Result Update

Hero MotoCorp

Accumulate

DART — DOLAT ANALYSIS & RESEARCH THEMES — IN-DEPTH• PRECISE• ACTIONABLE

Margins muted. Outlook better driven by pricing prudence. Maintain Accumulate

HMCL numbers were marginally below estimates due to input cost pressure and increase in marketing expenditure due to the festive season. HMCL did not resort to price cuttings to push volumes and hence underperformance on volume front as compared to industry. With industry also looking to go back to pricing sanity, we expect HMCL volumes to improve from the current levels. With 2 products – 1 in scooter and 1 in motorcycle, launch in FY20, HMCL is well geared up in all product categories. HMCL management believes that volumes should improve from Q1FY20 and some early signs are visible during January 2019. HMCL stock price has been beaten down due to industry level issues as well as margin underperformance. We believe that stock is undervalued and considering that industry volume should improve along with margins, we maintain Accumulate. We rollover valuations to FY21E with a target of ₹ 3,066.

Pricing Prudence – focus on profitability

HMCL did not budge under the pricing pressure to push volumes by other major player in the 2W segment. Growth of HMCL volumes were lagging behind the industry growth but HMCL maintained pricing prudence. This has resulted in realizations per unit improvement of 2.6% on a sequential basis. With other players in the industry also getting back to pricing and profitability, HMCL volumes should also improve. We expect HMCL to maintain its pricing strategy in future.

Margin pressure – all headwinds came together

HMCL faced raw material pressure, volume slowdown and higher marketing expenses all in last quarter. This has impacted operating margin profile. With volume outlook improving and raw material cost pressure easing, we expect HMCL margin profile to improve. HMCL will not hesitate to take price hikes if required to protect profitability.

Q3FY19 Result (₹ Mn)

Particulars	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)
Revenue	78,648	73,142	7.5	90,909	(13.5)
Total Expense	67,601	61,562	9.8	77,122	(12.3)
EBITDA	11,048	11,580	(4.6)	13,787	(19.9)
Depreciation	1,518	1,383	9.8	1,518	0.0
EBIT	9,529	10,197	(6.5)	12,269	(22.3)
Other Income	1,876	1,100	70.6	2,237	(16.1)
Interest	22	16	37.6	21	0.9
EBT	11,384	11,282	(6.5)	14,485	(21.4)
Tax	3,693	3,227	14.4	4,722	(21.8)
RPAT	7,691	8,054	(4.5)	9,763	(21.2)
APAT	7,691	8,054	(4.5)	9,763	(21.2)
			(bps)		(bps)
Gross Margin (%)	31.2	32.6	(143)	30.7	45
EBITDA Margin (%)	14.0	15.8	(179)	15.2	(112)
NPM (%)	9.8	11.0	(123)	10.7	(96)
Tax Rate (%)	32.4	28.6	383	32.6	(16)
EBIT Margin (%)	12.1	13.9	(183)	13.5	(138)

CMP	₹ 2,614
Target / Upside	₹ 3,066 / 17%
BSE Sensex	36,257
NSE Nifty	10,831

Scrip Details

Equity / FV	₹ 399mn / ₹ 2
Market Cap	₹ 522bn
	US$ 7bn
52-week High/Low	₹ 3,825/₹ 2,561
Avg. Volume (no)	516,870
NSE Symbol	HEROMOTOCO
Bloomberg Code	HMCL IN

Shareholding Pattern Dec'18(%)

Promoters	34.6
MF/Banks/FIs	15.4
FIIs	40.2
Public / Others	9.8

Valuation (x)

	FY19E	FY20E	FY21E
P/E	14.7	13.2	12.8
EV/EBITDA	8.9	7.9	7.6
ROE (%)	29.0	29.7	28.4
RoACE (%)	28.0	28.8	27.7

Estimates (₹ mn)

	FY19E	FY20E	FY21E
Revenue	351,312	389,957	421,153
EBITDA	52,041	58,443	61,393
PAT	35,600	39,516	40,823
EPS (₹)	178.2	197.9	204.4

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DOLAT CAPITAL

Valuation

We like HMCL for a) relatively stable margins b) better outlook in terms of volume c) increasing realizations and d) focus on product portfolio in higher value chains. We expect FY20 to perform better on value and margins terms and FY21 to perform marginally better than the industry. Risk to our call remains failure of new models. We have rollover valuations to FY21E. We maintain Accumulate rating with target price of ₹ 3,066.

Exhibit 1: Sales Volume for HMCL

Category	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)	YTD FY19	YTD FY18	YoY (%)
Total Sales	17,98,905	17,09,106	5.3	21,34,047	(15.7)	60,37,901	55,81,286	8.2

Source: DART, Company

Exhibit 2: Per Unit Realizations and profit matrix

Particulars	Q3FY19	Q3FY18	Y-o-Y (%)	Q2FY19	Q-o-Q (%)	9M FY19	9M FY18	Y-o-Y (%)
Realisation / Unit	43,724	42,804	2.1	42,604	2.6	42,666	42,359	0.7
Cost / Unit	30,099	28,850	4.3	29,520	2.0	29,603	28,702	3.1
Gross Profit / Unit	13,625	13,954	(2.4)	13,084	4.1	13,062	13,657	(4.4)
EBITDA / Unit	6,146	6,784	(9.4)	6,465	(4.9)	6,397	7,005	(8.7)

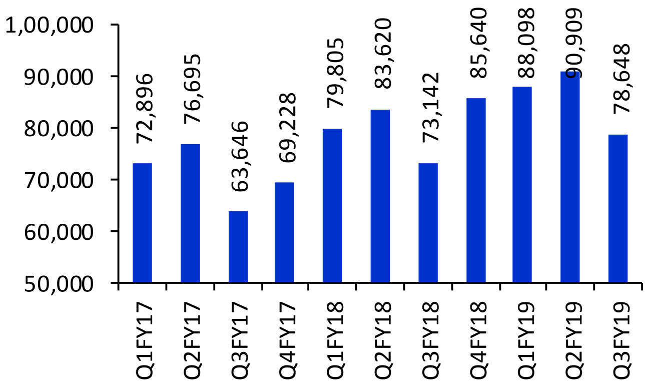
Source: DART, Company

Concall Highlights

- Demand have picked-up sequentially in Q4FY19, particularly in the 2nd half of Jan’19.
- Management expects pre-buying in the 2-wheeler segment in H2FY20, prior to BS VI norms kicking in.
- According to the HMCL management, rural demand has been muted. Demand improvement has been observed since last 10-15 days, expecting normalized demand from Q1FY20.
- HMCL took last price hike in Oct’19 to the tune of ₹ 500-600 per unit at ex-showroom price.
- Spare parts revenue for the quarter were at ₹ 7.3bn as compared to ₹ 6.9bn in Q3FY18. On YTD basis, it stands at ₹ 20.45bn as compared to ₹ 17.57bn in the same period last year.
- HMCL have already migrated to CBS/ABS for ~50% of its portfolio. CBS will have an impact of ₹ 500 per units as compared to ABS impact of ₹ 5000 (margin neutral).
- Destini 125 CC scooters have been performing well, commanding ~14% market share in the category.
- Management has guided for future pipeline - Maestro 125 in scooter segment and x-pulse in premium motorcycle segment.
- Scooter demand slowdown may be due to higher fuel priced (lower fuel efficiency).
- ~10 days of receivables have gone up in order to support distribution channel.
- Current inventory level for HMCL dealers are to the tune of 6-8 weeks as compared to normal inventory level of 4-6 weeks.

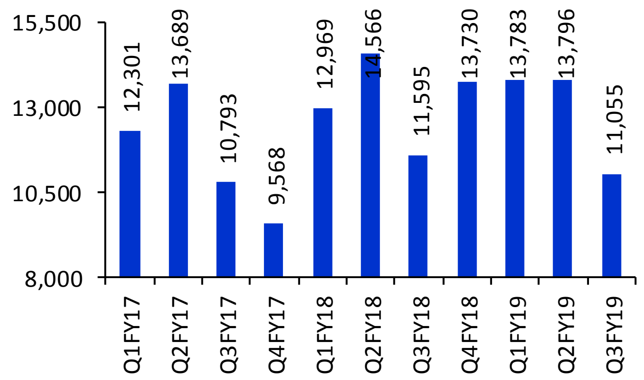
Quarterly Financial Charts

Exhibit 3: Net Sales (₹ Mn)



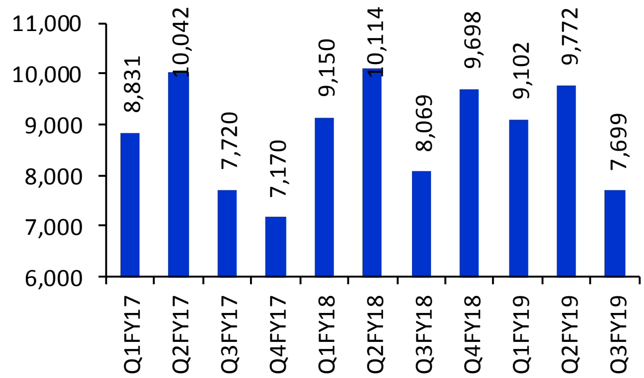
Source: DART, Company

Exhibit 4: EBITDA (₹ Mn)



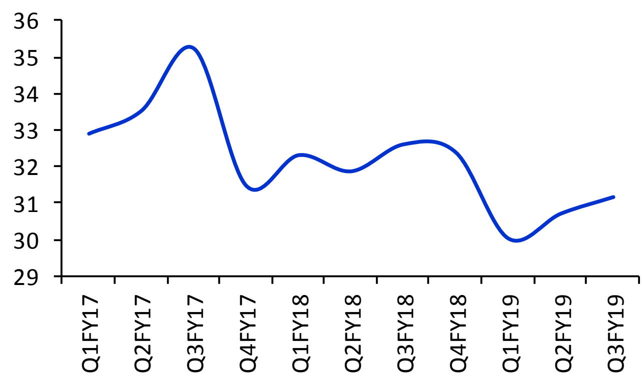
Source: DART, Company

Exhibit 5: Net profit (₹ Mn)



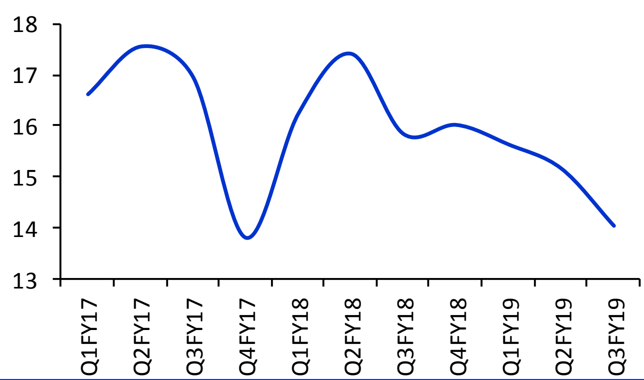
Source: DART, Company

Exhibit 6: Gross Margin %



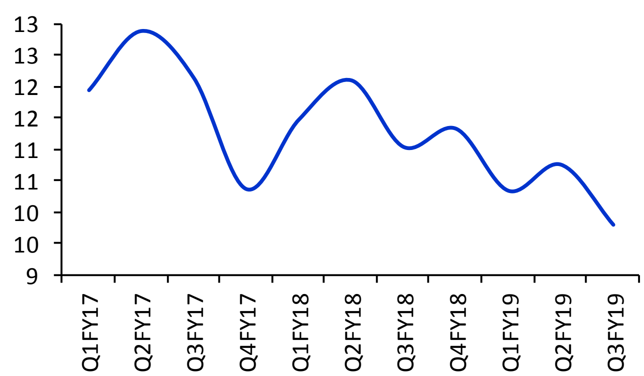
Source: DART, Company

Exhibit 7: OPM %



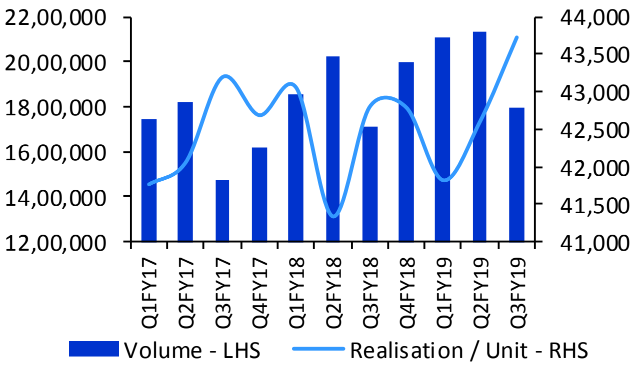
Source: DART, Company

Exhibit 8: NPM %



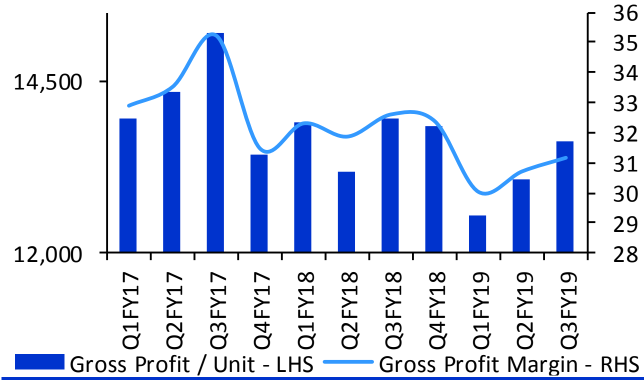
Source: DART, Company

Exhibit 9: Volumes and Realisations



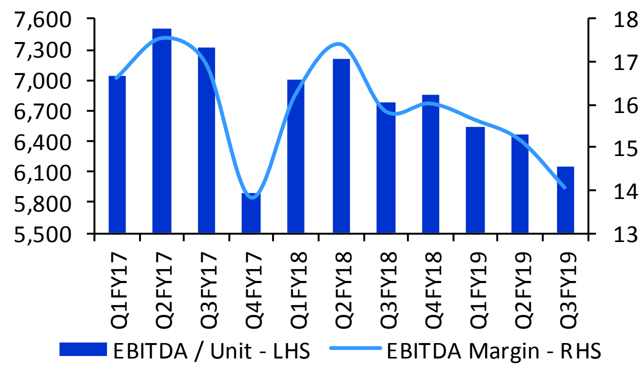
Source: DART, Company

Exhibit 10: Gross Spread and Gross Margin



Source: DART, Company

Exhibit 11: EBIDTA Spread and EBIDTA Margin



Source: DART, Company

Profit and Loss Account

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
Revenue	**322,305**	**351,312**	**389,957**	**421,153**
Total Expense	**269,503**	**299,272**	**331,514**	**359,760**
COGS	218,346	243,714	270,401	293,385
Employees Cost	15,401	16,941	18,636	20,499
Other expenses	35,755	38,616	42,477	45,875
EBIDTA	**52,802**	**52,041**	**58,443**	**61,393**
Depreciation	5,556	6,056	6,541	7,325
EBIT	**47,246**	**45,985**	**51,902**	**54,068**
Interest	63	80	100	110
Other Income	5,258	6,836	7,177	7,895
Exc. / E.O. items	0	0	0	0
EBT	**52,442**	**52,740**	**58,980**	**61,853**
Tax	15,468	17,141	19,463	21,030
RPAT	36,974	35,600	39,516	40,823
Minority Interest	0	0	0	0
Profit/Loss share of associates	**0**	**0**	**0**	**0**
APAT	**36,974**	**35,600**	**39,516**	**40,823**

Balance Sheet

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
Sources of Funds				
Equity Capital	399	399	399	399
Minority Interest	0	0	0	0
Reserves & Surplus	117,289	127,107	138,588	147,871
Net Worth	**117,689**	**127,506**	**138,987**	**148,271**
Total Debt	0	0	0	0
Net Deferred Tax Liability	5,117	4,605	4,144	4,559
Total Capital Employed	**122,805**	**132,111**	**143,132**	**152,829**
Applications of Funds				
Net Block	**46,545**	**47,179**	**57,064**	**59,777**
CWIP	3,184	3,200	3,600	2,800
Investments	28,720	28,600	28,000	33,000
Current Assets, Loans & Advances	**88,939**	**97,936**	**101,332**	**105,482**
Inventories	8,236	11,550	12,820	13,846
Receivables	15,202	21,175	23,504	25,385
Cash and Bank Balances	1,413	1,309	609	1,454
Loans and Advances	732	600	800	1,200
Other Current Assets	7,444	7,102	6,598	6,598
Less: Current Liabilities & Provisions	**44,583**	**44,804**	**46,864**	**48,230**
Payables	33,188	34,650	37,393	40,385
Other Current Liabilities	11,395	10,154	9,471	7,845
Net Current Assets	44,356	53,132	54,468	57,252
Total Assets	**122,805**	**132,111**	**143,132**	**152,829**

E – Estimates

Important Ratios

Particulars	FY18A	FY19E	FY20E	FY21E
(A) Margins (%)				
Gross Profit Margin	32.3	30.6	30.7	30.3
EBIDTA Margin	16.4	14.8	15.0	14.6
EBIT Margin	14.7	13.1	13.3	12.8
Tax rate	29.5	32.5	33.0	34.0
Net Profit Margin	11.5	10.1	10.1	9.7
(B) As Percentage of Net Sales (%)				
COGS	67.7	69.4	69.3	69.7
Employee	4.8	4.8	4.8	4.9
Other	11.1	11.0	10.9	10.9
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.0	0.0	0.0
Interest Coverage	755.9	574.8	519.0	491.5
Inventory days	9	12	12	12
Debtors days	17	22	22	22
Average Cost of Debt				
Payable days	38	36	35	35
Working Capital days	50	55	51	50
FA T/O	6.9	7.4	6.8	7.0
(D) Measures of Investment				
AEPS (₹)	185.1	178.2	197.9	204.4
CEPS (₹)	212.9	208.6	230.6	241.1
DPS (₹)	95.0	110.0	120.0	135.0
Dividend Payout (%)	51.3	61.7	60.7	66.0
BVPS (₹)	589.3	638.4	695.9	742.4
RoANW (%)	33.8	29.0	29.7	28.4
RoACE (%)	32.5	28.0	28.8	27.7
RoAIC (%)	41.9	36.5	38.0	36.8
(E) Valuation Ratios				
CMP (₹)	2614	2614	2614	2614
P/E	14.1	14.7	13.2	12.8
Mcap (₹ Mn)	522,056	522,056	522,056	522,056
MCap/ Sales	1.6	1.5	1.3	1.2
EV	464,732	464,547	464,447	463,603
EV/Sales	1.4	1.3	1.2	1.1
EV/EBITDA	8.8	8.9	7.9	7.6
P/BV	4.4	4.1	3.8	3.5
Dividend Yield (%)	3.6	4.2	4.6	5.2
(F) Growth Rate (%)				
Revenue	13.1	9.0	11.0	8.0
EBITDA	13.9	(1.4)	12.3	5.0
EBIT	14.1	(2.7)	12.9	4.2
PBT	12.6	0.6	11.8	4.9
APAT	9.5	(3.7)	11.0	3.3
EPS	9.5	(3.7)	11.0	3.3

Cash Flow

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
CFO	39,809	39,610	47,502	48,900
CFI	(19,152)	(13,546)	(19,306)	(14,239)
CFF	(20,467)	(25,779)	(28,135)	(31,650)
FCFF	31,816	26,233	28,396	39,661
Opening Cash	1,367	1,413	1,309	609
Closing Cash	1,413	1,698	1,370	3,620

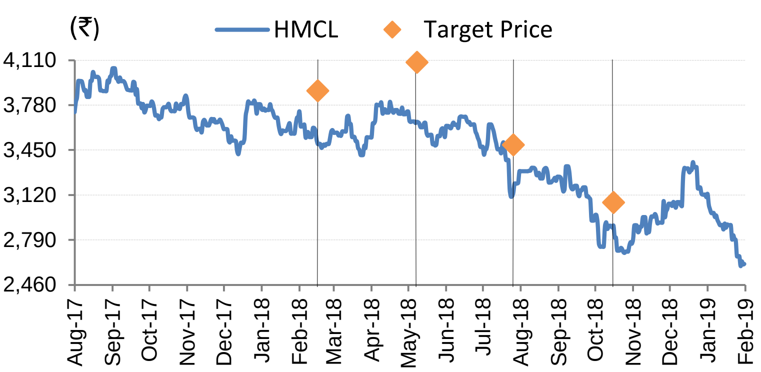
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	**> 20%**
Accumulate	**10 to 20%**
Reduce	**0 to 10%**
Sell	**< 0%**

Rating and Target Price History



Month	Rating	TP (₹)	Price (₹)
Feb-18	Accumulate	3,885	3,494
May-18	Accumulate	4,095	3,657
Jul-18	Accumulate	3,488	3,137
Oct-18	Accumulate	3,066	2,895

*Price as on recommendation date

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