

Stock Update

On a rough terrain

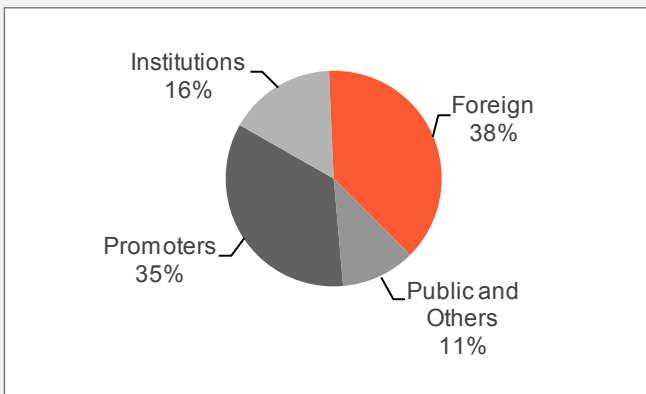
Hero MotoCorp

Reco: Hold | CMP: Rs2,604

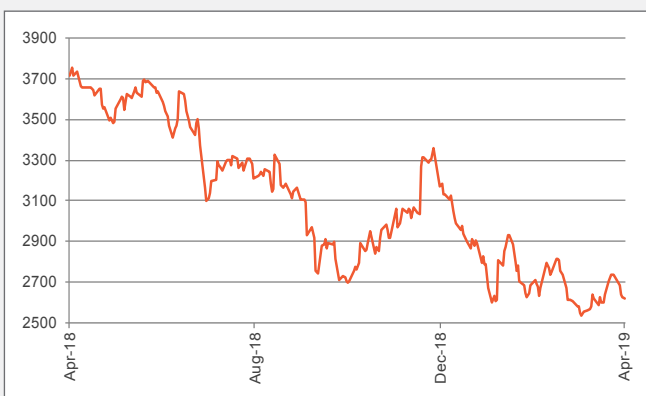
Company details

Price target:	Rs2,800
Market cap:	Rs52,012 cr
52-week high/low:	Rs3,819/2,517
NSE volume: (No of shares)	6.5 lakh
BSE code:	500182
NSE code:	HEROMOTOCO
Sharekhan code:	HEROMOTOCO
Free float: (No of shares)	13.06 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.4	-0.3	-1.2	-27.6
Relative to Sensex	-1.0	-7.4	-14.4	-36.3

Key points

- Q4FY2019 results meets our modest estimates:** Hero MotoCorp (Hero) has reported in-line set of results for the quarter. Revenue at Rs. 7,885 crore declined by 8% y-o-y. The drop in revenue can be attributed to a sharp 11% decline in volumes (the company resorted to channel inventory correction following sluggish retails and a high base in the corresponding quarter last year), while realisation per vehicle rose by 3.5% y-o-y on account of price hikes taken by the company. Operating margin at 13.6% declined by 240 BPS y-o-y and was in line with the estimated 13.4%. Operating margin was the lowest in the past four years. Higher raw-material prices, intense competition and operating de-leverage (due to volume drop) impacted volumes. EBITDA at Rs. 1,069 crore declined by 22% y-o-y and was in line with estimates. Tracking the weak operating performance, net profit at Rs. 730 crore dropped by 25% y-o-y and came broadly in line with our estimates.
- Industry woes to continue due to higher inventory levels and weak sentiment; Hero expects flat sales in H1FY2020:** The two-wheeler (2W) industry's growth declined sharply in H2FY2019, as increased insurance cost, liquidity financing crunch and slowing economic growth dented sales. From double-digit growth in H1FY2019, the 2W industry posted flat sales in H2FY2019. With uncertainty before general elections and demand stress in rural areas (due to deficient rainfall and lower Rabi sowing), 2W demand is expected to remain under pressure. Moreover, inventory levels in the 2W industry are high (current inventory is at 45-50 days as against industry norm of about 30 days). With subdued demand and inventory correction, Hero expects the 2W industry to remain flat in H1FY2020. The company expects demand to recover only in H2FY2020 and expects mid-single digit growth for the 2W industry for FY2020.
- Subdued volumes, aggressive pricing by competition, and regulatory costs to dent margins:** Hero's volumes are expected to remain under pressure as we expect 3% volume growth for FY2020. Weak volumes would result in operating de-leverage, which would drag margins. Further, competitive intensity is expected to aggravate further, as Hero (to defend market share) has also resorted to providing aggressive discounts. Moreover, upcoming regulatory changes (BS-6 emission norms coming in to effect from April 1, 2020) are likely to result in a substantial

cost increase (8-10% price increase expected), particularly entry level motorcycles, which form about 70% of Hero's sales. We expect Hero's margins to contract by 190 BPS over the next two years.

- ♦ **Outlook - Challenging times to continue; Expect earnings to drop in FY2020:** The 2W industry's demand is expected to be subdued with low to mid-single digit growth expected in FY2020. With margin pressures on account of operating deleverage, aggressive competitive pricing and higher regulatory costs, we expect Hero's net profit to decline by 2% in FY2020.

- ♦ **Valuations – Cut estimates to factor earnings pressure; earnings growth to be muted 1% over FY19-21; Retain Hold with PT of Rs. 2,800:** Given subdued outlook for the 2W industry and margin pressures, we have cut our FY2020 earnings by 6%. We have introduced FY2021 estimates in this report. Hero's earnings growth is expected to be muted 1% CAGR over the next two years. We retain our Hold rating on the stock with an unchanged price target (PT) of Rs. 2,800, as we rollover our target multiple on FY2021 earnings.

Result					Rs cr	
Particulars	Q4FY2019	Q4FY2018	YoY (%)	Q3FY2019	QoQ (%)	
Total Income	7,885.0	8,564.0	-7.9	7,864.8	0.3	
EBIDTA	1,069.3	1,370.6	-22.0	1,104.8	-3.2	
EBIDTA Margin (%)	13.6	16.0	(240) bps	14.0	(40) bps	
Depreciation	150.2	148.3	1.3	151.8	(1.1)	
Interest	2.2	1.5	42.2	2.2	1.4	
Other Income	164.2	166.5	(1.4)	187.6	(12.5)	
PBT	1,081.1	1,387.2	(22.1)	1,138.4	(5.0)	
Tax	365.7	419.8	(12.9)	369.3	(1.0)	
PAT	730.3	967.4	(24.5)	769.1	(5.0)	
EPS (Rs.)	36.6	48.4	(24.5)	38.5	(5.0)	

Valuation					Rs cr	
Particulars	FY17	FY18	FY19E	FY20E	FY21E	
Net Sales	28500.5	32230.5	33650.5	36641.2	40127.4	
Growth (%)	0.2	13.1	4.4	8.9	9.5	
EBIDTA	4634.8	5280.2	4930.1	4927.8	5120.4	
OPM (%)	16.3	16.4	14.7	13.4	12.8	
PAT	3377.1	3697.4	3384.9	3336.4	3458.8	
Growth (%)	6.9	9.5	-8.5	-1.4	3.7	
FD EPS (Rs.)	169.1	185.1	169.5	167.1	173.2	
P/E (x)	15.4	14.1	15.4	15.6	15.0	
P/B (x)	5.1	4.4	3.9	3.6	3.3	
EV/EBIDTA (x)	9.9	8.4	8.8	8.6	8.2	
RoE (%)	33.4%	31.4%	25.7%	22.9%	21.6%	
RoCE (%)	44.0%	42.4%	36.3%	32.7%	31.0%	

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