

**CMP: Rs 2604**

**Rating: Neutral**

**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)	3819 / 2517
Avg Weekly Vol (BSE+NSE)	143,866

**Shareholding Pattern**

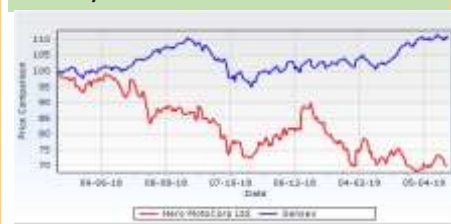
	<b>%</b>
<b>(As on March, 2019)</b>	
Promoters	34.6
Public & Others	65.4

Source: NSE, Arihant Research

<b>Stock Performance (%)</b>	<b>3m</b>	<b>6m</b>	<b>12m</b>
HMCL	-2.5	-3.8	-30.8
SENSEX	7.7	11.6	5.4

Source: ACE Equity, Arihant Research

**HMCL v/s SENSEX**



Source: ACE Equity, Arihant Research

**Result Highlights**

Hero Motocorp (HMCL) reported subdued results with decline in net sales of 8% YoY led by volume growth 11% YoY decline in volumes. Realizations of Rs 44k (3.5% YoY and 1% QoQ). Gross margins at 31% (-133 bps YoY/ flat QoQ) were impacted by inferior product mix and persistent weakness in rural demand which further dented the gross margins. Sales of Destini 125cc has seen a robust ramp up in volumes however has led to cannibalization in its 100cc scooter models (*Maestro, pleasure, Duet*). The EBITDA margin stood at 13.6% (-245bps YoY/-50bps QoQ; lowest in 16 quarters) were impacted by higher staff costs (+17% YoY). On the concall, management highlighted that near term demand has remained subdued due to persistent weakness in rural demand coupled with strong shift in the scooter category from 110 cc to 125 cc category. HMCL further plans to launch *Maestro Edge* in the 125 cc scooter segment and a new motorcycle in the premium motorcycle segment with *Xpulse 200cc*. HMCL also is commissioning a plant in Andhra near Chittoor with an investment of Rs 16bn with an installed capacity of 1.8mn units.

The two-wheeler industry has undergone significant slowdown due to 1) subdued demand led by high cost of ownership owing to insurance cost push and adverse fuel costs; 2) irrational discounting to clear up high inventories; 3) subdued rural demand led by weak agri sentiments; 4) saturation of scooter penetration levels in urban markets. **The near term challenging demand underpins our argument that domestic two-wheeler is undergoing significant slowdown, which is further likely to get impacted by the increase in costs of two-wheelers 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, HMCL will be unable to pass on the increased costs to the consumers in the high competitive environment and thus the margin recovery to peak levels still remains eluded.**

**Concall highlights**

- Near term **demand outlook** remains subdued led by prolonged softness in rural demand as the rural areas grapple from patchy rainfall, drought in some key regions whereas the subdued urban scooter demand as penetration levels near saturation point.
- The management expects demand in H1 to remain flattish and further grow by 5% in H2 FY19 on account of pre-buying ahead of BS VI related costs increases.
- HMCL is positive about the ramp up in **Destini 125cc** (19k/month) and further plans to launch **Maestro 125 cc** and **Xpulse 200 cc** over next month.
- The management indicated that **channel inventory** stood at high levels of 40-50 days and it plans to bring it down to four-six weeks within one month.
- HMCL took **price hikes** of Rs 100-150 in Q4 whereas Rs 300-350 starting April 19.
- Two-wheeler **financing** penetration stood at 37-40% in FY19
- Revenues from **spare parts** stood at Rs 2.5bn in Q4 and Rs 28bn in FY19.
- HMCL plans to incur **capex** of Rs 15bn in FY20

**Outlook and valuation**

We believe, the two-wheeler demand shall continue to witness headwinds in terms of overall rural and urban weakness. Further, we await the success from new model launches and HMCL's ability to pass on the emission and safety related regulations related cost in the intensely competitive environment. At CMP of Rs 2604, stock trades at 15x FY21E. We recommend a NEUTRAL rating on the stock and value it at 14x FY21E for a target price of Rs 2,573.

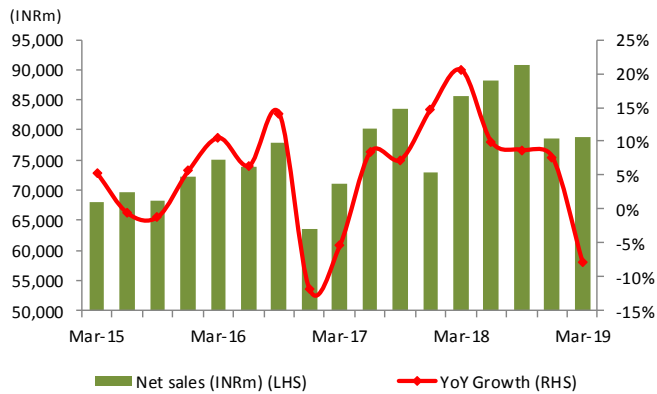
## Quarterly result summary

Standalone (Rs mn)	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	YoY (%)	QoQ (%)
<b>Net sales</b>	<b>85,640</b>	<b>88,098</b>	<b>90,909</b>	<b>78,648</b>	<b>78,850</b>	<b>(7.9)</b>	<b>0.3</b>
- Raw material	57,931	61,650	62,997	54,145	54,385	(6.1)	0.4
(% of net sales)	67.6	70.0	69.3	68.8	69.0	133	13
- Staff expenditure	3,809	4,131	4,341	4,357	4,473	17.4	2.7
(% of net sales)	4.4	4.7	4.8	5.5	5.7	123	13
- Other expenditure	10,195	8,544	9,784	9,098	9,298	(8.8)	2.2
(% of net sales)	11.9	9.7	10.8	11.6	11.8	(11)	22
Total expenditure	71,935	74,325	77,122	67,601	68,156	(5.3)	0.8
<b>EBITDA</b>	<b>13,706</b>	<b>13,773</b>	<b>13,787</b>	<b>11,048</b>	<b>10,693</b>	<b>(22.0)</b>	<b>(3.2)</b>
<b>EBITDA Margin (%)</b>	<b>16.0</b>	<b>15.6</b>	<b>15.2</b>	<b>14.0</b>	<b>13.6</b>	<b>(244)</b>	<b>(49)</b>
Depreciation	1,483	1,482	1,518	1,518	1,502	1.3	(1.1)
<b>EBIT</b>	<b>12,223</b>	<b>12,291</b>	<b>12,269</b>	<b>9,529</b>	<b>9,191</b>	<b>(24.8)</b>	<b>(3.6)</b>
Interest	15	21	21	22	22	42.2	1.4
Other Income	1,665	1,157	2,237	1,876	1,642	(1.4)	(12.5)
<b>PBT</b>	<b>13,872</b>	<b>13,427</b>	<b>14,485</b>	<b>11,384</b>	<b>10,811</b>	<b>(22.1)</b>	<b>(5.0)</b>
Tax	4,198	4,336	4,722	3,693	3,508	(16.4)	(5.0)
<b>Reported PAT</b>	<b>9,654</b>	<b>9,092</b>	<b>9,763</b>	<b>7,691</b>	<b>7,303</b>	<b>(24.3)</b>	<b>(5.0)</b>
<b>Adjusted PAT</b>	<b>9,674</b>	<b>9,092</b>	<b>9,763</b>	<b>7,691</b>	<b>7,303</b>	<b>(24.5)</b>	<b>(5.0)</b>
Adjusted EPS (Rs)	48.4	45.5	48.9	38.5	36.6	(24.5)	(5.0)
<b>Total volumes (Nos)</b>	<b>2,001,571</b>	<b>2,104,949</b>	<b>2,134,047</b>	<b>1,798,905</b>	<b>1,781,250</b>	<b>(11.0)</b>	<b>(1.0)</b>
<b>Net realisation (Rs)</b>	<b>42,787</b>	<b>41,853</b>	<b>42,600</b>	<b>43,720</b>	<b>44,266</b>	<b>3.5</b>	<b>1.2</b>
EBITDA / vehicle (Rs)	6,848	6,543	6,461	6,141	6,003	(12.3)	(2.2)

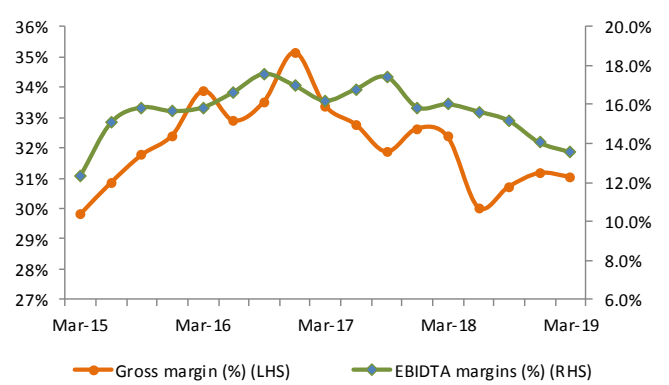
Source: Company, Arianth Capital Markets

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

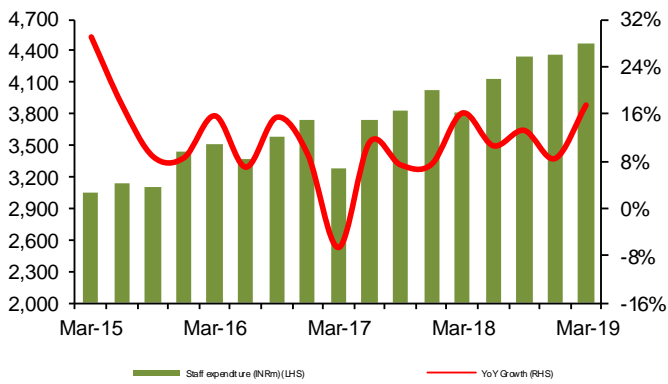


**Exhibit 2: Quarterly gross and EBITDA margin trend**

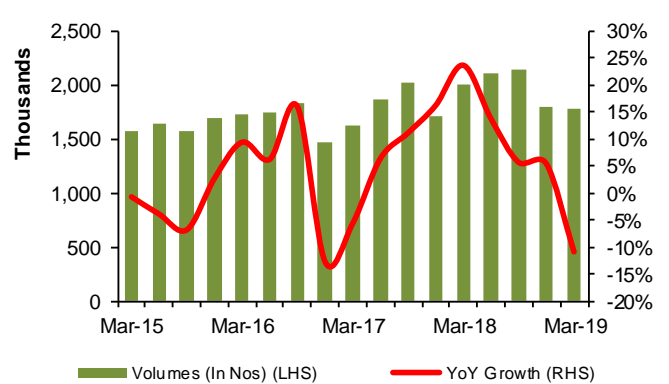


Source: Company, Arianth Capital Markets      Source: Company, Arianth Capital Markets

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



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



Source: Company, Arianth Capital Markets      Source: Company, Arianth Capital Markets

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### 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	185	169	166	184
PER (x)	14.6	14.1	15.4	15.7	14.2
Price/Book (x)	5.1	4.4	4.0	3.8	3.4
EV/EBITDA (x)	9.7	8.6	9.5	9.5	8.4
EV/Net sales (x)	1.6	1.4	1.4	1.3	1.2
RoE (%)	38	34	27	25	25
RoCE (%)	51	48	41	37	38
Fixed Asset turnover (x)	2.7	2.8	2.6	2.4	2.4
Dividend Yield (%)	3.3	3.5	3.3	3.8	3.8
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	9	(7)	(1)	10
EPS Growth, %	13	4	(8)	(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****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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