

Good quarter: Improving outlook

CMP: Rs 3429

Rating: HOLD

Target Price: Rs 3,689

Stock Info

| | |
|--------------------------|-------------------|
| BSE | 500182 |
| NSE | HEROMOTCO |
| Bloomberg | HMCL IN |
| Reuters | HROM.BO |
| Sector | Auto-2&3 wheelers |
| Face Value (Rs) | 2 |
| Equity Capital (Rs mn) | 400 |
| Mkt Cap (Rs mn) | 6,84,983 |
| 52w H/L (Rs) | 3560/1,475 |
| Avg Yearly Vol (in 000') | 1595 |

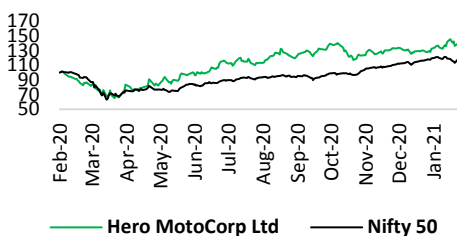
Shareholding Pattern %

(As on Dec, 2020)

| | |
|-----------|-------|
| Promoters | 34.76 |
| FII | 41.15 |
| DII | 14.72 |
| Others | 9.37 |

| Stock Performance (%) | 3m | 6m | 12m |
|-----------------------|------|------|------|
| Hero MotoCorp | 16.6 | 27.4 | 44.7 |
| Nifty | 5.3 | 34.7 | 23.7 |

Hero MotoCorp Vs Nifty



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Hero MotoCorp (HMCL) reported a good set of numbers in Q3FY21. Result above our estimates all fronts. Company has reported the highest ever revenue for any quarter. Company standalone revenue stood at INR 97,758 Mn, registering +39.7% YoY/+4.4% QoQ led by the robust sales volume during the quarter and a combination of key strategic initiatives such as cost reduction efforts to partially offset the impact of the commodity costs and intense operational efficiencies. EBITDA stood at INR 14,136 Mn (36.1%YoY/9.9% QoQ with margin of 14.5% (-39bps YoY/73bps QoQ). Profit for the quarter grew by 23.2% YoY/13.74% QoQ to INR 10,845 Mn vs INR 8804 during Q3FY20.

The total volumes (Motorcycles + Scooters) grew by 19.8% YoY to 18,45,274 units. The blended realization has seen an increase of 16.7% YoY to INR 52,977 unit on account of better product mix. The company has declared interim dividend of INR. 70 per share.

Conference Call Highlights

- Management believes that pent-up demand has now been catered to and macro fundamentals would drive demand going ahead. Also, personal mobility needs have surged given social distancing norms and limited public transport facilities, which should benefit the company.
- ASP expansion in Q3 was led by the price increase taken in Oct'20 and also a better product mix.
- Commodity prices are expected to trend upwards but management is confident of tackling this via better cost management and price hikes.
- HMCL stated that it has gained 190bps market share in the domestic market and 90bps in exports during Q3FY21.
- HMCL's LEAP-II Programme aided cost savings of 125bps (as a percentage of sales) in Q3.
- Inventory levels which were at about four weeks post festive season have now normalized to around six weeks.
- Spare parts revenue for the quarter stood at Rs 10bn and other operating revenue was at Rs 1.9bn.
- Financing of vehicles stood at 50% in Q3 of which Hero Fincorp commanded 40% share.
- Semi Conductor issue as a result of better storage and supply chain management, ensured that production has not been impacted. So far, HMCL believes the issue is under control. 2Ws have lower dependency on semi conductors compared to 4Ws

Outlook and valuation

At CMP of Rs 3,429, Hero MotoCorp is trading at FY23 PE of 15.8x. HMCL reported, highest ever revenue for any quarter. It effectively offset commodity inflation through via better cost management and price hikes. Combination of new product launches and introduction of premium variants (Splendor Canvas for example) has aided volumes while supporting margin. HMCL remains focused on building a strong presence in the premium market. While Partnership is icing on the cake and a step ahead for HMCL's premiumization aspiration. Meanwhile, a demonstrated ability to keep costs under check will continue to support margin. We expect HMCL to deliver an EPS CAGR of 9.7% over FY20–22E.

We value Hero MotoCorp at PE of 17x to FY23 EPS estimate of Rs 217, which yields a target price of Rs 3,689. We maintain our Hold rating on the stock.

Quarterly result summary

| Standalone (INR mn) | 3QFY21 | 3QFY20 | 2QFY21 | YoY (%) | QoQ (%) |
|-----------------------------|------------------|------------------|------------------|---------------|--------------|
| Net sales | 97,758 | 69,967 | 93,673 | 39.7 | 4.4 |
| - Raw material | 68,912 | 46,598 | 66,600 | 47.9 | 3.5 |
| (% of net sales) | 70.5 | 66.6 | 71.1 | 389bps | -61bps |
| - Staff expenditure | 5,167 | 4,697 | 5,112 | 10.0 | 1.06 |
| (% of net sales) | 5.3 | 6.7 | 5.5 | -671bps | -17bps |
| - Other expenditure | 9,543 | 8,282 | 9,097 | 15.2 | 4.9 |
| (% of net sales) | 9.8 | 11.8 | 9.7 | -208bps | 5bps |
| Total expenditure | 83,621 | 59,578 | 80,809 | 40.4 | 3.5 |
| EBITDA | 14,136 | 10,390 | 12,864 | 36.1 | 9.9 |
| EBITDA Margin (%) | 14.5 | 14.8 | 13.7 | -39bps | 73bps |
| Depreciation | 1,698 | 2,037 | 1,732 | (16.6) | -1.91 |
| EBIT | 12,438 | 8,352 | 11,133 | 48.9 | 11.73 |
| Interest | 47 | 59 | 46 | (21.5) | 0.22 |
| Other Income | 2,027 | 1,822 | 1,413 | 11.2 | 43.41 |
| PBT | 14,418 | 10,115 | 12,500 | 42.5 | 15.35 |
| Tax | 3,574 | 1,311 | 2,965 | 172.5 | 20.52 |
| Reported PAT | 10,845 | 8,804 | 9,534 | 23.2 | 13.74 |
| Adjusted EPS (Rs) | 54.3 | 44.1 | 47.7 | 23.2 | 13.74 |
| Total volumes (Nos) | 18,45,274 | 15,40,868 | 18,14,683 | 19.8 | 1.69 |
| Net realisation (Rs) | 52,977 | 45,408 | 51,620 | 16.7 | 2.63 |
| EBITDA / vehicle (Rs) | 7,661 | 6,743 | 7,089 | 13.6 | 8.07 |

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

Other Highlights

- Costs: RM cost spike is not new, similar cycles have been seen in the past as well
- This quarter, should have seen an impact of close to 100bps.
- Will focus on cost streamlining as well as judicious price hikes to overcome this challenge
- Other expenses - spiked to a certain extent due to higher A&P spend during the festive. This will normalise going forward.
- Spare part sales: Around a year and half, changed the method of selling/distribution of spares.
- Emulated some of the best practices of FMCG companies in supply chain management.
- Number of parts distributors is up about 50%. There is a huge push to increase penetration.
- Besides part, also increased focus on selling accessories

Export

- Had a two Phase strategy: Phase 1 – entering more markets and learning from on-ground experience
- Phase 2 – Introduce customized products as well as focus on the high potential markets.
- As a result, saw a good market share in Colombia. In-fact Colombia has achieved breakeven this quarter. In Nigeria, introducing longer seats (since it's a commercial vehicle market) has helped improve HMCL's traction.
- About 2/3rd of the focus and attention is going towards the top markets.
- Going forward, Mexico is the next big opportunity. HMCL's partner there has a sizeable presence, so HMCL expects to leverage this

| Profit & Loss Statement | | | | | |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| YE: Mar (Rs mn) | FY19 | FY20 | FY21E | FY22E | FY23E |
| Net sales | 3,36,505 | 2,88,361 | 3,09,157 | 3,82,513 | 4,20,217 |
| Growth, % | 2 | -14 | 7 | 24 | 10 |
| RM expenses | -2,33,177 | -1,96,974 | -2,19,192 | -2,73,263 | -2,96,211 |
| Employee expenses | -17,302 | -18,417 | -19,103 | -21,038 | -25,633 |
| Other expenses | -36,725 | -33,390 | -30,908 | -36,686 | -41,197 |
| EBITDA | 49,301 | 39,580 | 39,954 | 51,525 | 57,176 |
| Growth, % | -10 | -20 | 1 | 29 | 11 |
| Margin, % | 14.7 | 13.7 | 12.9 | 13.5 | 13.6 |
| Depreciation | -6,020 | -8,180 | -7,048 | -8,924 | -9,528 |
| EBIT | 43,281 | 31,400 | 32,906 | 42,601 | 47,648 |
| Growth, % | -12 | -27 | 5 | 29 | 12 |
| Margin, % | 12.9 | 10.9 | 10.6 | 11.1 | 11.3 |
| Interest paid | -86 | -220 | -231 | -243 | -255 |
| Other Income | 6,913 | 7,783 | 6,849 | 7,377 | 9,641 |
| Non-recurring Items | 0 | 6,774 | 0 | 0 | 0 |
| Pre-tax profit | 50,107 | 45,737 | 39,524 | 49,735 | 57,035 |
| Tax provided | -16,258 | -9,404.3 | -9,486 | -12,120 | -13,689 |
| Profit after tax | 33,849 | 36,333 | 30,038 | 37,614 | 43,346 |
| Others (Minorities, Associates) | - | - | - | - | - |
| Net Profit | 33,849 | 36,333 | 30,038 | 37,614 | 43,346 |
| Growth, % | -13 | 7 | -17 | 25 | 15 |
| Net Profit (adjusted) | 33,849 | 36,333 | 30,038 | 37,614 | 43,346 |

| Balance Sheet | | | | | |
|---------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| YE: Mar (Rs mn) | FY19 | FY20 | FY21E | FY22E | FY23E |
| Cash & bank | 1,365 | 2,419 | 5,443 | 12,283 | 24,489 |
| Marketable securities cost | 50,517 | 72,141 | 70,310 | 77,341 | 85,075 |
| Debtors | 28,216 | 16,031 | 22,022 | 27,247 | 29,933 |
| Inventory | 10,724 | 10,920 | 8,470 | 10,480 | 11,513 |
| Loans & advances | 850 | 896 | 997 | 1,243 | 1,348 |
| Other current assets | 8,931 | 6,348 | 6,982 | 7,680 | 8,449 |
| Total current assets | 50,085 | 36,614 | 43,915 | 58,935 | 75,731 |
| Investments | 9,169 | 10,086 | 11,094 | 12,204 | 13,424 |
| Gross fixed assets | 1,31,322 | 1,42,041 | 1,49,322 | 1,59,322 | 1,69,322 |
| Less: Depreciation | -72,893 | -81,073 | -88,120 | -97,045 | -1,06,573 |
| Add: Capital WIP | 3,607 | 1,603 | 1,603 | 1,603 | 1,603 |
| Net fixed assets | 58,429 | 60,969 | 61,201 | 62,277 | 62,749 |
| Total assets | 1,71,806 | 1,81,305 | 1,88,017 | 2,12,253 | 2,38,476 |
| Current liabilities | 40,713 | 37,929 | 35,501 | 43,015 | 46,777 |
| Provisions | 1,762 | 2,689 | 2,824 | 2,965 | 3,113 |
| Total current liabilities | 42,476 | 40,618 | 38,325 | 45,980 | 49,890 |
| Non-current liabilities | 760 | -677 | -677 | -677 | -677 |
| Total liabilities | 43,235 | 39,941 | 37,648 | 45,303 | 49,213 |
| Paid-up capital | 399.5 | 399.5 | 399.5 | 399.5 | 399.5 |
| Reserves & surplus | 1,28,172 | 1,40,965 | 1,49,969 | 1,66,550 | 1,88,863 |
| Shareholders' equity | 1,28,571 | 1,41,364 | 1,50,369 | 1,66,949 | 1,89,263 |
| Total equity & liabilities | 1,71,807 | 1,81,305 | 1,88,017 | 2,12,253 | 2,38,476 |

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

| Cash Flow | | | | | |
|-----------------------------|----------------|----------------|----------------|----------------|----------------|
| YE: Mar (Rs mn) | FY19 | FY20 | FY21E | FY22E | FY23E |
| Pre-tax profit | 50,107 | 45,737 | 39,524 | 49,735 | 57,036 |
| Depreciation | 6,020 | 8,180 | 7,048 | 8,924 | 9,528 |
| Chg in working capital | -19,213 | 12,668 | -6,570 | -524 | -681 |
| Total tax paid | -16,010 | -10,841 | -9,486 | -12,120 | -13,689 |
| CFO | 15,463 | 48,180 | 23,898 | 38,881 | 42,807 |
| Capital expenditure | -16,420 | -8,715 | -7,175 | -10,000 | -10,000 |
| Chg in investments | 15,566 | -22,540 | 822 | -8,140 | -8,954 |
| Other investing activities | 3,254 | 7,783 | 6,850 | 7,377 | 9,641 |
| CFI | 2,400 | -23,472 | 497 | -10,764 | -9,313 |
| Free cash flow | 14,609 | 16,925 | 17,546 | 20,740 | 23,853 |
| Debt raised/(repaid) | 0 | 0 | 0 | 0 | 0 |
| Dividend (incl. tax) | -20,333 | -21,034 | -21,034 | -21,034 | -21,034 |
| CFF | -20,418 | -21,254 | -21,265 | -21,276 | -21,289 |
| Net chg in cash | -2,555 | 3,454 | 3,130 | 6,841 | 12,205 |
| Opening cash balance | 1,413 | 1,365 | 2,419 | 5,443 | 12,283 |
| Closing cash balance | 1,365 | 2,419 | 5,443 | 12,283 | 24,489 |

| Ratios | | | | | |
|--------------------------|-------|-------|-------|-------|-------|
| YE: Mar | FY19 | FY20 | FY21E | FY22E | FY23E |
| EPS (INR) | 169 | 182 | 150 | 188 | 217 |
| PER (x) | 17.3 | 18.9 | 22.8 | 18.2 | 15.8 |
| Price/Book (x) | 4.5 | 4.8 | 4.6 | 4.1 | 3.6 |
| EV/EBITDA (x) | 10.8 | 15.4 | 15.2 | 11.6 | 10.1 |
| EV/Net sales (x) | 1.6 | 2.1 | 2.0 | 1.6 | 1.4 |
| RoE (%) | 27 | 27 | 21 | 24 | 24 |
| RoCE (%) | 41 | 29 | 27 | 32 | 32 |
| Fixed Asset turnover (x) | 2.6 | 2.0 | 2.1 | 2.4 | 2.5 |
| Dividend Yield (%) | 3.0 | 2.6 | 2.6 | 2.6 | 2.6 |
| Receivable (days) | 31 | 20 | 26 | 26 | 26 |
| Inventory (days) | 14 | 16 | 11 | 12 | 12 |
| Payable (days) | 43 | 44 | 37 | 37 | 37 |
| Net D/E ratio (x) | (0.4) | (0.6) | (0.5) | (0.5) | (0.6) |

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

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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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