

Sector: Automobiles

Result Update

	Change
Reco: Buy	↔
CMP: Rs. 2,805	
Price Target: Rs. 3,300	↑
↑ Upgrade ↔ No change ↓ Downgrade	

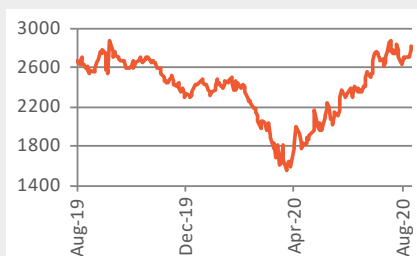
Company details

Market cap:	Rs. 56,036 cr
52-week high/low:	Rs. 3,021/1,475
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	6.0	27.8	22.8	5.2
Relative to Sensex	0.9	6.0	30.6	3.7

Sharekhan Research, Bloomberg

Hero MotoCorp (Hero) posted better-than-expected Q1FY2021 results. While volumes were down 69% y-o-y impacted by the lockdown due to COVID-19, realisation growth of 21% y-o-y was better than estimates, driven by price increases due to BS6 norms and increased spare sales. Negative operating leverage due to the steep fall in volumes led to operating margin dropping sharply to 3.6% as compared to 14.4% in Q1FY2020. However, margins were better than our estimates of 2.6%. Net profit at Rs. 61 crore was ahead of our estimates. Hero is witnessing consistent improvement in demand on m-o-m basis since the lockdown restrictions were relaxed. Hero has already reached 95% of Pre-COVID sales in July 2020 and the trend of demand improvement has sustained in early August as well. As per Hero, the trend is fundamental in nature and not just pent-up demand. Hero is expecting good demand for the festive season; and with the inventory lower than normalised levels, wholesale sales are expected to improve further. Moreover, rural areas are outperforming urban counterparts, which augurs well for Hero, which derives half of its volumes from hinterlands. Hence, we retain our Buy rating on the stock.

Key positives

- Hero's blended realisation grew by 21% y-o-y, driven by price increases due to BS6 norms and increased sales of spares. Realisations were better than estimates.
- Retail sales have been consistently improving on m-o-m basis. Early August trends also indicate improvement over July levels.
- Inventory is lower than normalised levels and Hero is ramping up production to bring inventory to normal levels, ahead of the festive season.

Key negatives

- Other income dropped by 32% y-o-y to Rs. 148 crore and was lower than our estimates.

Our Call

Fine-tuned estimates; Maintain Buy rating with a revised PT of Rs. 3,300: Hero is witnessing consistent m-o-m improvement in demand. Strong rural sentiments on account of normal monsoon so far, higher kharif sowing, and increased preference for personal transport are driving 2W demand. Hero expects urban demand to also pick up with the advent of the festive season. Demand is outstripping supply currently and Hero is ramping up production. Moreover, with inventory levels being lower than the norms and with the upcoming festival season, wholesale volumes are likely to improve further. We have fine-tuned our earnings estimates for both FY2021 and FY2022. At the CMP, the stock is trading at 15.2x 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. 3,300.

Key Risks

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

Valuation Particulars	Rs cr				
	FY18	FY19	FY20	FY21E	FY22E
Net Sales	32230.5	33650.5	28836.1	27321.9	34067.1
Growth (%)	13.1	4.4	-14.3	-5.3	24.7
EBIDTA	5280.2	4930.1	3958.0	3631.4	5034.5
OPM (%)	16.4	14.7	13.7	13.3	14.8
PAT	3697.4	3384.9	3178.7	2659.0	3673.5
Growth (%)	9.5	-8.5	-6.1	-16.4	38.2
FD EPS (Rs.)	185.1	169.5	159.2	133.1	183.9
P/E (x)	15.2	16.5	17.6	21.1	15.2
P/B (x)	4.8	4.4	4.0	3.8	3.5
EV/EBIDTA (x)	9.2	10.1	12.0	13.3	9.5
RoE (%)	31.4	26.3	22.5	17.8	22.9
RoCE (%)	42.4	37.2	26.5	23.1	29.8

Source: Company; Sharekhan estimates

Better-than-expected results: Hero's results were ahead of estimates. Revenue declined by 63% y-o-y, driven by 69% y-o-y drop in volumes on account of the lockdown due to COVID-19. Realisation grew by 21% y-o-y, driven by price hikes on account of BS6 norms and better mix (increased proportion of spares). Realisation was better than our estimate of 14% growth. Operating margin at 3.6% dropped by 1080 bps but was ahead of our estimate of 2.6%. Gross margin dropped by 90 bps y-o-y due to cost increases on account of BS6 norms. Moreover, negative operating leverage due to the steep fall in volumes impacted Q1FY2021 margins. EBIDTA at Rs. 108 crore was ahead of our estimate of Rs. 73 crore. Net profit at Rs. 61.3 crore was better than our estimate of Rs. 35.2 crore.

Demand pick up strong; Good outlook for the festive season: Hero stated that retail demand has been consistently picking up m-o-m post opening up of the economy. Hero stated that June 2020 sales reached 75% of pre-COVID levels, while July 2020 saw sales reaching 95% of pre-COVID levels. Demand improvement has been witnessed in early August 2020 as well and the company is looking at good demand for the festive season. The rural segment has been witnessing strong traction, driven by normal monsoon so far and increased kharif sowing. Moreover, increased preference for personal transportation is leading to demand revival. Hero expects urban demand to also pick up with the advent of the festive season. As per Hero, given that the demand improvement has sustained for three months, it is fundamental pick up and not just pent up demand. As per Hero, demand is currently outstripping supply and Hero is ramping up production. Moreover, with low channel inventory currently and the upcoming festive season, Hero's wholesale dispatches are expected to improve.

Key result highlights from Concall

- ◆ **Demand outlook:** Hero is witnessing strong traction in demand and expects m-o-m improvement in retail sales to continue. With the festive season kicking in, Hero expects demand improvement to sustain.
- ◆ **Rural sales witnessing strong traction:** Hero stated that retail sales have been outperforming urban areas given the strong sentiments on account of normal monsoon for the second consecutive year and increased kharif sowing. Better rural sales augur well for Hero.
- ◆ **New launches in the premium segment:** Hero stated that new launches in the premium segment Xtreme and XPulse have witnessed good customer response and the company expects share of premium motorcycles to improve. Hero is targeting at double-digit market share in the premium space compared to 3-4% currently.
- ◆ **Cash flows:** Hero raised Rs 1,000 cr of cash flows in Q1FY21 despite challenging scenario due to COVID-19.
- ◆ **Cost-control measures:** Hero has unveiled cost-control measures under the Leap 2 programme (will focus on cost reduction across expense heads) and is targeting cost savings worth 100 bps.
- ◆ **Capex:** The company has maintained capex guidance of Rs. 600 crore for FY2022.
- ◆ **Personal mobility:** Hero stated that it has witnessed increased preference for personal transportation. 2W would continue to gain, as it is the most affordable mode for personal transport.
- ◆ **Market share gains:** Hero has gained market share in the 2W segment on account of better performance in rural areas.
- ◆ **Regional market performance:** Hero stated that its top markets of UP and Bihar are performing well with double-digit growth. Southern markets are performing moderately while Western markets such as Maharashtra and Gujarat are lagging behind due to low sentiments.
- ◆ **Inventory:** Hero's inventory levels are lower than normal levels; and wholesales sales should improve with supply chain ramping up and the upcoming festive season.

Results	Rs cr				
Particulars	Q1FY21	Q1FY20	YoY %	Q4FY20	QoQ %
Total Income	2,971.5	8,030.3	-63.0	6,238.4	-52.4
EBIDTA	108.1	1,158.0	-90.7	659.9	-83.6
EBIDTA Margin (%)	3.6	14.4	(1080 bps)	10.6	(700 bps)
Depreciation	170.8	236.1	(27.7)	174.7	(2.3)
Interest	6.3	4.4	43.2	4.1	54.2
Other Income	148.5	218.8	(32.2)	169.5	(12.4)
PBT	79.5	1,136.4	(93.0)	650.6	(87.8)
Tax	18.2	623.7	(97.1)	29.9	(39.2)
Reported PAT	61.3	1,257.3	(95.1)	620.7	(90.1)
Adjusted PAT	61.3	762.5	(92.0)	620.7	(90.1)
EPS (Rs.)	3.1	38.2	(92.0)	31.1	(90.1)

Source: Company; Sharekhan Research

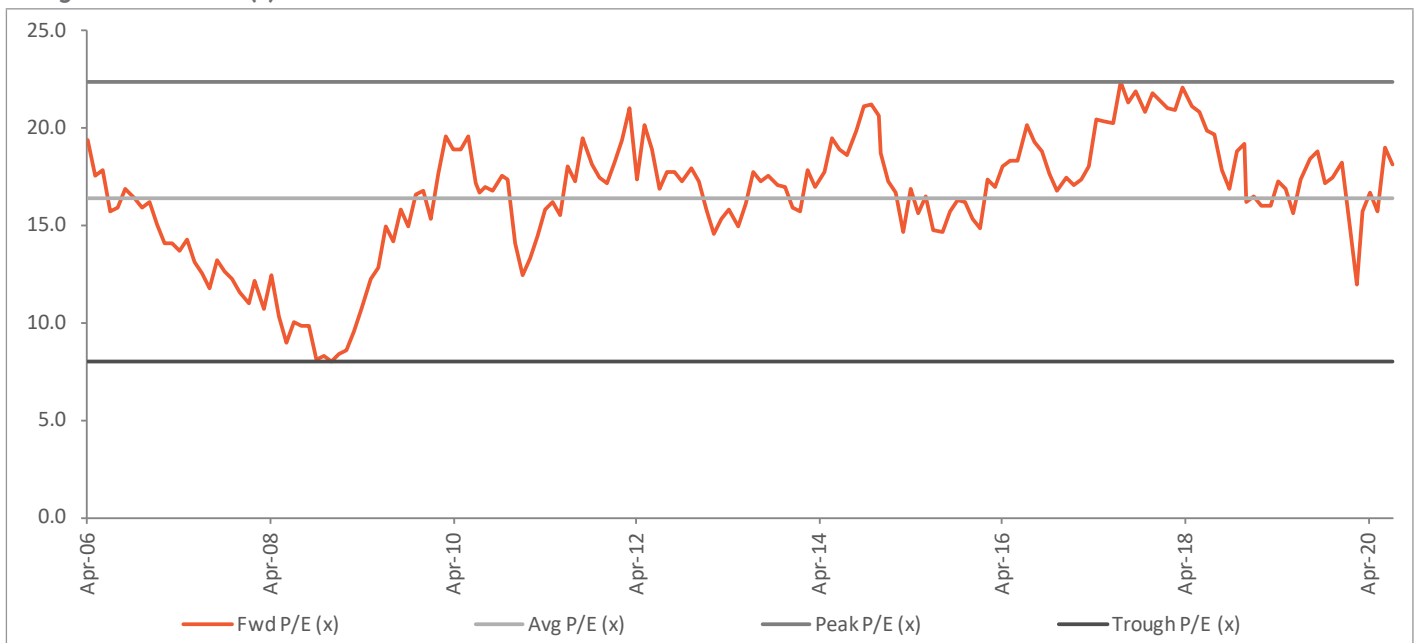
Outlook

Demand revival strong; Hero raising production: Hero is witnessing consistent m-o-m improvement in demand. Strong rural sentiments on account of normal monsoon so far, higher kharif sowing, and increased preference for personal transport are driving 2W demand. Hero expects urban demand to also pick up with the advent of the festive season. Moreover, wholesale volumes are likely to improve further with inventory levels being lower than the norms and with the upcoming festive season.

Valuation

Fine-tuned estimates; Retain Buy with a revised PT of Rs. 3,300: Hero is witnessing increased demand on m-o-m basis. As per management, consistent demand improvement for the past three months indicates that demand pick up is fundamental and not just pent-up demand. Demand is outstripping supply currently and Hero is ramping up production. We have fine tuned our earnings estimates for both FY2021 and FY2022. At the CMP, the stock is trading at 15.2x 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. 3,300.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
TVS Motor Co	37.4	20.6	14.0	9.3	4.3	3.8	11.5	18.4
Bajaj Auto	19.9	16.0	14.9	10.9	3.9	3.5	19.8	22.0
Hero Motocorp	21.1	15.2	13.3	9.5	3.8	3.5	17.8	22.9

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. Hero is witnessing consistent improvement in the demand on month on month basis since the lockdown restrictions were relaxed. Hero has already reached 95% of Pre-COVID sales in July 2020 and the trend of demand improvement has sustained in early August as well. As per Hero, the trend is fundamental in nature and not just pent up demand. Hero is expecting good demand for the festive season and with the inventory lower than normalized levels, wholesale sales are expected to improve further. Also, with rural areas outperforming urban counterparts augur well for Hero which derives half of its volumes from hinterlands. 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
2	MUNJAL PAWAN	13.98
3	Life Insurance Corp of India	5.24
4	Standard Life Aberdeen PLC	3.37
5	SBI Funds Management Pvt Ltd	2.99
6	Franklin Resources Inc	2.27
7	BlackRock Inc	2.24
8	Lazard Ltd	1.86
9	Vanguard Group Inc/The	1.75
10	ICICI Prudential Life Insurance Co	1.4

Source: Bloomberg

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