Hero MotoCorp

Reduce

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

Annual Report Analysis FY20

Poised for tapping rural demand

Hero Motocorp (HMCL) in its FY20 annual report, throws light on certain key aspects with regards to Covid-19 induced near term uncertainty on its business operations as well change in key trends. On the other hand, certain optimism is displayed due to certain factors such as potential recovery in semi urban/rural areas, increasing preference towards personal mobility due to safety needs and pent up in underlying demand. As incomes are affected due to the pandemic, downgrading is being witnessed, which may push up growth in the entry-level bike segment, HMCL is poised to gain incremental market share due to market leadership (69%). Management's objectives include filling up gaps in the product portfolio (premium bike and scooters bikes) and improving penetration in export markets, although progress along with benefits accrued from above initiatives remain visible to a marginal extent, in current context.

Given its rural based portfolio and leadership in entry level and executive segments, HMCL's volume recovery would be quicker than other 2W peers, further supported by a stable balance sheet that would aid the company to tide over current situation and additionally, support all of its stakeholders. Given its high return ratios (ROCE ~20%), consistent market leadership, and healthy dividend yield (~4%), we continue to remain positive on the stock, however, we believe the company will continue to face headwinds in the scooter and premium motorcycle segments. At CMP stock is trading at 18/16x for FY22/23E EPS and valuation leaves little upside. We roll forward our valuation from FY22E to FY23E, and raise TP to Rs.2990 (17x FY23E EPS) and recommend Reduce rating.

Key beneficiary of rural uptick

Management expects the industry would stabilize by the festive season and pent demand along with customer's need for personal mobility (to maintain safety standards) will provide the much-anticipated boost to the industry. The healthy Rabi output and extensive rural distribution network (contributed 50% of FY20 sales) should potentially help HMCL to tap the recovery of rural markets, which are not as impacted by COVID-19 as urban ones.

Focus on filling gaps in product portfolio

The company plugged gaps in its product portfolio for 125cc scooter and premium motorcycles. In FY20, the company has further strengthened its premium motorcycle portfolio with the launch of XPulse 200T and Xtreme 200S and will launch Xtreme 160R in FY21. In the scooter segment, the 110cc Pleasure+ has received a positive response. Destini and Maestro edge in the 125cc segment are picking up demand at a slow pace, which is expected to help in the recovery of lost market share.

Financial Snapshot

Revenue declined by 14.3% to Rs.288bn led by 18.2% volume drop. EBITDA margin stood at 13.7% (-93bps YoY) led by negative operating leverage. The Capex for FY20 stood at Rs.13.6bn mostly attributed towards new plant capitalisation at Chittoor-Andhra Pradesh. The total dividend (including interim dividend) for FY20 amounts to Rs.90 per equity share (versus Rs.87 per equity share in FY19). Cash and cash equivalent stood at Rs 63.6bn.

CMP	Rs 2,860
Target / Upside	Rs 2,990 / 5%
BSE Sensex	37,441
NSE Nifty	11,022

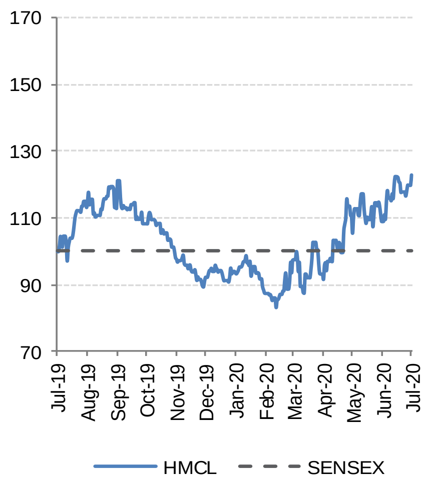
Scrip Details

Equity / FV	Rs 399mn / Rs 2
Market Cap	Rs 571bn
	US$ 8bn
52-week High/Low	Rs 3,023/Rs 1,475
Avg. Volume (no)	19,81,920
NSE Symbol	HEROMOTOCO
Bloomberg Code	HMCL IN

Shareholding Pattern Mar'20(%)

Promoters	34.6
MF/Banks/FIs	19.2
FIIs	36.8
Public / Others	9.4

AMRJ Relative to Sensex



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DOLAT CAPITAL

Annual Report Macro View

Key Management Changes	During the year under review, Company has appointed Ms. Tina Trikha as an Additional Director of the Company in the category of Non-Executive and Independent Directors effective October 23, 2019. During the year, Ms. Shobana Kamineni ceased to be a Director of the Company effective March 26, 2020, due to completion of her term of 5 years as an Independent Director
Auditors	No change. M/s. BSR & Co. LLP, Chartered Accountants continue to be the Auditors of the Company.
Credit Ratings	**Rating Agency** / **FY20** / **FY19** CRISIL / AAA stable (long term), A1+ (short term) / AAA-/stable (long term), A1+ (short term)
Pledged Shares	No pledge by Promoter group.
Macro-economic Factors	**Short term**: The short-term business outlook remains uncertain due to the COVID-19 pandemic. However, a robust Rabi harvest and bountiful rains coupled with good reservoir levels augur well for the upcoming Kharif season, positively impacting the rural sentiment. There could be a shift away from "shared mobility" to owned mobility. This is likely to benefit 2W demand in the short and medium term with recovery projected to pick up from the H2FY21 around the festive season. The potential pent-up demand and economic revival are also expected to support recovery in the sector. **Long Term:** The long-term growth story of two-wheeler industry remains intact. The industry has significant potential, considering that overall penetration levels are only 1/2 to 1/3 of the level in other ASEAN countries. 2W are not just a consumption good but they are also income enablers. The vehicle creates its own demand and feeds a virtuous cycle. Further, growing urbanisation, increasing numbers of women in the work force and an affordable product that supports last mile connectivity are likely to keep the demand for 2W buoyant. As the GDP grows, it will further fuel two-wheeler demand not just in the Entry and Executive segment, but also support demand for Scooters and Premium segment.

Credit Ratings detail:

Rating Agency	FY20	FY19
CRISIL	AAA stable (long term), A1+ (short term)	AAA-/stable (long term), A1+ (short term)

Source: DART, Company

Key Subsidiaries & Associates performance

Hero FinCorp Limited (HFCL)

- HMCL holds 41.19% in the equity share capital of HFCL. HFCL is the NBFC providing financial services, including two-wheeler financing and credit to Company's vendors and suppliers. Over the years, HFCL has added several new products and customers to its portfolio, like SME and commercial loans, loan against property etc. In FY20, its revenue jumped 51% to Rs.37.99bn in FY20 vs Rs.25.18bn in FY19. Profit has grown by 13.5% to Rs.2.78bn from 2.45bn in FY19. HFCL's profit attributable to the company is Rs.1.12bn in FY20 as against Rs.832mn in FY19.

Ather Energy Private Limited (AEL)

- AEL business is focused on developing, designing and selling premium electric two-wheelers. In FY20, loss attributable to the Company is Rs.774.1 mn. AEL reported a loss of Rs.2.1bn in FY20 as against loss of Rs.1.07bn in FY19.

HMCL Colombia S.A.S. (HMCLC)

- HMCLC is a joint venture between HNBV and Woven Holdings LLC. HNBV currently holds 68% equity in HMCLC and 32% equity is held by Woven Holdings LLC. The main business of HMCLC is to manufacture and sell two-wheelers in Colombia. In FY20, the Company has reported unadjusted revenue of RS.1.98bn and a net loss of Rs.413mn.

HMCL Niloy Bangladesh Limited ('HNBL')

- HNBL is a JV between HNBV and Niloy Motors Limited, Bangladesh as a limited liability company. HNBV currently holds 55% equity in HNBL and 45% equity is held by Nitol Niloy Group, Bangladesh. The main business of HNBL is to manufacture and sell two-wheelers. In FY20, HNBL reported unadjusted revenue of Rs.7.99bn and a net profit of Rs.872.8mn.

HMCL (NA) Inc.

- During the year under review, the Company's wholly owned subsidiary, HMCL (NA) Inc. had invested in Erik Buell Racing, Inc. which was dissolved. Erik Buell Racing, Inc. ceased to be the associate of Company. Total impairment loss was Rs.1.5bn.

Exhibit 1: Investment in subsidiaries

Company Name (Rs. Mn)	FY19	FY20
Hero Tech Centre Germany GMBH	196	196
HMCL Netherlands B.V	2,625	2,820
HMCL Americas INC	222	222
HMC MM Auto Limited	360	480
HMCL (N.A.),Inc.*	1,554	-
Impairment*	-1,550	
Total (A)	**3,406**	**3,718**
Investment in Associates		
Ather Energy Private Limited	2,004	3,304
Hero FinCorp Limited	10,263	12,747
Total (B)	12,267	16,050
Subtotal (A+B)	**15,673**	**19,768**

Source: DART, Company

Exhibit 2: Key related Party transaction with KMP

Particular (Rs.mn)	FY19	FY20
Purchase of raw materials and components etc.		
A .G. Industries Private Limited	9,980	8,104
Rockman Industries Limited	19,206	16,154
A.G Industries (Bawal) Pvt. Limited	2,339	1,670
Trade Payables		
A .G. Industries Private Limited	483	436
Rockman Industries Limited	2,205	1,271
A.G, Industries (Bawal) Pvt. Limited	102	29

Source: DART, Company

Segment wise performance

Entry (Economy)

- The industry declined by 20.4%, in FY20 led by a consumption slowdown in the first half of the year and the impact of the lockdown in the second half. While HMCL volumes declined by 6% over the preceding year, the consumption slowdown accentuated by stress in the financial sector impacted underlying demand. However, the company gained significant market share up from 58.1% to 68.9% in FY20.

Executive (Deluxe)

- The deluxe 100cc segment volumes contracted by 15.4% while HMCL volume declined by 19.5% resulting in loss of market share by 380bps to 74.8%, However, management expects Passion Pro 110 should help strengthen the segment. The 125cc segment declined by 11.3%, while HMCL volumes declined 21.5% over last year due to inventory correction in this segment which led to decline in market share by 650bps YoY to 49.8%. Management expects support from new launches to help strengthen the segment.

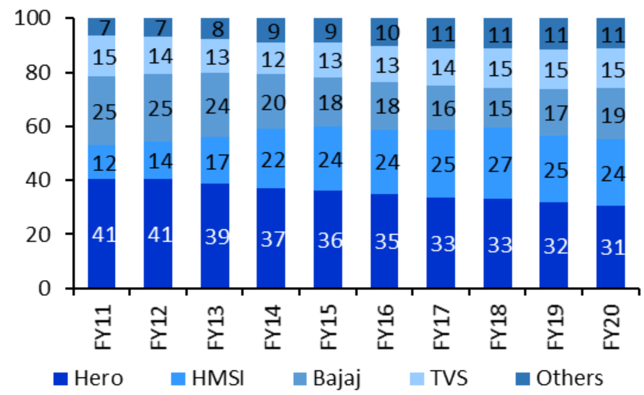
Premium

- HMCL currently commands 1.6% market share in the segment and is expected to further increase its market share. The launch of Xtreme and Xpulse facilitated market share improvement in FY20. With the launch of Xtreme 160, volumes and market share are expected to strengthen in FY21.

Scooter Segment

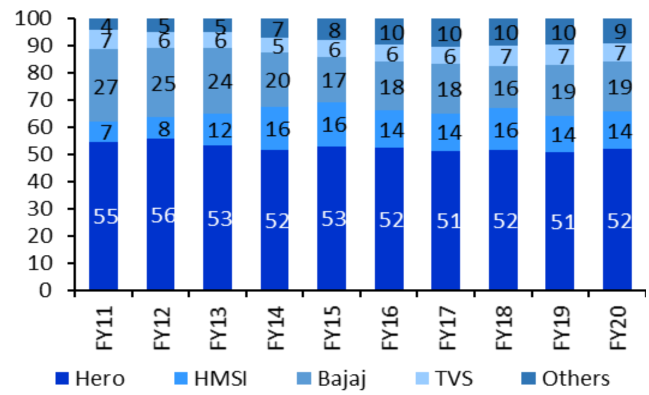
- During the scooter segment declined by 17%, while HMCL volumes contracted by 44% YoY. Company lost market share in FY20 by 350bps to 7.2%.
- HMCL has two models in the premium scooter segment - Destini 125 and Mastero 125. Company is working towards a relatively more profitable 125cc sub-segment.
- Factors like growing urbanisation, increasing number of women in the work force and an affordable product that supports last mile connectivity are likely to keep the demand for two-wheelers buoyant. As the GDP revives, it will further fuel two-wheeler demand not just in the Entry and Executive segment, but also support demand for Scooters and Premium segment.

Exhibit 3: 2W Market share (%)



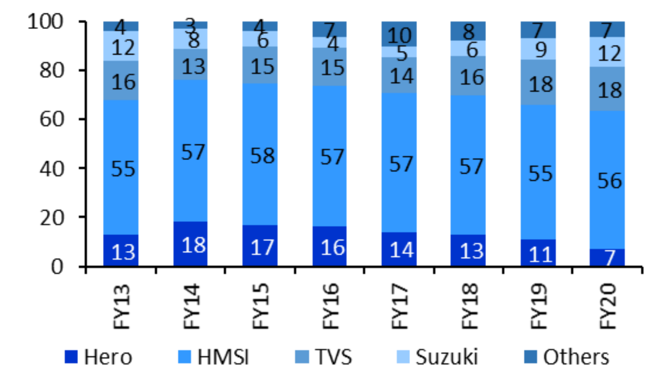
Source: SIAM, DART

Exhibit 4: Domestic MC Market share (%)



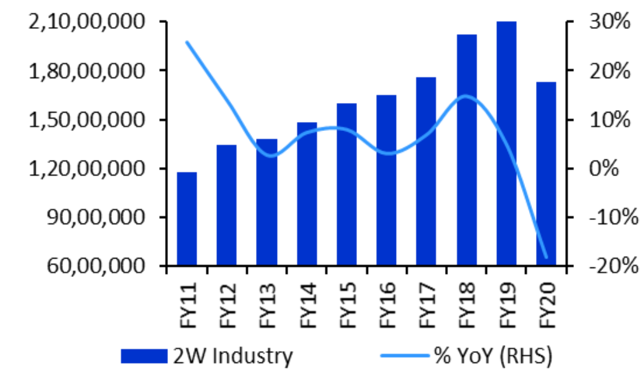
Source: SIAM, DART

Exhibit 5: Scooter market share (%)



Source: SIAM, DART

Exhibit 6: 2W industry de-grow due to economy slowdown and BS-6 transition



Source: SIAM, DART

Key drivers for future growth

Preference for personal mobility

- While management expects the slowdown to continue due to the to Covid-19 disruption, recovery in rural demand and increased preference for personal mobility are key silver lining. The management is hopeful of recovery in 2HFY21 in the 2W segment
- With safety as a key priority in the post-COVID scenario, people across the world and especially in developing economies are exploring personal mobility solutions.
- This trend could drive the demand for two-wheelers across categories and price points. Further, during a challenging economic environment, new buyers tend to buy affordable products from reliable market leaders. This could help players who have strong presence in multiple segments.

Semi-urban and rural rebound

- In India, semi-urban and rural areas are likely to see better growth than urban areas in the interim period. The expectation of high food grain production, forecast of normal monsoons and positive cash flow supported by higher disbursements through government schemes is likely to drive growth.

Export markets

- In FY20, exports de-grew 14% YoY at 178,261 units on account of economic regression in operating countries with the changed scenarios brought by COVID-19.

Afro-Latam markets: Africa and Latin America are some of the largest 2W markets beyond Asia. The key drivers for 2W markets in these geographies are a predominantly young population (median age 20s), inadequacy of public infrastructure and recent focus of governments on enhancing civic amenities leading to a rapid growth in the two-wheeler market in these region.

Promising Bangladesh markets: The key factors leading to strong two-wheeler market growth are the economic boom due to high growth rates and remittances from expatriates. The combination of tax and incentives for innovation, import policies, reduction of cost of ownership and introduction of ride-sharing services in major cities provide further impetus to the growth of the two-wheeler industry.

Focused on digitalization

- Following the pandemic outbreak, HMCL enhanced its focus on digitalisation across platforms (virtual showrooms, online bookings, test rides at doorstep, among others).
- Company is also targeting on sales leads through digital platform in Bangladesh, Nepal, Colombia, and Central American and Caribbean (CAC) countries.
- Major upgrades include the move from SAP to SOH (Suite On HANA) for improvement in the response time of business transactions (agility) and reduction of the data footprint.
- Other upgrades include upgrades across the value chain, from R&D to final sales tracking and its analysis. Some of these include, Product life cycle management system, Dealer Management System – on Hero Connect to better capture sales data, an analytics platform, cloud migration to help in remote working during the lockdown.

Financial Analysis (Standalone)

Profit & Loss Analysis

- Volume declined by 18.2% to 6.4mn units in FY20 largely reflective of the slowdown in economic activity, price increases due to regulatory issues, migration from BSIV to BSVI (recalibration of dispatches and inventory to ensure smooth transition), and spread of the pandemic and consequential lockdown of business operation impacted the volumes adversely.
- However, despite the volume drop of 18.2%, Revenue from Operations declined by 14.3% Rs.288bn vs Rs.336bn in FY19 due to multiple price hikes taken during the year, favorable product mix and dispatch of BSVI vehicles in fourth quarter of the year, helped in partially offsetting the volume drop.
- Spare parts revenue was Rs.28.96bn (+2% YoY) in FY20.
- The company reported EBITDA margin of 13.7% (-93bps YoY) and EBITDA of Rs.39.6bn in FY20; de-grew by 20% over FY19. EBIDTA margin continue to be under pressure due to inability to charge a profit margin on BS-VI costs as well as competitive intensity.
- Total employee expenses as a percentage of sales increased from 5.14% to 6.4%. Employee expenses increased from Rs.17.3bn in FY19 to Rs.18.4bn in FY20 led by fresh hiring and annual increment during the year.
- Adjusted PAT in FY20 was Rs.29.5bn as compared to Rs.33.8bn in FY19, reporting a de-growth of 12.7% YoY, attributed to drop in margin and higher tax rate.
- Gross margins improved 98bps to 31.7% in FY20 attributable to softening in material prices and value engineering initiatives also supported by periodical price increases in the two wheelers over the year in key raw material prices.

Balance Sheet Analysis

- Hero Motocorp continues to remain a net cash company Cash and cash equivalent stood at Rs 63.6bn.
- The capital expenditure for the year stood at Rs 13.6bn attributed towards new plant capitalization at Chittoor-Andhra Pradesh, additional capex for BSVI infrastructure, booking of Right of Use of Assets (ROU) as required by Ind AS 116 (Leases) and continued investment in innovation and technology.
- In FY20, despite challenging year company has managed its working capital cycle efficiently. Inventory days increased to 14 days from 12 days at Rs 11.4bn due to lower dispatches towards end of the March'20. Debtor days reduced significantly to 20 days versus 31 days in the previous year. Creditors' payable days increased 38 days from 36 days in FY19. Cash conversion cycle turn negative to -4 days in FY20 against 6 days in FY19.
- ROE and ROCE contracted by ~559bps/550bps YoY to 21.9%/22% respectively in FY20.

Cash Flow Analysis

- The Net Cash Flow from Operating Activities improved to Rs.541bn in FY20 from Rs.97bn in FY19 due to efficient working capital management.
- Despite capex to the tune of Rs.14bn, company has reported positive FCF of Rs.33.9bn for the year FY20 vs FCF of Rs.2.0bn in FY19.
- The total dividend (including interim dividend) for FY20 amounts to Rs.90 per equity share (versus Rs.87 per equity share in FY19). Total dividend outflow (including DDT) for FY20 was Rs.23.3bn.

Exhibit 7: Change in estimates

Rs Mn	FY21E			FY22E		
	New	Previous	Chg (%)	New	Previous	Chg (%)
Volume (Unit mn.)	5.4	5.4	0.0%	6.3	6.3	0.0%
Revenue	2,64,447	2,64,447	0.0%	3,10,655	3,10,655	0.0%
EBITDA	32,115	32,115	0.0%	42,618	41,642	2.3%
EBITDA Margin (%)	12.1	12.1	-	13.7	13.4	31(bps)
PAT	23,378	23,358	0.1%	31,522	30,697	2.7%
EPS (Rs.)	117.1	117.0	0.1%	157.8	153.7	2.7%

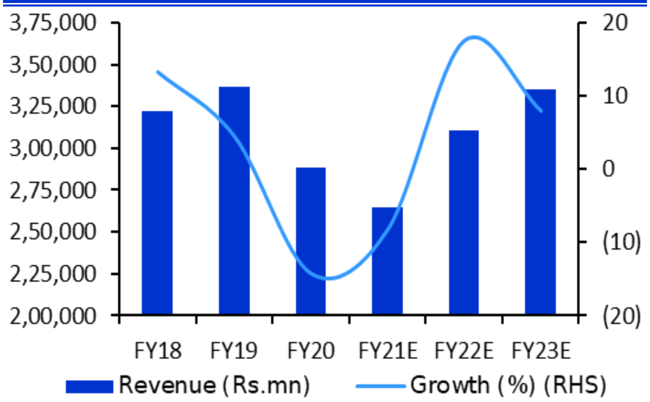
Source: DART, Company

Exhibit 8: Peer valuation

Company	Mcap (Rs Bn)	Rating	Adj EPS (Rs/sh)			P/E (X)			EV/EBITDA (X)			ROE (%)		
			FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Hero MotoCorp	**571**	**Reduce**	**117**	**158**	**176**	**24.4**	**18.1**	**16.3**	**15.3**	**11.2**	**9.7**	**15.5**	**18.8**	**19.3**
Eicher Motors	513	Reduce	441	724	874	42.6	26.0	21.5	27.0	17.1	14.2	11.5	16.9	17.8
Bajaj Auto	867	Reduce	158	177	191	18.9	16.9	15.7	18.9	16.6	15.3	19.9	18.8	18.4
TVS Motor	185	Sell	8	15	19	49.3	26.2	20.8	17.0	11.9	10.0	10.0	17.1	19.0

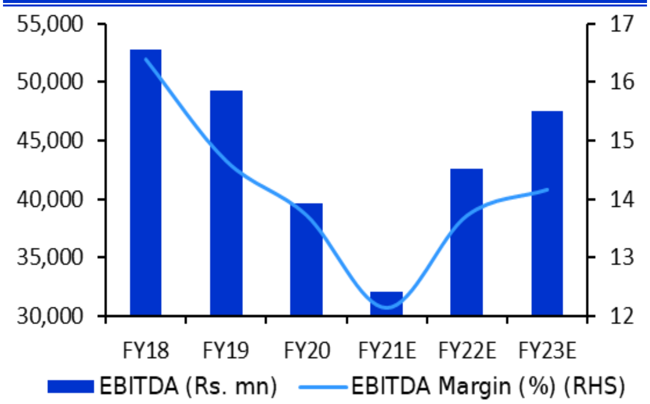
Source: DART, Company

Exhibit 9: Revenue to grow 13% CAGR over FY21-23E



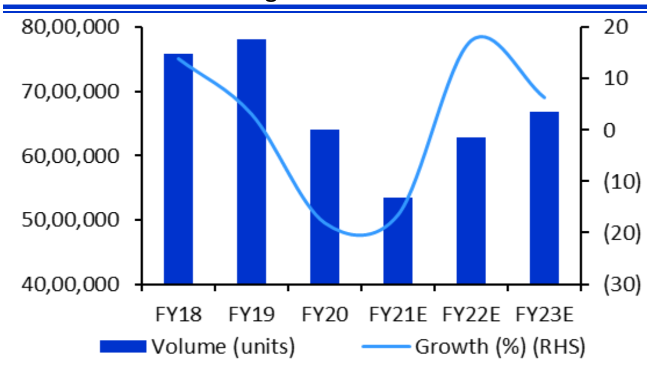
Source: Company, DART

Exhibit 10: Margin to improve from FY22



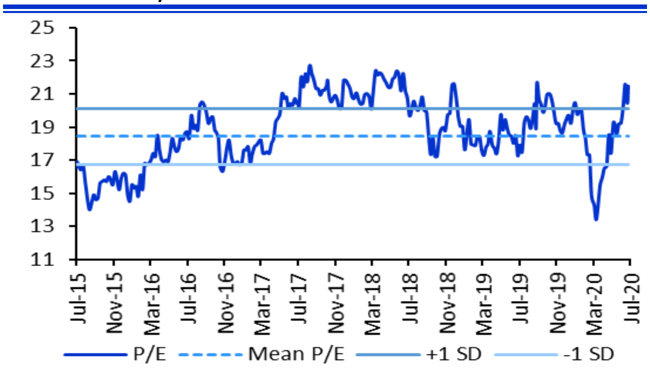
Source: Company, DART

Exhibit 11: Volume to grow at 12% CAGR over FY21-23E



Source: Company, DART

Exhibit 12: 1yr Forward PE band chart



Source: Company, DART

Profit and Loss Account

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
Revenue	**2,88,361**	**2,64,447**	**3,10,655**	**3,35,165**
Total Expense	**2,48,781**	**2,32,332**	**2,68,037**	**2,87,706**
COGS	1,96,974	1,83,526	2,14,973	2,31,264
Employees Cost	18,417	17,704	19,474	20,837
Other expenses	33,390	31,102	33,590	35,605
EBIDTA	**39,580**	**32,115**	**42,618**	**47,458**
Depreciation	8,180	8,567	8,577	8,932
EBIT	**31,400**	**23,548**	**34,040**	**38,526**
Interest	222	69	40	41
Other Income	7,783	7,901	8,301	8,652
Exc. / E.O. items	6,774	0	0	0
EBT	**45,735**	**31,380**	**42,302**	**47,137**
Tax	9,404	8,002	10,780	12,013
RPAT	36,331	23,378	31,522	35,125
Minority Interest	0	0	0	0
Profit/Loss share of associates	**0**	**0**	**0**	**0**
APAT	**29,557**	**23,378**	**31,522**	**35,125**

Balance Sheet

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
Sources of Funds				
Equity Capital	399	399	399	399
Minority Interest	0	0	0	0
Reserves & Surplus	1,40,965	1,60,790	1,73,907	1,88,524
Net Worth	**1,41,364**	**1,61,189**	**1,74,306**	**1,88,923**
Total Debt	0	0	0	0
Net Deferred Tax Liability	917	917	917	917
Total Capital Employed	**1,42,281**	**1,62,106**	**1,75,223**	**1,89,840**
Applications of Funds				
Net Block	**62,981**	**59,017**	**56,042**	**53,712**
CWIP	1,603	1,603	1,603	1,603
Investments	20,983	20,983	20,983	20,983
Current Assets, Loans & Advances	**98,852**	**1,20,980**	**1,42,571**	**1,62,967**
Inventories	10,920	8,694	8,511	10,101
Receivables	16,031	20,286	23,831	25,711
Cash and Bank Balances	63,662	79,222	95,603	1,11,549
Loans and Advances	5,438	10,578	12,426	13,407
Other Current Assets	2,801	2,200	2,200	2,200
Less: Current Liabilities & Provisions	**42,138**	**40,477**	**45,976**	**49,425**
Payables	30,305	28,644	33,046	35,471
Other Current Liabilities	11,833	11,833	12,930	13,954
sub total				
Net Current Assets	56,714	80,504	96,595	1,13,543
Total Assets	**1,42,281**	**1,62,106**	**1,75,223**	**1,89,840**

E – Estimates

Important Ratios

Particulars	FY20A	FY21E	FY22E	FY23E
(A) Margins (%)				
Gross Profit Margin	31.7	30.6	30.8	31.0
EBIDTA Margin	13.7	12.1	13.7	14.2
EBIT Margin	10.9	8.9	11.0	11.5
Tax rate	20.6	25.5	25.5	25.5
Net Profit Margin	12.6	8.8	10.1	10.5
(B) As Percentage of Net Sales (%)				
COGS	68.3	69.4	69.2	69.0
Employee	6.4	6.7	6.3	6.2
Other	11.6	11.8	10.8	10.6
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.0	0.0	0.0
Interest Coverage	141.4	341.3	851.0	939.7
Inventory days	14	12	10	11
Debtors days	20	28	28	28
Average Cost of Debt				
Payable days	38	40	39	39
Working Capital days	(4)	0	(1)	0
FA T/O	4.6	4.5	5.5	6.2
(D) Measures of Investment				
AEPS (Rs)	148.0	117.1	157.8	175.9
CEPS (Rs)	188.9	159.9	200.8	220.6
DPS (Rs)	90.0	58.5	78.8	87.9
Dividend Payout (%)	60.8	50.0	50.0	50.0
BVPS (Rs)	707.8	807.0	872.7	945.9
RoANW (%)	21.9	15.5	18.8	19.3
RoACE (%)	22.2	15.4	18.7	19.3
RoAIC (%)	39.2	29.2	41.9	48.8
(E) Valuation Ratios				
CMP (Rs)	2860	2860	2860	2860
P/E	19.3	24.4	18.1	16.3
Mcap (Rs Mn)	5,71,249	5,71,249	5,71,249	5,71,249
MCap/ Sales	2.0	2.2	1.8	1.7
EV	5,07,587	4,92,027	4,75,646	4,59,700
EV/Sales	1.8	1.9	1.5	1.4
EV/EBITDA	12.8	15.3	11.2	9.7
P/BV	4.0	3.5	3.3	3.0
Dividend Yield (%)	3.1	2.0	2.8	3.1
(F) Growth Rate (%)				
Revenue	(14.3)	(8.3)	17.5	7.9
EBITDA	(19.7)	(18.9)	32.7	11.4
EBIT	(27.5)	(25.0)	44.6	13.2
PBT	(8.7)	(31.4)	34.8	11.4
APAT	(12.7)	(20.9)	34.8	11.4
EPS	(12.7)	(20.9)	34.8	11.4

Cash Flow

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
CFO	54,101	27,714	40,458	43,127
CFI	(28,831)	(4,603)	(7,103)	(8,603)
CFF	(24,199)	(3,809)	(18,445)	(20,548)
FCFF	32,942	23,111	34,855	36,524
Opening Cash	43,992	63,662	79,222	95,603
Closing Cash	63,662	79,222	95,603	1,11,549

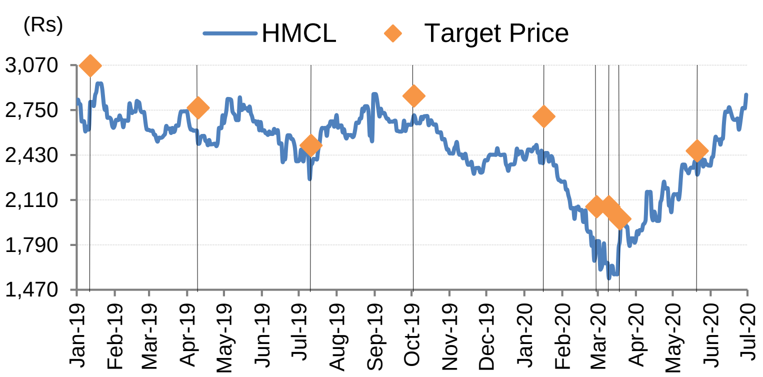
E – Estimates

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 (Rs.)	Price (Rs.)
Feb-19	Accumulate	3,066	2,807
Apr-19	Reduce	2,766	2,512
Jul-19	Reduce	2,498	2,356
Oct-19	Reduce	2,850	2,713
Feb-20	Accumulate	2,705	2,411
Mar-20	Buy	2,062	1,816
Mar-20	Buy	2,062	1,554
Apr-20	Accumulate	1,975	1,822
Jun-20	Accumulate	2,460	2,292

*Price as on recommendation date

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