

**Muted outlook; HOLD**

**CMP: Rs 2697**

**Rating: HOLD**

**Target: Rs 2941**

(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)	542
52w H/L (Rs)	3383 / 2228
Avg Weekly Vol (BSE+NSE)	511844

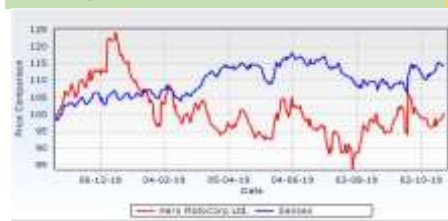
<b>Shareholding Pattern</b>	<b>%</b>
<b>(As on March, 2019)</b>	
Promoters	34.6
Public & Others	65.4

Source: NSE, Arihant Research

<b>Stock Performance (%)</b>	<b>3m</b>	<b>6m</b>	<b>12m</b>
HMCL	9.84	2.85	-0.31
SENSEX	2.80	1.30	15.40

Source: ACE Equity, Arihant Research

**HMCL v/s SENSEX**



Source: ACE Equity, Arihant Research

The company's revenue declined by ~17% YoY to Rs 75.7bn in Q2FY20 (against our estimate of Rs.75.2bn) led by subdued demand for two-wheelers in the domestic market. Other expenses rose to Rs. 8.7bn (11.6% vs 10.8% as a % of sales in Q2FY19). Hero's EBITDA was Rs.11bn and margin stood at 14.5% in vs 15.2% in Q2FY19 (14.4% in Q1FY20), in-line with our estimate of 14.3%. Sequentially, the RM cost declined to 67.7% (vs 69.6% in Q1FY20) of net sales led slight expansion in margin by 12bps. The company introduced voluntary retirement scheme (VRS) scheme for employees and has considered a provision of Rs. 0.61bn during the quarter. PAT dropped by 10.4% to Rs. 8.7bn which is above our estimate of Rs. 8.1bn on account of lower tax rate of ~14.8% (vs our estimate of ~25.1%).

**Concall highlights**

- Improvement in gross margin is driven by general softness in commodity prices, cost optimization, leap program
- Festive season showing a good build up, seeing low single digit growth for festive season. Post Dusherra, first 10 days of festive season were flattish however, post that started seeing positive sentiments in demand. Lot of rains in few states damaged crops, however expect this would be positive for rabi crops. Expect demand recovery to come by end of November rabi crop is in full swing for rural market. Saw massive hit for scooter in urban market
- The company has maintained 15% market share in 125cc segment
- The tax rate will be ~25-26% for FY20/FY21
- The management intend to reduce inventory levels to 30 days from normal dealer level inventory of 45 days from October end during festive season. 4-6 weeks inventory is required for normal operations.
- Recently launched Xtreme and X Pulse are picking up and helping to improve market share.
- BSVI vehicles led to have higher pricing which led to have pre-buying. BSVI transition: BSVI is on track and the company expects to launch product post festive season. BSVI price hike would be ~10-15%. Expect post BSVI, to have a major changeover in scooter segment.
- EV: Ather launched products in Bangalore and expanding in Chennai
- Employee expenses increased due to increments and increase in headcounts
- Spare revenue increased 1.5% YoY to Rs723crs in Q2FY20.
- Higher fuel prices are hurting the scooter sales. Motorcycle offers 30% higher mileage which is more feasible for consumer.
- Company has taken a price hike of Rs200 in July19.
- Financing level increased to ~46% for Q2FY20 vs ~44% in Q2FY19 for HMCL.

**Outlook and valuation**

We believe, the demand for 2W shall continue to remain weak in rural and urban market. However, we expect Hero is well-positioned to be the key beneficiary of rural demand recovery with its strong brand equity in entry and commuter segments and high rural exposure. At CMP of Rs 2697, stock trades at 14.7 x FY21E. We revise our rating to HOLD on the stock and value it at 16x FY21E for a revised target price of Rs 2,941 with an upside of 9%.

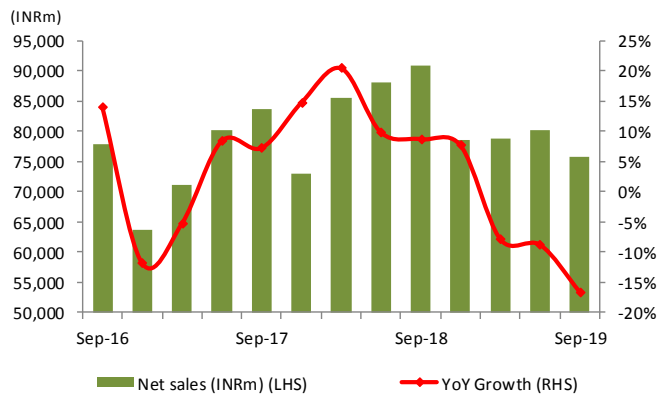
## Quarterly result summary

Standalone (Rs mn)	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	YoY (%)	QoQ (%)
<b>Net sales</b>	<b>90,909</b>	<b>78,648</b>	<b>78,850</b>	<b>80,303</b>	<b>75,707</b>	<b>(16.7)</b>	<b>(5.7)</b>
- Raw material	62,997	54,145	54,385	55,919	51,257	(18.6)	(8.3)
(% of net sales)	69.3	68.8	69.0	69.6	67.7	(159)	(193)
- Staff expenditure	4,341	4,357	4,473	4,677	4,689	8.0	0.3
(% of net sales)	4.8	5.5	5.7	5.8	6.2	142	37
- Other expenditure	9,784	9,098	9,298	8,127	8,750	(10.6)	7.7
(% of net sales)	10.8	11.6	11.8	10.1	11.6	79	144
Total expenditure	77,122	67,601	68,156	68,723	64,696	(16.1)	(5.9)
<b>EBITDA</b>	<b>13,787</b>	<b>11,048</b>	<b>10,693</b>	<b>11,580</b>	<b>11,011</b>	<b>(20.1)</b>	<b>(4.9)</b>
<b>EBITDA Margin (%)</b>	<b>15.2</b>	<b>14.0</b>	<b>13.6</b>	<b>14.4</b>	<b>14.5</b>	<b>(62)</b>	<b>12</b>
Depreciation	1,518	1,518	1,502	2,361	2,034	34.0	(13.8)
<b>EBIT</b>	<b>12,269</b>	<b>9,529</b>	<b>9,191</b>	<b>9,219</b>	<b>8,977</b>	<b>(26.8)</b>	<b>(2.6)</b>
Interest	21	22	22	44	77	258.4	75.5
Other Income	2,237	1,876	1,642	2,188	2,078	(7.1)	(5.0)
<b>PBT</b>	<b>14,485</b>	<b>11,384</b>	<b>10,811</b>	<b>11,364</b>	<b>10,979</b>	<b>(24.2)</b>	<b>(3.4)</b>
Tax	4,722	3,693	3,508	3,739	1,629	(65.5)	(56.4)
<b>Reported PAT</b>	<b>9,763</b>	<b>7,691</b>	<b>7,303</b>	<b>12,573</b>	<b>8,748</b>	<b>(10.4)</b>	<b>(30.4)</b>
<b>Adjusted PAT</b>	<b>9,763</b>	<b>7,691</b>	<b>7,303</b>	<b>7,625</b>	<b>9,349</b>	<b>(4.2)</b>	<b>22.6</b>
Adjusted EPS (Rs)	48.9	38.5	36.6	63.0	43.8	(10.4)	(30.4)
<b>Total volumes (Nos)</b>	<b>2,134,047</b>	<b>1,798,905</b>	<b>1,781,250</b>	<b>1,842,920</b>	<b>1,691,420</b>	<b>(20.7)</b>	<b>(8.2)</b>
<b>Net realisation (Rs)</b>	<b>42,600</b>	<b>43,720</b>	<b>44,266</b>	<b>43,574</b>	<b>44,759</b>	<b>5.1</b>	<b>2.7</b>
EBITDA / vehicle (Rs)	6,461	6,141	6,003	6,283	6,510	0.8	3.6

Source: Company, Arihant Capital Markets.

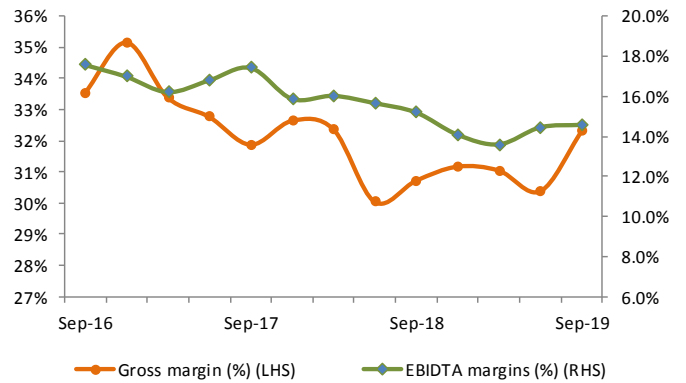
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**Exhibit 1: Quarterly revenue and growth trend**



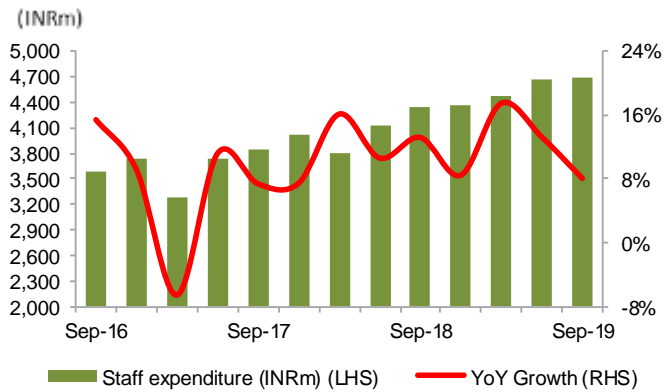
Source: Company, Arianth Capital Markets

**Exhibit 2: Quarterly gross and EBITDA margin trend**



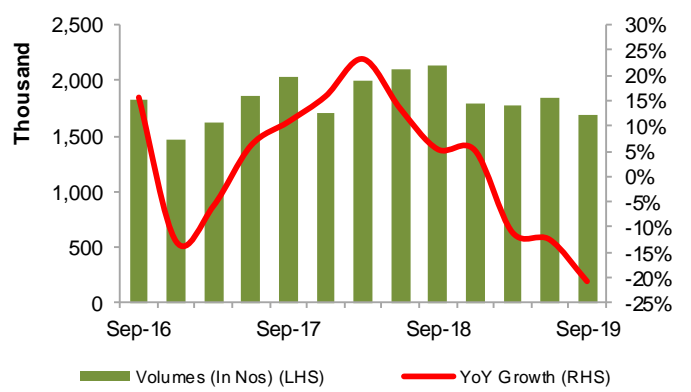
Source: Company, Arianth Capital Markets

**Exhibit 3: Staff costs trend continue inch upwards**



Source: Company, Arianth Capital Markets

**Exhibit 4: Quarterly volume and growth trend**



Source: Company, Arianth 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	16.1	14.5
Price/Book (x)	4.7	4.0	3.7	3.9	3.5
EV/EBITDA (x)	8.7	7.3	8.5	9.7	8.6
EV/Net sales (x)	1.5	1.2	1.2	1.4	1.3
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	3.7	3.7
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**

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

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