

Robust performance; remains portfolio play...

Hero MotoCorp (HMCL) reported a strong set of Q2FY21 numbers. Total 2-W sales volume for the quarter came in at 18.2 lakh units, up 7.7% YoY. Consequent net sales were at ₹ 9,367 crore, up 23.7% YoY. Blended ASPs were at ₹ 51,412/unit, a rise of ~15% YoY (courtesy BS-VI transition). EBITDA margins at 13.7% were down 80 bps YoY. The margin performance was impacted by a rise in raw material cost but employee and other expenses declined on a percentage of sales basis by 70 bps and 190 bps, respectively. Consequent PAT came in at ₹ 953.5 crore (up 9% YoY). Lower depreciation outgo and lower tax aided PAT print.

Rural traction to continue, outperformance extent may subside

Our initial post Covid hypothesis of rural-facing personal mobility segment i.e. motorcycles doing well has played out, to an extent, although PV performance has been better than expected. HMCL as market leader in domestic motorcycle segment (52% market share of FY20) with ~50% sales contribution from rural geographies was an outsized beneficiary of the trend in June-August (retail market share ~37-41% vs. 34-39% YoY, backed by consistently lower de-growth than 2-W industry). However, with urban pockets now returning amid reduced pandemic restrictions, usual market share readings should prevail. Nevertheless, continued buoyancy in the tractor industry courtesy firm farm incomes, positive sentiment (normal monsoon, healthy Kharif sowing, growth in government spends) indicate that rural 2-W demand should also remain supportive. In the short-term, HMCL's retail offtake in the rest of the festive period is a key monitorable, given the element of channel restocking observed in September wholesale dispatches. We build ~4% volume CAGR over FY20-23E.

Calibrated price hikes in offing to mitigate input cost increase

The company's control over other expenses in Q2FY21 (down ~190 bps YoY on a percentage of sales basis) was encouraging and demonstrates progress under Phase 2 of the LEAP (cost saving programme), which envisages 100 bps annual reduction in fixed costs. In the short run, however, pressure on gross margins is set to increase courtesy a spike in input material costs (chiefly steel). The same could put a strain on overall EBITDA margins, especially given that only cost element has largely been passed on to consumers under BS-VI, so far. The company took a price hike on some models in October. More such hikes could be necessary to transmit upcoming cost inflation in order to protect margins.

Valuation & Outlook

For HMCL, we build 10.2% sales, 4.5% PAT CAGR in FY20-23E. We believe the company's served segments will continue to see healthy demand traction. HMCL offers a play on rural revival post Covid and 2-W premiumisation. However, margin uptick could be limited in the medium term. We upgrade HMCL to **BUY** valuing it at ₹ 3,450 (20x P/E on average of FY22E, FY23E EPS). The company's strong financials (debt free b/s, consistent cash generation, robust dividend payout) make it a portfolio play.

Key Financial Summary

Key Financials	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net Sales	33,650.5	28,836.1	29,077.2	35,444.3	38,632.8	10.2%
EBITDA	4,929.8	3,958.0	3,394.2	4,428.6	5,003.0	8.1%
EBITDA Margins (%)	14.6	13.7	11.7	12.5	13.0	
Net Profit	3,384.6	3,633.3	2,468.5	3,230.3	3,657.2	0.2%
Normalised Net Profit	3,384.6	3,202.6	2,468.5	3,230.3	3,657.2	4.5%
EPS (₹)	169.5	181.9	123.6	161.8	183.1	
P/E	17.3	16.1	23.7	18.1	16.0	
RoNW (%)	26.3	22.7	16.0	19.0	19.4	
RoCE (%)	32.0	21.3	16.6	20.6	21.3	

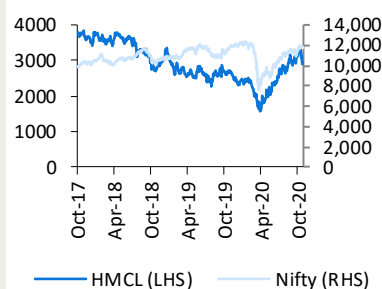
Source: ICICI Direct Research, Company



Particulars

Particular	Amount
Market Capitalization	₹ 58412.3 Crore
Total Debt (FY 20)	₹ 0 Crore
Cash & Inv. (FY 20)	₹ 6485 Crore
EV (FY 20)	₹ 51927 Crore
52 week H/L (₹)	3394 / 1475
Equity capital (₹ crore)	39.9
Face value	₹ 2

Price chart



Key Highlights

- Total 2-W sales volume in Q2FY21 at 18.2 lakh units, up 7.7% YoY. Blended ASPs rose ~15% YoY, courtesy BS-VI transition
- Margins at 13.7% higher than estimates on lower other expenses
- Rural tailwinds to continue to support motorcycle volumes but extent of outperformance seen dipping. Rise in input costs may limit medium term margin uptick with only cost element having been passed on so far under BS-VI
- Upgrade from HOLD to BUY with revised TP of ₹ 3,450 i.e. 20x P/E on average of FY22E, FY23E EPS

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Exhibit 1: Variance Analysis

	Q2FY21	Q2FY21E	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Comments
Total Operating Income	9,367	9,609	7,571	23.7	2,972	215.2	Topline came in lower than our estimates tracking lower than anticipated ASPs for the quarter
Raw Material Expenses	6,660	6,778	5,126	29.9	2,094	218.1	
Employee Expenses	511	480	469	9.0	382	33.7	Employee costs came in higher than estimates at
Other expenses	910	1,105	875	4.0	387	135.0	Other expenses came in much lower at 9.7% of sales vs. usual trend of ~12-13% of sales
Operating Profit (EBITDA)	1,286	1,246	1,101	16.8	108	1,090.6	
EBITDA Margins (%)	13.7	13.0	14.5	-1387 bps	3.6	-1010 bps	EBITDA margins came in ahead of estimates at 13.7% of sales primarily tracking savings realised in other
Other Income	141	178	208	-32.0	148	-4.8	
Interest	4.6	8.1	7.7	-39.5	6.3	-25.9	
Depreciation	173.2	222.6	203.4	-14.9	170.8	1.4	Depreciation came in lower than anticipated at ₹ 173
PBT after Exceptional Items	1,249.9	1,192.7	1,097.8	13.9	79.5	1,472.4	
Total Tax	296.5	300.6	162.9	82.0	18.2	1,530.9	Tax rate came in marginally lower at 23.7%
PAT	953.4	892.1	874.8	9.0	61.3	1,455.1	
EPS (Adjusted)	47.7	44.7	45.9	4.1	3.1	1,455.1	PAT came in ahead of estimates tracking beat on margins and lower depreciation charge for the quarter
Key Metrics							
Total 2-W Sales (lakh units)	18.22	18.2	16.91	7.7	5.65	222.5	Total 2-W sales volumes for quarter at 18.2 lakh units, up 7.7% YoY (16.91 lakh units in Q2FY20)
Net Blended ASP (₹/unit)	51,412	52,739	44,771	14.8	52,594	-2.2	Blended ASPs came in tad lower at ₹ 51400/unit

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

Exhibit 2: Change in Estimates								
	FY21E			FY22E			FY23E	
(₹ crore)	Old	New	% Change	Old	New	% Change	Introduced	Comments
Revenue	28,215	29,077	3.1	33,830	35,444	4.8	38,633	We upgrade our volume estimates for FY21E-22E leading to upward revision in revenue estimates for FY21E-22E. Introduce FY23E numbers. We expect topline to grow at CAGR of 10.2% over FY20-23E
EBITDA	3,225	3,394	5.2	4,404	4,429	0.6	5,003	
EBITDA Margin (%)	11.4	11.7	27 bps	13.0	12.5	-51 bps	13.0	Marginally tweak estimates, introduce FY23E margins at 13.0%
PAT	2,357	2,469	4.7	3,232	3,230	0.0	3,657	
EPS (₹)	118.0	123.6	4.7	161.8	161.8	0.0	183.1	Revision in sales, margin estimates lead to small change in EPS estimates for FY21E. Introduce FY23E EPS at ₹ 183. We expect normalised earnings at Hero MotoCorp to grow at CAGR of 4.5% over FY20-23E

Source: Company, ICICI Direct Research

Exhibit 3: Assumptions

	Current					Earlier		Comments
	FY19	FY20	FY21E	FY22E	FY23E	FY21E	FY22E	
Motorcycle volumes (lakh units)	71	60	51	61	66	50	60	We expect Hero MotoCorp to outperform domestic 2-W industry in FY21E with decline limited to ~13.6% YoY vs. our assumption of ~15% decline for industry. Post the blip, we expect sales volume to grow ~20% YoY primarily driven by high rural presence, innovative product profile and encouraging market response to recent new launches. In FY23E, we expect industry to return to its usual growth trajectory of ~1x GDP rate with volumes expected to grow ~8% in FY23E
Scooter volumes (lakh units)	7	4	4	6	6	4	5	
Total volumes (lakh units)	78	64	55	67	72	54	64	
Growth (% YoY)	-18.0%	-13.6%	20.2%	7.9%				
Gross Blended ASP	43,026	44,988	52,501	53,246	53,779	51,795	52,478	

Source: Company, ICICI Direct Research

Q2FY21 earnings conference call highlights

Management guidance/outlook and demand

- **HMCL has enjoyed a good start to the festive season, with overall print right now at ~96% of last year's levels (high base). Demand is doing well across models and regions (both rural, urban). Rural festive offtake is in the positive growth territory, dragged by semi urban and urban areas, which are now starting to catch up. Splendor retails during festive are showing YoY growth, thus far. Usually, north and central markets peak during Dhanteras period, with Navratri-Dussehra forming about one-third of overall festive sales. Dealer sentiment is also positive, with no major discounting trend being observed**
- **The company expects further rural positivity from November onwards as farmers sell Kharif harvest. HMCL is cautiously optimistic of post festive demand prospects. It plans to exit festive period with less than four weeks of inventory**
- Q2FY21 retail sales better than pre-Covid levels
- HMCL is gaining market share in scooters amid a good response to Pleasure, Destni. In premium motorcycles, the company is witnessing increased traction in south and west markets (on its way to doubling market share in centres like Mumbai)
- The company is witnessing increase in proportion of office goers among buyers, indicating a preference for personal mobility post Covid

Revenues, costs and margins

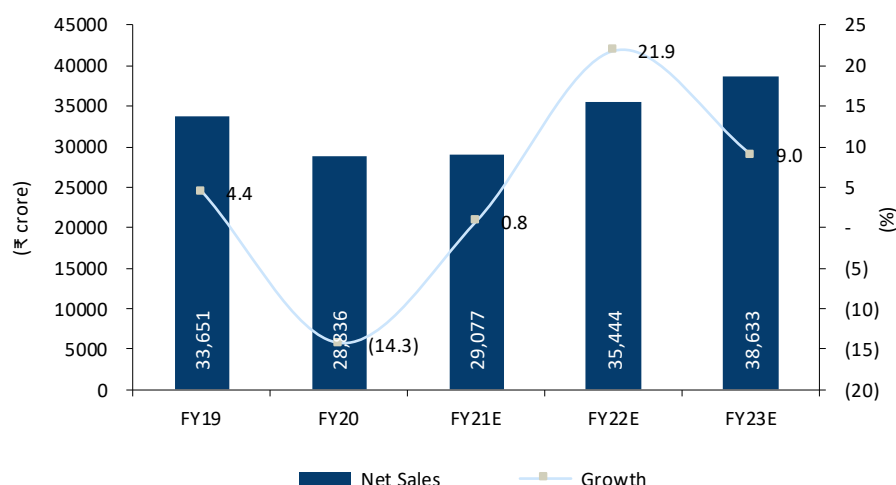
- Parts revenue in Q2FY21 were up 10.7% YoY to ₹ 801 crore, with other operating revenues at ₹ 187 crore
- **Leap programme covers the entire value chain spanning design to production. Phase 1 targeted 50 bps fixed cost reduction while phase 2 is targeting 100 bps. The programme is expected to aid efforts to move towards longer term margin ambition of ~14-16%**
- Recovery of gross margins under BS-VI will be gradual and effected via price hikes as well as savings under Leap-2
- Employee costs in Q2FY21 do not have any one-off element and are largely sustainable in nature. Other expenses, going forward, will be in tune with usual run rate of 11-12% of sales. Some advertising costs, which had reduced in Q2FY21 will return in Q3FY21
- **HMCL undertook some price increases in October**

Others

- **Association with Harley Davidson (HD) will accelerate HMCL premiumisation drive. Under the first leg of the arrangement, HMCL would sell and service HD motorcycles through exclusive HD stores and some HMCL branded outlets also (no contract manufacturing element). The second leg of the arrangement (licencing agreement) would see HMCL develop and sell HD branded motorcycles. The licencing agreement does not have any element of revenue sharing**
- HMCL said that rural demand is driven by first time buyers while urban demand is more replacement heavy
- Share of financed sales has grown to >40%, with Hero Fincorp's share within that at >50%. HMCL expects financing traction to improve as urban demand picks up

Financial story in charts

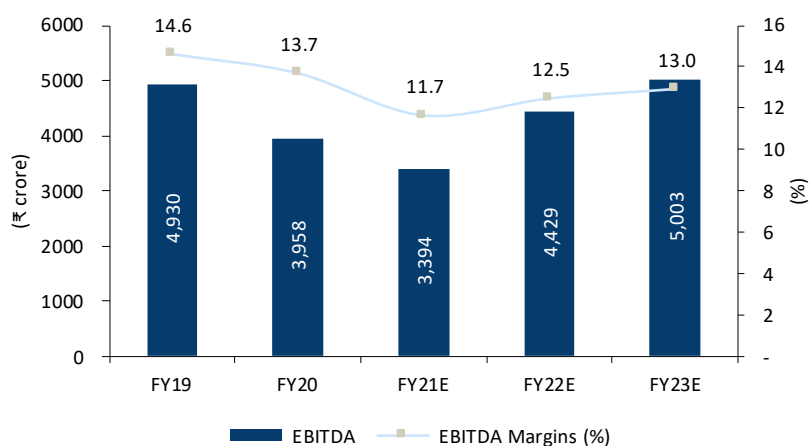
Exhibit 4: Growth in revenues



HMCL's revenues are expected to register CAGR of 10.2% over FY20-23E amid ~4% volume CAGR

Source: Company, ICICI Direct Research

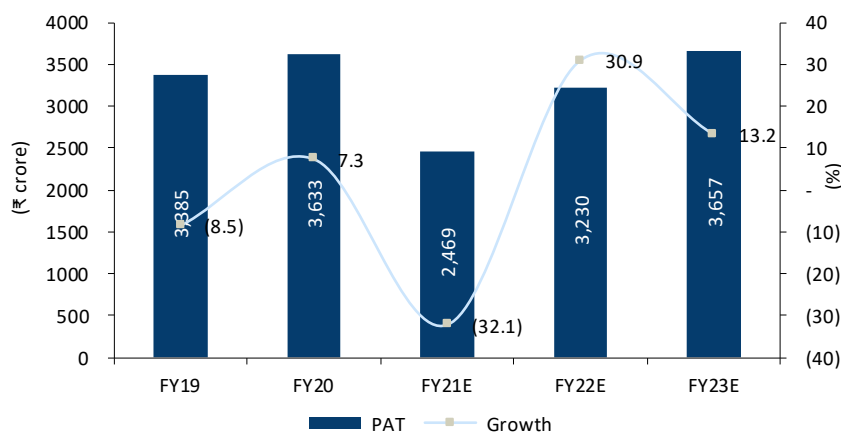
Exhibit 5: Margins trend



EBITDA margins are expected to remain under pressure with input cost rises adding to complexity of BS-VI pricing (only costs component passed through). Fixed cost savings programme, however, could mitigate some impact

Source: Company, ICICI Direct Research

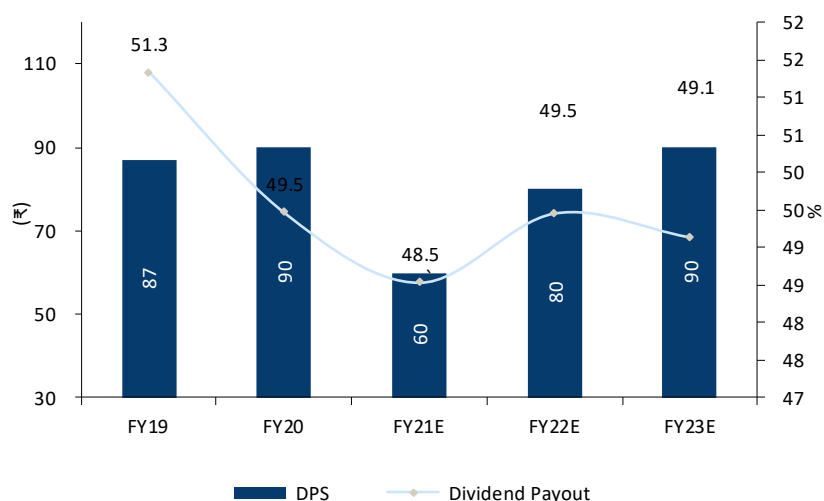
Exhibit 6: Trend in profitability



We expect HMCL to clock 4.5% CAGR in normalised PAT over FY20-23E

Source: Company, ICICI Direct Research

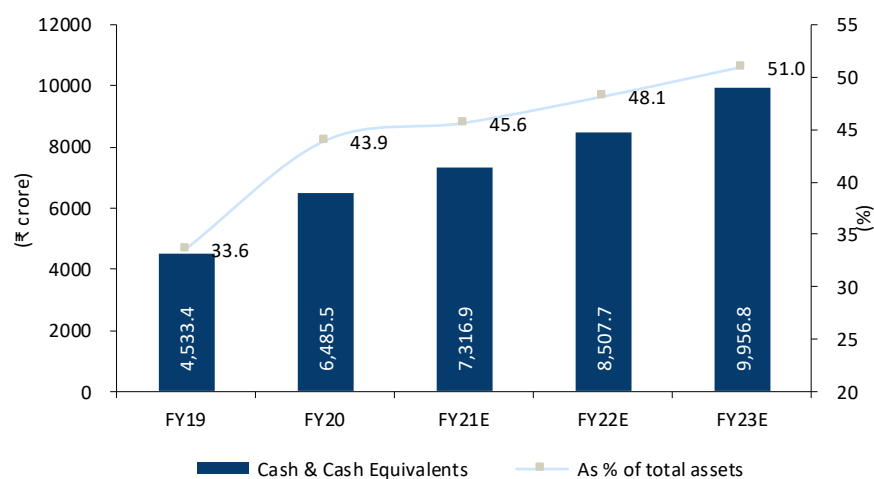
Exhibit 7: Dividend payout trend



HMCL has consistently paid out ~50% of post tax earnings as dividend

Source: Company, ICICI Direct Research

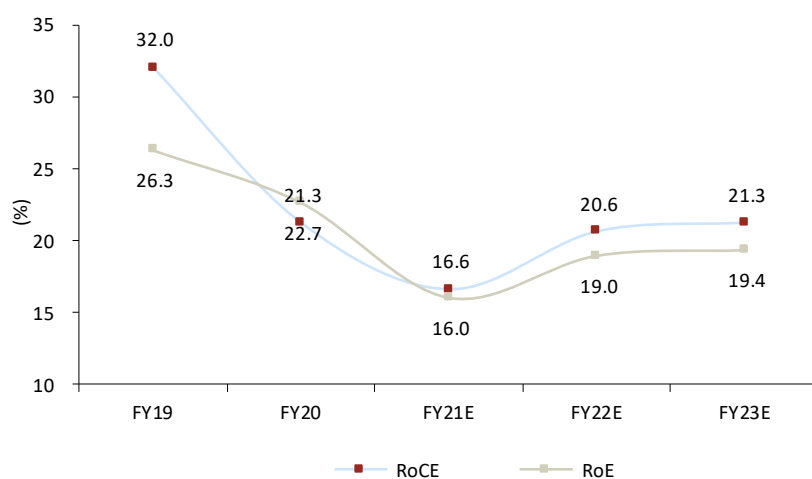
Exhibit 8: Cash as percentage of total assets



Cash & equivalents formed ~44% of total assets in FY20

Source: Company, ICICI Direct Research

Exhibit 9: Return ratios trend



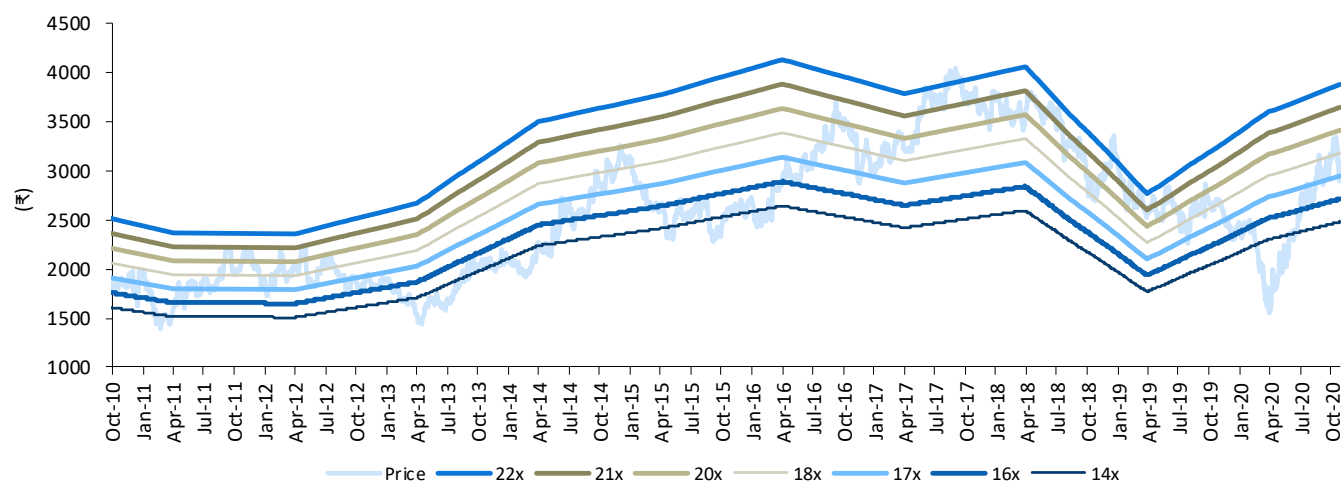
Return ratios have come off their highs in recent years. However, they are expected to return to ~20% levels in FY22E

Source: Company, ICICI Direct Research

Exhibit 10: Valuation

	Sales	Growth	EPS	Growth	PE	EV/EBITDA	RoNW	RoCE
	(₹ cr)	(%)	(₹ cr)	(%)	(x)	(x)	(%)	(%)
FY18	32,230.5	(16.6)	185.1	1.1	15.8	9.8	31.4	38.1
FY19	33,650.5	4.4	169.5	-8.5	17.3	10.9	26.3	32.0
FY20	28,836.1	(14.3)	181.9	7.3	16.1	13.1	22.7	21.3
FY21E	29,077.2	0.8	123.6	-32.1	23.7	15.1	16.0	16.6
FY22E	35,444.3	21.9	161.8	30.9	18.1	11.3	19.0	20.6
FY23E	38,632.8	9.0	183.1	13.2	16.0	9.7	19.4	21.3

Source: Company, ICICI Direct Research

Exhibit 11: HMCL currently trading at ~16x FY23E EPS of ~₹ 183.1


Source: Bloomberg, ICICI Direct Research

Exhibit 12: Shareholding pattern

(in %)	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Promoter	34.6	34.6	34.6	34.8	34.8
FII	36.5	35.3	34.3	32.7	33.3
DII	19.2	19.6	19.9	21.7	22.9
Others	9.7	10.5	11.2	10.8	9.1

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 13: Profit and loss statement ₹ crore				
(Year-end March)	FY20	FY21E	FY22E	FY23E
Total operating Income	28,836.1	29,077.2	35,444.3	38,632.8
Growth (%)	-14.3	0.8	21.9	9.0
Raw Material Expenses	19,697.4	20,712.8	25,229.2	27,464.5
Employee Expenses	1,841.7	1,834.5	1,987.9	2,116.8
Other expenses	3,339.0	3,135.7	3,798.6	4,048.5
Total Operating Expenditure	24,878.1	25,683.0	31,015.7	33,629.8
EBITDA	3958.0	3394.2	4428.6	5003.0
Growth (%)	-19.7	-14.2	30.5	13.0
Depreciation	818.0	726.9	779.8	849.9
Interest	22.0	21.4	22.4	23.6
Other Income	778.3	621.9	680.6	746.8
PBT	3896.3	3267.8	4307.0	4876.3
Total Tax	940.4	799.3	1,076.8	1,219.1
PAT	3633.3	2468.5	3230.3	3657.2
Growth (%)	7.3	-32.1	30.9	13.2
Normalised PAT (₹)	3,202.6	2,468.5	3,230.3	3,657.2
EPS (₹)	181.9	123.6	161.8	183.1
Normalised EPS (₹)	160.4	123.6	161.8	183.1

Source: Company, ICICI Direct Research

Exhibit 14: Cash flow statement ₹ crore				
(Year-end March)	FY20	FY21E	FY22E	FY23E
Profit after Tax	3,633.3	2,468.5	3,230.3	3,657.2
Add: Depreciation & Interest	840.0	748.3	802.2	873.5
Sub: Other Income	778.3	621.9	680.6	746.8
(Inc)/dec in Current Assets	1,459.9	-18.5	-738.1	-369.6
Inc/(dec) in CL and Provisions	-154.3	-247.3	816.5	408.9
CF from operating activities	5000.5	2329.1	3430.3	3823.2
(Inc)/dec in Investments	-1,846.7	-800.0	-1,150.0	-1,400.0
(Inc)/dec in Fixed Assets	-2,115.9	-600.0	-1,000.0	-1,000.0
Others	665.1	-300.0	-300.0	-300.0
Add: Other Income	778.3	621.9	680.6	746.8
CF from investing activities	-2519.2	-1078.1	-1769.4	-1953.2
Inc/(dec) in loan funds	0.0	0.0	0.0	0.0
Dividend paid & dividend tax	-2,156.8	-1,198.2	-1,597.6	-1,797.3
Inc/(dec) in Sec. premium & Others	-219.2	-21.4	-22.4	-23.6
CF from financing activities	-2376.0	-1219.6	-1620.0	-1820.9
Net Cash flow	105.3	31.4	40.8	49.1
Opening Cash	136.5	241.9	273.3	314.1
Closing Cash	241.9	273.3	314.1	363.2

Source: Company, ICICI Direct Research

Exhibit 15: Balance Sheet ₹ crore				
(Year-end March)	FY20	FY21E	FY22E	FY23E
Liabilities				
Equity Capital	39.9	39.9	39.9	39.9
Reserve and Surplus	14,096.5	15,366.8	16,999.5	18,859.4
Total Shareholders funds	14136.4	15406.8	17039.4	18899.3
Total Debt	0.0	0.0	0.0	0.0
Deferred Tax Liability	392.8	392.8	392.8	392.8
Others	244.0	244.0	244.0	244.0
Total Liabilities	14773.3	16043.6	17676.3	19536.2
Assets				
Gross Block	10,316.2	10,896.2	11,946.2	12,996.2
Less: Acc Depreciation	4,339.2	5,066.2	5,845.9	6,695.8
Net Block	5977.0	5830.0	6100.2	6300.3
Capital WIP	160.3	180.3	130.3	80.3
Total Fixed Assets	6,137.2	6,010.3	6,230.5	6,380.6
Investments	8,222.7	9,322.7	10,772.7	12,472.7
Inventory	1,092.0	956.0	1,165.3	1,270.1
Debtors	1,603.1	1,752.6	2,136.4	2,328.6
Loans and Advances	22.4	22.2	27.0	29.5
Cash	241.9	273.3	314.1	363.2
Total Current Assets	3,594.1	3,644.0	4,422.9	4,841.7
Creditors	3,030.5	2,788.2	3,398.8	3,704.5
Provisions	146.6	134.8	164.4	179.2
Total Current Liabilities	3,976.0	3,728.7	4,545.2	4,954.1
Net Current Assets	-382.0	-84.7	-122.3	-112.4
Application of Funds	14773.3	16043.6	17676.3	19536.2

Source: Company, ICICI Direct Research

Exhibit 16: Key ratios				
(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
EPS	181.9	123.6	161.8	183.1
Cash EPS	222.9	160.0	200.8	225.7
BV	707.9	771.5	853.3	946.4
DPS	90.0	60.0	80.0	90.0
Cash Per Share	324.8	366.4	426.0	498.6
Operating Ratios (%)				
EBITDA Margin	13.7	11.7	12.5	13.0
PBT / Net sales	10.9	9.2	10.3	10.8
PAT Margin	12.6	8.5	9.1	8.7
Inventory days	13.8	12.0	12.0	12.0
Debtor days	20.3	22.0	22.0	22.0
Creditor days	38.4	35.0	35.0	35.0
Return Ratios (%)				
RoE	22.7	16.0	19.0	19.4
RoCE	21.3	16.6	20.6	21.3
RoIC	40.0	32.2	41.1	44.2
Valuation Ratios (x)				
P/E	18.2	23.7	18.1	16.0
EV / EBITDA	13.1	15.1	11.3	9.7
Market Cap / Sales	2.0	2.0	1.6	1.5
Price to Book Value	4.1	3.8	3.4	3.1
Solvency Ratios				
Current Ratio	1.0	1.1	1.1	1.1
Quick Ratio	0.7	0.8	0.8	0.8

Source: Company, ICICI Direct Research

Exhibit 17: ICICI Direct coverage universe (Auto & Auto Ancillary)

Sector / Company	CMP	TP	Rating	M Cap	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)			FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Apollo Tyre (APOTYR)	143	120	Hold	8,180	8.3	4.9	8.9	17.2	29.1	16.1	7.4	6.4	5.5	4.7	4.7	6.6	4.8	2.5	4.9
Ashok Leyland (ASHLEY)	80	90	Buy	23,417	0.8	0.3	2.5	98.1	301.3	32.3	21.6	26.9	13.9	4.5	2.3	9.2	4.7	1.1	9.4
Bajaj Auto (BAAUTO)	2,930	3,570	Buy	84,785	176.2	142.5	180.2	16.6	20.6	16.3	13.2	14.7	10.6	23.9	24.1	27.3	25.6	18.5	20.7
Bharat Forge (BHAFOR)	453	415	Hold	21,090	7.5	3.5	13.7	60.4	130.0	33.1	21.2	28.8	15.9	5.8	2.2	7.9	7.8	3.0	11.1
Eicher Motors (EICMOT)	2,135	2,470	Buy	58,200	67.0	46.6	71.3	31.8	45.8	30.0	23.6	29.6	20.3	17.3	11.5	15.4	18.3	11.6	15.4
Escorts (ESCORT)	1,190	1,375	Buy	14,587	39.6	46.1	54.5	30.0	25.8	21.8	20.2	17.2	14.4	18.9	15.0	15.2	14.2	11.2	11.8
Exide Industries (EXIIND)	157	180	Buy	13,345	9.7	6.3	8.9	11.8	18.0	12.9	9.6	11.9	9.2	15.7	10.3	13.5	13.4	8.2	10.7
Hero Moto (HERHON)	2,900	3,450	Buy	57,913	181.9	123.6	161.8	15.9	23.5	17.9	13.0	14.9	11.2	21.3	16.6	20.6	22.7	16.0	19.0
M&M (MAHMAH)	593	760	Buy	73,722	11.2	29.1	40.0	53.2	20.4	14.8	12.1	12.5	9.4	12.9	10.8	13.8	6.4	9.2	11.6
Maruti Suzuki (MARUTI)	7,115	5,700	Reduce	2,14,930	187.1	124.9	203.4	38.0	57.0	35.0	24.5	33.6	20.6	7.4	3.5	8.2	11.7	7.4	11.1
Minda Industries (MININD)	319	370	Hold	8,364	5.9	2.8	10.0	54.0	113.3	31.8	15.1	17.5	11.3	10.2	6.3	12.7	10.3	4.0	13.0
Tata Motors (TATMOT)	132	165	Buy	47,490	-33.3	-16.6	6.1	NM	NM	21.6	5.1	4.7	3.4	1.3	2.8	6.4	-18.7	-10.6	3.7

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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