

Industry	Automobiles
Bloomberg	HMCL IN
BSE CODE	500182

Rural Growth to Remain Challenging in 1HFY20

RATING **NEUTRAL**

CMP	2604
Price Target	2476
Potential Upside	-5%

Rating Change 

Estimate Change 

Target Change 

Stock Info

52wk Range H/L	3,819/2,517
Mkt Capital (Rs Cr)	52012
Free float (%)	65%
Avg. Vol 1M (,000)	829
No. of Shares (Cr.)	20
Promoters Pledged %	0%

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4QFY19 Result Update

- HEROMOTOCO reported net sales of Rs.7885 crores (vs our estimates of Rs.7827 crores) with a de-growth of 7.9% YoY in 4QFY19. Volume growth declined by 11% YoY due to sluggish demand scenario in several geographies while realization increased by 3.5% YoY.
- EBITDA margin has declined by 40 bps QoQ to 13.6% due to model launch cost, advertising and promotional expenses and weaker operating leverage benefit.
- PAT declined by 25%YoY at Rs.730 crores (vs our estimates of Rs.754 crores). PAT margins declined by 52 bps QoQ to 9.3% due to lower other income.
- The company has plans to launch Maestro Edge in 125cc scooters segment and Xpulse in premium segment motorcycle in the May 2019.
- During the quarter, the company has invested Rs. 24.07 crores and Rs.19.37 crores in subsidiary companies HMCL Netherlands B.V. and Hero Tech Centre Germany GmbH. Further, the company has invested Rs.249.15 crores in an associate company Hero Fincorp Limited.

View and Valuation

HEROMOTOCO has once again posted a weak operational performance with 40bps QoQ decline in EBITDA margins because of weaker operating leverage, increased promotional expenses and higher inventory level during the quarter. The margin pressure is expected to continue due to sluggish demand scenario & higher promotional expenses because of new product launches (125cc scooter & 200cc motorcycles segment) in 1QFY20. The management has also cut down its margin guidance of 14-16% to current range of 13.5-15% level. The inventory level continues to be over 45-50 days and thus OEMs are forced to cut down their production by 15-20%. The company has further planned to take a production cut in 1QFY20 as well in order to bring down the inventory level to 35-40 days. The demand environment in rural areas seems challenging in 1HFY20 due to 40%YoY decline in rabi sowing. However, expectation of better kharif sowing on the back of good monsoon, marriage and festive season may drive growth in 2HFY20. The overall growth in FY20 is expected to be in mid-single digit driven by growth in 2HFY20. The overall scooter segment has also started declining sharply due to increased penetration in urban areas and increased fuel prices. Factoring the subdued demand scenario and compression on margins based on higher launch cost we reduce our FY20 EPS estimates by 4%. We value HEROMOTOCO at 14x FY20e EPS to arrive at target price of Rs.2476 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	FY19	FY20E
Net Sales	28457	28585	32458	33971	36085
EBITDA	4398	4576	5325	5018	5361
EBIT	3954	4074	4750	4394	4745
PAT	3112	3546	3722	3466	3532
EPS (Rs)	156	178	186	174	177
EPS growth (%)	32	14	5	-7	2
ROE (%)	35	34	31	26	24
ROCE (%)	44	39	39	33	32
BV	442	517	599	657	727
P/B (X)	6.7	6.4	6.0	4.0	3.6
P/E (x)	18.9	18.6	19.4	15.0	14.7

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4QFY19 Results

Margins below expectation

Financials	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	YoY %	QoQ%	FY18	FY19	YoY %
Volumes (000)	2002	2105	2134	1799	1781	-11%	-1%	7583	7819	3.1%
Realization	42,787	41,853	42,600	43,720	44,266	3%	1%	42,805	43,446	1.5%
Net Sales	8,564	8,810	9,091	7,865	7,885	-8%	0%	32,458	33,971	4.7%
Other Income	166	116	224	188	164	-1%	-12%	523	687	31.3%
Total Income	8,730	8,926	9,315	8,052	8,049	-8%	0%	32,982	34,658	5.1%
COGS	5,793	6,165	6,300	5,415	5,439	-6%	0%	21,886	23,444	7.1%
Staff Cost	381	413	434	436	447	17%	3%	1,584	1,778	12.3%
Other Exp.	1,020	854	978	910	930	-9%	2%	3,664	3,730	1.8%
Expenditure	7,193	7,433	7,712	6,760	6,816	-5%	1%	27,133	28,952	6.7%
EBITDA	1,371	1,377	1,379	1,105	1,069	-22%	-3%	5,325	5,018	-5.8%
Depreciation	148	148	152	152	150	1%	-1%	575	624	8.6%
EBIT	1,222	1,229	1,227	953	919	-25%	-4%	4,750	4,394	-7.5%
Interest	2	2	2	2	2	42%	1%	31	37	20.7%
PBT	1,386	1,343	1,448	1,138	1,081	-22%	-5%	5,242	5,044	-3.8%
Excpt. Item	-	-	-	-	-	0%	0%	-	-	0.0%
Tax	419	434	472	369	351	-16%	-5%	1,570	1,638	4.3%
PAT	967	909	976	769	730	-24%	-5%	3,722	3,466	-6.9%

Favourable product mix led to realization growth

The company reported net sales of Rs.7885 crores (vs our estimates of Rs.7827 crores) with a de-growth of 7.9% YoY in Q4FY19. Volume growth declined by 11% YoY due to sluggish demand scenario led by higher ownership cost and slow down in rural areas. While realization increased by 3.5% YoY supported by price hikes, higher sales in 125 cc scooter segment and spare part sales. The company has planned to launch Maestro Edge in 125cc scooters segment and Xpulse in premium motorcycles segment in May 2019. Spares revenue for the quarter was Rs.791 crores (+6%YoY).

New model launch cost and advertisement expenses led to margin contraction

EBITDA margin has declined by 40 bps QoQ to 13.6% due to model launch cost, advertising & promotional expenses and weaker operating leverage benefit. The company has taken a price hike of Rs.300-350 in April and going forward it will take pricing action based on commodity cost increases. Considering the subdued demand scenario and weaker operating leverage margins are expected to be in the current range of 13.-15% going forward.

PAT declined by 24.5% YoY

PAT declined by 24.5%YoY to Rs.730 crores (vs our estimates of Rs.754 crores). PAT margins declined by 52 bps QoQ to 9.3% largely due to decline in EBITDA margin and lower other income.

Concall highlights

- The overall industry is expected to grow in mid-single digit in FY20 and the company is expected to grow in-line with the industry.
- FY20 Growth Expectation: 1HFY20 is expected to remain flattish due to elections and correction of inventories while 2HFY20 is expected to grow by 5-7% due to improving liquidity issues, good monsoon, Kharif output, festive seasons and pre-buying ahead of BS-VI implementation.
- 1HFY20 will continue to remain challenging due to 40%YoY decline in Rabi sowing. However, recovery in rural demand is expected from 2HFY20 on the back of good monsoon expectation.
- Region-Wise demand outlook: North, East and Central market have better demand outlook, markets in West like Maharashtra have shown some recovery while markets in South continue to remain low.
- The overall market sentiment in April has not improved despite of Navratri and Gudiparva in Maharashtra. Some markets in north responded better due to festivals and the company expects to improvement in sales from May-June onwards.
- Inventory level stands at 45-50 days and it is expected to improve by 5-10 days in 1QFY20.

- **Concall highlights (continued...).**
- Margins are expected to be in the current range of 13-14% going forward.
- Spares revenue for the quarter was Rs.791 crores and for FY19 it was Rs 2836 crores with 13% YoY growth.
- The company will take further production cut in Q1FY20 itself in order to keep inventory level under control.
- Price hike of Rs.300-350 was taken up in April and going forward it will take pricing action based on commodity cost increases.
- 100-110cc scooters segment declined by 23% YoY while on full year basis it has declined by 8.5% YoY.
- The company will be ready with BS-VI product in time as the dealers will not be allowed to sale BS-IV vehicles from 1st April 2020.
- The pricing impact due to BS-VI will not have much impact in FY20 but it will happen from 1QFY21.
- Hero Fincorp share in overall financing was 43% in 4QFY19 and for FY19 it was 40%
- Capex guidance for FY20 is Rs.1500 crores which will include investments in Andhra plant and addition of BS-VI manufacturing lines.

Exhibit: Volume and Volume Growth Trend

Volume growth declined due to sluggish demand scenario in urban as well as rural areas

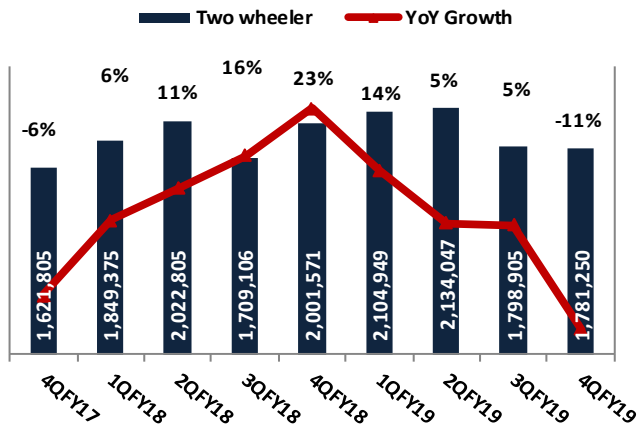


Exhibit: Realisation and Realisation Growth Trend

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

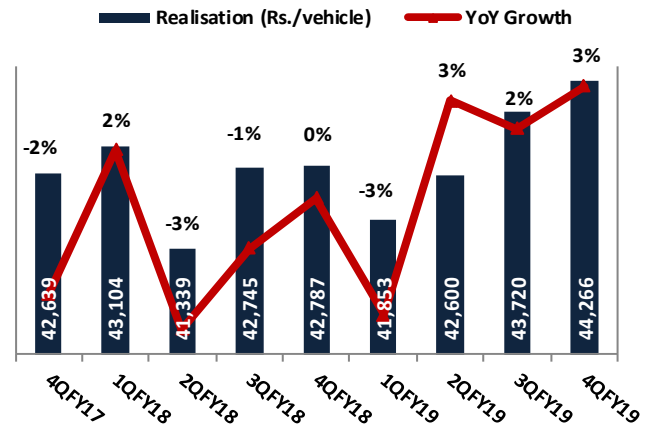


Exhibit: EBITDA (Rs. Crore) and EBITDA Margin Trend

Margin declined on account of higher A&P expenses and inventory build up

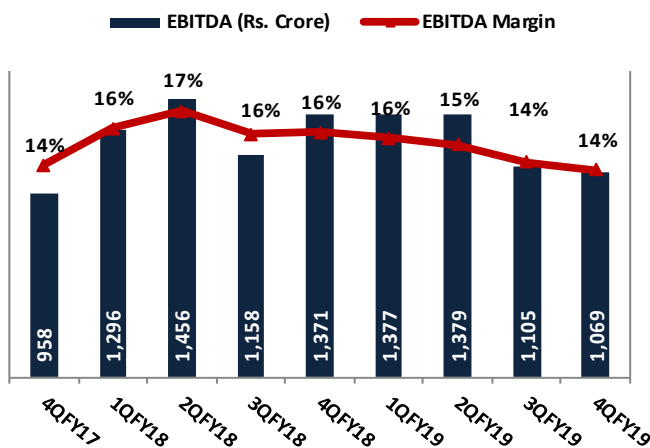


Exhibit: PAT (Rs. Crore) and PAT Margin Trend

PAT margin declined due to decline in EBITDA margin and lower other income

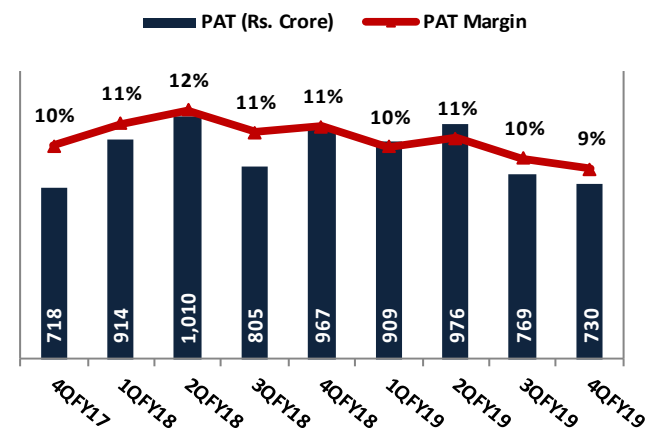


Exhibit: Trend in Segment Mix

Motorcycles sales continue to dominate scooter sales for third consecutive quarter

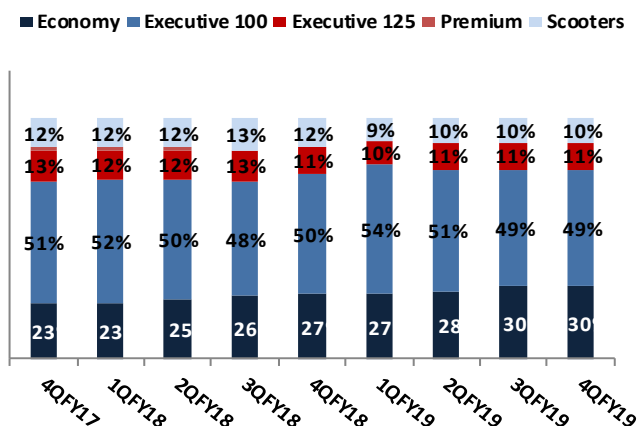
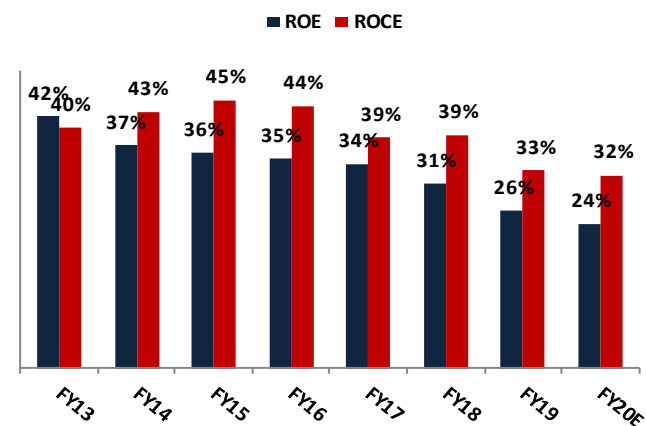


Exhibit: Return Ratios

Declining profitability will lead to reduction in return ratios going ahead



Financial Details

Balance Sheet

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E
Share Capital	40	40	40	40	40	40	40	40
Reserves	4,966	5,583	6,500	8,794	10,276	11,932	13,080	14,487
Networth	5,006	5,623	6,540	8,834	10,316	11,971	13,120	14,527
Debt	302	24	100	230	248	225	309	231
Other Non Cur Liab	-	-	31	-	-	-	-	-
Total Capital Employed	5,308	5,647	6,640	9,064	10,563	12,196	13,429	14,758
Net Fixed Assets (incl CWIP)	3,133	3,102	3,671	4,437	5,180	5,316	5,525	6,217
Non Cur Investments	614	830	821	1,030	1,522	918	1,234	1,457
Other Non Cur Asst	36	48	60	848	658	560	676	676
Non Curr Assets	4,564	4,563	5,275	6,592	7,741	8,395	10,091	11,006
Inventory	637	670	861	762	709	963	1,250	1,327
Debtors	665	921	1,372	1,282	1,552	1,427	2,745	2,916
Cash & Bank	181	120	216	75	74	131	208	208
Other Curr Assets	32	22	60	562	524	212	262	278
Curr Assets	5,078	5,558	5,380	6,303	7,571	9,002	8,413	9,084
Creditors	1,873	2,291	2,855	2,675	3,266	3,375	3,438	3,652
Provisions (both)	1,440	1,594	801	98	118	179	181	192
Other Curr Liab	888	588	309	506	457	765	501	532
Curr Liabilities	4,171	4,424	3,898	3,487	4,137	4,406	4,226	4,474
Net Curr Assets	907	1,135	1,481	2,816	3,434	4,596	4,188	4,610
Total Assets	9,642	10,122	10,654	12,896	15,312	17,397	18,504	20,090

Income Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E
Revenue from Operation	23,768	25,275	27,538	28,457	28,585	32,458	33,971	36,085
Change (%)	1	6	9	3	0	14	5	6
Other Income	398	444	492	413	522	523	687	413
EBITDA	3,284	3,539	3,497	4,398	4,576	5,325	5,018	5,361
Change (%)	(9)	8	(1)	26	4	16	(6)	7
Margin (%)	13.8	14.0	12.7	15.5	16.0	16.4	14.8	14.9
Depr & Amor.	1,142	1,107	540	443	502	575	624	616
EBIT	2,143	2,432	2,956	3,954	4,074	4,750	4,394	4,745
Int. & other fin. Cost	12	12	12	15	27	31	37	28
EBT	2,529	2,864	3,437	4,353	4,568	5,242	5,044	5,130
Exp Item	-	-	145	-	(262)	-	-	-
Tax	411	758	943	1,275	1,339	1,570	1,638	1,665
Minority Int & P/L share of Ass.	-	(3)	16	34	55	50	61	67
Reported PAT	2,118	2,103	2,365	3,112	3,546	3,722	3,466	3,532
Adjusted PAT	2,118	2,103	2,365	3,112	3,546	3,722	3,466	3,532
Change (%)	(11)	(1)	12	32	14	5	(7)	2
Margin(%)	8.9	8.3	8.6	10.9	12.4	11.5	10.2	9.8

Financial Details

Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E
ROE	42%	37%	36%	35%	34%	31%	26%	24%
ROCE	40%	43%	45%	44%	39%	39%	33%	32%
Asset Turnover	2.47	2.50	2.58	2.21	1.87	1.87	1.84	1.80
Debtor Days	10	13	18	16	20	16	29	29
Inv Days	10	10	11	10	9	11	13	13
Payable Days	29	33	38	34	42	38	37	37
Int Coverage	180	206	253	271	149	154	118	171
P/E	15	22	22	19	19	19	15	15
Price / Book Value	6	8	8	7	6	6	4	4
EV/EBITDA	9	13	15	13	14	14	10	10
FCF per Share	1,283	2,022	1,094	2,084	2,769	3,193	804	2,780
Div Yield	3.9%	2.9%	2.3%	2.4%	2.6%	2.6%	3.3%	3.4%

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	5,044	5,130
(inc)/Dec in Working Capital	(787)	55	(336)	323	462	197	(2,061)	(88)
Non Cash Op Exp	1,142	1,107	540	443	502	575	624	616
Int Paid (+)	12	12	11	15	27	31	37	28
Tax Paid	(613)	(649)	(1,000)	(1,103)	(1,187)	(1,513)	(1,638)	(1,665)
others	(392)	(426)	(294)	933	657	1,005	(369)	67
CF from Op. Activities	1,890	2,963	2,250	3,722	4,007	4,017	1,637	4,088
(inc)/Dec in FA & CWIP	(608)	(941)	(1,156)	(1,638)	(1,238)	(824)	(833)	(1,308)
Free Cashflow	1,283	2,022	1,094	2,084	2,769	3,193	804	2,780
(Pur)/Sale of Inv	628	(9)	1,354	(645)	(714)	(1,172)	-	-
others	(753)	(668)	(186)	(16)	(20)	138	1,555	(549)
CF from Inv. Activities	(733)	(1,618)	12	(2,300)	(1,972)	(1,858)	722	(1,857)
inc/(dec) in NW								
inc/(dec) in Debt	-	-	-	181	28	(33)	84	(77)
Int. Paid	(12)	(12)	(11)	(14)	(27)	(31)	(37)	(28)
Div Paid (inc tax)	(1,044)	(1,403)	(2,219)	(1,682)	(2,091)	(2,043)	(2,332)	(2,126)
others	-	1	-	40	54	5	-	-
CF from Fin. Activities	(1,056)	(1,414)	(2,231)	(1,475)	(2,036)	(2,102)	(2,285)	(2,231)
Inc(Dec) in Cash	101	(69)	32	(53)	(1)	57	74	0
Add: Opening Balance	34	135	66	127	75	74	131	208
Closing Balance	135	69	98	75	74	131	205	208

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