

**Incremental costs impact demand**

**CMP: Rs 2400**

**Rating: Hold**

**Target: Rs 2573**

(NR-Not Rated)

**Stock Info**

INDEX	
BSE	500182
NSE	HEROMOTOCO
Bloomberg	HMCL IN
Reuters	HROM.NS
Sector	Automobiles
Face Value (Rs)	2
Equity Capital (Rs mn)	399
Mkt Cap (Rs bn)	520
52w H/L (Rs)	3,695 / 2,360
Avg Weekly Vol (BSE+NSE)	143,866

**Shareholding Pattern**

<b>(As on March, 2019)</b>	<b>%</b>
Promoters	34.6
Public & Others	65.4

Source: NSE, Arihant Research

<b>Stock Performance (%)</b>	<b>3m</b>	<b>6m</b>	<b>12m</b>
HMCL	-3.9	-16.0	-28.3
SENSEX	7.7	11.6	5.4

Source: ACE Equity, Arihant Research

**HMCL v/s SENSEX**



Source: ACE Equity, Arihant Research

**HMCL market share analysis**

Mkt share	FY17	FY18	FY19	YoY bps
Motorcycles	51.3	51.5	50.7	-80 bps
Scooters	14.1	13.2	10.7	-240 bps
Total	36.8	36.5	35.9	-61 bps

Source: SIAM

**FY19 AR analysis – Industry vulnerable to cost pressures**

Higher costs of ownership due to increase in insurance and safety (ABS/CBS) related costs adversely impacted the consumer sentiments in FY19. HMCL's overall volumes were up 3% YoY led by in motorcycles (+6% YoY) whereas the scooter sales were down by 19% YoY. HMCL maintained its leadership position with the overall 2W market with a share of 35.9% (-60bps YoY). HMCL's motorcycle market share was at 50.7% (-80bps YoY). The scooters market share declined by 240bps YoY to 10.7% mainly due to faster growth in premium scooters (>125cc category). HMCL introduced Destini 125 in the H2FY19 which crossed 1lac units.

**FY20 outlook – Industry growth of 5-7% amid regulatory headwinds**

The industry is expected to grow at 5-7% YoY on the back of strong recovery in investments and consumptions coupled with improvement in system liquidity. HMCL indicated its readiness for BS VI much ahead of the BS VI timeline. However, the implementation of the BS VI may adversely impact the industry growth which led to a muted growth guidance for FY21E. This underscores our cautious outlook on the domestic 2W industry mainly due to costs pressures and the high competitive intensity led by the inventory clearance ahead of the Apr 2020 deadline of BS VI. We will wait for a meaningful volume recovery for re-rating of the stock.

**Ramp up in new model launches to plug the product gaps**

HMCL's scooter market share stood at 10.7% (-240bps YoY). The decline was attributed to faster growth in the premium scooter segment (>125cc). HMCL has launched the *Destini 125* which has done well within a short span. Further, the recent launch of *Maestro edge 125* and the all new *Pleasure* will likely add market share gains to HMCL over the medium term. HMCL presently has 1% market share in the premium motorcycle segment and has aggressive plans in the category with slew of product launches like *Hero XPulse 200*, *XPulse 200T*, *Xtreme 200R* and *Xtreme 200S*.

**Well on track on the path to EVs**

HMCL is working on multiple EV products at its R&D centre and has also made investments of Rs 1.3bn in Ather Energy (an electric 2W start up in Bengaluru) will help HMCL cater to the EV demand over the medium term. However, HMCL proposes a cautious and realistic EV roadmap will lead to a smoother transition.

**Higher working capital stressed the cash flows and return ratios**

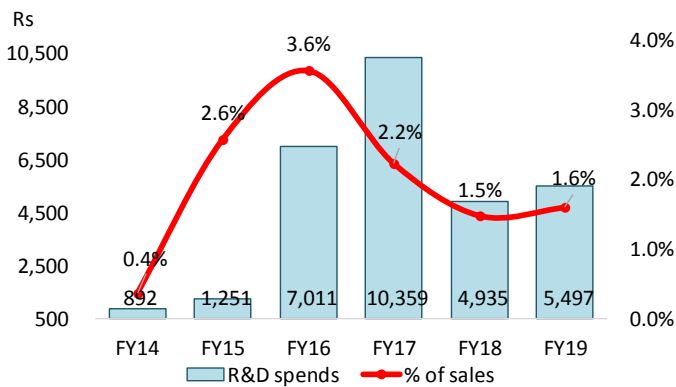
HMCL's EBITDA was down 10% YoY, however the operating cash flow was down 70% YoY and the free cash flows were impacted too on account of the stress in the working capital as the debtors were up 85% YoY (vs 70% YoY in Bajaj) and the inventories were up 30% YoY. ROE/ROCE stood at 27%/41% respectively which are below peak levels and significant improvement in return ratios may remain unlikely in the near term.

**Valuation and outlook – EPS estimates and TP intact**

The near term challenging demand underpins our argument that domestic 2W is undergoing significant slowdown, which is further likely to get impacted by upto Rs 8,000-10,000 due to BS VI and safety related costs. While HMCL has made efforts to enter the much crowded 125 cc scooter segment and the premium bike segment with *Xtreme 200R* and *Xpulse*, we believe, in the near term the incremental costs may be difficult to pass on due the high competitive environment and the thus the margin pressure is likely to persist. HMCL also has taken 1% increase in prices effective 8<sup>th</sup> July 2019 to absorb rising input costs.

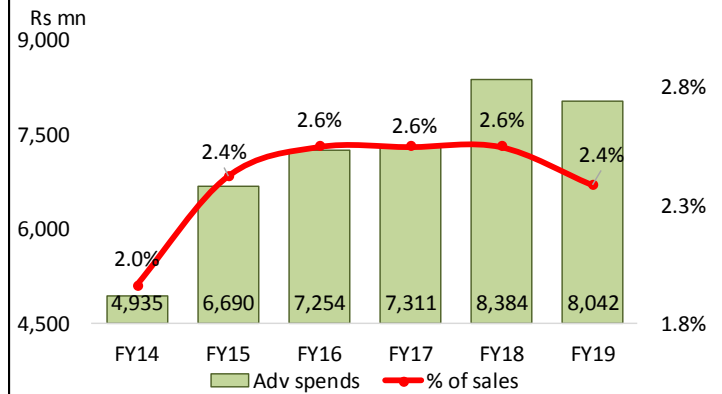
At CMP of Rs 2400, stock trades at 13.1x FY21E. While there are near term headwinds, HMCL continues to remain the market leader in 2W and has an attractive dividend yield of 4%. We believe, volume recovery led by success of the new model launches remains a key monitorable for HMCL over the long term. We revise rating to HOLD and value it at 14x FY21E for a unchanged target price of Rs 2,573.

**Exhibit 1: R&D spends and % of sales trend**



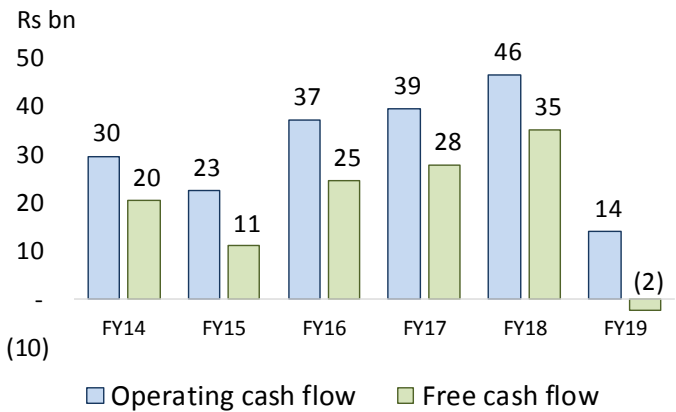
Source: Company, Aриhant Capital Markets

**Exhibit 2: Advertising spends and % of sales trend**



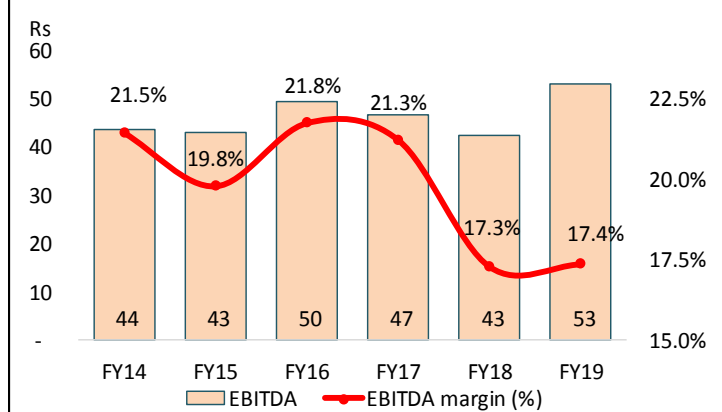
Source: Company, Aриhant Capital Markets

**Exhibit 3: OCF and FCF trend**



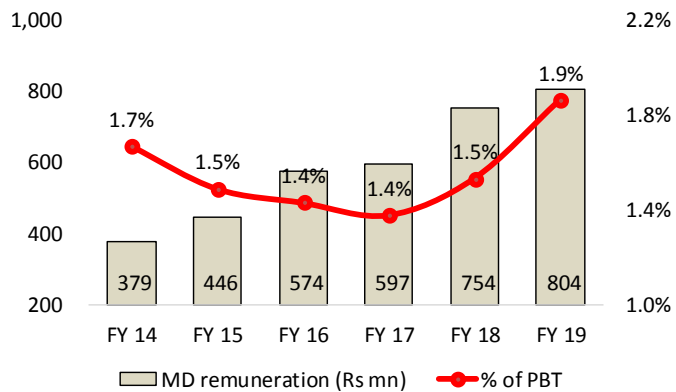
Source: Company, Aриhant Capital Markets

**Exhibit 4: EBITDA and EBITDA margin trend**



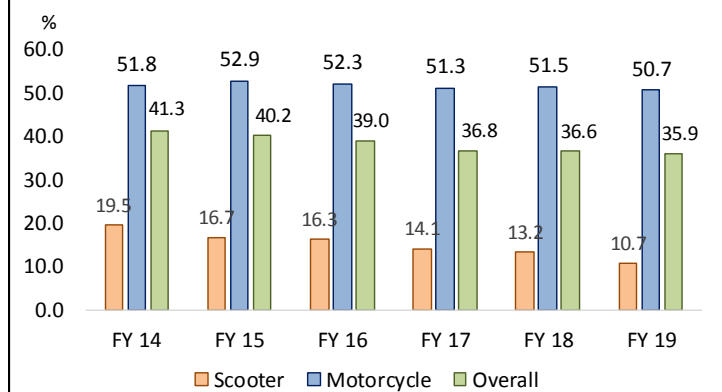
Source: Company, Aриhant Capital Markets

**Exhibit 3: MD remuneration and % of PBT trend**



Source: Company, Aриhant Capital Markets

**Exhibit 4: Market share trend**



Source: Company, Aриhant Capital Markets

**Profit & Loss Statement**

YE: Mar (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Net sales	286,680	328,718	336,505	347,192	364,306
Growth, %	1	15	2	3	5
RM expenses	-190,118	-218,346	-233,177	-243,034	-255,014
Employee expenses	-13,960	-15,401	-17,302	-18,748	-20,219
Other expenses	-34,324	-42,169	-36,725	-36,712	-35,288
<b>EBITDA</b>	<b>48,278</b>	<b>52,802</b>	<b>49,301</b>	<b>48,697</b>	<b>53,785</b>
Growth, %	8	9	(7)	(1)	10
<b>Margin, %</b>	<b>16.8</b>	<b>16.1</b>	<b>14.7</b>	<b>14.0</b>	<b>14.8</b>
Depreciation	-4,927	-5,556	-6,020	-6,624	-7,129
EBIT	43,351	47,246	43,281	42,073	46,656
Growth, %	8	9	(8)	(3)	11
Margin, %	15.1	14.4	12.9	12.1	12.8
Interest paid	-60	-63	-86	-86	-86
Other Income	5,224	5,258	6,913	7,466	8,212
Non-recurring Items	(1,930)	(47)	0	0	0
Pre-tax profit	48,515	52,442	50,107	49,453	54,782
Tax provided	-12,814	-15,468	-16,258	-16,319	-18,078
Profit after tax	35,701	36,974	33,849	33,133	36,704
Others (Minorities, Associates)	-	-	-	-	-
Net Profit	33,771	36,927	33,849	33,133	36,704
Growth, %	7	9	(8)	(2)	11
Net Profit (adjusted)	35,701	36,974	33,849	33,133	36,704

Source: Company, Arianth Capital Markets

**Cash Flow**

YE: Mar (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Pre-tax profit	46,585	52,395	50,107	49,453	54,782
Depreciation	4,927	5,556	6,020	6,624	7,129
Chg in working capital	6,208	6,034	-19,213	4,019	-205
Total tax paid	-10,821	-14,470	-16,010	-16,319	-18,078
CFO	39,474	44,319	14,077	36,397	35,502
Capital expenditure	-11,635	-11,331	-16,420	-11,995	-8,000
Chg in investments	-556	-556	-556	-556	-555
Chg in marketable securities	-12,533	-15,797	16,122	-7,800	-11,012
CFI	-19,500	-23,181	6,181	-12,885	-11,355
Free cash flow	27,283	32,432	-2,899	23,846	26,947
Debt raised/(repaid)	0	0	0	0	0
Dividend (incl. tax)	-19,860	-21,028	-20,327	-23,365	-23,365
CFF	-19,921	-21,091	-20,413	-23,451	-23,451
Net chg in cash	54	47	(155)	61	696
Opening cash balance	1,314	1,367	1,413	1,365	1,319
Closing cash balance	1,367	1,413	1,365	1,319	2,015

Source: Company, Arianth Capital Markets

**Balance Sheet**

YE: Mar (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Cash & bank	1,367	1,413	1,365	1,319	2,015
Marketable sec	51,322	66,917	50,517	57,957	68,515
Debtors	15,619	15,202	28,216	24,731	25,951
Inventory	6,563	8,236	10,724	9,512	9,981
Loans & advances	449	732	850	886	929
Other current assets	12,121	7,567	8,931	9,824	10,807
Total current assets	36,119	33,150	50,085	46,273	49,683
Investments	7,578	8,335	9,169	10,086	11,094
Gross fixed assets	107,216	119,216	131,322	144,322	152,322
Less: Depreciation	-61,317	-66,873	-72,893	-79,517	-86,646
Add: Capital WIP	2,707	2,038	3,607	2,707	2,707
Net fixed assets	45,899	52,343	58,429	64,805	65,675
Total assets	143,624	162,783	171,806	181,827	197,675
Current liabilities	40,543	42,835	40,713	37,840	40,104
Provisions	1,144	1,747	1,762	4,888	5,132
Total current liabilities	41,687	44,583	42,476	42,728	45,237
Non-current liabilities	824	512	760	760	760
Total liabilities	42,511	45,094	43,235	43,487	45,996
Paid-up capital	399	399	399	399	399
Reserves & surplus	100,714	117,289	128,172	137,940	151,279
Shareholders' equity	101,113	117,689	128,571	138,340	151,679
Total equity & liabilities	143,624	162,783	171,806	181,827	197,675

Source: Company, Arianth Capital Markets

**Ratios**

YE: Mar	FY17	FY18	FY19	FY20E	FY21E
EPS (INR)	179	195	169	166	184
PER (x)	13.4	12.3	14.2	14.5	13.1
Price/Book (x)	4.7	4.1	3.7	3.5	3.2
EV/EBITDA (x)	8.8	7.5	8.7	8.6	7.6
EV/Net sales (x)	1.5	1.3	1.3	1.2	1.1
RoE (%)	38	36	27	25	25
RoCE (%)	51	50	41	37	38
Fixed Asset turnover (x)	2.7	2.8	2.6	2.4	2.4
Dividend Yield (%)	3.5	3.8	3.6	4.2	4.2
Receivable (days)	20	17	31	26	26
Inventory (days)	10	11	14	12	12
Payable (days)	50	44	43	37	37
Revenue Growth (%)	1	15	2	3	5
EBITDA Growth (%)	8	14	(10)	(1)	10
EPS Growth, %	13	9	(13)	(2)	11
Net D/E ratio (x)	(0.6)	(0.6)	(0.4)	(0.5)	(0.5)

Source: Company, Arianth Capital Markets, Inventory= RM+FG

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**Stock Rating Scale****Stock Rating Scale**

	<b>Absolute Return</b>
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	<-5%

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