

CMP: Rs 2356

Rating: REDUCE

Target: Rs 2114

(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) | 3400 / 2228 |
| Avg Weekly Vol (BSE+NSE) | 143,866 |

Shareholding Pattern

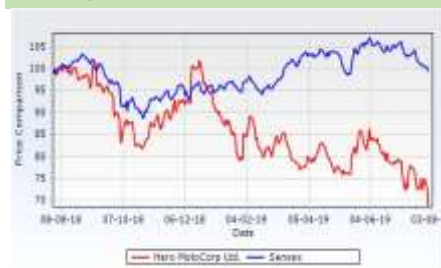
| | |
|----------------------------|------|
| | % |
| (As on March, 2019) | |
| Promoters | 34.6 |
| Public & Others | 65.4 |

Source: NSE, Arihant Research

| Stock Performance (%) | 3m | 6m | 12m |
|-----------------------|-------|-------|-------|
| HMCL | -10.1 | -13.4 | -29.5 |
| SENSEX | -4.2 | 5.1 | -0.3 |

Source: ACE Equity, Arihant Research

HMCL v/s SENSEX



Source: ACE Equity, Arihant Research

Result Highlights

Hero Motocorp (HMCL) results were slightly below our est as net sales stood at Rs 80.3bn (-8.8% YoY) vs our est of Rs 82.3bn. Revenues were cushioned by 4% YoY increase in realizations at 43.5k/unit on account of the price hikes taken to offset the safety related costs. Gross margins at 30.4% (+34bps YoY/ -66bps QoQ) were supported by stable commodity prices and improved product mix. The scooter sales have seen strong growth in the 125cc segment where HMCL has been able to plug the gaps with the *Destini 125cc* which is further supported by the all new *Maestro edge 125cc* and refreshed *Pleasure 110cc*. The EBITDA margin was 14.4% (-121bps YoY / +86bps QoQ) vs our est of 13.6%. Margin was impacted by higher staff costs (+13% YoY) which was mainly on account of the staff expansion in AP plant. Reported PAT stood at Rs 12.6bn on account of reversal of the provisions made towards NCCD. Adjusted PAT stood at Rs 7.6bn (-16.1% YoY / +4.4% QoQ). On the concall, the management highlighted that near term demand has seen some signs of improvement on the retail side and the management is confident of a stronger show in H2FY20 vs the H1 led by inventory de-stocking around the festive season.

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 will monitor the success of the new model launches demand scenario after the proposed hike in the registration fees.

Concall highlights

- Near term **demand outlook** remains uncertain at present and the management abstained from providing any volume guidance for FY20e. However, demand scenario is expected to increase in H2FY20 over H1 on the back of upcoming festive sales and improved monsoon outlook.
- HMCL is optimistic over the ramp up of **new model launches** like *XPulse 200*, *XPulse 20T*, *Xtreme 200*, *Maestro Edge 125*, *Destini 125* and the all new *Pleasure 110*.
- The management indicated that **channel inventory** stood at high levels of 42-45 days and it has managed to reduce the inventory by 80,000 units.
- HMCL took **price hikes** to the tune of Rs 300-400/unit in Q1FY19 to offset the rising input costs. Further, price hike of 0.8-1%/unit in July' 19.
- HMCL's **financing** penetration stood at 37% in Q1FY20 out of which Hero Fincorp's (financing arm of HMCL) presence stood at 47%.
- Revenues from **spare parts** stood at Rs 6bn in Q1 (-21% YoY / flat QoQ).
- HMCL lowered its capex guidance for FY20e from the previous guidance of Rs 15bn. Its green-field capacity in AP to commence in H2FY20E with initial capacity of 550k units. The management further clarified that the AP capacity is EV fungible.

Outlook and valuation

We believe, the two-wheeler demand shall continue to witness headwinds in terms of overall rural and urban weakness. However, HMCL's new model launches will likely arrest the market share loss and aid volume growth in FY20e. Further, its ability to pass on the emission related costs in the intensely competitive environment will remain a key monitorable. At CMP of Rs 2356, stock trades at 12.8x FY21E. We revise our rating to REDUCE rating (vs HOLD earlier) on the stock and value it at 11.5x FY21E for a revised target price of Rs 2114.

Reported vs Actuals

| Rs mn | Reported | Est | Var % |
|-------------------|----------|--------|-------|
| Net Sales | 80,303 | 82,395 | (2.5) |
| EBITDA | 11,580 | 10,149 | 14.1 |
| EBITDA Margin (%) | 14.4 | 12.3 | 210 |
| Adj PAT | 7,625 | 6,466 | 17.9 |
| Adj EPS | 38.2 | 32.4 | 17.9 |

Quarterly result summary

| Standalone (Rs mn) | 1QFY19 | 2QFY19 | 3QFY19 | 4QFY19 | 1QFY20 | YoY (%) | QoQ (%) |
|--------------------------|---------------|---------------|---------------|---------------|---------------|---------------|------------|
| Net sales | 88,098 | 90,909 | 78,648 | 78,850 | 80,303 | (8.8) | 1.8 |
| - Raw material | 61,650 | 62,997 | 54,145 | 54,385 | 55,919 | (9.3) | 2.8 |
| (% of net sales) | 70.0 | 69.3 | 68.8 | 69.0 | 69.6 | (34) | 66 |
| - Staff expenditure | 4,131 | 4,341 | 4,357 | 4,473 | 4,677 | 13.2 | 4.6 |
| (% of net sales) | 4.7 | 4.8 | 5.5 | 5.7 | 5.8 | 113 | 15 |
| - Other expenses | 8,544 | 9,784 | 9,098 | 9,298 | 8,127 | (4.9) | (12.6) |
| (% of net sales) | 9.7 | 10.8 | 11.6 | 11.8 | 10.1 | 42 | (167) |
| Total expenditure | 74,325 | 77,122 | 67,601 | 68,156 | 68,723 | (7.5) | 0.8 |
| EBITDA | 13,773 | 13,787 | 11,048 | 10,693 | 11,580 | (15.9) | 8.3 |
| EBITDA Margin (%) | 15.6 | 15.2 | 14.0 | 13.6 | 14.4 | (121) | 86 |
| Depreciation | 1,482 | 1,518 | 1,518 | 1,502 | 2,361 | 59.3 | 57.2 |
| EBIT | 12,291 | 12,269 | 9,529 | 9,191 | 9,219 | (25.0) | 0.3 |
| Interest | 21 | 21 | 22 | 22 | 44 | 107.1 | 99.5 |
| Other Income | 1,157 | 2,237 | 1,876 | 1,642 | 2,188 | 89.1 | 33.3 |
| PBT | 13,427 | 14,485 | 11,384 | 10,811 | 11,364 | (15.4) | 5.1 |
| Tax | 4,336 | 4,722 | 3,693 | 3,508 | 3,739 | (13.8) | 6.6 |
| Reported PAT | 9,092 | 9,763 | 7,691 | 7,303 | 12,573 | 38.3 | 72.2 |
| Adjusted PAT | 9,092 | 9,763 | 7,691 | 7,303 | 7,625 | (16.1) | 4.4 |
| Adjusted EPS (Rs) | 45.5 | 48.9 | 38.5 | 36.6 | 38.2 | (16.1) | 4.4 |
| Total volumes (Nos) | 2,104,949 | 2,134,047 | 1,798,905 | 1,781,250 | 1,842,920 | (12.4) | 3.5 |
| Net realisation (Rs) | 41,853 | 42,600 | 43,720 | 44,266 | 43,574 | 4.1 | (1.6) |
| EBITDA / vehicle (Rs) | 6,543 | 6,461 | 6,141 | 6,003 | 6,283 | (4.0) | 4.7 |

Source: Company, Arianth Capital Markets.

continued...

Exhibit 1: Quarterly revenue and growth trend

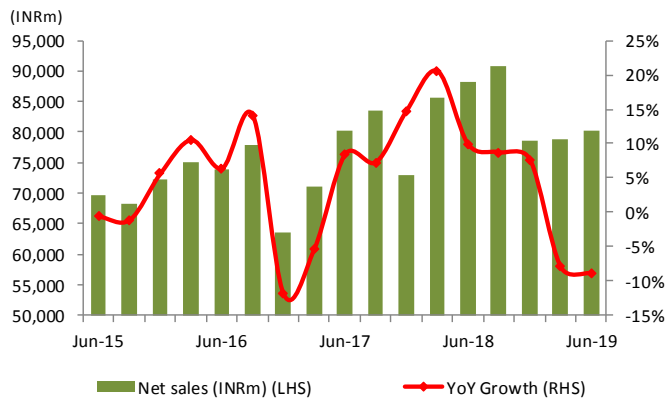
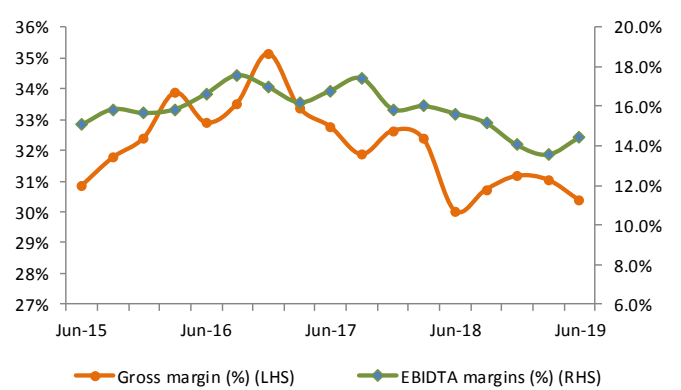


Exhibit 2: Quarterly gross and EBITDA margin trend



Source: Company, Aриhant Capital Markets Source: Company, Aриhant Capital Markets

Exhibit 3: Staff costs trend continue inch upwards

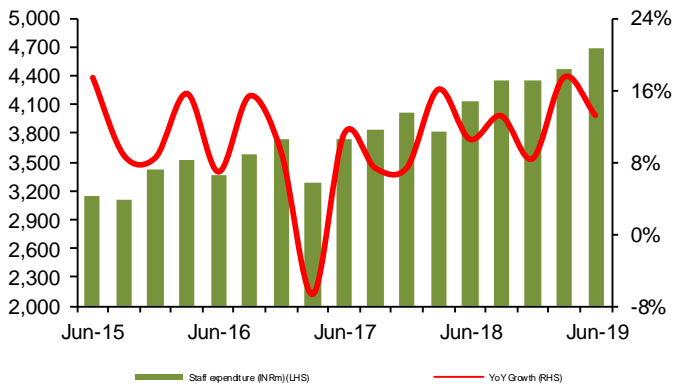
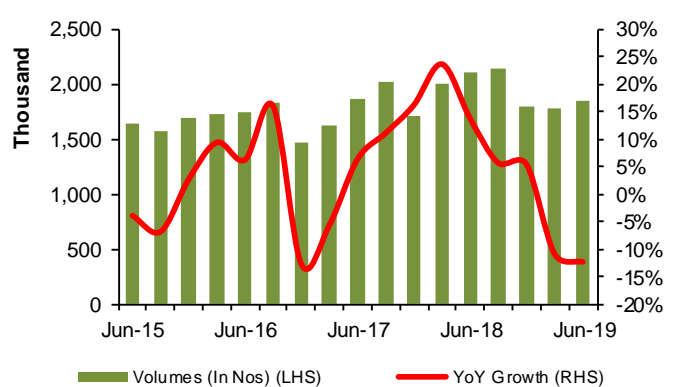


Exhibit 4: Quarterly volume and growth trend



Source: Company, Aриhant Capital Markets 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 | -40,105 | -36,725 | -36,712 | -35,288 |
| EBITDA | 48,278 | 54,865 | 49,301 | 48,698 | 53,785 |
| Growth, % | 8 | 14 | (10) | (1) | 10 |
| Margin, % | 16.8 | 16.7 | 14.7 | 14.0 | 14.8 |
| Depreciation | -4,927 | -5,556 | -6,020 | -6,624 | -7,129 |
| EBIT | 43,351 | 49,310 | 43,281 | 42,073 | 46,656 |
| Growth, % | 8 | 14 | (12) | (3) | 11 |
| Margin, % | 15.1 | 15.0 | 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 | 54,505 | 50,107 | 49,453 | 54,782 |
| Tax provided | -12,814 | -15,468 | -16,258 | -16,319 | -18,078 |
| Profit after tax | 35,701 | 39,037 | 33,849 | 33,133 | 36,704 |
| Others (Minorities, Associates) | - | - | - | - | - |
| Net Profit | 33,771 | 38,990 | 33,849 | 33,133 | 36,704 |
| Growth, % | 7 | 15 | (13) | (2) | 11 |
| Net Profit (adjusted) | 35,701 | 39,037 | 33,849 | 33,133 | 36,704 |

Source: Company, Arianth Capital Markets

Balance Sheet

| YE: Mar (Rs mn) | FY17 | FY18 | FY19 | FY20E | FY21E |
|----------------------------|---------|---------|---------|---------|---------|
| Cash & bank | 1,367 | 1,413 | 1,365 | 1,425 | 2,121 |
| Marketable securities cost | 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 | 46,379 | 49,789 |
| 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 | 181,826 | 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

Cash Flow

| YE: Mar (Rs mn) | FY17 | FY18 | FY19 | FY20E | FY21E |
|----------------------------|---------|---------|---------|---------|---------|
| Pre-tax profit | 46,585 | 54,458 | 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 | 44,318 | 14,183 | 36,397 | 35,502 |
| Capital expenditure | -11,635 | -11,331 | -16,420 | -11,995 | -8,000 |
| Chg in investments | -13,089 | -16,353 | 15,566 | -8,356 | -11,567 |
| Other investing activities | 5,224 | 4,502 | 7,035 | 7,466 | 8,212 |
| CFI | -19,500 | -23,181 | 6,181 | -12,885 | -11,355 |
| Free cash flow | 14,750 | 16,635 | 13,329 | 16,046 | 15,935 |
| 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 | 46 | (49) | 61 | 696 |
| Opening cash balance | 1,314 | 1,367 | 1,413 | 1,365 | 1,425 |
| Closing cash balance | 1,367 | 1,413 | 1,365 | 1,425 | 2,121 |

Source: Company, Arianth Capital Markets

Ratios

| YE: Mar | FY17 | FY18 | FY19 | FY20E | FY21E |
|--------------------------|-------|-------|-------|-------|-------|
| EPS (INR) | 179 | 195 | 169 | 166 | 184 |
| PER (x) | 13.2 | 12.1 | 13.9 | 14.2 | 12.8 |
| Price/Book (x) | 4.7 | 4.0 | 3.7 | 3.4 | 3.1 |
| EV/EBITDA (x) | 8.7 | 7.3 | 8.5 | 8.4 | 7.4 |
| EV/Net sales (x) | 1.5 | 1.2 | 1.2 | 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 (%) | 3.6 | 3.8 | 3.7 | 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) | (0.4) | (0.5) |

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

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Stock Rating Scale

| | Absolute Return |
|------------|------------------------|
| BUY | >20% |
| ACCUMULATE | 12% to 20% |
| HOLD | 5% to 12% |
| NEUTRAL | -5% to 5% |
| REDUCE | <-5 to -12% |
| SELL | <-12% |

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