

Hero MotoCorp Limited

Industry **Automobiles**
Bloomberg **HMCL IN**
BSE CODE **500182**

Demand headwinds coupled with weaker operating leverage to weigh on margins

RATING **NEUTRAL**

CMP **2612**

Price Target **2772**

Potential Upside **6%**

Rating Change

Estimate Change

Target Change

Q3FY19 Result Update

- ❑ HEROMOTOCO reported net sales of Rs.7865 crores with a growth of 7% YoY in Q3FY19. Volume growth has been 5% YoY led by new model launches and growth in entry segment motorcycles while realization increased by 3% YoY supported by price hikes and higher spare part sales.
- ❑ Gross margin increased by 45 bps QoQ to 31.2% due to price hike taken by the company despite higher commodity prices. EBITDA margin has declined sharply by 111 bps QoQ to 14% due to model launch cost, advertising and promotional expenses and weaker operating leverage benefit.
- ❑ PAT for the quarter stood at Rs.769 crores led by higher other income.
- ❑ The company has announced setting-up of its first R&D Centre at a global location, the Hero Tech Centre Germany GmbH, located at Stephanskirchen near Munich in Germany.
- ❑ During the quarter, the company has invested Rs.6 crores as part of capital contribution in a subsidiary company HMC MM Auto Limited and Rs.0.20crores to Hero Tech Center Germany GMBH. Further, the company has invested Rs.130 crores as part of capital contribution in associate company Ather Energy Private Limited.

View and Valuation

EBITDA margin has declined by 110bps QoQ to 14% due to higher commodity cost, promotional expenses and weaker operating leverage in 3QFY19. The demand scenario continues to be sluggish as the company is sitting with 6-8 weeks of inventory in comparison to normal level of 4-6 weeks. The growth in rural segment also remained muted due to low Rabi sowing. However the management expects demand to improve in Q4 on account of festive and marriage season in North. The scooter demand has been slowing down due to their lower fuel efficiency as compared to motorcycles and HEROMOTOCO's late entry in the 125cc scooter segment may put pressure on overall 125cc segment profitability. The new safety norms (ABS/CBS) which comes in from 1st April 2019 as it will further increase the ownership cost, thus resulting in pressure on volumes in 1QFY20. The company will launch new products in 1HFY20 in the premium segment motorcycles and 125cc scooter. Therefore, we expect further compression in margins due to higher fixed cost in FY20. Going ahead the demand in FY20 will be largely tilted towards 2HFY20 as pre-buying is expected due to BS-VI implementation from 1st April 2020. Factoring the subdued demand scenario, increased competition in the entry level motorcycles and compression on margins based on higher launch cost we reduce our FY19/20 EPS estimates by 2%/5%. We value HEROMOTOCO at 14x FY20e EPS (earlier 15x) to arrive at target price of Rs.2772 and maintain NEUTRAL rating on the stock.

Key Risks to our rating and target

- ❑ Sluggishness in rural demand
- ❑ Further increase in commodity prices

KEY FINANCIAL/VALUATIONS	FY16	FY17	FY18	FY19E	FY20E
Net Sales	28457	28585	32458	34912	38375
EBITDA	4398	4576	5325	5205	5895
EBIT	3954	4074	4750	4600	5217
PAT	3112	3546	3722	3570	3954
EPS (Rs)	156	178	186	179	198
EPS growth (%)	32	14	5	(4)	11
ROE (%)	35	34	31	27	27
ROCE (%)	44	39	39	34	35
BV	442	517	599	664	736
P/B (X)	6.7	6.4	6.0	3.9	3.5
P/E (x)	18.9	18.6	19.4	14.6	13.2

Research Analyst

NAVEEN KUMAR DUBEY

Naveen.dubey@narnolia.com

+91-22-62701235

Swati Singh

Swati.singh@narnolia.com

+91-22-62701224

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3QFY19 Results

In line with expectation

Financials	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	YoY %	QoQ%	FY17	FY18	YoY %
Volumes	1709	2002	2105	2134	1799	5%	-16%	6664	7583	13.8%
Realization	42,745	42,787	41,853	42,600	43,720	2%	3%	42,895	42,805	-0.2%
Net Sales	7,305	8,564	8,810	9,091	7,865	8%	-13%	28,585	32,458	13.6%
Other Income	110	166	116	224	188	71%	-16%	522	523	0.2%
Total Income	7,416	8,730	8,926	9,315	8,052	9%	-14%	29,107	32,982	13.3%
COGS	4,922	5,793	6,165	6,300	5,415	10%	-14%	19,091	21,886	14.6%
Staff Cost	402	381	413	434	436	8%	0%	1,432	1,584	10.6%
Other Exp.	824	1,020	854	978	910	10%	-7%	3,486	3,664	5.1%
Expenditure	6,148	7,193	7,433	7,712	6,760	10%	-12%	24,009	27,133	13.0%
EBITDA	1,158	1,371	1,377	1,379	1,105	-5%	-20%	4,576	5,325	16.4%
Depreciation	138	148	148	152	152	10%	0%	502	575	14.5%
EBIT	1,020	1,222	1,229	1,227	953	-7%	-22%	4,074	4,750	16.6%
Interest	2	2	2	2	2	38%	1%	27	31	12.9%
PBT	1,128	1,386	1,343	1,448	1,138	1%	-21%	4,568	5,242	14.8%
Excpt. Item	-	-	-	-	-	0%	0%	(262)	-	0.0%
Tax	323	419	434	472	369	14%	-22%	1,339	1,570	17.2%
PAT	805	967	909	976	769	-5%	-21%	3,546	3,722	5.0%

Revenue growth supported by volume as well as realization growth

HEROMOTOCO reported net sales of Rs.7865 crores (vs. our estimates of Rs.7702 crores) with a growth of 7.7% YoY in Q3FY19. Volume growth has been 5.4% YoY while realization increased by 2.3% YoY. The volume growth was driven by new model launches and continued growth momentum in entry segment motorcycles. Destini 125 has been received well by the customers with 17000 units per month sales since its launch date. Xtreme 200-R in premium segment has also generated a positive uptick in volumes. Realization growth was largely supported by price hikes and higher spare part sales. Spares revenue for the quarter was Rs.730 crores with 5%YoY growth. The company has done well in exports market primarily in Bangladesh and Columbia. There has been some setback in Sri Lanka market. The company is focusing on Nigeria market where there is an opportunity for more taxi bikes.

New model launch cost and advertisement expenses led to margin contraction

Despite higher commodity prices, gross margin increased by 45 bps QoQ to 31.2% led by price hikes taken by the company. The company has taken price hike in October of Rs.500-600. EBITDA margin, on the other hand, declined sharply by 111 bps QoQ to 14% due new model launch cost along with advertisement & promotional expenses and weaker operating leverage benefit.

PAT declined despite higher other income

PAT for the quarter stood at Rs.769 crores (vs. our estimates of Rs.749 crores). The other income stands on higher side on account of yield improvement.

Concall highlights

- The overall rural demand is expected to remain subdued.
- The market is expected to improve in coming months with the upcoming budget which may give impetus to agriculture and social sectors to trigger a positive turnaround in sentiments.
- The management expects higher single digit growth in FY20.
- The management expects recovery in Q4FY19 with the marriage season and festive days.
- The company will launch Maestro Edge in 125 cc segment and X-Pulse in premium segment in 1HFY20.
- There may be improvement in retail demand by 35%-50% from mid of January 2019.
- The company has taken price hike in October of Rs.500-600 on ex-showroom basis. Further change in price hikes will depend on commodity price situation.
- Other income included returns from investments made in debt funds.
- Inventory level has gone up from 4-6 weeks to 6-8 weeks due to festive off take. The management expects the inventory level to come down in Q4FY19.
- There has been increase in debtor days by 10 days due to festive season demand.
- Hero Fincorp has financed 3.96 lakh vehicles in Q3FY19. The growth in 9MFY19 is 59%.

Exhibit: Volume and Volume Growth Trend

The volume growth was driven by new model launches and continued growth momentum in entry segment motorcycles

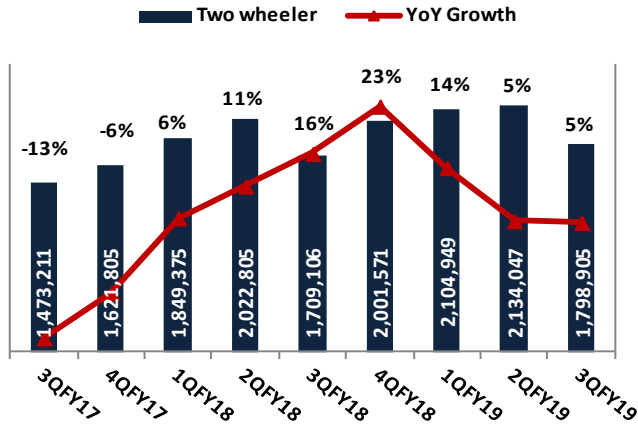


Exhibit: Realisation and Realisation Growth Trend

Realization growth was largely supported by price hikes and higher spare part sales.

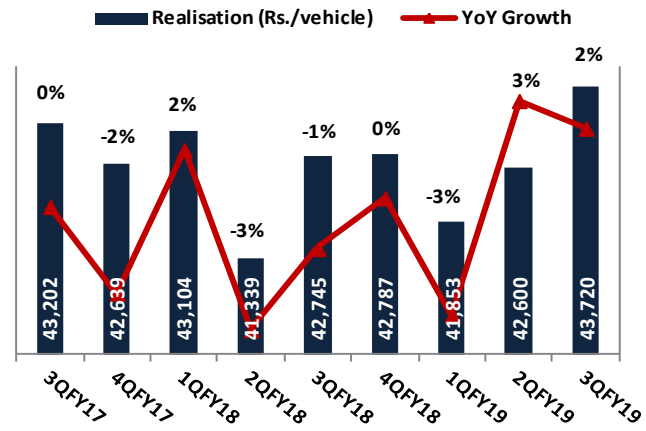


Exhibit: EBITDA (Rs. Crore) and EBITDA Margin Trend

Margin declined on account of higher advertisement & promotional expenses and new model launch cost

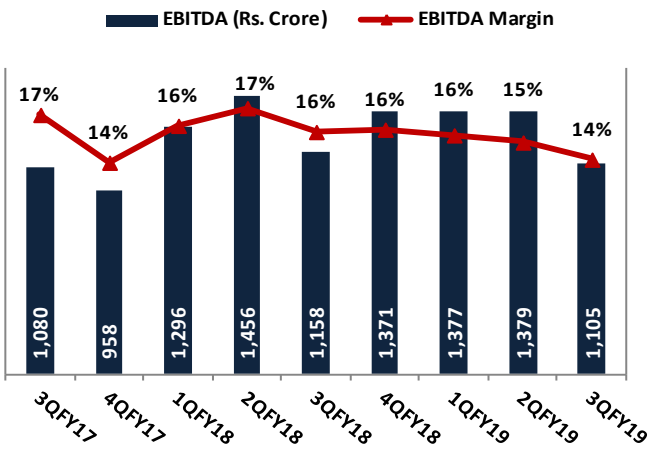


Exhibit: PAT (Rs. Crore) and PAT Margin Trend

PAT margin declined despite higher other income

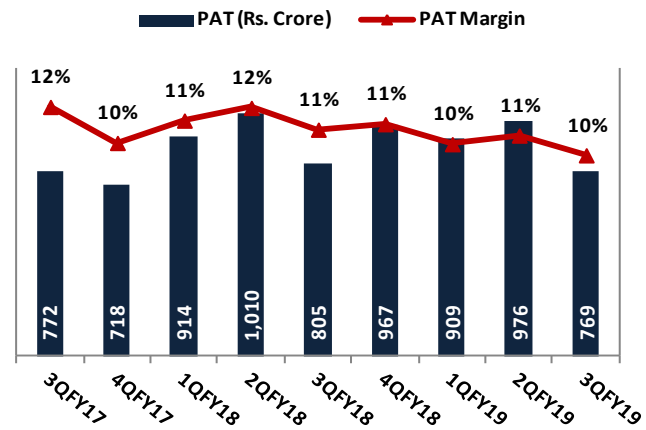


Exhibit: Trend in Segment Mix

Motorcycles sales continue to dominate scooter sales for second consecutive quarter

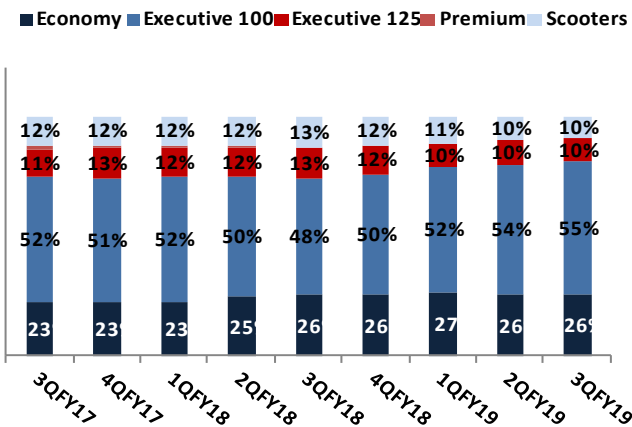
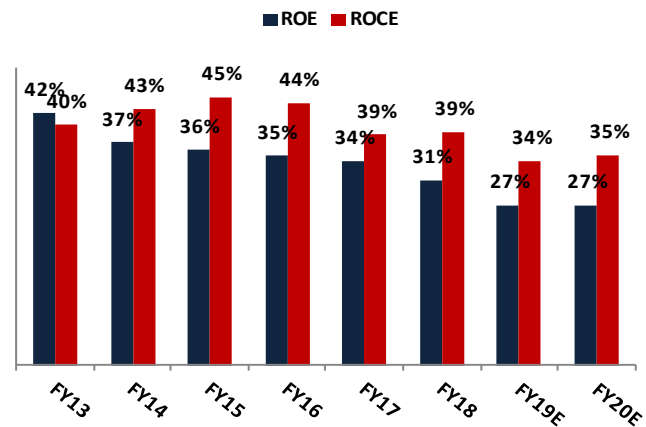


Exhibit: Return Ratios

Declining profitability will lead to reduction in return ratios going ahead



Financial Details

Balance Sheet

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Share Capital	40	40	40	40	40	40	40	40
Reserves	4,966	5,583	6,500	8,794	10,276	11,932	13,224	14,656
Networth	5,006	5,623	6,540	8,834	10,316	11,971	13,264	14,696
Debt	302	24	100	230	248	225	169	127
Other Non Cur Liab	-	-	-	-	-	-	-	-
Total Capital Employed	5,308	5,647	6,640	9,064	10,563	12,196	13,433	14,822
Net Fixed Assets (incl CWIP)	3,133	3,102	3,671	4,437	5,180	5,316	5,949	6,509
Non Cur Investments	614	830	821	1,030	1,522	918	2,589	3,428
Other Non Cur Asst	36	48	60	848	658	560	560	560
Non Curr Assets	4,564	4,563	5,275	6,592	7,741	8,395	9,538	10,937
Inventory	637	670	861	762	709	963	1,035	1,138
Debtors	665	921	1,372	1,282	1,552	1,427	1,535	1,687
Cash & Bank	181	120	216	75	74	131	134	256
Other Curr Assets	32	22	60	562	524	212	228	251
Curr Assets	5,078	5,558	5,380	6,303	7,571	9,002	9,297	9,736
Creditors	1,873	2,291	2,855	2,675	3,266	3,375	3,630	3,990
Provisons (both)	1,440	1,594	801	98	118	179	193	212
Other Curr Liab	888	588	309	506	457	765	698	767
Curr Liabilities	4,171	4,424	3,898	3,487	4,137	4,406	4,599	5,035
Net Curr Assets	907	1,135	1,481	2,816	3,434	4,596	4,698	4,701
Total Assets	9,642	10,122	10,654	12,896	15,312	17,397	18,835	20,673

Income Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Revenue from Operation	23,768	25,275	27,538	28,457	28,585	32,458	34,912	38,375
Change (%)	1	6	9	3	0	14	8	10
Other Income	398	444	492	413	522	523	631	564
EBITDA	3,284	3,539	3,497	4,398	4,576	5,325	5,205	5,895
Change (%)	(9)	8	(1)	26	4	16	(2)	13
Margin (%)	13.8	14.0	12.7	15.5	16.0	16.4	14.9	15.4
Depr & Amor.	1,142	1,107	540	443	502	575	605	679
EBIT	2,143	2,432	2,956	3,954	4,074	4,750	4,600	5,217
Int. & other fin. Cost	12	12	12	15	27	31	23	17
EBT	2,529	2,864	3,437	4,353	4,568	5,242	5,207	5,764
Exp Item	-	-	145	-	(262)	-	-	-
Tax	411	758	943	1,275	1,339	1,570	1,694	1,873
Minority Int & P/L share of Ass.	-	(3)	16	34	55	50	57	63
Reported PAT	2,118	2,103	2,365	3,112	3,546	3,722	3,570	3,954
Adjusted PAT	2,118	2,103	2,365	3,112	3,546	3,722	3,570	3,954
Change (%)	(11)	(1)	12	32	14	5	(4)	11
Margin(%)	8.9	8.3	8.6	10.9	12.4	11.5	10.2	10.3

Financial Details

Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
ROE	42%	37%	36%	35%	34%	31%	27%	27%
ROCE	40%	43%	45%	44%	39%	39%	34%	35%
Asset Turnover	2.47	2.50	2.58	2.21	1.87	1.87	1.85	1.86
Debtor Days	10	13	18	16	20	16	16	16
Inv Days	10	10	11	10	9	11	11	11
Payable Days	29	33	38	34	42	38	38	38
Int Coverage	180	206	253	271	149	154	199	301
P/E	15	22	22	19	19	19	15	13
Price / Book Value	6	8	8	7	6	6	4	4
EV/EBITDA	9	13	15	13	14	14	10	9
FCF per Share	1,283	2,022	1,094	2,084	2,769	3,193	2,963	3,579
Div Yield	3.9%	2.9%	2.3%	2.4%	2.6%	2.6%	3.6%	4.0%

Cash Flow Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
PBT	2,529	2,864	3,329	3,112	3,546	3,722	5,207	5,764
(inc)/Dec in Working Capital	(787)	55	(336)	323	462	197	3	168
Non Cash Op Exp	1,142	1,107	540	443	502	575	605	679
Int Paid (+)	12	12	11	15	27	31	23	17
Tax Paid	(613)	(649)	(1,000)	(1,103)	(1,187)	(1,513)	(1,694)	(1,873)
others	(392)	(426)	(294)	933	657	1,005	57	63
CF from Op. Activities	1,890	2,963	2,250	3,722	4,007	4,017	4,202	4,818
(inc)/Dec in FA & CWIP	(608)	(941)	(1,156)	(1,638)	(1,238)	(824)	(1,239)	(1,239)
Free Cashflow	1,283	2,022	1,094	2,084	2,769	3,193	2,963	3,579
(Pur)/Sale of Inv	628	(9)	1,354	(645)	(714)	(1,172)	-	-
others	(753)	(668)	(186)	(16)	(20)	138	(603)	(875)
CF from Inv. Activities	(733)	(1,618)	12	(2,300)	(1,972)	(1,858)	(1,842)	(2,114)
inc/(dec) in NW	-	-	-	-	-	-	-	-
inc/(dec) in Debt	-	-	-	181	28	(33)	(56)	(42)
Int. Paid	(12)	(12)	(11)	(14)	(27)	(31)	(23)	(17)
Div Paid (inc tax)	(1,044)	(1,403)	(2,219)	(1,682)	(2,091)	(2,043)	(2,277)	(2,522)
others	-	1	-	40	54	5	-	-
CF from Fin. Activities	(1,056)	(1,414)	(2,231)	(1,475)	(2,036)	(2,102)	(2,357)	(2,582)
Inc(Dec) in Cash	101	(69)	32	(53)	(1)	57	3	122
Add: Opening Balance	34	135	66	127	75	74	131	134
Closing Balance	135	69	98	75	74	131	134	256

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Correspondence Office Address: Arch Waterfront, 5th Floor, Block GP, Saltlake, Sector 5, Kolkata 700 091; Tel No.: 033-40541700; www.narnolia.com.

Registered Office Address: Marble Arch, Office 201, 2nd Floor, 236B, AIC Bose Road, Kolkata 700 020; Tel No.: 033-4050 1500; www.narnolia.com

Compliance Officer: Manish Kr Agarwal, Email Id: mkagarwal@narnolia.com, Contact No.:033-40541700.

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