

Hero Motocorp

India Research

RESULT REVIEW

 Bloomberg: HMCL IN
 Reuters: HROH.BO

BUY

Decent performance in Challenging Environment – Maintain BUY

During Q4FY19, HMCL's sales declined by 7.9% YoY to Rs78.9bn (our Estimates Rs77.4bn). Its EBITDA margins contracted by 244bps YoY to 13.6% (Our estimates 13.9%). PAT declined by 24.5% YoY to Rs7.3bn which was 4.9% below our estimates. To factor in present business outlook we reduce our PAT estimates by 4% and 3.5% for FY20E and FY21E respectively. We retain our BUY rating on the stock with a revised price target of Rs 3103 (PER of 16x FY21E) as we remain positive on the HMCL's positioning (benefitting from rural economic recovery) and its competitive advantages like strong brand and distribution network.

Q4FY19 Result Highlights:

During Q4FY19, HMCL's sales declined by 7.9% YoY to Rs78.9bn (our Estimates Rs77.4bn) which is combination of 11% volume de-growth and a 3.5% increase in average realizations. EBITDA margins during the quarter contracted by 244bps YoY to 13.6% (Our estimates 13.9%) on account of 133bps gross margin compression. PAT declined by 24.5% YoY to Rs7.3bn which was 4.9% below our estimates. Lower other income and high tax rate also impacted the profit during the quarter.

Volume growth to rebound in H2FY20:

The Company reported 11% Volume growth during Q4FY19 and 3.1% in FY19. This is after strong 13.9% volume growth in FY18. For HMCL, volumes witnessed sharp decline in H2FY19 on account of high insurance costs, tight liquidity in vehicle financing and general slowdown in the economy. The Company recovered some of the market share in entry level segment in Q4FY19 from its rivals. However, currently inventory levels at HMCL's dealers end are still high at 45-50 days which it plans to lower to 40 days and hence Management expects volume growth to remain tepid during Q1FY20. The Company has reduced FY20 volume growth guidance from high single digit to mid single digit with a soft H1 and relatively stronger H2 (10% volume growth). This is based on its strong product portfolio and likely uptake in the economic growth beginning from Q2FY20 in the country.

Key Financials:

Y/E (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	2,85,005	3,22,305	3,36,505	3,64,473	3,97,219
EBIDTA	46,348	52,802	49,301	51,393	56,906
EBIDTA Margin (%)	16.3%	16.4%	14.7%	14.1%	14.3%
PAT	33,771	37,972	34,097	34,996	38,744
YoY (%)	6.9	12.4	(10.2)	2.6	10.7
EPS (Rs)	169.1	190.1	170.7	175.2	194.0
ROCE (%)	35.6	34.4	28.0	26.5	26.6
ROE (%)	35.7	34.7	27.7	25.9	26.0
PE (x)	15.4	13.7	15.3	14.9	13.4

Source: Karvy Stock Broking

Recommendation

CMP:	Rs2,604
Target Price:	Rs3,103
Previous Target Price	Rs3,419
Upside (%)	19.2%

Stock Information

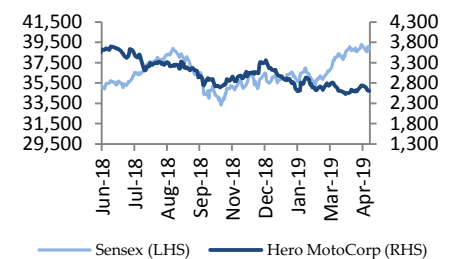
Market Cap. (Rsbn / US\$ mn)	520/7,448
52-week High/Low (Rs)	3,819/2,515
3m ADV (Rsmn / US\$ mn)	2,328/33
Beta	0.9
Sensex/ Nifty	39,067/11,755
Share outstanding (mn)	200

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	2.0	(0.4)	(30.2)	(16.1)
Rel. to Sensex	1.0	(9.2)	(37.5)	(22.6)

Performance

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Source: Bloomberg

Earnings Revision

(%)	FY20E	FY21E
Revenue	↑ 0.7	↑ 2.3
EBITDA	↓ 3.5	↓ 1.6
PAT	↓ 4.0	↓ 3.5

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EBITDA Margins to stabilize: The Company reported EBITDA margins of 13.6%, 244bps decline YoY. This is the 4th consecutive quarter margin decline reported by the Company which is attributed to higher sales promotion expense and higher commodity prices it incurred during the quarter. Despite recent price hike and lowering discounts, Management anticipates its gross margins and EBITDA margin to remain in the band of 13-14% during H1FY20. We believe, despite scale benefits and richer product mix, overall margin recovery will take at least 2-3 quarters as volume growth remains soft.

Growth Outlook: As per the management 2W demand in India continues to remain soft. Growth in rural and urban area has softened due to general slowdown in the economy and increase in prices of bikes. We believe, for HMCL, double digit volume growth is likely to be challenging for the next 2-3 quarters on account of subdued consumer sentiment and slow economic growth in the country. However growth is likely to rebound post Q2FY20 as uncertainties related to Monsoon and General Election is likely to be over. We expect HMCL to report 5%/7% volume growth during FY20E/21E.

Earning Revision: For HMCL, we reduce our PAT estimates by 4% and 3.5% for FY20E and FY21E respectively mainly on account of softening in EBITDA margin scenario. We expect HMCL to report 6% volume CAGR, 7.2% sales CAGR and 6.6% PAT CAGR over FY19-21E. The Company is expected to report EPS of Rs175 and Rs194 in FY20E and FY21E respectively.

Valuations and recommendations: At CMP Rs2604, the stock is currently quoting at 13.4x FY21E earnings. While near term growth outlook for HMCL remains challenging, we remain upbeat on its medium term growth prospects given its competitive advantages like strong brand and distribution network. Also HMCL is in a superior position to benefit from rural economic recovery. It is a debt-free, cash-rich entity with 35%+ average ROE. We reiterate our BUY rating on the stock with a revised price target of Rs 3103 (PER of 16x FY21E). We lower our target PE multiple from 17x to 16x to factor in single digit EPS growth over FY19-21E.

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Exhibit 1: Mar'19 Quarterly Performance

Rs Mn	Q4FY19	Q4FY18	YoY %	Q3FY19	QoQ %
Net Sales	78,850	85,640	-7.9%	78,648	0.3%
Cost of material consumed	53,356	57,211	-6.7%	54,750	-2.5%
Changes in inventories	1,029	720	42.9%	(605)	-270.2%
Raw Material	54,385	57,931	-6.1%	54,145	0.4%
Staff Cost	4,473	3,809	17.4%	4,357	2.7%
Other expenditure	9,298	10,195	-8.8%	9,098	2.2%
Total Expenditure	68,156	71,935	-5.3%	67,601	0.8%
EBITDA	10,693	13,706	-22.0%	11,048	-3.2%
Depreciation	1,502	1,483	1.3%	1,518	-1.1%
EBIT	9,191	12,223	-24.8%	9,529	-3.6%
Interest	22	15	42.2%	22	1.4%
Other Income	1,642	1,665	-1.4%	1,876	-12.5%
PBT	10,811	13,872	-22.1%	11,384	-5.0%
Tax	3,508	4,198	-16.4%	3,693	-5.0%
PAT	7,303	9,674	-24.5%	7,691	-5.0%
Margins	Q4FY19	Q4FY18	YoY(bps)	Q3FY19	QoQ(bps)
Gross margins	31.0%	32.4%	(133)	31.2%	(13)
EBITDA	13.6%	16.0%	(244)	14.0%	(49)
PAT	9.3%	11.3%	(203)	9.8%	(52)
Tax Rate	32.4%	30.3%	218	32.4%	1
Segmental	Q4FY19	Q4FY18	YoY %	Q3FY19	QoQ %
No. of Two wheelers sold	17,81,160	20,01,595	-11.0%	17,98,905	-1.0%
Average Relisation / Unit	44,269	42,786	3.5%	43,720	1.3%
EBITDA / Unit	6,004	6,847	-12.3%	6,141	-2.2%
PAT/ Unit	4,100	4,833	-15.2%	4,275	-4.1%

Source: Karvy Stock Broking

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Exhibit 2: Revision in Estimates

	FY20E	FY21E
NEW ESTIMATES		
Volumes (nos)	82,11,041	87,82,389
Net sales	3,64,473	3,97,219
EBITDA	51,393	56,906
Margins	14.1%	14.3%
PAT	34,996	38,744
OLD ESTIMATES		
Volumes (nos)	82,86,255	87,04,697
Net sales	3,62,026	3,88,210
EBITDA	53,235	57,843
Margins	14.7%	14.9%
PAT	36,464	40,165
CHANGE		
Volumes	-0.9%	0.9%
Net sales	0.7%	2.3%
EBITDA	-3.5%	-1.6%
Margins (bps)	-60	-57
PAT	-4.0%	-3.5%

Source: Karvy Stock Broking

Hero Motocorp**Key Con-Call Takeaways:**

- Management continues to take the price hikes of ~Rs 100-150 at the ex showroom level in Q4FY19 and ~Rs 300-350 in the month of April 19 to pass on the increasing raw material prices.
- HMCL is more focused on the new launches and is also expecting its mid segment to grow faster.
- The company's new launch Destini 125cc in the scooter category is helping HMCL to strengthen its existing scooter portfolio.
- The market share for Destini 125 stood at 19.4% and 10.4% for Xtreme 200R.
- HMCL is expected to launch X-Pulse 200 and Maestro 125 in the month of May 2019 which caters to premium segment.
- Revenues from the Spare Parts were up 13% YoY to Rs 28.36bn.
- Hero Fincorp's market share in financing stood at 43% in Q4FY19 and 40% in FY19.
- The current inventory level at the dealer end is at 45-50 days.

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Financials

Exhibit 3: Profit & Loss Statement

Y/E Mar (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Sales	2,85,005	3,22,305	3,36,505	3,64,473	3,97,219
YoY (%)	0.2	13.1	4.4	8.3	9.0
Raw Material	1,90,373	2,18,346	2,33,177	2,56,202	2,79,022
Employee Cost	13,960	15,401	17,302	18,525	19,906
Admin Expenses	34,324	35,755	36,725	38,354	41,386
Total Expenses	2,38,657	2,69,503	2,87,205	3,13,080	3,40,314
EBIDTA	46,348	52,802	49,301	51,393	56,906
EBIDTA Margin (%)	16.3%	16.4%	14.7%	14.1%	14.3%
Depreciation	4,927	5,556	6,020	6,486	6,987
EBIT	41,421	47,246	43,281	44,907	49,919
Interest	61	63	86	86	86
Other income	5,224	5,258	6,913	6,644	7,143
PBT	46,585	52,442	50,107	51,465	56,976
(-) Tax	12,813	14,470	16,010	16,469	18,232
Tax/ PBT	27.5	27.6	32.0	32.0	32.0
PAT	33,771	37,972	34,097	34,996	38,744
YoY (%)	6.9	12.4	(10.2)	2.6	10.7

Source: Karvy Stock Broking

Exhibit 4: Balance sheet

Y/E Mar (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Equity capital	399	399	400	400	400
Reserves	1,00,714	1,17,289	1,28,172	1,41,499	1,56,254
Net worth	1,01,113	1,17,689	1,28,571	1,41,899	1,56,653
Deferred Tax Liability	824	1,324	-3,028	-3,028	-3,028
Total Liabilities	1,01,937	1,19,013	1,25,544	1,38,871	1,53,626
Gross Block	1,03,772	1,11,344	1,17,005	1,29,005	1,36,005
Less: Acc. depreciation	59,816	64,799	70,819	77,305	84,291
Net block	43,956	46,545	46,186	51,700	51,714
Work in progress	4,651	3,184	5,419	5,419	5,419
Investments	58,899	75,252	59,686	59,686	59,686
Inventories	6,563	8,236	10,724	15,292	16,654
Debtors	15,619	15,202	28,216	22,514	23,449
Cash	1,367	1,413	1,365	12,616	27,382
Loans and advances	12,569	13,763	16,424	17,789	19,388
Current assets	36,118	38,614	56,728	68,212	86,873
Current liabilities	40,543	42,835	40,713	44,238	47,985
Provisions	1,143	1,747	1,762	1,909	2,080
Net current assets	-5,568	-5,969	14,253	22,066	36,807
Total Assets	1,01,937	1,19,013	1,25,544	1,38,871	1,53,626

Source: Karvy Stock Broking

Hero Motocorp
Exhibit 5: Cash Flow Statement

Y/E Mar (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Net profit	33,771	36,974	33,849	34,996	38,744
Depreciation	4,927	5,556	6,020	6,486	6,987
Deferred tax	1,993	999	248	0	0
Change in W/C	4,756	447	-20,270	3,438	24
Operating cash flow	45,447	43,975	19,847	44,920	45,755
Capex	-11,302	-6,179	-12,496	-12,000	-7,000
Investments	-13,088	-16,354	15,566	0	0
Investing cash flow	-24,391	-22,532	3,070	-12,000	-7,000
Free Cash Flow	34,144	37,796	7,352	32,920	38,755
Dividend	-20,910	-23,892	-20,958	-21,669	-23,989
Equity	-92	2,495	-2,008	0	0
Debt	0	0	0	0	0
Financing cash flow	-21,002	-21,396	-22,966	-21,669	-23,989
Net change in cash	54	46	-49	11,252	14,765
Opening cash	1,314	1,367	1,413	1,365	12,616
Closing cash	1,367	1,413	1,365	12,616	27,382

Source: Karvy Stock Broking

Exhibit 6: Ratios

Key Ratios	FY17	FY18	FY19E	FY20E	FY21E
EPS (Rs)	169.1	190.1	170.7	175.2	194.0
Book value (Rs/share)	506	589	644	710	784
Cash /Share (Rs)	234	287	165	222	296
P/E (x)	15.4	13.7	15.3	14.9	13.4
EV/EBDITA (x)	10.2	8.8	9.9	9.3	8.1
P/B (x)	5.1	4.4	4.0	3.7	3.3
ROCE (%)	35.6	34.4	28.0	26.5	26.6
ROE (%)	35.7	34.7	27.7	25.9	26.0
Free Cash/Share (Rs)	171.0	189.3	36.8	164.8	194.0
Dividend/Share (Rs)	87	95	87	90	100
Dividend Yield	3.3%	3.7%	3.3%	3.5%	3.8%
Free Cash Yield (%)	6.6%	7.3%	1.4%	6.3%	7.5%
Gross Asset Turnover (x)	2.9	3.0	2.9	3.0	3.0
Avg Net WC Days	-6	-8	3	11	9
Net W/C (% of sales)	-2.4%	-2.3%	3.8%	2.6%	2.4%

Source: Karvy Stock Broking

Stock Ratings	Absolute Returns
Buy	> 15%
Hold	5-15%
Sell	< 5%

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