	(9,037)
Changes in working capital	(24,871)	25,218	11,857	(2,655)	(4,587)
Other operating cash flows	(4,078)	2,301	0	0	0
<b>Cash flow from operations</b>	<b>3,922</b>	<b>57,253</b>	<b>42,250</b>	<b>30,726</b>	<b>32,355</b>
Capital expenditures	(7,895)	(21,159)	(6,435)	(15,421)	(10,200)
Change in investments	15,566	(22,540)	(22,770)	(8,000)	(15,000)
Other investing cash flows	6,912	7,783	5,799	7,630	9,037
<b>Cash flow from investing</b>	<b>14,583</b>	<b>(35,916)</b>	<b>(23,407)</b>	<b>(15,792)</b>	<b>(16,163)</b>
Equities issued/Others	57	44	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(86)	(220)	(218)	(220)	(220)
Dividends paid	(18,974)	(19,170)	(20,959)	(15,975)	(15,975)
Other financing cash flows	249	(1,437)	113	0	0
<b>Cash flow from financing</b>	<b>(18,754)</b>	<b>(20,783)</b>	<b>(21,065)</b>	<b>(16,195)</b>	<b>(16,195)</b>
<b>Changes in cash and cash eq.</b>	<b>(249)</b>	<b>555</b>	<b>(2,222)</b>	<b>(1,261)</b>	<b>(3)</b>
<b>Closing cash and cash eq.</b>	<b>1,365</b>	<b>2,419</b>	<b>2,572</b>	<b>1,751</b>	<b>2,188</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21P	FY22E	FY23E
Reported EPS	169.5	148.0	148.4	170.2	192.1
Adjusted EPS	169.5	148.0	148.4	170.2	192.1
Dividend per share	95.0	80.0	105.0	80.0	80.0
Book value per share	643.9	707.9	761.1	851.3	963.4

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21P	FY22E	FY23E
EV/Sales	1.7	2.0	1.9	1.6	1.5
EV/EBITDA	11.8	14.7	14.4	12.8	11.6
Adjusted P/E	17.2	19.7	19.6	17.1	15.2
P/BV	4.5	4.1	3.8	3.4	3.0

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21P	FY22E	FY23E
Tax burden (Net profit/PBT)	68.8	64.6	76.0	74.8	74.8
Interest burden (PBT/EBIT)	98.0	116.7	99.4	99.5	99.6
EBIT margin (EBIT/Revenue)	14.9	13.6	12.7	12.9	13.3
Asset turnover (Revenue/Avg TA)	270.7	211.8	208.2	217.3	212.9
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	27.5	21.9	20.2	21.1	21.2

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	4.4	(14.3)	6.8	14.5	10.2
EBITDA	(6.6)	(19.7)	1.5	12.6	11.1
Adjusted EPS	(8.5)	(12.7)	0.3	14.6	12.9
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	14.7	13.7	13.0	12.8	13.0
EBIT margin	14.9	13.6	12.7	12.9	13.3
Adjusted profit margin	10.1	10.3	9.6	9.6	9.9
Adjusted ROAE	26.3	20.9	19.5	20.0	19.9
ROCE	27.0	22.9	20.1	21.0	21.1
<b>Working capital days (days)</b>					
Receivables	24	28	24	27	27
Inventory	10	14	15	15	14
Payables	54	60	69	73	66
<b>Ratios (x)</b>					
Gross asset turnover	0.3	0.5	0.5	0.5	0.4
Current ratio	1.2	0.9	0.7	0.8	0.9
Net interest coverage ratio	(583.6)	(177.9)	(179.6)	(207.5)	(234.1)
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research

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### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

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

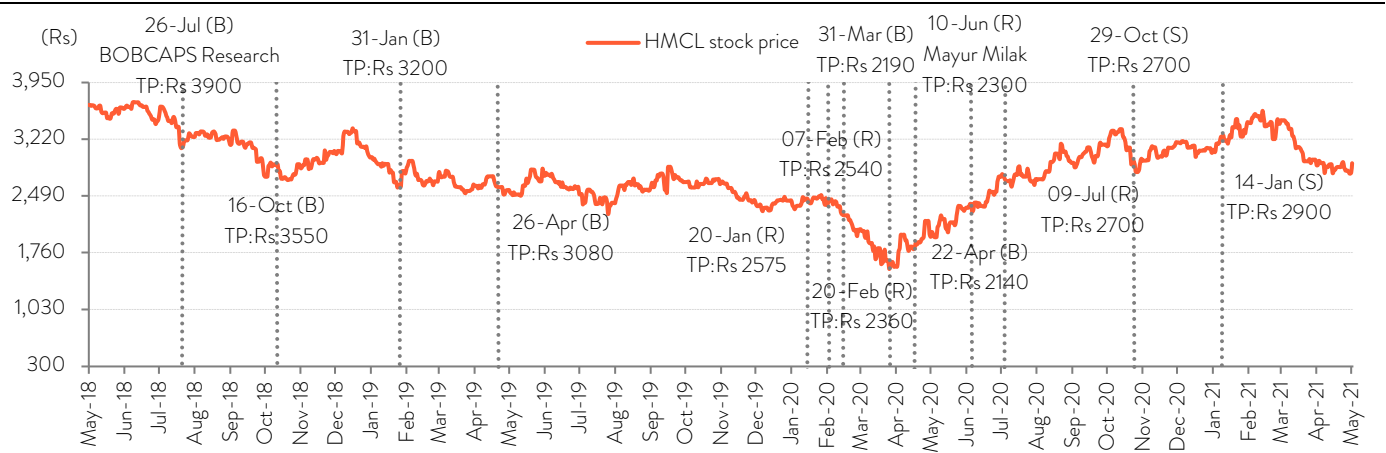
**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

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

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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



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

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