

Sector: Automobiles
Annual report review

	Change
Reco: Buy	↔
CMP: Rs. 2,858	
Price Target: Rs. 3,200	↑
↑ Upgrade ↔ No change ↓ Downgrade	

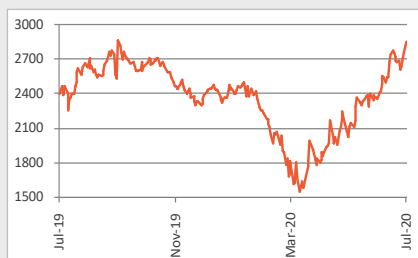
Company details

Market cap:	Rs. 57,082 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	18.5	56.4	19.0	18.8
Relative to Sensex	11.3	34.2	28.5	20.4

Sharekhan Research, Bloomberg

FY2020 was a challenging year for the two-wheeler (2W) industry, with volumes dropping by 18% y-o-y, impacted by increased cost of ownership, NBFC liquidity crisis, and lack of income growth. While the industry is facing short-term challenges on account of COVID-19, long-term growth factors are intact. Moreover, Hero MotoCorp (Hero) expects industry demand to recover as early as H2FY2021, driven by buoyancy in rural sentiments, pent-up demand, and preference for personal transport to ensure safety in post-COVID era. Hero's focus on premiumisation of product portfolio and enhancing exports would also aid in demand improvement. Hero, being a debt-free company and with strong reserves, would enable it to navigate the current challenging environment and prepare for the next growth cycle. Higher rural exposure with Hero deriving half of its volumes from rural areas would lead to its faster recovery. Hence, we retain our Buy rating on the stock and Hero continues to remain our preferred pick in the space.

Near-term challenges; Long-term growth intact; Company expects recovery from H2FY2021: FY2020 was a challenging year for the 2W industry due to higher cost of ownership due to mandatory insurance norms and BS6-related prices, liquidity crunch at NBFC's, and lack of income growth. While the 2W industry is facing short demand challenges on account of COVID-19, the long-term growth story is intact. Lower penetration levels, 2W being an income enabler, rising urbanisation, and 2W being an affordable mode of transport for last-mile connectivity would continue to drive demand. Moreover, Hero expects the 2W industry's demand to recover from H2FY2021. Pent-up demand, economic recovery, and people preference for personal transport (to ensure safety in post COVID-19 scenario) are expected to drive recovery.

Our Call

Valuations: Retain Buy with a revised PT of Rs. 3,200: Management expects the 2W industry to recover from H2FY2021 (around the festive season). Strong rural sentiments because of good rabi harvest, increased kharif sowing, and expectations of normal monsoon would benefit Hero, which derives half of its volumes from rural areas. Moreover, to ensure social distancing, consumers would increasingly prefer private transport, especially 2W. We have fine-tuned our earnings estimates for FY2021 and FY2022. At the CMP, the stock is trading at 16.1x its FY2022 earnings, which is lower than its long-term historical average. Hence, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 3,200 (earlier PT of Rs. 3,100).

Key Risks

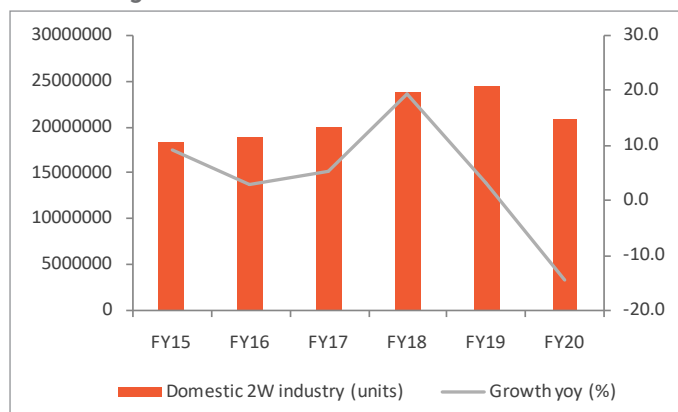
Prolonged COVID-19 infection in India can impact economic growth and consumer sentiments.

Valuation	Rs cr				
Particulars	FY18	FY19	FY20	FY21E	FY22E
Net Sales (Rs. cr)	32230.5	33650.5	28836.1	26427.9	32933.1
Growth (%)	13.1	4.4	-14.3	-8.4	24.6
EBIDTA (Rs. cr)	5280.2	4930.1	3958.0	3517.5	4821.3
OPM (%)	16.4	14.7	13.7	13.3	14.6
PAT (Rs. cr)	3697.4	3384.9	3178.7	2573.8	3535.0
Growth (%)	9.5	-8.5	-6.1	-19.0	37.3
FD EPS (Rs.)	185.1	169.5	159.2	128.9	177.0
P/E (x)	15.4	16.9	18.0	22.2	16.1
P/B (x)	4.8	4.4	4.0	3.8	3.6
EV/EBIDTA (x)	9.4	10.3	12.3	14.1	10.1
RoE (%)	31.4%	26.3%	22.5%	17.3%	22.2%
RoCE (%)	42.4%	37.2%	26.5%	22.5%	28.8%

Source: Company; Sharekhan estimates

FY2020 was a challenging year with the industry witnessing double-digit drop: Major industry headwinds such as higher cost of ownership due to insurance price increase from September 2019, liquidity crunch due to stress in the banking/NBFC sector, and increased overall cost of ownership (BSVI-related price hikes, other safety, and insurance costs) impacted the industry's demand in FY2020. After a double-digit decline of 16% in H1FY2020, H2FY2020 was even more difficult for the industry on account of lack of income growth, liquidity crunch, and overall consumption slowdown. H2FY2020's volumes for the 2W industry further dipped by 20% y-o-y. For FY2020, the 2W industry declined by 18% y-o-y to volume of 17.41 million units for FY2020.

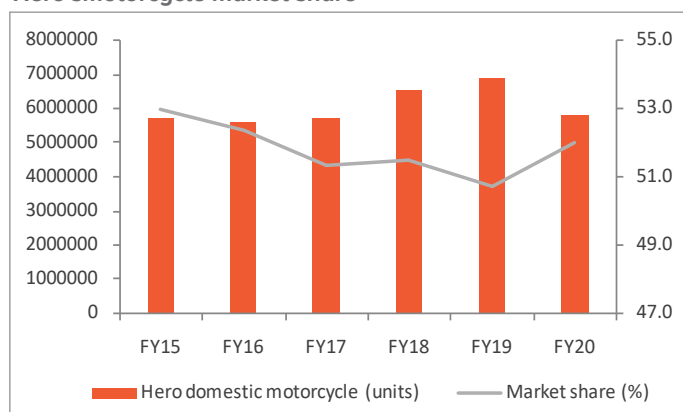
2W industry trend



Source: SIAM; Sharekhan Research

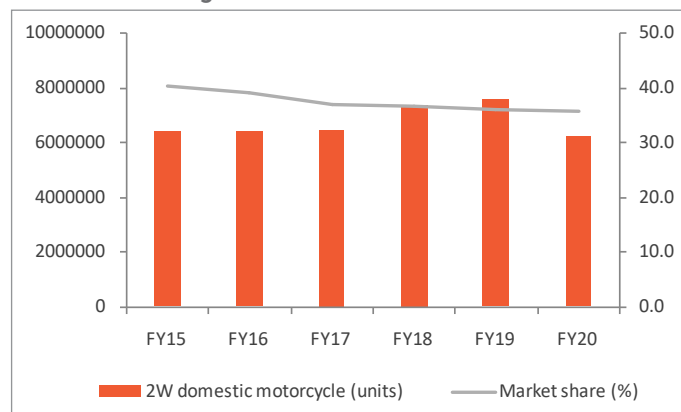
Hero marginally raised share in motorcycles; Held on to overall 2W market share: Hero further consolidated its leadership in the domestic motorcycle segment with market share improving from 50.7% in FY2019 to 52% in FY2020. Hero gained market share in the entry-level segment, driven by product upgrades and strong presence in rural areas. Hero's market share in the entry segment improved from 58.1% in FY2019 to 68.9% in FY2020. Hero's scooter market share slipped from 10.7% in FY2019 to 7.2% in FY2020. Overall, Hero retained its domestic 2W market share at 35.8% in FY2020, which is similar to 35.9% seen in FY2019.

Hero's motorcycle market share



Source: SIAM; Sharekhan Research

Hero's 2W industry market share



Source: SIAM; Sharekhan Research

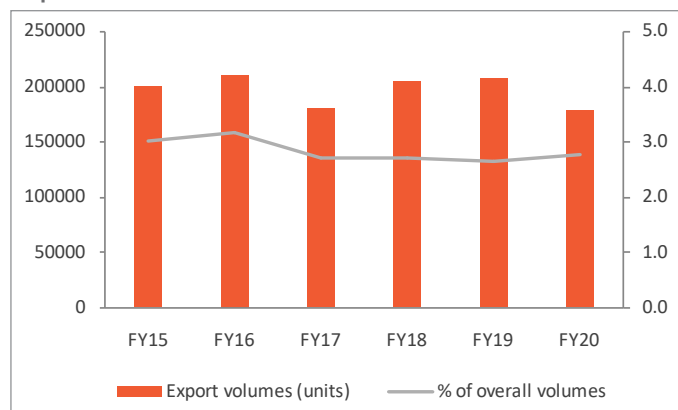
Hero expects demand to stabilise by the festive season; To recover from H2FY2021: Management stated that the 2W industry was facing short-term challenges due to the COVID-19 situation, but overall India growth story remained intact. Hero stated that the domestic industry would stabilise by the festive season. Hero expects recovery to pick up from H2FY2021 around the festive season. Potential pent-up demand and economic revival are expected to support recovery in the sector. For FY2021, Hero expects the industry to witness greater 2W demand due to the customer's need for personal mobility to maintain safety standards. Hero stated that 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 demand for 2W across categories and price points.

Hero expects rural and semi urban segment to perform better: Hero expects semi-urban and rural areas to see better growth than urban areas in the interim. As per Hero, expectations of high food grain production, forecast of normal monsoons, and positive cash flow supported by higher disbursements through government schemes would drive demand in these areas. A robust rabi harvest and a well-distributed monsoon coupled with good reservoir levels augur well for the upcoming Kharif season, which have positively impacted rural sentiment.

Long-term growth levers for the 2W industry intact: Hero stated that the long-term growth story of the 2W industry remains intact. Factors such as a) low penetration levels (overall penetration levels in India are only 1/2 to 1/3 of the level in other ASEAN countries); b) 2Ws are also income enablers and not just consumption goods with the vehicle creating its own demand and feeding a virtuous cycle; c) growing urbanisation and increasing number of women in the work force and an affordable product that supports last-mile connectivity would keep the demand for 2W buoyant.

Company focusing on exports and premiumisation of product portfolio: Hero is focusing on growing export markets by concentrating on African, Latin American, and Southeast Asian regions. Hero has continuously expanded its geographic footprint in export markets, increasing its presence from 29 countries in FY2016 to 40+ countries in FY2020. Hero stated that this has created a platform to build scale beyond India. The company would follow market-specific strategies to enhance export volumes. Hero will sharpen its focus on Africa with a bespoke strategy to build on the momentum it has accomplished among the Boda Boda (2W taxi) riders. For Asian and Latin American markets, the company plans to launch new models in the 150cc-160cc category and build on the momentum already gained. Hero is also deepening its financing network across markets and strengthening the momentum across Bangladesh and Nepal. The company would also focus on generating sales leads through the digital platform in Bangladesh, Nepal, Colombia, Central American, and Caribbean (CAC) countries.

Export volumes

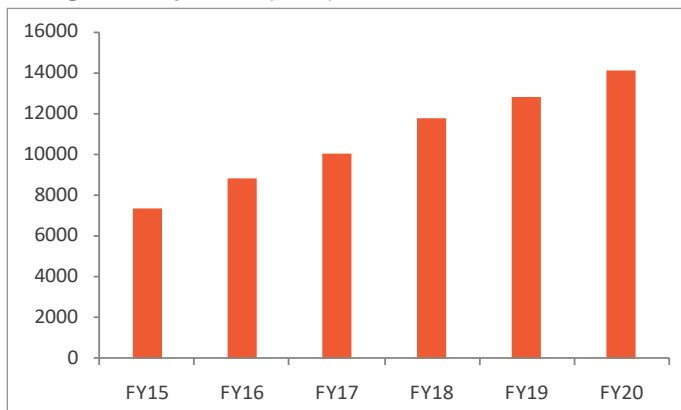


Source: SIAM; Sharekhan Research

The company is focusing on the premium segment with new launches in both the motorcycles and scooter space. Hero launched four new models in 18 months across three distinct segments with XPulse 200 (all drive adventure vehicle), XPulse 200T (modern tourer retro), and Xtreme 200S (sport bike targeted at youth looking for style and substance). Building on the X segment of premium motorcycles, Hero plans to launch the 'Xtreme 160R' built around the concept of Urban Racing in FY2021. As per Hero, Xtreme 160 would have the best-in-segment acceleration with first-in-segment All-LED Package, Side-Stand engine cut-off and integrated pillion grab. In the scooter segment, the company launched Destini 125 scooter with start-stop technology and Maestro Edge 125 scooter, which was India's first fuel-injected scooter and exclusive Prismatic Paint technology.

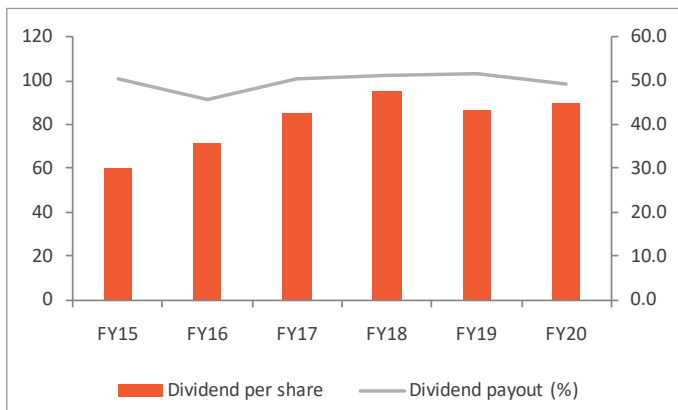
Strong balance sheet and dividend payout; Working capital turns negative: Hero has a strong balance sheet with zero debt. The company's reserves have reached Rs. 14,096 crore. The financial strength of the company augurs well and will help it to successfully navigate itself into the future in these challenging times. Hero has been a cheery dividend payer with the dividend payout ratio consistently ranging from 45% to 52%.

Strong reserve position (Rs cr)



Source: Company, Sharekhan Research

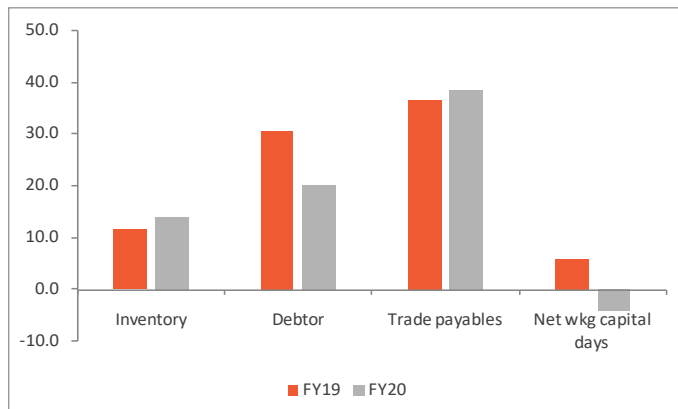
Consistently high dividend payout (%)



Source: Company, Sharekhan Research

Working capital turned negative for Hero in FY2020: Hero's working capital turned negative to -4 days in FY2020 as compared to six days positive in FY2019. While inventory and creditor days were fairly stable, debtor days fell from 31 days in FY2019 to 20 days in FY2020.

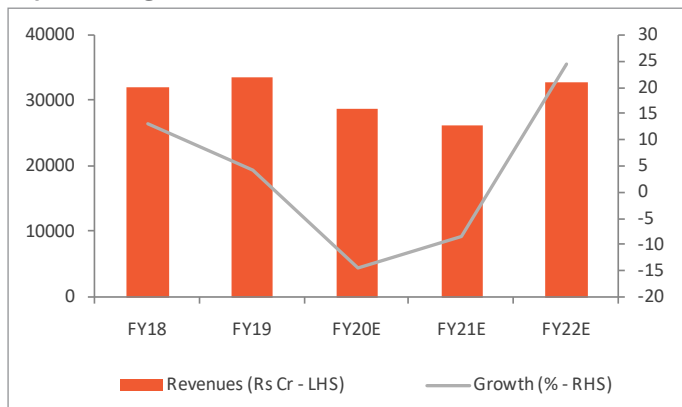
Working capital trend (No of days)



Source: Company, Sharekhan Research

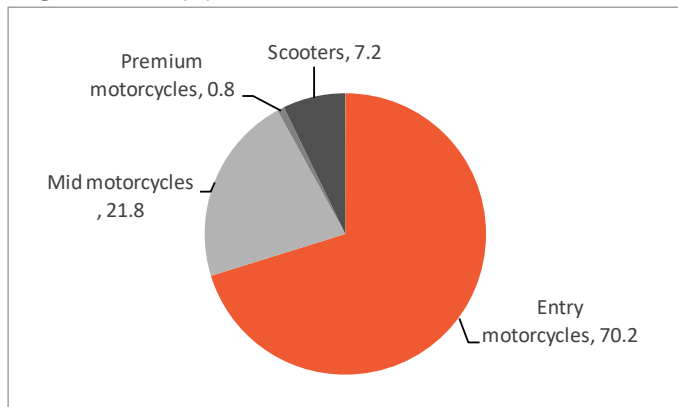
Financials in charts

Topline and growth trend



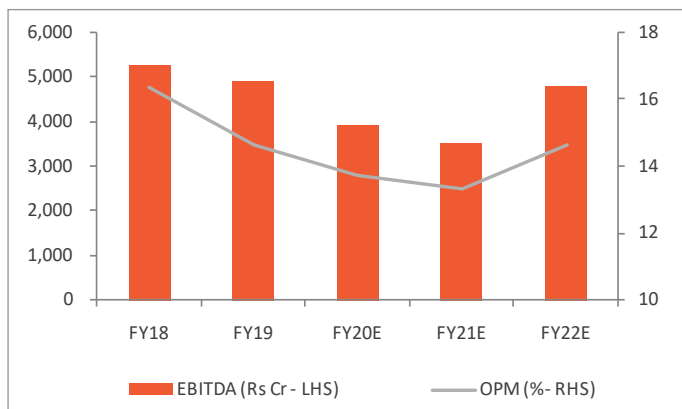
Source: Company, Sharekhan Research

Segmental mix (%)



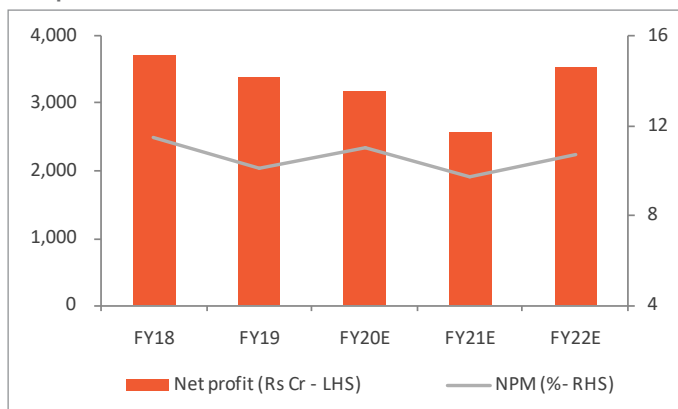
Source: Company, Sharekhan Research

EBITDA - OPM trend



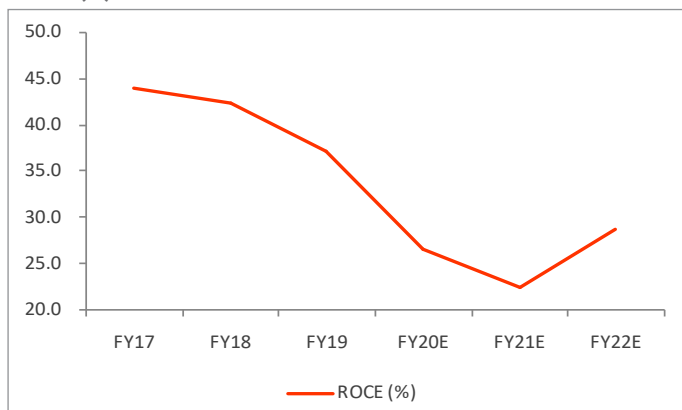
Source: Company, Sharekhan Research

Net profit trend



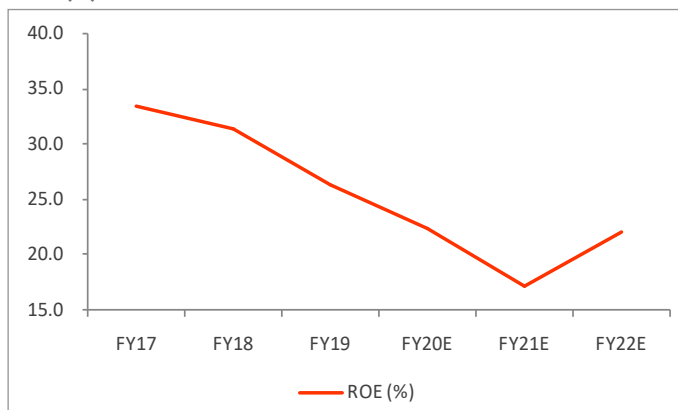
Source: Company, Sharekhan Research

ROCE (%)



Source: Company, Sharekhan Research

ROE (%)



Source: Company, Sharekhan Research

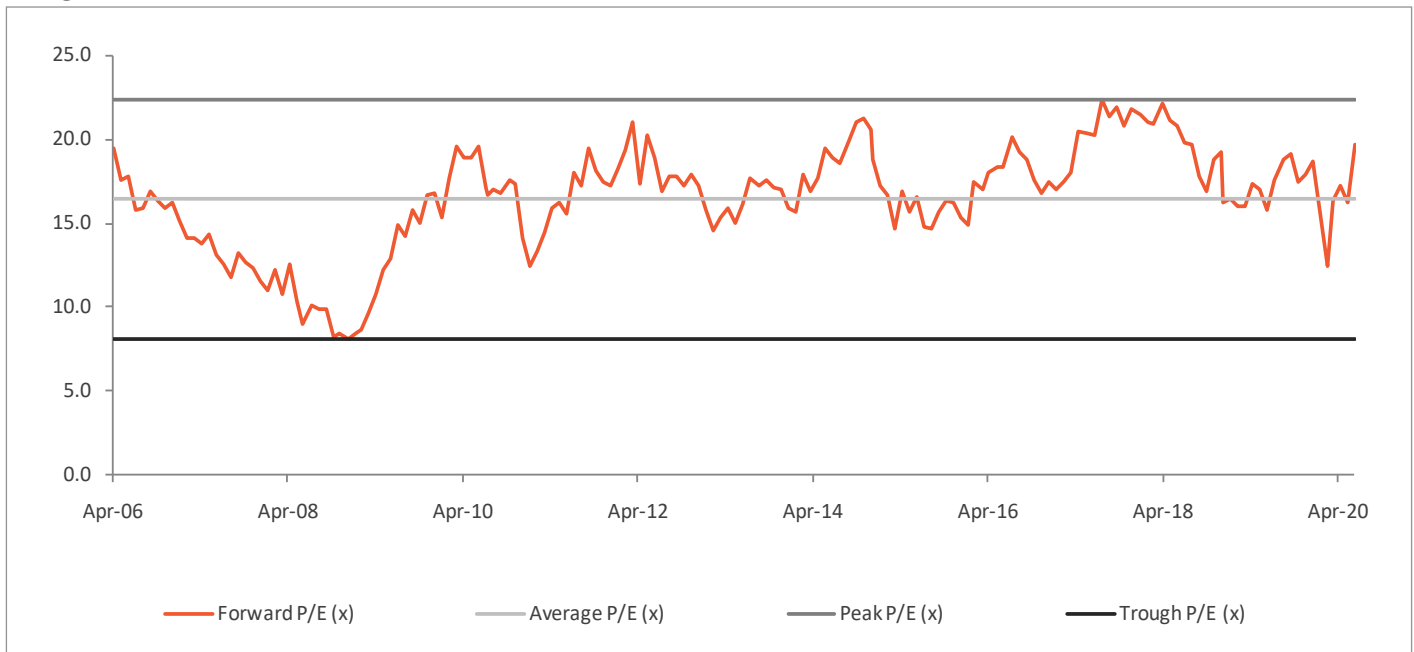
Outlook

Volumes expected to recover from H2FY2021: Strong rural sentiments because of good rabi harvest, increased kharif sowing, and expectations of normal monsoon would boost rural-centric 2W sales. Moreover, to ensure social distancing, consumers would increasingly prefer private transport, especially 2W. Management expects the 2W industry to recover from H2FY2021 (around the festive season), which exudes confidence. Hero, having the highest rural exposure (deriving half of volumes from hinterlands), would be the prime beneficiary of demand revival.

Valuation

Fine-tuned estimates; Retain Buy with a revised PT of Rs. 3,200: Management commentary on sales recovery from H2FY2021 because of potential pent-up demand and economic revival is encouraging. We have fine tuned our earnings estimates for FY2021 and FY2022. At the CMP, the stock is trading at 16.1x its FY2022 earnings, which is lower than its long-term historical average. Hence, we retain our Buy rating on the stock with a revised PT of Rs. 3,200.

One-year forward P/E 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	34.6	19.2	12.9	8.7	4.1	3.6	11.8	18.7
Bajaj Auto	18.7	15.7	12.1	9.1	3.2	2.9	17.2	18.6
Hero MotoCorp	22.2	16.1	14.1	10.1	3.8	3.6	17.3	22.2

Source: Sharekhan Research

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 longterm 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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