

Sector: Automobiles
Result Update

	Change
Reco: Buy	↔
CMP: Rs. 2,292	
Price Target: Rs. 2,525	↔

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 45,784 cr
52-week high/low:	Rs. 3021/1475
NSE volume: (No of shares)	13.4 lakh
BSE code:	500182
NSE code:	HEROMOTOCO
Sharekhan code:	HEROMOTOCO
Free float: (No of shares)	13.05 cr

Shareholding (%)

Promoters	34.6
FII	34.4
DII	19.6
Others	11.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.9	12.5	-0.2	-17.4
Relative to Sensex	1.4	16.6	15.1	-3.1

Sharekhan Research, Bloomberg

Hero Motocorp operating results were broadly in line with street estimates. However lower taxation led to PAT beat. Management stated that several one offs (discounts on transition to BS6 emission norms, provision on fiscal benefits on Neemrana plant and BS4 obsolescence provisions) impacted the margins which dropped 300 bps yoy. Hero stated that about 90% of dealerships have resumed operations and demand is gradually coming back. While economic slowdown due to COVID-19 and steep cost increases due to BS6 transition (prices have increased by 10-12%) would impact volumes in FY21, we expect recovery in FY22. With good rabi harvest, normal monsoon forecast and reform measures by Government, farm incomes would be boosted, which would drive recovery in volumes and benefit Hero which derives half of volumes from rural areas. Hence, we maintain Buy rating on the stock.

Key positives

- Realisation per vehicle grew by 5% y-o-y and was marginally higher than our estimates. Price hikes and higher share of BS6 bikes led to better realisation.
- Tax rate at 4.6% was lower than expectations, which resulted in PAT beat. Deferred tax credit led to lower taxation during the quarter.

Key negatives

- Certain one-off provisions such as discounts to clear BS4 inventory (amounting to Rs. 110 crore) and provision for fiscal benefits of the Neemrana plant (amounting to Rs. 57 crore) dragged the operating profit margin (OPM), which fell by 300 bps y-o-y.
- Volumes dropped sharply by 25% y-o-y in Q4FY2020 impacted by the lockdown due to COVID-19 and transition from BS4 emission to BS6 emission norms.

Our Call

Valuations: Broadly retain estimates; maintain Buy with unchanged PT of Rs 2,525: Hero's Q4 operating results were broadly in line with estimates. FY2021 would witness double digit earnings drop on account of volume pressures due to impact on economy on account of COVID-19 and steep cost increases due to BS6 emission norms. However, we expect recovery in FY22 driven by pent up demand and pick up in rural areas due to increased farm incomes on account of normal monsoon forecast and reform measures undertaken by Government. We have broadly retained our earnings estimates for both FY2021 and FY2022. At CMP, stock is trading at 14.1x its FY2022 earnings which is lower than its long-term historical average of 16-17x. Hence, we retain Buy rating on the stock with an unchanged PT of Rs 2,525.

Key Risks

Prolonged weakness in the domestic market on account of COVID-19 can impact financials. Further, adverse INR-JPY movement can impact margins as Hero imports raw materials from Japan.

	Rs cr				
Particulars	FY18	FY19	FY20E	FY21E	FY22E
Net Sales (Rs. cr)	32230.5	33650.5	28836.1	24459.2	31196.5
Growth (%)	13.1	4.4	-14.3	-15.2	27.5
EBIDTA (Rs. cr)	5280.2	4930.1	3958.0	3244.2	4424.1
OPM (%)	16.4	14.7	13.7	13.3	14.2
PAT (Rs. cr)	3697.4	3384.9	3178.7	2373.2	3238.0
Growth (%)	9.5	-8.5	-6.1	-25.3	36.4
FD EPS (Rs.)	185.1	169.5	159.2	118.8	162.1
P/E (x)	12.4	13.5	14.4	19.3	14.1
P/B (x)	3.9	3.6	3.3	3.1	2.9
EV/EBIDTA (x)	7.2	8.0	9.9	12.0	8.7
RoE (%)	31.4%	26.3%	22.7%	16.1%	20.7%
RoCE (%)	42.4%	37.2%	26.7%	20.8%	26.6%

Source: Company; Sharekhan estimates

Q4FY2020 operating results broadly in line with street estimates; Lower tax leads to PAT beat: Hero posted broadly in line operating results for Q4FY2020. Sales at Rs. 6,238 crore declined by 21% y-o-y because of a 25% drop in volumes. Lockdown on account of COVID-19 and transition from BS4 to BS6 emission norms impacted volumes. Realisations grew by 5% y-o-y due to price hikes and sales of high realisation BS6 bikes. Revenue was largely in line with estimates. OPM dropped by 300 bps y-o-y to 10.6% (in line with street estimates) primarily due to operating de-leverage due to a decline in volumes. Further, higher discounting because of clearance of old BS4 inventory (amounting to Rs. 110 crore), provision for fiscal benefits at Neemrana plant (amounting to Rs. 57 crore), and certain provisions relating on obsolescence of BS4 products dented margins. Hero stated that adjusting for one-offs, OPM would have been 13.5%. Tax rate for the quarter was lower at 4.6% (compared to 32.4% in Q4FY2019) on account of deferred tax credit. This resulted in PAT beating estimates. PAT stood at Rs. 621 crore as against the estimates of Rs. 495 crore.

Operations ramping up gradually: Hero stated that about 90% of its dealerships have resumed operations with the Government easing lockdown restrictions. Hero stated that demand is gradually coming back with increased consumer footfalls and conversions. While FY2021, would witness double digit drop in volumes on account of economic impact due to COVID-19 and steep price increases due to BS6 emission norms, we expect recovery in FY22. Increased farm incomes on account of good rabi harvest, forecast of normal monsoon and reform measures by Government would drive recovery in volumes. Hero deriving about half of the revenues from rural areas would be prime beneficiary of recovery in rural areas.

Conference call highlights:

- ◆ **Demand outlook:** Hero stated that is difficult to predict the demand for FY2021 given the uncertain environment in the near term; and the company has not provided any volume forecast for FY2021.
- ◆ **Rural economy:** Management stated that rural sentiments are buoyant, driven by good rabi harvest and forecast of normal monsoon. Hero expects rural market performance to be better as compared to urban market in FY2021.
- ◆ **Vendor update:** Hero stated that all vendors had resumed production and are gradually ramping up capacity.
- ◆ **Dealership update:** Hero stated that about 90% of dealerships have resumed operations and most dealers have reached 75-80% of demand at pre-COVID levels.
- ◆ **Retail sales:** Management stated that retail sales are picking up with increased footfalls as well as conversions. As per management, retail sales are better than expectations.
- ◆ **BS6 transition:** Management stated that is has successfully transitioned to BS6 emission norms. Hero has passed on the entire cost increases due to BS6. In Q4FY2020, Hero's BS6 dispatches were about half of its volumes.
- ◆ **Preference for personal mobility:** Management stated that to ensure social distancing, people may prefer to use personal transport (over public transport), which may enhance demand for 2W.
- ◆ **Capex guidance:** Hero has slashed capex for FY2021 to Rs. 600 crore as against earlier guidance of Rs. 1,000 crore. While capex on R&D and new product development will be retained, capacity enhancements and renovation capex would be deferred.
- ◆ **Cost control:** Hero is focusing on cost-control measures under the 'Leap' programme. Leap focuses on controlling raw material and overheads. Hero realised 50 bps margin savings in FY2020 due to Leap, and the company is targeting 100 bps margin savings in FY2021.

- ◆ **Price hikes:** Hero undertook price hikes of 1-2% in April-May 2020. This was primarily to enhance dealer margins and pass on the remainder of price hikes due to BS6 norms.
- ◆ **Financing:** The share of financing in overall sales stood at 43%. Captive financing arm Hero FinCorp financed about 46% of Hero's vehicles. Hero along with financing partners has launched innovative financing schemes such as low-down payment and flexi EMI to facilitate purchase of 2W by consumers.
- ◆ **Premium segment launch:** Hero has launched new premium motorcycle bike 'X-Pulse' in the premium segment and has received good initial response. Hero is targeting double-digit market share in the premium motorcycle space.
- ◆ **Downtrading:** Management stated that it has witnessed initial trends of customers downtrading (preferring entry level products) and the company is well poised to capture such trends.

Results					Rs cr
Particulars	Q4FY20	Q4FY19	%YoY	Q3FY20	%QoQ
Total Income	6,238.4	7,885.0	-20.9	6,996.7	-10.8
EBIDTA	659.9	1,069.3	-38.3	1,039.0	-36.5
EBIDTA Margin (%)	10.6	13.6	(300 bps)	14.8	(420 bps)
Depreciation	174.7	150.2	16.3	203.7	(14.2)
Interest	4.1	2.2	85.4	5.9	(31.4)
Other Income	169.5	164.2	3.2	182.2	(7.0)
PBT	650.6	1,081.1	(39.8)	1,011.5	(35.7)
Tax	29.9	365.7	(91.8)	131.1	(77.2)
Reported PAT	620.7	730.3	(15.0)	880.4	(29.5)
Adjusted PAT	620.7	730.3	(15.0)	880.4	(29.5)
EPS (Rs.)	31.1	36.6	(15.0)	44.1	(29.5)

Source: Company

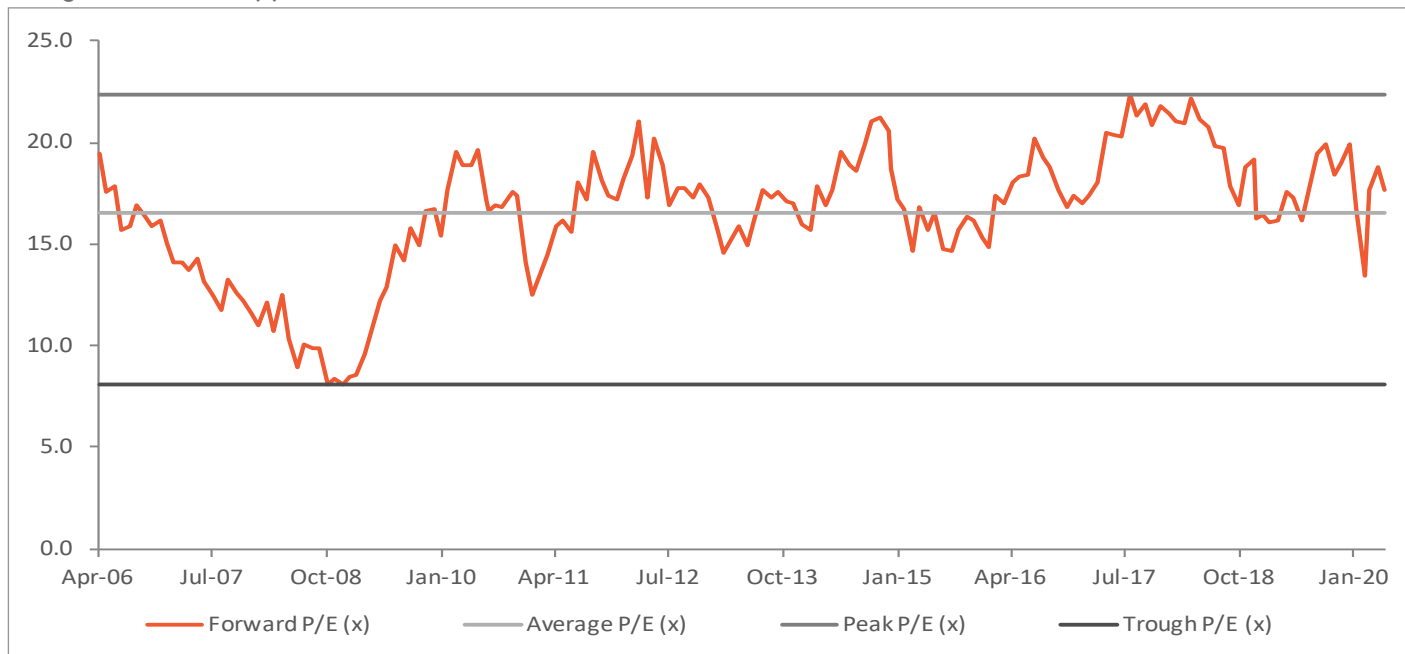
Outlook

FY21 volumes to be impacted; expect recovery in FY22: Lockdown on account of COVID-19 coupled with steep cost increases on account of BS6 norms (vehicle prices have increased by 10-12%) would impact volumes in FY2021 and we expect Hero's volumes to decline in double-digits. With good rabi harvest, normal monsoon forecast and reform measures by Government, farm incomes would be boosted, which would drive recovery in volumes in FY2022. Recovery in rural volumes would benefit Hero which derives half of volumes from hinterlands.

Valuation

Broadly retain estimates; maintain Buy with unchanged PT of Rs 2,525: Hero's Q4 operating results were broadly in line with estimates. FY2021 would witness double digit earnings drop on account of volume pressures due to impact on economy on account of COVID-19 and steep cost increases due to BS6 emission norms. However, we expect recovery in FY22 driven by pent up demand and pick up in rural areas due to increased farm incomes on account of normal monsoon forecast and reform measures undertaken by Government. We have broadly retained our earnings estimates for both FY2021 and FY2022. At CMP, stock is trading at 14.1x its FY2022 earnings which is lower than its long-term historical average of 16-17x. Hence, we retain Buy rating on the stock with an unchanged PT of Rs 2,525.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA		P/BV (x)		RoE (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
TVS Motor Co	30.4	19.0	11.1	8.1	3.4	3.1	11.3	16.2
Bajaj Auto	17.1	15.3	10.8	9.9	2.9	2.7	17.1	17.6
Hero MotoCorp	19.3	14.1	12.0	8.7	3.1	2.9	16.1	20.7

Source: Company, Sharekhan estimates

About company

Hero is the market leader in the 2W industry with a market share of 36%. Hero is present in both the motorcycles and the scooter segments, having market share of about 51% and 11%, respectively. Motorcycles form the major chunk of revenue, contributing about 90% to volumes, while scooters contribute 10% to volumes. Hero is a domestically focused company deriving about 97% of volumes from the Indian market. Entry-level motorcycles (75 cc to 110 cc) form a major chunk of about 70% of overall volumes.

Investment theme

Hero is the largest 2W manufacturer having the widest portfolio of motorcycles right from entry level to the premium segment. The company has an unparalleled reach in rural areas and derives about half of its revenue from hinterlands. Rural sentiments are extremely strong given the good rabi harvest and expectations of a normal monsoon. Further, farm sector reforms by Government such as opening up end markets for selling produce is likely to lead to better realisation which would aid rural demand. Hero is likely to be biggest beneficiary of demand recovery in rural areas. Moreover, currently stock is trading below its long-term historical averages. Hence, we retain Buy rating on the stock.

Key Risks

- ◆ Prolonged coronavirus infection in India and weaker consumer sentiments
- ◆ Yen-denominated imports account for 15% of revenue. Any adverse INR-Yen movement can have an adverse impact on volumes.

Additional Data

Key management personnel

Dr. Pawan Munjal	Chairman, Managing Director and CEO
Niranjan Gupta	Chief Financial Officer
Naveen Chauhan	Head- Sales and Aftersales
Neerja Sharma	Company Secretary and Chief Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Bahadur Chand Investments Pvt. Ltd.	20.0
2	Pawan Munjal	14.0
3	Life Insurance Corp of India	7.2
4	Standard Life Aberdeen PLC	3.4
5	SBI ETF Nifty 50	2.6
6	SBI Funds Management Pvt. Ltd.	2.3
7	BlackRock Inc.	2.0
8	Franklin Resources Inc	1.8
9	Norges Bank	1.5
10	Lazard Ltd	1.5

Source: Bloomberg

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

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